

3. Peru – output growth forecast for 2017 has been lowered to 3.5%

The downward adjustment is due to the delay in the construction of infrastructure

One of the risk factors in our growth forecasts for this year, described in our report on the previous quarter, materialised. The construction of infrastructure in 2017 has been weakened, mainly due to the postponement of the Southern Peru Gas Pipeline (GSP), a project worth more than USD 7,300 million. The consortium in charge of its construction was not able to finalise the financing to continue with the project, so that, in line with what was established in the contract, the Government withdrew the granting of the work.

We estimate that the smaller amount of infrastructure construction will take about six tenths of a percentage point away from the economic growth that we predicted three months ago for 2017. On the side of sectors, the impact will affect construction, non-primary manufacturing and services, while on the expenditure side the main impact will be on private investment (which will also drag back private consumption), mitigated by lower imports. Therefore, the expected recovery in domestic demand will be slower. Considering the time it will take to put the project back out to tender, our baseline projection scenario assumes that GSP construction work will resume in 2019.

However, the contribution of domestic demand to the growth of economic activity in 2017 will exceed the external sector

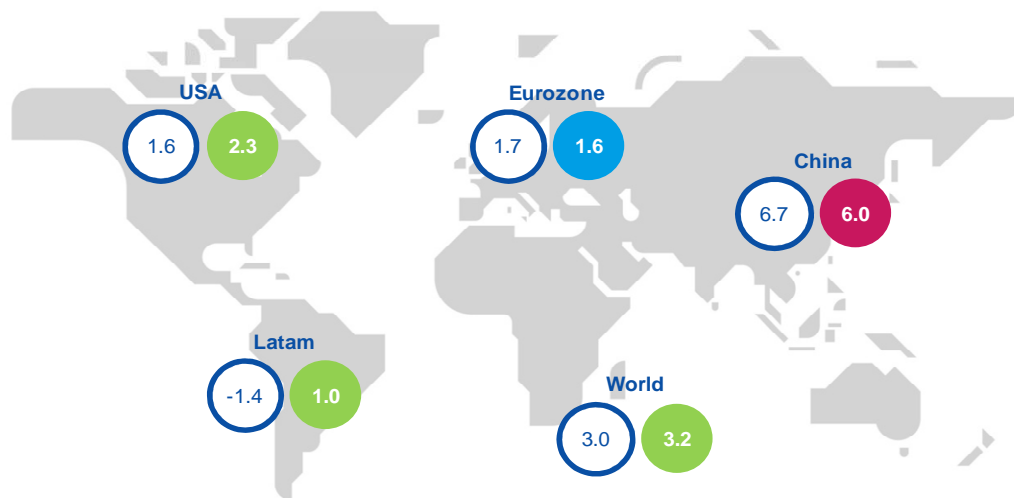
The base scenario for our forecasts considers the following:

- **External variables most relevant to the Peruvian economy**
 - Global GDP will perform better than last year (see Figure 3.1), especially in areas such as the US and Latin America, although China's dynamism will continue to moderate. The greater expansion of the US and LatAm will favour the demand for non-traditional Peruvian exports; on the contrary, the additional deceleration of China will affect the prices of the metals that Peru exports and probably the perception of risk for the Peruvian economy.
- **United States** We estimate that growth will accelerate in the short term due to the expectation of fiscal stimulus from the incoming administration (tax cuts, increased infrastructure spending) and the deregulation of certain activities. This will be carried out in a context where the labour market is solid, the rate at which wages rise maintains a certain upward trend (currently standing at around 2.5% YoY) and where corporate profits are improving. In addition, the drag of investing in the mining sector is dissipating (due to the recovery in the oil price) and the correction of inventories. However, the increase in the FED rate, a strong dollar and more

structural trends (lower productivity growth, for example) are in line with our forecast for US GDP growth in 2017 to 2.3%.

Figure 3.1

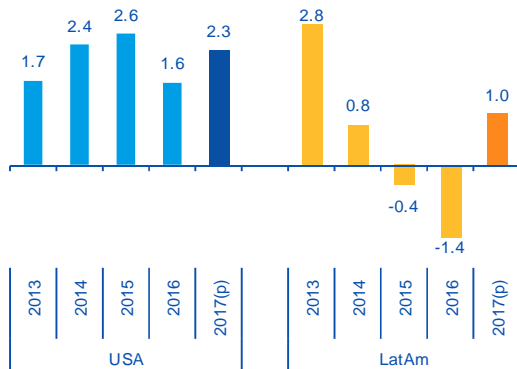
Global growth by geographic area estimated for 2016 and 2017¹
(change % YoY)



1. For 2017, green when growth accelerates, blue when it remains practically unchanged and red when it decreases.
Source: BBVA Research

- Latin America** After two years, economic activity in the region will once again expand, mainly due to the recovery of Brazil and Argentina and the improvement in Colombia's performance. The common denominator will be higher private investment, which will occur in an environment where commodity prices will rise, monetary policies will tend to become more flexible in several countries, reforms will be put forward or implemented (Brazil in fiscal and social security areas and Colombia regarding the reduction of VAT on the acquisition of capital goods). Furthermore, weather conditions in Colombia will improve in a more timely manner or, in the case of Argentina, there will be a more favourable environment for business (distortions being eliminated) and for accessing finance in capital markets. In this context, we estimate that LatAm will increase 1% in 2017, after falling back by 1.4% last year (see Figure 3.2).
- China** Our base scenario considers that economic growth will continue to moderate this year. Concern about growing financial vulnerabilities in some sectors of the country (real estate market, corporate sector indebtedness, public enterprises and parallel banking) will lead the authorities to lean a bit more towards the implementation of policies that prioritise financial stability instead of economic growth. That is to say, we are considering that there will be some more flexibility in the growth target for 2017, which could translate into a wider range around the medium-term target (6.5%). This will mean postponing additional monetary measures that seek to stimulate the economy and that macro-prudential measures are tightened somewhat more. In this context, we estimate that China will decelerate from 6.7% in 2016 to a rate closer to 6% this year (see Figure 3.3).

