

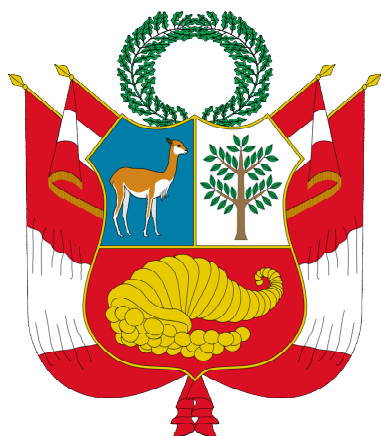


# Peru: Changing Growth Drivers

Investor Presentation

October 2016





**1** Economic Outlook

**2** Growth Strategy 2016-2021

**3** Macroeconomic Balances

**4** Commitment to Solarization & Development of PEN Market

# Peruvian economy is growing in line with its potential but with few and transitory drivers

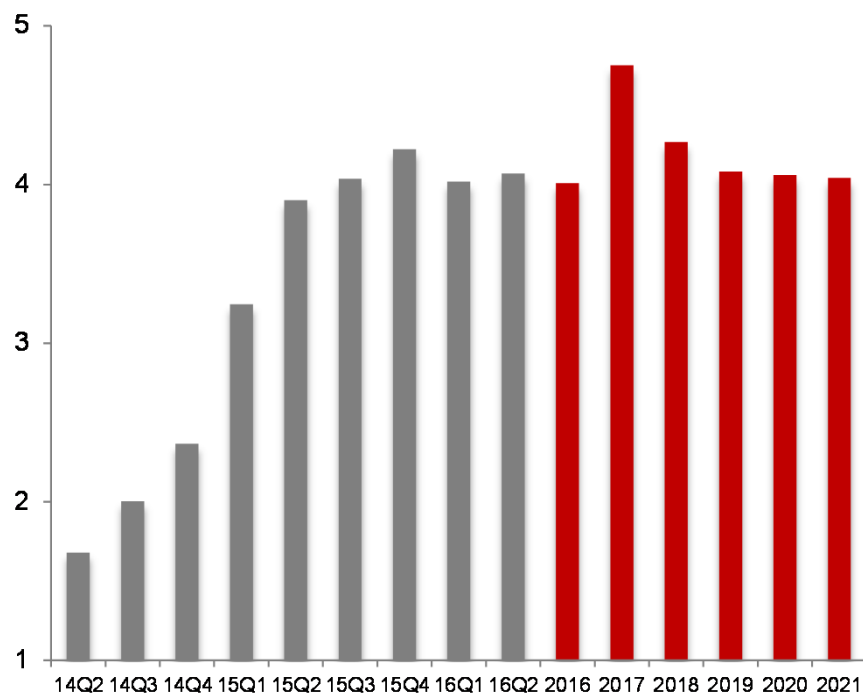


- From a demand-side point of view, the economy is growing 4% based on greater mining exports (14.3%) and an expansionary fiscal policy (9.1%).
- Both drivers are transitory.

- From a supply-side point of view, this type of growth has no productivity gains.

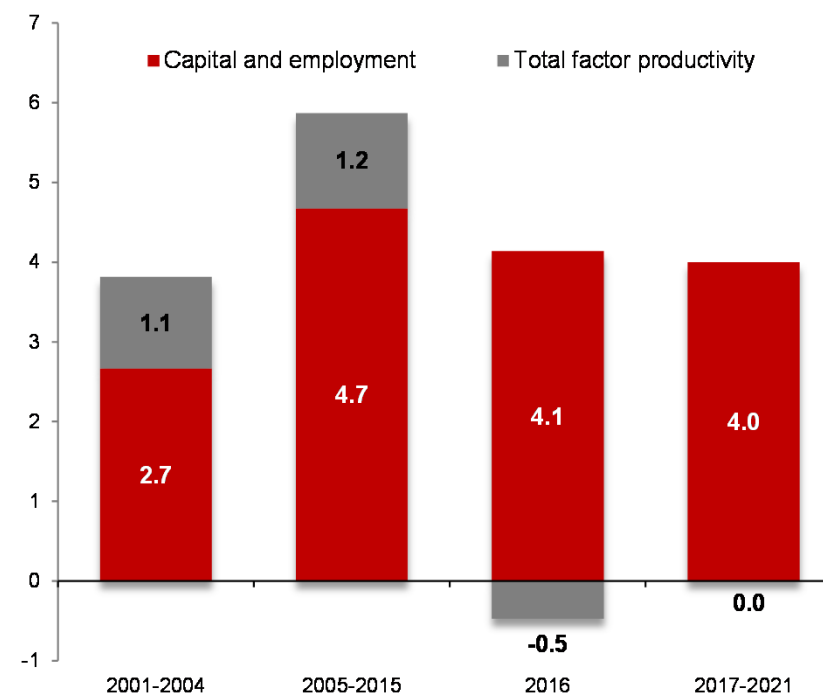
**Peru: GDP growth**

(Moving average, last 4 quarters)



**Peru: Potential growth in non – reforms scenario**

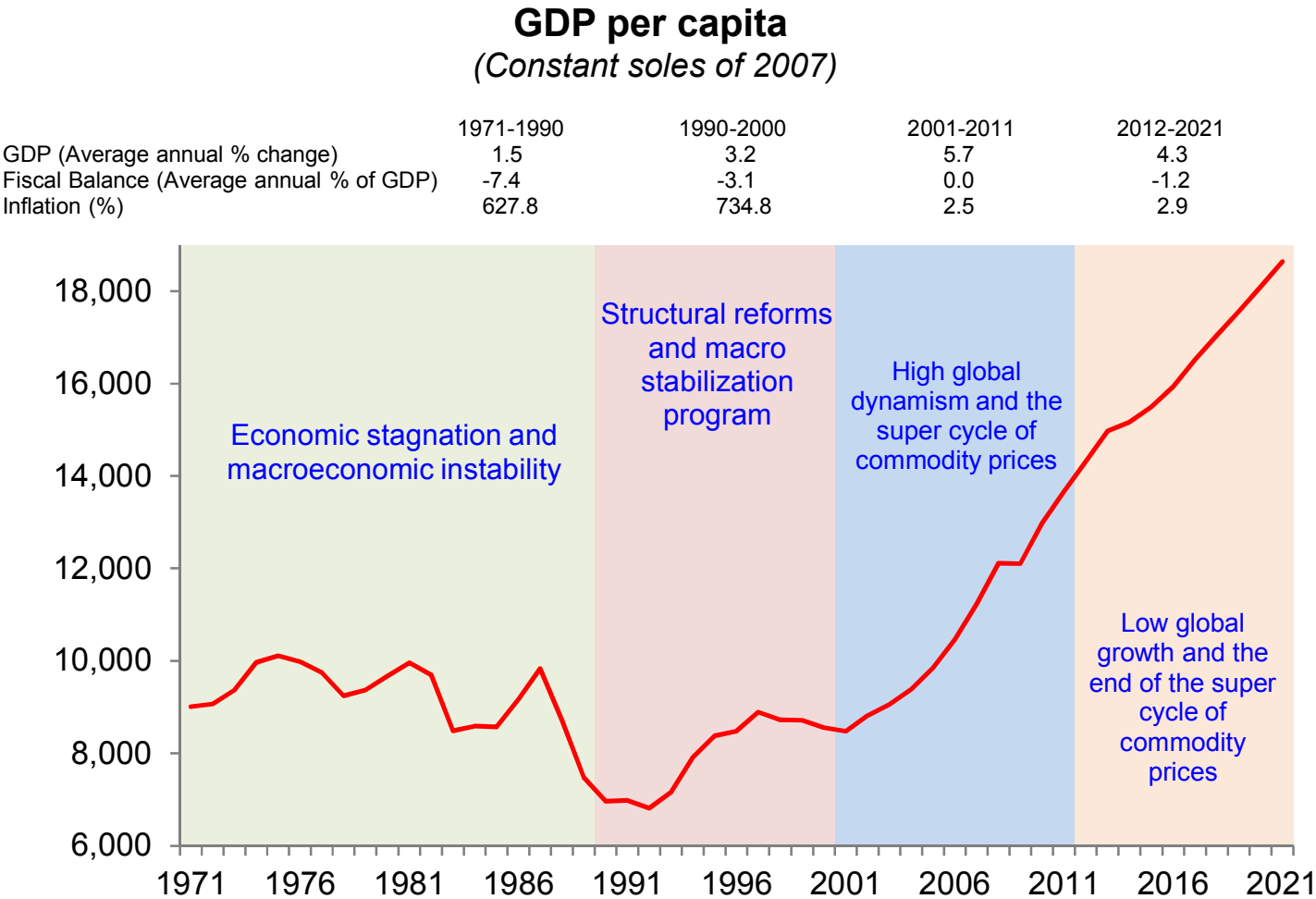
(Contribution in percentage points)



Source: BCRP, MEF Forecasts .



There is an urgent need for structural reforms that diversify growth drivers in the medium term but without hurting macroeconomic stability



Source: BCRP, MEF Forecasts.

## The super cycle of commodity prices is over

- New and sustainable drivers are required to boost potential growth:
  1. Higher business productivity and formalization
  2. Greater public and private investment
- Subject to the fiscal consolidation and decentralization processes.

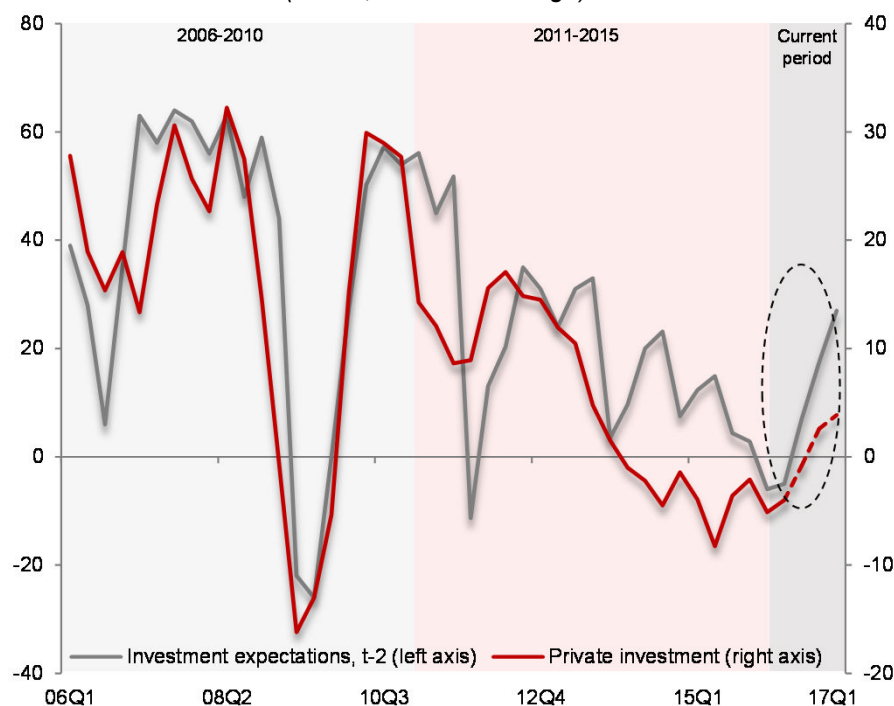


Following a 4 year decline, the start of the new administration has bolstered confidence indicators...

