BBVA Research

Peru Economic Outlook

October 2023

Creating Opportunities

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Contents

Creating Opportunities

Key points

Global situation

The world economy is slowing down with differences between regions: recent data are more positive in the U.S., relatively weak in the Eurozone, and particularly negative in China. The process of interest rate hikes seems to have reached its end. However, given the still high inflation and robust labor markets, the Fed and the ECB have left the door open to further interest rate hikes should inflation prove to be more persistent.

Local situation

Locally, the economy continues to face negative shocks. The drought and higher fertilizer prices in 2022 (with impacts on agricultural sector production this year), political and social unrest, and cyclone Yaku in the first quarter were followed in the second quarter by weather anomalies associated with the coastal El Niño phenomenon, with an intensity even greater than predicted by entities specialized in monitoring this phenomenon. In this environment of successive negative shocks, high inflation, high financing costs, absence of additional releases of pension funds, expectations of a complicated El Niño phenomenon in the coming quarters, and in which short-term business confidence has failed to recover, spending by the private sector has weakened significantly. In addition, firms have opted to cut inventories. As a result, GDP contracted 0.5% year-on-year in the second quarter, a larger drop than we estimated in our previous report (June). The situation does not seem to have improved much in the third quarter and analysts and authorities alike are adjusting their output growth forecasts downward for 2023.

Key points

Global macro outlook

Global growth is forecast to moderate from 3.5% in 2022 to 2.9% (no change with respect to the June forecast) in 2023 and 3.0% (2.9% in June) in 2024. In the U.S., strong domestic demand supports an upward revision of output growth forecasts and makes a recession unlikely. In China, growth prospects deteriorate, but the implementation of economic measures are expected to avoid a sharp slowdown. In the Eurozone, economic expansion is expected to be more modest than anticipated.

Inflation is likely to continue to slow, avoiding further interest rate hikes in the U.S. and the Eurozone. Even so, it will remain above target and upside risks will remain, making rate cuts unlikely in the near term and favoring a gradual reduction in liquidity.

Key points

Domestic macro outlook: economic activity

On the domestic side, the baseline forecast scenario has been revised to incorporate the negative surprise in second quarter GDP growth, the deterioration of El Niño forecasts for the second half of the year, and a more sustained weakness in private spending. Taking this into account, the output growth forecast for 2023 has been cut to 0.4% (1.6% in June).

This forecast considers a second half of the year in which activity will show some improvement (expansion of just over 1.0% year-on-year versus the 0.5% contraction in the first half), supported by a relatively more stable political situation with respect to what was observed at the beginning of the year, higher public spending focused on mitigating the impacts that the coastal El Niño will have in early 2024, declining inflation, and domestic currency interest rates starting to decrease. The above will be mitigated by Quellaveco's declining contribution to economic growth, which will dissipate starting in 4Q23. It should be added that the continued weakness of GDP at the beginning of the second half of the year has elevated the downside risk to this scenario.

For 2024, the output growth forecast has also been revised downward, from 2.6% to 2.3%. The coastal El Niño will probably unfold in the first months of that year with moderate intensity, not weak as was considered in the base scenario of June, so that rainfall will be higher and economic impacts will also be greater. After El Niño (negative supply shock dissipates), there will be a rebound in economic activity.

Key points

Domestic macro outlook: fiscal accounts

Peru will remain fiscally robust, although we now foresee a somewhat higher deficit. For this year, the deficit will stand at around 2.7% of GDP, up from the June forecast (2.4%), mainly due to a downward revision in projected mining revenues and a sharper slowdown in private spending. By 2024, the fiscal deficit will remain at 2.7% because although revenues will fall (as a % of GDP) due to the expected decline in metal and fuel prices, expenditures will also fall due to the withdrawal of the support given in 2023 related to the “Con Punche Peru” plans. In this context, gross public debt will be somewhat below 35% of GDP by the end of 2024.

Domestic macro outlook: external accounts

The Peruvian economy does not present external imbalances, making it easier to face the financial volatility that has been observed in the context of still high foreign interest rates. The balance of payments current account deficit (accumulated over the last four quarters) decreased from 4.0% of GDP in 4Q22 to 1.9% in 2Q23 due to increased mining production (more exports) and the slowdown in private spending (fewer imports). We expect the current account deficit to maintain this trend, favored by an expected normalization of inbound tourism, reaching a level equivalent to 1.2% of GDP by the end of 2023 and 1.0% in 2024.

Domestic macro outlook: foreign exchange

Depreciation pressures on the local currency in the last couple of months due to high USD interest rates and the prospects that they will remain high for quite some time, as well as the loss of dynamism of economic activity in China. We expect the PEN to weaken somewhat further going forward due to the start of the (gradual) normalization process in the domestic policy rate, which will reduce the PEN-USD interest rate differential (decreasing the attractiveness of holding local currency assets). The lower balance of payments current account deficit will moderate depreciation pressures. We expect the USDPEN to close the year between 3.70 and 3.80 soles per dollar (perhaps at the high end of that range) and between 3.80 and 3.90 by the end of 2024.

Key points

Domestic macro outlook: inflation

Although still at high levels (5.0% in September), inflation is decreasing. Base effects, the weakness of the economy, and the tight monetary policy stance suggest that this trend will continue in the following months, closing the year at around 4.1%. In 2024, when El Niño is over, inflation will resume its downward trend and end the year at 2.8%.

Domestic macro outlook: monetary policy rate

After a pause since February, the Central Bank reduced its policy interest rate in September (25 bp) to 7.50%. This took place in a context in which it revised its output growth and core inflation outlook downward for 2023. However, the statement accompanying the decision also stressed the latent risk of the impacts that El Niño may have on prices and that the cut in the policy rate does not imply the beginning of a cycle of successive reductions.

As indicated by the Central Bank, the next decisions it will take will be conditioned by the data available over time. We anticipate that inflation and economic activity trends, weather forecasts, and the Fed's decisions will be decisive. Our baseline scenario is consistent with further cuts in the policy rate to 6.75% by the end of the year and then a pause while the El Niño shock lasts into early 2024 and the Fed does not start its own monetary normalization cycle.

Main risks

On the external side, (i) episodes of recession and financial instability caused by persistent inflation and tight monetary policies; (ii) a sharper slowdown in China; (iii) geopolitical tensions; and (iv) the U.S. presidential elections. On the domestic side, (i) El Niño of greater intensity or with more significant impacts; (ii) renewed political and social tensions; (iii) populist measures affecting competitiveness (labor market, pension system); and (iv) a more persistent cyclical (structural?) slowdown in economic activity.

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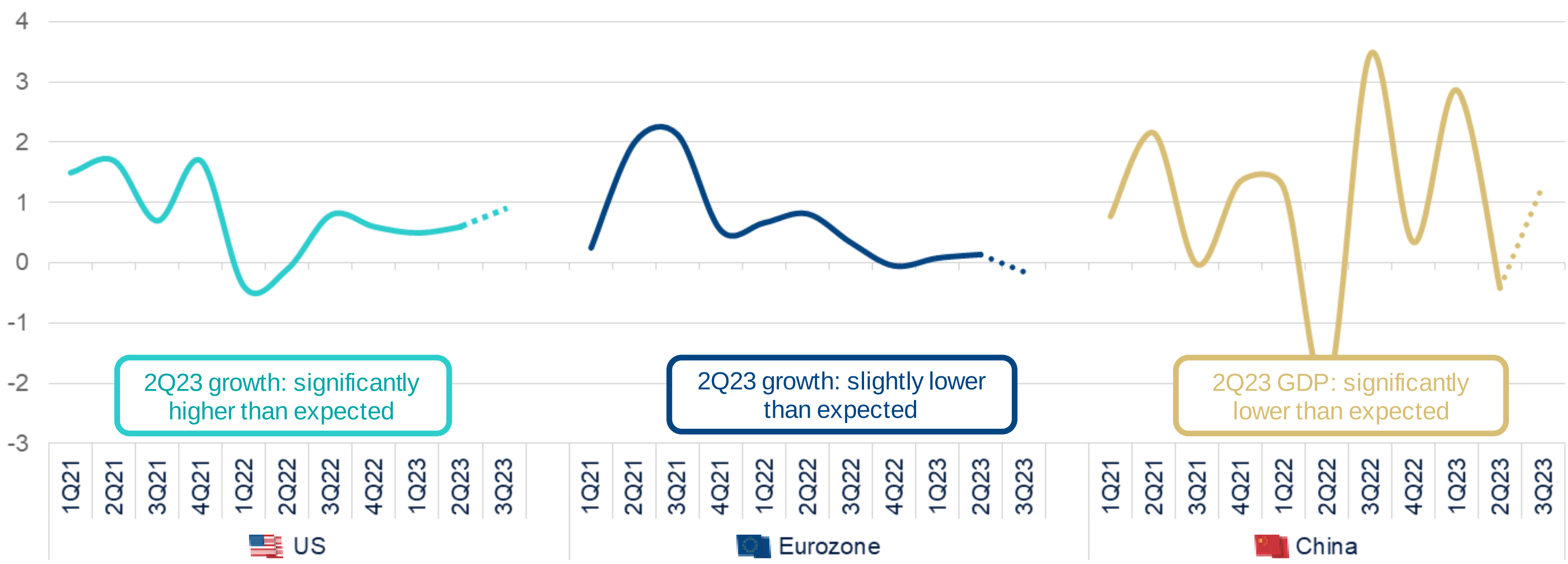
01

International context: activity and financial markets

GDP growth is losing momentum, mainly in China, but also in the Eurozone; labor markets and excess savings are still supportive, especially in the US

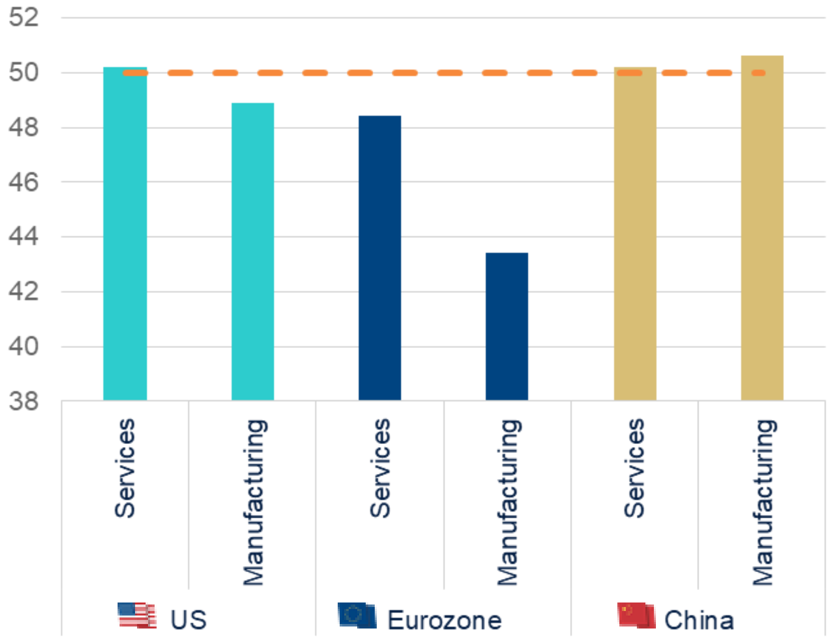
GDP: REAL GROWTH (*)
(Q/Q %)



(*) BBVA Research growth estimation for 3Q23.
Source: BBVA Research based on data from Haver.

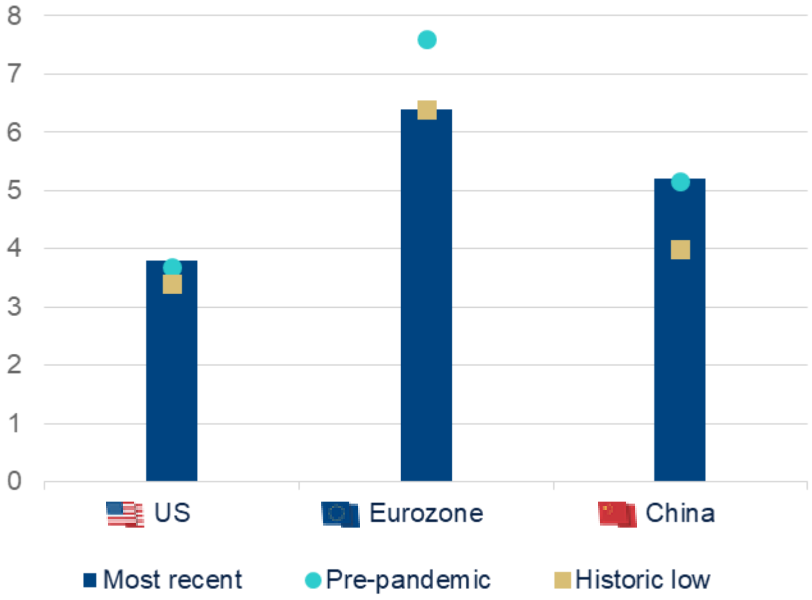
The service sector is losing some of its strength, adding to the weakness in manufacturing; labor markets remain robust despite the recent moderation

PMI INDICATORS: MOST RECENT FIGURES (*)
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



(*) Most recent data: Aug/23 in China. Sep/23 in the US and in the EZ.
Source: BBVA Research based on data from Haver.

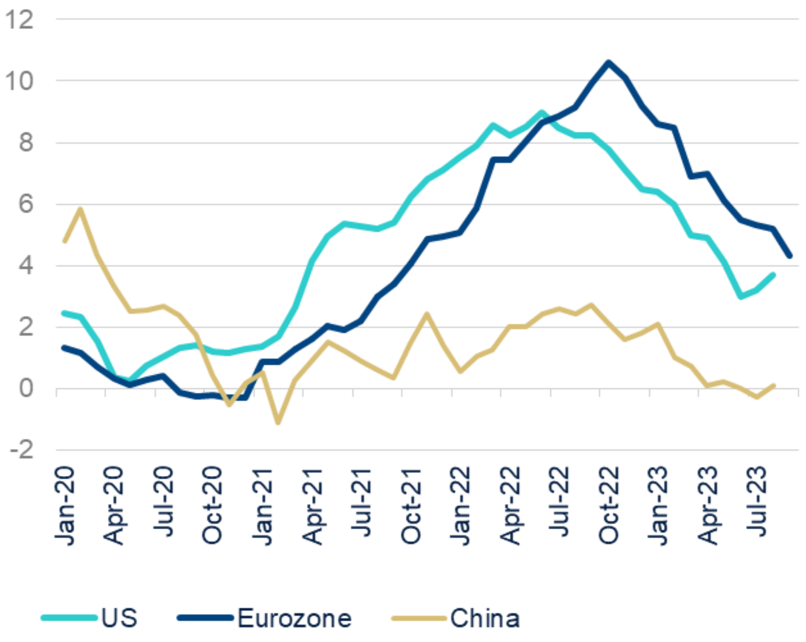
UNEMPLOYMENT RATE (*)
(% OF THE LABOR FORCE)



(*) Most recent data: Aug/23 in the US, Jul/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.

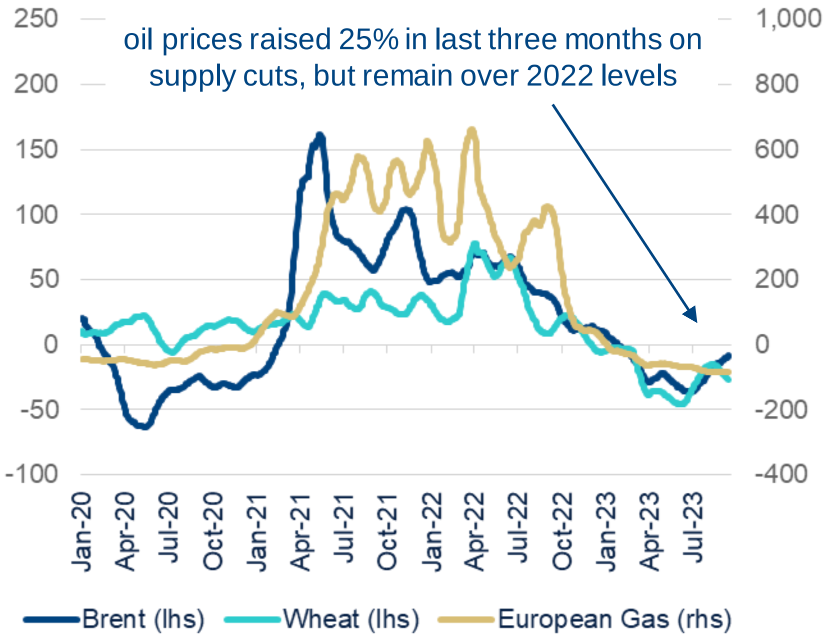
Inflation has been slowing thanks to base effects, easing of bottlenecks and declining commodity prices (despite the recent oil upward trend)

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

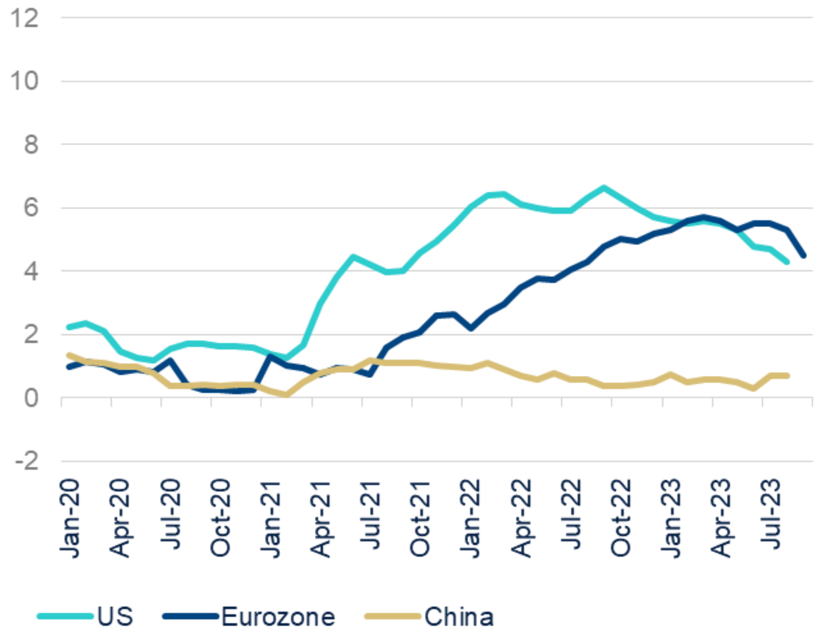
COMMODITY PRICES
(Y/Y %, 30-DAYS MOVING AVERAGE)



Source: BBVA Research based on data from Haver.

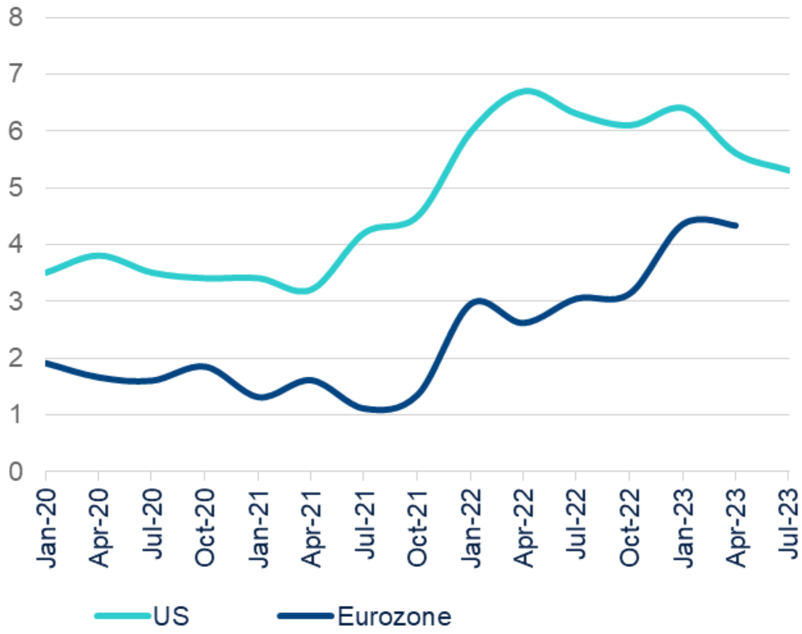
Core inflation remains sticky at high levels, also fueled by (limited) some second-round effects

CORE INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

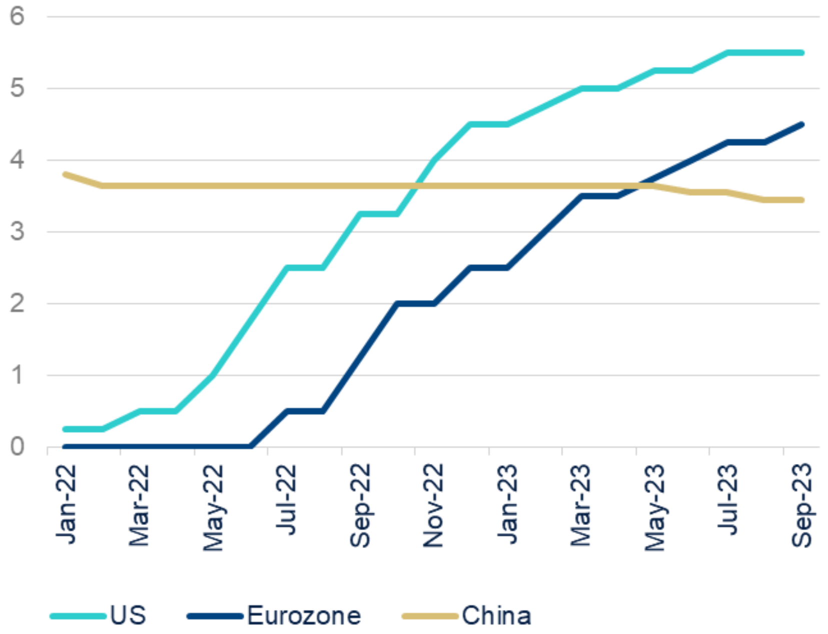
WAGE GROWTH (*)
(Y/Y %, QUARTERLY DATA)



(*) US: Atlanta Wage Tracker; 3Q23 data represents data for Aug/23 only. EZ: negotiated wages.
Source: BBVA Research based on data from the Fed and Eurostat.

