



Fwd: Peru: Latin America's Macro Economic Star

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Is Peru, the host of this week's World Economic Forum Latin America, a role model for the rest of the region?

Peru has become Latin America's macro-economic star, combining sustained high economic growth with low inflation.



Brazil's President Dilma Rousseff should take note as she tries to fight inflation in Latin America's largest economy.

For the past five years, Peru has had Latin America's best macro-economic environment, according to a Latinvex analysis of data from the International Monetary Fund. It has had the region's second-lowest inflation despite having the second-highest GDP growth rate.

Peru's economy grew on average 6.5 percent in the 2008-12 period, while its inflation reached an average of 3.5 percent. Although Panama has led GDP growth the past five years (8.6 percent), its inflation has also been higher than Peru's (5.3 percent). And while El Salvador has led the way in low inflation in the 2008-12 period (3.2 percent), it is also the economy that had the worst performance in the period, growing a mere 0.6 percent on average.

Peru is expected to see Latin America's second-lowest inflation rate this year as well, according to another analysis from Latinvex.

As a result of its strong GDP growth and low inflation, Peru is expected to have Latin

America's second-highest increase in purchasing power this year, according to a Latinvex analysis of estimates on salary increases from Mercer and GDP growth projections from the IMF.

STRONG GDP GROWTH

For the past eight years – during the period 2005 through 2012 – Peru's GDP has consistently been higher than that of Latin America each year. While Peru's economy grew on average 7.0 percent during that period, Latin America's GDP expanded by 4.1 percent.

The reason is a combination of factors. Aldo Defilippi, the executive director of the American Chamber of Commerce in Peru, points to macroeconomic stability, openness of the economy and respect for the rules of the game during the last twenty years.

This has allowed for predictability, a very important issue for local and foreign investors, he says.

Benat Bilbao, Associate Director and Economist at the World Economic Forum, agrees. "Peru in the past two decades [has] followed a quite successful model of managing macroeconomic stability," he says. "They have been managing the macro economic situation quiet well [while] opening up their markets...following the model of Chile. That has been quiet successful. ...In term of liberalizing markets [and] macroeconomic [stability], it provides important lessons to other regions."

POLITICAL STABILITY

Following economic chaos during the first presidency of Alan Garcia (1985-90), Peru started recovering thanks to a combination of pro-business reforms and economic stability. Inflation reached a whopping 7,481 percent in 1990 and an average of 2342 percent during Garcia's five-year term. Meanwhile, GDP fell on average by 1.6 percent in that period (and fell 13.4 percent in 1989).

Thanks to reforms during the first presidency of Alberto Fujimori and continued business-friendly policies during his successors, Peru was able to recover and become a macro economic star.

Ironically enough, Garcia himself in his second term (2006-2011) followed those more business friendly policies rather than the radical ones he had implemented in his first period. Garcia's second term became a positive surprise for many local and foreign investors.

However, they grew nervous when Ollanta Humala won the 2011 elections on a radical platform. Once in office, though, he moderated his policies and assured investors by keeping the well-respected central bank president Julio Velarde while appointing Miguel Castilla as economy minister. He had served as the vice minister of economy under Garcia.

The macro economic success has largely continued during Humala, with GDP growth of 6.3 percent last year – more than twice the Latin American average. However, inflation did grow slightly in 2011 and 2012. This year it is expected to reach 2.1 percent, the second-lowest rate in Latin America.

FAVORABLE BUSINESS CLIMATE

Overall, Peru has a very favorable business climate. It has Latin America's best environment for doing business, according to The World bank's latest Doing business report.

The WEF's Global Competitiveness report says Peru ranks among the six best countries in Latin America when it comes to competitiveness. And the Heritage Foundation ranks Peru

among the four best countries in the region in economic freedom.

Meanwhile, its transport infrastructure ranks among the six best in Latin America, according to Latinvex.

And thanks to a dynamic wireless sector, Peru now ranks fifth in Latin America in number of wireless subscribers, ahead of such countries as Venezuela and Chile, according to a Latinvex analysis of ITU data.

Despite several major corruption scandals, the country also ranks favorably in transparency. Peru is among the six countries in Latin America with lowest corruption, according to Transparency International. It has less corruption than countries like Panama and Mexico, but more than countries like Uruguay and Chile.

Peru ranks 8th on the Latinvex Law & Crime Index, which measures a country's law and crime environment through factors like homicide rates, corruption, judicial independence, reliability of police, overall rule of law and property rights. Peru ranks better than countries like Bolivia and Ecuador, but behind countries like Colombia and Brazil.

CHALLENGES

Not all is rosy in Peru, though. Despite the impressive economic growth, poverty remains a serious challenge. While it has been reduced thanks to the economic growth, the country still has a poverty rate of 31 percent, according to The World Bank.

While its economic achievements are impressive, there's still the challenge of how to ensure that the whole population benefits from the growth, World Bank president Jim Yong Kim said last week.

To help reduce poverty, the government needs to implement several reforms, Defilippi argues. "There is much to do to promote investment in infrastructure and education and the government has to reform the bureaucracy and the judicial system in order to reach a higher level of development and further reduce poverty through the creation of employment," he says.

Such policies will help Peru sustain the economic growth from recent years, Defilippi adds. Bilbao concurs. Peru has challenges in education and innovation that are endemic and where the country should make decisive changes, he says.

The education problem is affecting multinationals as well. More than 52 percent of employers in Peru are having difficulties finding skilled workers, according to a recent Manpower study. "Some multinationals have even begun importing workers from abroad, in spite of Peru's high unemployment rate," Antonio Martinez, a senior analyst for Latin America research at Frontier Strategy Group, pointed out in a recent commentary.

However, the big problem for multinationals is infrastructure. "Many multinationals are finding it difficult to expand outside of Lima, due to insufficient infrastructure," Martinez says. "This makes scaling up operations difficult and concentrates short-term opportunities in the capital city."

FDI JUMPS

Meanwhile, the country is expected to continue attracting foreign investors. Last year, foreign direct investment grew 48.8 percent to a record \$12.2 billion. That's almost as much as Mexico received (\$12.7 billion). It also is the equivalent of 6.2 percent of Peru's GDP last year. That was the second-highest FDI-GDP ratio among Latin America's leading economies, according to a Latinvex analysis of FDI data from Brazil, Chile, Colombia, Mexico, Peru and Venezuela. (Only Chile had a higher ratio).

The World Economic Forum Latin America conference taking place in Lima this week will further place Peru on the map of attractive investor destinations.

“As in the cases of the signature of the Free Trade Agreements with the major trading partners; the participation in the TPP and the Pacific Alliance; the improvements in the credit classification by the major credit rating agencies; the APEC, ALCUE, ASPA, AACCLA, and other international meetings that took place in recent years in the country, the WEF will attract the attention of investors to Peru,” Defilippi says.