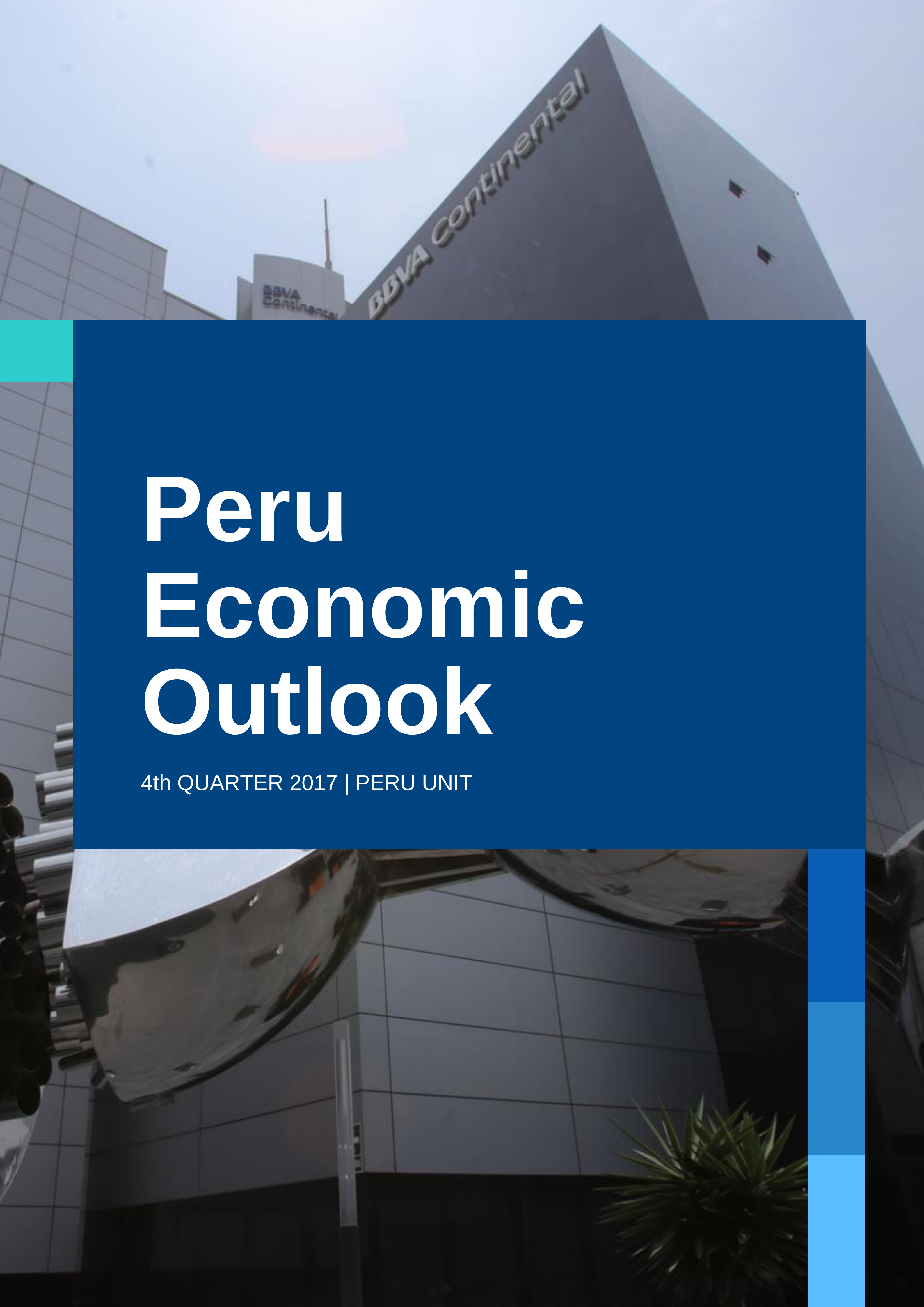


Peru Economic Outlook

4th QUARTER 2017 | PERU UNIT

BBVA | Research

Contents

Closing date: 6 October 2017

1. Summary

The economic outlook has improved in the second half of the year: the international context is favourable, the negative impacts of the El Niño Costero weather phenomenon are dissipating, and fiscal and monetary policies are taking on a more countercyclical tone. With this, domestic demand will tend to become more dynamic, which will offset the slower pace of export growth. The indicators available for the third quarter point in this direction. Investment is beginning to recover, especially public but also private. In sector terms, Construction is gaining traction, while the performance of Services and Commerce is improving. As a result, **the Peruvian economy will grow by around 2.5% year-on-year in the second half of the year and close to that figure for 2017 as a whole.** GDP growth in the second half of the year will not be much higher than in the first half (2.3%), but there will be an interesting change within GDP: growth for extractive activities will lose steam, these being more closely linked to exports, and those activities that more closely track the performance of domestic demand will steadily recover.

The forecast we have for economic activity growth next year is strongly conditioned by the anticipated rate for government spending. Spending on rebuilding areas that were affected by El Niño Costero and the acceleration of work on building infrastructure (the Line 2 of the Lima metro, for example) and venues (and supplementary road projects) to be used during the Pan American Games in 2019 will make a direct contribution of 1.2 percentage points to GDP growth next year according to our estimates. Although somewhat more moderate, the tailwinds for the international environment will remain present and, together with the fiscal stimulus, stand to boost private sector spending. **It is in this context that we predict that the Peruvian economy will grow at close to 4% in 2018.** Consistent with the more positive performance of domestic demand, in sector terms Construction, Non-primary Manufacturing and Services are some of the activities that will advance the most next year.

The increase in government spending in 2018 will have a positive impact on economic activity, but it is also true that it will result in some deterioration of the fiscal accounts. We estimate that due to the nature of the increased spending that will take place this will **only be transient**. **2019 will mark the beginning of fiscal consolidation.** It is important to mention that the principal risk rating agencies have held Peru’s sovereign credit rating with outlook stable, something that has not been the case for some of the other countries in the region. There is agreement on the record of credibility of Peruvian economic policy and the external accounts have improved, which are key strengths that allow the country to implement a temporary loosening of public spending associated with the reconstruction process. In this scenario, we predict that gross public debt will stabilise at around 29% of GDP in around 2021, below the limit imposed by the law (30%).

In terms of domestic financial markets, and in particular the forex market, the **PEN has appreciated 3% so far this year**. This strengthening has taken place in a context of a greater supply of foreign exchange associated with the improvement in the trade balance and a strong appetite for local financial assets. In the latter case, for example, non-resident investors have acquired around 75% of the net issuance of sovereign bonds that the Peruvian government has made so far in 2017. The Central Bank has been actively intervening in the foreign exchange market with the intention of relieving downward pressures on the exchange rate. We anticipate, however, that going forward the exchange rate will trend upwards. This indicates that both the Federal Reserve Bank of the United States (the Fed) and the European Central Bank (ECB) will gradually normalise their monetary policy stances so that global liquidity (abundant so far) will gradually diminish. In this context, US T-Bond yields will increase and the dollar will strengthen, which will discourage the search for profitability among the assets of emerging economies such as Peru. Moreover, China's growth will start to slacken and metal prices, including copper, will experience a downward correction. And finally, on the domestic front imports will gain momentum with the improvement of domestic demand, which will mean a greater demand for dollars. As a result, **we estimate that the dollar exchange rate will close the year at a level not unlike the current one (between 3.25 and 3.30 PEN), but that it will weaken a shade in 2018 and end that year in the 3.30 to 3.35 PEN range**.

On the price side, inflation returned to within the target range in September (2.9%). This was mainly due to the correction of food prices that spiked early on in the year due to El Niño Costero. Core inflation, the figure which strips out food and energy, and inflation expectations have all remained within the target range. In the absence of supply shocks, inflation will continue to decline because there is slack in the economy (on the absence of demand pressures), the depreciation we anticipate for the PEN is only minimal, and in the short term some food prices will still correct downwards. We estimate that in this context inflation will fluctuate from the end of this year and into the next at between 2.0% and 2.5%, except in the first quarter of 2018, when it is likely to stand at below these levels temporarily due to the high year-on-year base level for comparison at the start of this year (due to the effects of El Niño Costero).

In this **environment of weak GDP and domestic demand in the first half of the year**, and taking into account that inflation was only temporarily deviated above the target range (negative supply shocks), the **Central Bank has been loosening its monetary policy stance** through cuts to both the reserve requirement and the reference rate. Nonetheless, with the greater momentum of public spending since the second half of the year, any further monetary easing, particularly through the reference rate, is becoming less necessary. The policy rate currently stands at 3.50%. However, our baseline forecast scenario does not rule out this rate ending the year at 3.25% (and remaining there in 2018): if the recovery of public spending and private investment fails to be sustained, or if it continues but is not as strong as the central bank anticipates (this is what our baseline scenario assumes), this could lead to a new rate cut to 3.25%. There will be elbow-room to do this because inflation will fall back steadily and the depreciation of the PEN will be relatively contained.

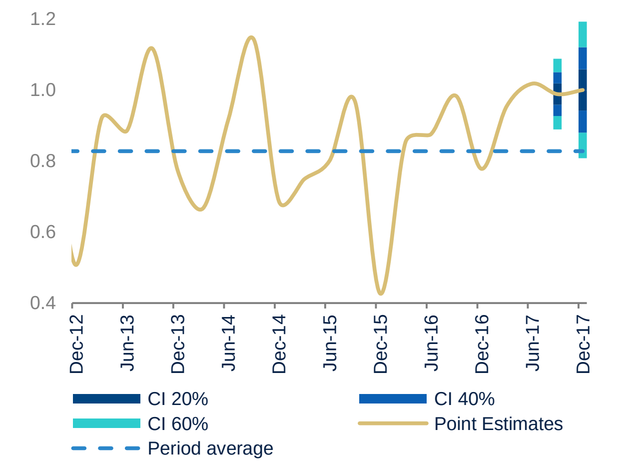
To conclude, **our forecasts of economic growth for 2017 and 2018 are subject to certain risks**. China's continuing financial vulnerability, uncertainty about what the Fed will do in 2018, delays to reconstruction work and infrastructure construction, and a deterioration in private sector confidence.

2. The positive global environment is strengthening

Robust and steady global growth with a more synchronized recovery across areas

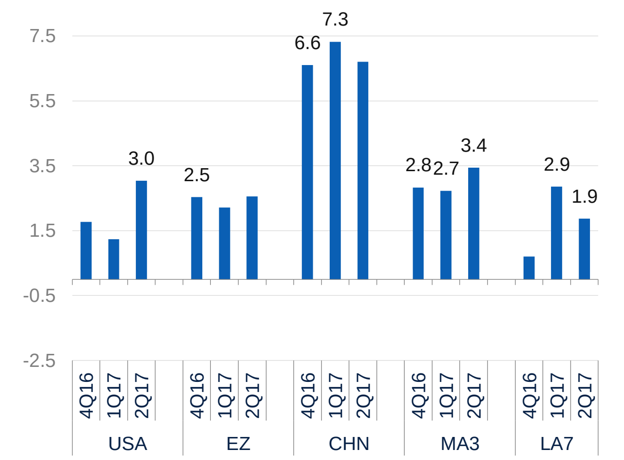
The growth rate of the world economy has stabilised by mid-year at around 1% QoQ, and the available indicators suggest so far that this trend will continue in the second half of the year (Figure 1). **Global confidence indicators continue to improve**, both in advanced and emerging economies, and anticipate a more positive outlook than the activity indicators, which slowed down at the beginning of the third quarter. Nonetheless, **global trade growth remains solid and the recovery of the industrial sector continues apace**, underpinning the upturn in investment, while private consumption remains resilient despite weaker tailwinds.

