

Peru Business Forecast Report Q3 2014

<https://marketpublishers.com/r/PD054C65160EN.html>

Date: June 2014

Pages: 45

Price: US\$ 1,195.00 (Single User License)

ID: PD054C65160EN

Abstracts

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Core Views

While we expect real GDP growth to level off at around 5.0% over the coming years, below its recent trend, significant mineral wealth, attractive investment opportunities at the sector level and a growing consumer story underpin our view that Peru will remain one of the most dynamic economies in Latin America in the coming years. We remain below-consensus for 2014 growth, when we are forecasting 5.1% real economic expansion.

Given our Asia Country Risk team's expectation that Chinese real GDP growth will trend lower in the coming years as the economy rebalances away from an investment-led growth model to one in which private consumption plays a larger role, we anticipate that Peru will continue to be hit hard by weaker Chinese demand, lower average metals prices and more moderate capital expenditure plans by major mining firms. Given these factors, we remain below consensus on real GDP growth in Peru in the next few years, and we anticipate that these dynamics will precipitate a widening of the country's current account deficit, place downward pressure on the budget balance and result in a weaker currency.

Major Forecast Changes

We have adjusted our current account deficit forecasts given indications that export volumes have begun to fall, exacerbating the expected impact of lower commodity prices. We are forecasting a shortfall of 5.7% of GDP in 2014, compared with our previous projection of 5.2%.

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CHAPTER 1: POLITICAL OUTLOOK

SWOT Analysis

BMI Political Risk Ratings

Domestic Politics

Mining Sector Tensions And Rising Disapproval To Increase Political Risk

President Ollanta Humala's approval rating has fallen to an all-time low, in part due to his perceived failure to address poverty and a intensifying crackdown on the country's informal mining sector. While political risk will remain an important source of investor concern over the coming quarters, we continue to believe that strong economic growth and attractive mineral deposits will help to maintain robust levels of foreign investment.

Table: Political Overview

Long-Term Political Outlook

Mining Disputes Main Threat To Stability

Peru's long-term political stability is undermined by key structural risks, most prominently associated with mining and hydrocarbons exploration in the country's Amazon region. Concerted efforts will be needed to address this issue, along with the ongoing problems of corruption and coca cultivation, if the country is to counter the increasing threat from populism. Nevertheless, our core scenario is for the country's ongoing export-led growth to raise living standards, creating a core of middle-class stability that will act as a buffer against other risks.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Real GDP Growth To Ease Amid Weaker Trade Balance

We maintain our view that growth in the Peruvian economy will slow in 2014 and remain below its historical average in the coming years. This will in large part be due to structural declines in the demand for the country's key exports. Nevertheless, growth in private consumption and investment is expected to be supported by a burgeoning middle class

and the government's renewed commitment to infrastructure upgrades.

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Current Account Deficit To Widen On Weaker Exports

Lower average prices for precious and industrial metals, combined with weaker production in the mining sector, will weigh on Peruvian exports over the coming months. As such, we forecast the current account deficit to widen from 4.9% of GDP in 2013 to 5.5% in

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Despite Inflationary Uptick, Authorities To Retain Dovish Bias

We expect the Peruvian benchmark interest rate to remain at 4.00% throughout the remainder of the year, with a modest tightening cycle unlikely to begin before 2015. Although inflation has remained above the central bank's target since the beginning of the year, growth has also disappointed, and authorities will likely seek to avoid creating additional headwinds.

Table: Monetary Policy

Fiscal Policy

Lower Metals Prices To Weigh On Fiscal Surplus

Although some of Peru's revenues, such as mining royalties, will likely be constrained by lower metals prices, we believe that prudent fiscal management and a favourable outlook for consumption taxes will help support the country's fiscal account. We are forecasting the budget surplus to narrow but remain in positive territory in 2014, at 0.4% of GDP, compared with 0.7% in 2013.

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Economic growth in Peru will cool to an average growth rate of 5.0% between 2014 and 2023 as a slowdown in Chinese economic growth dampens metals demand and prices in the short term, while fixed investment

and private consumption growth moderate from their recent highs. That said, we believe solid macroeconomic policies, substantial commodity wealth and a growing consumer base will continue to drive investor interest in Peru over the forecast period.

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