



# BTMU Focus Latin America



Peru: macroeconomic performance  
(1Q 2015)

**MUFG UNION BANK**  
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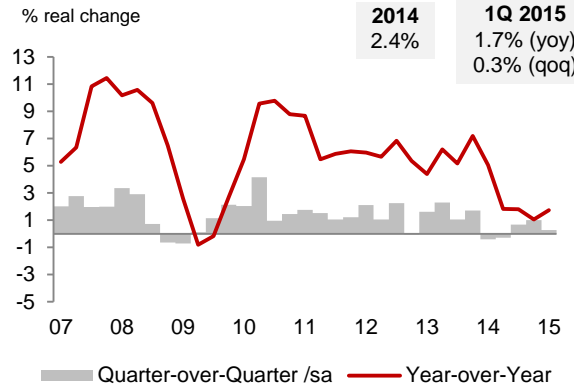
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# I) Peru: Growth Momentum (1)

Peru's economy opened the year with a timid recovery, after four consecutive quarters of slowing growth.

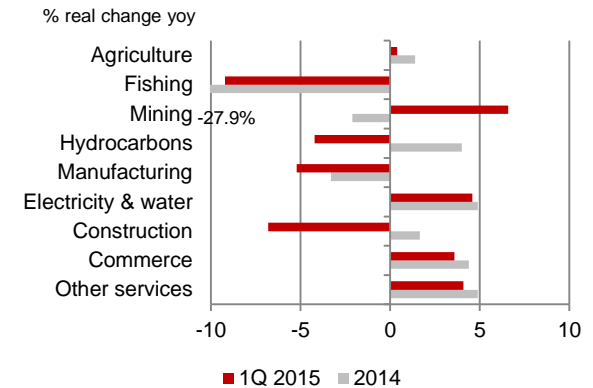
Peru's economy started the year with a timid recovery, as GDP expanded at a pace of 1.7% yoy in 1Q 2015, following an unsettling rate of just 1.1% in the last quarter of 2014 (the lowest since the global economic slowdown in 2009). The Peruvian economy, whose exports are heavily dominated by raw mineral ores, managed to crawl out of its downward spiral of slowing growth four quarters later, partly due to a partial turnaround in the primary sector (particularly in mining activity), and partly owing to several stimulus measures aimed at keeping consumer spending from faltering. Yet this rebound in GDP growth was not as strong as initially anticipated because private investment plunged for a fourth consecutive quarter, as the prospect of softer-than-expected domestic demand and low commodity prices, along with recent social conflicts in the mining sector, appear to have forced companies to slash their capital spending. Sluggishness in public investment, especially at the regional level, did not help either: capital spending in the public sector plummeted by 26.5% yoy in 1Q.

Figure 1: GDP Growth



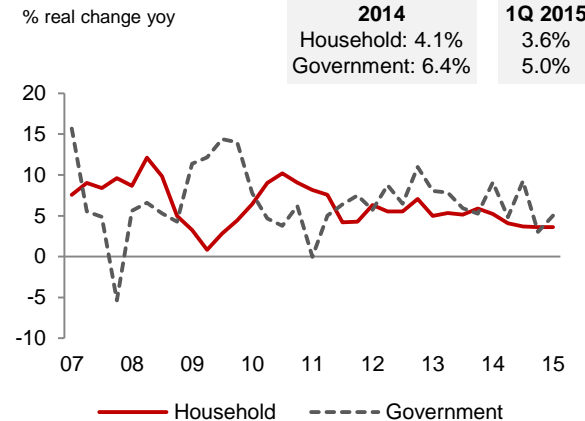
Source: Instituto Nacional de Estadística e Informática (INEI); Central Reserve Bank of Peru; BTMU

Figure 2: GDP by Sector



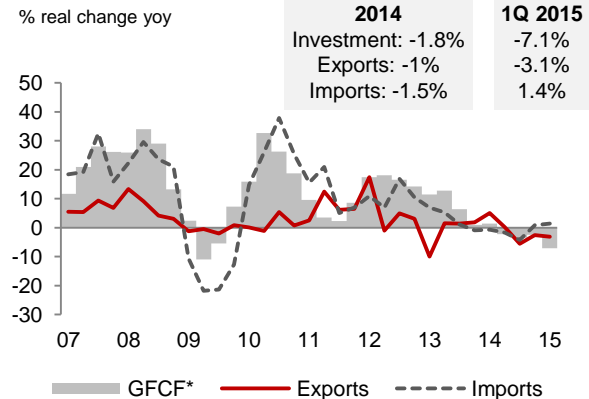
Source: Central Reserve Bank of Peru; BTMU

