BBVA Research

Peru Economic Outlook

2Q22

Closing date: April 5

Creating Opportunities

Key points

External background

The conflict between Ukraine and Russia

The conflict between Russia and Ukraine, together with the severe sanctions on Russia that followed, have reinforced both inflationary pressures and the trend to a slowdown of global growth. Uncertainty has risen again globally, to exceptionally high levels.

The supply shock arising from the conflict in the east of Europe is impacting through substantial increases in the prices of raw materials (food, energy). There has also been a tightening of production bottlenecks, confidence has waned, and financial volatility has increased.

Growth

At present, activity continues strong in the U.S., but there are signs of moderation in Europe, while in China the outbreaks of COVID-19 are leading to lockdown measures which are slowing growth.

Key points

External background

Inflation and the central banks

Higher and persistent inflation is deteriorating the purchasing power of families and leading to central banks speeding up the withdrawal of monetary stimuli around the world. The Fed began the cycle of monetary normalization in March with an initial increase in its key rate of 25 bps, with more to follow.

Financial Markets

In the LatAm financial markets, geographically removed from the conflict zone, and with few trade links to countries directly involved, and partly favored by the increase in the prices of raw materials, the negative impact of the conflict was temporary; the most recent data show the downward adjustment in the risk premiums and currencies tending to appreciate, while returns demanded from sovereign bonds have increased in the global environment of the withdrawal of monetary stimuli.

Key messages

Local context

Health situation

Locally, health indicators have once more improved significantly and the third wave of COVID has been left behind. In this context, together with the progress made in vaccination, permitted capacities have returned to normal in several activities. This will help the productive sectors which are more intensive in physical contact.

Economic activity

Despite the significant improvement of health indicators (only temporarily interrupted by the third wave), the GDP has lost its drive since the last quarter of 2021. The seasonally adjusted analysis suggests that economic activity slowed down markedly in the last quarter of last year and, according to our estimates, in the first quarter of 2022 it has slowed even further.

The indicators of economic activity available for February and March confirm the loss of traction. It should be noted that one of the factors affecting growth in the first quarter of the year were social conflicts which disrupted and paralyzed several mining operations.

Labor market

In the labor market, the number of workers in employment has returned to pre-pandemic levels. This is not true of the quality of employment; the rate of sub-employment continues to be high. As a result, the average wage has also not recovered, and this is being aggravated by higher inflation, which is eroding the purchasing power of household incomes.

Key messages

Baseline scenario for forecasts: the external context

The conflict between Ukraine and Russia

The baseline scenario for forecasts considers a less favorable external context than that of three months ago (January), due mainly to the conflict between Russia and Ukraine. There is great uncertainty regarding the outcome of the conflict in the coming weeks (and its impact).

The baseline scenario includes potentially permanent sanctions, but they will not escalate much more. In comparison with previous forecasts, (i) prices of raw materials are expected to be higher, with a tendency to reduce over the year; (ii) more severe and persistent bottlenecks in production; and (iii) financial systems will not suffer significant disruption.

Growth

In this context, the global economy will slow down more than expected: after growing by 6.1% in 2021, global GDP is expected to grow by 4.0% this year and 3.6% next (-0.4 pp and -0.2 pp in each case with respect to the previous forecasts). The downward revision of growth is significant in Europe and moderate in the rest of the geographic areas.

Inflation and the central banks

Inflationary pressures will be more marked than in the previous baseline scenario, above all due to the prices of raw materials, but also because of the bottlenecks. The central banks will maintain the focus on inflation, and thus make swifter progress in the process of withdrawing the monetary stimuli. The Fed will raise its key rate to at least 2% this year and 3% next; its balance sheet will begin to reduce in June. The ECB will begin to raise its rates toward the end of the year.

Key messages

Baseline scenario of forecasts: the local context (I)

Health situation

Health situation: more favorable than that assumed three months ago (projections made in January), which has allowed a quicker than expected return to normal in capacity restrictions. This will provide more support for the productive sectors which until now have been most affected by the isolation measures.

Political context

Political context: it is considered that the probability of implementation of radical economic and political changes has lowered, although tensions between the Government and the opposition remain high. The uncertainty linked to the political environment will continue to affect confidence and lead to caution regarding private spending, but somewhat less than in the previous baseline scenario.

Key messages

Baseline scenario of forecasts: the local context (II)

Economic policies

Economic policies: (i) the monetary policy rate will be higher than in the previous baseline scenario in a context of higher inflation; (ii) in terms of fiscal policy, a process of very gradual consolidation is assumed (at the closing date of this report, the Ministry of Economy and Finance had still not published which will be the parameters followed to boost the macro-fiscal rules), with a gradual reversal of the extraordinary spending measures implemented to tackle the health crisis (transfers to families and acquisitions of equipment and goods linked to health) and with a slump in public investment in 2023, following the sub-national elections (at the end of 2022).

Mining sector

Construction of the mining unit Quellaveco will soon be complete, together with two other medium-sized mines, and it will enter the production phase. Also, it is assumed that the social conflicts will continue to have a negative impact on production in some operations.

Key messages

Baseline scenario: projections

Activity

In this scenario there is a significant deterioration of the external situation, so the growth forecasts for 2022 and 2023 have been revised down from 2.3% to 2.0% in 2022 and from 3.0% to 2.8% in 2023.

On the sector side, in 2022 and 2023 we forecast an expansion of mining production, supported by the start of operations of new copper mines. On the expenditure side, this will be reflected in the growth of exported volumes, despite the deterioration in the external panorama. Meanwhile private investment will contract by 5% this year, in line with a slump in business confidence and a decline in mining investment.

The expansion of mining production and thus in GDP could be higher, but the social conflicts considered in our baseline scenario limit it. If the social conflicts affecting some mining units were resolved, GDP growth would be higher this year by 0.3 pp.

These projections are consistent, according to our estimates, with a potential output growing at a rate of around 2.0% in the medium term and a negative output gap which would be near to closing in 2023.

Key messages

Baseline scenario: projections

Fiscal

The baseline scenario assumes a very gradual process of fiscal consolidation, with a marginal reduction of the deficit in the coming years (compared with the level of 2.6% of GDP recorded in 2021).

This scenario is consistent with income (tax and non-tax revenues) remaining at around 20% of nominal GDP, supported in the short term by the revenue from mining in a context of metal prices at attractive levels. On the expenditure side, the factors considered are the steady reversal of the extraordinary measures implemented to address the health crisis and that public investment will have a slump in 2023, after the sub-national elections (at the end of 2022).

With the expected trend in the fiscal deficit, gross public debt as a percentage of GDP will remain relatively unchanged this year (around a level equivalent to 36% of GDP) but moving forward we forecast that it will continue to rise, and close at 39% in 2027.

A credible process of fiscal consolidation, which allows stabilization of the government debt at manageable levels for the size of the Peruvian economy and its sovereign bond market, will help offset the negative impact of the permanent political noise on the credit rating of the sovereign debt and to preserve its credit rating in the coming years.

According to our estimates, in order to stabilize gross public debt around a level equivalent to 40% of GDP, a primary surplus between 0.0% and 0.2% of GDP is required (in 2021 there was a primary deficit of 1.1% of GDP).

Key messages

Baseline scenario: projections

External

Given the conflict in Eastern Europe and recent developments, export prices are being revised up. The impact of this revision on the total value of exports is offset partially by a lower forecast of volume, in a context of lower growth and higher interest rates around the world compared with our January scenario. Moreover, we have also adjusted import prices up given the impact of the invasion of Ukraine on the price of oil and some key foods (corn, wheat and soy).

As a result, both the terms of trade and the trade balance are similar to the figures forecasted three months ago. In particular, the trade balance surplus would be USD 12.9 billion this year and USD 9.8 billion next.

The current account on the balance of payments will be at around 3.0% of GDP in 2022 and 2023, due to the increased profits generated by non-residents in the extractive sectors (mining, hydrocarbons), which will result in significant repatriation flows which more than offset the surplus of the trade balance.

One of the main sources of finance for the balance of payments current-account deficit will be the foreign public-sector debt, but this will not be sufficient to prevent a decline in international reserves, both this year and next.

Key messages
Baseline scenario: projections

Exchange rate

Although the local currency has had to appreciate this year to date, we forecast that in the coming months the depreciation pressures on the local currency will increase in a context in which the Fed will normalize its monetary position; and locally, the balance of payments current-account deficit will reach a level equivalent to 3% of GDP. The monetary adjustment of the central bank of Peru (BCRP) will moderate these depreciatory pressures.

In this context, we estimate that the local PEN/USD price will close 2022 (daily average for December) at between 3.85 and 3.95 PEN per USD, and in 2023 the price will be between 4.00 and 4.10 PEN per USD.

Inflation

Inflation has recorded a sustained upward trend since June due to increased food and energy prices, and despite the appreciation of the local currency.

The new baseline scenario has international food and fuel prices at high levels for a longer time due to the conflict between Russia and Ukraine. In this context, inflationary expectations will undoubtedly remain high, feeding back into pressure on prices.

Overall, the new baseline scenario has inflation higher in 2022 (5.0%) and 2023 (2.6%).

Key messages

Baseline scenario: projections

Monetary policy rate

The Central Bank has continued to increase its policy rate in recent months at a rate of 50 bps per month. Currently it stands at 4.0%.

We forecast that the adjustments will continue over the coming months and that the policy rate will hit a level of 5.50% in the third quarter of 2022. It is a higher level than what we anticipated in our previous baseline scenario (January) due to the revision in projected inflation (and the impact that higher inflation would probably have on inflationary expectations).

Depending on the behavior of inflationary expectations in the coming months, the level could be even more restrictive.

Moving forward, when inflation is closer to the target range, we forecast that the reference rate will start to move toward a more neutral level (5.0% at the close of 2023).

Key messages
Main risks

External

- Deterioration in the conflict between Russia and Ukraine (and escalation of sanctions), leading to stagflation
- Fed: swifter or disorderly adjustment of its monetary position, causing recession or financial disruption.
- More marked slowdown in China.
- New COVID-19 waves, social tensions, new geopolitical conflicts.

Local

- The Government implements more radical proposals.
- Greater social conflict.
- New coronavirus variants.
- Presidential impeachment? Congress dissolution?
- More positive response of private spending to the lower probability of the implementation of radical measures.

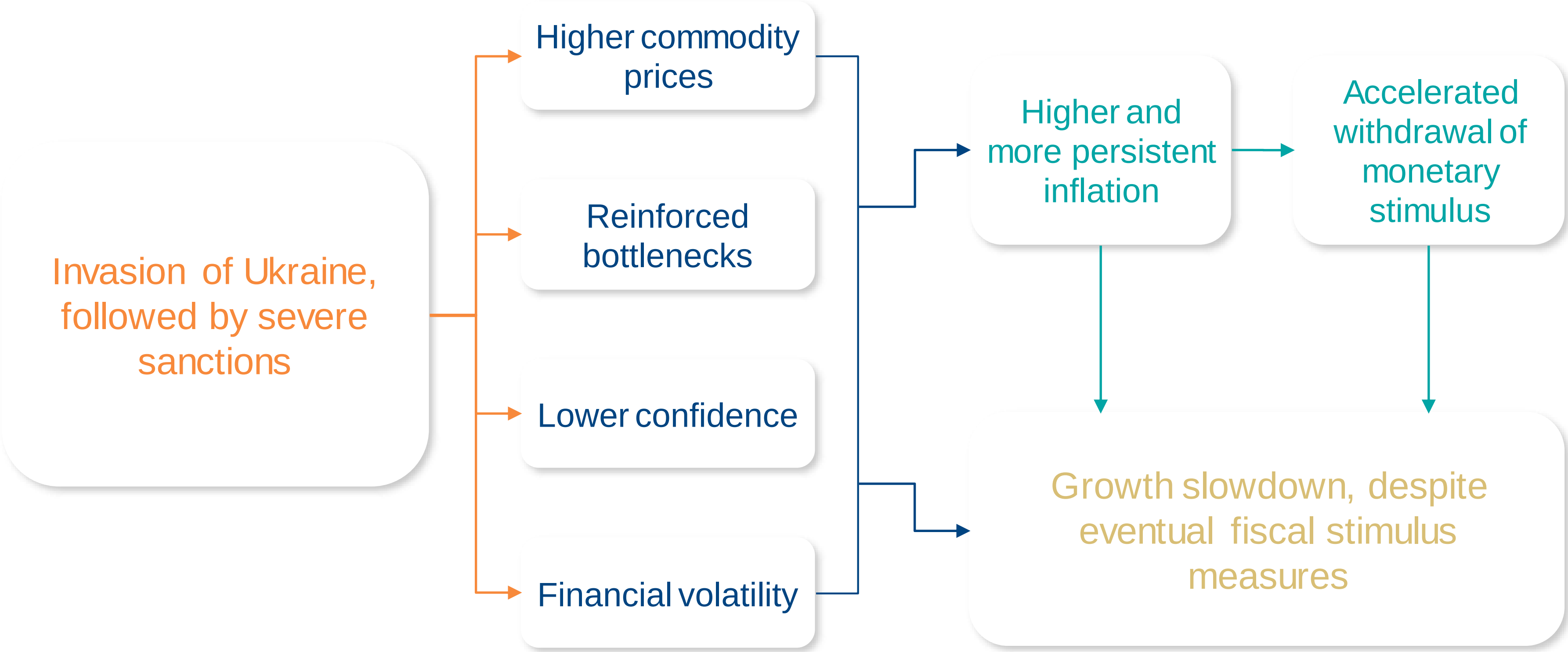
Contents

BBVA Research

01

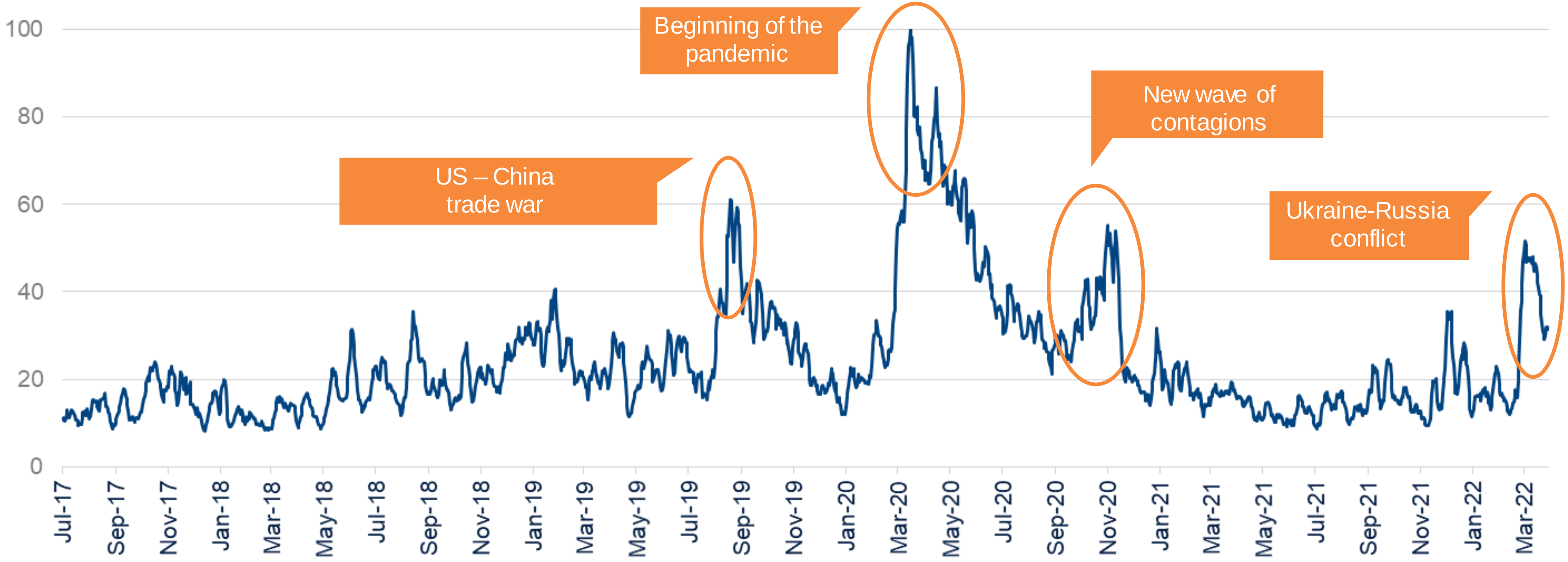
International context: activity and financial markets

The Ukraine-Russia conflict reinforces both inflationary pressures and the moderation trend in activity growth, mainly in Europe



Economic uncertainty, at unusually high levels, once again

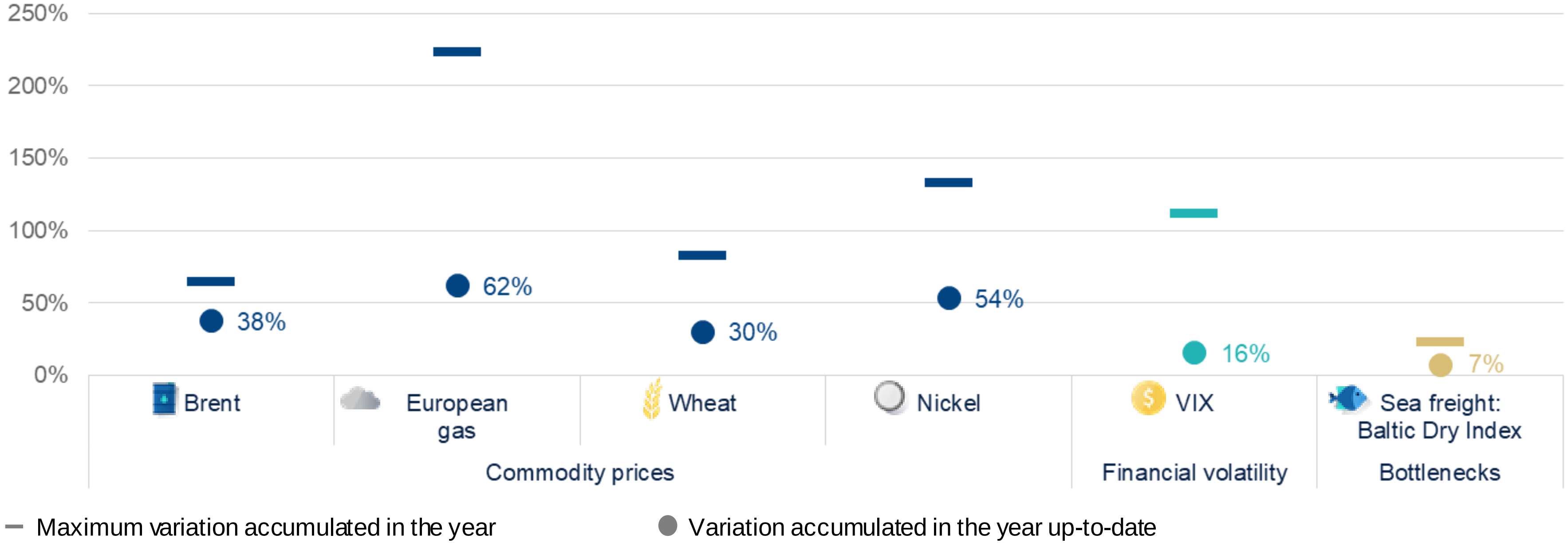
BBVA RESEARCH INDEX DE ECONOMIC POLICY UNCERTAINTY
(INDEX FROM 0 TO 100)



Source: BBVA Research based on data by GDELT.

