

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

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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.

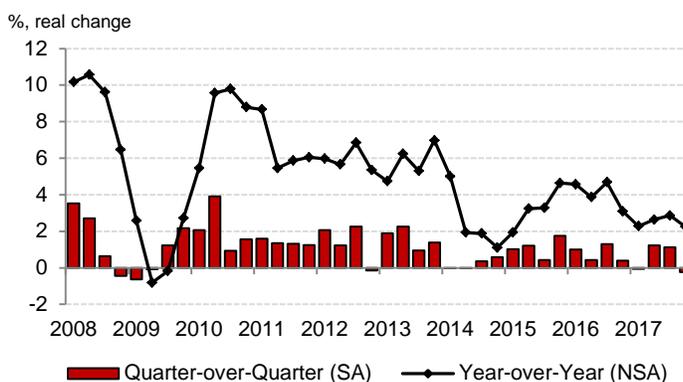
Most of the sectors grew during 2017, however, the pace of growth that some of them registered was considerably slower than in 2016. The primary sector (agriculture, fishing and mining sectors) went from growing 9.3% YoY in 2016 to 3.0% YoY in 2017 (Figure 2). This is mainly explained by the deceleration 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.

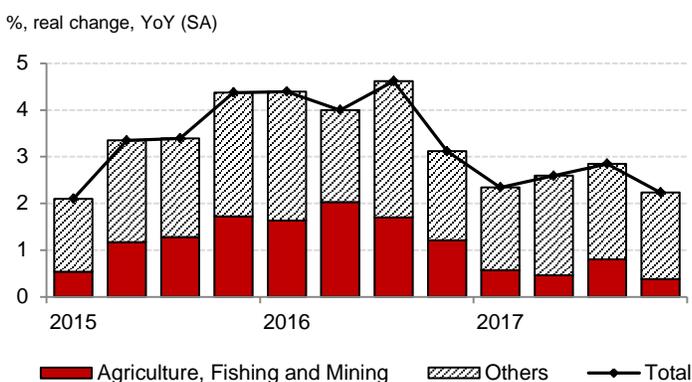
Meanwhile, household consumption grew 2.6% YoY in Q4 2017.

**Figure 1: GDP Growth**



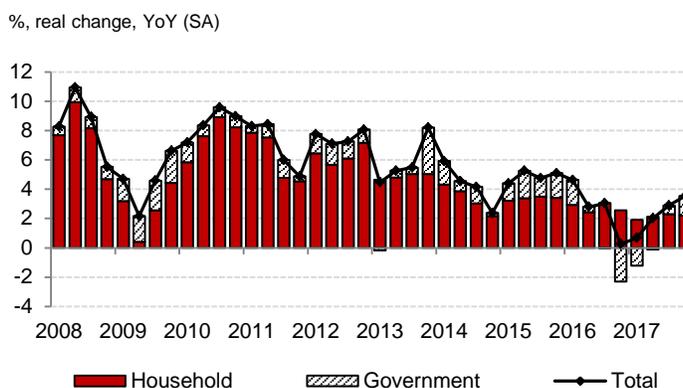
Source: Central Reserve Bank of Peru, MUFG

**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).

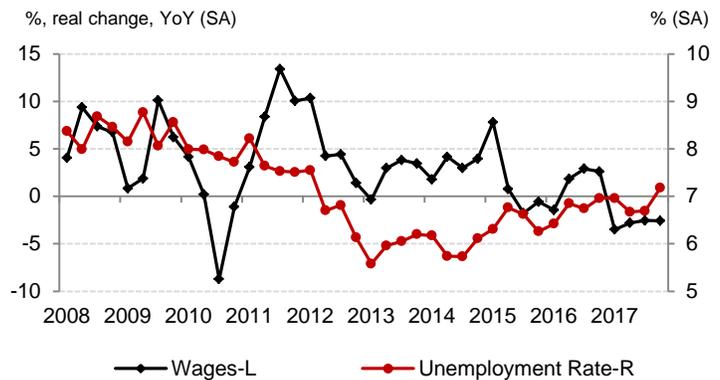
Public investment was supported by the initiation of projects for the Pan American Games<sup>1</sup>, the resumption of construction of Line 2 of the metro in Lima and other highway projects.

