
2017 Social Performance Report

Measuring what really matters



Financiera Confianza is an institution with a nationwide footprint, offering a complete range of financial products and support, to improve the incomes and standard of living of around half a million clients, whom it serves throughout the different phases of their business life cycles.

Financiera Confianza S.A.A. (Financiera Confianza) is a leading microfinance institution in Peru, with a mission of providing low-income families with opportunities, so that they can improve their incomes and standard of living with Productive Finance. The institution is a result of the merger in 2013 of Caja Nuestra Gente and the original Financiera Confianza, two institutions with a long track record in microfinance and extensive coverage across the nation. BBVAMF created Caja Nuestra Gente back in 2008 by merging three entities: Caja Nor Peru, Caja Sur and Edpyme Crear Tacna.

Financiera Confianza is the only microfinance institution with a physical presence in every one of the country's 25 provinces. It is particularly active in rural areas, with 153 branch offices and an extensive network of customer service points from which it helps clients along their journey of sustainable economic and social development. It currently serves around half a million people, whom it supports with financial products and services, as well as training, over time.

By making a responsible credit assessment, the institution encourages the progress of entrepreneurs with the net incomes generated by their businesses. This has given Financiera Confianza the highest caliber portfolio in the country's entire microfinance system, also making it the third largest microfinance institution by number of entrepreneurs with micro-enterprise credits: more than 200,000 clients in its portfolio have loans.

In 2017, this institution has continued innovating by designing credit products in areas such as access to higher education, housing improvements and healthcare.

Financiera Confianza has an extensive microfinance network, enabling it to serve around half a million people, whom it supports with financial products and services throughout their entrepreneurial journey

Headline figures

Data at December 31st, 2017

Total credit clients

493,164

Nº of disbursements in 2017

306,508

People receiving financial education

36,672

Gross loan portfolio (USD)

484,176,610

Average disbursement in 2017

2,066

Nº of branch offices

153

Amount disbursed in 2017 (USD)

633,338,655

Deposits & others (USD)

313,790,063

Nº of employees

2,127

Total clients

493,164

Financiera Confianza has over 211,000 credit clients and gives priority to low-income micro-entrepreneurs, with 70% of its clients in *vulnerability*. 42% of the new clients joining in 2017 have been banked* thanks to the institution. Our clients' good performance is evidenced by annual growth rates of their assets of close to 30%, suggesting an accumulation of assets and reinvestment in their micro-enterprises. Furthermore, Financiera Confianza has improved client service by extending its range of products.

* "Banked" clients, who are using the formal financial system for the first time in the last 12 months.

Total credit clients

211,635



70%

Vulnerability¹



50%

Women



26%

Rural environment



17%

Primary education at best²

New credit clients in 2017

81,212



75%

Vulnerability¹



52%

Women



24%

Rural environment



14%

Primary education at best²



1,294

USD

Average disbursement³



238

USD

Monthly net income *per capita*



2.9

people

Household size

1. According to the INEI poverty line (differentiating between the rural and urban environments). Clients whose monthly net income *per capita* (estimated as the business net income divided by the size of the household) is below the threshold calculated by multiplying the poverty line figure by three are in *vulnerability*. **2.** Proportion of all credit clients who have completed primary education, at best. **3.** Average disbursement: average disbursement of new clients served in 2017.

Source: Financiera Confianza. BBVAMF calculations.

1. Our clients



SDGs impacted

Socio-economic profile

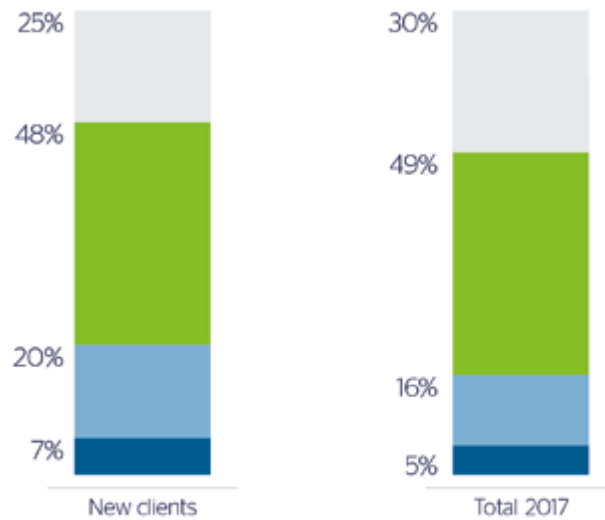
• 70% of the institution's clients are in a situation of *vulnerability*, with 21% of these not generating enough monthly net income to buy a basic basket of foodstuffs, the poverty line (PL) marker for each household member.

• In 2017, Financiera Confianza served 81,212 new clients, of whom 75% are in *vulnerability*. Poverty is much more widespread among women, who account for 60% of the new *poor* clients served, and 79% of the *extremely poor*.

• 50% of our clients are women, and of these 76% are in *vulnerability*. 28% are below the PL. The educational level is high, with only 17% of women having primary education at best. They are women entrepreneurs, most of whom (60%) work in Trade, unlike men, who concentrate their activities in Services and Agro.

1. According to the INEI's poverty line (distinguishing between rural and urban environments). Clients whose *per capita* net income (i.e. profit obtained from their microenterprise) divided by the number of people in the household unit is above the poverty line but no more than three times the poverty line of their corresponding country and are classified as *vulnerable*. 'Total' shows the number of clients current at 12.31.2017. 2. Proportion of clients current at 12.31.2017. New clients (no previous loans) signed up over the year.

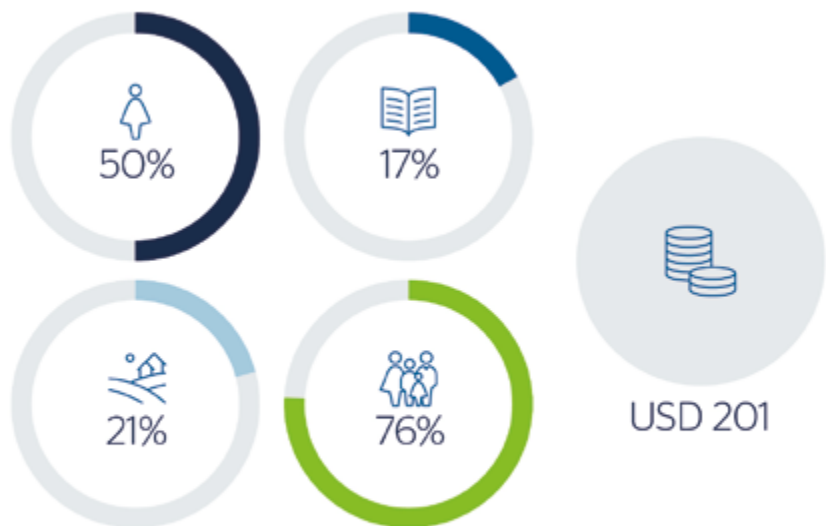
1. Client economic vulnerability



● Ext. poor ● Vulnerable
● Poor ● Others

Source: Financiera Confianza, BBVAMF calculations.

2. Women's profile



● Women ● % Vulnerability
● Primary education at best ● Monthly per capita net income (new clients)
● Rural environment

Source: Financiera Confianza, BBVAMF calculations.

- The businesses of female entrepreneurs served by Financiera Confianza in 2017 generate an average of USD 6.7 a day per household member (USD 201 *p.c.* monthly net income) which is below the minimum wage USD 8.7 (USD 263).

- Financiera Confianza puts a priority on offering financial opportunities to young people to break the cycle of poverty: 42% of new clients served in 2017 were young, and this segment accounted for 26% of all credit clients (see graph 6).

- New clients in *extreme poverty* possess a *p.c.* monthly net income of 38% of the PL, so their *p.c.* monthly net incomes would have to increase by 164% to make it to that line. *Poor* clients' net incomes would have to grow by 28% to overcome poverty.

- We have sought to identify the features common to clients suffering greater poverty levels: gender, level of studies and the sector in which they develop their activity, are relevant factors in determining it. 44% of urban women without higher education or apprenticeships working in the Retail trade sector are *poor*, followed by those working in Wholesale trade (42%) (see graph 7).

3. New credit clients



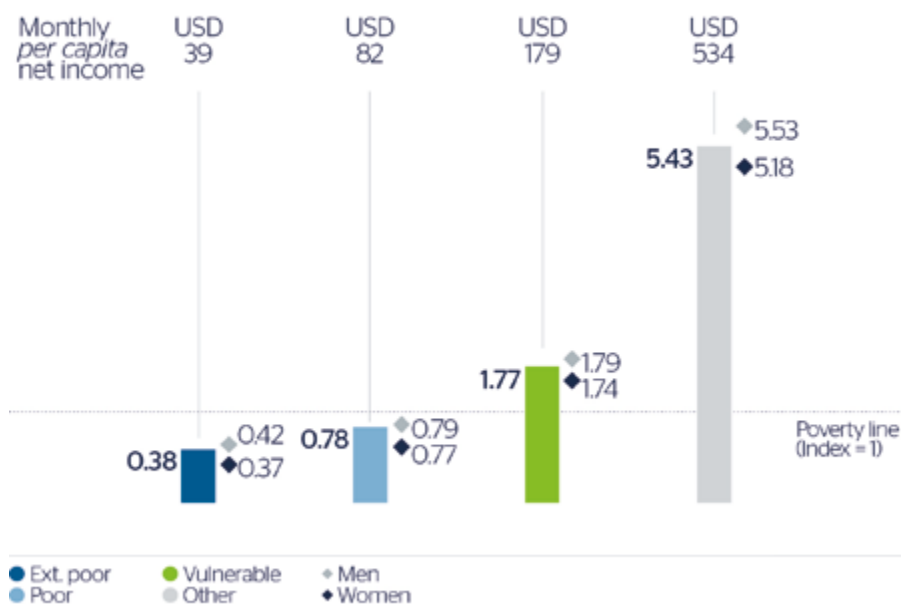
Source: Financiera Confianza. BBVAMF calculations.

