BBVA | RESEARCH

Economic Outlook

Peru

Third Quarter 2013
Economic Analysis

- **Slowdown in China and the uncertainty regarding the withdrawal of monetary stimulus in the United States** have led to a downward correction in commodity prices and tighter global financial conditions.
- **In this context, we expect the Peruvian economy to grow 5.8% in 2013 and 2014.** Private-sector expenditure will grow at a more moderate pace, but the greater boost from the fiscal side will lessen the impact on output.
- **The current-account deficit will temporarily increase** above 5% of GDP due to lower export prices.
- **Little room for the local currency to reverse the losses of recent months.** At the close of the year it will be at around its current level, but renewed episodes of volatility cannot be ruled out, though they will be moderated by the Central Bank through its interventions.
- **Monetary policy will be more focused on its stabilizing role against external turbulence.** The first line of action will be to continue with the reduction of reserve requirements.

Index

Closing date: August 1, 2013

1. Summary

The global economy is showing cyclical weakness, above all in emerging markets, and is facing more difficult financial conditions. This less favorable global economic scenario has led us to a downward revision of our global growth estimates for 2013 to 3.1%, 0.2 points less than three months ago. The growth outlook for 2014 remains unchanged, at 3.8%. This deterioration has been the result of i) a sharper slowdown than expected in emerging markets (among them, in China), which is reflected in a downward revision of its growth forecasts, compared with basically unchanged forecasts in developed economies; and ii) tougher financial conditions at global level, as a result of market reaction to the communication of details of the Fed's plans for a gradual reduction in its monetary stimuli.

Our new economic growth forecasts for Peru continue to suggest a positive scenario, with annual GDP expansion rates that we expect to remain slightly below 6.0% in the period 2013-2017. In general, we consider that the available indicators of economic activity show that the Peruvian economy is in a process of cyclical moderation, after various quarters of strong expansion, and not at the start of a pronounced and prolonged slowdown. Therefore, we expect a soft landing for the economy to growth rates that are sustainable in the medium term.

The growth estimates in this report are lower than those three months ago because of a less favorable external environment, which locally will lead to a moderation in private expenditure, in particular investment. This outlook is consistent with a fall in business optimism this year, which has been affected by volatility on the international financial markets, less favorable external financing conditions, lower prices of the metals that Peru exports and lower than expected growth in China. The slowdown in investment will also lead to a weaker labor market and thus consumption.

Starting in 2014, we forecast greater fiscal expansion due to the development of major infrastructure projects, which will reduce, to some extent, the weaker private sector demand. As a result of increased public expenditure and more limited improvements in fiscal revenue compared with expectations three months earlier, we forecast a steady reduction in the public-account surpluses starting this year, leading to moderate deficits starting in 2015. This expected trend for the fiscal accounts for the upcoming years does not undermine the public accounts sustainability, as the ratio of government debt to GDP will continue to fall, although at a slower pace than expected in our previous report. In this context, it is worth wondering whether it is a good idea to continue reducing the government debt ratio, as it is fairly low; the alternative would be to stabilize it and thus provide more room for spending on infrastructure.

At the same time, starting in 2015 growth will have additional support from a temporary acceleration of exports as various mining projects enter into operation. The improvement in metal export volumes will start to close the current-account deficit (as a % of GDP). In an environment of lower expected prices for the minerals exported by Peru, the deficit will expand this year and next to levels of close to 5.5% of GDP.

For the future, the challenges to sustaining the strength of the economy continue to be enormous. In particular, measures will be needed to boost productivity, such as large-scale development of infrastructure, improvements in the quality of education and a reform of the public administration.

On the price front, the expected moderation in private expenditure will limit any possible demand-side pressure. In addition, international prices of agricultural supplies and oil are expected to remain relatively stable. As a result, inflation will stand at 2.8% at the close of 2013; in 2014, in the absence of supply shocks, it will tend to fall toward the center of the Central Bank's target range (2.0% +/- 1.0 percentage point).

On the foreign-exchange market, we expect exchange-rate movements to be mainly sideways, fluctuating between 2.70 and 2.80. The improvement in trade flows will be limited, as although export volumes of metals will be stronger after a solution is found to the supply problems experienced since the end of last year, international metal prices will still have some additional way to fall. The balance is similar on the financial side, as capital will continue to flow into the country as foreign direct investment to finance construction projects, but some non-resident investors will probably also take advantage of windows of opportunity to gradually reduce their large positions in sovereign bonds. To sum up, there will be contrasting flows, with the exchange rate being without a clear trend. We do not rule out episodes of high volatility when the US Federal Reserve finally decides to start the process of cutting the rate of monetary expansion. We will certainly see a more active behavior in this respect by the Central Bank, with more decisive interventions through foreign-currency sales, above all if there is pressure on the exchange to rise above 2.80. In general, the foreign-exchange scenario we expect for the local currency (weaker than in our previous report) is consistent with a slight deterioration of the fundamentals of the Peruvian economy, lower metal prices, lower public savings and a greater risk perception of emerging markets.

With respect to monetary policy, to the extent that no inflationary pressures are expected, the Central Bank has some room to adopt a stabilizing role that gives greater support to private expenditure, if necessary. We expect that the main line of action guiding monetary policy toward a more accommodative policy against the backdrop of external turmoil will be a partial reversal of the high levels of reserve requirements. In fact, this has already begun and we will probably see more cuts in this respect in the upcoming months. The aim is to offset to some extent the tighter global financing conditions. We do not expect any changes to take place in the policy rate as this would lead to additional pressure weakening the local currency.

The main risk factors for the Peruvian economy come from abroad. The first is that the removal of monetary stimuli in the United States is disorderly and that this will generate a bigger adjustment to financing conditions at global level, combined with greater uncertainty. The second risk factor, which we consider more medium-term, is that the slowdown in China is steeper than expected in the baseline scenario. Although the Chinese authorities have instruments available to stimulate the economy, it is also true that the financial weakness of its economy restricts room for action. In this scenario, the impacts at local level would mainly come from a more pronounced adjustment in metal prices, business confidence and lower export volumes. However, Peru still shows fiscal, monetary and financial system strengths that will allow it to cushion the impact of possible future shocks.

2. Global environment: slowdown in China and uncertainty about the withdrawal of monetary stimulus in the U.S.

The global economy is showing cyclical weakness, above all in emerging markets, and is facing more difficult financial conditions

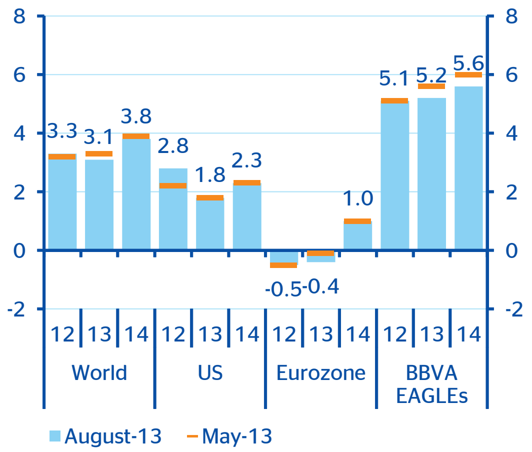
The global economic situation is less favorable than it was three months ago, when we issued our previous growth forecasts. We have therefore revised down our global GDP growth outlook to 3.1% in 2013, 0.2 percentage points below the forecasts three months ago. For 2014, we maintain our expectations of continued expansion, in this case at 3.8%, 0.2 pp below the figure we forecast in the last quarter. At least two reasons lie behind this deterioration and the resulting revision of our forecasts. First, the emerging markets are experiencing a sharper slowdown than expected, reflected in a greater downward revision of its growth forecasts (Chart 1). Above all, they include more moderate growth in China, due to its global implications beyond Asia, for example on the South American economies. Second, there has been an unexpected event, at least at the time when it occurred: the tightening of financial conditions at global level. This increased stress has basically been the result of market reaction to the communication of the details given by the Fed of its steady reduction and subsequent reversion of the third round of its quantitative easing program.

Making the markets used to less liquidity: the greatest impact will be on emerging economies with bigger short-term financing needs

Although the reasons for this may be varied, most of the shift in financing conditions at global level took place in mid-May, with the details announced by the Fed of its plans to limit and then put an end to its program of monetary expansion. The Fed has also reaffirmed its commitment to maintaining interest rates very low for an extended period and, perhaps more importantly, the whole process is conditional on economic recovery: i.e. on the economy continuing at "cruising speed".

However, market reaction to this plan (even after being clarified in all its details) has been stronger than probably desired by the Fed. As can be seen in Chart 2, long-term interest rates increased by more than 100 basis points, while futures now discount the first rise in the monetary policy rate for the start of 2015, practically one year before expected two months ago. In our opinion, what is being seen on the financial markets is probably partly an over-reaction, as shown by recent downward moves in both long-term rates and expectations of shorter-term rates. Even so, the implementation of the mechanism has generated a process of restructuring of portfolios in the face of the end of abundant liquidity, and thus of extra demand for bonds that kept interest rates at exceptionally low levels. In our opinion, therefore, we are being faced with the start of a cycle of normalization of financial conditions, with higher interest rates and lower demand for risk assets.

Chart 1
GDP growth in the main regions



* BBVA EAGLEs: Emerging and Growth-Leading Economies. The group is made up of China, India, Indonesia, Brazil, Russia, Korea, Turkey, Mexico and Taiwan
Source: BBVA Research

Chart 2
Yield on 10-year US public debt (%)

Source: BBVA Research and Bloomberg

Emerging markets have been most affected by the recent upsurge of financial stress. Currently the situation has clearly reversed the previous positive external funding conditions, with capital outflows from emerging markets (Chart 3). As well as falls in the stock markets and bond prices, there has also been a general depreciation in their currencies.

