Peru's Macroeconomic Performance: Q4 2018 GDP and Current Monthly Indicators

MUFG UNION BANK, N.A.
ECONOMIC RESEARCH (NEW YORK)
KAREN MARTINEZ
Latin America Economist
+1(212)782-5708
KMartinez@us.mufg.jp

MUFG Bank, Ltd.
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Peru's GDP grew 4.8% YoY during Q4 2018, an acceleration from the the previous quarter (2.3% YoY in Q3 2018). Meanwhile, the overall 2018 growth rate accelerated to 4.0% YoY from 2.5% YoY in 2017. On the demand side, robust consumption and an improvement in investment supported Peru's economy during 2018.

Consumption increased by 3.5% YoY in Q4 2018. Household consumption grew 3.8% YoY in Q4 2018, equal to its overall annual growth in 2018. The strong performance of household consumption offset weak government consumption.

Gross Fixed Capital Formation (GFCF) grew 5.8% YoY during Q4 2018, an acceleration in comparison to the previous quarter (1.0% YoY in Q3 2018). This brought overall annual growth of GFCF in 2018 to 5.2% YoY.

The consumer price index in Lima (CPI Lima) in January 2019 increased 2.0% YoY, decelerating from 2.2% YoY in December 2018 and continued to remain within the target band range (1.0%-3.0%).

At its February meeting, the Central Bank kept the policy rate unchanged for the eleventh consecutive time at 2.75%.

For 2019, it is expected that GDP will continue to expand solidly. The economy will continue to be underpinned by robust domestic demand, mainly driven by an increase in private investment. Low interest rates are expected to fuel private investment. Additionally, a sturdy labor market and low inflation will buttress household consumption. A pronounced slowdown in China's growth and lingering trade tensions between the US and China could weigh on the Peruvian economy going forward.

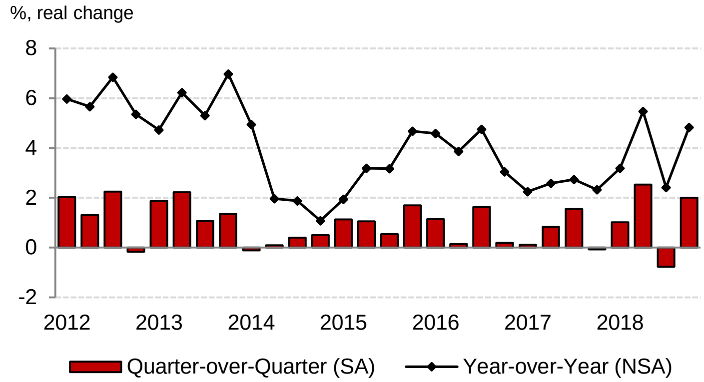
1. GDP

Peru's GDP grew 4.8% YoY during Q4 2018, an acceleration from the the previous quarter (2.3% YoY in Q3 2018) (Figure 1). Meanwhile, the overall 2018 growth rate accelerated to 4.0% YoY from 2.5% YoY in 2017.

On the demand side, robust consumption and an improvement in investment supported Peru's economy during 2018 (Figure 2).

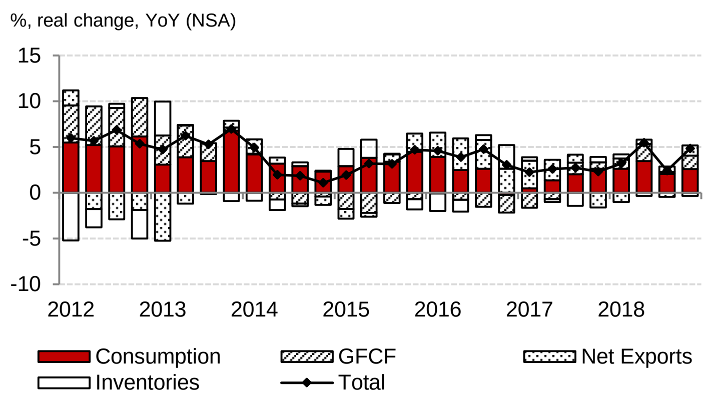
The low inflation rate and lower interest rate were two of the factors contributing to the economic acceleration.

