Research

Peru Economic Outlook

June 2023

Creating Opportunities

BBVA Research

Contents

Creating Opportunities

Key points

Global situation

The combination of persistently robust demand (due to buoyant labor markets and the lingering effects of the post-pandemic reopening) and the dissipation of supply shocks (due to lower commodity prices and the normalization of bottlenecks) have continued to support growth. Although inflation has generally peaked, underlying measures have not yet fallen significantly. Against this backdrop, central banks have reaffirmed their commitment to reducing inflation, which has contributed to tensions in US regional banks.

Local situation

On the local side, the year began with an escalation of political and social conflict, which was followed by weather anomalies such as cyclone Yaku and the unfolding of the El Niño Costero phenomenon. As a result, activity contracted 0.4% year-on-year in the first quarter. GDP weakness was therefore greater than we estimated in our previous report (March).

The situation did not improve much in the second quarter. Although the political and social upheaval receded, El Niño Costero reached a higher intensity than expected by entities specialized in monitoring this phenomenon, with more severe impacts on activity. This was one of the main risks in the previous baseline scenario. For example, the first anchovy fishing season in the central-northern part of the coast has been suspended until now. The still high inflation, high financing costs, and a business confidence that is only slowly recovering have not helped the rebound in activity, which has advanced very timidly in the second quarter.

Key points

Global macro outlook

Global growth in 2023 will be stronger than previously forecast (March), reflecting the most recent activity data, but weaker than anticipated in 2024 due to tighter monetary and lending conditions. Overall growth will therefore slow from 3.4% in 2022 to 2.9% in 2023 (0.2 pp more than forecast three months ago), a figure that will be repeated in 2024 (0.3 pp below the previous forecast).

Central banks will keep interest rates at restrictive levels for some time to come, possibly longer than the markets expect. Liquidity withdrawal programs, credit tightening driven by the turmoil in the U.S. banking sector and, possibly, less expansionary fiscal policies will act in the same vein on demand, gradually tempering it in the coming quarters. In the particular case of the United States, we expect the Fed to start easing its monetary stance only in the first quarter of 2024.

This moderation in demand (and labor markets), together with contained commodity prices, will favor lower inflation. However, some second-round effects will help to keep inflation still above central banks' targets.

Finally, on the market side, the baseline scenario considers a relatively high volatility and, in this context, limited flows toward assets perceived as higher risk. Tensions in U.S. banking would not spread to large U.S. banks or to banks abroad.

Key points

Local macro outlook: economic activity

On the domestic side, the baseline scenario has been revised to incorporate the negative shock to first quarter growth and the deterioration in forecasts for the El Niño Costero phenomenon. In March (previous baseline scenario), entities specialized in monitoring this climatological phenomenon anticipated a weak magnitude event until well into the third quarter (after which the outlook was uncertain), but the intensity of El Niño Costero is strong at present and will probably remain so until the third quarter. After that, it will decrease in magnitude but will still be felt until the beginning of 2024, with a weak to moderate magnitude at that time, which will imply moderate to strong rainfall on the coast and northern highlands.

Taking this into account, but also the fact that the authorities have announced efforts to prevent the impacts that El Niño will have in 2024, the relative stabilization of the political and social situation with the most likely scenario being that the general elections will not be brought forward to 2024 (they usually generate uncertainty in the previous months, affecting private spending), as well as the upward adjustment of the global growth forecast for 2023, we foresee that GDP will advance 1.6% this year, three tenths of a percentage point lower than the previous projection. The bias is on the downside because the main risks (a more intense El Niño Costero or with more severe impacts, renewed political and social tensions) point in that direction.

The growth forecast for 2024 has also been corrected downward, from 3.0% to 2.6%, due to the impact that El Niño would have in the first months of that year and the downward revision of global growth for 2024, and despite the post-Niño reconstruction works that is likely to be executed.

Key points

Local macro outlook: exchange rate

The baseline scenario considered is consistent with a depreciation trend for the PEN in the coming months because it is expected that the attractiveness of assets denominated in local currency will diminish as the interest rate differential (between soles and dollars) decreases. The Peruvian central bank has already concluded the upward cycle of its policy rate and will begin to normalize it from the fourth quarter of this year, while the FED will not begin to cut its rate until the first quarter of 2024. Furthermore, the moderation of global growth (with a technical recession in the United States in the coming quarters), a context that has normally been challenging for risk assets, will not favor the local currency either. Consequently, we forecast that the exchange rate, which is currently slightly below 3.65 PEN/USD, would be between 3.70 and 3.80 PEN/USD by the end of 2023.

Looking further ahead, given a context in which, on the one hand, the global economy will gradually gain traction and the local current account balance of payments deficit will be receding, and on the other, the interest rate differential will narrow even more, the exchange rate will end 2024 in a range similar to that of the previous year (between 3.70 and 3.80 PEN/USD).

Local macro outlook: inflation

Inflation has been slowly receding, and in May it stood at 7.9%. Successive supply shocks (political and social upheaval, adverse weather conditions, avian flu) have not favored a more rapid decline. Although the impacts of El Niño Costero will continue to impact on some prices (mainly, food), we expect inflation to ease faster moving forward (base effect, reversal of some supply shocks, contained commodity prices), ending 2023 at a level not far from 4.0%. This forecast has an upward bias due to the continued deterioration in weather forecasts. By the end of 2024 we project an inflation rate of 2.5%, when the impacts of El Niño will have dissipated.

Key points

Local macro outlook: monetary policy rate

The Central Bank has maintained the reference interest rate at 7.75% since last January. In the official statements released after the last monetary policy meetings, the Central Bank has left open the door for, eventually, resuming hikes, but we perceive that the likelihood of this scenario is low because inflation, core inflation, and inflationary expectations are declining (albeit slowly), activity is advancing very weakly, and the monetary stance is the most restrictive in the last twenty years.

Also, we do not foresee a process of normalization of the monetary position in the very short term. Before this happens, it is reasonable to expect that the possibility of resuming policy rate hikes will be removed from the Central Bank´s communiques. But beyond that, we expect that a scenario more conducive to starting the normalization cycle of the reference rate, hastened by the weak growth in activity, would be characterized by a Fed on pause, inflation closer to the target range, in clear decline, and inflationary expectations not far from 3%. Such a scenario is likely to materialize in the fourth quarter of this year and therefore we project that the policy rate will close 2023 at 7.25%. The normalization process will be gradual at first due to the unfolding of the El Niño phenomenon (FEN for its acronym in Spanish) and would accelerate after this weather anomaly recedes, with the reference rate ending 2024 at 5.0%.

Main risks

On the external side: (i) more persistent inflation resulting in higher and longer lasting interest rates, with a sharper slowdown in overall growth; (ii) renewed episodes of financial instability; y (iii) the geopolitical environment. On the local side: (i) a more intense El Niño Costero or with more severe impacts; (ii) renewed political and social tensions; and (iii) populist measures affecting competitiveness (labor market, pension system).

01

International context: activity and financial markets

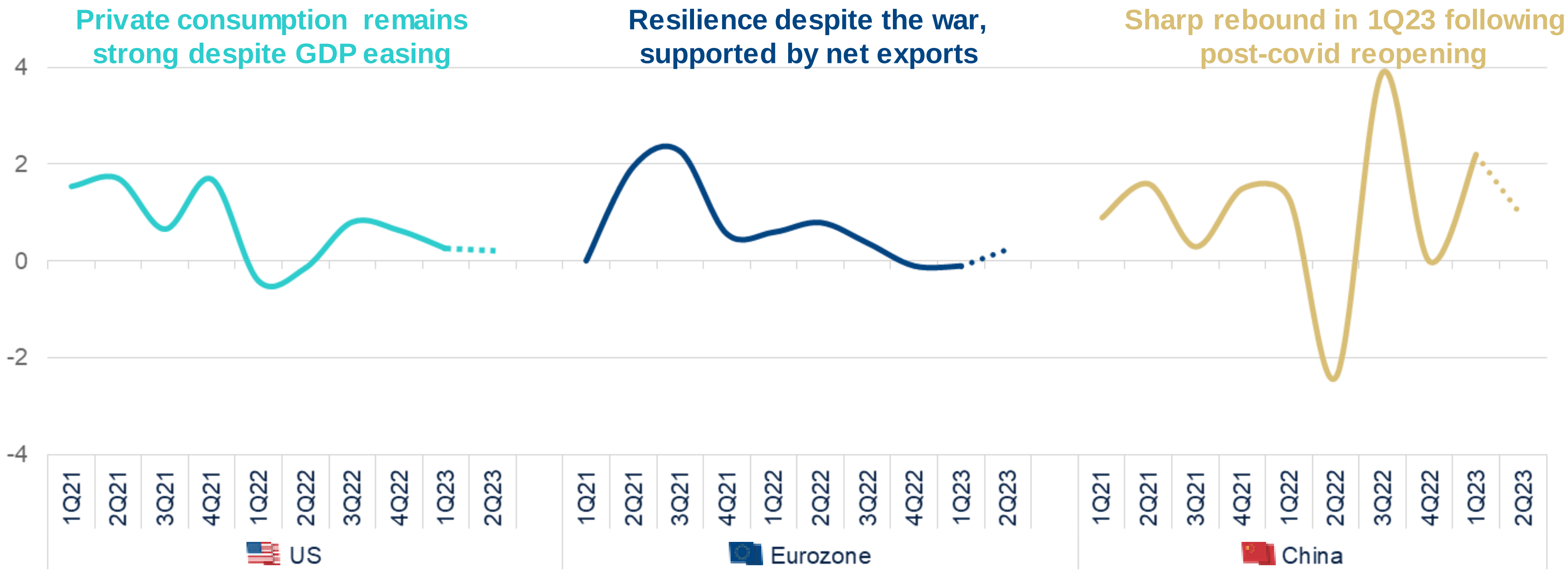
Growth and inflation are easing, but remain resilient, spurring a monetary tightening that continues to cause episodes of financial volatility

RECENT DEVELOPMENTS IN THE WORLD ECONOMY

Growth resilience	Inflation persistence	Restrictive monetary policy	Financial stress
Slow growth deceleration on tight labor markets and lingering post-covid effects.	Lower inflation on eased energy prices and bottlenecks, but sticky core inflation.	Central banks focused on inflation; policy rates at (or close to) peak, but higher for longer.	Bank turmoil, with contagion mostly limited to US regional banks (no financial dominance).

GDP growth is slowing down in the US, remains very moderate in the EU and has rebounded significantly more than expected in China in 1Q23

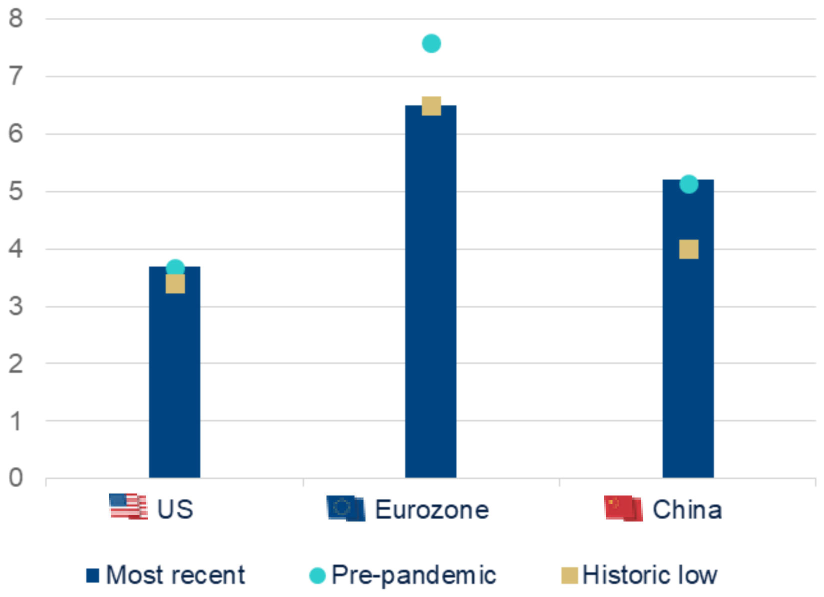
GDP: REAL GROWTH
(Q/Q %)



(*) BBVA Research growth forecasts for 2Q23.
Source: BBVA Research based on data from Haver.

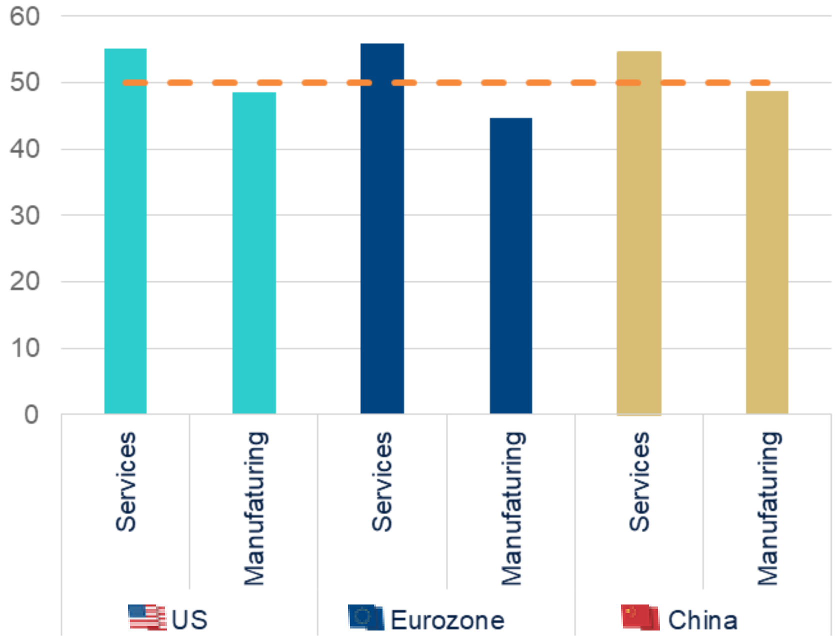
Activity dynamism, mainly in private consumption and the services segment, has been supported by strong labor markets and lingering reopening effects

UNEMPLOYMENT RATE (*)
(% OF THE LABOR FORCE)



(*) Most recent data: May/23 in the US, Apr/23 in China and in the EZ. Pre-pandemic: 2019 average.
Historic low: lowest level since Jan/04
Source: BBVA Research based on data from Haver.

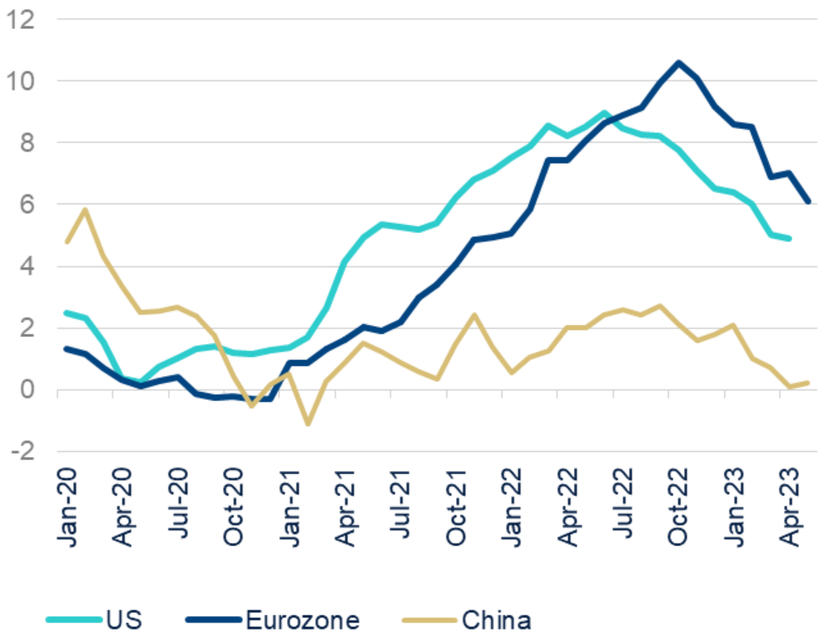
PMI INDICATORS: MAY/23
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



Source: BBVA Research based on data from Haver.

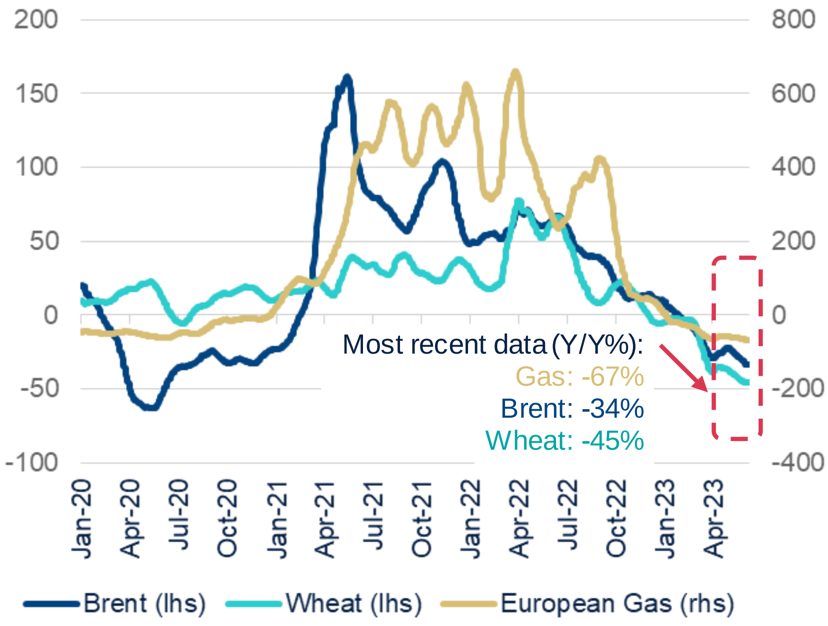
Headline inflation has been trending downwards, favored mainly by lower energy prices, the easing of supply bottlenecks and favorable base effects

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

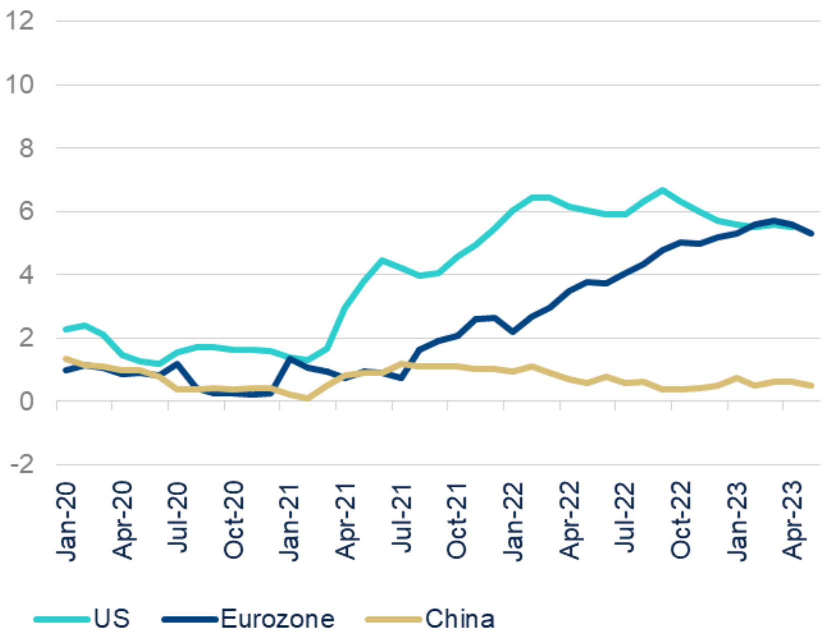
COMMODITY PRICES
(Y/Y %, 30-DAYS MOVING AVERAGE)



Source: BBVA Research based on data from Haver.

