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Rating Analyst

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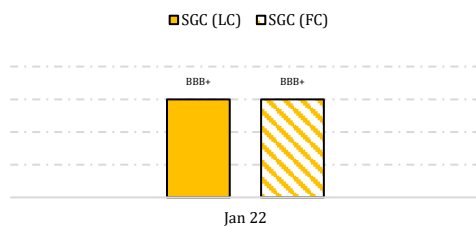
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## Ratings

Sovereign Government Credit (LC)	<b>BBB+</b>
Sovereign Government Credit (FC)	<b>BBB+</b>
Outlook (LC)	<b>Stable</b>
Outlook (FC)	<b>Stable</b>

\*These ratings are unsolicited

## Ratings dynamics



## Main Economic Indicators of Peru

Macro indicators	2019	2020	2021*
Gross gov. debt, LC bn	209	252	298
Nominal GDP, LC bn	770	718	853
Real GDP growth, %	2,2	-11,0	10,0
Gross gov. debt/GDP, %	27,1	35,1	35
Deficit (surplus)/GDP, %	-1,4	-8,3	-3,4
Inflation rate, %	1,9	2,0	6,4
Current Account Balance/GDP, %	-1,5	0,5	-0,4
External debt, USD bn	-	-	83,6****
<b>Development indicators</b>	<b>2019</b>		
Inequality adj. HDI	0,63		
GDP per capita, USD th	13,4**		
<b>Default indicator</b>	<b>28.01.2022</b>		
10Y Gov Bond Yield, %	3,20***		

Source: RAEX-Europe calculations based on data from the IMF, WB, BCRP, Ministry of Economy and Finance of Peru, INEI.  
\* Estimates \*\* 2021 Estimates \*\*\* USD-denominated with maturity in 2032  
\*\*\*\* 3Q 2021

## RAEX-Europe assigned 'BBB+' credit ratings to Peru. The rating outlook is stable.

RAEX-Europe assigned the sovereign government credit ratings (SGCs) of Peru at 'BBB+' (Moderately high level of creditworthiness of the government) in national currency and at 'BBB+' (Moderately high level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

## Summary

Peru's ratings are supported by solid macroeconomic stance, which helped the country combat the challenges of the COVID-19 pandemic, low level of public debt and successful track-record of monetary and fiscal policy since the beginning of the century. The ratings are, however, restrained by limited growth prospects, high dependency on commodity exports and limited government revenue base. Recent deviations from fiscal policy anchors undermine the confidence in previously strong fiscal discipline and create additional risks for the creditworthiness of the government. Moreover, political situation in the country remains highly unstable and also constraints the ratings. We observe high instability and fragmentation on the political landscape, which, in our opinion, can disrupt the implementation of macroeconomic policies, which in turn will negatively affect the country's economic stance.

**The Peruvian economy has experienced a significant contraction due to the COVID-19 pandemic, but recovery is in place.** The country entered the pandemic with a strong macroeconomic stance, which helped it combat the challenges posed by the COVID-19 pandemic. Severe restriction measures implemented by the Peruvian government to contain the spread of COVID-19 caused the worst economic contraction in decades. Despite having applied one of the strictest quarantine measures in the world, Peru was among the countries with the highest number of infection cases. The pandemic highlighted, among other factors, the weakness of the country's health system.

Nationwide confinement measures have resulted in a large supply shock on local activity which has led to a 39,2% y-o-y contraction of real GDP in April 2020, the largest monthly contraction since the start of the pandemic.

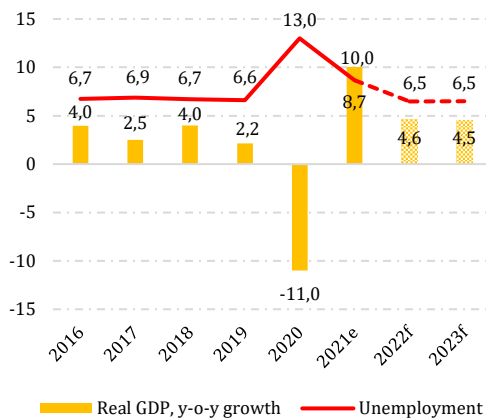
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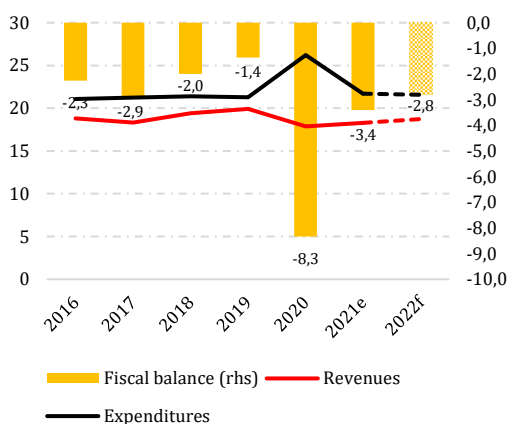
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**Graph 1: Macroeconomic indicators, %**



