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Payden & Rygel

TRIP NOTES

ARGENTINA & BRAZIL

OCTOBER 2026

The More Things Change, the More They Stay the Same

Last year, our trip to Argentina and Brazil highlighted how much the political cycle matters for both countries. This year, two political surprises stand out.

In Brazil, the market consensus was leaning decisively toward the incumbent, Luiz Inácio Lula da Silva (Lula), who is running for a fourth term as President. Since our trip, the race has swung sharply toward Flávio Bolsonaro, the son of imprisoned former President Jair Bolsonaro. Flávio finished first in the October 4 first round, and with the runoff due on October 25, 2026, Polymarket assigns almost an 85% chance that he wins.

In Argentina, President Javier Milei's La Libertad Avanza (LLA) did unexpectedly well in the October 2025 midterms, capturing 40% of the vote after a brutal campaign. In the run-up to the vote, sovereign bonds swooned and locals dollarized at a breakneck speed. The circuit breaker was a \$20 billion swap line from the US Treasury's Exchange Stabilization Fund. Many investors thought political uncertainty could be set aside until the 2027 election. Instead, our trip highlighted that the scars from the midterm volatility persist, keeping locals firmly focused on politics one year ahead of the presidential contest.

Argentina: The Economy Is Normalizing, Though Growth Lags

Argentina has undergone and come out the other side of a draconian macroeconomic adjustment spearheaded by

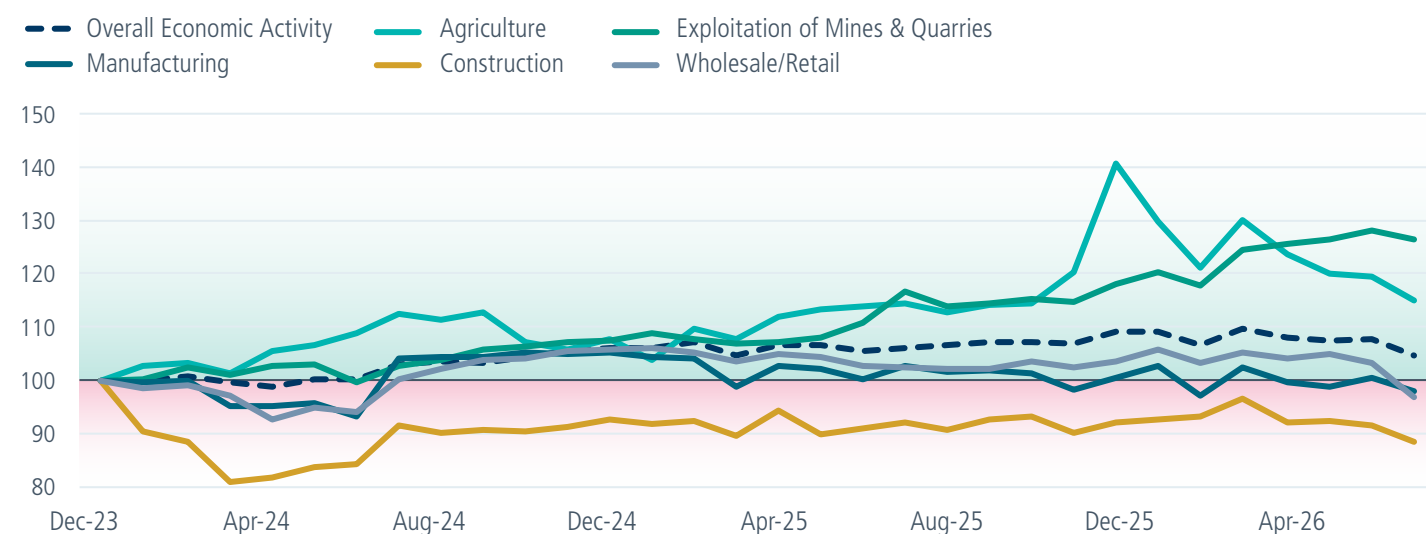
President Javier Milei. When Milei took office in December 2023, the country was on the brink of hyperinflation and faced the real prospect of sovereign default. Milei's harsh adjustment balanced the fiscal accounts and helped bring inflation under control. It is hard to overstate how significant Milei's commitment to fiscal restraint is for Argentina. This is a country with a long history of fiscal problems leading to debt distress. Reflecting this, Argentina was a 'CCC' credit from 2019 until this year, with rating agencies waiting for proof of concept before upgrading.