Figure 1. World GDP growth
(QoQ, %) Forecasts based on BBVA-GAIN



Source: BBVA Research

Figure 2. GDP growth by region
(Seasonally Adjusted Annual Rate, %)



Source: BBVA Research

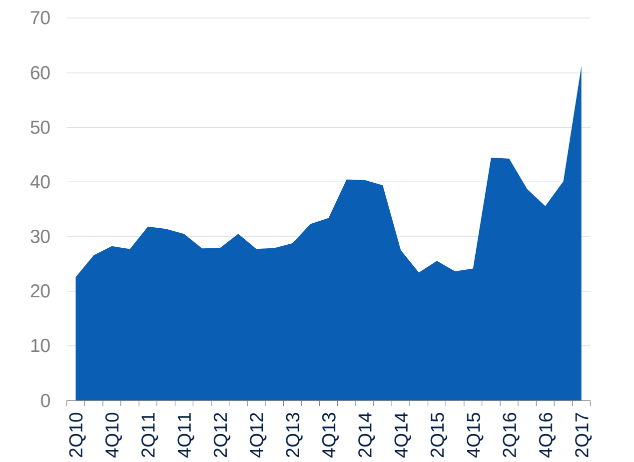
This positive dynamic reflects a stronger economic performance in all areas (Figure 2). In the advanced economies, US GDP rebounded in Q2 and dispelled doubts over the persistence of moderate growth in the coming quarters, while a greater strength from domestic factors was behind the positive surprise in Europe. In emerging economies, stable growth in China will continue to support the rest of Asia, which, coupled with favourable financial markets conditions, is also allowing growth in Latam countries to gain traction. In addition, the recovery in Russia and Brazil means that these countries are no longer dragging global growth. Hence, unlike other episodes of growth since the financial crisis (in early 2013 and mid 2014), the current recovery is proving to be more synchronised[1], according to our index[2].

1: Proof of this can be found in the fact that Harding and Pagan's concordance index for growth in developed and emerging economies has risen 25% since 2016.
2: The synchronisation index given here is the product of inverting the standard deviation of quarterly growth observed across countries. The index therefore associates less (more) growth volatility among countries with a higher (lower) degree of synchronisation worldwide.

This environment of positive and more synchronised growth has thus far been accompanied by **moderate levels of inflation**, also generalized by areas, despite the abundance of liquidity in the markets, while there are still no clear signs of accumulation of inflationary pressures. In the case of the emerging markets (EM), the appreciation of their currencies due to a weak dollar and a certain increase in commodity prices has helped inflation to continue to abate. Among the developed economies, the reduction in inflation results from the disappearance of the base effect of energy prices (especially in Europe) and certain transitory factors (mainly in the United States), although **core inflation remains at low levels** and doubts persist on whether the factors underlying this weakness of inflation are temporary or permanent. This context helps **central banks in the emerging economies to have greater room for manoeuvre to continue supporting** growth, **while it allows the monetary authorities in the advanced economies to remain cautious in normalizing their monetary policies**.

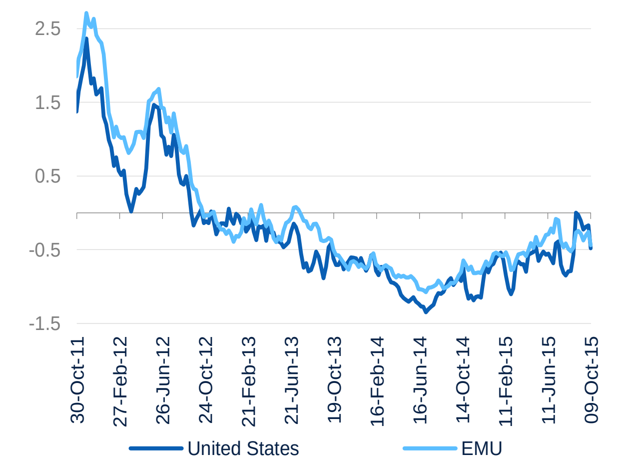
Other drivers behind the global performance, such as **fiscal policies, have generally been neutral or expansionary lately,** while relatively subdued commodity prices appear to extend over the forecast horizon, and **relatively complacent financial markets** are not suffering persistently from sources of political stress.

Figure 3. Synchronisation index (based on the time variance of GDP)



Source: BBVA Research

Figure 4. Financial tension index. USA vs. Eurozone (normalised)



Source: BBVA Research

Favourable environment in financial markets and normalization of monetary policies

In this quarter **market dynamics have been broadly unchanged since the first half of the year in spite of episodes of stress** (Figure 4), above all of a political (debt ceiling debate in the United States) and geo-political nature (tensions in North Korea). These events have caused a certain safe-haven effect on debt, which has led long-term interest rates to the lower end of the market range. However, its effect has been only transitory.

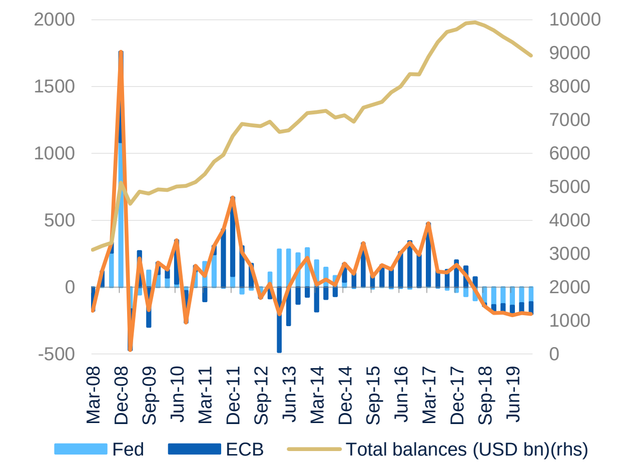
In an environment where growth remains dynamic and with no downward surprises on inflation, **central banks are pressing ahead with the gradual process of withdrawing monetary stimulus**. Specifically, the **US Federal**

Reserve (Fed) has announced it will start reducing its balance sheet as from October. This would take the form of a passive reduction, by allowing a portion of public and private bonds to expire, which has been well communicated, so it has not generated any tensions in markets. Moreover, the Fed, still expects to implement a series of rate hikes, even though the markets have systematically shown themselves to be more bearish. **We expect a 25 bp hike for official rates in December this year and then two further hikes up to 2% in 2018**. However, uncertainty about these hikes has increased, not only because inflation is still at low levels, but also **because of the changes that are going to take place at the Fed** following the exit of many of its members, including the vice chair, and with the uncertainty on whether its Chair will remain in office.

The European Central Bank **(ECB) will announce the tapering of its asset purchase programme in October**, which it would start to implement in January next year. The withdrawal of stimulus will be gradual and the ECB will be as flexible as possible, although the precise strategy it will adopt is uncertain as regards how much it will scale back its purchases and for how long the programme will continue. Our scenario contemplates a gradual reduction in purchases until the programme ends in summer 2018. **Rate hikes, however, will be delayed until mid 2019,** largely due to the ECB's growing concern over euro appreciation and its potential impact on inflation.

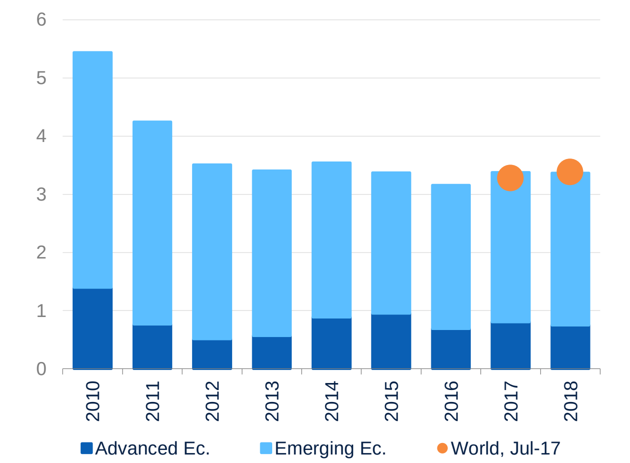
Like in the previous quarter, the combination of low volatility, low rates and dollar weakness have drawn a favourable outlook for EMs. Hunt for yield **strategies have led to strong inflows towards EMs**, particularly in the bond market, as well as currency strength.

Figure 5. Fed and ECB balance sheets
(level and quarterly changes, in billions of USD)



Source: BBVA Research

Figure 6. World GDP forecast by region
(% YoY)



Source: IMF and BBVA Research

Higher global growth on the upward revision in Europe and China

Our **new forecasts lead global growth to accelerate to 3.4% in 2017-18** (Figure 6), which implies an upward revision of around 0.2pp this year and acceleration from 3.2% in 2016. This change is due to **higher forecasted growth both for China and Europe in 2017** on account of positive surprises in both regions since Q2. For the United States, we are maintaining our estimate of sustained growth of slightly over 2% within the forecast horizon, while the better progress predicted for the Latam economies is being confirmed. In contrast, growth for the rest of the Asian economies will continue to be robust, although it will feel the effect of the expected slowdown in the Chinese economy in the coming quarters.

The underlying factors supporting the acceleration and stability of global growth will remain present, even though some of them could gradually wear off in the coming quarters. The most immediate will be the normalisation of monetary policy by both the Federal Reserve and the European Central Bank (Figure 5), as it will lead to gradual reduction in global liquidity and less support for capital flows into the emerging economies. In addition, **there are still multiple political risks that can influence economic confidence and market behaviour.**

The U.S.: sustained growth in spite of political uncertainty and natural disasters

GDP growth **rebounded to 3.1% YoY in Q3**, **bouncing back from the substantial decline experience din the two previous quarters.** Although uncertainty is still high, due to both natural disasters and economic policy, the **economic fundamentals remain consistent with sustained growth of around 2%** which has been recorded over the past two and a half years. The **net economic impact of the hurricanes will be limited at the national level**, given that the 0.2pp that we estimate could be subtracted from growth in Q3 should be offset by the reconstruction efforts in the final stretch of the year. Moreover, the agreement between the government and the Democrats has delayed **the deadline for approving the budget** (guaranteeing government funding until December) **and raised the debt ceiling**. With respect to economic policy, the government is now focusing on **tax reform, but this is still short on essential details** and offers only limited options for enhancing efficiency. Even if it is finally approved**, the tax cuts are unlikely to give a significant boost to economic growth** given the cyclical situation of the economy, which is very close to full employment.

