BBVA | RESEARCH

Economic Outlook

Peru

First Quarter 2012
Economic Analysis

- **We expect economic growth to moderate in 2012 to 5%.** The weakness of the global environment will curb foreign demand and private investment dynamism, while the recovery in public expenditure will act as a support for economic activity.
- **Inflation will fall to 2.3% in 2012,** reflecting the reversal of the supply shocks of the previous year, lower food and oil prices, and reduced demand pressures due to the more moderate pace of economic growth.
- **The Central Bank will maintain the policy rate at its current 4,25% level in the short term, with a downward bias.** The existing inflation outlook limits the room available to ease monetary conditions.
- **The most important risk in the short term is a disorderly resolution of the debt crisis in Europe.** However, the Peruvian economy has strengths that will mitigate the impacts.

Index

Closing date: February 2nd, 2012

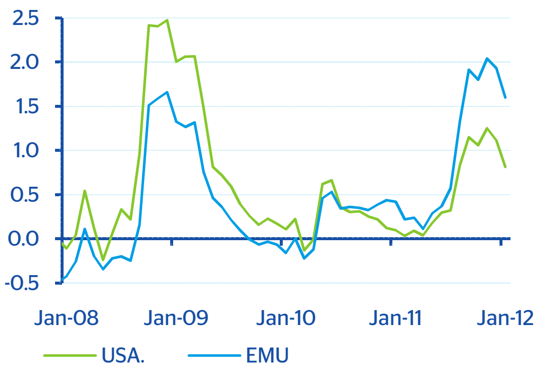
1. Global context: growth will slow down, with a downward bias

The global economy slowed down at the end of 2011, but will rebound in the second half of 2012, led by emerging economies

The global economy decelerated markedly in the last quarters of 2011. This was the result of weaker growth in Europe (with negative growth already in Q4) and the deceleration in emerging economies, to around 1% quarter-on-quarter at the end of 2011, their lowest growth rate since the 2008 crisis. The drivers of this deceleration could not be, however, more different in both areas. Europe is starting to feel the effects of persistently high financial tensions since September (see Chart 1), given the lack of major advances to solve the sovereign and financial crisis. On the other hand, the slowdown in emerging economies, apart from headwinds coming from developed economies, is partly the result of deliberate policy tightening until the first half of 2011, designed to avoid overheating.

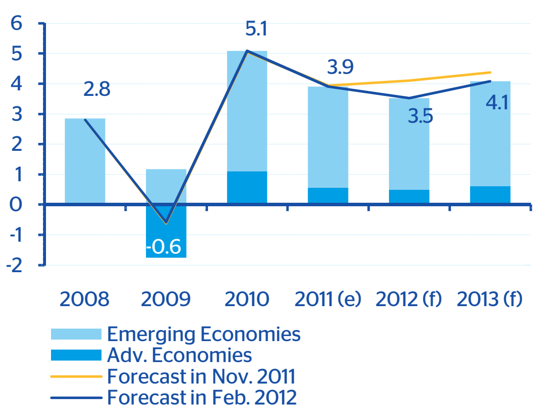
Going forward, we expect decisive action by European authorities that will slowly lower financial tensions in Europe and also global risk aversion, conditioning a global rebound in the second half of 2012. The biggest contribution to that rebound will nonetheless come from emerging economies, as their growth rates recover their historical differential of around 4 percentage points relative to those of developed countries and their policies turn more and more into growth-supportive mode. At the same time, even though the US will grow less than in previous recoveries, it will decouple from the recession in Europe in the first half of the year. Thus, we are revising down our forecasts for global growth by 0,6pp in 2012 and 0,3pp in 2013, to 3,5% and 4,1%, respectively (Chart 2).

Chart 1
BBVA Financial Stress Index



Source: BBVA Research

Chart 2
Global GDP growth (%yoy)



Source: BBVA Research and IMF

The lack of decisive advances in the resolution of the European crisis makes the euro area still the main risk to the global outlook

Even with the downward revision of growth rates in Europe and emerging countries, we still see risks to the global growth outlook tilted markedly to the downside. These risks continue to hinge on the evolution of the sovereign-financial crisis in Europe, which continues unabated and can potentially deepen the recession there and spill to other regions through trade links, financial exposures and an increase in risk aversion.

Although there have been some advances since October –mainly the provision of long-term liquidity by the ECB and some agreement towards more fiscal discipline– there needs to be more decisive action on the three main lines of action to solve the crisis in Europe. First, on the sovereign debt front, concerns about the solvency of Greece need to be cleared by finishing the deal with private sector bondholders. At the same time, sizable and credible sovereign firewalls must be erected to avoid contagion to illiquid countries. Second, macroeconomic reforms should continue to be pushed forward to increase growth, including those aimed at repairing financial institutions' balance sheets but taking care to avoid a sudden deleverage and a reduction in credit to the private sector. Finally, further advances in euro area governance are necessary to reinforce the monetary union, making it easier to implement sovereign firewalls establishing a clear roadmap to a fiscal union.

