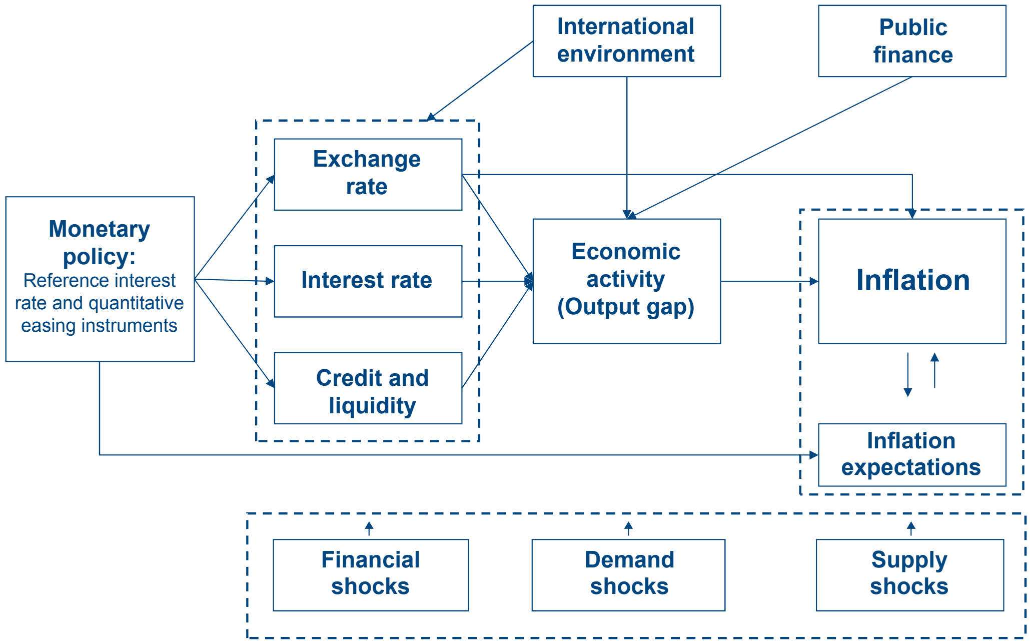
INFLATION REPORT:

Recent trends
and macroeconomic forecasts 2012-2014

September 2012



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INFLATION REPORT
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CENTRAL RESERVE BANK OF PERU

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CONTENT

This ***Inflation Report*** was drawn up using data on gross domestic product and the balance of payments as of June 2012, data on the operations of the non-financial public sector as of July 2012, and data on monetary accounts, inflation, financial markets, and foreign exchange rate as of August 2012.

Foreword

- In accordance with the Peruvian Constitution, the Central Reserve Bank of Peru (BCRP) is a public autonomous entity whose role is to preserve monetary stability.

- In order to consolidate this goal, the Bank's monetary policy is based on an inflation targeting scheme, with an inflation target of 2.0 percent, plus or minus one percentage point (between 1.0 and 3.0 percent). The Central Bank's inflation target is aimed at anchoring inflation expectations at a similar level to the inflation rate observed in developed economies and reflects the BCRP's permanent commitment with monetary stability.

- The nature of monetary policy is preventive and therefore aimed at anticipating inflationary or deflationary pressures, taking into account that inflation may be influenced by factors beyond the control of the Central Bank, such as supply shocks or the prices of imported products, which may result in transitory deviations of inflation from the target. The BCRP considers the annual increase in the consumer price index recorded each month and not only at year end.

- Each month, and according to a previously announced schedule, the Board of the BCRP approves a reference rate for the interbank lending markets. This interest rate, which is the monetary operational target, affects the rate of inflation through several channels in different timeframes and, therefore, is determined on the basis of macroeconomic forecasts and simulations.

- Additionally, the Central Bank implements preventive measures to preserve financial stability and monetary policy transmission mechanisms. Through interventions in the foreign exchange market, the Central Bank reduces excessive volatility in the exchange rate and accumulates international reserves, thus developing strengths to face negative events in an economy with still high levels of financial dollarization. The Central Bank also uses other monetary policy tools that affect the volume of liquidity and credit in a more direct manner, such as reserve requirements in domestic currency and in foreign currency.

- The forecasts on which monetary policy decisions are based are disseminated through the Inflation Report to show the consistency of the decisions adopted with the aim that economic agents' expectations take these forecasts into account. The Central Bank also disseminates the studies analyzing the risk factors that may cause deviations in the forecasts of the economic variables considered.

- The BCRP will publish its next Inflation Report in December 2012.

Summary

i. In the last months, several indicators of global economic activity have slowed down at a greater pace than forecast in our Inflation Report of June. This behavior is associated, in the first place, with uncertainty regarding the countries with debt problems in the Eurozone, which has weakened investors and consumers' confidence and deteriorated financial conditions in these countries. The European Central Bank has announced a new plan to allow purchases of sovereign bonds of Eurozone countries.

   In the second place, the U.S. economy has shown a more moderate evolution due to the slow recovery of employment and the real estate market, as well as due to uncertainty about the fiscal agreement required to approve the 2013 budget. The U.S. monetary authorities have recently announced measures of its third quantitative easing program that will be adopted to face the problems associated with the slow recovery being observed. In addition to this, a slowdown is also being observed in emerging countries such as China and India.

   In this context, the forecast of global growth for 2012 has been revised down from 3.2 to 3.1 percent and the forecast for 2013 has been revised down from 3.7 to 3.5 percent.

ii. In the first semester, Peru's GDP grew 6.1 percent, higher than estimated in our previous Inflation Report. Based on this and on recent indicators of activity, the forecast of GDP growth in 2012 has been revised up from 5.8 to 6.0 percent, due mainly to the favorable evolution of private investment. It should be pointed out that this upward revision considers less favorable external conditions for the Peruvian economy during the second semester of the year due to lower terms of trade and to a lower growth of the demand for export products.

   The forecasts for 2013 and 2014 consider the projections regarding the international environment, which point to a downward revision in the rates of global growth and in terms of trade. Thus, GDP is projected to grow between 5.8 and 6.2 percent in 2013 and between 6.0 and 6.5 percent in 2014.

iii. The current account deficit projected for 2012 has been revised up from 2.7 percent of GDP (Inflation Report of June) to 3.9 percent of GDP, while the projection for 2013 has been revised up from 2.8 to 4.1 percent of GDP as a result of lower terms of trade. On the other hand, the current account deficit in 2014 is projected to decline to 3.8 percent of GDP with the onset of operations of new mining projects.

This revision considers a lower growth in the volume of exports of traditional products, especially gold, a lower growth in the volume of non-traditional exports, and higher levels of imports.

iv. The projections of the balance of the operations of the non-financial public sector are based on the balance of the first semester, during which higher levels of fiscal deficit were observed, especially in the central government. Therefore, the economic balance for 2012 has been revised up to 1.5 percent of GDP (vs. 1.1 percent of GDP foreseen in our June Report).

The economic balance projected for both 2013 and 2014 is an economic surplus of 1.1 percent of GDP, a figure slightly higher than the one considered in our June Report (1.0 percent in both years), mainly as a result of an expected higher growth of current revenues associated with measures aimed at expanding the tax base. This effect would offset the lower revenues foreseen as a result of lower export prices. The projected level of nominal expenditure considered in our June Report remains unchanged for both years.

v. At August, inflation in the last 12 months shows a rate of 3.5 percent, level above the upper band of the target range. However, inflation in the central forecast scenario is expected to gradually converge towards the upper band of the target range (3.0 percent) by the end of the year after the inflationary pressures associated with significant rises in commodity prices subside. This inflation forecast considers the recent dynamism observed in the prices of fuels and food, which have been affected by tensions in the Middle East and by the drought in the United States, as well as by domestic supply shocks which have generated transitory rises in the prices of some perishable food products. Inflation in 2013 would show a rate between 1.5 percent and 2.5 percent.

vi. The Board of the Central Bank has decided to maintain the policy rate at 4.25 percent between June and September amid a context of uncertainty in international financial markets in which a deterioration of terms of trade and lower prospects for global growth are being observed. The decision also considers that inflation's current deviation from the target reflects mainly the impact of temporary supply factors in a context in which the Peruvian economy is growing at a rate close to its potential growth rate and that inflation is therefore expected to continue converging gradually to the target range towards the end of the year.

vii. The **balance of risks** for the inflation forecast is neutral in the forecast horizon. In other words, based on the information available today, the probability that inflation will fall below the projection in the baseline scenario is the same as the probability that it will fall above this projection.

viii. The **downward risk** scenarios in the inflation forecast are, on the one hand, external factors associated with the potential unfolding of an international financial crisis and, on the other hand, domestic factors, such as a contingent scenario of lower growth of domestic demand due to the postponement of investment projects.

a. Deterioration of the international environment

The baseline scenario considers a gradual recovery of global economic activity as from QIV-2012. A contingent scenario of deterioration of international conditions implies that this recovery would not take place and that there could even be a greater economic slowdown or decline of GDP in different regions of the world given growing uncertainty in international markets, which would contribute to weaken external demand and affect the Peruvian economy through the financial and trade channels.

In this scenario, an increase in global uncertainty and the drop of commodity prices could generate panic among investors and lead to a sudden reversal of capitals that would bring about a real depreciation of currencies and an increase in the country risk indicator in emerging economies like Peru.

If these risks materialized, the Central Bank would use some of its considerable amount of international reserves and several liquidity injection mechanisms in both national and foreign currency to offset the impact of this shock on domestic financial conditions. Even more, should this be the case, the Central Bank would respond easing monetary conditions.

b. Lower growth of domestic demand

This scenario analyzes the possibility that investment projects are either postponed or cancelled. This would generate less dynamism in the aggregate demand and lead, in the short term, to a rate of economic growth below the economy's potential growth which would generate downward pressures on inflation. In this scenario, the Central Bank would increase the monetary stimulus with the aim of leading inflation to fall within the target range in the forecast horizon

On the other hand, there are two scenarios of **upward risk** for inflation associated mainly with an increase in capital inflows and a rise in commodity prices.

c. Increased capital inflows

Together with the scarce options attractive for investment in a context of great global uncertainty, the highly significant amount of liquidity that would be available in international markets as a result of the implementation of new quantitative easing measures by the central banks of developed countries could promote a flow of foreign capitals to the emerging economies. This would be an event similar to the one observed in the second half of 2010 following the FED's announcement and implementation of QE2. The recently announced monetary expansion program (QE3) would include monthly purchases of US$ 40 billion, even though the total amount to be purchased is still unknown. A greater capital inflow would accelerate the growth of credit, stimulating aggregate demand and inflation, and would also exert appreciatory pressures on the nuevo sol, which would translate into lower inflation. A rise in inflation is estimated due to the effect of an increased capital inflow and the higher imported inflation this scenario entails.

In this scenario, the Central Bank would adjust its monetary position and use macroprudential policy instruments such as the rates of reserve requirements.

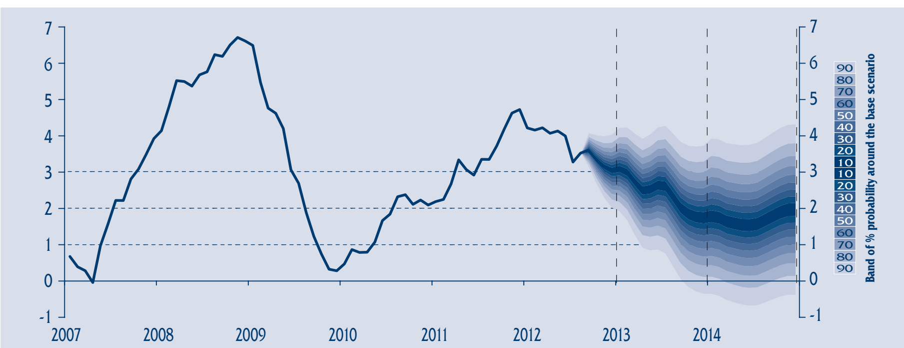
d. Domestic and external supply shocks

Even though the recent rise in the prices of food commodities and fuels has been considered in the baseline scenario, there is the risk that global inflationary pressures will be more persistent. For example, the impact of the drought in the United States on the international price of maize is an important risk factor and a rise in the tensions affecting the Middle East could lead to an increase in the price of crude. If they are persistent, these shocks could affect the evolution of inflation through higher imported costs and lower margins for local businesses, which could generate inflationary pressures.

In the domestic arena, even though the probabilities are lower, there is still the risk of having to face adverse climatic conditions associated with a possible El Niño event, which could affect the normal development of the production and supply of food products (especially fishing and farming products).

In this scenario, the Central Bank would adjust its monetary position only if these inflationary shocks increase inflation expectations.

INFLATION FORECAST: 2012-2014
(Last 12 months % change)



SUMMARY OF INFLATION REPORT FORECASTS

	2010	2011	2012 1/		2013 1/		2014 1/	
			IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
Real % change								
1. GDP	8.8	6.9	5.8	6.0	6.2	5.8 - 6.2	6.3	6.0 - 6.5
2. Domestic demand	13.1	7.2	6.3	7.1	6.4	6.2	6.5	6.3
a. Private consumption	6.0	6.4	5.8	5.8	5.6	5.5	5.8	5.7
b. Public consumption	10.0	4.8	6.0	8.7	4.9	5.7	6.3	5.8
c. Fixed private investment	22.1	11.7	10.2	13.5	8.7	8.2	8.7	8.2
d. Public investment	27.3	-17.8	31.0	23.7	10.0	14.3	9.3	11.0
3. Exports (goods and services)	1.3	8.8	5.7	3.3	7.7	7.7	8.5	9.4
4. Imports (goods and services)	24.0	9.8	8.3	9.0	8.3	8.1	8.9	8.9
5. Economic growth in main trading partners	4.6	3.6	2.8	2.7	3.2	3.0	3.4	3.3
Memo:								
Output gap 2/ (%)	0.1	0.8	-0.5 ; +0.5	-0.5 ; +0.5	-0.5 ; +0.5	-0.5 ; +0.5	-0.5 ; +0.5	-0.5 ; +0.5
% change								
6. Forecast inflation	2.1	4.7	2.0-3.0	3.0	1.5-2.5	1.5-2.5	1.5-2.5	1.5-2.5
7. Average price of crude oil	28.7	19.6	2.8	0.5	-2.5	0.0	0.0	0.0
8. Nominal exchange rate 3/	-2.1	-4.3	-2.6	-5.1	0.0	-0.4	0.0	0.0
9. Real multilateral exchange rate 3/	-3.0	-5.8	-1.7	-8.9	0.4	-1.1	2.6	1.6
10. Terms of trade	17.9	5.4	-3.6	-6.6	-1.1	-2.1	-0.5	0.4
a. Export price index	29.9	20.0	-6.2	-5.2	-1.2	-2.1	1.5	1.5
b. Import price index	10.1	13.8	-2.6	1.4	-0.1	0.1	2.0	1.1
Nominal % change								
11. Currency in circulation	25.4	12.9	17.5	14.0	13.0	13.0	13.2	13.2
12. Credit to the private sector 4/	21.0	19.6	14.5	14.0	12.5	12.5	12.7	12.7
% GDP								
13. Gross fixed investment rate	25.1	24.1	26.1	26.6	26.8	27.5	27.6	28.1
14. Current account of the balance of payments	-2.5	-1.9	-2.7	-3.9	-2.8	-4.1	-2.9	-3.8
15. Trade balance	4.4	5.3	3.4	1.8	3.1	1.3	3.0	1.6
16. Gross external financing to the private sector 5/	8.7	6.8	7.2	7.9	5.4	5.8	5.1	5.7
17. Current revenue of the general government	20.0	21.0	21.1	21.4	21.2	21.7	21.2	21.7
18. Non-financial expenditure of the general government	19.2	18.1	19.1	19.1	19.2	19.5	19.2	19.6
19. Overall balance of the non-financial public sector	-0.3	1.9	1.1	1.5	1.0	1.1	1.0	1.1
20. Total public debt balance	23.3	21.2	19.4	20.0	18.2	18.6	16.8	17.2

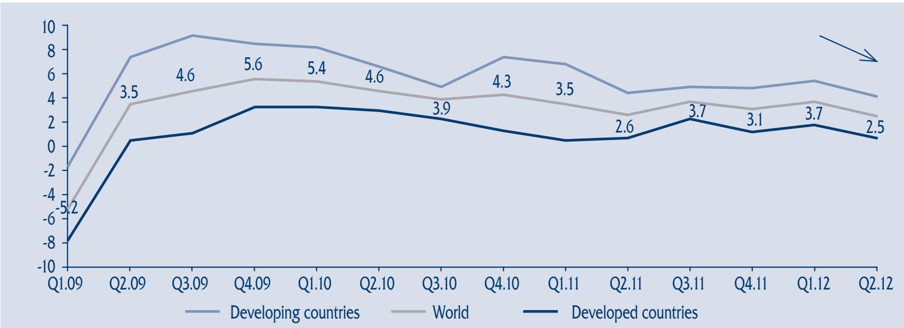
IR: Inflation Report.
1/ Forecast.
2/ Differential between GDP and potential GDP (%).
3/ Survey on exchange rate expectations.
4/ Includes loans made by banks' branches abroad.
5/ Includes foreign direct investment and private sector's long term disbursement.

I. International environment

Economic activity

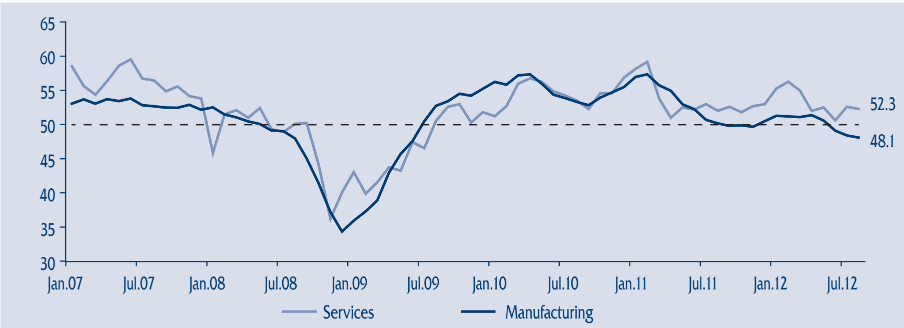
1. Global economic activity has slowed down more than expected over the past few months. In Q2, GDP registered the lowest growth rate since the first quarter of 2009 and the indicators of manufacturing activity continue declining and, on average, show levels in the contraction zone.

Graph 1
QUARTERLY SEASONALLY ADJUSTED WORLD GDP GROWTH
(Annualized rates)



Source: JP Morgan.

Graph 2
JP MORGAN GLOBAL PMI MANUFACTURING AND SERVICES
(January 2007- August 2012)



Source: Bloomberg.

This evolution is mainly associated with three factors. In the **Eurozone**, uncertainty about the economy of countries with debt problems has been affecting consumers and investors' confidence. This has also contributed to deteriorate financial conditions and has had an impact on the slowdown experienced by the larger economies in the region.

