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Letter: August, 2025

It's the politics, stupid!

We daily observe and debate the signs of dysfunctionality in Brazilian democracy. Our assessment is that this situation worsened after the 2022 elections, particularly due to the divergence between the political spectrum of choices for the Executive and the Legislative branches.

To measure the political demand expressed at the polls over recent decades, we developed and released in a previous letter the PPI (Political Position Index), a thermometer that captures the direction of the Brazilian electorate on the left-right scale over the past 30 years. We combine this index with the political position of each president to calculate the governability cost of each mandate.

The results are clear: the current government presents the highest governability cost in the series, stemming from the greatest distance ever observed between the political position of the president – more to the left – and that of a Congress that, in recent decades, has shifted to the right. This misalignment manifests in the Executive's difficulty in approving its agendas. The greater the distance of the president from the PPI, the harder governability becomes, and the more pressure is put on the democratic structure.

Looking ahead, a political realignment in the 2026 elections, with the victory of a center-right candidate, could bring an Executive committed to a reformist economic agenda, convergent with the profile of a Legislative branch of a similar spectrum. This rare convergence between the Executive and Legislative branches around an essential economic policy agenda would have the potential to produce a true leap in quality, bringing Brazil closer to the model of sustained growth observed in developed countries.

This would not be an unprecedented phenomenon: we saw a similar movement during FHC's mandates, when profound institutional reforms brought structural gains that reverberated for decades. The current moment, however, carries the possibility of an even more comprehensive realignment.

It is on this transformative potential – and on the opportunity it may represent for markets in the coming months – that we focus in this new letter.

Political, economic cycles, and their temporal conflicts

From an economic perspective, the difference between a developed and an emerging country can be defined by the capacity for growth and volatility of its economy.

The lower the volatility and the more sustained the growth, the more predictable economic cycles are, and consequently, the greater long-term investments become. This increases productivity, strengthens political-social stability, and creates a virtuous cycle that, maintained for decades, transforms the quality of life of the population.

In emerging countries, the striking characteristic is the occurrence of short economic cycles with very sharp variations. These are periods of strong temporary growth, followed by abrupt declines. This dynamic reduces structural investments due to high economic uncertainty and causes a drop in productivity. In downturn phases, there is intense social suffering: companies go bankrupt, unemployment skyrockets, popular dissatisfaction grows, and political instability sets in. Unlike the virtuous cycles observed in developed countries, emerging countries frequently experience vicious cycles.

The essential conflict in managing cycles is political in nature, as described by Alexis de Tocqueville. When studying the then-young American democracy, Tocqueville highlighted that one of the main differences between democratic and aristocratic governments lay in the State's decision-making horizon.

In the autocratic model, the central concern was to maintain and transmit wealth across generations. This objective led to long-term decisions, focused on structural investments that would preserve society's prosperity, especially for the power-holding elites. However, this model of government often underestimated the immediate demands of the poorer population, whose main urgency was short-term wealth distribution. The elite's inability to perceive and incorporate these viewpoints generated an environment of social tension which, in moments of economic downturn, could turn into strong political instability.

In democracies, however, the people in power would seek to solve urgent problems, such as the lack of essential goods and services. Representatives, by prioritizing these demands, would neglect the negative medium and long-term effects that could compromise the structural wealth of society.

To solve this dilemma, the young American democracy adopted an ambitious and delicate mixed model: it implemented a structure of checks and balances among the Executive, Legislative, and Judicial powers, combined with rotation of representation and strong state autonomy. In this way, different societal viewpoints began to be considered in the formulation of solutions for politico-economic challenges.

This political model was both solid and flexible, structured to reflect popular will through regular and legitimate elections. Although, at certain times, it is strained by social disputes that put the different powers on a collision course, its adaptability allows it to navigate periods of political instability while preserving fundamental principles and institutional continuity.

In this framework, the main function of economic policy is to manage growth cycles, meeting the immediate needs of the population, but without compromising structural growth, softening cycles to benefit all of society. To this end, there are two central tools: monetary policy, under the responsibility of central banks, and fiscal policy, conducted by the Executive branch.

The conflict between both arises because they are managed by different authorities with different incentives. While politicians tend to manage fiscal policy thinking about electoral cycles, central banks administer monetary policy with a focus on the economic cycle. This temporal clash between electoral and economic cycles is one of the main sources of GDP volatility in emerging economies, preventing them from advancing to the level of richer countries.

When fiscal policy is “free” in the hands of opportunistic politicians, it characterizes what is called political dominance, instead of a monetary dominance model, which is more efficient in the context of price stability. In practice, “political dominance” means adopting expansionary fiscal policies while monetary policy needs to be restrictive to compensate for inflationary effects, raising interest rates. The higher the interest rates set

by the Central Bank, the greater the growth of public debt, and the more difficult it becomes for private companies to finance itself and grow in a sustained manner.

This poor equilibrium traps the economy in short-term growth cycles, driven by fiscal spending, followed by sharp deceleration, without generating structural improvements for society.

Over the past decades, we have learned that economic policies focused only on the short term, without considering medium and long-term impacts, are detrimental to economic and social development. This lesson was also assimilated in Brazil during the hyperinflation process of the 1970s and 1980s. The consensus on the negative effects of inflation allowed, in the 1990s, the population to give a clear mandate to President Fernando Henrique Cardoso.

