BBVA Research

Peru Economic Outlook

March 2023

Creating Opportunities

BBVA Research

Contents

Key points

Global situation

Supply shocks (bottlenecks, commodity prices) have eased, while demand shows resilience, which has contributed to growth and reduced the likelihood of a near-term recession. China's post-COVID reopening reinforces this view. On the price side, while inflation has receded, the advance in the core component remains persistent.

Against this backdrop, and after a temporary disconnect, the markets aligned with the central bankers' view that interest rates will rise further and remain at those levels for longer. The most recent financial volatility, however, changed this outlook, at least for the time being.

Domestic situation

Locally, activity continued to lose momentum in the fourth quarter of 2022 (GDP grew 1,7% YoY versus 2.0% YoY in the third quarter). Quellaveco has been supporting activity, but the moderation of global growth, the lower positive effect of the post-COVID rebound of the sectors lagging behind in normalization, the increase in financing costs, high inflation, and the escalation of social unrest in the country worked against it. With this result, Peruvian GDP grew 2.7% in 2022, in line with what we anticipated in our previous report.

In early 2023, the weakness in GDP was intensified by social protests, which was then compounded by another negative shock, Cyclone Yaku, which caused significant damage, although less than that caused by El Niño Costero in 2017 (according to the information available at this time). Given this scenario, the private spending indicators compiled by BBVA Research deteriorated in the first quarter of the year and activity in that period is therefore likely to have practically come to a standstill.

Key points

Global macro outlook

After expanding 3.2% in 2022, global activity will moderate in 2023 in an environment of continuing high inflation and monetary tightening. Expectations are for growth of 2.8% this year. In line with the latest data suggesting lower energy prices, and the easing of anti-COVID policy in the case of China, the anticipated moderation in global growth is nevertheless now less pronounced than in the previous forecast (2.3%).

The improving outlook for growth, the strength of the labor markets, and the persistence shown by core inflation is consistent with central banks placing their interest rates at higher levels for a longer period. In the particular case of the FED, we expect the monetary policy rate to peak soon at around 5.25% (4.75% in last December's projection), although naturally the recent market turbulence (SVB bankruptcy) adds uncertainty to the timing and scope. Later on, as supply shocks dissipate and demand weakens, inflation will fall (although it will still remain above the 2% target in the US and Eurozone at least until the end of next year), giving room to start monetary normalization in 2024, which in the case of the Fed would start in Q1 (from 4Q23 in the previous projection).

With monetary policies starting to move toward a less restrictive stance and inflation rates receding, 2024 will see a rebound in global growth to 3.3%, similar to our previous baseline scenario.

Key points

Local macro outlook: economic activity

On the domestic side, the baseline scenario has been revised to incorporate the social upheaval at the beginning of the year and greater political uncertainty regarding the possible early elections and their outcome, elements that the previous baseline scenario (from early December) naturally did not contemplate. Notwithstanding the improved global growth outlook, the Peruvian economy is now expected to grow by 1.9% in 2023, down from the 2.5% previously projected.

These two elements are in addition to others that were already explaining a slowdown in activity this year in the previous baseline scenario (GDP growth of 2.7% in 2022), but now more accentuated: moderation of global growth, high interest rates, a lower positive effect of the post-COVID rebound in the sectors that are lagging behind in their normalization, and the usual slump in public investment after the change of authorities at regional and municipal level. These factors more than offset the increase in copper output due to Quellaveco and the normalizing trend of inbound tourism (slower in the new baseline scenario).

These factors will reverse in 2024: global growth will rebound, interest rates will decline, and public investment will normalize. If social unrest does not repeat its sharp rise at the beginning of 2023 and the elections (which the baseline scenario assumes will be brought forward to the first half of 2024) lead to a new government administration that fosters a more favorable climate for entrepreneurship, business and employment generation, GDP should increase by around 3.0% next year (2.4% in the previous forecast).

Key points

Local macro outlook: exchange rate

The baseline scenario considered is consistent with a tendency for the PEN to depreciate in the coming months because it anticipates: (i) an increase in global risk aversion when the largest economies show a more pronounced slowdown and (ii) a decrease in the interest rate differential between soles and dollars due to the fact that the Peruvian central bank would have already concluded the upward cycle of its policy rate and would start to normalize it as of 4Q23, while the FED will raise its rate even somewhat more and will not reduce it this year (this forecast differs from what the markets are currently expecting). In addition, local elections are getting closer and closer (the baseline scenario assumes that they will take place in the first half of 2024) and, as a rule, during the electoral campaign preceding them, investors and the public in general take defensive positions. In this environment, the exchange rate will be between 3.90 and 4.00 soles per USD at the end of 2023, perhaps closer to the lower end of that range.

Later, after the local elections, with the global economy rebounding, the balance of payments current account deficit receding, a new government more favorable to private initiatives (baseline scenario assumption), and despite the interest rate differential narrowing further, the PEN will strengthen and the exchange rate will close 2024 between 3.85 and 3.95 soles per USD.

Key points

Local macro outlook: fiscal policy

For this and the next few years, we anticipate fiscal deficits of around 2.0% of GDP. Government revenues are expected to remain relatively stable (around 20% of GDP, down from 22.1% in 2022). On the expenditure side, non-financial expenditures will moderate (from 22.0% of GDP in 2022 to 20.4% on average by 2025-2028), but interest payments will increase (from 1.6% in 2022 to 1.9% by 2025-2028). Gross public debt will rise from 34.0% to 36.2% of GDP. Political and social tensions will remain as risk factors for the sovereign credit rating.

Local macro outlook: inflation and monetary policy

Inflation continues to exhibit resistance to falling. However, we continue to forecast that from March onward it will start to decline (due to the high year-on-year comparison base and lower commodity prices) and that it will close the year at around 3.5%. This projection now has an upward bias due to the deterioration of the weather forecasts. For 2024 we project inflation of 2.5%.

With the coming onset of a declining trend in inflation, the reference interest rate is likely to remain at its current level of 7.75% in the coming months. The monetary stance will thus become even more contractionary in a passive manner (inflationary expectations will surely be receding). We foresee that only toward the last quarter of this year, in an environment in which a clear downward trend in local inflation will be more consolidated and in which the FED would have already ended the adjustment cycle of the federal funds rate, the BCRP will begin to cut the reference rate but gradually to avoid depreciation pressures on the PEN due to the likely pre-electoral context (baseline scenario assumption). We project that the policy rate will close the year at 7.25%, with which the BCRP will start a process of normalization of the monetary policy stance that would accelerate in 2024 to bring the rate to 5.0% by the end of that year.

Key points

Risks

The main external risk is that inflation will show greater persistence due to, for example, dynamic labor markets, second round effects, post-COVID recovery of demand in China, or further disruptions created by the war in Ukraine, triggering further monetary tightening and, potentially, recession, stagflation or even financial instability.

Domestically, the main risks are that the political and social environment will be more complicated than considered in the baseline scenario, further weakening the business environment, and the possibility that the current weather anomalies will continue until early next year and even worsen, leading to a strong or larger El Niño phenomenon in the summer of 2024. There is high uncertainty as to when the next general elections will be held.

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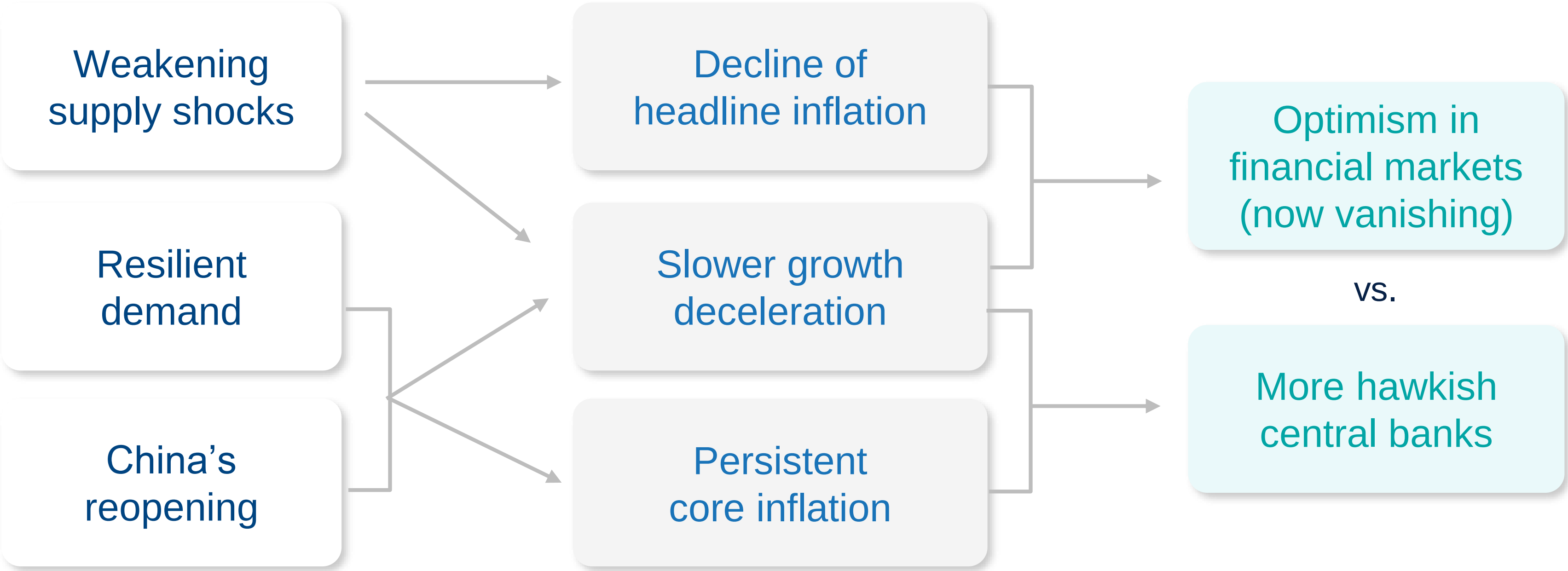
01

International context: activity and financial markets

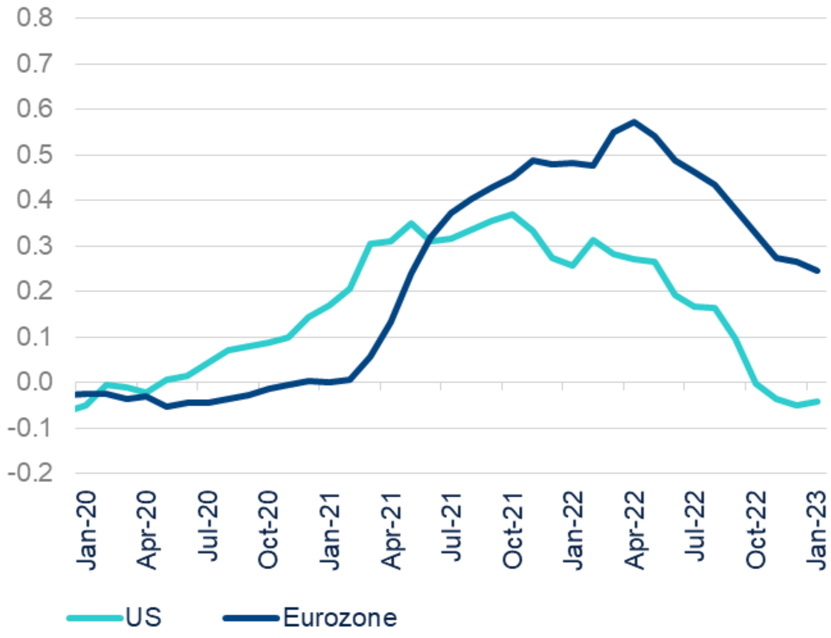
Weakening supply shocks, resilient demand and China’s reopening back growth, but also inflation fears despite the recent drop in headline measures

RECENT DEVELOPMENTS IN THE WORLD ECONOMY



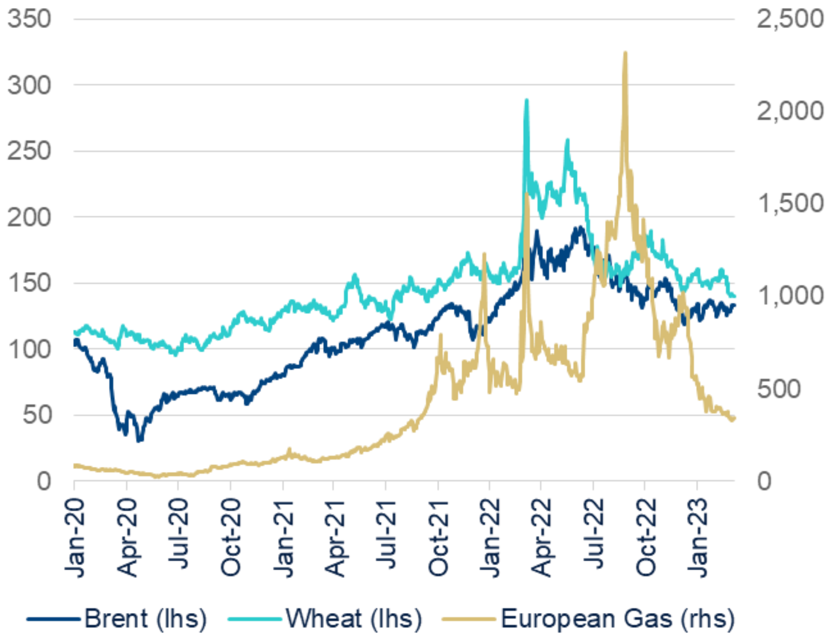
Weakening supply shocks: bottlenecks and commodity prices have eased; mild weather and healthy storage have helped to push gas prices down

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



Source: BBVA Research.

COMMODITY PRICES
(INDEX: 2019 AVERAGE = 100)

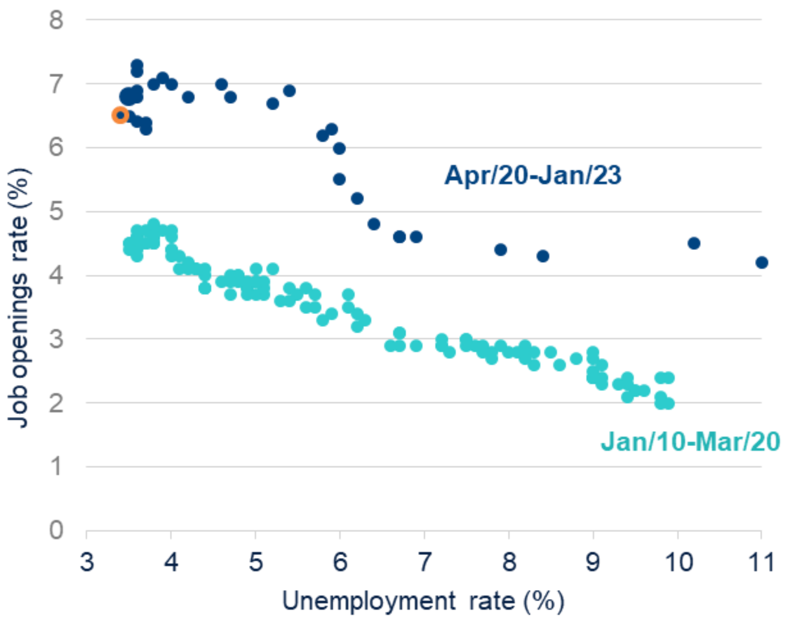


Source: BBVA Research based on data from Bloomberg.

Resilient demand: labor markets remain tight, backing private consumption and fueling concerns about more persistent price pressures

US: BEVERIDGE CURVE (*)

(MOST RECENT MONTHLY DATA HIGHLIGHTED IN ORANGE)



(*) Unemployment: share of labor force. Job openings: share of sum of employment and job openings.
Source: BBVA Research based on data from FRED.

EUROZONE: BEVERIDGE CURVE (*)

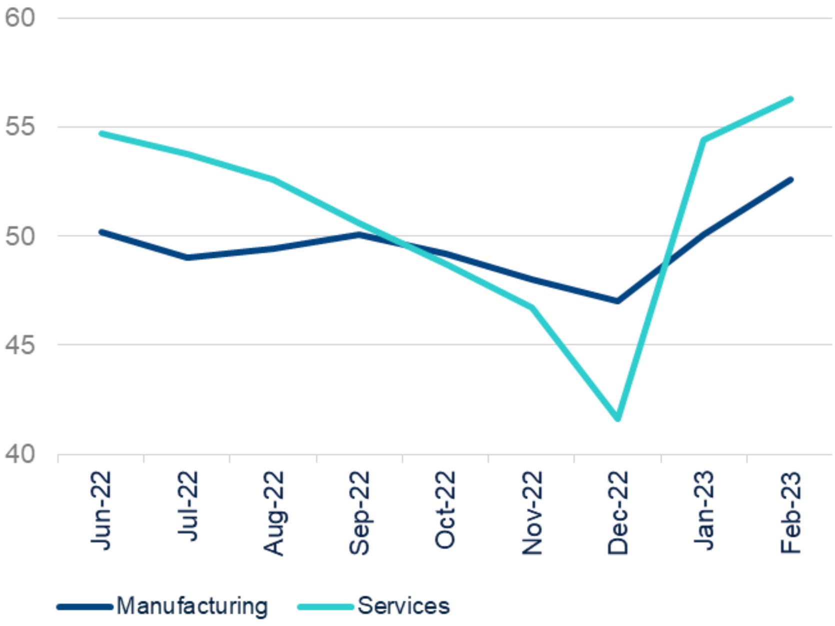
(MOST RECENT MONTHLY DATA HIGHLIGHTED IN ORANGE)

(*) Unemployment: share of labor force. Job openings: share of sum of employment and job openings.
Source: BBVA Research based on data from Eurostat.

China's reopening: after an initial negative impact on activity, unexpected easing of covid restrictions has boosted economic activity

CHINA PMI INDICATORS

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

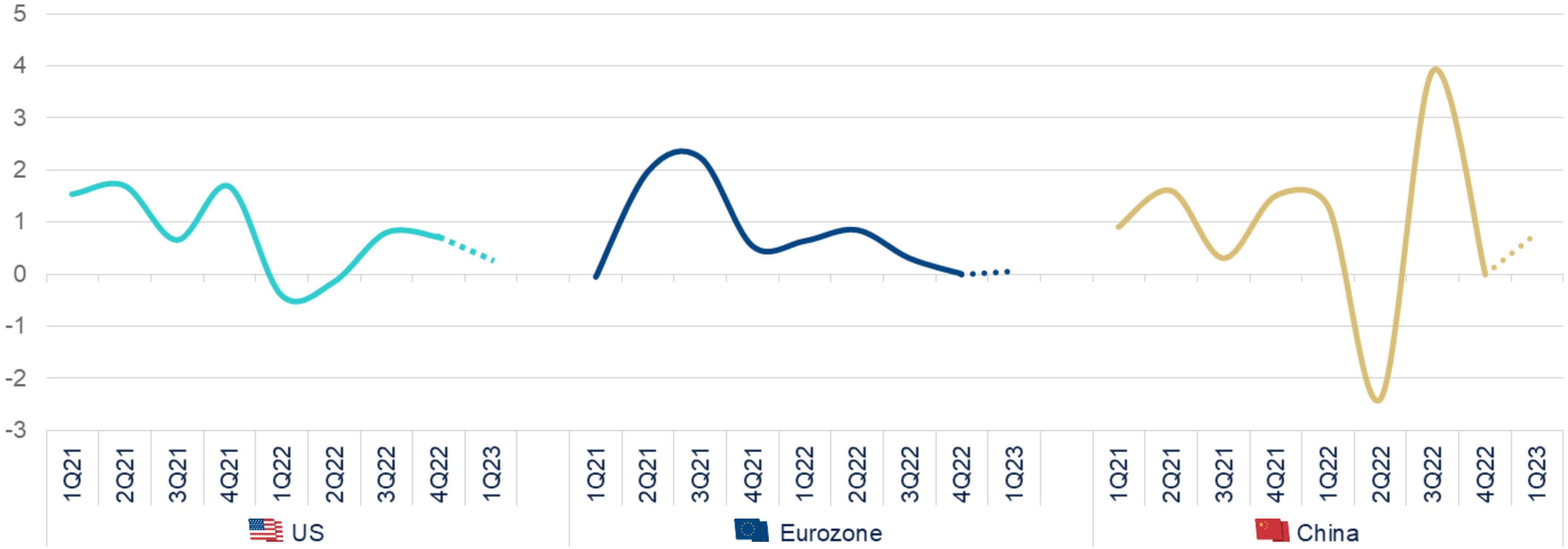


Source: BBVA Research based on data from Haver.

- China's flexibilization of covid policies was faster than expected; together with the measures to stabilize the real estate sector, it suggests that the focus is now on growth.
- The reopening initially drove infections up, contributing to the sharp downward surprise of 4Q22 GDP.
- But a solid recovery is now underway according to more recent data.
- The demand recovery pace compared to the rhythm of supply normalization, in a protectionist context, will be key for global activity and inflation dynamics.

Growth has slowed less than forecast, suggesting a recession is now less likely in the US and EZ; after a very weak 4Q22, activity is improving in China

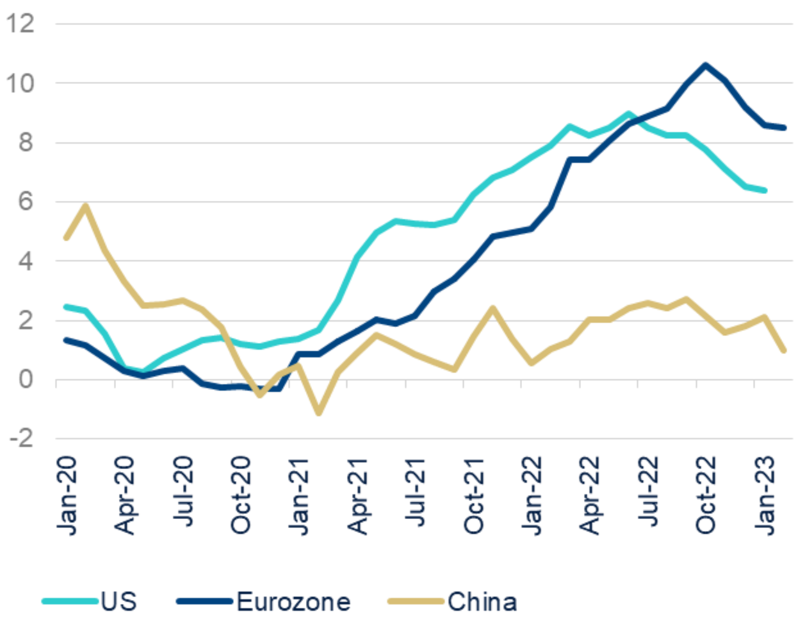
GDP: REAL GROWTH (*)
(Q/Q %)



(*) BBVA Research growth forecasts for the 1Q23.
Source: BBVA Research based on data from Haver.

