PERU

NO EXCEPTION

Peru is one of the Latin American countries to have suffered most from the Covid-19 crisis. After a sharp contraction in Q2 2020, the recovery that began in Q3 has continued. This said, economic activity is unlikely to regain its pre-crisis level before the end of 2022. The economic contraction and the massive stimulus programme introduced by the government have hit public finances, but the deterioration is likely to remain manageable, for the short term at least. However, the deterioration of the political climate seen over the past few years is affecting the medium-term outlook.

A VERY SEVERE RECESSION

Peru is one of the countries that has suffered most from the Covid-19 crisis. The very strict lockdown measures introduced in mid-March proved unable to limit transmission or protect the restricted capacity of the healthcare system. In all, the country has seen more than a million cases since the beginning of 2020 (for a population of 32 million), and its mortality rate is amongst the highest (ranking sixth according to World Bank figures). Having peaked in August (at nearly 8,000 new cases per day on average), the number of new daily cases has fallen since early September, stabilising at around 1,600 in December. However, it has been climbing again since early January, averaging 2,300 per day over the first ten days of the month.

On the economic front, the recession in 2020 was severe. Real GDP is estimated to have fallen by 12%, having risen by 2.2% in 2019 and by 3.2% over the previous five years. By way of comparison, the IMF estimates that the region as a whole saw an average recession of 8% in 2020.

Real GDP plummeted in the second quarter, dropping 30% year-on-year, following lockdown measures that ran from mid-March to end-June. In April alone, monthly GDP and the industrial production index collapsed by 40% and 53% y/y respectively. All sectors, including mining, saw only a very gradual recovery from the end of May.

Good macroeconomic fundamentals allowed a massive intervention by the authorities, in order to prevent an even more spectacular collapse in GDP and support the growth recovery that began in Q3. At the beginning of 2020, external debt and government debt were modest (at 35% and 27% of GDP respectively), the current account deficit was largely covered by inflows of foreign direct investment and reserves were at a comfortable level (more than 15 months of imports in December 2019).

The central bank cut its policy rate by 200 basis points to 0.25% and promised to provide substantial liquidity. At the same time, the government has put in place a vast stimulus package, comprising both short-term measures (worth some 8% of GDP), aimed mainly at supporting the most vulnerable households and companies as well as increasing healthcare spending, and longer-term measures (worth around 4% of GDP) to help support growth. The government also introduced a programme of lending to business, 'Reactiva Peru', financed by the central bank and equivalent to 8% of GDP.

Lastly, in order to support the recovery in household consumption, in May Congress approved a law to enable beneficiaries to withdraw up to 25% of their assets from private pension funds. After acrimonious debate in parliament, further withdrawals were authorised at the end of November, covering beneficiaries affected by certain illnesses or those who have not contributed over the preceding 12 months. Meanwhile, at the end of June, the IMF approved a Flexible Credit Line, a financing facility (for USD11 billion with a two-year term) designed to help deal with crises (Peru can trigger this credit line if its economic and financial situation worsens significantly) and reserved for countries with particularly solid macroeconomic fundamentals[1].

The monthly indicator of economic activity has recovered continuously since July, but in October was still 11% below its end-2019 level (chart 1). Driven by rising metals prices (mainly for gold and copper,

FORECASTS

	2019	2020e	2021e	2022e
Real GDP growth (%)	2.2	-12.0	8.0	3.5
Inflation (CPI, year average, %)	2.1	1.8	2.1	1.9
Central Gov. balance / GDP (%)	-3.0	-7.5	-7.5	-3.5
Public debt / GDP (%)	26.8	35.4	37.1	36.8
Current account balance / GDP (%)	-1.5	0.7	1.7	1.5
External debt / GDP (%)	34.7	44.7	42.2	41.7
Forex reserves (USD bn)	68.4	71.5	70.0	72.0
Forex reserves, in months of imports	19.4	25.1	18.5	18.0
Exchange rate USDPEN (year end)	3.3	3.6	3.7	3.6

TABLE 1 e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

REAL GDP

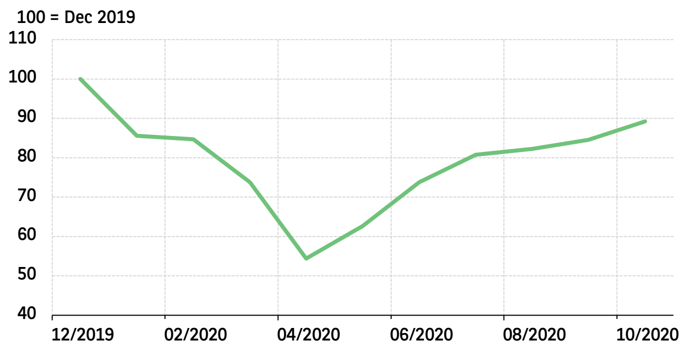

CHART 1 SOURCE: NATIONAL ACCOUNTS

1 To date, only five countries have been offered this facility: Chile, Colombia, Mexico, Peru and Poland.

the latter still accounting for nearly one-third of exports), favourable growth prospects in China (the main destination for exports since 2014) and the government's stimulus plan, the economic recovery should continue throughout 2021 and 2022. Real GDP growth is projected at 8% and 3.5% respectively. At this pace, the economy is unlikely to regain its pre-crisis level before the end of 2022.

