

# Peru Economic Outlook

Fourth quarter 2020

October 2020

## Key messages (I)

- The current context is characterized by the recovery of global and local economic activity, which is modest but with positive surprises. The evolution of the pandemic will be a determining factor in the type of economic recovery in the coming quarters.
- The baseline projection scenario considers: (i) an external outlook that is more favorable than that of three months ago, (ii) the absence of complicated fresh outbreaks of COVID-19 at the global and local levels, as well as a process for developing a vaccine (and distributing it globally) that has been brought forward by one quarter, (iii) a somewhat faster normalization of local activity, so that the positive carry-over effect for 2021 will be around six percentage points, (iv) a domestic demand that is more supported by public spending, and (v) uncertainty due to regulatory risks and the electoral process.
- In this context, we expect GDP to contract by 13% this year (-15% in the forecast made in July) and that it will grow 10% in 2021 (8% in July).
- On the fiscal policy side, the next administration will face the challenge of raising tax revenues in order to stabilize public debt (as a % of GDP). Assuming that a credible process of fiscal consolidation is implemented and hence that capital inflows materialize, as well as an improvement in the trade surplus, the domestic currency will strengthen.

## Key messages (II)

- The Central Bank will maintain a highly expansionary monetary policy stance, with the reference interest rate remaining at 0.25% (historic minimum level) until 2022, amid an absence of demand pressures. It cannot be ruled out that, if necessary, the monetary stimulus will be increased using unconventional policy measures (quantitative easing to reduce medium- and long-term interest rates and the strengthening of forward guidance by linking possible movements in the reference rate to some economic activity or prices variable).
- The main risks regarding the forecasted baseline scenario are, on the positive side, additional economic stimuli in the largest economies, and locally, higher-than-expected output growth in the last few months of this year (with the positive carry-over that this implies for 2021) and a faster distribution of a vaccine. In contrast, a delay in the development of a vaccine at the global level (or in its distribution), an increase in macroeconomic imbalances in countries within the region, and, at the local level, a significant resurgence of the virus, even greater uncertainty related to the political, electoral, and regulatory environment, and more serious sequels of the negative shock of the second quarter (e.g. financial system soundness) would have a negative impact on Peru's output growth forecasts. The balance of these risks is positive for 2020 and neutral for 2021.

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# 01

How are the financial  
markets and activity  
evolving?

# Global economic activity recovered rapidly in the third quarter, and is slowing in the fourth quarter due to the difficulty of controlling the pandemic

## RECENT DEVELOPMENTS IN THE WORLD ECONOMY

### Growth: 3Q20



Faster recovery than expected

### Economic stimuli



Growing and significant

### Growth: 4Q20



Signs of moderation

### Evolution of the pandemic

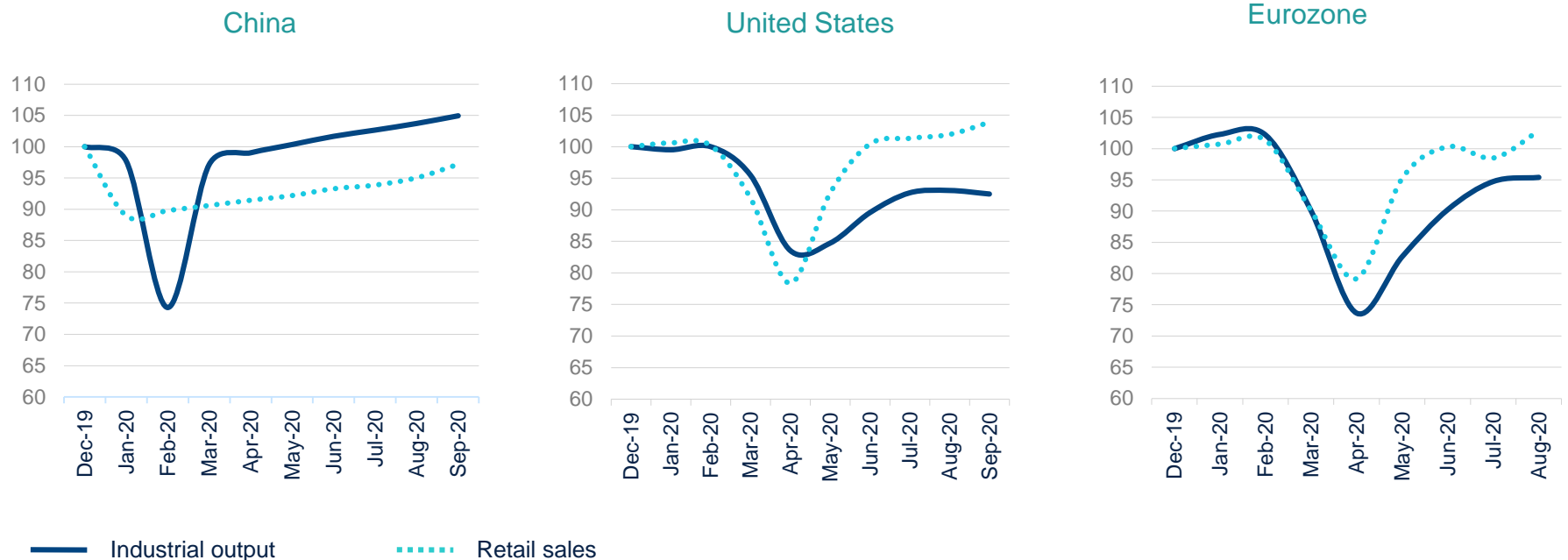


Infections on the rise in Europe and high in the Americas

# The recovery in global activity is modest, but has been somewhat faster than anticipated

## INDUSTRIAL OUTPUT AND RETAIL SALES

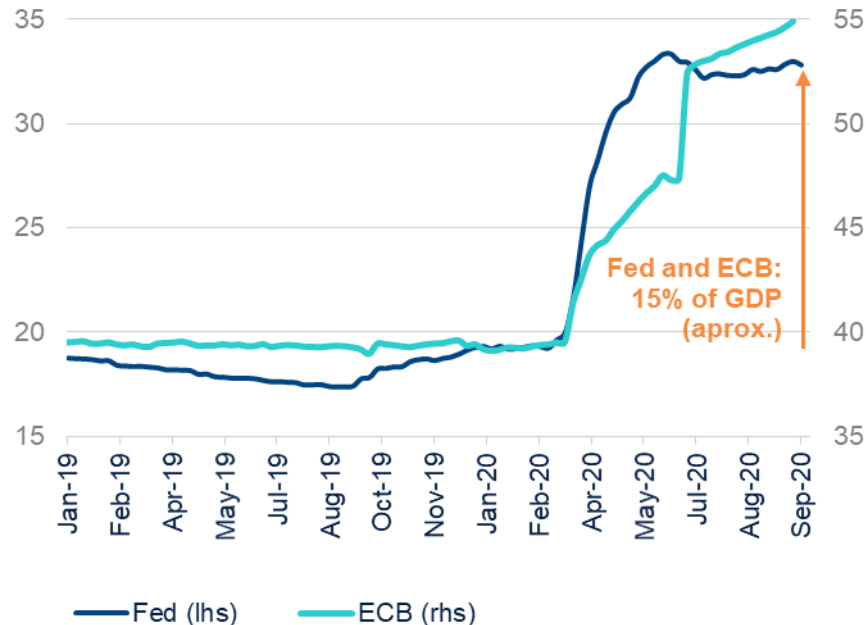
(AS A % OF THE LEVEL REACHED IN DEC.19)



# Central banks reinforce their commitment to maintaining and, if necessary, increasing monetary stimuli

## BALANCE SHEET OF CENTRAL BANKS

(% OF GDP)



Source: BBVA Research based on data from the Fed and the ECB.

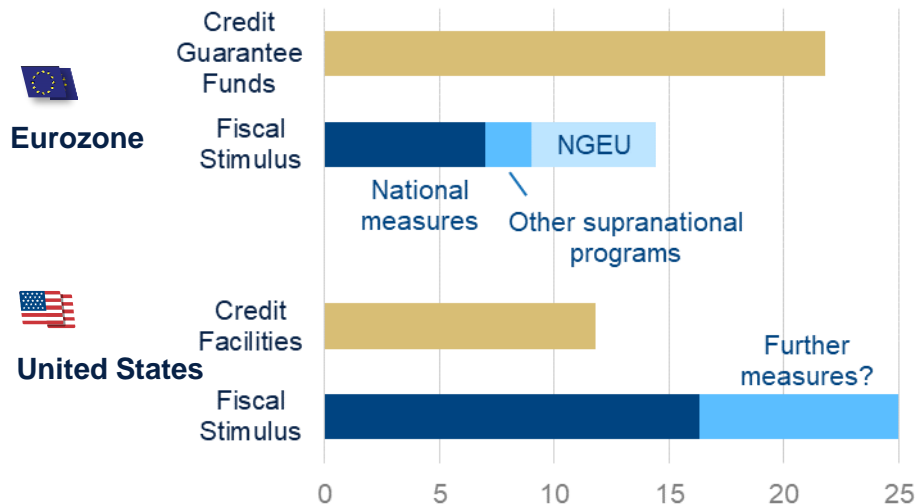
- The **Fed** updates its strategy:
  - more flexible inflation targets (average of 2%).
  - emphasis on achieving maximum employment.
  - willingness to keep rates low for a longer period and expand asset purchases.
- The **ECB** is showing concern about the low inflation (and therefore, about the recent exchange rate appreciation)...
- ...in addition, it considers it appropriate to maintain the stimuli and remains willing to use all its instruments.



# In the Eurozone, NGEU funds provide crucial economic support; while in the US additional fiscal stimuli remain uncertain

## FISCAL STIMULI AND LOAN PROGRAMS <sup>1</sup>

(% OF GDP)



<sup>1</sup> Fiscal stimulus: increased expenditure and reduced revenue; excludes resources channeled into guarantee funds and loans. In the case of the Eurozone, national measures represent the average of the stimuli announced in Germany, France, Italy and Spain and supranational measures include those of the EIB and the SURE. Loan programs: for the US, this includes the total amount of the Fed's loan facilities. For the Eurozone, it is the average of the loan guarantee funds of Germany, France, Italy and Spain.

Source: BBVA Research based on data from local statistical sources.

### ■ NGEU Funds: 5.4% of regional GDP (more than half in transfers):

- support (conditional) for growth starting in mid-2021.
- step toward greater tax integration.
- support for the euro as a currency of global reference.
- issuance of bonds for financing, possible precedent of a eurobond.

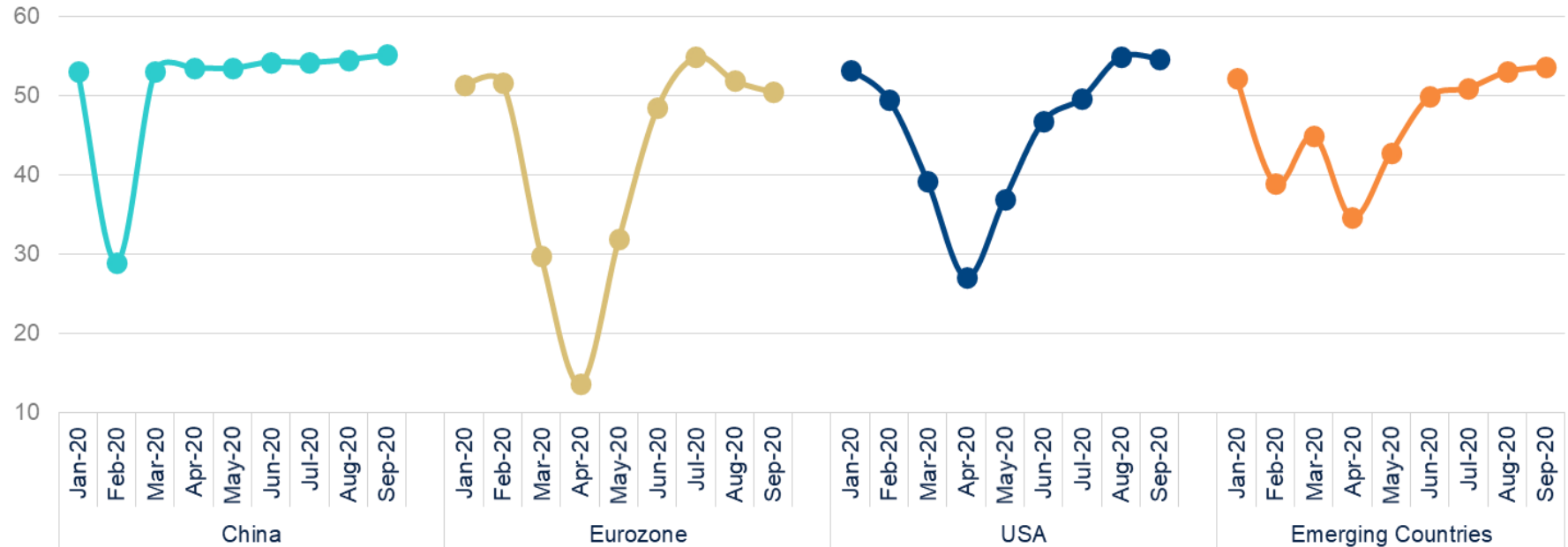
### ■ Fiscal stimuli in the United States:

- gradual reduction of the impact of previous aid programs.
- the political environment makes a new fiscal package before the elections difficult.

