Peru Economic Outlook

December 2023

Creating Opportunities

BBVA Research

Content

Creating Opportunities

Key points

Global situation

Growth and inflation are easing in the wake of recent monetary tightening. Lower commodity prices have helped rein in inflation, while cushioning the loss of momentum in activity. Good labor market readings, coupled with still expansionary fiscal policies, have also helped reduce the risk of recession, but have undermined disinflation. Financial markets have shown a more upbeat mood, but are still subject to volatility.

Local situation

Locally, the Peruvian economy underperformed expectations and contracted in the third quarter (1.0% y/y). Primary sectors were still affected by unusually warm weather, but non-primary activities, especially non-primary manufacturing, construction, and certain services, were the weakest. Service sector weakness reflected trends on the expenditure side: still high inflation -which hurts household purchasing power- high interest rates, expectations of a complicated El Niño phenomenon in the coming quarters, and low business confidence have caused household and business spending to slow, even more than expected. Against this backdrop, analysts and authorities continue to revise down their growth forecasts for 2023.

Key points

Global macro outlook

World economic growth should continue to slow as monetary conditions remain tight, fiscal policies become less expansionary, labor markets begin to struggle and there is still excess saving. Nevertheless, any major recession will likely be avoided. Global growth is expected to decline from 3.4% in 2022 to 3.0% in both 2023 and 2024, before picking back up to 3.3% in 2025.

On the price front, inflation should slow further, gradually converging toward targets. This would provide some respite for central banks and, therefore, a ceiling to Fed and ECB monetary policy interest rates. However, authorities are likely to take a cautious stance toward rate cuts, which we do not expect to begin anytime before mid-2024: the Fed could start in June and the ECB in September 2024. Liquidity levels should fall further.

Key points

Domestic macro outlook: economic activity

On the domestic side, the baseline scenario has been revised to factor in lower-than-expected third-quarter GDP growth and a more sustained weakness in private spending. Moreover, this scenario shows the El Niño phenomenon unfolding with strong intensity in the short term, Quellaveco's boost to year-on-year growth dissipating soon, and continued weakness in confidence for some time, but also increased public spending to mitigate the impacts of El Niño and a sharp drop in inflation, giving some breathing room to households and and the Central Bank to cut interest rates. In this environment, we estimate a 0.4% contraction of GDP in Peru for 2023 (vs. our previous forecast of growth of 0.4%).

Activity at the beginning of next year; i.e. during the rainy season, should still be affected by the El Niño phenomenon, but the intensity of this weather anomaly should lessen and the phenomenon should dissipate in the second quarter. Post-El Niño, activity should rebound on the back of favorable year-on-year comparison, increased public and private spending on rehabilitation and post-El Niño reconstruction against a more propitious backdrop for household and business spending (i.e. lower inflation, falling interest rates), and assuming relative political stability. Accordingly, we expect growth to reach 2.0% next year (down from our previous forecast of 2.3%) and the rebound to be complete in 2025, with the economy then growing by around 3.5%.

Key points

Domestic macro outlook: fiscal accounts

The fiscal deficit could widen temporarily, but Peru's public finances should remain sound. The deficit at present stands at 2.8% of GDP, but we expect it to rise slightly further by the end of the year (to 3.0%) against a backdrop of sustained weakness in private spending and public expenditure focused on mitigating the impacts of El Niño. The deficit in 2024 would probably not be much different: although activity should start picking back up, thereby driving fiscal revenue, spending on post-El Niño rehabilitation and reconstruction work is also likely to be higher. Later on, once the rebound in activity is complete and weather anomaly-related expenditure is curtailed, the deficit should contract toward 2.0%. This scenario is consistent with gross public debt, currently at 32.4% of GDP, no higher than 37% by the end of the forecast horizon (i.e. 2028).

Domestic macro outlook: external accounts

The Peruvian economy does not present external imbalances, making it easier to face bouts of financial volatility. The balance of payments current account deficit (accumulated over the last four quarters) decreased from 4.0% of GDP in 4Q22 to 0.7% in 3Q23 due to increased mining output (more exports) and the slowdown in private spending (fewer imports). We expect the current account deficit to end this year at around 0.4% and largely remain unchanged over the next two years because although private spending should normalize (thus boosting imports), so should exports affected by El Niño (agriculture, fishing) and inbound tourism.

Domestic macro outlook: exchange rate

Foreign exchange markets have been volatile over the last couple of months, in line with the trend in external interest rates and the markets' view on what action the Fed will take going forward. The PEN could weaken somewhat going forward as monetary easing in Peru comes about faster than in the U.S. (decreasing the attractiveness of holding assets denominated in local currency). Peru's low balance of payments current account deficit should provide a floor. We expect the USD-PEN exchange rate to end the year at between 3.75 and 3.85 soles per dollar and between 3.85 and 3.95 by the end of 2024.

Key points

Domestic macro outlook: inflation

Inflation is falling, even faster than expected, reaching 3.6% in November. The decline reflects high year-on-year comparisons, the reversal of certain supply shocks, and lackluster activity. This trend should continue going forward and become more evident after El Niño dissipates in 2Q24. We expect inflation to end this year at around 3.5%, with a bias toward reaching a level that is slightly closer to the Central Bank's target range, and at 2.8% next year.

Domestic macro outlook: monetary policy

With inflation declining rapidly and activity slowing, the Central Bank should continue to cut its monetary policy rate, but will probably proceed with caution in light of the potential impacts of El Niño on prices and financial volatility. The next decisions the Central Bank takes will probably still be conditioned by published data, especially on inflation and activity, not to mention weather forecasts, and the Fed's behavior. In our baseline scenario, Peru's reference interest rate, currently at 7.00%, will end this year at 6.75%, if not slightly lower, with cuts resuming once El Niño shocks are over and the Fed is ready to start on its own monetary normalization cycle, ending 2024 at 5.0%.

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 moderate/great intensity during the rainy season (baseline scenario), but with lower-than-average rainfall for this type of event (South Pacific anticyclone cools waters closer to the Peruvian coast); (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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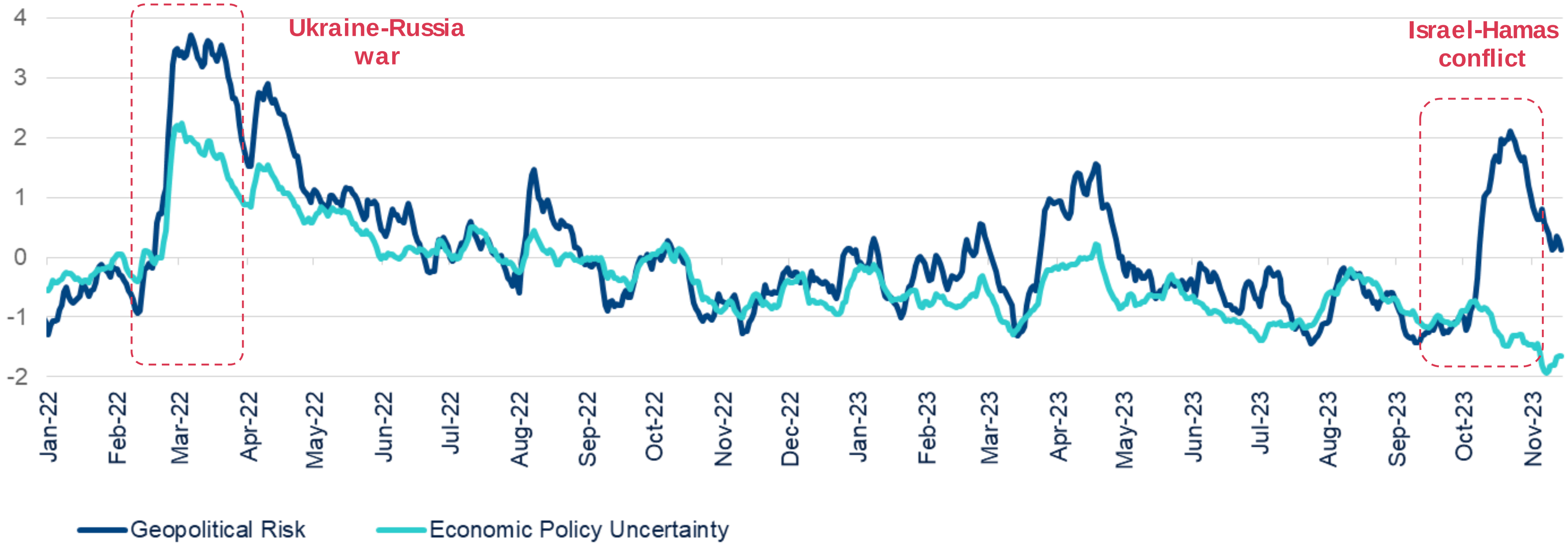
01

International context: activity and financial markets

Creating Opportunities

Geopolitical risks have increased on the Israel-Hamas conflict, but economic policy uncertainty has remained relatively low

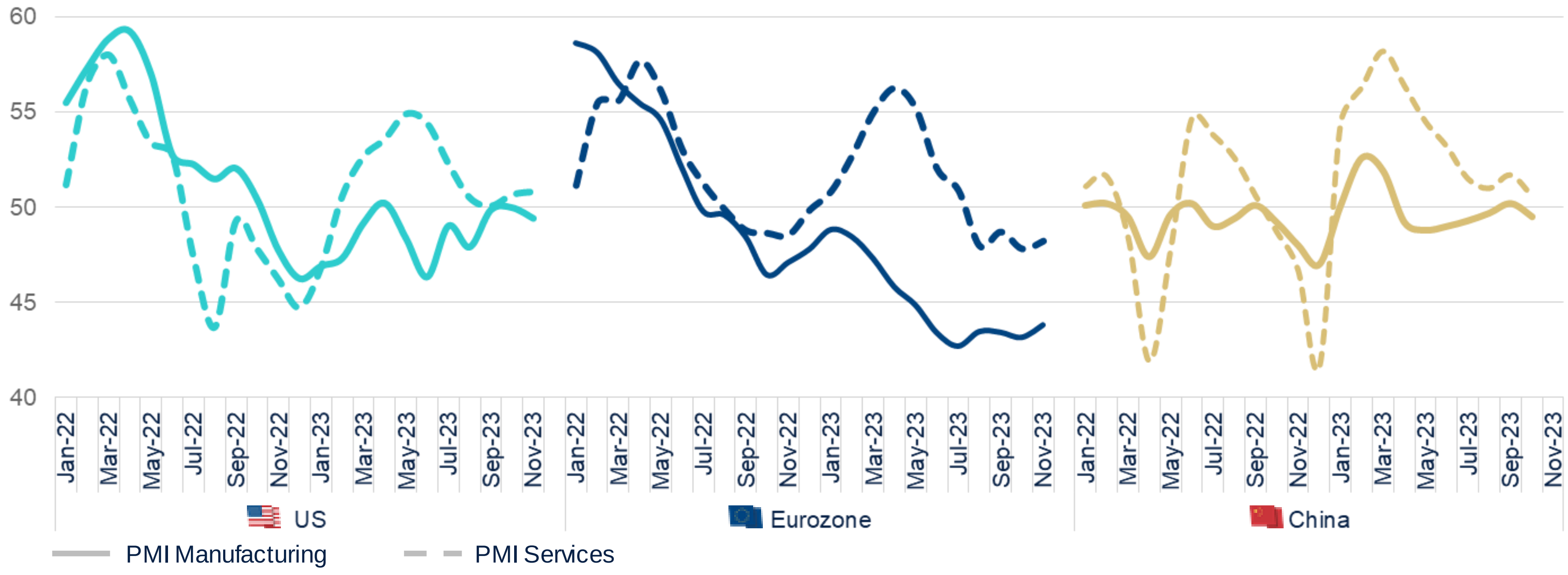
GEOPOLITICAL RISK AND ECONOMIC POLICY UNCERTAINTY IN G3 REGIONS (*)
(INDEXES: AVERAGE SINCE 2019 EQUALS TO 0, 28-DAY MOVING AVERAGE)



(*): US, Eurozone and China.
Source: BBVA Research Geopolitics Monitor.

Growth continues to trend down, mainly in the eurozone: services are still losing momentum, adding to the weakness in manufacturing

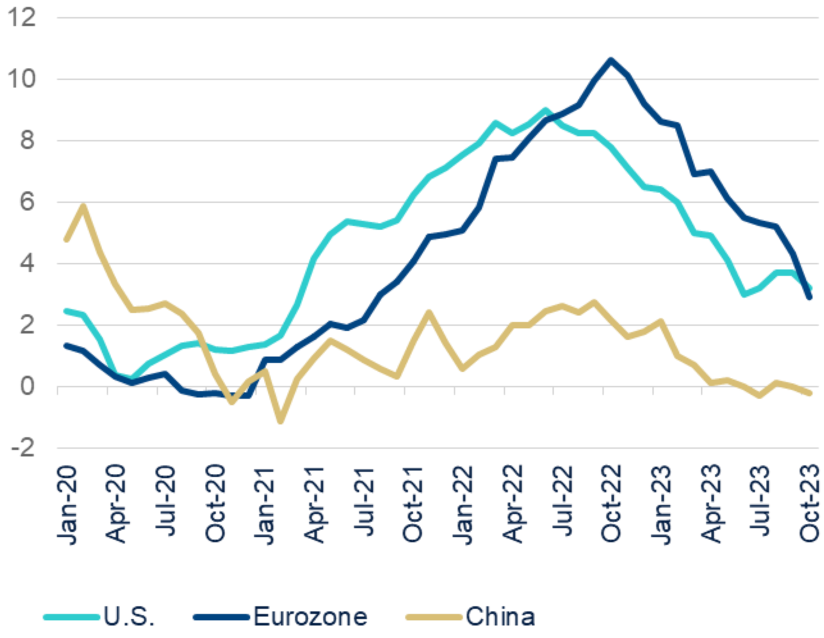
PMI INDICATORS
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



Source: BBVA Research based on data from Haver.

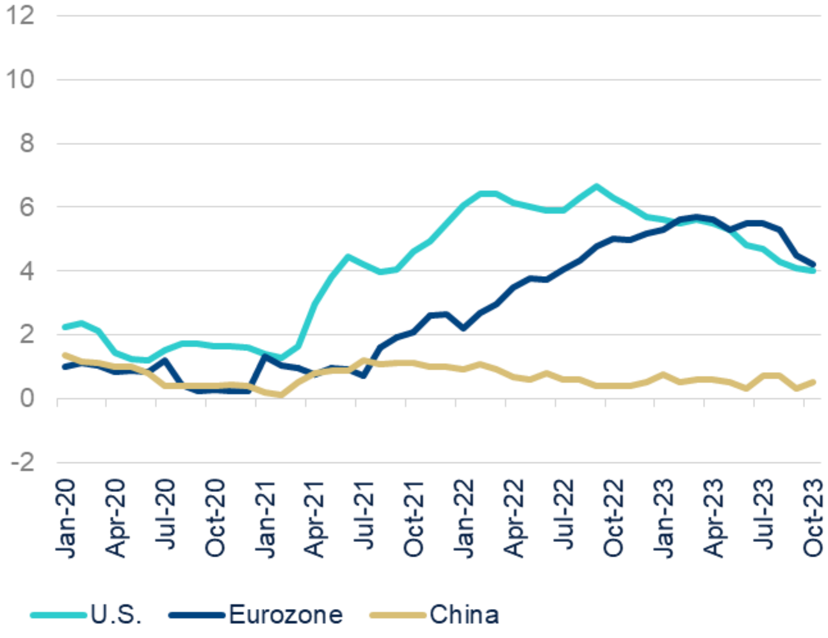
Inflation is also slowing: after the significant decompression of headline figures, there are clearer signs of moderation in (still high) core measures

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

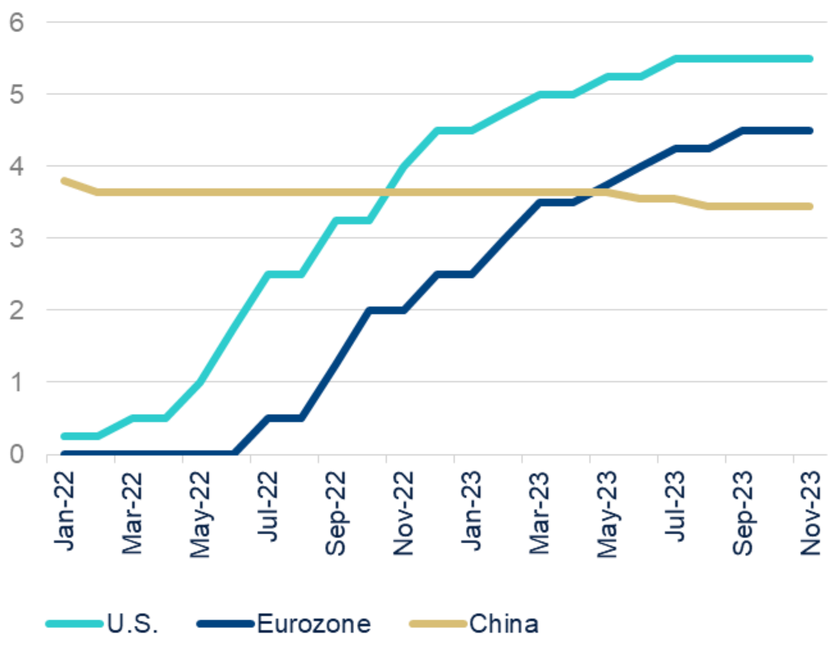
CORE INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

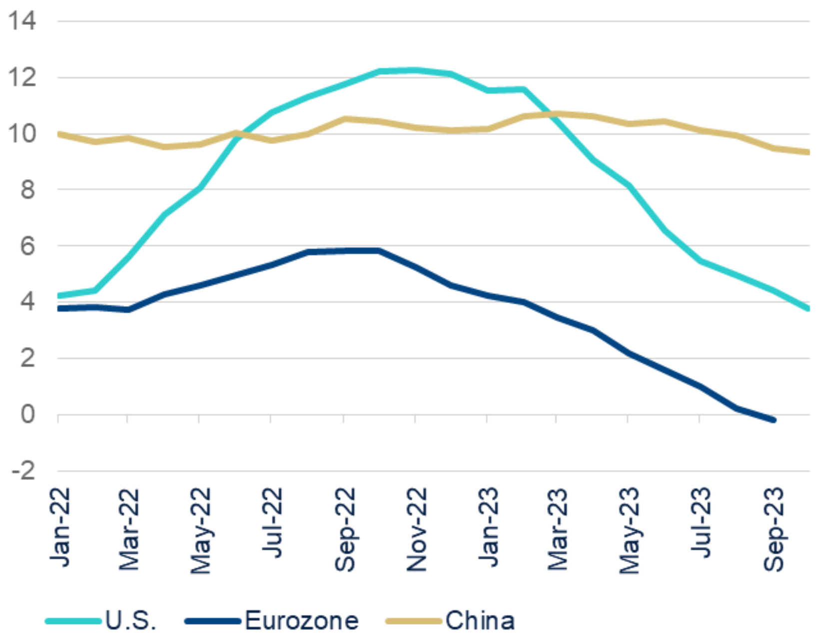
Growth and inflation are easing following the aggressive interest rate hiking cycles -which seem to be over now- and also on the decline of excess savings

POLICY INTEREST RATES (*)
(%)



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

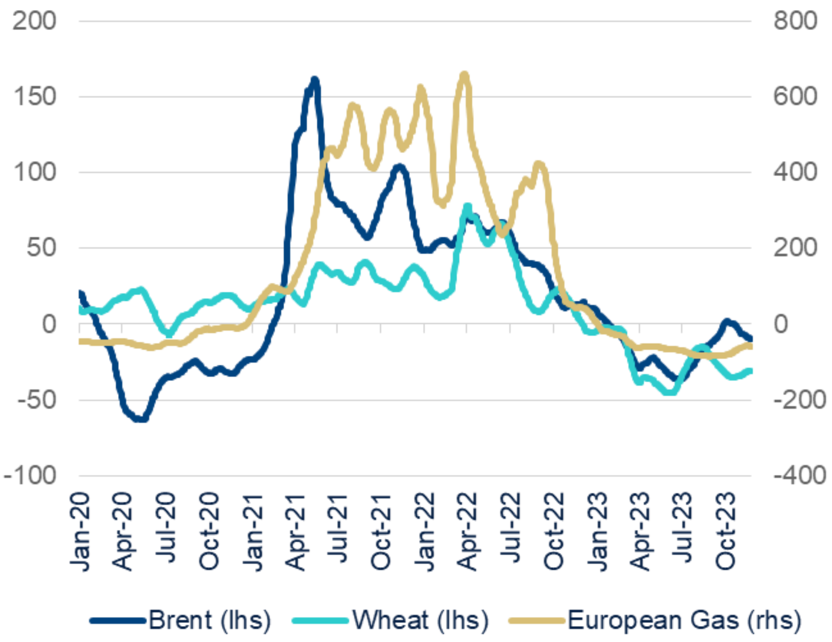
LENDING BY COMMERCIAL BANKS
(YOY %)



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

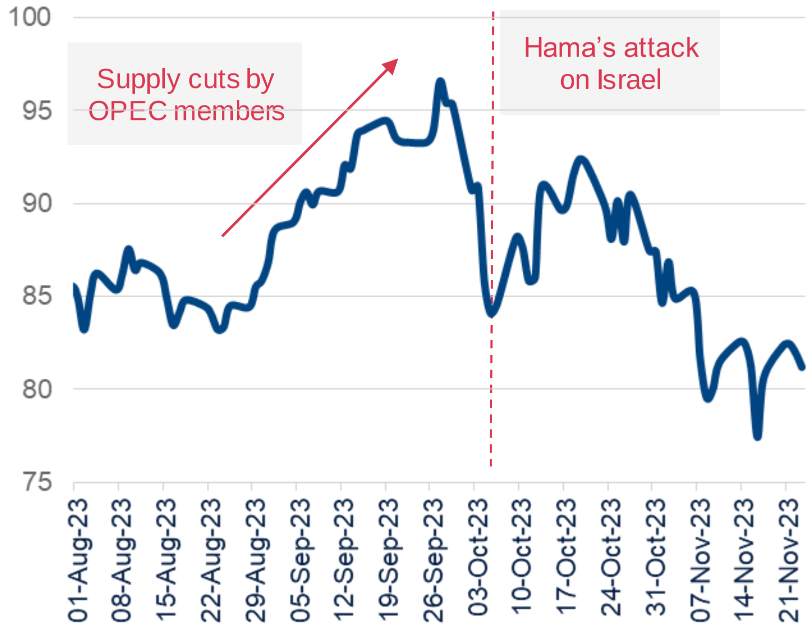
More contained commodity prices (despite Middle-East tensions) are also allowing inflation to ease, while providing some support to economic activity

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



Source: BBVA Research based on data from Haver.