DETERIORATION OF THE POLITICAL CLIMATE

The risks are on the downside. In particular, the worsening of the political climate seen over a number of years gathered pace at the end of 2020 and will weigh on short-term growth prospects, and probably on economic fundamentals over the medium term.

On the one hand, a lack of clarity on the supply of vaccines and the effective commencement of the vaccination campaign limits growth prospects for 2021. The Health Minister initially announced that the campaign would begin in the first quarter of 2021. According to the local press, it seems, however, that the political crisis in October and November not only delayed the rollout, but also prevented the finalisation of orders for vaccines. The start of the vaccination programme might end up being pushed back to the beginning of the second half.

On the other hand, structural weaknesses in governance worsened over the course of the latest mandate (since 2016), concerning mainly parliament's defiance of the government and numerous corruption scandals. The mandate has thus seen a succession of four presidents (three in November 2020) who were removed from office or forced to resign following their implication in corruption scandals, two parliaments and a high rate of turnover in ministerial offices. However, under the Peruvian constitution, the duration of presidential and parliamentary mandates remains fixed. The next general elections (presidential and legislative) will therefore take place as planned at the end of the current mandate.

In mid-November, parliament elected Francisco Sagasti, a deputy and founder of the centrist Morado party, as interim President. He will remain as interim President until elections are held. He has committed to respecting the electoral calendar, thus to hold the first round of elections on 11 April of this year, and to leave power on 28 July, when the next presidential mandate begins. However, this has not calmed the political climate. Relations between parliament and the interim government will remain extremely tense, particularly if the country faces a further wave of infections.

At present, given the large number of candidates, it is difficult to predict the likely winner of these elections and any majority in the next parliament. However, all candidates seem to agree on a degree of continuity in economic policy, concerning for example the respect of fiscal discipline that has been seen for a number of mandates now. Between 2015 and 2019, the government deficit remained limited to 2.2% of GDP on average, despite the collapse in copper prices and several natural disasters.

It is likely, however, that relations between government and parliament will remain strained during the next mandate. The budget targets for the short term (stimulus measures in 2021, consolidation from 2022) and the medium term (increase in receipts through a reform of the collection system), and reforms designed to boost Peru's potential growth (labour market reform, tackling the informal economy), could

BUDGET DEFICIT AND PUBLIC DEBT

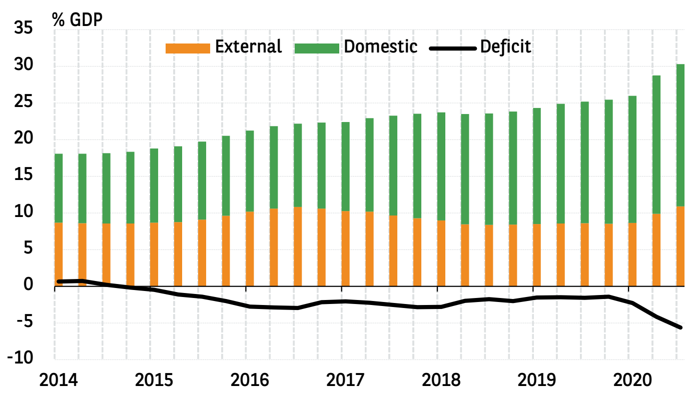

CHART 2

SOURCE: MINISTRY OF FINANCE

be delayed still further. In the longer run, political instability and the lack of reforms could hit potential growth and the attractiveness of the country to foreign investors.

THE SHORT-TERM INCREASE IN GOVERNMENT DEBT IS NOT WORRYING

The government estimates that after increasing to 8.5% of GDP in 2020 (from 1.6% in 2019), the government deficit will fall to 6.5% in 2021. We think that the figure is likely to be closer to 7.5% in both years. Tensions between parliament and government prevented the implementation of a number of measures in the stimulus package – including several public investment projects – which will therefore be delayed until 2021. The deficit is then likely to shrink, given the temporary nature of the increase in public spending. Government debt is estimated to have risen from 27% of GDP in 2019 to 35% in 2020 and then should rise further to 37% in 2021. It will therefore remain moderate

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