BBVA Research

Peru Economic Outlook

3Q22

Closing date: July 15

Creating Opportunities

BBVA Research

Contents

Key points

Global situation

The external environment has deteriorated even more than expected. Inflation remains at unusually high levels supported by high commodity prices (food and energy), bottlenecks (although there are some improvements) and relatively resilient demand.

In this environment, central banks have been accelerating the process of raising interest rates. The recent tone suggests that they will not hesitate to do what is necessary to control inflation in the medium to long term, so the risk of significant second-round effects and de-anchoring of inflationary expectations is moderate, albeit increasing. The Fed, in particular, will soon raise interest rates to restrictive levels.

Central banks' effort to curb inflation has raised concerns about global growth. In this context, markets have begun to discount a possible recession in the US: financial volatility has increased, commodity prices have fallen (especially those of industrial metals, mainly copper), and the risk perception regarding emerging economies has increased, which has dampened the appeal of emerging economies' assets.

Key points

Domestic situation

Domestically, activity was surprisingly positive in the first quarter, largely supported by household consumer spending, which coincided with the easing of pandemic isolation measures and a significant decline in the private saving rate. Growth would have been greater, but sustained social unrest did not allow it.

On the margin, however, the sequential analysis of the GDP level (seasonally adjusted) and the indicators available for the second quarter suggest a weakening of activity, which is consistent with persistently low confidence and the continued negative impact of social unrest in the extractive sectors.

In terms of prices, inflation rose to levels not seen in the last twenty-five years, reaching 8.8% year-on-year at the end of the second quarter. The rise in food and energy prices, sustained at high levels, has continued to push inflation upward. The upward trend shown since the middle of last year has contaminated and de-anchored inflationary expectations, and a significant part of the basket of goods shows prices increasing at a rate that exceeds the inflation target range.

In this environment, the Central Bank continues to adjust its stance on monetary policy, although it is still expansionary. Reference interest rate increases have so far been maintained at 50 basis points per month.

Key points

Global baseline scenario

The global economy will slow down significantly, with negative growth in more than one quarter in the US and the eurozone, which will contribute to the fall in inflation, which will still remain well above target in the short term. In the U.S., the anticipated sharp monetary tightening makes a (mild) recession likely, while in the eurozone, GDP declines are expected over the next few quarters primarily due to the disruptions created by the war, including energy shortages. The environment is very uncertain due to multiple coinciding shocks.

Compared to the previous baseline scenario (April), international food and fuel prices have been revised upward and, therefore, so has the inflation outlook. In this context, central bank responses will be more aggressive, in the particular case of the Fed taking its policy rate to restrictive levels, which will impact growth. The expected lower dynamism of global activity and greater fears of recession are consistent with a downward revision of metal prices, especially in the case of copper.

Key points

Domestic baseline scenario

With the most recent release of private pension funds and Compensation for Time of Service (CTS, an scheme for protection against unemployment) deposits, something new and not considered in the previous baseline scenario, households will have more liquidity to consume. This is not a minor amount. The positive impact on consumption will occur in the second half of 2022 and in 2023.

The baseline scenario continues to anticipate that the local political environment will not be the most conducive to supporting the business environment. Populist approaches, particularly in the regulatory field, are likely to continue to affect business confidence and lead to caution in investment spending. The assumption is also maintained that there will be no disruptive changes in the Executive or Legislative branches.

In mining, the Quellaveco project will soon enter the commercial production phase, which, as anticipated, will have a positive impact starting in the second half of 2022. Social unrest, on the other hand, will probably continue to affect the extractive sectors, with a more sensitive negative impact than that considered in the previous baseline scenario, although it is likely to dissipate in 2023.

Finally, from a fiscal standpoint, we continue to anticipate a dip in public investment next year (after the subnational elections in the fourth quarter of 2022), even more accentuated than the one we foresaw in the previous baseline scenario due to the high turnover of officials in key ministries, which hampers the proper management of spending.

Key points

Forecasts: activity

Considering the recent economic trends and the global and domestic scenarios, the 2022 growth forecast has been raised from 2.0% to 2.3%, while the 2023 forecast is maintained at 2.8%.

The upward adjustment in growth during 2022 (+0.3pp) reflects the more favorable trends in private spending observed in the first months of the year and the greater availability of liquidity for households in the second half of the year. These factors more than offset the deterioration of the external environment, higher inflation (erosion of the purchasing power of household incomes) and interest rates, and more pronounced social unrest.

The growth forecast for 2022 is consistent with a GDP expansion of close to 3.5% year-on-year in the first half of the year and between 1.0% and 1.5% in the second half, when, despite the greater availability of household liquidity and the start of production at Quellaveco, the deterioration of external and financing conditions will be more sensitive and the momentum of the sectors that were most affected by pandemic isolation measures will diminish.

The growth forecast for 2023 has not been modified because even though the new baseline scenario shows a greater deterioration of the external environment and higher inflation and interest rates, the year-on-year comparison base for mining output is lower (in 2022 it was greatly affected by social unrest, which is expected to gradually dissipate) and consumption will continue to be supported by the greater availability of household liquidity. As a result, the expansion forecast for 2023 is higher than that of 2022: the external outlook will be more complicated then, and public investment will dip, but mining output will be closer to normal and Quellaveco will be operating at full capacity.

Key points

Forecasts: fiscal accounts

The fiscal deficit narrowed significantly in the first half of the year, reaching a level equivalent to 1% of GDP in the second quarter of 2022 (cumulative over the last four quarters) whereas it stood at 2.5% at the end of 2021.

We forecast that, with measures to support families and some business sectors in order to mitigate the rise in the prices of essential inputs and finished goods (tax exemptions, tax rate reductions, new transfers), the lower dynamism of activity, and the decline in metal prices, the fiscal deficit will be closer to 2% of GDP by the end of 2022 and 2023.

However, the deficit for these two years is lower than was forecast three months ago due to the more positive impact of higher metal prices and signs of structural improvements in revenue collection, including a decrease in non-payment of value-added and income taxes.

The estimated trend for the fiscal deficit is consistent with a level of gross public debt (as a % of GDP) that will remain between 35% and 36% in 2022 and 2023, but will later trend upward.

The forecasts do not incorporate the latent risk of higher spending and funding implied by measures recently approved by Congress: reimbursement of FONAVI contributions and payment of bonuses to education sector workers.

Key points

Forecasts: external accounts

The deficit in the balance of payments current account widened in the first quarter of the year and reached 3.2% of GDP (accumulated over the last four quarters). The increase in the deficit coincided with a significant decrease in private saving.

We anticipate that this deficit will continue to increase for the remainder of the year: global growth will lose momentum, the prices of the metals that Peru exports have declined significantly, and we do not anticipate a major recovery, social unrest will likely continue to weigh on mining output performance, and local private consumption will remain relatively strong, which will favor imports. As a result, the balance of payments current account will be around 5% of GDP by the end of the year.

With mining output returning to normal (social conflicts are assumed to be dissipating), Quellaveco at full operating capacity, private spending more contained, and despite the expected decline in the terms of trade, the current account deficit in 2023 will be lower than in 2022, at around 3.5% of GDP.

The projected path for the balance of payments current account shows a larger deficit than in the previous baseline scenario. This adjustment is explained by the downward adjustment of terms of trade, the deterioration of the external outlook and the more sensitive impact of the social conflict in mining. The deterioration of the external outlook (higher risk perception regarding emerging economies, higher interest rates) and the low growth prospects of the Peruvian economy make it more difficult to finance these deficits, which may imply some loss of net international reserves.

Key points

Forecasts: exchange rate

The exchange rate is currently 3.90 soles per USD. The deterioration of the balance of payments current account, the more difficult environment for financing the external deficit, and the lower sol-dollar interest rate differential (in 2023) will induce a weakening of the local currency going forward. We thus forecast that the exchange rate will close 2022 (daily average for December) at between 3.90 and 4.00 PEN per USD, while in 2023 it will close at between 3.95 and 4.05 PEN per USD.

Forecasts: inflation

The high year-on-year comparison base, reinforced in recent weeks by the decline in international food and fuel prices, means that inflation will soon begin to decline. The decline in the year-on-year inflation rate could however be relatively slow due to the de-anchoring of inflationary expectations and the potential impact on the prices of local foodstuffs in the second half of 2022 and in 2023 of the difficulties that farmers have experienced in access to and higher cost of fertilizers. Thus, we forecast that inflation will only return to the target range in 2024 (closing 2022 at 6.8% and 2023 at 3.3%). The projected path for the inflation rate is higher than that forecast three months ago due to the upward surprises that have been occurring and are consistent with the upward revision of the outlook for international food and fuel prices.

Key points

Forecasts: monetary policy rate

The Central Bank will continue to raise the reference interest rate in the short term, perhaps causing the monetary position to be somewhat contractionary in the fourth quarter of the year. The level that the reference interest rate will reach in nominal terms will naturally depend on the behavior of inflationary expectations; at BBVA Research we expect this rate to be around 7.25% at the end of the year. Later, when the downward trend in inflation is clear and the Fed has completed the upward cycle of its own policy rate, the BCRP will begin to cut the reference rate—which will be only slightly above 6% by the end of 2023—and will continue to do so in 2024. These forecasts for the policy rate are higher than those of the previous baseline scenario, consistent with the higher inflationary pressures now present.

Main external risks

Deterioration due to the war in Ukraine or other geopolitical conflicts.
Persistent inflation (and more aggressive or disorderly interest rate hikes)
Sharp slowdown in the Chinese economy
Tension in debt markets and emerging markets

Main local risks

Less business-friendly political environment (increased populism or other disruptive events)
Greater social conflict
Fertilizer shortage
Impact of increased availability of household liquidity

Research

01

International context: activity and financial markets

In a complex and uncertain environment, central banks have been forced to accelerate rate hikes in order to tackle inflation

RECENT DEVELOPMENTS IN THE WORLD ECONOMY

COMMODITIES
Energy and food prices under heavy pressure due to war in Ukraine

SUPPLY DISRUPTIONS
Persistent bottlenecks due to war and covid mobility restrictions in China

DEMAND RESILIENCE
Robust employment and accumulated savings; weakness caused by covid in China

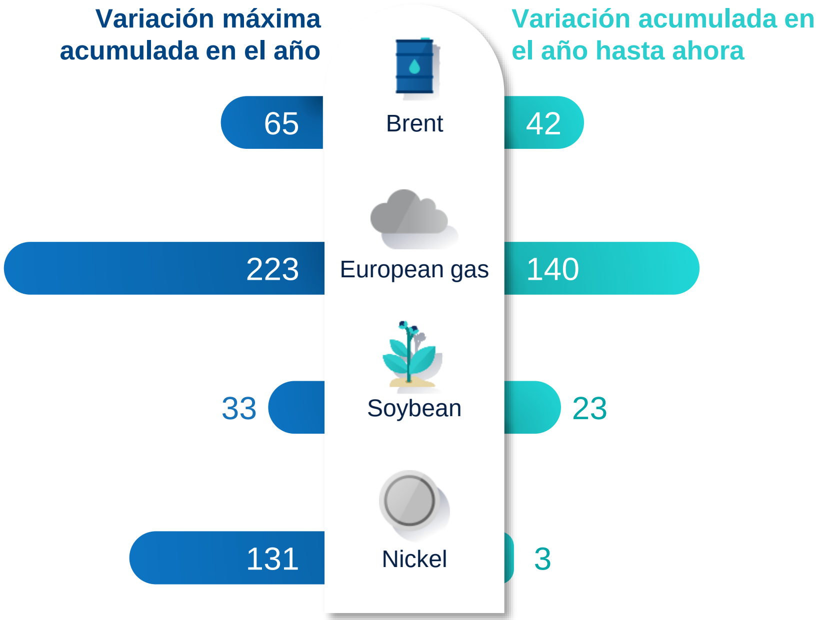
HIGH, PERSISTENT AND GENERALIZED INFLATION
Prices also pressured by incipient second-round effects and structural factors (such as de-globalization), with a risk of de-anchoring expectations.

MORE AGGRESSIVE CENTRAL BANKS AND FINANCIAL VOLATILITY
Stronger and earlier monetary tightening, particularly in the U.S., to reduce demand, which has kept financial volatility high.

Commodity prices have risen more than expected after the war, despite recent global slowdown concerns

COMMODITY PRICES

(ACCUMULATED PERCENTAGE VARIATION IN THE YEAR UP TO JULY 11, 2022)

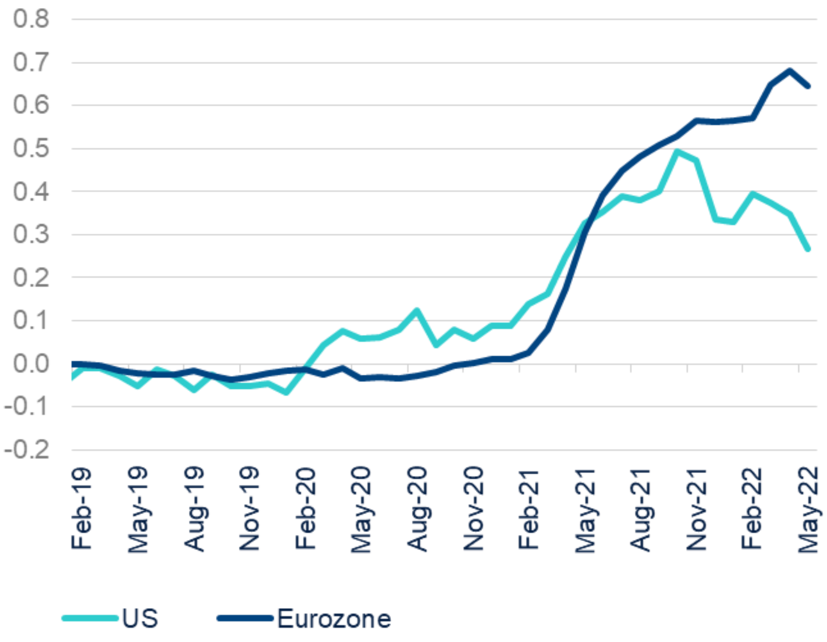


Source: BBVA Research based on data from Haver.

- War and sanctions have pressured commodity prices:
  - oil: affected by sanctions against Russia
  - gas: pressured by fears of supply restrictions b Russia
  - food: impacted by fertilizer prices and disruptions in Ukraine
  - metals: less direct exposure to the war, but pressured by energy transition
- The risk of a sharp global slowdown has recently triggered falls in commodity prices (but not in the gas price in Europe).

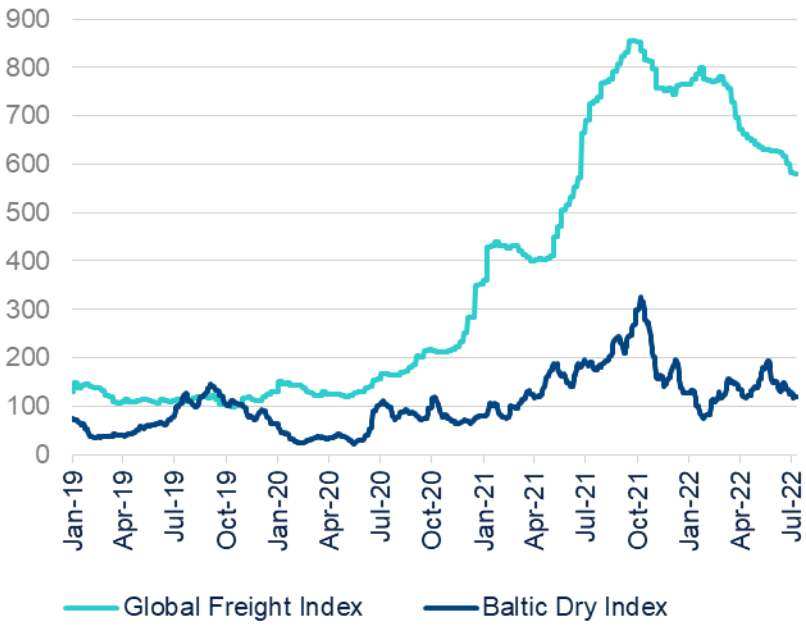
Bottlenecks remain at very high levels, but there are signs of improvement, mainly in the US

BBVA RESEARCH BOTTLENECK INDEX
(INDEX: AVERAGE SINCE 2003 = 0)



Source: BBVA Research.