For all these reasons **we maintain our GDP growth forecast of 2.1% in 2017 and 2.2% in 2018**. The solidity of global growth, dollar depreciation, expectations of sustainable oil prices and the mild improvement in construction should support **an upturn in investment.** On the contrary, the more gradual improvement in the labor market and higher inflation lead us to continue to forecast **a slowing down in private consumption** over the forecast horizon. Even so, more sluggish growth in prices in recent months and the absence of any clear signs of inflationary pressures mean that we expect the **Fed to continue slowly with its normalisation process** for monetary policy. The risks for this scenario are still to the downside owing to the unknowns regarding the implementation of the economic policy measures announced, whereas the long period of cyclical expansion together with lax demand-side policies still work in favour of a build-up of financial vulnerabilities that could trigger a recession in the medium term.

China: a more promising outlook in the short term

Support from the Chinese authorities, especially with a pro-growth fiscal policy, has led to **a somewhat better than expected economic performance in the first half of the year**, with GDP growth stabilising at 6.9% YoY. In spite of this, **measures have been taken over the year to tackle financial vulnerabilities and encourage an orderly deleveraging process.** Particularly, the tightening of regulation on shadow banking and real estate markets are being combined with more prudent monetary policy, less expansionary fiscal policy and the removal of certain controls from the exchange market. The Communist Party Congress in mid October should shed more light on both the commitment on the part of the authorities to taking on the expected structural reforms to adjust the growth pattern and whether priority will be given to financial stability over economic growth.

As a result of the recent improved performance, we have **revised up our GDP growth forecast upwards by around 0.2pp to 6.7% in 2017**, somewhat higher than the target of 6.5% that the authorities are aiming for, **although we maintain our prediction of a slowdown in 2018 to 6%**. Since mid-year available indicators were already showing us signs of more moderate economic growth and could be reflecting the impact of more prudent demand-side policies, but with the adverse effect on activity of regulatory tightening, the removal of over-capacity from companies and currency appreciation. Inflation remains subdued, especially in food, although industrial product prices have risen again due to supply-side disruptions. In contrast, the regulatory toughening and a stronger currency should continue to contain price developments, and thus we **are keeping our inflation forecast at 1.7% in 2017 and 2% in 2018**.

The authorities' strategy and the more gradual slowdown in growth have **diminished the risks over the forecast horizon, although they are still rising over the medium term** given that debt remains on the rise with some debt service indicators at high levels, while the adjustments by state-owned companies is still being delayed.

Eurozone: increased growth due to strong domestic demand

The **European economy** has advanced at a quarterly rate of **around 0.6% since the end of last year.** More sustained global demand continues to support exports, while the impact of a stronger euro has been limited. The strength of the euro partly reflects the best cyclical momentum **of the European economy, driven by the solidity of domestic fundamentals** (improvement in the labor market and increased confidence), which have encouraged a better performance by both consumption and investment. Although economic performance has been somewhat better than expected so far this year, the weakness of core inflation is keeping the ECB wary. Therefore, even if it will begin to reduce the bond purchasing programme at the beginning of next year,, monetary policy will still underpin growth through the maintenance of very low interest rates beyond the forecast horizon. Fiscal policy will also be mildly expansionary in 2017-18, being favoured by the positive impact of the cyclical recovery, which provides more room for the Member States to maintain a degree of fiscal support without compromising the achievement of targets. For all these reasons **we have revised forecast GDP upwards by 0.2pp in 2017 to 2.2%**, which represents above-potential growth for the third year in a row. This makes it hard to imagine a significantly higher acceleration in the short term. In addition, **certain tailwinds from the past are faltering somewhat** or starting to blow in the opposite direction (euro appreciation, rising oil prices and the stabilisation of world growth) **and are behind the expected slowdown to 1.8% in 2018**.

Headline inflation has held relatively stable in the third quarter, with lower energy and food prices being offset by a rise of around 0.1pp in core inflation (to 1.3%). Beyond the volatility and seasonality of certain components of inflation, the strength of domestic demand, the improvement in the labor market and the incipient rise in wages should start to push prices upwards in the coming quarters, although **the impact of recent euro appreciation on import prices leads us to revise our forecast for headline inflation downwards** by around 0.1pp in 2017 to 1.5% and 0.2pp in 2018 to 1.2%, while we **are keeping an unchanged forecast of a gradual increase in core inflation** (1.1% this year and 1.4% in 2018).

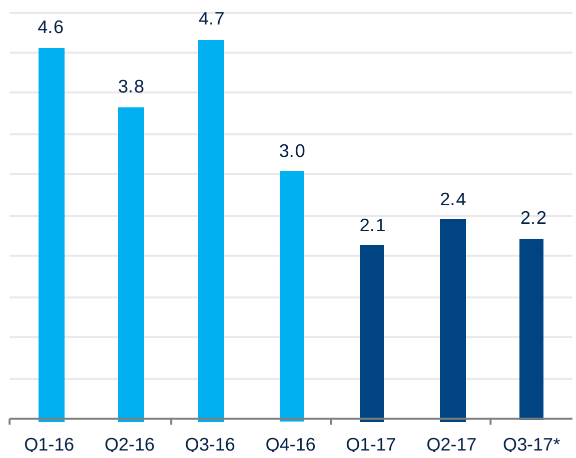
Domestic risks for the eurozone as a whole still have a downward bias but are moderate. And most of them are political, such as the obstacles in the Brexit negotiations, despite some recent rapprochement of the positions, the unresolved banking problems in certain countries, as well as the political tensions in certain Member States and the possible lack of support for moving ahead with the European project after the results of the German elections.

3. Peru: growth will accelerate in 2018, in line with fiscal stimulus and favourable external conditions

Economic activity grew by 2.4% in the second quarter of 2017, a figure not far removed from that in the first. The increased fishing activity accounted for about two thirds of the growth, a boost that is only transitory

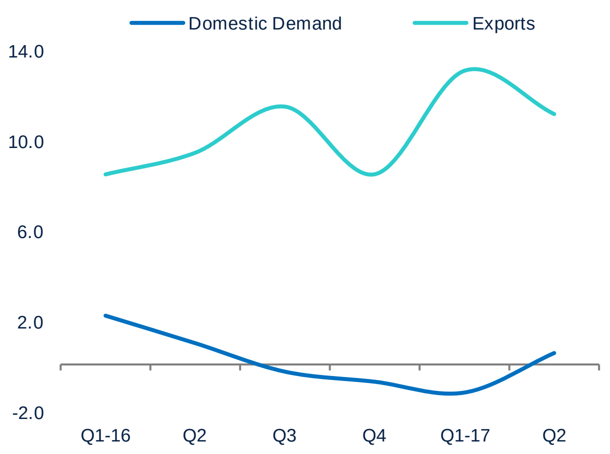
GDP continued to show slow momentum in the second quarter (see Figure 3.1). In terms of sectors, the positive was the boost from primary activities as a whole, that is, those linked to the extraction of natural resources. Fishing, in particular, was favoured by the greater volume of anchovy extraction in a context in which the first anchovy-catching season off the north central coast began earlier this year than last and the quota that was established for landing such fish was substantially larger. This, positive knock-on effect on the industry that produces fish flour and oil. We estimate that the larger anchovy catches accounted for about one and a half percentage points of the GDP growth rate in the quarter. The group of non-primary activities, on the other hand, performed even weaker than in the first quarter of the year. On the expenditure side, what was observed was strong export growth, which continues to reflect the significant increase in copper production, and this was compounded by the greater production of fish flour and oil, while domestic demand maintained a poor performance (see Figure 3.2). Within the latter, public spending and private investment continued to decline, albeit to a more limited extent than in the first quarter in an environment in which the adverse impact of El Niño Costero began to dissipate.

Figure 3.1 GDP
(% ch. YoY)



Source: Central Reserve Bank of Peru and BBVA Research

Figure 3.2 Domestic demand* and Exports
(in real terms, % ch. YoY)

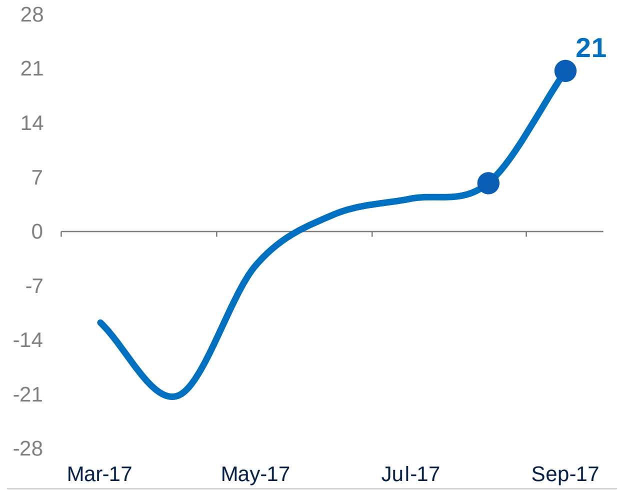


* Excludes change in inventories
Source: Central Reserve Bank of Peru and BBVA Research

The pace of GDP growth is likely not to have picked up in the third quarter. Even so, a change in the composition of growth is thought to be happening: domestic demand is gaining prominence and exports are losing strength

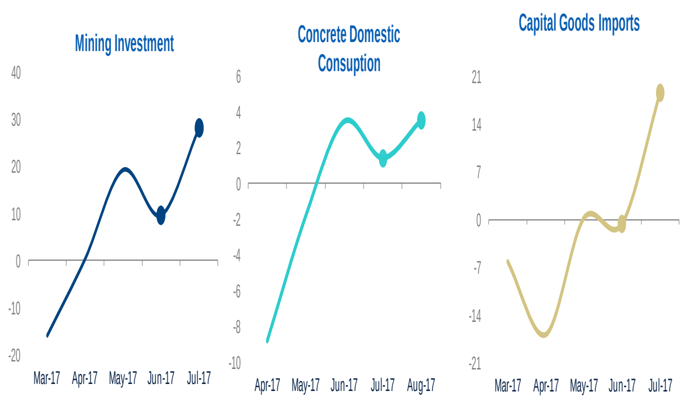
We estimate that in the third quarter GDP increased between 2.0% and 2.5% YoY, a figure not very different from that observed in the previous two quarters. However, the beginnings of a restructuring of GDP appear to be underway. On the expenditure side, exports, the mainstay of growth for almost two years, have probably weakened in an environment where the growth rate of copper production has subsided and the positive impact of a larger volume of anchovy catches is wearing off (the first anchovy-catching season off the north central coast ended in July). The opposite is expected to have occurred with domestic demand, which seems to be gaining in prominence. This improvement appears to have found an ally in the favourable external outlook (in terms of world growth, expansionary monetary policies in the more developed economies, low global risk aversion and high metal prices) and, domestically, in the fact that the negative impact of El Niño Costero is finally dissipating while monetary and fiscal policies are giving more support to economic activity. For example, public investment has moved ahead again, something that has not happened for a year (see Figure 3.3); the indicators available for private investment, meanwhile, suggest that this should have increased again in the third quarter (see Figure 3.4), something that in this case had not happened since the end of 2013.

