

Economic Watch

Peru

Lima, August 1, 2011
Economic Analysis

Francisco Grippa
fgrippa@grupobbva.com.pe

Brazil and Peru: opportunities that start to be exploited

- **Economic links between Brazil and Peru are still relatively scarce**
However, in recent years there has been significant and sustained growth in trade and direct investment between them.
- **There are attractive opportunities for enhancing their relationship**
On the one hand, Peru has plenty of natural resources which could be used in Brazilian industries, it is a natural gateway for trade with Asia, and presents itself as a very interesting place for setting up companies. Brazil, on the other hand, is a big market, not only for Peruvian raw materials, but also for finished goods and tourism services, added to which are the investments that it could make in Peru.
- **Trade and investment between them will continue to increase in the coming years**
Together with the interest shown by their authorities, both the complementarity of these two economies and their relationship's low development suggest that links between them will improve at a fast pace.

Introduction

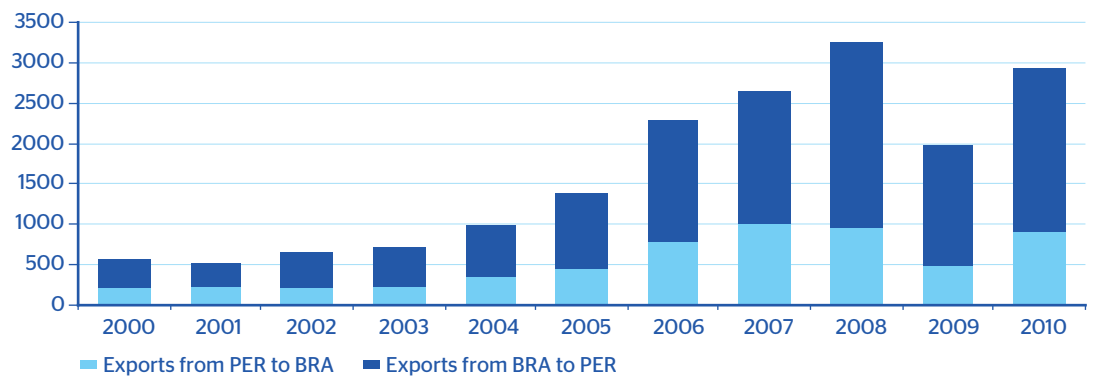
Brazil's growth in recent years has converted it into the world's seventh largest economy, with a GDP currently higher than USD 2 billion. This has resulted in a significant poverty reduction and an enlarging middle class. Along with its authorities' increasing interest in making it a global player, the growing demand of its population (nearly 200 million inhabitants) has been making the country look carefully at external markets. The most attractive of these are naturally its neighbours and the world's most dynamic economic areas.

It is in this context that Peru becomes an interesting partner for Brazil. Although the two countries share a border of almost three thousand kilometers, its difficult geography (Amazon rainforest) has so far hindered the connection between them, and thus the development of close economic ties. However, Peru represents, with its abundance of resources, a potential supplier of raw materials for Brazil's industries. It is also a natural gateway (reducing costs) for trade with the most dynamic economic area in the world: Asia. Furthermore, the business environment in Peru is one of the best in LatAm, the country boasting free trade agreements signed with economies that concentrate nearly 90% of world GDP (including the United States, China, Japan, the European Union and some of the largest countries in Southeast Asia), elements that make it an attractive place for Brazilian firms to install themselves. For Peru, Brazil represents not only a large potential market for its raw materials, but also for finished goods and tourist services due to its growing middle class. In addition, Brazilian firms wanting to locate in the country would need to invest, creating jobs. In sum, the benefits for both countries of strengthening links between them are significant. How is this process going on?

Commercial trade

Trade relations between Brazil and Peru operate under the Acuerdo de Complementación Económica N° 58 (ACE58) framework, an agreement signed at the end of 2005. Since then, the exchange of goods between the two countries has doubled, from USD 1,4 billion to nearly USD 3 billion (see Chart 1).

Chart 1
Trade between Brazil and Peru (USD million)



Source: : Brazilian Ministry of Development, Industry and Foreign Trade

Brazilian purchases are mainly concentrated in raw materials like copper, zinc and silver (See Table 1), but there are also increasing acquisitions of more processed products such as textiles, clothing, and agro-industrial goods. Meanwhile, Peru's purchasing from Brazil focuses on raw materials like crude oil, iron and steel manufactured products, and capital goods that include trucks, buses, trailers and equipment for construction and mining.

