

Peru's Macroeconomic Performance: Q4 2017 GDP and Current Monthly Indicators

MUFG UNION BANK, N.A.
ECONOMIC RESEARCH (NEW YORK)
KAREN MARTINEZ
Latin America Economist
+1(212)782-5708
KMartinez@us.mufg.jp

30 APRIL 2018

MUFG Bank, Ltd.
A member of MUFG, a global financial group

Peru's GDP growth decelerated during Q4 2017 to 2.2% YoY in comparison to the previous quarter (2.9% YoY). 2017 annual growth reached 2.5%, well below the 4.0% expansion Peru registered during 2016.

Consumption increased by 3.5% YoY in Q4 2017, driven by an increase in government consumption. Meanwhile, household consumption grew 2.6% YoY in Q4 2017. Two factors could have limited the scope of expansion, 1) stagnant real wages and 2) the high unemployment rate.

Gross Fixed Capital Formation (GFCF) started to recover during the second half of 2017. During Q4 2017, it grew at 2.4% YoY as a result of increasing public and private investment. The improvement in private investment reflected an improvement in investment in the mining industry. Low interest rates could be one of the main drivers for this improvement, as well as higher prices of metals.

In March 2018, Consumer Price Index (CPI) reached its lowest level (0.4% YoY) since December 2009 and has remained below the Central Bank target rate (2.0%) for five consecutive months. This low inflation is mainly driven by a sharp decline in food prices.

At its last meeting in April 2018, the Central Bank decided to keep the policy rate unchanged at 2.75%. The Central Bank highlighted the decline in both, inflation and inflation expectations as well as the weak economic growth as some of the reasons behind the decision.

For 2018, it is expected that Peru's GDP growth will accelerate. Low inflation and low interest rates will likely underpin household consumption. Investment will be supported by low interest rates, higher commodity prices and a potential upturn of public investment that is expected to pick up due to the reconstruction process after the impact in 2017 from the El Niño phenomenon.

1. GDP

Peru's GDP growth decelerated during Q4 2017 to 2.2% YoY in comparison to the previous quarter (2.9% YoY) (Figure 1). 2017 annual growth reached 2.5%, well below the 4.0% expansion Peru registered during 2016.

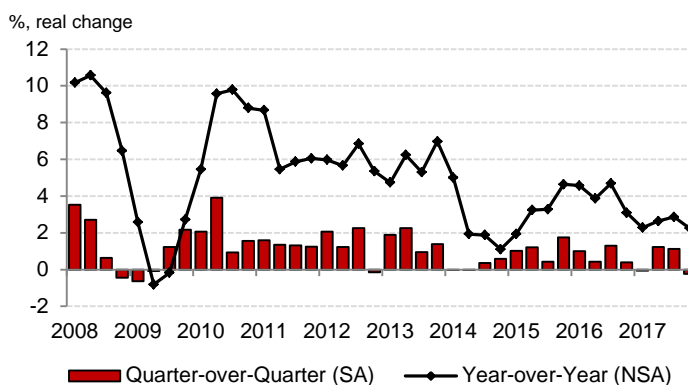
Most of the sectors grew during 2017, however, the pace of growth that some of them registered was considerably slower than in 2016. The primary sector (agriculture, fishing and mining sectors) went from growing 9.3% YoY in 2016 to 3.0% YoY in 2017 (Figure 2). This is mainly explained by the deceleration of the mining sector. The non-primary sector saw its growth remain unchanged from 2016 to 2017 (2.4% YoY both years) recording mixed results.

Consumption

Consumption increased by 3.5% YoY in Q4 2017 (Figure 3), driven by an increase in government consumption (9.3% YoY) mainly explained by an increase in spending by the regional and local administrations.

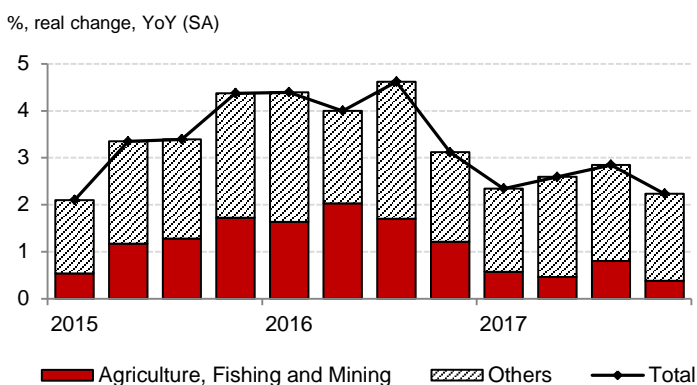
Meanwhile, household consumption grew 2.6% YoY in Q4 2017.

