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Peru Economic Outlook

December 2022

Creating Opportunities

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Contents

Key points

Global situation

Slower economic growth, despite resilient labour markets and the (decreasing) impact of the reopening after COVID-19. High inflation, interest rate hikes, the impact of the war in Ukraine, and COVID-19 in China have caused economic activity to slow down throughout the year.

The Fed has been reducing its asset holdings and aggressively raising its interest policy rate. Together with the moderation of bottlenecks and commodity prices, this monetary tightening has helped inflation in the US to start declining recently, even more than expected, setting a more positive tone in the markets in recent weeks.

Domestic situation

Locally, economic activity lost momentum in the third quarter. The slowdown took place in a more challenging environment for private sector spending (high inflation and interest rates, depressed confidence), while the positive impact of the post-COVID-19 rebound fades away. Continued high political tensions are deteriorating the business environment and have been a determining factor in Fitch downgrading the sovereign credit outlook (from stable to negative, maintaining the BBB rating).

Key points

Global macro outlook

Economic activity is expected to lose steam over 2023. Global growth is forecast to reach 2.3% in 2023 -an unusually low level- after having grown 6.3% in 2021 and around 3.3% in 2022. Aggressive monetary tightening coupled with still significant price pressures, amid the war in Ukraine and increasing hurdles to free-trade, will likely weaken labour markets and private consumption, which have been holding up relatively well so far. Uncertainty is high and risks are tilted to the downside: a sharper-than-expected activity deceleration could pave the way for a global recession.

The ongoing easing of commodity prices and bottlenecks reinforces the prospects that inflation will slow down ahead, favored by positive base effects. In the US inflation is already falling; in the Eurozone, price pressures continue to build, but inflation is still expected to peak soon if expectations and second-round effects remain under control. Still, inflation will remain well above targets, at least throughout 2023. Risks of more persistent price increases remain.

The interest-rate hiking cycle is likely to come to an end in early 2023, both in the US and the EZ. Policy rates are forecast to converge to around 5% in the former and 2.75% in the latter. However, there will be scarce room for monetary easing till the end of 2023. Besides, as part of the monetary policy tightening cycle, quantitative tightening is set to remain in place in the US and to be launched next year in the EZ.

Declining global liquidity, high interest rates, and US dollar strength could continue spurring volatility and significant corrections in financial markets. Stress episodes, such as those recently observed in the UK and in crypto markets, and even a financial crisis could emerge ahead, specially if inflation and interest rates end up being higher than expected.

Key points

Domestic macro outlook: economic activity

After increasing by 1.7% year-over-year in the third quarter, activity will perform better in the fourth quarter, supported by Quellaveco's copper output. As a result, economic growth for the year will stand at 2.7% (upward revision from the previous forecast of 2.3%). In 2023, GDP expansion will be 2.5%, a forecast that has a downward bias. The external environment will be more challenging, interest rates will remain high, and public investment will suffer a bump after the change of authorities at the regional and municipal levels. On a positive note, Quellaveco will reach its full operational capacity and tourism will continue to normalise.

In 2024, these factors will reverse: global growth will rebound, interest rates will ease, and public investment will normalise, while at the same time growth arising from Quellaveco's copper output and the return of tourism to a more normal level will dissipate. As a result, GDP will increase by 2.4%.

Domestic macro outlook: foreign exchange

The local currency will exhibit some weakness in 2023 in an environment of greater global risk perception (marked slowdown in worldwide growth) and a narrowing of the interest rate differential between soles and USD, which will reduce the appetite for emerging markets assets. We expect that, after ending 2022 between 3.85 and 3.95 soles per USD, the exchange rate will end 2023 between 4.00 and 4.10 soles per USD. Later, amid a global economic rebound and the current account deficit moving back toward more sustainable levels, the exchange rate will close 2024 at a level not much different from the previous year.

Key points

Domestic macro outlook: inflation

We expect inflation to end the year around 8.0% and next year around 3.5%. In the short term, inflation will prove resistant to decline (due to a certain de-anchoring of inflationary expectations and second-round effects). However, from March 2023 onwards, the decline in inflation will be more noticeable in a context with both a favorable year-on-year base of comparison (high inflation in 2022) and international food and oil prices on a downward trend.

Domestic macro outlook: monetary policy rate

In the short term, given the persistent high inflation, as well as inflationary expectations for the end of 2024 that remain above the target range, we do not rule out that the Central Bank may raise somewhat more its policy interest rate before the end of the year (reinforcing the restrictive monetary stance), despite the slowdown in activity. Later, in mid-2023, when we expect inflation to be in a clear decline and the Fed has paused, the Central Bank will find room to start normalising monetary policy, moving its policy rate toward a more neutral stance. We estimate rate cuts during the second half of next year, although initially in a limited way given that inflation will remain above the target range, as well as to avoid sharp exchange rate movements in an environment of market sensitivity likely due to the global economic slowdown. Rate cuts will pick up pace in 2024.

Risks

The main external risk is that inflationary pressures will require sharper interest rate increases, pushing the global economy into a deep recession and increasing the likelihood of financial turbulence. A possible escalation of the war in Ukraine and other geopolitical tensions are also latent external risks. Locally, the main risks include a more complicated political environment, which further weakens the business environment, and increased negative repercussions of social unrest.

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01

International context: activity and financial markets

Creating Opportunities

Economic activity has weakened throughout 2022, amid high inflation, sharp monetary tightening and financial volatility, while still exhibiting resilience

RECENT DEVELOPMENTS IN THE WORLD ECONOMY

EASING BUT STILL RESILIENT GROWTH

Easing growth on monetary tightening, price pressures, effects of the war and covid in China.

But activity has shown resilience: robust labor markets, (declining) reopening effects.

SHARP MONETARY TIGHTENING

Fed: has started a quantitative tightening and sharply hiked interest rates, but monetary tightening has still some way to go.

ECB: rates are moving up, bank lending conditions have been tightened and a quantitative tightening is being prepared.

China: moderately expansionary policies.

HIGH INFLATION

US inflation is trending down as commodity prices and bottlenecks ease and interest rates move up.

In Europe, pressures continue to build up amid more widespread and frequent price rises.

Expectations remain broadly under control, also in China, where inflation remains relatively low.

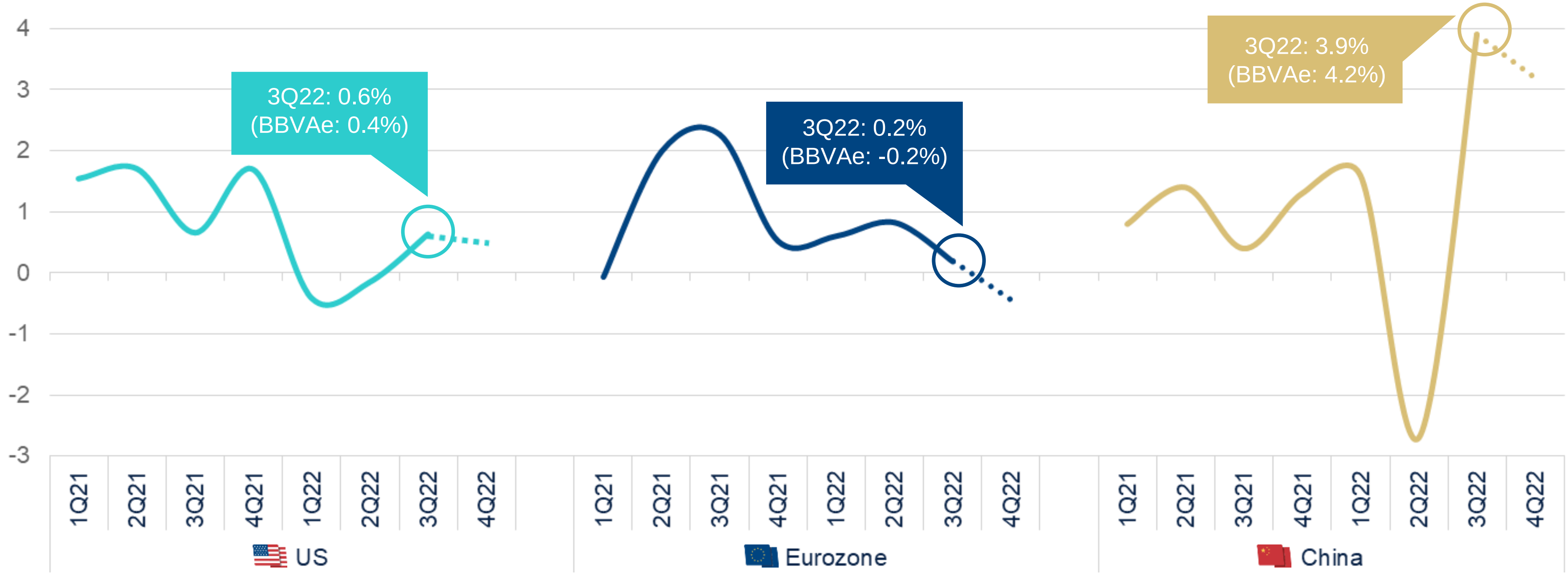
FINANCIAL VOLATILITY

Declining liquidity, higher rates and dollar strength have sparked volatility and corrections across financial markets and countries.

Financial turmoil has emerged in some specific cases,
such as in the UK and in crypto markets.

Growth has lately surprised upwards in the US and the EZ, despite the negative trend, and downwards in China, mostly due to covid and real estate tensions

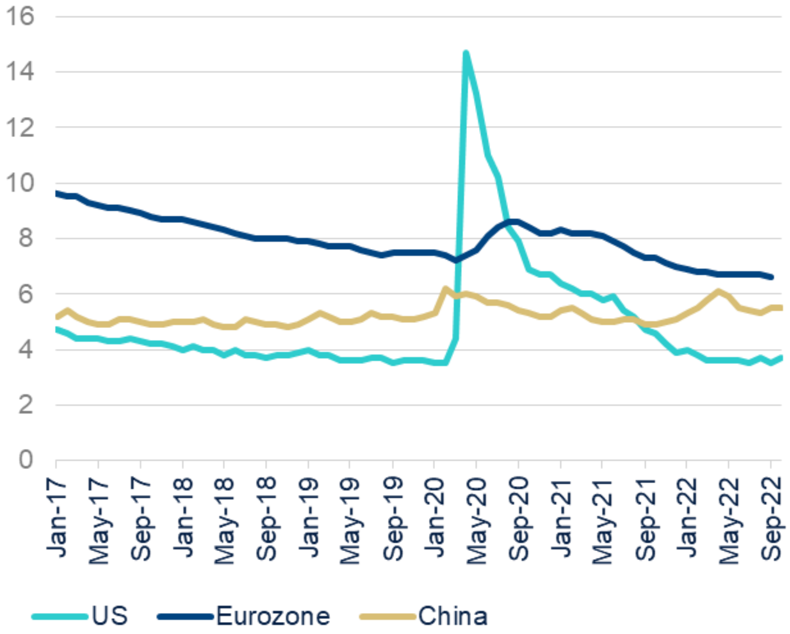
GDP GROWTH (*)
(QOQ %, SEASONALLY ADJUSTED)



(*): BBVA Research estimates for the 4Q22
Source: BBVA Research based on data from Haver.

The labor market strength and the (fading) effects of the post-Covid reopening continue to support private consumption in the US and in the Eurozone

UNEMPLOYMENT RATE
(%)

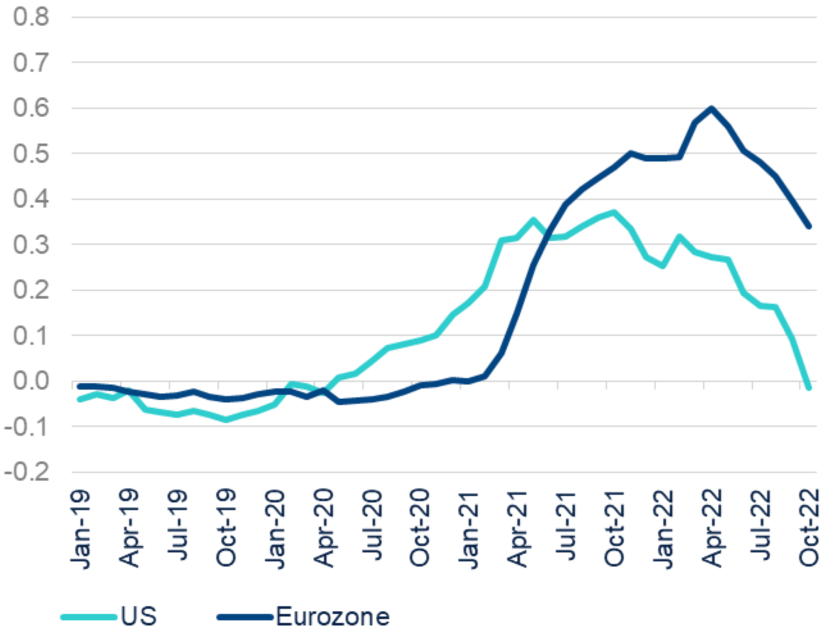


Source: BBVA Research based on data from Haver.

- Tight labor markets, mainly the US: unemployment is at record-low levels, job vacancies remain very high and wages are growing at a faster pace (but below inflation).
- Accumulated savings and pent-up demand seem to be still supporting demand, although at a declining pace.
- Private consumption has been holding up well, better than investment, despite easing signs: it grew 0.5% QoQ in 2Q22, 0.3% QoQ in 3Q22 in the US; 1.0% QoQ in 2Q22 in the Eurozone.
- In China, domestic demand shows a relatively downbeat tone given covid concerns and property markets tensions.

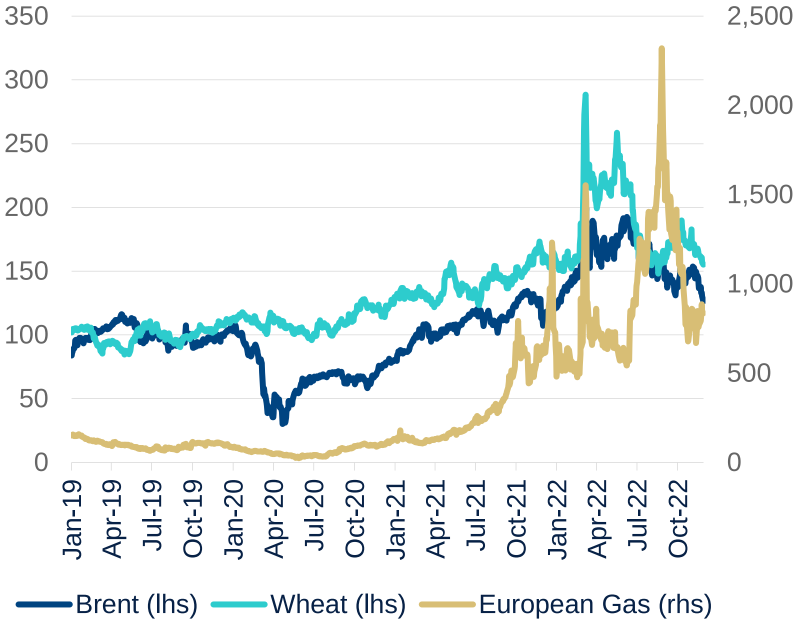
Growth slowing has contributed to easing bottlenecks and commodity prices; gas prices have fallen on high reserves and saving measures in the EU

BBVA RESEARCH BOTTLENECK INDEX
(INDEX: AVERAGE SINCE 2003 = 0)



Source: BBVA Research

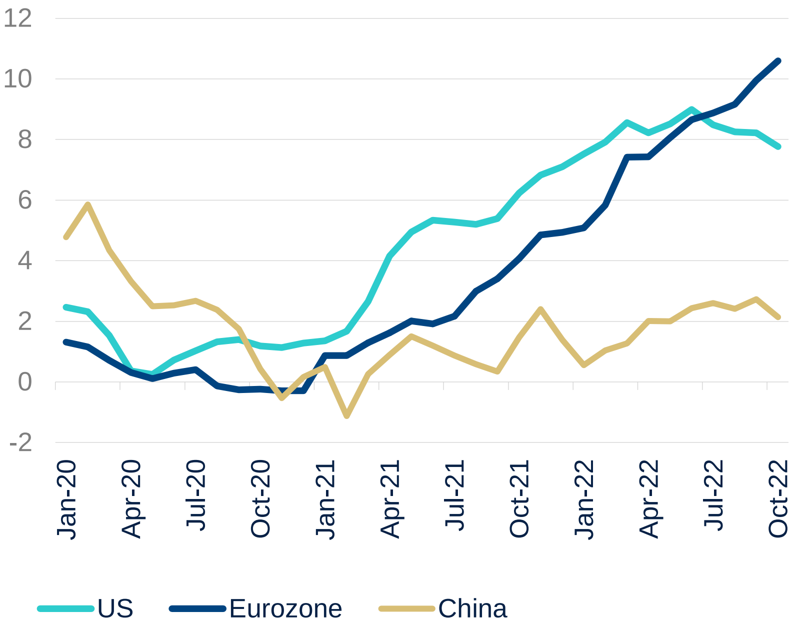
COMMODITY PRICES
(INDEX: 2019 AVERAGE = 100)