His presidential victory was accompanied by a politically aligned Congress, governors, and mayors, which reduced the cost of governability and enabled structural changes in economic policy.

During Fernando Henrique Cardoso's two terms, Brazil experienced a rare moment of institutional and economic leap despite successive international crises. This advancement generated lasting results in the following decades.

This improvement was only possible thanks to a political alignment that has not been repeated since the mandates of Fernando Henrique Cardoso. We believe, however, that this alignment may be about to repeat itself in 2026.

The Mixed Signals of 2022

We consider the ideological divergence between the different spheres of power as a central factor in explaining the complex issues that currently surround our democracy and hinder the country's progress towards the level of development of richer nations.

In January 2025, we released a letter analyzing the growth of the evangelical population in Brazil¹. In it, we developed a political position index (PPI) to visualize, based on elections held since the 1990s, how the "political pointer" of Brazilian society has shifted over time.

The purpose of this index is to function as a historical "thermometer" of the population's political demand. The methodology is simple: we classify parties on a scale from -2 (left) to +2 (right), with the center represented by 0, and then allocate the total votes received to calculate the midpoint of each election..

Graph 1: Classification of political parties by ideological spectrum

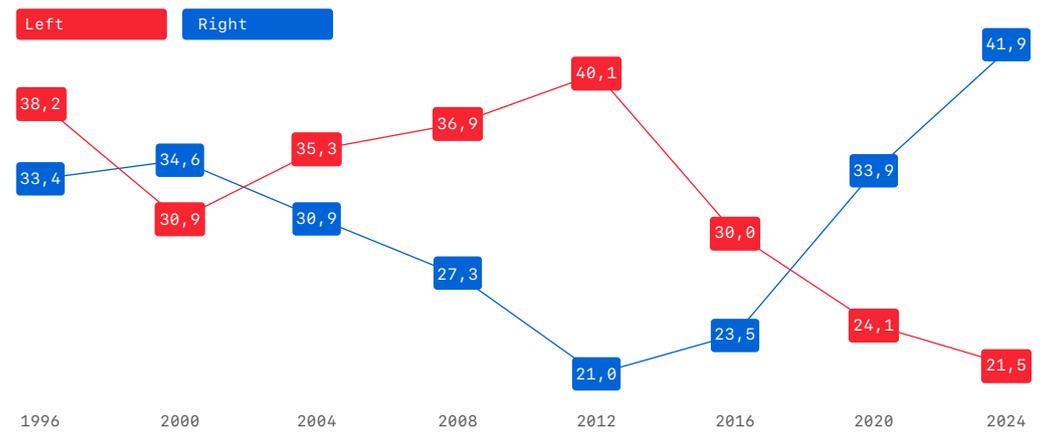
-2 para partidos da esquerda e +2 para partidos à direita



Source: Mar Asset Management

Graph 2: % of votes in municipal elections in the first round according to party bias

% of total valid votes



Source: TSE, Mar Asset Management

1 Letter: "Preaching in the Desert". January 2025.

We applied this method to disputes for mayors, federal deputies, senators, governors, and presidents. The consistency of the political direction of votes is particularly relevant between mayoralities and legislative positions, showing a good correlation with the result for governors.

Although this political pointer indicates the average trend of electoral demand, presidential elections can break this logic because of their plebiscitary nature. This occurs because the personal characteristics of candidates exert enormous influence on rejection and, therefore, on the choice of vote.

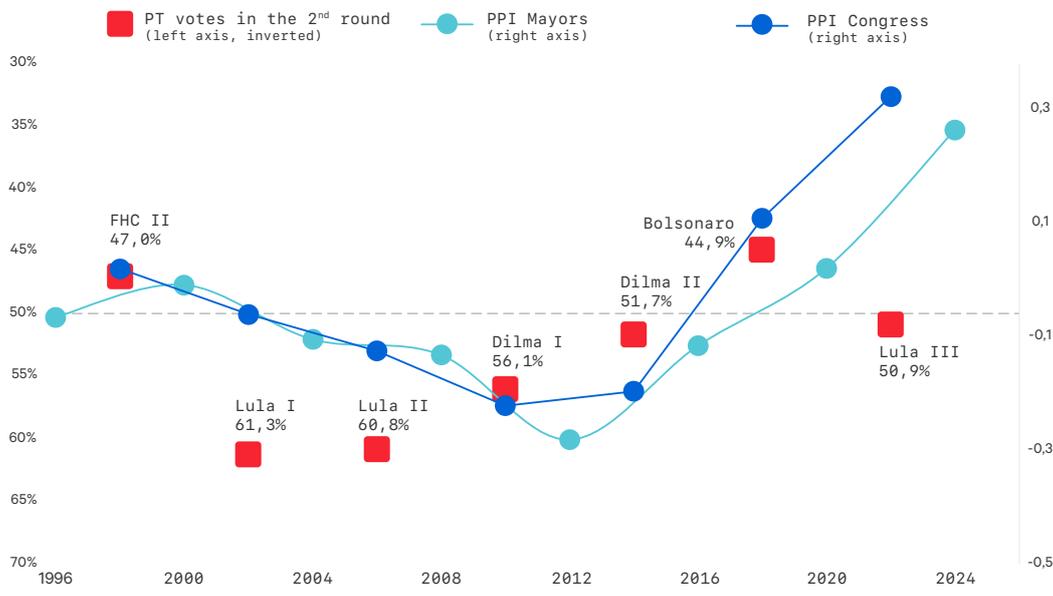
In other words, the political direction captured in municipal and legislative elections suggests a bias for the presidential choice, but it is not determinant.

