Lula Wins a Fourth Term: What the Market Got Wrong and How to Position

October 25, 2026 · **Divya Singaravelu**, Emerging Markets and Multi-Asset Investor & Head of Research

Meridian 1305 Capital | Rates, Credit and Emerging Markets

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Summary

President Lula won Brazil's runoff with 51.76% of valid votes against 48.24% for Flávio Bolsonaro, a lead of about 4.4 million votes. Markets had given Lula only about one chance in four, so this is the outcome they were least ready for. In the first overnight trading, BRL fell about 10% in overnight CME futures trading, to near R$5.51 per US$, and Ibovespa-linked funds trading overseas fell between 11% and 20%. We think that first move goes too far, in thin markets. The policy signals over the next 30 days will decide where prices settle.

What the result confirms

- **The market was wrong and the polls were closer.** Flávio led the first round 47.0% to 45.2%, and markets priced him at about 75%. The final Datafolha poll showed a 50/50 race. Lula came from behind to win by 3.5 points.

- **Continuity in economic policy.** Lula's Partido dos Trabalhadores (PT, Workers' Party) has said it will keep the 2023 fiscal framework. Finance Minister Dario Durigan is the most likely choice to stay.
- **A harder Congress.** From February, the Partido Liberal (PL, Liberal Party) will be the largest party in the Chamber of Deputies, with 121 of 513 seats, and it also has a large group in the Senate. Lula will have to negotiate every fiscal measure with the centrist parties.

What it does not yet settle

- **Acceptance of the result.** As of Sunday night, Flávio had not conceded. His campaign coordinator, Rogério Marinho, criticized a Supreme Court decision to extend voting hours. Lula said on Sunday morning that he would accept the result, whoever won.
- **The economic team.** Durigan has not yet been confirmed. A change at the Finance Ministry would add to the fiscal risk premium.
- **Fiscal tightening.** Whether the plan to cut real spending growth from 2.5% to 1.5% a year goes to Congress, and whether it passes.
- **Inflation and the Copom.** A weaker BRL and Brent near US$117 a barrel both push inflation up. We expect the Copom to pause its rate cuts on November 4.
- **Global risk.** The US 10-year Treasury yield closed Friday at 5.00%, and oil rose more than 6% last week on Strait of Hormuz tensions. Both make a Brazil sell-off harder to absorb.

How to position

- **Do not sell into the first move.** Overnight markets are thin, and the Banco Central do Brasil can use FX swaps and auctions if trading becomes disorderly. We would wait for the B3 open and the first signals on the economic team.
- **Local rates:** stay in short-term rates. The front end pays close to 13.5%, about 9% after inflation. Avoid long DI duration until the economic team and the 2027 budget are clear. Prefer Mexico local duration over Brazil.
- **Inflation protection:** hold short-dated NTN-Bs as a hedge against inflation driven by spending and a weaker BRL.
- **Equities:** rotate into USD-earning exporters that benefit from a weaker BRL: Vale (VALE3 / VALE), Suzano (SUZB3 / SUZ), Embraer (EMBJ3 / EMBJ), JBS (JBSS32 / JBS) and Minerva (BEEF3). Among banks, prefer Itaú (ITUB4 / ITUB). Avoid Banco do Brasil (BBAS3) and Petrobras (PETR4 / PBR) because of political-interference risk.

- **Dollar bonds:** underweight BRAZIL against MEX, with BRAZIL CDS as the hedge. We see EMBI Brazil at 185–205bp and 5-year CDS at 135–150bp in our base case. Prefer USD-revenue corporates such as VALEBZ and SUZANO over the sovereign.

Who's who

- **Luiz Inácio Lula da Silva (Lula).** Re-elected president for a fourth term, for the Partido dos Trabalhadores (PT, Workers' Party). He takes office on January 5, 2027.
- **Flávio Bolsonaro.** Senator from Rio de Janeiro and the eldest son of former president Jair Bolsonaro. He ran for the Partido Liberal (PL, Liberal Party) and returns to the Senate, where he will lead the opposition.
- **Dario Durigan.** Lula's finance minister. He has argued that markets treat Lula's fiscal record unfairly. Whether he stays is the first test for investors.
- **Rogério Marinho.** A senator from the PL and Flávio's campaign coordinator. How he and Flávio respond to the result in the coming days matters for the political risk premium.
- **The Centrão.** The bloc of centrist parties in Congress. They do not belong to either camp and will decide which of Lula's fiscal bills pass.

