

International Commentary — July 11, 2025

Brazil's Post-Tariff Threat Economic & Electoral Outlook

Summary

Tariff threats have injected new volatility into Brazilian financial markets, but while we do not believe levies will have a material impact on Brazil's economy, tariffs could give President Lula a new platform to rally support ahead of presidential elections next year. In our view, Lula still has a tough road to re-election but the combination of aggressive populist-style policies, nationalism and patriotic pride, and plausible deniability of negative economic and market consequences, may give Lula more than just a fighting chance to win a fourth term. With Lula potentially on the rise and the U.S. administration demonstrating explicit support for Bolsonaro, Brazil's election is now more complicated. Political developments are now more uncertain; however, we have become more confident in our view that the Brazilian real will come under sharp pressure over the medium-term as fiscal support is deployed, and political risk rises in the lead up to the election.

Economist(s)

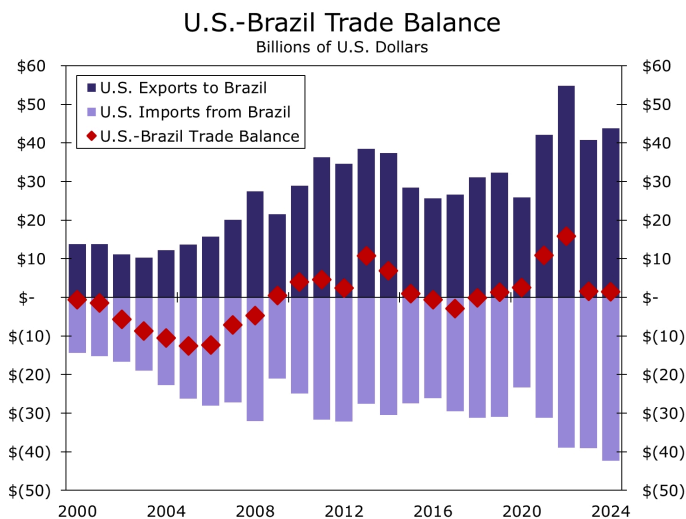
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Brazil's 2026 Presidential Election Just Got More Complex

President Trump's 50% tariff threat on Brazil is interesting for a few reasons. First, the U.S. runs a trade surplus with Brazil. While the U.S. did have persistent trade deficits with Brazil from the early 2000s until 2008, and again briefly from 2016-2018, those trade imbalances have been eliminated over the past few years ([Figure 1](#)). Typically, but not always, the Trump administration has imposed tariffs due to trade deficits and highlighted a preference for rebalancing trade back in favor of the United States. Running a trade surplus currently with Brazil would, on the surface, seem inconsistent with the underlying motivation for "Liberation Day" tariffs and "Letter Day" tariffs. Second, President Trump made clear that the decision to impose tariffs was not, at least primarily, trade related but rather politically motivated. President Trump's letter to Brazil explicitly stated his objections to the judicial proceedings against Brazil's former president Jair Bolsonaro. President Trump's letter also indicated his preference for Bolsonaro's ban from local politics to be lifted, and that Bolsonaro be allowed to participate as a candidate in Brazil's presidential election next year. In addition, President Trump and President Lula have volleyed contentious rhetoric around BRICS nations considering alternatives to the U.S. dollar, which is a movement Lula seems to be leading the charge on. While difficult to know for sure, and not something Trump explicitly expressed frustration with in his letter, rhetoric around shifting away from the U.S. dollar likely played a role in the tariff threat. As far as the economic impact of a 50% tariff, if that levy is indeed imposed in full come early August, we believe tariffs would not have significant direct effects on Brazil's economy. Brazil is a relatively closed economy that is not dependent on trade, and not on trade with the United States ([Figure 2](#)). As of now, we forecast Brazil's economy to grow a little over 2% in 2025. A 50% tariff perhaps shaves up to a half percentage point off of our GDP forecast when we update our forecasts, but U.S. imposed tariffs are not material enough to push Brazil's economy into recession.