Source: BBVA Research based on data from Bloomberg

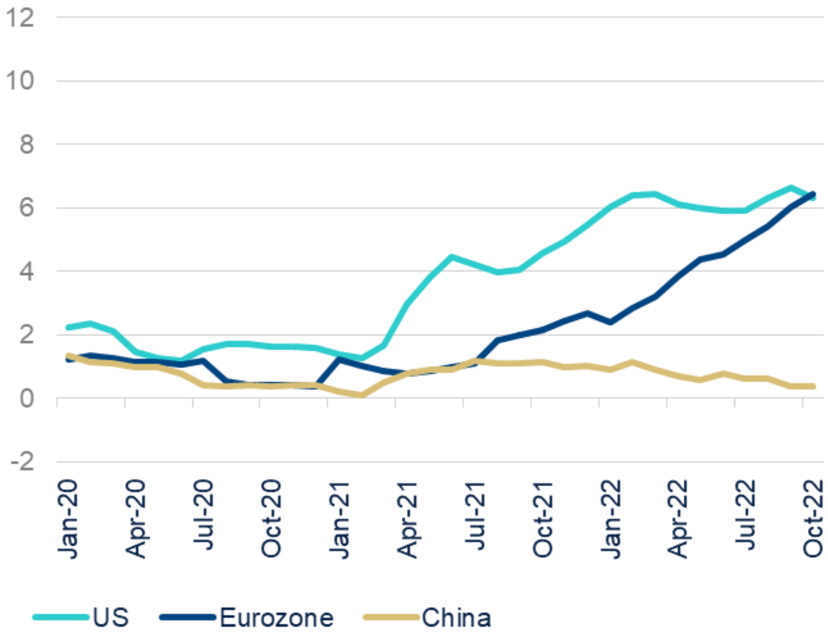
Inflationary pressures have continued to build in the Eurozone, started to recede in the US and remained under control in China

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

CORE INFLATION: CPI
(Y/Y %)

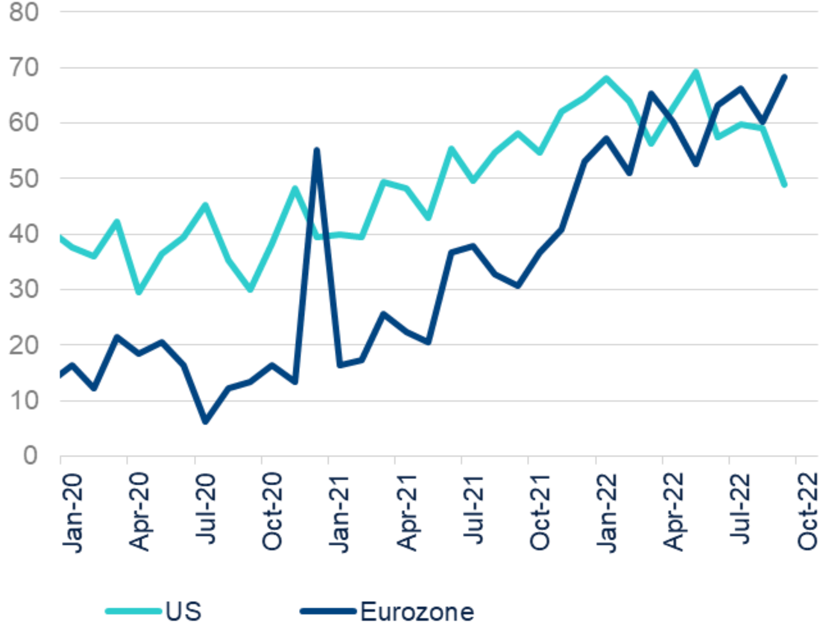


Source: BBVA Research based on data from Haver.

Price adjustments are still becoming more widespread and more frequent in the Eurozone, while the situation continues to improve in the US

ITEMS OF THE CPI BASKET WITH ANNUALIZED MONTHLY INFLATION HIGHER THAN 4%

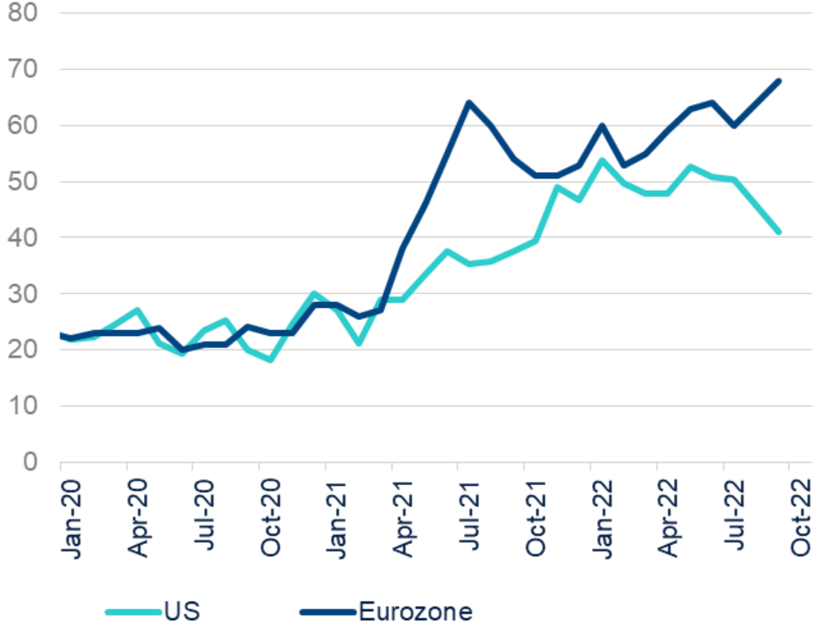
(SHARE OF TOTAL 2-DIGIT CPI ITEMS)



Source: BBVA Research based on local statistics.

ITEMS OF THE CPI BASKET WITH THREE CONSECUTIVE MONTHLY PRICE RISES

(SHARE OF TOTAL 2-DIGIT CPI ITEMS)

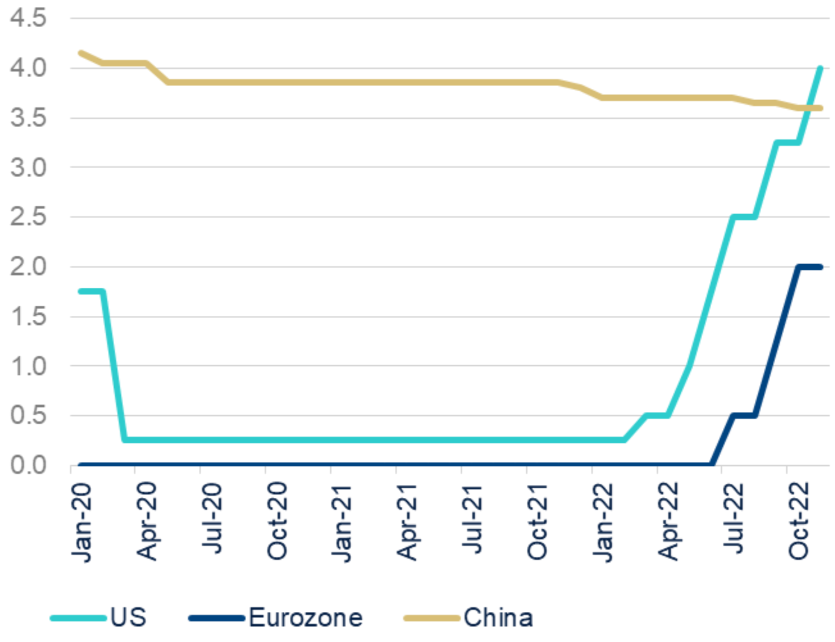


Source: BBVA Research based on local statistics.

Policy rates are high and still rising; market rates have stabilized recently on prospects of a less hawkish Fed following lower inflation in the US

POLICY INTEREST RATES

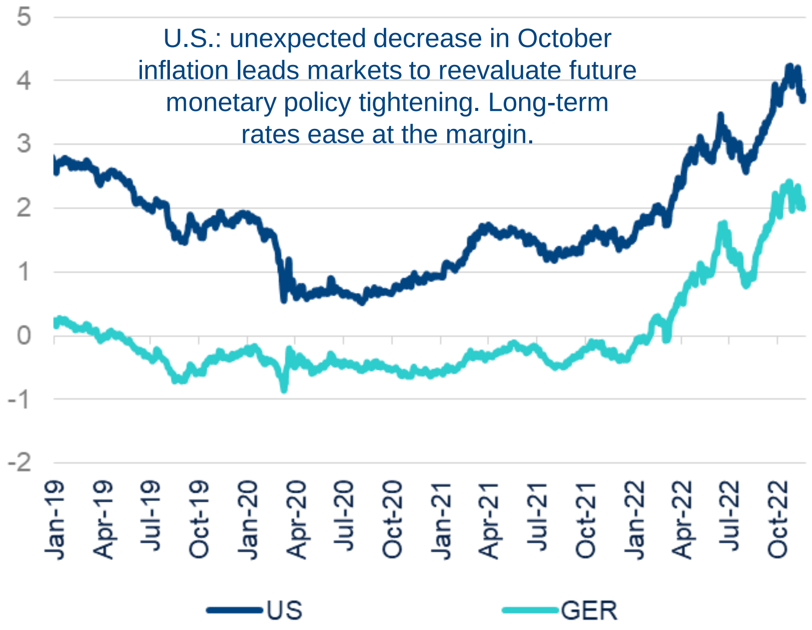
(%, END OF PERIOD)



Source: BBVA Research based on data from Haver.

MARKET INTEREST RATES: US AND GERMANY 10-YEAR BOND YIELDS

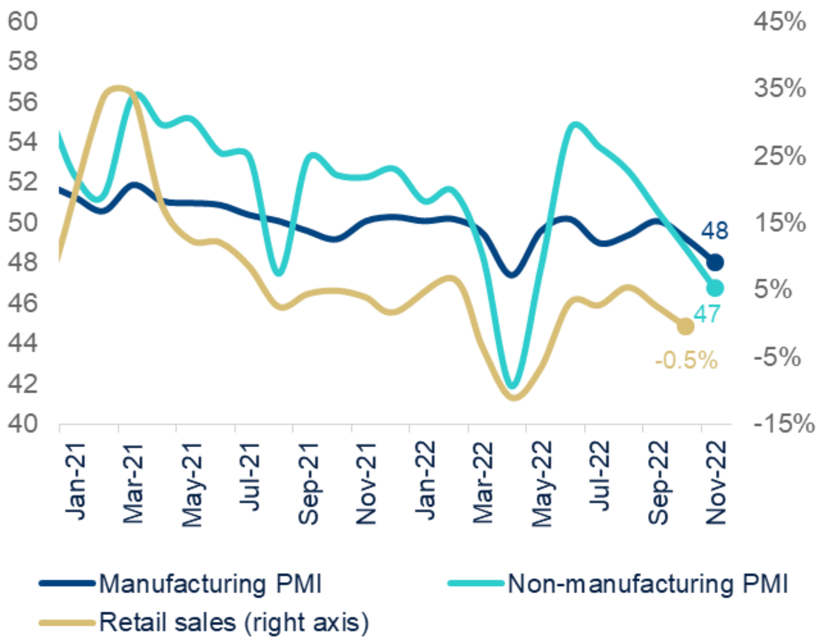
(%)



Source: BBVA Research based on data from Haver.

Chinese authorities also announced measures to bolster the real estate market and signaled the beginning of a relaxation of the "zero COVID-19" policy

CHINA: ACTIVITY INDICATORS:
(PMI: POINTS, OVER 50 INDICATES EXPANSION; SALES: Y/Y%)

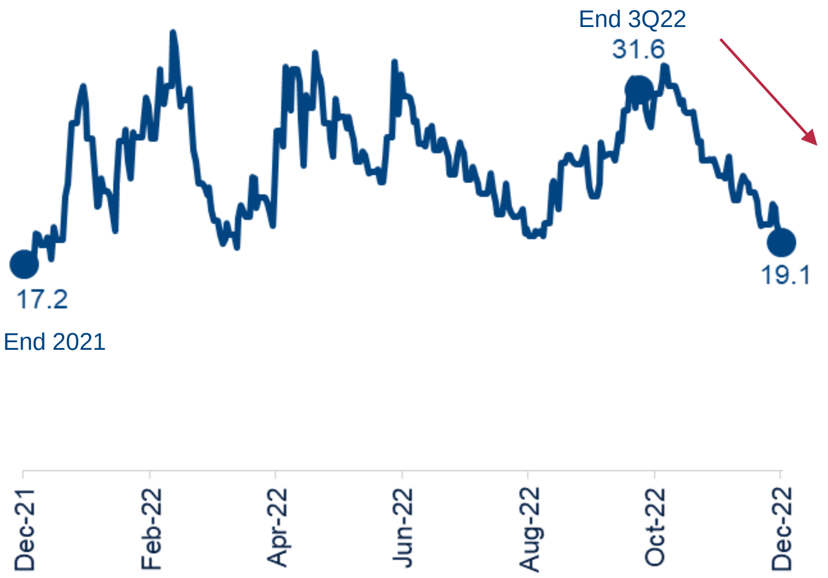


Source: Investing.

- In this context of reduced dynamism:
  - Strict "zero COVID-19" measures are beginning to ease: reduced quarantine for foreign tourists.
  - A 16-point plan is implemented to contain the deterioration of the real estate market: banks will have more time to adapt to the caps on loans to the sector, facilities for the repayment of developer debt, among other measures.
- However, contagions have continued to increase, and it will take time to advance in the vaccination process and in improving the healthcare infrastructure so that greater flexibility can be achieved. In the real estate market, will the measures be enough to restore confidence in developers?

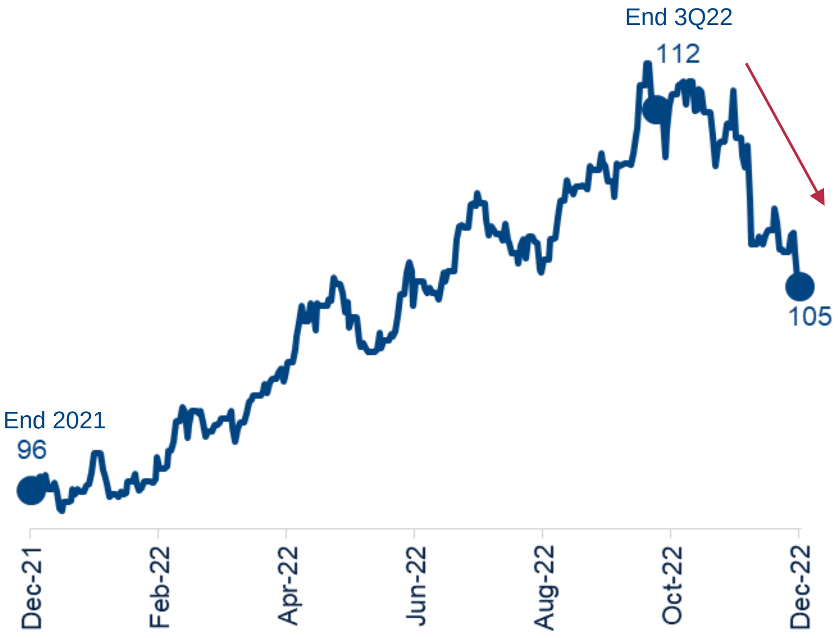
Less hawkish Fed outlook and measures of easing and support in China contributed to positive overall market sentiment

VIX
(POINTS)



Source: Bloomberg.

DXY
(INDEX)



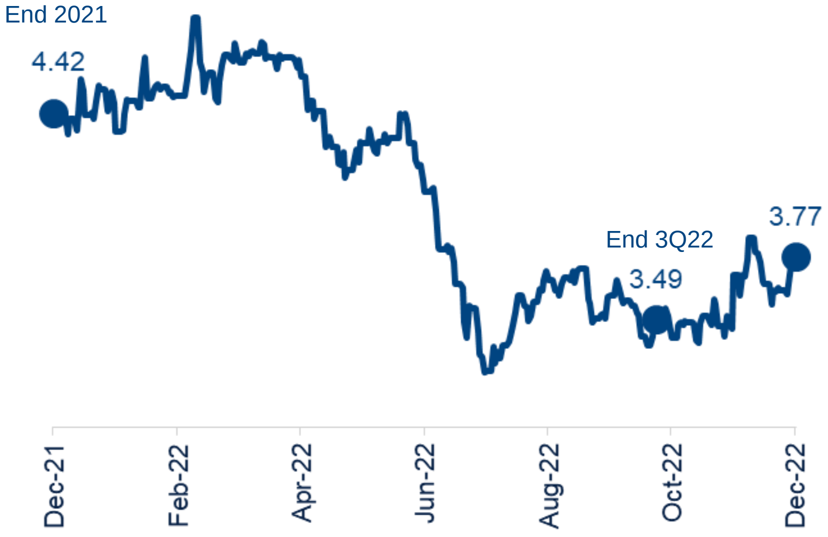
Source: Bloomberg.

Asset and industrial commodity prices, including copper, rebounded in recent weeks

EQUITY MARKETS
(POINTS)

Source: Bloomberg.