Table 1

Main Peruvian products traded with Brazil: 2010

Exported goods	Amount (USD million)	Percentage structure	Imported goods	Amount (USD million)	Percentage structure
Mining products	621	66%	Transportation vehicles and automotive parts	573	26%
Gasoline	47	5%	Oil	444	20%
Olives	24	3%	Steel products	133	6%
Chemicals	19	2%	Tubes for oil/gas pipelines	122	6%
Other	237	25%	Other	911	42%
Total	948	100%	Total	2183	100%

Source: SUNAT (Peru)

These figures show that trade links between the two countries are stepping up quickly. Moreover, there is ample room for this to continue. Firstly, because while in recent years trade has increased, it is still relatively small: Brazil buys from Peru less than 1% of what it acquires from the rest of the world. Secondly, because although the ACE58 has freed trade between these countries from tariffs, the exchange of goods has been eroded by non-tariff barriers affecting Peruvian shipments, including those of agricultural goods. A solution to this problem is already being implemented and this should boost acquisitions from Peru and will tend to level out the balance of trade between Peru and Brazil (currently favourable to Brazil). A third factor is the improvement in air and land connections between the two countries. In the case of land connection, the construction of the intercontinental highway (called Carretera Interoceánica), as part of the Initiative for the Integration of Regional Infrastructure in South America (IIRSA), will facilitate the access of Peruvian products to the growing Brazilian markets and, in turn, of goods produced in Brazil to the Pacific coast for subsequent shipment to Asian markets. Two of the three road connections with Brazil included in the IIRSA - the South and the North - have already been put into service. This increased connectivity will not only boost trade, but also tourism.

Summing up, there are elements that support continued trade growth between Brazil and Peru in the coming years. The renewed interest of their authorities in strengthening this relationship is an additional one and it is already being seen in the greater promotion of trade between them through public agencies (the so-called Multi-Service Centers, or CEMUs), which provide advice about potential markets, contacts, requirements and regulations.

Direct investment

In terms of investment, Brazilian firms have a total balance of a little over USD 1 billion¹ in Peru. It has been rising sharply in recent years, with an average annual growth rate of more than 30 per cent since late 2005. These investments are mainly concentrated in sectors such as mining and hydrocarbons, industry, and services. As in the case of trade, however, the amount of Brazilian direct investment in Peru is still relatively low. In comparison, Chile, a much smaller economy than Brazil and in many ways a country that competes with Peru rather than a complement, invests 30% more.

This suggests that there is a long journey lying ahead for Brazilian investment, not only in size but also in terms of diversification by sector. The attractiveness of Peru for Brazilian firms lies in its resources to supply raw materials, the facilities provided by its free trade agreements and its good business environment for use as an export platform. This implies that investments will not only continue in the current sectors, but will also go, for example, into energy and infrastructure in general, since, in order to benefit from the advantages offered by Peru, it requires expansion and improvement to its roads, ports, railways, airports and electricity interconnection.

1: Source: Proinversión

Table 2

Brazilian investments: announced and under way

Sector	Company	Projects	Investment (USD million)	Status
Hydrocarbons	Petrobras	Modernization of the refinery in Talara	700 (est.)	Announced / EIA approved
Hydrocarbons	Petrobras	Exploration and drilling of Block 58 (Cusco)	130	Announced
Hydrocarbons	Kuntur (Odebrecht)	South Andean gas pipeline	3000	Announced / EIA approved
Hydrocarbons	Odebrecht / Petrobras	Petrochemical industry in Southern Peru (Ilo/ Matarani)	2000	Announced
Mining	Vale do Rio Doce	Bayóvar (phosphates)	450 (est.)	Under way
Mining	Votorantim	Modernization of the Cajamarquilla refinery (zinc)	300	Under way
Iron and steel	Gerdau	Modernization of Siderperú	120 (est.)	Under way
Agro-industry and energy	Odebrecht	Chavimochic	852	Under way
		Olmos	300	Under way
Energy	Electrobras	Concessions for five hydroelectric power plants generating 6,7GW in total	15000 (est.)	Announced
Infrastructure	Odebrecht / Andrade Gutiérrez / GyM Consortium	Interoceánica Sur highway	800	Under way
Infrastructure	IIRSA Norte Consortium	Interoceánica Norte highway	500	Under way

