

# Peru Economic Outlook Second quarter 2017

April 2017



## Main messages

1. **World growth continues apace**, accompanied by a certain clarification regarding US policy. Overall, global risk remains a concern.
2. **Economic activity.** We have cut back our growth projection for 2017 from 3.5% to 2.5% in view of weak data in 1Q2017 and the “El Niño Costero” weather phenomenon.
3. **Exchange rate.** The PEN has depreciated due to the reduction in the interest rate differential between soles and US dollars. Improving trade figures and capital inflows will limit the depreciation.
4. **Inflation.** Temporary uptick due to supply shocks. It will start to come down from the second half of this year
5. **Monetary Policy Rate.** The central bank has hinted at a more dovish stance. We are projecting two rate cuts of 25 bps each in the remainder of 2017.



# 1. GLOBAL

Growth is taking hold, but  
there are still risks



## Positive global dynamic takes hold

The main trends continue...

Recovery of  
industrial activity and  
international trade confirmed

No stresses in financial markets

Headline inflation continues to rise,  
but core inflation holds steady

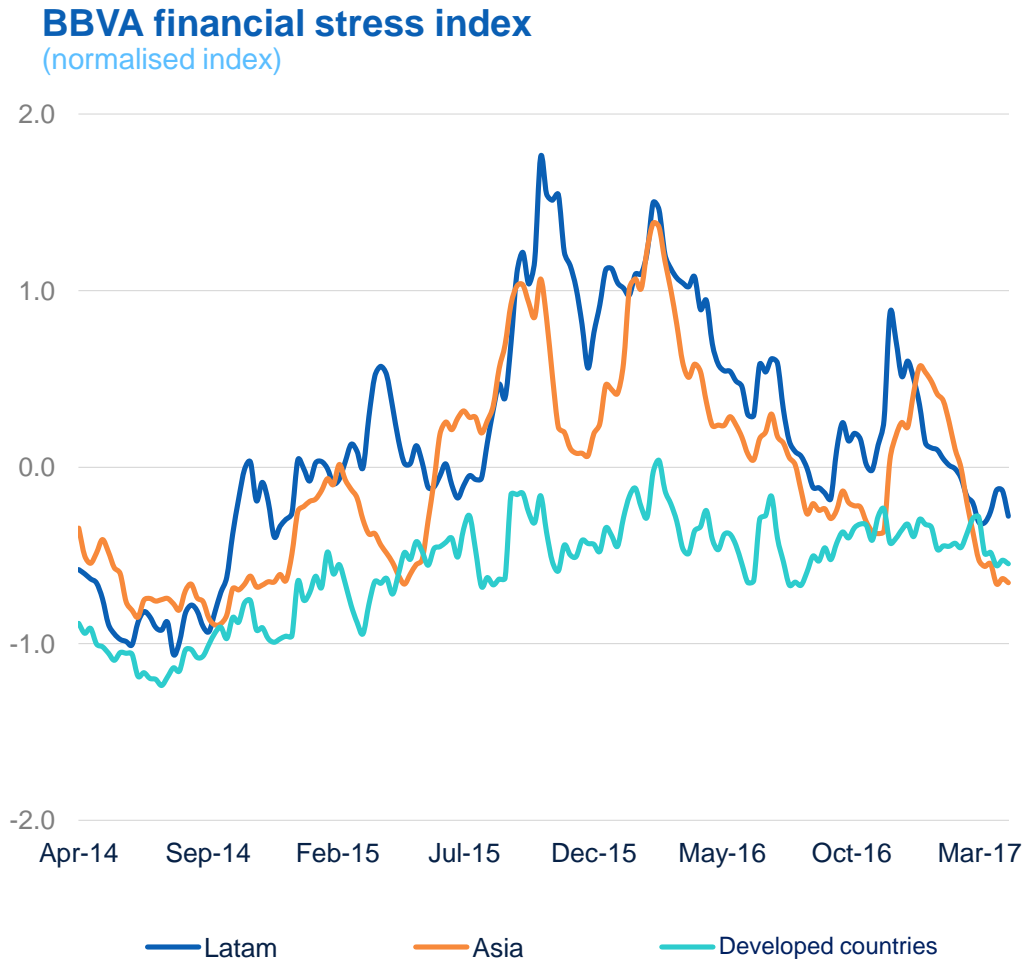
...and the probability of the baseline  
scenario increases

Substantial stimulus to the US  
economy seems less likely...

...but so do more  
protectionist scenarios

Central banks move  
towards normalisation

## Financial stresses remain low



Source: BBVA Research

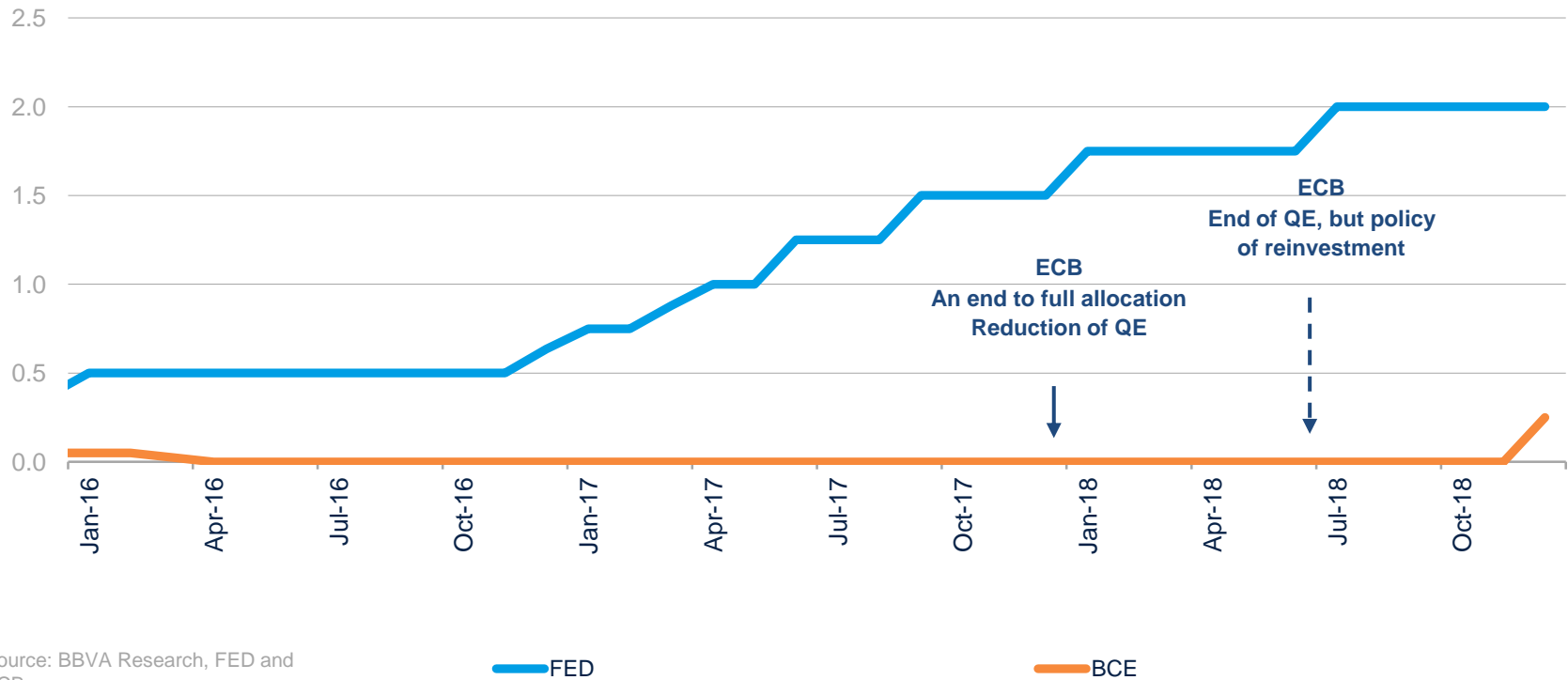
- ◆ Volatility has fallen despite uncertainty about economic policy
- ◆ Monetary stimulus measures mask a certain underlying unease
- ◆ Europe has been the exception, with sovereign spreads widening somewhat in connection with the French elections and the overall political panorama



# Central banks move towards normalisation of their policies

## US Federal Reserve and European Central Bank (ECB) interest rates

(bps)