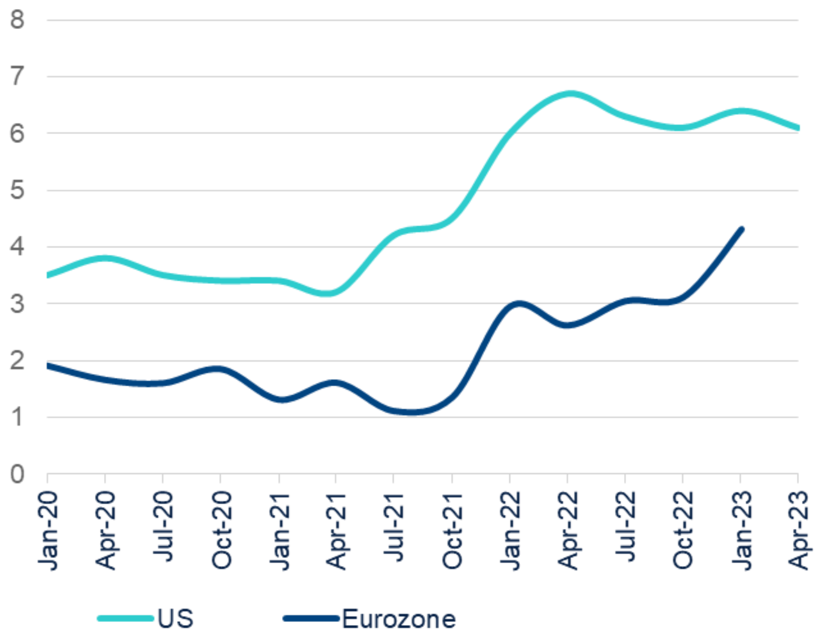
Core inflation has stabilized at high levels in a context where robust demand has favored some (limited) second-round effects

CORE INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

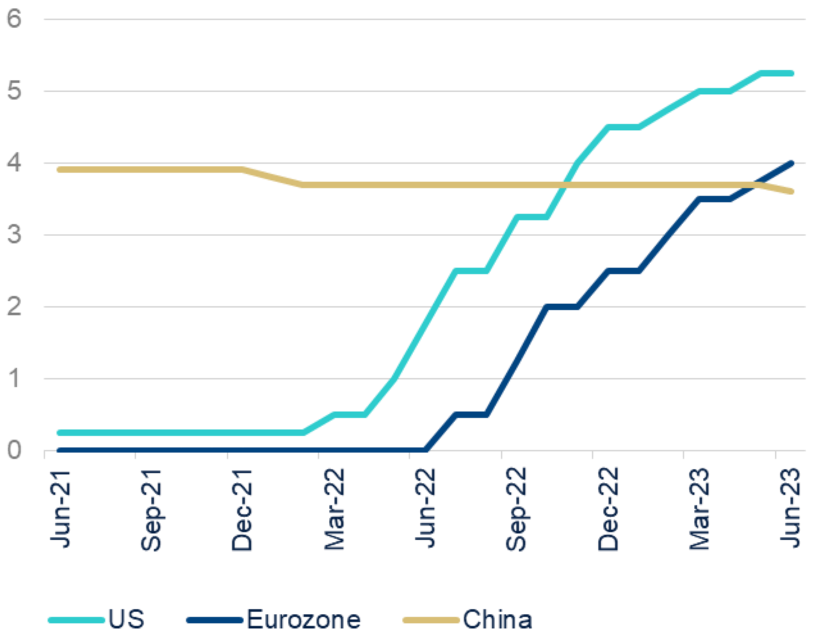
WAGE GROWTH (*)
(Y/Y %, QUARTERLY DATA)



(*) US: Atlanta Wage Tracker; 2Q23 data represents data for Apr/23 only. EZ: negotiated wages.
Source: BBVA Research based on data from the Fed and Eurostat.

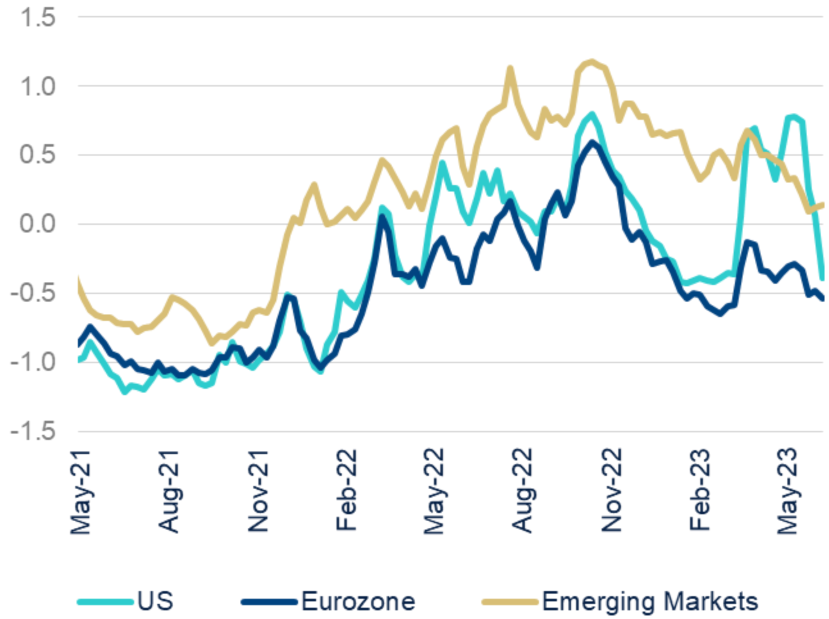
The sharp reversal of monetary conditions continues to pave the way for episodes of instability in financial markets

POLICY INTEREST RATES (*)
(%)



(*) Refi rates in the case of the ECB.
Source: BBVA Research based on data from Bloomberg.

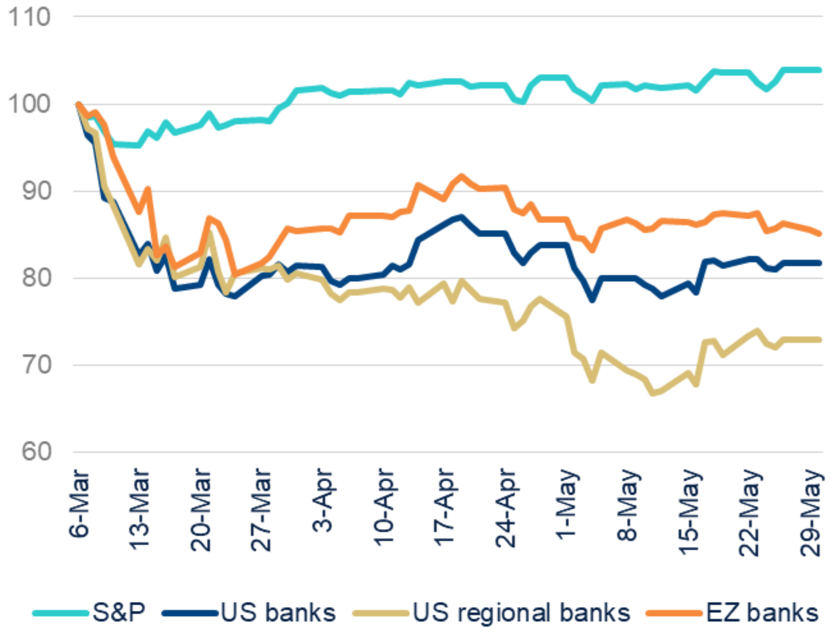
BBVA FINANCIAL TENSIONS INDEX
(INDEX: HISTORIC AVERAGE = 0)



Source: BBVA Research based on Bloomberg.

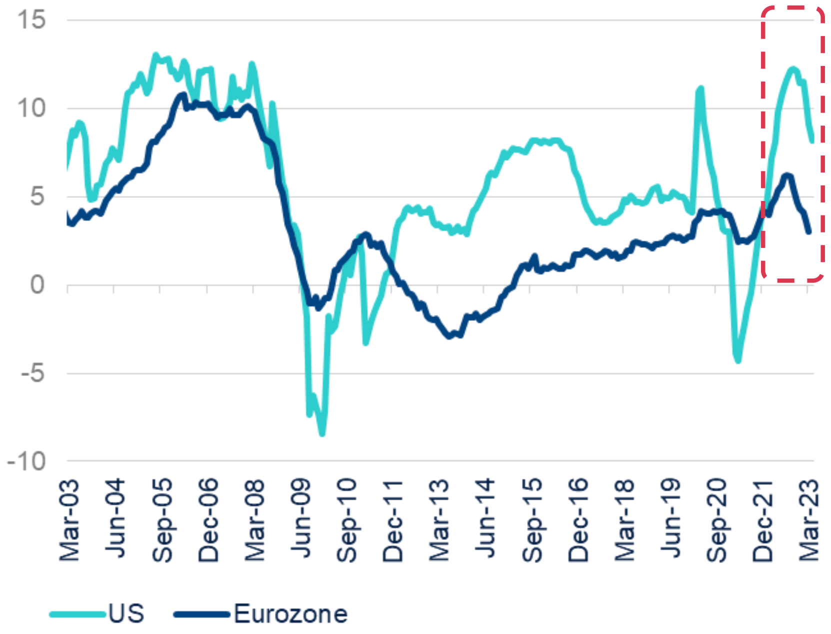
Bank stress, driven by deposit outflows and asset losses, has boosted credit tightening; policy reaction has limited contagion, prevented financial dominance

EQUITY MARKETS
(INDEX: MARCH 6TH = 100)



Source: BBVA Research based on Bloomberg.

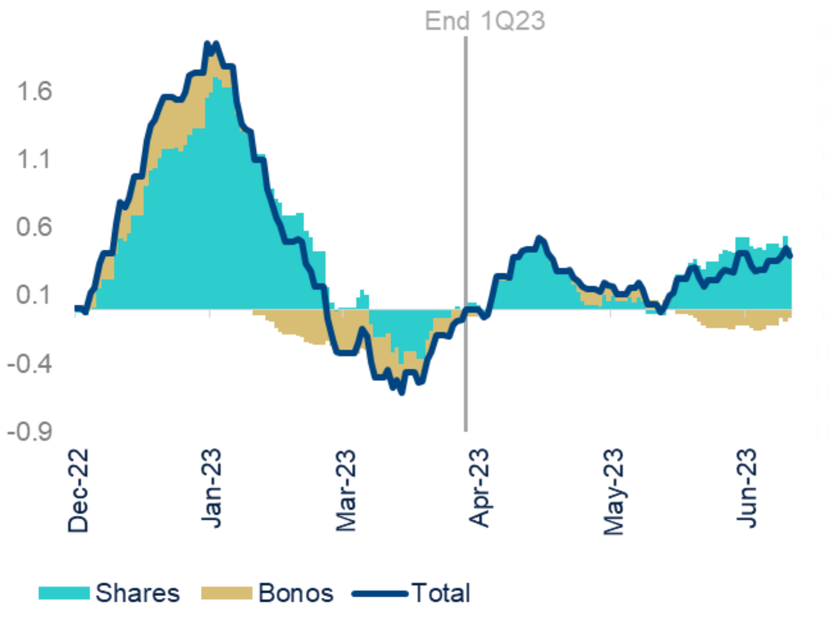
LENDING BY COMMERCIAL BANKS
(YOY %, MONTHLY DATA)



Source: BBVA Research based on data from FRED and ECB.

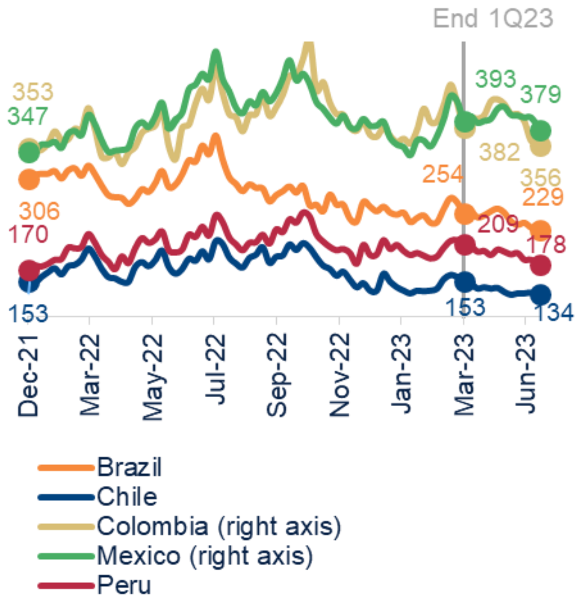
With global growth still resilient, rates at record highs and financial stress contained, EM inflows recover, risk premiums decline…

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



Source: IIF (information as at June 14).

EMBI
(BASIS POINTS)

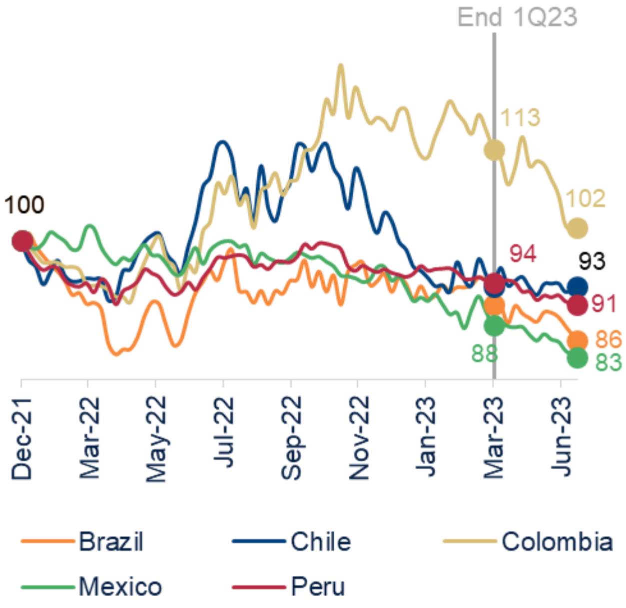


06/19/2023 vs 03/31/2023 (bp)	Accum. year (bp)
-14	-7
-26	-13
-25	-29
-31	-16
-31	-16

Source: Bloomberg (information as at June 19).

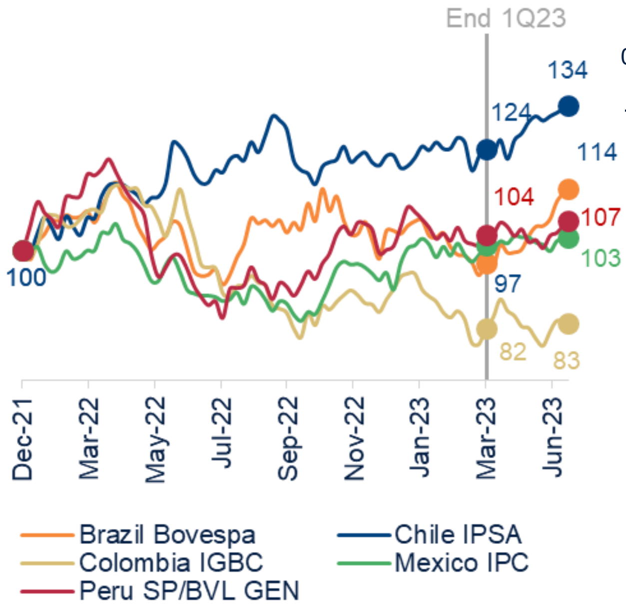
…currencies in the region are strengthening, stock market indicators are improving, and…

LATAM: EXCHANGE RATE
(LOCAL CURRENCY VS. USD, INDEX 100 = DEC 2021)



06/19/2023 vs 31/03/2023 (%)	Accum. year (%)
-10,0	-14,2
0,0	-6,6
-3,4	-4,5
-5,6	-9,5
-5,3	-12,4

LATAM: STOCK MARKETS
(INDEX 100 = DEC 2021)

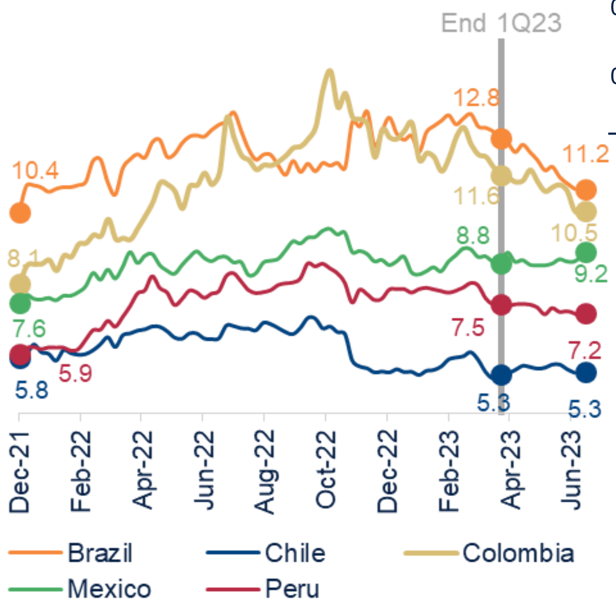


06/19/2023 vs 03/31/2023 (%)	Accum. year (%)
8,1	9,4
17,6	9,2
3,1	5,8
1,9	13,3
1,4	-8,7

Source: Bloomberg (information as at June 19).

… sovereign debt yields decline. In Peru, in particular, a recovery in sovereign holdings by non-residents has been observed

LATAM: SOVEREIGN BOND YIELDS 10 YEAR (%)

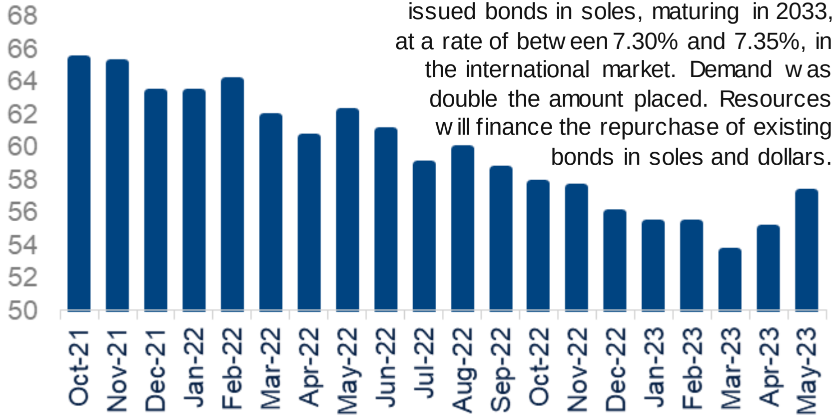


06/19/2023 vs 03/31/2023 (bp)	Accum. year (bp)
-166	-160
-121	-264
29	-25
-53	-99
2	-7

Source: Investing (information as at June 19).

PERU SOVEREIGN BOND HOLDINGS BY NON-RESIDENTS (BILLIONS)

On May 31, the Peruvian government-issued bonds in soles, maturing in 2033, at a rate of between 7.30% and 7.35%, in the international market. Demand was double the amount placed. Resources will finance the repurchase of existing bonds in soles and dollars.



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

Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Apr-23	May-23
49.4	47.8	46.0	43.5	41.1	38.7	39.0	39.6

Source: MEF.

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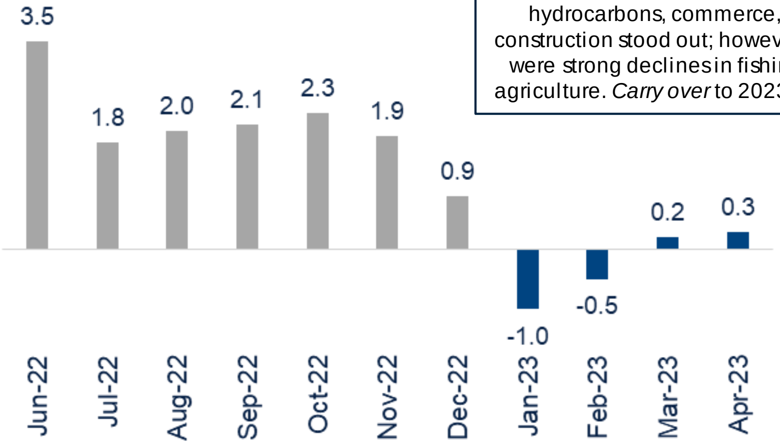
02

Domestic context: activity, employment and fiscal accounts

After a difficult first quarter, a very timid improvement in activity at the beginning of the second quarter: GDP grew 0.3% year-on-year in April

GDP
(Y/Y % CHG.)

