

MNI POLITICAL RISK ANALYSIS-Colombia

Election Preview

by Adam Burrowes, Tom Lake, and Jack Lewis

Colombia holds the first round of its presidential election on Sunday 29 May in a vote that is seen as a key test of the country's democratic institutions and could result in a major shift in local and regional foreign policy. In this election preview we include a brief on the main candidates contesting the vote, an outline of how the election works, a chartpack of the latest opinion polling, technical analysis of the Colombian peso, scenario analysis with MNI Political Risk team's outcome probabilities, and a round-up of sell-side reports on the election.

Executive Summary

- Leftist candidate Gustavo Petro is seen as overwhelmingly likely to make the second-round run-off on 19 June, with a first-round victory likely out of his reach. He remains the overall favourite for the Colombian presidency
- The identity of the second-placed candidate will be crucial. A win for conservative candidate Federico Gutierrez raises the prospect of a Petro presidency, given Gutierrez's poor second-round polling. However, should outsider populist candidate Rodolfo Hernandez make the second round against Petro polls show that contest as too close to call at present.
- A win for Petro would be the first for a leftist candidate in Colombia and could see major policy shifts in terms of foreign policy (away from US cooperation), and the economy (higher taxes on dividends and wealth).
- Given the intense mistrust of Petro (a former M-19 guerilla) from sections of Colombian society on one hand, and on the other Petro's campaign comments about "a coup against the popular vote", there is the notable prospect of civil unrest erupting post-election.

Preliminary results for presidential elections in Colombia are usually published relatively quickly. There is expected to be a high degree of certainty regarding the final results by around 1900 local time. However, a particularly tight race between two candidates may take longer to be called. It is worth noting that Monday is a holiday in the US and Colombia, so the bulk of the market response will come to fruition on Tuesday, May 31.

Main Candidates

- **Gustavo Petro** – Historic Pact for Colombia (*Pacto Histórico por Colombia*; PHxC) – **Background:** Senator (2006-10, 2018-), Presidential Candidate (2010, 2018), Mayor of Bogotá (2012-14, 2014-15), Member of the House of Representatives (1998-2006), M-19 guerilla (1970s/80s) – **Political Identification:** Left-wing, democratic socialism, progressive – **Running Mate:** Francia Marquez (Human rights lawyer, environmental activist)
- **Federico Gutiérrez** – Team for Colombia (*Equipo por Colombia*) – **Background:** Mayor of Medellín (2016-19), Municipal Councillor of Medellín (2004-11), Engineer – **Political Identification:** Centre-right, conservatism, economic liberalism, conservative liberalism – **Running Mate:** Rodrigo Lara (Mayor of Neiva (2016-19), Physician)
- **Rodolfo Hernández Suárez** – League of Anti-Corruption Governors (*Liga de Gobernantes Anticorrupción*, LIGA) – **Background:** Mayor of Bucaramanga (2016-19), building magnate – **Political Identification:** Centrist, anti-corruption, anti-establishment, economic liberalism – **Running Mate:** Marelen Castillo (Academic, University Lecturer)
- **Sergio Fajardo** – Hope Center Coalition (*Coalición Centro Esperanza*, CCE) – **Background:** Presidential Candidate (2018), Governor of Antioquia (2012-16), Vice-Presidential Candidate (2010), Mayor of Medellín (2004-08), Mathematician and Academic – **Political Identification:** Centrism, social democracy, liberalism, environmentalism – **Running Mate:** Luis Gilberto Murillo (Minister of Environment and Sustainable Development (2016-18), Governor of Choco (1998-99, 2012))

