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Unwinding the Tide. Latin America's Shift to the Political Right

Summary

Left-leaning policy platforms gathered momentum across Latin America after COVID, sparking the region's second "Pink Tide" political phenomenon. However, those same administrations have seen approval ratings decline and overall popularity falter more recently. Over the next 18 months, most major Latin American nations will host elections, and in our view, regional politics will shift to the right side of the political spectrum. As the political pendulum moves right, we expect the second Latin American "Conservative Wave" to improve longer-term political risk profiles as well as bring about regional financial market stability. But before the "Conservative Wave" fully forms, policies that typically generate regional financial market instability are likely to be pursued in full force, which in the interim, can create short-term volatility across regional and local financial markets.

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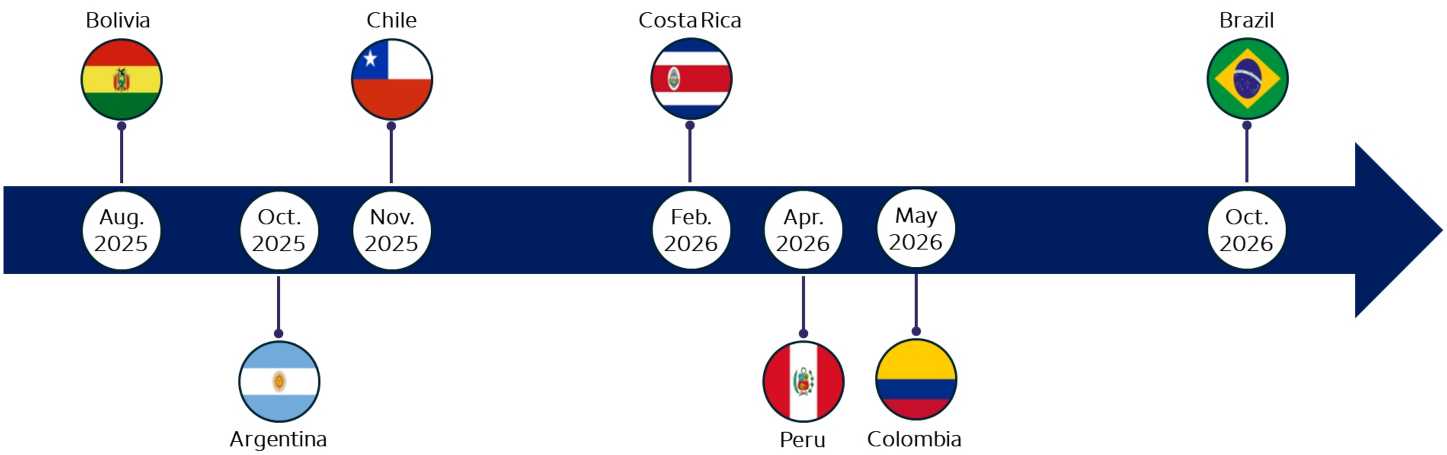
Latin America has experienced multiple eras of political ebbs and flows: starting with the Spanish American wars of independence in the 1800s to the original "Pink Tide" and beyond. As fascinating as the entire Latin American political saga is, for the purposes of this report, we will focus on the "Pink Tide" and "Conservative Wave" eras of the last 40–50 years. When we say "Pink Tide", we are referring to the rise of left-leaning political platforms and more liberal politicians across Latin America. Pink Tide support started in the 1980s, many decades after the wars of independence ended and right-wing governments dominated political office. Multiple catalysts sparked the original Pink Tide, including: regional democratization, economic malaise following multiple sovereign debt crises in Latin America, and global acceptance of more liberal policy ideologies. Pink Tide momentum gathered throughout the 1990s and eventually culminated with Venezuela electing Hugo Chavez in 1998. Left-leaning politicians remained popular through the end of the 20th century and into the mid-2000s with most Latin American nations participating in the trend. By the 2010s, Pink Tide momentum slowed. The death of Hugo Chavez in 2013 may have been the starting point for the shift away from left-leaning policy platforms, although multiple developments over the next few years—including the Odebrecht case, Operation Car Wash, the end of the commodity supercycle and sluggish economic growth—heavily contributed to the effective end of the first Pink Tide and the start of the "Conservative Wave."

