

# Challenges for the Monetary Policy Implementation in Peru in a Context of Capital Outflows

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Central Reserve Bank of Peru

XII Central Banking Operations Meeting  
June 2022



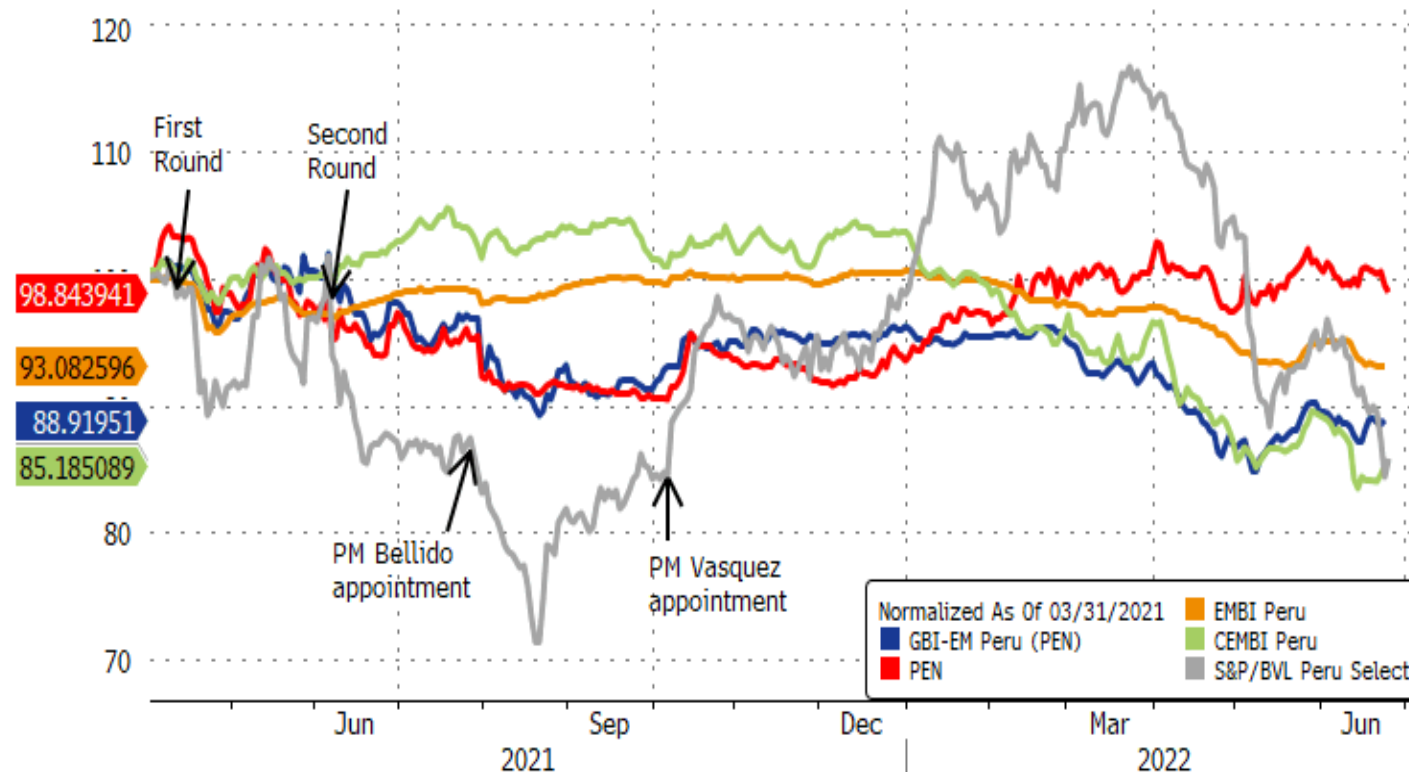
BANCO CENTRAL DE RESERVA DEL PERÚ

100 años

Castillo's victory surprised market participants. Local assets underperformed their peers between April and September, while dollar denominated bonds were more stable. Peruvian assets recovered after Vasquez was appointed prime minister.

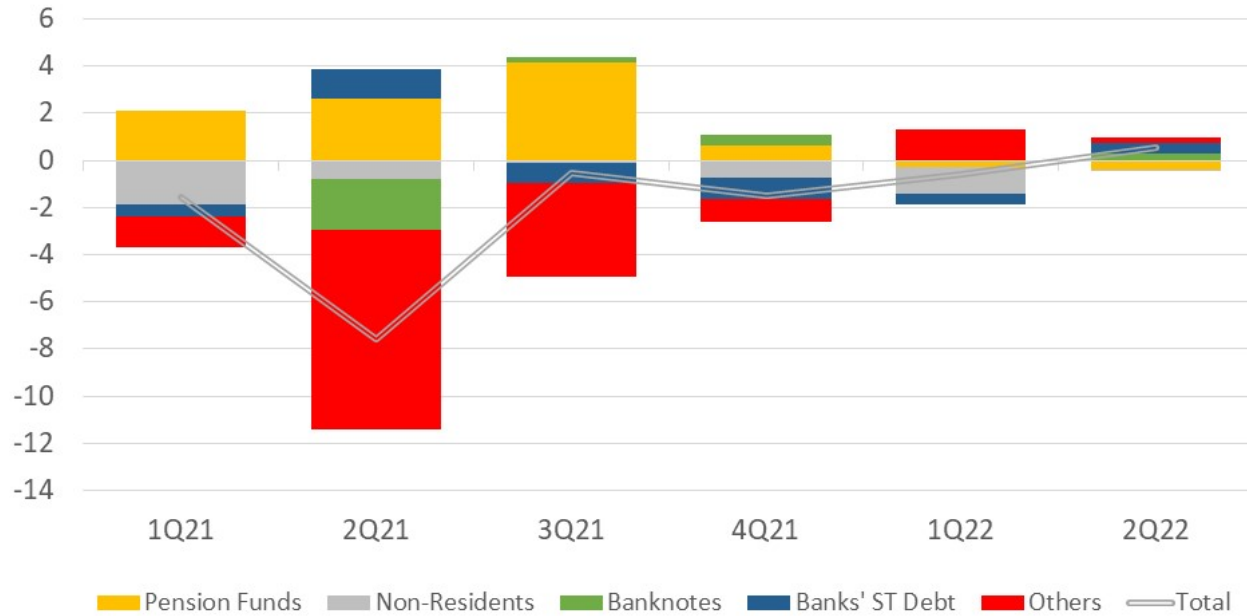
### Performance of Peruvian Assets

March21 = 100

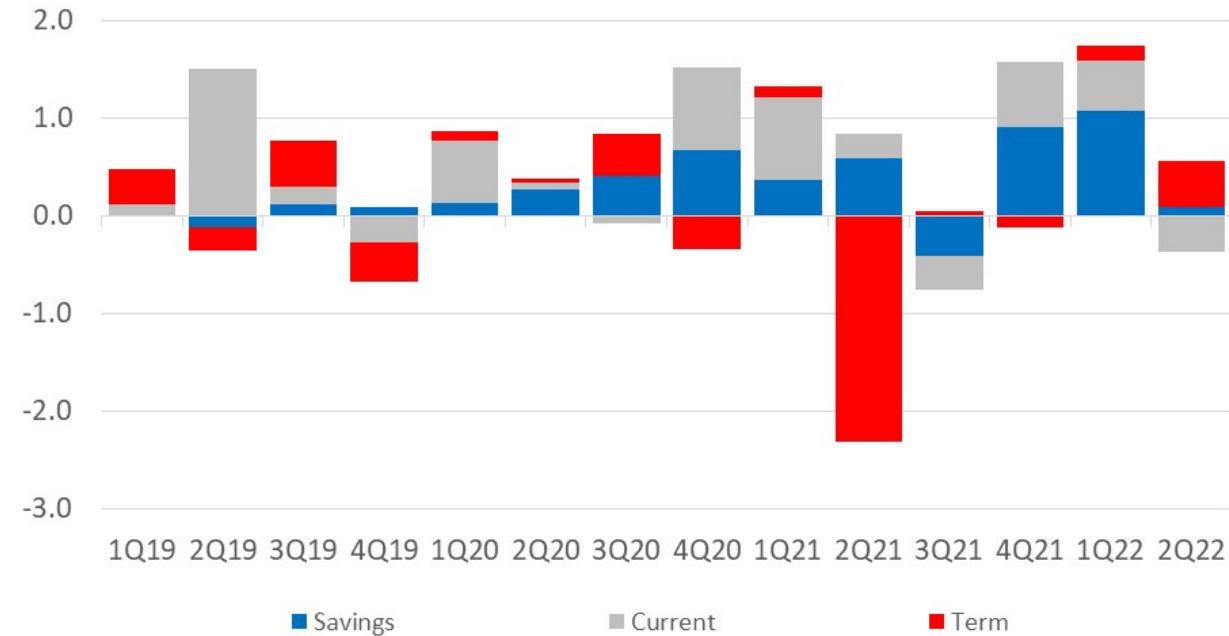


Political uncertainty triggered massive capital outflows from non-financial local entities that reached USD 15 billion during 2021, concentrated between March and September. Other locals increased their USD deposits, but this was not significant compared to outflows. Local Banks had to import USD banknotes as cash withdrawal increased.