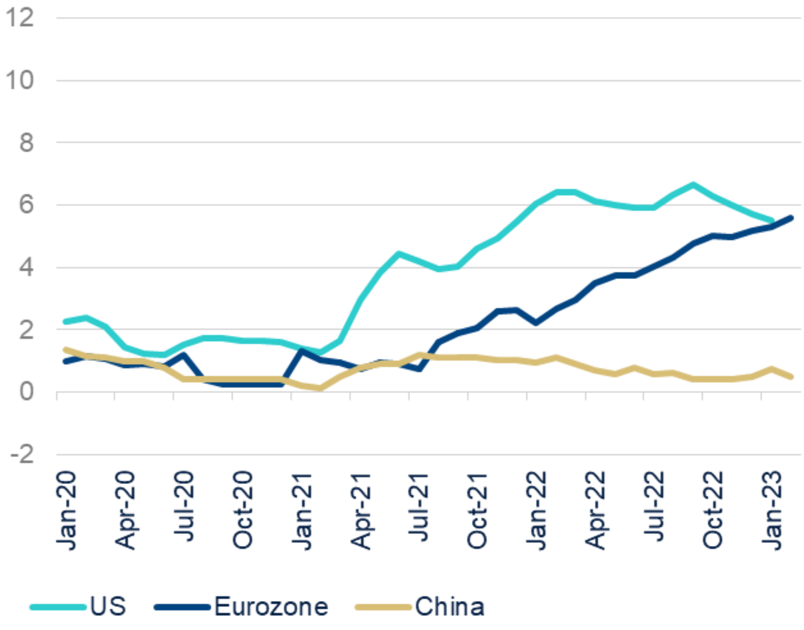
Headline inflation is falling, mainly on declining energy prices, but resilient consumption is still contributing to keep core figures at very high levels

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

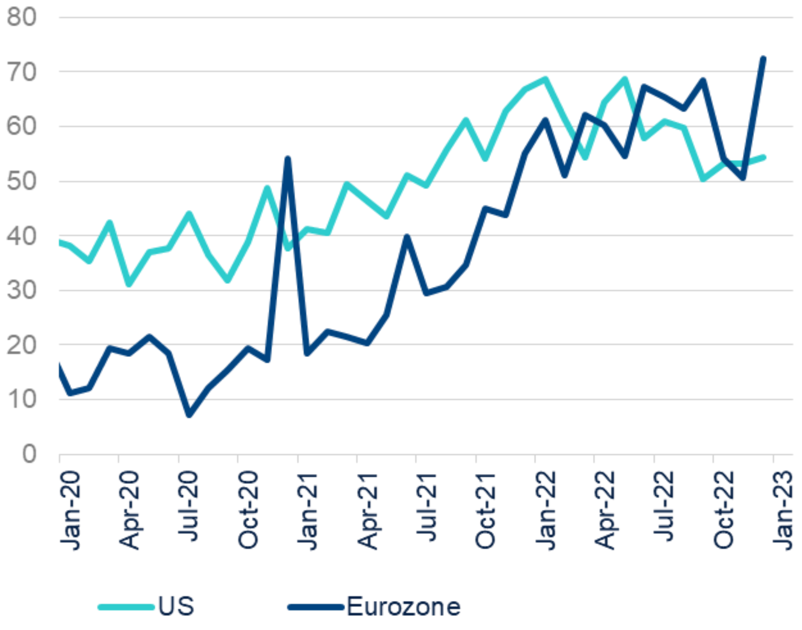
CORE INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

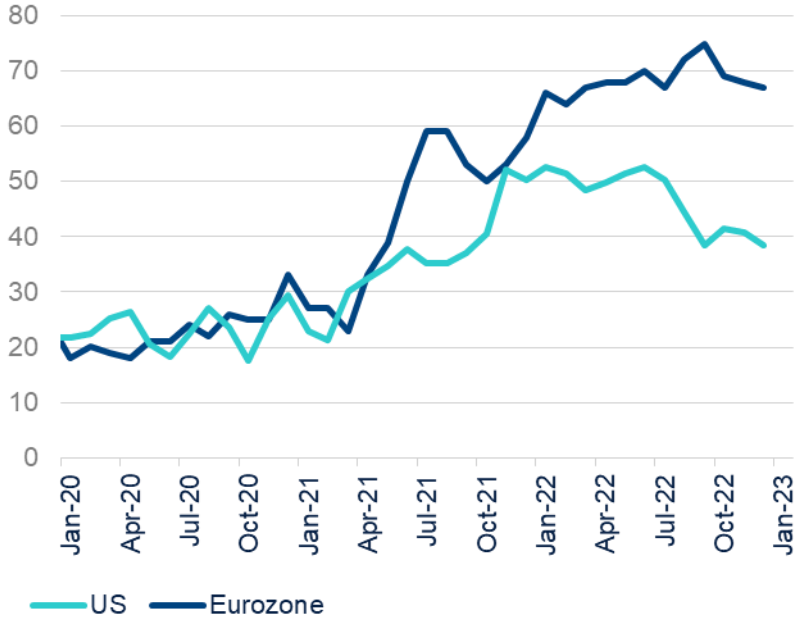
Price adjustments have become less widespread and frequent in the US, but there are no clear signs yet of improvement in the Eurozone

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.

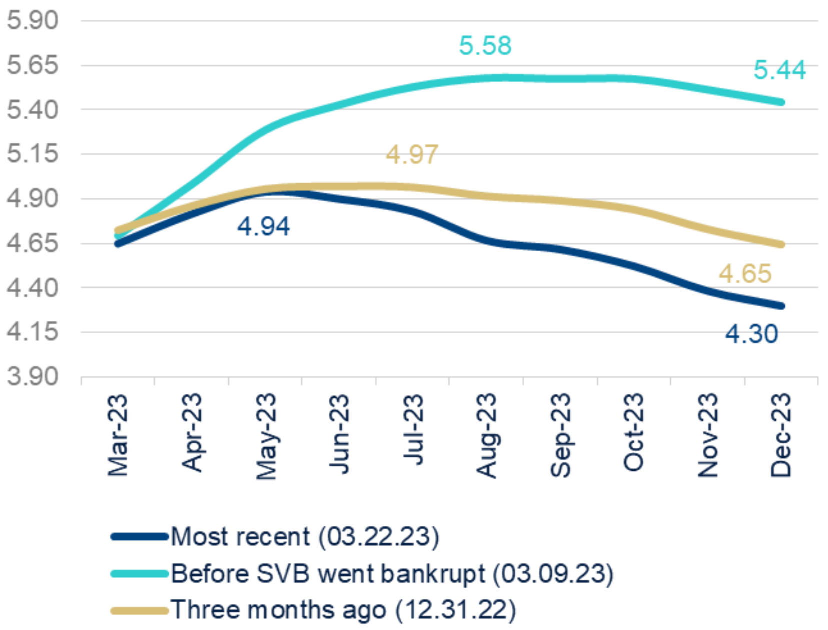
ITEMS OF THE CPI BASKET WITH THREE CONSECUTIVE MONTHLY PRICE RISES
(SHARE OF TOTAL 2-DIGIT CPI ITEMS)



Source: BBVA Research based on local statistics.

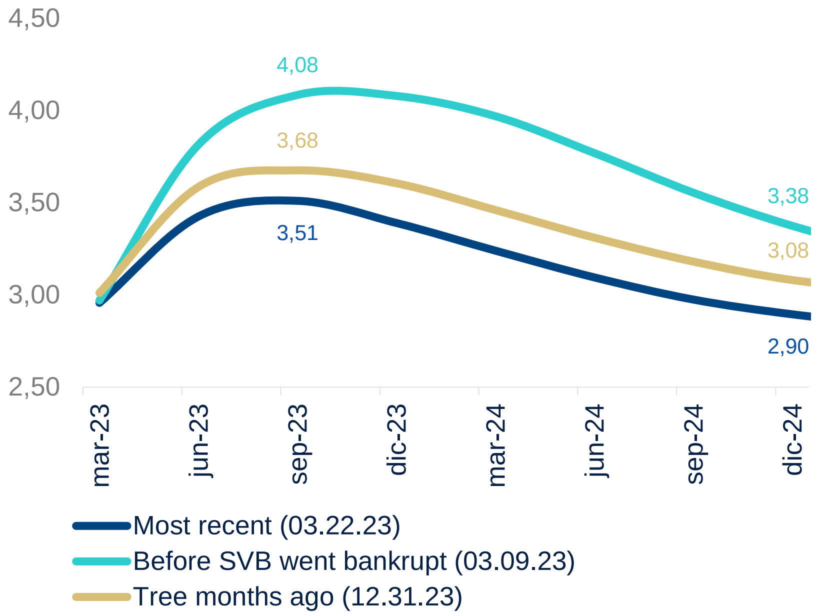
After a temporary decoupling, markets are now in line with central bank's view that rates have room to rise and the easing cycle will not be immediate

IMPLIED FED INTEREST RATE IN FED FUND FUTURES
(%)



Source: Bloomberg.

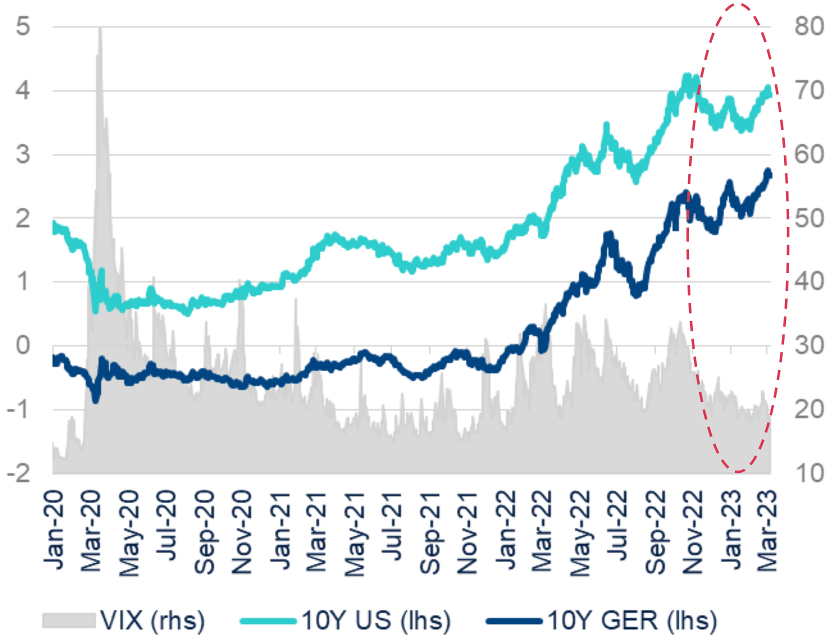
IMPLIED POLICY RATES IN 3M EURIBOR FUTURES(*)
(%)



(*) Interest rate of the ECB deposit facility.
Source: BBVA Research based on data from Bloomberg.

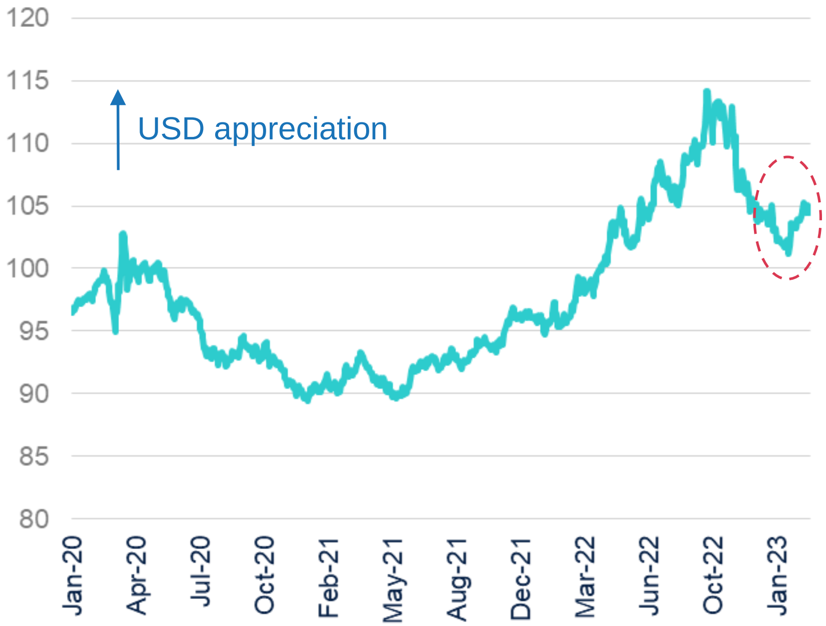
The recent increase in bond yields, driven by central bank hawkish rhetoric, has provided support to the dollar and fueled volatility, albeit limited

US AND GERMANY 10-YEAR BOND YIELDS, VIX
(%, INDEX)



Source: BBVA Research based on data from Bloomberg.

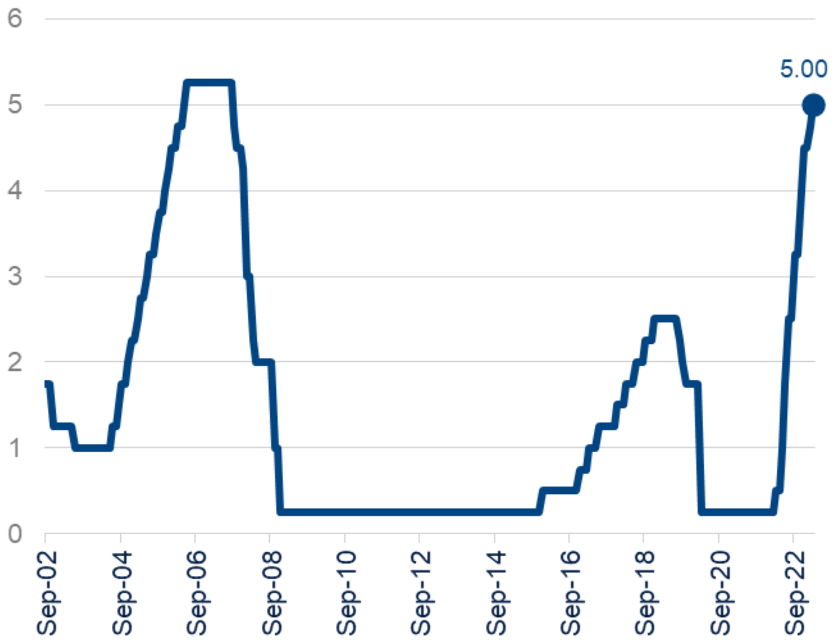
US DOLLAR INDEX: DXY
(INDEX)



Source: BBVA Research based on data from Bloomberg.

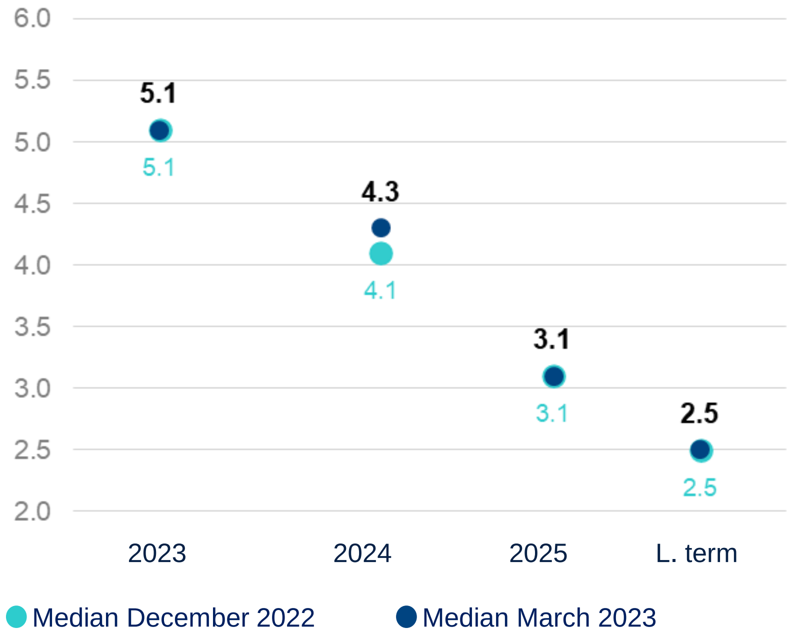
In March, after the recent banking turbulence, the FED continued adjusting its policy rate, increasing it by 25 bps, albeit with a dovish tone

US FEDERAL FUNDS RATE
(%)



Source: Bloomberg.

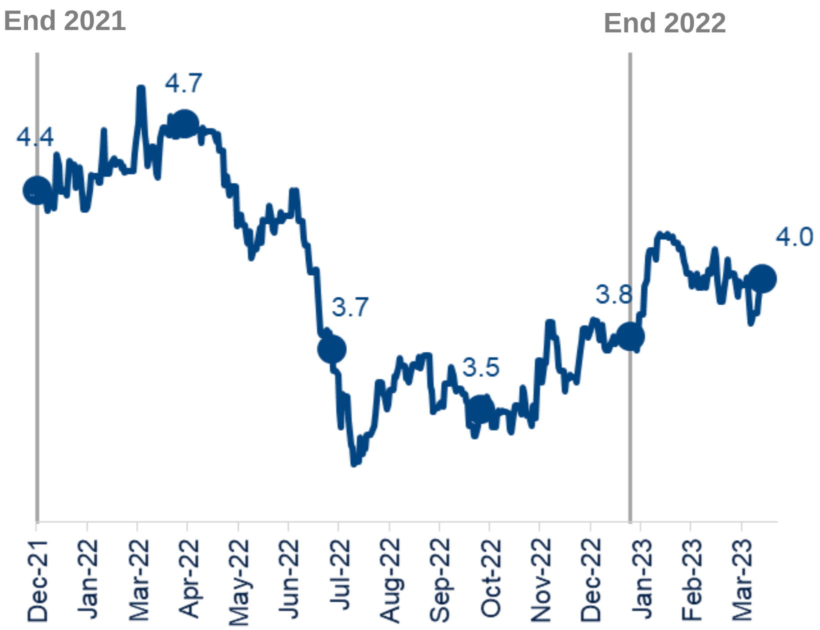
RATE FORECASTED BY THE FOMC
(MEDIAN OF THE PROJECTIONS, END OF PERIOD, %)



Source: FOMC.

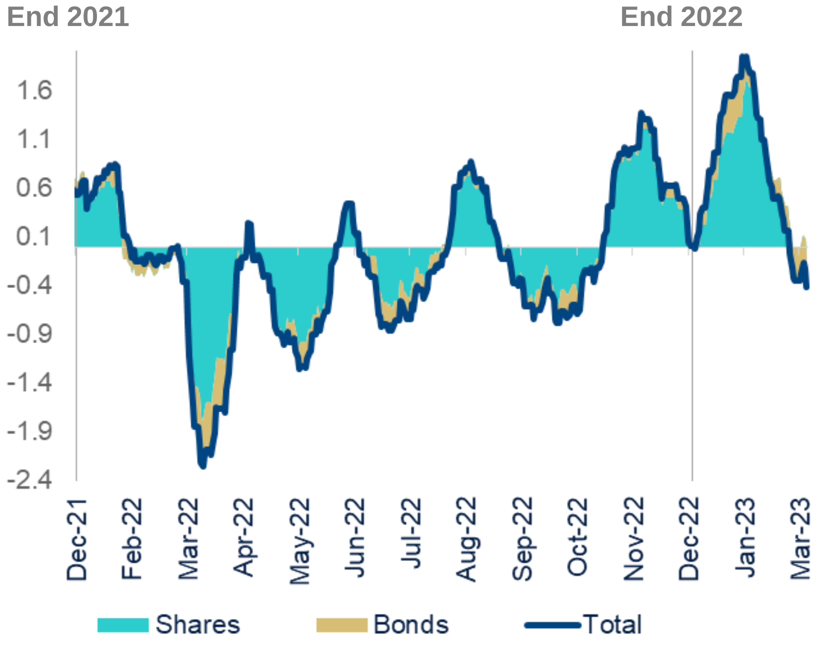
In this context, the copper price corrected downward in recent weeks; capital inflows to EM weakened

COPPER PRICE
(LME, USD PER POUND)



Source: Bloomberg (information as at March 22).

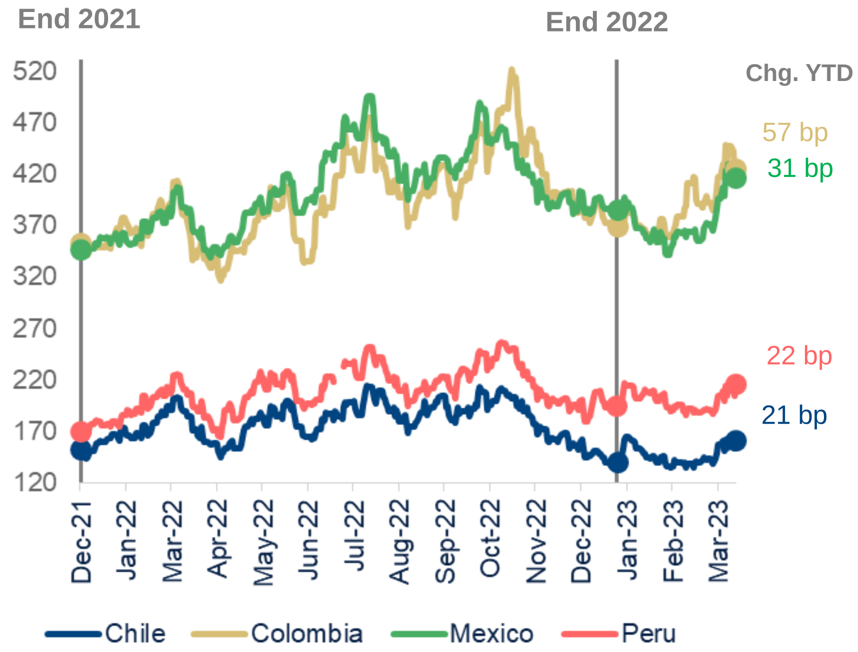
CAPITAL INFLOWS TO EMERGING MARKETS
(USD BILLIONS, 28-DAY MOVING AVERAGE)



Source: IIF (information as at March 20).