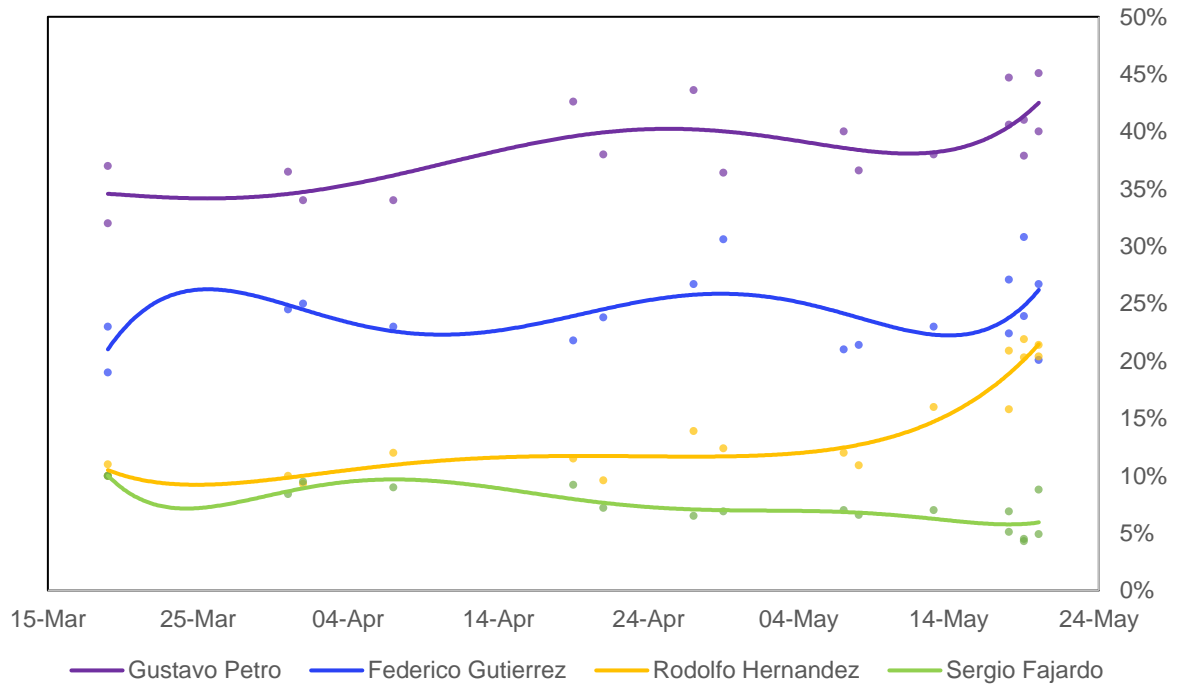
Electoral System

Colombian presidents are elected for a single four-year term that is non-renewable. The election takes place in a two-round system, with a vice-presidential candidate running on the same ticket as the presidential candidate.

Any number of registered candidates can run in the first round. Should no candidate win an overall majority, a second-round run-off between the two highest placing candidates will take place on 19 June. After the election, the runner-up in the presidential contest is given a seat in the Senate, while their vice-presidential running mate becomes a member of the House of Representatives.

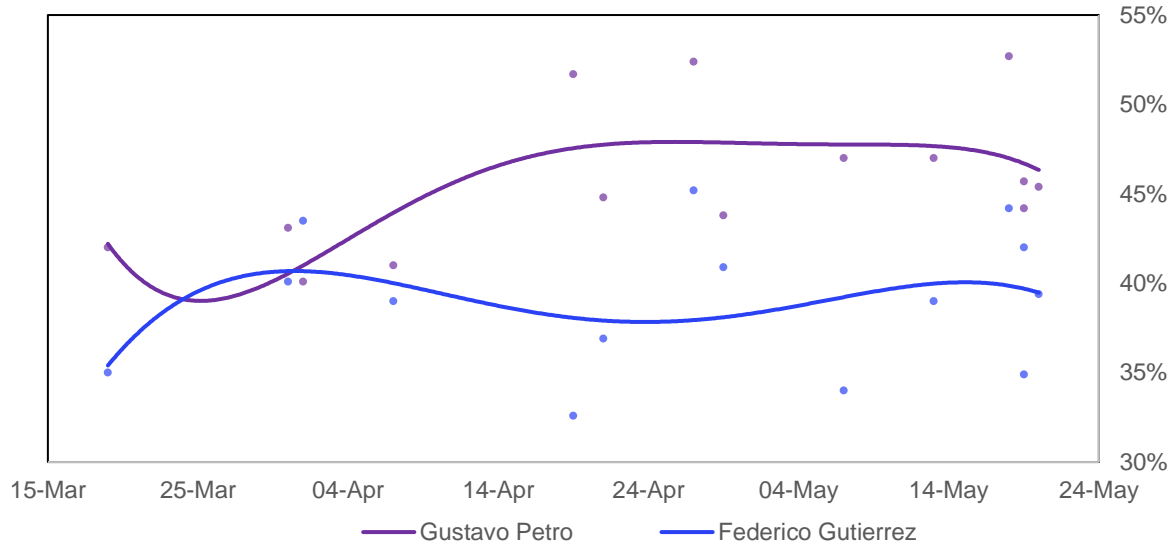
Opinion Polling Chartpack

Chart 1. Colombia Presidential Election Opinion Polling, First Round, % and Trendline



