

Fraga-Backed Neves Reemerges in Bull Sign for Brazil Stocks (2)

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(Adds iShares MSCI Brazil ETF in sixth paragraph.)

By Julia Leite and Ney Hayashi

Oct. 6 (Bloomberg) -- Aecio Neves, the Brazilian presidential candidate favored by many investors, was a forgotten man on the campaign trail the past month.

How forgotten? When his economic adviser, Arminio Fraga, the ex-central banker who helped save Brazil from default in 1999, held a press conference in Manhattan on Sept. 4 to promote the candidate's policies to the international community, only three reporters showed up.

So when Neves scored a second-place finish in the vote yesterday to force a runoff with the incumbent Dilma Rousseff, it was a surprise result that's likely to boost financial markets after they plunged in recent weeks on expectation of a Rousseff re-election. UBS AG and Allianz Global Investors predict stocks and the currency will post short-term gains on Neves's move into the second round.

Rousseff got 41 percent of yesterday's votes, followed by Neves with 34 percent and Marina Silva with 21 percent, the Superior Electoral Court said, based on 97 percent of ballots counted. The benchmark index for Brazilian equities had tumbled

12 percent since Sept. 2 as recent voter polls showed increased support for Rousseff, who has overseen the slowest economic growth for any president in two decades. The gauge could rise almost 20 percent from last week's close to 65,000 should Neves win the runoff vote on Oct. 26, according to Geoffrey Dennis, the head of emerging-market strategy at UBS.

Princeton Trained

"The closeness of the result is a surprise," Dennis, who's been covering Brazilian stocks since the early 1990s, said in a telephone interview from Boston. He has an underweight rating on the country. "Investors looking for macro change in Brazil would have always preferred to see Neves as the next president."

Petroleo Brasileiro SA, Brazil's state-controlled energy producer, advanced 18 percent in Frankfurt, set for the largest gain on record, as 4,206 shares changed hands, according to data compiled by

Bloomberg. The IShares MSCI Brazil ETF, which invests in the nation's stocks, climbed to \$46.2 in pre-market trading at 10:56 a.m. in London from its Oct. 3 close of \$43.38.

Neves has said he would name Fraga as his finance minister if he becomes president. The Princeton University-trained economist has been a force in Brazilian finance for the past two decades, having served as chairman of the country's main stock exchange, founded a hedge fund that was purchased by JPMorgan Chase & Co. and managed funds for billionaire financier George Soros. Yet it was his time at the central bank that earned him the most notoriety.

Market Volatility

Arriving in early 1999 in the aftermath of a currency devaluation, Fraga boosted benchmark interest rates to 45 percent in his first day on the job to staunch outflows and regain investor confidence. The real rebounded immediately, easing the financial crisis and allowing him to cut rates to 19 percent by the end of that year.

While price swings will continue until the final result of the election, Brazilian assets should rally after yesterday's results as some investors had expected Rousseff to clinch a victory in the first round, said Kunal Ghosh, a Singapore-based emerging-market money manager at Allianz Global Investors, which has \$511 billion in assets under management.

"The market is going to like that he's going into a second round and that there's a shot," Ghosh said by phone. "It will be extremely volatile."

Christopher Garman, an analyst at Eurasia Group who correctly predicted Silva would fall in polls when she was leading the incumbent in August, said it's still probable that Rousseff will win another four-year term.

State Intervention

"I don't see Aécio making it over the top," he said.

Neves's Brazilian Social Democracy Party, known as PSDB, and Rousseff's Workers' Party, or PT, have alternated in power since 1995. Neves, a 54-year-old senator and former governor of Minas Gerais, draws his support from voters with higher incomes and more education, polls ahead of the vote showed. Rousseff gets most of her backing from lower-income families.

Since taking office in January 2011, Rousseff has stepped up the government's role in companies, changing concession rules to lower electricity rates and capping gasoline prices to tame inflation. Brazil's economy slipped into its first recession in more than five years in the second quarter, with inflation hovering near the upper limit of the central bank's target range.

Brazil's real fell 8.6 percent last month, and closed at 2.4584 per dollar on Oct. 3, near the weakest level in six years. It's the world's worst-performing major currency in the past month.

Business Friendly

The Ibovespa would drop as much as 12 percent to 48,000 if Rousseff is re-elected, according to UBS's Dennis. The index rose 1.9 percent to 54,539.55 on Oct. 3.

Brazil's benchmark stock index has tumbled 21 percent during Rousseff's first term, compared with a 13 percent drop for the MSCI Emerging Markets Index. State-controlled oil producer Petroleo Brasileiro SA and government-run lender Banco do Brasil SA have slumped more than 17 percent during the period.

"If a Rousseff defeat occurs, that is very positive from a stock perspective," Wasif Latif, who helps oversee \$28 billion in mutual funds as the head of global multi-assets at USAA Investments, said in an interview in New York before the first-round vote. "The opposition would probably be more market and business friendly."

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--With assistance from Michelle F. Davis and Rita Nazareth in New York and Raymond Colitt in Brasilia Newsroom.

To contact the reporters on this story:

Julia Leite in New York at +1-212-617-0458 or jleite3@bloomberg.net; Ney Hayashi in Sao Paulo at +55-11-2395-9164 or ncruz4@bloomberg.net To contact the editors responsible for this story:

Brendan Walsh at +1-212-617-4831 or

bwalsh8@bloomberg.net

Rita Nazareth, Daliah Merzaban