

# Peru Economic Outlook

Fourth quarter 2019

October 2019

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- 05 Summary of macroeconomic projections

## Key Points (I)



- Economic activity and spending indicators show that GDP growth accelerated in the third quarter (between 3.0% and 3.5% year-on-year). Domestic demand, especially private spending and, within this, investment, also rose. Part of the improvement in the latter is, however, explained by a low year-on-year basis of comparison.



- As is the case each quarter, the macroeconomic forecast baseline scenario has been revised. The outlook for the remainder of 2019 and for 2020 factors in a continuation of trade tensions between the US and China on the international front, although the impact thereof will be partly mitigated by countercyclical policies (although these will not avoid a global slowdown). Against this backdrop, metal and oil prices will fall (terms of trade will worsen slightly).



- On a domestic level, the baseline scenario sees mining output recovering and public investment picking up. It is believed that the business confidence index will remain at around 50 points ahead of forthcoming parliamentary elections in January next year and then general elections (second quarter of 2021).

## Key Points (II)



- Growth forecasts for 2019 and 2020 are 2.5% and 3.1%, respectively. Faster GDP growth next year is due to the rebound in extractive activities and uptick in public investment. Private spending, on the other hand, will lose steam somewhat. The growth forecast for 2020 is three percentage points (pp) down on the August figure (because of greater uncertainty caused by holding elections twice in less than two years).



- Heightened political tensions in the country have had a limited impact on domestic financial markets. The exchange rate, especially, only fluctuated moderately, which was more closely associated with external rather than domestic factors. We envisage the year-end exchange rate varying little from the current level, showing some appreciation in 2020 (fueled by an increase in mining investment and a growing trade surplus), ending the year at between 3.30 and 3.35.



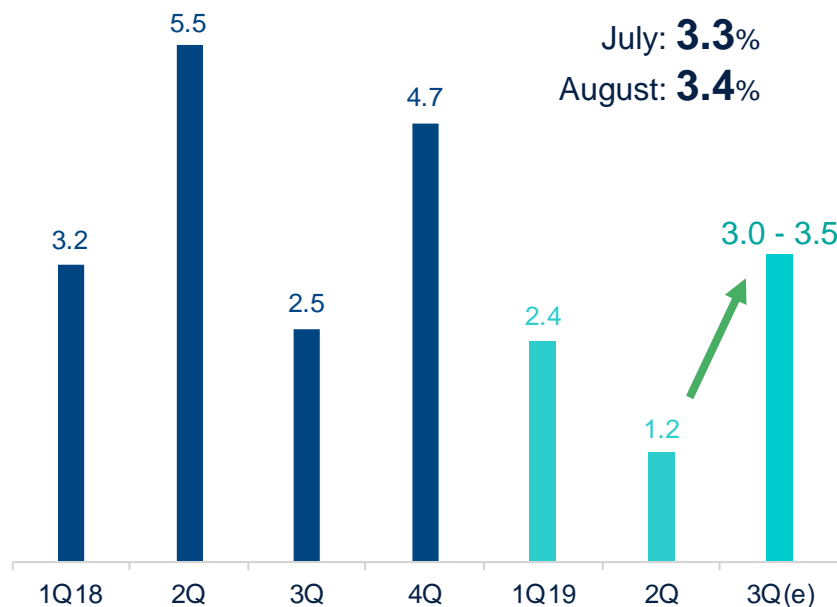
- The Central Bank of Peru kept its key interest rate at 2.50% in October, despite the downgrading of its estimates for the output gap (more negative) and neutral interest rate suggesting a rate cut. The forecast baseline scenario includes further monetary stimulus in 2020, at a time when we envisage GDP (and domestic demand) growing more slowly than expected by the Central Bank.

# 01

## Economic activity

# Indicators suggest that GDP growth accelerated in the third quarter...

## GDP (YOY % CHANGE)



(e) Estimated.

Source: INEI (Instituto Nacional de Estadística - Peruvian National Institute of Statistics and IT) and BBVA Research

## MORE BUOYANT ACTIVITY WAS FUELED BY...



On the primary side

### Fishing (and primary manufacturing)

Part of the quota assigned for the first anchovy season was caught in the third quarter.

### Hydrocarbons

Normalization of production (in the third quarter of last year: halting of production at block 192 and maintenance shutdown at the Las Malvinas plant) and commissioning of block 95.



On the non-primary side

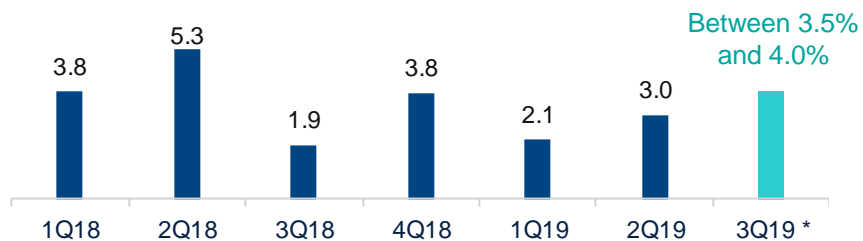
### Services, retail, non-primary manufacturing

Includes the increase in domestic demand in the third quarter.

# ... and domestic demand, above all private-sector spending and, within this, investment

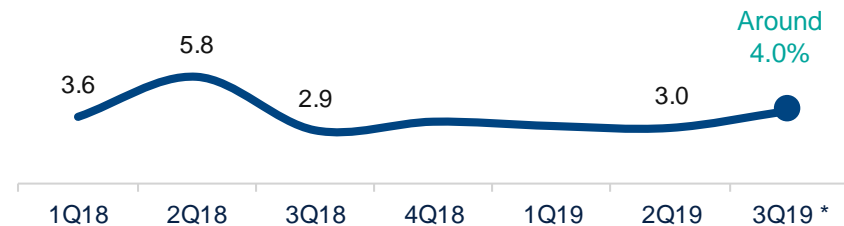
## DOMESTIC DEMAND

(EXC. INVENTORIES, YOY % CHANGE)



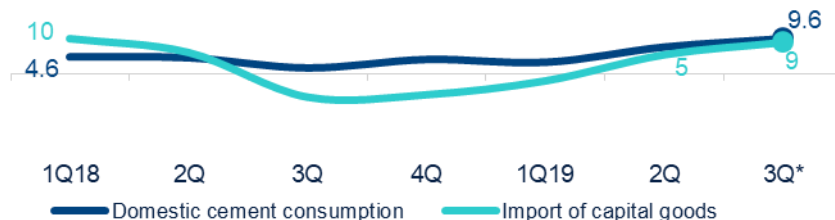
## PRIVATE SPENDING

(YOY % CHANGE)



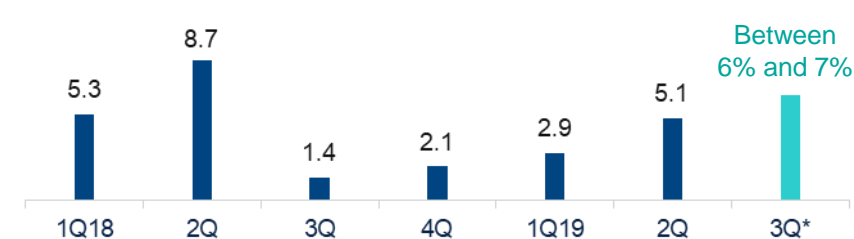
## PRIVATE INVESTMENT INDICATORS

(YOY % CHANGE)



## PRIVATE INVESTMENT

(YOY % CHANGE)



\*Estimated.

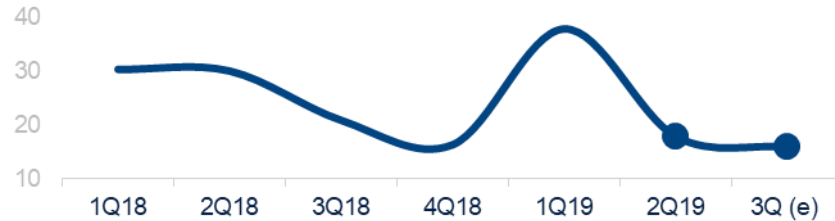
Source: INEI, BCPR (Banco Central de Reserva del Perú - Reserve Bank of Peru), SUNAT (Superintendencia Nacional de Aduanas y de Administración Tributaria - Peruvian Revenue and Customs Office) and BBVA Research

# Part of this growth in private investment is, however, explained by a low year-on-year basis of comparison

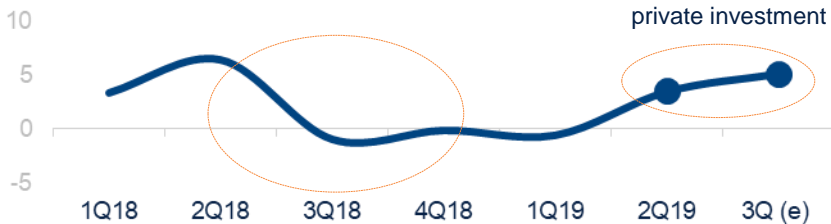
## PRIVATE INVESTMENT: COMPONENTS

(YOY % CHANGE)

### Mining investment



### Non-mining investment



## NON-MINING INVESTMENT

(DESEASONALIZED, ANNUALIZED QOQ % CHANGE)



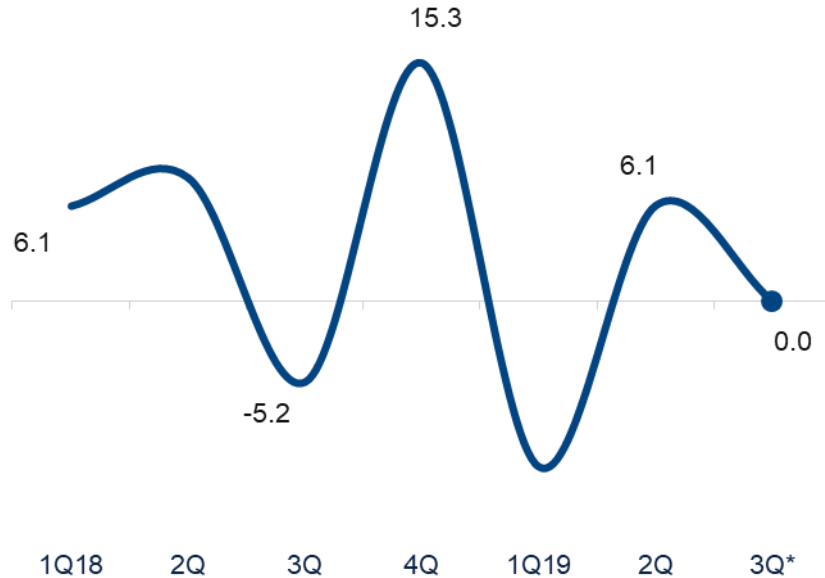
(e) Estimated.