There are various factors behind these major capital outflows. As well as an immediate anticipation of the new global liquidity scenario through a restructuring of portfolios, the cyclical weakness of some large emerging markets and the growing risk of a steeper slowdown in China are factors pointing in the same direction. Moreover, monetary expansion in Japan has done little to generate the expected capital flows to emerging markets in search of higher returns.

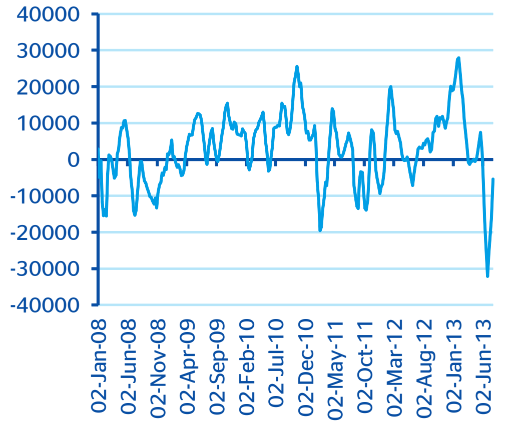
Overall, however, although the rate of capital outflow from emerging markets is very high, there are reasons for optimism. First, the most recent data on capital flows show more moderate outflows over recent weeks. Second, the profile of investors who have headed up the outflows is of a shorter-term investment horizon, compared with institutional investors with longer-term horizons. Finally, the portfolio reorganization has to take into account that if we are moving towards an environment of lower central-bank support for liquidity, this is because the global economic cycle is tending to improve. We should also not forget the fundamentals that emerging markets have constructed in terms of their policy certainty and comparative advantages against the most developed countries with respect to their solvency ratios.

Slowdown in China: sluggish external demand and steps to limit indebtedness and the scope of shadow banking

The recent tightening in the Chinese interbank lending market is an example of the side effects of the Chinese authorities' efforts to limit rapid credit growth, both in the official banking sector and the credit generated by the shadow banking, which is unregulated. The commitment of the authorities to achieve this goal has been made clear over recent months, as they have notably allowed a liquidity squeeze in the interbank system.

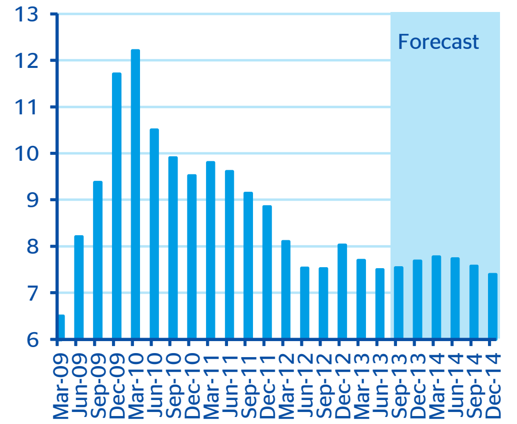
The baseline scenario is still one of a continued moderate slowdown (Chart 4). The measures taken to limit credit growth will act as a constraint to some extent, but even so, the Chinese authorities appear comfortable with the current GDP growth rates, as they are the result of changes that make for more sustainable (and quality) medium and long-term growth. Even so, we still consider that the government has room for maneuver if the growth slips below the official targets. The authorities have the instruments to prevent any accident to the financial system, at least in the short term, and we do not rule out new economic stimulus measures.

Chart 3
Capital flows to emerging markets (USD million, moving four-week average)



* Capital flows to fixed-income and equity
Source: BBVA Research and EPFR

Chart 4
China GDP growth (y/y %)



Source: BBVA Research and CEIC

More diversified global risk events, but with less potential impact

This highly likely global baseline scenario still has some uncertainty ranges somewhat more tilted to the downside than to the upside, but with no high probability of disruptive events that would prevent an outlook of, at least, sustained global growth in 2013 and 2014 near 2012 levels. This diagnosis is a sign of a return to normality in the economic landscape.

The downside risks that could once again delay global recovery (relatively less likely than on other occasions) would basically be the persistence of events that complicated the outlook last quarter to the point of generating additional tensions in the conditions for accessing finance and a decline in the confidence of the economic agents. This could be: i) a new, intense and continued fall in the price of risk-less assets like the U.S. Treasury bond as a result of a market less compliant with the wishes of the Federal Reserve; ii) a resurgence of doubts about the progress towards banking union and the “exceptional nature” of Greece; and iii) a sharper downturn in the Chinese economy amid its necessary process of economic rebalancing and adjustment of the size of its financial system. Although it is true that the authorities have room for maneuver to prevent “tail” events, the process of change faced by China is notable and requires extensive, ongoing and decisive reforms.

3. Peru: new growth estimates at around 5.8%

Our new economic growth forecasts for Peru continue to signal a positive scenario, with annual GDP growth rates that we expect to remain just under 6.0% in the 2013-2017 period (see Chart 5). In general, we consider that the available indicators of economic activity show that the Peruvian economy is in a process of cyclical moderation, after various quarters of strong expansion, and not at the start of a pronounced and prolonged slowdown. That is why we expect a soft landing for the economy to rates of growth that are sustainable in the medium term.

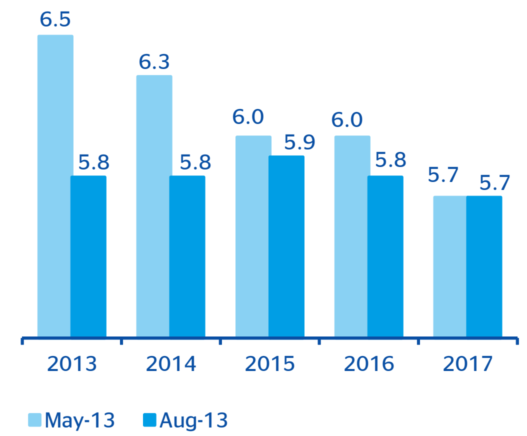
The growth estimates in this report are lower than those three months ago because of a less favorable external environment, which locally will lead to a moderation in private expenditure, in particular investment. This outlook is consistent with a fall in business optimism during this year, which has been affected by volatility on the international financial markets, less favorable external financing conditions, lower prices of the metals that Peru exports and lower than expected growth in China. The slowdown in investment will also lead to a weaker labor market and thus consumption. The downward revision in private expenditure has been particularly important in our forecasts for this and next year (see Chart 6).

Starting in 2014, we forecast greater fiscal expansion due to the development of major infrastructure works, which will to some extent offset weaker private-sector demand. As a result of the increase in public expenditure and more limited improvements in fiscal revenue compared with expectations three months earlier, we forecast a steady reduction in the public-account surpluses starting this year, leading to moderate deficits starting in 2015. This expected trend for the fiscal accounts for the upcoming years does not undermine the sustainability of the public accounts, as the ratio of government debt to GDP will continue to fall, although at a slower pace than expected in our previous report. In this context, it is worth wondering whether it is a good idea to continue reducing the government debt ratio, as it is fairly low; the alternative would be to stabilize it and thus provide more room for spending on infrastructure.

At the same time, starting in 2015 growth will have additional support from a temporary acceleration of exports as various mining projects enter into operation. The improvement in metal export volumes will start to close the current-account deficit (as a % of GDP). In an environment of lower expected prices for the minerals exported by Peru, the deficit will expand this year and next to levels of close to 5.5% of GDP.

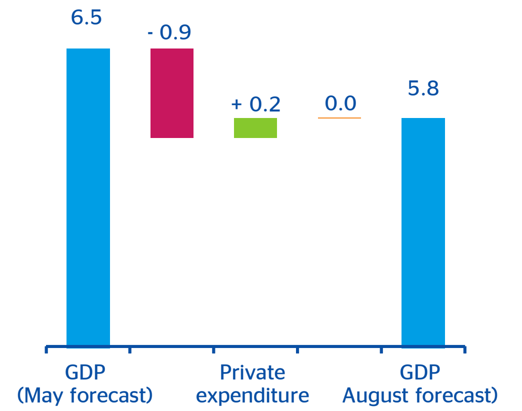
For the future, the challenges to sustaining the strength of the economy continue to be enormous. In particular, measures will be needed to boost productivity, such as large-scale development of infrastructure, improvements in the quality of education and a reform of the public administration.

Chart 5
Peru: GDP growth 2013-2017 (% change)



Source: BBVA Research Peru

Chart 6
Peru: demand components that explain the change in the growth forecast for 2013 (% change and pp)



Source: BBVA Research Peru

Available indicators anticipate a moderation in private expenditure…

During the first half of the year there have been signs that the pace of expansion in private expenditure begins to moderate. This is clearest in the case of investment. Imports of capital goods, for example, increased by nearly 15% in 2012, but in the first half of this year they did so by somewhat less than half (see Table 1). Business confidence has weakened substantially. Since it peaked in January at 67 points, it has fallen to 51 points in June (see Chart 7), barely above neutral level. This indicator tends to pretty well anticipate the future behavior of private investment, so its present movement suggests that private investment will slow. It is important to mention that the major adjustment in recent months probably anticipates something similar for business expenditure. However, this conclusion is weakened by observing what is happening to the other indicators of business confidence. In general all of them show a downward trend so far this year, but the fall is more moderate in some indicators than in business confidence. For example, businesses expectations about their own sector remained stable in June at 56 points. In other words, businesses trusted that their own sector would be in relatively good shape in the future, but the situation changes when they give their opinions about the rest of the sectors, those about which they have less information. The decision to invest depends in the end more on what businesses anticipate will occur in their own sector, which they know, and not so much on what they think will occur in the rest of the economy. So the signal emerging from the business confidence indicators as a whole is that private investment will be less strong in the upcoming quarters, but will remain in relatively good shape.