4. New credit clients' vulnerability, by gender



Source: Financiera Confianza. BBVAMF calculations.

5. Relative net income of new clients



Source: Financiera Confianza. BBVAMF calculations.

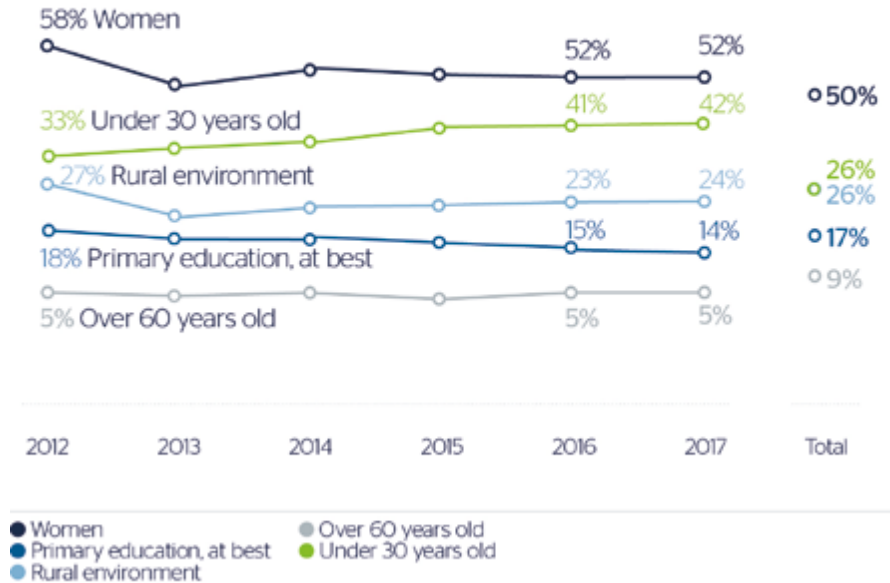
3 & 4. New clients (no previous loans) signed up over the year. 5. According to INEI (National Statistics and IT Institute) poverty lines, differentiating between rural and urban environments. Considers clients signed up during the year (no previous loans).

1. Our clients

- Peru has one of the highest levels of education in Latin America, which is why women without higher education or apprenticeships have the highest rate of poverty. In the case of men, the highest poverty levels are to be found in those who have not even been to secondary school.

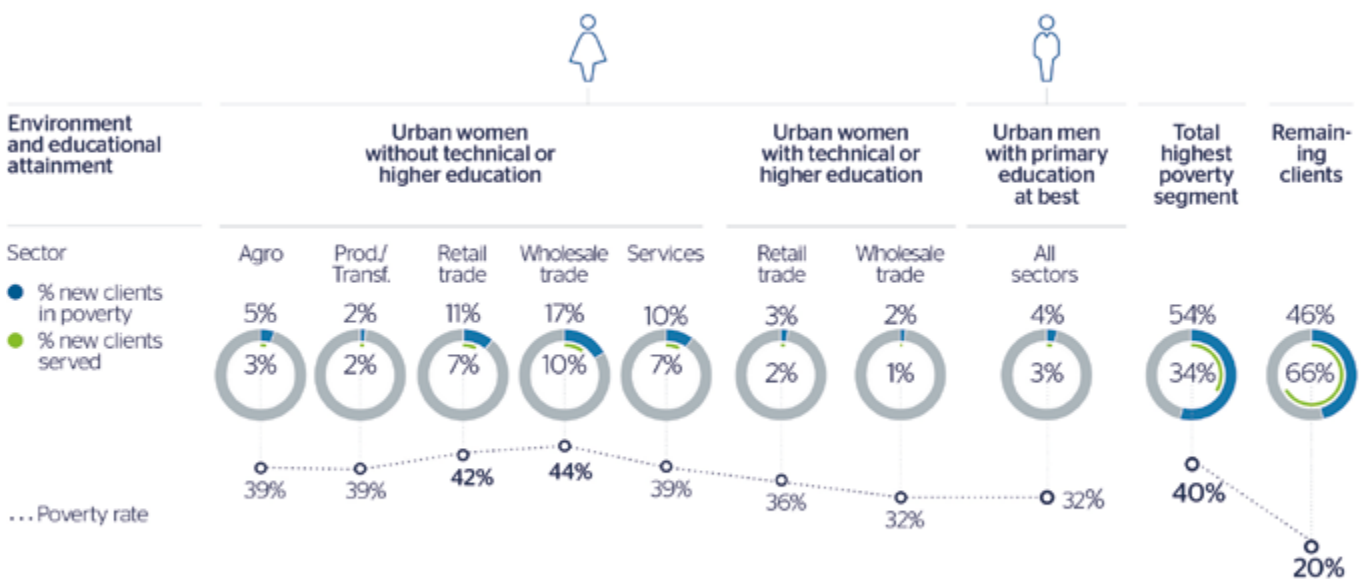
- People without higher education opt to invest in small businesses requiring low technical qualifications and relatively high short-term profitability (such as Trade), to offset the difficulty of accessing resources or the traditional labor market. This data shows the need to invest in education, as already acknowledged by Financiera Confianza, which has launched several pilot projects in training during 2017, in collaboration with Peru's Banking & Insurance Authority (the regulator).

6. Profile of new credit clients



Source: Financiera Confianza, BBVAMF calculations.

7. Clients with the highest poverty rates



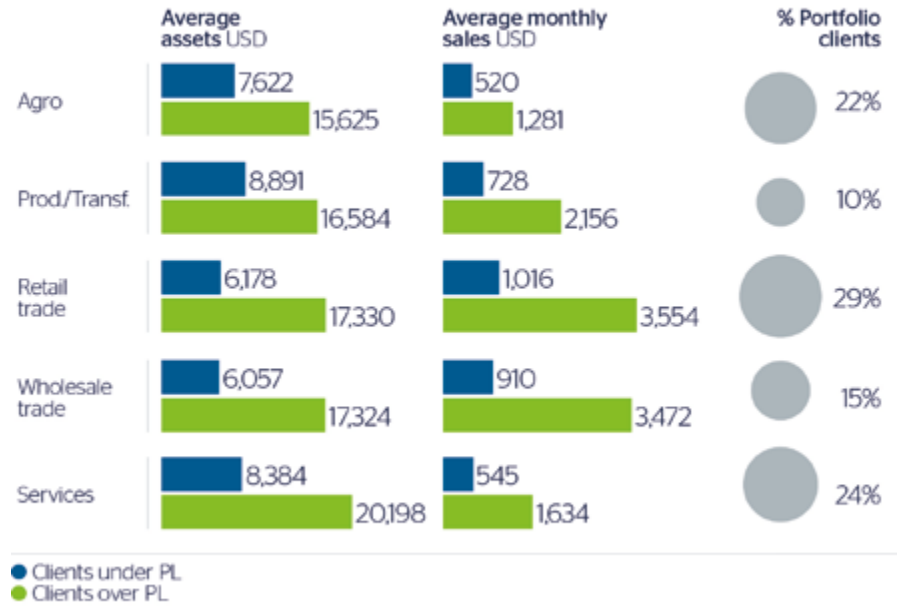
Source: Financiera Confianza, BBVAMF calculations.

• Women are particularly vulnerable in Peru. It is noticeable that, even if they have higher education or apprenticeships, the segment of “women” in and of itself continues to experience high economic *vulnerability* (it has the second highest rate of poverty, at over 30%), since some of their conditions at the outset (access to property or to the job market, and heading up single-parent families) make it more difficult.

