

Macro scenario - Peru



October 4, 2024

Recovery gains steam

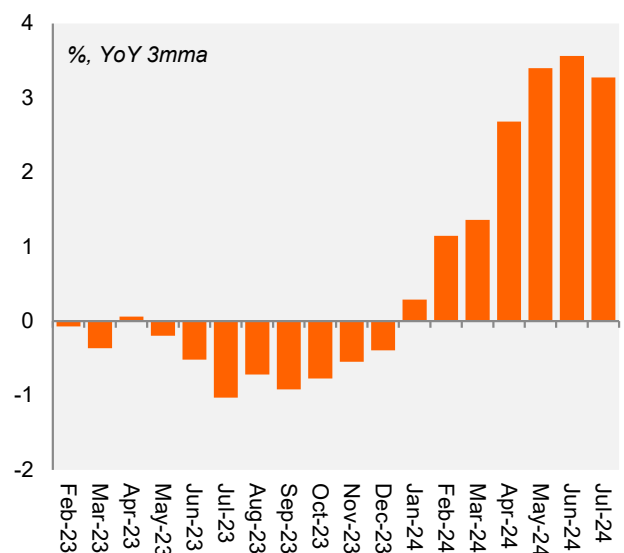
- ▶ We expect the BCRP to reach neutral slightly earlier than previously envisaged, getting to 4.75% by year-end 2024, and 4% in 2025. The BCRP has made substantial progress in bringing the policy rate closer to neutral over the course of the last year; yet we believe the central bank is likely to deliver two additional cuts later this year to 4.75% (previously 5.00%), in the context of well-behaved inflation, inflation expectations that are gradually converging to the target, and lower exchange-rate pressure from the BCRP-Fed rate differential.

Looking like more than just green shoots

Activity roared back in July. After a significantly weaker-than-expected monthly GDP proxy in June (+0.2% yoy), mainly driven by volatile and transitory factors, activity jumped in July, rising by 4.5% with growth across practically all sectors. On a sequential basis, the monthly GDP proxy expanded by 2.3% mom/sa, which led to a statistical carryover of 2.5%. Importantly, a broad set of indicators suggests the recovery is gaining steam. Business expectations have gradually improved swinging back to positive territory, the wage bill continues to rise, and the pace of formal job creation has recovered over the past several months (back to the 2016-2022 average). Imports of capital goods are also flashing green, increasing by 5.9% in the rolling quarter ending in July.

Rating outlook stabilized. In this context, rating agency Moody's maintained Peru's long-term foreign-currency rating at Baa1 but improved the outlook from negative to stable. According to the agency, the review was driven by a more stable political environment along with political reforms (including the return to a bicameral congress) that should contribute to even greater political stability over time. In April, S&P downgraded Peru to BBB- with a stable outlook, while Fitch affirmed the sovereign's rating at BBB with a negative outlook.

Monthly GDP recovering



Source: INEI, Itaú

Turning the tide. In previous reports we have noted Peru's fiscal headwinds, which mainly result from persistent revenue disappointments, leading to misses in fiscal deficit targets and added pressure on the sovereign's rating. Importantly, data in recent months suggest cyclically related revenue growth may have turned the corner, rising by 5.5% YoY in real terms over the last rolling quarter ending in August; these have declined by 2.91% in the year through August. High copper prices and the recovery of economic activity should further support the improvement in revenues going forward. Non-financial expenditure growth remained strong through August, rising by 7.5% in the last rolling quarter, with fiscal spending likely to moderate in the seasonal December spike; these have increased by 3.6% in the year through August.

Another downside inflation surprise. Following the monthly 0.28% rise in August, inflation unexpectedly fell by 0.24% MoM in September, well below market expectations of a 0.08% increase. The monthly decline in September was mainly driven by large declines in volatile food items, that led to a fall in the food and non-alcoholic beverage category, roughly 23% of the CPI basket, of 0.97% MoM. On an annual basis inflation fell to 1.78%, falling below the center of the 2+/-1% target, and the lowest since October 2020. Core inflation (ex-food & energy) was flat monthly, which led to another annual fall to 2.64%. At the margin, our seasonally adjusted three-month annualized CPI estimate came in at 0.28% in September (0.59% in 2Q24), while core inflation stood at 0.87% in the quarter (from 2.12% in 2Q24).