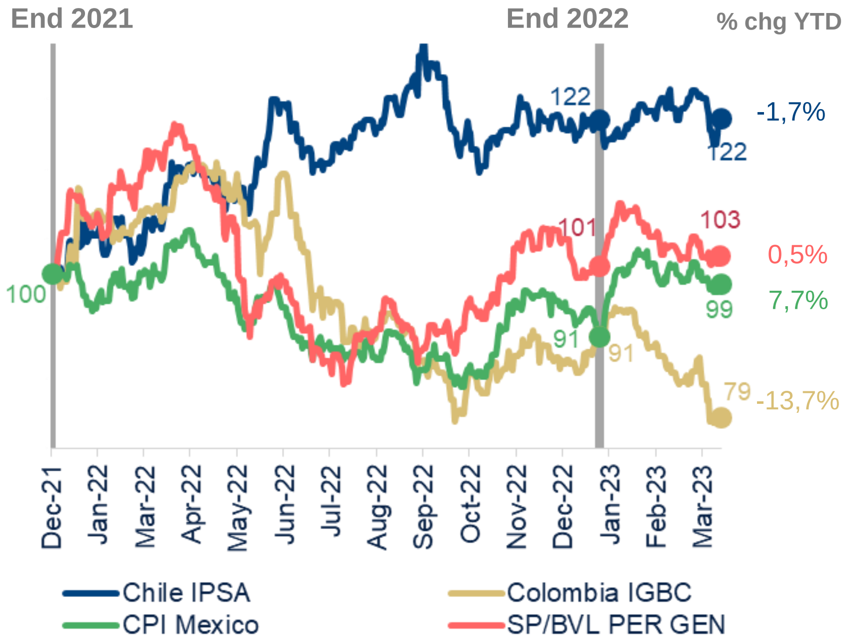
In LatAm, risk premiums have risen and stock market indexes have tended to decline…

EMBI
(BASIS POINTS)



Source: Bloomberg (information as at March 22).

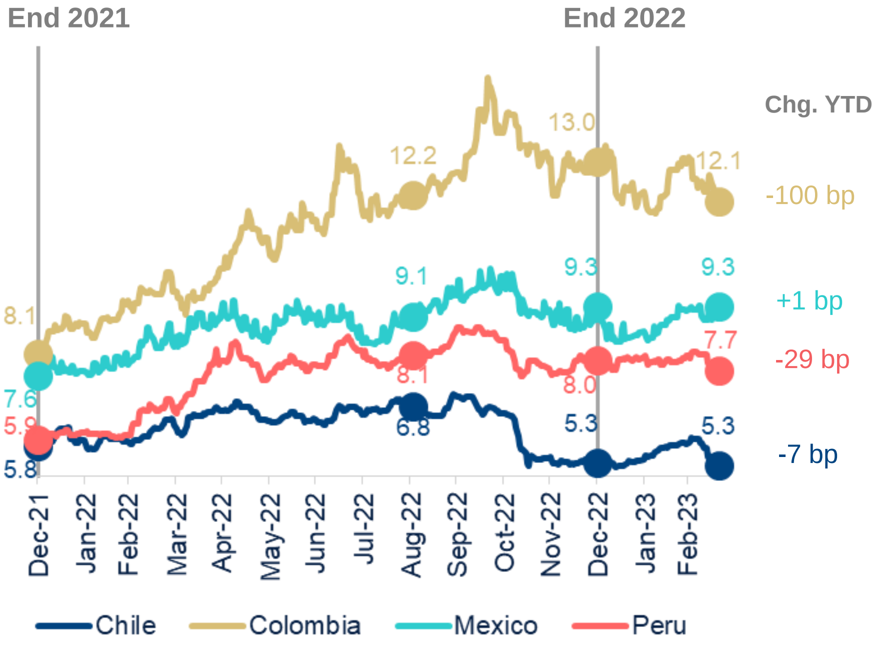
LATAM: STOCK MARKETS
(INDEX, DEC31, 2021 = 100)



Source: Bloomberg (information as at March 22).

… but other assets in the region, such as sovereign bonds and currencies, performed more positively

LATAM: 10-YEAR SOVEREIGN BOND YIELD
(%)



Source: Investing.

LATAM: EXCHANGE RATE
(LOCAL CURRENCY VS. USD, INDEX 100 = Dec. 31, 2022)

Fuente: Bloomberg (información al 22 de marzo).

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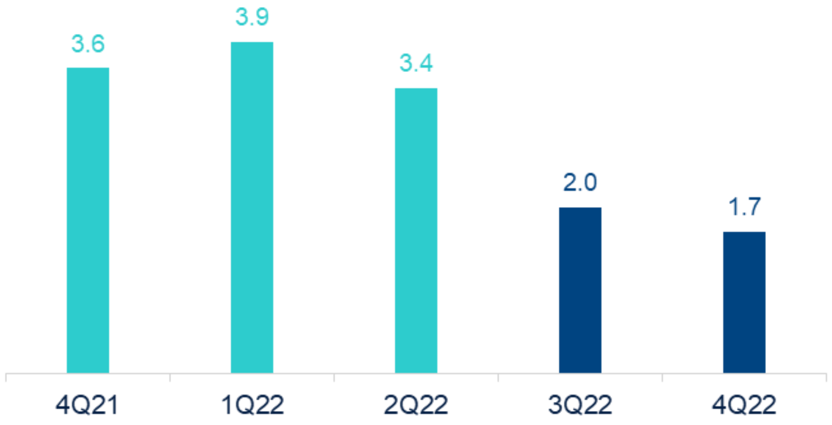
02

Domestic context: activity, employment and fiscal accounts

Local activity continued to lose dynamism in 4Q22: Quellaveco boosted the primary component of GDP, but...

GDP
(% CHG. YOY)

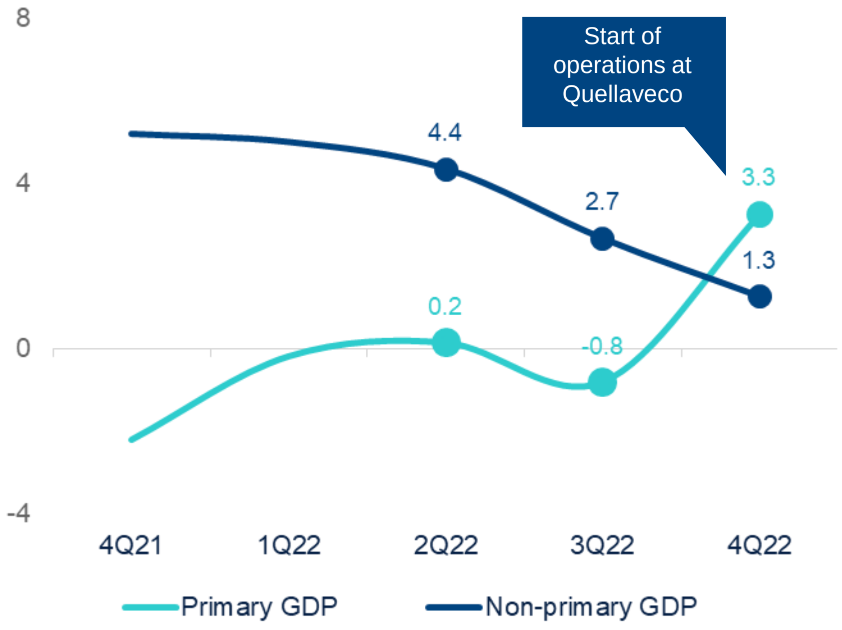


GDP
(INTER-QUARTERLY AND ANNUALIZED CHANGE, %)

4Q21	1Q22	2Q22	3Q22	4Q22
1.4	1.5	1.3	3.4	0.5

Source: BCRP.

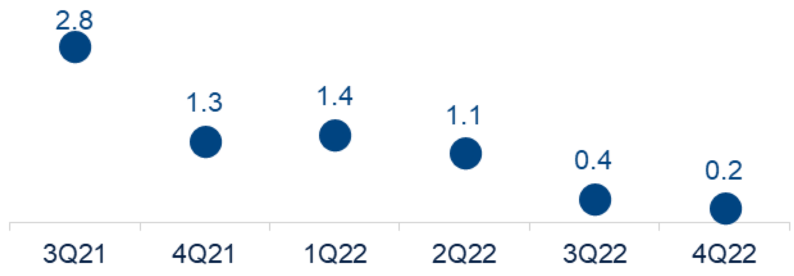
PRIMARY AND NON-PRIMARY GDP
(VAR. % INTERANUAL)



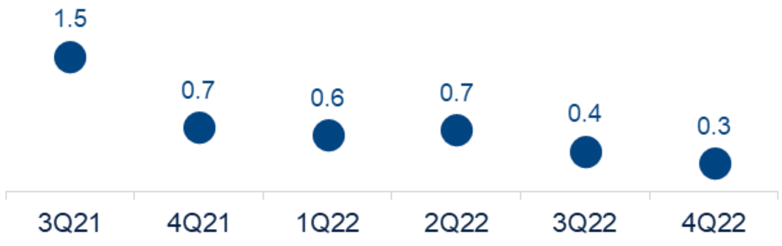
Source: BCRP.

… global growth continued to moderate, the post-COVID rebound dissipated, financial costs continued to rise, and social unrest escalated

ACCOMMODATIONS AND RESTAURANT
(CONTRIB. TO GROWTH, PERCENTAGE POINTS OF GDP)

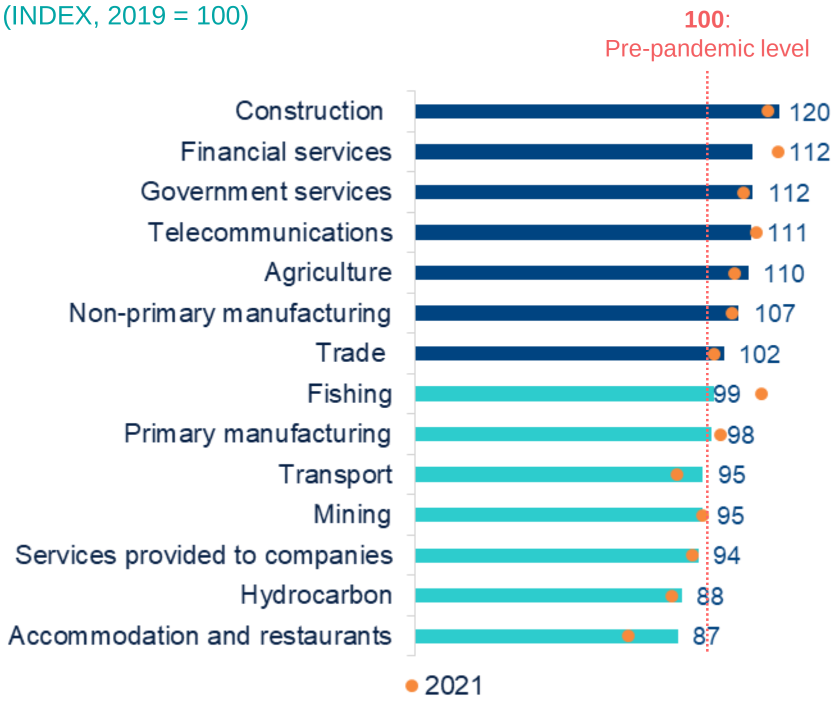


TRANSPORT
(CONTRIBUT. TO GROWTH, PERCENTAGE POINTS OF GDP)



Source: INEI.

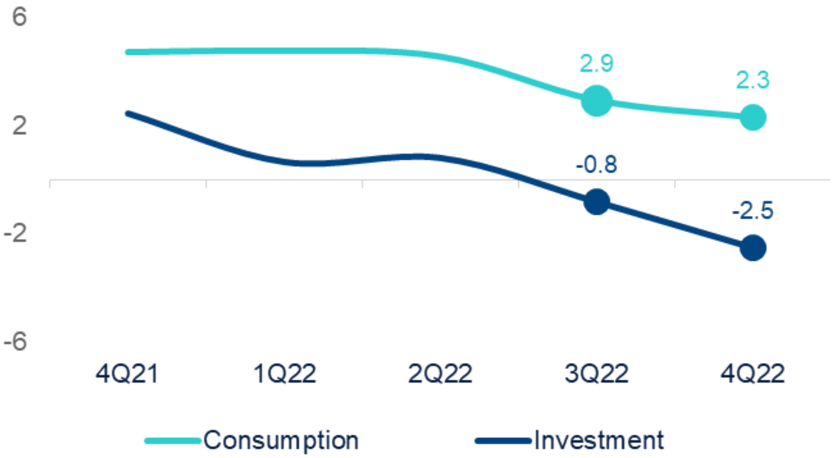
SECTORAL GDP, 2022
(INDEX, 2019 = 100)



Source: INEI.

On the demand side, these elements were reflected in a weaker private spending, both in consumption and investment

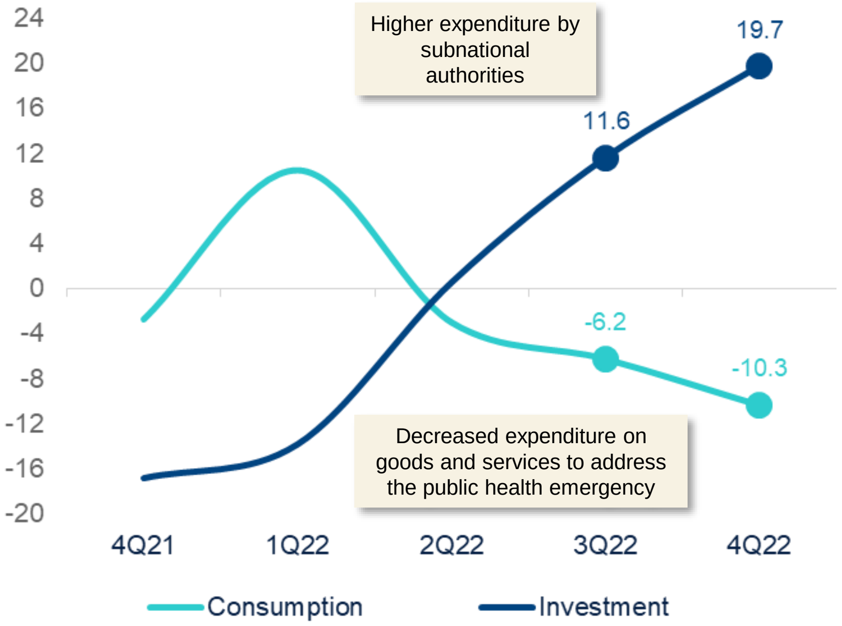
GDP: PRIVATE EXPENDITUREDE
(IN REAL TERMS, % CHG. YOY)



INVESTMENT IN MINING
(% CHANGE YOY IN REAL TERMS)

4Q21	1Q22	2Q22	3Q22	4Q22
22.0	6.0	3.2	-12.5	-12.3

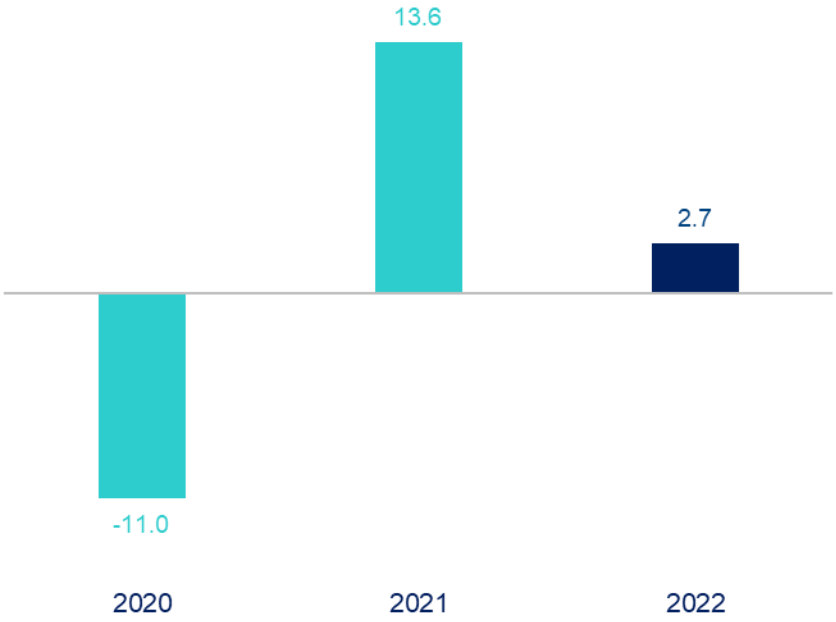
GDP: PUBLIC EXPENDITURE
(IN REAL TERMS, % CHG. YOY)



Source: BCRP.

With this result, GDP advanced 2.7% in 2022, a complex year on both the external and domestic sides

GDP
(% CHG. YOY)



Source: BCRP.

EXTERNAL ENVIRONMENT

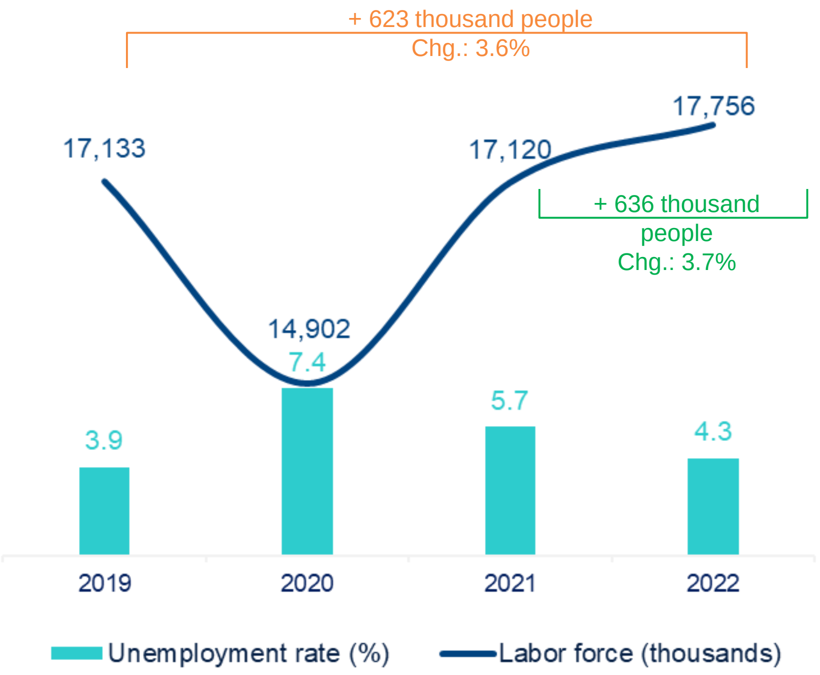
- War in Ukraine
- Sustained increase in interest rates
- Slowing global growth
- Decrease in metal prices in the second half of the year

LOCAL ENVIRONMENT

- The post-COVID effect dissipates
- Significant price increases (erosion of purchasing power)
- Sustained increase in interest rates
- Escalation of social conflicts
- On the positive side, start of operations of the Quellaveco copper mine

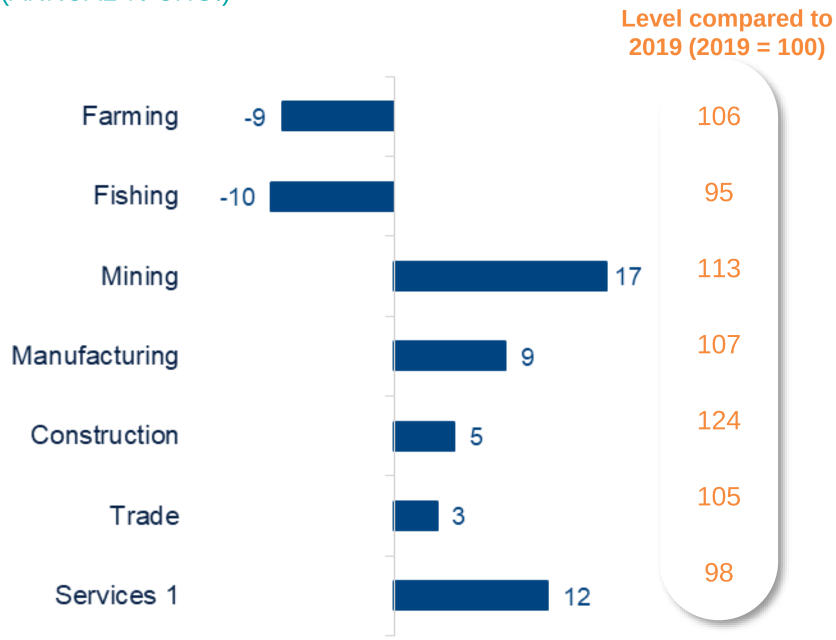
In the labor market, employment continued to increase in 2022 and thus exceeding its pre-pandemic level, although...

EMPLOYMENT AND UNEMPLOYMENT RATE



Source: INEI (National Household Survey).

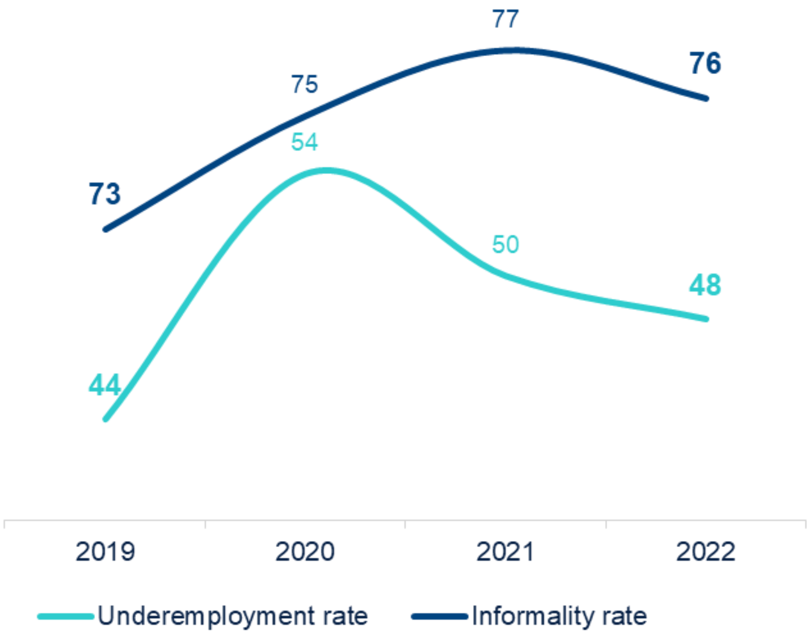
EMPLOYMENT BY SECTOR
(ANNUAL % CHG.)



1: Includes Transport and communications. Financial intermediation, Real estate, business and renting activities, Education, Health and social work activities.
Source: INEI (National Household Survey).