Source: INEI, BCRP, MINEM (Ministerio de Energía y Minas - Peruvian Ministry of Energy and Mines) and BBVA Research

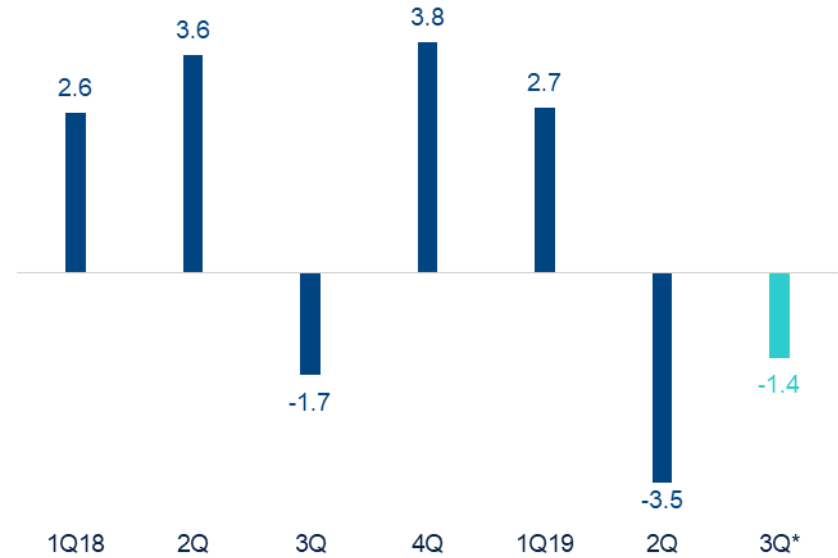


# Moreover, no growth in public investment in the third quarter with lower exports

## PUBLIC INVESTMENT (REAL, YOY % CHANGE)



## EXPORTS (VOLUME OF GOODS, YOY % CHANGE)



# Quarterly review of forecasts: the baseline scenario for the remainder of 2019 and for 2020 factors in...

## 01

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A continuation of US-China trade tensions, with the monetary policy of the central banks of the largest economies taking an even more expansionary tone, although without the slowdown in growth being avoided.

## 02

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Slump in metal prices at a time of lower growth in China and globally (although terms of trade will not worsen notably because oil prices will also fall).

## 03

---

Mining output will pick up following the challenges it has been facing.

## 04

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Uptick in public investment: the impact of the change in regional governments will wane and spending on reconstruction and Line 2 of the Lima subway will gather pace.

## 05

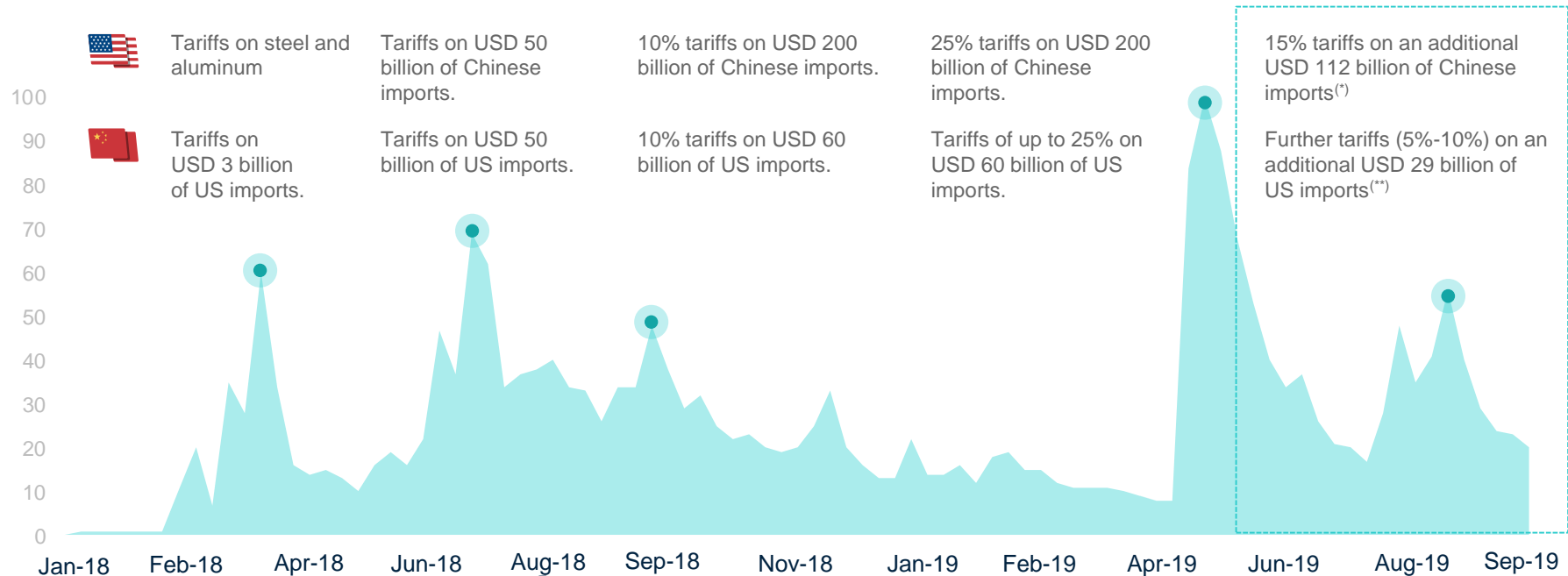
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The business confidence index will remain in neutral territory (around 50 points) pending parliamentary elections (January 2021) and, later, general elections (2Q21).

# Trade tensions will continue, although counter-cyclical policies will dampen their impact...

## TRADE WAR INDEX: GOOGLE SEARCHES FOR THE TERM “TRADE WAR”

(INDEX FROM 0 TO 100)



(\*) And until Dec-19, further 5% tariffs (from 25% to 30%) on USD 250 billion and 15% on other Chinese imports.

(\*\*) And until Dec-19, further tariffs (5%-10%) on an additional USD 46 billion of US imports. Source: BBVA Research and Google Trends

# Trade tensions will continue, although counter-cyclical policies will dampen their impact...



## GLOBAL UNCERTAINTY

Tensions between the US and China will continue:

- A partial trade deal between the two countries is probable.
- It is unlikely that tariffs will return to the levels they were at a few months ago.
- Structural and technological headwinds will continue to cause turbulence.

Brexit and political and geopolitical tensions in certain regions will cause further uncertainty.



## COUNTER-CYCLICAL POLICIES

Monetary policy:

- Counter-cyclical measures will stay center stage...
- ... despite their limited effectiveness in the current climate.
- Additional adjustments in the coming months.
- In the case of the FED, an additional rate cut, to 1.75% in October.

Fiscal policy:

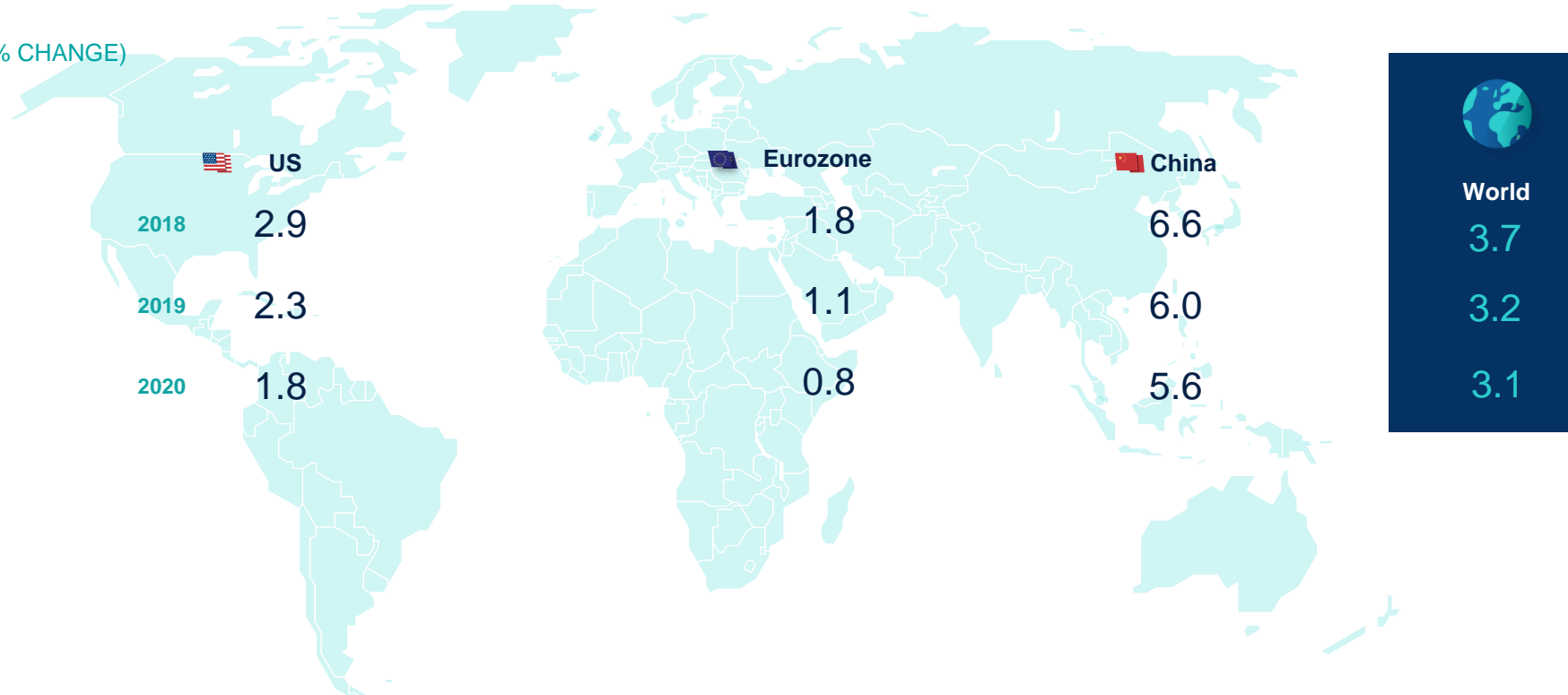
- Should play a greater role...
- ... but the political climate and high level of debt are restricting its use.
- Measures in China and to a lesser extent in Europe.