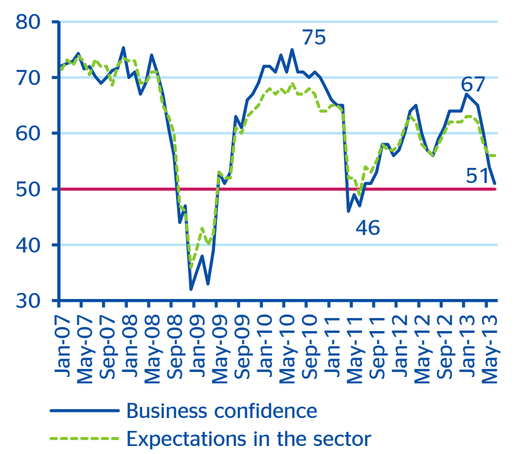
Table 1
Indicators of economic activity (y/y % change, index)

Activity indicators	1Q13	2Q13
Dependent employment	3	1
Family car sales (EoP)	13	8
Business confidence (index)	66	55
Imports of capital goods *	7	6
Public investment	11	23
Public consumption	10	13
Electricity production	6	7
Exports (volume)*	-14	2

* Figures through May
Source: INEI, Araper, BCRP, MEF, COES

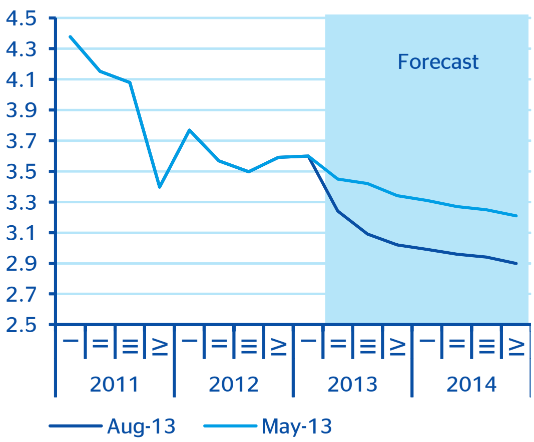
In addition to what the indicators show, there are three elements supporting slower growth in private investment in the forecast horizon with respect to what we forecast three months earlier. First, the fall in the price of metals (see Chart 8) and greater uncertainty about the level at which they will converge in the future, which overall reduces the attractiveness of mining investment projects. Second, tighter financial conditions at global level, which will result in higher costs, both for companies taking loans on the international markets and for those using local banks. Finally, the greater volatility of the Peruvian sol, which increases risks of currency mismatches, or alternatively generates the need to assume additional costs for hedging instruments.

Chart 7
Business confidence (Index)



Source: BCRP

Chart 8
Copper price forecast (USD/lb.)



Source: BBVA Research

In this context, the Government launched two packages of measures between May and June to improve the business environment (see Box 1). In addition, the work of ProInversión (the state-run agency that promotes private investment) is also being streamlined so that in last July three projects were awarded for a total of USD 785 million. It is worth pointing out that this agency plans to grant a total of USD 9 billion this year, most of it in the second half of the year, including finance for Line 2 of the Lima Metro for an amount equivalent to around half of this total.

Box 1. Recent measures taken by the government to stimulate private investment

Between May and June this year, the government issued two packages of measures to promote private investment. They aimed above all to streamline procedures related to infrastructure, mining and energy investments, and also to reduce the paperwork faced by businesses. The main measures are as follows:

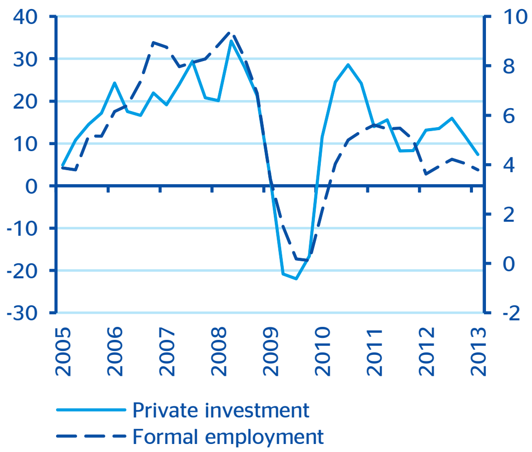
1. Law on expropriations: this provision separates the act of expropriation of the asset from the payment of its compensation price. It speeds up the acquisition of land for executing projects declared of public need. This procedure was little used before as it lasted between two and three years and required the approval of ten different entities. The projects immediately benefiting from this law are the Interoceánica Sur highway and Chinchero airport.
2. Law speeding up the issue of certificates accrediting the non-existence of archeological remains: this law establishes a term of twenty days for a response from government; if none is received, the lack of response is taken as approval. In the past it took around a year and a half for these certificates to be issued.
3. One-stop-shop for environmental impact studies (EIS): the law establishes that the official terms of reference for the EIS must be ready in less than a month and there is a maximum term of one hundred days for mining and energy projects. In these cases, this procedure used to take between one and two years.
4. Creation of a monitoring team for investment projects: this team will aim to remove the bureaucratic obstacles in the way of the most important infrastructure, mining and energy projects.
5. Law reforming the stock market: this law reduces the requirements and costs for accessing finance through the capital market for medium-sized and small companies.
6. Law for capital replacement: this law makes bonds more flexible and thus more valuable, by giving them the capacity to be used as a means of payment and to be sold before their maturity.
7. Measures to smooth over the investment process: it strengthens the capacity of Indecopi to penalize public-sector entities and public officials who generate bureaucratic obstacles, and also makes it easier to classify urban rehabilitation and building projects.
8. Measures to promote the development of small and medium-sized companies: it promotes the use of negotiable bills, which gives greater liquidity to SMEs and makes payment from government more predictable.
9. Tax reform to boost the competitiveness of companies: reduces by half the time required to take advantage of the early return of the IGV tax and allows tax credits for research spending (whether linked or not to the company purpose) and training skills for personnel.
10. Reform of the law for works through taxes: has extended this regime to public investment in general and by any government fund. Previously, it could only be used for infrastructure works and in regions that applied levies, surcharges and royalties. In addition, maintenance works and pre-investment studies are now also included in the system.

We consider that the impact of these measures on specific investments may begin to be seen in one or two years, as the recently created monitoring team has already identified 31 locked major projects, representing an investment of USD 22 billion. However, it will take some time for small and medium-sized companies to make frequent use of the mechanisms favoring them. In the short term, it is expected that these measures will support business expectations, because with them the government is showing greater willingness to facilitate private initiative.

Although private consumption remains strong, moderation of private investment and employment will affect it in the upcoming months…

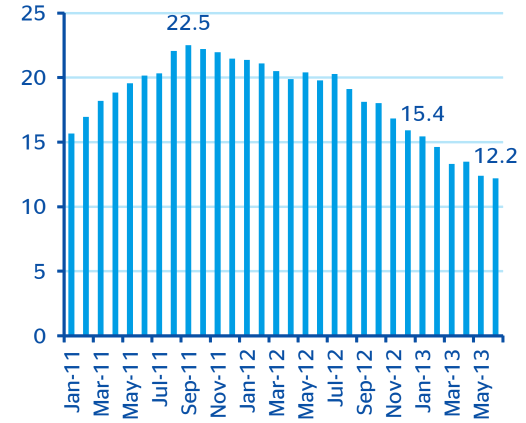
Currently the indicators linked to private consumption are on average promising; above all those related to employment. The unemployment rate is at all-time lows (5.8% in 2Q13) and the purchasing power of wages has continued to increase (at around a real 3% y/y in 2Q13). However, from this point on, labor conditions could become less favorable, as we expect a moderation of private investment to begin to have an effect on job creation in the upcoming months. The two variables are closely interrelated (see Chart 9) and their movement suggests that a slowdown in private investment precedes lower growth of formal employment by around one to three quarters. This would have begun to be noted in dependent employment, which barely grew in the second quarter (0.5% y/y), a slowdown on 3% growth in the previous quarter. Currently this effect is more notable in small companies. According to our estimates, formal urban employment (dependent and independent) will tend to grow at a rate of between 2% and 3% starting in the third quarter, under the 4% average it has been posting since last year.

Chart 9
Peru: private investment and formal employment (y/y % change)



Source: BCRP and MTPE

Chart 10
Consumer finance from private banks (y/y % change)



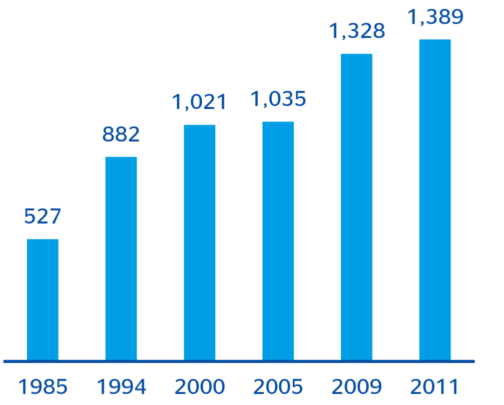
Source: SBS and BBVA Research Perú

This would be in addition to the slowdown that has also been recorded in the financial environment, as consumer finance has slowed (see Chart 10) due to the macroprudential measures that have been implemented over recent months. It would also be reflected in the sale of durable goods; in particular, family cars, which reduced their rate of growth to 8.3% in June, after growing at double-digit rates for 18 consecutive months.