Profile of their businesses

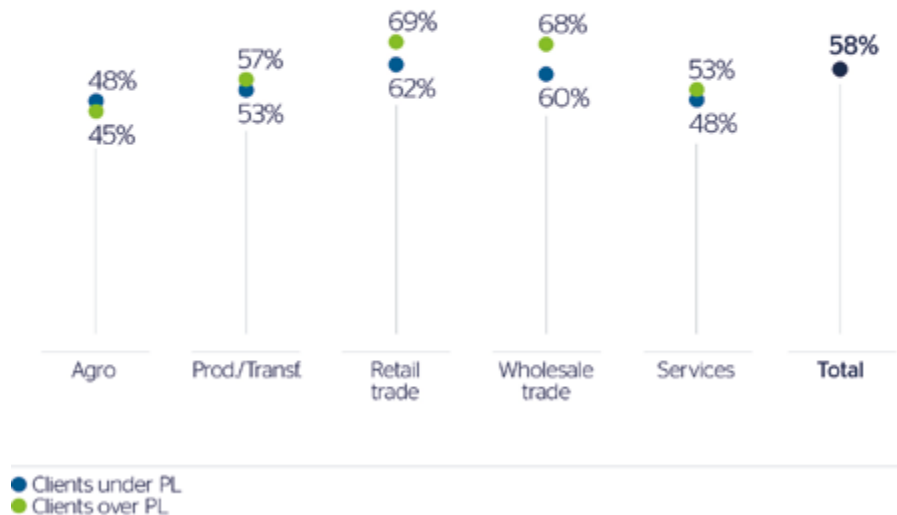
- Financiera Confianza serves clients from a wide cross-section of sectors. The most popular are in Retail trade (29%) and Services (24%).
- Women clients served by the institution mainly carry out their productive activity selling foodstuffs, drinks and tobacco (26%), or clothes and textile products (9%).
- Entrepreneurs in the Services sector show a greater capacity to accumulate assets compared with other sectors, with an average value of nearly USD 20,198 for *non-poor* clients and of USD 8,384 for *poor* clients.

8. Average monthly sales and assets - clients under and over the poverty line (PL)



Source: Financiera Confianza, BBVAMF calculations.

9. Average expenses as percentage of sales, by sector - clients under and over the poverty line (PL)



Source: Financiera Confianza, BBVAMF calculations.

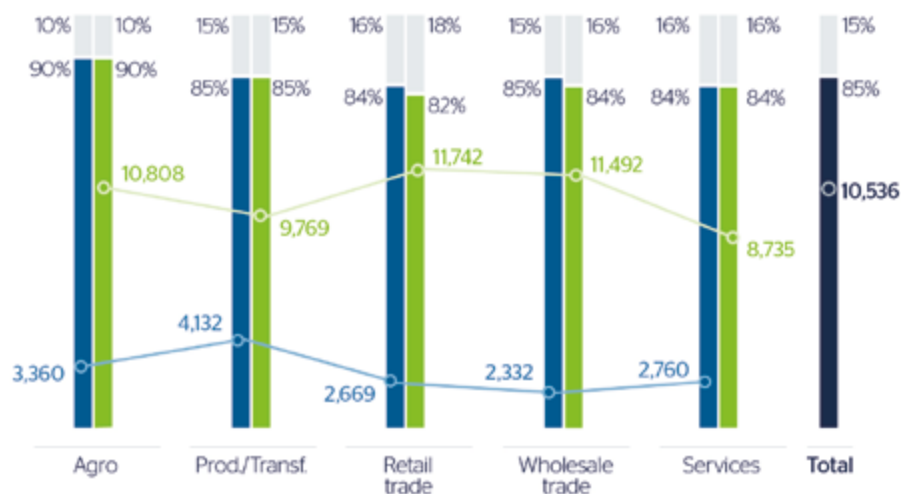
6. New clients (no previous loans) signing up during the year. 'Total' shows the number of clients current at 12.31.2017. **7.** New clients (no previous loans) signing up during the year. 'Total' shows the sum of the participation of the segments analyzed, calculated over total new clients served in 2017. 'Remaining' shows the participation of segments not included in the table, calculated over total new clients served during 2017. **8.** Average monthly sales and average assets in each sector, segmented as under the PL (classified as *extremely poor* and *poor*) and over the PL (classified as *vulnerable* and *others*) clients. Clients current at 12.31.2017. **9.** Average sales in each sector, calculated as the average of each client's ratio. Segmented as under the PL (classified as *extremely poor* and *poor*) and over the PL (classified as *vulnerable* and *others*) clients. Clients current at 12.31.2017.

1. Our clients

- When costs are analyzed as a proportion of sales in our clients' businesses, according to their level of *vulnerability*, we see that only in the Agro sector do clients with income under the PL need, on average, a greater proportion of sales to run their operations. The Retail trade sector for *non-poor* clients is the least efficient, with costs making up 69% of sales (see graph 9).

- The balance sheet by sector shows our clients' average leverage. The Agro sector, because of idiosyncratic characteristics and its seasonal nature, requires lower average investment over the year. Here microfinance offers a solution.

10. Assets, liabilities and equity, by sector - clients under and over the poverty line (PL)



10. Data on the assets, liabilities and equity, together with their ratios, for each sector, segmented as under the PL (classified as *extremely poor* and *poor*) and over the PL (classified as *vulnerable* and *others*) clients. The loan granted by the institution is not included in liabilities. Covers clients current at 12.31.2017.

● Clients under PL Equity / Assets
● Clients under PL Liabilities / Assets
○ Clients under PL Avg. equity
● Clients over PL Equity / Assets
● Clients over PL Liabilities / Assets
○ Clients over PL Avg. equity

Source: Financiera Confianza, BBVAMF calculations.

Where our clients are

- Financiera Confianza has a footprint in every province in the country, with a total of 153 branch offices and an extensive network of service points, reaching some of the poorest spots in the north of the country, where it has historically had a significant presence, such as Cajamarca, Amazonas and Loreto.

- The effort we make shows in the service to new poor clients over the course of 2017. The regions of Callao (49%), Ucayali (53%), San Martín (42%) and Loreto (38%) report the best indicators. We should point out that in areas of high population density, such as Callao, we serve more poor clients than our average for other regions, because

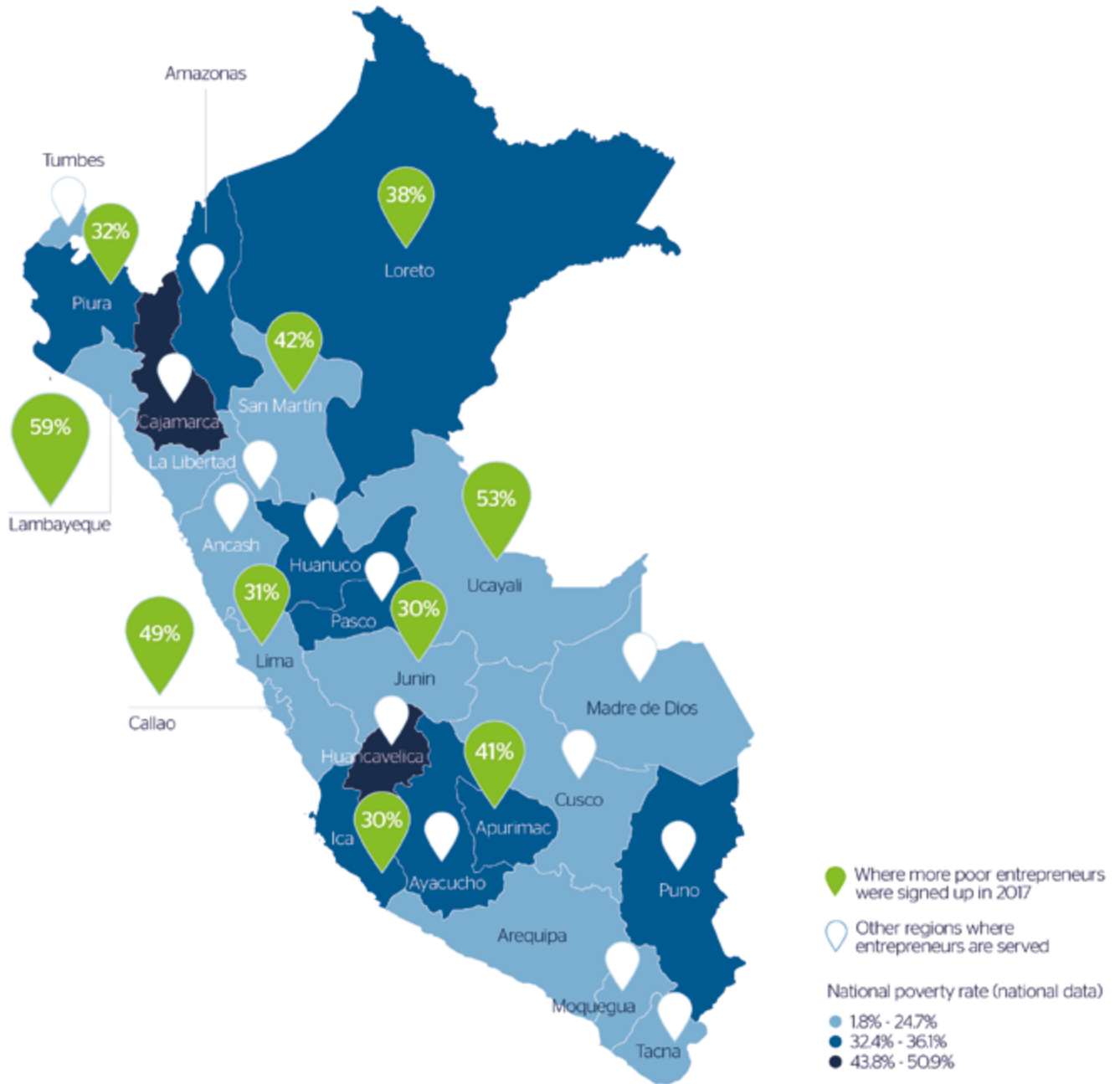
of this very density. In addition, these are the areas where the competition is stronger.