Source: BBVA Research, FED and ECB

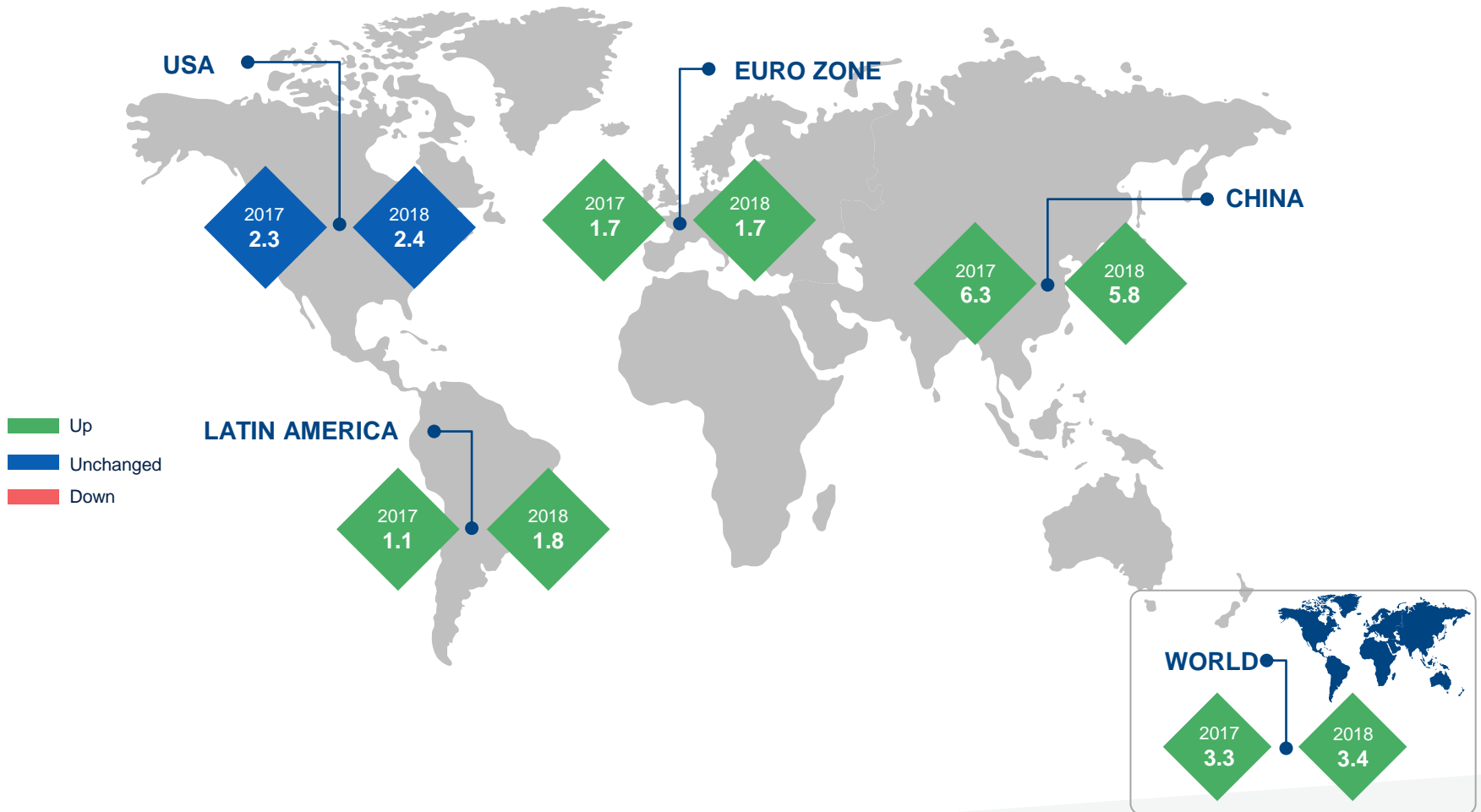
FED

BCE

The Federal Reserve continues to raise its monetary policy rate, although it remains cautious as far as the economic panorama is concerned

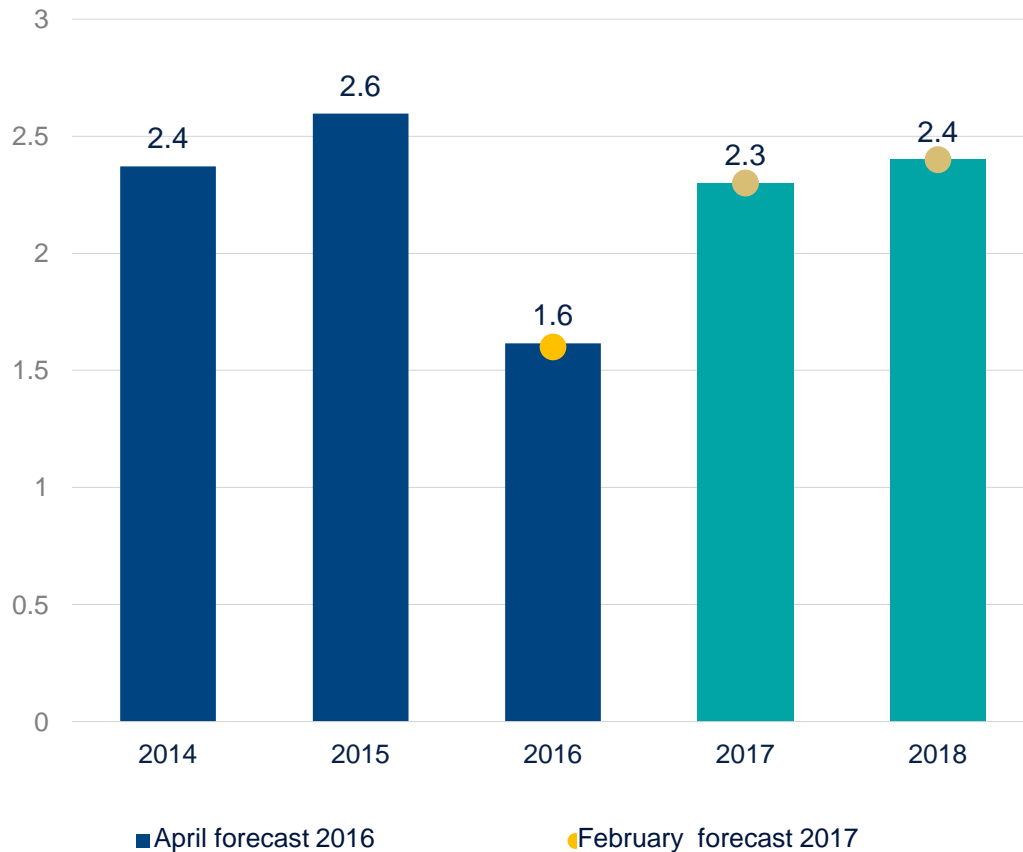
The ECB is increasingly discussing exit guidelines for monetary policy

# World growth revised upwards...



# USA: expected boost to the economy delayed

## GDP growth (YoY, %)

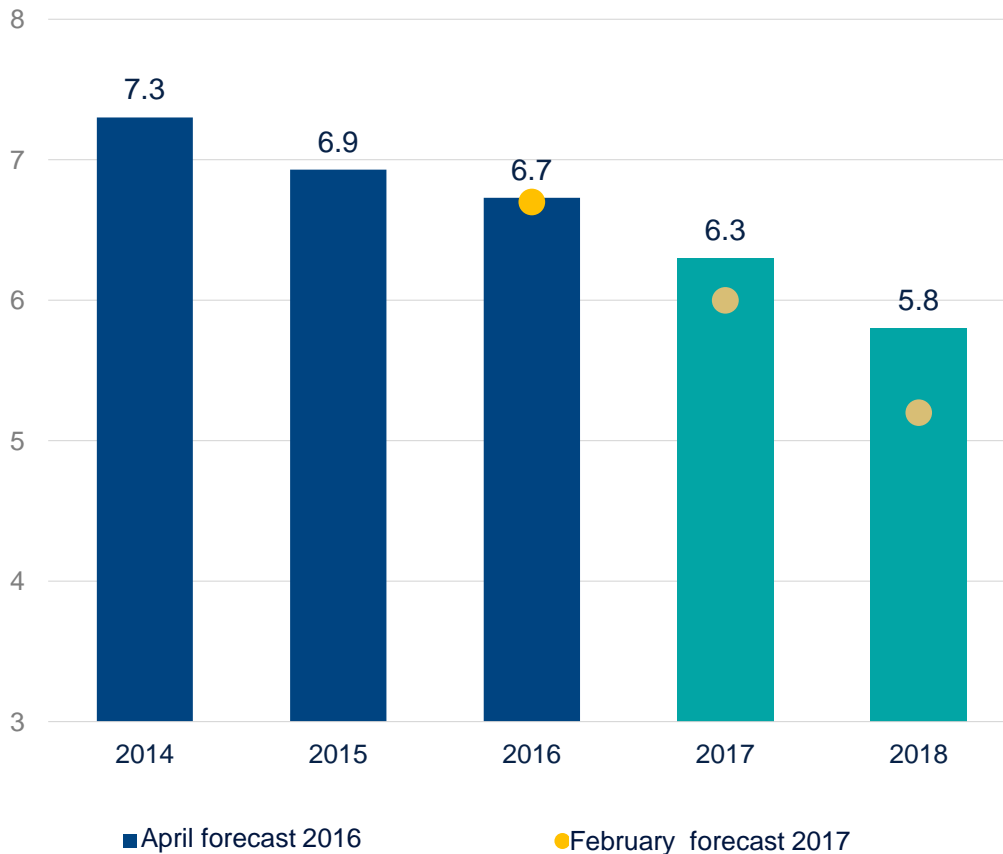


- ◆ **Accelerating activity in 2017** due to the expected improvement in investment; however, consumption is rather less dynamic
- ◆ **Economic policy risk continues** despite the more optimistic tone in recent months



# China: a new push from old drivers

## GDP growth (YoY, %)

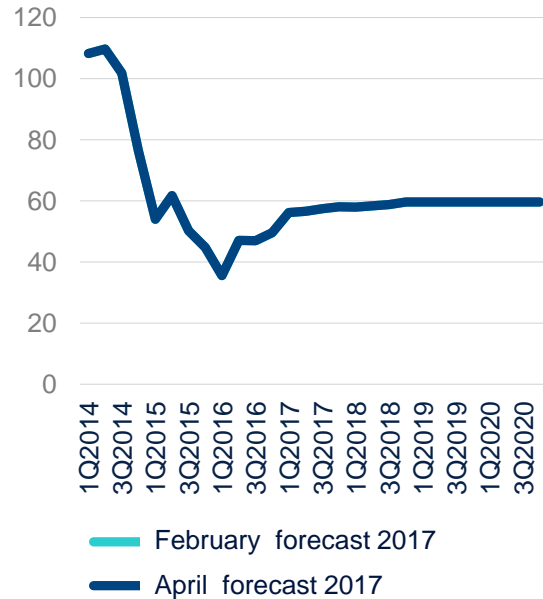


◆ We have revised our growth forecasts for 2017 and 2018 upwards in the light of recent figures and fiscal support. Gradual slowdown under way.