Figure 3.2

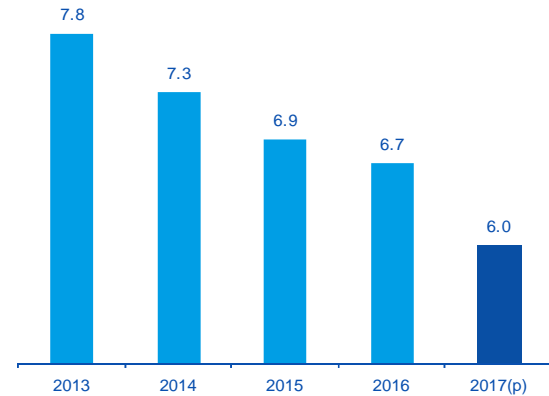
**The US and LatAm¹: GDP
(change % YoY)**

1. This corresponds to LatAm7, which consists of Brazil, Mexico, Argentina, Colombia, Venezuela, Chile and Peru.

(p): projection

Source: Bloomberg and BBVA Research

Figure 3.3

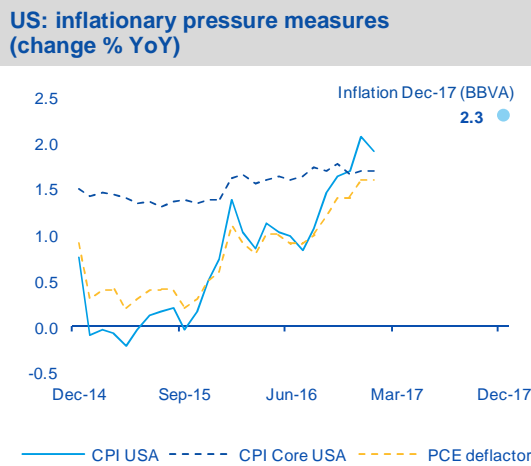
**China: GDP
(change % YoY)**

(p): projection

Source: Bloomberg and BBVA Research

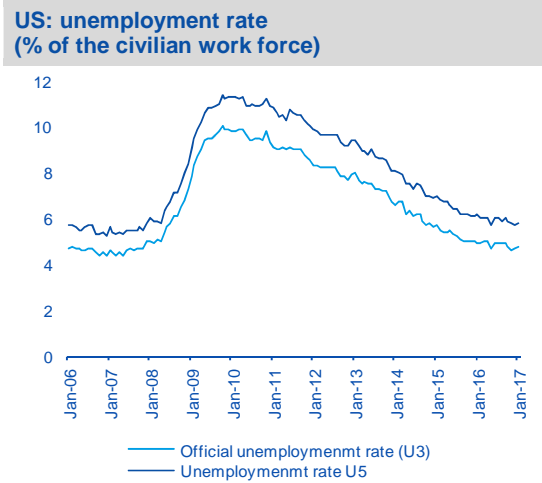
- Following the adjustment of 25 basis points last December, we expect that in 2017 the Fed will continue with a gradual and moderate increase in the US monetary policy interest rate. Inflationary pressures are increasing gradually (see Figure 3.4) in an environment of higher energy prices, lower labour market slack (see Figure 3.5) and expectations of a fiscal boost from the incoming administration; the strength of the dollar has been posting a steep rise. We anticipate that the Fed will act cautiously as there is still a great deal of uncertainty as to the policies that President Trump's administration will implement (what will be done, how it will be done, how much, when). The rotation of voting members that this year will be on the committee that takes the monetary policy decisions within the FED, (the new members have a more dovish bias than the outgoing members), also suggests that it will behave in that way. In this context, we estimate that during the first half of the year there will be a 25bp increase in the FED rate, to 1%, highly probable in June; then, in the second half, there would be another increase of similar magnitude, closing the year at 1.25%. This projection for the trend of the FED rate, higher expectations for economic growth and inflation, a certain appetite for global risk and the slight upward correction in the term-premium have been consistent with a moderate increase in yields of two-year (from the current 1.2% to 1.5% at year end) and ten-year (from the current 2.5% to 2.7% at year end) treasury bonds.

