WELLS FARGO

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"Conservative Wave" Still Flows With Major Latam Elections Looming

Summary

Latin America's 2nd "Conservative Wave" remains intact as general elections in late 2025 and early 2026 resulted in right-leaning policy platforms being voted into office. Elections over the last few months add to a years long regional trend of voters opting for more conservative policy agendas, especially political platforms associated with tougher rule of law components. The latest election cycle, in our view, reduces regional political risk in the aggregate and improves political risk profiles of countries that have opted for more business-friendly administrations. Improved political risk reduces political risk premium, and in turn, allows for more long-term financial stability in Latin America.

But still looming are perhaps the most important elections for the region: congressional and presidential votes in Brazil and Colombia. Polls are mixed, and as of now, presidential candidates representing the left and the right sides of the political spectrum seemingly have equal chances of winning. For us, as well as corporates and investors alike, we do not have the luxury of waiting until elections are over to start planning. So in that sense, we offer a high-level scenario analysis for how presidential elections in Brazil and Colombia could unfold, what the policy priorities of each administration could be and how financial markets may react to either outcome. In short, we expect the political right to win in Colombia and Brazil, and for the Conservative Wave to broaden out to a few of the more economically important regional countries. Colombia's experiment with the left is likely to end, and we believe Lula peaked too early in Brazil's election cycle.

With that said, conviction in each election call is not high. Financial markets could turn volatile in the lead up to each election as candidates jockey for votes via fiscal stimulus and other populist-style actions. But could this volatility be temporary should a shift to the right unfold? Or, could Colombia and Brazil go against the regional grain, double down on the left and have political risk premiums be embedded in local financial markets for longer? Time will tell, and we will provide updates on our election scenarios over the course of each election cycle, especially if our views materially change.

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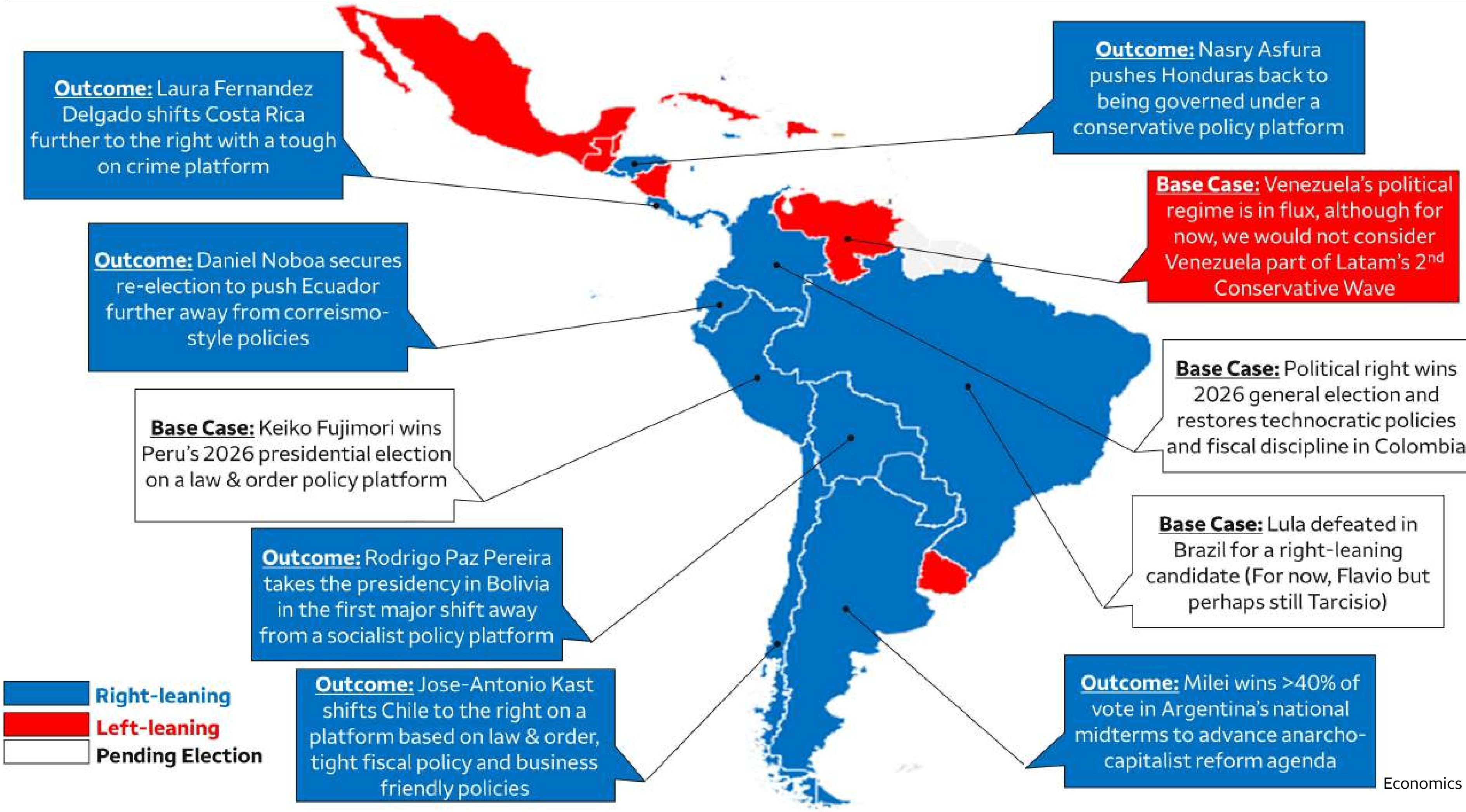
In our view, Latin America will unwind the post-pandemic 2nd "Pink Tide" for a 2nd "Conservative Wave"

