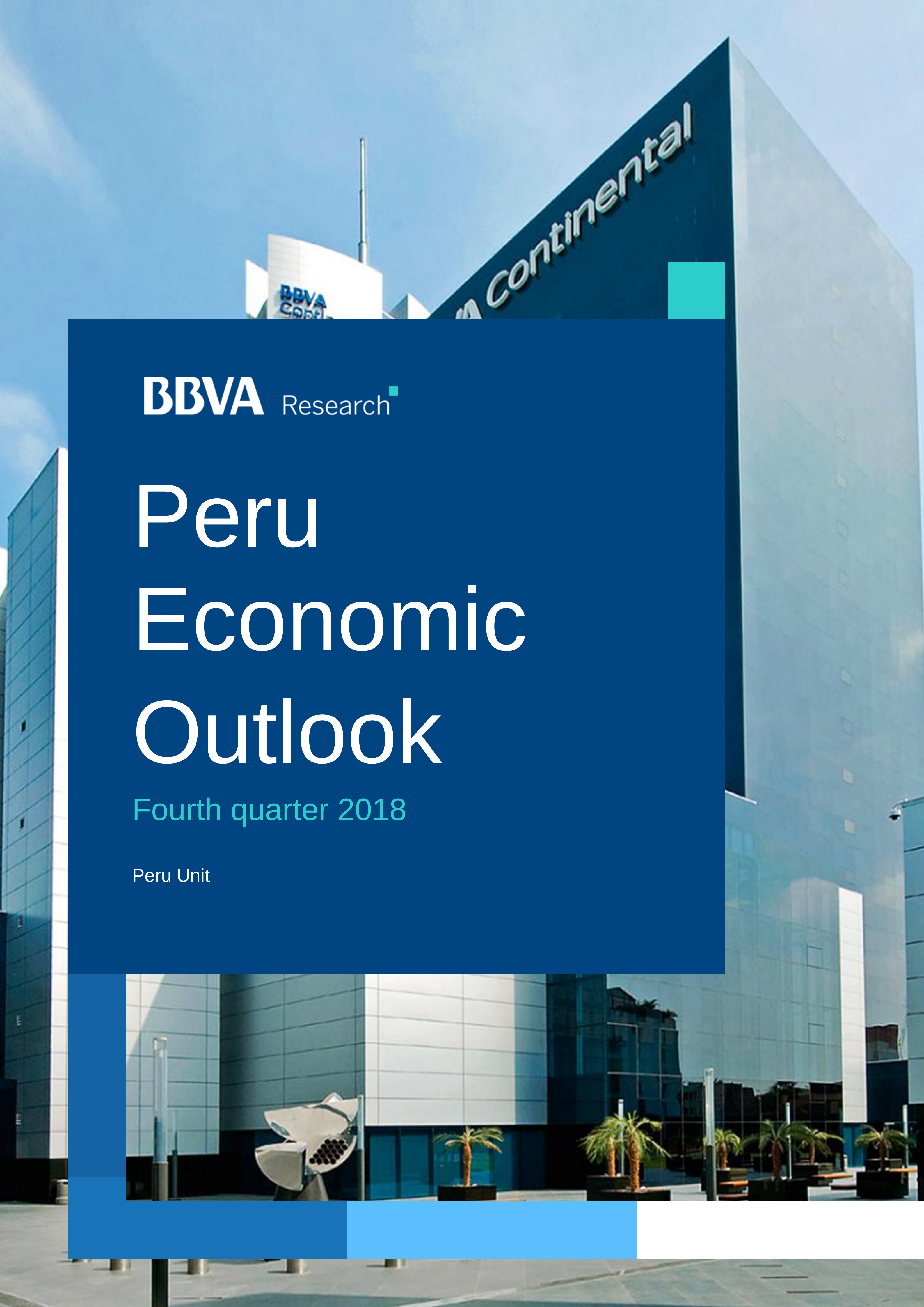


BBVA Research

Peru Economic Outlook

Fourth quarter 2018

Peru Unit

Contents

Closing date: **12 October 2018**

1. Summary

The **expansion of business activity moderated in recent months, with rates that have been below 2.5% YoY since June**. This occurred in an environment in which mining production declined due to major units having been exploiting areas with low mineral content and in which hydrocarbon production contracted sharply because the pipeline broke down in the north of the country and maintenance work was carried out on a plant that processes natural gas. Added to this was the slowdown in public investment - which had a similar effect on construction activity - and, more generally, the positive effect of the low year-on-year comparison base dissipated (in the first months of 2017, economic activity was hit by the El Niño Costero weather pattern). On the contrary, prominent in offsetting the above, albeit only partially, were the indicators of household expenditure, such as the wage bill and credit to finance consumption. On this basis, **we estimate GDP growth in the third quarter to be between 2.0% and 2.5% year-on-year**. It will be the weakest of the year.

The **slowdown in growth will be temporary**, however. In the fourth quarter, the second season of anchovy catch will begin in the north-central coastal zone, which in our baseline scenario will start earlier than last year and will have a higher quota. In addition, elements of a transitory nature that have been affecting certain activities, such as the production of hydrocarbons, will have dissipated. Increased anchovy fishing and hydrocarbon production will have a positive impact on primary industrial activity. On this basis, **we estimate GDP growth in the fourth quarter to be between 3.5% and 4.0% YoY.With this, the year will close with a growth of around 3.6%**, a figure that has a certain upward bias. **This forecast for 2018 is similar to the one we presented in our previous report** (July), but inside we are now incorporating a greater expansion of private sector spending (consumption, in particular) and slower progress than the public sector.

For next year, our baseline scenario considers, on the external side, a less favourable environment. While global growth will continue to be robust (3.6%), it will be somewhat more moderate than this year's and less synchronised by geographic areas, with expansion in the US remaining at around 2.8%, but with China moderating its growth to 6.0% (6.5% in 2018). In addition, interest rates in foreign currency will be higher in a context in which the process of monetary normalisation will continue in some of the largest and most developed economies. In the US, for example, the Fed will raise its rate from the current 2.25% to 3.25% at the end of 2019 (2.50% at the end of 2018), while in Europe the ECB will begin the cycle of rate increases towards the end of that year. With more moderate global growth, rising financing costs, and trade tensions between the US and China likely to continue into next year, the average price of metals will tend to decline, including copper (from around USD 2.95 per pound in 2018 to between USD 2.85 and USD 2.90 per pound in 2019), so the terms of trade will fall back.

Locally, the main growth support in 2019 will be the construction of new mines such as Quellaveco, Mina Justa, and the Toromocho expansion. These are projects that have already been announced, in which investment has already begun, and which have relatively low production costs for the industry. We estimate that, as a result of the construction of these mines, investment in the mining sector will increase next year by USD 2 billion, more spending in the economy equivalent to about 1% of GDP. Our base scenario also considers four other things. First, that business sentiment will continue to be relatively favourable for investment despite the increased political noise. Second, the absence of an El Niño coastal climate phenomenon in the summer (austral) or, at most, the presence of a low-intensity one, which would have little impact at the macroeconomic level. Third, that overall progress in public infrastructure construction will continue to be slow until 2019, with an increase in annual spending on reconstruction work in areas affected by the 2017 Coastal El Niño, but less on major works such as the 2019 Pan American Games venues (to be completed by the middle of next year) and the second line of Lima's subway (a lower amount has been budgeted for next year). Finally, the baseline scenario takes into account that the change in sub-national authorities from the beginning of next year will probably slow down investment temporarily at that level of government, as has occurred on previous occasions.

Against this backdrop of strong growth in mining investment, still slow progress in the construction of public infrastructure, and less favourable external conditions, we estimate that GDP growth in 2019 will be around 3.9%. This figure is similar to the one we presented in our previous report, but — as we have also done for 2018 — it incorporates a greater expansion of private sector spending (consumption, above all) and a slower advance than that of the public sector (delay in infrastructure construction), thus causing the materialisation of two of the risks we pointed out in our previous report. On the sectoral side, **the activities that will stand out will be those most linked to the increase in mining investment, such as Construction, Non-Primary Manufacturing, and Services**, as well as those that in 2018 faced temporary difficulties and next year will operate under more normal conditions (Mining, Hydrocarbons).

On the **fiscal side**, the **deficit has continued to fall in recent months**, mainly due to improved revenues. In our baseline scenario **we expect this deficit to be at a level equivalent to just over 2.5% of GDP in 2018 (3.1% in 2017) and to continue to decline in the coming years**. Projected deficits are lower than we anticipated three months ago, particularly for the short term, because of the difficulties faced by the Government in implementing investment spending. In addition, they are consistent with a gross public debt that will converge to a level equivalent to about 27% of GDP in the coming years. The planned fiscal consolidation process and the low level of gross public debt are favourable for the country especially in a context of tightening international financing conditions and increased external risks.

In the **local exchange market**, the **Peruvian currency continued to face depreciation pressures**. These **pressures have mainly reflected external factors** such as the perception that the Fed will be more aggressive in its monetary normalisation process, the escalation of protectionist trade measures, and the greater signs of a slowdown in China, a context in which metal prices fell significantly. Although foreign investors maintain interest in sovereign bonds (their holdings have continued to increase in recent months), exchange pressures have been observed through derivatives (perhaps to cover positions that were uncovered); in recent months there has also been an increase in investments made abroad by private pension fund administrators (they continued to raise the operating limit that they have for doing this). Despite pressures on the local currency, central bank exchange rate interventions have been infrequent in recent months and have been limited to the use of exchange *swaps*, which imply a contingent liability in local currency for the central bank and thus do not compromise net international reserves. **In the context of emerging economies, the depreciation of the Peruvian currency has been relatively limited**. The **greater resilience reflects the country's good macroeconomic fundamentals**, including fiscal soundness, a relatively low external deficit (balance of payments current account deficit equivalent to 1.1% of GDP in 2017, which we estimate will increase to 2.2% in 2018 and 2019, a level that will remain low), and high net international reserves. In projection, **we anticipate that the exchange rate will end this year at around 3.33, not much different from the current level, and closer to 3.30 by the end of next year**. The fall in the USDPEN in 2019 is supported by the supply of dollars both on the commercial side (the trade balance will be in surplus by almost USD 6 billion, despite the decline in metal prices) and on the financial side (foreign direct investment, for example in the mining sector), elements that will mitigate the effects of the rise in the Fed's monetary policy rate. This forecast is a little higher than the one we presented in our previous report, especially for the short term, due to the downward correction in terms of trade.

As to prices, **inflation is currently at 1.3%**, within the central bank's target range (2%, +/- 1 pp). Expectations and measures of inflationary trends, meanwhile, are between 2.0% and 2.5%. **We estimate that inflation will soon be close to 2% and that it will close the year at around 2.3%, remaining around that level in the first quarter of 2019**. This forecast is consistent with the anticipated normalisation of some foodstuff prices (which are currently declining year-on-year), with an increase in the depreciation rate of the local currency in the short term, and with the gradual decrease in the looseness maintained in some sectors of the economy (in the last four years GDP has increased below its potential pace). Later, with the downward correction of the oil price and the appreciation of the local currency (in year-on-year terms), inflation will yield a little and close 2019 at just over 2%.

