Atradius
Managing risk, enabling trade

Atradius Country Report

South America – March 2016

Contents

South American Countries:
Atradius STAR Political Risk Rating*:

Argentina:	**8 (High Risk) - Stable**
Brazil:	**5 (Moderate Risk) - Positive**
Chile:	**3 (Moderate-Low Risk) - Stable**
Colombia:	**4 (Moderate-Low Risk) - Stable**
Peru:	**4 (Moderate-Low Risk) - Stable**

* The STAR rating runs on a scale from 1 to 10, where 1 represents the lowest risk and 10 the highest risk.

The 10 rating steps are aggregated into five broad categories to facilitate their interpretation in terms of credit quality. Starting from the most benign part of the quality spectrum, these categories range from 'Low Risk', 'Moderate-Low Risk', 'Moderate Risk', 'Moderate-High Risk' to 'High Risk', with a separate grade reserved for 'Very High Risk.'

In addition to the 10-point scale, rating modifiers are associated with each scale step: 'Positive', 'Stable', and 'Negative'. These rating modifiers allow further granularity and differentiate more finely between countries in terms of risk.

For further information about the Atradius STAR rating, please click here.

Argentina

Main import sources (2014, % of total)	
Brazil:	21.8 %
China:	16.4 %
USA:	13.5 %
Germany:	5.4 %
Bolivia:	4.2 %

Main export markets (2014, % of total)	
Brazil:	20.3 %
China:	6.5 %
USA:	5.9 %
Chile:	4.1 %
Venezuela:	2.9 %

Key indicators	2013	2014	2015	2016*	2017*
Real GDP (y-on-y, % change)	2.9	0.5	1.6	1.0	1.8
Consumer prices (y-on-y, % change)	10.6	21.4	16.6	35.0	25.1
Real private consumption (y-on-y, % change)	4.3	-0.5	-0.1	1.0	2.0
Retail sales (y-on-y, % change)	14.5	13.1	9.5	-8.0	-7.1
Industrial production (y-on-y, % change)	0.0	-1.8	0.0	0.1	1.8
Unemployment rate (%)	7.1	7.3	7.2	8.2	7.7
Real fixed investment (y-on-y, % change)	3.1	-5.5	4.4	0.9	2.4
Fiscal balance (% of GDP)	-1.9	-2.5	-5.1	-4.7	-3.5
Export of goods and non-factor services (y-on-y, % change)	-4.0	-7.5	-2.7	-0.3	0.9

* forecast Source: IHS

Argentina industries performance outlook


Excellent:
The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend.


Good:
The credit risk situation in the sector is benign / business performance in the sector is above its long-term trend.


Fair:
The credit risk credit situation in the sector is average / business performance in the sector is stable.


Poor:
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Bleak:
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March 2016

Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction	Construction Materials
				
Consumer Durables	Electronics/ICT	Financial Services	Food	Machines/ Engineering
				
Metals	Paper	Services	Steel	Textiles
				

Political situation

Head of state/government:
President Mauricio Macri
(since December 2015)

Government type:
Republic

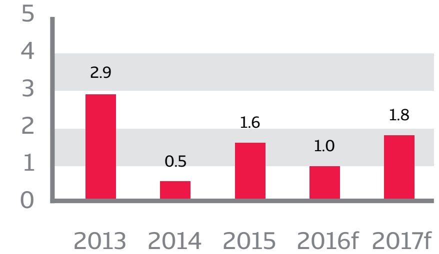
Population:
42.1 million (est.)

A new, reform-minded president in power

In November 2015 the former mayor of Buenos Aires, Mauricio Macri, won the run-off election for presidency against Daniel Scoli, the candidate of the government coalition. Macri's campaign was supported by a coalition of mainly centrist non-Peronist parties, called 'Cambiemos' (Let´s change). He advocates a more liberal, business friendly economic policy than his predecessor. However, while Cambiemos gained more seats in the October 2015 general elections, it still lacks a majority in the Chamber of Deputies and the Senate. This means that Macri has to cooperate with the opposition in order to assure parliamentary majority for structural reforms.

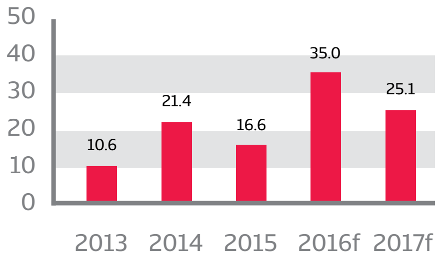
Economic situation

Real GDP growth (y-on-y, % change)



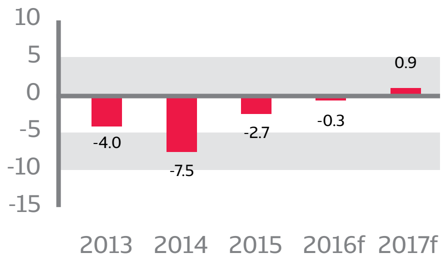
Source: IHS

Consumer prices (y-on-y, % change)



Source: IHS

Export of goods and non-factor services (y-on-y, % change)



Source: IHS

Major reforms implemented, but the shaky state of the economy persists

The economic policy of former President Fernández de Kirchner was characterised by interventionist measures and very expansionary fiscal policies, which have undermined government creditworthiness and resulted in accelerating inflation and capital flight. Argentina went into sovereign default in July 2014, after the government failed to secure a settlement with litigant holdout creditors in line with a US court ruling. That meant that the country continued to be shut out of global capital markets. The debt default, subsequent deepening of interventionist policies and mounting economic problems in Brazil and in Venezuela have exacerbated the economic problems since 2014.