Sharp rise in commodity prices, financial volatility and signs of further deterioration of supply bottlenecks

SELECTED INDICATORS OF COMMODITY PRICES, FINANCIAL MARKETS AND SUPPLY BOTTLENECKS
(PERCENTAGE CHANGE ACCUMULATED IN THE YEAR UP TO MARCH 31ST, 2022)

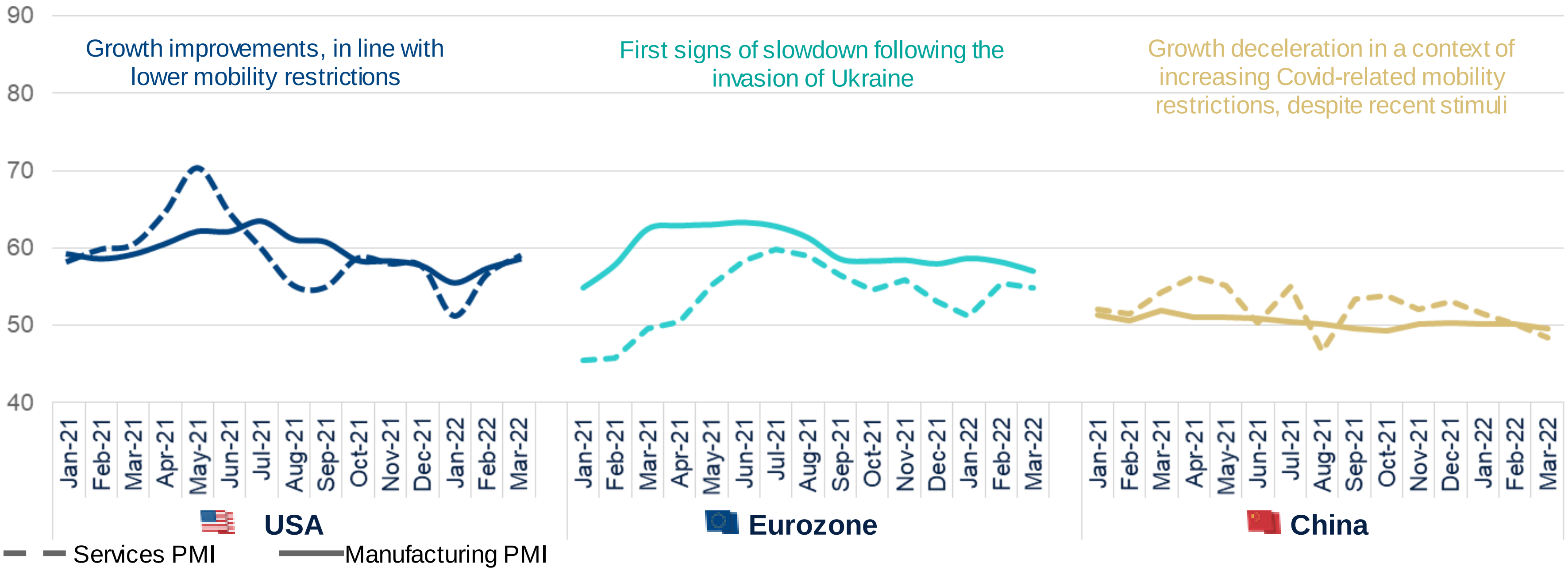


Source: BBVA Research based on data by Haver.

Activity moderates in Europe and exhibits resilience in the US, following the invasion of Ukraine, while it slows in China amid increasing Covid restrictions

PMI INDICATORS

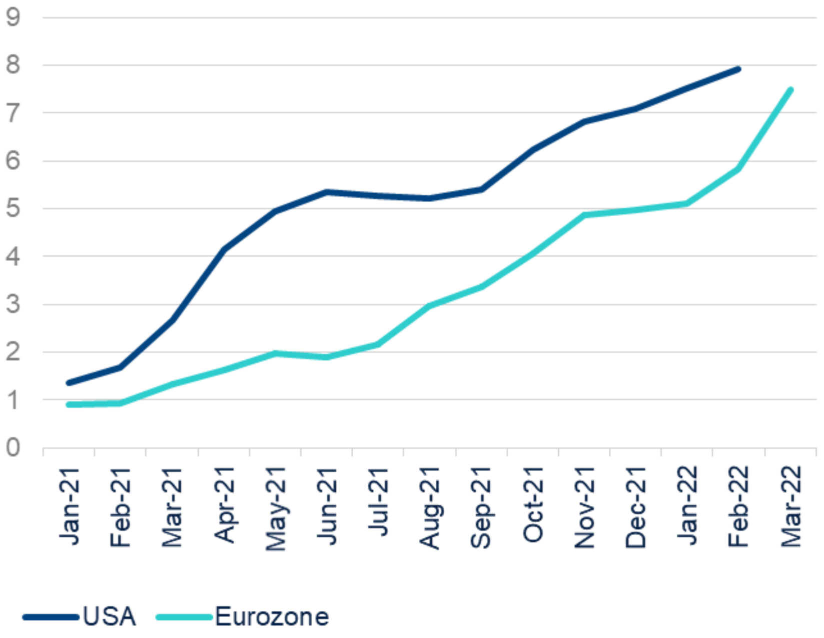
(HIGHER THAN 50: EXPANSION; LOWER THAN 50: CONTRACTION)



Source: BBVA Research based on data by Haver.

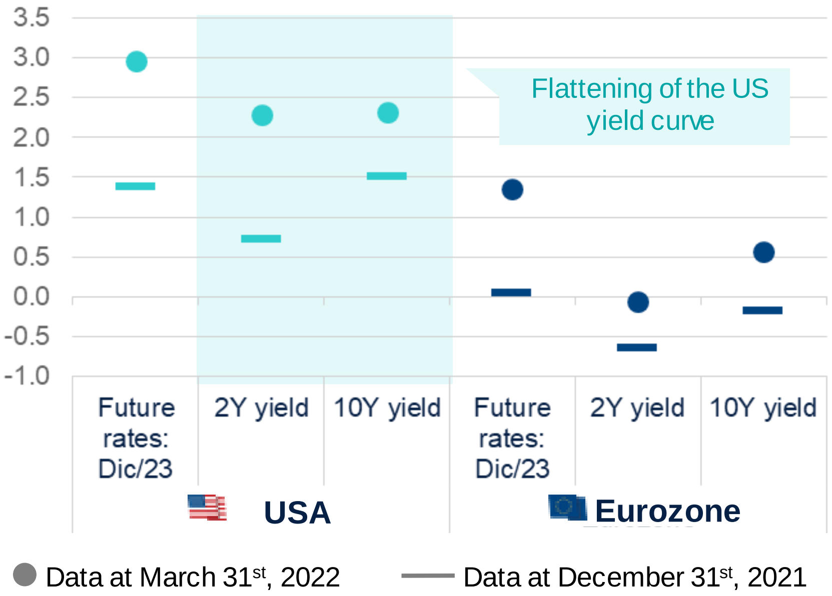
Given the increase in inflationary pressures, expectations of monetary tightening ahead have been reinforced

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on local statistics.

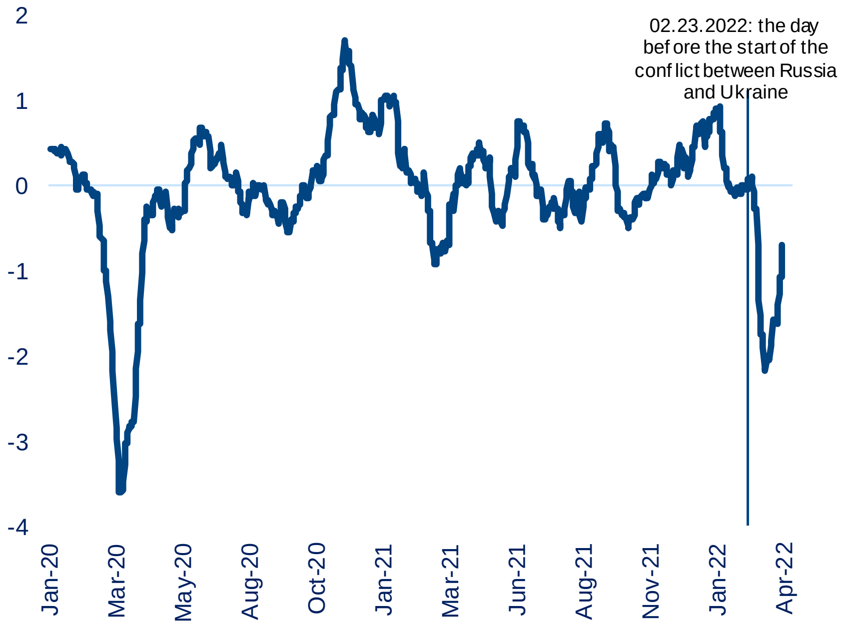
POLICY RATES: MARKET EXPECTATIONS; SOVEREIGN BOND YIELDS *
(%)



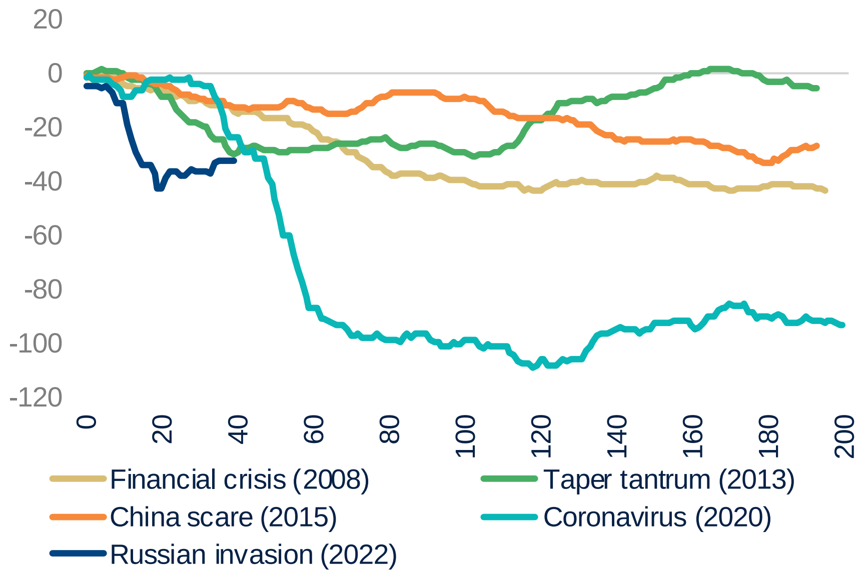
*: Market expectations for policy rates in Dec/23 implicit in future contracts. Eurozone yields: German bond yields. .
Source: BBVA Research based on data by Bloomberg.

This environment saw major capital outflows from emerging economies, although with a recent partial reversion

CAPITAL FLOWS TO EMERGING COUNTRIES [1]
(USD BILLIONS, MOVING 28-DAY AVERAGE)



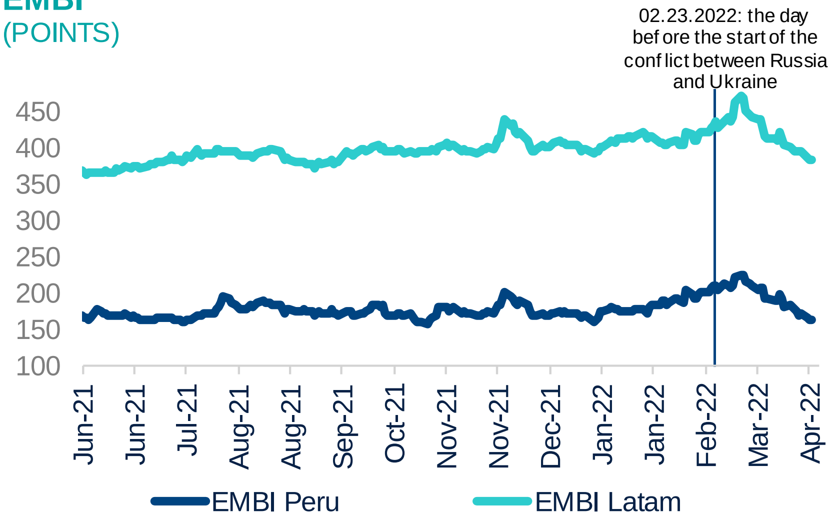
CAPITAL FLOWS TO EMERGING COUNTRIES [1]
(USD BILLIONS, CUMULATIVE TOTAL SINCE THE START OF TURBULENCE)



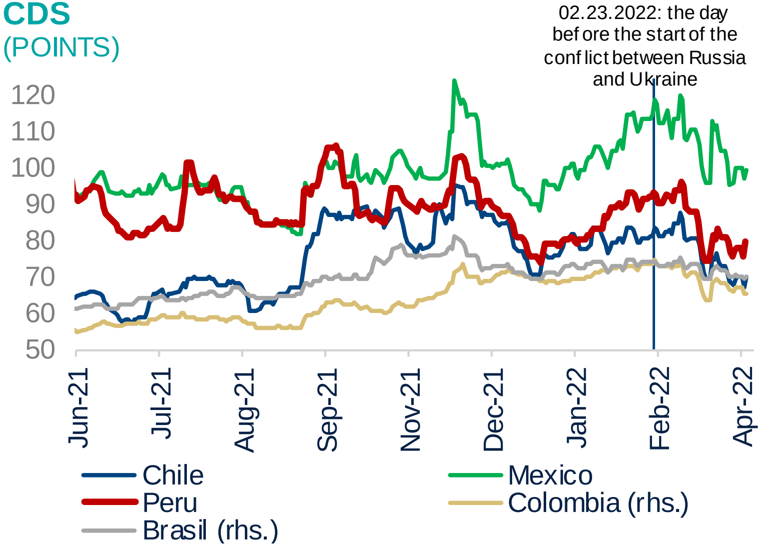
1: Includes bonds and shares. Information at April 4.
Source: BBVA Research based on IIF data.

In LatAm, which is not as exposed to the conflict and boosted by the rise in commodity prices, the impact on financial markets is only temporary...

EMBI
(POINTS)



CDS
(POINTS)



EMBI

Variation in basis points	EMBI LatAm	Peru
Cumulative YTD	-15	9
04.05.2022 vs 02.23.2022	-49	-8

CDS

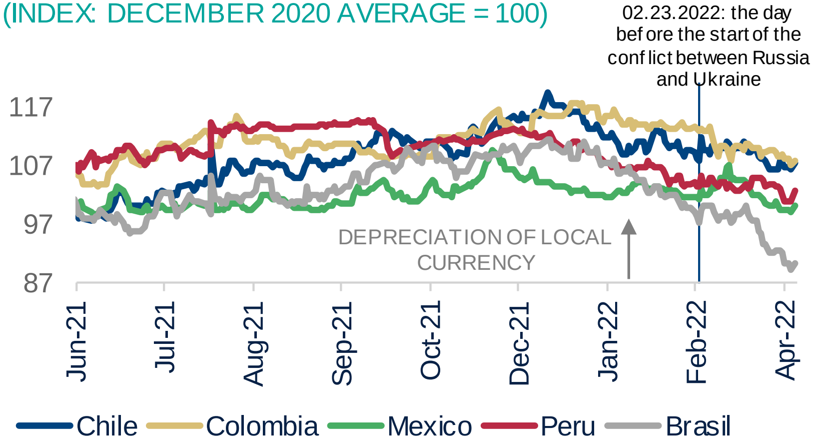
Variation in basis points	Chile	Peru	Mexico	Brazil	Colombia
Now (05.04.2022) vs End 2021 (31.12.2022)	-1	4	10	1	-22
Now (05.04.2022) vs 2.23.2022	-13	-14	-19	-24	-48

Source: BBVA Research based on Investing and Bloomberg data.

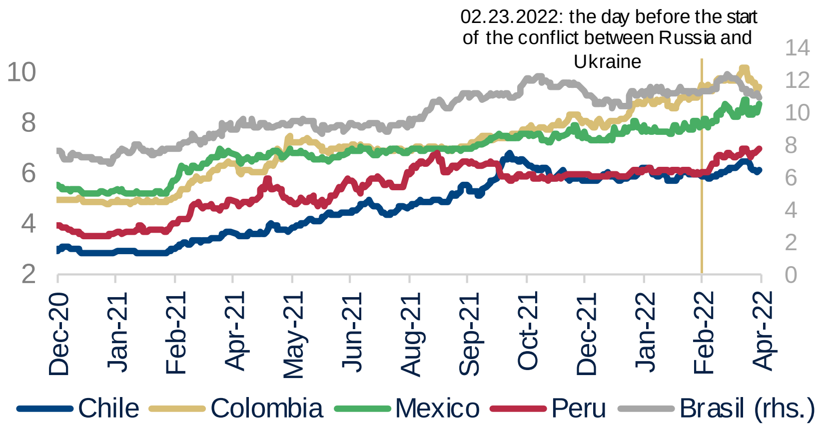
... with currencies even gaining against the USD, although sovereign yields are increasing due to the withdrawal of monetary stimuli

LATAM: LOCAL CURRENCIES VS USD

(INDEX: DECEMBER 2020 AVERAGE = 100)



LATAM: 10-YEAR SOVEREIGN BOND YIELD (%)



LATAM: LOCAL CURRENCIES VS USD

Var.%	Chile	Mexico	Peru	Colombia	Brazil
Now (04.05.2022) vs End 2021 (12.31.2021)	-7,7%	-2,6%	-7,6%	-8,3%	-16,6%
Now (04.05.2022) vs 02.23.2022	-0,4%	-1,2%	-1,0%	-4,4%	-7,1%

LATAM: VARIATION IN 10-YEAR SOVEREIGN BOND YIELD

(Basis points)	Brazil	Chile	Colombia	Mexico	Peru
Now (04.05.2022) vs End 2021 (12.31.2021)	48	35	127	120	104
Now (05.04.2022) vs 02.23.2022	-25	16	15	91	96

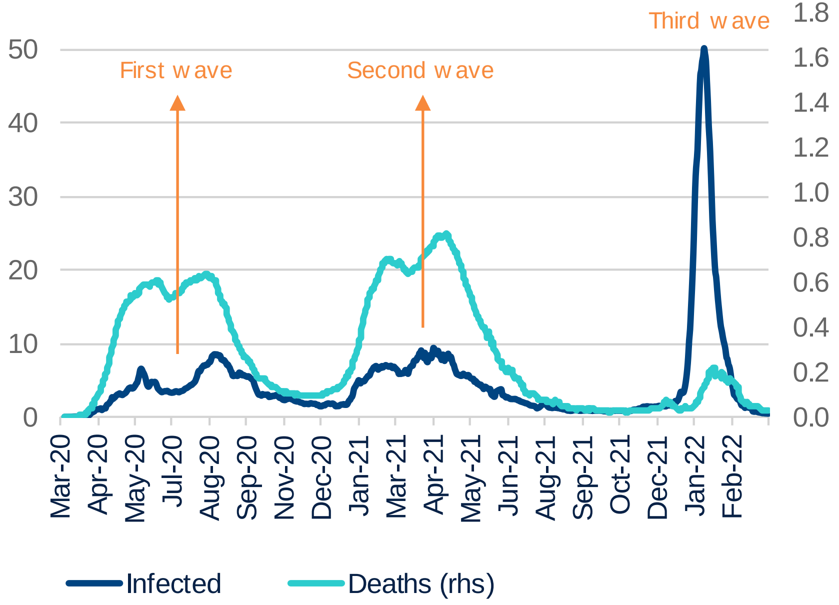
Source: BBVA Research based on Investing and Bloomberg data.

02

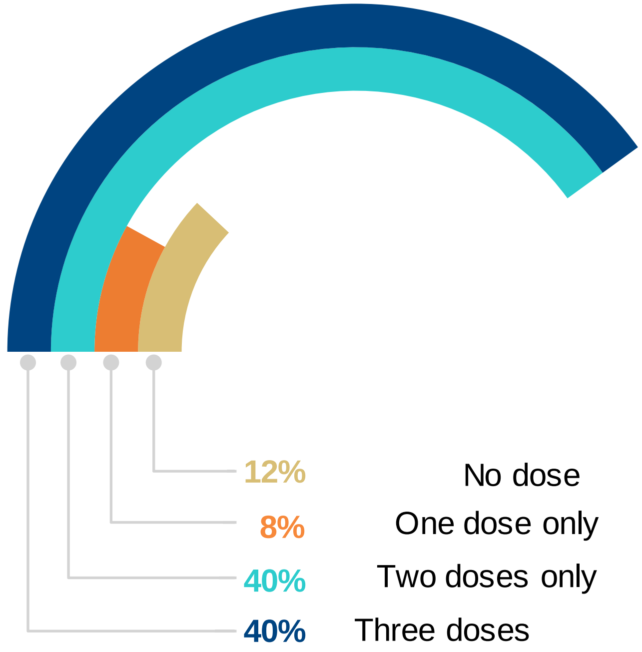
Local context: activity, employment and financial markets

On the health side, the indicators show that the third wave is behind us, while the vaccination process continues to make progress

PERU. COVID-19: NEW INFECTIONS AND DEATHS[1]
(THOUSANDS OF PEOPLE PER DAY, 7-DAY MOVING AVERAGE)



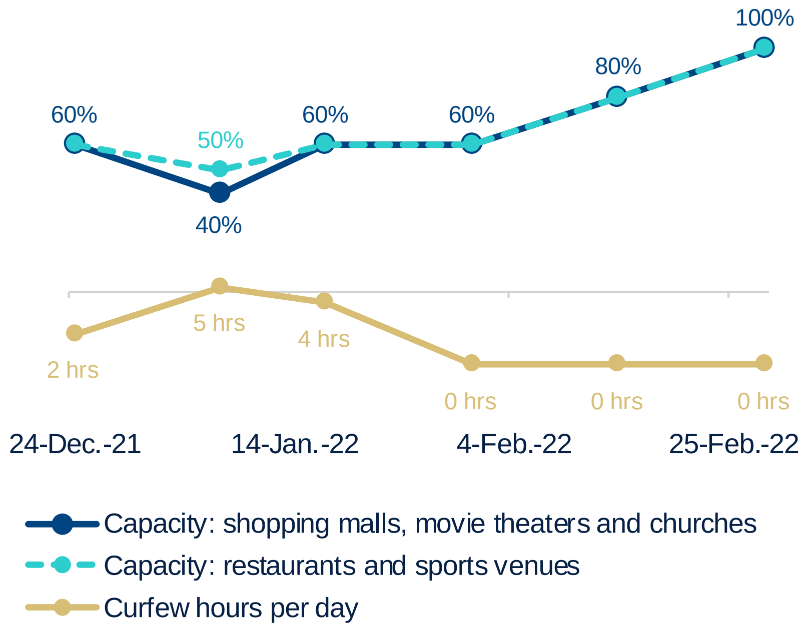
PERU. PROGRESS IN THE VACCINATION PROCESS[1,2]
(% OF THE TARGET POPULATION)



1: Information at April 3. 2: The target population (people aged 5 years and over) is almost 33 million.
Source: BBVA Research based on Ministry of Health data.

