

Brazil Macro Compass

“Party Window” Shifts Power in Lower House

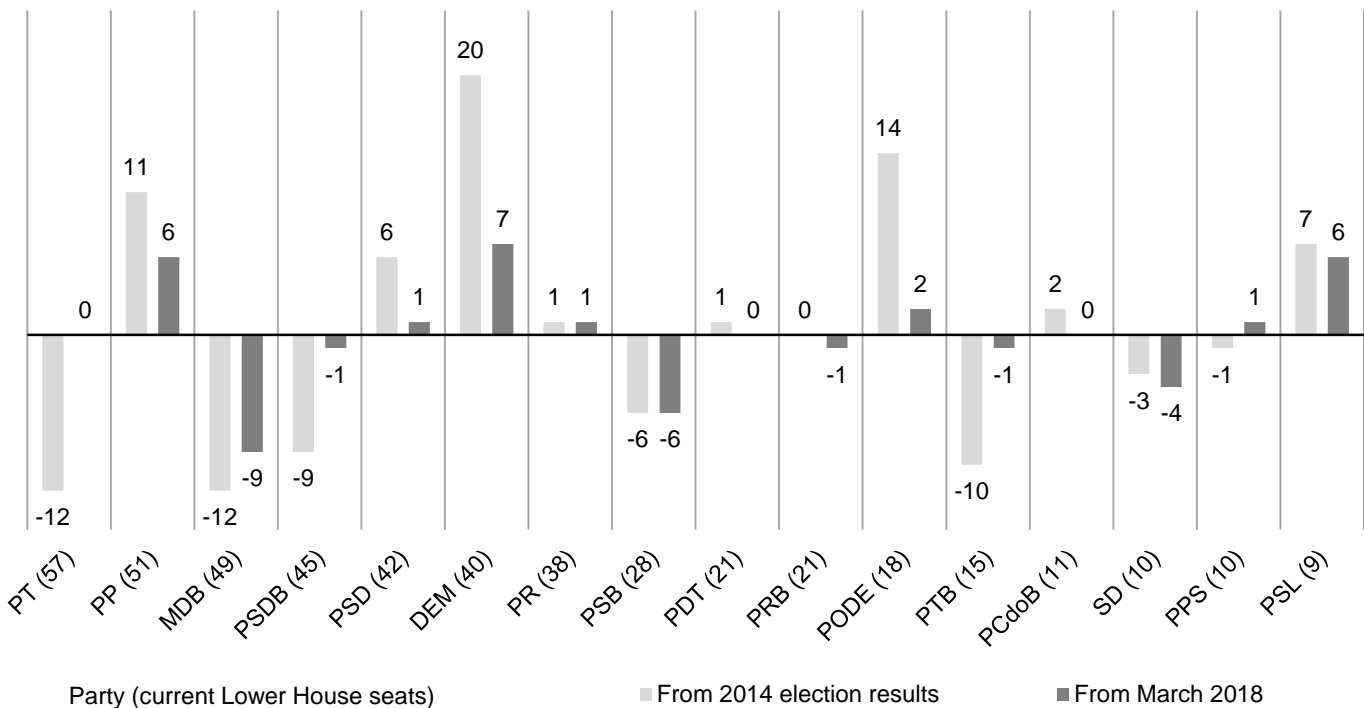
Luciano Sobral*
 lusobral@santander.com.br
 +5511 3553 3753

Chart of the Week: New Composition of the Lower House

The “party window” that allowed lawmakers to change parties freely closes tomorrow, likely bringing significant changes to the Lower House’s composition. These potential changes would be especially important since about half of the campaign finance funds for the October general elections will be distributed according to the distribution of seats in the Lower House just before the elections.

After the latest changes, Lula’s Workers’ Party (PT) once again becomes the largest party in the house in terms of members, as President Temer’s Brazilian Democratic Movement (MDB) lost nine deputies, falling two places in the rank. MDB was also surpassed by the Progressive Party (PP), which was one of the parties that grew the most during the one-month window. Other gainers include the Democrats (DEM), gaining seven seats (doubling from the 2014 election results), and Jair Bolsonaro’s PSL, which added six deputies to its relatively small roster.