- ◆ Nevertheless, medium-term risk is still considerable:
- The rebalancing process toward services and consumer spending has stagnated
  - Economic policy mistakes may lead to a disorderly deleveraging process

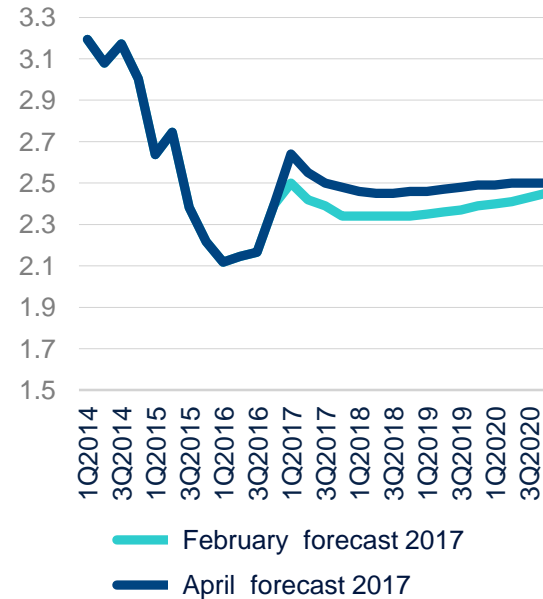
# Commodities: we continue to see commodity prices gently converging to their long-term equilibrium

**BRENT CRUDE**  
(US\$ per barrel)



Source: BBVA Research and Bloomberg

**COPPER**  
(US\$ per lb.)



Source: BBVA Research and Bloomberg

Oil prices continue to rely on the OPEC agreement on production limits and the increase in demand. Copper prices benefit not only from greater demand but also from interruptions in supply.

No significant change in long-term outlook for commodities.

## The main global risks for the region and for Peru centre on policies in the US and rebalancing in China

1



Lingering uncertainty about **measures to be taken in the US**, especially regarding trade

2



The monetary policy stimulus measures taken to bolster the recent strength of investment in **China** may hold up the process of reducing imbalances

3



**Election results in France and Italy** in the (unlikely) event of a win for anti-EU parties

4

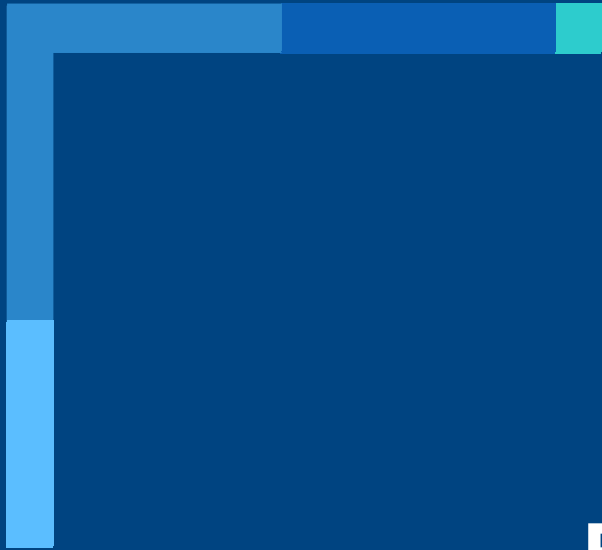


Risks associated with the **normalisation of monetary policy**, especially in the US.

## 2. PERU

Growth hit by weak domestic demand and the “El Niño Costero” weather phenomenon

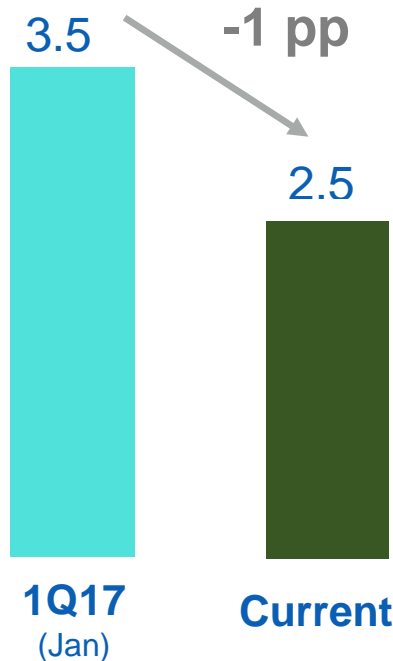




# Economic activity

# We are cutting back our growth forecast for 2017

**GDP 2017**  
(chge. % YoY)



## 1 pp less growth:

Figures for the first two months of the year weaker than expected

**-0.2**

Effects of the “El Niño Costero” weather phenomenon

**-0.6**

Fall in business confidence

**-0.2**

Less public spending on infrastructure (Lima Metro Line 2 and Talara Refinery modernisation)

**-0.5**

Public spending on emergency/reconstruction (implying a deficit of 2.9% of GDP)

**+0.5**

Source: Central Bank of Peru and BBVA Research

## “El Niño Costero”: damage to infrastructure estimated at equivalent to 1.9% of GDP

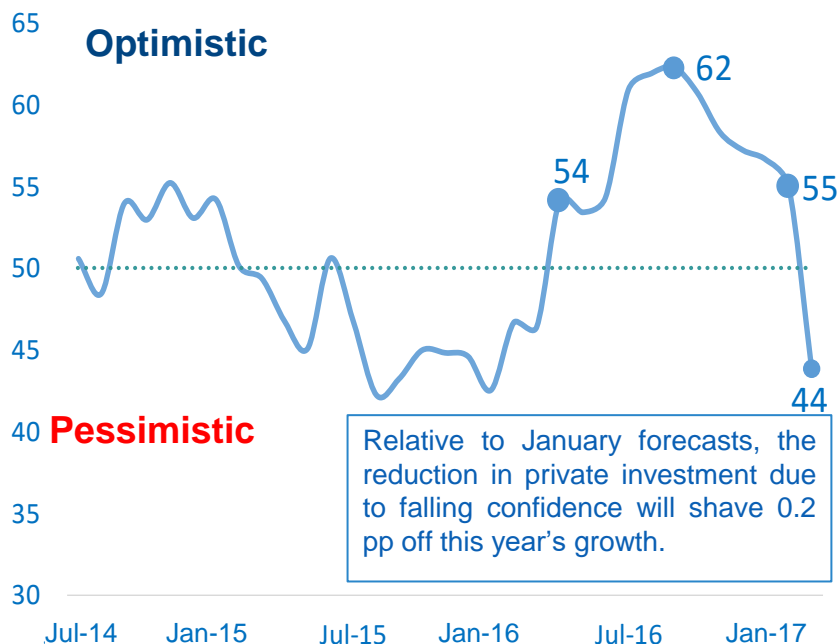
### Damage to infrastructure caused by El Niño Costero\*

<b>Sectors</b>	<b>Units</b>	<b>USD Millions</b>	<b>% Part.</b>	<b>% GDP</b>
Roads (Km)	8,951	1,424	35	0.7
Housing (Units)	278,123	944	24	0.4
Bridges (Units)	839	474	12	0.2
Farming areas (Ha)	82,083	234	6	0.1
Schools (Units)	2,165	152	4	0.1
Irrigation canals (Km)	23,176	628	16	0.3
Country tracks (Km)	12,843	68	2	0.0
Health centres (Units)	742	91	2	0.0
<b>Total</b>		<b>4,015</b>	<b>100</b>	<b>1.9</b>



# Confidence in negative territory

## Business confidence (index in points\*)



\*Values of more (less) than 50 indicate expectations of better (worse) economic performance in the next three months

