The Return of the Left, Fiscal Troubles and Political Polarization
A guide to the key political events in the Americas in 2022
Executive summary

While the 2022 political cycle in the Americas is less hectic than in 2021, the events on the horizon this year—general elections in Brazil, Colombia and Costa Rica, midterm elections in the U.S., and a constitutional referendum in Chile—still pack a serious punch. With notable policy shifts in the offing, three overarching themes will be at play: The return of the left to the forefront of regional politics, fiscal difficulties in the wake of the pandemic, and fragmented legislatures potentially constraining reforms.

First, the return of the left. The economic fallout from Covid-19 laid bare the enduring deep socioeconomic inequalities in the Americas, which incumbent right-wing government failed to address. This was a factor behind the strong showing of leftwing candidates in 2021 elections held in countries such as Chile, Honduras and Peru. This year could follow a similar pattern: Gustavo Petro—ex guerrilla member and former mayor of Bogotá—is currently the most popular presidential candidate in Colombia, while leftist former president Lula Da Silva holds a seemingly unassailable poll lead in Brazil. Meanwhile, in Chile, the new constitution currently in the works could radically revise the country’s liberal economic model by beefing up the role of the state. By the end of 2022, all the major Latin American economies—Argentina, Brazil, Chile, Colombia, Mexico and Peru—could be run by left-wing politicians.

However, the dire fiscal situation in many countries will restrict the radicalism of this new crop of leaders. Public debt and budget deficits
Executive summary

have surged due to the pandemic, leading to a cascade of ratings downgrades in the region. Investors are now watching anxiously to see if governments embark on budget consolidation, and could be unforgiving with those that aim to make current fiscal largesse permanent. This will stymie the spending plans of Lula and Petro if they are elected. Meanwhile, the next president of Costa Rica will need to abide by the fiscal strictures of the IMF support plan currently in place. Even in Chile—where public debt is still low by regional standards—markets could sour on domestic assets if the new constitution appears likely to lock in higher government spending.

Political divisions will be another thorn in leaders’ sides. All four elections this year are set to result in fragmented legislatures. The problem will be particularly acute in Brazil, due to the vast number of parties likely to be present in the next parliament, and in the U.S., due to the highly partisan political atmosphere. In Chile, the incoming government of Gabriel Boric could have difficulty legislating for any new social rights enshrined in the constitution, due to the lack of a majority in either house of Congress.

As a result, unless politicians temper expectations from the get-go, 2022 could see a huge gap between political rhetoric and reality. This could further weaken the already-fragile trust that citizens in most parts of the Americas place in their leaders, potentially spurring renewed social unrest and ensuing economic uncertainty.
Costa Rica

Vote: Presidential & legislative elections
Date: 06 February 2022

Given the crowded presidential field, no candidate is likely to meet the 40% vote threshold to win the presidency outright, so a second-round runoff is likely in early April. Polls suggest that José María Figueres of the centrist PLN and Lineth Saborío of the center-right PUSC are the frontrunners, though other candidates from across the political spectrum cannot be discounted. Plus, the PLN seems set to make gains in parliament, but could still lack a majority. As such, the most likely scenario for now is a moderate, business-friendly president contending with a fractured parliament.

The election will be key for the IMF support program. If Figueres or Saborío win the election, the program should remain in place, albeit with some potential modifications. That said, if a more fringe candidate wins—such as leftist José Maria Villalta—this could put the future of the IMF deal in doubt, potentially weighing on the colón.

Key Takeaway
Moderate candidate likely to claim presidency, but parliament to stay fractured

The IMF deal and associated adjustment is necessary for Costa Rica’s fiscal future, in our view, as interest payments now represent close to 40% of all outlays and debt levels are still increasing. Regardless of who clinches the presidency, Congress will likely continue to be fragmented, which would continue to limit the nation’s ability to obtain external financing, given the limitation that all external debt requires congressional approval.”

Esteban Tamayo, economist at Citigroup Global Markets

Consensus GDP Forecasts
(ann. var. %)

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<th>Year</th>
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Colombia

Vote: Presidential & legislative elections
Date: 13 March and 29 May 2022

Presidential elections in May will follow parliamentary elections in March, with a June run-off if no one secures over half of the vote. The final list of presidential candidates will only be known in March. As such, the contest is open, although incumbent Duque’s elevated disapproval rating could open the door to a more left-wing candidate.