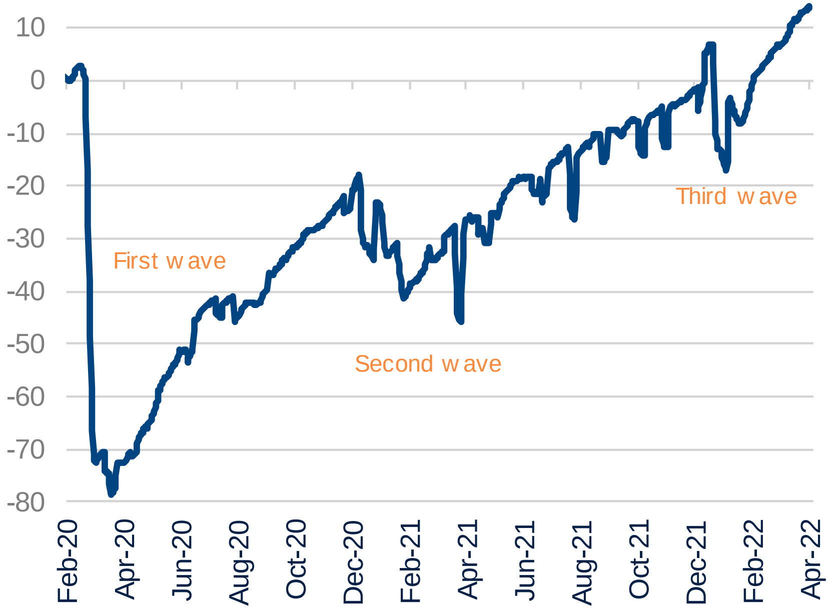
The economic impact of the third wave was limited, and after it capacity constraints and indicators of mobility have normalized

PERMITTED CAPACITIES AND EXTENSION OF THE CURFEW
(%; HOURS PER DAY)



Source: BBVA Research based on Ministry of Health data.

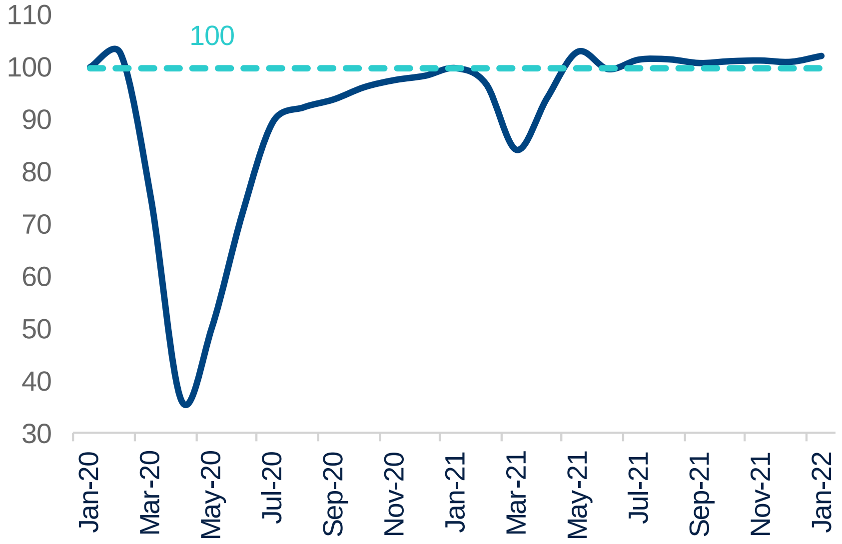
MOBILITY OF PEOPLE TO PLACES OF WORK
(INDEX: 0 = PRE-PANDEMIC SITUATION)



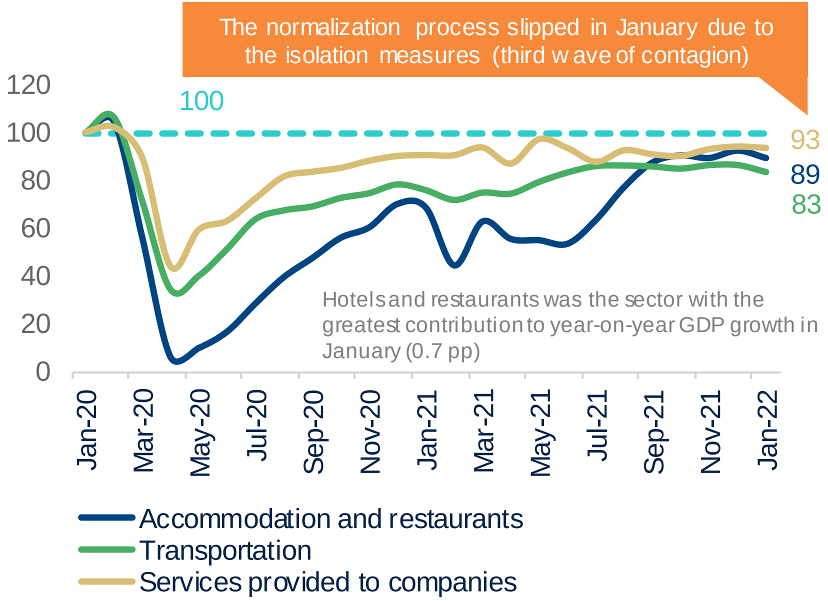
1: Information as at April 2.
Source: Google Mobility.

This boosted productive activity in sectors whose operations require greater physical contact

SECTORAL GDP: RETAIL
(INDEX: 100 = LEVEL IN SAME PRE-PANDEMIC MONTH [1])



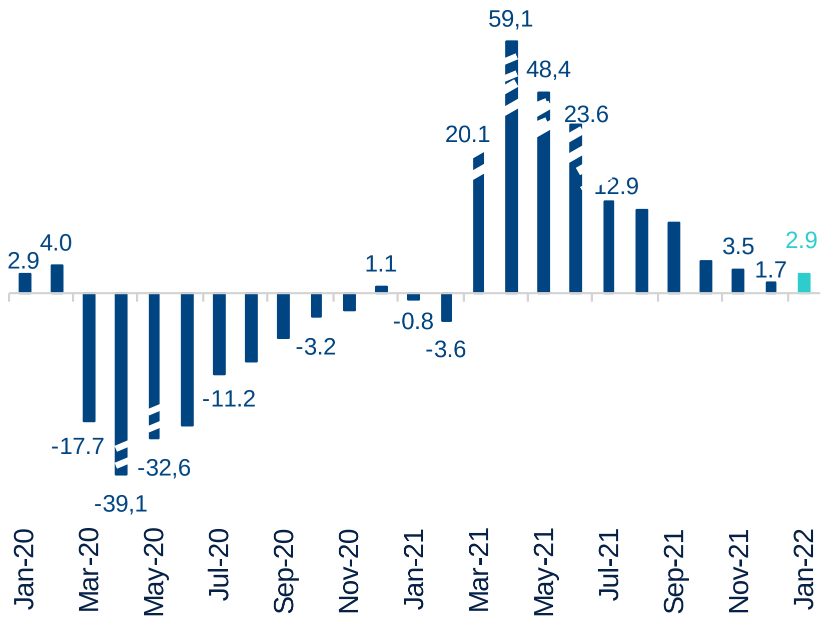
SECTORAL GDP: OTHER SECTORS
(INDEX: 100 = LEVEL IN SAME PRE-PANDEMIC MONTH [1])



1: The pre-pandemic period is considered that from February 2019 to January 2020.
Source: BBVA Research based on INEI data.

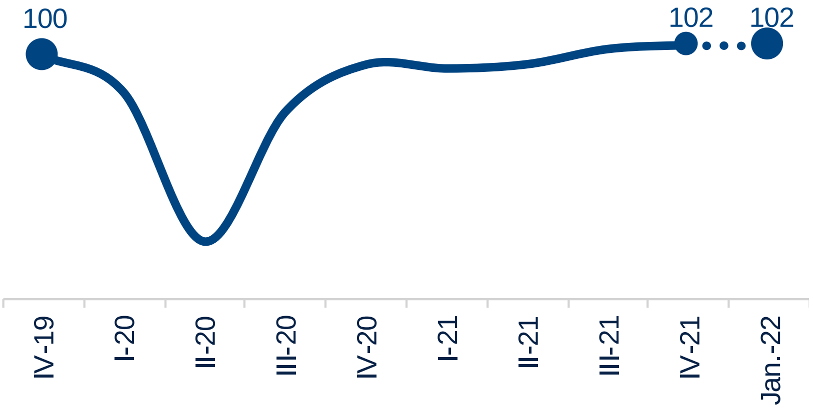
Despite the limited impact of the third wave, GDP has lost its dynamism in recent months

GDP
(% YEAR-ON-YEAR VAR.)



Source: BBVA Research based on INEI data.

SEASONALLY ADJUSTED GDP
(INDEX: 4Q19 = 100)

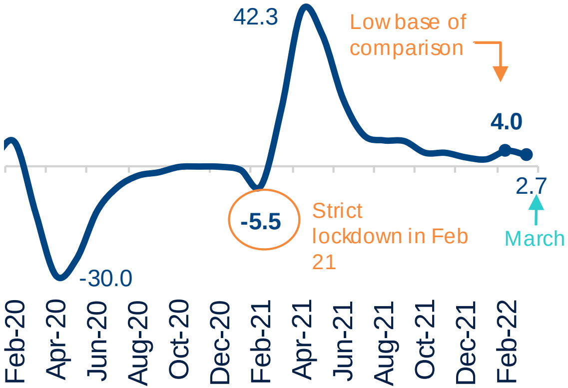


	IV-19	I-20	II	III	IV	I-21	II	III	IV	e-22[1]
Seasonally adjusted GDP (4Q19 = 100)	100	94	69	91	99	98	99	101	102	102
Quarterly % var.		-6.0	-26.1	30.6	8.6	-0.6	0.7	2.5	0.6	0.03

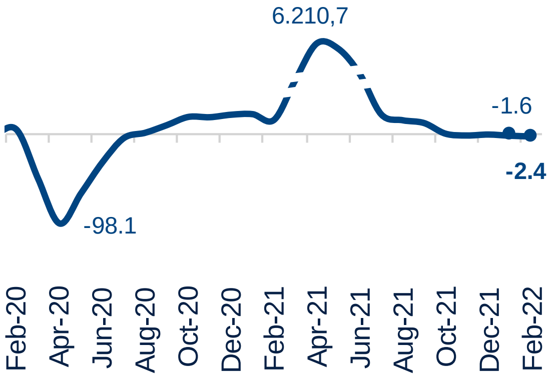
1: Variation, January 2022 compared with the fourth quarter of 2021.
Source: BBVA Research based on BCRP data.

The available indicators of activity suggest that this weakness remained in February and March

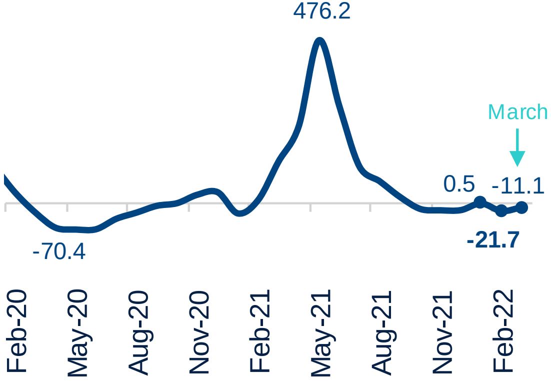
ELECTRICITY PRODUCTION
(YEAR-ON-YEAR % VAR.)



DOMESTIC CEMENT CONSUMPTION
(% YEAR-ON-YEAR VAR.)



PUBLIC INVESTMENT
(% YEAR-ON-YEAR VAR.)



(% VAR. ON PRE-PANDEMIC SITUATION)

Nov 21 / Nov 19	3.2
Dec 21 / Dec 19	1.8
Jan 22 / Jan 20	0.5
Feb 22 / Feb 20	-1.8

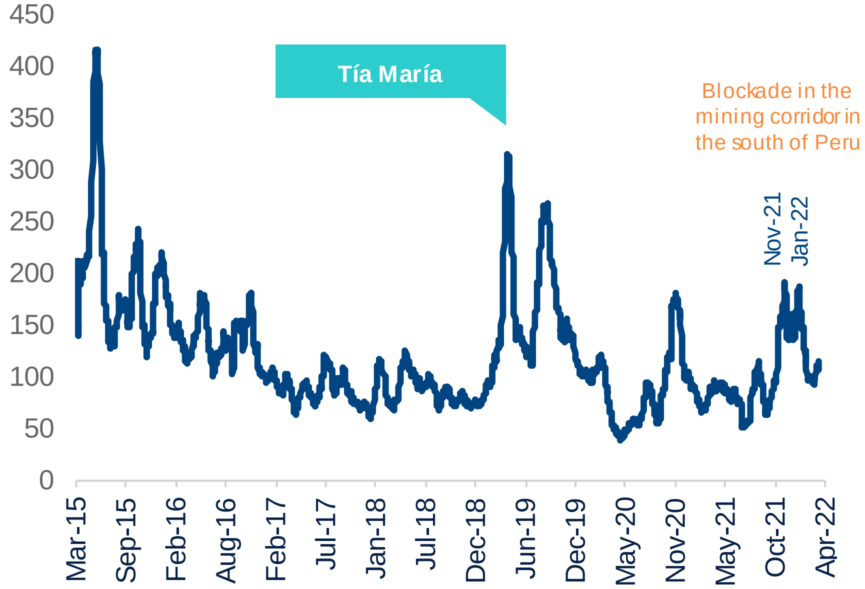
Nov 21 / Nov 19	17.2
Dec 21 / Dec 19	21.2
Jan 22 / Jan 20	20.1
Feb 22 / Feb 20	13.1

Nov 21 / Nov 19	1.2
Dec 21 / Dec 19	7.8
Jan 22 / Jan 20	-28.4
Feb 22 / Feb 20	-13.5

Source: BBVA Research based on BCRP data.

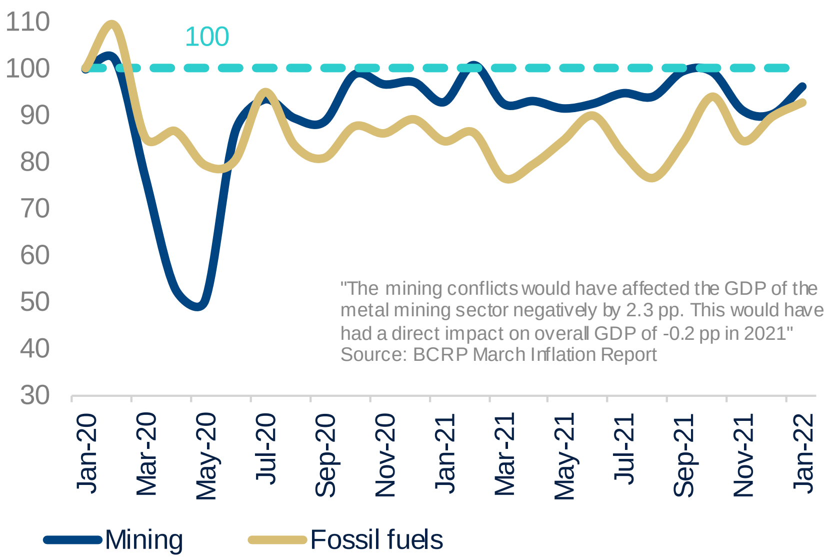
Greater social conflict is one of the factors that explain the loss of dynamism

SOCIAL CONFLICTS IN MINING: MENTIONS IN THE MEDIA (INDEX: DEC.19 AVERAGE = 100)



Source: BBVA Research based on GDELT data.

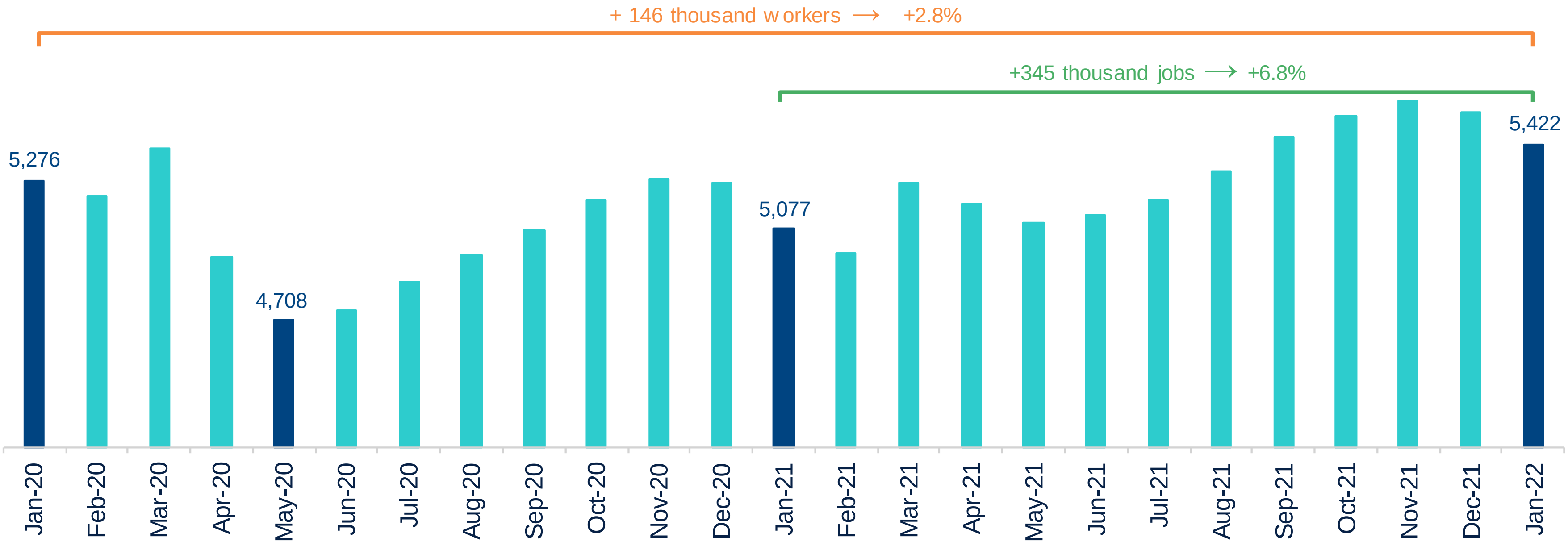
SELECTED EXTRACTIVE SECTORS (INDEX: 100 = LEVEL IN SAME PRE-PANDEMIC MONTH [1])



1: The pre-pandemic period is considered that from February 2019 to January 2020.
Source: BBVA Research based on INEI data.

In the labor market, formal employment at national level is above the pre-pandemic levels, but...