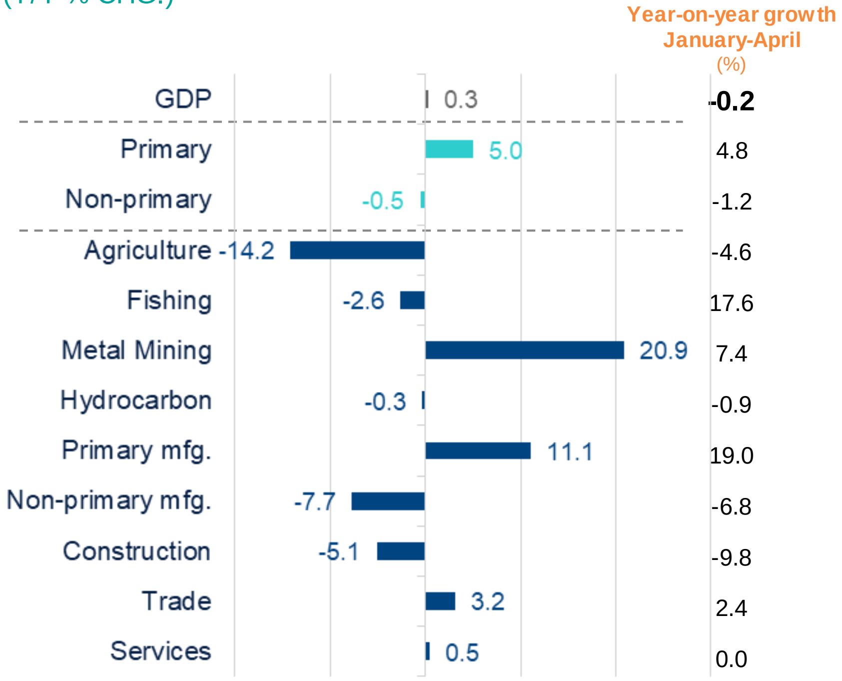


In a sequential analysis (s.a), GDP grew 0.4% in April compared to the previous month. Mining and hydrocarbons, commerce, and construction stood out; however, there were strong declines in fishing and agriculture. *Carry over* to 2023: -0.2%

SEASONALLY ADJUSTED GDP (M/M % CHG)

Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23
1.2	-1.5	0.3	0.9	-0.5	-0.3	-0.2	-1.0	0.7	0.0	0.4

GDP BY PRODUCTIVE SECTORS IN APRIL 2023
(Y/Y % CHG.)

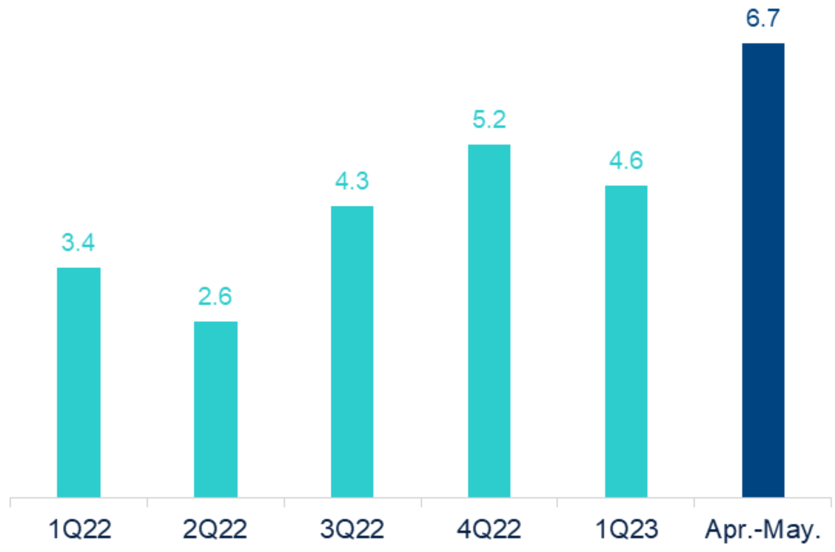


Source: INEI.

Indicators available for May suggest that activity continued to be weak in the second quarter

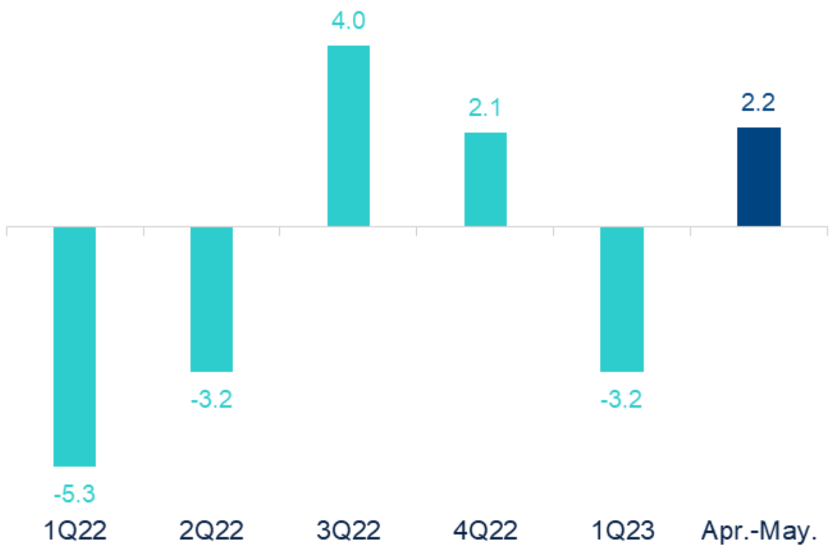
AVAILABLE ACTIVITY INDICATORS
(Y/Y % CHG.)

ELECTRICITY PRODUCTION



Source: BCRP, INEI, BBVA Research.

BIG DATA INVESTMENT INDEX[1]

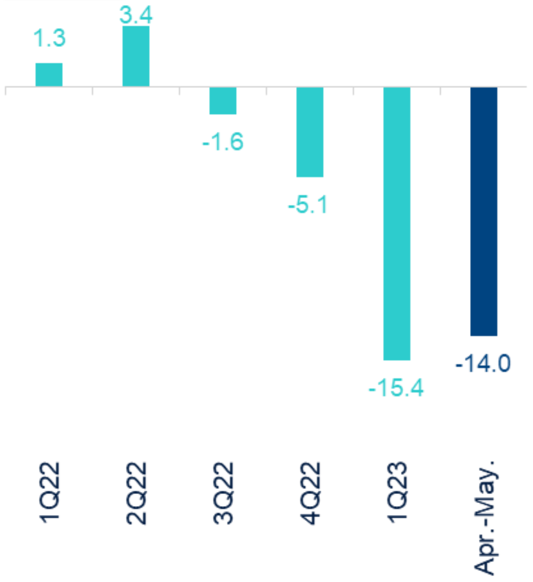


1: Uses information on payments into accounts of selected companies.
Source: BBVA Research based on BBVA data.

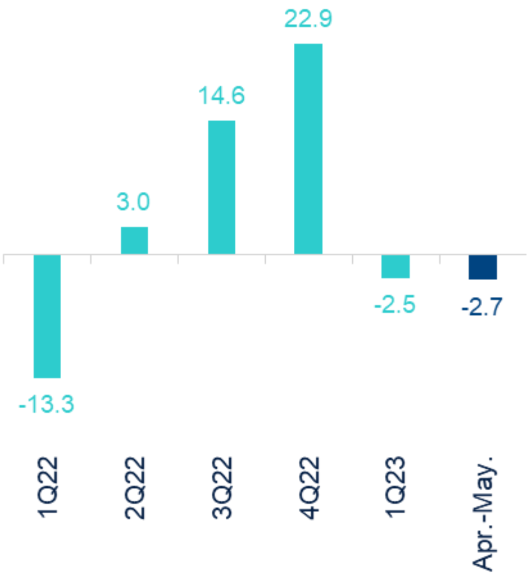
Indicators available for May suggest that activity continued to be weak in the second quarter

AVAILABLE ACTIVITY INDICATORS
(Y/Y % CHG.)

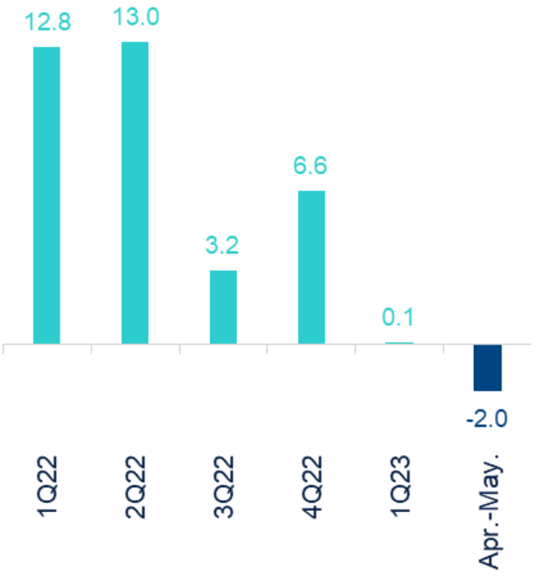
DOMESTIC CEMENT CONSUMPTION



PUBLIC INVESTMENT



CONSUMER BIG DATA INDEX[1]

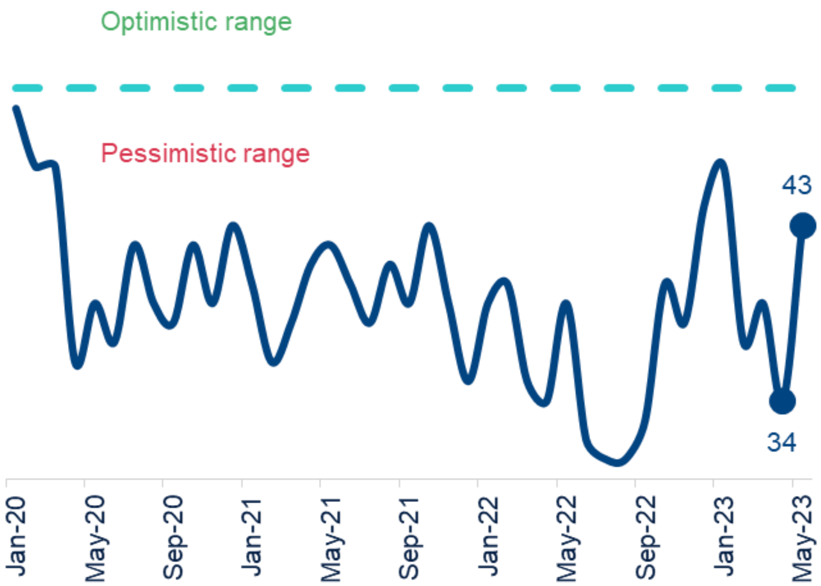


Source: INEI, BBVA Research.

1: 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.

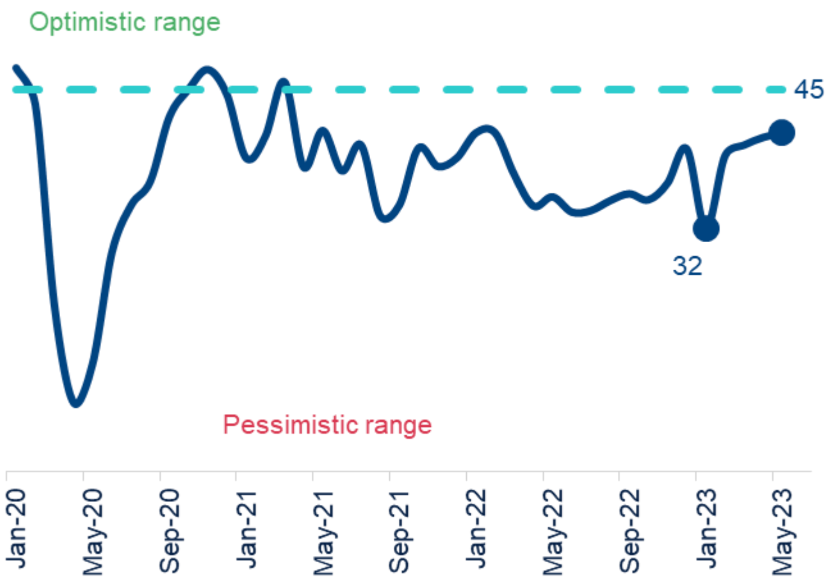
Confidence has recovered as the intensity of the negative shocks of 1Q23 has diminished, but remains in pessimistic territory.

CONSUMER CONFIDENCE[1]
(POINTS)



Source: Apoyo Consultoría.

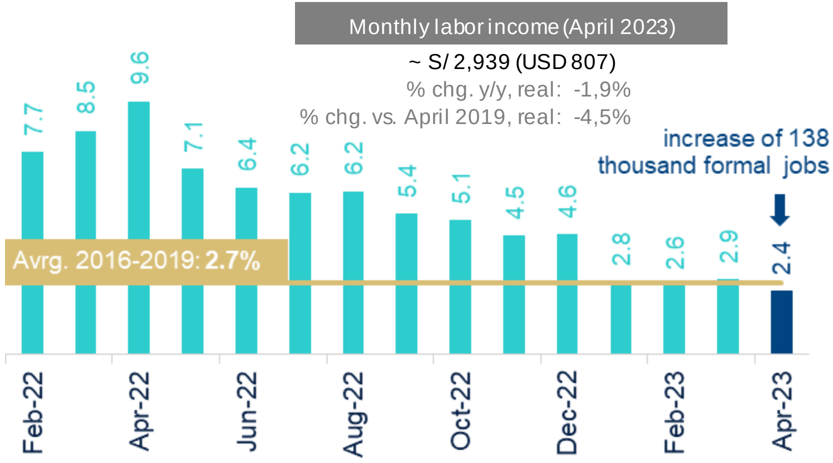
BUSINESS CONFIDENCE[1]
(POINTS)



1: 3-month outlook for the economy.
Source: BCRP.

In the labor market, formal employment also lost dynamism, and seems to have consolidated at around 2.5%

NATIONAL FORMAL EMPLOYMENT
(Y/Y % CHG.)

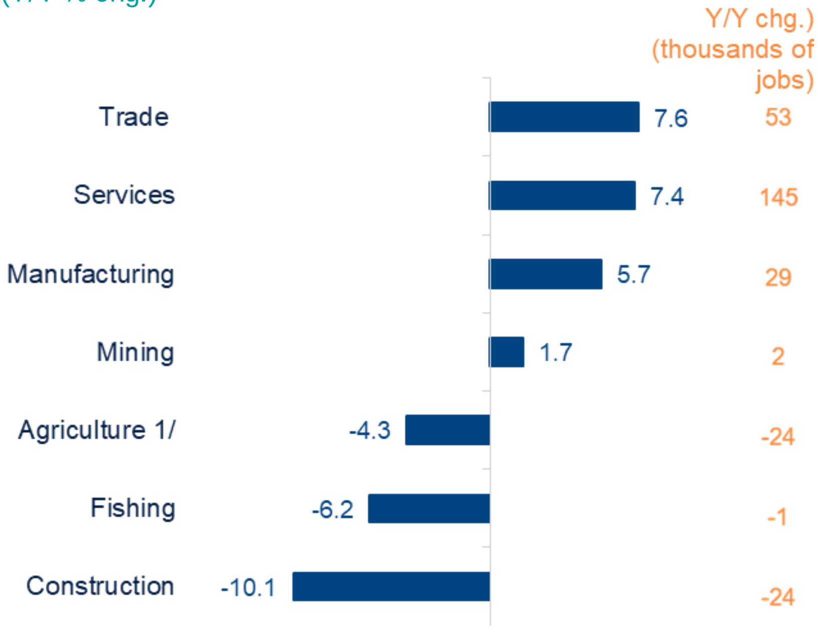


(THOUSANDS OF FORMAL JOBS)

Apr-19	Apr-20	Apr-21	Apr-22	Apr-23
5,259	4,969	5,183	5,683	5,821

Source: SUNAT (Spreadsheets) and BCRP. Prepared by: BBVA Research.

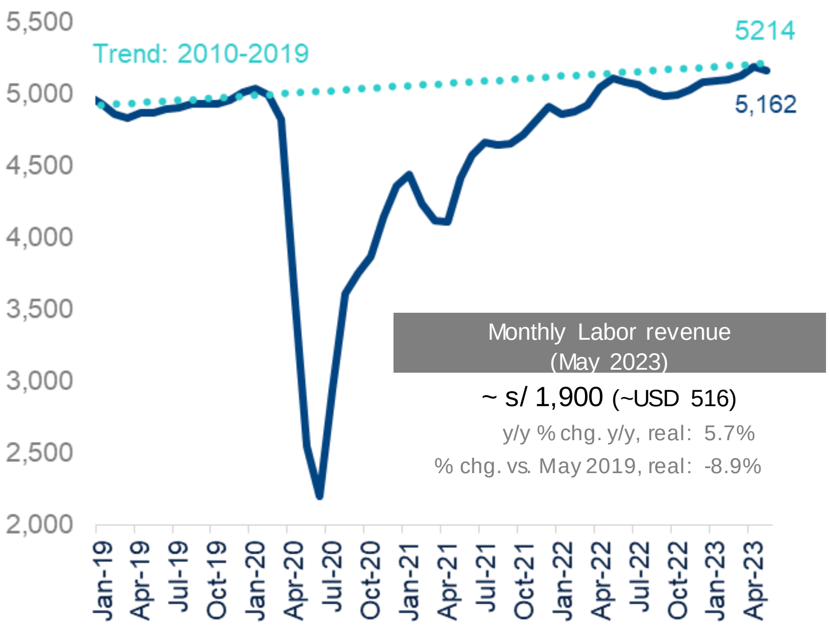
FORMAL PRIVATE EMPLOYMENT BY SECTOR IN MARCH 2023
(Y/Y % chg.)



1: Includes processing and preservation of fruits and vegetables.
Source: SUNAT (Spreadsheets) and BCRP. Prepared by: BBVA Research.

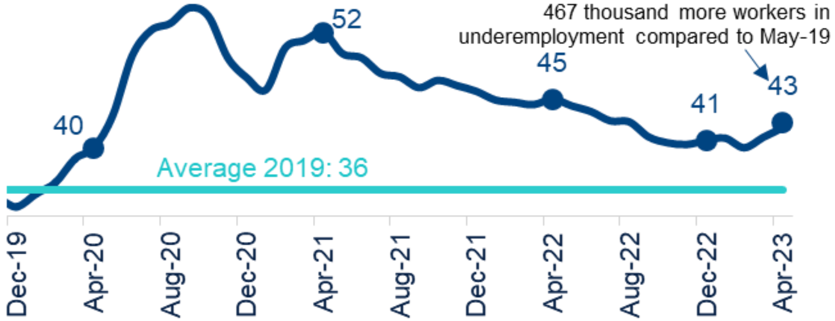
In Lima, employment has recovered its pre-pandemic trend level, but not the quality of employment.

EMPLOYMENT IN THE LIMA METROPOLITAN AREA
(THOUSANDS OF WORKERS, 3-MONTH ROLLING AVERAGE)



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

SUB-EMPLOYMENT RATE IN METROPOLITAN LIMA
(AS % OF EMPLOYED PERSONS, 3-MONTH ROLLING AVERAGE)



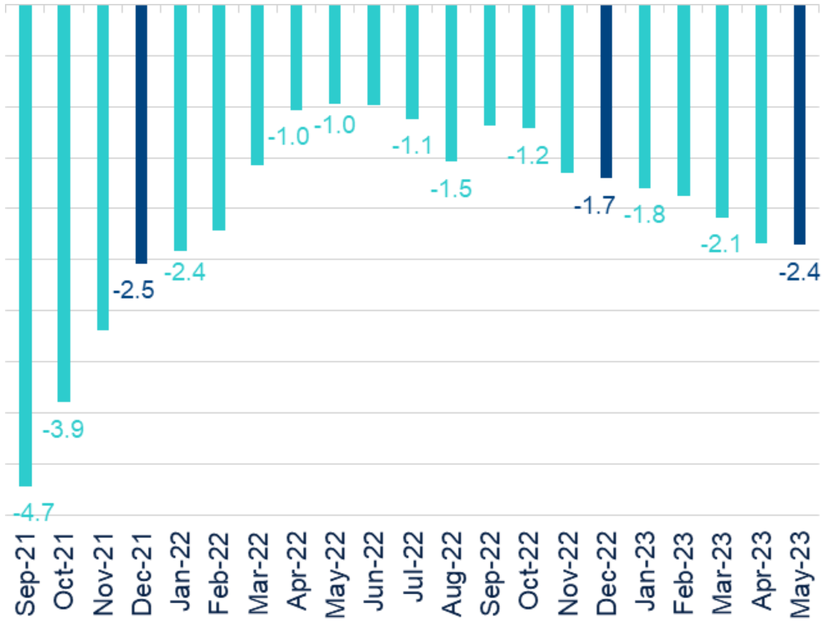
EAP EMPLOYED IN LIMA BY QUALITY OF EMPLOYMENT (THOUSANDS OF PEOPLE, 3-MONTH ROLLING AVERAGE)

	May-19	May-20	May-21	May-22	May-23
Adjusted [1]	3,120	1,436	2,196	2,829	2,947
SUB-EMPLOYMENT	1,747	1,113	2,213	2,284	2,215
Total	**4,867**	**2,549**	**4,409**	**5,113**	**5,162**

1: Workers who work 35 or more hours per week and earn an income higher than the Minimum Reference Income estimated by INEI (S/ 1,217 in March 2023).
Source: INEI (Permanent Employment Survey). Prepared by: BBVA Research.

