

International Commentary — April 9, 2021

Peruvians Head to the Polls

Summary

Peruvian politics have been unsettled for some years. Multiple Presidents have been impeached or forced to resign, resulting in elevated political risk across the country. Last year was no different as President Vizcarra was impeached as a result of corruption allegations, while his successor, Manuel Merino, was forced to resign amid social unrest after just a few days in office. Since Merino's resignation, Peru has operated under an interim President; however, this weekend elections will take place to determine a new "full-time" administration as well as all seats in Congress. The outcome is far from certain as polls suggest no candidate has a clear path to the Presidency; however, market friendly candidates have made a late push according to recent poll data.

The Peruvian sol has rallied the last few weeks on the prospects of a business friendly candidate taking office. But, with no candidate likely to receive a majority of votes this weekend, we expect a runoff election to take place in June. The composition of candidates in the runoff election should have an influence over the short-term path of the Peruvian currency. Should the market friendly Hernando de Soto make it to the second round of the election, it is possible the currency could continue to rally. However, should the runoff vote be comprised of left-leaning candidates, we would expect the recent rally to stall and for the currency to come under some renewed pressure. Only until after the President and Congress are decided do we expect longer-term and sustained strength in the Peruvian currency.

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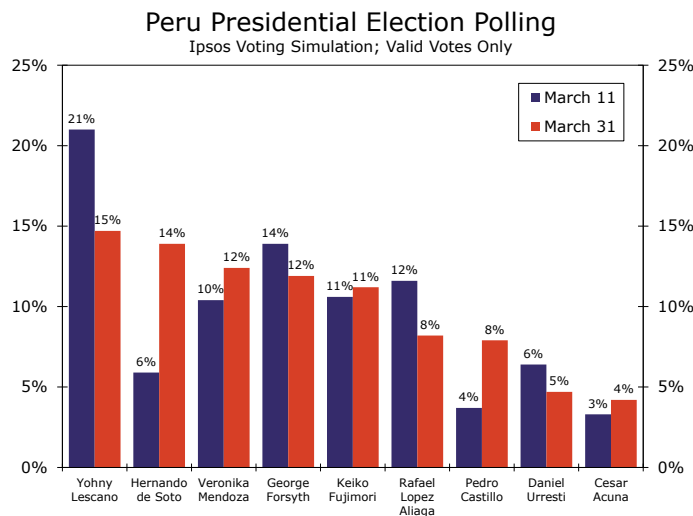
An Attempt at Political Stability

For decades, political risk in Peru has been a market concern. Allegations of corruption and bribery have been rampant and been associated with the highest levels of political office. Since 2000, many former Presidents of Peru have been implicated in corruption allegations tied to the Odebrecht scandal, while others have been investigated or imprisoned. Recently, two of the last three Presidents have either resigned or been impeached due to corruption investigations. Last year arguably marked a new low for Peruvian politics. Martin Vizcarra, widely viewed as a political figure known for his anti-corruption platform, was controversially impeached over bribery allegations. Vizcarra's removal from office sparked politically charged protests across Lima and has even been declared a coup by many local media outlets and political analysts. In the days following Vizcarra's impeachment, his successor, Manuel Merino, was forced to resign from office amid social unrest and allegations of his role in fueling impeachment proceedings against Vizcarra. While Merino's resignation calmed protests and demonstrations, Peru was left with an interim president and elevated political uncertainty.

In an effort to stabilize local politics and at least partially resolve uncertainty, Presidential and Congressional elections are set to take place this weekend. As of now, there are 18 Presidential candidates on the ballot, none of which, according to polls, seem to have enough support to outright win the election this weekend. In Peru, a candidate must accumulate at least 50% of the total votes to win. If no candidate secures a majority, the two candidates with the most votes then go into a runoff election, where the winner of the runoff will be declared President. Recent polls suggest no candidate will secure enough votes to win outright this weekend; however, market and business friendly candidates appear to have gathered momentum, in particular Hernando de Soto. De Soto is an economist by trade, with a track record of supporting policies targeting business and property rights. In addition, he acted as an advisor to prior administrations, was a former board member of the Central Bank of Peru and has also been credited with bringing macroeconomic stability to Peru in the 1990s.