During our trip, we found a macro picture that has more in common with Argentina's single-B peers. One shared trait is a concern around the growth cycle. Economic activity came into the year with positive momentum but has stalled since the second quarter of the year. This is a problem for the government: with Q3-26 data continuing to come in weak, it is unclear whether the economy can avoid a technical recession (two quarters of negative sequential growth). For the year, growth is now likely to be under 2%, disappointing earlier government estimates.

A second issue is that growth is uneven. Argentina has become a two-speed economy. Agriculture, mining, and energy are booming, helped by deregulation, an investor-friendly incentive regime known as RIGI, and abundant natural resources. In contrast, sectors that are less competitive in a newly open economy—led by retail/wholesale and manufacturing—have flatlined, along with construction, since the end of the previous administration (see Fig. 1 next page). These sectors are seeing rising informality and slowing real wage growth, and they are

Figure 1: Argentine Economic Activity by Sector, Uneven Growth

12/2023=100 (seasonally adjusted by Macrobond)



Source: Macrobond

also the sectors that employ the most people and are concentrated in urban areas. As one local economist put it: “Argentina is facing a supply-side expansion but a demand-side recession.”

Inflation has fallen to about 30% and is expected to decline further, though gradually. This is a notable achievement, even if the monetary framework remains difficult to assess: the Central Bank (BCRA) targets “private transactional M2,” obscuring the policy stance.¹ Positively, interest rate volatility, which strained the financial system, particularly ahead of last year’s midterms, appears to be easing. The peso has remained relatively stable, depreciating gradually with periodic intervention, although most analysts consider the real exchange rate stronger than ideal (more on that below).

The most significant improvement is visible on the external accounts. After a small deficit last year, consensus forecasts call for a balanced current account this year. Some analysts we follow see a surplus of 1% of GDP. Exports are doing very well: one consultant expects \$101 billion this year, up from \$87 billion last year. Part of this is temporary, reflecting the bumper harvest and terms-of-trade gains. That said, the export base is also broadening. Argentina, long a net energy importer, is now a net exporter of energy to the tune of over \$11 billion on a rolling 12-month basis (as of August 2026), and gross energy exports should top \$18 billion this year. Per our local consultant’s data, mining

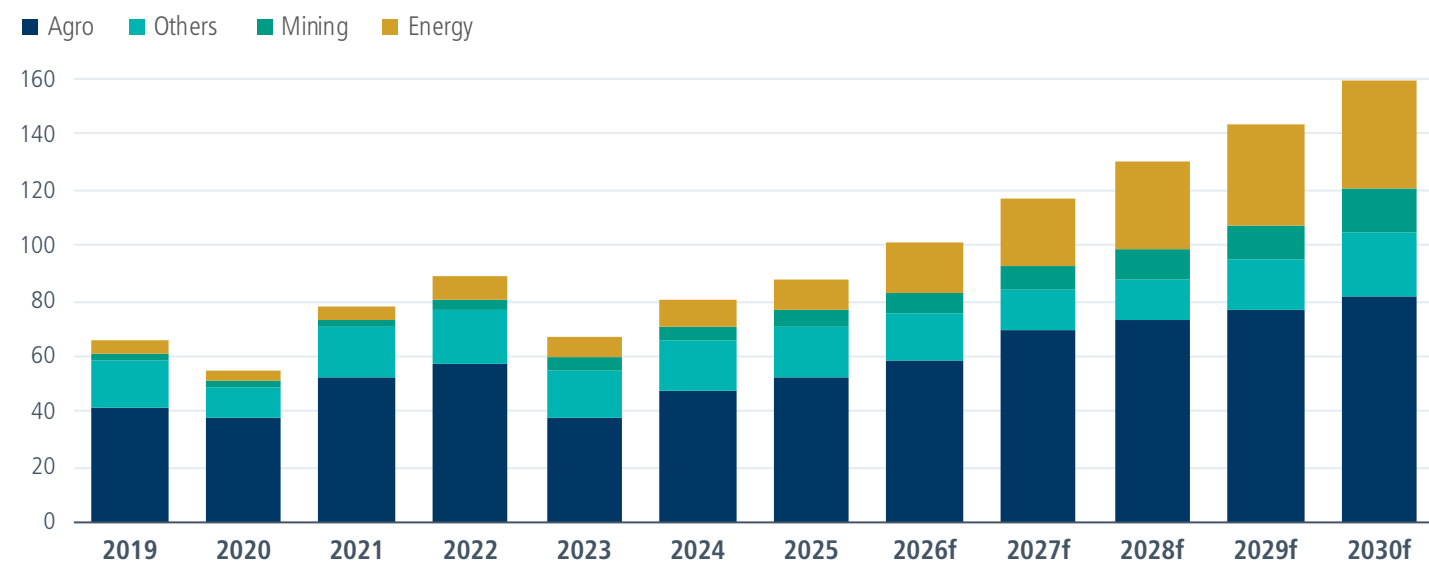
projects are also getting off the ground, with exports forecast at \$8 billion in 2026. These commodity exports have significant room to grow, given the pipeline of current projects (see Fig. 2 next page).

