

12069

Republic of Peru

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Long-term Rating

A-

Outlook*

Stable

Short-term Rating

-

*Long-term Rating refers to Foreign Currency Long-term Issuer Rating in principle.

1. Overview

Peru, with a population of about 31.4 million (mid-2016), had a nominal GDP of approximately USD200 billion and a per capita GDP of around USD6,200 in 2016. It has a prosperous mining industry, endowed with various mineral resources such as copper, silver, gold and zinc. Since the early 2000's, the country's prudent macroeconomic management has proved effective in reducing unemployment and poverty while depressing inflation and promoting fiscal consolidation. Even after the prices of primary commodities, its main export items, plunged in 2012, the country saw only a limited deterioration of the current account balance while preserving its fiscal discipline. It has an ample international liquidity on accumulated foreign reserves and a contained public external debt, and has been maintaining a flexible exchange rate system. Taking an open economic policy, Peru has been working to forge multilateral Free Trade Agreement networks. As a member of the Alianza del Pacifico, together with Colombia, Chile and Mexico, it is aiming to promote an economic integration among the member countries and strengthen economic and political ties in the Asia Pacific region.

Since its inauguration in July 2016, the administration of President Pedro Pablo Kuczynski has been tackling infrastructure development, promotion of SMEs and poverty reduction while adhering to the previous administration's disciplined macroeconomic management and trade and investment promotion. Being a minority government, it needs to seek policy collaboration with Popular Force (FP), the largest opposition party led by Keiko Fujimori.

2. Political and social situation

The Kuczynski administration led by the Peruvians for Change (PPK) has set forth the main policies to (i) equip the country with full water and sewerage systems, (ii) improve the public education and healthcare systems, (iii) formalize the workers in the economy's informal sector and (iv) eradicate corruption and discrimination. It has already addressed (a) reinforcement of the Public-Private Partnership framework for efficient infrastructure investment, (b) modification of the corporate income tax regime for SMEs and, (c) restructuring of the state oil company, Petroperu, and so on.

A major corruption scandal involving Brazilian construction giant Odebrecht (Lava Jato Scandal) unfolded in December 2016, forcing former presidents and cabinet members to face criminal investigations and bringing the Southern Gas Pipeline construction project to a halt. In addition, the massive El Nino-related flooding and landslides that had continued since December 2016 inflicted heavy damage mainly on the coastal areas. The opposition parties cooperated with the government for compiling disaster recovery measures that require expeditiousness.

The approval rate of President Kuczynski plunged to 22% in September 2017 from about 60% at the time of his inauguration (according to DATUM) due in part to a spate of resignations by his key cabinet ministers in connection with the corruption scandal. The next presidential election is scheduled for April 2021. Re-election of an incumbent president is prohibited under the constitution.

3. Economic trend

The economy grew 4.0% in real GDP terms in 2016, outpacing 3.3% in 2015, led by expanding mineral exports and solid private consumption. The country's annual exports accounted for 19% of GDP in 2016. Major export items were minerals, which accounted for 59% of the total, or 11% of GDP. Specifically, copper and gold accounted for 28% and 20%, respectively of the total exports, with their values accounting for 5% and 4% of GDP, respectively. Main export destinations were China (23%), the US (17%) and Switzerland (7%).

In the early months of 2017, the El Nino flooding caused huge damage on domestic infrastructure and a part of public investment was stalled by extensive corruption investigations. This slowed down the real GDP growth rate to 2.1% in the January-March 2017 and to 2.4% in the April-June. JCR projects that the real growth rate may slow down to less than 3% in 2017.

The government set up the Authority for Reconstruction with Changes (ARCC) and launched the recovery and reconstruction after compiling the "Reconstruction Plan with Changes", which set forth an investment of soles 25.655 million or 3.65% of GDP on disaster recovery by 2020. Assuming the smooth cooperation between political parties, JCR expects the real GDP growth rate to return to 3-4% from 2018 onward on an accelerated public investment.

The Central Reserve Bank of Peru, the central bank, has been pursuing an inflation targeting policy since January 2002. The current inflation target range is between 1.0% and 3.0% on a year-on-year basis. At the beginning of 2017, food prices soared on the agricultural damage caused by the El Nino flooding. However, the inflation rate peaked out at 4.0% in March and fell to 2.9% in July to stay within the target range. The central bank which had kept its base rate at 4.25% since March 2016, lowered it by 25 bps in May 2017 in light of the decelerating inflation. The bank cut the rate by another 25 bps in July, September to shore up the economy and maintained it at 3.5%.

4. Fiscal policy

The government has kept prudent fiscal management in accordance with the Fiscal Responsibility and Transparency Act. In 2016, the ratios of the non-financial public-sector fiscal deficit and the gross non-financial public-sector debt to GDP stood at 2.6% and 23.8%, respectively. As a consequence of the increased

spending on disaster recovery and economic stimulus, the fiscal deficit will widen to 3.0% in 2017 and 3.5% in 2018. However, the government is committed to resume its fiscal consolidation efforts from 2019 onward and curb the fiscal deficit to 1% of GDP by 2021. It prospects the public debt to GDP ratio remain at 27.8% in 2021 less than 30% which stipulated by the fiscal responsibility law. A currency breakdown of the public debt shows that the ratio of sol-denominated debt rose to 50% at the end of March 2017 from 40% at the end of 2009. The government has been promoting the flotation of sol-denominated sovereign bonds in a bid to develop the local debt market and mitigate currency mismatches.

