

Peru



Outlook

	Average 10-14	2015	2016	2017	2018	2019	Forecasts		
							2020	2021	2022
GDP growth (%)	5.8	3.3	4.1	2.5	4.0	2.2	-13.9	7.3	5.0
CPI inflation (%)*	2.9	3.5	3.6	2.8	1.3	2.1	1.7	1.9	2.3
Fiscal balance (% of GDP)	0.9	-2.1	-2.3	-2.9	-2.0	-1.4	-9.4	-4.3	-3.2
Public debt (% of GDP)	22.0	24.1	24.5	25.4	26.2	27.1	39.5	39.1	39.7
Reference rate (%)*	3.7	3.4	4.2	3.8	2.8	2.6	0.7	0.3	1.3
Exchange rate (PEN/USD)*	2.8	3.2	3.4	3.3	3.3	3.3	3.5	3.5	3.4
Current account balance (% of GDP)	-3.4	-5.0	-2.6	-1.3	-1.7	-1.4	-1.1	-0.3	-0.6
External debt (% of GDP)	30.4	35.1	35.9	31.6	29.6	30.8	38.8	36.9	36.5

Note: * Annual average.

Source: CaixaBank Research, based on data from national statistical agencies and the IMF.

- Peru has been one of the countries with the highest incidence of COVID-19 in Latin America** and has one of the highest death rates per million inhabitants in the world. The recent political crisis has exposed the country's institutional weakness and the dysfunctional nature of its political system. **The elections in April 2021 will be decisive** and, depending on the outcome, the political situation could see some stabilisation and subsequent economic improvement, or it could continue to undermine the economic fundamentals of the country. In turn, this uncertainty coupled with the continued deterioration in fundamentals could lead to negative credit rating reviews.
- Real shock of COVID-19 and health strategy.** Peru has had the sharpest contraction among the main Latin American economies and one of the highest death rates per million inhabitants in the world. This poor performance is attributed to the weak health system (with years of underinvestment) and structural economic deficiencies. The strict closure in response to the pandemic during Q2 reduced mining exports and investments and affected household consumption. As a result, GDP contracted by more than 30% year-on-year, achieving some recovery in Q3 (-9.4% year-on-year) with the gradual easing of the lockdown measures. The lockdown has been especially hard in a country with a level of informal labour that is close to 70%, which has amplified the real effects of the shock.
- Economic policy response**
 - Monetary policy.** The Central Bank took a highly expansionary monetary approach, which placed the interest rate at 0.25%, the lowest in South America. It has also launched credit lines for commercial loans and other liquidity measures so that pension funds can respond to the pension withdrawals approved by Congress as a relief measure against the pandemic. Furthermore, although inflation will continue to fluctuate in line with commodity prices and demand, it is expected to remain within the target range (1%-3%) set by the Central Bank.
 - Fiscal policy.** The Ministry of Economy and Finance has allocated an expenditure of about 20% of GDP to the economic recovery and containment plan, whereby the fiscal deficit would rise above 9% of GDP. However, political instability could mean an incomplete implementation of the announced stimulus. For 2021, the Government estimates a deficit reduction to 6% of GDP (our forecast is a deficit of 4.3% of GDP). Similarly, the planned withdrawal of the current public pension plan would add approximately 2.3% to 2020 GDP in terms of additional financing needs, probably in 2021, which will in turn require more external financing in the coming years.

Outlook (continued)

- **Evolution of the exchange rate.** The Peruvian sol has been exposed to high volatility in 2020 due to political noise and increased aversion to emerging markets. However, the Central Bank has managed to curb depreciation pressures through the issuance of currency swaps. In the medium term, the sol may continue to fluctuate in times of political uncertainty, considering that foreigners own around 55% of the stock of domestic debt.

Main risks

- **Political risk.** Political volatility increased in early November, when Congress decided to remove former President Martín Vizcarra (2018-2020) on charges of corruption. Vizcarra was replaced by the then President of Congress, Manuel Merino, from the centre-right Popular Action party. However, the move was perceived as an illegitimate takeover and sparked widespread protests across the country. Finally, Francisco Sagasti, from the centrist Purple Party, was selected as the new interim president and will serve the rest of the presidential term, which will end in July 2021. The upcoming elections on 11 April 2021 offer an opportunity to re-legitimise the authorities; however, polls still show a highly fragmented political landscape. Risks to governance will persist if the president-elect's allies do not win enough seats in Congress (44 out of 130) to avoid a ministerial and presidential censure motion. Political fragmentation makes it difficult for the legislature to make decisions and leaves Congress more exposed to the influence of interest groups and erratic policies, making the country's outlook less predictable. This continued instability could have long-lasting implications for Peru's economy and reduce potential GDP growth.
- **Sovereign risk.** Debt levels will remain at around 40% of GDP. Peru has a BBB+ rating, but the imminent deterioration of fiscal accounts coupled with a deterioration in policy predictability puts the rating at risk. Fitch was the first rating agency to state its opinion by changing its outlook from stable to negative, given the challenges the country faces in reducing fiscal deficits to levels consistent with the stabilisation of debt and the populist legislative bias of Congress in recent months.

	Rating	Last changed	Outlook	Last changed
 STANDARD & POOR'S	 BBB+	19/08/13	Stable	19/08/13
 MOODY'S	 A3	02/07/14	Stable	02/07/14
 FitchRatings	 BBB+	23/10/13	Negative	10/11/11

 Indicates that the country has "investment grade".

 Indicates that the country does not have "investment grade".

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