

Macro scenario - Peru



June 10, 2024

Further rate cuts are likely

- ▶ The political landscape remains challenging. There have been three more unsuccessful impeachment attempts against President Boluarte, and the public prosecutor's office filed a constitutional complaint against her for alleged corruption.
- ▶ We now expect the central bank to implement three 25-bp additional policy rate cuts this year, reaching a year-end rate of 5.00% (from 5.75% in our previous scenario). Our updated call is supported by still-weak growth, well-behaved inflation, and the BCRP President's clear comfort in further reducing the rate differential between the BCRP and the U.S. Fed.

Peruvian stand-off

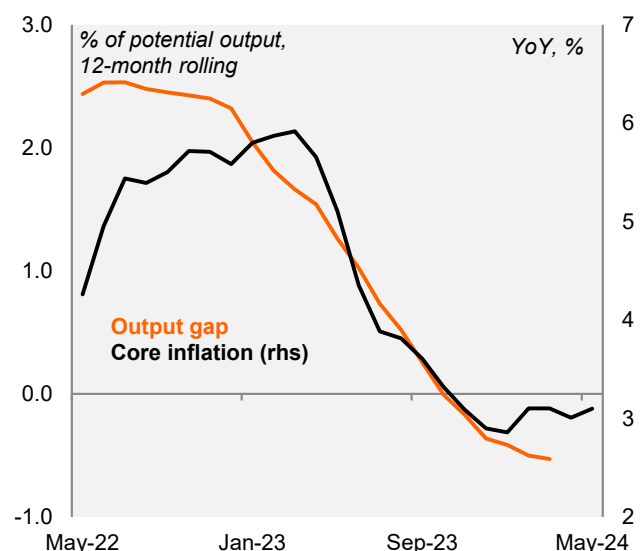
Three new unsuccessful attempts to impeach President Boluarte emerged. According to the motions to impeach, President Boluarte interfered with investigations against her brother, who was arrested on corruption charges. However, as expected and in line with previous efforts by congress to oust the president, the motions to impeach failed to garner enough support in Congress (52 votes) to start procedures. Congress is unlikely to approve an impeachment (87 votes needed) because it would trigger immediate general elections, cutting the current legislators' terms short. Meanwhile, the public prosecutor's office filed a constitutional complaint against Boluarte for the alleged luxury watch corruption crime; Boluarte is only likely to face these accusations after her presidency, given that, according to the Constitution, a sitting President cannot be tried for this type of crime. Continuing political turmoil has its costs. We note, for instance, that the S&P rating agency recently lowered Peru's sovereign rating to BBB-, one notch above junk, stating that the country's complex political landscape limits the government's capacity to implement policies to boost investment, curbing the growth outlook.

Increasing odds of further rate cuts

A fragile activity recovery and well-behaved inflation suggest further rate cuts ahead. GDP growth slowed to a below-trend rate of 1.4% YoY in 1Q24, supported by a recovery in private consumption and investment. The annual GDP growth mainly

reflects the favorable base effects, given the social conflicts and weather shocks in 1Q23. At the margin, GDP expanded by 0.5% QoQ/SA. Meanwhile, inflation delivered another negative surprise in May (-0.09% vs. market consensus of 0.12%), following a drop in food prices. On an annual basis, headline inflation fell to 2.00% in May (from 2.42% in April), in line with the central bank target, while core inflation (excluding energy and food items) stood at 3.10%.

Fragile activity recovery



Source: BCRP, Itaú.

While the narrowing of the BCRP-Fed rate differential might suggest limited scope for rate cuts ahead, recent comments by the central bank president suggest that the policy rate could fall below the FFR, increasing the odds of further rate cuts. The current 5.75% policy rate is very close to the Fed's policy rate range of 5.25%-5.50%, which has pressured the USD/PEN (also due to the persistent political turmoil and S&P's recent rating downgrade) despite gains in copper prices. The currency weakened by 0.2% in April and May (in contrast with the USD/CLP, which appreciated by 6.7%), while copper prices rose by 14.8%. However, Central Bank President Julio Velarde recently noted that the policy rate could fall to 100 bps below the Fed's rate.

The central bank will likely attempt to mitigate the currency volatility by intervening in the currency market. The BCRP intervened in the spot market again in April-May, selling USD 78 million; the previous intervention was in February, with the sale of USD 233 million, when markets priced in a delay in the start of the Fed's easing cycle. The BCRP also sold USD 3.8 billion in currency swaps during the same period. At least for the moment, the country can afford it. Better terms of trade point towards a sizeable improvement of the current account. Moreover, the central bank's net reserves reach around 19% of GDP, which according to IMF's ratio of reserves to ARA metric¹, are well above the adequate level (2.33 versus an adequate range of 1-1.5).

Lower rates this year

Our GDP growth forecast for this year stands at 2.7%. We expect activity to show a clearer recovery for the remainder of the year, considering the positive terms of trade shifts and strong growth in Peru's main trading partners. For next year, we estimate GDP growth of 3.0%.