The coordination of policies between countries is now less likely.

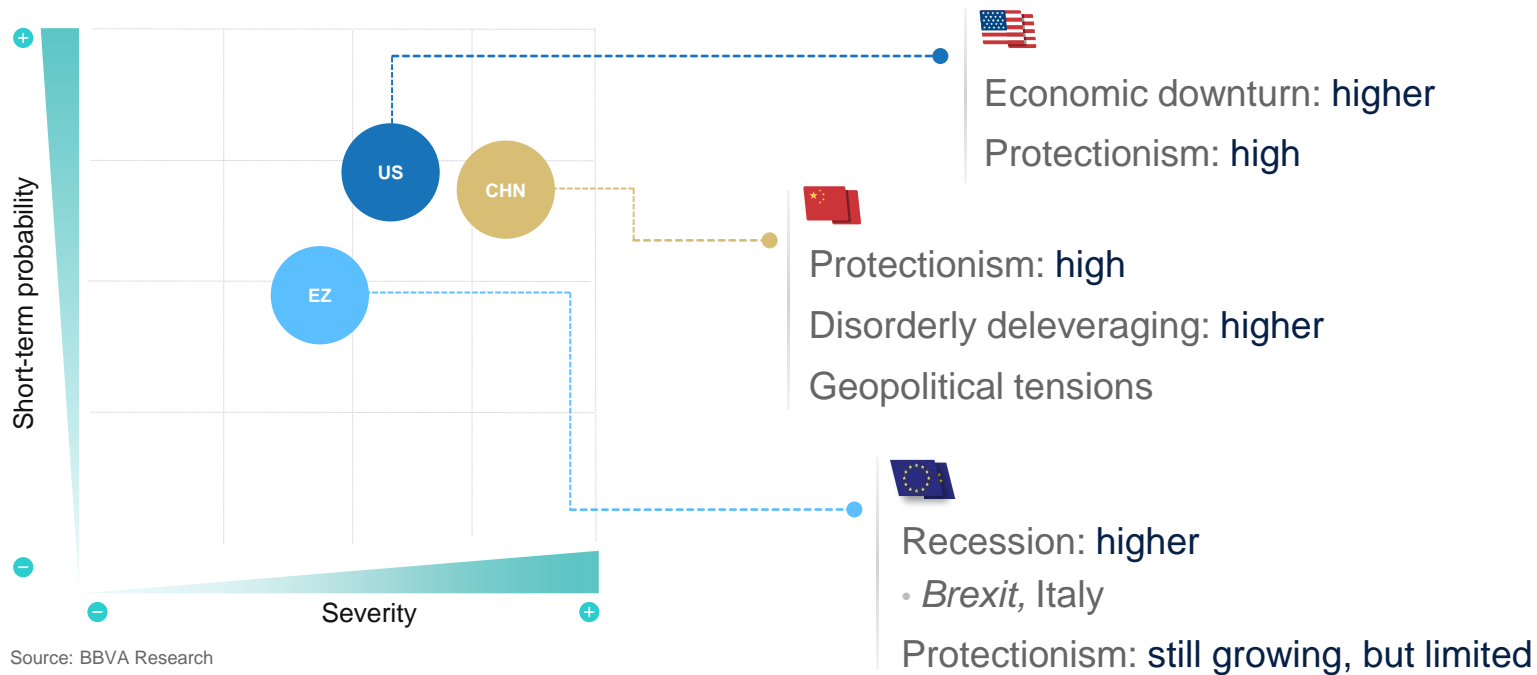
## ... although without avoiding a global slowdown

### GDP

(YOY % CHANGE)



# Global risks continue to heighten, primarily due to tensions between China and the US

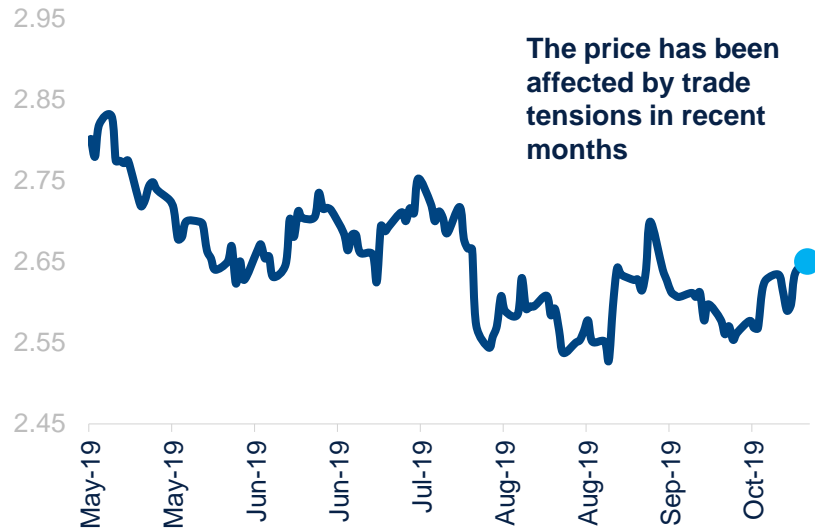


The risk of geopolitical upheaval in the Middle East has also increased.  
Financial vulnerabilities may exacerbate the severity of risks.

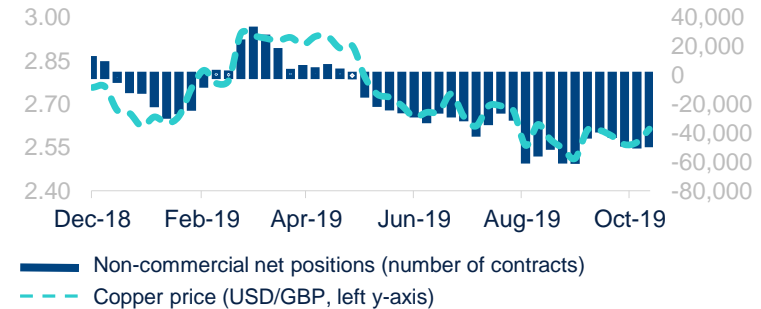
# In light of lower global growth and trade tensions, a fall is expected in metal prices, especially copper, and...

## COPPER PRICE

(AVERAGE FOR PERIOD, USD/GBP)

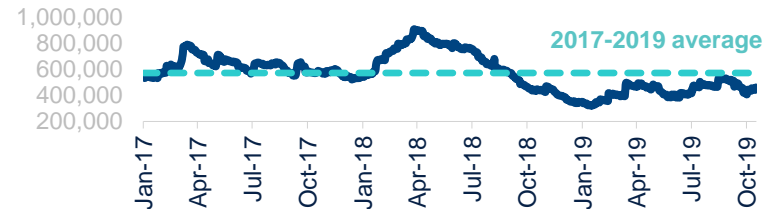


## COPPER PRICE AND NON-COMMERCIAL NET POSITIONS



## COPPER STOCKS

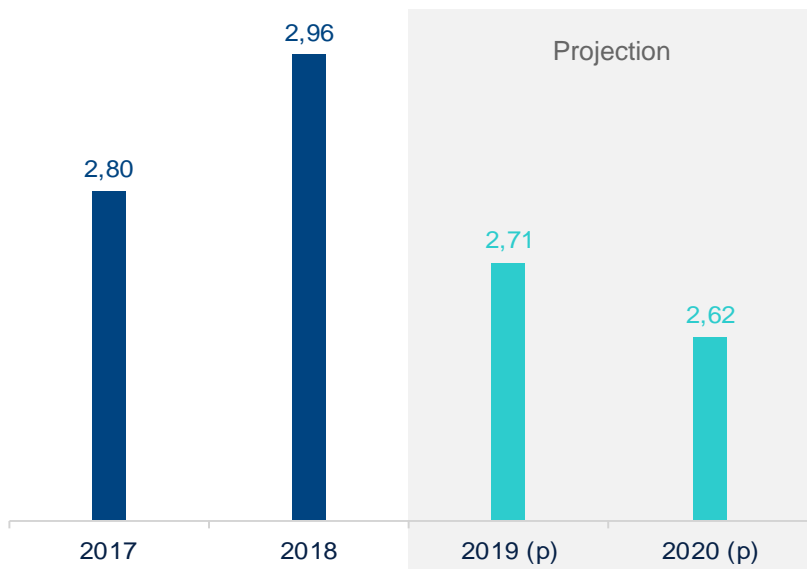
(MT)



# In light of lower global growth and trade tensions, a fall is expected in metal prices, especially copper, and...

## COPPER PRICE

(AVERAGE FOR PERIOD, USD/GBP)

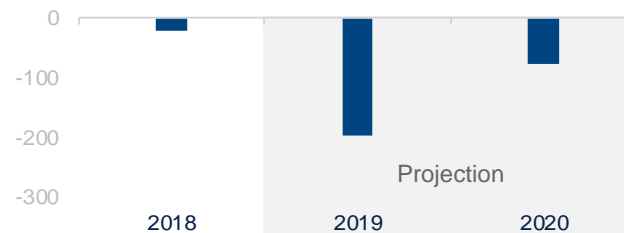


(P) Projection.