Figure 1: GDP Growth



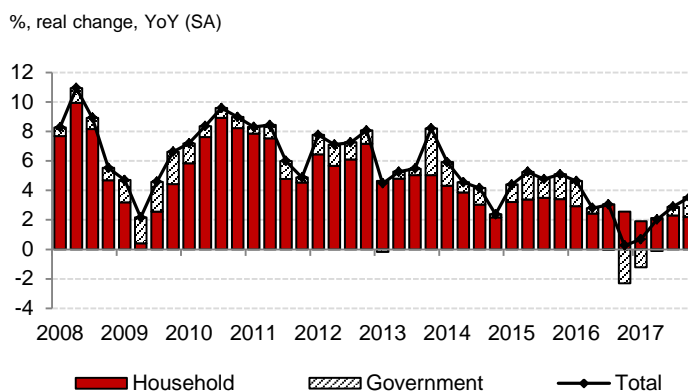
Source: Central Reserve Bank of Peru, MUFG

Figure 2: GDP by Sector



Source: Central Reserve Bank of Peru, DataStream, MUFG

Figure 3: Consumption



Source: Central Reserve Bank of Peru, DataStream, MUFG

Household consumption was underpinned by a deceleration in inflation, however two factors could have limited the scope of expansion, 1) stagnant real wages (affected partially by the fact that the government did not increase the minimum wage during 2017) and 2) the high unemployment rate (the annual average in 2017 was 6.9%, the highest since 2011) (Figure 4).

Investment

Gross Fixed Capital Formation (GFCF) started to recover during the second half of 2017. During Q4 2017, it grew at 2.4% YoY as a result of increasing public and private investment (Figure 5).

Public investment was supported by the initiation of projects for the Pan American Games¹, the resumption of construction of Line 2 of the metro in Lima and other highway projects.

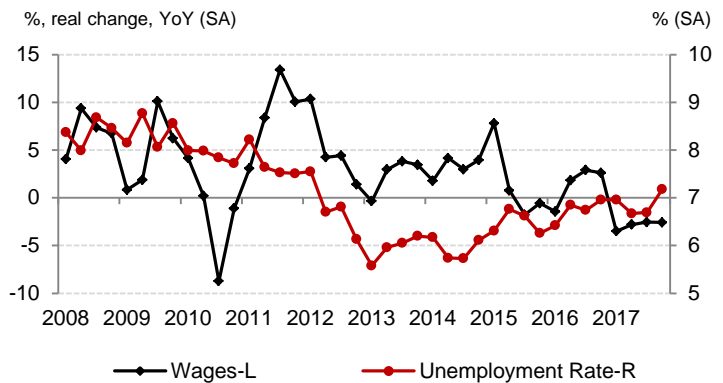
Meanwhile, the improvement in private investment reflected an improvement in investment in the mining industry. Low interest rates could be one of the main drivers for this improvement, as well as higher prices of metals.

Exports and Imports

Exports of goods grew during Q4 2017 (12.4% YoY) although with a slower pace than in the previous quarter (Figure 6). The upturn in traditional goods, mainly copper (22.3% YoY in Q4 2017) was the main driver for the positive results in exports. This expansion is the result of the continued improvement in the global economy and commodity prices.

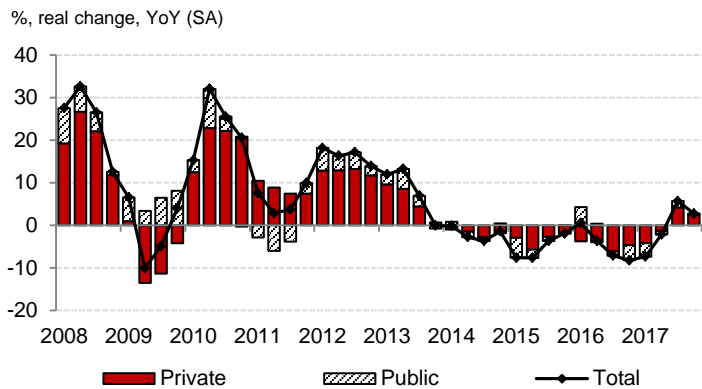
¹The Pan American Games are a major sporting event in the Americas featuring summer sports in the year before the Summer Olympic Games. The games are scheduled to be held from July 26 to August 11, 2019, in Lima, Peru.