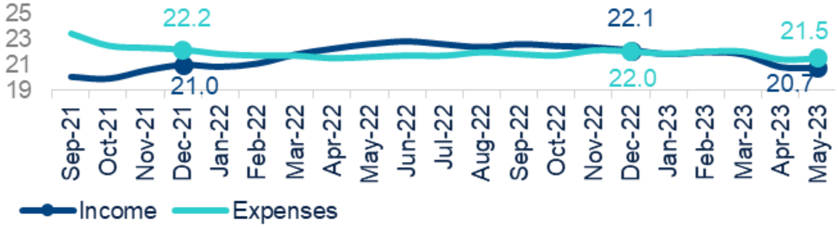
So far this year, the fiscal deficit has widened due to lower government revenues…

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

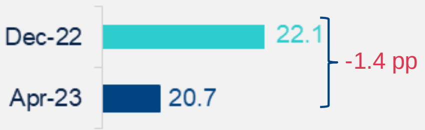


Source: BCRP.

FISCAL REVENUE AND EXPENDITURE
(ACCUMULATIVE IN LAST FOUR QUARTERS, % OF GDP)



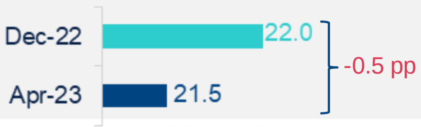
Revenue (accum. four qtrs. % of GDP)



The lower revenues are due to:

- **60% for Income Tax**, reflecting the lower regularization for fiscal year 2022
- **36% due to VAT (known as IGV in Peru)**, reflecting the weakness of domestic demand
- **4% Other** (Non-tax revenues, Selective Consumption Tax and others)

Expenditure (accum. four qtrs. % of GDP)



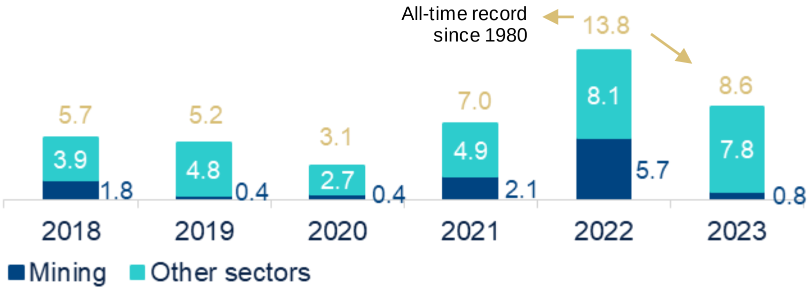
The lower expenditure is due to:

- **85% for Current expenditure**, reflecting a decrease in spending related to the health emergency
- **15% for Capital Expenditure**

Source: BCRP.

… linked to the lower collection of income tax and IGV (VAT)

INCOME TAX REGULARIZATION JANUARY - MAY
(BILLION SOLES)



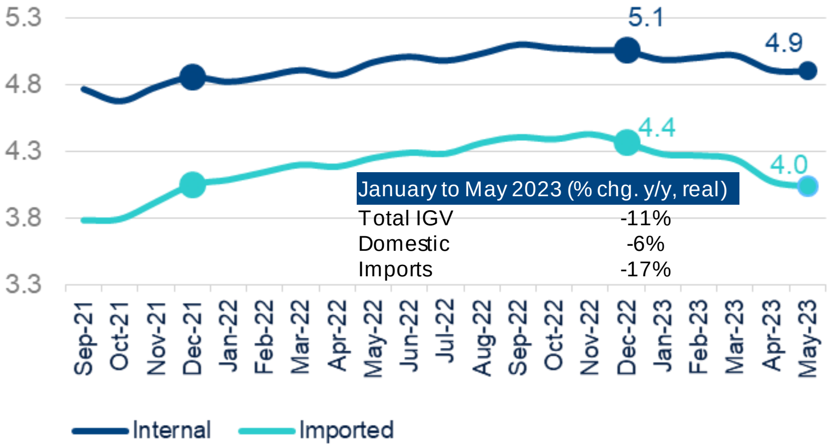
INCOME TAX REGULARIZATION JANUARY - APRIL (% OF GDP)

2018	2019	2020	2021	2022	2023
0.7	0.6	0.4	0.8	1.4	0.8

Source: SUNAT and BCRP.

- **The lower regularization of the 2022 financial** year is explained by the fact that payments on account were high, which has reduced the balance pending regularization in March and April 2023 (Source: SUNAT).

IGV (VAT)
(ACCUMULATIVE IN LAST FOUR QUARTERS, % OF GDP)



Source: MEF.

- **Domestic IGV:** its growth moderated in line with the slowdown of the economy
- **IGV on imports**: growth moderated due to lower import volumes and the appreciation of the local currency

BBVA Research

03

Global economy forecasts

Creating Opportunities

Reinforced prospects for growth and inflation easing despite recent resilience: credit tightening amid banking stress likely to add to monetary tightening

BBVA RESEARCH BASELINE SCENARIO

High-for-long interest rates

Restrictive monetary stance, also on credit tightening and liquidity withdrawal; cautious policy reversal from 1Q24 (or later).

Growth slowdown

Labor markets and demand will eventually ease, driving growth down despite supply normalization.

Gradual disinflation

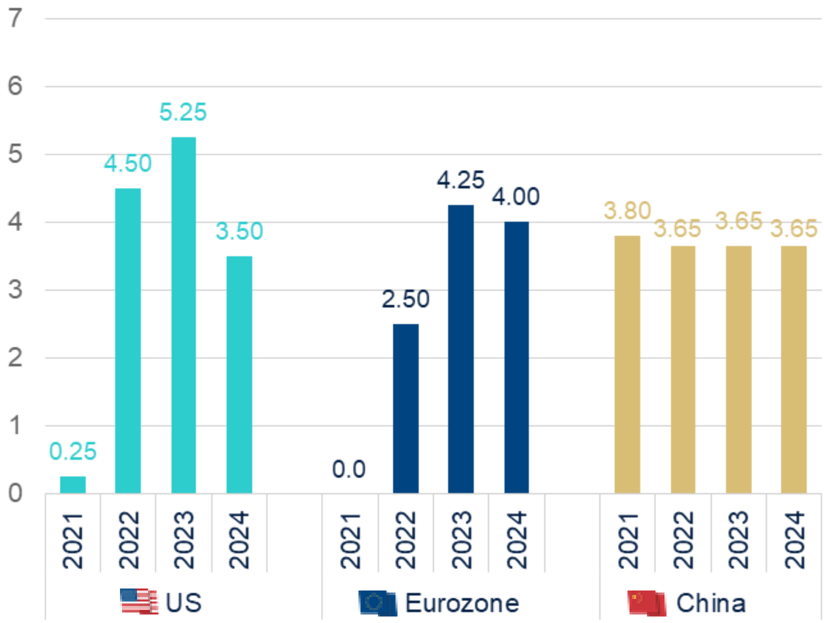
Contained commodity prices and limited second round effects, but inflation above targets for some time.

Financial volatility

Relatively high volatility and limited flows to riskier assets; US banks stress, with no contagion to large banks or abroad.

Central banks will remain focused on inflation despite banking stress: after reaching restrictive levels, rates will likely remain unchanged for a long period

MONETARY POLICY INTEREST RATES (*)
(%, END OF PERIOD)

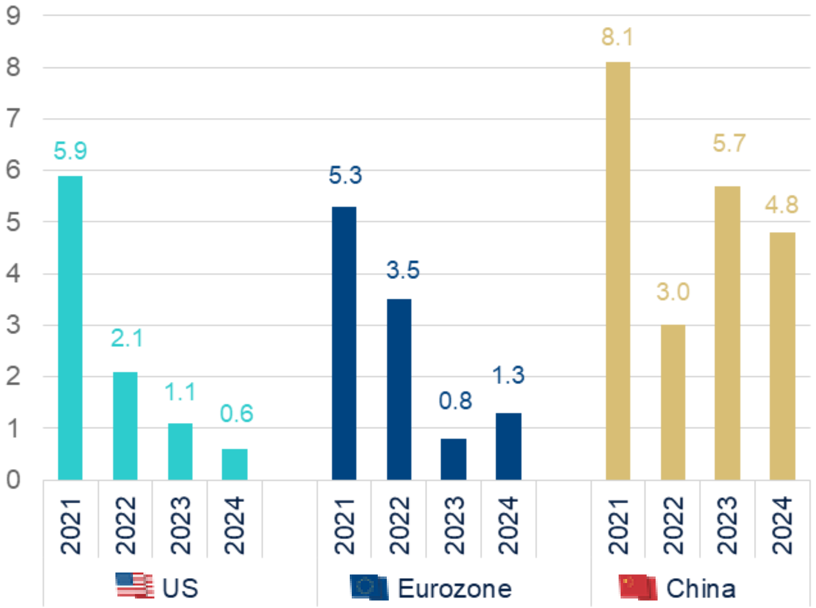


(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- Central banks are likely to use policy rates to fight inflation and liquidity tools to address bank stress; financial dominance is not expected, but is a risk.
- The rate hiking cycle is presumably over in the US (but one more hike is possible) and closer to its end in the EZ, where at least two more hikes are likely.
- Easing cycles are not likely before 1Q24 in the US and 4Q24 in the EZ.
- Still, Fed and ECB will maintain quantitative tightening programs in place, with a gradual and predictable liquidity withdrawal pace.
- Credit tightening and, eventually, fiscal policy are likely to help monetary policy to reign in on inflation.

GDP forecasts: up in 2023 on robust demand and easing supply shocks, but down in 2024 on the lagged impact of tighter monetary and credit conditions

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

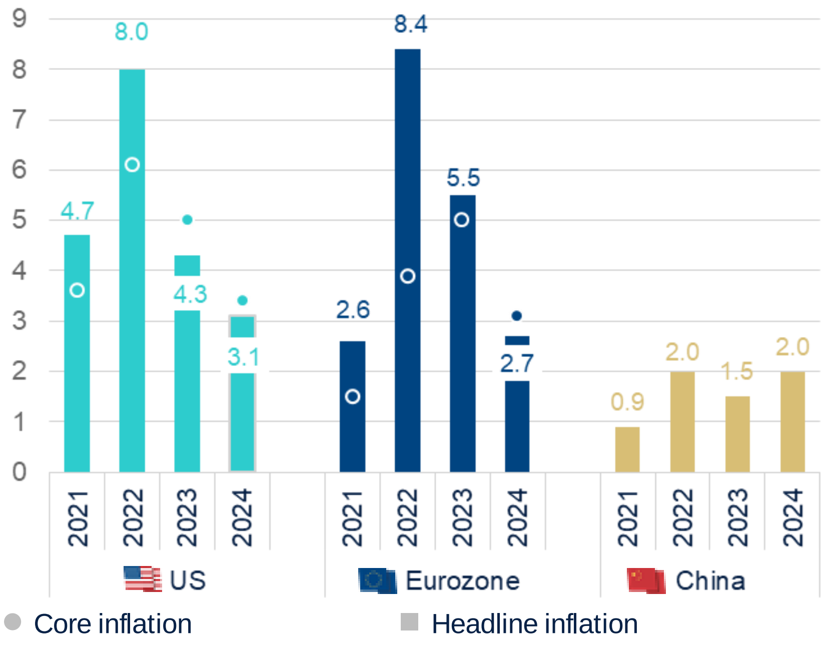


(*) Previous forecasts: 0.8% in 2023 and 1.8% in 2024 in the US, 0.6% in 2023 and 1.6% in 2024 in the Eurozone, 5.2% en 2023 and 5.0% in 2024 in China.
Source: BBVA Research.

- 2023 upward revisions (US: 0.3pp, EZ: 0.2pp, CHN: 0.5pp) on supportive incoming data reflecting strong private consumption (mainly in the US and China) and lower energy prices (mainly in the EZ).
- 2024 downward revisions (US: -1.2pp, EZ: -0.3pp, CHN: -0.2pp) on effects of tighter monetary policy and less supportive credit conditions, to which the recent banking stress is likely to contribute.
- Vanishing reopening effects, easing fiscal support and financial volatility are also likely to hit growth.
- Global growth to slow from 3.4% in 2022 to 2.9% (+0.2pp) in 2023 and 2.9% (-0.3pp) in 2024.

Inflation will continue to ease, but will be more persistent than previously expected; it will be over the targets for long in the US and EZ

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

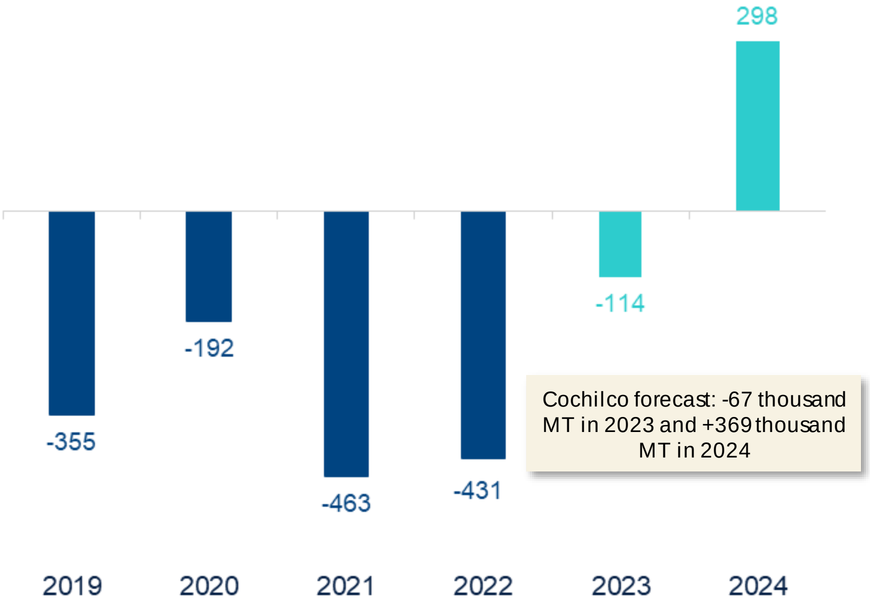


Source: BBVA Research.

- Supply improvement (lower commodity prices, bottleneck normalization) and monetary tightening will pave the way for a further decline in inflation: headline inflation has peaked; core inflation is set to soon ease more significantly.
- Still, the dynamism of private consumption amid tight labor markets will favor (contained) increases in wages and profit margins, slowing inflation's downward trend.
- In China, price pressures remain under control despite the post-covid recovery due to favorable commodity prices, supply recovery and private sector "balance sheet recession".

Copper: improved supply due to the entry into production of some large projects, but demand will rise significantly from now on

WORLD COPPER BALANCE SHEET
(THOUSANDS OF MT)

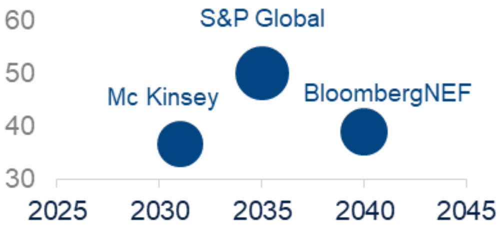


Source: International Copper Study Group.

MAJOR COPPER UNITS ENTERING PRODUCTION PHASE

Name	Country	Start of operations	Annual capacity (thousands of MT)
Kamoa Kakula (ph. 1 and 2)	D.R. Congo	2021 – 2022	400
Quellaveco	Peru	2022 – 2023	350
Quebrada Blanca	Chile	2022 – 2023	300
Spence	Chile	2021 – 2022	180
Udokan	Russia	2023	150
Almalyk	Uzbekistan	2024	270
Malmyzh	Russia	2024	250
Kamoa Kakula (ph. 3)	D.R. Congo	2024	200

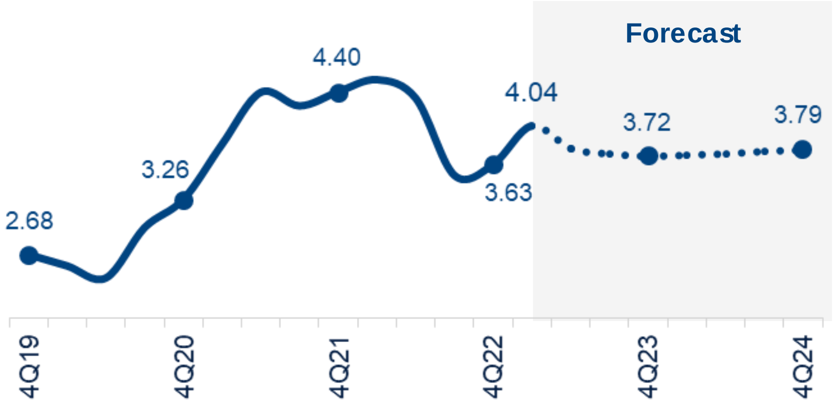
LONG-TERM GLOBAL COPPER DEMAND ESTIMATES (MILLIONS OF MT)



International Energy Agency: 33.4 million MT are required by 2040 to achieve the sustainable development goals. In 2022, 25.6 million MT were produced and it is estimated that 26.3 million MT will be produced in 2023.

Copper: against this backdrop we foresee a downward correction in the average copper price in 2023, with a constructive outlook going forward

INTERNATIONAL COPPER PRICE
(USD PER POUND, QUARTERLY AVERAGE)



INTERNATIONAL COPPER PRICE
(USD PER POUND, ANNUAL AVERAGE)

2019	2020	2021	2022	2023*	2024*
2.73	2.80	4.22	4.00	3.83	3.76

*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 uncertain context, the risk that high inflation and tight monetary conditions triggers a recession or financial instability has increased lately

MAIN RISKS

PERSISTENT INFLATION AND TIGHT MONETARY POLICY:

- strong demand
- tight labor markets
- China recovery
- higher commodity prices
- wage-price spirals
- not fully anchored expectations

→

FINANCIAL INSTABILITY
(contagion from US banking stress, vulnerabilities in real estate and leverage markets, non-banking sector, etc.)

GLOBAL RECESSION

MAIN UNCERTAINTIES

GEOPOLITICAL TENSIONS

US-CHINA RIVALRY (DEGLOBALIZATION, ETC)

ENERGY TRANSITION AND CLIMATE CHANGE

SOCIAL TENSIONS AND POPULISM

04

Local economy forecasts

4.1 Economic activity

Baseline scenario 2023/24

LOCAL BASELINE SCENARIO: MAIN CONSIDERATIONS

1. Contraction of activity in the first quarter (social conflicts, cyclone Yaku, sea warming)
GDP in the first quarter was lower than estimated (down 0.4% y-o-y versus the expected +0.2% expected).

2. Adverse weather conditions
A strong El Niño Costero phenomenon in the second quarter of 2023, tending to decrease in intensity thereafter, although it will still be felt in the first quarter of 2024 (with a weak to moderate intensity).

3. Increased public spending to prevent El Niño impacts in 2024

In 2023: public expenditure for prevention will be 0.3% of GDP.

In 2024: expenditure for emergency response, rehabilitation, and reconstruction of 0.2% of GDP is assumed.