It is natural to assume that when the population elects congressmen and the president with similar ideas, the governability of the new head of the Executive is facilitated. The president's proposals would find greater receptivity in Congress, as all spheres of power would be constituted defending aligned general principles.

On the other hand, when the population votes in one political direction for the Legislative and another for the Presidency, governability is expected to be hampered, since Congress would not be receptive to the proposals of a president who does not represent the ideas that guided the election of parliamentarians. In Argentina, this phenomenon is called "ballot splitting"².

² In Argentina, voting occurs by inserting each candidate's ballot into an envelope that is deposited in the ballot box. The ballots of candidates from the same political front are connected by dotted lines. When the voter decides to vote for president from one front, governor, and deputy from another, they have to separate the ballot of the chosen president, join the ballots of the candidates from the other front, insert them into the envelope, and deposit it in the ballot box. The need for "ballot splitting" increases the difficulty of voting for different fronts in the same election.

Graph 3: PPI Mayoral and Congressional elections and PT (Workers' Party) votes in presidential elections (second round)



Source: TSE, Mar Asset Management

This lack of clarity about the mandate being given to those elected tends to generate institutional paralysis.

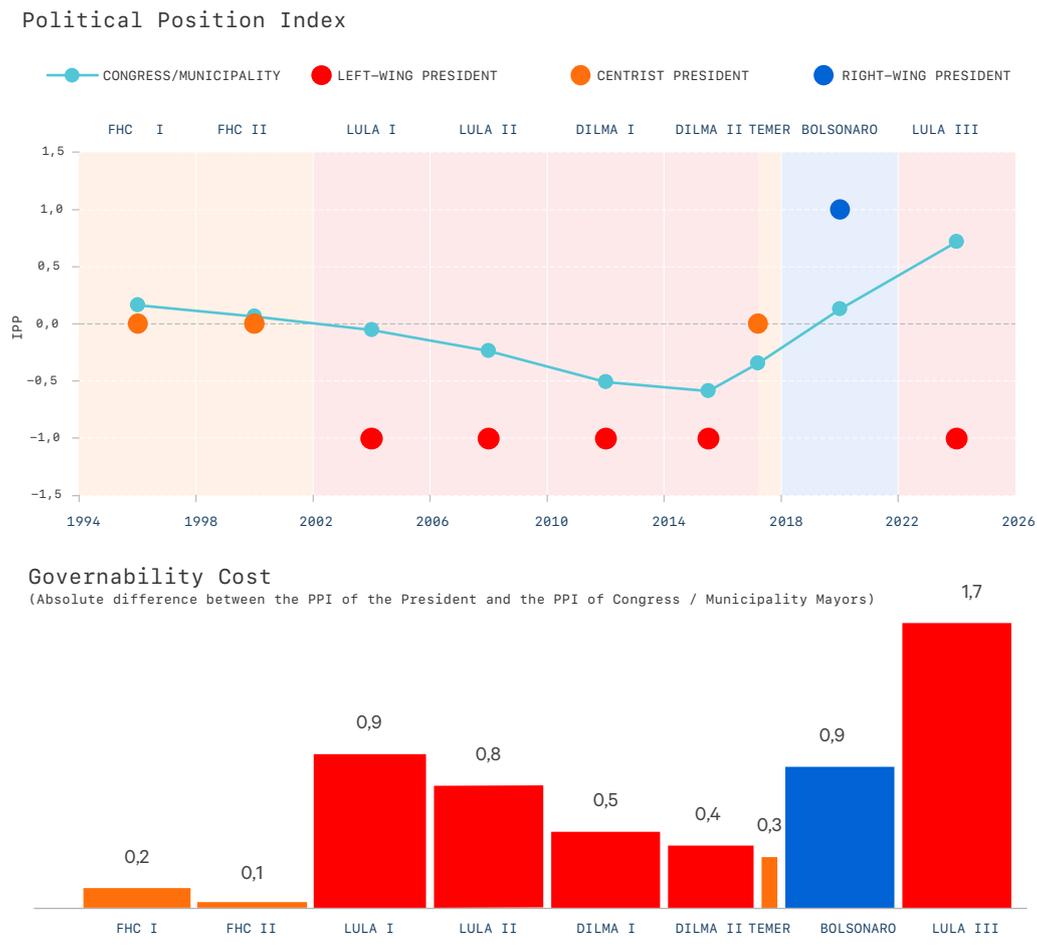
We believe this is the situation Brazil has been experiencing since the 2022 elections.

To measure this dynamic over time, we combine the PPI, which captures the average orientation of municipal and legislative elections, with the ideological position of the elected president.

The difference between the political position of the president's party and the PPI indicates the cost of governability for each mandate. The closer the president is to the PPI, the lower the cost tends to be; the further away, the greater the difficulty in governing.