In December 2015 the newly elected President Macri took measures for an economic policy turnaround by abolishing export taxes on some agricultural products, reducing the levy on soybean exports to 30% and lifting currency controls, allowing the overvalued Argentinian peso to float freely. This triggered a depreciation of the peso of more than 30%. The new administration has also started to negotiate with hold-out creditors in order to close a debt deal, which could lead to renewed access to international credit markets.

While the sharp peso depreciation helps exporters, it has led to an increase in the already high inflation rate, which is expected to rise 35% in 2016. In December 2015 the Central Bank raised interest rates on short-term fixed deposits by 8%, to 38%. Another increase in order to stabilise the peso and to contain inflation cannot be ruled out.

Another issue is the need to tackle public finances. These have deteriorated due to the expansionary fiscal policy in the past and the monetisation of the fiscal deficit to compensate for the lack of access to capital markets. The new government stated it will phase out subsidies in order to trim the deficit. However, this could hurt the already feeble economic growth, given that the highly expansionary fiscal policy was the main driver of growth in the recent past. Moreover, this could also lead to social unrest. It remains to be seen how much the abolishment of export taxes and currency depreciation really help to boost exports and to increase the amount of (still depleted) foreign exchange reserves, given that global demand for agricultural products has decreased and prices are expected to remain low. Official reserves are still insufficient to cover the external refinancing needs.

For the time being, the risk of uncontrolled currency volatility and transfer and convertibility risk remain high, given tight liquidity and the continued lack of access to international capital. High inflation and fiscal austerity measures could even lead to an economic contraction in the short term.

Brazil

Main import sources (2014, % of total)	
China:	16.3 %
USA:	15.4 %
Argentina:	6.2 %
Germany:	6.0 %
Nigeria:	4.1 %

Main export markets (2014, % of total)	
China:	18.0 %
USA:	12.1 %
Argentina:	6.3 %
The Netherlands	5.8 %
Japan:	3.0 %

Key indicators	2013	2014	2015	2016*	2017*
Real GDP (y-on-y, % change)	3.0	0.1	-3.7	-3.0	1.4
Consumer prices (y-on-y, % change)	6.2	6.3	9.0	6.9	4.9
Real private consumption (y-on-y, % change)	3.5	1.3	-4.1	-3.4	1.5
Retail sales (y-on-y, % change)	4.4	2.2	-3.9	-1.4	1.1
Industrial production (y-on-y, % change)	2.2	-2.9	-8.3	-5.8	1.9
Unemployment rate (%)	7.2	6.8	8.1	9.7	9.5
Real fixed investment (y-on-y, % change)	5.8	-4.5	-13.3	-8.2	1.1
Fiscal balance (% of GDP)	-3.0	-6.0	-10.3	-8.1	-6.9
Government debt (% of GDP)	52.7	55.1	66.2	70.7	74.5
Export of goods and non-factor services (y-on-y, % change)	2.6	-1.0	7.3	1.9	2.3
Current account (% of GDP)	-3.6	-4.4	-3.3	-2.7	-2.9

* forecast Source: IHS

Brazil industries performance outlook

Excellent:
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March 2016

Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction	Consumer Durables
				
Electronics/ICT	Financial Services	Food	Machines/ Engineering	Metals
				
Oil/gas	Paper	Services	Steel	Textiles
				

Political situation

Head of state/government:
President Dilma Rousseff (since January 2011)

Form of government:
A broad coalition, comprising the left-wing Workers' Party (PT) and the centrist Democratic Movement Party (PMDB)

Population:
204.5 million (est.)

A massive corruption scandal casts its shadow

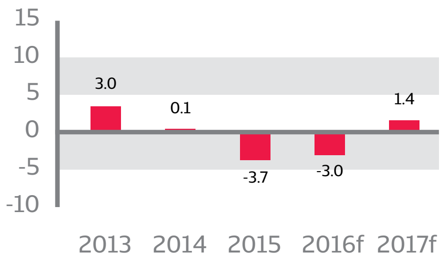
After her re-election in 2014, Dilma Rousseff of the Workers´ Party (Partido dos Trabalhadores, PT) started her second term promising a return to more orthodox macroeconomic policies, such as combating inflation and trimming the budget deficit.

