



Latam Focus

– Politics and Investments. The aftermath of the “pink tide”.

Quarterly Call Q3



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Politics and Investments. The aftermath of the “pink tide”

When Lula won the presidential elections last October, it was a general statement that Latin America had “turned pink.” This was underscored by the fact that left-leaning heads of state now controlled most governments in the region. A first for some, an old acquaintance for others – the overall feeling across the investment landscape was of impending doom. Still, Latam has been one of the best-performing regions year-to-date, but it is not out of the woods yet. Thus, we will delve into what has changed in the first semester of the year in political terms, what the consequences of this “pink tide” have been for the region, and what we can expect for the remaining months of 2023.

As we highlighted in our previous call, 2023 has been

an eventful year in politics for Latam. With the second half of the year having the most important events, it is still relevant to review the last quarter. The presidential race is officially on in Argentina, with the official presidential candidacies being announced by the end of June.

FinMin Sergio Massa will be the Peronist candidate, representing the newly rebranded Peronist coalition as “Unión por la Patria,” with Kirchnerism not having a stand-alone candidate at the time of this writing – a first in ten years. Meanwhile, the candidate representing the opposition coalition Juntos por el Cambio is expected to emerge from the PASO primaries in August. In this race, Patricia Bullrich or Horacio Rodríguez Larreta seem the most probable winners.

Massa was Peronism’s last hope to regain control of the economy when he was appointed FinMin; however, his tenure has not rendered positive results, with triple-digit inflation figures and the economy sliding into recession. Those facts could bode ill for his presidential aspirations later this year. On the other hand, Javier Milei, an Argentinian economist and businessman who is a current federal deputy of Buenos Aires and, who, as leader of the political coalition “Libertad Avanza,” wants to dollarize the economy, has been losing some of the popularity he gained in the last months because of the opposition gaining ground. Still, the presidential battle looks anything but decided.

In Colombia, the government coalition looks frailer than at the beginning of the year. The Petro administration was dealt a blow when its three major reforms – pensions, health, and labor – did not survive the first legislature. The labor reform should be presented again in the upcoming legislature set to begin on July 20 after the initial project was shelved, whereas the health and the pensions reforms still have pending debates in Congress. This fact seemed to have brought additional calm to the investment environment, especially considering that two rating agencies recently affirmed

Colombia's credit rating, citing the country's macroeconomic and financial stability, among other factors. Meanwhile, the October regional elections are expected to steal the spotlight for the second half of the year in political terms, given the importance that coalitions impart on regional representation. This could decrease the importance that Senators and Representatives could give to reform debates since their focus could be outside Bogota.

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Meanwhile, the political situation in Chile has also experienced some changes. The Constitutional Council had its members elected on May 7 and has already started working on potential modifications to the base constitution created by the expert commission. Their deadline is November 7, with the exit plebiscite still planned for December 17. Most market analysts expect a less radical version for this new iteration of the Constitution, given the strong presence of right-leaning parties in the Constitutional Council. At the moment of this writing, the Constitutional Council was set to start discussing popular economic initiatives, with two being tied to pensions. Some other initiatives that have garnered enough support to be discussed by the Council are related to water rights, health, and workers' rights.

On the other hand, the Boric administration stated in

June its intention to push through the previously shelved tax reform after the President reinforced the need for such reform to fund, among others, healthcare and infrastructure. Considering that his political capital has waned during his tenure, the market has started to believe that if the tax reform were to pass Congress, it would do so in a very diluted manner.

Lastly, Mexico had gubernatorial elections in June, with Morena, President AMLO's ruling party, winning in the state of Mexico and ending a ruling of almost 100 years of the opposition under the Partido Revolucionario Institucional, or PRI from its Spanish acronym. This victory led Morena to control two-thirds of the 21 regional governments, thus cementing even further Morena's dominance. Moreover, the race for the 2024 elections already took off, with several candidates – both from Morena and the opposition alike – already announcing their intentions to take part in the race. The deadline to quit public office to become a presidential candidate is December 1. However, Morena recently released their timeline for selecting their candidate, with the polling amongst pre-candidates occurring between August 28 – September 3. The party expects to announce its candidate by the beginning of September. Meanwhile, it is worth remembering that AMLO has been clashing with the national electoral institute or INE. With AMLO bent on implementing reforms to the Mexican electoral framework, the Supreme Court invalidated the remainder of that reform. This means AMLO will not be allowed to make changes that could affect the workings of the INE or how the upcoming 2024 presidential election will be organized.

If we turn our attention to how markets have digested the political turmoil in the region, it could come as a surprise the positive performance that Latin American markets have had year-to-date. Against a backdrop of decreasing risk perception visible in the 5-year CDS behavior, most Latam assets have outperformed within the EM universe. We highlighted this in one of

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our previous publications; however, the overperformance of Latin American assets is something we are more doubtful about for the second half of the year. Latam central banks were ahead of the curve in implementing tighter monetary policy to tame inflation when inflation figures were posting decade-highs, which in turn set the stage for the region to be a more attractive opportunity for international investors that wanted to profit from a carry trade. That phenomenon, which widened the yields across local curves and coupled with devaluated currencies during the pandemic that had not returned to trading at fairer values, turned the region into an attractive investment destination.

Still, this apparent shine may not last long since part of its sparkle depends on the US's monetary policy. Just like in other parts of the world, the Fed has had its hand forced into hiking its monetary policy rate to levels last seen in 2006 as a reactive measure to control inflation. However, the Fed was late to the hiking game, leading some market participants to believe that an easier monetary policy would still be farther away.

