Peru Economic Outlook

March 2024

Creating Opportunities

Index

Key points

Global situation

In developed economies, high interest rates have affected the manufacturing sector, but services remain resilient, preventing faster disinflation. Against this backdrop, and given the geopolitical risks, central banks have been cautious and financial markets have reduced their expectations of aggressive monetary easing.

Local situation

Locally, economic activity contracted in 2023 (-0.6%), something that has not occurred since 1998, excluding the most complicated period of the pandemic (2020). This took place against a backdrop of political and social unrest at the beginning of the year, weather anomalies, high inflation and interest rates, and weak confidence. Primary activities such as fishing and agriculture were heavily affected, but so were non-primary sectors such as construction and manufacturing. Output growth figures for the fourth quarter, however, suggest the beginning of a change in trend, something that the indicators available for the first few months of 2024 seem to confirm. A relatively calmer political and social environment than at the beginning of last year, the decrease in weather anomalies (less intense than anticipated three months ago and, thus, with weaker negative impacts on economic activity), inflation slowing down, and the gradual monetary easing contributed to the better performance of the Peruvian economy at the beginning of the year.

Key points

Global macro outlook: inflation and interest rates

Inflation will continue to decline, in line with an expected slowdown in services and assuming no new supply shocks occur. This will give the Fed and the ECB room to cut interest rates starting in the middle of this year.

Global macro outlook: economic growth

Growth in the United States will lose strength, although less than expected three months ago, and will remain relatively weak in the eurozone and China. Moderation in inflation and interest rates will favor a recovery starting in the second half of the year, except in China, where structural factors will continue to have negative effects.

Global structural factors

Geopolitics will affect future economic dynamics, conditioning policies. Uncertainty will increase and it is difficult to rule out supply disruptions. Together with factors such as demographics and fiscal policy, these shocks will put pressure on inflation, forcing central banks to keep interest rates at relatively high levels, above what was seen pre-COVID.

Key points

Domestic macro outlook: economic activity

The most important change in the forecast scenario is related to a more benign impact of the coastal El Niño. Weather anomalies generated by this phenomenon had a weak to moderate magnitude at the beginning of the year, less than what entities specializing in monitoring the coastal El Niño had anticipated three months ago as the most likely scenario. Thus, the negative impact on economic activity has also been more limited. Forecasts for the remainder of the rainy season suggest that these anomalies will tend to dissipate from now on, and that while this happens, their intensity will be less than expected.

Considering that weather anomalies are tending to dissipate, that the political and social situation has calmed down from what it was at the beginning of 2023 (although it is fragile), and that the environment is increasingly conducive to the recovery of private sector expenditure (inflation contained, interest rates declining), we continue to forecast that the Peruvian economy will rebound this year. However, this expansion will be around 2.7%, seven tenths of a percentage point above the previous projection (mainly due to the lower impact of weather anomalies). In 2025, with El Niño then over and interest rates at low levels, output growth will reach 2.9%.

Key points

Domestic macro outlook: fiscal accounts

Weak economic activity negatively affected tax revenue in 2023 and the deficit thus increased to a level equivalent to 2.8% of GDP (1.7% in 2022). With the expected rebound of the Peruvian economy this year, revenue collection will improve and the fiscal deficit will decrease. We estimate that it will close 2024 at around 2.3% of GDP. In the baseline scenario, fiscal policy will henceforth be focused on putting public finances in order, reducing the deficit and seeking to bring it closer to the established ceilings. Monetary policy will thus be left with the task of supporting the recovery of economic activity in the short term. Accordingly, fiscal deficits will trend in the coming years to a level equivalent to 2% of GDP, so that gross public debt would not exceed 36% of GDP by the end of the forecasting horizon (2029).

Domestic macro outlook: external accounts

The Peruvian economy does not present external imbalances, which positions it well to successfully face episodes of financial volatility. The current account of the balance of payments went from a deficit of 4.0% of GDP in 2022 to a surplus of 0.6% in 2023, supported by the increase in mining production (exports) and lower import prices (oil and food) and volumes (slowdown in economic activity). We forecast that the surplus this year will be 0.8% of GDP as mining continues to perform well and the sectors most affected by El Niño in 2023 rebound. The recovery of imports will be more gradual and will be completed in 2025, when the current account surplus will reach 0.2% of GDP.

Key points

Domestic macro outlook: exchange rate

Exchange rate volatility in the first few months of 2024 has been tied to the market's outlook for how the Fed will move forward. The Central Bank has been very active in the foreign exchange market. As monetary easing in Peru will progress faster than in the United States (thus reducing the attractiveness of holding assets in local currency), the PEN will experience a weakening trend in the remainder of the year, although this will be limited by the positive result in the current account of the balance of payments. In a scenario in which the Peruvian Central Bank's foreign exchange interventions moderate, we estimate that the USDPEN will close the year in a range between 3.85 and 3.95 soles per dollar. In 2025, with the interest rate differential recovering, the exchange rate will end between 3.70 and 3.80 soles per dollar.

Domestic macro outlook: inflation

Inflation declined rapidly in the second half of 2023 and ended the year at 3.2%. At the beginning of this year, it has encountered some resistance to falling further, mainly related to the weather phenomena still present. It currently stands at 3.3%. With El Niño over, and with a high year-on-year comparison base, inflation will trend downward in the second and third quarters, moving into the target range (2%, +/- one percentage point). Toward the end of the year, however, the positive effect of the high year-on-year comparison base will reverse and, together with the lagged impact of the global El Niño on food prices, will lead inflation to close 2024 at around 2.6%. The forecast for 2025 is 2.4%.

Key points

Domestic macro outlook: monetary policy

The Central Bank has been cutting its policy interest rate since September, and it currently stands at 6.25%. The decline in inflation opened the space to do so, giving some support to the recovery of economic activity. However, the process is gradual due to both the risk of El Niño impacting prices and volatility in financial markets; the monetary policy stance remains restrictive. We expect rate cuts to continue in the coming months. With inflation already expected to be within the target range, these cuts will be reflected more clearly in the monetary position. Therefore, each cut is expected to be of limited magnitude, as has been the case so far, which would avoid exacerbating pressures on the exchange rate. In this scenario, the policy interest rate will end the year at 4.25%, somewhat below the level we consider as neutral, and would remain there in 2025.

Main risks

On the external side: (i) higher interest rates for longer due to more persistent inflation, inducing episodes of financial instability and recession; (ii) sharper slowdown of the Chinese economy; and (iii) geopolitical environment with latent tensions. On the domestic side: (i) a more intense-than-expected coastal El Niño in the remainder of the rainy season; (ii) renewed political and social unrest; (iii) populist measures that affect competitiveness (labor market, pension system); and (iv) greater insecurity due to increased crime and the presence of illegal economies.

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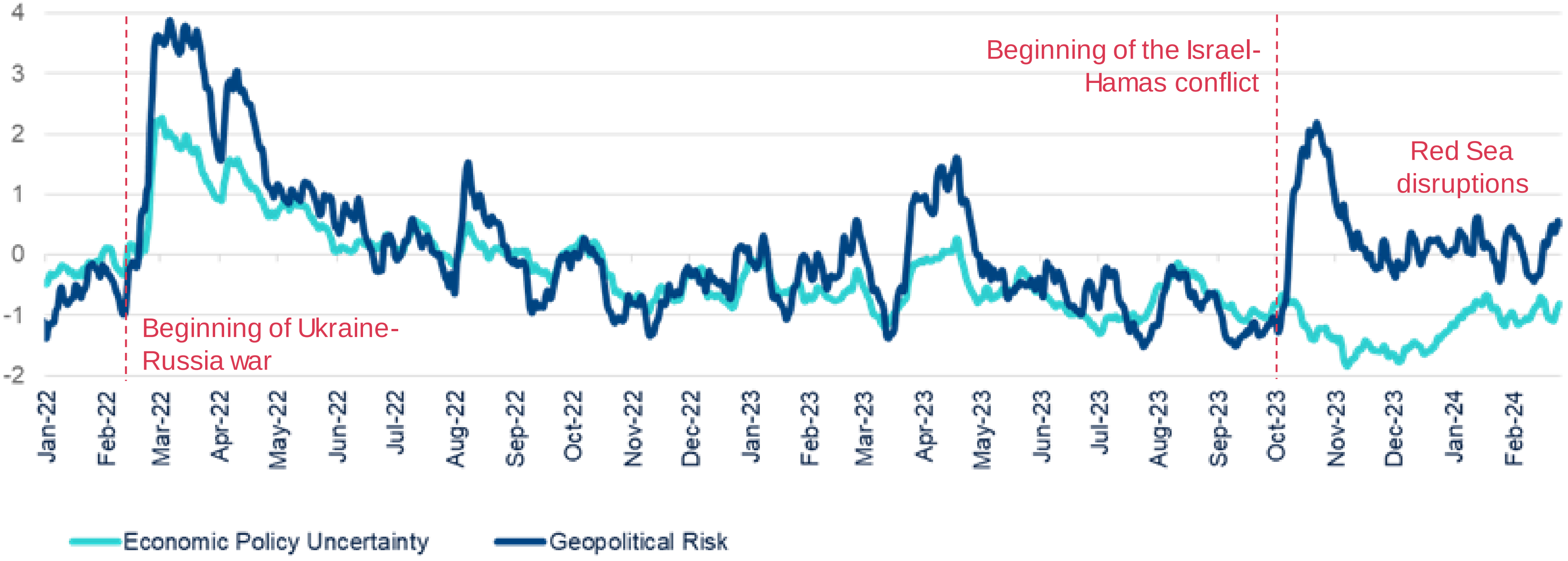
01

International context: economic activity and financial markets

The geopolitical context continues to be a source of concern; the conflict in the Middle-East has escalated somewhat, with limited economic effects so far

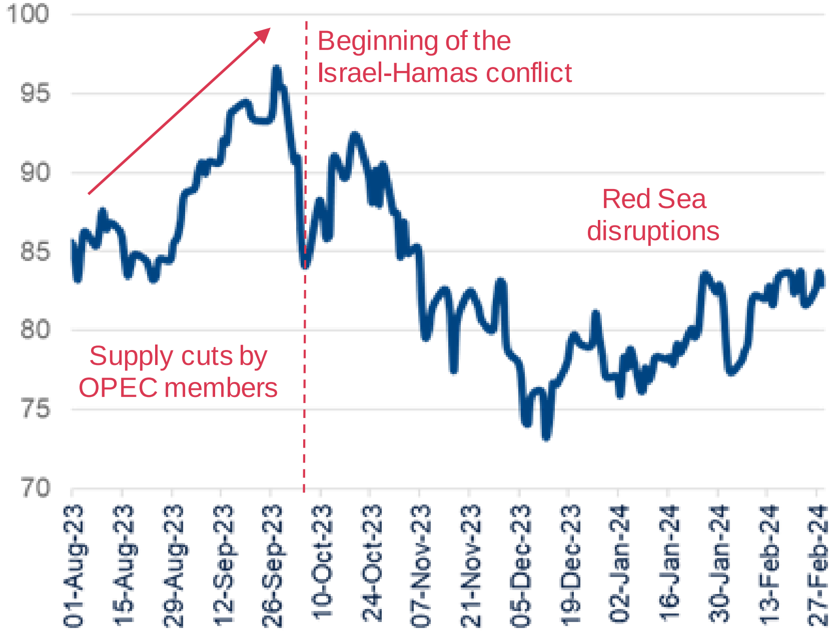
GEOPOLITICAL RISK AND ECONOMIC POLICY UNCERTAINTY IN G3 REGIONS (*)
(INDEXES: AVERAGE SINCE 2019 EQUALS TO 0, 28-DAY MOVING AVERAGE)



(*): G3 regions: U.S., Eurozone and China.
Source: BBVA Research Geopolitics Monitor.

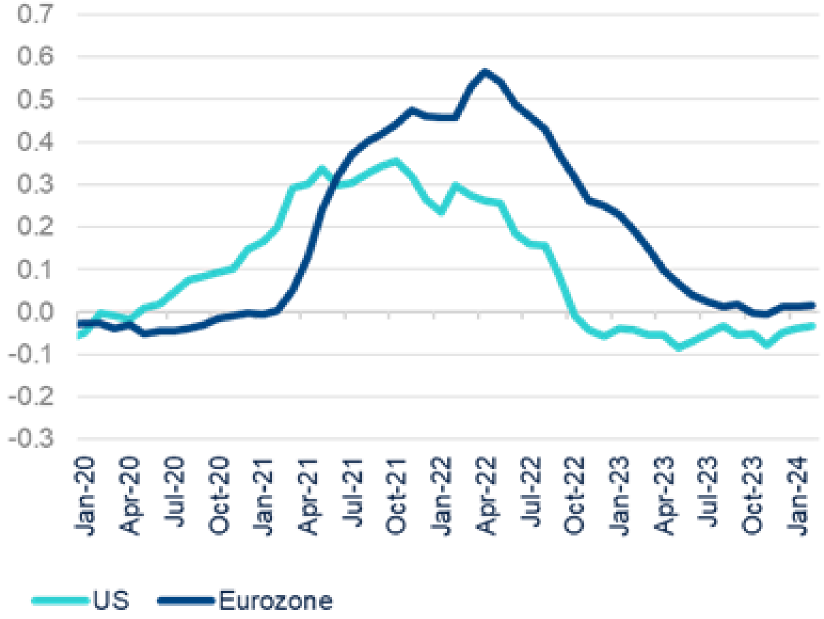
Despite geopolitical tensions, including the maritime disturbances in the Red Sea, commodity prices and bottleneck disruptions remain relatively low

BRENT PRICES
(USD PER BARREL)



Source: BBVA Research based on data from Haver.

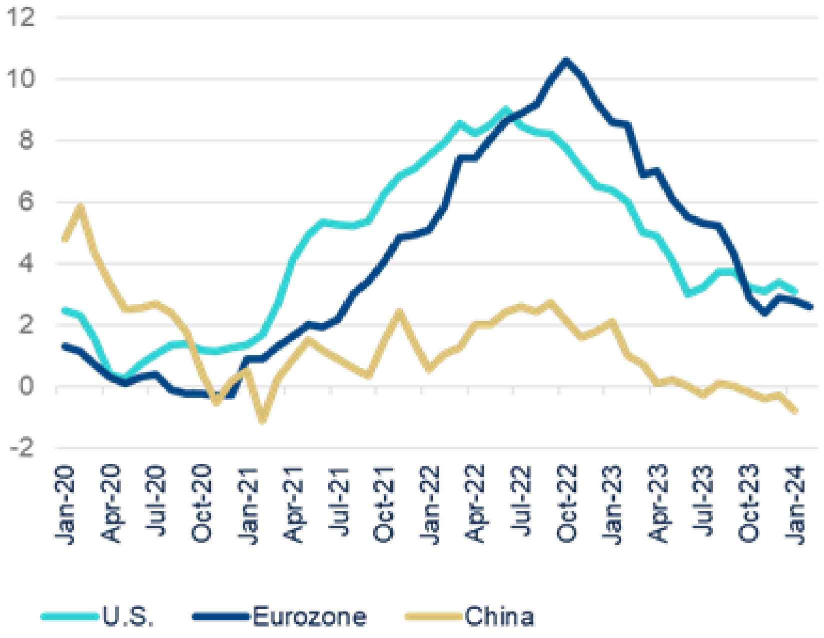
BBVA RESEARCH BOTTLENECKS INDICATOR
(INDEX)



Source: BBVA Research based on data from Haver Analytics.

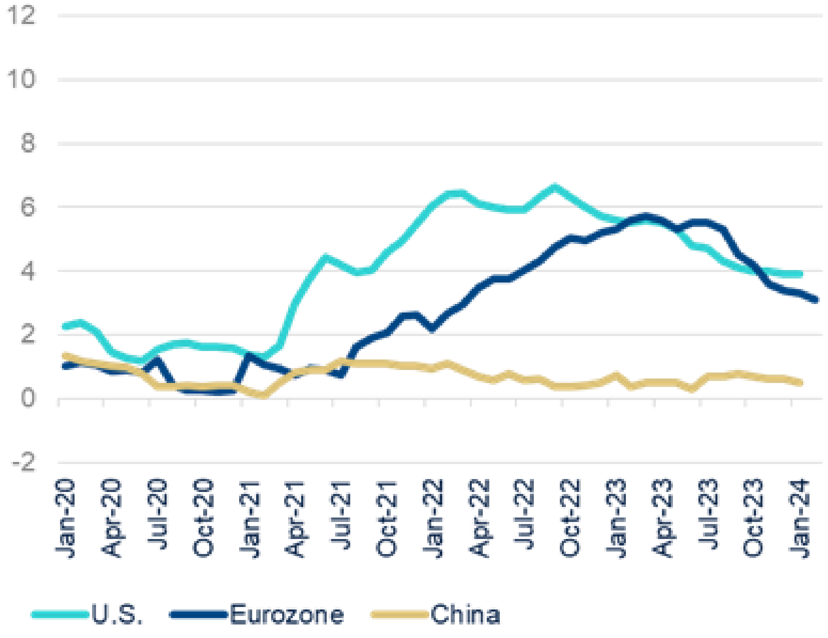
The disinflationary trend has lost some steam in the last few months, amid resilient service inflation; in China, deflation fears remain alive

CPI INFLATION: HEADLINE
(Y/Y %)



Source: BBVA Research based on data from Haver.

CPI INFLATION: CORE
(Y/Y %)

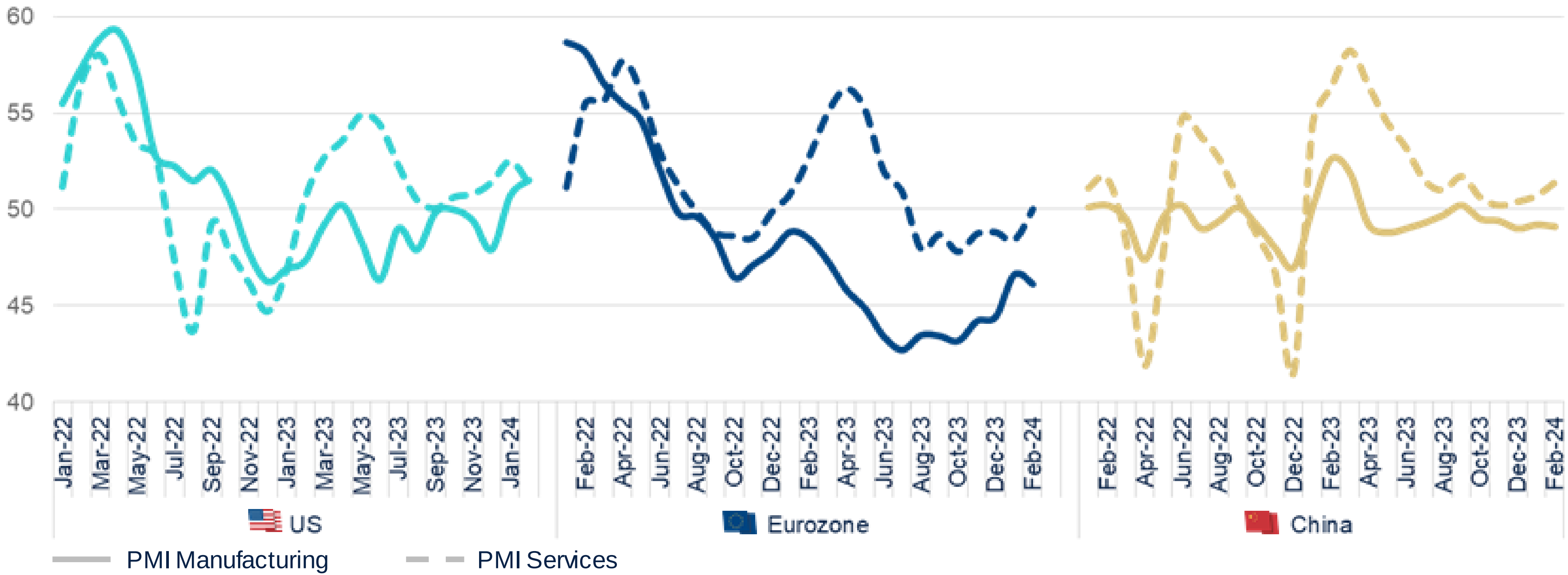


Source: BBVA Research based on data from Haver.