Source: Central Bank of Peru and BBVA Research

## Consumer confidence (index in points)

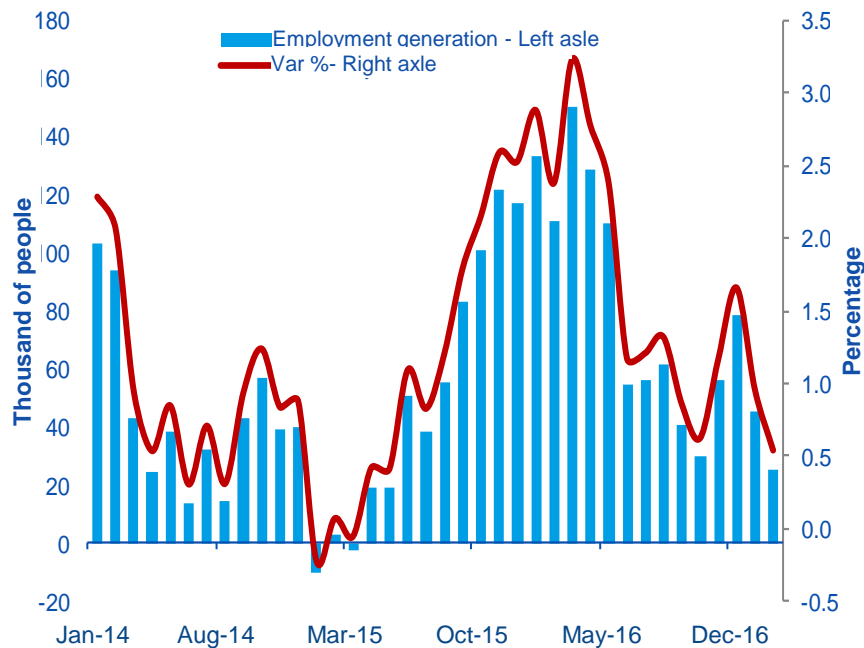


Source: Apoyo Consultoría and BBVA Research

# Job creation in Greater Lima slows, with a fall in suitable employment for the first time since 2005

## Job creation

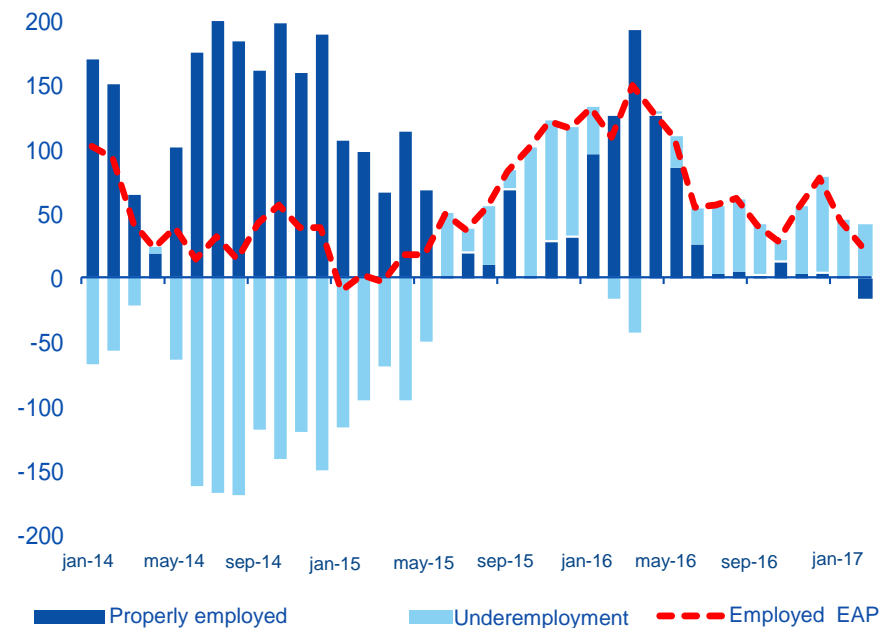
(number of people in thousands and chge. % YoY)



Source: INEI

## Job creation by category

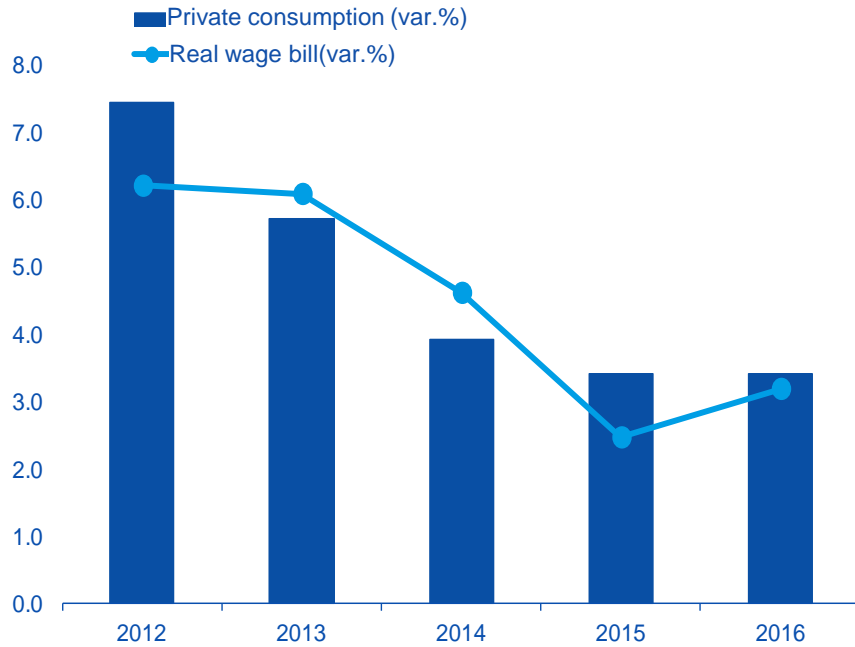
(number of people in thousands)



Source: INEI

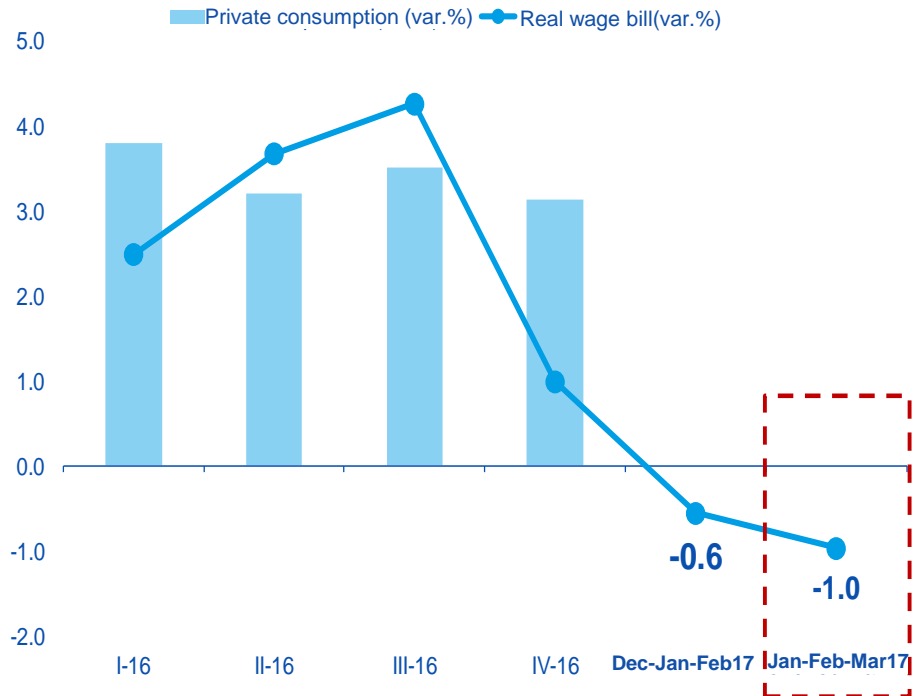
# Slowdown in job creation and deterioration in quality of employment affects total household incomes and will slow consumption in the remainder of the year

**Total payroll and private consumption**  
(chge. % YoY)



Source: INEI

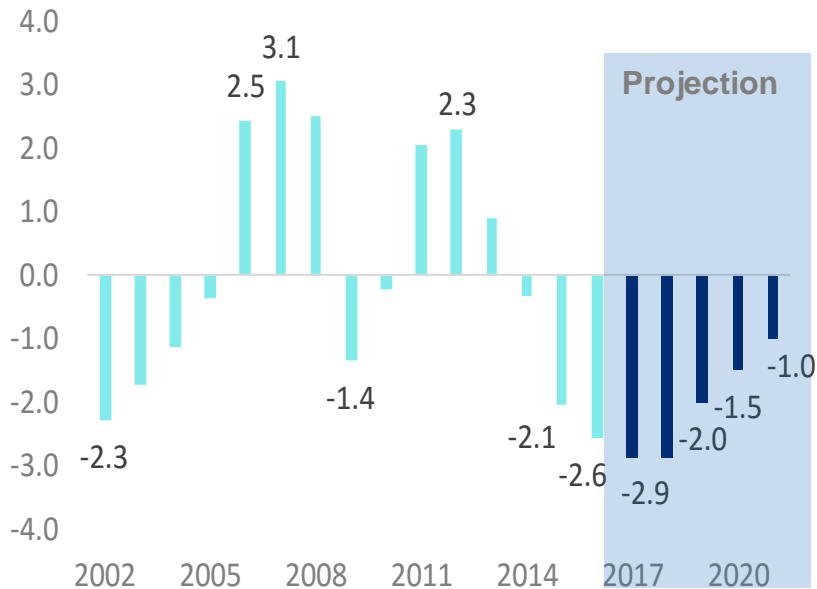
**Total payroll and private consumption**  
(chge. % YoY)



