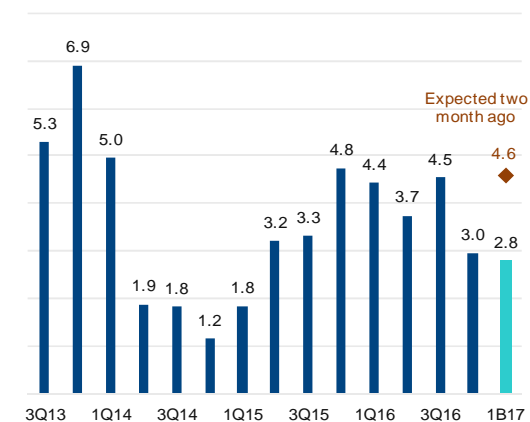


3. We have cut back our 2017 growth forecast from 3.5% to 2.5%

Weaker data in the first two months allied to the heavy coastal rains have taken their toll

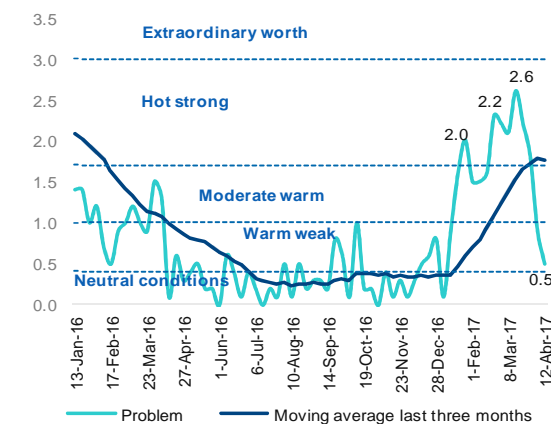
Economic activity rose by 2.8% QoQ in the first two months, which is lower than what we expected in our previous report (see Figure 3.1). This weaker dynamism at the beginning of the year occurred in a context that had seen the risks we pointed out in that report come true: firstly, the weather problems persisted (see Figure 3.2), and secondly, progress was slow in the building of infrastructures, among which second underground line in Lima figures. Investment in the mining sector also continues to fall. The lower economic growth in the first two months knocked two decimal points off our prediction as regards GDP expansion for 2017.

Figure 3.1. GDP (YoY % variation)



Source: INEI, Central Bank of Peru and BBVA Research.

Figure 3.2 Temperature problem in the Peruvian sea* (in °C)



* Covers the 1+2 zone (Peruvian coast)
Source: NOAA and BBVA Research

The drastic sea temperature problem, known as *El Niño Costero*, not only extended into February, but even intensified in March (see Figure 3.2). It caused heavy rains along the country's coast, leading to flooding rivers and mud and rock slides, wreaking havoc on farming areas and infrastructure, such as housing, roads, bridges, irrigation canals and schools. Our forecasts suggest that, at the close of this report, the damage in farming areas and infrastructure will amount to a little over USD 4 thousand million (see Table 3.1). This damage, in turn, affected both agricultural, business, industrial and building activities as well as transport services. We estimate that the reduced dynamism of these activities will knock six decimal points off the GDP growth we had estimated for 2017. The sea temperature problem subsided at the beginning of April.

Table 3.1 Damage to infrastructure caused by the heavy rains brought by *El Niño Costero** (USD million)

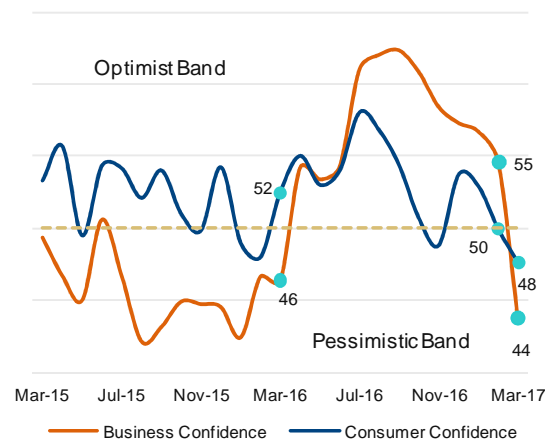
Infrastructure	Measure	Total units**	(USD millions)
Roads	Km	8,951	1,424
Housing	Units	278,123	944
Bridges	Units	839	474
Farming areas	Ha	82,083	234
Schools	Units	2,165	152
Irrigation canals	Km	23,176	628
Country tracks	Km	12,843	68
Health centres	Units	742	91
Total			4,016

* BBVA estimate based on information correct as of 18 April.

** Reflects the sum total per type of infrastructure involved, regardless of its degree of damage.

Source: INDECI and BBVA Research.

Figure 3.3 Business confidence and Consumer confidence* (index, in points)



* Values over (under) 50 indicate an expectation of a better (worse) performance of the economy in the next three months.