# Recovery shows increasing signs of a slowdown

## PMI INDICATORS 1/

(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)

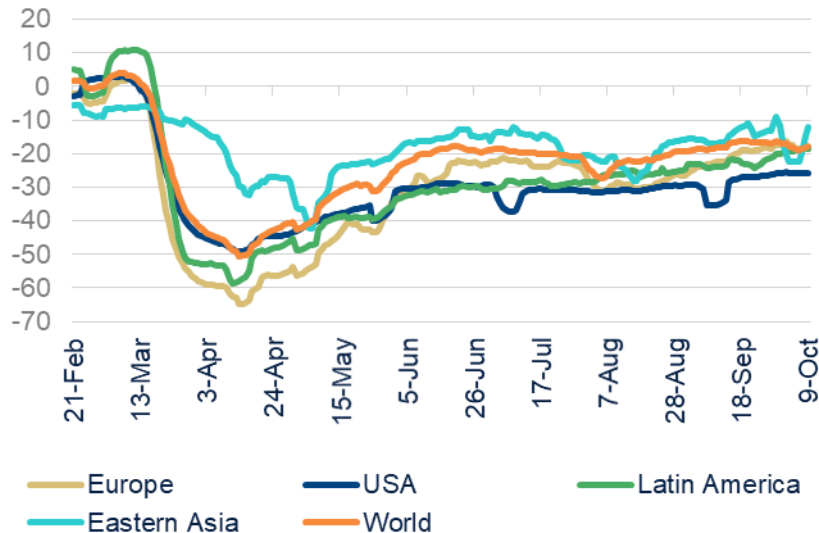


1/ Corresponds to the composite PMI (manufacturing and services)

Source: BBVA Research based on data from Haver.

# New lockdown measures are less restrictive and more focused than before, but mobility remains below "normal" levels

## MOBILITY TO THE WORKPLACE <sup>1</sup> (HIGHER VALUES INDICATE GREATER MOBILITY)



<sup>1</sup> The mobility indicator reflects the trends in mobility compared with the baseline period (January 3 through February 6). Average for the last 7 days. Europe: Germany, Spain, France, Italy, Portugal, the United Kingdom and Turkey. Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay. Eastern Asia: China, South Korea, Japan and Singapore.

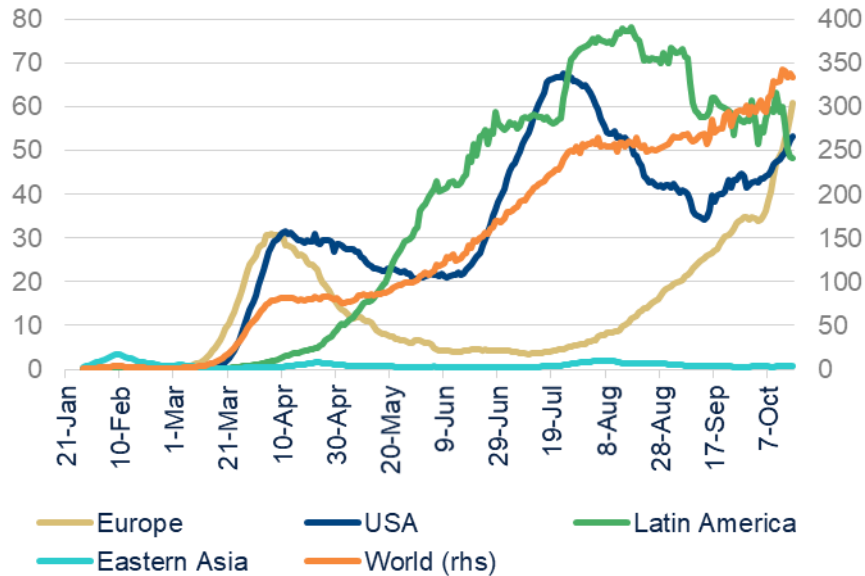
Source: BBVA Research based on Google Mobility Reports.

- Mobility is greater now than in the first few months of the pandemic:
  - preference for selective, less restrictive lockdowns.
  - high economic and social cost of severe lockdowns.
- However, mobility remains below "normal" levels:
  - official restrictions in many countries (increasingly in Europe).
  - new habits adopted voluntarily, due to fear or inertia.
- It is difficult for mobility to normalize without an approved vaccine.

# The pandemic is re-emerging in Europe, continues to worsen in the Americas and is under control in Eastern Asia

## DAILY CASES OF COVID-19 <sup>1</sup>

(THOUSANDS OF PEOPLE, MOVING AVERAGE OVER THE LAST 7 DAYS)



<sup>1</sup> Europe: Germany, Spain, France, Italy, Portugal, the United Kingdom and Turkey. Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay. Eastern Asia: China, South Korea, Japan and Singapore.

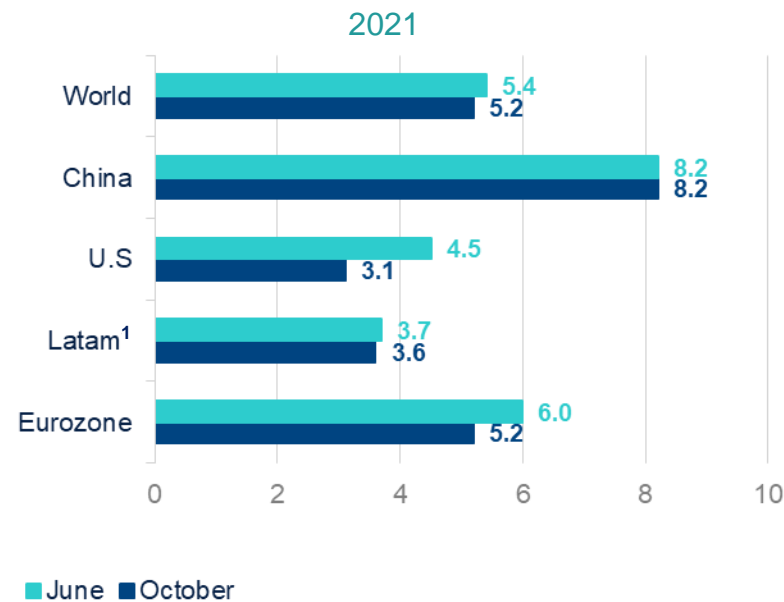
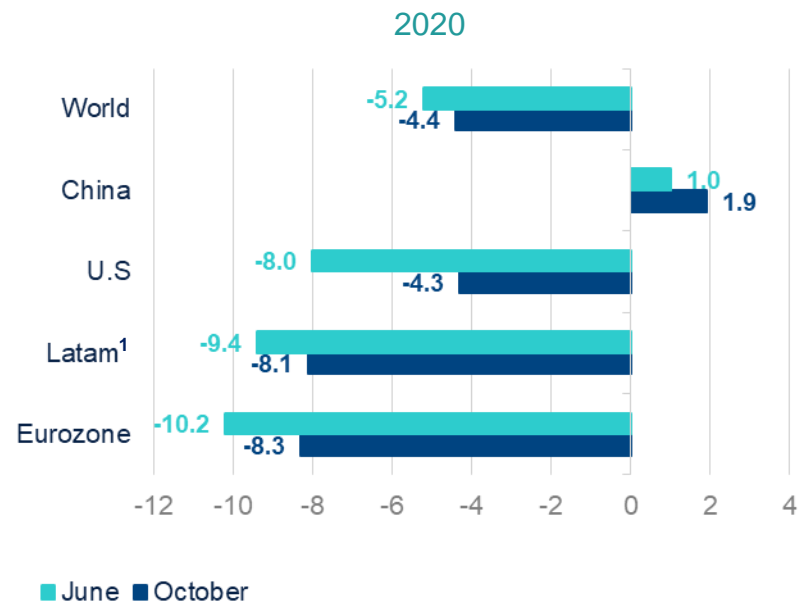
Source: BBVA Research based on data from Johns Hopkins University.

- Cases of COVID-19 worldwide have rebounded since September.
- **Europe:** infections on the rise, but with a relatively limited fatality rate so far.
- **United States:** after a respite, infections are back up in September.
- **LATAM:** infections are stable or falling, except in Argentina, where they are on the rise.
- **China** and other Asian countries: relatively under control.
- At least 10 **vaccines** are in the final phase of clinical evaluation, raising expectations that the virus will be controlled.

# In this context, the IMF has softened its forecasts for global GDP contraction this year and moderated growth forecasts for 2021

## GROWTH PROJECTION

(ANNUAL PERCENTAGE CHANGES,%)



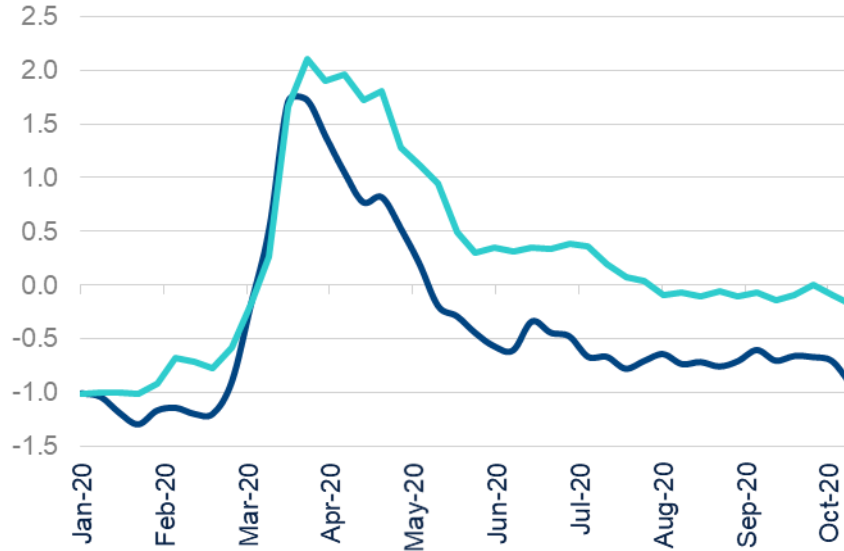
<sup>1</sup> Latin America and the Caribbean.

Source: World Economic Outlook, October 2020 (IMF).

# Financial stress remains limited, but has not disappeared, particularly in emerging markets

## FINANCIAL STRESS

(FINANCIAL STRESS INDEX: AVERAGE SINCE 2006 = 0)



— Financial Tensions Index: Developed Countries

— Financial Tensions Index: Emerging Countries

Source: BBVA Research

- Relative stability of financial markets in recent months.
- Economic stimulus and recovery of activity weigh positively.
- The epidemiological context and geopolitical tensions are sustaining risk aversion.
- Increasing differentiation between markets and countries.

# Increased volatility in financial markets in recent weeks

**S&P 500**  
(POINTS)



Source: Bloomberg and BBVA Research.

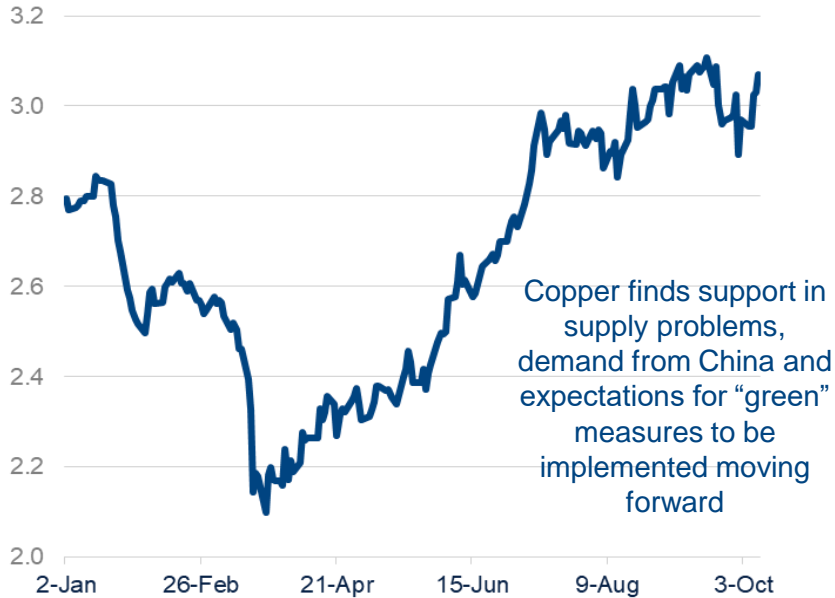
**US TREASURY BOND YIELDS**  
(%)



Source: Bloomberg and BBVA Research.

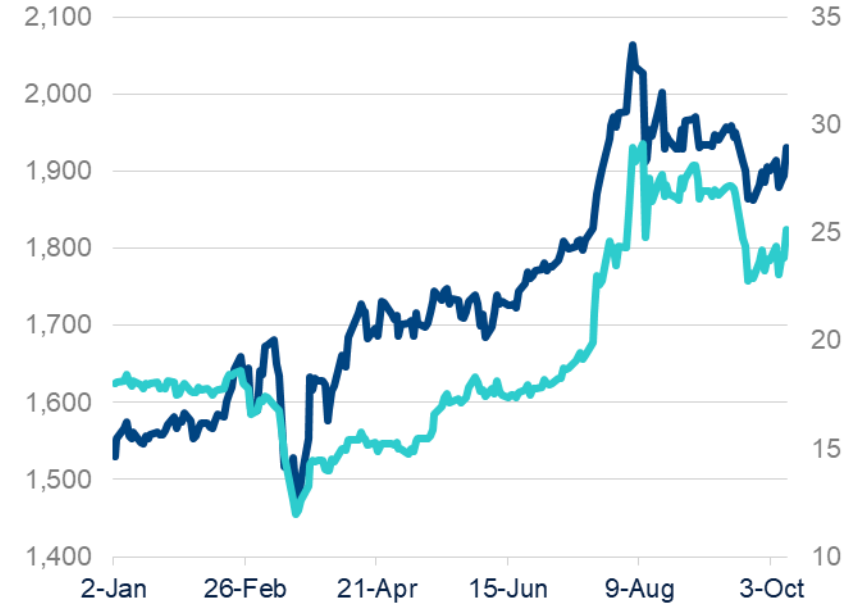
# Copper prices at two-year highs and precious metals remain attractive as safe haven assets

## COPPER (USD/POUND STERLING)



Source: Bloomberg and BBVA Research.