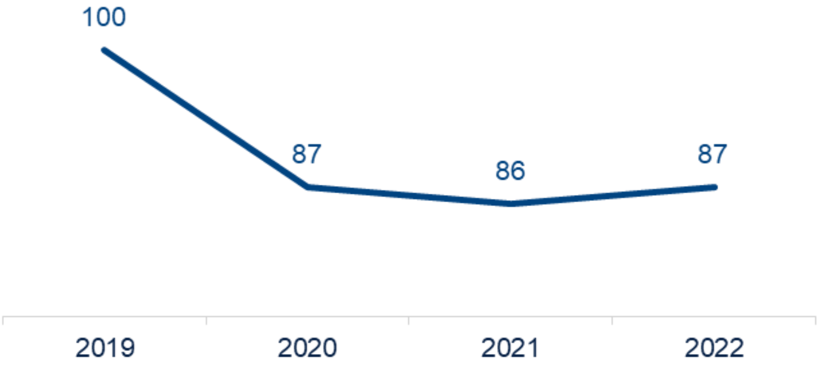
… job quality has failed to normalize and the purchasing power of the average wage continues to lag

UNDEREMPLOYMENT AND INFORMALITY RATE
(% OF THE EMPLOYED POPULATION)



Source: INEI (National Household Survey).

WORKER'S AVERAGE MONTHLY INCOME
(INDEX, 100 = 2019, ADJUSTED FOR INFLATION)



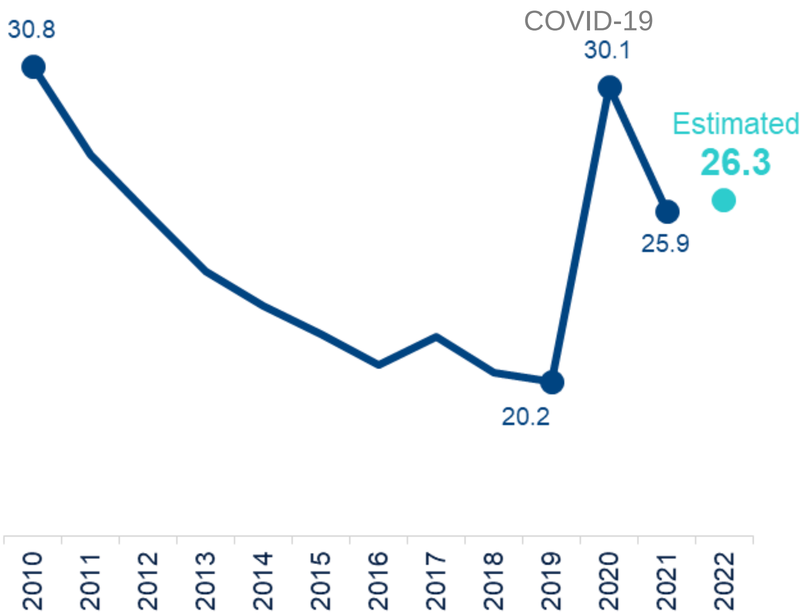
WORKER'S AVERAGE MONTHLY INCOME
(AT CURRENT PRICES)

	2019	2020	2021	2022
Soles	1 595	1 415	1 445	1 589
Annual % chg.		*-11.3*	*-2.1*	*10.0*
% chg vs. 2019				*-0,4%*

Source: INEI (National Household Survey).

In this context, we estimate that monetary poverty would have increased somewhat in 2022

MONETARY POVERTY
(% OF THE POPULATION BELOW THE POVERTY LINE)

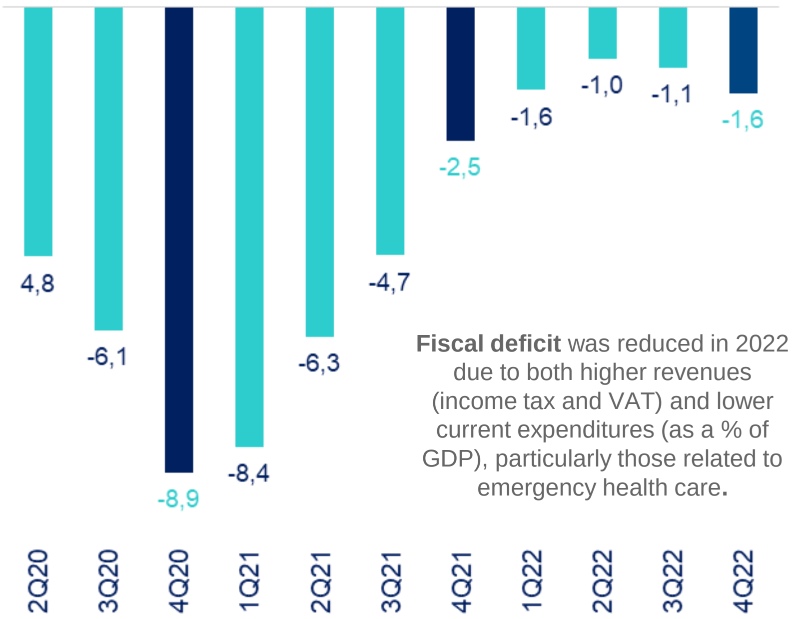


Source: INEI and BBVA Research.

- The monetary poverty rate would have increased in 2022, exceeding 26% (an increase of 200 thousand people in the year).
- The high inflation rate, especially for food, did not favor the decline in poverty in 2022. Transfers from government to households (vouchers) softened the deterioration.
- It is unlikely that the poverty rate will soon reach levels similar to those observed before the pandemic because the growth of the Peruvian economy will be relatively weak (and, therefore, the quality of job creation) and because prices will still remain high. Our own preliminary estimate is that poverty will be close to 27% in 2023.

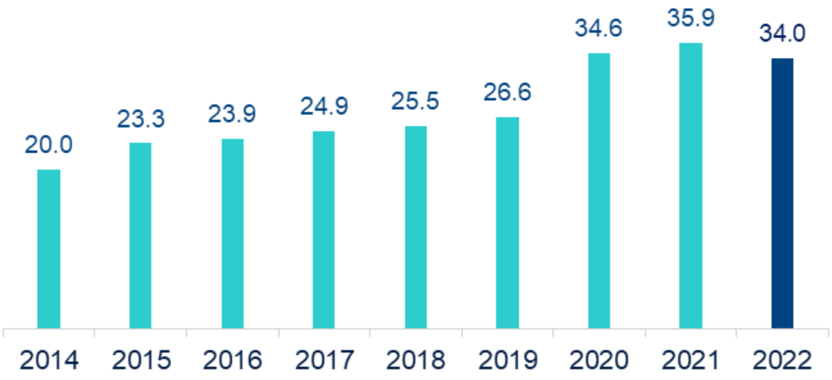
Despite slowing growth, the foundations of the Peruvian economy remain sound: fiscal deficit and public debt declined in 2022

FISCAL BALANCE
(NFPS, CUMULATIVE IN LAST FOUR QUARTERS, % OF GDP)



Fiscal deficit was reduced in 2022 due to both higher revenues (income tax and VAT) and lower current expenditures (as a % of GDP), particularly those related to emergency health care**.**

GROSS PUBLIC DEBT
(NFPS, % OF GDP)



NET PUBLIC DEBT
(% OF GDP)

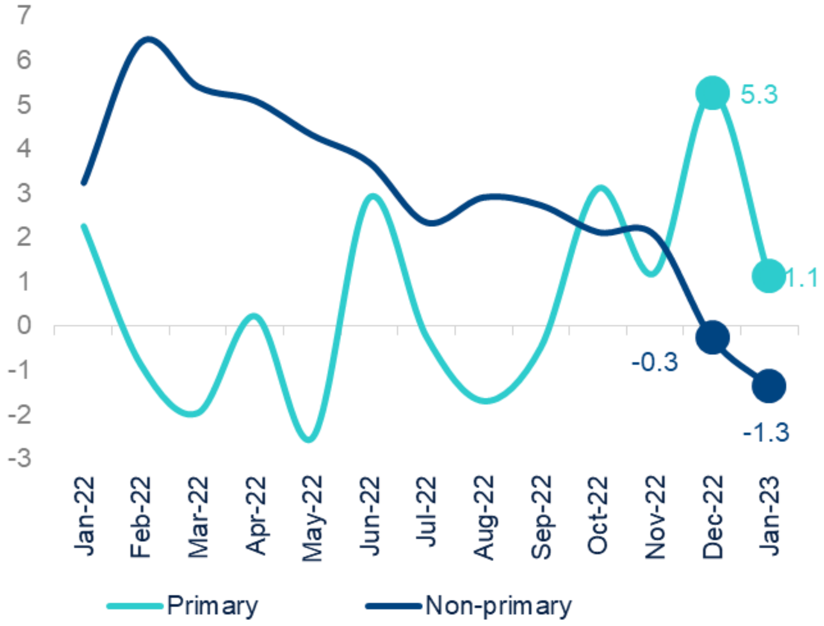
2019	2020	2021	2022
12.9	22.2	21.7	21.2

Source: BCRP.

GDP weakness was intensified at the beginning of the year by social protests

GDP
(VAR. % INTERANUAL)

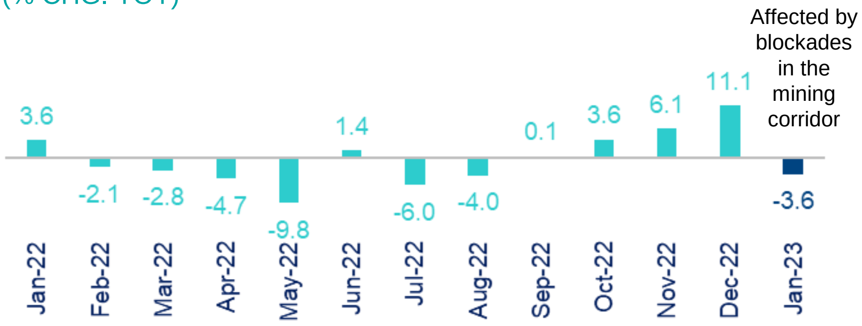
GDP
(VAR. % INTERANUAL)



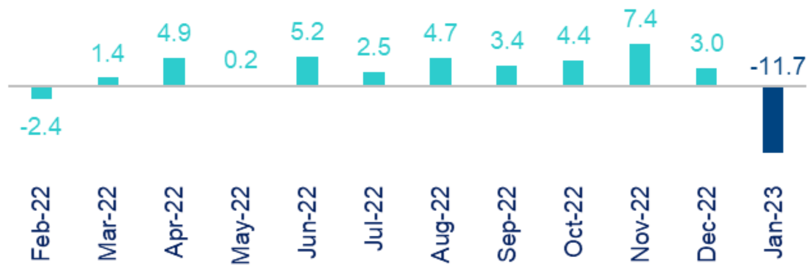
Source: INEI.

Mining again suffered from the blockade of the mining corridor; social unrest also affected construction, commerce and services

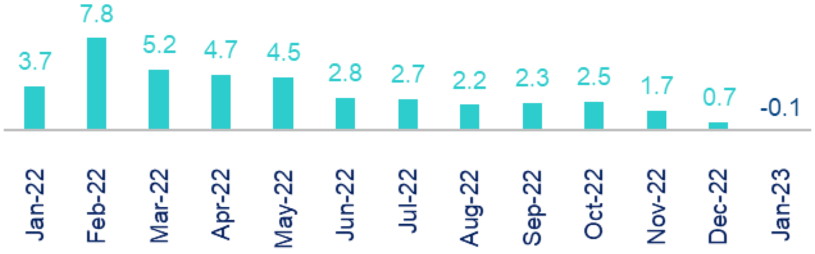
METAL MINING
(% CHG. YOY)



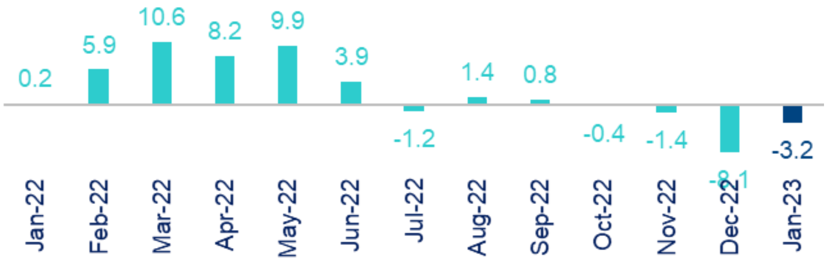
CONSTRUCTION
(CHG. % YOY)



TRADE AND SERVICES
(% CHG. YOY)



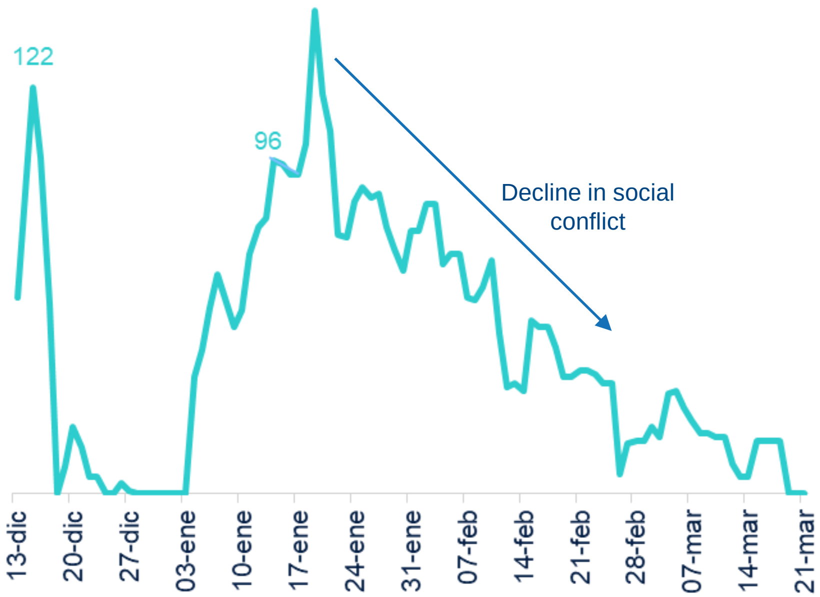
NON-PRIMARY MANUFACTURING
(% CHG. YOY)



Source: INEI.

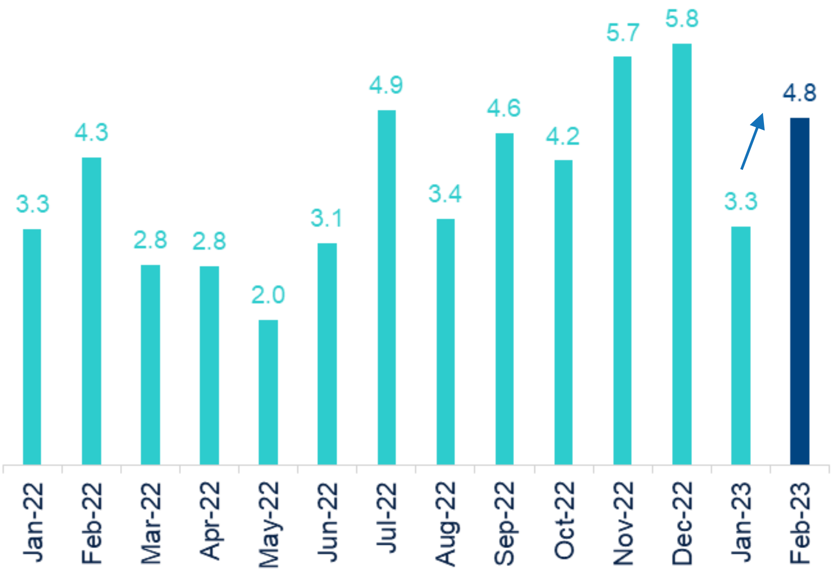
In February, available indicators point to some improvement of activity…

ROADBLOCKS DUE TO DISTURBANCES



Source: Ombudsman.

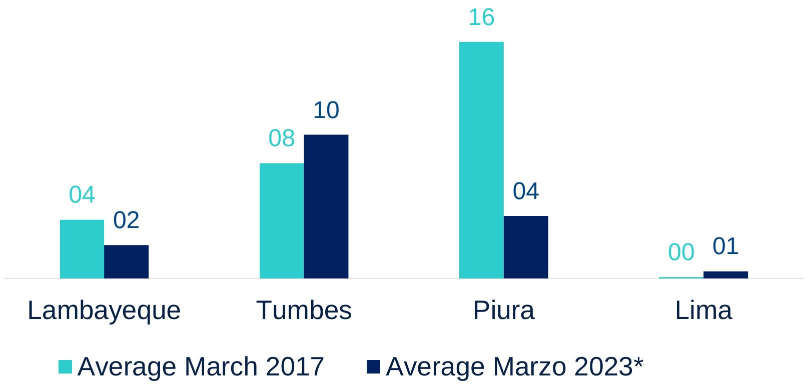
ELECTRICITY OUTPUT
(VAR. % INTERANUAL)



Source: INEI.

… but in March another negative shock struck the Peruvian economy: Cyclone Yaku, which caused significant but less severe damage than El Niño 2017

AVERAGE DAILY RAINFALL FOR MARCH IN SOME REGIONS (MILLIMETERS PER DAY)



*Information as at March 21
Source: Senamhi. Created by Macroconsult.

COMPARISON OF DAMAGE GENERATED BY EL NIÑO COSTERO IN 2017 AND CYCLONE YAKU 2023*

Type of damage	El Niño Costero 2017	Cyclone Yaku	Unit
Homes destroyed	63 802	1 146	Number
Homes affected	350 181	24 095	Number
Schools collapsed	318	0	Number
Schools affected	2 870	22	Number
Health care facilities destroyed	62	14	Number
Health care facilities affected	934	87	Number
Rural roads affected	221 219	354	Kilometers
Rural roads destroyed	12 832	7	Kilometers
Road affected	13 311	440	Kilometers
Road destroyed	4 778	43	Kilometers
Bridges destroyed	449	51	Number

*Information as at March 21.
Source: COEN Created by Macroconsult.

Midagri: damages caused by rains and floods represent 1.2% of the agricultural area (16.5 thousand hectares were lost and 33.9 thousand hectares were affected).

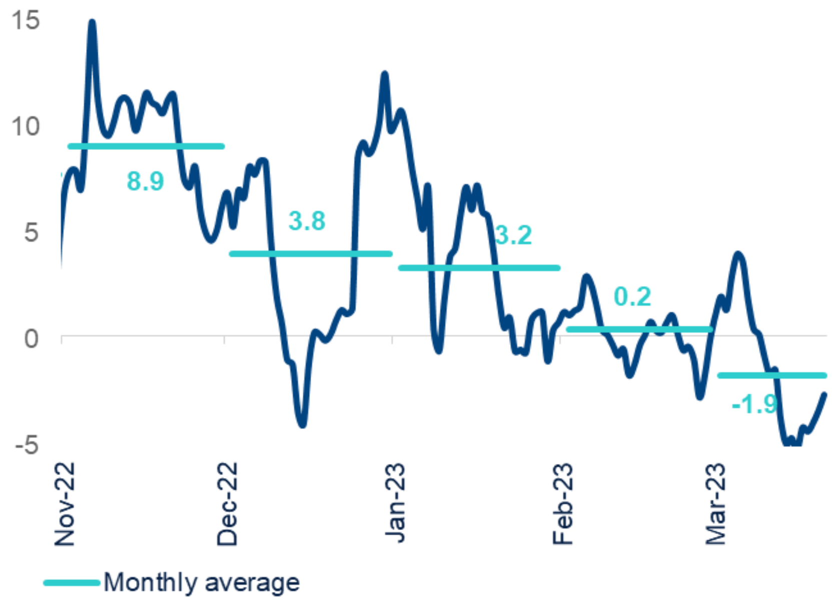
MEASURES IMPLEMENTED BY AUTHORITIES TO CONTAIN ECONOMIC IMPACTS OF YAKU

- Bank credit rescheduling for up to six months in emergency areas.
- Postponement of tax obligations for three months.
- Increased resources to subnational governments to address the emergency.

In general, the available indicators, including those for expenditure elaborated by BBVA Research, suggest a relative stagnation

CONSUMER BIG DATA INDEX[1]

(% CHG. YOY, IN REAL TERMS, 7-DAY AVERAGE)



1: Information as at March 21. This indicator uses data on the amount of credit and debit card purchases made by households and cash withdrawals through ATMs and teller windows.
Source: BBVA Research based on BBVA data.

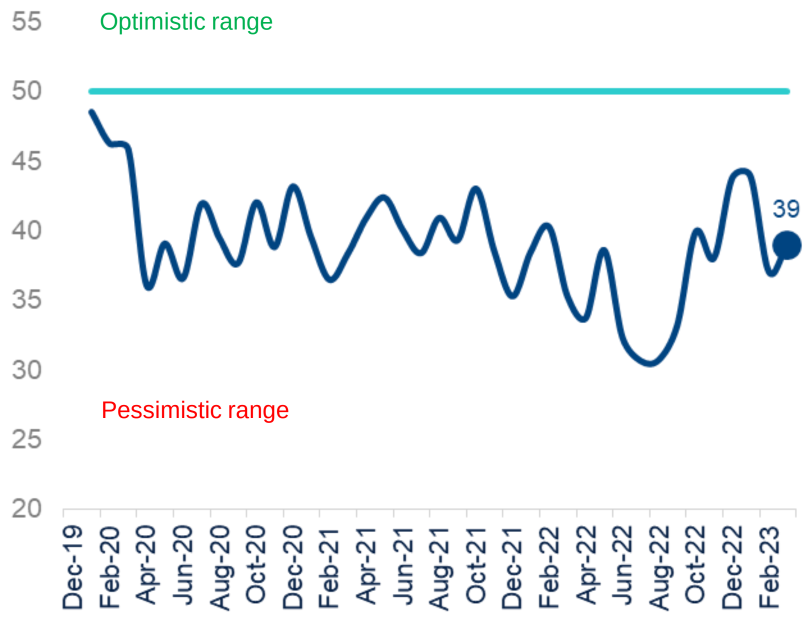
BIG DATA INVESTMENT INDEX[1]

(% CHG. YOY, IN REAL TERMS, 28-DAY AVERAGE)

1: Information as at March 21. This indicator uses information on payments into accounts of companies.
Source: BBVA Research based on BBVA data.

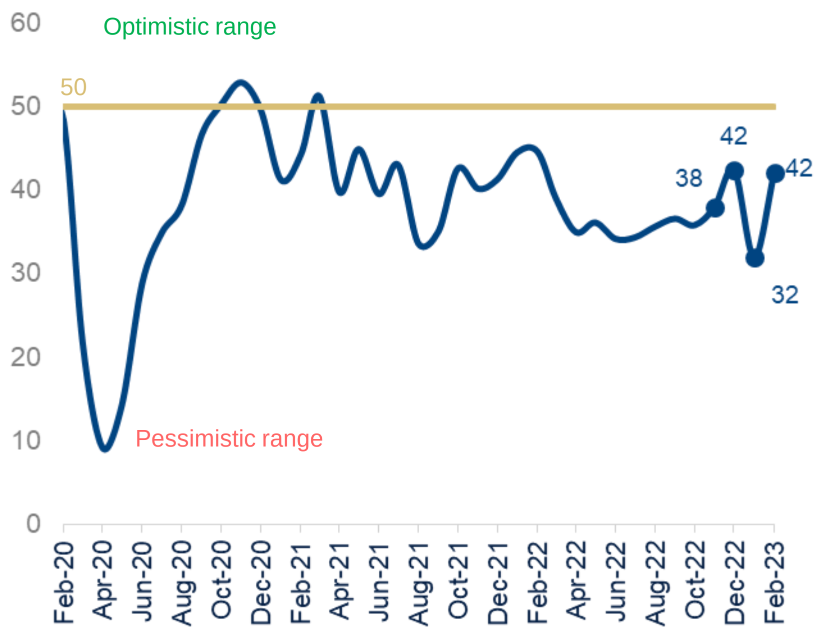
… with confidence remaining at low levels

CONSUMER CONFIDENCE
(POINTS)



Source: Apoyo Consultoría.