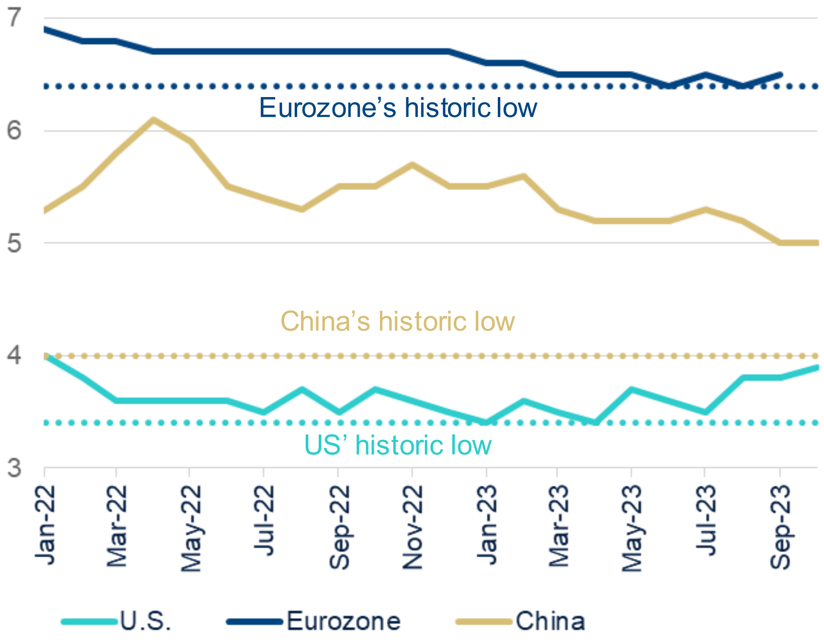
BRENT PRICES
(USD PER BARREL)



Source: BBVA Research based on data from Haver.

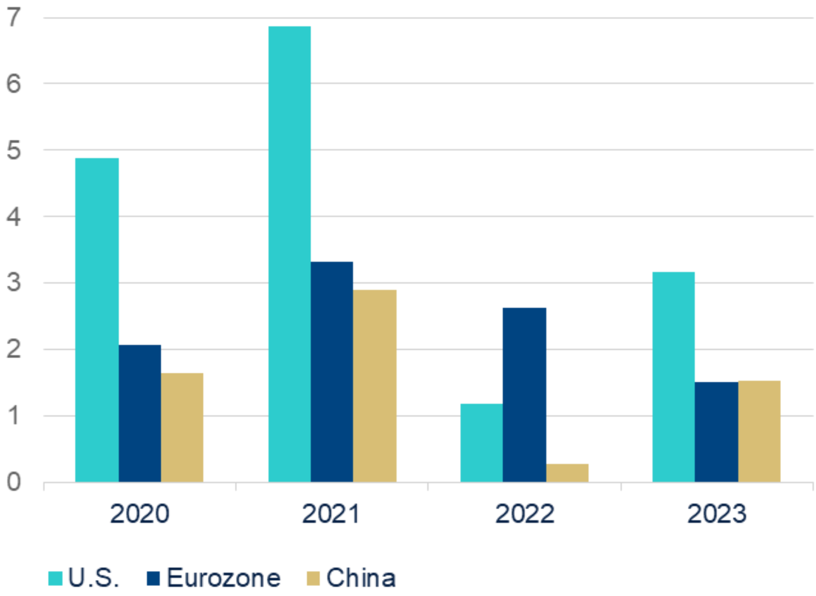
Labor markets and fiscal policy are still supporting growth, helping to prevent recessions while contributing to keep inflationary concerns alive

UNEMPLOYMENT RATE
(% OF THE LABOR FORCE)



(*) Historic low: lowest unemployment rate since Jan/04.
Source: BBVA Research based on data from Haver.

"EXCESSIVE" FISCAL STIMULUS (*)
(% OF GDP)

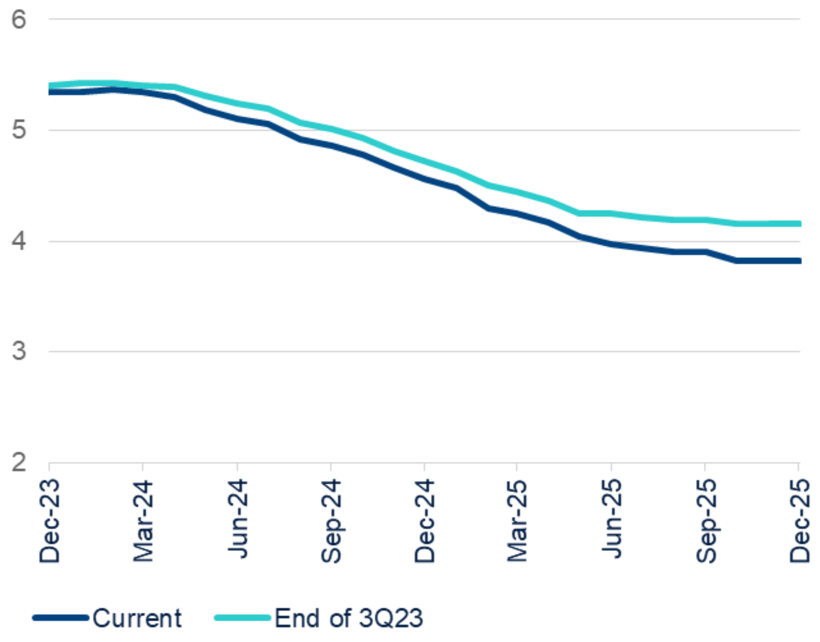


(*) "Excessive" fiscal stimulus: difference between the cyclically-adjusted primary balance and the equilibrium primary balance (calculated as the average relationship between the cyclically-adjusted primary balance and GDP growth in the 2001-2023 period).
Source: BBVA Research based on data from the IMF and AMECO.

Despite the still hawkish tone exhibited by the Fed and the ECB, markets are now pricing an early and more aggressive monetary easing cycle

FED: IMPLICIT RATE IN FUND FUTURES

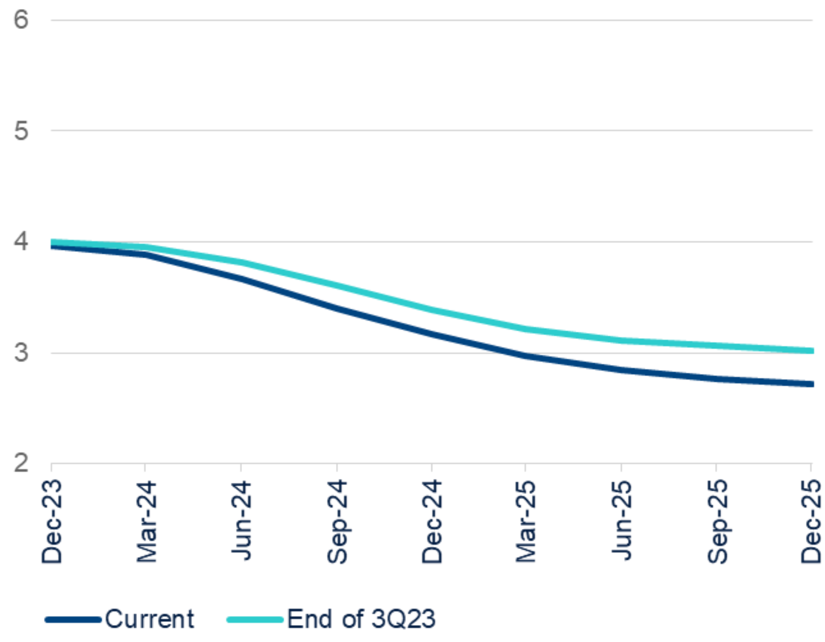
(%)



Source: BBVA Research based on Bloomberg.

ECB: IMPLICIT RATE IN 3-MONTH EURIBOR FUTURES (*)

(%)

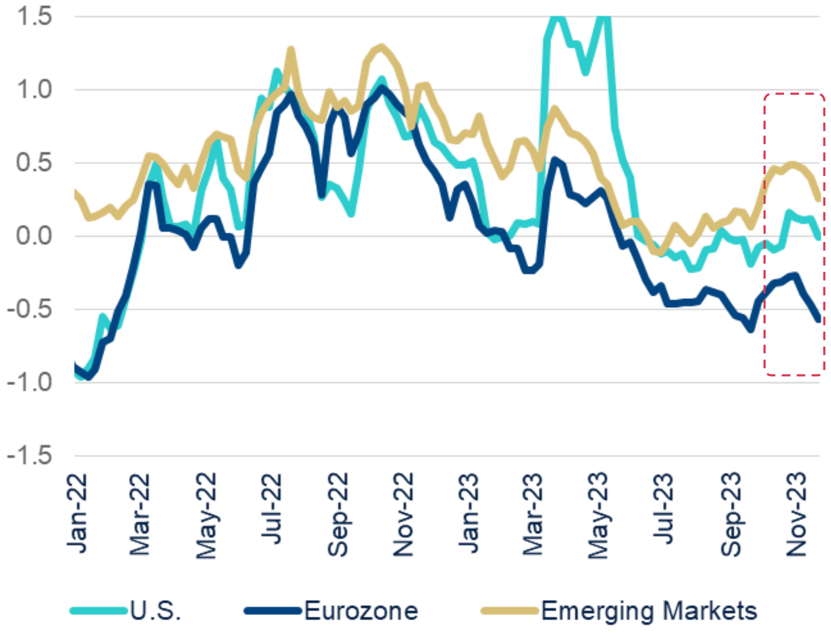


Source: BBVA Research based on Bloomberg.

Financial tensions and sovereign yields have fallen with optimism on inflation and early monetary easing cycle, but markets remain subject to volatility

BBVA RESEARCH FINANCIAL TENSIONS INDEX

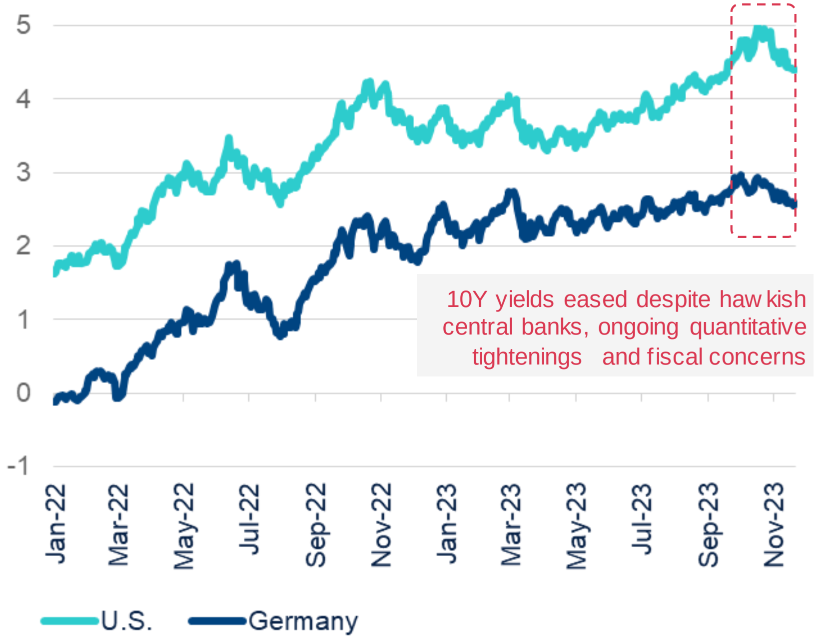
(INDEX: HISTORIC AVERAGE = 0)



Source: BBVA Research based on Bloomberg.

US AND GERMAN SOVEREIGN YIELDS: 10Y

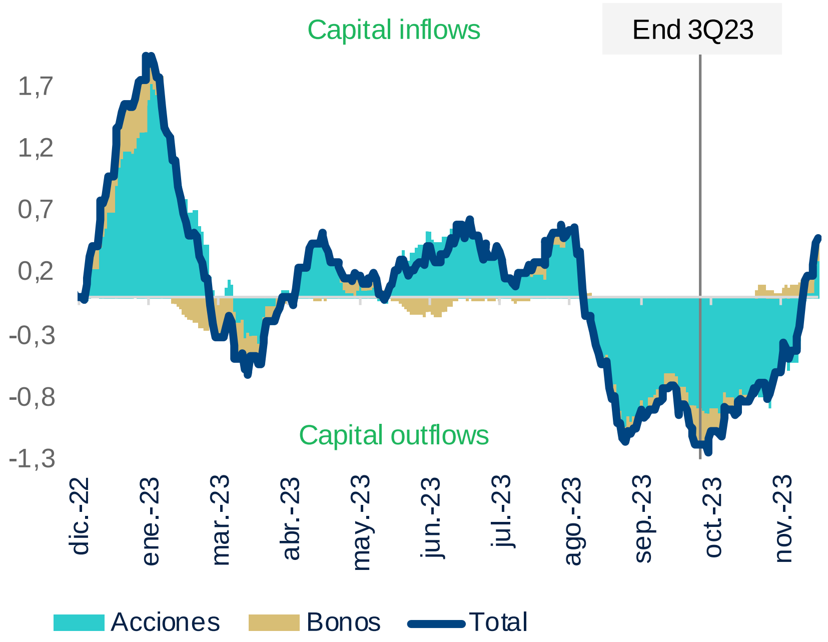
(%)



Source: BBVA Research based on Bloomberg.

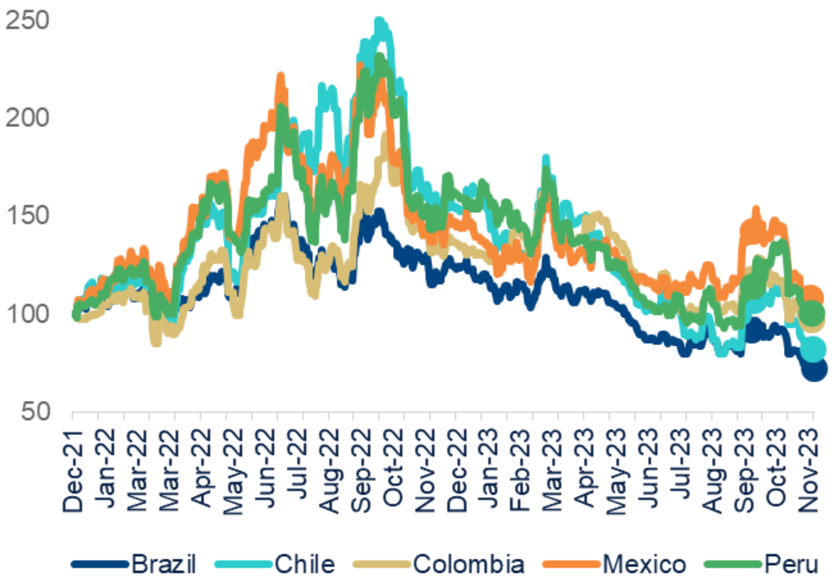
In these circumstances, flows to emerging markets rebound and risk premiums in LatAm decrease…

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



Source: IIF (information as at November 22).

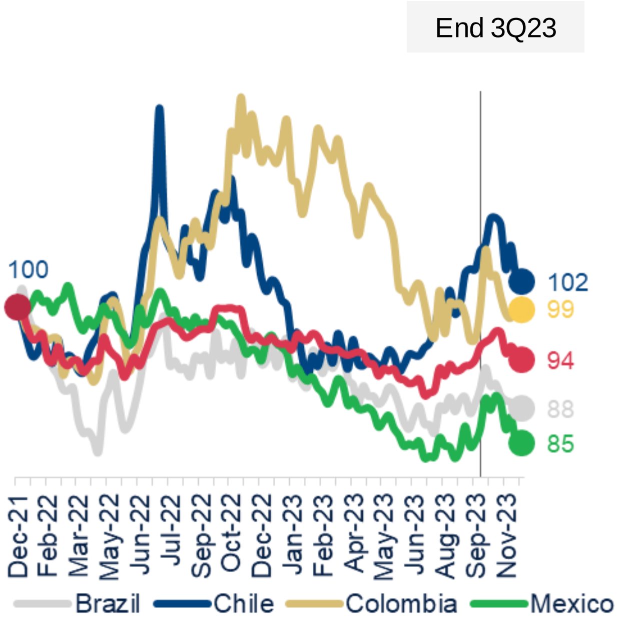
LATAM: COUNTRY RISK
(MEASURED BY CDS, BP, INDEX 100=DEC 2021)



Source: Bloomberg (information as at November 23).

…currencies strengthen vis-à-vis the dollar and required yields on sovereign debt fall

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

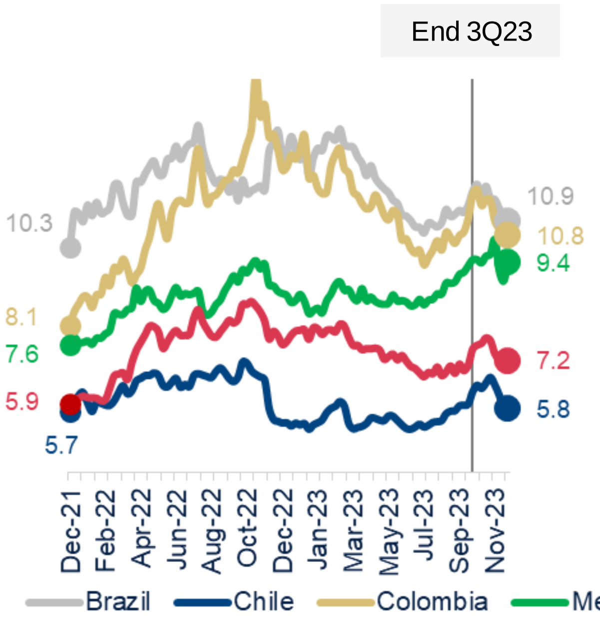


01/12/23 vs. 30/09/23 (%)*	Cum. YTD (%)*
-2.4	2.2
-1.2	-17.2
-0.9	-1.4
-1.8	-6.4
0.2	-10.5

*Positive sign: depreciation
Negative sign: appreciation

Source: Bloomberg (information as at December 1).

LATAM: SOVEREIGN BOND YIELDS 10 YEAR (%)



01/12/23 vs. 30/09/23 (pp)*	Cum. YTD (pp)*
-82	-187
-87	-223
-102	-6
-29	-91
-52	39

Source: Bloomberg (information as at December 1).

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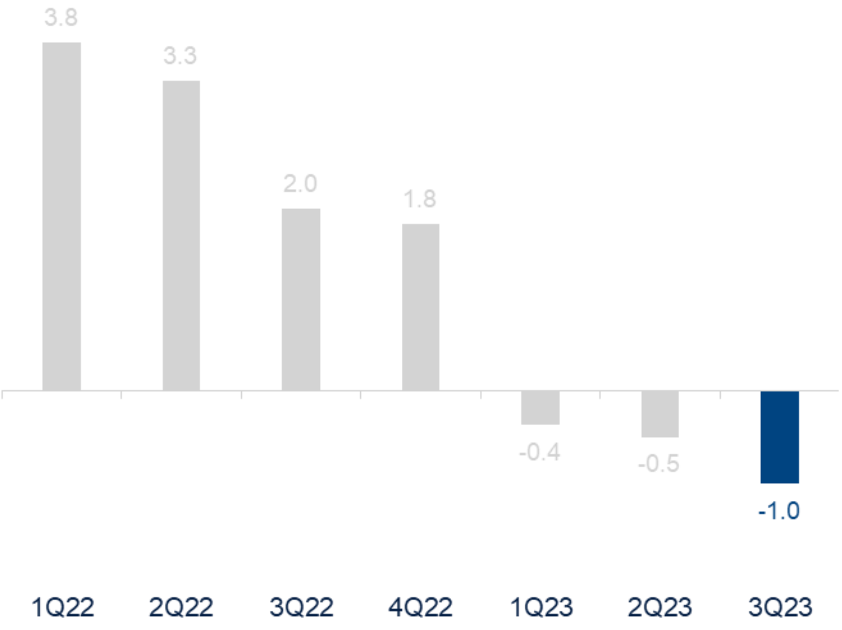
02

Local context: employment and activity

Creating Opportunities

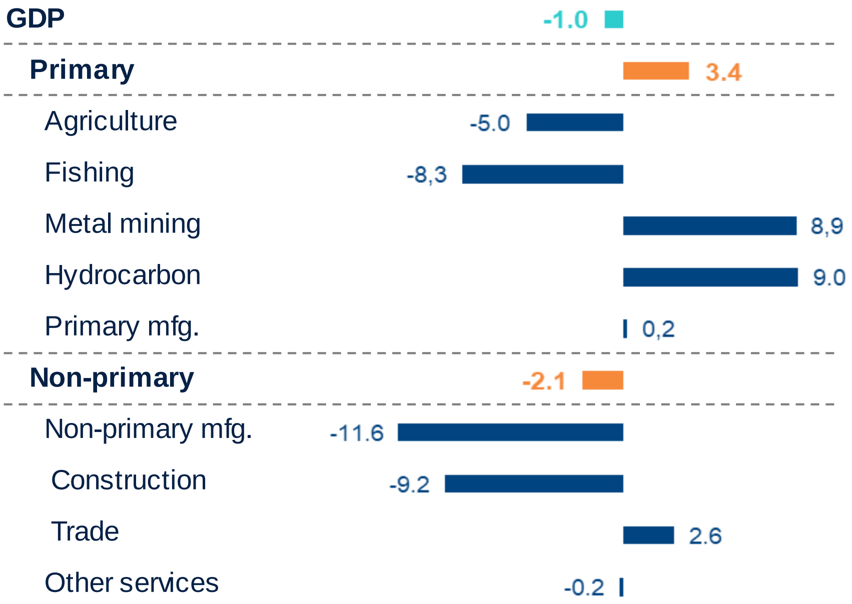
Fresh downturn in economic activity in the third quarter, reflecting marked weakness in non-primary sectors...

GDP
(Y/Y % CHG.)



Source: BCRP and BBVA Research.

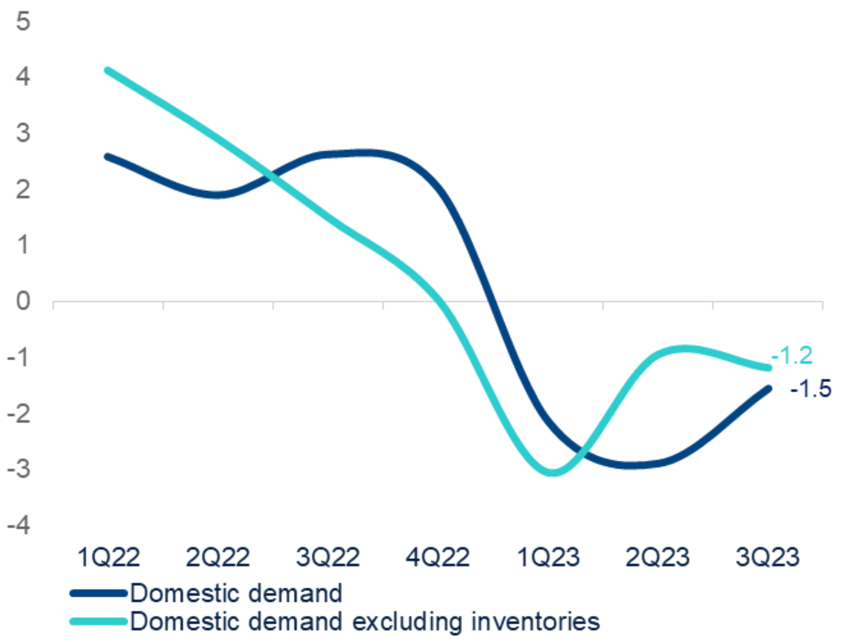
GDP BY PRODUCTIVE SECTORS IN 3Q23
(Y/Y % CHG.)



