

# POPULISM REVISITED: EXPECT MORE TWISTS AND TURNS AHEAD

Updating our two-year-old research on populism, we find that the agenda continues to advance on multiple fronts. Investors should expect more populist policies in the years ahead, which is likely to shift macroeconomic outcomes in a more challenging direction.

In the second half of 2016, following the Brexit vote and the emergence of Donald Trump as a US presidential candidate, we kicked off a research initiative into the rise of populism. The goal was to understand populism's drivers, how long the shift might last and what it could mean for the global economy and markets.

Was the tidal shift in politics temporary, reflecting influences such as residual anger from the global financial crisis of 2008–2009, or from the handling of the European sovereign crisis? If this were true, we would see a return to “normal” for politics and policy as economies recovered. Policymaking would revert to what had been its guiding framework since the early 1980s—an emphasis on global openness, independent macroeconomic policy and market deregulation.

But if populism were a structural theme, it would have a much more lasting impact. In this case, populism would reflect long-term trends, including rising inequality, stagnant incomes, fears of disruption and a sense that the political system just wasn't delivering. In this world, we would see a “new” policy architecture that would likely be delivered through three main channels:

1. **Raising the drawbridge**, as policies become more local and less global
2. **Institutional erosion**, with institutions facing attacks or being undermined
3. **Redistribution**, characterized by efforts to transfer wealth among society's segments

When we conducted the initial research, our thinking was heavily biased toward viewing populism as a far-reaching structural theme. One of our major conclusions: this political dynamic would likely be a central factor in driving global inflation higher over the medium term.

Two years after that initial research, does populism seem mostly temporary, or does our initial conclusion of a long-term political shift still stand? To answer that question, we first needed to look at how politics and policies have evolved. Based on what we see, the factors driving populism seem to be alive and well.



**Guy Bruten**  
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**THE UNDERLYING FACTORS  
DRIVING POPULISM SEEM  
ALIVE AND WELL.**

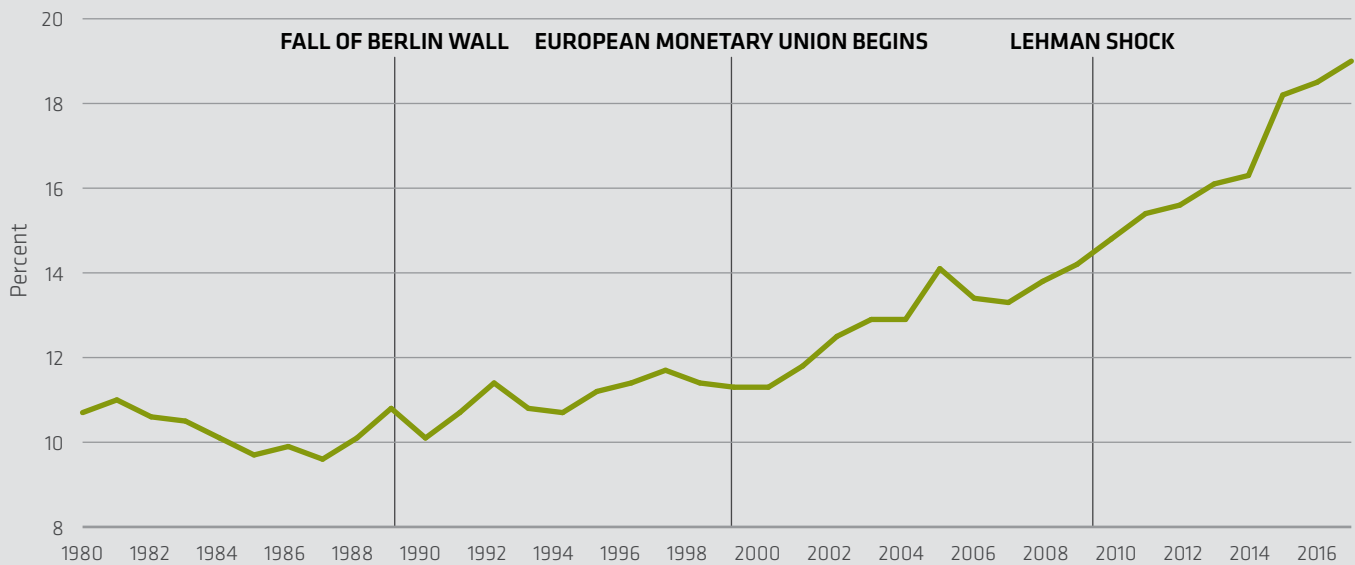
### THE POLITICS: DISILLUSIONMENT CONTINUES TO GROW