- In the south of Peru, where the national poverty rate is also high, we face a lot of competition, particularly from rural Savings & Loan associations with which clients may feel a greater cultural affinity.

- Agricultural clients, who are located in rural areas with a high rate of national poverty, are not served by most of the financial and micro-finance sector because they are high risk. These are Financiera Confianza's target audience. Even though they are not classified as *poor*, according to the institution's criteria, they account for 22% of all credit clients.

Financiera Confianza serves vulnerable clients in remote rural areas that lack access to essential services

11. National poverty rate and sign-ups of poor entrepreneurs in 2017



Source: Financiera Confianza. BBVAMF calculations.

11. Proportion of poor households by regions and district (2016). INEI. The 10 regions with the highest percentage of *poor* new clients served during 2017 are shown.

2. Our clients' development

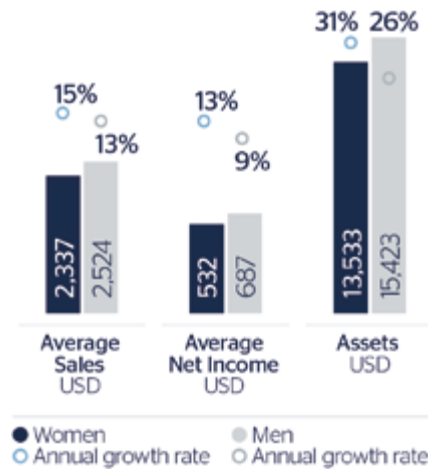


SDGs impacted

Growth of their businesses

- Financiera Confianza's clients report positive average growth in their assets, sales and monthly net incomes, particularly women (13% annual growth of their monthly net incomes, reaching USD 532).
- Women's businesses, in absolute terms, have lower assets than men's, which results in higher growth rates (in sales, assets and net incomes).
- The sectors with the highest average growth rates in net incomes are Retail trade (13.5%) and Wholesale trade (11.6%). The Agro sector, with an annual rate of 6.5%, is the lowest of all.
- In the asset variable, the Trade and Production/transformation sectors, have average annual growth of 30%.

12. Avg. growth rates of monthly sales, net income and assets, by gender



Source: Financiera Confianza. BBVAMF calculations.

13. Avg. growth rates of monthly sales, by sector



Source: Financiera Confianza. BBVAMF calculations.

14. Avg. growth rates of monthly net income, by sector



Source: Financiera Confianza. BBVAMF calculations.

15. Avg. growth rates of assets, by sector



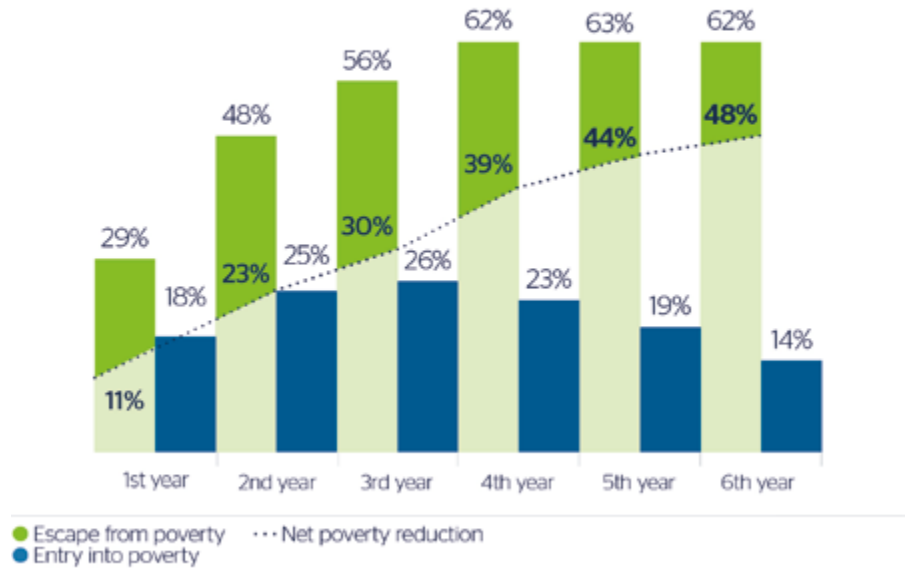
Source: Financiera Confianza. BBVAMF calculations.

12. Clients current at some point in the year who have made a disbursement or update in the last 12 months of their relationship with the institution. The compound annual growth rate (CAGR) of the 2012-2017 cohorts was used for the calculation, and the weighted average of these rates presented by gender. 13, 14 & 15. Clients current at some point in the year who have made a disbursement or update in the last 12 months of their relationship with the institution. The compound annual growth rate (CAGR) of the 2012-2017 cohorts was used for the calculation, and the weighted average of these rates presented for each sector.

Escaping poverty

- The longer that *poor* clients continue with the institution, the more the percentage of those succeeding in overcoming poverty grows. In the first year, 29% of clients manage to improve their situation at the outset, escaping from *poverty*; after four years, 62% have done so.
- The segment in *poverty* falls by 23% after two years, mainly thanks to clients' improved returns. Poverty in Peru fell by 2.4 percentage points between 2014 and 2017 and is expected to continue falling. Financiera Confianza's clients are participating in this improvement too.
- There is a group of *non-poor* clients that suffer mishaps that trigger their fall back into *poverty*: around 10% of *non-poor* clients in each period falls into *poverty*.

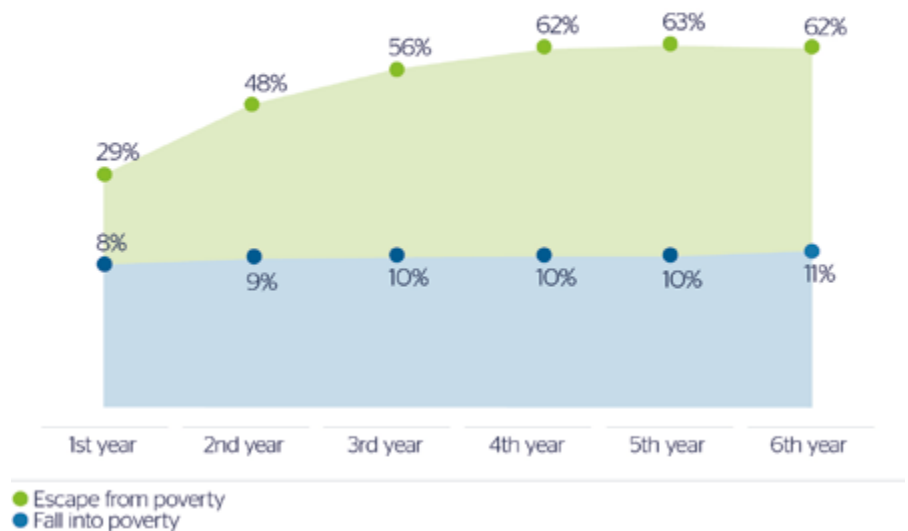
16. Net poverty variation



Source: Financiera Confianza, BBVAMF calculations.

17. Clients falling into and escaping poverty

16. Clients current at some point in 2017 whose data was updated in the last 12 months of their relationship with the institution. Clients who have been written off are excluded from the escape from poverty figure. • Escape from poverty: clients in poverty (classified as *extremely poor* and *poor*) at the outset, who have climbed above the poverty line, as a percentage of all those in poverty at the outset. • Entry into poverty: clients not in poverty (classified as *vulnerable* or *others*) at the outset, who have fallen into poverty, as a proportion of clients in poverty at the outset. • Net poverty reduction: Escape from poverty minus Entry into poverty. **17.** Clients current at some point in 2017 were recorded and their data updated in the final 12 months of their relationship with the institution. Clients who have been written off are excluded from the escape from poverty figure. • Escape from poverty: clients in poverty (classified as *extremely poor* and *poor*) at the outset, who have climbed above the poverty line, in terms of their own segment (poverty). • Fall into poverty: clients not in poverty (classified as *vulnerable* or *others*) at the outset, who have fallen into poverty, divided by the number of *non-poor* clients at the outset.



Source: Financiera Confianza, BBVAMF calculations.

2. Our clients' development

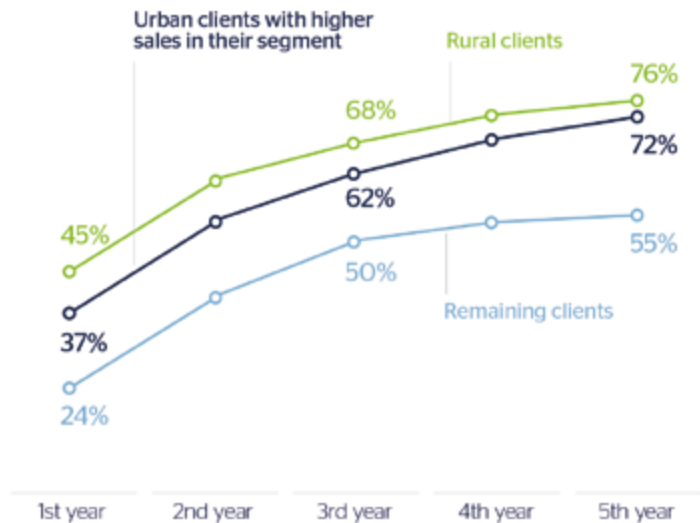
- As anticipated in the 2016 report and after a multi-variate analysis, we saw that it was the rural clients who recorded the best performance (whether their situation at the outset was one of *extreme poverty* or of *poverty*) for a number of reasons. It is likely that the lower cost of living, the lower competition and the possibility of choosing clients with a more entrepreneurial outlook (given the limited access to financial resources) contributes to a greater impact on client performance, and thus, the escape from *poverty* indicator.