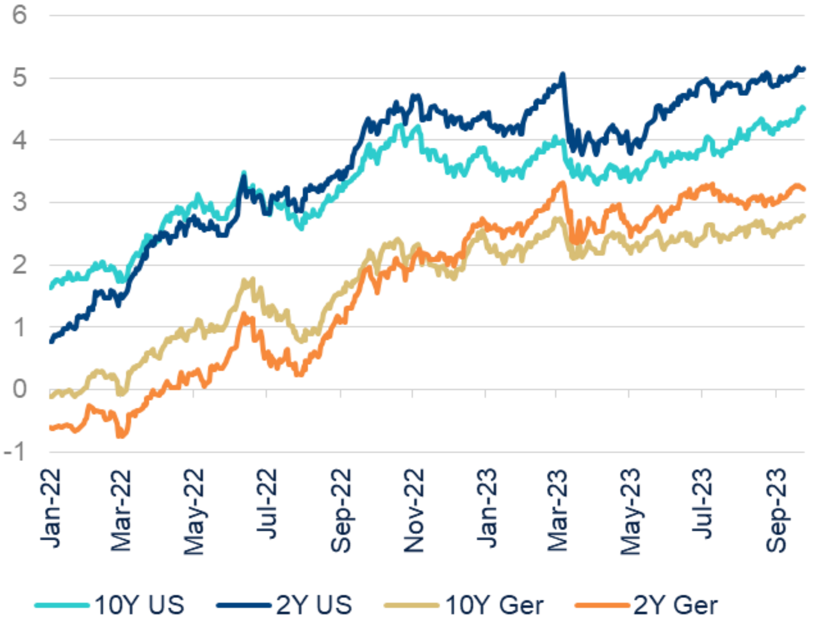
Fed and ECB rate hike cycles seem to be over, but doors are open for extra raises if inflation surprises upwards; PBoC: (small) rate cuts to back growth

POLICY INTEREST RATES (*)
(%)



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

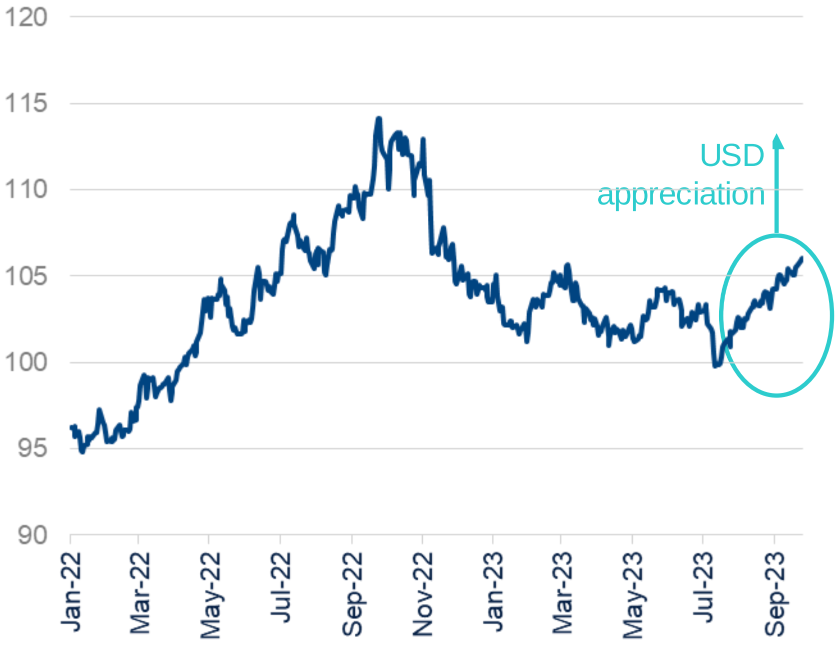
US AND GERMAN SOVEREIGN YIELDS: 2Y AND 10Y
(%)



Source: BBVA Research based on Bloomberg.

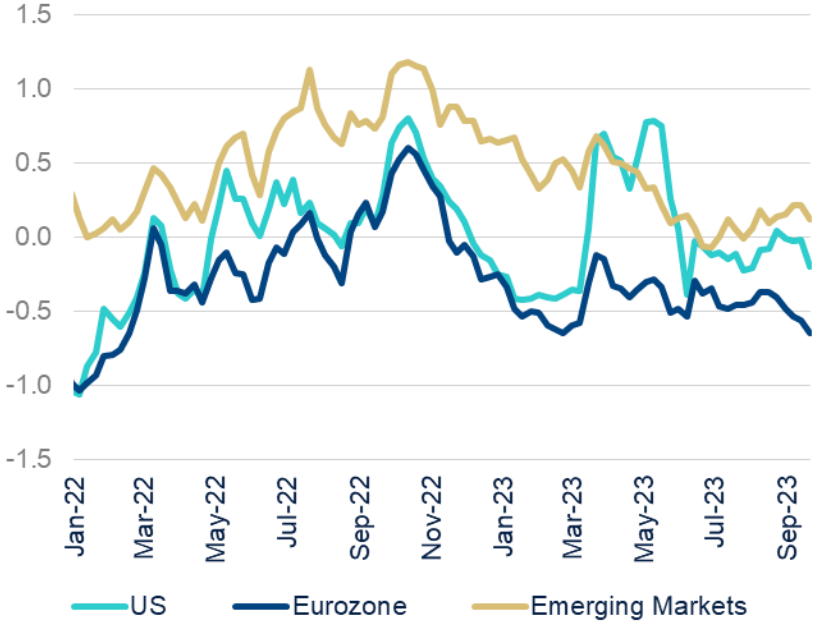
Despite higher interest rates and a stronger US dollar, financial tensions remain relatively low; the US banking turmoil has eased

US DOLLAR INDEX: DXY
(%)



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

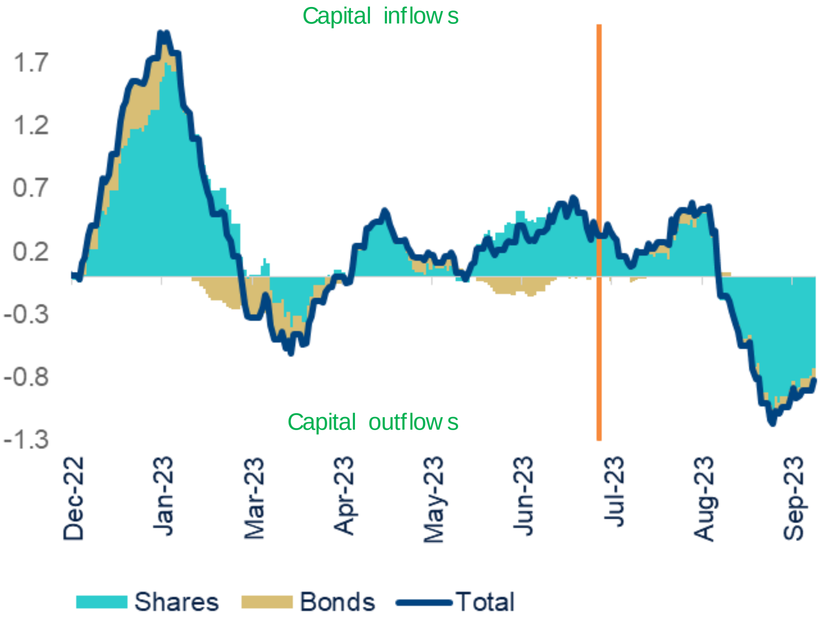
BBVA RESEARCH FINANCIAL TENSIONS INDEX
(INDEX: HISTORIC AVERAGE = 0)



Source: BBVA Research based on Bloomberg.

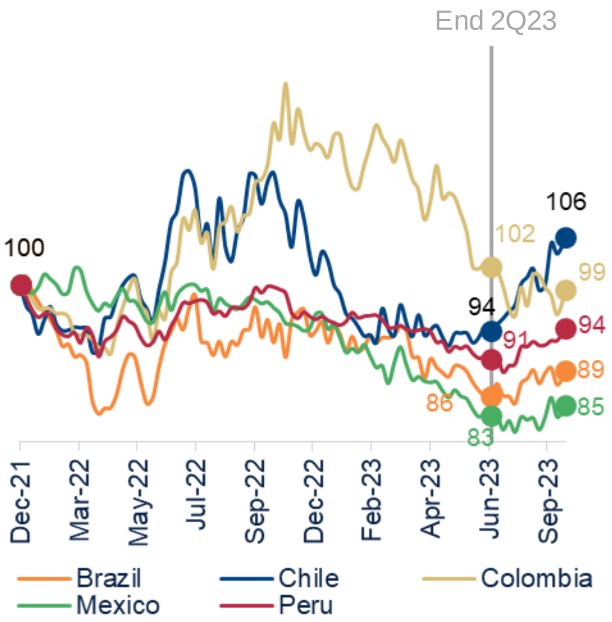
Flows to emerging markets recede, currencies in the region weaken...

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



Source: IIF (information as at September 27).

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



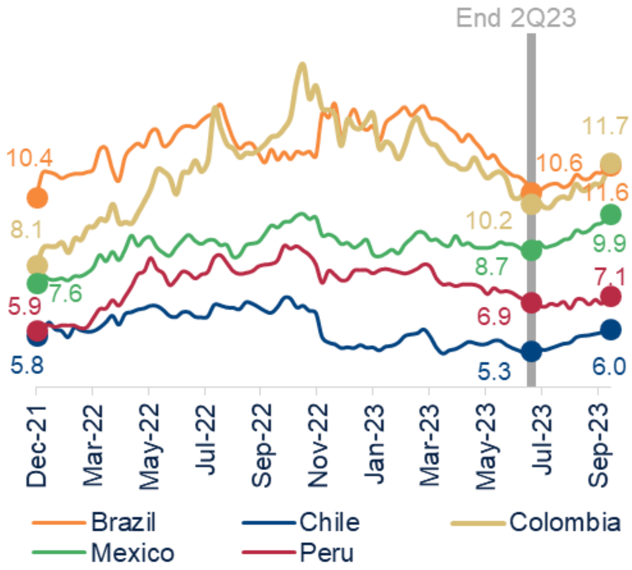
03/10/2023 vs. 30/06/2023* (%)	Accum. Year* (%)
1.1	-15.6
4.9	0.4
4.6	-7.0
13.5	7.7
6.9	-2.0

*Positive sign: depreciation.
Negative sign: appreciation

Source: Bloomberg (information as at October 3).

... and the required yield on sovereign debts increases, while in Peru, in particular, holdings of sovereigns by non-residents decrease.

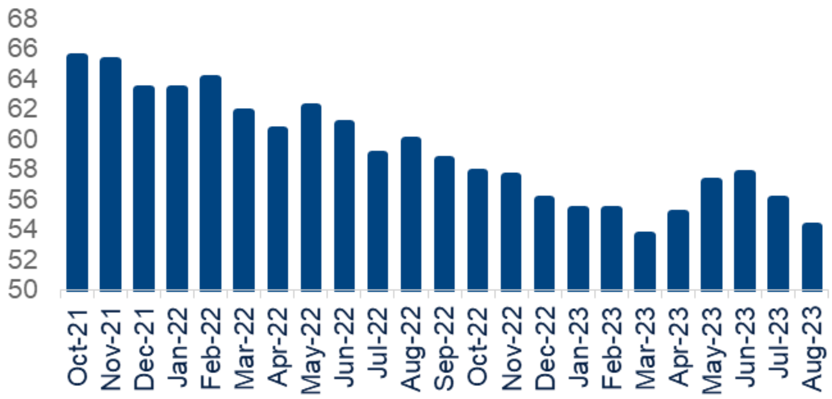
LATAM: SOVEREIGN BOND YIELDS 10 YEAR (%)



03/10/203 vs. 30/06/2023	Accum. year
(bp)	(bp)
130	96
196	-85
145	-68
55	-54
108	99

Source: Bloomberg (information as at October 3).

PERU SOVEREIGN BOND HOLDINGS BY NON-RESIDENTS (PEN BILLIONS)



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

Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Jun-23	Jul-23	Aug-23
49.4	47.8	46.0	43.5	41.1	39.1	37.9	36.6

Source: MEF

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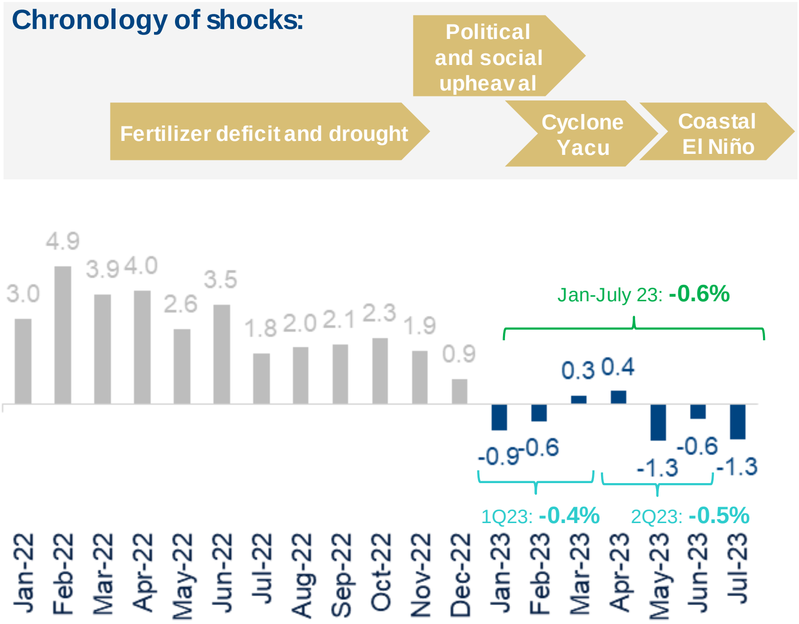
02

Local context: activity and employment

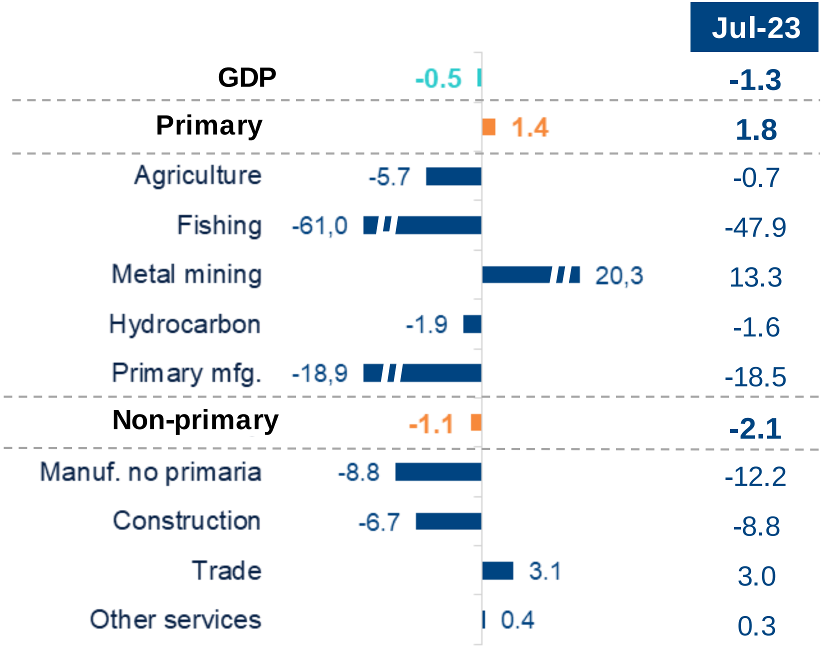
Economic activity contracted again in the second quarter of the year, in an environment of adverse weather conditions

GDP
(Y/Y % CHG.)



Source: BCRP and BBVA Research

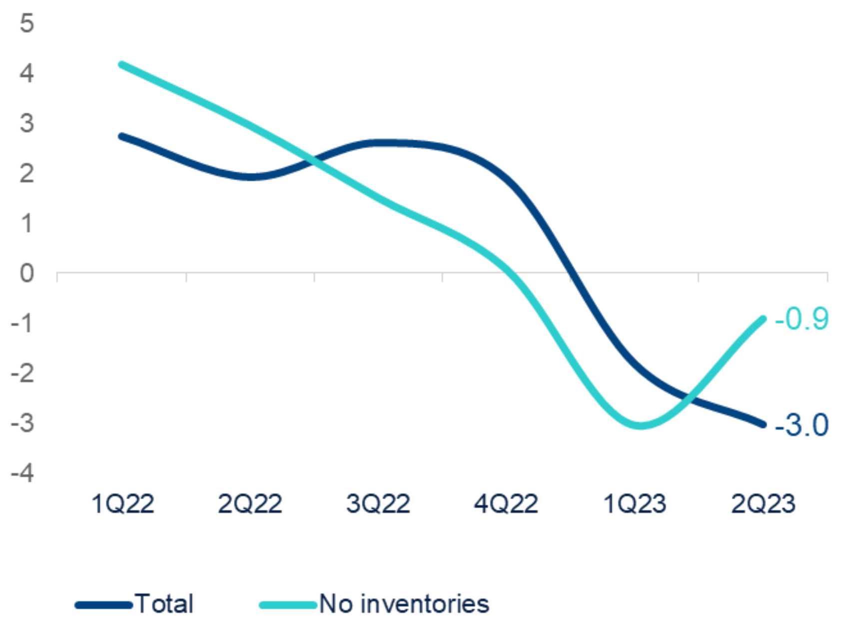
GDP BY PRODUCTIVE SECTORS IN 2Q23
(Y/Y % CHG.)



Source: BCRP and BBVA Research.

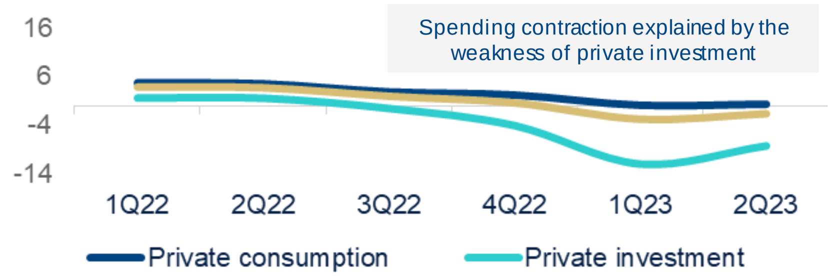
In accordance with the deterioration of non-primary sectors, domestic demand continued to fall, particularly due to lower private spending

DOMESTIC DEMAND
(Y/Y % CHG.)

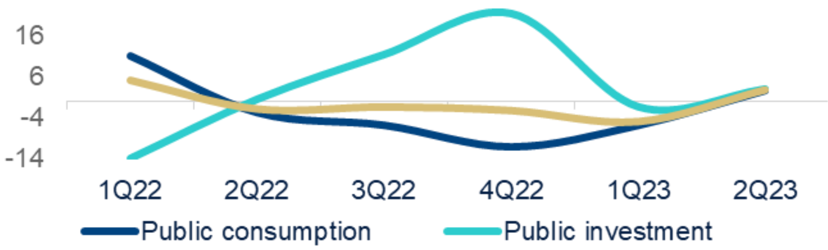


Source: BCRP and BBVA Research

PRIVATE EXPENDITURE
(Y/Y % CHG.)



PUBLIC EXPENDITURE
(Y/Y % CHG.)

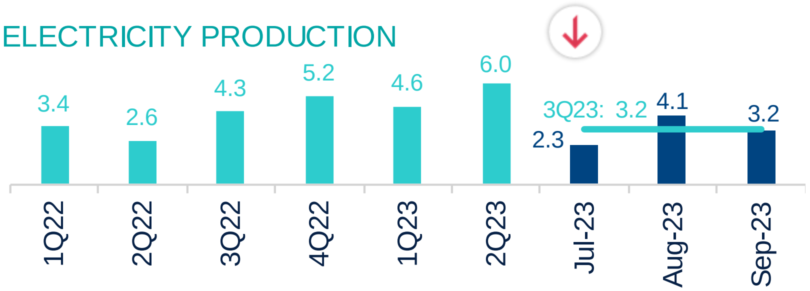


Source: BCRP and BBVA Research

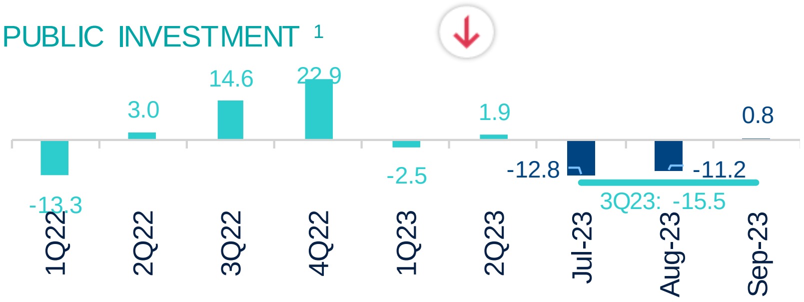
Available indicators show in balance that economic activity in the third quarter remained weak

AVAILABLE ACTIVITY INDICATORS
(Y/Y % CHG.)