Greater fiscal expansion will limit the moderation in private expenditure

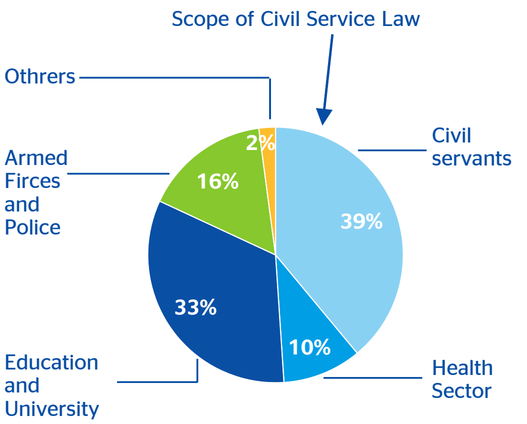
From the end of last year, but more particularly starting this year, the current expenditure of the public sector has risen, due mainly to wage increases. Given the number of public-sector workers (see Chart 11), who account for 10% of the working economically active population (EAP), this has a significant impact on economic activity. These improvements have favored above all education and the armed forces. In addition, the recent approval of the Law on the Civil Service is possibly the most important reform carried out so far by the current government. This Law covers 39% of public-sector employees (see Chart 12). It lays down criteria for recruitment similar to those in the private sector and reduces the variety of employment regimes within the public administration. Even more important, the Law stimulates productivity by establishing annual assessments of civil servants and disciplinary dismissals based on them (for example, if two consecutive assessments are failed, after skills training). The maximum cost of this measure is calculated at around PEN 2.3 billion per year (0.4% of GDP), used to pay the benefits that will now be enjoyed by workers in the public sector such as bonuses (payment of an additional monthly wage in July and December) and CTS (self-financed unemployment insurance).

Chart 11
The civil service (thousands of employees)



Source: SERVIR

Chart 12
Breakdown of the civil service (%)



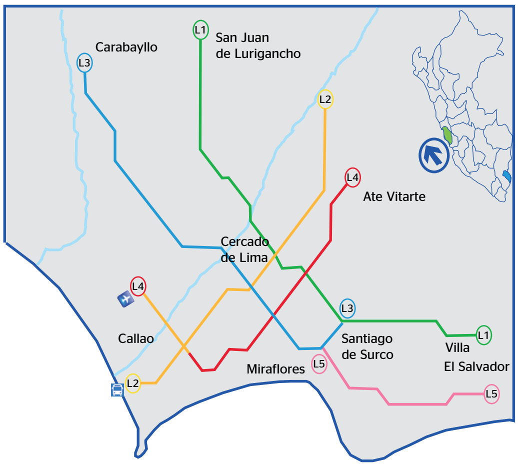
Source: SERVIR

In addition, a reform of the health sector is being implemented. It also involves higher wages for doctors, as well as the modernization of hospitals and measures to promote universal access to services. The cost of this reform is estimated at PEN 4.3 billion through 2016, of which PEN 1.4 billion (0.3% of GDP) will be budgeted for next year. With these reforms, the government's objective of having higher paid public-sector employees is being met in nearly all its facets (see Chart 12). We expect that these stimuli will have an effect on the national economy through greater efficiency of the services provided by the government.

We expect public investment to be even more dynamic, with average expansion rates of close to 13% from this year to 2016. This forecast takes into account the implementation of major public infrastructure works, such as Line 2 of the Lima Metro, the Carretera Longitudinal de la Sierra highway and the fiber optic backbone network. The Line 2 project consists of the design, construction and equipment of a rail transport line of 35 km (see Chart 13). Investment is estimated at USD 4.5 billion (co-financed) and is will be awarded in the last quarter of this year. If it is completed in four years, this investment will have a direct impact of 0.5 pp of GDP each year.

At the same time, between the last quarter of this year and the first half of the next sections 2, 4 and 5 of the Carretera Longitudinal de la Sierra highway will be awarded. This project consists of the rehabilitation and regular maintenance of nearly 2,000 kilometers of highways running through the center of the country (see Chart 14), which is a difficult zone geographically due to the mountainous terrain. It is expected to boost economic integration and complementarity between the cities involved, and connect them to the more developed logistical platforms of the cities close to the sea. Estimated investment amounts to over USD 900 million (0.4% of GDP).

Chart 13
Lima Metro (basic structure)



Source: ProInversión

Chart 14
Carretera Longitudinal de la Sierra highway

Source: BBVA Research Peru

Other important projects include the deployment of a fiber optic cable backbone, which involves connecting more than 200 towns and cities in the country through a broadband network, providing quicker speeds and thus a greater volume of data flows across the Internet. The total cost of the investment is around USD 315 million and it is expected to be awarded at the end of this year.

Given the greater flexibility being shown by ProInversión and the interest now being shown by the government in boosting investment, our forecast has brought forward the time frames in which these projects will be executed. We expect that the national budget for next year, which will be presented to Congress on August 30 at the latest, will include the bigger planned expenditure on both civil service reforms and infrastructure projects.

Exports will record higher growth rates starting in 2015, due to the maturity of mining mega-projects

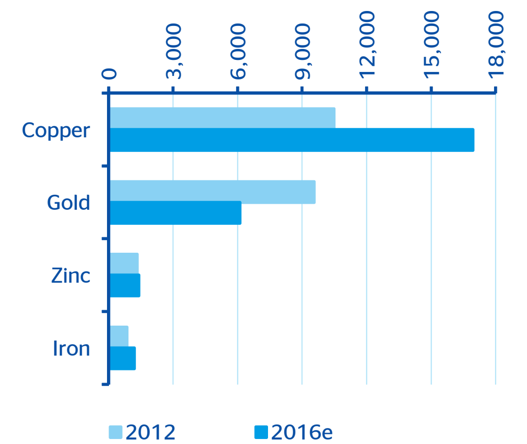
In the first half of the year, the value of total exports fell by 12.6% (15.0% traditional and 4.7% non-traditional). Weak exports have been linked to temporary supply factors that affected mining production in the first quarter of the year (maintenance operations and closure of mines due to exhaustion; they are gradually being replaced by others), as well as lower foreign demand, which is affecting the export of products with greater aggregate value, such as textiles. For the rest of the year, we expect a steady improvement in exports as the temporary factors recede and non-traditional exports are expected to stabilize. Against this backdrop, we have adjusted down the forecast growth for exports this year from 4.5% in the previous report to 2.0%.

Looking ahead, we have maintained an upward trend in our forecast for exports, because major mining projects will enter the extractive phase, as they are already making good progress and have the finance (see Chart 15). In fact, between this and next year four mining projects will mature and increase copper production by around 50% (1.3 million MT in 2012). Toromocho will enter the production stage in the last quarter of this year, and Las Bambas, the Toquepala extension and Constancia will also start production in 2014. In addition, there are the projects that will begin to be completed in the upcoming years (Quellaveco, subject to the decision and continuity of the Anglo American management; and the extensions of Cerro Verde and Toromocho). With these, we expect copper production to double at least by 2016. Another mineral that will increase production significantly will be iron, due to the extension of Marcona, which will add about 50% to current production. In contrast, gold will reduce its weight within mining exports, due to lower grades in some mines (such as Yanacocha), though this will be mitigated by the entry into service of the Ollachea mine in 2015.

There are at least two other projects that could add to this trend toward a greater proportion of copper production in mining. The first is Minas Conga (in Cajamarca), which is currently paralyzed due to opposition by the local population to its execution. The second is La Granja, which is considered one of the biggest copper deposits in the world. Its operator Río Tinto has requested a modification to its Environmental Impact Study (EIS) in order to continue in the exploratory phase for four more years. Iron could also increase its share if the Pampa de Pongo project is executed, with estimated investment of over USD 3 billion. It would have an annual estimated production of over twice total current production. If the right conditions for executing these three projects are presented, copper and iron production will triple its current levels.

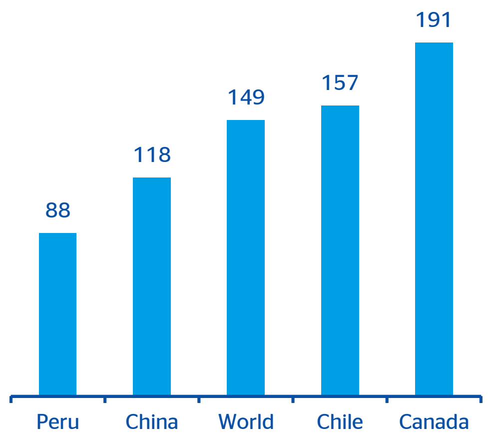
Finally, we do not expect a significant impact from lower metal prices on the main mining operations, as their operating costs are relatively low (see Chart 16).

Chart 15
Value of mining exports (USD million)



Source: MINEM, BCRP, MEF and BBVA Research Peru

Chart 16
Estimated average operating costs for copper extraction (USD cents per pound)



Source: APOYO

Box 2. Sustaining a high rate of growth in the medium term means strengthening the factors that support productivity

In the last decade (2001-2010) the Peruvian economy expanded strongly. Real GDP recorded average annual growth of 5.7%, and real per capita GDP had a cumulative expansion of 53%. What factors have contributed to this performance? More importantly, what factors have to be maintained or fostered to sustain high rates of future growth? What reforms or policy measures are required? To provide an answer to these questions we have carried out a simple growth accounting exercise.

