

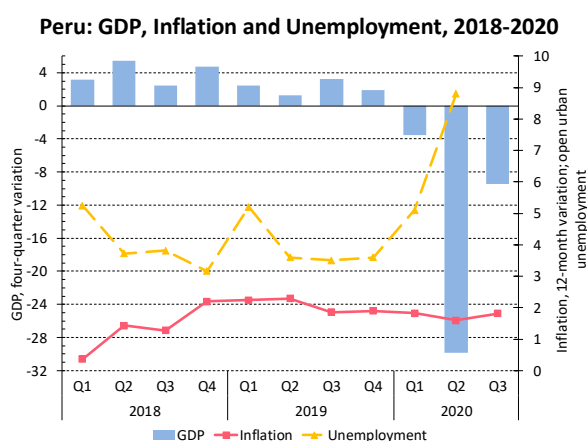
## Peru

In 2020, the Peruvian economy is expected to contract by 12.9% (following a 2.2% expansion in 2019), owing to the recession induced by the coronavirus disease (COVID-19) pandemic, in which Peru has been one of the hardest-hit countries in the world. The GDP reduction among Peru's trading partners severely weakened external demand; and domestic demand plummeted in the wake of reduced household spending and the interruption of investment projects. Compounding the contraction in aggregate demand, the economy suffered a major supply shock caused by the shutdown of production resulting from the strict lockdown, which lasted for several months. Attempts were made to cushion the fall in domestic demand and keep the financial markets and payment system functioning, by deploying unprecedented expansionary fiscal and monetary packages. In May, a phased reopening of activities began; but by September, the recovery was already showing signs of weakening without having regained pre-crisis levels. In November, the situation was complicated further by uncertainty generated by the domestic political crisis. The economic contraction produced massive job losses and eroded the public finances. The domestic currency (sol) depreciated, affected by uncertainty and the fall in the interest rate. The current account deficit narrowed, so, despite reduced foreign investment inflows and other capital outflows, large public debt issues made it possible to accumulate international reserves, thanks to central bank interventions. Inflation, on the other hand, remained within the target range (around 2.1 percent), despite the depreciation of the sol during the year.

The economic contraction severely eroded tax revenue in the non-financial public sector, which fell by 17.2% in nominal terms in the first 11 months of the year. Meanwhile, non-financial expenditure rose by 10.3%. Current spending increased on transfers to households (two universal bonuses were paid during the year), support for businesses, and measures to address the pandemic. In contrast, capital expenditures declined since public works were at a standstill for several months. Overall, the non-financial public sector deficit surged to 7.7% of GDP in the 12 months to November 2020 (compared to the year-earlier 1.6%); and at the end of 2020 the public debt is set to be close to 35% of GDP (up from 26.8% in 2019). This increase corresponds largely to external debt associated with international loans from the World Bank and the purchase of sovereign bonds by non-residents.

Monetary policy focused on cushioning the fall in aggregate demand and ensuring the liquidity of the payment system through expansionary measures. These involved both conventional instruments—the lowering of the benchmark interest rate (on two occasions, March and April) from 2.25% to an unprecedented low of 0.25%, and the easing of bank reserve requirements—as well as unconventional ones—the provision of liquidity to the financial system by expanding and easing conditions on repurchase operations (repos), and a programme to guarantee the financial system's credit portfolio.

These measures, made possible by the historic increase in global liquidity facilitated by



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

the main developed-country central banks, contributed to the fact that the average interest rate in national currency fell from 18.8% in March to 13.2% in early November, thereby making borrowing cheaper. In line with this decline, the year-on-year rate of credit expansion accelerated from 7.2% in January to 13.1% in October (supported by the “Reactiva Perú” State guarantee program, which seeks to underpin business liquidity), although behaviour by segment varied. Credit to firms picked up sharply (although it was used partly to pay suppliers, workers and other debts). In contrast, mortgage lending started to falter and consumer credit began to contract, hit by the sharp deterioration in the labour market and the drop in household incomes.

The central bank increased its interventions on the foreign exchange markets to limit the depreciation of the nominal exchange rate (the sol depreciated from 3.2 to 3.6 soles per dollar between January and November, but was less volatile than the region’s currencies generally), with the aim of maintaining price stability and preventing currency mismatches. In terms of macroprudential policies to reduce systemic risk, in addition to accumulating reserves, the central bank requested a flexible credit line from the International Monetary Fund (IMF) of US\$ 11 billion on a precautionary basis. It also participated in the United States Federal Reserve dollar liquidity provision programme in exchange for Treasury bonds, and it signed an agreement to access a collateralized credit line of US\$ 2 billion with the Bank for International Settlements (BIS).

On the external front, the current account deficit narrowed to 0.1% in the first nine months of 2020 from 2.1% in the year-earlier period, owing to a sharp reduction in the income-account deficit. This reflected the reduced profits of foreign investment firms following the suspension of their production during the second quarter of the year. In contrast, the deficit in services trade widened, owing to the poor performance of the tourism sector, following border closures. In the first nine months of the year, the value of exports fell by 19.8% (-18.4% in volume terms), somewhat less than the drop in imports, which were down by 20.6% in value (-16.2% in volume). In the same period, the terms of trade improved by 3.2%, as import prices fell by more than those of exports (-5.6% compared to -2.5%, respectively).