However, since late 2014 the administration and the ruling Workers´ Party have come under pressure due to a massive corruption scandal involving state oil company Petrobras. State prosecutors alleged leading construction companies and other businesses paid huge bribes to high-ranking officials of Petrobras and to politicians, mainly from the Workers´ Party, in return for contracts. To date, more than 100 people have been arrested in the two-year investigation, including politicians and former top executives at Petrobras, and some from the country's biggest construction firms. President Rousseff, who chaired Petrobras when much of the corruption is believed to have taken place, has been cleared of involvement, but is still threatened by an impeachment proceeding on charges of manipulation in order to hide a growing public deficit.

The government´s weakness and the Petrobras scandal seriously hamper the administration´s legislative agenda and have affected foreign and domestic investors' sentiment. The chances that urgently needed growth-enhancing structural reforms will be taken up (e.g. reforming the pension and tax system, reducing bureaucracy and corruption and improving education) have faded. It remains very uncertain if President Rousseff will continue to support more orthodox policies, given that such adjustments would be politically painful.

Economic situation

Real GDP growth (y-on-y, % change)



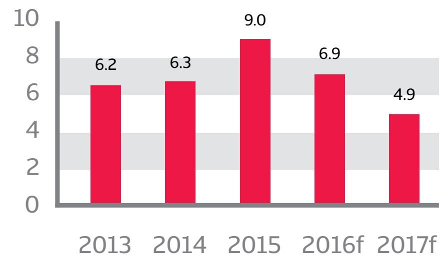
Source: IHS

Another GDP contraction expected in 2016

Brazil´s economic growth already started to slow down in 2014, mainly due to weak domestic and foreign demand and decreased commodity prices. Additionally, major supply side constraints (low investment and savings ratios, weak infrastructure, complex business and regulatory environments) had an adverse effect on the economy. The contraction deepened in 2015, with sharp decreases in private consumption, investment and industrial production, due to fiscal and monetary tightening, deteriorated business and consumer confidence and the negative impact of the Petrobras corruption scandal, which was much larger than anticipated (especially on oil and gas and the construction sectors). Due to the scandal, new investments are being put on hold and many companies may face financial difficulties (Petrobras investments alone represent 2% of Brazil's GDP).

The economy is forecast to contract further in 2016, by 3.0% with unemployment rising to nearly 10%. Only a weak 1.4% GDP rebound is expected in 2017.

Consumer prices (y-on-y, % change)

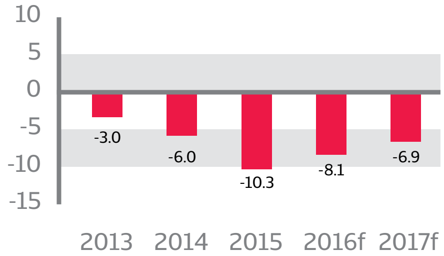


Source: IHS

High inflation expected to persist

Inflation increased to 9% in 2015, well above the 6.5% ceiling of the Central Bank´s target range, mainly due to tax increases and the sharp depreciation of the real. To slow price increases, the Central Bank has raised the SELIC benchmark interest rate (its overnight lending rate) several times since October 2014, to 14.25% - the highest level in more than 10 years. However, at the same time, those high interest rates impede investments and lending. Inflation is expected to remain high in 2016, at around 7%.

Fiscal balance (% of GDP)



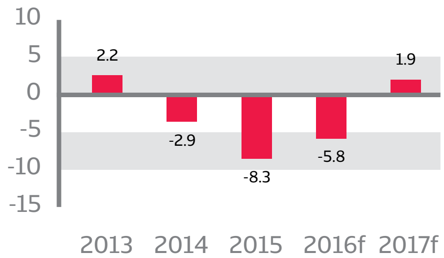
Source: IHS

Government debt to increase above 70% of GDP in 2016

Until 2014 Brazil´s fiscal policy was quite expansionary, as investment to exploit the huge offshore oil fields, the 2014 FIFA World Cup and the 2016 Olympics fuelled public sector spending. The budget deficit increased to 6% of GDP in 2014, and despite the implementation of fiscal austerity , it rose to more than 9% in 2015, with government debt increasing to more than 60% of GDP. In 2016, an 8% fiscal deficit is forecast as a consequence of higher interest expenditures, falling revenues, a shrinking GDP and losses associated with currency swaps provided to businesses. Government debt is forecast to increase above 70% of GDP in 2016. Fiscal consolidation is becoming increasingly difficult due to the deep economic contraction, high interest rates and a Congress obstructing the passing of fiscal adjustment measures. Additionally, the current government crisis has heightened concerns over the administration‘s ability to bolster public finances, while repeated revisions in fiscal targets have added to concerns about its willingness to do so. For example, the government seems unwilling to raise the retirement age, while 40% of the (non-interest) public spending is devoted to pensions.

That said, most of the debt is domestically financed in local currency at an average maturity of 6.5 years, while the government is a net-external creditor. This mitigates currency, refinancing and sovereign default risk.