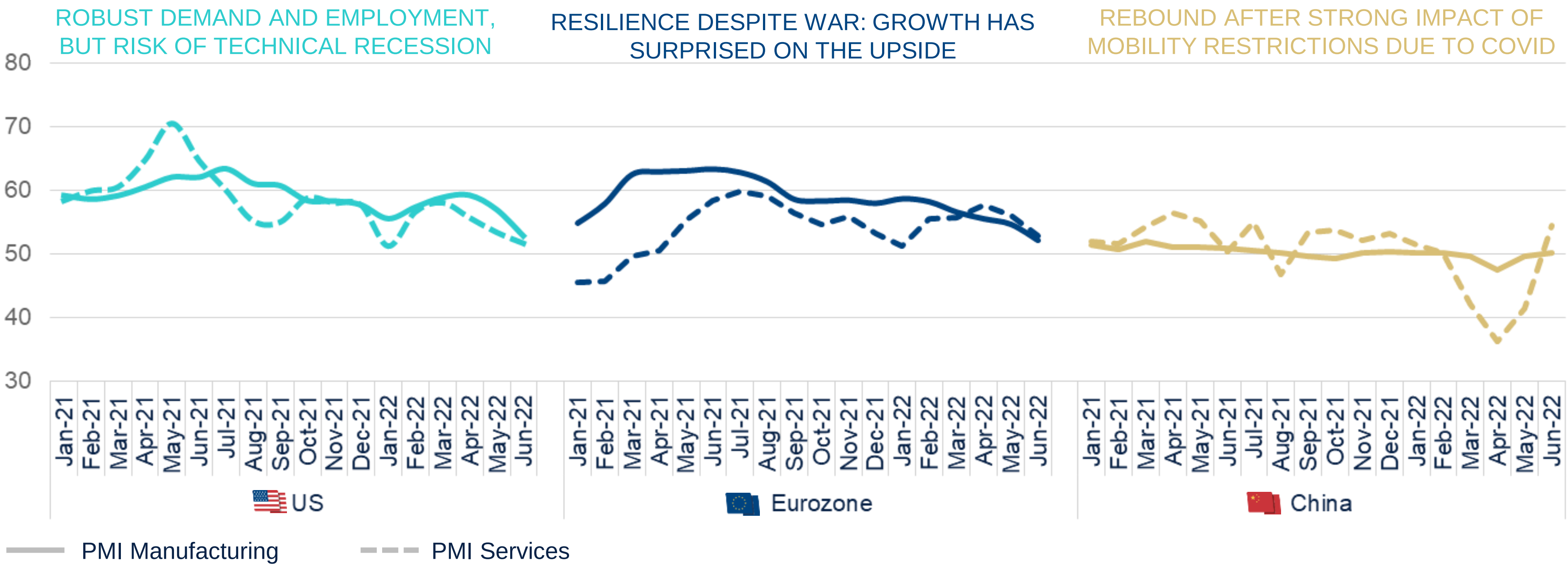
CONTAINER FREIGHT RATES: GLOBAL AND BALTIC
(INDEX: 2012 = 100)



Source: BBVA Research based on data from Haver.

Growth is easing, but demand remains resilient given the high level of accumulated savings and the dynamism of both consumption and services

PMI INDICATORS
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)

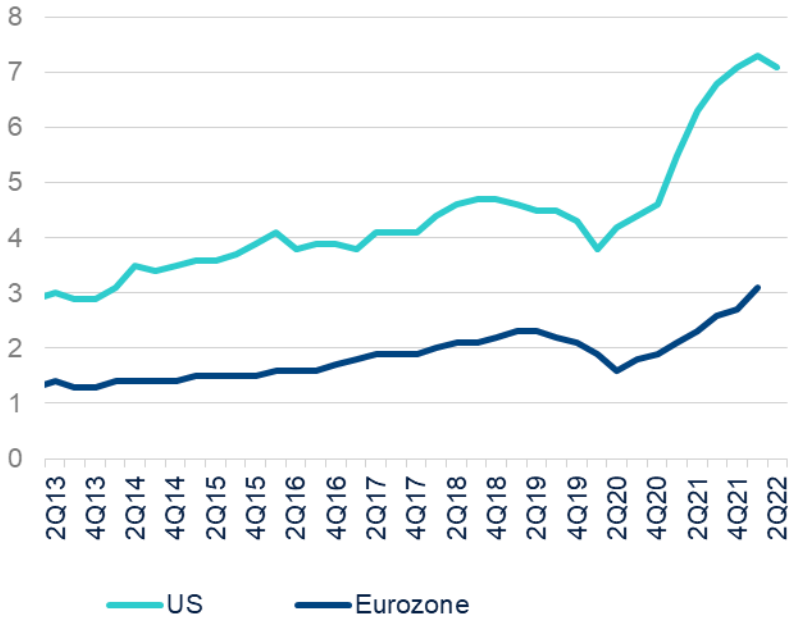


Source: BBVA Research based on data from Haver.

Dynamic labor markets support private consumption, but reinforce concerns about inflationary dynamics

LABOR MARKET: VACANCY RATE

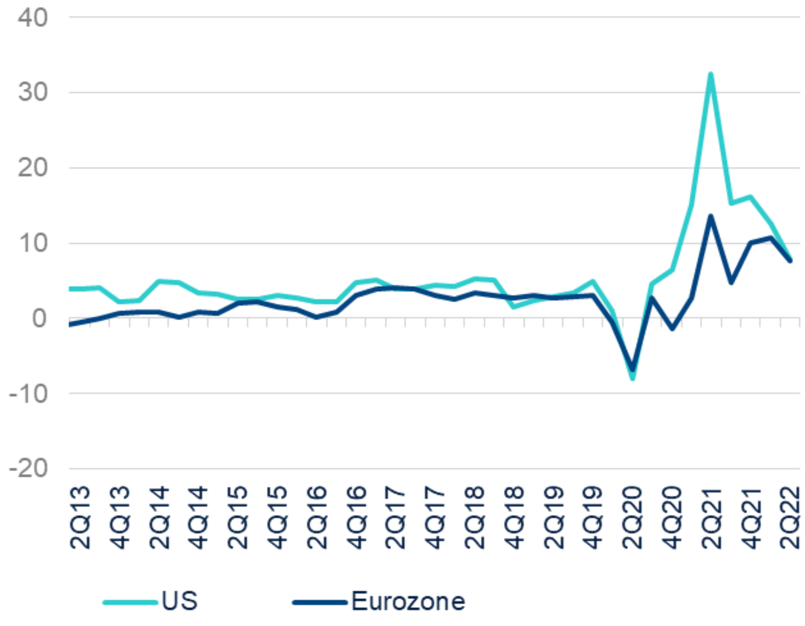
(%, QUARTERLY AVERAGES)



* Vacancies as a proportion of the sum of total employment and the number of vacancies.
Source: BBVA Research based on data from Haver.

PRIVATE CONSUMPTION: RETAIL SALES

(% Y/Y, QUARTERLY AVERAGES)

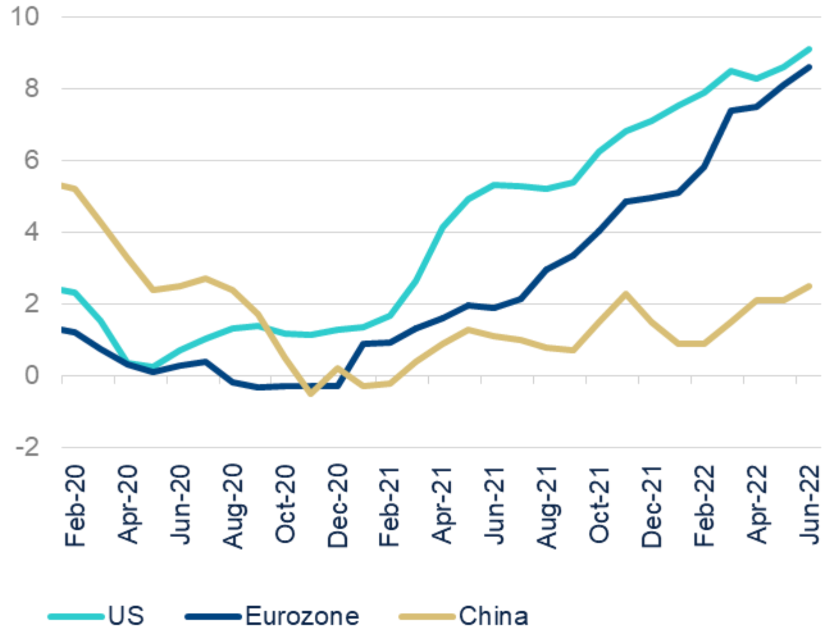


Source: BBVA Research based on data from Haver.

High, persistent and widespread inflationary pressures, largely due to supply-side and labor market-related factors

INFLATION: CPI

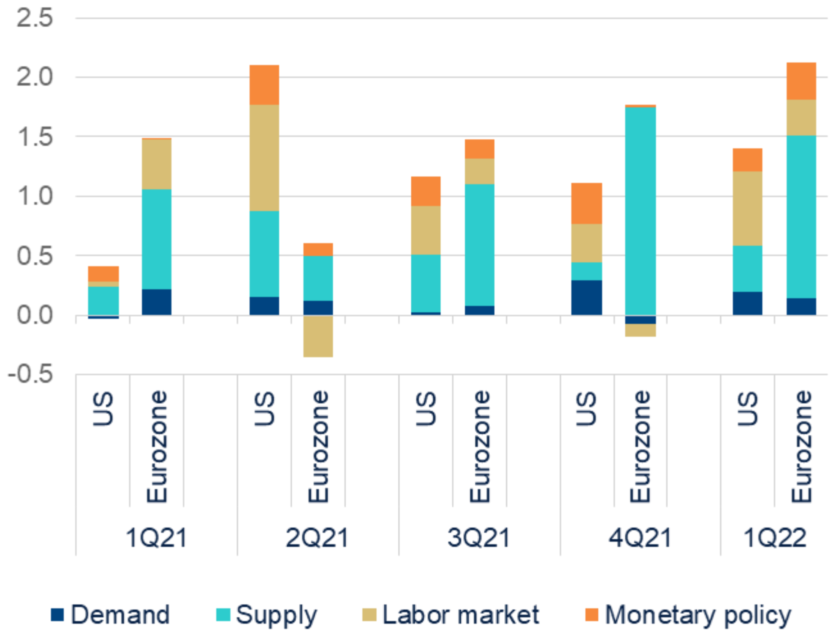
(Y/Y %)



Source: BBVA Research based on local statistics.

SHOCKS TO CORE INFLATION

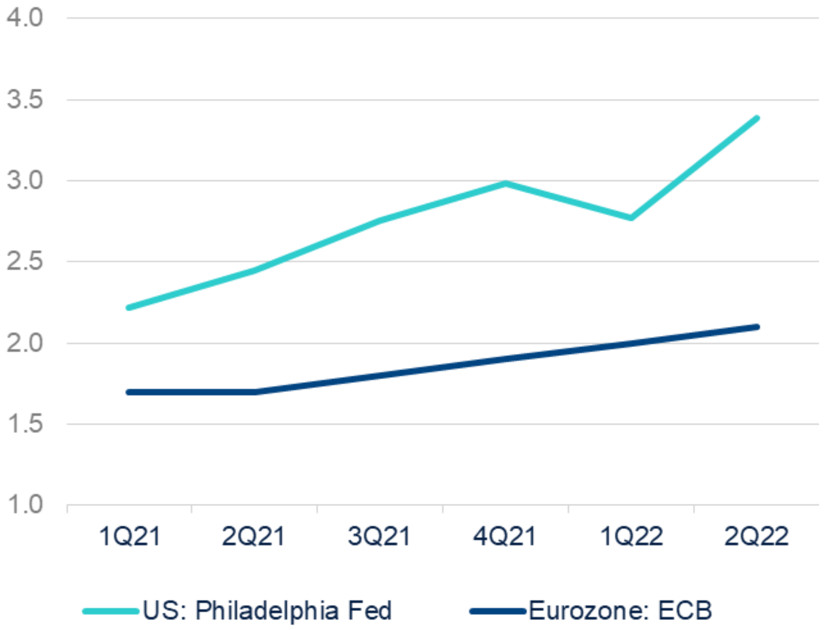
(PP)



Source: BBVA Research estimates using a SVAR model.

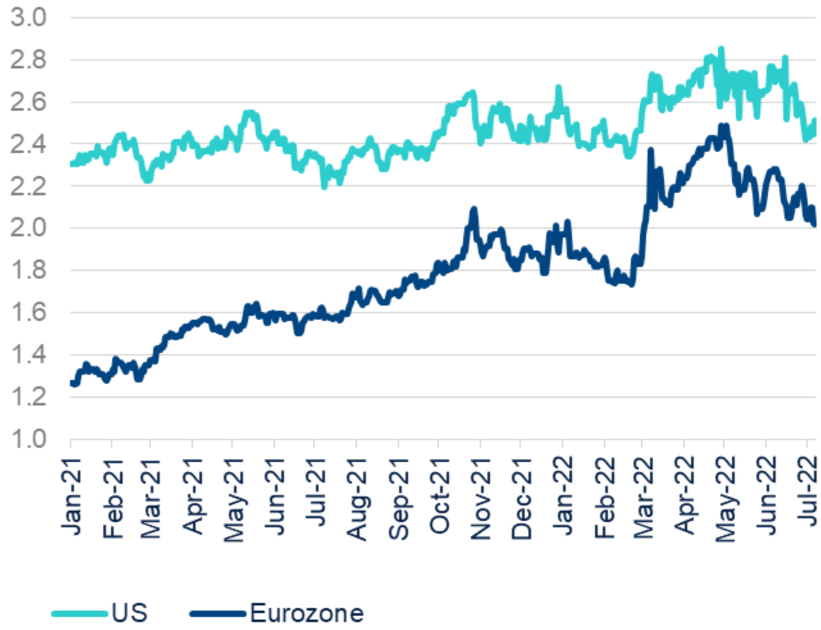
Inflation expectations have risen significantly

5-YEAR INFLATION EXPECTATIONS: ANALYSTS SURVEYS (%)



Source: BBVA Research based on data from the Fed and the ECB.

LONG-TERM INFLATION EXPECTATIONS: MARKETS* (%)

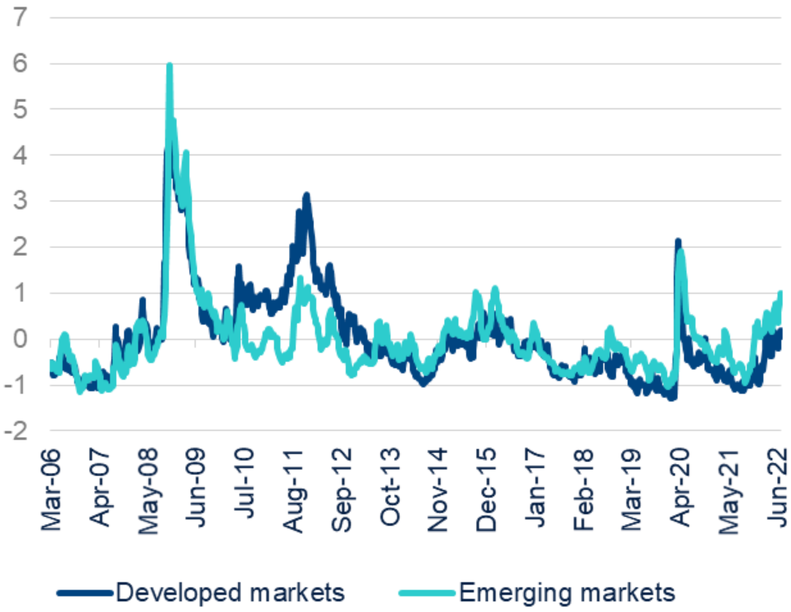


* Based on 5Y5Y forward swaps

Source: BBVA Research based on Haver data.

Central banks hawkish tone in response to rising inflation, in a context of activity slowdown, has increased financial volatility

BBVA RESEARCH FINANCIALTENSIONS INDEX
(INDEX: AVERAGE SINCE 2005 = 0)

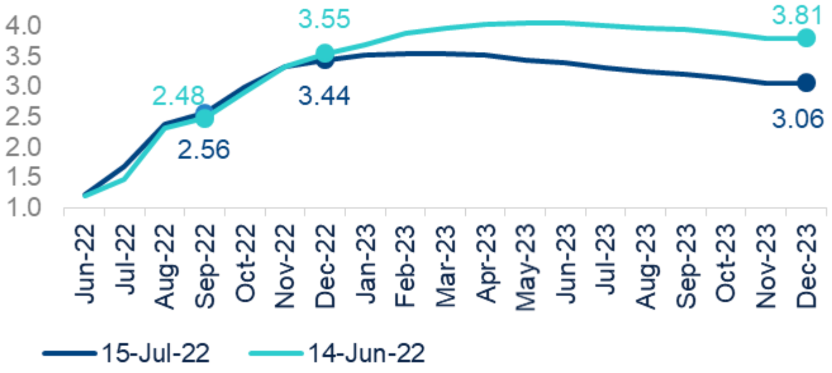


Source: BBVA Research.

- The Fed has raised rates to 1.75% (+150bp since March) and has indicated further significant adjustments in the coming months.
- The ECB has indicated that its rate hike cycle will begin this month and that it will address the risk of fragmentation with flexible PEPP reinvestment and a new instrument.
- Sovereign bond yields have risen sharply since March, although they have recently moderated due to cyclical risk.
- Stock markets have fallen, risk premia have moved higher and the dollar has appreciated.

