

Colombian election: a left turn?

The potential market implications of Colombia's impending election



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Key points

- Colombians will vote on 29 May to elect a new president for the 2022-2026 term. If no candidate secures more than 50% of the vote, a runoff election will be held on 19 June
- Polls show left-wing Gustavo Petro from the *Pacto Histórico* coalition holding the lead, but he is unlikely to win outright in the first round
- A runoff election will likely pit Petro against right-wing candidate Federico Gutiérrez from *Equipo por Colombia*. While still behind Petro in a hypothetical runoff election, Gutiérrez's campaign is experiencing strong momentum and has managed to reduce the gap between the two contenders
- Although Petro's policy platform differs significantly from Colombia's traditionally market-friendly framework, we believe it will be hard for him to pass any radical reforms through the country's highly-fragmented Congress
- A Petro victory will likely have an immediate effect on bond yields as investors may start questioning Colombia's fiscal sustainability under his rule.

Election at a difficult juncture

During a time of great national discontent, Colombians will head to the polls on 29 May to elect a new president for a four-year term. A runoff will be held on 19 June if no candidate receives more than 50% of the vote in the first round. Left-wing Senator Gustavo Petro, the runner-up in the last election, has emerged as the frontrunner riding a wave of widespread anger at the conservative political establishment.

In the last four years, President Iván Duque's popularity rating has plummeted from 55% to barely 25%, while 73% of adults believe the country is currently on the wrong track according to pollster Invamer. These numbers reflect the multiple crises the country is currently facing – mass social protests, irregular armed conflict on its borders and the ongoing pandemic which has exacerbated Colombia's longstanding issues of poverty and inequality. With this social upheaval as a backdrop, the country could elect its first decidedly leftist president in recent history. Moreover, a Petro victory would be hailed as the latest sign of a resurgence of the so-called 'pink tide' – a turn towards the left – in Latin America. Notably, in the past four years, left-of-centre candidates were elected in Argentina, Bolivia, Chile, Honduras, Mexico and Peru.

The former guerrilla, who is popular among poorer Colombians and students, is the figure that generates most concern in the business community. Some of Petro's promises, like halting new oil projects, changing the pension system and increasing social

spending have spooked investors. His harshest critics claim his policies could turn the country into another failed state like Venezuela. Meanwhile, Petro has distanced himself from the Venezuelan government and has stated that Colombia needs “democracy and peace”, not socialism. He has also abandoned the idea of pushing for a constitutional referendum and has pledged not to nationalise property. What is clear is that a Petro presidency would seek to shift away from Colombia’s traditionally market-friendly framework to one where the state plays a larger role. That said, it will be tough for Petro (or any other candidate) to push radical changes through Colombia’s fragmented Congress.

The other candidates

The presidential primaries held on 13 March by the three different coalitions have significantly narrowed the field of candidates. Gustavo Petro secured his coalition’s nomination (*Pacto Histórico*) by obtaining over 4.5 million votes, the largest number received by any candidate during the primaries. In contrast, former governor of Antioquia, Sergio Fajardo, won the nomination for the centre-left coalition *Centro Esperanza* with only 720,000 votes. Despite his coalition’s overall poor showing, Fajardo enjoys strong name recognition (this is his third presidential bid) and is a moderate politician whose plans to increase equity levels in the country are in line with many citizens’ social demands. Meanwhile, former mayor of Medellín Federico Gutiérrez will be the presidential candidate for the right-wing coalition *Equipo por Colombia*. A Gutiérrez victory would be viewed favourably by the market as he would likely guarantee continuity in Colombia’s policy making. While ‘Fico’ (as he is popularly known) is still behind Petro in the polls, his campaign is gaining strong momentum. Finally, Rodolfo Hernández Suárez is the only candidate outside the coalition system with some support in the polls. He fashions himself as an anti-establishment candidate with no clear ideological position and as such he could potentially draw votes from across the political spectrum.

Petro’s platform

Are investors’ fears of a Petro presidency warranted? What exactly does he propose? Petro’s policy platform is both thoroughly ambitious and vague. His most notable plans include radical changes for the energy sector and pensions system as well as tax hikes. However, he may end up having to dilute some of his most provocative proposals during an eventual runoff campaign to broaden his appeal to a wider range of voters.