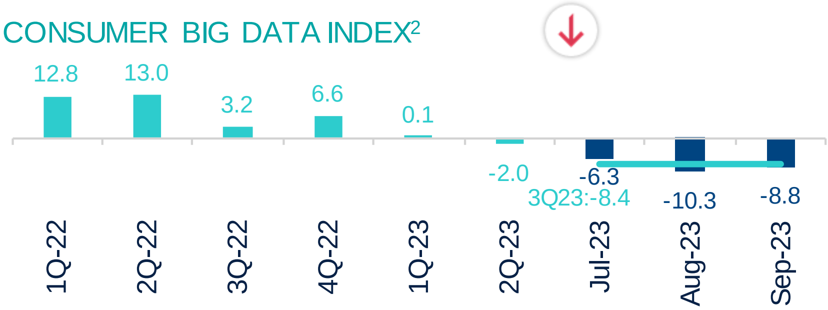
ELECTRICITY PRODUCTION



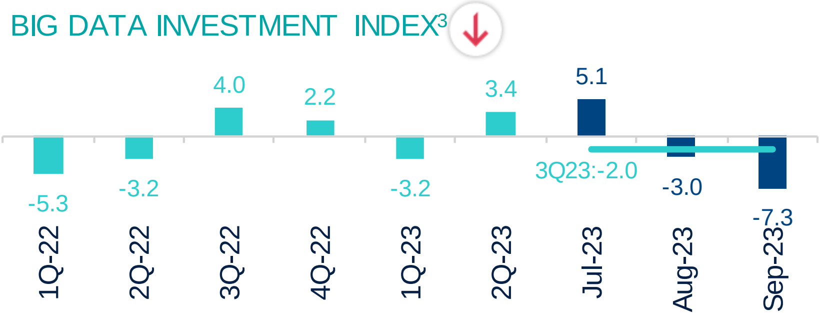
PUBLIC INVESTMENT [1]



CONSUMER BIG DATA INDEX [2]



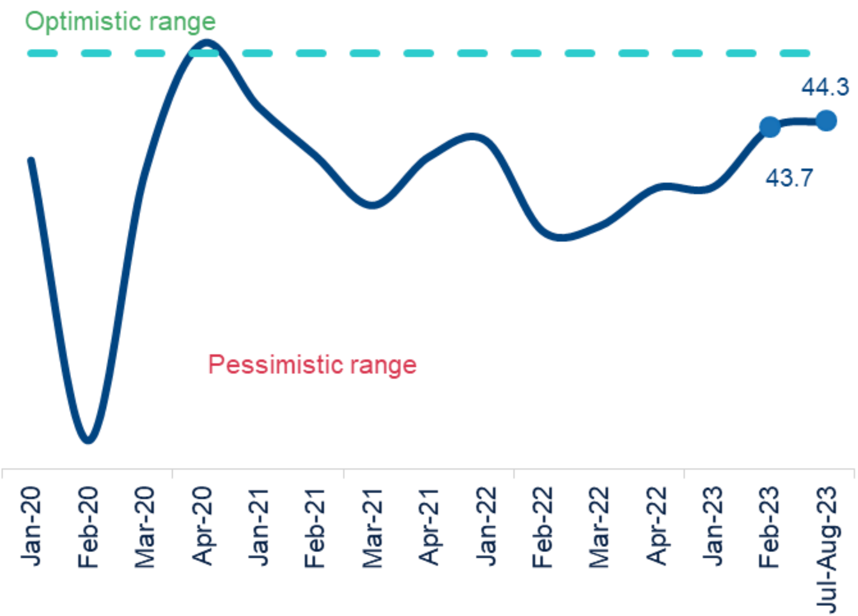
BIG DATA INVESTMENT INDEX [3]



1/ Data for September is estimated.
2/ Uses data on the amount of credit and debit card purchases made by households and cash withdrawals through ATMs and teller windows.
3/ Uses information on payments into accounts of selected companies.
Source: INEI, BBVA Research.

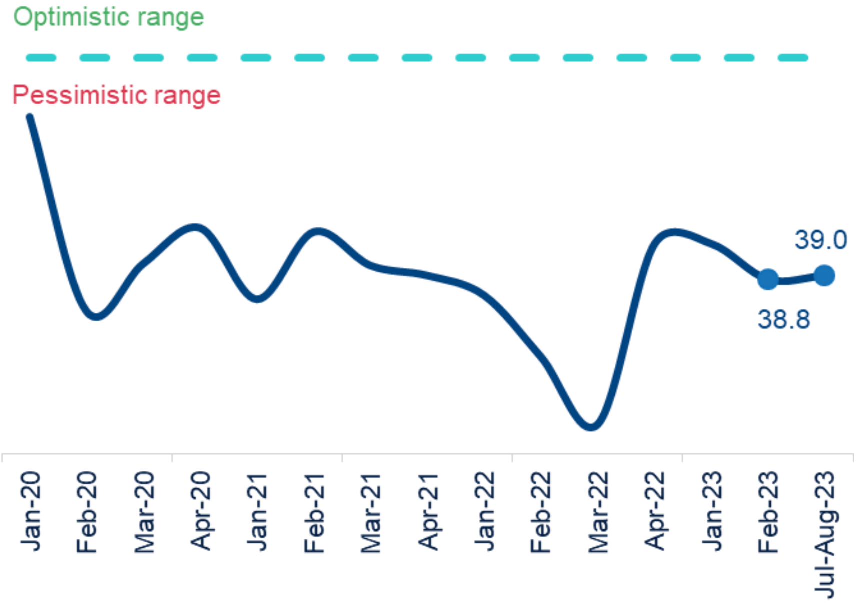
Confidence shows no major improvement in 3Q23

CONSUMER CONFIDENCE
(POINTS)



Source: Apoyo Consultoría.

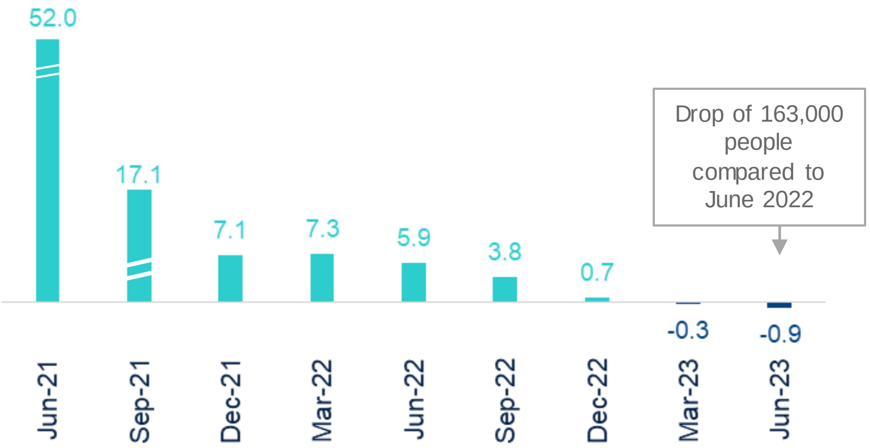
BUSINESS CONFIDENCE[1]
(POINTS)



1: Three-month economic outlook.
Source: BCRP.

In the context of weak activity, employment at the national level contracted more sharply in the second quarter of the year

EMPLOYMENT AT NATIONAL LEVEL [1]
(Y/Y % CHG., 3-MONTH MOVING AVERAGE)



(average last 3 months)

	Jun-22	Jun 23
Employed EAP (millions)	17.5	17.3
Unemployment rate (%)	4.2	5.3

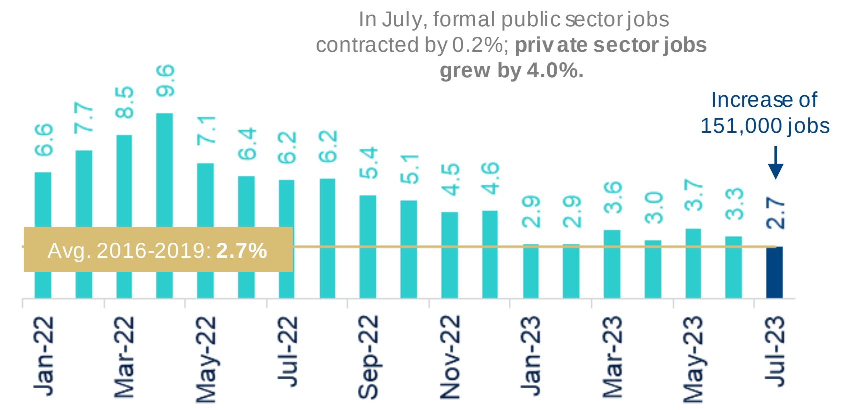
1: Until December 2022, information from the ENAHO is used; for the first and second quarters of 2023, the EPEN is used.
Source: INEI (ENAHO EPEN). Prepared by: BBVA Research

In 2Q-23:

- By sector, construction showed the largest decline (-13.1%).
- By company size, the smallest (1 to 10 workers) were the most affected.
- By worker characteristics, the segments of younger and less educated workers showed the largest declines.
- By quality of employment, the underemployment rate remained around 49%, while the informal employment rate experienced a slight reduction from 73.5% to 72.7% compared to the first quarter.

The creation of formal jobs continued at around 3.0% year-on-year, while the average wage (adjusted for inflation) continued to fall

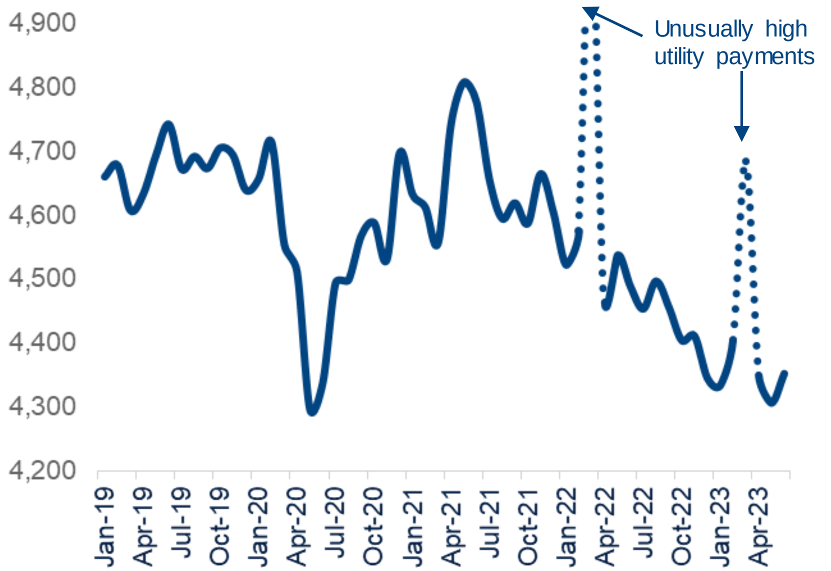
NATIONAL FORMAL EMPLOYMENT
(Y/Y % CHG.)



(MILLIONS OF FORMAL JOBS)

Jul-19	Jul-20	Jul-21	Jul-22	Jul-23
5.2	4.9	5.2	5.5	5.7

MONTHLY INCOME FROM FORMAL EMPLOYMENT, ADJUSTED FOR INFLATION [1]
(SEASONALLY ADJUSTED, SOLES AT JUL-23)



1: In July 2023, the average income of a formal job was PEN 4,385 (PEN 2,849 in June 2023), which includes bonuses. For the graph, the original income series has been seasonally adjusted to smooth the peaks in March (profit payments), July and December (bonus payments). The series has been normalized so that the latest data (July 2023) matches the nominal monthly income for the month.
Source: SUNAT (Spreadsheets) and BCRP. Prepared by: BBVA Research.

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03

Global economy forecasts

Global growth is likely to soft land while monetary policy will remain restrictive for a longer than usual period to help inflation ease towards targets

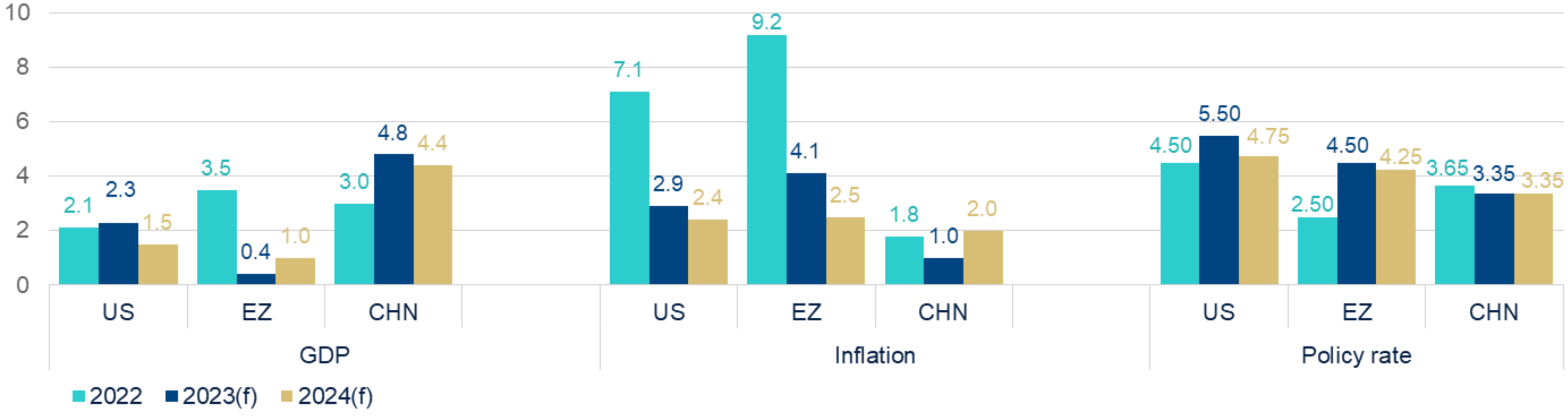
BBVA RESEARCH BASELINE SCENARIO: GDP GROWTH, INFLATION AND POLICY INTEREST RATES (*)

(GDP GROWTH: %, INFLATION: YOY %, EOP, POLICY INTEREST RATES: %, EOP)

Global growth: from 3.5% in 2022 to 2.9% (+0.0pp) in 2023 and 3.0% (+0.1pp) in 2024

Inflation will remain high, but will trend down as demand weakens and given no extra supply shocks

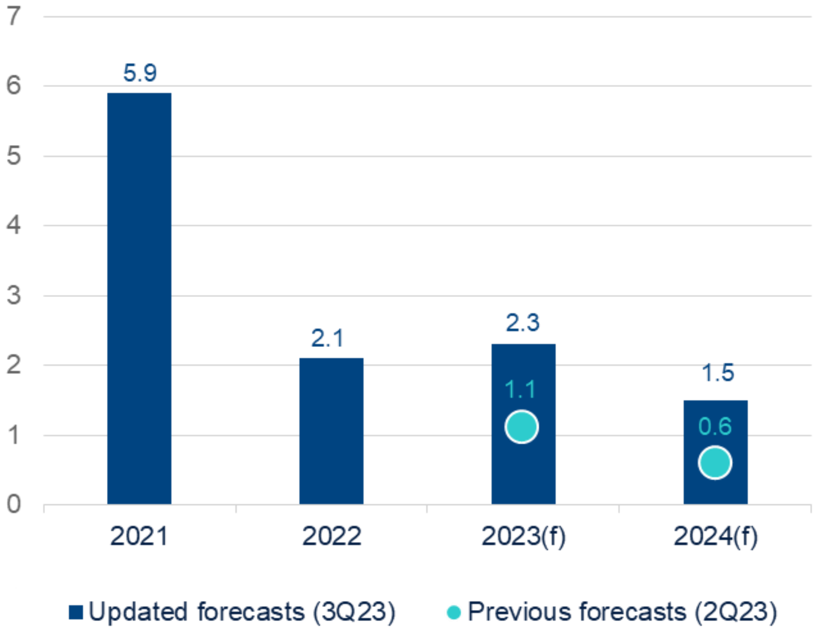
Monetary tightening cycle is likely over in the US and the EZ, but rate cuts are not around the corner



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

US: growth resilience signs make a recession unlikely ahead, postponing the prospects for the beginning of the easing cycle to mid-2024

US: GDP GROWTH
(%)

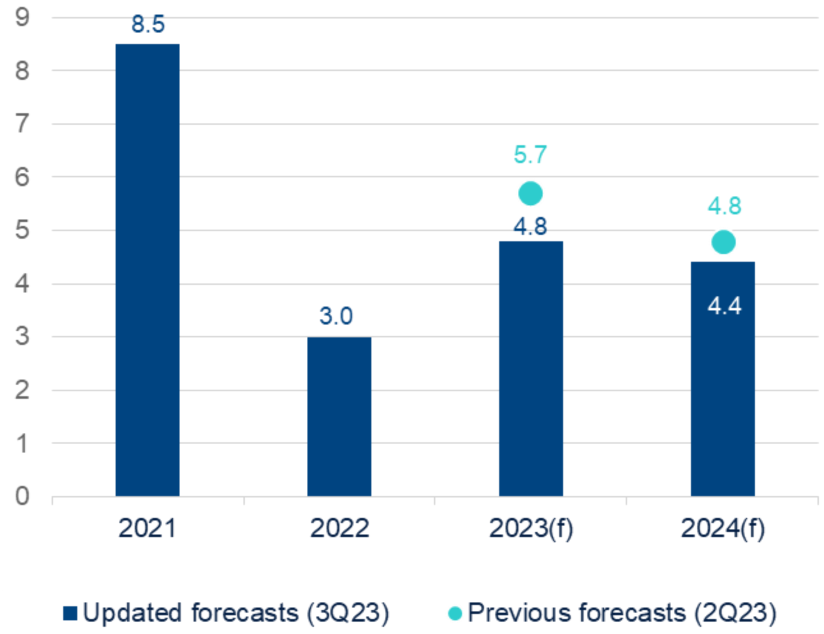


(f): forecast.
Source: BBVA Research

- GDP forecasts revised up on robust domestic demand: solid consumption and resilient investment (boosted by housing market recovery as well as IRA and CHIPS acts).
- Inflation expected to reach 2.9% in Dec/23 and 2.4% in Dec/24; upside risks are still relevant.
- Fed: inflation improvement will prevent extra rate rises (but a hike is still possible in 4Q23); an easing cycle from Jun/24 is likely to take rates to 4.75% in Dec/24.
- Risks: a recession or financial stress on tight monetary conditions and persistent inflation, presidential elections.

China: prospects deteriorated significantly and risks increased given increasing structural challenges, but a gradual growth slowdown is still likely

CHINA: GDP GROWTH
(%)

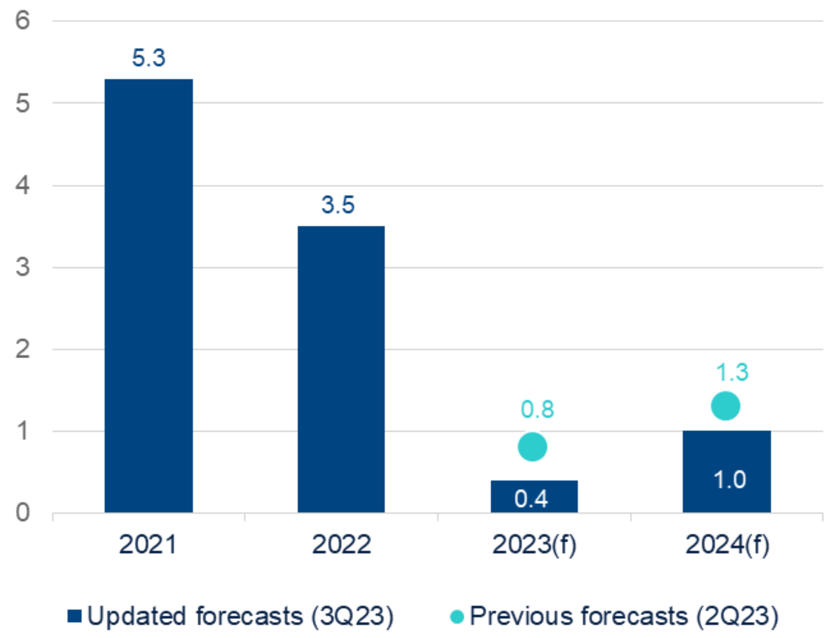


(f): forecast.
Source: BBVA Research

- Generalized deceleration on weak confidence, real estate crunch, 2021 "regulatory storms" and global slowdown.
- Still, the most likely scenario is that further targeted monetary, fiscal and regulatory measures sustain growth and drive inflation up.
- Although a soft-landing is still expected, GDP forecasts have been revised down on incoming data and a costly (but controlled) addressing of real estate imbalances.
- Structural challenges: balance-sheet recession and deflation, US-China confrontation, middle-income trap, unfavorable demographics, etc.