The result and the first market reaction

Lula won by 3.5 points, a wider margin than any final poll showed, and markets reacted sharply in the first overnight trading.

Market	October 22 close	October 23 close	First overnight trading (October 25)
Ibovespa	204,120	205,083 (+0.47%)	Ibovespa-linked funds overseas down 11–20%
BRL per US$	5.038	4.993 (BRL +0.9%)	About 5.51 in CME futures (BRL down about 10%)
DI Jan-27	13.48%	13.475%	B3 opens Monday
DI Jan-29	12.66%	12.595%	B3 opens Monday
DI Jan-31	12.67%	12.575%	B3 opens Monday

Market	October 22 close	October 23 close	First overnight trading (October 25)
EMBI Brazil	164bp (Oct 20)	Not available	Not available
BRAZIL 5y CDS	117bp (Oct 20)	Not available	Not available
US Treasury 10y	4.96%	5.00%	—
Brent, US$ per barrel	—	116.72 (+3.1%)	—

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On Friday, markets were still trading a Flávio win: BRL closed below R$5 per US$ for the first time in the campaign and the DI curve flattened, even as Eurasia Group cut the chance of an opposition win from 70% to 60%. October IPCA-15 inflation also came in lower than expected, at 0.32% for the month and 4.62% over 12 months. That positioning is why the reaction to Lula's win is so large.

The overnight moves came in thin markets and should be read as a direction, not a level. In 2022, the market did not hit its low on election night. It sold off hardest in Lula's first days in office, when he extended a fuel tax exemption over his finance minister's objection.

What a fourth Lula term means for policy

A fourth Lula term means continuity in economic policy, but he has to deliver fiscal discipline through a Congress controlled by the opposition and the centrist parties.

Lula's case rests on his record: growth close to 3% a year this term, record-low unemployment, the consumption-tax reform, income-tax cuts for the middle class and the end of the six-day work week. The concern is fiscal. Targets were changed rather than met, and gross debt rose more than 10 points of GDP during his term, to 82.9%.

The 2023 fiscal framework lets spending grow up to 2.5% a year above inflation and sets an annual target for the primary balance. It controls how fast spending grows, not the level of debt. With the Selic at 13.75%, interest costs keep pushing debt up. The economic team has signaled a tighter cap of 1.5%, a review of the health and education spending floors and a pension reform. Each one needs Congress, and the last two need constitutional majorities.

Our view: the framework is credible only if it is tightened. Without the 1.5% cap, we expect debt to rise to 86–88% of GDP by the end of 2027. The market will watch two things first: whether Durigan stays, and whether the 2027 budget contains real cuts or relies on revenue that Congress has not approved.

Hard-currency sovereign relative value

Dollar bonds should widen much less than local assets. Reserves of US$373bn and little FX debt limit the downside.

