Peru

The Peruvian economy grew by 7.2% thanks mainly to the strength of domestic demand. The expansion of the world economy led to a new improvement in the terms of trade, resulting in a marked increase in the value of exports, in the trade surplus and in national income, and boosting fiscal accounts significantly. This robust economic growth had a favourable effect on the labour market, while inflation remained within the range forecast by the authorities, closing the year below 2%.

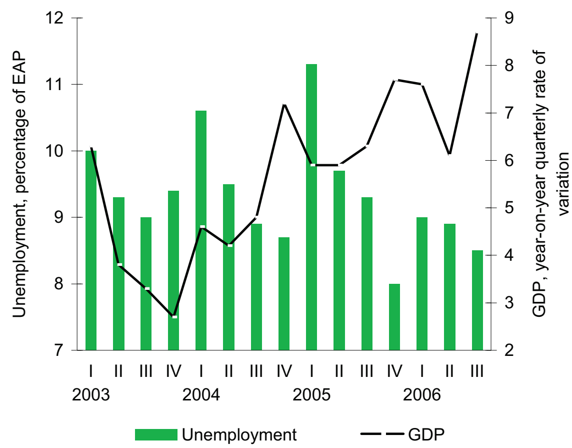
A new government took office in July after closely contested elections. The change did not result in any fundamental alteration of macroeconomic policy although the new authorities announced an increase in public investment and more vigorous anti-poverty measures.

The fiscal results for 2006 showed revenues considerably higher than predicted owing to stronger economic growth and the high prices for mining products which pushed up the tax contributions payable by companies in that sector. For the year as a whole, the authorities estimate that general government revenue will be equivalent to 19.4% of GDP, one percentage point higher than in 2005. With expenditure increasing at a similar rate to GDP growth, the general government primary surplus rose from 1.6% to 2.5% of GDP. Thus, the small non-financial public-sector (NFPS) deficit (0.3% in 2005) was replaced by a surplus (0.6%).

Although not strictly enforced, the macrofiscal rules established in the Fiscal Prudence and Transparency Act helped to contain the increase in expenditure despite the availability of windfall resources. Expenditure switching within the general government budget resulted in an increase in investment from 2.7% to 3.2% of GDP, while current expenditure declined in relative terms from 16.2% to 15.6% of GDP. The new government announced a strategy for a steady increase in capital expenditure to a target of 4.2% of GDP in 2009. The fiscal surplus, together with the nominal exchange-rate appreciation, led to a marked reduction in public debt from 37.8% to 32.8% of GDP.

The authorities are expecting revenues from natural resources to decrease in 2007; thus the NFPS primary surplus should decline to 1.3% of GDP, while the overall balance should be slightly negative, at 0.8%. This deficit would be financed on the domestic market.

Figure 1
PERU: GROSS DOMESTIC PRODUCT AND UNEMPLOYMENT



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

With the inflation target set in a range of 1.5% to 3.5%, the authorities faced a more buoyant economy than predicted and rising interest rates on international markets; in response, the benchmark interest rate was raised gradually from 3.0% in December 2005 to 4.5% in May 2006. Subsequently, with inflation within the targeted range and no signs of acceleration, the rate stabilized. Short-term lending rates followed the upward movements in the benchmark rate, but in the context of high liquidity, the rates trended downwards from June onwards and the annual average lending rate (fixed structure) declined by almost one percentage point.

Between late 2005 and the beginning of 2006, the monetary authorities bought local currency to counteract the depreciation triggered by the elections. In the second half-year, the new sol started to appreciate again. The authorities responded by purchasing foreign currency and up to the beginning of November, international reserves increased by US$ 1.7 billion. Even so, between December 2005 and October 2006, the bilateral real and real effective exchange rates declined by 3.6% and 2.1%, respectively.