Second, the recovery in the **United States** has been more moderate than expected due, on the one hand, to the slow evolution of employment and the real estate market, and, on the other hand, to uncertainty regarding the fiscal agreement about the budget for 2013. The high price of crude, associated with geopolitical factors, is another factor of uncertainty which has been reducing the disposable income and offsetting the recovery of consumption.

The third factor is the economic slowdown observed in the emerging economies, particularly in **China** and **India** –the second and fourth largest economies in GDP purchasing power parity terms– where, together with unfavorable climatic shocks, a lower external impulse and a slowdown of domestic demand is being observed despite the stimulus measures already adopted. Like in other emerging economies, the rise in the price of food products may offset the effect of monetary policy response to face the economic slowdown due to the impact it may have on inflation expectations.

2. In line with these developments, it is estimated that the world economy will grow 3.1 percent in 2012, which represents a downward revision compared to our estimates of June, and 3.5 percent in 2013 (vs. 3.7 percent estimated in our previous Report).

Table 1
WORLD GDP GROWTH: 2011-2014
(Annual % change)

	2010	2011	2012		2013		2014	
			IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
Developed countries	**3.0**	**1.6**	**1.3**	**1.3**	**1.9**	**1.6**	**2.1**	**2.1**
1. United States	2.4	1.8	2.2	2.2	2.4	2.0	2.5	2.4
2. Eurozone	2.0	1.5	-0.5	-0.5	0.5	0.3	1.3	1.3
Germany	4.2	3.0	0.8	0.8	1.2	1.0	1.5	1.5
France	1.7	1.7	0.0	0.0	0.5	0.5	1.4	1.4
Italy	1.8	0.4	-1.8	-2.3	-0.3	-0.4	0.5	0.5
Spain	-0.3	0.4	-1.8	-1.6	-0.5	-1.3	1.2	0.8
3. Japan	4.4	-0.7	2.1	2.3	1.9	1.3	1.5	1.5
4. United Kingdom	2.1	0.7	0.2	-0.4	1.1	1.4	1.5	1.5
5. Canada	3.2	2.5	2.0	2.0	2.0	2.0	2.0	2.0
6. Other developed countries	5.8	3.2	2.5	2.2	3.4	3.2	3.6	3.6
Developing countries	**7.5**	**6.1**	**5.3**	**5.1**	**5.7**	**5.6**	**5.9**	**5.9**
1. Sub-Saharan Africa	5.3	5.1	4.3	4.3	5.4	5.4	5.4	5.4
2. Central and Eastern Europe	4.6	5.2	2.0	2.0	3.0	2.8	3.4	3.4
3. Community of independent countries	4.6	4.7	4.0	3.8	4.2	4.2	4.2	4.2
Russia	4.0	4.1	3.9	3.7	4.0	4.0	4.0	4.0
4. Developing Asia	9.7	7.8	7.1	6.8	7.5	7.4	7.8	7.8
China	10.4	9.2	8.0	7.8	8.5	8.3	8.7	8.7
India	10.6	7.2	6.7	6.1	7.3	7.0	7.5	7.5
5. Middle East and Northern Africa	4.9	3.5	3.5	3.5	3.7	3.7	3.7	3.7
6. Latin America and the Caribbean	6.1	4.5	3.5	3.1	3.8	3.7	3.9	3.9
Brazil	7.5	2.7	3.0	1.8	3.9	3.9	4.0	4.0
World Economy	**5.2**	**3.8**	**3.2**	**3.1**	**3.7**	**3.5**	**3.9**	**3.9**
Memo:								
BRICs 1/	9.4	7.4	6.6	6.2	7.2	7.0	7.3	7.3
Peru's trading partners 2/	4.6	3.6	2.8	2.7	3.2	3.0	3.4	3.3

IR: Inflation Report.
Source: Bloomberg, FMI and Consensus Forecast.
1/ Brazil, Russia, India and China.
2/ Basket of Peru's 20 main trading partners.

There are risk factors that could lead the world economy to grow below the level considered in the baseline scenario. The risks of an additional rise in the prices of food and fuels add to the risks associated with a worsening of the **Eurozone** crisis, a disorderly adjustment in fiscal accounts in the **United States** in 2013, and a greater than anticipated deceleration in **China** and other emerging economies. However, the implementation of non-conventional monetary measures and fiscal stimulus, such as the ones recently announced by the U.S. and Eurozone authorities offset these risks.

Graph 3
GDP GROWTH

* Forecast.
Source: BCRP.

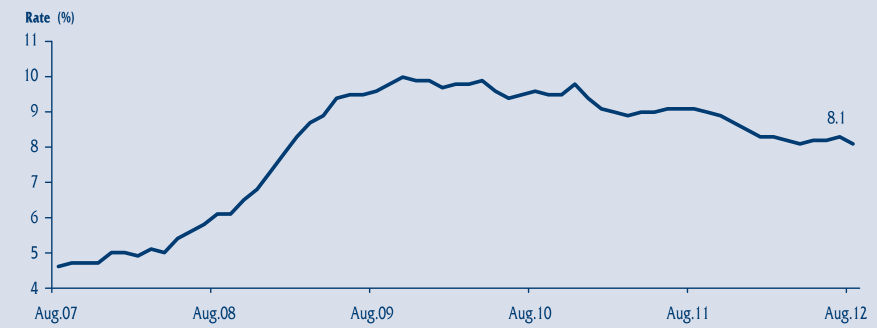
Developed economies

3. Growth in the developed economies continued to slow down in Q2. The largest economies –**USA, Germany,** and **Japan**– continued to show positive growth rates,

although showing signs of deceleration, a trend confirmed by more recent indicators. On their side, the **Eurozone** countries with debt problems continue showing a significant contraction. In line with this, the forecast on the growth of developed countries has been revised down, especially the forecast for 2013.

4. In the **United States**, the lower GDP growth registered in Q2 is explained by the deceleration of personal consumption. The consumption of durable goods has been affected by the weak situation of the labor market and by the deterioration of consumer confidence. Even though the rate of unemployment has fallen from 8.5 percent in December 2011 to 8.1 percent in August of this year, the creation of new jobs has decelerated since April 2012.

Graph 4
USA: UNEMPLOYMENT RATE

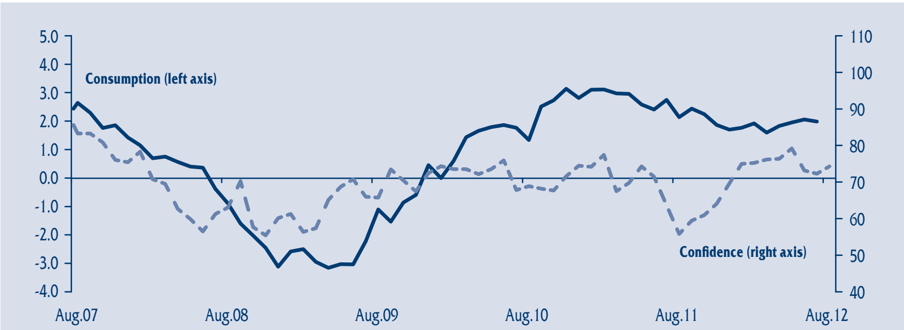


Source: Bloomberg.

Graph 5
USA: CREATION OF NEW JOBS

Source: Bloomberg.

Graph 6
USA: REAL PERSONAL CONSUMPTION (12 month % change)
AND CONSUMER CONFIDENCE (Index of Univ. Michigan)



Source: Bloomberg.

In contrast with consumption, investment has been showing a favorable evolution. The growth observed in residential investment stands out, with the real estate market showing an increase in construction permits and house sales. This increased dynamism is reflected in the rise of real estate prices in the last months.

Table 2
USA: SEASONALLY ADJUSTED GDP GROWTH (Q1.10 - Q2.12)
(Quarterly annualized rates)

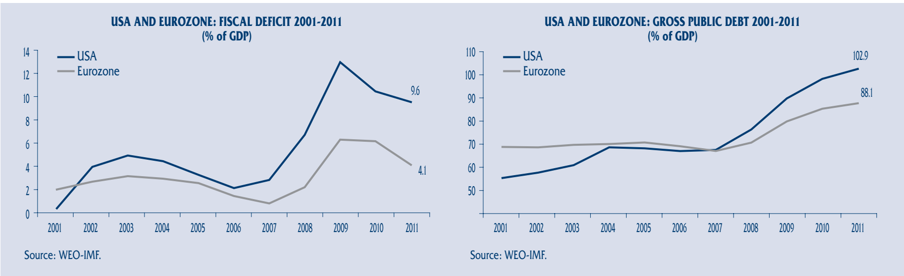
	Q1.10	Q2.10	Q3.10	Q4.10	Q1.11	Q2.11	Q3.11	Q4.11	Q1.12	Q2.12
GDP	**2.3**	**2.2**	**2.6**	**2.4**	**0.1**	**2.5**	**1.3**	**4.1**	**2.0**	**1.7**
Personal consumption	2.5	2.6	2.5	4.1	3.1	1.0	1.7	2.0	2.4	1.7
Durable	5.5	10.5	7.2	15.2	7.3	-2.3	5.4	13.9	11.5	0.0
Non Durable	5.1	0.1	2.2	4.5	4.6	-0.3	-0.4	1.8	1.6	0.5
Services	1.2	2.3	1.9	2.3	2.0	1.9	1.8	0.3	1.3	2.4
Gross investment	19.8	14.6	16.4	-5.9	-5.3	12.5	5.9	33.9	6.1	3.0
Fixed investment	-0.9	14.5	-1.0	7.6	-1.3	12.4	15.5	10.0	9.8	5.1
Non Residential	2.1	12.3	7.7	9.2	-1.3	14.5	19.0	9.5	7.5	4.2
Residential	-11.4	23.1	-28.6	1.5	-1.4	4.1	1.4	12.1	20.5	8.9
Exports	5.9	9.6	9.7	10.0	5.7	4.1	6.1	1.4	4.4	6.0
Imports	10.4	20.2	13.9	0.0	4.3	0.1	4.7	4.9	3.1	2.9
Government expenditure	-3.1	2.8	-0.3	-4.4	-7.0	-0.8	-2.9	-2.2	-3.0	-0.9

Source: US Bureau of Economic Analysis.

In this context, the forecast of growth in the United States in 2013 has been corrected down from 2.4 to 2.2 percent, while the forecast on growth in 2012 remains in line with the execution observed in Q2 and with the weak data on activity, employment, and confidence.

The main risk factor in this forecast is the likelihood of a disorderly adjustment in fiscal accounts as from 2013 if no agreement about the fiscal budget is reached by December. A new negotiation on the limit of the public debt is also foreseen given that the current balance of the debt, which is approximately US$ 16 trillion, is close to the limit of US$ 16.4 trillion established early this year.

Graph 7



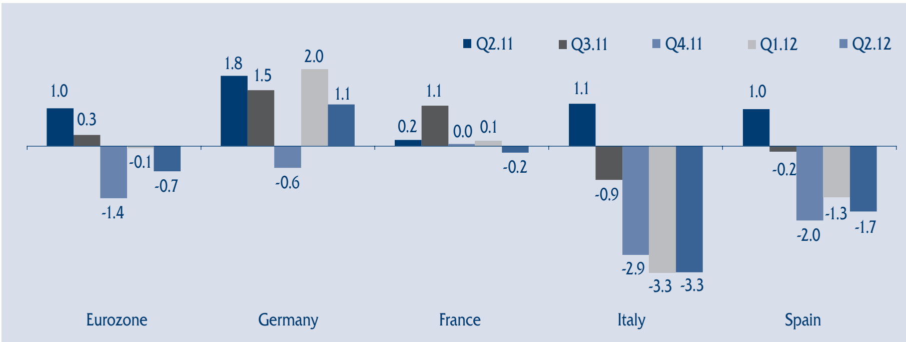
Inflationary pressures in the United States have decelerated. Total CPI inflation fell from an annual rate of 3.0 percent in December 2011 to 1.4 percent in July 2012, while core inflation declined slightly to 2.1 percent. In this context, on September 13 the FED announced a third program of quantitative easing (QE3) which consists of bond purchases for US$ 40 billion each month, even though the date when these purchases will culminate has not been specified. The FED also announced that it would maintain exceptionally low interest rates at least until mid-2015 (previously this date was mid-2014).

5. Economic activity in the **Eurozone** contracted 0.7 percent in Q2 after remaining stagnated in Q1. It is estimated that activity in this region would register a decline of 0.5 percent in 2012 and that it would recover slightly in 2013. The economies with debt problems would show a contraction in the period 2012-2013, while the economies in the North would grow at a lower rate than estimated in our Inflation Report of June.

GDP in **Germany**, the major economy in the **Eurozone**, shows an expansion of 1.1 percent in Q2. The most frequent indicators reflect a deceleration explained by a lower dynamism in investment and by the deterioration of the business climate. Moreover, exports in the **Eurozone** have declined and could even be more affected by the recent developments in **China**. In line with these factors, the forecast on growth in Germany in 2013 has been revised down from 1.2 to 1.0 percent.

The Eurozone peripheral economies continued to be affected by concerns about a new debt restructuring in **Greece** and by the fiscal position of **Spain** and **Italy**, weakened by prospects of low growth, high unemployment, and unfavorable financing conditions. It is estimated that these economies will continue to show negative growth rates during 2013, that is, longer than considered in our previous Inflation Report.

Graph 8
EUROZONE: QUARTERLY GROWTH
(Seasonally adjusted annualized quarterly rates)



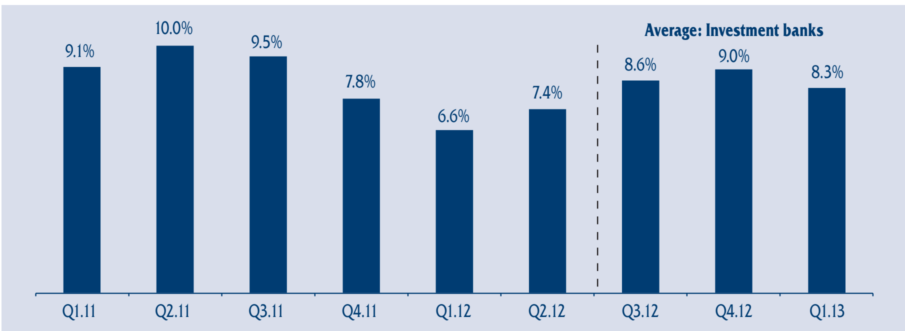
6. In **Japan**, the economy has continued to show a favorable evolution due to expenditure for reconstruction (after the earthquake that hit the country last year) and to the dynamism registered in the consumption of durable goods and services. The growth of consumption has been driven by the incentive given for the purchase of hybrid cars and by expectations about the end of the deflationary period (inflation has remained at positive levels during most of the year).

Emerging economies

7. The recent deceleration observed in the emerging economies has exceeded previous estimations. The situation in the **Eurozone** and lower growth in the **United States** have affected trade volumes, particularly in **Asia**, while the drop in commodity prices, especially of basic metals, has affected **Latin American** economies.

8. In **China**, investment has shown lower dynamism due to the evolution of expenditure in infrastructure, while the export sector has been affected by the lower demand of most developed economies, particularly the **Eurozone**.

Graph 9
CHINA: QUARTERLY GDP
(Seasonally adjusted annualized rates)



By sectors, the deceleration observed in industrial production since end 2011 continues. The measures adopted by the government to stimulate aggregate demand, particularly investment, do not translate into a considerable recovery yet. However, markets still await a rebound in the second half of the year. The forecasts for 2012 and 2013 have been revised slightly down (to 7.8 and 8.3 percent, respectively).

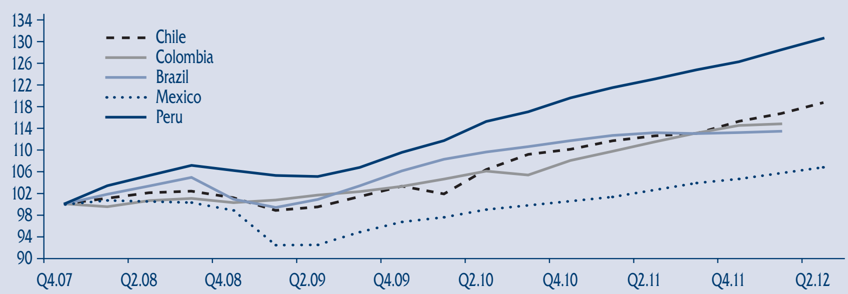
Table 3
CHINA'S ECONOMIC INDICATORS: 2010 - 2012

	2010	2011				2012		
	Dec.	Mar.	Jun.	Sep.	Dec.	May.	Jun.	Jul.
Manufacturing PMI (50 neutral level)	53.9	53.4	50.9	51.2	50.3	50.4	50.2	50.1
Industrial Production (12 month % change)	13.5%	14.8%	15.1%	13.8%	12.8%	9.6%	9.5%	9.2%
Investment in fixed assets (12 month % change)	24.5%	25.0%	25.6%	24.9%	23.8%	20.1%	20.4%	20.4%
Retail sales (12 month % change)	19.1%	17.4%	17.7%	17.7%	18.1%	13.8%	13.7%	13.1%
Exports (12 month % change)	17.9%	35.8%	17.9%	17.1%	13.4%	15.3%	11.3%	1.0%
Imports (12 month % change)	25.6%	27.3%	19.3%	20.9%	11.8%	12.7%	6.3%	4.7%
New loans (Billions of yuan)	481	679	634	470	641	793	920	540
CPI (12 month % change)	4.6%	5.4%	6.4%	6.1%	4.1%	3.0%	2.2%	1.8%
Food prices (12 month % change)	9.6%	11.7%	14.4%	13.4%	9.1%	6.4%	3.8%	2.4%

Source: Bloomberg.

9. In **Latin America**, most economies continued showing positive growth rates. However, with the exception of Chile and Peru, many of them show a deceleration in line with the developments in the global economy and, to a lesser extent, with the evolution of domestic demand.

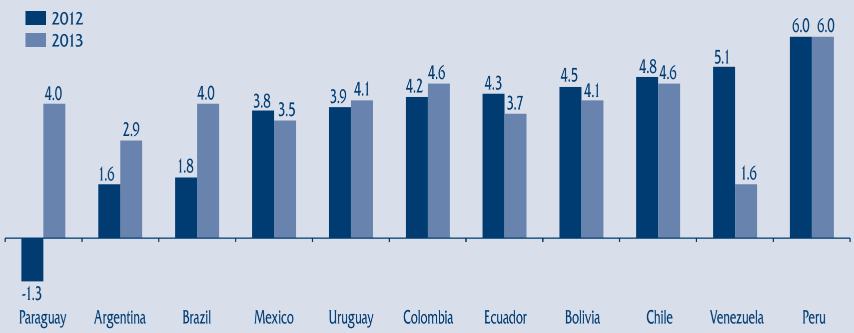
Graph 10
EVOLUTION OF LATIN AMERICA GDP
(Seasonally-adjusted data. Q4.07=100)



Source: Central banks and statistics institutes.

