Macro scenario - Peru

April 12, 2024

BCRP surprises again

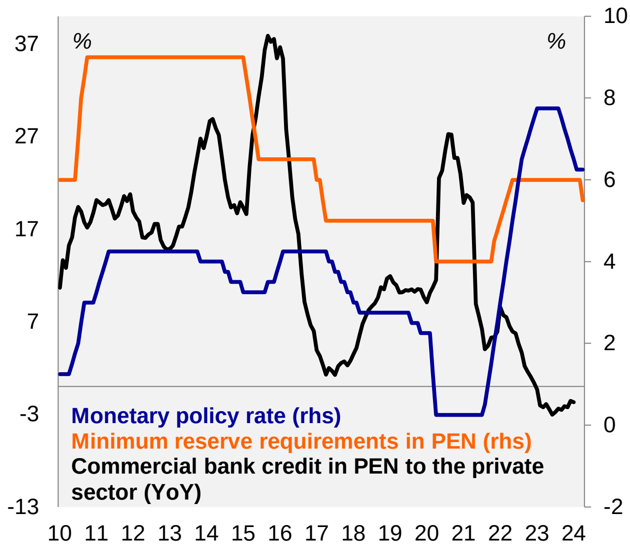
- After the BCRP surprised in the March meeting by keeping the policy rate unchanged, in April they did so with a rate cut. The fact that the BCRP cut the reserve requirement rate in March, using it as a countercyclical tool, and cut the policy rate in February suggest soft economic activity is an important concern which suggests further monetary easing is likely. However, we continue to see limited room for adjusting the policy rate in the near term, given the narrowing of the rate differential amid Fed repricing. In fact, we increased our end of year policy rate forecast to 5.75% (previously at 5.25%) which would imply only another rate cut of 25-bp during the rest of the year. We think further reductions in the reserve requirement rate, to stimulate the economy, are more likely.
- Congress approved a 7th pension withdrawal. The initiative could result in outflows from pension funds of 3.2% of GDP, according to authorities. While withdrawals could boost activity in the short term, at the same time they could generate volatility in domestic assets as pension funds sell them to meet withdrawals, while raising the risk premia. On the political front, the fourth and fifth attempts to remove Boluarte were archived.

The BCRP surprises again

After the BCRP surprised in the March meeting by keeping the policy rate unchanged at 6.25% (consensus expected 6.00%), now they did so with a rate cut of 25-bp (reaching a level of 6.00% versus consensus of 6.25%). The forward guidance was kept the same as in the previous statement (March), where they surprised markets by keeping the policy rate on hold: future adjustments to the reference rate will be dependent on inflation evolution and its determinants. The inflation tone of the statement seems similar to the previous communique, noting that the recent inflation rebound is transitory. However, this communique noted that volatility in financial markets associated to the start of the easing cycle of advanced economies persists, likely referring to this week's Fed repricing pointing to a delay in the beginning of the easing cycle. Following the decision, the real ex-ante policy rate stood at 3.44% (from 3.6%), still well above the real neutral rate of 2.0%.

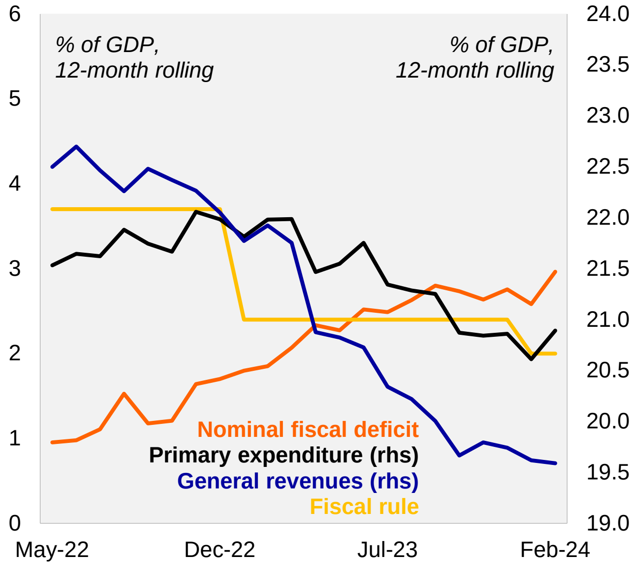
In our view, the decision to surprise with a rate cut appears hard to square with recent global events and local data releases since the March meeting. After surprising markets in March by keeping the policy rate unchanged, there was a higher-than-expected inflation print (1.01% MoM in March versus consensus of 0.76%), as odds of a seventh pension fund withdrawal increased (approved right after the decision), and there was a Fed repricing pointing to a delay in the beginning of the easing cycle. However, concerns of a soft economic activity recovery remain. While in the March meeting the policy rate was kept unchanged, the BCRP cut the reserve requirement rate starting in April to 5.50% (from 6.00%) with the objective of stimulating the economy. The central bank of Peru is one of the few banks in the region that actively uses reserve requirements as a macroprudential and countercyclical tool. Reserve requirements can have an effect on financial conditions (through credit) and hence activity. However, in contrast to the reference monetary policy rate, reserve requirements do not seem to have an effect on capital flows, containing depreciation episodes. The chart below shows that reserve requirements have been used by the BCRP as a complementary monetary policy tool. Commercial bank credit to the private sector seems to react to both monetary policy tools. However, we note that in some periods credit to the private sector from commercial banks was boosted by extraordinary policy measures. For instance, during the pandemic, financial institutions gave credit to firms with a government guarantee, which financial institutions swapped to the central bank for liquidity (*Reactiva Perú* program).