Eurozone: persistent inflation, despite weaker GDP growth, is likely to force the ECB to maintain policy rates at restrictive levels for long

EUROZONE: GDP GROWTH
(%)



(f): forecast.
Source: BBVA Research

- Growth revised down on incoming data amid a deceleration of China, whose effects will be mostly offset by higher US growth.
- Fiscal policy is still supportive, but will likely become more targeted and less expansionary onwards.
- Average inflation forecasts revised up: 5.7% in 2023, 3.0% in 2024 on service stickiness, rebound in oil prices.
- ECB: rates are likely to remain at current levels until Dec/24; increasing focus on liquidity reduction measures.
- Risks: higher energy prices, more persistent inflation, stagflation, China's deceleration.

Risks: the soft-landing scenario could be potentially derailed by problems in China and the effects of the still high inflation and interest rates

MAIN RISKS

Recession and financial stress on tight monetary conditions

- mainly under more persistent inflation (on labor tightness, second-round effects, higher energy prices, etc.)

A hard-landing in China

- due to real estate problems, low confidence, US-China confrontation, deflation, etc.
- potential financial spillovers

MAIN UNCERTAINTIES

- **Geopolitical and political tensions**
- **US-China rivalry and deglobalization**
- **Climate change and energy transition**
- **Social tensions and populism**

04

Peru economy forecasts

4.1 Economic activity

Base scenario for the second half of 2023 and for 2024: key considerations

Forecast deteriorates — Forecast improves — Forecast remains the same

1. Negative surprise in Q2

New GDP contraction in the second quarter (0.5%): adverse weather conditions affected the agricultural and fishing sectors. In addition, various non-primary activities showed sustained weakness.

GDP in the second quarter came in below the June estimate (equivalent to a three-tenths of a percentage point cut in the forecast for the year).

2. Adverse weather conditions

Deterioration of forecasts with respect to what was considered three months ago (June): Coastal El Niño with strong magnitude even until November; it will reach moderate intensity in the first quarter of 2024.

3. Public expenditure related to El Niño

In 2023: public expenditure for prevention efforts equivalent to 0.3 pp of GDP has been considered. No change with respect to previous baseline scenario.

In 2024: expenditure for emergency response, rehabilitation, and reconstruction will be higher by the equivalent of 0.2 pp of GDP with respect to the previous forecast (because El Niño will have more sensitive impacts).

4. Increased mining production (Quellaveco)

Between January and July, mining production grew by 12%, supported by the contribution of copper (20%).

Quellaveco's production reached full operating capacity ahead of schedule.

Normalization of some mines due to less social conflict in the sector.

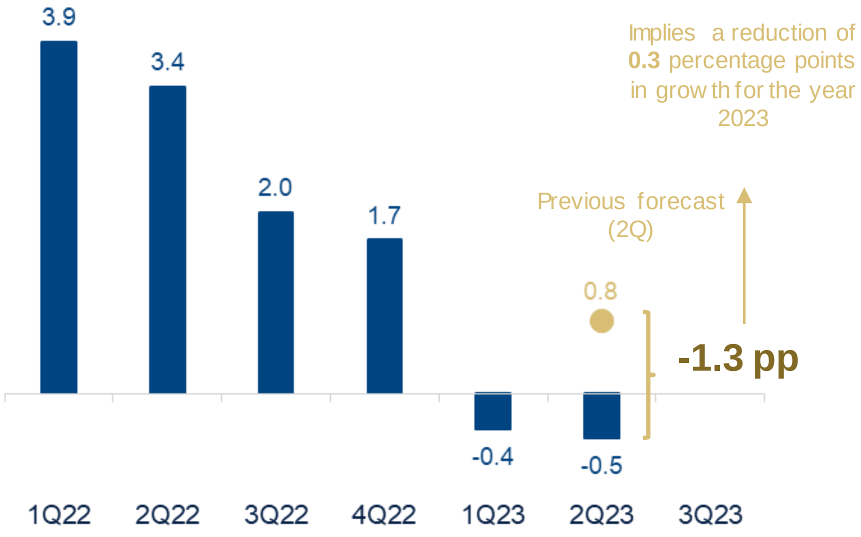
5. Relatively stable political context

Fragile state of calm in the political environment.

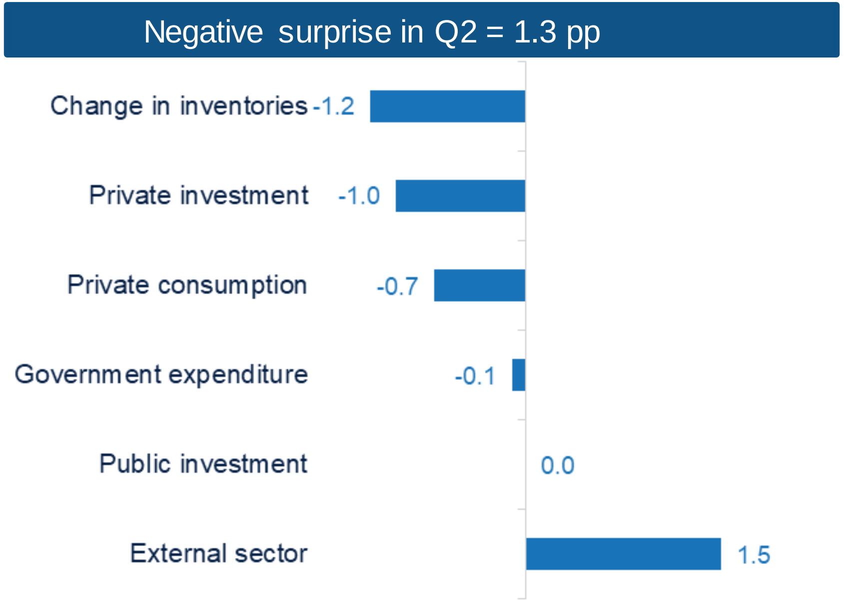
Similar scenario to the one predicted three months ago.

1 Negative surprise in the second quarter, due to inventory cuts and lower private spending

GDP
(Y/Y % CHG.)



CHANGE IN GDP GROWTH FORECAST Q2
(CONTRIBUTION TO GROWTH, PP)

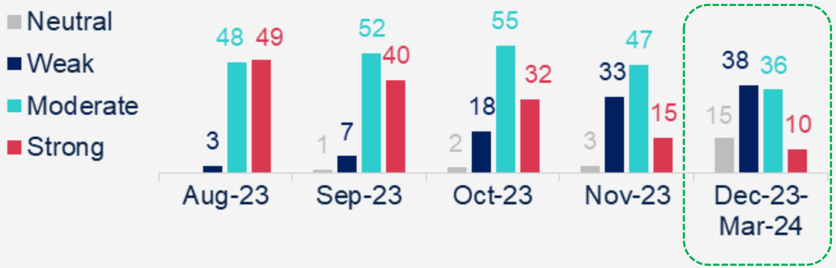


Source: BCRP and BBVA Research

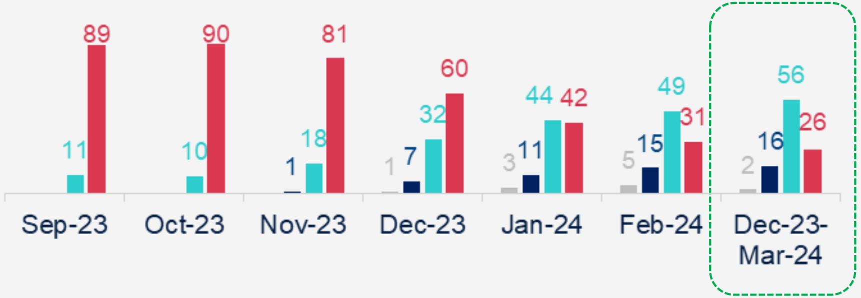
2 Forecasts for the El Niño Phenomenon (FEN) suggest greater intensity for the remainder of the year and the first quarter of 2024...

COASTAL EL NIÑO | PROBABILITY OF OCCURRENCE BY MAGNITUDE (%)

SCENARIO IN JUNE 2023



SCENARIO IN SEPTEMBER 2023



Source: ENFEN.

EL NIÑO GLOBAL | PROBABILITY OF OCCURRENCE ACCORDING TO MAGNITUDE, FOR THE BEGINNING OF 2024 (%)

SCENARIO IN JUNE 2023

	ENFEN (for Dec23-Mar24)
- / Weak El Niño	**56**
Moderate El Niño	38
Strong El Niño / +	6

SCENARIO IN SEPTEMBER 2023

	ENFEN (for Dec23-Mar24)
- / Weak El Niño	13
Moderate El Niño	**51**
Strong El Niño / +	36

Source: ENFEN.

Source: ENFEN

2 ... which will imply an excess of rainfall in the coastal areas of the north and center of the country, and droughts in the Andean south

EL NIÑO: MAIN IMPACTS AT GEOGRAPHICAL LEVEL

Source: BBVA Research and BCRP.

EL NIÑO: MAIN IMPACTS AT SECTORAL LEVEL

Agriculture — 7% of GDP

- Affects the flowering of fruit trees.
- Increased presence of pests.
- Loss of crop areas due to flooding.
- Lower poultry production due to animal dehydration.

Transport and trade — 16% of GDP

- Limitation of freight and interprovincial transport due to road damage, which hinders trade.

Fishing — 1% of GDP

- Reduced availability of anchovy due to the deepening of the species, displacement to the south, and less food. Alterations in its reproductive cycle.

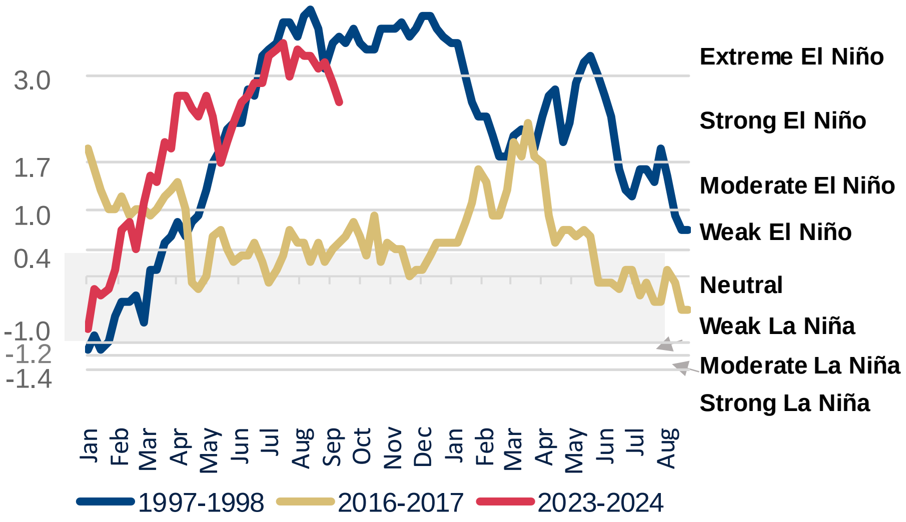
Manufacturing — 12% of GDP

- Lower production of fishmeal and fish oil, associated with less fishing activity.
- Road closures slow down production by preventing the transfer of inputs.
- Damage to factories and stoppages.
- Lower demand for some products (e.g., textiles).

2 The pattern followed by the current El Niño is so far very similar to that of the 1997/98 El Niño, which had an impact of 2.2 pp on GDP

SURFACE SEA TEMPERATURE ANOMALY ON THE NORTHERN PERUVIAN COAST

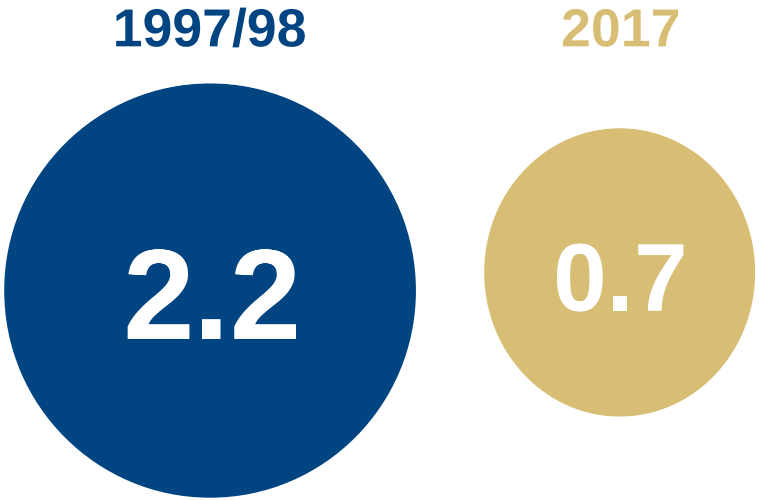
(DEGREES CELSIUS, WEEKLY MOVING AVERAGE)



Source: NOAA and ENFEN

NEGATIVE IMPACT OF EL NIÑO ON GDP

(PERCENTAGE POINTS)



The impact on GDP will ultimately depend on the intensity of the weather phenomenon, its duration, and the prevention, emergency care, and rehabilitation/reconstruction work carried out.

Source: Macroconsult (based on INDECI and BCRP data) and BBVA Research.

3 Public expenditure related to the El Niño phenomenon (FEN)

“Con Punche Emergency 2023" *

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

Immediate emergency response

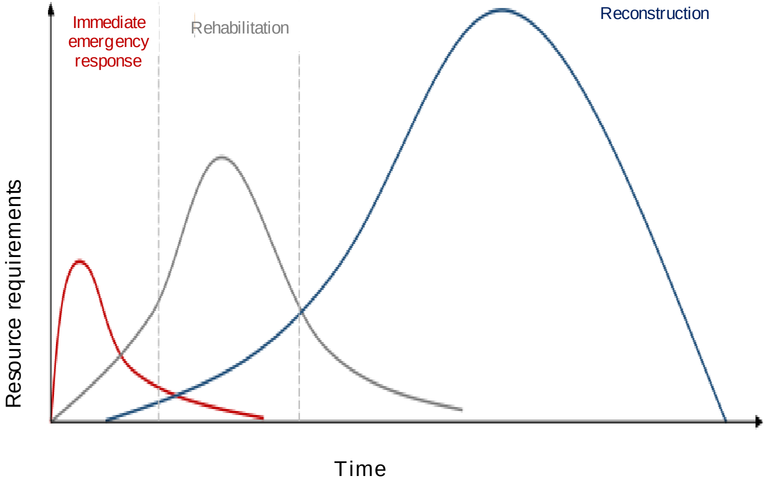
Prevention, protection and resilience of infrastructure

Measures for the recovery of productive capacity

- **Progress: as of October, 2,4 billion soles have been allocated, of which 13% has been executed (source:** MEF).

- **In 2024:** greater expenditure (+0.2% of GDP) on rehabilitation and reconstruction is assumed compared to the June forecast; this scenario considers a more intense coastal El Niño in the summer of next year.

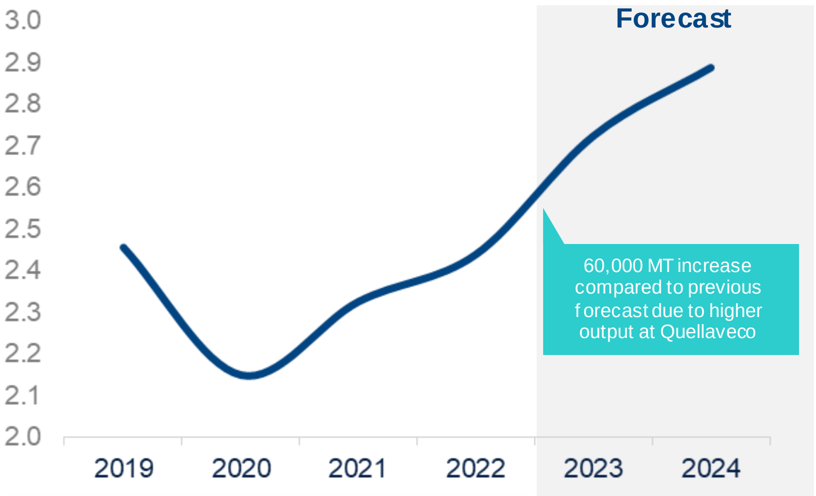
FINANCING NEEDS IN THE EVENT OF A NATURAL DISASTER



Source: World Bank, Swiss Cooperation and Ministry of Economy and Finance. "Peru: A Comprehensive Strategy for Financial Protection against Natural Disasters", 2016

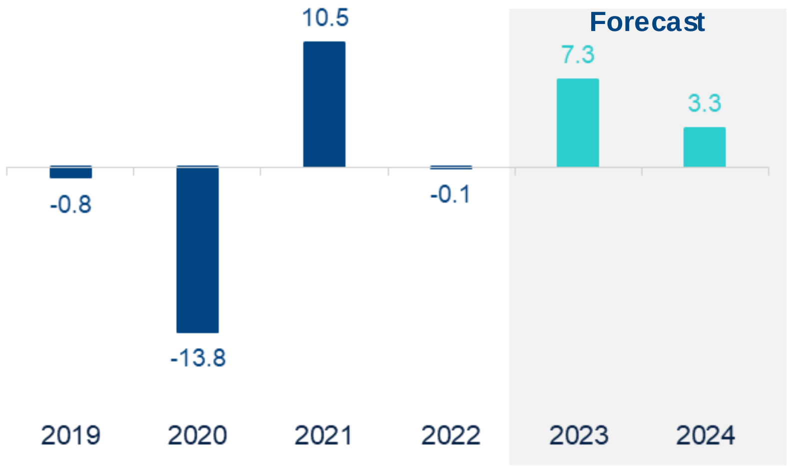
4 Quellaveco reaches full production capacity faster than expected in June, giving mining a boost

COPPER OUTPUT
(MILLIONS OF MT)



The direct impact of Quellaveco on the 2023 GDP growth rate would be between 0.5 and 0.6 percentage points.

METAL MINING
(ANNUAL % CHG.)



Quellaveco explains mining expansion this year; in 2024, output improves due to lower incidence of social conflicts

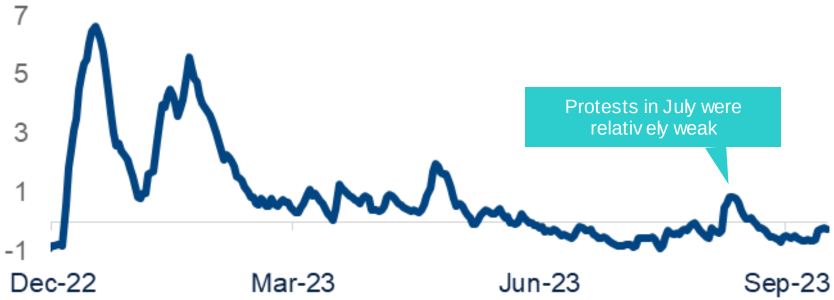
Source: MINEM, BCRP, and BBVA Research.

5 On the political side, the Boluarte administration stabilizes, although the situation remains fragile

FACTORS INFLUENCING THE RELATIVE STABILIZATION OF DINA BOLUARTE'S GOVERNMENT

- Support of Congress ✓
- Protests ✓
- Tax investigations ✓
- Public opinion (presidential approval: 16%) ✗

POLITICAL TENSIONS INDICATOR
(INDEX, 28-DAY MOVING AVERAGE)



INTERNATIONAL ACCEPTANCE


Cancillería Perú
@CancilleriaPeru

Con ocasión del 202° aniversario patrio, en misiva enviada a la señora Presidenta de la República Dina Boluarte, @POTUS Joseph Biden reafirmó su voluntad de continuar profundizando la asociación entre nuestras naciones, construyendo un crecimiento económico integrador.

Source: Macroconsult.

Have we hit rock bottom yet? GDP weakness is persistent; it is likely that a recovery trend will only be seen after El Niño

WHAT WILL THE RECOVERY LOOK LIKE?

V

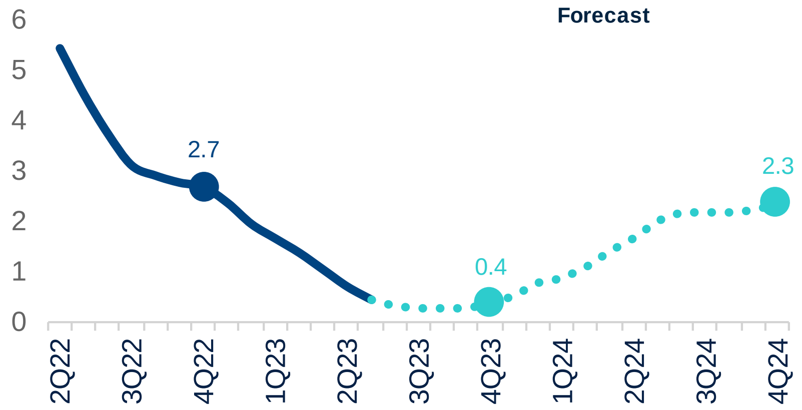
- ❑ Rebound and quick exit
- ❑ Supply shocks dissipate and leave no lingering impacts.

- ❑ Limited recovery
- ❑ An environment with a slowdown in private spending (without major savings that can provide support) and limited fiscal space.

L

- ❑ The economy is stagnating due to persistent supply shocks and other factors that negatively affect demand: tighter financial conditions, low investment and job creation, deterioration of private balance sheets due to NFE, etc.

