Scotiabank

GLOBAL ECONOMICS

**LATAM INSIGHTS**

September 9, 2024

**Contributors**

**Guillermo Arbe,** Head Economist, Peru
+51.1.211.6052 (Peru)
guillermo.arbe@scotiabank.com.pe

# Peru—Highlights of the Government's Fiscal Intentions

On August 23rd, the Finance Ministry released its yearly economic policy framework document, the Marco Macroeconómico Multianual 2025–2028 (Multiannual Macroeconomic Framework 2025–2028, MMM).

The document presents no great surprises. Economic forecasts were refreshed (see table 1) and, although some figures differ from our own, they remained for the most part within the realm of possibility. As an example, the MMM forecasts GDP growth of 3.2% in 2024, to our 3.0%, and 3.1% in 2025, to our 2.5%. The difference is not sufficiently material to be questionable. Interestingly, Finance Minister José Arista has stated that actual growth for either year could approach 4.0%. Thus, at least in the government's own eyes, the figures in the MMM are more conservative than optimistic.

Well, perhaps this may be so for GDP growth figures. The fiscal account figures, however, may be a bit more optimistic than they should be. This is especially true for 2024, for which the MMM expects to comply with the fiscal deficit rule of no more than 2.8% of GDP. This seems like quite a challenge, considering that the deficit was 4.0% to July. Our own forecast for 2024 is 3.1%. Of course, the government needs to attempt to comply with its fiscal rule, or else why have a fiscal rule at all?

As a reminder, the fiscal rule is multiannual, with the following fiscal deficit compliance goals going forward: 2.8% of GDP in 2024; 2.2% of GDP in 2025; 1.8% in 2026; 1.4% in 2027; and 1.0% of GDP in 2028.

Complying with the fiscal rule of 2.2% of GDP in 2025 is, perhaps, less of a challenge than for 2024, given the expected surge in mining income tax revenue thanks to the high metal prices in 2024. Our 2025 fiscal deficit forecast is 2.4% of GDP, although it has a wide enough margin of error to encompass the 2.2% rule. After 2025, in order for the deficit to continue declining this will depend on metal prices, domestic growth, and policy changes following the 2026 elections.

**Table 1: Peru—Main Macroeconomic Indicators**

| | 2024 | 2025 | 2026 | 2027 | 2028 | Average 2025 -2028 |
|---|---|---|---|---|---|---|
| **GDP Growth (%)** | | | | | | |
| Aggregate GDP | 3.2 | 3.1 | 2.9 | 3.0 | 3.0 | 3.0 |
| Domestic Demand | 3.2 | 3.0 | 2.7 | 2.9 | 3.0 | 2.9 |
| Private Consumption | 2.9 | 3.0 | 3.0 | 3.1 | 3.1 | 3.0 |
| Public Sector Consumption | 1.1 | 1.0 | 0.9 | 0.9 | 0.9 | 0.9 |
| Private Investment | 2.5 | 3.0 | 3.0 | 3.2 | 3.4 | 3.1 |
| Public Investment | 8.0 | 6.9 | 0.0 | 3.0 | 3.0 | 3.2 |
| **External Accounts** | | | | | | |
| Current Account (% of GDP) | 1.62 | 1.3 | 0.98 | 1.0 | 1.02 | 1.1 |
| Trade Balance (USD mn) | 23090 | 22893 | 22625 | 23351 | 23998 | 23217 |
| Exports (USD mn) | 73929 | 75499 | 77041 | 79437 | 82110 | 78522 |
| Imports (USD mn) | -50839 | -52606 | -54416 | -56086 | -58113 | -55305 |
| **Fiscal Accounts (% of GDP)** | | | | | | |
| Government Revenue | 19.5 | 20.3 | 19.9 | 19.9 | 19.9 | 20.0 |
| Fiscal Deficit | -2.8 | -2.2 | -1.8 | -1.4 | -1.0 | -1.6 |
| Total Public Sector Debt | 33.2 | 33.3 | 33.3 | 33.0 | 32.4 | 33.0 |
| FX Rate period average (PEN per USD | 3.77 | 3.79 | 3.80 | 3.80 | 3.80 | 3.80 |

1 Note: FX taken from BCRP monthly polls for 2024-2026. Figure for 2026 is used for 2027-2028.

Sources: Scotiabank Economics, FMI, BCRP, Ministry of Finance, Forecasts Ministry of Finance.