Figure 4: Wages and Unemployment Rate



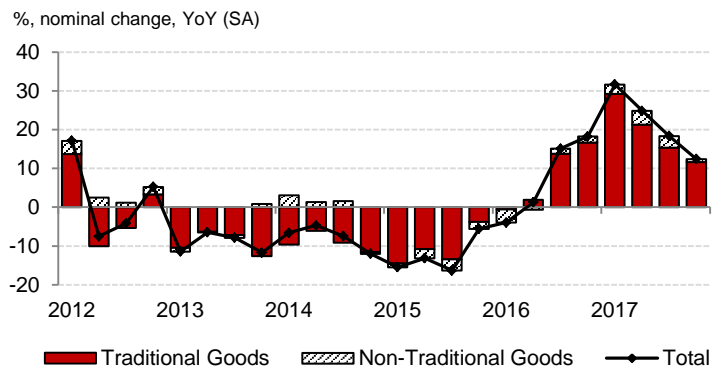
Source: Central Reserve Bank of Peru, DataStream, MUFG

Figure 5: Gross Fixed Capital Formation



Source: Central Reserve Bank of Peru, DataStream, MUFG

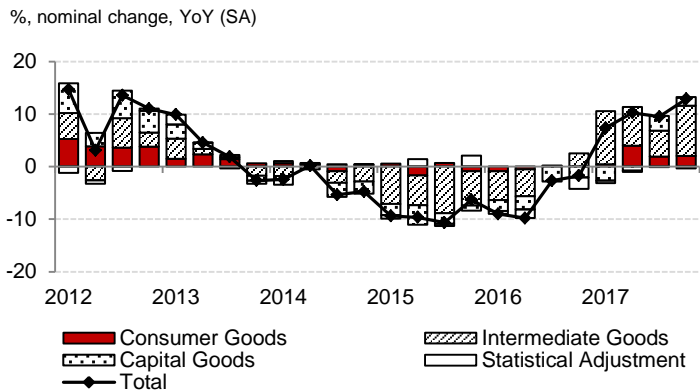
Figure 6: Exports of Goods



Note: Traditional goods include mining, agricultural and fish meal products.
Source: Central Reserve Bank of Peru, DataStream, MUFG

Imports of goods grew 12.9% YoY during Q4 (Figure 7). The increase was driven mainly by an upturn in intermediate goods (21.4% YoY in Q4 2017), which is related with improved investment and high exports.

Figure 7: Import of Goods

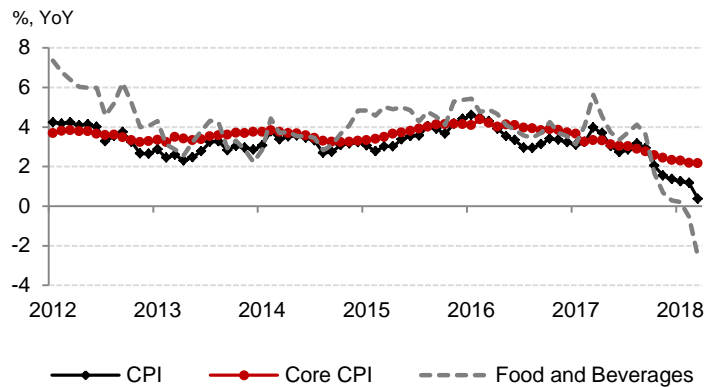


Source: Central Reserve Bank of Peru, DataStream, MUFG

2. Inflation and Monetary Policy

In March 2018, Consumer Price Index (CPI) reached its lowest level (0.4% YoY) (Figure 8) since December 2009 and has remained below the Central Bank target rate (2.0%) for five consecutive months. This low inflation is mainly driven by a sharp decline in food prices. After the impact of the El Niño phenomenon during the beginning of 2017, weather patterns have returned to a more normal pattern, leading to a reduction in the rate of increase of food prices. Core CPI² continued with a decreasing trend that is signaling lower inflationary pressures on the demand side.