We have analyzed the sources of GDP per capita growth in two steps. First, we decomposed GDP per capita growth, using the following identity:

$$\frac{Y}{P} = \frac{Y}{L} \times \frac{L}{WEP} \times \frac{WEP}{P}$$

Which at the same time can be expressed in terms of percentage changes as follows:

$$\Delta\% \left(\frac{Y}{P}\right) = \Delta\% \left(\frac{Y}{L}\right) + \Delta\% \left(\frac{L}{WEP}\right) + \Delta\% \left(\frac{WEP}{P}\right)$$

This expression makes clear that changes in GDP per capita may be associated with the growth of (i) labor productivity or output per worker (Y/L); (ii) the ratio of the labor force or economically active population over working-age population (L/WEP); and (iii) the demographic bonus or working-age population over the total population (WEP/P). This decomposition and the corresponding data allow us to identify that over the past decade growth was linked mainly to an increase in labor productivity, and to a lesser extent, to demographic factors (see Chart 17).

The second step aims to identify the factors that have boosted growth of labor productivity. To do so, GDP is assumed to depend on the stock of physical capital (K), the quality of human capital (H) and on the labor force (L):

$$Y = AK^{\alpha} (HL)^{1-\alpha}$$

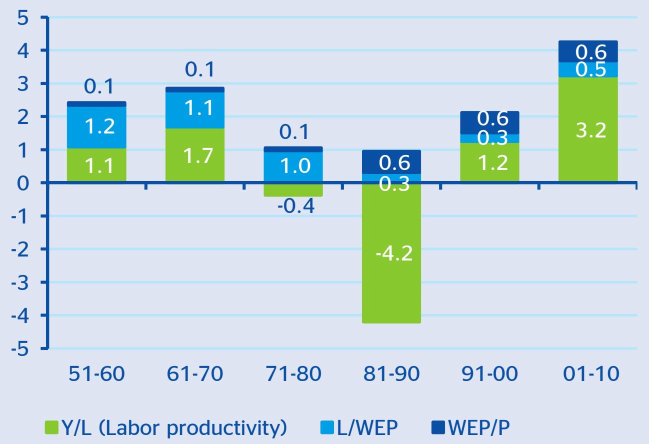
The above expression is in reality a Cobb-Douglas "production function", with constant returns to scale, where $0<\alpha<1$ is the participation of capital in output and A represents total factor productivity or TFP. Miller (2003)[1], estimates that the value of α in Peru would be around 0.50. The calculation of capital stock uses the perpetual inventory method assuming an initial capital ratio over GDP of 2.5 and a depreciation of 5%. Human capital is approximated through the average of the number of years of schooling (primary, secondary and tertiary); the data are taken from Barro and Lee (2010)[2]

Based on the above function, we find that the growth of labor productivity is determined by: (i) the deepening of physical capital per worker (K/L); (ii) the quality of the labor force or human capital (H); and (iii) total factor productivity or TFP (A).

$$\Delta\% \left(\frac{Y}{L}\right) = \Delta\%A + \alpha\,\Delta\% \left(\frac{K}{L}\right) + (1-\alpha)\,\Delta\%H$$

In this case we find that the growth of labor productivity has been mainly associated with the TFP increased (see Chart 18). This variable includes various factors that have allowed more efficient use of resources, such as: (i) greater institutionalization of economic policies; (ii) increased opening up of the economy; (iii) greater financial depth; (iv) favorable external conditions, etc. We can also see that a more intensive use of capital has had a positive influence on labor productivity, while the contribution of human capital has declined.

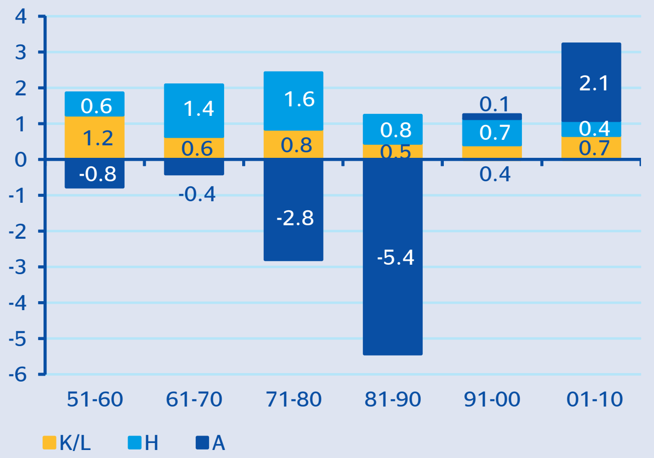
Chart 17
Contribution to GDP growth per capita (percentage points)



Source: BBVA Research Peru

1: Miller, Shirley (2003) "Métodos alternativos para la estimación del PBI potencial: Una aplicación para el caso de Perú", Working Document, Central Reserve Bank of Peru.
2: Barro, R. and J. Lee (2010) "A New Data Set of Educational Attainment in the World, 1950-2010", NBER Working Paper No. 15902.

Chart 18
Contribution to growth of labor productivity (percentage points)



Source: BBVA Research Peru

To sum up, the evidence shows that the sustained high rates of GDP growth per person recorded in the last decade can be mainly explained by the contribution to productivity of the labor force and, which in turn was boosted by total factor productivity (TFP).

Thus to continue recording high per capita GDP rates of growth in the medium term the key element will be to ensure growth in labor productivity maintains its contribution to growth, as the demographic factors will gradually lose their force.

How can we therefore sustain the contribution of labor productivity to growth? The first option is to strengthen TFP, which will require microeconomic reforms that improve market efficiency. For example, the labor market could be made more flexible so that a significant number of workers now carrying out activities in the informal sector of the economy (low productivity and low capital levels) move into the formal sectors.

A second possibility is to deepen the use of physical capital per worker (K/L) and increase the contribution to economic growth of this variable to similar levels from those recorded in the 1950s (contribution somewhat higher than 1 percentage point, compared with 0.7 pp in the last decade). The mass development of public infrastructure would point in this direction. It is worth noting that a study by the University of the Pacific and ESAN University estimated that the infrastructure gap in 2021 would be USD 88 billion or 44% of 2012 GDP, with the sectors requiring most investment being Energy (38%), Transport (24%) and Communications (22%).

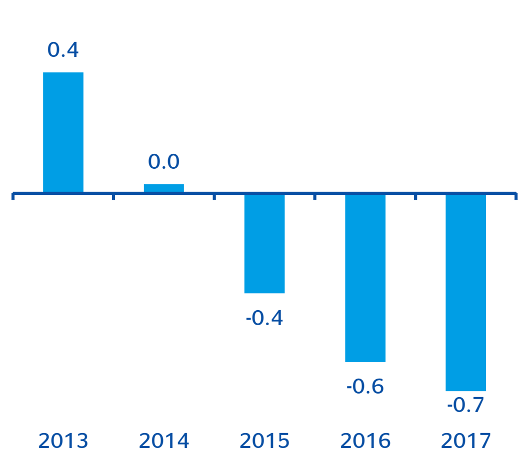
Even if the infrastructure gap could be closed, in the medium term the increasing labor productivity cannot be sustained solely by factor accumulation, so it will be important to reverse the declining trend of contribution from human capital. There is still a long way to go in this aspect, above all in the case of public education. Peru was in 63rd place out of 65 countries in the 2009 Program for International Student Assessment (PISA), which measures the quality of education. In addition, we have to redouble our efforts to reduce the chronic malnutrition levels of children aged under 5 (according to the Demographic and Family Health Survey 2012, 20% of children suffer from it).

We expect a reduction in public saving and temporary extension of the current account deficit

In our forecast horizon, the reforms of the public administration and public infrastructure projects will lead to increased expenditure; while on the fiscal revenue side, we expect that the efforts to extend the tax base will be limited by the lower tax receipts in a context of more moderate economic growth and lower metal prices. As a result, we estimate that the tax burden will remain relatively stable, at just over 16% of GDP.

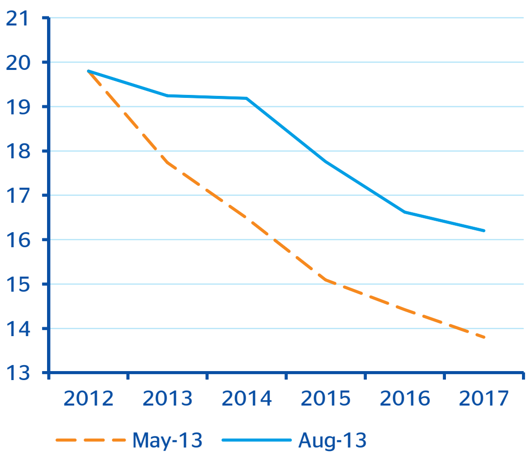
As a result of this forecast of tax revenue and expenditure, we expect a steady reduction of the public surpluses starting this year, which will become slight deficits starting in 2015 (see Chart 19). It is worth noting that these results do not undermine fiscal solvency, as we continue to forecast a fall in the government debt ratio, although slower than in our previous forecast (see Chart 20). This is because economic activity will grow faster than public debt.