...together with a vast support to structural reforms.

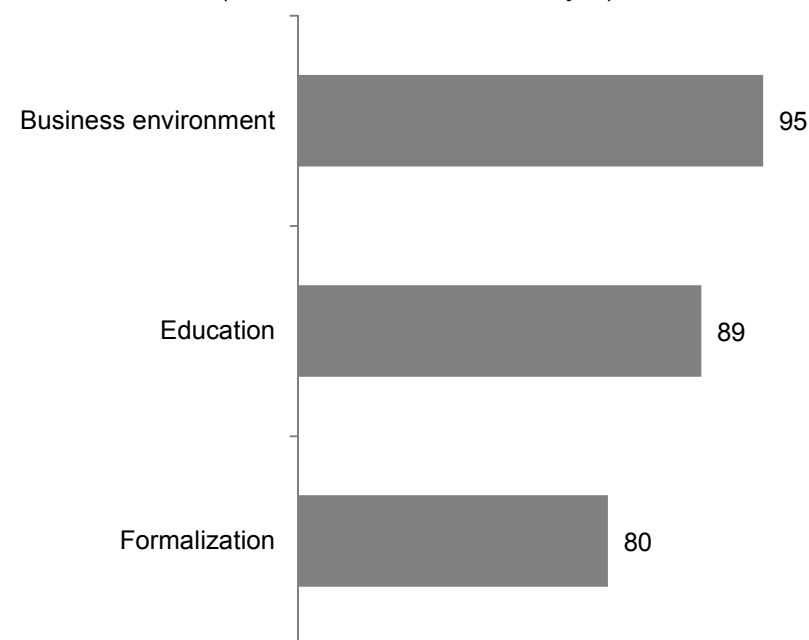
## Investment expectations<sup>1</sup> and private investment

(Points, annual % change)



## Businessmen that foresee improvements in the following sectors towards 2021<sup>2</sup>

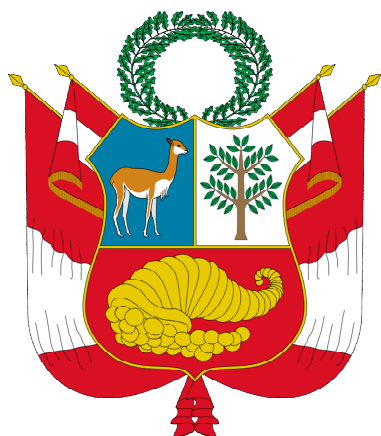
(% of total businessmen surveyed)



1/ Investment expectations consider percentage of firms (SAE clients) expecting to accelerate its investment plans minus firms expecting to reduce them in the next six months. Also, for 2016Q3 we use August record (27 points).

2/ Result of the sum of the percentage of executives that consider that Peru will be "slightly better" and "much better" with regard to the current situation.

Source: APOYO Consultoría, BCRP, MEF Forecasts.



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	Near-term measures	Medium-term measures
Promoting Investment	Promote (i.e. addressing delays, sourcing pending approvals of) both public and PPP investment projects	Redesign of processes for the granting and monitoring of public and PPP investment projects
Boosting Business Productivity (and increasing formality)	<p>Seek a tax framework that promotes a better business environment and the expansion of the tax base:</p> <ul style="list-style-type: none"> <li>• Commitment to lower taxes (VAT)</li> <li>• Increase in the taxpayer base</li> <li>• Greater tax equity</li> <li>• Lower avoidance and evasion</li> <li>• Maximize the flow of resources to regional and local governments</li> </ul>	<p>Strengthen multi sectoral efforts to reduce informality:</p> <ul style="list-style-type: none"> <li>• National Council of Competitiveness and Formality</li> <li>• Reform of the tax authority</li> <li>• Red tape removal</li> <li>• Entrepreneurial training for small businesses</li> <li>• Access to credit and financial inclusion</li> </ul>
Enhancing Fiscal Responsibility	Promote an institutional framework that improves fiscal transparency and makes fiscal rules more enforceable.	Improve financial programming (e.g. systems, protocols, controls) in regional and local governments



## To promote investment in the near term, the unlocking of infrastructure projects would be key

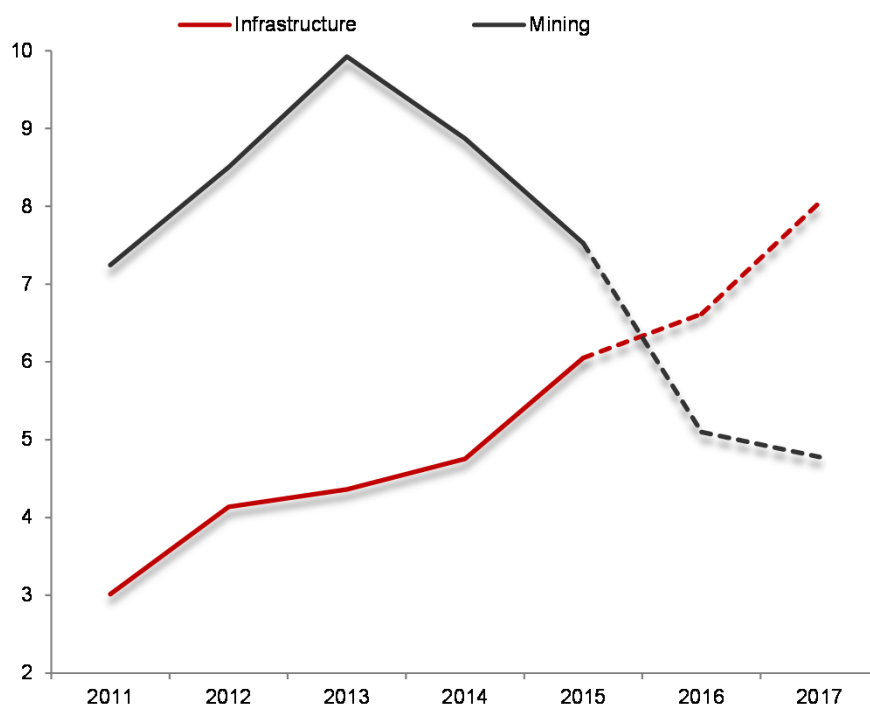


A considerable uptick in infrastructure spending would offset an expected decrease in mining investment as key projects come into operation

The Government has prioritized a US\$ 18 billion portfolio of high impact projects

**Investment by sectors<sup>1</sup>**

(US\$ billion)



### Short – term: fast track of US\$ 18 billion in infrastructure projects

Main projects	Investment US\$ mill.	% executed	Land access	Pre Investment Studies
Gasoducto Sur Peruano (GSP)	7,300	34.5	✓	✓
Line 2 of the Metro	5,346	0.0	●	●
Lima's Airport	1,062	0.0	●	●
Northern Dock	883	0.0	✓	✓
Chavimochic irrigation project	715	29.7	●	●
T.L. Moyobamba-Iquitos	654	7.0	●	●
Southern Dock	600	41.0	✓	✓
Chincheró International Airport	599	0.0	●	✓
Majes – Siguas II Irrigation project	550	0.2	●	✓

■ Potential quick wins
 ✓ Concluded
 ● In progress

1/ Include: public and private investment in transportation, irrigation, electricity, telecommunications, hydrocarbons transportation, tourism and sanitation, and the modernization of Talara refinery.  
Source: MEF, MINEM, ProInversion, Ositran, Osinergrmin, Perúpetro, APOYO Consultoría.



Reforms



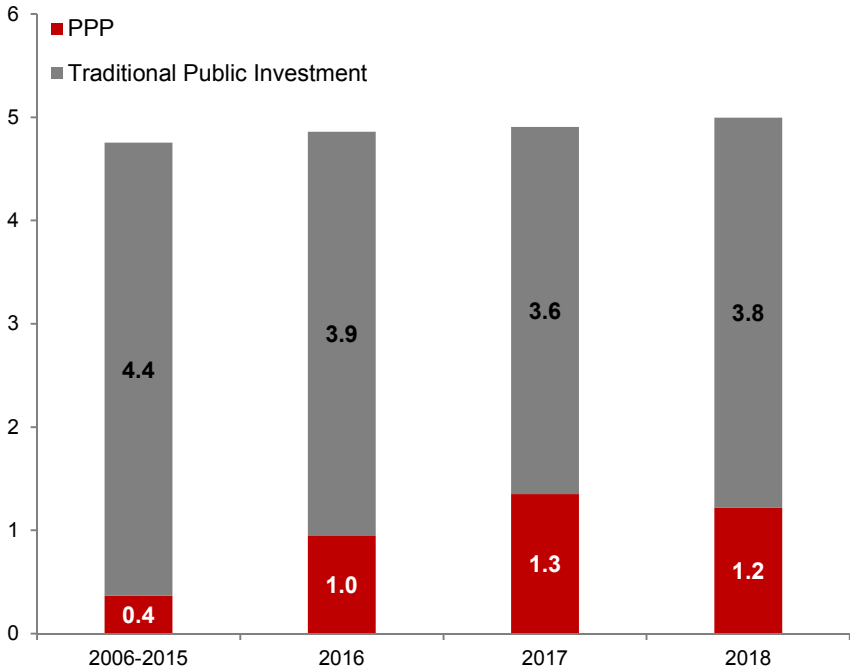
- Will participate in post-awarding phase.
- Decentralization.
- Multiannual investment program (PPP, Works for Taxes).



- Red tape removal.
- Guarantee execution and quality of investment projects.
- Creation of a prioritized portfolio for regions and local governments.