The other bright spot is the BCRA’s decision to accumulate reserves. Since changing policy in December 2025, the BCRA has purchased over \$14.5 billion, above its announced \$10 billion floor. Though not all of this has stayed in reserve balances (some went to amortizations), the trend has clearly shifted. Net reserves (per the IMF definition) are still negative, but cash reserves are now about \$24 billion by one local consultant’s measure. This is not enough for Argentina, but a big improvement on the near-zero level Milei inherited.

The main risk is next year’s election. In times of political uncertainty, Argentines dollarize in size. This is visible in the financial account and is the counterpoint to the country’s improved current account position. In 2025, BCRA’s proxy showed \$32 billion of dollarization, concentrated around the midterms; that trend has slowed but is still high. If it accelerates in 2027, it will pressure reserves just as \$20 billion of principal falls due to private creditors and the IMF. Even an exceptional current account could not stave off FX pressure in that scenario. Buffers are being built, but not as fast as creditors would like. The priority, then, is to minimize political volatility.

¹ Countries transitioning their monetary frameworks, particularly where interest-rate transmission is weak, often anchor policy to monetary aggregates before moving to an interest-rate operating target and, ultimately, inflation targeting (IMF, 2015). Argentina’s central bank (BCRA) uses monetary aggregates as its primary operational target. Its tailored aggregate is “private transactional M2” which they believe tracks money demand.

Figure 2: Argentine Exports by Type, Moving on Up
USD billions



Source: Alberdi Partners

The Rub

For a country that has normalized as successfully as Argentina, it is puzzling that sovereign bonds maturing within 10 years yield between 11% and 11.5%. In our view, this is mostly a political premium. With presidential elections a year out, there is growing concern that Milei may not be able to win another mandate easily. Milei's approval, at just below 40%, is competitive but does not guarantee an election victory in the first round. Even if one year is an eternity in Argentine politics, the scars of 2025 are still fresh for markets.

Milei's popularity, after reaching highs close to 50%, steadily declined in 2026, touching a nadir in the high 30s in July 2026. Two factors stand out. First, workers are disappointed that they are not seeing more tangible results from Milei's economic program. Even as the current account improves, the strong peso has become a political problem. The IMF estimates that the peso was overvalued by roughly 15% in 2025 (over the year, on average), and, per the BCRA's measure, the peso has appreciated another ~9.5% in real terms since end-2025. That squeezes manufacturing, for example—a labor-intensive sector that is already lagging. A weaker peso would not, over the medium term, spare the sector from adjusting, but it could cushion the blow, spreading job losses over time. One could ask why the government does not want to allow a weak FX rate. The reason is inflation. A weakening currency tends to feed through to inflation, undermining another one of the government's goals: taming inflation. In other words, the government is grappling with a growth-inflation tradeoff.

Second, unforced political errors have weighed on Milei's popularity. Chief among these were the corruption accusations linked to Milei's former Cabinet Chief, Manuel Adorni. Adorni eventually resigned, but the scandal hurt a president who had campaigned as an anti-system, anti-corruption candidate. Milei's divisive style has also alienated some groups, particularly women. One statistic stuck with us: per one political expert, Milei's approval among women is 20 percentage points below that among men.