Figure 1: GDP Growth



Source: Central Reserve Bank of Peru, MUFG

Figure 2: GDP by Demand Components

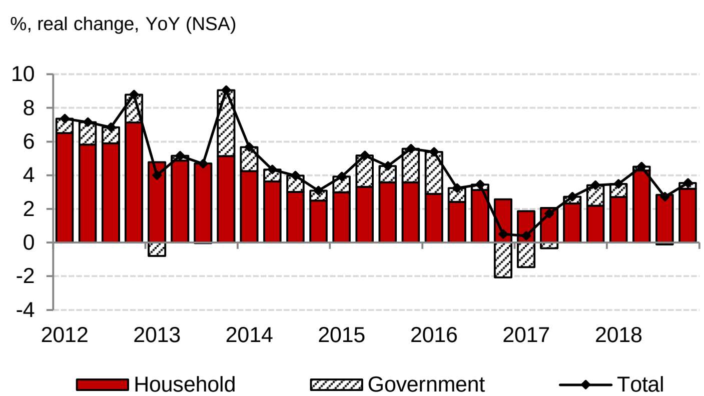


Note: GFCF stands for Gross Fixed Capital Formation.
Source: Central Reserve Bank of Peru, MUFG

Consumption

Consumption increased by 3.5% YoY in Q4 2018. Household consumption grew 3.8% YoY in Q4 2018, equal to its overall annual growth in 2018 (Figure 3). The strong performance of household consumption offset weak government consumption.

Figure 3: Consumption

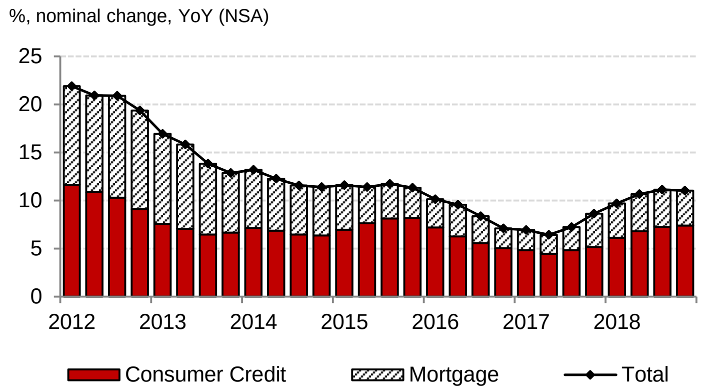


Source: Central Reserve Bank of Peru, MUFG

One of the possible factors that could explain the positive performance of household consumption is the continued improvement of household credit (11.6% YoY expansion during Q4 2018) (Figure 4). This is partially the result of low interest rates.

In addition, the labor market improved in 2018, with the unemployment rate falling to 6.6% in 2018, lower than its historical average of the last 15 years (7.8% from 2003-2017).

Figure 4: Outstanding Household Credit



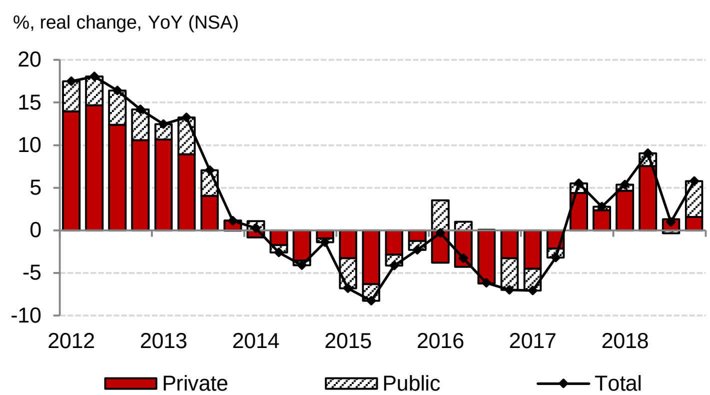
Source: Central Reserve Bank of Peru, MUFG

Investment

Gross Fixed Capital Formation (GFCF) grew 5.8% YoY during Q4 2018, an acceleration in comparison to the previous quarter (1.0% YoY in Q3 2018) (Figure 5). This brought overall annual growth of GFCF in 2018 to 5.2% YoY. This was a significant improvement in GFCF after 3 consecutive years of investment falling between 2014-2016 and a minimal increase in 2017. Two factors could have affected investment growth in 2018. 1) Investment was spurred by the low year-over-year comparison[1]. 2) Increase in investment in mining in 2018 (25.9% YoY) (Figure 6).