Public investment

(% of GDP)

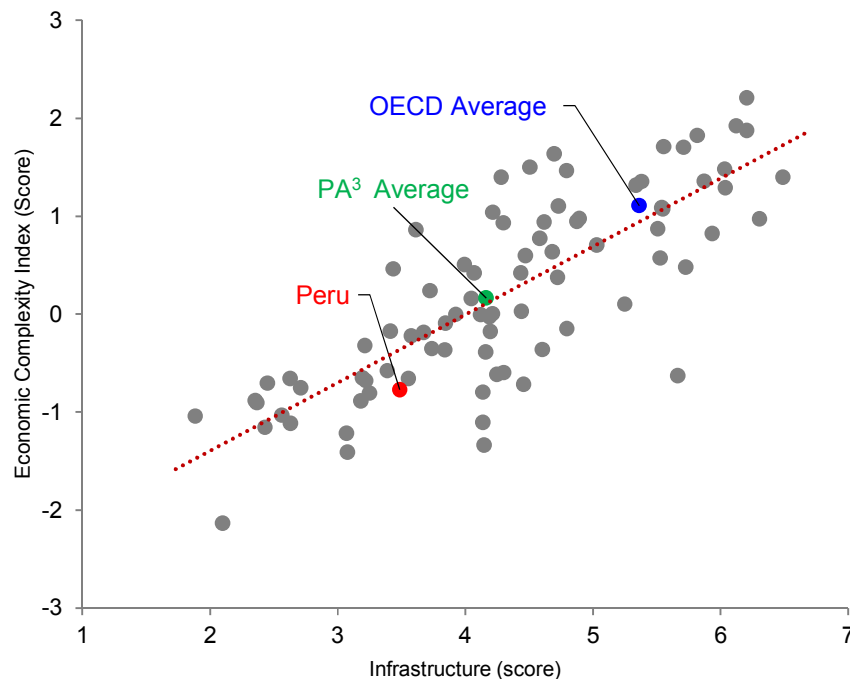


Source: MEF.



There is a strong relationship between infrastructure and economic diversification

**Economic Complexity<sup>1</sup> Index and Infrastructure Indicator<sup>2</sup>**  
(Country record)



**Of 13 prioritized projects from the US\$ 18 billion portfolio  
4 will induce diversification**

## Tourism



### **Tourism projects:**

- Lima's Airport (US\$ 1.1 billion).
- Chinchero International Airport (US\$ 0.6 billion).

### **Tourism potential:**

International tourist arrivals in New7Wonders countries:

- Peru: 3.2 million
- China: 55.6 million.

## Agribusiness



### **Agribusiness projects:**

- Chavimochic (US\$ 0.7 billion).
- Majes – Sigüas II (US\$ 0.6 billion).

### **Agribusiness potential:**

Agriculture land use in Peru:

- Cultivated area: 58%
- Other uses: 42%

1/ Economic Complexity Index ranks how diversified and complex a country's export basket is. It can take values from -2.5 to 2.5, where a higher value implies greater economic complexity.

2/ Infrastructure index measures the quality of overall infrastructure in a country. It can take values from 0 to 7, where a higher score indicates better quality of infrastructure.

3/ Doesn't include Peru.

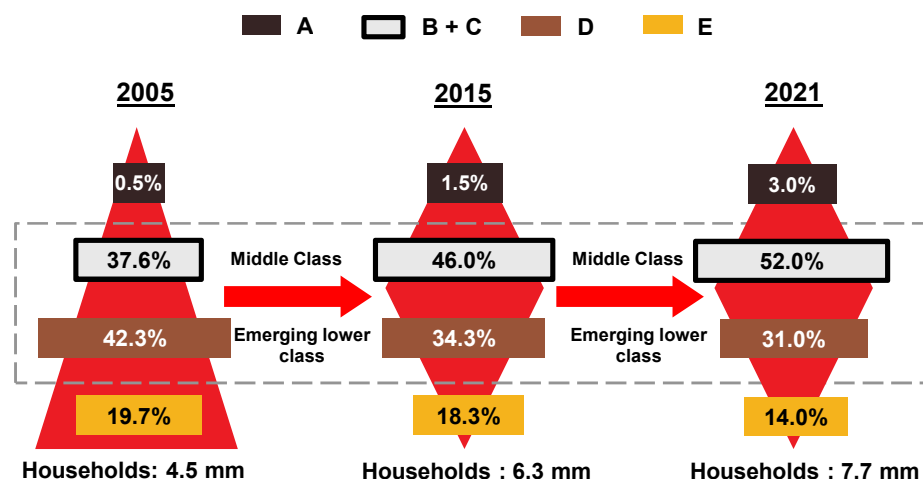
Source: Pew Research Center, WEF-IFM, The Atlas of Economic Complexity.

Also, an increasing middle class has induced a private sector-led pipeline of consumer-related investment projects totaling more than US\$ 10 billion



### Urban Peru: Socioeconomic levels

(% de households)



### Main private investment announcements

(Excluding infrastructure, mining and hydrocarbons; announced from January 2015 to July 2016)

Sector	Number of announcements	Investment (USD million)
Retail	59	2,174
Real Estate	51	2,099
Tourism	33	1,367
Services	20	1,033
Industrial	40	970
Massive consumption	23	872
Logistics	10	503
Education	32	391
Health	11	316
Agriculture	12	240
Vehicle sales	13	127
<b>Total</b>	<b>304</b>	<b>10,092</b>

Source: INEI, ENAHO, Investment announcements gathered by APOYO Consultoría.

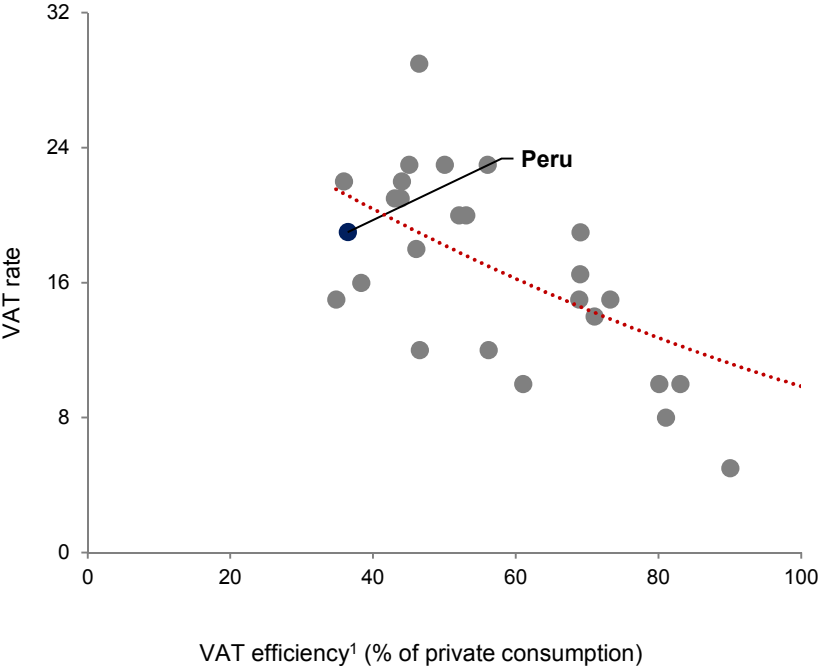
# The Peruvian tax system has a bad combination: high tax rates, low tax base and high tax avoidance



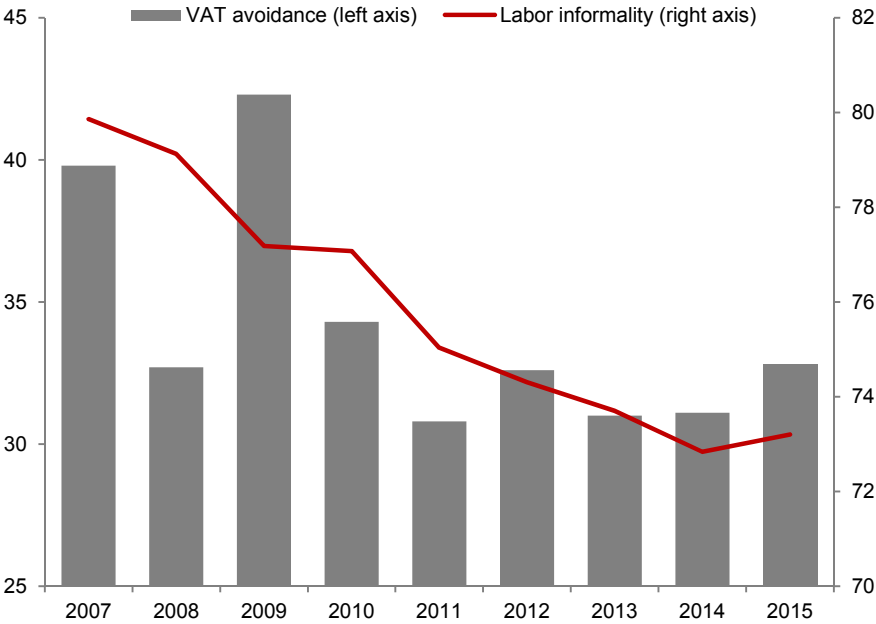
There is ample room to reduce tax rates and increase tax base...

... in order to formalize the economy

**VAT tax rate and efficiency**  
(VAT rate and % of private consumption)



**Tax avoidance<sup>2</sup> and labor informality**  
(% of potential base and % of total employees)



- Labor informality is around 70%.
- In Peru, fiscal revenues are equivalent to 20.1% of GDP which is lower than Chile (23.5%), Colombia (26.7%) and Mexico (23.5%).

1/ Ratio between revenue and private consumption multiplied by the rate of VAT.  
2/ VAT tax avoidance index considers the estimated avoidance as numerator and the theoretical potential VAT tax base as denominator after discounting the effect of current tax expenditures in each period.  
Source: Lora (2012), Sokolovska y Sokolovskyi (2015), SUNAT, INEI.



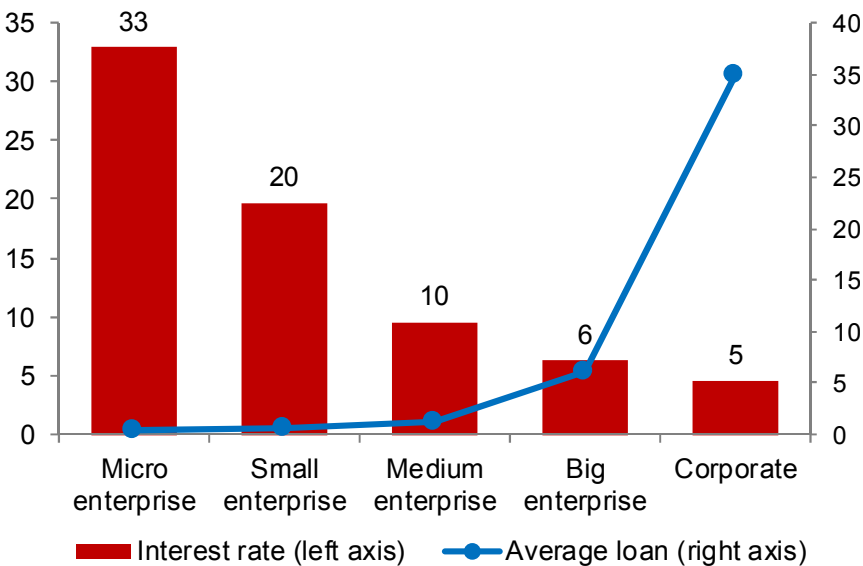
Tax	Policy Measure
<b>Value Added Tax</b>	<ul style="list-style-type: none"> <li>• Reduction of 1% in VAT tax rate (from 18% to 17%) in 2017 and then convergence to 15% subject to tax collection targets.</li> </ul>
<b>Corporate Income Tax</b>	<ul style="list-style-type: none"> <li>• Reversal of the reduction in the corporate income tax rate (from 28% to 30%) and the increase in the dividend tax rate (from 6.2% to 4,1%).</li> </ul>
<b>Special tax regime for small businesses</b>	<ul style="list-style-type: none"> <li>• Simplification of procedures to declare and pay taxes (VAT and IT).</li> <li>• Progressive tax rates applied to net income or sales (for 10 years).</li> <li>• To extinguish tax debt under 1 UIT (PEN 3 950).</li> </ul>
<b>Personal Income Tax</b>	<ul style="list-style-type: none"> <li>• Tax deduction for health and housing expenditures, supported by electronic payment receipts<sup>1</sup>.</li> </ul>
<b>Tax on capital gains</b>	<ul style="list-style-type: none"> <li>• Preferential treatment to financial instruments traded on stock exchanges markets and supervised by the SMV (Peru's Exchange and Securities Supervisory agency).</li> </ul>
<b>Others</b>	<ul style="list-style-type: none"> <li>• Tax amnesty.</li> <li>• Tax benefits for repatriation of capital.</li> <li>• Simplification of procedures.</li> </ul>

1/ Receipts, tickets, etc..  
Source: MEF.