With this benign panorama for prices, **the central bank since March has maintained the reference interest rate at 2.75%**, which implies an ex-ante real interest rate of 0.3% and, thus, an **expansive monetary position** (the central bank estimates the neutral real interest rate at 1.75%). This has taken place in a context in which stimulus is still required to consolidate the recovery that is beginning to be observed in private sector spending and in which depreciation pressures on the local currency have been moderate. In its press releases, the central bank has emphasised that it will maintain an expansive monetary position until inflation converges to the centre of the target range, inflationary expectations are anchored, and the GDP is close to its potential level. Taking this into account, **we estimate that the policy rate will remain at 2.75% for the remainder of this year and until the beginning of 2019**, and then, in the second quarter of next year, when economic activity is more consolidated, inflation is (temporarily) around 2.5%, and the currently positive differential between sol-dollar interest rates has closed, start to gradually orient it to a more neutral level, closing that year at a level of 3.25%.

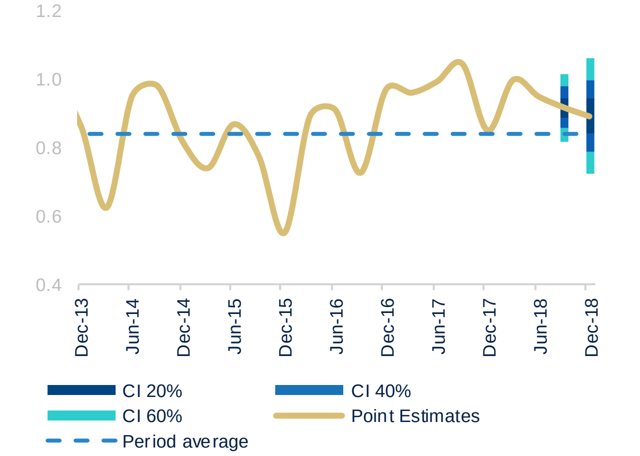
Lastly, as with any projection, there are **risks that economic growth may deviate from what we are anticipating in our baseline scenario**. On the external side, there are three main risks: that the **protectionist measures to global trade escalate** (including the possibility of that this could generate uncertainty and affect investment), that the **monetary adjustment in the US will be more aggressive** (due to a more pronounced acceleration of inflation) and that this tightens the conditions of international financing even more, and that the **moderation in the growth of China may be more marked than we have anticipated**. On the local side, there is a risk that **progress in the construction of public infrastructure will be even less than we are considering**, that the **greater political noise will have a more sensitive impact on business confidence**, and that in the summer (Southern hemisphere) **there will be an El Niño Costero of moderate or greater intensity**, which would have macroeconomic impacts on infrastructure, activity and prices. **These are all downside risks** to the economic growth outlook. As a **rising risk** factor, however, we have a local element: **that for the second season of anchovy catch in 2018 in the north-central zone of the coastline, a larger fishing quota than planned should be allocated**.

2. The global economy: growth is slowing down slightly while risks are intensifying

The global economy continues to show positive data, though in an environment of growing uncertainty. Inertia in world growth has continued over the past three months, prolonged by the effect of the fiscal stimulus on the US economy and a certain stability in the Chinese and European economies within a context of slowdown. But the protectionist escalation between the US and China has intensified, while the appreciation of the dollar has been reflected in an increase in financial tensions in emerging economies, with a greater impact on those that are more vulnerable (such as Turkey and Argentina). In this context, both the Federal Reserve (Fed) and the European Central Bank (ECB) continue to make progress in normalising monetary policy, which means a gradual tightening of monetary conditions that will continue to put pressure on emerging economies in the coming quarters. In spite of this, we do not seem to be faced with a systemic crisis in the aforesaid countries. Faced with a global scenario of relative continuity with a slight slowdown in 2019, the main risk in the short term continues to be protectionism, the effect of which could be felt in the coming year.

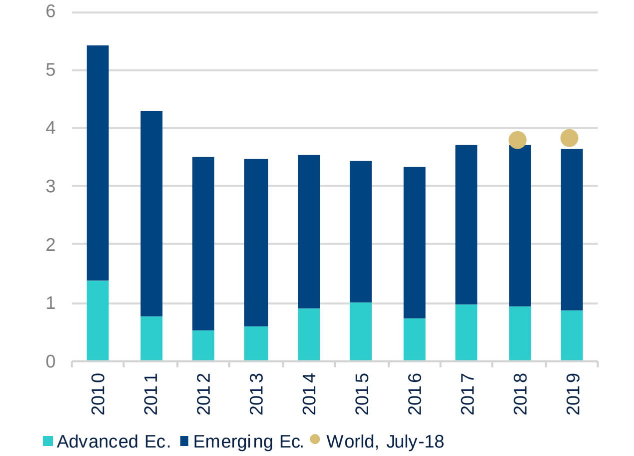
Global growth was expected to have slowed again in the third quarter of the year (Figure 2.1) and regional differences would have intensified. The strength of the US economy contrasts with the moderation in China and the euro zone and, above all, with the significant adjustments observed in the emerging economies most vulnerable to the increase in financial tensions.

Figure 2.1 World GDP growth
(QoQ, %)



Source: BBVA Research

Figure 2.2 World growth forecasts
(%)



Source: BBVA Research based on Bloomberg

The normalisation of monetary policy, together with increased uncertainty, will continue to put pressure on emerging economies Growth in developed economies remains robust and reinforces the ongoing normalisation process of major central banks in the coming quarters, which will continue to affect financial conditions in emerging markets. On the one hand, the Fed is continuing with the normalisation of its monetary policy and a rise of more than 25 basis points is expected to reach 2.5% by the end of this year and 3.25% by the end of 2019. For its part, the ECB has reaffirmed and begun its exit strategy. Coupled with this, the upward pressure on the dollar against major currencies has been maintained, driven by the flight to quality and an increasingly favourable interest rate differential. In this environment, the feeling of risk aversion among investors has continued for another quarter, particularly affecting the most vulnerable emerging countries (those with the greatest external financing needs and high foreign currency indebtedness), while developed countries continued to benefit from an environment generally free of financial tensions.

On the other hand, trade tensions are continuing. Although trade tensions between the U.S. and some areas have eased for the time being, the agreement with Mexico and Canada has yet to be ratified and negotiations on the automotive sector with Europe will be reopened after the US mid-term elections in November. Meanwhile, some of the US protectionist threats towards China have already materialised, with their respective countermeasures by the Asian country. The impact that these steps will have on gross domestic product, along with those already approved on steel and aluminium imports through the trade channel, is limited (around 0.1% of China's GDP). However, to this direct impact could also be added other indirect effects (lower confidence among economic agents, impact on financial markets), especially for China and emerging economies, which are difficult to estimate but could subtract around 0.1 pp from growth. However, in a scenario of escalating tariffs between China and the US from January 2019 and although the Chinese authorities are willing to implement policies to support growth, a trade war affecting all US-China trade could derail the global recovery.

The downward revision of growth in emerging economies explains the expected moderation of global growth Global growth forecasts for both 2018 and 2019 have been revised downward by around 0.1% to 3.7% and 3.6% respectively (see Figure 2.2), as we now expect the slight moderation in the second half of the year to be consolidated as we move forward. This slowdown in global activity is mainly due to the slower-than-forecast growth in emerging economies, which is above all the result of greater external vulnerability.

In the US, the increase in consumption and the strength of investment continue to support the forecast of 2.8% growth in 2018-19. However, the acceleration of the economy in the second quarter seems transitory after the strong momentum of the foreign sector, and some moderation is expected in the coming quarters due to the appreciation of the dollar. In China, the authorities are implementing more flexible policies in order to try to halt the slowdown in domestic demand and counteract the increase in protectionism. The good performance of the economy in the first half of the year leads us to revise upwards the growth forecast by two tenths to 6.5% in 2018. On the fiscal side, tax reductions are being carried out, both for workers and companies, and the increase in infrastructure investment is being favoured. On the monetary policy side, the main measures are aimed at encouraging banks to extend credit to small and medium-sized enterprises and at stabilising the exchange rate. With all this, the forecast of 6% growth for 2019 remains unchanged. In the euro zone, the strength of domestic demand and accommodative policies (both monetary and fiscal) could compensate for the greater uncertainty and moderation in global demand, thus maintaining the GDP growth forecast of 2% in 2018 and 1.7% in 2019.

Protectionism and the Fed's exit strategy continue to be the most relevant risks on the forecasting horizon. The global scenario continues to be subject to mostly negative risks. On the one hand, the risk of a trade war remains unabated and could worsen after the November elections in the US, especially with China, but negotiations with the EU and Japan will also be reopened, mainly with threats involving the interests of important sectors in those regions, such as the automobile sector. While the direct impact of the measures would be limited, the risk of a trade war could act as a drag on confidence, increase risk aversion in the markets and curb global flows of direct investment, with the consequent impact on global growth potential. In addition, the escalation of the price of oil (due to the sanctions on Iran) is also a risk to be taken into account due to its potential asymmetrical impact by country.

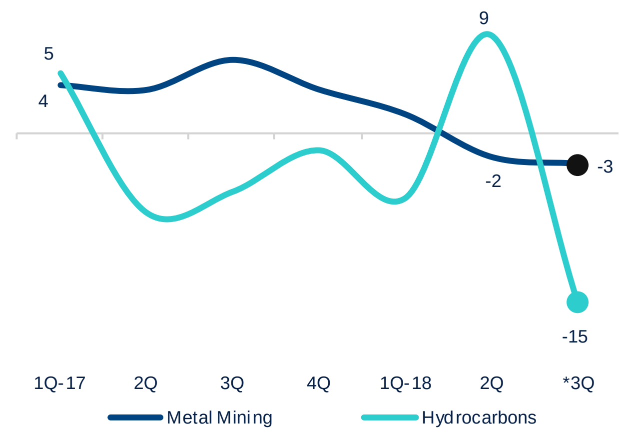
On the other hand, in a more volatile financial environment and with a tightening of global financial conditions, increased financial tensions in emerging economies could intensify, especially in the most vulnerable countries, and have an amplifying effect on global risks. The combination of increased protectionism and accelerated normalisation of US monetary policy together with a possible slowdown in the global economy could trigger the perception of risk in emerging financial markets, raising the likelihood of a halt in capital flows. In this context, the risk of an abrupt adjustment of the Chinese economy remains, as some measures to respond to a slowdown in demand and the effects of protectionist measures imposed by the US could limit or delay the process of deleveraging and restructuring its economy.

3. Peru: we have maintained our growth forecasts for 2018 and 2019

The indicators available for the third quarter show that the progress of activity has moderated

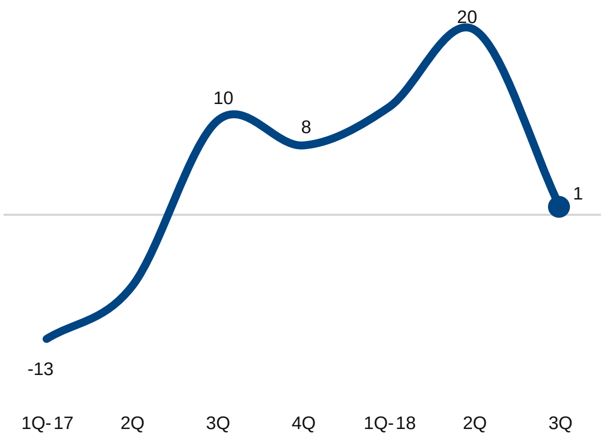
The expansion of activity moderated in recent months, with rates that have been below 2.5% YoY since June. This occurred in a context in which mining production declined due to important units exploiting areas with low mineral content and in which hydrocarbon production contracted sharply because the pipeline broke down in the north of the country and maintenance work was carried out on a plant that processes natural gas (see Figure 3.1).