In line to these three points, European prospects would be greatly helped if the agreed fiscal compact is finally approved at the national level and rapidly implemented after the March EU summit, together with economic reforms proposed for peripheral countries to reduce their vulnerabilities and increase long-term growth. Rapid implementation of that side of the implicit "grand bargain" between core and peripheral Europe will allow the discussion to pivot to two urgent measures to reduce sovereign stress in Europe. First, rapidly increase the resources available to erect a sovereign firewall around Greece, perhaps with a more decisive action by the ECB; second, take into account the negative effect of a weaker cycle on the ability to meet the agreed deficit targets in most European countries.

Sustained financial tensions have pushed Europe into recession. The growth gap with the US will widen in the next two years

Financial tensions in Europe continue at levels higher than after the fall of Lehman Brothers in 2008 (Chart 1). This, together with the effect of fiscal adjustment in peripheral countries, imply a downward revision of our growth projections for Europe, and we are now expecting negative growth at least in the first half of 2012, and -0.5% for the year as a whole, with a slow rebound in 2013. Nonetheless, it is important to note that these projections depend on a fast resolution of the crisis and a notable reduction of financial stress, to avoid a sharper effect on growth. The different performance between the core and the periphery in Europe will continue to be large, partly because of the large fiscal adjustment in the latter.

Contrary to Europe, the US will show resilience in 2012, as in the second half of 2011. Our forecast remains unchanged from 3 months ago, at 2.3% in 2012 and 2.2% in 2013. However, this recovery is weaker than post-recession cycles, and is surrounded by the risks emanating from Europe and the domestic risk of high policy uncertainty, including a possible massive fiscal tightening in 2013 (as tax cuts expire and automatic spending cuts related to the debt ceiling limit agreement are implemented automatically). In addition, weak housing conditions, tight credit markets and ongoing deleverage will limit the pace of consumption growth. All in all, we see more risks to the downside than to the upside in the US.

Emerging economies are heading for a soft landing, buttressed by strong domestic demand. Policies will become more growth-supportive going forward

One important aspect of the current crisis is that confidence has remained resilient in emerging economies, as opposed to the aftermath of the fall of Lehman Brothers in 2008. One possible determinant of this resilience is the surprising nature of the Lehman fall (mostly absent in the European crisis) and the different speed at which each one develop (the European crisis advancing in "slow motion"). This has allowed domestic demand in emerging economies to hold up well, even as some of the effects of increased global risk aversion are felt in financial markets in the region, through lower capital inflows, some impact on trade finance, reduced asset prices and lower exchange rates.

The slowdown in emerging economies during 2011 meant that their growth gap relative to advanced economies was close to 3 percentage points at the end of 2011, below the historical 4 percentage points seen since the beginning of the 2000's. We expect global risk aversion to remain high, but ease slowly in the second half of 2012, in line with the expected gradual reduction of tensions in Europe. In addition, economic policies will take advantage of existing buffers (including lower inflationary pressures and some fiscal space) and turn more and more into growth-supporting mode, in contrast with the tightening experienced in the first part of 2011. This will allow domestic demand to continue supporting growth in the region, in the face of external headwinds coming from developed countries. In this context, emerging economies are expected to recover growth rates close to 2% quarter-on-quarter at the end of 2012 (from 1% at end-2011), and grow 6.2% for the year as a whole. The main exception to this good performance will be concentrated on emerging countries in Europe, as they will be more affected by closer trade and financial links to the euro area.

2. Peru: 5% growth, with more supportive public expenditure

Although the pace of economic activity began to moderate in the middle of last year, the available indicators for the fourth quarter suggest that it is beginning to stabilize. One sign of this is that public capital spending grew by nearly 30% in December, in contrast with the negative rates for much of 2011. This recovery is the first reflection of the measures announced by the government to promote public investment. Another sign is that although business confidence has not recovered its levels of the first half of 2011, it has remained in the optimistic range over recent months. This suggests that the slowdown in private investment will not last for much longer. In this context, we expect economic activity to bottom out at the start of the year, and that from then on the boost provided by public expenditure will combine with the more moderate support from private and foreign demand.