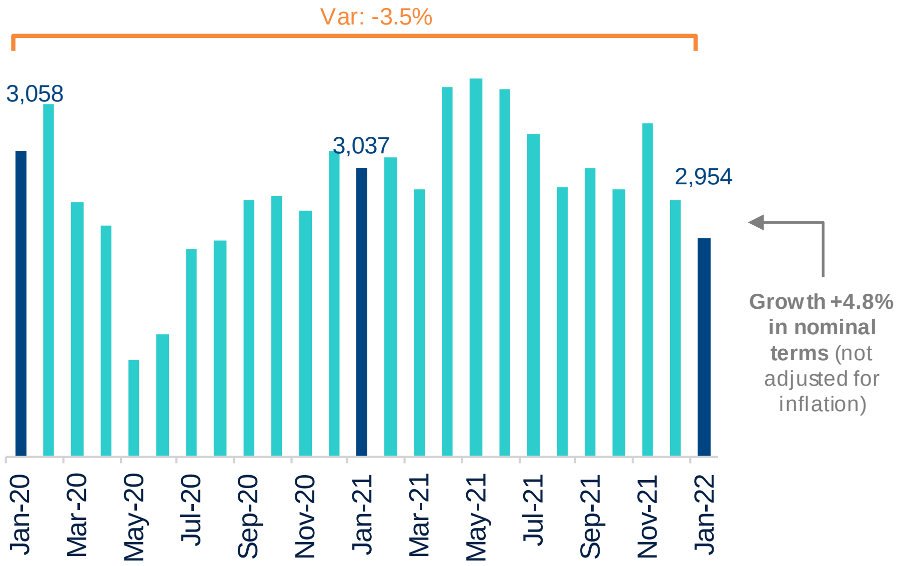
FORMAL EMPLOYMENT
(THOUSANDS OF JOBS)



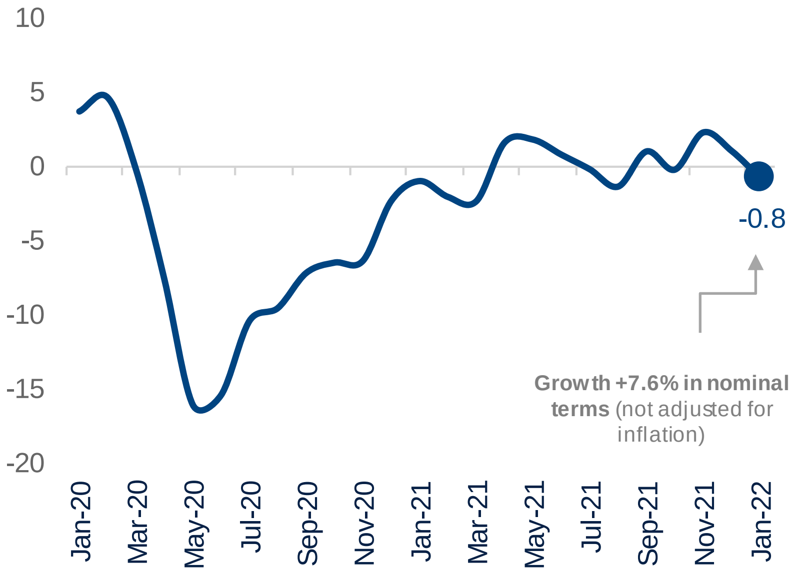
Source: SUNAT (spreadsheets, December data are preliminary) and BCRP. Creation: BBVA Research.

… inflation has eroded the purchasing power of wages, and the total wage bill has not recovered yet in real terms

MONTHLY WAGE INCOME IN FORMAL JOBS [1]
(AT CONSTANT JANUARY 2022 PEN)



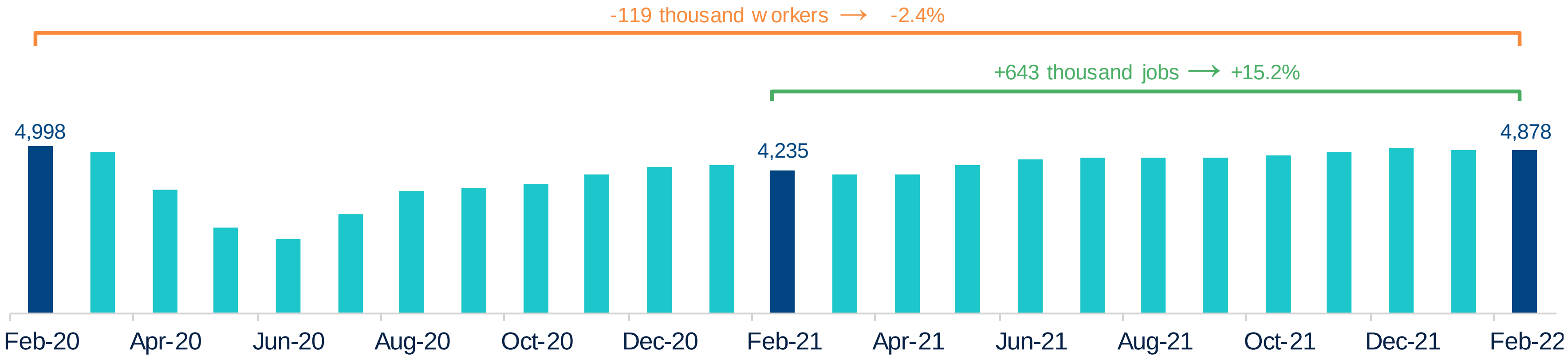
TOTAL WAGE BILL OF FORMAL JOBS [2]
(% VAR. WITH RESPECT TO PRE-PANDEMIC LEVELS, SERIES ADJUSTED FOR INFLATION)



1: seasonally adjusted series
2: The total wage bill is calculated by multiplying the number of jobs by wage income.
Source: SUNAT (spreadsheets, December data are preliminary) and BCRP. Creation: BBVA Research.

In Lima, the employed EAP is still below pre-pandemic levels and there has been a deterioration in the quality of employment

EAP IN EMPLOYMENT IN LIMA
(THOUSANDS OF PEOPLE, 3-MONTH MOVING AVERAGE)



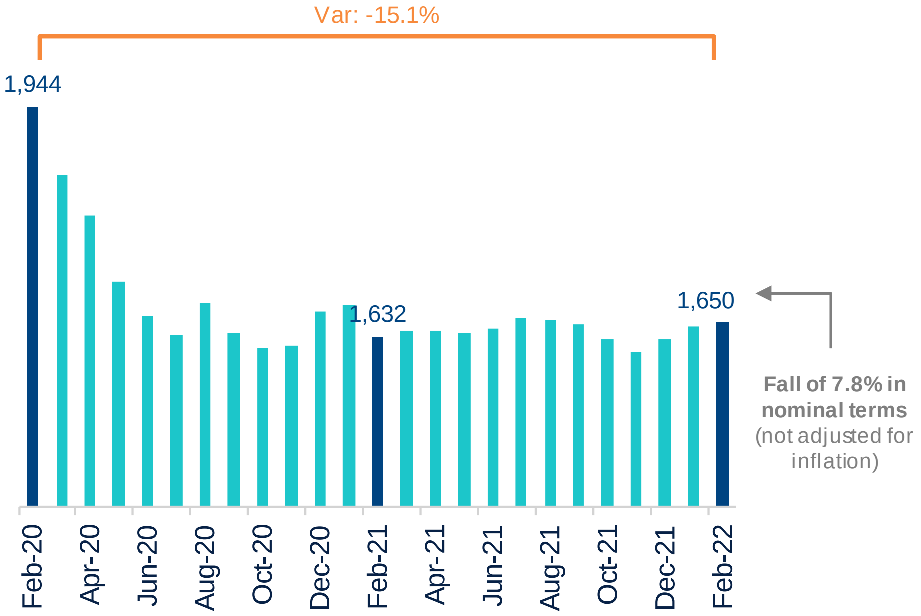
RATE OF SUB-EMPLOYMENT
(% EAP IN EMPLOYMENT IN LIMA)

Avg. 2019	Feb 20	Jun-20	Sep-20	Dec 20	Feb 21	Jun 21	Sep 21	Dec 21	Feb 22
36	**37**	44	55	48	51	50	47	46	**45**

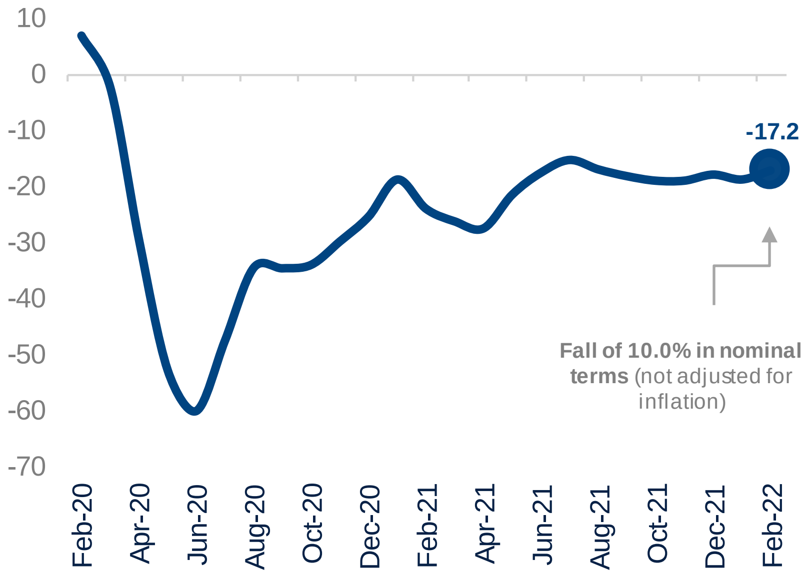
Source: INEI (EPE). Creation: BBVA Research

As a result of the above (employment still not recovered and lower quality) and inflation, real incomes have declined substantially

MONTHLY WAGE INCOME IN LIMA
(AT CONSTANT PEN, FEBRUARY 2022, 3-MONTH MOVING AVERAGE)



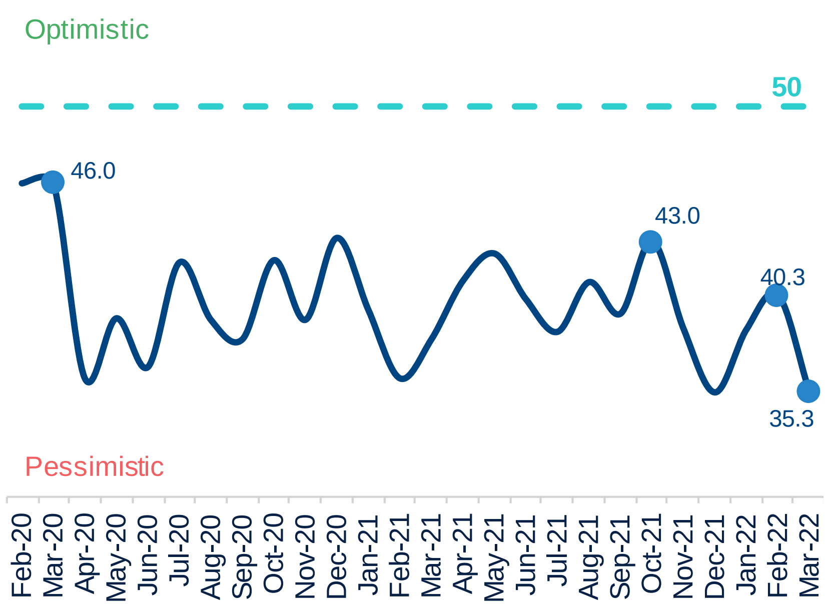
TOTAL WAGE BILL IN LIMA[1]
(% VAR. WITH RESPECT TO PRE-PANDEMIC LEVELS, SERIES ADJUSTED FOR INFLATION, 3-MONTH MOVING AVERAGE)



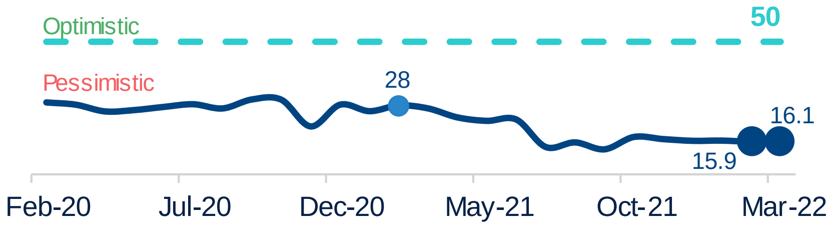
1: The total wage bill is calculated by multiplying the number of workers by wage income.
Source: INEI (EPE). Creation: BBVA Research

With the slowdown in activity and the loss of purchasing power of wages, consumer confidence remains in pessimistic territory...

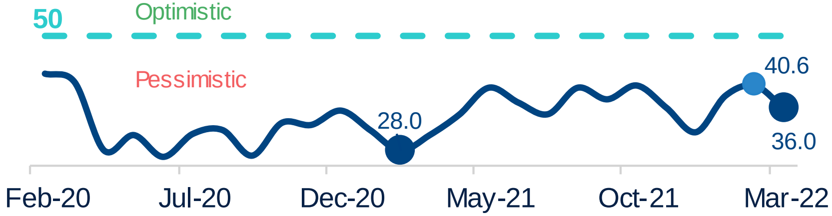
CONSUMER CONFIDENCE
(POINTS)



CONSUMER PERCEPTION ON PRICES
(POINTS)



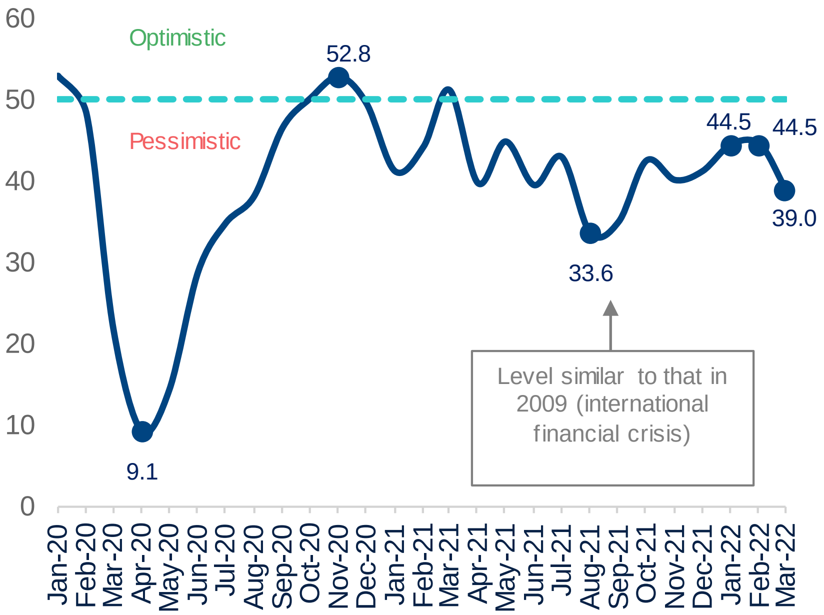
CONSUMER PERCEPTION OF EASE OF FINDING A JOB
(POINTS)



Source: BBVA Research based on Apoyo consultancy.

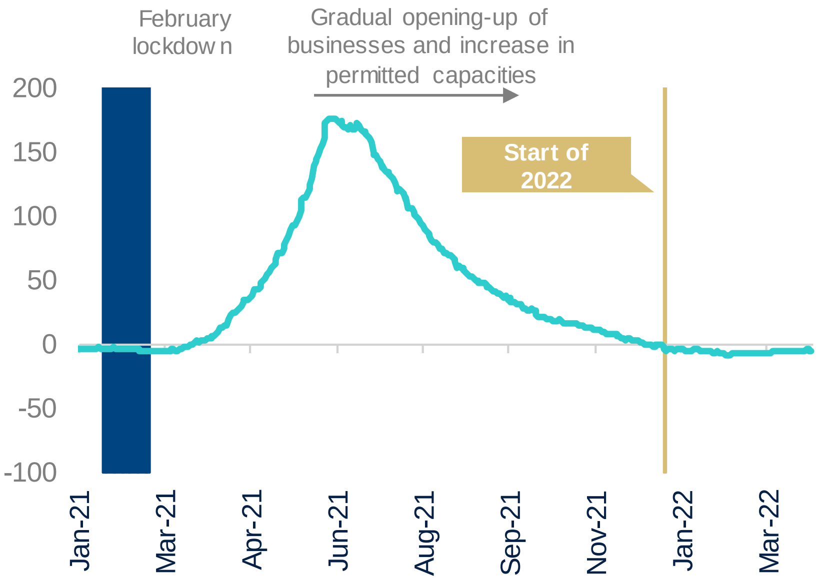
Business confidence is also trapped in the pessimistic range, which is consistent with the weakness of investment indicators

BUSINESS CONFIDENCE
(POINTS)



Source: BBVA Research based on BCRP data.

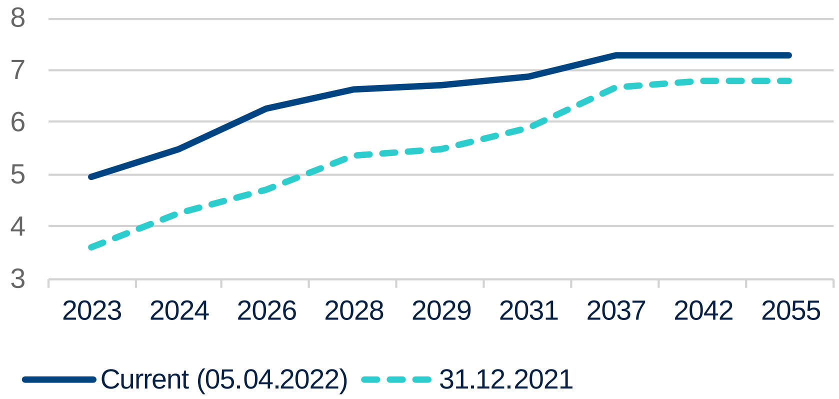
BBVA BIG DATA INVESTMENT INDEX[1]
(IN REAL TERMS, 3-MONTH MOVING AVERAGE, % YEAR-ON-YEAR VAR.)



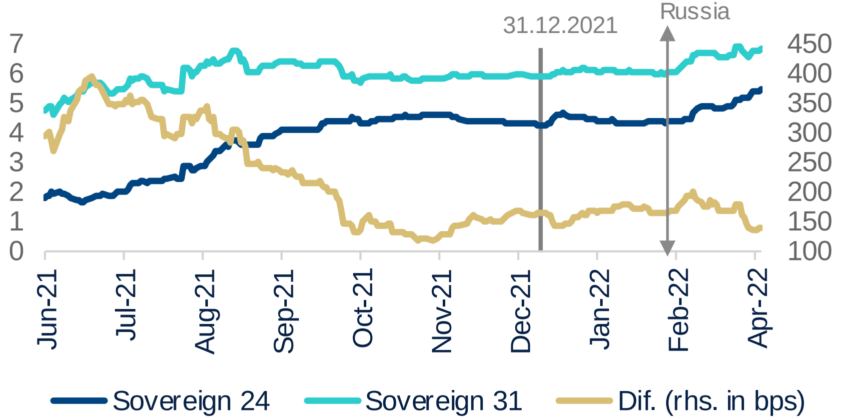
1: Uses information on payments into accounts of selected companies.
Source: BBVA Research based on BBVA data.

