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FEATURED Q&A

How Much Longer Can Peru Continue to Grow its Economy?

Q Despite economic woes abroad, Peru's economy is expected to post more than 6 percent growth this year, Finance Minister Luis Miguel Castilla told lawmakers on Sept. 5. Growth is happening not just in Lima, but in smaller cities as well, he said. What are the most important drivers of Peru's economic growth? Which policies have led to that growth? Will the country's economic expansion continue into the foreseeable future?

A Richard Francis, director of sovereign ratings at Standard & Poor's in New York: "We expect Peru's growth to reach nearly 6 percent in 2012 and 2013, driven by domestic demand. Due to rising levels of employment and disposable income, private consumption is expected to rise by over 5 percent in 2012-13. Urban employment levels continue to grow, averaging 5.5 percent since 2007, well above Peru's annual population growth of about 1.2 percent. Furthermore, domestic credit is growing at 15 percent, outpacing nominal GDP growth. These factors will underpin consumption. Over the past three years, there has been a strong resurgence of domestic investment, in particular private investment, after a decline in 2009, a result of the uncertainties in the global environment. Investment is expected to reach above 26 percent of GDP in 2012, one of the highest levels in Latin America. Total foreign direct investment (FDI) in 2011 was $8.2 billion and is expected to reach nearly $10 billion in 2012. While private investment in the mining sector continues to draw the largest share, it has become more broad based. A number of large investments are underway in infrastructure, energy, and oil and gas. Important expansion projects of mines at Antamina, Antapaccay and Marcona are expected to come on-stream in the second half of this year, which will increase export volumes significantly. Economic growth should

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Venezuela: Campaign Rhetoric Heats Up Ahead of Oct. 7 Vote

Opposition candidate Henrique Capriles, above, ridiculed Venezuelan President Hugo Chávez Monday for claiming to pursue socialist policies and pledged to use the country's oil wealth more effectively. See related story on page 2.

Photo: Capriles Campaign.

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NEWS BRIEFS

Chile's CMPC Buys Forestry Assets in Brazil for $303 Million

CMPC, a Chilean forestry and paper company, said on Monday it had bought Brazilian forestry properties from **Fibria** for $303 million, Reuters reported. The properties total 100,000 hectares (247,000 acres) in the Rio Grande do Sul state. Eucalyptus has already been planted on about 38,000 hectares, the company said. Last month, CMPC said its second-quarter net profit tumbled 76 percent year-on-year to $38.57 million, MarketWatch reported. The company said lower pulp prices and foreign exchange losses hurt its results.

Carmakers in Brazil Face New Fuel Efficiency Requirements

Brazil's government will demand that carmakers improve fuel efficiency by 11 percent next year or lose a substantial discount on their tax bill, Reuters reported Monday. The rule change is aimed at bolstering investments in local engine plants. The government already gives a tax advantage to cars made with a minimum amount of local content. Carmakers who do not meet the local content requirements would see their tax bills rise 30 percentage points, Reuters reported.

Chilean Startup Plans $400 Million IPO for Wind, Hydro Projects

Energy startup **Latin America Power**, a firm backed by Brazilian billionaire Andre Esteves, is considering an initial public offering in Santiago as it seeks to raise $400 million for projects in Chile, Peru and Panama, Bloomberg News reported Monday. The company plans to raise the funds within two years to develop hydroelectric dams and wind farms in the three countries, CEO Roberto Sahade said.

Political News

Venezuela Presidential Campaign Heats Up Ahead of Oct. 7 Vote

With less than a month to go before election day, the candidates for Venezuela's presidency continued their fiery rhetoric and barrage of insults on the campaign trail Monday. The opposition candidate, Henrique Capriles, ridiculed President Hugo Chávez for claiming to pursue socialist policies and pledged to use the country's oil wealth more effectively, the Associated Press reported. "If they're socialists, I'm Marxist-Leninist, because I invite them to compare who is doing more on the social front and who is using resources to solve the problems of our people, not to save other countries," Capriles said during a speech in which he laid out his plans if he wins the Oct. 7 vote. "This government imports gasoline from the United States and says it fights against imperialism. It imports rice from the U.S. and it says that it has gained its independence," he said. For his part, Chávez on Monday called Capriles "a rich kid disguising himself as poor, as a boy from the barrio." In a speech Sunday, Chávez urged wealthy voters to back him or face "civil war," Reuters reported.

