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Bovespa Recession Market Rebound Makes Lula 'My Man' for Obama

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By Joshua Goodman



June 3 (Bloomberg) -- The last time Brazil elected a president with a radical past, investors panicked and started bailing out of markets. The year was 2002; the nation's currency plummeted 60 percent, and its borrowing costs tripled to 24 percent.

Next year, Brazilians face a presidential election in which the two front-runners include a one-time Marxist guerilla fighter and a career politician who gained fame by threatening global pharmaceutical companies with breaking their AIDS drug patents.

So is Brazil girding for another round of capital flight? "This is going to be the most uneventful election in decades," says Gustavo Franco, former president of **Brazil's central bank**.

Franco says that's because whoever wins, no one is likely to meddle with the centrist policies of **Luiz Inacio Lula** da Silva, the 2002 winner. Lula, as he is known, ran for office criticizing the market-friendly reforms of the then incumbent president, Fernando Henrique Cardoso. At one point, Lula hinted he would default on Brazil's debt.

He then moved quickly to embrace many of those same stands while balancing them with an expansion of spending on Brazil's poor. His signature program, known as Bolsa Familia, pays small cash grants to an estimated 13 million impoverished families. By contrast, the country's deficit-plagued social security system reaches half that number of people and costs 20 times as much.

Landslide Victory

So popular has the former labor organizer's stewardship been that he swept to a re-election landslide in 2006, winning a runoff with a 60 percent majority. In March, the 63-year-old Lula's **approval rating** stood at 78 percent, according to the Brazilian Institute of Public Opinion and Statistics, known as IBOPE. That rating was 84 percent until Brazil's economy, buffeted by the global economic crisis, began to lose steam in the fourth quarter of 2008.

Lula's popularity helps to explain why the two leading contenders to replace him, Sao Paulo state Governor **Jose Serra**, who ran and lost against Lula in the 2002 campaign, and **Dilma Rousseff**, Lula's cabinet chief, have thus far proposed no policies that deviate much from Lula's playbook. Instead, they have sworn loyalty to what has emerged as the holy trinity of Brazilian politics: fiscal discipline, inflation targeting and a free-floating exchange rate. Serra and Rousseff both refused requests to be interviewed for this story.

'Domestic Popularity'

"Whoever wins will continue on the same path because that path has been delivering," says **Mohamed El-Erian**, chief executive officer of Pacific Investment Management Co., the Newport Beach, California-

based company that gambled in 2002 on Lula's free-market tilt and tripled its investments in the country. "Clearly there's a tremendous amount of domestic popularity for that path. The key issue is whether Brazil can grow rapidly. The Brazilians have built tremendous momentum, and I suspect whoever comes next will continue with what's been built."

Franco, now chief strategist for Sao Paulo-based money manager **Rio Bravo Investimentos**, says, "Lula destroyed all anxiety about a change in government leading to revolution." The turnaround has been sweeping. When Lula took office in 2003, **GDP growth** under Cardoso had averaged only 2.31 percent a year; the poverty rate as measured in per capita income was about 29 percent; and the country was counting on a **\$30 billion** International Monetary Fund loan to stave off a looming financial crisis.

Investment Grade

A 2008 World Bank report **credited Brazil** with having achieved "stable macroeconomic management with well-directed social policies" that have resulted in "significant reductions in poverty and income inequality."

By World Bank estimates, those policies lifted more than 17 million people -- 9 percent of the population -- out of poverty from 2003 to 2007 alone. Lula also leveraged a timely run-up in world commodity prices to accumulate \$200 billion in **foreign-currency reserves**, a decisive factor in Standard & Poor's decision in May 2008 to grant the country's debt its first-ever investment-grade rating. Brazilian **stocks** have surged 352 percent during Lula's two terms -- 37 percent this year alone as of June 2.