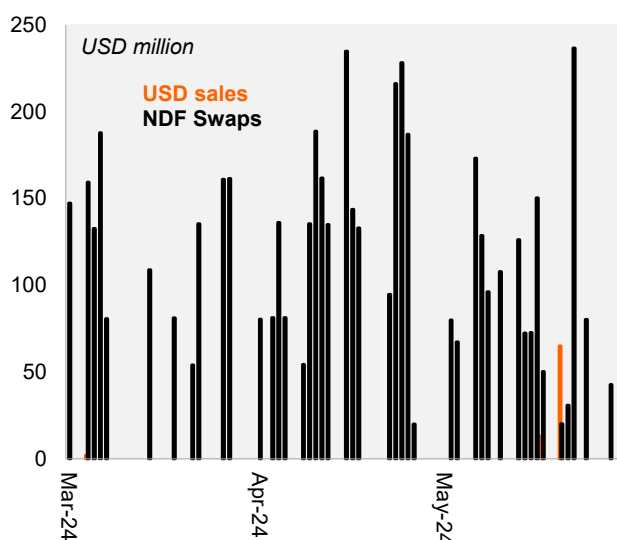
We now expect the central bank to implement three extra 25-bp policy rate cuts this year, reaching a year-end rate of 5.00% (from 5.75% in our previous scenario). Our updated call is supported by below-trend growth, well-behaved inflation, and the BCRP president's comfort in further reducing the rate differential between the BCRP and the U.S. Fed.

A narrower rate differential will weigh on the currency but will be limited by higher copper prices and the central bank intervention in the currency market. Our YE24 currency forecast now stands at USD/PEN 3.80 (from USD/PEN 3.75 in our previous scenario).

Higher copper prices led to the upward revision of our trade surplus forecast for this year to USD 18.5 billion, from USD 16 billion in our previous scenario. Our new current account balance forecast calls for a surplus of 0.8% of GDP, from a deficit of 0.1% of GDP in our previous scenario.

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BCRP intervention in currency market



Source: BCRP.

¹ The IMF's metric has four weighted components: short-term external debt; M2; export income; and other liabilities.

Peru | Forecasts and Data

| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024F | | 2025F | | |
|-----------------------------------|-------|-------|-------|-------|-------|--------------|----------|--------------|----------|--|
| | | | | | | Current | Previous | Current | Previous | |
| Economic Activity | | | | | | | | | | |
| Real GDP growth - % | 2.2 | -10.9 | 13.4 | 2.7 | -0.6 | 2.7 | 2.7 | 3.0 | 3.0 | |
| Nominal GDP - USD bn | 233 | 206 | 226 | 244 | 267 | 283 | 284 | 297 | 298 | |
| Population (millions) | 33.2 | 33.5 | 33.8 | 34.2 | 34.5 | 34.9 | 34.9 | 35.2 | 35.2 | |
| Per Capita GDP - USD | 7,030 | 6,156 | 6,690 | 7,155 | 7,747 | 8,130 | 8,149 | 8,448 | 8,467 | |
| Unemployment Rate - year avg | 6.6 | 13.6 | 10.9 | 7.7 | 6.8 | 6.8 | 6.8 | 7.0 | 7.0 | |
| Inflation | | | | | | | | | | |
| CPI - % | 1.9 | 2.0 | 6.4 | 8.5 | 3.2 | 2.8 | 2.8 | 2.5 | 2.5 | |
| Interest Rate | | | | | | | | | | |
| Monetary Policy Rate - eop - % | 2.25 | 0.25 | 2.50 | 7.50 | 6.75 | 5.00 | 5.75 | 4.25 | 4.25 | |
| Balance of Payments | | | | | | | | | | |
| PEN / USD - eop | 3.31 | 3.62 | 4.00 | 3.81 | 3.70 | 3.80 | 3.75 | 3.80 | 3.77 | |
| Trade Balance - USD bn | 6.9 | 8.1 | 15.1 | 10.2 | 17.7 | 18.5 | 16.0 | 18.0 | 17.0 | |
| Current Account - % GDP | -0.6 | 0.9 | -2.1 | -4.0 | 0.8 | 0.8 | -0.1 | -0.7 | -1.0 | |
| Foreign Direct Investment - % GDP | 2.0 | 0.3 | 3.2 | 4.6 | 1.5 | 2.5 | 2.5 | 3.0 | 3.0 | |
| International Reserves - USD bn | 68.4 | 74.9 | 78.5 | 72.2 | 71.3 | 74.0 | 74.0 | 76.0 | 76.0 | |
| Public Finances | | | | | | | | | | |
| NFPS Nominal Balance - % GDP | -1.6 | -8.9 | -2.5 | -1.7 | -2.8 | -2.5 | -2.5 | -2.2 | -2.2 | |
| NFPS Primary Balance - % GDP | -0.2 | -7.3 | -1.0 | -0.1 | -1.1 | -0.8 | -0.8 | -0.4 | -0.4 | |
| NFPS Debt - % GDP | 26.5 | 34.5 | 35.8 | 33.9 | 32.9 | 33.9 | 33.9 | 34.1 | 34.1 | |

Source: IMF, INEI, BCRP, Itaú

Macro Research – Itaú

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