There is no silver bullet, but the government's pre-election strategy struck us as thoughtful. First, unlike in the midterms, the government is looking to ally with friendly governors, which could create a stable electoral bloc. Second, officials recognize that growth-friendly measures are necessary, and some are being rolled out at the margin, including dollar credit lines and infrastructure repair projects due to come online soon. Moreover, after the energy shock earlier this year, inflation is settling lower, potentially boosting real wages in the formal sector. More optimistic economists see growth picking up in Q4 2026.

In our conversations with locals, we registered impatience with Milei's style. What left a lasting impression, however, was how vocal Argentines were about not returning to the politics of the last Peronist government, which cratered the economy. One analyst quoted a statistic that we think is worth repeating: 75% of the population does not want a return to having the Peronist party in government. This complements the mood that we experienced—critical of Milei, sure, but unwilling to vote for the hard-left Peronism of the past.

Figure 3: Brazilian General Government Debt, Wrong Direction

Percent of GDP



Source: Macrobond

Brazil: Fiscal Remains Precarious

Brazil's economic backdrop is, in many ways, in the eye of the beholder. On one side, the country is a solid BB sovereign: a large, diversified economy with a sophisticated, inflation-targeting central bank. Growth has been positive for several years, the country is running a modest negative basic balance,² and inflation, though above the center of the target, is under 5%. At a cursory level, this checks many of the boxes for an investable EM economy.

Brazil's macroeconomic inconsistencies are concentrated on the fiscal side of the ledger. Its fiscal trajectory is unsustainable—the government spends too much, and this spending is “sticky.” The federal government's fiscal deficit is running at some 8.5% of GDP, and the debt, under the left-leaning government of Lula, has increased by over 11 percentage points of GDP to over 83% of GDP (see Fig. 3). The past four years have been an exercise in gauging how far the Lula government would test the market with expansionary fiscal policy.

The IMF's latest staff report puts numbers on how the Lula government's fiscal largesse bleeds into the economy. One conundrum for investors and IMF economists alike has been why Brazil's growth has surprised to the upside since 2021. The answer is a consumption-led post-pandemic recovery: private consumption has beaten the IMF's start-of-year forecasts every year since 2021, and beaten private-sector forecasts by even more, on the back of a tight labor market, strong income gains, and robust credit growth.³

Fiscal policy added fuel to the fire. Government consumption and total primary spending repeatedly overshot forecasts. The IMF estimates that fiscal support pushed output above potential—in its words, “a procyclical boost.”

Higher growth is not universally positive, though. The composition of Brazil's growth has been subpar: investment has expanded but remains below its pre-pandemic path. Total investment is only about 17% of GDP, and private investment is under 14%. There are practical costs as well. Brazil has some of the highest interest rates in the world. Many years ago, an economist we traveled with to Brazil made a point that still applies today: Brazilian fiscal policy has historically pushed on the accelerator, leaving the central bank to do all the braking. The policy rate (Selic) sits at 13.75%, against an IMF-estimated nominal neutral rate of 8%, and Brazilian analysts expect rates to stay restrictive through 2027.

This is what crowding out looks like in Brazil. Financing a deficit from 6-9% of GDP year after year means the Brazilian Treasury competes heavily for domestic savings. Meanwhile, the central bank must lean against fiscally fueled demand, and investors charge a fiscal risk premium on top.⁴ The result is a high cost of capital for private borrowers. The problem also feeds on itself. Nearly half of government debt is floating rate, so a high Selic swells the interest bill. That is why this year's federal deficit should run between 8.5% and 9% of GDP even though the primary balance is only modestly negative.

² The “basic balance” is the current account balance + net FDI inflows into the economy. This number shows how much of a country's external financing need (current account deficit) is covered by stable, long-term money (FDI), as opposed to portfolio flows that can leave quickly.

³ IMF, Brazil: 2026 Article IV Consultation—Staff Report, Country Report No. 26/191 (July 2026), Box 1, p. 7.

⁴ Ibid., Box 8, p. 27.

After the latest fiscal “blowup” in late 2024, markets are waiting for the next big policy signal, and the October 25, 2026 presidential runoff will surely deliver it. There are two very different states of the world. If Lula wins re-election, his advisors and the pundits we spoke to in Brasília told us to expect very modest consolidation. Our translation: in the first two years of a fourth Lula term, the government would try to buy some credibility by consolidating perhaps 0.5 percentage points of GDP—far less than the 3 to 4 percentage points of GDP that is needed to put debt on a downward path.⁵ Though we doubt this would be enough to buy a long runway of market calm, it is something.