The greater deceleration has been observed in **Brazil**, where industrial activity has accumulated ten consecutive months of decline in annual terms, and credit show increasingly lower growth rates. In this context, the government has implemented a series of measures aimed at constructing more infrastructure and the Central Bank has continued lowering its interest rate. On the other hand, Chile's higher growth is explained by the rebound of domestic demand, particularly consumption, which has been in part offset by lower exports.

Graph 11
LATIN AMERICA: GDP GROWTH FORECAST*



* Consensus Forecasts and BCRP (Peru).

As regards inflation, different conducts have been observed in the rates of inflation in Latin American countries over the past two months in a context in which the international prices of food commodities rose due to supply shocks in important producing and exporting areas and the prices of crude rebound. Within the group of countries with inflation targeting regimes, inflation has risen in **Brazil** and **Mexico**, but have continued to correct downwards in **Chile**, **Colombia**, and **Uruguay**.

10. In the rest of emerging economies, the deceleration observed in India stands out. **India's** economy has been affected by a weak external demand, agricultural supply problems caused by disturbances in the rain cycle, and an unfavorable investment climate due to high inflation levels and high interest rates. On their side, the main economies in **Eastern Europe** and **Russia** have continued to show signs of a slowdown in Q2 influenced mainly by the evolution of the Eurozone, as a result of which their growth forecasts have been revised slightly downwards.

Financial markets

11. The evolution of international financial markets was marked by the tensions observed in the Eurozone, which affected mainly European stock and debt markets, and by increased evidence of a global economic slowdown.

The deepening of the Eurozone crisis is explained mainly by uncertainty about the renegotiation of the program for Greece (and this country's potential exit from the Eurozone) as well as by the situation of Spain. These events have increased financial risks, particularly in Spain and Italy, generating uncertainty about the possibility that these countries will require in the near future a similar sovereign bailout to the one provided to Greece, Portugal, and Ireland. Moreover, financial markets were also affected by the signals of global economic deceleration.

In this scenario, measures were adopted by European leaders in June and increasing expectations of new stimulus measures in most developed economies and new bond purchase programs by the ECB materialized when this was finally announced in September. Likewise, the FED announced a new monetary stimulus program (quantitative monetary expansion program or Quantitative Easing). Both factors have temporarily reversed risk aversion and partially offset tensions in financial markets.

12. In **sovereign debt markets**, tensions associated with Greece and Spain maintained the spreads high during the last months. The yields in Spain were higher than in Italy and surpassed 7 percent and registered new records on several occasions. In the last weeks of August, however, the trend corrected due to expectations of interventions of the ECB in the bond markets.

THE EUROZONE DEBT CRISIS: RECENT EVENTS

European Summit

1. A Summit of European leaders was held on June 28 and 29 to discuss the policy options to face the crisis. Some of the most significant actions agreed upon this summit included the following:
    - Designate the European Central Bank (ECB) as the sole bank regulator in the Eurozone, which implies the establishment of a regulation scheme.
    - Allow rescue funds to intervene in the secondary markets of sovereign debt to stabilize the markets in the short term.
    - Once the bank regulation scheme is operating, allow rescue funds to recapitalize banks directly, without a total program with the IMF/EU.

Intervention of the ECB in the bond market

2. On its policy meeting of August 2, where its policy rate was maintained at 0.75 percent, the ECB announced that steps were being taken to reinitiate the ECB's purchases of sovereign bonds in the secondary market. This short term bond buying avoids violating the treaty which prevents financing government deficits. It is worth mentioning that the ECB has not bought sovereign bonds since March of this year and that the balance of these bonds is estimated at 200 billion. The ECB has also said that the interventions would not take place before September and that any intervention should be preceded by purchases made by the existing stabilization funds. Finland and the Bundesbank have recently expressed their opposition to the ECB intervention plan.

In September, the ECB announced that it will start purchasing bonds in the secondary market and that the purchases will include only short-term bonds (with 1- to 3-year maturities), that there will be no pre-established quantitative limits (that is, that they will be discretionary and potentially unlimited), and that they will be fully sterilized. The ECB also said that a total program (Macroeconomic Adjustment) or a preventive program (Credit Line with Reinforced Conditionality) with rescue funds (EFSF/ESM) is previously required. Finally, the ECB also announced that it will ease its collateral policy.

Greece

3. A Government coalition in favor of the IMF/EU program was managed to be formed with the results of the elections of June 17, which has dissipated the risk that Greece will exit the Eurozone.

   In July, the "Troika" (the European Commission, the ECB, and the IMF) initiated the review of the program. Greece's failure to meet the goals and its request for more funding generated new fears that it would exit the Eurozone given European leaders' reluctance to grant more concessions to this country. In the first days of August, the coalition government managed to agree on fiscal saving measures for a total of € 11.5 billion by 2013-14, which is one of the actions required by the program (although there are disagreements among the members of the government coalition on the policy composition required to reach this figure). The Troika pointed out that progress had been made in the talks with the government about the program: the evaluation mission reported that negotiations with the new Government had been productive and that there will be another meeting in early September. However, there is uncertainty about the possibility that the government may request to extend the program of fiscal adjustment from 2014 to 2016, with an additional funding of € 20 billion, and therefore there is still uncertainty about Greece's position in the European Union, which has again generated uncertainty in the market.

Spain

4. In Spain, the heavy losses of Bankia –the fourth largest bank in the system– associated with its exposure to the real estate market, and its subsequent nationalization generated uncertainty regarding the financial position of Spanish banks as well as regarding the government's capability to achieve an adequate recapitalization.

   This situation led the government to request the bailout of the EU/IMF to recapitalize Spanish banks, as a result of which Spain became the fourth country to request a rescue program from the EU and IMF. The European leaders have already agreed to give Spanish banks a loan of up to € 100 billion, in exchange of which the government announced more fiscal adjustment measures (for a total of € 65 billion) to ensure compliance with the new deficit targets. The budget plan submitted to the European Commission proposes measures for € 102 billion to meet the fiscal deficit goals for 2012, 2013, and 2014 (6.3%, 4.5% and 2.8% of GDP, respectively). The government has also established limits to the debts of the 17 semi-autonomous regions to be able to meet their budget goals. All the regions, except four, have voted in favor of borrowing limits. In 2011, together the regions recorded debt and deficit ratios of 13.1% and 3.3% of GDP, respectively.

However, the possibility that the country will request a total bailout in the future which will involve a conditionality for fiscal policy and the implementation of structural reforms, as in the case of Greece, Ireland, and Portugal, has not disappeared.

Italy

5. The Prime Minister asked Parliament support to accelerate the adoption of cuts of over € 4 billion this year, which will allow postponing a rise in the VAT. The measure had already been supported by a vote of confidence from the Senate last week.

   However, given the weak growth Outlook, the markets consider the possibility that the government will fail to comply with the fiscal deficit goal for this year.

Table 4
SOVEREIGN SPREADS OF DEVELOPED COUNTRIES

	End of period				Difference in basis points		
	Dec.11 (4)	Mar.12 (3)	Jun.12 (2)	Aug.12 (1)	Jun.12 (1)-(2)	Mar.12 (1)-(3)	Dec.11 (1)-(4)
CDS (bps)							
USA	49	30	48	40	-8	10	-9
United Kingdom	98	63	69	54	-15	-10	-44
Germany	102	74	102	63	-39	-12	-40
France	220	168	189	139	-50	-29	-81
Spain	380	436	526	519	-7	83	139
Italy	484	395	484	468	-16	72	-17
Greece 1/	8,786	25,423	10,667	14,543	3,876	-10,880	5,757
Portugal	1082	1070	786	656	-130	-414	-426
Ireland	724	573	553	435	-118	-138	-289
10 Year Treasury yields (%)							
USA	1.87	2.21	1.64	1.55	-10	-66	-32
United Kingdom	1.98	2.20	1.73	1.53	-21	-68	-45
Germany	1.83	1.79	1.58	1.36	-23	-44	-47

Source: Bloomberg.
1/ Proceeds from the Greek debt restructuring the Greek spread was reduced to a level of 5,730 basis points.

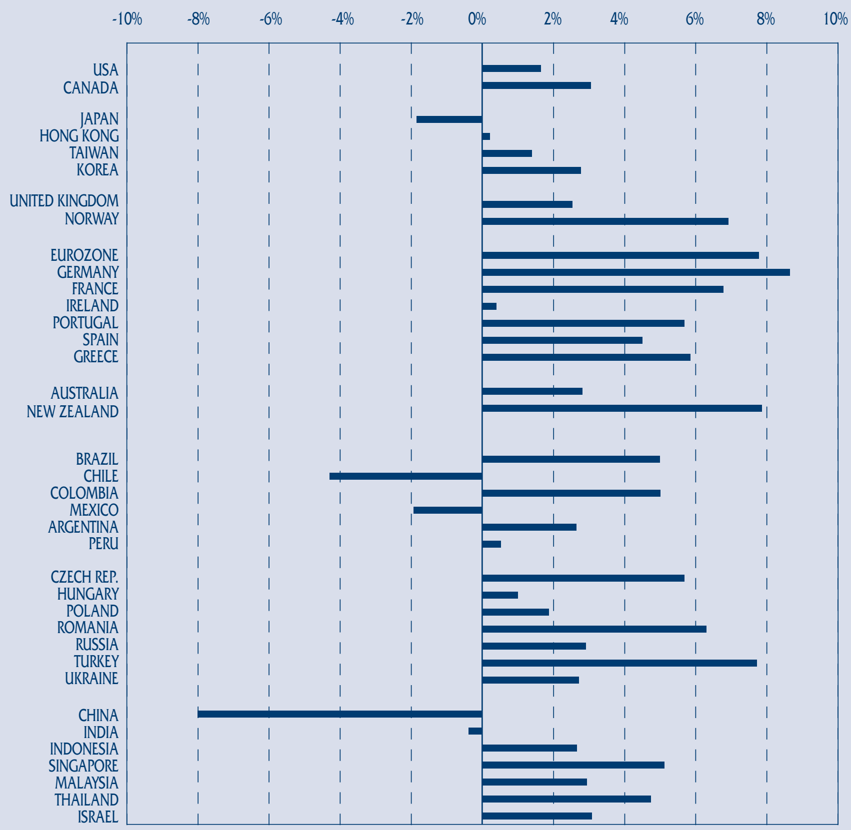
Conversely, the yields on assets considered to be safe continued to show a downward trend. The yield on the 10-year German bond reached its lowest level in two years and the US Treasury bond remained below 2 percent since April 12. Moreover, German and French shorter-term bonds (with 1-year or shorter maturities) even registered negative yields.

Debt markets in Latin American countries showed a favorable evolution, correcting the conduct they showed during Q2. Moreover, this took place in a context in which some of the region's economies –like Uruguay and Peru– registered an upgrade in their sovereign risk rating.

13. A slight recovery was observed in stock exchange markets in the last months, even though this recovery did not reverse the drops recorded in the first semester. In most cases, expectations of additional stimulus by some of the major developed economies and China as well as favorable corporate results in the USA offset the effects of the global economic deceleration and of uncertainty regarding the Eurozone.

The greatest increases were recorded in some economies of the Eurozone which, like Germany and France, showed a different behavior from other countries in the region and therefore received important capital flows. US stock markets also had a bullish behavior due to the corporate results of Q2 and due to expectations of stimulus by the FED. In contrast, on the other hand, the stock exchange markets in China and Chile dropped, affected by the marked economic slowdown in the case of the former and by the fall of the price of copper in the case of the latter.

Graph 12
STOCK MARKETS
(End of period; % chg. Aug.12 respect to Jun.12)



Source: Bloomberg.

Money markets

14. The money markets stabilized after the liquidity injection operations made by the ECB at the end of February. This trend, which has remained in recent months, has been favored by high levels of liquidity and low policy interest rates (the monetary policy of the ECB interest rate was lowered by 25 bps. and reached a historical low). Thus, the differential between the Euribor and OIS rate, which measures tensions in money markets, remained stable after the sharp decline seen in June.

Graph 13
SPREAD BETWEEN THE 3-MONTH EURO-LIBOR RATE AND O/N OF SWAP MARKET (OIS)
(January 2008 - August 2012)

Source: Bloomberg.

Exchange rate

15. The situation in the Eurozone and the weak prospects for growth led to an increase in the demand for dollars and other refuge currencies as the yen. Thus, between June and August the dollar strengthened 0.7 percent against the euro, reaching even its highest level in two years on July 24. However, given the expectation and subsequent announcement of the measures adopted by the FED on September 13, the US dollar has resumed its depreciatory trend. The yen, on the other hand, recorded an appreciation of 1.8 percent against the dollar during the same period, although showing a marked volatility in recent months affected in part by the deterioration of the trade balance.

Graph 14
US DOLLAR INDEX*
(January 2008 - August 2012)

*A rise in the index represents an appreciation of the US dollar.
Source: FED.

In the past two months, the currencies of the region have shown a volatile behavior against the dollar, accumulating mixed variations, in a context of uncertainty associated with the European debt crisis. On the one hand, the Argentine peso and the Colombian peso continued depreciating, while, on the other hand, the Chilean peso, the Mexican peso and the Brazilian real appreciated.

In Chile, the peso appreciated due to greater capital inflows and expectations of lower inflation, while in Brazil the real appreciated only 0.3 percent.

Compared to the end of 2011, the currencies of the region show accumulated appreciations against the dollar, with the exception of the Brazilian real and the Argentine peso. The depreciation of the real (9.0 percent) would be associated in part to the new policy rate cuts adopted by the Central Bank and by lower capital flows. According to statistics of the Brazilian Central Bank, a net capital inflow of US$ 22 billion –including net outflows in May and August– was registered between January and August. This amount is lower than the one recorded in the same period of the previous year (US$ 60 billion).

Table 5
EXCHANGE RATE
(End of period)

	Dec.08	Dec.09	Dec.10	Dec.11	Mar.12	Jun.12	Aug.12	% chg. compared to:		
								Jun.12	Dec.11	Dec.10
Canada	1.217	1.052	0.997	1.019	0.998	1.017	0.986	-3.0	-3.2	-1.0
Japan	90.60	92.90	81.15	76.94	82.79	79.79	78.39	-1.8	1.9	-3.4
United Kingdom (US$/c.u.)	1.463	1.616	1.560	1.554	1.601	1.571	1.587	1.0	2.1	1.7
Eurozone (US$/c.u.)	1.398	1.432	1.338	1.295	1.334	1.267	1.258	-0.7	-2.9	-6.0
Switzerland	1.067	1.036	0.934	0.938	0.902	0.949	0.955	0.7	1.8	2.3
Brazil	2.313	1.743	1.659	1.863	1.826	2.037	2.031	-0.3	9.0	22.4
Chile	635.5	507.2	467.8	519.3	488.1	501.1	480.6	-4.1	-7.4	2.7
Colombia	2,246	2,040	1,915	1,936	1,787	1,784	1,825	2.3	-5.7	-4.7
Mexico	13.65	13.06	12.36	13.95	12.80	13.36	13.19	-1.3	-5.4	6.8
Argentina	3.454	3.799	3.979	4.302	4.377	4.572	4.639	1.5	7.8	16.6
Peru	3.136	2.890	2.808	2.697	2.669	2.653	2.612	-1.5	-3.2	-7.0
Hungary	188.30	187.96	208.15	243.28	220.49	225.84	225.92	0.0	-7.1	8.5
Poland	2.96	2.86	2.96	3.44	3.10	3.35	3.31	-1.0	-3.7	12.1
Russia	30.53	30.31	30.57	32.19	29.32	32.42	32.31	-0.4	0.4	5.7
Turkey	1.54	1.50	1.54	1.88	1.78	1.81	1.82	0.5	-3.5	18.3
China	6.82	6.83	6.59	6.29	6.30	6.35	6.35	-0.1	0.9	-3.7
India	48.58	46.40	44.70	53.01	50.87	55.64	55.53	-0.2	4.7	24.2
Israel	3.78	3.79	3.52	3.81	3.70	3.91	4.01	2.7	5.4	14.0

Source: Bloomberg and Reuters.

It is worth pointing out that the appreciatory pressures observed in emerging economies, particularly in those with better fundamentals and lower risk perception, are explained in part by the return of capital flows due to expectations that monetary stimulus will be maintained in developed economies for an extended period of time. The prices of commodities have also given support to the currencies of the emerging countries.

Monetary policy decisions

16. In a context of high uncertainty in the international environment, most central banks have maintained their policy rates unchanged in recent months. In many economies, inflationary pressures –influenced by the high prices of food and crude– have offset the response of monetary policy.

Thus, 23 of the 33 countries subject to follow-up have maintained their policy rates since June, nine countries have lowered them, and only one, Serbia, has raised its policy rate. The most significant rate reductions have been adopted by Pakistan, Brazil and South Africa, which are countries that face simultaneously a more pronounced economic slowdown and a substantial reduction in inflationary pressures. The ECB's rate cut of 25 bps. adopted in a context of recession and contained inflationary pressures in several European economies also stands out here.

Table 6
MONETARY POLICY INTEREST RATE

	Sep.08	Dec.08	Dec.11	Mar.12	Jun.12	Aug.12	Chg. compared to:	
							Jun.12	Dec.11
Pakistan	13.0	15.0	12.0	12.00	12.00	10.50	-150	-150
Brazil	13.8	13.8	11.0	9.75	8.50	7.50	-100	-350
South Africa	12.0	11.5	5.5	5.50	5.50	5.00	-50	-50
China	7.2	5.3	6.6	6.56	6.31	6.00	-31	-56
ECB	4.3	2.5	1.0	1.00	1.00	0.75	-25	-25
South Korea	5.3	3.0	3.3	3.25	3.25	3.00	-25	-25
Colombia	10.0	9.5	4.8	5.25	5.25	4.75	-50	0
Philippines	6.0	5.5	4.5	4.00	4.00	3.75	-25	-75
Hungary	8.5	10.0	7.0	7.00	7.00	6.75	-25	-25
Australia	7.0	4.3	4.3	4.25	3.50	3.50	0	-75
Chile	8.3	8.3	5.3	5.00	5.00	5.00	0	-25
USA	2.0	0.3	0.3	0.25	0.25	0.25	0	0
Indonesia	9.3	9.3	6.0	5.75	5.75	5.75	0	-25
Iceland	15.5	18.0	4.8	5.00	5.75	5.75	0	100
Japan	0.5	0.1	0.1	0.10	0.10	0.10	0	0
Peru	6.5	6.5	4.3	4.25	4.25	4.25	0	0
United Kingdom	5.0	2.0	0.5	0.50	0.50	0.50	0	0
Turkey	16.8	15.0	5.8	5.75	5.75	5.75	0	0
Slovakia	4.3	2.5	2.5	2.50	2.50	2.50	0	0
Canada	3.0	1.5	1.0	1.00	1.00	1.00	0	0
India	9.0	6.5	8.5	8.50	8.00	8.00	0	-50
Israel	4.3	2.5	2.8	2.50	2.25	2.25	0	-50
Malaysia	3.5	3.3	3.0	3.00	3.00	3.00	0	0
Mexico	8.3	8.3	4.5	4.50	4.50	4.50	0	0
Norway	5.8	3.0	1.8	1.50	1.50	1.50	0	-25
New Zealand	7.5	5.0	2.5	2.50	2.50	2.50	0	0
Poland	6.0	5.0	4.5	4.50	4.75	4.75	0	25
Sweden	4.8	2.0	1.8	1.50	1.50	1.50	0	-25
Switzerland	2.8	0.5	0.3	0.25	0.25	0.25	0	0
Thailand	3.8	2.8	3.5	3.00	3.00	3.00	0	-50
Taiwan	3.5	2.0	1.9	1.88	1.88	1.88	0	0
Uruguay	7.3	7.8	8.8	8.75	8.75	8.75	0	0
Serbia	15.8	17.8	9.8	9.50	10.00	10.50	50	75

Source: Reuters and Bloomberg.

