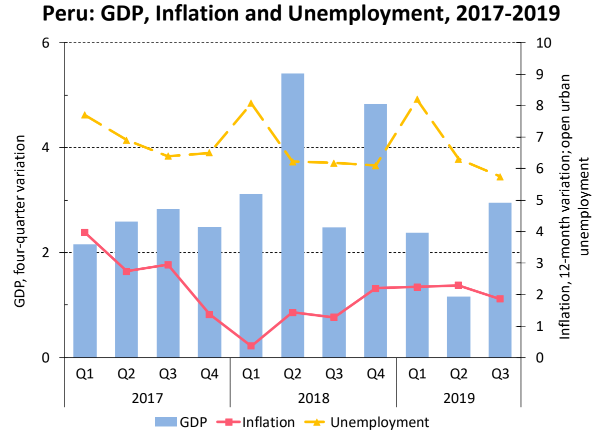
Peru

In 2019 Peru's economic growth slowed to 2.3% from the previous year's 4.0%, owing to worsening external and domestic conditions. Foreign demand for traditional exports has weakened, and prices have fallen, while transitory events have hampered primary sector production (mining, hydrocarbons and fishing). These production shocks, which have acted as a brake on activity growth, were compounded domestically by the meagre rise in public spending. Public investment has been held back by the change in subnational authorities, while current spending has been constrained by the decision to stay on the path of fiscal consolidation (in other words to reduce the deficit to 1.0% of GDP in 2021). Taken together, these events have taken steam out of the labour market, which in turn has led to a slowdown in consumption. Nonetheless, the latter has proved more resilient than production (partly thanks to consumer credit and immigration). By contrast, private investment has expanded, boosted by mining and construction (representing 13.0% of GDP). Imports have retreated in line with the activity slowdown; and this, combined with the contraction of exports, has resulted in a reduction in the merchandise trade surplus and a moderate widening of the current account deficit. Nonetheless, thanks to vigorous foreign investment flows (channelled into mining investment projects currently under construction), together with favourable international financing conditions and the country's healthy financial position (which has enabled it to issue local-currency bonds at low rates), it has been possible to finance the current account deficit and also build up reserves.

The fiscal deficit of the non-financial public sector has narrowed by more than expected, from 2.3% of GDP in 2018 to 2.0% in 2019. This is explained by the reduction in public investment and an upturn in revenue obtained as a result of tax inspection actions, tax policy measures (selective consumption tax) and higher non-tax income (due to improved results recorded by public enterprises). Revenues are forecast to increase from 19.3% of GDP in 2018 to 19.7% in 2019. Expenditure has remained stable at 20.2% of GDP in 2019, with a smaller contribution from capital spending (down by 0.2 percentage points) associated with the change of subnational governments, but higher current expenditure (+0.3 percentage points in respect of remuneration and goods and services procurement.

Against a backdrop of controlled inflation and cuts in international interest rates, the central bank has doubled down on its expansionary stance, lowering the benchmark interest rate twice, in August and November (from 2.75% to 2.25%), given the persistent negative performances of the primary sectors and public investment, which have kept GDP growth below potential.

Peru: GDP, Inflation and Unemployment, 2017-2019



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

In keeping with this, interest rates in national currency turned down in August, and dropped from 20.1% in January to 18.4% in November. At the same time, the annual growth of credit to the private sector, which had faltered in the first half of the year (from 9.1% at end-2018 to 7.7% in June 2019) in keeping with the slackening pace of activity growth, recovered some of its momentum in the second half of the year (up 8.4% in October), stimulated by the reduction in interest rates —both domestically, and internationally in July, September and October. By credit category, the growth of lending to business slowed during the year (from 7.7% in 2018 to 6.5% as of October 2019), while mortgage lending continued to expand by around 9%. By contrast, consumer credit remained the most buoyant category, with growth of 13.1% in 2018 and 13.0% in 2019, especially in the vehicle and credit card segments, thereby mitigating the slowdown in consumer demand. However, given the time horizon over which monetary policy operates, together with a recent deterioration in expectations among entrepreneurs and consumers, it remains to be seen whether the recent rate cuts will continue to energize lending, especially to businesses.