Source: INEI

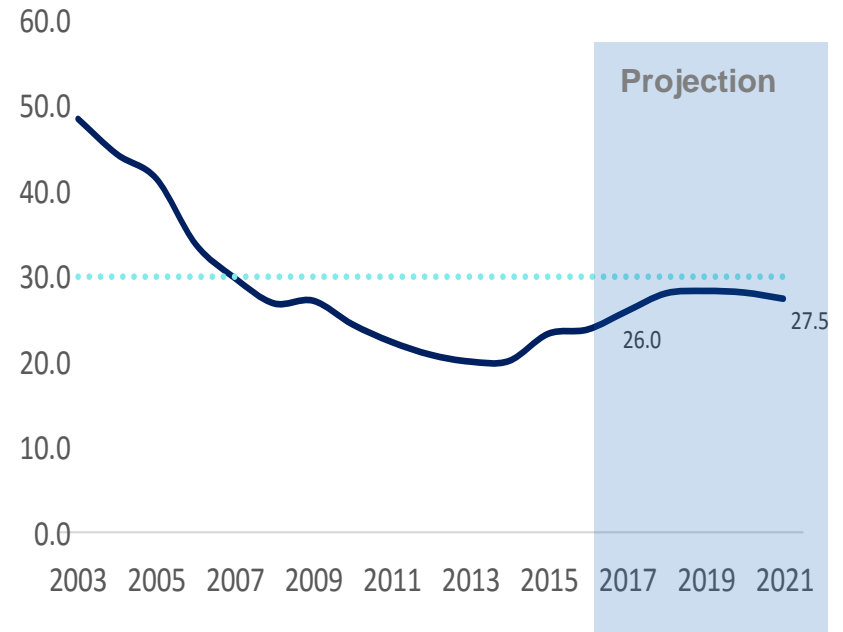
# Public deficit will increase temporarily due to the reconstruction effort, but without endangering fiscal sustainability

**Fiscal result**  
(% of GDP)



Source: Central Bank of Peru and BBVA Research

**Public Debt**  
(% of GDP)



Source: Central Bank of Peru and BBVA Research

# Peru: GDP growth in 2017 by sector

## GDP by sector (chge. % YoY)

	2016	2017
Agriculture	1.8	2.0
Fishing	-10.1	17.0
Mining and oil and gas	16.3	4.2
Metal mining	21.2	4.1
Oil and gas	-5.4	4.8
Manufacturing	-1.6	0.1
Primary	-0.5	4.3
Non - Primary	-1.9	-1.4
Electricity and water	7.3	4.0
Construction	-3.1	0.8
Trade	1.8	0.9
Other services	4.3	3.2
<b>Global GDP</b>	<b>3.9</b>	<b>2.5</b>
Primary GDP	9.8	3.9
Non - primary GDP	2.4	2.0

Anchovy catch projected at 4.3 million metric tons for the year

Mining: copper up by 7.3%  
Oil: commissioning of oil pipeline

Reconstruction works

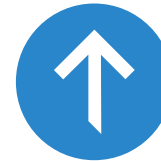
Less private spending

Source: BBVA Research

# Peru: GDP growth in 2017 from the expenditure point of view

## GDP from expenditure point of view (chge. % YoY)

	2016	2017
<b>1. Domestic Demand</b>	<b>0.9</b>	<b>2.1</b>
a. Private Consumption	3.4	2.7
b. Public Consumption	-0.5	5.4
c. Gross Domestic Investment	-4.9	-1.4
Gross Fixed Investment	-5.0	0.4
- Private	-6.1	-1.5
- Public	-0.5	8.0
2. Exports	9.7	2.2
<b>3. GDP</b>	<b>3.9</b>	<b>2.5</b>
4. Imports	-2.3	0.5
<b>Contribution to growth (pp)</b>		
Private Expenditure	1.0	1.4
Public Expenditure	-0.1	1.0



Public spending up  
due to reconstruction,  
taking fiscal deficit to  
2.9% of GDP

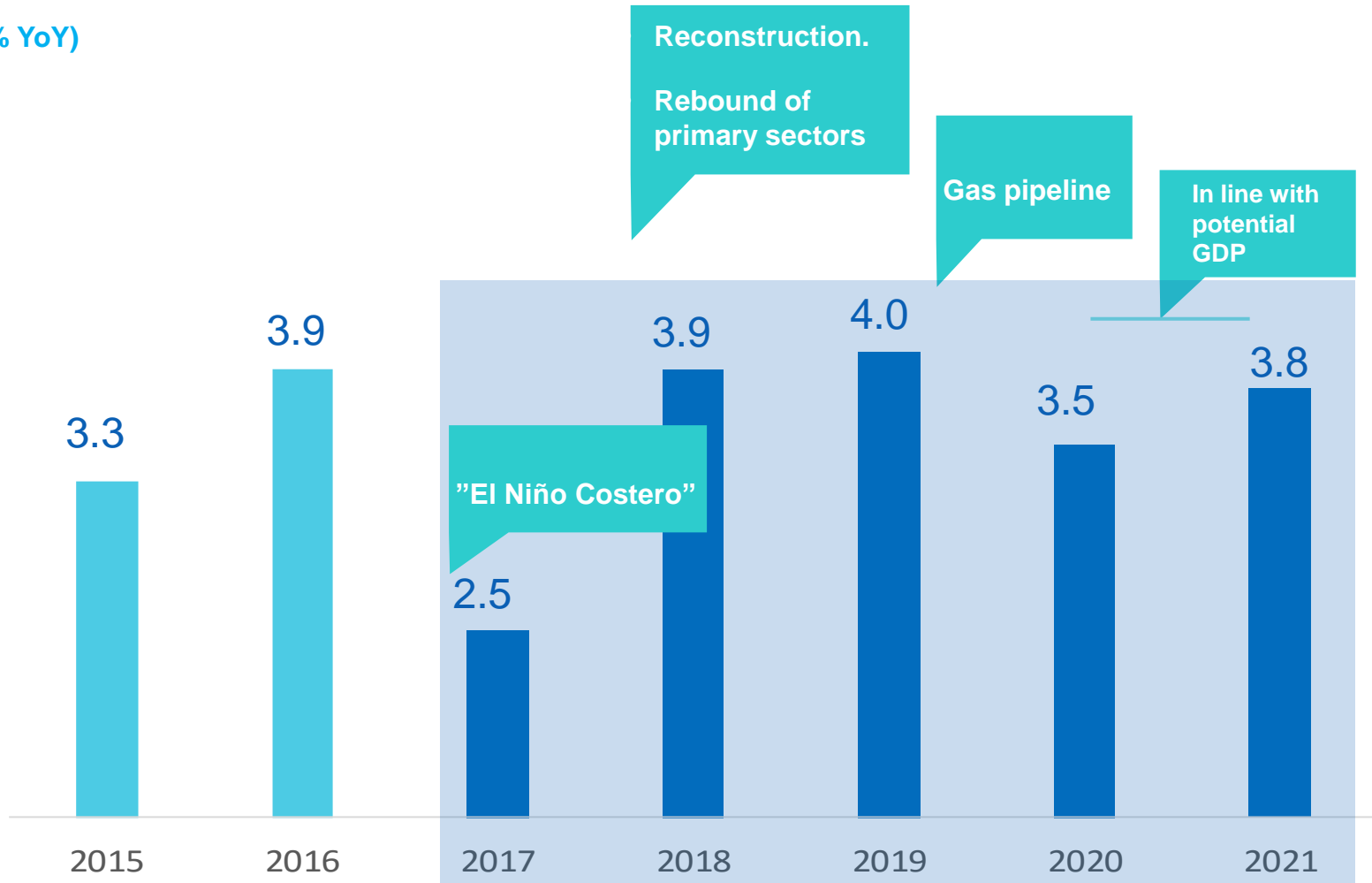


Private demand will  
remain weak: falling  
investment and  
slowing consumption

Source: Central Bank of Peru and BBVA Research

# Peru: temporary acceleration in growth in 2018 and 2019

**GDP**  
(chge. % YoY)





## Peru: risks to growth forecasts

### External

**More marked slowdown in China's economy**

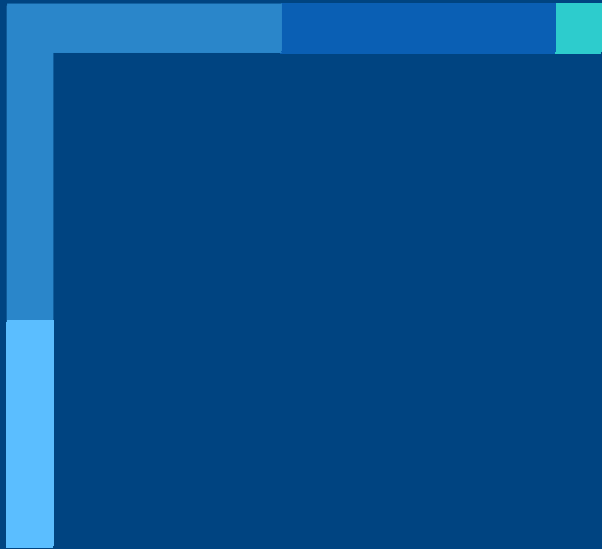
**Uncertainty about policies of the new US administration  
(fiscal, trade, deregulation and immigration)**

