

LATAM ELECTIONS: THE LURE OF THE LEFT

Introduction: The Timetable

Three of Latin America's largest economies, accounting for roughly two thirds of the region by both GDP and population, had election scheduled for this year. The results have profound implications for the economic policies that will be enacted, and ultimately help to determine the fate of the nations in question for several years to come. One issue has, and will continue, to dominate the election schedule more than any other: corruption.

Below we delve deeper into the forces at play in each country, and the investment implications of the results.

Colombia: Defence drives Duque to victory

The LatAm election season kicked off with Colombians voting in congressional elections and presidential primaries on 11 March, with the Presidential election recently concluded as the second round run-off took place on 17 June.

The second round challengers were Iván Duque from the right and Gustavo Petro from the left.

Gustavo Petro grabbed much of the headlines for his anti-establishment stance and populist overtones, including nationalization and reducing the country's dependency on oil revenues. In particular, he has capitalised on the public anger towards the ongoing "parapolítica" scandal. This arose during the conservative government of Álvaro Uribe in 2005, in which it was alleged that the government was colluding with the far right militia group United Self-Defense Forces of Colombia (AUC) in its fight against the Revolutionary Armed Forces of Colombia (FARC). Petro is not immune to controversy himself. As a former member of the M-19 guerrilla group, he helped to broker a peace deal that saw him enter politics and become the mayor of Bogotá. As he lacked strong parliamentary support, with his left wing Decentes coalition faring poorly in parliamentary elections, Petro's campaign, necessarily, relied heavily on the use of social media platforms such as Twitter. He proved popular with young voters and was feared by businesses, who were quick to draw parallels with the late Hugo Chavez in neighbouring Venezuela.

Iván Duque stood as the candidate of the right, the protégé of former conservative President Álvaro Uribe, he was able to benefit from the former president's continued popularity. Duque's campaign centred on a pro-business and pro-security programme which promised tax cuts and a rollback the most controversial aspects of the FARC peace deal. Unlike Petro,

Duque had a strong campaign machine behind his candidacy and strong parliamentary support in the form of the right-wing Centro Democrático (CD) party.

Following the results of the first round, even though Petro's candidacy remained a wild card, our expectation was that Duque would triumph on economic and security concerns, particularly given the economic woes in neighbouring Venezuela, with Duque much better positioned than Petro to win over voters supporting the more centrist candidates in the first round. The final results did indeed confirm Duque's victory, triumphing 54% to 41.8%, which should be, *ceteris paribus*, supportive for the Colombian Peso as, despite the potential for some delay, fiscal consolidation will move to the centre of government policy.

Mexico: AMLO and behold

Mexico was next to cast its vote with presidential and congressional elections taking place on 1 July. The campaign was dominated by the rise of populist leftist Andrés Manuel López Obrador (AMLO), who has previously not shied away from his criticism of the outgoing administration's energy reforms and the over-dependency of the country's economy on NAFTA.

AMLO is the founder of the Movimiento Regeneración Nacional (MORENA) party and is closely associated with populist policies which have historically included government austerity, progressive taxation, agricultural subsidies and job creation. AMLO is also a strong critic of the electoral system, having previously accused the PRI party, without success, of electoral fraud in both his earlier presidential campaigns. This combination, together with a strong social media presence, helped AMLO to tap into the widespread public anger against the established parties, and hence cement his place as the anti-establishment candidate in Mexico.

AMLO's main challenger was Ricardo Anaya of the Partido Acción Nacional (PAN), which despite occupying the centre-right ground formed a coalition with the centre left Partido de la Revolución Democrática (PRD). Anaya's campaign focussed on providing a mainstream alternative to the ruling Partido Revolucionario Institucional (PRI) party, yet at the same time targetting moderate leftists, fearful of AMLO.

The third main candidate was José Antonio Meade, from the ruling PRI. Meade tried to distance himself from the corruption allegations that have dogged outgoing President Enrique Peña Nieto. Unfortunately for Meade, the stigma of the PRI proved

too difficult to shake off given the level of public distrust and desire for change.

Corruption and security defined the presidential race in Mexico. Both Anaya and Meade were drawn into corruption allegations, with Anaya directly implicated as the beneficiary of a money laundering scheme. Whilst the investigation into Anaya was dropped, the accusation alone damaged his campaign, with AMLO benefitting as a result. Despite Anaya's strong debate performances and backing from former independent candidate Margarita Zavala, we expected AMLO to secure the presidential vote given the extent of negative public sentiment towards the traditional party candidates.

We were proven correct as AMLO fared even better than expected, securing over 53% of the vote. Despite concerns surrounding AMLO, we do not believe that investors should panic. AMLO has moderated his policies significantly over the years in order to make himself more electable. Despite AMLO's appeal also translating to strong support for MORENA, they lack the two-thirds majority in the Senate required to overturn constitutional reforms. Hence, despite earlier rhetoric, a reversal of Mexico's energy reforms is unlikely. AMLO has also moderated his stance towards NAFTA, recently vocalising support for the agreement, though he is likely to push hard for better terms for the agricultural sector.

In aggregate, we expect volatility to remain elevated as AMLO's cabinet and policy announcements are made in the coming weeks, with some investors having already disinvested from Mexican assets on the prospect of an AMLO win. However, we expect to see broad policy continuity, which will likely see investors return to Mexico, particularly given a combination of cheap asset prices, declining inflation and the removal of policy uncertainty.

Brazil: Lula conviction leaves political chasm

Attention now shifts to Brazil, as in October 2018 the population will elect a new President, as well as all 513 members of the Lower House, governors and state assembly members, and 54 out of 81 members of the Senate. The composition of the next Congress will also be key, as the new representatives will need to renew their focus on the much needed pension reform in 2019. Therefore the next few months will likely see ongoing volatility. A market friendly outcome will require a government that is willing to stick to reform in order to generate a strong primary fiscal surplus and to help stabilise the debt trajectory.