Net transfers of money from abroad through the banking system  
(USD billions)

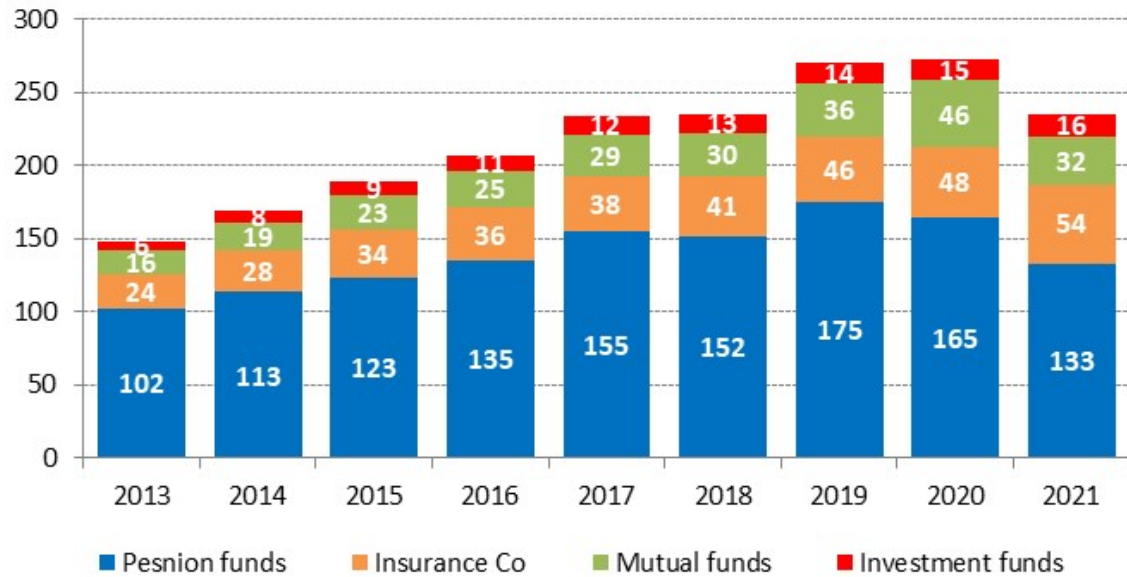


Quarterly change in USD deposits in the banking system  
(USD billions)

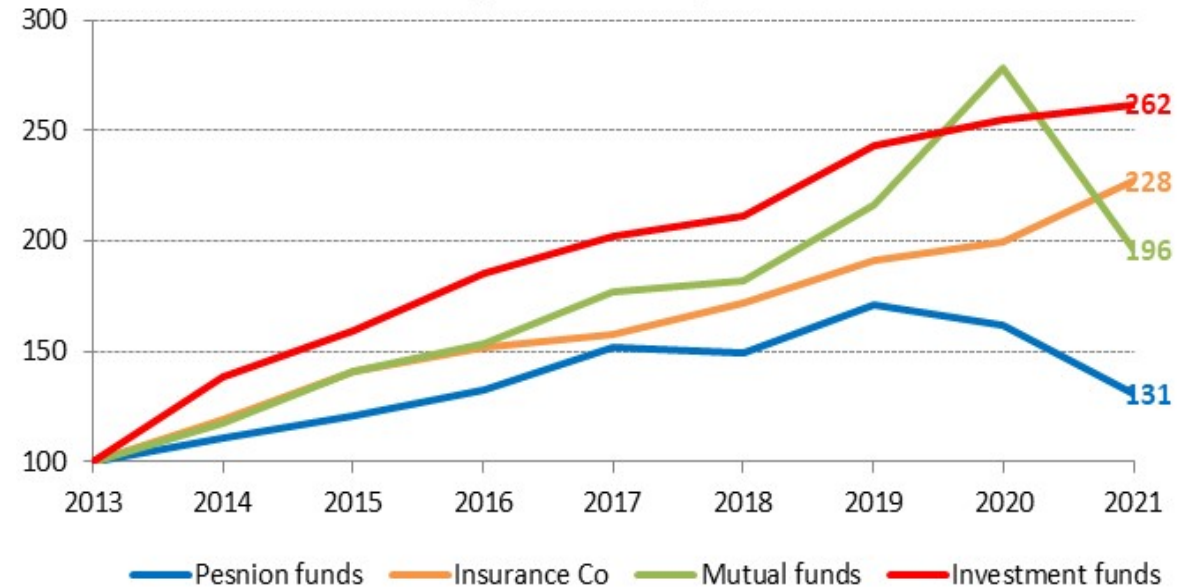


Institutional investors faced withdrawals. Congress approved the sixth pension funds withdrawal equivalent to 20% of AUM, putting pressure on the market. Political uncertainty also prompted mutual funds redemptions of 30% of AUM, mainly PEN denominated.

