Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: Peru AFP Withdrawals Vote, BCRP Decision

- **Peru: The significance of Peru's pension fund withdrawals**

*We refer our readers to yesterday's **Latam Daily** for our expectation for today's BCRP rate decision (pause).*

PERU: THE SIGNIFICANCE OF PERU'S PENSION FUND WITHDRAWALS

On March 15th, Peru's congressional Economics Committee voted in favour of an initiative that would allow affiliates to the private pension fund system, AFPs, to withdraw up to PEN 20,600 (nearly USD5,700) from their (presumably intangible) individual funds.

The final vote for the initiative on the congressional floor is scheduled for April 11th. If approved, and there is a good chance that it will be, then the first of the four monthly withdrawals could begin in June, although this will depend on whether it is vetoed by the Executive—after which Congress is likely to override the veto—and on the time needed by the Bank Superintendent to produce the legally required regulatory framework.

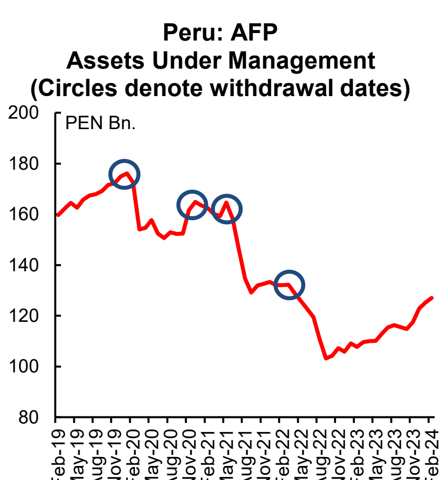
If approved, this will be the seventh withdrawal from pension funds since 2020. Not all the previous withdrawals occurred under the same terms and conditions, however. The current initiative is similar to the fifth and sixth withdrawals in that it is open to all, and the ceiling is comparable in magnitude.

The fifth withdrawal saw a total of PEN 32.2 billion withdrawn, which represented approximately 20% of total funds under AFP management at the time. The sixth withdrawal involved PEN 22.0 billion or 17% of assets under management. Assuming a similar 17% to 20% range as likely, the seventh withdrawal could imply an outflow of anywhere between PEN 21.6 billion and PEN 25.4 billion from the AFP system.

This is a magnitude that is not likely to be regained quickly. Withdrawals since 2020 have occurred with a frequency that has not allowed assets under management (AUM) to recuperate its previous level entirely (see chart 1).

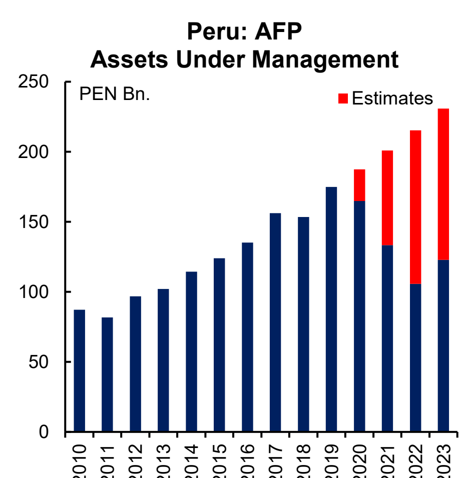
The time that elapsed since the sixth fund, approximately two years to date (May 2022) gives an idea of just how long it takes for the aggregate level of AUM to return to their pre-withdrawal level. Currently AUM are still 7% below where they stood in May 2022, the date of the sixth withdrawal (actual withdrawals were drawn out over several months). A seventh withdrawal of similar magnitude, then, would likely lead to a drop in AUM that would take at least two years to recoup.

Chart 1



Sources: Scotiabank Economics, SBS.

Chart 2



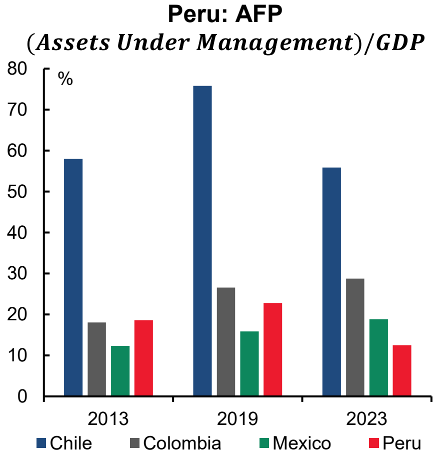
Sources: Scotiabank Economics, SBS.

Table 1: Peru-Pension Fund Withdrawals

Date	PEN Bn	% PBI	Contributors who withdrew	Withdrawal per capita	Description	Law
Apr-20	2.97	0.50	1,935,164	1,533	Up to 2,000 PEN	DU 34-2020
Apr-20	2.09	0.40	1,305,719	1,604	Up to 2,000 PEN	DU 38-2020
Apr-20	19.65	2.30	3,775,066	5,204	Upt to 25% fund	31017
Nov-20	9.02	1.20	1,256,679	7,174	Up to 4 UIT	31068
May-21	32.22	4.20	3,218,211	10,011	Up to 4 UIT	31192
May-22	21.99	2.90	3,133,149	7,020	Up to 4 UIT	31478

Source: Scotiabank Peru Economics

Chart 3



Sources: Scotiabank Economics, Central Banks,

Due to the withdrawals, assets under management are currently at levels they were a decade ago, in 2014. One wonders what the situation would be if there had been no withdrawals. We've done the exercise, using the average annual composite growth rate of AUM that occurred between 2010 and 2019 for our estimates (see chart 2). Under this assumption, had there been no withdrawals, assets under management would currently be around PEN 250 billion, or approximately double the actual current level of PEN 127 billion. Thus, Congressional withdrawal initiatives have reduced assets available for pension funds by half. The impact on individual funds is, of course, disproportionate. Well-endowed individual funds should not have been impacted greatly, whereas many smaller individual funds have been pretty much depleted.

To put things into further perspective, at the end of 2023 AUM of AFPs represented 12% of Peru's GDP, down from its 2019 peak level of 23% of GDP. That's a huge difference of eleven percentage points. In comparison with other Pacific Alliance countries, ten years ago Peru's pension fund system had a higher AUM than Colombia or México. At the end of 2023, AUM in Peru fell below all Pacific Alliance countries (see chart 3).

Past withdrawals produced knee-jerk reactions in sovereign bond yields, the FX rate and country risk measurements. Markets typically recovered partially from these initial reactions over the course of the following weeks. What has persisted over time, however, has been the decline in weight and significance that AFPs have in the bond markets and in the financial system. Currently, assets under Management represent 23% of domestic savings in Peru, which is a sharp decline from a 35% weight in 2019, before any withdrawal took place. We expect a seventh withdrawal to lower this ratio to 19%. Regarding the sovereign bonds market, AFP assets under Management represented 140% of total Peru sovereign bonds outstanding in 2023, a proportion that fell to 80% in 2023.

—Guillermo Arbe, Mario Guerrero & Ricardo Avila