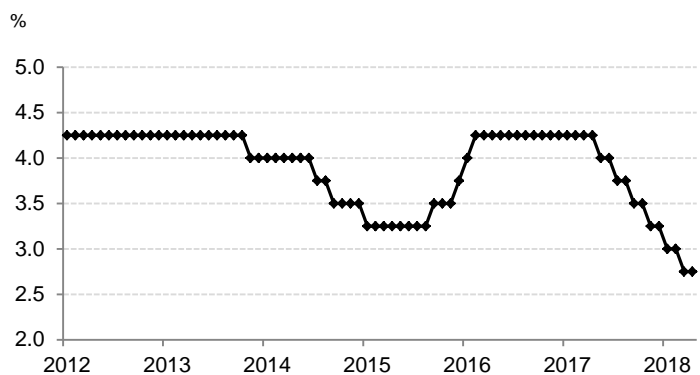
Figure 8: Inflation



Source: Instituto Nacional de Estadística e Informática (INEI), MUFG

Throughout 2017, the Central Bank cut its policy rate 4 times (by a total of 1.0 percentage points) (Figure 9). So far in 2018, the Central Bank cut its policy rate 2 times (during its January and March meetings). At its last meeting in April 2018, the Central Bank decided to keep the policy rate unchanged at 2.75%. The Central Bank highlighted the decline in both, inflation and inflation expectations as well as the weak economic growth as some of the reasons behind the decision.

Figure 9: Policy Rate



Source: Central Reserve Bank of Peru, MUFG

²CPI excluding food and beverages and energy prices.

3. Outlook

For 2018, it is expected that Peru's GDP growth will accelerate. Low inflation and low interest rates will likely underpin household consumption. Investment will be supported by low interest rates, higher commodity prices and a potential upturn of public investment that is expected to pick up due to the reconstruction process after the impact in 2017 from the El Niño phenomenon.

On March 23, former vice president Martín Vizcarra became the new president of Peru, after a period of turmoil that resulted in President Kuczynski's resignation³. Vizcarra's objective seems to be to create political stability and to seek consensus in Congress. His cabinet picks so far have been mostly technocrats with a pro-market profile and this could help Peru's economy accelerate.

For reference to our previous reports, see our website at: <https://mufgamericas.com/economic-research>

The information herein is provided for information purposes only, and is not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities or other financial instruments. Neither this nor any other communication prepared by MUFG Bank, Ltd. (collectively with its various offices and affiliates, "MUFG Bank") is or should be construed as investment advice, a recommendation to enter into a particular transaction or pursue a particular strategy, or any statement as to the likelihood that a particular transaction or strategy will be effective in light of your business objectives or operations. Before entering into any particular transaction, you are advised to obtain such independent financial, legal, accounting and other advice as may be appropriate under the circumstances. In any event, any decision to enter into a transaction will be yours alone, not based on information prepared or provided by MUFG Bank. MUFG Bank hereby disclaims any responsibility to you concerning the characterization or identification of terms, conditions, and legal or accounting or other issues or risks that may arise in connection with any particular transaction or business strategy. While MUFG Bank believes that any relevant factual statements herein and any assumptions on which information herein are based, are in each case accurate, MUFG Bank makes no representation or warranty regarding such accuracy and shall not be responsible for any inaccuracy in such statements or assumptions. Note that MUFG Bank may have issued, and may in the future issue, other reports that are inconsistent with or that reach conclusions different from the information set forth herein. Such other reports, if any, reflect the different assumptions, views and/or analytical methods of the analysts who prepared them, and MUFG Bank is under no obligation to ensure that such other reports are brought to your attention. MUFG Bank, Ltd. retains copyright to this report and no part of this report may be reproduced or re-distributed without the written permission of MUFG Bank, Ltd. MUFG Bank, Ltd. expressly prohibits the re-distribution of this report to Retail Customers, via the internet or otherwise and MUFG Bank, Ltd., its subsidiaries or affiliates accept no liability whatsoever to any third parties resulting from such re-distribution.

³On March 21, President Kuczynski resigned after a year and seven months in office. Mr. Kuczynski was facing an impeachment vote (the second one in three months) due to his financial ties to Odebrecht, the Brazilian construction firm that is at the center of a region-wide bribery scandal.