The leading candidate in the polls at this stage is the decidedly investor-unfriendly, yet highly popular, former President Lula of the left wing Partido dos Trabalhadores (PT). Most remarkably, Lula has retained this position despite being imprisoned in April, and has vowed to continue campaigning, despite being declared ineligible, as he fights his conviction through a series of appeals, which could take several months.

Lula's popularity can be traced back to his time as President during which, he oversaw a period of economic prosperity by unleashing a huge wave of investment in 2006 on the back of strong commodity demand from China. The hangover came in

2014, after Lula's tenure ended, as the end of the stimulus programme coincided with a slump in Chinese commodity demand.

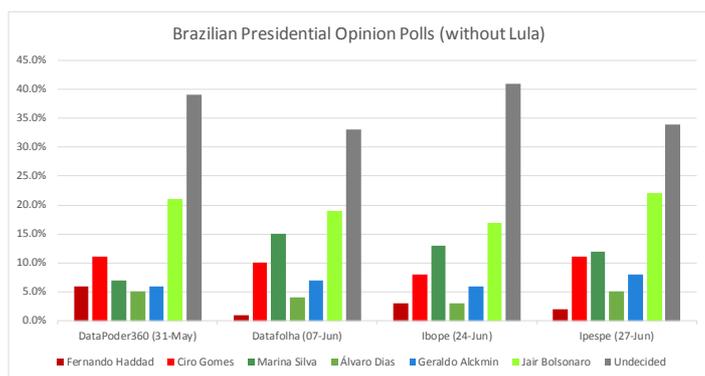
Despite his strong popularity, Lula's presidential bid has now been thwarted. In March 2016, as part of Operação Lava Jato (Operation Car Wash), he was detained by police on allegations of lobbying. At the end of January 2018 the appeals court upheld Lula's corruption conviction and increased his prison term from nine to 12 years. Though Lula can still appeal his conviction in an attempt to register his candidacy by the August 15th deadline it is now highly unlikely that he will be permitted to run.

To date, the right-wing Congressman Jair Bolsonaro of the, somewhat misnamed, Partido Social Liberal (PSL), would lead in a first round vote without Lula. Bolsonaro is a controversial character, having advocated far-right views on a number of social policies. He has benefitted from a polarization in the Brazilian political landscape and disillusionment with democracy, and used his strong-man image to forge a strong social media following. Despite this, his economics team would likely pursue a number of liberal economic policies including privatisation and tax simplification. Despite his strong first round polling, Bolsonaro may struggle in the second round as his divisive nature could prevent him from appealing beyond his narrow supporter base. He will also lack TV and Radio time once official campaigning starts in August as his party's presence in parliament is minimal.

Meanwhile, back on the left-hand side of the political spectrum Ciro Gomes from the Partido Democrático Trabalhista (PDT) looks poised to try to capitalise on Lula's downfall, as he could receive support from Lula's party should his candidacy be blocked. Gomes strongly opposes privatisation, and would likely obstruct the path to, or else dilute the impact of, pension reform. We do not expect, however, Lula's votes to transfer particularly well to Gomes, partly due to the high fragmentation of parties on the Left.

Another Leftist challenger is Marina Silva of the Rede Sustentabilidade (REDE) party. Silva's platform is a pro-environmental one, opposing the deforestation of the Amazon. Like Bolsonaro, Silva also has a strong social media presence, with strong support amongst younger voters. However, again, like Gomes, we do not believe Lula's votes would easily transfer to Silva, and like Bolsonaro, she will also lack TV and Radio time.

Last, but not least, of the notable candidates, is centre right, São Paulo Governor, Geraldo Alckmin of the Partido da Social Democracia Brasileira (PSDB). Alckmin is a clear reformist and proponent of pension reform. His centrist position would enable him to form coalitions across a fragmented parliament, and hence would likely muster enough support to follow through on the reforms initiated by his predecessor. Alckmin's parliamentary support also guarantees him propitious TV and radio time in a country where internet access is still limited.



Once the official campaigning starts in August voters could well begin to favour a mainstream candidate that has addition media time and an established campaign machine. Hence, we expect Alckmin to challenge both Gomes and Silva for a place in the second round, most likely against Bolsonaro. Should he make it to the second round, we would expect him to prosper as he has the broadest appeal of all candidates. Nevertheless, there is now a growing probability of an all anti-establishment second round with Gomes or Lula's potential replacement from the PT (probably Fernando Haddad) looking increasingly competitive for the left.

Clearly, the uncertainty surrounding Brazil's election is highest amongst the three countries, and hence our overall conviction is lower. However, expectations surrounding a market friendly candidate succeeding are already low, with potential for a positive surprise coming from Alckmin's bid. Having said that, should an anti-establishment candidate prevail the prospect for reform would look decidedly bleak. Our investment stance toward Brazil therefore remains one of caution, yet with potential for upside in the event of a strong Alckmin campaign.

Conclusion: Risks rising, but reforms should be resilient

So, as we are now in the midst of election season in LatAm we believe that the reform agenda should survive beyond the political turbulence, yet differentiation remains key. Despite the structural fiscal challenges that Colombia faces we believe the election outcome should provide a government well positioned to address these challenges head-on. In Mexico, despite the anti-establishment campaign rhetoric from AMLO we do not believe that he will jeopardise the reform agenda. The risks are clearly highest in Brazil, where we believe caution is the most justified; nevertheless, it is also where there is still time for a pro-reform candidate to flourish.

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