## GOLD AND SILVER (USD/TROY OUNCE)



— Gold  
— Silver (right axis)

Source: Bloomberg and BBVA Research.



# Latin American currencies weaken in a context of capital outflows from emerging economies

## LATAM EXCHANGE RATE

(DEC 31, 19 = 100)

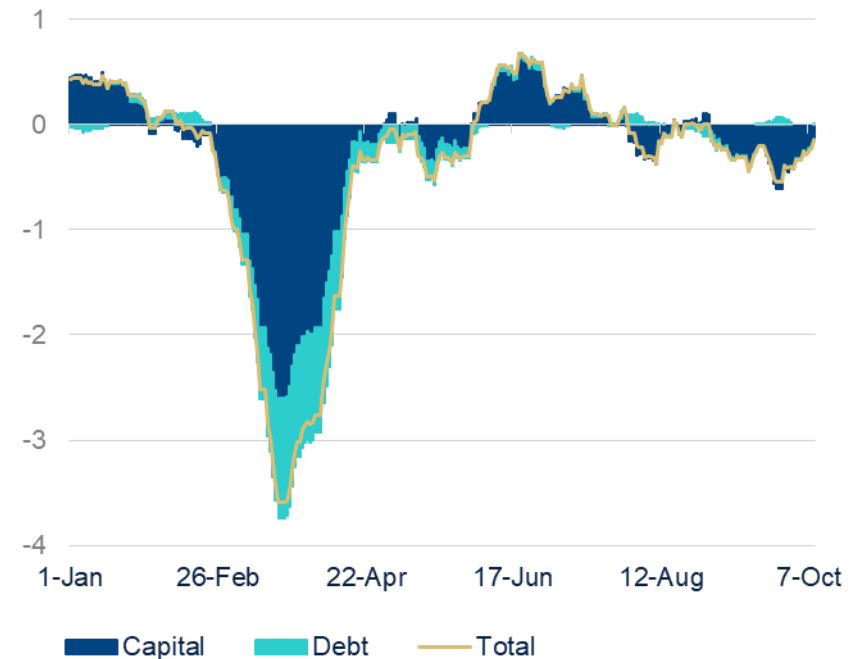
	21-sep. / 21-oct.	2020
Brazil	3.5%	39.5%
Chile	1.0%	3.9%
Colombia	-0.3%	14.6%
Mexico	-1.1%	11.5%
Peru	1.5%	8.6%



Source: Bloomberg and BBVA Research.

## CAPITAL FLOWS TO EMERGING MARKETS

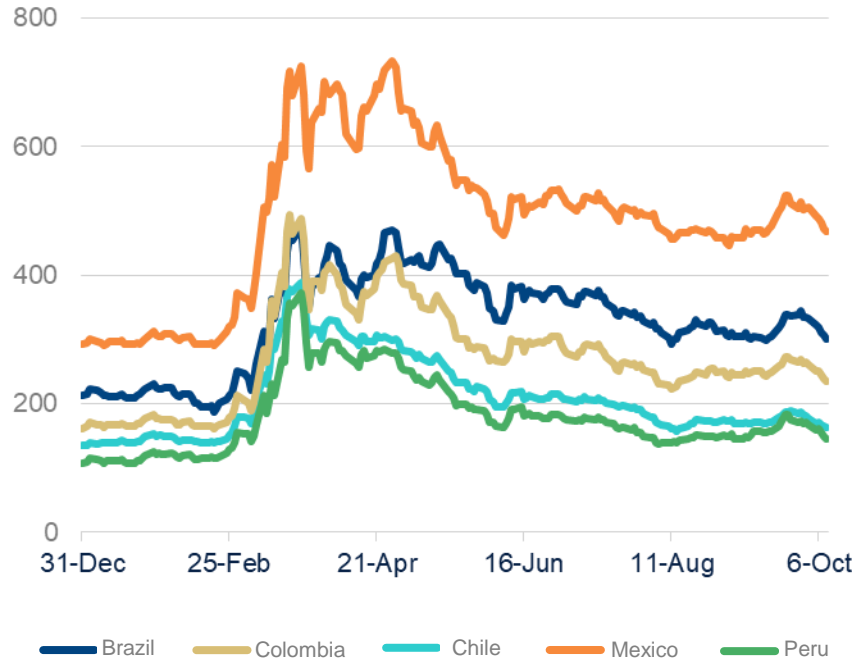
(USD BILLIONS, 28-DAY MOVING AVERAGE)



Source: Bloomberg, IIF and BBVA Research.

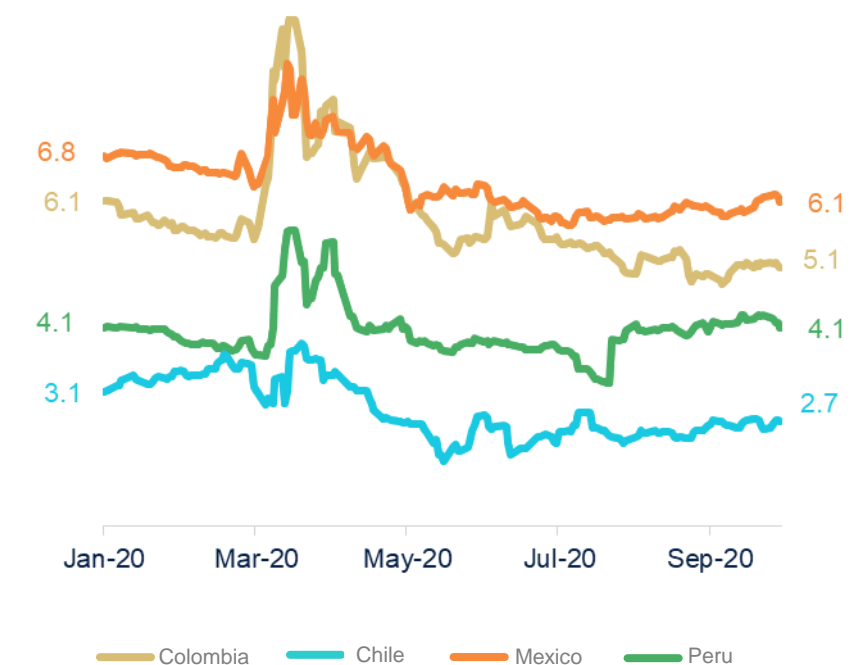
# EMBI in Latin America fall while sovereign yields have remained relatively stable in recent weeks

**EMBI**  
(POINTS)



Source: Bloomberg and BBVA Research.

**SOVEREIGN BOND RATES**  
(%)

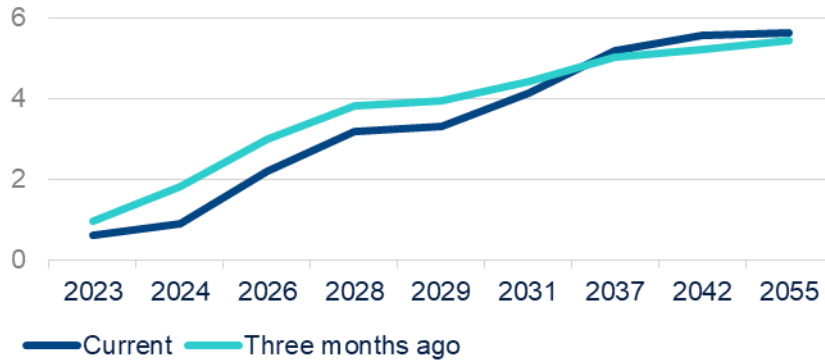


Source: Bloomberg and BBVA Research.

# In Peru, the sovereign curve has been relatively flat in the last four weeks, while non-resident holdings have increased

## SOVEREIGN PERFORMANCE CURVE (%)

(%)



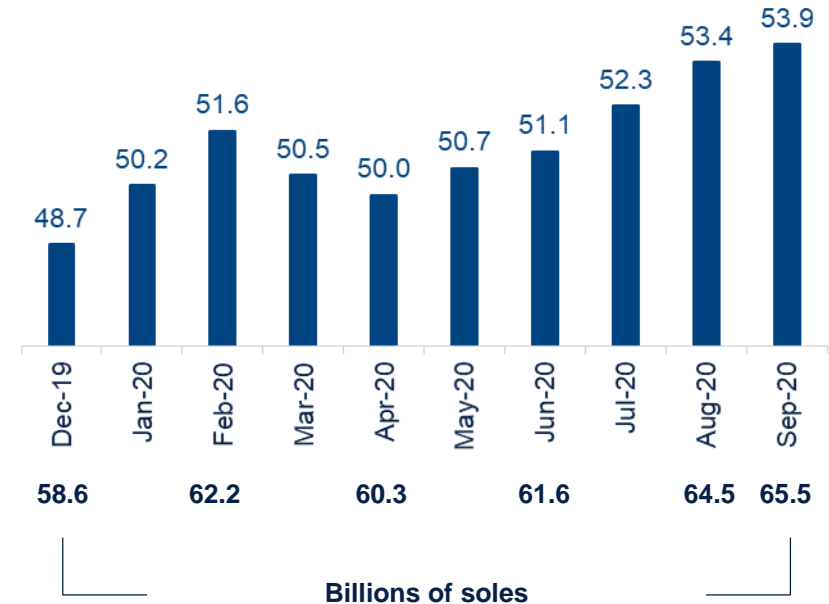
## CURRENT LEVEL VS: (BASIS POINTS)

	2023	2024	2026	2028	2029	2031	2042
One month ago	2	-31	-6	-2	1	9	3
Three months ago	-39	-89	-82	-68	-61	-10	-2
One year ago	-164	-207	-136	-199	-92	-56	-1

Source: Bloomberg, MEF and BBVA Research.

## SOVEREIGN BOND HOLDINGS BY NON-RESIDENTS (% OF TOTAL)

(% OF TOTAL)

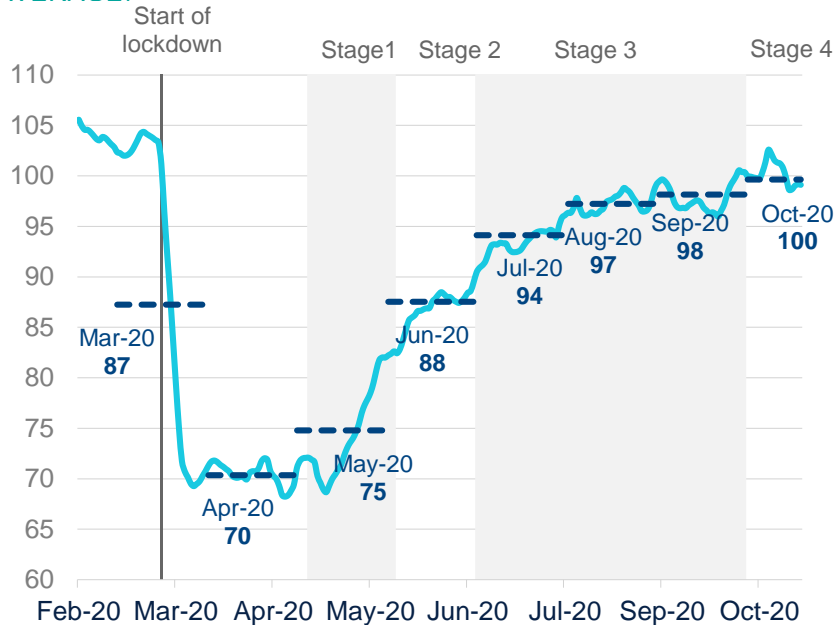


Source: Bloomberg, MEF and BBVA Research.

