Peru

Peru's economic growth has accelerated in 2018, reaching 3.9%, compared to 2.5% in 2017, thanks to a recovery in domestic demand, which picked up after overcoming the impacts felt in 2017 as a result of the El Niño phenomenon and corruption cases related to some investment projects. Stronger private consumption and investment underpinned that higher growth. Private consumption was boosted by the sharper uptick in wages and domestic credit. Private investment grew thanks to new mining projects. Following the volatility seen in emerging markets, the public sector prioritized fiscal consolidation at the expense of a few basis points of growth. The country's financial position is sound and the level of public debt is among the lowest in the region. The current account deficit is low and the central bank still has a high stock of international reserves to mitigate the effect of temporary shocks. Inflation is under control within the target range.

After the deterioration in international financing conditions and volatility in emerging countries, President Vizcarra's government prioritized fiscal consolidation and the deficit of the non-financial public sector decreased more than expected, from 3.1% of GDP in December 2017 to 2.2% in October 2018, thanks to a smaller increase in spending than in revenues.

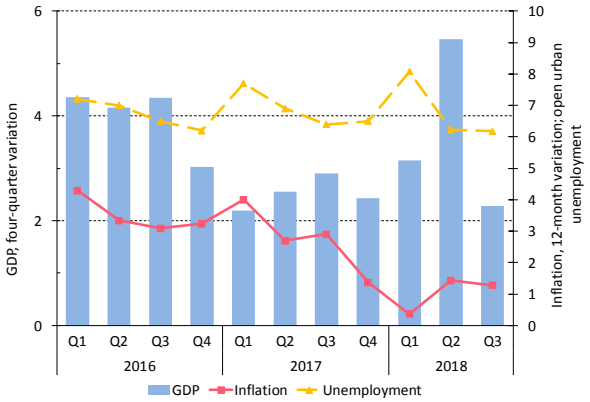
The central bank estimates that revenues rose from 18.1% of GDP in 2017 to 19.1% in 2018, thanks to higher income tax (up 0.3 percentage points) and value added tax (up 0.4 percentage points) receipts, in line with higher metal prices and the economic recovery; the new excise duty (0.1 percentage points); and lower repayments (0.1 percentage points) as the consolidated amortization schemes of past mining investments are settled.

Non-financial expenditure has risen from 20.1% of GDP in 2017 to 20.5% in 2018, owing to higher current spending (up 0.2 percentage points) on wages and to capital for investment in infrastructure (0.2 percentage points). Interest expenditure stands at 1.3% of GDP (up 0.1 percentage point).

This fiscal performance translated into a weighted fiscal stimulus that was practically zero (0.3% of GDP), according to the central bank's calculations, and an increase in non-financial public sector debt, up from 24.9% in 2017 to 25.7% in 2018.

The central bank implemented an expansionary monetary policy, as GDP is below its potential and inflation is under control. In 2018, the bank reduced its reference rate twice (from 3.25% to 2.75%), while also taking steps to raise the monetary multiplier by lowering the legal reserve rate for dollar-denominated deposits to cushion the impact on the local economy of international rate hikes.

Peru: GDP, Inflation and Unemployment, 2016-2018



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Accordingly, commercial bank interest rates fell across the board until May, then picked

up as a result of the financial uncertainty in emerging markets, before stabilizing (going from 15.9% in January to 14.2% in November). Rates in foreign currency inched up over the course of the year, keeping pace with the increase in international rates.

The year-on-year growth rate in loans to the private sector climbed from 6.0% in January to 10.7% in October, in parallel with the economic recovery, with the highest growth in consumer credit (12% in October), followed by mortgage loans (8.8% in October) and business credit (7.6% in October).

Following the turbulence in emerging markets, the real effective exchange rate depreciated by 2.1% on the cumulative average to September compared to the same period last year. This resulted in one of the lowest depreciation rates of the countries of the region, based on good macroeconomic fundamentals and the central bank's efforts to stabilize the sol, mainly by reducing foreign currency reserves. Meanwhile, the international reserves position weakened (by September the cumulative loss was close to US$ 5.4 billion). By the end of the year, the currency depreciated a little more, following the central bank's decision to allow a greater adjustment, thus avoiding a further reduction in its international reserves position.

