Peru

1. General trends

In 2008, for the seventh consecutive year, Peru turned in a strong economic performance. Growth reached 9.8%, formal employment grew by 8.3% and the country posted a fiscal surplus of 2.1% of GDP, which allowed public debt to be reduced once again. However, as a result of higher international prices, inflation exceeded the target range, ending the year at 6.7%. Worsening terms of trade and the strong rise in imports meant that the balance-of-payments current account deficit rose to 3.3% of GDP.

In the fourth quarter of the year, the global economic and financial crisis began to take a toll, first on the financial market and later on the real sector. The authorities responded by applying countercyclical measures to inject liquidity into the financial markets, avoid a surge in exchange-rate volatility and stabilize domestic demand. Even so, economic growth slowed in the fourth quarter of 2008 and remained weak in early 2009. Growth is expected to stand at 2.0% by the end of 2009, while inflation is expected to continue to fall towards the central target of 2%.

2. Economic policy

The favourable external context that had buoyed Peru's economic growth in recent years changed markedly. Initially, starting in late 2007, inflation surged on the back of higher international prices for hydrocarbons and food, leading authorities to adopt a more restrictive monetary policy to offset expectations of across-the-board price hikes.

Nevertheless, the changing international situation and its effects on the Peruvian economy prompted authorities to reverse their monetary policy and focus on ensuring liquidity in the financial system, avoiding a rapid depreciation of the currency and stimulating the credit market though a series of cuts in the benchmark interest rate. They also adopted an expansionary fiscal policy in response to faltering demand.

(a) Fiscal policy

In early 2008, the aim of fiscal policy was to take advantage of high revenues so as to significantly increase public investment while containing current spending to avoid undermining the sustainability of public finances. The government hoped to lower the surplus of the non-financial public sector to the equivalent of 2.0% of GDP, from 3.1% in 2007. In the second half of the year, the authorities responded to rising inflation by further restricting public spending and raising the fiscal surplus target for 2008 to 2.7% of GDP. In December, however, as the consequences of the global crisis for the Peruvian economy proved to be stronger than expected, the authorities announced an economic stimulus plan for

2009-2010, which was expected to cost the equivalent of 3.2% of GDP and to entail a considerable rise in public investment.

Throughout 2008, fiscal receipts continued to benefit from strong economic growth, with general sales tax receipts rising from 7.5% to 8.5% of GDP. Income tax revenue, which had surged in previous years mostly because of high minerals prices, remained relatively stable in GDP terms; by contrast, revenue from the import tax and selective consumption tax declined because the rates had been lowered to halt the upturn in inflation seen in the first half of 2008. Indeed, at the beginning of the year, tariffs on 571 food items were lowered or eliminated altogether, and the selective consumption tax on fuel was lowered several times. In addition, the financial transaction tax was cut from 0.08% to 0.07%. As a result, central government revenue remained quite stable, with a small increase from 18.2% to 18.3% of GDP. Capital expenditure by the non-financial public sector (NFPS) rose from 3.2% to 4.3% of GDP, while current spending declined slightly. The surplus of the NFPS decreased by one percentage point, returning to its 2006 level of 2.1% of GDP. Part of the reason for this was a reduction —equivalent to a half a percentage point of GDP— in the surplus of non-central government public-sector bodies. At the same time, gross public debt fell from 29.6% to 24.0% of GDP.

The economic stimulus plan that began to take shape in early 2009 emphasized an expansion and acceleration of public investment both by central government agencies and decentralized entities. In addition, the duty drawback rate for non-traditional exports was raised temporarily from 5% to 8%, an accelerated-depreciation scheme for buildings was introduced, access to low-income housing was expanded, as was the temporary public employment programme, and two funds, one for retraining workers and another for refinancing microfinance institutions, were established.

Given the decrease in revenue, the authorities may finance increased public spending with resources from the fiscal stabilization fund, which in late 2008 contained US$ 1.807 billion, and incur a fiscal deficit, which could be financed with lines of credit from international financial institutions. To meet its financing needs for 2010, the government issued US$ 1 billion in 10-year global bonds in March 2009.