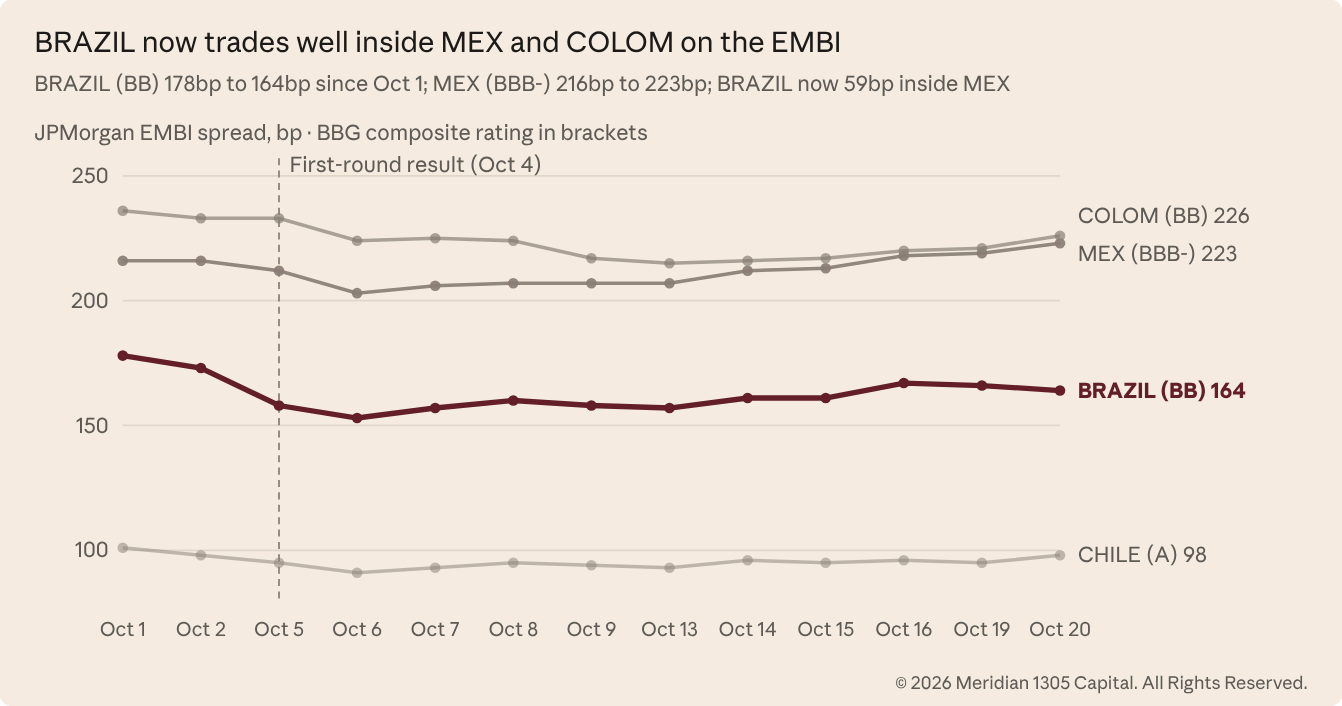

Figure 1. Source: Meridian 1305 Capital; JPMorgan EMBI via boletinextraoficial.com. Daily closes, October 1 to October 20, 2026. Pre-vote levels.

Before the vote, BRAZIL traded at 164bp on the EMBI, 59bp inside MEX (BBB-) and 62bp inside COLOM (BB), even though BRAZIL is rated BB. That premium was built on a Flávio win. In our base case, BRAZIL gives back about 20–40bp of it.

