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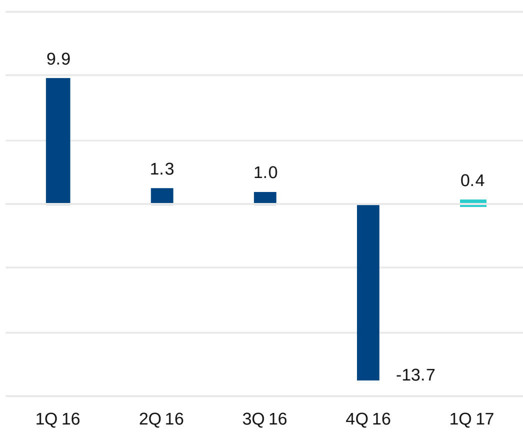
4. Fiscal policy: the public deficit will rise temporarily owing to expenditure on infrastructure reconstruction

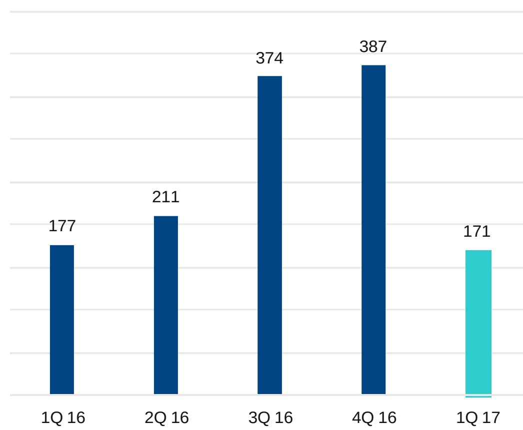
First quarter government expenditure was lower than forecast in our previous report (see Figure 4.1). This can partly be explained by the less than expected execution of the infrastructure programmes in which the government is involved (e.g. Line 2 of the Lima Underground, see Figure 4.2). Our new baseline scenario assumes that expenditure on these projects will increase in the coming quarters, but not as much as we estimated two months ago. Moreover, the baseline scenario assumes that this lower public expenditure on infrastructure will be offset by spending on servicing the damages caused by *El Niño Costero*: emergency and rehabilitation (public consumption) mainly, as well as infrastructure reconstruction (public investment). Accordingly, in nominal terms, our public expenditure projection practically remains unchanged with respect to that foreseen two months ago.

Figure 4.1 Public expenditure* (YoY % variation)



(*) Central Government
Source: Central Reserve Bank of Peru and BBVA Research

Figure 4.2 Line 2 Lima Subway* (millions of soles)



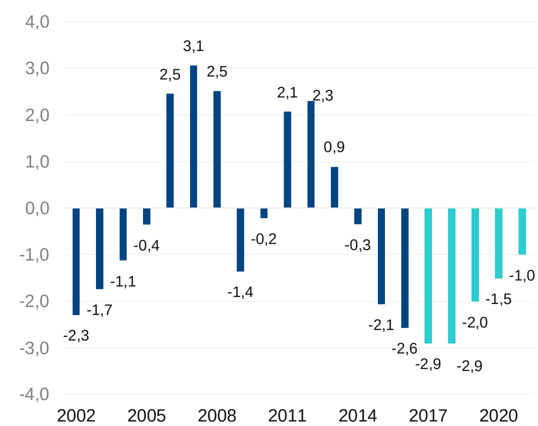
*As of 10 April, 9% of the budgeted amount had been implemented (S/ 2 thousand million). Source: MEF – SIAF.

On the revenue side, however, the projection has been revised downwards. Higher tax refunds and less revenue owing to slower economic activity growth explain this revision.

As a result, the projected fiscal deficit for this year has been raised to 2.9% of the GDP (2.5% in the previous forecast) and is expected to remain at a similar level next year (2.3% estimated two months ago), the latter for an environment in which it is expected that there will be a speed-up in the reconstruction effort. This increase in the fiscal deficit forecast is in keeping with the request the government is expected to submit to the parliament to expand deficit targets for 2017 and 2018.

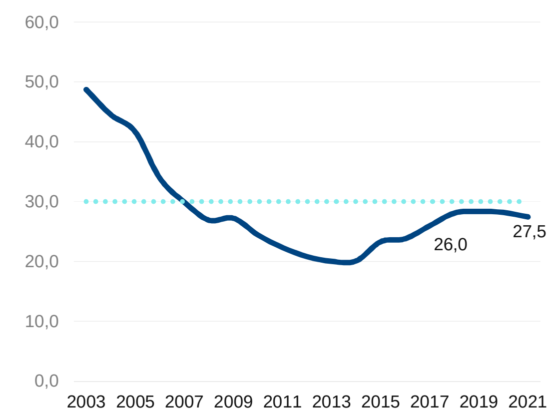
We are assuming that the forthcoming years will see a restart of the fiscal consolidation process, in line with the path marked out by the government to reduce the deficit prior to the natural disasters in March (see Figure 4.3). This means that in 2019 the deficit will be reduced to 2% of the GDP (from the predicted 2.9% for the previous year), an adjustment that we consider to be feasible given that by that time the provisional emergency and rehabilitation expenditure will be considerably less (or down to zero). The consolidation process is expected to culminate in a GDP deficit of 1% for 2021. Given the expected trend for fiscal deficit and our economic growth projections for the forthcoming years, we estimate that gross national debt will stabilise at around 28% of the GDP, below the 30% threshold established in the Fiscal Transparency and Responsibility Act (see Figure 4.4).

Figure 4.3 Fiscal result (% of the GDP)



(*) Projection
Source: Central Reserve Bank of Peru and BBVA Research

Figure 4.4 Gross national debt (% of the GDP)



Source: Ministry of Economy and Finance of Peru, Central Reserve Bank of Peru and BBVA Research

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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