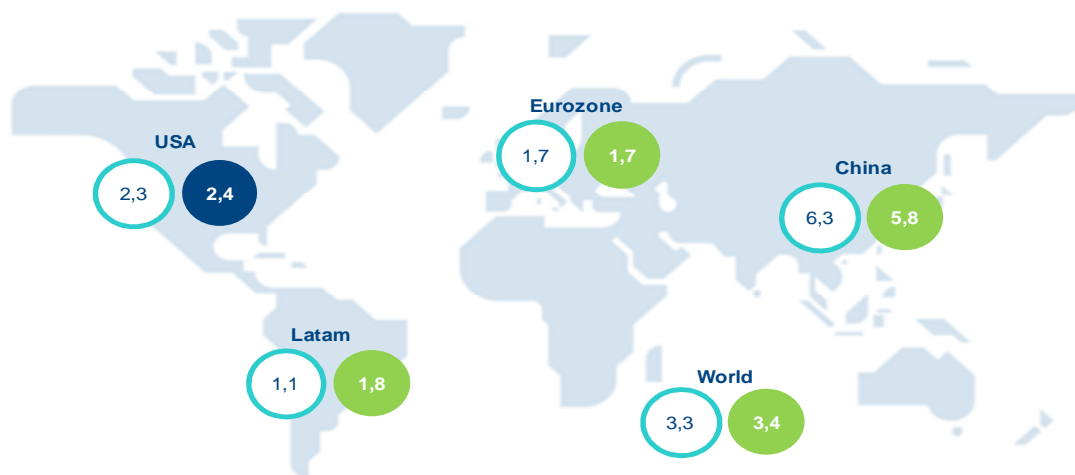
Source: Central Reserve Bank of Peru and BBVA Research.

Owing to this scenario of weak growth, slow progress in infrastructure building and serious weather problems (causing serious economic impact), the confidence of economic agents has weakened. Particularly in March there was a sharp drop in business confidence, seeing it fall into the pessimistic bracket (see Figure 3.3). This business sector caution augurs a drop in the investment dynamism of the private sector. It should also be added that consumer spending forecasts are also now erring toward pessimism (see Figure 3.3).

The decline in the vigour of economic activity over the first two months and the intensification of the weather problems in March have seen 8% knocked off the 2017 GDP growth forecasts we made two months ago (3.5%). Our new baseline scenario also takes the following into consideration.

- Externally, relatively favourable conditions for the Peruvian economy.
 - Worldwide growth. It will continue to grow owing to the improved performance of the developed economies and a slowdown in China which we now perceive as more contained (see Figure 3.4).

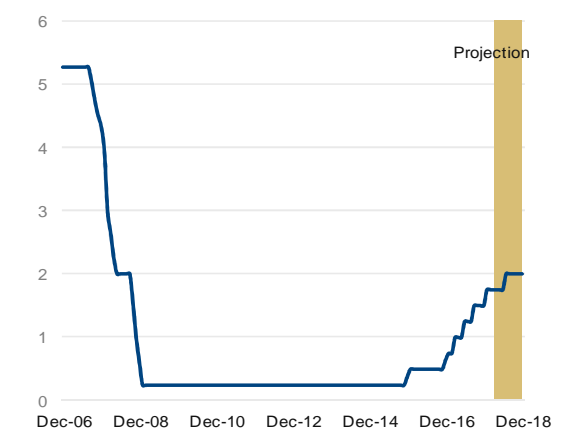
Figure 3.4 Estimated worldwide growth by geographical areas for 2017 and 2018⁽¹⁾ (YoY % variation)



(1) For 2018, green when growth accelerates in comparison to our February report, blue when it remains practically unchanged and red when it decreases.
Source: BBVA Research

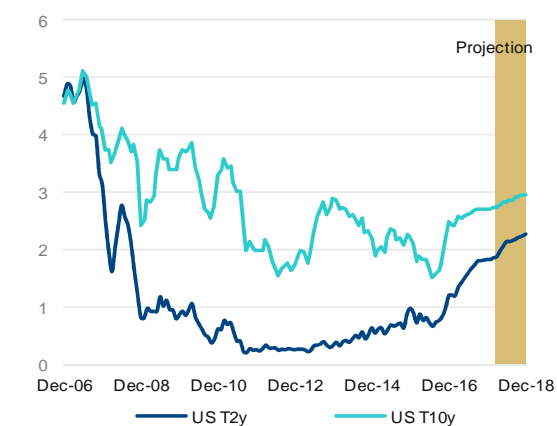
- **FED rate.** It will continue to adjust gradually. We expect to see two 0.25% rises in 2017 and a further two in 2018 (see Figure 3.5). This will mean increases in interest rates over longer periods (see Figure 3.6), albeit more reduced than in the case of short-term ones, with the yield curve levelling off.