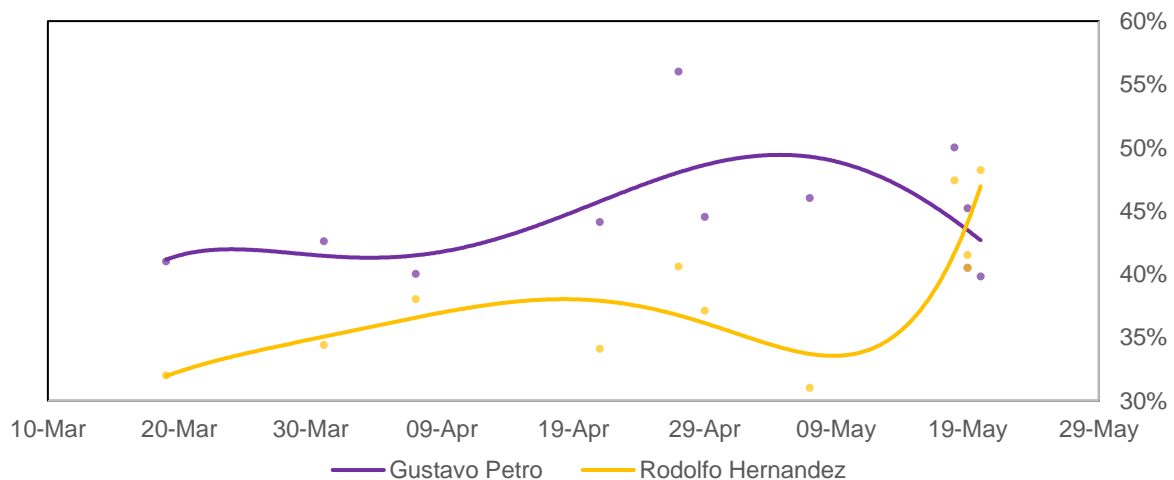
Source: AtlasIntel, CELAG, Guarumo, CNC, Invamer, Mosqueteros, TYSE, Yanhaas,

Chart 2. Colombia Presidential Election Opinion Polling, Second Round Hypothetical – Petro vs Gutierrez, % and Trendline



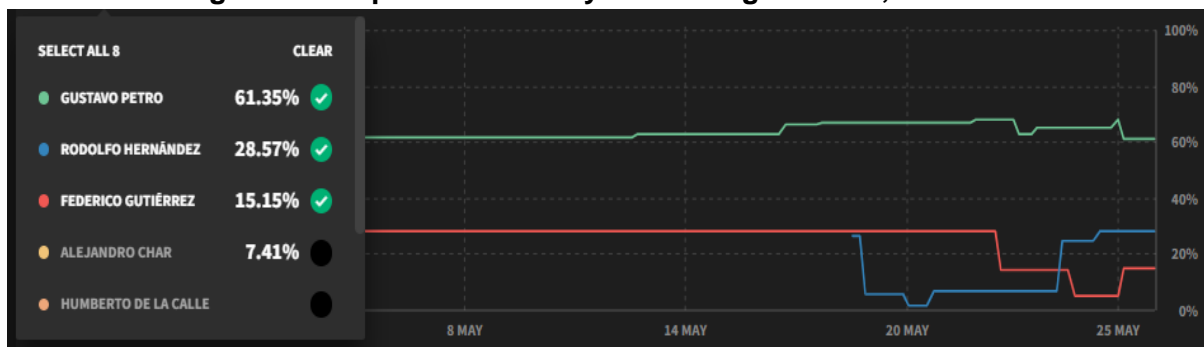
Source: AtlasIntel, CELAG, Guarumo, CNC, Invamer, Mosqueteros, TYSE, Yanhaas,

Chart 3. Colombia Presidential Election Opinion Polling, Second Round Hypothetical – Petro vs Hernandez, % and Trendline