Figure 3.3 Public investment*
(% ch. YoY)



* Only relates to General Government; does not include public enterprises
Source: Central Reserve Bank of Peru and BBVA Research

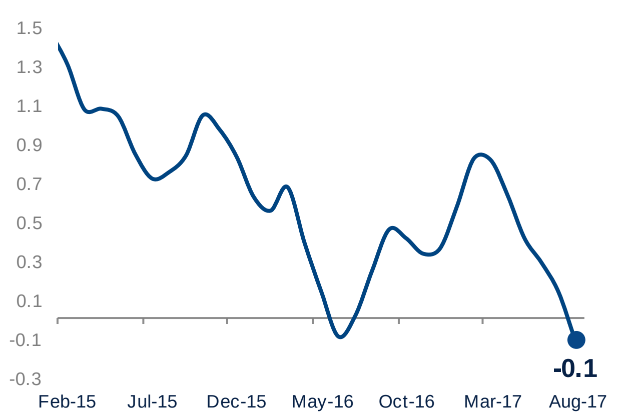
Figure 3.4 Private investment indicators
(three-month moving average, % ch. YoY)



Source: Ministry of Energy and Mines (MINEM), National Institute of Statistics and Informatics (INEI), Central Bank of Peru and BBVA Research.

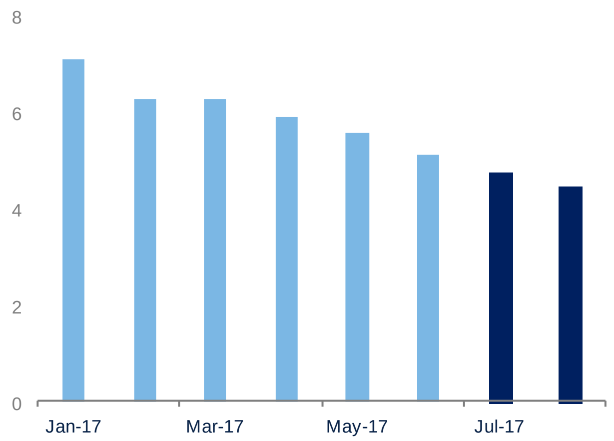
It is important to mention that, on the private consumption side, some available indicators also show an improvement in recent months, such as sales of new family vehicles. Other indicators are not so auspicious. Formal job creation, for example, remains weak (see Figure 3.5) and consumer lending by banks is progressing at a slower pace (see Figure 3.6). It is therefore less clear that private consumption has improved significantly in the third quarter. However, past evidence suggests that household spending responds with a certain lag to increased investment. If the latter is significant and sustained, the demand for labour will recover as the slack in the productive sectors is reduced, which will favour job creation and thus spending by families. The fall in inflation we anticipate for the coming periods will also have a positive impact.

Figure 3.5 Urban formal employment (three-month moving average, % ch. YoY)



Source: Ministry of Labour and Promotion of Employment.

Figure 3.6 Banking: consumer finance lending (% ch. YoY)



Source: Superintendency of Banking, Insurance and Pension Funds (SBS)

On the sector side, the redistribution of growth in favour of domestic demand, and in particular of investment, is reflected in an improved performance in non-primary activities. We estimate that in the third quarter, Construction again expanded and even led sector growth, while Commerce and Services ought to have performed more positively. Fishing and Primary Manufacturing, on the other hand, should have slipped back, in line with the lower anchovy haul.

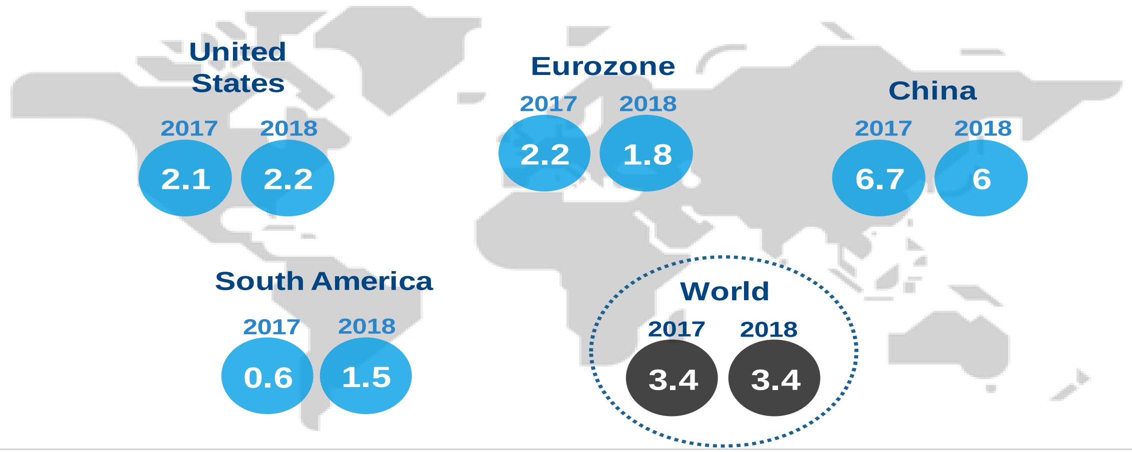
For the remainder of this year and for 2018 our baseline scenario assumes favourable external conditions and a fiscal stimulus associated with the expenditure on reconstruction and infrastructure. In this context, we forecast that Peru will grow by 2.4% in 2017 and 3.9% in 2018

In addition to the current trends observed in Peru’s economy, our forecast baseline scenario for the rest of the year and going forward factors in the following aspects.

On the external side, favourable conditions due to:

- Growth of global economic activity. Consolidates at around 3.4% in 2017 and 2018 (see Figure 3.7), with greater synchronisation between the main blocks: good performance in developed economies (in particular the United States and Europe), improvements in some emerging markets such as Russia and Brazil, which are moving out of deep recessions, and a slight slowdown in China (we have maintained the forecast of a slowdown and gradual rebalancing in the medium term).

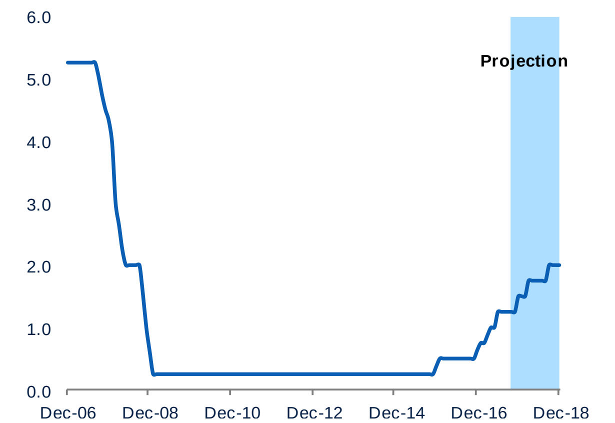
Figure 3.7 World growth
(% ch. year-on-year)



Source: BBVA Research

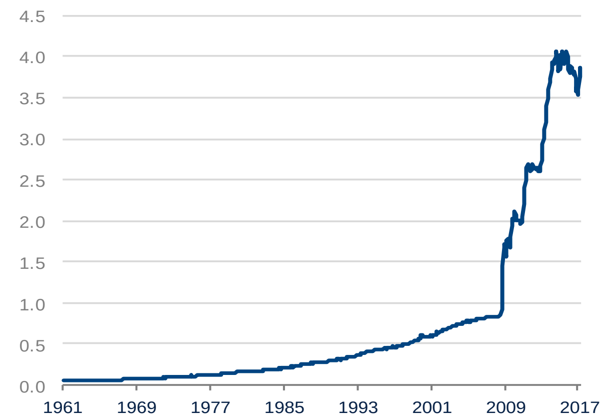
- Monetary policy in the most developed countries. Central banks are moving toward normalisation, though this is gradual. The Fed will continue its normalisation of monetary conditions in the United States in a signalled and orderly manner, making it easier for the market to assimilate. This implies that the next rate increase will be in December and that there will be two additional hikes in 2018, all of them of 25 bp each (see Figure 3.8). Likewise, we are assuming that the Fed will make a start on scaling back its balance sheet (see Figure 3.9) from October and according to what has been announced. In the case of the European Central Bank, the tapering of bond purchasing will start in the first half of 2018 and we estimate that there will be no rate hikes before mid 2019.

Figure 3.8 Forecast for the Fed rate
(%)



Source: Bloomberg and BBVA Research

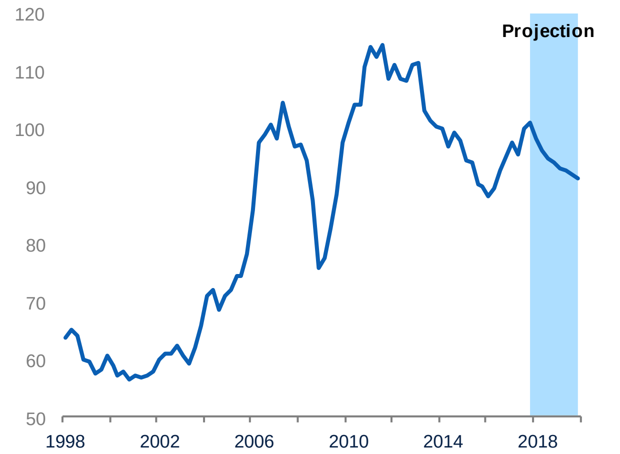
Figure 3.9 United States: monetary base
(trillions of dollars)



Source: Fed and BBVA Research.

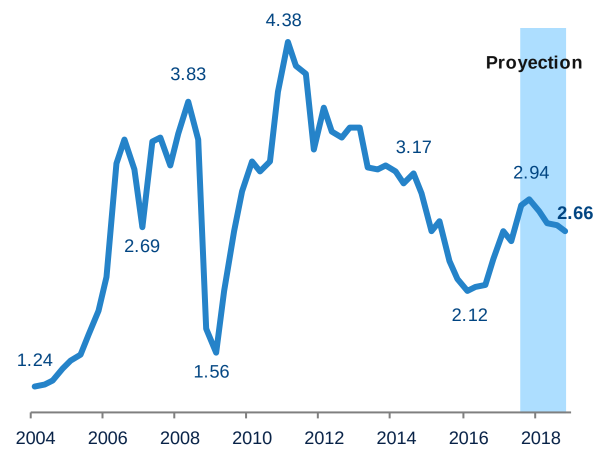
- The average prices of the metals that Peru exports will stabilise at levels similar to those observed this year, so that a scenario will be maintained with the highest prices since 2015. As for the prices of the main imported products, we expect a slight upward trajectory, similar to what we anticipated three months ago. The average level of terms of trade will therefore show a recovery in 2017, after five years of consecutive declines, and will be corrected downward over the horizon 2018-2021 (see Figure 3.10).