**AUM by local institutional investors**  
(PEN billions)

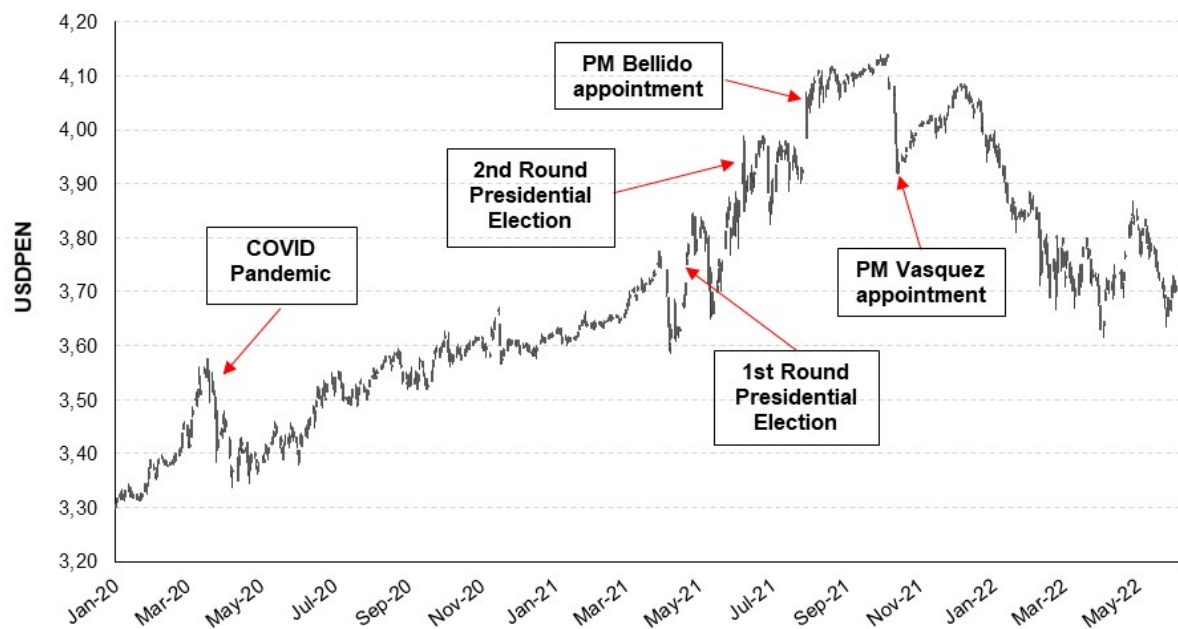


**AUM normalized**  
(Base = Dic 2013)



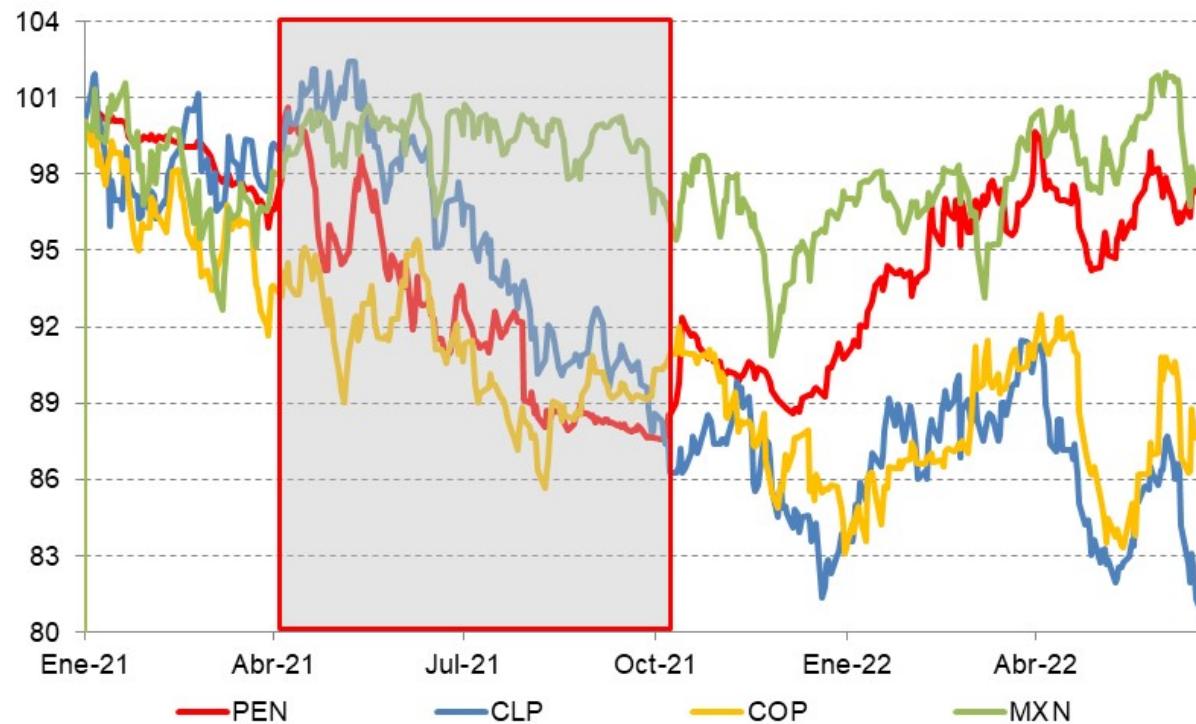
Unlike past episodes of political instability, 2021 elections raised fears of changes to the legal framework. PEN experienced increased volatility; however, performance was close to its peers.

USDPEN Exchange Rate Evolution



Latam FX versus USD

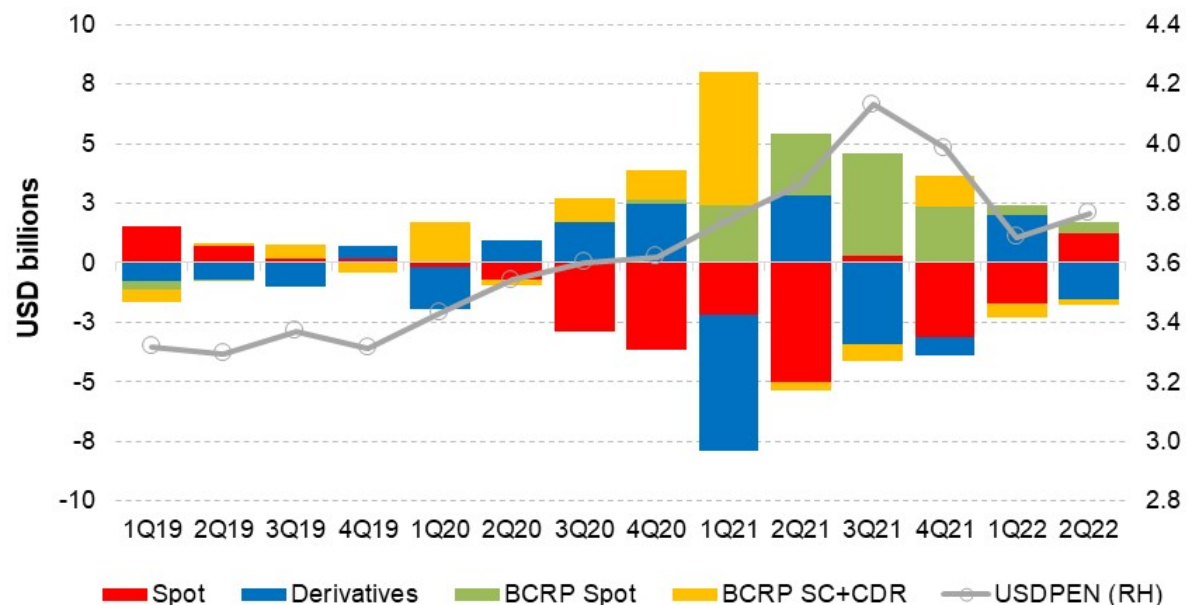
31Dec20 = 100



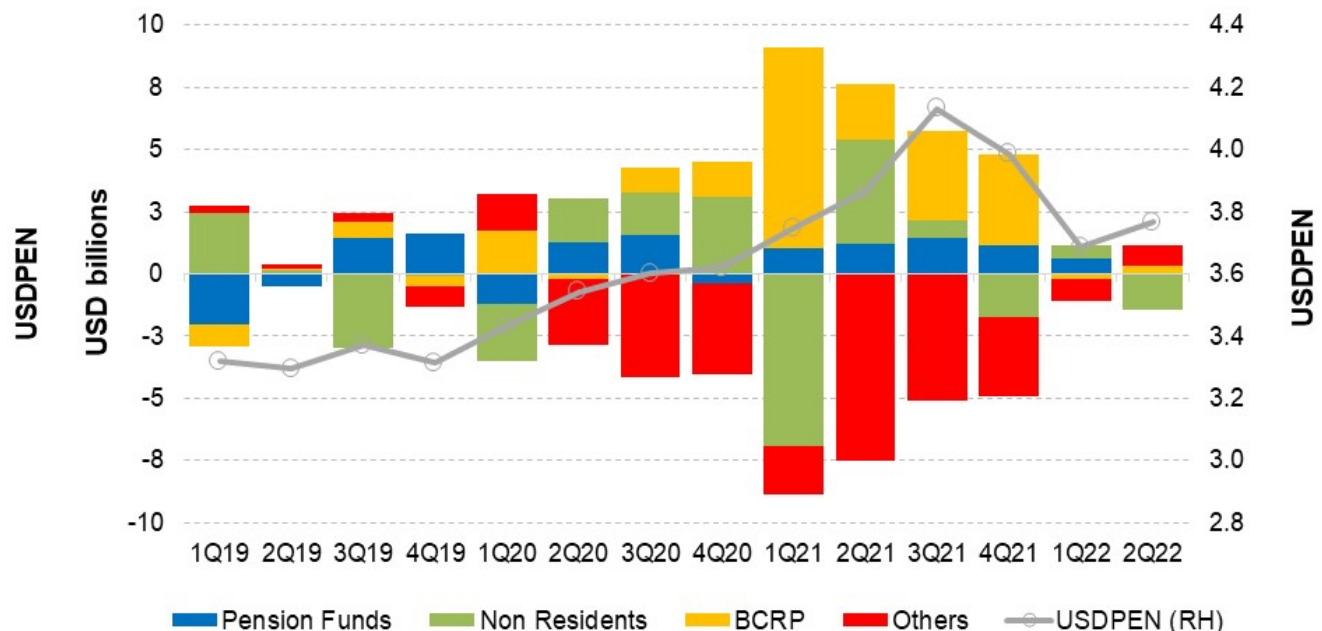
Source: Bloomberg

During 2020, BCRP participated in the FX market mainly through derivatives. During 2021, BCRP used a combination of spot and derivatives matching the source of the FX demand. BCRP sold a record USD 11,6 billion in the spot market in order to offset capital outflows. Main buyers were local non-financial entities. However, NIR increased USD 3.8 billion in 2021.