GDP
(% Y/Y CHG., AVERAGE LAST 12 MONTHS)



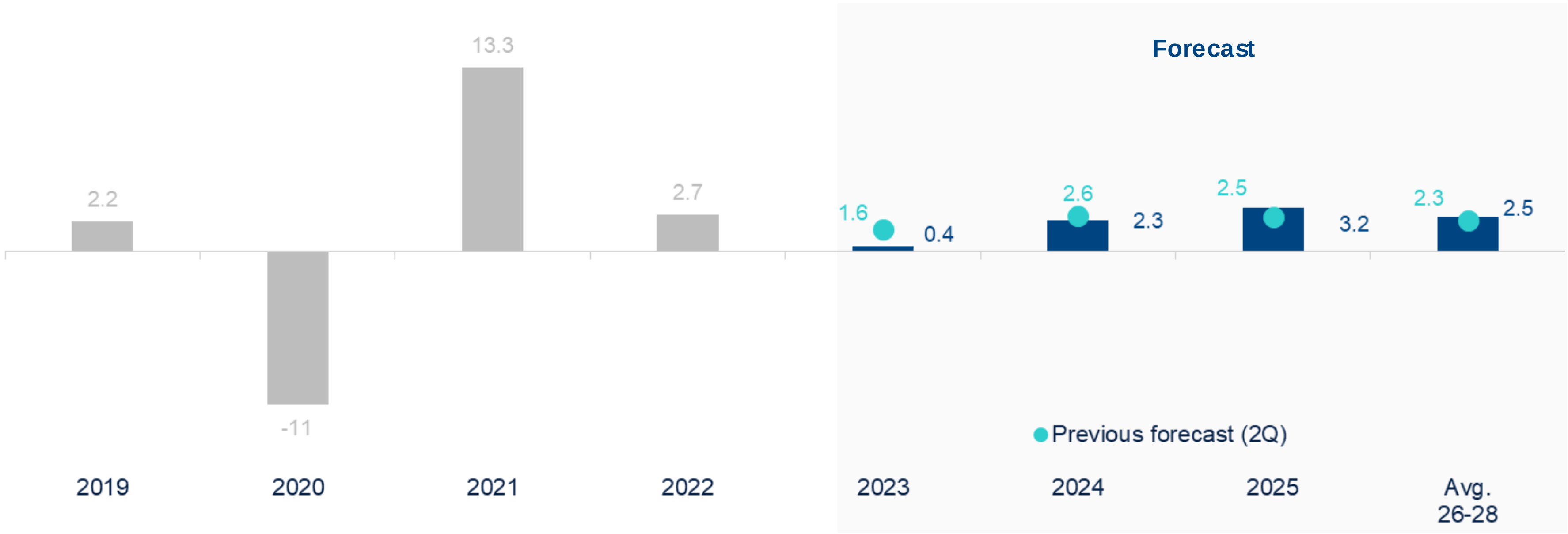
SEASONALLY ADJUSTED GDP
(CHG % QUARTER-ON-QUARTER)

1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24
-1.3	0.3	1.3	1.6	-1.5	1.3	0.9	1.8

Source: BCRP and BBVA Research (forecasts)

Balance of all these factors: downward revision of growth forecasts for 2023 and 2024, with rebound in 2025 (supply shock dissipates)

GDP (CHG. % Y/Y)

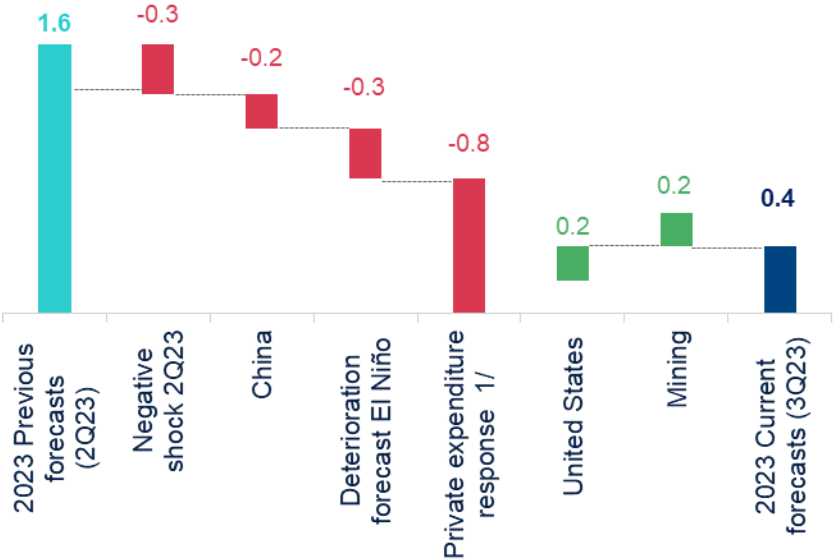


Source: BCRP and BBVA Research (forecasts)

Balance of all these factors: downward revision of growth forecasts for 2023 and 2024, with rebound in 2025 (supply shock dissipates)

BREAKDOWN OF THE CHANGE IN THE GROWTH FORECAST IN 2023

(PERCENTAGE POINTS)

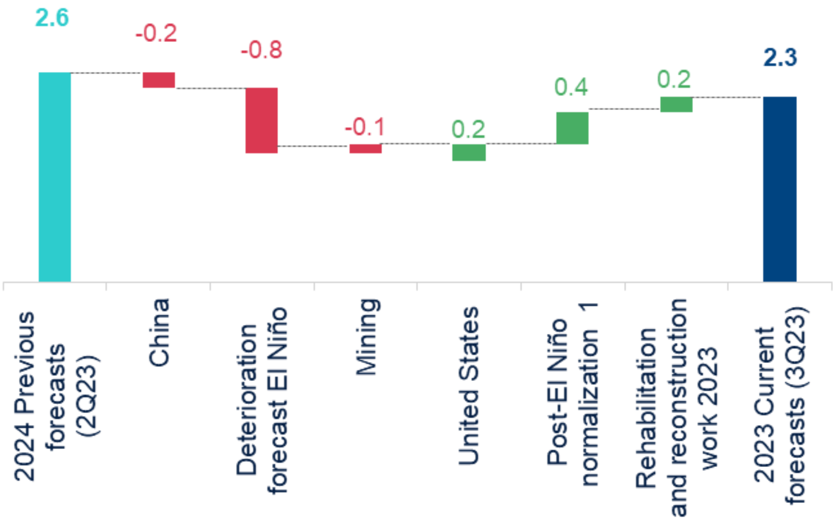


1/ More sensitive response of private spending to the environment of high inflation, high interest rates, absence of additional releases of funds (AFP, CTS), expectation of an El Niño phenomenon of considerable magnitude in the coming months, and weak business confidence (in the short term).

Source: BCRP and BBVA Research (forecasts)

BREAKDOWN OF THE CHANGE IN THE GROWTH FORECAST IN 2024

(PERCENTAGE POINTS)

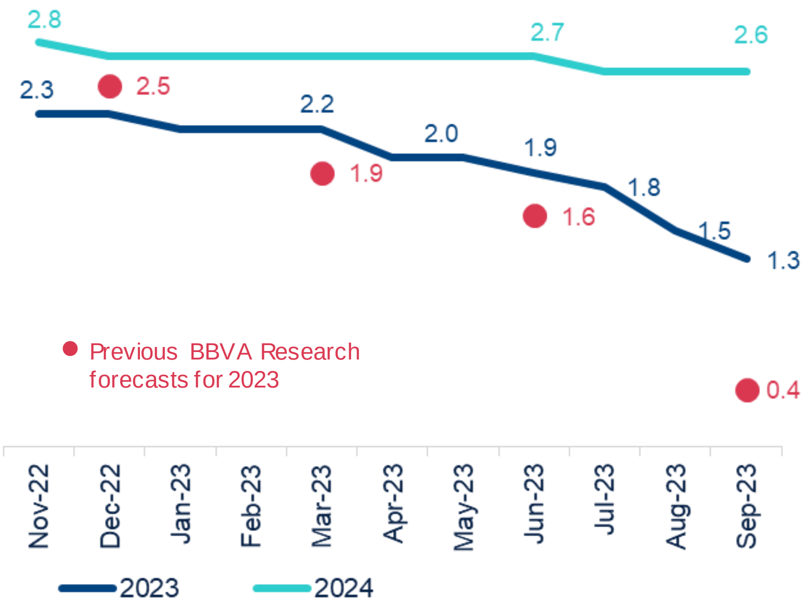


1/ Year-on-year normalization in 2H24 following a stronger El Niño in the second half of 2023.

Source: BCRP and BBVA Research (forecasts)

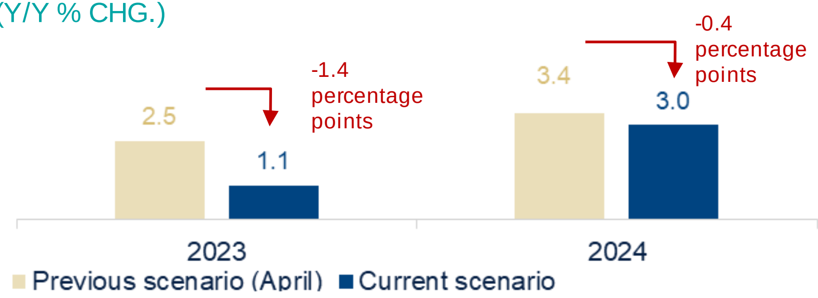
Authorities' growth forecasts and analysts' consensus have been adjusted downward throughout the year

ANALYST CONSENSUS | FORECASTS FOR GDP GROWTH IN 2023 AND 2024
(Y/Y % CHG.)

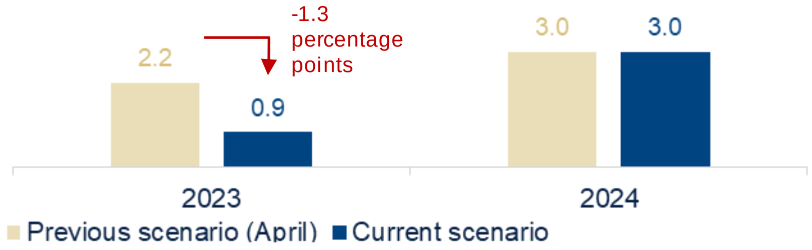


Source: Latin Focus Consensus Forecast and BBVA Research

MEF FORECASTS
(Y/Y % CHG.)



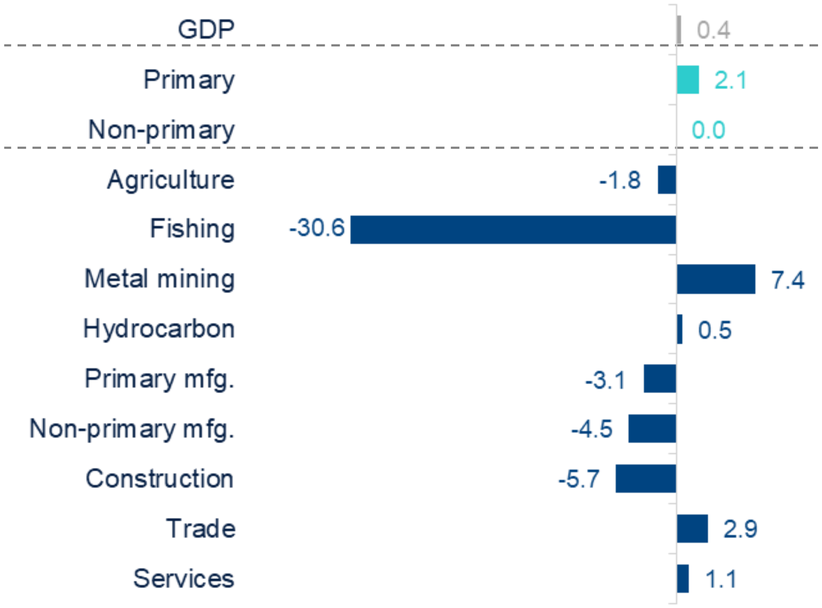
BCRP FORECASTS
(Y/Y % CHG.)



Source: Finance Ministry (MEF) and Central Bank (BCRP)

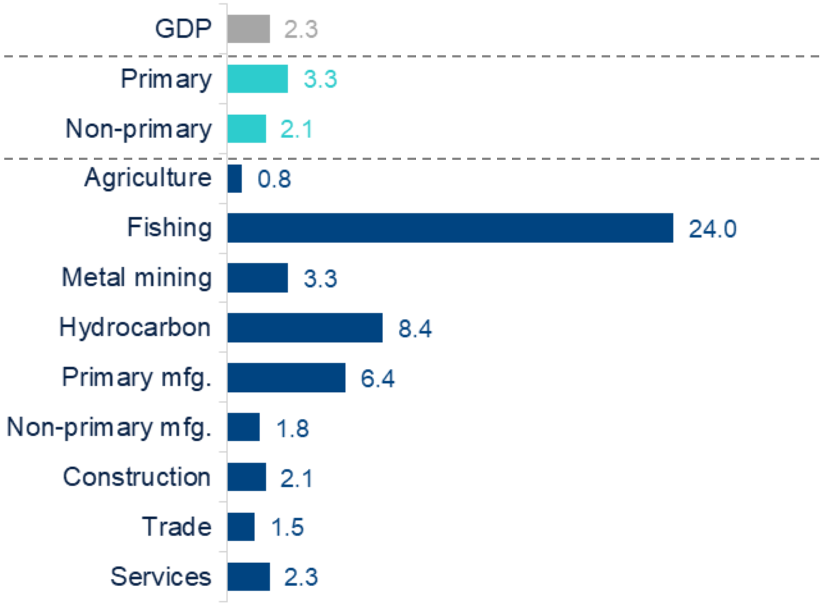
By sector, the performance of Metal Mining will stand out in 2023 and 2024, and Fishing is expected to recover next year.

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



Source: BBVA Research.

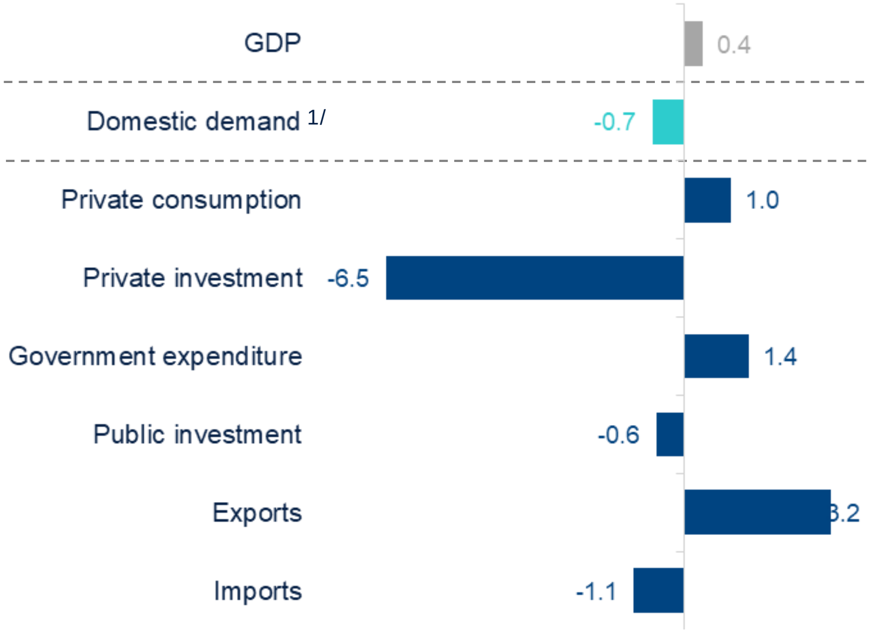
2024: SECTORAL GDP FORECAST
(Y/Y % CHG.)



Source: BBVA Research.

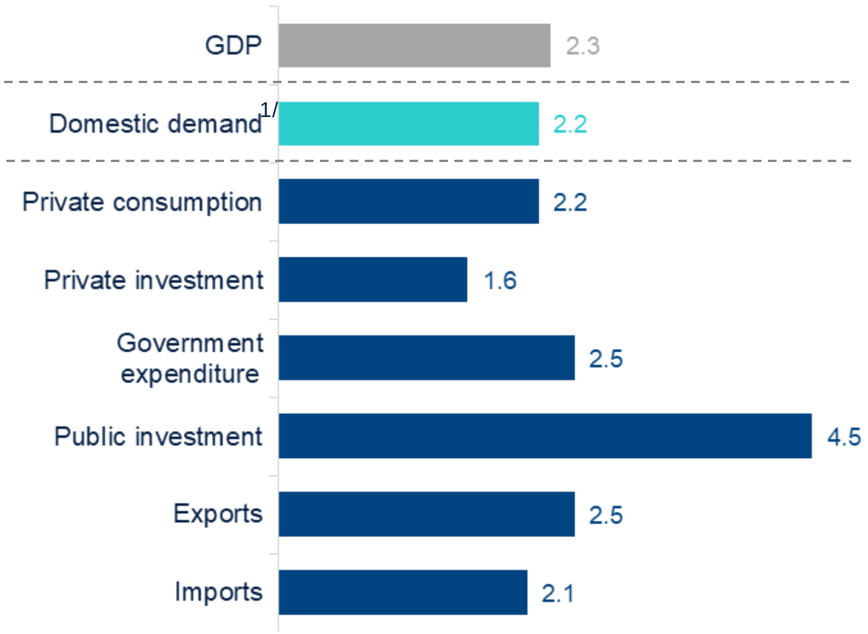
On the expenditure side, exports will reflect a better performance of mining in 2023 and 2024. Private investment will decline this year

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



1: Inventories not included.
Source: BBVA Research.

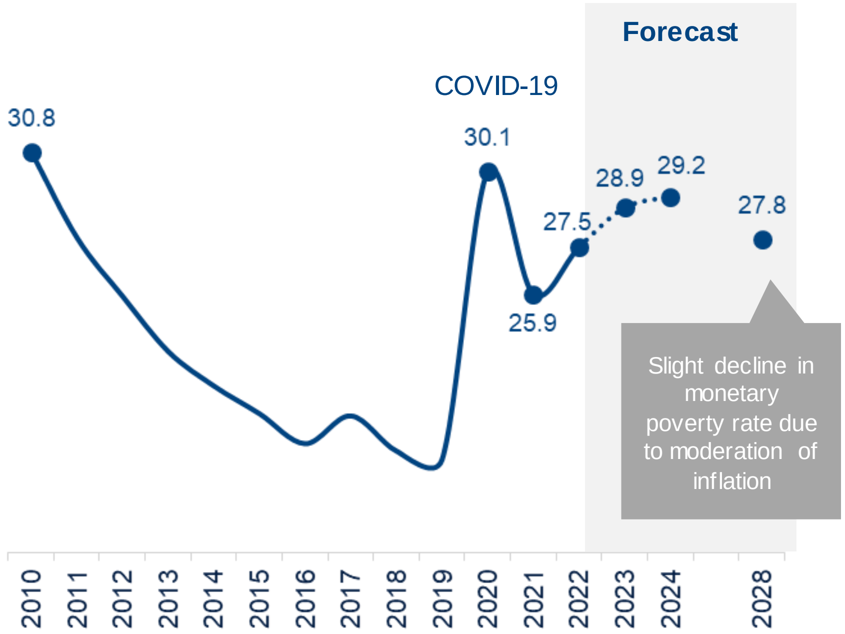
2024: EXPENDITURE-SIDE GDP FORECAST (Y/Y % CHG)



Source: BBVA Research.

We estimate that poverty will increase in 2023 and 2024, in a context of low GDP growth and rising food prices

MONETARY POVERTY
(% OF POPULATION)

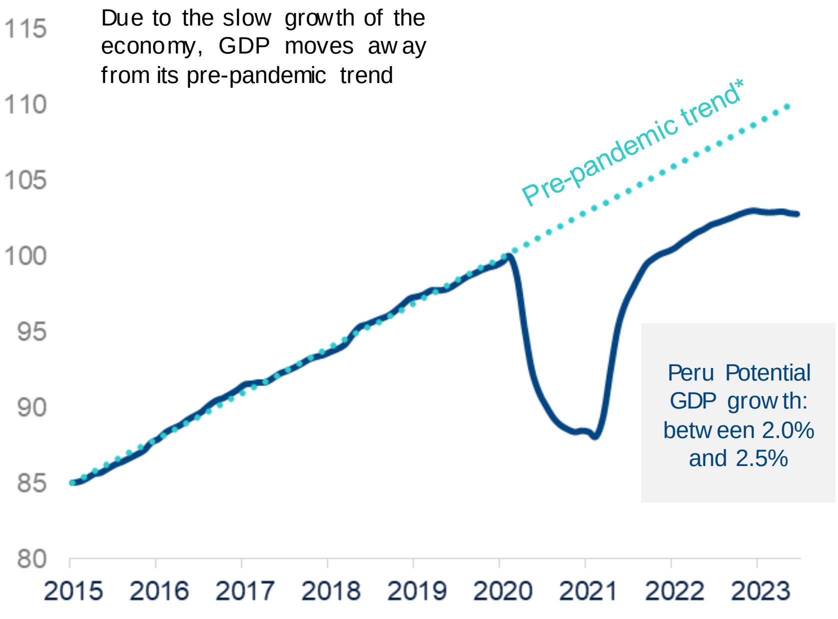


Source: INEI and BBVA Research.

- We forecast monetary poverty to increase in 2023 and 2024, standing at 28.9% and 29.2% of the population, respectively.
- This would bring 9.8 million people below the poverty line in 2023 (9.2 million in 2022).