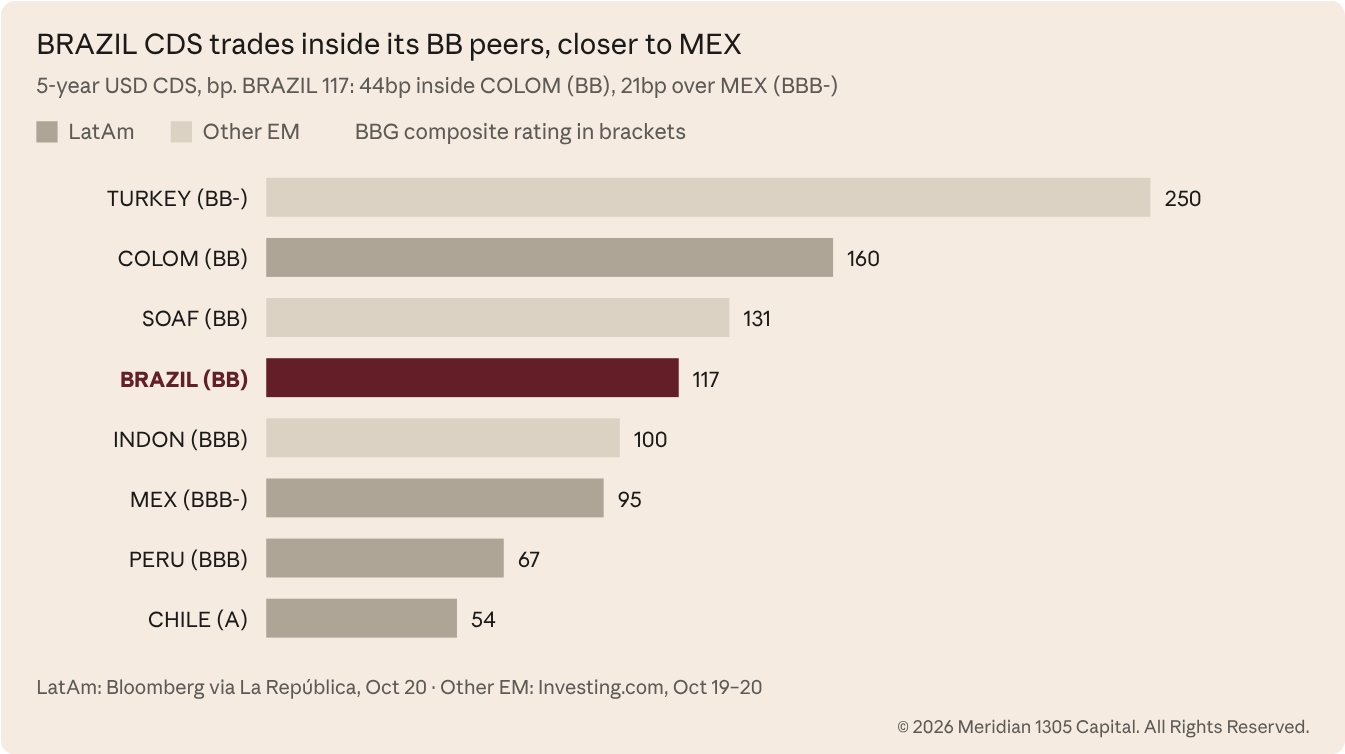

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Figure 2. Source: Meridian 1305 Capital; Bloomberg via La República; Investing.com. 5-year USD CDS as of October 20, 2026. Pre-vote levels. BBG composite ratings derived from Moody's, S&P and Fitch. Bars are rounded; the gaps in the subtitle use unrounded quotes (COLOM 160.34, BRAZIL 116.67, MEX 95.43).

Our view: BRAZIL 5-year CDS at 117bp traded about a notch better than its BB peers. We expect it to move back to the pre-election range of 135–150bp, between MEX (95bp) and COLOM (160bp). We do not expect a crisis-level move, because Brazil's external position is strong.

Local rates and BRL

The long end gives back most of its election rally, while the front end stays tied to the Copom.