Figure 3.1 Mining and hydrocarbon production
(% change YoY)



* Third quarter data is for the months of July and August
Source: INEI (National Statistics & IT Institute) and BBVA Research

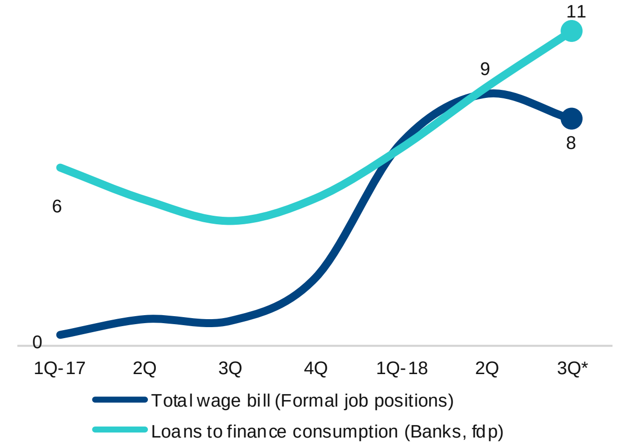
Figure 3.2 Public investment.
(General Government, real, % change YoY)



Source: Central Reserve Bank of Peru and BBVA Research

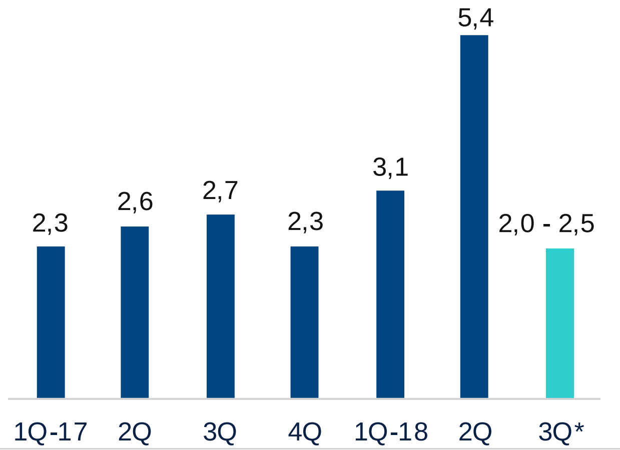
Added to this was the slowdown in public investment (see Figure 3.2) — which had a similar effect on construction activity — and, more generally, the positive effect of the low year-on-year comparison dissipated (in the first months of 2017, economic activity was hit by the El Niño Costero climatic phenomenon). On the contrary, prominent in offsetting the above, albeit only partially, were the indicators of household expenditure, such as the wage bill and credit to finance consumption (see Figure 3.3). On this basis, we estimate GDP growth in the third quarter to be between 2.0% and 2.5% YoY (see Figure 3.4).

Figure 3.3 Household expenditure indicators
(% change YoY)



* Estimated on the basis of available information
Source: INEI (National Statistics & IT Institute) and BBVA Research

Figure 3.4 GDP
(% change YoY)

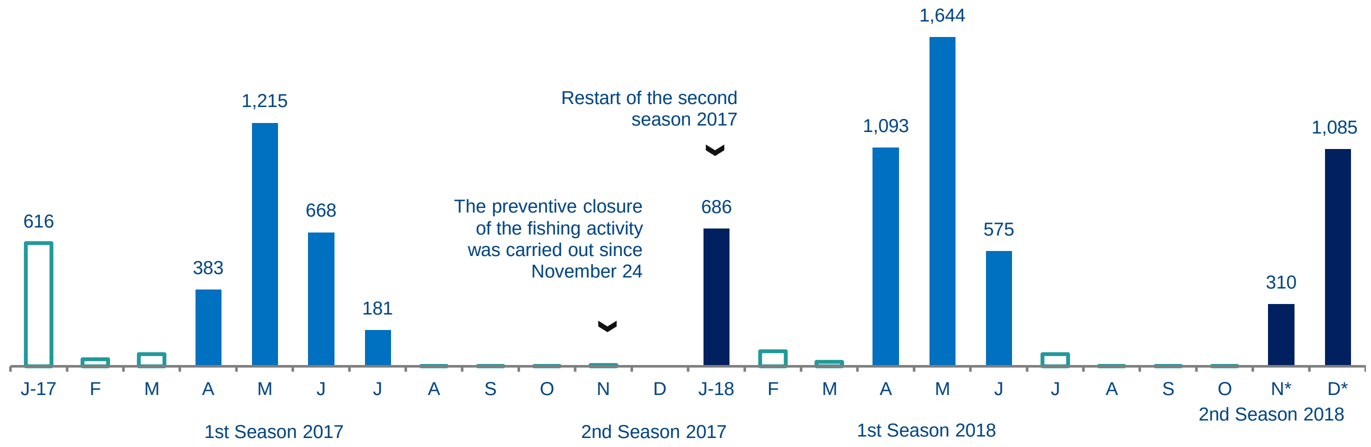


* Estimated
Source: INEI (National Statistics & IT Institute) and BBVA Research

The slowdown in growth will, however, be temporary

In the fourth quarter, the second season of anchovy catch will begin in the north-central coastal zone, which in our baseline scenario will start earlier than last year and will have a higher quota (see Figure 3.5). According to our estimates, this second season of anchovy catch explains about 1 pp of GDP expansion in 4Q18. In addition, elements of a transitory nature that have been affecting certain activities, such as the production of hydrocarbons, will have dissipated. Increased anchovy fishing and hydrocarbon production will have a positive impact on primary industrial activity.

Figure 3.5 Anchovy
landings (Thousands of tonnes)



* Estimates for October, November, and December 2018
Source: IMARPE, PRODUCE and BBVA Research

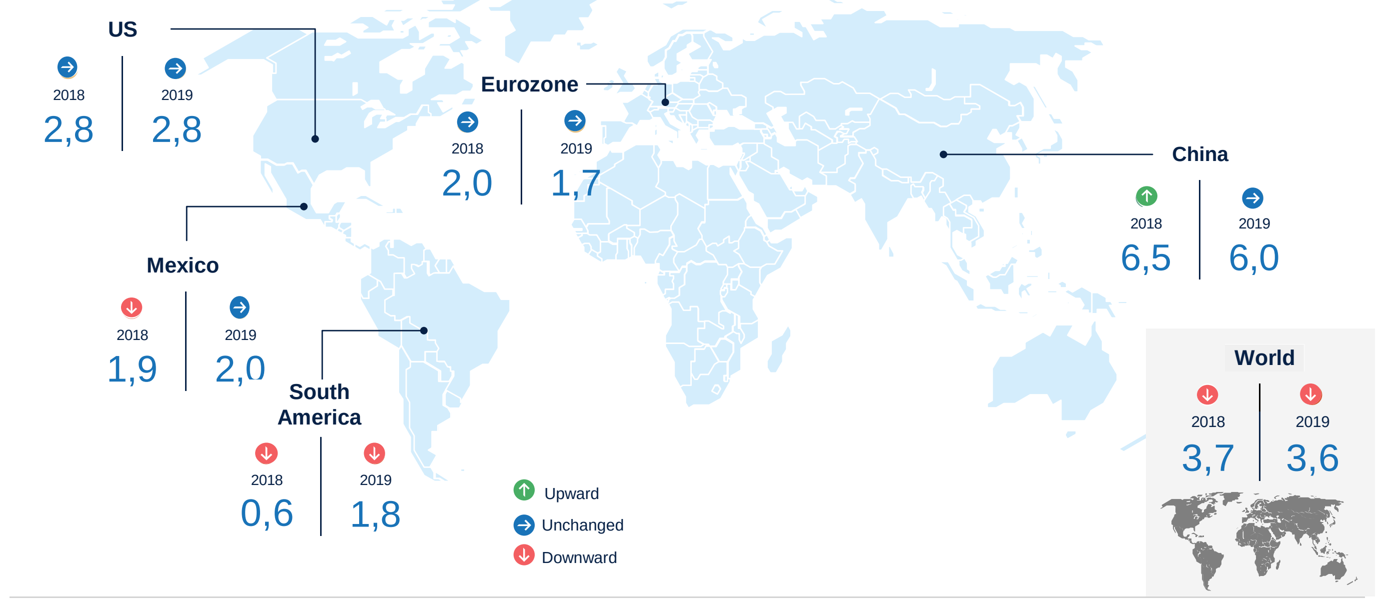
On this basis, we estimate GDP growth in the fourth quarter to be between 3.5% and 4.0% YoY. With this, the year will close with a growth of around 3.6%, a figure that has a certain upward bias. This forecast for 2018 is similar to the one we presented in our previous report (July), but inside we are now incorporating a greater expansion of private sector spending (consumption, in particular) and slower progress than the public sector.

Base scenario of projections for 2019

For next year, our baseline scenario considers, on the external side, a less favourable environment.

- **Global growth will remain robust, but also somewhat more moderate than 2018 and less synchronised by geographic areas**. We estimate that the world economy will grow 3.6% in 2019 (see Figure 3.6), slightly less than what it will grow this year (3.7%) and what we anticipated three months ago. By geography, US GDP will again grow 2.8% next year, but the expansion of China and Europe will be more contained. It is worth mentioning that our base scenario incorporates trade tensions, which will be maintained next year, with the increase in January from 10% to 25% of the tariff rate to a value of USD 200 billion of US imports from China. The impact of the measures approved so far (plus the increase in the tariff rate from 10% to 25%) is having, however, a limited effect on world growth.

Figure 3.6 World growth*
(change % YoY)



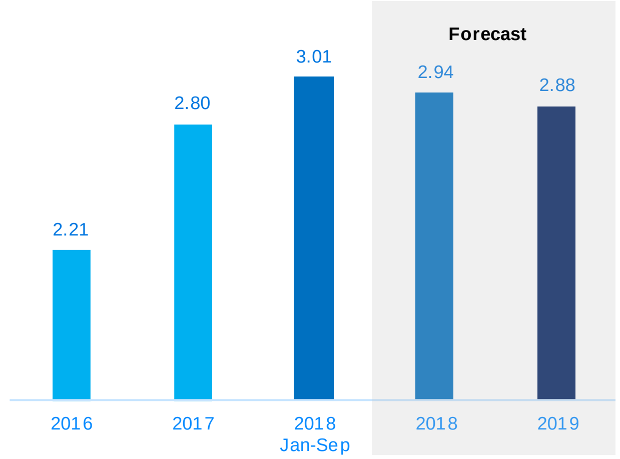
*The current projection is compared (qualitatively) with that of three months ago.
Source: BBVA Research

- **Interest rates in foreign currency will continue to rise**. The U.S. Federal Reserve will raise its interest rate once again in December of this year (by 25 bps), placing it at 2.50%, and three more times during 2019, meaning it will close next year at 3.25%. The European Central Bank, for its part, will gradually complete the quantitative easing of its balance sheet (December 2018) and start raising rates from September 2019. External financing conditions will tend to become more expensive for Peru. Episodes of financial volatility linked to these adjustments cannot be ruled out.

- **The terms of trade will decrease**. In the particular case of the **copper price**, we estimate that the average annual price will decline in 2019 (see Figure 3.7) reflecting more moderate global growth, rising financing costs and trade tensions between the U.S. and China that are likely to continue into next year. The price we expect will reach copper, however, it will continue to be attractive for mining investment and will not affect the development of projects currently under construction such as Quellaveco, Mina Justa, and the Toromocho expansion, units that have relatively low production costs for the industry. The new projection for the average copper price in 2019 (and for metals in general) is somewhat lower than the one we presented in our previous report (July) because we now estimate that trade tensions between the U.S. and China will last until next year; this affects the terms of trade in the same direction and, thus, the trade balance.