Petro’s plans for Colombia’s vital oil and mining sector are perhaps his most controversial proposal and as such they have drawn the most attention from investors. Hydrocarbon exports represent around half of Colombia’s total exports (Exhibit 1). The sector is also an important revenue source for the government, accounting for around 10% of tax revenue. In an effort to fast-track Colombia’s energy transition towards renewables, Petro has promised to stop oil exploration and

introduce a ban on fracking and open-air mining projects, among other measures. The suspension of oil exploration would imply that the country would need to drastically change the structure of its economy in around just six years – the time that it would take to deplete Colombia’s proven oil reserves, according to the Ministry of Mines and Energy. The leftist candidate has claimed that he would replace oil revenues with tourism revenue and higher taxes. Nevertheless, he has not specified exactly how this would work, nor how he would replace foreign direct investment flows into the sector. If implemented, his agenda for the energy sector would add additional pressure to the country’s already-weak fiscal position, worsen its current account and lower investment in the country, thus hurting Colombia’s potential growth outlook.

Exhibit 1: Oil fuels Colombia’s economy



Source: Datastream and AXA IM Macro Research, 4 May 2022

When it comes to fiscal issues, Petro has highlighted the need to increase tax revenues by around 5.5% of GDP to pay for a large social spending package to address income inequality. This would represent a considerable increase, as tax revenue was 13.8% of GDP last year. Higher taxes on affluent individuals and large companies would be at the heart of his tax reform. In this sense, Petro’s plans would effectively dismantle President Duque’s 2019 reform, which had lowered corporate tax rates. Likewise, Petro’s proposal would increase taxes on dividends and capital gains. New taxes would also be introduced, like a levy on wealth held in tax havens and taxes on large unproductive land areas.

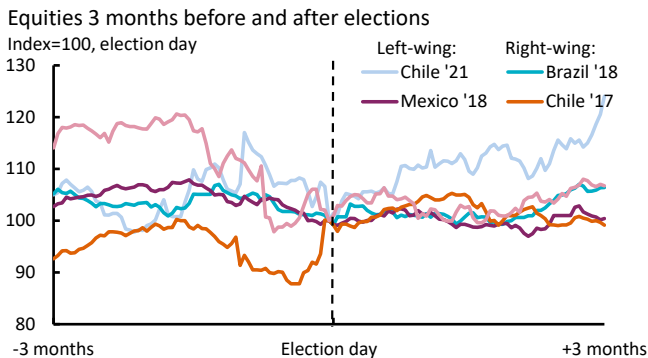
All major presidential candidates have expressed the need to reform Colombia’s unbalanced pension system so that it provides greater and better coverage. Less than 25% of people of retirement age receive a pension. The country currently uses a mixed pension scheme, combining a pay-as-you-go public pension with a privately funded pension system, allowing workers to switch between the two. Petro’s proposal would force all workers to make a minimum contribution into *Colpensiones* (the state-owned pension fund) to guarantee a basic pension for everyone. According to Petro, this change would redirect around US\$5bn in contributions every year to private funds towards *Colpensiones*. Critics decry that his plans would constitute a confiscation of people’s savings and would effectively turn Colombia’s mixed regime into a mostly public one.

Potential market reaction to a Petro victory

If we look at recent elections in major Latin American countries, it is unclear whether victories by left-wing candidates have had a worse impact on markets vis-à-vis victories by right-wing candidates. Exhibits 2, 3 and 4 show the evolution of the stock market, local currency (versus the US dollar) and 10-year bond yields three months before and after election day.

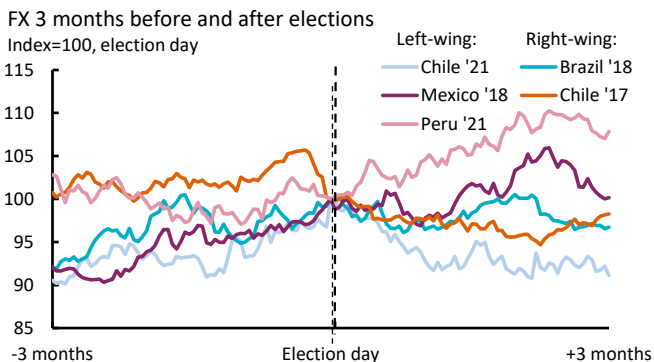
In terms of the stock market, it is interesting to contrast right-wing politician Sebastián Piñera's victory in Chile in 2017, with the recent election of Gabriel Boric, who ran on a leftist platform. In 2017, equities rallied for a couple of weeks prior to the elections as Piñera's triumph looked increasingly more certain (Exhibit 2). Conversely, equities declined considerably in the run-up to Boric's election. However, three months after the election, the stock market performed markedly better under Boric compared to Piñera. In the currency market, the Peruvian sol and Mexican peso depreciated significantly before and after the election of left-wing politicians Pedro Castillo and Andrés Manuel López Obrador (Exhibit 3). However, the data also shows the Chilean peso under Boric as the best performing currency three months after election day. Meanwhile, the election of right-wing Jair Bolsonaro in Brazil did not provide an additional boost to the real.