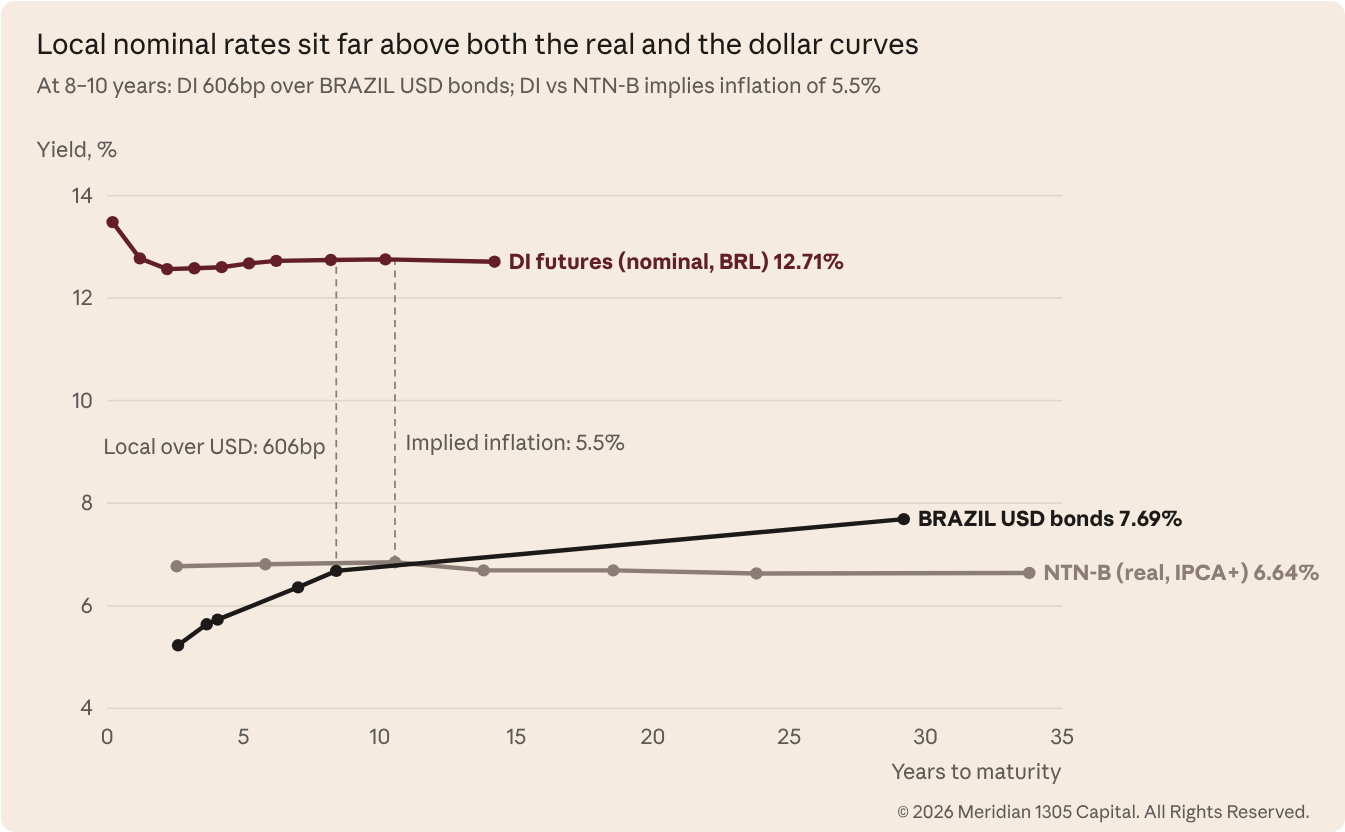

Figure 3. Source: Meridian 1305 Capital; B3 DI settlement; Tesouro Direto NTN-B quotes; BondTerminal BRAZIL USD bond yields. Pre-vote levels, October 14–22, 2026. The 606bp gap and 5.5% implied inflation compare matched maturities: DI against the BRAZIL USD bond at about 8 years, and DI against the NTN-B 2035 at about 10 years. The labels at the end of each line show each curve's longest maturity, so they should not be subtracted from each other.

DI Jan-29 fell about 140bp from late August to Friday's 12.60%, and most of that move was tied to the election. We expect the long end to give back most of it and the curve to steepen. BRL is the easiest way for foreign investors to exit, which is why it moved first and most overnight.

Our view: at R$5.50 or weaker, and with short-term rates near 13.5%, BRL carry becomes attractive again for investors who can hold through the volatility. We would start rebuilding BRL only after the economic team is confirmed.

Three scenarios for a fourth Lula term

Base case (55%): Durigan stays and the fiscal framework is kept, with a partial attempt to tighten it. Congress blocks new revenue measures. The Banco Central do Brasil steadies BRL, and part of the first move reverses.

Bull case (20%): Lula confirms Durigan and a strong budget team quickly and sends the 1.5% spending cap to Congress early. The centrist parties cooperate on the 2027 budget, and the Copom resumes rate cuts in early 2027.

Adverse case (25%): Durigan is replaced by a political name or Lula announces new spending, such as fuel subsidies. Flávio contests the result. Oil stays above US$115 and the Fed stays hawkish, and the Copom has to raise rates.

	October 23 close	Base	Bull	Adverse
Markets, next 3 months				
Ibovespa	205,083	180,000–195,000	195,000–210,000	160,000–175,000
BRL per US$	4.99	5.30–5.55	5.10–5.30	5.70–6.10
Short-term rates (DI Jan-27)	13.48%	13.9–14.3%	13.5–13.8%	14.5–15.0%
Long-term rates (DI Jan-31)	12.58%	13.4–13.9%	12.9–13.3%	14.3–15.0%
Inflation-linked bonds (NTN-B 2035, real yield)	~6.85%	7.2–7.5%	6.9–7.1%	7.7–8.2%
Expected inflation over 10 years (breakeven)	~5.5%	5.8–6.1%	5.5–5.7%	6.3–6.8%
Dollar bond spread (EMBI Brazil)	164bp (Oct 20)	185–205bp	170–185bp	220–260bp
Default insurance (BRAZIL 5y CDS)	117bp (Oct 20)	135–150bp	125–135bp	165–200bp
Economy, end-2027				