PRICE OF COPPER
(LME, USD PER POUND)



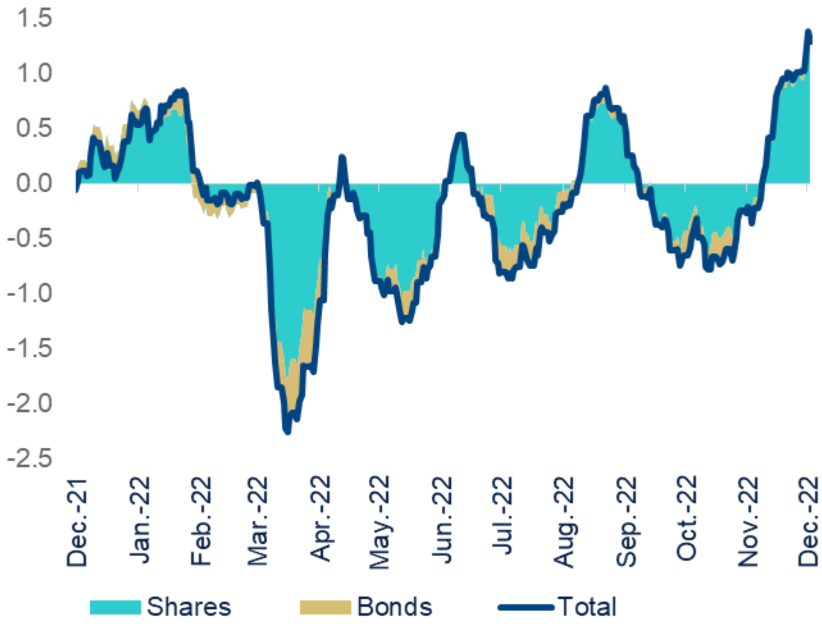
Source: Bloomberg.

Emerging economies' risk premiums declined, and capital inflows recovered

CDS
(BASIS POINTS)

Source: Bloomberg.

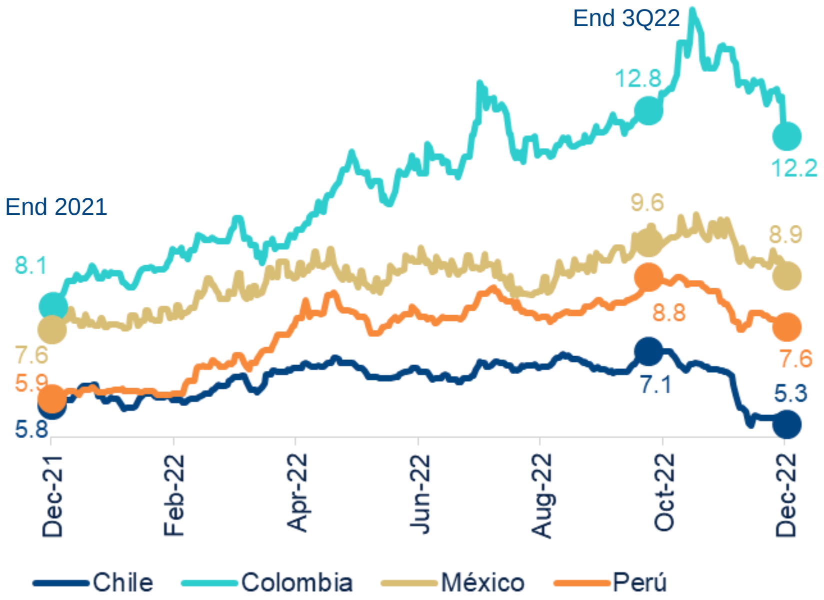
CAPITAL INFLOWS TO EMERGING MARKETS
(USD BILLIONS, 28-DAY MOVING AVERAGE)



Source: IIF.

In LatAm, sovereign debt yields declined, and currencies appreciated

LATAM: 10-YEAR BONDS
(%)



Source: Investing.

LATAM: EXCHANGE RATE
(MONEDA LOCAL VS. USD, 100 = 31 Dec. 2021)

Source: Bloomberg.

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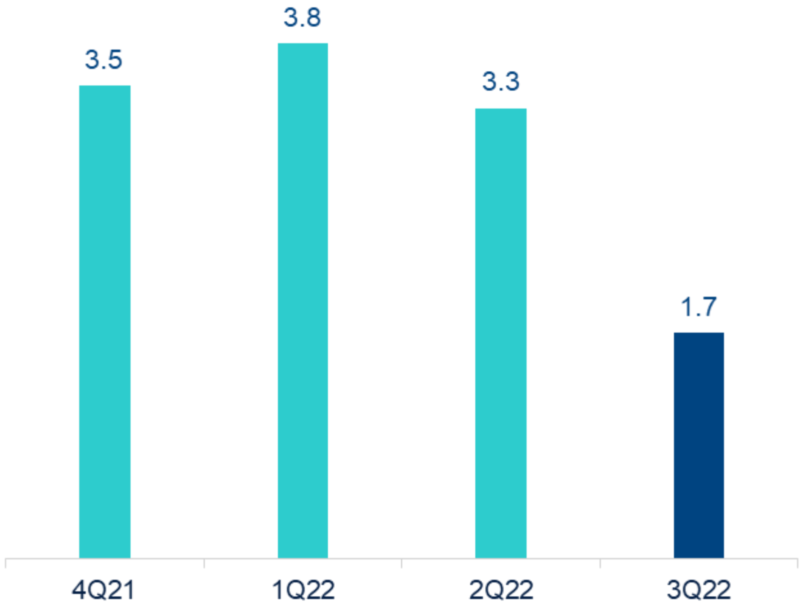
02

Local context: activity, employment and fiscal environment

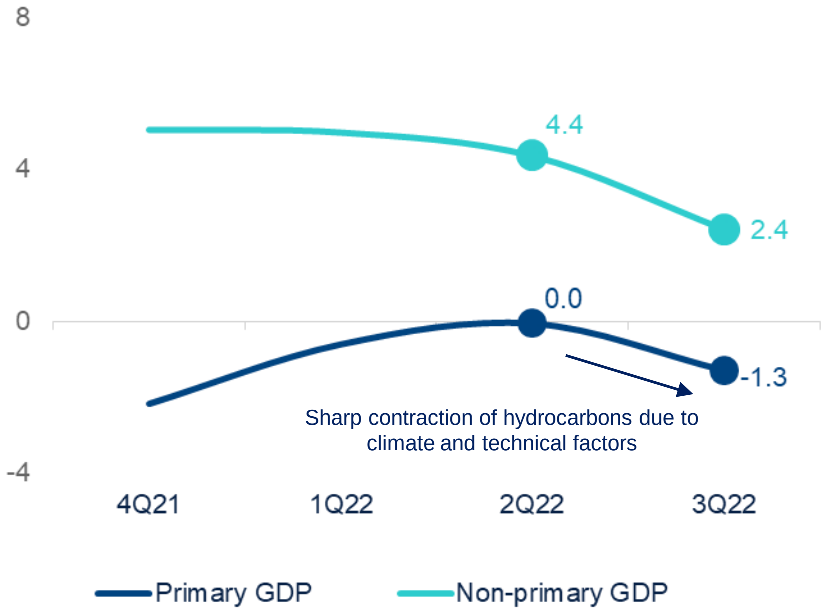
In the third quarter, economic activity lost dynamism, both in primary and non-primary sectors: transitory factors...

GDP
(YEAR-ON-YEAR % CHG.)



Source: BCRP

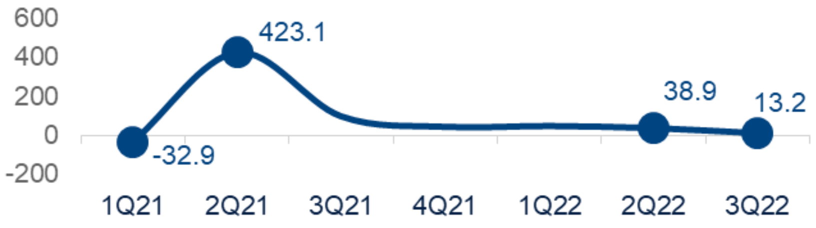
PRIMARY AND NON-PRIMARY GDP
(YEAR-ON-YEAR % CHG.)



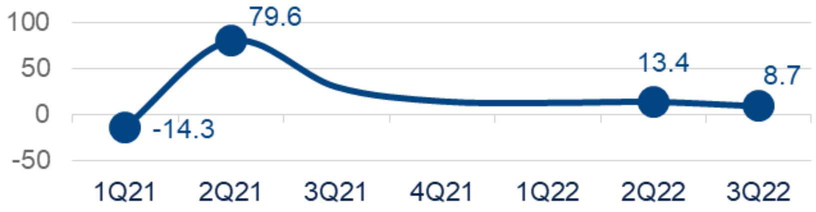
*Without inventories.

... but also more trend-related factors, such as the fading of the "rebound effect" of the activities most affected by the healthcare restrictions

HOSPITALITY AND RESTAURANTS
(YEAR-ON-YEAR % CHG.)

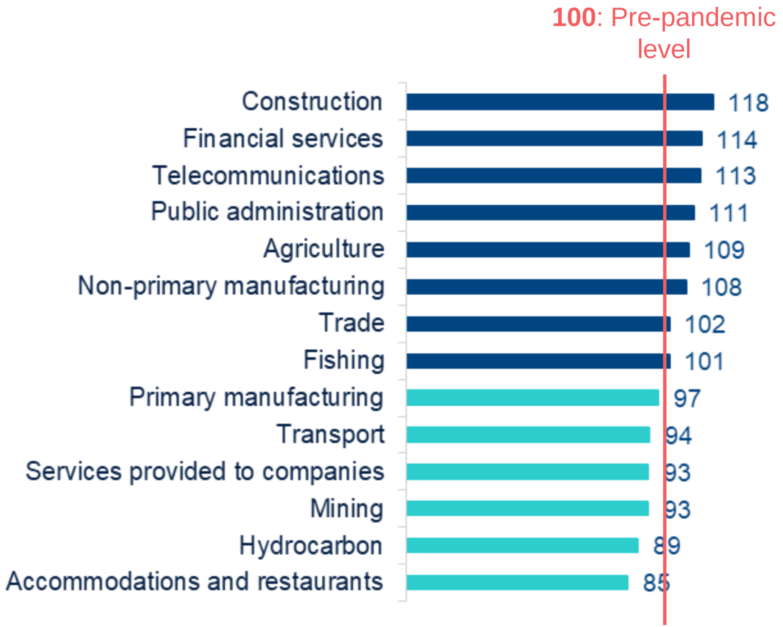


TRANSPORT
(YEAR-ON-YEAR % CHG.)



Source: INEI.

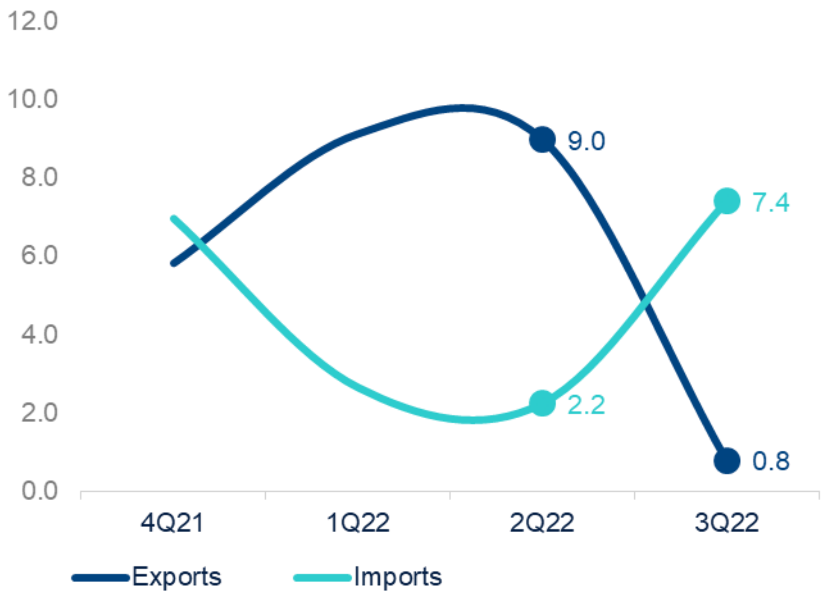
SECTORAL GDP SEPTEMBER 2022
(CUMULATIVE LAST TWELVE MONTHS, INDEX, 2019 = 100)



Source: INEI.

On the expenditure side, the slowdown in activity in the third quarter stemmed from the behaviour of net exports

GDP ON THE EXPENDITURE SIDE: EXTERNAL DEMAND
(REAL YEAR-ON-YEAR % CHG.)

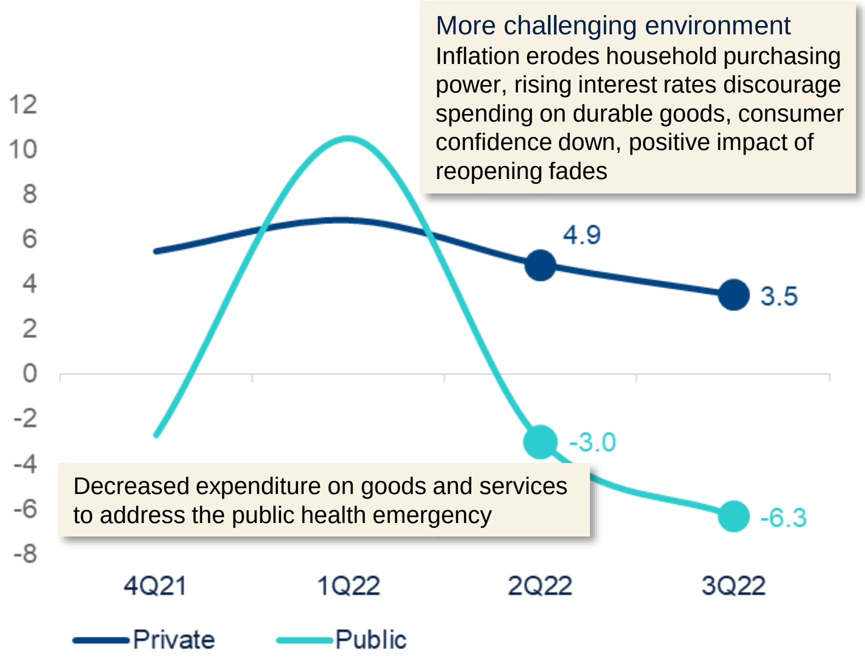


Source: BCRP

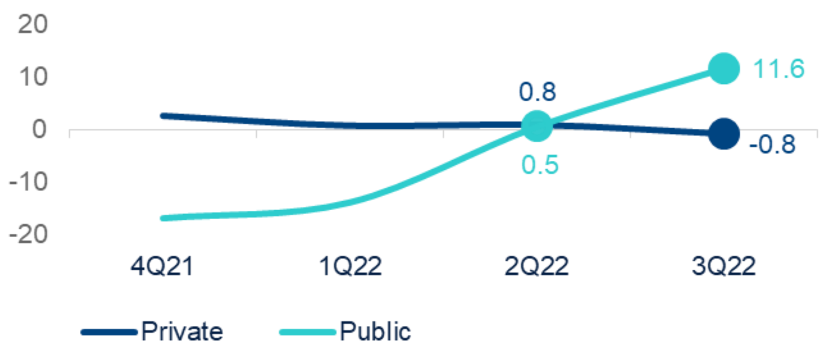
- The slowdown in exports of goods and services mainly stems from lower output in the metal mining and hydrocarbon sector.
- In contrast, imports of goods and services picked up pace due to an increase in the import volume of durable and non-durable goods and industrial inputs.

In addition, private sector consumption and investment lost momentum in the third quarter, while public investment rebounded

EXPENDITURE-SIDE GDP: CONSUMPTION
(REAL YEAR-ON-YEAR % CHG.)



EXPENDITURE-SIDE GDP: INVESTMENT
(REAL YEAR-ON-YEAR % CHG.)



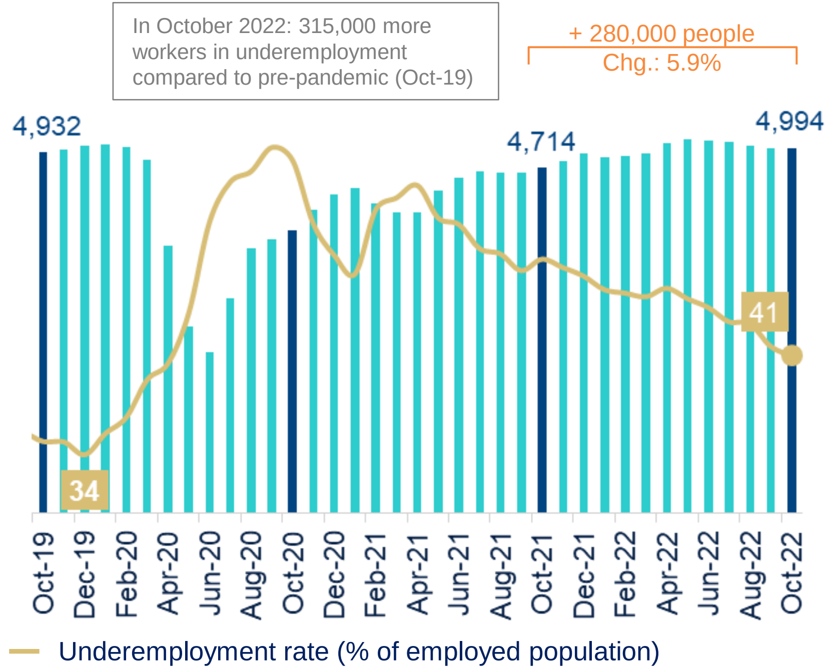
INVESTMENT IN MINING
(REAL YEAR-ON-YEAR % CHG.)

