Peru

The Peruvian economy's growth rate for 2017 fell to 2.5% (from 4.0% in 2016) owing to a slowdown in domestic demand that was compounded by the impact of the coastal effects of El Niño and by the discovery of cases of corruption involving Brazilian construction firms. In response, in the second half of the year the government launched a reconstruction and fiscal stimulus plan based on public investment, and, given the fact that inflation was under control (thanks, in part, to below-potential growth), the central bank was able to deploy an expansionary monetary policy. The external sector continued to buoy the economy's growth, since exports were robust and the terms of trade improved substantially (with rising prices for copper and zinc), although their contribution was smaller than it had been in 2016 owing to the expansion of imports.

Although the first two quarters were a time of fiscal consolidation, fiscal policy for the year overall heralded the start of an expansionary phase, with the fiscal momentum being provided in the final two quarters by public investment. The non-financial public sector deficit widened from 2.6% of GDP in 2016 to 3.0% of GDP as activity slackened somewhat.

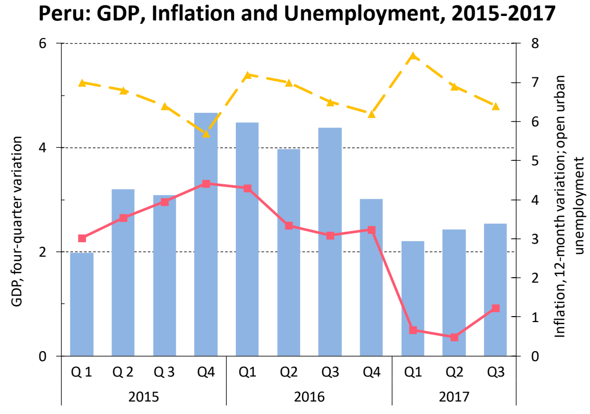
Current income slipped from 18.5% of GDP in 2016 to 18.1% of GDP in 2017 owing to the slower pace of economic activity, higher export rebates, tax deferrals in disaster areas and the provision of tax breaks to microenterprises and small businesses. During the first eight months of the year, the revenue downturn occurred primarily in receipts from income taxes (-0.7% of GDP) and the value added tax (VAT) (-0.2% of GDP).

Non-financial expenditure held virtually steady, edging up from 19.9% to 20.0% of GDP. The components of this category of spending did change, however, with the share of current expenditure declining from 15.3% in 2016 to 15.0% while that of capital expenditure climbed from 4.7% al 5.0%.

This fiscal performance translated into an increase in the public debt that boosted the non-financial public-sector debt from 23.8% in 2016 to 24.9%.

As noted above, the central bank implemented a moderately expansionary monetary policy in 2017, as the economy's growth remained below its potential level and inflation was held under control, and lowered the monetary policy rate on four different occasions (from 4.25% to 3.25%). It also took steps to raise the monetary multiplier by lowering the legal reserve requirement for sol-denominated deposits and the marginal reserve requirement for dollar-denominated ones in order to cushion the impact on the local economy of international rate hikes. Bank lending rates fell in step with the central bank's rates (from 7.12% for large corporations as of December 2016 to 6.91% in August 2017, from 21.65% to 20.87% for small companies during the same period and from 8.52% to 8.27% for mortgages in that period), while interest rates on dollar-denominated assets climbed more slowly than international rates did.

Peru: GDP, Inflation and Unemployment, 2015-2017



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

The growth rate for private-sector credit slackened during the first half of the year in line with the pace of economic activity but showed signs of rebounding late in the third quarter in line with the authorities' expansionary monetary policy and was expected to close out the year with a growth rate in the range of 5.0%–5.5%, which is just slightly below the 5.6% rate registered in 2016. The expansion of credit for small and medium-sized enterprises (SMEs) and consumer loans outpaced the increase in mortgages, automobile loans and corporate credit.