Figure 3: Consumption



Source: Central Reserve Bank of Peru; BTMU

Figure 4: Investment, Exports and Imports



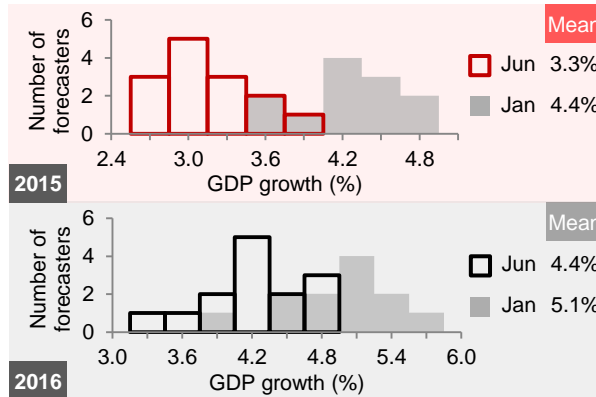
\*Gross Fixed Capital Formation  
Source: Central Reserve Bank of Peru; BTMU

# I) Peru: Growth Momentum (2)

■ The Peruvian economy could grow around 3% this year, far from its potential growth of 4.5%.

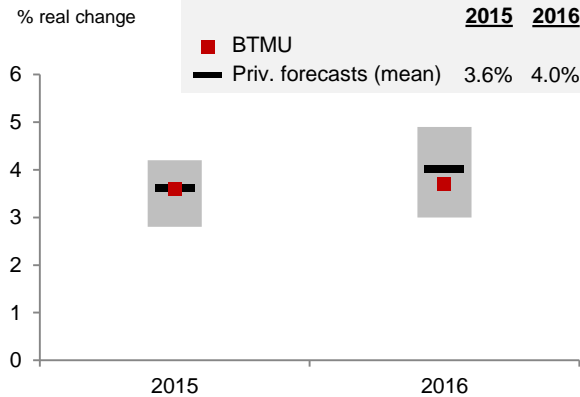
■ After a disappointing 2014, when the economy grew at its slowest pace since 2009, even a tepid recovery in 1Q is certainly a glimmer of good news. But the truth is that this quarter's results cast more doubts than certainties over the strength of Peru's export-led economy in the short-to-medium term, especially in this context of low metal prices. No wonder the market has cut its growth outlook for 2015 and 2016 to 3.3% and 4.4%, respectively, from 4.4% and 5.1%. As of June, we also expected the Peruvian economy to grow around 3.0% this year, and accelerate to about 4.0% in 2016. But downside risks to this outlook are significant. The first reason for caution is private consumption. While most analysts expect consumer spending to speed up next year, we see it growing at a similar pace as in 2015: (i) the effects of recent demand-side stimulus are likely to fade away next year; (ii) the Central Bank might be forced to adopt a hawkish stance once the Fed raises interest rates; and (iii) tighter credit conditions for consumer loans (including mortgage) could hinder private spending.

Figure 5: GDP Growth (Private forecasts)



Source: Consensus Economics; BTMU

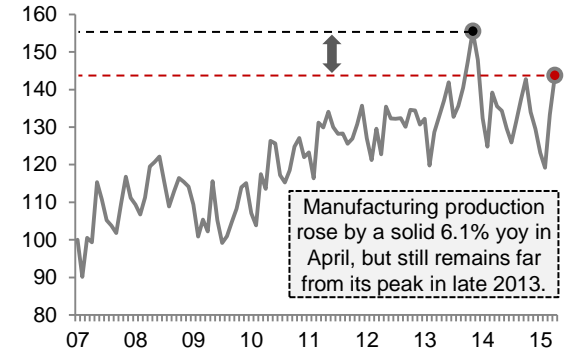
Figure 7: Private Consumption (Forecasts)



Source: Consensus Economics; BTMU

Figure 6: Manufacturing Production

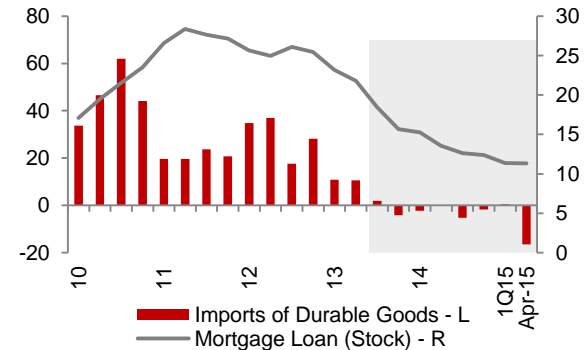
Volume index (2007, Jan=100)