Figure 3.4



Source: Bloomberg and BBVA Research

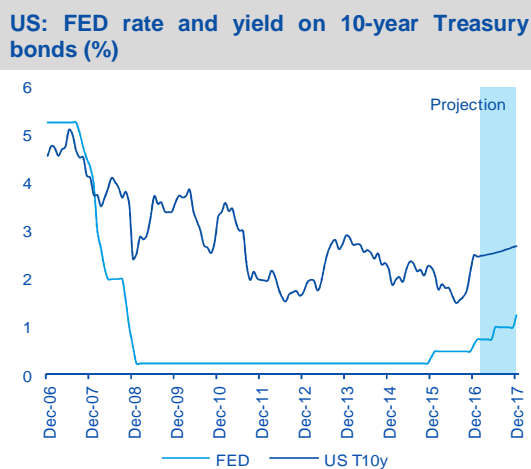
Figure 3.5



Source: Bloomberg and BBVA Research

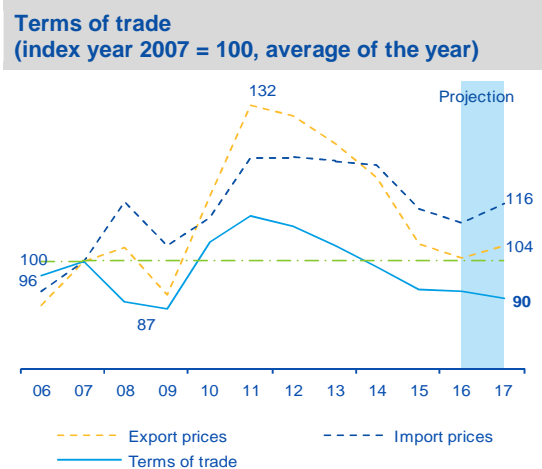
- The "search for yield" by global investors will be maintained throughout the year in an environment of relative abundance of liquidity and still low interest rates in the more developed countries. This will continue to favour the appetite for assets of emerging economies, among them Peru. However, as US dollar-denominated global interest rates (FED, US Treasury bonds, see Figure 3.6) are adjusted upwards and pressures to curb monetary stimuli from other developed countries' central banks increases (in the case of the ECB, for example, we estimate that by the end of the year tapering could start being evaluated and that this, in early 2018) would initiate the moderation in the trend in that demand for the assets of emerging economies. Locally, the support that the Peruvian sol has at this moment will decrease, perhaps more clearly in the second half of the year.

Figure 3.6



Source: Bloomberg and BBVA Research

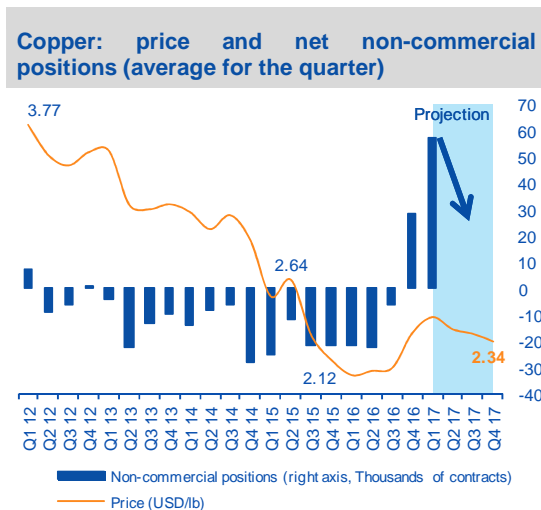
Figure 3.7



Source: Central Bank of Peru and BBVA Research

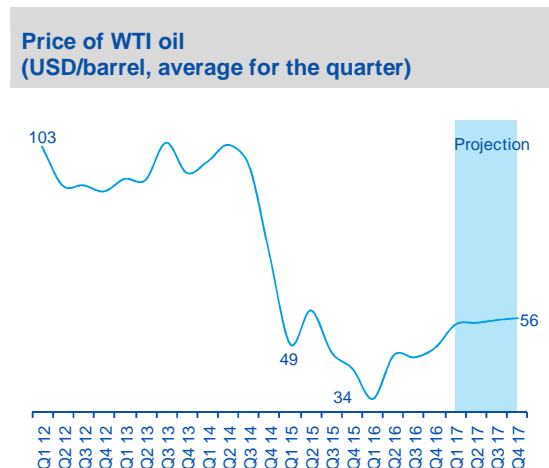
- The terms of trade as an average for the year will revert back in 2017 (see Figure 3.7), mainly due to the fact that although the price of copper is set to rise, the price of oil will also increase and in a more pronounced way.
- We estimate that the average price of copper will increase by 9% in 2017. At this time, the price of this metal, Peru's main export, is around 2.60 USD/lb. We believe that this level is far from what the most fundamental variables in the market suggest; on the contrary, it is mainly explained by a great deal of activity on the part of non-commercial agents (see Figure 3.8). These positions, which speculate that the price of copper will rise, have increased significantly over a short time. We expect that in the coming months these speculative positions will be corrected, so that the copper price will decline, being in the fourth quarter of the year at around 2.35 USD/lb. Despite the expected decline over the year, the average price of copper in 2017 (2.41 USD/lb.) will be higher than last year (2.21 USD/lb.)

Figure 3.8



Source: Bloomberg and BBVA Research

Figure 3.9



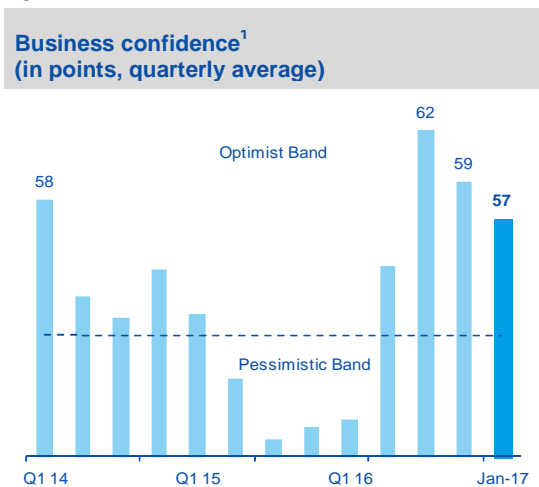
Source: Bloomberg and BBVA Research

- We forecast that the average price per barrel of WTI oil, a product imported by Peru, will increase by 28% this year. The price is currently around 53 USD/barrel. We estimate that throughout the year, it will increase gradually to around 56 USD/barrel in the fourth quarter. This will take place within a context in which, in general, the agreement on production quotas between the main oil exporting countries will continue to be implemented, leading to a downward correction of inventories, thus giving price support. The strength of the dollar, the recovery of shale oil production in the US (as a result of the price increase since the first quarter of last year) and some improvement in production in Libya and Nigeria will all limit the increase in the listed price. With this forecast, we anticipate that, for the price of a barrel of WTI oil throughout the year, the average price will increase in 2017 up to 55 USD/barrel from the 43 USD/barrel of last year.