Table 1
Large public investment projects: spending in 2012 (PEN million)

Highway concessions (including IIRSA Sur)	2029
Construction, rehabilitation and improvement to roads and railroads	1824
Schools	1300
Electric train – second phase (Cercado – San Juan de Lurigancho)	1266
Hospitals (including Cusco, Villa el Salvador, Vitarte, Tingo María)	837
Majes Siguas irrigation project – second phase	154

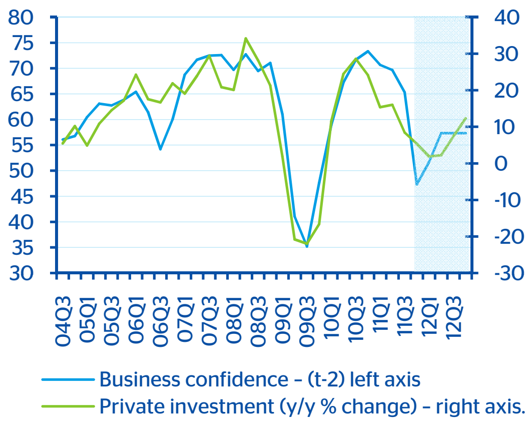
Source: MEF

Fragile conditions abroad will moderate expansion in exports and private expenditure in 2012

The weakness of global economic activity will have a negative effect on the tradable sector of the Peruvian economy through two channels: first, lower foreign demand will reduce the volumes of manufacturing exports such as textiles, footwear and agro-industrial products; second, lower prices of base metals (copper and zinc) will have a negative impact on their sales abroad. However, mineral exports will recover in volume terms (determined by the supply side) due to the extension of the Antamina copper and zinc mine (run by the companies BHP Billiton and Xstrata, where production will be up by 38%) and the gold mines of Tantahuatay, La Arena, Pucamarca and Breapampa. This will provide some support to exports, though it will not prevent them from growing at a slower pace than in 2011.

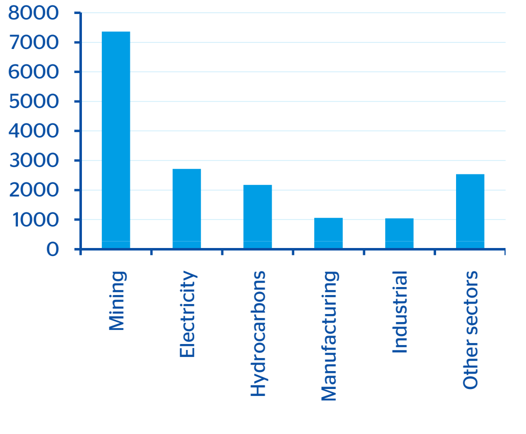
Private-sector investment will also slow in an environment where the noise linked to financial tension abroad is affecting business confidence. Moreover, local factors such as environmental conflicts and proposals that would make the labor market more rigid are not helping investor expectations to improve (see Chart 3).

Chart 3
Business confidence and private investment (index, y/y % change)



Source: BCRP and BBVA Research Peru

Chart 4
Private investment in 2012 (USD million)



Source: BCRP

CIt is important to note that the index of business confidence shows a strong correlation with future movements in investment (the index anticipates spending decisions by business by two quarters). The current level of this index is consistent with a growth rate of investment of around 6.0% for the year, which is below the figure of around 11% that will be recorded for 2011. This forecast includes the support from those projects that are already underway, mainly linked to mining activity. For example, more than USD 7 billion of investment in mining is expected in 2012 (see Chart 4), sustained by the extension of copper projects such as Cerro Verde, Toquepala and Antamina, and iron projects such as Marcona. In addition to these, other projects will be terminated this year or next, such as Antapaccay and Toromocho (both copper), La Arena (copper and gold) and Tantahuatay (gold and copper). There are also major projects underway in other sectors: construction of the petrochemical complex in Marcona by CF Industries (industry); the fiber-optic cabling in the Andes by Telefónica Peru (infrastructure); and the construction of the hydroelectric power station in Chaglla (electricity). These three projects involve investment of USD 5 billion dollars in total.

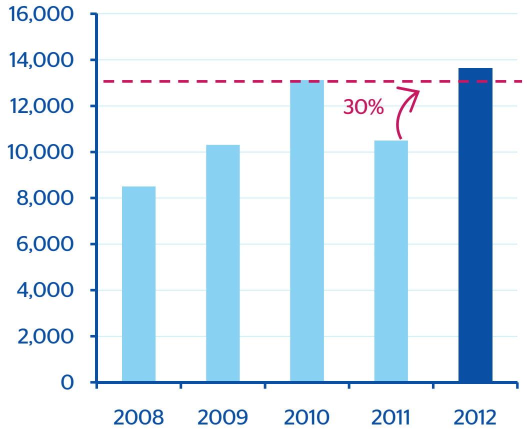
Investment will be lower than we expected this year. This will slow job creation starting in the second half of the year, and thus have an impact on private-sector consumption expenditure, which we estimate will grow at 5.1% in 2012

The major increase in public expenditure will ease the slowdown in output

Increased public expenditure will mainly reflect the expansion of government investment, which we expect to recover in real terms to levels similar to those of 2010 (see Chart 5). Thus public investment will grow by 30% this year, boosted by the measures announced by the Ministry of the Economy, which help implement spending by local government and transfer additional funds for the execution of infrastructure projects (DU No. 054-2011).