4Q21	1Q22	2Q22	3Q22
22.0	6.0	3.2	-12.5

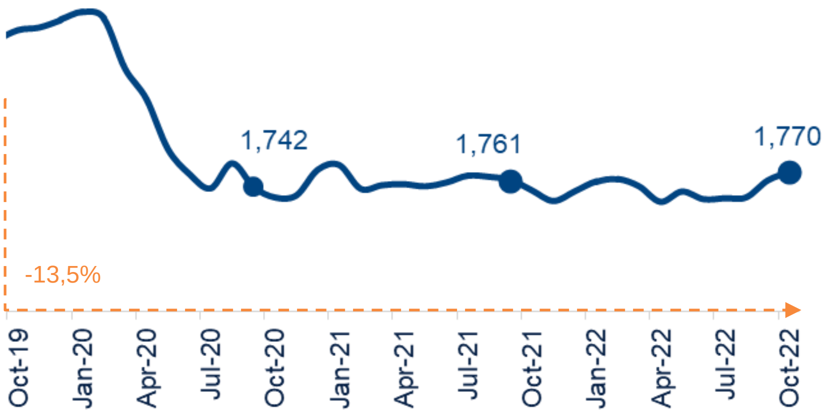
Source: BCRP

Employment continued to rise, but the quality of jobs and the purchasing power of wages are still far from their pre-pandemic level, both in Lima and...

EMPLOYMENT IN THE LIMA METROPOLITAN AREA
(THOUSANDS OF PEOPLE, 3-MONTH MOVING AVERAGE)



AVERAGE MONTHLY INCOME OF WORKERS IN METROPOLITAN LIMA (IN SOLES, AUGUST-OCTOBER 2022 PRICES, 3-MONTH MOVING AVERAGE)

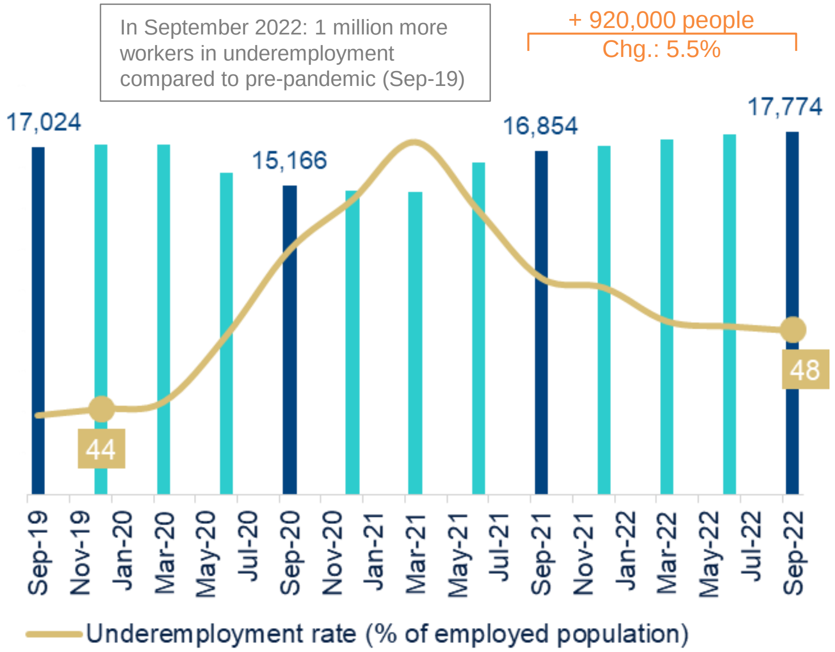


Oct-22	Year-on-year % chg. (vs. Oct-21)	Pre-pandemic % chg. (vs. Oct-19)
Nominal wage income	10.6	0.5
Real wage income	2.1	-13.5

Source: INEI (Permanent Employment Survey). Prepared by: BBVA Research.

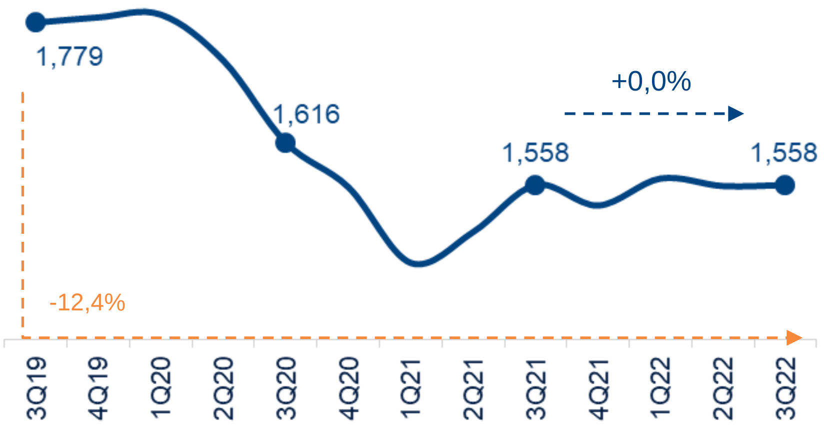
...at a national level

EMPLOYMENT AT NATIONAL LEVEL
(THOUSANDS OF PEOPLE, AVERAGE OF LAST 4 QUARTERS)



Source: INEI (ENAHO. Information from 2022 is preliminary). Prepared by: BBVA Research

MONTHLY WAGE INCOME [1]
(IN SOLES, AT OCT21-SEP22 PRICES, MOVING AVERAGE LAST 4 QUARTERS)

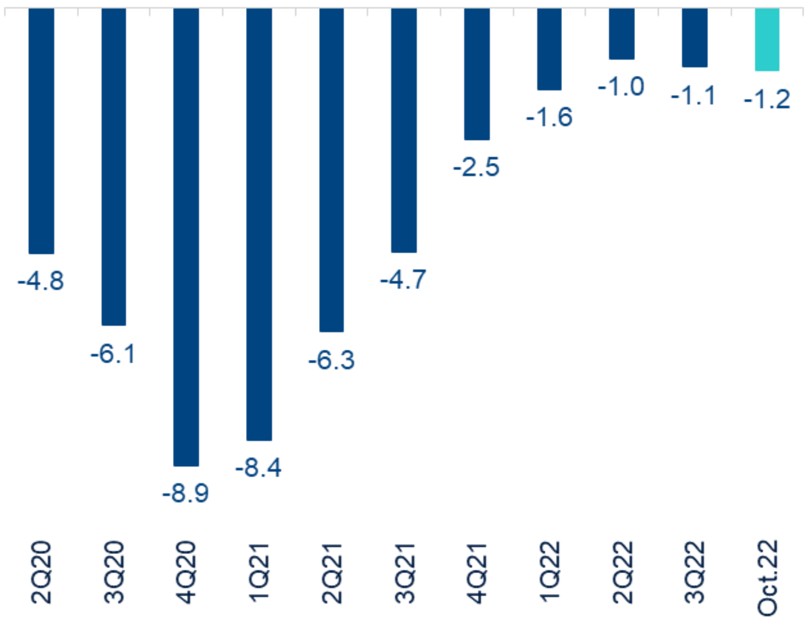


Moving year at Sep-22	Year-on-year % chg. (vs. Sep-21)	Pre-pandemic % chg. (vs. Sep-19)
Nominal wage income	7.3	-1.5
Real wage income	0.0	-12.4

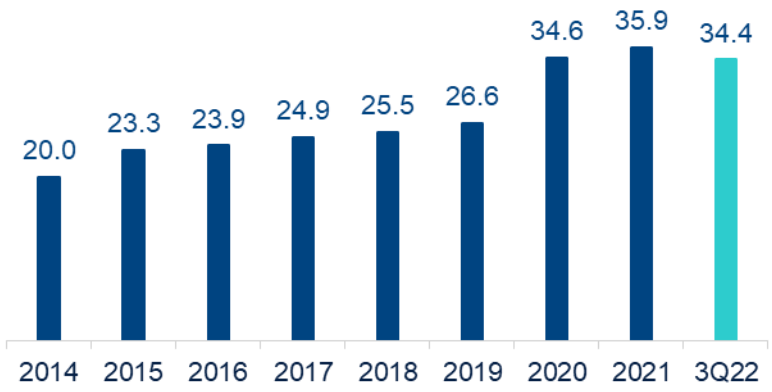
1/ Corresponds to urban workers

On the fiscal side, the deficit remained at low levels and the debt decreased throughout the year, thereby...

FISCAL BALANCE
(NFPS, CUMULATIVE IN LAST 12 MONTHS, % OF GDP)



GROSS PUBLIC DEBT
(NFPS, % OF GDP)



NET PUBLIC DEBT
(% GDP)

2019	2020	2021	3Q22
12.9	22.2	21.8	20.0

Source: BCRP

... S&P affirmed BBB credit rating with "stable" outlook ... but Fitch downgraded outlook to "negative" due to political context

Fitch: BBB, “negative” outlook

"Deteriorating political stability and government effectiveness have increased downside risks for the ratings. Fitch does not expect political paralysis to end during the forecast period [2022/24]."

SOVEREIGN CREDIT RATINGS AND OUTLOOKS

	S&P	Moody’s	Fitch
Peru	BBB	Baa1	BBB
Chile	A	A2	A-
Mexico	BBB	Baa2	BBB-
Colombia	BB+	Baa2	BB+
Brazil	BB-	Ba2	BB-

Positive outlook   Stable outlook
Negative outlook   Downgrade in 2021/22

Source: Fitch Ratings, S&P and Moody’s

FITCH: BBB, “NEGATIVE” OUTLOOK

Fitch Ratings
Summary of criteria for sovereign credit rating assessment

Quantitative analysis
Sovereign Rating Model (SRM [1])

Structural characteristics
Macroeconomic
Public finance
External accounts

Qualitative analysis
(adjustment)

Within the group of BBB countries, Peru shows weaknesses in structural characteristics. "Qualitative analysis" incorporates assessment of political context.

1: Regression model based on 18 variables
Source: Fitch Ratings

Unfortunately, political tensions have escalated further and an environment of social unrest continues. Risk to sovereign credit rating

POLITICAL CONFLICT

- Congress admits the Attorney General's Office charge against President Castillo for alleged crimes of corruption and obstruction of ongoing investigations.
- The Executive Branch presents a question of confidence in order to repeal the law that reaffirms that any referendum on changes to the Constitution must be approved by Congress.
- Congress "flatly rejects" this request and the Executive Branch interprets this as a denial of confidence. This counts as the first of two denials of confidence that would empower the president to dissolve Congress. With this argument, the ministerial cabinet enters crisis.
- New motion of vacancy.
- The approval of the 2023 Budget was not free of conflict, although a consensus was finally reached.

SOCIAL CONFLICT

"Las Bambas: Challhuahuacho community members report alleged police repression in Apurimac"

November 22, 2022 (La República)

"Transportation union will observe an indefinite strike starting this Tuesday, November 22"

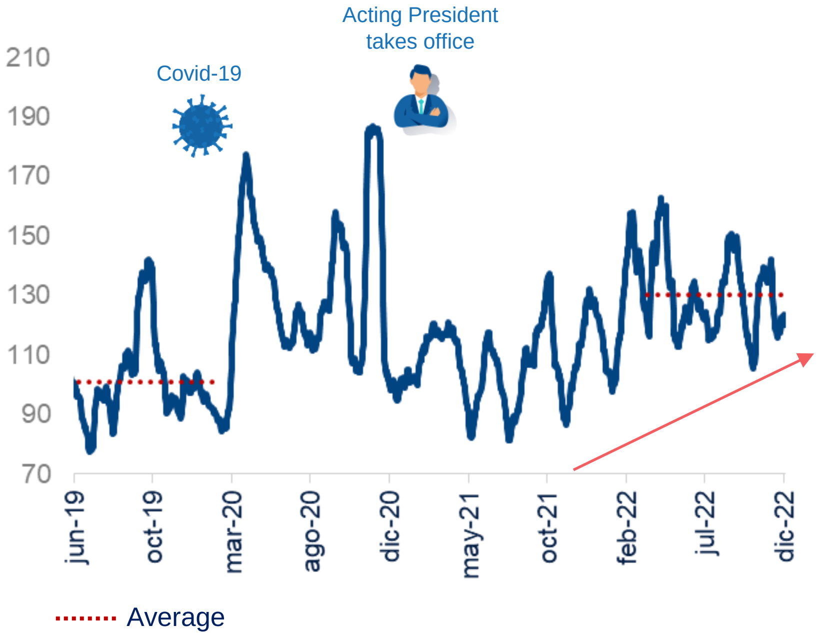
November 21, 2022 (Perú 21)

"Farmers' strike in Arequipa: 'If there is no solution, we will go on strike indefinitely'"

November 23, 2022 (Infobae)

This socio-political scenario increases uncertainty, which affects business confidence and restrains private investment decisions

POLITICAL TENSION MEASURED THROUGH THE MEDIA
(INDEX, JUN21-FEB22=100)



BUSINESS CONFIDENCE
(POINTS)

Business confidence remains pessimistic, which has a negative impact on private investment and hence on potential GDP growth.

Source: GDELT and BCRP

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03

Macroeconomic forecasts

3.1. GDP and economic activity

A sharp growth deceleration, with (mild) recessions in the US and the EZ, is likely in 2023 as interest rates and inflation will remain at high levels

BBVA RESEARCH CENTRAL SCENARIO: MAIN ASSUMPTIONS AND IMPACTS

GROWTH TO SLOW DOWN SIGNIFICANTLY

Global growth to ease from 6.3% in 2021 to 3.3% (+0.1pp) in 2022, 2.3% (-0.1pp) in 2023, and to bounce back to 3.3% in 2024.

Energy prices to soon push the EZ into a recession, but gas shortages are not expected.

A mild recession by the mid-23 is likely in the US.

Growth to remain relatively weak, despite a likely recovery in China.

MONETARY TIGHTENING: STILL NOT OVER

Policy rates will continue to raise, but likely at a more gradual pace as inflation/growth lose steam.

Once they peak in 1Q23, rates are likely to remain unchanged at least till the end of 2023.

Rate increases will be complemented by quantitative tightening

Pro-growth measures to remain in place in China.

INFLATION TO EASE WHILE REMAINING HIGH

Inflation expected to slow as commodities prices and bottlenecks continue easing.

Wages are likely to grow more than in the past, but less than inflation.

Large second-round effects to be prevented.

Monetary tightening to reign in on expectations.

FINANCIAL VOLATILITY TO REMAIN IN PLACE

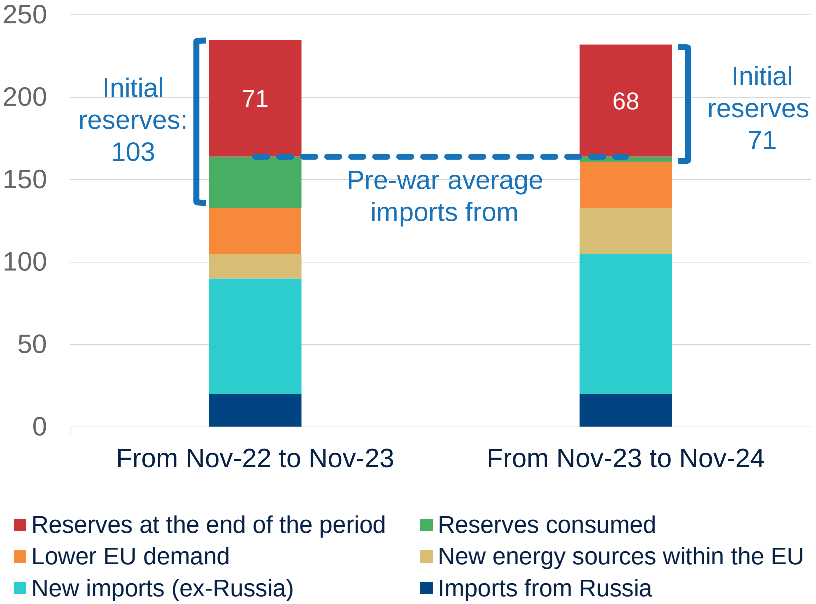
Inflation easing to take some pressure off central banks.

But lower global liquidity and high interest rates to continue supporting the USD and bond yields.

Volatility is set to remain relatively high and stress episodes should not be ruled out.

Gas markets: high reserves, saving measures and flows from alternative sources will prevent shortages in 2023, and, possibly, also in 2024

EUROPEAN GAS: BASE SCENARIO FOR SUBSTITUTION OF RUSSIAN IMPORTS (*)
(BCM: BILLION CUBIC METERS)



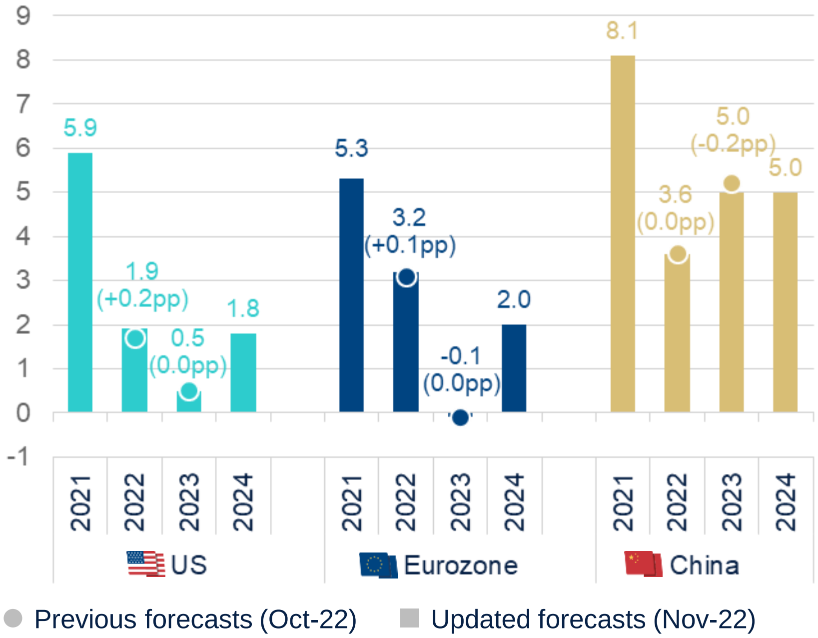
(*) Current reserves: 103 BCM. Imports from Russia ahead: 20 BCM/year. Assumed demand reduction: 7% lower than the pre-war (2017-21) average.
Source: BBVA Research.

