

# GLOBAL MACRO SHIFTS

with Michael Hasenstab, Ph.D.

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## LATIN AMERICA: THE RISE AND FALL OF POPULISM



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This edition of Global Macro Shifts explores Latin America's failed experiments with populism and the important lessons those experiences have for the developed world.

This document is a summary version of the full research-based briefing, which can be found in its entirety at the [Global Macro Shifts homepage](#).

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Global Macro Shifts is a research-based briefing on global economies featuring the analysis and views of Dr. Michael Hasenstab and senior members of Templeton Global Macro.

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# Overview



“We’re optimistic on the outlook for Latin America as the region departs from a decade of failed populism and moves toward more orthodox policy.”

**Michael Hasenstab, CIO**  
Templeton Global Macro

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Populism has been on the rise across a wide range of countries in recent years. While populism can mean different things to different people, we use the term to describe policies that promise rapid solutions to problems, often economic in nature, without the pain that typically accompanies more orthodox prescriptions. Traditional policy advice has been to address macroeconomic imbalances using a macroeconomic toolkit consisting, but not restricted to, prudent fiscal and monetary policies, openness to trade, deregulation and a movement toward greater global economic integration.

In the aftermath of the various global crises of the past decade, these traditional remedies are becoming dangerously unfashionable. This has been especially striking in some advanced economies. It contributed to the Brexit vote, where a majority of UK voters opted to take the country out of the European Union (EU) to limit immigration and re-establish a stronger degree of national control over policies and regulations. Populist and nationalist parties have gained popularity in several other EU countries, raising uncertainty for upcoming elections in 2017.

Populist elements have also been strong and vocal in the recent US presidential election on both the Republican and Democratic sides; they have advocated a more inward-looking and interventionist economic focus as well as a more isolationist approach to global trade, with

proposals to impose high import tariffs, scrap or renegotiate trade treaties, and curb immigration. Sharp criticism of the North American Free Trade Agreement and of immigration from Mexico signaled a temptation for the US to turn its back on Latin America. This would be damaging to the US economy, and especially ironic at a time when key Latin American economies are moving in the opposite direction, turning away from populist economic policies to embrace free-market and pro-business reforms.

In this paper, we analyze the experience of Latin American countries over the last several years. We focus mainly on three countries that had embraced populist economic policies: Argentina, Brazil and Venezuela. The former two have recently reversed course, whereas the latter has not. We think comparing their experiences holds some valuable lessons for any policymakers currently at risk of being seduced by the sirens’ song of populism.

Of course, advanced economies are in a much stronger position than the countries covered in this paper, in terms of both macroeconomic fundamentals and institutions. However, we believe that the economic consequences of misguided policies would be qualitatively similar. In a

situation where the temptation of protectionist policies, in particular, is strong, we believe therefore that this analysis can offer some useful guidance. In addition, this paper underscores the potential attractiveness of investment opportunities in Argentina and Brazil and, more generally, of countries with solid, orthodox macroeconomic policies.

# 1. The Sirens of Populism

Exhibit 1 summarizes the experiences of four Latin American countries, three of which (Argentina, Brazil and Venezuela) were lured into the trap of populist policies, whereas one was not (Colombia). All of these countries were hit to varying degrees by the end of the commodity supercycle, and their ability to sustain their respective policy frameworks was tested—those that turned to populism were found wanting. Exhibit 1 to the right provides a snapshot of the kinds of measures deployed by the more interventionist governments.

## A Summary of Interventionist Policies

### Exhibit 1: Failed Policy Measures Employed by Country

As at 5 December 2016

|   | Argentina | Brazil | Colombia | Venezuela |
|---|-----------|--------|----------|-----------|
| Price Controls                                  | X         | X      |          | X         |
| Foreign Exchange (FX) Controls and Manipulation | X         |        |          | X         |
| Over-Ambitious Social Programs                  | X         | X      |          | X         |
| Fiscal Dominance                                | X         | X      |          | X         |
| Meddling in Private Sector                      | X         | X      |          | X         |

Source: Templeton Global Macro. As at 2016 for Argentina, 2015–2016 for Brazil, and the present for Venezuela and Colombia.

# 2. The Damage

In all three countries that followed populist policies, such policies have brought about significantly adverse consequences: Inflation rose to high levels, the economic system was severely distorted, productivity growth suffered, manipulation of the exchange rate combined with high inflation caused a significant appreciation of the

real exchange rate (which undermined competitiveness), and in some cases public debt expanded rapidly.

The damage that was inflicted on these economies by the drift away from prudent macro policies is in the process of being reversed in Argentina and Brazil; the

experience of Venezuela, which has refused to follow this path, speaks for itself. Exhibit 2 provides a snapshot of the damage suffered by the different countries, with Colombia being the outlier in that it maintained prudent policies.