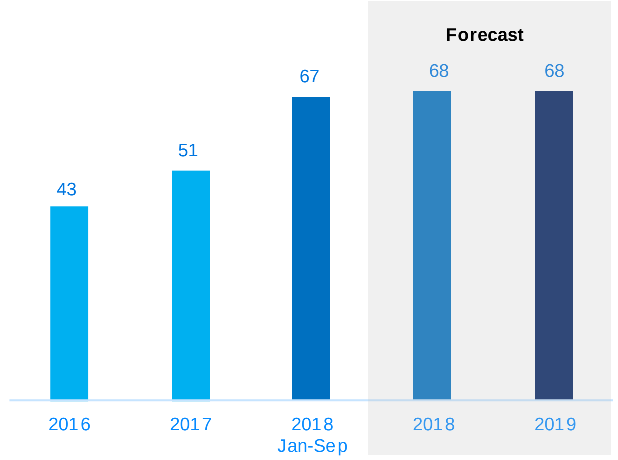
Regarding the **price of oil** (Peru is a net importer of this raw material), our baseline scenario considers an average annual price for 2019 similar to this year's (see Figure 3.8). Throughout the quarterly path, however, it implies a decline from a level of USD 71 per barrel at the end of 2018 (which will be sustained in the first months of 2019) to USD 64 per barrel at the end of next year. The decrease in the price of oil throughout 2019 is due, on the demand side, to the fact that it corrected downwards towards its trend rhythm in line with the lower world growth in that year, while on the supply side it reflects the fact that in the US the problems in transporting oil will be overcome and, in this way, the export capacity of that country will increase.

Figure 3.7 Price of copper
(period average, USD/lb.)



Source: Bloomberg and BBVA Research

Figure 3.8 Price of oil WTI
(period average, USD/barrel)



Source: Bloomberg and BBVA Research

The base scenario for macroeconomic forecasts also considers various local elements, some of them positive, such as the increase in mining investment, and others that are not, such as the probable slowdown of investment by sub-national governments when the new elected authorities (in the fourth quarter of 2018) assume their functions early next year.

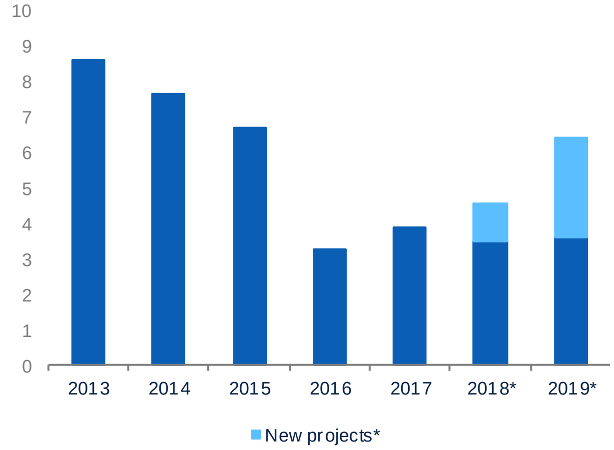
- **Mining investment will increase significantly in 2019**. This will be the main growth support next year. It will reflect the increased spending on the construction of Quellaveco, Mina Justa, and the Toromocho expansion. The mining investment in these three units (and in two smaller ones) will be around USD 3 billion in 2019 (see Table 3.1), with which the total mining investment will increase by about USD 2 billion that year (see Figure 3.9), that is, around 40%, higher spending that is equivalent to just under 1% of GDP.

Table 3.1 Mining investment in new projects
(USD millions)

Project	Anual Production	Investment USD Millions	Year 2019	Year 2020
Quellaveco	225 000 TMF/Cu	5,300	1,300	1,300
Mina Justa	110 000 TMF/Cu	1,600	636	636
Amp.Toromocho	75 000 TMF/Cu	1,300	650	650
Quecher Main	200 000 Oz/Au	300	200	
B2 de Minsur	5 000 TM/Sn	200	80	
Total		**8,700**	**2,866**	**2,586**

Source: MINEM, press releases and BBVA Research

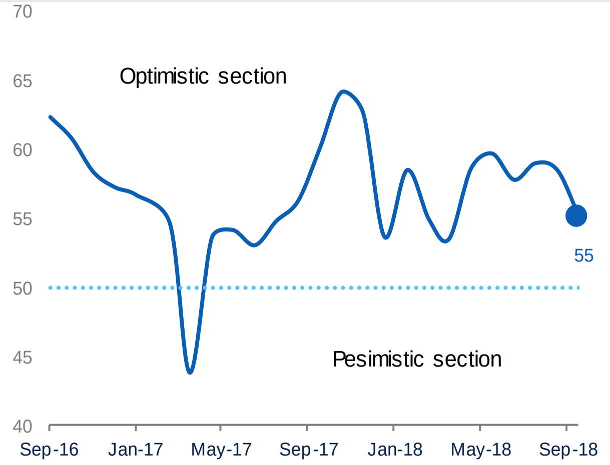
Figure 3.9 Mining Investment
(USD billions)



* Investment in new projects corresponds to Quellaveco, Mina Justa, the Toromocho expansion, and two other smaller mines
Source: Central Reserve Bank of Peru, MINEM (Ministry of Energy & Mines) and BBVA Research

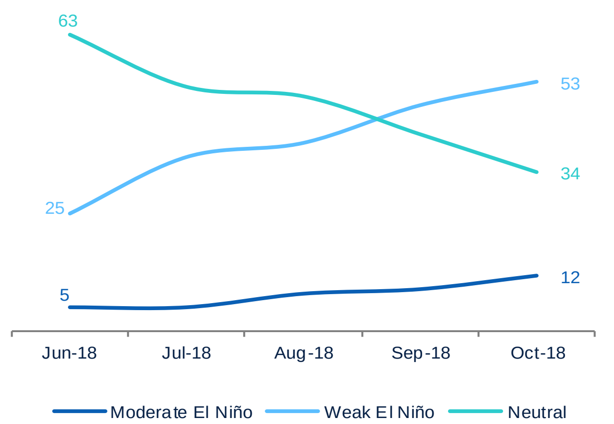
- **Business sentiment will continue to be relatively favourable for investment**. In recent months, business confidence was close to 60 points, although in the most recent measurement (September) it fell to 55 points (see Figure 3.10). It thus remains on the optimistic side. The decrease in September is largely explained by the change in the sentiment of business leaders in the mining-hydrocarbon sector, perhaps reflecting the difficulties that some mining units are facing (temporary exploitation of areas with low mineral content) and the deterioration of the external conditions (sharp decline in the price of copper in the third quarter, increase in financing costs). Our baseline scenario is based on the assumption that business optimism will be sustained in the coming quarters, with a political noise that will not affect it in a sensitive way as it will not imply a greater risk of a change in the business rules at an aggregate level.

Table 3.10 Business confidence
(Points, period average)



Source: Central Reserve Bank of Peru and BBVA Research

Figure 3.11 El Niño Costero: estimated probabilities for different scenarios* (%)

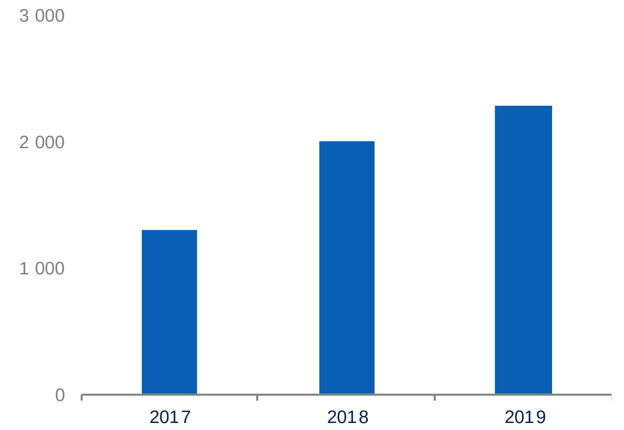


* Corresponds to zone 1+2 of the Eastern Pacific Ocean
Source: ENFEN and BBVA Research

- **Absence of El Niño Costero in the summer or the presence of one with weak intensity**. In its last official press release[1], the multisectorial commission that is in charge of studying the El Niño phenomenon (ENFEN) indicated that the most probable scenario in the (Southern Hemisphere) summer is that of an El Niño Costero (off the Peruvian coasts) of weak intensity (see Figure 3.11). In that scenario, the rains would be normal or only slightly stronger than normal. This would not have a significant negative impact on infrastructure, activity in general or on prices. That is the scenario that is taken into account in our macroeconomic forecasts.

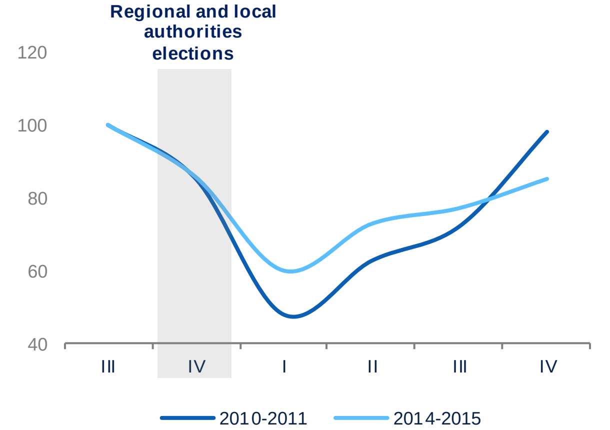
- **Construction of public infrastructure is progressing slowly and is not likely to gain traction until the second half of 2019**. The Government continues to face difficulties in implementing investment expenditure. In the case of reconstruction in the north of the country, for example, an expenditure equivalent to USD 1.227 billion was budgeted for 2018, but up to the first days of October only USD 251 million had been executed. On the second line of the Lima metro, the budget for the year (after having been corrected downwards) is equivalent to USD 238 million, but up to the beginning of October the expenditure executed did not even reach half that amount. This materialised a downside risk that we pointed out in our previous report. Our new baseline scenario considers that the construction of public infrastructure will continue to advance slowly until 2019, but that later, from the second half of that year, its dynamism will be greater. In annual terms, spending on reconstruction in the north of the country will increase, but less will be spent on major projects such as the 2019 Pan American Games venues (which are being completed by the middle of next year) and the second Lima subway line (a lower amount has been budgeted for 2019). In the balance sheet, investment in the main public infrastructure works will increase only moderately (see Figure 3.12).

Figure 3.12 Public Infrastructure Construction Expenditure* (USD millions)



*Includes spending on reconstruction in the north of the country, the second line of the Lima subway, the refinery in Talara, irrigation projects, Lima airport, two port terminals, and the sporting venues for the 2019 Pan American Games.
Source: MEF (Ministry of Economy and Finance) and BBVA Research

Figure 3.13 Investment by sub-national governments* (Index, pre-election quarter = 100)



*In seasonally adjusted terms. It is down to the regional and local government, which together make about 60% of the public investment of the general government.
Source: Central Reserve Bank of Peru and BBVA Research

- **The change of sub-national authorities from the beginning of next year will probably temporarily slow down investment at that level of government**. This is what has happened on previous occasions (see Figure 3.13). In 2015, for example, a year in which there was a change in sub-national authorities, investment spending at that level of government contracted by more than 20%. The new authorities are gradually getting to know the processes for executing expenditure, which takes some time; they are also reviewing, as is natural, the works set in motion by the previous administration, which may slow down expenditure in the short term;

1:Official press release ENFEN N°11-2018.Callao, 12 October 2018.

and, eventually, they may decide not to start some of the works planned by the previous government and may instead plan others, which also takes time. There are not many reasons to think that this opportunity will be different, especially considering that the sub-national authorities could not be re-elected this time.