Industrial production (y-on-y, % change)



Source: IHS

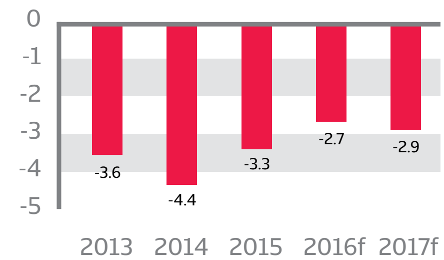
Corporate debt has sharply increased

Currency depreciation and the on-going recession have increased worries about the health of corporate balance sheets. Non-financial corporate debt in Brazil increased from 30% of GDP at the end of 2007, to 49% of GDP in H1 of 2015. Although this level is still modest, the increase is one of the highest among emerging market economies. However, the fact that almost 90% of this debt is financed domestically and in local currency mitigates the refinancing and currency risk.

With 49% of export receipts, the external debt of Brazilian businesses is at a relatively high level, but it seems that many companies that borrow in foreign currency are adequately hedged. That said, corporates operating in the commodity sector that have borrowed extensively in foreign currency face higher risks, as their earnings are negatively affected by low commodity prices. Moreover, their debt servicing costs are under upward pressure due to the high currency depreciation.

Brazil´s banking sector is well regulated and sufficiently capitalised. The system is not dollarized and the dependency on external wholesale financing is low, shielding the banking system from adverse shocks.

Current account (% GDP)



Source: IHS

Still vulnerable to changing investors’ sentiment, but resistant to shock

Brazil remains vulnerable to changing investors’ sentiment, due to a relatively high stock of portfolio investment inflows (96% of international reserves in January 2016). However, a strong financial sector and relatively low external refinancing needs enable the flexible exchange rate to act as a shock absorber. Brazil´s external financial situation is expected to remain robust. External debt is still quite low and liquidity is more than sufficient to cover imports (more than 15 months) and external refinancing needs. The currency depreciation and weak domestic demand contribute to a correction of external imbalances: the trade balance returned to a surplus and the current account deficit is decreasing on the back of lower imports.

Print this article

Chile

Main import sources (2014, % of total)	
USA:	20.9 %
China:	19.8 %
Brazil:	7.8 %
Argentina:	4.0%
Germany:	3.6 %

Main export markets (2014, % of total)	
China:	24.6 %
USA:	12.2 %
Japan:	10.0 %
South Korea:	6.2 %
Brazil:	5.4 %

Key indicators	2013	2014	2015	2016*	2017*
Real GDP (y-on-y, % change)	4.3	1.8	2.0	2.2	2.8
Consumer prices (y-on-y, % change)	1.9	4.4	4.4	4.1	3.5
Real private consumption (y-on-y, % change)	5.9	2.2	1.7	2.1	1.9
Retail sales (y-on-y, % change)	9.6	1.2	0.7	1.3	0.6
Industrial production (y-on-y, % change)	3.4	0.4	-0.5	0.7	2.1
Unemployment rate (%)	6.0	6.3	6.3	6.6	6.9
Real fixed investment (y-on-y, % change)	2.5	-6.2	0.4	0.5	2.0
Fiscal balance (% of GDP)	3.0	2.4	1.0	-0.1	0.4
Government debt (% of GDP)	12.0	13.3	15.2	16.2	16.8
Export of goods and non-factor services (y-on-y, % change)	3.4	0.6	-0.8	2.3	1.2

* forecast Source: IHS

Chile industries performance outlook

March 2016


Excellent:
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Good:
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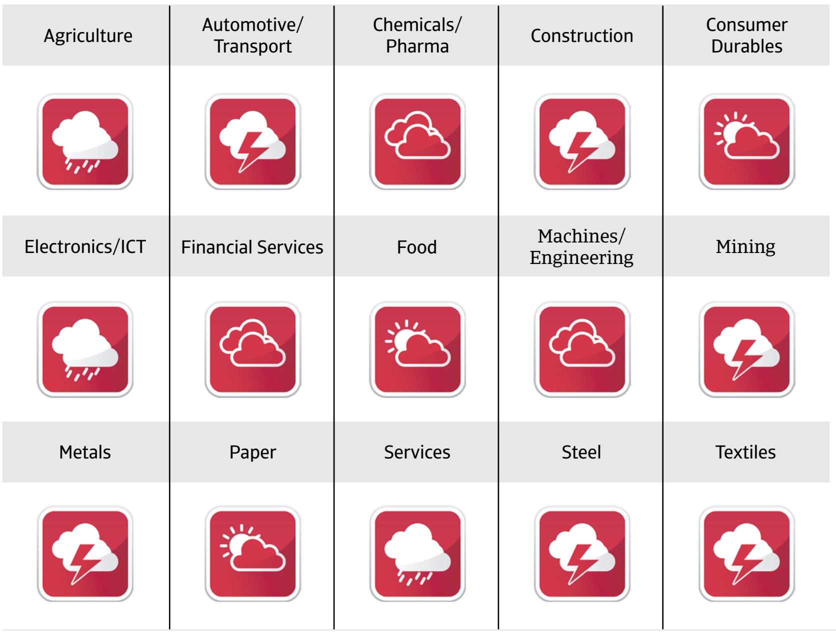