This analysis makes it clear how confusing the 2022 elections were as a political signal. When the PPI reached its most right-wing point in our recent history, Lula was elected for his third term.

Graph 4: Political Position Index and Governability Cost



Source: TSE, Mar Asset Management

The political pendulum continued to shift to the right between 2018 and 2022 in elections for Congress and regional governments, as it had been doing since 2016. Despite this context, Jair Bolsonaro, a right-wing candidate and incumbent, was defeated by Lula.

This "ballot splitting" can be explained by the rejection battle that marked the 2022 presidential election. The total rejection of Bolsonaro by voters, particularly because of his handling of the pandemic, was higher than the rejection of former President Lula.

PT's positive performance in the Northeast changed little between 2018 and 2022, as did the evangelical population's rejection of the party, which remained stable regardless of whether the candidate was Fernando Haddad or Lula.

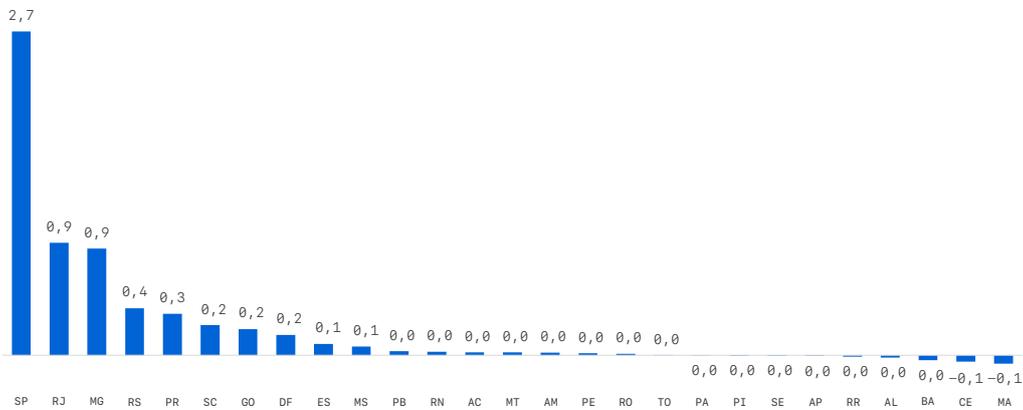
The relevant change among Bolsonaro voters in 2018 who migrated to Lula in 2022 occurred especially in the Southeast – notably São Paulo – among the non-evangelical, high-income population.

This segment of the population began to identify Bolsonaro as a risk to democracy. We interpret that they are generally former PSDB voters and were responsible for deciding the 2022 election. In the United States, this type of voter is called a swing voter.

Graph 5: How much did each state contribute to the increase in PT votes in the 2nd round between 2018 (Haddad) and 2022 (Lula)?

p.p., contribution of the variation of valid votes per state

Total: +6%
 SP: +2.7% (+5.3 million votes compared to the 2018 difference)



Source: TSE, Mar Asset Management

Graph 6: Increase in PT votes in the second round of the 2018 and 2022 presidential elections

p.p., valid votes



Source: TSE, Datafolha, Mar Asset Management

Graph 7: Higher-income municipalities were those that increased PT votes between 2018 and 2022

p.p., variation in votes per municipality in each group

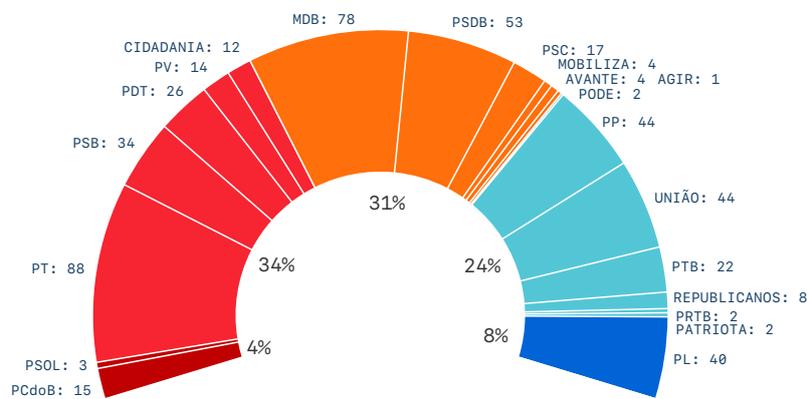


Source: TSE, IBGE, Mar Asset Management

Lula was elected in the second round of the tightest election in Brazilian history, encountering, upon taking office, the most right-leaning Congress since the 1990s. Faced with an environment hostile to his left-wing project, Lula concluded that the best way to improve governability would be to expand his popularity. To achieve this, he aggressively gambled on the expansion of public spending. Lula, observing the restrictions and the political cycle, used an economic tool with the objective of obtaining electoral benefits.

