

PERU

Key conditions and challenges

Table 1 2020

Population, million	33.0
GDP, current US\$ billion	200.1
GDP per capita, current US\$	6068.0
International poverty rate (\$ 19) ^a	2.2
Lower middle-income poverty rate (\$3.2) ^a	7.5
Upper middle-income poverty rate (\$5.5) ^a	20.6
Gini index ^a	41.5
School enrollment, primary (% gross) ^b	113.5
Life expectancy at birth, years ^b	76.5

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2019), 2011 PPPs.

(b) Most recent WDI value (2018).

Peru's economy is expected to rebound by around 8 percent, induced by a general recovery in domestic demand and exports. Poverty is projected to decline slightly this year, although additional monetary transfers might accelerate its reduction. These projections are conditional on the evolution of the second wave of the pandemic and the successful vaccination rollout. Overcoming structural challenges related to widespread informality, limited economic diversification and poor effectiveness of the state are critical for medium-term prospects.

The end of the commodity boom and the subsequent slowdown in economic activity revealed the structural weaknesses of Peru's growth model, related to widespread informality, limited economic diversification and poor governance. Despite maintaining macroeconomic stability and trade openness, the main domestic pillars of the model, productivity growth was close to zero between 2013 and 2019, slowing the pace of poverty and inequality reduction. Although informality prevents most firms from growing and is an important source of low productivity, it employs around 70 percent of workers, reflecting pervasive distortions in the labor market, among other factors. An inefficient state deprives millions of Peruvians from access to quality public services. Also, reduced economic opportunities, combined with a generous availability of minerals, results in a concentrated export structure, rendering the economy vulnerable to fluctuations in commodity prices.

The COVID-19 crisis made these structural shortcomings increasingly visible. Peru has been among the countries hardest hit by the pandemic. Excess deaths of over 300 per 100,000 people in 2020 are amongst the world's highest. Informality, overcrowded housing conditions and poor provision of water and sanitation services are among the main causes. Furthermore, the precarious condition of the

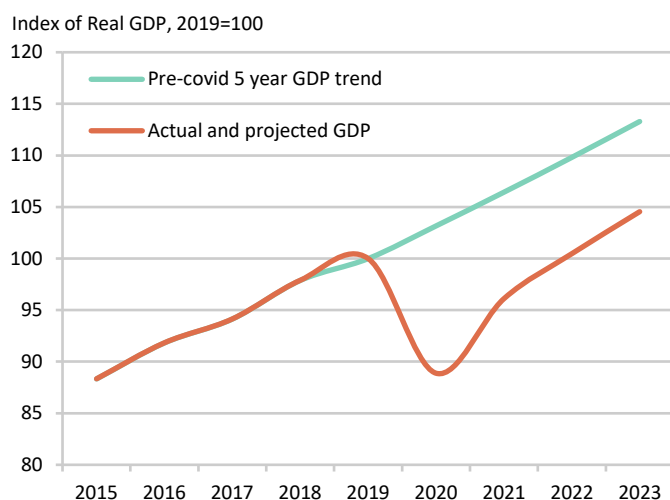
health sector led the government to enact a strict and prolonged quarantine, with considerable economic effects. Also, job informality delayed the implementation of the cash transfer program, because of incomplete citizen registries and limited access to bank accounts; however, the program did help mitigate the rise in poverty.

In the short term, the economic rebound will depend largely on the evolution of the second wave of the pandemic, containment measures, and the deployment of the vaccination program. Although the government expects to vaccinate most of the population by the end of the year, delays are likely, given limited global supply. Also, the loss of human capital during the pandemic (enrollment in early childhood and primary education fell by 7.2 and 1.9 percentage points, respectively) will constrain the productivity of the future labor force. The presidential and parliamentary elections to be held between April and June are also a source of uncertainty in the short term. In the medium-term, informality and state effectiveness must be addressed to underpin potential growth.

Recent developments

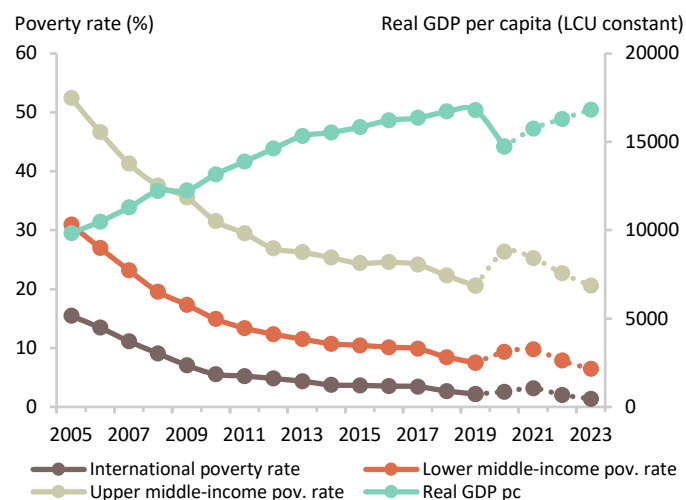
GDP declined 11.1 percent in 2020, one of the deepest recessions in the world. Total employment fell by 40 percent (about 7.1 million workers) in the first half of 2020 while earnings declined substantially for those who remained employed. Informal

FIGURE 1 Peru / Real GDP levels, pre-covid trend vs baseline projection



Source: World Bank staff calculations.