Source: Bloomberg, Cochilco and International Energy Agency (IEA)

## WORLD BALANCE OF REFINED COPPER

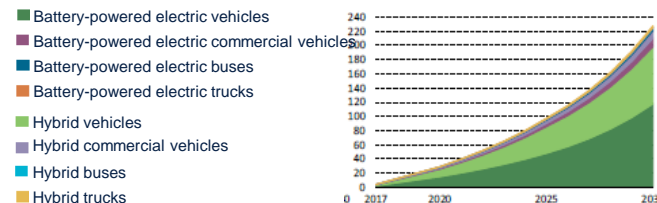
(THOUSAND MT)



Copper prices will continue to fall over the year ahead due to lower growth in China (which consumes 50% of global output), which will be offset by a reduced global supply of the red metal.

## NUMBER OF ELECTRIC VEHICLES IN THE WORLD

(MILLIONS OF UNITS)



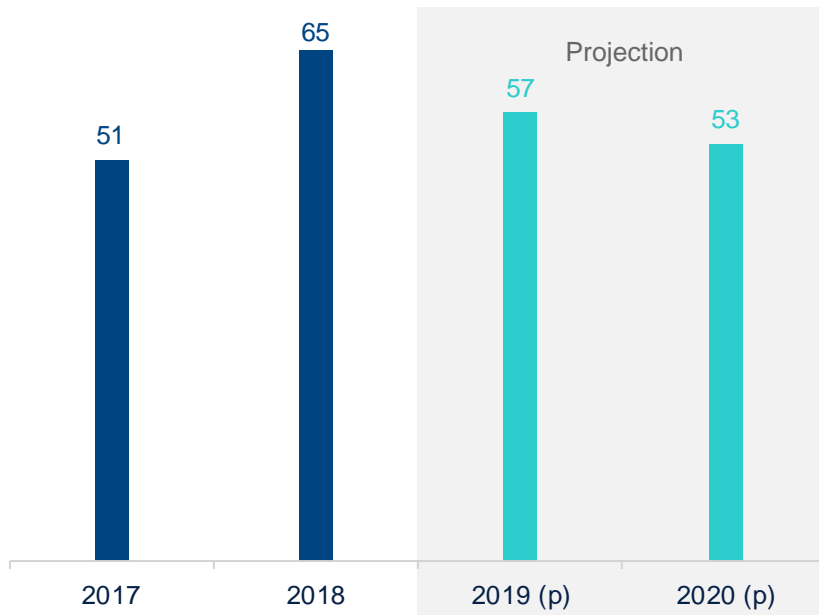
In the coming years, the price of copper will find support in the increased demand from industries such as that of electric vehicles.



## ... oil prices

### OIL PRICE

(AVERAGE FOR PERIOD, USD/WTI BARREL)



(P) Projection.

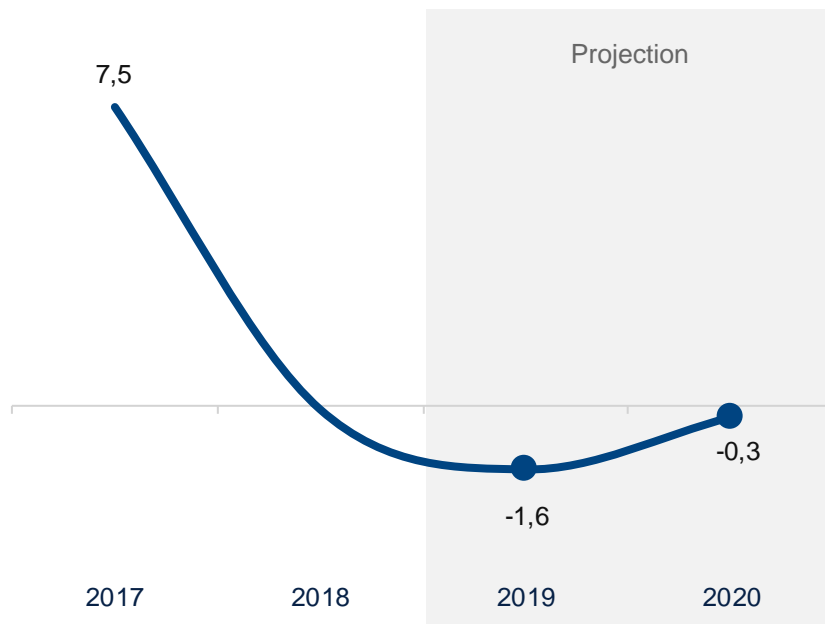
Source: Bloomberg and BBVA Research

- Slight upgrading of forecasts over the short-term and a risk of worsening tensions in oil producing countries will drive up oil prices.
- In any event, it is still expected that oil prices will level off over the medium term given the relative robustness of supply at a time of reduced demand.

## In this context, Peru's terms of trade will worsen slightly

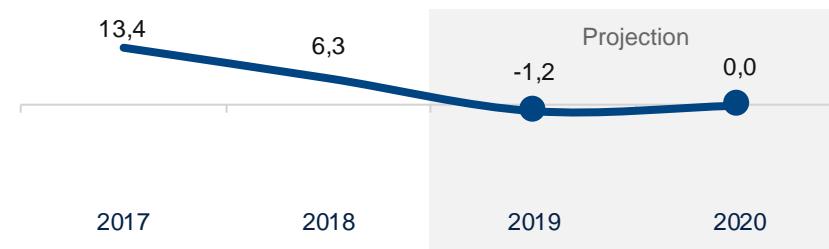
### TERMS OF TRADE

(AVERAGE FOR THE PERIOD, YOY % CHANGE)



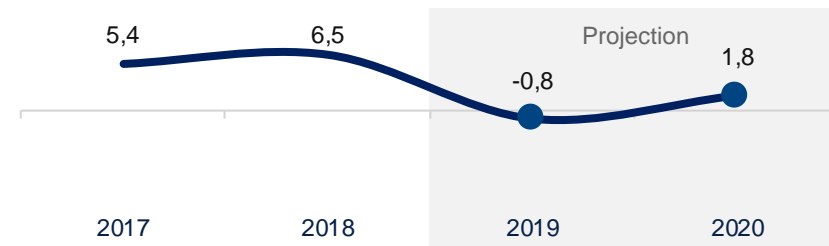
### EXPORT PRICES

(AVERAGE FOR THE PERIOD, YOY % CHANGE)



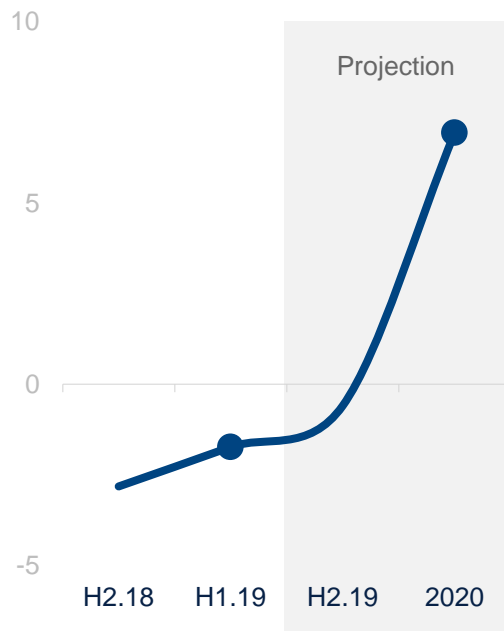
### IMPORT PRICES

(AVERAGE FOR THE PERIOD, YOY % CHANGE)



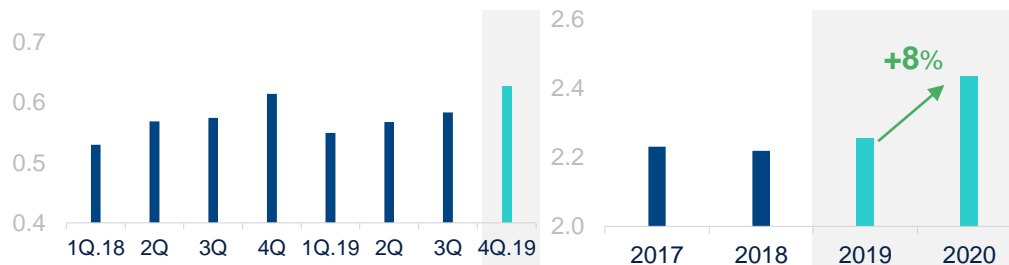
# Locally, mining output will pick up following the challenges that the sector has been facing

## MINING OUTPUT (YOY % CHANGE)



Source: MINEM and BBVA Research

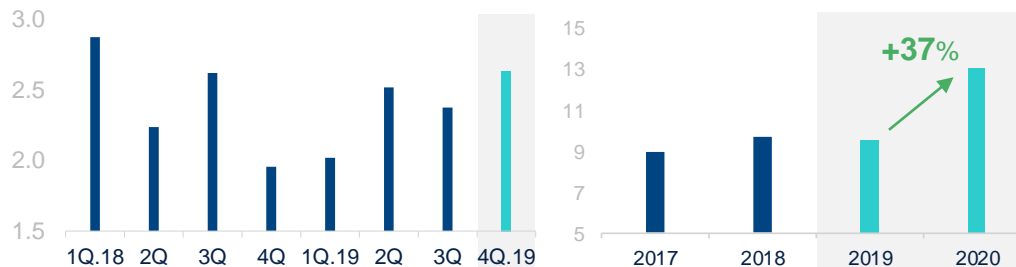
## COPPER PRODUCTION (MILLIONS OF MT)



From the fourth quarter of 2019...

- > Copper production normalizes.
- > Enlargement of Toquepala will reach full production capacity.