BUSINESS CONFIDENCE
(POINTS)



Source: BCRP.

BBVA Research

03

Macroeconomic forecasts

3.1. Economic activity

BBVA Research baseline scenario: interest rates will be higher for longer to ease demand and curve inflation down

BBVA RESEARCH BASELINE SCENARIO: MAIN ASSUMPTIONS AND FEATURES

COMMODITIES AND BOTTLENECKS

Commodity prices to remain under 2022 levels, but China’s demand and supply issues will limit downward corrections and favor rebound of oil prices in 2H23.

Supply bottlenecks to continue normalizing.

EUROPEAN GAS

Prices assumed to remain somewhat higher than ongoing levels, mainly from mid-2023.

Gas reserves to be enough to prevent shortages, even under relatively unfavorable scenarios.

FINANCIAL AND MONETARY CONDITIONS

More restrictive monetary policy, also through monetary tightening programs.

A strong dollar, higher sovereign yields and modest capital inflows into riskier assets are expected.

ACTIVITY AND PRICES

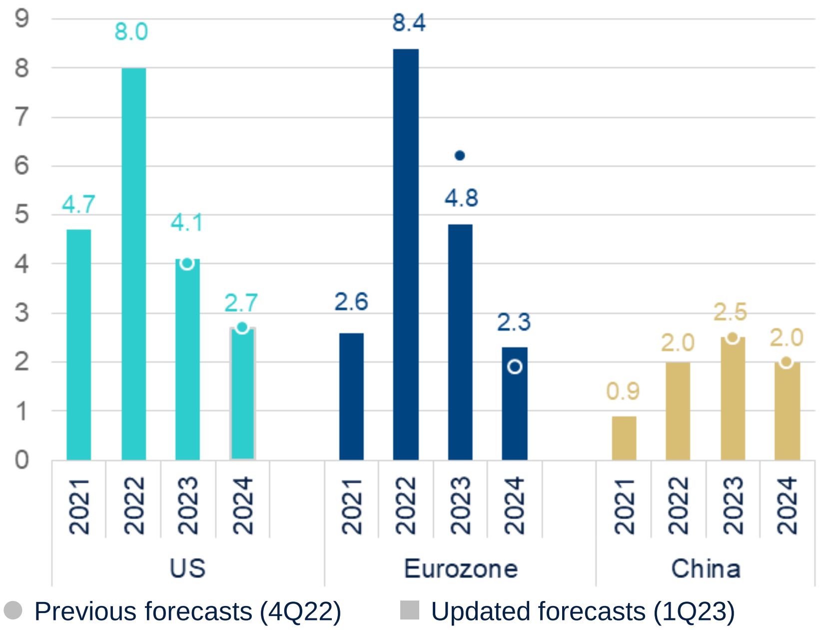
Monetary tightening will pave the way for demand deceleration.

Price and wage pressures will gradually ease and price and wage spirals will be avoided.

Inflation will continue trending downwards, but slower demand deceleration will prevent it from converging to the target over the next two years

INFLATION:CPI

(Y/Y %, PERIOD AVERAGE)



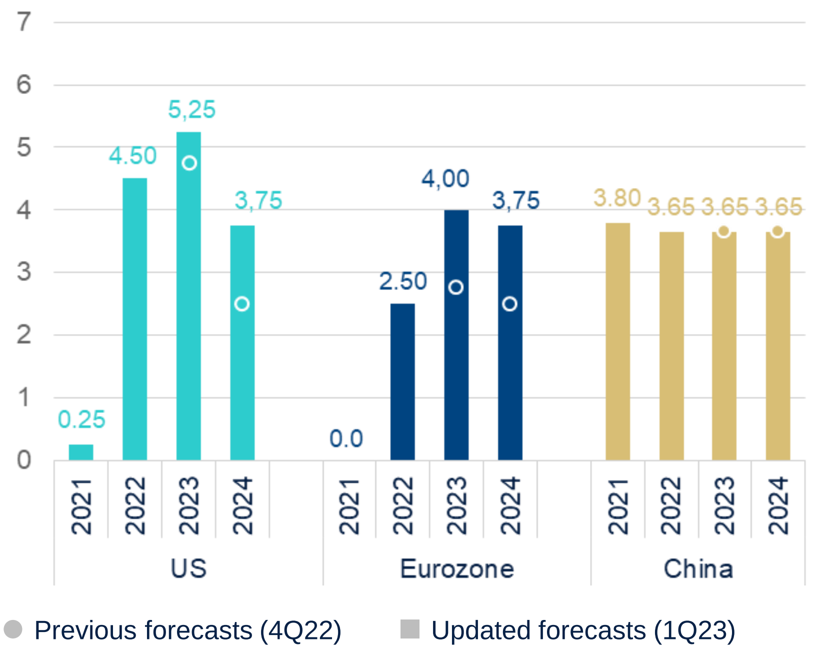
Source: BBVA Research.

- Downward surprises in headline inflation pave the way for lower-than-expected price pressures in the short-run both in the US and the EZ.
- Still, sticky core prices amid more resilient labor markets as well as scarcer room for further falls in energy prices will keep inflation high for longer than expected.
- In China, inflation will probably remain under control, but the risk is that higher domestic demand coupled with the impact of protectionist measures more than offset the effects from the supply normalization, which would add to inflation pressures.

Central banks will remain focused on inflation: interest rates will rise more and will be kept higher for longer than expected

MONETARY POLICY INTEREST RATES (*)

(%, END OF PERIOD)

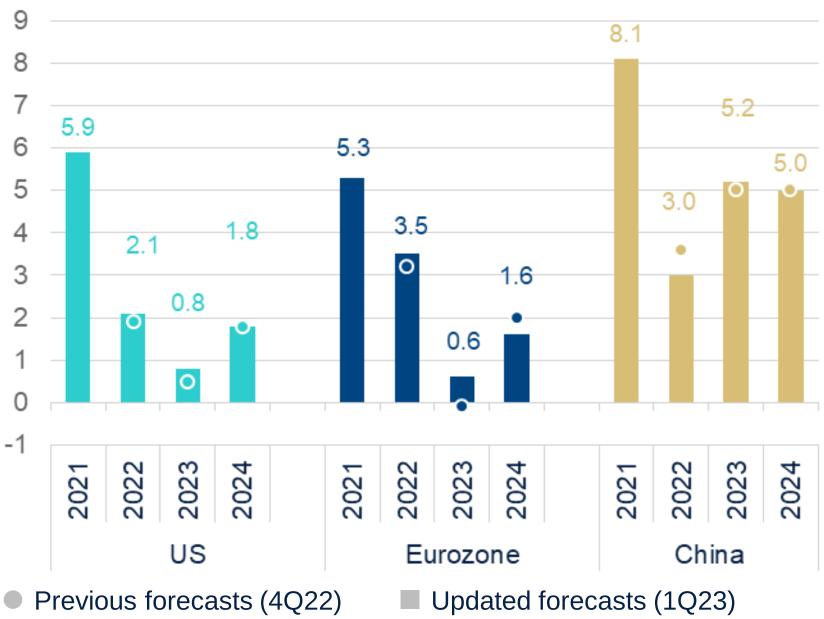


(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- Terminal interest rates will be higher than expected, but uncertainty is large due to the volatile inflation dynamics, the unexpected resiliency of demand and doubts about the power of monetary policy in this context.
- One option is to accelerate quantitative tightening in exchange for smaller additional rate hikes, but that entails financial instability risks.
- The most likely is that rates soon reach 5.25%-5.50% in the US and 4.00%-4.25% in the euro zone.
- High rates can be expected for longer, given the slow process of disinflation.

Better growth prospects for 2023: a softer deceleration in both the US and the Eurozone, and a stronger rebound in China

GDP: ANNUAL GROWTH IN REAL TERMS (*)
(%)

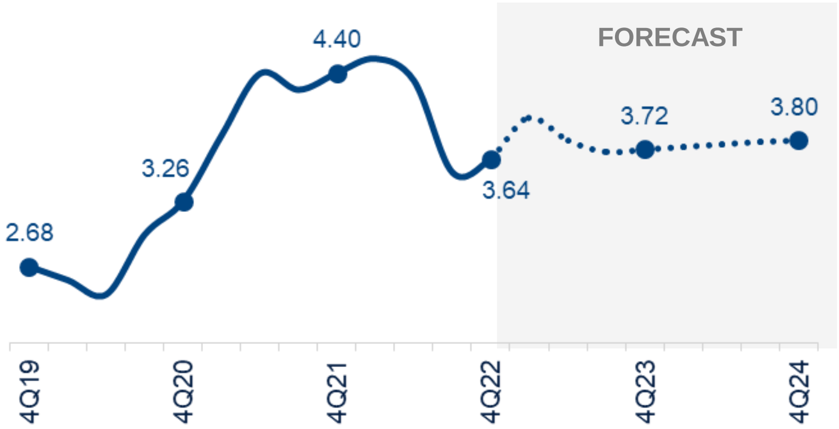


(*) Previous forecasts: 0.5% in 2023 and 1.8% in 2024 in the US, -0.1% in 2023 and 2.0% in 2024 in the Eurozone, 5.0% en 2023 and 5.0% in 2024 in China.
Source: BBVA Research.

- Global GDP is expected to grow 2.8% (0.5pp higher than forecast) in 2023 and 3.3% (0.0pp) in 2024, after having grown 3.2% in 2022.
- 2023 forecasts have been revised up in the US and the EZ on positive incoming data (resilient demand) and lower energy prices.
- Upward revision in 2023 GDP also in China: the reopening will support consumption and supply-side normalization; policy stimuli will back investment.
- Deceleration prospects remain in place due to monetary tightening and high inflation, but some factors (private sector's balance sheets, NGEU in Europe) will be supportive and a deep recession will likely be avoided.

We continue to foresee some downward pressure on the average copper price in 2023, but a constructive outlook going forward

INTERNATIONAL COPPER PRICE
(USD PER POUND, QUARTERLY AVERAGE)



COTIZACIÓN INTERNACIONAL DEL COBRE
(USD PER POUND, ANNUAL AVERAGE)

2019	2020	2021	2022	2023*	2024*
2.73	2.80	4.22	4.00	3.81	3.78

*Forecast.
Source: BBVA Research.

- Slowdown in global economic activity in 2023 will not favor demand for copper. In addition, there will be a greater incoming supply.
- However, some factors will give some support to the price: output costs will remain at high levels (energy), inventories are starting from low levels, and output problems in some large operations.
- On balance, downward pressure on the red metal price for the remainder of 2023.
- Once the cyclical adjustment of the global activity ends, there is a more constructive outlook for the copper price from 2024 onward: structural support from greater investment in green infrastructure and vehicle reconversion, both in Europe and in the USA.

In an uncertainty context, the main risk is that sticky inflation requires extra monetary tightening, triggering a recession, stagflation or financial instability

MAIN RISKS

MORE PERSISTENT INFLATION AND TIGHTER MONETARY POLICY:

- stronger demand (tight labor markets, fiscal stimulus, etc.)
- demand-driven Chinese recovery
- higher energy prices on the war or other factors
- wage-price spirals

GLOBAL RECESSION OR STAGFLATION

FINANCIAL INSTABILITY

MAIN UNCERTAINTIES

GEOPOLITICAL TENSIONS

US-CHINA RIVALRY (DEGLOBALIZATION, ETC)

ENERGY TRANSITION AND CLIMATE CHANGE

SOCIAL TENSIONS AND POPULISM

Local baseline scenario: social upheaval at the beginning of the year and political uncertainty will drag growth in 2023, but there will be a rebound in 2024

LOCAL BASELINE SCENARIO: MAIN CONSIDERATIONS

−

Social unrest will continue to weigh on growth

High political uncertainty: Elections? When? Outcome?

The post-COVID rebound dissipates

Public investment will be boosted in 2023 (by new subnational authorities) **and will rebound in 2024**.

El Niño phenomenon (weak)
Sea temperatures slightly above normal in the fall/winter of 2023 (limited impact on activity)

+

Quellaveco copper mine operations

Inbound tourism
Recovery (slower)

Reactivation plans
(Impulso Perú and Con Punche Perú)

GDP will increase 1.9% in 2023 (downward revision from 2.5%) and **3.0% in 2024** (upward revision from 2.4%)

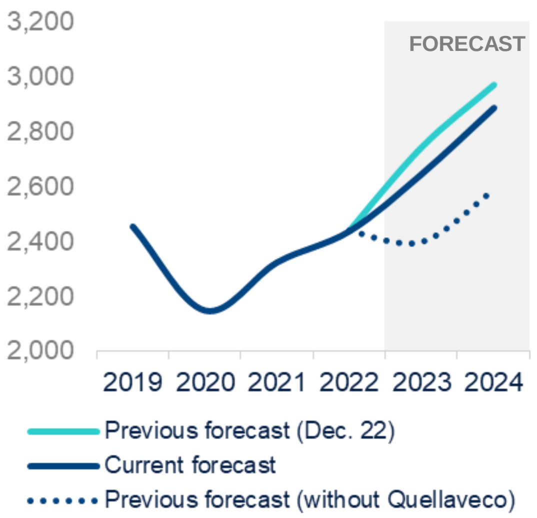
Social upheaval in early 2023 to subtract just over 0.3pp from growth in 2023; low year-over-year comparison baseline for 2024

Relatively good export performance due to Quellaveco and gradual normalization of inbound tourism, despite social unrest and a slowdown in global growth in 2023

Slump in domestic demand in 2023 due to uncertainty and high interest rates (contraction of private investment) and new subnational authorities (decline in public investment); **rebound in 2024** due to normalization of interest rates and assumption of a new government administration more supportive of private initiatives

Quellaveco will favor an increase in mining output, but social unrest in the country will continue to hinder its performance

COPPER OUTPUT
(MILLIONS OF MT)



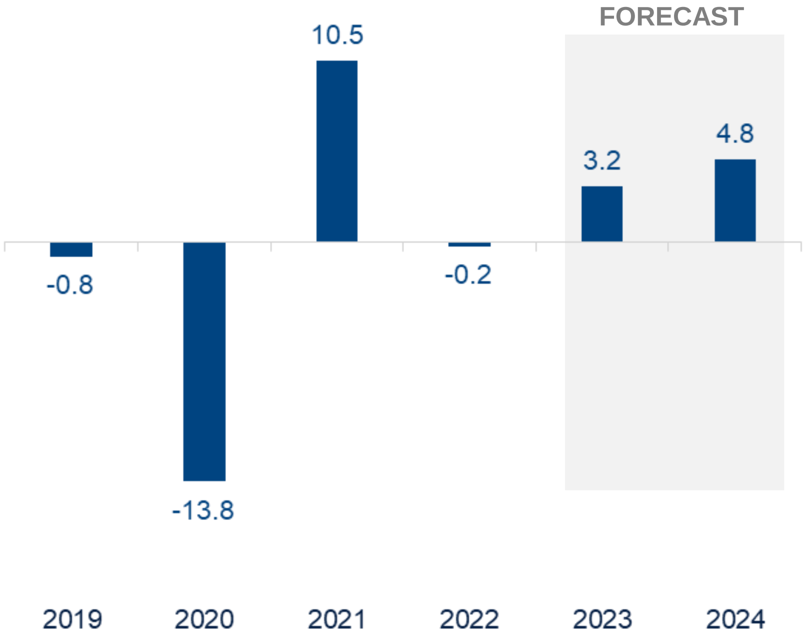
SOCIAL UNREST AT THE BEGINNING OF THE YEAR AFFECTED THE OUTPUT OF SEVERAL MINES:

- San Rafael
- Antapaccay
- Las Bambas
- Julcani
- Hudbay

Delay of the second Toromocho extension

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

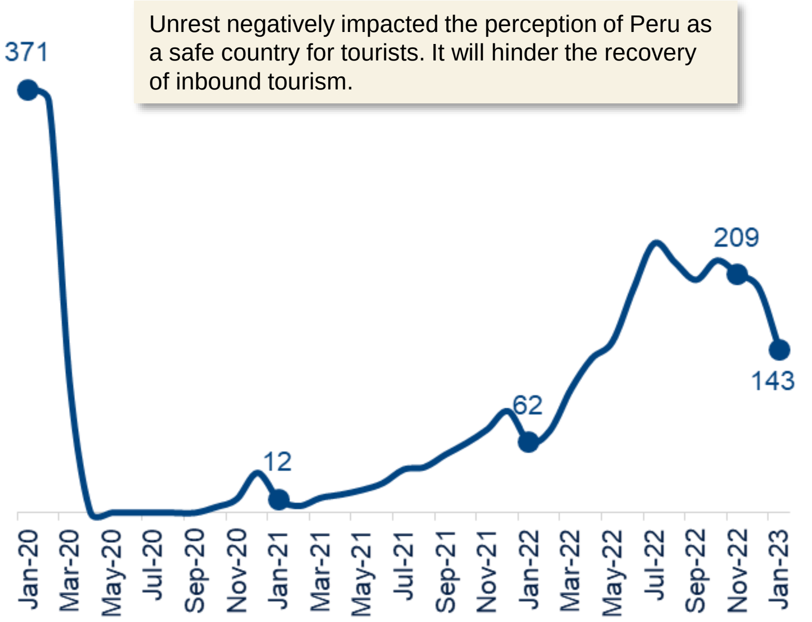
METAL MINING
(VAR. % ANUAL)



Source: MINEM, BCRP, and BBVA Research.

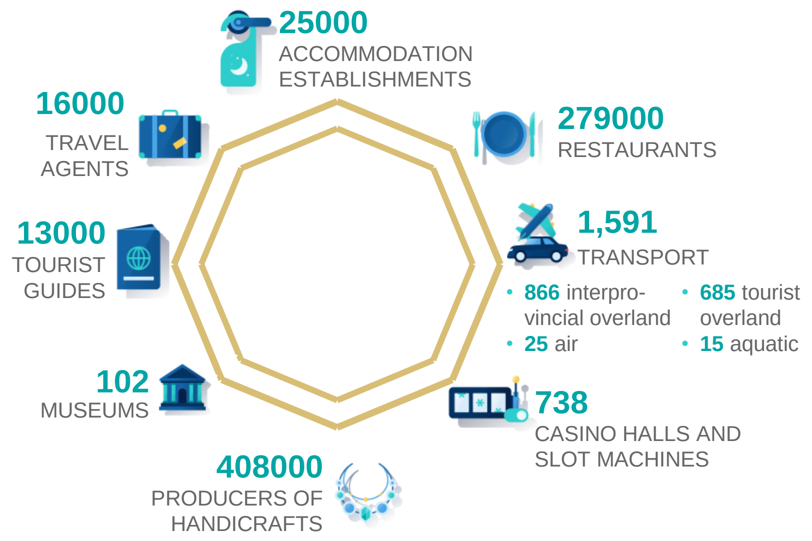
Inbound tourism will tend to recover, but at slower pace due to the somewhat lasting impact of the social upheaval at the beginning of the year

ARRIVAL OF FOREIGN TOURISTS IN PERU
(THOUSANDS OF PEOPLE)



Source: Ministry of Foreign Trade and Tourism (Mincetur)."Monthly Tourism Report January 2023".

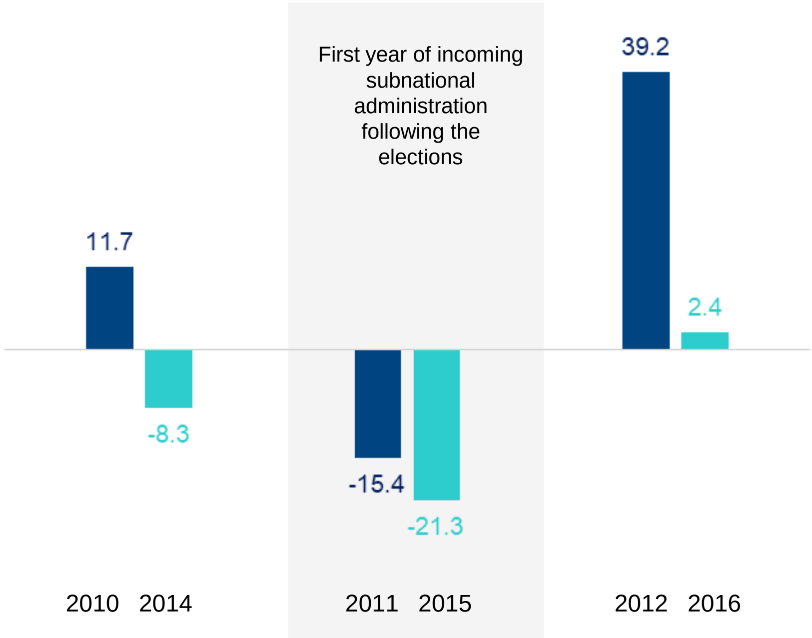
TOURISM-RELATED BUSINESSES/ESTABLISHMENTS
(INFORMATION AS AT JANUARY 2023)



Source: Ministry of Foreign Trade and Tourism (Mincetur)."Monthly Tourism Report December 2022".

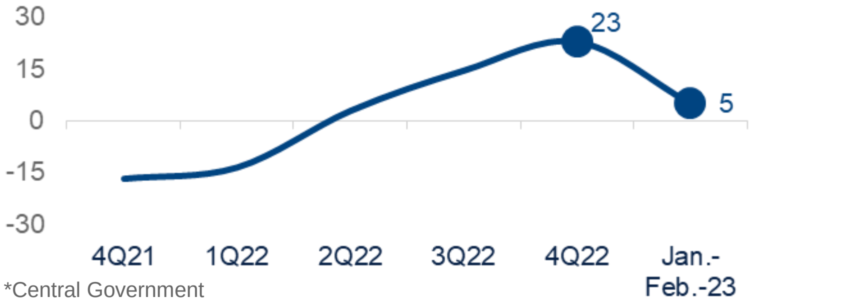
Drop in public investment in 2023 (due to new subnational authorities), although less marked than in the previous forecast, and normalization in 2024

PUBLIC INVESTMENT BY SUBNATIONAL GOVERNMENT (REAL % CHG.)