Gradually edging to neutral. Following the decision, the real ex-ante rate fell to 2.81% (from 3.06%), still above the BCRP's neutral rate of 2.0%. Throughout this easing cycle, the BCRP has brought the policy rate down from a peak of 7.75% in September 2023 to the current 5.25% and has complemented its monetary policy decisions with gradual reductions to the reserve requirement (from 6.75% in March to 5.75%).

The BCRP's decision to cut takes place as headline inflation has been within the target range (2+/-1%) for five consecutive months, and core inflation fell within the range in August. Headline and core inflation stood at 2.03% and 2.78% in August, respectively. The central bank expects annual inflation to remain around the central target. Twelve-month inflation expectations fell further, to 2.44% in August from 2.49% in July.

A slightly faster path to neutral

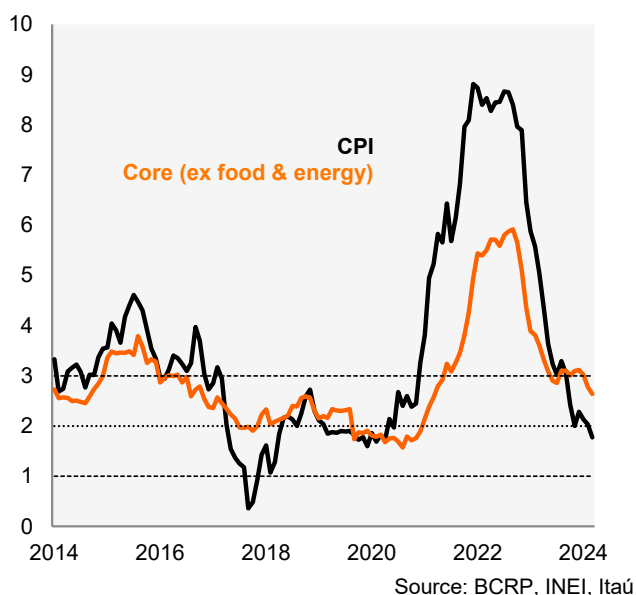
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Following the improvement in economic activity in July, we removed the downside bias to our 2024 GDP growth forecast of 3.1%. Positive terms of trade, greater momentum in the services sector and the improvement in business confidence suggest the economic recovery remains well on track. We forecast 2025 GDP growth at 3.0%, in line with market consensus and the BCRP's recent inflation report.

We still expect inflation to end the year at 2.8%, within the tolerance range of the BCRP's 2+/-1% inflation target, although recent downside inflation surprises lead us to incorporate a downside bias to our scenario.

Andrés Pérez M.

Annual inflation



Steady as she goes

The Central Bank of Peru (BCRP) cut the policy rate by 25 bps for the second consecutive meeting in September, taking it to 5.25%. The statement repeated the data-dependent guidance, keeping the door open for further rate adjustments depending on inflation (emphasizing the core index) and its determinants. In parallel, the central bank also cut its reserve requirement rate in local currency to 5.75%, from 6.0%, after cutting it by 25 bps in August.

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	3.1	3.1	3.0	3.0	
Nominal GDP - USD bn	233	206	226	244	267	284	284	296	296	
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	8,140	8,140	8,413	8,413	
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	4.75	5.00	4.00	4.25	
Balance of Payments										
PEN / USD - eop	3.31	3.62	4.00	3.81	3.70	3.80	3.80	3.80	3.80	
Trade Balance - USD bn	6.9	8.1	15.1	10.2	17.7	18.5	18.5	18.0	18.0	
Current Account - % GDP	-0.6	0.9	-2.1	-4.0	0.8	0.8	0.8	-0.7	-0.7	
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	-2.8	-2.8	-2.2	-2.2	
NFPS Primary Balance - % GDP	-0.2	-7.3	-1.0	-0.1	-1.1	-1.1	-1.1	-0.4	-0.4	
NFPS Debt - % GDP	26.5	34.5	35.8	33.9	32.9	34.0	34.0	34.2	34.2	

Source: IMF, INEI, BCRP, Itaú

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