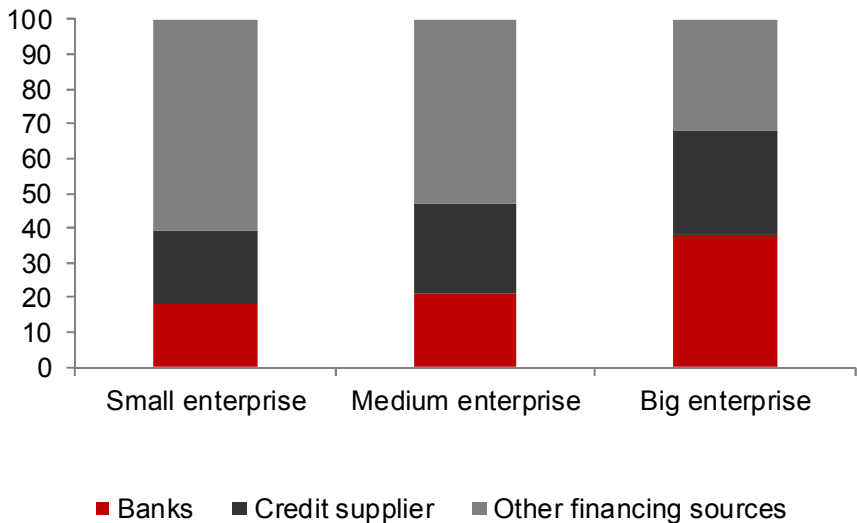


Strengthen articulation among available financial instruments (Cofide, BN, Agrobanco, FMV, Financial Inclusion Strategy) to enhance the supply and reduce the costs for formal business.

Peru: Credit cost and average loan by business size  
(% and US\$ millions)



Peru: financing sources by enterprise size  
(% of total credit)



Source: MEF estimates and forecasts.

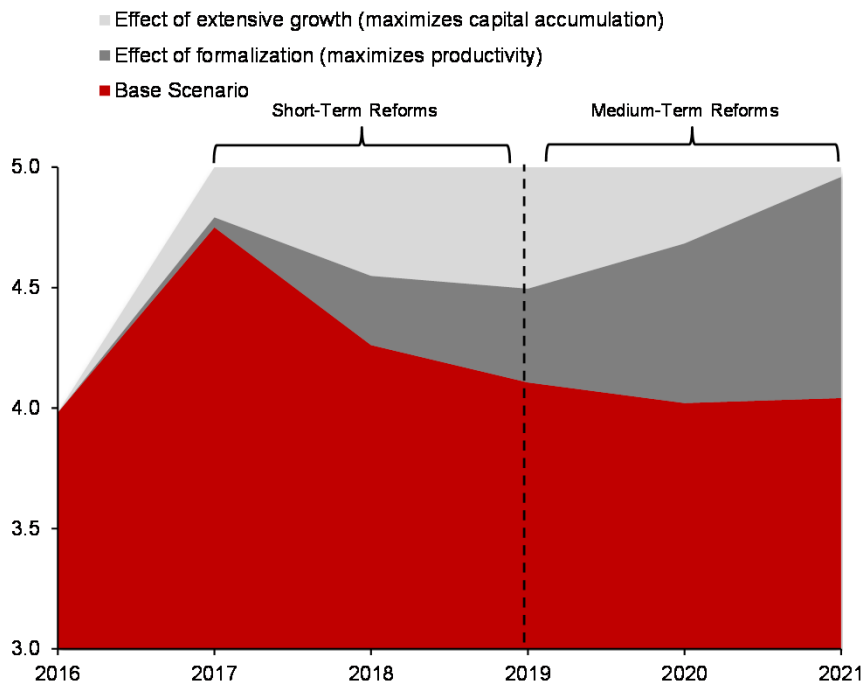
## Impacts on the Growth Strategy 2016-2021

Potential growth will increase from 4% to 5% ...

...with greater permanent fiscal revenues

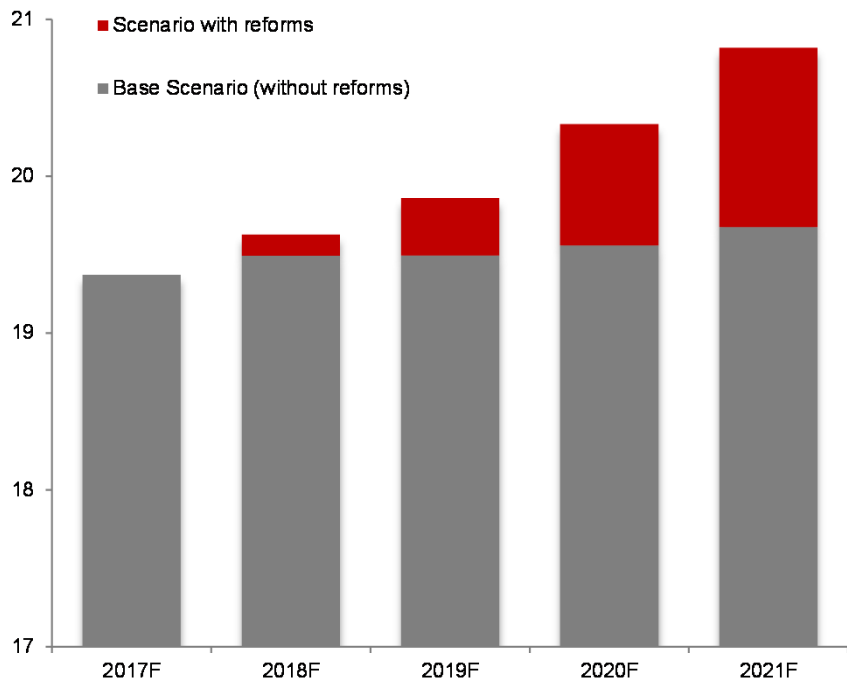
**Effect of reforms on potential GDP**

(Annual % change)



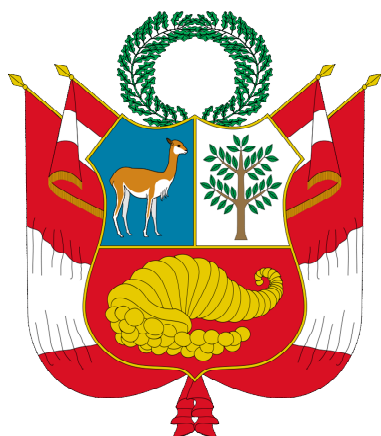
**Effect of reforms on fiscal revenues<sup>1</sup>**

(% of GDP)



1/ Does not include extraordinary fiscal revenues.  
Source: MEF estimates and forecasts.





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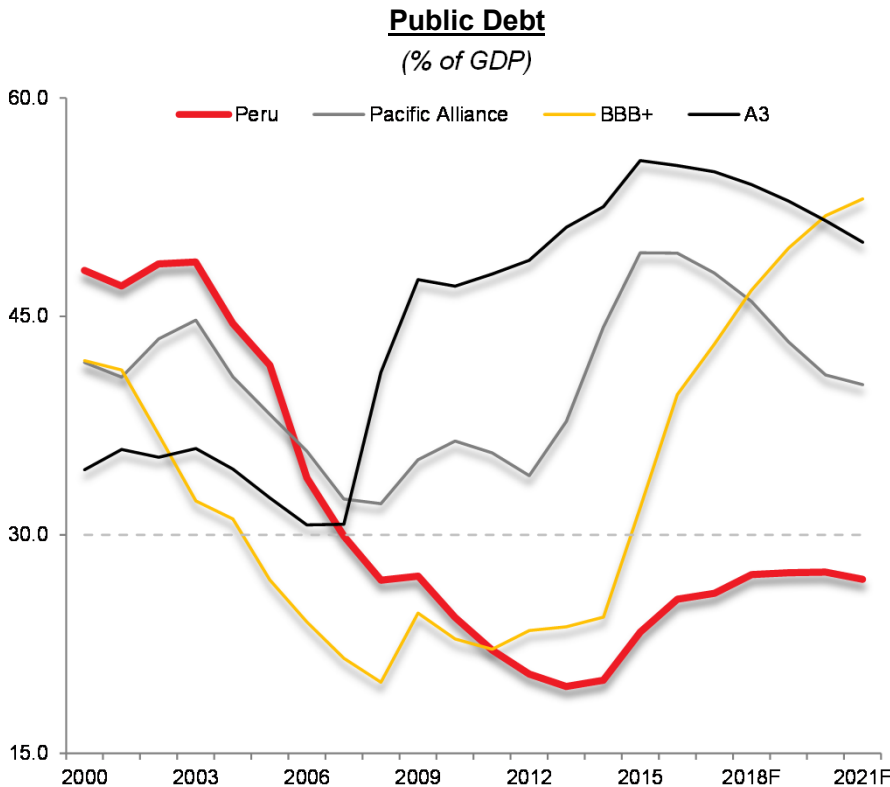
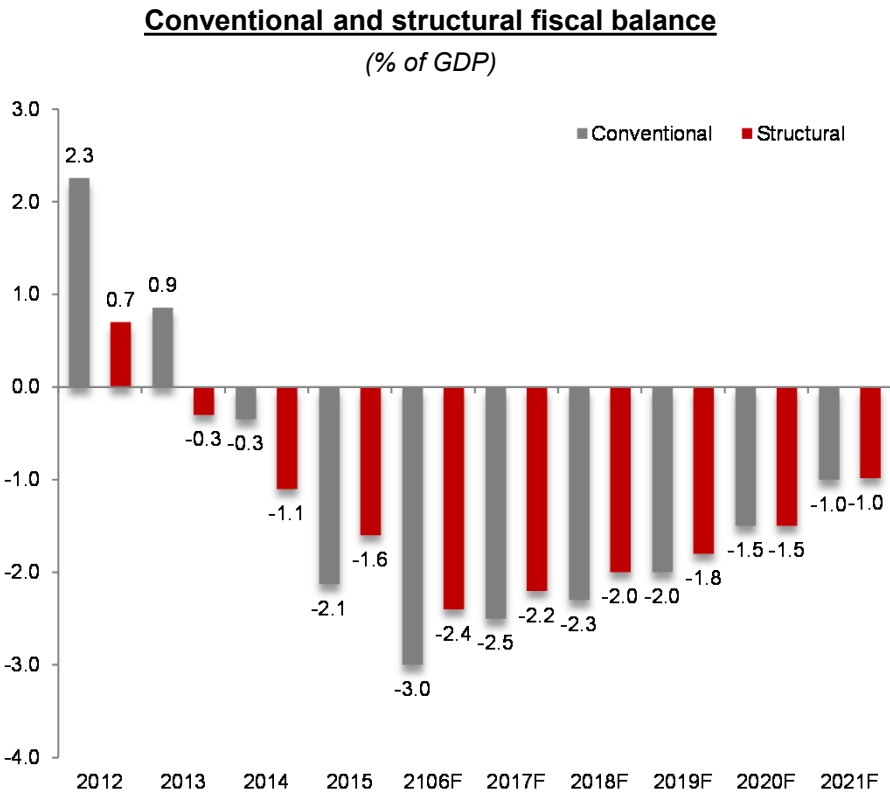
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Gradual fiscal consolidation will begin in 2017...