Chart 19
Forecast overall public sector balance (GDP %)



Source: BBVA Research Peru

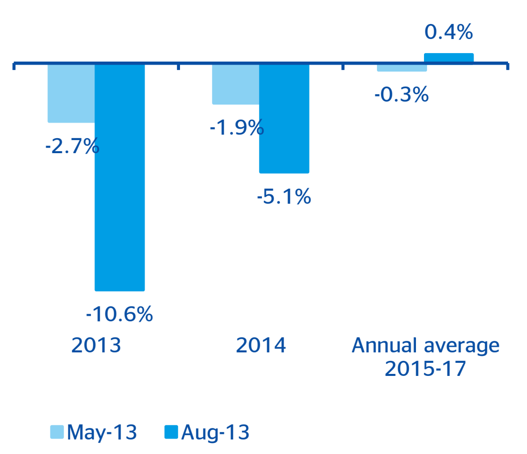
Chart 20
Public debt (% GDP)



Source: BCRP and BBVA Research Peru

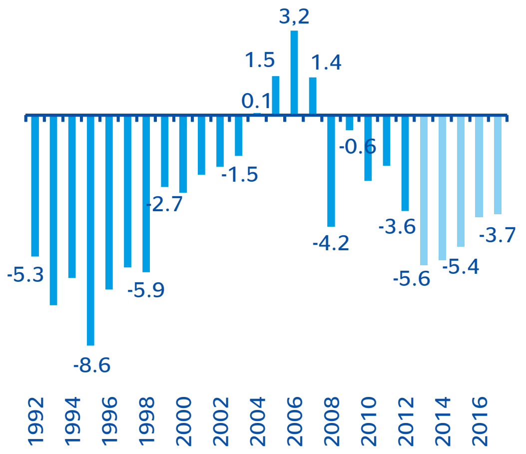
On the external front, the downward adjustment of the export prices forecast (see Chart 21) will deteriorate the current account of the balance of payments which will only be partly offset because of the expected slowdown in domestic demand due to lower imports. This and next year, the deficit will be around 5.5% of GDP, a level that has not been seen since the end of the 1990s (see Chart 22). Although this may generate some concern, it also reflects the greater strength of investment, and its temporality. Part of this investment is geared to the tradable sector of the economy, in particular the development of major mining projects, which will enter into production starting at the end of 2014 and substantially increase the export volumes of metals. Since, current-account deficit will continue to fall.

Chart 21
Export prices (% change, annual average)



Source: BBVA Research Peru

Chart 22
Current account of the balance of payments (% GDP)



Source: BCRP and BBVA Research Peru

Of course, the wider external gap will increase the vulnerability of the Peruvian economy, as it becomes more dependent on external finance in a context where conditions for access to such finance will be more difficult. This has already begun to be seen. Mining companies, for example, are facing growing costs to fund their operations. The returns that era demanded have substantially increased, above all in the case of the smaller ones, and issues of mining shares in the main stock markets around the world have fallen drastically. This will particularly affect exploration work and could delay the start of the construction of new projects. Peruvian companies that operate in other productive sectors face a similar outlook. In the first four months of the year they issued securities abroad for over USD 5 billion, a record, but since May this has dried up.

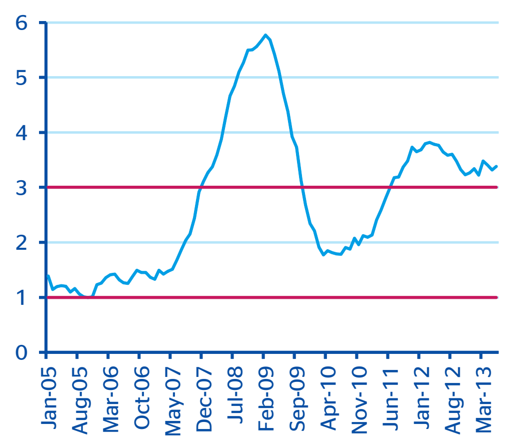
Our forecast for external finance takes into account this more difficult environment. Although we still project that the level of foreign direct investment will be significant, geared to activities such as construction of mining mega-projects already underway and with secured finance, we have cut it to reflect factors such as the fall in mining exploration work. We have also revised down our forecast on the issue of Peruvian corporate securities abroad, which we estimate to be insignificant for the rest of the year. Finally, we have considered that the high level of sovereign bonds held by non-resident investors, which accounts for around 3.3% of GDP, will steadily reverse as global portfolios are restructured in an environment of greater uncertainty. As a result, in 2013 the financial account will not greatly exceed the current-account deficit, while in 2014 financial flows will just about offset trade flows. This implies two things. First, if capital inflows will end up being lower than expected, the Peruvian economy will have to adjust by combining lower GDP growth with a weaker currency than we have considered in our baseline scenario. Second, is very important for the construction of mining mega-projects to progress according to the estimated time frames; if they do not, the current-account deficit will remain high for a longer period of time, and thus increase the probability of adjustments on the output and the foreign-exchange market.

4. Weaker private expenditure will limit demand pressures on prices

In line with expectations, year-on-year inflation has remained close to the upper limit of the Central Bank's (BCRP) target range (2% +/- 1 pp) since the second quarter, closing at 3.2% in July. The resistance shown by inflation to converge at the center of the target range mainly reflects that the core inflation component (most closely linked to demand factors) has remained persistently above 3.0% in a context of strong domestic demand (see Chart 23). Within this component there have been notable increases in items such as Food Outside the Home, Education, and Health, with year-on-year changes of between 3% and 6%. At the same time, some items whose prices are linked to the exchange rate have been affected by the depreciation of the local currency so far this year. This is the case of Rentals, which in July increased year-on-year by 2.4%. In the future, we expect that the moderation of private expenditure will reduce demand pressure on prices, so core inflation will tend to move down steadily.

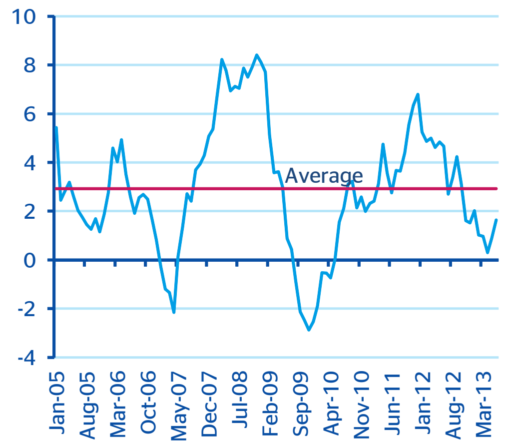
The non-core component of inflation (that closest linked to supply factors such as variations in the price of food) has picked up pace slightly since April. In fact, this movement is a process of normalization and convergence to levels consistent with historical average, after hitting lows a few months ago due to the reversal of supply shocks affecting the price of various foodstuffs (see Chart 24). In the next few months, non-core inflation will tend to stabilize in a context of no major rises in international prices of agricultural supplies and oil. According to the latest report from the United Nations Food and Agricultural Organization (FAO), cereal production will increase significantly in 2013 which will remain contained the prices of agricultural supplies. We estimate that the international oil price will remain stable and that the increases of recent weeks will only be temporary and tend to reverse as the political tension in the Middle East calms down. It is worth pointing out that our inflation forecast assumes that La Niña phenomenon, which is now active on the country's coast, will have a moderate impact on inflation; although it is a risk factor, as if it strengthens it will have notable effects on various agricultural products, particularly crops that require more water.

Chart 23
Year-on-year inflation, core component (%)



Source: BCRP

Chart 24
Year-on-year inflation, non-core component (%)

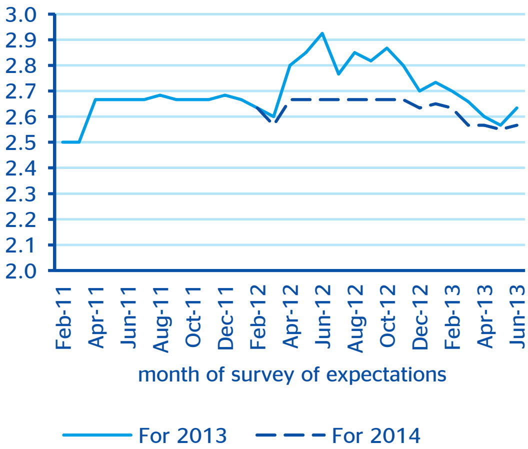


Source: BCRP

Finally, it is worth adding that although inflation expectations have fallen, they are still around the upper limit of the target range for this and the next year (see Chart 25), so possible supply shocks could raise them with the risk of second-round effects on prices.

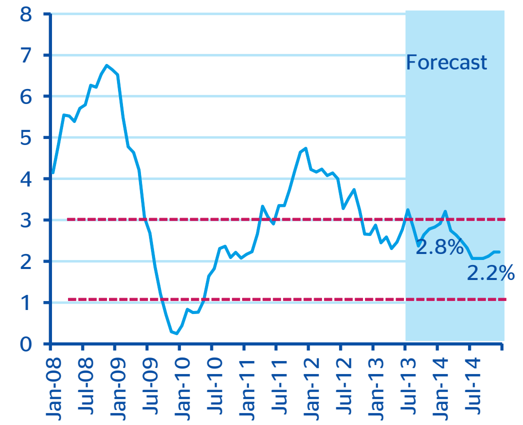
To sum up these different trends in prices, we forecast inflation closing the year around the upper limit of the target range. In 2014, in the absence of supply shocks and lower private expenditure that we expect to limit demand pressure on prices, we will see a steeper decline in the core component, so inflation will converge at the center of the target range (see Chart 26)..

