Latam Daily: Peru Saw Mixed Q3 GDP Growth, Sovereign Returned to Fixed-Income Markets

- **Peru: Third quarter GDP results were mixed; Sovereign returned to fixed-income markets with a new century bond issue**

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PERU: Q3 GDP; NEW BOND ISSUE

I. Third quarter GDP results were mixed

Peru's third quarter results were a mixture of good and bad. In annual terms, third quarter GDP contracted by -9.4% y/y (table 1). This was mildly better than the -10% y/y we had been expecting, and much better than the -29.8% contraction in Q2-2020 (revised from -30.2% y/y). But, Q3 GDP was still significantly off from last year. The trend is positive, however, and the quarter was up a strong 30% q/q (seasonably adjusted).

Considering that the lockdown partially continued into Q3, especially in July, the fourth quarter should be quite a bit better, although we do see a bit of downside risk to our full-year forecast of -11.5% y/y real GDP growth. Our projection now requires Q4-2020 growth of just over 3% y/y (i.e., approximately 2% q/q). For now, we are waiting with great anticipation for October's GDP figures (to be released on December 15): leading indicators point to a much better month than the -7% y/y contraction we saw in September. November, with the turbulence caused by recent political events, is a bit more questionable, although, given that the crisis was short-lived and the outcome satisfactory, the impact should be mild. In line with this view, electricity demand is trending at -0.9% y/y in November compared with -0.4% y/y growth in October.

The Governor of the BCRP, Julio Velarde, stated last week that GDP data was coming in stronger than the central bank's -12.7% full-year forecast. How much stronger is unclear, but Gov. Velarde's statement implies that the BCRP is adjusting its expectations to be more in line with our own forecast. There are several reasons that Q4-2020 should be stronger than Q3-2020, including:

- COVID-19 has subsided significantly, the economy is nearly completely unlocked, and there is a sense of greater consumer movement. Having said this, consumption growth continues to be a concern;
- In Q3-2020, private-sector investment contracted much less than we expected. This could conceivably continue in Q4; and
- Public investment and exports underperformed in Q3-2020, but both look significantly stronger so far in Q4. Public-investment growth finally turned positive in October and there is reason to believe that mining and fishing exports will rebound more strongly. Looking in more detail:
    - Government investment reportedly increased by 6.6% y/y in October, the first month of positive growth since February. We understand that growth in public investment continued in early-November. The risk is

that this improving trend could be interrupted in late-November and December given the operational delays that are likely to occur with the change of Government. Given the positive note that marked the beginning of Q4, public-investment growth is likely to be materially better than the -24.5% y/y we saw in Q3-2020;

Table 1

Peru: GDP Growth, y/y % change

	Q1-2020	Q2-2020	Q3-2020
GDP	**-3.5**	**-29.8**	**-9.4**
Domestic Demand	-2.5	-26.8	-8.5
Private consumption	-1.7	-22.1	-9.7
Gov't spending	6.5	-8.8	4.3
Private investment	-16.8	-60.2	-7.1
Public investment	14.9	-70.7	-24.5
Exports	-9.0	-41.6	-23.2

Sources: Scotiabank Economics, BCRP.

- Mining production continued underperforming in Q3 as COVID-19 led to quarantines at important copper mines. It is our understanding that quarantines at these mines were lifted in October and operations normalized. With these developments, output at the copper mines should begin adding to, rather than subtracting from, GDP growth; and

- Fishing should also add to exports in the coming months. The seasonal (i.e., November to January) fishing quota is similar to 2019's levels, but, unusually, the quota was not fully met in 2019. Thus, fishing's contribution to annual GDP growth should be relatively strong owing to positive level effects The impact should be greatest, however, in January, when processing of the catch is expected to reach a peak.

II. Sovereign returned to fixed-income markets with a new century bond issue

The Ministry of Finance brushed off the political turbulence of the past few weeks and on Monday, November 23, it issued USD 4.0 bn in global bonds, some of which featured a 100-year "century" maturity. The issue's bid-to-cover ratio exceeded 3.8x, which signalled that investor appetite for Peru's financial assets remains firm.

The bond issue was exceptional on a number of fronts. It was Peru's largest-ever issue and the country's first instrument with such a long maturity. It was also very likely the first time in Peru's history that the sovereign has undertaken such significant issuance less than a week after a new finance minister had been appointed to office. According to press reports, the results of the bond placement were: USD 1 bn with a 12-year maturity at a spread of 100 bps over USTs; USD 2 bn at the 40-year tenor with a spread of 125 bps over USTs; and USD 1 bn at the ground-breaking 100-year maturity at a spread of UST+170 bps.

The issue did not include a debt re-profiling component: that is, none of the proceeds of the issue will roll over existing debt. Rather, the funds will be used entirely to finance fiscal needs planned for this year and pre-finance part of 2021's budget. The debt-GDP ratio is set to reach 34.1% following this issue, a move up from the 26.8% hit at the end of 2019. In the sovereign's previous issue in April, Peru placed global bonds amounting to USD 3.0 bn, some with a five-year maturity and a yield of 2.392%, and the rest with a 10-year maturity and a yield of 2.783%.

—Guillermo Arbe