

## 9. Growth projection for 2018 with high degree of uncertainty pending clarification of the new political scene

Our baseline scenario for GDP in 2018 assumes on the external front that the slowing of growth in China will be moderate, that the normalisation of monetary conditions in the most developed economies will continue to be smooth, without jolts, and that in this context prices of metals, and copper in particular, will remain at attractive levels which will favour mining investment (in exploration and the start of construction of a number of small- and medium-size mines. On the domestic front, the baseline scenario for 2018 is consistent with the acceleration in public spending to reconstruct the infrastructure damaged by *El Niño Costero*, to construct the infrastructure required for the 2019 Pan American Games and the major infrastructure projects such as the second line of the Lima Metro. If what finally materialises for each of these external and domestic factors turns out to be different from what is projected, this will naturally lead the GDP for 2018 to also be different from what we expect (growth of 3.5%). The specific risks identified in each of these elements are as follows.

- **Growth of China's economy.** The baseline scenario assumes that China will grow by 6.3% in 2018 (having grown by around 6.7% in 2017). The slowdown is moderate and growth should still give good support to commodity prices. The risk is that this slowdown could be sharper due to a greater impact of regulatory tightening and reduced support from monetary and fiscal policies. If that happens, there will be a negative impact on world growth and on commodity prices. On the home front, the advance in economic activity (mining investment and confidence) will suffer and asset prices will fall (greater risk premium, less capital inflow), among them the national currency.
- **Monetary conditions in the most developed economies.** The baseline scenario assumes that the US Federal Reserve will continue to raise rates in 2018 in an orderly and foreseeable manner (+75 bps in the year) and that it will continue to adjust its balance sheet in accordance with its announcements, while the ECB will reduce its asset purchases this year. This will mean a moderate decline in appetite for financial assets of emerging economies, among them Peru. However there is a risk that these adjustments could be more intense. In the case of the US, for example, this could happen if inflationary pressures increase sharply (in an environment of reduced slack in the labour market and tax cuts) or if the signs of over-valuation shown by certain assets intensify. In this risk scenario, commodity prices would probably fall (with the consequent negative impact on mining investment), risk premiums would increase and there would be negative effects on domestic financing conditions, whether in foreign or domestic currency, which would have an adverse effect on economic activity.

- **Boost from public spending.** The risk here is that this boost is less than that assumed in the baseline scenario, for example in the reconstruction of the areas affected by *El Niño Costero* and in the major infrastructure projects, even in spite of the downward revision that we have already incorporated. There is also the risk that the judicial investigations that may be faced by some construction firms will inhibit the authorities from signing the necessary addenda for public works in general to move forward or calling for tenders for new projects. In this scenario, the reduction in fiscal boost would have a direct impact on economic activity and also an indirect one through loss of confidence and reduced dynamism in the rest of the economy.

An additional factor, and an important one, on which our growth projection for 2018 also depends, is the domestic political situation. The baseline scenario incorporates a degree of caution in spending by both businesses and households, as well as in public spending, following the political noise and fatigue generated by the presidential impeachment process and the pardon of former president Fujimori last December. These events seem to have increased the sense that political stability is precarious and hence to uncertainty. The significant rise in our indicator of political stresses at the end of December and the sharp fall in business confidence in the same month point in that direction. However, it is still too soon to know how the domestic political scene will be resolved following the events of late last year or what the implications of that resolution will be. Nor can we yet anticipate the extent or implications of the next steps in the “Lava Jato” (“Operation Car Wash”) investigation. All of those represent an additional risk of GDP growth in 2018 deviating from our forecasts.

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This report has been produced by the Peru Division

**Chief Economist, Peru**

Hugo Perea  
hperea@bbva.com  
+51 1 2092042

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.belapatiño@bbva.com

**BBVA Research**

**Chief Economist BBVA Group**

Jorge Sicilia Serrano

**Macroeconomic Analysis**

Rafael Doménech  
r.domenech@bbva.com

**Global Macroeconomic Scenarios**

Miguel Jiménez  
mjimenezg@bbva.com

**Global Financial Markets**

Sonsoles Castillo  
s.castillo@bbva.com

**Long-Term**

**Global Modelling and Analysis**

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

**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 12092042-bbvaresearch@bbva.com  
www.bbvaresearch.com