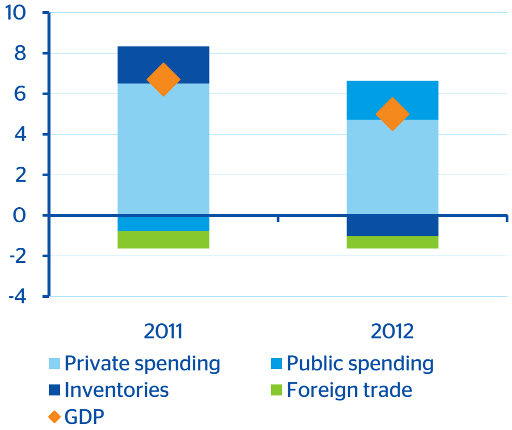
Public consumption is also expected to speed up slightly this year due to the stimulus measures that have been implemented by the government since the last quarter of last year (DU 058-2011). These measures include government purchases of clothes and footwear from SMEs, which will also have an impact on employment, given that they are labor-intensive activities. We estimate that total public expenditure (consumption and investment) will contribute around 2 percentage points to growth this year (see Chart 6). Our growth forecast is therefore conditioned on a significant improvement in the execution of expenditure by local government.

Chart 5
Public investment (real, PEN million)



Source: BCRP and BBVA Research Peru

Chart 6
GDP: contribution to growth (percentage points)



Source: BBVA Research Peru

On the supply side, we expect a stronger construction sector

Increased government investment will have a positive effect on the construction sector, which we expect to grow this year by around 8%. The sector will also continue to be supported by major mining and hydroelectric projects and the strength of the real-estate sector. According to CAPECO estimates, potential demand for housing currently stands at 370,000 households who have stable income, save 30% of them and are interested in buying a home. This potential demand is nearly 17 times the figure for homes sold in 2011, which was around 22,000. Another sector that will recover will be mining. After seeing output decline over the last three years, we expect the sector to post record growth of around 5% in 2012 due to the entry into service of the extension of the Antamina copper and zinc mine and the gold mines of Tantahuatay, La Arena, Pucamarca and Breapampa. Manufacturing will be the sector hardest hit by the slowdown in private capital expenditure, so we expect a growth of 3.8% for this sector, below the figure of 5.6% recorded in 2011.

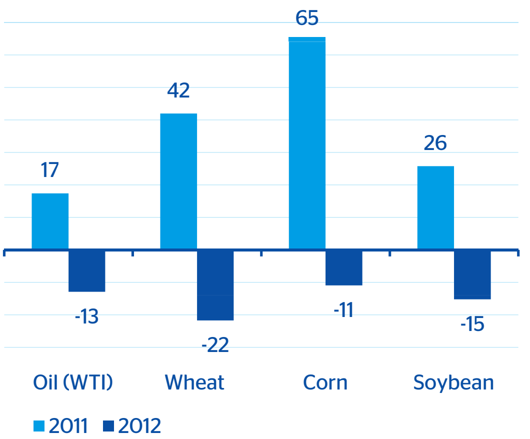
Higher economic growth in the upcoming years calls for measures to boost competitiveness

In the coming years, we expect the economy to converge to an annual growth rate of 5.5%, mainly supported by growth in capital stock resulting from the recovery in the levels of private-sector investment and continued public expenditure in infrastructure. Any additional growth requires the country to increase its productivity and competitiveness. According to the diagnosis issued by the World Economic Forum, in the case of Peru this boost to long-term productivity requires cutting the infrastructure gap, upgrading the quality of education, improving the institutional environment, and fostering an innovative approach in the productive sector.

3. We expect a significant downward correction for inflation

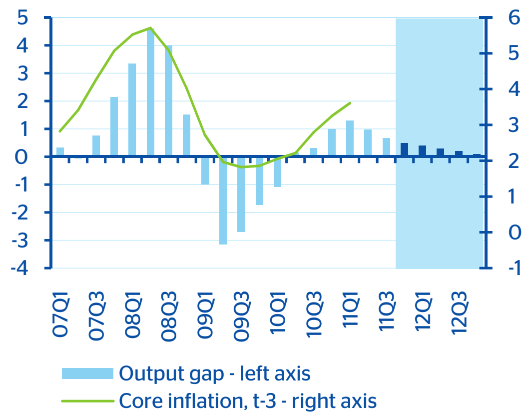
Following the deterioration in the inflation outlook last year (inflation increased from around 2% to 4.7%), we expect the rate of price increases to return to within the Central Bank's target at around 2.3% at the close of 2012. Three factors support this view. First, the rise in food prices resulting from local supply shocks, which had a significant effect on inflation in the second half of last year, will tend to be reversed as weather conditions return to normal. This has already begun to be seen at the start of the year. Second, the average international prices of basic foodstuffs and oil will fall in 2012 as the global economic environment weakens (see Chart 7). Finally, the weak economic activity will gradually close the current positive output gap, so demand pressures will be reduced (see Chart 8).

