

Latin America: The Political Pendulum Swings Left

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After a period of center-right leadership across the region, each country has elected or appears on the verge of electing left-leaning leaders who can take their economies in different directions.

Latin America carries a long history of polarized politics. From an economic perspective, generally speaking, this has translated into periods focused on spending, wealth redistribution, high taxes, and state influence over the economy vs. more traditional periods of fiscal orthodoxy, market liberalizations, and waves of privatization. After a period of center-right leadership across the region (Peña Nieto in Mexico – 2012-2018, Macri in Argentina – 2015-2019, Piñera in Chile – 2018-2022, Kuczynski/Vizcarra in Peru – 2016-2020, Duque in Colombia – 2018-2022, and Bolsonaro in Brazil-2019-present), each country has elected or appears on the verge of electing left-leaning leaders who can take their economies in different directions. However, when looking at valuations, it seems that investors have already priced in the worst. In this paper, we will walk through current and potential forthcoming leadership for each major economy across Latin America, along with their economic goals.

Brazil

Luiz Inácio Lula da Silva

*Leading presidential candidate
(and former President from 03-11)*

Next Election: 2022



Brazil's presidential elections are held in October 2022 and former President Lula is currently leading in the polls vs. the incumbent candidate, President Jair Bolsonaro. The leader of the Worker's Party first years as former President coincided with a strong economic period for Brazil. Thus, he has been less vocal during the current campaign, as there is already a positive connection between him and a more prosperous economic period. However, he has commented on his desires for:

- **Instituting a new fiscal framework:** Increasing taxes on the wealthy and eliminating the cap on government spending.
- **Increasing spending on social programs & public investments:** Similar to previous rhetoric.
- **Increasing the role of state-owned-companies towards government defined goals:** In his previous administration, he was able to control fuel prices and lending rates of state-owned enterprises in an effort to build political capital.

Though often feared by the market, Lula chose Henrique Meirelles (a pro-market economist) as the head of the central bank during his first term and also renewed strict agreements with the International Monetary Fund, which helped his government achieve surpluses during his first two years as President.

Argentina

Alberto Fernandez

2019-Present

Next Election: 2023



Fernandez was elected President with considerable support from his Vice President and former President and First Lady of Argentina, Cristina Kirchner. In his first few months as President, Fernandez:

- Hiked taxes on foreign currency purchases, agricultural exports, wealth, and car sales.
- Froze utility rates.
- Created bonuses for retirees.
- Passed a bill giving the President's office additional powers to renegotiate sovereign debt.

The country defaulted on its debt in May 2020 and restructured its loans in the following months. Looking forward, Fernandez' objective is to reduce the deficit, increase reserves, and stabilize the currency, all while supporting the broad population to ensure that Kirchnerism survives through 2023.

Mexico

Andres Manuel Lopez Obrador (AMLO)

2018-Present

Next Election: 2024



AMLO has shown himself as a unique political figure who balances a large interventionist government with a focus on social reforms while maintaining relative fiscal conservatism. Some of his key pillars include:

- **Salary increases:** AMLO promised to double the minimum wage during his presidency. That meant a 12% yearly increase. This year we saw a 22% increase.
- **Energy Reform:** Increasing government control of power generation to benefit state-owned utilities over private companies.
- **Public Projects:**
 - Stopping construction of the new airport in Mexico City and building one at Santa Lucia.
 - Build the Dos Bocas refinery which now runs at 30% capacity.
 - Building a passenger train line up the Mayan Riviera.
- **Conservative Spending:** AMLO has been one of the most austere presidents in the region. In fact, Mexico was one of the few countries with minimal stimulus through the Covid-19 pandemic.

Chile

Gabriel Boric

2022-Present

Next Election: 2025



Boric emerged as a political leader during the civil protests of 2019, when he helped negotiate the path towards a constitutional referendum. He was the candidate of a coalition that included both the Socialist Broad Front and the Communist Party. He is the youngest President in the history of Chile's democracy. Some of his economic goals include:

- **Approving the Constitution proposal:** The proposal increases the role of the state with a focus on social services (housing, education, health), the environment, and indigenous groups. The proposal would dissolve the Senate (replacing it with a Chamber of Regions in 2026), create parallel judicial systems (including one for indigenous matters), adjust the definition of property rights (with expropriation at a "fair price," versus the "market price" in the current version), and enshrine individuals' right to water, among many other changes. In contrast with the current constitution, regions may eventually issue debt and create public firms, and Congress may present spending bills, eroding the control that the Executive branch currently has over expenditures.
- **Tax reforms:** The reforms consider adjustments across several instruments, including changes to personal taxes, amendments to the mining royalty initiative currently in the Senate, and measures that are geared toward reducing tax evasion. The goal is to raise revenues by over 4% of GDP.
- **Overhauling the pension system:** Building on the Universal Basic Pension (PBU), he aims to create a Reserve Fund targeted to ensure fiscal sustainability, instill mandatory contributions (invested by a new public entity), and add a voluntary pillar where workers may complement mandatory contributions for their future pension.

Colombia

Gustavo Petro

2022-Present

Next Election: 2026



Petro, a former guerilla fighter turned economist turned Senator, is the most recently elected leader in Latin America. He is still putting together his cabinet, but the financial pillars of his election rhetoric included:

- **Ending new exploration contracts for the petroleum sector:** Petro wants to focus on more sustainable and renewable forms of energy.
- **Tax reforms:** He aims to raise 50 billion Colombian pesos (around 4% of GDP) by increasing taxes on the wealthy, cutting exemptions, and maintaining the tax on financial transactions.
- **Subsidies:** Petro's pledged to include a guaranteed payment to the elderly (half a minimum salary) and student debt forgiveness.