Terms of trade and commodity prices

17. So far this year, the prices of commodities show mixed variations compared to last year. The prices of oil and basic metals have recorded accumulated drops due to uncertainty associated with the European debt crisis and expectations of slower global growth, both in the developed and emerging economies. On the other hand, the international prices of food commodities have shown important increases since July due to negative supply factors in the main producing areas of the USA and the Black Sea region, while the price of oil has been boosted by geopolitical tensions in the Middle East.

On average, the terms of trade in the forecast horizon are expected to drop 6.6 percent in 2012. This drop is higher than the one foreseen in our previous Inflation Report due to the expected recovery of import prices, which would rise 1.4 percent on average due to expected higher food prices, while the prices of exports would fall 5.2 percent, showing a slightly lower correction than the one previously estimated.

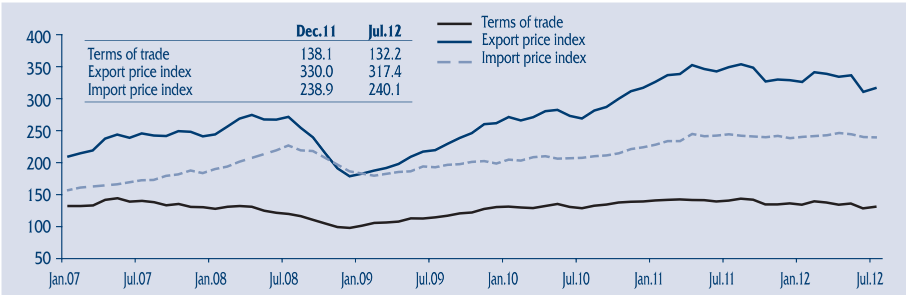
Table 7
TERMS OF TRADE: 2010 - 2014
(Annual average data)

	Executed		2012		2013		2014	
	2010	2011	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
Terms of trade 1/	**17.9**	**5.4**	**-3.6**	**-6.6**	**-1.1**	**-2.1**	**-0.5**	**0.4**
Price of exports 1/	**29.9**	**20.0**	**-6.2**	**-5.2**	**-1.2**	**-2.1**	**1.5**	**1.5**
Copper (US$ cents per pound)	*342*	*400*	*357*	*359*	*348*	*358.3*	*347*	*357.5*
Zinc (US$ cents per pound)	*98*	*100*	*88*	*87*	*88*	*88.0*	*88*	*89*
Lead (US$ cents per pound)	*98*	*109*	*91*	*91*	*89*	*93*	*89*	*95*
Gold (US$ per ounce)	*1,225*	*1,570*	*1,624*	*1,661*	*1,600*	*1,700*	*1,600*	*1,700*
Price of imports 1/	**10.1**	**13.8**	**-2.6**	**1.4**	**-0.1**	**0.1**	**2.0**	**1.1**
Oil (US$ per barrel)	*79*	*95*	*98*	*96*	*95*	*95*	*95*	*95*
Wheat (US$ per ton)	*195*	*280*	*251*	*280*	*277*	*330*	*282*	*324*
Maize (US$ per ton)	*157*	*262*	*234*	*281*	*214*	*295*	*209*	*259*
Soybean oil (US$ per ton)	*859*	*1,191*	*1,140*	*1,182*	*1,143*	*1,254*	*1,132*	*1,209*

IR: Inflation Report.
1/ Average annual % change.

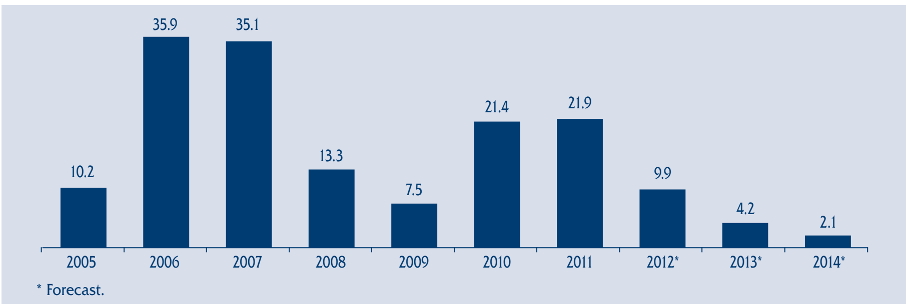
It should be pointed out, however, that in the current context of high uncertainty about a further deterioration of the world economy, the likely additional monetary stimulus measures that would be implemented by the world's major central banks may increase global liquidity and induce in this way further rises in the prices of commodities, as has been the case in recent weeks after information about the FED minutes was released and after expectations of new unconventional measures that would be adopted by the central banks of China and Japan generated price rises.

Graph 15
TERMS OF TRADE, EXPORT AND IMPORT PRICE INDICES: JANUARY 2007 - JULY 2012
(1994=100)



Graph 16
TERMS OF TRADE
(% change)

Graph 17
DEVIATION FROM TERMS OF TRADE
(As % of average index last 10 years)

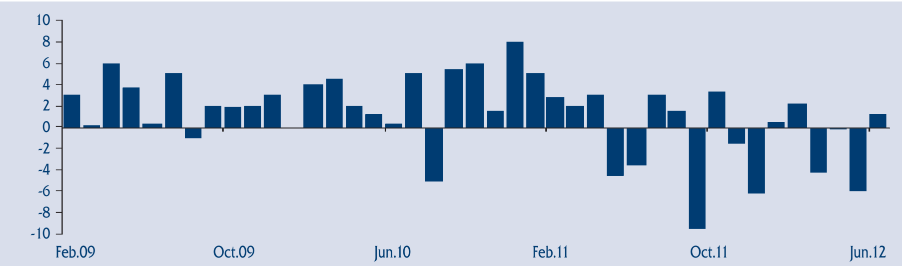


Non-commercial positions

18. A record net outflow of US$ 5.3 billion was registered in Q2 in commodity investment funds due to ongoing uncertainty regarding the European debt crisis and evidence of a slowdown in the larger emerging economies, such as China, whose demand for food is considerably significant. However, a slight recovery was observed in investment in these funds in June due to expectations of a lower

global supply of food, which increased the appeal of these assets as an investment alternative.

Graph 18
COMMODITIES INVESTMENT FLOWS
(Billions of US$)



Source: Bloomberg and Barclays Capital.

Copper

19. The price of **copper** has shown a volatile behavior over the past two months, influenced by continued uncertainty regarding the European debt crisis, the recovery of the US economy, and especially by the evolution of activity in China, the world's major importer of this metal. On average, the international price of copper rose 2 percent in July, while in August it registered a 1 percent correction, closing the month at an average level of US$ 3.40 per pound.

    Despite the economic slowdown, the market for copper is tight: the market of refined copper recorded a global deficit of 405 thousand tons between January and May –a higher deficit than the one of 98 thousand tons observed in the same period in 2011[1]– and the level of inventories is lower than the one recorded last year. Nonetheless, the slowdown of Chinese imports and reduced activity in Europe would give relief to the market. In line with these developments, it is estimated that copper prices will reach in the forecast horizon a level higher than the one considered in our last Inflation Report.

Graph 19
COPPER: JANUARY 2007 - DECEMBER 2014
(ctv. US$/pd.)

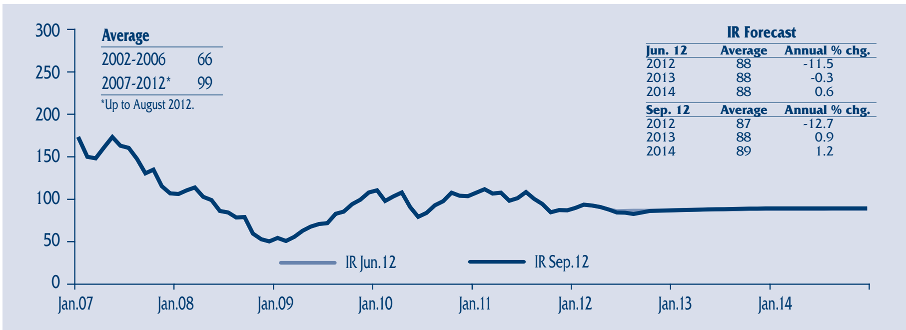
1 Data of the International Copper Study Group (IGSG).

Zinc

20. Year-to-date, the average price of **zinc** has declined 5 percent, with zinc closing at an average level of US$ 0.82 per pound in August. This decline reflects that conditions in the world market are less tight. The latest available data[2] show that the world market records a surplus of 152 thousand tons and that global inventories have increased by 130 thousand tons. These results are consistent with the increase of 11 percent registered in mining production compared to the same period of 2011, in contrast with what is observed in the production of refined metal (which has declined 1.1 percent).

    These conditions are expected to remain similar in the global market in 2012 and in 2013. The international price of zinc is expected to be slightly below the levels considered in our Inflation Report of June in the forecast horizon.

Graph 20
ZINC: JANUARY 2007 - DECEMBER 2014
(ctv. US$/pd.)



Gold

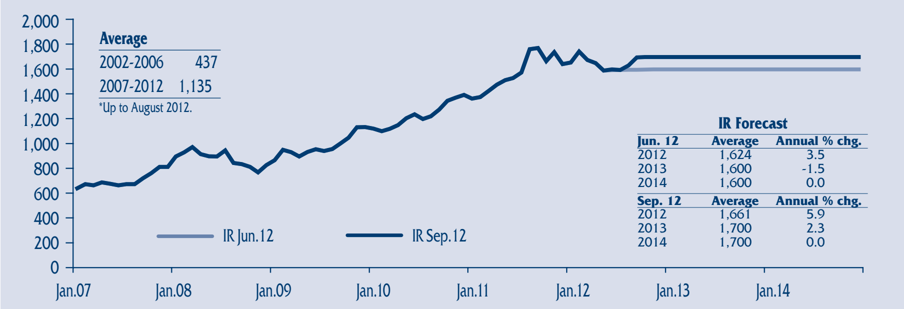
21. Closing with an average level of US$ 1,631 in August, the price of **gold** has registered a reduction of 1 percent so far this year. After declining for three consecutive months since March, the price of gold started showing an upward trend since June, when it rose 1 percent, and rose again 1 percent in August.

    The volatile behavior of gold over the past two months followed closely the evolution of the dollar. In addition, it was also associated with continuous global risk aversion and with the maintenance of monetary stimulus by the major central banks in a context of lower global demand, both physical and for investment purposes. Thus, after registering a fall in global demand in Q2, the price of gold was driven since the second half of August by the depreciation of the dollar as well as by increased

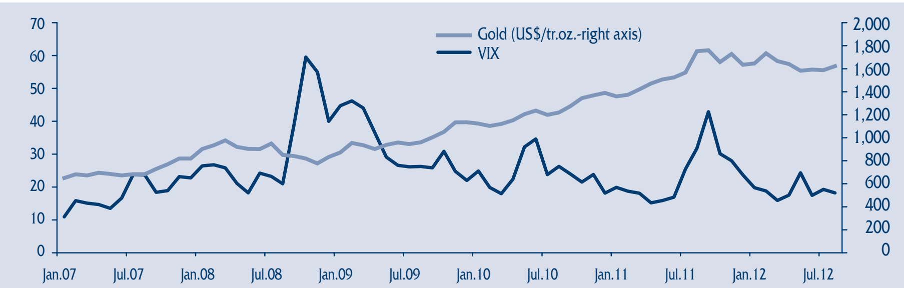
2 Data of the International Lead and Zinc Group (ILZG) for the first half of the year.

expectations that the FED would implement new monetary stimulus measures. The price of gold is expected to register slightly higher levels than those estimated in our previous report.

Graph 21
GOLD: JANUARY 2007 - DECEMBER 2014
(US$/tr.oz.)



Graph 22
GOLD PRICE AND S&P-500 VIX INDEX
(January 2007 - August 2012)



Source: Bloomberg.

Oil

22. The average price of **WTI oil** has been recovering in the last two months after having dropped in previous months. With this recovery, in August WTI oil closed at an average price of US$ 94 per barrel, a level 4 percent lower than the one registered at the end of December 2011.

During the month of July the price of oil increased 7 percent. This price recovery was supported by the reduction of Iran exports, affected by the embargo imposed by the European Union and the United States' sanctions, as well as by strikes in Norway. In August, the price of crude increased again 7 percent, in line with growing geopolitical fears in the Middle East and with the decline of crude and gasoline inventories in the United States. Moreover, in August the US Department of Energy raised its price forecast for the first time since April after estimating a higher consumption.

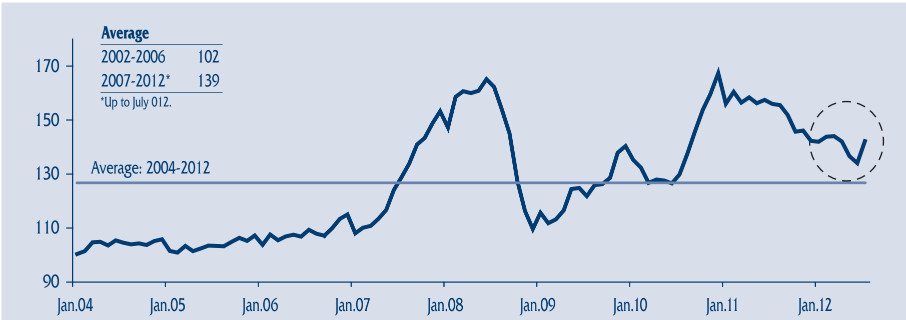
Due to this recent recovery, the price of WTI oil is expected to show levels similar to those estimated in our Inflation Report of June. However, both upward and downward risk factors have increased. Even though the probability of further price rises has increased due to political tensions in the Middle East, the higher anticipated global slowdown could offset this rises.

Graph 23
WTI OIL: JANUARY 2007 - DECEMBER 2014
(US$/bl)

Foodstuffs

23. After declining for three consecutive months, FAO's real price index increased 6.2 percent in July compared to June. Despite this increase, this index registers an annual drop of 8.9 percent.

Graph 24
FAO REAL FOOD PRICE INDEX*
(Base 2002 - 2004 = 100)



* The real price index is the index of nominal prices deflated by the unit value of manufactures of the World Bank.

In contrast with other commodities, the upward evolution observed in food commodities since June is associated with expectations of lower global supply due to unfavorable weather conditions in the USA and in the region of the Black Sea. The United States has experienced the most severe drought seen in more than 50 years, which has affected the expected yield of soybean crops and especially of corn crops, since the latter were precisely in a key stage that determines their yields. In addition to this, investors increased their net non-commercial positions and wheat and soy bean positions reached maximum historic levels. Moreover, maize positions reached levels similar to those recorded in 2008, but lower than the ones observed in 2010 and 2011.

In general terms, the situation of global food markets for the 2012/13 season shows tighter conditions, leading the market to anticipate a reduction in final inventories which, in many cases, would reach historical minimum levels. This situation makes the prices of food commodity highly sensitive to any unforeseen shock in terms of global supply or demand.

Table 8
USDA: BALANCE OF GLOBAL SUPPLY AND DEMAND
(Millions tons)

	2010/11	2011/12	2012/13	% change	
	(3)	(2)	(1)	(2) / (3)	(1) / (2)
MAIZE					
Initial stock	145.8	127.5	136.0	-12.6	6.7
Production	830.8	876.8	849.0	5.5	-3.2
Global supply	**976.6**	**1,004.3**	**985.0**	**2.8**	**-1.9**
Total consumption	849.1	868.4	861.6	2.3	-0.8
Final stock	127.5	136.0	123.3	6.7	-9.3
WHEAT					
Initial stock	200.6	198.0	197.6	-1.3	-0.2
Production	651.9	695.2	662.8	6.6	-4.7
Global supply	**852.5**	**893.2**	**860.4**	**4.8**	**-3.7**
Total consumption	654.5	695.6	683.3	6.3	-1.8
Final stock	198.0	197.6	177.2	-0.2	-10.3
SOYBEAN OIL					
Initial stock	3.3	3.5	3.1	4.5	-9.9
Production	41.3	42.1	42.4	2.0	0.7
Global supply	**44.6**	**45.5**	**45.5**	**2.2**	**-0.1**
Total consumption	40.8	41.9	43.0	2.7	2.6
Final stock	3.5	3.1	2.0	-9.9	-36.3

Source: US Department of Agriculture. August 2012.

BOX 1
RECENT TRENDS IN INTERNATIONAL FOOD MARKETS

A series of unfavorable conditions, which had not been foreseen in our previous Inflation Report, have been observed in the international food markets since mid-June and have led to an increase in the prices of food: the food index of Commodity Research Bureau (CRB) –which is based on ten food commodities– have increased by 10 percent between May and August this year and the prices of maize and soybean have reached historic highs.

The upward trend is explained mainly by unfavorable weather conditions and, to a lesser extent, by the recent recovery experienced by the price of oil. In the USA, persistent extreme temperatures and lack of rainfall have led to the worst drought in 56 years, damaging maize and soybean crops and causing expectations of lower yields. Wheat, the substitute of maize on the consumer side, has also seen its price pushed upward. In addition to this, a lower global production of wheat is also foreseen due to the lower harvest expected to be obtained in the Black Sea producing areas.

The futures markets expect that prices remain under pressure due to the low levels of inventories and the supply constraints that could extend until the next season (the lower production of the current season will decrease the initial inventories of the next). However, in the current context of global economic slowdown and appreciation of the dollar, the likelihood of a significant additional rise in the prices of food commodities is relatively low.