	October 23 close	Base	Bull	Adverse
GDP growth	2.0% y/y (Q2 2026)	1.2–1.6%	1.6–2.0%	0.3–0.9%
Inflation (IPCA)	4.62% (IPCA-15, Oct)	4.7–5.2%	4.3–4.7%	5.5–6.5%
Policy rate (Selic)	13.75%	13.0–13.75%	12.0–12.75%	14.5–15.5%
Government debt, % of GDP	82.9% (Aug)	86–88%	85–86%	89–91%
Credit ratings (Ba1/BB/BB)	Stable	Stable	Stable	Outlook turns negative
How we would position				
Local rates		Short-term rates only; no long duration yet	Buy long-term rates once the team is confirmed	Avoid long-term rates; pay the long end
Inflation-linked bonds		Short-dated NTN-Bs as a hedge	Add longer NTN-Bs	Short-dated NTN-Bs only
BRL		Rebuild slowly above R$5.50	Buy	Hedge
Equities		Exporters and Itaú: VALE3, SUZB3, EMBJ3, JBSS32, BEEF3, ITUB4	Add back domestic names: Magazine Luiza (MGLU3), Lojas Renner (LREN3), Cyrela (CYRE3), MRV (MRVE3)	Exporters only; avoid PETR4 and BBAS3
Dollar bonds		Underweight BRAZIL against MEX	Neutral	Underweight BRAZIL; buy CDS protection

The probabilities and ranges are Meridian 1305 Capital estimates.

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Positioning by issuer

Issuer	Equity (B3 / US)	USD bonds (Bloomberg)	View
Federative Republic of Brazil	—	BRAZIL	Underweight against MEX; widens toward 185–205bp, but contained
Vale	VALE3 / VALE	VALEBZ	Relative winner on a weaker BRL
Suzano	SUZB3 / SUZ	SUZANO	Relative winner; USD revenue
Embraer	EMBJ3 / EMBJ	—	Relative winner on a weaker BRL
JBS, Minerva	JBSS32 / JBS, BEEF3	—	USD revenue from protein exports
Itaú Unibanco	ITUB4 / ITUB	—	Our preferred bank: strong capital and returns
Petrobras	PETR4 / PBR	PETBRA	High oil helps, but political-interference risk returns
Banco do Brasil	BBAS3	—	Underperforms on directed-lending risk
Magazine Luiza, Lojas Renner	MGLU3, LREN3	—	First to sell off with higher rates
Cyrela, MRV	CYRE3, MRVE3	—	Sell off with the long end

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Our highest-conviction calls

1. **Short-term local rates in every scenario.** Even after the result, the front end pays close to 9% after inflation. Few emerging markets pay that.
2. **Exporters over domestic names.** Vale, Suzano, Embraer, JBS and Minerva earn in US dollars and gain when BRL weakens.
3. **MEX over BRAZIL in dollar bonds.** BRAZIL was priced for a Flávio win. MEX pays more spread with a higher rating (BBB- against BB).
4. **Wait for the economic team before adding long duration or BRL.** The first 30 days of policy will matter more than election night, as they did in 2022–23.

What would change our view

The next 30 days will decide how far the sell-off goes.

- **Acceptance of the result.** A concession from Flávio and certification by the electoral court would remove one source of risk. A long challenge would keep BRL and long rates volatile.
- **The economic team.** Confirming Durigan and a credible budget team would limit the sell-off. A political pick would extend it.
- **The 2027 budget and the spending cap.** Sending the 1.5% real spending cap to Congress early would be the strongest signal that fiscal discipline is real.
- **Congress.** Early cooperation from the centrist parties on the budget would reduce the risk premium. Open conflict would add to it.
- **The Fed on October 28 and the Copom on November 4.** A Copom pause would be expected. A rate hike, or a hawkish Fed, would add pressure on BRL.

Methodology

Market data are as of the close of business on October 23, 2026, unless otherwise noted, and all calculations are by Meridian 1305 Capital. Overnight levels from October 25 come from news reports of CME BRL futures and Ibovespa-linked funds trading overseas, and should be read as indicative. EMBI and CDS levels are as of October 20, 2026. Election results are from the Tribunal Superior Eleitoral (TSE, Superior Electoral Court) with 99.8% of ballots counted. Spreads and breakeven inflation are computed at matched maturities. Scenario probabilities and ranges are Meridian 1305 Capital estimates, not forecasts from any outside source.

Disclosures

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