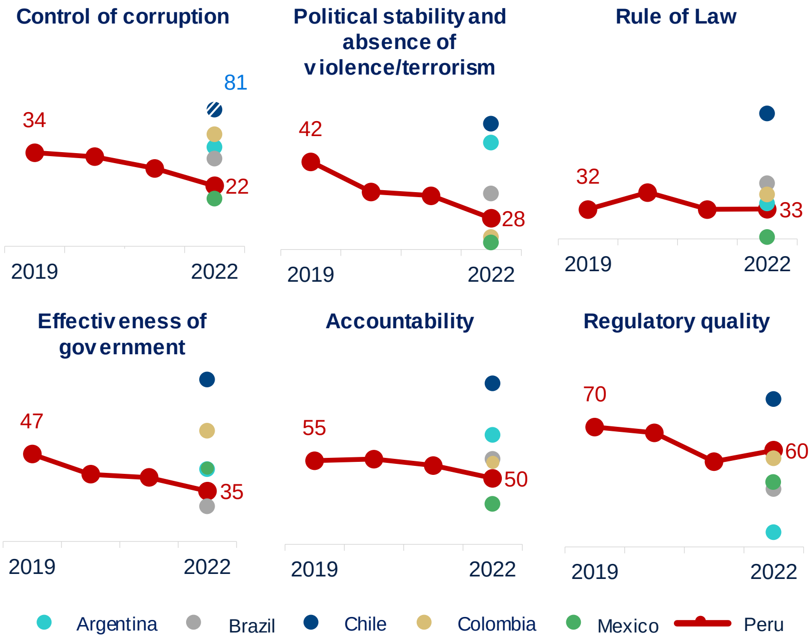
Accelerating growth and reducing poverty will require substantial improvements in structural factors linked to governance and institutionality.

GDP
(FEB.20=100, 12-MONTH MOVING AVERAGE)



* From 2015 to February 2020.
Source: BCRP and IPE. Prepared by: BBVA Research

GOVERNANCE INDICATORS
(PERCENTILE AMONG 214 COUNTRIES, 0: WORST, 100: BEST)



Source: World Bank - Worldwide Governance Indicators

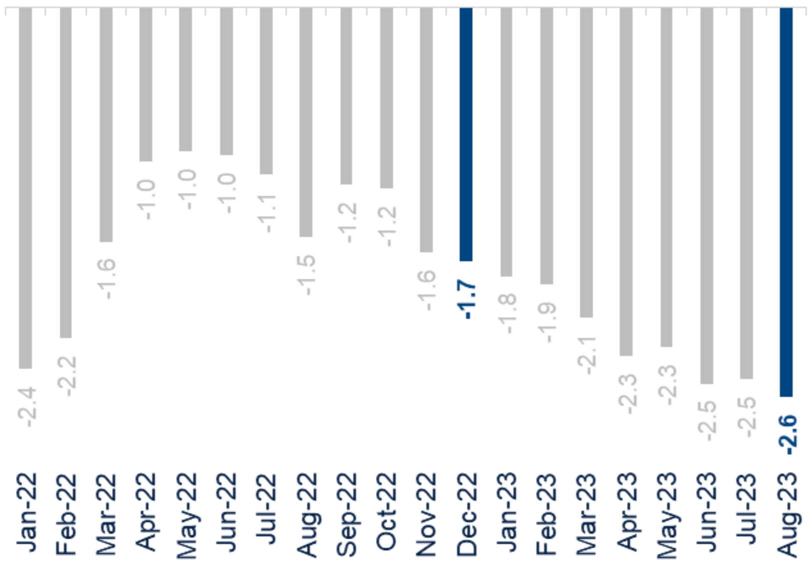
04

Peru economy forecasts

4.2. Fiscal balance and public debt

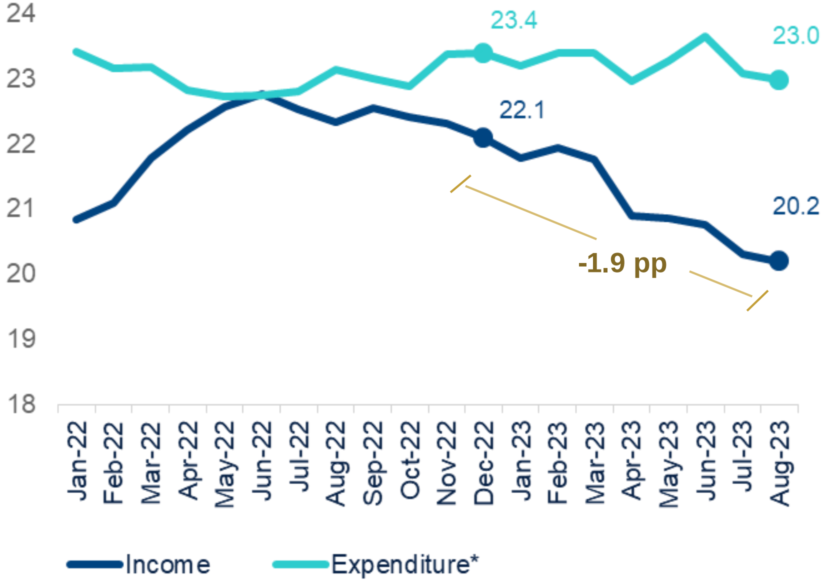
In August the fiscal deficit widened to 2.6% of the GDP, mainly due to lower tax revenues...

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



Source: BCRP.

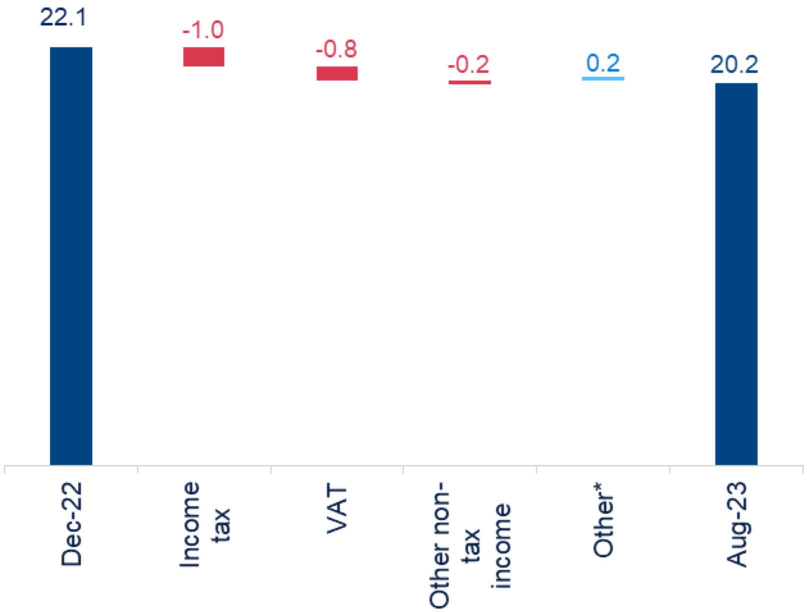
FISCAL REVENUE AND EXPENDITURE
(CUMULATIVE IN LAST 12 MONTHS, % OF GDP)



*Considers interest expense and the primary result of public companies.

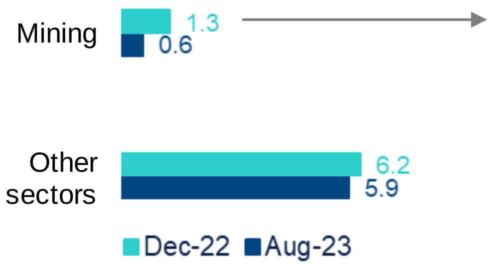
... due to lower revenue from Income Tax (linked to the mining sector) and VAT (weakness of domestic demand)

CENTRAL GOVERNMENT REVENUE
(CUMULATIVE IN LAST 12 MONTHS, % OF GDP)



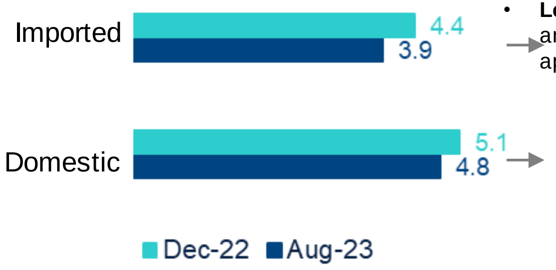
*Includes local tax revenue, selective consumption tax, import tax and refunds.
Source: BCRP.

INCOME TAX
(CUMULATIVE IN LAST 12 MONTHS, % OF GDP)



- **Lower tax regularization** due to high advance payments 2022, which caused the outstanding balances to be regularized to be smaller.
- **Lower advance payments** due to the use of balances in favor by companies and lower coefficients used in the monthly calculation of income tax.

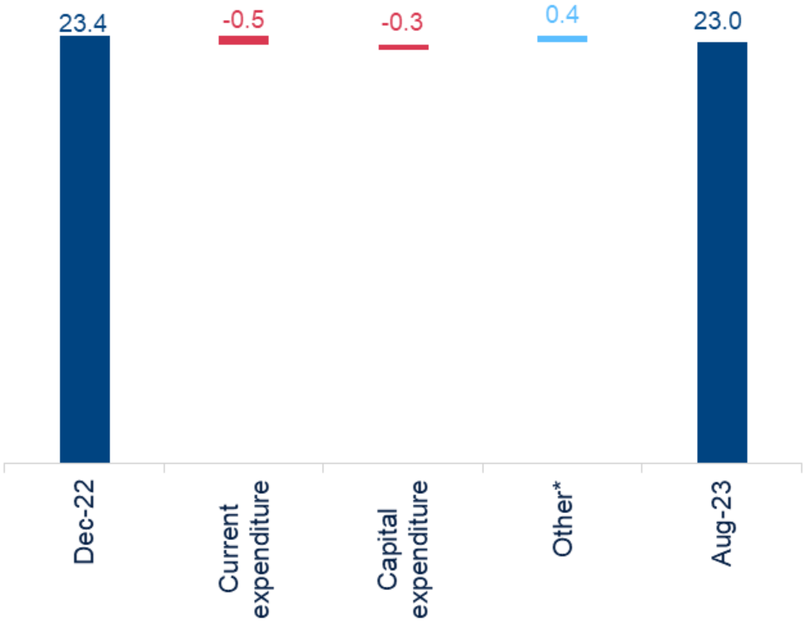
VAT
(CUMULATIVE IN LAST 12 MONTHS, % OF GDP)



- **Lower imports** and exchange rate appreciation
- **Weakening of domestic demand**

On the expenditure side, the moderation of the current component linked to lower transfers and spending on goods and services stands out

NON-FINANCIAL PUBLIC SECTOR EXPENDITURE
(CUMULATIVE IN LAST 12 MONTHS, % OF GDP)



*Includes the results of public companies and interest on public debt.
Source: BCRP.

CURRENT EXPENDITURE

- The decrease **in spending on goods and services** (accumulated last twelve months) is explained, for the most part, by the lower expenditures linked to the health emergency, mainly in medical supplies, **and in current transfers** due to the lower allocations granted to the FEPC.

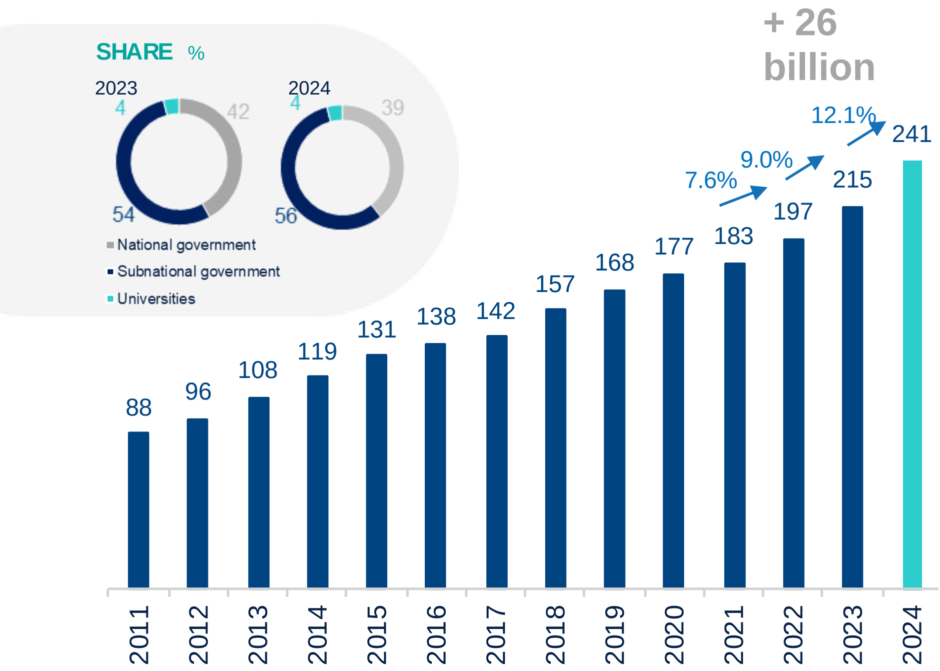
CAPITAL EXPENDITURE

- **The decrease in public** investment (accumulated last twelve months) is explained by the lower execution of subnational governments, which was partially offset by the execution of the national government (reconstruction).

- **The decrease in other capital** expenditures (accumulated last twelve months) is explained by the lower granting of credit guarantees from the Reactiva Peru Program.

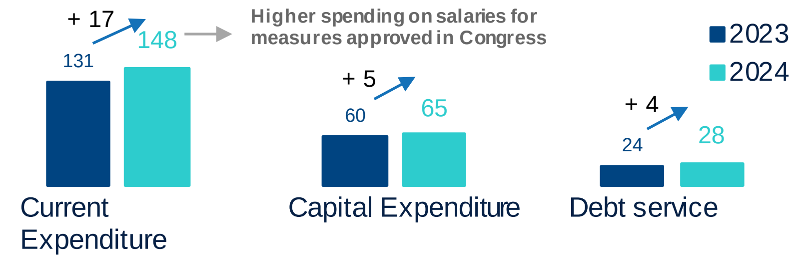
Budget Law for 2024 proposes an increase of 12.1% in expenditures

INITIAL BUDGET PROPOSAL
(BILLIONS OF SOLES)

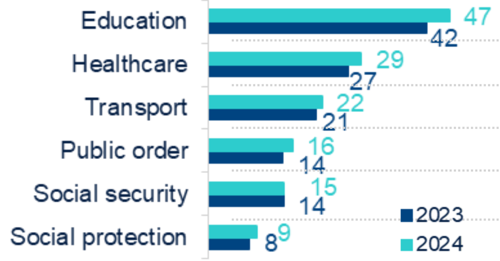


Source: MEF

INITIAL BUDGET PROPOSAL ACCORDING TO TYPE OF EXPENDITURE (BILLIONS OF SOLES)



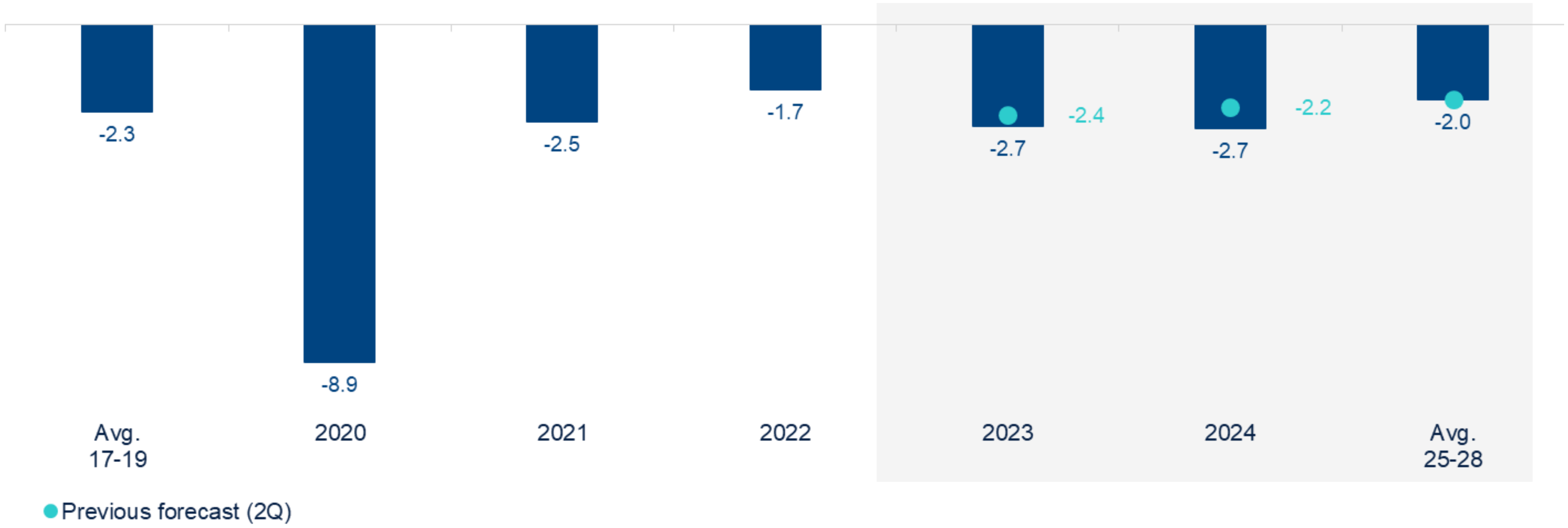
INITIAL BUDGET PROPOSAL ACCORDING TO FUNCTIONS
(BILLIONS OF SOLES)



	Chg. PEN 2024/2023	Chg.% 2024/2023
Education	4.4	10.6%
Healthcare	2.5	9.2%
Transport	1.3	6.5%
Public order	1.9	13.0%
Social security	0.2	1.4%
Social protection	1.5	19.2%

Upward revision of the deficit in 2023 and 2024 due to weaker activity and an increase in El Niño-related spending (2024)

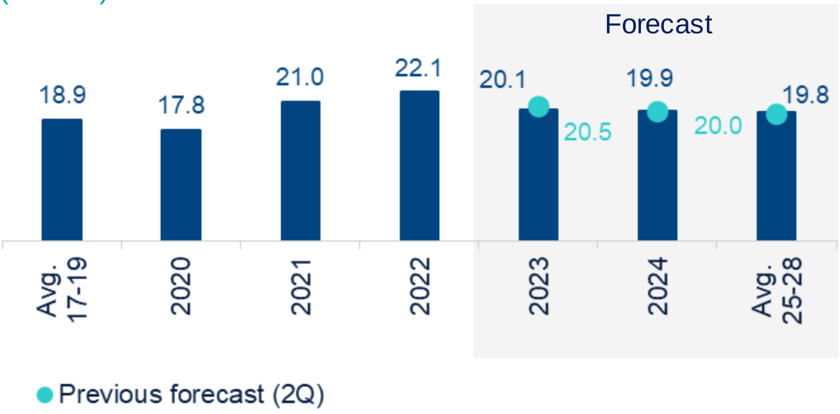
FISCAL BALANCE*
(NON-FINANCIAL PUBLIC SECTOR, % OF GDP)



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

Upward revision of the deficit in 2023 and 2024 due to weaker activity and an increase in El Niño-related spending (2024)

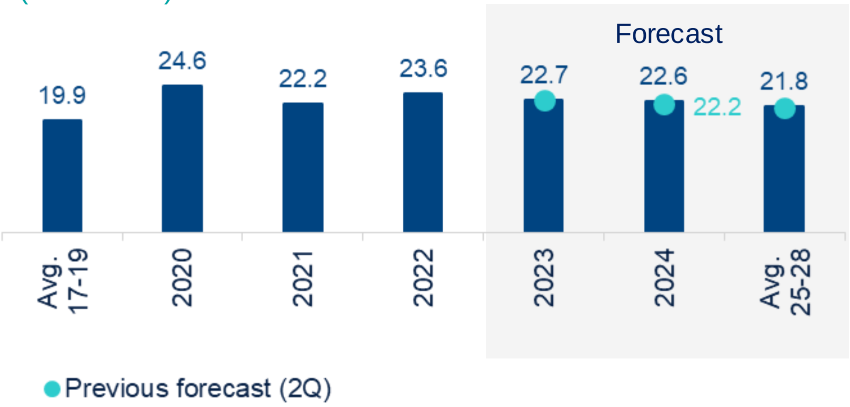
CENTRAL GOVERNMENT REVENUE
(% GDP)



- The revenue forecast in 2023 is revised downward, due to execution and lower growth in activity in the second half of the year.
- Going forward, revenues are projected to stabilize at around 20% of GDP, above pre-pandemic levels, in line with potential GDP growth.

Source: BCRP and BBVA Research.