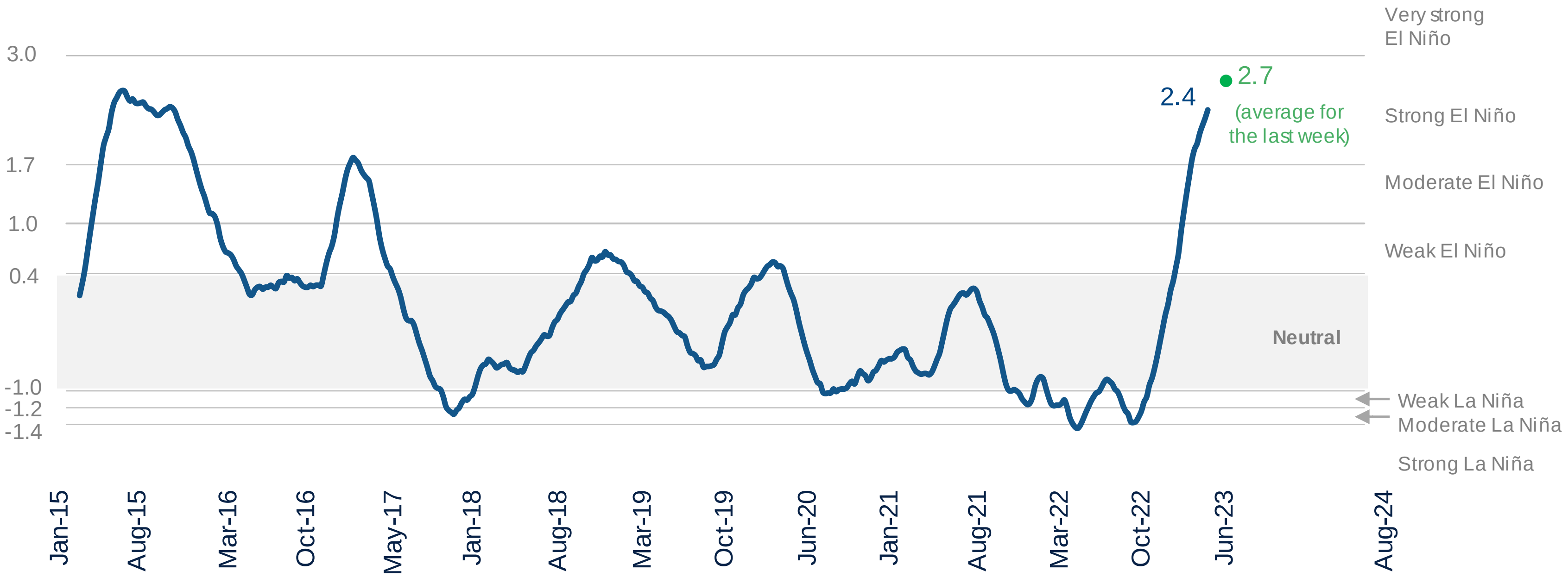
4. Increased mining output (Quellaveco) The direct impact of Quellaveco on the GDP growth rate for 2023 would be between 0.4 and 0.5 percentage points.

5. Relative yet precarious political and social stability

GDP will increase 1.6% in 2023 (downward revision from 1.9%) and **2.6% in 2024** (downward revision from 3.0%). Downside bias for 2023.

2. El Niño Costero phenomenon: reached "strong Niño" magnitude in the second quarter

SURFACE SEA TEMPERATURE ANOMALY ON THE NORTHERN PERUVIAN COAST
(DEGREES CELSIUS, THREE-MONTH ROLLING AVERAGE)

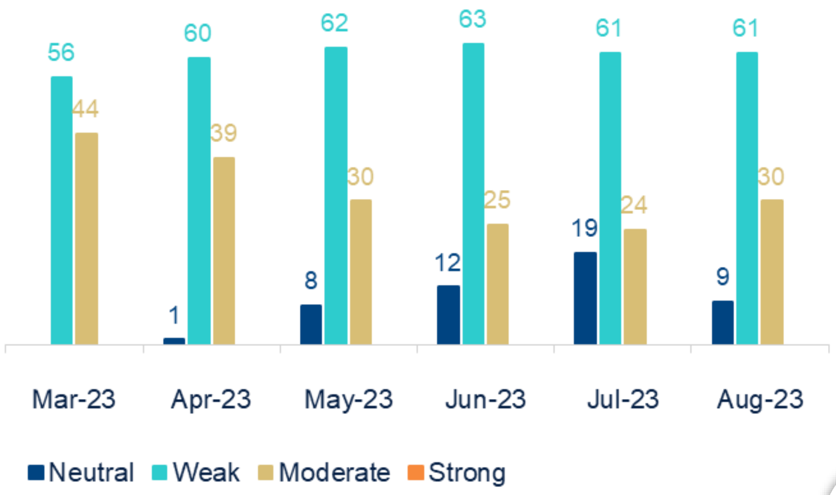


Source: NOAA and ENFEN.

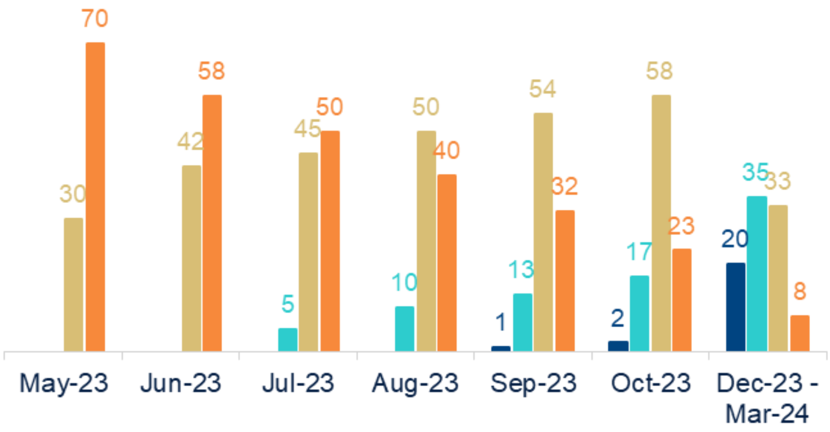
2. El Niño Costero phenomenon: forecasts have deteriorated, both in magnitude and temporal extension (will last until 2024)

EL NIÑO COSTERO PHENOMENON: PROBABILITY OF OCCURRENCE OF DIFFERENT SCENARIOS (%)

OUTLOOK IN MARCH 2023



OUTLOOK IN JUNE 2023



Source: ENFEN.

ENFEN: El Niño Costero phenomenon could reach weak to moderate magnitude in the summer of 2024
What does this mean? Moderate to heavy rains in the northern coast and northern mountain range.

2. El Niño Costero phenomenon: although its intensity will tend to diminish in the second semester, it is currently having a negative impact on activity

FISHING

Sea warming has a negative impact on anchovy landings (and on the industry that processes this resource)

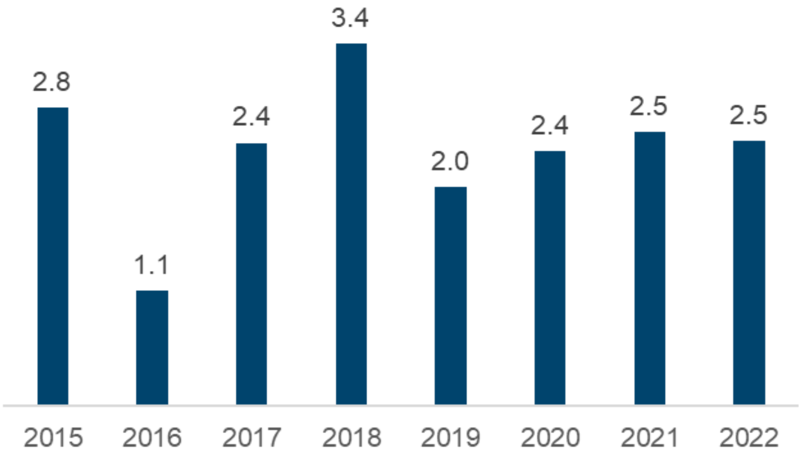
Ministry of Production (June 8, 2023):

"The first anchovy fishing season will not begin in the central-north zone of the country"

- Results of the most recent exploratory fishing: there are no biological conditions for the performance of anchovy extractive activities (biomass size, juvenile index).
- Juvenile index: more than 86% in number and 77% in weight.
- A new study is expected to begin in the next few days.

Source: IMARPE.

ANCHOVY EXTRACTION BETWEEN APRIL AND JULY (MILLIONS OF TONS)



Source: BCRP.

Negative impact on May GDP will be 1.3 percentage points. No extraction of anchovy in June would also imply a similar negative impact in that month.

3. Increased public spending to prevent El Niño impacts in 2024

Con Punche Perú Plan

"Con Punche Emergency" *

Fiscal expenditure: approximately S/4 billion (0.4% of GDP)

- Immediate emergency response
- Prevention, protection and resilience of infrastructure
- Measures for the recovery of productive capacity

Con Punche Perú 1 and 2 Fiscal expenditure: approximately S/13.6 billion (1.3% of GDP)

- Reactivation of family economy
- Regional reactivation
- Reactivation of sectors
- Reactivation of MSEs

- As at June 19, S/2.7 billion have been transferred (Source: MEF)

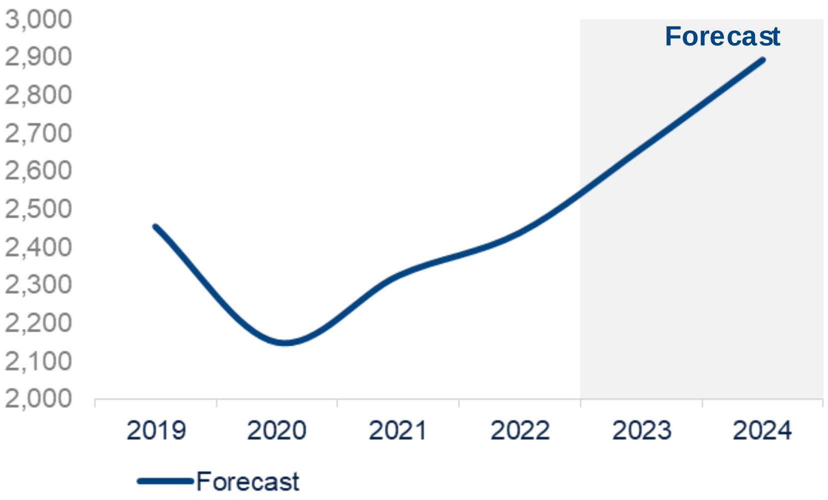
- Con Punche Perú 1 (December 2022): S/7.9 billion (0.8% of GDP).
- Con Punche Perú 2 (May 2023): S/5.8 billion (0.6% of GDP).

*Launches at the end of March 2023
Source: MEF.

4. Mining output will increase, supported mainly by Quellaveco, but it is assumed that social conflicts will continue to affect its normal performance

COPPER OUTPUT

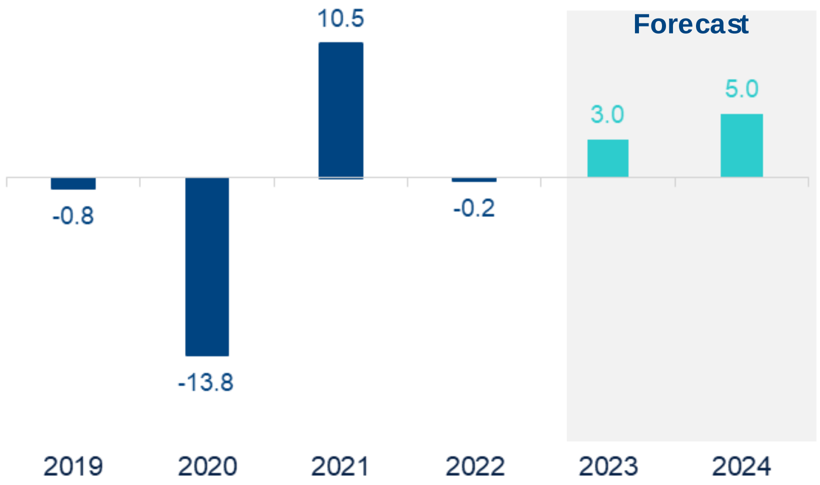
(MILLIONS OF MT)



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

METAL MINING

(ANNUAL % CHG.)

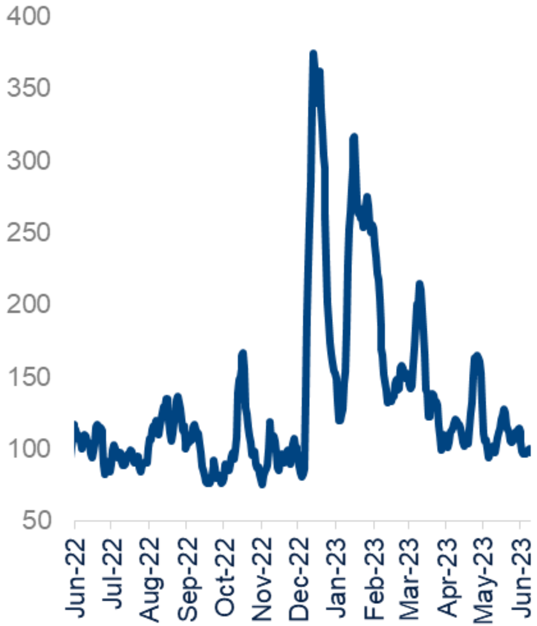


Quellaveco will boost mining growth this year. Next year's expansion is due to a low comparison baseline (particularly this year's Q1) and our assumption of a lower incidence of social conflicts.

Source: MINEM, BCRP, and BBVA Research.

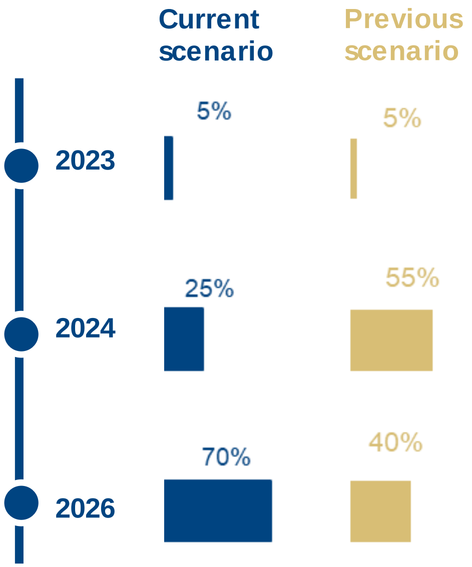
5. Political and social tensions: have decreased, although the balance is precarious, and elections will most likely be held in 2026.

POLITICAL TENSION INDICATOR
(INDEX AVG. LAST 7 DAYS, AVG. JUN.22=100)



Source: BBVA Research based on GDELT data.

YEAR IN WHICH THE NEXT GENERAL ELECTION WILL BE HELD
(PROBABILITY OF OCCURRENCE)



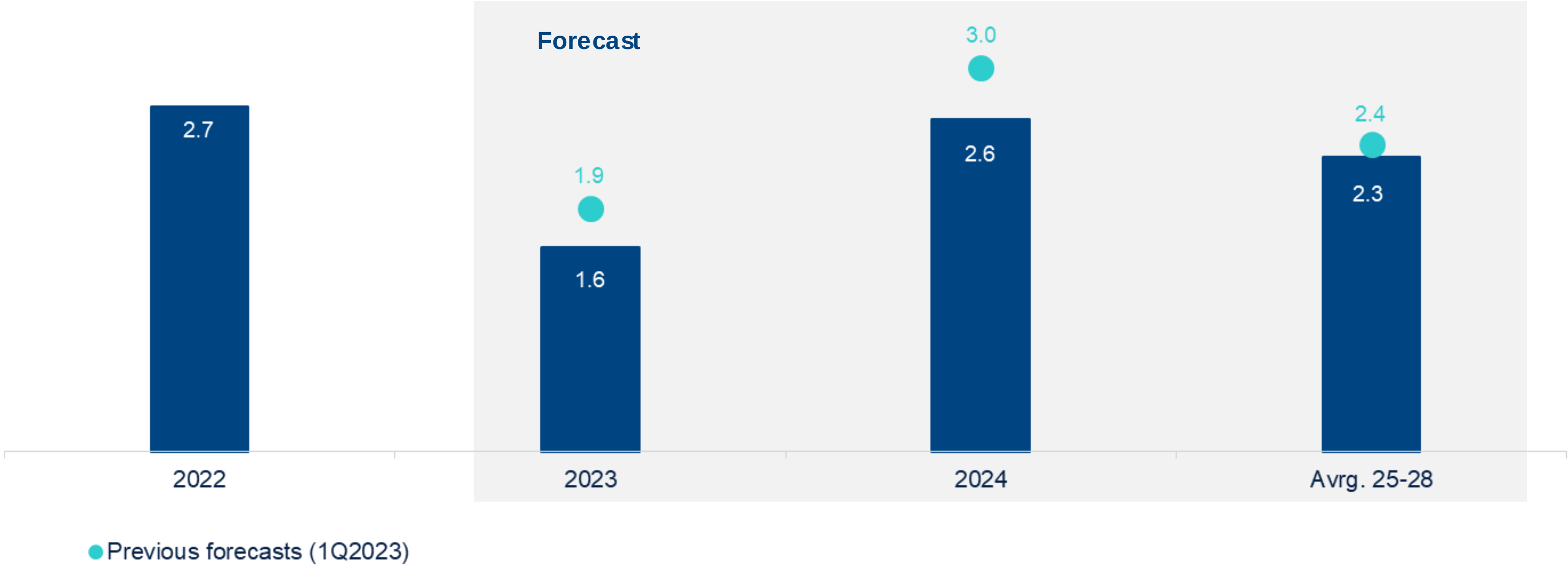
Source: BBVA Research.

CONSTITUENT ASSEMBLY[1/]: MENTIONS IN THE MEDIA
(INDEX: JUN.21 AVERAGE = 100)

1: Mentions of constitutional changes are also considered
Source: BBVA Research based on GDELT data.

Growth forecasts for 2023 and 2024 have been cut for the Peruvian economy, mainly due to the El Niño phenomenon. Downward bias for this year

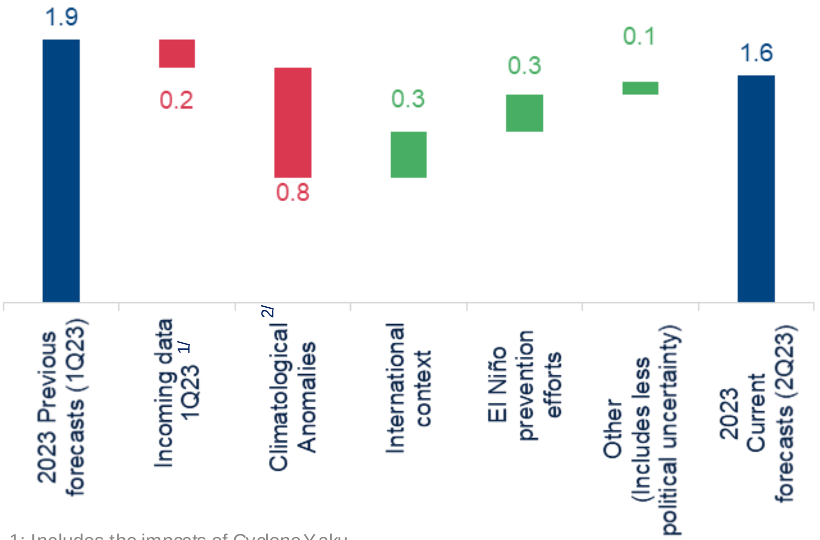
GDP
(Y/Y % CHG.)



Source: BCRP and BBVA Research.

Growth forecasts for 2023 and 2024 have been cut for the Peruvian economy, mainly due to the El Niño phenomenon. Downward bias for this year

BREAKDOWN OF THE CHANGE IN 2023 GROWTH FORECASTS: JUNE VS MARCH
(PP GDP)



1: Includes the impacts of Cyclone Yaku.
2: It includes the delayed impacts of the drought recorded in the fourth quarter of 2022 and the impacts of a strong El Niño Costero phenomenon between the second and third quarter of this year, which then tends to decrease in intensity.

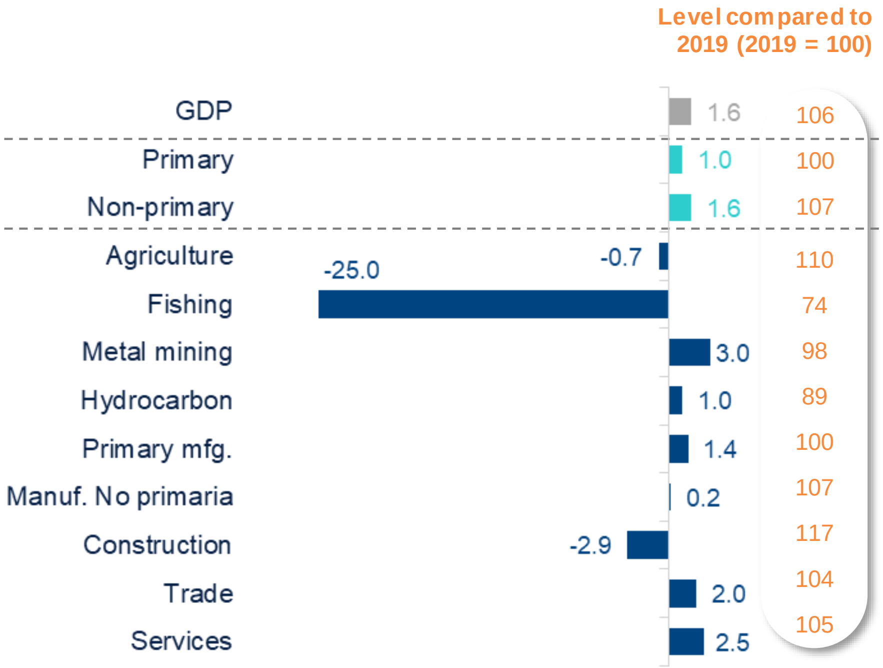
Source: BBVA Research.