# On the local activity side, indicators are approaching or exceeding last year's levels, but also show that the recovery is losing momentum

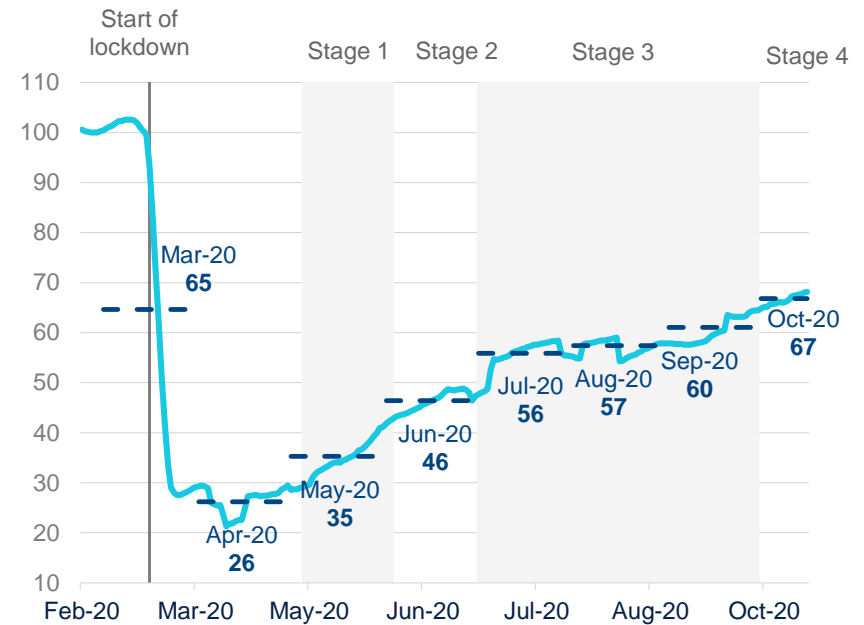
## PERU: ELECTRICITY OUTPUT<sup>1</sup>

(AS A % OF THE LEVEL IN THE SAME PERIOD OF 2019, 7-DAY AVERAGE)



## PERU: MOBILITY TO THE WORKPLACE<sup>2</sup>

(AS A % OF PRE-COVID-19 LEVEL, 7-DAY AVERAGE)



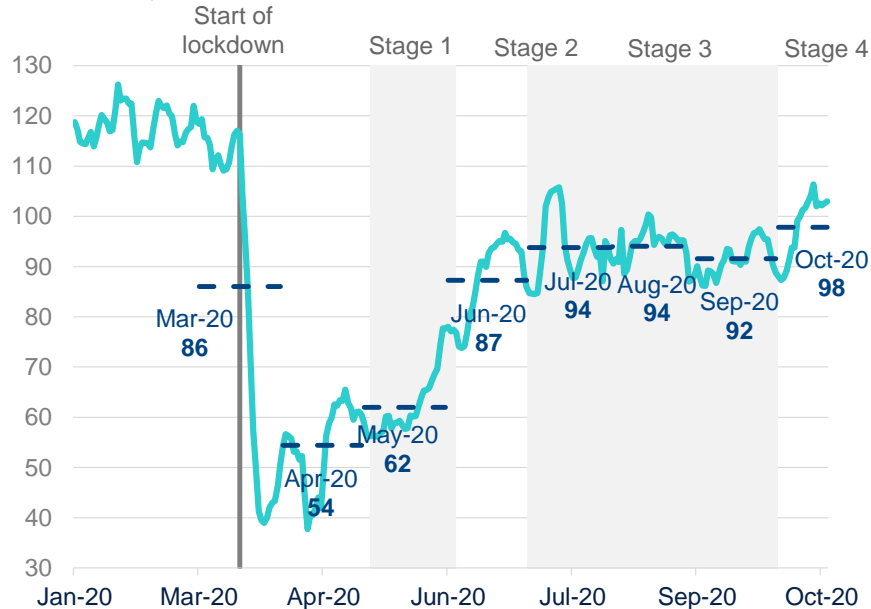
1: Information up until October 19. 2: Information up until October 16.

Source: Google Mobility, COES and BBVA Research.

# On the local activity side, indicators are approaching or exceeding last year's levels, but also show that the recovery is losing momentum

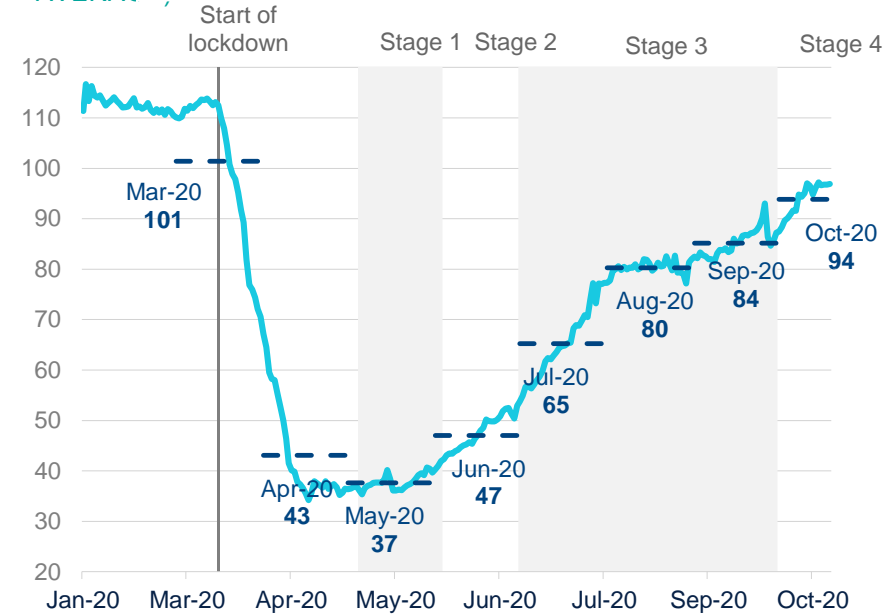
## PERU: CONSUMPTION INDICATOR<sup>1, 2</sup>

(AS A % OF THE LEVEL IN THE SAME PERIOD OF 2019, 7-DAY AVERAGE)



## PERU: INVESTMENT INDICATOR<sup>1, 3</sup>

(AS A % OF THE LEVEL IN THE SAME PERIOD OF 2019, 28-DAY AVERAGE)



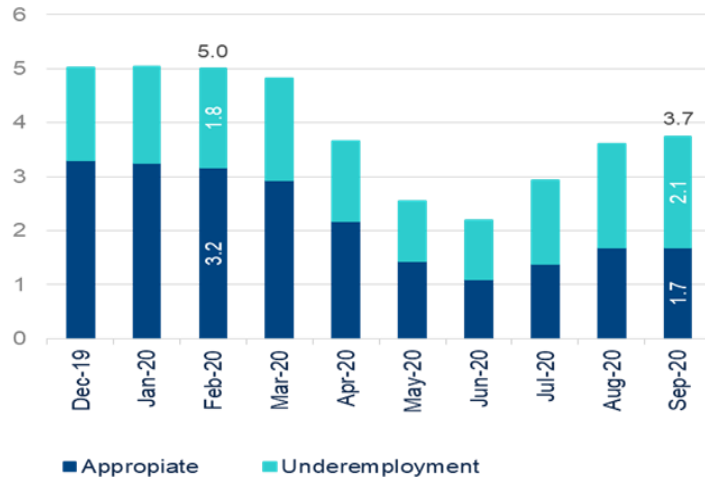
1: Information up until October 19. 2: Credit and debit card purchases and withdrawals by individuals are taken into consideration. 3: Income to accounts of companies operating in investment goods is taken into consideration.

Source: BBVA.

# Employment is also recovering... but for new low-quality jobs

## EMPLOYMENT IN LIMA

(EMPLOYED EAP, MILLIONS OF PEOPLE, AVERAGE FOR THE LAST THREE MONTHS)



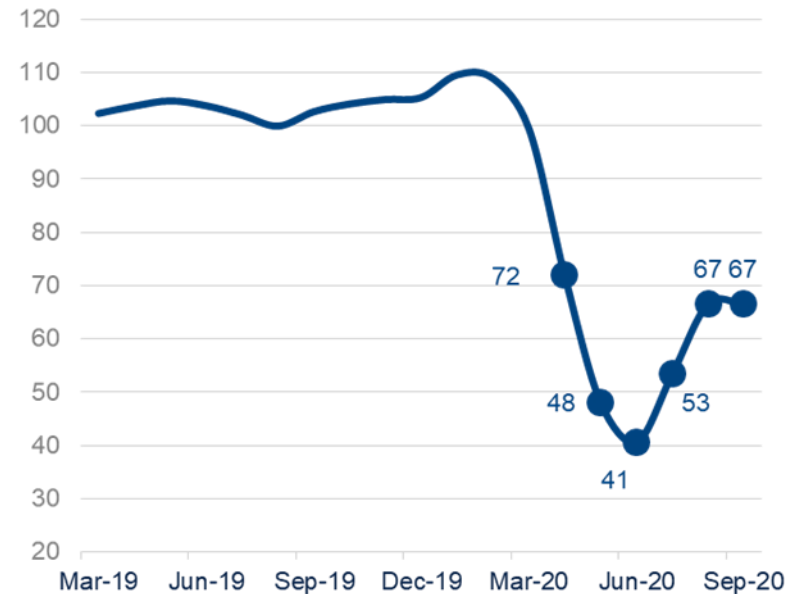
## UNDEREMPLOYMENT (% OF EMPLOYED EAP, AVERAGE FOR LAST THREE MONTHS)

Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Set-20
35.5	36.6	39.1	40.2	43.7	49.9	52.7	53.4	55.0

Source: INEI and BBVA Research.

## TOTAL WAGE BILL OF LIMEAN WORKERS

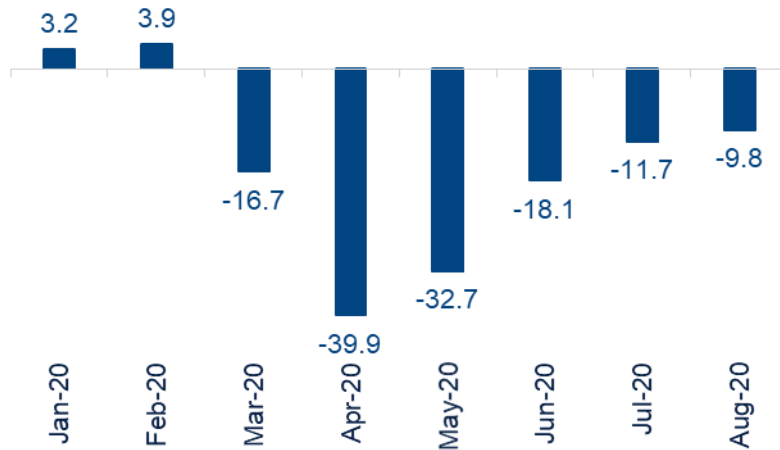
(AS A PERCENTAGE OF THE LEVEL REACHED IN THE SAME PERIOD IN 2019, AVERAGE FOR THE LAST THREE MONTHS)



Source: INEI and BBVA Research.

# GDP contraction is moderate and activity shows a more pronounced rebound than in the rest of Latin America

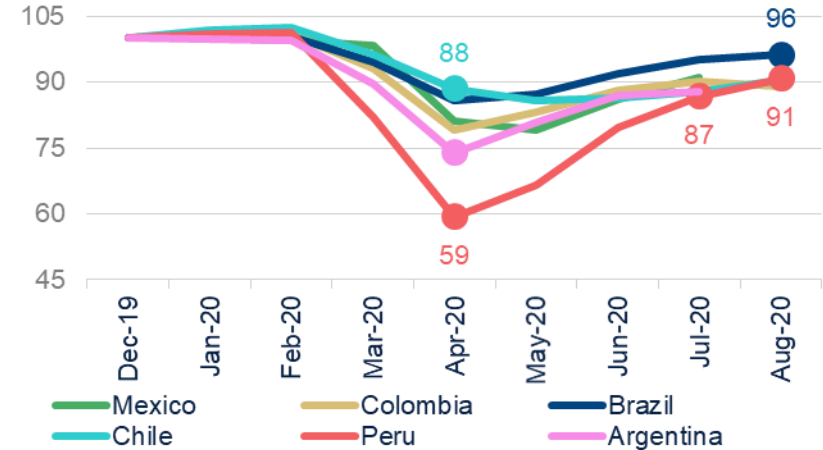
## GDP (YOY % CHANGE)



The decline in 2Q20 (-30%) was lower than expected (-33%). Trends observed in recent months suggest that contraction in 2H20 will be less pronounced.

Source: INEI and BBVA Research.