Favourable economic and financial conditions, together with the improved access to the financial system for the general public, led to a 14.3% year-on-year credit expansion to October. Low inflation and exchange-rate stability helped to promote dedollarization of the financial sector and between December 2005 and October 2006, the proportion of credit in local currency increased from 33.3% to 37.6%.

In April, Peru signed a free trade agreement with the United States, which was approved by the Peruvian parliament in June, although the United States Congress has yet to ratify it. The amplification of the economic complementarity agreement with Chile was also adopted.

Economic activity was brisker, exceeding not only the projections made at the beginning of the year but also the previous year's figure. The most dynamic component of the 7.2% projected growth was gross public and private investment. Boosted by the increase in the wage bill and total credit, private consumption expanded by more than 5%, the highest percentage since 1995. Export volumes of the products that had led the economic recovery in recent years recorded only a slight increase owing to sluggish production of some minerals (copper, tin, zinc, molybdenum) and fishmeal. This is reflected in weak growth in branches of activity linked to mining, hydrocarbons and fisheries, and in the processing of raw materials. Domestic demand had a favourable effect on growth in construction, non-primary manufacturing industry, commerce and other services. While the weaker performance of the components of domestic demand will have a moderating impact on economic growth in 2007, a relatively high growth rate (6%) is once again expected.

Despite strong domestic demand, inflation remained between 1.5% and 2.5%. The factors contributing to this result were the slight exchange-rate appreciation in the second half of the year, measures taken to avoid sharp rises in fuel prices, lack of pressure from labour costs and expectations linked to monetary policy. The fact that wholesale prices rose only slightly more than the consumer price index (CPI) (2.0%, compared with 1.5% in November) would seem to indicate that there is no pressure in terms of lagged inflation. As a result, in 2007 prices are again expected to remain within the inflation target range of 1.5% to 3.5%.

Table 1
PERU: MAIN ECONOMIC INDICATORS

	2004	2005	2006[a]
	Annual growth rates		
Gross domestic product	5.2	6.4	7.2
Consumer prices	3.5	1.5	1.5[b]
Average real wage	1.1	-1.9	1.0[c]
Money (M1)	22.1	29.1	17.5[d]
Real effective exchange rate[e]	1.5	0.7	2.2[d]
Terms of trade	8.9	7.3	25.7
	Annual average percentages		
Urban unemployment rate	9.4	9.6	8.5[f]
Central government overall balance/GDP	-1.3	-0.7	0.3
Nominal deposit rate	2.4	2.7	3.4[g]
Nominal lending rate	18.7	17.9	17.2[g]
	Millions of dollars		
Exports of goods and services	14 802	19 625	25 853
Imports of goods and services	12 530	15 200	17 896
Current account	19	1 105	2 292
Capital and financial account	2 306	423	-749
Overall balance	2 325	1 528	1 543

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to November 2006.
[c] Estimate based on data for June.
[d] Year-on-year average variation, January to October.
[e] A negative rate indicates an appreciation of the currency in real terms.
[f] Estimate based on data from January to October.
[g] Average from January to November, annualized.

Formal job creation increased at a year-on-year rate of over 6%, reflecting the robust economic growth. The strength of labour demand had a favourable impact on the unemployment rate (down from 9.6% to an estimated 8.5%) and on time-related underemployment. Average labour income recorded a modest real increase of 1%.

While there was no significant increase in the volume of merchandise exports, export earnings increased by over 30% to stand at more than US$ 23 billion, thanks mainly to the higher prices of many of the natural resources exported by Peru but also to the increase in non-traditional exports. The merchandise trade surplus, which also reflected a substantial, albeit somewhat lower, increase in imports, expanded further from 6.6% to 10% of GDP. This increase was partially counterbalanced by higher payments for factor services, but the current-account surplus was greater than the 2005 figure (2.6% and 1.4% of GDP, respectively). The public-sector debt paydown policy contributed to a deficit on the financial account. The overall balance closed with a surplus of 1.8% of GDP, similar to the previous year's figure.