Brazil – Changes in the Lower House Composition (Number of Deputies)



Sources: Lower House, Estadão, Valor, G1, parties’ websites. Information updated the morning of March 6, still subject to changes until the following day.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE “IMPORTANT DISCLOSURES” SECTION OF THIS REPORT.

U.S. investors’ inquiries should be directed to Santander Investment at (212) 350-0707.

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Political Agenda: Reactions to Lula's Arrest Order

Last Wednesday, Brazil's Supreme Court (STF) denied, in a tight vote (6-5) former President Lula's *habeas corpus* request, which triggered a surprisingly quick (on the following day) arrest order for him to start serving the sentence given by a court of appeals on January 24. However, several justices argued during the session that the court should revisit a 2016 ruling on sending convicted individuals to jail after their sentences are confirmed by a court of appeals (the previous interpretation allowed convicted to stay free until all appeals are exhausted). It is mostly up to the sitting Chief Justice to submit this matter to a vote, but a dissident justice could try a maneuver next Wednesday to override the Chief Justice's authority and submit the current interpretation of the Constitution to a new vote.

The current Chief Justice's term ends in early September, so even if she stands the pressure and current jurisprudence is maintained, her successor could reopen the discussion once she steps down. **These decisions will be key in determining what will be Lula's role in the presidential campaign:** if he is free before August 15 (the deadline for candidacy registration), he is likely to become a candidate and start campaigning, even knowing that the Electoral Court could eventually consider him unelectable under the "clean slate" (*ficha limpa*) law and that he must be replaced by September 17. Otherwise, although his party could still present him as its candidate if he is still in jail, the incentives to look for an alternative in this case would be higher, in our view.

Former Supreme Court justice Joaquim Barbosa joined the Brazilian Socialist Party (PSB), a mid-sized, center-left party that launched Marina Silva as its presidential candidate in 2014 (she finished third, receiving more than 22 million votes). This signals his intention (though not a commitment, by any means) to run for office in October. Barbosa had (depending on the alternatives presented) between 3% and 5% vote intention in the last Datafolha poll (concluded on January 30) and is among the few names not disapproved by more than 50% of the sample in February's *Barômetro Político Estadão-Ipsos* survey (see the "Chart of the Week" in the March 23 edition of this report).

With the end of the "party window" (see more in the "Chart of the Week" below), Congress may now advance some bills pending a floor vote. We highlight two of them: (i) One could significantly increase the amount of data that would be available to credit bureaus, allowing financial institutions to share information on non-delinquent clients (*cadastro positivo*). This bill, which is supported by the Central Bank and the Banks' Association, is expected to contribute to a reduction in credit spreads, which could ultimately boost consumption. (ii) The Central Bank's independence bill, led by the Speaker of the House and which would establish a fixed four-year term (not coinciding with the presidential cycle) for the governor and safeguards for other board members. However, all the noise surrounding Lula's case may be an additional hurdle to the government's economic legislative agenda, which counted some losses in the recent past: this week the Lower House floor overruled a presidential veto over a tax relief program for small companies, and two decrees that would increase tax collection (on the delay of wage adjustments and increase of social security mandatory contribution for civil servants, and on a tax increase on private wealth funds) will expire next Sunday without being voted into law by the Congress.

Upcoming Data: March Inflation, February Activity Indicators

We expect March CPI inflation, to be released next Tuesday, at 0.09% m/m – the lowest for the month since 2006. Twelve-month inflation should fall to 2.68%, from 2.8% in February. Food prices continue to contribute to lower headline inflation (at -4.3% y/y, according to our forecast), but core inflation should also continue to decelerate (to 2.81% y/y, from 2.89% in February), signaling the continuity of a deep disinflation process. We expect headline inflation to accelerate to 3.5% y/y at year end, mostly due to the normalization of food inflation (core inflation should stay around current levels, in our view).

On Thursday and Friday, respectively, IBGE releases February retail sales and volume of services data. We expect both indicators to reverse part of the poor January performance and resume a more positive trend. We forecast core retail sales growth at 3.7% y/y (from 2.0% in January), while the volume of services should fall 0.5% y/y (from -1.4% in the previous month).