Impact on inflation in emerging economies

Rises in food prices have a greater impact on inflation in emerging countries because the weight that food products have in the consumer price index is higher than in other countries. In Latin America, most countries with inflation targeting regimes failed to meet their targets in 2008 and in almost all the cases registered a two-digit inflation rate in food inflation. Moreover, food inflation in 2011 increased compared to 2010.

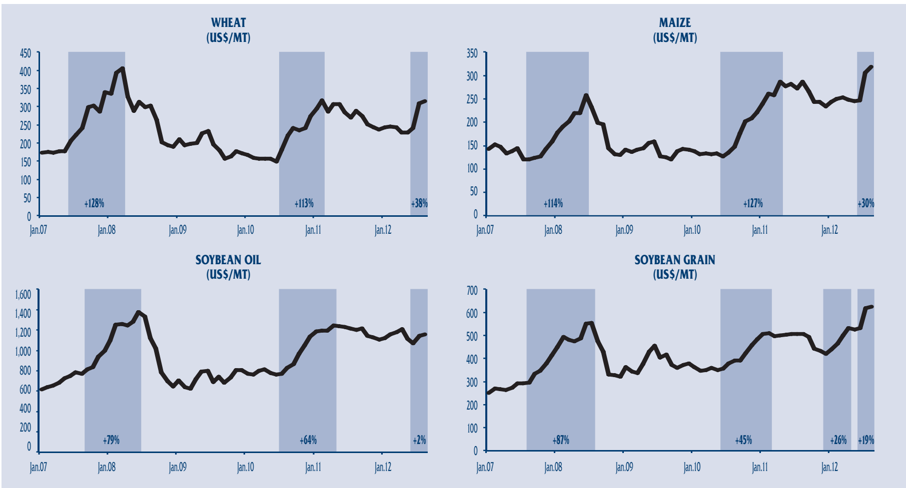
TOTAL INFLATION AND FOOD INFLATION

	Dec.08		Dec.09		Dec.10		Dec.11		Jul.12	
	Total	Foods	Total	Foods	Total	Foods	Total	Foods	Total	Foods
Brazil	5.9	11.1	4.3	3.2	5.9	10.4	6.5	7.2	5.2	8.7
Chile	7.1	15.7	-1.4	-1.3	3.0	7.0	4.4	8.6	2.5	6.5
Colombia	7.7	13.2	2.0	-0.3	3.2	4.1	3.7	5.3	3.0	3.8
Mexico	6.5	10.2	3.6	4.3	4.4	5.3	3.8	6.0	4.4	8.2
Peru	6.7	9.7	0.2	0.6	2.1	2.4	4.7	8.0	3.3	4.6
China	1.2	4.2	1.9	5.3	4.6	9.6	4.1	9.1	1.8	2.4
Korea	4.1	8.7	2.8	2.8	3.5	10.6	4.2	7.5	1.5	2.4
Malaysia	4.5	10.4	1.0	1.1	2.1	2.6	3.0	5.1	1.4	2.6
Thailand	0.4	13.8	3.5	2.2	3.0	5.6	3.5	9.1	2.7	5.4
USA	0.1	5.8	2.7	-0.4	1.5	1.5	3.0	4.4	1.4	2.3
Eurozone	1.6	3.2	0.9	-1.3	2.2	1.8	2.7	3.0	2.4	2.5
Japan*	0.4	3.6	-1.7	-2.5	0.0	0.7	-0.2	-0.1	-0.1	0.2

* Data from Japan corresponds to June 2012.
Source: Bloomberg and central banks.

As illustrated, the recent evolution of the international prices of food may significantly influence overall inflation. In Latin America, where food accounts for nearly 30 percent of the consumer basket, a rise in prices has a greater relative weight on total CPI. According to JP Morgan estimates, a permanent rise in food prices can generate an accumulated increase of between 30 and 60 basis points in total annual inflation in the following 3 to 6 months after the shock was experienced.

However, to assess the impact of these rises on inflation, it is necessary to consider the variations in the prices of food, rather than price levels. Thus, even though high levels of prices are seen today, the percentage variation of these prices is significantly lower than the one observed in the first semester of 2008 in all food products.



BOX 2
PERU'S EXPOSURE TO CHINA'S ECONOMY

China's economic slowdown, which started in Q4-2011, has continued in recent months. Even though the deterioration of external demand still has a substantial negative effect on the economy –exports in August registered an annual growth of only 2.7 percent–, analysts highlight the insufficient drive of its domestic demand at present. Industrial production in August showed an annual growth of 8.9 percent, the lowest growth rate observed since May 2009, while imports showed an annual contraction of 2.6 percent. This would be reflecting that the stimulus measures adopted recently –infrastructure works mainly– have not had the expected effect yet.

In this context, the markets are now expecting that the bottoming out of China's economic deceleration will continue until Q3-2012 and current forecasts on the annual growth of the country's GDP are around or even below 8 percent.

The IMF estimates that China is the world's most "central" business partner[3], that is, it is the economy that has more connections with other major partners and therefore its capacity to transmit shocks (either external or domestic) to a wide range of economies is significantly high. As the table below shows, in 2008 China already ranked first in importance in terms of total exports of capital goods and consumer goods. As a result of its aggressive integration to the global economy over the past years, China currently ranks as the first or second trade partner of 78 countries which represent 55% of global GDP (vs.13 countries which accounted for 15% of global GDP in 2000).

CENTRALITY IN GLOBAL EXPORTS
(Rank, with 1 being the most central)

	Total exports		Capital goods		Consumer goods	
	2000	2008	2000	2008	2000	2008
China	4	1	5	1	1	1
Eurozone	1	2	3	3	2	2
Japan	3	4	1	2	3	4
United Kingdom	5	5	7	9	5	3
USA	2	3	2	4	4	5
Brazil	15	12	14	15	15	17
Russia	10	8	18	19	13	7
India	19	15	17	16	14	9
Korea	7	6	8	5	7	6
Mexico	6	10	6	7	6	8

Source: IMF.

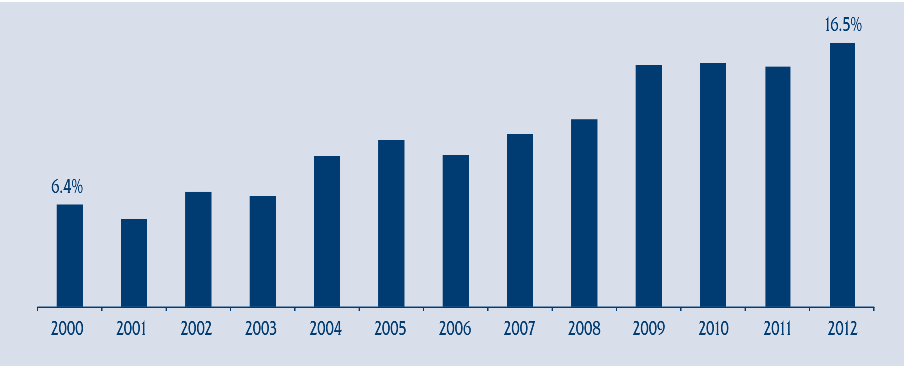
Given the low levels of openness in the capital market, the impact of China on the global economy is predominantly transmitted through the trade channel. The role of the Chinese economy as an exporter of reprocessed imported inputs that reacted passively to the final demand in the G-7 countries has been changing significantly. The IMF says that the capacity of China's economy to generate shocks has considerably increased given that the contribution of China's final demand in the GDP of its trading partners has increased two-fold between 2000 and 2008. Even though China's contribution is equal to 50% of the contribution of USA and the Eurozone, this trend is expected to become stronger due to the China's recent emphasis on the "re-balancing" of its economy towards domestic demand.

Thus, China has become a major importer of a wide range of commodities, which reflects not only the orientation of China's economy towards exports of industrial goods, but also the favorable bias to capital accumulation induced by distortions in factor prices (interest rate). As a result, the impact of China's economy on the world prices of commodities is now more important. Peru has not been immune to this change in the role of China in global trade. In 2011 China became the main

3 People's Republic of China. Spillover Report. IMF, June 27, 2012. Centrality is an indicator that measures the importance of a country in trade, considering the number of countries with which it has trade relationships as well as its relative importance in terms of world trade.

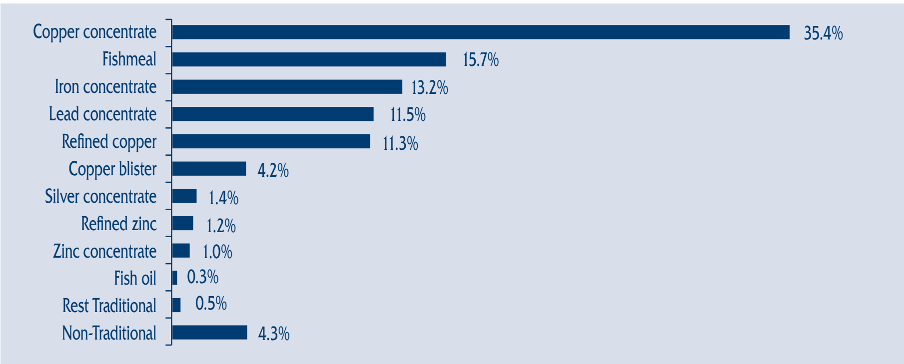
destination of Peruvian exports and, in percentage terms, China currently accounts for 16.5% of total Peruvian exports (vs. 6.4% in 2000).

CHINA'S SHARE OF TOTAL PERUVIAN EXPORTS
(% 2000-2012)



In addition to this, the share of Peruvian commodities exported to China has remained above 95% in recent years, the main export products including copper concentrates, fishmeal, iron concentrates, lead concentrates, refined copper, and copper blister. This strong trade relationship reflects the exposure of the Peruvian economy to demand fluctuations in China as well as China's impact on international prices.

PERUVIAN EXPORTS TO CHINA
(% contribution, 2012)



Finally, the main risk foreseen in the medium term is that China may experience a strong deceleration (or hard landing) with real effects beyond its borders and with a negative impact on our terms of trade if external demand remains weak and excess installed capacity persists in the Chinese economy.

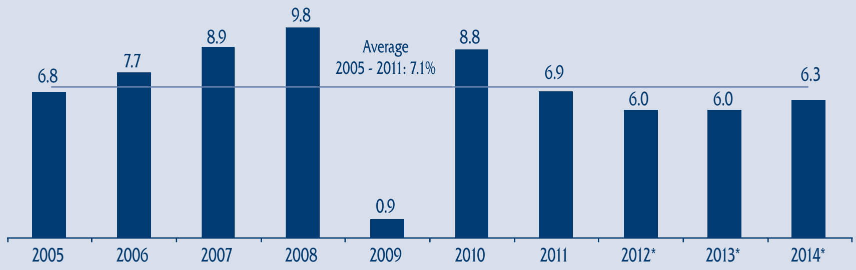
There are also some potential effects on the financial side. Even though China's economy has a low level of financial openness, China currently has a balance of international reserves equivalent to

US$ 3.2 trillion dollars, which is equivalent to nearly 50 percent of the reserves of emerging countries. In addition to this, China is the largest foreign holder of American Treasury bonds (US$ 1.2 trillion) and other securities issued by the private sector. This high balance of securities held by China is mostly explained by the strong entries of dollars obtained from the trade surplus it has maintained for a long period of time, which were sterilized through interventions of the Central Bank. Therefore, a lower growth of the export sector could have an indirect but significant impact on the exchange rate of the dollar and the yield of the US Treasury bonds, among other variables of the international financial markets.

II. Economic activity

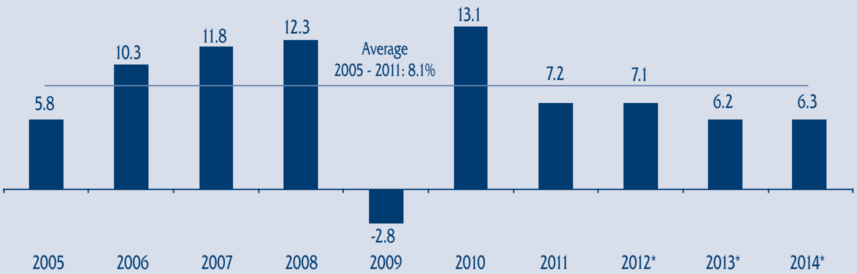
24. In line with the evolution of domestic demand, which grew at a rate of 6.4 percent, GDP recorded an accumulated rate of 6.1 percent in the first semester of the year. Compared to the previous year, the moderation of growth observed both in GDP and in domestic demand is consistent with a scenario in which economic activity converges to a rate of growth similar to that of the economy's potential output. Exports have shown less dynamism in this period due to the negative conditions observed in the international environment. The growth of private consumption has become more moderate, while private investment has continued to show two-digit growth rates.

Graph 25
GDP: 2005-2014
(Real % change)



* Forecast.

Graph 26
DOMESTIC DEMAND: 2005-2014
(Real % change)

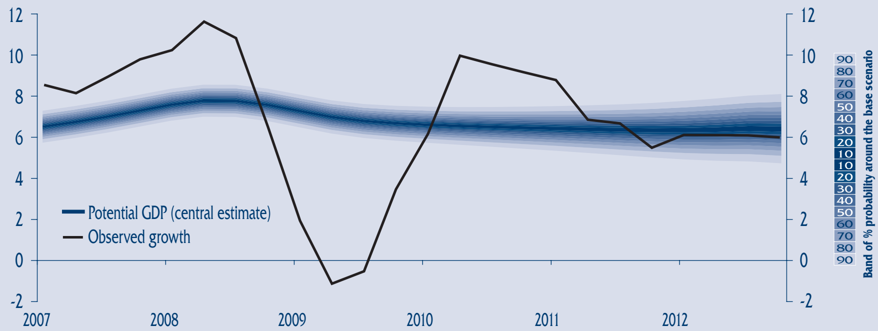


* Forecast.

The central forecast scenario considers a GDP growth rate of 6.0 percent for 2012, a higher rate than the one estimated in our June report (5.8 percent) since the growth forecast on private investment has been revised up from 10.2 to 13.5 percent. On the other hand, considering the downward revision of global growth and the terms of trade, in 2013 GDP is estimated to grow between 5.8 and 6.2 percent, while in 2014 it is estimated to grow between 6.0 and 6.5 percent.

Since potential growth in the forecast horizon is estimated at an annual rate of 6.0 percent and given that GDP growth in the next two years growth is foreseen to be close to its potential growth rate, it is estimated that the output gap will be close to equilibrium, which means that the dynamism of the economy will not be limited by bottlenecks.

Graph 27
GDP POTENTIAL GROWTH AND ACTUAL GROWTH: 2007-2012
(% change in the last 4 quarters)



Memo: Potential GDP is not an observable variable and has to be estimated. Because of this, the graph shows uncertainty about its growth rate. As in the case of the output gap and the inflation forecast, each band concentrates a probability of occurrence of 10% and total bands represent a probability of occurrence of 90%.

Forecast of expenditure components

25. Based on data about the first half of the year and on recent indicators of activity, the growth forecast of **domestic demand** in 2012 has been revised upwards, basically due to the favorable evolution expected in private investment. This upward revision assumes that the Peruvian economy would experience a lower external drive in the second half of the year.

Table 9
GDP AND DOMESTIC DEMAND
(Real % change)

	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
1. Domestic demand	**9.1**	**7.2**	**6.4**	**6.3**	**7.1**	**6.4**	**6.2**	**6.5**	**6.3**
a. Private consumption	6.4	6.4	5.9	5.8	5.8	5.6	5.5	5.8	5.7
b. Public consumption	2.9	4.8	5.0	6.0	8.7	4.9	5.7	6.3	5.8
c. Private investment	15.7	11.7	13.6	10.2	13.5	8.7	8.2	8.7	8.2
d. Public investment	-24.7	-17.8	33.5	31.0	23.7	10.0	14.3	9.3	11.0
2. Export	**9.1**	**8.8**	**7.2**	**5.7**	**3.3**	**7.7**	**7.7**	**8.5**	**9.4**
3. Import	**15.9**	**9.8**	**8.4**	**8.3**	**9.0**	**8.3**	**8.1**	**8.9**	**8.9**
4. GDP	**7.8**	**6.9**	**6.1**	**5.8**	**6.0**	**6.2**	**6.0**	**6.3**	**6.3**
Memo:									
Government expenditure	*-6.5*	*-4.2*	*12.9*	*14.5*	*13.8*	*6.9*	*8.9*	*7.5*	*7.8*

IR: Inflation Report.
* Forecast.

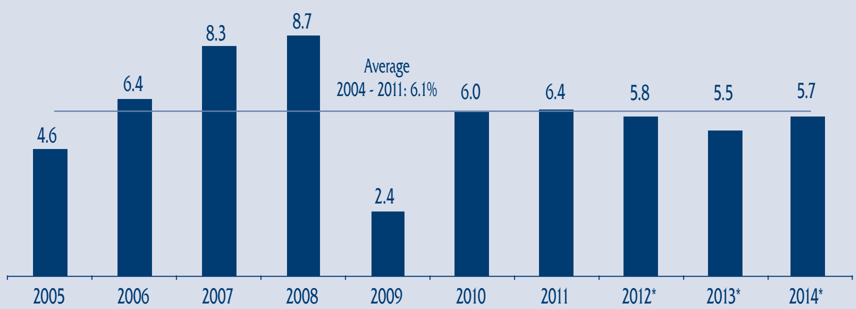
Table 10
GDP AND DOMESTIC DEMAND
(Contributions to the real % change)

	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
1. Domestic demand	**9.4**	**7.5**	**6.7**	**6.6**	**7.4**	**6.7**	**6.5**	**6.8**	**6.7**
a. Private consumption	4.4	4.2	4.0	3.9	3.9	3.7	3.6	3.8	3.7
b. Public consumption	0.3	0.5	0.4	0.6	0.8	0.5	0.5	0.6	0.6
c. Private investment	3.3	2.5	3.0	2.3	3.0	2.0	2.0	2.1	2.0
d. Public investment	-1.1	-1.1	1.1	1.5	1.1	0.6	0.8	0.6	0.7
e. Inventory variation 1/	2.7	1.4	-1.8	-0.1	0.1	-0.2	-0.3	-0.4	-0.6
2. Export	**1.5**	**1.6**	**1.2**	**1.0**	**0.6**	**1.4**	**1.4**	**1.6**	**1.7**
3. Import	**3.2**	**2.1**	**1.8**	**1.8**	**2.0**	**1.9**	**1.8**	**2.1**	**2.1**
4. GDP	**7.8**	**6.9**	**6.1**	**5.8**	**6.0**	**6.2**	**6.0**	**6.3**	**6.3**
Memo:									
Government expenditure	*-0.9*	*-0.7*	*1.5*	*2.0*	*1.9*	*1.1*	*1.3*	*1.2*	*1.2*

IR: Inflation Report.
* Forecast.
1/ Percetage of GDP.

