

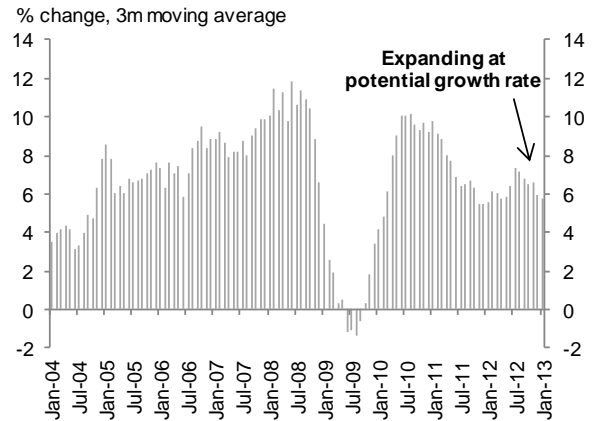
PERU: SUSTAINING DYNAMISM

April 12th 2013

Economic activity: Balanced domestic demand is sustaining growth

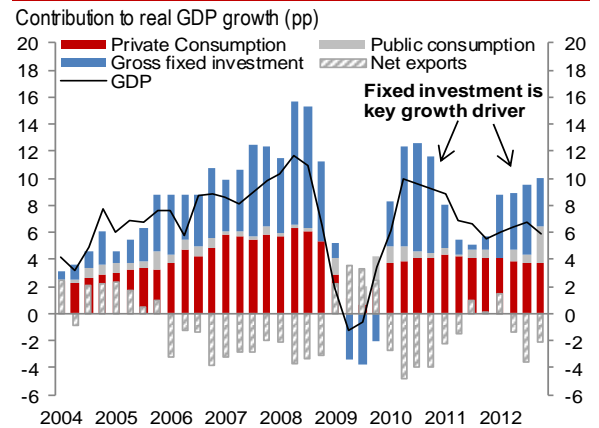
- Peru's economy is expanding at a steady pace that is both near its potential and above the regional average. Real GDP grew by 6.3% in 2012. This marked a deceleration from 6.9% in 2011, but the economy is maintaining dynamism at its potential growth rate, which the Central Bank estimates at 6.3%.
- Real monthly GDP grew by 6.2% yoy in January 2013, according to the National Statistics Agency (INEI), confirming the view shared by the government and private sector that December's lower result (4.3% yoy) was owed to seasonal effects on a lower number of working days and slower construction activity.
- Growth will be near potential in 2013 despite a weak external environment. Balanced domestic demand is supporting robust growth. It rose by 7.4% yoy in 2012 and 8.3% yoy in January. Domestic demand will remain the main growth driver, perhaps at a slightly moderated pace that will be counterbalanced by mining growth in 2013-17.
- Private consumption is the largest demand-side contributor to growth. It is steadily rising at a pace of 5.8% yoy and continues to be supported by real wage growth, high consumer confidence, appreciation of the Peruvian *sol* (PEN), and credit expansion.
- The rise of fixed investment is making a sizable growth contribution. Private investment—which accounts for 80% of capital spending—increased by 13.6% yoy in 2012 upon broad construction, infrastructure, and mining expenditures. Public investment is rising firmly for infrastructure, though it is prone to delays in execution.
- Public consumption will have a more expansionary impulse this year. The government is increasing public sector wages over a 5-year period, by an estimated 0.25% - 0.4% of GDP per year, starting in 2013. This will raise the earnings of the middle-income class, which is typically likely to spend increases in income.
- On the supply side, sectors linked to domestic demand are the most dynamic. The construction, financial services, and retail sectors expanded by 15.2% yoy, 10.4% yoy, and 6.7% yoy, respectively, in 2012. Sectors tied to the external environment grew at a slower pace, as manufacturing grew by 3.1% yoy and mining by 2.2% yoy.
- Main downside growth risks include weakness in external demand and commodity prices (ie, China slowdown) and challenges in the socio-political environment. On the other hand, growth acceleration could come upon more investment and the expected large increase in mining output and exports in 2013-17 (See Page 2).

Real GDP growth



Source: INEI; BTMU Economic Research.