Figure 3.5 US: FED rate (%)



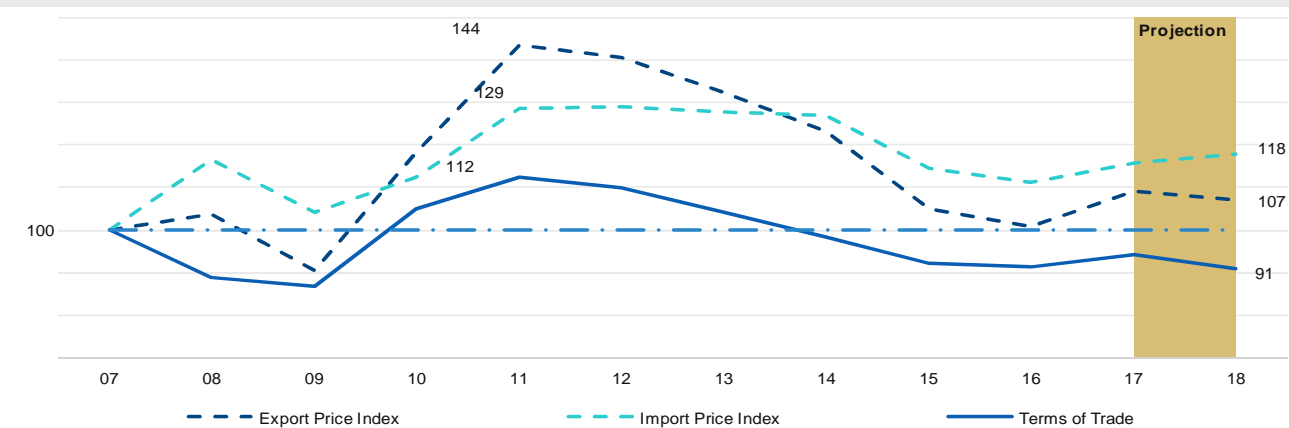
Source: Bloomberg and BBVA Research

Figure 3.6 US: yield on 2-year and 10-year treasury bonds (%)



Source: Bloomberg and BBVA Research

- **Terms of trade.** These will improve in 2017 (see Figure 3.7). For example, on the export prices side, we predict that the average copper price will be 15% higher than last year and that the price of zinc in 2017 will be slightly over 20% higher than in 2016. These higher export prices will be offset in part by the increase in import prices, which in the case of the international price of WTI oil will rise by around 30%.

Figure 3.7 Terms of trade (2007 index = 100, year's average)


Source: Central Reserve Bank of Peru and BBVA Research

- On the domestic front, the panorama is more challenging and entails the following.
 - Infrastructure construction. In addition to the slow-moving progress in the first two months of the year, we have incorporated into the baseline scenario the fact that the pace of expenditure implementation will also be lower for the rest of the year (in comparison to the projections in our previous report). The new expenditure level forecast for the major construction projects means that there will be no great increase with respect to last year's figure. Consequently, it will make no contribution to GDP growth in 2017 (two months ago we had estimated a half percentage point contribution).
 - Business confidence. We assumed that business confidence would remain in the optimistic bracket in our previous estimates and so drive private investment. This has not been the case: business confidence fell sharply in March (see Figure 3.3), which has most likely picked up on the uncertainty as to the magnitude of the impact left by *El Niño Costero*. Our new baseline scenario considers that, to the extent that the effects of this weather problem dissipate and are assimilated, business confidence will gradually improve, heading towards the 50 point threshold. The new path foreseen for business confidence means that support for private investment has weakened and, therefore, for economic activity in general, knocking two decimal points off the GDP growth rate for 2017 that we foresaw a couple of months ago (see Table 3.2).

Table 3.2 Breakdown of the change in the GDP growth forecast for 2017 (percentage points)

	Percentage points
Weaker data than those expected for the first two months of 2017	-0.2
Effects of "El Niño Costero"	-0.6
Less business confidence	-0.2
Less expenditure on major infrastructure projects	-0.5
Higher public expenditure (emergency / restoration / reconstruction)	+0.5
Total	-1

Source: BBVA Research

- Copper production levels will continue to rise to the end of the year, albeit at an increasingly lower rate. We estimate it will contribute 0.5% to the GDP in 2017, which is less than last year's 2%.
- The fiscal deficit will stand at around 2.9% of the GDP in 2017 and 2018 (see the section on fiscal policy for greater detail).

In the baseline scenario we foresee a growth of 2.5% for the GDP in 2017. In terms of sectors (see Table 3.3), primary activities will once again prove to be the most dynamic (with a joint growth of 3.9%), underscoring progress in Fisheries, Oil and Gas, Metal Mining and Primary Manufacturing. As far as non-primary sectors are concerned (activities that are more linked to internal demand), Electricity and Services are set to be the most dynamic, whereas progress in Construction and Business will be more discreet, while it is expected that Non-primary Manufacturing will contract.