26. After growing 6.0 percent in Q1, **private consumption** slowed down slightly to 5.8 percent in Q2 in a context of slight deterioration of consumer confidence (which remains on the optimistic side), as well as of a lower growth of employment. Other indicators of private consumption, such as the sale of new family cars and consumer loans continued to show a positive evolution and recorded rates of 47.4 percent and nearly 20 percent, respectively, in Q2.

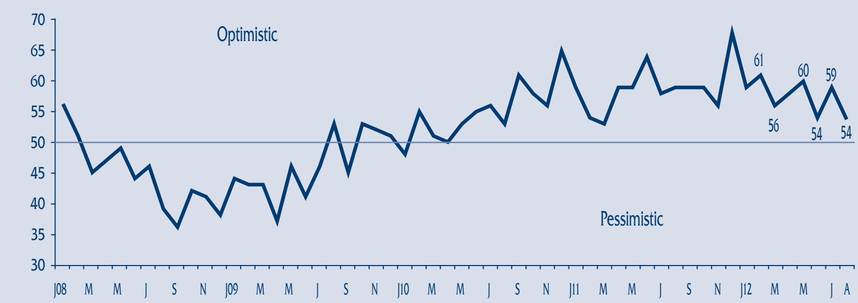
Graph 28
PRIVATE CONSUMPTION: 2005-2014
(Real % change)



Several indicators reflect the recent evolution of private consumption:

a. Even though the Consumer Confidence Index remains on the optimistic segment, it showed a deterioration in Q2, recording an average level of 57 points (vs. 59 points in Q1). This indicator registered a transitory recovery in July, but declined again in August.

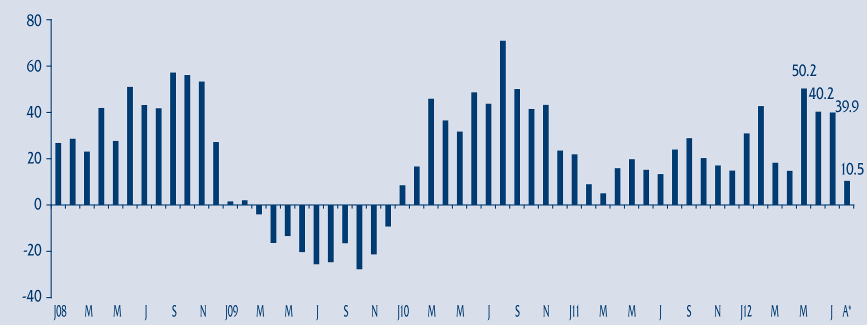
Graph 29
CONSUMER CONFIDENCE INDEX: 2008-2012
Households' economic situation



Source: Ipsos APOYO.
Elaboration: BCRP.

b. The volume of imports of durable consumer goods continued to grow at high rates, even though preliminary data shows a deceleration in August.

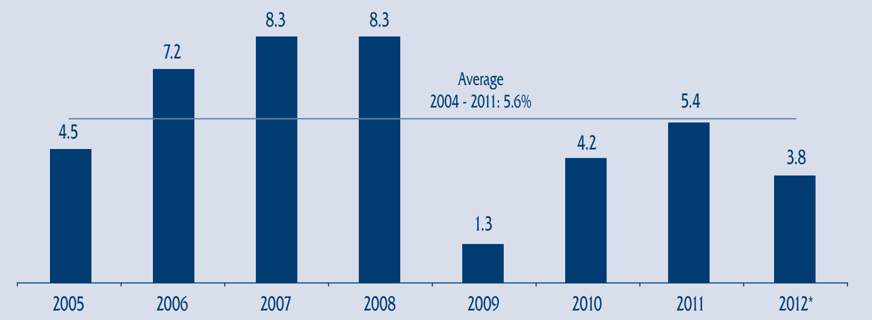
Graph 30
VOLUME OF IMPORTS OF DURABLE GOODS: 2008-2012
(12 month % change)



* Preliminary.

c. Urban employment in firms with 10 and more workers grew 3.8 percent in the first semester of 2012, a lower rate than the one recorded last year (5.4 percent).

Graph 31
URBAN EMPLOYMENT: 2005-2012
(% change)



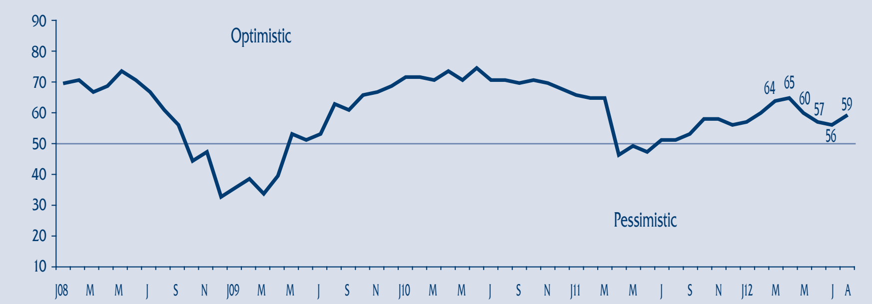
* January - June.
Source: MTPE.

27. The growth forecast for private consumption in 2012 is the same as the one estimated in our Inflation Report of June (5.8 percent), whereas the estimates for 2013 and 2014 have been revised slightly downwards to 5.5 and 5.7 percent, respectively (down by 0.1 percentage points), in line with the new scenario of a lower rate of growth and lower terms of trade considered in this report.

28. **Private investment** maintained a high pace of growth during the first two quarters of the year and recorded a rate of 13.6 percent in the first semester. Several indicators reflect this evolution of private investment:

    a. Business expectations on the situation of the economy in the three months ahead continue to be on the optimistic segment and have recovered in August.

Graph 32
EXPECTATIONS ABOUT THE ECONOMY IN THE NEXT 3 MONTHS: 2008-2012



Source: Survey of Macroeconomic Expectations, BCRP. Survey conducted during the second fortnight of July 2012.

b. Economic agents' expectations of GDP growth remain stable at an annual rate of 6.0 percent in the forecast horizon.

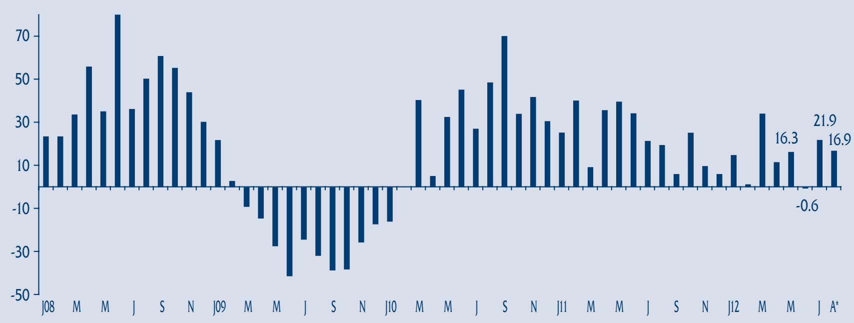
Table 11
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH
(%)

	IR Mar.12	IR Jun.12	IR Sep.12*
Financial entities			
2012	5.3	6.0	6.0
2013	5.6	6.0	6.0
2014	-.-	6.0	6.0
Economic analysts			
2012	5.0	6.0	5.8
2013	5.6	6.0	5.9
2014	-.-	6.2	6.0
Non-financial firms			
2012	5.5	6.0	6.0
2013	6.0	6.0	6.0
2014	-.-	6.0	6.0

IR: Inflation Report.
* Survey made during the second half of August 2012.

c. The volume of imports of capital goods, indicator of investment demand, has continued to grow at two-digit rates during a great part of the semester and has even registered higher rates in July and August.

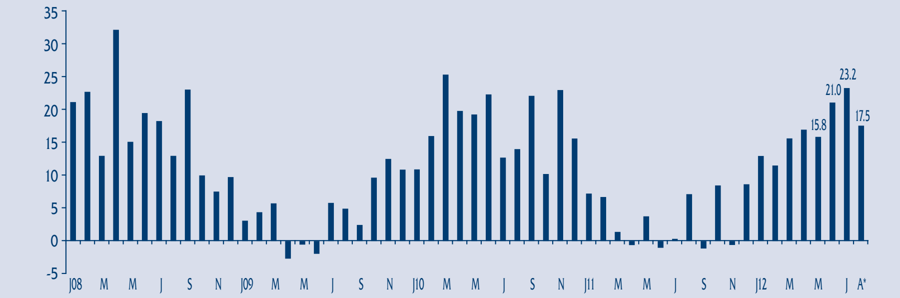
Graph 33
VOLUME OF IMPORTS OF CAPITAL GOODS: 2008-2012
(12 month % change)



* Preliminary.

d. The domestic consumption of cement has shown a faster pace between June and July, but has registered again a rate closer to that of April in August.

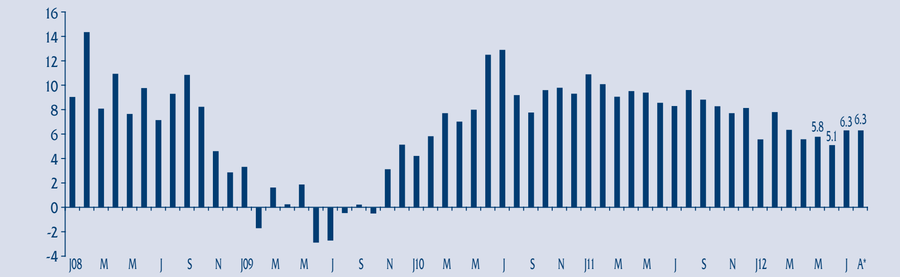
Graph 34
DOMESTIC CONSUMPTION OF CEMENT: 2008-2012
(12 month % change)



* Preliminary.

e. The production of electricity continued to grow at rates of between 5 and 6 percent in Q2. The information of July and August shows a growth rate of 6.3 percent, a rate slightly higher than in Q2 and similar to the rates observed in Q1.

Graph 35
ELECTRICITY PRODUCTION: 2008-2012
(12 month % change)



Source: COES.

29. Investment announcements are another relevant factor that allows us to analyze the evolution of private investment. Investment projects announced for the period 2012 – 2014 would amount US$ 51.7 billion, a figure US$ 0.6 billion higher than the one considered in our Inflation Report of June.

Table 12
INVESTMENT PROJECTS ANNOUNCED
(Millions of US$)

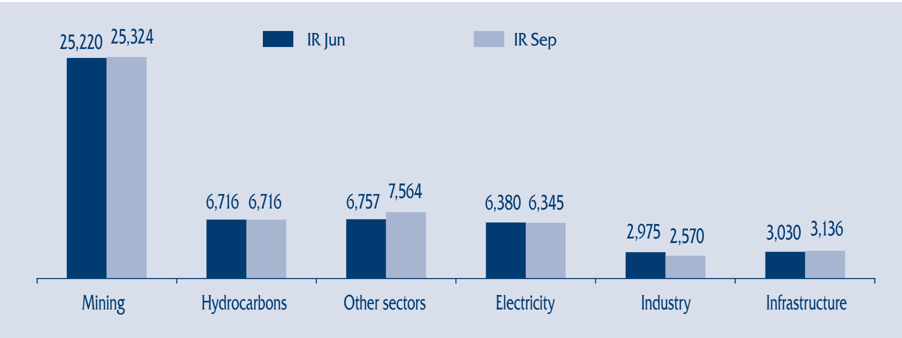
	2012	2013	2014	2012 - 2014
Mining	7,455	8,323	9,546	25,324
Hydrocarbons	2,250	2,756	1,710	6,716
Electricity	2,611	2,355	1,379	6,345
Industry	1,122	816	632	2,570
Infrastructure	1,472	1,092	572	3,136
Other sectors	3,601	2,751	1,212	7,564
Total	**18,511**	**18,093**	**15,051**	**51,655**

Source: Press media and information companies.

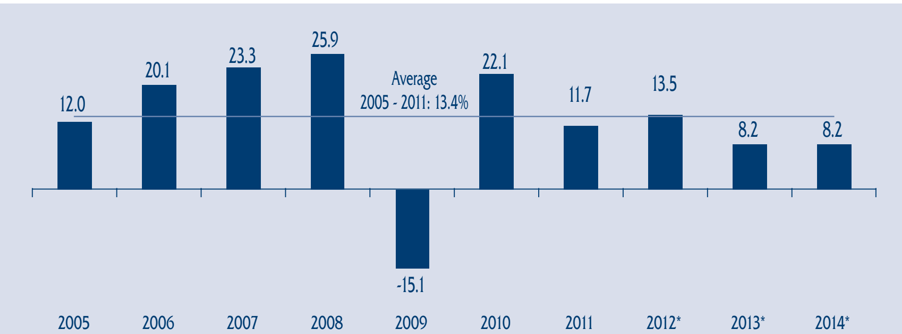
Investment projects in the **mining sector** include projects such as Las Bambas, Galeno, Quellaveco, and the expansions of Antamina and Cerro Verde. It is also worth pointing out that companies like the Canadian company HudBay and the Australian corporation Xstrata have announced that they will increase the investment amounts previously estimated for the mining projects of Constancia and Las Bambas not only because leading technology is required, but also because of new environmental and social requirements. The investment project of Minas Conga is not considered here given that the implementation of this project is currently suspended. However, it should be highlighted that despite the social conflicts observed in recent months, mining investments in the period of January-May 2012 amounted to US$ 2.9 billion, a figure 20.5 percent higher than the one recorded in the same period of 2011.

Investment projects worth pointing out in **other sectors** include increased investment announcements in the real estate sector (construction of new housing and office projects) and in the retail sector (expansion, remodeling, and construction of malls), as well as projects associated with health care (clinics and specialized health centers), which will be developed in the main cities of the country.

Graph 36
INVESTMENT PROJECTS ANNOUNCED: 2012-2014
(Millions of US$)



Graph 37
PRIVATE INVESTMENT: 2005-2014
(Real % change)



* Forecast.

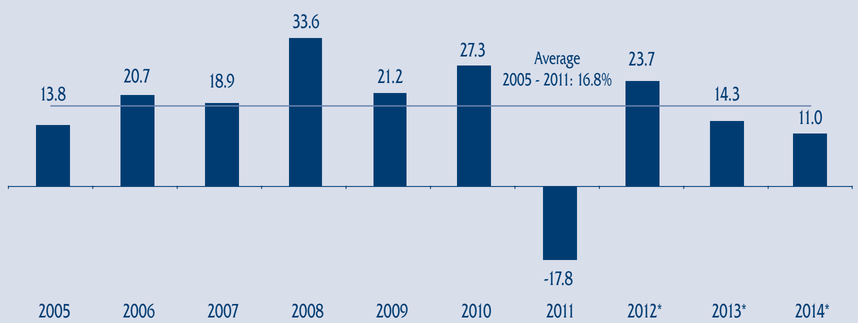
Table 13
ANNOUNCED MAIN INVESTMENT PROJECTS: 2012-2014

SECTOR	COMPANY	PROJECT NAME
Mining	Xstrata Copper	Las Bambas
	Sociedad Minera Cerro Verde S.A.	Expansion: Cerro Verde
	Jinzhao Mining Perú S.A.	Pampa del Pongo
	Anglo American Plc.	Quellaveco
	China Minmetals Corporation y Jiangxi Copper Company	El Galeno
	HudBay Minerals Inc.	Constancia
	Southern Perú Copper Corp. Sucursal del Perú	Los Chancas
	Antares Minerals Inc.	Haquira
	Aluminium Corp of China Ltd. (Chinalco)	Toromocho
	Candente Copper Corp.	Cañariaco Norte
	Gold Fields Ltd.	Chucapaca
	Southern Perú Copper Corp. Sucursal del Perú	Expansion: Toquepala
	Marcobre S.A.C.	Mina Justa
	Bear Creek Mining Corporation	Corani
	Apurimac Ferrum	Hierro Apurimac
	Compañía Minera Milpo S.A.	Expansion: Cerro Lindo and El Porvenir
	Shougang Corporation	Expansion: Marcona
	Compañía Minera Antamina S.A.	Expansion: Antamina
	Anglo American Plc.	Michiquillay
	Río Tinto Plc.	La Granja
Hydrocarbons	Conduit Capital Partners - Odebrecht	Andino del Sur pipeline
	Pluspetrol Perú Corp. S.A.	Expansion of Pisco and Malvinas plants
	Savia Perú S.A.	Lot Z-2B: Perforation, exploration and others
	Petrobras	Lot 58 and Lot X
	Transportadora de Gas del Perú S.A. (TgP)	Expansion of gas (capacity of transportation)
	Cálidda Gas Natural del Perú	Expansion of main grid
	Perenco	Exploration Lot 67 and pipeline
	Pluspetrol Perú Corp. S.A.	Exploration Lots 88 and 56
	SK Energy	Exploration Lot Z 46
	Repsol YPF	Lot 39
Electricity	Odebrecht S.A.	Hydroelectric plant of Cerro de Chaglla
	Kallpa Generación S.A.	Hydroelectric plant of Cerro del Águila
	Norwind	Wind energy park Cerro Chocan
	SN Power Perú S.A.	Hydroelectric plant Cheves
	Fénix Power Perú S.A.	Thermal power plant
	Energía Azul S.R.L.	Hydroelectric plant Santa María
	Inkia Energy	Kallpa IV
	GDF Suez	Hydroelectric plant Quitaracsa I
	Inevarante	Hydroelectric plant Acco Pucará
	GDF Suez	Cold reserve stations - Ilo
Industry	Grupo Celepsa	Expansion of lamination plant (N° 2)
	SAB Miller	Investment plan 2012-2014
	Cementos Pacasmayo	Phospates plants
	Repsol YPF	Expansion of La Pampilla plant
	Corporación JR Lindley	Expansion and new plants
	Cementos Interoceánicos	Expansion of plant in Puno
	Grupo de Pilkington Limited	Manufacture plant of glasses
	Cementos Lima	Expansion of installed capacity
Infrastructure	OAS S.R.L.	Parque Rimac express way
	Consorcio APM Terminals Callao	Modernization of North Pier
	Covisol	Trujillo-Sullana Sol Highway
	Grupo Ronmero	Expansion of Port of Matarani
	Consorcio Transportadora Callao	Minerals Pier
	Autopista del Norte SAC	Pativilca – Port of Salaverry Road Network No. 4
	Terminales Portuarios Euroandinos	Expansion of Port Paita
	Covi Peru	Pucusana - Cerro Azul - Ica Road Network No. 6
	El Consorcio Aeropuertos Andinos del Perú	Regional airports (second tranche)
Other sectors	Telefónica del Perú S.A.	Optical fiber project at Los Andes
	América Móvil Perú S.A.C.	Expansion of infrastructure, capacity and technological innovation
	Graña y Montero Vivienda (GMV)	Housing projects
	Grupo Falabella	Mall Aventura Plaza: new malls
	Holding Banmédica	Health centers
	Maestro Perú	Investment projects and expansión 2012-2014
	Inmobiliari S.A	Real state
	Besalco S.A.	Real state
	Grupo Fierro	Real state
	Cencosud	New supermarkets and malls
	Grupo Interbank	Expansion and modernizations of new malls

Based on the result registered by **private investment** in the first half of the year as well as on the evolution of investment indicators and announcements of private investment projects, the forecast for 2012 has been revised upwards from 10.2 to 13.5 percent. In 2013 and 2014 private investment would grow at a rate of 8.2 percent, that is, higher than the GDP growth rate.