Growth remains more positive in the US and in the services sector, but after a previous slowdown there are now preliminary recovery signs in other markets

PMI INDICATORS

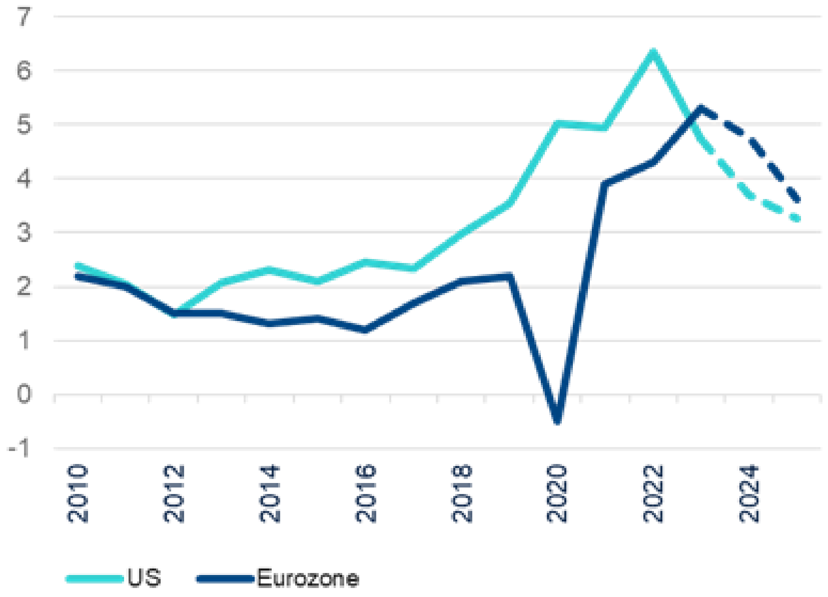
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



Source: BBVA Research based on data from Haver.

Tight labor markets, fiscal policy and excess savings are still supporting growth, partially offsetting the contractionary impact of monetary policy

NOMINAL WAGES: ANNUAL GROWTH (*)
(%)

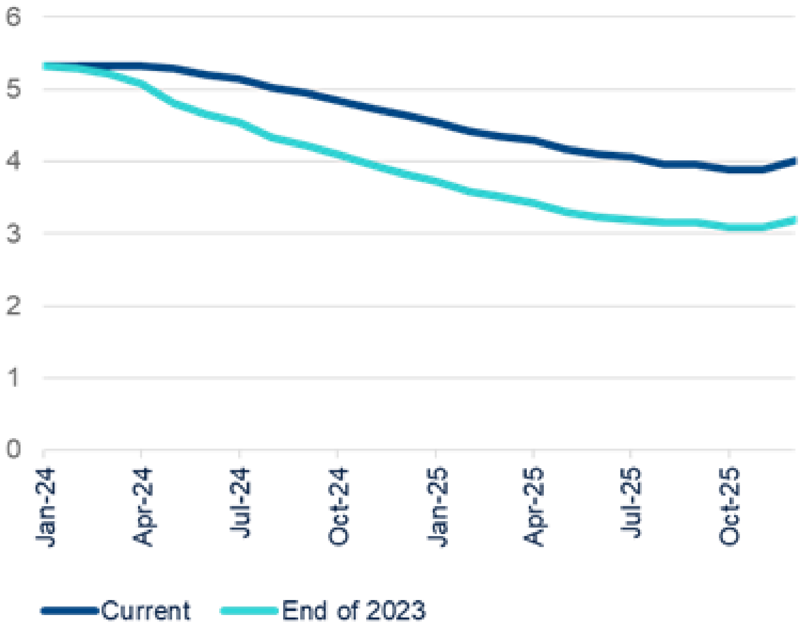


(*) 2024 and 2025 figures: simulated paths consistent with BBVA Research activity and inflation forecasts. US data: average hourly earnings of production and nonsupervisory employees, total private. Eurozone data: compensation per employee
Source: BBVA Research based on data from the BLS and Eurostat.

- Some factors continue backing activity, mainly the services sector, but less than before:
  - labor markets: low unemployment and robust wage growth;
  - fiscal policy: robust spending;
  - excess savings: still supportive, but waning.
- Anyway, monetary tightening has favored a gradual growth slowdown:
  - borrowing costs have increased;
  - bank lending has sharply eased;
  - exchange rate has appreciated (at least in US)
  - inflation expectations have remained broadly anchored (slightly above 2%).

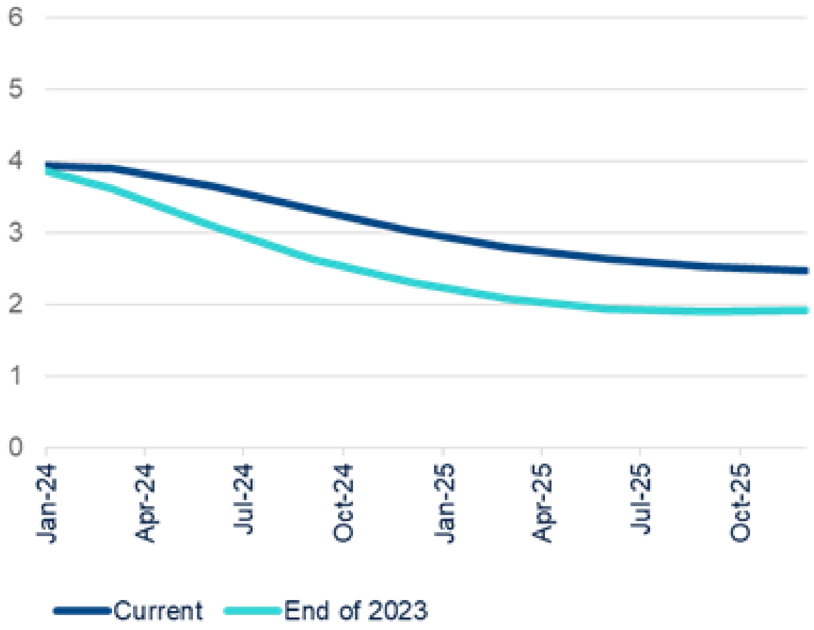
Markets have scaled back their expectations for aggressive easing following the latest macro data and signs of caution from central banks

US: IMPLICIT RATE IN FED FUND FUTURES (%)



Source: BBVA Research based on Bloomberg.

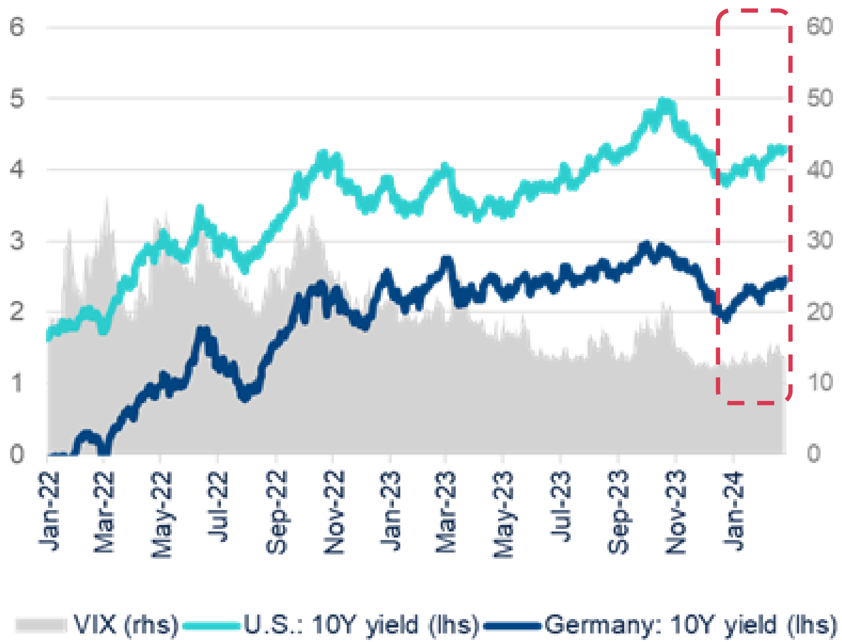
EZ: IMPLICIT RATE IN 3-MONTH EURIBOR FUTURES (*) (%)



(*) Depo interest rates.
Source: BBVA Research based on Bloomberg.

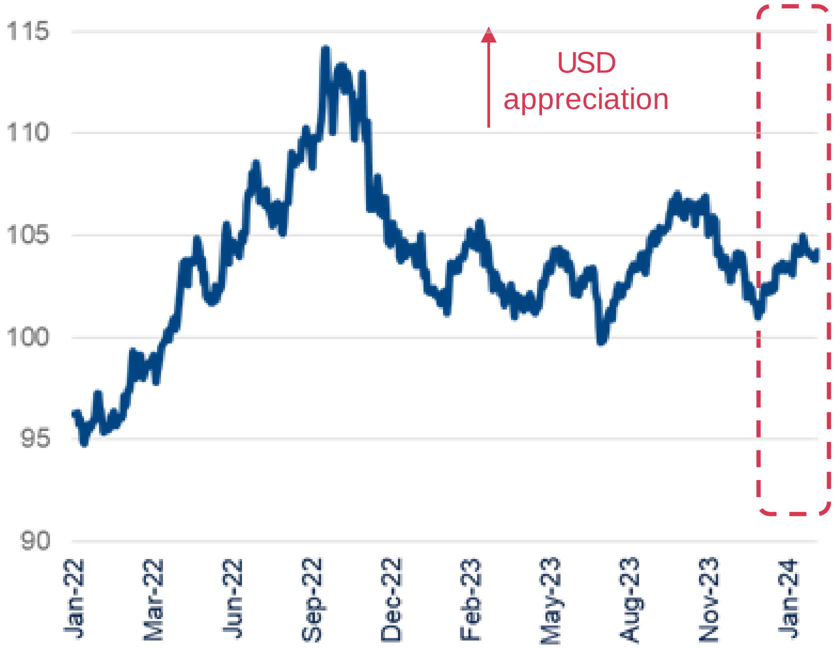
Despite the recent increase in sovereign yields and the strength of the dollar, volatility remains limited on financial markets

SOVEREIGN YIELDS AND VOLATILITY
(%, INDEX)



Source: BBVA Research based on Bloomberg.

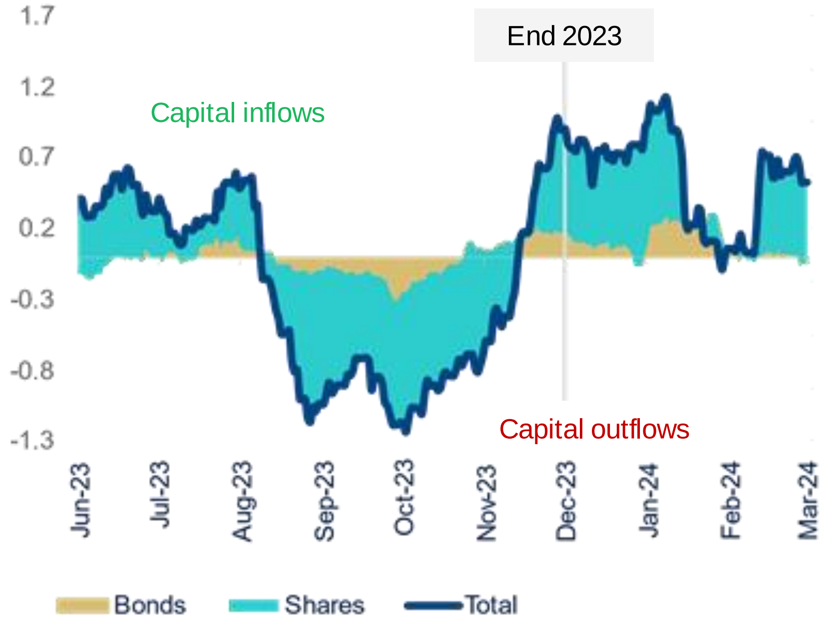
US DOLLAR: DXY
(INDEX)



Source: BBVA Research based on Bloomberg.

... which favors capital inflows to emerging markets and helps to maintain risk premiums in LatAm at relatively low levels

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



Source: IIF (information from March 3).

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

	Cum. YTD (bp)
Brazil	-1.5
Chile	-1.4
Colombia	2.1
Mexico	-2.9
Peru	7.9

Source: Bloomberg (data from March 8).

LatAm sovereign bond yields and exchange rates rise on increasing dollar interest rates

LATAM: SOVEREIGN BOND YIELDS 10-YEAR (%)

	Cum. YTD (bp)
Brazil	50
Chile	29
Colombia	0
Mexico	24
Peru	28

Source: Bloomberg (data from March 8).

LATAM: EXCHANGE RATES (LOCAL CURRENCY VS. USD, INDEX 100 = JUN. 31). 2023)

	Cum. YTD (%)
Brazil	2.5
Chile	10.0
Colombia	1.6
Mexico	-1.0
Peru	-0.5

Source: Source: Bloomberg (data from March 8).

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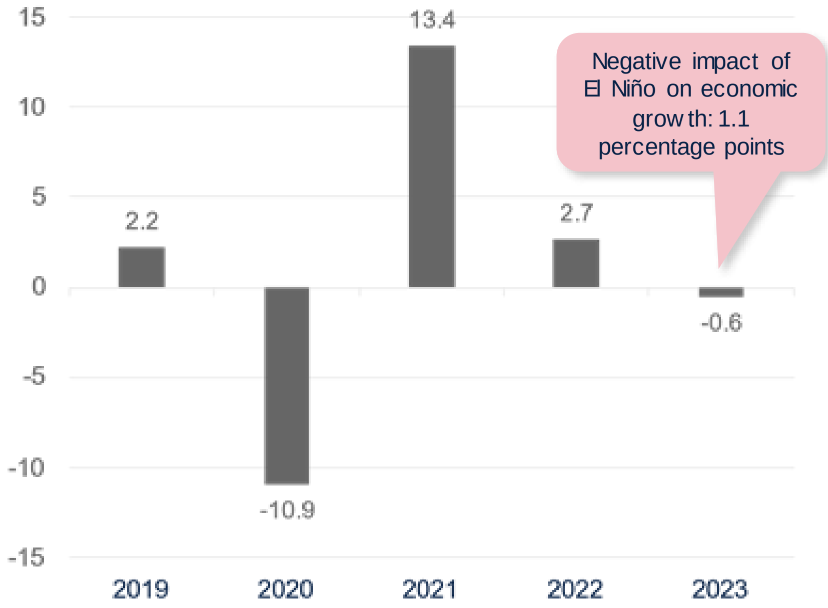
02

Local context: employment and economic activity

Creating Opportunities

Peru's economy contracted 0.6% in 2023, the first setback since 1998 (excluding the pandemic), affected by transitory factors

GDP
(% CHANGE YEAR-ON-YEAR)

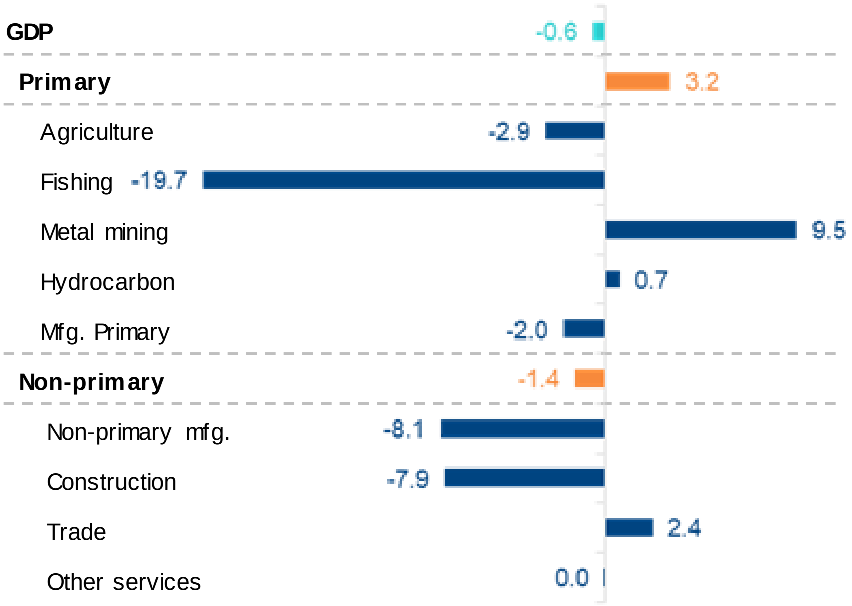


Source: BCRP. Preparation: BBVA Research.

- **Political** unrest at the beginning of the year
- **Weather anomalies:** cyclone Yaku, coastal El Niño, global El Niño
- **New subnational authorities** (investment expenditure usually slows down during the first year of management)
- **High inflation and interest rates**
- **Weak confidence**

Sectorally, weather anomalies had a strong negative impact on the primary component of GDP ...

SECTORAL GDP, 2023
(% CHANGE YEAR-ON-YEAR)



Source: INEI, BCRP. Preparation: BBVA Research.

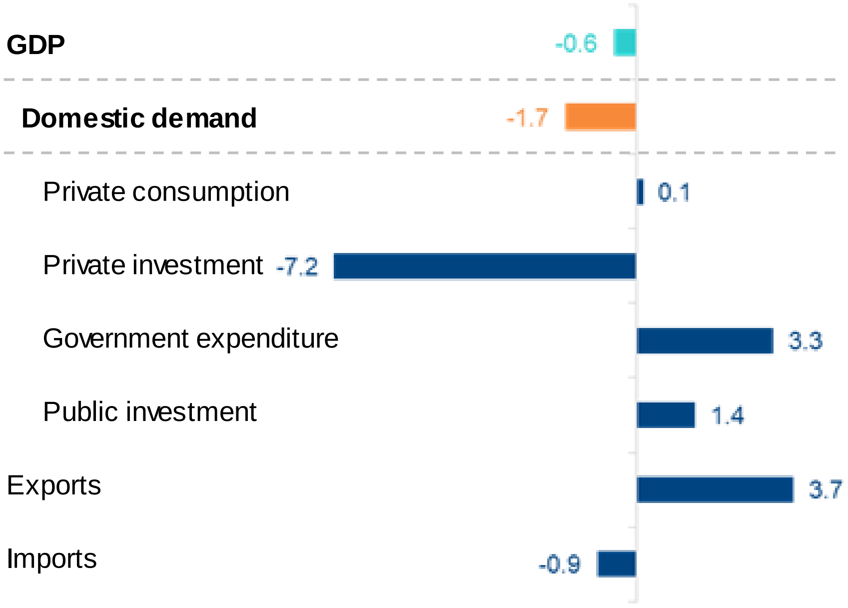
Weather anomalies mainly affected the following sectors:

- Fishing: the biomass of anchovy was affected, so that the first catch season in the north-central zone was not opened and the quota allocated for the second season was relatively low.
- Agriculture: fruit flowering and poultry supply were affected. The sector was already facing problems (low availability of fertilizers and drought in 2022). Bird flu also had a negative impact.
- Primary manufacturing: reduced availability of fishery and agricultural inputs.