... allowing the government to preserve its ongoing target of prudent and sustainable debt management



- Peru will benefit by increasing transparency via the announcement and commitment to a target on the conventional fiscal deficit.

Source: BCRP, MEF Forecasts.

# The New Fiscal Rule: simulate a structural pattern for the public spending but through observed and transparent fiscal targets



Rules	Current framework	Proposal
Public debt	Limit of 30% of GDP	Maintained
Fiscal balance	Structural fiscal balance as a function of potential output and long-term commodity prices <sup>1</sup>	Conventional fiscal balance
Primary expenditure (current and capital)	Expenditure ceiling in PEN only for the National Government and as a function of structural fiscal deficit	Real growth for the General Government and as a function of historical and projected GDP growth
Current expenditure	Expenditure ceiling in PEN only for the National Government and as a function of potential output	Real growth for the General Government (wages, pensions, goods & services <u>excluding maintenance</u> )
Sub-national Governments	<ul style="list-style-type: none"> <li>- Expenditure rule</li> <li>- Debt stock rule</li> </ul>	<ul style="list-style-type: none"> <li>- Debt stock rule</li> <li>- Overall fiscal balance rule</li> </ul>

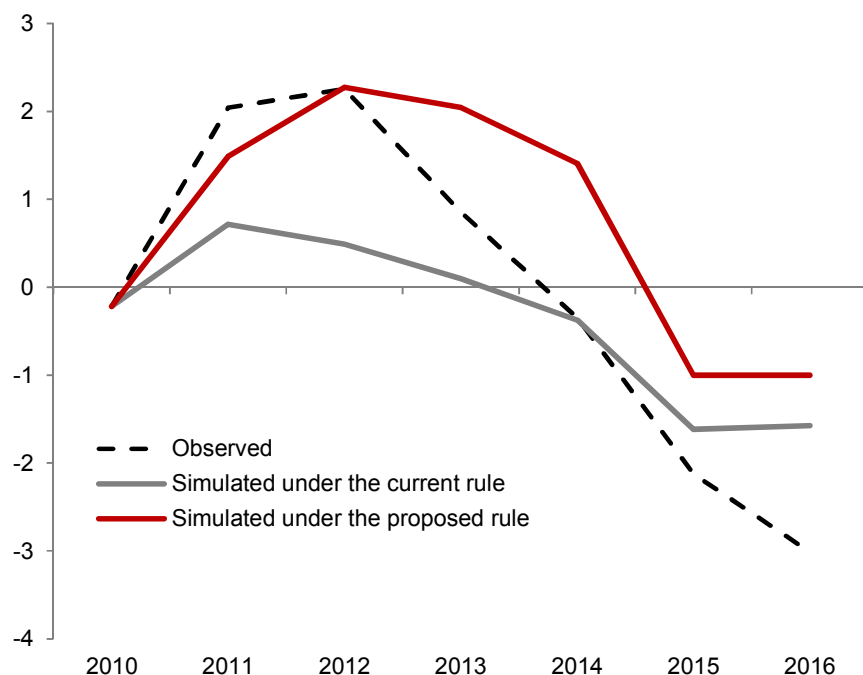
Compliance as a whole

1/ According to the official methodology for the calculation of structural fiscal accounts approved by Ministerial Resolution.  
Source: MEF.



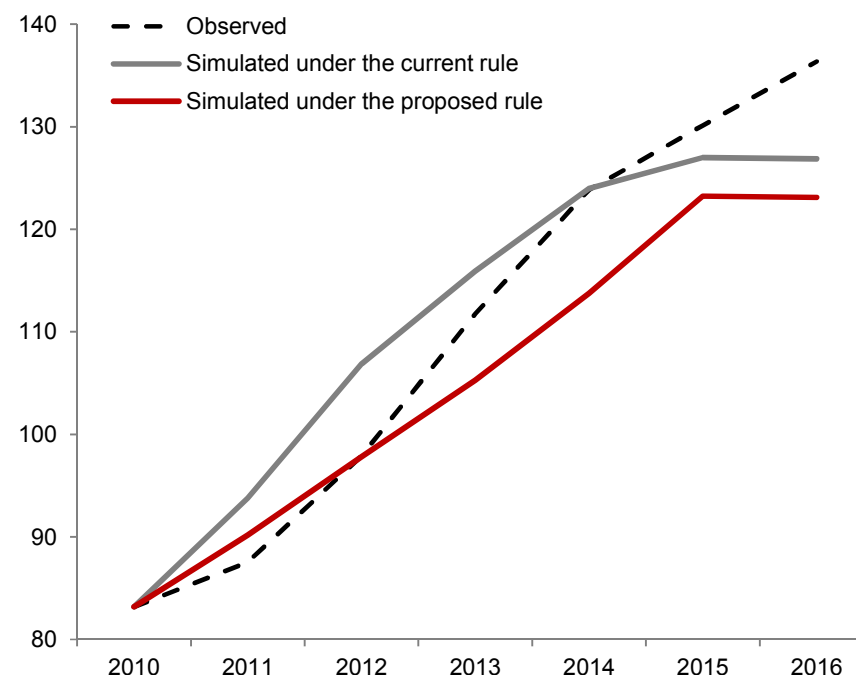
### **Non-financial Public Sector overall fiscal balance**

(% of GDP)



### **General Government non-financial expenditure**

(PEN Billion)



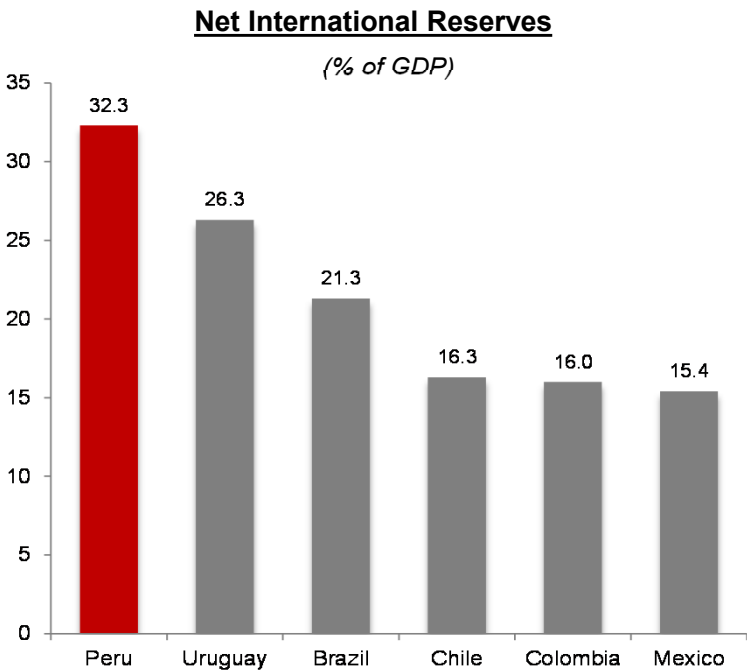
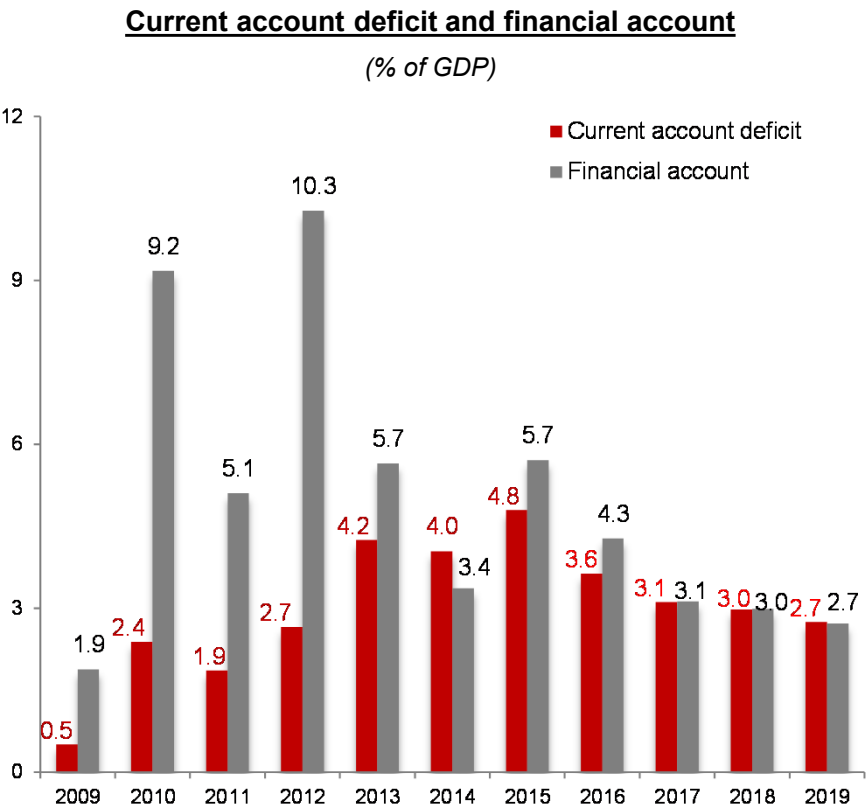
- Under the proposed fiscal rule, the 2016 public debt would have been 20.4% of GDP, lower than the current estimate (25.6% of GDP).

Note: the current rule consider the official methodology for the calculation of structural fiscal accounts approved by Ministerial Resolution.  
Source: Forecasts MEF.