Peru: main economic indicators, 2016-2018

	2016	2017	2018 [a]
	Annual growth rate		
Gross domestic product	4.0	2.5	3.8
Per capita gross domestic product	2.7	1.3	2.6
Consumer prices	3.2	1.4	1.8 [b]
Real average wage [c]	4.0	-0.5	4.1
Money (M1)	4.4	8.1	14.1 [d]
Real effective exchange rate [e]	1.5	-2.9	2.1 [d]
Terms of trade	-0.7	7.3	1.9
	Annual average percentage		
Open urban unemployment rate	5.2	5.0	5.2
Central government			
Overall balance / GDP	-2.2	-2.9	-2.6
Nominal deposit rate [f]	2.6	2.7	2.3 [b]
Nominal lending rate [g]	16.5	16.8	14.6 [b]
	Millions of dollars		
Exports of goods and services	43 394	52 669	57 938
Imports of goods and services	43 415	47 532	52 838
Current account balance	-5 239	-2 414	-3 584
Capital and financial balance [h]	5 407	4 043	-1 614
Overall balance	168	1 629	-5 198

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
a/ Estimates.
b/ Figures as of October.
c/ Average income in the formal sector.
d/ Figures as of September.
e/ A negative rate indicates an appreciation of the currency in real terms. Refers to the global real effective exchange rate.
f/ Market deposit rate, average of credit operations that have a current balance to date.
g/ Market lending rate, average of credit operations that have a current balance to date.
h/ Includes errors and omissions.

The current account deficit widened from 1.1% in 2017 to 1.6% in 2018, as the improvement in the goods balance failed to offset the worsening in the services (more trips abroad, transport and construction services for major projects, etc.) and income balances (higher profits for foreign companies and higher debt interest payments).

There was a sharp rise in foreign direct investment inflows to the financial account, attracted by mining investment (55% to September 2018), which were however offset by important outflows under other budget categories (portfolio flows and other investment). The overall balance of both accounts led to a substantial reduction in reserves, which by September 2018 amounted to US$ 5.4 billion.

At the sectoral level, the economic recovery (up 3.6% during the first three quarters of the year) was the result of a general improvement in all sectors, led by manufacturing (contributing 0.6 percentage points), other services (0.5 percentage points) and agriculture (0.4 percentage points), with only the extractive industry making a negative contribution (-0.1 percentage points). In the fourth quarter, this sector is expected to recover and the fishing industry will contribute some 0.8 percentage points with the second fishing season, which affects both the fishing sector and manufacturing.

On the demand side, private consumption was the main engine of growth, contributing 2.4 percentage points, followed by exports (1.1 percentage points), the contribution of which has been reduced by lower ore grades and cuts in some mines' production, and by private investment (0.7 percentage points), which increased its contribution. The contribution of the public sector was very

modest, through public spending (0.4 percentage points) and investment (0.2 percentage points), owing to fiscal consolidation and difficulties encountered in carrying out infrastructure projects. Imports slowed (down 1.5 percentage points) but to a lesser extent than exports, which meant that the external sector as a whole hindered GDP growth.

The annual inflation rate rose from 1.4% in December 2017 to 1.8% in October 2018, and this trend is expected to continue slightly, albeit within the confines of a more moderate economic recovery than forecast, and to be slightly above 2% by the end of 2018 (the target range is 2%, with a 1% margin in either direction).

With regard to the national labour market, the average employment rate (68.9% in 2018, compared to 69.0% in 2017) and unemployment rate (4.5% in both periods) remained stable in the first three quarters of the year. Formal employment rose by 3.7% and the average formal employment wage increased by 3.9% in real terms.

In 2019, growth is expected to continue at 3.6%, underpinned by the consolidation of private consumption and mining investment (large and medium-sized investment projects such as Quellaveco, the expansion of Mina Justa and Toromocho, among others, have already been confirmed). The public sector is expected to continue to follow the path of fiscal consolidation, with public investment suffering amid the assumption of newly elected subnational governments. The external sector will contribute to growth again as mining production recovers, as expansions are carried out and as work gradually begins on new projects.