The global economic backdrop has continued to improve, with unemployment rates in many developed-market economies sitting at multidecade lows. But despite this progress, the attraction of populist candidates has continued unabated.

Candidates or parties who paint debates in simple choices—“us” versus “them,” “the people” versus “the corrupt elites” or other constructs—are taking a bigger share of the popular vote (*Display 1*). These groups push a similar agenda: at its core, the message is antiestablishment, authoritarian and nativist. Across Europe, these inroads continue a trend that’s been under way since the early 1990s.

#### DISPLAY 1: POPULISM IS STILL ON THE RISE

Share of Votes for Populist Parties



Through December 31, 2017

Source: Timbro (data extracted using WebPlotDigitizer)



**DEEP-SEATED TRENDS ARE DRIVING THE SENSE THAT CURRENT POLITICAL INSTITUTIONS AREN'T DELIVERING.**

It's not surprising that populists are now in charge in Italy, given how poorly the Italian economy has performed under the European Monetary Union. But even in Germany, recent state electoral results showed a further deterioration of the political center in favor of both the left and right extremes.

The erosion of the center is picking up across emerging countries, too, with populists elected to head Latin America's two largest economies in the second half of 2018. Andrés Manuel López Obrador, from the left side of the political spectrum, was elected in Mexico last July. From the right, Jair Bolsonaro was elected in Brazil last October. Both rode waves of popular disillusion with mainstream politics.

Meanwhile, the Brexit saga continues to roll on and the US midterm elections fell short of the "blue wave" revolt that some had expected.

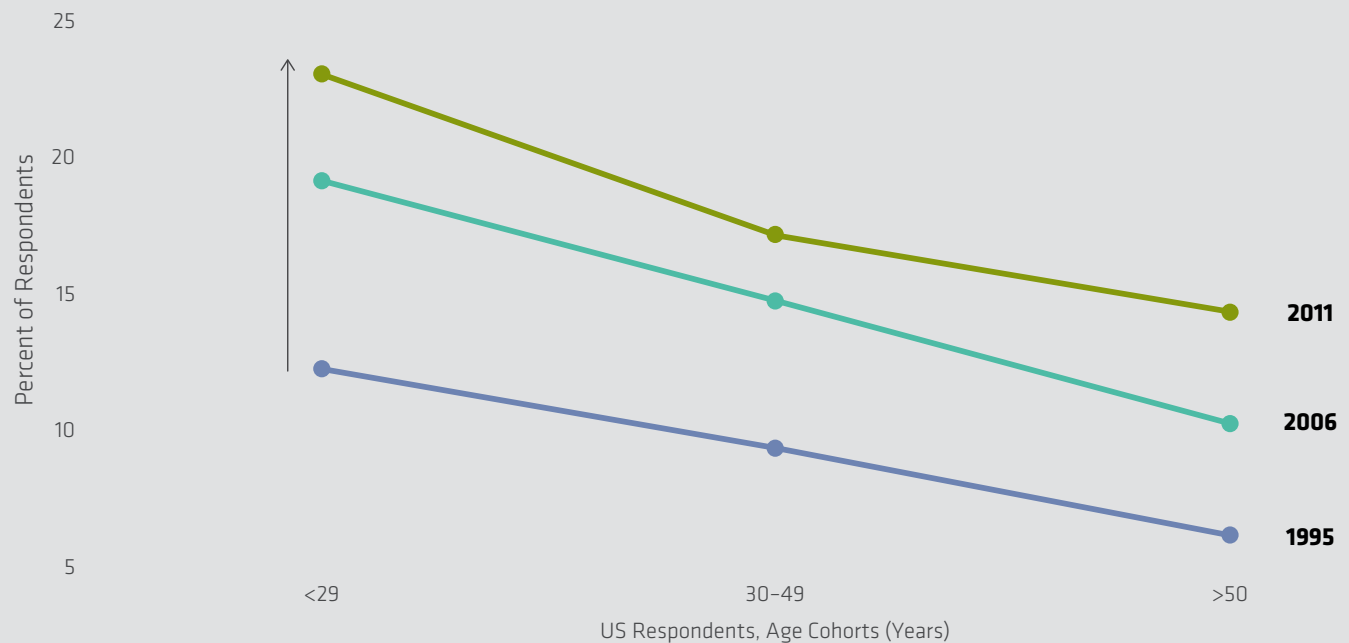
All in all, it seems pretty safe to say that concerns about what the populist urge might bring next are only intensifying.