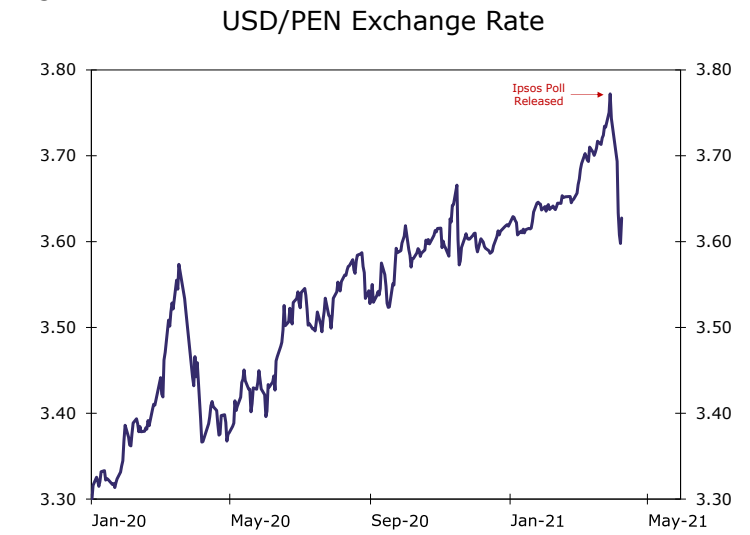
In a March 31 Ipsos poll, support for De Soto jumped and he is now expected to win 14% of the votes, up from only 6% a few weeks earlier. While still well below the needed 50% majority, de Soto has a reasonable chance of making it to the runoff election, a possibility that appeared slim in early March. As a result of the updated polling data, local Peruvian financial markets have rallied over the last two weeks. To that point, the Peruvian sol traded from an all-time low of PEN3.77 against the U.S. dollar to PEN3.60 in a matter of days. Typically, the Peruvian sol is one of the more stable and predictable currencies in Latin America. A 5% move in the sol over the course of a few days is relatively large and could be interpreted as a signal financial markets are becoming more confident in the prospects for political stability in Peru.

Figure 1.



Source: Ipsos and Wells Fargo Securities

Figure 2.



Source: Bloomberg LP and Wells Fargo Securities

Expect Short-term Currency Swings

Despite the recent rally in the currency, we believe further outsized moves could still be coming. With no candidate likely to win a majority of votes this weekend, we expect the election to head to a runoff. As of now, the runoff election is scheduled for June and we believe the composition of the runoff candidates will have a short-term impact on the path of the Peruvian sol. To that point, if polls are accurate and de Soto does indeed make it to the runoff, we would expect the sol to continue to strengthen. The scenario that could result in the most upside for the currency would be de Soto securing a commanding lead this weekend and have little in his way to win the Presidency. While this scenario is a low probability event, any elevated likelihood of him winning the Presidency would probably result in a further rally in the currency and for USD/PEN to break below PEN3.60.

However, it is very uncertain who will wind up in the June runoff. Most top candidates have campaigned on "left-leaning" policy agendas, and according to the most recent Ipsos poll, it is entirely plausible the runoff could include two of these candidates. Yohny Lescanao as well as former soccer star George Forsyth are billed as more left-center politicians, while Veronika Mendoza is an outspoken leader of the democratic socialist "New Peru" movement. As of the end of March, Lescanao could have the most support, while Mendoza and Forsyth are not far behind. A runoff election of Lescanao and Forsyth could result in modest weakness for the Peruvian currency; however, should Mendoza win a place in the runoff, the currency could under more pressure. Any sign Peruvian politics could be headed in a more populist or socialist agenda could create elevated financial market volatility, which might see the sol retest its recent weakest levels against the U.S. dollar.

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