- **Local Variables**

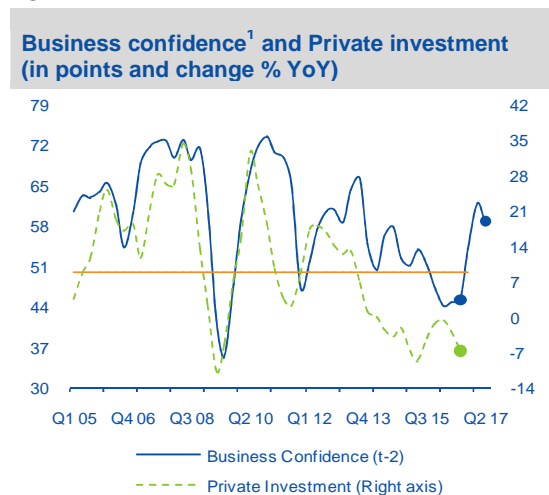
- Progress will be made in the construction of major infrastructure projects. The list of the largest projects we are keeping track of, includes one transport project (the second line of the Lima metro), two hydrocarbon projects (GSP and the new Talara refinery), two airports (Lima and Chinchero-Cusco) and two irrigation projects (Chavimochic III and Majes-Siguas). Our base projection scenario considers that this year the construction of the second line of the Lima metro, the Talara refinery, the Lima airport expansion, the Chinchero airport in Cusco and the Majes-Siguas irrigation project will accelerate. However, it considers that there will be no major progress on the Chavimochic III irrigation project or, above all, on the GSP. As a result, spending on these works will, in 2017, contribute six tenths of a percentage point to GDP growth.
- Business confidence is being maintained on the optimistic side, at levels not very different from current ones. Despite some decline over the last four months, business confidence remains relatively high, at levels close to the highest in the last three or even four years (see Figure 3.10). This favours non-mining investment and thus total private investment (see Figure 3.11), as well as some recovery in formal employment (limited by a lack of flexibility in the labour market). The measures that the State has announced to boost investment and in general to favour the business facilitating environment (administrative simplification of the State, reduction of bureaucratic barriers) will in future support business confidence, although additional delays in construction could erode it.

Figure 3.10



1. Measured through the expectation of entrepreneurs about how the economy will progress in the next three months.
Source: Central Bank of Peru and BBVA Research

Figure 3.11

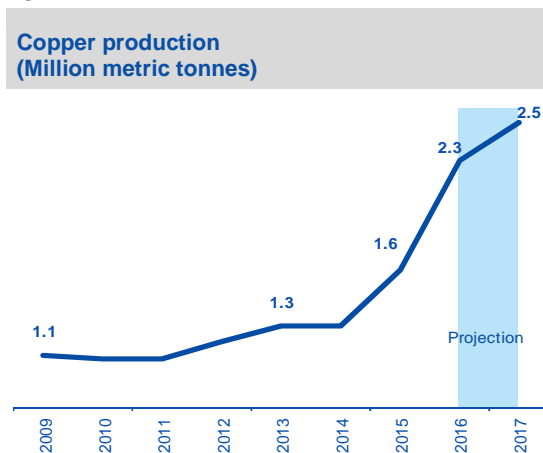


1. Measured through the expectation of entrepreneurs about how the economy will progress in the next three months.
Source: Central Bank of Peru and BBVA Research

- Copper production will continue to increase in 2017, albeit at a slower pace than in previous years. We estimate that copper extraction will be 2.5 million metric tonnes (see Figure 3.12), 10% more than last year. This figure is based on Las Bambas achieving its maximum annual operating capacity in 2017 and that Toromocho will gradually continue to approach its peak level. As a result, increased copper production will contribute 0.5%-0.6% to GDP growth.

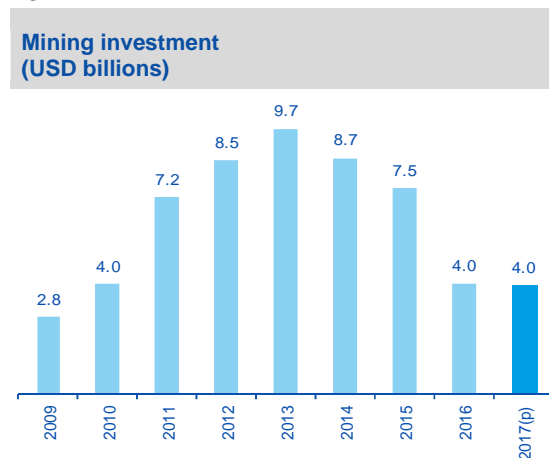
- Anchovy extraction will increase this year by about 100% (it decreased by 25% in 2016), reaching a little over 5.3 million metric tonnes. The forecast assumes that weather conditions will improve after the anomalies that occurred last year (a moderately intense El Niño phenomenon). That figure also includes the more than 600 thousand metric tonnes that were already captured last January and that correspond to part of the quota allocated for the second season of anchovy extraction belonging to 2016. Together with the positive impact it also has on economic activity, when used as an input in fish-meal and fish oil production, we estimate that the larger haul of anchovy will contribute about five tenths of a percentage point to GDP growth in 2017.