Table 3.3 GDP by productive sector (YoY % variation)

	2015	2016	2017 (e)	2018 (p)
Farming	3.2	1.8	2	3.9
Fisheries	15.8	-10.1	17	13.1
Mining and oil and gas	9.5	16.3	4.2	6.2
Metal mining	15.7	21.2	4.1	5.3
Oil and gas	-11.6	-5.4	4.8	11.2
Manufacturing	-1.5	-1.6	0.1	3.1
Primary	1.3	-0.5	4.3	5.7
Non-primary	-2.4	-1.9	-1.4	2.1
Electricity and water	5.9	7.3	4	4.7
Construction	-5.8	-3.1	0.8	6.6
Trade	3.9	1.8	0.9	2.1
Other services	5.1	4.3	3.2	3.8
Total GDP	3.3	3.9	2.5	3.9
Primary GDP	6.8	9.8	3.9	5.7
Non-primary GDP*	2.7	2.4	2	3.6

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

* Non-primary GDP excludes taxes and import duties.

Source: Central Reserve Bank of Peru, INEI (National Statistics and IT Institute) and BBVA Research

On the demand side (see Table 3.4), the total public expenditure expansion (consumption and investment) of over 6% will stand out, which contrasts with the 0.5% drop recorded last year (see the fiscal policy section for greater detail). Progress in government expenditure will be lessened by the slowdown of family consumption and a new slump in private sector investment, a fall-off that comes about in a context of low growth expectations and expansion possibilities for businesses, caution by employers and a new decline in mining investment.

Table 3.4 GDP on the expenditure side (YoY % variation)

	2015	2016	2017 (e)	2018 (p)
1. Domestic demand	3.1	0.9	2.1	3.2
a. Private consumption	3.4	3.4	2.7	3
b. Public consumption	9.8	-0.5	5.4	2
c. Gross domestic investment	-0.7	-4.9	-1.4	4.2
Gross fixed investment	-5	-5	0.4	5.3
- Private	-4.4	-6.1	-1.5	4.2
- Public	-7.3	-0.5	8	9
2. Exports	3.5	9.7	2.2	4.3
3. GDP	3.3	3.9	2.5	3.9
4. Imports	2.5	-2.3	0.5	1.2
<i>Private spending (excl. inventories)</i>	<i>1.4</i>	<i>1.1</i>	<i>1.7</i>	<i>3.3</i>
<i>Public spending (consumption and investment)</i>	<i>4.4</i>	<i>-0.5</i>	<i>6.1</i>	<i>4</i>

(e): estimated (p): projected.

Source: Central Reserve Bank of Peru, INEI (National Statistics and IT Institute) and BBVA Research

For 2018, in a context in which mining activities bounce back owing to the stabilisation of weather conditions, reconstruction work on infrastructure is felt more and the construction of major infrastructure projects speeds up, we have raised the GDP growth forecast by 0.3% to 3.9%.

Going forward, the re-activation of infrastructure projects brought to a halt and the restoration of infrastructure damaged by *El Niño Costero* will be important factors in maintaining the growth rate above the 3.5% mark

We estimate an annual growth of 3.8% for the 2019-2021 period, peaking at 4% in 2019, assuming that construction work will be resumed on Peru's Southern Gas Pipeline. This scenario also considers that the infrastructure affected by the country's recent heavy rains and flooding will be quickly rebuilt in 2018 and 2019.

Both of the aforementioned elements are essential to creating an environment with greater confidence that encourages investment decisions. Intensifying the measures implemented at the start of the year by the government to speed up investment and to simplify administrative procedures may also improve the climate for business.

It is important to emphasise that capital accumulation must be speeded up quickly. Otherwise, the medium-term potential growth of the Peruvian economy will be compromised and could fall below the 3.5% mark.

LEGAL NOTICE

This document, prepared by BBVA Research Department, is informative in nature and contains data, opinions or estimates connected with 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, express or implied, as to the document's accuracy, completeness or correctness.

The estimates contained in this document have been formulated according to generally accepted methods and should be taken as such, i.e. as estimates or projections. The historical evolution of economic variables (positive or negative) is no guarantee that they will evolve in the same way in the future.

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

BBVA assumes no responsibility 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, divest or acquire any interest in assets or financial instruments, nor can it form the basis of any contract, commitment or decision of any kind.

In particular as regards investment in financial assets that may 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 which may potentially offer them investment products are legally obliged to provide all the information they need to take these decisions.

The contents of this document are protected by intellectual property law. It is expressly prohibited to reproduce, process, distribute, publicly disseminate, make available, take extracts, reuse, forward or use the document in any way and by any means or process, except where it is legally permitted or expressly authorised by BBVA.

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