Chart 25
Inflation expectations for 2013 and 2014 (%, end of period)



Source: BCRP

Chart 26
Year-on-year inflation (%)

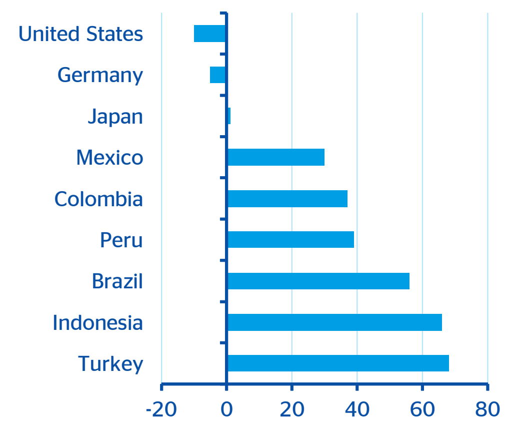


Source: BCRP and BBVA Research Peru

5. Volatile exchange rate due to external events

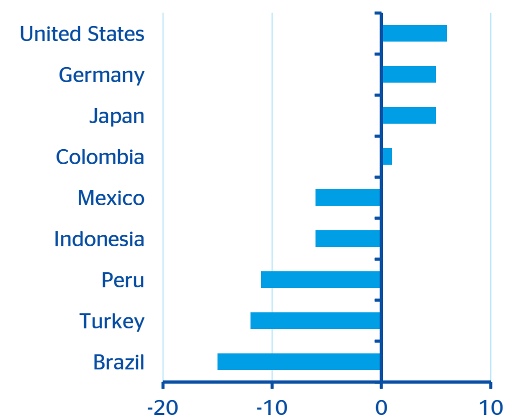
Since May, financial tension on global markets increased due to the growing possibility that the Federal Reserve will cut the pace of its monetary stimulus early and that economic activity in China will slow down significantly. Emerging markets have been most affected (see Charts 27 and 28).

Chart 27
5-year sovereign debt CDS (change between April 30 and July 19, basis points)



Source: Bloomberg

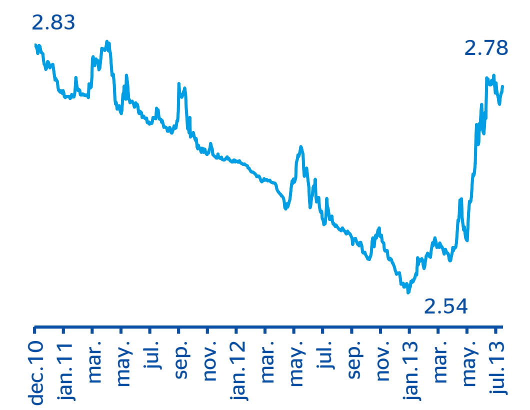
Chart 28
Stock market indexes (% change between April 30 and July 19)



Source: Bloomberg

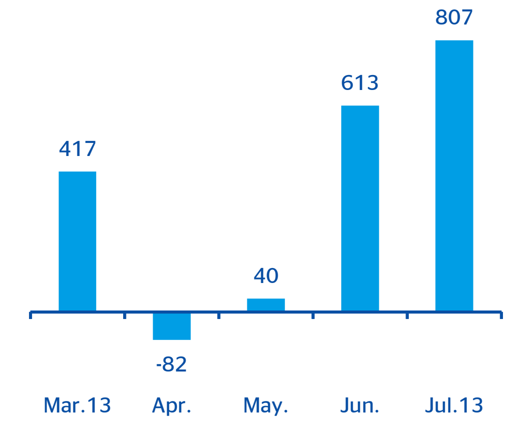
Peru is no exception. In this more difficult environment, the local currency weakened by 5% since April and 9% since the end of last year, wiping out the appreciation of the last two years (see Chart 29). In terms of flows, various factors explain this behavior. First, the economic agents have chosen to increase their net foreign-currency positions. Banks, for example, have increased their foreign exchange accounting position by around USD 900 million since the end of April (see Chart 30). This happened despite the fact that over 90% of the flow of deposits in recent months have been denominated in foreign currency (greater public preference for the dollar compared with the observed until April). In the forward fx market, positions have also moved in favor of foreign currency by around USD 500 million since the end of April. Non-domestic investors may have been trying to hedge the greater exposed exchange-rate risk of some of their assets denominated in soles, among them sovereign bonds.

Chart 29
PEN/USD exchange rate (an increase in the figure reflects a weaker local currency)



Source: BCRP

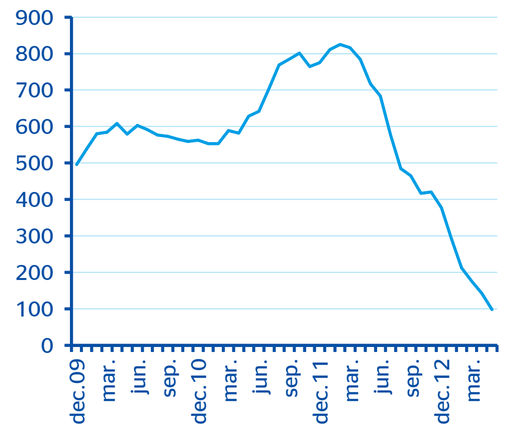
Chart 30
Banks' foreign-exchange accounting position (USD million)



Source: BCRP

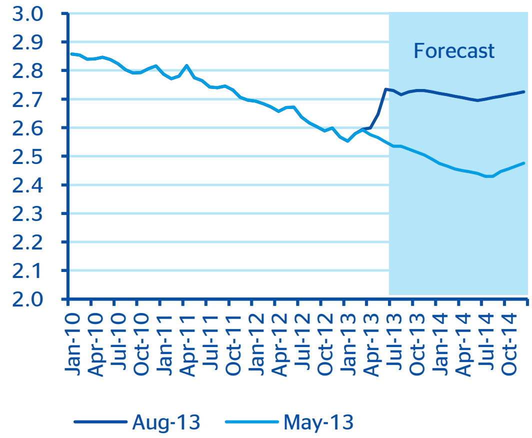
Second, trade flows have suffered a major deterioration. The major decline in metal prices and weakness in export volumes has lead to a pronounced downward trend in the trade balance surplus (see Chart 31), even moving into negative territory in the last two months (in April and May the deficit was over USD 400 million). Although we still have no data for June and July, the situation will probably have not improved. The gold price has fallen 10% since the end of May and the copper price by 5%. These two products together account for over 40% of total exports, which should have offset an eventual recovery in the volume of metal sales abroad. Finally, on the side of financial flows, the support given by them to the local currency has weakened. For example, the issues of Peruvian corporate bonds abroad boomed until April, at all-time highs, but have dried up since May. To sum up, flows have supported the depreciation of the domestic currency. For much of this time the Central Bank has remained relatively at the margin, with limited interventions, so there was no major counterweight to these flows. It appears that the monetary authority considered that the local currency was overvalued, so its weakening was healthy. Only when the exchange rate moved toward 2.80 there was a more energetic intervention (foreign-currency sales for USD 570 million and issue of securities in soles whose yield is readjusted to the exchange rate changes by an equivalent of close to USD 1 billion).

Chart 31
Trade balance
(USD million, average for last 12 months)



Source: BCRP

Chart 32
USD/PEN exchange rate



Source: BCRP and BBVA Research Peru

In the future, there is little room for the local currency to reverse the losses of recent months. Our forecast is that it will fluctuate within the range of 2.70 and 2.80, closing 2013 at around 2.76. On the trade front, we estimate that for the rest of the year metal prices will fall further from their current levels as the Fed begins to reduce the rate of its monetary stimulus and China shows more signs of a slowdown. Thus the improvement that we forecast in the exports volumes of these products after solving the supply problems suffered since the end of last year will on balance provide a slight support to the local currency. On the financial side, capital will continue to flow into the country as foreign direct investment for construction projects. But we are unlikely to see more issues of corporate bonds abroad due to worsening conditions. In addition, foreign investors will aim to take advantage of windows of opportunity to gradually reduce their positions in sovereign bonds (a swift adjustment could generate significant capital losses in a market with as little liquidity and profundity as that of Peru). Expectations of an appreciation in the local currency have eased, which limits the returns available from these trends; while the attraction of US T-bonds have increased in terms of both return and risk level. Finally, in a context in which the local currency appears weak, public portfolios may suffer some risk of dollarization. To sum up, we see opposing flows that will limit the sol to mainly sideways movements for the rest of the year, without a clear trend, and with the Central Bank keeping a watchful eye to intervene (it has a significant level of international reserves) if there is major pressure pushing the exchange rate far above its current level. We do not rule out episodes of high volatility when the US Federal Reserve finally decides to start the process of cutting the pace of monetary expansion. In 2014 the process will continue, so we estimate that the domestic currency will weaken somewhat more, ending this year at around 2.80.

In general, the new trend we see for the exchange rate (a weaker sol compared with the exercise in April) is consistent with a fundamentals deterioration of the Peruvian economy: lower metal prices, weaker fiscal balance, and greater risk perception.

6. Monetary policy will be more focused on its stabilizing role against external turbulence

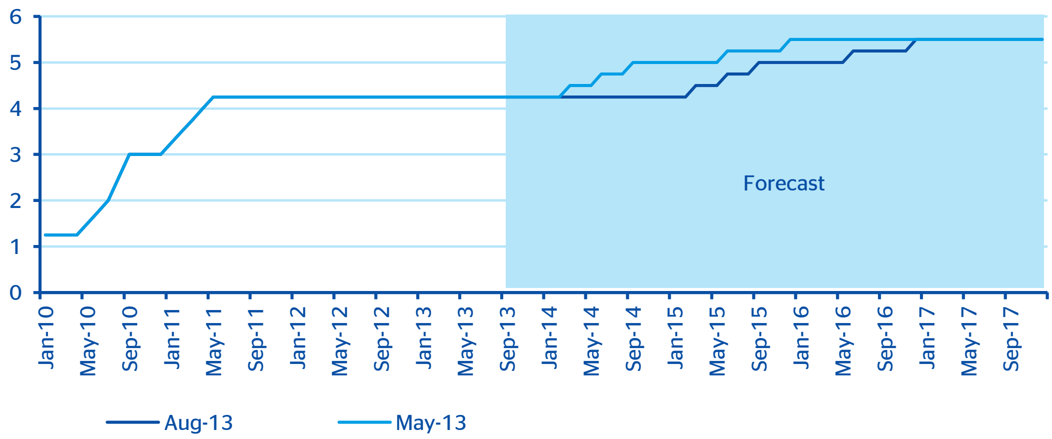
In the last three months, the global macroeconomic outlook has changed significantly…

With respect to emerging markets, we have moved from a situation in which the main concerns were the major capital inflows, the risk of bubbles and overheating to another in which the financing conditions have tightened, prices of domestic assets have corrected strongly down and output is slowing. The Peruvian economy has not been immune to this change. Locally, the currency has been under strong pressure to depreciate. At the same time, the indicators of private expenditure suggest that this is beginning to lose steam, above all on the investment side, which will eventually have an impact on consumption. In this context, demand pressure on prices will moderate, and will lead to inflation continuing over the next few months on a trend that is more in line with the Central Bank's target range.