FX net Inflows by market



FX net inflows by participant



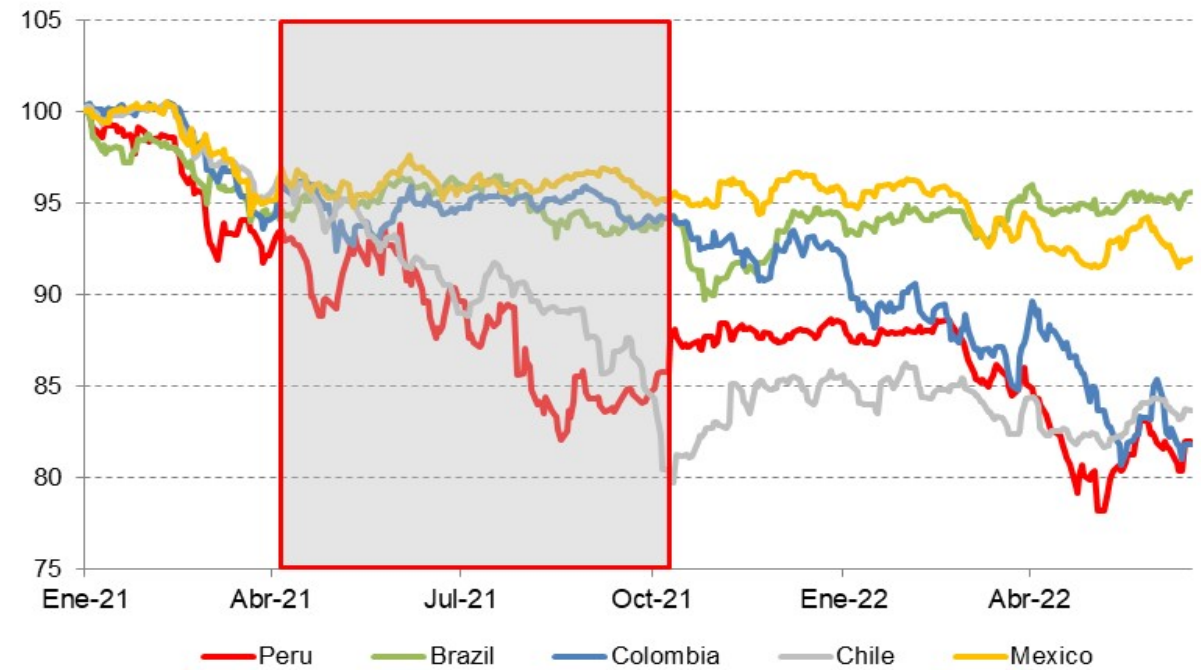
Market participants were nervous due to elections, Treasuries (BTP) sell-off in Q1 2021 and the new pension fund withdrawal. Moreover, local banks had increased their BTP holdings by PEN 8 billion (66%) in 2020, so there were doubts about their capacity to buy more BTP. As a result, BTP market underperformed its peers during Q2 2021.

YTM of Generic BTP vs Policy Rate



GBI-EM Index (Local Currency)

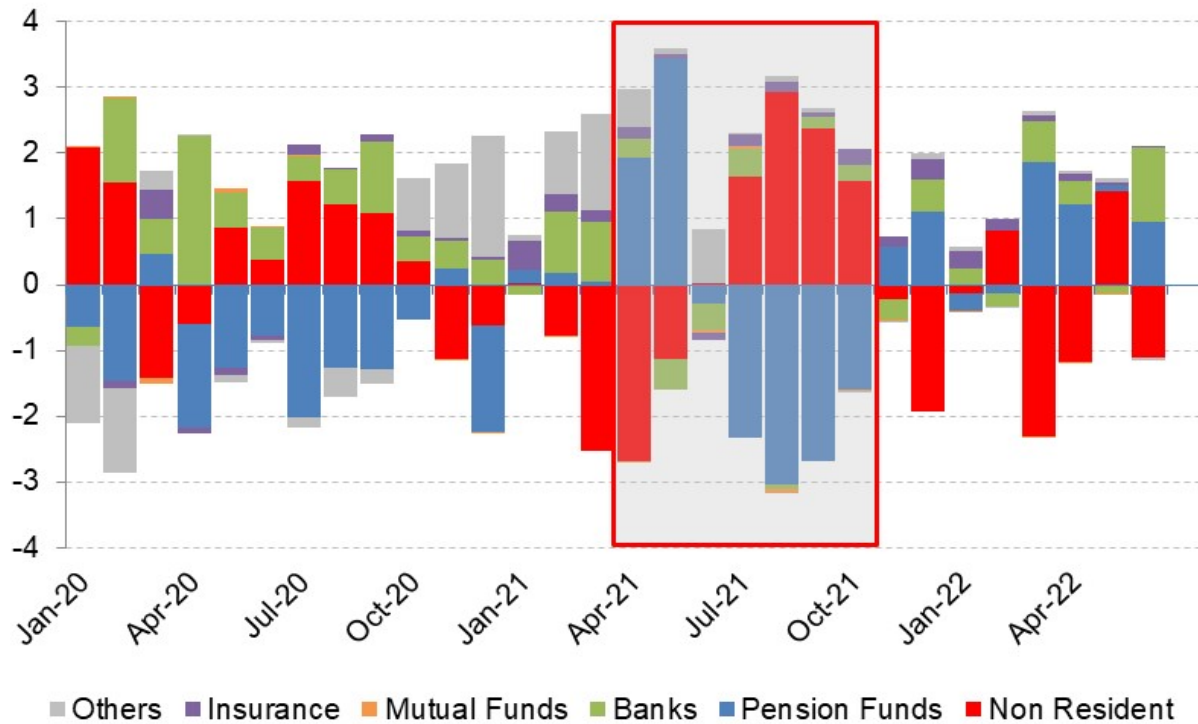
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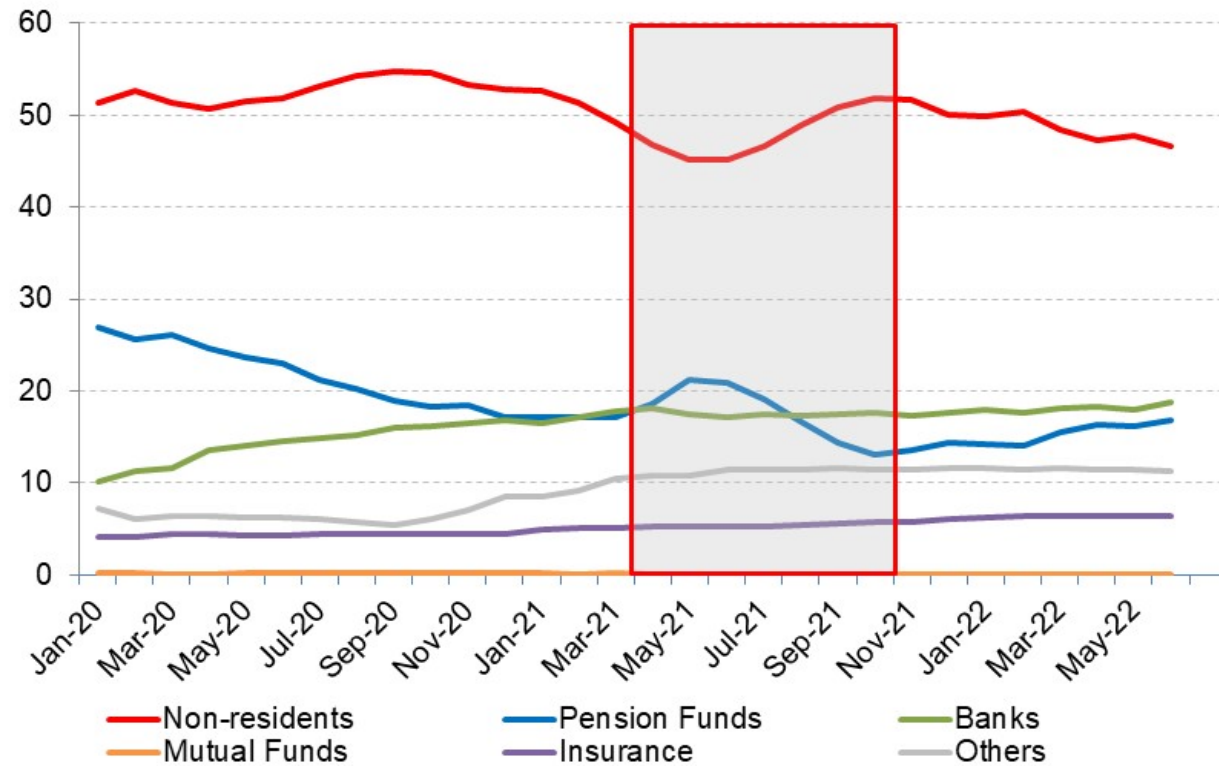
Source: Bloomberg

BCRP announced a repo facility for pension funds. This allowed fund managers to buy BTP before the first round of withdrawals to absorb non-residents supply. The BCRP also bought BTP in the secondary market before the second round. Non-residents returned to the market once BTP' yields touched multi-year maximums and once they were confident no extreme change would take place in Peru.