Political situation

Head of state/government:
President Michelle Bachelet
(since March 2014)

Government type:
Republic

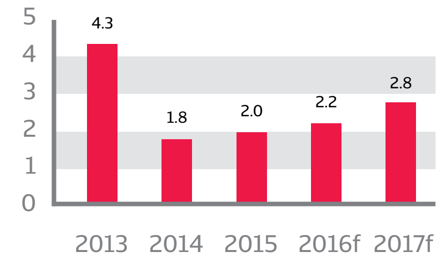
Population:
18.0 million (est.)

Stable – but the government´s popularity has decreased

President Michelle Bachelet´s administration is backed by a comfortable majority of the centre-left Nueva Mayoría coalition in both houses of Congress. However, structural reforms to combat inequality and to promote infrastructure investments are progressing. In 2015 a corruption scandal involving the president's son weakened the government's authority. At the same time, a campaign-financing scandal hurt the conservative opposition´s reputation. Those incidents have sharply damaged approval ratings and popularity for both government and opposition. Next presidential and general elections are due to be held in November 2017.

Economic situation

Real GDP growth
(y-on-y, % change)



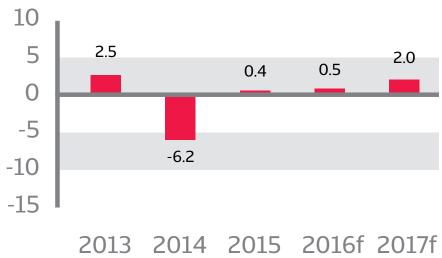
Source: IHS

Lower growth rates due to the end of the commodity boom

Chile's open economy is highly dependent on copper exports (accounting for more than 50% of export earnings, 25% of direct and indirect government revenues and 10% of GDP) and on the global financial cycle (due to its large internationally integrated financial sector). Growth has slowed down since 2014 as the global commodity boom came to an end (especially lower imports from China) and domestic demand decreased, affecting both investments and consumption. However, government spending growth continues, with GDP forecast to increase 2.2% in 2016 and 2.8% in 2017. Non-copper-related revenues have increased over the past decade (copper now accounts for 6.5% of direct government income, down from 34% in 2005), but there is still more potential to diversify the economy by increasing investments in non-mining related sectors. Income inequality, low education and low productivity remain stumbling blocks for long-term economic growth.

Inflation increased 4.4% in 2014 and 2015, on the back of several interest rate cuts in 2014 intended to stimulate the economy and the depreciation of the Chilean peso. Inflation is expected to be lower in 2016 due to a recent monetary tightening.

Real fixed investment
(y-on-y, % change)

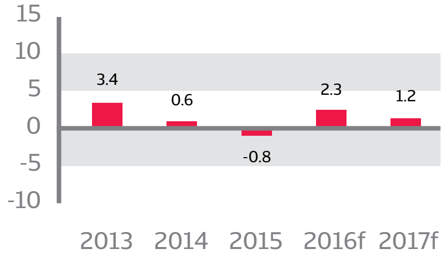


Source: IHS

More pressure on import-dependent sectors

In 2016 the external environment is expected to remain difficult, as a consequence of uncertainty involving the Chinese economy and persistently low copper prices. The Chilean peso depreciated by about 30% since 2013, which led to an increase in import prices. Import-dependent sectors like consumer electronics, retail and plastics are the most vulnerable, and we have observed that some businesses are using currency depreciation and price volatility as a pretext for delayed payments.

Exports of goods and non-factor services (y-on-y, % change)



Source: IHS

A resilient economy

Despite increased currency volatility, the Central Bank still has ample reserves to intervene in the managed float of the currency, and further depreciation should be limited. The economy´s shock resistance is strong, given prudent macroeconomic and financial policies, low public debt (less than 20% of GDP), a sustainable external debt rate of 62% of GDP in 2016, and sufficient liquidity due to Chile´s Sovereign Wealth Fund (SWF). When copper prices were high, substantial fiscal savings were stored in the SWF, for use in case of a downturn. The value of the SWF currently amounts to USD 22.3 billion, or 9.2% of GDP. The Chilean business environment is one of the best in the region and the government continues to stimulate foreign investment. Chile´s banking sector is healthy, well-regulated and sufficiently capitalised, with low nonperforming loans (about 2% on average). Good access to foreign and domestic capital by local companies reduces the refinancing risk.