… and with it the monetary policy tone we can expect in the future

The new local outlook we expect for prices and output suggests that the monetary position will be more accommodative than the considered in our previous report (see Chart 33). The somewhat restrictive tone of its current stance according to our estimates (in a broad definition that not only includes the conventional instrument of the monetary policy rate but also the reserve requirements) gives room for monetary policy to adopt a stabilizing role and give greater support to private expenditure.

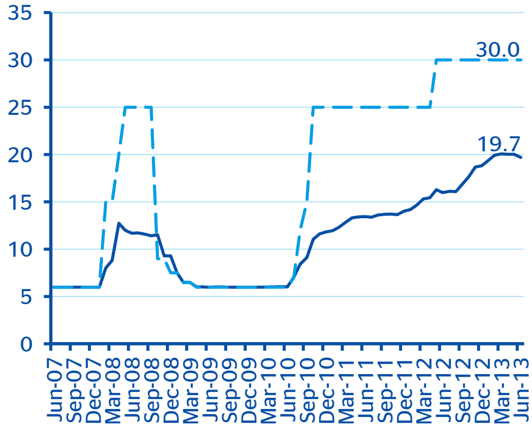
Chart 33
Policy interest rate (% in nominal terms)



Source: BCRP and BBVA Research Peru

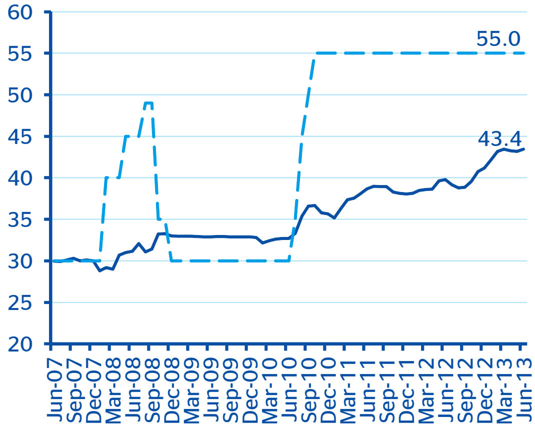
We expect the Central Bank's main line of action with respect to external turbulence will be a partial reversal of the high levels of reserve requirements (see Charts 34 and 35). In fact, this process has already begun and we will probably see more cuts in the upcoming months. This injection of liquidity will partly offset the tougher financing conditions at global level. In contrast, we do not expect movements in the monetary policy rate for the rest of this year or in 2014. A reduction of this reference rate to boost private sector expenditure would also make positions in favor of foreign currency more attractive and weaken the sol even more. However, the Central Bank with its foreign exchange interventions has insinuated that the local currency has already reached a level in accordance with its fundamentals and that additional pressure on it to weaken (above 2.80) would be excessive.

Chart 34
Domestic-currency reserve requirement (% of obligations subject to reserve requirement)



Source: BCRP

Chart 35
Foreign-currency reserve requirement (% of obligations subject to reserve requirement)



Source: BCRP

7. The main risk factors come from abroad

In the short term, the main risk factor is a disorderly withdrawal of the Federal Reserve's quantitative easing program. Faults in communication by the Fed with respect to the form, rate and period in which the withdrawal will be made could lead to an overreaction by financial markets, and with it a premature and unwanted tightening of monetary conditions in the United States.

A more medium-term risk is a steeper slowdown in the Chinese economy and the consequences this could have on the price of metals exported by Peru. In this respect, it is worth noting that the Chinese authorities have shown to be more prepared to accept a lower but sustainable rate of growth. What lies behind this are the financial fragilities shown by China (excessive expansion of credit boosted by the poorly regulated informal shadow banking, local increased of the government debt, a further overheating of real-estate prices), which would have been exacerbated by the measures introduced to limit the impact of the global financial crisis of 2008-2009. This experience now obliges the Chinese government to be more cautious when it comes to implementing stimulus policies to counter external shocks.

The impacts at local level will vary. If the risk comes from the United States, the financial channel appears most important, while if it comes from China, it will be the trade channel. In the case of the financial channel, the risk premium would increase, thus making finance more expensive; capital inflows would be reduced; and there would be stronger pressure on the exchange rate (depreciation of the local currency). In the case of trade channel, there would be a fall in foreign demand, mainly for traditional products for which China is our main trading partner. In both cases, we would see a collapse in international mineral prices (copper and gold), which would further extend the current-account deficit, and reduce the levels of confidence and private expenditure.

There is also a risk that the response of business confidence to the global macroeconomic environment will be more sensitive than expected, so we could see a greater slowdown in private investment. This response could be heightened if the recent government measures to boost investment are slow to produce a result.

However, growing strengths of the Peruvian economy (see Table 2) makes us believe that the local impacts would be relatively limited. The fiscal position has improved over recent years and there is room to implement countercyclical measures, while on the monetary side there are instruments whose use would facilitate the provision of liquidity and support growth.

Table 2
Fiscal and external vulnerability indicators (% of GDP)

	2008	2013*
Gross public debt	25.9	18.6
Fiscal Stabilization Fund	1.4	4.3
NIR (% GDP)	24.5	33.9
NIR (over STFL** for the economy)	5.0	7.0
PECP** de la banca (% colocaciones)	5.1	5.4

* Latest figures
** STFL: short-term foreign liabilities
Source: BCRP

8. Tables

Table 3
Annual macroeconomic forecasts

	2011	2012	2013p	2014p
GDP (y/y %)	6.9	6.3	5.8	5.8
Inflation (y/y %, EoP)	4.7	2.6	2.8	2.2
Exchange rate (vs USD, EoP)	2.70	2.57	2.76	2.78
Monetary policy interest rate (%, EoP)	4.25	4.25	4.25	4.25
Private consumption (y/y %)	6.4	5.8	5.3	4.5
Public consumption (y/y %)	4.8	10.6	11.0	8.0
Investment (y/y %)	5.1	14.9	8.9	6.2
Fiscal balance (% GDP)	1.9	2.1	0.4	0.0
Current account (% GDP)	-1.9	-3.6	-5.6	-5.4

Source: BCRP and BBVA Research Peru

Table 4
Quarterly macroeconomic forecasts

	GDP (y/y %)	Inflation (y/y %, EoP)	Exchange rate (vs USD, EoP)	Monetary policy interest rate (%, EoP)
1Q12	6.0	4.2	2.67	4.25
2Q12	6.4	4.0	2.67	4.25
3Q12	6.8	3.7	2.60	4.25
4Q12	5.9	2.6	2.57	4.25
1Q13	4.8	2.6	2.59	4.25
2Q13	6.3	2.8	2.73	4.25
3Q13	5.5	2.4	2.80	4.25
4Q13	6.5	2.8	2.76	4.25
1Q14	6.3	2.7	2.74	4.25
2Q14	6.0	2.3	2.73	4.25
3Q14	5.8	2.1	2.75	4.25
4Q14	5.1	2.2	2.78	4.25

Source: BCRP and BBVA Research Peru

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates´ salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons.The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.

BBVA | RESEARCH

This report has been produced by the Peru Unit

Chief Economist for Peru
Hugo Perea
+51 1 2112042
hperea@bbva.com

Francisco Grippa
+51 1 2111035
fgrippa@bbva.com

Daniel Barco
+51 2111548
daniel.barco@bbva.com

Isaac Foinquinos
+51 1 2111649
ifoinquinos@bbva.com

BBVA Research

Group Chief Economist
Jorge Sicilia

Emerging Markets:
Alicia García-Herrero
alicia.garcia-herrero@bbva.com.hk

Cross-Country Emerging Markets Analysis
Álvaro Ortiz Vidal-Abarca
alvaro.ortiz@bbva.com

Asia
Stephen Schwartz
stephen.schwartz@bbva.com.hk

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Latam Coordination
Juan Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@grupobbva.com.pe

Venezuela
Oswaldo López
oswaldo_lopez@provincial.com

Developed Economies:
Rafael Doménech
r.domenech@bbva.com

Spain
Miguel Cardoso
miguel.cardoso@bbva.com

Europe
Miguel Jiménez
mjimenezg@bbva.com

United States
Nathaniel Karp
nathaniel.karp@bbvacompass.com

Global Areas:

Economic Scenarios
Julián Cubero
juan.cubero@bbva.com

Financial Scenarios
Sonsoles Castillo
s.castillo@bbva.com

Innovation & Processes
Clara Barrabés
clara.barrabes@bbva.com

Financial Systems & Regulation:
Santiago Fernández de Lis
sfernandezdelis@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Regulation and Public Policy
María Abascal
maria.abascal@bbva.com

Contacts details:

BBVA Research Latam
Pedro de Valdivia 100
Providencia
97120 Santiago de Chile
Tel: + 56 26791000
E-mail: bbvaresearch@bbva.com
www.bbvaresearch.com