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MEMORANDUM FOR:

The attached S-Project, Peru: Current Economic Situation, was handcarried

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~~17 Apr 1974~~
(DATE)

FORM NO. 101 REPLACES FORM 10-101
1 AUG 64 WHICH MAY BE USED.

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Peru: Current Economic Situation

- I. Although Peru's economic situation appears relatively good, it is still plagued by budgetary deficits and rapidly increasing external debt.
 - A. Gross domestic product grew by 5.6% in 1973, to about \$8 billion with industry contributing 7% and agriculture recovering slightly from its slump in 1972.
 - B. Output in the mining sector decreased by 9.7%, however, export earnings from minerals increased by 35% to almost \$550 million due to high world prices.
 - C. Agricultural performance, depressed since the implementation of the agrarian reform in 1969, showed an improvement of about 2.3% last year.
 - D. Inflation reached 14% in 1973, high for Peru, which usually maintains an 8%-10% range.
 - E. Peru's external debt has now reached about \$1.6 billion. Amortizations and prepayments amounted to \$462 million last year, almost 65% of total borrowing.
- II. The outlook in the fishmeal industry is improving but its contribution to GDP will not reach previous levels

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in 1974 and probably not in 1975.

- A. The anchovy catch is expected to be 3 million metric tons, a 60% increase over last year, but still 7 million metric tons less than the average peak year levels.
- B. Fishmeal production should range between 600,000 and 700,000 tons. Latest estimates set a maximum of 630,000 tons available for export. At a conservative average price of \$400/ton, Peru's income from sales abroad should be about \$252 million compared with a 1973 level of \$136 million.

III. Peru has a half billion dollars in credits and foreign investment under negotiation despite its uncertain investment climate. Successful compensation negotiations with the US has opened the way for greater US participation in Peru's development.

- A. Peru obtained over \$700 million in Western development credits in the last 15 months and is presently seeking an additional \$500 million.
- B. Since 1971, about 16 foreign oil companies signed joint venture contracts with the State Oil Company (Petroperu) to develop Peru's petroleum resources. While most of these companies are still in the early

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stages of exploration, promising finds have been reported. Six test wells have yielded about 17,000 bpd. On the strength of these finds, Petroperu is pushing for the construction of the Transandean pipeline from the interior to the coast. Limited shipments of crude from the new wells are presently being transported by barge down the amazon to Brazil.

- C. Negotiations for a \$400 million financing package for the construction of the pipeline is under way with a consortium of banks headed by Bank of America. Peruvian officials hope for successful completion of these negotiations and are opposed to having to obtain piecemeal credits for the construction project.

IV. The Southern Peru Copper Corporation is in the process of completing financing for the Cuaajonc Copper project, scheduled for completion in 1976.

- A. Now that tensions have eased between the US and Peru, Export-Import Bank participation is guaranteed. Total credits for the \$650 million project now total over \$450 million dollars including a \$55 million credit from Ex-Im.
- B. Cuaajonc, when completed will add another 180,000 tons of copper annually to Peru's current production of 240,000 tons.

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- V. Peru has increased its economic ties with Communist countries, thereby generating numerous joint ventures, credits and trade.
 - A. Peru maintains a positive trade balance of about \$90 million with Communist countries; copper and fishmeal comprise the largest percentage of their acquisitions.
 - B. Communist aid extended to Peru last year totaled \$25 million.
 - C. Romanian interest in joint ventures increased with the visit of President Ceausescu. Romania is investing about \$60 million in the development of the Antamina copper deposits.
 - D. Negotiations are underway for Polish participation in the development of Peru's coal deposits. No agreements have yet been announced.
 - E. The Soviets may provide economic and technical assistance for hydroelectric and steel projects costing in excess of \$500 million.
 - F. The Soviets have succeeded in selling arms to Peru and already have delivered 25-35 tanks and 5 helicopters. Additional purchases are being negotiated.

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- VI. In 1974 the Peruvian economy will maintain about the same rate of growth as in 1973, largely reflecting increases in fishmeal production and exports. The likely promulgation of the social property law may cause some problems in the manufacturing sector. High food and petroleum import costs present the government with a policy dilemma. Continued government subsidy of food and petroleum prices are keeping consumption at high levels and place an increasing burden on the government's limited revenues.
- A. Projections for 1974 indicate a real GDP growth rate of between 3 and 5 percent.
 - B. Agricultural production continues to be depressed as it has been since the implementation of the agrarian reform. The prospect of the promulgation of a social property law for industry sometime this month also dampens the outlook for the industrial sector. The social property concept provides for each enterprise, either new or converted from private ownership, to be owned by all of its workers. Financing for these enterprises will be provided by CONFIDE (State Development Financing Corporation) or the National Fund for Social Property.

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- C. Projections for a balance of payments deficit this year with some drop in private investment inflows necessitate increased foreign borrowing, partial refinancing of the external debt, and drawing down of foreign exchange reserves.
 - D. Peru currently imports 30% of its crude oil supplies and over 75% of its wheat. Although prices for these commodities have risen sharply the government continues to keep retail prices at artificially low levels, thereby encouraging consumption growth. Peru's 1974 import bill for these commodities alone is estimated at about \$235 million.
 - E. About \$288 million in debt service payments -- equal to 25% of projected export earnings -- are falling due in 1974, but the government/hoping^{is} to refinance a large portion.
- VII. Peru's prospects for this year and next depend a lot on what happens in the world economy.
- A. Slowing of industrial production in developed economies would tend to cause raw material prices, including mineral prices, to fall, however, export earnings would dampen economic activity and reduce Peru's capacity to cope with its large and growing import needs.

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VIII. Peru's fishmeal and mineral exports play a role in prospects for the international economy.

- A. Recovery in fishmeal production and exports is a factor in controlling world food prices.
- B. Peru is a large copper export and a member of the Council of Copper Exporting Countries (CIPEC). Moves to withhold copper from the market in order to raise prices would be detrimental both to developed economies and CIPEC countries.
- C. Potential large petroleum exports from Peru would add to available supply.

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