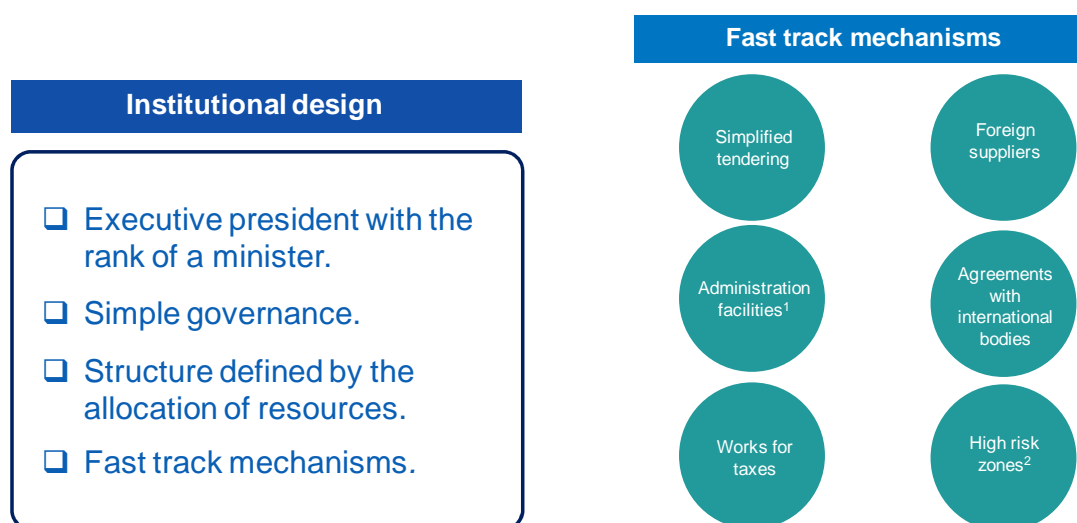


4 Fiscal policy: the institutional framework for reconstruction increases the likelihood that the fiscal stimulus will take place in 2018

As we have already mentioned, our growth forecasts for next year are highly dependent upon the fiscal stimulus from spending on the reconstruction of infrastructure damaged by the El Niño Costero, which devastated the centre-northern coast of the country in the first quarter. In our opinion, the law creating the Authority for Reconstruction with Changes (ARCC) is well drafted, increasing the likelihood that public spending in this area will actually materialise.

Table 4.1 Institutional design of the Authority for Reconstruction with Changes



1. The administrative procedures required to execute the Plan will be cost free, and take a maximum of 7 working days, and will be considered approved in the event of administrative silence.

2. People living in areas of high risks that cannot be mitigated must renounce ownership to access benefits under the Plan.

Source: Central Reserve Bank of Peru and BBVA Research

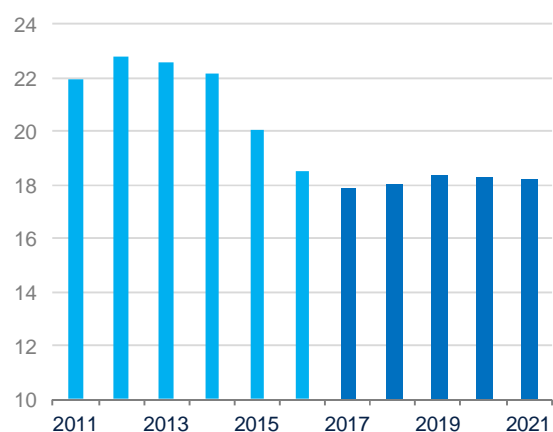
The positive features of the design of the ARCC - some of which are similar to those of other bodies set up in response to natural disasters, such as the successful experiences in Mexico (1985) and Colombia (1999) - include (see Table 4.1): (i) creation of a new agency specifically charged with designing the reconstruction plan; (ii) an executive chairman with ministerial rank; (iii) simple governance, with a Directorate that comprises four line ministers, in addition to the chairman; (iv) a clearly defined structure for allocating the funds for the actions identified; and (v) simplified contracting procedures ("fast track" mechanisms).

It should be noted that Peru's economy has no powerful, automatic stabilisation mechanisms - such as flexible prices and wages, unemployment insurance that supports the consumption of people who lose their jobs or a wide-reaching

income tax structure - that would help to return growth to levels more in tune with its potential growth rate. This makes intervention through counter-cyclical policies even more necessary. In particular, a significant fiscal stimulus (note: backed by the monetary side) is needed to end the current vicious cycle of low growth leading to low investment (why invest if the market is not growing?) leading to low growth, etc. The serious effect of not breaking this cycle is that the lack of short-term demand (due to low investment and low employment) impacts in the longer term on the supply side, undermining the economy's potential growth. The ARCC's efforts will be decisive in this regard.

