10 Sep 2019 | Fitchwire

Fitch Rtgs: Slower GDP Growth Raise Risks to Peru's Deficit Reduction Plan

Fitch Ratings-New York-10 September 2019: Peru's 2020 budget, released last week, underscores the government's policy commitment to fiscal consolidation and our expectation for the deficit to narrow further, says Fitch Ratings. That said, downward revisions to the economic growth outlook point to risks for the government's revenue-led deficit reduction plan.

The budget continues an existing deficit-reduction plan. Government revenues recovered to an annualized 19.8% of GDP in June 2019 from a low of 18% of GDP in 2H18. The government aims to lift revenues by roughly 1pp to 20.7% of GDP by 2021, benefiting from policy efforts to reduce tax evasion as well as cyclically firmer mining revenues and household consumption. This would, in conjunction with the conclusion of some construction projects, reduce the general government deficit to 1% of GDP, the limit under Peru's fiscal rule. It also results in a small primary surplus that will help to stabilize the government debt burden.

General government debt has risen marginally in recent years, although remains manageable and much less than the current 'BBB' median of 36.3% of GDP. Total nonfinancial public sector debt was 25.8% of GDP as of June 2019, comfortably below the 30% of GDP debt ceiling. We estimate government debt service at 6.6% of revenues for 2019.

Peru's fiscal policy remains credible, supported by a track record of adjustment. For example, within the 2020 budget, the Peruvian government revised down its revenue expectations for 2019-2020, relative to the April 2019 update, compensating by lowering planned expenditure.

However, macroeconomic uncertainties cloud the medium-term outlook, increasing the probability that further downward revisions of government revenue will require further budget revisions during 2019-2021. The budget assumes real GDP growth will return to near 4% over the 2020-2021 period. Some signals show that growth will accelerate in 2020. However, consensus estimates suggest that budget expectations (3%, 4.2% and 4.2% growth in 2019, 2020 and 2021, respectively) may be optimistic.

Fitch revised down our economic growth forecasts for Peru to 2.5% for 2019 (from 3.5% in June) and around 3% (from 3.7%) for 2020-2021. Underlying our weaker forecasts are expectations that weaker external demand for copper and near-term domestic political uncertainty will soften private investment and exports despite the easing of temporary shocks in 2H19. Growth in 2Q19 decelerated to 2.7% YOY (12-month rolling sum) from 3.8% YOY in 1Q19 amid dampening copper prices that were affected by escalating U.S.-China trade tensions, one-off mining and fishing production shocks, and temporarily lower subnational government capital spending due to administrative transitions.

Externally, the ongoing U.S.-China trade war will continue to add to the uncertain environment for copper and other Peruvian exports and risks to the growth outlook. Domestically, governability challenges have re-emerged. Political tensions between the president and opposition-led congress has weighed on business confidence, which dipped during March-July, and point to a subdued private investment outlook during 2H19-2020. President Vizcarra called for an early general election in 2020 (they are scheduled for 2021) amid stalled institutional reforms in Congress. Fitch does not anticipate any significant progress on economic reforms in 2019-2020.

The outlook for mining investment, Peru's key economic motor (15% of GDP in 2018), especially in large midsized construction projects, is robust at current copper prices, reflecting Peru's low production costs, large copper reserves, and juridical stability. However, Peru's mining industry would not be immune from significantly weaker copper prices.

Fitch affirmed Peru's 'BBB+'/Stable rating in March. A failure to consolidate public finances or deterioration in the fiscal and external balance sheets could trigger negative rating pressure. In contrast, higher growth, improved institutional capacity, stronger fiscal and external balance sheets would be positive.

For additional information on Peru's rating outlook refer to: Presentation: Peru Sovereign Rating Outlook.

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