- Base scenario: gas prices settle below record highs, but above current levels, with no shortages over 2023-24 even if Russia halves current provision (40 bcm/year) from now on.
- The main risk is that Russia cuts gas exports to zero: reserves could fall below 50 bcm in Nov/23, potentially insufficient to match the needs for the winter of 2024.
- This risk scenario implies that Russian liquified gas would likely be available to other buyers, meaning that Europe could find new supplies elsewhere.
- Scenarios ahead will depend on weather conditions and global demand for gas, on top of flows from alternative sources and saving measures in Europe.

Growth to stagnate before going back to potential levels in 2024 in the US and EZ in 2023, and to converge to 5%, with downside risks, in China

GDP: ANNUAL GROWTH IN REAL TERMS (*)

(%)

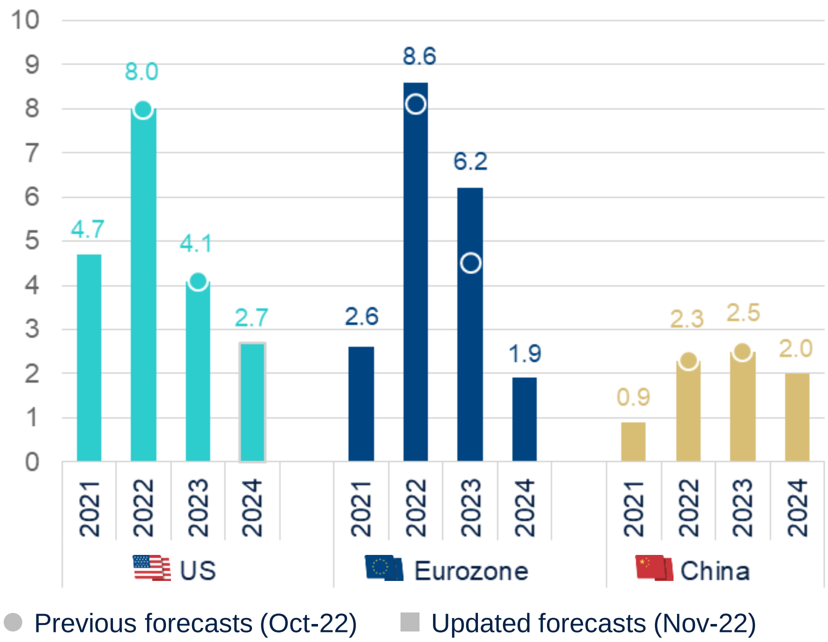


(*) Forecast change in parentheses.
Source: BBVA Research.

- 2022 GDP forecasts revised slightly up in US and EZ, in line with upward 3Q22 surprises.
- Deceleration prospects remain broadly unchanged: monetary tightening and price pressures will eventually hit harder labor markets and private consumption.
- A mild recession is likely over the next few quarters in the EZ, although gas shortages are not anticipated, and by mid-2023 in the US.
- In China, growth is still expected to recover, supported by infrastructure investment, but 2023 GDP forecast has been revised down.
- The recent measures to ease covid policies and support to the real estate sector are insufficient to significantly reduce concerns about weak growth.

Inflation will decline more quickly in the US than in the EZ, at least in 2023, as the shock imposed by the war will continue affecting mainly the latter

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



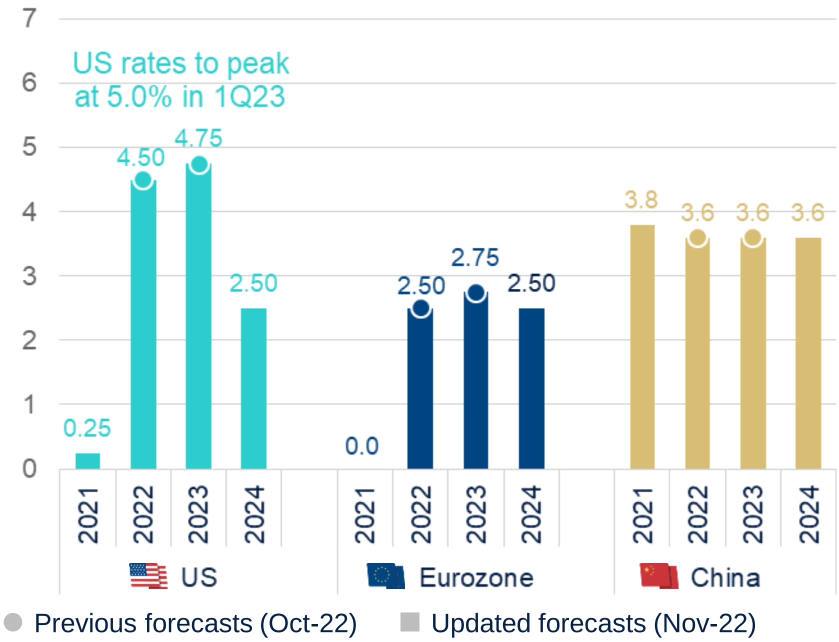
Source: BBVA Research.

- Inflation is set to continue slowing in the US as ongoing shocks wane and demand weakens, but it will be above the 2% target for some time.
- In the EZ, inflation is likely to soon peak, but forecasts have been revised up as the effects of more widespread price revisions, higher wage growth (to be around 4% ahead) and a weaker euro offset lower than expected energy prices.
- Inflation expectations are expected to remain broadly anchored both in the US and in the EZ.
- In China, inflation will continue at low levels largely on declining commodity prices, increasing imports from Russia and subdued demand.
- Inflation forecasts still have an upward bias.

The interest-rate hiking cycle is likely to come to an end in early 2023 in the US and the EZ, but there will be scarce room for monetary easing before 2024

MONETARY POLICY INTEREST RATES (*)

(%, END OF PERIOD)

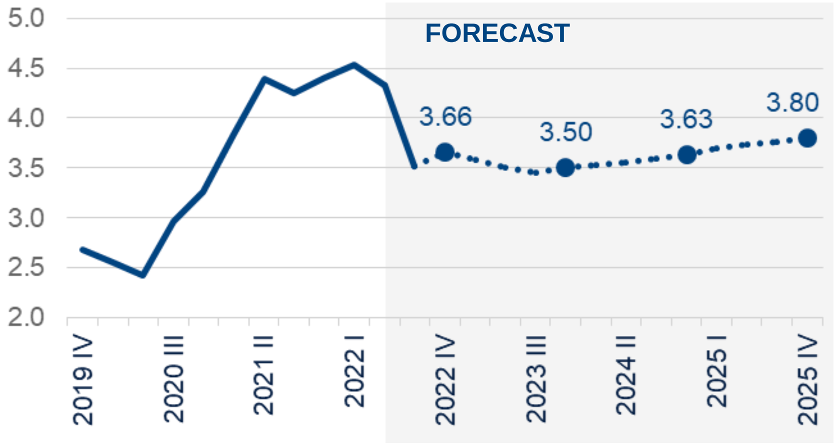


(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- The Fed and the ECB will continue raising rates , but probably at a softer pace than in the last few months: policy rates to reach 5.0% in the US and 2.75% (with an upside bias) in the EZ in 1Q23.
- A long pause is likely afterwards: inflation above targets should prevent rate cuts before Dec/23.
- Although rate hiking cycles should be soon over, a quantitative tightening is set to remain in place in the US and to soon start in the EZ.
- A non-expansionary fiscal policy is likely in the US, but not necessarily in the EZ.
- In China, controlled inflation will allow policy rates to remain low, but significant monetary stimulus are not anticipated.

For the remainder of 2022 and for much of next year, downward pressure on copper prices, but constructive outlook after that

INTERNATIONAL COPPER PRICE
(USD PER POUND, QUARTERLY AVERAGE)



INTERNATIONAL COPPER PRICE
(USD PER POUND, ANNUAL AVERAGE)

2019	2020	2021	2022*	2023*	2024*	2025*
2.73	2.80	4.22	4.01	3.51	3.58	3.75

*Forecast.
Source: BBVA Research.

- Copper prices improved in recent weeks thanks to the unexpectedly positive inflation in the U.S. and expectations of higher growth in China (start of the easing of COVID-19 measures, support for the real estate sector).
- Going forward, the slowdown in global economic activity will imply lower demand for copper. Also, higher incoming supply in 2022 and 2023. In this context, the price of the red metal will be under downward pressure until the end of 2023.
- Price supports: higher output costs (energy), inventories remain tight, and output problems in some large operations.
- Once the cyclical adjustment of the economy ends, a more constructive outlook for the copper price from 2024 onwards: structural support from greater investment in green infrastructure and vehicle reconversion.

Risks: multiple factors, such as long-lasting inflation or new war-related shocks, could trigger a global recession or a financial crisis

MAIN SHORT-TERM RISKS TO THE WORLD ECONOMY

PERSISTENT INFLATION AND HIGHER RATES

UKRAINE WAR AND GEOPOLITICS

HARD-LANDING IN CHINA

SOCIAL TENSIONS AND POPULISM

GLOBAL RECESSION

Growth in G3 economies could weaken more than expected, pushing emerging markets and the global economy into a recession. In particular, if inflation refrains from easing significantly (due to new supply shocks or monetary policy mismanagement, for example), a stagflation scenario could also emerge.

FINANCIAL CRISIS

Declining global liquidity, higher Fed rates, financial volatility and a strong USD could trigger sharp corrections and financial turmoil. Risks are higher in some segments: leveraged loans, high yield debt markets, shadow banking, dollar indebted agents and EM countries, real estate in some DMs, etc.

Baseline forecast scenario: Quellaveco and tourism in the positive, but lower global growth, post-COVID rebound dissipates, and public investment slump

BBVA RESEARCH CENTRAL SCENARIO: KEY ASSUMPTIONS

MINING PRODUCTION
Quellaveco starts production... although social unrest will continue to negatively impact extractive activities.

TOURISM
Recovery of inbound tourism, with a positive impact on services.

LOCAL POLITICAL CONTEXT
Tensions between the Executive Branch and the Legislative Branch continue. Deteriorating public management. Caution in expenditure.

OTHERS
The "rebound effect" dissipates after the most critical stage of COVID-19. High interest rates. Slump in public investment in 2023 (new authorities).

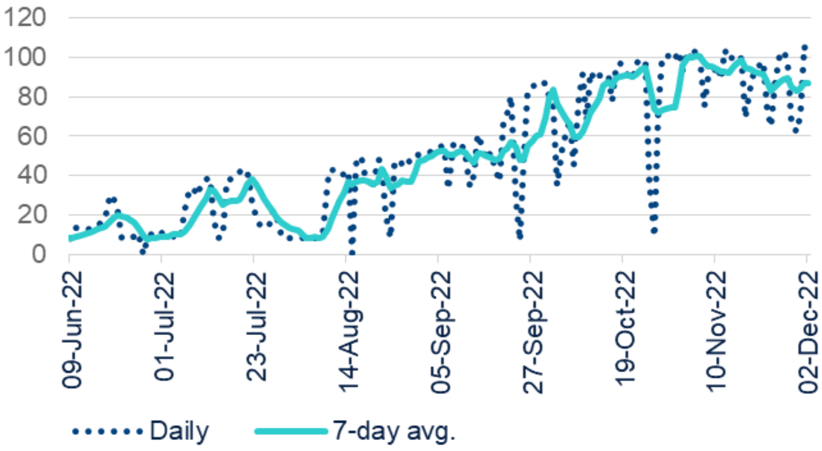
Growth will tend to moderate going forward
GDP will grow 2.7% in 2022 (upward revision from 2.3% previously due to unexpectedly positive 3Q22), **2.5% in 2023, and 2.4% in 2024** (the impact of Quellaveco and tourism dissipates, but overall growth and public investment recover, while interest rates and inflation ease).

Change in growth composition
- **Slowdown in domestic demand is sharper than that of GDP in 2023** due to a more challenging environment for private spending, shrinking mining investment (Quellaveco construction concludes), and a slump in public investment. **Recovery in 2024.**
- **Export performance improves in 2023,** but the sources of that increased dynamism (Quellaveco, tourism) shut down in 2024.

In positive factors for growth, Quellaveco began commercial operations in September and will drive expansion of mining production going forward

ELECTRICITY DEMAND OF QUELLAVECO

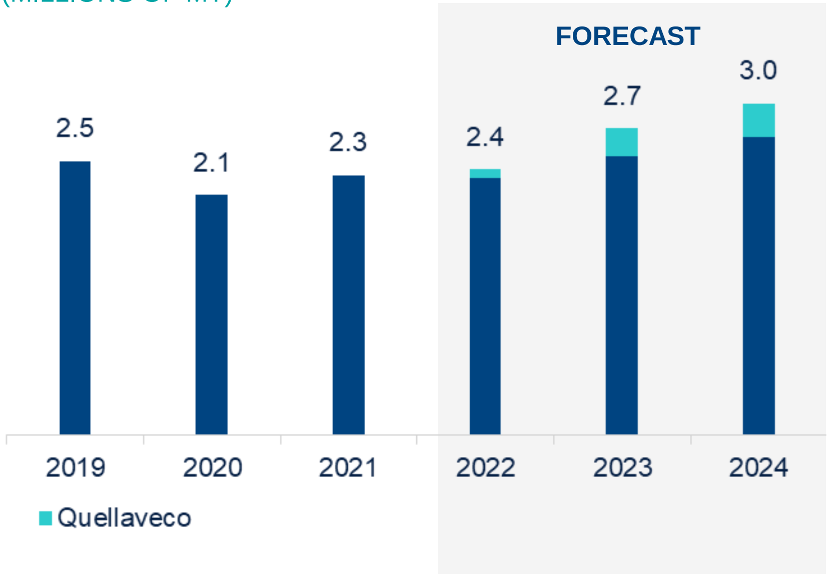
(INDEX, DEC 2, 2022=100)



Quellaveco has been producing since July, but received the commercial license in September, when it reported production of 21,000 MT of copper. It is estimated that this year it will produce approximately 80,000 MT (equivalent to 0.3% of GDP in 2022).

COPPER PRODUCTION

(MILLIONS OF MT)

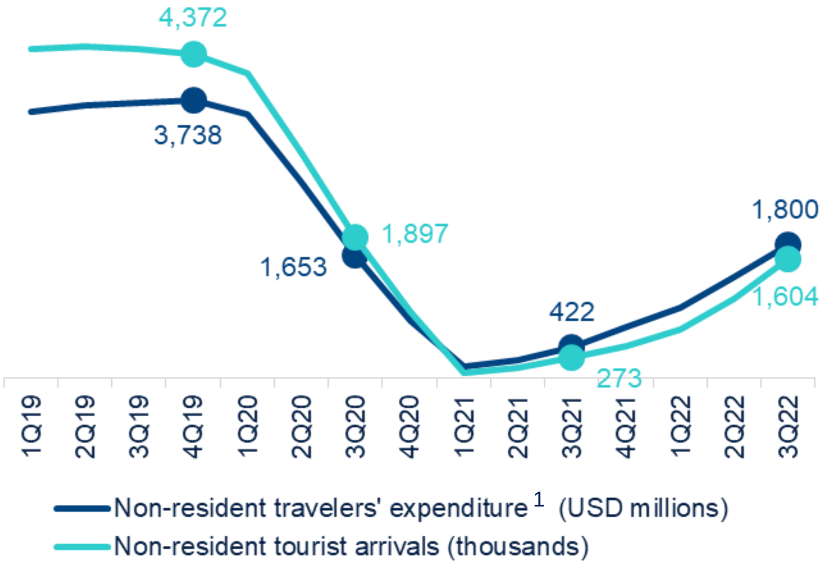


The direct impact on the 2023 GDP growth rate would be between 0.4 and 0.5 percentage points.

Source: COES and BBVA Research.

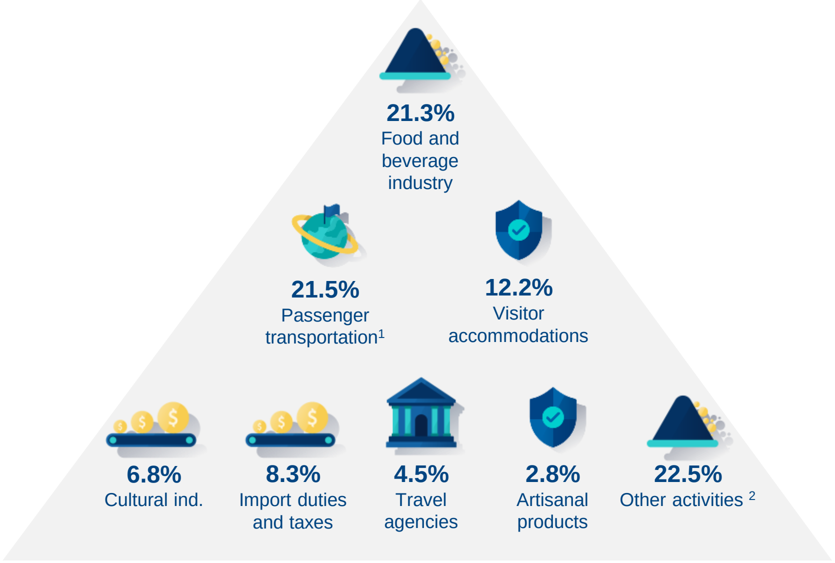
The recovery of inbound tourism will also have a favorable impact on services

ARRIVAL OF FOREIGN TOURISTS IN PERU AND THEIR SPENDING IN THE COUNTRY
(CUMULATIVE LAST 4 QUARTERS)



1: Travel is considered as part of exports of services in the balance of payments. It includes expenditures on accommodations, food and beverages, entertainment events, domestic transportation, gifts, souvenirs and objects acquired for the traveler's own use.
Source: BCRP and BBVA Research.