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

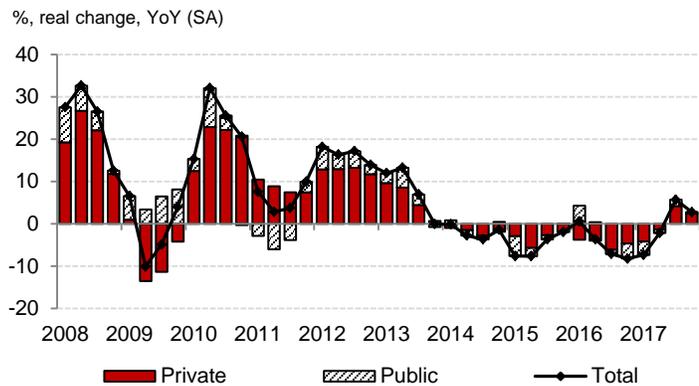
Exports of goods grew during Q4 2017 (12.4% YoY) although with a slower pace than in the previous quarter (Figure 6). The upturn in traditional goods, mainly copper (22.3% YoY in Q4 2017) was the main driver for the positive results in exports. This expansion is the result of the continued improvement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

**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**

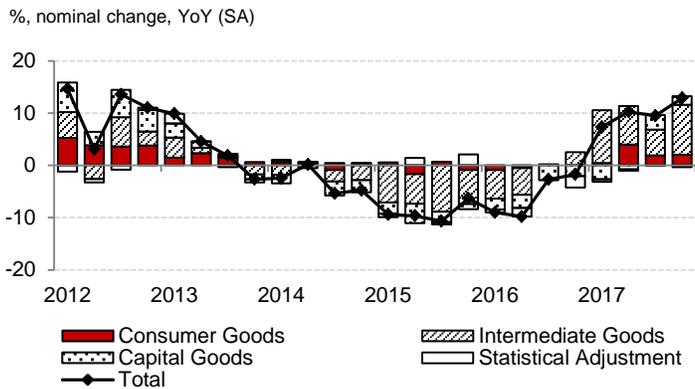


Note: Traditional goods include mining, agricultural and fish meal products.  
Source: Central Reserve Bank of Peru, DataStream, MUFG

<sup>1</sup>The 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.

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**

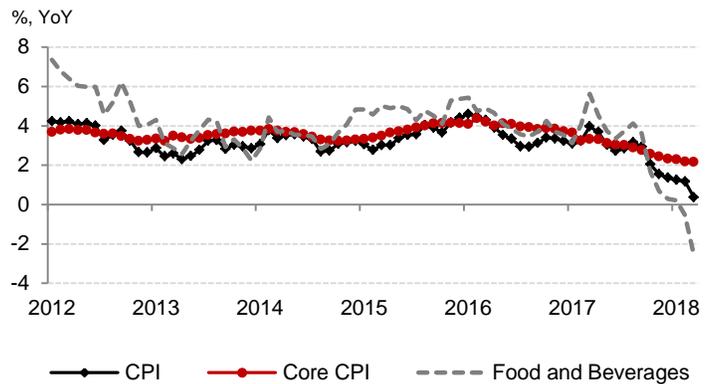


Source: Central Reserve Bank of Peru, DataStream, MUFG

## 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 CPI<sup>2</sup> continued with a decreasing trend that is signaling lower inflationary pressures on the demand side.

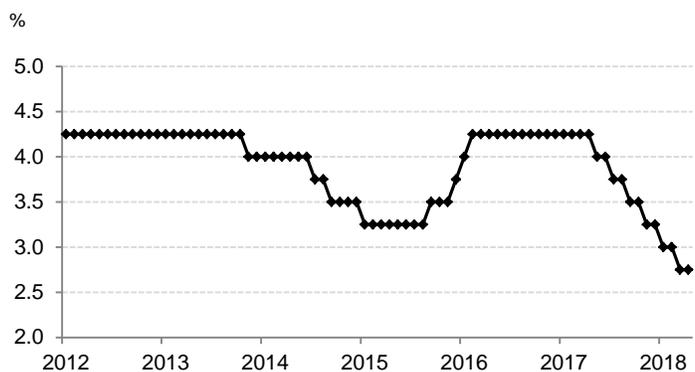
**Figure 8: Inflation**



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

<sup>2</sup>CPI excluding food and beverages and energy prices.

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### 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 resignation<sup>3</sup>. 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.

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<sup>3</sup>On 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.