Exhibit 2: Mixed results



Source: Datastream and AXA IM Macro Research, 4 May 2022

Exhibit 3: Considerable depreciation in Mexico and Peru

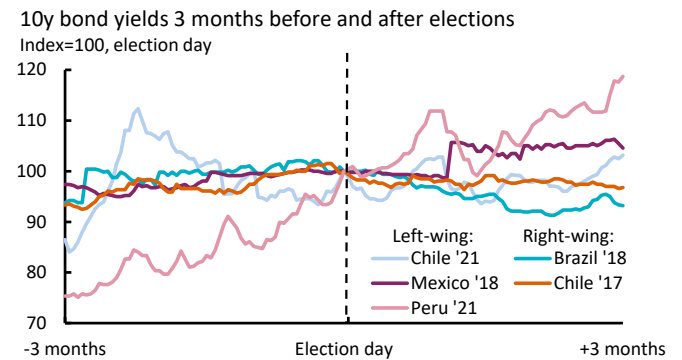


Source: Datastream and AXA IM Macro Research, 25 April 2022. Note: An increase in the index denotes currency depreciation versus the US dollar.

It is in the bond market where a more discernible impact can be observed following the election of a left-wing candidate.

Bond yields in Brazil and Chile (under Piñera) declined continuously after election day (Exhibit 4). The reverse was true for Mexico, Peru and Chile under Boric. These results seem to suggest that investors are mainly preoccupied with a left-wing president's commitment to fiscal sustainability, which makes intuitive sense as their platforms typically call for higher social spending. Therefore, should Petro be elected, we would expect a considerable increase in bond yields. Nonetheless, it is unclear what to expect in terms of the currency and equity markets. As the data shows, the election of left-wing candidates does not necessarily spell bad news in the short-term for a country's stock market and local currency. Moreover, in the case of Colombia, it is unclear to what extent investors really believe that Petro will have the willingness and political capital to radically change Colombia's macro framework.

Exhibit 4: Right-wing victories keep a lid on yields

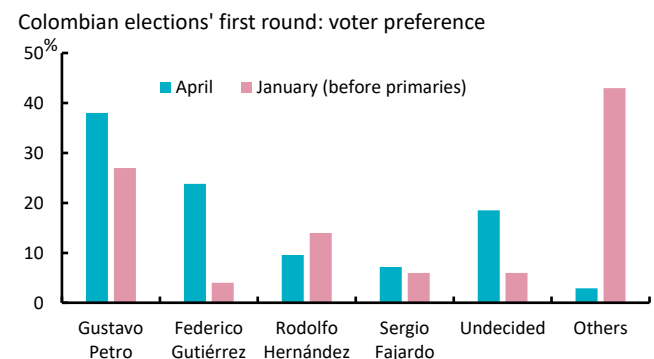


Source: Datastream and AXA IM Macro Research, 4 May 2022

Petro has the lead but Gutiérrez the momentum

While Petro continues to comfortably lead the polls with 38% of voting intentions, it seems highly unlikely that he will be able to get past the 50% threshold in the first round and avoid a runoff (Exhibit 5). A hypothetical run-off would likely pit Petro against Gutiérrez, who has vaulted into second place following March's primary elections and is now favoured by 23.8% of voters. Although the gap between the two contenders remains significant, the election is still open. Momentum is on Gutiérrez's side as his campaign continues to forge political alliances across the ideological spectrum.