Quellaveco supported mining, on the positive side

... while political instability, high inflation and interest rates, and weak confidence negatively affected private spending

EXPENDITURE-SIDE GDP 2023
(% CHANGE YEAR-ON-YEAR)

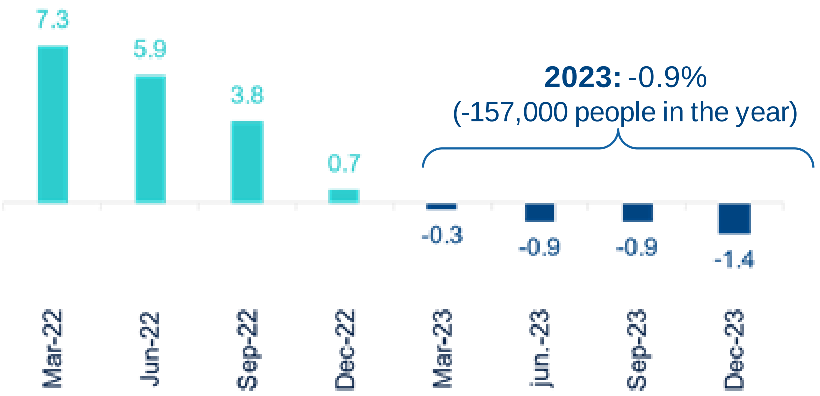


Source: BCRP. Preparation: BBVA Research.

- **Private spending** impacted by high inflation and interest rates and, in this context, by weak confidence. Private savings increased during the year.
  - Sharp contraction in **private investment** in 2023 (high base of comparison in the case of mining investment, slowdown in self-building). As a result, private investment, as a % of GDP, returned to its pre-pandemic levels.
  - **Private consumption** stagnated due to falling employment and high inflation and interest rates.
- Contraction of domestic demand had a negative impact on **imports.**
- **Exports** favored by increased mining production.

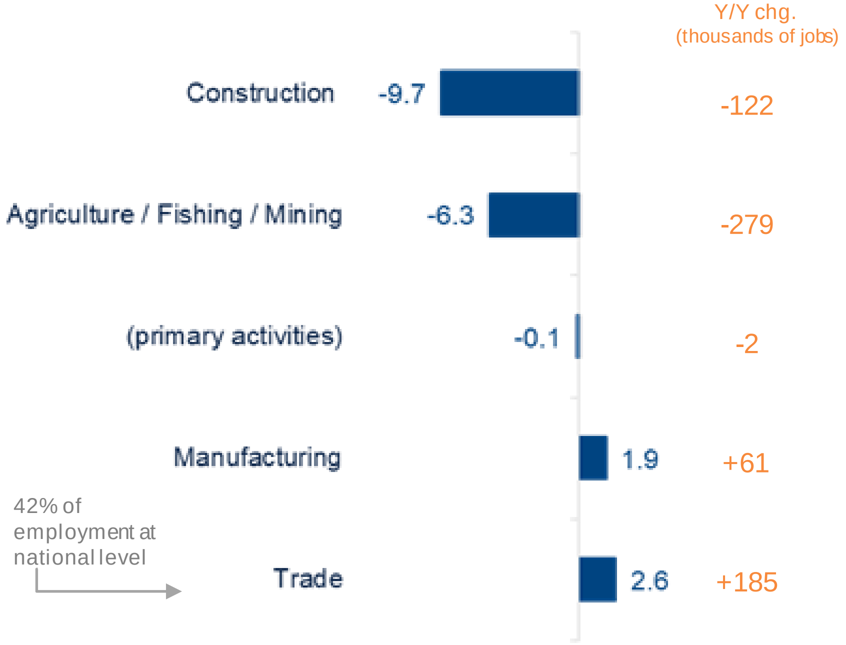
In this scenario, employment in 2023 fell by 0.9%, with the sharpest declines in construction and primary activities

EMPLOYMENT [1]
(% CHANGE, 3-MONTH MOVING AVERAGE)



	2022	2023
Employed EAP (1,000 people)	17,337	17,180
Unemployment rate (%)	4.7	5.4

2023: EMPLOYMENT BY SECTOR
(% CHANGE YEAR-ON-YEAR)



1: Until December 2022, data from ENAHO is used; for 2023, 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.

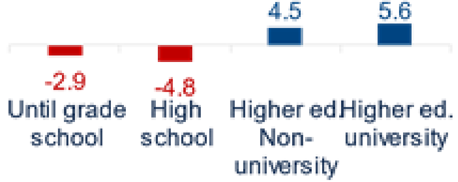
However, employment in larger firms and for more experienced and educated workers is growing, favoring average pay

2023: EMPLOYMENT AT NATIONAL LEVEL BY CHARACTERISTICS
(% CHANGE YEAR-ON-YEAR)

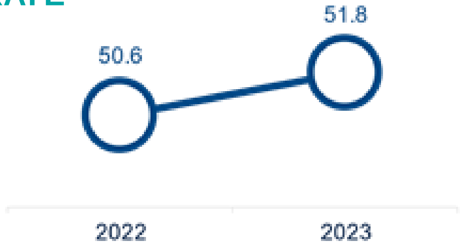
BY COMPANY SIZE

BY WORKER'S AGE

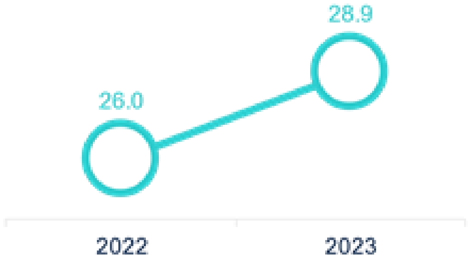
BY WORKER'S EDUCATION LEVEL



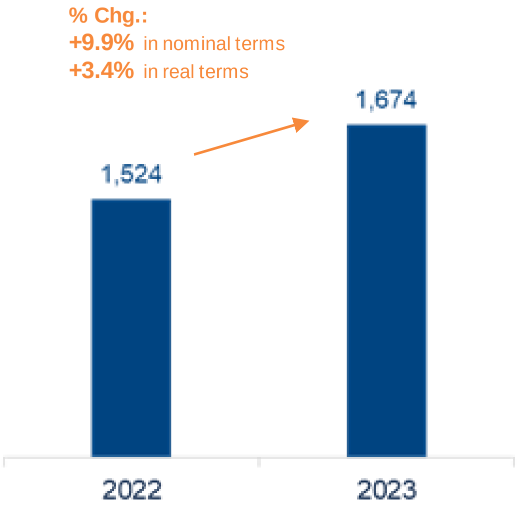
2023: ADEQUATE EMPLOYMENT RATE



2023: FORMALITY RATE



AVERAGE WORKER'S NOMINAL INCOME
(MONTHLY SOLES)

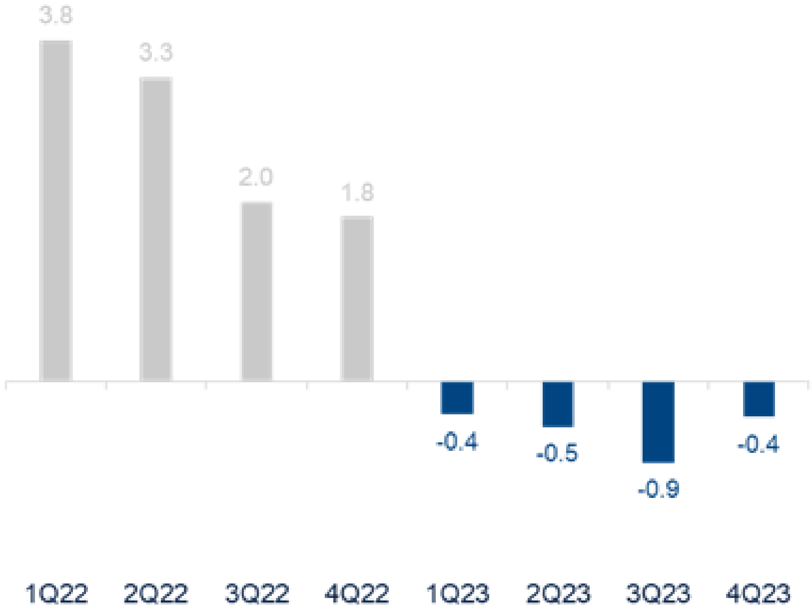


The total wage bill grew by 2.5% in real terms in 2023

Source: INEI (EPEN).

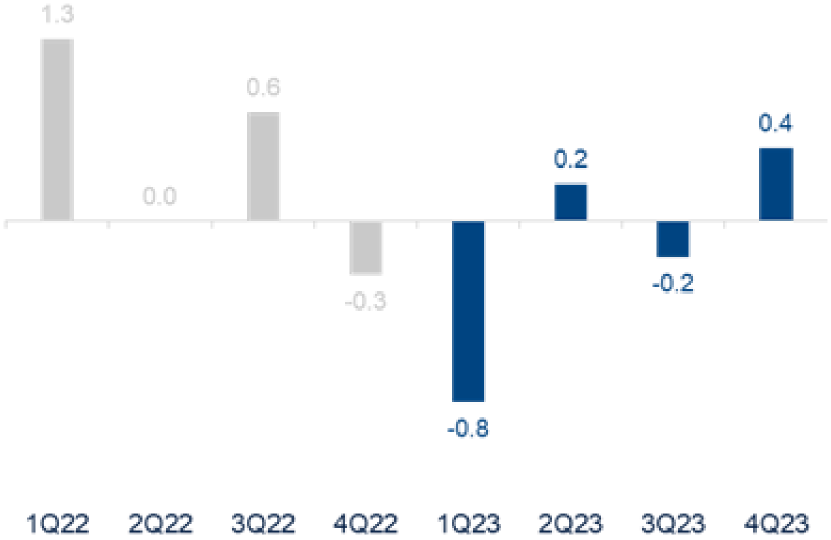
Economic activity seems to start to turn around as of the fourth quarter of 2023

GDP
(% CHANGE YEAR-ON-YEAR)



Source: BCRP. Preparation: BBVA Research.

GDP
(SA, % CHANGE QUARTER-ON-QUARTER)

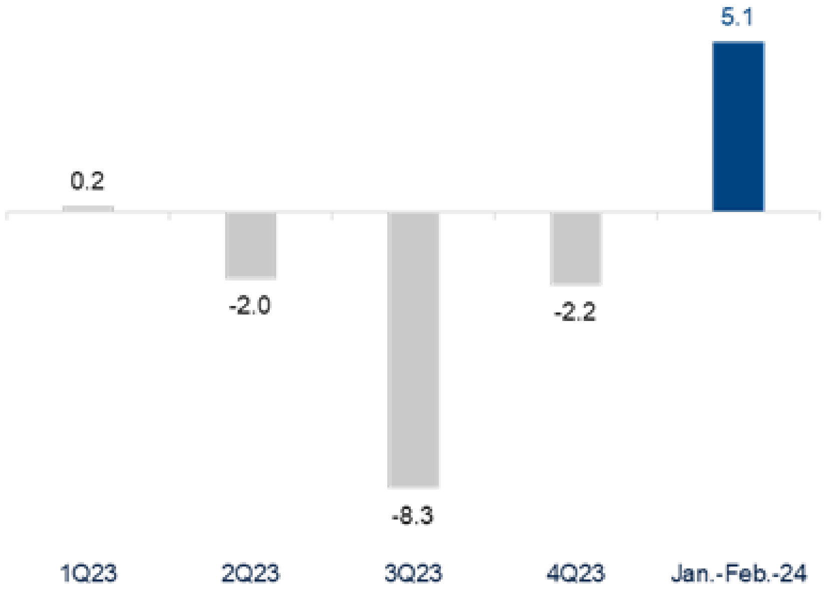


Source: INEI. Preparation: BBVA Research.

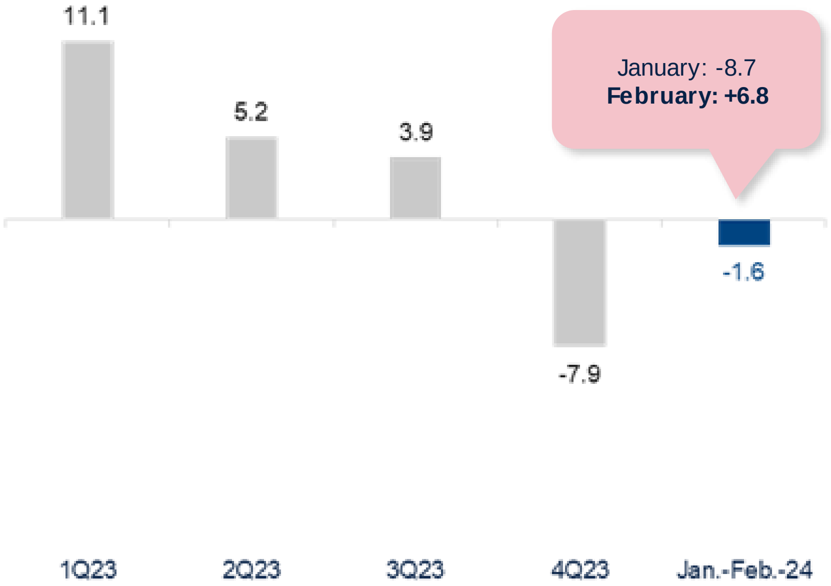
In early 2024, the outlook is somewhat more encouraging: available indicators suggest that spending is starting to improve...

ECONOMIC ACTIVITY INDICATORS AVAILABLE FOR THE FIRST TWO MONTHS OF 2024
(% CHANGE YEAR-ON-YEAR)

PRIVATE CONSUMPTION BIG DATA INDEX[1]



CAR SALES

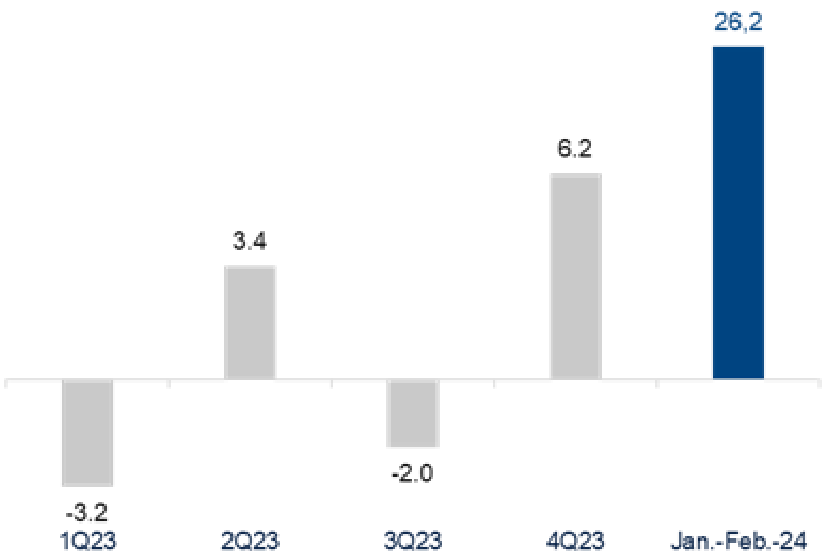


1/ Uses data on the amount of credit and debit card purchases made by households and cash withdrawals through ATMs and teller windows.
Source: Peru Automotive Association and BBVA Research.

in early 2024, the outlook is somewhat more encouraging: available indicators suggest that spending is starting to improve...

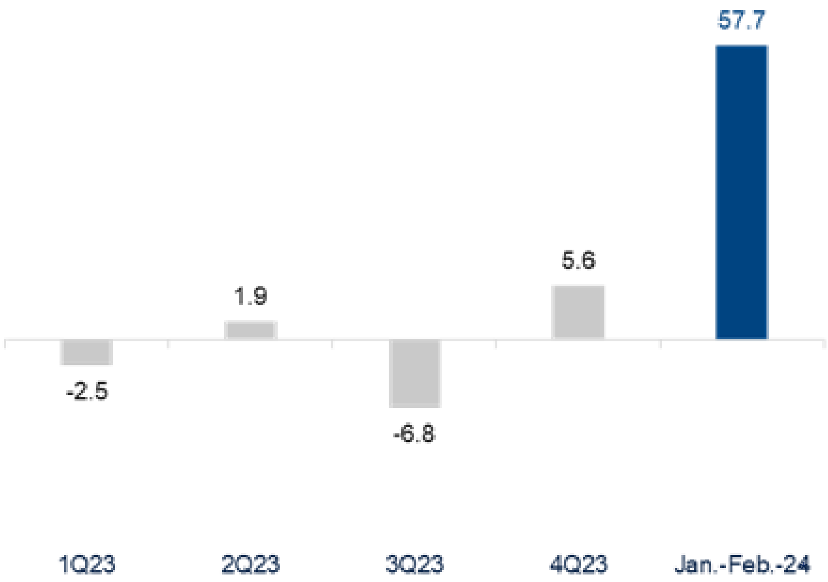
ECONOMIC ACTIVITY INDICATORS AVAILABLE FOR THE FIRST TWO MONTHS OF 2024
(% CHANGE YEAR-ON-YEAR)

BIG DATA TOTAL INVESTMENT INDEX[1]



1/ Information on the amounts of income to enterprises belonging to sectors related to the production of inputs, intermediate and capital goods is used.
Source: BCRP and ASOCEM. Preparation: BBVA Research.

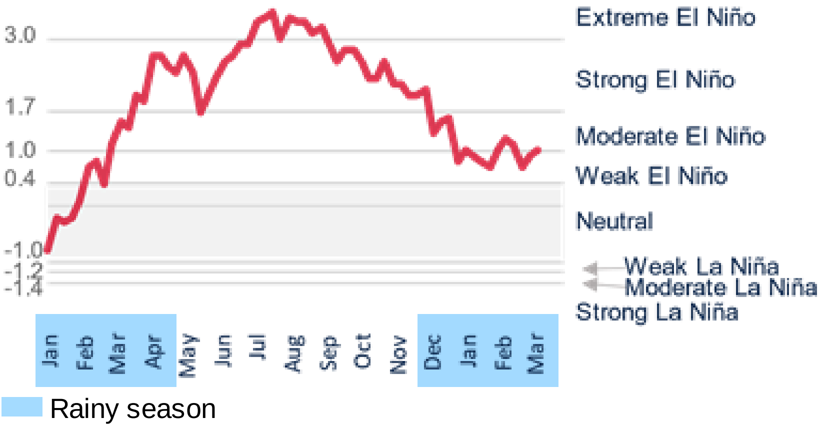
PUBLIC INVESTMENT



*Estimate.
Source: MEF and BBVA Research (estimates).

... weather anomalies have decreased, most clearly those related to coastal El Niño and more benign than expected...

