

Economic Watch

Peru

Lima, March 6, 2013
Economic Analysis

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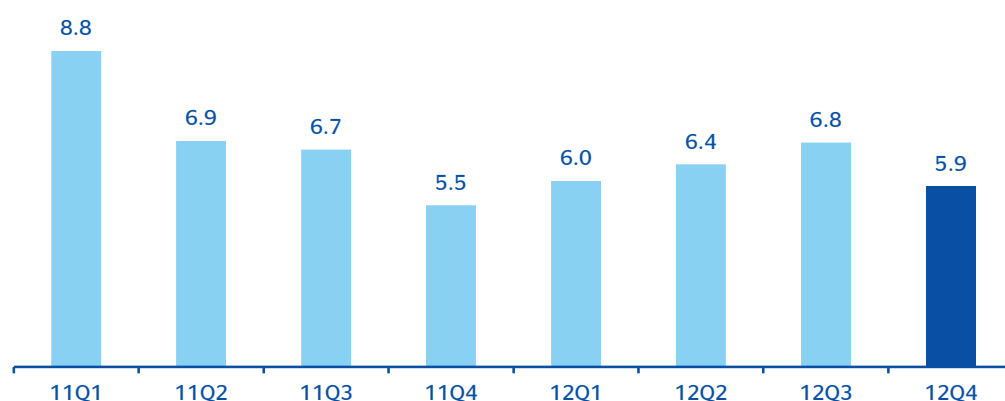
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Economic activity continued to show strong momentum in 4Q12

- Domestic demand remains the growth driver, supported by private and public spending
- By sectors, the activities most related to domestic demand, such as Construction, Services and Commerce are those with the greatest progress
- Available indicators show that in the first quarter, growth in GDP has risen above 6% y/y
- The strength of domestic demand continues to be reflected in the external accounts, but the deficit is financed fully with the inflows of long-term private capital
- Fiscal accounts remain in surplus and public debt continued to fall, making more likely an improvement in Peru's sovereign credit rating

Chart 1
GDP (% change y/y)

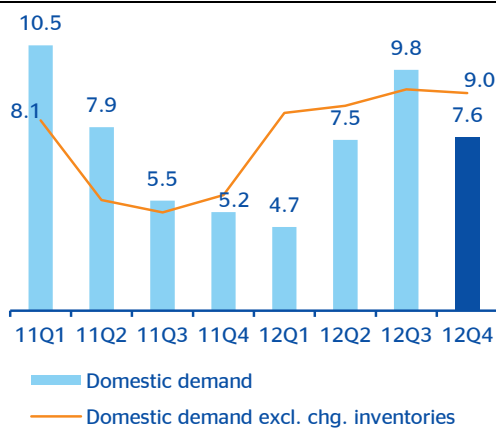


Source: BCRP

Domestic demand remained the growth driver in the fourth quarter of 2012...

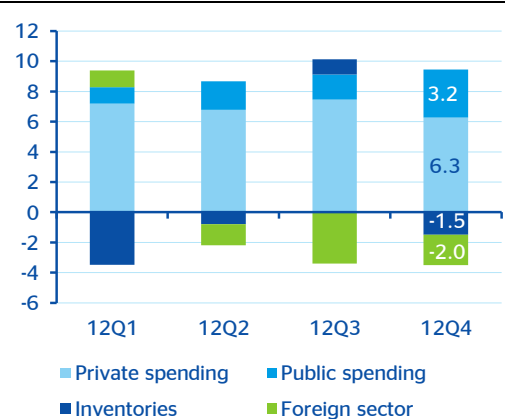
GDP rose 5.9% y/y during the fourth quarter (see Chart 1). Looking at the growth in terms of spending, it is important to note three things. First, domestic demand remains the main driver of activity (+7.6% y/y, see Chart 2), particularly in the private sector (see Chart 3). Buoyant spending by families and companies remains important, underpinned by the high optimism and the good financing conditions. Second, there was a strong drive in public spending. The public's contribution to the growth was the highest in the fourth quarter since 2009, when the impact of the international financial crisis needed a greater support from the public sector. This acceleration mainly reflects the increased in government acquisitions of goods and services. Lastly, the weakness of the external demand, especially in some traditional exports, and the downward adjustment of business inventories had a negative impact on GDP in the latter part of the year, and this was also evident in the annual aggregate. The 4Q figure reveal that the Peruvian economy recorded 6.3% growth in 2013, a similar rate to the average growth over the last five years.

Chart 2
Domestic Demand (% change y/y)



Source: BCRP

Chart 3
GDP: contributions to growth (percentage points)



Source: BCRP

... meaning that the heaviest growth was seen in sectors closely associated with domestic demand

The Construction sector was again at the forefront of growth (12.6% y/y), underpinned as in past quarters by continued real estate, commercial and hotel projects, as well as transport and public infrastructure works. The growth in Services (above 7% y/y) and Trade was also important. Primary activities, on the other hand, reported a sluggish performance. Overall, production in these sectors, including the industrial processing of primary resources, fell by 0.5% y/y. This was due, on the one hand, to the lower Fishing activity - largely the result of the smaller share assigned for anchovies' capture in the second part of the year - and, on the other, to the fall in metal mining activity, particularly gold extraction from the Yanacocha mine and the one estimated from the informal mining activity.