## The Consequences of Populism

### Exhibit 2: Policy Consequences by Country

As at 5 December 2016

|                                      | Argentina | Brazil | Colombia | Venezuela |
|--------------------------------------|-----------|--------|----------|-----------|
| Rising Inflation                     | X         | X      | X        | X         |
| Expanding Debt                       | X         | X      |          | X         |
| Real Exchange Rate Over-Appreciation | X         | X      |          | X         |
| Low Productivity                     | X         | X      |          | X         |
| Economic Distortions                 | X         | X      |          | X         |

Source: Templeton Global Macro.

## 3. Reversing Course

In **Argentina**, the protracted deterioration in economic conditions eventually resulted in the ouster of Cristina Kirchner by Mauricio Macri in November 2015. President Macri was elected on a strong economic liberalization platform. The new government swiftly launched a broad range of reforms, including strengthening institutions, tightening monetary policy, fiscally consolidating, normalizing FX policy, and regularizing international relationships. This strong and broad-ranging reform effort represents a clear departure from the past, and sends a strong signal to international investors that the government is strongly committed to its new economic policy course—we think the willingness to immediately tackle many of the toughest challenges is the most convincing way of establishing credibility.

In **Brazil**, policy correction was forced upon the former president, Dilma Rousseff, as the market increasingly denied her the financing needed to continue on her unsustainable path and her popularity ratings plummeted. The new Brazilian government, led by President Michel Temer, has pushed forward with the first steps toward fiscal consolidation, lowering the ceiling on public spending and readying a possible reform of social security. The government has also begun to reverse the

previous micro-management of the economy so as to reduce policy-induced distortions. One of the biggest steps was to begin deregulating administered prices in 2015. Faced with rising inflation and an economy still in recession, the central bank had to strike a difficult balance in 2015; after keeping the real interest rate stable through mid-2015, it allowed it to creep up (even while starting to reduce nominal rates) to secure a decline in inflation in 2016. A more prudent monetary policy was also manifested in a reversal of the previous credit expansion.

In **Colombia**, despite the lack of any serious deterioration of policies, the government has actually taken steps to tackle the inflation that resulted from exchange rate depreciation. Monetary policy was tightened; steps have been taken to consolidate the fiscal accounts

further to address any potential impact from lower revenues on the back of lower oil prices; and finally, in parallel, negotiations with the Revolutionary Armed Forces of Colombia—People’s Army (FARC-EP) were pursued to end the long conflict with the guerilla group, further strengthening and safeguarding the democratic institutions of the country.

**Venezuela’s** populist policies are still in full swing at the time of this writing. The population now faces extremely harsh conditions, with high unemployment and a severe lack of food and other basic necessities. This has triggered protests and increased the risk to social stability but has not yet resulted in political change, much less in a policy correction. Exhibit 3 provides a summary of policy adjustments (or lack thereof) implemented by each country.

### A Summary of Policy Adjustments

#### Exhibit 3: Policy Adjustments by Country

As at 5 December 2016

|                            | Argentina | Brazil | Colombia | Venezuela |
|----------------------------|-----------|--------|----------|-----------|
| Price Deregulation         | +         | +      |          |           |
| FX Deregulation            | +         |        |          |           |
| Fiscal Consolidation       | +         | +      | +        |           |
| Strengthening Institutions | +         | +      | +        |           |

Source: Templeton Global Macro.

## 4. Forging into the Decade Ahead

**Colombia’s** policy-making stands as the mirror image to Venezuela—steadfast in its rejection of populism. It is notable that Colombia, having maintained prudent macro policies, only suffered from the increase in inflation brought about by the depreciation of the exchange rate. A starker contrast is hard to draw.

In both **Argentina** and **Brazil**, there are reasons to be optimistic, although the policy correction has just begun. While it will be crucial to maintain the momentum in the coming years, in both countries the most important factor—political

commitment—appears to be in place, and if the new policies are maintained we think the benefits will be substantial.

By contrast, it is hard for us to feel anything but pessimistic about the outlook for **Venezuela**. It simultaneously has greater oil reserves than Saudi Arabia and the world’s fastest contracting economy, inflation that is estimated to be heading toward 1000%,<sup>1</sup> and shortages of food and medicine that are pushing the country toward a humanitarian crisis. It is difficult to come up with a more dire set of circumstances for a country.

These examples that we have drawn from Latin America have important lessons to offer the developed world. While we are not suggesting that the US or the various countries in Europe that are flirting with populism are at risk of traveling down some of the extreme paths we explore in the full paper, these examples do offer a cautionary tale at a time when orthodox economic policymaking is at risk of falling increasingly out of favor.

1. Source: International Monetary Fund, World Economic Outlook, October 2016.



## About Global Macro Shifts

Global Macro Shifts is a research-based briefing on global economies featuring the analysis and views of Dr. Michael Hasenstab and senior members of Templeton Global Macro. Dr. Hasenstab and his team manage Templeton's global bond strategies, including unconstrained fixed income, currency and global macro. This economic team, trained in some of the leading universities in the world, integrates global macroeconomic analysis with in-depth country research to help identify long-term imbalances that translate to investment opportunities.

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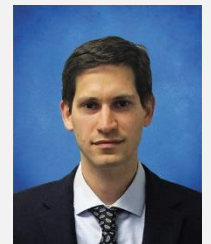
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