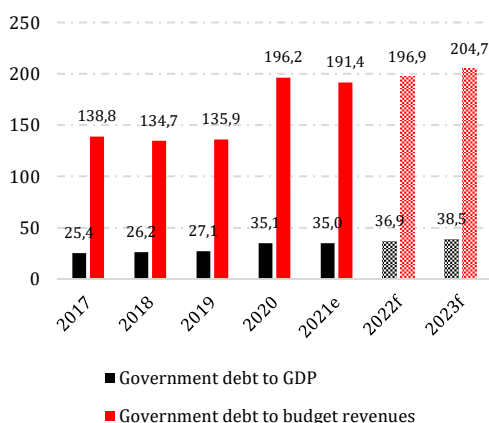
Source: RAEX-Europe calculations based on data from IMF, Ministry of Economy and Finance of Peru, BCRP

**Graph 2: Fiscal budget dynamics, % of GDP**



Source: RAEX-Europe calculations based on data from IMF, BCRP, Ministry of Economy and Finance of Peru

**Graph 3: Government debt dynamics, %**



Source: RAEX-Europe calculations based on data from IMF, Ministry of Economy and Finance of Peru, BCRP

After the implementation of gradual phases of economic reopening and through the introduction of monetary and fiscal stimuli, the Peruvian economy has gradually recovered throughout 2020: in October the real GDP registered a much smaller decline of 3,8% percent y-o-y and 4Q of 2020 was 1,7p.p. below the corresponding 2019 levels. In 2020 the Peruvian economy contracted by 11% y-o-y in real terms (see graph 1). In 2021 the economy of Peru continued to recover to pre-pandemic levels and we estimate real GDP growth of around 10% for 2021. Our base case scenario assumes the preservation of the current strong macroeconomic stance of Peru in the mid-term; we forecast the real GDP growth of around 4,5% for 2022-2023.

At the same time, we also note several negative aspects about Peru's economy, which constrain the ratings. Values of institutional indicators, namely corruption perception index (CPI), position in the Ranking on Doing Business, Government Effectiveness Index, Inequality-adjusted HDI, while fairing decent against Latin American peers, still lack behind those of more developed countries. The level of poverty, which was already high in 2019 at 21,7% has further increased to 27,5% in 2020 and remains a significant challenge for the government. Additional investments in infrastructure are also required in order to increase productivity and facilitate sustainable economic growth. Moreover, the country's growth prospects are restrained by limited government revenue base and exports are highly concentrated on the mining industry. Finally, potential negative developments of the pandemic (new waves and / or variants of the virus) might constrain the growth prospects and have a negative impact on public finances.

**Fiscal policy quality and fiscal balance.** Fiscal measures implemented to mitigate the effects of the pandemic included additional health expenditures, postponement of tax payments for businesses, affected by lockdowns, support of households in the form of transfers and tax postponements. Increase in government expenditures combined with lower revenues led to a fiscal deficit of 8,3% of GDP in 2020 (see Graph 2); In 2021 fiscal deficit has demonstrated a favorable dynamics. Government revenues have increased thanks to the recovery of economic activity and favorable metal prices while current expenditures have declined, which led to the fall of fiscal deficit to an estimated 3,4% in 2021. We expect the preservation of augmented, in comparison to pre-pandemic periods, levels of fiscal deficits in the mid-term and gradual consolidation of public finances in the long-term. However, recent deviations from fiscal policy anchors undermine the confidence in previously strong fiscal discipline and create additional risks for the creditworthiness of the government.