Figure 3.12



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

Figure 3.13

(p): projected.
Source: MINEM and BBVA Research

- Mining investment has completed its adjustment process and this year is practically constant (zero growth). After the last large copper mines (Las Bambas and the Cerro Verde expansion) were completed by the end of 2015, investment in the mining sector contracted sharply (see Figure 3.13), from USD 7.5 billion to about USD 4 billion in 2016. This as a result of the fact that the investment made in the production stage is less than that in the construction phase and that last year there were no other big construction projects starting up to take the batten (something that we did not anticipate in 2017). The decline in mining investment was equivalent to 1.5 percentage points of GDP. Our base scenario for this year forecasts that mining investment will remain at an amount that does not differ too greatly with that of last year and will therefore not generate a negative impact on GDP in 2017. On the other hand, when the drag dissipates, it will statistically favour the growth figure for economic activity by just over 1.5 percentage points. This positive effect will offset the lower momentum of this year's advance in copper production.
- The fiscal deficit will decline from 2.7 percent of GDP in 2016 to 2.5 percent this year, in line with the Government's target. This is, however, consistent with an acceleration of public spending as this will be financed, for example, by the exceptional tax collection that will result from the incentives to repatriate capital abroad that until now have not been declared to the tax authority. The acceleration of public spending also means that the general sales tax rate (see details below) will not be cut, a tax that is equivalent in other countries to VAT.

With these assumptions that characterise our base scenario, we expect GDP to grow 3.5% in 2017. On the sectoral side (see Table 3.1), we anticipate that the push for primary (extractive) activities will continue to be important, but will moderate compared to 2016 because the expansion in metallic mining production will be more limited in line with the lower advance of copper extraction, especially from the second quarter onward. This will more than compensate for the greater haul of anchovy, which will benefit fishing and primary manufacturing.

Table 3.1

GDP by productive sector (change % YoY)			
	2015	2016(e)	2017(p)
Farming	3,4	1,1	2,8
Fisheries	15,8	-10,1	25,2
Mining and oil and gas	9,4	16,3	5,5
Metal mining	15,6	21,2	5,3
Oil and gas	-11,6	-5,4	6,4
Manufacturing	-1,5	-1,9	3,0
Primary	1,3	-0,8	10,2
Non-primary	-2,4	-2,2	0,5
Electricity and water	5,9	7,3	6,3
Construction	-5,8	-3,5	1,7
Trade	3,9	1,7	1,4
Other services	5,1	4,3	3,8
Total GDP	3,3	3,8	3,5
Primary GDP	6,8	9,6	5,8
Non-primary GDP*	2,7	2,3	2,9

(e): estimated; (p): projected.

* Non-primary GDP excludes taxes and import duties.

Source: INEI, Central Bank of Peru and BBVA Research

The group of non-primary activities, on the other hand, will perform better in 2017. This includes the expansion that will be re-registered by both Construction and Non-Primary Manufacturing, which will however be limited in both cases. The first of them will advance after two years of decline, supported by infrastructure construction, increased public spending on investment and business confidence that has improved compared to the previous two years. The greater dynamism of the Construction sector will mean an increase in demand for Non-Primary Manufacturing, an activity that will expand again (although still in a limited way) after three years of contraction and which will also be favoured in 2017 by the higher growth of the commercial partners of Peru (particularly those that demand non-traditional exports) and the performance of non-mining investment in an environment in which the prospects of the business sector have improved.

On the expenditure side, we forecast that domestic demand will play a greater role in 2017 (see Table 3.2), while the contribution of the external sector to economic growth will decline in a context in which, the impulse from greater mining production will moderate (although non-traditional exports and fish-meal and fish oil exports will perform better) as imports start to recover due to the higher expenditure of the private and public sectors.

Table 3.2

GDP on the expenditure side (change % YoY)			
	2015	2016(e)	2017(p)
1. Domestic demand	3,0	0,6	2,8
a. Private consumption	3,4	3,4	3,0
b. Public consumption	9,5	2,0	4,3
c. Gross domestic investment	-1,0	-7,4	1,2
Gross fixed investment	-5,1	-4,9	2,1
- Private	-4,5	-6,5	1,0
- Public	-7,5	1,6	6,3
2. Exports	3,5	10,0	3,5
3. GDP	3,3	3,8	3,5
4. Imports	2,1	-2,7	0,8
<i>Note:</i>			
Domestic demand (excl. inventories)	1,9	1,2	3,0
Private spending (excl. inventories)	1,4	1,0	2,6
Public spending (consumption and investment)	4,2	1,9	4,8
Accumulation of inventories (contribution to GDP growth)	1,1	-0,6	-0,2

(e): estimated; (p): projected.

* Non-primary GDP excludes taxes and import duties.