Source: AtlasIntel, CELAG, Guarumo, CNC, Invamer, Mosqueteros, TYSE, Yanhaas,

Chart 4. Betting Market Implied Probability of Winning Election, %

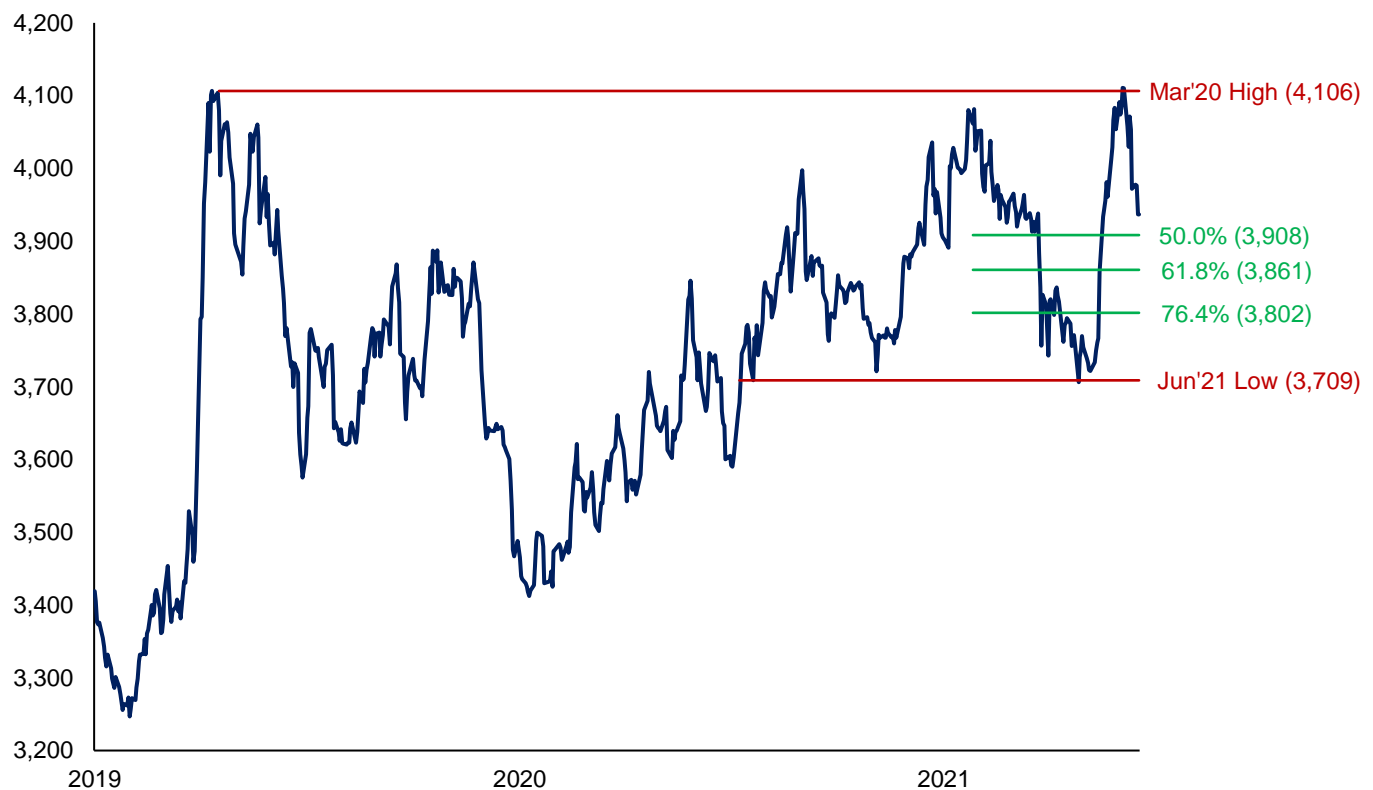


Source: Smarkets

USDCOP Technical Picture

- The Colombian peso has been the worst performing currency in the region this year. Despite the rally in oil prices, a degree of political risk premium, as well as a less attractive carry profile have provided notable headwinds for COP amid a strengthening greenback.
- The medium-term technical range appears well defined with the pandemic highs just above 4100 proving strong resistance earlier this month. In similar vein, the June 2021 lows around 3700 were supportive in April this year and are the notable level on the downside.
- Given the high probability of a run-off scenario, greater focus should be placed on the short-term picture. We highlight the Fibonacci retracements of the April 4 - May 12 upleg. In particular, the 61.8% at 3861 may provide support in the event of the potential marginal positive surprise of a Petro-Hernandez runoff.