Markets have begun to discount a possible recession in the US.

USA: FED RATE FUTURES
(%)

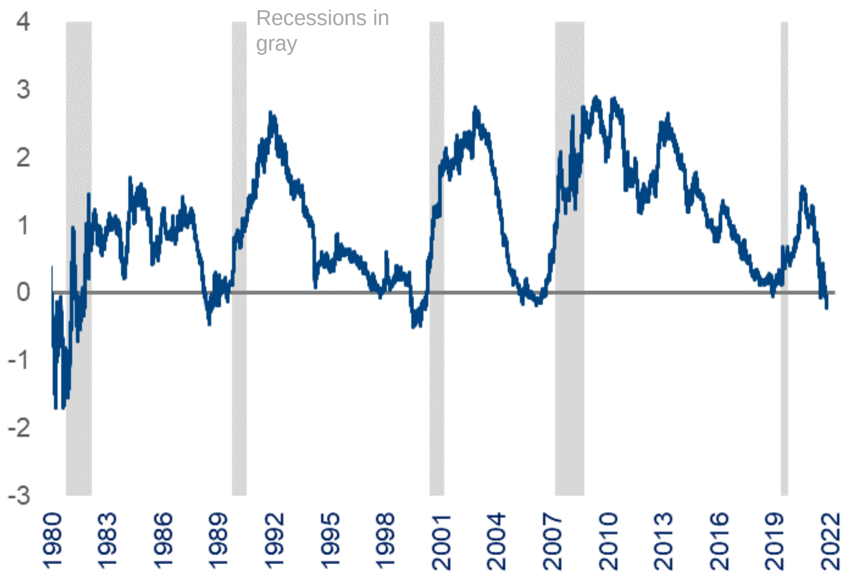


FED'S FORECAST FOR THE FEDERAL FUNDS RATE
(%, FORECAST AS OF June 15)

2022	2023	Medium-term
3.4	3.8	2.5

Source: Bloomberg.

USA: SLOPE OF YIELD CURVE
(TREASURY BILL YIELD, 10 YEARS MINUS 2 YEARS)

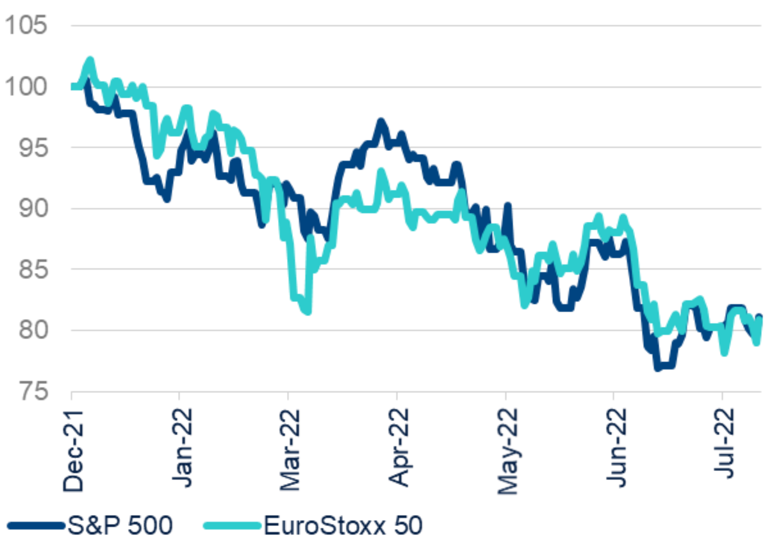


Source: Bloomberg and NBER.

Uncertainty over probable recession generates risk aversion and puts downward pressure on metal prices

STOCK MARKET INDICES

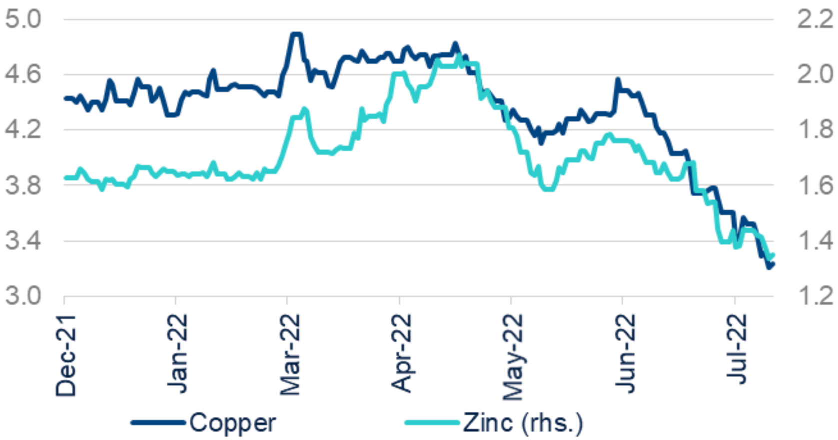
(100 = DECEMBER 31, 2021)



Source: Bloomberg.

COPPER AND ZINC PRICES

(USD PER POUND)

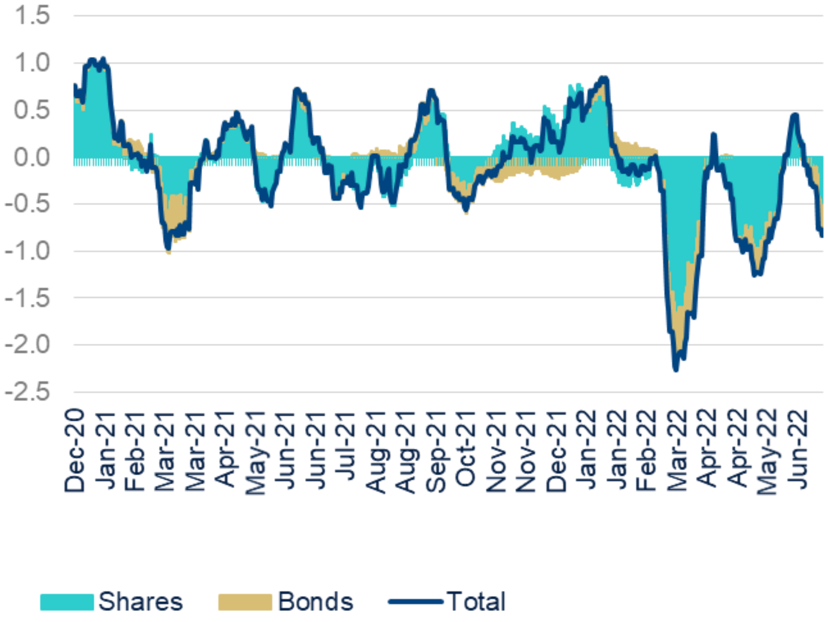


	31-Dec-21	15-Jul-22	Chg. % YTD
Copper	4.43	3.23	-27.0
Zinc	1.63	1.35	-17.0

Source: Bloomberg.

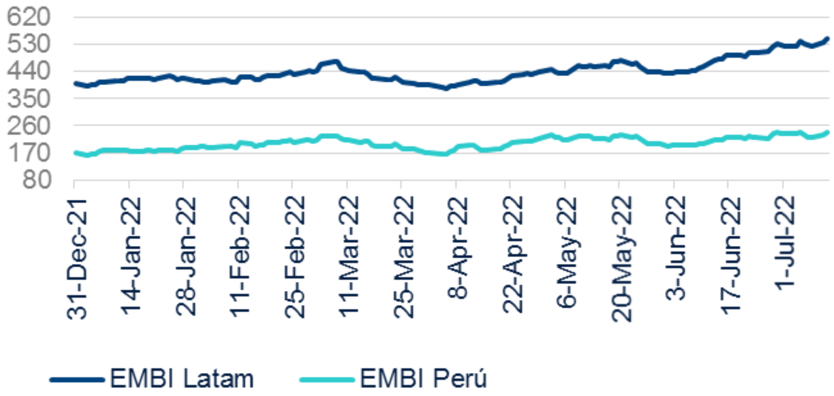
In this environment, sentiment on emerging economies have deteriorated

CAPITAL INFLOWS TO EMERGING MARKETS
(BILLIONS OF USD)



Source: IIF.

EMBI
(BASIS POINTS)



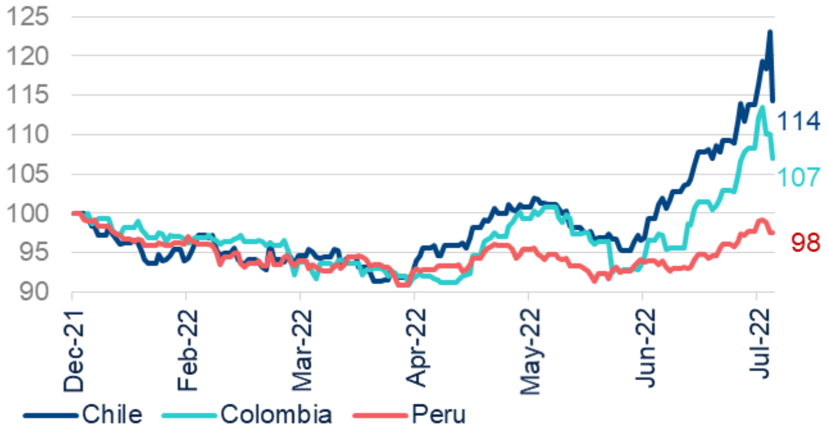
EMBI

	EMBI LatAm	Peru
Latest available data, bps (July 15)	568	252
Cumulative chg. in year, bps	169	82

Source: Bloomberg.

As a result, a weakening of currencies and increases in sovereign debt yields have been observed in LatAm

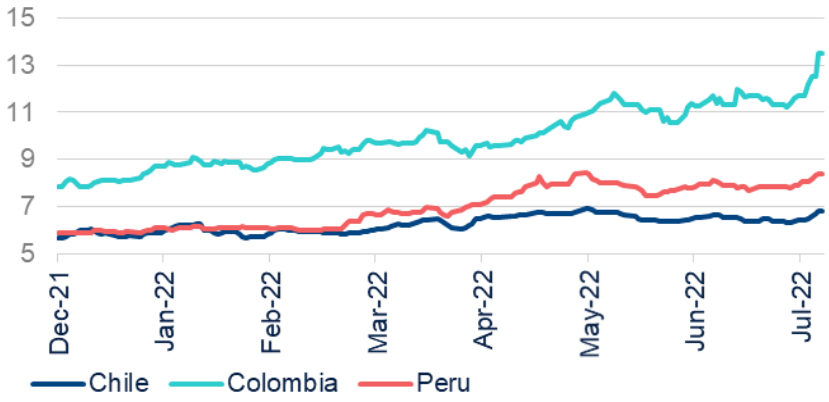
EXCHANGE RATE (LOCAL CURRENCY UNITS PER USD, INDEX: (31.DEC.2021 = 100)



	Peru	Colombia	Chile
Latest data available, local currency units per USD	3.90	4361	974
Cumulative chg. in year, %	-2.4	6,9	14.3

Source: Bloomberg.

10-YEAR SOVEREIGN BOND YIELD (%)



10-YEAR SOVEREIGN BOND YIELD

	Chile	Colombia	Peru
Latest available data, % (July 15)	6.8	13,5	8.4
Cumulative chg. in year, bps	104	534	249

Source: Bloomberg.

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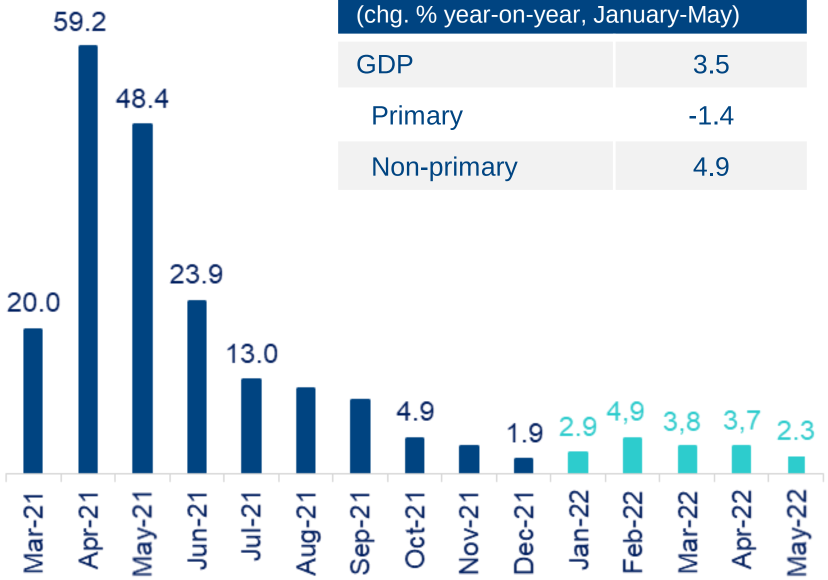
02

Domestic context: activity, employment and financial markets

GDP expanded 3.5% year-on-year in the first five months of the year. On the expenditure side, support from private consumption

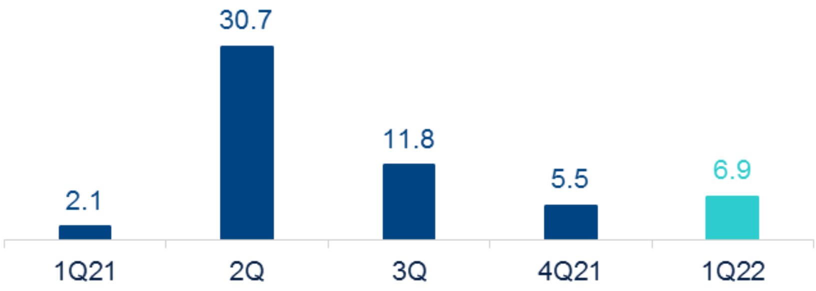
GDP
(CHG. % YEAR-ON-YEAR)



GDP (chg. % year-on-year, January-May)	
GDP	3.5
Primary	-1.4
Non-primary	4.9

Source: INEI.

PRIVATE CONSUMPTION
(CHG. % YEAR-ON-YEAR)



	SPP* (balance, PEN/ billions)	CTS (balance, PEN/ billions)	Consumer credits (chg. % year-on-year)	Private savings (accum. last 4 qtrs, % of GDP)
Dec-19	173.3	22.8	12.9	17.7
Dec-21	131.9	11.8	5.0	16.8
May-22	124.5	14.2	22.2	14.0**

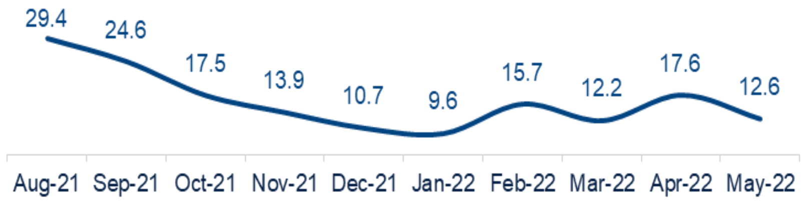
* Sistema privado de pensiones (private pension system). ** March.
Source: BCRP and ASBANC.

On the sectoral side, non-primary activities continue to show a positive year-on-year rebound after the relaxation of pandemic isolation measures.

ACCOMMODATIONS AND RESTAURANTS
(CHG. % YEAR-ON-YEAR)

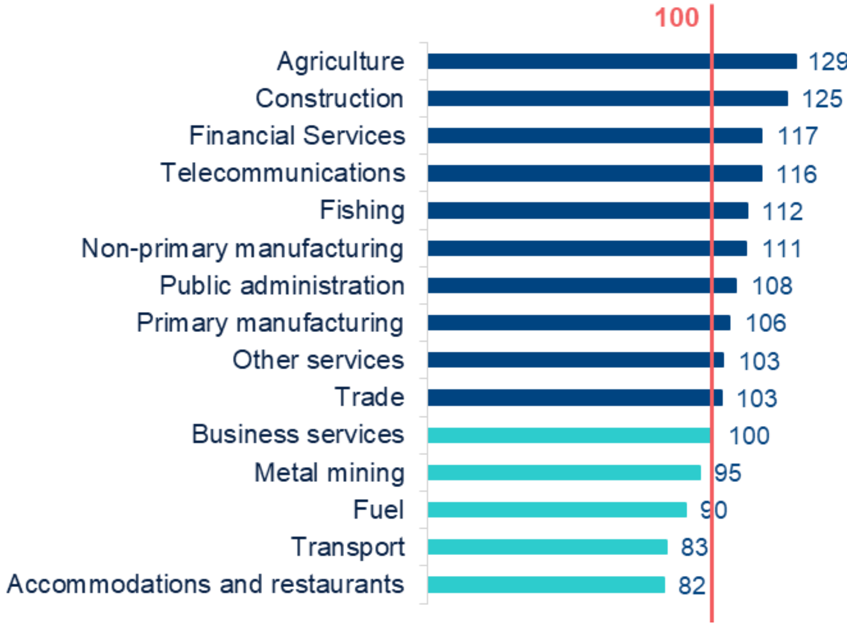
TRANSPORT
(CHG. % YEAR-ON-YEAR)

Together, the Accommodations & Restaurants and Transport sectors account for 1.5 percentage points (43%) of the year-on-year growth in the period of Jan.-May 2022 (3.5%).