5. Financial system

The country's US dollar preference in financial transactions was historically strong after it experienced hyper-inflation at the beginning in the early 90's. However, the dollarization has been declining lately amid the decelerating inflation and recovering confidence in the national currency of sol. As for changes of the dollarization ratio in the banking sector from 2007 to 2016, it declined from 59% to 48% in deposits and from 57% to 29% in loans to the private sector. While the nonperforming loan ratio rose to 4.6% at the end of March 2017 from 3.9% at end of 2015, the capital adequacy ratio was enhanced to 15.8% from 14.3% in the same period. Due in part to the prominence of the country's informal economy, the ratio of private-sector loans to GDP stayed low at 41% at the end of 2016. Further de-dollarization and improvement of financial intermediation functions remain crucial challenges for Peruvian banks.

6. External position

On the external front, the country has little concern as its imbalances remain small. The current account deficit narrowed to 2.7% of GDP in 2016 from 4.8% a year earlier. The deficit is likely to remain modest in the future as massive mine development projects will boost the export of copper and other minerals. The country's net external debt was equivalent to about 39% of GDP at the end of 2016. Non-debt creating foreign direct investment accounted for about 50% of its gross external liability. The foreign exchange reserves stood at USD61.7 billion at the end of 2016, or equal to over 9 times of the short-term external debt as of the same date.

7. Overall assessment and rating outlook

The ratings are supported by the country's prudent macroeconomic management, low public debt and relatively sound external position. Meanwhile, the ratings are constrained by its growth-impeding factors such as a wide-ranging informal economy, an underdeveloped infrastructure and a high dependence on primary commodities. Considering these factors, JCR assigned the "A-/A" Foreign Currency and Local Currency Long-term Issuer Ratings with Stable outlook. On a separate note, JCR assigned "A+" for the country ceiling for Peru.

The Peruvian economy is faced with the headwind stemming from the massive disaster left by the El Nino flooding and delayed infrastructure investment caused by the extensive corruption investigations. Meanwhile, the country needs to carry out enormous infrastructure development projects on transportation, telecommunication, energy, water and sewerage. JCR will closely watch the initiative of the Araoz' new cabinet and the cooperation between political parties those necessary for implementing the public investments.

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Selected Economic and Fiscal Indicators

| | | 2012 | 2013 | 2014 | 2015 | 2016 |
|-------------------------------------|-----------|-------|--------|--------|--------|--------|
| Nominal GDP | bil USD | 189.3 | 197.9 | 203.1 | 192.3 | 195.6 |
| Population | million | 30.1 | 30.5 | 30.8 | 31.2 | 31.5 |
| GDP per head | USD | 6,272 | 6,494 | 6,589 | 6,174 | 6,197 |
| GDP per head | \$ at PPP | 9,947 | 10,574 | 10,906 | 11,264 | 11,730 |
| GDP (% real change pa) | % | 5.9 | 5.8 | 2.5 | 3.3 | 3.9 |
| Consumer prices (% change pa; av) | % | 3.7 | 2.8 | 3.2 | 3.5 | 3.6 |
| Recorded unemployment | % | 6.8 | 5.9 | 5.9 | 6.5 | 6.7 |
| Budget balance*(% of GDP) | % | 2.3 | 0.9 | -0.3 | -2.1 | -2.6 |
| Primary balance*(% of GDP) | % | 3.4 | 2.0 | 0.8 | -1.0 | -1.5 |
| Public debt*(% of GDP) | % | 20.8 | 20.0 | 20.1 | 23.3 | 23.8 |
| Current account balance(% of GDP) | % | -2.8 | -4.7 | -4.4 | -4.8 | -2.7 |
| Trade balance(% of GDP) | % | 3.4 | 0.3 | -0.7 | -1.5 | 1.0 |
| Services balance/GDP(% of GDP) | % | -1.3 | -1.0 | -0.9 | -1.1 | -1.0 |
| Income balance/GDP(% of GDP) | % | -6.7 | -5.7 | -4.9 | -3.9 | -4.7 |
| Current transfers balance(% of GDP) | % | 1.7 | 1.7 | 2.2 | 1.7 | 2.0 |
| Total external Debt(% of GDP)** | % | 31.4 | 30.6 | 34.1 | 38.1 | 38.2 |
| Total reserves (excluding gold)*** | bil USD | 62.2 | 64.4 | 61.0 | 60.4 | 60.5 |
| Import cover (months)*** | months | 18.2 | 18.2 | 17.8 | 19.4 | 20.7 |
| Exchange rate LCU:\$ (end-period) | sol/USD | 2.550 | 2.795 | 2.985 | 3.411 | 3.356 |

*:Non-financial public sector

**: Bonds and private and public external debt

***: Total reserves excludes gold and silver

(Source) Ministry of Economy and Finance, Central Reserve of Peru, IMF, World Bank

Ratings

| | Rating | Outlook* | Amount | Rate (%) | Issue Date | Maturity Date | Release |
|--|--------|----------|--------|----------|------------|---------------|------------|
| Foreign Currency Long-term Issuer Rating | A- | Stable | - | - | - | - | 2017.09.01 |
| Local Currency Long-term Issuer Rating | A | Stable | - | - | - | - | 2017.09.01 |

History of Long-term Issuer Rating (Foreign Currency Long-term Issuer Rating or its equivalent)

| Date | Rating | Outlook* | Issuer Name |
|------------|--------|----------|------------------|
| 2017.09.01 | A- | Stable | Republic of Peru |

*Outlook for Foreign Currency long-term issuer rating, or direction in case of Credit Monitor

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