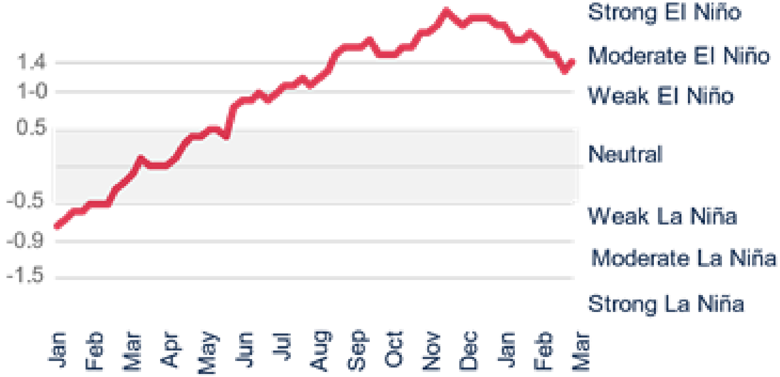
SEA SURFACE TEMPERATURE ANOMALY ON THE NORTHERN PERUVIAN COAST
(DEGREES CELSIUS, 2023 AND 2024, WEEKLY AVERAGE)



FORECASTS IN NOVEMBER

	Dec-23	Jan-24	Feb-24
Neutral -	0	0	2
Weak	0	3	10
Moderate	40	44	**46**
Strong +	**60**	**53**	42

SEA SURFACE TEMPERATURE ANOMALY IN THE PACIFIC OCEAN ZONE 3.4
(DEGREES CELSIUS, 2023 AND 2024, WEEKLY AVERAGE)



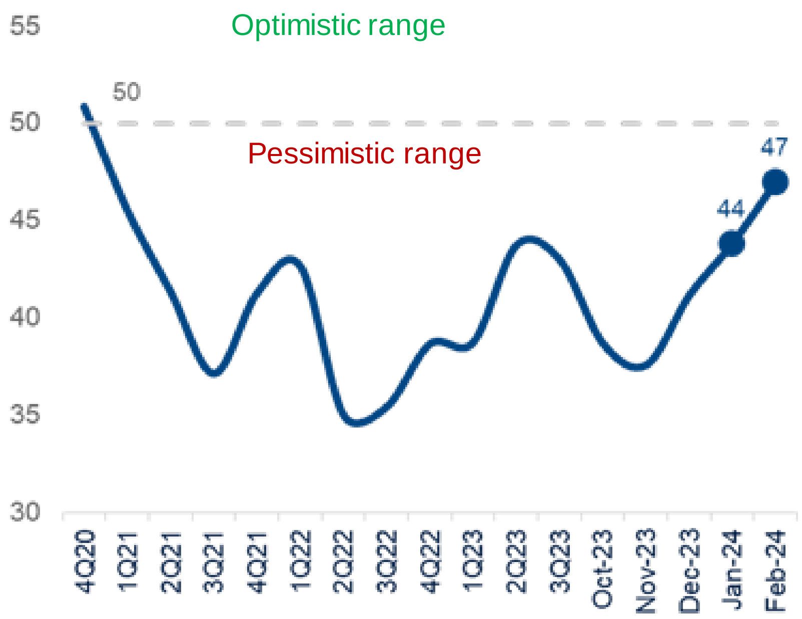
FORECASTS IN NOVEMBER

	Dec-23	Jan-24	Feb-24
Neutral -	0	0	0
Weak	0	0	2
Moderate	8	11	28
Strong +	**92**	**89**	**70**

Source: NOAA and ENFEN. Preparation: BBVA Research.

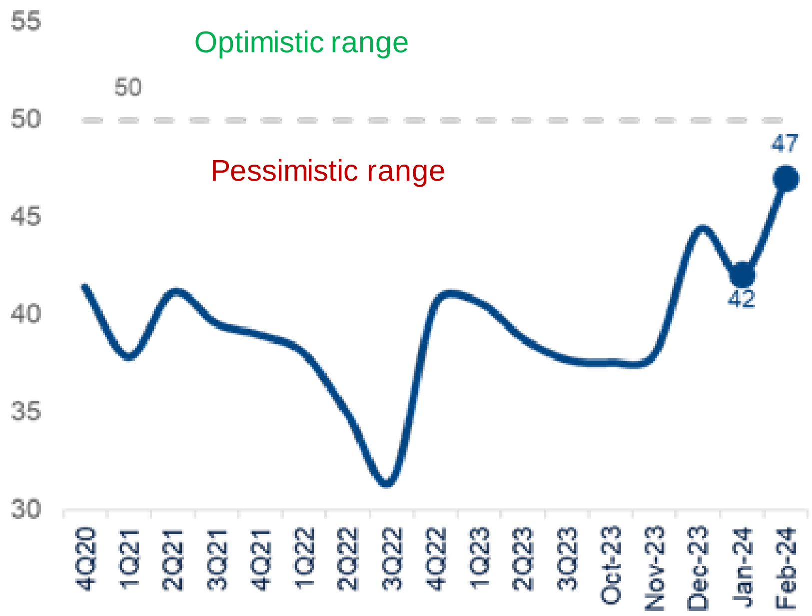
… and in this context, although still on the pessimistic side, confidence has trended upward since the end of last year

BUSINESS CONFIDENCE
(POINTS)



Source: BCRP. Preparation: BBVA Research.

CONSUMER CONFIDENCE
(POINTS)



Source: APOYO Consultoría. Preparation: BBVA Research.

03

Global economic forecasts

Creating Opportunities

Supply normalization and (surprisingly slow) demand weakening amid high interest rates have triggered an (incomplete) easing of growth and inflation

Main scenario drivers

Waning supply shocks: easing of commodity prices and bottlenecks, despite geopolitical tensions

Demand moderation, on monetary tightness, but backed by fiscal policy and labor markets

Recent macro trends

Declining inflation, which is still above targets, mostly on service pressures

Growth soft-landing: manufacturing weakness, but resilience services

Central banks and financial markets

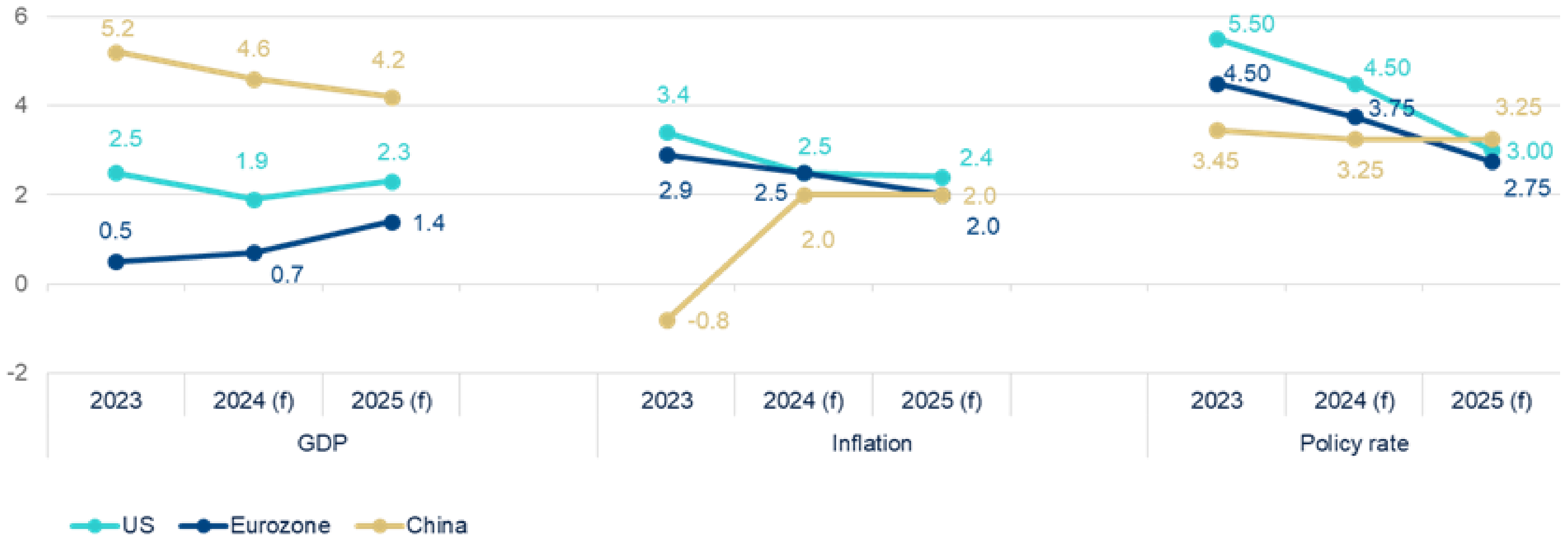
Rate-hiking cycles seem over; focus on timing and speed of coming easing cycles

Limited financial volatility, despite the scaling back of sharp monetary easing expectations

Output slows down, leading to extra easing of inflation and rate cuts from mid-2024; still, price pressures and interest rates will remain relatively high

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

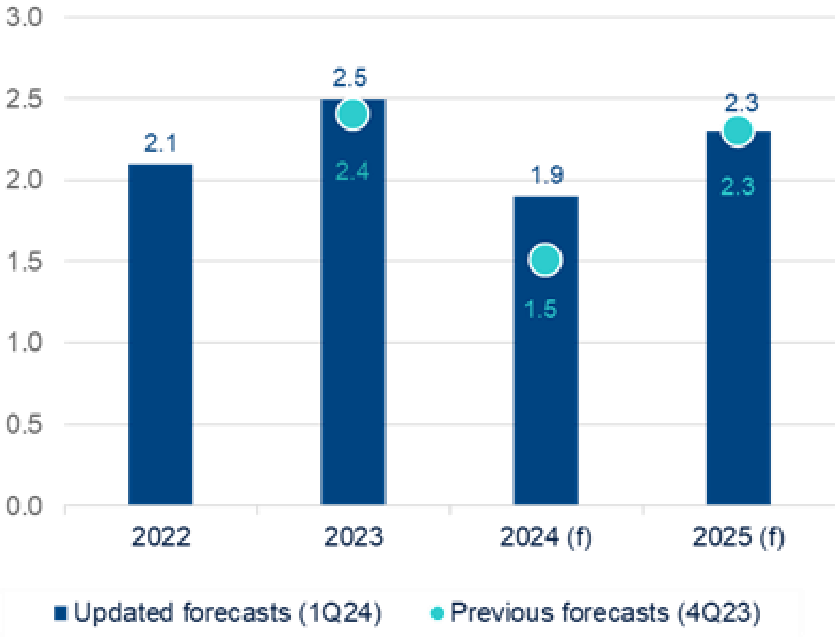
(GDP GROWTH: %, INFLATION: YOY %, EOP, POLICY INTEREST RATES: %, EOP)



(*) Global GDP growth: 3.1% (+0.1pp in comparison to previous estimation), 3.1% (+0.1pp) in 2024 in 2024 and 3.3% (+0.0) in 2025.
(**) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research.

U.S.: demand strength supports higher growth in 2024, but a moderation is still likely ahead, which would allow a cautious Fed to cut rates from mid-year

U.S.: GDP GROWTH
(%)

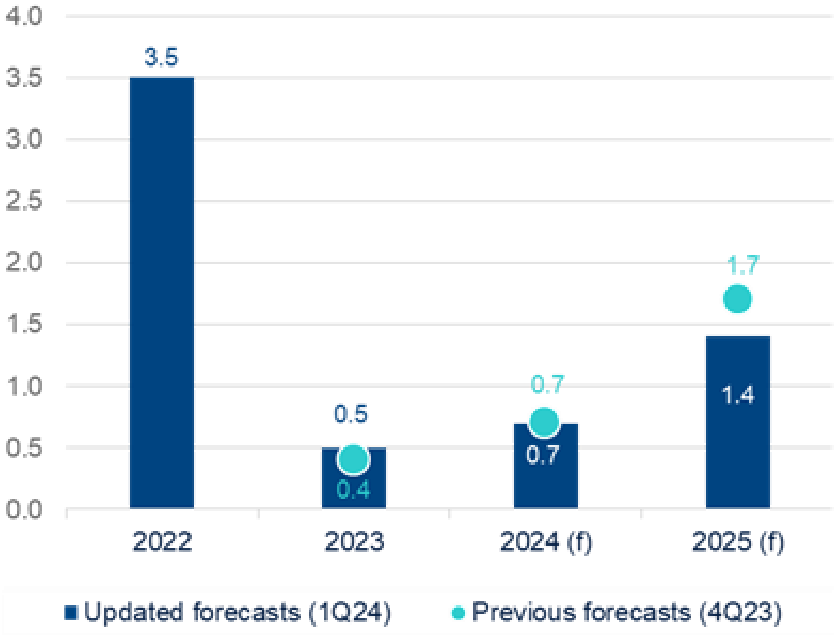


(f): forecast.
Source: BBVA Research.

- Domestic demand and services inflation remain resilient, but further easing is likely on excess savings depletion and tight monetary conditions.
- Extra inflation moderation (forecasts remain broadly unchanged) would pave the way for a monetary easing from May/24, which would take rates to 4.50% in Dec/24 and 3.0% in Dec/25, supporting a growth recovery from late this year.
- A growth acceleration that jeopardizes the inflation convergence to 2% and keeps rates higher is possible, but not very likely; anyway, risks are balanced and a sharper decline of growth and inflation is also a possibility.
- Risks: presidential elections, recession or financial stress on high rates, expansive fiscal stance.

Eurozone: weak growth and declining inflation favor cautious cuts of ECB policy rates from Jun/24, which would then favor a mild recovery ahead

EUROZONE: GDP GROWTH
(%)

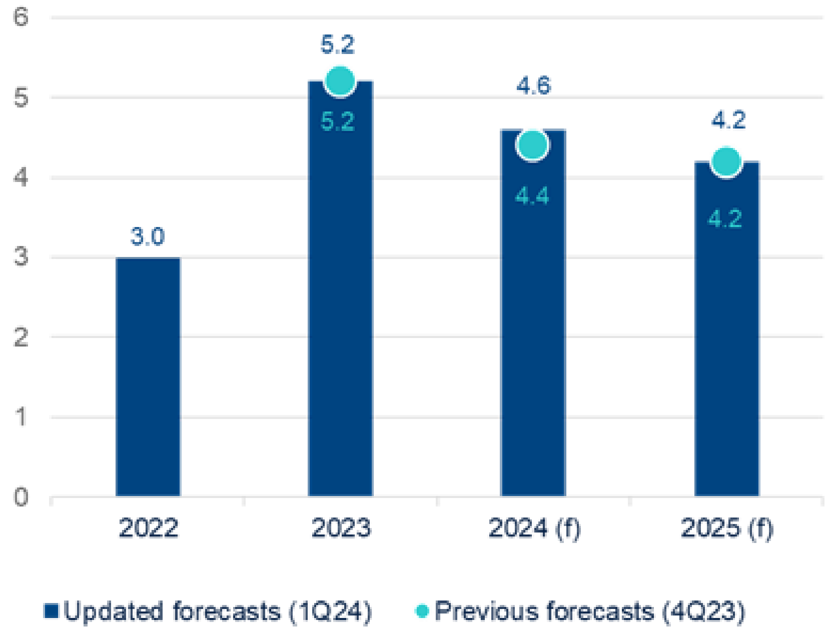


(f): forecast.
Source: BBVA Research.

- Growth: stagnation (no recession) in 2023 and beginning of 2024; cross-country divergence.
- A recovery is likely from mid-year, but 2025 GDP forecast was cut on prospects of larger fiscal consolidation given the new fiscal rules.
- Inflation forecasts revised down on incoming data and lower energy prices, despite service inflation and wage dynamism.
- Policy rates: 75 bps cuts this year and 100 bps cuts in the next one are expected.
- Quantitative tightening will continue, mainly through a reduction of the PEPP portfolio; new operational framework by 2Q24.
- Risks: geopolitical tensions, stagflation and sovereign debt tensions.

China: targeted fiscal, monetary and regulatory policies are likely to sustain growth, but will not prevent a structural slowdown of GDP growth

CHINA: GDP GROWTH
(%)

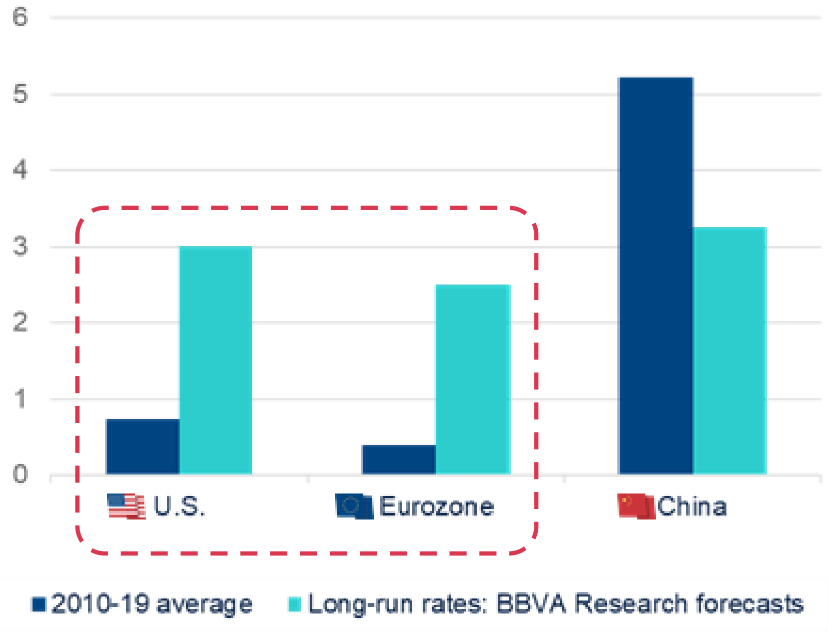


(f): forecast.
Source: BBVA Research.

- Activity, in particular the troubling real estate sector, will be backed by monetary and fiscal measures and some regulatory easing.
- Fiscal policy is expected to remain expansionary and more cuts in reserve requirements and policy rates are likely after the Fed starts reducing rates.
- A structural growth slowdown is likely on real estate problems, local government debt, ageing, US relationship…
- Inflation remains below zero, but is forecast to converge to 2% on supportive policies, pork price normalization, confidence improvement.
- Risks: real estate tensions, deflation, balance-sheet recession, weak FDI and financial inflows, geopolitical tensions.

Over the next few years, geopolitics and other factors will likely help to keep inflationary pressures and interest rates higher than in the pre-COVID period

NOMINAL POLICY INTEREST RATES (*)
(%)

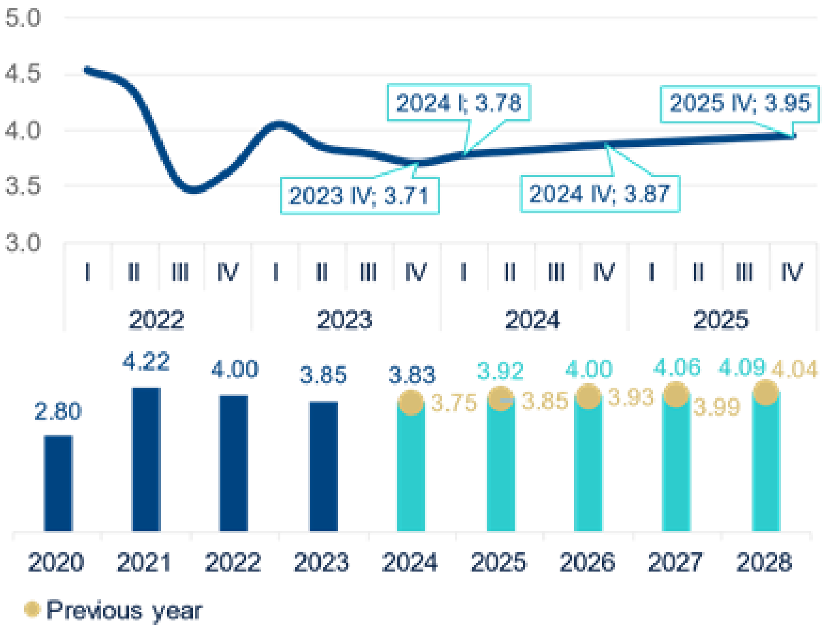


(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on data from the BLS and Eurostat.

- Geopolitics will be a source of uncertainty, supply shocks and price pressures:
  - conflicts in Ukraine and Middle-East, and potentially in other regions: pressure on energy and other input prices;
  - lack of coordination on key global issues: protectionism, climate policies, etc..
- Other factors potentially fueling inflation:
  - elections in the US and other regions (tariff increases, migration policies, etc.);
  - extreme weather events, climate policies;
  - tight labor markets, adverse demographics;
  - fiscal policy: strong spending (defense, green, social...); high public debt levels.
- Productivity gains could, at least partially, weaken inflationary pressures.

Copper price: we anticipate an upward trend on the back of gradually improving activity in major economies and recent negative supply shocks

COPPER PRICE
(USD/POUND AVERAGE FOR THE PERIOD)



Source: Bloomberg and BBVA Research (forecasts).