### Domestic

**More delays in carrying out infrastructure works**

**Confidence failing to recover, or even continuing to fall**

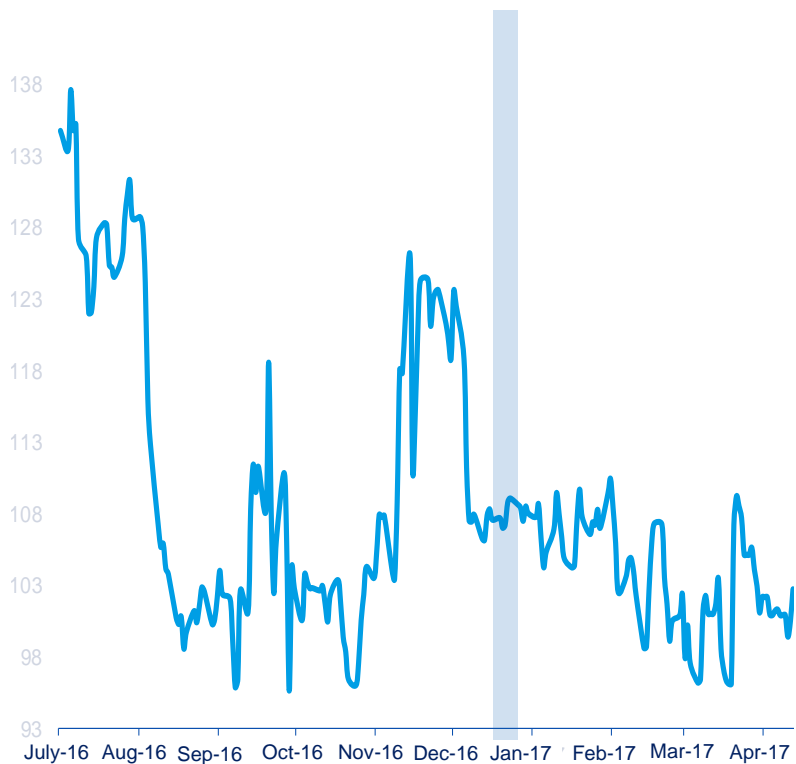
**Execution of public spending not achieved**



# Financial markets and exchange rate

# Risk indicators have moderated so far this year...

## Peru CDS at 5 years (bps)



Source: Bloomberg

## EMBIG Peru (bps)

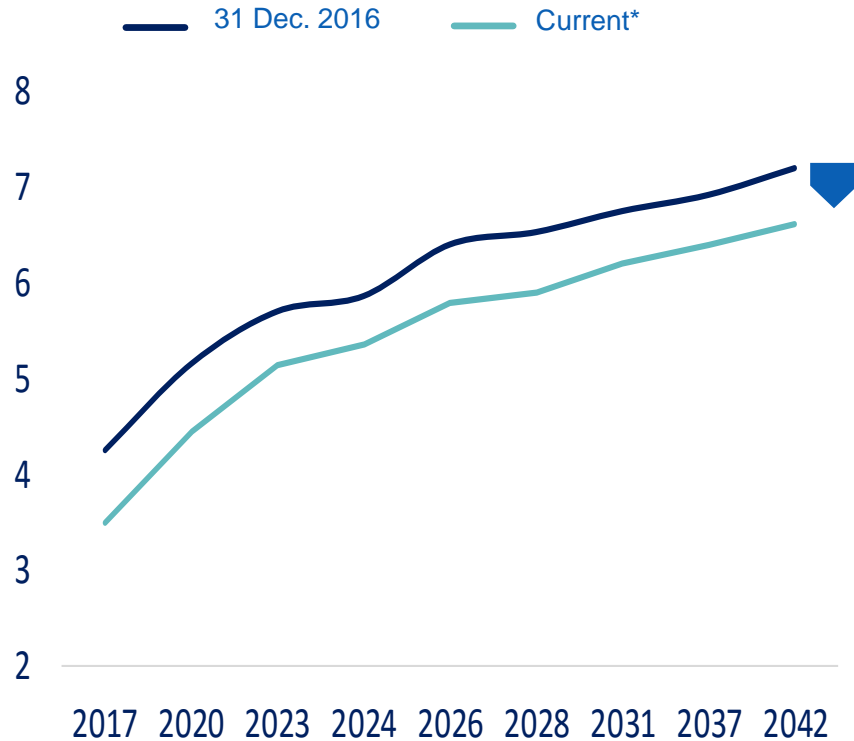


Source: Bloomberg

# ...Sovereign bond yields decline...

## Yields on Sovereign Bonds

(%)



## Yields on Sovereign Bonds

(% and bps)

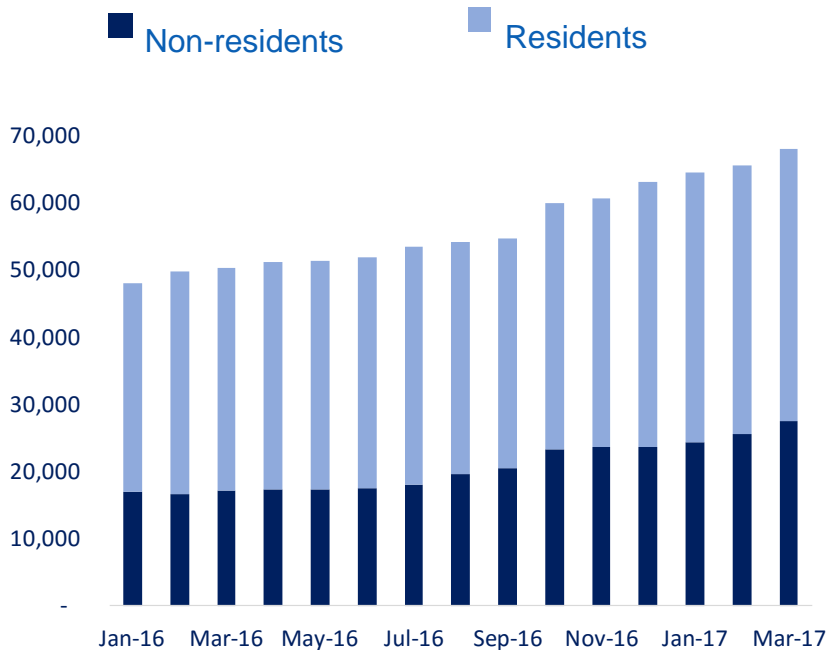
Bond	Yield (%)		Var. Actual data vs. (en pbs) Dec-16
	Dec-16 (A)	Actual data (B)	
2020	5.2	4.5	-70.0
2023	5.7	5.1	-56.0
2024	5.9	5.3	-52.0
2026	6.4	5.8	-59.3
2031	6.8	6.2	-55.0
2037	6.9	6.4	-51.0
2042	7.2	6.6	-65.0

(\* ) As at 18 April.  
Source: Bloomberg

(\* ) As at 18 April.  
Source: Bloomberg

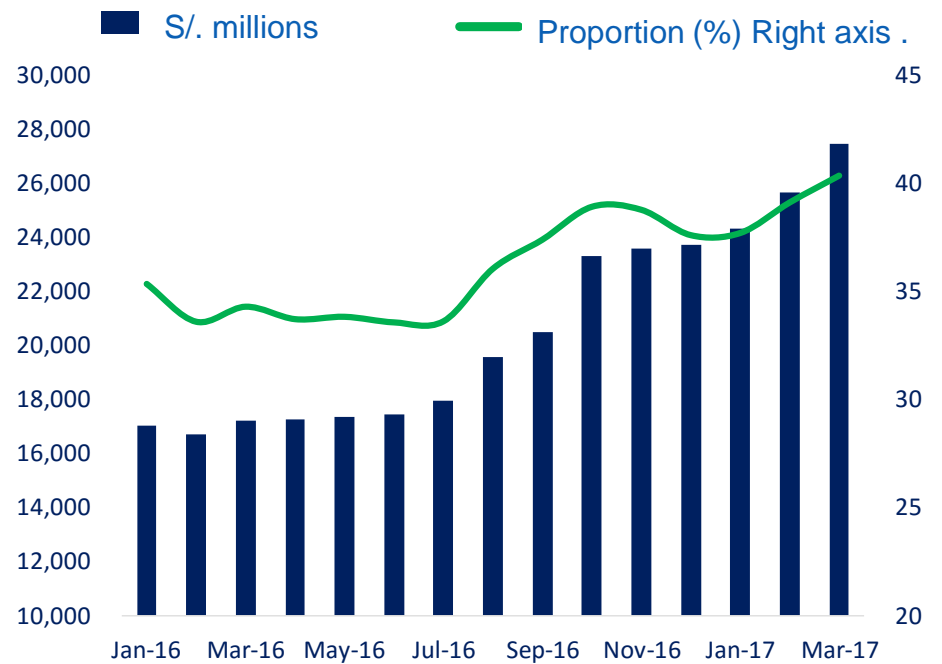
# ... while non-residents' holdings increase