**Monthly Change in Nominal Holding of BTP by Investor**  
(PEN Billions)

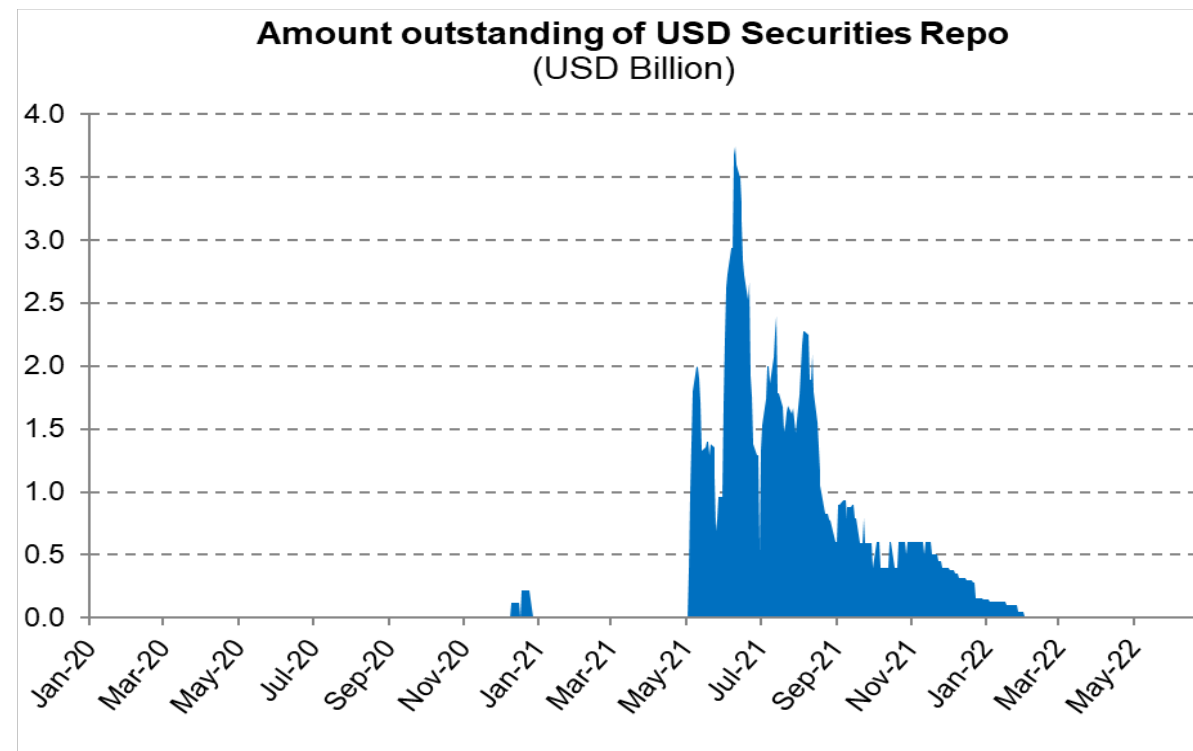
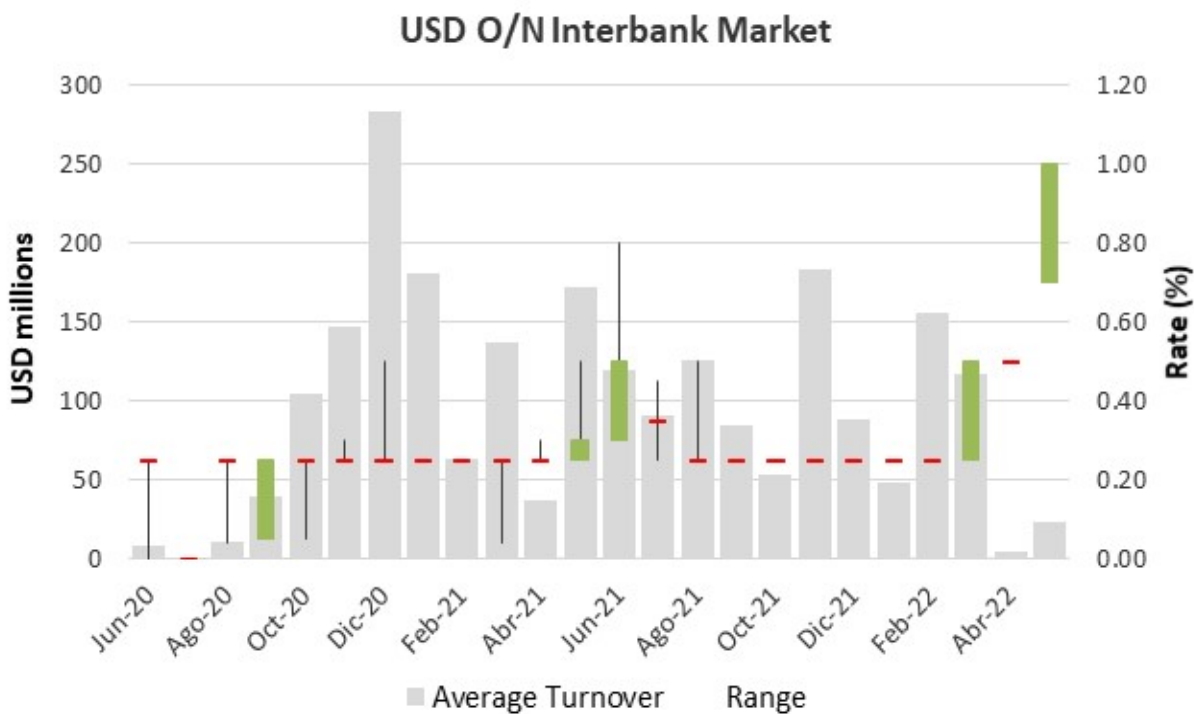