Source: INEI.

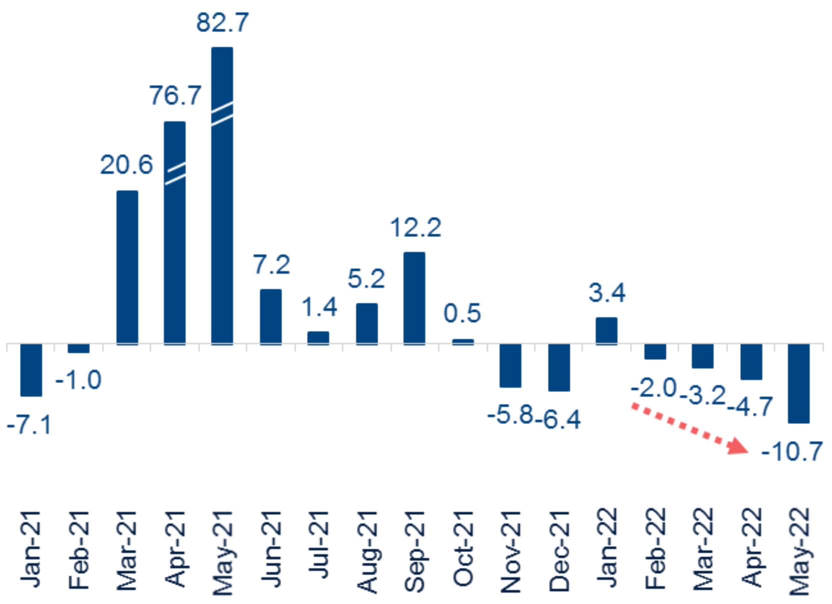
SECTORAL GDP JAN.-MAY 2022
(INDEX: FIRST TWO MONTHS 2020 = 100)



Source: INEI.

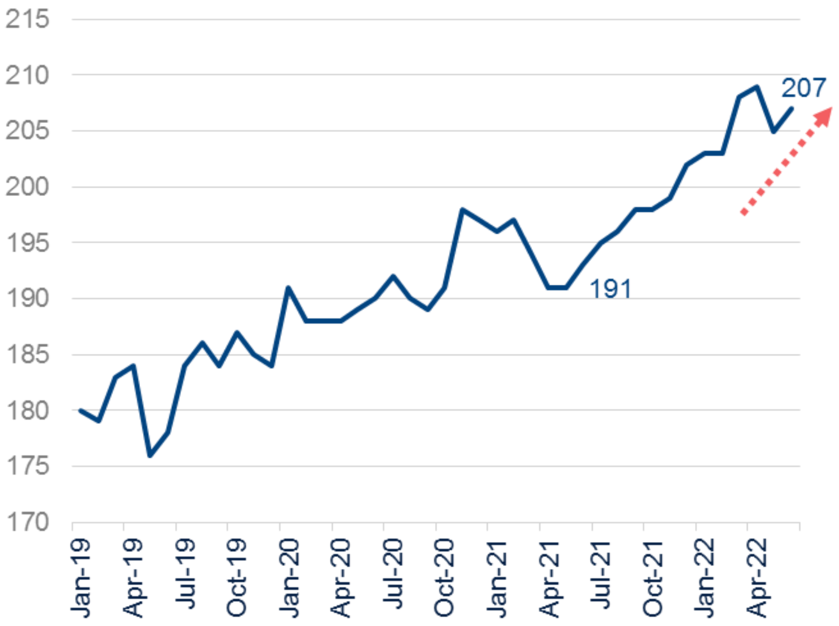
By contrast, primary (extractive) sectors affected by social unrest (metallic mining)

GDP METAL MINING
(CHG. % YEAR-ON-YEAR)



Source: BCRP.

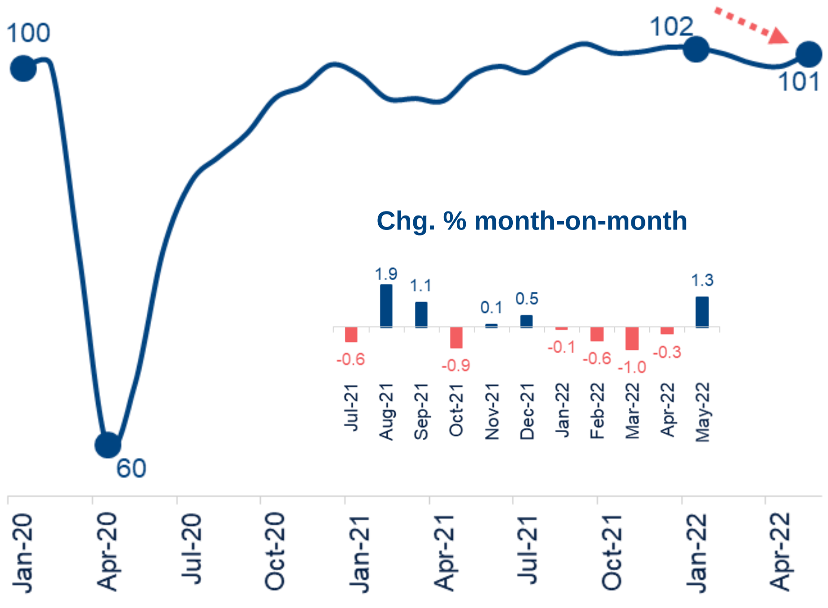
SOCIAL CONFLICTS
(NUMBER OF CONFLICTS RECORDED)



Source: Ombudsman.

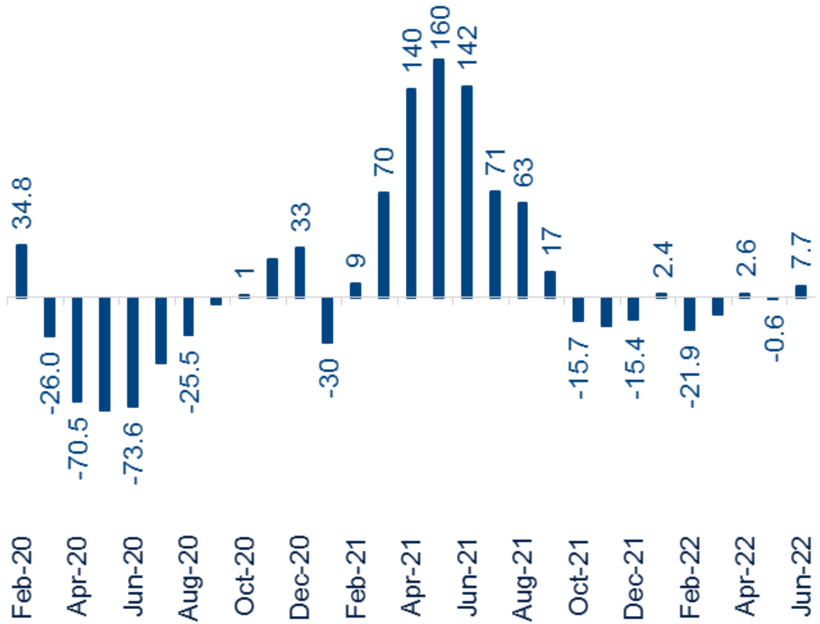
Sequential analysis and higher-frequency data suggest a weakening of activity

SEASONALLY ADJUSTED GDP
(INDEX: FIRST TWO MONTHS 2020 = 100)



Source: BCRP and BBVA Research estimate for May.

PUBLIC INVESTMENT
(CHG. % YEAR-ON-YEAR)



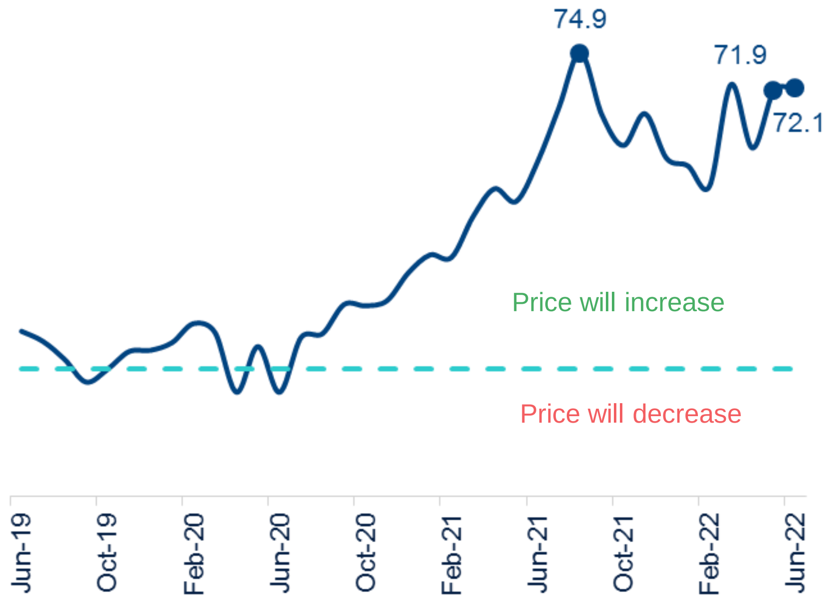
Source: BCRP.

More forward-looking indicators, such as business confidence, anticipate further cooling of private investment and higher output costs

BUSINESS CONFIDENCE
(POINTS)

Source: BCRP.

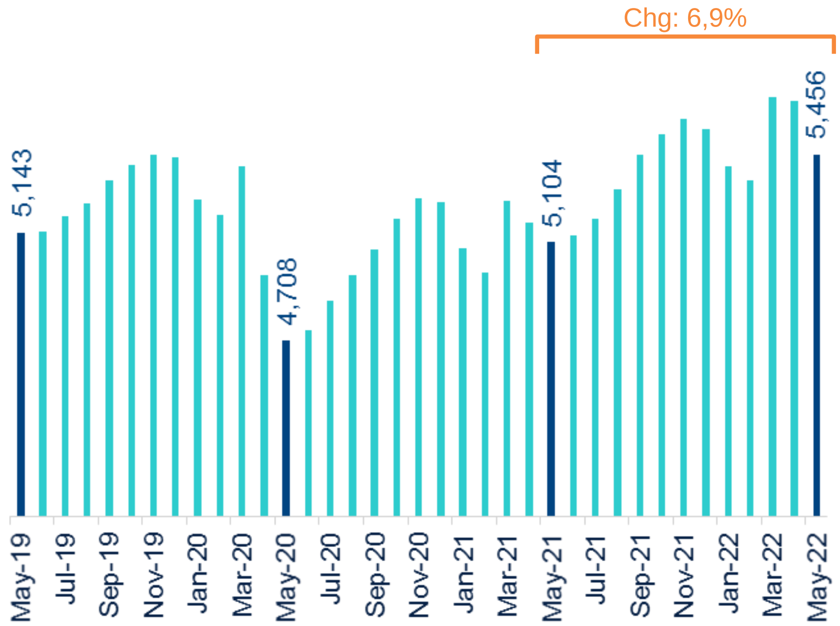
3-MONTH AVERAGE INPUT PRICE EXPECTATION
(POINTS)



Source: BCRP.

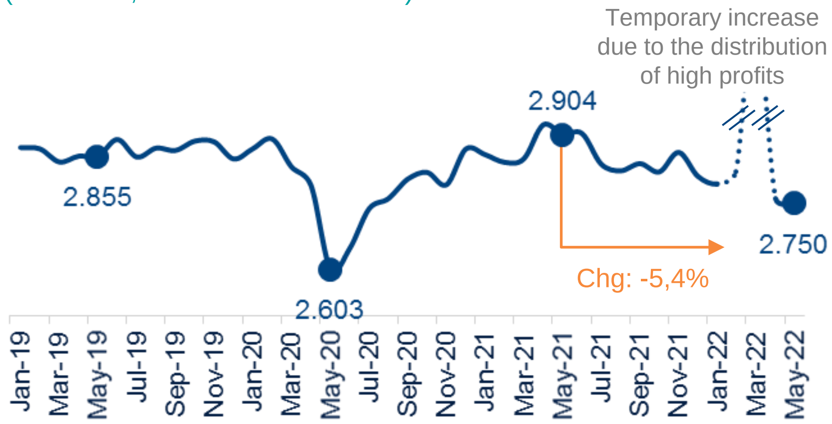
In the labor market, employment is growing, but wages remain weak — even more so with the erosion caused by rising inflation

NATIONAL FORMAL EMPLOYMENT
(THOUSANDS OF JOBS)



Source: SUNAT (Electronic Records) and BCRP. Preparation: BBVA Research.

MONTHLY WAGE INCOME FROM FORMAL JOBS[1]
(IN SOLES, AT MAY 2022 PRICES)



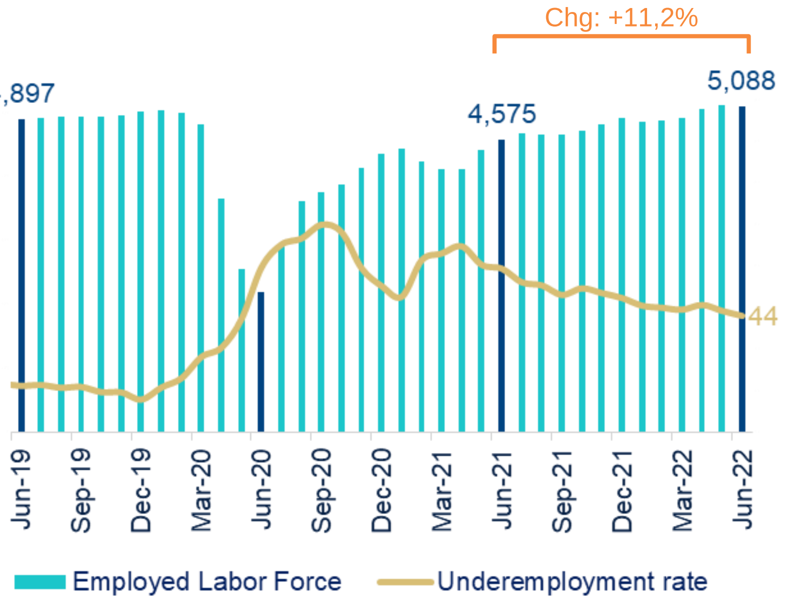
MAY-22: TOTAL WAGE BILL OF FORMAL EMPLOYMENT[2]

	Wage	Inflation	Real wage	Formal jobs	Total formal wage bill
Chg. % year-on-year	2.3	8.1	-5.40	6.9	1.1
Chg. % change over the same period in 2019	9.4	12.7	-2.9	6.1	2.9

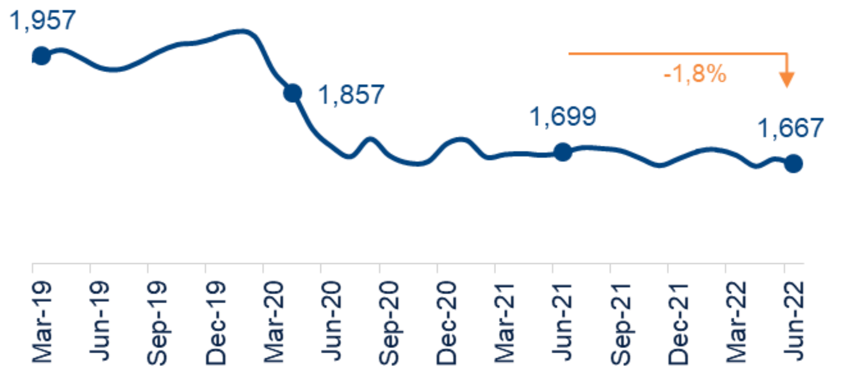
1: Seasonally adjusted series.
2: The total wage bill is calculated by multiplying the number of jobs by wage income.