Source: INEI; BTMU

Figure 8: Imp. of Durable Goods & Mortgage Loan

% nominal change yoy



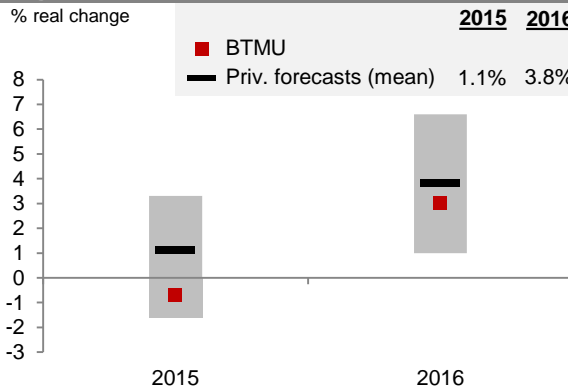
Source: Central Reserve Bank of Peru; BTMU

# I) Peru: Growth Momentum (3)

## Investment will probably contract for two consecutive years.

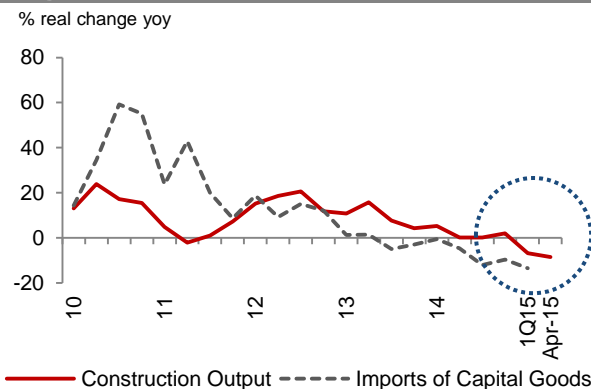
A swift recovery was expected in gross fixed capital formation (GFCF) this year, as large public-private infrastructure projects such as Lima's first subway line begin construction; but the poor results so far this year seem to suggest the opposite. Import of capital goods and construction output, two main components of GFCF according to official statistics, dipped by 13.5% and 6.8% yoy in 1Q, respectively. This downward trend will probably last until 2Q due to delay in some mining and infrastructure projects, as well as slow execution of public investment at the regional level. All this means that both private and public investment will need to expand at a pace above 7% in the second half in order to offset the initial drag. This, of course, is unlikely given the uncertainty over public investment and weak business confidence. Thus, we expect GFCF to contract by around 0.5% this year, and gradually recover in 2016. Lastly, we expect mining exports to pick up in the next quarters, buoyed by higher production of copper; but fishing exports will hinge on the intensity of El Niño weather phenomenon.

**Figure 9: Gross Fixed Investment (Forecasts)**



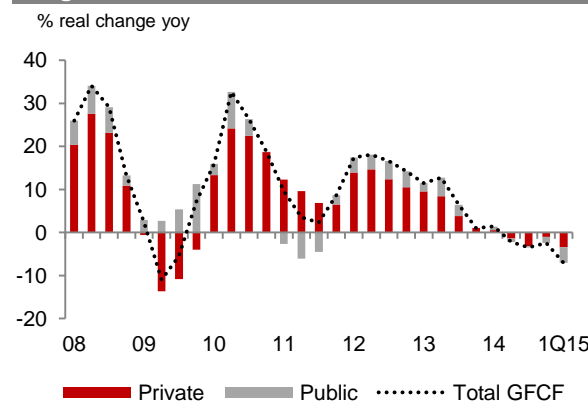
Source: Consensus Economics; BTMU

**Figure 10: Construction & Imp of Capital Goods**



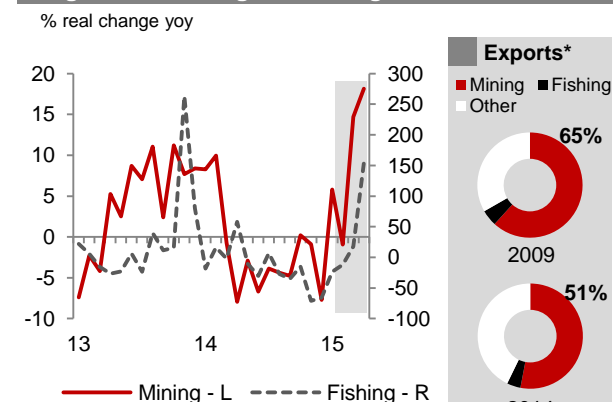
Source: INEI; Central Reserve Bank of Peru; BTMU