Monetary policy tools & credit growth



Source: BCRP

Not on target yet



Source: BCRP

Fiscal consolidation is not on track, but there is time

The nominal fiscal deficit figures from February deviated further from the fiscal rule. On a 12-month rolling basis, the nominal fiscal deficit stood at 3.0% of GDP in February, above the fiscal rule of 2.0% of GDP. The widening of the fiscal deficit is explained by a combination of greater primary expenditures (current and fixed capital expenditure) and weak fiscal revenues, as activity recovered at a softer pace than expected in the first month of the year. While improvement in fiscal revenues should be the main driver for the narrowing of the nominal fiscal deficit, the Ministry of Finance is also implementing measures to contain spending. For instance, recently, the Council of Ministers approved cutting expenditures associated with trips, consultancies and acquisition of vehicles, among others. However, savings from these measures appear unclear. Missing the fiscal target last year did not immediately trigger a rating action, but another fiscal misstep could result in a downgrade, especially considering that the three main rating agencies have a negative outlook on the sovereign rating (Moody's: Baa1 S&P/Fitch: BBB).

Noisy policy and politics

Congress approved a seventh private pension fund withdrawal. The reform allows all pension affiliates to withdraw up to PEN 20.6 thousand from their individual savings account. According to the Banking, Insurance and Pension regulatory agency (SBS), the initiative could result in outflows from pension funds of 3.2% of GDP, equivalent to roughly 27% of the current assets under management (AUM) of the private pension funds. Pension funds need to sell assets from their portfolios to meet affiliates withdrawals, likely pressuring domestic assets. We note that government bonds, which represent 22% of AUM of all pension funds, could be affected the most given their liquidity (relative to other pension fund holdings). In the medium term, lower AUM in pension funds could reduce the depth of the domestic market and raise long-term fiscal pressures.

Meanwhile, confrontation between the executive power and Congress persists. Two impeachment motions against President Boluarte (the fourth and fifth attempts) arguing "moral incapacity" due to accusations of alleged illicit enrichment failed to reach the required quorums for approval.

Higer rates

Soft activity recovery amid inflation close to the upper bound inflation target of 3.0% suggest further monetary easing is likely. However, we continue to see limited room for adjusting the policy rate given the narrowing of the rate differential, also considering a Fed repricing pointing to a delay in the beginning of the easing cycle. In fact, we increased our end of year policy rate forecast to 5.75% (previously at 5.25%) which would imply only another rate cut of 25-bp during the rest of the year. We think further reductions in the reserve requirement rate, to stimulate the economy, are more likely.

Our GDP growth forecast is at 2.5%, recovering from last's year's 0.6% contraction, affected by social conflicts and harsh weather conditions. The recovery this year is limited by a moderate/weak *El Niño* weather phenomenon in 1Q24.

Andrés Pérez M.
Julio Ruiz

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	**2.5**	2.5	**3.0**	3.0
Nominal GDP - USD bn	233	206	226	245	268	**283**	281	**297**	297
Population (millions)	33.2	33.5	33.8	34.2	34.5	**34.9**	34.9	**35.2**	35.2
Per Capita GDP - USD	7,012	6,148	6,685	7,177	7,767	**8,133**	8,067	**8,446**	8,440
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	**5.75**	5.25	**4.25**	4.25
Balance of Payments									
PEN / USD - eop	3.31	3.62	4.00	3.81	3.70	**3.75**	3.75	**3.77**	3.77
Trade Balance - USD bn	6.9	8.1	15.0	10.3	17.4	**16.0**	16.0	**14.0**	14.0
Current Account - % GDP	-0.6	1.1	-2.2	-4.0	0.6	**-0.1**	-0.1	**-1.0**	-1.0
Foreign Direct Investment - % GDP	2.0	0.4	3.3	4.4	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	**-2.0**	-2.0	**-1.5**	-1.5
NFPS Debt - % GDP	26.6	34.6	35.9	33.8	32.9	**33.7**	33.7	**33.4**	33.4

Source: IMF, INEI, BCRP, Itaú

Macro Research – Itaú

Mario Mesquita – Chief Economist

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