Graph 8: Seats in Federal Congress by party in 2011

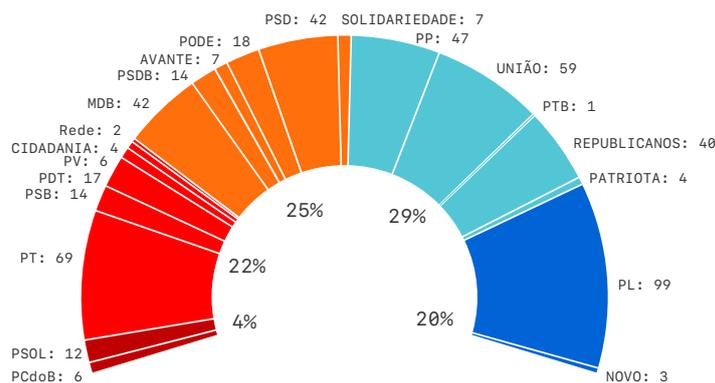
Number of deputies per party



Source: Câmara dos Deputados, Mar Asset Management

Graph 9: Seats in Federal Congress by party in 2023

Number of deputies per party



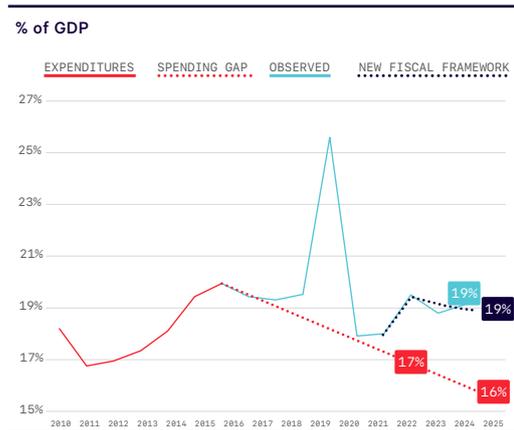
Source: Câmara dos Deputados, Mar Asset Management

At the beginning of his third term, the Central Bank of Brazil (BCB) was ending a long cycle of interest rate hikes, initiated to slow down the economy after intense stimuli adopted in the post-pandemic period. While developed countries were reducing fiscal spending and returning economic policy leadership to their central banks, the Lula government publicly attacked the first independent BCB president and approved the PEC da Transição (a constitutional amendment bill that allowed for an expansion of public spending), aggressively expanding public expenditures to improve an already fragile political situation.

It was clear that, in the following years, the country would experience an economic policy environment where fiscal and monetary policies would move in opposite directions. The result would be the maintenance of interest rates and inflation at much higher levels than they would be if fiscal policy were more contained.

Fiscal spending stimulated growth and reduced unemployment. However, it also brought higher inflation and the highest interest rates in the last 20 years. This unsustainable equilibrium originates from growth based not on investments and increased productivity, but on boosting household consumption via expanded government transfers.

Graph 10: Primary expenses – projected at the time of the approval of the Spending Cap vs. actual



Source: National Treasury, Mar Asset Management

Graph 11: Selic rate



Growth of this nature, accompanied by high inflation and interest rates, signals a period of adjustment ahead and deters the private sector, which begins to compete for access to credit. With interest rates making new productive investments unfeasible, the phenomenon known as crowding out occurs: the public sector, with recurrent and growing deficits, absorbs available capital and raises real interest rates, reducing space for business financing.

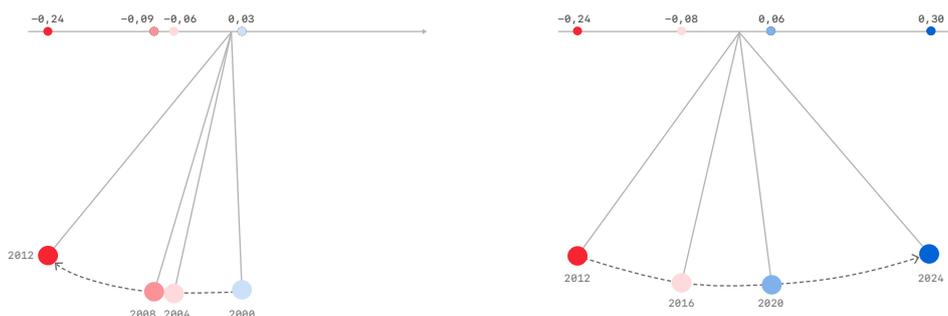
Institutional conflicts: structural or situational?

To achieve governability, the Executive branch also resorted to the Judiciary to try to bypass the Legislative's resistance, further straining an already fragile relationship with Congress.

The dynamic established between the three powers in recent years is not natural or healthy for the long term, as it strains the relationship between the powers by having the Supreme Federal Court (STF) take a leading role in resolving political conflicts that should be decided by the plenary sessions of the Chamber and Senate. This environment raises risks for both the political and economic spheres.

Between 2002 and 2014, our political pointer shifted to the left in each election, facilitating the governability of PT mandates. Since 2016, however, the movement has been rapid and intense towards the right. In 2024, municipal elections produced the most right-wing PPI in our series, indicating that, despite Lula's victory in 2022, the electorate continued its consistent move to the right.

Graph 12: PPI of municipal elections showed a pendulum movement between 2000 and 2024 and is now at its most right-wing level



Source: TSE, Mar Asset Management

The last municipal elections point to an even more right-wing Congress and an anti-PT bias in the 2026 elections. However, we know that the presidential election does not exclusively obey current political energy: the result is strongly influenced by personal rejection. So, even if the national trend continues to shift the political pointer to the right, increasing the probability of a candidate from that field winning, the presidential election will have its own dynamics, and some considerations must be made.