Source: Peru's General Consulate in San Pablo and various other sources

For now, there are important projects under way and in portfolio (see Table 2). Brazilian firms Odebrecht and Andrade Gutiérrez have an active stake in the intercontinental highway (both north and south branches). Both Petrobras and Odebrecht have interests in the Camisea gas, its transportation to the Peruvian southern coast and its use in the petrochemical industry the second of the two firms has announced it will build between the ports of Ilo and Matarani. In the future, there will also be important investments resulting from the energy agreement signed last year between the two countries. There are plans to build a series of hydroelectric power plants in the Peruvian Amazon, a project in which Brazilian firms will have an active stake. Energy surpluses generated in either of the countries may then be sold to the other. For this reason, transmission lines to interconnect the electricity networks will also be constructed (or improved). The energy generated will not only support the economic expansion of both Peru and Brazil, but will also give the former access to reserves provided by a country with much greater energy potential. From Brazil's point of view, the agreement allows it to mitigate the impact of difficulties faced by the construction of hydroelectric plants in its own territory, as in the case of Belo Monte. Electrobras is already requesting the concession to build five hydroelectric plants in the Peruvian Amazon, with a combined power of 6,7GW. With a total investment of around USD 15 billion, this would make Brazil the main source of foreign direct investment in Peru. The project, however, will require previous approval from local communities for building the power plants, and this will in turn demand appropriate communication of the project's benefits and a possible compensation for damages caused. Certainly, the process could be hard, as seen recently in the case of the Inambari power plant.

Peruvian investments in Brazil, on the other hand, are limited. In the mining industry, Minsur acquired some companies from the Parapanema group in 2008. In services, Peru's ACP group and the State Support Centre for Entrepreneurs (Ceape) of Maranhão federal state in Brazil signed an agreement in 2010 to form the first bank specializing in microfinance in this country. Looking to the future, food and beverages firms have also shown interest in installing production plants in Brazil, given the large size of the potential market.

Final remarks

Trade and direct investments between Brazil and Peru are relatively small. However, in recent years they have begun to grow in a significant and sustained way. This trend is expected to continue due to the benefits that both countries will obtain from deepening their economic relations. The intercontinental roads connecting the two countries will trigger the development of greater links. In particular, there are opportunities for increasing trade in finished goods and tourism, while direct investments will increasingly target the energy and infrastructure sectors, to which a gradual increase in the number of Brazilian companies using Peru as an export platform may eventually be added. The renewed interest of both countries' authorities in strengthening the bilateral relationship, and facilities implemented in this regard, provide additional support.

AVISO LEGAL

Este documento, así como los datos, opiniones, estimaciones, previsiones y recomendaciones contenidas en el mismo, han sido elaborados por Banco Bilbao Vizcaya Argentaria, S.A. (en adelante "BBVA"), con la finalidad de proporcionar a sus clientes información general a la fecha de emisión del informe y están sujetas a cambio sin previo aviso. BBVA no asume compromiso alguno de comunicar dichos cambios ni de actualizar el contenido del presente documento.

Ni el presente documento, ni su contenido, constituyen una oferta, invitación o solicitud de compra o suscripción de valores o de otros instrumentos o de realización o cancelación de inversiones, ni pueden servir de base para ningún contrato, compromiso o decisión de ningún tipo.

El inversor que tenga acceso al presente documento debe ser consciente de que los valores, instrumentos o inversiones a que el mismo se refiere pueden no ser adecuados para sus objetivos específicos de inversión, su posición financiera o su perfil de riesgo ya que no han sido tomadas en consideración para la elaboración del presente informe, por lo que debe adoptar sus propias decisiones de inversión teniendo en cuenta dichas circunstancias y procurándose el asesoramiento específico y especializado que pueda ser necesario. El contenido del presente documento se basa en informaciones que se estiman disponibles para el público, obtenidas de fuentes que se consideran fiables, pero dichas informaciones no han sido objeto de verificación independiente por BBVA por lo que no se ofrece ninguna garantía, expresa o implícita, en cuanto a su precisión, integridad o corrección. BBVA no asume responsabilidad alguna por cualquier pérdida, directa o indirecta, que pudiera resultar del uso de este documento o de su contenido. El inversor debe tener en cuenta que la evolución pasada de los valores o instrumentos o los resultados históricos de las inversiones, no garantizan la evolución o resultados futuros.