- Urban clients with higher sales also stand out as the segment with the second highest probability of overcoming the PL. In more competitive urban environments, the capacity to generate comparatively higher incomes is a sign of more effective business management; these clients therefore perform better than the average for Financiera Confianza's *poor* clients.

- We should note that clients do not perform differently by age, gender or civil status; the determining factors are the environment, the features of the micro-enterprise and the financial products and services they are using. However, in the case of *poor* clients, a higher educational level can impact on a greater likelihood of escaping poverty.

18 & 19. Clients current at some point in 2017 who have updated their data during the last 12 months. Clients who have defaulted are excluded from the "escaping poverty" category. % of clients by segment. **20.** For the sample of clients served between 2011 and 12.31.2017. The client classification was based on their degree of *vulnerability* during the first credit and shows the progress of net income in each credit cycle, relative to each country's official poverty line. Relative *per capita* monthly net income takes the value of one when it is equal to the poverty line.

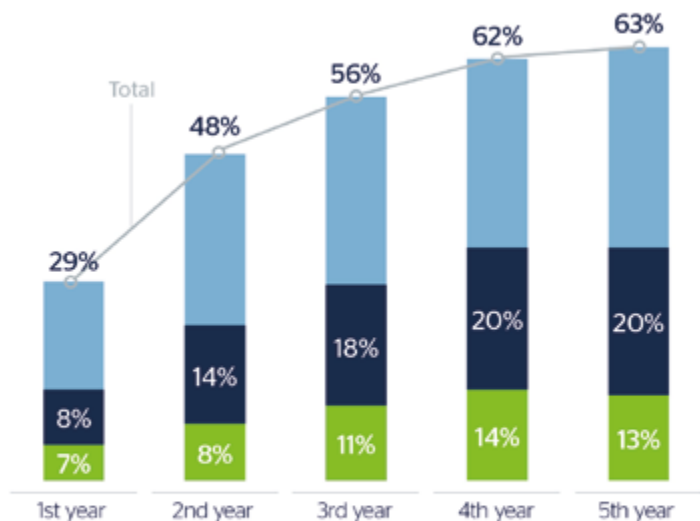
18. Clients escaping poverty, by best performing segments



● Urban clients with higher sales in their segment
 ● Rural clients
 ● Remaining clients

Source: Financiera Confianza, BBVAMF calculations.

19. Distribution of clients escaping poverty



● Urban clients with higher sales in their segment
 ● Rural clients
 ● Remaining clients
 ○ Total escaping poverty

Source: Financiera Confianza, BBVAMF calculations.

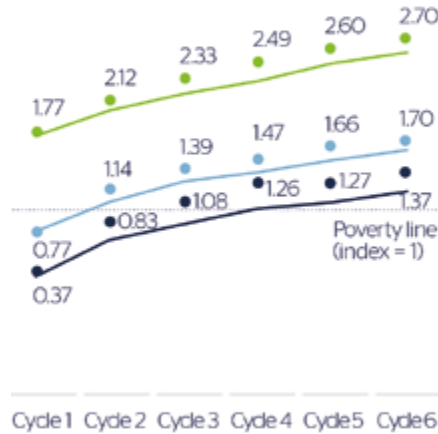
- Financiera Confianza's *poor* clients only need two loan cycles to succeed in overcoming the PL, whereas clients in *extreme poverty* need three. When we look at the *p.c.* net monthly incomes of clients served over the year, we see that these clients record better *p.c.* monthly returns at each renewal.

- Once again, sustained growth levels are consolidated over time: clients in *extreme poverty* can increase their average *p.c.* net income by 77%, and those in *poverty* can do so by 32% when they reach the fourth cycle (see graph 21). This shows sustained growth rates at each cycle, although they are higher when *vulnerability* is greater.

- Income instability is very much a part of our clients' experience; many will grow but then suffer periods of setback. When we analyze clients who have taken out five loans or more, we note: 69% of *poor* clients succeed in climbing out of poverty, 46% permanently, while 23% will do so temporarily (crossing the poverty line at least twice).

21. For the sample of clients served between 2011 and 12.31.2017. The client classification was based on their degree of vulnerability at each credit cycle. 22. Clients served between 2011 and 12.31.17 who have had at least five disbursements. The classification by *vulnerability* considers their situation at the first loan and is segmented by under the PL (classified as *extremely poor* and *poor*) and over the PL (classified as *vulnerable* and *others*). • Volatile: client who crosses the poverty line at least twice. • Escape from poverty: client who escapes poverty and doesn't fall back in. • Fall into poverty: client enters poverty in one cycle and does not escape it again. • Stable: client who remains *poor* or *non-poor* throughout the five disbursement cycles. 23. Clients who have been current at some point in 2017 and have updated their data in their last 12 months with the institution. Shows those clients who at the outset were classified as *non-poor* and who are currently classified under the poverty line (PL).

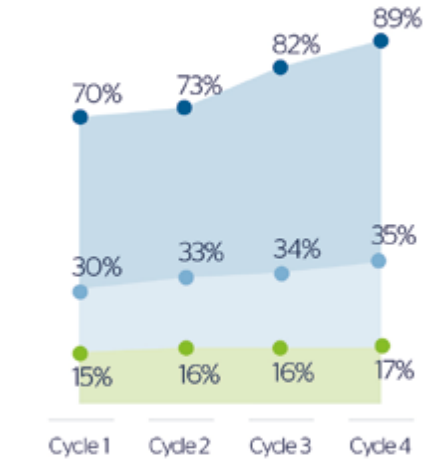
20. Net income relative to the PL



— Ext. Poor (EP) ● Disbursement 2017-EP
 — Poor (P) ● Disbursement 2017-P
 — Vulnerable (V) ● Disbursement 2017-V

Source: Financiera Confianza. BBVAMF calculations.

21. Average net income growth relative to the PL



● Ext. poor
 ● Poor
 ● Vulnerable

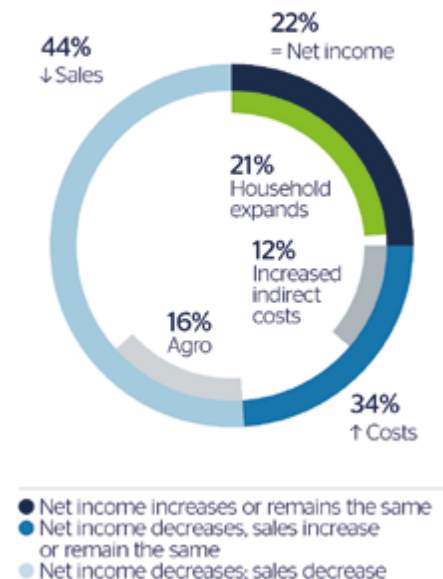
Source: Financiera Confianza. BBVAMF calculations.

22. Net income volatility relative to the poverty line



Source: Financiera Confianza. BBVAMF calculations.

23. Clients falling into poverty



Source: Financiera Confianza. BBVAMF calculations.

2. Our clients' development

- When it comes to clients who at the outset were *non-poor*, 6% will fall into *poverty* and 12% will do so temporarily. This demonstrates the importance, not only of achieving income above the PL, but also of stabilizing it, so financial products must be developed to support this (see *graph 22*).

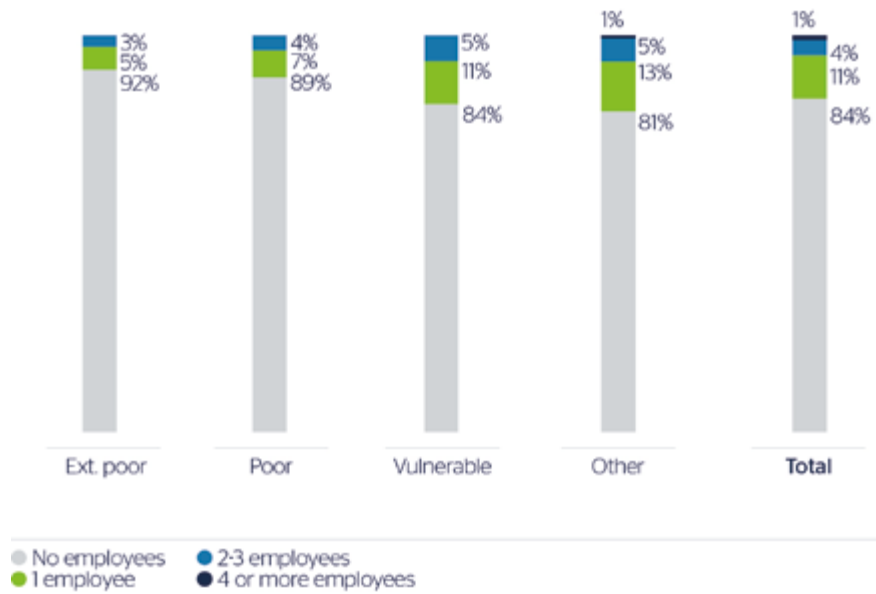
- Of clients falling into *poverty* in 2017, 44% do so because of a reduction in their sales, principally in the Agro sector (16%), 34% because of an increase in their costs, and the remaining 22% mainly as a result of an increase in the number of people in the household (see *graph 23*).

