Macro scenario - Peru

May 14, 2024

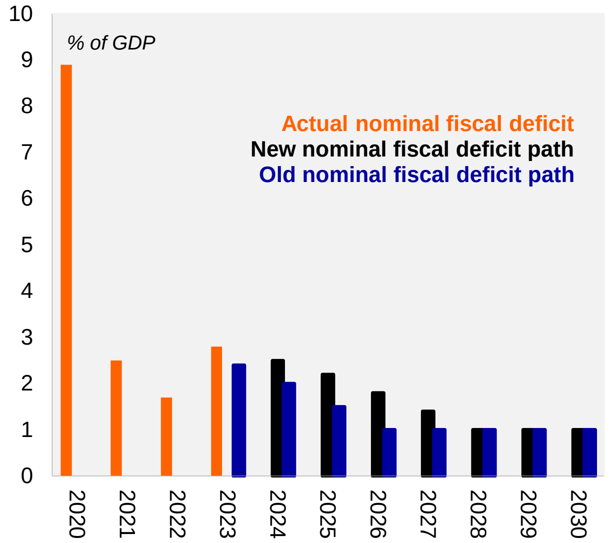
Slower fiscal consolidation

- After missing the fiscal target last year, primarily due to weak revenues, the government's official forecasts slowed the expected pace of fiscal consolidation for 2024. We increased our 2024 nominal fiscal deficit estimate to 2.5% of GDP (previously at 2.0% of GDP), leading to an uptick in the gross public debt to GDP ratio, to a still low 33.9%.
- The recovery of economic activity in 1Q24 has been favored by calendar and base effects; we expect the economy to gain traction as it shakes off the effects of weather shocks and benefits from even better terms-of-trade. We raised our 2024 GDP growth forecast to 2.7% (previously at 2.5%), still below potential, consistent with our call of higher growth in China this year.

Another fiscal misstep this year

Updated official macro forecasts point to a slower fiscal consolidation path in 2024, after the government missed the 2023 nominal fiscal deficit target (2.8% versus 2.4%). The MoF now foresees the 2024 nominal fiscal deficit at 2.5% of GDP (previously at a deficit of 2.0% of GDP), and converging to a 1.0% deficit by 2028, instead of by 2026 as in the previous path. The MoF argued that keeping the previous fiscal consolidation path in the aftermath of last year's misstep would imply a sharp fiscal adjustment of 0.8% of GDP, which could jeopardize the economic recovery. Recently, the nominal fiscal deficit on a 12-month-rolling basis deviated further from the target, standing at 3.3% of GDP in March (from 3.0% in February and 2.8% in 2023). Weak revenues, amid stable expenditure, were the main reasons behind the widening of the fiscal deficit. The new fiscal deficit path would imply gross debt of 33.5% of GDP by the end of 2024, peaking slightly higher at 33.7% in 2026 and then falling gradually toward 30% in the following years. In our view, the new fiscal deficit path will not significantly change Peru's historically strong fiscal accounts, with debt-to-GDP likely to remain the lowest in the LatAm region. However, further delays of consolidation could eventually weaken fiscal strength, and hence weigh on the ability of macroeconomic fundamentals to mitigate the effect of persistently elevated political uncertainty on the economy.

