Scotiabank.

GLOBAL ECONOMICS

LATAM DAILY

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Table 1

Peru: Growth Indicators

y/y % change	November	December
Fishing	13.0%	
Mining	-5.3%	
Electricity	3.5%	2.4%
Cement Demand	-1.3%	
Govt Current Spending	4.6%	
Public Investment	-17.9%	
Sales Tax Revenue	28.8%	

Sources: Scotiabank Economics, INEI.

Latam Daily: Signs of Slower Growth in Peru, But Inflation Pressures Augur Bigger Rate Hikes

- **Peru: Signs of slower growth, but inflation pressures augur bigger rate hikes**

I. Early indicators suggest a slowdown in GDP growth in November

Growth indicators for November were mixed, and also mildly disappointing (table 1). Normally, electricity growth, up 3.5% y/y, would be a good indicator of GDP growth for November. However, the decline in both cement demand and public investment suggest that aggregate GDP could be materially lower, perhaps in the 2% to 2.5% range. Both indicators point to negative construction growth in November. Construction was a leading driver of growth ever since the lockdown in 2020 ended. It appears that it will no longer play that role in 2022. Furthermore, the nearly 18% y/y decline in public investment is a bit alarming. Public investment was holding up fairly well during the first few months of the Castillo regime. The decline in November could indicate that earlier growth reflected momentum from projects started before the Castillo government took office. We fear that the figure for November may be more in line as to what to expect from the Castillo government. Meanwhile, mining activity continues to decline, although this has ceased to be surprising, as it has been happening throughout 2021. The positives, fishing and sales tax revenue, are not enough of a counterbalance; fishing because it has too low a weight in the growth index, and sales tax revenue because it appears to be more a reflection of a structural change towards greater, and more formal, digital payments, than a gauge of consumption per se.

—Guillermo Arbe

II. BCRP is likely to raise its policy rate another 50 bps on January 6

We now see a 50 bps increase in the BCRP's benchmark interest rate more likely at the meeting tomorrow, Thursday, January 6. Two factors inform our views:

First, inflation has been consistently higher than expected by the BCRP, reaching 6.4% y/y in 2021, above the revised official projection of 6.2% y/y. At the same time, all the trend indicators followed by the central bank are above the target range. In particular, core inflation in December exceeded the upper limit of the target range for the first time in 65 months.

Second, the BCRP has become more aggressive in its FX market interventions. The central bank began 2022 with significant FX intervention to prevent the FX from crossing the threshold of 4.00 (between December 29 and January 3 it sold US$ 237 million), which we interpret as a sign of concern regarding the pass-through of PEN depreciation (10.2% in 2021) into future inflation. A 25bps hike, when the market consensus expects 50bps according to Bloomberg, could pressure PEN volatility unwanted by the BCRP. The interest rate swap market also points in this direction (2.96% with a three-month term).

For the full-year 2022, we continue to expect a hike of at least 150 bps to 4.00%, as we indicated in our Latam Weekly (November 5, 2021). Compared to other economies in the region, the benchmark rate in Peru is relatively low. The real interest rate for monetary policy remains in negative territory, at -1.2% in December.

We also expect the BCRP to announce a new sequence of increases in PEN reserve requirements, which would complement the increases in the reference interest rate and strengthen monetary control. In October 2021 the BCRP raised the minimum reserve requirement to 4.5% for November 2021, to 4.75% for December 2021 and to 5.0% for January 2022 (reached pre-pandemic level), so we anticipate that at this Thursday's meeting it will announce additional increases that would apply from February 2022.

—Mario Guerrero