Source: BCRP and BBVA Research.

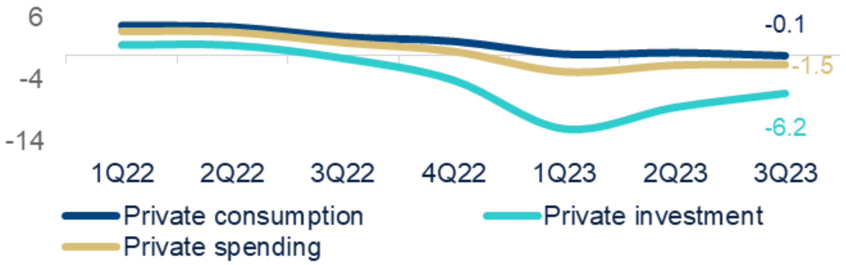
…and, on the demand side, slowdown in private sector spending.

DOMESTIC DEMAND
(Y/Y % CHG.)

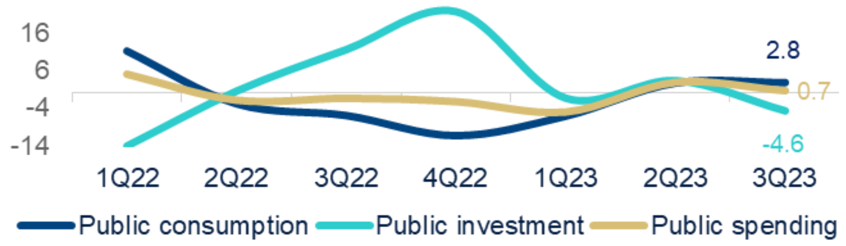


Source: BCRP and BBVA Research.

PRIVATE SPENDING
(Y/Y % CHG.)



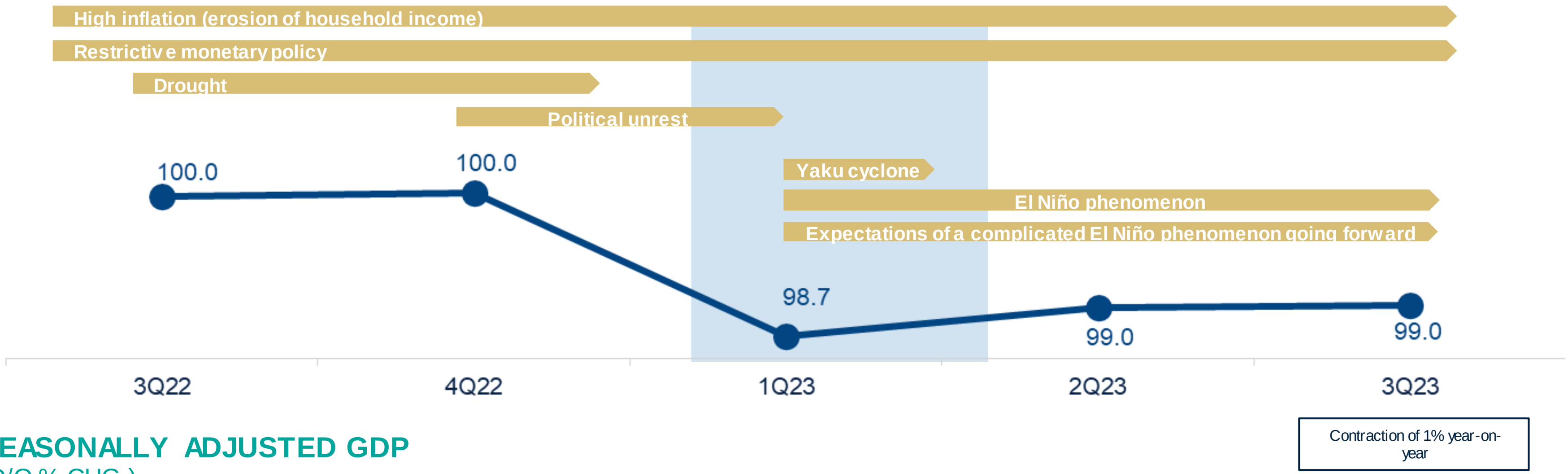
PUBLIC EXPENDITURE
(Y/Y % CHG.)



Source: BCRP and BBVA Research.

Sequential analysis indicates failure by the economy to recover from negative shocks from earlier this year

SEASONALLY ADJUSTED GDP
(INDEX 100 = 3Q22)



SEASONALLY ADJUSTED GDP
(Q/Q % CHG.)

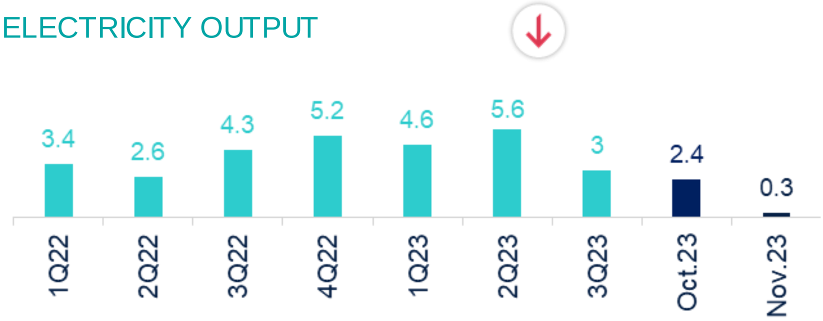
3Q22	4Q22	1Q23	2Q23	3Q23
0,7	0,0	-1,3	0,3	0,0

Source: BCRP and BBVA Research.

Available indicators show that the economy was still weak at the beginning of the fourth quarter

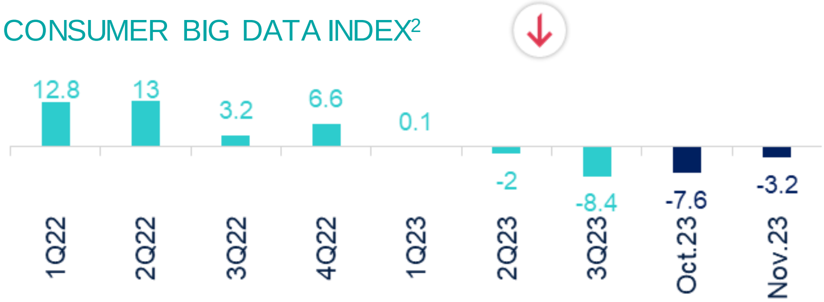
AVAILABLE ACTIVITY INDICATORS
(Y/Y % CHG.)

ELECTRICITY OUTPUT

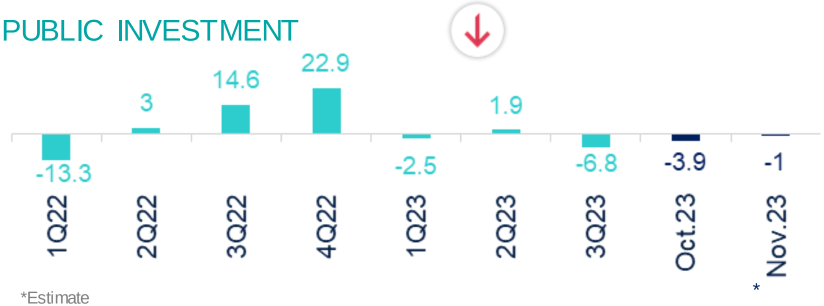


BIG DATA INVESTMENT INDEX[1]

CONSUMER BIG DATA INDEX[2]



PUBLIC INVESTMENT

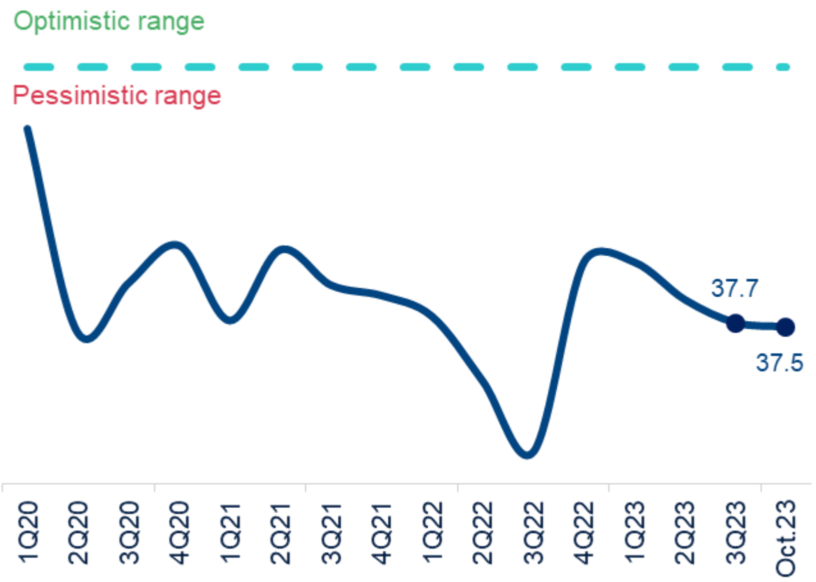


*Estimate

1/ Uses information on payments into accounts of selected companies.
2/ Uses data on the amount of credit and debit card purchases made by households and cash withdrawals through ATMs and teller windows. Information as at November 22, 2023.
Source: INEI, BBVA Research.

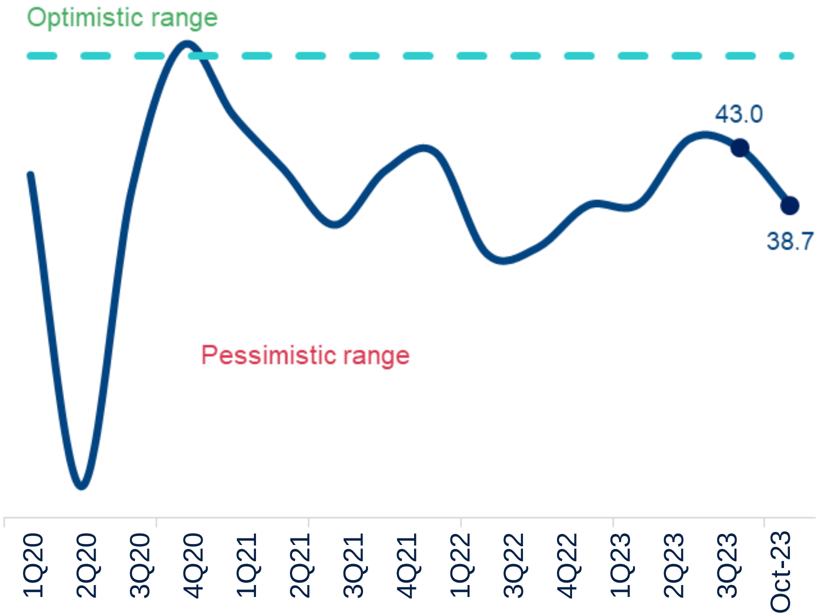
Confidence indicators suggest that private spending and, accordingly, activity are unlikely to show any meaningful improvement in the short term

CONSUMER CONFIDENCE
(POINTS)



Source: Apoyo Consultoría.

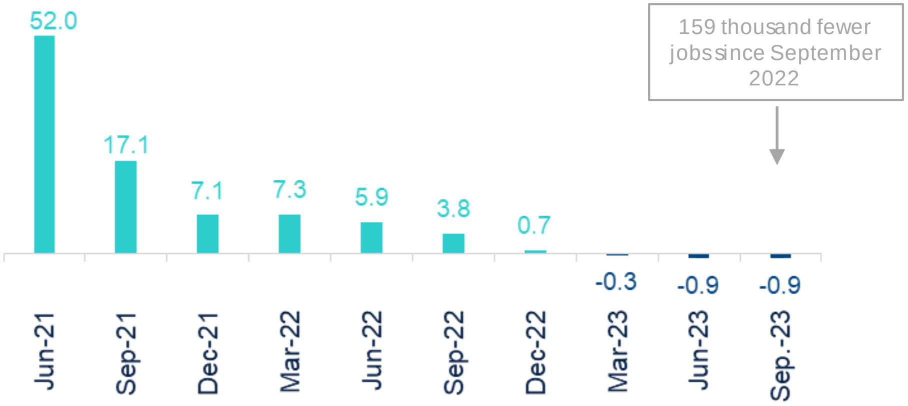
BUSINESS CONFIDENCE[1]
(POINTS)



1: 3-month ahead economic outlook.
Source: BCRP.

Employment also drops, particularly in primary activities (affected by weather anomalies), manufacturing and construction

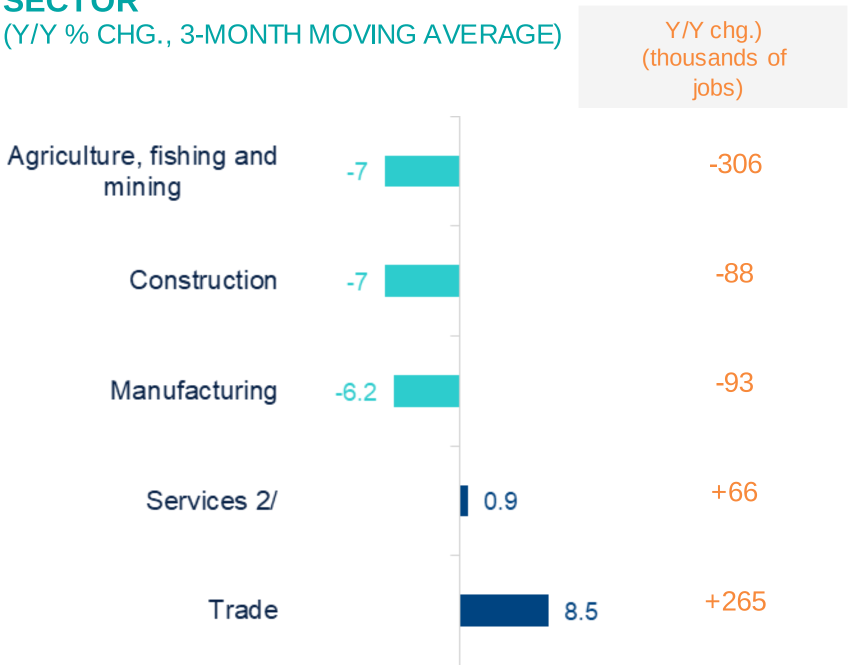
EMPLOYMENT AT NATIONAL LEVEL [1]
(Y/Y % CHG., 3-MONTH MOVING AVERAGE)



(average last 3 months)

	Mar-22	Jun-22	**Sept-22**	Mar-23	Jun-23	**Sept-23**
Employed EAP (millions)	17.1	17.5	**17.4**	17	17.3	**17.2**
Unemployment rate (%)	6.2	4.2	**4.3**	5.9	5.3	**5.1**

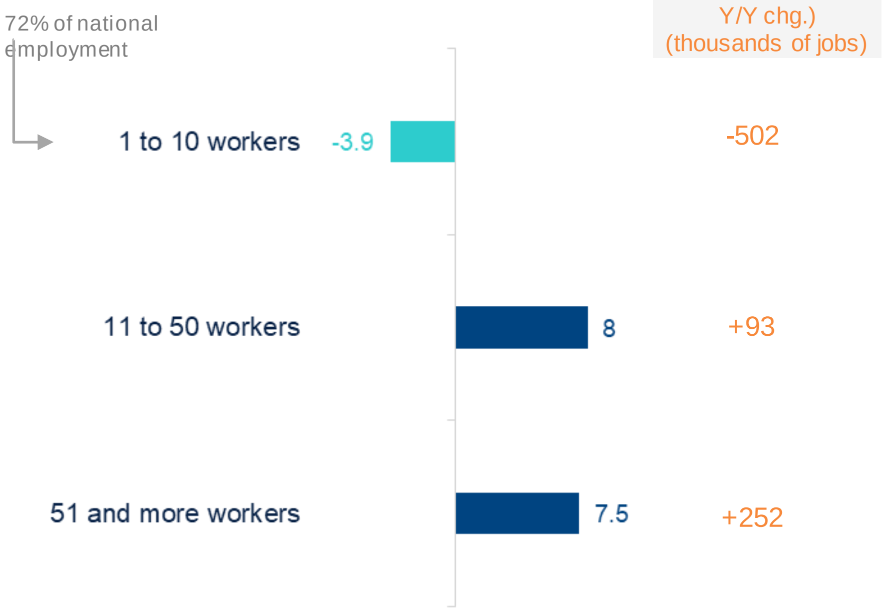
SEPT-23: EMPLOYMENT AT NATIONAL LEVEL BY SECTOR
(Y/Y % CHG., 3-MONTH MOVING AVERAGE)



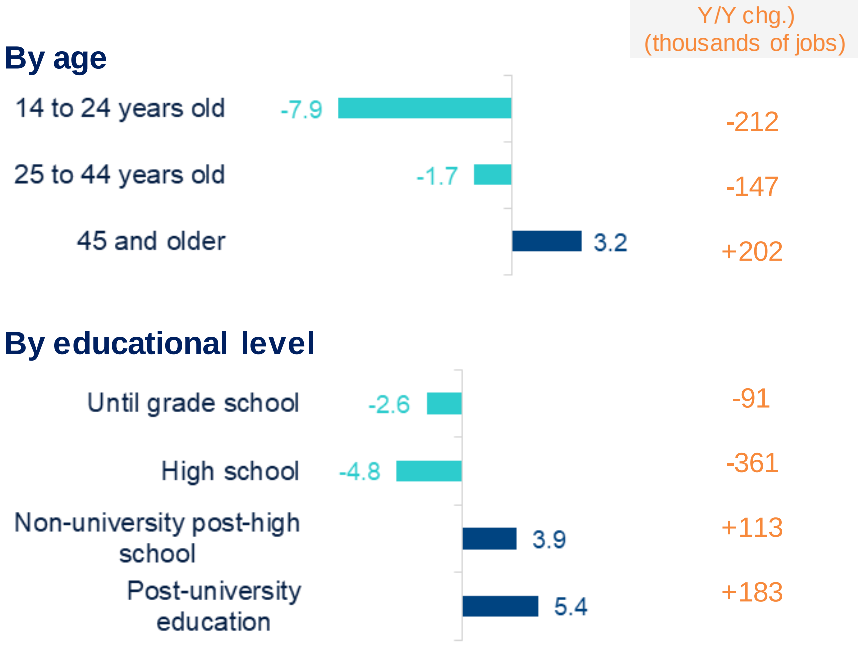
1: Until December 2022, information from the ENAHO is used; for the first and second quarters of 2023, the EPEN is used.
2: Includes: Transport and communications, Financial intermediation, Real estate, business and renting activities, Education, Health and social work activities.
Source: INEI (ENAHO, EPEN). Preparation: BBVA Research.

Job losses are concentrated in smaller companies and affect mostly younger and less educated workers.

SEPT-23: EMPLOYMENT AT NATIONAL LEVEL BY COMPANY SIZE
(Y/Y % CHG., 3-MONTH MOVING AVERAGE)



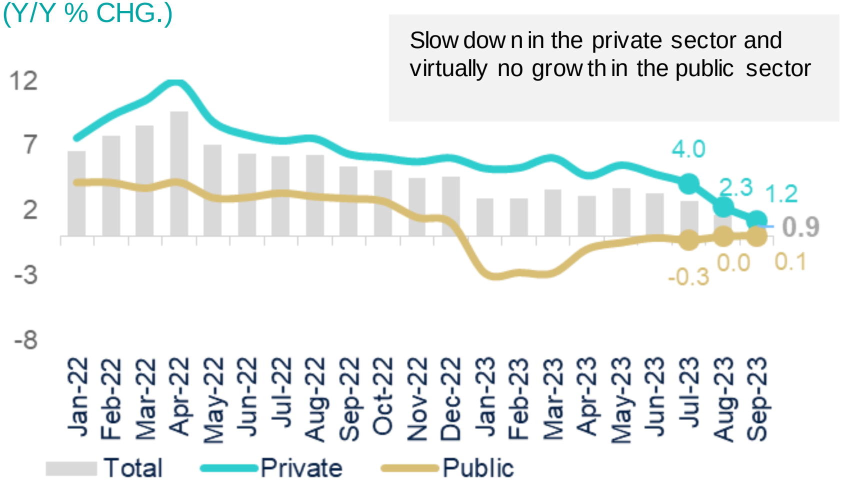
SEPT-23: EMPLOYMENT AT NATIONAL LEVEL BY WORKER CHARACTERISTICS
(Y/Y % CHG., 3-MONTH MOVING AVERAGE)



Source: INEI (EPEN). Preparation: BBVA Research.

Formal job creation in the labor market continues to grow, but at a slower pace, while the purchasing power of wages is improving marginally

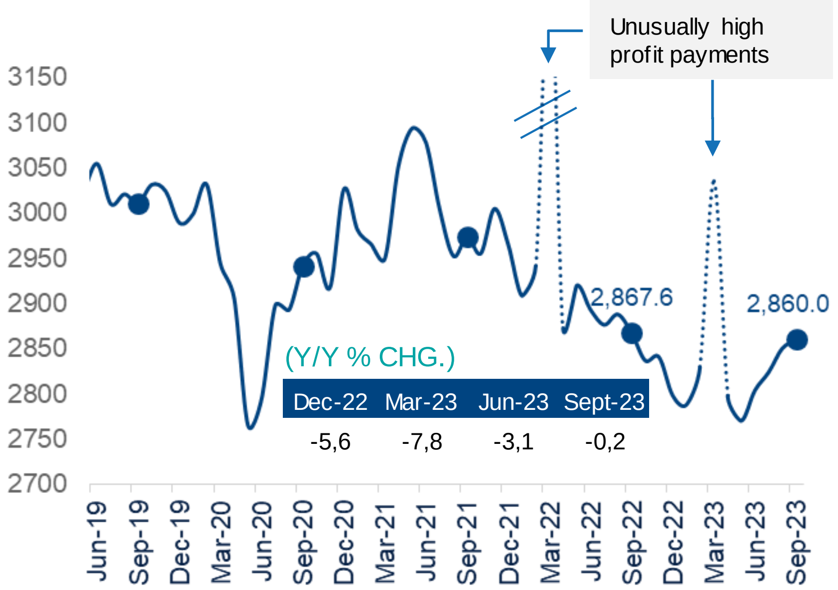
NATIONAL FORMAL EMPLOYMENT
(Y/Y % CHG.)