Current account deficit is fully covered by a strong financial account...

...while a significant international reserves position provides comfort in facing any potential external shocks



**Coverage Indicators of International Reserves:**

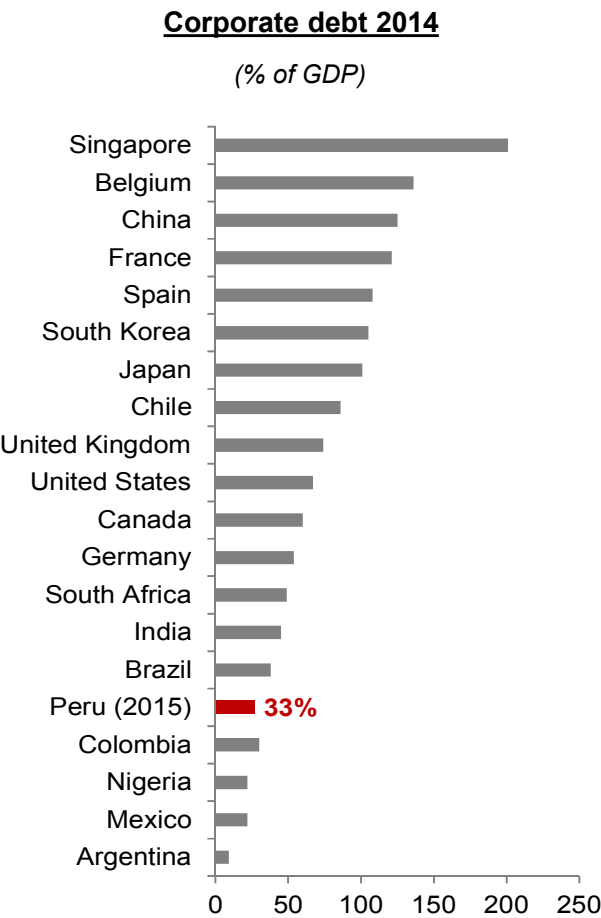
As % of:	2016
Short-term External Debt <sup>1</sup>	555.0
Short-term External Debt plus current account deficit	320.0

1/ Include short-term stock debt plus amortization of private and public sector.  
Source: BCRP, Forecasts MEF, Bloomberg.

# External private debt has been reduced and now local business are in a better position to invest



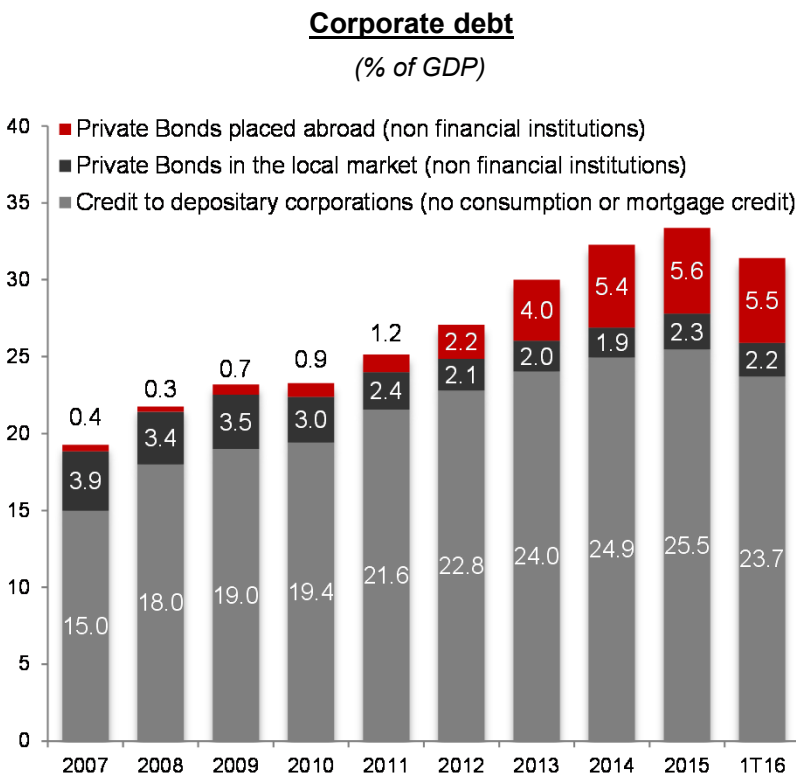
Growth of corporate debt remains in low levels...



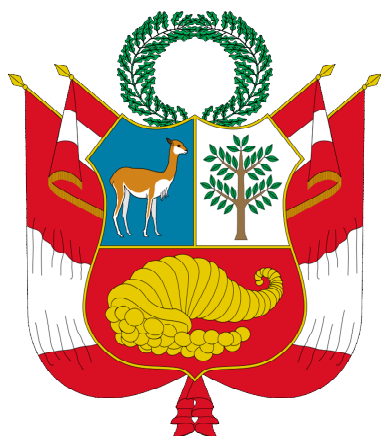
- Corporate debt grew 11% since 2007, below the average of countries that increased their corporate debt (17%).

Source: Bloomberg, BCRP, McKinsey Global Institute analysis.

... and local firms have prioritized a financial strategy to reduce their leverage and improve their balances



- Lindley, Alicorp and Ferrycorp – firms that had a strong debt increase in 2013 – have shown a reduction of external debts up until 1H2016.



**1**

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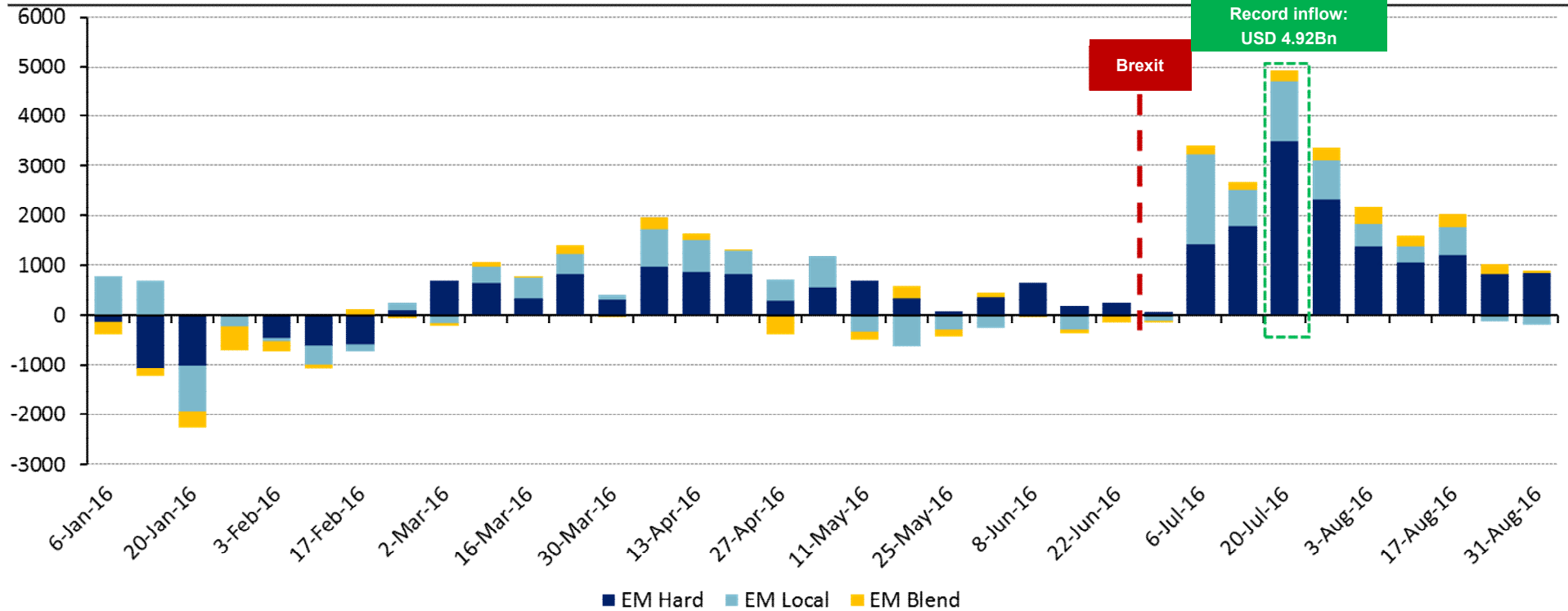
**4**

Commitment to Solarization & Development of PEN Market

# Emerging markets continue to gain momentum as shown by strong capital inflows into the region



Emerging markets flows in 2016	Jan 1st till June 24th (Brexit) USD millions	June 27th till Sep 5th USD millions
EM – Hard currency	7 306	14 922
EM – Local currency	1 403	9 347



Source: Bloomberg, as of 09/05/2016.



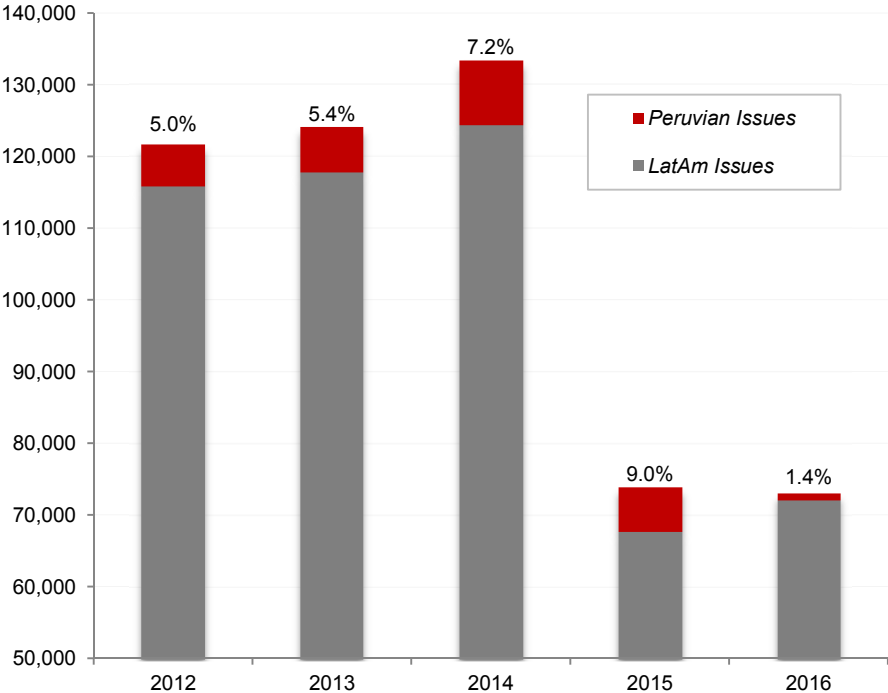
# A significant shortage in Peru’s debt supply has created considerable scarcity value for Peru bonds both, Soles and USD...