Figure 3.10 Terms of trade
Index, base 2007=100



Source: Central Reserve Bank of Peru and BBVA Research

Figure 3.11 Copper price
(USD/lb)



Source: Bloomberg and BBVA Research

For 2017, in particular, we forecast that the average annual price of copper will increase by just over 25%, which is largely explained by the level reached in recent months, –the average price of copper topped USD 3.0 per pound in September, the highest level in almost three years— in an environment of international depreciation of the dollar and the bigger positions taken by non-commercial agents (speculators). China's best figures in 1H17 have also supported the higher price of copper. In the medium term, however, we continue to see a gradual convergence of the price of copper from current levels towards USD 2.52 per pound (see Figure 3.11), a level more consistent with our current estimates of demand and supply balances.

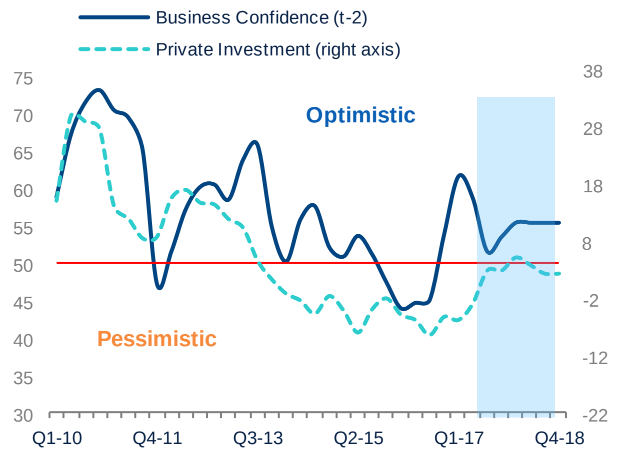
As for oil (Peru is a net importer of this commodity), we forecast that the WTI average price for this year will be around USD 49 per barrel, an increase over the previous year, but slightly below what we were forecasting three months ago. Going forward, we continue to factor in a gradual adjustment of the current imbalances and a convergence towards levels of USD 57 per barrel.

On the domestic side, we are working from the following assumptions:

- Confidence indices will remain at levels similar to the current ones, i.e. fluctuating between 50 and 55 points (see Figure 3.12).

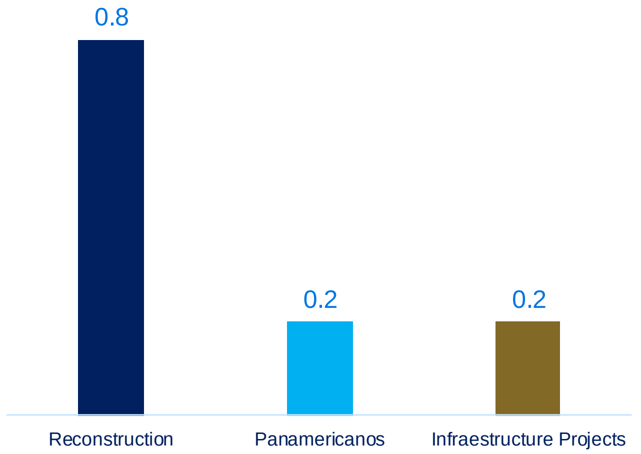
A significant fiscal stimulus[3] due to: (i) the reconstruction work on infrastructure damaged by El Niño Costero, (ii) greater execution of major infrastructure works (including Lima Metro's Line 2), and (iii) construction of the venues for the Pan American Games (as well as supporting road projects). In this way, we estimate that the support of the higher fiscal spending in these three tasks will be important for the advance of economic activity next year, with a direct contribution to growth of around 1.2 percentage points (see Figure 3.13).

Figure 3.12 Business confidence and private investment (index in points, % ch. YoY)



Source: Central Reserve Bank of Peru and BBVA Research.

Figure 3.13 Fiscal stimulus: contribution to GDP growth in 2018 (percentage points)



Source: BBVA Research

In the baseline scenario, we expect 2.4% GDP growth in 2017 and 3.9% in 2018. On the sector side, the primary sectors[4] will continue to be the most dynamic (we project that these sectors will grow by 3.8% and 6.2% in 2017 and 2018 respectively, see Table 3.1). In 2017, the Fishing sector will expand rapidly (around 24%), impacting positively on industries that process fish products. This underpins the contention that primary manufacturing will grow by more than 5% this year. In 2018, the acceleration of primary activities is mainly attributable to metal mining (via the normalisation of production levels[5]) and production of hydrocarbons (we assume that normal operation of the Norperuano pipeline will be restored).

With regard to non-primary activities (more linked to domestic demand and representing a little more than 70% of total production of goods and services), we expect these to accelerate in 2018 due to the boost in spending on reconstruction and infrastructure work, which will be reflected in greater momentum in the Construction, Non-Primary Manufacturing and Services sectors.

3: For further details, see the fiscal section.
4: Agriculture & Livestock, Fisheries, Mining and Hydrocarbons and Primary Manufacturing, all linked to the extraction of natural resources.
5: In copper production, the mines which have shown extraction levels below their potential this year, such as Antamina, are predicted to recover.

Table 3.1 GDP by productive sector
(% ch. YoY)

	2015	2016	2017(e)	2018(p)
Agriculture and livestock	3.5	2.3	2.1	3.9
Fishing	15.8	-10.1	23.6	3.5
Mining and fuel	9.5	16.3	3.7	7.0
Metals	15.7	21.2	4.1	5.7
Fuel	-11.6	-5.4	1.6	14.5
Manufactures	-1.5	-1.4	-0.2	3.2
Primary	1.3	-0.6	5.0	7.0
Non-primary	-2.4	-1.6	-2.0	1.9
Electricity and water	5.9	7.3	2.0	4.5
Construction	-5.8	-3.1	0.8	6.4
Commerce	3.9	1.8	1.0	1.9
Other services	5.0	4.4	3.1	3.7
Global GDP	**3.3**	**4.0**	**2.4**	**3.9**
Primary sectors	6.9	9.9	3.8	6.2
Non- primary sectors*	2.6	2.5	1.8	3.4

* Excludes import duties and taxes
Source: Central Reserve Bank of Peru and BBVA Research.

Table 3.2 GDP on the expenditure side
(% ch. YoY)

	2015	2016	2017 (e)	2018 (p)
1. Domestic demand	**2.9**	**1.0**	**2.2**	**3.8**
a. Private Consumption	3.4	3.4	2.5	2.8
b. Public Consumption	9.8	-0.5	2.0	4.9
c. Gross Domestic Investment	-1.5	-4.3	1.8	5.9
Gross Fixed Investment	-5.3	-4.6	0.3	6.0
- Private	-4.3	-5.9	-0.5	3.5
- Public	-9.5	0.6	3.7	15.1
2. Exports	4.0	9.5	3.2	3.8
3. GDP	**3.3**	**4.0**	**2.4**	**3.9**
4. Imports	2.4	-2.2	2.8	3.0
Note:				
Domestic demand (excl. inventories)	*1.8*	*1.0*	*1.9*	*3.8*
Private Expenditures (excl. inventories)	*1.5*	*1.2*	*1.8*	*2.9*
Public Expenditures (consumption and investment)	*3.6*	*-0.2*	*2.5*	*7.8*

Source: Central Reserve Bank of Peru and BBVA Research

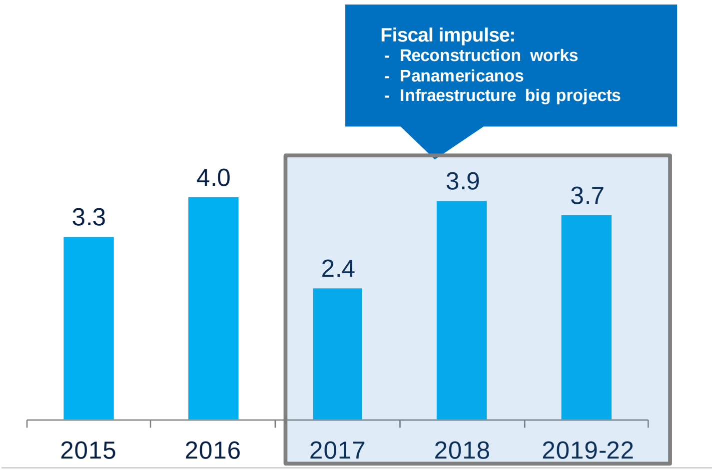
On the expenditure side, it should be noted that next year, domestic demand will continue to accelerate, (see Table 3.2), mainly thanks to higher public expenditure (infrastructure, reconstruction and the Pan American Games), which should gradually elicit a response from private spending. Meanwhile, exports will slacken6 and imports will start to recover due to the greater dynamism of domestic demand.

In 2019-2021 growth will slow. And while the execution of investment megaprojects that are in the pipeline should provide a greater boost, the most important thing is to relaunch the agenda of reforms

For 2019-2021 we estimate an average annual growth rate (AAGR) of 3.7% (see Figure 3.14). This is a passive scenario in which we do not expect reforms to improve the country's productivity and competitiveness to be implemented. Under this scenario, the ratio of gross fixed investment (private and public) to GDP should stabilise at around 23%, below the highest levels (around 27%) observed in the period of strong growth in 2012-2013 (see Figure 3.15), and also lower than those in economies going through rapid growth phases, such as in East Asia.

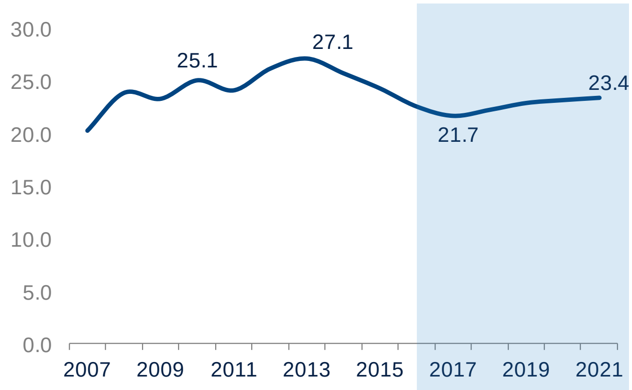
6: On a year-on-year basis, the thrust of mining –and, in particular, copper production—will steadily decline as major projects/mines have already reached full capacity levels.

Figure 3.14 GDP
(% ch. YoY)



Source: Central Reserve Bank of Peru and BBVA Research.

Figure 3.15 Gross Fixed Investment
(% of GDP)



Source: Central Reserve Bank of Peru and BBVA Research.

It should be noted that average growth over the three years from 2019 to 2021 could gather pace in the event of rapid execution of the major investment projects in the pipeline (amounting to USD 18 billion) that have a reasonable chance of being announced in the coming months (see Table 3.3): (i) Quevalleco (a project that is in the Anglo American portfolio and is thought to be worth approximately USD 5 billion); (ii) Michiquillay (USD 1.95 billion, a project that the government hopes to award a contract for in November this year); (iii) Line 3 of the Lima Metro (USD 5.6 billion); and (iv) The Lima ring-road (USD 2.047 billion). On the last two projects, the government plans to grant concessions for them by the end of next year.