GENERAL GOVERNMENT EXPENDITURE*
(% OF GDP)



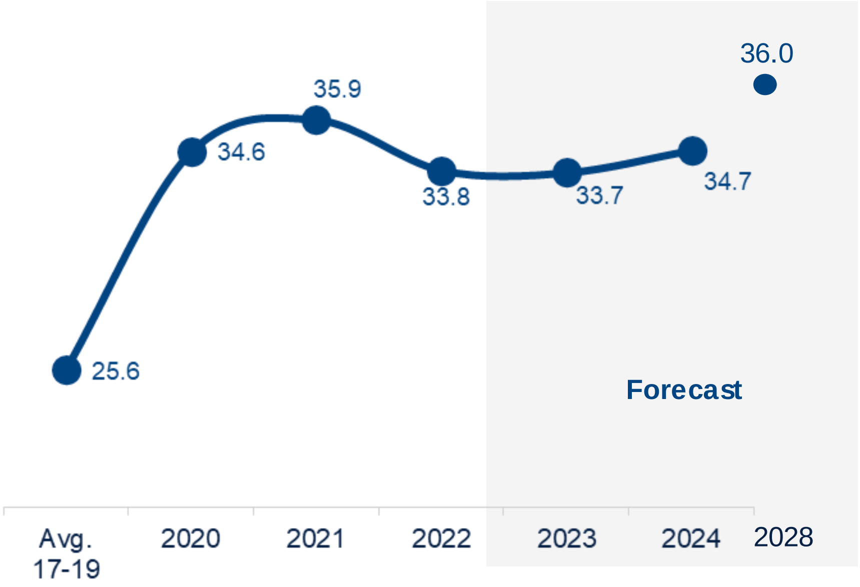
- The forecast for expenditure in 2023 is maintained.
- For 2024, the forecast is revised upward due to the increase in reconstruction-related expenditure due to the effect of El Niño in the summer.

*Includes interest payments

Source: BCRP and BBVA Research.

Public debt will experience a slight upward trend in the medium term. Overall, indicators indicate that fiscal soundness will be maintained

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



NON-FINANCIAL PUBLIC SECTOR INDICATORS

	2019	2020	2021	2022	2023	2024
Assets (% of GDP)	13.7	12.4	14.2	12.8	11.4	10.7
Net debt (% of GDP)	12.9	22.2	21.8	21.0	22.3	24.0
Dollarization of public debt (%)	32	43	54	52	50	48
Interest as % of tax revenues	7.0	9.0	7.2	7.1	8.1	8.3

Source: BCRP and BBVA Research.

However, potential spending demands could erode the strength of government accounts.

CONGRESSIONAL SPENDING PRESSURES

Law No.	Description	Date
Law 31097 1/	Law that establishes that the State invest annually not less than 6% of GDP in education	Dec-20
Law 31125	Health sector emergency and reform process	Feb.-21
Law 31187	Collective bargaining in the public sector	May-21
Law 31173 2/	Refund of Fonavi money	Apr.-22
Law 31495 3/	Special bonus for teachers' class preparation	Jun-22
Law 31703	Incorporation into the labor regime of Legislative Decree 728 to EsSalud workers who are under an indefinite term CAS contract	Jul-22
Law 31495 4/	Change from CAS-COVID contract to CAS	Aug-22
Law 31703	Incorporates into the labor regime of Legislative Decree 728 the workers of the EsSalud who are under CAS contract	Mar-23
Law 31729	Recognition bonus for transfer of the ONP to the Private Pension System	Apr.-23

1/ Permanent cost: PEN 18 billion. 2/Temporary cost: PEN 5.3 billion. 3/ Temporary cost: PEN 2.8 billion, 4/ Permanent cost: PEN 2.2 billion.

Source: MEF.

- Petroperú, a state company, recorded losses of USD 380 million in the first half of the year.
- Petroperú recently asked the Government for financial support of USD 3.2 billion, in addition to the support of USD 2.4 billion that the Government granted to the state company at the end of 2022.
- In this sense, the Ministry of Economy has indicated that there are no resources to meet the financial requirement of this company.
- The risk remains that the company continues to have losses and pressure the State with greater demands for resources, which implies neglecting other expense specifications. Therefore, the institutional strengthening of Petroperú is required in order to strengthen governance and financial sustainability.

BBVA Research

04

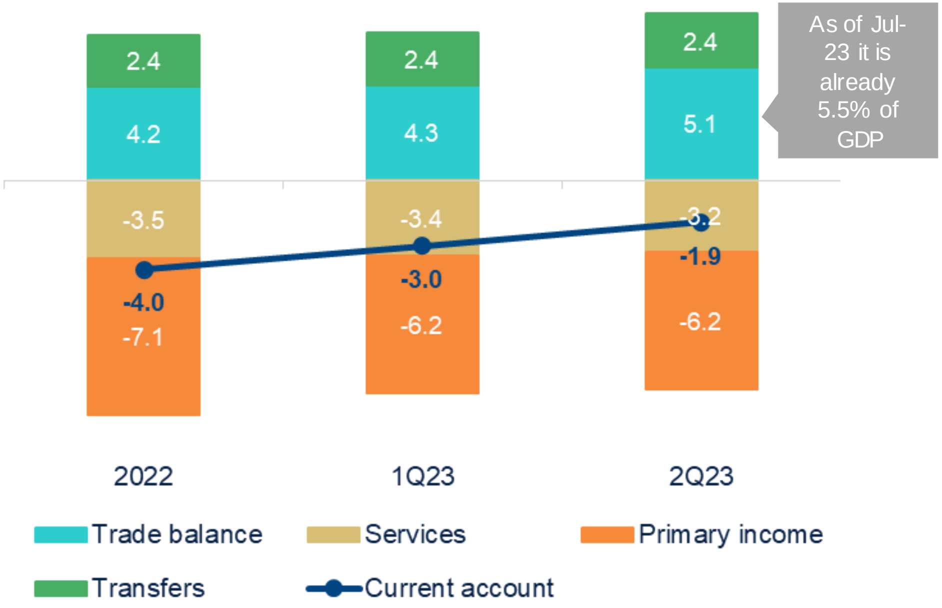
Peru economy forecasts

4.3. External sector and exchange rate

Creating Opportunities

External accounts: improving trade balance has been leading to a lower current account deficit

CURRENT ACCOUNT BALANCE OF PAYMENTS
(LAST 4 QUARTERS, % OF GDP)

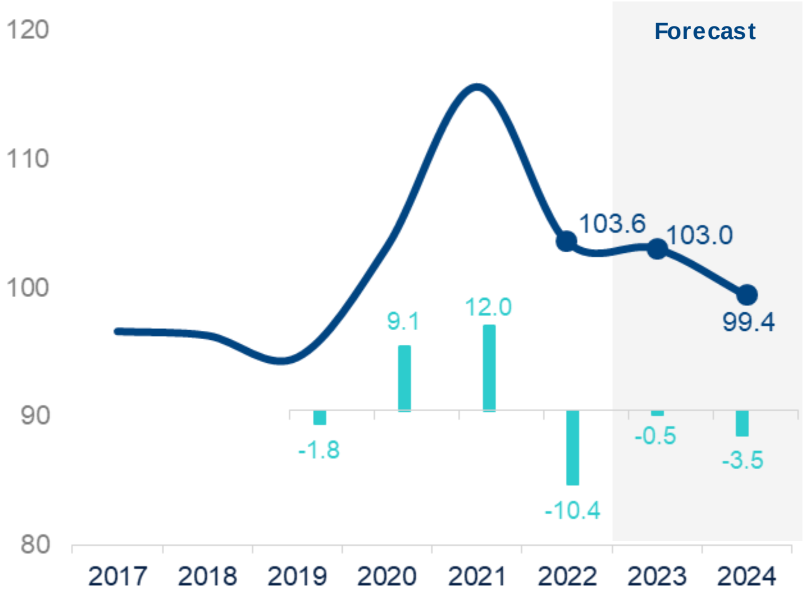


Source: BCRP and BBVA Research.

- Higher export volumes due to improved mining production and a fall in import volumes in the second quarter (associated with weak economic activity) have resulted in a significant increase in the trade surplus and, with this, the current account deficit decreases.
- Lower profits by foreign companies have also contributed to the improvement in the current account.

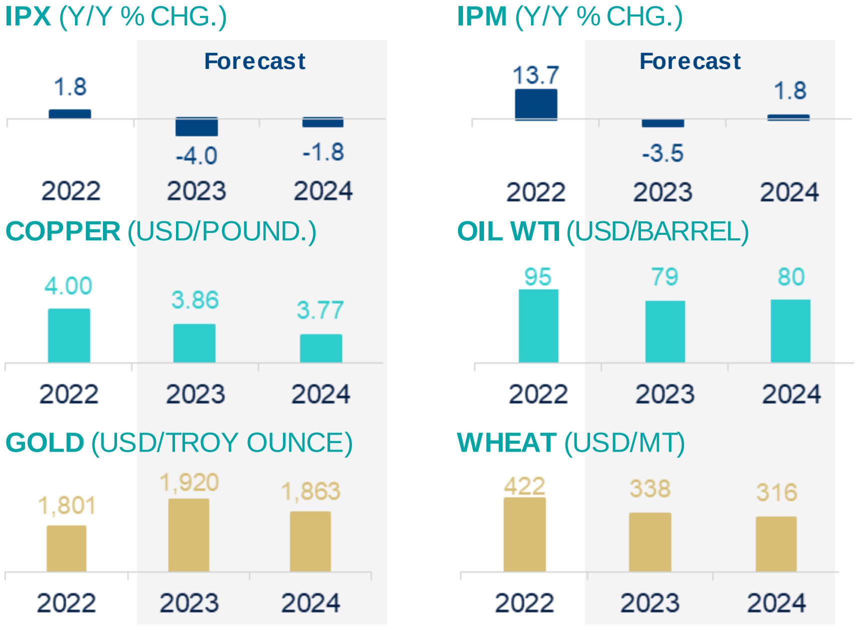
External accounts: lower terms of trade in 2023 and 2024 due to lower export prices (copper price normalization)

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



Source: BCRP and BBVA Research.

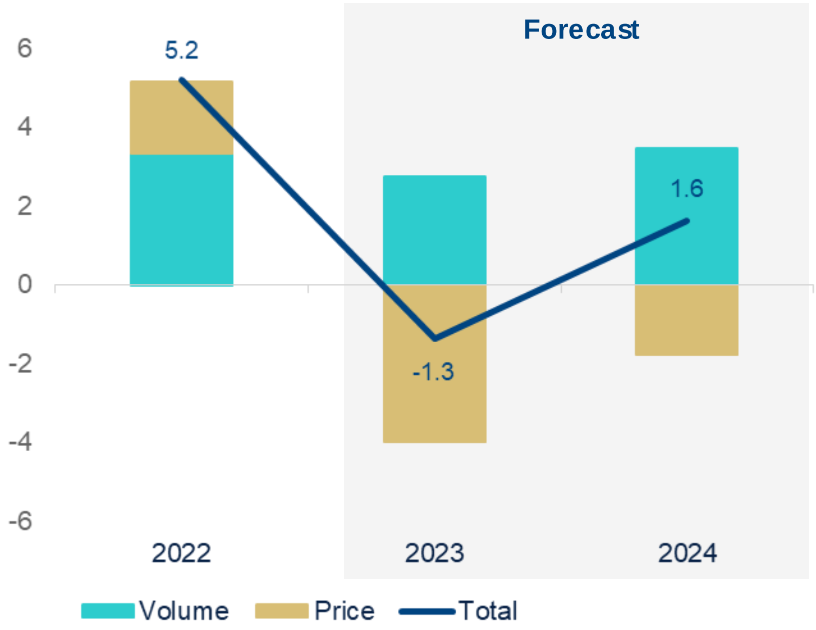
EXPORT (IPX) AND IMPORT PRICES (IPM)



Source: BCRP and BBVA Research.

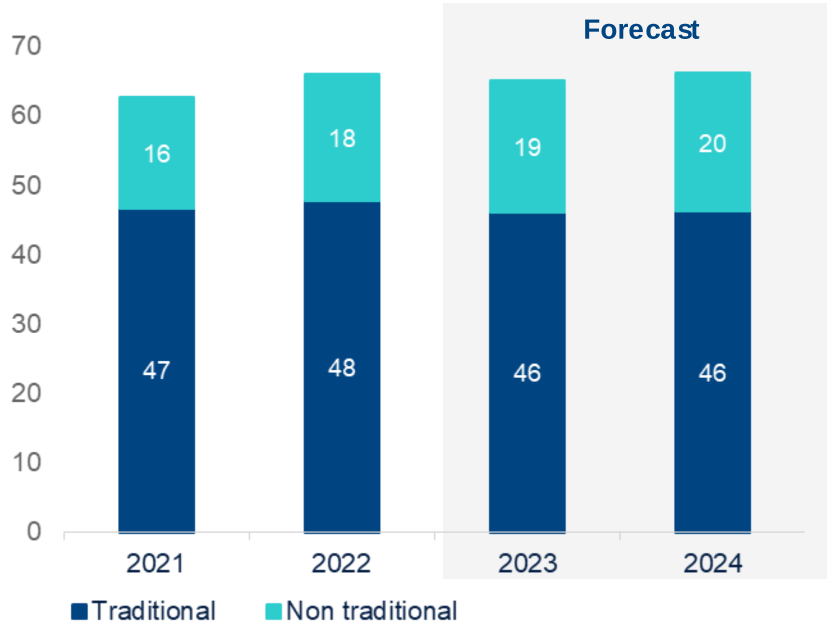
Lower export prices and lower anchovy catch (El Niño) will induce a slight drop in the value of exports in 2023

EXPORTS
(Y/Y % CHG.)



Source: BCRP and BBVA Research.

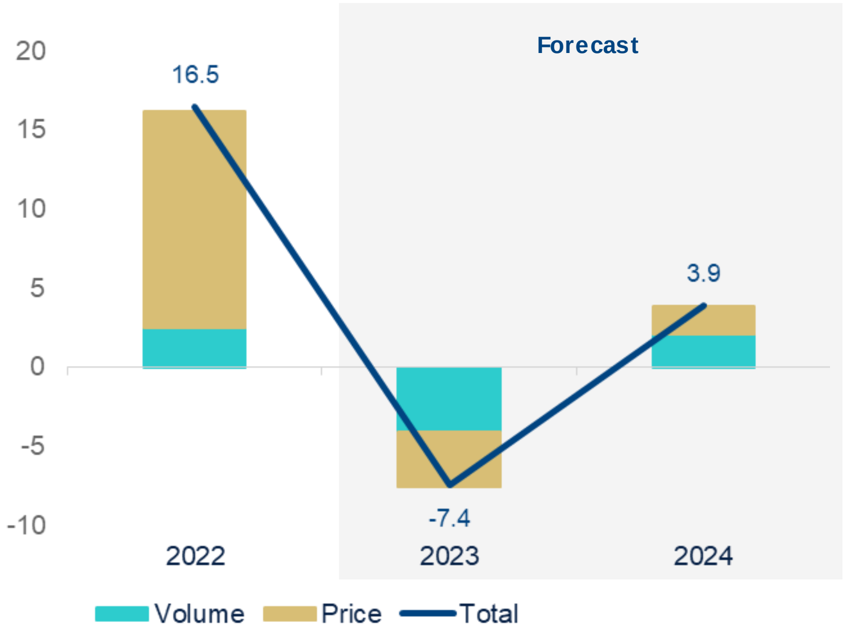
EXPORTS
(USD BILLIONS)



Source: BCRP and BBVA Research.

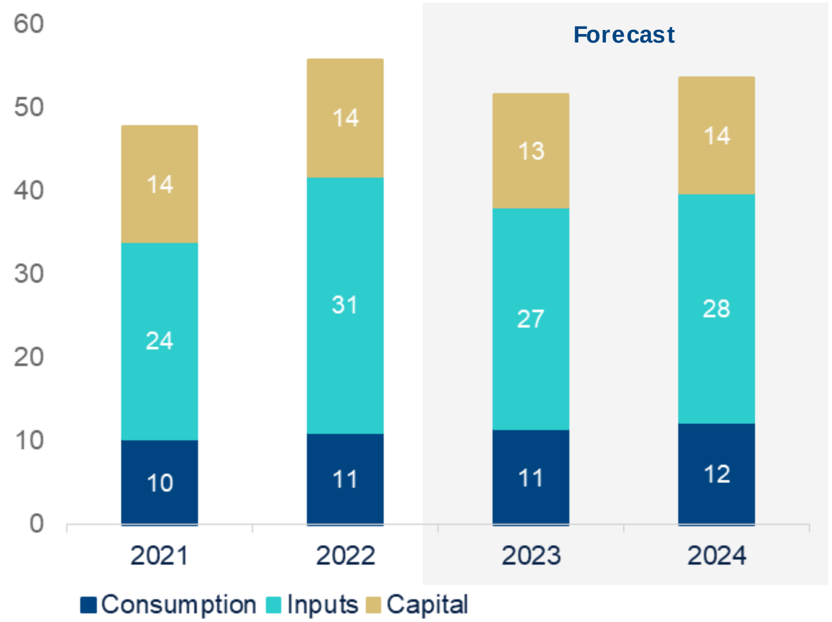
The value of imports will fall significantly this year due to the weak economic activity and the correction in prices

IMPORTS
(Y/Y % CHG.)



Source: BCRP and BBVA Research.

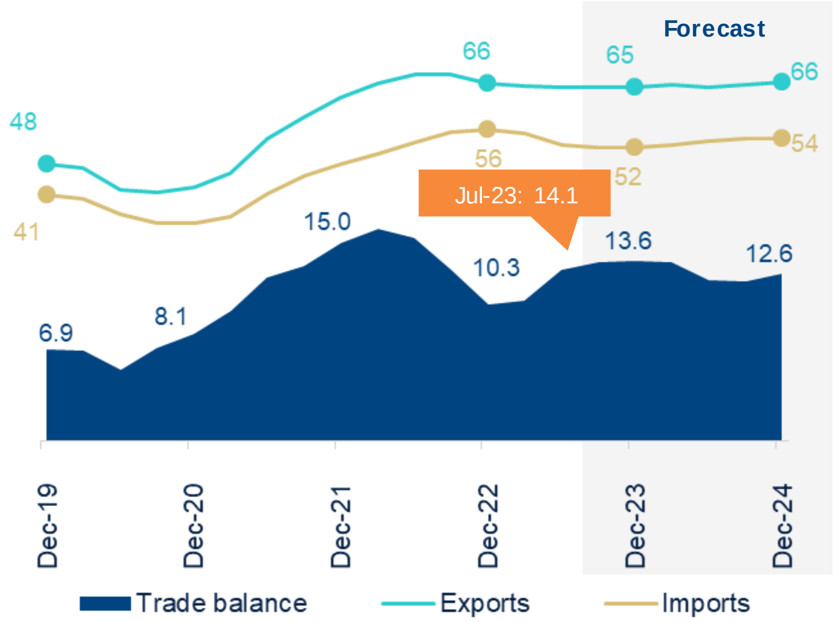
IMPORTS
(USD BILLIONS)



Source: BCRP and BBVA Research.

As a result, the trade balance surplus will grow this year and moderate the next

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

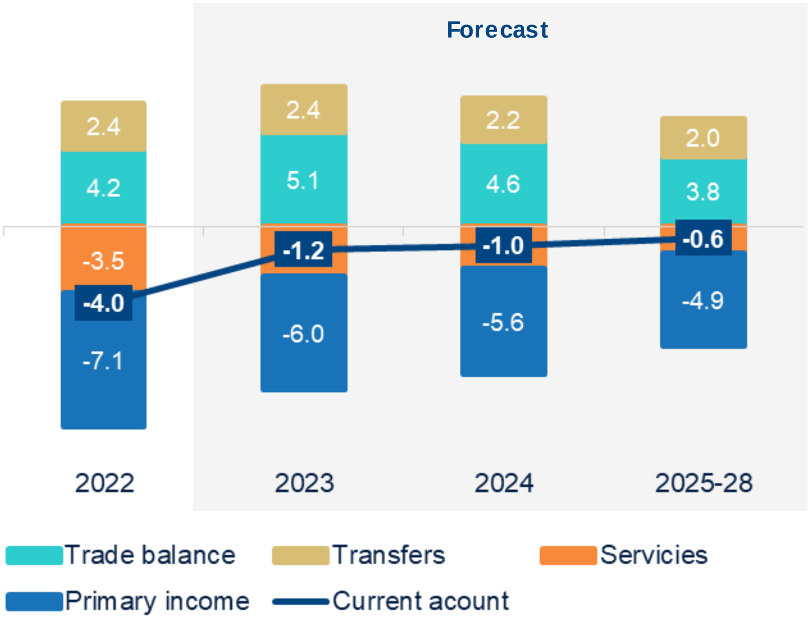


Source: BCRP and BBVA Research.

- So far this year, the trade balance surplus has risen as a result of the slowdown in imports and in greater export of minerals.
- In 2023, the lower volume of imports associated with the weakness of economic activity more than compensates for the fall in export prices (metals) and lower anchovy catch.
- In 2024, imports recover in a context of recovering domestic demand, which moderates the trade balance even though traditional exports also recover (after this year's setback due to social conflicts and weather anomalies).

The current account balance of payments deficit will gradually close due to the increased trade surplus and lower profits of foreign companies.