El precio de los valores o instrumentos o los resultados de las inversiones pueden fluctuar en contra del interés del inversor e incluso suponerle la pérdida de la inversión inicial. Las transacciones en futuros, opciones y valores o instrumentos de alta rentabilidad (high yield securities) pueden implicar grandes riesgos y no son adecuados para todos los inversores. De hecho, en ciertas inversiones, las pérdidas pueden ser superiores a la inversión inicial, siendo necesario en estos casos hacer aportaciones adicionales para cubrir la totalidad de dichas pérdidas. Por ello, con carácter previo a realizar transacciones en estos instrumentos, los inversores deben ser conscientes de su funcionamiento, de los derechos, obligaciones y riesgos que incorporan, así como los propios de los valores subyacentes a los mismos. Podría no existir mercado secundario para dichos instrumentos.

BBVA o cualquier otra entidad del Grupo BBVA, así como sus respectivos directores o empleados, pueden tener una posición en cualquiera de los valores o instrumentos a los que se refiere el presente documento, directa o indirectamente, o en cualesquiera otros relacionados con los mismos; pueden negociar con dichos valores o instrumentos, por cuenta propia o ajena, proporcionar servicios de asesoramiento u otros servicios al emisor de dichos valores o instrumentos, a empresas relacionadas con los mismos o a sus accionistas, directivos o empleados y pueden tener intereses o llevar a cabo cualesquiera transacciones en dichos valores o instrumentos o inversiones relacionadas con los mismos, con carácter previo o posterior a la publicación del presente informe, en la medida permitida por la ley aplicable.

Los empleados de los departamentos de ventas u otros departamentos de BBVA u otra entidad del Grupo BBVA pueden proporcionar comentarios de mercado, verbalmente o por escrito, o estrategias de inversión a los clientes que reflejen opiniones contrarias a las expresadas en el presente documento; asimismo BBVA o cualquier otra entidad del Grupo BBVA puede adoptar decisiones de inversión por cuenta propia que sean inconsistentes con las recomendaciones contenidas en el presente documento. Ninguna parte de este documento puede ser (i) copiada, fotocopiada o duplicada en ningún modo, forma o medio (ii) redistribuida o (iii) citada, sin el permiso previo por escrito de BBVA. Ninguna parte de este informe podrá reproducirse, llevarse o transmitirse a aquellos Países (o personas o entidades de los mismos) en los que su distribución pudiera estar prohibida por la normativa aplicable. El incumplimiento de estas restricciones podrá constituir infracción de la legislación de la jurisdicción relevante.

Este documento será distribuido en el Reino Unido únicamente a (i) personas que cuentan con experiencia profesional en asuntos relativos a las inversiones previstas en el artículo 19(5) de la ley de servicios y mercados financieros de 2000 (promoción financiera) de la orden de 2005, (en su versión enmendada, en lo sucesivo, la "orden") o (ii) entidades de grandes patrimonios sujetas a lo dispuesto en el artículo 49(2)(a) a (d) de la orden o (iii) personas a las que legalmente se les pueda comunicar una invitación o propuesta para realizar una inversión (según el significado del artículo 21 de la ley de servicios y mercados financieros de 2000) (en adelante, todas estas personas serán "personas relevantes"). Este documento está dirigido únicamente a las personas relevantes y las personas que no sean personas relevantes no se deberán basar en el mismo ni actuar de conformidad con él. Las inversiones o actividades de inversión a las que hace referencia este documento sólo están disponibles para personas relevantes y sólo se realizarán con personas relevantes.

Ninguna parte de este informe podrá reproducirse, llevarse o transmitirse a los Estados Unidos de América ni a personas o entidades americanas. El incumplimiento de estas restricciones podrá constituir infracción de la legislación de los Estados Unidos de América.

El sistema retributivo del/los analista/s autor/es del presente informe se basa en una multiplicidad de criterios entre los cuales figuran los ingresos obtenidos en el ejercicio económico por BBVA e, indirectamente, los resultados del Grupo BBVA, incluyendo los generados por la actividad de banca de inversiones, aunque éstos no reciben compensación basada en los ingresos de ninguna transacción específica de banca de inversiones.

BBVA no es miembro de FINRA y no está sujeta a las normas de revelación previstas para sus miembros.

"BBVA está sometido al código de conducta de los Mercados de Valores del Grupo BBVA, el cual incluye, entre otras, normas de conducta establecidas para prevenir y evitar conflictos de interés con respecto a las recomendaciones, incluidas barreras a la información. El Código de Conducta en los Mercados de Valores del Grupo BBVA está disponible para su consulta en la dirección Web siguiente: www.bbva.com / Gobierno Corporativo".

BBVA es un banco, supervisado por el Banco de España y por la Comisión Nacional del Mercado de Valores, e inscrito en el registro del Banco de España con el número 0182.