The other state of the world looks much more favorable for local debt and rate investors. The market believes Flávio will be much more fiscally prudent than Lula. In our meeting with his campaign staff, we spent almost the entirety of the discussion focused on Brazil’s fiscal imbalances. What remained undefined is exactly what a Flávio government would do about them. In other words, the campaign was not shy about diagnosing the problem but was loath to share the “cure.” In our view, this vagueness is purposeful. Fiscal consolidation is not a winning campaign formula.

Politics: Just When It Looked Like a Done Deal

When we visited Brasília in late August 2026, the election looked like a “done deal”: we came away thinking the race was 70/30 in Lula’s favor, and in our meetings with pundits, journalists, and pollsters, Flávio was treated as an afterthought.

We left Brazil thinking it would take a “Comey moment,” akin to the 2016 US presidential race, to turn the political tide. That is exactly what happened in September 2026. The months-long corruption scandal surrounding Daniel Vorcaro, owner of the now-failed Banco Master, flared up again. On September 1, a Federal Police report alleged that Supreme Court Justice Alexandre de Moraes had personally edited a \$26 million contract between Banco Master and his wife’s law firm. Days later, more than 50 messages from Vorcaro to de Moraes were released publicly. De Moraes denies the allegations.

This scandal hurt President Lula on two fronts. First, the allegations made the Supreme Court look corrupt, and many Brazilians blamed the administration on whose watch it happened. Second, de Moraes took a critical stance on Jair Bolsonaro (Flávio’s father) over the 2022–23 coup plot

Figure 4: Flavio Bolsonaro



“Plenário do Senado” by Carlos Moura/Agência Senado, www.flickr.com/photos/agenciasenado/55503128699/, licensed under CC BY-SA 4.0, creativecommons.org/licenses/by-sa/4.0/

and the January 8, 2023, attack. Though President Lula did not appoint de Moraes, voters tie the two together. That is striking, because ties to Vorcaro touch both candidates. In May 2026, newspapers published audio of Flávio negotiating roughly \$25 million with Vorcaro to finance a film about his father. Yet, given the timing and nature of the allegations, the Supreme Court scandal dominated, and Lula bore the political cost.

Even in an optimistic case for the opposition, Lula was expected to lead the first round by three points or slightly less. Instead, Flávio finished first, almost 2 percentage points ahead of Lula. Since then, the race has shifted decisively in Flávio’s favor, with markets pricing an almost certain Flávio victory. Congressional and gubernatorial races also leaned decisively to the right, which matters to investors because it signals better chances of structural reform implementation. If Flávio wins on October 25, he will likely have a much stronger congressional base than Lula has today. It would also mark another market-friendly outcome in the region—since 2025, market-friendly presidents have won every large election in the region.

Portfolio Implications

Trips to our markets give us the opportunity to revisit our positioning as we update our country view. In Argentina, we came away confident that the medium-term structural change story is still intact. That said, the near-term political volatility is bound to cause noise and will be hard to time. We remain overweight in Argentina but have shifted some

⁵ The necessary fiscal adjustment is sensitive to interest rate and growth assumptions. In a market-friendly administration where interest rates are lower and growth is potentially higher, the magnitude of the adjustment needed would be less. One analyst estimated that we spoke to noted it could be 2 to 3 ppt of GDP in Flávio scenario.

of our exposure toward shorter bonds, which are less likely to sell off in the event of political uncertainty. Moreover, if there are political gyrations, we would not rule out the US Treasury coming to Argentina's aid once again.

In Brazil, going into September, when Lula was expected to win, we thought local rates exposure presented an interesting opportunity. Carry was very high and, if Lula were re-elected and delivered a minor fiscal adjustment, risks of a severe sell-off in the near term were limited.

As momentum shifted to Flávio, the risk/reward became skewed toward large positive returns: a sell-off would still

be capped in a Lula victory, but with the chances of a Flávio win increasing and markets banking on dramatic fiscal consolidation, there was scope for a significant rally in FX and rates. As this trade-off became clearer, we added to our Brazilian local rates and FX exposure, after the Supreme Court scandal and before October 4 first round elections. After Flávio's first-round performance, local rates rallied by up to 130 bp in one day, and the real strengthened by almost 4.5%.

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