Electoral Scenario

Lula has already been able to win an election even in the face of a clear shift of the PPI to the right. The 2022 victory was extraordinary, especially when analyzed from the perspective of the profile of voters who migrated their vote between 2018 and 2022. In our assessment, this anomaly was mainly due to the high rejection of then-President Jair Bolsonaro. For this reason, we believe that repeating the 2022 performance in 2026 will be a very difficult task despite incumbency.

There is no indication that the evangelicals' rejection of his government has decreased. At the same time, there are signs of wear and tear among the electorate that secured his victory in the most disputed election since re-democratization.

The growth of the evangelical population imposes a lower vote ceiling on the PT. In 2018 and 2022, the vote of this segment was almost identical (70% anti-PT and 30% pro-PT), indicating that the replacement of Haddad by Lula as the left-wing candidate did not alter the voting pattern.

Since the beginning of the current government, there has been a steady increase in rejection from this group. Even the slight improvement in government approval, after the implementation of tariffs by the USA, was concentrated among non-evangelical voters.

At the other end of the ideological spectrum – the Northeast region – there also appears to be no room for additional growth of support for Lula in 2026. The voting pattern of approximately 70% pro-PT has likely reached its limit. This solid floor of votes, observed throughout recent elections, is being eroded by the growing evangelical presence in the region, something that is already beginning to reflect in popularity polls.

Graph 13: Lula III government's net approval among evangelicals and among Northeast voters



Source: Datafolha, Mar Asset Management

Graph 14: How would the PT vote change in each region solely due to the continued increase in the evangelical population?

%, valid votes

	2022		2026	
	% Evangelicals (Census)	PT Votes 2 nd Round	% Evangelicals na população (estimated)	PT Votes 2 nd Round (estimated)
Norte	36.8%	49.0%	40.3%	46.9%
Nordeste	22.4%	69.3%	25.1%	67.1%
Sudeste	27.8%	45.8%	29.5%	45.6%
Sul	23.7%	38.2%	25.1%	37.8%
Centro Oeste	31.4%	39.7%	33.3%	39.2%
Brasil	26.9%	50.9%	29.0%	50.0%

Source: IBGE, Mar Asset Management

The current administration has yet to win even greater support than in 2022 among the so-called swing voters. However, even within this group, the president's popularity is now considerably lower than at the beginning of his term. Despite fiscal efforts and positive economic results, recovering lost ground in this segment of society by next year's elections seems like an arduous task.

The great surprise of Lula's third term is the low correlation between his popularity and the evolution of the economy, as measured by the misery index. Even registering new records of improvement in this index, we observe a downward trend in presidential popularity.

The variable that best indicates an incumbent president's chances of re-election is their current approval rating. Until the end of last year, there was a gradual downward trend in Lula 3 government's approval rating. This movement intensified since January.

Converting these ratings into voting intentions – using the conversion of previous incumbent presidents – we find a range between 38% and 45% of valid votes in a second round, clearly insufficient to ensure victory for Lula.

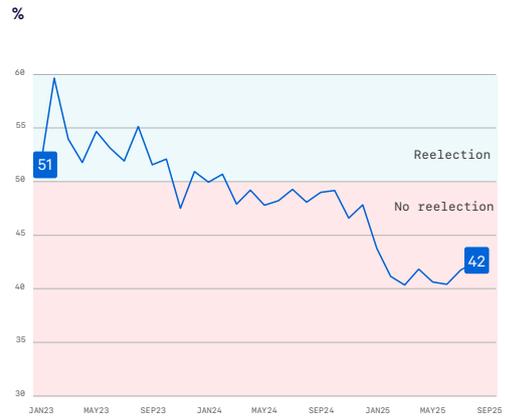
Graph 15: Lula government's net approval

p.p., difference between excellent/good and bad/terrible evaluation



Source: Datafolha, Quaest, Paraná, Futura, Atlas, MDA, IPEC, PoderData, Mar Asset Management

Graph 16: Valid votes based on the historical conversion of incumbent presidents' approval polls



Source: Datafolha, Mar Asset Management

In early 2025, the president appointed marketer Sidônio Palmeira as Minister of Communication. The diagnosis was that low popularity was mainly due to failures in communication with the population. Sidônio promised a significant improvement within three months and implemented an aggressive institutional communication plan, based on the premise that the best defender of the government is the president himself.

Following this logic, Lula announced an extensive list of new income transfer programs, visited local radio stations, and held collective and exclusive interviews, seeking to directly disseminate his message. However, the polls did not show the expected results: popularity continued to decline.

With this level of approval, Lula will face not only great difficulty in getting re-elected, but also difficulties in forming his slate.

There is still time until candidates are officially defined, but we already observe an early start to the electoral campaign by the president. Sidônio Palmeira, a professional marketer, acts as a Chief of Staff, defining the government's agenda and directly taking care of the presidential image.

This early campaign has two objectives: to test Lula's ability to influence public perception of his administration and help him decide whether to run for re-election, and to raise his popularity by early 2026 in order to facilitate political-party alliances that broaden his support base, ensure widespread reach, and secure valuable TV time for the presidential campaign.