**Participation in BTP holdings by Investor type**



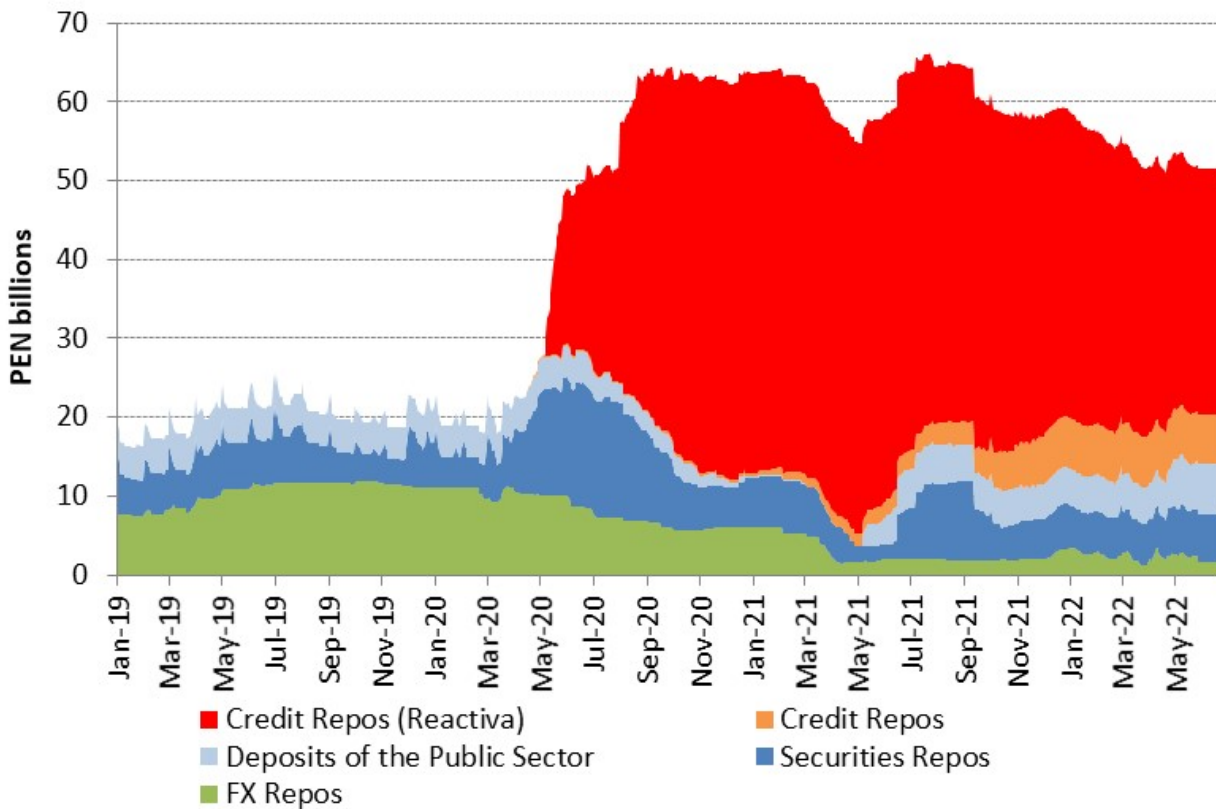


Banks had plenty of USD liquidity before elections. However, capital outflows changed the landscape. Banks had to take short term foreign loans and BCRP injected temporary USD liquidity through repos. Finally, BCRP's spot intervention injected permanent USD liquidity.

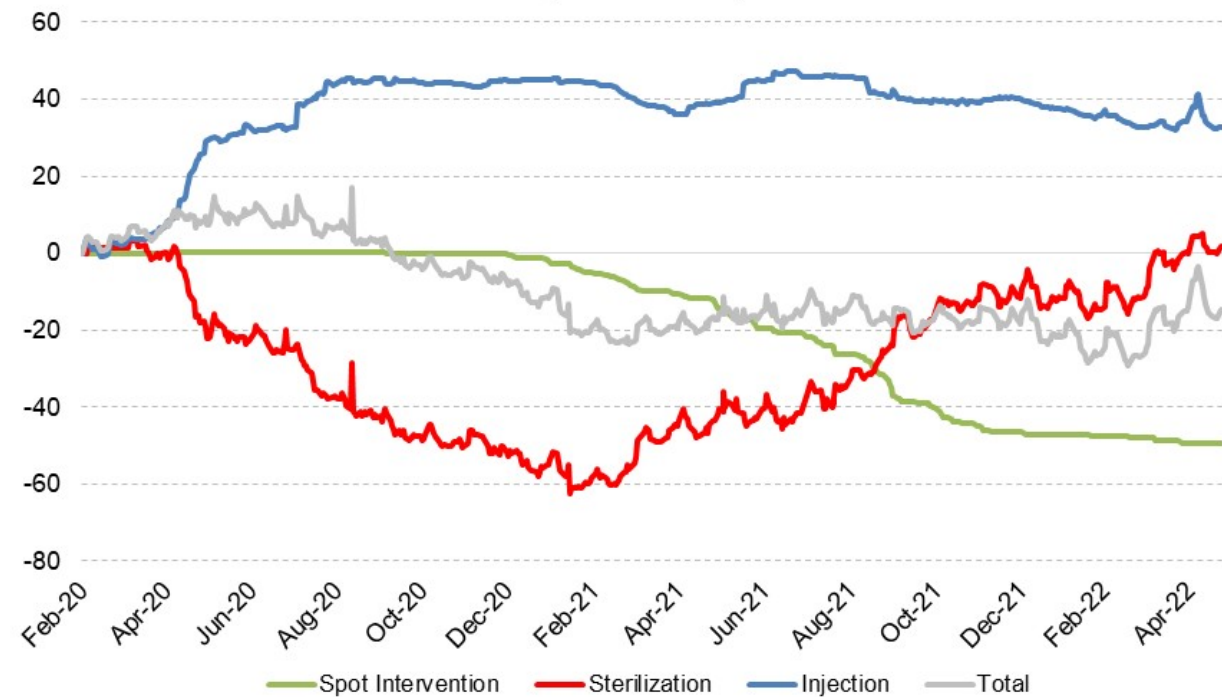


Local Currency liquidity from “guaranteed repos” was sterilized with deposits and securities issued by BCRP. However, this liquidity has been decreasing along with the amortization of Reactiva loans. On the other hand, FX spot intervention reduced local currency liquidity. BCRP injected liquidity with credit repos and Treasury deposits auctions.

Amount outstanding of injection operations

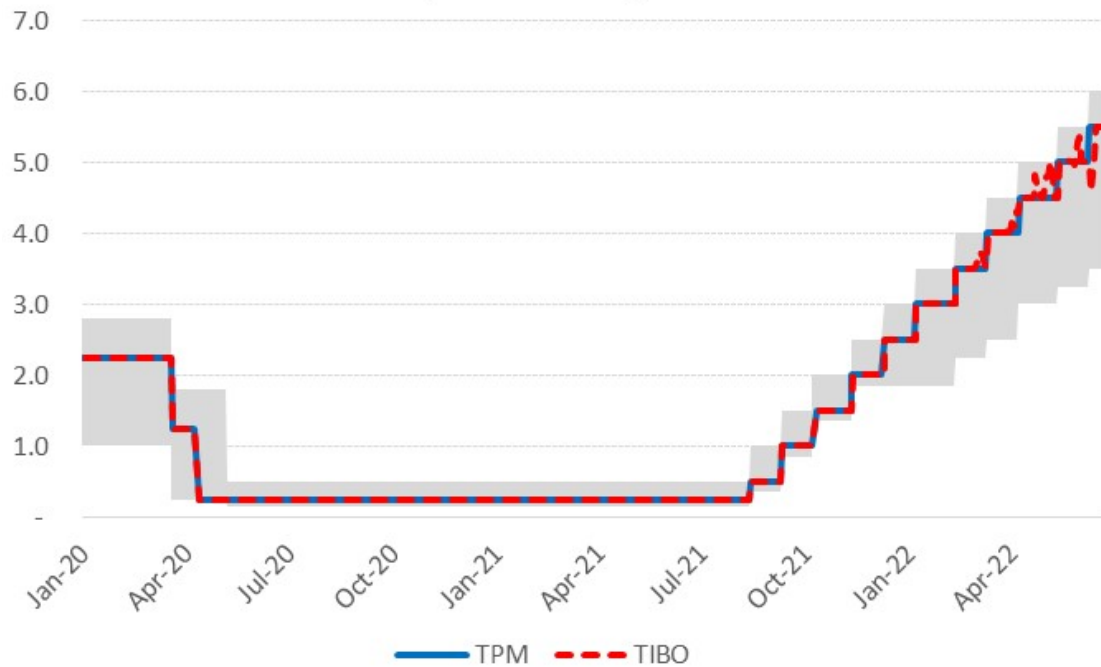


Impact on PEN Liquidity from BCRP's Operations (PEN Billions)

