Peru’s Macroeconomic Performance: 2Q 2017 GDP and Current Monthly Indicators

Overview

The Peruvian economy grew at 2.4% YoY in Q2 2017, a slight improvement in comparison to Q1 2017 (2.1% YoY). The acceleration of the growth rate during Q2 2017 was principally explained by an expansion in the fishing (128.7% YoY) and manufacturing (3.5% YoY) sectors.

The fiscal consolidation that began during the last quarter of 2016 has seen a short life due to the negative effects of the El Niño Costero phenomenon that hit coastal areas in Peru during Q4 2016 and Q1 2017.

The YoY inflation rate in July 2017 was 2.8%, within the target band for inflation. The upward pressure of the El Niño Costero phenomenon (that affected the prices of some perishable goods, during Q1 2017) was transitory, and the slow growth of economic activity has allowed for a fall in the annual rate of inflation. With weak economic activity and ebbing inflation, the Central Bank cut its policy rate to 3.5% in its most recent meeting in September.

The GDP growth rate is expected to decelerate in 2017. The main causes of this deceleration are the delay of very important investment projects due to corruption scandals and, to some extent, the negative impact of the El Niño Costero phenomenon during the first half of the year.

The GDP growth rate is expected to accelerate in 2018. 1) Government investment via a fiscal stimulus is expected in order to help rebuild the areas affected by the El Niño; 2) Most of the investment projects affected by the corruption scandals are expected to resume because they are in the process of being concessioned to new companies; and 3) Private investment, is expected to pick up as commodity prices continue to improve.
1. GDP, Economic activity

The Peruvian economy grew at 2.4% YoY in Q2 2017, a slight improvement in comparison to Q1 2017 (2.1% YoY) (Figure 1).

GDP by Sector

The acceleration of the growth rate during Q2 2017 was principally explained by an expansion in the fishing (128.7% YoY) and manufacturing (3.5% YoY) sectors. These two sectors contributed 0.5 percentage points and 0.4 percentage points, respectively (Figure 2) to GDP growth.

The fishing sector recovered from an unusual performance during 2016 as a result of a heat wave that caused spawning to begin earlier than normal and forced fishing operations to cease.

An expansion in the food and chemical industries explained the good performance of the manufacturing sector.

Mining and fuel is an important sector for Peru’s economy (around 15% of GDP). Although an improvement in commodity prices has had a positive impact on the sector lately, the expansion during Q2 2017 (1.9% YoY) was lower than in Q1 2017 (4.1% YoY). This is explained by lower production of gold and copper.

The construction sector suffered its fourth consecutive contraction in Q2 2017, explained by low levels of both private and public investment. While construction negatively affected GDP growth in both Q1 and Q2, the contraction in the sector diminished from 5.3% YoY in Q1 to 2.9% YoY in Q2.
Consumption

On the demand side, household consumption grew 2.2% YoY, the same growth rate as in Q1 (Figure 3). The weak growth of household consumption is explained by the lingering effects caused by the El Niño Costero phenomenon at the beginning of the year and the continued weak labor market, affected in part by delays on large scale investment projects.

Government consumption continued to contract (-1.4% YoY), albeit at a slower pace.

Investment, Exports and Imports

Gross Fixed Capital Formation (GFCF) contracted 3.1% YoY in Q2 2017 (Figure 4). This contraction is the result of delays in infrastructure projects¹ due principally to corruption scandals² and, to a lesser extent, the El Niño Costero phenomenon.

Exports continued to increase and contributed positively to GDP growth during Q2 2017. Exports rose by 11.2% YoY due to an increase in copper exports, fish sub-products and oil. Imports also increased by 4.7% YoY in Q2 2017 due to a rise in oil and car imports.

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¹ Projects related to highways, pipeline and building the metro line in Lima were affected by the corruption scandal.
² This scandal is called the Oderbrecht Case and involves the Brazilian company responsible for building the metro line. It was revealed that they paid over 29 million dollars to important public authorities between 2005-2014 in order to win bids for investment projects. This is the same company that was a catalyst for much of the political turmoil in Brazil that took place during 2016 as a result of various corruption scandals.
2. Fiscal Policy

Fiscal revenues have decreased 3.9% YoY during the first half of 2017. The causes of this decline are related to the El Niño Costero phenomenon that led authorities to postpone the declaration and payment of taxes from the affected areas. Fiscal expenditures have increased 2.9% YoY.

The fiscal consolidation that began during the last quarter of 2016 has seen a short life. As a result of the negative effects of the El Niño Costero phenomenon that hit coastal areas in Peru during Q4 2016 and Q1 2017, the government approved a law to increase the deficit objective from 2.5% of GDP to 3.0% of GDP in 2017, and from 2.3% of GDP to 3.5% of GDP during 2018. As a result of these changes, a fiscal stimulus is expected during the second half of 2017 and all of 2018 that will increase the fiscal deficit. Due to a nationwide teachers’ strike earlier this year that lasted for more than two months, teachers won a salary increase that will begin in November 2017 and that will most likely lead to a further expansion in government expenditures.

3. Inflation and Monetary Policy

The YoY inflation rate in July 2017 was 2.8%, within the target band for inflation (Figure 5). The upward pressure of the El Niño Costero phenomenon (that affected the prices of some perishable goods, during Q1 2017) was transitory, and the slow growth of economic activity has allowed for a fall in the annual rate of inflation.

With weak economic activity and ebbing inflation, the Central Bank cut its policy rate three times so far this year, the latest being at its meeting in September where it lowered the rate to 3.5%.
4. Exchange Rates

The Peruvian Sol has gained around 4% of its value so far this year (Figure 6).

Some of the causes for this slight appreciation are the depreciation of the US dollar against many foreign currencies and a recuperation of commodity prices (especially copper).

5. Outlook

The GDP growth rate is expected to decelerate in 2017 from its growth rate in 2016 (3.0% YoY in comparison to 3.9%). The main causes of this deceleration are the delay of several important investment projects due to corruption scandals and, to a lesser extent, the negative impact of the El Niño Costero phenomenon during the first half of the year.

The GDP growth rate is expected to accelerate in 2018. 1) Government investment via a fiscal stimulus is expected in order to help rebuild the areas affected by the El Niño; 2) Most of the investment projects affected by the corruption scandals are expected to resume because they are in the process of being concessioned to new companies; and 3) Private investment, is expected to pick up as commodity prices continue to improve.