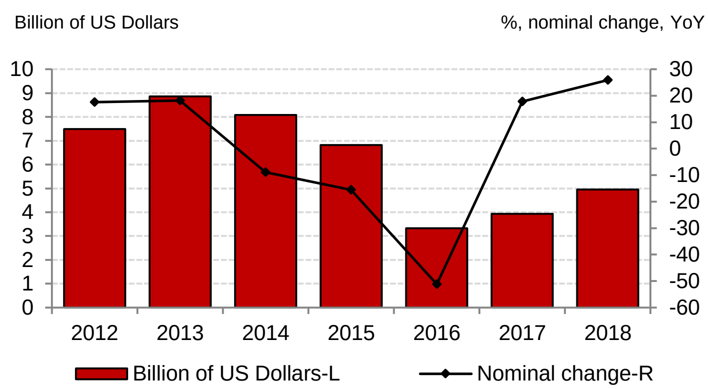
Public investment registered an increase of 17.0% YoY during Q4 2018. This is explained because both national and local governments increased the execution of infrastructure projects.

Figure 5: Gross Fixed Capital Formation



Source:Central Reserve Bank of Peru, MUFG

Figure 6: Investment in Mining



Source: Ministry of Energy and Mining, MUFG

[1] Investment decreased during Q1 and Q2 in 2017 as a result of the completion of two large projects in the mining sector: at Las Bambas and Cerro Verde and delays in other non-mining projects, such as the International Airport of Chinchero, the Metro line in Lima, and an oil pipeline in southern Peru as a result of corruption scandals.

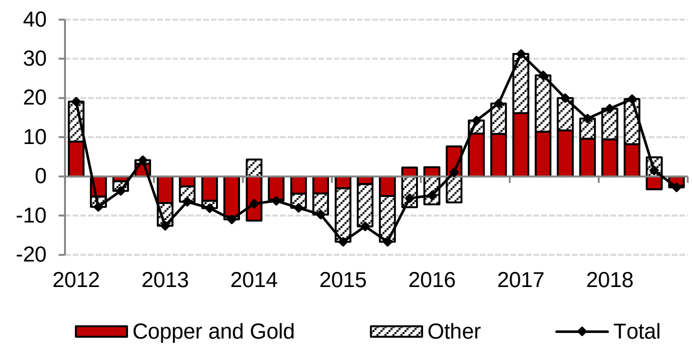
Exports and Imports of Goods

Exports of goods decreased by 2.8% YoY in Q4 2018 (Figure 7). This represents the worst result since Q1 2016 and was the result of a decrease in exports of mining, principally copper (-6.3% YoY) and gold (-2.1% YoY). This contraction is possibly the result of a drop in copper prices and lower gold output.

Imports of goods grew at a slower pace during Q4 2018, increasing 1.1% YoY (Figure 8), the lowest increase since Q4 2016. Consumption goods decreased as a result of a decrease in durable goods (-8.0% YoY in Q4 2018). Capital goods decreased principally as a result of a decrease in imports of agricultural equipment (-15.2% YoY) and transportation equipment (-10.9% YoY).

Figure 7: Exports of Goods

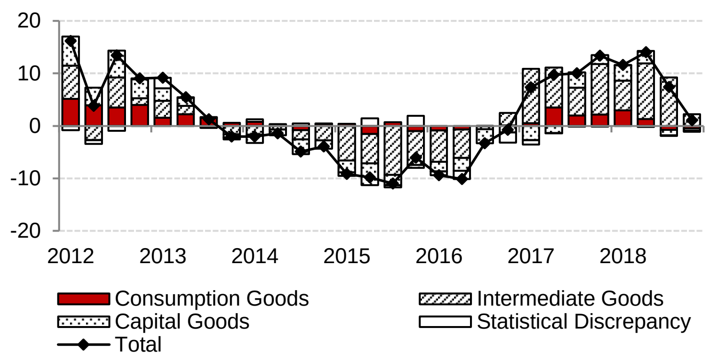
%, nominal change, YoY (NSA)