Free electoral advertising will continue to be a strategic channel for a government that faces communication difficulties in digital media.

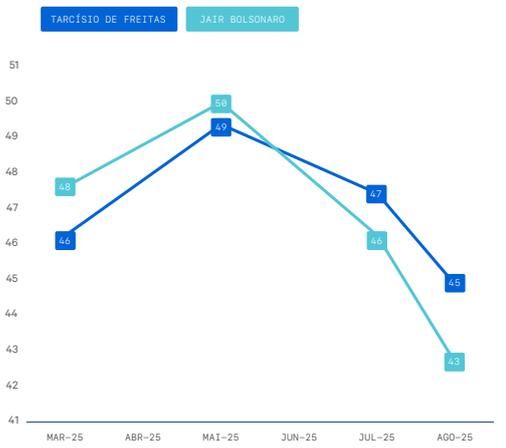
Regarding the definition of the right-wing candidacy, the tariff episode revealed, for the first time since the beginning of this term, a division between center-right and far-right politicians. The tariffs had an effect similar to that of Covid-19 vaccines: the center-right adopted a moderate stance, while the Bolsonaroist right fully defended the narrative of its leaders. Initial polls indicated a drop in the popularity of the Bolsonaroist right.

Nonetheless, Minister Alexandre de Moraes's reaction, by imposing an electronic ankle monitor and then decreeing house arrest for Jair Bolsonaro, reunited the center and far-right.

So far, we assess that there was a lot of noise generated by Trump's actions, but this did not significantly alter the political dynamic we had already been observing. The marginal effect was a reduction in the electoral viability of the far-right and a slight improvement in government approval, signaling that the isolated far-right cannot remain competitive, even in the face of a poorly evaluated president.

Graph 17: Voting intention against Lula in the second round of 2026

% , valid votes in the second round in a scenario against Lula



Source: Quaest, Mar Asset Management

Graph 18: Lula and Tarcísio's approval in the municipality of São Paulo

% difference between excellent/good and bad/terrible ratings



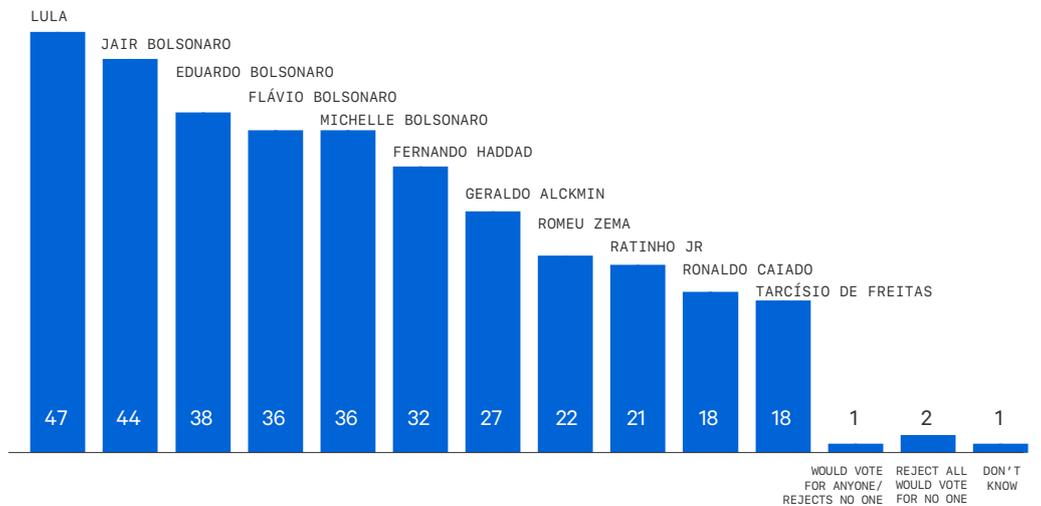
Source: Instituto Paraná, Mar Asset Management

This political tide continues to indicate that Lula's probability of re-election is low, as he does not represent the predominant demand of the electorate. As we approach the election, the chances of a sharp recovery in his popularity decrease.

The swing voter group from the 2018 and 2022 elections, which was predominantly concentrated in SP, suggests that the well-regarded Governor Tarcísio de Freitas is the natural choice to reverse Bolsonaro's poor performance in the state.

Still, for Lula to repeat his 2022 vote, he would have to face a candidate with a high level of rejection, which is not the case for other center-right governors.

Graph 19: Rejection: which of these possible candidates would you definitely not vote for in the first round of the 2026 presidential election? Poll released on August 2, after Trump's tariff imposition on Brazil.



Source: Datafolha, Mar Asset Management

Leap in Quality: What would be the political impact of a potential victory of a center-right candidate?