FIGURE 2 Peru / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

workers experienced a disproportionate increase in unemployment. Gender gaps widened as female-dominated sectors were the most affected by social-distancing measures and also due to the increased responsibilities associated with school closures. While rural areas experienced lower employment losses, the quality of jobs and income levels fell more than in urban ones.

Peru's ample macroeconomic buffers allowed it to adopt a package of monetary, fiscal and financial measures equivalent to around 20 percent of GDP, aimed at supporting companies, households, and economic recovery. Nevertheless, the poverty rate (\$5.5 in 2011 PPP) increased by an estimated 6 percentage points, pushing almost two million people into poverty. The Gini coefficient increased by 0.2 points in 2020. The massive roll-out of cash transfers helped mitigate the rise in poverty, which would have otherwise increased by 10 percentage points.

The public deficit increased to 8.9 percent of GDP in 2020, from 1.6 percent the previous year. Revenues fell dramatically due to the sharp contraction in economic activity. Also, the large fiscal package (health expenditures, social transfers, payroll subsidies, etc), estimated at 7 percent of GDP, pushed up expenditures. The public debt closed the year at around 36 percent of GDP, above the 30 percent legal limit.

The current account turned positive in 2020, as more favorable terms of trade, especially in the second half of 2020, helped to improve trade balance despite an abrupt decline in export and import volumes. In addition, lower outflow of investment income supported current account surplus. Inflation remained stable during the pandemic averaging 1.8 percent, while the Peruvian sol depreciated around 10 percent during the year.

Outlook

Peru's GDP is expected to rebound 8.1 percent in 2021, following last year's deep recession. Public investment execution is expected to accelerate, and private spending and the labor market will gradually gain momentum with the COVID-19 vaccine rollout. Also, external conditions would support the rebound. Copper price is at the highest level since 2012 and interest rates are projected to remain low this and next year. This would add to the favorable conditions for private investment. Under such a scenario, by end-2022, the economy is projected to return to its pre-COVID output level. Poverty is expected to decline by 1 percentage point in 2021, considering the economic recovery and the cash transfers programs implemented

by the government. Inequality is projected to remain above the 2019 levels. Another round of transfers like those of 2020 would help reduce poverty, bringing it close to 2018 levels.

The fiscal deficit is projected to narrow in 2021, but public debt is expected to continue trending upwards. Economic recovery in 2021-22 should bring recovery of revenues, which, combined with the gradual expiration of pandemic-related spending programs, should reduce the fiscal deficit to around 5.5 percent of GDP in 2021. Public debt is projected to continue rising and peak in 2023, with the gradual reduction of the deficit.

The current account is expected to remain close to balance in 2021 and 2022, due to the counterbalancing effects of rising exports and imports. Mining exports are likely to increase due to the recovery in the global markets but also greater domestic supply. On the other hand, imports would mirror the expected recovery in domestic demand. Inflation is expected to remain in the lower half of the Central Bank's target range, despite temporary price pressures in specific markets and an expansionary monetary stance. Due to weak demand, closing of the negative output gap is likely to be gradual and slow, maintaining prices in check in the medium term.

TABLE 2 Peru / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	4.0	2.2	-11.1	8.1	4.5	4.1
Private Consumption	3.7	3.0	-9.8	7.6	4.0	4.0
Government Consumption	2.7	4.2	5.5	4.6	4.7	4.0
Gross Fixed Capital Investment	4.7	2.3	-20.5	9.4	6.8	5.4
Exports, Goods and Services	3.9	0.6	-18.0	14.4	5.0	4.3
Imports, Goods and Services	3.3	1.3	-14.5	11.5	5.3	5.0
Real GDP growth, at constant factor prices	4.0	2.2	-11.1	8.1	4.5	4.1
Agriculture	9.6	0.9	1.4	2.2	3.2	3.1
Industry	2.9	-0.2	-13.0	10.0	4.1	3.5
Services	4.1	3.9	-11.3	7.7	5.0	4.5
Inflation (Consumer Price Index)	1.3	2.1	1.8	2.1	2.0	2.0
Current Account Balance (% of GDP)	-1.7	-1.5	0.5	0.3	-0.1	-0.3
Net Foreign Direct Investment (% of GDP)	3.1	4.3	2.1	3.6	4.0	3.7
Fiscal Balance (% of GDP)	-2.3	-1.6	-8.9	-5.5	-3.5	-2.5
Debt (% of GDP)	26.6	27.0	35.0	37.7	38.6	39.3
Primary Balance (% of GDP)	-0.9	-0.3	-7.3	-4.1	-2.1	-1.1
International poverty rate (\$1.9 in 2011 PPP)^{a,b}	2.7	2.2	2.6	3.2	2.1	1.4
Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{a,b}	8.4	7.5	9.4	9.9	7.9	6.5
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	22.3	20.6	26.6	25.5	22.9	20.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.

(a) Calculations based on SEDLAC harmonization, using 2007-ENAH0, 2013-ENAH0, and 2019-ENAH0. Actual data: 2019. Nowcast: 2020. Forecast are from 2021 to 2023.

(b) Projections for 2020 and 2021 consider the impact of emergency cash transfers. Projections for 2022 and 2023 use a poverty-GDP elasticity with 0.7 pass-through.