The economic slowdown and lower minerals prices are expected to lead to a reduction in revenue in 2009. In the first quarter, the central government's current revenue decreased by 13.5% in real terms, mainly as a result of lower income tax and selective consumption tax receipts, whereas general sales tax revenues declined only slightly —as a result of declining imports— and internal general sales tax receipts continued to rise.[1] Central government non-financial expenditure increased nearly 20% in real terms, mainly as a result of increased capital spending.

(b) Monetary and exchange-rate policy

As regards monetary policy, it became necessary to tackle inflation, which had been above target since late 2007. Although the situation was triggered by higher international prices, the authorities felt that, given strong domestic demand, there was a danger of inflationary expectations regarding consumer prices in general. In September they raised the benchmark rate from 5.0%, at which it had stood since the beginning of the year, to 6.5%, where it remained until January 2009. Lower interest rates in the United States in the first half of 2008 triggered an influx of short-term capital, which led to an appreciation of the new sol. To counteract this trend and halt the credit expansion, the authorities raised the legal reserve requirement, in several increments, from 6% to 9%, and the marginal reserve requirement to 25% for local currency and 49% for foreign currency, as well as the cost of transactions for non-residents. In addition, between January and April 2008, the central bank bought US$ 8.7 billion, which raised its reserves to US$ 35.5 billion.

In Peru, the effect of the international crisis was felt first in the financial markets. Starting in September 2008, stock market indicators deteriorated sharply, massive amounts of short-term capital flowed out of the country, the price of external credit rose, and there was an increased preference for dollar liquidity, which, as a share of the total liquidity of depository corporations, rose from 39.5% in May 2008 to 47.5% in March 2009.

Consequently, in September the authorities adopted measures to ensure the financial system's liquidity both in local currency and in dollars. The legal reserve requirement was lowered to 6% and eliminated for certain transactions, repo operations were expanded, central bank certificates were bought back and foreign-currency swaps were introduced. In addition, in a bid to avoid a sharp depreciation of the new sol, between May 2008 and February 2009, the authorities sold some US$ 7 billion.

In real terms, between April and December 2008, the new sol depreciated only 6.4% against the dollar and, given its previous appreciation, both the bilateral average real exchange rate for the year and the end-of-year variation declined (by 8.3% and 2.0%, respectively). Moreover,

[1] In January, the selective consumption tax decreased as a result of a modification to the payment system, which returned to normalcy starting in February. In addition, as a result of lower prices for hydrocarbons at the end of 2008, the selective consumption tax on fuel was raised. As a result, since February, receipts from this tax have risen in real terms.

because the exchange rates of other trading partners depreciated more than did that of Peru in the second half of the year, towards year end the real effective exchange rate of the new sol declined even more (5.1%). The currency continued to lose value in the first few months of 2009, but began to recover in March.

Given the gradual decline in inflation and the signs of economic slowdown, the benchmark interest rate was lowered several times starting in February 2009, and in June it stood at 3.0%.

Despite these fluctuations, lending to the private sector continued to grow in 2008. In the first half of 2009, the year-on-year increase slowed, but remained over 20%. At the same time, the gradual de-dollarization of lending continued, as the proportion of dollar-denominated loans shrank from 56.6% of the total in December 2007 to 50.4% in March 2009. In line with the benchmark interest rate, local-currency interest rates gradually rose in 2008, especially short-term rates, which slightly exceeded the annual average rate for 2007. The lowering of the benchmark rate began to impact market rates in March 2009. Foreign-currency interest rates declined sharply in the second half of 2008, in line with international trends.

The problem of non-performing loans was kept under control: in December 2008, the ratio of loans in arrears to all bank lending stood at 1.3%, the same percentage as in the previous year, before rising slightly in March 2009, to 1.4%.

(c) Trade policy

Peru continued to raise its profile in international markets by entering into bilateral free trade agreements. In February 2009, its free trade agreement with the United States came into force, and in March, its economic complementarity agreement with Chile took effect. It signed free trade agreements with Canada and Singapore in May 2008 and with China in April 2009. Trade negotiations with Mexico continued and talks began with the European Union, Japan and the Republic of Korea.