Source: Central Reserve Bank of Peru, MUFG

Figure 8: Imports of Goods

%, nominal change, YoY (NSA)



Source: Central Reserve Bank of Peru, MUFG

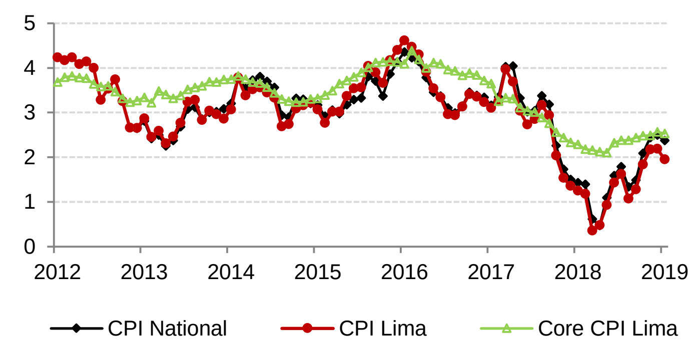
2. Inflation and Monetary Policy

The consumer price index in Lima[2] (CPI Lima) in January 2019 increased 2.0% YoY, decelerating from 2.2% YoY in December 2018 (Figure 9) and continued to remain within the target band range (1.0%-3.0%).

The slower growth in food and beverages prices (1.5% YoY in January 2019 in comparison to 1.9% YoY in December 2018), contributed to the slower growth of CPI in January.

Figure 9: Inflation

%, YoY (NSA)



Note: CPI National is only available from December 2012. There is not Core CPI National calculated by an official authority in Peru and disaggregation of information is limited.
Source:National Institute of Statistics and Informatics (INEI), MUFG

[2] For the case of Peru, CPI Lima is widely used as a proxy for CPI because of the detailed breakdown of data it provides, which is not the case for CPI National.

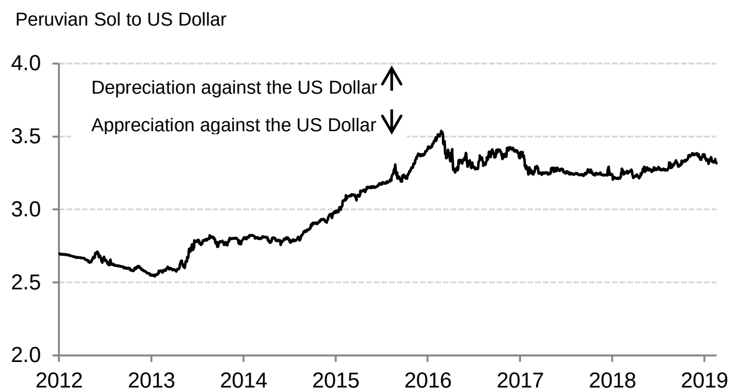
Core CPI Lima, at 2.5% YoY in January 2019 slightly decreased from the previous month (2.6% YoY in December 2018). Core CPI Lima remained within the target band range but has been showing an upward trend for the last 8 months. Although core inflation is showing an upward trajectory, its levels are still below the average of the last 10 years (3.5% YoY).

At its February meeting, the Central Bank kept the policy rate unchanged for the eleventh consecutive time at 2.75%. The Central Bank stated that the reasons behind its decision were that inflation continued to be moderate, inflation expectations remained well anchored and economic activity remains below potential.

3. Exchange Rate

The Peruvian Sol appreciated 1.5% so far this year (up to February 15) (Figure 10). The US Federal Reserve decision to be more cautious about the normalization of its monetary policy could be one of the factors causing the recent appreciation of the Peruvian Sol.

Figure 10: Exchange Rate



Source: DataStream, MUFG

4. Outlook

For 2019, it is expected that GDP will continue to expand solidly. The economy will continue to be underpinned by robust domestic demand, mainly driven by an increase in private investment. Low interest rates are expected to fuel private investment. Additionally, a sturdy labor market and low inflation will buttress household consumption. A pronounced slowdown in China's growth and lingering trade tensions between the US and China could weigh on the Peruvian economy going forward.