What's New: Weak February Industrial Production

February industrial production data added to a string of weaker-than-expected 1Q18 economic activity indicators. Volume of industrial production grew 0.22% in the month, significantly below both our forecast (0.6%) and market consensus. Year-on-year growth decelerated to 2.3%, from 3.25% in January and 6.4% in December. We attribute a downside risk to our 2018 GDP growth forecast (currently at 3.2%).



Number of the Week

10.5

Last Wednesday's Supreme Court session that decided on former president Lula's *habeas corpus* request was 10.5 hours long.

Quote of the Week

A lack of penal culpability would make it impossible for the state to hold people accountable, and that can lead to impunity.

— **Chief Justice Cármen Lúcia**, casting the final vote in last Wednesday's landmark Supreme Court session.

What We've Been Reading

- "Brazil's Lula and Government by Judges", by Michael Reid (*The Economist*). A balanced analysis of the anti-corruption drive that reached a new high this week.
- "Chicago Boy Helps Calm Bankers' Fears About Brazil Wild Card", by David Biller and Cristiane Lucchesi (*Bloomberg*). A profile of Jair Bolsonaro's top economic advisor.
- *Assessing Firm-Support Programs in Brazil*, by Jose Claudio Linhares Pires and Nathaniel Russell (Inter-American Development Bank). A comprehensive assessment of Brazil's many governmental programs targeting companies and their effects on productivity. A conclusion: "To summarize, there were few positive results on productivity or other indicators."
- "Is Populism Returning to Latin America?", by Andrés Velasco (*Project Syndicate*). Why a new generation of populists politicians is expected to gather many votes in Colombia, Mexico, and Brazil.
- "Latin America's Anti-Corruption Leaders: 'Corruption Always Fights Back'" (*Americas Quarterly*). An interview with judge Sérgio Moro and corruption fighters from Peru and Mexico.
- *Agregador Jota de Pesquisas Eleitorais*. A useful aggregator of Brazilian presidential polls freshly launched.

Recent Publications (Available on Our Website)

- *Falling Interest Rates Leading to BRL Weakness* (March 28, 2018)
- *NPLs Improving More Than Meets the Eye* (March 26, 2018)
- *TJLP: Less Discretion, More Volatility?* (March 19, 2018)
- *Food (Inflation) for Thought (2): Forecasts* (March 9, 2018)
- *Food (Inflation) for Thought: Relative Prices* (March 7, 2018)



CONTACTS / IMPORTANT DISCLOSURES

Macro Research

Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@bzwbk.pl	48-22-534-1888
Sergio Galván*	Economist – Argentina	sgalvan@santanderrio.com.ar	54-11-4341-1728
Maurício Molan*	Economist – Brazil	mmolan@santander.com.br	5511-3012-5724
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Diana Ayala	Economist - Colombia	diana.ayala@santander.us	212-350-0979
Tatiana Pinheiro*	Economist – Peru	tatiana.pinheiro@santander.com.br	5511-3012-5179
Piotr Bielski*	Economist – Poland	piotr.bielski@bzwbk.pl	48-22-534-1888
Marcela Bensión*	Economist – Uruguay	mbension@santander.com.uy	5982-1747-5537

Fixed Income Research

Diana Ayala	Macro, Rates & FX Strategy – Latin America	diana.ayala@santander.us	212-407-0979
Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderrio.com.ar	5411-4341-1065
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778
David Franco*	Macro, Rates & FX Strategy – Latin America	david.franco@santanderio.com	44-207-756-6633
Aaron Holsberg	Head of Credit Research	aholsberg@santander.us	212-407-0978

Equity Research

Christian Audi	Head LatAm Equity Research	caudi@santander.us	212-350-3991
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Nicolas Schild*	Head, Chile	nschild@santander.cl	5622-336-3361
Valder Nogueira*	Head, Brazil	jvalder@santander.com.br	5511-3012-5747
Pedro Balcao Reis*	Head, Mexico	pbalcao@santander.com.mx	5255-5269-2264

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