Macro scenario - Peru

November 18, 2024

Recalibrating the monetary policy path

- We revised our 2024 growth forecast down to 2.9% (from an above-consensus 3.1%). The bouts of strikes related to security concerns pose transitory downside risks to activity. Lower carryover led us to revise our 2025 growth forecast down to 2.8%.
- Persistent downside surprises have led us to revise our yearend inflation forecast to 2.5% (from 2.8% in our previous scenario), and unchanged at 2.5% by the end of 2025.
- We believe the BCRP is likely to pause in December, leading us to revise our year-end call to 5.0% (from 4.75%). Fewer cuts by the Fed and still above target inflation expectations have led us to raise our terminal rate forecast to 4.5%, from 4.0%.

Activity slows in 3Q

The monthly GDP fell 0.5% MoM in September, according to our estimates, with activity momentum decelerating to 0.8% QoQ in the third quarter, down from 1.8% in 2Q24. On an annual basis, the monthly GDP proxy increased by 3.2% YoY in September, down from 3.5% YoY in August, led primarily by manufacturing (2.7% YoY) and commerce (3.5% YoY YoY). Mining expanded slightly by 1.1% YoY, moderating significantly from August (8.9% YoY). Agriculture grew 1.1% YoY, while fishing contracted 14.6 YoY. Construction and transport increased 2.9% YoY and 7.6% YoY respectively, accelerating from the previous month (2.2% and 6.3%. Hotels and Restaurants grew 4.5% YoY in September (2.9% in August), benefited by withdrawals from pension funds. Most business confidence indicators remain squarely in positive territory, while imports of capital goods rose by 12% in the rolling quarter ended in September. Strikes that took place in October are estimated to shave roughly 0.1pp per day of quarterly GDP.

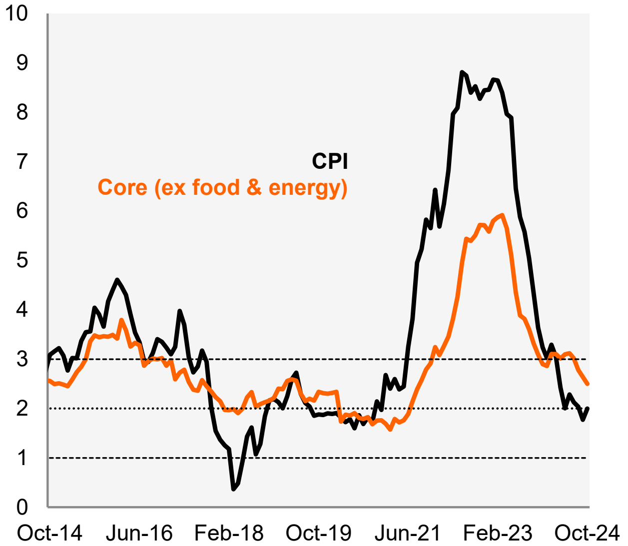
Fiscal revenues continue to normalize. Last month we anticipated a change in the tide in Peru's fiscal headwinds, which until then had resulted mainly from persistent revenue disappointments. Fiscal revenues continued to improve at the start of 4Q24, with cyclically related real revenues rising by 9.1% YoY in the rolling quarter ending in October, down from the previous month (12.7%), yet material up from the first semester. Still, weak revenue performance during the first half of the year has led to a year-to-date decline of 0.2% YoY through October. Elevated copper prices and the recovery of economic activity should further support the improvement in revenues. Non-financial real expenditure growth year-to-date through October has increased by 7.9% YoY, which should moderate in 4Q24 mainly due to base effects.

Another rating outlook stabilization. Following the stabilization of the sovereign's outlook by Moody's (from negative) with the rating unchanged at Baa1 last month, this month Fitch affirmed Peru's long-term foreign currency debt rating at BBB and stabilized the outlook (from negative). According to Fitch, sound policymaking has supported the economic recovery despite political volatility. In April, S&P downgraded Peru to BBB- with a stable outlook.

Déjà vu on inflation

Inflation fell again by 0.1% MoM in October, below market expectations, and recorded its second consecutive fall. The decline was mainly driven by volatile food items, that led to a fall of 0.6% MoM in the food and non-alcoholic beverage category. On an annual basis, inflation rose by 23 bp to 2.01%, given negative base effects, returning to the mid-point of the 2% (+/- 1%) target. Headline inflation has stood within the target range for seven consecutive months. Core inflation (ex-food & energy) rose slightly 0.1% in October, which led to an annual fall to 2.5% from 2.6% in September, recorded its lowest level since August 2021. Led by Don Julio Velarde, the Peruvian central bank keeps outperforming its regional peers regarding inflation control.

Low annual inflation



Source: BCRP, INEI, Itaú

Sticking to the plan

Another cut in November. In its November meeting, the Central Bank of Peru (BCRP) cut the policy rate by 25 bps to 5.0%, resuming the easing cycle after unexpectedly maintaining the policy rate at 5.25% in October. In contrast to previous communiqués, the statement explicitly mentioned that the decision took the real rate close to neutral. However, 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.

Gradually edging to neutral. Twelve-month inflation expectations remained essentially unchanged at 2.45% in October, taking the one year real ex-ante rate to 2.55% (from 2.81%), edging closer to the 2.0% neutral real rate. Throughout this easing cycle, the BCRP has brought the nominal policy rate down from a peak of 7.75% in September 2023 to the current 5.0%. In our view, greater exchange rate volatility would be mitigated by central bank interventions or pauses on the path towards the terminal rate.

Raising the monetary policy path

Even though activity has recovered, and leading indicators show an improvement, we revised our 2024 growth forecast down to 2.9% (from an above-consensus 3.1%). The bouts of strikes related to security concerns pose transitory downside risks to activity. Lower carry-over led us to also revise our 2025 growth to 2.8%, slightly below potential of 3.0%. A renewed US-China trade war poses downside risks to Peru's growth outlook, through a weaker external impulse and lower terms of trade. One third of Peru's exports are destined to China.

Persistent downside surprises led us to revise our yearend inflation forecast to 2.5% (from 2.8%), and unchanged at 2.5% by the end of 2025.

We believe the BCRP is likely to pause in December, leading us to revise our year-end call to 5.0% (from 4.75%). Updated language in the BCRP's statement, fewer cuts by the Fed and still above target inflation expectations have led us to raise our terminal rate forecast to 4.5%, from 4.0%.

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Peru | Forecasts and Data

	2019	2020	2021	2022	2023	2024F Current	2024F Previous	2025F Current	2025F Previous
Economic Activity									
Real GDP growth - %	2.2	-10.9	13.4	2.7	-0.6	**2.9**	3.1	**2.8**	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	**2.6**	2.8	**2.5**	2.5
Interest Rate									
Monetary Policy Rate - eop - %	2.25	0.25	2.50	7.50	6.75	**5.00**	4.75	**4.50**	4.00
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	**-3.2**	-2.8	**-2.2**	-2.2
NFPS Primary Balance - % GDP	-0.2	-7.3	-1.0	-0.1	-1.1	**-1.4**	-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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