**Figure 11: Private and Public Investment**



Source: Central Reserve Bank of Peru; BTMU

**Figure 12: Fishing and Mining Production**



\*Nominal  
Source: Central Reserve Bank of Peru; BTMU

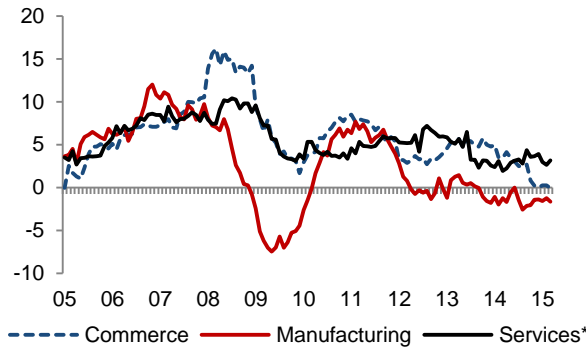
## II) Peru: Labor Market and Prices

### ▪ Inflation hit 3.5% in June, exceeding the Central Bank's target band.

- Labor Market:** Weak economic activity appears to have weighed on employment, particularly in the manufacturing and commerce sectors, although unemployment rate remained low at 7.4% in May. But in this case traditional indicators do not fully capture the current employment situation because Peru has one of the highest informality rates in Latin America, with more than half of its labor force working outside the law or in micro-enterprises that lack labor rights, according to several estimates.
- Inflation:** 12-month inflation picked up sharply from 2.8% in February to 3.5% in June, exceeding the Central Bank's target band (1% to 3%). At least two factors were behind the surge. First, food and beverage prices, which account for more than one-third of a typical consumer's basket, rose by 3.0% since the start of the year, as unfavorable weather conditions disrupted supply. Second, electricity prices went up significantly due to the pass-through effect of a weaker currency (higher oil-import costs). Thus, the Central Bank expects a slower convergence to its target of 2%.

**Figure 13: Employment by Sector**

Volume index (2010, October=100)

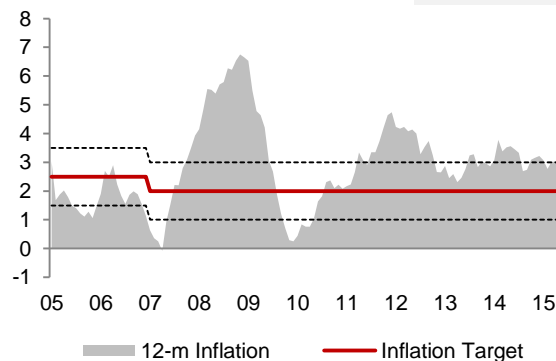


\*Does not include the commerce sector  
Source: Central Reserve Bank of Peru; BTMU