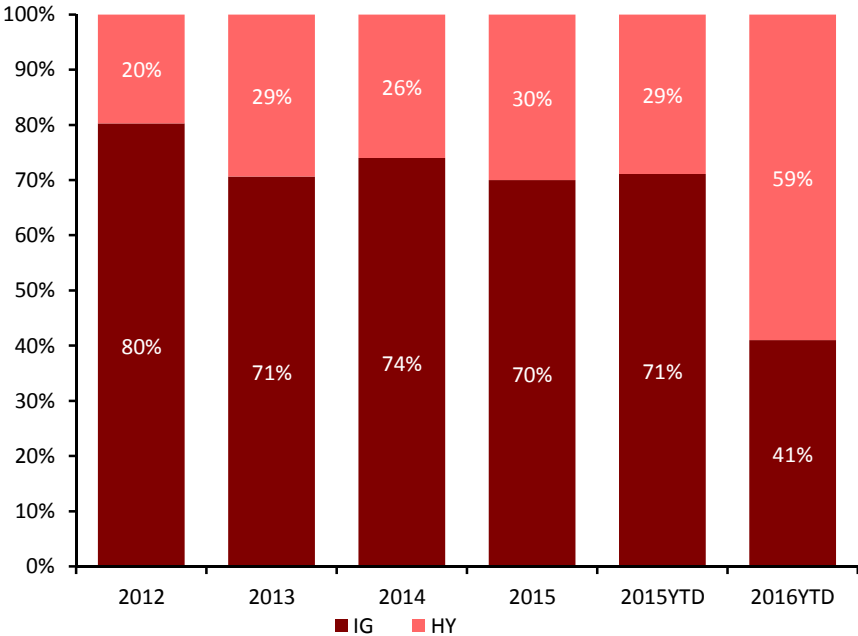
Peru represents only 1.4% of the LatAm and EM primary market supply...making it on of the most valued and demanded credits amongst EM sovereign issuers

Peru is amongst the lessen group of investment grade issuers in the region...

**Peruvian Bond Issues in Latin America**  
(USD billions)



**Evolution of LatAm issuers by credit rating**



Source: Bloomberg

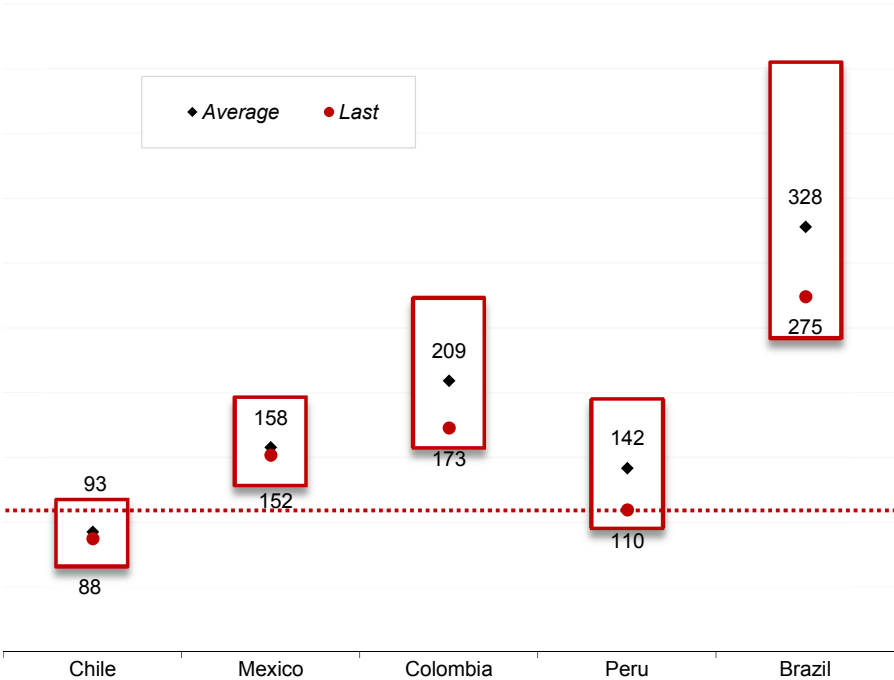
# Peru's 5-year CDS spread is currently trading near its 6-month low and below every sovereign in LatAm (ex-Chile)



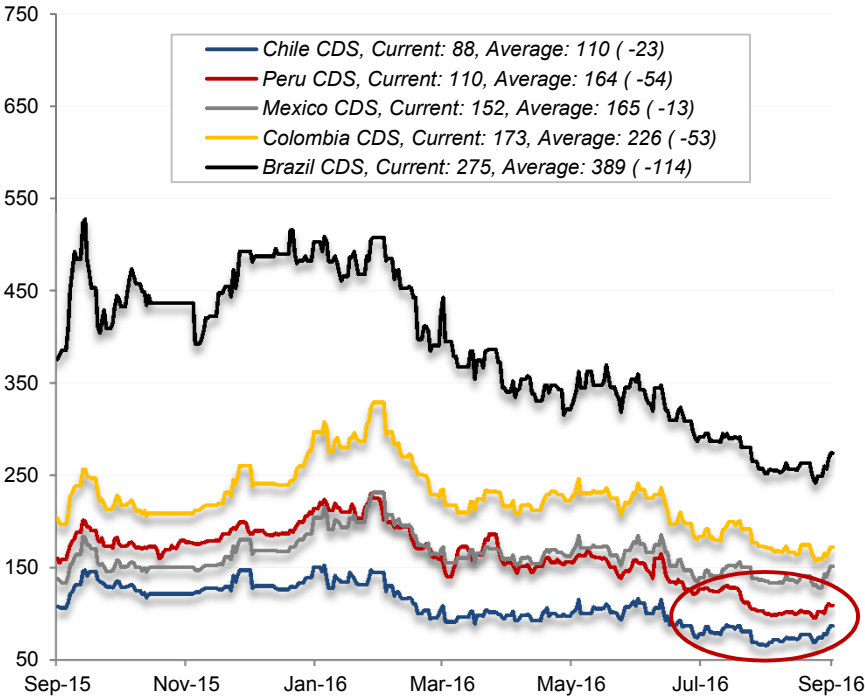
The Peru 5-year CDS spread currently stands at 32bps inside of 6M averages...

...and has been trading closer to Chile than UMS over the past 3 months and has outperformed its regional investment grade peers over the past year

LatAm 5-year CDS Current and Average Levels  
(Last 6 months)



LatAm 5-year CDS Evolution  
(Last year)



Source: Bloomberg



## Lines of defense to Finance Economic Growth

### Assets

#### Fiscal Stabilization Fund

Fund size as of June 30, 2016  
**USD 8,165mn**



### Liabilities

#### Debt Capital Markets

##### Local Market

Issuance of Soberanos

##### International Market

Issuance of Global Bonds

### Sources of Funds

#### Secondary Liquidity Reserve

Reserve size as of June 30, 2016  
**PEN 1,978mn; USD603mn  
 equivalent**

#### Multilateral and Bilateral Loans

CAF BID BIRF Others

Contingency loans

**USD 4,400mn**

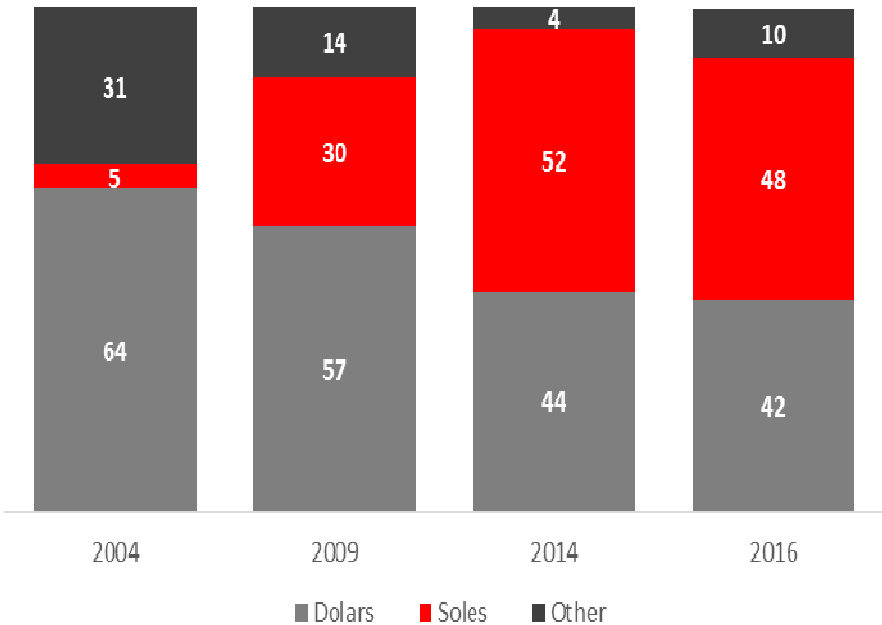
# Peru has successfully sought to increase “Solarization” while raising the average life of its debt



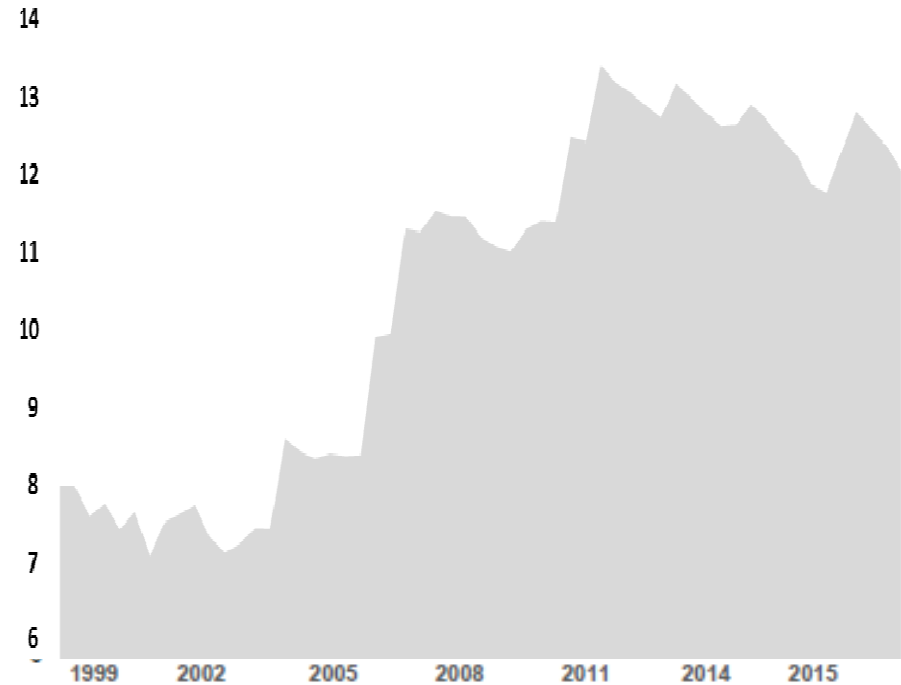
In line with other high-grade sovereigns, Perú’s debt management has focused in de-dollarizing its debt profile...