In the local financial markets, sovereign bond yields have increased YTD

SOVEREIGN BOND YIELD CURVE (%)



SOVEREIGN BOND YIELDS (%)



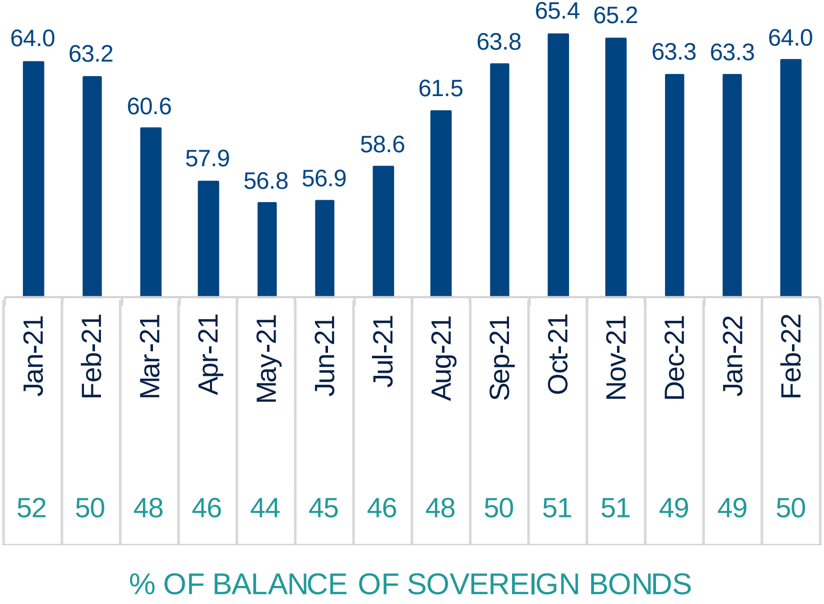
SOVEREIGN BOND YIELDS (%)

	2023	2024	2026	2028	2029	2031	2037	2042	2055
End of 2021 (12.31.2021)	3,62	4,25	4,71	5,36	5,49	5,90	6,67	6,79	6,81
Now (04.05.2022)	4,95	5,48	6,24	6,64	6,73	6,87	7,27	7,28	7,30
Now vs End of 2021 (bps)	**133**	**123**	**154**	**128**	**124**	**97**	**60**	**49**	**49**

Source: BBVA Research based on Bloomberg data.

In the local financial markets, sovereign bond yields have increased YTD

SOVEREIGN BOND HOLDINGS BY NON-RESIDENTS
(PEN BILLIONS)



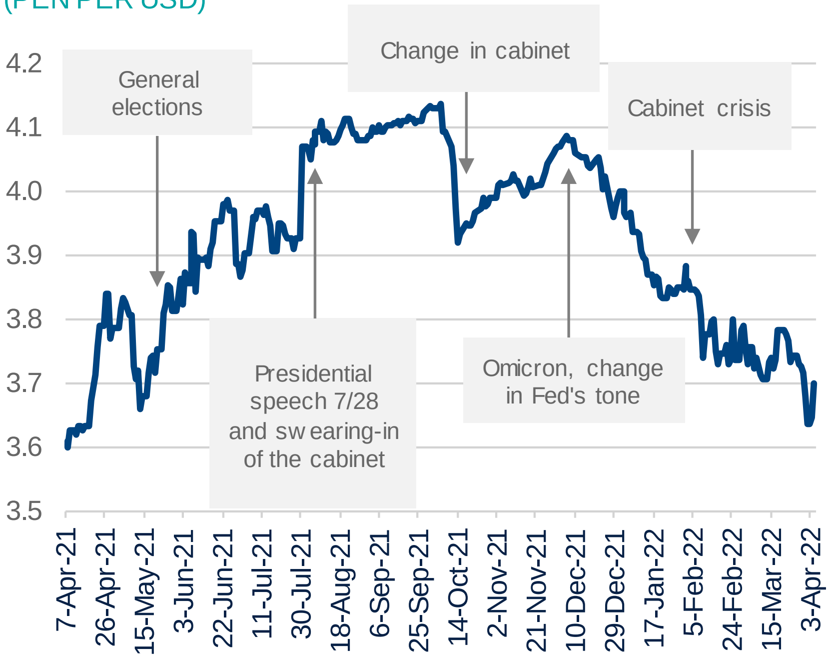
Yields demanded from sovereign bonds increased in an environment of...

1. Central Bank of Peru monetary adjustment.
2. Fed's adjustment of monetary position.
3. Conflict between Ukraine and Russia

Source: BBVA Research based on MEF data.

Meanwhile, the local currency has strengthened, supported by the local monetary adjustment, the high trade surplus and seasonal factors

EXCHANGE RATE
(PEN PER USD)



Source: BBVA Research based on Bloomberg data.

Supports for the PEN...

- Seasonal factors (payment of income tax)
- Interest-rate differential in favor of the PEN
- Strong trade surplus and metal prices
- Improvement of fiscal accounts
- Lower perceived likelihood of the implementation of extreme political and economic measures

Appreciation of the local currency, despite: (i) start of the Fed's monetary adjustment, (ii) intense local political noise, and (iii) downgrade of sovereign rating

BBVA Research

03

Macroeconomic forecasts

3.1. GDP and economic activity

Key assumptions on the external front

The Russia-Ukraine conflict

The baseline scenario for forecasts considers a less favorable external context than that of three months ago (January), due mainly to the conflict between Russia and Ukraine.

High level of uncertainty regarding the future of the conflict in the coming weeks (and impact).

Assumption of potentially permanent sanctions (but not escalated much more), with the greatest economic cost in 2022.

In comparison with the previous baseline scenario (January): (i) higher commodity prices, with a tendency to decline over the year; (ii) greater and persistent bottlenecks in production; and (iii) financial systems which will not suffer significant disruption.

Economic growth

The global economy will slow down more than expected: after growing by 6.1% in 2021, global GDP is expected to grow by 4.0% this year and 3.6% next (-0.4 pp and -0.2 pp in each case with respect to the previous forecasts). Downward revision of growth is significant in Europe and moderate in the rest of the geographic areas.

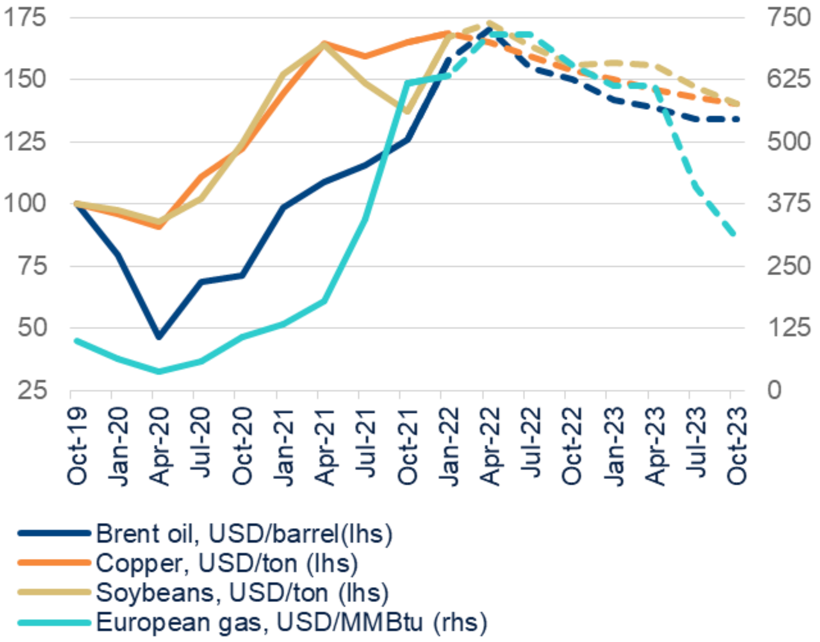
Inflation and the central banks

Inflationary pressures will be more acute than in the previous baseline scenario, above all due to the prices of raw materials, but also the bottlenecks.

The central banks are expected to maintain the focus on inflation, and thus make quick progress in the withdrawal of monetary stimuli. The Fed will raise its key rate to at least 2% this year and 3% next; the balance sheet will begin to decline in June. The ECB will begin to raise rates toward the end of the year.

The war represents a significant supply shock, with negative economic effects mainly through higher commodity prices

COMMODITY PRICES: FORECASTS
(4Q19 AVERAGE= 100, QUARTERLY AVERAGE)



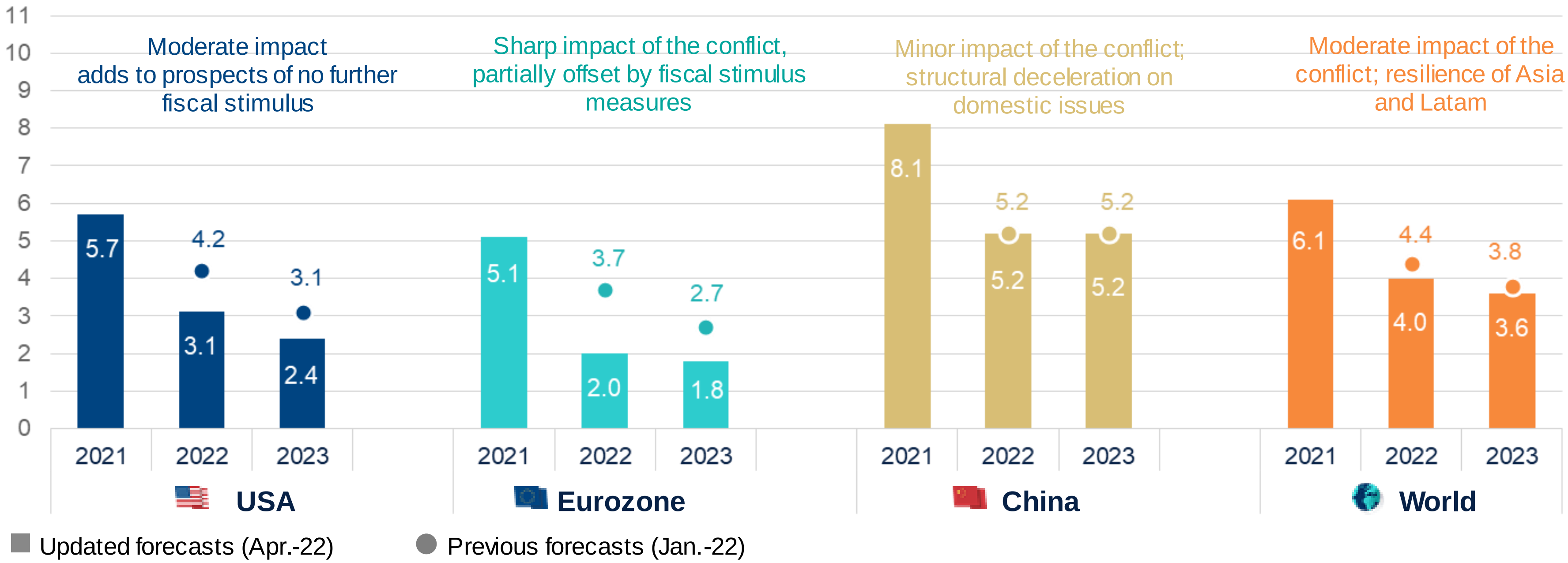
Source: BBVA Research.

- Base economic scenario in an environment of high uncertainty: moderation in growth and higher inflation, mainly in Europe; a scenario of global stagflation is avoided.
- Main assumptions behind the base scenario:
  - the sanctions are potentially permanent and have a higher economic cost in 2022
  - significant further escalation of sanctions (including an imposed reduction of gas/oil flows between RUS and EUR) is avoided
  - commodity prices: strong price increase, especially in the short term
  - confidence: high volatility in 1H22
  - bottlenecks: higher and more persistent
  - financial systems: no significant disruptions.

Growth forecasts are revised significantly to the downside in Europe, despite the expected (but uncertain) fiscal measures, and moderately in other regions

GDP: ANNUAL GROWTH IN REAL TERMS

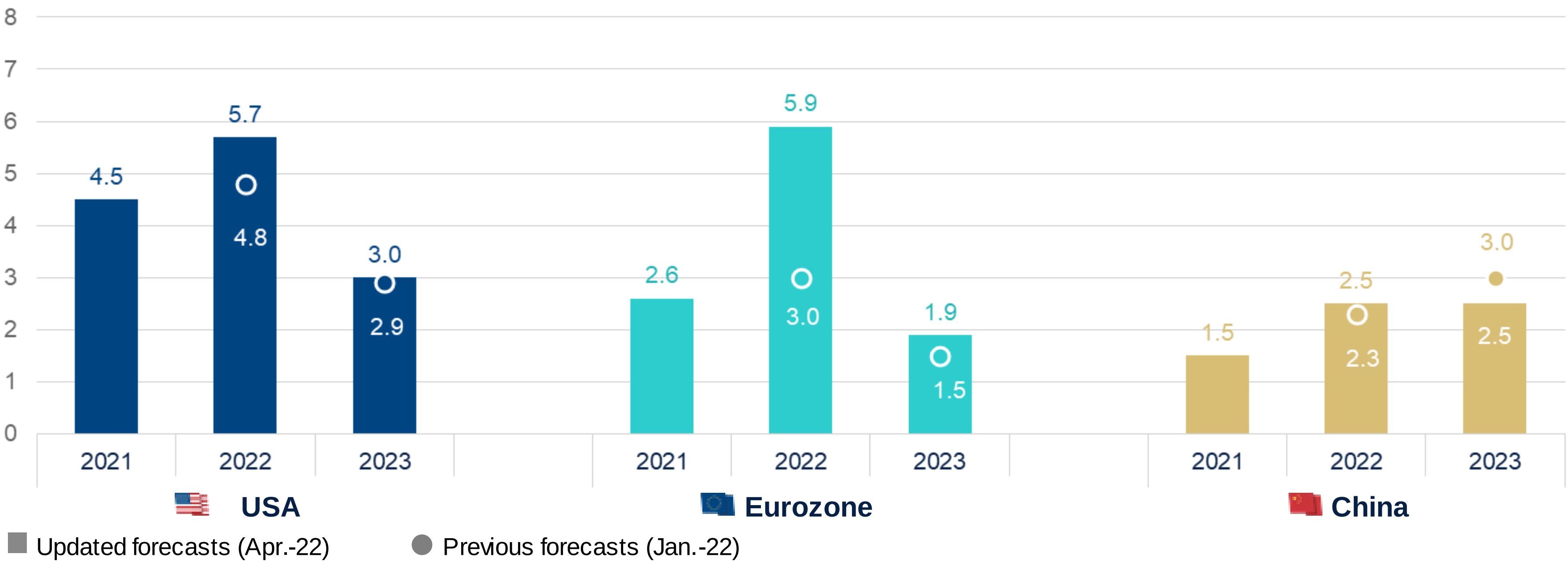
(%)



Source: BBVA Research.

Commodity prices and additional bottlenecks will add to previous pressures and keep inflation very high, at least this year

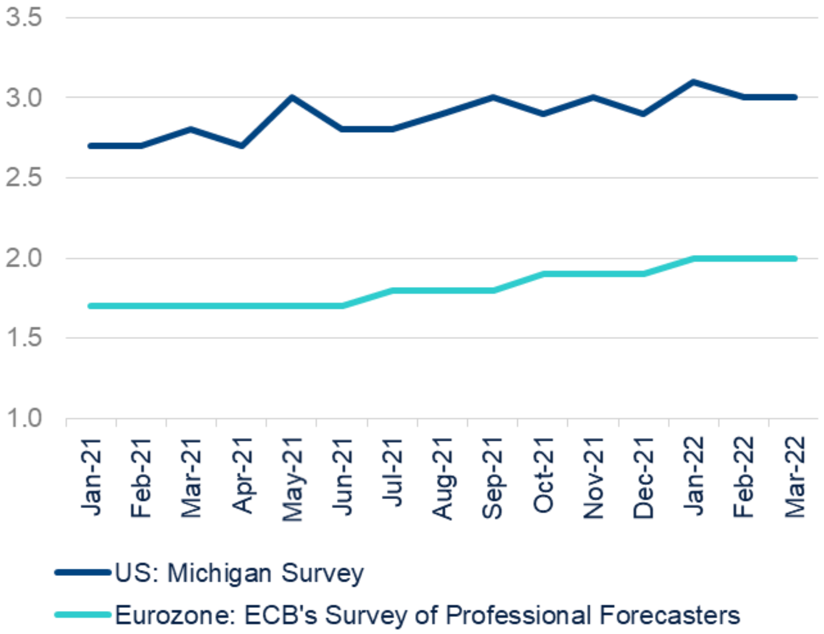
INFLATION: CPI
(Y/Y %, PERIOD AVERAGE)



Source: BBVA Research.

The second-round effects of high inflation are of particular concern in the US, and also, although to a lesser extent, in Europe

5-YEAR INFLATION EXPECTATIONS, BASED ON ANALYSTS SURVEYS(%)



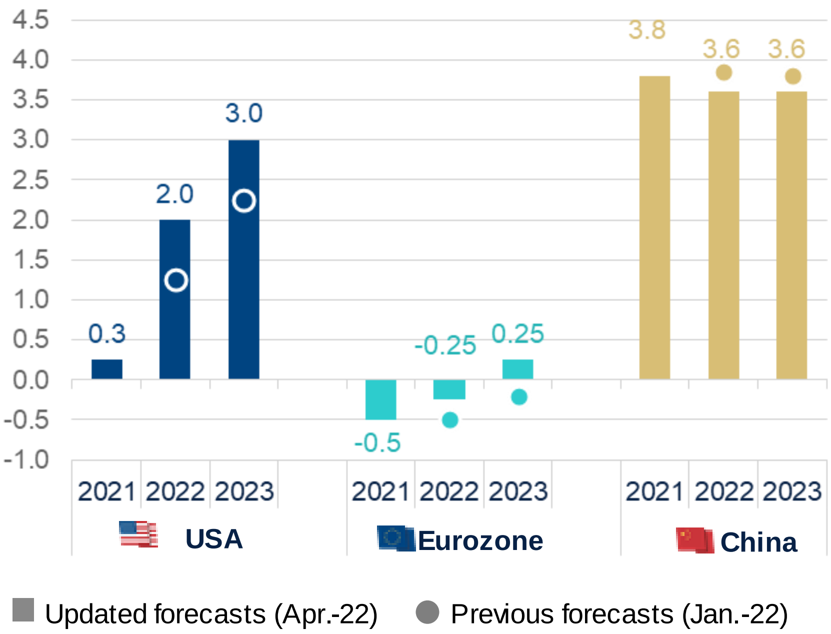
Source: BBVA Research based on data by Haver.

- Persistence of current shocks: high uncertainty, but the pandemic, the war, the energy transition... could have more lasting impacts on inflation.
- Labor markets: dynamism in the US (not so much in the Eurozone) favors second-round effects, but tightness could be temporary.
- Economic policy: central bank credibility is key, but the current environment increases the risk of mismanagements.
- Inflation expectations: above the 2% target in the US and rising, but still anchored, in the Eurozone.

Interest rate hikes by the Fed (more aggressive) and by the ECB (despite the dilemma) from 2022; new fiscal stimulus in the Eurozone, but not in the US

MONETARY POLICY INTEREST RATES*

(%)



* In the case of the ECB, deposit facility rates.
Source: BBVA Research.

Controlling inflation is the main objective

- Fed: more aggressive rate hikes and a reduction in the balance sheet from Jun/22 given high inflation and the labor market strength.
- Fiscal policy: the approval of further fiscal stimulus packages is no longer expected.

Monetary normalization, fiscal support

- ECB: accelerated reduction of the asset purchase program (APP) until its end in 3Q22; gradual rate hikes starting in 4Q22.
- Fiscal policy: additional stimuli at national and European level, in defense, energy, refugees...

Focus on avoiding a sharp slowdown

- PBoC: one/two more rates cuts, credit expansion
- Fiscal policy: local government bond issuance, tax cuts...

Possible long-term effects of the conflict

Higher military spending and higher taxes

Deglobalization

Higher cost of security (cybernetics, energetic...)

Geopolitics emerge as a salient global risk

New geopolitics map

More incentives to accelerate energy transition

Further EU integration

Key assumptions on the local front

Covid-19

Health situation: more favorable than that considered three months ago, which has allowed a quicker than expected return to normal in capacity constraints. This will provide more support for the productive sectors which until now have been most affected by the isolation measures.

The assumption is that future new waves of contagion will have a limited impact on activity.

Political context

We consider a lower probability that radical changes will be implemented on the economic and political front, although the tensions between the Government and opposition will remain high.

Uncertainty linked to the political environment will continue to affect confidence and lead to caution in private spending, although somewhat less than in the baseline scenario presented three months ago (January).

Economic policies

The monetary policy rate will be higher than in the previous baseline scenario in a context of higher inflation.

Fiscal policy: a process of very gradual fiscal consolidation is assumed (at the closing date of this report, the Ministry of Economy and Finance had still not published the parameters that will be followed to boost the macro-fiscal rules), with a gradual reversal of the extraordinary spending measures implemented to tackle the health crisis (transfers to families and acquisitions of equipment and goods linked to health) and with a slump in public investment in 2023, following the sub-national elections (at the end of 2022).

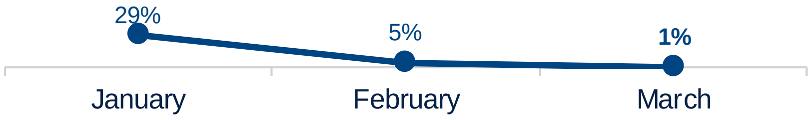
Mining production

Construction on the mining unit Quellaveco will shortly be complete, and together with two other medium-sized mines, will enter the production phase.