Indirect impact

- 16% of Financiera Confianza's clients have generated direct employment and taken on at least one employee, with the corresponding greater impact on the communities in which they work.

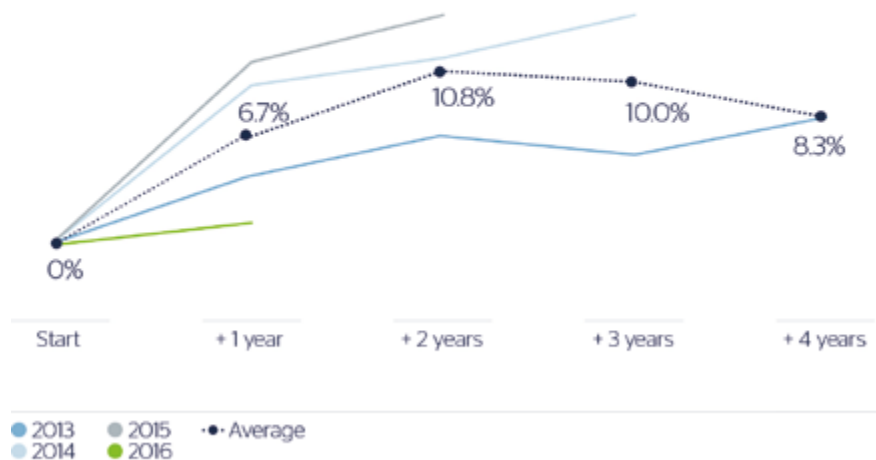
- Some of client net incomes is spent on improving their current housing situation; 10% will have made improvements after three years.

24. Micro-enterprise employee breakdown



Source: Financiera Confianza. BBVAMF calculations.

25. Client improvement in housing (by cohort)



Source: Financiera Confianza. BBVAMF calculations.

24. Number of employees working for clients current at 12.31.2017. 25. Proportion of clients current as of 12.31.2017 in each cohort that has improved their living arrangements (moving from parents' to a rented or own home, moving from rented to own home), increased the n° of bedrooms, installed running water, or improved the building materials. Averages from cohorts 2013-2016 are shown.

3. Relationships with clients



SDGs impacted

• 43% of Financiera Confianza's clients have credit products, 31% have also taken out voluntary insurance. Clients require an increasingly wide range of products, and Financiera Confianza seeks to provide them.

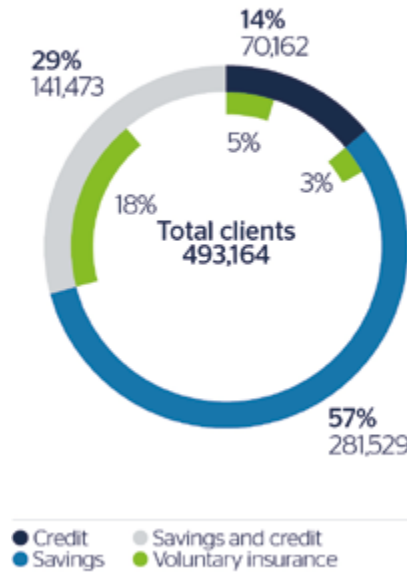
Relationship with our credit clients

• Financiera Confianza serves new clients with increasingly low average monthly sales, a sign of its interest in serving clients who are more vulnerable. The installment payments on monthly sales do not vary substantially over time, closing 2017 at 10.2%.

• Disbursements of clients who renew their loans have been growing year on year, at a rate close to 16% annually, reaching, on average, USD 2,769 after five years.

26. Clients current at 12.31.2017. Savings clients with a balance greater than PEN 1 or with account movements in the previous 9 months, are considered throughout the report. **27.** New clients (no previous loans) signed up over the year. Average disbursement, calculated as the average of the first disbursement for new clients in each year. Weight of the installment calculated as a ratio average (installment over sales). YoY: 2016-2017 annual growth rate. **28.** Change in the average disbursement per transaction by length of time since the client was signed up. "Value at the outset" is the average of the outset value of 2012-2017 cohorts to which the average growth of the disbursement of cohorts 2012-2017 is applied. **29.** 'Retention': Percentage of credit clients in each cohort still current at each year-end and to 12.31.2017; shows averages from 2012-2017 cohorts. 'Recurrence': Clients served since 2011. % of clients that, after an initial loan, accesses another. Distance between cycles is the number of days between two successive disbursements.

26. Client linkage by product type



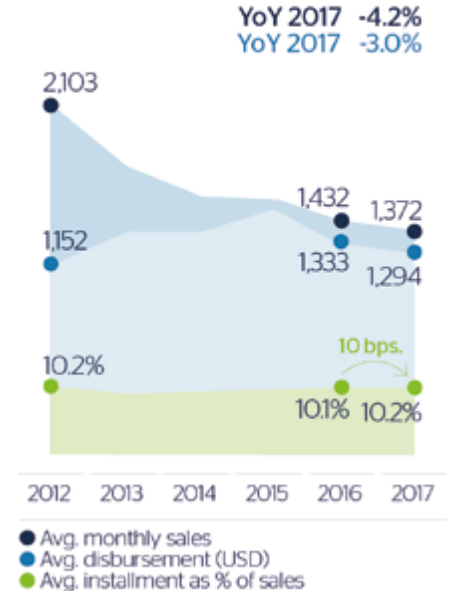
Source: Financiera Confianza. BBVAMF calculations.

28. Average disbursement per transaction (by cohort)



Source: Financiera Confianza. BBVAMF calculations.

27. Sales, disbursements (USD) and weight of installment for new clients



Source: Financiera Confianza. BBVAMF calculations.

29. Credit client retention and recurrence

Retention

Start	100%
+ 1 year	57%
+ 2 years	32%
+ 3 years	21%
+ 4 years	15%
+ 5 years	11%

Recurrence

Recurrence	Distance (days)
Cycle 1	100% 0
Cycle 2	57% 296
Cycle 3	36% 282
Cycle 4	24% 261
Cycle 5	16% 240
Cycle 6 or +	11% 218

Source: Financiera Confianza. BBVAMF calculations.

3. Relationships with clients

- The most important factor in achieving client development is fostering long-term relationships. Financiera Confianza clients, in 57% of cases, continue with the institution after the first year and 57% take out a second credit, building a relationship in which Financiera Confianza is positioned as a strategic partner (see *table 29*).

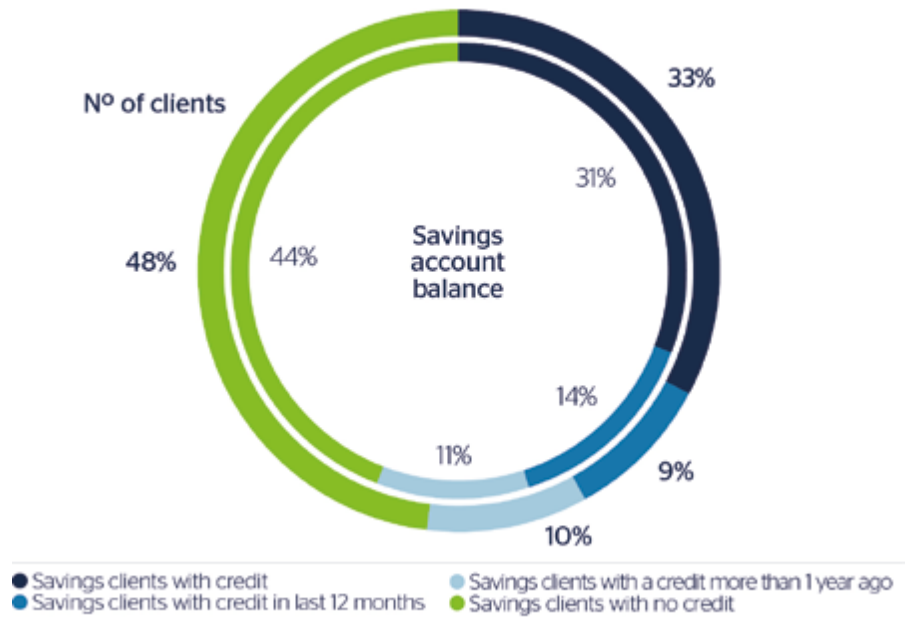
Relationship with our savings clients

- The importance of client capitalization in their overall development makes savings a critical variable in reducing their income instability.