BREAKDOWN OF THE CHANGE IN 2024 GROWTH FORECASTS: JUNE VS MARCH
(PP OF GDP)

1: It is assumed that intensity will be weak to moderate in the first quarter of 2024.

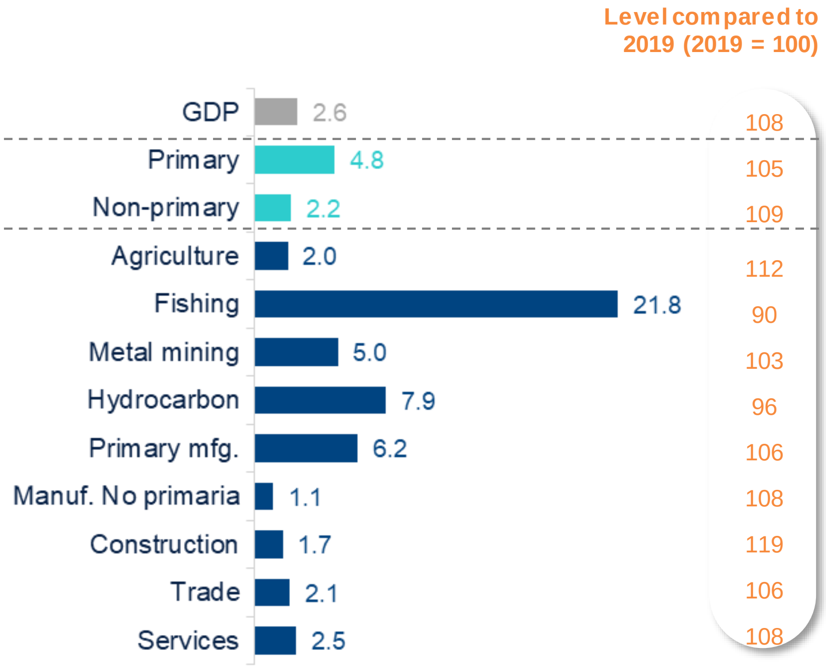
On the sectoral side, the performance of Mining will stand out in 2023 and 2024, and Fishing is expected to recover next year

2023: SECTORAL GDP FORECAST
(Y/Y % CHG.)



Source: BBVA Research.

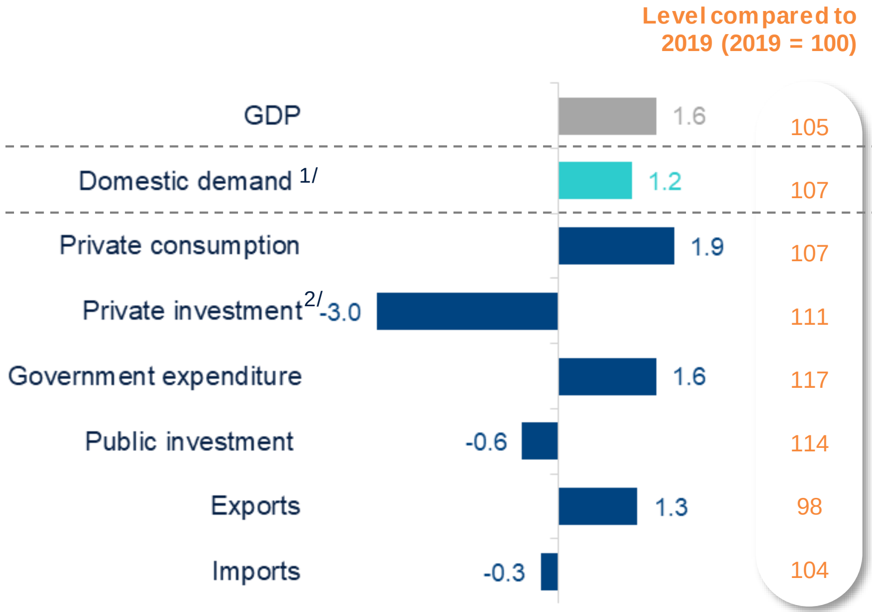
2024: SECTORAL GDP FORECAST
(Y/Y % CHG.)



Source: BBVA Research.

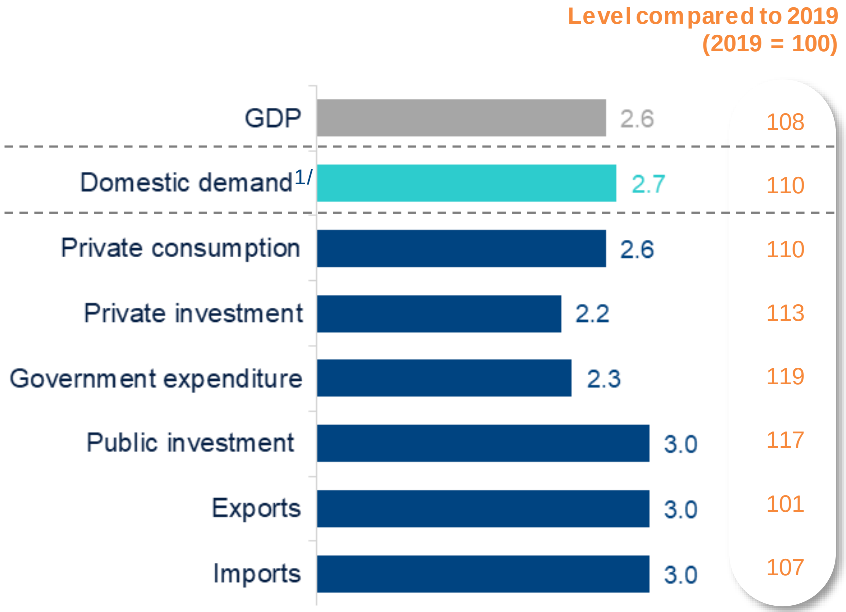
On the expenditure side, exports will reflect the better performance of mining in 2023 and 2024. Private investment will decline this year

2023: EXPENDITURE-SIDE GDP FORECAST
(Y/Y % CHG.)



1: Inventories not included.
2: The decline in private investment reflects the 36% drop in mining investment, partially offset by the 1.0% growth in non-mining investment
Source: BBVA Research.

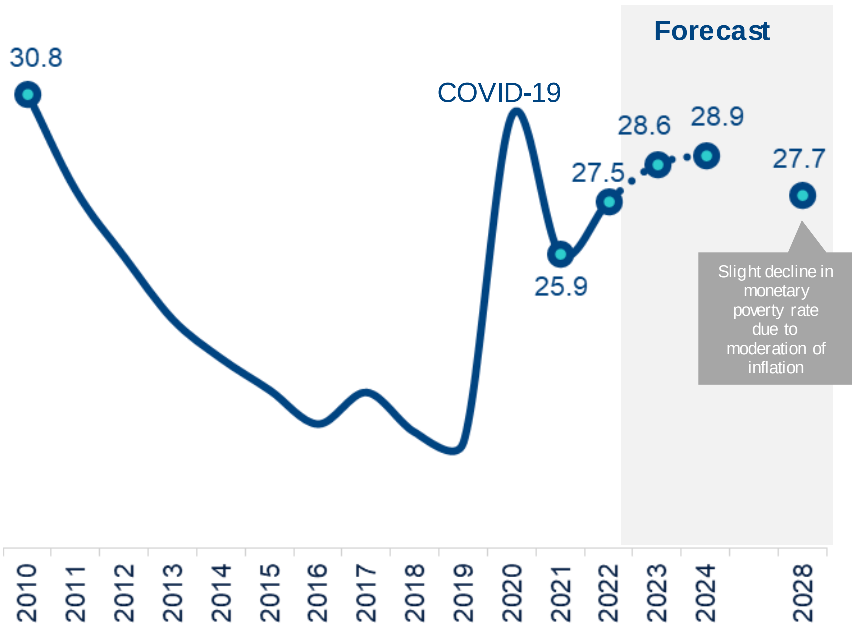
2024: EXPENDITURE-SIDE GDP FORECAST
(Y/Y % CHG.)



Source: BBVA Research.

In a context of low growth and only gradual containment of inflation, monetary poverty will continue to increase in 2023 and 2024

MONETARY POVERTY
(% OF POPULATION)



Source: INEI and BBVA Research.

In 2022:

- The monetary poverty rate increased to 27.5% (9.2 million people, 628 thousand more than in 2021)
- The extreme monetary poverty rate increased from 4.1% to 5.0% (1.7 million people, 319 thousand more than in 2021)
- The vulnerable population (with a high probability of falling into poverty) fell from 34.6% in 2021 to 32.3%.
- The poor population plus the vulnerable population stood at 59.8% (60.5% in 2021), but remains above the pre-pandemic percentage (54.2% in 2019).
- High inflation (food) was one of the determining factors of the increase in poverty

Consistent with our macroeconomic projections (low growth, low quality employment and still relatively high inflation), we expect poverty to increase in 2023 and 2024.

BBVA Research

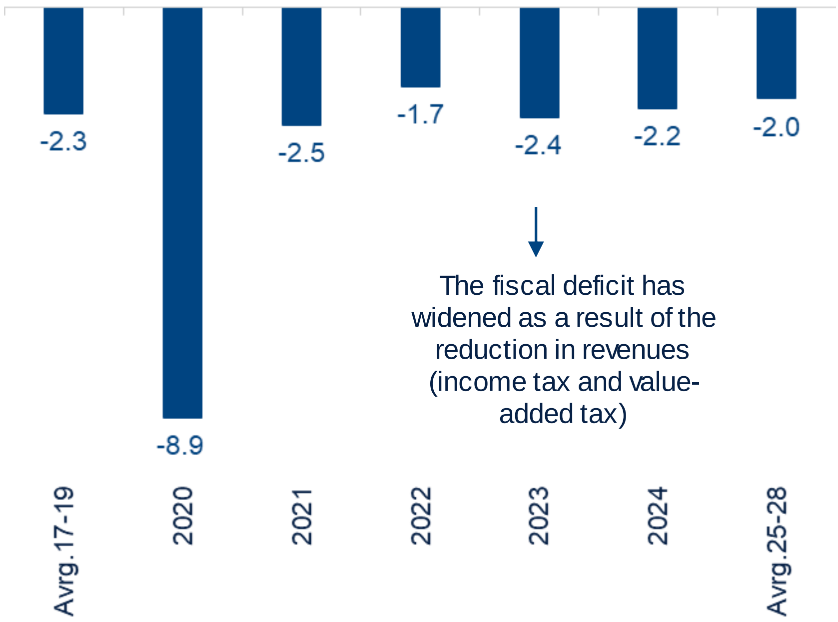
04

Local economy forecasts

4.2. Fiscal balance and public debt

Fiscal deficit will stabilize at around 2.0% in the coming years

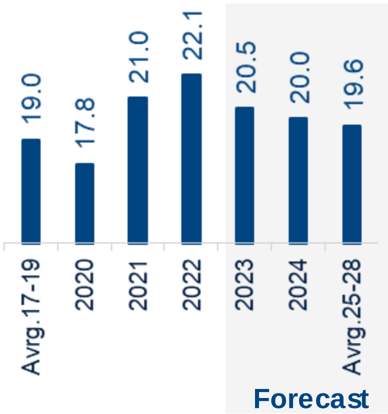
FISCAL BALANCE*
(NON-FINANCIAL PUBLIC SECTOR, % OF GDP)



*: forecast for 2023 onwards.
Source: BCRP and BBVA Research.

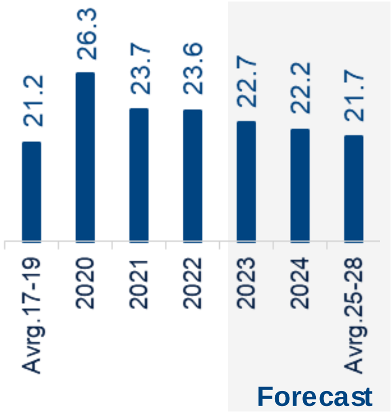
Fiscal revenues are projected to decline, but to remain above pre-pandemic levels. Expenditures will decrease somewhat more due to the reversal of outlays for the COVID-19 crisis and for supporting vulnerable sectors due to high inflation, but interest outflows will increase.

GENERAL GOVERNMENT REVENUES
(% GDP)



Source: BCRP and BBVA Research.

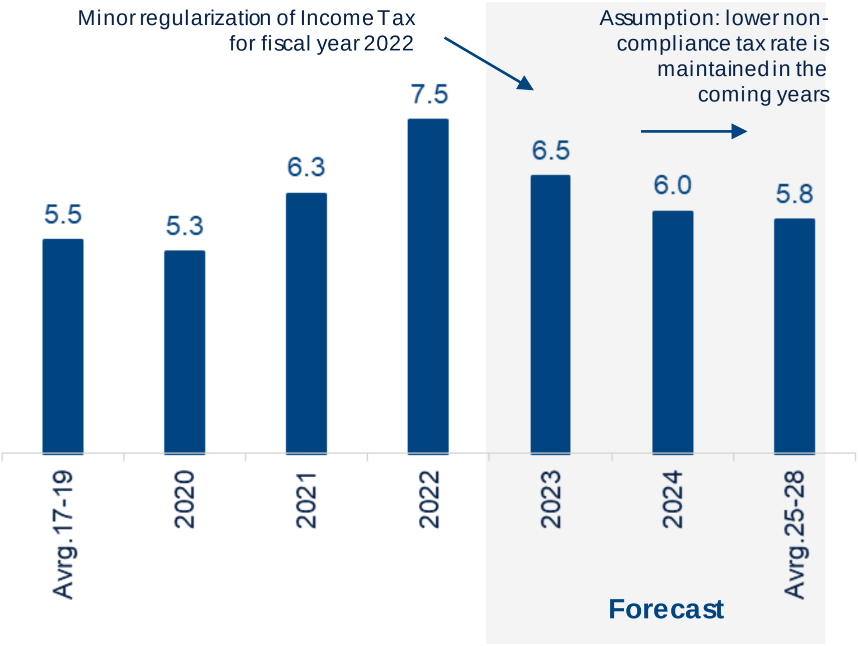
GENERAL GOVERNMENT EXPENDITURES* (% OF GDP)



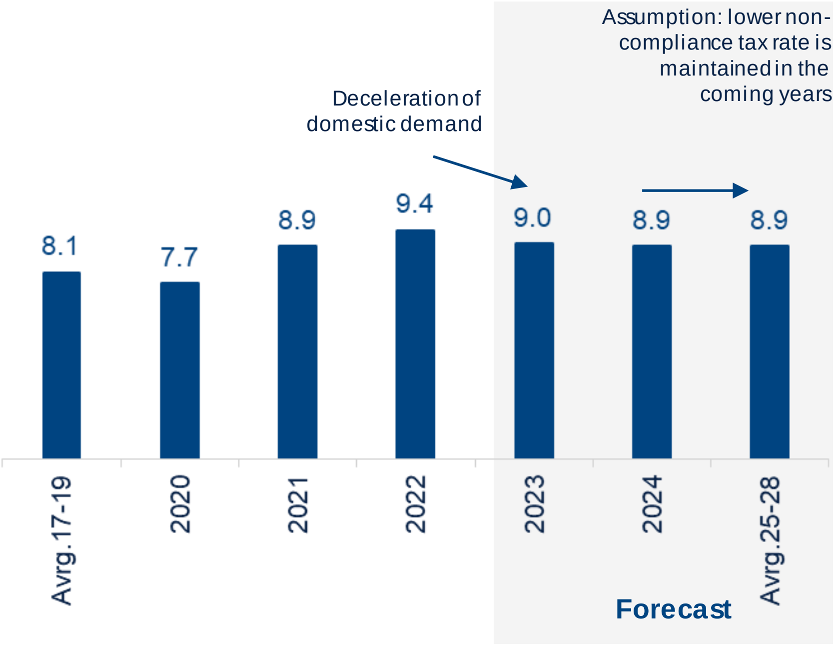
*Includes the non-financial public sector interest expense

On the revenues side, after the drop in 2023, we expect revenues to stabilize at higher-than-pre-pandemic levels

INCOME TAX
(% GDP)



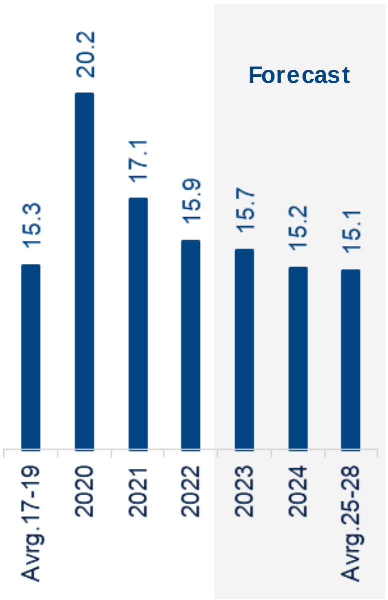
VALUE ADDED TAX
(% GDP)



Source: BCRP and BBVA Research.

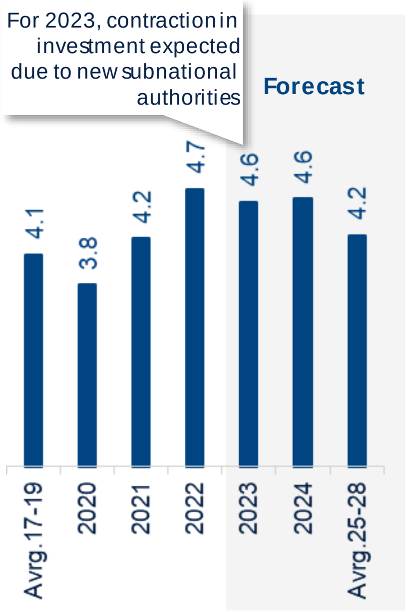
As for non-financial expenditures, a gradual reduction is expected, while interest outflows are expected to increase

GENERAL GOVERNMENT CURRENT EXPENDITURES (% OF GDP)

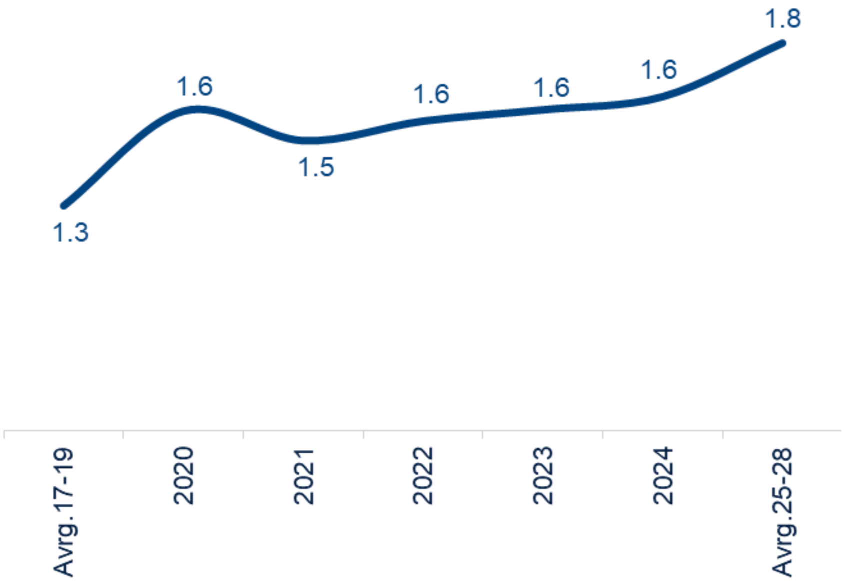


Source: BCRP and BBVA Research.

GENERAL GOVERNMENT INVESTMENT EXPENDITURES (% OF GDP)



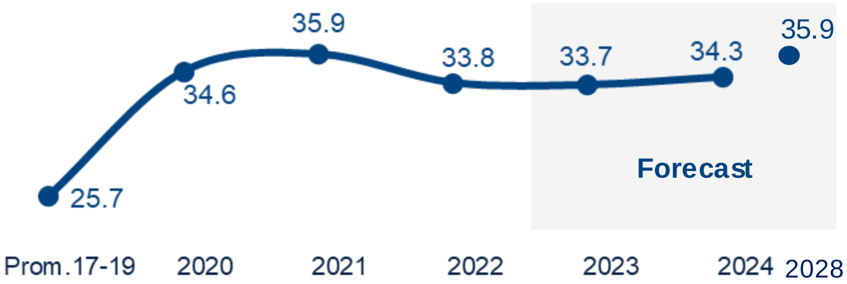
GOVERNMENT INTEREST PAYMENTS* (% GDP)



Source: BCRP and BBVA Research
*Non-Financial Public Sector.