Growth in early 2013 should be in excess of 6% y/y

Available data in the first quarter show stronger activity at the start of the year (see Table 1). Confidence indicators - which reflect household and business optimism, and thus willingness to spend - have shown an upward trend since mid-2012. This support for the private sector comes in addition to a dynamic labour market, which has brought the present unemployment rate to historically low levels (see Chart 4), which favours consumer's income, and the facilities

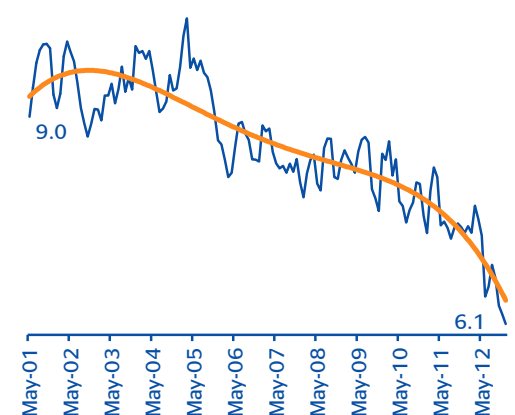
enjoyed by companies for seeking funding on the international markets, with stronger security issues abroad that drives the investment¹. What this all suggests, is not only that domestic demand remains very strong, but also, in this context, it is unlikely that companies have once again reduced stocks in the first quarter (as they did at the end of last year), eliminating the negative impact that this would have on growth. The dynamic economic situation in early 2013 is consistent with our estimate growth in GDP of 6.5% in 2013.

Table 1
**Indicators
of economic activity (average of period)**

	3Q12	4Q12	January
Business confidence (index)	59	64	67
Imports of capital goods (% change y/y)	12	14	23
Consumer confidence (indicator)	53	56	58
Adequate employment in Lima (% change y/y)	3	2	4
Public investment (% change y/y)	31	23	28
Electricity output (% change y/y)	6	6	7

Source: BCRP, Apoyo, INEI, MEF and COES

Chart 4
Unemployment rate in Lima (% of workforce)



Source: BCRP

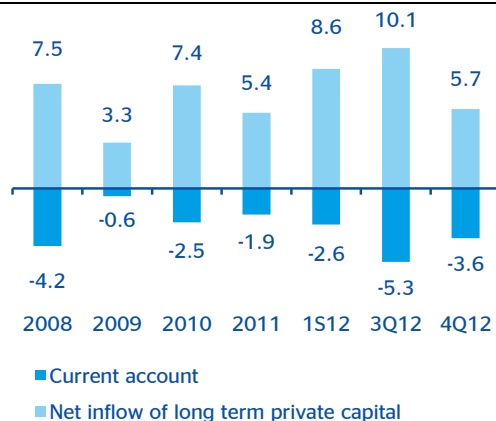
The strong domestic demand continues to be seen on external balances...

The deficit in the current account of the balance of payments amounted to 3.6% of GDP in 4Q12 (also 3.6% in the annual aggregate). This deficit increased in comparison with the same period of the previous year due to the reduction in the trade surplus. Three factors explain this decline. The most important reason is the strength of import volumes (+9.0% y/y) due to the sharp growth in domestic demand. Furthermore, export volumes fell in the fourth quarter (-1.0%), especially of gold and textiles. The former evidences the lower production by the informal sector, which is being reorganized, and by the Yanacocha mine; while the latter is due to sluggish external demand. Lastly, there was a slight fall in terms of trade. In coming quarters, we expect the current account deficit to stand on average at similar levels to 4Q12, because the GDP will continue to be mainly sustained by domestic demand, while external demand should recover gradually.

It is important to note that the deficit in external balances continued to be comfortably financed with the net inflow of long term capitals focused on private activity (8.2% of GDP, see Chart 5), which includes foreign direct investment and the placement of shares on international markets. Consequently, international reserves of the Central Bank rose by USD 2.8 billion in the fourth quarter, equivalent to 5% of the balance they reached in 3Q12.

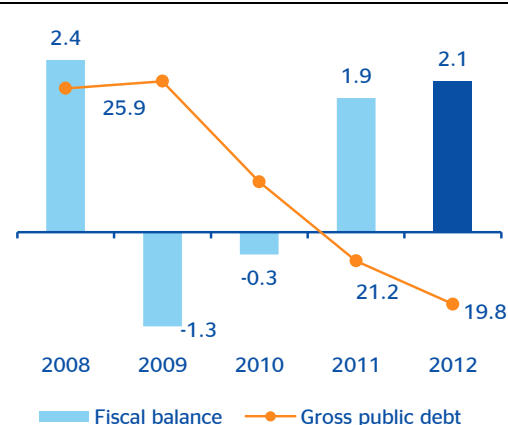
¹: In the first two months of the year, Peruvian companies placed securities of USD 1.30 billion in international markets, approximately 40% of the amount issued in 2012, a record year for these kind of operations.

Chart 5
Balance of payments: Current account and
inflow of long-term private capital (% GDP)



Source: BCRP

Chart 6
Fiscal balance and Gross public debt
(% of GDP)



Source: BCRP

... and on the fiscal balance, leading the public balances to stay in positive despite the fiscal stimulus and the continued downward trend in gross public debt

The non-financial public sector's overall balance amounted to 2.1% of GDP in 2012, 0.2 pp higher compared to previous year. This shows the growth in the fiscal balance against a background in which the dynamic momentum in GDP was conducive to collection of income tax and value added tax, an effect that was partly offset by the increased spending on investment. The fiscal surplus reached in the year induced a further decline in gross public debt stock to 19.8% of GDP (21.2% in 2011, see Chart 6). Furthermore, there was an increase in the percentage of these obligations in local currency (+3pp, to 50% of the total) and at fixed interest rate (+0.5pp, to 87% of the total). Against this background, we believe it is likely that if the macroeconomic and - in particular - if the fiscal performance continue, Peru's sovereign credit rating might improve at some point over the next twelve months.

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