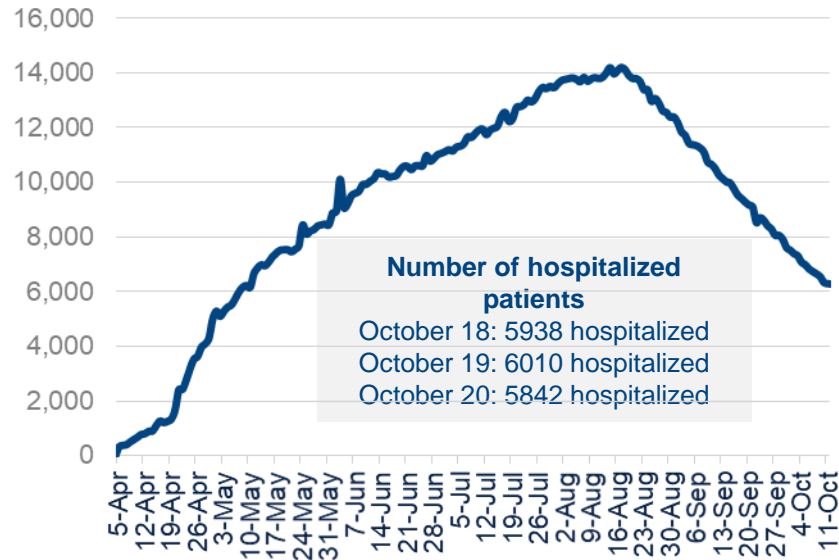
## LATAM: ECONOMIC ACTIVITY (SEASONALLY ADJUSTED, AS A % OF THE LEVEL REACHED IN DEC. 19)



Source: Argentina: National Institute of Statistics and Census (INDEC); Brazil: Central Bank of Brazil (BCB); Mexico: National Institute of Statistics and Geography (INEGI); Colombia: National Administrative Department of Statistics (DANE), Chile: Central Bank of Chile, Peru: BCRP and BBVA Research

# Pandemic indicators continue to improve, but the situation remains fragile

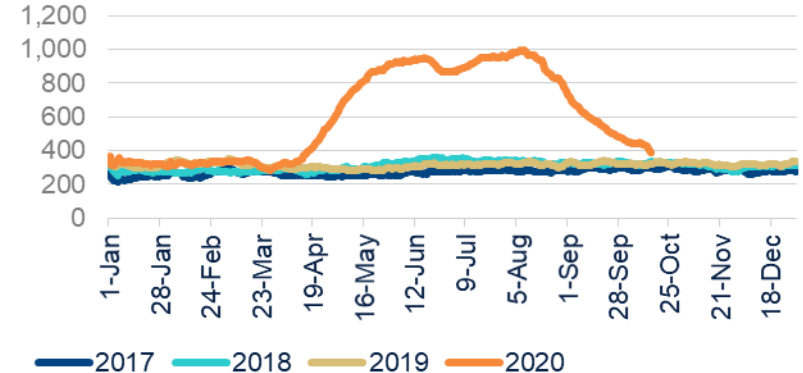
## NO. OF HOSPITALIZED PATIENTS



## DAILY DEATHS ACCORDING TO SINADEF<sup>3</sup>

(PEOPLE, 7-DAY MOVING AVERAGE, 20/10)

- **Excess deaths** (accumulated so far this year)<sup>1</sup>: **+85,943**
- **Excess deaths per day**<sup>2</sup> (difference with respect to the 7-day moving average):
  - October 18: **+91**
  - October 19: **+82**
  - October 20: **+56**

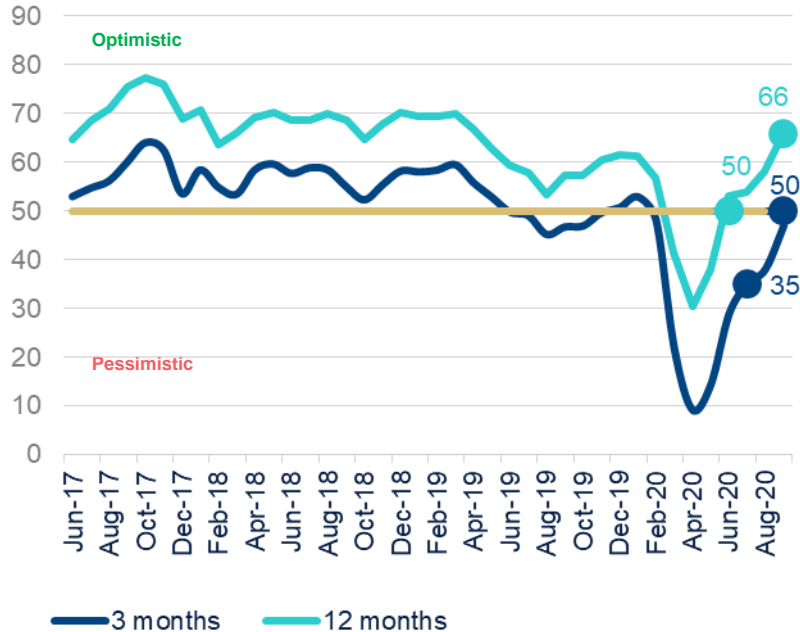


1: Cumulative excess deaths are calculated as the difference between deaths in 2020 and those in 2019. 2: Daily excess deaths are calculated as the difference between the 7-day moving average of deaths and the average deaths in 2017, 2018 and 2019. 3: Due to the break in the series, the moving average is recalculated from 07/23 and 08/13. 4: Sinadef performs important data reviews for the 14 days prior to the last update date.



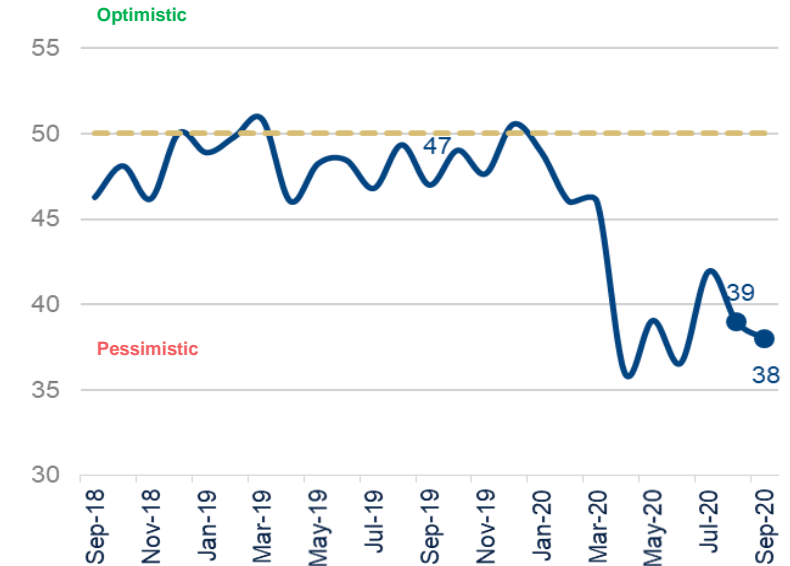
# In this context of relative improvement, business confidence is restored yet consumer confidence remains weak

## BUSINESS CONFIDENCE (POINTS)



Source: BCRP and BBVA Research.

## CONSUMER CONFIDENCE (POINTS)



Source: Apoyo Consultoría and BBVA Research.

# 02

## Quarterly review of macroeconomic forecasts

### 2.1. GDP and economic activity

# The baseline forecast scenario for the rest of 2020 and 2021 involves the following assumptions for external and national scenarios

## EXTERNAL

### 01

Vaccine available in 1Q21. Distribution in developed economies will begin during the same period.

### 02

Activity continues to normalize in the coming quarters. Upward revision of global growth forecasts (2020 and 2021), with economic stimuli that will remain in place at least until the recovery is consolidated. Gradual reduction of volatility and risk aversion throughout 2021.

### 03

Commodity prices will remain at levels close to those already reached.

### 04

Emerging markets will continue to attract capital, albeit with differentiation

# The baseline forecast scenario for the rest of 2020 and 2021 involves the following assumptions for external and national scenarios

## LOCAL

### 05

No major fresh virus outbreaks involving significant tightening of isolation measures. Vaccine is distributed locally in the second half of 2021.

### 06

Positive carry-over effect for next year (as a smaller contraction in GDP in 2020 compared to what was anticipated three months ago).

On the supply side, phase 4 is gradually unfolding.

On the demand side, infrastructure maintenance and construction expenditure increases. The weakness of household and business expenditure continues.

Resilience of local banking

### 07

Uncertainty due to regulatory risk and the election result is set to continue until the end of 1H21.

The new administration maintains basic macroeconomic principles (fiscal and monetary discipline) and market economy orientation.

# COVID-19 assumptions: Gradual progress following the announcement, introduction and subsequent distribution of an effective vaccine

## 1. HEALTH

Countries will continue to struggle to keep the virus under control. Severe levels of lockdown are avoided.

Large-scale inoculation in DM and gradual relaxation of social distancing regulations, with a positive effect on activity

4Q20

1Q21

2Q21

3Q21

4Q21

Credible announcement of an effective vaccine, with a positive effect on confidence; inoculation (vaccination) of risk groups at least in DM.

**Large-scale inoculation and relaxation of social distancing regulations are consolidated in DM and gradually extended in EM.**

# Activity continues to normalize in the coming quarters. Upward revision of global growth forecasts (2020 and 2021)

## 2. GLOBAL GROWTH

GDP (YOY % CHANGE)

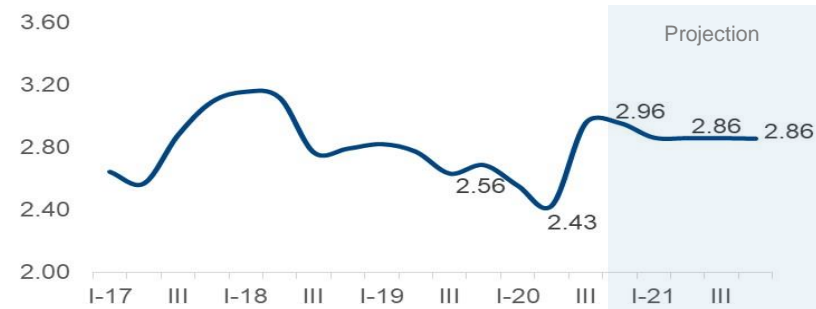


# Raw material prices will remain at levels close to those already reached

## 3. RAW MATERIAL PRICES

### COPPER PRICE

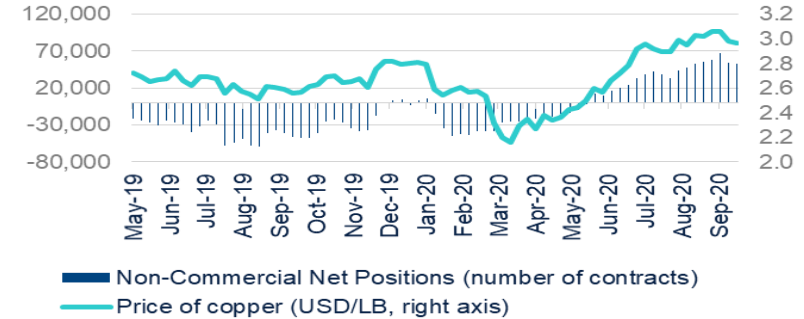
(AVERAGE FOR THE PERIOD, USD/GBP)



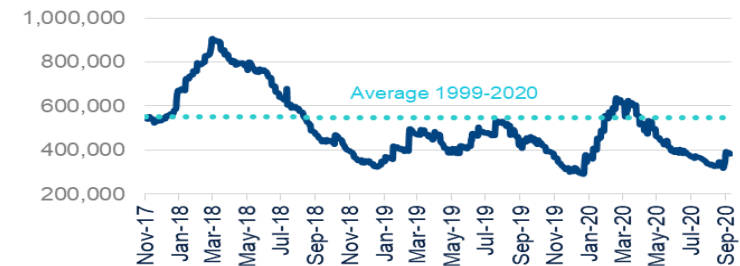
	2019	2020	2021	2022	2023	2024	2025
Copper (USD/LB)	2.73	2.72	2.86	2.75	2.75	2.65	2.65
Oil (USD barrel)	57	38	47	54	57	57	57
Terms of trade (YoY% change)	-1.8	7.0	1.0	-4.0	-1.4	-2.8	-1.4

Source: Bloomberg and BBVA Research.

### COPPER PRICE AND NON-COMMERCIAL NET POSITIONS



### COPPER INVENTORIES (MT)



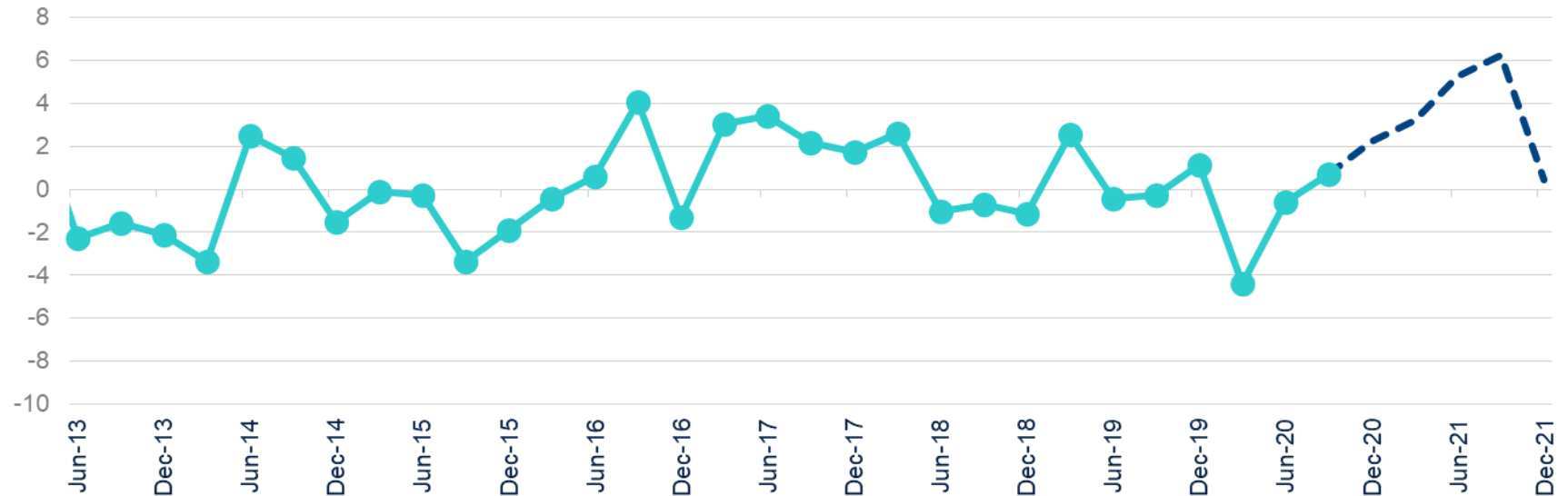
Improved performance of global economic activity, particularly that of China, and abundant global liquidity will support the price of copper.