3. The main variables

(a) Economic activity

During most of 2008, the Peruvian economy continued to grow at a fast pace —its annual growth rate even increased to 9.8%— driven by buoyant domestic demand (12.3%). Notably, gross fixed investment rose by 28.0%, fuelled by increased private-sector and public-sector investment (25.6% and 41.9%, respectively). Gross domestic investment consequently rose to 26.6% of GDP, from 22.9% in 2007 and only 17.9% in 2005. Higher household income from labour and the expansion of credit led also to a strong increase (8.8%) in private consumption. The moderate rise in public consumption (4.0%), on the other hand, reflected fiscal spending priorities. Exports, for their part, grew at a faster pace (8.2%) than in previous years, although not as fast as the economy overall. The rise in imports (19.9%), meanwhile, mirrored the strong domestic demand.

Unlike in previous years, in 2008 all branches of economic activity grew at high rates of 6% or more. Robust domestic demand spurred double-digit growth in construction and commerce.

Nevertheless, starting in the fourth quarter, when growth of 6.5% was recorded, the economy experienced a marked deceleration, with growth declining to 1.8% in the first quarter of 2009 and slowing even more in the second quarter. Exports declined and inventories shrank significantly. Manufacturing contracted, mainly because of falling exports and lower inventories generated by sluggish demand. Fisheries were also adversely affected by the reduced availability of some species and the imposition of the closed season, and some agricultural export activities also suffered. A slight upturn in the second half of 2009 is expected to translate into a 2.0% rate of economic growth for the year overall.

(b) Prices, wages and employment

Inflation had remained below 3% since February 2005, but in the second half of 2007 it began to accelerate as a result of higher international prices for hydrocarbons and food. It stood at 3.9% at the end of 2007 and 6.7% twelve months later. Prices of other items also rose, leading to higher core inflation, which in December stood at 5.6%. Against a backdrop of lower international prices, year-on-year inflation gradually eased as of December 2008, falling to 3.1%