Figure 1

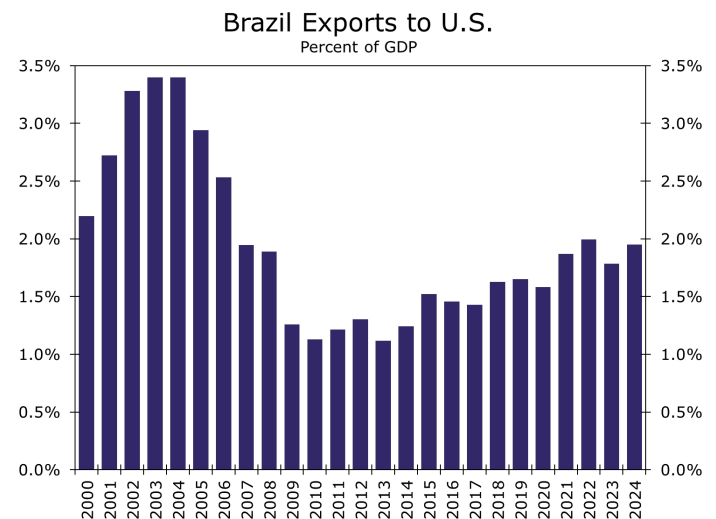


Source: Bloomberg Finance L.P. and Wells Fargo Economics

We do, however, hold larger concerns about the indirect impact—mostly political effects—of tariffs being imposed on Brazil. [As we mentioned in a prior report](#), we believe Brazil's presidential election in 2026 could yield a more conservative and right-leaning administration. Tariffs on the other hand, may give Lula's election prospects a shot in the arm and offer Lula arguably the best platform to rally support ahead of the election. Here's how:

- Tariffs give Lula the political will and economic justification (perceived or actual) to implement a more populist policy agenda, primarily fiscal support. Enhancing and extending cash transfer programs and other forms of social assistance raises Lula's political profile across low-income households and other demographics across Brazil. This would be the same playbook, but even more populist, he has deployed over the course of his political career.
- New trade tensions with the U.S. results in a wave of nationalism and patriotic pride across Brazil. Lula leading the resistance against foreign interference in domestic affairs is celebrated for

Figure 2



Source: Bloomberg Finance L.P., IMF and Wells Fargo Economics

defending Brazil's judicial and electoral processes. Lula recaptures his "man of the people" image that made him, one of the most popular politicians in the world not long ago.

- Lula now has an external force to blame for any potential economic slowdown, renewed inflation pressures, or local financial market volatility. If tariffs go into effect and Brazil's economy enters recession (which we view as unlikely), Lula can blame tariffs. If inflation spikes, blame tariffs. If financial markets' sell off, blame tariffs. Lula now has plausible economic/markets deniability.

Time will tell whether tariffs and this strategy will be deployed and/or helpful for Lula at the polls. But assuming Lula tries to push the tariff narrative in his favor—which media reports suggest is already under way—the prospects for a fourth Lula presidential term may rise. At the same time, if Lula does in fact see approval ratings improve and his position in polls turn more favorable, financial markets would likely start to price a material rise in political risk premium into Brazilian financial markets. Looser fiscal policy is something we assumed Lula would pursue in the lead up to the election, but if there is popular and congressional support for fiscal stimulus due to tariffs, fiscal support could be larger, more widespread, and come sooner than we initially thought. Brazil's public finances have improved in recent months, but are still in precarious shape and sovereign debt is still unsustainable. A significantly looser fiscal stance, possibly including an elimination of spending restraints under Brazil's fiscal framework, can place sharp depreciation pressure on the Brazilian real. However, a flip side also exists where, rather than Lula, the political right can be the perceived winner of Trump's tariff threat. Should Bolsonaro speak with Trump and tariff threats be lifted, or at least reduced, the Brazilian population may view Bolsonaro more favorably. We will not comment on whether Bolsonaro would then be allowed to run for office, but if Bolsonaro names a successor or endorses a candidate on the right-side of the political spectrum, that person could see electoral prospects improve by association. Headlines this week suggested that Bolsonaro could indeed reach out to Trump and ask for Brazil's tariff reprieve. The Brazilian real rallied on the notion that Bolsonaro might be in touch with the U.S. administration and tariff tensions could recede as a result. Time will also tell on whether Bolsonaro attempts to intercede, but if he does and is successful, right-leaning presidential candidates affiliated with or endorsed by Bolsonaro could see a boost. Local financial markets would likely rally on reduced political risk and prospects of improved debt dynamics going forward.

For now, we maintain our view that Brazil's presidential election will result in a right-leaning government and Lula's time in office will come to a close. But recent developments certainly add a bit more complexity to next year's election. We felt relatively confident political turnover would materialize late next year, and local politics would be the foundation of a greater degree of financial market stability in Brazil as well as reduced sovereign risk premium. Lula potentially getting a boost reduces our confidence at the margin. In addition, the U.S. administration showing outright support for Bolsonaro also adds another layer of complexity into Brazil's election. While our confidence in a right-leaning victory next year has reduced to some extent, our confidence in elevated local market volatility in the lead up to the election has risen. Our base case is centered around Lula deploying fiscal stimulus and a more populist platform to rally support, and now that Bolsonaro is in the political spotlight, local markets could also turn volatile from this angle as well. So while the politics have become more complicated, in our view, the path for the Brazilian real and sovereign risk premium remains similar to our previous outlook. We continue to believe the USD/BRL exchange rate will rise sharply over the course of 2026, potentially to the point where the Brazilian real tests all-time lows against the U.S. dollar.

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