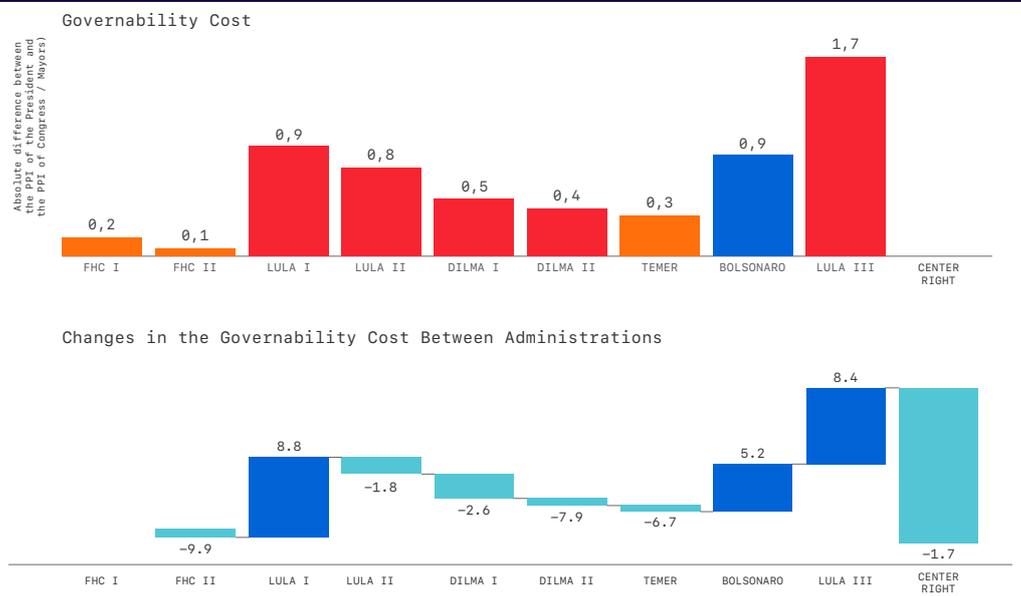
Following the PPI reading derived from the 2024 municipal elections, we project that the Congress elected in 2026 will be even more to the right than the current one³. A victory by a center-right candidate, possibly one of the governors from this field, would have the potential to generate a

³ Please refer to our study: ["Keep the faith! The electoral impact of the growth of evangelicals,"](#) slides 69 and 70.

structural realignment between the Executive and Legislative branches, creating a more balanced political environment that would reduce the need for Judicial intervention to resolve conflicts.

A new presidential term with this profile would be capable of building an environment of low "governability cost" – a phenomenon only observed in Brazil during Fernando Henrique Cardoso's mandates. This cost, which has remained high since then, with a brief pause during Michel Temer's mandate, could see the largest sequential drop in the historical series, moving from the highest level ever recorded to the lowest.

Graph 20: Victory of a center-right candidate could produce the largest reversal of governability cost between mandates, as well as the greatest ideological alignment between executive and legislative in the historical series



Source: TSE, Mar Asset Management

The decrease in conflicts between the powers would rebalance institutional relations and restore democracy's "normal" functioning. A coherent voting direction for different levels of government would create an environment where negotiations for presidential agendas would become more fluid and less litigious.

The Supreme Federal Court would naturally cease to occupy the center of political news, and democratic normality would be re-established.

This political-institutional normality would also bring a desired normality to economic policy. Fiscal policy would return to operating in a more restrictive manner, ceasing to be used as a tool to leverage popularity. A moderate deceleration of activity would be accompanied by inflation converging to the target and, gradually, the Selic rate falling to the neutral level, estimated at around 7%. Thus, we would return to an environment of monetary dominance and there would be a crowding in the Brazilian economy.

A newly elected president, with a clear mandate, tends to make government approval more solid and, therefore, less vulnerable to unpopular agendas that are already part of our economic agenda.

The culture of Protestant religious denominations helped spread the idea of individual autonomy in society as a path to personal and professional success. This mentality reduces popular resistance to governments that propose reducing the state's size in the economy and encouraging private initiative, whether through privatizations, stimulating individual entrepreneurship, or simplifying regulations.

Agendas that, for a long time, were politically forbidden - because they resulted in instability and abrupt drops in the popularity of those who advocated them - now tend to find greater acceptance among a population that has consistently voted more to the right on the ideological spectrum.

Topics such as the de-indexation of pensions from the minimum wage, the de-constitutionalization of spending floors for education and health, and the privatization of state-owned companies would incur lower political costs. These measures would contribute to reversing the growing trajectory of public debt and a structural fall in our interest rate.

After three decades, Brazil could experience a new leap in quality, adopting economic policies similar to those that, for decades, have driven sustained growth in developed countries. We would finally operate with more stable cycles than those observed in the last 20 years.

Portfolio

The optimistic thesis on Brazil, which we have maintained in our portfolio since the end of last year, is based on the possibility of an unprecedented structural political-economic alignment. This view is supported by a long and consistent change in voting patterns over the last 12 years, opening space for the implementation of agendas that can promote a structural leap in our economy.

This positive scenario, which could consolidate in the coming months, has high market reaction potential. Therefore, we believe it is time to maintain exposure to Brazil in our portfolio, even more than a year before the election and after a strong price rally throughout 2025.

Still, we recognize that projections based on political analyses are inherently fragile, even when supported by extensive investigation of electoral patterns and deep qualitative analysis. For this reason, we maintain our exposure with the aim of capturing this positive scenario, but under constant vigilance and with controlled potential losses should reality not match our projections. We always keep in mind the phrase attributed to Magalhães Pinto, former governor of Minas Gerais:

“Politics is like a cloud. You look at it, and it's one way; you look again, and it has already changed.”

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