# Capital inflows to emerging markets are assumed, but with differentiation

## 4. CAPITAL FLOWS TO EMERGING MARKETS

### CAPITAL FLOWS TO EMERGING ECONOMIES

(% OF ASSETS ADMINISTERED)



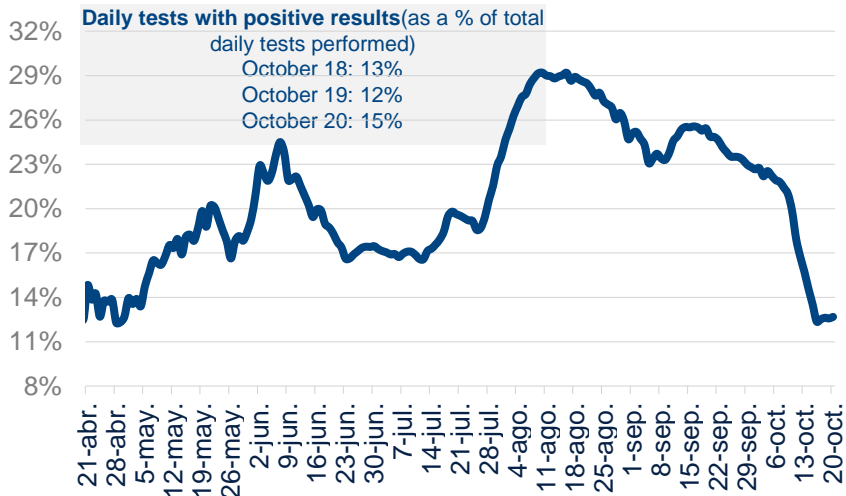


# No fresh virus outbreaks leading to significant tightening of social isolation measures

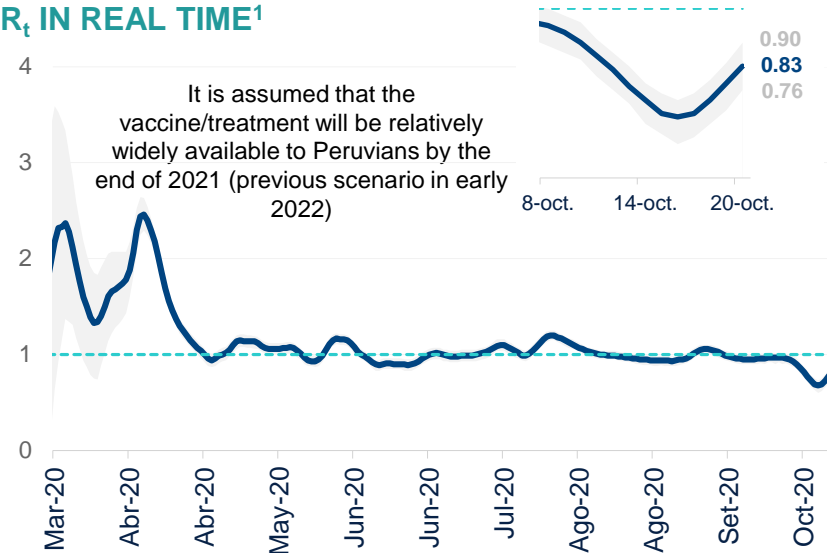
## 5. LOCAL HEALTH SITUATION

### DAILY TESTS WITH POSITIVE RESULTS

(7-DAY MOVING AVERAGE, %)



### $R_t$ IN REAL TIME<sup>1</sup>



<sup>1</sup> MINSA data since March 6. BBVA Research Peru estimates (compensating for the variation in the number of tests) based on:

- Bettencourt & Riberiro (2008), "Real Time Bayesian Estimation of the Epidemic Potential of Emerging Infectious Diseases."
- Systrom (2020), "The Metric We Need to Manage COVID-19."
- Vaidyanathan (2020), "Estimating COVID-19's  $R_t$  in Real-Time."

Source: MINSA and BBVA Research.

# On the demand side, increased expenditure on infrastructure maintenance and construction

## 6. DEMAND AND BANKING SYSTEM



### "Arranca Perú" (Kickstart Peru program)

USD 2 billion (2020).  
USD 944 million (2021).  
About 80% related to road maintenance activities.



### "Reconstrucción con Cambios" (Reconstruction with changes plan) <sup>1</sup>

USD 2 billion (from 2021).  
It includes the integral solutions of 17 rivers, 5 streams and 7 stormwater drains in coastal cities.  
Reconstruction and infrastructure in health (15 hospitals) and education (74 schools).



### Infrastructure construction

Lima Metro line 2.  
Ports: San Martín, Salaverry and Chancay.  
Jorge Chávez Airport.

<sup>1</sup> The contract was signed with the UK government in June.  
Source: MEF, Reconstrucción con Cambios, media and BBVA Research.

# Banks are comfortably meeting the requirements of the regulator in response to this crisis and have strengthened in the months following its onset

## 6. DEMAND AND BANKING SYSTEM

### FINANCIAL INDICATORS OF THE BANKING SYSTEM

	Required by the regulator	Pandemic	
		Dec-19	Aug-20
<b>SOLVENCY</b>			
Global Capital Ratio	10	14.5	14.8
Provisions / Delinquent Loans		152	188
<b>ASSETS QUALITY</b>			
Delinquent Loans (SBS criteria) / Direct Loans		3.0	3.1
<i>Delinquent Loans DC (SBS criteria) / Direct Loans DC</i>		3.3	3.1
<i>Delinquent Loans FC (SBS criteria) / Direct Loans FC</i>		2.3	3.1
<b>PROFITABILITY</b>			
Annualized Net Profits / Average Equity		18.3	9.7
Annualized Net Profits / Average Asset		2.3	1.1
<b>LIQUIDITY</b>			
Liquidity ratio DC (Average monthly balance)	8.0	27.0	40.7
Liquidity ratio FC (Average monthly balance)	20.0	49.6	56.4

Banks are facing this crisis with ample capital and provisions.

Delinquency is relatively stable, but is expected to increase in the coming months.

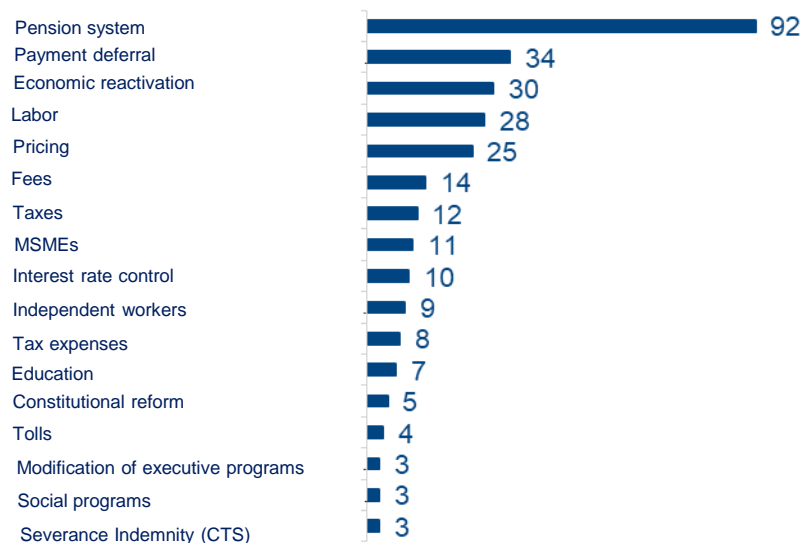
Sharp drop in profitability, but remains positive despite higher provisions.

Adequate liquidity supported by Central Reserve Bank of Peru (BCRP) measures.

# Uncertainty due to regulatory risk and election outcome in the second quarter of 2021

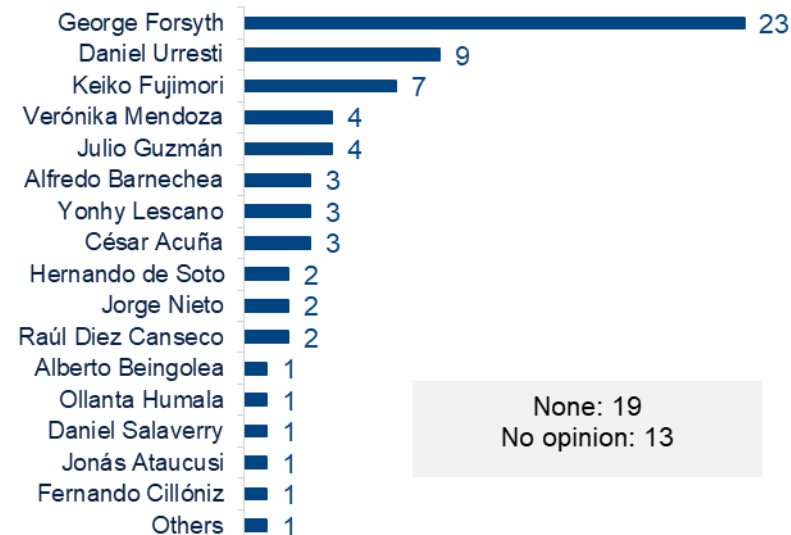
## 7. POLICY

### ECONOMIC BILLS (NUMBER)



Source: The Congress of the Republic Preparation: Macroconsult.

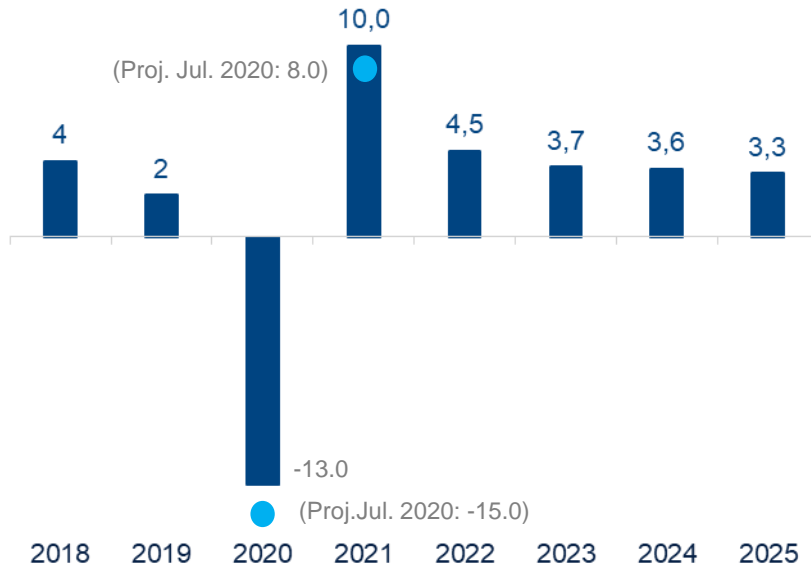
### VOTING INTENT: SEP-2020 <sup>1</sup> (%, PUBLIC OPINION)



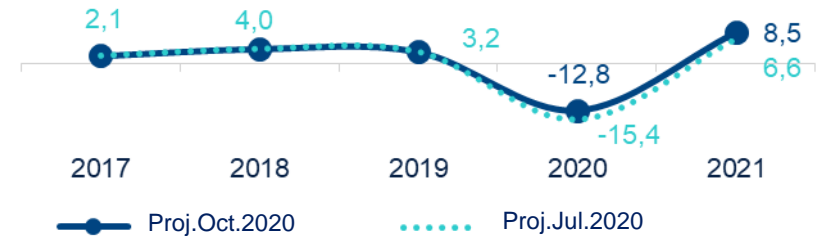
<sup>1</sup> Others: Marco Arana, Roque Benavides, Pedro Cenas and Rafael López Aliaga.  
Source: Ipsos Peru.

# In this context, we predict that GDP will fall 13% this year and rebound 10% next year

## GDP (YOY % CHANGE)



## PRIVATE SPENDING (EXCLUDES INVENTORY ACCUMULATION, YOY % CHANGE)



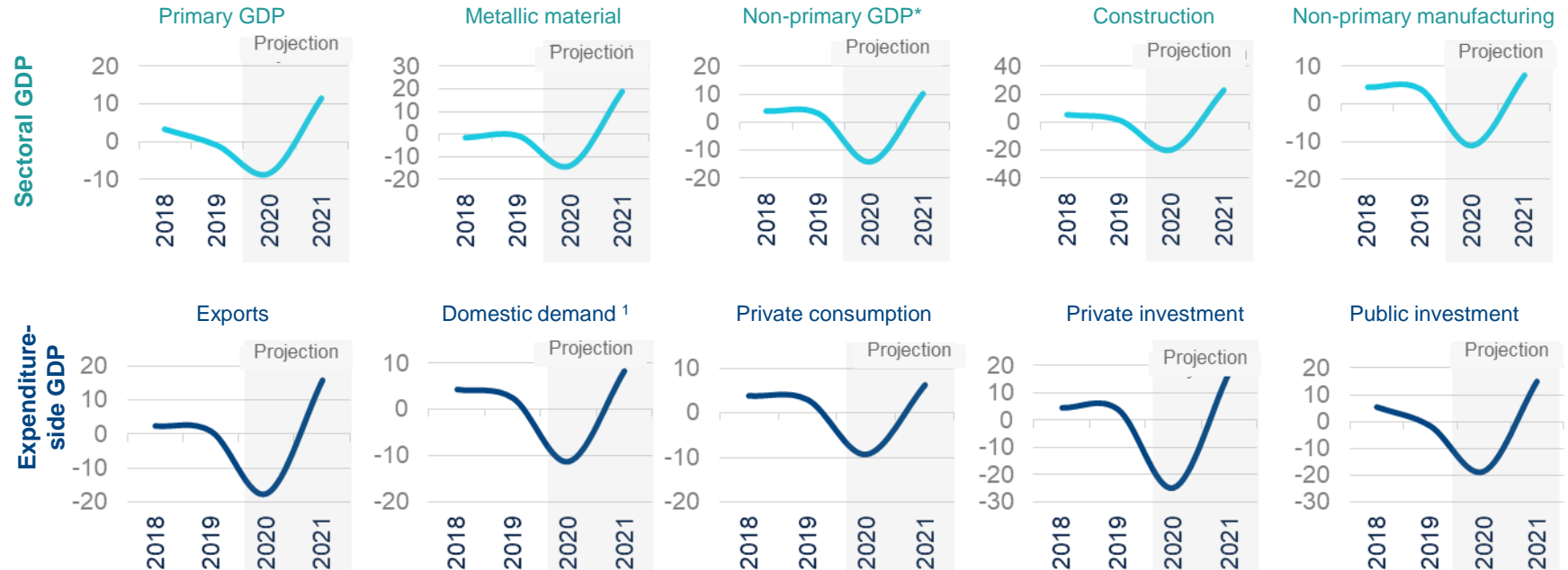
## PUBLIC EXPENDITURE (YOY % CHANGE)