Table 1

PERU: MAIN ECONOMIC INDICATORS

	2000	2001	2002	2003	2004	2005	2006	2007	2008 [a]
					Annual growth rates [b]				
Gross domestic product	3.0	0.2	5.0	4.0	5.0	6.8	7.7	8.9	9.8
Per capita gross domestic product	1.6	-1.1	3.7	2.8	3.7	5.6	6.5	7.6	8.6
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	6.8	-0.1	6.1	2.3	0.1	5.3	8.0	3.5	6.7
Mining and quarrying	2.4	9.9	12.0	5.5	5.3	8.4	1.4	2.7	7.6
Manufacturing	5.8	0.7	5.7	3.6	7.4	7.5	7.5	10.8	8.5
Electricity, gas and water	3.2	1.6	5.5	3.7	4.5	5.6	6.9	8.5	7.7
Construction	-6.5	-6.5	7.7	4.5	4.7	8.4	14.8	16.6	16.5
Wholesale and retail commerce, restaurants and hotels	3.4	0.7	3.2	2.9	5.9	6.0	10.3	9.4	12.8
Transport, storage and communications	2.6	-0.4	3.7	4.9	6.4	8.5	9.2	18.9	9.0
Financial institutions, insurance, real estate and business services	2.3	-1.2	4.9	4.1	3.9	6.5	7.5	9.3	9.0
Community, social and personal services	1.7	-0.0	3.7	5.0	3.8	5.3	5.8	4.8	9.0
Gross domestic product, by type of expenditure									
Consumption	3.6	1.2	4.4	3.4	3.7	5.1	6.6	7.9	8.3
General government	3.1	-0.8	-0.0	3.9	4.1	9.1	7.6	4.5	4.0
Private	3.7	1.5	4.9	3.4	3.6	4.6	6.4	8.3	8.8
Gross domestic investment	-2.7	-7.1	3.0	4.7	4.5	8.9	26.5	26.1	24.8
Exports (goods and services)	8.0	6.8	7.5	6.2	15.2	15.2	0.8	6.2	8.2
Imports (goods and services)	3.8	2.9	2.3	4.2	9.6	10.9	13.1	21.3	19.9
					Percentages of GDP				
Investment and saving [c]									
Gross domestic investment	20.2	18.8	18.4	18.4	18.0	17.9	20.0	22.9	26.6
National saving	17.2	16.5	16.4	16.9	18.0	19.3	23.1	24.1	23.3
External saving	2.9	2.3	2.0	1.6	-0.0	-1.4	-3.1	-1.1	3.3
					Millions of dollars				
Balance of payments									
Current account balance	-1 556	-1 217	-1 117	-958	19	1 148	2 854	1 220	-4 180
Goods balance	-411	-195	292	853	3 004	5 286	8 986	8 287	3 090
Exports, f.o.b.	6 955	7 026	7 714	9 091	12 809	17 368	23 830	27 882	31 529
Imports, f.o.b.	7 366	7 221	7 422	8 238	9 805	12 082	14 844	19 595	28 439
Services trade balance	-735	-963	-994	-900	-732	-834	-737	-1 187	-1 929
Income balance	-1 410	-1 101	-1 457	-2 144	-3 686	-5 076	-7 580	-8 374	-8 144
Net current transfers	999	1 042	1 041	1 233	1 433	1 772	2 185	2 494	2 803
Capital and financial balance [d]	1 415	1 640	2 085	1 482	2 397	380	-128	8 368	7 292
Net foreign direct investment	810	1 070	2 156	1 275	1 599	2 579	3 467	5 425	4 079
Other capital movements	605	571	-71	207	798	-2 199	-3 595	2 943	3 213
Overall balance	-142	423	968	525	2 417	1 528	2 726	9 588	3 112
Variation in reserve assets [e]	440	-275	-852	-516	-2 443	-1 628	-2 753	-9 654	-3 169
Other financing	-298	-148	-116	-9	26	100	27	67	57
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [f]	100.0	102.8	106.5	112.5	106.4	118.7	106.5	95.5	83.7
Terms of trade for goods (index: 2000=100)	100.0	95.6	98.4	102.2	111.3	119.4	152.1	157.6	136.9
Net resource transfer (millions of dollars)	-293	391	512	-670	-1 262	-4 596	-7 681	61	-796
Total gross external debt (millions of dollars)	27 981	27 195	27 872	29 587	31 244	28 657	28 672	33 137	34 587
					Average annual rates				
Employment									
Labour force participation rate [g]	64.4	66.7	68.4	67.4	68.1	67.1	67.4	68.9	68.1
Open unemployment rate [h]	8.5	9.3	9.4	9.4	9.4	9.6	8.5	8.4	8.4
Visible underemployment rate [h]	12.3	12.8	11.8	9.8	9.6	9.5	9.4	9.5	8.9
Prices					**Annual percentages**				
Variation in consumer prices (December-December)	3.7	-0.1	1.5	2.5	3.5	1.5	1.1	3.9	6.7
Variation in wholesale prices (December-December)	3.8	-2.2	1.7	2.0	4.9	3.6	1.3	5.2	8.8
Variation in nominal exchange rate (Annual average)	3.2	0.5	0.3	-1.1	-1.9	-3.4	-0.7	-4.4	-6.6
Variation in average real wage	0.8	-0.9	4.6	1.6	1.1	-1.9	1.2	-1.8	2.6
Nominal deposit rate [i]	...	...	3.5	2.9	2.4	2.7	3.4	3.5	3.3
Nominal lending rate [i]	...	...	22.3	20.2	18.7	17.9	17.1	16.5	16.7

Table 1 (concluded)