Colombia

Main import sources (2014, % of total)	
USA:	28.5 %
China:	18.4 %
Mexico:	8.2 %
Germany:	4.0 %
Brazil:	3.9 %

Main export markets (2014, % of total)	
USA:	26.4 %
China:	10.5 %
Panama:	6.6 %
Spain:	6.0 %
India:	5.0 %

Key indicators	2013	2014	2015	2016*	2017*
Real GDP (y-on-y, % change)	4.9	4.6	2.8	2.1	3.1
Consumer prices (y-on-y, % change)	2.0	2.9	5.0	5.7	3.6
Real private consumption (y-on-y, % change)	3.8	4.4	3.3	3.7	2.8
Retail sales (y-on-y, % change)	1.9	6.5	3.9	6.7	2.8
Industrial production (y-on-y, % change)	-1.3	1.5	0.3	-0.1	1.7
Unemployment rate (%)	9.7	9.1	9.0	9.4	9.3
Real fixed investment (y-on-y, % change)	6.0	10.9	2.9	3.0	2.3
Fiscal balance (% of GDP)	-0.4	-2.3	-4.1	-3.7	-3.4
Export of goods and non-factor services (y-on-y, % change)	5.3	-1.7	-0.5	-0.1	3.8

* forecast Source: IHS

Colombia industries performance outlook

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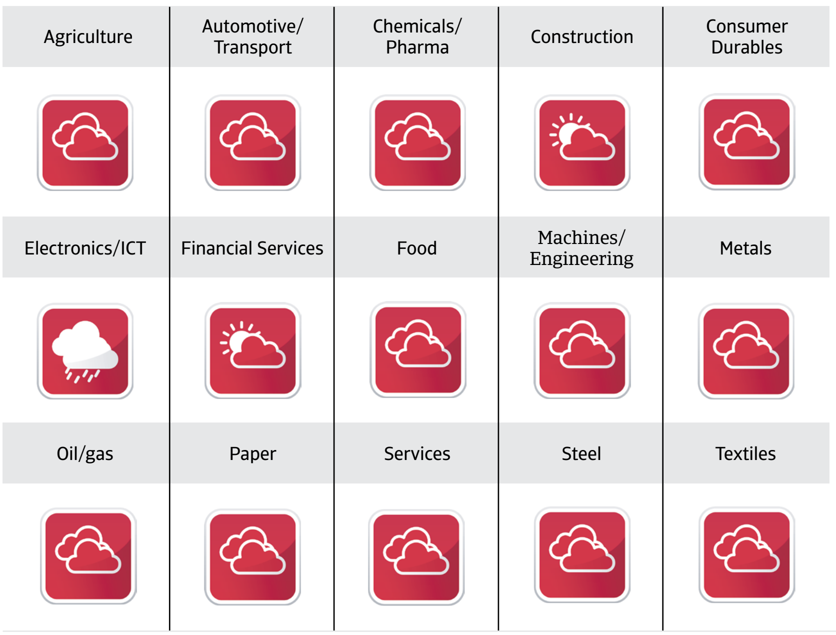
March 2016



Political situation

Head of state/government:
President Juan Manuel Santos (since August 2010; re-elected in 2014)

Government type:
Republic

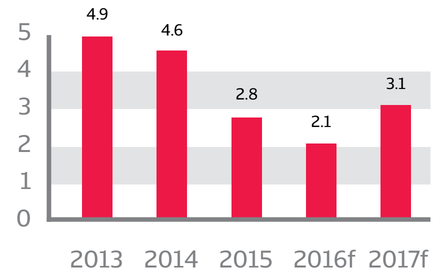
Population:
48.2 million (est.)

A comprehensive peace accord on the horizon

For more than five decades Colombia's state authority has been challenged by (drug-financed) guerrilla groups. However, at the end of 2015 the Colombian government and the main guerrilla group FARC reached an agreement to conclude a decisive peace accord. A final settlement is expected in March 2016, followed by the demobilisation of the FARC forces. This would be a milestone improvement of the country´s security situation. However, domestically the government is widely criticised due to some major concessions it made (e.g. that FARC leaders accused of war crimes would only face minor punishment after a final settlement).

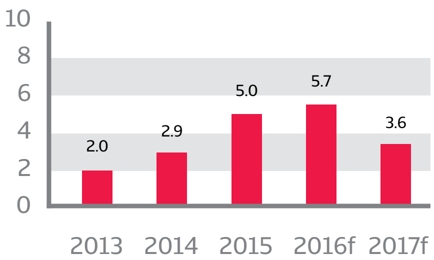
Economic situation

Real GDP growth (y-on-y, % change)



Source: IHS

Consumer prices (y-on-y, % change)



Source: IHS

Under pressure from lower oil prices

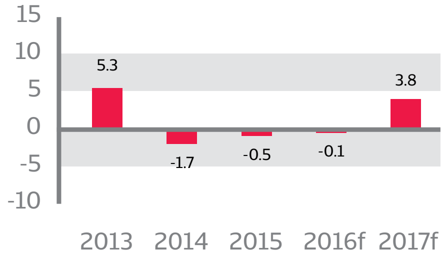
In 2015 Colombia´s GDP growth slowed down due to decreasing commodity prices (commodities like coal and oil account for 80% of Colombian exports, with oil alone accounting for more than 55%). That said, the slowdown is expected to be partly offset by government investments in infrastructure, a further improving business climate and a growing middle class. In 2016 and 2017 the economy is expected to grow 2.1% and 3.1% respectively. However, poverty and unemployment remain high.