**Figure 15: Inflation**

Percentage

**12-m inflation**  
3.54% (Jun-15)

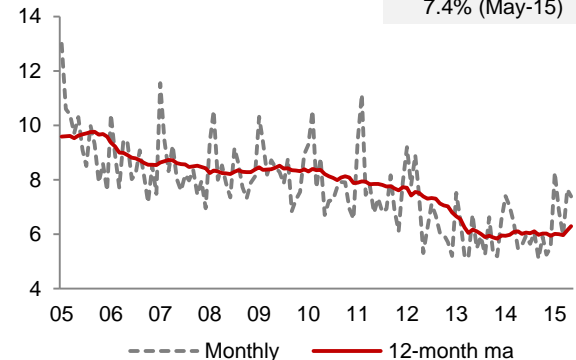


Source: INEI; BTMU

**Figure 14: Unemployment Rate**

Percentage

**Unemployment rate**  
7.4% (May-15)

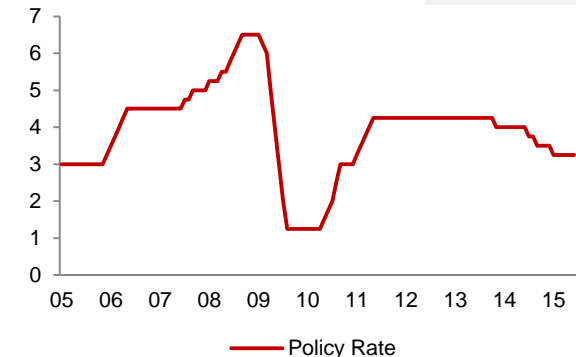


Source: Central Reserve Bank of Peru; BTMU

**Figure 16: Policy Rate**

Percentage

**Policy rate**  
3.25% (Jun-15)



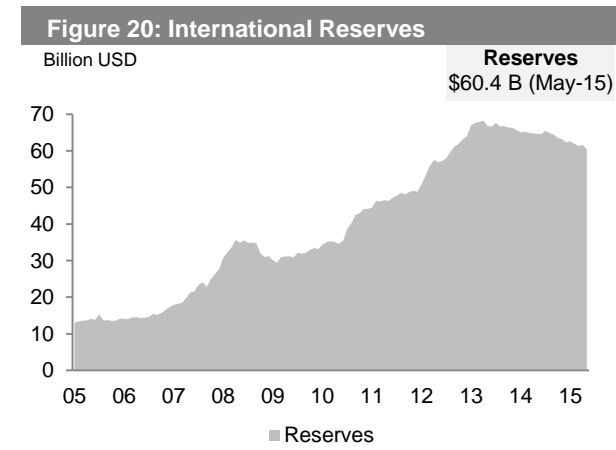
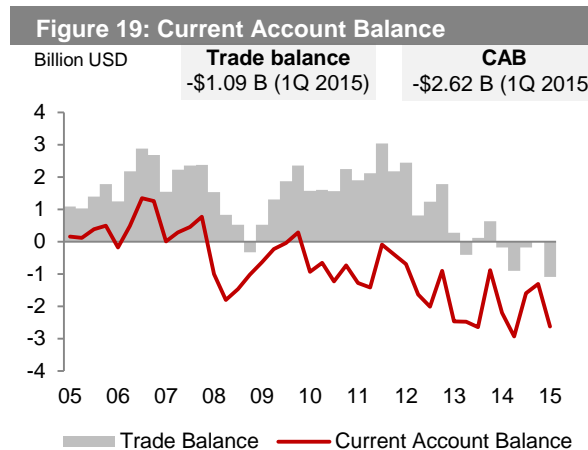
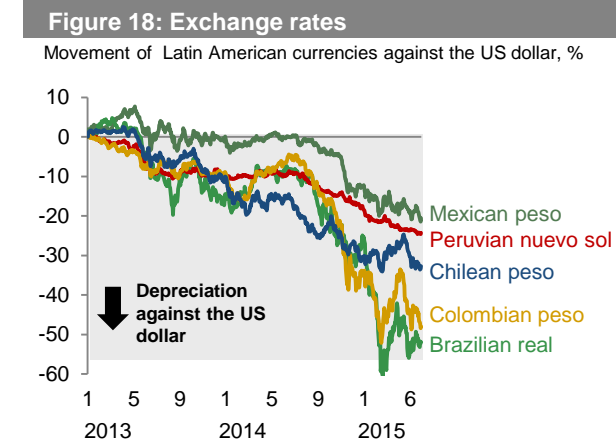
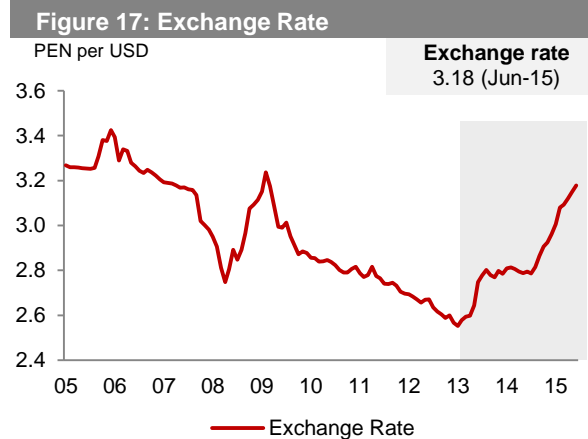
Source: Central Reserve Bank of Peru; BTMU

# III) Peru: Exchange Rate and Current Account

Trade deficit widened to a record low level of \$1.1 billion in the first quarter of 2015.

**Exchange Rate:** The Peruvian sol has depreciated steadily against the US dollar since the beginning of 2013, despite the Central Bank's active intervention in the foreign-exchange market to smooth volatility and limit risks related to high dollarization. The sol has lost about 24% of its value since early 2013, but it has fared better than other currencies of the region. Yet a possible interest rate hike by the Fed will likely put further downward pressure on Peru's currency, and could force the Central Bank to keep using its reserves to shore up the sol.

**Current Account:** Peru's external accounts have deteriorated significantly in 1Q 2015. Current account deficit doubled in 1Q to \$2.6 billion from the previous quarter; while trade deficit expanded to a record low level of \$1.1 billion as a result of deteriorating terms of trade and weakening demand from China. However, trade balance is expected to improve gradually in the second half of year, mainly on the back of higher mining and fishing exports, and declining imports.



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