Domestic demand is leading growth

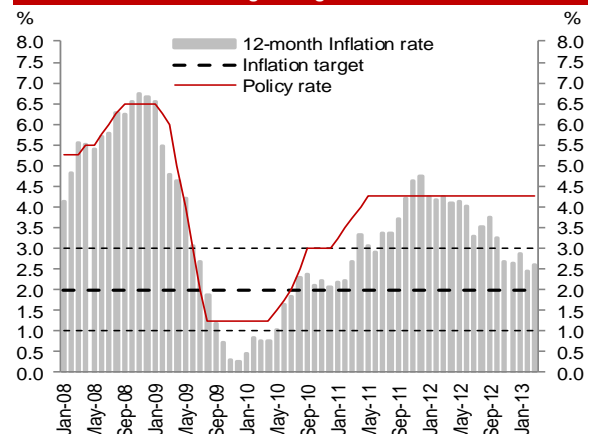


Source: BCRP; BTMU Economic Research.

Firm fundamentals: High growth, low inflation, fiscal surplus

- Peru's macroeconomic stability and predictable policies are supportive of the sustained growth of domestic demand as well as of inflows of foreign direct investment. The combination of low volatility of GDP growth, low inflation, fiscal surplus, and a stable (and strengthening) FX maintains a favorable investment climate overall, despite focalized tensions in the mining sector. Peru's growth pace has exceeded the regional average for eight consecutive years through 2012.
- The government has kept a solid fiscal position, with a low gross government debt stock (19.8% of GDP at end-2012) and a net surplus in the non-financial public sector balance (2.1% of GDP). Even with foreseen higher spending in 2013, it is expected to maintain a fiscal surplus of above 1% of GDP. Moreover, the government has built a Fiscal Stabilization Fund (at around 4% of GDP) that supports counter-cyclical policy.
- Inflation expectations are well-anchored. The 12-month consumer price inflation rate came in at 2.59% yoy in March, within the BCRP's target range of 2% +/- 1%, yet there was acceleration in core inflation that will be worth monitoring going forward. The BCRP anticipates convergence to the target by 2014, with neutral inflation risks.

Inflation is within the target range

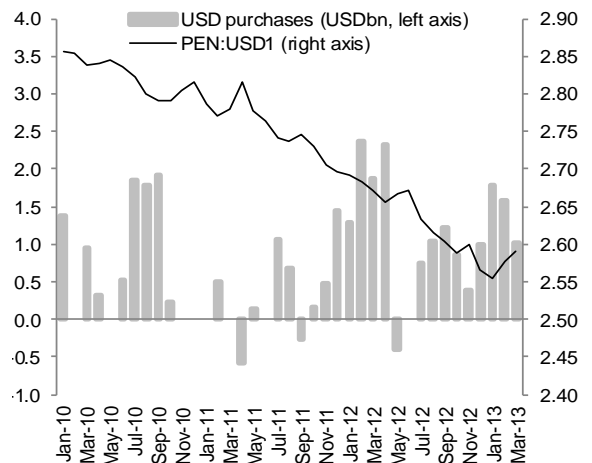


Source: INEI; BCRP; BTMU Economic Research.

Monetary policy: Amid capital inflows, focus on slowing PEN appreciation

- With GDP growth near potential and inflation within target, monetary policy decisions have focused on the exchange rate. The PEN has strengthened 7% in real effective terms since January 2012, and the pace of appreciation will be key to monitor in 2013. Fiscal policy will be expansionary this year, so the Central Bank will implicitly take on a greater responsibility to direct macroeconomic stabilization policies.
- The BCRP has kept the policy rate at 4.25% since mid-2011. But, amid large capital inflows, it is actively intervening to slow the pace of PEN appreciation and—via measures other than rate hikes—tighten monetary conditions.
- The active policy tool is the reserve requirement. The BCRP has raised the RR on bank deposits four times this year. The last three increases focused on USD deposits and targeted institutions granting USD auto and housing loans. The BCRP remains vigilant in acting to reduce risks of capital inflows on FX fluctuations and growth of USD credit. Peru still has a high, but falling, degree of financial dollarization. One-third of savings and less than one-half of credits are dollarized, down from 80% in 2001.
- The BCRP is continuing to purchase USD in the FX market. Net purchases totaled USD13bn in 2012 (or 6.5% of GDP), about three times more than in 2011. It has bought USD4.4bn so far in 2013. International reserves now amount to 34% of GDP, the highest ratio among Latam-5 countries. Also, since January, the BCRP has lifted Private Pension Fund’s investment limit abroad from 30% to 36% of total investment.