Gross public debt to show a slight upward trend in the medium term, but potential spending demands erode fiscal strength

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



NON-FINANCIAL PUBLIC SECTOR INDICATORS

	2019	2020	2021	2022	2023*
Assets (% of GDP)	13.7	12.4	14.2	12.8	11.9
Net public debt (% of GDP)	12.9	22.2	21.8	21.0	21.8
Dollarization of public debt (%)	32	43	54	52	51
Interests payments as % of tax revenues	7.0	9.0	7.2	7.1	7.8

*Estimate.
Source: BCRP and BBVA Research.

SPENDING PRESSURES

Law No.	Description	Status	Cost	Type
Law 31097 (12.29.20)	Law that establishes that the State invest annually not less than 6% of GDP in education	In force	S/ 18 billion	Permanent cost
Ruling of the Constitutional Court	FONAVI refund law	In force	S/ 5.3 billion	Temporary cost
Law 31495 (06.16.22)	Law that establishes the payment of the bonus for class preparation without the requirement of a court sentence	In force	S/ 42.8 billion	Temporary cost
Law 31539 (07.31.22)	Law authorizing the change from CAS - COVID contracts to CAS	In force	S/ 2.2 billion	Permanent cost

Source: Fiscal Council.

04

Local economy forecasts

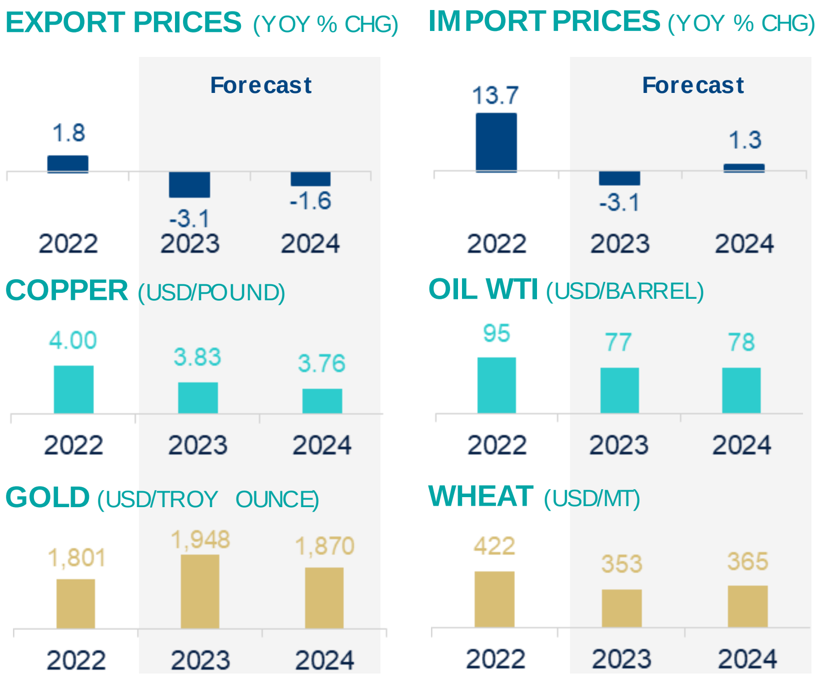
4.3. External sector and exchange rate

External accounts: lower terms of trade in 2023 and 2024 due to reduced export prices…

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

Source: BCRP and BBVA Research.

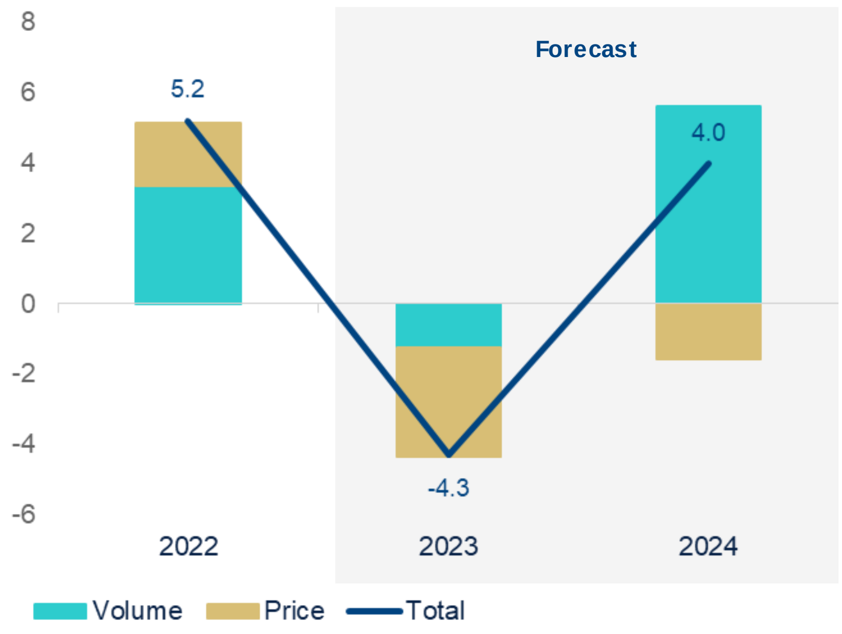
EXPORT AND IMPORT PRICES



Source: BCRP and BBVA Research.

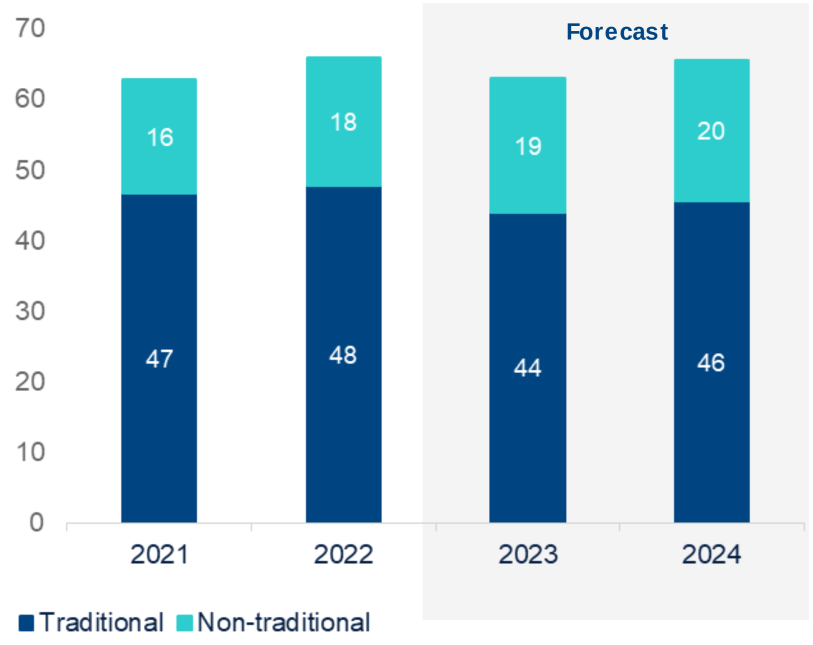
… which, together with the suspension of the first anchovy fishing season, will lead to a drop in the value of exports

EXPORTS
(YOY % CHG.)



Source: BCRP and BBVA Research.

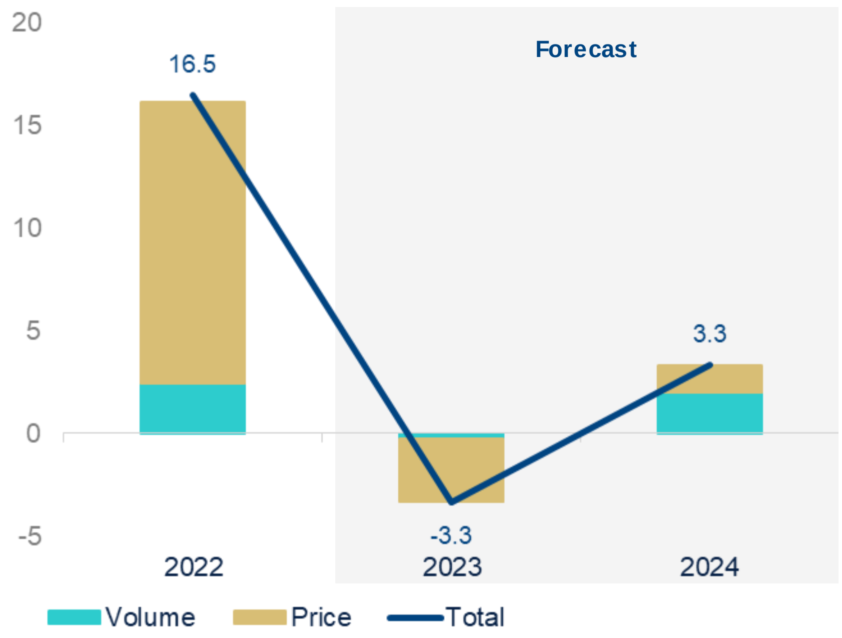
EXPORTS
(USD BILLION)



Source: BCRP and BBVA Research.

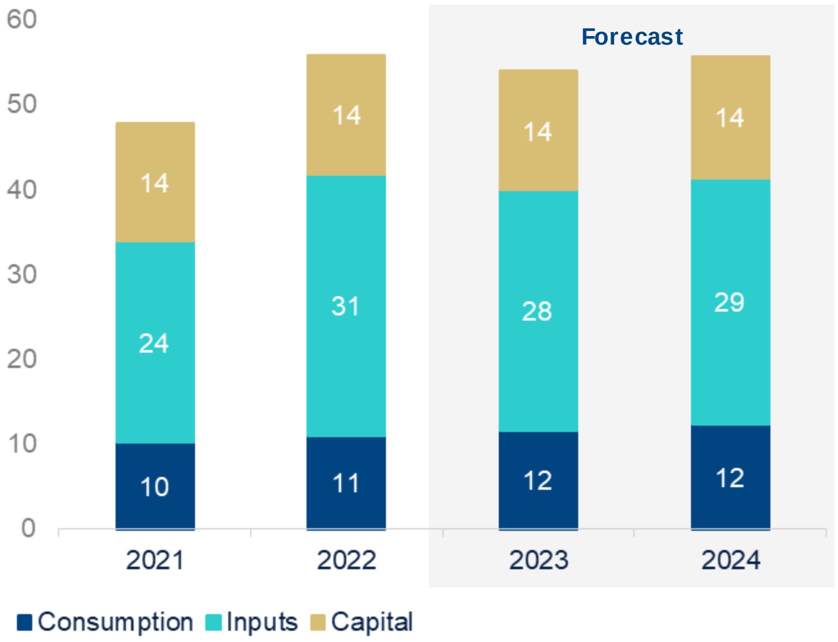
The value of imports will fall this year due to the slowdown in economic activity and the correction in prices, but will rebound slightly next year

IMPORTS
(YOY % CHG.)



Source: BCRP and BBVA Research.

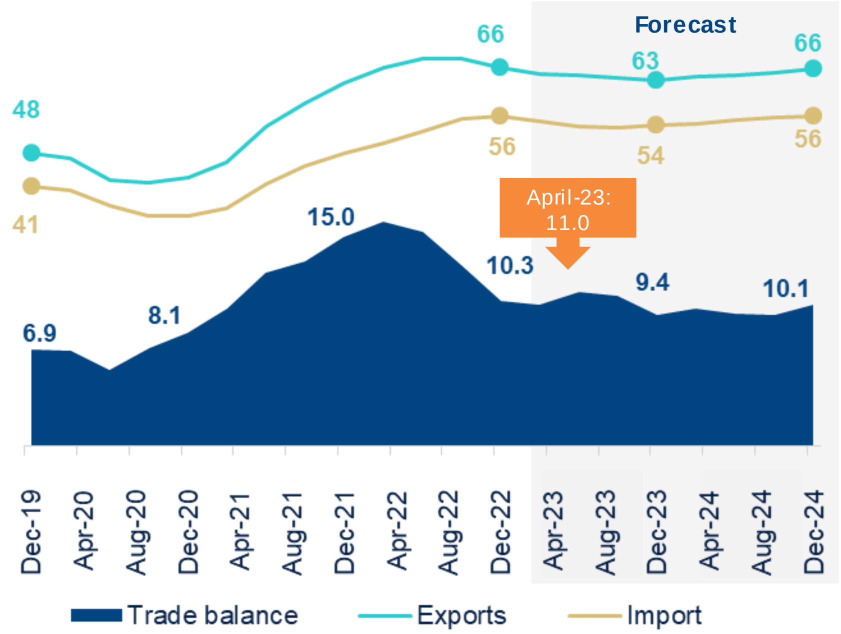
IMPORTS
(USD BILLION)



Source: BCRP and BBVA Research.

As a result, the trade balance surplus will shrink this year and recover the next

TRADE BALANCE
(USD BILLION, ACCUMULATED FOR LAST 12 MONTHS)

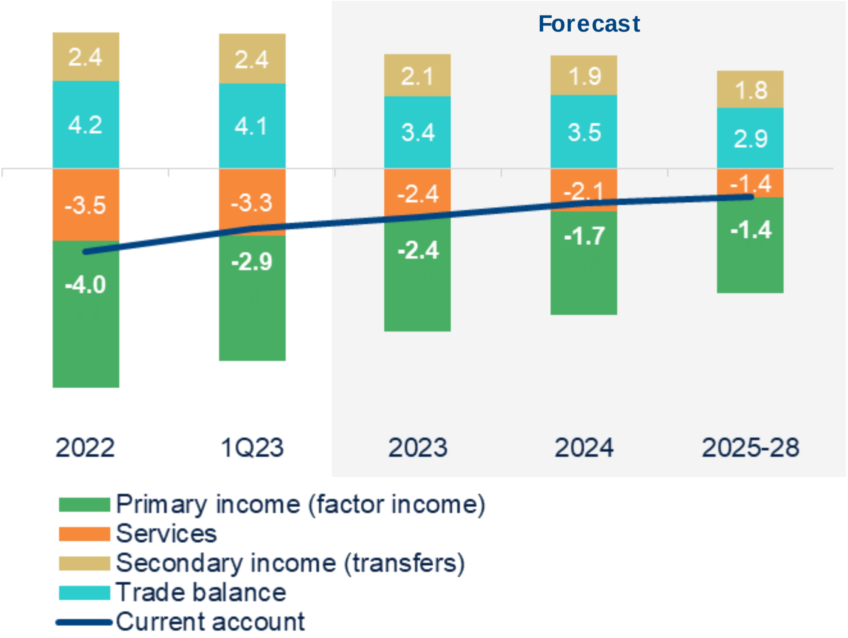


Source: BCRP and BBVA Research.

- So far this year, the trade balance surplus has risen as a result of the slowdown in imports.
- For 2023, the drop in export prices (metals) and the suspension of the first anchovy fishing season is partially offset by lower international oil and food prices.
- In 2024, traditional exports recover (after this year's setback due to both political/social unrest and weather anomalies). Higher imports in a context of recovering domestic demand moderate the impact on the trade balance.

The deficit in the current account of the balance of payments will gradually close due to the recovery of tourism and lower corporate profits

CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS
(% GDP)

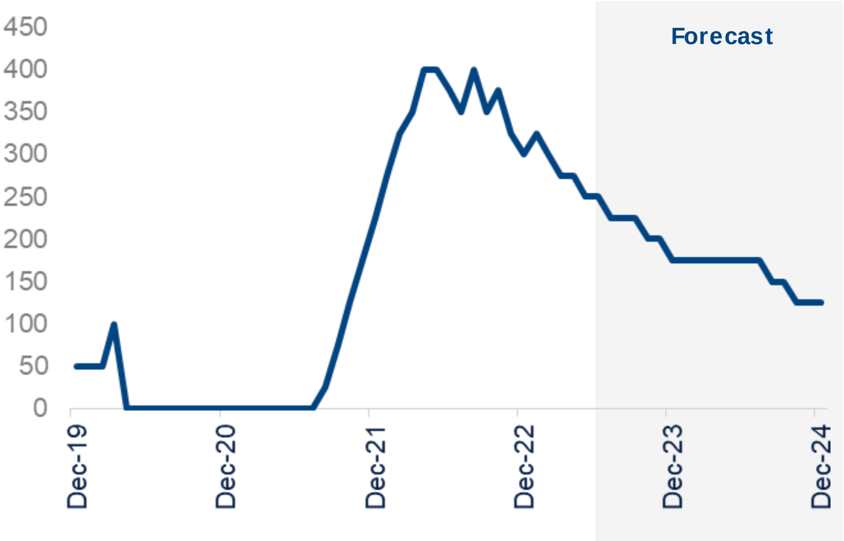


Source: BCRP and BBVA Research.

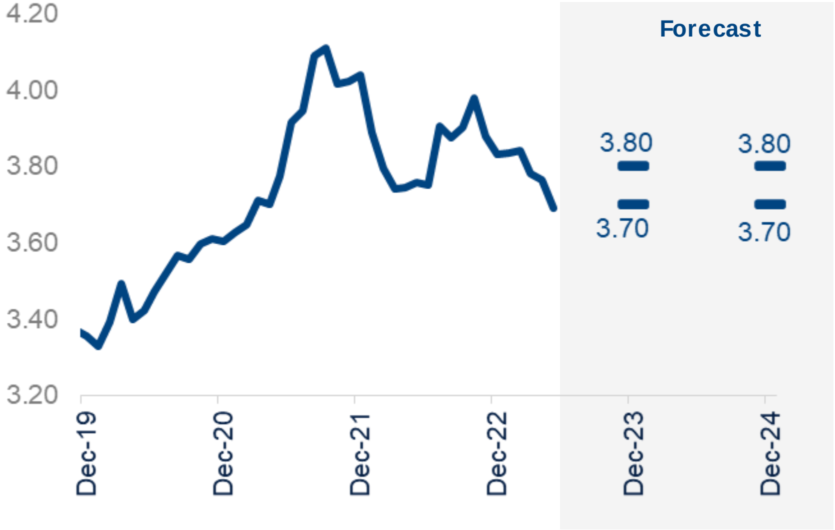
- Higher profits of foreign companies and the cost of imported services (e.g. freight) generated a widening of the current account of the balance of payments deficit in 2022.
- In 2023, the lower trade surplus and transfers (as a percentage of GDP) will be offset by: (i) improvement in the services account (normalization of inbound tourism and lower freight costs) and (ii) lower profit remittances from foreign companies (in line with lower metal prices).
- Moving forward, this process will continue with the current account deficit continuing to narrow toward sustainable levels (consistent with stable net foreign liabilities as a % of GDP).