	2000	2001	2002	2003	2004	2005	2006	2007	2008 [a]
	Percentages of GDP								
Central government									
Total Income	15.2	14.5	14.5	15.0	15.0	15.8	17.6	18.2	18.3
Current income	14.9	14.3	14.3	14.8	14.9	15.7	17.4	18.1	18.2
Tax income	12.2	12.4	12.1	12.8	13.1	13.6	15.0	15.6	15.6
Capital income	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Total expenditure	18.0	17.3	16.6	16.7	16.2	16.5	16.1	16.4	16.1
Current expenditure	15.1	15.0	14.6	14.8	14.4	14.7	14.1	14.2	13.8
Interest	2.2	2.1	2.0	2.0	1.8	1.8	1.8	1.6	1.4
Capital expenditure	2.8	2.2	2.0	1.9	1.8	1.9	2.0	2.1	2.4
Primary balance	-0.6	-0.6	-0.2	0.2	0.6	1.1	3.2	3.5	3.6
Overall balance	-2.8	-2.8	-2.1	-1.7	-1.3	-0.7	1.5	1.8	2.2
Central government public debt	45.2	44.2	45.7	47.4	41.8	38.2	31.3	27.2	24.8
Domestic	8.8	9.6	9.3	10.4	8.0	9.0	8.0	9.3	8.6
External	36.4	34.5	36.5	36.9	33.7	29.2	23.2	17.9	16.2
Money and credit [j]									
Domestic credit	15.2	14.8	13.4	13.2	12.9	13.9	14.6	17.8	14.9
To the public sector	-6.2	-4.4	-4.8	-4.1	-4.3	-3.4	-3.6	-5.3	-7.2
To the private sector	31.9	30.4	30.1	28.7	27.0	28.7	28.6	33.1	34.0
Others	-10.5	-11.2	-11.8	-11.4	-9.9	-11.3	-10.5	-10.0	-11.9
Liquidity (M3)	25.4	26.1	26.1	24.7	24.0	25.8	24.3	26.9	30.3
Currency outside banks and local-currency deposits (M2)	7.7	8.7	9.1	9.4	10.8	11.7	12.0	14.5	16.1
Foreign-currency deposits	17.7	17.4	17.1	15.3	13.2	14.1	12.4	12.4	14.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures.
[b] Based on figures in local currency at constant 1994 prices.
[c] Based on figures in local currency expressed in dollars at current prices.
[d] Includes errors and omissions.
[e] A minus sign (-) denotes an increase in reserves.
[f] Annual average, weighted by the value of goods exports and imports.
[g] Economically active population as a percentage of the working-age population, Lima metropolitan area; 2000, urban total.
[h] Percentage of the economically active population, Lima metropolitan area.
[i] Fix-weighted average interest rate.
[j] The monetary figures are end-of-year stocks.

in June 2009, while core inflation lagged behind and fell to 4.7% in the same period.

The trend in average labour income was favourable, with a 4.6% rise in real terms.

Strong economic growth generated high labour demand, which led to an 8.3% increase in formal employment. It slowed in the fourth quarter of 2008, however, to 6.8%, and even further in the first quarter of 2009 (to 3.4%). In urban areas, the annual average employment rate rose from 66.6% to 67.2%, contributing to a slight decrease in unemployment. Nevertheless, in Metropolitan Lima, the employment rate registered a moderate decline which did not translate into a higher unemployment rate because labour participation decreased slightly. These trends continued into early 2009.

To encourage the creation of formal employment, in 2008 a law was enacted reducing labour costs for micro- and small enterprises. In 2009, to stimulate household demand, the authorities temporarily allowed formal workers to gain access to their seniority bonuses and eliminated the requirement that social-security contributions be paid on the twice-yearly bonuses received by formal wage earners.

(c) The external sector

After four years of running a surplus, the balance-of-payments current account ended 2008 at a deficit equivalent to 3.3% of GDP. This turnabout was in part generated by sluggish exports. The unfavourable trend in export prices, which declined sharply in year-on-year terms starting in the fourth quarter, dampened export growth. Nevertheless, goods exports rose 13.1%, with two-digit increases in both traditional and non-traditional items. Imports, on the other hand, grew by 45.1%, owing to strong domestic demand and higher prices with, most notably, a 57.6% surge in purchases of capital goods abroad. The increase in the deficit in services stemming from higher transportation costs also contributed to a sharp decline in the trade-balance surplus, from 6.6% to 0.9% of GDP.

In 2008, the country's terms of trade deteriorated by 13.1% in relation to the previous year. Although at the end of the year import prices began to come down, in year-on-year terms, the terms of trade continued to worsen.