# In this context, we predict that GDP will fall 13% this year and rebound 10% next year

## GDP: SELECTED COMPONENTS FOR THE SECTORAL AND EXPENDITURE SIDES

(IN REAL TERMS, YOY % CHANGE, PROJECTIONS 2020–21)

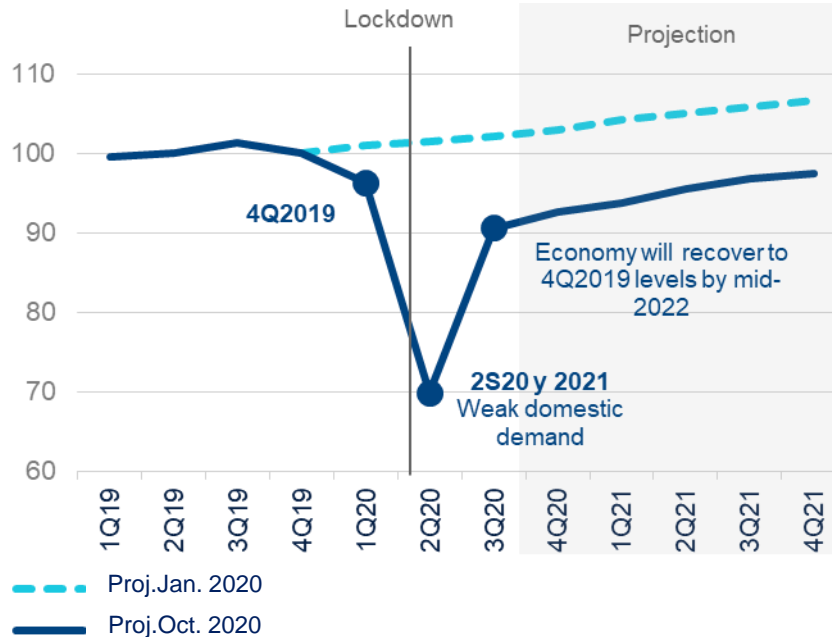


<sup>1</sup> Excludes inventory accumulation  
Source: BCRP and BBVA Research.

# The severity of the crisis and its aftermath on demand will induce a slow output

## PERU GDP: LEVEL

(SEASONALLY ADJUSTED QUARTERLY INDEX, 4Q2019 = 100)



Source: BCRP and BBVA Research.

## Consumption

- Family income has declined: Jobs have been lost, formal jobs will take a long time to recover, tendency toward informality, excess labor supply
- Urban middle class will shrink by about 10 percentage points (from 47% to 37%). More than 2.5 million people will no longer be considered urban middle class
- Poverty will increase: An increase of between 8 and 10 percentage points is estimated in 2020 (2.5 million people).
- Consumption expenditure has been affected, moreover, by family caution and increased precautionary saving

## Public investment

- Private investment contained by gaps in installed capacity and deterioration of business confidence

## Public expenditure

- Can it be significantly expanded?

# 02

## Quarterly review of macroeconomic forecasts

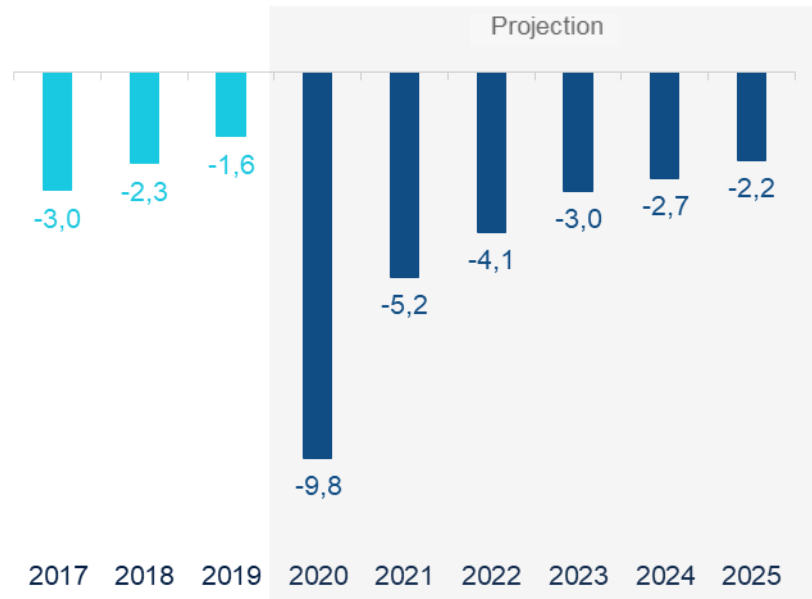
### 2.2. Fiscal result and public debt



# Fiscal position: stabilization of public debt will require measures to recover revenues

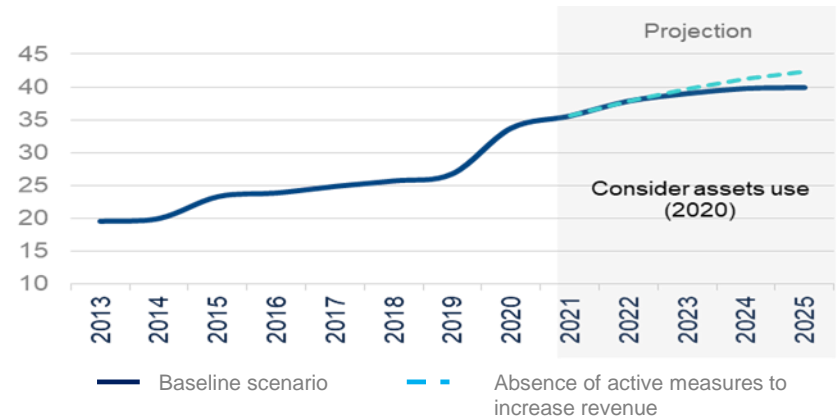
## FISCAL OUTCOME <sup>1</sup>

(% OF GDP)



## GROSS PUBLIC DEBT <sup>1</sup>

(% OF GDP)



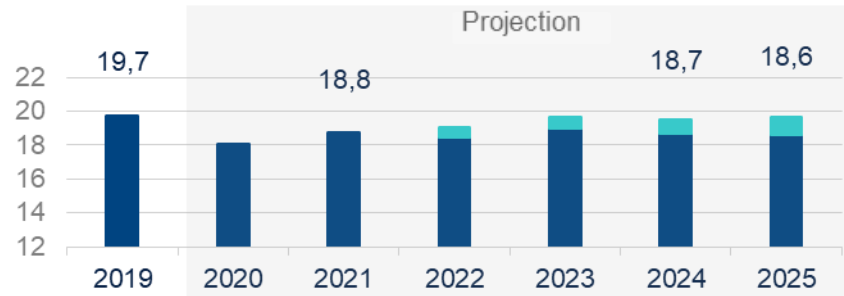
Source: BCRP, MEF and BBVA Research

- Baseline scenario considers that the sovereign credit rating does not change on the forecast horizon (new government introduces measures to raise revenues from 2022).

<sup>1</sup> An expected loss of 10% is assumed in the "Reactiva Perú" (Reactivate Peru) program (from 2021).  
Source: BCRP, MEF and BBVA Research

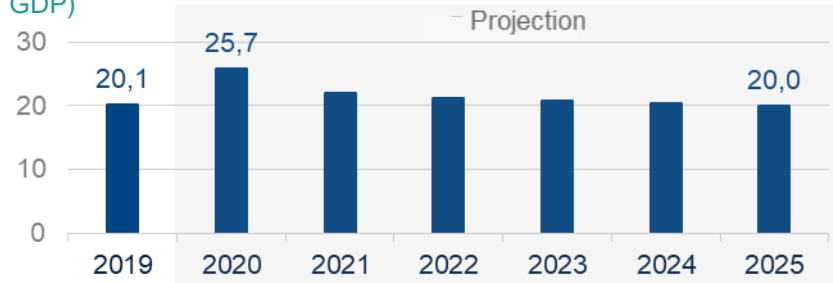
# Fiscal position: stabilization of public debt will require measures to recover revenues

## CENTRAL GOVERNMENT TAX REVENUE (% OF GDP)



■ Additional income to be defined

## CENTRAL GOVERNMENT TAX EXPENDITURE (% OF GDP)

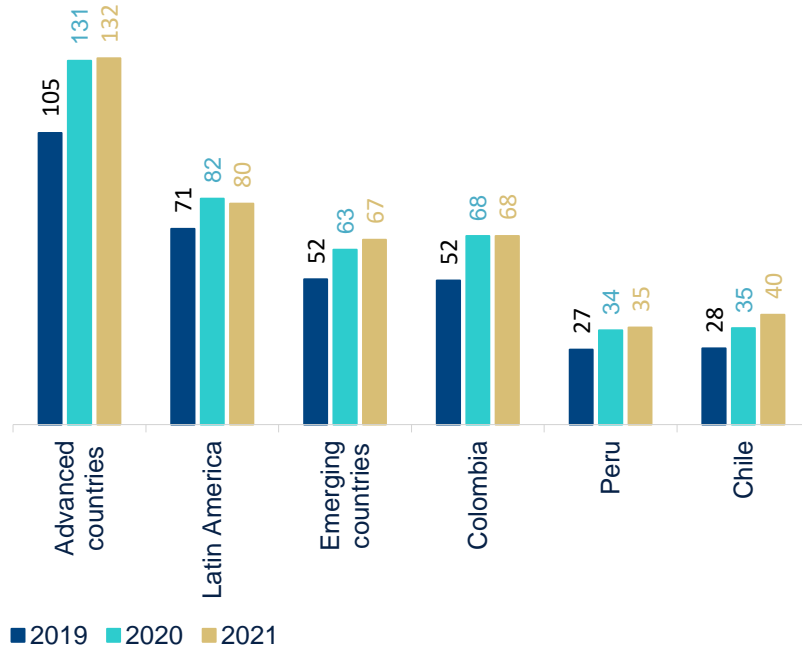


Source: BCRP, MEF and BBVA Research

- Collection in 2020 affected by noncompliance and tax fractioning. Revenue normalizes in the next three years.
  - As of 2022, tax revenues are considered necessary to maintain public debt at around 40%.
  - Possible tax measures: (i) increase in VAT, (ii) increase in excise duty (ISC), (iii) reduction of the exonerated segment of personal income tax, (iii) simplification of tax regimes for MSMEs, (iv) changes to the capital gains tax, (v) revision of the property tax, (vi) others (severance indemnity (CTS), ISC to the Amazon, drawback).
- 
- Adjustment of expenditure through the reversal of transfers.

# Fiscal position: greater concern about rising sovereign debt, particularly in emerging debt

## PUBLIC DEBT (% OF GDP)



Source: IMF, BCRP, MEF and BBVA Research.

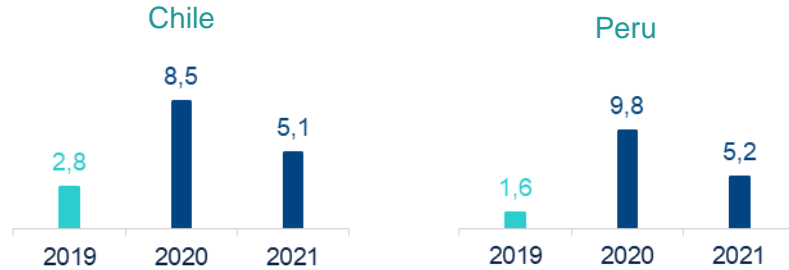
“ Emerging economies face rising interest rates as capital flows ebb  
Financial Times, October 5 ”

“ Emerging economies tap debt markets but risks pile up ahead  
Financial Times, September 27 ”

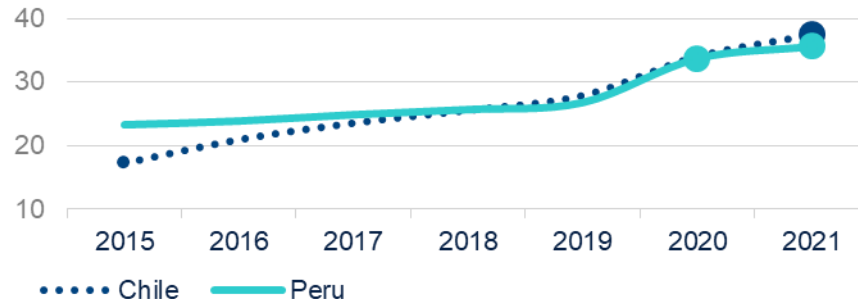
“ Investors are getting pickier in emerging markets  
Financial Times, September 21 ”

# Weakening of public finances and difficulties in implementing future fiscal consolidation process is leading to rating cuts

## FISCAL DEFICIT (% OF GDP)



## GROSS PUBLIC DEBT (% OF GDP)



Source: BCRP, Fitch Ratings and BBVA Research.