In this context, we project that GDP will grow by 3.9% in 2019

In view of the strong increase in mining investment, slow progress in the construction of public infrastructure, and less favourable external conditions, we estimate that GDP growth will be around 3.9% next year. The impetus of greater mining investment in sectoral terms will favour Construction (attenuated by the still-slow progress of public infrastructure construction) and non-primary Manufacturing, which will show a greater dynamism in 2019 (see Table 3.2). The performance of Mining and Hydrocarbons will also improve next year as the difficulties they faced in their operations during 2018 will dissipate (in the case of Mining, in addition, the Marcona and Toquepala expansions will begin operations).

Table 3.2 GDP by productive sector
(change % YoY)

	2017	2018 (f)	2019 (p)
Agricultural	2.6	6.3	3.5
Fishing	4.8	33.9	-2.8
Minning and Hydrocarbons	3.5	-1.3	5.9
Metallic mining	4.5	-1.6	5.2
Hydrocarbons	-2.3	0.9	10.3
Manufacturing	-0.2	5.2	2.7
Primary	1.5	12.0	0.5
Non primary	-0.9	2.9	3.5
Electricity y water	1.1	3.7	4.3
Construction	2.1	3.1	4.8
Commerce	1.0	2.6	2.5
Other services	3.2	4.4	4.4
Global GDP	**2.5**	**3.6**	**3.9**
Primary GDP	3.0	2.7	4.4
Non primary GDP*	2.1	3.8	4.0

* Excludes import duties and taxes
Source: Central Reserve Bank of Peru and BBVA Research

Table 3.3 GDP on the expenditure side
(change % YoY)

	2017	2018 (f)	2019 (p)
1. Domestic demand	**1.6**	**4.0**	**3.6**
a. Private consumption	2.5	3.7	3.5
b. Public consumption	0.2	1.9	3.6
c. Internal gross investment	-1.1	6.4	4.4
Fixed gross investment	-0.3	4.0	4.8
- Private	0.2	4.0	6.0
- Public	-2.3	4.0	0.0
2. Exports	7.8	1.5	5.8
3. GDP	**2.5**	**3.6**	**3.9**
4. Imports	4.1	3.0	5.0
Note:			
Inner Demand (excl. inventories)	1.6	3.6	3.8
Private spending (excl. inventories)	2.0	3.8	4.0
Public spending (consumption and investment)	-0.5	2.5	2.6

Source: Central Reserve Bank of Peru and BBVA Research

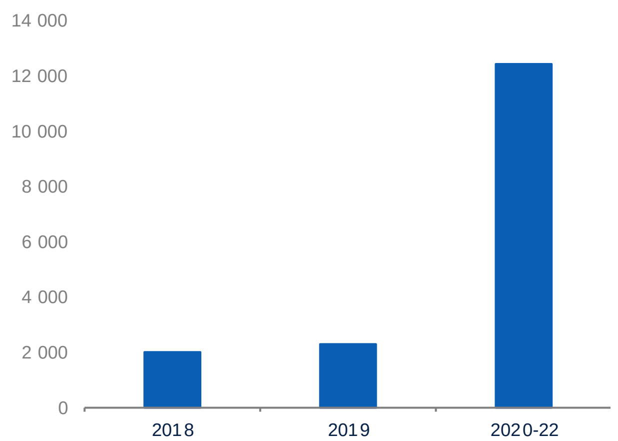
On the expenditure side, greater mining investment and business sentiment that is set to remain relatively optimistic will lead to accelerated private investment. Private consumption, on the other hand, which is more inertial, will continue to grow at a promising rate next year in an environment in which the generation of formal jobs is sustained and despite the fact that there will no longer be the transitory positive effect of the football World Cup (which in the second quarter of 2018 involved, for example, a greater consumption of textiles and travel, among others). Overall, the spending by the private sector will show a better performance in 2019 (see Table 3.3). On the contrary, we estimate that public investment will not grow next year because of the slowdown in sub-national government spending explained above and because progress in the construction of public infrastructure will be relatively limited. Finally, the improvement of Mining and Hydrocarbons will be reflected in a greater dynamism of exports.

This figure forecast for growth in 2019 (3.9%) is similar to the one we presented in our previous report, but — as we have also done for 2018 — it incorporates a greater expansion of private sector spending (consumption, in particular) and slower growth than that of the public sector (delay in infrastructure construction), thus materialising two of the risks we pointed out in the July report.

In order to sustain growth in the medium term it is necessary to take measures

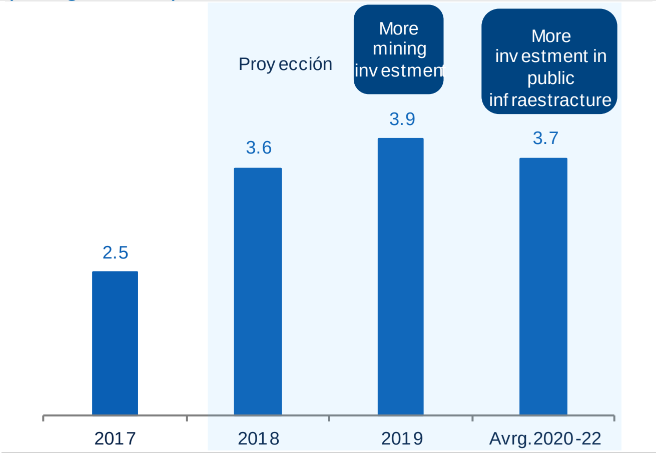
Our baseline scenario considers that infrastructure construction will underpin growth in 2020 (see Figure 3.12). This is the impetus postponed since 2017 as a reflection of the difficulties faced by the Government in executing the investment expenditure. It therefore depends on whether these problems (e.g. ease of expropriating land, cleaning it up, freeing up interference, dealing quickly with disputes in bidding processes) are resolved soon. After that, however, once the correction of the loopholes that still have certain economic activities (non-primary Manufacturing, for example) is over, growth will decrease to its potential level, which is not much above 3.5% (see Figure 3.13). In order to sustain growth at a later stage, it is necessary to take measures to boost productivity and competitiveness, and it will also be essential to make more room for investment in public infrastructure with a structural increase in revenue collection. The State has recently begun to address these issues by proposing some general guidelines for improving productivity[2]. However, progress is still limited and what will be done is yet to be translated into concrete actions, how the tasks will be prioritised, or how progress will be evaluated. The most difficult part has yet to be done.

Figure 3.12 Investment in Public Infrastructure
(USD millions)



Source: Central Reserve Bank of Peru and BBVA Research

Figure 3.13 GDP
(change % YoY)



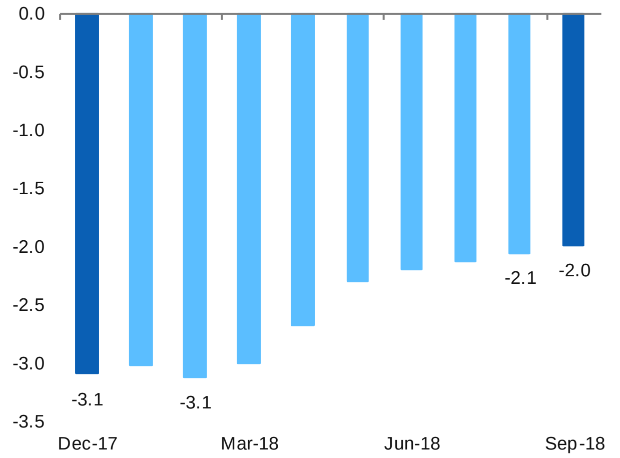
Source: Central Reserve Bank of Peru and BBVA Research

2: The guidelines have been designed to achieve a more efficient use of production factors:(i) capital stock, through the provision of quality infrastructure; (ii) formation and accumulation of human capital, through a regulatory framework that generates formal employment and promotes basic and higher education aligned with productive needs; and (iii) total factor productivity, promoting sources of funding for research and development, strengthening the country's institutional framework, and increasing access to local and external financing. For more details see here

4. Fiscal policy: lower deficit, but partly due to difficulties in implementing investment expenditure

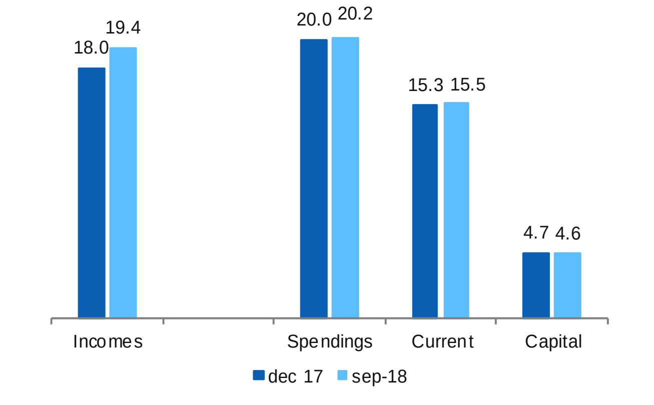
The fiscal deficit continued to decline and currently stands at around 2.0% of GDP. This is mainly explained by the improvement in collection (see Figure 4.2): the annual regularisation of the payment of income tax was exceptional[3] and general sales tax revenues[4] have improved in a context of greater dynamism in domestic demand.In addition, tax refunds were reduced[5].

Figure 4.1 Fiscal result
(accumulated in last twelve months, % of GDP)



Source: Central Reserve Bank of Peru

Figure 4.2 General Government Revenues and Expenditures (accumulated in last twelve months, % of GDP)



Source: Central Reserve Bank of Peru

We estimate that in the remainder of 2018 the fiscal deficit will increase to some extent, to just over 2.5% of GDP by the end of the year. This result is explained because, as a percentage of GDP, fiscal revenues will decrease in an environment in which the dynamism of domestic demand will be temporarily lower in the fourth quarter of the year and metal prices have fallen. In addition, the extraordinary income generated by the tax amnesty (for undeclared income generated abroad) at the end of 2017 will not be taken into account. On the expenditure side (as a percentage of GDP), the baseline scenario incorporates a somewhat less slower progress since the end of the year in the reconstruction of the areas affected by El Niño Costero[6], as well as the acceleration of work to complete the construction of the venues for the 2019 Pan American Games[7].