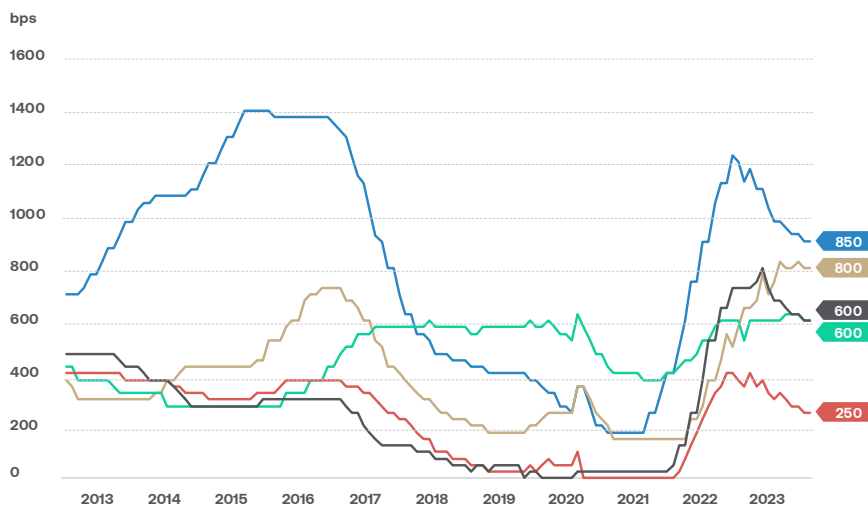
In Latam, the countries that first started their hiking cycles, namely Chile and Brazil, are expected to be the first ones to start easing. In the case of Chile, most market participants are penciling in a 50bps cut in its upcoming meeting on July 28, on the back of a stark descent in its inflation prints and a deceleration in its most recent activity readings. For Brazil, after maintain-

ing its rate stable for seven consecutive meetings, the latest COPOM minutes provided a mildly dovish tone by keeping a rate cut on the cards at the upcoming August meeting but also highlighting that a premature cut could backfire. Moreover, Peru, Mexico, and Colombia have had their rates stable for shorter periods (seven, four, and two months, respectively) which leads us to believe that the normalization of their monetary policy could be further down the line.

Here it is relevant to keep in mind that even if the easing of monetary policy would be positive for the local-currency bonds and could propel a normalization of the curves – for example, in the case of Chile and Brazil that currently exhibit inverted curves – the yield tightening phenomenon that would follow the implementation of easier monetary policy would lead local assets to lose part of their shine. This is because the monetary policy easing of Latam would happen simultaneously with the Fed sticking to its script of higher rates for longer, thus compressing the rate differentials and shifting the investment interest towards developed markets – i.e., a higher rate for undertaking a lesser amount of risk – from the region. Still, it is relevant to highlight that current rate differentials are not far from their decade highs, as can be seen in Graph 1 (except for Brazil), leaving some room for the Central Banks to maneuver. Furthermore, it is important to stress that central banks in the region have emphasized the importance of their inflation targeting scheme, and with inflation prints still above and far from their targets,

Central Banks have some room to maneuver – rate differential between Latam and US is, in most cases, still wide.

- Brazil
- Chile - US
- Colombia - US
- Mexico - US
- Peru - US



Source: Bloomberg. Data as of June 30, 2023

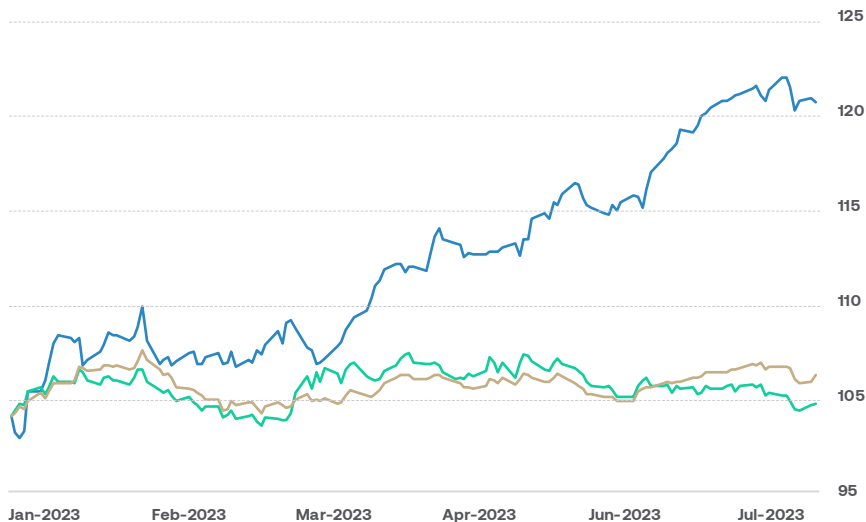
the pace at which they can ease will still be very data-dependent.

Lastly, even if the performance of Latam has exceeded that of other markets year-to-date, for the second half of 2023, we consider that the fixed income allocation for Latam should maintain a stance of caution. Investors should remember that Latam has had more tailwinds than headwinds this year. If the region’s carry trade

starts losing its charm and investors shift their preference towards more battered markets, the close to 21% total return Latam currently exhibits, despite a challenging macroeconomic and political backdrop, could translate into a lower figure. Still, we would venture to say that our preference towards EM stated at the beginning of the year has paid off, and for now, our positioning should favor quality factors and shorter duration, no matter the region. ■

Local-currency Latam bonds have outperformed year-to-date – Bloomberg Barclays fixed income indices (100 = December 31, 2022)

- Latam LC
- US Treasuries
- EM USD Aggregate



Source: Bloomberg. Data as of July 11, 2023

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