Figure 1: USDCOP Medium-Term Range Well Defined



Source: MNI Market News, Bloomberg

MNI Scenario Analysis

Petro versus Gutiérrez run-off: 60% probability:

- This has been the baseline projection from the first round of voting for a number of weeks.
- Polling suggests that Gutiérrez has a limited capacity to defeat Petro in this second-round scenario, although this is subject to change following debates and new polling in the period between the first and second round of voting.

Petro versus Hernández run-off: 40% probability

- Although looking less likely than a Petro-Gutierrez runoff, odds have shortened as Hernández has made a late surge into contention. Should he progress to the second round, Hernández looking the most likely candidate to challenge Petro. The latest polling suggests that a Petro-Hernández run-off would be too close to call.
- It is looking likely that the establishment and right-wing vote will coalesce around the more business-friendly Hernández in a bid to block Petro.
- There are some factors to consider which may work against Hernández.
 - His economic proposals don't contain any of the tax reforms which are highly popular in Petro's economic proposal.
 - His lack of political historical or party affiliation may not transfer popularity into electoral success.

Two factors to consider for the second round

- The anti-establishment vote: Although markedly different in policy and political history, both Petro and Hernández lay claim to the anti-establishment vote. According to the average of the polls, Petro and Hernandez together enjoy nearly 60% support.
- The anti-leftist vote: Gutierrez and Hernandez, have combined support of 44%. This exceeds Petro's 40%. If either Gutierrez or Hernández can muster the support of the other in the second round the anti-leftist vote has an outside chance of beating Petro.

A Petro Presidency - Colombia's first leftist president

- Petro proposes a shakeup of Colombia's economy, energy policy, diplomatic relations, and a new framework for peace.
- He has pledged to combat income inequality, tax the rich, reform healthcare and pension, and tackle corruption.
- Petro says continuing to have an economy based on oil would be the 'politics of death.'
 - Oil and coal account for nearly 60 percent of Colombia's total exports, and policies would be enacted at a time when the treasury is receiving strong profits triggered by Russia's invasion of Ukraine.
- Petro would push a tourism-driven economy and give 'productive organisations' a say in monetary policy. He has also promised to guarantee public sector jobs for anyone who's out of work.
- Most analysts agree that his radical agenda will experience stiff opposition in Congress and the Supreme Court. Petro would be further restricted by the one-term limit on presidency.

Analyst Views (Alphabetical Order)

Barclays: The Balance Of Risks Is Asymmetrically Positive

- A surge in support for right-wing candidate Rodolfo Hernandez is reshaping the election. Polls are simultaneously indicating the anti-establishment sentiment and conservative inclinations of the electorate. Which of these will prevail is still to be seen, but Barclays think the balance of risks is asymmetrically positive.
- Local assets are trading at very cheap levels. The COP is among the cheapest currencies in EM according to their FFV model. Local yields are high relative to fundamentals, especially on the bond curve, which seems too steep compared with the IBR curve. The current level of 10y TES is consistent with additional increases in risk variables (CDS, FX vol), high terminal policy rates (above 9% as currently priced in IBR), some reduction in foreign ownership of local bonds, and a modest deterioration in the one-year budget balance.
- Barclays believe that room for a sell-off in case of a negative political development is more limited. In FX, they also believe there is asymmetry (COP is cheap), but perhaps not as extreme as in rates.
- Barclays assess three potential market scenarios: A Petro versus Gutiérrez run-off (most likely) would prompt a very muted market response. Petro versus Hernández run-off (less likely, but with increased probability) - likely be positive for COP, as he is a business-friendly outsider that could gather anti-establishment votes, possibly taking away support from Petro in the run-off. In the third scenario of Petro winning outright (very unlikely) - the initial market reaction could be quite negative, with pressure on COP and local rates. Barclays think that USDCOP could breach the year's highs. Concerns would likely mount, as a first-round victory would give Petro a stronger mandate and more political capital. Focus would turn to policy and cabinet announcements.
- Credit Strategy recommend buying basis through Colombia 27s and buying 5y CDS.

