

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)

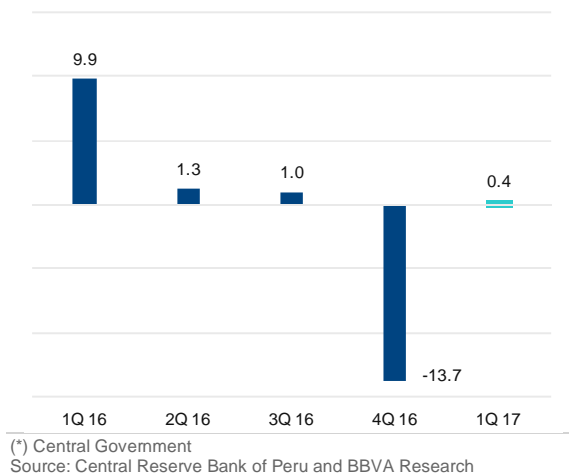
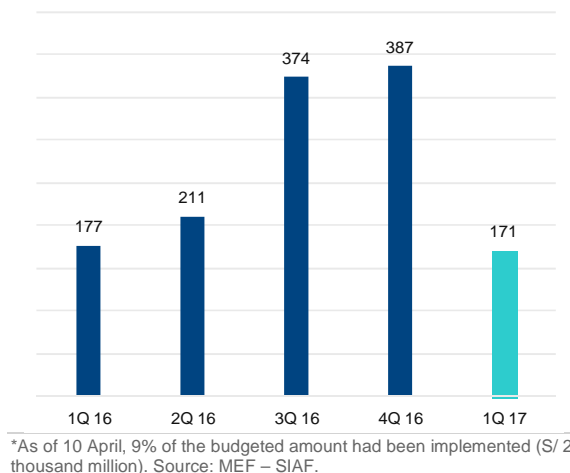


Figure 4.2 Line 2 Lima Subway* (millions of soles)

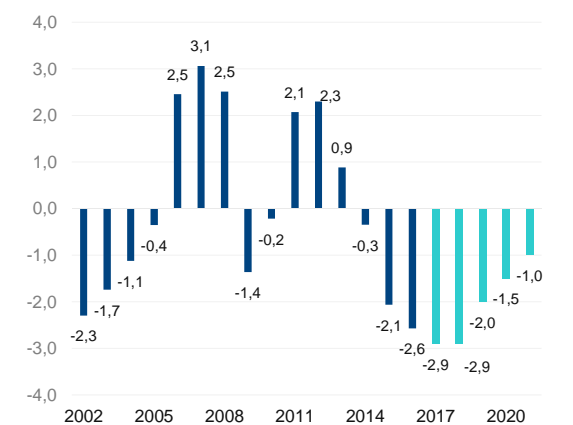


On the revenue side, however, the projection has been revised downwards. Higher tax refunds and less revenue owing to slower economic activity growth explain this revision.

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).

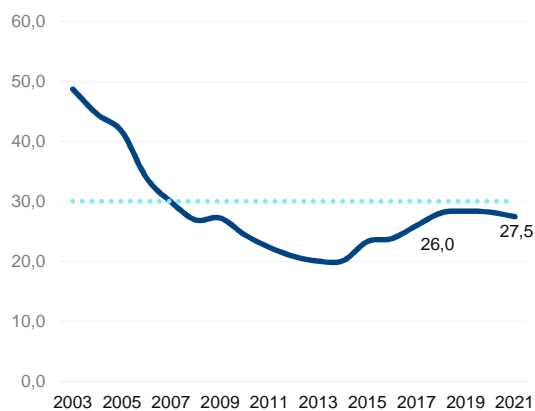
Figure 4.3 Fiscal result (% of the GDP)



(*) 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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