Exchange rate: domestic currency will tend to depreciate in 2H23 due to a narrowing interest rate differential and capital outflows

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



EXCHANGE RATE (SOLES PER DOLLAR)

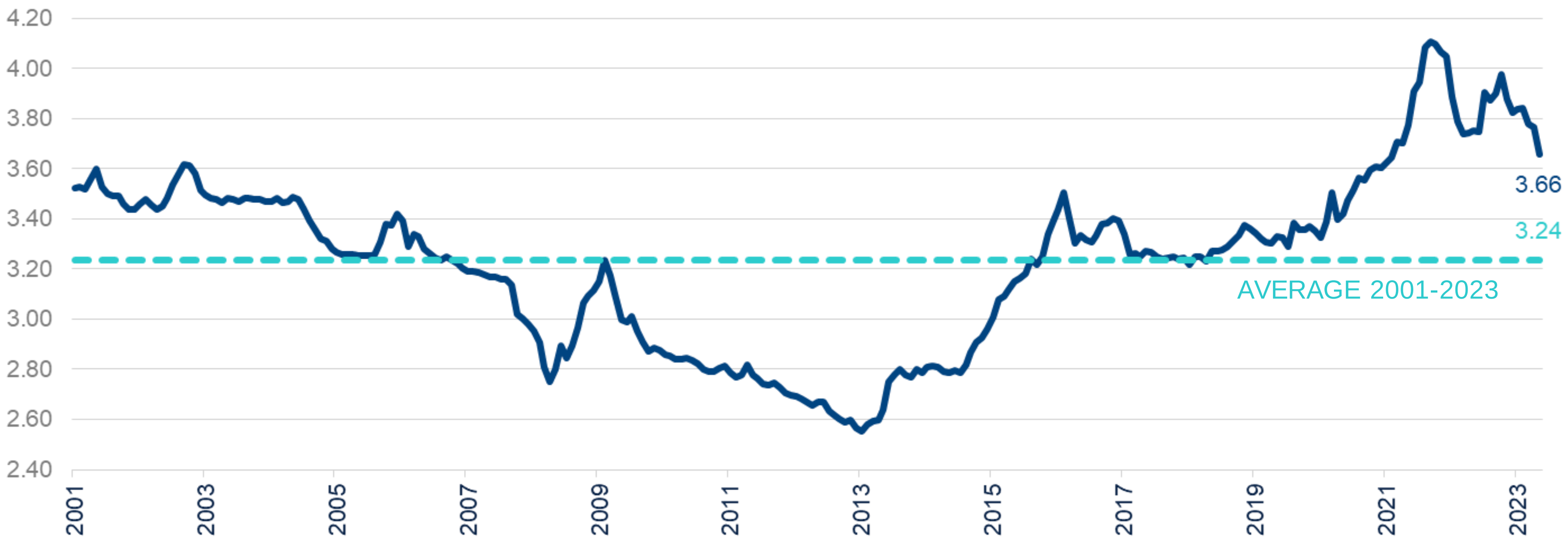


Declining PEN-USD interest rate differential will reduce attractiveness of domestic currency assets. A moderating global economic growth (US technical recession in the coming quarters), an environment that has usually been challenging for risky assets, will not favor the PEN either.

Source: FRED, BCRP and BBVA Research.

Exchange rate: currently above its long-term average, but...

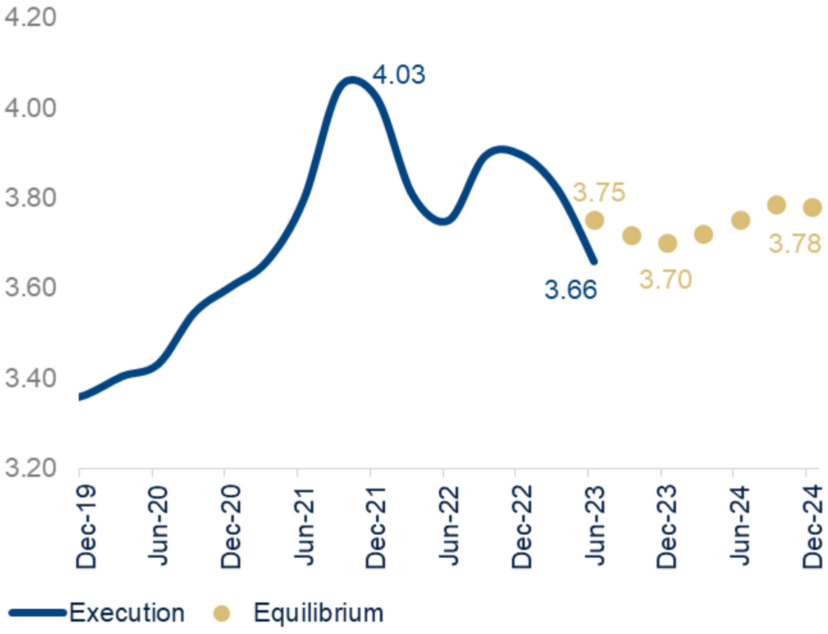
EXCHANGE RATE
(PEN PER USD)



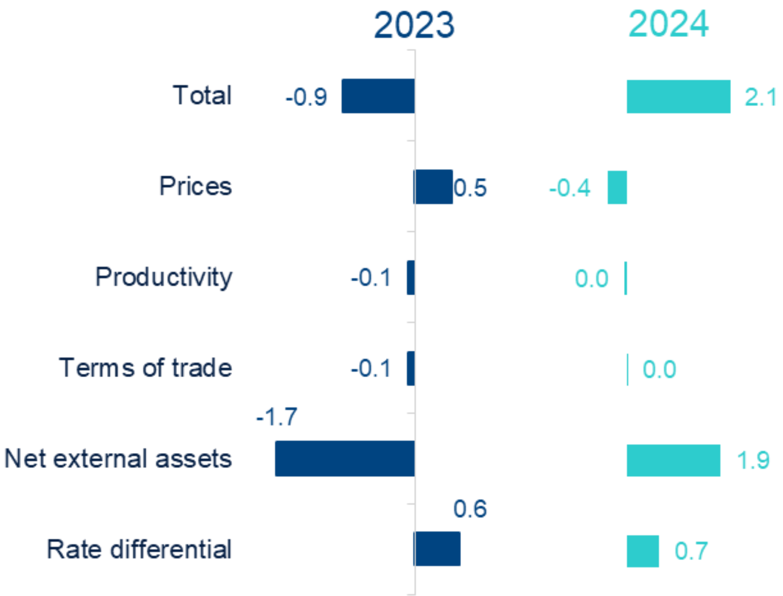
Source: BCRP and BBVA Research.

… not too far from the level consistent with macro fundamentals

EXCHANGE RATE
(PEN PER USD)



EQUILIBRIUM EXCHANGE RATE
(YOY % CHG. BREAKDOWN)



Source: BCRP and BBVA Research.

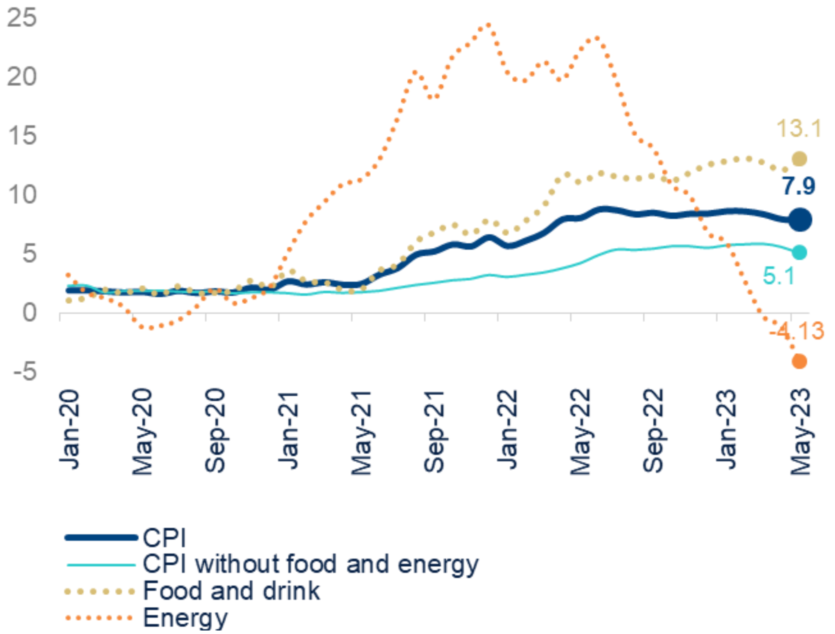
04

Local economy forecasts

4.4. Inflation and monetary policy

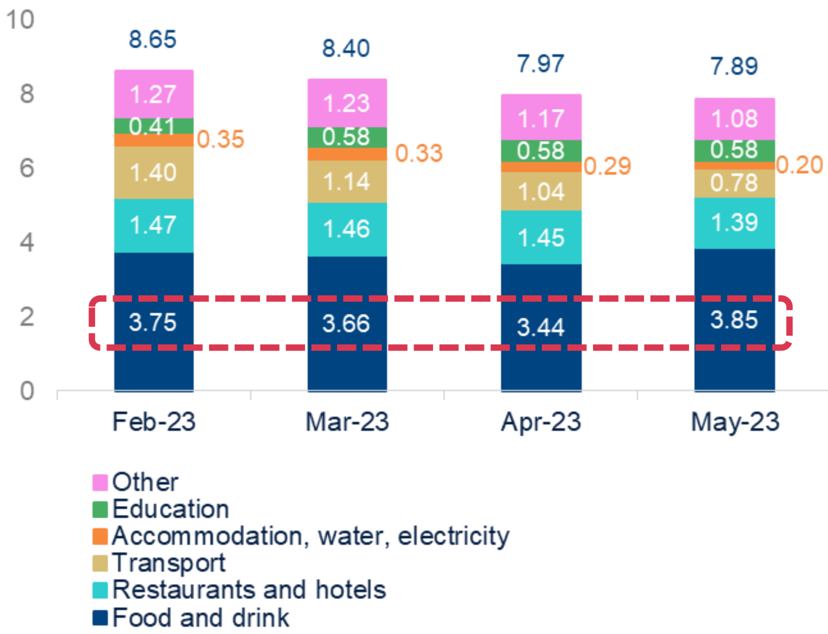
Inflation in recent months has remained elevated mainly due to supply shocks affecting domestic food prices

INFLATION: TOTAL AND BY COMPONENTS
(YOY % CHG.)



Source: INEI.

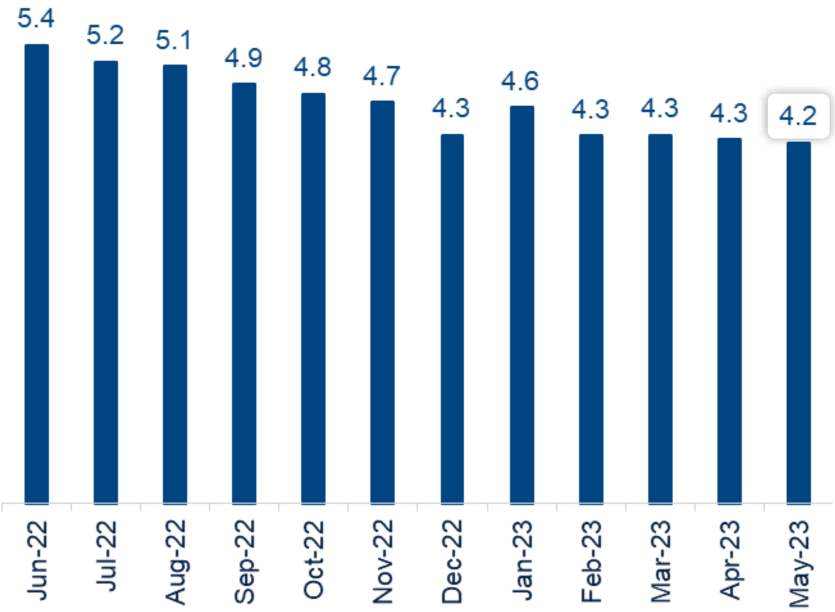
INFLATION BY CATEGORY
(YOY % CHG. AND CONTRIBUTION)



Source: INEI.

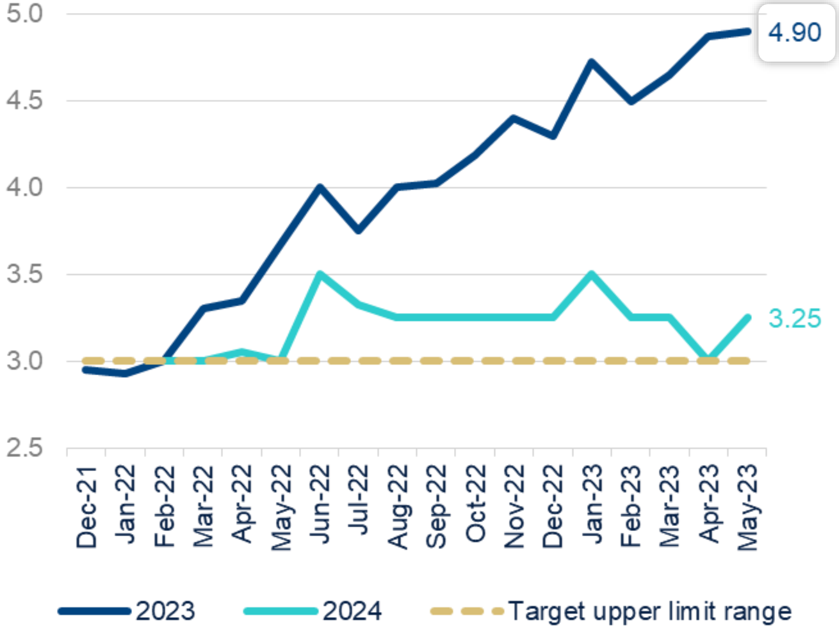
… while inflation expectations are persistent

INFLATION EXPECTATIONS
(ONE YEAR AHEAD, %)



Source: BCRP.

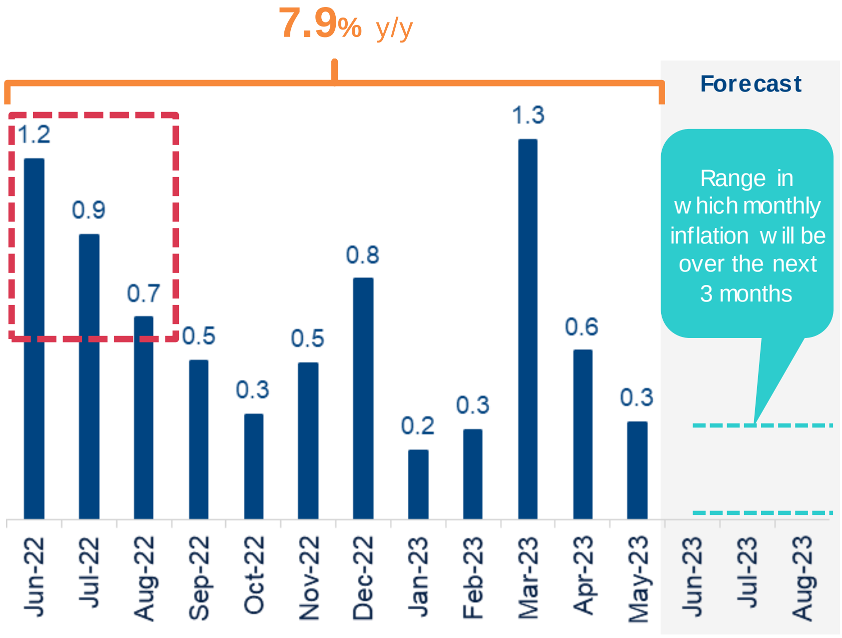
INFLATION FORECASTS [1/]
(FOR YEAR-END, %)



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

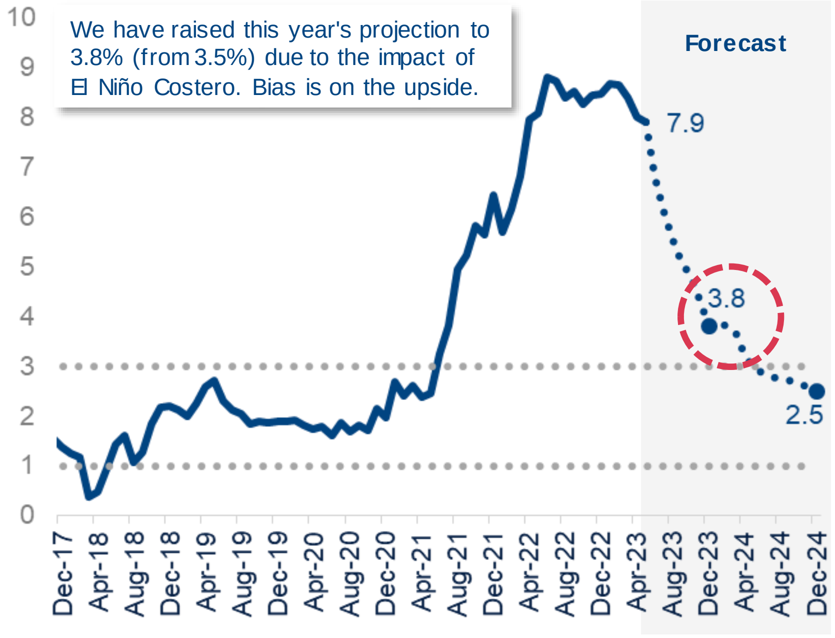
Nevertheless, we expect inflation to show a significant decline in the coming months due to base effects

MONTHLY INFLATION
(%, MOM)



Source: INEI and BBVA Research.

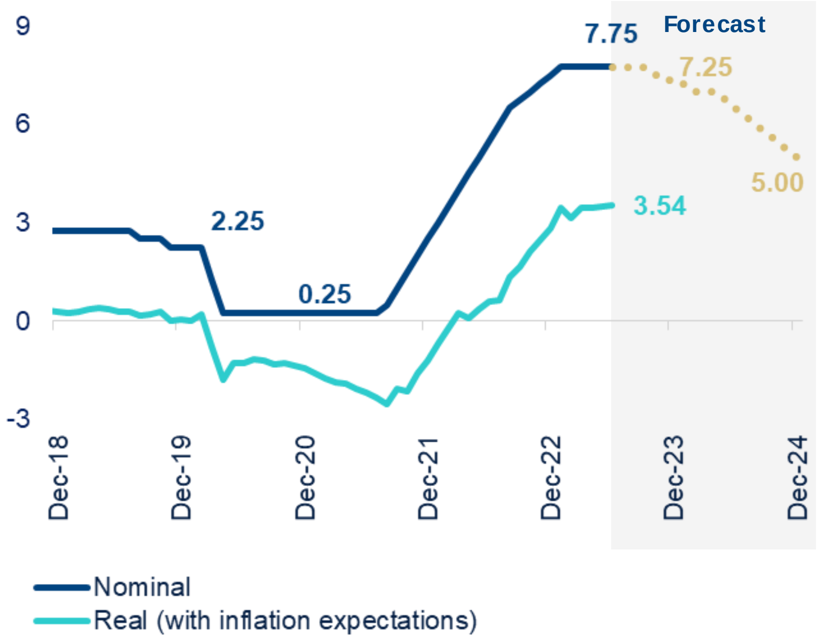
YEAR-ON-YEAR INFLATION
(%, YOY)



Source: INEI and BBVA Research.

The Central Bank will not begin to cut rates until 4Q23

MONETARY POLICY INTEREST RATE
(%)



Source: BCRP and BBVA Research.

- Inflation will soon begin to show a more clear downward trend. As a result, we believe rate hikes have ended. 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 ease along with inflation.
- We expect that by the last quarter of 2023, in an environment of a clear downward trend in inflation and with the Fed having already completed its monetary tightening, the BCRP will begin to cut the reference rate, albeit gradually at first. We forecast that the policy rate will close the year at 7.25%. The monetary normalization process would accelerate in 2024, after El Niño, bringing the reference rate to 5.0% by the end of that year.

Research

05

Main risks to Peru's economic outlook

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

ON THE EXTERNAL SIDE

More persistent global inflation and even higher interest rates.

Sharper global growth slowdown or greater financial instability.

ON THE LOCAL SIDE

Renewed political and social tensions.

A more intense El Niño Costero or with even more severe impacts on activity.

Populist measures affecting competitiveness (labor market, pension system).

Sovereign credit rating downgrade

Research

06

Summary of forecasts

Macroeconomics forecasts

	2021	2022	2023 (f)	2024 (f)
GDP (YoY % change)	**13.6**	**2.7**	**1.6**	**2.6**
Domestic demand (excluding inventories, YoY % change)	**17.0**	**2.1**	**0.8**	**2.4**
Private spending (YoY % change)	**17.6**	**2.6**	**0.8**	**2.5**
Private consumption (YoY % change)	12.4	3.6	1.9	2.6
Private investment (YoY % change)	36.9	-0.4	-3.0	2.2
Public spending (YoY % change)	**14.2**	**-0.5**	**1.0**	**2.5**
Public consumption (YoY % change)	10.9	-3.4	1.6	2.3
Public investment (YoY % change)	24.8	7.7	-0.6	3.0
Exchange rate (vs. USD, eop)	**4.04**	**3.83**	**3.70 – 3.80**	**3.70 – 3.80**
Inflation (% Y/Y, eop)	**6.4**	**8.5**	**3.8**	**2.5**
Monetary policy interest rate (%, eop)	**2.50**	**7.50**	**7.25**	**5.00**
Fiscal balance (% GDP)	**-2.5**	**-1.7**	**-2.4**	**-2.2**
Balance of payments: current account (% GDP)	**-2.2**	**-4.0**	**-2.4**	**-1.7**
Exports (USD billion)	63.0	66.2	63.4	65.9
Imports (USD billion)	48.0	55.9	54.0	55.8

(f) Forecast. Forecast closing date: June 9, 2023.
Source: BBVA Research.

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Peru Economic Outlook

June 2023

Creating Opportunities