There are deep-seated causes for this shift in global political dynamics. Income and wealth inequality has been widening since the early 1980s. Disruptive forces from globalization, technological change and other factors are increasing the stresses from high debt levels and aging populations. All of this is driving the sense that current political institutions aren't delivering—a sense that's heightened among younger generations (*Display 2*).

The bottom line, as we see it, is that populist forces are here to stay. But how effectively have these political forces been channeled into tangible actions that will impact economies and markets? To answer that question, we need to update our three channels with the benefit of nearly two years of experience.

**DISPLAY 2: DEMOCRATIC DISSATISFACTION HIGHER AMONG THE YOUNG**

Percent of US Citizens Who Feel that the Democratic System Is "Fairly Bad" or "Very Bad"



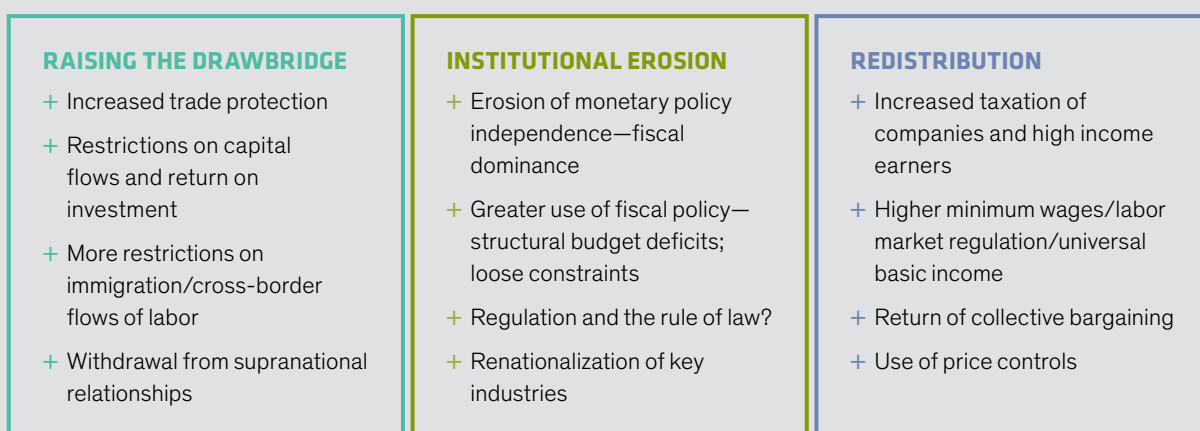
Latest available data on Wave 6 survey from World Values Surveys as of October 31, 2018  
Source: World Values Surveys

## ASSESSING ADVANCES IN POPULISM'S THREE MAIN CHANNELS

Our original research drew on previous episodes of populism (particularly those in Latin America) and then-current populist agendas to group expected policy changes into the three broad channels mentioned earlier: raising the drawbridge, institutional erosion and redistribution.

The sequencing of policy changes has varied from country to country, but if populism is as persistent as we think it is, the advances should be noticeable at this point. Two years on, the “progress” report shows that populism has continued to advance (*Display 3*)—but to different degrees in each channel.

### DISPLAY 3: THE RISE OF POPULISM—REVISITING THE THREE KEY CHANNELS



Evidence Increasing/Decreasing?