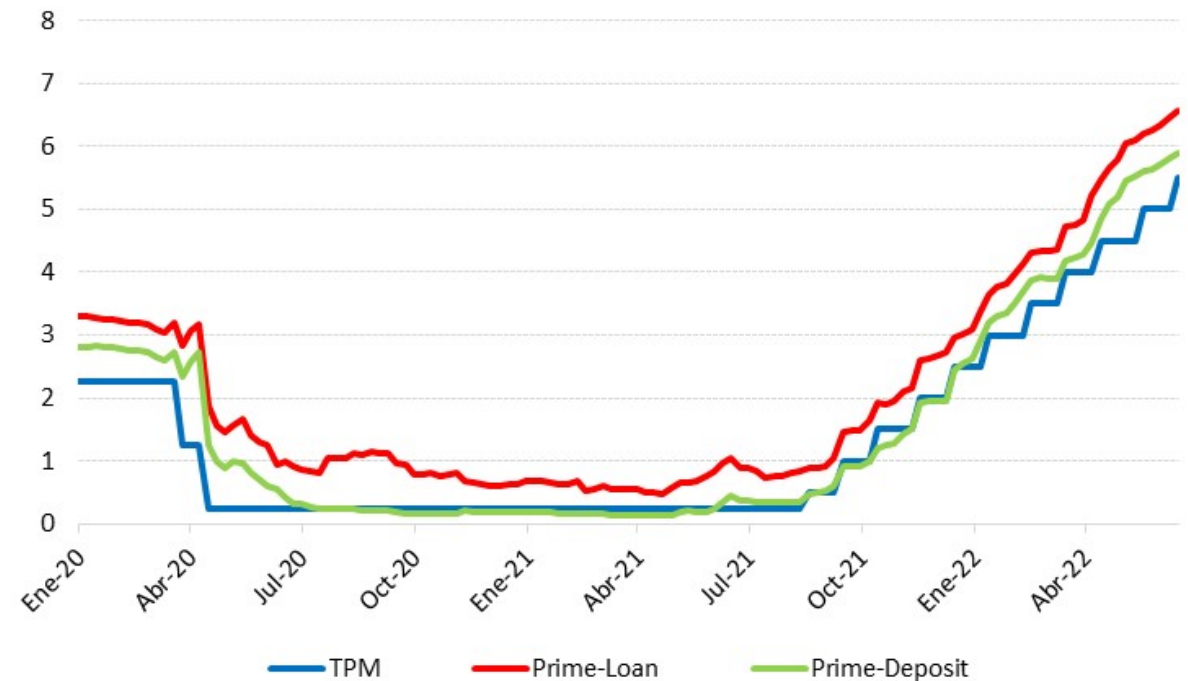


The interbank rate remained at the level of the policy rate. Short term deposit rates were stable, while loan rates increased due to higher risk perception.

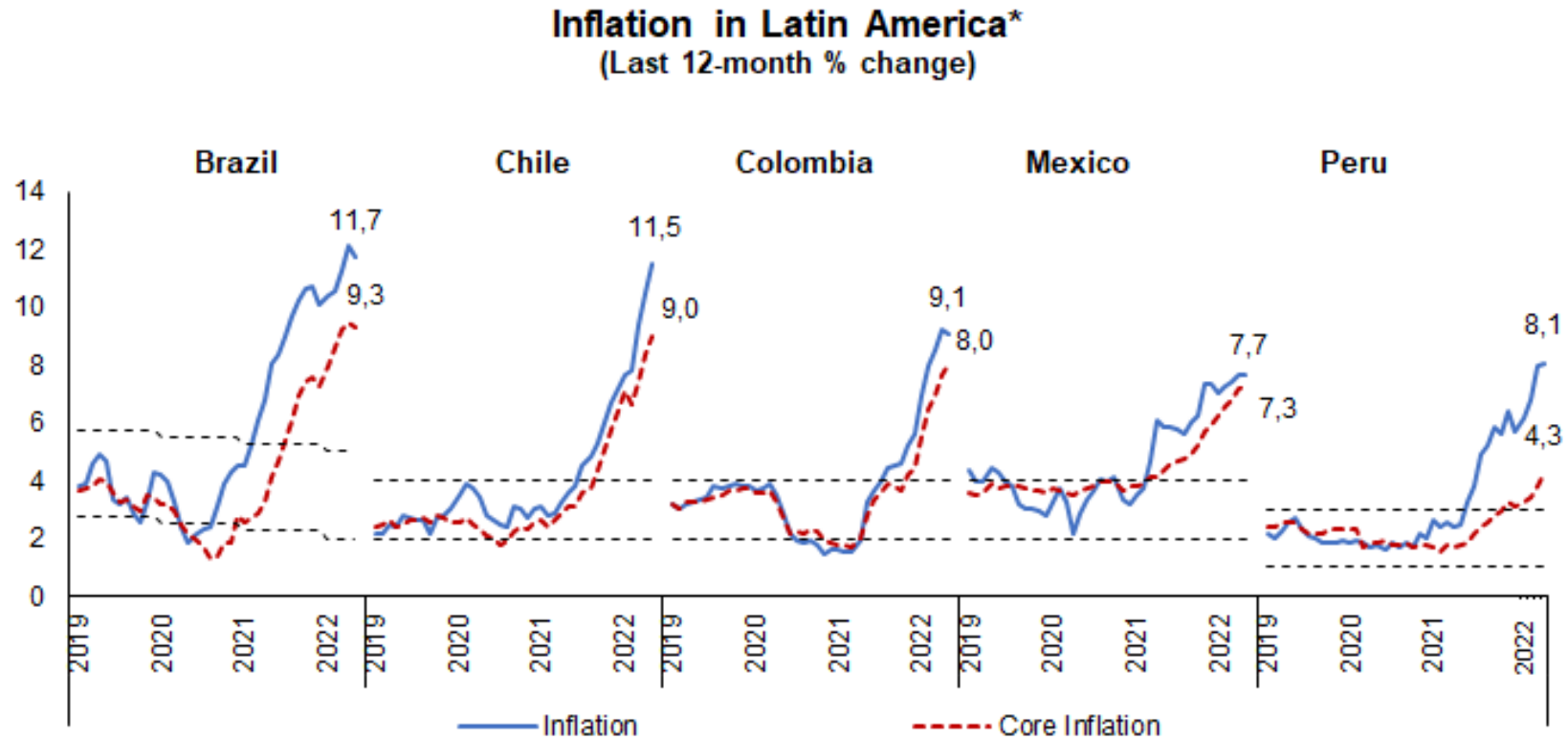
Policy Rate vs Average Interbank Rate



Policy Rate vs 3M Prime Rates



Inflation has been trending higher in Peru since the Q2 2021 due to FX depreciation and increasing commodity prices. Inflation in Peru and Latam are far above their targets.



\*Last data available corresponds to May 2022

One-year ahead inflation expectations is at 4.89%, above the upper limit of the inflation target range. Local agents expect inflation to converge to BCRP's target in 2024.



\* Corresponds to the average on expectations of financial entities and economic analyst.

Survey of Macroeconomic Expectations: Inflation (%)

|   | Survey date |          |        |   |
|---|-------------|----------|--------|---|
|   | March 31    | April 30 | May 31 |   |
| <b>Economic analyst<sup>1/</sup></b>    |             |          |        |   |
| 2022                                    | 5,00        | 5,50     | 6,00   | ↑ |
| 2023                                    | 3,10        | 3,20     | 3,80   | ↑ |
| 2024                                    | 3,00        | 3,00     | 3,00   | = |
| <b>Financial entities<sup>2/</sup></b>  |             |          |        |   |
| 2022                                    | 4,50        | 5,00     | 5,50   | ↑ |
| 2023                                    | 3,50        | 3,50     | 3,55   | ↑ |
| 2024                                    | 3,00        | 3,10     | 3,00   | ↓ |
| <b>Non-financial firms<sup>3/</sup></b> |             |          |        |   |
| 2022                                    | 4,20        | 5,00     | 5,80   | ↑ |
| 2023                                    | 3,50        | 4,00     | 4,00   | = |
| 2024                                    | 3,20        | 3,50     | 3,80   | ↑ |