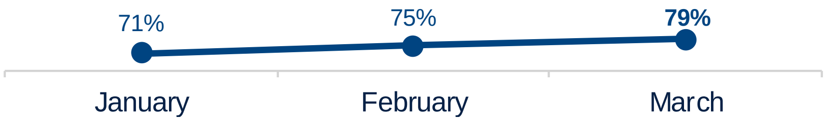
It is assumed that social conflicts will continue to have a negative impact on the production of some sectors.

On the health side, improvement in indicators and swifter increase in permitted capacity will favor the productive sectors most affected by isolation measures

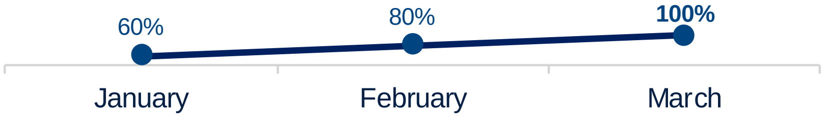
POSITIVE COVID TESTS
(% OF TOTAL TESTS, LAST WEEK OF THE MONTH)



VACCINATED WITH AT LEAST 2 DOSES
(% TARGET POPULATION, LAST WEEK OF THE MONTH[1])

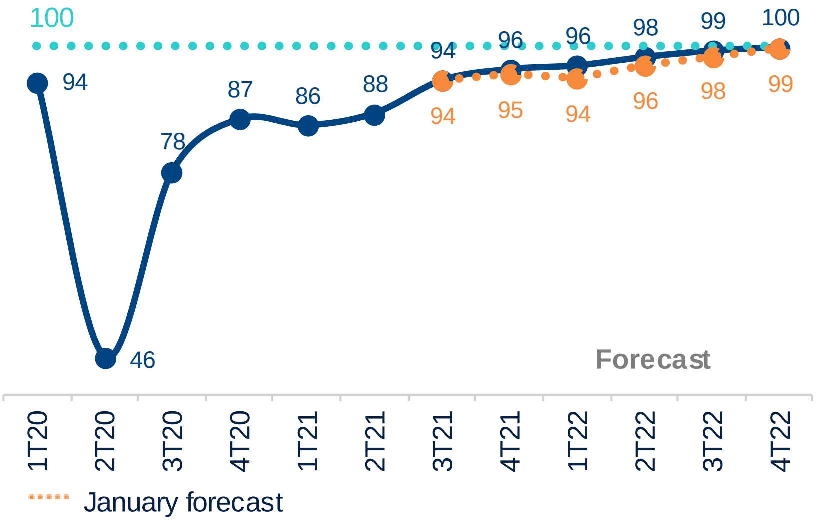


PERMITTED CAPACITY IN RESTAURANTS AND OTHER BUSINESSES (LAST WEEK OF THE MONTH)



1: Target population (people aged 5 or more) is nearly 33 million.
Source: BBVA Research based on Ministry of Health data.

INDEX OF ACTIVITY OF ALL THE SECTORS MOST AFFECTED BY ISOLATION MEASURES[1]
(LEVEL AS % OF THAT IN THE SAME QUARTER OF 2019)



1: The index considers the retail sector and some services (transportation, hotels and restaurants and other serv ices). Overall, this index groups together 22% of total GDP.
Source: BBVA Research based on INEI data.

On the political side there is high uncertainty, but a perception of reduced probability that radical economic and political measures will be implemented

Sustained local political uncertainty...

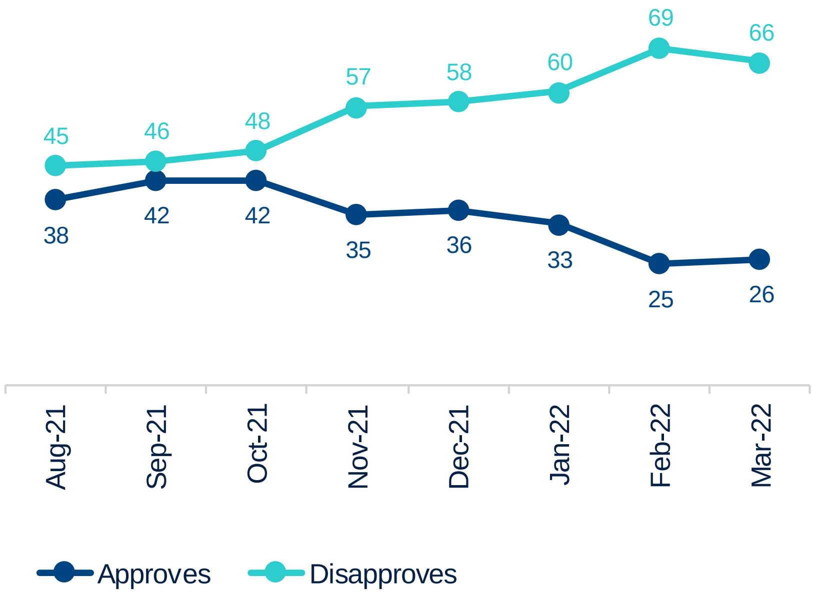
"Pedro Castillo announces that he will void the order of mandatory curfew in Lima and Callao"
Diario El Comercio, April 5, 2022

"April 5: the history of a curfew which triggered mass protests in Lima and Callao"
Diario El Comercio, April 6, 2022

... but the probability of radical economic and political measures being implemented is lower

"Congress: publishes a law which regulates the referendum for constitutional reforms"
Diario Gestión, January 30, 2022

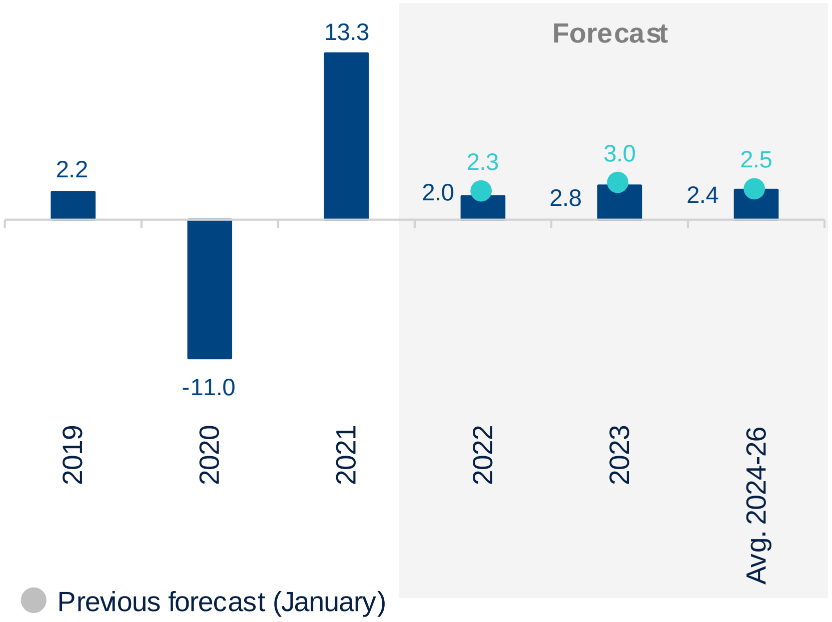
PRESIDENTIAL APPROVAL
(%)



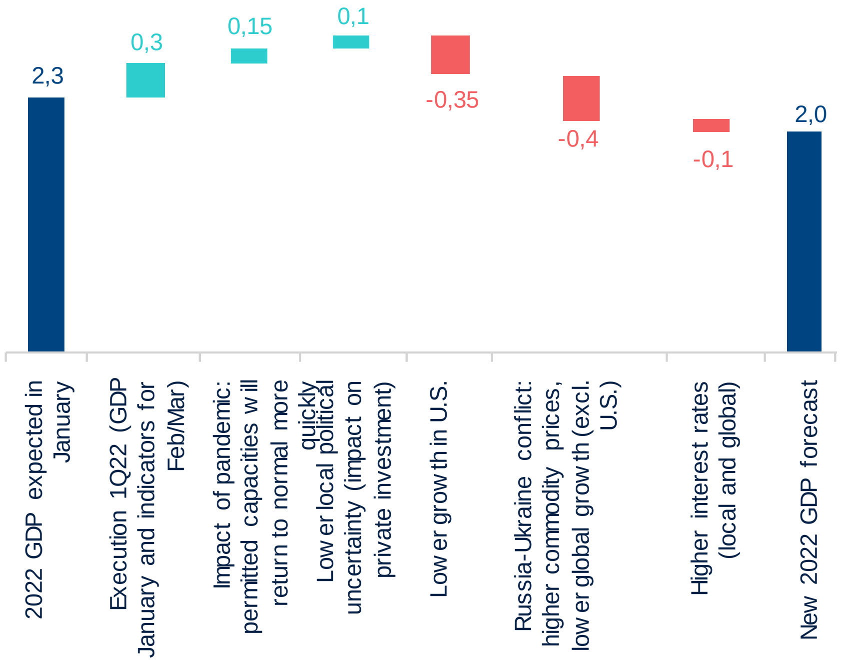
Source: BBVA Research, based on Ipsos Peru (Report published in March).

In this scenario, the growth forecasts for 2022 and 2023 have been revised down, due mainly to the deterioration of the external situation

GDP
(% YEAR-ON-YEAR VAR.)



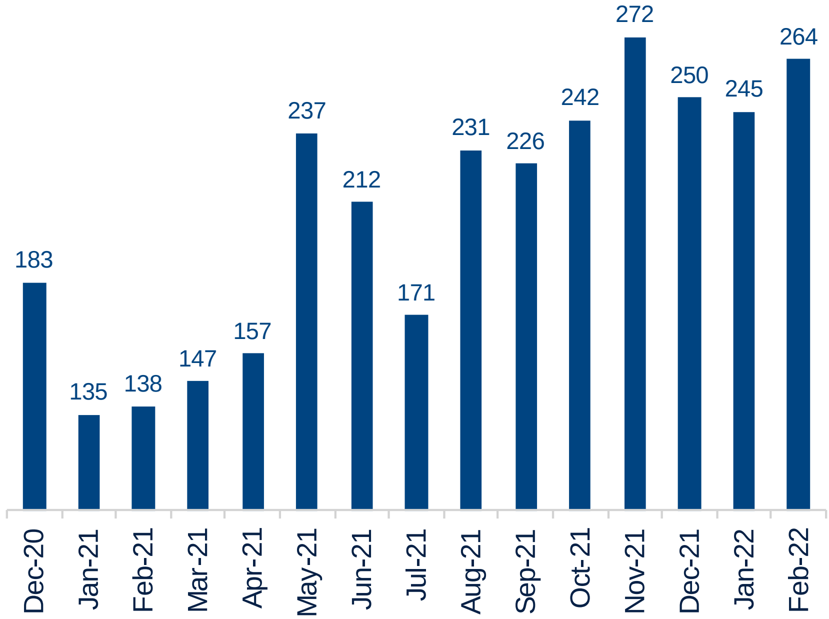
BREAKDOWN OF THE CHANGE IN THE GROWTH FORECAST IN 2022
(PERCENTAGE POINTS OF GDP)



Source: BBVA Research based on BCRP. Projection: BBVA Research.

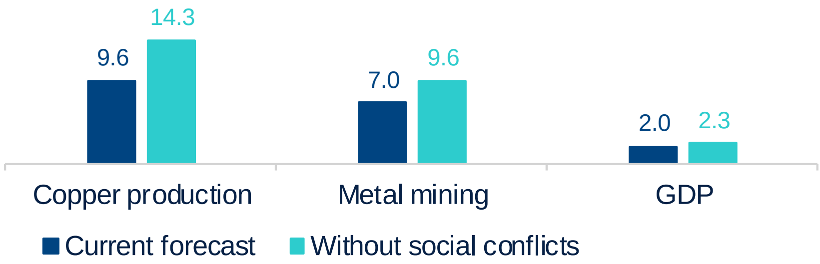
Social conflicts that affect mining in our baseline scenario have a significant impact on the GDP

COLLECTIVE PROTEST ACTIONS
(NUMBER OF ACTIONS)



Source: Ombudsman and BBVA Research.

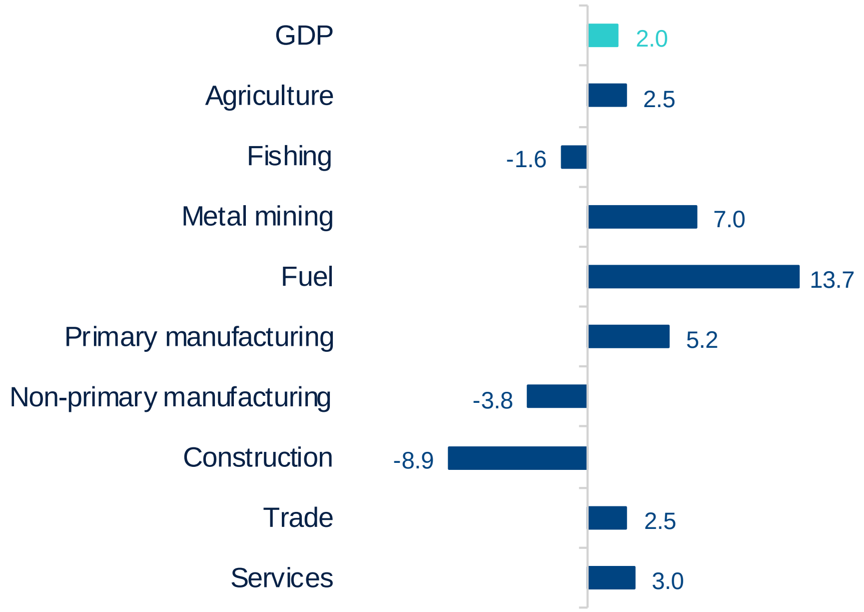
OUTPUT OF COPPER AND METAL MINING, AND GDP
(% YEAR-ON-YEAR VAR., 2022)



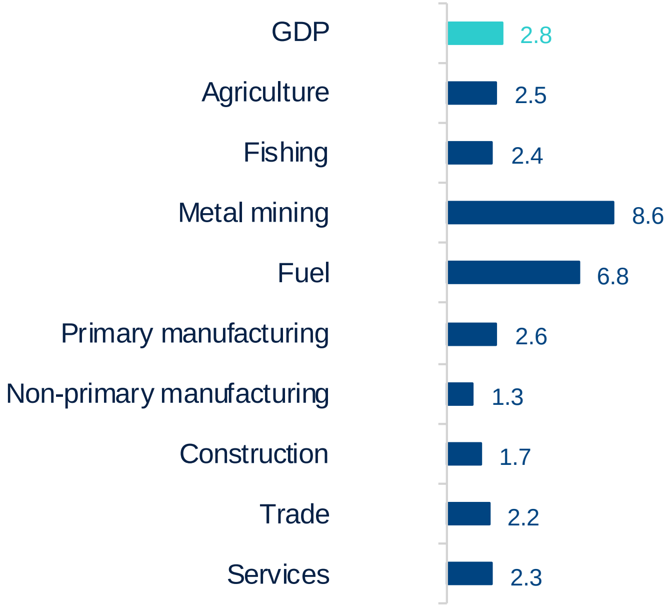
- We estimate that if the social conflicts that have been affecting Las Bambas (MMG) and Cuajone (Southern Copper Corporation), among others, were resolved, copper production could reach 2.6 million MT this year (compared with 2.5 million MT in our baseline scenario).
- As a result, the social conflicts will reduce GDP growth this year by 0.3 pp (-0.2 pop in 2021, according to the BCRP).

Despite everything, in 2022 and 2023 there will be a significant expansion of mining output, supported by the launch of operations in new copper mining units...

SECTORAL GDP IN 2022
(% YEAR-ON-YEAR VAR.)



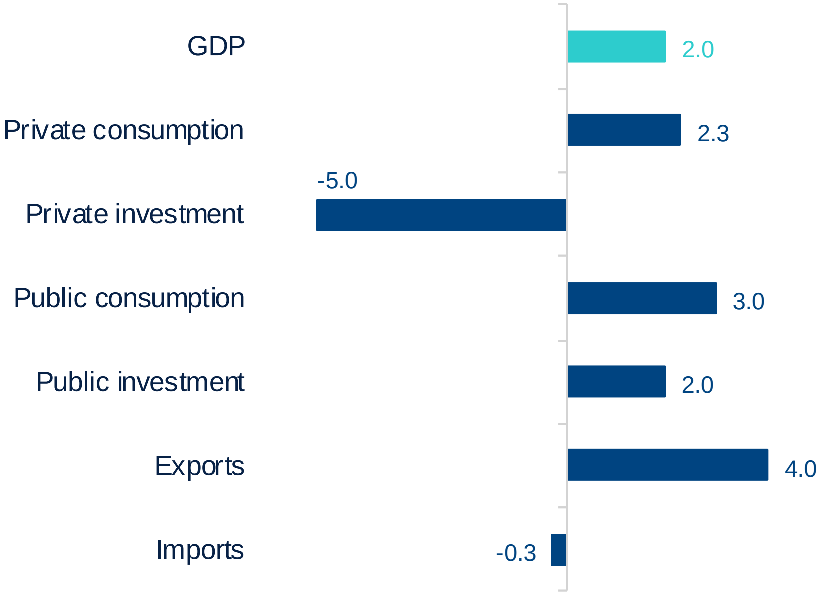
SECTORAL GDP IN 2023
(% YEAR-ON-YEAR VAR.)



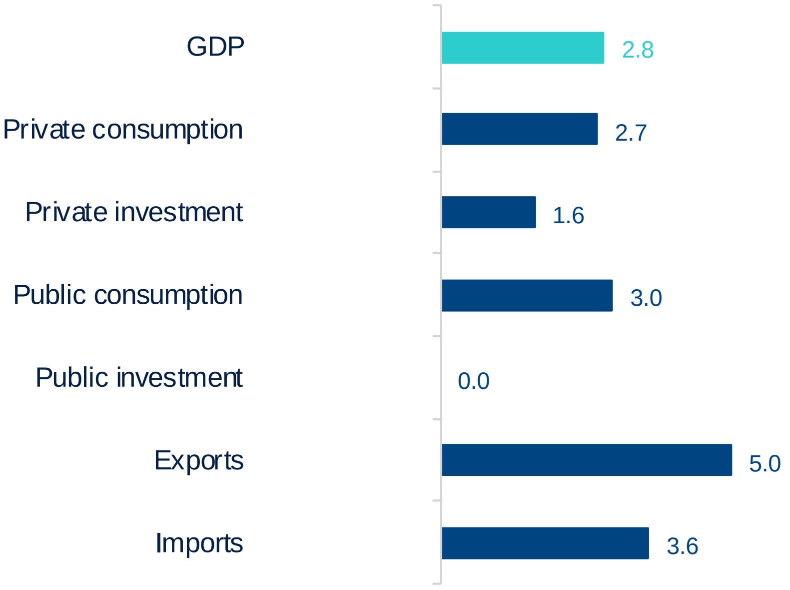
Source: BBVA Research.

... which will be reflected on the expenditure side in the growth of exported volumes (despite the weakened external outlook)

EXPENDITURE-SIDE GDP 2022
(% YEAR-ON-YEAR VAR.)



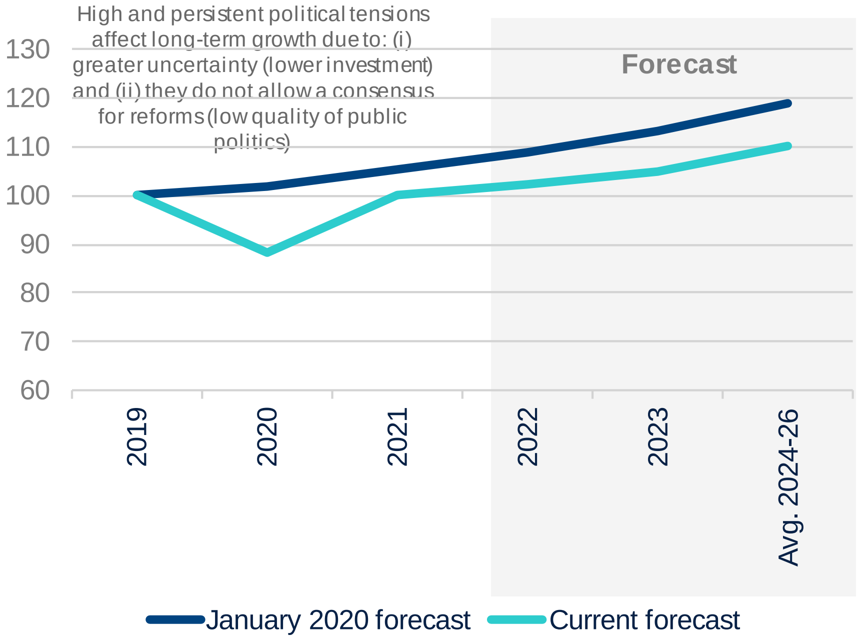
EXPENDITURE-SIDE GDP 2023
(% YEAR-ON-YEAR VAR.)