In recent years sound economic policies have contributed to higher earnings capacity and economic resilience. The fiscal deficit is widening due to lower oil revenues, but not to a very large extent, and while government debt is rising, sustainability is not at risk. Sound fiscal management has reduced exchange rate, refinancing and interest rate risks.

Solid macroeconomic fundamentals and sound policy frameworks also indicate that Colombia is quite well positioned to deal with the challenge of continuously low commodity prices. The depreciation of the Colombian peso in response to tumbling commodity prices since 2014 has helped to absorb any potential economic shocks. Managed currency floating is supported by a limited dollarization of the economy and modest external debt (34% of GDP in 2015). The peso is expected to gradually weaken further in coming years.

Inflation increased 5% in 2015, triggered by the currency depreciation. The Central Bank has repeatedly increased the benchmark interest rate to contain inflation since September 2015, to 6% in January 2016. That said, inflation is expected to increase further in 2016.

Export of goods and non-factor services (y-on-y, % change)



Source: IHS

Solid external fundamentals

Colombia's external economic position is solid. While foreign debt is increasing, also on the back of the currency depreciation, it remains modest. The international liquidity position is sound, with international reserves amounting to more than nine months of import cover, sufficient to cover the external financing requirement. Official reserves are underpinned by a precautionary IMF Flexible Credit Line of USD 5.8 billion. The current account deficit is expected to decrease only slightly in 2016, as the effect of the peso weakening will be largely offset by import demand. The deficit can be easily financed by capital inflows, especially foreign direct investments. Stable investment grade ratings and excellent payment records allow Colombia to easily access international capital markets.

Despite significant economic progress, Colombia still has high rates of poverty and inequality, especially in rural areas. In order to achieve sustainable long-term economic growth, job growth promotion, social reforms and infrastructure improvement would be necessary.

Atradius
Managing risk, enabling trade

Peru

Main import sources (2014, % of total)	
China:	21.2 %
USA:	20.9 %
Brazil:	4.7 %
Mexico:	4.6 %
Ecuador:	4.2 %

Main export markets (2014, % of total)	
China:	18.3 %
USA:	16.2 %
Switzerland:	6.9 %
Canada:	6.6 %
Japan:	4.1 %

Key indicators	2013	2014	2015	2016*	2017*
Real GDP (y-on-y, % change)	5.7	2.4	2.5	2.8	3.1
Consumer prices (y-on-y, % change)	2.8	3.2	3.5	4.0	2.5
Real private consumption (y-on-y, % change)	5.3	4.1	3.1	3.8	3.5
Industrial production (y-on-y, % change)	4.9	-3.6	-2.0	0.7	2.5
Unemployment rate (%)	6.0	6.0	6.3	6.5	6.5
Real fixed investment (y-on-y, % change)	7.7	-2.1	-6.2	2.4	3.5
Fiscal balance (% of GDP)	2.0	0.9	-1.5	-3.5	-2.9
Export of goods and non-factor services (y-on-y, % change)	-1.5	-0.8	0.7	0.7	1.8

* forecast Source: IHS

Peru industries performance outlook

Excellent:
The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend.

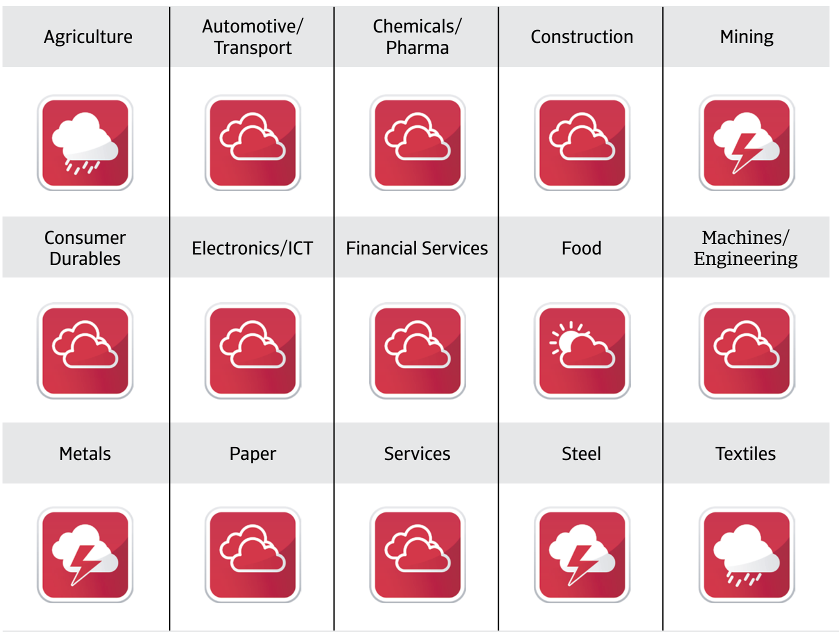
Good:
The credit risk situation in the sector is benign / business performance in the sector is above its long-term trend.