...while increasing the A/L of its debt by printing longer-dated transactions and executing liability management transactions

Composition of Public Debt by Currency (1)  
(% of total debt)



Average Life of Public Debt  
(Years)



- While the Republic has focused on Solarization, it remains deeply committed to both its USD and EUR curves, and, over time, will continue to issue in these currencies in order to:
  - provide liquidity (via benchmark-sized securities) to these curves,*
  - preserve access to alternative funding sources and*
  - continue to grow the depth and breadth of its investor base*

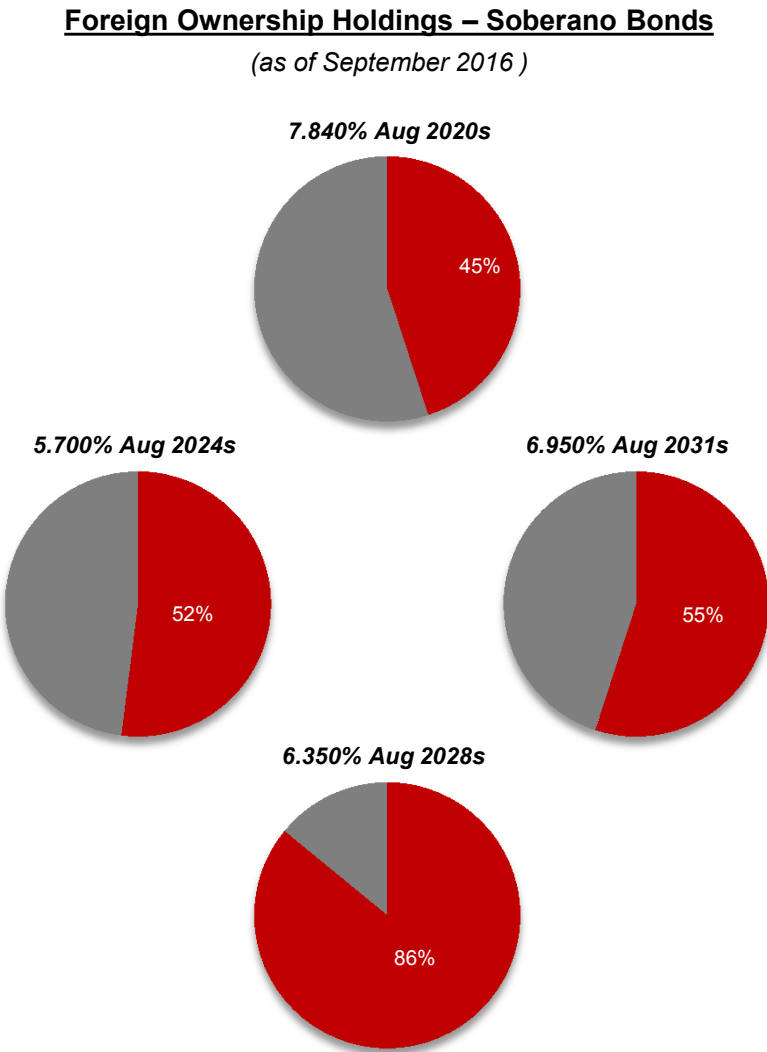
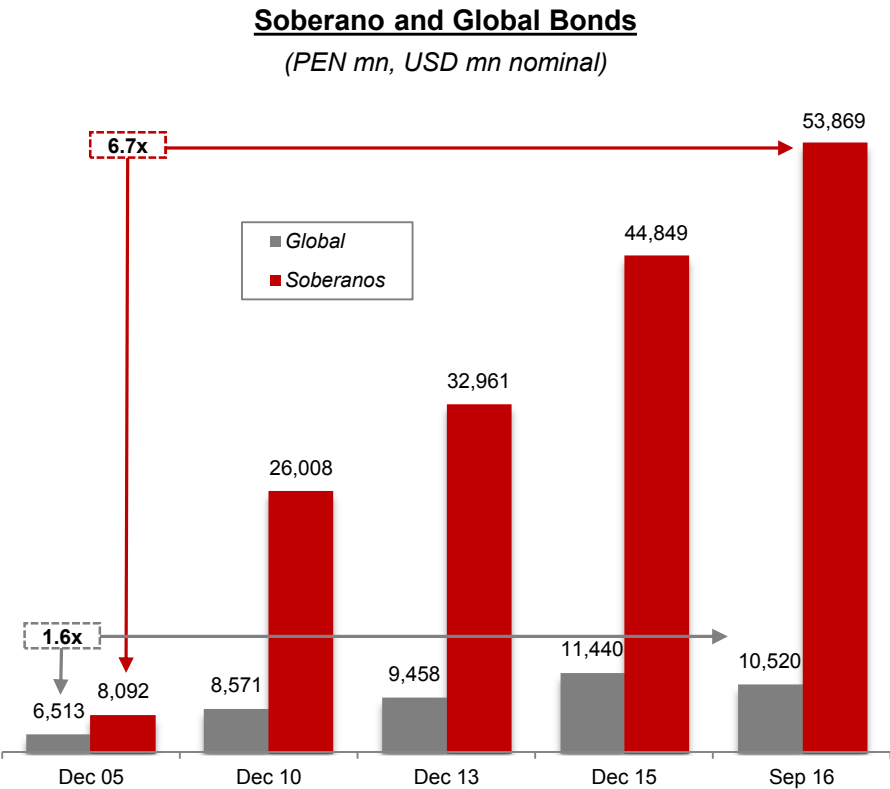
1) Source: BCRP, MEF (Jun16)

# Peru has significantly increased its Soberanos (PEN) debt stock by relying on GDN's



Over the past 10 years Peru has successfully increased its Soberanos (PEN) debt stock by 6.0x compared to a growth of 1.9x for its Global Bond (USD) debt stock...

...by focusing on PEN-denominated international issuances that have further developed the PEN market and significantly increased foreign-ownership of its bonds



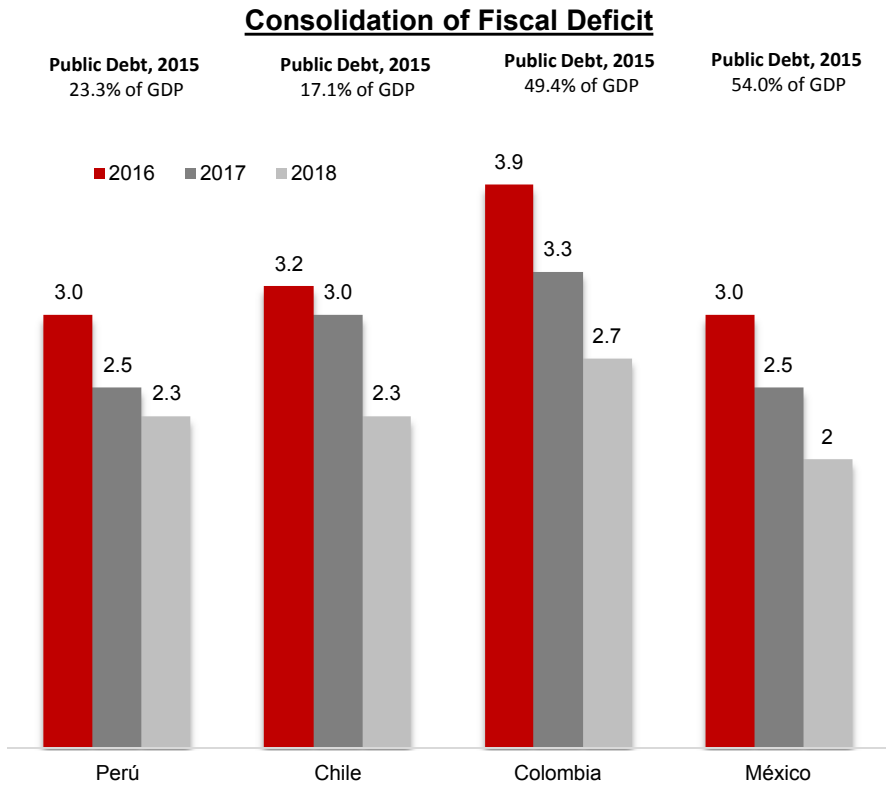
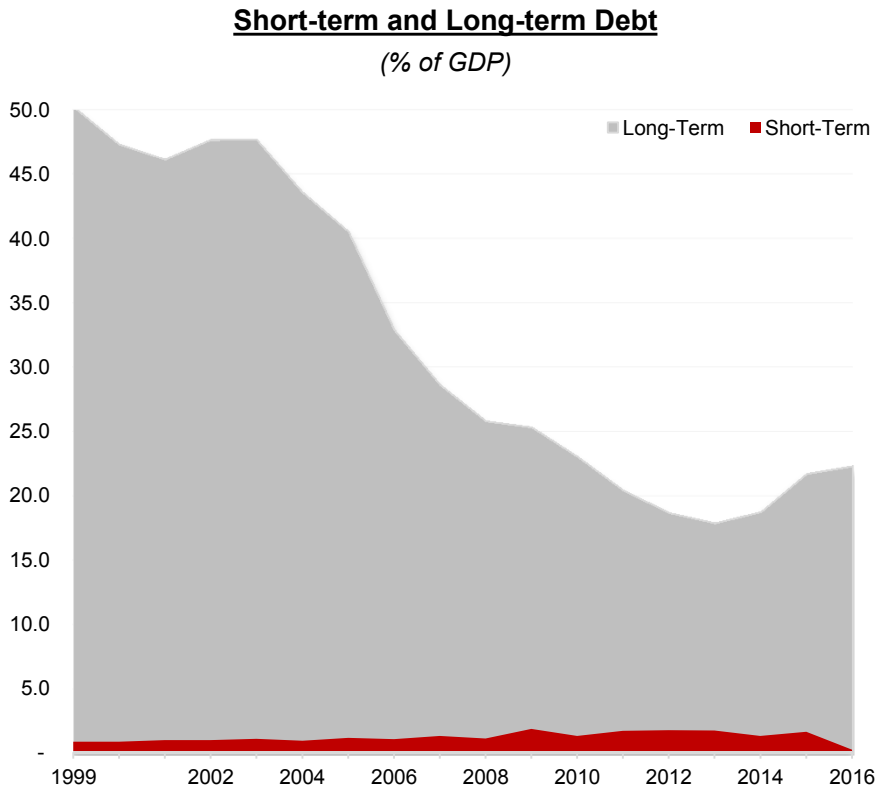
1) Source: MEF and Bloomberg

# The administration expects indebtedness levels to remain low as the fiscal deficit continues to consolidate



Both short-term and long-term debt to GDP levels have fallen significantly...

...and we expect the trend to continue on the back of a planned fiscal consolidation process



1) Source: BCRP, Forecasts MEF (Sep6)



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