Source: BCRP and BBVA Research.

PUBLIC INVESTMENT* (REAL % CHG.)



*Central Government

- Public investment showed a better performance at the beginning of the year than we anticipated (National Government expenditure on Reconstruction with Changes).
- In addition, in order to cushion the economic impact of the increased social conflict, the "Con Punche Perú" plan was announced. The fiscal cost of this plan amounts to S/ 6 billion, approximately half of which will be spent on investment.
- Taking the above into account, we now estimate that the contraction of public investment in 2023 will be more moderate.

Baseline scenario forecast now incorporates greater political uncertainty: early elections? outcome of the eventual elections?

GENERAL ELECTIONS: SCENARIOS

(LIKELIHOOD IN PARENTHESIS)

2023 (5%) Unlikely. Perhaps only the resignation of President Boluarte in the next few months would make this scenario possible (she has indicated that she will not).

2024 (55%) Central scenario. It would give some room for some electoral and political reforms that could favor Congress to lean toward this scenario.

2026 (40%) The likelihood of this scenario is increasing, especially if the unrest subsides, among other considerations.

Baseline scenario: general elections in the first half of 2024

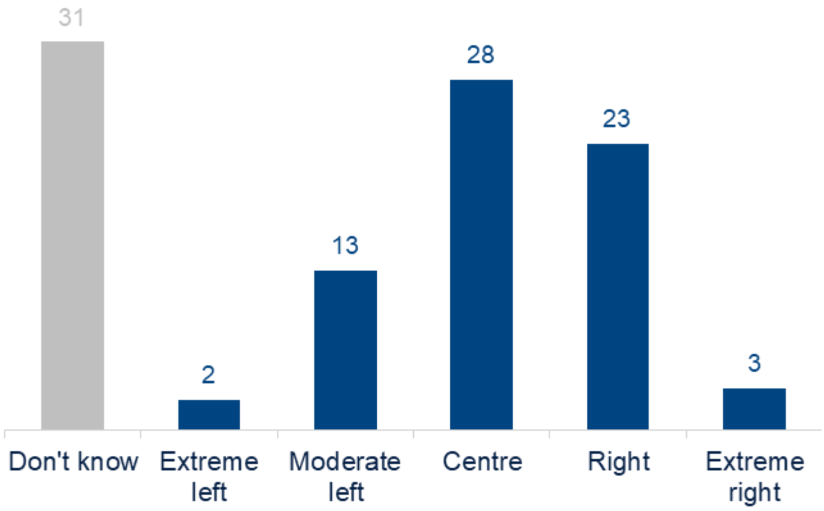
Post-election scenario?

RIGHT-WING OR LEFT-WING CANDIDATE?

(PREFERENCE, % OF TOTAL)

If a presidential election were held tomorrow, for which of these ideologies would you vote?

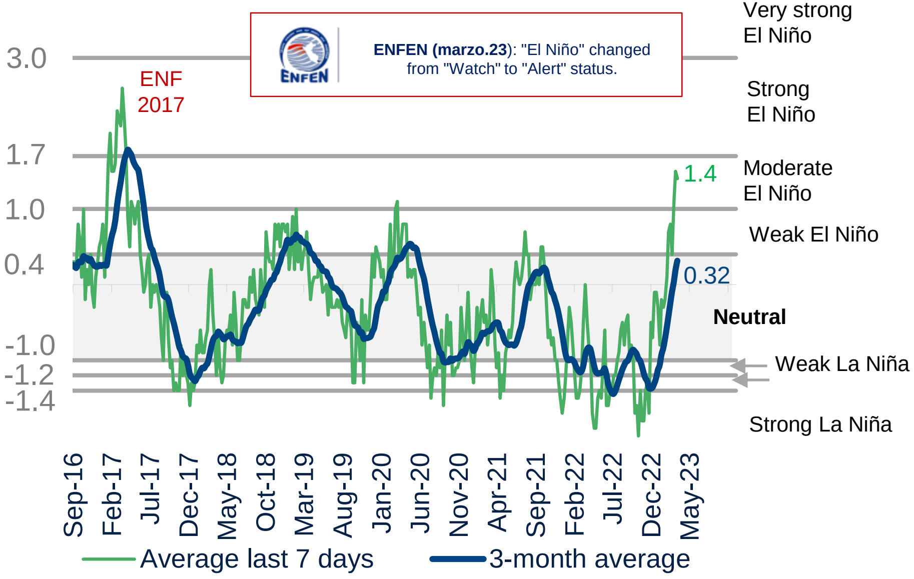
Central scenario assumes that a new center/right leaning government would be elected



Source: CPI (January 2023).

The El Niño phenomenon (ENP) is now also being considered in the coming months, albeit weak and during a period in which rainfall is relatively absent

CLIMATOLOGICAL ANOMALY ON THE NORTHERN COAST OF PERU (NIÑO 1+2) [1]



. 1: The temperature anomaly is weekly reported by the National Oceanic and Atmospheric Administration (NOAA) and is calculated as the deviation of sea temperature with respect to the period 1990-2020. The thresholds that determine the magnitude of a coastal El Niño Phenomenon are taken from the National Study of the El Niño Phenomenon (ENFEN).
Source: NOAA and ENFEN

Risk

That the El Niño will last until the beginning of 2024 and intensify, causing significant damage to activity.

ECONOMIC COST OF ENF IN THE PAST:

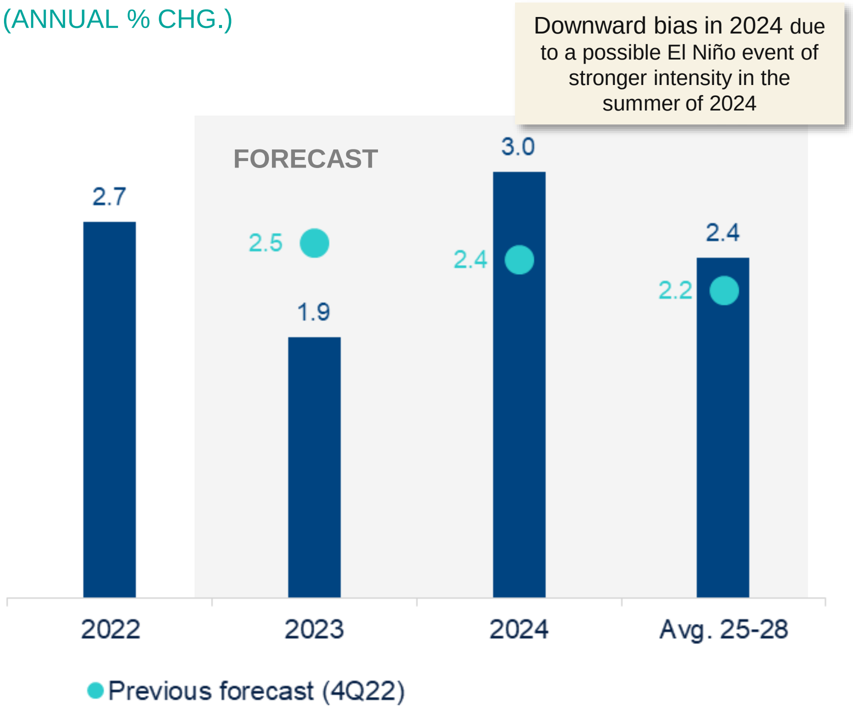
- (**Extraordinary ENP**) El Niño 1982/83: USD 3.283 billion (11.6% of annual GDP)
- (**Extraordinary ENP**) El Niño 1997/98: USD 3.500 billion (6.2% of annual GDP)
- (**Moderate ENP**) El Niño 2017: USD 6.261 billion (2.9 % of annual GDP)

Source: SENAMHI (2014). "El Niño Phenomenon in Peru", INDECI "Negative impact of the Coastal FEN in Peru" . In the case of the 2017 FEN, the Macroconsult estimate was considered.

The impact on economic activity of an ENP in 2024 will depend on the intensity (strong, extraordinary), duration (all summer or only part of it), and prevention efforts.

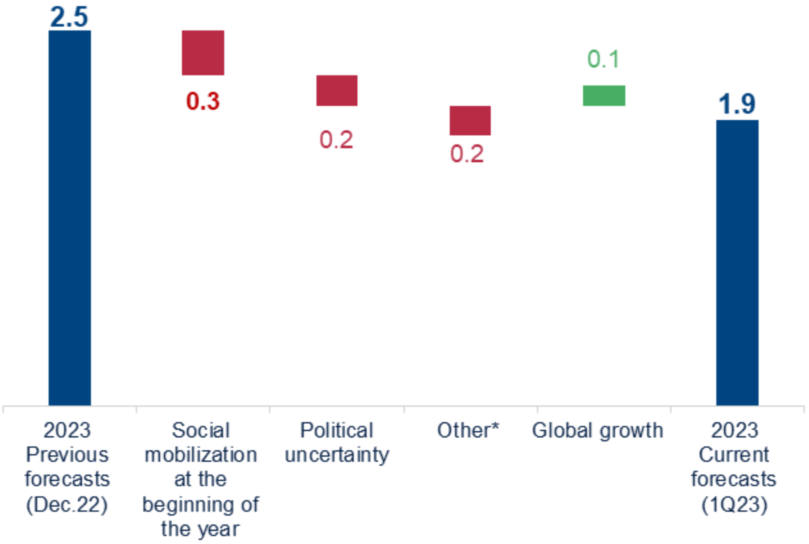
In this context, growth will slow in 2023 (to 1.9%), but rebound in 2024 (to 3.0%)

GDP
(ANNUAL % CHG.)



Source: BCRP and BBVA Research.

BREAKDOWN OF THE CHANGE IN 2023 GROWTH FORECASTS (% OF GDP)

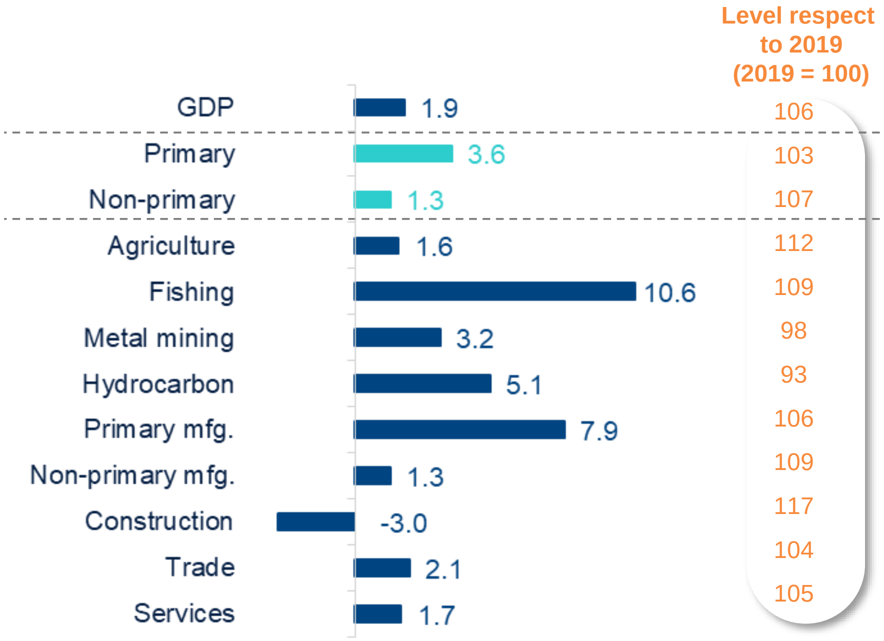


* For example, it considers a prolonged impact of the social upheaval at the beginning of the year on inbound tourism and a more conservative scenario regarding the impact of social unrest (extractive sectors).

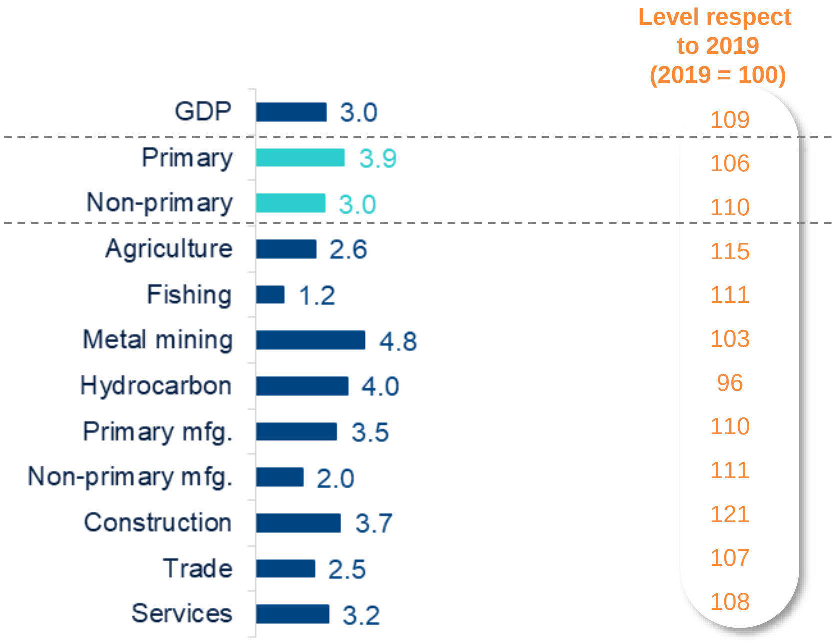
Source: BBVA Research.

On the sectoral side, extractive activities (including mining) will be the best performers in 2023 and 2024.

2023: SECTORAL GDP FORECAST
(ANNUAL % CHG.)



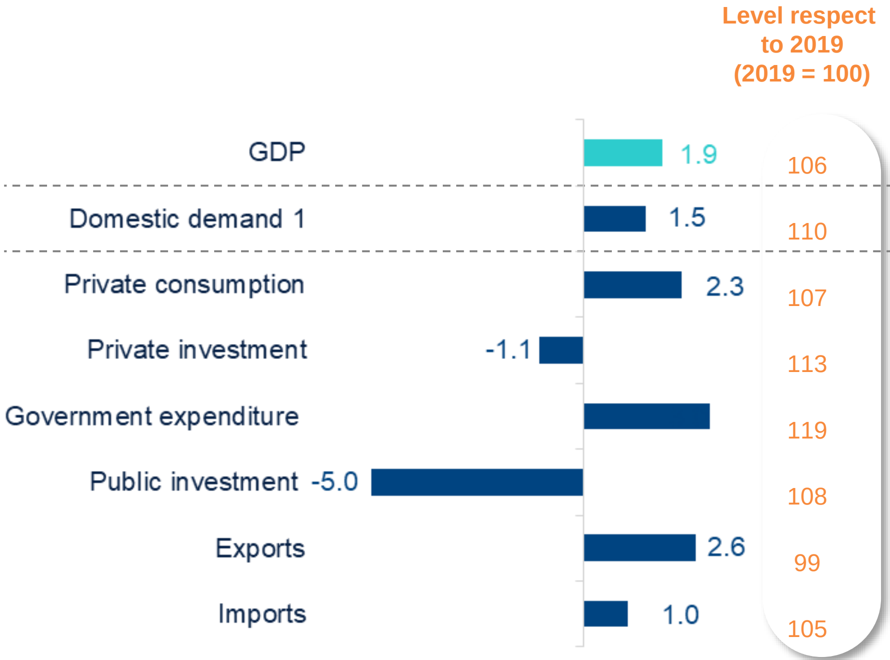
2024: SECTORAL GDP FORECAST
(VAR. % ANUAL)



Source: BBVA Research.

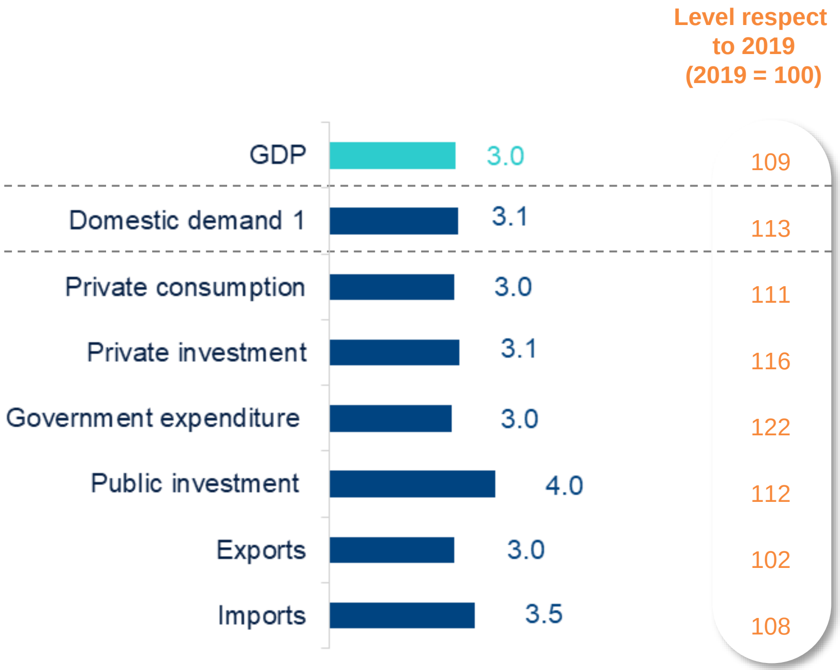
On the expenditure side, exports (mining) will support GDP growth, while public investment will decline in 2023 (new subnational authorities)

2023: EXPENDITURE-SIDE GDP FORECAST
(VAR. % ANUAL)



1: Inventories not included
Source: BBVA Research.

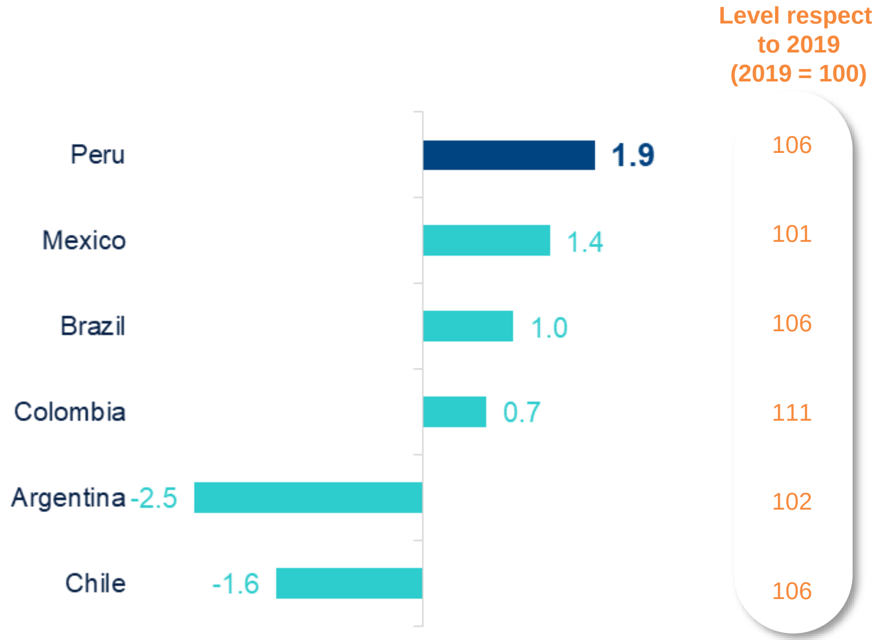
2024: EXPENDITURE-SIDE GDP FORECAST
(VAR. % ANUAL)



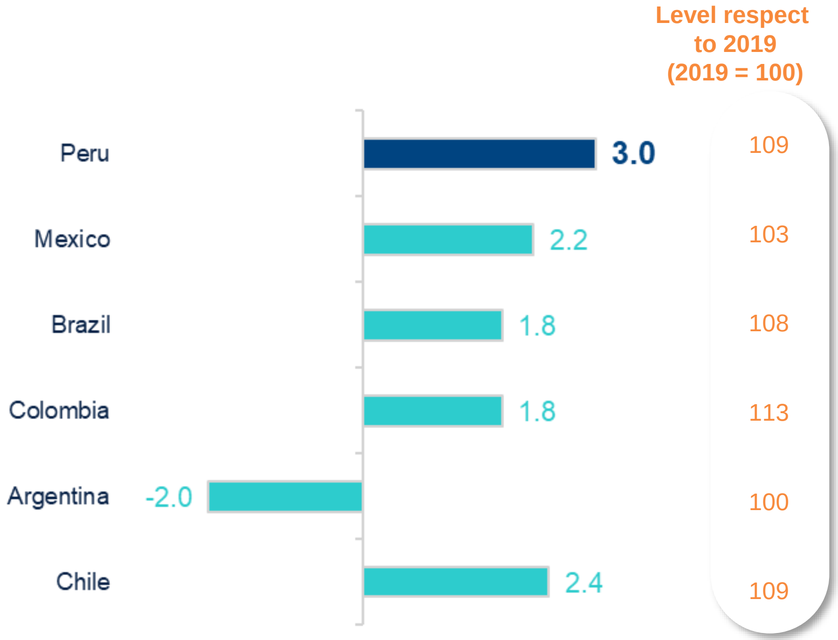
Fuente: BBVA Research.

Peru will be fastest-growing economy in 2023 and 2024 within the region's largest economies

LATAM GDP: 2023
(ANNUAL % CHG.)



LATAM GDP: 2024
(ANNUAL % CHG.)



Fuente: BBVA Research.

Research

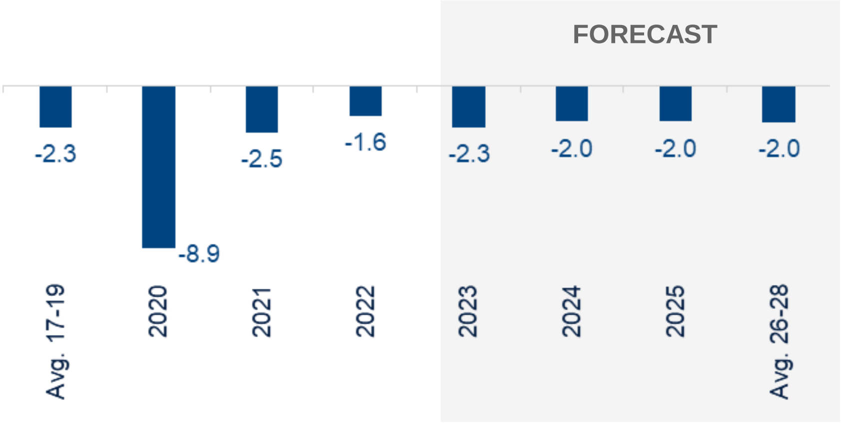
03

Macroeconomic forecasts

3.2. Fiscal balance and public debt

Deficits around 2.0% of GDP, with fiscal revenues remaining relatively stable (as a % of GDP) and...