- In the coming quarters, copper prices should trend upward, reflecting the gradual improvement in the performance of large economies such as the United States and Europe, as well as inventories that remain at historically low levels (partly due to supply shocks such as the closure of the Cobre Panamá mine).
- In the medium term, we maintain the view that greater investment in "green" infrastructure and vehicle retrofitting will support the price. The importance of these factors will gradually increase over the next few years.
- Compared to the previous year, the expected path for the copper price is revised upward given the improved growth outlook for the United States and China.

04

Peru economic forecasts

4.1 Economic activity

Global macro outlook: key considerations and domestic impacts

FACTORS CONSIDERED

- **In the United States and China, economic growth will lose momentum, although not as much as anticipated.** Over the course of 2024, the moderation of inflation and interest rates in the U.S. will allow a recovery for the U.S. starting in the second half of the year; in China, however, structural factors will continue to have negative effects.
- **Inflation will continue to decline,** in line with the expected slowdown in services and assuming no new supply shocks occur. **This will create room for the Fed to cut interest rates from the middle of this year, cautiously**.
- **Limited financial volatility** despite reduced expectations of strong monetary easing.
- **Geopolitical tensions** will remain latent.

LOCAL IMPACTS

- **The external environment is more favorable for the growth of the Peruvian** economy (growth of trading partners, export prices and interest rates). External demand —especially for non-traditional products— remains somewhat supportive. It is a positive for domestic business confidence.
- **Exchange rate:** the Fed's caution in lowering its policy rate and latent geopolitical tensions will reduce support for the PEN.

Domestic macro outlook: key considerations

FACTORS CONSIDERED

1

So far this year, **warm conditions related to coastal El Niño have been milder than anticipated**. The negative impact on activity has also been more limited. **The forecasts for the coming months are also better than those considered in the previous baseline scenario** (published in December 2023): the anomaly will be less intense and it will dissipate faster. **Forecasts for the global El Niño are also more benign.** In 2025, the rebound of activity post-El Niño will be complete.

2

Relative political and social stability. However, the state of calm is fragile. Similar scenario to that included in the previous forecast.

3

Improved performance of public investment and inbound tourism. Greater execution of public investment expenditure at the subnational level after the first year of its government administration (when this expenditure usually suffers). Compared to the previous baseline scenario, however, this improvement is more limited because, as the impact of coastal El Niño on infrastructure has been lower than expected (and will probably continue to be so for the rest of the summer), spending on reconstruction will also be lower. On the tourism side, greater political and social calm and dissipation of weather anomalies favor the arrival of foreign tourists.

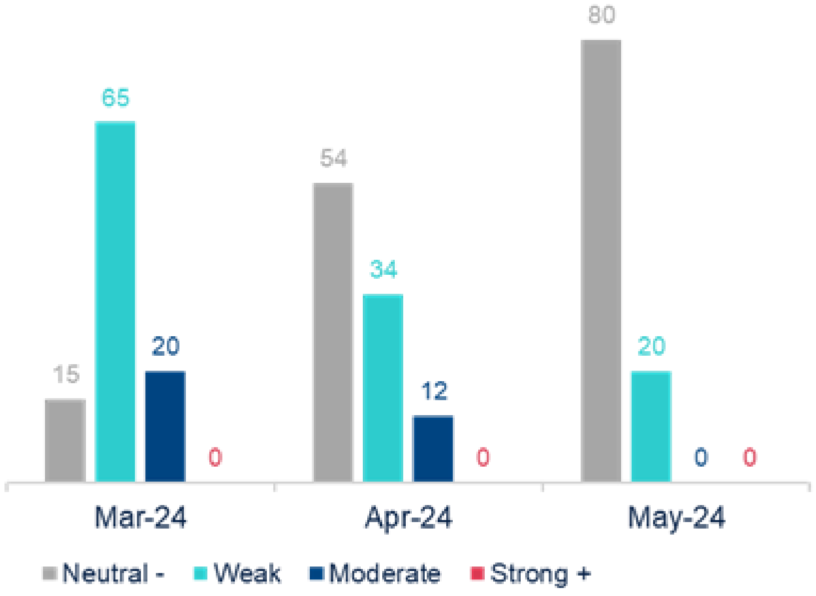
4

The contribution by the mining sector to growth is tending to wane. Quellaveco's contribution to the year-on-year growth rate will fade. Absence of new major mining projects going forward.

1. Coastal El Niño: warm conditions will weaken hereafter; the anomaly will be less intense and less long-lasting than previously anticipated

COASTAL EL NIÑO PHENOMENON | LIKELIHOOD OF DIFFERENT SCENARIOS OCCURRING (%)

CURRENT SITUATION



Source: ENFEN and BBVA Research.

PREVIOUS SITUATION (NOVEMBER*)

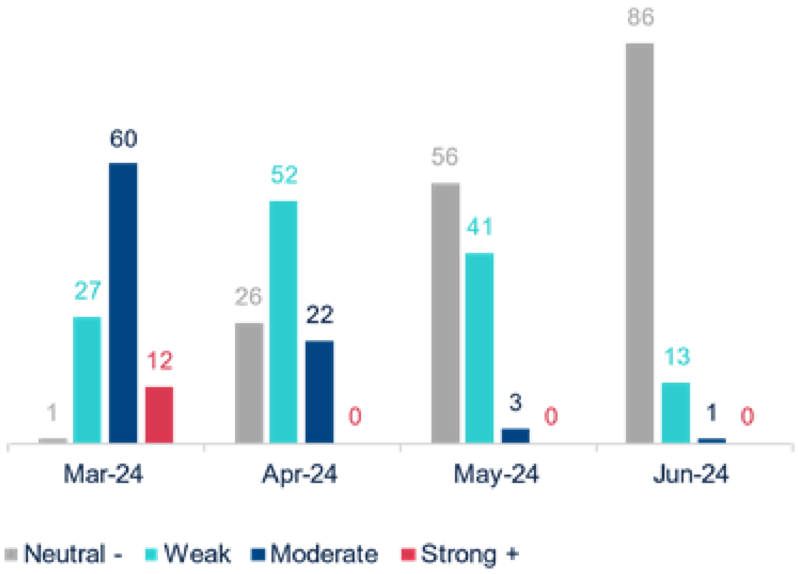
	Mar-24	Apr-24
Neutral -	6	18
Weak	15	32
Moderate	**40**	**37**
Strong +	**39**	13

* Forecasts published on November 24, 2023.
Source: ENFEN and BBVA Research.

1. Global El Niño: still moderate in intensity, the anomaly will decrease going forward; forecasts are more benign than three months ago

GLOBAL EL NIÑO PHENOMENON | LIKELIHOOD OF DIFFERENT SCENARIOS OCCURRING (%)

CURRENT SITUATION



Source: ENFEN and BBVA Research.

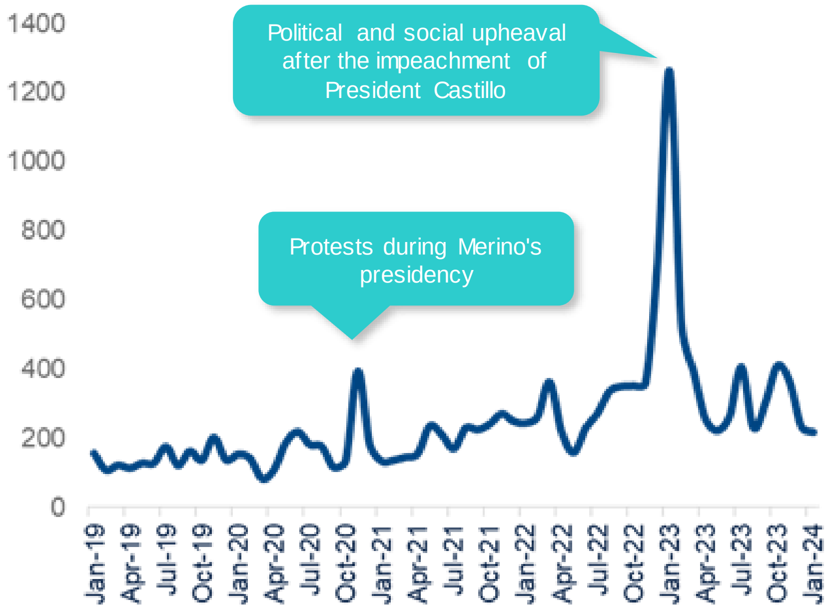
PREVIOUS SITUATION (NOVEMBER*)

	Mar-24	Apr-24
Neutral -	1	6
Weak	9	25
Moderate	42	**45**
Strong +	**48**	24

* Forecasts published on November 24, 2023.
Source: ENFEN and BBVA Research.

2. Political situation: relative political and social stability, although the balance is fragile; unchanged from the previous baseline scenario

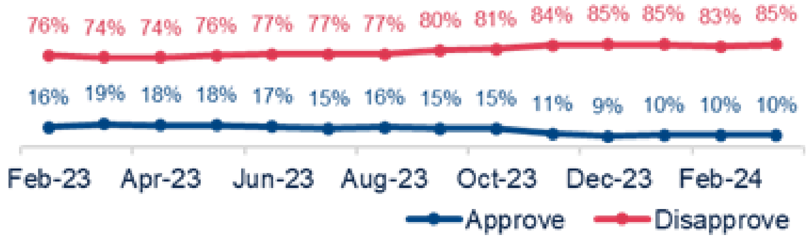
COLLECTIVE PROTEST ACTIONS
(NUMBER OF CASES)



Source: Ombudsman. Preparation: BBVA Research.

APPROVAL OF PRESIDENT DINA BOLUARTE
(% RESPONDENTS)

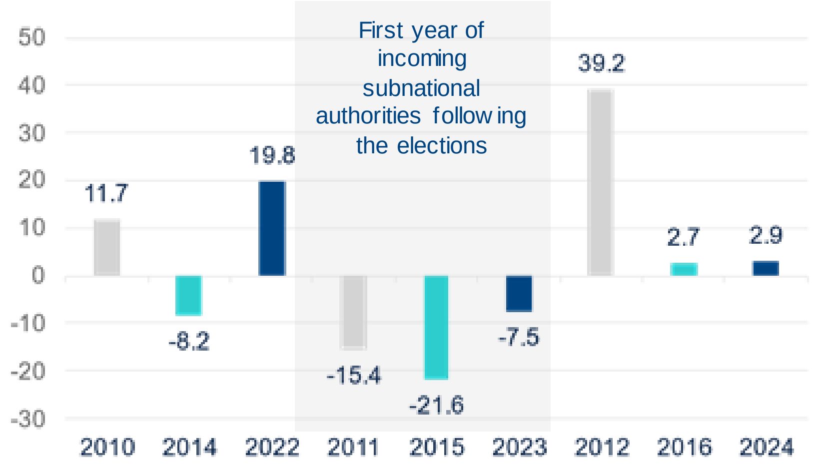
- Today, early elections or a Constituent Assembly are off the table.
- However, the government has low approval among the public.
- Room for political maneuver is limited to contain initiatives with a more populist tone.
- Weak governance and institutionality affect the quality of public policies and medium-term growth.
- Years of low growth, instability and insecurity open up space for presidential candidates with more extreme positions.



Source: Datum.

3. Public investment and inbound tourism will perform better in 2024

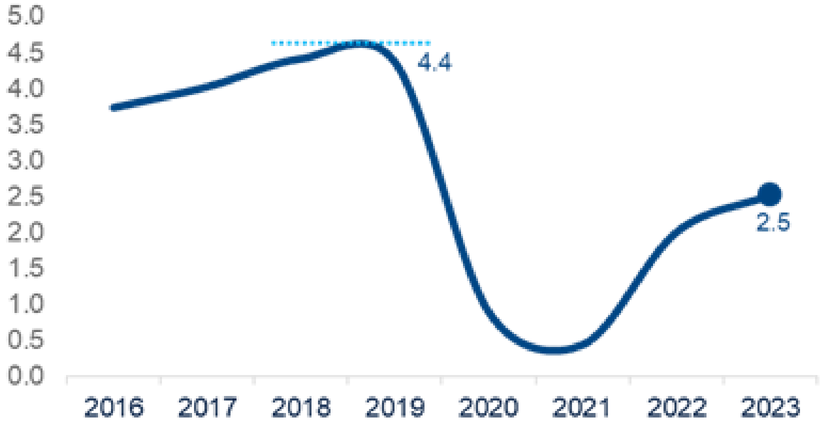
PUBLIC INVESTMENT BY SUBNATIONAL GOVERNMENT (IN REAL TERMS, CHG. %)



Recovery in public investment at the subnational level in 2024, although less pronounced than that considered in the previous baseline scenario due to the fact that spending on reconstruction after the coastal El Niño will be less necessary.

Source: BCRP and BBVA Research (forecasts).

ARRIVAL OF FOREIGN TOURISTS (MILLIONS)



TOURISM REVENUE* (MILLIONS OF USD)

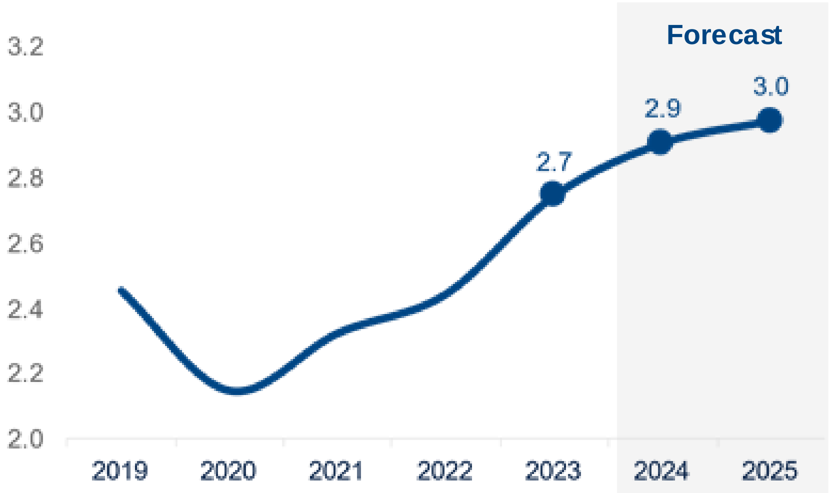
2019	2020	2021	2022	2023
4,703	1,002	1,042	2,938	3,606

*Corresponds to the transport and travel item (credits) of the services account of the current account of the balance of payments.
Source: Ministry of Foreign Trade and Tourism and BCRP.

4. After excelling in 2023, mining's boost to growth will trend toward dissipation

COPPER PRODUCTION

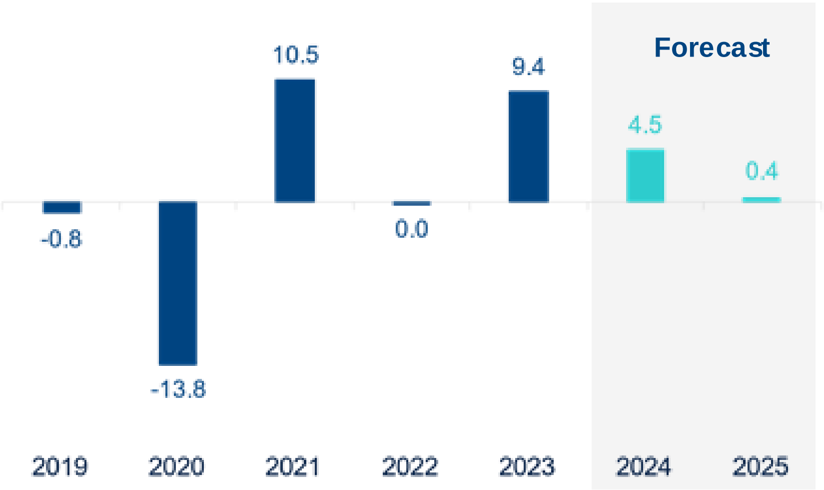
(MILLIONS OF MT)



Source: MINEM, BCRP and BBVA Research (forecasts).

METAL MINING

(ANNUAL % CHANGE)

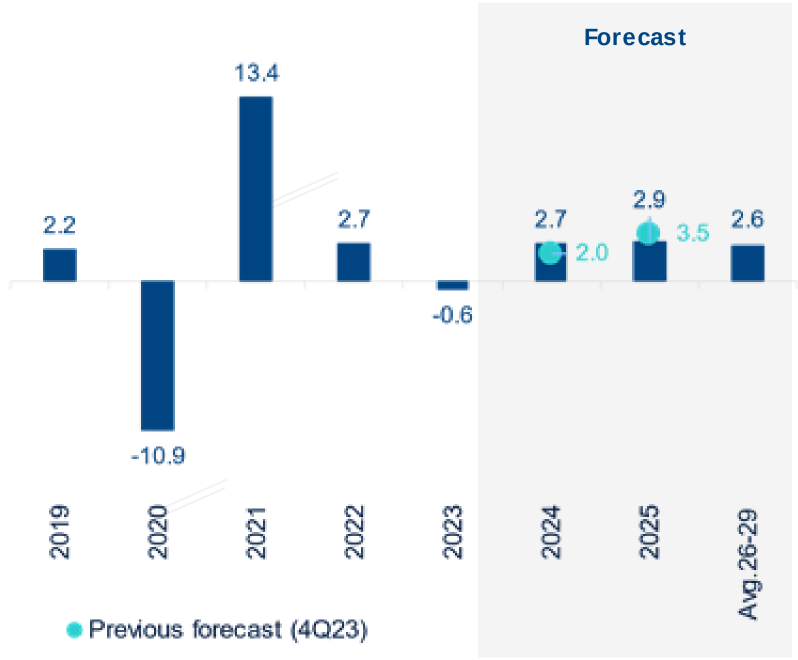


Source: MINEM, BCRP and BBVA Research (forecasts).

The mining growth forecast in 2024 incorporates normalization of copper production at mines affected at the beginning of last year during the political and social upheaval, as well as higher production of molybdenum (from Quellaveco, which began extracting this metal in May last year).

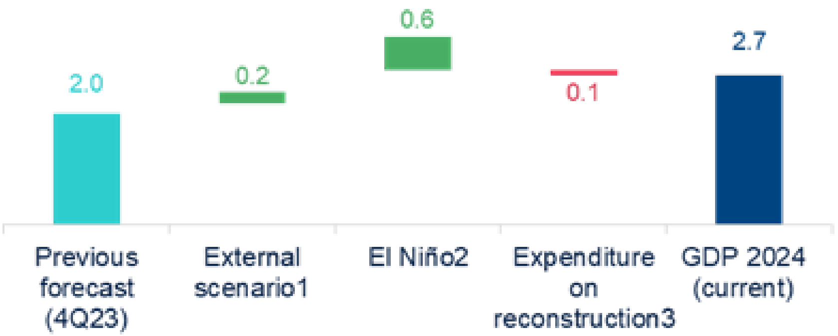
In balance, the rebound in 2024 will be more pronounced than expected in the previous scenario, mainly due to the lower impact of El Niño

GDP (% CHANGE YEAR-ON-YEAR)



Source: BCRP and BBVA Research (forecasts).