ACTIVITIES RELATED TO TOURISM GDP
(2019, SHARE OF TOURISM IN TOTAL GDP, %)



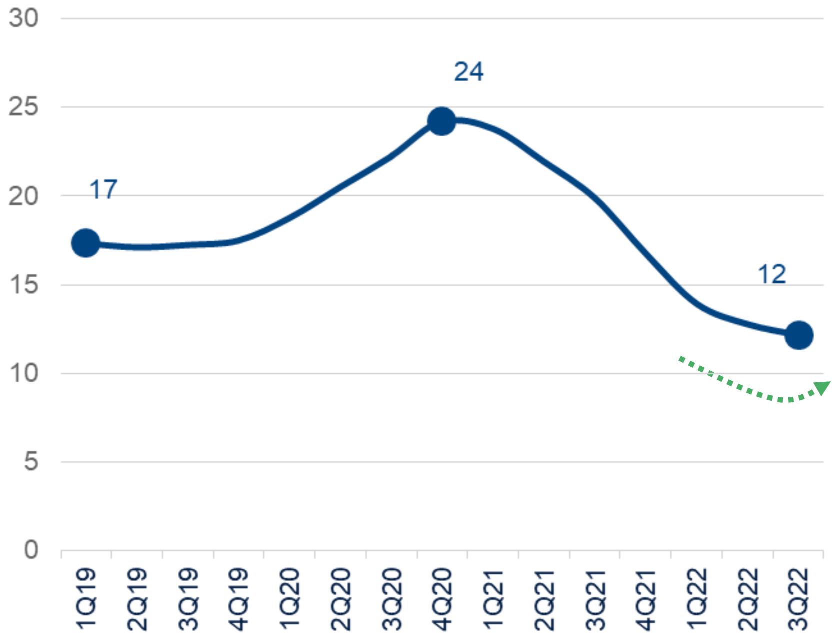
1: Road transport, air transport and water transport.
2: Financial services and insurance, services related to transportation, second homes, urban transportation, railroad transportation, vehicle rental, chambers and associations, public administration and tourism promotion and other activities related and not related to tourism.
Source: Ministry of Foreign Trade and Tourism (Mincetur).”Cuenta Satélite de Turismo 2015-2020”

In contrast, there are elements that suggest that private spending and domestic demand will lose dynamism in 2023

FACTORS THAT WILL MODERATE PRIVATE CONSUMPTION

- Inflation will remain high for much of the year, reducing income purchasing power
- High costs for financing the purchase of durable goods
- It is assumed that there will be no new extraordinary liquidity injections for families (other than those already announced)
- Private savings rate to normalize, reducing support for consumption

PRIVATE SAVINGS
(CUMULATIVE LAST FOUR QUARTERS, % OF GDP)



Source: BCRP

In contrast, there are elements that suggest that private spending and domestic demand will lose dynamism in 2023

FACTORS THAT WILL KEEP PRIVATE INVESTMENT SPENDING LIMITED

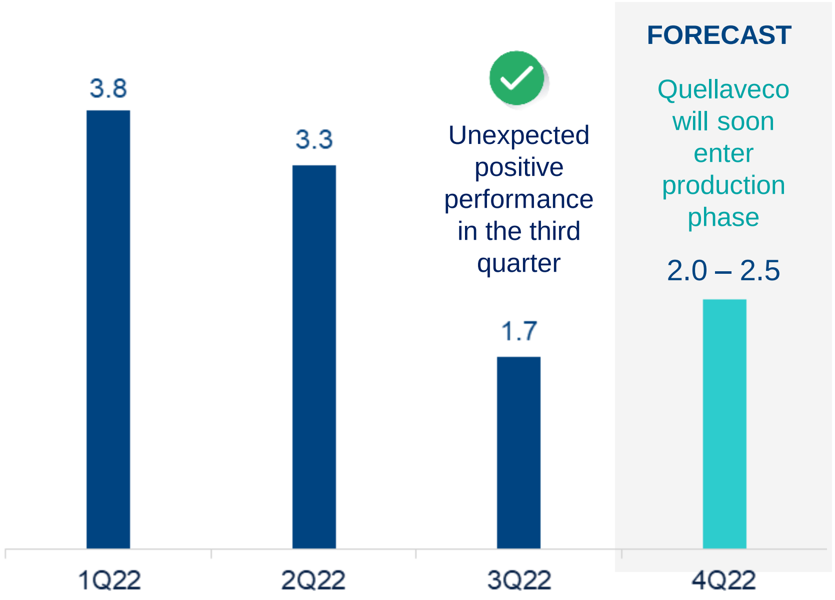
- High interest rates
- Depressed business confidence
- Quellaveco project is completed; new mines to be built are of smaller size (San Gabriel, Magistral)
- Accelerated investment spending assumed for some infrastructure projects (e.g. Chancay port) will partially offset the above

FLOW OF INVESTMENT: SELECT PROJECTS PORTFOLIO (USD MILLION)

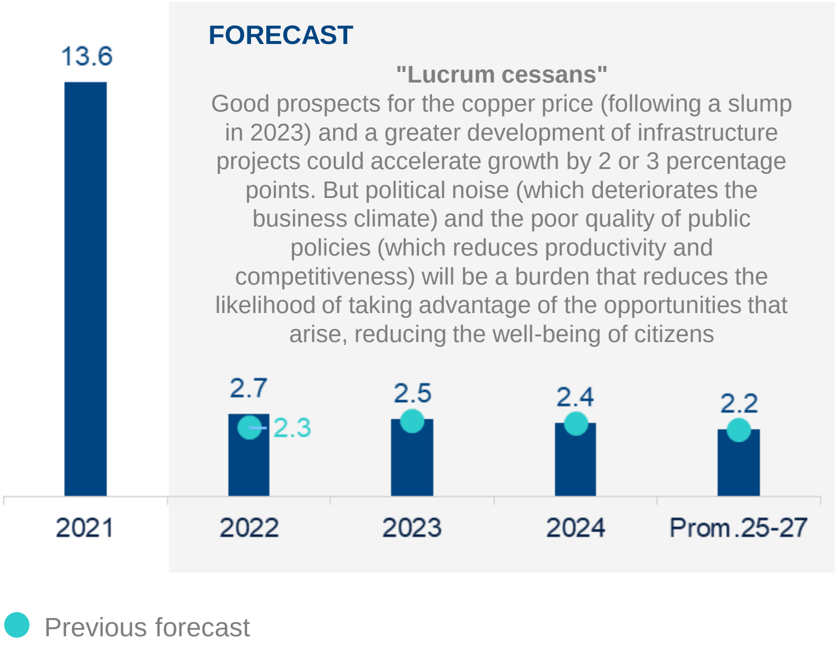
Source: MINEM, Apoyo Consultoría and BBVA Research.

In this context, low growth rates are expected, despite factors that could accelerate the expansion of the economy in the medium term

GDP
(YEAR-ON-YEAR % CHG.)



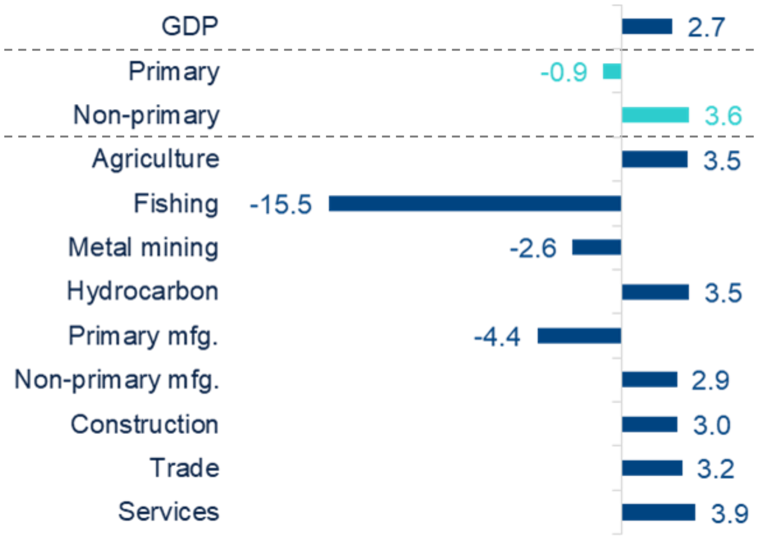
GDP
(YEAR-ON-YEAR % CHG.)



Source: BCRP and BBVA Research.

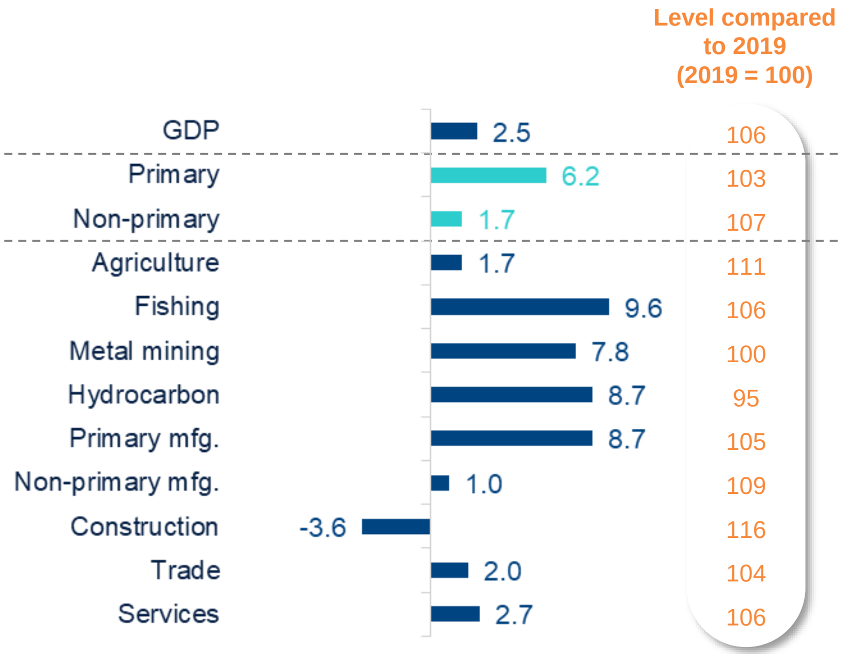
GDP: by sector, better performance of the extractive sectors (including metal mining) will support growth in 2023

2022: SECTORAL GDP FORECAST
(YEAR-ON-YEAR % CHG.)



1: Inventories not included
Source: BBVA Research.

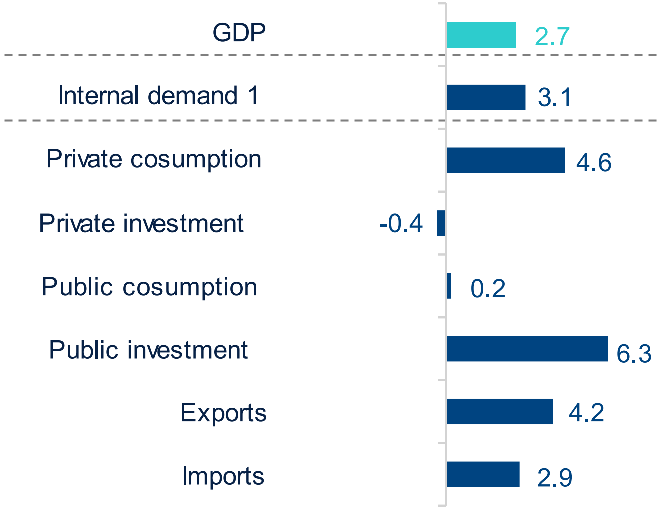
2023: SECTORAL GDP FORECAST
(YEAR-ON-YEAR % CHG.)



Source: BBVA Research.

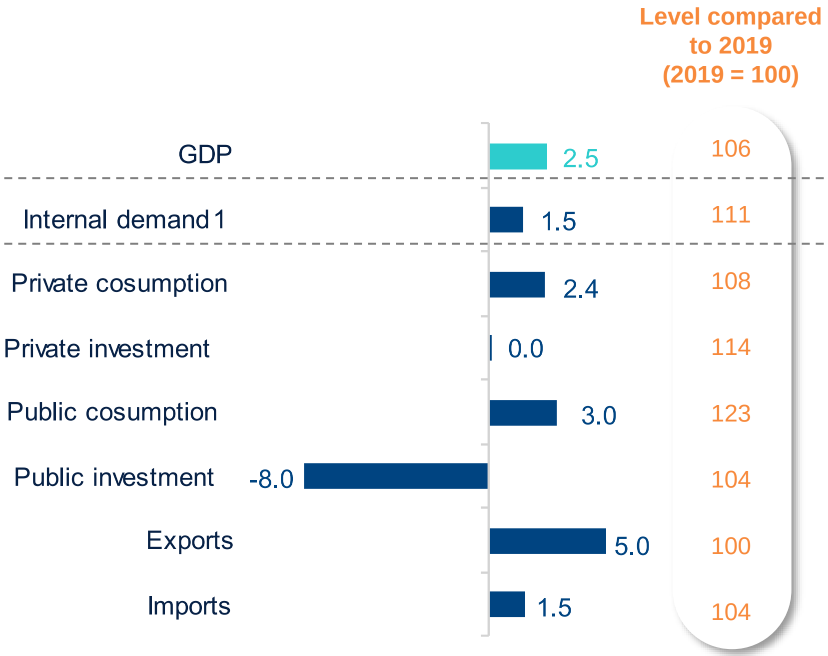
GDP: acceleration of exports (mining) on the expenditure side, while domestic demand moderates

EXPENDITURE-SIDE GDP 2022 FORECAST
(YEAR-ON-YEAR % CHG.)



1: Inventories not included
Source: BBVA Research.

EXPENDITURE-SIDE GDP 2023 FORECAST
(YEAR-ON-YEAR % CHG.)



Source: BBVA Research.

BBVA Research

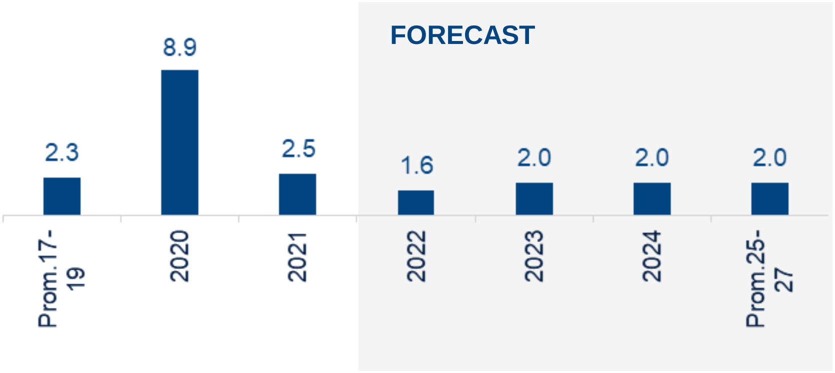
03

Macroeconomic forecasts

3.2. Fiscal balance and public debt

Deficits around 2.0% of GDP or more, with fiscal revenues moderating (lower metal prices and lower domestic demand)

FISCAL DEFICIT
(NON-FINANCIAL PUBLIC SECTOR, % OF GDP)



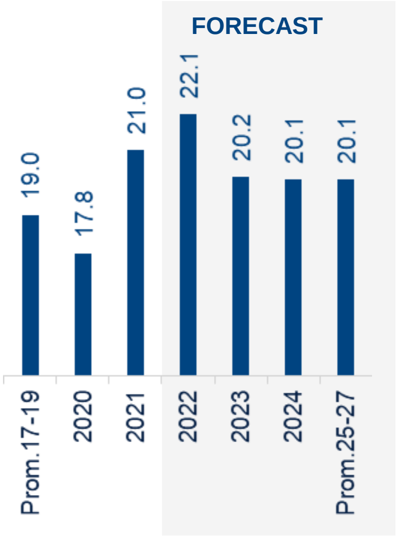
STRUCTURAL FISCAL BALANCE
(% POTENTIAL GDP)

2019	2020	2021	2022	2023	Avg. 24-27
-1.4	-4.5	-3.0	-1.8	-2.2	-2.4

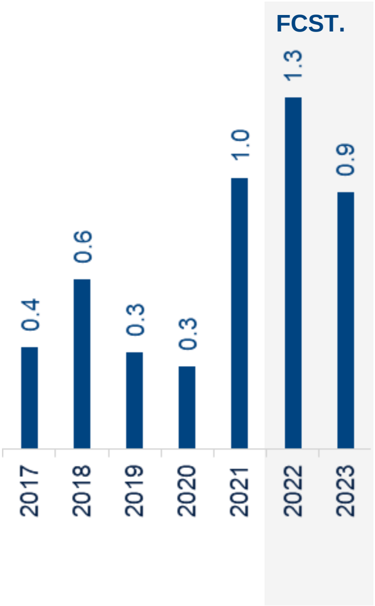
Source: BCRP and BBVA Research.