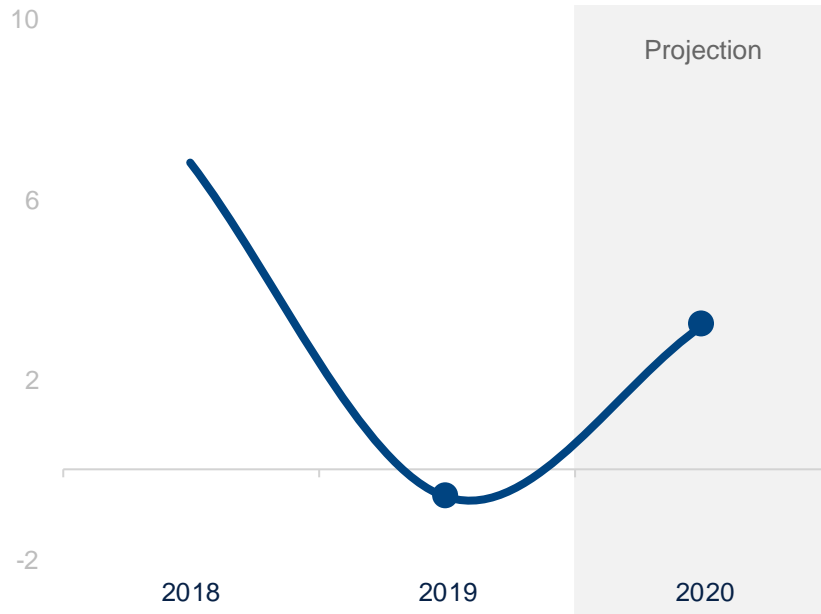
## IRON PRODUCTION (MILLIONS OF MT)



- > Iron production normalizes.
- > Enlargement of the mining unit in Marcona (Shougang)

## Public investment will rise

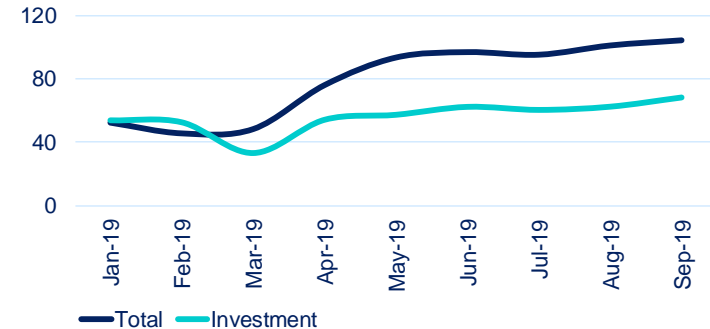
### PUBLIC INVESTMENT\* (YOY % CHANGE)



\* Includes central government and public companies.  
Source: BCRP, MEF ( Ministerio de Economía y Finanzas - Peruvian Ministry of Economy and Finance) and BBVA Research

### EXPENDITURE ON RECONSTRUCTION IN THE NORTH OF THE COUNTRY

(THREE-MONTH MOVING AVERAGE, USD MILLIONS)



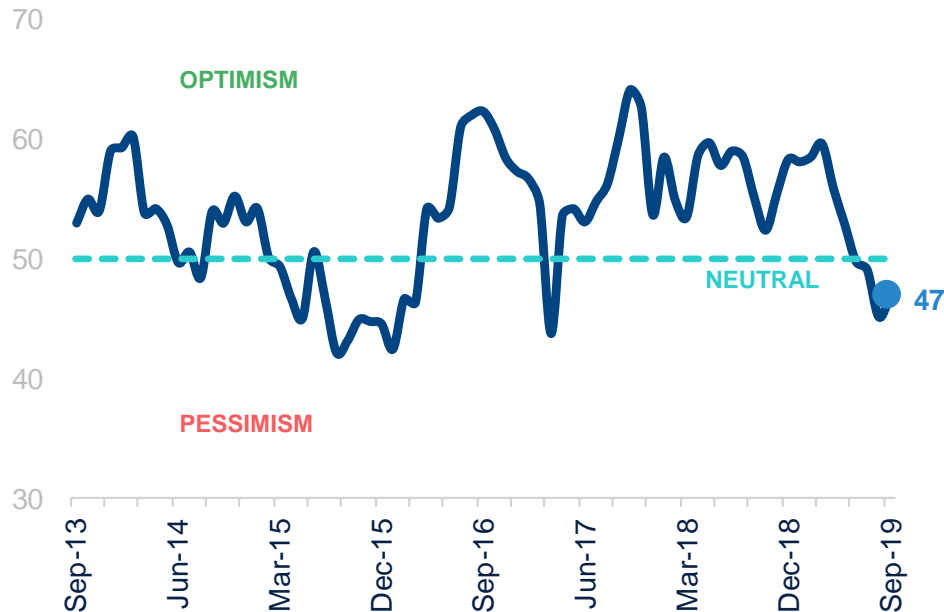
Total year-to-date spending (cumulative to September) is USD 750 million (2019 estimate: USD 1 billion)

#### In 2020:

- The effect of the change in regional governments will wane, accelerating growth in public investment at a regional level.
- An acceleration in spending on reconstruction in the north of the country (it is assumed that the current monthly rate of spending will continue).
- An acceleration in spending on Line 2 of the Lima subway.

## The baseline scenario considers that the business confidence will be in neutral zone (around 50 points)...

### BUSINESS CONFIDENCE (POINTS)



... in the context of...

#### International climate

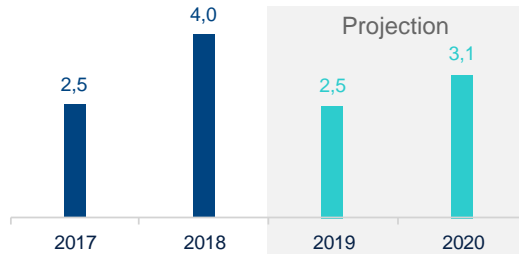
- ▶ Ongoing trade tensions
- ▶ Lower global growth

#### Domestic climate

- ▶ Parliamentary elections (1Q20)
- ▶ General elections (2Q21)

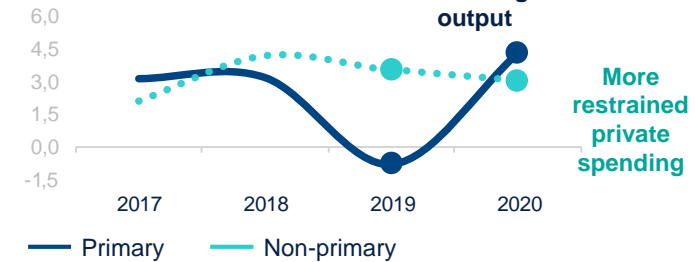
# This baseline scenario is consistent with growth of 2.5% in 2019 and 3.1% in 2020

## GDP (YOY % CHANGE)

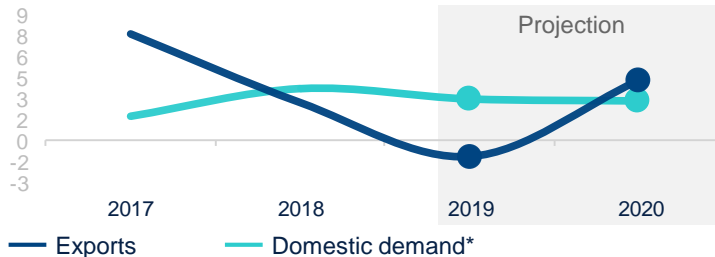


The current forecast is three tenths of a percentage point lower than the August forecast due to: (i) increased uncertainty regarding two consecutive elections (leading to greater caution around investing); and (ii) a lower global growth forecast (with a negative impact on non-traditional exports)

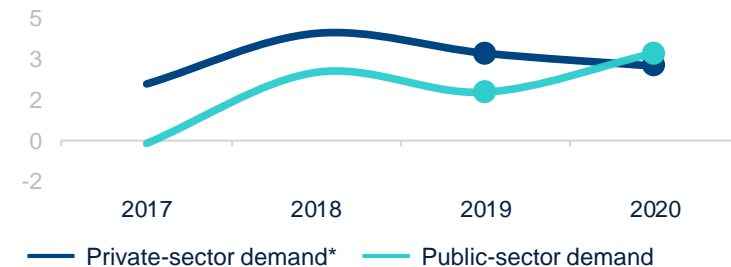
## SECTOR GDP (YOY % CHANGE)



## DOMESTIC DEMAND\* AND EXPORTS (YOY % CHANGE)



## PUBLIC AND PRIVATE INVESTMENT (YOY % CHANGE)



# What are the main risks affecting the projected baseline scenario for the remainder of 2019 and 2020?

## External

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- ↓ Escalating trade tensions between the US and China.
- ↓ US economic downturn
- ↓ Disorderly adjustment of Chinese imbalances.

## Local

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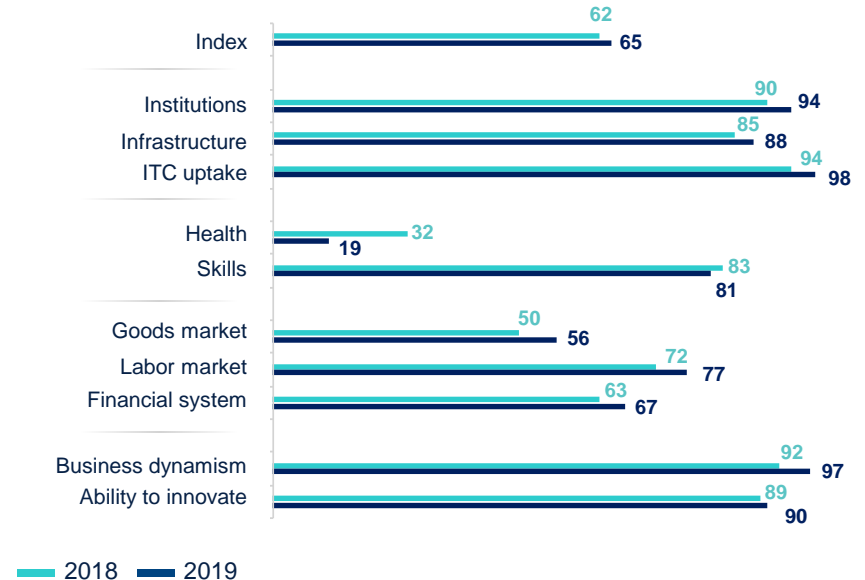
- ↓ Less pronounced recovery of primary sectors (mining).
- ↓ Escalation of social conflicts.
- ↓ Initiatives of the newly installed Congress.
- ↑ Higher public spending.