30. **Public investment** grew 30.3 percent in Q2 due to the increased investment spending of local and regional governments, which contrasts with the low level of spending of the national government. Because it is expected that the central government will maintain a low pace of spending in the second half of the year, the forecast rate of public investment in 2012 has been revised downwards to 23.7 percent for this year. The forecasts for the next years consider the increases in public investment already announced by the government.

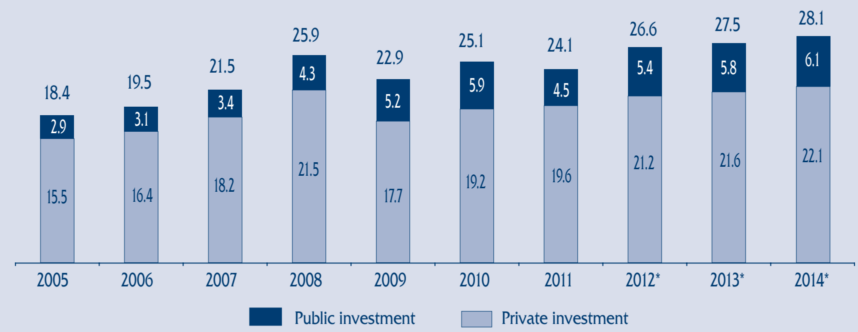
Graph 38
PUBLIC INVESTMENT: 2005-2014
(Real % change)



* Forecast.

31. The gross investment-to-GDP ratio has been over 20 percent of GDP since 2007 and has shown a growing trend since then, except in year 2009 when it dropped in the context of the international crisis. It recovered thereafter and is now estimated to be over 26 percent of GDP in 2012. Taking into account the forecasts of growth of private investment and public investment for 2013 and 2014, this ratio is expected to rise to levels around 28 percent of GDP in 2014.

Graph 39
GROSS FIXED INVESTMENT: 2005-2014
(% of GDP)



* Forecast.

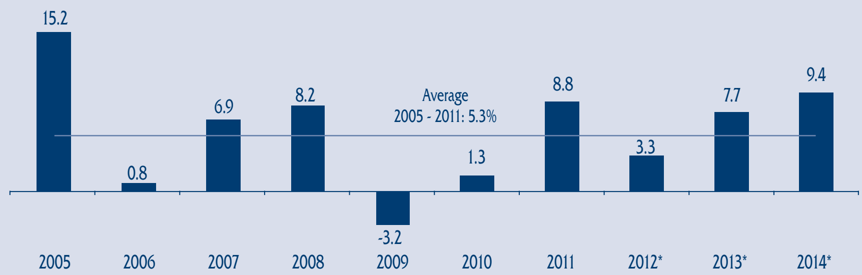
32. Real **exports** of goods and services grew 7.2 percent in the first semester, mainly due to the evolution of some traditional exports, such as fishmeal, coffee, iron, copper, and lead. However, a lower growth of exports of traditional products was recorded in Q2 together with the slower pace of growth observed in trading partners such as China. On the other hand, the volume of non-traditional exports grew throughout the first semester, showing a rate of 12.1 percent in Q1 and a lower rate in Q2 (6.2 percent).

Exports would show a rising trend in the forecast horizon, due to the onset of operations of some copper mining projects, such as the expansions of Southern and Antamina.

On the other hand, decelerating relative to Q1, real **imports** grew 5.7 percent in Q2 due to lower imports of inputs and, to a lesser extent, to a slower growth in imports of capital goods. The forecast on the growth of imports in 2012 has been revised upwards.

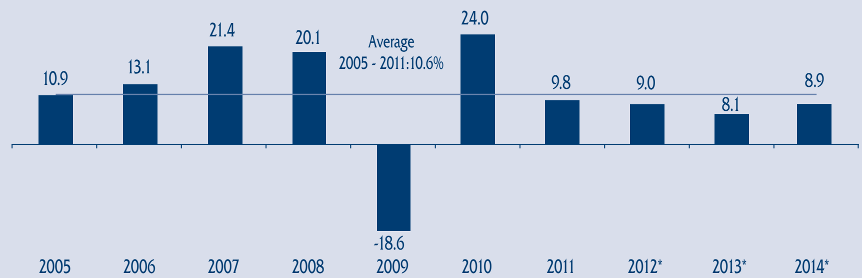
Imports in 2013 and 2014 would register growth rates of 8-9 percent, lower rates than the ones observed in the period 2005-2011.

Graph 40
EXPORTS OF GOODS AND SERVICES: 2005-2014
(Real % change)



* Forecast.

Graph 41
IMPORTS OF GOODS AND SERVICES: 2005-2014
(Real % change)



* Forecast.

Sector GDP

33. In the first semester of 2012, GDP grew 6.1 percent, driven by non-primary sectors such as construction, commerce, and services, reflecting the evolution of domestic demand. In the primary sectors, growth in agriculture was offset by the delayed beginning of the first season of anchovy fishing.

    The growth rate registered in the agricultural sector in recent months reflects the strong expansion of the agricultural sub-sector, which is explained by a higher production of rice after the normalization of harvests in the northern areas of the country, as well as by the higher yields of potatoes, olives, and hard yellow maize obtained. However, some crops, like lemon and onion, have been affected by weather anomalies which led to lower planting, harvests, and yields. Assuming normal weather conditions, the growth forecasts in this sector in 2013 and 2014 are still the ones considered in our previous Inflation

Report. The growth forecast considers an increase of 3.6 percent in sown areas to 2,075 thousand hectares in the 2012 crop year, which would translate into an increase in rice, hard yellow maize, and potato crops for the domestic market. Moreover, the growth of this sector would continue to be driven by external demand and agro-industry.

The evolution of the fishing sector in the first semester was marked both by a lower quota for anchovy fishing and by the presence of positive sea temperature anomalies. The extraction of anchovy is expected to recover in the forecast horizon and to return to levels close to its historical average of 6 million tons per year, with which the growth of the sector towards the end of the forecast horizon would come mainly from the recovery and greater presence of species intended for human consumption. The probability of occurrence of an episode of El Niño has subsided, as evidenced by the reversal of sea temperatures off the coast in the northern areas of Peru, particularly in the month of August, when colder temperatures were registered.

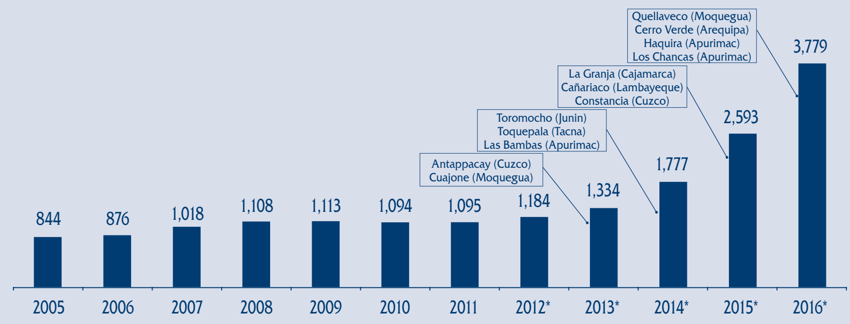
Table 14
SEA TEMPERATURE ANOMALIES - PORT OF PAITA: 1970 - 2012
(In degrees centigrades)

	Episode of "El Niño"								
	Oustanding		High	Medium			Low		
	1982-1983	1997-1998	1972-1973	1991-92	2006-2007	1986-87	2002-2003	2008-2009	2012-2013
Jan.	1.0	-1.6	-1.2	-1.7	0.5	1.4	-1.6	1.3	0.5
Feb.	-2.4	-0.2	-1.6	0.4	2.1	-0.1	1.5	2.6	1.1
Mar.	-2.1	1.8	1.5	-0.6	-0.5	-1.6	3.4	3.1	0.6
Apr.	-1.4	1.9	2.5	-1.3	-2.2	-1.8	2.5	2.1	1.2
May.	0.1	4.6	3.5	-0.1	-0.1	-0.9	0.6	0.2	0.7
Jun.	1.7	5.3	4.2	0.5	0.0	-1.1	-0.3	1.9	1.3
Jul.	3.6	6.5	4.1	-0.2	1.2	0.7	-0.1	2.0	1.2
Aug.	0.7	5.3	3.0	1.2	1.7	0.9	0.1	1.7	-0.3
Sep.	1.3	4.4	0.6	-0.2	0.6	-0.6	0.9	0.6	0.18*
Oct.	4.1	4.6	2.1	0.9	2.2	1.5	1.9	-0.5	
Nov.	5.5	7.0	1.5	0.0	1.5	2.1	2.4	-0.2	
Dec.	5.9	7.9	4.4	2.0	-0.2	1.4	2.0	-0.6	
Jan.	6.5	8.0	3.3	1.7	2.0	1.8	0.6	0.6	
Feb.	0.0	6.9	0.9	1.7	-0.3	3.5	-1.2	0.5	
Mar.	5.9	7.0	-0.4	3.9	-1.5	3.2	-1.2	-0.7	
Apr.	9.4	6.1	-2.4	4.8	-2.0	2.2	-2.3	0.3	
May.	10.5	6.3	-3.1	3.0	-2.3	1.6	-1.6	1.0	
Jun.	10.7	1.2	-2.7	0.4	-0.5	0.6	-1.5	0.6	
Jul.	6.2	0.7	-1.9	-0.8	-0.5	1.1	-0.7	0.9	
Aug.	2.4	-0.2	-1.8	-0.7	-0.6	0.7	1.3	1.1	
Sep.	1.8	-0.5	-1.8	-0.8	-1.3	0.7	0.8	0.5	
Oct.	0.8	-0.6	-1.7	-0.7	-0.3	2.0	1.7	-0.1	
Nov.	0.2	-0.8	-1.3	0.1	-1.0	0.7	1.8	0.8	
Dec.	-0.6	-1.0	-1.8	-0.6	-2.4	-0.2	-0.3	2.6	

Source: IMARPE.
*As of September 11, 2012.

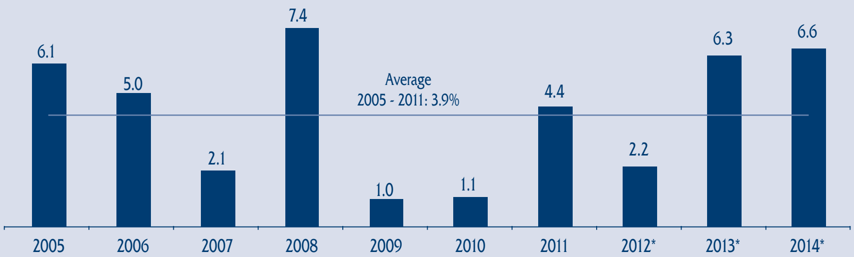
The high rates of growth expected in the primary sectors in 2013 and 2014, translated into a higher growth of exports, are explained by the evolution of the mining and hydrocarbons sector. This is mainly associated with the expected onset of operations at Toromocho and Las Bambas copper projects and with the expansions of Southern's Cuajone and Toquepala, as well as with the onset of operations at the Antapaccay copper project which is scheduled for 2012.

Graph 42
COPPER PRODUCTION: 2005-2016
(Thousands of tons)



* Forecast.

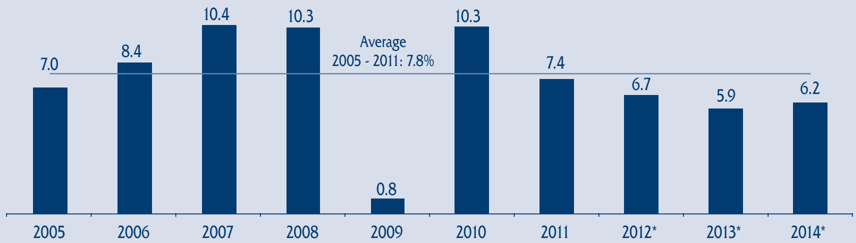
Graph 43
PRODUCTION IN PRIMARY SECTORS: 2005-2014
(Real % change)



* Forecast.

34. **Non-primary sectors** grew 7.0 percent in the first semester, mainly due to the dynamism of construction, trade, and services, offset by the weak growth recorded by non-primary manufacturing which was affected by the lower demand for textiles abroad. A more moderate pace of growth is expected in almost all non-primary sectors, in line with the evolution of domestic demand. However, the rising growth rates of the world economy would reflect in the rate of growth of non-primary manufacturing, which would accelerate in the forecast horizon.

Graph 44
PRODUCTION IN NON PRIMARY SECTORS: 2005-2014
(Real % change)



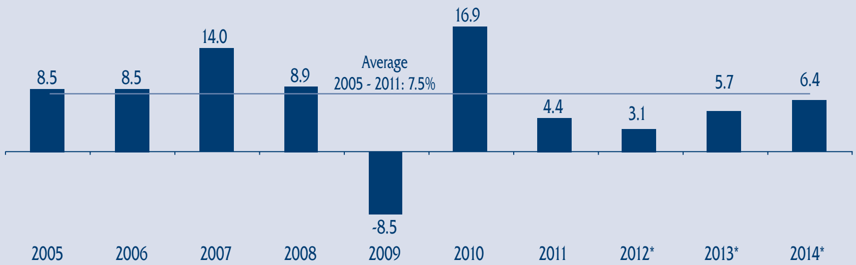
* Forecast.

Table 15
GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS
(Real % change)

	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
Agriculture and livestock	**2.9**	**3.8**	**4.5**	**4.0**	**4.0**	**4.3**	**4.3**	**4.2**	**4.2**
Agriculture	0.8	2.8	4.2	3.8	3.5	3.7	3.8	4.1	3.9
Livestock	6.7	5.2	4.4	4.6	4.5	4.6	4.6	4.6	4.6
Fishing	**17.4**	**29.7**	**-12.5**	**-8.9**	**-7.7**	**2.8**	**4.9**	**2.5**	**1.1**
Mining and hydrocarbons	**-1.3**	**-0.2**	**3.8**	**3.1**	**3.3**	**11.2**	**9.2**	**12.1**	**11.8**
Metallic mining	-6.7	-3.6	4.1	3.7	3.9	9.5	6.7	12.1	11.7
Hydrocarbons	33.0	18.1	2.4	0.6	0.8	18.9	18.6	12.4	12.4
Manufacturing	**9.0**	**5.6**	**-0.4**	**2.1**	**2.1**	**6.2**	**5.9**	**6.2**	**6.0**
Raw materials	11.8	12.3	-7.7	-1.5	-3.4	6.0	6.7	4.2	3.9
Non-primary industries	8.5	4.4	1.1	2.8	3.1	6.2	5.7	6.5	6.4
Electricity and water	**7.3**	**7.4**	**5.6**	**5.7**	**5.3**	**5.9**	**5.9**	**7.0**	**7.0**
Construction	**4.1**	**3.4**	**14.7**	**12.0**	**15.4**	**7.6**	**6.7**	**8.0**	**7.8**
Commerce	**9.5**	**8.8**	**7.1**	**6.6**	**6.4**	**5.4**	**5.4**	**5.9**	**5.9**
Other services	**9.1**	**8.3**	**7.4**	**6.5**	**6.6**	**6.1**	**6.1**	**5.9**	**5.9**
GDP	**7.8**	**6.9**	**6.1**	**5.8**	**6.0**	**6.2**	**6.0**	**6.3**	**6.3**
Memo:									
Primary GDP	3.4	4.4	1.7	2.5	2.2	6.8	6.3	6.8	6.6
Non-Primary GDP	8.7	7.4	7.0	6.4	6.7	6.1	5.9	6.2	6.2

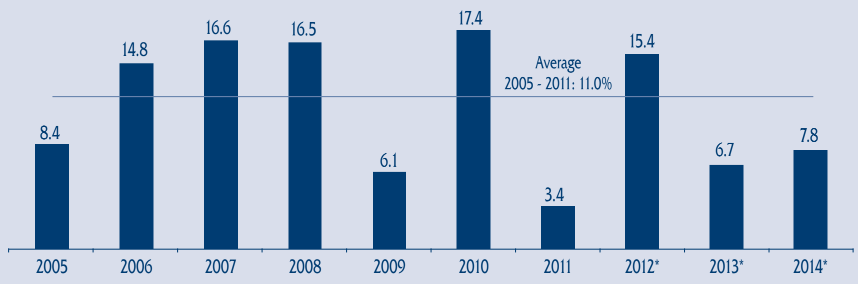
IR: Inflation Report.
* Forecast.

Graph 45
NON-PRIMARY MANUFACTURING: 2005-2014
(Real % change)



* Forecast.

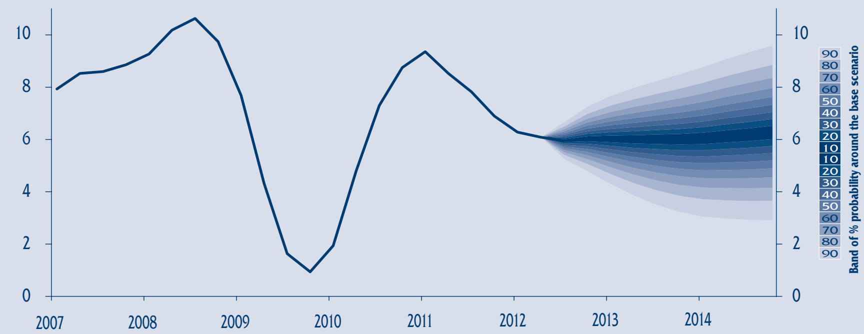
Graph 46
CONSTRUCTION: 2005-2014
(Real % change)



* Forecast.

35. Every growth forecast is subject to potential events that may divert it from the central scenario. In todays' context of uncertainty, the materialization of some risks may lead GDP to register different growth rates from the ones originally projected. The domestic risk scenario considers adverse demand shocks associated with the impact of social conflicts on private investment. On the other hand, growing uncertainty in the global economy would contribute to deteriorate macroeconomic conditions, a situation that would contrast with an eventual massive capital inflow associated with the search for investment options in emerging markets. The risk scenarios considered in this report are discussed in the chapter Balance of risks.

Graph 47
FORECAST OF GDP GROWTH[1/]: 2012 - 2014
(Interanual % change)



Memo: The graph shows the probability of occurrence of GDP growth forecasts in the future, the values of which were established combining statistical analysis (using data as of June 2012) and the subjective perception of the BCRP. Thus, in each period of the forecast horizon, each pair of bands with the same shade concentrates a probability of 10%. This can be interpreted as that 10 of every 100 possible values of future GDP growth values are expected to fall within the darkest bands (located in the center).