CENTRAL GOVERNMENT REVENUE
(% GDP)

Considers that the collection of VAT is steadily improving due to the decrease in tax non-compliance



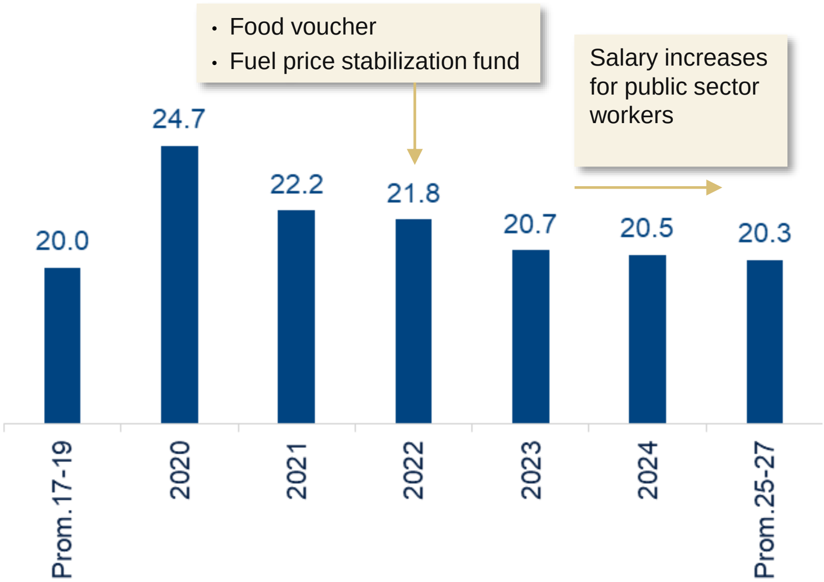
MINING SECTOR INCOME TAX
(% GDP)



Source: BCRP and BBVA Research.

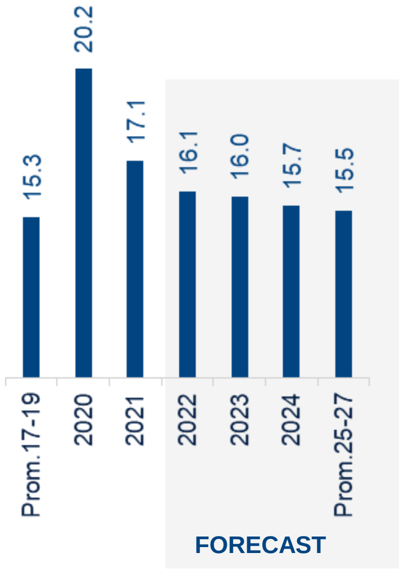
Expected decrease in expenses due to lower disbursements to address COVID-19 and due to support measures against high inflation

GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE (% GDP)

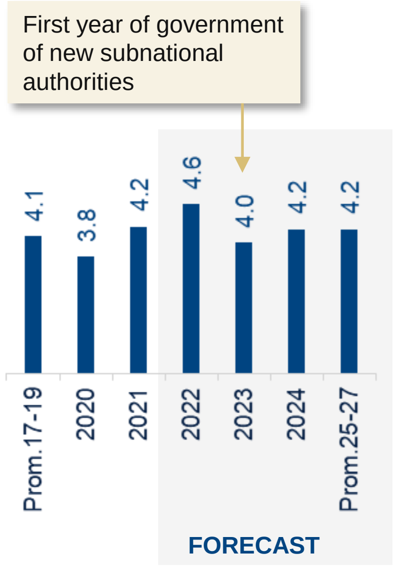


Source: BCRP and BBVA Research.

GENERAL GOVERNMENT CURRENT EXPENDITURE (% GDP)



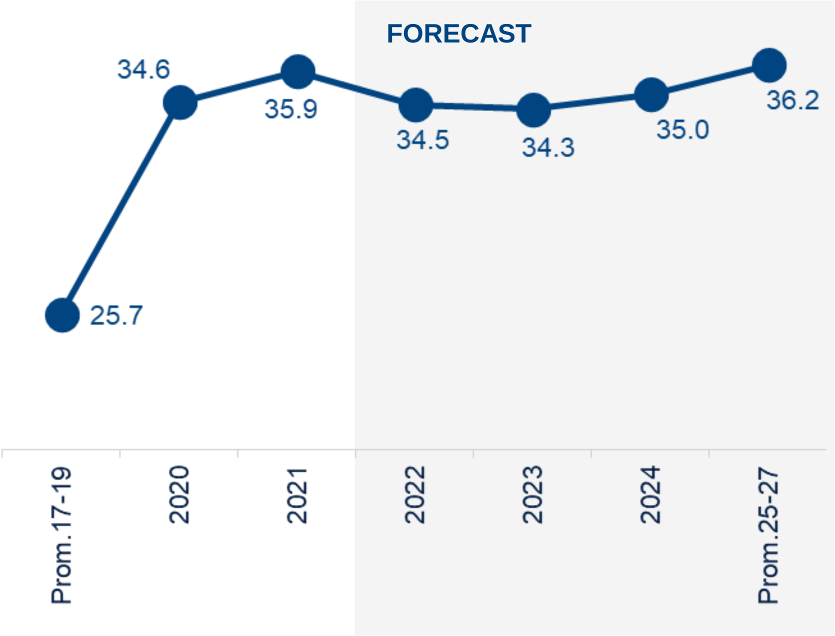
GENERAL GOVERNMENT INVESTMENT EXPENDITURE (% GDP)



Source: BCRP and BBVA Research.

Public debt will show a small upward trend in the medium term, but potential demands for higher spending pose a macro-fiscal risk

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



Source: BCRP and BBVA Research.

VULNERABILITIES

- **Dollarization of public debt has increased:** rose from 32% in 2019 to 54% in 2021.
- **Interest expense** (as a % of General Government revenues) will increase in the coming years.

Public debt will show a small upward trend in the medium term, but potential demands for higher spending pose a macro-fiscal risk

NON-FINANCIAL PUBLIC SECTOR INDICATORS

	2019	2020	2021	2022*
Assets (% of GDP)	13.7	12.4	14.2	14.4
Net debt (% of GDP)	12.9	22.2	21.8	20.0
Dollarization of public debt (%)	32	43	54	53
Interest as % of tax revenues	7.0	9.0	7.2	7.5

* As of the third quarter. As of October in the case of interest as a % of tax revenues.

Source: BCRP and BBVA Research.

RISKS

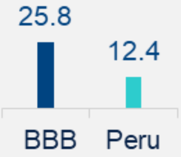
- **PetroPerú:** Contingent liability for guarantees granted and macro-fiscal risk if the company does not improve its management (recent financial support requires so).
- **Higher potential expenditure demands:** payment of bonuses to education sector workers and reimbursement of FONAVI contributions.
- **Constitutional Court:** Congress has spending initiative, although not for the current year.
- **Possible deterioration** of the sovereign credit rating.

Credit rating: Peru excels in macro and public finance factors, but weak in structural factors

COMPARISON BETWEEN PERU AND BBB ECONOMIES ACCORDING TO CRITERIA USED BY FITCH RATING IN THE EVALUATION OF SOVEREIGN CREDIT RATINGS

Structural characteristics

GDP per inhabitant* [1]
(thousands of USD)



*PPP adjusted

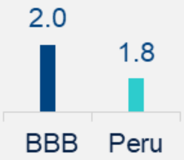
Governance indicators, 2021 (index)*

	Peru	BBB
Control of corruption	29	49
Political stability	32	55
Rule of Law	33	56
Effectiveness of Government	41	63

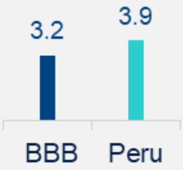
* "0" corresponds to the lowest rating and "100" to the highest rating

Macroeconomic characteristics

GDP growth[1]
(real % chg.)

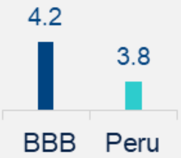


Inflation [1]
(%)

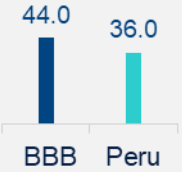


Public finance

Fiscal deficit [1]
(% of GDP)

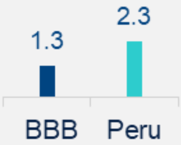


Public debt [1]
(% GDP)

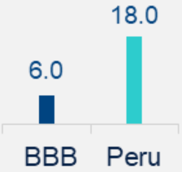


External accounts

Current account deficit
(% GDP)[1]



International reserves in terms of months of imports [2]



[1] Average 2019-2022; [2] 2021
Source: IMF, World Bank and BBVA Research

BBVA Research

03

Macroeconomic forecasts

3.3. External sector and exchange rate

External accounts: decline in terms of trade will induce moderation of trade balance surplus going forward...

TERMS OF TRADE

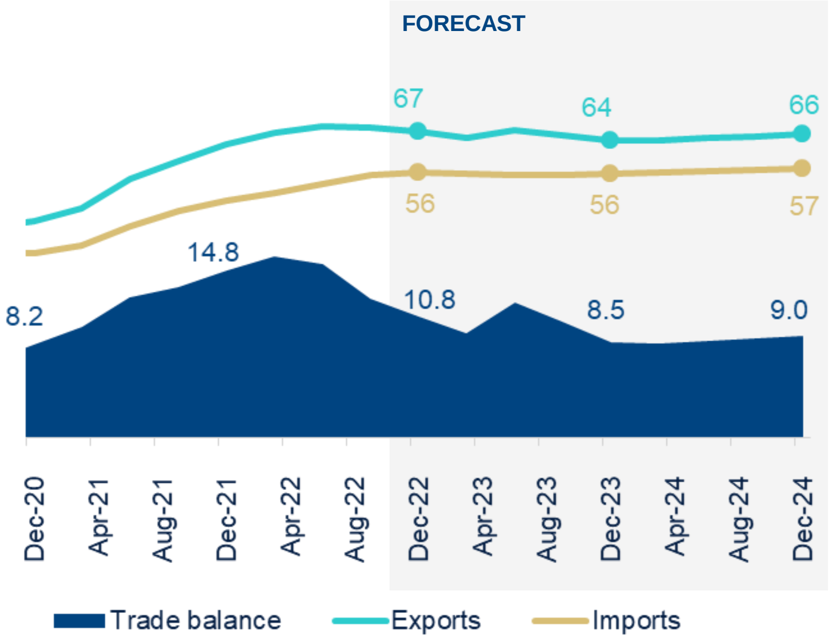
(INDEX: 2007 = 100 AND YEAR-ON-YEAR % CHG.)

Price index (Chg. %)	Exports	Imports	Terms of trade
2022*	3.0	12.6	-8.4
2023*	-7.7	-1.7	-6.1
2024*	-0.7	-0.3	-0.4

*Forecast.
Source: BCRP and BBVA Research.

TRADE BALANCE

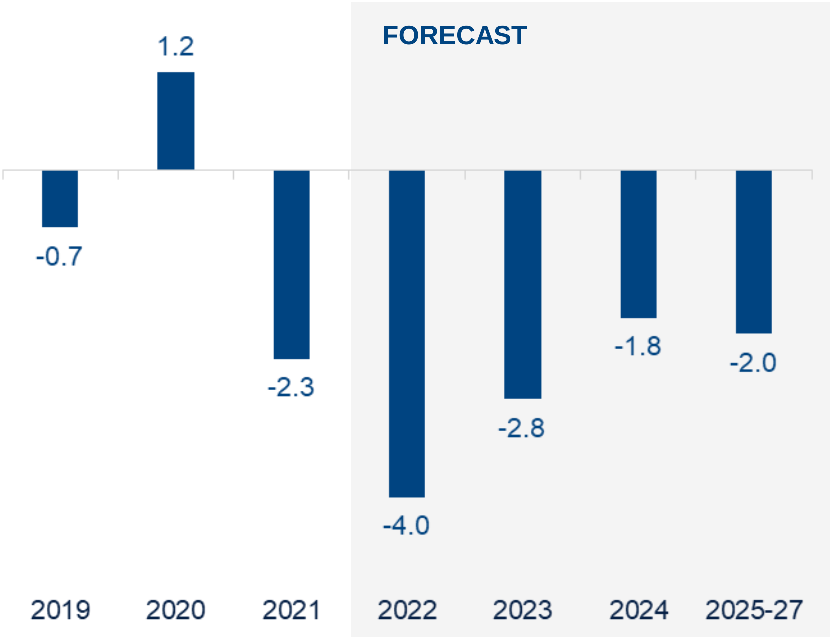
(USD BILLION, CUMULATIVE IN THE LAST FOUR QUARTERS)



Source: BCRP and BBVA Research.

... but improvement in tourism and lower profits of foreign firms will lead to gradual decrease in current account deficit

BALANCE OF PAYMENTS CURRENT ACCOUNT
(% GDP)

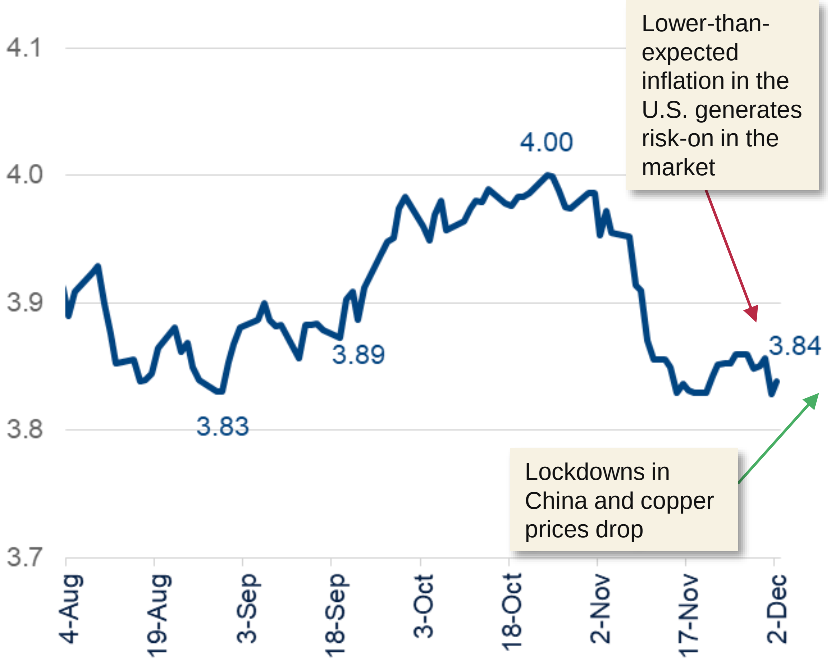


Source: BCRP and BBVA Research.

- Higher prices of imported goods have generated a widening of the current account deficit so far this year.
- In 2023, a lower trade surplus will be offset by: (i) lower profit remittances from foreign companies (in line with lower international metal and oil prices), and (ii) an improvement in the services account (normalization of inbound tourism and lower freight costs).
- Later on, the recovery of industrial metal prices (copper, in particular) will favor a further decrease in the current account deficit, in line with a sustainable medium-term level (which stabilizes net external liabilities).

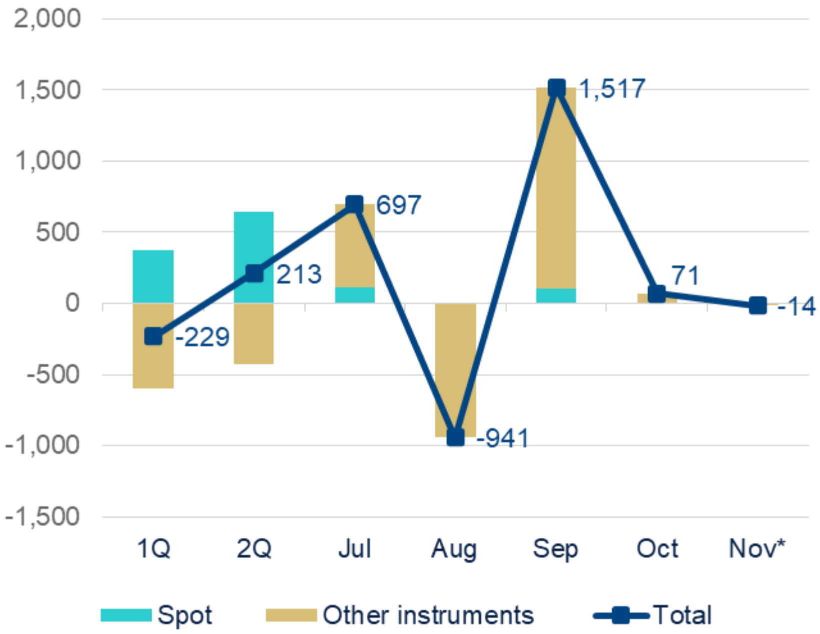
In the foreign exchange market, high volatility in recent weeks due to events in the U.S. (Fed) and China, with the Central Bank reducing (net) interventions

EXCHANGE RATE
(PEN PER USD)



Source: Bloomberg

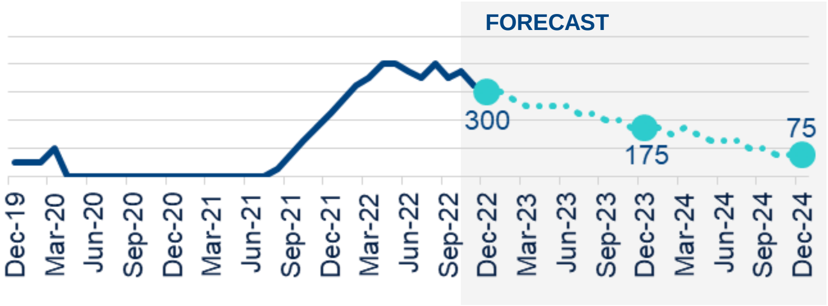
BCRP INTERVENTION IN THE FOREIGN EXCHANGE MARKET (IN SELLING POSITION, USD MILLION)



* As of November 22.
Source: BCRP

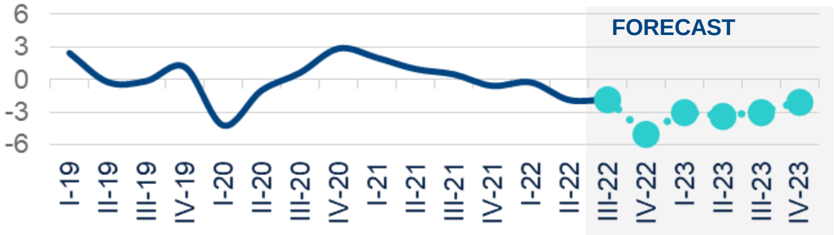
Going forward, PEN will tend to depreciate due to lower interest rate differential and higher risk aversion (slowdown in the U.S.)