Table 3.3 Investment projects

Mining	Transports*
USD 9 550 millions	USD 8 530 millions
USD 5 000 millions Quellaveco	USD 5 600 millions Line 3 - Metro de Lima
USD 1 950 millions Michiquillay*	USD 2 047 millones Peripheral Road Ring
USD 1 300 millions Toromocho Ampliation	USD 464 millones Longitudinal de la Sierra Section 4
USD 520 millions San Gabriel	USD 215 millones Modernization of Salaverry Port
USD 480 millions Pukaqaqa	USD 204 millions Huancayo - Huancavelica Railway
USD 300 millions Magistral	

*To be put out to tender.
Source: Apoyo Consultoría and Proinvestment.

However, to ensure that the Peruvian economy can sustain a higher growth rate beyond the projected horizon in the analysis, it is necessary to relaunch the reform agenda to improve productivity, competitiveness and productive diversification. It is important to note that in the recently published 2017 Competitiveness Index (WEF), Peru dropped five places compared to the previous year (see Figure 3.16)[7]. The pillar that showed the greatest deterioration was Institutions (down 10 positions); in contrast, the pillars relating to technology and innovation had a better performance (see Table 3.4).

Figure 3.16 Competitiveness Index
(placing in the ranking)

Source: WEF and BBVA Research.

Table 3.4 Pillars in the Competitiveness Index
(placing in the ranking)

Pillars	2013	2016	2017	Gap 2017-2016
Basic Factors				
1. Institutions	109	106	116	10
2. Infrastructure	91	89	86	-3
3. Macroeconomic Stability	52	75	78	3
4. Health and Primary Education	95	98	93	-5
Efficiency				
5. Higher education and training	86	80	81	1
6. Goods market efficiency	65	69	75	6
7. Labor market efficiency	48	61	64	3
8. Development of the financial marke	40	26	35	9
9. Technological disposition	86	88	86	-2
10. Market Size	43	48	48	0
Innovation				
11. Business Sophistication	72	80	81	1
12. Innovation	122	119	113	-6

Source: WEF and BBVA Research.

In general, there is a need to improve the functioning of the factor markets (in particular the labour market, where approximately 70% of the labour force is "trapped" in low-productivity activities) and to reform key institutions and sectors in all market economies (such as the judiciary, and the education and health sectors) to transform them into "pro-growth" entities that generate the right incentives to invest and innovate.

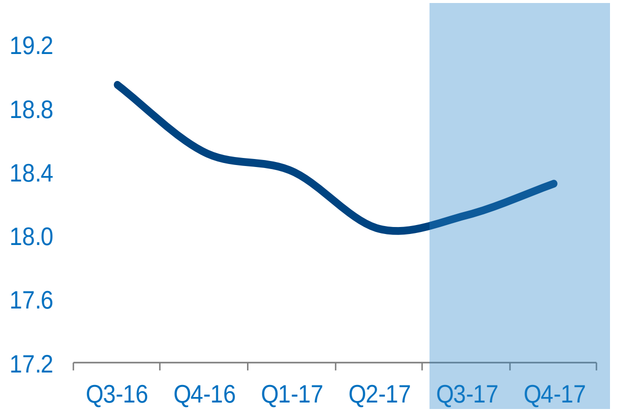
In addition, greater political understanding will be critical in defining a minimum agenda of measures and reforms that strengthen medium-term growth prospects. However, without the support of political players, the economy could slow persistently, making it more difficult to continue to reduce poverty, combat the informal economy, improve the availability of public goods and services and, in general, continue to foment inclusion.

[7] Countries in the region such as Chile (33) Mexico (51) and Colombia (66) are better placed.

4. Fiscal policy: the credit rating is being maintained and revenue prospects are improving in an environment of recovery for metal prices

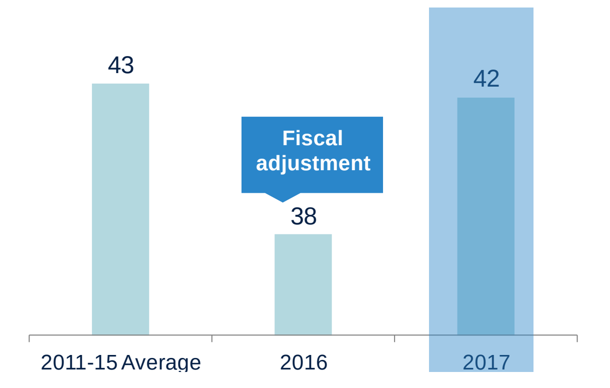
We estimate that in 2017 the fiscal deficit will be 2.7% of GDP, below what was forecast three months ago (3.0% of GDP). This lower deficit is consistent with higher projected tax revenues and a downward correction of public investment spending. With regard to revenues, we project higher collection levels (see Chart 4.1), linked to a more positive path of the copper price and greater dynamism in spending by the private sector. It is important to mention that in the tax revenue forecast for the year, the revenue from the tax amnesty for undeclared foreign capital (0.2% of GDP)[8] and the end of the deferral of payment of tax obligations in areas affected by El Niño Costero will both favour an improvement in revenue in the second half of the year compared to the first half. On the other hand, with respect to the downward correction in public expenditure (compared to the forecast we made three months ago), this is based on the negative surprise in public investment during the second quarter, added to which we have assumed lower expenditure in the fourth quarter so that the execution ratio is more on a par with that observed in the years prior to the fiscal adjustment in late 2016 (see Figure 4.2).

Figure 4.1 General Government revenues (cumulative annual figure, as % of GDP)



Source: Central Reserve Bank of Peru and BBVA Research.

Figure 4.2 Public investment: expenditure in the October-December period as a proportion of the total spent in the year (%)



Source: Central Reserve Bank of Peru and BBVA Research.

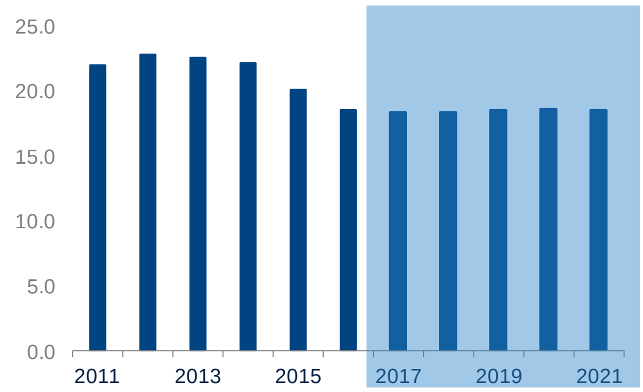
In 2018, the expected fiscal deficit has also been reduced[9] due to higher revenues linked to a firmer copper price. On the expenditure side there are no major changes compared to what was forecast three months ago. Thus, the fiscal stimulus that includes the execution of large infrastructure projects, among these Line 2 of the Lima metro (PEN 2.7 billion) and construction of the refinery in Talara (PEN 3 billion), is being maintained. This embraces the reconstruction

8: The projection baseline scenario assumes that the collection from this item will be PEN 2.4 billion next year (0.3% of GDP)
9: The current projection for the deficit is 3.3% of GDP, 0.2 percentage points of GDP below what was projected three months ago

work[10] (PEN 7.1 billion[11]) and the roll-out of infrastructure for the 2019 Pan American Games (PEN 2.3 billion[12]). With all of this, we project government expenditure growth of close to 8% in 2018 (15% on investment and 5% on consumption).

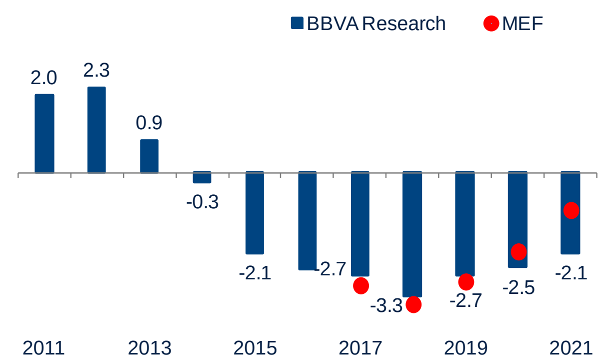
It is important to note that tax revenues as a percentage of GDP will remain at low levels compared to those achieved four years ago (see Figure 4.3). Furthermore, given the greater expenditure that needs to be made on infrastructure and improvements in public administration, raising government revenues in the coming years remains a challenge. Along these lines, the government would implement various tax measures to increase tax collection, including strengthening municipal taxation, streamlining tax exemptions, steadily bringing down evasion rates and improving the tax revenue mechanisms of SUNAT (Superintendency for Customs and Tax Administration). Income Tax has an evasion level of 57% and VAT one of 36%.[13].

Figure 4.3 General Government revenues (% of GDP)



Source: Central Reserve Bank of Peru and BBVA Research.

Figure 4.4 Fiscal balance (% of GDP)



Source: BCRP, MEF (Ministry of Economy and Finance) and BBVA Research

Going forward, we maintain a scenario of fiscal consolidation (see Figure 4.4). As a result, gross public debt will stabilise at around 29% of GDP in around 2021 (see Figure 4.5), about half a percentage point below what was forecast three months ago. It is important to note that the main risk rating agencies have held Peru's sovereign credit rating at outlook stable, thus differentiating it from other countries in the region that have outlook negative or whose ratings have been downgraded (Chile is an example, see Figure 4.6[14]). It should be noted that Fitch Ratings, Standard & Poor's and Moody's agree that the credibility of policies and a better external profile are key strengths that provide support to implementing a temporary relaxation of fiscal policy (reconstruction).

10: The Reconstruction with Changes Plan will require an investment of PEN 25.655 billion (3.6% of GDP) between 2017 and 2020. 77% of the expenditure is for reconstruction of damaged infrastructure; the rest involves spending on damage prevention and capacity enhancement. About 50% of the investment is concentrated in the regions of Piura and La Libertad. In addition, the Transport and Education sectors together account for just over 60% of the total investment amount

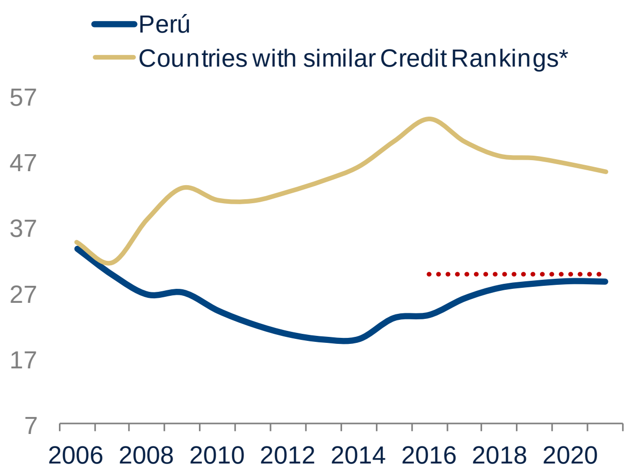
11: It will be financed with PEN 3.2 billion from the Fiscal Stabilisation Fund (FEF), by issuing PEN 2.2 billion of sovereign bonds, and PEN 1.7 billion in contingent loans (source: Ministry Of Economy And Finance (MEF)

12: This involves the construction of infrastructure in eight locations and complementary works that will allow mitigation of road transport problems in Lima. Works should be ready by mid-2019

13: The tax evasion rates are high compared to those of other countries in the region. Income tax evasion is 31% in Chile and 34% in Colombia. In the case of VAT, the tax evasion rate is 20% in Chile and 23% in Colombia. Source: Ministry of Economy and Finance (MEF)

14: Between July and August, S&P and Fitch Ratings downgraded Chile from AA- to A+ and from A+ to A, respectively.