In Lima, employment recovers, but underemployment does not decline, and the purchasing power of wages remains well below pre-pandemic levels

LIMA METROPOLITAN AREA: EAP AND UNDEREMPLOYMENT RATE (EMPLOYMENT IN THOUSANDS OF PEOPLE; UNDEREMPLOYMENT RATE AS % OF EAP; 3-MONTH MOVING AVERAGE)



LIMA METROPOLITAN AREA: MONTHLY WAGE INCOME (IN SOLES, AT APRIL-JUNE 2022 PRICES, 3-MONTH MOVING AVERAGE)



JUN.-22: TOTAL WAGE BILL IN METROPOLITAN LIMA[1]

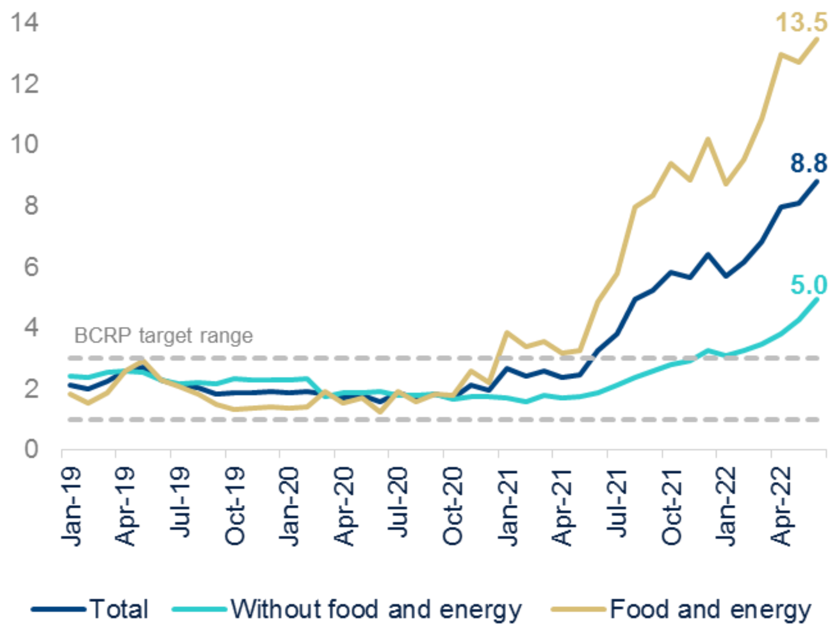
	Average wage	Inflation	Average real wage	EAP in employment	Total formal wage bill
Chg. % year-on-year	6,3	8,3	-1,8	11,2	9,2
Chg. % change over the same period in 2019	-2,0	13,1	-13,4	3,9	-10,0

Source: INEI (Permanent Employment Survey).

1: The total wage bill is calculated by multiplying the number of employed people by wage income.

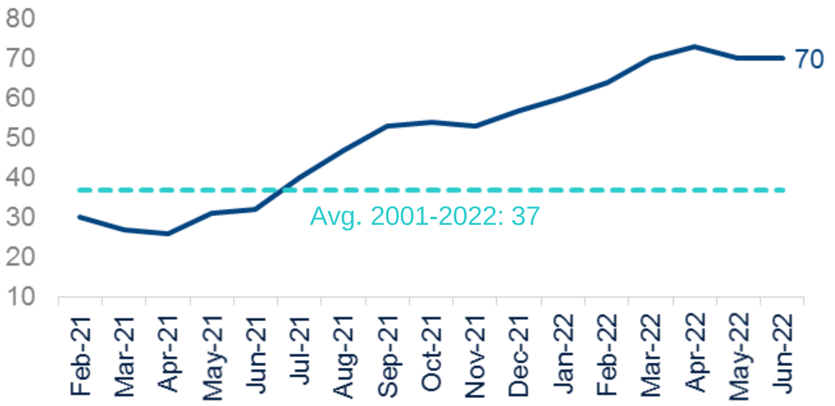
Inflation at 25-year highs mainly due to sustained high input prices, which have contaminated other prices and expectations

INFLATION
(%)



Source: INEI and BCRP.

PERCENTAGE OF CPI ITEMS WITH YEAR-OVER-YEAR PRICE VARIATION GREATER THAN 3% (%)



INFLATION EXPECTATIONS AT 1 YEAR (%)

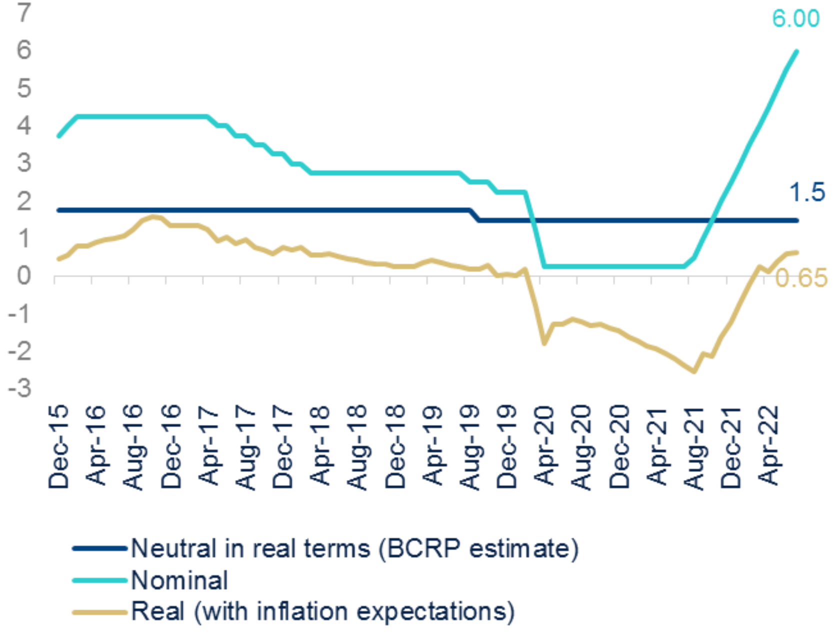
Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22
3.7	3.7	3.8	4.4	4.6	4.9	5.4

Source: INEI and BCRP.

The Central Bank has been tightening monetary policy, which is still expansionary, to avoid further de-anchoring of inflationary expectations

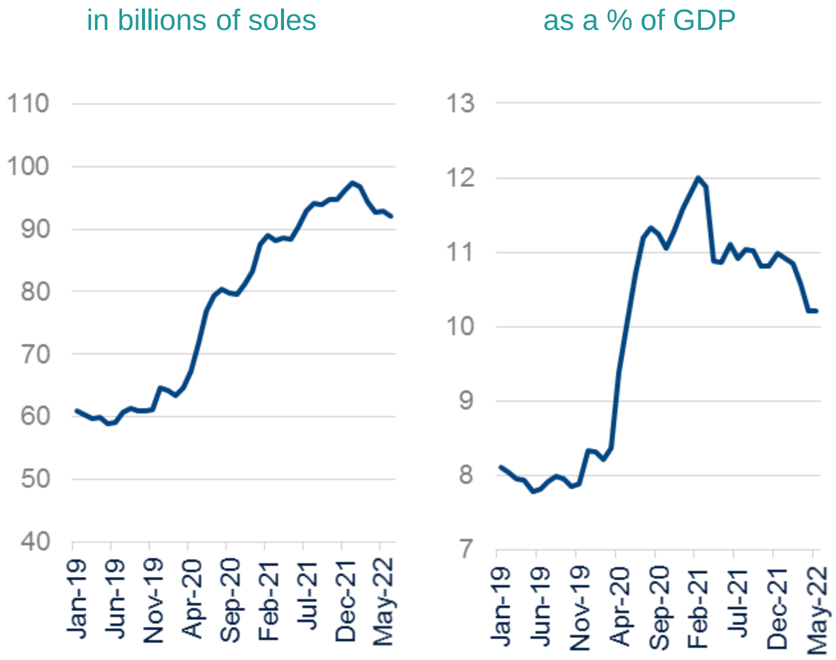
REFERENCE INTEREST RATE

(%)



Source: BCRP.

PRIMARY ISSUANCE



Source: BCRP and BBVA Research.

BBVA Research

03

Macroeconomic forecasts

3.1. GDP and economic activity

Considerations regarding external aspects

BBVA RESEARCH CENTRAL GLOBAL SCENARIO:

The rise in interest rates, necessary for containing inflation expectations, will have a negative impact on activity and lead to recessionary episodes

STRICTER MONETARY MEASURES

Impact through demand (consumption/investment), financial burdens and wealth, financing, etc.

COMMODITIES

Pressure on fuel and food prices, compounded by gas shortages in the Eurozone (at least next winter). However, lower metal prices.

SUPPLY DISRUPTIONS

The bottlenecks will be gradually reduced in the absence of any further negative shocks.

SLOWDOWN OF GROWTH

A gentle recession in the USA due to the rising interest rates and another in the Eurozone due to gas shortages.

INFLATION SLOWS

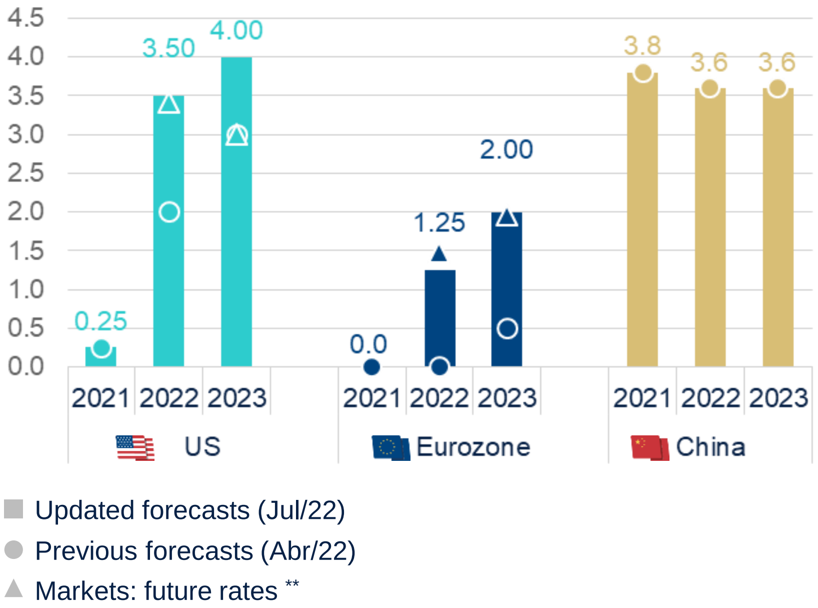
It will remain well above the inflation targets in 2022-23. In addition, lower metal prices will mean less support for exporters.

FINANCIAL VOLATILITY

A strong dollar, higher risk premiums, capital outflows from emerging markets.

Interest rates will rise further and sooner than expected, reaching restrictive levels in the USA and close to neutral ones in the Eurozone

MONETARY POLICY INTEREST RATE*
(%, END OF PERIOD)



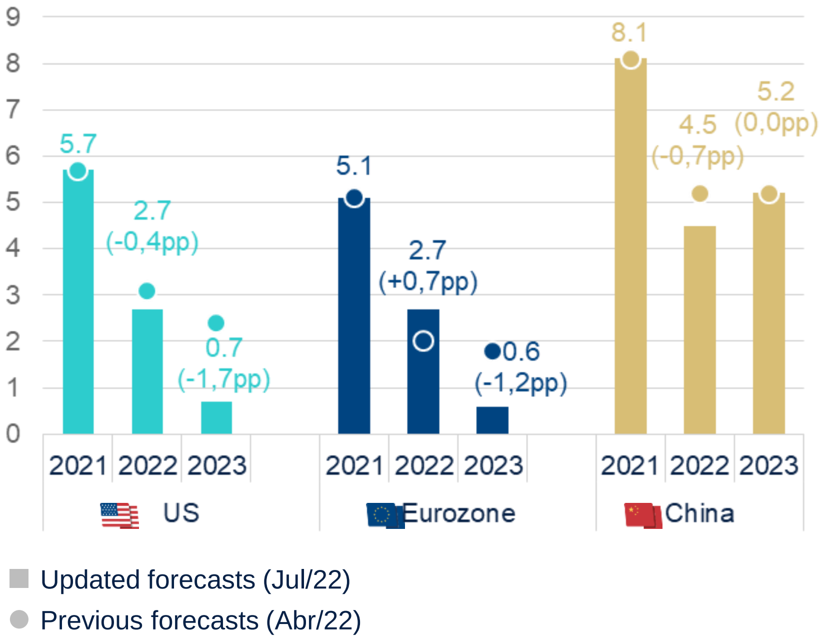
* In the case of the Eurozone, it corresponds to the interest rate for refinancing operations.
** Futures market data for 11 July.
Source: BBVA Research, based on Bloomberg data.

- The Fed is expected to raise the policy rate to 4.0%, above the break-even level (between 2% and 3%), and it will continue to sell assets to reduce its balance sheet.
- The ECB is launching its interest rate rise cycle, which will be less aggressive than the Fed's due to the lower demand pressures and the risk of financial fragmentation.
- Unlike the USA, the fiscal policy in the Eurozone will focus on growth through the NGEU funds and the suspension of the fiscal rules until 2023.
- In China the policies will continue to have a moderately expansionary nature.

Global slowdown: after increasing by 6.2% in 2021, the world's GDP will grow by 3.4% in 2022 and 2.5% in 2023 (respectively 0.6pp and 1.1pp less than expected)

GDP

(REAL, % Y/Y VARIATION)

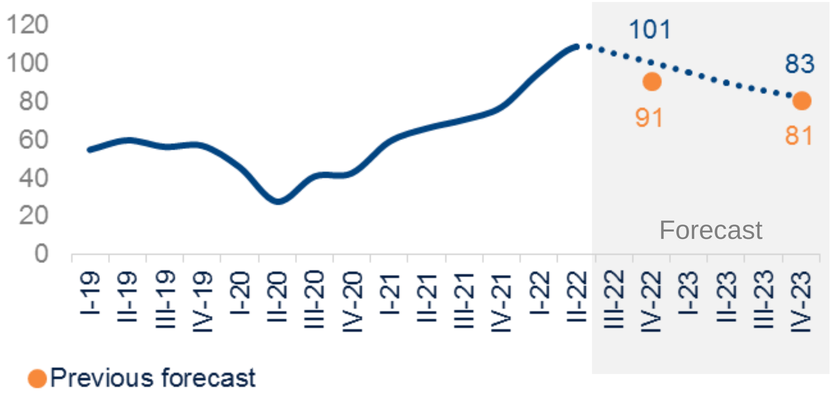


* Forecast change in parentheses.
Source: BBVA Research.

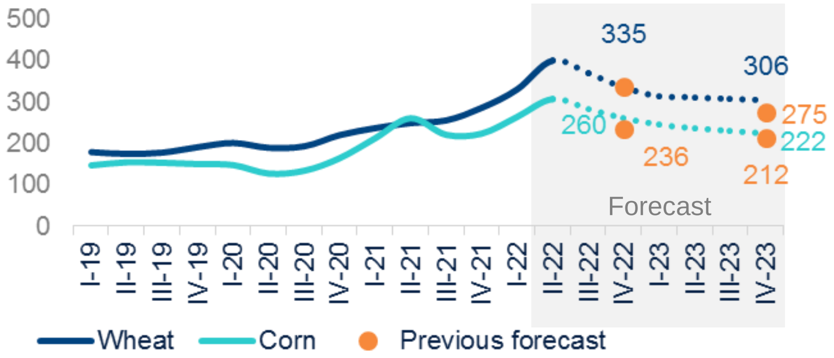
- USA: the rising interest rates will probably lead to a recession in 2023, which is expected to be mild given the robustness of employment and the solid balance sheets of families and the financial system.
- Eurozone: the impact of the war will be stronger in the coming quarters due to the expected gas restrictions, pushing the GDP growth slightly down.
- China: growth will recover from the impact of the recent lockdowns, but the zero-tolerance COVID policy remains a potential problem.

International fuel and food prices will tend to moderate going forward, but are higher than in our previous forecast

INTERNATIONAL WTI OIL PRICE
(USD PER BARREL)



INTERNATIONAL WHEAT AND CORN PRICES
(USD PER MT)



INTERNATIONAL WTI OIL PRICE
(ANNUAL AVERAGE, USD PER BARREL)

2019	2020	2021	2022*	2023*
57	39	68	102	88

*Estimate
Source: Bloomberg and BBVA Research.

INTERNATIONAL PRICE
(ANNUAL AVERAGE, USD PER MT)

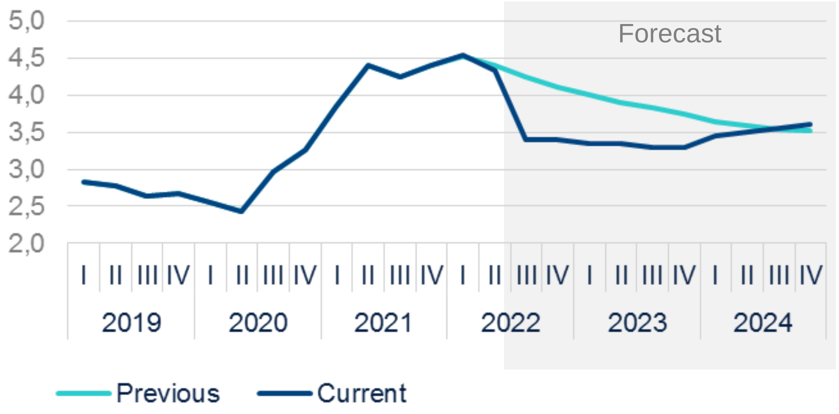
	2019	2020	2021	2022*	2023*
Corn	151	143	229	278	233
Wheat	182	202	258	359	310

*Estimate
Source: Bloomberg and BBVA Research.