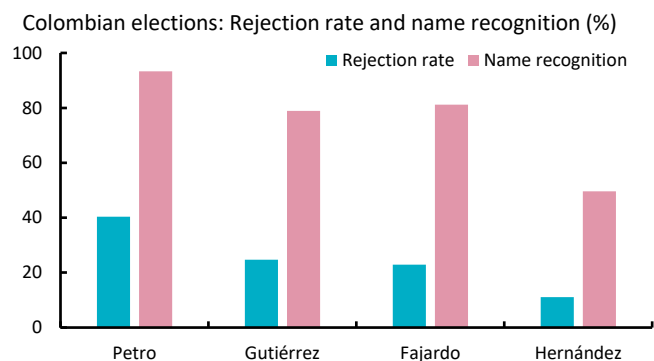
Exhibit 5: A two-horse race



Source: Invamer and AXA IM Macro Research, 4 May 2022

Back in March, Óscar Iván Zuluaga, the candidate of the right-wing ruling *Centro Democrático* Party, withdrew from the race and announced his support for Gutiérrez. Without a right-wing challenger to worry about, Gutiérrez is now able to pivot to the centre to try to draw votes from Fajardo's centrist *Centro Esperanza* coalition. In fact, he recently chose a politician from the country's ecological party as his Vice-President to appeal to the centre. Similarly, the influential centre-left Liberal Party, which has the largest number of seats in the lower house, recently announced its endorsement of Gutiérrez. In contrast, Petro's high rejection rate among voters has limited his capacity to widen his coalition (Exhibit 6). As a matter of fact, Petro failed to secure an agreement with the Liberal Party which, ideologically speaking, should have been his coalition's natural ally.

Exhibit 6: Petro has the highest rejection rate

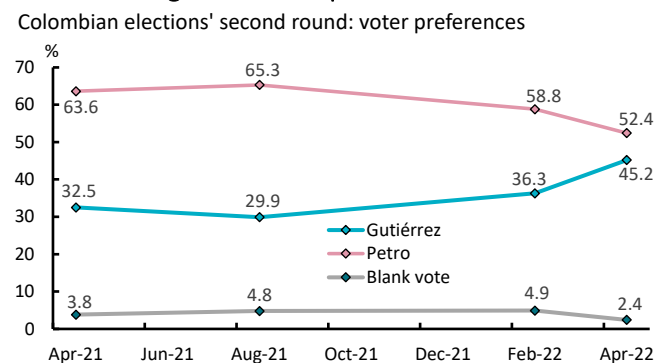


Source: Invamer and AXA IM Macro Research, 4 May 2022

It also seems unlikely that any candidate will see a sudden boost with less than a month to go to make it into the second round. Support for outsider Hernández nosedived following March's primaries. Meanwhile, Fajardo is polling at 7%, a dismal number for what should have been a strong candidate – although Fajardo's *Centro Esperanza* coalition could play kingmaker in an eventual presidential runoff. Fajardo has so far abstained from voicing his support for either Petro or Gutiérrez, but he could eventually tip the scale.

Recent polls show that in a hypothetical runoff between Petro and Gutiérrez, the left-wing candidate still holds a lead, at 52.4% versus 45.2%. Nevertheless, Gutiérrez has been continuously closing that gap and probably has not yet hit an electoral ceiling (Exhibit 7). Gutiérrez has a much lower rejection rate and name recognition than his contender, which suggests that his campaign still has room to grow. The question is whether Gutiérrez will have enough time to catch up with Petro.

Exhibit 7: A tighter-than-expected race



Source: Invamer and AXA IM Macro Research, 4 May 2022

Reality check

Although concerns about Petro's potential victory are not baseless, it is unlikely that he would be able to carry out his most radical reforms. Petro would start his presidency hamstrung by Colombia's institutional framework and economic realities. For example, his coalition only holds 15% of seats in Colombia's highly fragmented Senate. Therefore, Petro would not be able to pursue his agenda without significant compromise with the moderate and right-wing parties that continue to dominate Congress. Other institutional constraints include an independent judiciary, an autonomous central bank, a strong party system and a ban on immediate presidential re-election.

In addition to Colombia's strong checks and balances in the executive, it seems improbable that Petro would be willing to risk derailing the country's robust post-COVID-19 recovery by disrupting its oil industry at a time where commodity prices are high. In fact, polls show that the state of the economy is the main source of concern for Colombians and that most of them do not approve of Petro's plans to stop oil exploration.

Outlook

Regardless of who wins, Colombia's next president will need to walk a tightrope between addressing the country's many social demands without endangering the ongoing economic recovery nor putting fiscal sustainability at risk. Against this backdrop, we expect Colombia to remain as one of the most dynamic economies in Latin America, growing at an estimated 5.1% this year. Moreover, higher commodity prices should have a positive effect on the country's fiscal and external accounts. In contrast, like in most other countries in the region, high inflation remains an issue. It reached 9.2% in April, the highest in almost 21 years.

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