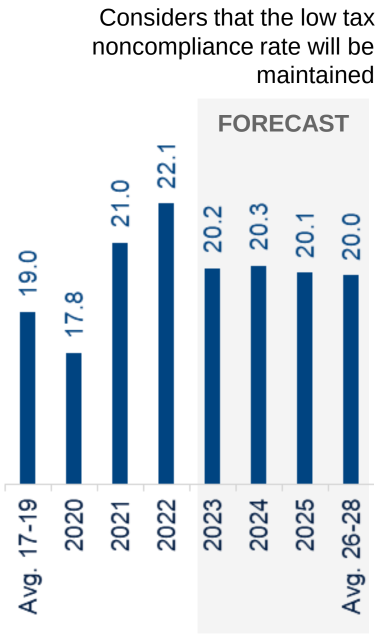
FISCAL BALANCE
(NON-FINANCIAL PUBLIC SECTOR, % OF GDP)



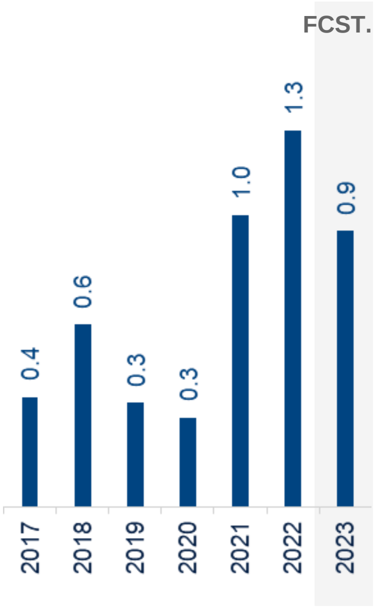
STRUCTURAL FISCAL BALANCE
(% POTENTIAL GDP)

2019	2020	2021	2022	2023	2024	2025	Avg. 26-28
-1.4	-4.5	-3.0	-1.9	-2.5	-2.4	-2.4	-2.4

CENTRAL GOVERNMENT REVENUE
(% GDP)



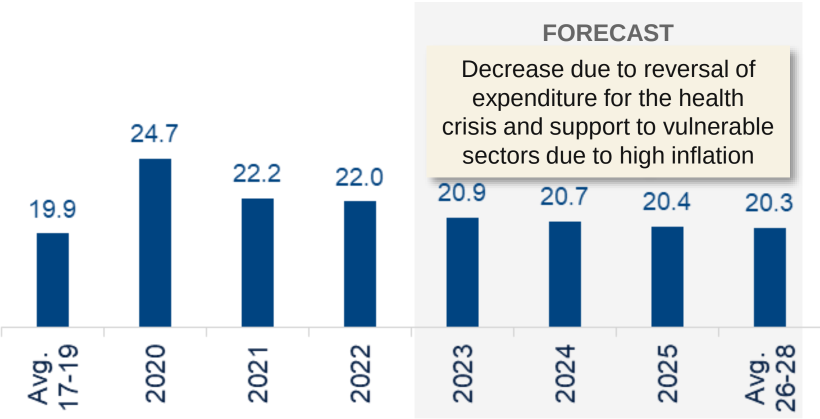
MINING SECTOR INCOME TAX
(% DEL PIB)



Source: BCRP and BBVA Research.

…and with a decrease in non-financial expenditure, but an increase in interest payments

CENTRAL GOVERNMENT NON-FINANCIAL EXPENDITURE (% GDP)



GOVERNMENT* INTEREST PAYMENTS (% OF GDP)

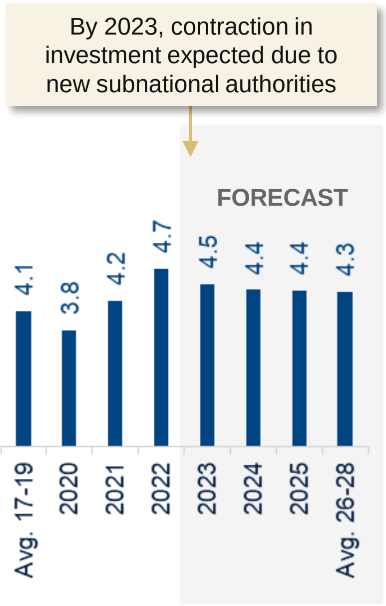
2019	2020	2021	2022	2023	2024	2025	Avg. 26-28
1.4	1.6	1.5	**1.6**	1.6	1.7	1.8	**1.9**

*Non-Financial Public Sector

Source: BCRP and BBVA Research.

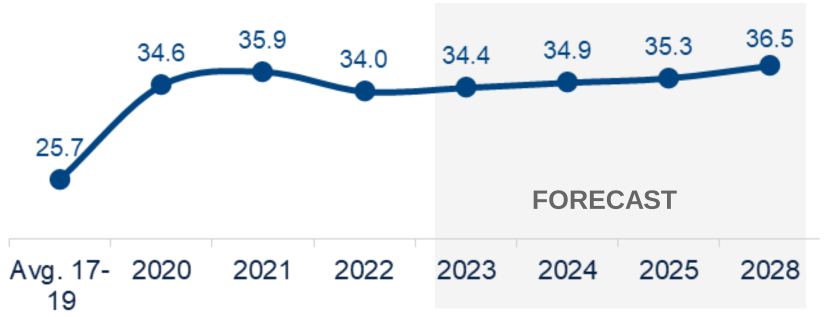
CENTRAL GOVERNMENT CURRENT EXPENDITURE (% DEL PIB)

CENTRAL GOVERNMENT INVESTMENT EXPENDITURE (% DEL PIB)



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)



NON-FINANCIAL PUBLIC SECTOR INDICATORS

	2019	2020	2021	2022
Assets (% of GDP)	13.7	12.4	14.2	12.8
Net debt (% of GDP)	12.9	22.2	21.7	21.2
Dollarization of public debt (%)	32	43	54	52
Interest as % of tax revenues	7.0	9.0	7.2	7.1

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 expenditure initiative, although not for the current year.
- Possible deterioration of the sovereign credit rating.

Credit rating: outlook downgraded due to political environment, despite maintaining good macro fundamentals

"Moody's changes outlook for Peru due to political and social risks"
January 31, 2023 (Gestión)

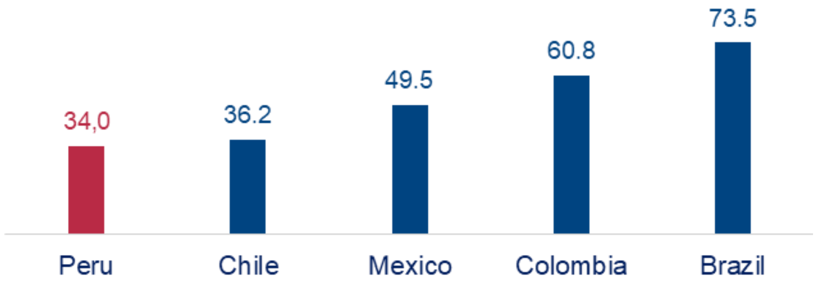
"S&P downgrades Peru's rating outlook to negative due to elevated political risk"
December 12, 2022 (Management)

CREDIT RATINGS AND OUTLOOK

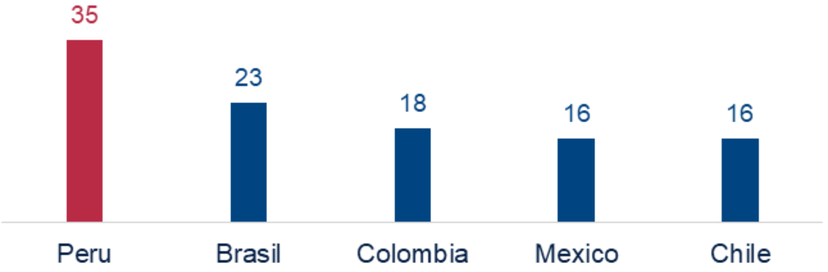
	S&P	Moody's	Fitch
Peru	BBB	Baa1	BBB
Chile	A	A2	A-
Mexico	BBB	Baa2	BBB-
Colombia	BB+	Baa2	BB+
Brazil	BB-	Ba2	BB-

Positive outlook
Stable outlook
Negative outlook
Downgrade in 2021/22

GROSS PUBLIC DEBT 2022
(% OF GDP)



NET INTERNATIONAL RESERVES 2021
(% OF GDP)



Source:S&P, Moodys, Fitch, World Bank, BCR and MEF

BBVA Research

03

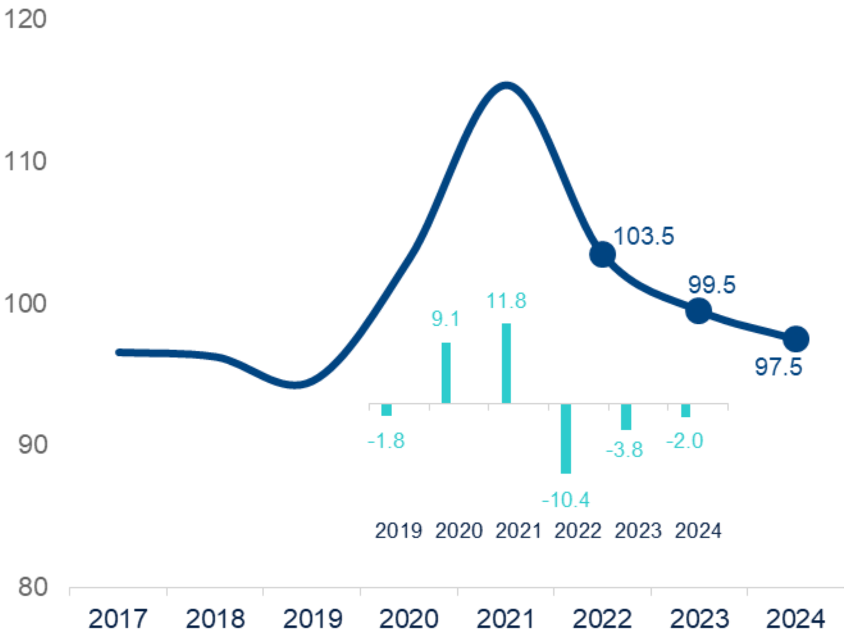
Macroeconomic forecasts

3.3. External sector and exchange rate

Creando Oportunidades

External accounts: lower terms of trade in 2023 and 2024 due to a downward correction of average metal prices…

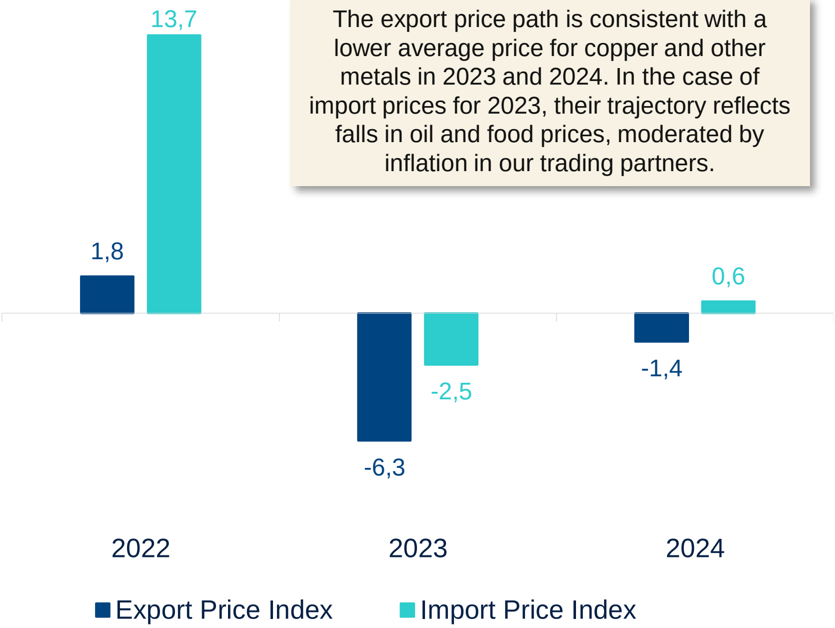
TERMS OF TRADE
(INDEX: 2007 = 100 AND YOY % CHG.)



Source: BCRP and BBVA Research.

EXPORT AND IMPORT PRICES
(YOY % CHG.)

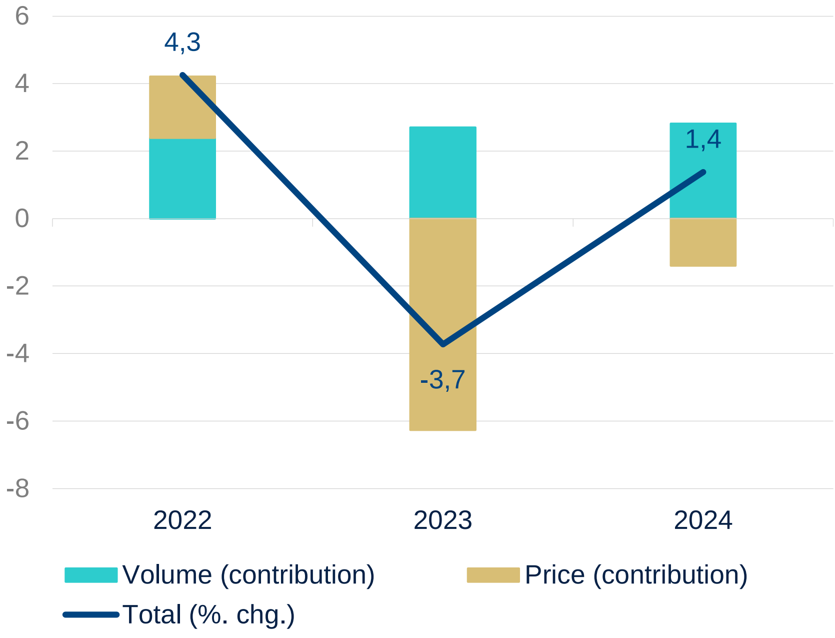
The export price path is consistent with a lower average price for copper and other metals in 2023 and 2024. In the case of import prices for 2023, their trajectory reflects falls in oil and food prices, moderated by inflation in our trading partners.



Source: BCRP and BBVA Research.

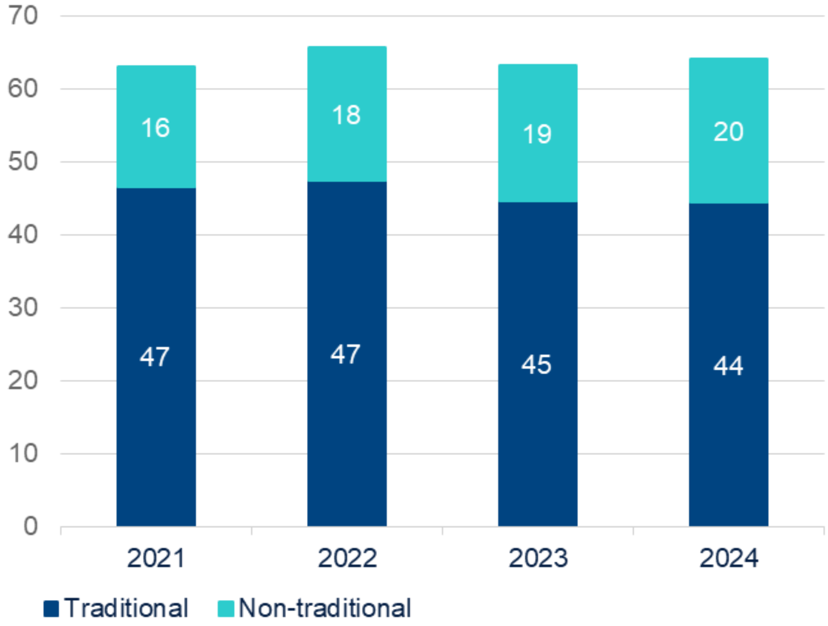
… which will lead to a moderation in the growth of export value

EXPORTS



Source: BCRP and BBVA Research.

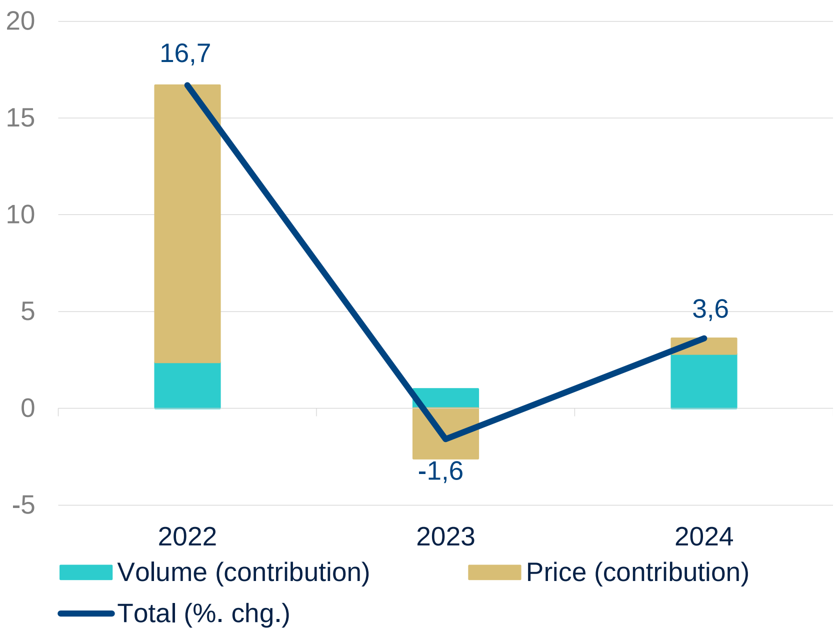
EXPORTS
(USD BILLIONS)



Source: BCRP and BBVA Research.

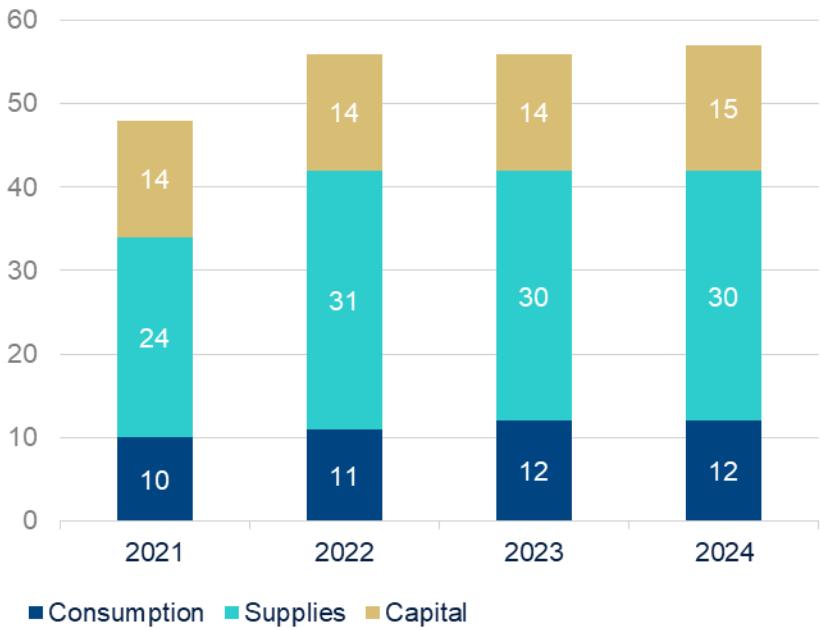
The value of imports will fall this year due to the slowdown in activity and the correction in prices, but will rebound next year

IMPORTS



Source: BCRP and BBVA Research.

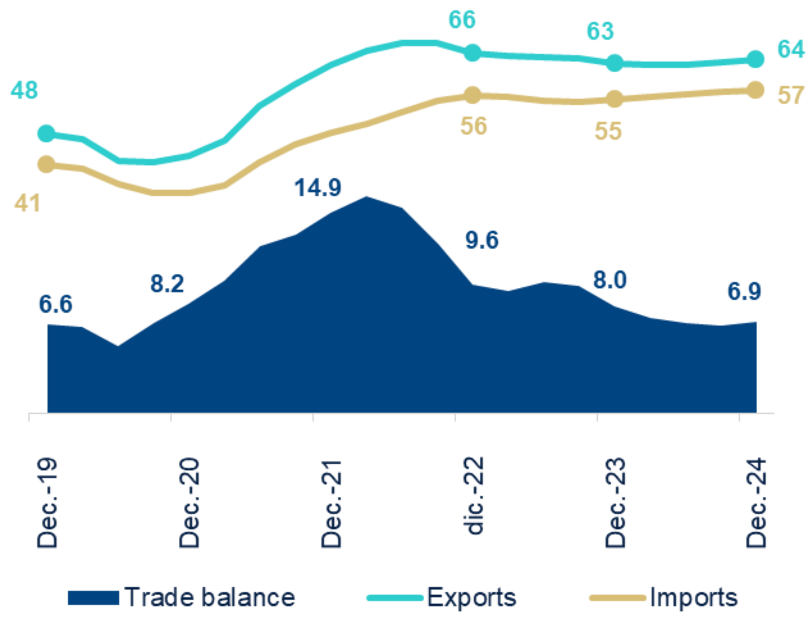
IMPORTS
(USD BILLIONS)



Source: BCRP and BBVA Research.

As a result, the trade balance moderate in 2023 and 2024

TRADE BALANCE
(USD BILLIONS, ACCUMULATED IN LAST 12 MONTHS)

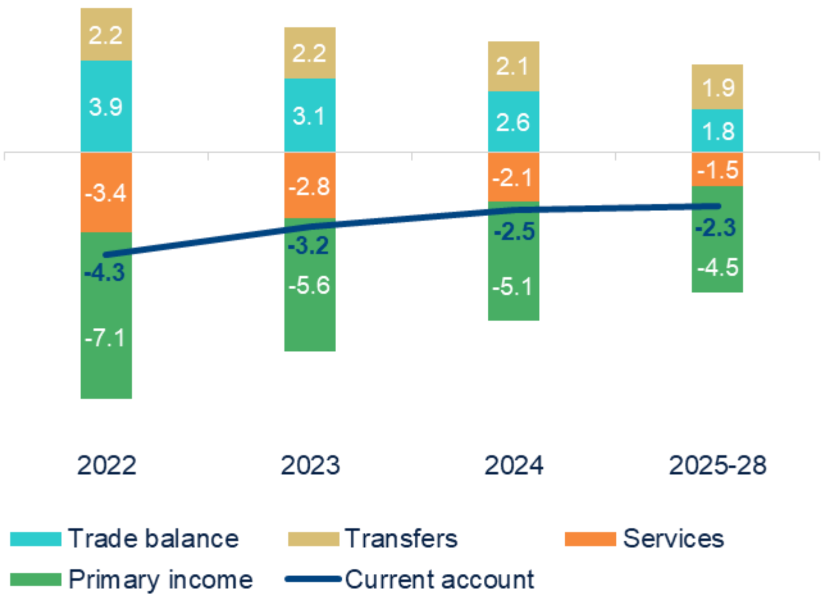


Source: BCRP and BBVA Research.