Chart 7
International commodity prices (% change)



Source: Bloomberg and BBVA Research

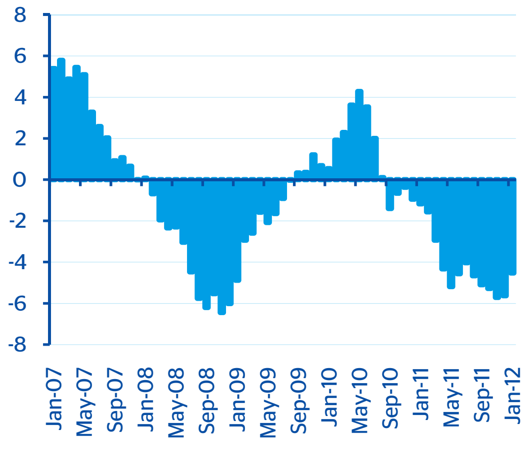
Chart 8
Output gap and Core inflation
(pp of potential GDP; yoy % change)



Source: BCRP and BBVA Research Peru

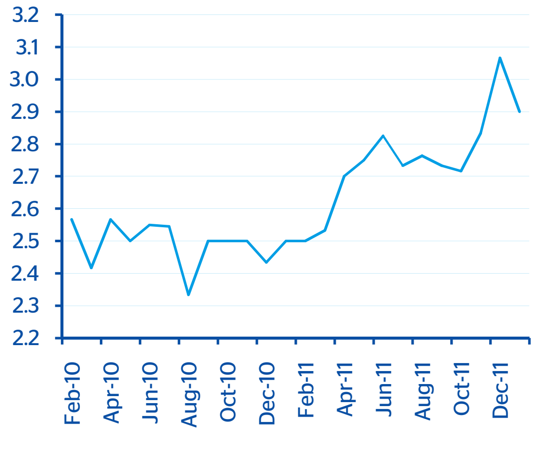
However, the convergence of inflation to within the Central Bank's target range will be gradual and not complete until the start of the second half of 2012. This is due to a number of reasons: first, the profit margins of retailers fell last year as the increases in wholesale prices they were faced with were not passed on entirely to the end consumer (see Chart 9). This could be corrected in 2012 and thus add some inertia to the inflation rate. More inertia will be provided by the high level of inflationary expectations in recent months (see Chart 10). Finally, it is interesting to note that the core component of inflation lags behind the output gap. This suggests that the slowdown in activity in the second half of 2011 and the start of 2012 will be more clearly reflected in prices in the second half of this year.

Chart 9
Retail margins on agricultural products* (%)



* Retail prices of agricultural products over wholesale agricultural prices
Source: BCRP and BBVA Research Peru

Chart 10
Inflation expectations for 2012 (%)



Source: BCRP

4. For how much longer will the monetary pause last?

Since September last year, the increasing uncertainty about how the crisis in Europe will be resolved and the risk of contagion to the rest of the world led the Central Bank to announce that it was ready to make monetary conditions more flexible if local economic activity was affected. This put a downward bias on the monetary policy rate. So far, however, it has been maintained at 4.25%. The inflation outlook and a positive output gap, which is only being closed gradually, has limited room for a cut.

The inflation outlook gives the Central Bank little room to cut rates in the short term...

On the side of prices, the Central Bank will have little room to reduce the monetary policy rate over the coming months. Although inflation has begun to ease, it will still remain above the target range in the first half of the year. This means it will have been outside the target for more than a year, and will only converge with it slowly. In addition, inflationary expectations have reached high levels. Cutting the rate in these conditions, particularly if there is no major deterioration in foreign conditions, could exacerbate inflationary expectations and make it more difficult to moderate the rate of price increases.

... and we do not expect the additional slowdown in economic activity to be neither intense nor prolonged, reining in the need to cut the policy rate...

Another element that supports our forecast that the monetary policy rate will remain at 4.25% over the coming months is the pace of economic growth we expect for the coming quarters. In our base scenario, global financial tensions will continue high, but will not increase. At the same time, the United States will continue its steady recovery and China will have a soft landing. In other words, the foreign outlook will be difficult in 2012, but not more than what it currently is. At the local level, the strength in public expenditure is expected to increase substantially on the figure for last year, above all starting in the second quarter. As a result, the slowdown in the Peruvian economy may possibly continue at the start of the year, but it will not be very marked or prolonged.

It is also important to point out that the current policy rate level has already provides support to economic activity. The pause in interest-rate adjustments in the second half of last year and the parallel increase in inflation and inflationary expectations has led the reference rate to fall in real terms to 1.4%. This level is below our estimate for the natural rate of interest, which is closer to 3%.

A rate cut does not therefore appear essential at present from the point of view of economic activity, and still less so considering the time it takes for it to be transmitted on to the real sector of the economy. The inflation outlook even suggests that a reduction in the policy rate in the short term could be somewhat hasty. We believe that the Central Bank will take these factors into account, and although it will remain watchful of developments in economic activity and the room given by prices, it will not modify its monetary policy position in the upcoming months. Further into the future, in the second half of the year, inflation will continue to converge steadily towards the center of the Central Bank's target, and output towards its potential level. This is coherent with a reference rate level similar to the one we have now (in real terms it will tend to its natural level).