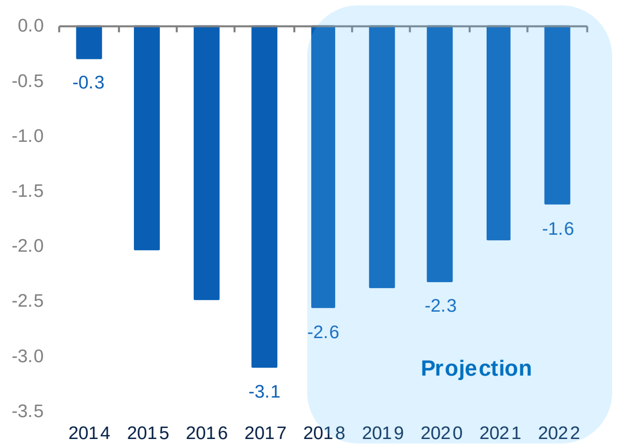
It should be noted that the fiscal deficit projection for 2018 is 0.3 pp lower than the estimate made three months ago. The adjustment is due to the surprise drop in the execution of public infrastructure works. As mentioned earlier, the government has difficulty making progress with spending on reconstruction in the northern part of the

3: Corresponding to the 2017 financial year. Between March and April more than S/5 billion came from the regularisation in the 2017 financial year. This is a record level and S/2.3 billion more than was collected for the 2016 financial year (50% of this increase is the result of collection from the mining sector).
4: Equivalent to VAT in other countries.In addition to the positive effect of the recovery in domestic demand, the increase in the drawdown rate also contributed positively to the increased collection of the IGV tax.
5: This is mainly due to the return of taxes to exporters.
6: The new Legal Framework for Reconstruction approved at the end of May (Law 30776) is expected to begin to bear some fruit. This new scheme allows for the following: simplifying the cycle of investments and hiring, expanding contracting procedures to include a similar form to that of the Pan American Games when the works are complex (through State-to-State agreements), and establishing exceptions in issues of environmental and archaeological regulation.
7: The construction works at the eight sporting venues encompass a budget for this year of just over one billion soles.

country: between January and September 20% of the government's target for this year was executed (a target equivalent to USD 1.227 billion); something similar is occurring with the second line of the Lima metro, which is 30% ahead in the first nine months of 2018 (with respect to the initial target equivalent to USD 370 million by 2018, a target that was later reduced).

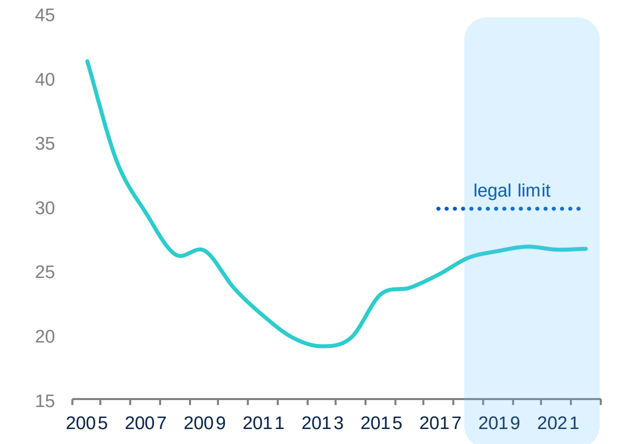
In 2019, the fiscal deficit will continue to moderate and we expect it to reach a level equivalent to 2.4% of GDP. This scenario is consistent with higher revenues, measured as a percentage of GDP, in a context in which the growth of activity will accelerate (from 3.6% in 2018 to 3.9% in 2019) and in which the increase in the rates of the selective consumption tax for some products will be in force from the beginning of the year (they were introduced in May 2018). In addition, we incorporate that tax refunds will decrease as a percentage of GDP. On the other hand, public investment will decline next year (Table 3.3) due to the change of sub-national government authorities and the still-slow progress of spending on public infrastructure. We estimate that fiscal consolidation will continue in the following years and that it will converge in 2022 at a level of between 1.5% and 2.0% of GDP (see Figure 4.3). This scenario is consistent with a gross public debt that will reach a level close to 27% of GDP, below the 30% limit contemplated in the Fiscal Responsibility and Transparency Law (see Figure 4.4).

Figure 4.3 Fiscal result
(% of GDP)



Source: BCRP, MEF (Ministry of Economy and Finance) and BBVA Research

Figure 4.4 Gross national debt
(% of the GDP)

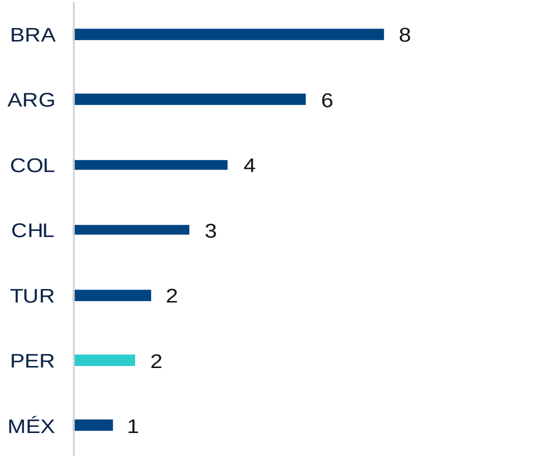


Source: BCRP, MEF (Ministry of Economy and Finance) and BBVA Research

Beyond the fact that part of the reduction of the fiscal deficit foreseen for this and next year is explained by the difficulty faced by the Government in executing investment expenditure, the consolidation path of the public accounts positions Peru well in comparison with other emerging countries. At the macro level there is fiscal strength. And it is not only the low deficit (and its downward trend) or the relatively limited level of public debt, as shown in Figures 4.5 and 4.6, but it is worth noting the fact that about 90% of that debt is agreed at a fixed interest rate, that about 60% of the debt is denominated in local currency, and that the average life is twelve years. This has been one of the factors that explain why international risk rating agencies have kept Peru's sovereign credit rating unchanged[8], something that has not been the case with other emerging economies. All of this is favourable for the country, especially in a context in which international financing conditions will tighten and in which external risks have increased.

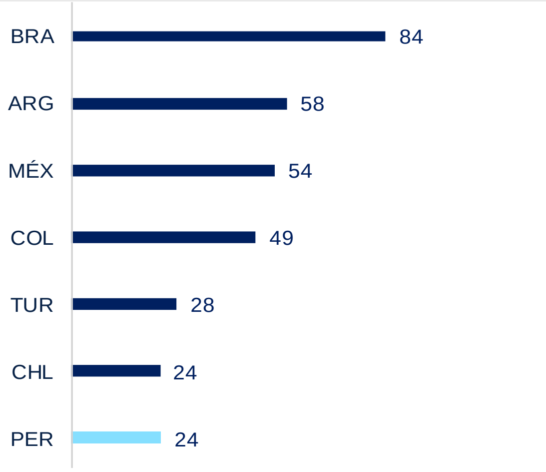
8: In August Moody's maintained Peru's sovereign credit rating at A3 (with a stable outlook) and the following month Fitch also maintained its rating at BBB+ (with a stable outlook).

Figure 4.5 Fiscal deficit*
(% of GDP, at the end of 2017)



*In the case of Peru, this is the data from 3Q18
Source: BBVA Research

Figure 4.6 Public debt
(% of GDP, year-end 2017)



Source: IMF

It is important to mention that the country still has an infrastructure gap to close in sectors such as transportation, education or health. To achieve this, it is necessary to improve the government's spending capacity (at all three levels). Doing so, however, could complicate the fiscal consolidation, even if spending is more efficient. For this reason, it is also important to increase revenue, which in structural terms has suffered a significant drop in recent years[9].

Along these lines, the Government has been working on a tax reform. The first measures have been approved within the framework of powers delegated to it by Congress and seek to adapt Peruvian legislation to international best practices in order to increase transparency and reduce tax avoidance[10]. The State has also, in order to reduce the rate of tax evasion, been implementing a strategy to promote the use of electronic payment vouchers (CPEs) by sellers and buyers. The electronic emission system is a tool that allows transactions to be instantly documented, reducing the levels of omission in the declaration of income and sales. Until 2017, this system was optional; from 2018 onwards, it has been obligatory to issue CPEs for companies considered to be the main taxpayers, for IGV tax retention and collection agents, and for those newly registered with the RUC. On the purchasers' side, as an incentive to apply for CPEs in a transaction, the Government will seek to allow them to deduct some expenses when declaring their income tax (this measure is like an advertisement). It is important to point out that as of May 2018, about 164,000 companies already issue CPEs and this figure is expected to rise to more than 230,000 by the end of the year. It is also important to mention in this context that the IMF (2018)[11] points out that digitalisation can reduce the public and private costs of tax compliance, as well as increase the collection of indirect taxes. For example, since the mandatory introduction of electronic invoicing in Estonia in 2014, the rate of non-compliance with the IGV tax[12] fell by 5 pp (of potential collection) in one year. Electronic invoicing allowed the tax collector to automatically compare tax credit claims against the payment of the tax. In addition, with more conventional Big

9: Major tax non-compliance (evasion and avoidance) would have been instrumental in this outcome, as would lower metal prices and low economic growth.
10:Anti-circumvention measures will prevent the use of tax loopholes especially in operations with international parent or subsidiary companies.For example, forcing taxpayers to report who their final beneficiaries from companies are, modifying the limit for interest deductions on loans between related and independent parties in order to avoid erosion of the tax base through the payment of this item.In addition, to make sources of income transparent, Peru recently ratified its accession to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (CAAMMT).This will make it possible to exchange and cross tax information on natural and legal persons in more than 150 countries.
11:For more details see the Tax Monitor's "Digital Governance" chapter. IMF (April 2018).
12: In 2013, the default rate stood at 14% of potential IGV tax revenue. In 2014 it stood at 9%.

Data tools, taxpayer data was used to identify risks in IGV credit claims, as well as continuous monitoring of those most prone to fraud[13].

Finally, the Government has also been working on other tax[14]measures, which deal with the simplification of income tax regimes, the rationalisation of tax benefits, and the strengthening of local government revenues.

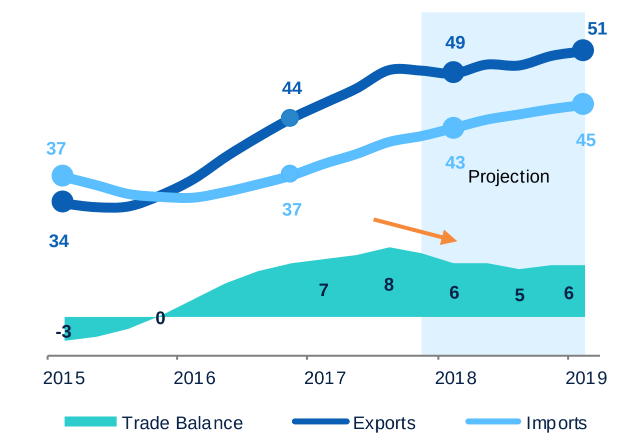
13: For example, online adjustments quickly repeated by taxpayers that systematically reduce or reverse their liabilities.
14: They will be presented to Congress as bills for debate

5. External sector: trade surplus remains relatively high despite adjustment in terms of trade

The trade surplus continued until July, when it accumulated around USD 8 billion in last twelve months, a level equivalent to 3.6% of GDP. This occurred in a context in which the metals prices increased and world growth as robust, so exports went from USD 45 billion at the end of last year to about USD 50 billion in July. Within exports, the increases were widespread, with an expansion in shipments abroad of traditional (mining, especially) and non-traditional products (fabricated metal products, chemical, basic metal industries and jewelry, textile, and agricultural). On the side of imports there was also an increase -although not as marked as that of exports- and these went from around USD 39 billion at the end of last year to just over USD 41 billion in July,thus recognizing the best performance of domestic demand and the increase in the price of oil. The three components of imports increased throughout the year, for example, in the case of imports of inputs, also due to the increase in prices.