Outflows of foreign currency for factor payments declined, mainly as a result of lower profit remittances

Table 2
PERU: MAIN QUARTERLY INDICATORS

	2007				2008 [a]				2009 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	8.5	8.1	8.9	9.8	10.3	11.8	10.9	6.5	1.8	...
Goods exports, f.o.b. (millions of dollars)	5 739	6 665	7 540	7 938	7 771	8 470	8 814	6 474	5 313	...
Goods imports, c.i.f. (millions of dollars)	4 208	4 495	5 290	5 602	6 265	7 550	7 976	6 648	4 867	...
International reserves (millions of dollars)	18 456	21 555	22 855	27 720	33 608	35 550	34 732	31 233	30 961	30 822
Real effective exchange rate (index: 2000=100) [c]	103.3	105.0	105.2	103.0	101.4	100.7	101.4	97.7	98.2	94.7 [d]
Unemployment rate	9.8	8.3	8.2	7.5	9.3	7.9	8.5	7.8	9.3	...
Consumer prices (12-month percentage variation)	0.2	1.5	2.8	3.9	5.5	5.7	6.2	6.6	4.8	3.1
Average nominal exchange rate (new soles per dollar)	3.2	3.2	3.2	3.0	2.9	2.8	2.9	3.1	3.2	3.0
Average real wage (variation from same quarter of preceding year)	...	-3.6	...	0.1	...	2.7	...	...	...	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	3.5	3.5	3.5	3.6	3.5	3.2	3.1	3.3	3.5	3.3 [d]
Lending rate [e]	16.8	16.6	16.3	16.3	16.5	16.5	16.7	17.1	17.2	16.5 [d]
Interbank interest rate	4.5	4.5	4.8	5.0	4.9	5.5	6.2	6.6	6.4	4.8 [d]
Sovereign bond spread (basis points) [f]	121	117	137	178	223	199	310	509	425	278
Stock price index (national index to end of period, 31 December 2000=100)	1 420	1 851	1 806	1 450	1 439	1 348	931	583	764	1 081
Domestic credit (variation from same quarter of preceding year)	35.0	42.6	31.5	35.7	27.3	11.4	9.0	-7.1	-12.6	0.8 [g]
Non-performing loans as a percentage of total credit	1.6	1.6	1.5	1.3	1.4	1.2	1.2	1.3	1.4	1.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures.
[b] Based on figures in local currency at constant 1994 prices.
[c] Quarterly average, weighted by the value of goods exports and imports.
[d] Data to May.
[e] Fix-weighted average interest rate.
[f] Measured by JP Morgan's EMBI+ index.
[g] Data to April.

and payments of interest on public debt, which kept down the size of the current-account deficit. Another factor was the stability of current transfers.

Some trends that emerged in the fourth quarter continued through early 2009, including a sharp decrease in the prices and volume of exports, a decline, although minor, in imports, and a drop in profit remittances.

As noted above, there was a massive influx of short-term capital in the first half of 2008, but this trend was reversed towards the end of the year. Similarly, large inflows of foreign investment were received at the beginning of 2008, but because of disinvestment in the final months of the year, annual foreign-investment inflows fell from US$ 5.425 billion in 2007 to US$ 4.079 billion in 2008. In 2008, the public sector continued to pay down its debt: the early repayment of loans to the Andean Development Corporation and of Brady Bonds reduced the net external public debt from 19.6% to 15.7% of GDP. The financial account (including errors and omissions) posted a surplus equivalent to of 5.7% of GDP, compared with 7.8% in 2007; the central bank's net reserves increased to 2.5% of GDP.

In 2008, the investment-grade rating given to the country by certain credit-rating agencies helped improve its access to credit on international financial markets. This improvement was, however, undermined by the overall trends in those markets. In the context of a preference for dollar holdings, the yield spread with respect to United States Treasury bonds rose from 154 basis points in May 2008 to 524 basis points in December, before dropping to 292 basis points in May 2009. In March 2009, to meet its financing needs for 2010, the government issued US$ 1 billion in 10-year sovereign bonds, at an interest rate of 7.125%.