But the bias in our forecast is downward: if conditions become more adverse, the Central Bank will prioritize support for economic activity

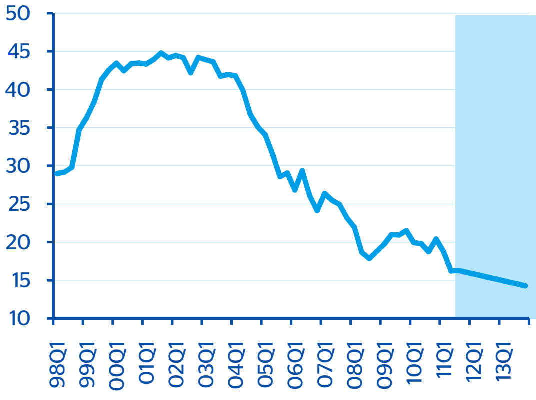
Finally, it is important to recall that the bias in our forecasts of global activity is downward. In other words, if there is any deviation with respect to what we include in our base scenario, it is more likely to occur due to lower global growth. This naturally puts a bias in the same direction to output at local level and thus to our forecast for the policy rate. Thus, if the slowdown in the Peruvian economy is sharper or more prolonged than expected, we think that the Central Bank will ease monetary conditions, even if the room to do so in inflationary terms is still limited, and thus give additional support to aggregate expenditure.

5. The PEN will continue to gain this year

In the short term, there will be continued pressure on the PEN/USD exchange rate (appreciation), due to the fact that at least temporarily, the environment of global risk aversion is somewhat more benign. In the future, the fundamentals of this variable support the trend for a stronger PEN: first, our estimates of the productivity differential with the U.S. are favorable to the Peruvian economy; second, net long-term foreign liabilities as a percentage of GDP show a falling trend in our forecasts (see Chart 11), which makes it less necessary to generate a surplus in the balance of payments current account in the future. In addition to these two factors, we estimate that the sustainable level of the current account (which in the long term stabilizes net foreign liabilities at around their average level for the last years) is lower than its structural level (which corrects the price deviations of base metals exported by Peru and of GDP growth with respect to long-term trends). This suggests that the economy could absorb a greater appreciation of the PEN (see Chart 12). Finally, our estimates for the equilibrium exchange rate show that the PEN will be undervalued by approximately 7.0%.

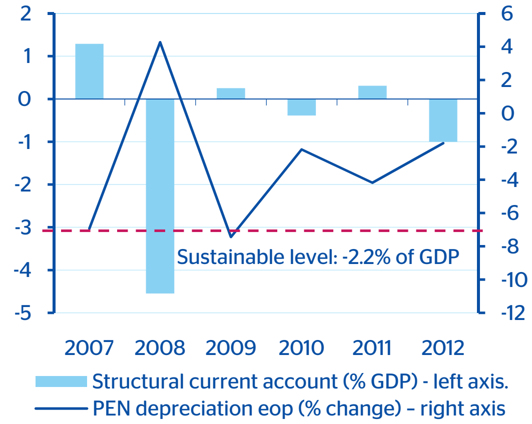
Based on this, and assuming there will be no greater deterioration in financial tensions in Europe, we expect the PEN to continue to appreciate. However, we believe that this trend in the exchange rate will be gradual, as the Central Bank will remain active in the foreign-exchange markets to moderate the rate of appreciation, as it has usually done. As a result, international reserves will continue to increase.

Chart 11
Long-term net foreign liabilities (% GDP)



Source: BCRP and BBVA Research Peru

Chart 12
Structural current account and PEN depreciation



Source: BCRP and BBVA Research Peru

6. Credit growth will moderate somewhat in 2012

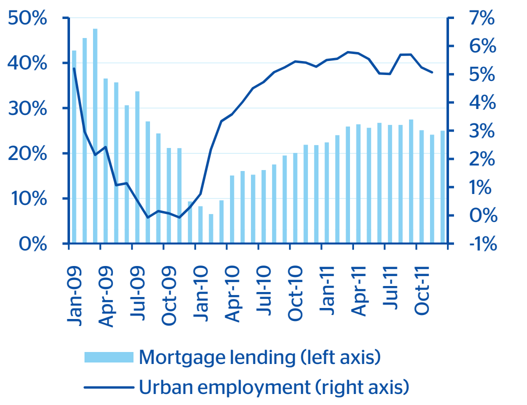
In line with slowing output growth, we expect an expansion in bank lending of close to 14%, under the figure for 2011 (17.5%). However, some finance products such as mortgage loans and consumer finance will maintain growth rates of over 20%. This reflects the significant increase in average income for workers (in the Metropolitan Lima area there was a real increase of 5.4% last year), which has increased household demand for homes and durable goods (unit sales of family cars increased by 26% in 2011).