Economic News

Jamaica 'Could Collapse' if IMF Negotiations Fail, Former PM Says

Jamaican opposition leader Andrew Holness said Monday the country "could collapse" if the government fails to negotiate a new agreement with the International Monetary Fund, the *Jamaica Gleaner* reported. Speaking on a local television program, the former prime minister accused the government of using a "delay strategy" to deal with the IMF, asserting that the tactic is negatively affecting Jamaica's credibility and stability in the financial market. Holness suggested the ruling party must act now to address the country's structural weaknesses, including the tax and pension systems. **Standard & Poor**'s in August raised the short-term sovereign credit rating on Jamaica to 'B' from 'C' while holding the country's outlook as 'negative,' *Caribbean Journal* reported. The negative outlook reflected the "likelihood of a downgrade" if Jamaica fails to increase its primary surplus and meet other requirements necessary to receive IMF funding. "Our view is that the government's room for fiscal maneuvering is narrowing," the ratings firm said. "If the government fails to stabilize both the external and fiscal accounts, we would likely lower the rating." In related news, the Jamaica Confederation of Trade Unions said Monday it is endorsing the initiative of the government of Prime Minister Portia Simpson-Miller and the Jamaica Chamber of Commerce to create some 40,000 jobs. Last month Jamaica's unemployment rate rose to 14.3 percent, the highest it has been in 12 years.

Peruvian, Indonesian Leaders Agree to Begin Bilateral Trade Talks

Peru and Indonesia have agreed to start bilateral trade negotiations, state news agency Andina reported Monday. Attending the Asia-Pacific Economic Cooperation summit in Russia last weekend, President Ollanta Humala and his Indonesian counterpart, Susilo Bangban, agreed to adopt a plan to start negotiations on "education, technology transfer, trade and biodiversity conservation," Andina reported. "We are commodity-producing countries, but technology transfer is a key part to continue growing and we see the possibility to have an economic agreement. We hope to sign this agreement soon," Humala said.

Humala and Bangban (L-R)

Photo: Andina.

Company News

Banco Cruzeiro Faces Wednesday Deadline for Bids: Report

Troubled Brazilian lender **Banco**

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Cruzeiro do Sul failed in an effort last week to receive firm takeover bids, Reuters reported Monday. Concern over a potential liquidation, which would be Brazil's largest financial sector bankruptcy in nearly a decade, has scared away six lenders that showed initial interest in Cruzeiro do Sul, according to the report. None of those turned up on Sept. 7 at the headquarters of the deposit guarantee fund, **FGC**, to make a firm bid, according to a report in *Valor*, a local newspaper. The privately owned FGC has been administering Cruzeiro do Sul at the behest of the central bank since the government found accounting problems that led to a $1.3 billion shortfall. FGC has until Wednesday to win the approval of at least 90 percent of creditors to pass a 49.3 percent average discount on bond debt.

Cemex Wins Acceptance to Restructure Debt, Extend Loans

Mexico-based **Cemex** said Monday it has won acceptance by creditors holding 92.6 percent of its debt to extend maturities of more than $7 billion in bank loans by three years, Bloomberg News reported Monday. The restructuring had to be accepted by 91 percent of creditors to go through after the threshold was lowered from an initial 95 percent, and the transaction is expected to become effective in the following weeks. The company plans to sell $500 million of new 9.5 percent senior notes due in 2018 as part of the exchange. Cemex had fifty-five institutional creditors participate in the debt exchange offer. Cemex must pay banks $1 billion in March 2013 as part of the debt exchange, and it has said it will sell assets to raise money. Last month, Cemex announced plans to sell a minority stake in its Latin American assets through a listing on Colombia's stock exchange. Still the largest cement company in the Americas, Cemex was hit hard by the housing downturn in the United States after more than a decade of expansion as one of the leading "multi-Latinas" in the region. Cemex shares fell to 13-year lows last October on doubts over whether the company could turn itself around, but Cemex stock last month rose to its highest level in 18 months, Reuters reported.

Featured Q&A

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remain at 6 percent in 2013, underpinned by continued strength in domestic consumption. Although investment levels will likely slow modestly in 2013 compared to 2012, they will continue to grow at levels higher than overall economic growth. There also has been increased FDI from Asia, especially China, South Korea and Japan. Free trade agreements have been signed with each over the past three years. We would expect much slower growth in Peru if there were a much deeper than expected recession in Europe and/or slower growth in China and the United States. Under such a scenario, copper prices would likely fall sharply lower, which would lead to delays in investment in the mining sector and lower exports. However, the government has ample room to boost spending and cut interest rate, which would help counteract these contractionary forces."