INTEREST RATE DIFFERENTIAL, SHORT-TERM (BCRP VS. FED, BP)



CAPITAL FLOWS TO EMERGING MARKETS

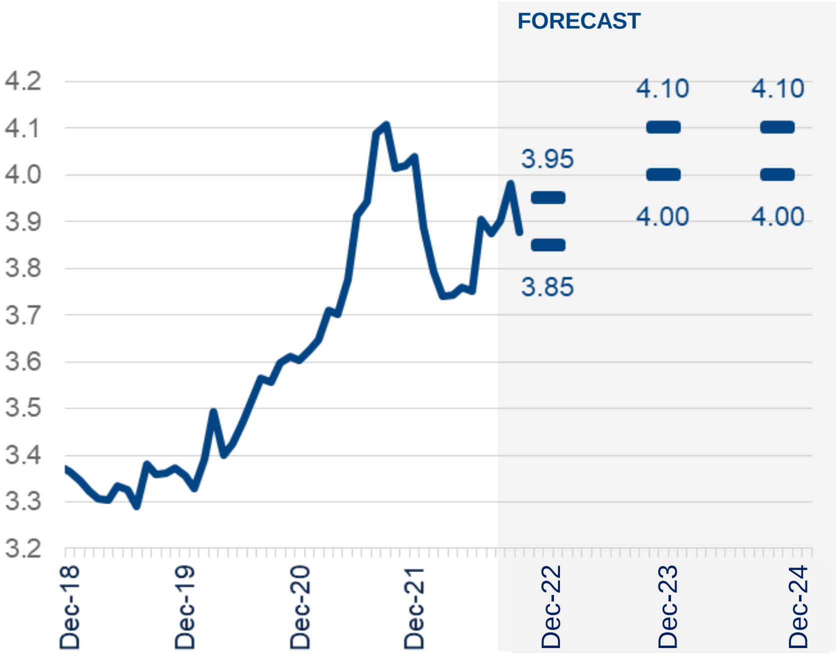
(% OF ASSETS UNDER MANAGEMENT, CUMULATIVE FOUR QUARTERS)



Source: FRED, BCRP and BBVA Research.

EXCHANGE RATE

(SOLES PER DOLLAR)



Source: BCRP and BBVA Research.

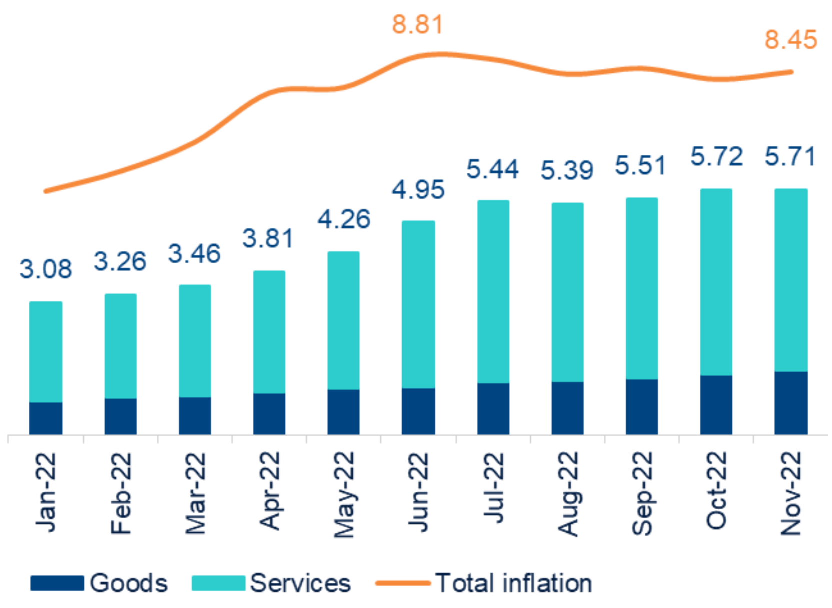
03

Macroeconomic forecasts

3.4. Inflation and monetary policy

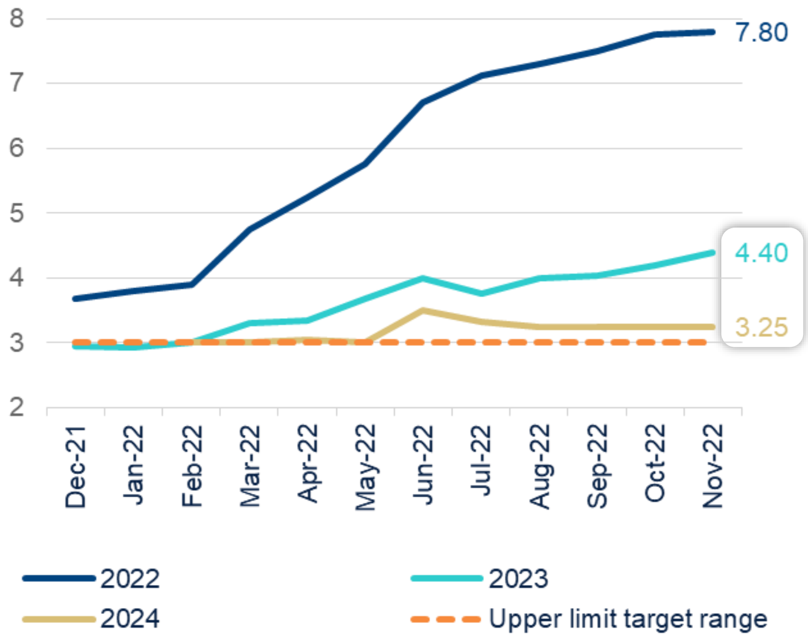
Price outlook still complicated: high and only slowly easing inflation, stagnant core inflation, and expectations unanchored to some extent

TOTAL INFLATION, WITHOUT FOOD AND ENERGY
(AT YEAR-END, YEAR-ON-YEAR % CHG.)



Source: INEI.

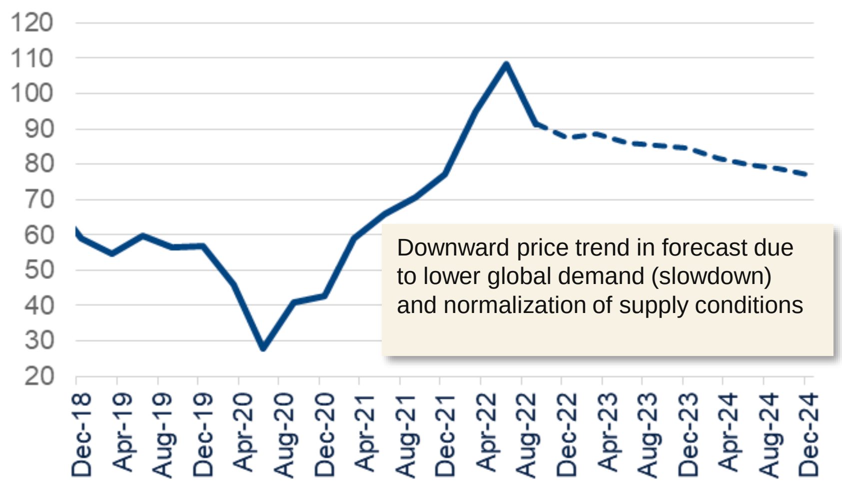
INFLATION FORECASTS 1/
(AT YEAR-END, YEAR-ON-YEAR % CHG.)



1/ Economic analysts' and financial system's expectations
Source: BCRP.

Inflation forecast sees oil and food prices trending lower going forward

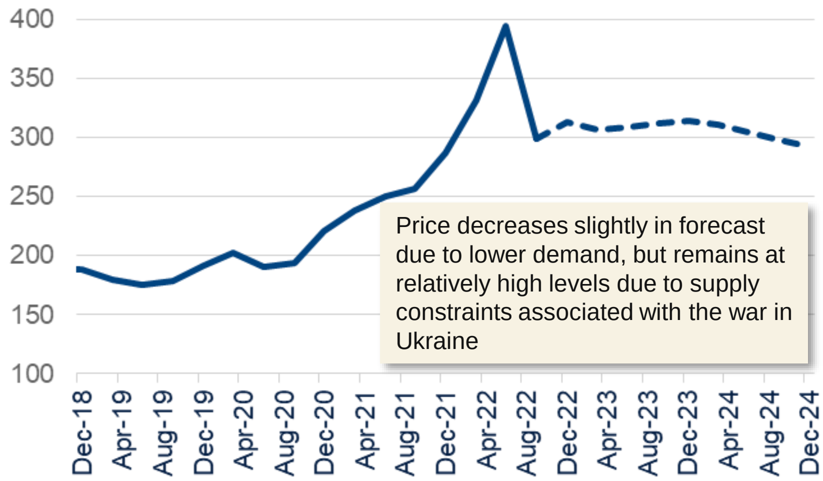
PRICE OF WTI OIL
(USD PER BARREL)



Year-on-year % chg.	2020	2021	2022	2023	2024
WTI	-25.2	81.0	13.4	-3.3	-9.1

Source: Bloomberg and BBVA Research.

PRICE OF WHEAT
(USD PER MT)

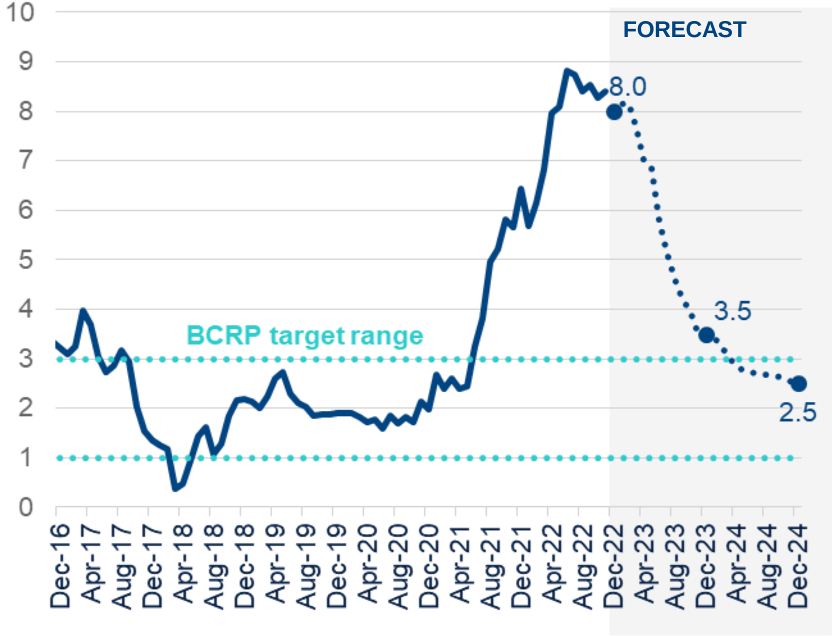


Year-on-year % chg.	2020	2021	2022	2023	2024
Wheat	15.2	29.7	9.2	0.3	-7.1
Corn	9.6	35.9	19.5	-9.3	-10.3
Soy	24.3	10.3	12.0	-5.8	-4.1

Source: Bloomberg and BBVA Research.

In this context, inflation will show resistance to decline in the short term, but will drop more clearly in the second half of 2023

INFLATION
(%)

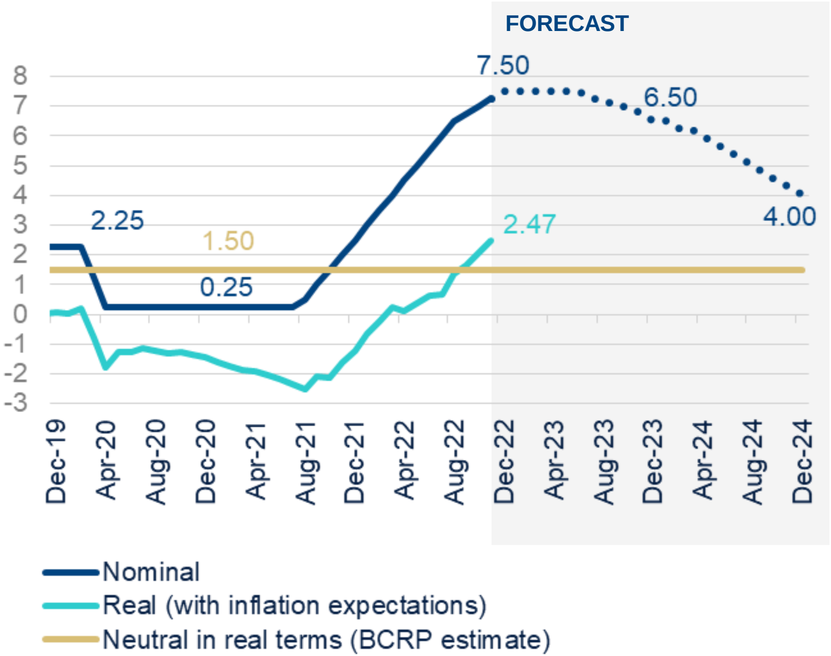


Source: INEI and BBVA Research

- High inflation in Peru is due to costs (not so much to demand). In forecast, commodity prices correct downward. In addition, year-on-year basis of comparison is high going forward, especially as of March next year.
- It may take some time for the transfer to the price of the final good because business margins were compressed (in the increase, not everything was passed on to the final consumer) and some contagion to the rest of the goods in the consumer basket is evident, with inflation without food and energy at levels close to 6%.
- Higher fertilizer prices will continue to affect food prices in the first half of 2023.

Still-complicated short-term inflation outlook does not rule out additional adjustment in monetary policy rate; normalization from 2H23 onwards

REFERENCE INTEREST RATE
(%)



Source: BCRP and BBVA Research.

- The Central Bank continued to adjust monetary policy in an environment of persistently high inflation, bringing it into restrictive territory. However, it reduced the magnitude of these increases to 25bp (previously 50bp).
- Future decisions will be highly conditioned by new information (total and core inflation, inflationary expectations).
- Additional adjustment is not ruled out if inflation excluding food and energy does not ease and (medium-term) inflationary forecasts remain de-anchored.
- In the second half of 2023, when inflation is declining more clearly and the Fed has concluded its upward cycle, a gradual normalization of the benchmark rate will begin, accelerating in 2024.

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04

Main risks

Main local risks to the baseline scenario for 2022 and 2023

ON THE EXTERNAL SIDE

- Persistence of global inflation
- A sharper global growth slowdown.

ON THE LOCAL SIDE

- Increased political noise
- Risk of greater populism affecting competitiveness (labor market, pension system).
- More negative impact of social conflict.
- Fertilizer shortage has major negative impact on agricultural output and inflation.
- Sovereign credit rating downgrade

05

Summary of forecasts

Macroeconomic projections: summary

	2021	2022 (f)	2023 (f)	2024 (f)
GDP (% chg)	**13.6**	**2.7**	**2.5**	**2.4**
Domestic demand (excluding inventories. % chg)	**16.6**	**3.1**	**1.5**	**2.4**
Private spending (% chg)	**14.9**	**2.5**	**2.0**	**2.1**
Private consumption (% chg)	11.7	4.6	2.4	2.2
Private investment (% chg)	37.4	-0.4	0.0	2.0
Public spending (% chg)	**14.0**	**1.8**	**0.0**	**3.5**
Public consumption (% chg)	10.6	0.2	3.0	3.0
Public investment (% chg)	24.9	6.3	-8.0	5.0
Exchange rate (vs USD. EOP)	**4.04**	**3.85 – 3.95**	**4.00 – 4.10**	**4.00 – 4.10**
Inflation (% Y/Y. EOP)	**6.4**	**8.0**	**3.5**	**2.5**
Monetary policy rate (% EOP)	**2.50**	**7.50**	**6.50**	**4.00**
Fiscal balance (% GDP)	**-2.5**	**-1.6**	**-2.0**	**-2.0**
Balance of payments current account (% of GDP)	**-2.3**	**-4.0**	**-2.8**	**-1.8**
Exports (Billions of USD)	63.2	66.5	64.2	65.9
Imports (Billions of USD)	48.3	55.8	55.7	56.8

(e) Estimated. (p) Forecast. Forecast closing date: December 2, 2022.
Source: BBVA Research.

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Peru Economic Outlook

December 2022

Creating Opportunities