1. Summary

The global environment improved in the last months of 2016 and is continuing to do so in early 2017. Global economic growth has accelerated, confidence has improved, industrial sector indicators are growing and there is an incipient improvement in global trade. Our forecasts are that world GDP will grow by 3.2% this year, slightly above the increase in 2016. In addition to the improvement in activity, inflationary pressures in developed economies have also increased. In this context, central banks in these economies will this year continue to adjust their rates gradually, as in the case of the FED, or they will begin to evaluate the quantitative stimulus they are implementing, as in the case of the ECB.

Locally, we have revised our growth projection downwards, from 4.1% to 3.5%. The delay in infrastructure construction, one of the main risk factors considered in the report that we published last quarter, materialised in early 2017. The gas pipeline works in Southern Peru, a project worth more than USD 7.3 billion, has been delayed because the consortium in charge of its construction was not able to finalise the financing to continue with the project. In line with what was established in the contract, the Government withdrew the concession. We estimate that, with respect to our previous scenario, the delay in the construction of the gas pipeline will take away about six tenths of a percentage point from economic growth in 2017.

The output growth forecast for 2017 of 3.5% takes into account infrastructure construction work on large projects such as the second Lima metro line, the new Talara oil refinery, the Lima and Chinchero-Cusco airports, and the Majes-Siguas irrigation project, which will all move forward at a faster rate this year. Our output growth forecast also considers that business confidence remains optimistic, at levels not so distant from the current one, which in turn is close to the highest for the last three or even four years, thus supporting non-mining investment and the creation of formal employment. The GDP projection incorporates too, on the extractive side, that copper production will continue to increase in 2017, albeit at a slower rate than in previous years, and that anchovy extraction will reach somewhat more than 5 million metric tonnes if current climate anomalies do not prolong. An additional element that has been considered is that the burden from the strong contraction that mining investment has undergone will dissipate, compensating for the smaller thrust of mining production and, in particular, of copper. Finally, the fiscal deficit target of 2.5% of GDP is taken into account, which means that the value added tax rate will not be reduced and that instead there will be exceptional tax revenues that will come from incentives to repatriate capital from abroad, thus giving the public sector room to accelerate its spending.

On the demand side, this forecasted GDP growth for 2017 reflects a larger contribution from domestic demand, particularly from private investment (which, even so, will still advance weakly) and from public spending, the first in an environment where the burden of mining investment is dissipating and confidence is holding in this upbeat stretch. This will mean higher imports, which together with the moderation in exports growth (reflecting the more limited expansion of mining production) will reduce the contribution of the external sector to GDP increase.

As for the financial markets, investors have been showing increased appetite for domestic assets. In that environment, the local currency has appreciated more than 2% so far this year. However, we expect that it will in the future tend to depreciate, probably more clearly in the second half of 2017, and that it will close the year at between 3.40 and 3.45 Sol per dollar. This projection is consistent with, on the one hand, that in the coming quarters capital inflows to emerging economies will tend to moderate in an environment where the Fed gradually raises its rate and central banks from other developed economies reassess their quantitative monetary stimuli and in which the incoming US administration makes investment in that country more attractive with the announced cut in taxes. On the other hand, the projection reflects that in the coming quarters the price of copper will decrease, China will moderate its economic growth, the thrust of mining production will slow and domestic demand will begin to gain traction (boosting imports), all of which will imply a certain deterioration in the balance of payments current account deficit (in the fourth quarter of 2016 it would have decreased substantially, almost closing according to our preliminary estimates).

In terms of prices, we expect that for a good part of the year inflation will keep around 3% or even somewhat above that. This projection considers that even if the world oil price does not have much additional room to move further upwards, in YoY terms it will continue to push inflation upwards (through local fuel prices), especially during the first half of the year. This forecast also incorporates some short-term pressures from food prices, related to recent weather anomalies that for the moment we believe are just transitory. In the second half of the year, when the effect of higher oil prices wears off and food prices increase at a more contained rate, inflation will tend to decline and we estimate that it will end the year at around 2.7%.

In this scenario, where spending by firms and families is still weak and where inflation is set to fall, we cannot rule out that the Central Bank will be encouraged to cut its policy interest rate in the second half of 2017. This would anticipate the smaller room the public sector would probably have to keep supporting economic activity growth next year, when no extraordinary tax revenue will be collected.

Finally, our forecasts for 2017 are subject to certain risks. On the external side, the financial vulnerabilities presented by China and the high uncertainty about the policies that the incoming administration will implement in the US. Locally, risks are related to further infrastructure works delays, lower business confidence if there is no improvement in the economy, and persistent weather anomalies. The risk balance on our economic growth forecast for this year is downwards.

DISCLAIMER

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