(THOUSANDS OF FORMAL JOBS)

	Sept-19	Sept-20	Sept-21	Sept-22	Sept-23
Total	5.354	5.076	5.453	5.745	5.798
Private	3.859	3.524	3.872	4.118	4.169
Public	1.495	1.552	1.581	1.627	1.629

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



1: In September 2023, the average income of a formal job was PEN 2.860. 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 (September 2023) matches the nominal monthly income for the month.
Source: SUNAT (Electronic Records) and BCRP. Preparation: BBVA Research.

In a bid to address the stagnant economy and bolster confidence, the Peruvian Government unveiled a set of measures: the "United Plan"

MAIN MEASURES ANNOUNCED UNDER THE PLAN

- **Protection of the payment chain.** Increase in the amount allocated to the Impulso MyPerú (MyPeru Boost program, state guarantees for MyPE), from PEN 5 billion to PEN 15 billion.
- **Promotion of water infrastructure megaprojects.** The main project is Chinecas.
- **Incentives for agro-export sectors.** Company contributions to Essalud in 2024 and 2025 will remain a 6% (with plans to increase this to 7% in 2025 and then more, to 9% in 2029).
- **Maintenance of public infrastructure.** PEN 5.5 billion in 2024, of which PEN 900 million is earmarked for road maintenance.
- **A shock to unlock mining projects.** Construction is scheduled to begin on seven mining projects toward 2025 (worth USD 4.6 billion)[1/].
- **PPP shock.** As much as USD 8 billion will be awarded to 40 projects in 2024 (up from USD 2.3 billion in 2023).
- **Boost to human capital.** Higher investment in educational credit programs.
- **Development of the petrochemical industry.**

1/ Expansion of Toromocho Phase II and refurbishment of Antamina, Yumpag, Romina, Corani, Chorobamba and Zafranal.
Source: MEF.

ASSESSMENT

- The United Plan is largely a rehash of previously announced measures.
- Part of the plan is geared toward medium- and long-term growth (reactivation of investment projects, improvement of human capital), which is good but not exactly new. However, several state entities and public officials of different ranks will have to be involved to implement the measures; incentives must be changed so they are aligned to achieve a common objective.
- Measures with a medium- or long-term objective could also have a positive short-term impact through improvement in confidence. However, public response to the United Plan has been lukewarm.
- Short-term measures announced will not require any major increase in public expenditure over the coming months (e.g. road maintenance was already budgeted).
- Impulso MyPerú (MyPeru Boost program): will there be demand amid a backdrop of economic weakness that could continue for a few more months? Is there enough liquidity?

BBVA Research

03

Global economic forecasts

A soft landing of both growth and inflation is likely to pave the way for cautious rate-cutting cycles, which are closer now but are not imminent yet

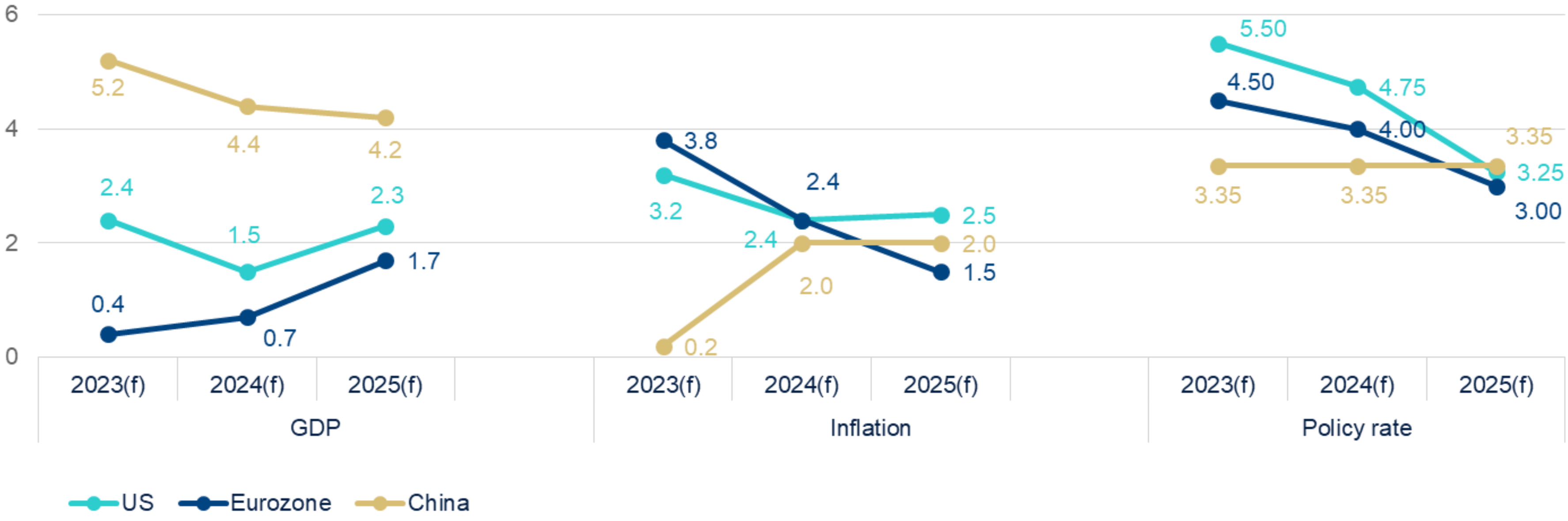
BBVA RESEARCH BASELINE SCENARIO

Growth and inflation slowdown	Cautious central banks	Financial volatility	Geopolitical tensions
Growth and inflation will ease on extra demand weakening, given no extra supply shocks, but risks are still significant	Fed and ECB rates have peaked but are unlikely to be cut before Jun/24; anyway, quantitative tightening will continue	Volatility will remain in place on high interest rates, still hawkish central banks and large uncertainty	Rising risks, but large economic effects are not assumed; Middle-East conflict to have limited impact on energy prices

Global growth will be relatively low, while inflation and policy rates will decline without converging to pre-pandemic (ultra-low) levels over the next two years

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

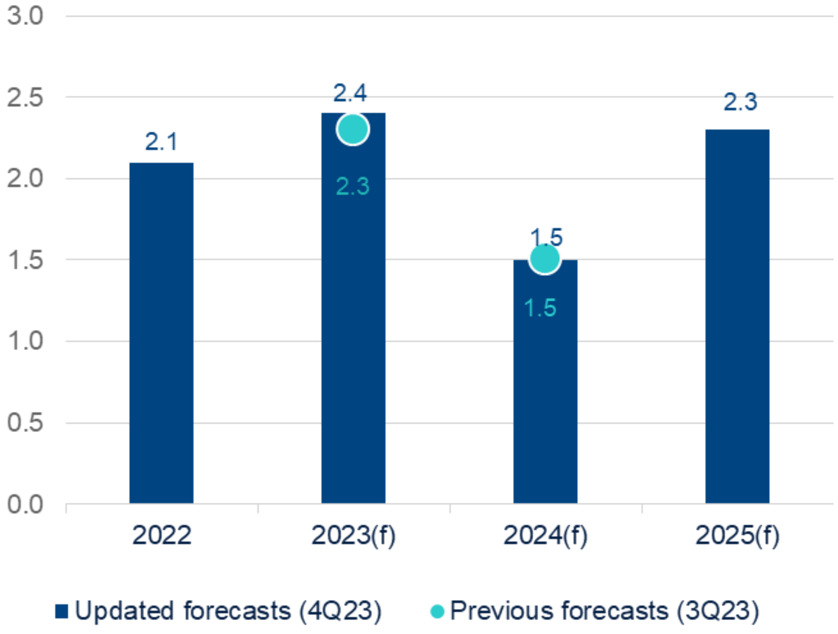
(GDP GROWTH: %; INFLATION: YOY %, END OF PERIOD, POLICY INTEREST RATES: %, END OF PERIOD)



(*) Global GDP growth is forecast to ease from 3.4% in 2022 to around 3.0% (+0.1pp) in 2023, 3.0% (0.0pp) in 2024 and 3.3% in 2025, below the 2000-2022 average (3.6%).
(**) In the case of the Eurozone, interest rates on refinancing operations.
(f): forecasts
Source: BBVA Research based on Bloomberg data.

US: solid domestic demand supports 2023 growth; high interest rates (despite eventual rate cuts from June) likely to weigh more on growth in 2024

US: GDP GROWTH
(%)

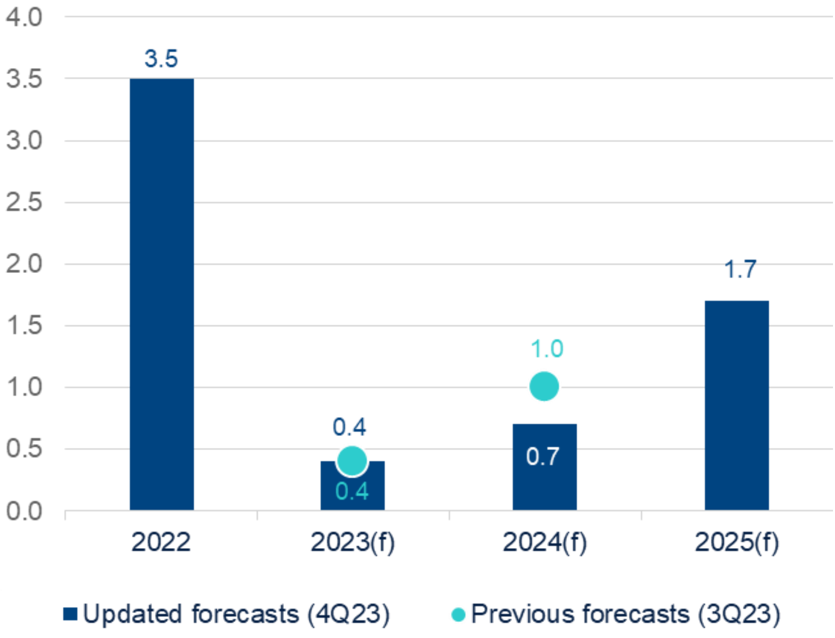


(f): forecast.
Source: BBVA Research

- 2023 growth revised up, despite moderation signs: consumption backed by still significant excess savings and strong labor markets; manufacturing is benefiting from bottleneck normalization.
- Growth to ease in 2024 mainly on the lagged effect of the recent monetary tightening.
- Inflation to keep falling as labor markets come into a better balance.
- Fed: the most likely is a pause with gradual cuts from Jun/24; fears of incomplete convergence to the 2% target to prevent earlier cuts.
- Risks: recession or financial stress on high rates, presidential elections and expansive fiscal stance.

Eurozone: milder growth and lower inflation favor a reduction of ECB policy rates from September, somewhat earlier than previously expected

EUROZONE: GDP GROWTH
(%)

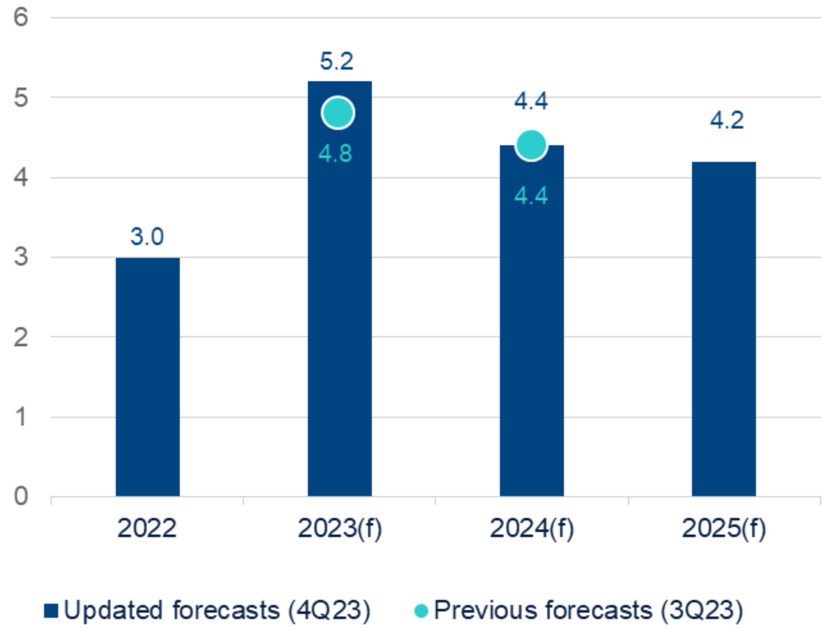


(f): forecast.
Source: BBVA Research

- GDP forecasts: unchanged in 2023 but revised down in 2024; recent data suggest a (minor) recession in 2H23.
- Inflation forecasts revised down: pressures from energy prices, fiscal policy and labor markets to be offset by sharper core disinflation, in line with incoming data.
- ECB: rate cuts from Sep/24, when the disinflation process will be clearer; balance sheet reduction will continue, with focus on PEPP reinvestment and new operational framework.
- Risks: stagflation and competitiveness problems on high energy prices, sovereign debt tensions.

China: recent data reinforce the view that a hard-landing will likely be avoided, but growth is set to ease in 2024-25 as structural challenges remain in place

CHINA: GDP GROWTH
(%)



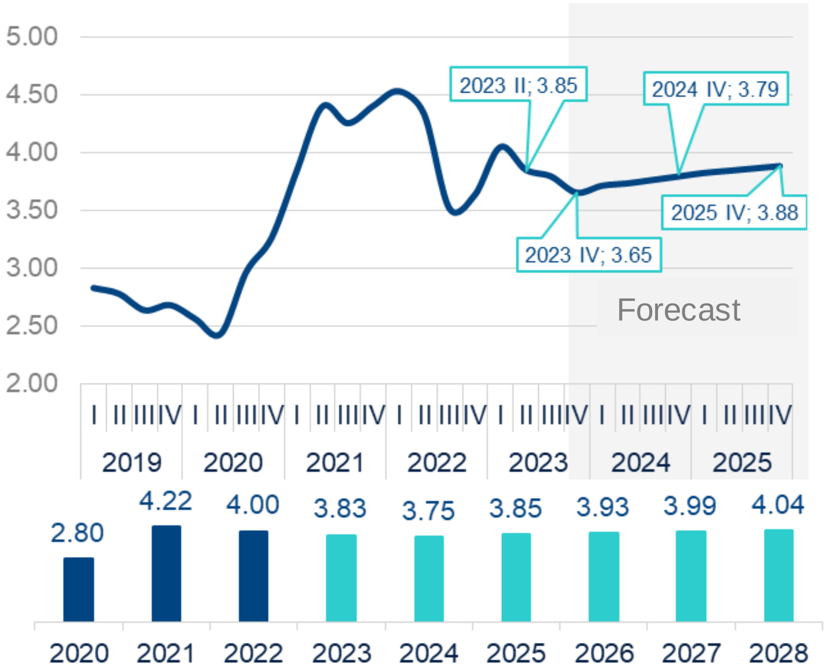
(f): forecast.
Source: BBVA Research

- 2023 GDP was revised upwards in line with incoming data showing that demand improved somewhat after series of stimulus policies were adopted to avoid a hard-landing.
- Growth is likely to weaken ahead and hard-lading is still a risk as real estate tensions, large local government debt and other structural problems (middle-income trap, ageing, US confrontation etc.) remain in place.
- Inflation remains close to zero, but is forecast to converge to 2% on more supportive policies and some confidence improvement.
- Risks: sharp growth deceleration, deflation and balance-sheet recession, geopolitical tensions.

Lower copper prices due to still high interest rates and the initial impact of tensions in the Middle East

COPPER PRICE

(USD/POUND AVERAGE FOR THE PERIOD)



Source: Bloomberg and BBVA Research.

- We expect prices to pick back up gradually over the coming months on the back of (ii) expectations of Fed and ECB rate cuts in 2024 and (ii) historically low inventory levels (due in part to supply shocks).
- We still believe that higher investment in green infrastructure and vehicle conversion should support prices over the medium and becoming increasingly important factors in the next few years.

Risks: tensions in the Middle-East add to the concerns about the potential consequences of high inflation and interest rates and a hard-landing in China

Inflation and high interest rate risks	Financial tensions risks	Growth deceleration risks
Higher energy prices on **Middle-East or Ukraine conflicts**	**Risk-off** and financial volatility	**Stagflation,** mainly in the EZ and other energy net-importers
Strong demand on **public spending** (scarce fiscal consolidation)	Tensions in **sovereign debt markets**	**Recession,** including (but not only) in the US
Strong demand on **private spending** (labor tightness, etc.)	Tensions in **private debt markets**	**Hard-landing in China,** with balance-sheet recession and deflation risks

Uncertainty on series of economic, political, geopolitical and climate factors

Economic uncertainty	Political uncertainty	Geopolitical uncertainty	Climate uncertainty
Inflation and macro policy mix	**US presidential** elections	**Israel-Hamas** conflict	**El Niño effects** mainly on S. America
Monetary tightening impact, neutral level	**Political tensions** in DMs and EMs	**Ukraine-Russia** war	**Climate disruptions** and weather shocks
Fiscal consolidation	**Populism** and social unrest	**US-China rivalry:** deglobalization, Taiwan	**Energy transition** policies

BBVA Research

04

Peru economic forecasts

4.1 Economic activity

Global macro outlook: key considerations and local impacts

FACTORS CONSIDERED

Lower growth and inflation. Demand is set to decline, provided there are no new supply shocks.

Cautious central banks. Fed and ECB policy interest rates have peaked, but are unlikely to start coming down before June '24. Liquidity should continue to decline.

Market volatility due to high interest rates, the aggressive stance of central banks, and uncertainty.

Geopolitical tension, with increasing risks, but minimal impacts on the economy. Scant impact of energy prices of the war in the Middle East.

LOCAL IMPACTS

- **Activity:** Drop in external demand, especially for non-traditional products.
- **Exchange rate:** the cautious stance by the largest central banks (regarding rate cuts), market volatility, and geopolitical tension will undermine support for the PEN.

Domestic macro outlook: key considerations

FACTORS CONSIDERED

1. Growth in the third quarter underperformed expectations, especially in sectors of production related more closely to domestic demand, which continues to show a greater sensibility to the challenging economic environment (and will probably continue to do so in the short term).

2. The El Niño phenomenon will remain active over the rest of the year, with strong intensity. It should moderate well after the start of 2024 and dissipate in the year's second quarter.

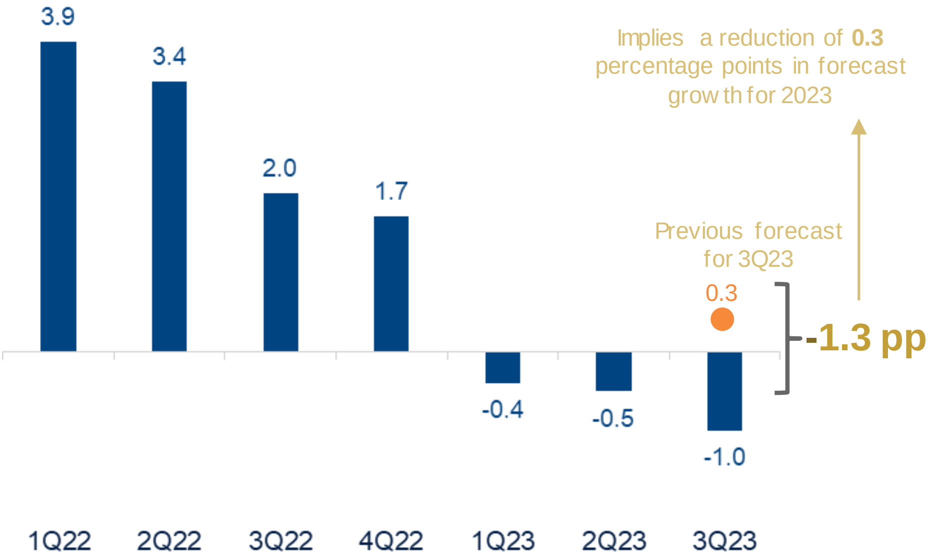
3. The pace of public spending picks up, focused on mitigating the impacts of El Niño in 2024. Post-El Niño rehabilitation and reconstruction work. Bond disbursements for public sector workers are now being considered over the remainder of 2023.

4. The mining sector contribution to growth is tending to wane. Quellaveco's contribution to the year-on-year growth rate will disappear (this mine started producing copper in September last year). This was already factored in the previous forecast.

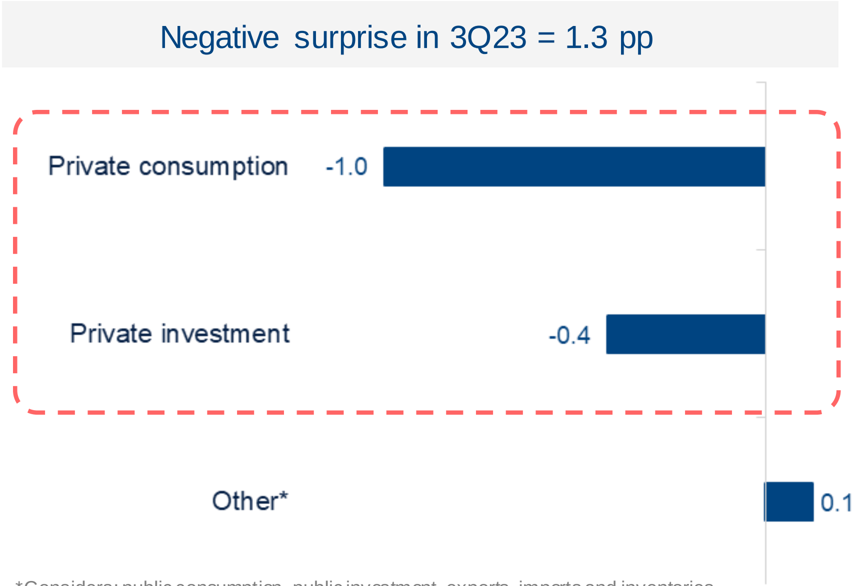
5. Relatively stable political context. However, the state of calm is fragile. Similar scenario to that included in the previous forecast.

1 The third quarter featured a negative surprise in growth, with private spending showing greater sensibility to the challenging environment

GDP
(Y/Y % CHG.)