Over the medium term, in a scenario without reforms, growth will remain below 4%. It is, therefore, important to implement measures to boost the country's productivity and competitiveness

## GDP (YOY % CHANGE)



## COMPETITIVENESS INDEX (POSITION IN THE RANKING)





# Moderate exchange-rate volatility, fueled more by external rather than domestic factors

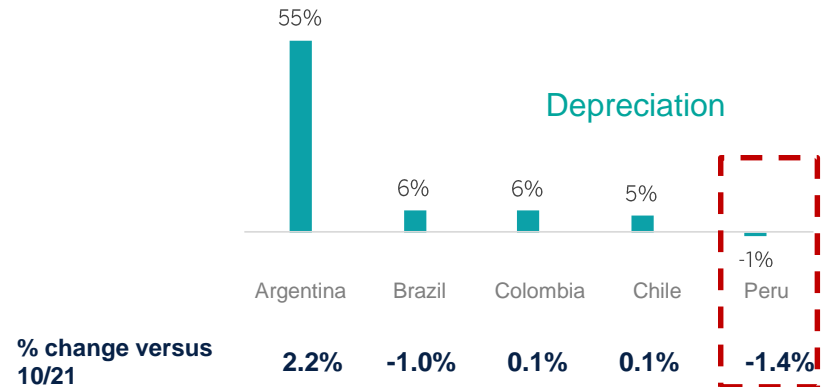
## EXCHANGE RATE (USD/PEN)



## Exchange rate volatility mainly due to external factors:

- Escalation of trade tensions and concerns about global growth
- FED more *dovish*

## PERCENTAGE EXCHANGE RATE FLUCTUATION (UNITS OF LOCAL CURRENCY PER DOLLAR, CURRENT LEVEL VS 12/31/18)

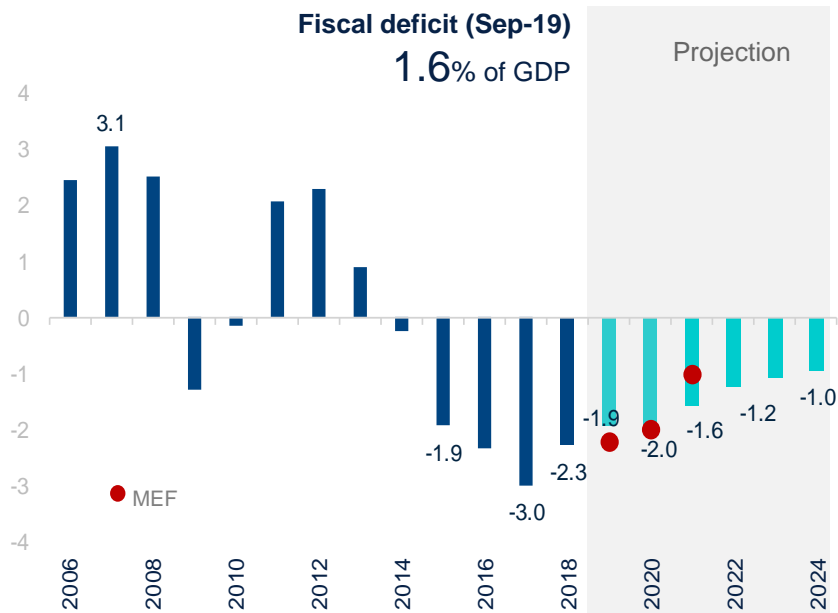


# 02

## Fiscal and external accounts

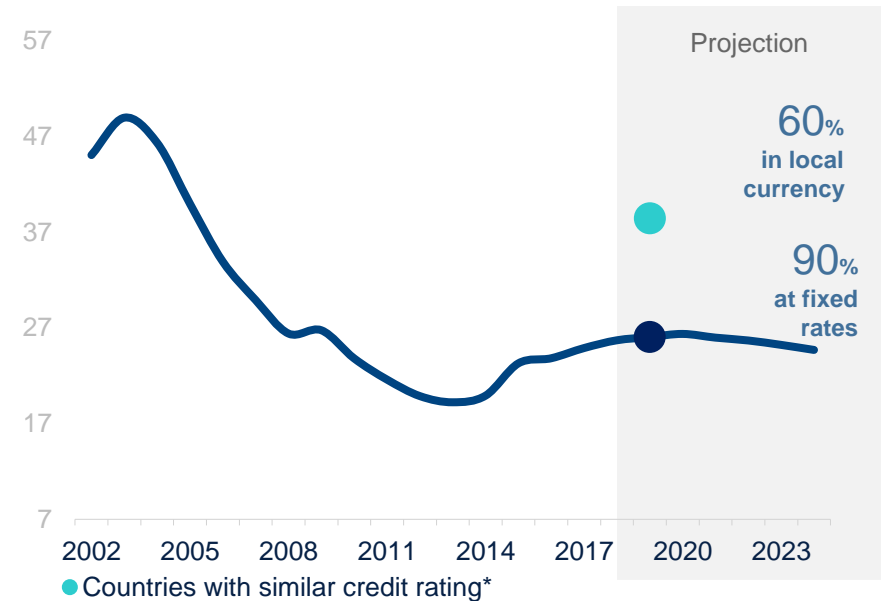
# Fiscal consolidation is expected to continue in the coming years, although more gradually than that announced by the Government

## FISCAL RESULT\* (% OF GDP)



\* Non-finance public sector.  
Source: IMF, BCRP, macro data and BBVA Research






## GROSS PUBLIC DEBT\* (% OF GDP)



\* Includes countries which Fitch, S&P and Moody's consider as having a similar sovereign credit rating to that of Peru. Uses the median for this group of countries.

# Agencies have not changed the credit rating of Peruvian state debt, which is primarily explained by the country's strong fiscal position

## LATIN AMERICA: CREDIT RATINGS AND OUTLOOKS

	S&P	Moody's	Fitch
 <b>Peru</b>	BBB+	A3	BBB+
 <b>Chile</b>	A+	A1	A
 <b>Colombia</b>	BBB-	Baa2	BBB
 <b>Mexico</b>	BBB+	A3	BBB
 <b>Brazil</b>	BB-	Ba2	BB-

Stable outlook



Negative outlook



Stable outlook with downgrade in the last 18 months



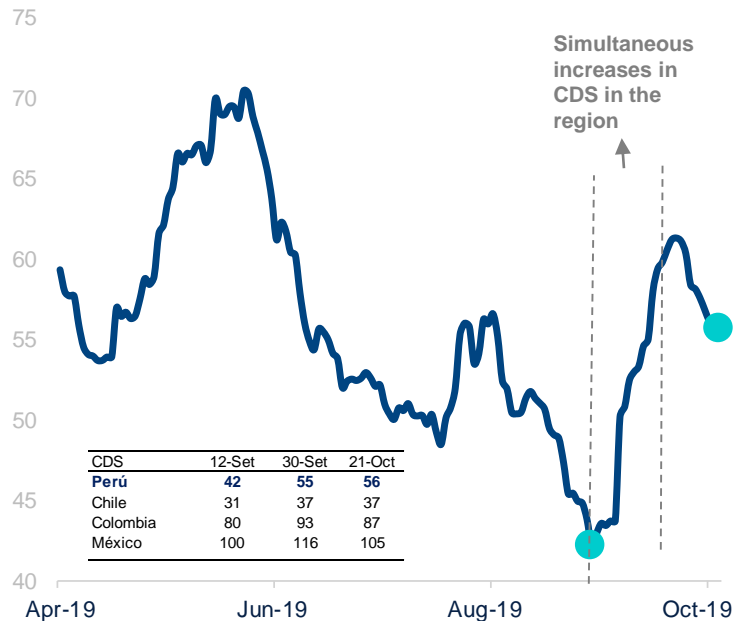
## Fitch Ratings

“Long-standing credible and consistent macroeconomic policies are a sovereign rating strength, as we noted when we affirmed Peru at BBB+/Stable on September 25. Governance indicators are lower than the BBB category median and the recent events highlight some of Peru’s institutional weaknesses. However, economic policymaking has been largely unaffected during previous episodes of political volatility”

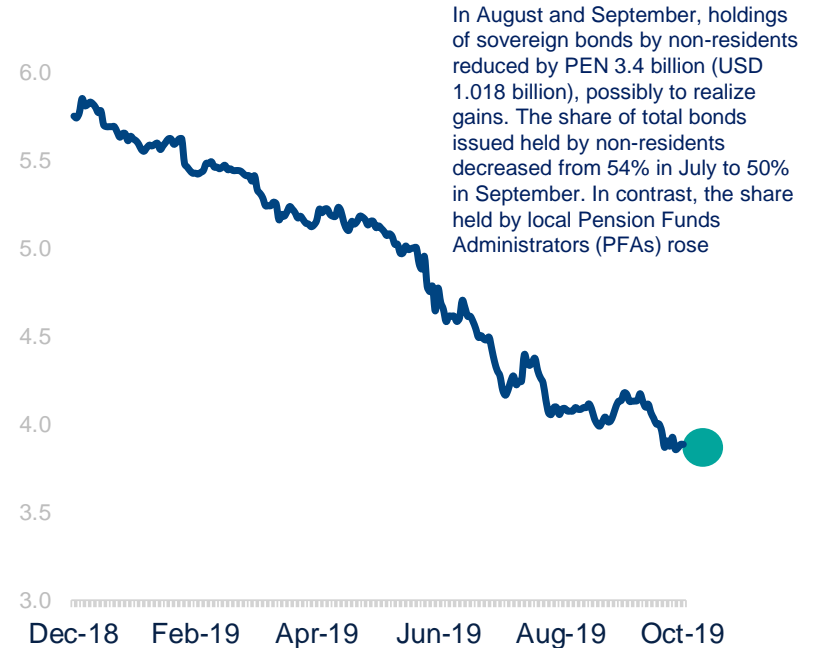
10/08/19

# The risk premium rose in recent weeks (from historically low levels), mainly due to external factors. However, sovereign bond yields have not been affected