Figure 4.5 Gross national debt (% of GDP)



* Includes countries that Fitch, S&P, and Moody's consider as having a similar sovereign credit rating as Peru. The median of this group of countries is used Source: IMF, Central Bank of Peru and BBVA Research.

Figure 4.6 Credit Rating and Outlook

	S&P	Moody´s	Fitch
Peru	BBB+	A3	BBB+
Chile	A+	Aa3	A
Colombia	BBB	Baa2	BBB
Mexico	BBB+	A3	BBB+
Brasil	BB	Ba2	BB
Uruguay	BBB	Baa2	BBB-

Stable Outlook

Negative Outlook

Steble Outlook with recent markdown

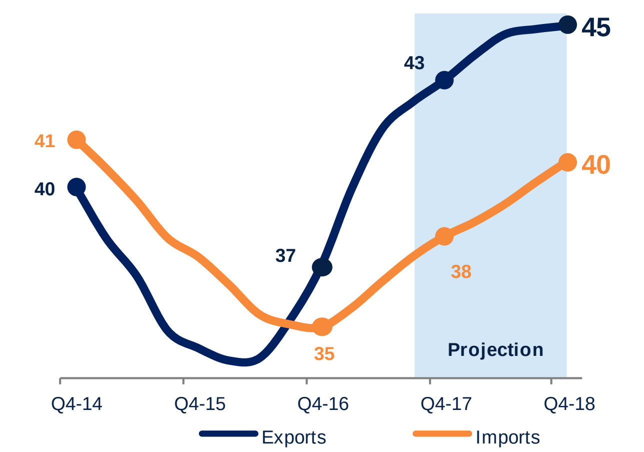
Source: Ministry of Economy and Finance (MEF)

5. Current account deficit at low levels and compatible with a relatively stable ratio of external liabilities to GDP in 2017-2021

For this year, we forecast that the trade surplus will almost triple compared to 2016 (USD 4.9 billion against USD 1.9 billion, see Figure 5.1). This result is due to the recovery of the exported value of goods, which we estimate will amount to USD 42.9 billion, the highest level since 2013, meaning that there will be a change in the declining trend observed between that year and 2016. The improvement in export value mainly reflects the positive effect of higher export prices, which is particularly apparent in traditional exports (in particular mining). Likewise, exports from the fisheries sector will grow due to increased catches of anchovies. On the other hand, non-traditional exports will register a modest recovery due to a better performance by economic activity in the countries in the region (main buyers).

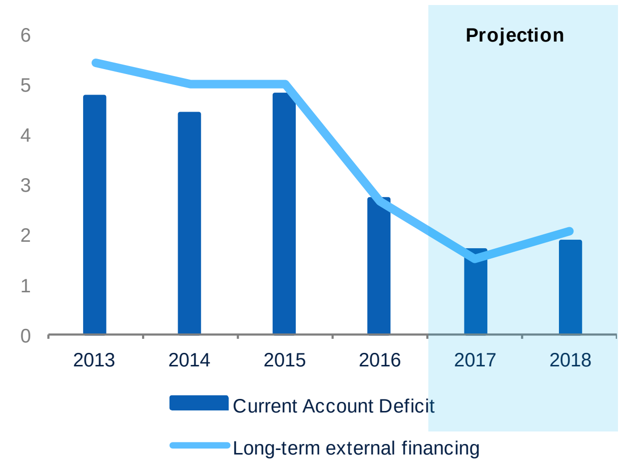
This strong performance on the trade side means that the current account deficit in the balance of payments will end 2017 at 1.7% of GDP. Going forward, this deficit will remain between 2.0% and 2.5% of GDP, which will favour the stabilising of the ratio of external liabilities to GDP at current levels. The low current account deficit in the next few years suggests that the countries external borrowing requirement will be relatively limited, strengthening the hand of Peru's economy in the face of any bouts of volatility that might arise from abroad (see Figure 5.2).

Figure 5.1 Annualised balance of trade (USD million)



Source: Central Reserve Bank of Peru and Superintendency for Customs and Tax Administration (SUNAT)

Figure 5.2 Current account and long-term private financing from abroad[1/] (% of GDP)



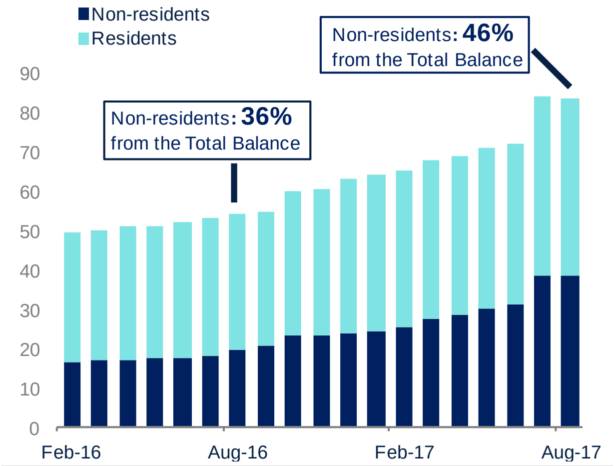
1/ Includes foreign direct investment and long-term loans.
Source: Central Reserve Bank of Peru and BBVA Research.

6. Financial markets: stable short-term exchange rate, but going forward we expect a slight depreciation of the PEN

So far this year, the PEN has appreciated 3%. The strengthening of the Peruvian currency has occurred in a context of a greater supply of foreign exchange: improvement in the balance of trade and a strong appetite for domestic financial assets. The Central Bank has been actively intervening in the foreign exchange market with the intention of relieving downward pressures on the exchange rate.

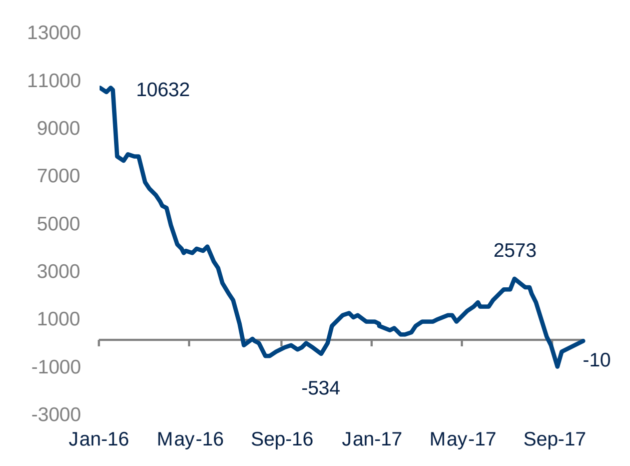
On the balance of trade side, this has shifted from a cumulative deficit of USD 540 million in July 2016 to a surplus of USD 4.6 billion in July of this year (see Figure 5.1), mainly due to the increase in metal prices and higher mining production. On the financial side, the strong appetite for domestic financial assets is reflected in the increase in sovereign bond holdings by non-resident investors. Thus, of the PEN 20 billion by which sovereign bonds issuance has risen so far this year, PEN 15 billion has been acquired by foreign investors (see Figure 6.1). This exposure to the local currency does not appear to have been hedged in the foreign exchange forward market; on the contrary, net foreign currency selling by banking companies in the forward market dropped by more than USD 600 million in the last quarter (see Figure 6.2).

Figure 6.1. Holdings of sovereign bonds (PEN billion)



Source: Ministry of Economy and Finance (MEF)

Figure 6.2. Banks: balance of net sales of foreign currency in the forward market (USD million)



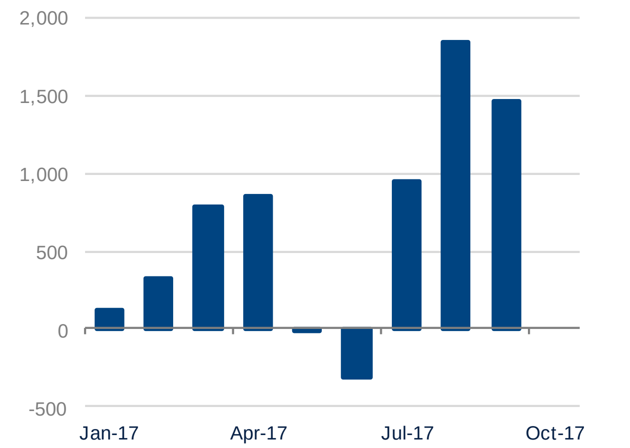
Source: Central Reserve Bank of Peru

In this context, the Central Bank has remained proactive to alleviate pressure on the PEN to appreciate in recent months. In the third quarter of the year, net purchases of foreign currency amounted to just over USD 3.5 billion and the net balance of CDLDs15 increased by almost USD 600 million. These exchange rate interventions (see Figure

15: Central Bank Certificates of Deposits Payable in US Dollars

6.3) drained liquidity in dollars and, in this environment, foreign currency interest rates increased in the local market (the interbank dollar rate rose from 1.2% in July of this year to 2.4% in September).

Figure 6.3. Foreign exchange market: buying intervention by the Central Bank (USD million)



* As at 3 October
Source: Central Reserve Bank of Peru

Figure 6.4.USD/PEN exchange rate

Source: Central Reserve Bank of Peru and BBVA Research

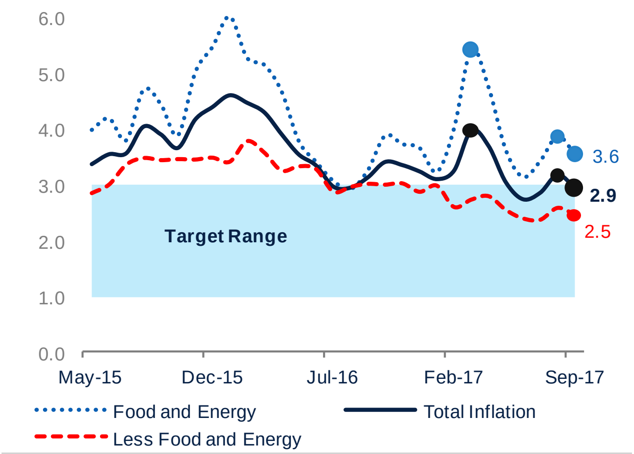
In recent weeks, however, with the increase in the probability given by the markets that the Fed will raise its rate in December and a certain downward correction in the international price of copper, the pressure of appreciation on the PEN has worn off and it has drifted slightly weaker. In this context, there has been no more Central Bank currency intervention as a buyer and local dollar interest rates have corrected downwards.