3Q23 EXPENDITURE-SIDE GDP: DEVIATIONS FROM OUR PREVIOUS FORECAST (PP OF GDP)



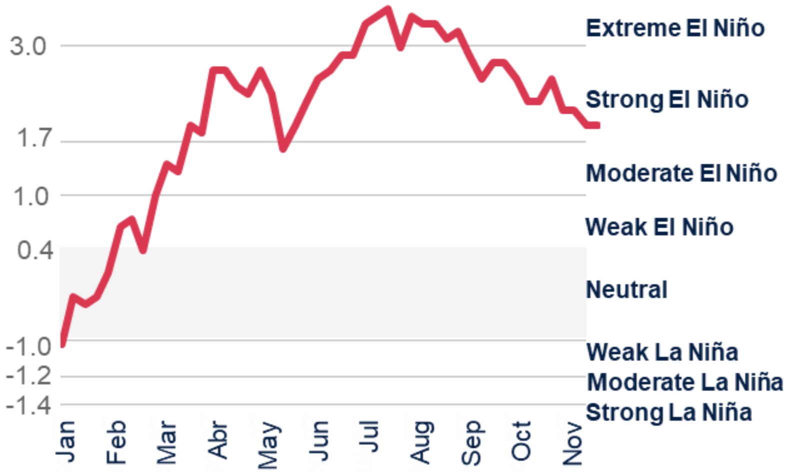
*Considers: public consumption, public investment, exports, imports and inventories

Source: BCRP and BBVA Research.

2 The coastal El Niño phenomenon (Pacific areas 1 and 2) will continue in the rest of the year and through the summer of 2024 (heavy rain in northern coast)

SEA SURFACE TEMPERATURE ANOMALY ON THE NORTHERN PERUVIAN COAST

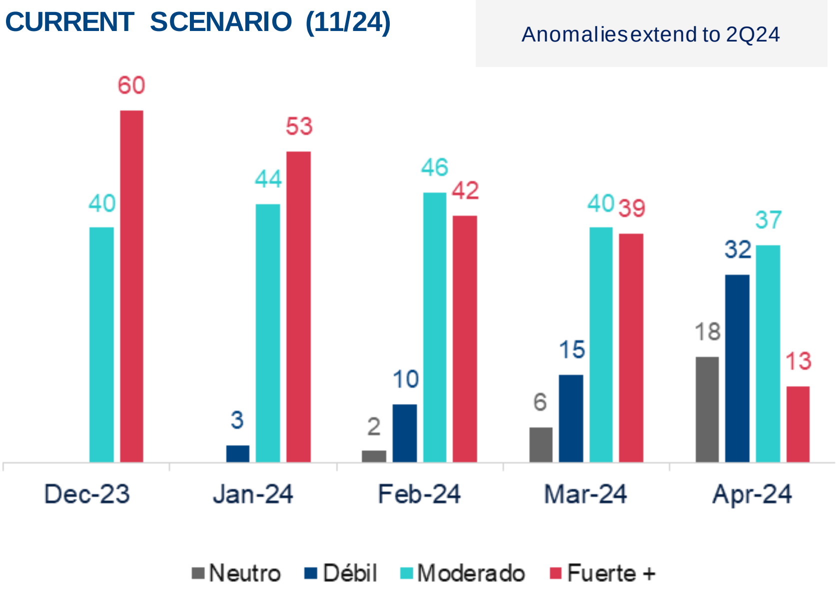
(DEGREES CELSIUS, WEEKLY MOVING AVERAGE)



The second anchovy catch season kicked off seizing the decrease in the anomaly of sea temperatures, with a higher-than-expected quota: 1.7 million tons compared to the 1.0 million tons considered in Sept 23.

COASTAL EL NIÑO | PROBABILITY OF OCCURRENCE BY MAGNITUDE

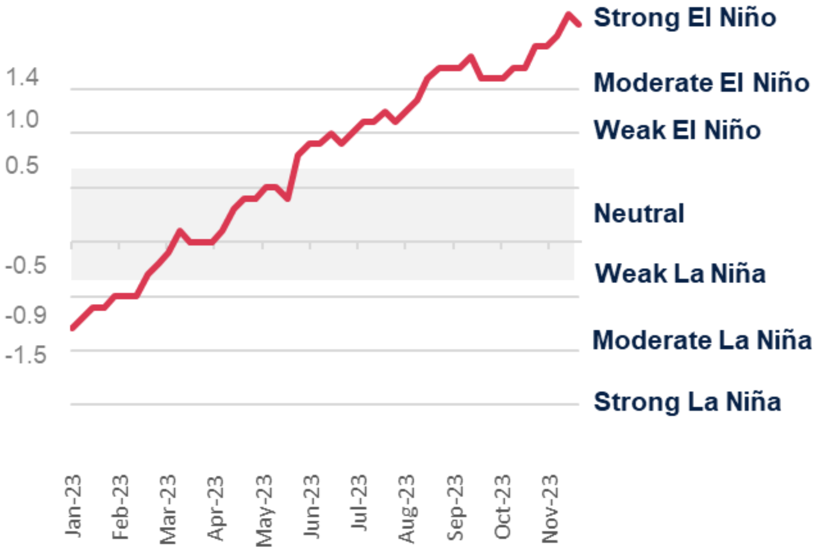
(%)



Source: NOAA, ENFEN and BBVA Research.

2 The global El Niño phenomenon (Pacific area 3.4) will continue to unfold throughout the rest of 2023 and in the summer of 2024 (drought in the southern Andean region)

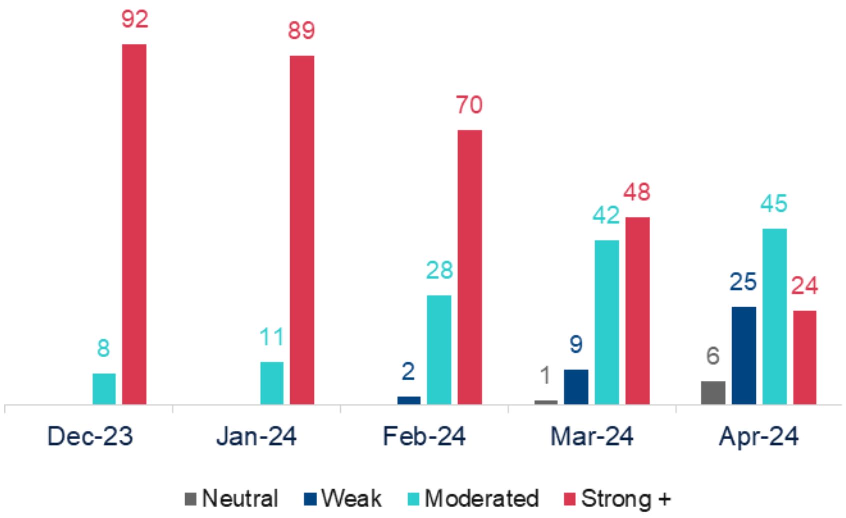
SEA SURFACE TEMPERATURE ANOMALY IN REGION 3.4
(DEGREES CELSIUS, WEEKLY MOVING AVERAGE)



GLOBAL EL NIÑO PHENOMENON | PROBABILITY OF OCCURRENCE BY MAGNITUDE
(%)

CURRENT SCENARIO (24/11)

Anomalies last until the beginning of 3Q24

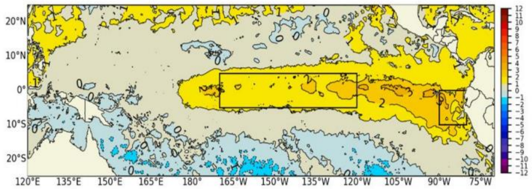


Source: NOAA, ENFEN and BBVA Research

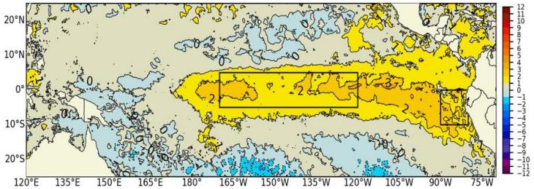
2 Assuming the current outlook for the summer of 2024, rainfall is expected to increase along the north and central coast and be lower than average in the mountains

AVERAGE SST ANOMALIES IN THE TROPICAL PACIFIC
(Cº)

November 1-15

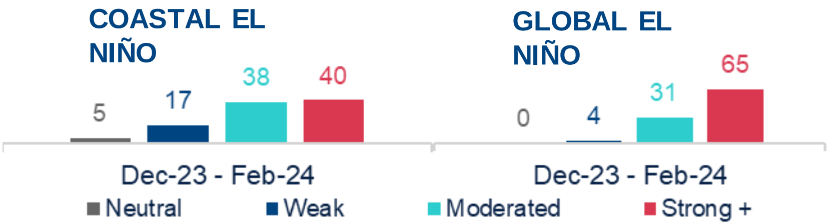


November 15-20



- Sea surface temperatures have risen in virtually the entire equatorial Pacific area and more so in the 3+4 area.
- They have decreased further in the eastern equatorial Pacific, but conditions remain extremely warm.

EL NIÑO PHENOMENON | PROBABILITY OF OCCURRENCE BY MAGNITUDE DEC 23-FEB 24
(%)

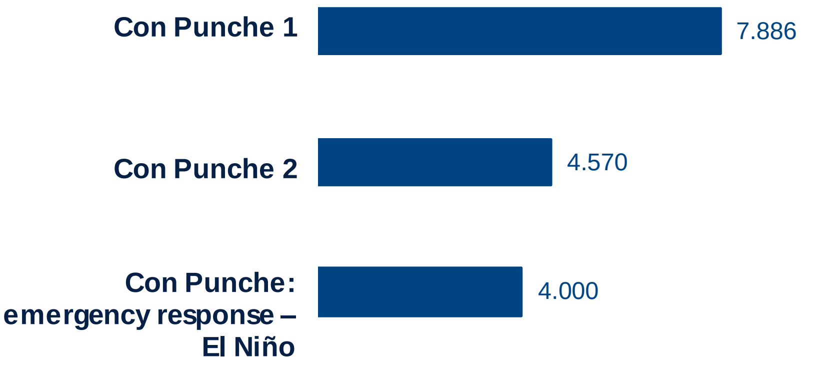


- The December 2023-February 2024 seasonal forecast calls for warm air temperatures to persist along the coast.
- Assuming occurrence of the global coastal El Niño, the summer of 2024 is more likely to feature higher-than-normal rainfall along the northern and central coasts and in the northern mountain range. **These areas could also sustain heavy rainfall.**
- Assuming the occurrence of the global El Niño in the central Pacific, lower-than-average rainfall is expected in the Andean region, particularly in the southeastern mountain range.

Source: ENFEN and BBVA Research.

3 Implementation of the "Con Punche Peru" plan should gather pace in the rest of the year, plus somewhat more public expenditure in 2023 and 2024

AMOUNTS ANNOUNCED UNDER THE FRAMEWORK OF THE CON PUNCHE PERU PLANS
(MILLIONS OF SOLES)



Total: 16 456

MONITORING OF THE CON PUNCHE PERU PLANS
(% OF TOTAL BUDGET, OUT-TURN THROUGH 12/4)

	Expenditure budgeted	Expenditure realized
Con Punche 1 and 2	86%	61%
Con Punche: emergency response – El Niño	61%	41%

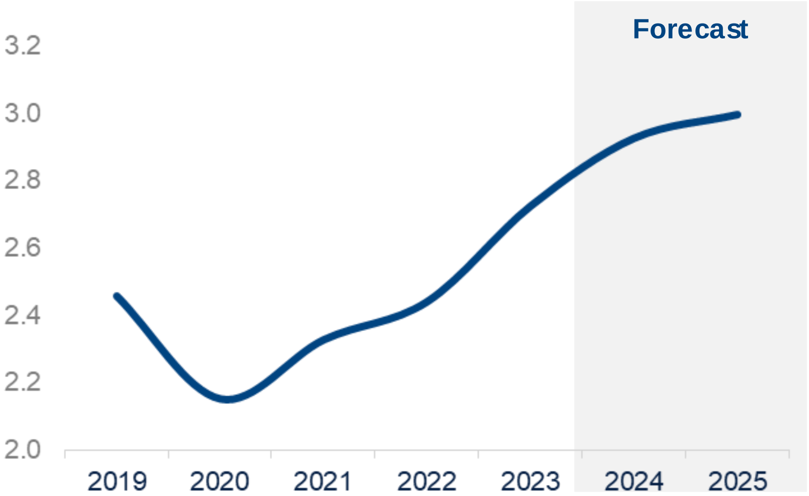
The Peruvian Government announced special bonuses for public sector workers and wage increases in the health sector equal to 0.2 pp of GDP.

With a more complicated El Niño in 2024, our baseline scenario calls for a slight increase in public expenditure on infrastructure rehabilitation and reconstruction.

Source: MEF and BBVA Research.

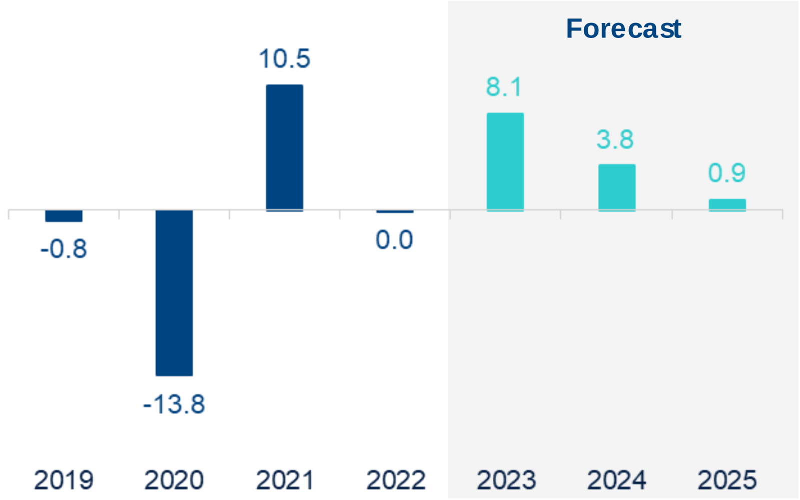
4 Quellaveco drives mining growth this year, but the impact will wear off going forward in the absence of new projects

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
(Y/Y % CHG.)

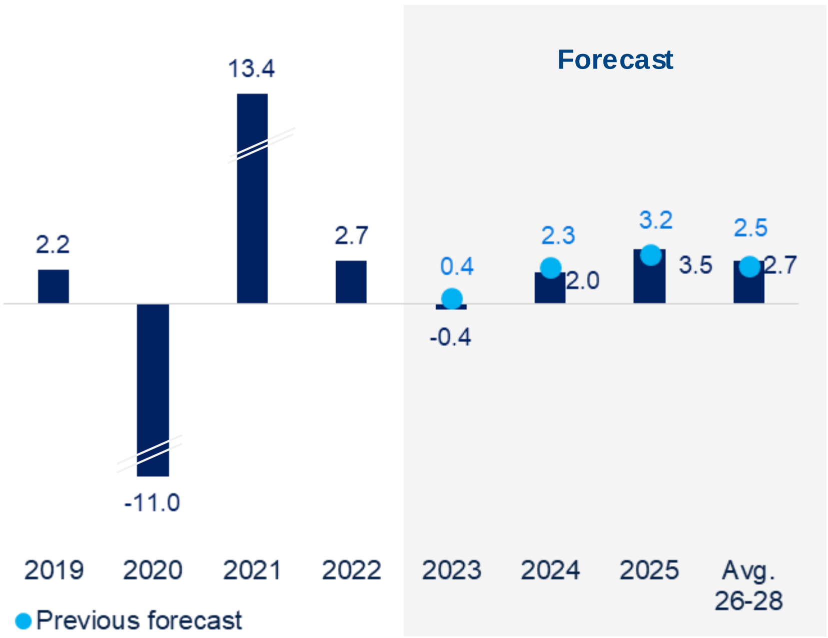


Quellaveco drives growth in mining this year. In 2024, output improves due to a lower incidence of social conflicts. Growth should slow in 2025 due to the absence of new projects.

Source: MINEM, BCRP and BBVA Research.

On balance, we estimate that the economy will contract by 0.4% this year and that growth will rebound in 2024 and 2025 to 2.0% and 3.5%, respectively.

GDP (CHG. % Y/Y)



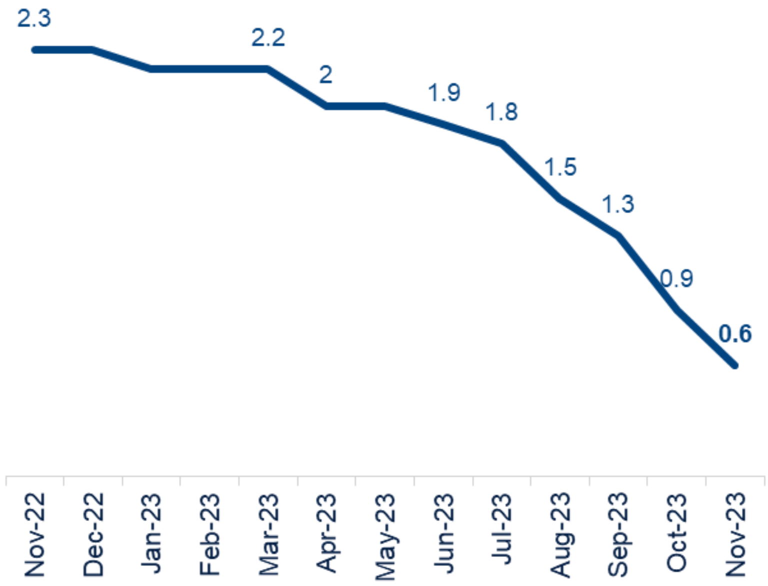
Source: BCRP and BBVA Research (forecasts).

- On our forecast, GDP will contract 0.4% this year amid supply shocks (social protests and weather anomalies), which have undermined the normal performance of productive activities.
- We expect growth to rebound in 2024 and 2025 to 2.0% and 3.5%, respectively, as the negative impact of these shocks wears off, interest rates are cut and domestic demand picks back up.
- We have revised down growth forecasts for 2023 and 2024, and we now expect a sharper rebound in 2025. The downgrade is the result of the negative surprise in third quarter growth and the sustained weakness of private spending, which looks set continue until as late as mid-2024, after the effects of El Niño dissipate.
- Available information indicates that rainfall in the summer could less intense (see Appendix)

Analysts' consensus growth forecasts for 2023 and 2024 have been revised down, but still point to higher growth than we are forecasting

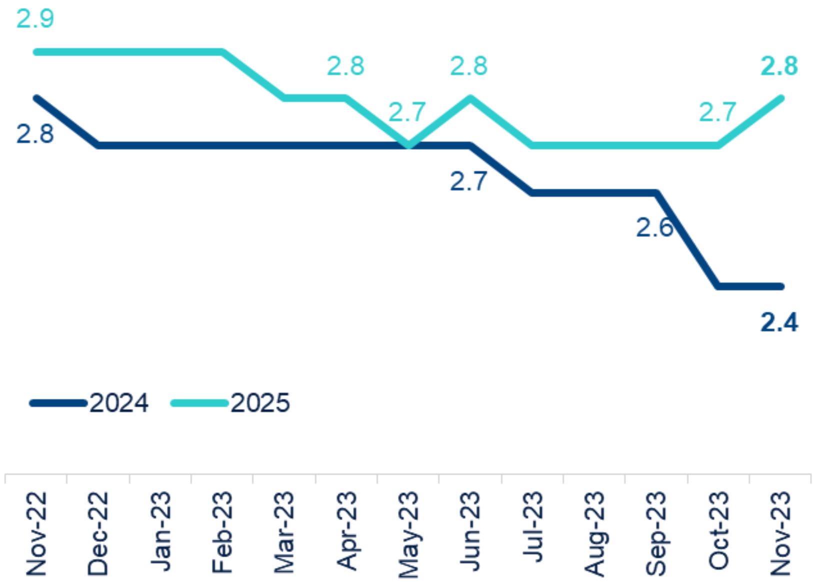
ANALYST CONSENSUS | FORECASTS FOR GDP GROWTH (IN BP) IN 2023

(Y/Y % CHG.)



ANALYST CONSENSUS | FORECASTS FOR GDP GROWTH (IN BP) IN 2024 AND 2025

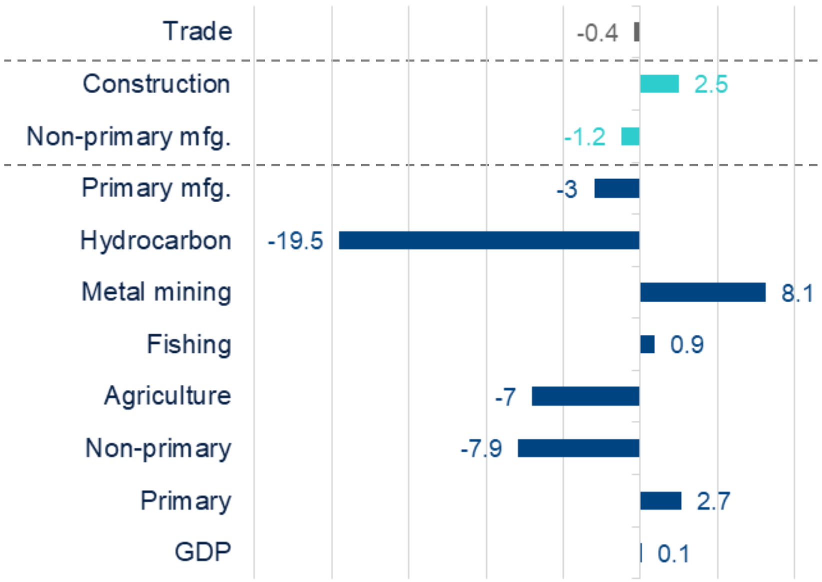
(Y/Y % CHG.)



Source: Latin Focus Consensus Forecast.

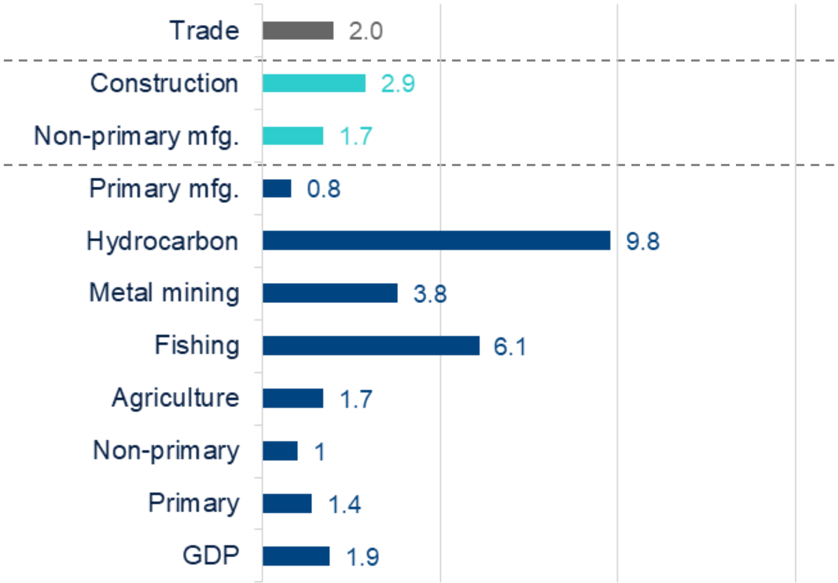
By sector, the performance of Metal Mining will stand out in 2023 and Fishing is expected to recover next year.

