# 1. Summary

**Economic growth continues to strengthen worldwide in an environment in which both confidence and global trade are improving**, the latter aided by monetary and fiscal incentives in China. There is also somewhat greater clarity regarding the US economy: the scenarios that augured a speedy recovery of inflation endorsed by a fiscal boost or a swift turn towards protectionism are at present less likely (or will at least will be held off). This, along with the tranquillity apparent on global financial markets, has encouraged the central banks of the more developed economies to gradually progress towards stabilisation in their monetary policies. Looking ahead, our baseline forecast considers that the international setting will continue to be relatively positive for the Peruvian economy. The US will consolidate its recovery over the 2017/18 period at a sustained growth rate of 2.3% to 2.4%. Meanwhile, Latin America will start to expand again this year, an expansion that will speed up next year. The eurozone will progress slightly beyond its potential, whereas China will continue to parry its exposure and moderate its growth rate to more sustainable values. Given such a context, the FED will continue stabilising its monetary position, albeit gradually, with two further increases to its rate policy this year and another two in 2018, until it stands at 2%.

**On the domestic front, we have revised our growth projection for this year by a percentage point to 2.5%.** This adjustment reflects the fact that the three local risks we indicated in our February report have finally materialised: the weather problems continued and had a significant impact on economic activity, particularly in March, the delay in the major infrastructure construction projects continued, meaning they will fail to contribute GDP growth this year and finally, business confidence dropped even further and is now viewed with pessimism. There was also a twenty-day strike in the biggest copper mine in the country – Cerro Verde – while mining investment continued to fall. The measures announced by the government to boost public expenditure and to restore and rebuild infrastructure damaged on account of the weather problems somewhat offset the downward revision of the GDP growth for 2017. Accordingly, the greater public expenditure this year will constitute an important basis for growth on the demand side. For 2018, in a context in which mining activities bounce back owing to the stabilisation of weather conditions, reconstruction work on the damaged infrastructure caused by the latter is increasingly noted and the construction of major infrastructure projects accelerates, we have raised the GDP growth forecast by 0.3% to 3.9%.

**The boost that public expenditure will afford growth on the demand side means that the fiscal consolidation process in our projections will be put back.** We expect the deficit to hover around a level equivalent to 3% of GDP, in both 2017 and 2018 (2.6% in 2016), which stands above that which was agreed with parliament last year (2.5% in 2017 and 2.3% in 2018), a target which, at least for the time being, is holding up. However, any deviation that may arise will, we feel, be related to servicing the emergency situation caused by a natural disaster and, afterwards, restoring or rebuilding the damaged infrastructure. This does not reflect bad fiscal behaviour. Quite the contrary, the government seems to be strongly committed to the sustainability of public finances, as attested to by the adjustment made in the final quarter last year to guide deficit towards consolidation, despite the cost in terms of lower economic growth. Our fiscal estimates for Peru in 2017, 2018 and thereafter, continue to compare well against the other big

Latin American economies and suggest that gross national debt will not exceed a level equivalent to 28% of the GDP in the next five years.

**As far as local financial markets are concerned, they have performed well so far this year.** This has given rise to a context in which the international prices for the metals that Peru exports, such as, for example, gold and copper, have been high, thus favouring the improvement in the trade balance. This is also a context in which the gradual pace of the monetary adjustment in the more developed economies has continued to inspire a strong appetite for investors in Peruvian financial assets. The local currency has appreciated by over 3% so far this year. We expect, however, that this will tend to depreciate from here on in, albeit to a limited extent and most likely more clearly in the second half of the year, closing at 3.35 to 3.40 soles per US dollar. This forecast is in keeping with the expectation that in the coming quarters, capital inflows to emerging economies will tend to slow down in an environment where the FED gradually raises interest rates and the central banks of other developed countries start to consider reducing their quantitative easing. It is also consistent with the fact that monetary policies in the emerging countries – particularly in Peru – are being rendered more flexible. The increase in the exchange rate will be limited, as the smaller gap between the interest rates in the local and foreign currency will be offset by the improvement to the trade balance (mainly because copper production will continue to rise throughout the rest of the year, albeit at a more moderate pace).

**As far as prices are concerned, we expect inflation to remain above the 3.5% mark in YoY terms until the third quarter, thus deviating from the Central Bank's target range.** This forecast takes two factors into account. Firstly, even if there is little room for any additional rises in the international oil price, the YoY comparison will continue pushing inflation upwards (by way of local fuel prices), especially in the course of what is left of the first half of the year. And secondly, even though the recent rises in food prices (on account of the weather problems) are provisional, and as such should fall again, part of these rises might remain uncorrected because of some farming areas that will take time to recover. It is also quite likely that there has been a certain contamination in inflationary expectations, which will impose a certain inertia on inflation. Looking now at the second half of the year, we feel that internal demand and the expenditure of the private sector will continue to be weak, the international price of oil will remain relatively stable and food prices will continue to stabilise, while inflation will tend to drop. We expect that it will end the year in or around the target ceiling range.

**Given this weak growth and pessimistic confidence setting, it is quite likely that the Central Bank will not wait for inflation to return to the target range to cut its policy rate but will bring this forward.** Our interpretation of the most recent monetary policy statement leads us to foresee that there will be a reduction in the interest rate as soon as inflation stops rising. This cut in interest rates could take place in May or June. Our baseline scenario incorporates an interest rate reduction of 25% in the second quarter and another reduction in the fourth quarter.

**Lastly, our forecasts for 2017 are subject to certain risks.** On the external side, China's financial exposure and the uncertainty that still surrounds the policies to be implemented by the incoming US administration. On the domestic front, that the delay in commencing the infrastructure work will continue, that the confidence of businesses and consumers alike will not be recovered and that public expenditure will fail to materialise as planned.

## LEGAL NOTICE

BBVA | Research

## This report has been produced by the Peru Division


**Head Economist, Peru**
Hugo Perea
hperea@bbva.com
+51 1 2112042

Francisco Grippa
fgrippa@bbva.com

Ismael Mendoza
ismael.mendoza@bbva.com

Yalina Crispin
yalina.crispin@bbva.com

Marlon Broncano
marlon.broncano@bbva.com

Vanessa Belapatiño
vanessa.belapatino@bbva.com


## BBVA Research


**Chief Economist BBVA Group**
Jorge Sicilia Serrano

**MACROECONOMIC ANALYSIS**
Rafael Doménech
r.domenech@bbva.com

**Global Economic Situations**
Miguel Jiménez
mjimenezg@bbva.com

**GLOBAL FINANCIAL MARKETS**
Sonsoles Castillo
s.castillo@bbva.com

**Long-Term Global Modelling and Analysis**
J. 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

**International Coordination**
Olga Cerqueira
olga.gouveia@bbva.com

**DIGITAL REGULATION**
Álvaro Martín
alvaro.martin@bbva.com

**Regulation**
María Abascal
maria.abascal@bbva.com

**FINANCIAL SYSTEMS**
Ana Rubio
arubiog@bbva.com

**Financial Inclusion**
David Tuesta
david.tuesta@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 Geopolitical**
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

**Chile**
Jorge Selaive
jselaive@bbva.com

**Colombia**
Juana Téllez
juana.tellez@bbva.com

**Peru**
Hugo Perea
hperea@bbva.com

**Venezuela**
Julio Pineda
juliocesar.pineda@bbva.com

ENQUIRIES TO: BBVA Research Peru Av. República de Panamá 3055, San Isidro, Lima 27, Peru. Tel: + 51 12112042-bbvaresearch@bbva.com
www.bbvaresearch.com