We estimate that the exchange rate will be between 3.25 and 3.30 at the end of the year, that is, at a level not far removed from the current one. Further ahead, bearing in mind that the central banks of the more developed economies (US and Eurozone) will make inroads into the gradual normalisation of their monetary policies, China's growth will moderate, the price of copper will decline over the coming year, and that, locally, the recovery of domestic demand will lead to a stronger performance by imports, we predict that the trend will be for the USD/PEN rate to rise, albeit moderately. We project that in 2018 the depreciation of the local currency will be less than 2% and that the exchange rate will thus be between 3.30 and 3.35 at the end of the year (see Figure 6.4).

7. Inflation: we anticipate a scenario without greater pressure on prices in the upcoming months

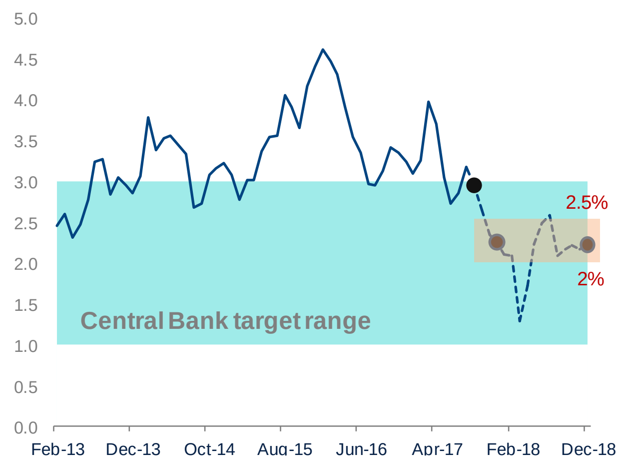
After the effects observed on the prices of some foods during the El Niño Costero period, inflation in year-on-year terms (which reached 4.0% in March) began to decline and stood within the target range at 2.9% in September. More trend-related measures of inflation, such as core inflation and ex food and energy, remain relatively stable (for example, inflation ex food and energy slipped from 2.6% in August to 2.5% in September, see Figure 7.1). Going forward, we anticipate that inflation will continue its downward trend (see Figure 7.2) in an environment where there is slack in the economy (absence of demand pressures) and the depreciation of the local currency will only be moderate, and where, in the short term, the prices of certain foods are still correcting downwards.

Figure 7.1 Inflation: total, ex food or energy, and only food and energy (% ch. YoY in the CPI)



Source: INEI, Central Bank of Peru and BBVA Research

Figure 7.2. Inflation (% ch. YoY in the CPI)



Source: INEI, Central Bank of Peru and BBVA Research

It is also likely that the high year-on-year basis for comparison from earlier this year (due to the effects of El Niño Costero) will lead to inflation continuing to fall back in early 2018, but will then normalise and close the year at a level not very different to that seen at the end of 2017. Thus the inflation outlook is relatively benign.

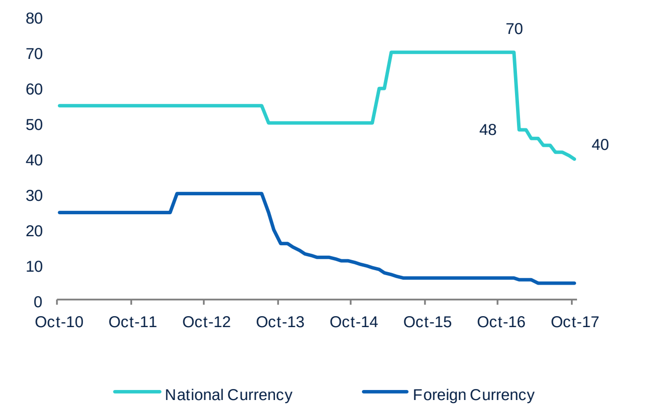
8. Monetary policy: we do not rule out an additional cut in the reference rate over the rest of the year

In September, the Central Reserve Bank of Peru (BCRP) cut the benchmark rate from 3.75% to 3.50%, the third cut so far this year in a context of weak domestic demand. This decision was made considering that inflation and expectations one year out are within the target range[16], and that the exchange rate is relatively stable. The Central Bank has also been cutting foreign exchange reserve requirements (see Figure 8.1) in an environment of rising international interest rates (the reserve ratio fell from 48% at the beginning of the year to 40% in October 2017).

The rate cut in September came ahead of BBVA Research's forecasts, as we were expecting this to happen at the beginning of the fourth quarter. However, given the current context, we do not rule out a further cut of 25 basis points over the remainder of the year because (i) GDP remained weak in July (1.6%) and August (2.0% -2.5%), (ii) inflationary pressures will be contained going forward and expectations will continue to be corrected downward, and (iii) the exchange rate will be relatively stable. An additional cut in the policy rate would help to consolidate the positive trends beginning to be shown by domestic demand. The cut will be more likely if the recovery that is beginning to be observed in public spending and private investment fails to sustain itself, or if it continues but is not as strong as the Central Bank anticipates (this is what our baseline scenario contemplates).

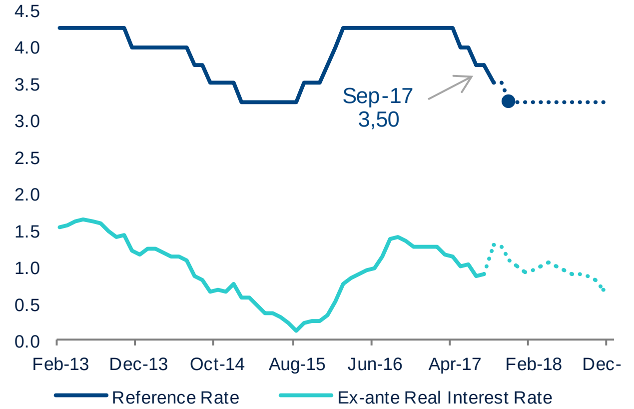
Additional monetary stimuli in 2018 will be more dependent on the information that emerges, in particular, on economic recovery and the progress of the fiscal stimulus associated with expenditure on reconstruction and infrastructure.

Figure 8.1 Marginal reserve rate in local and foreign currency (% of liabilities subject to reserve requirements)



Source: INEI, Central Bank of Peru and BBVA Research

Figure 8.2. Reference rate



Source: INEI, Central Bank of Peru and BBVA Research

16: Current inflationary pressures are considered transitory.

9. Risks to our growth forecast for 2018

There are four main downside risks in the baseline scenario we envisage for economic activity in 2017 and 2018. **The first of these is linked to the Chinese economy.** The strength of this country's economic growth continues to be fuelled by greater borrowing and driven by investment. In this context, the stabilisation of sources of growth for the country is progressing more slowly than expected and domestic financial vulnerabilities have intensified. Should these vulnerabilities fail to be plugged and end up derailing the landing for the Chinese economy, this would affect global growth and commodity prices. On the domestic front, the impacts would be reflected in slower than expected activity growth and a bigger decline in financial asset prices, including the local currency.

The second is that there will be additional delays to infrastructure construction. This has become a recurrent risk in macroeconomic forecasts for Peru. In fact, infrastructure construction is one of the main factors explaining the acceleration in economic activity in our baseline scenario next year. In this context, if the pace of progress with infrastructure construction is slower than expected, this will hit growth in economic activity in 2018.

A third risk is friction in implementing public spending on reconstruction in the north of the country. As discussed in the previous report, our evaluation of the mechanism planned for implementing this spending (the Authority for Reconstruction with Changes) is positive. It also has the funds for this. It therefore seems likely to us that this expenditure will finally materialise. However, if the reconstruction does not pan out as expected, public spending will not grow as forecast, negatively impacting our economic growth projections, particularly for 2018.

And finally, a fourth downside risk relates to a deterioration of business confidence. Our projection baseline scenario assumes that business confidence will remain at levels not very different from those that have been observed throughout 2017 (around 54 points), which will imply a gradual improvement in the expenditure made by the companies. However, this would probably be weakened by any amplification of political noise, frictions between the executive and the legislature, and social conflicts. Weaker business confidence would compromise the gradual recovery in private sector spending that we anticipate in our baseline scenario.

An upside risk emerges in contrast to the four risks mentioned above: that of a Fed acting surprisingly more slowly than expected in the baseline scenario. Our baseline scenario for 2017-18 builds in a gradual rise in the US policy rate (a 25 bp increase in December 2017 and two of the same order next year), together with the start of measures to unwind the Fed's balance sheet in October. However, if the monetary tightening process is carried out more slowly than anticipated, then there could be positive impacts on borrowing conditions (in foreign and local currency) and thus on economic activity. This scenario would also have a favourable impact on the prices of the base metals that Peru exports, such as copper. For example, it is estimated that in a scenario where the Fed does not raise the rate in December, the copper price could surpass our projection for the average price in the 2018 baseline scenario by at least 3%. And finally, a more dovish Fed would also lead to greater dollar weakness and different movements in investor's portfolios to those assumed in the baseline scenario.

10. Tables

Table 10.1 Macroeconomic forecasts

	2014	2015	2016	2017	2018
GDP (% ch. YoY)	2.4	3.3	4.0	2.4	3.9
Domestic demand (% ch. YoY)	2.2	3.1	1.0	2.2	3.8
Private consumption (% YoY)	3.9	3.4	3.4	2.5	2.8
Public consumption (% YoY)	6.1	9.8	-0.5	2.0	4.9
Gross fixed investment (% YoY)	-2.5	-5.0	-4.6	0.3	6.0
Inflation (% YoY, EOP)	3.2	4.4	3.2	2.3	2.2
Exchange rate (vs. USD, EOP)	2.96	3.39	3.40	3.28	3.34
Policy interest rates (%, EOP)	3.50	3.75	4.25	3.25	3.25
Fiscal balance (% of GDP)	-0.3	-2.1	-2.6	-2.7	-3.3
Current account (% of GDP)	-4.4	-4.8	-2.7	-1.7	-1.9

Forecast closing date: 06 October 2017
Source: Central Reserve Bank of Peru and BBVA Peru Research

Table 10.2 Quarterly macroeconomic forecasts

	GDP (% ch. YoY)	Inflation (% YoY, EOP)	Exchange rate (vs. USD, EOP)	Policy interest rate (%, EOP)
Q1 16	4.4	4.3	3.41	4.25
Q2 16	3.7	3.3	3.32	4.25
Q3 16	4.5	3.1	3.38	4.25
Q4 16	3.0	3.2	3.40	4.25
Q1 17	2.1	4.0	3.27	4.25
Q2 17	2.4	2.7	3.27	4.00
Q3 17	2.2	2.9	3.25	3.50
Q4 17	2.7	2.3	3.28	3.25
Q1 18	4.8	1.4	3.30	3.25
Q2 18	4.5	2.6	3.32	3.25
Q3 18	2.9	2.3	3.33	3.25
Q4 18	3.6	2.2	3.34	3.25

Forecast closing date: 06 October 2017
Source: Central Reserve Bank of Peru and BBVA Peru Research

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