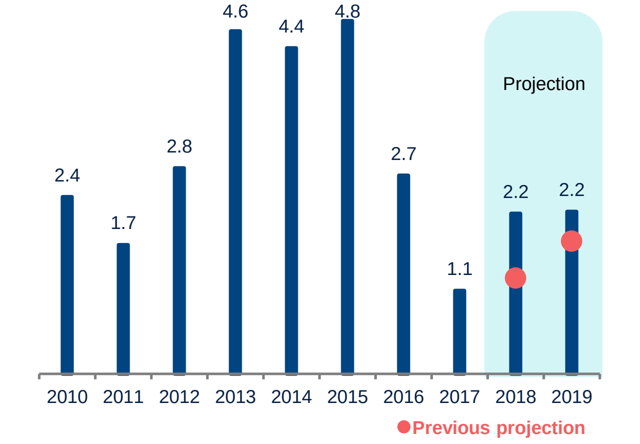
In August, however, the trade surplus decreased. We estimate that this is the beginning of a downward trend over the next few months, which is supported by the strong correction in the decline that has been registered in the prices of metals and in the transitory difficulties that are in the mining production. In this way, the trade balance will be around USD 6 billion in 2018 (see Chart 5.1). Next year, although, the terms of trade will decrease and demand keep good performance. There will also be a normalization in mining and hydrocarbon production. to which will be added the extraction of copper in the expansion of Toquepala and iron in the expansion of Marcona. As a result, trade balance will reach USD 6 billion. With respect to the forecasts presented in our previous quarterly report, we have adjusted the trade surplus downwards in 2018 and 2019 due to the revision in the same sense of metal prices and (in 2018, in particular) of the production mining and hydrocarbons, as well as the upward adjustment in the average price of oil.

Figure 5.1 Balance of trade
(USD billions, cumulative 4 quarters)



Source: Central Reserve Bank of Peru and BBVA Research

Figure 5.2 Deficit in the current account of the balance of payments (% of GDP)



Source: Central Reserve Bank of Peru and BBVA Research

In terms of the deficit in the current account of the balance of payments, at the end of the second quarter it is located at a level equivalent to 1.4% of GDP. The expected decrease in the trade surplus will lead to an increase in the short term and close the year around 2.2%. In our baseline scenario, this deficit will continue at similar levels next year. The current level of deficit in the current account of the balance of payments and the one we expect to have in the next few years is relatively low, being broadly covered, for example, by direct foreign investment in the country (in around 3.0% of GDP this year and 3.6% next year) or with the net international reserves of the central bank (equivalent to 27% of GDP). The low external deficit, together with the limited short-term external liabilities (equivalent to 3.8% of GDP), the high net international reserves, the soundness of the fiscal accounts, and the credibility of the Peruvian macroeconomic policy, is a a positive aspect, valued above all in a situation in which the costs of external financing are increasing and will continue to do so.

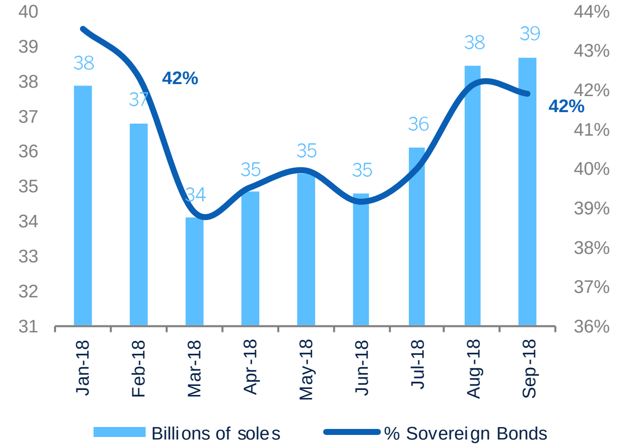
6. Local financial markets resist international turbulence that is affecting emerging economies

In the local exchange market, the Peruvian currency continued to face depreciation pressures. These pressures have mainly reflected external factors such as the perception that the Fed will be more aggressive in its monetary normalisation process (Figure 6.1), the escalation of protectionist trade measures, and the greater signs of a slowdown in China, a context in which metal prices fell significantly.

Figure 6.1 Probability of three Fed rate increases in 2019 (%)

Source: Bloomberg

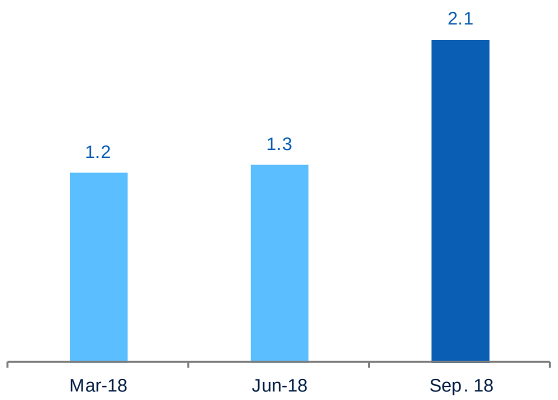
Figure 6.2 Non-resident holdings of Sovereign Bonds (%)



Source: MEF (Ministry of Economy and Finance) and BBVA Research

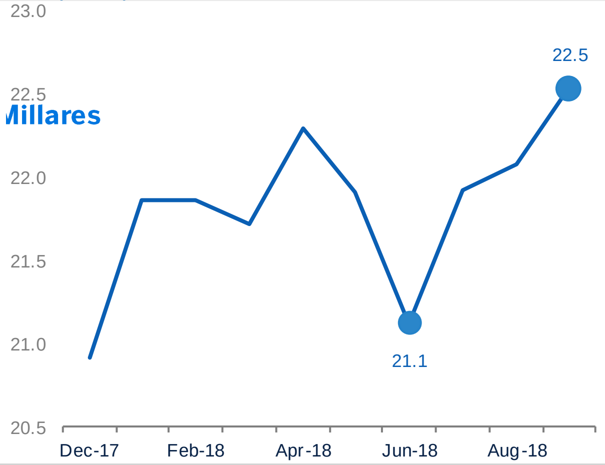
Although foreign investors maintain interest in sovereign bonds (their holdings have continued to increase in recent months, going from a balance of S/35 billion in June to S/39 billion in September, see Figure 6.2), exchange pressures have been observed through derivatives (perhaps to cover positions that were uncovered, see Figure 6.3); in recent months there has also been an increase in investments made abroad by private pension fund managers (they have grown by USD 1.4 million since June) in line with the continuous rise in the operating limit that they have for doing this (see Figure 6.4).

Figure 6.3 Net balance of non-delivery Forward (sale minus purchase, from the point of view of the bank, in USD million)



Source: Central Reserve Bank of Peru

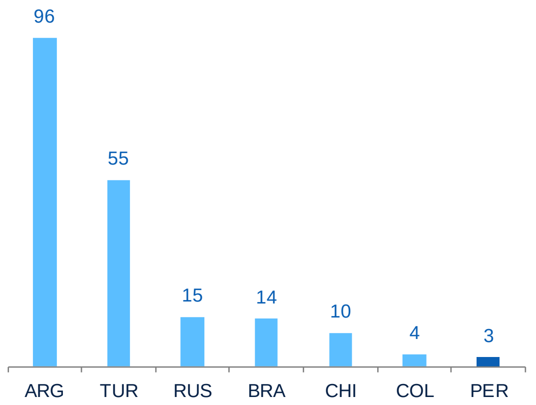
Figure 6.4 Foreign Investments of the Private Pension System (basis points)



Source: Central Reserve Bank of Peru

Despite pressures on the local currency, central bank exchange rate interventions have been infrequent in recent months and have been limited to the use of exchange swaps, which imply a contingent liability in local currency for the central bank and thus do not compromise net international reserves (since June, it has only intervened on four occasions through exchange swaps totalling the equivalent of USD 837 million). In the context of emerging economies, the depreciation of the Peruvian currency has been relatively limited (see Figure 6.5). The greater resilience reflects the country's good macroeconomic fundamentals, including fiscal soundness, a relatively low external deficit (balance of payments current account deficit equivalent to 1.1% of GDP in 2017, which we estimate will increase to 2.2% in 2018 and 2019, a level that will remain low), and high net international reserves.

Figure 6.5 Increase in selected emerging markets exchange rate (exchange rate defined as local currency units per USD, year-to-date % change*)



* Figures as at 12 October Source: Bloomberg and BBVA Research

Figure 6.6 Exchange rate (PEN/USD)

Source: Central Reserve Bank of Peru and BBVA Research

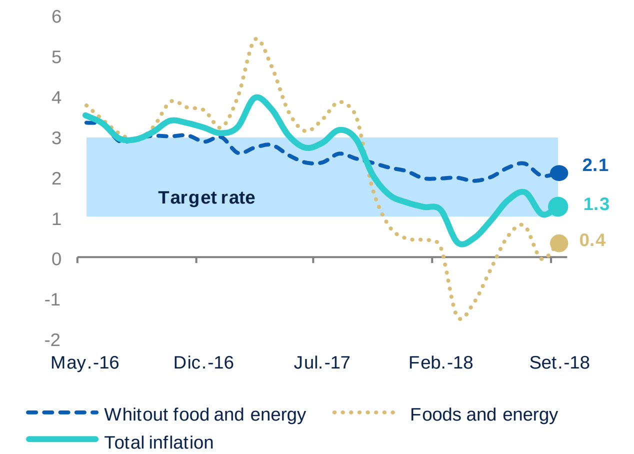
In projection, we anticipate that the exchange rate will end this year at around 3.33, not much different from the current level, and closer to 3.30 by the end of next year. The fall in the USDPEN in 2019 is supported by the supply of dollars both on the commercial side (the trade balance will be in surplus by almost USD 6 billion, despite the decline in metal prices) and on the financial side (foreign direct investment, for example in the mining sector), elements that will mitigate the effects of the rise in the Fed's monetary policy rate. This forecast is a little higher than the one we presented in our previous report, especially for the short term, due to the downward correction in terms of trade.

7. Inflation: without major pressures and converging toward the centre of the target range

In recent months, the price outlook has remained benign. In September, year-on-year inflation stood at 1.3%, very close to the lower limit of the Central Bank's target range (2%, +/- 1 pp). This result was achieved in a context of contraction in food and beverage prices (due to a high year-on-year comparison base resulting from the effects of the El Niño phenomenon in 2017 on some foods), which offset the rise in some services, fuels and goods which are more closely linked to the exchange rate. Expectations and inflationary trend indicators (such as inflation without food or energy) are between 2.0% and 2.5% (see Figure 7.1).

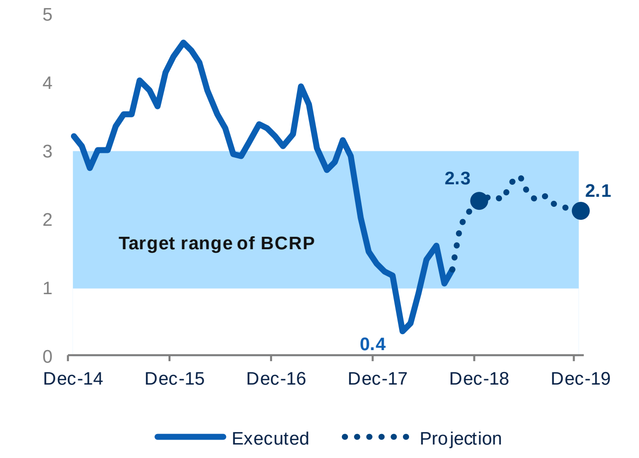
We estimate that inflation will soon be close to 2% and that it will close the year at around 2.3%, remaining around that level in the first quarter of 2019. This forecast is consistent with the anticipated normalisation of some foodstuff prices (which are currently declining year-on-year), with an increase in the depreciation rate of the local currency in the short term, and with the gradual decrease in the looseness maintained in some sectors of the economy (in the last four years GDP has increased below its potential pace). Later, with the downward correction of the oil price and the appreciation of the local currency (in year-on-year terms), inflation will yield a little and close 2019 at just over 2% (see Figure 7.2).