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



Source: BBVA Research.

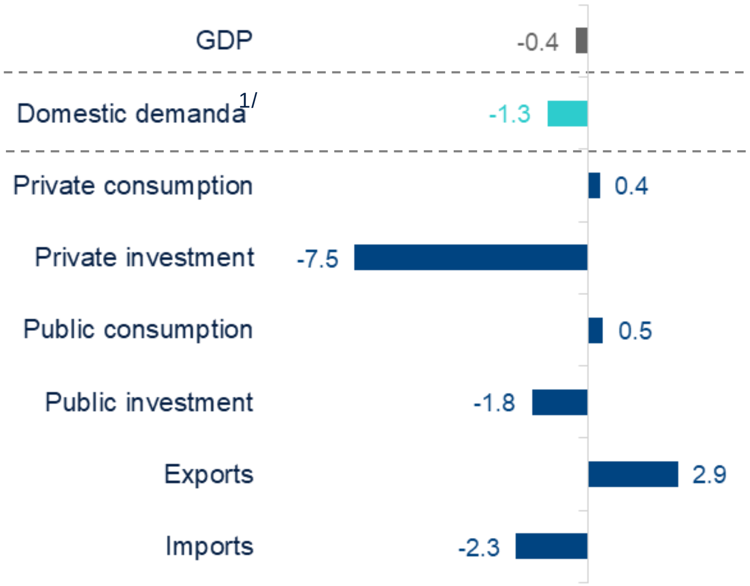
2024: SECTORAL GDP FORECAST
(Y/Y % CHG.)



Source: BBVA Research.

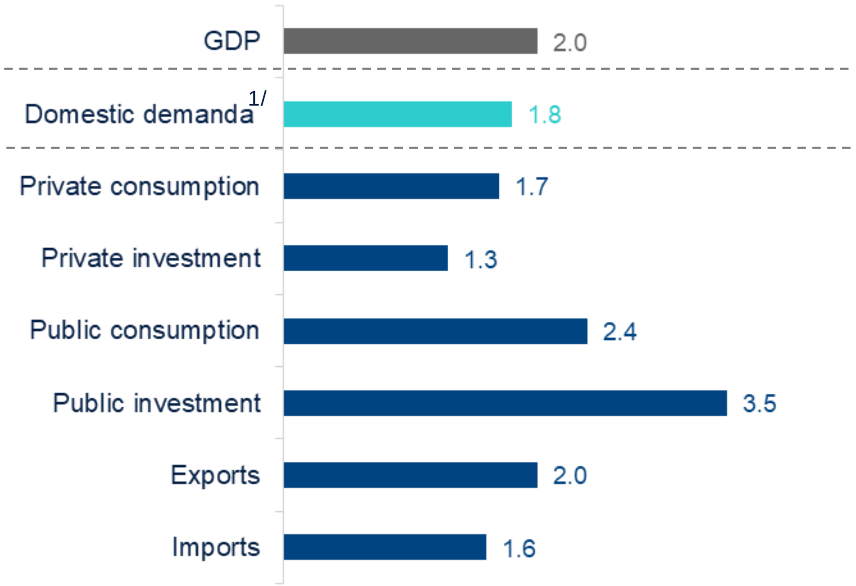
On the expenditure side, exports will reflect the improved performance of mining in 2023 and 2024. Private investment will decline this year.

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



1: Inventories not included.
Source: BBVA Research.

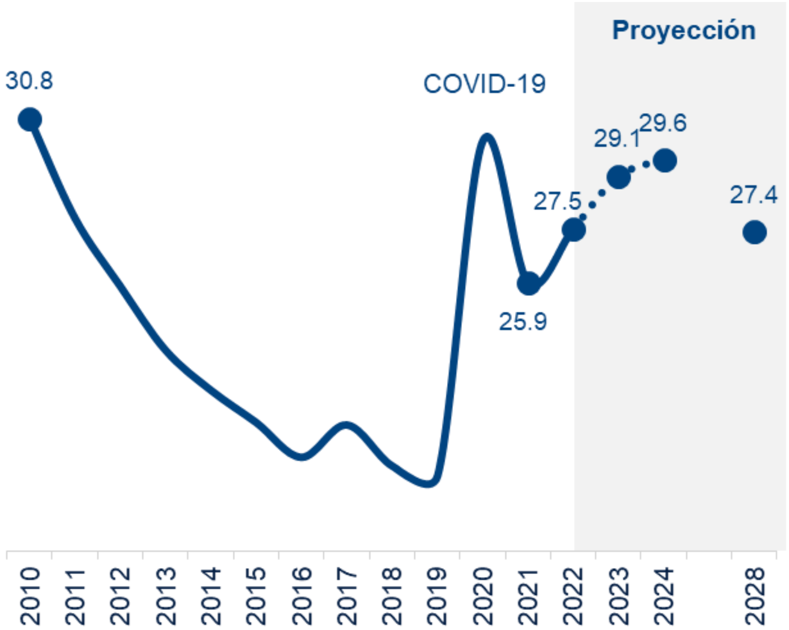
2024: EXPENDITURE-SIDE GDP FORECAST (Y/Y % CHG)



Source: BBVA Research.

We estimate that the population living in poverty will increase in 2023 and 2024, in a context of low economic growth and rising food prices.

MONETARY POVERTY
(% OF POPULATION)

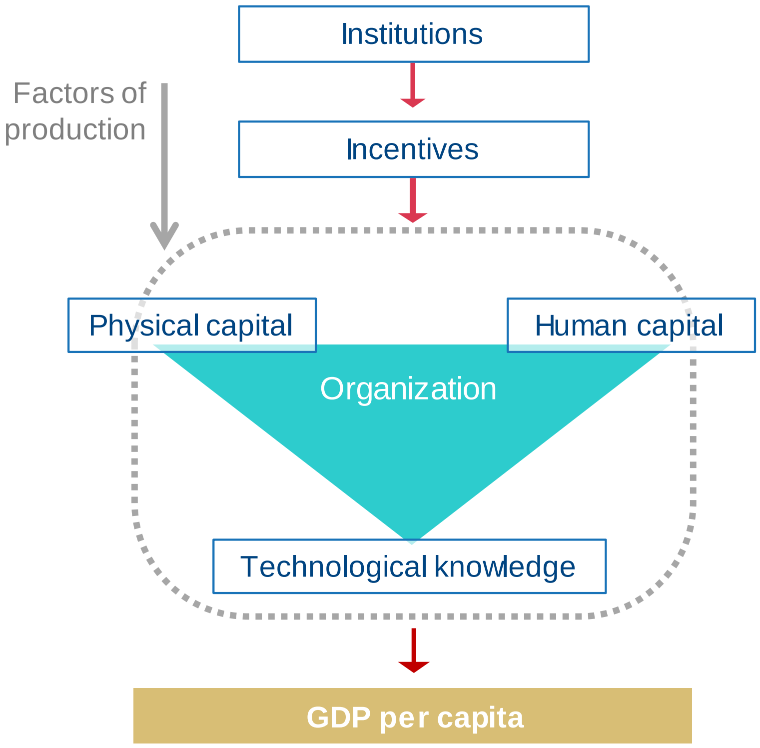


Source: INEI and BBVA Research.

- We forecast monetary poverty to increase in 2023 and 2024, standing at 29.1% and 29.6% of the population, respectively.
- This would bring 9.8 million people below the poverty line in 2023 (9.2 million in 2022).
- The monetary poverty rate would come down over the medium term in an environment of food price deflation and increased economic activity.

Medium-term growth is being undermined by institutional weakness

DETERMINING FACTORS OF GDP PER CAPITA



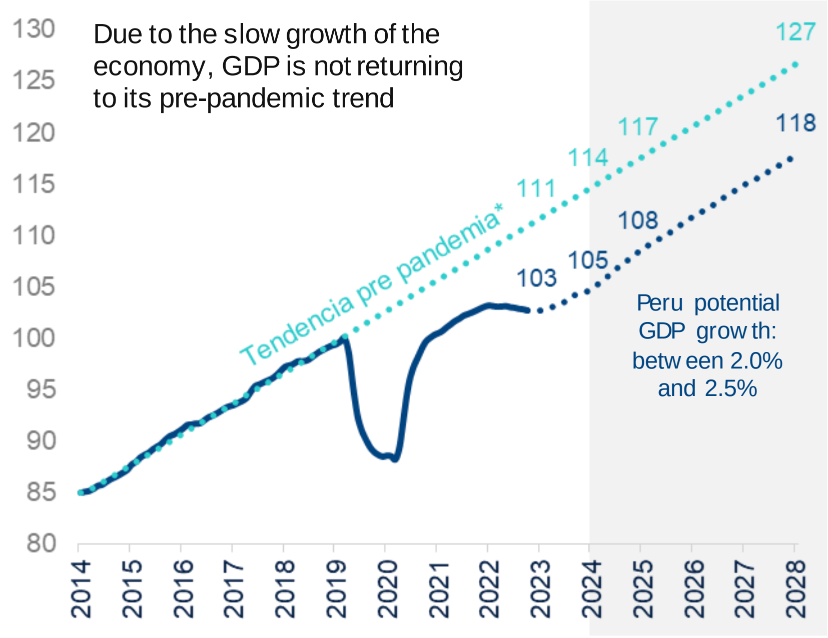
FIVE FUNDAMENTAL INSTITUTIONS FOR A MARKET ECONOMY TO OPERATE EFFECTIVELY AND CREATE PROSPERITY FOR ALL

1. Protection of property rights
2. Honest government
3. Political stability and ability to govern
4. Reliable judicial system
5. Competitive and open markets

Preparation: BBVA Research.

Accelerating growth and reducing poverty will require substantial improvements in structural factors

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



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

KEY INITIATIVES TO DRIVE GROWTH

- Steer government spending toward providing quality public services: special emphasis on education and safety.
- Bridge the infrastructure gap and work on preventing, responding to and rebuilding after natural disasters.
- Promote a more flexible labor market and labor formalization.
- Ensure a more propitious business environment for private investment, focusing on social, political and legal stability.

In the short term, a **confidence shock** is needed for growth to resume

Preparation: BBVA Research.

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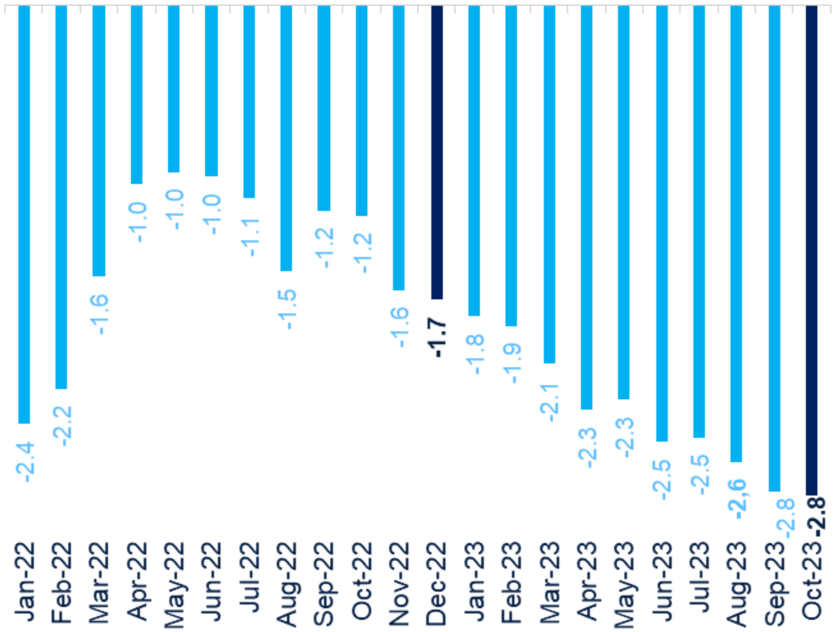
04

Peru economic forecasts

4.2. Fiscal balance and public debt

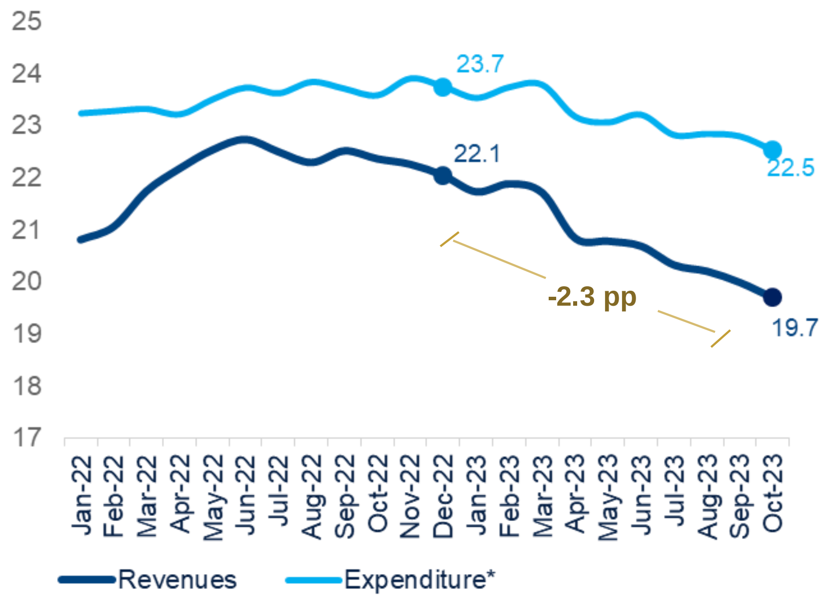
In October, the fiscal deficit widened to 2.8% of GDP, mainly due to lower government revenues...

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



Source: BCRP.

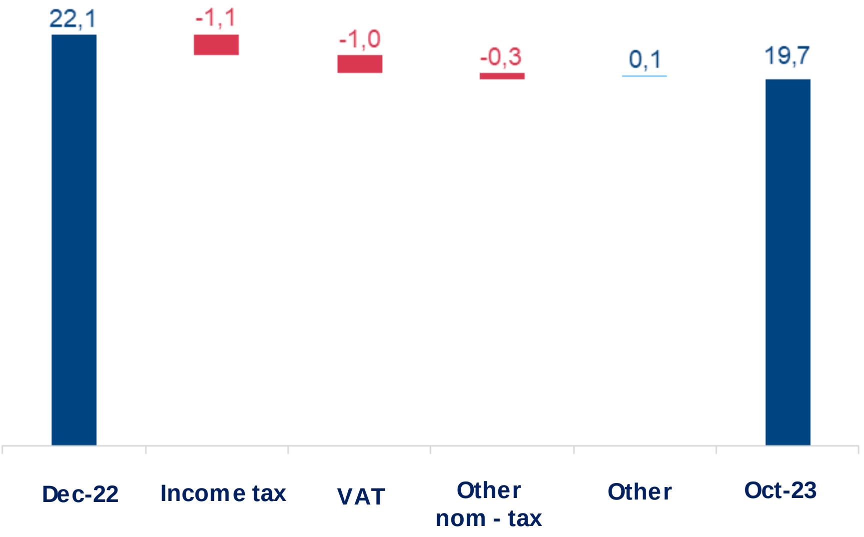
FISCAL REVENUE AND EXPENDITURE
(CUMULATIVE IN LAST 12 MONTHS, % OF GDP)



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

...caused by lower income tax revenue (linked to the mining sector) and VAT (weakness of domestic demand)

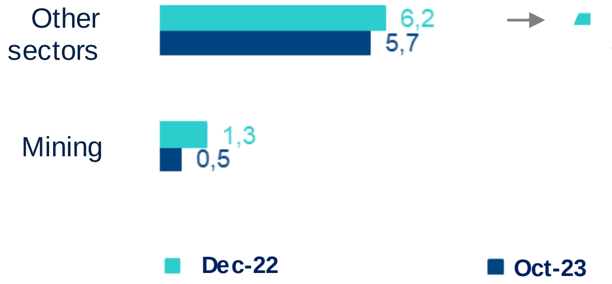
CENTRAL GOVERNMENT REVENUE
(CUMULATIVE IN LAST 12 MONTHS, % OF GDP)



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

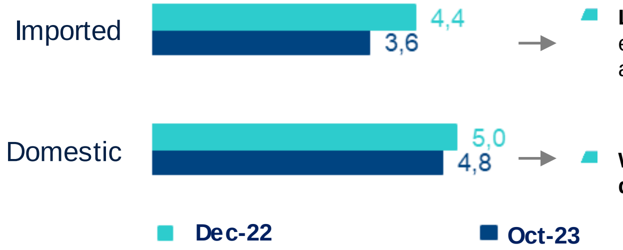
Source: BCRP.

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



- **Lower revenue from corporate tax** (especially in the mining sector) and regularization payments

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 capital expenditure component (lower public investment) 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.

CAPITAL EXPENDITURE

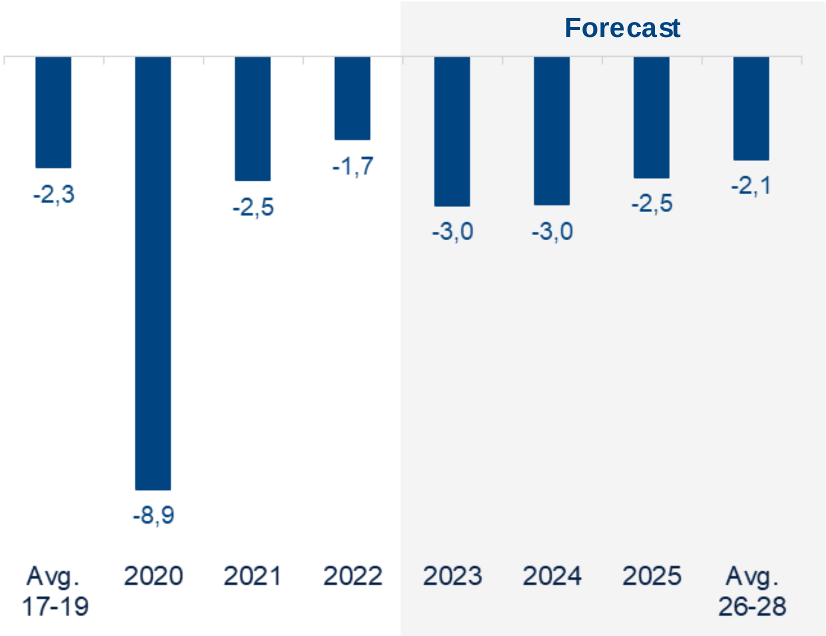
- **The decrease in public** investment (cumulative in last 12 months) is explained by the lower execution of subnational governments, which was partially offset by the execution of the national government (reconstruction).
- **The decrease in other capital expenditures** (cumulative in last 12 months) is explained by the lower granting of credit guarantees from the Reactiva Peru Program. Also due to a capital contribution made by the Public Treasury in October 2022 to Petroperu (PEN 2.0 billion).

CURRENT EXPENDITURE

- **The decrease in social transfers and spending on goods and services** (cumulative in last 12 months) is explained, for the most part, by the lower expenditures linked to the health emergency

Deficits of 3.0% of GDP in 2023 and 2024, declining thereafter as tax revenues stabilize slightly above pre-pandemic levels

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



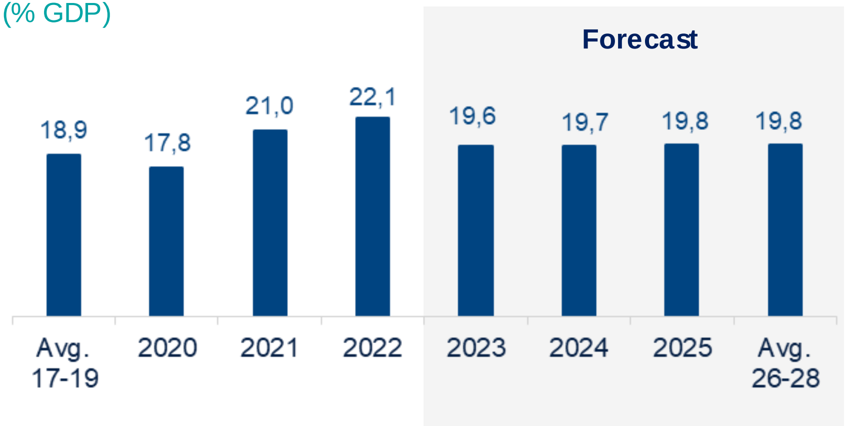
*: forecast for 2023 onward.
Source: BCRP and BBVA Research.

- The fiscal deficit should be similar in 2024 to this year (3.0%). Improved activity should help stabilize fiscal revenues (as a % of GDP), while there is also the impact of higher spending related to El Niño and post-El Niño rehabilitation/reconstruction. Nevertheless, the deficit will exceed the level in tax rules (2.4% for 2023 and 2.0% for 2024) largely due to the need for higher expenditures because of El Niño.
- Taking our growth forecasts and the real interest rates the Government will pay over the coming years, to stabilize public debt (as a % of GDP) at between 35% and 40% (sustainable levels given the size of the sovereign bond market) we estimate that a total deficit of around 1.5% is required. Therefore, public debt stabilization can be assured with a gradual fiscal effort.
- The Government must reiterate its pledge to reduce the deficit and stabilize debt in the coming years if it wants to minimize the possibility of a downgrade to its credit rating.

Deficits of 3.0% of GDP in 2023 and 2024, declining thereafter as tax revenues stabilize slightly above pre-pandemic levels

CENTRAL GOVERNMENT REVENUE

(% GDP)

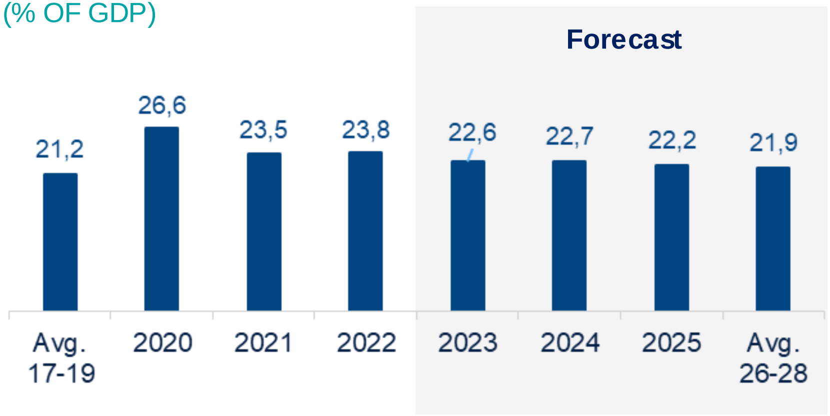


- Going forward, revenues are projected to stabilize at around 20% of GDP, above pre-pandemic levels (assuming lower tax non-compliance).

Source: BCRP and BBVA Research.