JPMorgan: Strong Argument That 2022 Is Shaping Up As A “Change” Election

- The last round of polls ahead of Colombia's May 29 first round election is showing a late breaking narrative shift. Rodolfo Hernandez (independent) is regaining strong momentum and looks poised to potentially catch and surpass the center-right “Fico” Gutierrez, who, since the March 13 primary, had seemed to have consolidated his position in second place.
- Recent elections in the Andeans suggest that we should not discount late momentum from outsider candidates. Castillo in Peru was an unknown who surprised by upending a muddled group of centrists, mainly establishment candidates. The traditional centrist parties in Chile were surpassed by the far-right Kast in the final stretch. Both these elections also show that there are no guarantees in the second round, and much depends on the matchup of personalities, as well as the demand for change from the electorate.
- Back in Colombia, one can make a strong argument that 2022 is shaping up as a “change” election, given the structural decline in faith in institutions and declining conviction that Colombia is on the right track. Protests in recent years are also warning flags. The question, however, as we approach the May 29 first round, is

whether that change will be Petro, or the one candidate who perhaps can portray himself as even more of an outsider—Rodolfo Hernandez.

- As for his economic policies, Hernandez's proposals are more of a mixed bag. He is a businessman, and his instincts seem to be to provide space for the private sector, though some of his ideas suggest he could lean towards protectionism and (Latin American) industrial policy, favouring trade protection for the agricultural sector.
- His main agenda and message by far is anti-corruption, and, for example, he says his plans to reorder Colombia's fiscal accounts by reducing the public payroll and other spending, which he seems to link to clientelism and the excess of politicians. At the same time, he says he would slash the VAT from 19% to 10% even while his stances on social spending and the minimum wage have a more populist flavour. As for energy policy, much in the spotlight given Petro's plans for a rapid energy transition, Hernandez would propose no abrupt changes and would be open to advancing on non-conventional hydrocarbons exploration.

Oxford Economics: Colombian Peso Could Fall 9% With Petro's Agenda

Colombian assets will suffer a hard blow if presidential candidate Gustavo Petro is elected and gets his reform package approved, Oxford Economics analyst wrote in a note.

- Within the Bloomberg report of the note:
- "If Gustavo Petro pushes through his populist agenda, we expect depleted fiscal credibility to depreciate the peso 9% against the US dollar, and a 1% structural increase in interest rates, while simultaneously dealing with increased risks of lower growth and higher inflation".
 - The peso would trade closer to COP4,850 per dollar by 2026 against a baseline forecast of COP4,450 per dollar.
- Oxford Economics' base case is a scenario where Petro faces conservative Federico Gutierrez in the June 19 runoff:
 - "A tighter second-round race could help moderate radical moves and keep Petro from pushing unorthodox policies that could scar the economy in the long term".
- Investors have key concerns over a Petro agenda:
 - The leftist senator's agenda includes universal income for vulnerable families, the end of oil exploration and an overhaul of the private pension system.
 - "If implemented, such policies would impose a heavier burden on fiscal accounts at a time when fiscal consolidation is badly needed".
- Five-year bond yields would rise 8.5% compared to 7.1% baseline:
 - "An exogenous increase to five-year bond yields is expected to be detrimental to the determination of Colombia's neutral policy rate".
 - Oxford Economics used a stress test scenario using EMBI spreads.

SocGen: Political Situation Is Perhaps Not Conducive To Bet Big On The Economy

- Consensus expects Colombia to be the fastest-growing major economy in the region in 2022 (consensus growth expectation: 4.8% vs SG current forecast 3.8%). Despite these benefits, investors just don't want to bet much on the policy challenges that lie ahead. As a result, while the economy was about 8% larger in March than the

corresponding pre-crisis level, quarterly fixed capital formation in 1Q22 was still 6% lower than in 4Q19.

