

October 22, 2018

Return of the Strongman: Part I

On October 7th, Jair Bolsonaro, a far-right populist, made it out of the first round of presidential elections in Brazil in decisive fashion. A controversial figure within his country, Bolsonaro was able to build his popularity on the growing distrust of the government. Rising crime, corruption scandals and a record-breaking recession have led the public to push for an end to the current three-party coalition's dominance in government. Bolsonaro's off-the-cuff remarks, although sometimes considered offensive, have helped him form an image as being relatable to the common Brazilian. His political opponent, Fernando Haddad of the Workers' Party, has struggled to gain support in light of the corruption scandals that plague his party. As a result, Bolsonaro has a commanding lead in the polls going into the second round of run-off elections. Barring a major upset, Bolsonaro is poised to win the October 28th presidential election.

Brazilian equities jumped following the results of the first round of elections. The rise can be attributed to the anticipated removal of the Workers' Party from office as opposed to approval of Bolsonaro. Furthermore, the reputation of the Workers' Party for overspending and mismanaging Brazil's economy has deterred voters. Rising scandals have only added to those woes as its party leader, Dilma Rousseff, was impeached from the presidency and its original presidential candidate, Luiz Inácio Lula da Silva, was convicted and jailed on

corruption charges. However, it appears that markets may be willing to give Bolsonaro a chance. He has admitted he does not know much about economics but says he is willing to allow his economic advisors to guide his policies.¹

Despite being the largest economy in South America, Brazil has a turbulent economic history. Blessed to be rich in commodities, Brazil's reliance on commodity exports has left it vulnerable to boom and bust cycles. As a result of the fluctuations in its economy, the public has experimented with different political regimes and schools of economic thought. In Part I of this report, we will give a brief summary of Brazil's history, from its time as a Portuguese colony to what it has become today. The report will be broken into three periods, the first will discuss Brazil's time as a colony, then Brazil as a military dictatorship and finally present-day Brazil as a republic.

Brazil as a Colony

Brazil was a Portuguese colony from the 16th to the 19th century. Under colonial rule, Brazil emerged as one of the largest exporting colonies in the world. Its list of exports included sugar, cotton, diamonds, gold, coffee and tobacco. Portugal used the wealth generated by these exports to expand its empire and strengthen its military prowess throughout Europe. As a result, the wealth was mostly repatriated rather than reinvested back into Brazil. In addition, Portugal limited Brazilian exports to other

¹ <https://www.bloomberg.com/news/articles/2018-10-10/brazil-s-far-right-candidate-jair-bolsonaro-is-having-a-bad-day>

Portuguese colonies.² This dynamic would change after Portugal was invaded by the French during the Napoleonic Wars.

After the French gained control over Portugal, it began developing infrastructure within Brazil. The French invested in various projects throughout the region ranging from universities, banks and cultural exhibits. In addition, the French opened Brazilian ports to facilitate trade with other countries. Thus, the investments made by the French gave Brazil access to global markets and made it possible for the country to eventually become self-sufficient.

Between a Rock and Hard Place

After the fall of Napoleon and a series of coups, Brazil was able to gain independence and establish itself as a republic in 1891. In Brazil's first attempt at self-governance it achieved some success as the economy boomed due to the growing popularity of coffee. Brazil produced 75% of all the coffee in the world at that time and was able to establish itself as an international exporting hub.³ The income generated from the coffee boom allowed the government to invest in industrial and urban development projects throughout the country. Despite the boom in the economy, the period was marked by excessive violence as the government struggled to maintain stability, with civil unrest becoming more prevalent, especially in rural areas. Problems would become worse after a global recession in 1930 led to a drop in the world price of coffee.

² Odekon, M. (2011). *Booms and Busts: An Encyclopedia of Economic History from the First Stock Market Crash of 1792 to the Current Global Economic Crisis*. New York, NY: Taylor & Francis.

³<https://economics.rabobank.com/publications/2014/january/brazils-macro-economy-past-and-present/#>

The global recession sparked a shift in thinking with regard to Brazil's form of government as well as its economy. Following a series of coups from 1930 to 1965, Brazil flip-flopped between being a republic and a military dictatorship. Eventually, the military would win out. The public supported military rule because it was able to establish order and direct resources more efficiently than a democratic government. The embrace of the military also resulted in the embrace of alternative economic ideologies.