BREAKDOWN OF THE CHANGE IN THE 2024 OUTPUT GROWTH FORECAST (PP OF GDP)

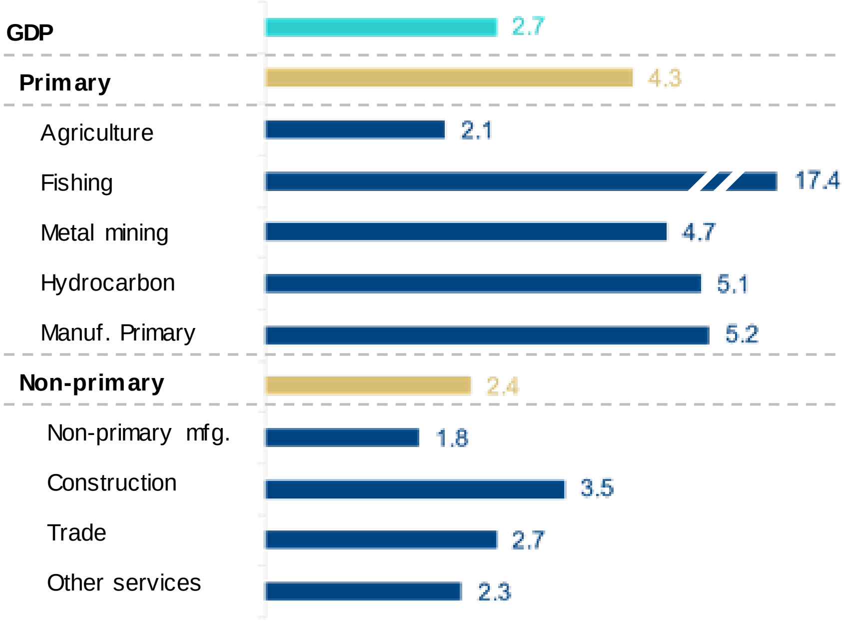


1/ More positive forecasts for the global environment (growth in the U.S. and China, export prices and interest rates).
2/ More benign weather anomalies.
3/ Better weather conditions will mean less destruction of infrastructure and thus less need to rebuild.

With a milder coastal El Niño in 2024, normalization in 2025 (as that shock dissipates) will also be less intense, leading to a downward correction of next year's growth to 2.9%.

On the sectoral side, in 2024 the recovery of the fishing sector and the rebound of the non-primary sectors will stand out

2024: SECTORAL GDP FORECAST
(% CHANGE YEAR-ON-YEAR)

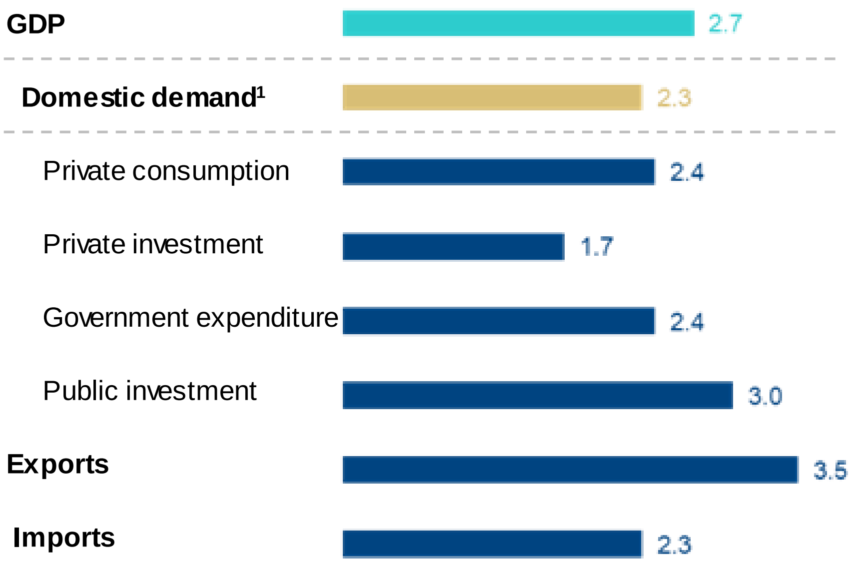


Source: BBVA Research.

- **Normalization of fishing activity.** Recovery of anchovy landings, which were heavily affected in 2023 by adverse weather conditions. It will have a positive impact on the production of fishmeal and fish oil (primary manufacturing).
- **Agriculture.** Trend toward normalization as weather anomalies and bird flu dissipate.
- **Mining.** Moderation of growth due to lower momentum from Quellaveco. It will still continue to show significant growth rates due to the normalization of production in some mines affected in 2023 by the political and social upheaval.
- **Construction.** Recovery in public investment at subnational level, better conditions for self-building (lower inflation, lower material costs, El Niño risk dissipates).
- **Trade and services.** Lower inflation and financing costs favor the demand for services in general.

On the expenditure side, domestic demand—and especially private sector spending—begins to recover in 2024

2024: EXPENDITURE-SIDE GDP FORECAST (% CHANGE YEAR-ON-YEAR)

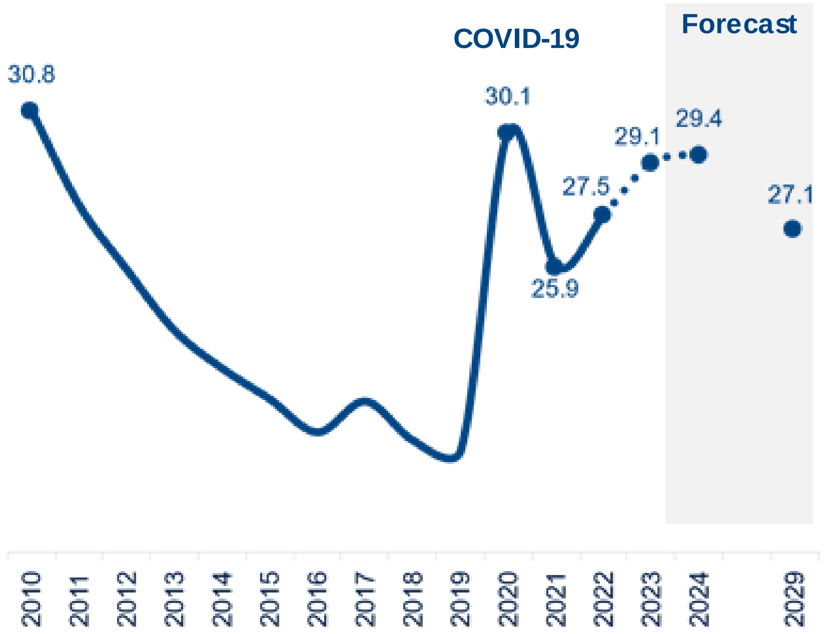


1: Inventories not included.
Source: BBVA Research.

- **Private investment.** Improving non-mining investment: construction sector and progress of infrastructure projects. Mining investment will not be weighed down by a high base of comparison, but, on the contrary, will be supported by the progress of some small and medium-sized projects (expansion of Toromocho, San Gabriel, others).
- **Private consumption.** Lower inflation and financing costs, as well as more opportunities in the labor market, will encourage household spending.
- **Public investment.** Improvement after the first year in office of the subnational authorities elected at the end of 2022.
- **Exports.** Recovery of volume in mining, fishery and agricultural exports. Trend toward normalization of inbound tourism.

Weak economic activity and still-high inflation should have led to the monetary poverty rate increasing in 2023; it should still increase in 2024

MONETARY POVERTY [1]
(% OF POPULATION)



1/ Estimated for 2023
Source: INEI and BBVA Research (forecasts).

- The population in **monetary poverty increased from 27.5% in 2022 to 29.1% in 2023** (an increase of 640 thousand people in this situation)**,** in a context of deterioration in economic activity and still relatively high inflation.
- **In 2024,** with inflation more under control but growth still weak, the **poverty rate should rise again, reaching 29.4%.**
- This would bring 10 million people below the poverty line in 2023 (9.2 million in 2022).
- A decrease in the monetary poverty rate in the medium term, with a moderate increase in prices (especially for food) and a growth in activity of between 2.5% and 3.0%.

BBVA Research

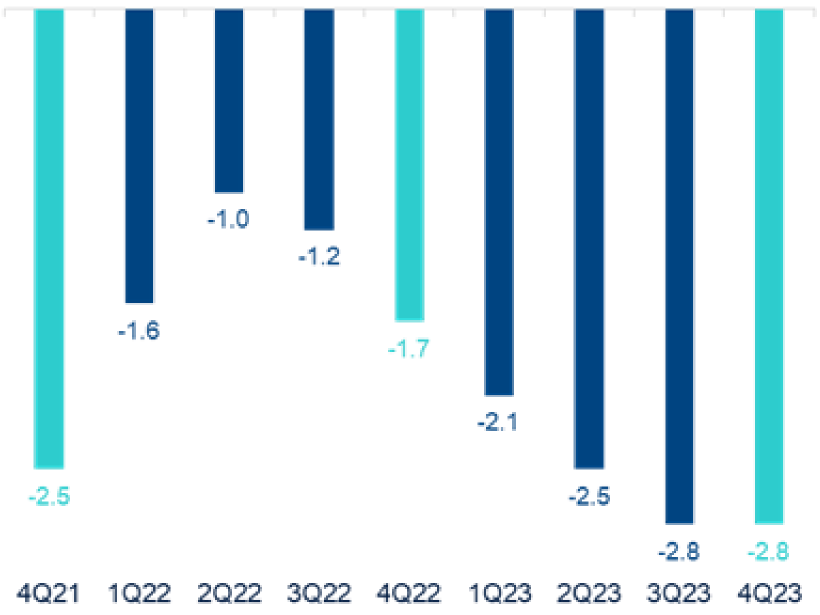
04

Peru economic forecasts

4.2. Fiscal balance and public debt

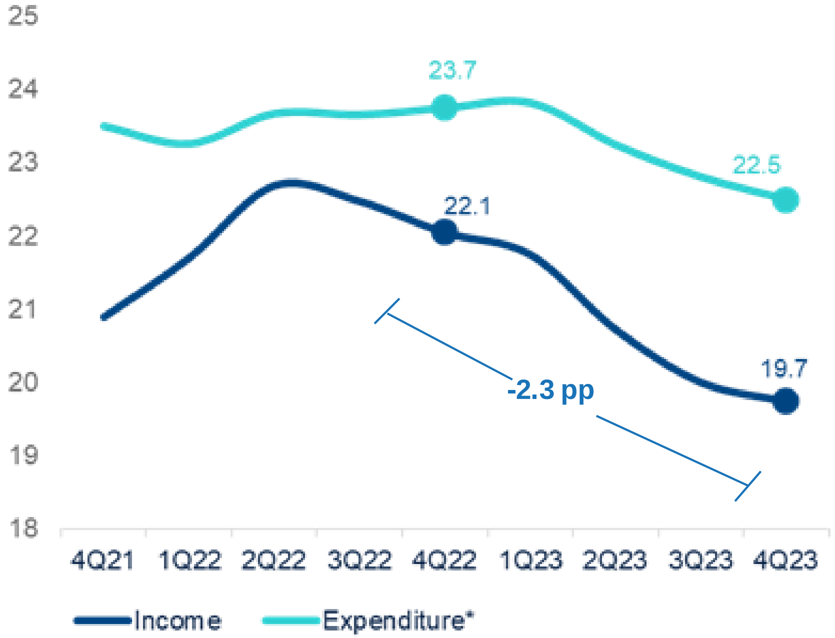
Against a backdrop of economic weakness and lower commodity prices, tax revenues suffered and the deficit increased in 2023

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



Source: BCRP.

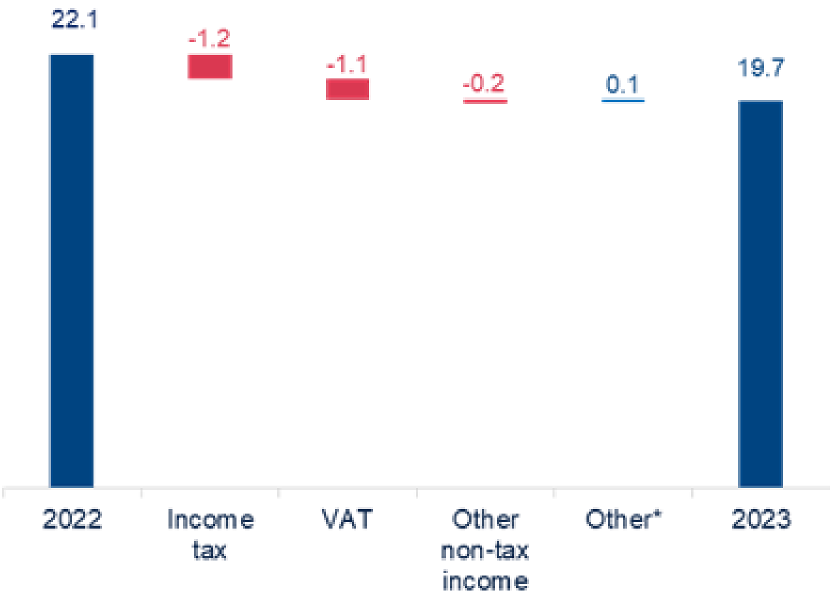
FISCAL REVENUE AND EXPENDITURE
(CUMULATIVE LAST FOUR QUARTERS, % OF GDP)



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

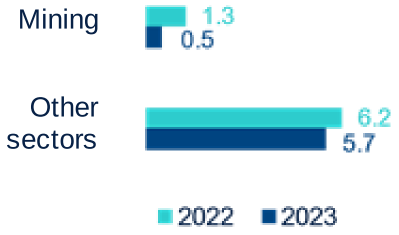
Revenue decrease especially from income tax (linked to the mining sector) and VAT (domestic demand weakness)

GENERAL GOVERNMENT REVENUE
(% OF GDP)



* Includes import tax, selective consumption tax, other national government tax revenues, local government tax revenues, and tax refunds.
Source: BCRP.

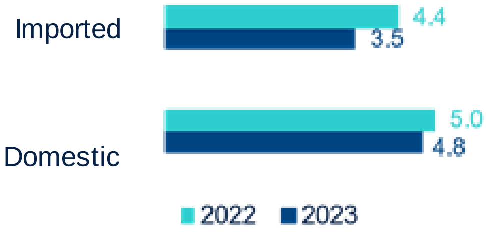
INCOME TAX
(% OF GDP)



Lower tax revenue from companies, especially mining companies.

Mining companies made lower regularization payments due to high payments on account in 2022, reflecting the favorable export product prices in 2021 and early 2022.

VAT
(% OF GDP)

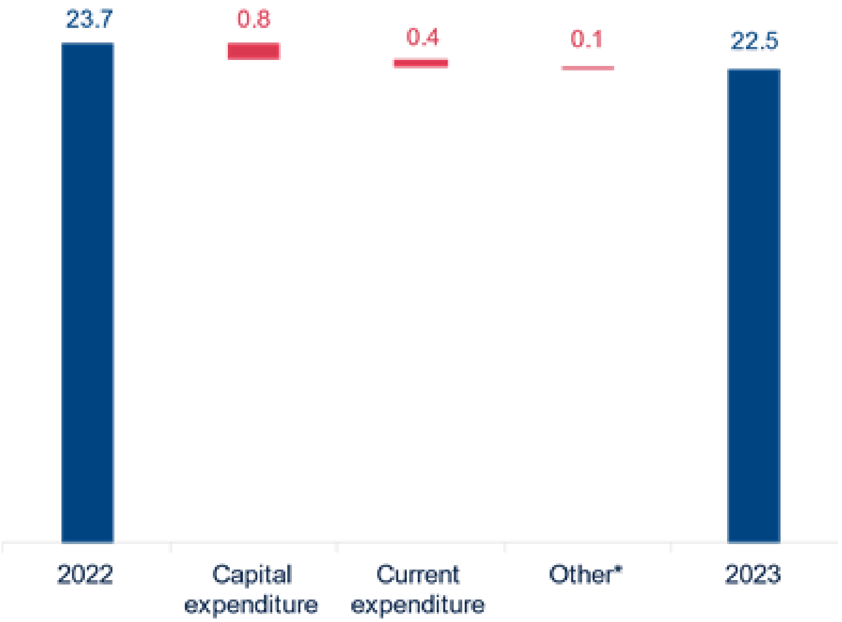


Decrease in imports (by volume and price) and appreciation of the sol.

Weakening of domestic demand.

On the expenditure side, the moderation of the capital expenditure component (lower public investment) stood out

GENERAL GOVERNMENT SECTOR EXPENDITURE
(% OF GDP)



* Considers the results of non-financial public enterprises and interest on public debt.
Source: BCRP.

CAPITAL EXPENDITURE

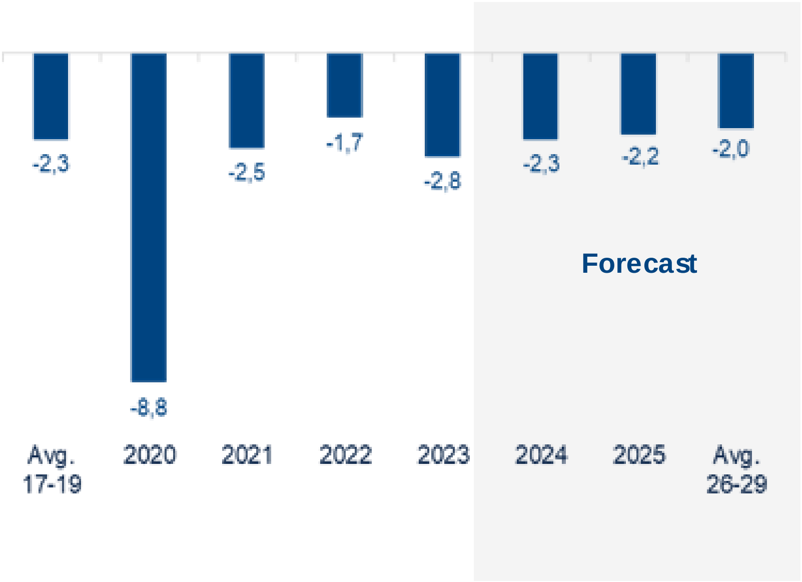
- **Decrease in public investment** due to less execution by subnational governments (as usual during their first year in office), partially offset by greater execution by the national government (in the reconstruction of the north under the G2G agreement with the United Kingdom).

CURRENT EXPENDITURE

- **Lower social transfers and a decrease in spending on goods and services** as expenditures related to the public health emergency decline, mitigated by higher disbursements within the framework of the Con Punche Peru plan (reactivation and emergency linked to the El Niño phenomenon).

The fiscal deficit is forecast to narrow in 2024 because the rebound in economic activity will lead to an improvement in revenues

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

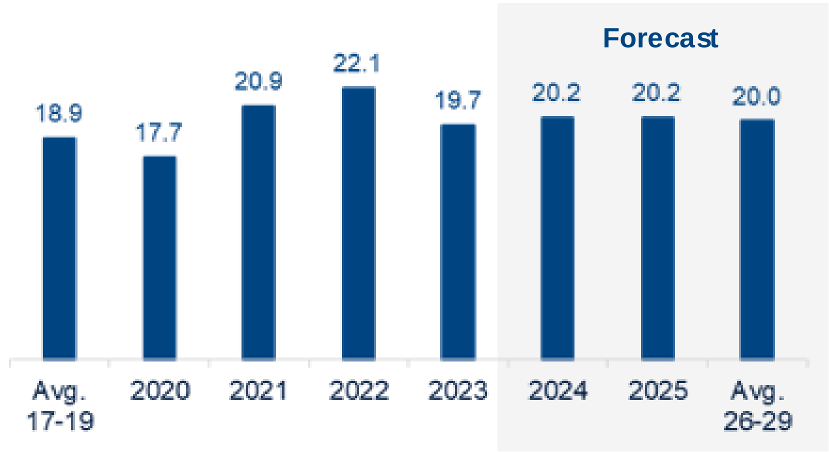


Source: BCRP and BBVA Research (forecasts).

- The expected reduction in the fiscal deficit by half a percentage point of GDP is mainly driven by the rebound in activity in 2024, which will favor tax collection and compliance (it is procyclical).
- On the expenditure side, we don't expect much support for deficit reduction: although the aid and stimuli that were provided in 2023 (Con Punche Perú) will be withdrawn and expenditure related to El Niño will decrease, there will be a higher current expenditure related to salaries, depending on what emerges from the budget.
- In the baseline scenario, fiscal policy will henceforth be geared toward consolidating public finances, leaving monetary policy the task of supporting the recovery of activity in the short term.
- In this context, fiscal deficits will trend toward a level equivalent to 2% of GDP.