The "Conservative Wave" was a political phenomenon that saw right-leaning governments elected across Latin America. For example, Argentina pushed back on Peronism with the election of Mauricio Macri in 2015. Brazil impeached Dilma Rousseff in 2015, and following a temporary conservative caretaker government, elected the far-right Jair Bolsonaro in 2018. Peru and Chile both opted for conservative political platforms during this time, while Bolivia, Ecuador, Guatemala, Honduras and Paraguay also voted for right-leaning presidential candidates to lead policymaking. Overall, the "Conservative Wave" era put right-leaning and conservative policymakers largely in control of Latin America's political theater through the end of the last decade. By the time COVID hit, the Conservative Wave was fading, and the pandemic all but ended Latin America's shift to the right side of the political spectrum. Not only did COVID upend the Conservative Wave, but the pandemic also acted as a starting point for Latin America's second "Pink Tide." Over the course of the early post-COVID years, left-leaning policy agendas saw renewed interest from voters across the region. Bolivia elected Luis Arce and the Movement for Socialism party, Peru opted for the socialist Pedro Castillo, Honduras and Chile elected left-leaning presidents, Colombia chose the first leftist government in the country's recent history, and the trend was punctuated by the return of the far-left Lula in Brazil for a third term. For most of the post-pandemic era, Latin American politics have been dominated by left-leaning political ideologies.



Source: Wells Fargo Economics

But more recently, political momentum and the political pendulum has tentatively shifted back to the right, and a second Conservative Wave is in the early stages of taking shape. Paraguay elected the right-leaning Santiago Pena not long ago, Ecuador opted for a conservative political platform in recent elections, and Argentina pushed back on Peronism again by opting for the far-right Javier Milei in 2023. In fairness, we say a tentative shift to the right, as the left-leaning MORENA won Mexico's presidential and congressional elections in a landslide last year, while Uruguay's presidential election also yielded a more liberal policymaking platform. However, going forward, we believe the second Conservative Wave will gather significant momentum. Countries across the region will head to the polls over the next 18 months or so, and in our view, the large majority of elections—if not all—will result in right-leaning governments coming to office. This trend is likely to be most visible in economically important countries such as Chile, Colombia, Peru, and Brazil as incumbents and their respective political parties continue to see approval ratings and broader popularity decline. Argentina is a modest exception, as the nation will only host congressional elections this year. While Milei himself is not up for re-election, he—as well as his policy platform—are essentially facing a referendum. Milei remains very popular, and with Argentina's economy recovering and overall conditions improving, Argentine voters are likely to opt for further progress on the reform agenda and double-down on Milei's far-right policy mix.

Generally speaking, the next Conservative Wave should act as a long-term catalyst for regional and local improvements in political risk as well as financial market stability. Not always, but for the most part, right-leaning governments have focused on fiscal discipline and making progress toward balanced budgets relative to left-leaning administrations. Historically, large fiscal deficits and rising debt burdens have generated financial market volatility across Latin American and country-specific asset prices, a dynamic that is still present today. Should governments across Latin America embark on a shift toward more public finance responsibility, a key source of risk premium could be partially lifted. Risk premiums could fall the most in the more systemically important countries with acute fiscal issues, such as Colombia and Brazil, and to a lesser extent, post-Milei Argentina. More fiscal discipline is a key dynamic behind why we include a relief rally in most of our Latin America FX forecasts around the time of each local election. This is true in Colombia, Brazil, Chile, and Peru, while we have also flagged the possibility of nominal Argentine peso strength following congressional elections. However, the shift to the political right and more financial-market-friendly policies is unlikely to be seamless. In most cases, particularly in Colombia and Brazil, we expect fiscal spending to pick up pace as incumbent presidents seek to support individual re-election prospects or their respective party's campaign. So, while the second Conservative Wave may bring about longer-term market stability and contain political risk, in the interim a further erosion of public finances, a spike in political risk, and local markets volatility are likely to materialize before the shift fully develops.

As elections come more into focus, we plan on publishing deeper dives into the dynamics surrounding each vote. As mentioned, we believe each election will result in more market-friendly outcomes. However, we will lay out policy platforms for leading candidates as well as produce a scenario analysis for how local financial markets could perform in our base case as well as alternative scenarios. We have already produced politically focused reports on Brazil and Argentina, and in the coming weeks, we will publish a follow-up on Argentina as well as layout early scenarios for Chile's election. We expect elections from the Latin American region to be relatively top of mind, and we plan on commenting frequently on dynamics leading into elections, but also as policies are proposed and eventually implemented by new administrations.

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