Source: INEI, Central Bank of Peru and BBVA Research

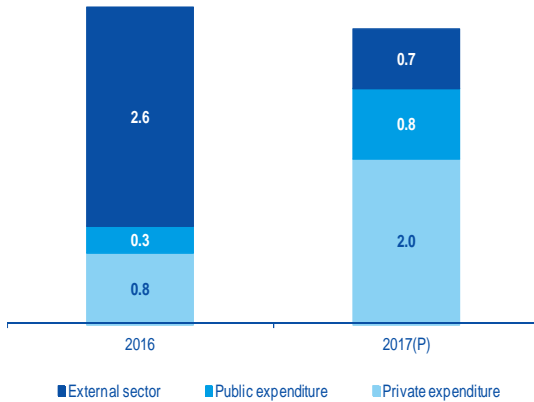
In the particular case of private sector spending, we expect investment to post a positive result in 2017 after three consecutive years of contraction. The reversal is largely related to the fact that mining investment has completed its adjustment process and will no longer be a drag. That will be reflected in this year's figure. In addition, the improvement in business confidence and the measures implemented by the State to encourage investment, and more generally to favour a 'doing business' environment, which could begin to have something of a positive impact given that from 2017 onward, this will support non-mining investment.

As for private consumption, we estimate that there will be some slowdown in 2017. Household spending continued to grow at around 3.4% over the last two years, despite the slowdown in employment, particularly in the formal sector, and the erosion of purchasing power, which leads to sustained price increases at a rate of more than 3.5% YoY in that period. This happened in a context in which part of the funds accumulated by the workers in their compensation for time served (CTS, which resembles unemployment insurance) was released, a measure that became permanent; certain deductions, which were made to the gratuities of the workers were eliminated; and salaries were increased in the public sector. In addition, families used banks to support their spending, which was reflected in the transitory acceleration of consumer loans. Our base scenario projection for this year does not incorporate any additional measures as described, as consumer credit has tended to lose momentum, probably due to the greater caution of families in an environment in which the generation of formal employment has weakened (and we do not anticipate a strong acceleration in 2017) and inflation continues (and will continue for much of the year) at a rate of more than 3% YoY.

In summary, we expect a GDP expansion of 3.5% in 2017, with a smaller contribution from exports because mining production will lose strength and with a greater contribution from domestic demand, which will reflect the increase that we anticipate in fiscal spending and the start of the recovery in spending by the private sector, particularly investment (see Figure 3.14). This growth rate will continue to place Peru as the fastest growing country in the region's largest group of economies (see Figure 3.15).

Figure 3.14

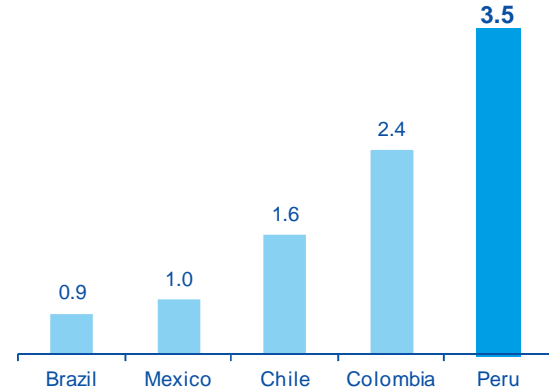
GDP from the expenditure side: contribution to growth (in percentage points of GDP)



(p): projection
Source: BBVA Research

Figure 3.15

LatAm: growth projection for GDP in 2017 (change % YoY)



Source: BBVA Research

In the first quarter of the year, in particular, economic activity will grow somewhat above 4%, supported by the renewed dynamism of primary activities

In the first quarter, the expansion of the Fisheries sector will stand out, since in January the remaining (slightly over 600 thousand metric tonnes) quota allocated for the second anchovy fishing season of last year was extracted. The extracted resource will then be used to make fish-meal and fish oil, which will favour the primary manufacturing sector. It will also highlight the greater production of copper, especially in Las Bambas; the extraction of this metal will increase 25% in inter-annual terms, perhaps the last quarter in which it does so at a double-digit rate. Finally, there will be a recovery of hydrocarbon production as the fluid transport of gas and gas liquids from the highlands to the coast through the pipeline is anticipated, something that did not happen at the beginning of last year. On the side of non-primary activities, the advance will be discrete, around 2% YoY. Even so, this figure will be higher than that registered in the previous quarter, reflecting two things – that the public expenditure adjustment implemented at the end of last year has ended and that the negative burden of lower mining investment will begin to dissipate. These two elements will have a positive impact on construction (its decline will moderate) and on non-primary manufacturing (possibly expanding again, something that it has not done since the second quarter of 2016).

Further ahead? The deepening of measures to boost investment, and, in general, to favour the environment for doing business, can improve future growth prospects

We project an average annual growth of 3.7% for the period 2018/2021. By 2018, in particular, we expect GDP growth that is not too different to the one we estimated for this year, because although the public sector will have less space within which to spend, since the extraordinary revenues of 2017 will no longer be present and the fiscal deficit target will somewhat tighten, private sector spending will continue to recover.

For this recovery to take place, four things will be important: the advancement of concessions, greater incentives to invest, simplification of administrative procedures in the State and a reduction of bureaucratic barriers.

As for the progress on the concessions, this year the Government is seeking to unlock projects that altogether will involve investments of USD 12 billion; their development would support 2018 GDP. It also plans to award concessions worth USD 4 billion this year, the construction of which could begin to have a positive effect on GDP from 2018. Finally, the pre- and post-awarding processes of concessions have been strengthened with the modification to legislation on PPPs – strengthening public officials who take decisions, accompanying, monitoring and facilitating the contractual execution of investment projects. A further part of these changes are higher private sector involvement in the decision-making process of ProInversión and, with regards to OXI, the elimination of the implementation limit of projects with sub-national governments, extension of the sectors in which this mechanism can be used. This may make it, possible for sub-national governments to sign joint-way agreements, in order that projects can have two sources of financing. All of this will take place in a more general framework that promotes competition and seeks to prevent companies related to acts of corruption, inside or outside Peru, being able to gain contracts with the State.