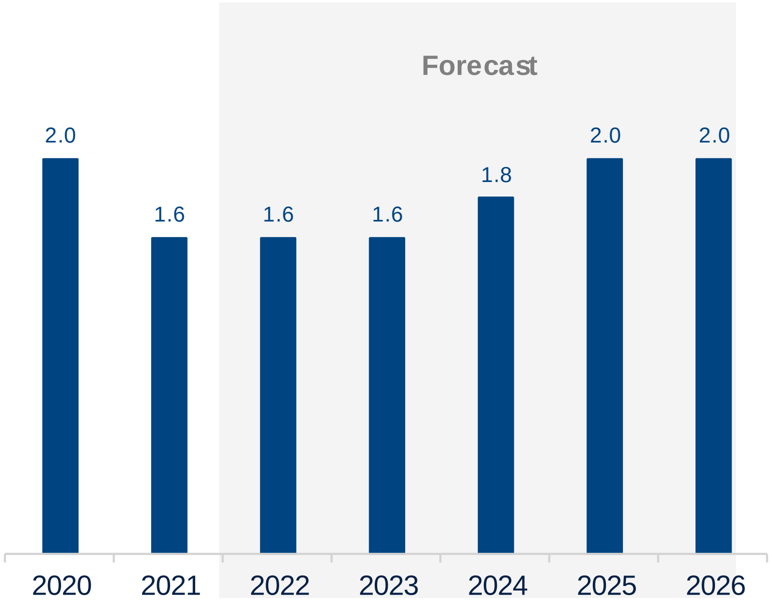
Source: BBVA Research.

Moving forward, the high and persistent political tensions may have permanent effects on the economy and limit recovery

PERU GDP: LEVEL
(SEASONALLY ADJUSTED QUARTERLY INDEX, 2019 = 100)



GDP: POTENTIAL
(% YEAR-ON-YEAR VAR.)



Source: BCRP and BBVA Research.

BBVA Research

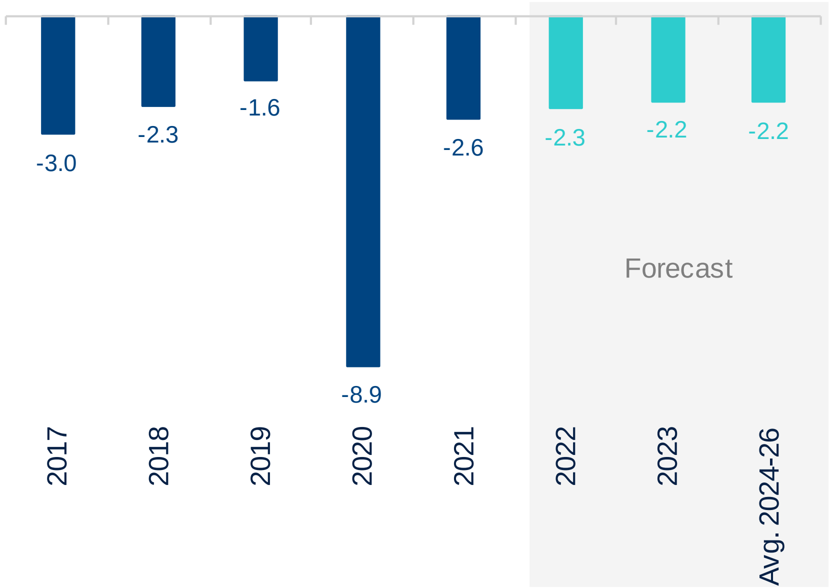
03

Macroeconomic forecasts

3.2. Fiscal balance and public debt

The high prices of metals and tendency for spending on health to return to normal will result in the fiscal deficit falling again in 2022

FISCAL BALANCE[1/]
(NON-FINANCIAL PUBLIC SECTOR, % OF GDP)

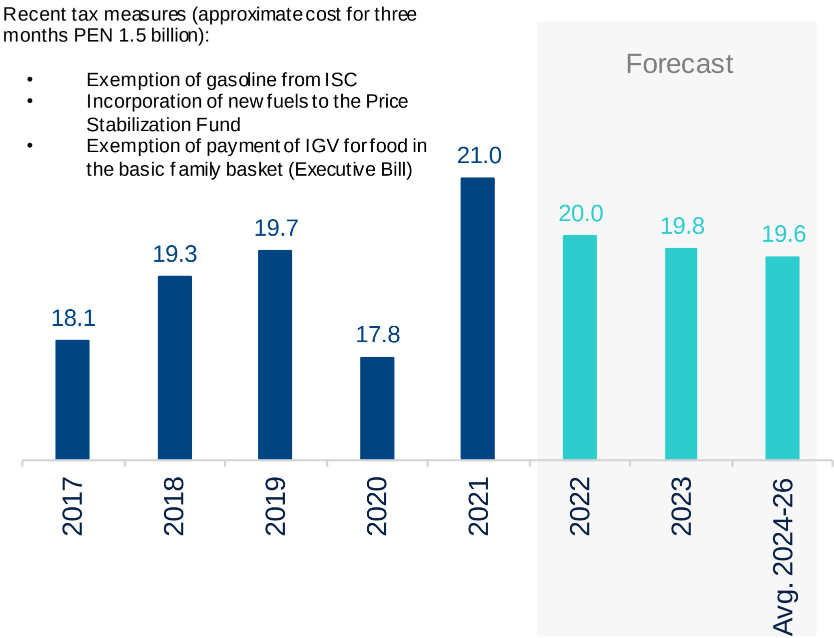


1/ The macro-fiscal rules for 2022 establish that (i) the fiscal deficit may not be greater than 3.7% of GDP and (ii) that the gross public debt may not be greater than 38% of GDP (D.U. 079-2021).
Source: BBVA Research based on BCRP. Projection: BBVA Research.

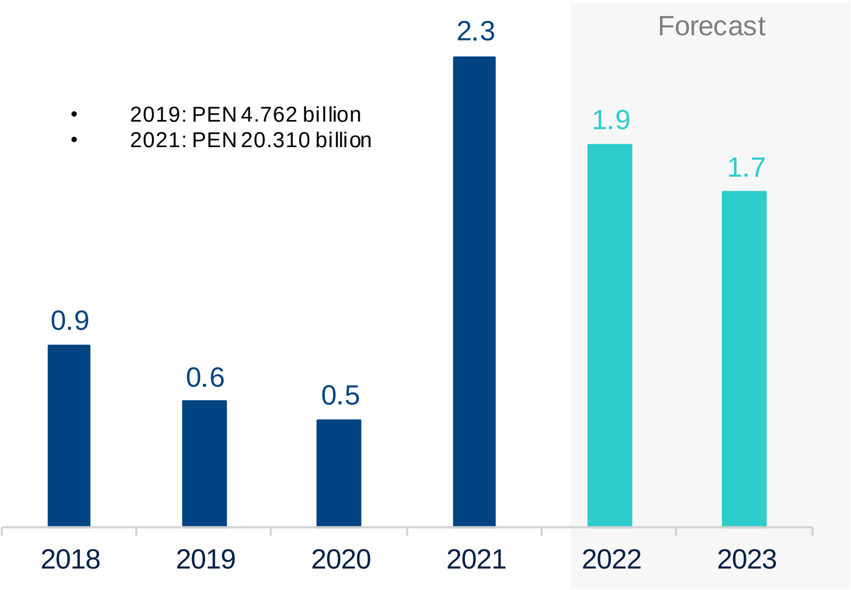
- At the close of this publication, the Ministry of Economy and Finance has not yet published the parameters that will dictate the reactivation of the macro-fiscal rules.
- The baseline scenario assumes a very gradual process of fiscal consolidation, with a marginal reduction of the deficit in the coming years (compared with the level recorded in 2021).
- This scenario is consistent with a steady reversal of the extraordinary expenditure measures implemented to address the health crisis and with a public investment drop in 2023, after the sub-national elections (at the end of 2022).

Government revenues will remain around 20% of GDP, with support in the short term from revenues from mining

TOTAL CENTRAL GOVERNMENT REVENUES
(% GDP)



TAX REVENUES FROM THE MINING SECTOR 1/
(% GDP)



1/ In 2021, extraordinary revenues were registered from the mining sector of PEN 6.270 billion (0.7% of GDP) corresponding to the payment of tax debt by four important mining companies, and revenues associated with controlling shares held by SUNAT.
Source: BBVA Research based on BCRP, SUNAT and MEF. Projection: BBVA Research.

International Monetary Fund: Report on proposed tax measures

- According to the IMF the current tax regime for mining in Peru is progressive and competitive. The tax burden is somewhat greater than in Chile, but in the average band of a selected group of copper producing countries.
- There is thus some room to increase the tax burden in the mining sector (particularly the rates on profits), without significantly affecting competitiveness... but care must be taken to preserve it.
- There would be room to increase the tax burden on incomes in the first and second category. However, their additional contribution to tax revenues would be minor. It is suggested that the tax rates should be progressive.

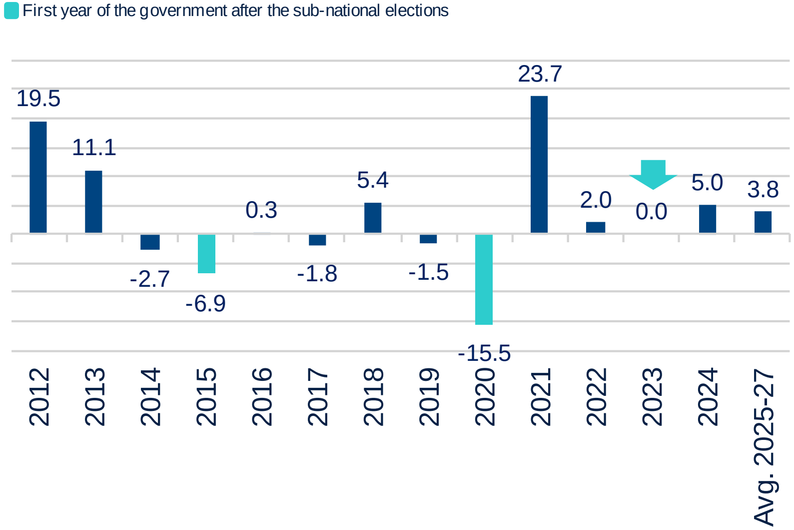
Commentary by BBVA Research:

- Beyond the changes in the tax burden, the ideal would be to increase the tax base. For example, it would be a good idea for SUNAT to continue to increase the facilities for taxpayers and simplify processes (combatting tax avoidance and evasion). Measures such as these have generated a considerable reduction in the default ratio in collection of IGV and income tax (from 18% in 2015 to 10.4% in 2021).

On the expenditure side, a steady normalization of the payments which have been made to address the health emergency is assumed

CENTRAL GOVERNMENT SPENDING
(% GDP)

PUBLIC INVESTMENT
(REAL % VAR.)

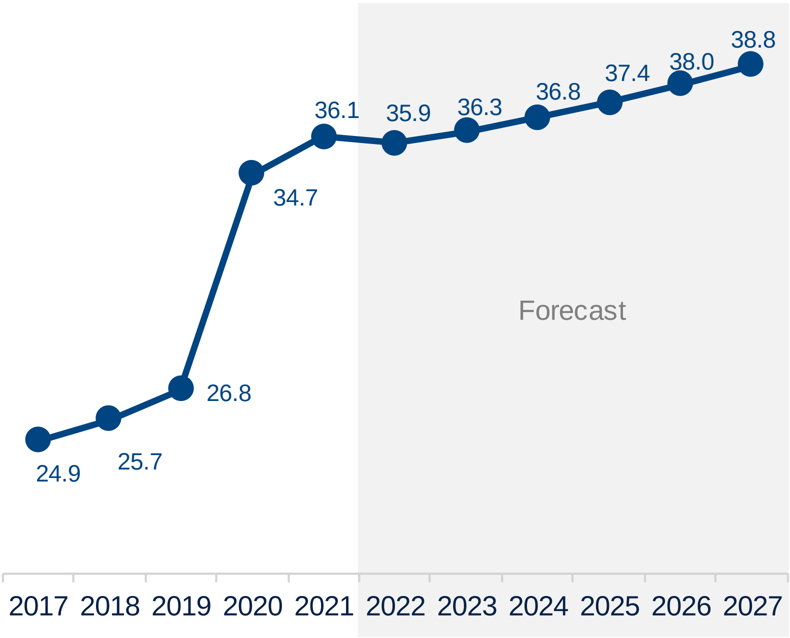


- Public investment will slump in 2023, after the sub-national elections (at the end of 2022).

Source: BBVA Research based on BCRP. Projection: BBVA Research.

The expected trend in the fiscal deficit is consistent with a level of gross public debt whose trend will be upward starting in 2023

PUBLIC DEBT
(NON-FINANCIAL PUBLIC SECTOR, % OF GDP)



Source: BBVA Research based on BCRP. Projection: BBVA Research.

- In this scenario, the gross public debt as a percentage of GDP will remain relatively unchanged this year (around a level equivalent to 36% of GDP), but moving forward we forecast that it will continue to rise, and close at close to 39% in 2027.
- Recent vulnerabilities: (i) foreign-currency debt rose to account for 54% of the total in 2021 (32% in 2019); and (ii) spending on debt servicing will increase in the next five years by 0.3 pp of GDP.
- We estimate that to stabilize the gross public debt around a level equivalent to 40% of GDP a primary surplus of between 0.0% and 0.2% of GDP is required (in 2021 there was a primary deficit of 1.1% of GDP).

To maintain the sovereign debt rating, a credible process of fiscal consolidation must be implemented

CREDIT RATING OF SOVEREIGN FOREIGN-CURRENCY BONDS

	S&P	Moody's	Fitch
Peru	BBB	Baa1	BBB
Chile	A	A1	A-
Colombia	BB+	Baa2	BB+
Mexico	BBB	Baa1	BBB-
Brazil	BB-	Ba2	BB-

Positive outlook   Stable outlook   Negative outlook

Source: BBVA Research based on data from S&P, Moody's, Fitch and MEF.

- The fiscal consolidation effort will help mitigate the negative impact of the ongoing political noise on the credit rating of Peruvian government debt.
- S&P downgraded the credit rating of sovereign foreign-currency bonds not long ago to BBB (from BBB+). The rating outlook moved to stable (from negative).
- According to the agency, the persistent political stagnation is undermining the efforts to maintain the confidence of investors and limiting the prospects for growth.
- What about the next two years? According to S&P, if the fiscal results worsen together with the debt metrics, due to pressure on expenditure or a lower than expected growth, there could be a further downgrade in the sovereign credit rating.

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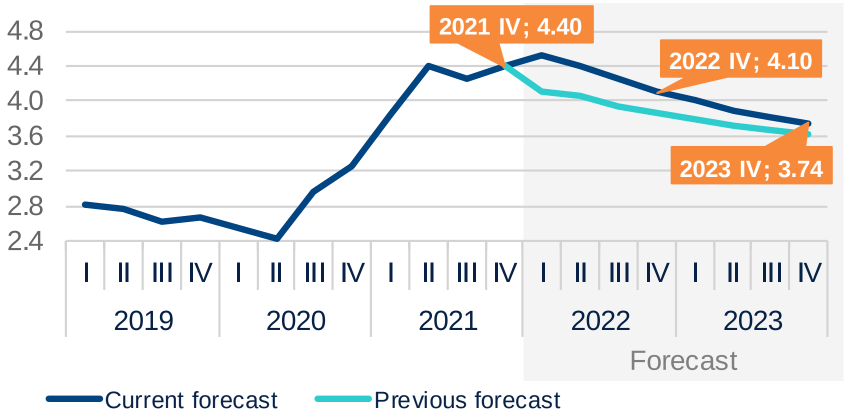
03

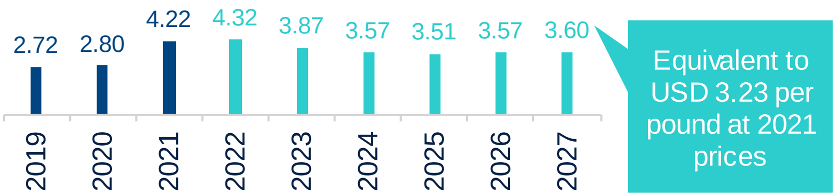
Macroeconomic forecasts

3.3. External sector and exchange rate

On the side of export prices, the main export, copper, will continue at high levels, although with a tendency to decline in the future

COPPER PRICE
(USD/POUND AVERAGE FOR THE PERIOD)



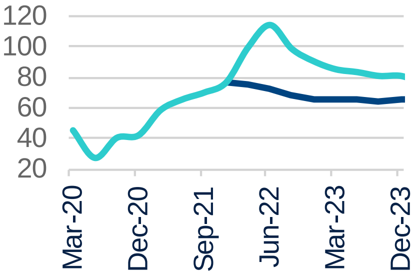


Source: BBVA Research based on Bloomberg. Projection: BBVA Research.

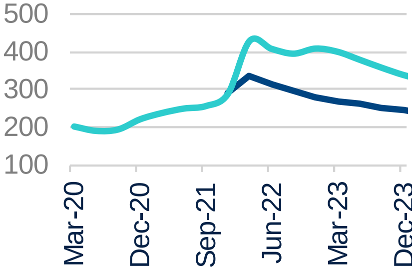
- The global copper deficit will reduce in 2022 due to (i) the entry into production of some mines (Quellaveco, for example) and (ii) the moderation in global growth.
- However, the copper price will be supported in the short term by (i) logistical problems associated with the conflict in the east of Europe; and (ii) production problems due to social conflicts (Peru, for example), which will take time to dissipate.
- In the medium term, the copper price will find support in the increased investment in "green" infrastructure and in the change in the vehicle fleet, which little by little will become of greater relevance.

On the import side, prices are also high due to the conflict between Russia and Ukraine, in particular fuels and food; they will take time to adjust

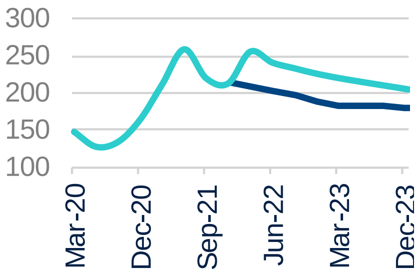
OIL
(USD PER BARREL)



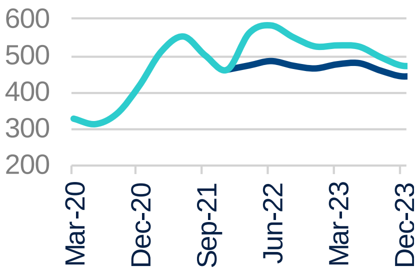
WHEAT
(USD PER MT)



CORN
(USD PER MT)



SOY
(USD PER MT)



Previous forecast (Jan-22) Current projection

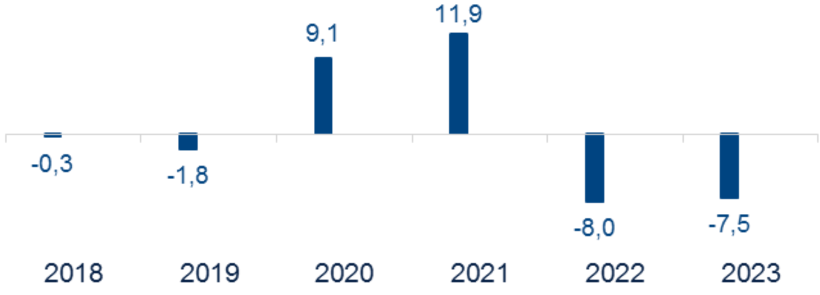
IMPORT PRICES
(% YEAR-ON-YEAR VAR.)