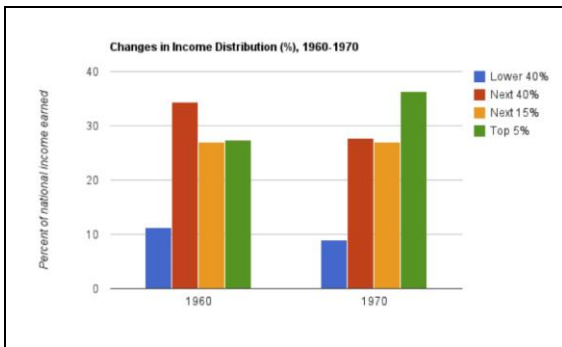
Growing nationalism led to skepticism of traditional economic ideologies as the public began resenting global trade. David Ricardo's theory of comparative advantage was particularly scrutinized as intellectuals questioned whether global trade benefited all parties involved. The belief was that developing countries trading commodities for industrial goods were not able to become self-sufficient. As a result, they believed resources should be used domestically in order to build up the country's manufacturing sector. This line of thinking eventually paved the way for policies that promoted import substitution industrialization, which favored barriers to imports and promotion of exports.

Military Takeover

The military dictatorship (1964-1985) was able to garner public support and ruled over Brazil for twenty years. During its time in power, it was able to draw foreign capital by downplaying its authoritarian tendencies and opening up its markets to foreign capital. The government was able to use the foreign capital to invest in domestic industries and purchase resources it lacked, such as petroleum.

Broadly speaking, the military was successful in boosting the Brazilian

economy. Economic growth was so strong during the seventies that the period was coined the “Brazilian miracle.” Its strategy to boost growth was to provide tax incentives to the wealthy to stimulate demand. The idea was that the wealthy would use those savings to purchase domestically produced goods.⁴ In addition, the wealthy were given access to loans to invest domestically. Despite its success, income inequality grew wider as most of the growth went to the rich. The chart below shows income distribution from the decades of 1960 and 1970. In the 1960s, most of the wealth went to median income households, but in the 1970s most of the income went to the top 5% of income households.



(Source: Brown University)

As a result of Brazil’s accumulation of foreign debt, its economy was vulnerable to changes in global interest rates. Federal Reserve Chairman Paul Volcker’s anti-inflation policies in the early 1980s became a proximate cause for the Latin American debt crisis in the 1980s, of which Brazil was a participant. In addition, malinvestment exacerbated issues as many of the projects never lived up to expectations. Excessive fiscal spending eventually led to rapidly rising inflation. The rise in inflation continued well after Brazil transitioned away from military rule in 1985 as the

⁴<https://library.brown.edu/create/fivecenturiesofchange/chapters/chapter-7/economic-miracle/>

government struggled to contain it. Two years following the end of military rule Brazil was forced to reschedule its debt in 1987.⁵



A New Beginning

Although military rule was successful in creating economic growth, it did so at the expense of widening social inequality. The return of democracy resulted in a push for disinflationary policies and social welfare spending. Three political parties developed following the end of military rule: The Brazilian Democratic Movement party (PMDB), the Workers’ Party (PT) and the Brazilian Socialist Party (PSBD). These three parties have very similar ideologies. In fact, arguably the most conservative group, PMDB, which has supported restrictive fiscal policy at the behest of the IMF, backed the leftist PT candidates Lula da Silva and Dilma Rousseff for president.

Despite their similarities, the three-party coalition garnered broad support with the public because it addressed social inequality, contained inflation and, until recently, maintained economic stability. During PMDB’s stint in power, it was able to control inflation through austerity and

⁵https://archive.nytimes.com/www.nytimes.com/fo dors/top/features/travel/destinations/centralandso uthamerica/brazil/riodejaneiro/fdrs_feat_129_9.ht ml?n=Top%252FFeatures%252FTravel%252FDestinat ions%252FCentral+and+South+America%252FBrazil %252FRio+de+Janeiro

hawkish monetary policy. When austerity was too much to bear, the PT was able to create a series of social programs to improve the lives of the poor. That being said, the rampant corruption that was prevalent during military rule is still prevalent and in some cases more blatant. In addition, crime has also risen. The public has tolerated these shortcomings as long as their living standards were improving and inflation was under control.



The recent recession has redrawn the focus back to the corruption which ended the career of the previous president, Dilma Rousseff, and is weighing on the current president. As a result, the populace has become fed up with the current three-party coalition that dominates Brazilian politics, which has led to the unexpected victory of Jair Bolsonaro and the rise of his Social Liberty Party.

Part II

In next week's report, we will delve into Jair Bolsonaro's background, his ideology and why voters find him appealing.

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October 22, 2018

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