Less dynamism than anticipated in global activity leads to a downward revision in our copper price forecast

COPPER PRICE

(USD/POUND AVERAGE FOR THE PERIOD)



	2020	2021	2022*	2023*	2024*	2025-2027*
Current forecast	2.80	4.22	3.91	3.33	3.53	3.78
Previous forecast	2.80	4.22	4.32	3.87	3.57	3.56

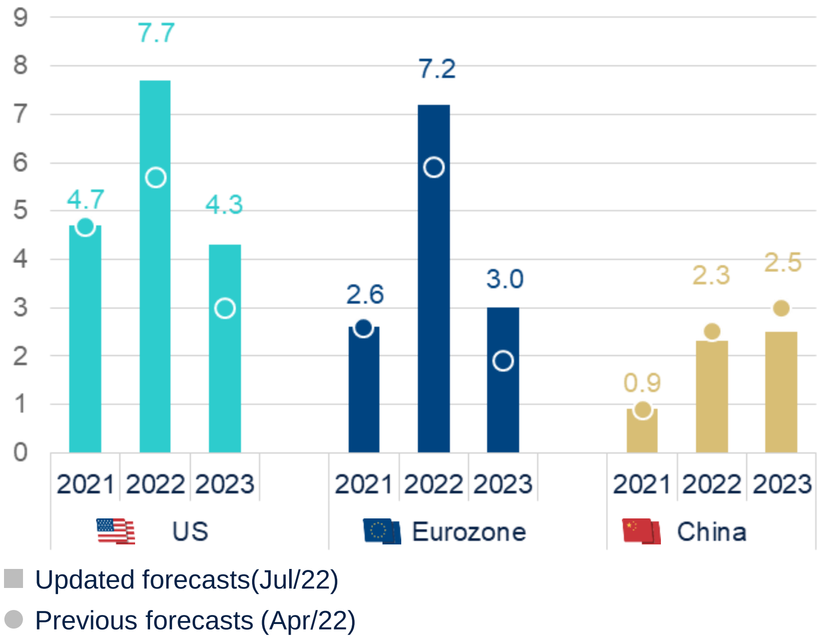
*Estimate
Source: Bloomberg and BBVA Research.

- In the short term, the price drop is explained by the liquidation of speculative positions, in line with expectations of lower global growth.
- Price supports: higher output costs (energy), inventories remain tight, and production problems in some large operations.
- Higher incoming supply in 2022 and 2023, as well as lower demand in the face of a slowdown, contain a significant price recovery.
- In the medium term, structural support through greater investment in green infrastructure and vehicle conversion.

Within this context, inflation will remain well above the central banks' targets, mainly in the short term

INFLATION

(% Y/Y VARIATION IN THE AVERAGE CPI FOR THE YEAR)



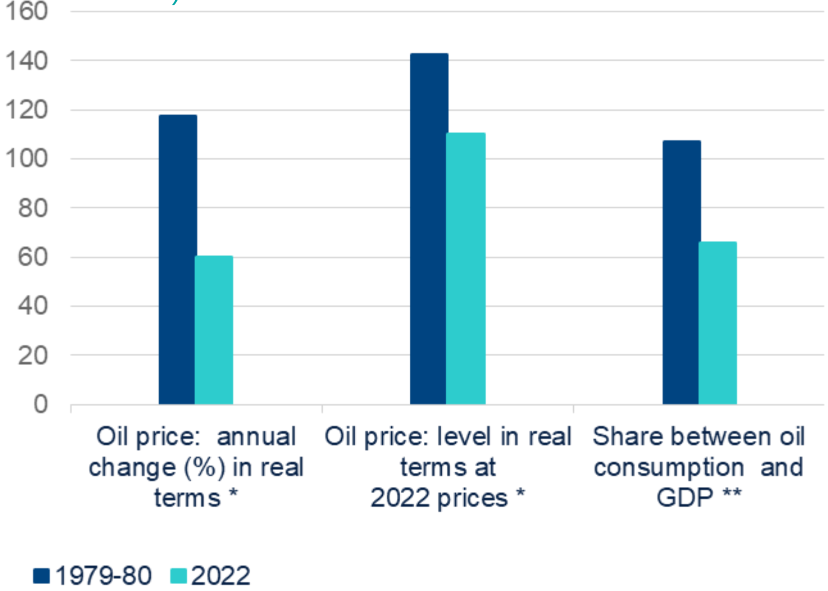
Source: BBVA Research.

- Upward review of the inflation forecasts, largely due to the higher commodity prices.
- Inflation will eventually decline as the current shocks fade away and the central banks continue to act.
- The slowing demand will reduce the scope for significant salary increases, making a salary-price spiral unlikely.

The likelihood of a prolonged period of higher inflation has increased, but a return to the inflationary spiral of the 1970s remains improbable

OIL: PRICE AND INTENSITY OF USE

(PRICE AND INTENSITY VARIATION: %; PRICE LEVEL: USD/BARREL)



* Maximum observed in each period.
** For the world economy.
Source: BBVA Research based on Fed and Haver data.

A less vulnerable economic structure:

- less oil-intensive production
- more open economies and lower levels of unionisation will make a salary-price spiral less likely

A more credible monetary policy:

- independent
- with express inflation targets
- with an exclusive prerogative to combat inflation
- with effective action and monitoring tools

Considerations regarding local aspects

INCREASED AVAILABILITY OF LIQUIDITY FOR FAMILIES
Withdrawals of pension savings and CTS and Government transfers

→ Increased household consumption

POLITICAL ENVIRONMENT
It is assumed that the same level of political activity will continue and that there will be no disruptive changes in the Executive or Congress

→ Business confidence will remain weak, leading to caution in investment spending

SOCIAL UNREST
A more noticeable negative impact in 2022, with a tendency towards moderation next year

→ This year's mining activity will be more intensely affected (compared to the forecasts three months ago), but there will be a greater recovery in 2023

ECONOMIC POLICIES
A more pronounced monetary adjustment and a fall in public investment in 2023 (after the elections for new sub-national authorities)

→ Negative impacts on private and public spending

Increased availability of liquidity for households will support private consumption in the second half of this year and in 2023, but...

WITHDRAWAL OF PRIVATE PENSION FUNDS (SPP) AND COMPENSATION FOR TIME OF SERVICE (CTS) FUNDS

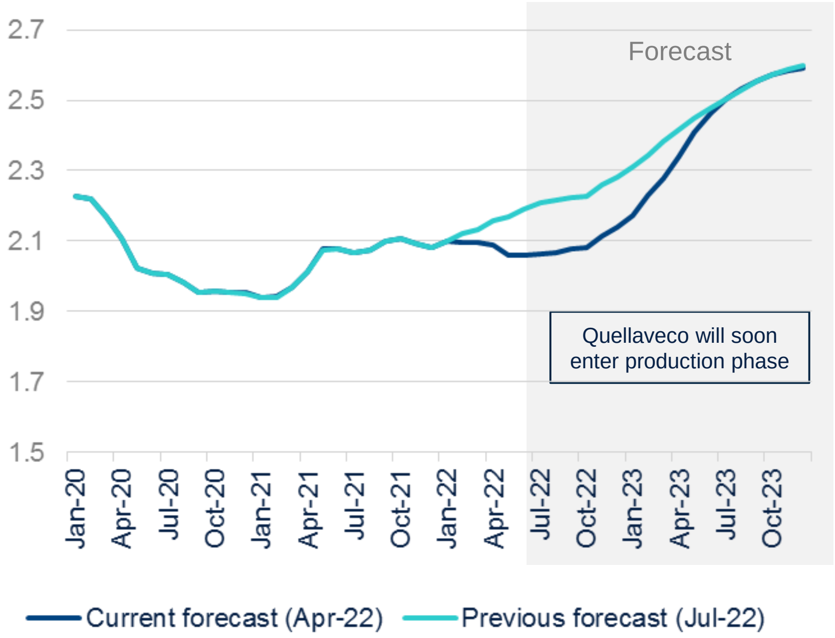
	2020 and 2021	**Potential withdrawal** 2022 and 2023
SPP	PEN 66 billion[1]	PEN 32 billion[3]
CTS	PEN 11 billion[2] (reduction of the balance)	PEN 10 billion[4]

1: Equivalent to 7.2% of GDP. 2: Corresponds to the decrease in the CTS balance in the financial system, from PEN 23 billion (December 2019) to PEN 12 billion (December 2021). CTS withdrawals were actually higher because deposits were made in those years. 3: SBS estimate. 4: Own estimate.
Source: SBS and BBVA Research.

- It is expected that a significant portion of the released pension and CTS savings will be used for consumption (locally produced or imported goods and services).
- At BBVA Research, we estimate that around PEN 15 billion will be spent by households (on imported or locally produced goods and services) between the second half of 2022 and 2023.
- This estimate considers or assumes: (i) the behavior observed in previous withdrawals; (ii) in the case of private pension funds, withdrawals are increasingly linked to higher income contributors (who are those who still maintain funds and have a lower marginal propensity to consume); and (iii) in the case of CTS, all additional deposits made in 2022 and 2023 would be withdrawn.
- Upward impact on GDP would be between four and five tenths of a percentage point in 2022. Similar impact in 2023.

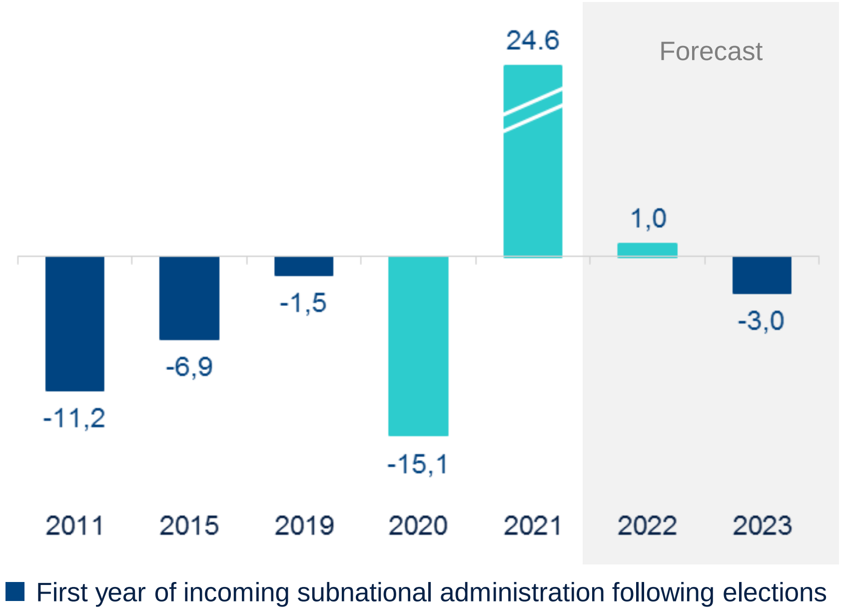
... social conflict with a more sensitive impact on mining (although it is assumed that this will trend toward dissipation) and a slump in public investment in 2023

COPPER OUTPUT
(MILLIONS OF MT, ACCUMULATED IN LAST 12 MONTHS)



Source: MINEM and BBVA Research.

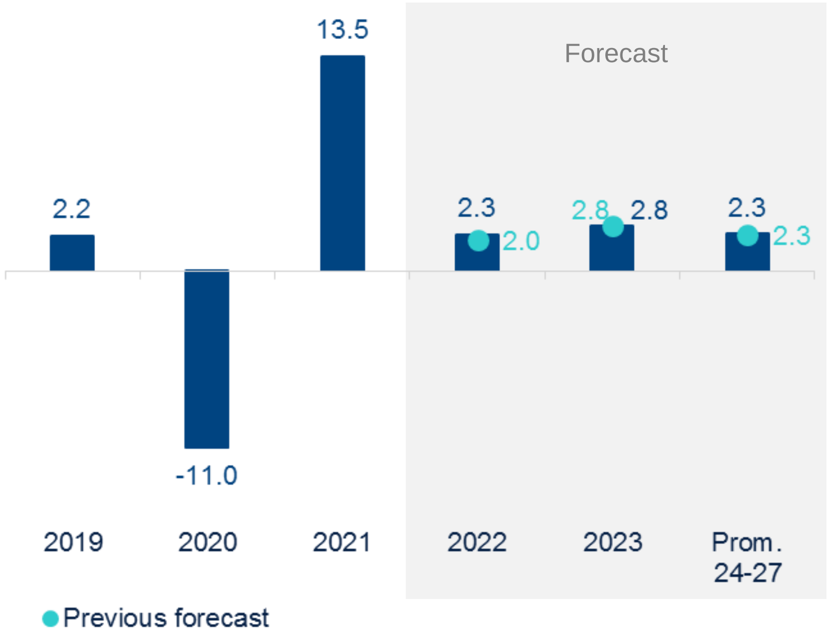
PUBLIC INVESTMENT
(CHG. % YEAR-ON-YEAR)



Source: BCRP and BBVA Research.

This year's growth forecast is increased to 2.3% and the forecast for 2023 is maintained at 2.8%

GDP
(CHG. % YEAR-ON-YEAR)



Source: INEI and BBVA Research.

- Upward adjustment in growth 2022 (+0.3 pp) due to: (i) more favorable trends in private spending (surprise in the first months of the year) and (ii) greater availability of liquidity for households in the second half of the year. These factors more than offset the deterioration of the external environment, higher inflation, higher interest rates and more pronounced social unrest.

- 2023 outlook unchanged: deterioration of the external environment and a somewhat more pronounced slump in public investment, but these offset the greater contribution of mining due to the low base of comparison with the previous year and more consumption due to the availability of household liquidity. These last two elements also explain why next year's growth is higher than in 2022.

- In the medium term, low growth prospects. Contained investment, regulatory risk and the absence of adequate policies to promote productivity all limit the economic expansion rate.

Private consumption remains buoyant in 2022, while exports rebound in 2023 (mining output)

EXPENDITURE-SIDE GDP
(CHG. % YEAR-ON-YEAR)

	2020	2021	2022*	2023*
Private consumption	-9.8	11.7	4.5	2.6
Private investment	-16.5	37.4	-1.5	0.1
Public consumption	7.8	10.6	3.5	3.0
Public investment	-15.1	24.9	1.0	-3.0
Exports	-19.6	13.7	3.0	5.5
Imports	-15.8	18.6	2.5	1.7

* Forecast.
Source: BBVA Research.

SECTORAL GDP
(CHG. % YEAR-ON-YEAR)

	2020	2021	2022*	2023*
Agriculture	1.0	4.2	2.3	0.1
Fishing	4.2	2.8	-7.9	3.2
Metal mining	-13.9	9.7	-0.1	16.2
Hydrocarbon	-11.1	-4.6	12.3	8.3
Primary manufacturing	-2.3	3.0	1.4	2.7
Non-primary manufacturing	-16.1	24.9	1.9	-0.2
Construction	-13.3	34.8	-1.7	-1.0
Trade	-16.0	17.8	2.3	2.6
Other services	-10.4	10.4	3.7	2.1

* Forecast.
Source: BBVA Research.

BBVA Research

03

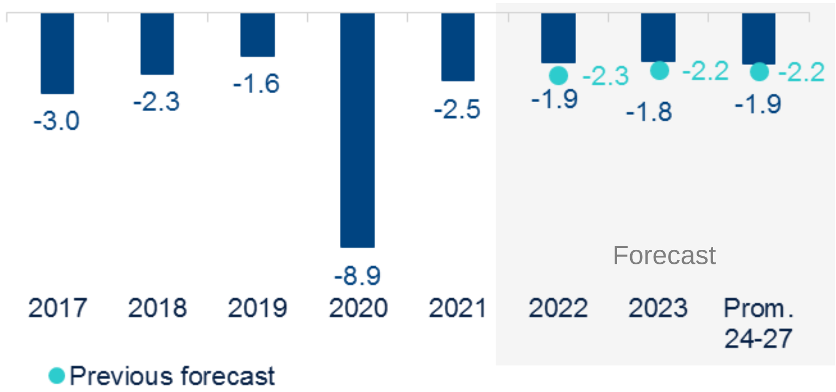
Macroeconomic forecasts

3.2. Fiscal result and public debt

Creating Opportunities

On the fiscal side, the deficit will decrease somewhat more than expected, thanks to higher revenues (cyclical but also structural factors)

FISCAL RESULT
(NON-FINANCIAL PUBLIC SECTOR, % OF GDP)

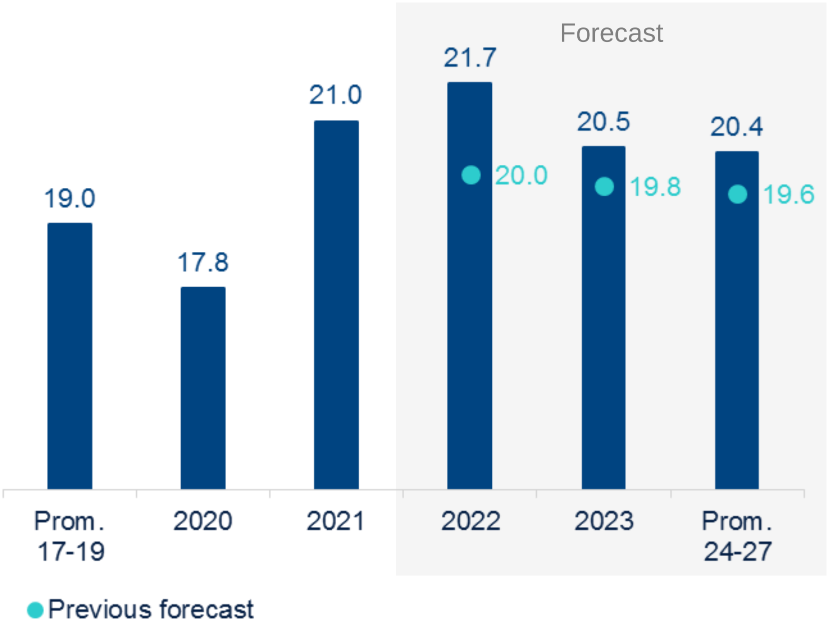


STRUCTURAL FISCAL RESULT
(% POTENTIAL GDP)

2019	2020	2021	2022	2023	2024	2025
-1.4	-4.5	-3.0	-2.2	-2.1	-2.3	-2.3

Source: BCRP and BBVA Research.