Whilst the positive aspects of the ARCC make it likely that public spending will ultimately accelerate, we see worrying trends on the revenue side (see Figure 4.1). The path of fiscal consolidation announced by the government could be complicated from 2019 or 2020, if no measures are taken to increase collections or growth remains relatively low.

Figure 4.1 General Government revenues (% of GDP)



Source: Central Reserve Bank of Peru and BBVA Research.

Table 4.2 Tax measures to increase collections

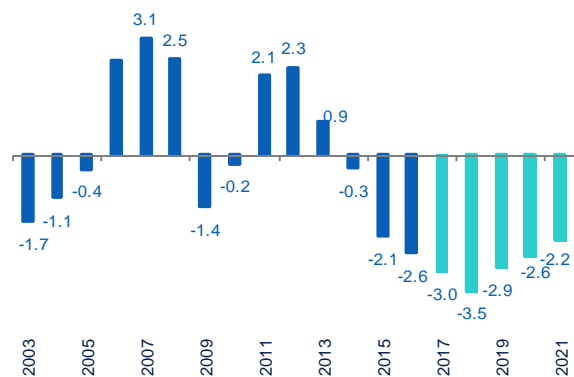
Aspects considered by MEF for increase the collection

1. Rationalization of tax exonerations
2. Property tax increase
3. Reduction of VAT and Income Tax evasion

Source: MEF (Macroeconomic Forecast Update Report) and BBVA Research.

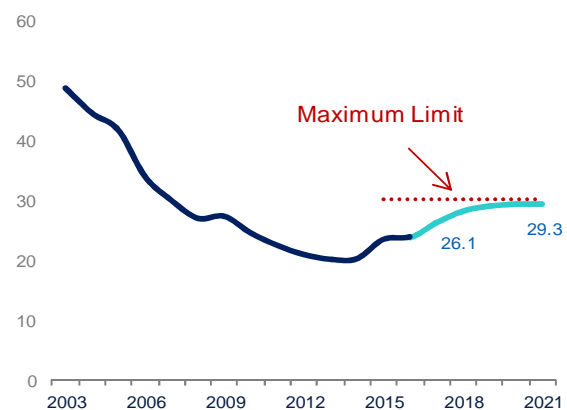
Therefore, given this, we are assuming that the deficit will be as announced by the government in the period 2017-2019 (see Figure 4.2). However, assuming no measures are implemented to increase government revenues, we consider that the deficit will adjust more gradually in 2020-2021, and will not converge on the limit of 1% of GDP established in the Fiscal Responsibility and Transparency Act. As a result, we expect gross public debt to rise and approach the 30% limit set in the Act (see Figure 4.3).

Figure 4.2 Fiscal result
(% of GDP)



Source: Central Reserve Bank of Peru and BBVA Research.

Figure 4.3 Gross national debt
(% of GDP)



Source: Central Reserve Bank of Peru and BBVA Research.

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Este informe ha sido elaborado por la unidad de Perú

Economista Jefe de Perú

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.belapatinho@bbva.com

BBVA Research

Economista Jefe Grupo BBVA

Jorge Sicilia Serrano

Análisis Macroeconómico

Rafael Doménech
r.domenech@bbva.com

Escenarios Económicos Globales

Miguel Jiménez
mjimenezg@bbva.com

Mercados Financieros Globales

Sonsoles Castillo
s.castillo@bbva.com

Modelización y Análisis de Largo

Plazo Global
Julián Cubero
juan.cubero@bbva.com

Innovación y Procesos

Oscar de las Peñas
oscar.delaspenas@bbva.com

Sistemas Financieros y Regulación

Santiago Fernández de Lis
sfernandezdelis@bbva.com

Coordinación entre Países

Olga Cerqueira
olga.gouveia@bbva.com

Regulación Digital

Álvaro Martín
alvaro.martin@bbva.com

Regulación

María Abascal
maria.abascal@bbva.com

Sistemas Financieros

Ana Rubio
arubiog@bbva.com

Inclusión Financiera

David Tuesta
david.tuesta@bbva.com

España y Portugal

Miguel Cardoso
miguel.cardoso@bbva.com

Estados Unidos

Nathaniel Karp
Nathaniel.Karp@bbva.com

México

Carlos Serrano
carlos.serranoh@bbva.com

Oriente Medio, Asia y

Geopolítica
Álvaro Ortiz
alvaro.ortiz@bbva.com

Turquía

Álvaro Ortiz
alvaro.ortiz@bbva.com

Asia

Le Xia
le.xia@bbva.com

América del Sur

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

Perú

Hugo Perea
hperea@bbva.com

Venezuela

Julio Pineda
juliocesar.pineda@bbva.com

INTERESADOS DIRIGIRSE A: BBVA Research Perú: Av. República de Panamá 3055, San Isidro, Lima 27 (Perú) Tel: + 51 12112042-
bbvaresearch@bbva.com www.bbvaresearch.com