Fair:
The credit risk credit situation in the sector is average / business performance in the sector is stable.

Poor:
The credit risk situation in the sector is relatively high / business performance in the sector is below long-term trend.

Bleak:
The cedit risk situation in the sector is poor / business performance in the sector is weak compared to its long-term trend.

March 2016



Political situation

Head of state/government:
President Ollanta Humala
(since July 2011)

Government type:
Republic

Population:
31.9 million (est.)

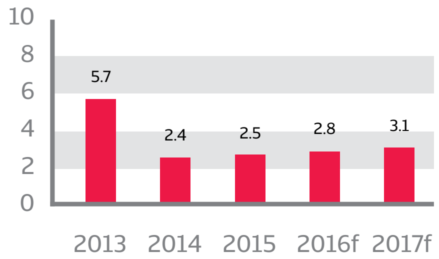
Institutional weaknesses and social conflicts persist

The government headed by former army officer Ollanta Humala continues to face a series of challenges, including rising tensions with the opposition, in-fighting within the ruling Gana Perú coalition and on-going corruption scandals. Institutional weaknesses still hamper governability and necessary social reforms. Next presidential and parliamentary elections to be held in April 2016.

Despite remarkable economic progress made in the last few years, the country still has to cope with high poverty and very large income inequality, especially between the coastal and the heartland regions. There are still social conflicts flaring up, mainly in the vital mining sector. The lack of effective state control in some remote areas remains a challenge for the government, enabling illegal business activities (contraband trade, coca-leaf farming), and some radical groups to cause social unrest and to disrupt business.

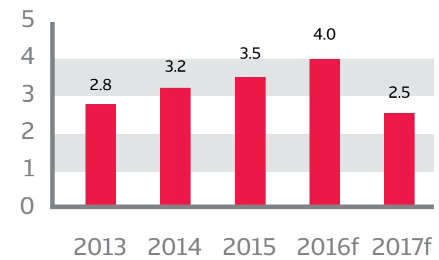
Economic situation

Real GDP growth
(y-on-y, % change)



Source: IHS

Consumer prices
(y-on-y, % change)



Source: IHS

Growth expected to pick up again in 2016

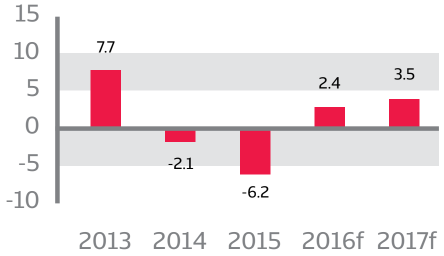
Peru's small, open economy is highly dependent on minerals (copper, gold, oil and gas), which account for more than 60% of exports. Due to this dependence and a large informal economy (more than 50% of the workforce), high corruption and poor governance in the public sector, Peru´s economic structure is rather weak.

After recording high annual GDP increases between 2010 and 2013 growth slowed down since 2014, mainly as a result of decreased commodity prices. However, due to prudent economic and fiscal policies during the boom years with regular budget surpluses, the government has room to stimulate growth with higher spending on capital investments (e.g. two mega mining projects and public sector infrastructure projects) and social programmes. This is accompanied by robust consumer demand. The Peruvian economy is expected to increase 2.8% in 2016 and 3.1 % in 2017.

In 2014 and 2015 inflation increased above the Central Bank´s target rate of 1%-3%, and is expected to increase further in 2016, despite a tighter monetary policy.

Peru's liquidity situation is very strong, with international reserves amounting to about 16 months of import cover. Solvency is under control, despite increased external borrowing by the private sector, as debt service is manageable at 15%. The current account deficits are moderate and to a large extent, but no longer fully, covered by foreign direct investments in the mineral/mining sector. The solid liquidity and solvency ratio bolster Peru´s resilience against external economic shocks.

Real fixed investment (y-on-y, % change)



Source: IHS

Some risks persist

Main risks to Peru´s economic outlook are a hard landing of the Chinese economy and growing social unrest in the mining sector, which would negatively affect the investment climate. At the same time, Peru's small, but well-capitalised and supervised financial sector is highly dollarized (i.e. the US dollar is preferred in large transactions and in savings), leaving it exposed to potential currency risks.

To sustain high growth rates going forward, the government needs to step up structural reforms, such as reducing state bureaucracy, strengthening the judicial system, reducing the rigidity of the labour market, and improving infrastructure/education.

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Atradius N.V.
David Ricardostraat 1– 1066 JS Amsterdam
Postbus 8982 – 1006 JD Amsterdam
The Netherlands
Phone: +31 20 553 9111
info@atradius.com
www.atradius.com