GENERAL GOVERNMENT EXPENDITURE*

(% OF GDP)



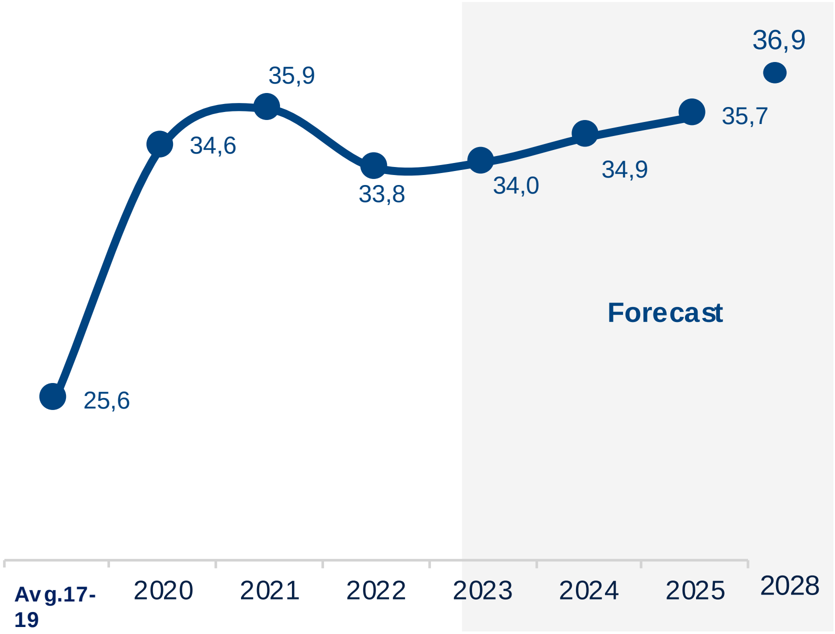
- Public expenditure should decrease gradually over the coming years thanks to a reversal of the extraordinary El Niño-related expenditures.

*Includes interest payments and the result of public companies

Source: BCRP and BBVA Research.

Public debt should experience a slight upward trend. Overall, after some deterioration, indicators suggest that fiscal soundness will be maintained

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



Source: BCRP and BBVA Research.

NON-FINANCIAL PUBLIC SECTOR INDICATORS*

	2019	2020	2021	2022	2023	2024
Assets (% of GDP)	13,7	12,4	14,2	12,8	11,2	10,0
Net debt (% of GDP)	12,9	22,2	21,8	21,0	22,8	24,9
Dollarization of public debt (%)	32	43	54	52	50	48
Interest as % of tax revenues	7,0	9,0	7,2	7,1	8,7	8,5

*Figures for 2023 and 2024 are forecasts

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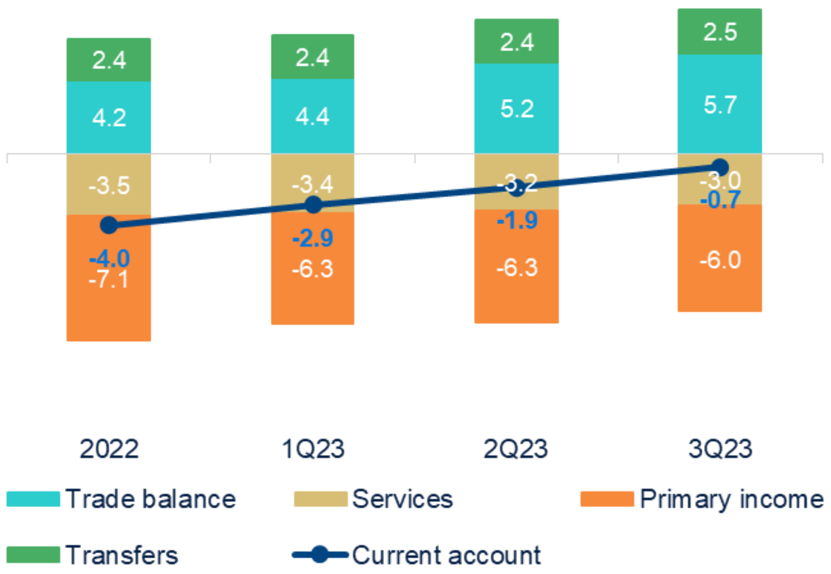
04

Peru economic forecasts

4.3. External sector and exchange rate

Improvement in the trade balance has led to a significant reduction (compared to the end of 2022) in the current account deficit (external deficit)

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

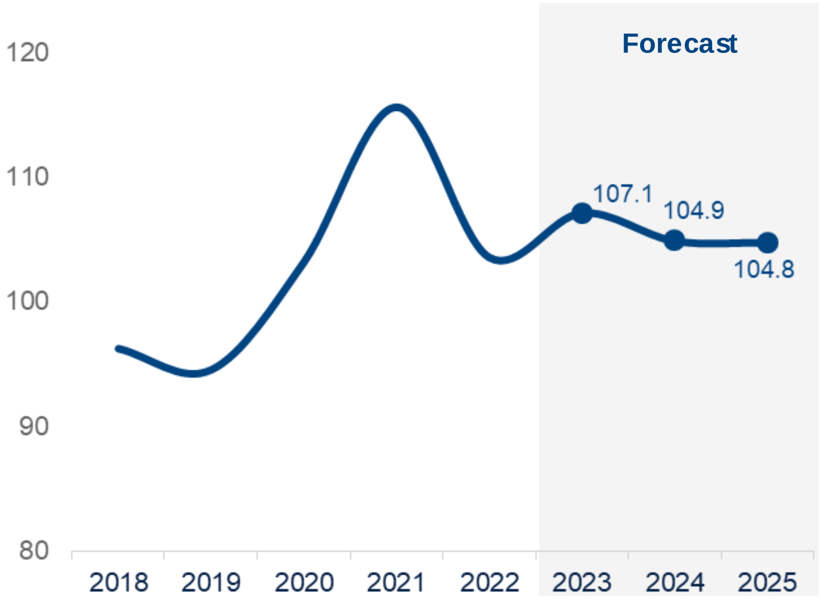


Source: BCRP and BBVA Research.

- Higher export volumes due to higher mining output and a fall in import volumes in the third quarter (associated with weak activity) have resulted in a significant increase in the trade surplus and, with this, a further reduction in the current account deficit.
- Lower profit remittances by foreign companies have also contributed to the improvement in the current account.

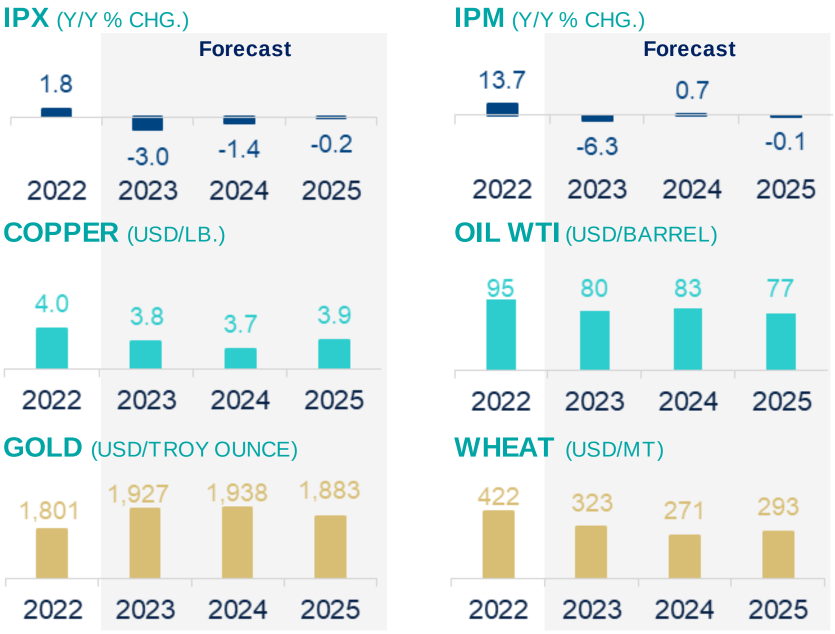
Higher terms of trade in 2023 due to lower import prices, but they should fall next year

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



Source: BCRP and BBVA Research.

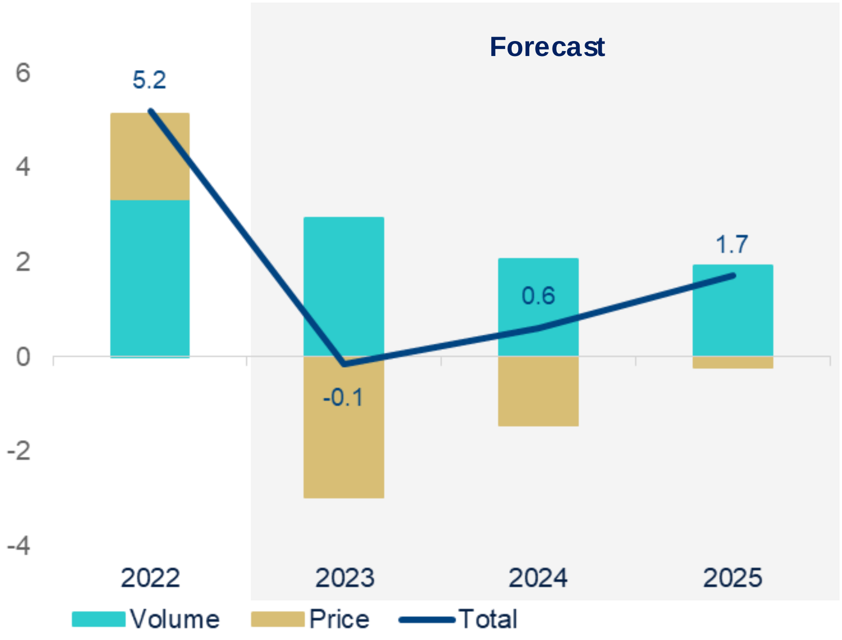
EXPORT (IPX) AND IMPORT PRICES (IPM)



Source: BCRP and BBVA Research.

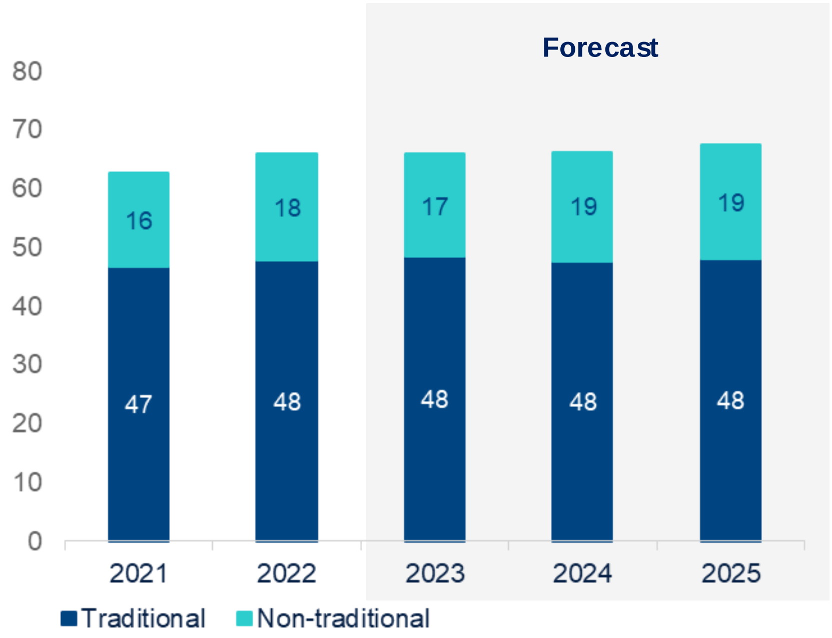
Lower export prices and lower anchovy catch have resulted in a slight drop in the value of exports this year, but the impact should be more moderate in 2024

EXPORTS
(Y/Y % CHG.)



Source: BCRP and BBVA Research.

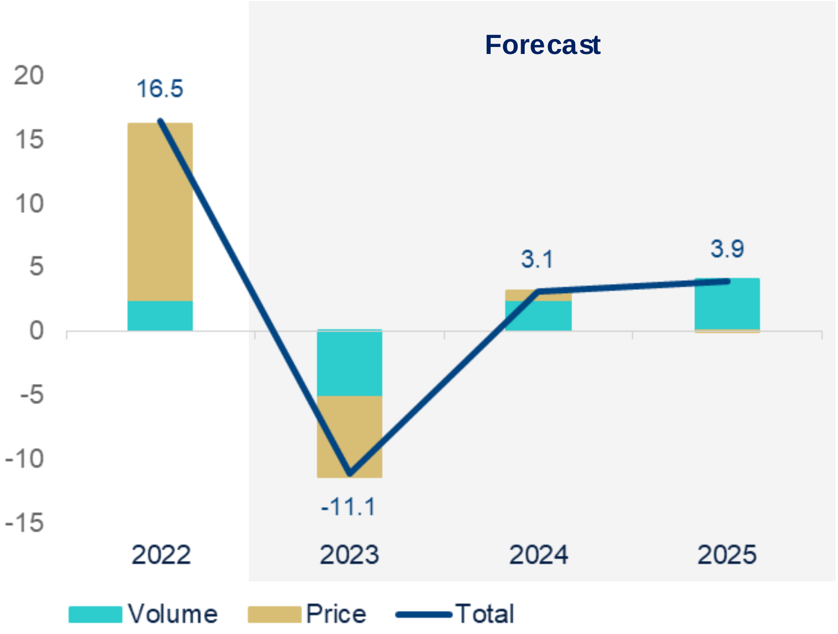
EXPORTS
(USD BILLIONS)



Source: BCRP and BBVA Research.

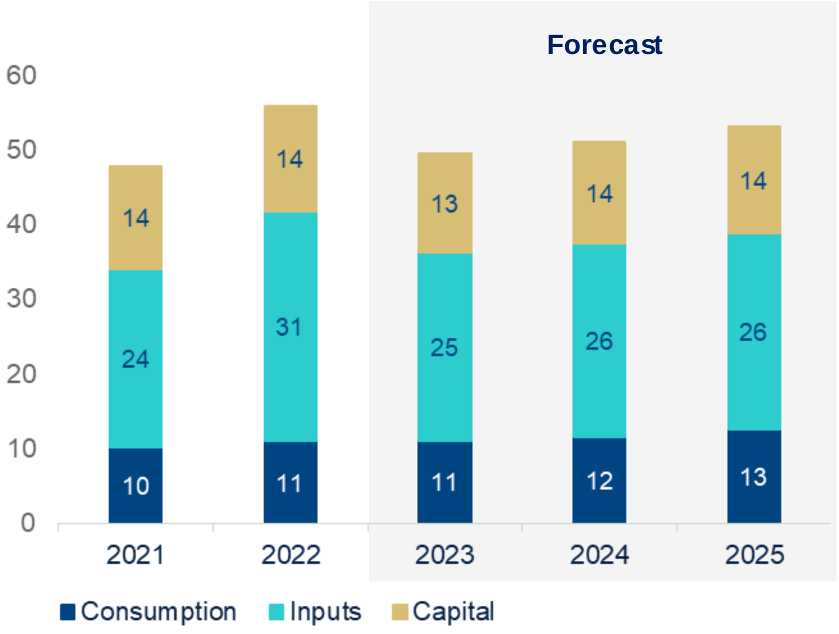
The value of imports should fall significantly this year due to weak economic activity and the correction in prices, before rebounding in 2024

IMPORTS
(Y/Y % CHG.)



Source: BCRP and BBVA Research.

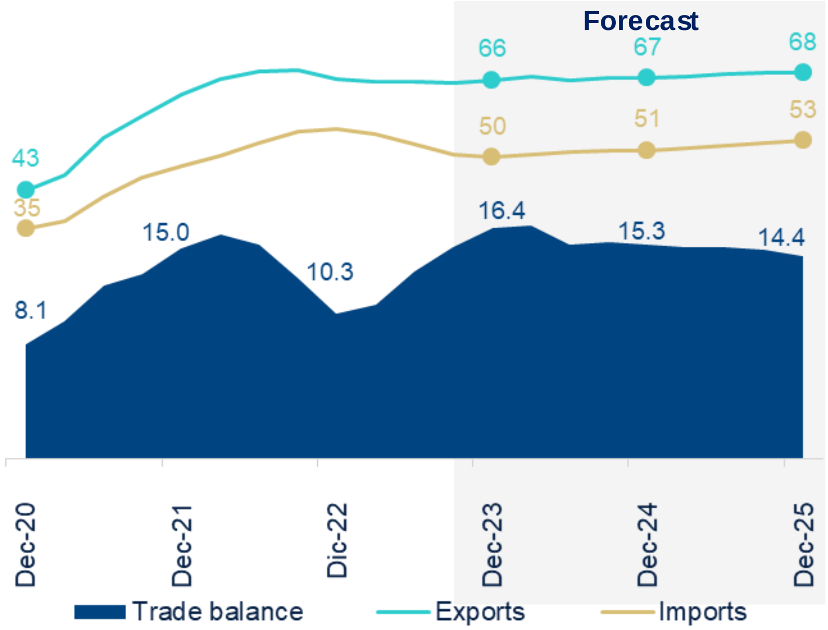
IMPORTS
(USD BILLIONS)



Source: BCRP and BBVA Research.

As a result, the trade surplus should widen this year, but decrease in 2024

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



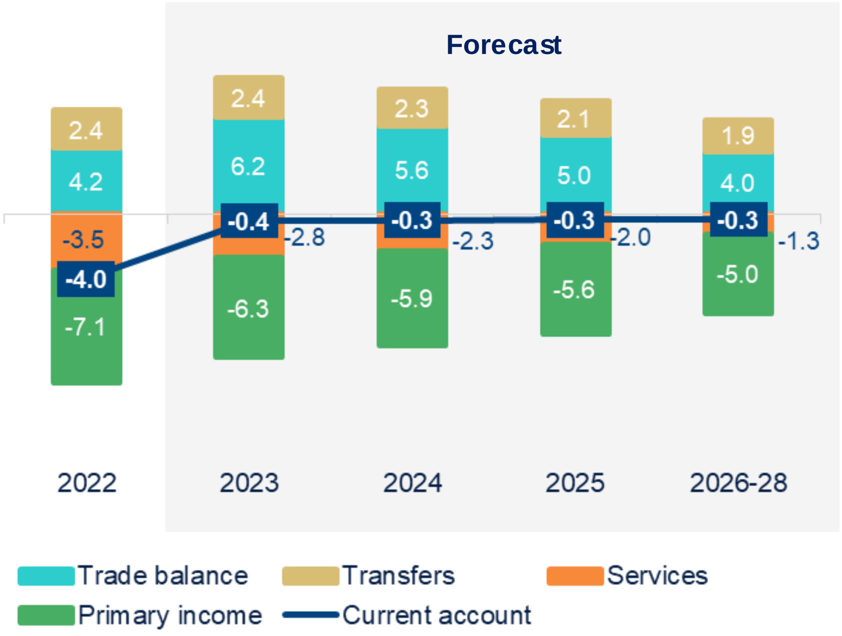
Source: BCRP and BBVA Research.

- 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 has more than compensated for the fall in export prices (metals) and lower anchovy catch.
- In 2024, the trade surplus should decrease as imports rise on the back of a recovery in domestic demand. The improved performance by exports (after this year's setback caused by social conflicts and weather anomalies) should counterbalance to some extent the decrease in the trade surplus.

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

CURRENT ACCOUNT BALANCE OF PAYMENTS

(% GDP)

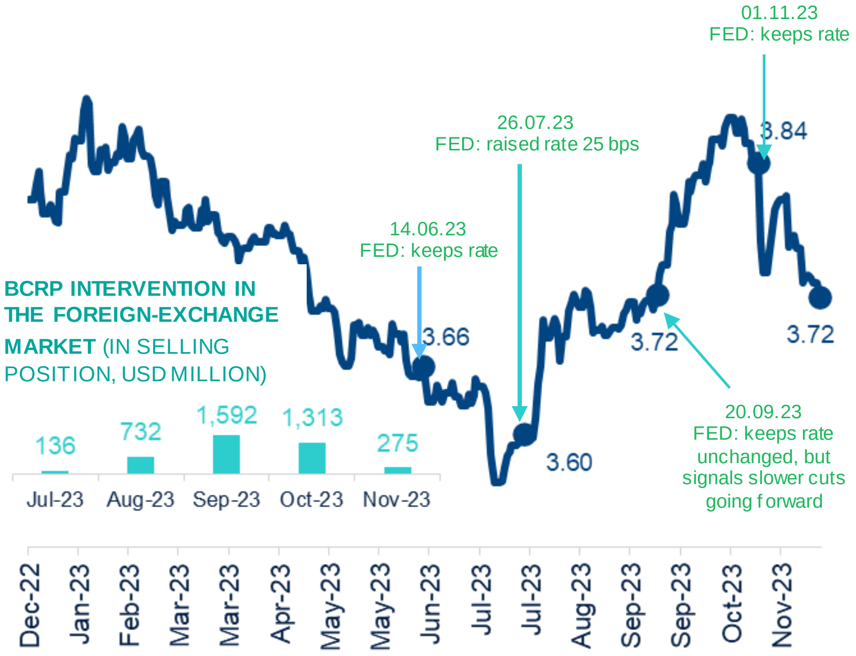


Source: BCRP and BBVA Research.

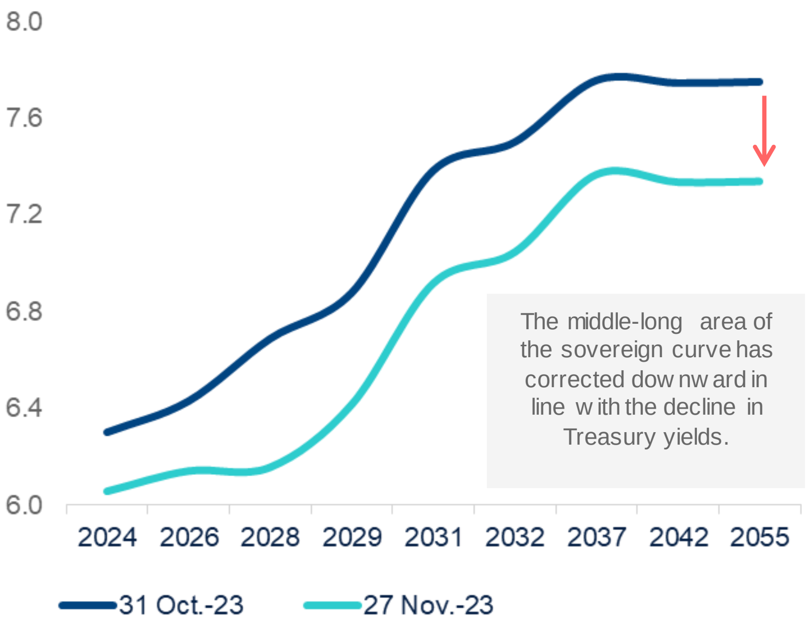
- Higher profits of foreign companies and the cost of imported services (e.g., freight) generated a widening of the current account balance of payments deficit in 2022.
- In 2023, the current account has improved as a result of (i) a higher trade surplus, (ii) lower profit remittances from foreign companies (in line with lower metal prices) and (iii) improvement in the services account (normalization of inbound tourism and lower freight costs).
- These trends should hold going forward, thereby capping the current account deficit and meaning the Peruvian economy will not face any large external financing requirements in the next few years.