- In 2017 Financiera Confianza topped 420,000 savings clients, 6.8% up on the year before, keeping growth in balances similar to other years. With 10,000 deposit clients it is also looking to offer higher-segment clients (with bigger savings balances) a greater variety of savings products.

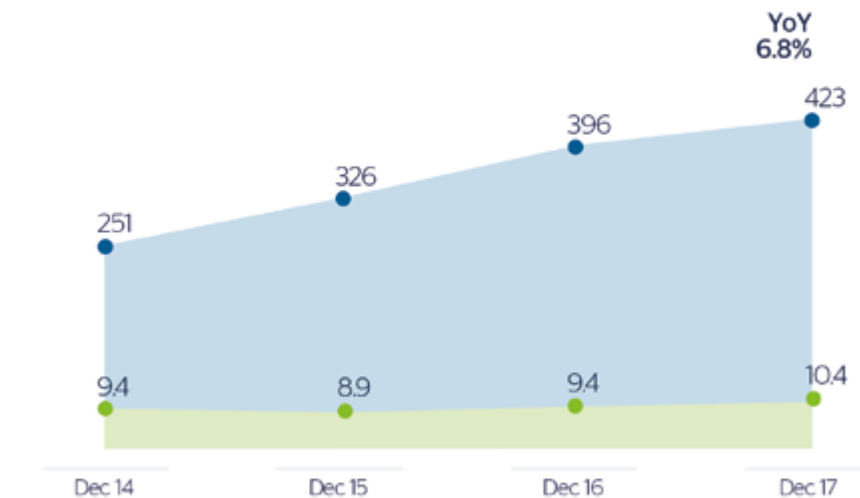
- In Financiera Confianza 48% of clients have a current savings account as their only product and the weight in the institution's total balance is 44%. Clients who have a savings product and a credit account for 33%, and their balances make up 31% of Financiera Confianza's total savings balances.

30. Linkage of savings clients



Source: Financiera Confianza, BBVAMF calculations.

31. Clients with savings and deposit accounts ('000)



● Total savings clients (savings and deposit accounts)
● Clients with deposit accounts

Source: Financiera Confianza, BBVAMF calculations.

30. Clients and savings balances at 12.31.2017.

31. Clients with savings products (savings accounts & deposits) on each date.

- The microfinance sector is stepping up to the challenge of turning saving accounts into transactional products. 23% of these clients have had over three movements in the last three months, which is a good ratio within the sector.

- Clients behave in similar ways, irrespective of gender, in terms of savings transactions: 23% of men and 22% of women have made more than three movements in savings accounts in the previous three months, and women's balances account for 49% of total balances by gender. Men have higher average balances, at USD 1,295, higher than women's by 16%.

- As the years go by, savings balances tend to be higher, which is visible in the case of clients over 60 who, on average, have savings of USD 1,757. Clients aged between 30 and 60 have lower savings than young people, which would seem to indicate that their family expenses are a burden, or else that they are saving with other, non-financial assets.

32. Transaction figures, by gender



● Men
● Women

Source: Financiera Confianza, BBVAMF calculations.

33. Savings account balance, by segment



32. Clients who conduct transactions (n° of movements in the last three months), excl. administrative movements (interest, fees) in their overdrawn balances to 12.31.2017. **33.** Savings clients with balances at 12.31.2017. Percentages represent the number of clients in each segment.

Source: Financiera Confianza, BBVAMF calculations.

Macroeconomic analysis

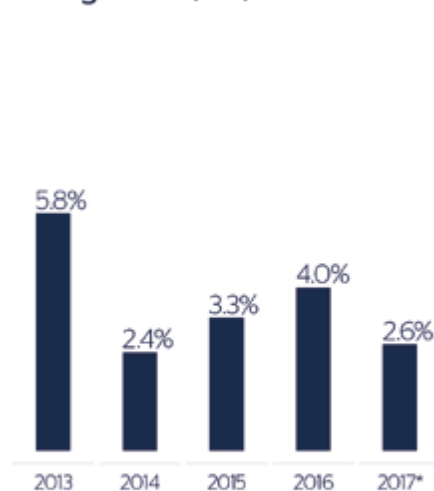
Peru

Sharp supply-side shocks have affected economic performance, which has shown weak domestic demand in a low inflationary context, while the informal economy has a heavy weight in employment. Poverty reduction has slowed, as has the improvement in income distribution.

Economic context

Economic growth: weak internal demand

GDP growth (var)



Source: Central bank (Banco de la Reserva del Perú).
* BBVAMF Research estimates.

The country suffered strong negative shocks, most of which were associated with the coastal El Niño climate phenomenon, which conditioned the economy's behavior. Activity grew by 2.6% in 2017, fundamentally because of good performance in the primary sectors, which expanded by 3%, while other sectors were up by 2.5%¹.

The first semester was conditioned by a contraction in investment and public consumption, which caused internal demand to shrink by 0.4%. Over that period the economy still grew by 2.3%, because of the 13.4% jump in exports.

The economy has been recovering since the setback suffered from the im-

pact of the coastal El Niño, growing in the second semester by 3.3%, with a recovery of internal demand, which expanded by 2.5%. The recovery of private investment after 14 consecutive trimesters of contraction, occurred thanks to higher business confidence and public spending growth.

The highest growing sector over the year was Fisheries, which expanded by 4.4%, despite the impact of the recent cooling of the sea, which affected anchovy stocks, preventing the development of the adult fish; for this reason fishing was suspended in November and December, triggering a 74% drop in the sector in the second semester.

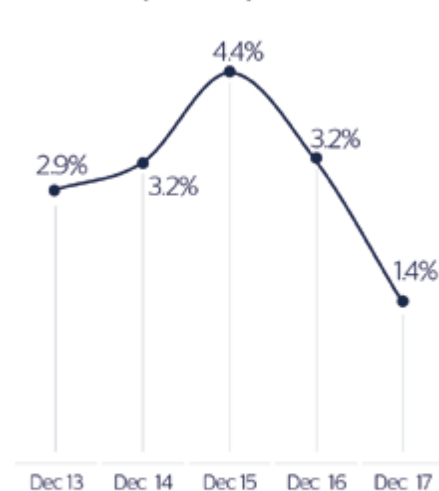
The Construction sector, however, was up by 3.6%, despite the 4.2% fall in the first semester, bouncing back in the second half, taking most public and private investment, and growing by 11% in the second half.

The Mining and hydrocarbon sector posted a 3.5% rise, less than in previous years, because of lower copper production, mainly in the Las Bambas and Cerro Verde mines which reached their optimal production levels in 2016. Services, meanwhile, expanded by 3.5%.

Manufacturing shrank by 0.5%, a consequence of the deterioration in the production of goods for consumables, lower production of sugar because of the coastal El Niño, and of fishmeal and oil as a result of the small anchovy catch. The sector fell by 3.3% in the second half.

Inflation: the lowest for the last seven years

Inflation (CPI var)



Source: Central bank.

Inflation in 2017, at a year-on-year rate of 1.4%, was the lowest in the last seven years. The prices of some foodstuffs, which had risen for a short time, taking inflation to 4% in March, started falling again, mainly because of the disappearance of the factors that caused the production of agricultural products to drop, such as the drought at the end of 2016 and the coastal El Niño phenomenon that affected the first trimester of the year.

The appreciation of the exchange rate and the weakness of internal demand are two other factors that have had an impact, due to the absence of inflationary demand pressure and moderate import inflation. The rate of inflation,

1. Conducted to the end of November 2017. All estimates by BBVAMF Research.

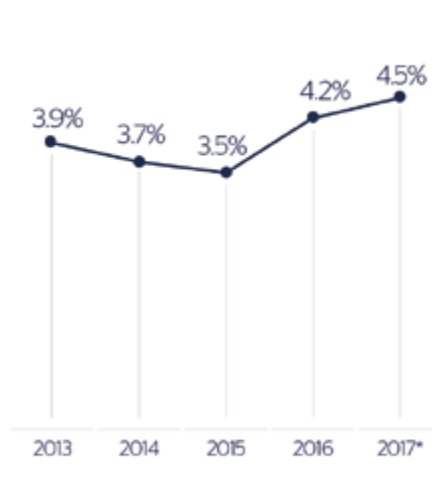
Economic context

excluding data on foodstuffs and energy, was 2.1%, within the Central bank's target range. In this context, this institution has made four reductions to the monetary policy rate, closing the year at 3.25%, with enough leeway remaining for further reductions. The reduction of the benchmark interest rate is consistent with the reversal of supply-side factors, which have positioned inflation in the lower band of the target rate.

In the first semester both investment and public consumption shrank as a result of the coastal El Niño phenomenon

Labor market: 72% working in the informal economy

Unemployment rates (% of the workforce)



Source: National Statistics Institute (INE).
* BBVAMF Research estimates.

In 2017, the national unemployment rate was 4.5%, up by 0.3 percentage point (p.p) from the year before. In the decade from 2007 to 2017, around 250,000 new jobs were generated. The annual rate of job creation has slowed in the last two years, falling from 325,000 jobs a year between 2007 and 2011, to around 270,000 new jobs a year between 2016 and 2017, period in which the occupation rate was 69%.