As for the greater incentives to invest, the State has introduced a tax incentive for the acquisition of capital goods by MSEs and the anticipated recovery of the general sales tax. There has also been progress regarding the administrative simplification of the State. For example, the intention is to facilitate labour recruitment procedures and commercial operating licenses, the search for standardisation of procedures at all levels of State and the analysis of the regulatory quality of administrative procedures at the level of the executive branch of State. In the latter case, all legal rules establishing administrative procedures will be reviewed, reducing or eliminating those that are unnecessary, unjustified, disproportionate, or redundant. In addition, any new rule that establishes administrative procedures in the Executive Branch will first have to be evaluated by a multi-sectoral commission before it comes into force, which will only be extended for three years (then it will have to be reassessed, something that will also apply with regard to the norms current at this time). Finally, on the reduction of bureaucratic barriers, the judgements issued will now be of general application, that is, the bureaucratic barrier cannot be demanded of anyone subject to an administrative process (and not only, as previously, the person who submitted the complaint), a mandate that fails to be complied with will be sanctioned. In addition, if the resolution is appealed against, the non-derogation mandate will remain enforceable on the administrative entity during the appeals process. In addition, anonymous complaints can be made about the imposition of a bureaucratic barrier, a situation in which INDECOPI (National Institute for the Defence of Competition and Protection of Intellectual Property) will evaluate an *ex-officio* action. All these measures also contribute to the formalisation of business activity.

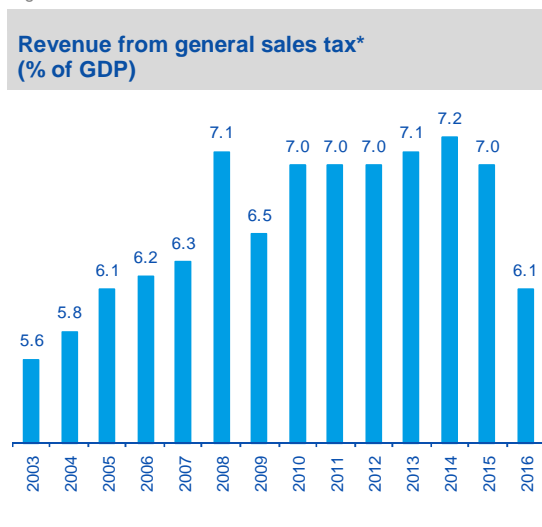
The measures described above to boost investment and to favour the environment for doing business in, will have a positive impact not only in 2018 but also in future. Our base projection scenario considers that from 2019, this will be added to by the restart of the construction of the gas pipeline in the south of the country.

Fiscal policy: the public sector deficit will continue to fall this year, in line with the path announced by the Government

The non-financial public sector deficit would have closed last year at 2.7% of GDP, below the ceiling proposed by the Government (3%). This result is explained by the fiscal adjustment implemented during the fourth quarter of 2016, which was more intense than we anticipated. The contraction in public spending reduced GDP by about two percentage points in that quarter. An extraordinary income equivalent to 0.15% of GDP was also invested in the tax result as a result of the transfer between the two foreign private companies involved in the Línea Amarilla road project¹.

For this year, our baseline scenario assumes that the fiscal deficit will decrease to 2.5% of GDP, in line with the target to which the Government committed itself. We regard the probability of the target being met as being relatively high. We feel that the reduction in the general sales tax rate (IGV) will in the end not happen (one of the proposals during the now President Kuczynski's election campaign was that this rate would be cut). This is because the reduction is conditional on the fact that before the middle of the year, an objective in terms of the collection of net IGV on internal returns (7.2% of GDP) is met², which at the moment is located around 6.1% of GDP (see Figure 3.16); the target will be difficult to achieve in a context where domestic demand is only beginning to recover.

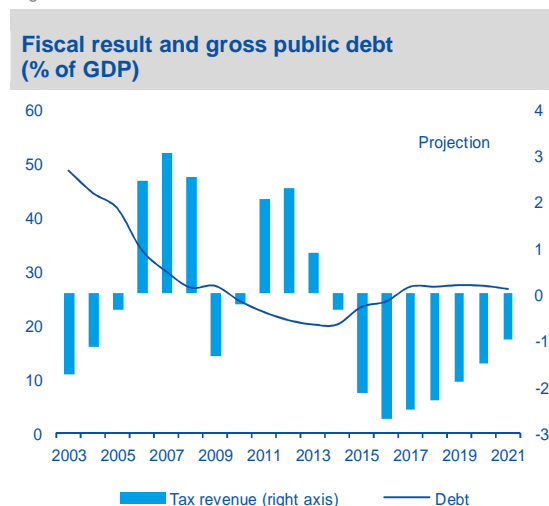
Figure 3.16



*Net returns.

Source: SUNAT, Central Bank of Peru and BBVA Research

Figure 3.17



Source: Central Bank of Peru and BBVA Research

It is important to note that with this fiscal scenario, conditional not only on the IGV rate not being cut but also on the exceptional tax collection that will result from the incentives to repatriate capital from abroad (that to date have not been declared to the tax authority³ and which we estimate will be equivalent to four tenths of a

1: In the statistical report of the tax authority (SUNAT), the extraordinary payment amounts to S/ 978 million and is recorded under the non-domiciled income tax heading.

2: The legal provision indicates that the IGV rate will be reduced by one percentage point from July 2017, only if the collection (annualised as of May 31 of this year) of the net total IGV of its internal returns reaches a level similar or higher than 7.2% of GDP.