## SOVEREIGN DEBT: CDS (bp)

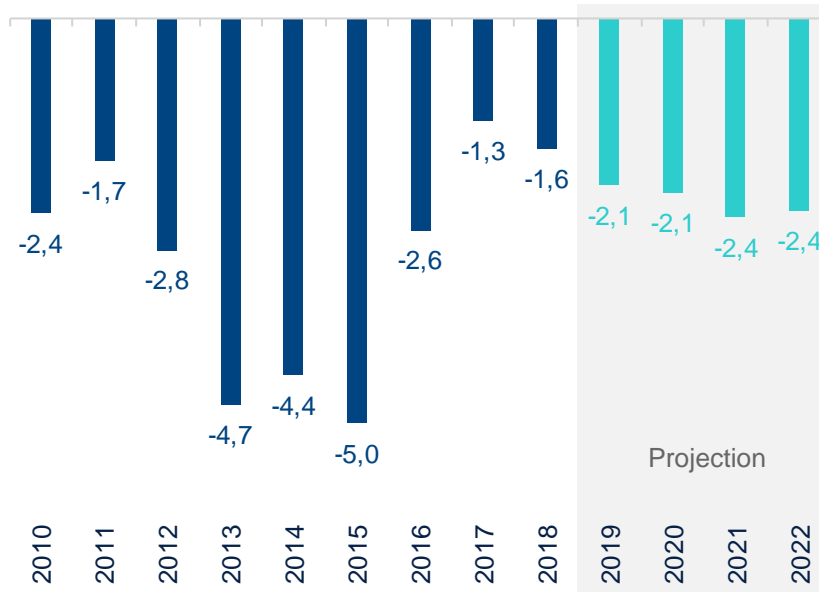


## SOVEREIGN BOND YIELD, 2028 (%)



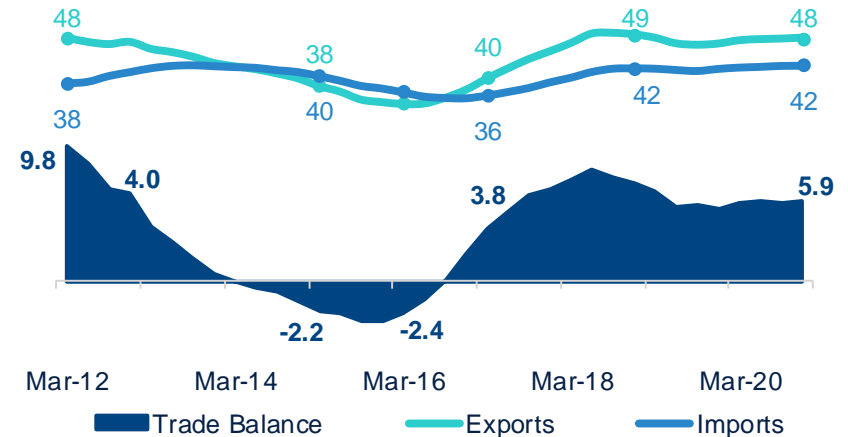
# External accounts: a limited and sustainable deficit in the balance of payments current account due to trade surplus

## CURRENT ACCOUNT BALANCE IN THE BALANCE OF PAYMENTS (% OF GDP)



## TRADE BALANCE

(USD BILLION, ACCUMULATED OVER THE LAST FOUR QUARTERS)



Along the forecast path...

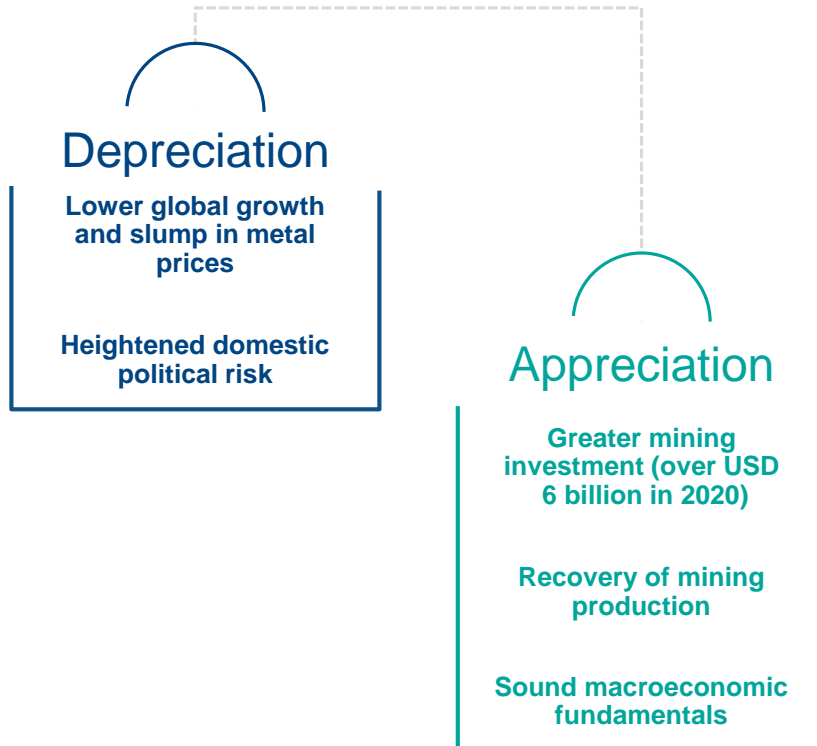
↑ Increased mining production  
Drop in the oil price

↓ Drop in metal prices

03

# Currency market

# The forecast baseline scenario is consistent with an appreciation of the local currency in 2020



## EXCHANGE RATE (USD/PEN, MONTHLY AVERAGE)





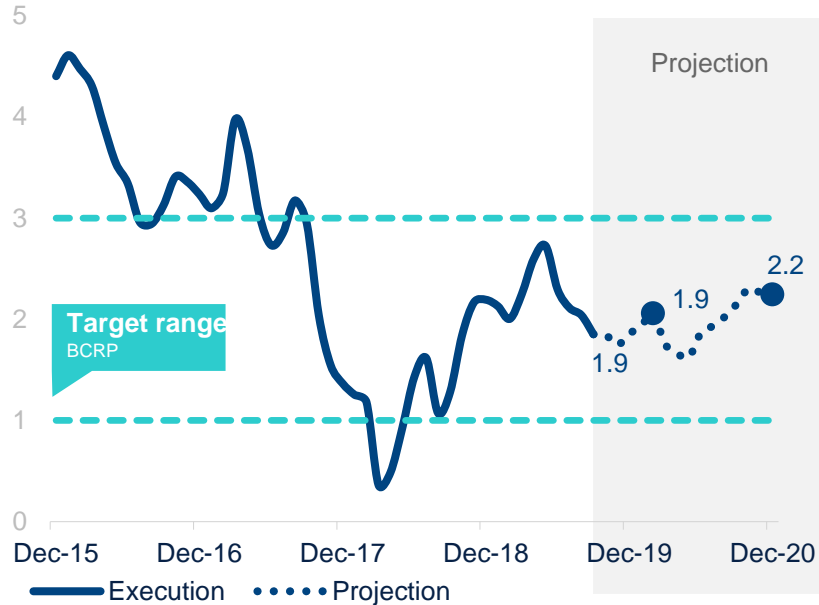
# 04

## Inflation and monetary policy

# Inflation around the central target range, albeit skewed downward. Inflation forecasts have fallen sharply

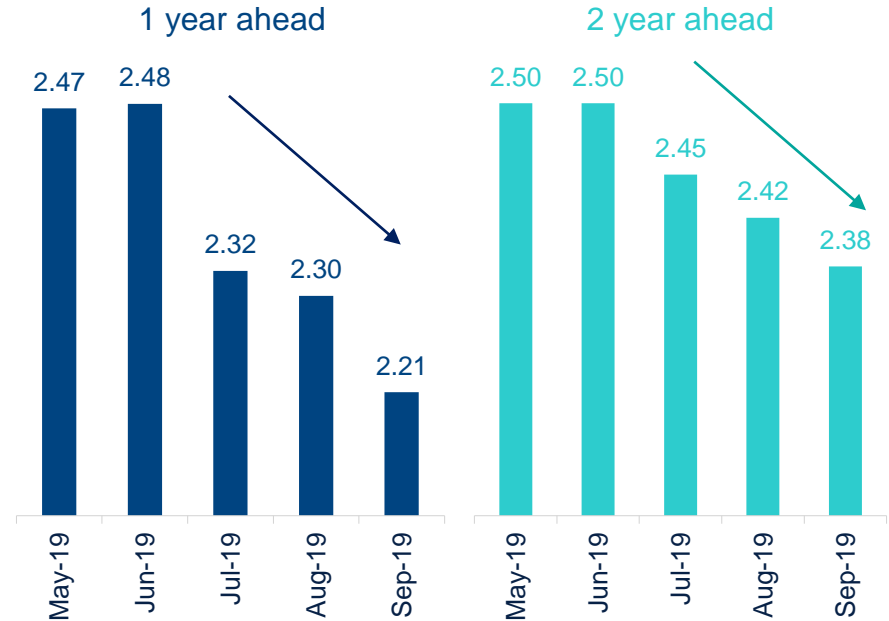
## INFLATION

(YOY % CHANGE IN CPI)