CENTRAL GOVERNMENT REVENUE
(% GDP)

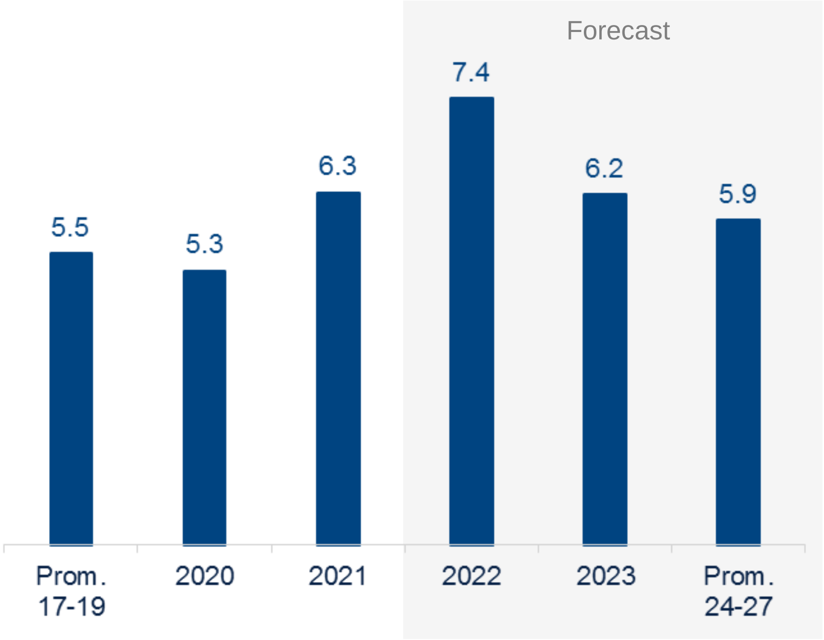


Source: BCRP and BBVA Research.

The increase in tax revenues in 2022 is supported by higher income tax collections (driven by the mining sector) and...

INCOME TAX REVENUES

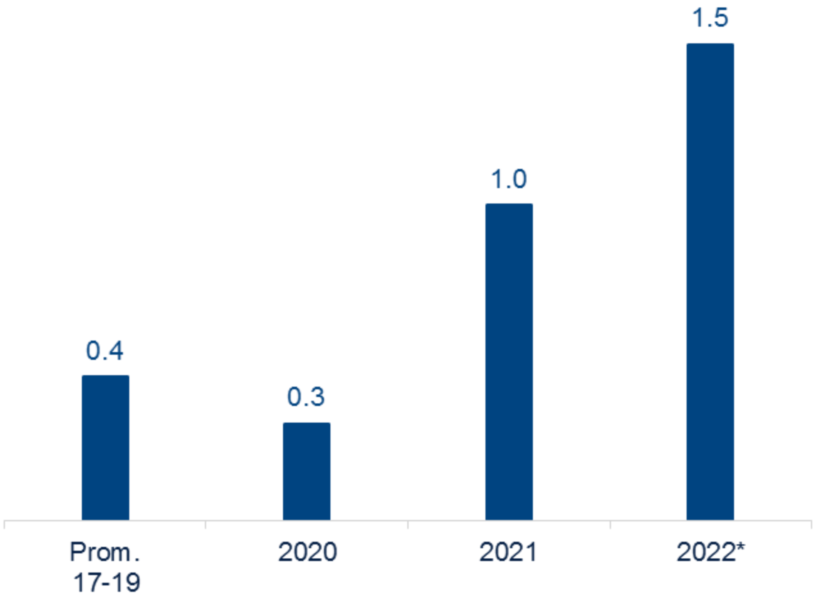
(% GDP)



Source: BCRP and BBVA Research.

MINING SECTOR INCOME TAX

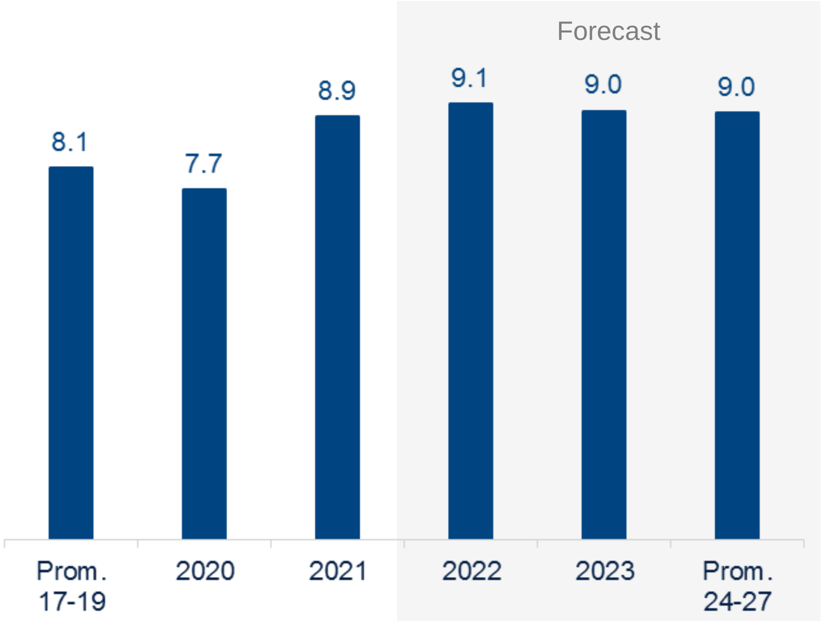
(% GDP)



*Estimate.
Source: BCRP and BBVA Research.

...by General Sales Tax (VAT)

VAT REVENUE
(% GDP)



Source: BCRP and BBVA Research.

SUNAT: non-compliance in the payment of the VAT decreased between 2020 and 2021 from 38.4% (of potential revenue) to 28.0%.

BBVA Research: This reduction in non-compliance is equivalent to approximately PEN 7 billion in increased revenues.

Why has VAT revenue increase

Domestic VAT

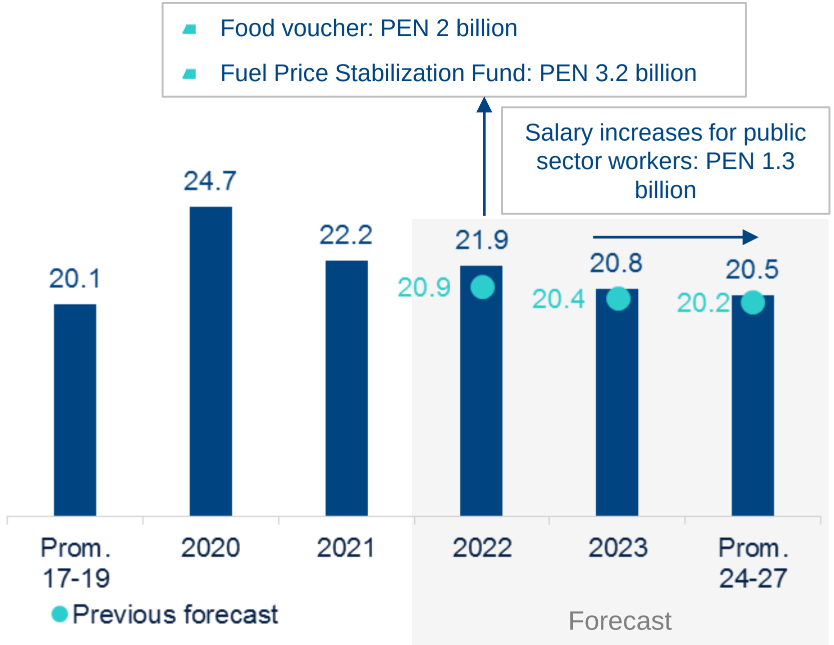
- Strong expansion of private consumption
- Increased use of credit and debit cards
- Measures to reduce tax non-compliance

Imported VAT

- High prices of imported inputs

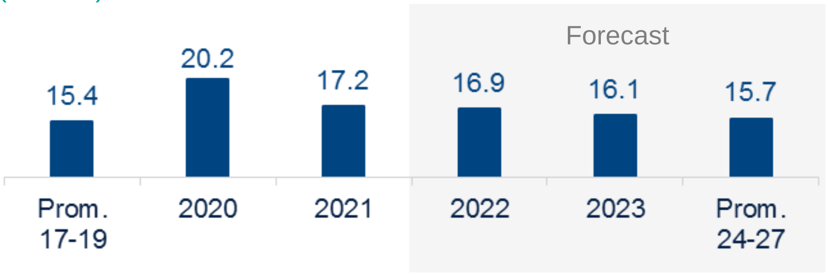
On the expenditure side, the baseline scenario foresees a gradual normalization of disbursements to deal with the pandemic

GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE (% GDP)

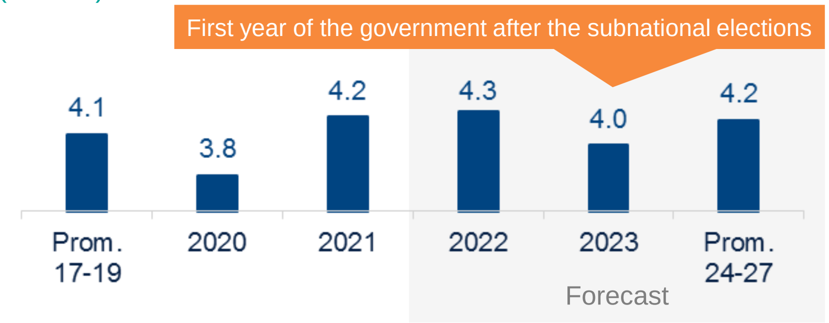


Source: BCRP and BBVA Research.

GENERAL GOVERNMENT CURRENT EXPENDITURE (% GDP)



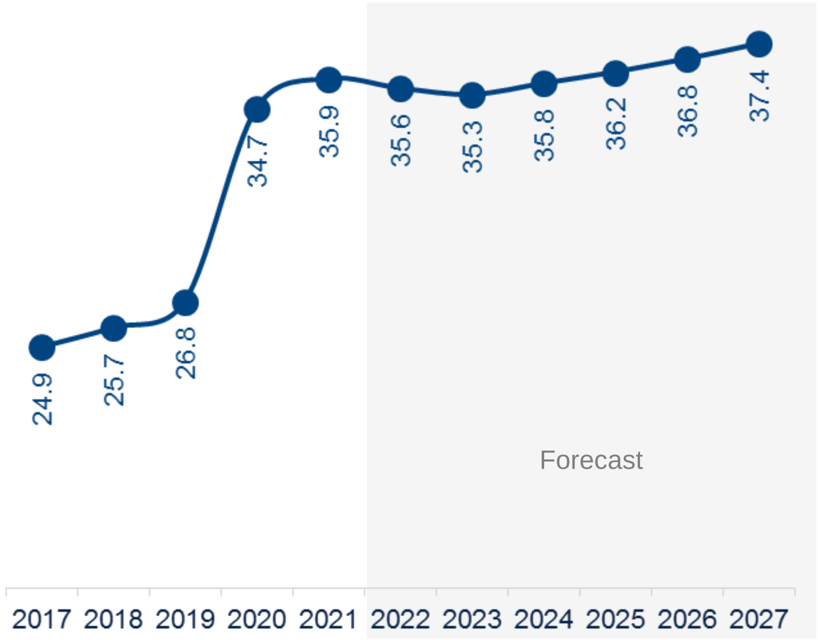
GENERAL GOVERNMENT INVESTMENT EXPENDITURE (% GDP)



Source: BCRP and BBVA Research.

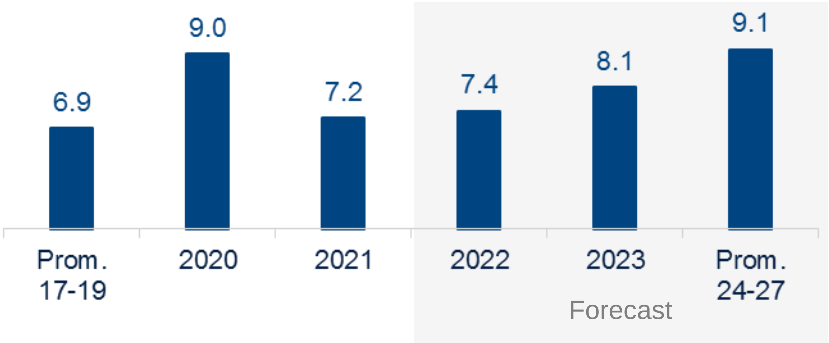
The expected trend in the fiscal deficit is consistent with a level of gross public debt which will increase slightly starting in 2023

GROSS PUBLIC DEBT
(NON-FINANCIAL PUBLIC SECTOR, % OF GDP)



Source: BCRP and BBVA Research.

INTEREST EXPENDITURE
(AS % OF CENTRAL GOVERNMENT REVENUE)



- Gross public debt will resume its upward trend in the coming years.
- Dollarization of public debt has increased: from 32% in 2019 to 54% in 2021.
- Interest expense (as a % of General Government revenues) will increase in the coming years. As a % of GDP, we estimate that it will be between 1.6% and 1.9% between 2022 and 2027.

BBVA Research

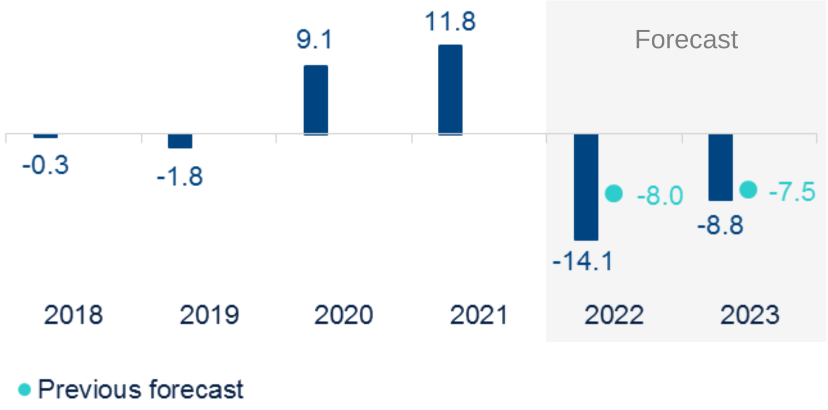
03

Macroeconomic forecasts

3.3. External sector and exchange rate

On the external side, the terms of trade and trade balance forecasts have been revised downward

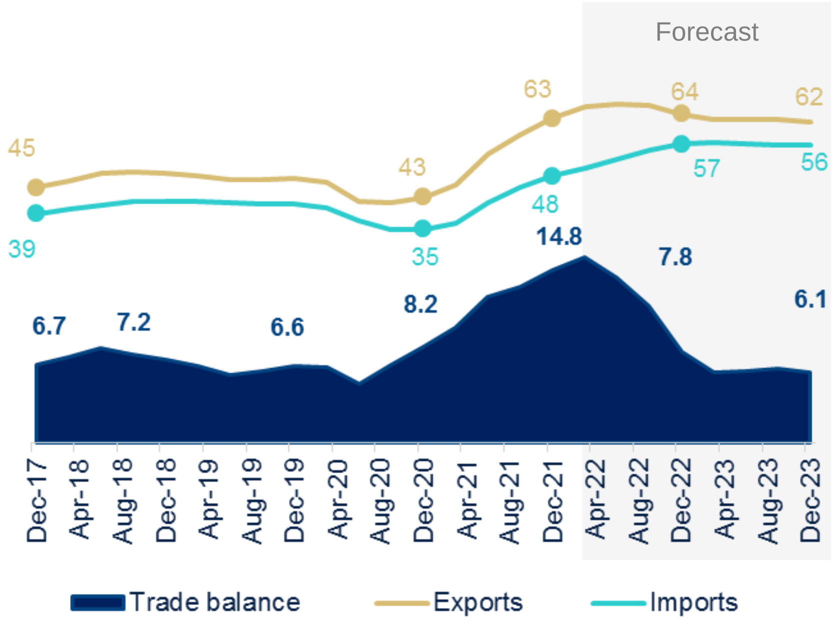
TERMS OF TRADE
(CHG. % YEAR-ON-YEAR)



	XPI	MPI	ToT
2022*	-2.1	14.2	-14.1
2023*	-10.8	-2.3	-8.8

*Forecast.
Source: BCRP and BBVA Research.