Exchange rate and BCRP intervention

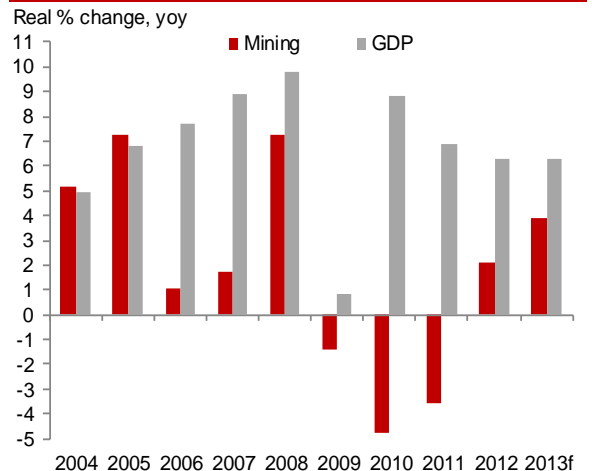


Source: Central Bank; BTMU Economic Research.

Mining sector: Set to lift production and exports in 2013-17

- Peru is a major player in the global mining industry. Though GDP growth and fiscal revenues have become less dependent on mining revenues thanks to improved macroeconomic fundamentals and domestic demand, the economy may receive an additional boost to growth from higher mining output in 2013-17.
- Several large copper projects are moving forward and are expected to begin extraction during this period. Gross copper output could double by 2017, though production growth will depend on the management of social conflicts and inclusion. Expected production growth has the potential to raise mining exports, which account for 57% of total exports, in the view of the government and private sector.
- Setbacks in the Peruvian mining sector have escalated in 2011-12, however, they are focused in certain regions and on specific projects. Projects in the center and south regions are moving forward, though more slowly than in previous years, while those in the north are held up by tensions between local communities, mining companies, and the government. In general, copper projects face less obstacles than gold projects.
- An estimated USD8.5bn was invested in the mining sector in 2012, up from just USD1.3bn in 2007. Currently, about USD30bn is in the pipeline of investments for copper mines in 2013-17.

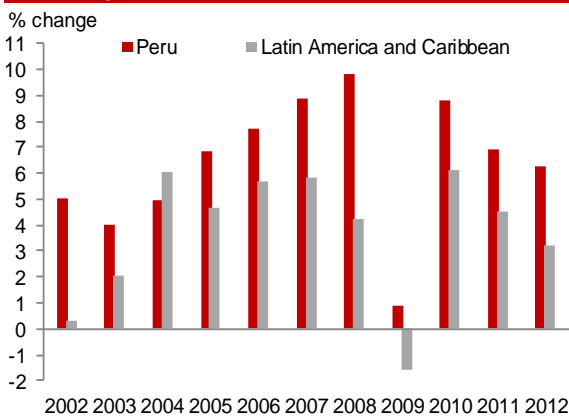
Mining and GDP growth



Source: INEI; BCRP (forecast); BTMU Economic Research.

Appendix of charts

Real GDP growth: Peru vs. Latin America



Source: INEI; IMF; BTMU Economic Research.

Peru: Global position in metals production in 2012

Metal	Share of global output	Global ranking
Silver	14.4%	3rd
Tin	12.3%	3rd
Zinc	9.8%	3rd
Molybdenum	7.8%	4th
Copper	7.7%	3rd
Gold	5.9%	6th
Lead	4.5%	5th

Source: USGS; BTMU Corporate Research; BTMU Economic Research.



For historical data and commentary following BTMU's Economic News Releases, see our website at: <https://reports.us.bk.mufg.jp/portal/site>.

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