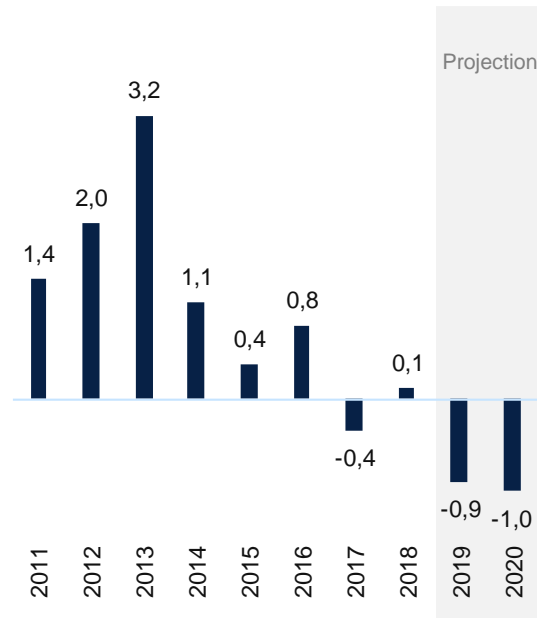
## INFLATION FORECASTS

(%)



# What other factors will shape inflation?

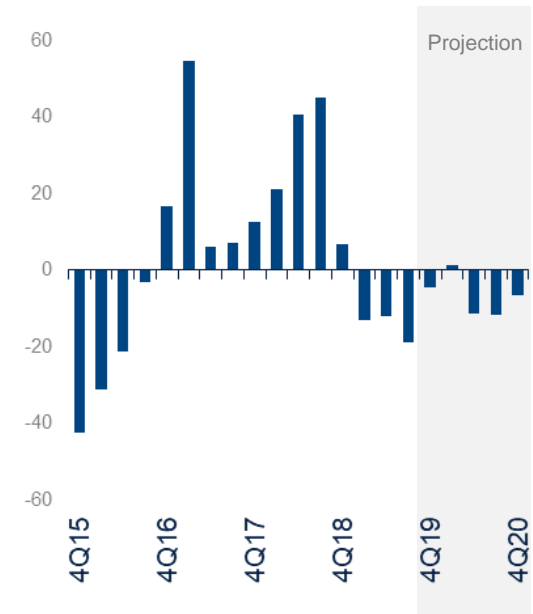
**OUTPUT GAP\***  
(% OF POTENTIAL GDP)



**EXCHANGE RATE**  
(YOY % CHANGE)



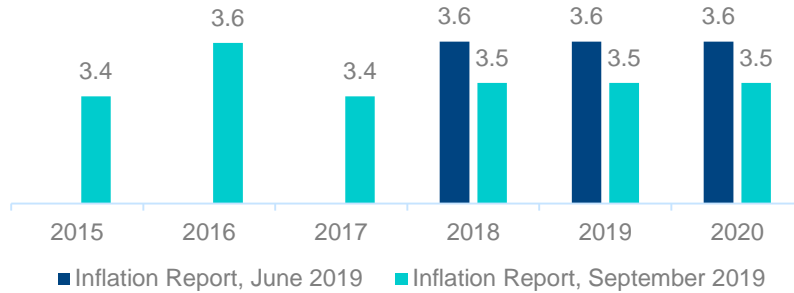
**OIL PRICE**  
(YOY % CHANGE)



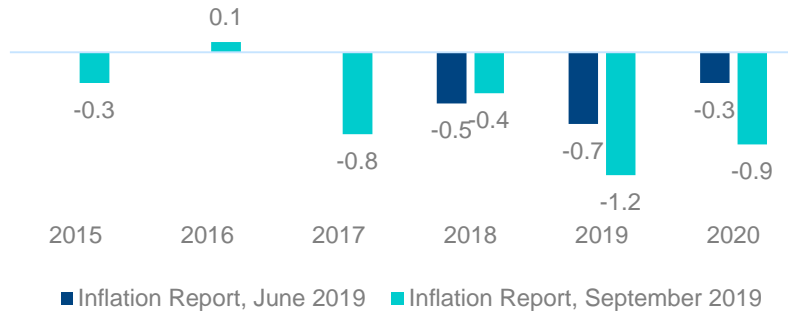
\* Total GDP, average of three methodologies.  
Source: INEI, BCRP and BBVA Research

# In its latest inflation report, the BCRP decreased its estimates for the natural rate of interest, potential growth and GDP gap

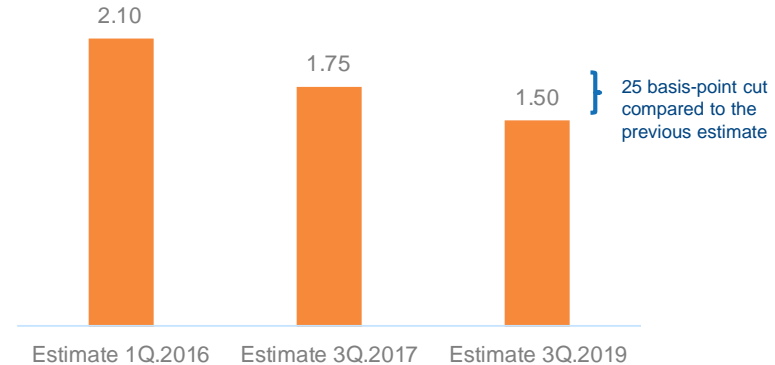
## POTENTIAL GROWTH (YOY % CHANGE)



## OUTPUT GAP (% OF POTENTIAL GDP)



## NATURAL RATE OF INTEREST (%)



## Implications?

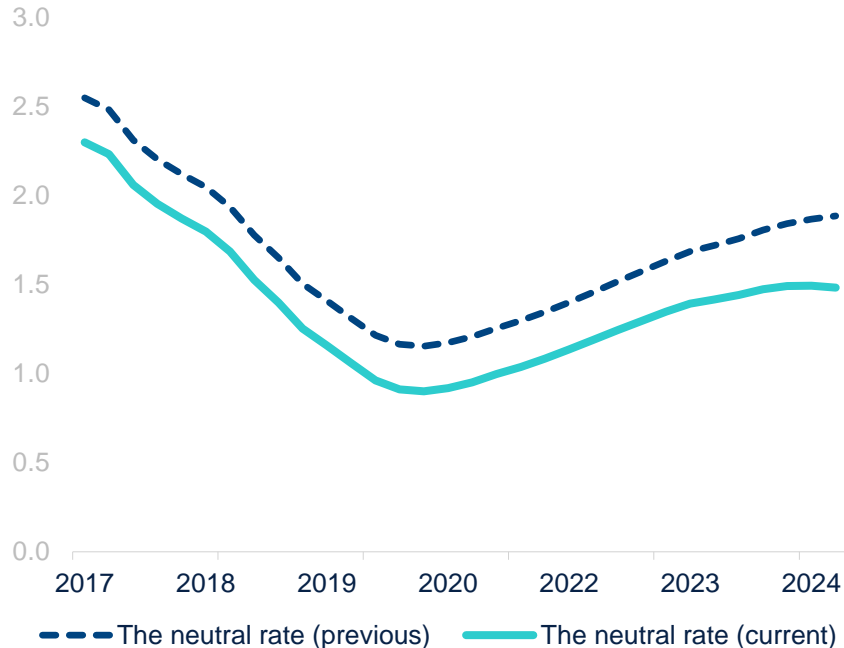
The reference rate would need to be cut in order to maintain the same monetary stimulus (forecast to September)

Given that the negative GDP gap has widened, the economy would also need greater monetary stimulus

# BBVA Research has also downgraded its estimate of the neutral real rate of interest

## NEUTRAL REAL RATE OF INTEREST

(%)



Source: BCRP and BBVA Research

- BBVA Research recently revised its forecasts for the neutral rate of interest of monetary policy for Peru and found that, in real terms, it is some 30 basis points lower than previously estimated.
- This is in line with the 25 basis-point reduction in the Central Bank's estimate of this variable in its September 2019 Inflation Report.
- These findings suggest that a more accommodative monetary policy cannot be ruled out in the future.

# Against this backdrop, we foresee two further cuts to the reference rate in 2020

## POLICY INTEREST RATE

(%)



Source: BCRP and BBVA Research

## Statement (October)

Central Bank kept the rate at 2.50% in October.

Market consensus is split (between keeping the rate as is or cutting it by 25bp).

BCRP highlighted that the primary sectors and public investment are recovering. It forecasts GDP growth of 2.7% in 2019 and 3.8% in 2020.

There is a downward bias (downside risks also affecting domestic demand).

## Forecast baseline scenario

**Increase in monetary stimulus in 2020**, when we expect that GDP (and domestic demand) will rise more slowly than the BCRP expected

# 05

## Summary of macroeconomic projections

# Macroeconomic projections

	2014	2015	2016	2017	2018	2019 (f)	2020 (f)
GDP (% chge.)	2.4	3.3	4.0	2.5	4.0	2.5	3.1
<b>Domestic demand (excludes invent., % chge.)</b>	2.4	2.3	1.3	1.7	3.7	3.0	2.8
Private spending (% chge.)	2.3	1.9	1.5	2.1	3.9	3.2	2.7
Private consumption (% chge.)	3.9	4.0	3.7	2.6	3.8	3.0	2.9
Private investment (% chge.)	-2.2	-4.2	-5.4	0.2	4.2	3.8	2.0
Public spending (% chge.)	3.1	4.5	0.3	-0.1	2.5	1.8	3.2
Public consumption (% chge.)	6.0	9.8	0.3	0.5	0.8	2.7	3.2
Public investment (% chge.)	-2.7	-6.9	0.3	-1.8	6.8	-0.6	3.2
Exchange rate (vs. USD, eop)	2.96	3.38	3.40	3.25	3.37	3.37	3.32
Inflation (YoY %, eop)	3.2	4.4	3.2	1.4	2.2	1.9	2.2
Policy Interest rate (% eop)	3.50	3.75	4.25	3.25	2.75	2.50	2.00
Fiscal balance (% GDP)	-0.2	-1.9	-2.3	-3.0	-2.3	-1.9	-2.0
Balance of payments: current account (% of GDP)	-4.4	-5.0	-2.6	-1.3	-1.6	-2.1	-2.1
Exports (billions of USD)	39.5	34.4	37.1	45.4	49.0	47.0	47.8
Imports (billions of USD)	41.0	37.3	35.1	38.7	41.9	41.6	42.0

(f) Forecasts.

Forecast closing date: October 11, 2019.

Source: BCRP and BBVA Research Peru



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