**MMM Economic Policy Highlights**

In a very summarized form, these are the main economic policy objectives outlined in the MMM:

- Focus on stimulating growth.
- Greater infrastructure spending, with emphasis on energy and irrigation projects.
- Cutting red-tape ("regulatory simplification") for investment projects in general.
- Greater spending on fighting crime and national defense.
- Stimulate private investment in mining, including new projects (e.g. Tía María) and exploration.
- Gradual increase in the execution of Public-Private Partnerships, PPPs.

**Table 2: Peru—Public Debt Service Forecast (PEN mn; % of GDP)**

| | Service Payments (PEN mn) | | Service Payments (% of GDP) | |
|---|---|---|---|---|
| | Amortization | Interest | Amortization | Interest |
| **2024** | 28,410 | 18,491 | 2.6 | 1.7 |
| **2025** | 7,433 | 20,799 | 0.7 | 1.8 |
| **2026** | 13,638 | 21,974 | 1.1 | 1.8 |
| **2027** | 13,366 | 23,204 | 1.1 | 1.9 |
| **2028** | 17,904 | 24,625 | 1.4 | 1.9 |
| **2029** | 13,559 | 25,473 | 1.0 | 1.9 |
| **2030** | 17,034 | 26,510 | 1.2 | 1.8 |
| **2031** | 36,539 | 27,596 | 2.4 | 1.8 |
| **2032** | 34,804 | 28,719 | 2.2 | 1.8 |
| **2033** | 40,647 | 29,887 | 2.5 | 1.8 |

Note: Preliminary Information
Sources: Scotiabank Economics, BCRP, Ministry of Finance, forecasts: Ministry of Finance.

**The Health of Public Finances**

Following the PEN 21bn (2.0% of GDP) sovereign bond offering and liability management that took place in June 2024, over 83% of public debt is now in fixed-rate instruments, while nearly 53% is in PEN. There is little short-term overhang, as long-term debt dominates (average life of around 13 years). Sovereign bonds account for 77% of total public debt.

This is a healthy debt profile, overall. The MMM has government debt ending 2024 at 33.2% of GDP, and stabilizing at 33.3% in 2025, before declining to 32.4% in 2028, 31.5% in 2030 and 29.7% in 2035.

The MMM also highlights the existence of State financial assets that total 10.3% of GDP. The message seems directed at those concerned with the currently high fiscal deficit, perhaps with hopes that the rating agencies will also take note. These financial assets include US$3.2bn parked at the Fiscal Stabilization Fund (1.2% of GDP). The largest portion of assets, 3.2% of GDP, consists as of yet unspent budget allocations. Outside of the Fiscal Stabilization Fund, most of the financial assets extant are earmarked for some specific purpose.

The MMM has published the expected debt servicing table (see table 2), but is otherwise vague as to future financing needs or intentions, outside of stating a continued priority for new debt in PEN, and of elongating maturity, with future emissions linked to both budgetary financing needs, and to liability management. There is a secondary intention to diversify into ESG bonds, among others.

One thing that was particularly noticeable in the MMM was how little mention there was of Petroperú and its debt burden. The underlying message apparently continues to be that the government is not willing to consider this burden as sovereign. The unanswered question, then, is, well then, what is it? How will this debt be dealt with when push comes to shove and Petroperú approaches critical insolvency?

**The Fiscal Deficit**

The question we had when we began to read the MMM was how the government planned on lowering the fiscal deficit from 4.0% of GDP currently, to 2.8% by the end of 2024.

So then, how do we get from a 4.0% of GDP deficit currently, to 2.8% by year end? The MMM holds that, of the 4.0% yearly deficit, only 0.7% of GDP corresponds to the first half of 2024. The remaining 3.3% of GDP comes from 2023 and was linked to El Niño. So, the government would need to maintain a feasible—according to the MMM—deficit of 2.1% of GDP, which is in line with the historical average.