- Fitch Rating recently downgraded Chile's sovereign credit rating From "A" (negative outlook) to "A-" (stable outlook)
- The rating downgrade reflects:
  - Weakening of public finances due to recession and increase in social expenditure (upward trend in debt)
  - Economic downturn due to COVID-19
  - Stabilization fund has been significantly reduced.
  - Risk of lower quality public policies
  - Difficulties in consolidating fiscal accounts moving forward due to political uncertainty, elections and social pressures
- Chile's scenario has similarities with what we see here. Therefore, to stabilize the public debt ratio in Peru, the next government will need to implement measures to: (i) raise (structural) revenue, (ii) improve the quality of public expenditure and (iii) accelerate medium-term growth (structural reforms).

# 02

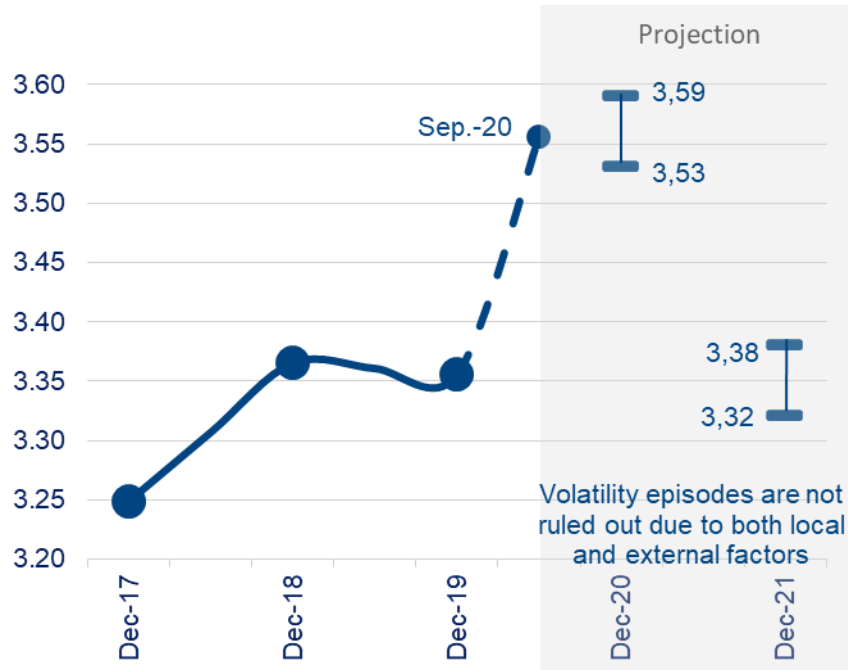
## Quarterly review of macroeconomic forecasts

### 2.3. External sector and exchange rate

# Exchange rate: The PEN is prone to appreciate, but with episodes of volatility due to electoral uncertainty and external shocks

## EXCHANGE RATE

(USD/PEN, DAILY AVERAGE FOR THE MONTH)



Source: BCRP and BBVA Research.

## BALANCE OF TRADE

(USD MILLIONS, ACCUMULATED TWELVE MONTHS)



Source: BCRP and BBVA Research.

# 02

## Quarterly review of macroeconomic forecasts

### 2.4. Inflation and monetary policy

# Inflation: at the lower end of the Central Bank's target range in a context of weak demand

## INFLATION

(YOY % CHANGE IN CPI)



Source: BCRP and BBVA Research.

## Determinants of the 2021 inflation projection

- Rebound of economic activity (10%) reduces the liquidity margin.
- Oil price contracting 30% in 2020 and rising 35% next year (partial transmission at local fuel prices).
- On the downside, the exchange rate is falling.

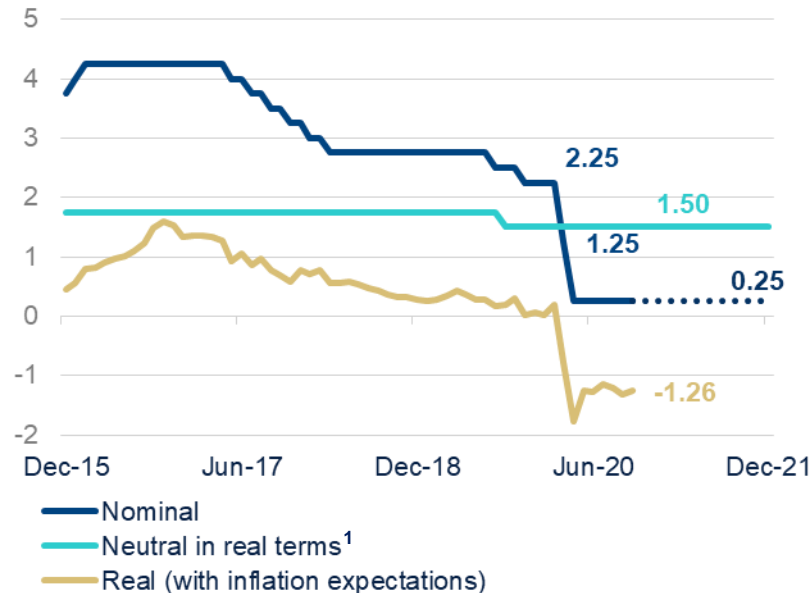
Inflation has found downward resistance in recent months due to transient factors: increased costs (health protocols), a higher exchange rate and climatic anomalies.



# Monetary policy: reference rate at 0.25% until 2022

## REFERENCE INTEREST RATE

(%)



<sup>1</sup> The neutral rate was re-estimated in the September 2019 Inflation Report, from 1.75% to 1.50%. Own estimates point to a value of close to 1.25%, providing less in the way of monetary stimulus. Source: BCRP and BBVA Research.

- In its October statement, the Central Bank reaffirmed its commitment to keep the interest rate at its current level for a prolonged period.
- It also raised its inflation forecast for 2020 and 2021. It now expects inflation to be around the lower limit of the target range.
- We believe that if the stimulus needs to be expanded, forward guidance can be strengthened by linking future rate decisions to an activity or price indicator.

03

# Risks

## Risks regarding the baseline projection scenario go both ways



### External risks

- Additional fiscal and monetary stimuli. ✓
- Greater global policy coordination. ✓
- Fresh virus outbreaks, delayed development/distribution of a vaccine. ✗
- Political, geopolitical and social tensions. ✗
- Macroeconomic imbalances in countries of the region (and contagion). ✗



### Domestic risks

- Higher growth in 2H20 (and higher carry-over 2021). ✓
- Faster local distribution of vaccine in 2021. ✓
- Fresh outbreak of the virus and tightening of isolation measures. ✗
- Greater political, electoral and regulatory uncertainty. ✗
- The aftermath of the second quarter negative shock (e.g. downgrading of sovereign credit rating, financial system robustness). ✗

The balance of risks is up for 2020 and neutral for 2021

# 04

## Summary of projections

# Macroeconomic forecasts: summary

	2018	2019	2020 (p)	2021 (p)
<b>GDP (% chge.)</b>	4.0	2.2	-13.0	10.0
<b>Domestic demand (excluding inventories, % chge.)</b>	3.6	2.9	-10.8	8.2
<b>Private spending (% chge.)</b>	4.0	3.2	-12.8	8.5
Private consumption (% chge.)	3.8	3.0	-9.4	6.3
Private investment (% chge.)	4.5	4.0	-24.7	17.5
<b>Public spending (% chge.)</b>	1.6	1.0	-0.5	6.7
Public consumption (% chge.)	0.1	2.1	6.6	4.2
Public investment (% chge.)	5.6	-1.4	-18.4	15.2
<b>Exchange rate (vs. USD, EOP)</b>	3.37	3.36	3.56–3.59	3.32–3.38
<b>Inflation (% YoY, eop)</b>	2.2	1.9	1.3	1.4
<b>Monetary policy interest rate (% eop)</b>	2.75	2.25	0.25	0.25
<b>Fiscal balance (% GDP)</b>	-2.3	-1.6	-9.8	-5.0
<b>Balance of payments: checking account (% GDP)</b>	-1.7	-1.5	-0.1	-1.0
Exports (USD billion)	49.0	47.7	40.6	48.1
Imports (USD billion)	41.9	41.1	34.6	38.7

(f) Forecast.

Source: BCRP and BBVA Research Peru.

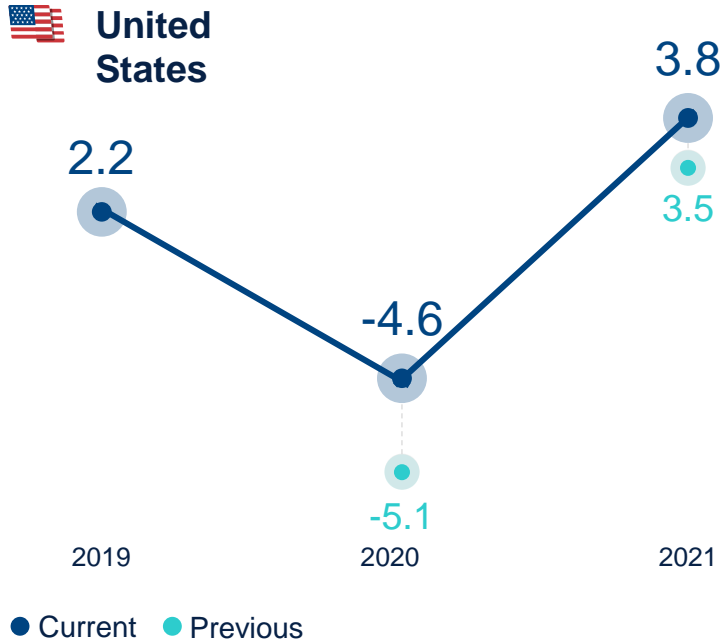
# 05

# Annexes

## United States: faster than expected recovery this year; interest rates will remain low for a long period of time

### GDP: ANNUAL GROWTH

(%)

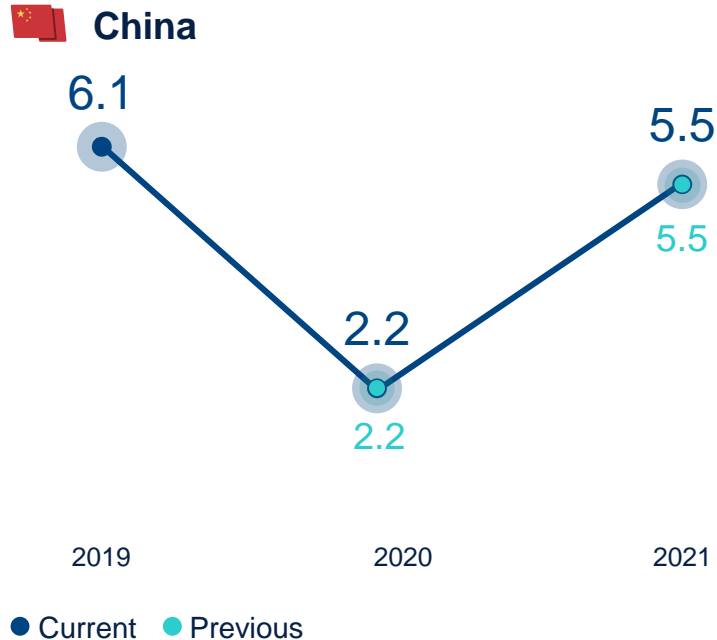


Source: BBVA Research.

- GDP revised upward due to recent data, countercyclical policies and likely relaxation of social distancing.
- Pre-crisis GDP will recover in 2022.
- Labor market: improving quickly, but only partially.
- Rates will remain at their current levels until 2025, considering the Fed's new strategy.
- Uncertainty about new fiscal measures, due to the political environment.
- Inflation: rising due to the rapid recovery in activity and greater tolerance by the Fed.
- Main risks: Covid, elections, fiscal situation of regional governments.

## China: growth forecasts remain unchanged, but recent data and control of the pandemic add an upward bias

### GDP: ANNUAL GROWTH (%)



Source: BBVA Research.

- Activity indicators show a strong recovery of growth.
- Increased economic dynamism and the base effects add an upward bias to the growth forecast for 2021.
- The imbalance between (stronger) supply and (weaker) demand is shrinking, but deflation remains a risk.
- With the consolidation of the recovery, no further stimulus measures are anticipated and a more appreciated exchange rate is expected.
- External risks, such as the relationship with the US, are growing but manageable.



# Eurozone: the increase in infections will slow recovery in the short term, but the NGEU will support growth starting in mid-2021

## GDP: ANNUAL GROWTH

(%)

### Eurozone



● Current ● Previous

Source: BBVA Research.

- The recovery has been surprisingly upward until the start of 3Q20, but will slow down in the coming months due to the increase in infections.
- Regional GDP will return to its pre-crisis level in 2022.
- The NGEU will support growth (around +1 pp per year) between mid-2021 and 2023.
- Inflation will rise, but remain well below the ECB's targets.
- The ECB will keep rates unchanged for a long period of time; further expansion of its purchase program (PEPP) is likely.
- The euro will appreciate more, mainly because of the positive impact of the approved NGEU.

# Peru Economic Outlook

Fourth quarter 2020

October 2020