Latam Daily: Resilient Growth Despite Political Noise

- **Peru: Growth holds up well in Q2, overriding political noise**

PERU: GROWTH HOLDS UP WELL IN Q2, OVERRIDING POLITICAL NOISE

GDP growth was 3.3% y/y in Q2 (chart 1), and continued to show extraordinary resilience. Growth was driven more by exports, 6.6%, than by domestic demand, 2.6% (table 1), but this has been the case for some time now. Perhaps more importantly, domestic demand, 2.6%, was actually slightly stronger, rather than weaker (as had been expected), than the 2.1% growth in Q1.

The bottom line is that Q2 was strong enough for us to see upside now to our full-year 2022 forecasts of 2.6% GDP growth and 2.0% domestic demand growth, which are now under revision.

Among domestic demand components, growth was led by private consumption. This was not surprising in itself, but the magnitude, 4.9% was, to a certain extent, although there had been signs of lofty consumption levels for some time (chart 2). Don't mind the decline from 6.9% in Q1 to 4.9% in Q2, that's mostly a base comparison effect.

Consumption has remained high due to an improved labour market, to some extent, but also to the significant strengthening of household balances that has taken place over the past two years, as windfall inflows to households from government transfers, access to worker compensation funds and, especially, pension fund withdrawals, have fortified household balances, making households much more comfortable to spend and to increase consumer debt. There is a caveat here, however, as the sharp increase in interest rates by the BCRP should begin to affect consumption to some degree going forward.

Even so, consumption is likely to continue strong in Q3, and into Q4, given the new withdrawal of pension funds, in the vicinity of 3% of GDP, that is taking place from July to September. Never in history have households had access to such a great amount of resources not related to monthly labour inflows, as has occurred over the past three years. Of course, bringing future consumption forward is an extremely risky course of action for future growth and welfare.

Businesses have continued to resist the siren calls of higher demand beckoning them to invest more. Private investment continued to languish in Q2, with only 1.0% y/y growth. The figure would have been even lower, if not for a final spurt in mining investment, as the large Quellaveco project comes to an end. Mining investment rose 4.0% y/y in Q2, while non-mining investment was a dismal 0.6%. Not that this was surprising, with business confidence indicators in the doldrums.

Table 1: Peru—Quarterly GDP Growth

%	2021 Q3	2021 Q4	2022 Q1	2022 Q2
GDP	11.9	3.5	3.8	3.3
Domestic demand	14.6	3.7	2.1	2.6
Private consumption	11.8	5.5	6.9	4.9
Private investment	22.5	2.5	0.8	1.0
Public consumption	15.0	-2.7	10.5	-3.2
Public investment	40.4	-16.9	-13.8	1.8
Inventories	-0.9	1.5	-3.3	-0.5
Exports volume	12.5	5.8	9.7	6.6
Imports volume	24.6	7.0	2.4	2.6

Sources: Scotiabank Economics, BCRP.

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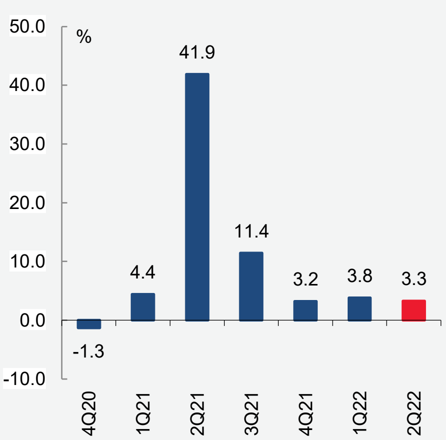
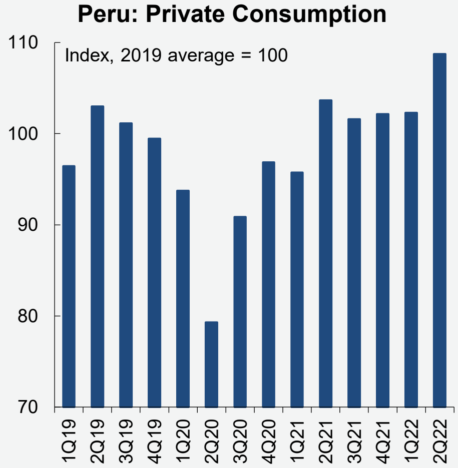
Chart 1



Sources: Scotiabank Economics, INEI.

Chart 2



Sources: Scotiabank Economics, BCRP.

Still, at least private non-mining investment was not negative. Note that, although lower investment probably continues to reflect political instability more than higher interest rates, the increase in interest rates is another factor that does not bode well for investment growth going forward.

So, what held back the economy in Q2? Well, the government. Public sector (non-investment) spending plummeted 3.2% y/y in Q2, while public sector investment rose a paltry 1.8%. No wonder fiscal accounts have been so strong (the fiscal deficit was 1.0% in 2Q)! The big question, then, is will this change? Consumption growth cannot rely on pension fund withdrawals forever, and private investment will be hard put to improve significantly with so much political instability and higher interest rates. So, eventually the economy will slacken unless government spending steps in. The new Finance Minister, Kurt Burneo, is promising to do just that. A true Keynesian at heart, Burneo is bent on revving up fiscal motors to stimulate the economy. How much so and where will likely be revealed when the Ministry of Finance releases its Multiannual Macroeconomic Framework (Marco Macroeconómico Multianual, MMM) before the end of August.

The bottom line, however, is that Q2 results, the impact of the new pension withdrawals, and the promise of greater fiscal spending, suggests a rosier future—higher interest rates notwithstanding—than we were contemplating heretofore… at least in terms of growth!

—Guillermo Arbe