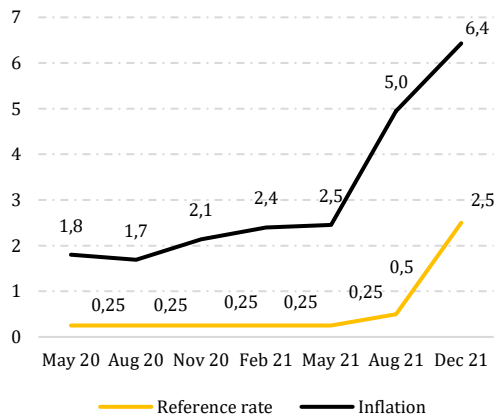
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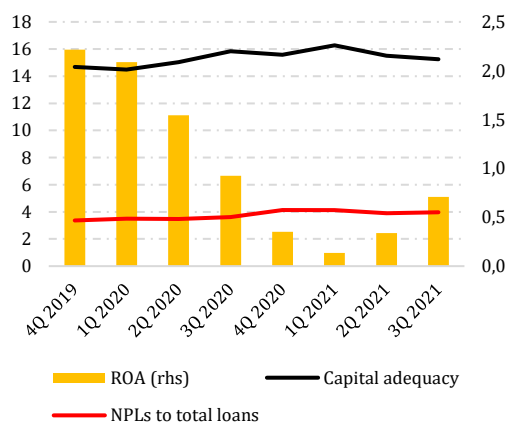
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**Graph 4: Refinance rate vs inflation rate, %**



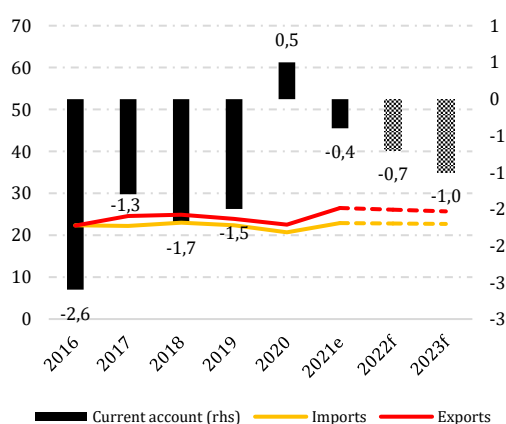
Source: RAEX-Europe calculations based on data from BCRP

**Graph 5: Financial soundness indicators, %**



Source: RAEX-Europe calculations based on data from IMF, BCRP

**Graph 6: External sector indicators, % of GDP**



Source: RAEX-Europe calculations based on data from IMF, Ministry of Economy and Finance of Peru, BCRP

**The level of public debt is sustainable.** Despite the rapid growth of the level of public debt between 2019 and 2020 and its further projected growth in the mid-term (see graph 3) we assess the debt position of Peru as sustainable. We highlight the low level of public debt relative to Latin American peers, where the ratio of public debt to GDP on average exceeded 80% as of 2020. We also emphasize the favorable term structure of Peru's debt position, with short-term debt comprising less than 1,5% of the total debt burden as of 1Q 2021. Public debt is mostly comprised of liabilities in PEN – 44,6% and USD – 48,7%, as of September 2021; as of the same period, 85,6% of public debt had a fixed-rate. In addition, we consider that the government is in a favorable position to attract additional funds if required. Peru has a good track-record of cooperation with international financial institutions; recent issues of Peruvian sovereign debt have attracted solid demand from investors and the country was able to issue debt at favorable terms.

**Monetary response to the pandemic was adequate and comprehensive.** With the introduction of the confinement period the Central Reserve Bank of Peru (BCRP) lowered the reference rate to 0,25%, the lowest level in history. The BCRP also lowered several reserve requirements of financial institutions in order to ease financial conditions. Other pandemic reaction measures included extension of the amounts and maturity terms of the security and currency repos, carrying out credit portfolio repo operations, creation of the Government-Backed Portfolio Credit Repos within the framework of the Reactiva Peru Program, establishing National Government Guarantee Program for the credit portfolio of financial entities. In our opinion, BCRP's response to the pandemic was timely, adequate and comprehensive. With the acceleration of inflation in 2H of 2021 (see graph 4), the BCRP has increased the refinance rate several times; the latest change came in the beginning of January, when the rate was raised from 2,5% to 3,0%. Overall, we assess the quality of the monetary policy as credible. The inflation-targeting scheme, implemented by the BCRP since the beginning of century, has successfully kept inflation rate at low single-digit figures. Despite the recent growth of the inflation rate, we believe that BCRP has enough capacity to maintain monetary stability in the long-term. We furthermore highlight the transparency and consistency of BCRP's policy.