340,000 jobs were created in urban areas, whereas rural zones have lost around 80,000; despite this, urban unemployment came to 5.3%, with the lowest urban unemployment rates in the provinces of Ucayali (2.4%), San Martín (2.4%), Ica (2.5%) and Amazonas (2.9%). Around 27% of all jobs were generated in Lima in 2017, but even so, the unemployment rate in the region was 6.9%, higher by 0.2 (p.p) than the rate in 2016. In 2017, the female Economically Active Population (EAP) was more dynamic, growing by 2.6%, while male EAP increased by 0.8%.

In 2017, 72% of workers had an "informal" occupation, in other words, seven out of every 10 people in the occupied EAP. Around 55% of the total occupied EAP worked in the informal economy, whereas 17% did so in the formal sector, but on an informal basis. The provinces reporting the highest rates of informal employment were: Huancavelica (91%), Apurímac (90%), Cajamarca (88%), Ayacucho (87%) and Huánuco (86%).

Informal employment among women was 74%, a rate that was six p.p. lower in the case of men, at 68%. This rate was much higher in the rural environment, at 95%, than in urban settings, where it posted at 64%. The average monthly la-

Among women the rate of informal employment was recorded at 74%, whereas among men it was 6% lower

bor income of a worker with a formal job was 2.6 times higher than that of a worker with an informal occupation.

92% of workers with primary education or less work in the informal sector, whereas 52% of professional workers with non-university higher education and 38% of those with university-level education, carried out their activities in the informal sector. Looking at a broader indicator, the annual rate of underemployment was 44%; of this, the rate of underemployment in terms of income was 41%, and the rate of underemployment in terms of hours worked was 3%.

Financial inclusion: striking differences by area

According to official figures, in 2016, 32% of the adult population possessed a credit product, up from 26% in 2011, which means that in the last five years 1.5 million borrowers have joined the financial system, by December 2016 topping 6.3 million natural persons with a loan².

Over the same period, nearly 483,000 micro and small businesspeople joined the financial system, with this segment accounting for around 2.2 million borrowers by the end of 2016. According to the survey conducted by the Banking, Insurance & Pension Fund Management Authority (SBS), around 66% of the country's population is saving inside and/or outside the financial system. 32% of the savings population does so within the financial system. Although there is more money being saved exclusively outside the financial system in rural areas, there is also a significant amount in urban areas³.

Contributions to the pension system involve signing up for an obligatory savings scheme. 25% of urban dwellers have one, whereas in the countryside this percentage is a mere 4%, due to the greater extent of informal employment compared to towns and cities.

Nationwide, 60% of the population saves because they want to, both inside and outside the financial system, which breaks down into 57% in urban

areas and 71% in rural ones. Voluntary saving is mainly outside the financial system, representing 68% of savers, while only 18% keep all their savings in the financial system. Among country dwellers who save, the amount saved outside the financial system accounts for 92% of the total, whereas in towns and cities it is 59%. Only 8% of the rural population that saves uses the financial system.

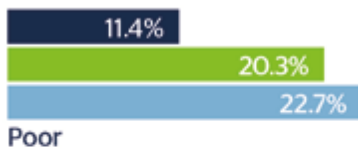
53% of the population in the metropolitan area of Lima and Callao that saves uses the services of financial institutions. In small cities this proportion drops to 22%, whereas 78% saves outside the financial system. Transactional costs are a key determinant in this difference between urban and rural zones.

Another important issue is the time needed to get to the financial institution. Despite recent progress, customer service point coverage in rural areas and small urban populations is much lower. Whereas in rural areas it takes an average of two hours to reach the nearest branch office, an urban dweller needs an average of just 20 minutes. There are significant disparities within the urban environment too, since inhabitants of small cities need an average of 50 minutes to reach their nearest office, whereas for those living in the metropolitan area of Lima and Callao, or other large cities, only take between 10 and 15 minutes.

Social environment

Poverty: poverty reduction slows down

Poverty (% of the population)



● 2030 Goal ● 2017* ● 2014

Source: National Statistics Institute (INEI).
* BBVAMF Research estimates, UN.

In 2017, 20.3% of the population was in a situation of monetary poverty, which represented a 2.4% drop from 2014; in other words, 534,000 people escaped poverty, leaving 6.46 million still in this predicament. Between 2006 and 2017, poverty fell by 10p.p., that is, 2.63 million people escaped poverty⁴.

Poverty in the rural environment reached 43.4% of the population, a 4.6p.p. reduction from 2014; in urban areas it affected 13.8%, a fall of 1.5p.p. Higher levels of poverty remain in: the rural Sierra region, at 47.7%, the rural Selva

region, at 39.4%, and the rural Costa region, with a poverty rate of 29%.

At the end of 2017, around 3.8% of the population found itself in conditions of extreme poverty, practically unchanged since 2016. This figure has fallen by 0.5p.p. compared to 2014, which means that 115,000 people have escaped poverty. Between 2006 and 2017, extreme poverty shrank by 10%, allowing 2.63 million people to better their situations.

In the rural environment extreme poverty hit 13.4% of the population; in towns and cities it was only 1%. The region suffering from the highest rate of extreme poverty is the province of Cajamarca, followed by Amazonas, Ayacucho and Huancavelica, while those with the least extreme poverty are the provinces of Arequipa, Ica, Madre de Dios, Moquegua, Callao, Lima and Tacna.

In general terms, poverty reduction was underpinned by better economic performance and the impact of this on the informal sector. Between 2006 and 2017, GDP grew at an average annual rate of 5.5%, at the same time as the proportion of informal employment dropped from 84% to 72%. This differentiated change in economic activity could also be seen in the behavior of informal employment in the formal sector itself, which has edged down from 18.5% in 2006 to 17% in 2017. Over this period the occupied EAP expand-

ed by over three million people in urban areas, while in rural areas it fell by around 500,000 workers. This shows that the increase in the supply of goods and services has provided new job positions predominantly in formal sectors. At around two thirds, this increase was reflected in the wages paid by large and medium-sized companies in particular.

58% of the poor work in Agriculture, Fishing and Mining, 12% are in Services, 11% in Trade, and the remaining 19% in other sectors. The poverty gap, defined as the proportion of a poor person's shortfall between their income and the poverty line, was 5.1%. Between 2014 and 2017 the poverty gap closed by 0.7p.p. Between 2006 and 2017 this fell by 12.6%, indicating that the poor, even if they do not escape from poverty, have noticeably improved their consumption; in other words, the poor are increasingly less poor.

The severity of poverty, which measures the differences in spending among the poor, has tapered over time, standing currently at 1.7%: it has shaved off 0.5p.p. since 2014, whereas between 2006 and 2017 it dropped by 6.7p.p.

4. All estimates by BBVAMF Research. 5. National Statistics Institute INEI.

Reduction in inequality

Inequality (Gini ratio)



Source: National Statistics Institute.
* BBVAMF estimates.

In 2017, income distribution inequality in Peru, measured using the Gini ratio (that takes values between 0 and 1, ranging from absolute equality to maximum inequality), stood at 0.432, a slight improvement over 2016, when it was 0.440.

By this estimate, Peru's inequality ratio has fallen by just 0.011 between 2014 and 2017, which is a tapering of the trend, given that between 2002 and 2008 inequality fell by 2.2% and by 1.7% from 2008 to 2017.

Breaking the indicator down by urban vs. rural and also by region, we see that the Gini ratio has been stable over the last three years. Inequality in the rural environment and particularly in rural Selva is greater than in towns and cities. If we analyze long-term results (2006-2017), we see that inequality is falling nationally and in nearly all regions, except in rural Costa and rural Selva. The greatest fall in inequality is in the metropolitan area of Lima and the urban Sierra, followed by urban Costa and urban Selva.

When we analyze the concentration in the income distribution, we see in 2017 a reduction from 2006 in the participation of the wealthiest quintile, from 52.1% to 48.8% in monetary income, while the poorest quintile now accounts for 6.7% of wealth, up from 5.2%.

It takes six times as long to reach the nearest branch office in rural areas, which has a determining effect on their lower financial inclusion

Other dimensions

18.7% of the country's population lives in households with at least one basic need that is unmet⁵. Over the last five years, this figure has shrunk by 4.6p.p.; and in the last 10 years, it has fallen by 12.8p.p. 74.8% of poor households have access to the public water network. 41.3% of these households are on the public sewage system. The power network reaches 84.9%, but this is lower than the national average, which is 94.5%.

51.9% of the population that is 15 years old or more and in conditions of poverty has no education or primary education at best. 41.7% of the population in poverty has studied one or more years of secondary education, while 6.4% studied further education.

Schooling attendance rates for girls and boys from three to five years old at playschool were 82.4%, and the net attendance rate of six to eleven-year-olds at primary school was 92.5%. In both dimensions there has been progress since the previous year, apart from attendance by children from three to five in rural areas.

School attendance rates for the 12 to 16 age group was 85.6%, with an 8% gap between urban and rural areas. 13.1% of the population over 15 in a situation of poverty is illiterate, while the national illiteracy rate is 5.9%.

34.3% of the country's citizens suffers from some form of chronic ill-health: 61.1% of the population between 50 and 59, which rises to 74.1% in the population aged 60 or over, in both urban areas (75.3%) and the countryside (70.9%).