Even after the improvement Lula has wrought, his successor will have plenty to do amid worries that lingering global recession may hamper a continuation of Lula's reforms. About 18 percent of Brazil's 190 million people still live in poverty, and a World Bank report estimates that 10.4 percent of its population ages 15 and older remained illiterate as of 2007. The murder rate is four times the U.S. rate, according to 2009 U.S. State Department **data**.

Peer Pressure

Brazil also is behind emerging-market peers in some important economic barometers. IMF data from 2003 to 2008 pegged Brazil's annual growth rate at 4.1 percent, about double the rate under the Cardoso government yet still lower than Peru's rate of 7 percent and Chile's of 4.6 percent over the same period.

Peru and Chile are the only two other South American nations with investment-grade debt ratings. Brazil, at about 18 percent, also falls below the rest of Latin America's average of 22.8 percent in terms of investment as a percentage of gross domestic product, according to 2008 IMF **data**.

Serra, 67, the probable candidate for the centrist **Brazilian Social Democracy Party**, or PSDB, gained national recognition in his losing run against Lula in the 2002 presidential race. In 2006, he was elected governor of Sao Paulo, Brazil's most populous state and industrial center.

Student Leader

Serra won notoriety in 2001 when, as Cardoso's health minister, he declared Brazil would begin making its own generic AIDS drugs based on patents held by pharmaceutical giants including Basel, Switzerland-based Roche Holding AG unless the companies cut prices by at least 70 percent.

The strategy was part of Brazil's policy to guarantee its citizens free access to AIDS medicines. The public arm-twisting worked, and Brazil's free-access policy has since spread throughout the developing world.

A former student leader, Serra shares a history of activism with **Rousseff**. Both were enemies of Brazil's military dictatorship, which seized power in 1964 on fears of the kind of leftist guerilla movements inspired by **Fidel Castro's** Cuba. Serra took exile in Chile and the U.S., along the way earning a Ph.D. in economics from **Cornell University** in Ithaca, New York. Rousseff joined Brazil's armed resistance.

'Barbarically Tortured'

The daughter of a Bulgarian-born businessman, Rousseff, 61, was a member of a Marxist-inspired rebel group that tried to embarrass Brazil's generals through high-profile heists and political kidnappings. She was arrested in 1970, and for the next three years her interrogators subjected her to harassment and electric shocks while she hung crouched over from a torture rack known as the parrot's perch.

During testimony last year before a Brazilian congressional commission looking into contemporary political corruption, Rousseff told a commission questioner that she was "**barbarically tortured**" and lied to her captors "because by lying I saved comrades from the same torture."

An economist by education who has never run for office, Rousseff owes her candidacy entirely to Lula. She replaced Lula's longtime ally and heir apparent **Jose Dirceu** as cabinet chief in 2005. Dirceu and several co-founders of Lula's **Workers' Party**, known as the PT, resigned after opposition parties exposed an alleged effort by the PT to pay some members of Congress monthly stipends to vote in favor of government legislation. The scandal almost engulfed Lula in impeachment proceedings until opposition leaders decided that pursuing the popular president would be a blow to Brazil's stability.

Serra Leading

Rousseff joined the PT in 2001. At the time, she was energy secretary in Rio Grande do Sul, Brazil's southernmost state, gaining the expertise that led Lula to promote her to energy minister two years later.

Until Rousseff revealed in April that she had a treatable form of **lymphoma**, her biggest hurdle was a lack of recognition. Nearly half of Brazilians said they had never heard of her in a **poll by Datafolha**, a private Sao Paulo-based polling firm, published on March 20. The survey found her trailing Serra in the presidential race by about 30 points, with a margin of error of plus or minus 2 percentage points; in a Datafolha poll taken May 26-28, Dilma had narrowed Serra's lead by 8 percentage points.

Rousseff was thrust center stage last year when Lula branded her the "mother of the PAC." The acronym is for the Portuguese name of his **\$244 billion public works drive**, which she now controls.