**The banking system is overall solid.** On the positive side, we observe that after a sharp decline of the profitability of banks, indicated by the ROA, throughout 2020 and 1Q 2021, the indicator's reading improved in 2Q and 3Q of 2021 and as of 3Q 2021 stood at 0,7%. We point out that capital adequacy ratio remained solid throughout the pandemic and as of 3Q 2021

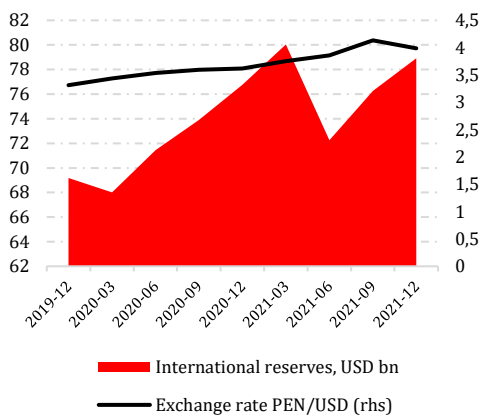
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**Graph 7: International reserves and exchange rate**



Source: RAEX-Europe calculations based on data from BCRP

stood at 15,2%. As to the negative aspects, the share of NPLs to total loans has increased since the beginning of the pandemic; the indicator's value, however, remains below 4% as of 3Q 2021. We also note high concentration of the banking sector in Peru, with 3 largest banks accounting for more than 72% of the system's loan portfolio as of April 2021.

**External stance is strong.** After registering a current account surplus of 0,5% of GDP in 2020, we estimate the figure to be in a slightly negative territory in 2021 and in the mid-term (see graph 6). Net international reserves have been stable throughout last several years and as of December 2021 amounted to 79 bn USD covering 98% of the gross government debt. According to our calculations, Peru's international reserves cover more than 16 month of imports.

**Political uncertainty persists.** In 2017 Peru entered currently ongoing political crisis, which has involved executive, legislative and judicial powers. Although the peak of the unrest seems to be behind, political stability in the country is still far from being robust: we observe high fragmentation in the newly-elected Congress; Pedro Castillo, who took president's office on 28 July 2021 after a very close win against Keiko Fujimori, has already faced an impeachment attempt. In our opinion, existing political instability can disrupt the implementation of macroeconomic policies, which in turn will negatively affect the country's economic stance.

**Support-factor:**

- Participation in the Pacific Alliance. The initiative is comprised of Chile, Colombia, Mexico and Peru. The Alliance's key objectives are integration of the members, further growth and development of the economies of the members (very weak support-factor);

**Stress-factor:**

- High probability of significant political changes in the short run. In 2017 Peru entered currently ongoing political crisis. We observe high fragmentation in the newly-elected Congress; Pedro Castillo, who took president's office on 28 July 2021 after a very close win against Keiko Fujimori, has already faced an impeachment attempt (very weak stress-factor)

**SENSITIVITY ASSESSMENT:**

The following developments could lead to an upgrade:

- Higher than projected rate of economic growth;
- Decline of political instability in the country;
- Faster than anticipated fiscal consolidation;

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- Greater than projected decrease of the inflation rate;

The following developments could lead to a downgrade:

- Economic growth below the forecast levels;
- Deterioration of political environment which would cause economic turmoil and would hurt public finances;
- Slower than anticipated or lack of fiscal consolidation;
- Further preservation of high inflation rates;

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Drivers of change factors

- None.

Next scheduled rating publication: 29 July 2022. The full sovereign rating calendar can be found at [Sovereign Rating Calendar 2022](#)

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## RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
28.01.2022	First assignment of both types of ratings for the country	BBB+	BBB+	Stable	Stable

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### Minute's summary

The rating committee for Peru was held on 28 January 2022. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: [Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version](#) (from August 2020). Descriptions and definitions of all rating categories can be found under the [Rating scale](#) section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

The definition of default can be found on the Agency's website in the section for [Internal policies](#).

**These ratings are unsolicited. The rated entity did not participate in the rating process.**

Main sources of information: International Monetary Fund, World Bank, Central Reserve Bank of Peru, Ministry of Economy and Finance of Peru, National Institute of Statistics and Informatics of Peru (INEI), World Federation of Exchanges.

### ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: [ESG factors in RAEX-Europe's Credit Ratings](#)

### Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

### Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

### Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

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The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.

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