After approaching levels of 3.90 in October, the exchange rate fell due to the Fed's more dovish tone and the decrease in long-term dollar rates

EXCHANGE RATE
(PEN-USD)



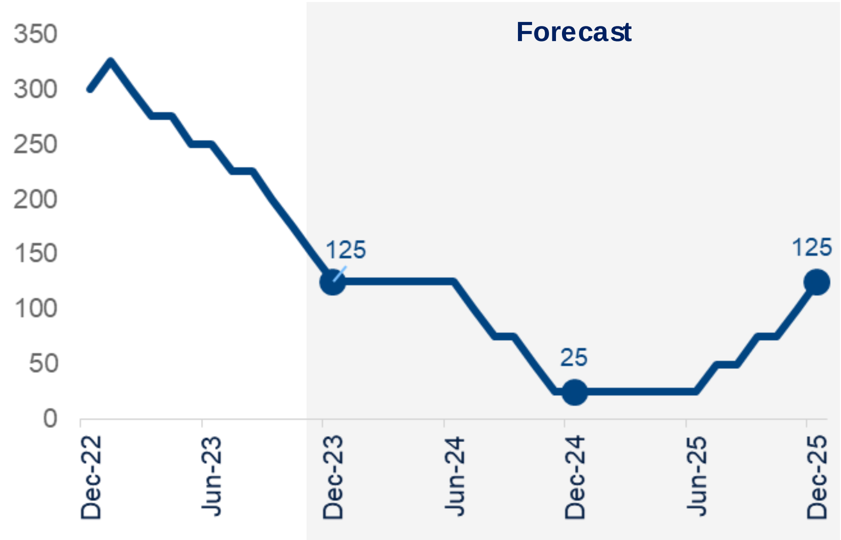
SOVEREIGN BOND YIELD CURVE
(%)



Data as at 12/1.
Source: BCRP, Bloomberg and BBVA Research.

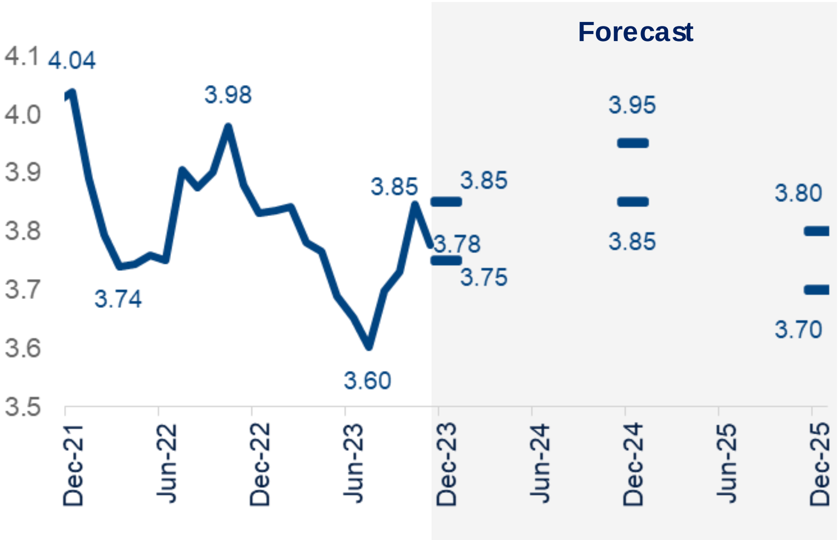
Local currency should tend to depreciate next year due to the narrowing interest rate differential and capital outflows

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



Source: FRED, BCRP and BBVA Research.

TIPO DE CAMBIO (SOLES PER DOLLAR, AVERAGE LEVEL FOR THE MONTH)



A decrease in PEN-USD interest rate differential will undermine the appeal of local-currency-denominated assets. In addition, capital outflows from emerging economies are expected to reduce the appetite for risk. A smaller current account deficit should alleviate exchange rate pressures.

Research

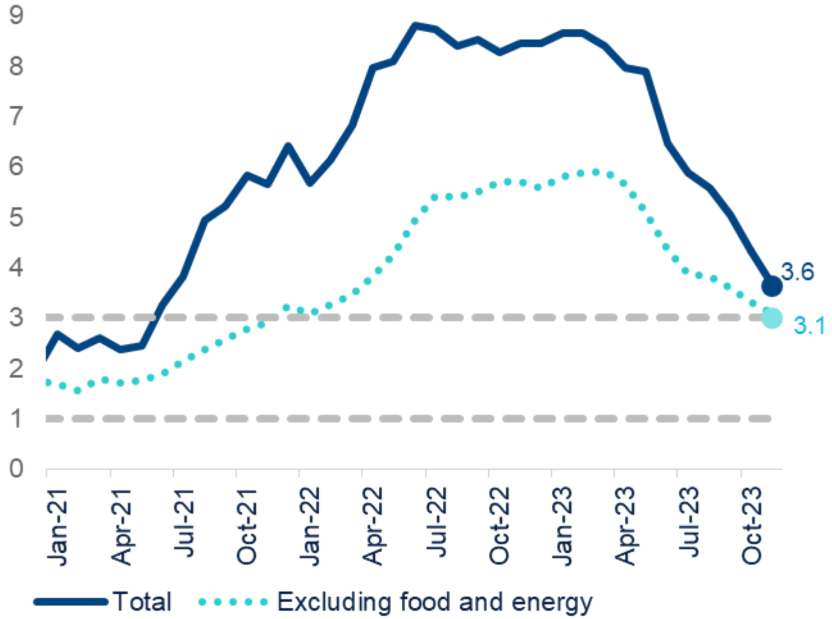
04

Peru economic forecasts

4.4. Inflation and monetary policy

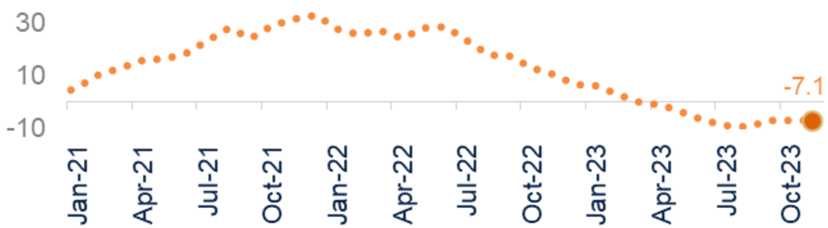
Inflation eases due to high year-on-year comparison base, reduction in international input prices and weakness in domestic activity

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

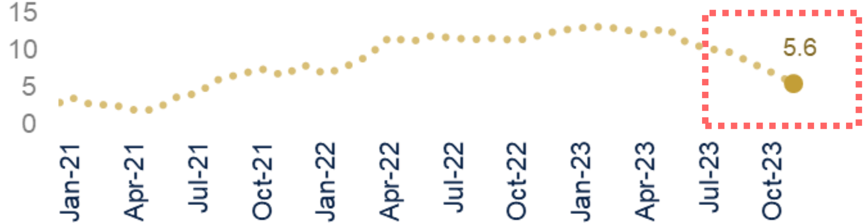


INFLATION: FOOD AND ENERGY
(Y/Y % CHG.)

ENERGY



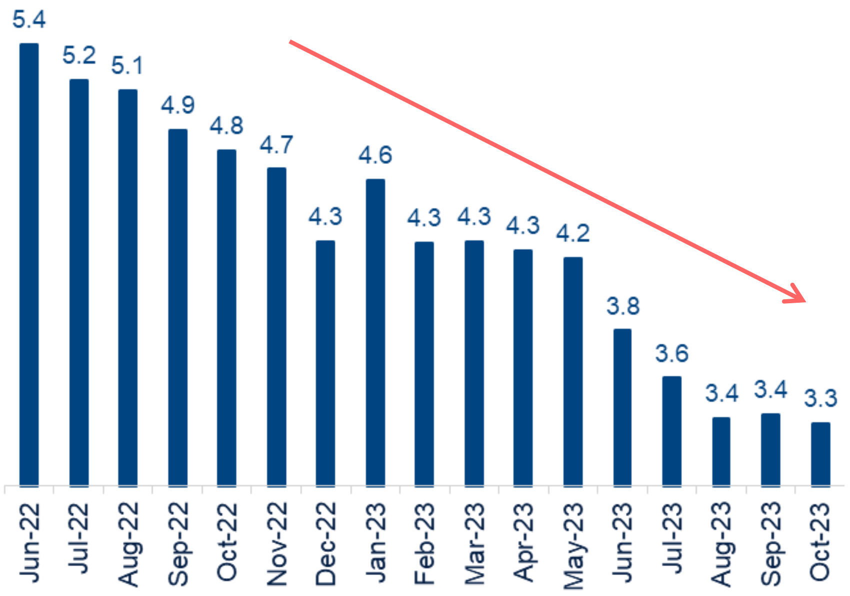
FOOD



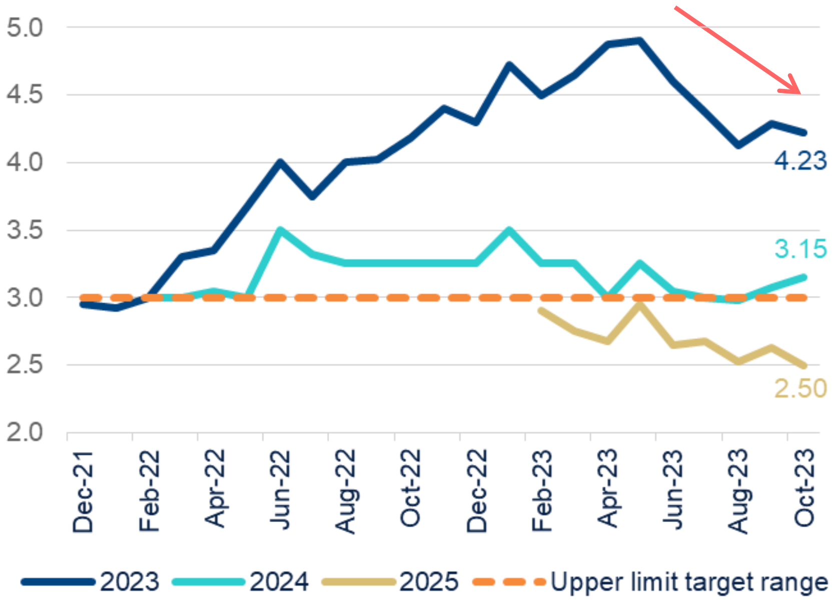
Source: INEI.

Inflation expectations have also corrected downward significantly

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



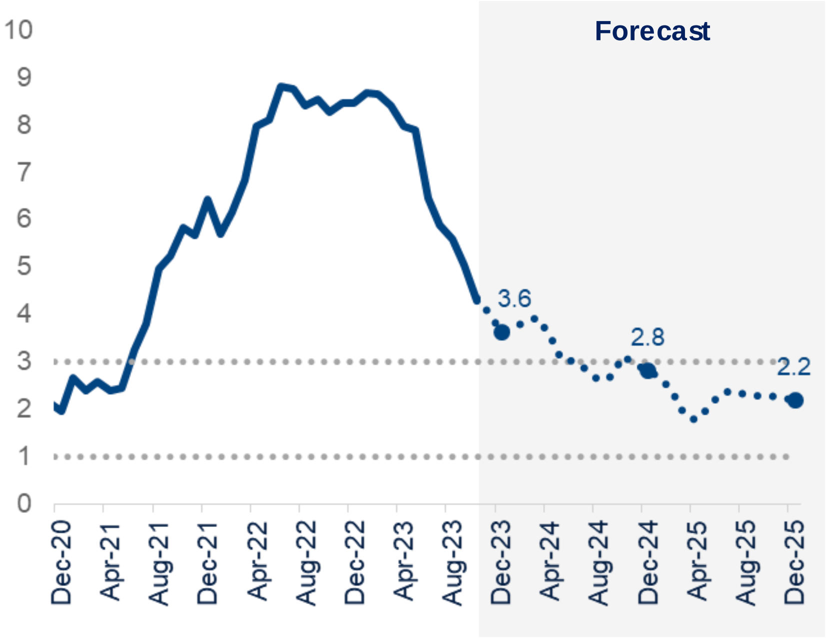
INFLATION FORECASTS
(BY YEAR-END, %)



Source: BCRP.

Inflation should continue to come down over the next few months, with the pace of decline accelerating once the El Niño effect dissipates in the second half of 2024

INFLATION
(Y/Y %)



Source: BCRP and BBVA Research (forecasts).

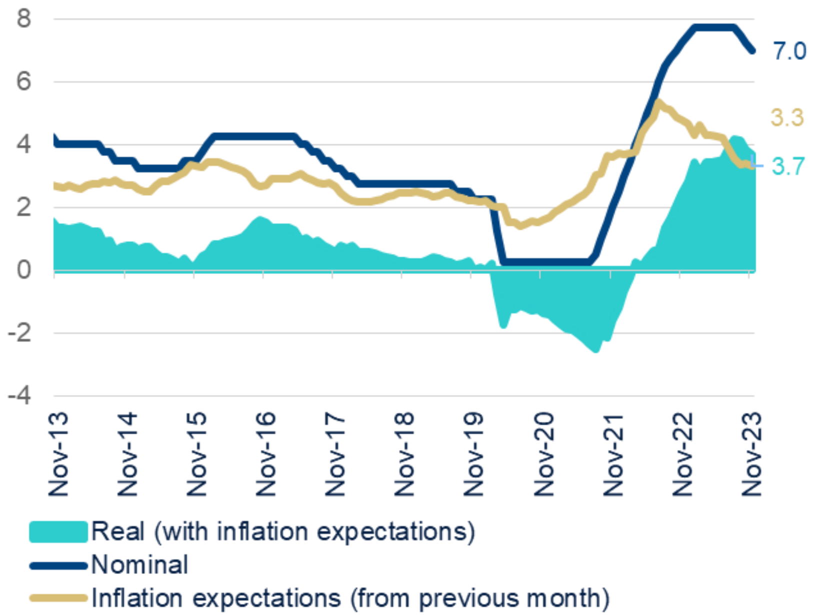
- The year-on-year rate of inflation should continue to fall thanks to the high comparison base.
- Tight monetary policy, weak spending, lower prices of international inputs (e.g. oil), and the reversal of supply shocks also bode well for lower inflation over the forecast horizon.
- According to our baseline scenario, El Niño should be strong during part of the first quarter of 2024 (higher-than-average rainfall, affecting the production and supply of certain goods) and ease until the middle of the second quarter of 2024. As a result, inflation could show a temporary stubbornness to decrease.

PRICE PER BARREL OF WTI OIL
(Y/Y % CHG., END OF PERIOD)

2022	2023	2024	2025
7.1	4.2	-6.9	-8.1

With activity losing momentum and inflation falling, the Central Bank has been cutting its reference rate

MONETARY POLICY RATE
(%)



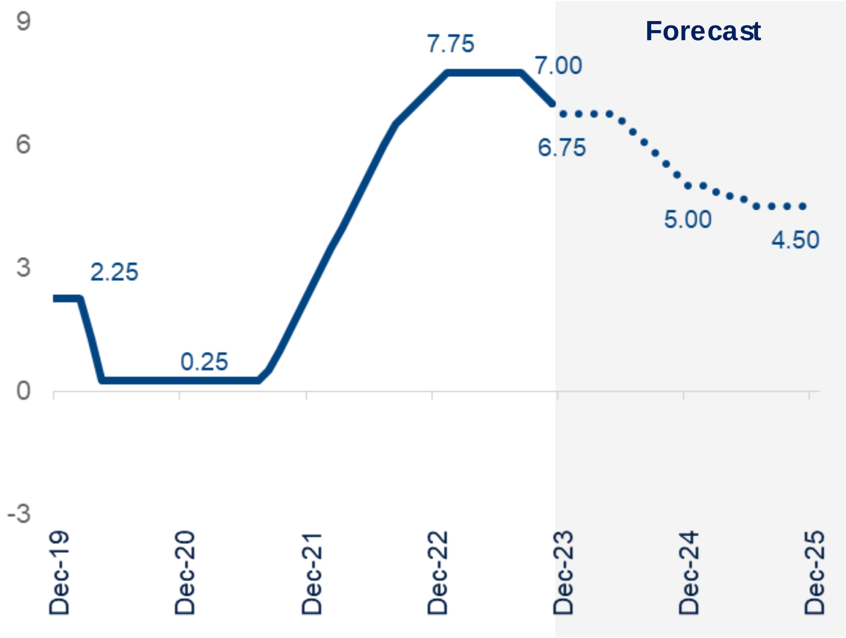
Source: BCRP and BBVA Research.

- The Central Bank has been cutting its reference rate gradually since September: three 25bp cuts to 7.00% in November.
- The monetary policy stance is still tight. The ex-ante interest rate decreased from 4.2% (in August) to 3.7%.
- Inflation and inflationary expectations are falling according to various measures, but are still above the target range, limiting the scope for more aggressive rate cuts.
- In addition, there is the underlying risk of potential El Niño impacts on prices. Financial market volatility is another area of concern noted in the monetary authority's most recent statement.
- The Central Bank is in data-dependent mode. In its statements, it has reiterated that its latest decisions do not necessarily herald a cycle of successive rate cuts and that future adjustments will be contingent on new data on inflation and its drivers.

Our baseline scenario is consistent with rate cuts continuing in December and after El Niño dissipates.

- Weak private spending, tight monetary policy and decreases in different inflation measures and inflationary expectations would suggest that there is room for further cuts in the reference rate.
- Considering how coastal El Niño is unfolding, with strong/moderate intensity during the rainy season, the Central Bank is likely to take a conservative attitude toward cutting rates in the early months of 2024.
- Against this backdrop, the Central Bank is likely to keep its data-dependent stance over the coming months.
- Our forecast assumes that the monetary normalization cycle could be paused in early 2024 (depending on El Niño impacts).
- In the year's second quarter, when the main El Niño-related impacts have dissipated and Fed has embarked on its own monetary easing cycle, interest-rate cuts should resume.

MONETARY POLICY RATE
(%)



Source: BCRP and BBVA Research (forecasts).

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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

- Coastal El Niño in the summer of 2024: less intense rainfall
- Renewed political and social tensions.
- Populist measures affecting competitiveness (labor market, pension system).
- Slowdown in activity of a cyclical rather than situational nature

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06

Summary of forecasts

Summary of macroeconomic forecasts

	2021	2022	2023 (f)	2024 (f)	2025 (f)
GDP (Y/Y % Chg.)	13.4	2.7	-0.4	2.0	3.5
Domestic demand (excluding inventories, Y/Y % Chg.)	17.0	2.1	-1.3	1.8	3.5
Private spending (Y/Y % Chg.)	17.6	2.6	-1.5	1.6	3.7
Private consumption (Y/Y % Chg.)	12.4	3.6	0.4	1.7	3.7
Private investment (Y/Y % Chg.)	36.9	-0.4	-7.5	1.3	3.5
Public expenditure (Y/Y % Chg.)	14.2	-0.5	-0.1	2.7	2.8
Public consumption (Y/Y % Chg.)	10.9	-3.4	0.5	2.4	2.6
Public investment (Y/Y % Chg.)	24.8	7.7	-1.8	3.5	3.3
Exports (Y/Y % Chg.)	13.2	6.1	2.9	2.0	2.5
Imports (Y/Y % Chg.)	18.0	4.4	-2.3	1.6	3.3
Exchange rate (vs. USD, eop)	4.04	3.83	3.75 – 3.85	3.85 – 3.95	3.70- 3.80
Inflation (% y/y, eop)	6.4	8.5	3.6	2.8	2.2
Monetary policy interest rate (%, eop)	2.50	7.50	6.75	5.00	4.50
Fiscal balance (% of GDP)	-2.5	-1.7	-3.0	-3.0	-2.5
Current account balance of payments (% of GDP)	-2.2	-4.0	-0.4	-0.3	-0.3
Exports (USD billion)	63.0	66.2	66.1	66.5	67.7
Imports (USD billion)	48.0	55.9	49.7	51.3	53.3

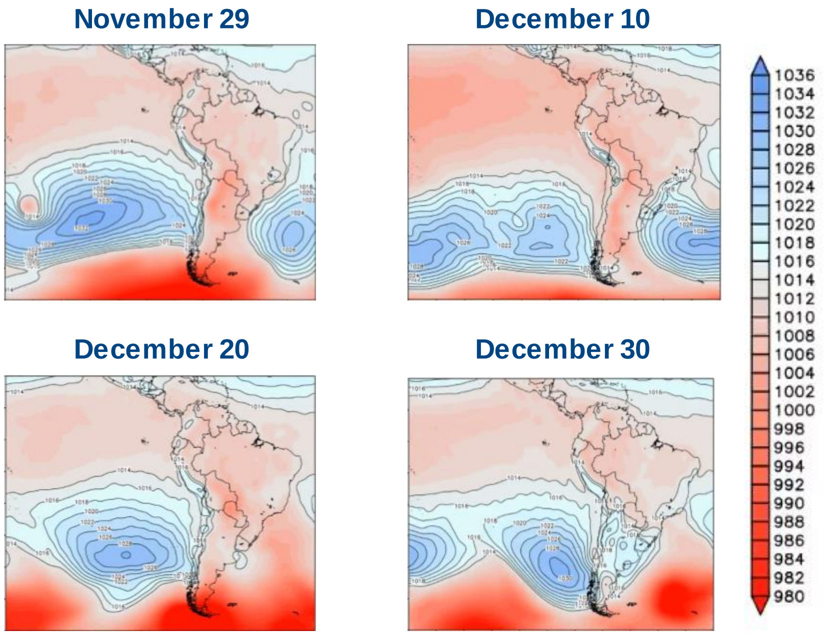
(f) Forecast. Forecast closing date: December 1, 2023.
Source: BBVA Research.

07

Appendix

Recent trends in the southern anticyclone could indicate that the impact of coastal El Niño is easing (less intense rains).

GLOBAL FORECASTING MODEL: SEA LEVEL PRESSURE
(HCA)



Source: NOAA, ENFEN and BBVA Research

- The southern anticyclone is a permanent system consisting of a cold air current that blows along the South American coast from south to north.
- While the anticyclone continues during the next few weeks, it could cool to a certain extent the warming of the sea, thereby decreasing the chances of heavy rainfall on the northern coast over the summer.
- However, the anticyclone is just one of several climate-related key variables. Therefore, we cannot say with any degree of confidence what level of rainfall we will see in the first quarter of 2024.
- Some meteorologists (e.g. Abraham Levy) are now saying that certain NOAA models (e.g. CFS.v2) are even forecasting lower-than-normal precipitation for the January-March 2024 period

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Peru Economic Outlook

December 2023

Creating Opportunities