- In 2023, the lower trade surplus is mainly due to the fall in export prices (metals), which are falling more than import prices.
- In 2024, the trade balance will continue to moderate due to the greater dynamism of imports (due to improved activity and higher prices) compared to exports (export prices will correct downward).

Despite lower trade surplus, current account deficit will close as tourism recovers and corporate profits decline

BALANCE OF PAYMENTS CURRENT ACCOUNT
(% GDP)

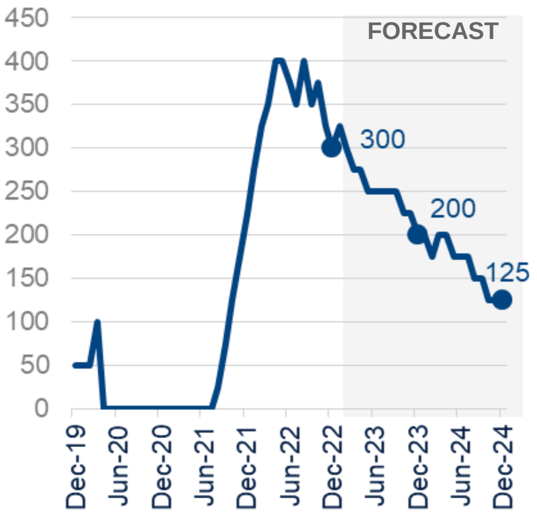


- Higher profits of foreign companies and the cost of imported services (e.g. freight) generated a widening of the current account deficit last year.
- In 2023, a lower trade surplus will be offset by: (i) lower profit remittances from foreign companies (in line with lower international metal and oil prices), and (ii) an improvement in the services account (normalization of inbound tourism and lower freight costs).
- This process will continue going forward, with the current account deficit continuing to narrow toward sustainable levels (consistent with a balance of stable net external liabilities as a % of GDP).

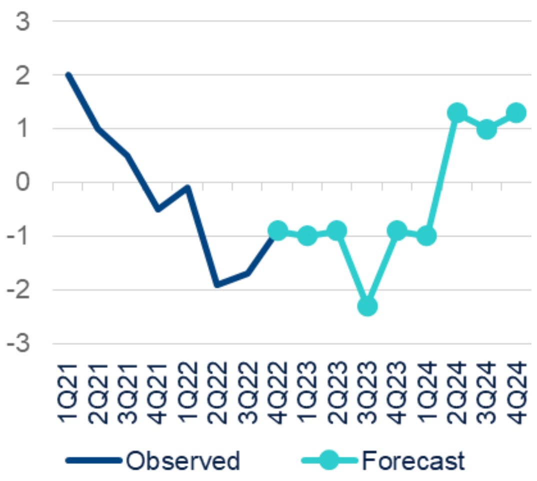
Source: BCRP and BBVA Research.

PEN will tend to depreciate this year due to a narrowing of the PEN-USD rate differential and a FED that will be much harsher than expected by the markets

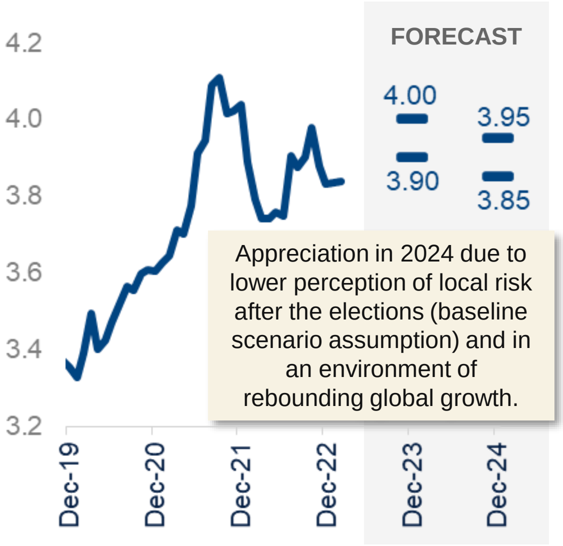
INTEREST RATE DIFFERENTIAL, SHORT-TERM (BCRP VS. FED, BP)



CAPITAL FLOWS TO EMERGING MARKETS (% OF ASSETS UNDER MANAGEMENT, CUMULATIVE OF FOUR QUARTERS)



EXCHANGE RATE (SOLES PER DOLLAR)



Source: FRED, BCRP and BBVA Research.

Important: BBVA Research anticipates: (i) an additional Fed rate hike (of 25 bp) this year, bringing it to 5.25% (upper ceiling), and (ii) that it will remain at that level throughout 2023. This differs from what the market currently expects: end of the upward cycle and cuts this year.

04

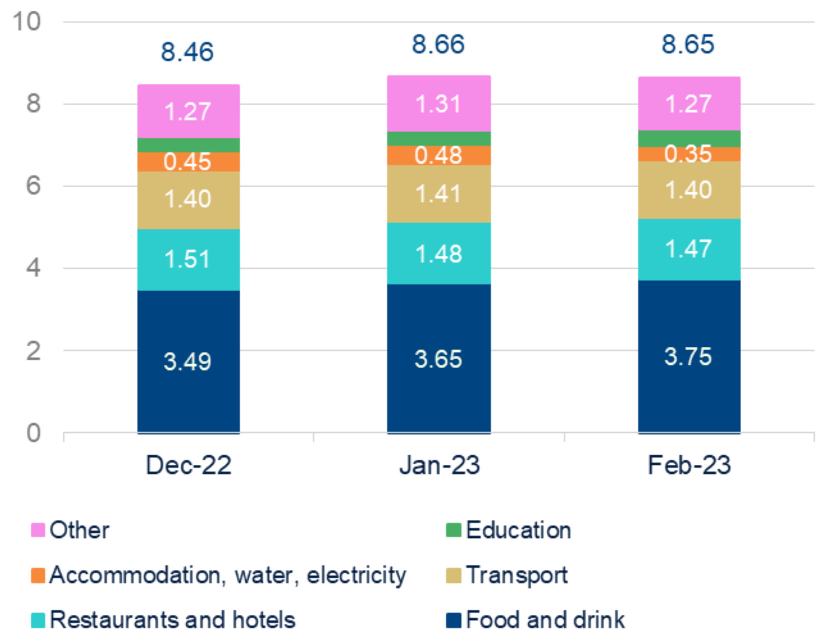
Macroeconomic forecasts

3.4. Inflation and monetary policy

Inflation in recent months has remained elevated mainly due to transitory local supply shocks affecting food prices

INFLATION, BY COMPONENT

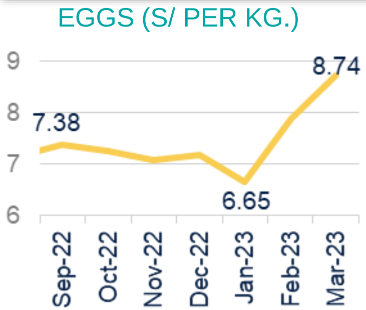
(% CHG. YOY)

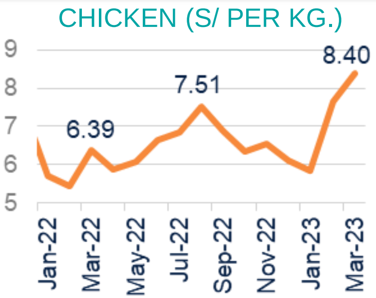


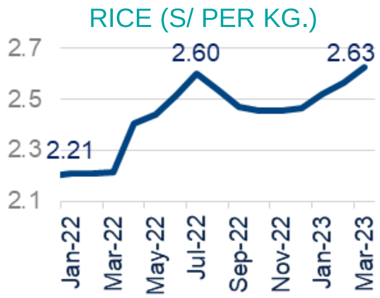
Source: INEI.

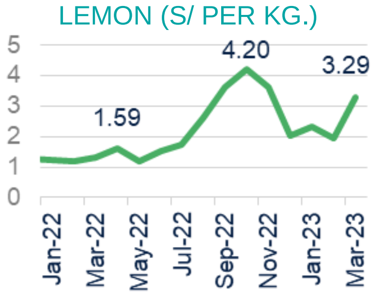
FOOD PRICES

High temperatures in February, avian flu and the higher local price of soybean cake affected the supply of poultry products





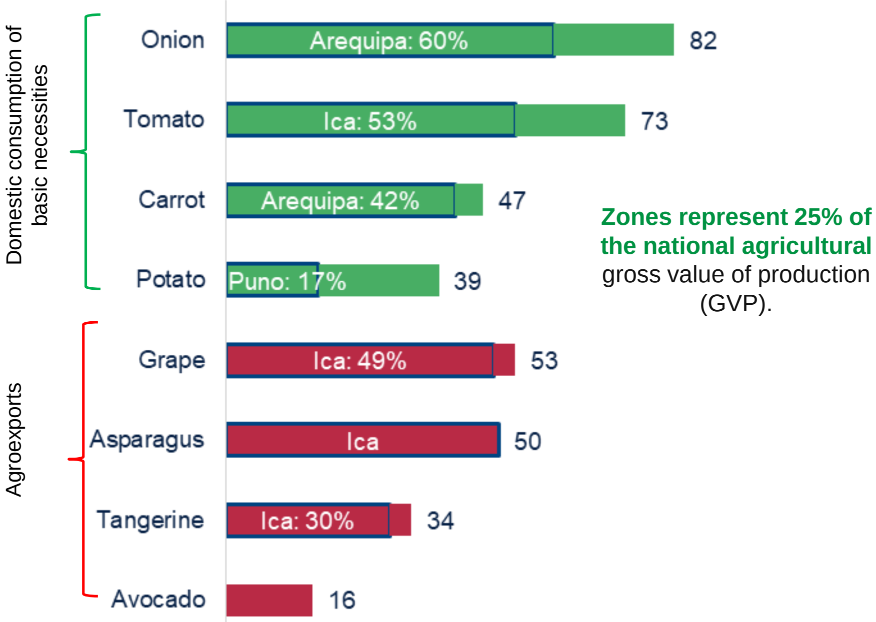




Source: MIDAGRI, Apoyo.

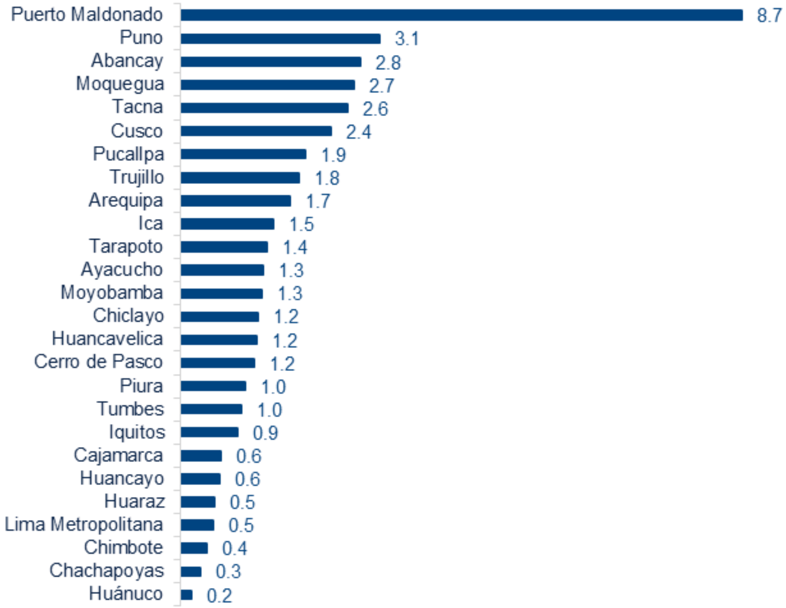
In particular, social conflicts gave an additional boost to inflation in recent months

AGRICULTURAL OUTPUT IN CONFLICT ZONES BY DESTINATION 2021
(% OF THE DOMESTIC TOTAL)



Source: Midagri and Minem. Created by Macroconsult.

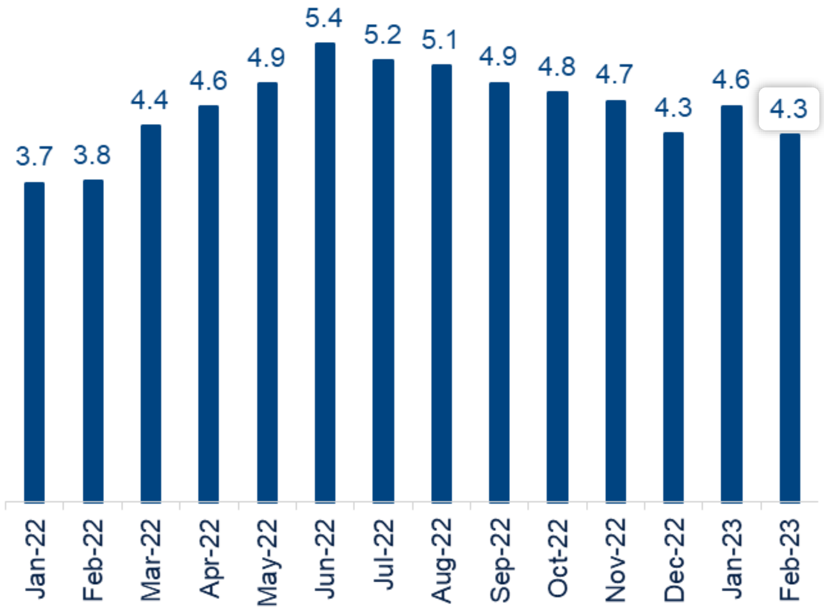
INFLATION: MAIN CITIES
(ACCUMUL. % CHG. 2023)



Source: INEI.

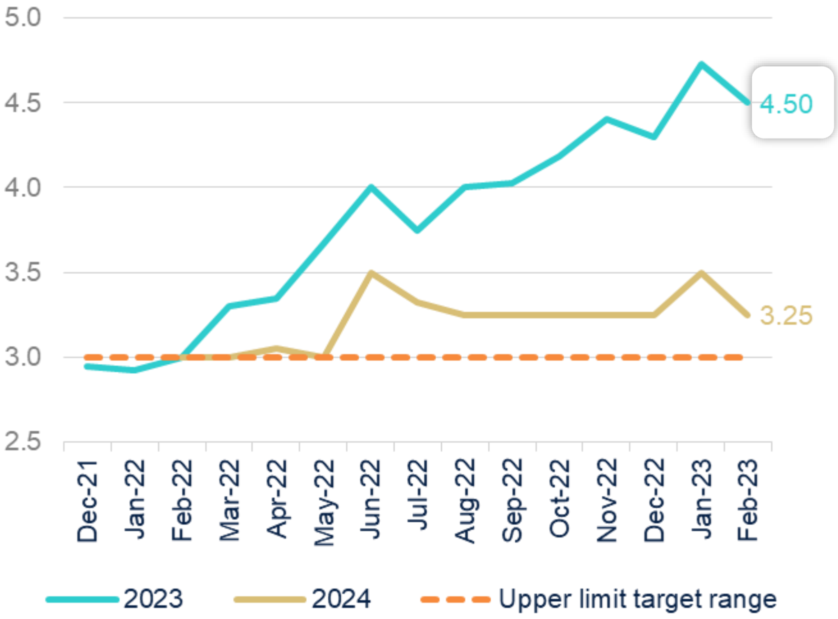
Inflation expectations, however, fell in February

12-YEAR INFLATIONARY EXPECTATION
(VAR % INTERANUAL)



Source: BCRP.

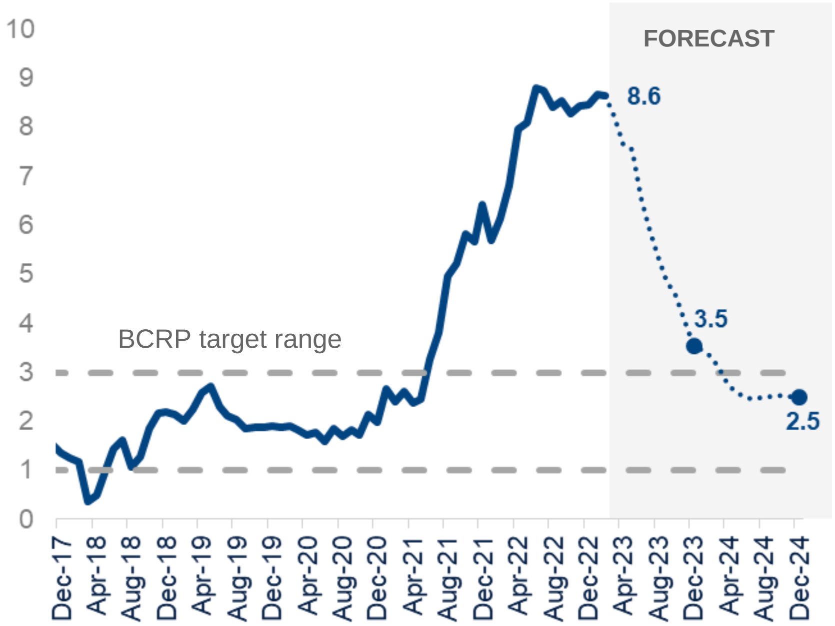
INFLATION FORECASTS 1/
(AT YEAR-END, YEAR-OVER-YEAR % CHG.)



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

Inflation projection for 2023 remains at 3.5%, but the bias is now upward due to climatological anomalies

INFLATION
(%)

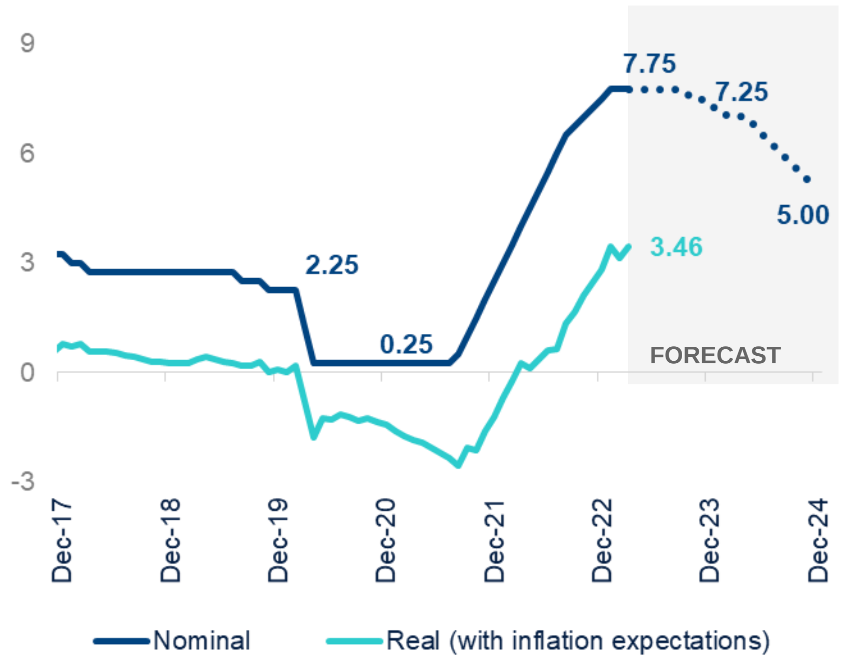


Source: INEI and BBVA Research.

- Inflation will show a significant decrease as of March due to the high year-over-year comparison baseline.
- In addition, commodity prices are projected to correct downward.
- It may take some time to pass through this positive effects to the prices of final goods because business margins were previously compressed (during the increase of input prices, not everything was passed on to the final consumer). In addition, 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%.
- Above-normal temperatures are likely to continue to affect production and thus food prices (poultry, eggs) in 2Q23.

The upward cycle of the reference rate would have culminated and that the BCRP will begin the process of monetary policy normalization in 4Q2023

REFERENCE INTEREST RATE
(%)



Source: BCRP and BBVA Research.

- With the early onset of a declining trend in inflation, the reference interest rate will remain at its current level of 7.75% in the coming months. The monetary stance will thus become even more passively contractionary as inflationary expectations are likely to recede.
- We expect that by the last quarter of 2023, in an environment of a clear downward trend in inflation and in which the FED has already completed its monetary tightening, the BCRP will gradually begin to cut the reference rate to avoid depreciation pressures on the PEN. We project that the policy rate will close the year at 7.25%, with which the BCRP will begin a process of normalization of the monetary policy stance that would accelerate in 2024 to bring the rate to 5.0% by the end of that year.

BBVA Research

05

The main risks to Peru's economic outlook

Main local risks to the baseline scenario for Peru: 2023 and 2024

ON THE EXTERNAL SIDE

Persistent global inflation and even higher interest rates.

A sharper global growth slowdown and/or financial instability.

ON THE LOCAL SIDE

Increased political noise.

More negative impact of social unrest and mobilization.

Sovereign credit rating downgrade

El Niño phenomenon will last until the beginning of 2024 and intensify, causing significant damage to activity.

Risk of greater populism affecting competitiveness
(labor market, pension system).

05

Summary of forecasts

Macroeconomics forecasts

	2021	2022	2023 (f)	2024 (f)
GDP (YoY % change)	**13.6**	**2.7**	**1.9**	**3,0**
Domestic demand (excluding inventories, YoY % change)	**17.0**	**2.0**	**1.5**	**3,1**
Private spending (YoY % change)	**17.6**	**2.6**	**1.5**	**3,0**
Private consumption (YoY % change)	12.4	3.6	2.3	3,0
Private investment (YoY % change)	37.4	-0.5	-1.0	3,1
Public spending (YoY % change)	**14.0**	**-0.7**	**0.7**	**3,3**
Public consumption (YoY % change)	10.6	-3.4	3.0	3,0
Public investment (YoY % change**)**	24.9	7.1	-5.0	4,0
Exchange rate (vs. USD, eop)	**4.04**	**3.83**	**3.90 – 4.00**	**3,85 – 3,95**
Inflation (% Y/Y, eop)	**6.4**	**8.5**	**3.5**	**2,5**
Monetary policy interest rate (%, eop)	**2.50**	**7.50**	**7.25**	**5,00**
Fiscal balance (% GDP)	**-2.5**	**-1.6**	**-2,3**	**-2,0**
Balance of payments: checking account (% GDP)	**-2.3**	**-4.3**	**-3,2**	**-2,5**
Exports (USD billion)	63.2	66.8	63,4	64,3
Imports (USD billion)	48.2	56.3	55,4	57,4

(f) Forecast. Forecast closing date: March 15, 2023.
Source: BBVA Research.

Disclaimer

Research

Peru Economic Outlook

March 2023

Creating Opportunities