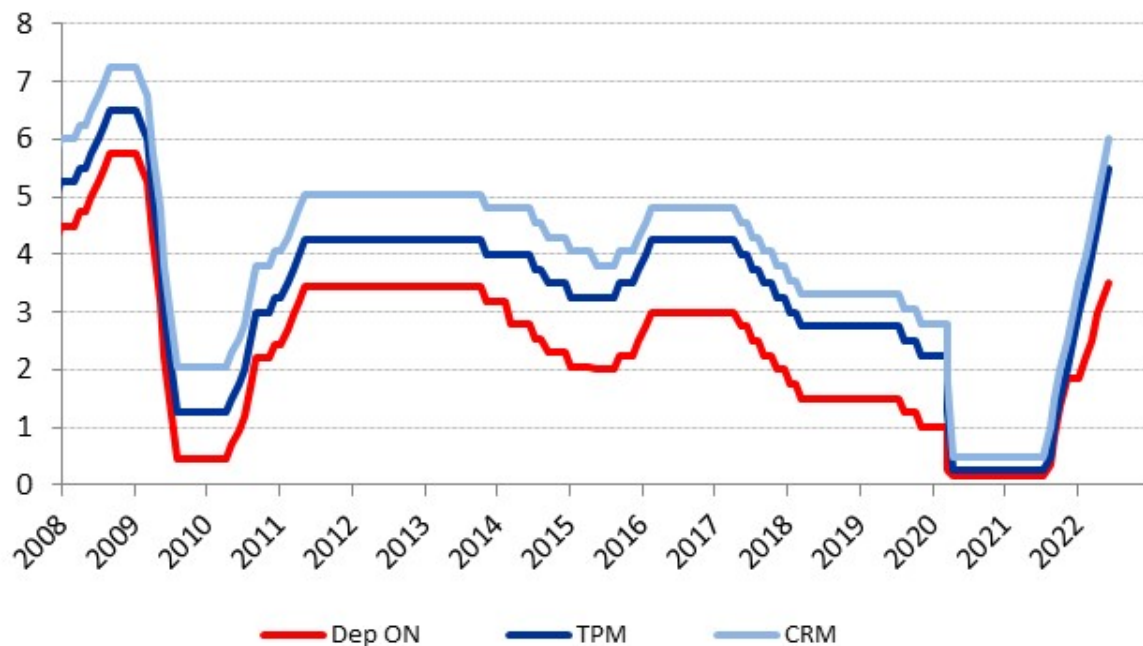
<sup>1/</sup> 21 analyst in March, 17 in April and 19 in May 2022.

<sup>2/</sup> 15 financial entities in March, 15 in April and 14 in May 2022.

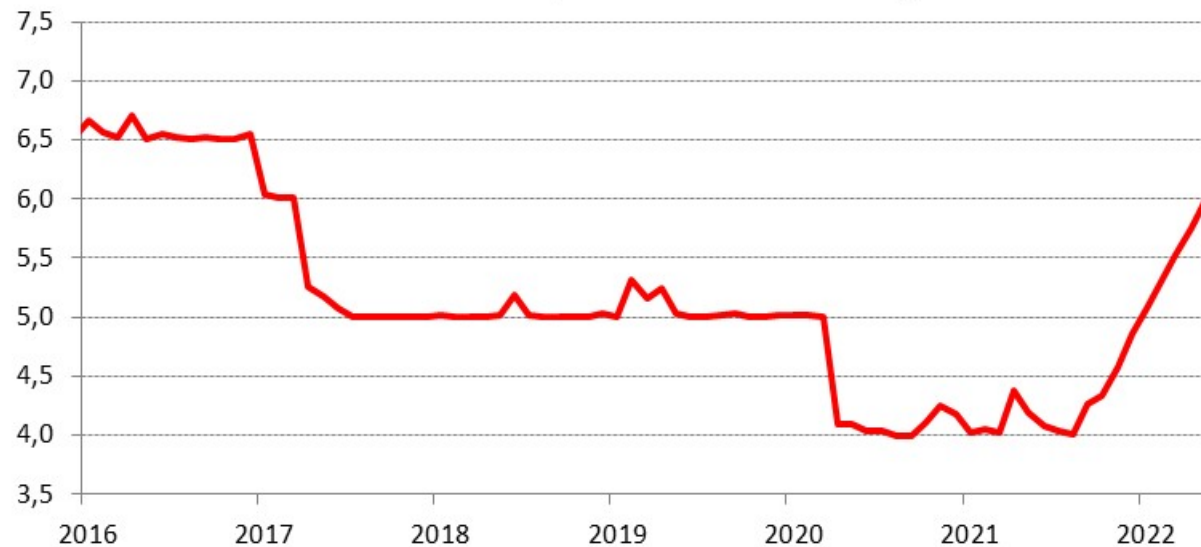
<sup>3/</sup> 295 non financial firms in March, 294 in April and 295 in May 2022.

BCRP started its tightening cycle in August 2021. Since then, it has raised its policy rate by 525 bps and increased the reserve requirement in local currency by 2% in order to curb inflation and to avoid the de-anchoring of inflation expectations.

Policy Rate

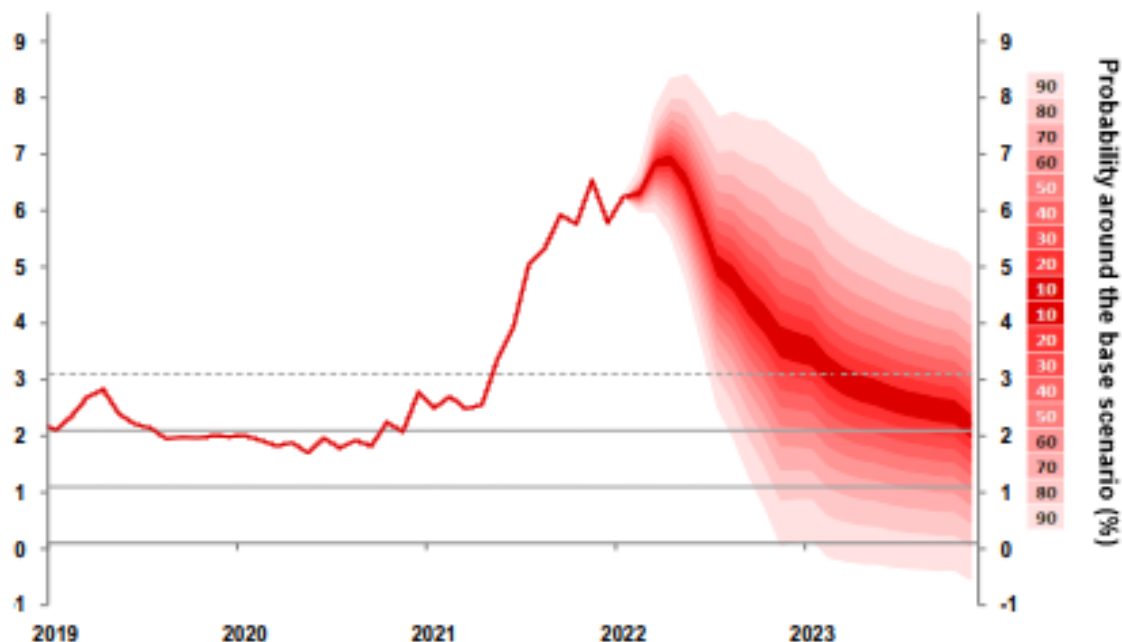


Reserve Requirement in Local Currency



BCRP expects inflation to return to the target range between the second and the third quarter of 2023. The downward path is expected to begin in July, as the transitory pressures (exchange rate and international fuel and grain prices) begin to recede, with economic activity still below potential. BCRP's projections for Peru's inflation are the lowest among peers.

**Inflation Forecast: 2022-2023**  
(Last 12 month % change)



**Projections 2022-2023**

|                        | Inflation (%) |      | GDP (%)     |            |
|------------------------|---------------|------|-------------|------------|
|                        | 2022          | 2023 | 2022        | 2023       |
| Brasil <sup>1/</sup>   | 8,8           | 4,0  | 1,0         |            |
| Chile <sup>1/</sup>    | 10,8          | 5,0  | 1,50 - 2,25 | -1,0 - 0,0 |
| Colombia <sup>2/</sup> | 7,1           | 4,8  | 5,0         | 2,9        |
| México <sup>1/</sup>   | 7,5           | 3,5  | 2,2         | 2,4        |
| Perú <sup>3/</sup>     | 6,4           | 2,5  | 3,1         | 3,2        |

<sup>1/</sup> Monetary Policy Minutes of June 2022

<sup>2/</sup> Monetary Policy Minutes of April 2022

<sup>3/</sup> Inflation Reporte June 2022

## Final Remarks

- Unlike past episodes of political instability, 2021 elections raised fears of changes to the legal framework that prompted local assets underperformance and capital outflows.
- BCRP used a combination of spot and derivatives intervention matching the source of the FX demand. In 2021, FX demand in the spot market came from non-financial local entities, so BCRP sold a record USD 11.6 billion in order to reduce excessive volatility.
- BTP performance was also affected by pension fund withdrawals. BCRP announced a repo facility for pension funds and bought BTP in the secondary market before the second round of withdrawals.
- Liquidity in PEN and USD were affected and BCRP used a combination of instruments to provide all the necessary liquidity in both currencies.
- BCRP is committed with monetary stability. It has raised its policy rate by 525 bps and increased the reserve requirement in local currency by 2% in order to curb inflation and to avoid the de-anchoring of inflation expectations.



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