Indeed, left-of-center Gustavo Petro is leading in the polls. He would likely aim to move away from a reliance on natural resource extraction, raise taxes on the wealthy and boost social spending. As such, a Petro victory could weigh on the peso and investor intentions. However, the scope for radical reform would be limited by the need to protect the country’s only investment-grade credit rating, as well as by a potentially opposition-controlled Congress. More centrist opponents, such as Sergio Fajardo or Alejandro Gaviria, should gain traction as the final number of candidates is whittled down.

Key Takeaway
Left-wing candidate has early poll lead, but the race will grow more competitive

“EIU expects the political scene to heat up as the 2022 legislative and presidential elections [...] approach. Numerous factors will fuel polarisation and bickering between the right-wing, centrist and left-wing presidential hopefuls, including: unmet social demands for improved wages and public services, wealth redistribution, social inclusion and political participation; growing discontent with perceived government corruption; slow implementation of peace agreements with the FARC guerrillas; and electoral calculations.”

The Economist Intelligence Unit
The constituent assembly has until July 2022 to finish work on a new constitution, followed by a referendum on the text in H2. Given immense social pressure, and that right-wing parties failed to secure a one-third blocking minority, the assembly should reach an agreement. Failure to do so, or a subsequent rejection in the referendum, could throw the political system into disarray and lead to renewed social unrest. The new constitution will boost the state’s role, and condition policymaking even without making legally binding commitments, as citizens will expect the government to follow through on the text. Together with the election of Gabriel Boric as president, Chile will thus become a less economically liberal country ahead. While the process is ongoing, business sentiment will be dampened, and both investment and the peso will be hit if the constitution seems set to shift the country far to the left and adopts a number of populist measures.

Key Takeaway
New constitution will lead to a less liberal economic model

“Mr. Boric will [...] assume office in an environment of high expectations, increasing social demands, and significant political/social polarization. Meeting these expectations [...] in a fiscally responsible way, while preserving the appropriate incentives for investment and growth will be challenging. [...] Given the left-leaning composition of the convention and the presidential election outcome, the constitution is likely to validate a larger and more interventionist state and the broadening of the social safety net.”

Sergio Armella, economist at Goldman Sachs
Brazil

Vote: Presidential & legislative elections
Date: 02 October 2022

Presidential polls suggest that Lula da Silva, the leftist former president, is way ahead. Moreover, incumbent president Bolsonaro faces a fresh challenge on the right from Sergio Moro, his former justice minister. Victory for Lula would herald a focus on social spending and tackling inequality. However, room to expand the state will be limited by a fractured Congress and the perilous fiscal situation. Moreover, Lula was pragmatic during his first stint as president in 2003–2010 and signs suggest he is likely to govern in a similar style this time around. If Bolsonaro wins, he would likely reattempt to advance his stalled liberalizing reform agenda. However, tensions with other branches of the state would stay elevated. Social unrest and a volatile real are distinct possibilities this year. In addition, extra spending is likely under the Auxilio Brasil program: While this could support private consumption in the near term, it will also spur fiscal concerns.

Key Takeaway
Lula set for return to power; fiscal woes and fractured politics to limit policy room

“Irrespective of who wins, the next president will inherit a weak economy with considerable fiscal challenges and weakened confidence around the spending ceiling, thereby increasing the need for fiscal adjustment and reforms. Congressional fragmentation would continue after the elections, posing a challenge for consensus-building but also preventing a radical shift in economic policies.”

Fitch Ratings

Consensus GDP Forecasts (ann. var. %)

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United States

Vote: Midterm elections
Date: 08 November 2022

The Republicans are on track to make gains, potentially retaking both the House and the Senate. The lack of progress on the government’s Build Back Better program, surging inflation and foreign policy missteps have all weighed on the Democrats’ popularity. Plus, changes to voting districts and new voting laws in some states should favor Republicans.

The loss of one or both chambers of Congress would paralyze Biden’s domestic legislative agenda and largely limit the president’s role to international affairs. Moreover, the political environment would likely grow even more polarized and fractious as a result. However, some factors could help the Democrats close the poll gap: Inflation should have eased sharply by Q4, while the infrastructure and Build Back Better packages (assuming the latter is eventually passed) should boost activity. Regardless of the election result, the economy should continue to perform well over the next few years.

Key Takeaway
Midterms could bring political gridlock, but economy to stay robust regardless

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(ann. var. %)

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“The U.S. economy should remain in good form in the coming years, despite likely legislative paralysis if Biden loses control of Congress. A flexible labor market, solid demographics, healthy investment and the ease of doing business should all propel activity ahead. However, the lack of political agreement will stop the government from addressing lingering problems, such as poor public services, elevated inequality, and the constant upward march of the public debt ratio.”

Steven Burke, U.S. economist at FocusEconomics
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