Peru

Pedro Castillo

2021-Present

Next Election: 2026



Castillo is a former elementary school teacher turned union leader and then presidential candidate of the Marxist Free Peru party. His central bank appointments have been well received, and Peru's fiscal balance has remained steady. Some of his main economic goals include:

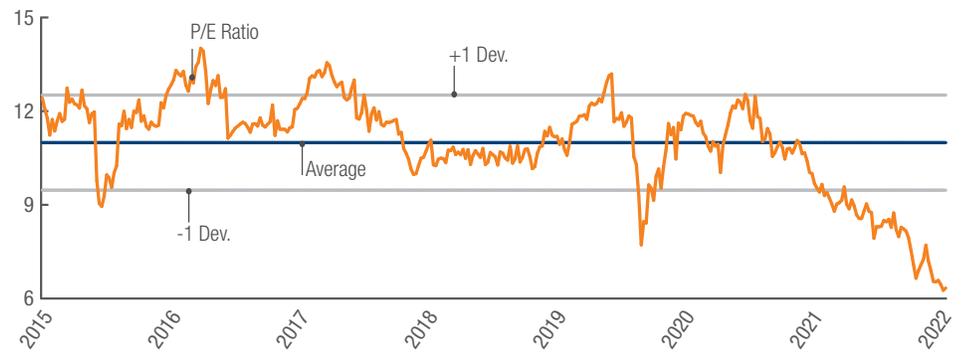
- **Ensuring that 70% of business profits stay in the country:** Roughly the inverse of the 30% that does so today.
- **Increasing taxes on the mining sector:** Though he does support privatized mineral extraction in the country.
- **Regulating monopolies and oligopolies:** Castillo sees a need to improve competition and establish a "mixed economy." This also includes renegotiating tax breaks with the private sector.
- **Creating a state-owned national airline:** He claims that LATAM airlines owes Peru close to USD 1 billion.

Conclusion

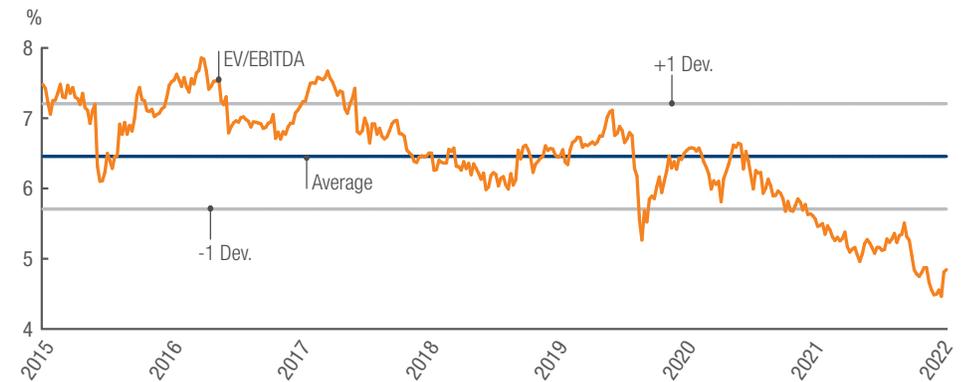
Latin America’s political pendulum is swinging to the left, but sometimes expectations overshoot market fundamentals. This is not a slate of Guevara, Castro, Chavez, and Allende, but the “pink tide” is rising, and market multiples are trading more than one standard deviation below their historical averages, despite high return profiles. In addition, Latin American central banks have acted well ahead of the Fed and European Central Bank in raising rates to combat inflation. If these new leaders find a way to balance their ideologies with their fiscal plans, nominate qualified candidates to their finance ministries and central banks, and make responsible decisions from the windfall of recent elevated commodity prices, then these markets could present select opportunities for active managers to generate alpha in a global or regional portfolio.

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Latin America: P/E Ratio



Latin America: EV/EBITDA



Latin America: ROE



Source: Bloomberg, as of 7/07/2022.
Latin America = MXLA Index

Alpha measures the difference between a fund's actual returns and its expected performance, given its level of risk as measured by beta.

Enterprise value to earnings before interest, taxes, depreciation, and amortization ratio (EV/EBITDA) compares the value of a company—debt included—to the company's cash earnings less non-cash expenses.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

Kirchnerism is an Argentine political movement based on populist ideals formed by the supporters of Néstor Kirchner and his wife Cristina Fernández de Kirchner, who consecutively served as Presidents of Argentina. Although considered a branch of Peronism, it is opposed by some factions of Peronists and is generally considered to fall into the category of left-wing populism.

MSCI Emerging Markets Latin America Index captures large and mid cap representation across 5 Emerging Market countries in Latin America.

One standard deviation plotted above or below the average value on that normal distribution curve, would define a region that includes 68 percent of all the data points.

Pink Tide is the tendency towards left-wing governments in Latin America.

Price/earnings (P/E) ratio is the ratio for valuing a company that measures its current share price relative to its per-share earnings.

Return on Equity (ROE) is a measure of profitability that calculates how many dollars of profit a company generates with each dollar of shareholders' equity.

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