**Balance of Sovereign Bonds**  
(S/. millions)



Source: MEF

**Non-residents' holdings of Sovereign Bonds\***  
(S/. millions and %)

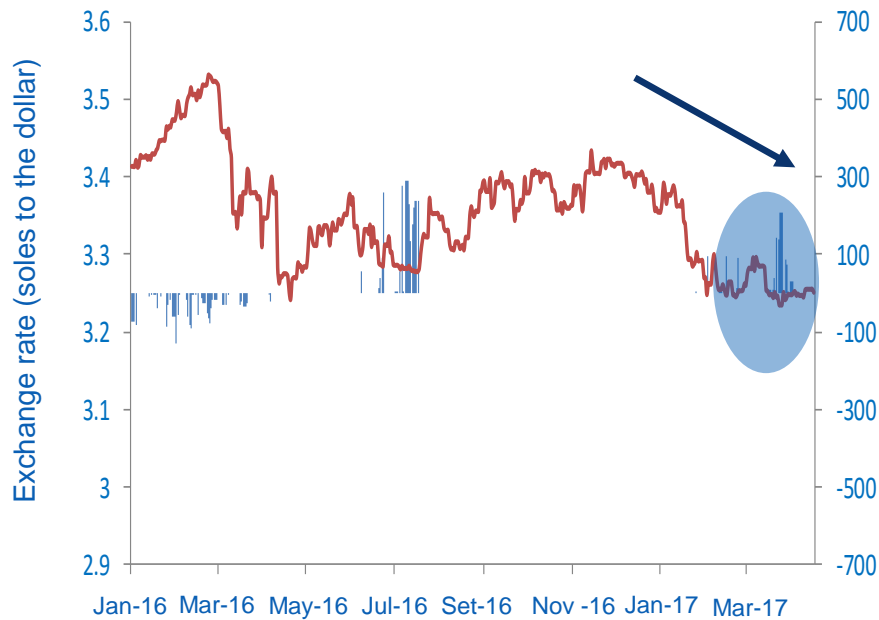


(\* ) So far this year issues have totalled S/. 5.3 billion

Source: MEF

## Also, the PEN has shown a slight tendency to appreciate

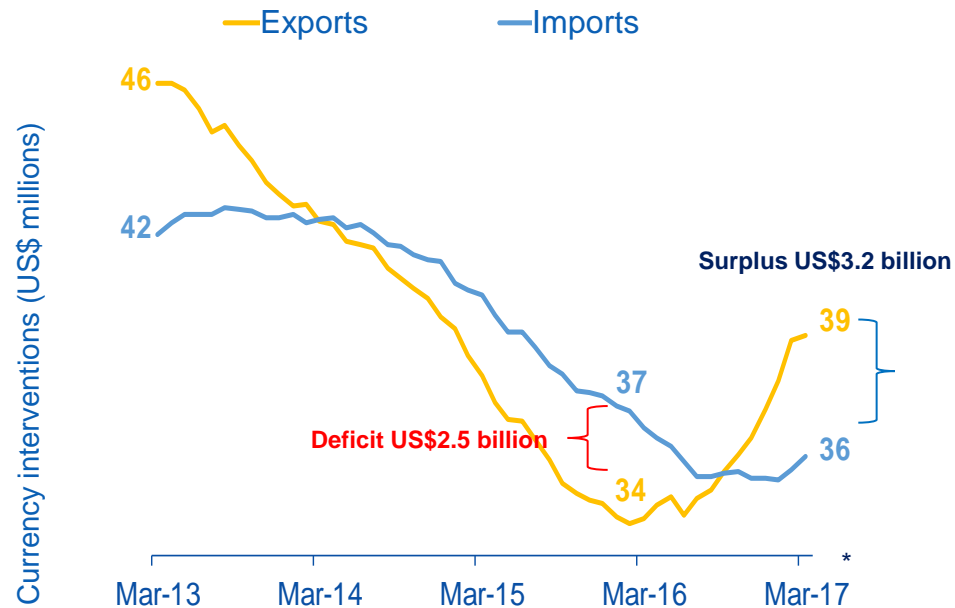
### Exchange rate and currency interventions of the BCRP\*



(\*) So far this year the central bank has bought US\$1.54 billion

Source: Bloomberg and BCRP

### Exports and imports (cumul., 12 mths, US\$ billions)



(\*) Estimated

Source: Central Bank of Peru

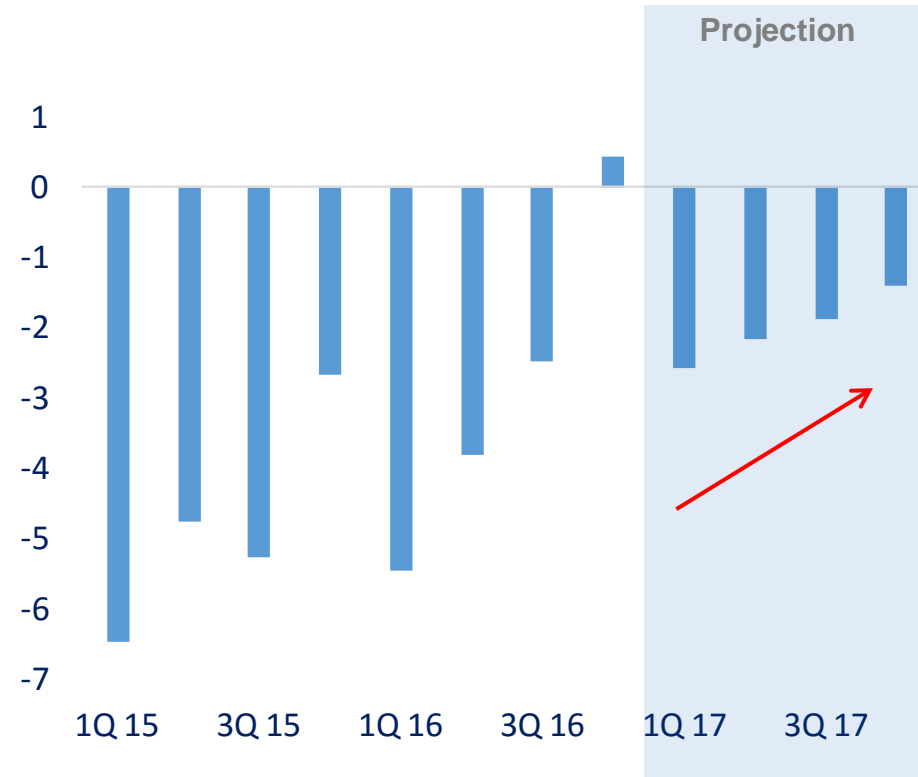
# Going forward, slight depreciation due to reduction in interest rate differential, mitigated by lower external financing requirements

**Exchange rate**  
(PEN/USD)



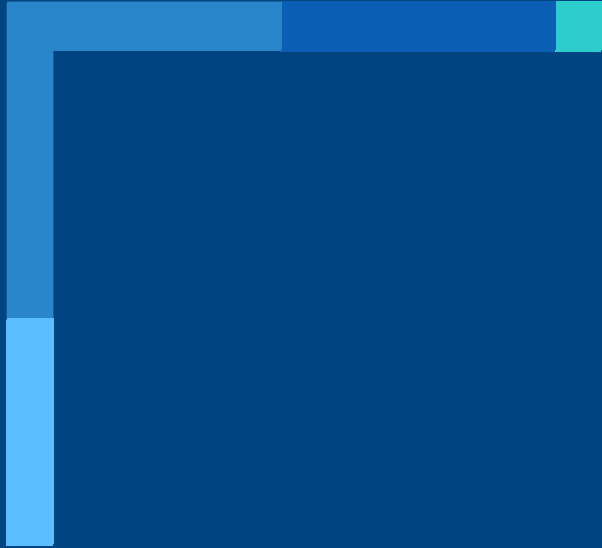
Source: Central Bank of Peru

**Balance of payments on current account**  
(% of GDP)



Source: Central Bank of Peru





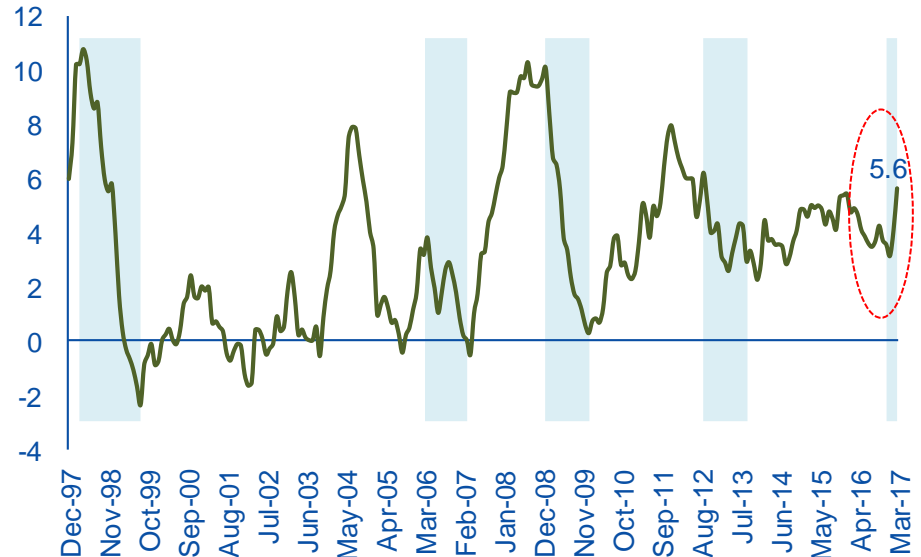
# Inflation

# In March, inflation rose due to increases in food prices. The evidence points to the shock being temporary.

## Inflation\* (change % YoY)

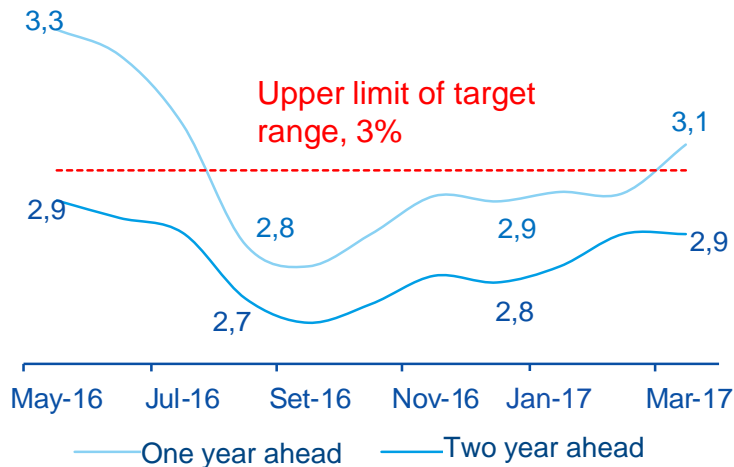
	Var. % m/m	Var. % y/y
	mar-17	mar-17
<b>Core Inflation</b>	<b><u>0.74</u></b>	<b><u>2.6</u></b>
Goods	0.18	3.0
Services	1.09	2.4
Transport	0.09	2.1
Communications	0.03	0.2
Education	3.93	4.9
Rental	0.22	0.5
Other services	0.02	1.0
<b>Non core inflation</b>	<b><u>1.85</u></b>	<b><u>5.5</u></b>
Food	0.35	3.9
Food (underlying)	4.94	8.4
Fuel	-0.15	7.8
Electricity	-0.08	1.2
<b>Inflation</b>	<b><u>1.30</u></b>	<b><u>4.0</u></b>