CURRENT ACCOUNT BALANCE OF PAYMENTS
(% GDP)

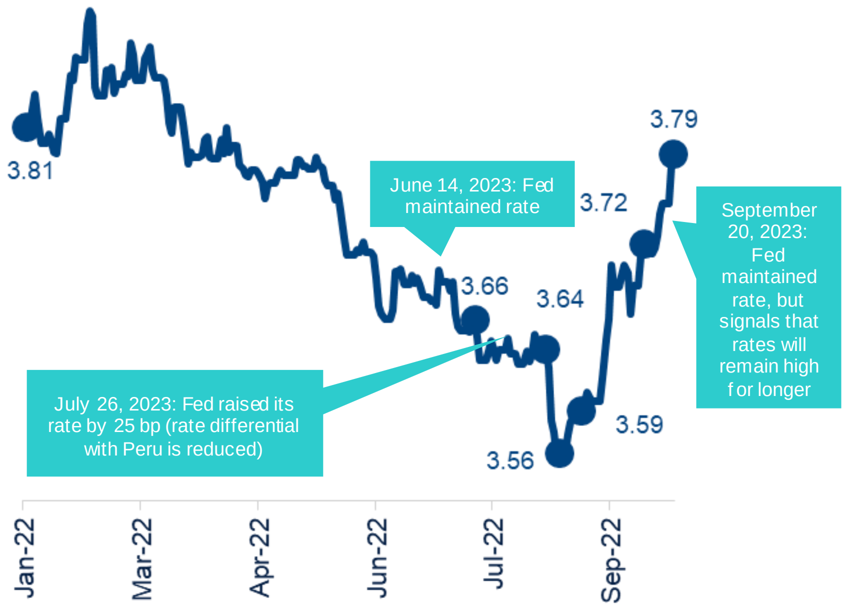


Source: BCRP and BBVA Research.

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

On the exchange rate side, depreciation of the PEN mainly due to external factors

EXCHANGE RATE: USDPEN
(SOLES PER DOLLAR)

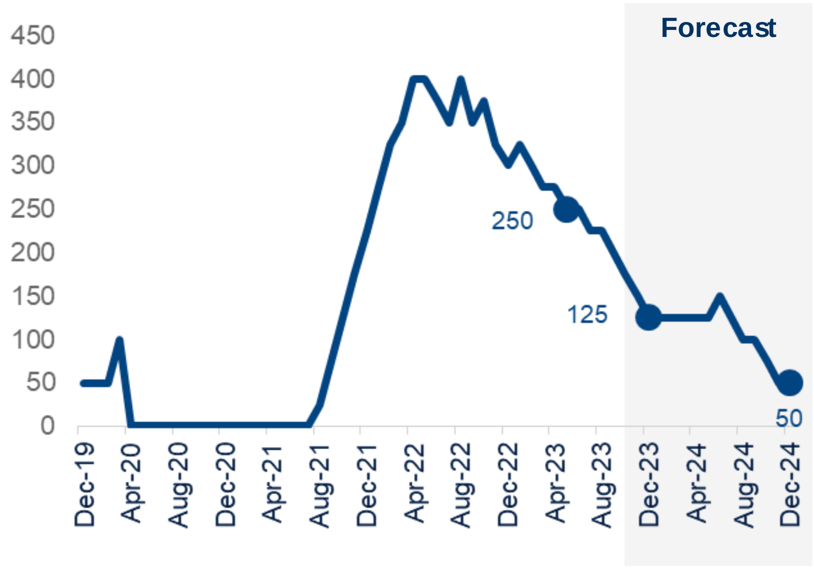


Source: BCRP and BBVA Research.

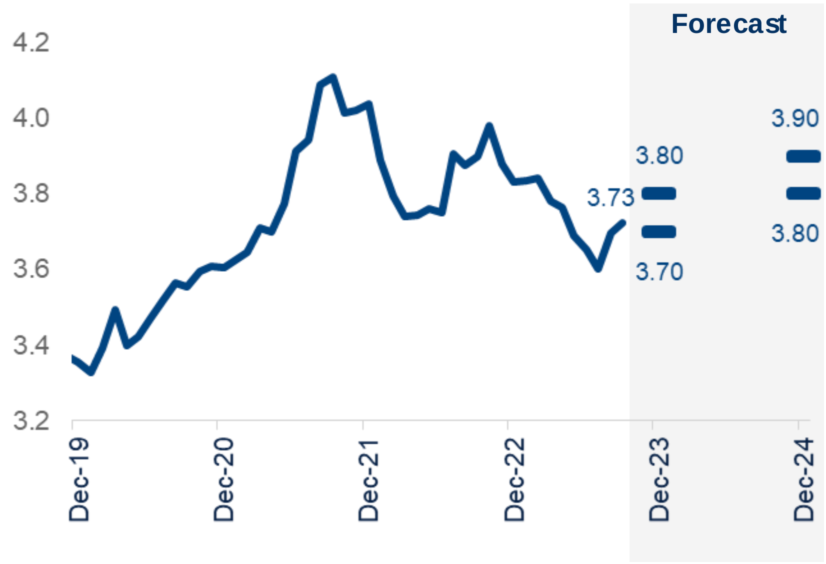
- The Fed has been signaling that it will keep its policy rate elevated for longer in response to resilient activity, and markets are responding with higher yields demanded over longer maturities.
- In China, weak indicators of economic activity. In addition, the problems with the real estate sector are aggravated.
- Copper prices are reduced, in part, by the increase in inventories and the deterioration of the outlook for demand in China, as well as the change in the forecast for the Fed rate.

Exchange rate: local currency will tend to depreciate moving forward due to narrowing interest rate differential and capital outflows

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



EXCHANGE RATE (SOLES PER DOLLAR, AVERAGE LEVEL FOR THE MONTH)



Source: FRED, BCRP and BBVA Research.

Narrowing the PEN-USD interest rate differential will reduce the attractiveness of local currency assets. In addition, capital outflows from emerging economies are anticipated due to lower risk appetite. A smaller current account deficit will attenuate exchange rate pressures.

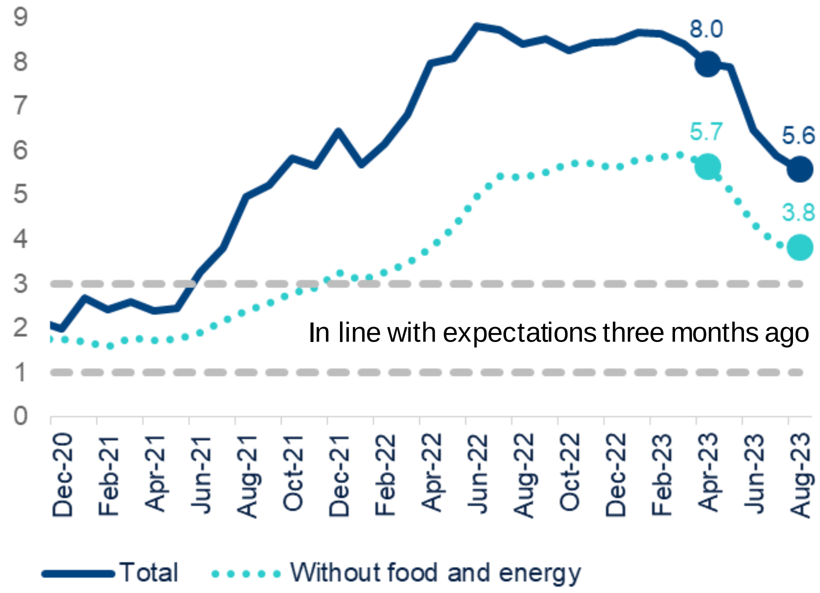
04

Peru economy forecasts

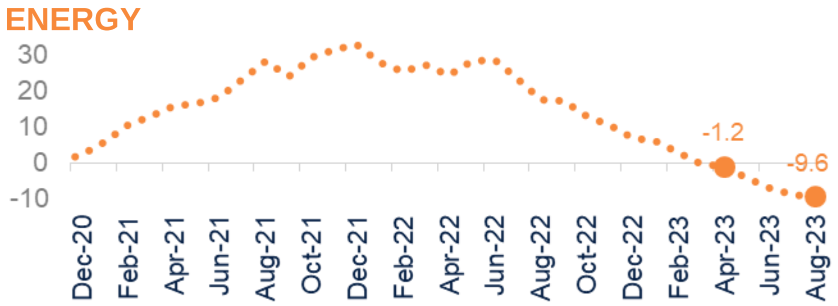
4.4. Inflation and monetary policy

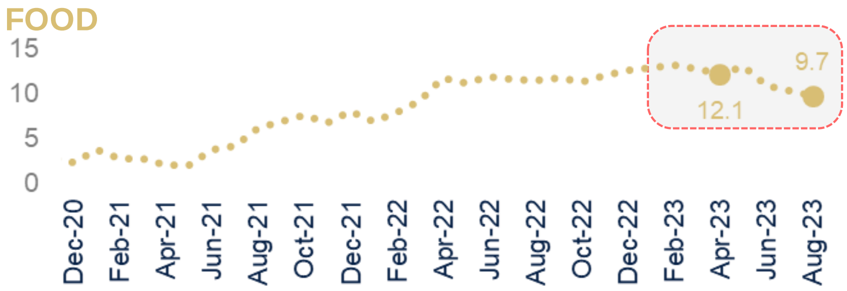
Inflation eases due to high year-on-year comparison base, reduction in international input prices and weakness in domestic activity

INFLATION: TOTAL AND CORE
(Y/Y % CHG.)



INFLATION: FOOD AND ENERGY
(Y/Y % CHG.)

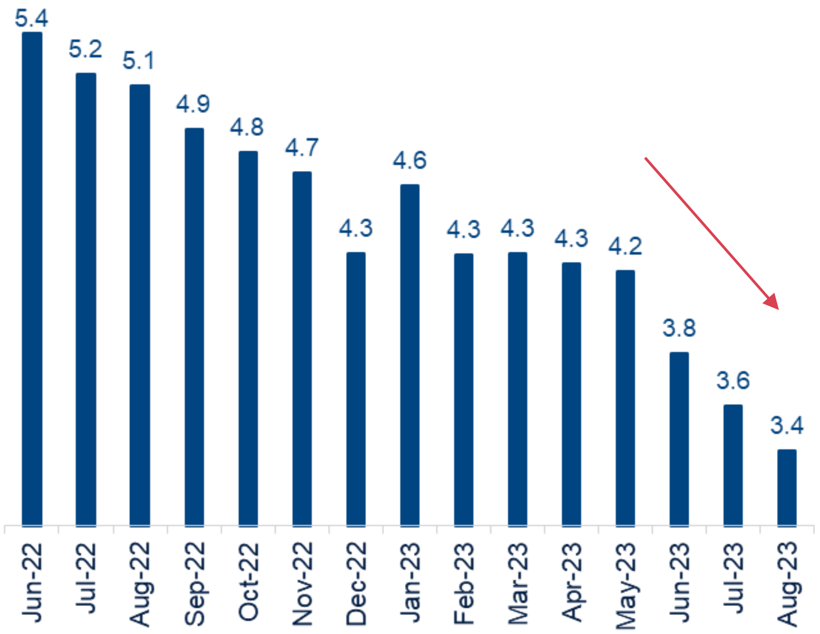




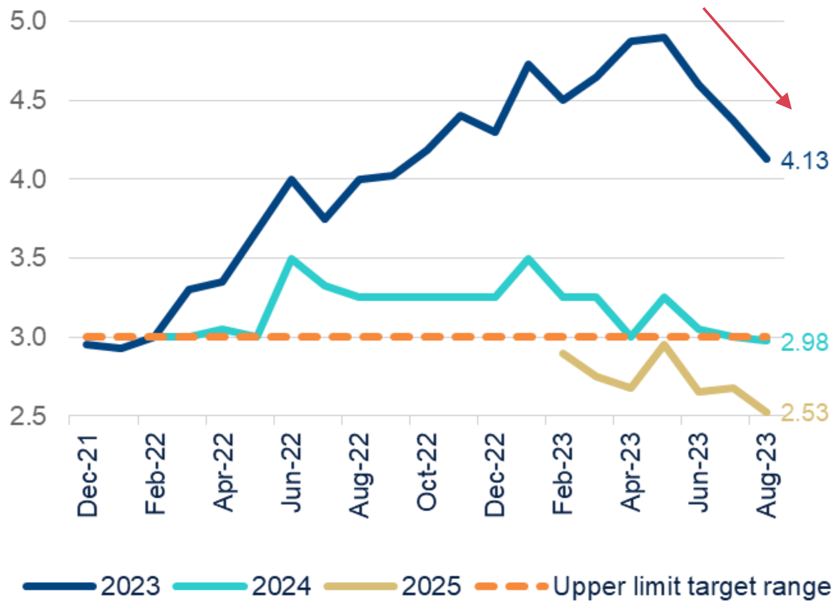
Source: INEI.

Inflation expectations have also corrected downward significantly

1 YEAR AHEAD INFLATIONARY EXPECTATION
(Y/Y % CHG. EXPECTED FOR CPI)



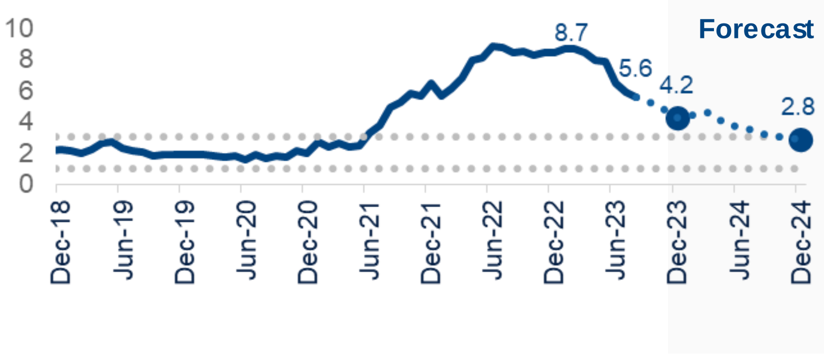
INFLATION FORECASTS
(BY YEAR-END, %)



Source: BCRP.

Inflation will tend to fall from now on, but more slowly than expected mainly due to El Niño and despite a slowdown in activity

INFLATION
(%)



- Inflation will continue to fall in the short term due to high comparison base, weakness of the economy, and restrictive monetary policy. El Niño will likely have impacts on food prices in 1Q24. Then, inflation would resume a downward path.
- With respect to June, we revised the inflation forecast upward, reflecting the deterioration of the forecasts for El Niño and greater depreciation of the local currency.

Source: BCRP and BBVA Research (forecasts)

Global El Niño: droughts in high Andean areas would reduce plantings, with lagged upward impact on food prices

Cconchaccota is thousands of meters above sea level, stretching out across the Andes. *(AP: Guadalupe Pardo)*

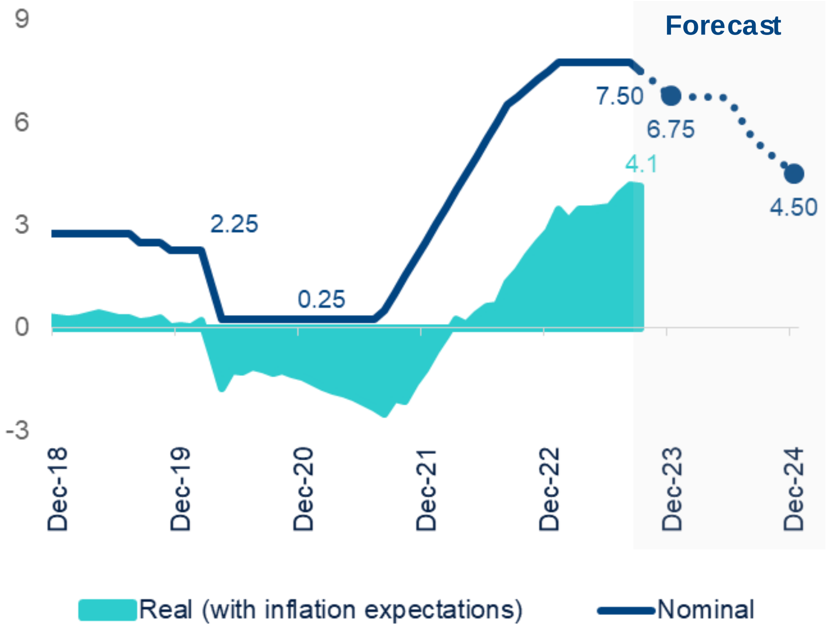
The planting of potatoes, which is the only crop that grows in Ms Huamani's village, has been delayed. *(AP: Guadalupe Pardo)*

PRICE OF WTI OIL
(% CHG. YEAR-ON-YEAR END OF PERIOD)

	2021	2022	2023	2024
Current forecast	81,0	7,1	**1,5**	**-7,3**
Previous forecast (June 2023)	81,0	7,1	**-4,0**	**-3,2**

The Central Bank cut the reference rate by 25 bp in September... We expect more cuts in the short term

MONETARY POLICY RATE
(%)

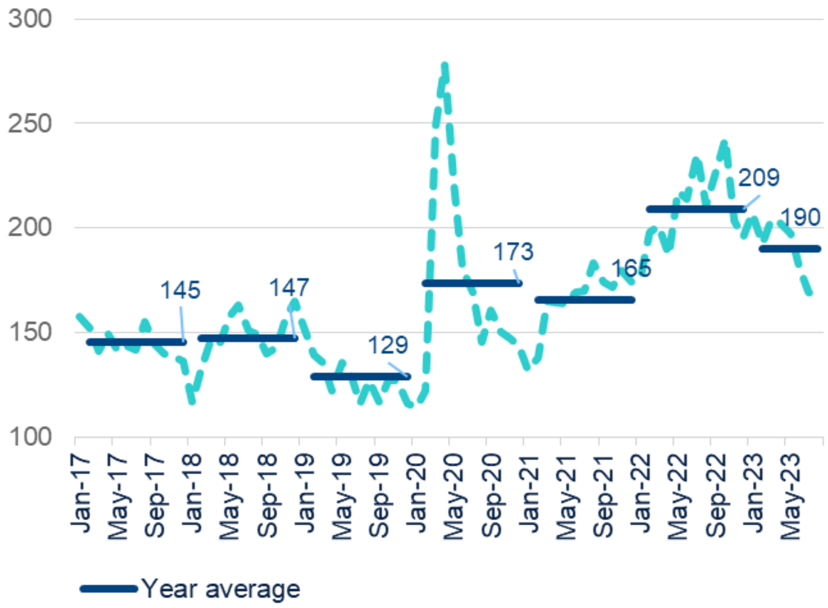


Source: BCRP and BBVA Research.

- In September, the Central Bank cut the reference rate from 7.75% to 7.50%. The BCRP pointed out that the decision does not imply a cycle of successive reductions in the reference rate.
- The BCRP expects the downward trend in inflation to continue in the coming months, but they see risks to prices due to El Niño.
- They noted their concern about economic weakness: "The shocks derived from social conflicts and the coastal El Niño have had a greater impact than expected on economic activity and domestic demand."
- In the balance, we interpret that the BCRP has implemented a "hawkish cut", so that going forward, additional cuts will be gradual and highly conditioned to the new information that appears, in line with what was previously planned.
- We expect that in an environment of moderation in inflation and weak activity, the BCRP will continue to cut the reference rate in the short term, pause in 1Q 2024 (the most complicated moment of El Niño) and resume cuts at the end of Q2 2024 (end of El Niño and start of easing by the Fed).

The Central Bank revised its estimate of the natural interest rate upward by 50 bp, in line with higher country risk

COUNTRY RISK — EMBIG
(BASIS POINTS)



Source: BCRP.

BCRP ESTIMATES OF THE NATURAL INTEREST RATE (%)

	Real	Nominal
2019	1,4	3,4
2020	1,3	3,3
2021	1,4	3,4
2022	1,6	3,6
2023	**2,1**	**4,1**

This higher natural interest rate implies that the neutral level for the Central Bank's reference rate would now be 4.50% (previously: 4.00%)

Source: BCRP. Real and nominal natural interest rates show the median of the average values estimated by Lahura and Vega (2023), MPT with Kalman filter, Pérez (2023) and Ledesma (2023) that includes extended UCUR (exogenous rate) and extended UCUR (closed economy).

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05

The main risks to Peru's economic outlook

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

ON THE EXTERNAL SIDE

Episodes of instability and recession due to persistent inflation

Sharper slowdown in the Chinese economy

Geopolitical environment with latent tensions

Presidential elections in the U.S.

ON THE LOCAL SIDE

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

Renewed political and social tensions.

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

Slowdown in activity of a cyclical rather than situational nature

Research

06

Summary of forecasts

Creating Opportunities

Macroeconomics forecasts

	2021	2022	2023 (f)	2024 (f)
GDP (YoY % change)	**13.3**	**2.7**	**0.4**	**2.3**
Domestic demand (excluding inventories, YoY % change)	**17**	**2.1**	**-0.5**	**2.2**
Private spending (YoY % change)	**17.6**	**2.6**	**-0.8**	**2**
Private consumption (YoY % change)	12.4	3.6	1	2.2
Private investment (YoY % change)	36.9	-0.4	-6.5	1.6
Public spending (YoY % change)	**14.2**	**-0.5**	**0.9**	**3.1**
Public consumption (YoY % change)	10.9	-3.4	1.4	2.5
Public investment (YoY % change)	24.8	7.7	-0.6	4.5
Exchange rate (vs. USD, eop)	**13.2**	**6.1**	**3.2**	**2.5**
Inflation (% Y/Y, eop)	**18**	**4.4**	**-1.1**	**2.1**
Monetary policy interest rate (%, eop)	**4.04**	**3.83**	**3.70 – 3.80**	**3.80 – 3.90**
Fiscal balance (% GDP)	**6.4**	**8.5**	**4.1**	**2.8**
Balance of payments: checking account (% GDP)	**2.5**	**7.5**	**6.75**	**5.25**
Exports (USD billion)	**-2.5**	**-1.7**	**-2.7**	**-2.7**
Imports (USD billion)	**-2.2**	**-4**	**-1.2**	**-1**

(f) Forecast. Forecast closing date: October 2, 2023.
Source: BBVA Research.

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Peru Economic Outlook

October 2023

Creating Opportunities