Peru: main economic indicators, 2017-2019

	2017	2018	2019 [a]
	Annual growth rate		
Gross domestic product	2.5	4.0	2.3
Per capita gross domestic product	1.3	2.7	1.1
Consumer prices	1.4	2.2	1.9 [b]
Real average wage [c]	-0.5	4.1	0.8 [d]
Money (M1)	7.9	13.5	10.5 [d]
Real effective exchange rate [e]	-3.4	1.7	-2.5 [d]
Terms of trade [f]	7.2	-0.1	-3.4
	Annual average percentage		
Open urban unemployment rate	4.1	3.9	4.2 [g]
Central government			
Overall balance / GDP	-2.8	-2.0	-1.8
Nominal deposit rate [h]	2.7	2.3	2.4 [d]
Nominal lending rate [i]	16.8	14.5	14.5 [d]
	Millions of dollars		
Exports of goods and services	52 816	56 431	53 708
Imports of goods and services	47 550	51 767	51 215
Current account balance	-2 669	-3 594	-4 644
Capital and financial balance [j]	4 297	-36	13 964
Overall balance	1 629	-3 629	9 320

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/ Economic Development Division, calculations for Preliminary Overview 2019.
g/ The figure correspond to the average from the first to the third quarter.
h/ Market deposit rate, average of credit operations that have a current

In the first nine months of 2019 the real effective exchange rate appreciated slightly by an average of 2.5%.

On the external front, the current account deficit widened to 2.0% in 2019 compared to the previous year’s 1.6%, owing to a worsening merchandise trade balance (exports fell back by 7.0%, while imports decreased by 3.0%). The increase in the trade deficit was to some extent mitigated by a narrower gap on the income account (reflecting reduced profits remittances by foreign firms and smaller interest payments, owing to a reduction in the risk premium and lower rates). Peru’s terms of trade deteriorated by 3.4%.

A comfortable surplus has been restored on the financial account, thanks to robust growth of inflows and a reduction in outflows; and this is likely to easily outweigh the current account deficit. Stronger inflows are being fuelled by long-term public sector borrowing (taking advantage of favourable financial conditions) and foreign direct investment (the start of work on large mining projects). Outflows have been reduced by the liquidation of short-term investments in the wake of cuts in international interest rates. As an overall result, the country accumulated an additional US$ 6.5 billion in reserves up to November, thus raising their level to US$ 66.8 billion (equivalent to 29% of GDP).

Considering individual sectors, the slowing of activity growth (2.1%) in the first nine months of the year partly reflects a contraction in primary sectors such as fishing (-0.1 percentage points owing to reduced catches), metallic mining (-0.1 percentage points owing to lower ore grades and production stoppages) and primary manufacturing (-0.2 points). In addition, activity in non-primary manufacturing and services has also slowed, and these sectors are contributing less to GDP.

On the demand side, in keeping with the slower pace of economic activity, the growth of private consumption has slackened, and its contribution to the overall expansion of GDP decreased from 2.4 percentage points in 2018 to 1.9 points, according to third-quarter data). At the same time, public investment has stalled, with its growth contribution slipping from 0.3 to 0.0 percentage points, following a change in regional authorities and execution difficulties. The contribution of private investment increased slightly (from 0.7 percentage points in 2018 to 0.9 in the third quarter data) thanks to the buoyancy of mining activity. Public consumption increased its contribution slightly (from 0.3 to 0.5 percentage points). Lower imports mean that less is subtracted from growth (-0.4 percentage points in the third quarter of 2019 compared to -0.9 points in 2018). The reduction in exports turned their growth contribution negative (from +1.1 percentage points in 2018 to -0.1 in the third quarter of 2019).

Inflation picked up again to average 2.2% in the first 10 months of 2019 (compared to the previous year's 1.3%), mainly owing to higher prices among services (education and meals outside the home). The rate is expected to end December at the midpoint of the central bank's target range (2.0% with a tolerance band of ± 1.0%), given the expected absence of inflationary pressures (reduction in the price of imported inputs such as oil, wheat and soybeans; containment of labour costs due to immigration; and a negative output gap).

In the national labour market, average employment for the first three quarters of the year, at 72.2%, was stable relative to the 2018 level, and the unemployment rate averaged 4.2%. However, August 2019 data show formal employment growth slowing up to 2.4%, compared to 3.9% in 2018, owing to the slackening pace of activity. In the first nine months of 2019, the average wage rose by 0.8% in real terms, having risen by 3.3% in 2018.

For 2020, growth is expected to rebound to 3.2%, on the back of a revival in the primary sectors following the reversal of transitory events (normalization of copper production and the regularization of fishing seasons) and the recovery of public investment. The external sector is again likely to contribute positively to growth, as primary production and exports regain their previous levels, expansions in the mining sector reach full capacity, and new projects enter the production phase. Nonetheless, the trend of private investment (especially outside the mining sector, given its incipient weak recovery status) will have an important role to play in coping with the complex external and domestic panorama. The economy will be confronted by slower growth in its two main trading partners (the United States and China), which will have repercussions for metal prices; and this will be compounded by uncertainty surrounding the congressional elections (scheduled for January 2020) and the presidential election in April 2021. There is also the risk of an escalation of socioenvironmental tensions in new mining regions (an example being the Tía María Project in Arequipa, where tensions have forced a review of the environmental impact study).