

**Relative spreads to deteriorate further as politics remain unsupportive**

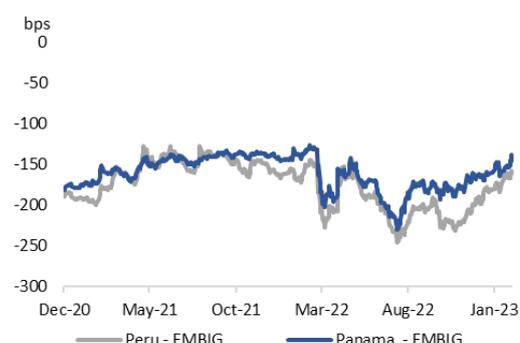
- We reaffirm our UW recommendation; we prefer Panama to Peru
- Congress is unlikely to ratify Boluarte’s empty “new” proposals
- Crisis of representation with no end in sight
- Weaker fundamentals will deepen the de-rating process already in place

**We reaffirm our UW recommendation on Peruvian bonds and prefer Panama to Peru.** Peru’s relative spreads (versus EMBIG) have increased consistently in the past few months as headwinds from domestic politics continue to mount. Unsupportive news has also dented the credit worthiness of Panama, another traditional safe haven in Latin America. These two names used to be almost indistinguishable from a trading perspective, offering almost identical spread levels in 2015-19 (see Table 1). Except for the period of the 2021 presidential elections, Peru has become mildly detached from Panama from 2019 onwards. However, recent political instability in Peru has been penalised more severely by investors than negative fiscal news in Panama, where we also see the de-rating story unfolding and hold an UW. Thus, there has been an accelerated convergence from below of Peru’s relative spreads to those of Panama (Chart 1). As we explain below, we do not see an easy solution to the Peruvian political crisis in the near-term. This could accelerate negative ratings actions, causing Peruvian relative risk to even exceed that of Panama in the case of severe political turmoil.

**Table 1. Relative Spreads: Peru vs. Panama**

	Panama	Peru
2015-2019	-210	-209
2019	-217	-228
2020	-212	-233
2021	-148	-155
2022	-172	-196
3-Feb-23	-142	-160

**Chart 1. Relative Spreads: Peru vs. Panama**



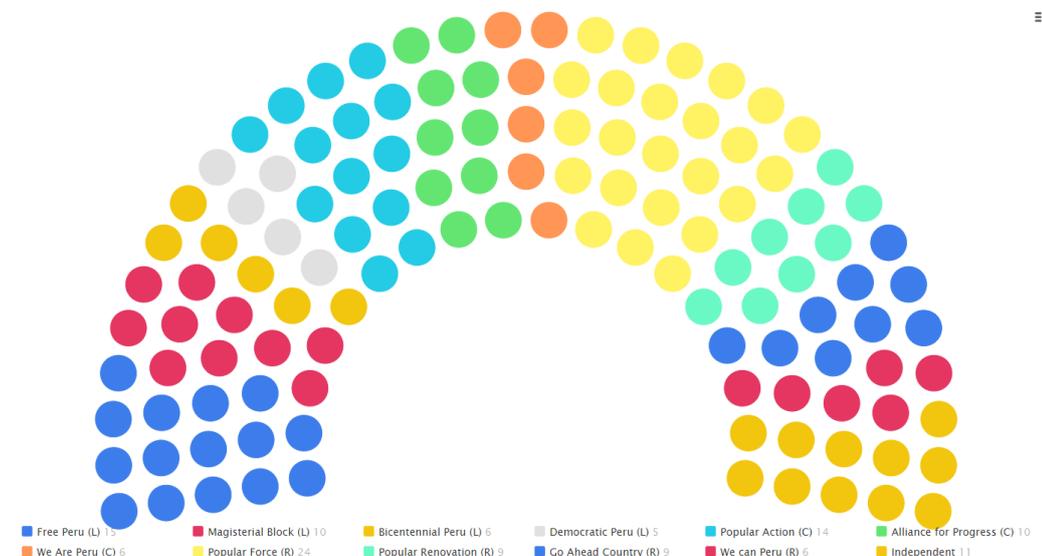
**What is behind the legislative refusal to accept the early elections bill?** We think that the persistent failure of Congress to pass a bill that allows for early elections has been driven by the opportunism of left-wing sectors. In this vein, lawmakers have conditioned moving forward the elections to holding a referendum on the need to

summon a Constituent Assembly -a long-time aspiration of leftist factions- on the same day of the ballot. Legislators have also been demanding the immediate resignation of President Boluarte. This could pave the way to unlock the political gridlock, since the President of Congress would be legally entitled to call for new elections. In tandem, legislators who oppose Boluarte would be able to showcase a political victory that they can use as an argument ahead of the general elections.

**Boluarte’s empty “new” proposals and possible exits to the crisis.** After the reiterated rejection of the reform bill to hold early elections last week, President Boluarte sent two “new” legislative proposals to Congress, which were presented by Justice Minister José Tello. The first one envisaged “a constitutional reform to inevitably hold elections in 2023”, nothing really *new* under the sun as this initiative had been already turned down by lawmakers several times. The second proposal depicted a “total reform of the Constitution” as a solution to the political crisis, but not exactly by means of a Constituent Assembly. Instead, a Constitutional Committee of the newly elected Congress would be in charge of coming up with the draft of a revamped constitution. This “solution” was not going to satisfy the demands of leftist groups, who seek an alternative institutional mechanism, with different rules and participants, and also potentially broader powers. The bills did not even reach the plenary of Congress and last Friday were rebuffed by a 11-9 majority in the legislative Constitutional Commission. In the context of a highly fragmented and dysfunctional Congress (Chart 2), the resignation of Boluarte would be the most likely scenario (see Peru Flash Report: [Back to musical chairs?](#), 8 December 2022). Furthermore, do not rule out a military intervention under severe social unrest.