Figure 7.1 Inflation: total; without food and energy; and only food and energy (change % YoY)



Source: Central Reserve Bank of Peru and BBVA Research

Figure 7.2 Inflation (change % YoY CPI)



Source: INEI (National Statistics & IT Institute) and BBVA Research

It is worth mentioning that, regarding what was foreseen in our previous report, we revised our inflation projection upwards in 2018, and downwards in 2019, mostly linked to the exchange rate. Thus, for example, for 2018 we revised slightly upwards, from 2.0% forecast 3 months ago to 2.2%, which is mainly due to the influence of a temporarily higher exchange rate in the coming months than expected (for the end of 4Q18 a PEN of 3.33 is now projected versus 3.26 three months ago). For 2019, the inflation forecast has been revised downwards, from 2.4% to 2.2%, due to the end-of-period appreciation that we now have in the USDPEN (in the previous version it was depreciating).

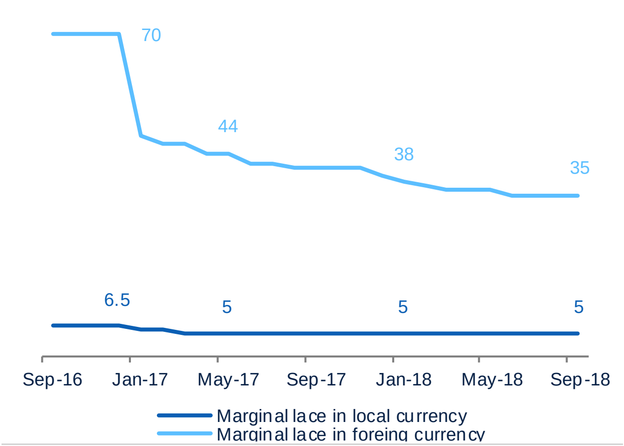
8. Monetary policy: reference rate at 2.75% until early 2019

With the benign price outlook, **the central bank has maintained since March the reference interest rate at 2.75%**, which implies an ex-ante real interest rate of 0.3% and, thus, an **expansive monetary position** (the central bank estimates the neutral real interest rate at 1.75%). This has taken place in a context in which stimulus is still required to consolidate the recovery that is beginning to be observed in private sector spending and in which depreciation pressures on the local currency have been moderate.

Likewise, another instrument that the Central Bank is using in line with an expansive policy is the reduction of the reserve rate in foreign currency (Figure 8.1). With this, it releases dollars to the economy and reduces the effect of rising international interest rates, in a context of moderate devaluation pressures of the local currency.

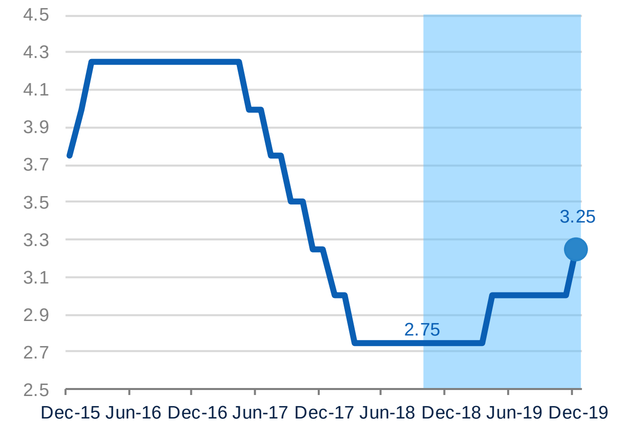
In its press releases, the central bank has emphasised that it will maintain an expansive monetary position until inflation converges to the centre of the target range, inflationary expectations are anchored, and the GDP is close to its potential level. Taking this into account, **we estimate that the policy rate will remain at 2.75% for the remainder of this year and until the beginning of 2019**, and then, in the second quarter of next year, when economic activity is more consolidated, inflation is (temporarily) around 2.5%, and the currently positive differential between sol-dollar interest rates has closed, start to gradually orient it to a more neutral level, closing that year at a level of 3.25% (see Figure 8.2).

Figure 8.1 Legal reserve
(% of total bonds subject to reserve requirements)



Source: Central Reserve Bank of Peru

Figure 8.2 Monetary policy interest rate
(%)



Source: Central Reserve Bank of Peru and BBVA Research

9. Risks to our growth forecasts for 2018 and 2019

Among the main **external risk factors** that could deviate our growth forecasts with respect to the baseline scenario are those that follow.

- Our baseline scenario assumes that trade tensions will continue into 2019, with the tariff rate increasing from 10% to 25% on Chinese imports worth USD 200 billion in January 2019. The risk is that more protectionist measures will be deployed. For example, if Trump's threat to apply tariffs on the remaining USD 267 billion of Chinese imports, and China's eventual responses, are implemented, it could have effects on the global economy. It is important to note that Trump is unlikely to go through with the threat of taxing all Chinese imports because it would affect sectors he has sought to protect so far (key goods in the supply chain of technology companies and vehicles). On the other hand, we estimate that the measures already announced will have fairly insignificant direct impacts on the Peruvian economy in 2018 and 2019.

- A surprise increase in aggressiveness of the US Federal Reserve's monetary policy adjustment, due to an acceleration of inflation. Under this risk scenario, we would have a stronger dollar, higher global interest rates for Peru, lower copper prices, and probably lower growth in Peru's main trading partners, which would also lead to lower GDP growth locally.

- A more marked slowdown in China's economy. The probability of this scenario occurring is limited by the resilience that is being shown by the Chinese economy and by the monetary and fiscal stimulus measures that are being implemented to sustain growth.

On the local side, the main risk factors that could derail our growth forecasts are those that follow.

- On the downside, less progress in the construction of the public infrastructure that we are considering, such as the reconstruction works and the second metro line in Lima.

- More noticeable negative impact of political noise on business confidence

- El Niño Costero of moderate or strong intensity. As of October, the most likely scenario is that there will be normal summer conditions in the eastern Pacific area (see Figure 3.11)

- As an upside risk factor, however, we have a higher-than-planned anchovy catch quota for the second season of 2018.

10. Tables

Table 10.1 Macroeconomic forecasts

	2015	2016	2017	2018	2019
GDP (change % YoY)	3.3	4.0	2.5	**3.6**	**3.9**
Domestic demand (change % YoY)	2.9	1.1	1.4	**4.1**	**3.7**
Private consumption (change % YoY)	4.0	3.3	2.5	**3.7**	**3.5**
Public consumption (change % YoY)	9.8	0.2	0.2	**1.9**	**3.6**
Gross fixed investment (change % YoY)	-5.2	-4.4	-0.3	**4.0**	**4.8**
Inflation (YoY, %, EOP)	4.4	3.2	1.4	**2.3**	**2.1**
Exchange rate (vs. USD, EOP)	3.39	3.40	3.25	**3.33**	**3.30**
Policy interest rate (%, EOP)	3.75	4.25	3.25	**2.75**	**3.25**
Fiscal balance (% of GDP)	-2.0	-2.5	-3.1	**-2.6**	**-2.4**
Current account (% of GDP)	-4.8	-2.7	-1.1	**-2.2**	**-2.2**
Balance of Trade (USD billions)	-2.9	2.0	6.6	**6.0**	**6.0**

Forecast closing date: 12 October 2018.
Source: Central Reserve Bank of Peru and BBVA Research Peru

Table 10.2 Quarterly macroeconomic forecasts

	GDP (change % YoY)	Inflation (YoY, %, EOP)	Exchange rate (vs. USD, EOP)	Monetary policy interest rate (%, EOP)
1Q16	4.6	4.3	3.41	4.25
2Q16	3.9	3.3	3.32	4.25
3Q16	4.7	3.1	3.38	4.25
4Q16	3.1	3.2	3.40	4.25
1Q17	2.3	4.0	3.27	4.25
2Q17	2.6	2.7	3.27	4.00
3Q17	2.7	2.9	3.25	3.50
4Q17	2.3	1.4	3.25	3.25
1Q18	3.1	0.4	3.25	2.75
2Q18	5.4	1.4	3.27	2.75
3Q18	**2.2**	1.3	3.31	2.75
4Q18	**3.8**	**2.3**	**3.33**	**2.75**
1Q19	**5.0**	**2.3**	**3.30**	**2.75**
2Q19	**3.5**	**2.4**	**3.28**	**3.00**
3Q19	**4.2**	**2.2**	**3.29**	**3.00**
4Q19	**3.3**	**2.1**	**3.30**	**3.25**

Forecast closing date: 12 October 2018.
Source: Central Reserve Bank of Peru and BBVA Research Peru

DISCLAIMER

This document, prepared by BBVA Research Department, is informative in nature and contains data, opinions or estimates as at the date of its publication. These derive from the department's own research or are based on sources believed to be reliable, and have not been independently verified by BBVA. BBVA therefore makes no guarantee, either express or implied, as to the document's accuracy, completeness or correctness.

Any estimates contained in this document have been made in accordance with generally accepted methods and are to be taken as such, i.e. as forecasts or projections. Historical trends in economic variables (positive or negative) are no guarantee that they will move in the same way in the future.

The contents of this document are subject to change without prior notice, depending on (for example) the economic context or market fluctuations. BBVA does not give any undertaking to update any of the content or communicate such changes.

BBVA assumes no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

Neither this document nor its contents constitute an offer, invitation or solicitation to acquire, disinvest or obtain any interest in assets or financial instruments, nor can they form the basis of any contract, undertaking or decision of any kind.

In particular as regards investment in financial assets that could be related to the economic variables referred to in this document, readers should note that in no case should investment decisions be made based on the contents of this document; and that any persons or entities who may potentially offer them investment products are legally obliged to provide all the information they need to take such decisions.

The contents of this document are protected by intellectual property law. The reproduction, processing, distribution, public dissemination, making available, taking of excerpts, reuse, forwarding or use of the document in any way and by any means or process is expressly prohibited, except where this is legally permitted or expressly authorised by BBVA.

BBVA Research

This report has been produced by the Peru Division

Chief Economist, Peru
Francisco Grippa
fgrippa@bbva.com

Economist
Marlon Broncano
marlon.broncano@bbva.com

Economist
Yalina Crispín
yalina.crispin@bbva.com

Economist
Vanessa Belapatiño
vanessa.belapatiño@bbva.com

Economist
Ismael Mendoza
ismael.mendoza@bbva.com

BBVA Research

Chief Economist BBVA Group
Jorge Sicilia Serrano

Macroeconomic Analysis
Rafael Doménech
r.domenech@bbva.com

Digital Economy
Alejandro Neut
robertoalejandro.neut@bbva.com

Global Macroeconomic Scenarios
Miguel Jiménez
mjimenezg@bbva.com

Global Financial Markets
Sonsoles Castillo
s.castillo@bbva.com

Long term Global Modelling and Analysis
Julián Cubero
juan.cubero@bbva.com

Innovation and Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

Financial Systems and Regulation
Santiago Fernández de Lis
sfernandezdelis@bbva.com

Digital Regulation and Trends
Álvaro Martín
alvaro.martin@bbva.com

Regulation
Ana Rubio
arubiog@bbva.com

Financial Systems
Olga Cerqueira
olga.gouveia@bbva.com

Spain and Portugal
Miguel Cardoso
miguel.cardoso@bbva.com

United States
Nathaniel Karp
nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Middle East, Asia and Big Data
Álvaro Ortiz
alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

Asia
Le Xia
le.xia@bbva.com

South America
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Francisco Grippa
fgrippa@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

CONTACT DETAILS:
BBVA Research Peru Av. República de Panamá 3055, San Isidro, Lima 27, Peru. Tel: + 51 12091035-bbvaresearch@bbva.com
www.bbvaresearch.com