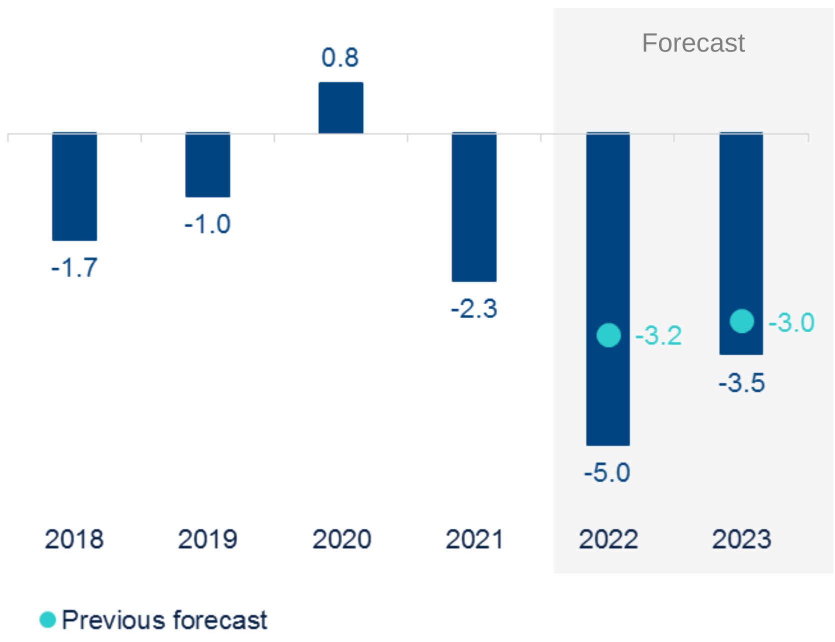
TRADE BALANCE
(USD BILLION, CUMULATIVE IN THE LAST FOUR QUARTERS)



Source: BCRP and BBVA Research.

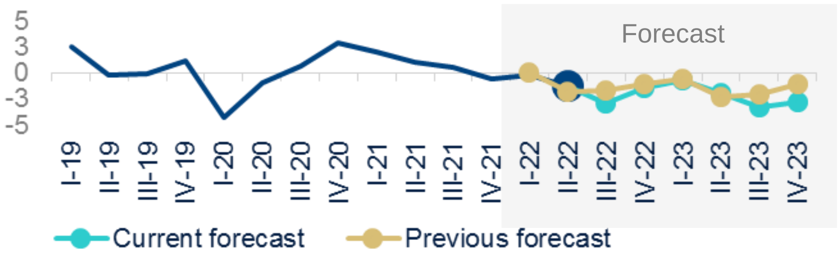
Current account deficit will be wider, in a less favorable global environment and with higher risk perception regarding EM

BALANCE OF PAYMENTS CURRENT ACCOUNT
(% GDP)

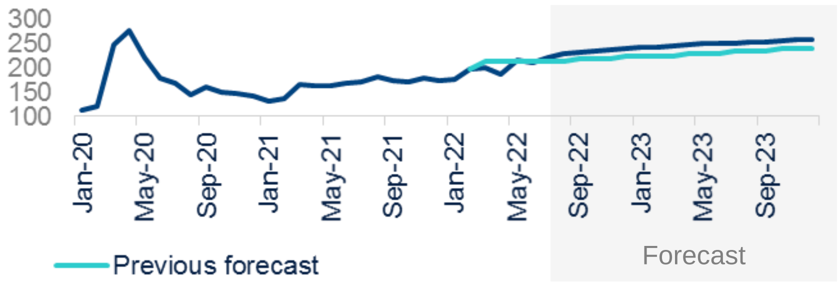


Source: BCRP and BBVA Research.

CAPITAL INFLOWS TO EMERGING MARKETS
(% OF MANAGED ASSETS)



EMBI PERU
(DAILY AVERAGE FOR THE MONTH, IN BASIS POINTS)

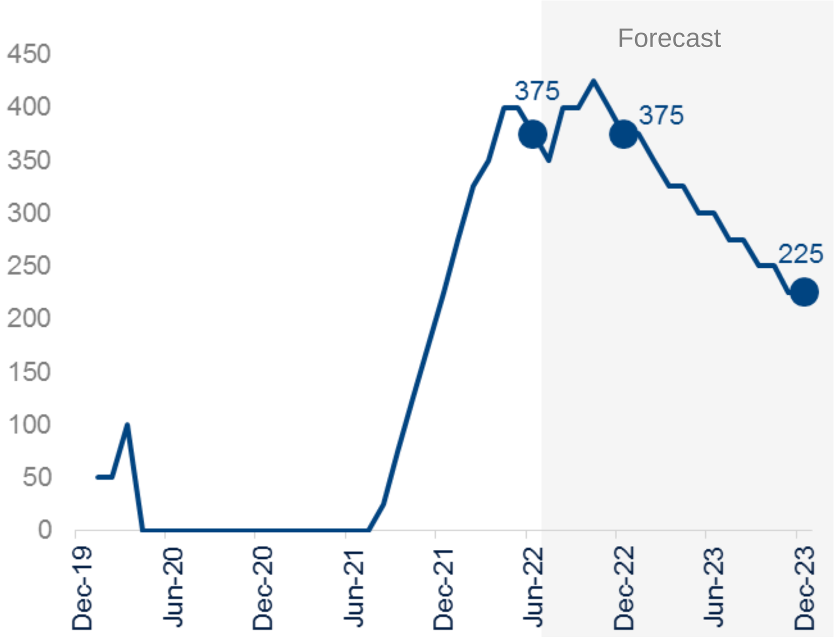


Source: EPFR, Bloomberg and BBVA Research.

Deterioration of external accounts, higher risk perception, and lower interest rate differential will induce a weakening of the PEN in the future

INTEREST RATE DIFFERENTIAL

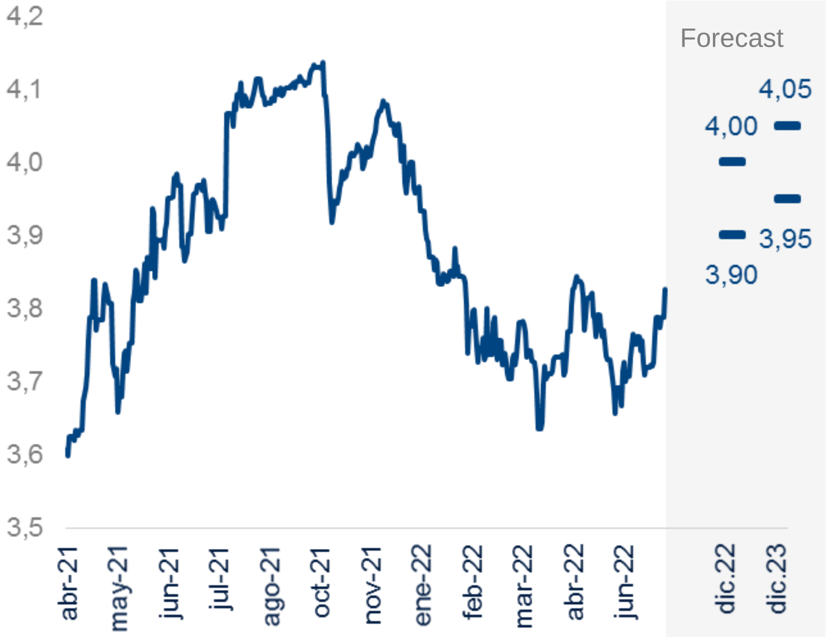
(REAL EX-POST MONETARY POLICY RATES, PEN-USD, IN BASIS POINTS)



Source: BBVA Research.

EXCHANGE RATE

(PEN PER USD)



Source: Bloomberg and BBVA Research.

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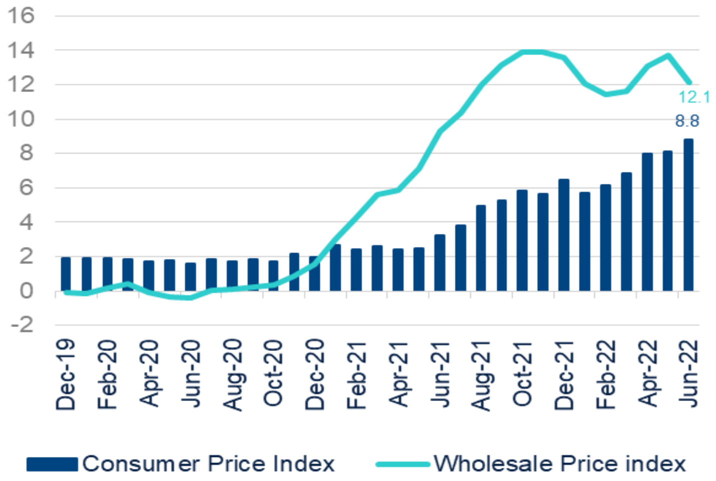
Macroeconomic forecasts

3.4. Inflation and monetary policy

Gradual decrease in inflation: local pass-through of lower commodity prices may be slow and inertia due to expectations

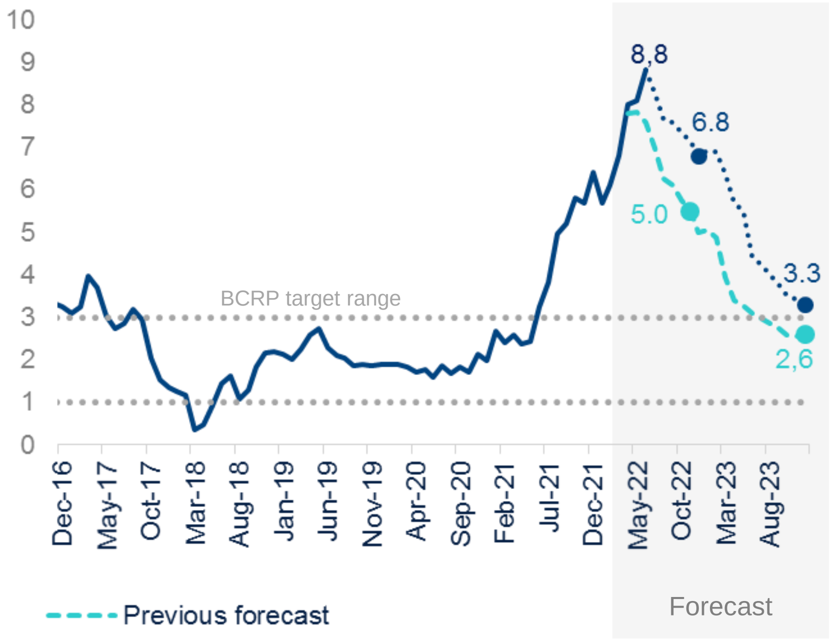
INFLATION AND WHOLESALE PRICES
(CHG. % YEAR-ON-YEAR OF CPI AND WPI)



	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Inflationary expectation at 1 year	2.2%	2.6%	3.6%	3.7%	4.4%	5.4%

Source: INEI and BCRP.

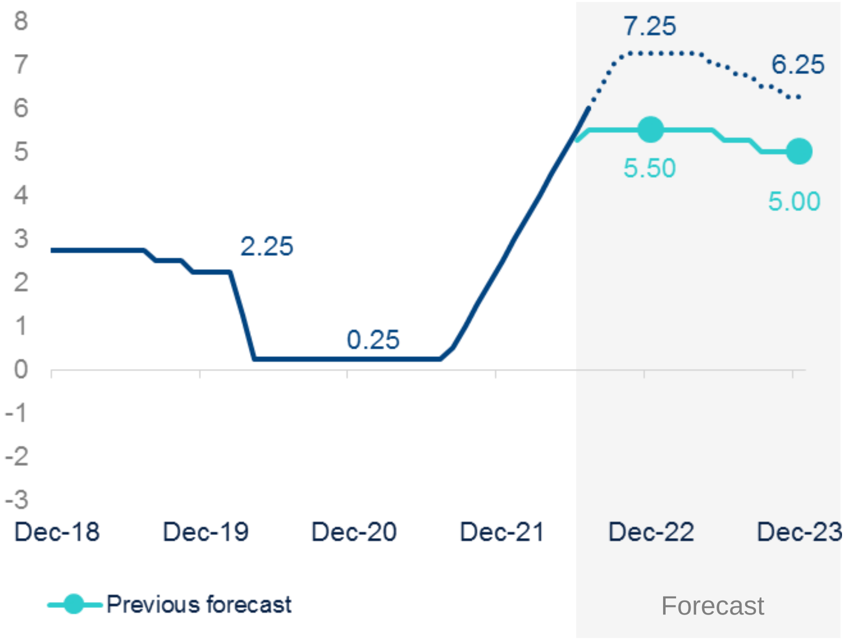
INFLATION
(CHG. % YEAR-ON-YEAR OF LIMA CPI)



Source: INEI and BBVA Research.

The Central Bank will continue to raise the reference interest rate in the short term, perhaps causing the monetary position to be somewhat restrictive in 4Q22

REFERENCE INTEREST RATE
(%)



Source: BCRP and BBVA Research.

- The reference interest rate (nominal) reaches will depend on the behavior of inflationary expectations.
- We expect the reference rate to be around 7.25% at the end of the year, so the monetary policy stance could be somewhat contractionary.
- In 2023, with inflation trending downward and the Fed having concluded its policy rate hike cycle, the BCRP will begin to cut the reference rate.

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04

Main risks

Main risks to the baseline scenario for 2022 and 2023 forecasts

MAIN SHORT-TERM RISKS TO THE WORLD ECONOMY

- Persistence of inflation
- More severe recession
- Financial fragmentation in the eurozone
- Tension in debt markets and emerging markets
- Stagflation
- Deterioration due to the war in Ukraine or other geopolitical conflicts
- Sharp slowdown in the Chinese economy
- COVID-19
- Social tensions and populism

Further inflationary persistence could trigger more aggressive interest rate hikes and a sharp deterioration in growth (bias toward lower growth)

Main risks to the baseline scenario for 2022 and 2023 forecasts

MAIN SHORT-TERM RISKS TO THE LOCAL ECONOMY

- More populist Executive and Legislative (labor market, SPP private pension funds)
- Presidential impeachment or congressional shutdown

Social conflict unlikely to dissipate

Construction of Yanacocha Verde (a mining project) begins

Fertilizer shortage has major negative impact on agricultural output and inflation

Impact of additional withdrawals from pension and CTS deposits

Further deterioration of fiscal accounts due to payment of bonuses in the education sector and refund of FONAVI contributions (possible deterioration of sovereign credit rating).

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05

Summary of macroeconomic forecasts

Macroeconomic forecasts: summary

	2020	2021	2022 (f)	2023 (f)
GDP (YoY % change)	**-11.0**	**13.5**	**2.3**	**2.8**
Domestic demand (excluding inventories, YoY % change)	**-9.3**	**16.6**	**3.0**	**1.9**
Private spending (YoY % change)	**-11.3**	**17.1**	**3.1**	**2.0**
Private consumption (YoY % change)	-9.8	11.7	4.5	2.6
Private investment (YoY % change)	-16.5	37.4	-1.5	0.1
Public spending (YoY % change)	**1.3**	**14.0**	**2.8**	**1.4**
Public consumption (YoY % change)	7.8	10.6	3.5	3.0
Public investment (YoY % change**)**	-15.1	24.9	1.0	-3.0
Exchange rate (vs. USD, eop)	**3.60**	**4.04**	**3.90 – 4.00**	**3.95 – 4.05**
Inflation (% Y/Y, eop)	**2.0**	**6.4**	**6.8**	**3.3**
Monetary policy interest rate (%, eop)	**0.25**	**2.50**	**7.25**	**6.25**
Fiscal balance (% GDP)	**-8.9**	**-2.5**	**-1.9**	**-1.8**
Balance of payments: checking account (% GDP)	**0.8**	**-2.3**	**-5.0**	**-3.5**
Exports (USD billion)	42.9	63.2	64.3	62.2
Imports (USD billion)	34.7	48.3	56.5	56.2

(f) Forecast. Forecast closing date: July 15, 2022.
Source: BBVA Research.

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Peru Economic Outlook

3Q22

Closing date: July 15

Creating Opportunities