Regional politics have shifted across the political spectrum over the last few decades. Following the pandemic, thematically, left-leaning policy platforms were elected in mass for the second time (2nd "Pink Tide"). However, elections over the last few years, and those still to come in 2026, are likely to yield a broad shift back to the right (2nd "Conservative Wave")

Source: Wells Fargo Economics

Momentum behind the 2nd "Conservative Wave" remains intact in early 2026 but major regional elections loom

Costa Rica recently elected a right-leaning political platform to advance Latin America's "Conservative Wave" into 2026. Three major elections are still on the horizon all of which we expect to deepen the conservative movement. Venezuela is still a "left-leaning" nation; however, U.S. intervention and influence could mean a structural political change may be imminent



Brazil's election is set to come into focus in the coming months and we still believe the political right will unseat Lula

Lula Victory (Likelihood: 45%)

Scenario: Lula deploys a populist policy platform centered around enhancing fiscal support to households and defending Brazil's judicial and electoral processes from foreign interference. Fiscal stimulus and defending Brazil's institutions resonates with voters across the wealth and income spectrum, and the recent rise in Lula's approval ratings is sustained through the election cycle. Lula also benefits from a unique position to defer any local market volatility or slowdown in local economic activity on U.S. tariffs/tariff threats. He uses plausible markets and economic deniability to redirect attention away from his administration to elsewhere to help capture a fourth presidential term.

Policy Platform: A fourth Lula term would likely be similar to his prior administrations. In the past, and during his current term, Lula administrations have been defined by loose fiscal policy and the state playing a larger role across Brazil's economy. We would expect similar dynamics in a fourth term, where Lula uses fiscal stimulus as means to generate robust consumer spending and resilient economic activity, while also promoting local development banks (BNDES) to lead low-interest rate lending. Select expenditures may be scaled back; however, Brazil's government debt-to-GDP ratio more rapidly climbs toward and above 100% by the end of Lula's fourth term. "Fiscal dominance" concerns remain top of mind in another Lula-led government, and the Brazilian Central Bank (BCB) turns more cautious toward interest rate reductions to defend against BRL depreciation and runaway inflation expectations.

FX & Monetary Policy: Given Brazil's already unsustainable debt trajectory and market participants' focus on local fiscal trends, BRL weakens sharply. Sporadic BCB FX intervention provides temporary support to BRL but does little to disrupt the overall BRL depreciation trend as political and fiscal risk premium rises. BCB policymakers, already taking a cautious approach to easing, ends the cycle as fears of renewed inflation gather momentum.

Economic Outlook: 2026 GDP growth of ~1.5%, although the longer-term outlook for Brazil's economy is more uncertain. Rather than shifting toward a more business-friendly backdrop, a renewed rise in local political risk delays capex spending and capital flows to Brazil. FX depreciation disrupts consumer spending, although loose fiscal policy supports household spending. Brazil avoids recession, but experiences anemic growth of 1%-1.5% in 2027.

Lula Defeated (Likelihood: 55%)

Base Case: Elevated inflation and local markets volatility prompts voters to opt for a change in the direction of policy. Candidates focused on fiscal responsibility and placing government debt on a more sustainable trajectory gather momentum, especially when fiscal discipline is framed in the context of how spending restraints can result in softer inflation, stable financial markets and lower interest rates. While official candidates are technically still to be determined, we take the view that the overall conservative policy platform rather than the specific candidate will be the driving force of voter intentions. Recent trade and broader tensions with the U.S. add a layer of complexity for the political right to navigate.