'Selling Soap'

"It was a dream campaign opportunity," says **Eduardo Bernini**, who until 2007 was CEO of power generator AES Corp.'s Brazilian unit, Eletropaulo Metropolitana. "With that kind of boost, electing Dilma should be as easy as selling soap."

Rousseff has baggage, too. She lacks Lula's working-class roots, and the Brazilian press has reported accounts of Rousseff rebuking cabinet members. Kennedy Alencar, an influential columnist for the **Folha de S. Paulo newspaper**, calls her "Brazil's iron lady."

"I'm a tough woman surrounded by sweet men," Rousseff told O **Estado de S. Paulo** in March.

Since November, when Lula endorsed her as his would-be successor, she has sought to buff up her political appeal by flying cross-country with her political mentor to inaugurate public works such as a biodiesel power plant and a 112-kilometer (70-mile) aqueduct to drought-stricken northeastern Brazil. She has also talked publicly about a recent face-lift and paraded in the Brazilian carnival earlier this year to try to soften her image.

Lymphoma Wildcard

Her lymphoma has thrown a wild card into the race, as questions arise about her ability to campaign. Rousseff revealed the illness at a press conference in April. Her doctors, after removing an early stage tumor from her armpit, gave her a 90 percent chance of full recovery after four months of chemotherapy. In May, Rousseff was hospitalized for complications and told a live TV audience that she would have to reduce her workload.

Supporters say Brazilians, who are required by the constitution to cast ballots, may even empathize with a successful cancer battler, giving Rousseff an edge over Serra. His frequent public grimacing and a reputation for aloofness prompted some Brazilian satirists, in both a recent YouTube video and a mock-

up of a Wikipedia **entry**, to compare him to Mr. Burns, the antagonistic, power-hungry manager of a nuclear power plant on The Simpsons animated TV series.

'Magic Dust'

"Lula has pulled off so many things before, I don't see why he can't sprinkle a little magic dust on Dilma," says **Thomas Skidmore**, a historian trained at Harvard and Oxford universities and the author of **six books** on Brazilian history. "He's a tremendous symbol and knows how to exploit it."

Lula's **rise** from **street urchin** to the helm of the world's 10th-biggest economy was a watershed event, marking the first time a leader wasn't chosen from the country's elites. His innovative poverty-reducing Bolsa Familia program, funded at a cost of 0.7 percent of GDP, is so popular that even allies in Serra's PSDB say they plan to expand it if Serra is elected.

"Lula didn't embrace the status quo, he changed it," says **Paulo Vieira** da Cunha, who until last year was a Brazilian central bank board member and now helps manage \$140 million in emerging-market debt at **Tandem Global Partners** LLC in New York. "Being such a transformative figure makes it hard to go against his policies, even if they're flawed."

Lula's About-Face

After winning in **2002**, Lula shocked friends and foes alike by warming to many of Cardoso's policies, including a commitment to the IMF that Brazil cut spending by a record 14.1 billion reais (\$6.9 billion) in exchange for the **\$30 billion IMF loan** that the country desperately needed. The Lula government repaid the loan two years early in 2005. To reassure skittish investors, he named **Henrique Meirelles**, a former FleetBoston Financial Corp. executive, to run the central bank.

The about-face calmed markets but angered Marxist academics, union radicals and Landless Workers' Movement militants who helped Lula create the PT in 1980. Leftists heckled Lula while he was onstage in Porto Alegre, Brazil, at the 2005 World Social Forum, an annual gathering of anti- globalization activists. He's since outflanked them all, visiting 71 countries in a bid to convert Brazil's growing economic muscle into global clout. He's also **opened 35 embassies**, most of them in Africa, where he's pushing a "south- south" trade agenda hoping to expand trade between developing nations, thereby reducing dependence on rich ones.

Voice for the Poor

"He's discovered a brilliant way for undercutting the political opponents -- not hanging around in Brasilia to be thrown stones at," **historian** Skidmore says.