A Luis Oganes, managing director and head of Latin America Research at JPMorgan Chase & Co. in New York: "Peru's GDP growth has closed the first half of the year on a remarkably strong note. GDP in June grew at an annualized pace of 7.1 percent, above the J.P. Morgan and market consensus expectations of 6.4 percent. The reading translates to a robust pace of 1.6 percent over the previous month, representing a somewhat surprising burst of momentum at the end of the second quarter and keeping Peru's sequential growth elevated at 6 percent on a quarter-on-quarter basis, down from the booming 8.3 percent growth of the first quarter of this year (which in turn represented a rebound from the 4 percent pace of the last quarter of 2011). Growth continues to be led by the construction sector (20.6 percent), followed by a rebounding agricultural sector (8.1 percent) and the steady performance of commerce (6.7 percent). Manufacturing remains sluggish, but mining bounced back a bit in June to 4.8 percent, led largely by natural gas. Household demand remains strong and business confidence has recovered somewhat despite lingering social tensions that have led to multiple cabinet reshuffles and most recently an indefinite pause to the large Conga project in Cajamarca. The government's hope is that by taking this particularly controversial project offline, social tension may be defused, allowing other projects in other regions to go forward. The move could still backfire, however, if Conga's disruption becomes a template to be replicated elsewhere—which we do not expect at this point. In all, the performance of the second quarter suggest some upside risk to our full-year 6 percent growth forecast, which depends on sequential growth of just over 5 percent in the second half—i.e., modestly softer than the first-half sequential pace."

A Miguel Palomino, manager of the Instituto Peruano de Economía: "Over the past decade, Peru has had the greatest economic expansion in its history and growth remains strong today. Real GDP grew 85 percent from 2001 to 2011 and will likely grow by 6 percent this year despite the negative international environment. Record growth is the result of the radical shift from disastrous populist policies to free trade, monetary and fiscal discipline and investor friendly policies that took place in the early 1990s and has given fruit gradually since then. Growth has been higher in rural than in urban areas, has halved the poverty rate, greatly expanded the middle class and strongly benefitted all income groups such that studies of income inequality indicate that, at worst, it hasn't improved. It is likely that growth will remain well above world averages over the next years, although the growth differential will erode gradually if further, more complex, reforms are not implemented. The current government has shown more willingness to push reforms forward than the previous three, but its ability to successfully implement them is still in question. Despite its pragmatic and largely pro-investment approach, a distrust of private investment appears to linger in the highest spheres of government and, although fiscal and mon-

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Featured Q&A

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etary discipline are firmly upheld, increased state intervention—in totally unnecessary activities—also appears to be in favor. How these contradictions and challenges are resolved will determine whether the 'Peruvian Miracle' will extend for another decade or will gradually peter away."

Kathryn Rooney Vera, partner and director of macroeconomic strategy at Bulltick Capital Markets: "Private consumption and domestic investment, both public and private, remain the main demand-side growth drivers for the Peruvian economy in 2012, and it will be these main motors that drive the 5.8 percent economic expansion we have forecasted for some time. Despite the notable slowdown in exports and deterioration in Peru's terms-of-trade, domestic demand remains constant and strong, pulling up the heels of the resilient Peruvian economy, and pushing it to likely post one of the highest rates of economic growth this year in the region. We forecast domestic demand to expand 7.3 percent year-over-year in the second quarter and average 6.0 percent year-over-year in the second half of 2012, for on average 6.2 percent year-over-year overage expansion compared to 2011's 7.5 percent and 2010's 13.5 percent year-over-year. This robustness in the domestic sector has more than offset the more complicated external sector, with May's data continuing the disappointing April performance. In May, exports collapsed 16.6 percent year-over-year after April's 11.2 percent annual decline, while imports rose 10.8 percent year-over-year after April's 3.3 percent year-over-year, the latter further evidencing the resiliency of domestic consumption. Our economic growth models point to 5.82 percent year-over-year 2012 growth being driven by a 7.5 percent year-over-year expansion in gross domestic investment, itself driven by a 2.5 percent of GDP government fiscal stimulus directed to infrastructure investment and 6.0 percent year-over-year rise in private consumption. On the inflation front, consumer prices fell 0.04 percent month-over-month in June, driven by a decline in the cost of food and energy. Despite consumer price gains remaining above the central bank target range, we think authorities will be reluctant to hike rates especially given uncertainties globally and its recent tightening. We are holding our call for a benchmark rate of 4.25 percent for year-end. The rating agencies are responding to Peru's recent history of resiliency to global shocks, and we expect this rating trend to continue. Moody's recently upgraded Peru to Baa2 outlook positive, the final of the three main agencies to move the sovereign credit to mid-BBB while last month S&P matched Moody's rating outlook, taking Peru to 'positive' from a stable outlook, increasing the chances of yet another rating upgrade to the highest rung of the BBB category over the next 12 months. Fitch is the only agency now on stable outlook. Peru is in fact looking very strong economically. Moody's had put Peru on positive outlook back in March 2011, just before last year's presidential elections, making a pointed statement at that time as to their lack of concern on the political front. This is an economy that has proven extremely elastic to global hits; despite a worsening in the external sector, domestic demand has powered growth of 6 percent in the first half of this year. From 2006-2011 Peru grew on average 7.2 percent annually with inflation on average 3.3 percent y/y over that timeframe, spent three out of the six years in fiscal surplus, maintains 30 percent of GDP in reserves and a declining public debt/GDP trend."

The Advisor *welcomes reactions to the Q&A above. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*

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