Source: AB

### RAISING THE DRAWBRIDGE—ABUNDANT EVIDENCE

Of the three channels, we’ve certainly seen much evidence of policy advances in raising the drawbridge, a category in which policies become more “national” and less “global.” These include restrictions on trade, labor and capital flows. This channel is also a conduit for reduced multilateral cooperation and coordination, as well as other policies, that help one country but hurt its neighbors.

We’ve seen an ongoing trade conflict between the US and its partners, including China, Canada and Mexico. There are also the withdrawals from multinational arrangements, such as the Trans-Pacific Partnership and the Paris Climate Accord. Anti-Brexit and anti-Brussels sentiment apply here, too. There’s really no shortage of examples to choose from.

### INSTITUTIONAL EROSION—SUBSTANTIAL EVIDENCE

We’ve also seen numerous examples in the second channel, institutional erosion. This conduit includes measures to undermine

or ignore constraints on political behavior—or threats to the independence of central institutions, such as the media and the judiciary. Attacks on institutions can also seek to dismiss financing constraints in fiscal policy and weaken central bank independence.

In the last couple of years, there have been many attacks on media independence, from President Trump’s complaints about “fake news” to the closure or limiting of media outlets in Hungary and Turkey. Fiscal policy constraints are also being ignored—notably in the US, but also in Europe, by way of Italy’s budget proposals.

There are also signs that the days of independent central banks may be numbered, from open criticism of the Fed to Turkey’s President Recep Tayyip Erdogan stating that his patience on central bank policy “has limits.” The dispute between India’s Prime Minister Narendra Modi and Governor Urjit Patel over the Reserve Bank of India’s independence is just the third in what are certainly more examples.

### REDISTRIBUTION—SOMEWHAT LIMITED EVIDENCE

In the third channel—where we’d expect to see efforts to transfer wealth from one group to another, often through the budgetary process—there’s less evidence of policy action. This action might include initiatives to shift wealth from the “rich” to the “poor,” from the “elites” to the “people,” or from “corrupt corporations” to the “workers.”

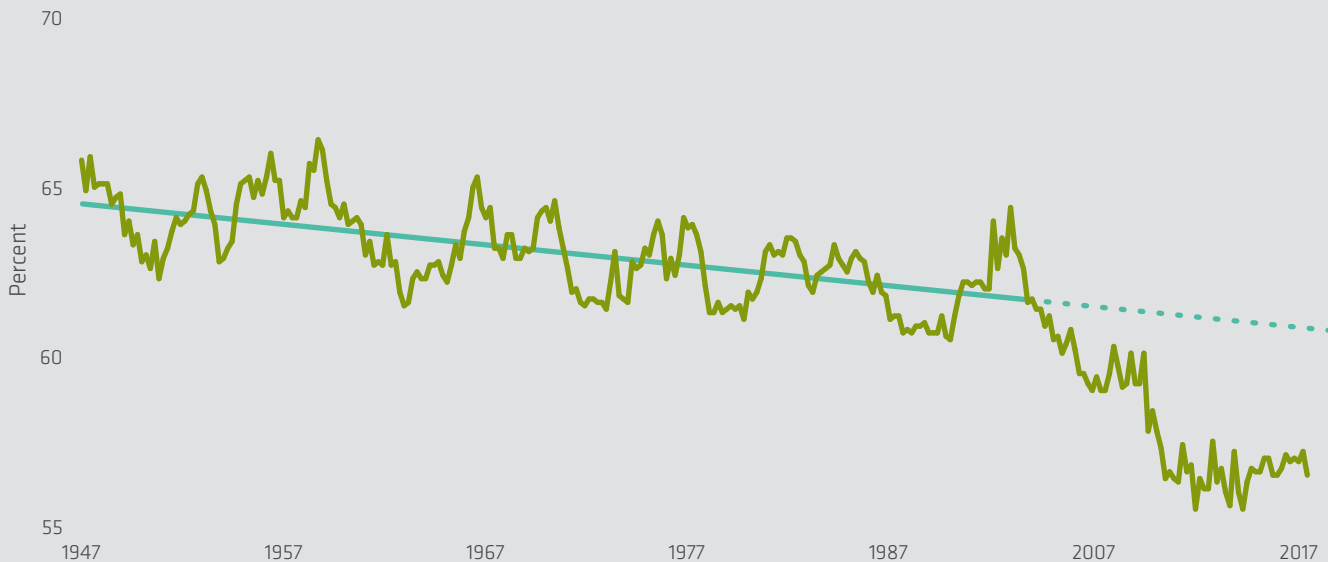
National income has been shifting away from labor for quite some time. In the US, labor’s share of income has fallen from percentages in the mid-60s to percentages in the mid-50s since 1945—a decline that accelerated sharply in the 2000s (*Display 4*). The story is similar in many industrialized countries, but it has largely flown under the radar so far.