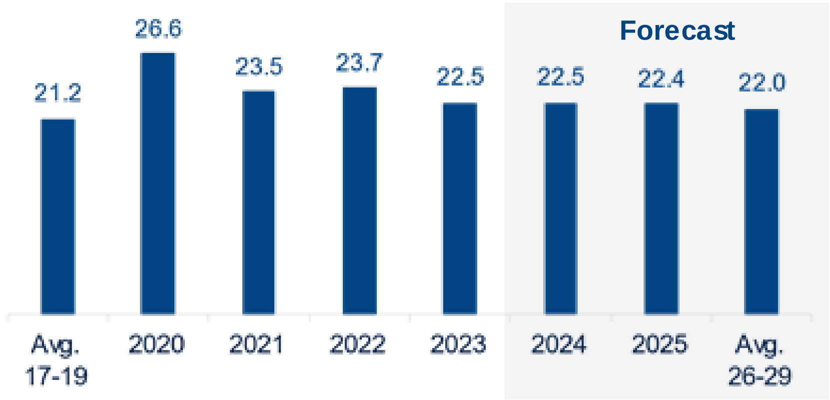
The fiscal deficit will trend toward 2% of GDP in the medium term: revenues stabilize somewhat above pre-pandemic levels, but higher inflexible expenditure

GENERAL GOVERNMENT REVENUE
(% OF GDP)



Going forward, revenues are forecast to stabilize at around 20% of GDP, above pre-pandemic levels, which assumes that tax non-compliance has trended downward.

GENERAL GOVERNMENT EXPENDITURE*
(% OF GDP)



SPENDING ON WAGES (% OF GDP)

Avg. 17-19	2020	2021	2022	2023	2024
6.2	7.4	6.2	5.9	6.2	6.7

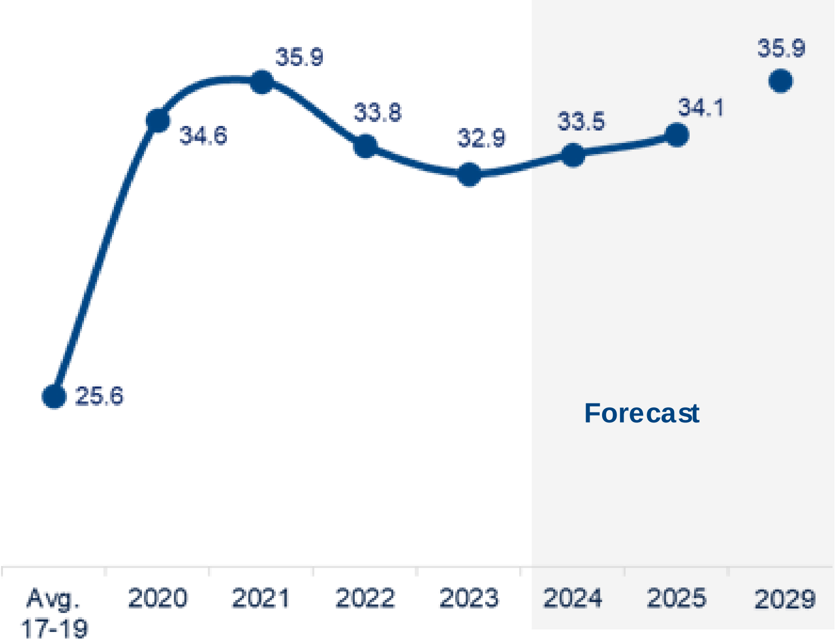
Pressure from spending on wages does not allow for a more pronounced decline in the fiscal deficit.

Source: BCRP and BBVA Research (forecasts).

* Considers the results of non-financial public enterprises and interest on public debt.

In this context, public debt will see an upward trend in the coming years, although fiscal strength will remain sound in general

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



Source: BCRP and BBVA Research (forecasts).

NON-FINANCIAL PUBLIC SECTOR INDICATORS

	2019	2020	2021	2022	2023	2024(f)	2025 (f)
Assets (% of GDP)	13.7	12.4	14.2	12.8	10.5	9.8	9.4
Net debt (% of GDP)	12.9	22.2	21.8	21.0	22.4	23.7	24.8
Dollarization of public debt (%)	32	43	54	52	48	46	42
Interest as % of tax revenues	7.0	9.0	7.2	7.1	8.4	8.5	8.9

(f) forecasts.

Potential expenditure demands and contingent liabilities risk eroding Peru's fiscal accounts strength

INCREASE IN INFLEXIBLE EXPENDITURE

Salary increases. In 2024, for example, the budget incorporates an increase of 10 billion soles in spending on salaries (sectors: education, healthcare and administrative).

CONTINGENT LIABILITIES

- **Update of the Recognition Bonus** for ONP contributors and former contributors.
- **Subnational government borrowing operations.** For example, the Municipality of Lima recently borrowed 1.2 billion soles (the plan is to borrow a total of 4 billion soles).
- **Financial support for PetroPerú: will it be enough?**

PetroPerú faces a delicate financial situation: the Peruvian government continues to support the oil company, but also improves governance

Current situation (2023)

- **Losses 2023:** USD 823 million (USD 271 million in 2022).
- **Net debt: USD 6.5 billion** (USD 3 billion correspond to 2032 and 2047 bonds, with an annual interest charge of USD 240 million).
- **Debt to suppliers of USD 1.9 billion.**
- **Problems are structural:** deficiencies in corporate governance and management, lack of transparency.

Request for new financial support

- **Around USD 3 billion:** USD 1.15 billion capital contribution, 2022 loan capitalization (USD 750 million), credit line guarantees (USD 650 million) and USD 500 million credit line extension.

New support (March 28)

- **Government guarantees loan of USD 800** million granted by the Banco de la Nación (to ensure fuel inventories)
- Government **extends, until the end of the year, the guarantee for USD 500 million** for PetroPerú loans
- Government extends deadline for PetroPerú to cancel 500 million soles in taxes related to crude oil imports and fuel marketing
- **Change of shareholding** (in favor of the MEF), **new board of directors, austerity** (including a voluntary retirement program for workers).

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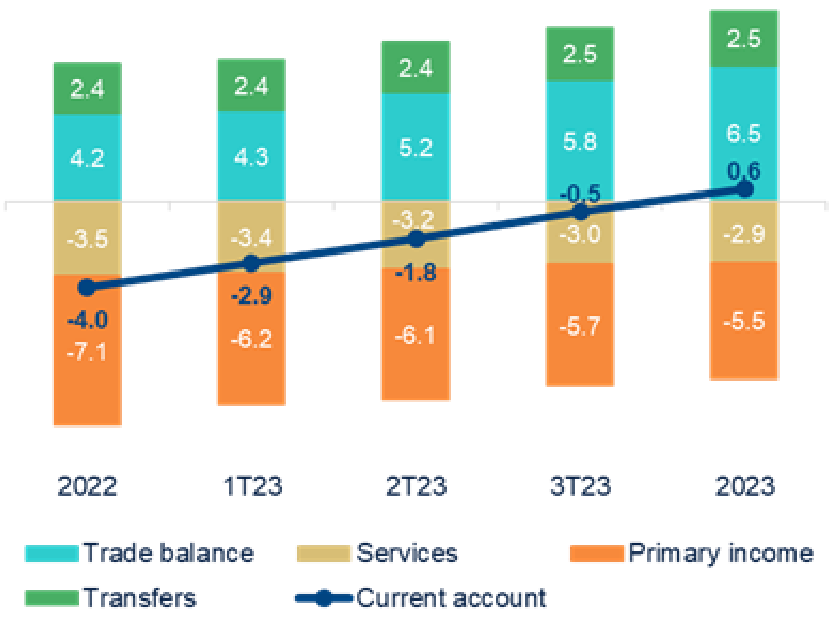
04

Peru economic forecasts

4.3. External sector and exchange rate

A larger trade surplus and lower remittances from foreign companies helped the current account balance in 2023, which went into surplus

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

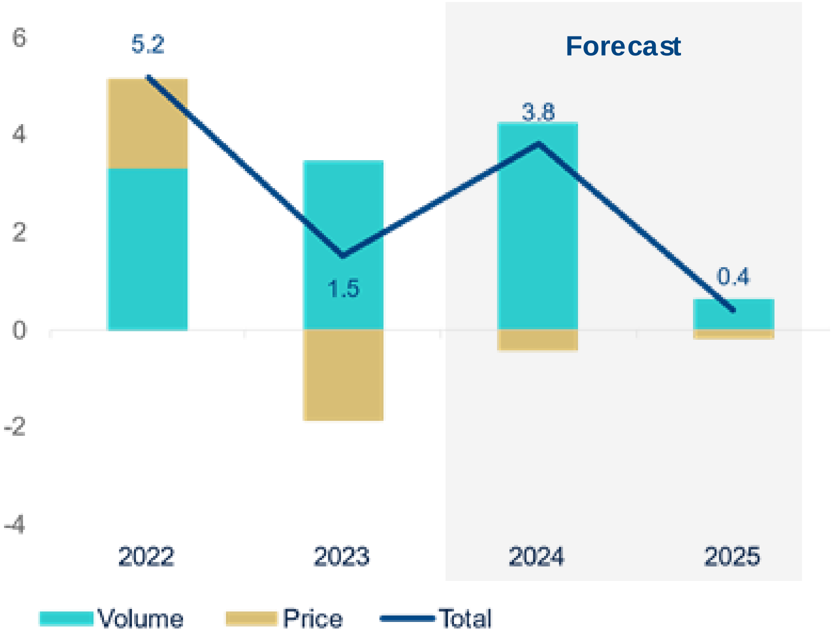


Source: BCRP.

- Significant increase in the trade surplus, which grew to USD 17.4 billion (from USD 10.3 billion in 2022), supported by (i) higher volumes exported due to the increase in mining production and (ii) a decrease in imports due to the lower prices and volumes, the latter due to a slowdown in local activity.
- The deficit in the services account was reduced in part thanks to the normalization of freight costs.
- Lower remittances of profits from foreign firms, especially in the oil sector (lower prices), also contributed to the improvement in the current account.

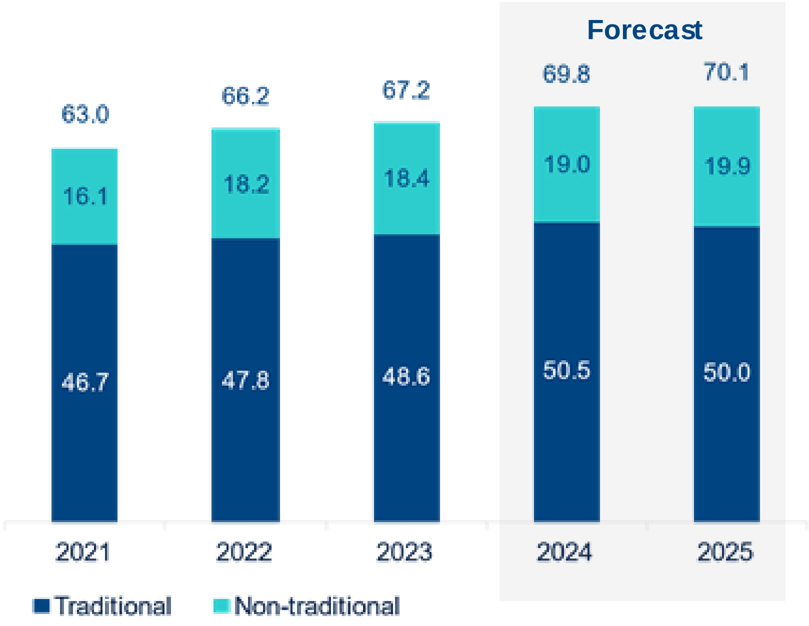
On the export side, support from mining will continue in 2024 and there will also be a normalization of the sectors most affected by El Niño

EXPORTS OF GOODS
(% CHANGE YEAR-ON-YEAR)



Source: BCRP and BBVA Research (forecasts).

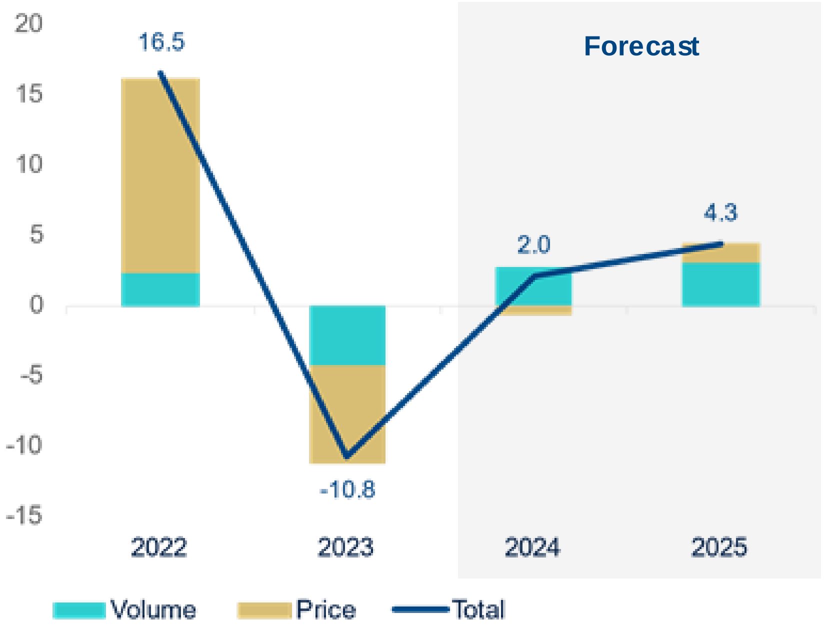
GOODS EXPORTS
(USD BILLIONS)



Source: BCRP and BBVA Research (forecasts).

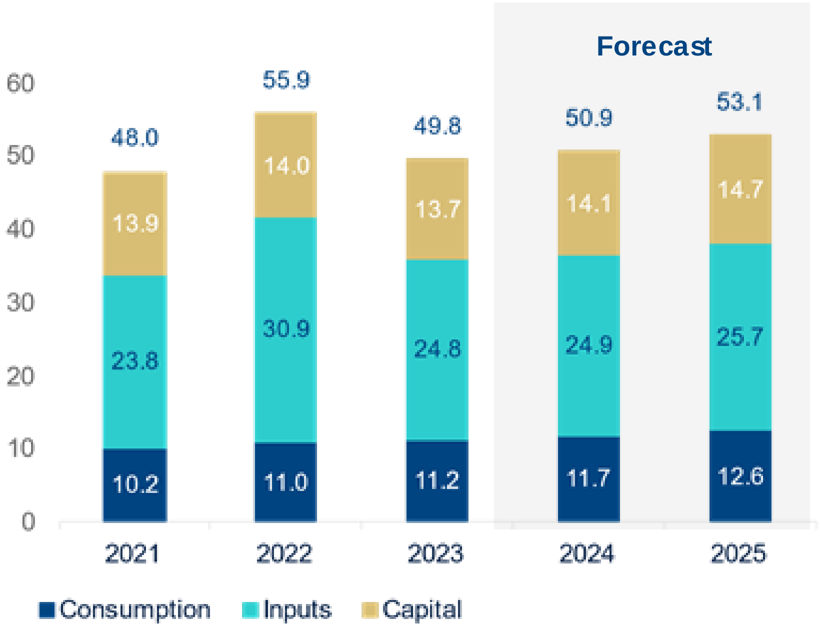
Better performance of imports going forward as economic activity rebounds after negative shocks in 2023

GOODS IMPORTS
(% CHANGE YEAR-ON-YEAR)



Source: BCRP and BBVA Research (forecasts).

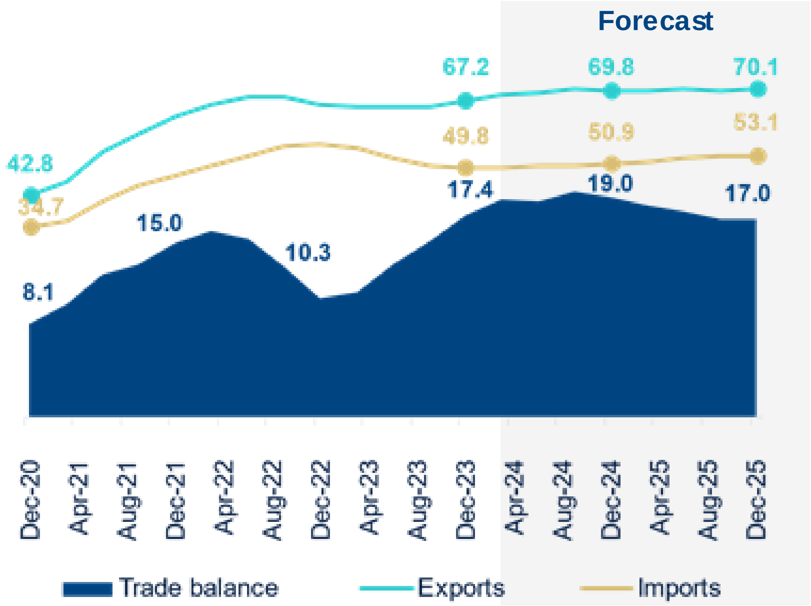
GOODS IMPORTS
(USD BILLIONS)



Source: BCRP and BBVA Research (forecasts).

In balance, the trade surplus will increase again this year, reaching its peak, and then give way in 2025 when the rebound in economic activity is completed

TRADE BALANCE
(USD BILLIONS, CUMULATIVE LAST 12 MONTHS)

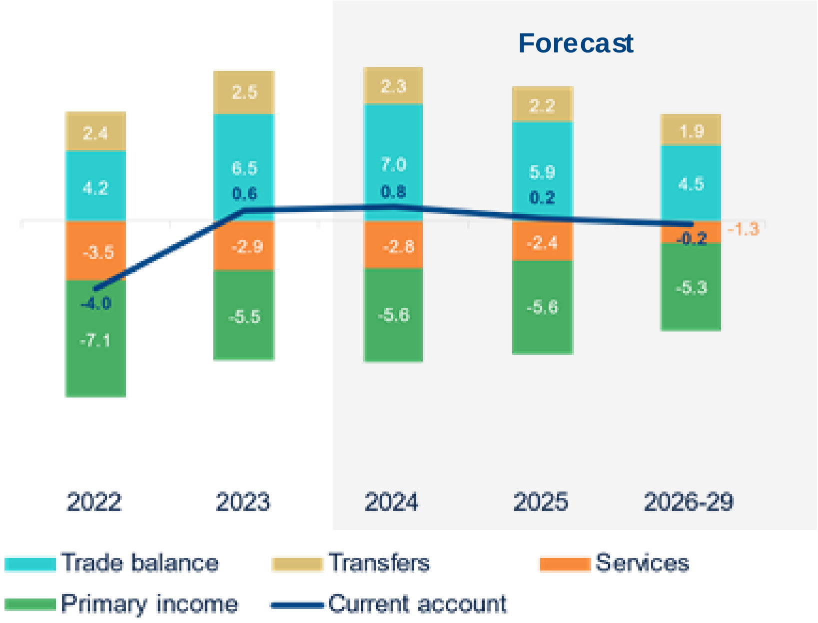


Source: BCRP and BBVA Research (forecasts).

- In 2024, mining and the normalization of supply in sectors most affected by El Niño (fishing, agriculture) will drive exports, while on the import side, normalization after the shocks of 2023 will be more gradual. Against this backdrop, the trade surplus will increase again this year.
- In 2025, some moderation in the trade surplus will emerge when the rebound in activity (especially domestic demand) is completed (propelled by low inflation and interest rates throughout the year), which will imply higher demand for imports.