In fact, the strength of these banking products has led the Central Bank to suggest a package of measures designed to moderate their increase, and in particular that of home purchase. The suggested measures are as follows: (i) an increase in the capital levels required for banks through a procyclical component, or request for a greater capital reserve for credits with a higher loan to value ratio (LTV); (ii) application of procyclical provisions linked to both GDP and house prices; and (iii) establishment of a limit of 80% to the LTV ratio and 50% to the household debt burden.

Our assessment is that these proposals are not consistent with the current situation of credit and the real-estate market. The growth in mortgage lending over the past year has been closely linked to demand factors, such as 5.4% increase in employment in companies with more than 10 workers (see Chart 13), higher wages, and a greater capacity for household saving. In addition, most of these loans are for first homes, which are associated with a lower probability of default.

Apart from this, if the concern is for the increase in house prices, it should be remembered that real-estate market indicators are not registering extreme values. While GDP per inhabitant increased 56% in real terms between 1998 and 2011, the real value per square meter in the most popular districts of the capital increased by 34%. At the same time, the ratio of the price over the value of the home (14.6 for Lima) is in the lower band of the “normal” range (12.5-25) and the affordability ratio (the price of a 100m2 home over per capita GDP) is at a level of 19, similar to that in Mexico, and below the figure for Argentina, Ecuador and Brazil (see Chart 14).

Chart 13
Employment and mortgage lending (yoy % change)



Source: MINTRA and SBS

Chart 14
House prices and Affordability ratio (USD, %)

	2010	
	Sale price per m2	**Affordability ratio**
United Kingdom		
United States	13428	28
Argentina	2625	25
Brazil	2616	20
Mexico	2024	19
Chile	1875	13
Colombia	1624	23
Peru	1063	19
Ecuador	981	23

Source: Global Property Guide, BCRP

7. Europe continues to be the main risk factor

A marked deterioration in the European crisis would have significant effects on the Peruvian economy...

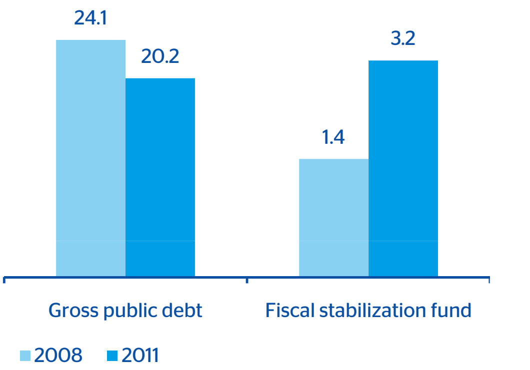
A possible trigger to a more difficult scenario in Europe would be if one of the countries with a high level of government debt and with a high fiscal deficit declared a moratorium on repayments of its sovereign debt, or if a large financial institution collapsed. In this scenario, financial and liquidity tensions would increase significantly, and this would generate a severe credit squeeze. The real economy in the euro zone would be affected significantly and the negative effects would spread to the rest of the world. Global risk aversion would increase substantially.

In this risk scenario, the Peruvian economy would be affected through a number of channels. First, 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). Commodity prices and foreign demand would then both fall. Finally, business and consumer confidence would be reduced. Private investment would be the component of expenditure most affected, as we already saw in the crisis of 2008-2009.

But Peru is in a better position today than in 2008 to apply stimulus measures

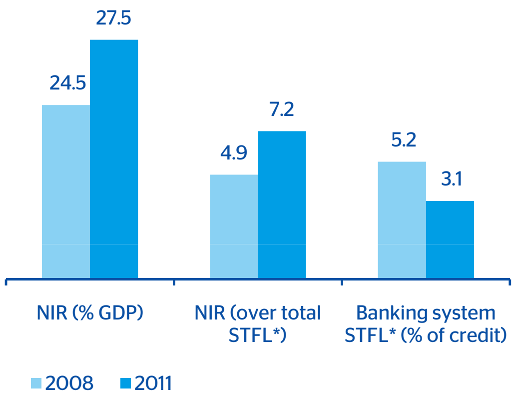
On the fiscal side, for example, the amount the government has in the Fiscal Stabilization Fund is equivalent to just over 3 percentage points of GDP, while in 2008 the figure was less than half that (see Chart 15). In addition to this there are the funds from the fiscal surplus of 2011, which was close to 2% of GDP. This reduces the need to go to the financial markets to obtain funds, which is increasingly important in an environment of high risk aversion and demand for liquidity.

Chart 15
Fiscal vulnerability indicators (% GDP)



Source: BCRP and BBVA Research Peru

Chart 16
External vulnerability indicators



* STFL: short-term foreign liabilities
Source: BCRP and BBVA Research Peru

An additional factor assisting the stimulus on the fiscal side is the experience learned from the 2008-2009 crisis on how to channel it in the best way. In particular, it is now understood that public investment can face difficulties in execution due to management problems and increased bureaucratic requirements. In contrast, public consumption proved more effective. An appropriate stimulus must therefore now provide a better balance between public consumption and public investment.