"Lula's proof that politicians who preserve stability are the ones rewarded," says **Joaquim Levy**, Lula's former head of the treasury and now finance secretary for the state of **Rio de Janeiro**.

Whether it's fighting protectionism by rich nations or calling on Obama to end the half-century U.S. embargo on Cuba, Lula has become an assertive voice for the developing world. At an April London summit meeting of the Group of 20, a forum that Lula helped to organize, he reminded the heads of rich nations that he was the only one there to have personally experienced hunger. Afterward, Obama praised Lula as "my man" and the "**most popular politician** on Earth" in a widely broadcast videotaped segment.

In some ways, Lula has been emboldened by the economic crisis. Barely a day goes by when he doesn't criticize rich countries for ignoring the so-called Washington Consensus policies -- reducing debt, liberalizing trade and privatizing industries -- that the IMF and U.S. **Treasury Department** have prescribed to stabilize Latin American economies.

Slamming Bankers

"This is a crisis caused and fueled by the irrational behavior of white-skinned, blue-eyed people that before the crisis acted as if they knew everything and now have been shown to know nothing," Lula told reporters as he stood alongside British Prime Minister **Gordon Brown** in Brasilia when Brown visited in late March.

Lula says the billions in bailouts for U.S. banks, insurance companies and carmakers vindicate the state's role in the economy, and he has moved at home to ramp up Brazil's help for its own industries. The **BNDES** state development bank is set to increase lending 30 percent this year, to 120 billion reais, much of it to companies in struggling, export-driven industries.

"The courage to say no to the market is the biggest lesson Lula can teach the world," says Marcelo Neri, a development economist at the **Getulio Vargas Foundation** business school in Rio de Janeiro.

Record GDP Plunge

Lula has also taken some licks. GDP plunged 3.6 percent in the fourth quarter of 2008, the most since the government began publishing quarterly statistics in 1996. The economy has since shown tentative signs of recovering. Industrial production grew for the third straight month in March, as companies **resumed hiring** after a record 655,000 job cuts in December. Still, even optimistic analysts are forecasting at best zero growth this year.

"Dilma's candidacy hinges on how well Brazil weathers the crisis," says Roberto Teixeira da Costa, who was president of **CVM**, the Brazilian securities regulator, from 1977 to 1980. "For now, things appear to be holding steady, but there's a long way to go yet."

One dark cloud is profligate spending on what Brazilians call the "state machine," much of it to win over the sought-after constituency of government workers. Under Lula, federal government hiring has jumped 25 percent, pushing up public spending, including debt service, to 46 percent of GDP compared with about 28 percent in 1998, according to Vieira Da Cunha.

Spending Spree

The spending spree went largely unnoticed because of an unquenched thirst for Brazilian commodities, especially from China, which as a result of the crisis this year replaced the U.S. as Brazil's biggest trading partner. Since Lula took office in 2002, exports of soybeans, iron ore and other products have tripled, reaching a **record \$198 billion last year**. Tax **receipts** have also soared in the same period, letting the government exceed its budget target last year and salt away into a new sovereign wealth fund 14.2 billion reais in extra savings.

This year, as the economy faces its first recession since 1992, the dynamics have reversed. If the pace of the global economic recovery is slow, the next government may be forced into some tough choices: raising taxes, slashing spending or unleashing inflation by expanding the money supply. That could make it more difficult to vigorously attack the lingering poverty and education rates that are holding back the country.

"The next guy won't have it as lucky," says **Greg Lesko**, who helps oversee \$500 million at Deltec Asset Management LLC in New York. "The tail winds are gone, and a lot of the reform that Lula kicked down the road will need to be addressed."

Still, even Lula thinks Brazil's prospects post-election will be undimmed, no matter who wins. "I am optimistic about the future, including with regard to presidential elections," he said in a recent interview published in Epoca, a weekly Brazilian news magazine. "I'm happy for a country whose presidency in 2010 will be disputed between Serra and Dilma. There are no right-wing troglodytes competing."

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