Peru: main economic indicators, 2015-2017

	2015	2016	2017 [a]
	Annual growth rate		
Gross domestic product	3.3	4.0	2.5
Per capita gross domestic product	1.9	2.7	1.3
Consumer prices	4.4	3.2	2.0 [b]
Real average wage	-0.3	1.7	-0.9
Money (M1)	5.1	4.4	6.7 [c]
Real effective exchange rate [d]	2.0	1.5	-3.9 [c]
Terms of trade	-6.3	-0.8	5.0
	Annual average percentage		
Open urban unemployment rate	4.4	5.2	5.4
Central government			
Overall balance / GDP	-2.2	-2.4	-2.9
Nominal deposit rate [e]	2.3	2.6	2.7 [c]
Nominal lending rate [f]	16.1	16.5	17.0 [c]
	Millions of dollars		
Exports of goods and services	40 651	43 332	51 493
Imports of goods and services	45 607	43 418	46 626
Current account balance	-9 169	-5 303	-2 441
Capital and financial balance [g]	9 242	5 472	5 118
Overall balance	73	168	2 677

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
a/ Estimates.
b/ Figures as of October.
c/ Figures as of September.
d/ A negative rate indicates an appreciation of the currency in real terms. Refers to the global real effective exchange rate.
e/ Market deposit rate, average for transactions conducted in the last 30 business days.
f/ Market lending rate, average for transactions conducted in the last 30 business days.
g/ Includes errors and omissions.

The exchange rate was buttressed by favourable external conditions as the dollar weakened worldwide, external capital flowed into the country in pursuit of higher yields and external accounts were fueled by rebounding commodity prices. As a result, the real effective exchange rate for the sol had risen by 3.9% as of September. Given these factors, the central bank bought up dollars in order to curb the appreciation of the currency and has consequently strengthened its international reserves position.

The deficit on current account narrowed from 2.7% in 2016 to 2.0% thanks to an improvement in the export trade balance brought about by climbing commodity prices and by the larger volume of mineral exports made possible by the expanded development of ore deposits in recent years. These trends were offset to some extent by an upswing in capital goods imports (given the resurgence of domestic demand in the second half of the year) and a bulkier deficit on the income account caused by an increase in mining companies' profit repatriations.

Private-sector long-term external capital (chiefly foreign direct investment) will continue to be the main source of financing and, although inflows were down relative to 2016 because of the fall-off in investment projects, they were enough to cover the current account deficit and to finance a build-up in reserves.

At the sectoral level, the downturn in activity can be traced to the contraction in non-primary sectors (a cumulative drop of -1.7% as of August), which breaks down into actual declines in non-primary manufacturing (-2.3%), hydrocarbons (-2.5%) and construction (-1.9%) and slower growth in commerce (0.7%), power and water (1.4%) and services (2.9%). Meanwhile, commodities and especially commodity exports buoyed growth (4%), with metal mining, raw material processing and fisheries leading the way with growth rates of 3.9%, 11% and 40%.

On the demand side, net exports were the main engine of growth. Public spending rose by 3.6%, with the expansion being driven by public investment, following a contraction in the first half of the year caused both by the downturn in consumption resulting from fiscal consolidation efforts and a slump in investment as public works came to a standstill. Private consumption slowed by around 2.6% against the backdrop of a weak labour market and the slower expansion of credit. Private investment rebounded thanks to the momentum generated by mining exploration and seemed poised to move into the black after 14 quarters in the red.

The annual inflation rate diminished from 3.2% to 2.0% in October 2017 despite the weather-related shocks felt during the year, which put it in the middle of its target range (1%–3%). Contributing factors included the appreciation of the exchange rate, the negative output gap and the absence of further adverse shocks.

As for the labour market, in step with the slackening pace of economic activity, the average annual variation in quality employment for the first nine months of the year was just 0.2% (measured by employment in private firms in the formal sector having 10 employees or more in urban areas of Peru). In the Lima metropolitan area, unemployment edged up from an average of 6.9% in the first three quarters of 2016 to 7.0% for the corresponding period of 2017.

For 2018, an economic growth rate of 3.5% is expected, with a better balance being struck between the external sector and domestic demand as the latter is spurred by a 15% jump in public investment (construction works for the 2019 Pan American Games, reconstruction in the northern part of the country, the building of Line No. 2 of the Lima subway system and the modernization of the Talara refinery, among others) and by private investment, which is being bolstered by activity in the metal mining sector. Nevertheless, the economic recovery is likely to be uneven. While the construction sector is expected to grow rapidly and while the reinvestment of profits in the mining sector is also expected to be robust given high metal prices, the recovery will be more halting in terms of formal-sector job creation and private consumption.