Peru's currency falls sharply amidst economic crisis

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The sharp fall in the value of Peru's currency, the nuevo sol, against the US dollar—crossing the psychological benchmark of 3 soles to the dollar last week—signifies a turning point in the economic future of the country. The last time the Peruvian currency was above 3 soles per dollar was in June 2009—67 months ago. In January 2013, it reached 2.47 soles to the dollar, its highest rate relative to the US currency.

The general stability of the Peruvian currency from mid-2009 to mid-2014—notwithstanding the conscious manipulation of the US dollar against its main competitors—was a statistic used by government economists and forecasters to pitch Peru as the best place to invest.

In 2014, with the global economic deceleration spreading, sectors A and B (the rich and upper middle class) began to move their financial assets to US dollar deposits. The dollarization of bank accounts in foreign currency increased from 39.4 percent in March 2013 to 47.2 percent in November 2014.

Due to an annual devaluation of 6.4 percent of the Peruvian currency, US dollar financial investments yielded 10 percent while nuevos soles yielded 6.6 percent. To counteract this tendency the banks are increasing the interest rates paid for soles accounts.

It remains to be seen if this measure, which would constitute part of a "new" fifth reactivation package—to be discussed in Congress next month—has any positive effect. Since the Great Recession (2007-2008), Peru has promoted itself as a paradise for foreign investors. In July 2014, the US credit rating agency Moody's Investor Services upgraded the country's credit rating to A3, better than that of Mexico or Brazil and only trailing Chile in Latin America.

Other indications of Peru's deepening crisis over the last week include the deceleration in consumption, mounting discontent with the political situation and the role played by political parties in Congress and an astonishing 80 percent change from positive to negative outlook by 300 CEOs polled by the financial consulting firm *Apoyo Consultoria*.

The most important and longstanding cause of the deterioration of the Peruvian economy is the sharp drop in copper exports of 9.4 percent to US$ 3.63 billion. This is due in large part to the slashing of copper imports by China to the lowest level since 2010, and the lack of resurgence within the global economy in general.

Peru is the third largest copper producer in the world. Copper together with gold account for 40 percent of the country's exports. The price of copper fell 18 percent on the world market last year—the worst performance for any industrial metal. Forecasters consulted by *Bloomberg* expect an additional drop of 13 percent in 2015. Copper revenues dropped 17 percent—US$ 920 million—last December according to Peru's Central Bank. Metals in general experienced a similar fall of 18.4 percent in the same month. Shares of copper mining companies recorded heavy losses on the stock market.

Another development indicating a general deterioration in the economic situation is the action taken by private pension funds (Asociacion de Fondos de Pension, or AFPs) that hold a total of US$ 38 billion in assets. Over the past two years, Peruvian AFPs portfolios have cut exposure to local stocks in half, from 26.1 percent in January 2013 to 11.8 percent in January 2015.

The money went to foreign mutual funds. The exposure to these funds grew from 18.6 percent to 35.6 percent in two years. Also, Exchange Traded Funds (ETFs)—the most common investment fund traded on exchanges; most track a popular stock index—have become popular because they provide a broader exposure to diversified markets in the US, Europe and Asia.

Significantly, it was the Peruvian Central Bank's lifting of foreign investments to 42 percent that allowed AFPs to go global.

Originally modeled to replicate Chilean private pensions, Peruvians AFPs funds were supposed to become the driving force in the growth of a national stock market; that is, people's pensions would be invested in new national industries and expanding infrastructure, which supposedly would generate jobs and better wages. These promised benefits never materialized and, with the shift away from the Lima Stock Exchange and into foreign mutual funds and ETFs, Peru's pension fund portfolios are even more closely tracking the speculative and parasitic nature of the financial markets in advanced countries.

Heads of industries have reacted with alarming pessimism to recent economic and political developments. Business daily *Gestion* wrote that 80 percent of Peruvian business executives believe that "the internal political situation will worsen in 2015… the most important risk factor that could affect the timid recovery of business confidence." CEOs interviewed think the poor handling of "social conflicts" is at the heart of the problem.

According to *Apoyo Consultoria*, "the social conflicts are not related only to the extractive industries (mining and hydrocarbons)," as has been the case since the beginning of President Ollanta Humala's government, "but also with themes as diverse as payments to the *fonavistas* [those who made compulsory contributions to FONAVI, a government housing fund that was dissolved under former President Alberto Fujimori to pay off the foreign debt] to the youth labor law."

The youth labor law was repealed by Congress last week. But in the process, it produced major internal conflicts within bourgeois parties. As *Gestion* reports, "an evident loss of the ruling party's relative majority in the Congress and the closeness to the beginning of the 2016 electoral process does not allow any expectation of an improvement in the conditions for governability."

It is unquestionable that Congress repealed the youth labor law—which slashed benefits under the pretext of making it more attractive for employers to hire younger workers—under pressure from the thousands of students and workers who took to the streets in several cities in defiance of police repression. Initially led by students, street demonstrations rapidly gained support among layers of workers from several industries, as well as the main union confederations, and professionals working for government institutions, like nurses and doctors.

The new fissures opening up within the bourgeois political parties, together with the rapid turn toward a negative outlook on the part of the business establishment indicate fears within the ruling class of a potential for social upheavals that would frighten off foreign investors.

On the consumer side, supermarket sales grew a disappointing 8.6 percent in December (the holiday season) compared to 11 percent in November. According to *Gestion*, the total number of debtors amounts to just over 6 million people—the population of Peru is 30 million. The largest number involves consumer debt, 4.5 million, 3.2 million of which corresponds to commercial banks. The *pymes* (small and micro businesses) have more than 2 million borrowers in debt. The default rate for these businesses has risen to 8.9 percent, the magazine reported.

President Humala's government is highly unpopular among all sections of the population. The disputes and cracks appearing among bourgeois political parties and entrepreneurs are giving rise to sectors of the ruling class demanding a strong hand to suppress any social conflict that will interfere with their interests.

It is noteworthy that in a recent student demonstration, the interior minister, Daniel Urresti, proposed that students be compelled to show identification papers in order to join the march. Such a measure, constituting an attack on the basic democratic rights of assembly, is indicative of how the economic crisis is driving the Peruvian state to dispense with democratic forms and resort to repressive measures.