On the monetary policy side, there is room to limit the risk of a cut in the chain of credit, moderate a sudden depreciation in the local currency and stimulate private expenditure. In the case of credit, the Central Bank has a set of instruments that help inject liquid funds into the banking system when required. Currently the banking system holds more than PEN 17 billion in securities issued by the Central Bank or in time deposits in the Bank. This amount is equivalent to more than USD 6 billion, or around 12% of outstanding lending. These securities could be used for repo transactions with the Central Bank. An alternative would be foreign-currency swap transactions. There could even be a reduction in the banks' PEN reserve requirement. In addition, if the banks had problems in renewing their short-term foreign debt (USD 1.7 billion), the currently high rates of foreign-currency reserve requirements could be cut (the average foreign-currency reserve requirement rate is around 38% of foreign-currency deposits and debt).

In this risk scenario, the Central Bank would also try to avoid a sudden fall in the value of the local currency to moderate the negative impacts this would involve for an economy in which 45% of lending to the private sector is in foreign currency. To deal with this, it can make use of its net international reserves of more than USD 50 billion (28% of GDP) and issue foreign-exchange linked bonds, as has been seen in previous periods of volatility.

Finally, there is room to cut the interest rate (currently at 4.25%) and support private expenditure. Although the inflationary outlook is not now the most appropriate for this measure, in a difficult scenario inflation would tend to steepen its downward curve, so the Central Bank could prioritize economic activity at a time of external shock.

It is important to point out that any possible support provided by economic policies should be dispensed carefully. The most developed economies will grow for some years at a slow, irregular pace. They do not have any additional capacity to implement significant stimulus measures (as happened in 2008-2009, which also provided a boost to emerging economies). Thus the size of the support offered in the short term will have to be assessed carefully.

To sum up, although a more severe deterioration of the foreign situation would have impacts on local activity, the Peruvian economy has strengths capable of mitigating them. In this scenario, Peru could grow at around 3% in 2012 and then begin a steady recovery. Of course, the public and foreign balances would be weakened, but this would be manageable. The public balances would be affected by lower revenues linked to cuts in metal prices and slowing activity; while expenditure would be higher due to the increased debt service payments and attempts to support growth. In a complicated scenario such as this, reduced tax revenues and stimulus measures (we estimate these will cost 0.8 percentage points of GDP as an annual average between 2012 and 2014) would lead to fiscal deficits of not more than 1.5% of GDP. Even so, the public debt would only hit 24% of GDP, so there would not be a notable deterioration in the public finances. In the external balances the deterioration over the coming years would be the result of a less favorable environment for export prices, a reduction of foreign demand and lower revenues from remittances. However, this would be mitigated by the lower rate of expansion of domestic demand, as already seen in 2009. The balance of payments current-account deficit could at the most critical level reach a figure of around 4% of GDP.

8. Tables

Table 2
Annual macroeconomic forecasts

	2010	2011	2012	2013
GDP (y/y % change)	8.8	6.7	5.0	5.3
Inflation (y/y % change, eop)	2.1	4.7	2.3	2.3
Exchange rate (against USD, eop)	2.82	2.70	2.65	2.60
Monetary policy interest rate (%, eop)	3.00	4.25	4.25	5.00
Private consumption (y/y % change)	6.0	6.2	5.1	4.8
Public consumption (y/y % change)	10.6	5.0	5.5	4.5
Investment (y/y % change)	22.1	4.1	10.1	6.8
Fiscal balance (% GDP)	-0.5	2.0	1.2	1.0
Current account (% GDP)	-1.5	-1.5	-2.7	-3.1

Source: BBVA Research Peru

Table 3
Quarterly macroeconomic forecasts

	GDP (yoy % change)	Inflation (yoy % change, eop)	Exchange rate (vs. USD, eop)	Monetary policy rate (%, eop)
1Q10	6,2	0,8	2,84	1,25
2Q10	10.0	1.6	2.84	1.75
3Q10	9.6	2.4	2.79	3.00
4Q10	9.2	2.1	2.82	3.00
1Q11	8.9	2.7	2.78	3.75
2Q11	6.8	2.9	2.76	4.25
3Q11	6.6	3.7	2.75	4.25
4Q11	4.8	4.7	2.70	4.25
1Q12	4.3	4.2	2.70	4.25
2Q12	4.7	3.9	2.67	4.25
3Q12	5.0	2.9	2.66	4.25
4Q12	5.9	2.3	2.65	4.25
1Q13	5.3	2.1	2.64	4.25
2Q13	5.3	2.2	2.62	4.50
3Q13	5.3	2.2	2.61	4.75
4Q13	5.3	2.3	2.60	5.00

Source: BBVA Research Peru

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