More gradual fiscal consolidation



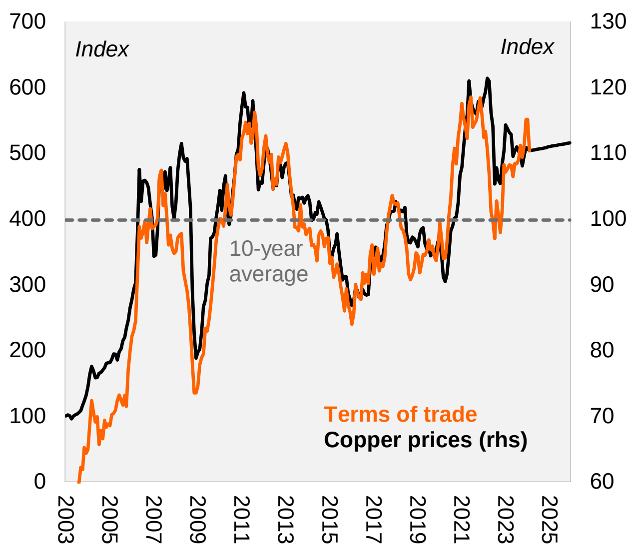
Source: MEF, Itaú

In this context, rating agency S&P downgraded Peru's rating to BBB- (from BBB) with a stable outlook, driven by the effects of political uncertainty on growth. S&P noted that the complex political landscape will persist (beyond this administration), limiting the government's capacity to implement timely policies to boost investment and economic growth. Still, S&P noted Peru's limited fiscal and external imbalances. The day after S&P's decision, Fitch reaffirmed Peru's BBB rating with a negative outlook. Importantly, both rating agencies already envisaged a more gradual fiscal consolidation path in 2024, similar to the MoF's updated fiscal projections. Moody's, which rates Peru at Baa1 with a negative outlook, above Fitch and S&P's ratings, is expected to deliver a decision in the second half of the year. They also seem comfortable with the fiscal outlook, noting that a higher deficit target in 2024, as high as 2.5% of GDP, would not be negative for the rating, considering a balance between fiscal consolidation and needed support for the economy.

Activity recovery remains fragile

Activity rebounded in February, supported by base effects associated with social conflicts and the leap year. The monthly GDP proxy grew 2.8% YoY in February (from 1.4% in January). The rebound was driven by services, commerce, and mining, which were the sectors most affected by social conflicts at the beginning of 2023. The recovery in economic activity was curbed by a fall in the agricultural sector (-1.9%), still weighed down by the persistent *El Niño* weather phenomenon. However, at the margin, using the central bank's seasonally adjusted figures, monthly GDP fell by 0.1% mom/sa in February (after growing at a soft 0.2% in January), taking the quarter-over-quarter (non-annualized) growth-rate expansion to practically zero (from 0.5% in 4Q23). Still, we expect activity to improve as we move into 2Q24, as weather shocks fade and the effects of even better terms-of-trade feed through.

Positive terms of trade



Source: Bloomberg, Itaú

A benign inflation print in April amid a fragile activity recovery led the BCRP to cut its policy rate by 25-bp (reaching a level of 5.75%) in May. Headline inflation surprised to the downside, falling by 0.05% mom, compared with the market consensus of 0.25%. On an annual basis, headline inflation fell to 2.42% in April (from 3.05% in March), entering the central bank's 2+/1% target. Core annual inflation (excluding energy and food items) fell to 3.01% (from 3.10%). While the BCRP cut its policy rate, they kept the reserve requirement rate unchanged at 5.50%. The statement did not close the doors for additional rate adjustments, noting that it will depend on inflation and its determinants. The BCRP noted that inflation is inside the target range of 2+/-1%, while 12-month inflation expectations remained practically unchanged at 2.6%, also inside the target range, for fifth consecutive month. As a result, the real ex-ante rate stood at 3.13%, still above the neutral rate of 2.0%.

A larger fiscal deficit

We now expect the economy to grow by 2.7% in 2024, slightly up from our previous forecast of 2.5%, driven by our call of higher growth in China. We expect activity to gain traction in 2Q24, as weather shocks fade and the economy benefits from even better terms-of-trade.

Well behaved inflation amid a fragile activity recovery suggests there is still room for the BCRP to continue easing. However, increased uncertainty regarding the start of the Fed's easing cycle considering the narrowing of the BCRP-Fed rate differential limits how low the policy rate can go in the short term. Our base case is for the BCRP to keep the policy rate unchanged during the rest of year, relying on lowering the reserve requirement rate to ease financial conditions, instead. Still, we cannot rule out an additional policy rate reduction this year (risking pressure on the currency) if inflation surprises further to the downside.

We raised our 2024 nominal fiscal deficit forecast to 2.5% of GDP (compared with our previous scenario of a deficit of 2.0% of GDP), in line with the new fiscal-consolidation path published by the MoF. Our new fiscal deficit forecast implies gross public debt at 33.9% of GDP (previously at 33.7% of GDP).

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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**	2.5	**3.0**	3.0
Nominal GDP - USD bn	233	206	226	245	268	**284**	283	**298**	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	**8,149**	8,133	**8,467**	8,446
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**	5.75	**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	10.2	17.7	**16.0**	16.0	**17.0**	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	**-2.5**	-2.0	**-2.2**	-1.5
NFPS Debt - % GDP	26.6	34.6	35.9	33.8	32.9	**33.9**	33.7	**34.1**	33.4

Source: IMF, INEI, BCRP, Itaú

Macro Research – Itaú

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