In this context, the current account of the balance of payments will remain in surplus this year and next, also supported by the recovery in tourism

BALANCE OF PAYMENTS CURRENT ACCOUNT
(% OF GDP)

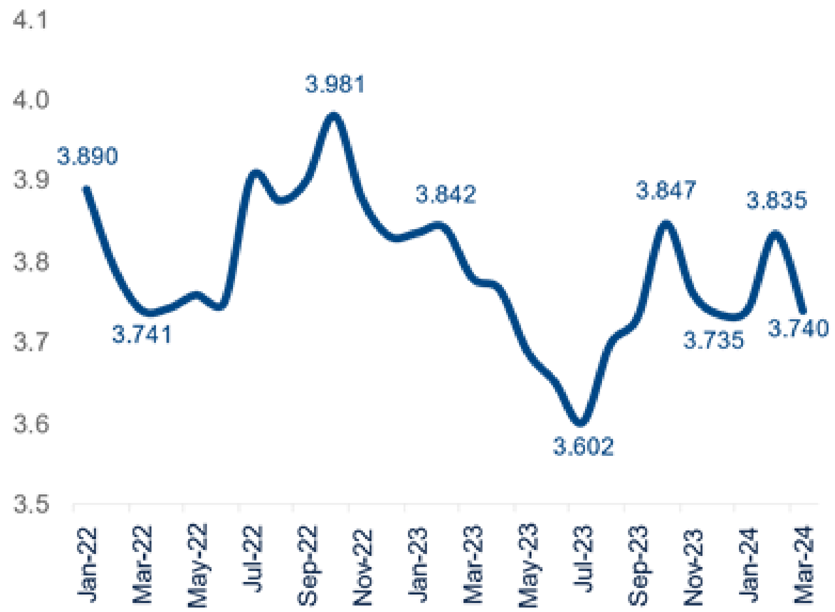


Source: BCRP and BBVA Research (forecasts).

- In 2024, the current account should improve due to (i) a larger trade surplus and (ii) an improvement in the services account (a trend toward normalization of inbound tourism and lower freight costs).
- Subsequently, the trade surplus will moderate due to the absence of new investment projects to boost goods exports, while goods imports will increase as domestic demand also increases.

In the foreign exchange market, USDPEN moves in response to the market's outlook on the Fed's policy rate, with a very active participation of the BCRP

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



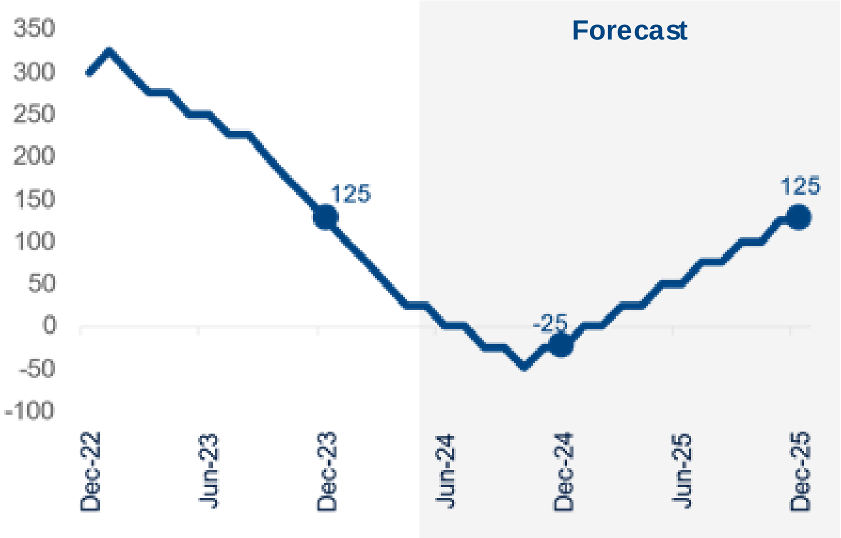
(*) As of March 8
Source: BCRP and Bloomberg.

BCRP EXCHANGE RATE INTERVENTIONS (*)
(USD MILLIONS; SELLING POSITION)

(*) As of March 8
Source: BCRP.

The domestic currency is expected to depreciate in 2024 due to a narrowing interest rate differential, tempered by a current account surplus

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



Source: FRED, BCRP and BBVA Research (forecasts).

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

(*) As of March 8
Source: BCRP and BBVA Research (forecasts).

A decrease in PEN-USD interest rate differential will undermine the appeal of local-currency-denominated assets. Geopolitical risks and presidential elections in some key areas of the world will also trigger more defensive positions. In 2025, the rate differential will shift in favor of the PEN (and the current account of the balance of payments will remain in surplus), which will prompt the strengthening of the local currency.

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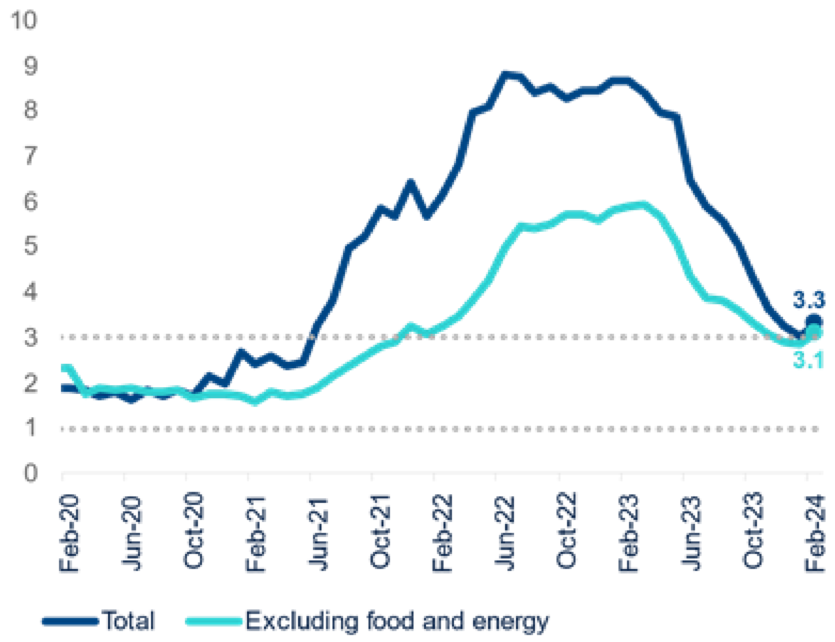
04

Peru economic forecasts

4.4. Inflation and monetary policy

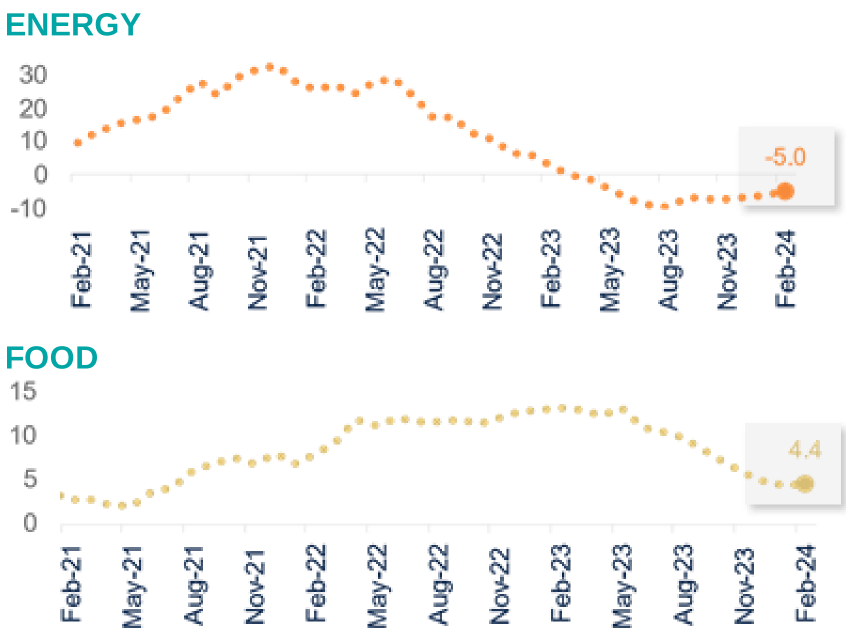
Inflation eased quickly in the second half of 2023, but earlier this year it encountered some resistance to falling further (El Niño)

INFLATION: TOTAL & CORE
(% CHANGE OF CPI)



Source: INEI.

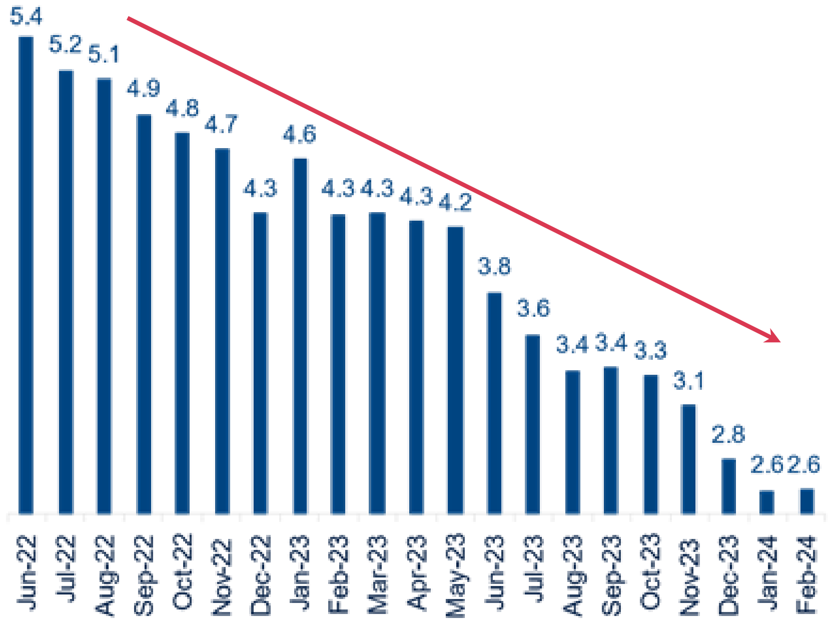
INFLATION: FOOD & ENERGY
(% CHANGE YEAR-ON-YEAR)



Source: INEI.

Inflation expectations have also continued to correct downward and are now within the Central Bank's target range

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



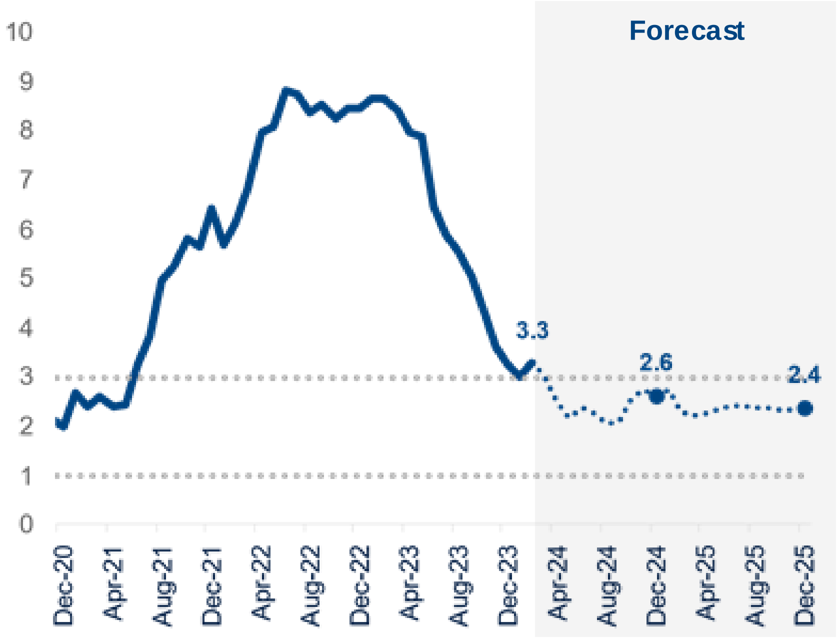
Source: BCRP.

INFLATION FORECASTS
(BY YEAR-END, %)

Source: BCRP.

Inflation will continue to recede after El Niño dissipates, supported by a high year-on-year comparison base

INFLATION
(% CHANGE OF CPI)

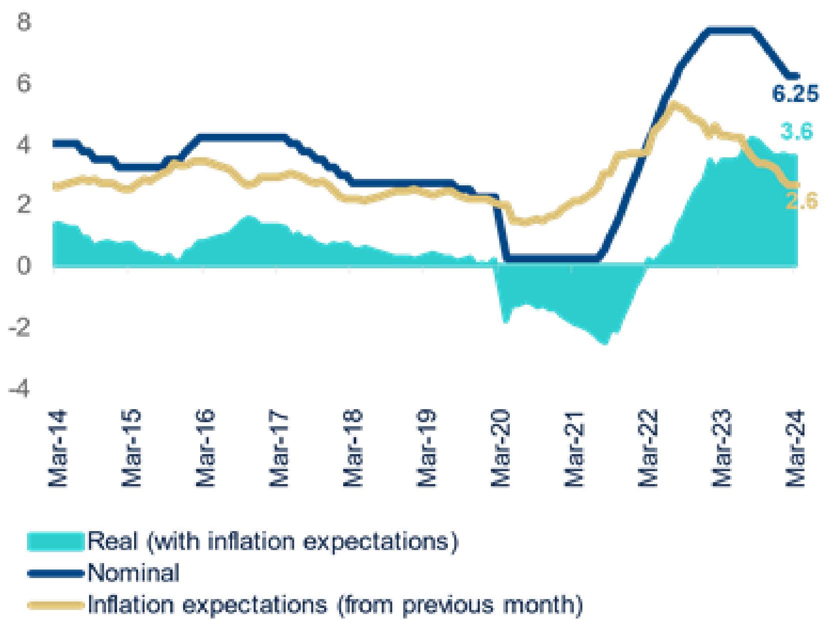


Source: BCRP and BBVA Research (forecasts).

- The baseline scenario assumes that the warm conditions related to coastal El Niño will be weak in March (rainfall somewhat above normal, but with little impact on output and supply of some goods) and that they will dissipate thereafter. Pressure on prices will be reduced (poultry, for example).
- Lower international food input prices and slack in the economy will also contribute to the decline in inflation in 2024.
- High comparison base will aid in this decline in the second and third quarters, so at some point inflation will be closer to 2%. However, the base effect will partially reverse in the fourth quarter and, together with the lagged impact of the global El Niño (on agricultural production in the south of the country), will lead to inflation closing the year slightly above 2.5%.

The central bank has been cutting the policy rate since September, albeit cautiously given the still latent risk of El Niño and volatility in the markets

MONETARY POLICY INTEREST RATE
(%)

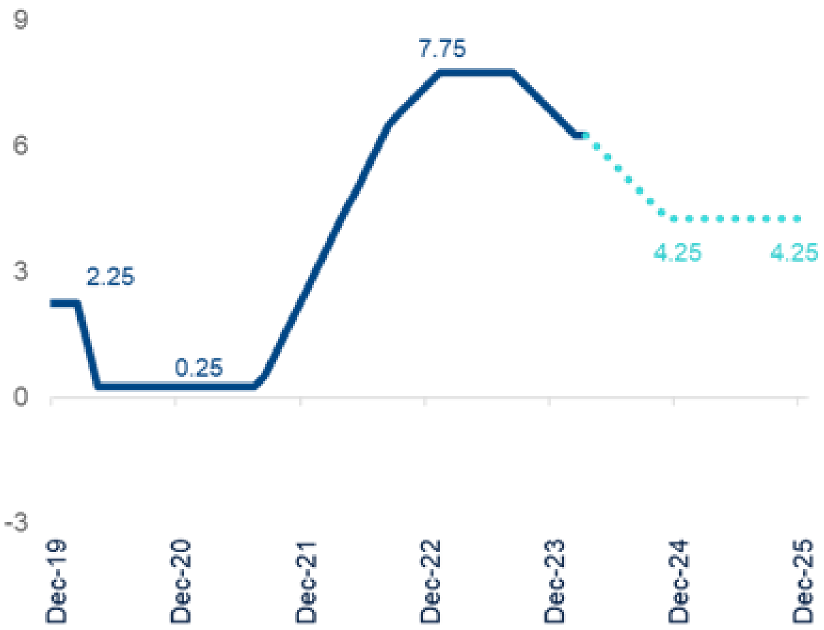


Source: BCRP.

- The BCRP has been cutting its reference rate since September, albeit gradually: six consecutive cuts of 25 bp each to reach a level of 6.25% in February. The decline in inflation opened the space to do so, giving some support to the recovery of activity.
- A pause in March, which coincided with a surprise uptick in inflation (from 3.0% in February to 3.3%) and with a Central Bank active in the foreign exchange market, supporting the local currency.
- The pause in March has a dovish bias: the reserve requirement rate in local currency was reduced from 6.0% to 5.5% starting in April.
- The Central Bank is acting cautiously, relying on the data that emerges, in an environment in which the risk El Niño could have on prices is still latent and financial markets are volatile. It points to the need to "guarantee" the return of inflation to the target range.

The baseline scenario is consistent with additional monetary easing: the policy rate would reach a level somewhat below neutral in 2024

MONETARY POLICY RATE
(%)



Source: BCRP and BBVA Research (forecasts).

- Activity only beginning its recovery and the tightness of the monetary stance suggest the need for the normalization of the policy rate to continue. In addition, the fiscal policy will not be geared toward supporting product.
- Inflation will resume a downward trend in the coming months, which will create room for the policy rate to continue to decline.
- With inflation already expected to be within target range, additional rate cuts will be reflected more clearly in the monetary position. Therefore, each cut would be of limited magnitude, as has been the case so far, which would avoid exacerbating pressures on the exchange rate. Decisions will remain data-dependent.
- In this scenario, the reference interest rate will end the year at 4.25%, somewhat below the level we consider neutral, and would remain there in 2025.

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05

The main risks to Peru's economic outlook

Main local risks to the baseline scenario for Peru

ON THE EXTERNAL SIDE

- Higher interest rates for longer due to more persistent inflation, inducing episodes of financial instability and recession
- Sharper slowdown in the Chinese economy
- Geopolitical environment

ON THE LOCAL SIDE

- A more intense coastal El Niño in the remainder of the rainy season
- Renewed political and social tensions
- Populist measures affecting competitiveness (labor market, pension system)
- Growing insecurity due to increased crime and the spread of illegal economies

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06

Summary of macroeconomic forecasts

Summary of macroeconomic forecasts

	2021	2022	2023	2024 (f)	2025 (f)
GDP (% CHG.)	13.4	2.7	-0.6	2.7	2.9
Domestic demand (excluding inventories, % CHG.)	17	2.1	-0.9	2.3	3.0
Private spending (% CHG.)	17.6	2.6	-1.6	2.2	3.0
Private consumption (% CHG.)	12.4	3.6	0.1	2.4	3.1
Private investment (% CHG.)	36.9	-0.4	-7.2	1.7	3.0
Public expenditure (% CHG.)	14.2	-0.5	2.7	2.6	2.7
Public consumption (% CHG.)	10.9	-3.4	3.3	2.4	2.4
Public investment (% CHG.)	24.8	7.7	1.4	3.0	3.6
Exports (% Chg.)	13.2	6.1	3.7	3.5	2.0
Imports (% Chg.)	18	4.4	-0.9	2.3	2.9
Exchange rate (vs. USD, EOP)	4.04	3.83	3.74	3,85–3,95	3,70-3,80
Inflation (% y/y, EOP)	6.4	8.5	3.2	2.6	2.4
Monetary policy interest rate (%, EOP)	2.5	7.5	6.75	4.25	4.25
Fiscal balance (% of GDP)	-2.5	-1.7	-2.8	-2.3	-2.2
Current account balance of payments (% of GDP)	-2.2	-4.0	0.6	0.8	0.2
Exports (USD billion)	63	66.2	67.2	69.8	70.1
Imports (USD billion)	48	55.9	49.8	50.9	53.1

(e) Estimate. (f) Forecast. Forecast closing date: March 8, 2024.
Source: BBVA Research.

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Peru Economic Outlook

March 2024

Creating Opportunities