Policy Platform: To varying degrees, but candidates that may lead the right (Flavio Bolsonaro or Tarcisio) represent fiscal discipline. While most of Brazil's budget expenditures are rigid and difficult to adjust without constitutional amendments, attempts at social assistance-related expenditure cuts and public sector expenditure reductions can gather momentum. Tax reform and privatizing state-owned assets would likely be pursued, while commitment to Brazil's existing fiscal framework, or an improved version, is reinforced. Winning the presidency is key; however, congressional support will be just as important. Implementing fiscal adjustment needs constitutional amendments with any amendment requiring $3/5^{th's}$ policymaker support in both houses of congress, a threshold that may be difficult to obtain and certainly less likely than the probability of our base case scenario coming to fruition.

FX & Monetary Policy: A shift toward a fiscally conservative government would likely improve investor sentiment toward the Brazilian real and BRL experiences a relief rally after the election. The extent of congressional support for right-leaning policies may prolong the BRL rally into 2027. BCB policymakers adopt a more confident posture that they can continue to lower policy rates after the election as fiscal risks subside and BRL strengthens.

Economic Outlook: We forecast Brazil's economy to experience growth of ~1.5% in 2026. An extended period of restrictive monetary policy places downward pressure on activity that pre-election rate cuts and looser fiscal policy cannot fully offset. A shift to a more business-friendly environment attracts new capital flows and capex spending that combined with more accommodative monetary policy drives a pickup in growth to ~2.5% in 2027.

Source: Wells Fargo Economics

Colombia's presidential election will reveal whether the move left was temporary or a true shift in voter sentiment

Left-leaning Experiment Continues

Likelihood: 45%

Scenario: Petro's approval rating has trended lower during his term and remains suppressed. However, renewed support for Petro's platform and voter interest in whomever Petro endorses as his potential successor could materialize after a large hike in the minimum wage. Petro has not officially endorsed a candidate just yet; however, the internal consultation of Petro's Historic Pact recently elected Ivan Cepeda as the coalition's 2026 presidential candidate. Cepeda is well-known in local political circles and has a similar background to President Petro. Should Petro's support improve, perhaps also on the back of tensions with the U.S. in addition to the minimum wage hike, combined with brand name recognition associated with Cepeda, the left could sneak away with back-to-back wins at presidential elections.

Policy Platform: With Cepeda coming out of the Historic Pact primary, we will focus on the policy platform he may implement. Cepeda is very similar to Petro from a policy perspective, and we would view a Cepeda administration as the policy continuity outcome. In that sense, fiscal balance may be elusive. Public debt dynamics would unlikely improve, and the sovereign debt burden would continue to rise. Cepeda has not made any formal declarations toward restarting oil exploration activity, but should Petro energy policy remain intact Colombia's growth profile as well as external position could continue to weaken.

FX & Monetary Policy: A Cepeda victory in 2026 would keep local political risk elevated and additional underlying FX fundamentals would likely not improve. COP would continue to be a "high vulnerability" currency and particularly sensitive to external shocks or broad risk-off sentiment. If further fiscal slippage materializes COP would be associated with an additional risk premium as the erosion in public finances gets perceived as long-lasting and not a Petro-administration temporary setback in fiscal responsibility.

Shift Back to the Center/Right

Likelihood: 55%

Base Case: Historically, Colombian voters have preferred right-leaning policy platforms, with the election of Petro in 2022 the first major shift to the left side of the political spectrum. Rather than further test left-leaning policies, Colombian voters opt for a shift back right as elevated inflation, rising crime rates, sluggish economic growth and broader policy certainty incentivize voters for a return to conservative policies. Our base case scenario is for a conservative-leaning candidate to win the presidency; however, we have stronger conviction in the direction of policy rather than candidate that will ultimately win. Multiple technocratic candidates in the center-right are emerging (Sergio Fajardo and Abelardo), which can lead to political fragmentation and keeps our conviction in this scenario materializing restrained for the time being.

Policy Platform: Full details are yet to be revealed, but reinstating Colombia's fiscal anchor and restoring policy orthodoxy would be paramount. Implementing corruption control and tough on crime policy as well as technocratic economic policy agenda would also be priorities. Other right-leaning candidates are likely to pursue similar proposals, although with varying degrees of aggression and preference. Regardless of the candidate, we believe a right-leaning administration would put Colombia's fiscal accounts on an improving trajectory and reduce overall country risk.

FX & Monetary Policy: The Colombian peso has become a "high vulnerability" currency as political risks have remained elevated and underlying economic fundamentals have deteriorated. In our view, a shift back toward the center or right will reduce overall FX vulnerability. An additional degree of FX risk premium may be lifted as the trajectory for public finances improves. CDS and sovereign spreads can narrow, while downgrade pressure on Colombia's sovereign rating can stabilize.

Source: Wells Fargo Economics

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