The increased globalization, technological disruption and institutional change that have compressed living standards for workers at the middle to bottom end of income distribution have also bolstered corporate profits. But for whatever reason, the corporate sector hasn’t yet been a lightning rod for populist anger in the way that China, “free trade” or “the Washington swamp” have.

Sure, there have been some efforts to raise minimum wages—witness South Korean President Moon Jae-in’s minimum wage hikes of 16% in 2018 and 10% in 2019 as a concrete example. But we haven’t seen broader attempts to shift the balance of bargaining power from capital back toward labor—at least not yet.

#### DISPLAY 4: LABOR VERSUS CAPITAL—GREATER CONFLICT AHEAD?

Labor’s Share of Income in US Non-Farm Business Sector



Through June 30, 2018  
Source: US Bureau of Labor Statistics

### THE POLICY FRONT: COMING ATTRACTIONS

What policy measures are we likely to see over the next couple of years? To some extent, we can simply extrapolate from what we've already seen. The idea of becoming less global and more national will probably last—whether through trade disputes, arguments over who pays for NATO, the Brexit divorce or a broader European backlash against Brussels.

We're likely to see economic policy challenges reflected in more erosion of institutions. One of the easiest ways to cope with public sector finances that are bloated by debt is for governments to lean on central banks to keep things moving. It raises the potential for more helicopter money—central-bank-financed fiscal stimulus.

One new area populist policies could target is the corporate sector. Two avenues have already emerged. The first is a rethink of competitive, or antitrust, policies. In recent decades, these policies have made many industries more concentrated across developed markets, with a handful of firms—or sometimes one—dominating. Concentration has also driven consumer prices down (like the “Amazon effect”), so it hasn't entered the sights of antitrust regulators.

But that could change. There have already been second thoughts on this policy stance, partly intertwined with the idea that competitive dominance comes hand-in-hand with political power and the ability to exert a broader influence on public policy. It's not out of the question that we see a return to the sort of antitrust policy that ruled before the 1980s.

The second avenue to greater corporate scrutiny is through more explicit initiatives to shift the balance of power back toward labor.

The UK Labour Party's manifesto under Jeremy Corbyn outlines some of the possibilities, including a four-day work week, mandatory employee representation on boards and a bigger role for unions in collective bargaining. As a group, these measures would shift policy from decades of being business friendly to a decidedly labor-friendly tone.

### ASSESSING THE MACRO IMPACT: WATCH THE MIX

The populist shift is already impacting the global macroeconomic outlook. We've been emphasizing the ramifications of these policies for the medium-term inflation path, but there are plenty of near-term consequences, too.

For example, the Trump administration's fiscal-spending boost continues to put upward pressure on US interest rates. The ongoing trade dispute between the US and China is muddying China's growth prospects. The long and uncertain negotiations over Brexit and uncertainty about Italy's political situation cast a shadow on Europe's economic outlook.

The bottom line, from our perspective, is that we shouldn't expect a return to the policymaking orthodoxy of the decades that led up to the global financial crisis. More populist-inspired initiatives through the three main channels—raising the drawbridge, institutional erosion and redistribution—are likely.

Together, these policies are likely to shift potential macro outcomes in a more challenging direction. Even if nominal income growth were to stay the same, the mix would surely change, and we would see higher inflation, lower economic growth rates and more pressure on corporate profit margins.



**POPULIST-INSPIRED POLICIES WILL  
LIKELY LEAD TO HIGHER INFLATION,  
LOWER GROWTH AND MORE PRESSURE  
ON CORPORATE PROFIT MARGINS.**



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