

Flash Comment

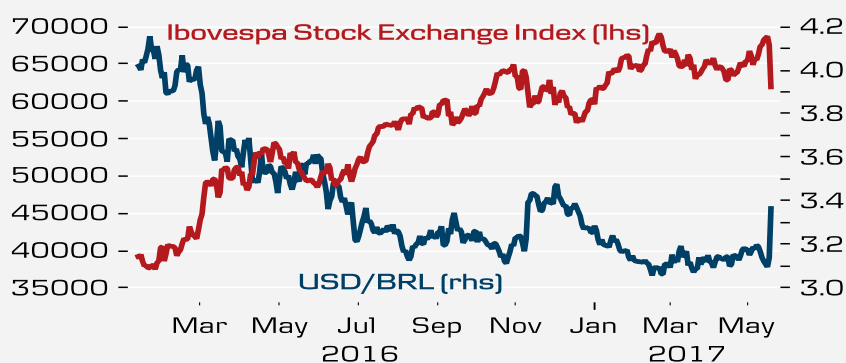
Brazil rocked by renewed political crisis

Brazil was thrown into a fresh political crisis yesterday after fresh corruption charges hit President Michel Temer. The President has been accused in one of the biggest Brazilian newspapers of endorsing the payment of money to the imprisoned former speaker of the lower house of Congress, Eduardo Cunha, to ‘silence’ him in the ongoing corruption probe. On Thursday afternoon, the paper’s website posted an audiotape that purports to be of Temer discussing the alleged payoff. Yesterday, President Temer responded on Brazilian television that he vows to hold onto his power and prove his innocence. The opposition parties have called for Temer to step down and a public protest took place in several Brazilian cities.

The fresh political crisis in Brazil could not come at a worse time for the Brazilian economy. The Temer government is in the midst of carrying out extensive fiscal reforms to address the significant fiscal challenges that have been accumulating over the past decade with the Lula-Rousseff governments, with the fiscal deficit hovering close to 9% of GDP and public debt levels at 70% of GDP. Late last year, the government adopted a spending gap and extensive pension reforms are currently being discussed in parliament. On the back of the government’s reform, a fragile recovery has started to take hold as business and household confidence have rebounded.

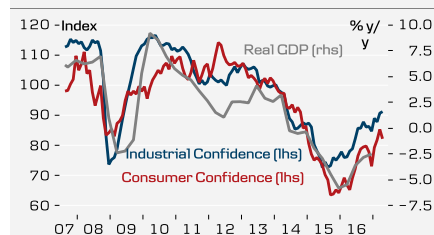
The outlook for the BRL and Brazilian assets depends on the ability of the President to fend off the allegations over the next few days. The opposition parties will certainly maintain pressure on Temer to step down or start an impeachment process against him. The problem for the Temer government is that it is struggling with low approval ratings and eight of his cabinet ministers have been forced to resign over allegations of misconduct. Investors have bought into the ability of the Temer government to push through reforms and generally hold his economic team in high regard. However, although the market is still long the Brazilian real, it is not at the same stretched positions as a few months ago. However, the latest bout of political uncertainty creates upside risk to our forecast for USD/BRL of 3.30 by end-June.

BRL and Brazilian stock market rocked by renewed political uncertainty



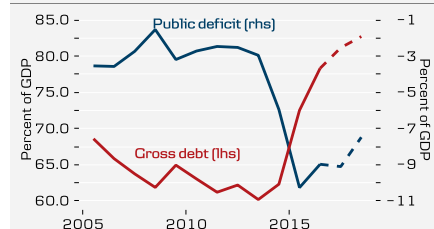
Source: Bloomberg

A fragile economic recovery has started to take hold...



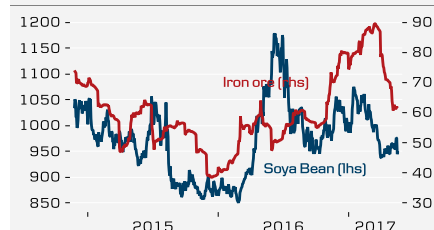
Source: Macrobond Financial

...but Brazil faces daunting fiscal challenges...



Source: Macrobond Financial, IMF

...and the tailwinds from commodity prices are fading



Source: Macrobond Financial

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Expected updates

None.

Date of first publication

See the front page of this research report for the date of first publication.

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