In the first half of 2020, the financial account reported a smaller net capital inflow owing to a substantial drop in inward direct investment (partly due to less reinvestment of profits because of the halt in production). Public-sector debt placements grew strongly, reflecting financing needs. The inflows for both items more than offset the outflow of the remaining non-FDI flows, caused by the risk aversion initially generated by the pandemic. Together, the flows received made it possible to finance the declining current account deficit and also accumulate US\$4.2 billion in reserves by October, which raised their level to 37% of GDP. During the first nine months of the year, the sol depreciated in nominal

#### Peru: main economic indicators, 2018-2020

	2018	2019	2020 <sup>a</sup>
	<b>Annual growth rate</b>		
Gross domestic product	4.0	2.2	-12.9
Per capita gross domestic product	2.2	0.5	-14.2
Consumer prices	2.2	1.9	1.8 <sup>b</sup>
Real average wage <sup>c</sup>	3.3	0.8	-0.1 <sup>b</sup>
Money (M1)	13.5	10.1	30.8 <sup>b</sup>
Real effective exchange rate <sup>d</sup>	1.7	-2.2	0.7 <sup>b</sup>
Terms of trade	-0.4	-1.8	3.4
	<b>Annual average percentage</b>		
Open urban unemployment rate	3.9	3.9	7.8 <sup>b</sup>
Central government			
Overall balance / GDP <sup>e</sup>	-2.0	-1.4	...
Nominal deposit rate <sup>f</sup>	2.3	2.4	1.7 <sup>b</sup>
Nominal lending rate <sup>g</sup>	14.5	14.4	13.1 <sup>b</sup>
	<b>Millions of dollars</b>		
Exports of goods and services	56 157	55 292	18 780 <sup>h</sup>
Imports of goods and services	51 720	51 792	19 853 <sup>h</sup>
Current account balance	-3 821	-3 531	-733 <sup>h</sup>
Capital and financial balance <sup>i</sup>	192	10 440	3 044 <sup>h</sup>
Overall balance	-3 629	6 909	2 311 <sup>h</sup>

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

a/ Estimates.

b/ Figures as of September.

c/ Average income in the formal sector.

d/ A negative rate indicates an appreciation of the currency in real terms. Refers to the global real effective exchange rate.

e/ General government.

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/ Cumulative figures to the second quarter of 2020.

i/ Includes errors and omissions.

terms by 4%, which increased the foreign debt burden and could have negative balance sheet effects. The real effective exchange rate depreciated by 0.7 percent on average during the same period.

At the sector level, most sectors contributed to the 14.5% overall contraction in activity in the first nine months of the year. Mining (-2.0 percentage points), manufacturing (-2.3 percentage points), commerce (-2.1 percentage points), business services (-1.2 percentage points) and other services (-1.5 percentage points) all suffered from the supply shock caused by the suspension of activities during the strict lockdown period, although by September they had managed to stage a partial recovery, without regaining their pre-crisis levels. Accommodation and restaurants (-1.8 percentage points) and transport (-1.6 percentage points) remain very depressed, whereas construction (-1.6 percentage points) managed to regain its pre-crisis level in September. In contrast, financial services made a positive contribution to GDP growth (0.5 percentage points), as did telecommunications (0.2 percentage points) and public administration (0.2 percentage points), thanks to increased demand in the wake of the pandemic.

In terms of aggregate demand, the contraction in private consumption stood out (-8.0 percentage points of contribution to GDP growth in the first half of 2020), in line with the deterioration in the level of production and income; and private investment (-5.6 points) suffered from the suspension of activities and increased uncertainty. Public investment also contracted (-1.9 points) as infrastructure works were suspended, while public consumption was the only component to make a positive contribution (+0.2 points), following the deployment of measures to mitigate the effects of the pandemic and the crisis. The deterioration of external demand led to a drop in exports (-6.5 percentage points), while the slump in domestic demand explained the collapse of imports, which partly offset the contraction of GDP (+5.1 percentage point contribution to GDP).

Despite the heavy negative impact on domestic demand, the inflation rate remained relatively stable, and the cumulative 12-month variation stood at 2.1% in November (compared to 1.9% at the end of 2019). This was in the middle of the target range of  $2\% \pm 1\%$ . The weakness of aggregate demand and the reduction in labour costs helped to curb inflation, while the rise in food prices and the exchange-rate depreciation worked in the opposite direction.

In the national labour market, the number of persons employed plummeted as a result of the lockdown and suspension of activities; and, in the third quarter of the year, employment was still 17.1% below its year-earlier level, as production remained slack. This deterioration was accompanied by a higher rate of unemployment (9.6% in the third quarter, compared to 3.6% in the last quarter of the previous year), a deterioration in working conditions (greater prevalence of precarious and informal employment) and a 5.4% reduction in the average real wage in the first nine months of 2020.

Although growth is expected to rebound strongly in 2021 (+9.0%), this will be insufficient to regain the pre-crisis levels of GDP and production. The improvement will depend on the behaviour of factors on the demand side, since the impacts of the production and export restrictions caused by the lockdowns will have dissipated by then. Private consumption and investment could surge (largely owing to the statistical effect of the low baseline). Exports would help stimulate aggregate demand, supported by the coming-on-stream of new mines (Mina Justa and the expansion of the Toromocho mine) and by favourable metal prices. However, there are also numerous downside risks, such as the evolution of the pandemic, which could undermine public investment, lower the exchange rate, increase the cost of financing and attract less foreign investment. The increase in debt would also accentuate downside risks, especially if external and domestic demand prove weaker than expected; and an increase in uncertainty in the event of a new political crisis prior to the upcoming presidential elections in April 2021, could also aggravate the situation. Last but not least, the pace and quality of the labour market recovery will be key factors, since the increase in underemployment and informality could erode worker productivity and, consequently, reduce potential GDP.