## CPI for food and beverages (chge. % MoM)



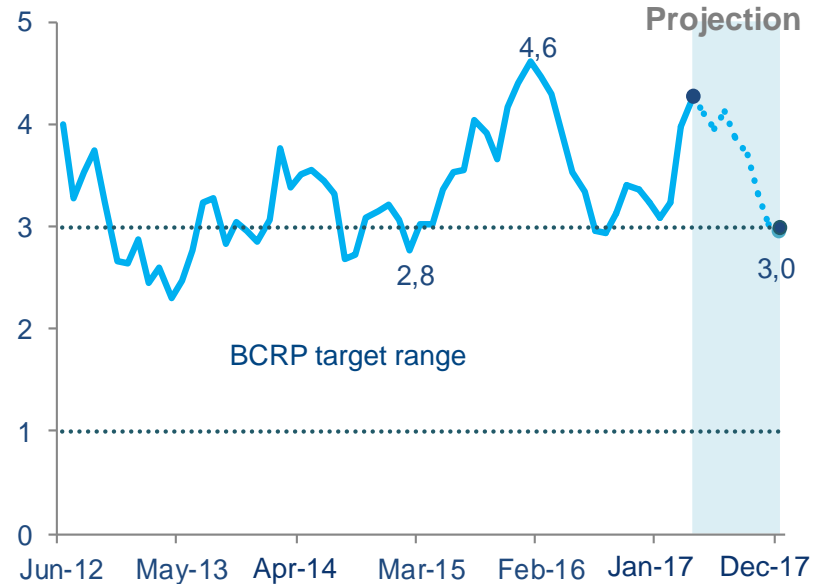
# Inflation will tend to decrease in the second half of the year, creating room for an easing of monetary policy.

## Inflationary expectations (chge. % YoY expected of CPI)



Source: INEI, Central Bank of Peru and BBVA Research

## Inflation (chge. % YoY in CPI)

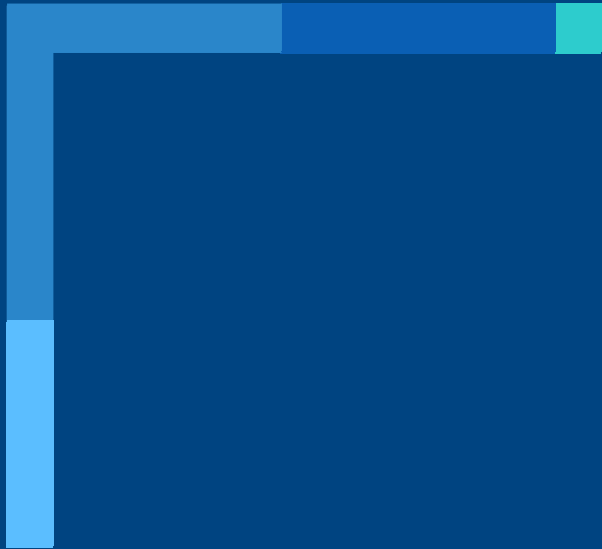


Source: INEI, Central Bank of Peru and BBVA Research

Reversal of food price hikes, but...

...increase in expectations will make the fall in inflation more gradual.

Absence of demand pressures and limited depreciation in the remainder of the year



# Monetary policy rate

## Monetary policy adopts a more dovish stance



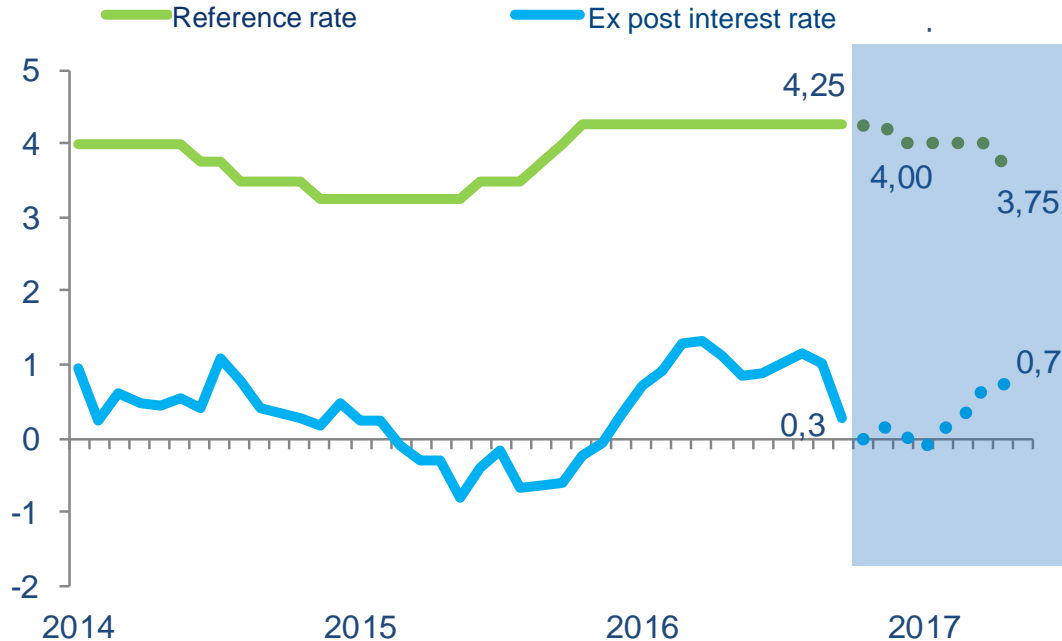
### **MONETARY PROGRAM FOR APRIL 2017 BCRP MAINTAINED THE POLICY INTEREST RATE AT 4.25%**

1. The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy interest rate at 4.25 percent. This decision is consistent with an inflation forecast in which inflation converges to the target range during 2017 and takes into account the following factors:
  - i) The faster pace of inflation observed recently is transitory and is associated with the supply shocks caused by the effects of El Niño;
  - ii) Expectations of inflation in 12 months are temporarily close to the upper band of the inflation target range;
  - iii) The pace of growth of domestic economic activity has continued to slow down in the first quarter of 2017, showing a pace of growth below its potential growth level. Economic activity is expected to gradually show greater dynamism in the following quarters as a result of increased government spending and higher export prices, and
  - iv) The global economy shows signals of recovery, although there is still uncertainty about developed countries' policies.
2. The Board oversees new data on inflation and inflation determinants, giving particularly close attention to data about the reversal observed in terms of supply shocks, to ease the monetary policy stance in the short term.



# As inflation starts to ease, we foresee a cut of 50 bps in the base rate in the remainder of the year

## Monetary policy reference rate (%)



Reduction in the reference rate will support private demand. We also expect greater monetary easing in 1Q2018

## Main messages

1. **World growth continues apace**, accompanied by a certain clarification regarding US policy. Overall, global risk remains a concern.
2. **Economic activity.** We have cut back our growth projection for 2017 from 3.5% to 2,5% in view of weak data in 1Q2017 and the “El Niño Costero” weather phenomenon.
3. **Exchange rate.** The PEN has depreciated due to the reduction in the interest rate differential between soles and dollars. Improving trade figures and capital inflows will limit the depreciation.
4. **Inflation.** Temporary uptick due to supply shocks. It will start to come down from the second half of this year
5. **Monetary Policy Rate.** The central bank has hinted at a more dovish stance. We are projecting two rate cuts of 25 bps each in the remainder of 2017.





# Macroeconomic projections for 2017

## Main macroeconomic variables

	2014	2015	2016	2017 (p)
GDP (chge. % YoY)	2.4	3.3	3.9	2.5
Inflation (eop, chge. % YoY)	3.2	4.4	3.2	3.0
Exchange rate (per US\$, eop)	2.96	3.38	3.40	3.36
Policy interest rate (% eop)	3.50	3.75	4.25	3.75
Private consumption (chge. % YoY)	4.1	3.4	3.4	2.7
Public consumption (chge. % YoY)	9.7	9.3	-0.5	5.4
Investment (chge. % YoY)	-2.1	-5.0	-5.0	0.4
Fiscal result (% of GDP)	-0.3	-2.1	-2.6	-2.9
Current Account (% of GDP)	-4.0	-4.8	-2.7	-2.0

Source: BCRP (Central Reserve Bank of Peru), INEI (National Statistics and IT Institute) and BBVA Research Peru

# Peru Economic Outlook Second quarter 2017

April 2017