This sounds reasonable until one begins diving deeper into the numbers. The deterioration in fiscal accounts began in 2023, with a 10.5% decline in real fiscal revenue (table 3). This was in line with moderately soft metal prices and, more importantly, a 2.1% decline in domestic demand (aggregate GDP growth fell 0.6%). Fiscal revenue has begun to improve very mildly now in mid-2024, and the factor that is inflating the deficit this year has been more on the fiscal spending side. So, does the government expect revenue to rise, or spending to fall going forward?

Both. In general terms, the MMM forecasts real revenue growth of 4.0%, or 6.5% in nominal terms. Note, however that nominal revenue growth to July was -0.4%, YoY (-3.0% in real terms). Thus, to turn this around and reach 6.5% nominal growth for the full year would require

| Table 3: Peru—Fiscal Accounts (PEN mn) | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | Average 2025-2028 |
| **I. General Government Revenue** | **196730** | **209551** | **229158** | **236315** | **248490** | **261267** | **243807** |
| % Growth | -10.5 | 4.0 | 6.9 | 0.8 | 3.0 | 3.1 | 3.4 |
| **II. Government Expenditure** | **209589** | **219666** | **233512** | **237335** | **244180** | **251836** | **241716** |
| % Growth | -4.5 | 2.3 | 3.9 | -0.7 | 0.7 | 1.1 | 1.3 |
| **Current Expenditure** | **156416** | **161742** | **168535** | **172088** | **176393** | **181254** | **174568** |
| % Growth | -1.6 | 0.9 | 1.9 | -0.2 | 0.4 | 0.7 | 0.7 |
| **Public Sector Investment** | **53173** | **57924** | **64977** | **65246** | **67787** | **70582** | **67148** |
| % Growth | -12.2 | 6.3 | 9.7 | 1.3 | 1.7 | 1.9 | 2.8 |
| **III. Public Enterprise Balance** | **1386** | **-1775** | **738** | **1624** | **1715** | **1865** | **1485** |
| % of GDP | 0.1 | -0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| **IV. Primary Balance (before interest)** | **-11473** | **-11891** | **-3616** | **604** | **6025** | **11295** | **3577** |
| % of GDP | -1.2 | -1.1 | -0.3 | 0.1 | 0.5 | 0.9 | 0.3 |
| **V. Interest Payments** | **16701** | **18491** | **20799** | **21974** | **23204** | **24625** | **22651** |
| % of GDP | 1.7 | 1.7 | 1.8 | 1.8 | 1.9 | 1.9 | 1.9 |
| **VI. Fiscal Balance** | **-28174** | **-30382** | **-24415** | **-21371** | **-17180** | **-13330** | **-19074** |
| % of GDP | -2.8 | -2.8 | -2.2 | -1.8 | -1.4 | -1.0 | -1.6 |

Sources: Scotiabank Economics, FMI, BCRP, Ministry of Finance, Forecasts Ministry of Finance.

around 15% nominal revenue growth for the remainder of the year. We do expect robust revenue growth going forward as the trend is improving with the improving economy, but a 15% increase seems a bit of a stretch. That's not to mention (not that the MMM does mention this, as a risk to its figures) the preferential tax treatment that Congress has been awarding to a number of industries, or its decision to modify interest rates on overdue taxes, among similar initiatives.

On the spending side, the MMM forecasts 2.3% real growth in 2024. This is equivalent to 4.8% nominal, which we will use for ease of comparison. Since government spending rose 9.6%, YoY, in nominal terms in the year to July, spending would need to not grow at all in the remainder of the year to meet the full-year forecast. Is this feasible? Maybe. The MMM holds that the slowdown in government spending growth in the second half of 2024 will rely on the withdrawal of the extraordinary spending that took place in the second half of 2023. True, 2023 was a year in which the economy was beset by external shocks, foremost of which was the El Niño severe weather. The government responded with a sharp increase in spending in the latter half of the year. This extraordinary spending will not be repeated in 2024, and spending growth should moderate sharply in the remainder of 2024. However, it will also need to occur in spite of PEN 3 bn expansion in public investment. Furthermore, we need to consider that nearly two-thirds of State investment spending is in local government hands, and not under national government control.