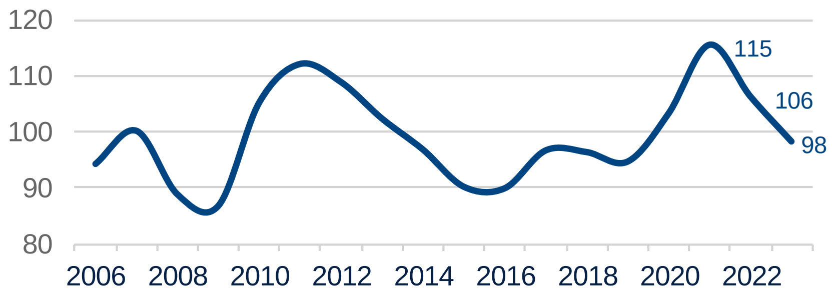
Previous forecast

Source: BBVA Research based on Bloomberg. Projection: BBVA Research.

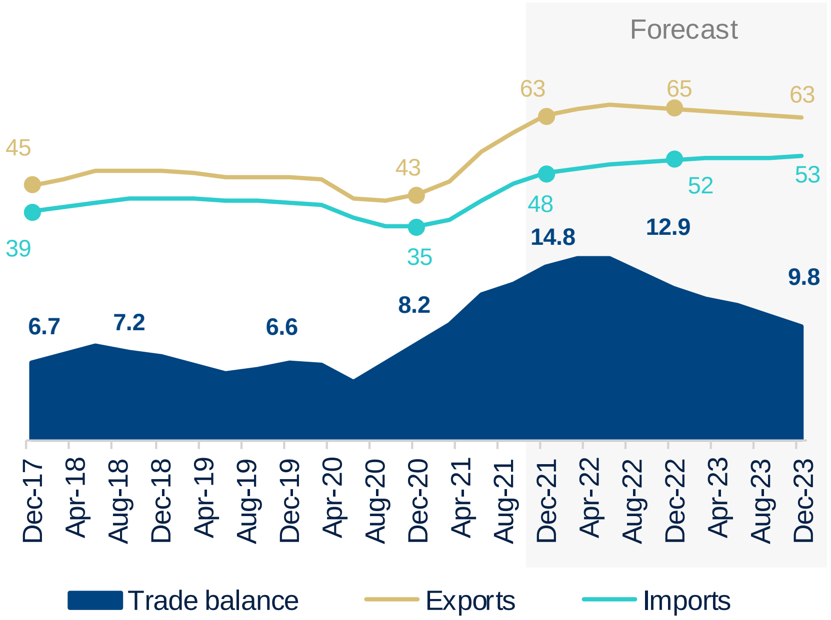
In this context, the forecast terms of trade do not vary substantially, and we continue to anticipate a downward adjustment in 2022 and 2023

TERMS OF TRADE
(YEAR-ON-YEAR % VAR.; INDEX: 2007 = 100)





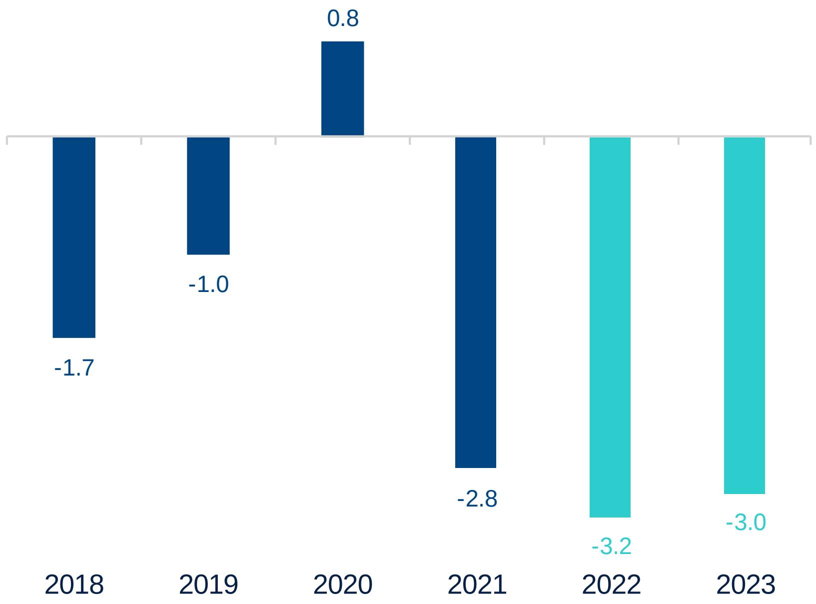
TRADE BALANCE
(USD BILLION, CUMULATIVE IN THE LAST FOUR QUARTERS)



Forecast for 2022 and 2023.
Source: BBVA Research based on BCRP. Projection: BBVA Research.

The trade surplus forecast for 2022 and 2023 is consistent with current-account deficits that are not very different from those in 2021

BALANCE OF PAYMENTS CURRENT ACCOUNT
(% GDP)

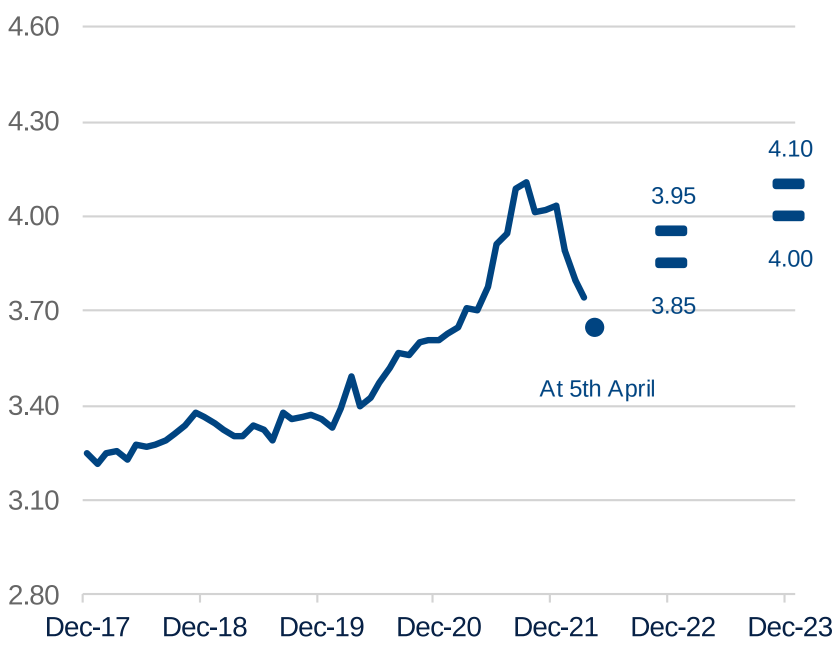


Forecast for 2022 and 2023.
Source: BBVA Research based on BCRP. Projection: BBVA Research

- The deficits forecast for the balance of payments current account are greater than those of our previous baseline scenario (January) due to increased profits generated by foreign companies (extractive sectors like mining and hydrocarbons).
- These deficits are moderate. However, some adjustment will be required to avoid a rising trend in the foreign debt: we estimate that to stabilize the current level of net external liabilities the current account deficit should not exceed 2.0% of GDP.

In the foreign-exchange market, we anticipate that downward pressures on the PEN will increase from now on, due to the Fed's monetary adjustment

EXCHANGE RATE
(PEN PER USD, DAILY AVERAGE FOR MONTH)



Source: BBVA Research based on Bloomberg. Projection: BBVA Research

- We foresee seven increases in the Fed's rate of 25 bps each this year, and four more in 2023. Moreover, the Fed will begin to reduce the size of its balance sheet in June, which will favor the USD in relative terms.
- Locally, to this will be added a balance of payments current-account deficit similar to that of last year, a level somewhat bigger than required to stabilize the current ration of net liabilities over GDP (a deficit of not more than around 2.0% of GDP).
- In this context, we estimate that the local PEN/USD price will close 2022 (daily average for December) at between 3.85 and 3.95 PEN per USD, and in 2023 the price will be between 4.00 and 4.10 PEN per USD.

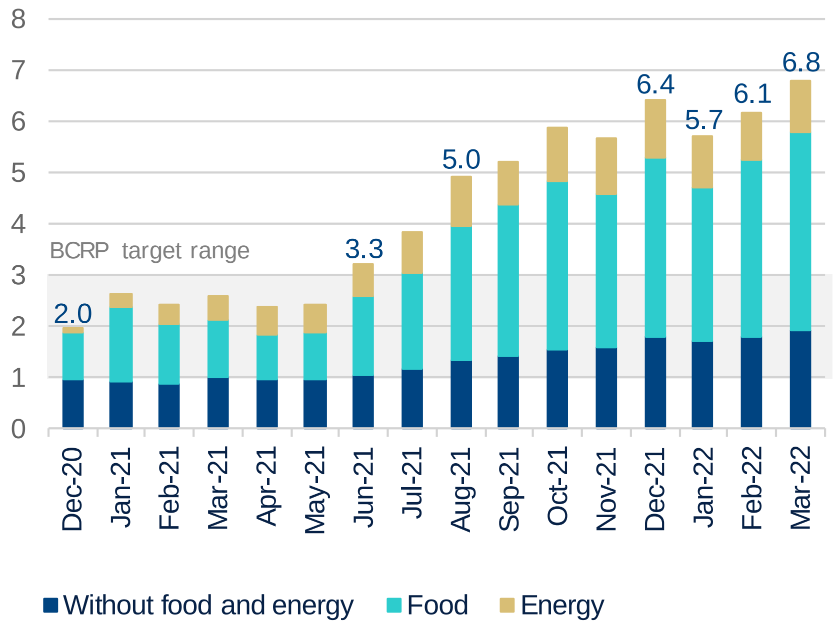
03

Macroeconomic forecasts

3.4. Inflation and monetary policy

Inflation has risen steadily since June due to increased food and energy prices, and despite the appreciation of the local currency

INFLATION: MAIN COMPONENTS
(BREAKDOWN OF % YEAR-ON-YEAR CPI VAR.)



INFLATION
(% YEAR-ON-YEAR VAR.)

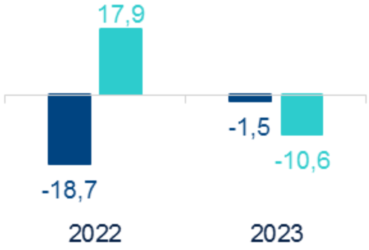
	Peso	Dec-20	Dec-21	Mar-22
Total	100,0	2,0	6,4	6,8
Without food and energy	55,3	1,8	3,2	3,5
Food	40,0	2,2	8,0	9,2
Energy	4,7	2,1	24,4	21,3

Source: BBVA Research based on BCRP data.

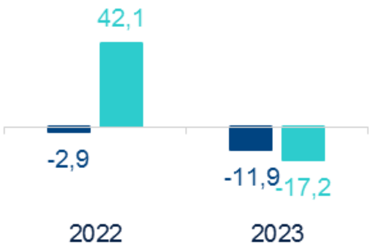
New baseline scenario: upward revision of commodities will sustain inflation at high levels for longer

PROJECTIONS: INTERNATIONAL COMMODITY PRICES
(% VAR. OF PERIOD)

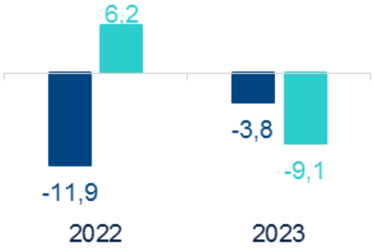
OIL



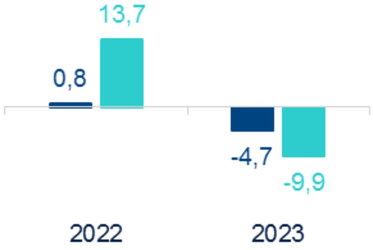
WHEAT



CORN



SOY



Local impact on…

Oil
- Gasoline and lubricants
- Gas.
- Transportation.

of the basic basket
~11%

Wheat
- Bread
- Noodles

of the basic basket
~2%

Corn
- Chicken
- Eggs

of the basic basket
~3,5%

Soy
- Oils

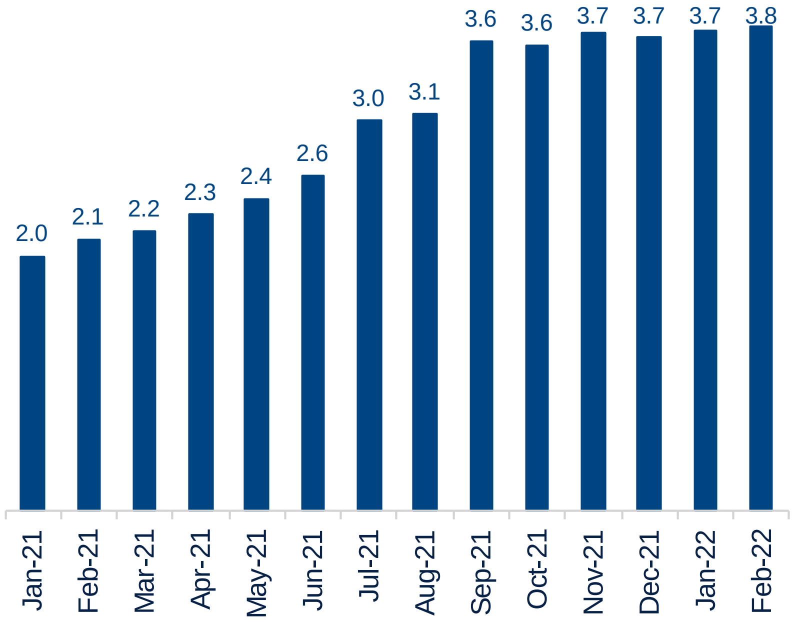
of the basic basket
~0,5%

January projection | Current scenario

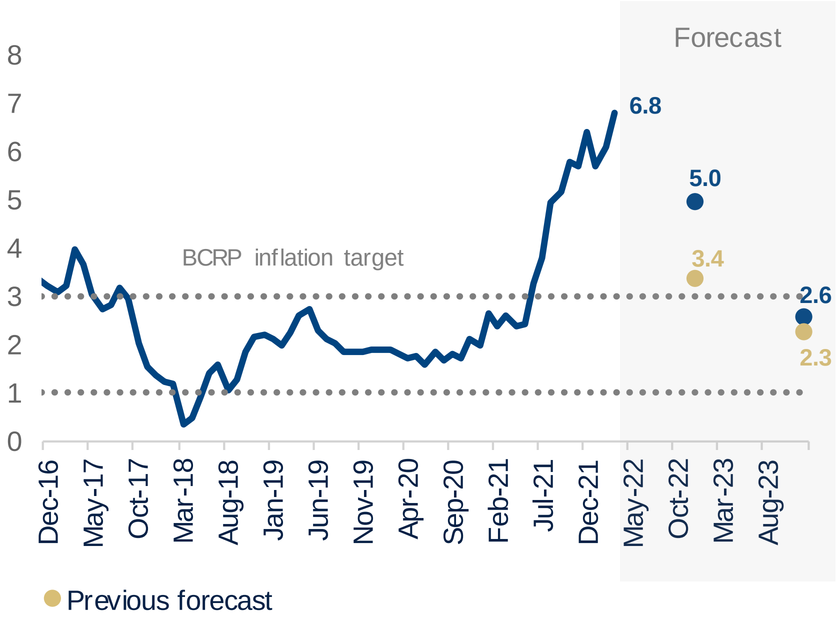
Source: BBVA Research.

With very high and persistent inflation, inflationary expectations are bound to continue high, feeding back into pressure on prices

INFLATIONARY EXPECTATION AT 1 YEAR
(%)



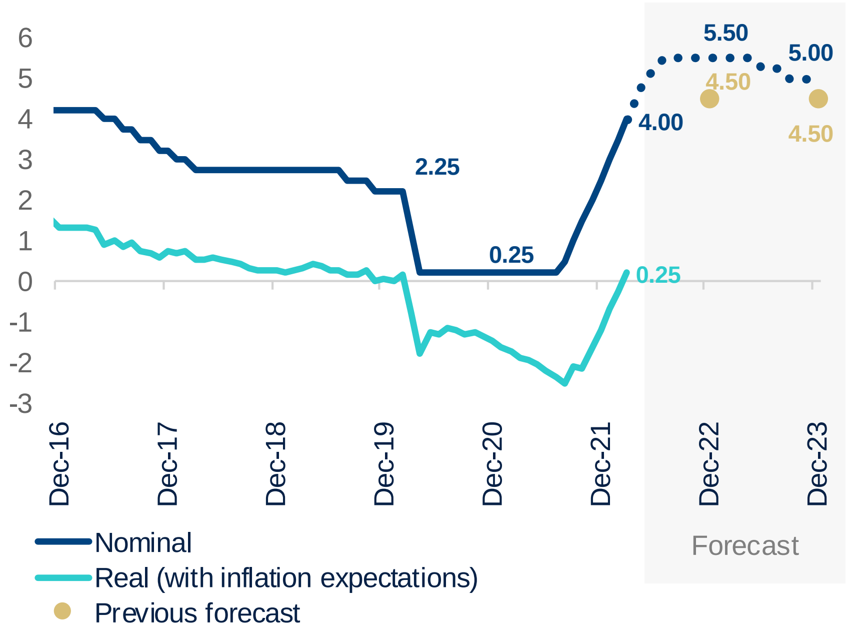
INFLATION
(% YEAR.ON-YEAR VAR. LIMA CPI)



Source: BBVA Research based on BCRP. Projection: BBVA Research.

In this more challenging inflationary environment, the BCRP will be more aggressive in the adjustment of its reference interest rate

REFERENCE INTEREST RATE
(%)



Source: BBVA Research based on BCRP. Projection: BBVA Research.

- The BCRP has continued to increase its policy rate in recent months at a rate of 50 bps per month. Currently it stands at 4.0%.
- We expect the adjustments to continue and for the rate to reach 5.50% in 3Q22.
- This is a higher level than forecast in our baseline scenario in January due to the revision made in projected inflation and the impact this would have on inflationary expectation. Depending on how these expectations behave in the coming months, this level could even be restrictive.
- Moving forward, when inflation is close to the target range, we forecast that the reference rate will start to move toward a more neutral level.

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04

Main risks

Main risks to the baseline scenario for forecasts

EXTERNAL

- Deterioration in the conflict between Russia and Ukraine (and escalation of sanctions), leading to stagflation
- Fed: swifter or disorderly adjustment of its monetary position, causing recession or financial disruption.
- More marked slowdown in China.
- New COVID-19 waves, social tension, new geopolitical conflicts.

POLITICAL

- The Government implements more radical proposals.
- Presidential impeachment? Congress dissolution?
- More positive response of private spending to the lower probability of the implementation of radical measures.

OTHERS

- New coronavirus variants.
- Greater social conflict.

05

Summary of forecasts

Macroeconomic forecasts: summary

	2020	2021	2022 (f)	2023 (f)
GDP (YoY % change)	**-11.0**	**13.3**	**2.0**	**2.8**
Domestic demand (excluding inventories, YoY % change)	**-9.5**	**14.4**	**0.9**	**2.4**
Private spending (YoY % change)	**-11.3**	**17.2**	**0.5**	**2.5**
Private consumption (YoY % change)	-9.8	11.7	2.3	2.7
Private investment (YoY % change)	-16.5	37.6	-5.0	1.6
Public spending (YoY % change)	**1.1**	**13.8**	**2.7**	**2.2**
Public consumption (YoY % change)	7.6	10.7	3.0	3.0
Public investment (YoY % change)	-15.5	23.7	2.0	0.0
Exchange rate (vs. USD, eop)	**3.60**	**4.04**	**3.85 – 3.95**	**4.00 – 4.10**
Inflation (% Y/Y, eop)	**2.0**	**6.4**	**5.0**	**2.6**
Monetary policy interest rate (%, eop)	**0.25**	**2.50**	**5.50**	**5.00**
Fiscal balance (% GDP)	**-8.9**	**-2.6**	**-2.3**	**-2.2**
Balance of payments: checking account (% GDP)	**0.8**	**-2.8**	**-3.2**	**-3.0**
Exports (USD billion)	42.4	59.2	62.2	62.7
Imports (USD billion)	34.7	43.9	44.0	45.0

(f) Forecast. Forecast closing date: October 18, 2021.
Source: BBVA Research.

Disclaimer

Peru Economic Outlook

2Q22

Closing date: April 5

Creating Opportunities