3: A temporary regime is established and substitutes the income tax for taxpayers domiciled in the country who declare or repatriate and invest in the country the undeclared income generated up to 2015. The applicable rate will be 10% on the taxable amount on the part of the money that is repatriated. In the case of repatriation and investment, the rate is 7%. This measure will be in force until 29 December 2017.

percentage point of GDP), there is room for public sector spending to support the growth of economic activity in 2017. However, not only are the funds required to support growth, but also the execution of those funds. To achieve this, the central government performed the transfers to sub-national governments to continue the investments that were not completed by the end of 2016. Although this is undertaken every year, this time it happened earlier and the amount was greater. It has also brought the transfers forward of investment resources corresponding to the 2017 fiscal year, which could help increase the execution of funds available for the year. Finally, there will be weekly monitoring of the progress of the most important spending units, including those related to highways, Lima metro, educational infrastructure, the Pan American Games and urban sanitation. In this context, we anticipate that the contribution of public spending to GDP growth will be higher this year, despite the fact that it will simultaneously be sought to reduce the fiscal deficit.

For the next few years, and in a manner consistent with the firm commitment that the Government seems to have regarding the fiscal consolidation process announced, we are taking on the government's projection of a downward trend for the public sector deficit. With this path and our forecasts for economic growth, we estimate that gross public debt as a percentage of GDP will stabilise at around 27% in the following years (see Figure 3.17).

The current account deficit will continue to decline this year thanks to higher copper and fish-meal exports

The deficit in the current account of the balance of payments declined significantly in 2016, retreating by slightly more than two percentage points (see Figure 3.18). The main element that explained this improvement was the reversal in the balance of the trade balance, which became a surplus, a result that has not been seen since 2013. The improvement in the trade balance is due both to an increase in exports (by USD 2.6 billion) and to a decrease in imports (by USD 2.3 billion). In the first case, it mainly reflects the momentum of higher mining production, particularly copper (see Figure 3.12) while in the second, the weakness of domestic demand and the decrease in average prices of inputs that Peru imports, including oil and some food is highlighted.

Figure 3.18

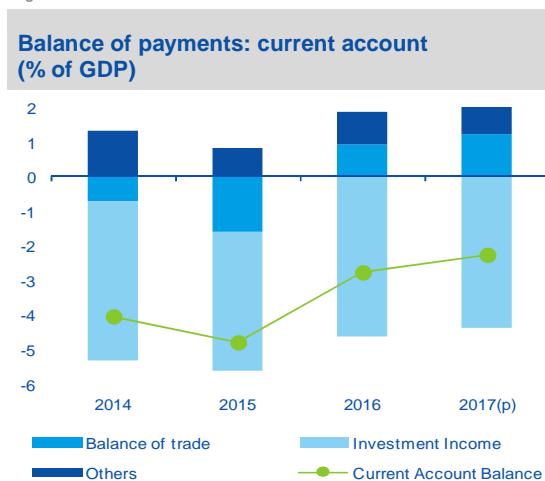
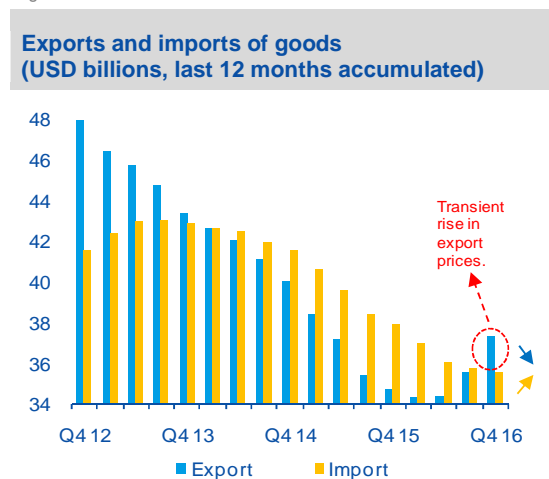


Figure 3.19



For this year, we forecast that the current account deficit will decline to a level just below 2.5% of GDP. This will positively affect the increase in the volume of exports, especially traditional exports such as copper and fish-meal. The recovery that domestic demand will begin to register, which will cause imported volumes to perform better in 2017. The additional decline that we estimate for the terms of trade will limit an even more favourable performance from the trade balance as well as from the balance of payments on the current account.

It should be mentioned that in the last quarter of last year the current account deficit fell significantly. According to our estimates, this deficit would almost have closed in that quarter, something that has not happened since 2011, which implies a decline of around three percentage points of GDP compared to the result achieved in the same quarter of 2015 (and around 2% of GDP below the result achieved in the third quarter of 2016). The significant improvement in the current account coincides with the sharp rise in export prices (+7% YoY) - especially metals -, the significant increase in mineral production and exports and the weakness of domestic demand, which together favoured the balance of trade (see Figure 3.19). We consider that this situation is temporary and will soon be rectified, perhaps from the second quarter of this year and more clearly in the third. This is because, as explained above, the price of copper (and other metals) will yield, copper production will moderate its advance significantly, domestic demand will begin to recover and the price of oil will still rise slightly, which together will result in a deterioration of the trade balance and, therefore, of the current account of the balance of payments, in a manner consistent with the deficit that we have projected for this last variable of 2017.

For the next few years, we forecast moderate current account deficits of between 2.4% and 2.8% of GDP. In this way, the country's external financing requirements will also remain relatively contained, which is positive in a context in which capital flows to emerging economies are expected to decline.

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