However this may be, 2024 is mostly over, and it's really 2025 one must look at. The biggest windfall will be, of course, the expected surge in mining income tax next year due to the impact of this year's high metal prices on the earnings of mining companies. This alone makes the government expectation of a 6.9% increase in real terms in fiscal revenue credible. The MMM expects that the impact of higher metal prices could add 0.4 percentage points to the intake in the 2025 income tax season versus 2024. Or, if you wish, reduce the fiscal deficit in 2025 by 0.4 percentage points.

In addition, the government has recently been introducing a number of initiatives to expand the scope of the IGV sales tax, most especially to encompass digital platforms and on-line betting. The MMM suggests other similar tax broadening initiative may be in the cards. These initiatives will become effective in 2025.

Other factors that would help boost fiscal revenue include:

- a one-off sale of State electricity asset
- the end of the temporary tax relief for hospitality sectors (there is a risk that the tax relief will be renewed)
- the rest of the improvement in tax revenue would be the natural outcome of a growing economy

For 2025, total public spending would rise 3.9% in real terms. This includes a 1.9% in current expenditure, and 9.7% in public investment. Well, maybe. Around 10% growth in public investment is credible even considering increased national and regional government spending enthusiasm. However, Congress has enacted a number of spending initiatives, largely public sector salaries, that makes one wonder how the government figures such a low current expenditure growth number.

Anything after 2025 is subject to the political cycle.

**View**

There is a good likelihood that the government will miss its new fiscal rule targets. Should we be worried? Our answer in general is, it's premature to be worried over the fiscal situation in general, since it is quite manageable, but the trends warrant monitoring.

The current (July) fiscal deficit of 4.0% is a big reason why the situation should be monitored more closely. A large part of the reason why the deficit has soared is that in late 2023 and early 2024, the government increased spending to stimulate growth, in true Keynesian fashion. One could argue that this worked, as government spending has been a main component of GDP growth in the first half of 2024. The government holds that spending will soften henceforth. There are a couple of caveats. One is that much of government spending is in the hands of local and regional governments, and it is unlikely that this component of spending slows before 2026. There is also the question of magnitude. The type of slowdown in spending that would be required to comply with the fiscal rule is quite sharp. A sudden halt in spending, as required in the second half of 2024, is quite steep, even considering the MMM argument that it's off a high base. Moreover, the MMM forecasts an average annual increase in real government spending of only 1.3% in the 2025–2028 period. This would be quite a feat, due to the fact that elections will be held in the middle of this period.

On the other hand, the 3.4% increase in real government revenue on average for the 2025–2028 appears more feasible. Only, will it be enough to comply with the fiscal rule? The wishful thinking situation that would allow the government to meet the fiscal rule target going forward would be one in which metal prices surge again, and remain rather higher for rather longer. This, however, is windfall, not policy.

Finally, just how concerned should we be if the government does not comply with the fiscal rule? Non-compliance would create a lot of noise. But, it is also true that the fiscal rule, especially 1.0% of GDP fiscal deficit (by 2028) appears to be unnecessarily harsh. As long as the fiscal deficit is consistently lower than GDP growth, such that Peru's debt as a percent of GDP declines, then it's hard to see too much cause for concern. This is a threshold that is much more feasible.

Currently valid fiscal rules (legally binding, albeit, with no penalty for non-compliance):

1. Debt Rule: total debt outstanding cannot exceed 38% of GDP in 2024, and should be 30% of GDP or lower by 2035.
2. Deficit Rule: the fiscal deficit cannot exceed 2.8% of GDP in 2024, 2.2% in 2025; 1.8% in 2026; 1.4% in 2027 and 1.0% in 2028.
3. Government Spending Rule: the annual increase in non-financial government spending cannot exceed by more than one percentage point the average growth rate of GDP over the past 20 years.
4. Government Current Spending Rule: current government spending growth for the 2025–2028 period cannot exceed the average growth rate of GDP over the past 20 years minus 1.2 percentage points.