- The Colombian peso has gained marginally this year (up 1.8% vs the USD), but is still the weakest performing major currency in the region despite oil being the country's primary export. Of course, the worsening trade balance has contributed to the currency weakness amid surging imports on strong domestic demand growth. Nevertheless, weak inflows have also contributed to a relatively modest performance of the peso.
- Petro is seen falling way short of a majority in the first round, making predictions for the 19 June run-off round crucial.
- Recent polls by El Tiempo (as reported by Bloomberg) suggests that Petro is only marginally ahead of Gutierrez and Hernandez in the second round, with the vote share difference falling close to margin of errors. The market is probably taking Petro's victory as its baseline scenario, but not completely discounting other possibilities. Polls show that the race has tightened considerably in recent weeks, with Hernandez gaining vote share at the cost of both Petro and Gutierrez. In one of the polls, Hernandez was seen winning against Petro in the second round. As a result, we can expect significant financial market volatility around or post the election dates, irrespective of the result.
- Front-runner Petro has not shown much inclination to gravitate towards the centre during his campaign so far and this is very likely a source of uncertainty for investors. Petro has asked for higher taxes on dividends and wealth to fund greater employment in the public sector.
- The Colombia Congress (after March 2022 elections) remains a divided house, with left parties falling well short of a majority. This would require Petro, should he win the election, to compromise with other parties to bring substantial policy changes. The exact nature of these compromises is unknown at this stage. Of the others, Gutierrez is primarily considered a continuity candidate, while Hernandez's policy calls – primarily centred around corruption eradication – are yet to fully evolve. Arguably, the market would prefer a great degree of policy visibility and stability over radical changes.
- Food prices are rising at the fastest pace in decades, making the political situation of an economically unequal country like Colombia vulnerable. The unemployment rate has declined to pre-crisis levels but remains the highest among the major economies in the region. While high commodity prices tend to support growth and other economic parameters in the economy, the political situation is perhaps not conducive for investors to bet big on the economy.

UBS

- Based on his published government plan platform and his public appearances, Petro's economic plans revolve around three key ideas which, taken together, would mark a major departure from the current Colombian economic model.
 - First and foremost, Petro wants to end "exclusive dependence on the extractive model" and switch towards a "productive economy"; that is, a greener and more diversified economy with a preponderance of agricultural and local industrial activities.

- Petro's second key idea is the relaunch of a “new social pact”, meaning the “defense and implementation of the principles encoded in the 1991 Constitution”.
- We believe the third key idea is his plan to finance the expansion of public expenditures implied by the measures discussed above. The plan proposes tax reform with an ambitious goal of collecting 5.5% of GDP. The proceeds would come from: 1) elimination of regressive tax policies and increased scrutiny of the wealthiest contributors [...]; 2) elimination of tax benefits for corporations and individuals, particularly those related to president Duque's first tax reform; and 3) emphasis on the fight against tax evasion and elusion.
- Additionally, one of Petro's most salient campaign proposals is revamping the pension system, currently a dual system where public-owned Colpensiones and private pension funds (AFPs) coexist. In essence, he proposes a switch towards a unified system that would put “the right to retirement above profit”.
- Although implementation of Petro's ideas could possibly weigh on growth and other macro fundamentals, we think some factors may limit the scope of changes to the current economic model, at least in the short term.
 - The first factor is the legislative power composition, which points to division.
 - A second line of opposition could be the Constitutional Court and its mandate to revise and rule over laws and dispositions implemented by the legislative and the executive branches, with the ultimate power to stop their application.
- There are other areas where Petro could make progress in his platform if he is elected. One example is the institutional framework for the hydrocarbon sector, a key piece in the implementation of his ambitious plan to de-escalate the extractive industry. According to subject experts, presidential attributions may trigger a plan to conduct an overhaul in the energy sector.
- [Gutierrez's] government platform, under the slogan of “order and opportunities”, with emphasis on growth as the main engine to reduce inequality and foster social progress, has similar points to those of President Duque and the ruling party coalition, which comes as no surprise, since they both represent traditional right-wing parties in Colombia.
- While most of [Hernandez's] proposals lack details, in recent weeks, he has shared some potential measures of a hypothetical presidential term, such as the issuance of decrees to cut expenses at different levels of government (a populist proposal, given the negligible fiscal impact of those budget cuts), reduction of the value-added tax to 10% and changing positions in his stance towards fracking and conditions under which expropriations would apply.
- With high uncertainty around who could join Gustavo Petro in a possible runoff, we will watch the following closely:
 - The strength of Petro's vote in the first round, particularly how close he gets to the 50% of valid votes, to understand the strength of Pacto Historico voters' turnout in a runoff.
 - A victory for Gutierrez over Hernandez may initially provide a negative reading for markets, given the reasons that limit his competitiveness as a second-round candidate, as discussed above. Nevertheless, Gutierrez may

- be able to attract some of the centrist voters who supported Hernandez in the first round.
- Conversely, a victory for Hernandez over Gutierrez could improve market sentiment, given the narrower gap between him and Petro in second-round polls and the attributes that make him a relatively more competitive candidate for a runoff. Moreover, such a scenario could lead Petro to redefine his strategy for a runoff, perhaps including more efforts to attract centrist/undecided votes

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