**A crisis with deep roots.** As we have flagged in the past, chronic political instability is the symptom of a protracted crisis of representation (see 2023 Year Ahead Outlook: “[Lingering challenges](#)”, 16 December 2022), one that has been intensified by a combination of social, political, and economic factors. Specifically, certain segments of society have been showing an increasing frustration with the failure of Peru’s economic model to significantly improve well-being across the country. Despite a rapid economic rebound, poverty has remained elevated in the post-pandemic. In 2021, for example, monetary poverty reached 25.9%, the highest since 2011 (excluding the rate of 30.1% observed in 2020), with rural poverty almost doubling the level seen in urban areas.

**Chart 2. Congress dysfunctional fragmentation**



Political organisations were grouped from left to right according to their main ideological stance (L: Left, R: Right, C: Centre).  
Sources: BancTrust & Co. based on National Congress.

Besides poverty and regional inequality, **the high incidence of corruption in Peru is also eroding governance.** The recently-published 2022 Corruption Perceptions Index, built by Transparency International, ranked Peru 101 among 180 nations. The country compared poorly with the remarkably high position attained by Uruguay (14°) and Chile (27°) but was also below the unimpressive rankings of Colombia (91°), Argentina (94°), and Brazil (94°). Furthermore, results from a poll by Ipsos conducted in September 2022, revealed that the number of Peruvians who considered corruption to have increased in the last 5 years had reached an unprecedented level of 81%. In fact, corruption was evaluated, at that moment, as the second most important problem facing the country (57%), only behind insecurity (60%) and above the political crisis (37%).

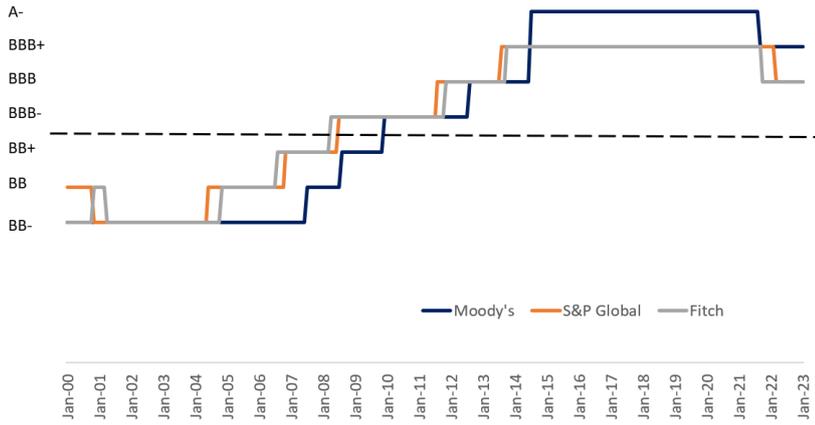
**The perception of widespread corruption also explains the broad discontent with democracy,** with 80% of the population expressing dissatisfaction with the political system in a poll by the Institute of Peruvian Studies (IEP) in December 2022. The IEP also found that in January 2023 the disapproval rate of Congress had reached a historical record of 88%, while that of President Dina Boluarte stood at 71%. Importantly, the public consensus around the need to hold early election was overwhelming, with 9 out of 10 participants supporting the electoral event as the most convenient outcome for the country.

**A representativeness crisis with no end in sight.** Even after legislators eventually approve an early election initiative (or President Boluarte is forced to resign), the political outlook will continue to be notoriously unclear. The uncertainties emerge not only from a potential installation of a Constituent Assembly, but also from the lack of leadership that could be able to guarantee political stability in the short and medium terms. In the same poll by IEP, in response to the open question “who could be a good presidential candidate in the general elections?”, 76.1% of participants responded “doesn’t know”, “doesn’t precise”, or “none/nobody”. The potential candidate that grabbed the highest spontaneous support was Hernando de Soto with just 3.6%! De Soto was one the designers of the neoliberal programme of reforms implemented by Alberto Fujimori in the early 1990s.

**In the context of prolonged crisis, we do not rule out a recession.** It is important to note that growth was already showing increasing signs of fragility before the eruption of the social crisis last December. Real GDP declined, in seasonally adjusted terms, during October and November (-0.5% m-o-m and -0.3% m-o-m, respectively), and the negative effects of protests and road blockades would clearly extend the decline in December and January. Although the annual comparison is likely to remain positive, risks of a downturn in 2023 cannot be ruled out. The increase of political uncertainty and the tightening of financial conditions at home and abroad will surely translate into a more noticeable reduction of private investment, while the drop in real incomes will dampen consumption.

**Weaker fundamentals will translate into a de-rating.** As we alerted after the downfall of Pedro Castillo, deteriorating politics should eventually pave the way to a credit downgrade as a result of weaker trend growth and fiscal vulnerabilities (see [Back to musical chairs?](#)). The three main agencies have placed their ratings on negative watch (Fitch on 20 October, S&P Global on 12 December, and Moody’s last week). A de-rating seems unavoidable, in our view, as negative headlines will continue to build up.

**Chart 3. Peru's Sovereign LT Ratings**



Sources: BancTrust & Co. based on rating agencies.

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