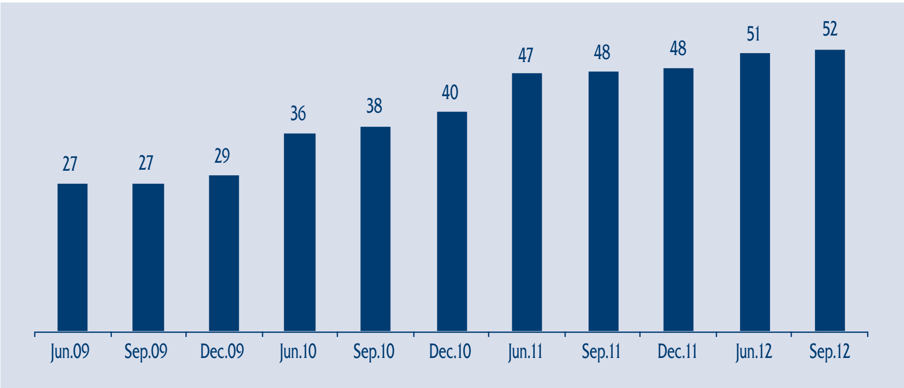
1/ GDP growth is defined as the percentage change of the moving average in four quarters compared to the same quarter of the previous year. Thus, the figure in Q4 coincides with the GDP growth rate in the year.

BOX 3
ANNOUNCED PRIVATE INVESTMENT PROJECTS

Peru's economy is expected to grow in the next years at an average rate compatible with its long-term potential growth. Among other factors, this potential growth depends on having a favorable climate for private investment in the country given that the dynamics of this variable allows for the expansion of the economy's capital stock. This factor is also important because new investments incorporate technological changes that also bring about productivity improvements in the different economic sectors.

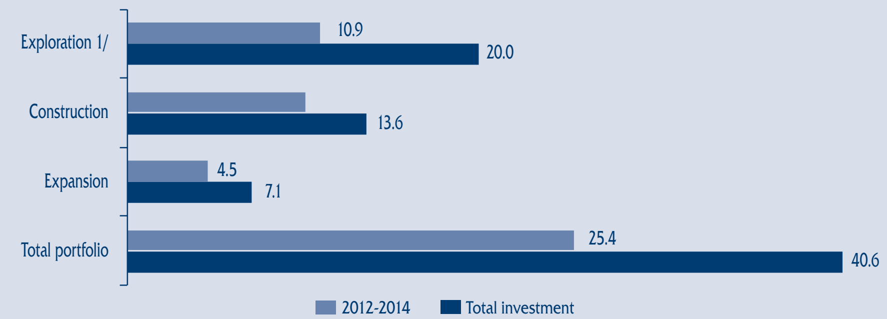
Private investment projects announced for the period 2012-2014 amount to US$ 52 billion. These announced investments concentrate especially in the sector of mining and hydrocarbons, and also in other sectors associated with real estate, commercial activities, and health. It should be pointed out that the latter have a great capacity for expansion given their current low level of penetration. Thus, the announced projects to be implemented in the coming years show that private investment will be diversified both in terms of sectors and geographically.

ANNOUNCED INVESTMENT: FOR THE NEXT THREE YEARS
(Billions of US$)



Announced investment has maintained a rising trend over the past few years, in line with the favorable outlook for the economy and economic agents' increased confidence, which is reflected in the implementation of major investment projects. In the specific case of mining projects, the increase in costs associated with requirements of leading technology and new conditions to meet environmental requirements and social commitments have led some companies to increase the amounts of estimated investment, as in the case of Las Bambas (from US$ 4.2 billion to US$ 5.2 billion) and Constancia (from US$ 1 billion to US$ 1.5 billion), for example.

PROJECT PORTFOLIO IN THE MINING SECTOR
(In thouands of US$)



1/ Environmental impact studies.
Source: MEM.
Elaboration: BCRP.

The project portfolio announced to be implemented in the mining sector totals US$ 41 billion, of which US$ 25 billion will be carried out between 2012 and 2014. Approximately half of the announced projects already have approved final environmental impact studies and are currently in the construction or expansion stage.

III. Balance of payments

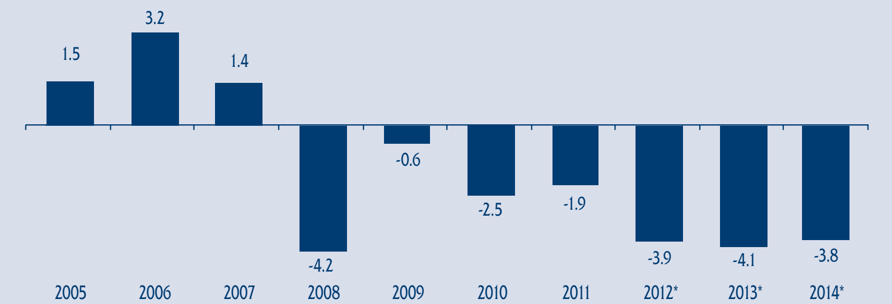
36. In the first half of this year the current account recorded a deficit equivalent to 3.1 percent of GDP, a balance higher by 0.1 percentage point than the one recorded in the same period in 2011. The balance in the financial account in this period was US$ 11.74 billion, that is, higher by US$ 6.75 billion than in the previous year, which resulted in an overall positive balance of payments with a balance of US$ 8.72 billion. The financial flows from abroad comprise mainly non-residents' reinvestment of profits, long-term disbursements of the financial sector, and private issuances of bonds abroad.

Table 16
BALANCE OF PAYMENTS
(Millions of US$)

	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
I. CURRENT ACCOUNT BALANCE	**-2,596**	**-3,341**	**-3,024**	**-5,341**	**-7,709**	**-5,970**	**-8,664**	**-6,905**	**-8,783**
% of GDP	*-3.0*	*-1.9*	*-3.1*	*-2.7*	*-3.9*	*-2.8*	*-4.1*	*-2.9*	*-3.8*
1. Trade Balance	4,088	9,302	2,547	6,740	3,541	6,676	2,809	6,971	3,817
a. Exports	21,858	46,268	22,111	45,750	44,330	49,255	47,162	54,879	53,067
b. Imports	-17,770	-36,967	-19,563	-39,010	-40,789	-42,578	-44,353	-47,908	-49,250
2. Services	-1,095	-2,132	-985	-2,373	-2,179	-2,744	-2,389	-3,025	-2,792
3. Investment income	-7,153	-13,710	-6,219	-13,069	-12,418	-13,446	-12,596	-14,458	-13,451
4. Current transfers	1,563	3,200	1,634	3,362	3,347	3,544	3,511	3,607	3,643
Of which: Remittances	*1,309*	*2,697*	*1,378*	*2,842*	*2,830*	*2,997*	*2,969*	*3,033*	*3,073*
II. FINANCIAL ACCOUNT	**4,990**	**8,065**	**11,745**	**16,040**	**19,508**	**9,970**	**11,664**	**9,905**	**11,783**
Of which:									
1. Private Sector (long and short term)	5,166	8,313	8,402	13,091	15,840	9,817	11,602	9,750	11,972
2. Public Sector	101	848	1,870	2,046	2,186	148	58	147	-193
III. BALANCE OF PAYMENTS (=I+II)	**2,394**	**4,724**	**8,722**	**10,700**	**11,800**	**4,000**	**3,000**	**3,000**	**3,000**

IR: Inflation Report.
* Forecast.

Graph 48
CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS: 2005-2014
(% of GDP)

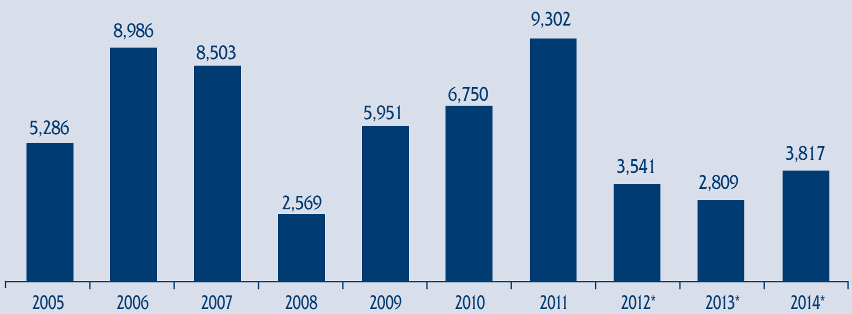


* Forecast.

37. The annual deficit in the current account of the balance of payments is estimated to reach 3.9 percent in 2012, a result 1.2 points higher than the one projected in June (US$ 2.37 billion) as a result of lower exports (down US$ 1.42 billion) and higher imports (up US$ 1.78 billion), which would be offset by a reduction of the net payments of income factors (US$ 651 million). These flows are explained by the effect of lower external demand on export prices and volumes, as well as by the effect of higher domestic demand on imports.

38. The deficit in the current account in 2013 would increase from 2.8 percent (estimated in our Inflation Report of June) to 4.1 percent of GDP as a result of lower terms of trade, the anticipated lower growth of non-traditional exports associated with the economic slowdown foreseen in our major trading partners, and the higher levels of imports of both consumer goods and capital goods. Moreover, the deficit in the current account in 2014 is estimated at 3.8 percent of GDP, higher than the deficit estimated in our previous report (2.9 percent of GDP).

Graph 49
TRADE BALANCE: 2005-2014
(Millions of US$)



* Forecast.

39. The **trade balance** for 2012 has been revised downwards from US$ 6.7 billion (Inflation Report of June) to US$ 3.5 billion, considering the lower surplus observed in the first semester of the year and the lower terms of trade projected for this year relative to the ones considered in the previous report.

A trade surplus of US$ 2.8 billion is currently estimated for 2013 (vs. US$ 6.7 billion considered in the previous report), due mainly to the decline of exports in a context of lower global growth than the one foreseen in our June report, the higher prices of food anticipated for 2013, and to the higher levels of imports of consumer goods and capital goods observed since the first half of 2012. In 2014 the trade surplus would increase to US$ 3.8 billion due to a higher volume of exports, especially mining exports, as a result of the onset of operations of some copper mining projects.

Table 17
TRADE BALANCE
(Millions of US$)

	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
EXPORTS	**21,858**	**46,268**	**22,111**	**45,750**	**44,330**	**49,255**	**47,162**	**54,879**	**53,067**
Of which:									
Traditional products	17,074	35,837	16,732	34,658	33,333	36,759	35,064	41,049	39,787
Non-traditional products	4,625	10,130	5,198	10,748	10,617	12,124	11,727	13,442	12,892
IMPORTS	**17,770**	**36,967**	**19,563**	**39,010**	**40,789**	**42,578**	**44,353**	**47,908**	**49,250**
Of which:									
Consumer goods	2,982	6,692	3,777	7,569	7,999	8,461	8,864	9,676	10,184
Inputs	8,871	18,255	9,143	18,586	19,020	19,405	19,809	21,350	21,404
Capital goods	5,731	11,665	6,519	12,522	13,136	14,358	15,059	16,505	17,039
TRADE BALANCE	**4,088**	**9,302**	**2,547**	**6,740**	**3,541**	**6,676**	**2,809**	**6,971**	**3,817**

IR: Inflation Report.
* Forecast.

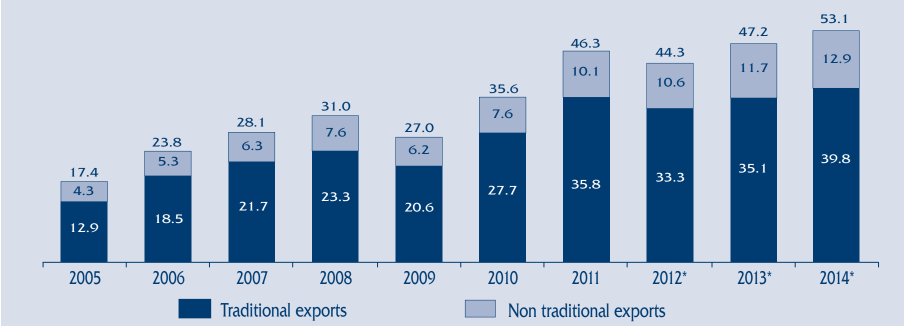
40. The projection of **exports** in 2012 has been revised downwards to about US$ 44 billion, which represents a reduction of 4.2 percent compared to 2011. This downward revision results mainly from the lower growth projected in terms of the volume of exports –5.4 percent was estimated in June– due to lower exports of traditional products, especially fishmeal, gold, and oil. This lower volume of exports would be partially offset by an increase in copper exports derived from the increased production projected for the year due to the onset of operations at two projects: the expansion of Antamina and Antapaccay.

Table 18
TRADE BALANCE
(% change)

	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
1. Value:									
Exports	35.9	30.1	1.2	-1.1	-4.2	7.7	6.4	11.4	12.5
Traditional products	36.1	29.5	-2.0	-3.3	-7.0	6.1	5.2	11.7	13.5
Non-traditional products	35.5	32.6	12.4	6.1	4.8	12.8	10.5	10.9	9.9
Imports	37.3	28.3	10.1	5.5	10.3	9.1	8.7	12.5	11.0
2. Volume:									
Exports	8.7	8.5	3.7	5.4	1.1	8.9	8.6	9.8	10.9
Traditional products	5.2	5.2	2.4	5.5	0.3	8.6	8.5	10.5	12.1
Non-traditional products	21.5	20.2	9.1	4.7	4.1	9.9	8.9	7.7	7.1
Imports	19.1	12.8	7.8	8.4	8.8	9.2	8.7	10.3	9.8
3. Price:									
Exports	24.8	20.0	-2.8	-6.2	-5.2	-1.2	-2.1	1.5	1.5
Traditional products	28.6	22.9	-4.5	-9.4	-5.9	-2.9	-3.3	0.5	0.8
Non-traditional products	11.5	10.4	3.1	1.4	0.9	2.6	1.4	2.9	2.7
Imports	15.2	13.8	2.2	-2.6	1.4	-0.1	0.1	2.0	1.1

IR: Inflation Report.
* Forecast.

Graph 50
EXPORTS OF GOODS: 2005-2014
(Billions of US$)



Memo: Total exports also includes other exports.
* Forecast.

Exports in 2013 would amount to US$ 47 billion, a lower figure than the one estimated in our previous report, due to lower export prices, the lower growth of the volume of mining exports, and the lower growth of non-traditional exports, in line with the downward revision of the global growth forecast made in this report. Moreover, exports in 2014 would amount approximately to US$ 53 billion, which represents a nominal growth of 12.5 percent compared to 2013. This increase would be associated with higher exports of mining products, mainly copper and molybdenum due to the onset of operations at Toromocho, Las Bambas, and the expansion of Southern units, as well as with higher exports of iron ores due to the expansion of Shougang's unit in Marcona.

Graph 51
VOLUME OF COPPER EXPORTS
(Index 1994=100)

* Forecast.

Graph 52
VOLUME OF IRON EXPORTS
(Index 1994=100)

* Forecast.

Graph 53
NON TRADITIONAL EXPORTS VOLUME
(Index 1994=100)

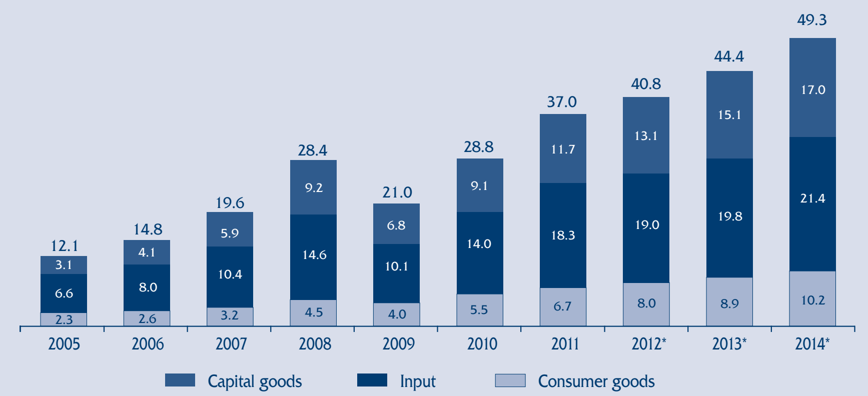
* Forecast.

41. On the other hand, the forecast on **imports** in 2012 has been revised upwards to approximately US$ 41 billion, which represents an increase of 10.3 percent compared to 2011. The higher value of imports considered in this report reflects mostly the higher results registered in the first half of the year as a result of the higher prices of imports, especially of consumer goods, capital goods, and crude.

In terms of volume, imports of goods would grow 8.8 percent in 2012. This growth rate, which is higher than the one estimated in the previous report rate (8.4 percent), would be explained by higher volumes of imports of consumer goods and capital goods, and partially offset by the lower volumes of oil imports registered in the first six months of the year.

In 2013 imports would amount to US$ 44 billion, while in 2014 they would reach US$ 49 billion. The volumes of imports would continue showing high rates of growth in the forecast horizon (8.7 percent in 2013 and 9.8 percent in 2014), in line with the evolution of domestic demand.

Graph 54
IMPORTS OF GOODS: 2005-2014
(Billions of US$)



Nota: Total imports also includes other imports.
* Forecast.

Financial account

42. In Q2-2012 the **long-term financial account of the private sector** totaled US$ 2.57 billion, a sum higher by US$ 828 million than the one recorded in Q2-2011. This increase results both from the higher long term disbursements of the financial sector and from insurance companies' lower acquisitions of assets abroad, which was partially offset by a lower reinvestment of profits. With this, the flow of long-term capital of the private sector accumulates a total of US$ 7.80 billion in the first semester.

Table 19
PRIVATE SECTOR FINANCIAL ACCOUNT FLOWS
(Millions of US$)

	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
ASSETS (1)	**-526**	**-1,298**	**-714**	**-2,925**	**-1,956**	**-2,809**	**-2,183**	**-2,677**	**-2,350**
Direct investment abroad	30	-113	-68	-300	-68	0	0	0	0
Portfolio investment abroad	-557	-1,185	-646	-2,626	-1,887	-2,809	-2,183	-2,677	-2,350
LIABILITIES (2)	**5,536**	**10,918**	**8,511**	**15,481**	**16,303**	**12,131**	**12,851**	**12,002**	**13,518**
Foreign direct investment in the country	4,157	8,233	5,440	10,006	9,868	8,242	8,264	8,739	9,063
Foreign portfolio investment in the country	11	-102	846	2,016	1,701	1,895	1,862	1,426	1,946
Capital participation	5	147	12	154	62	170	170	165	165
Other liabilities	5	-249	835	1,863	1,639	1,725	1,692	1,261	1,781
Long-term loans	1,368	2,787	2,225	3,459	4,734	1,995	2,725	1,837	2,509
Disbursements	1,646	3,886	2,730	4,541	5,845	3,323	4,043	3,316	4,041
Amortization	-278	-1,099	-505	-1,082	-1,112	-1,328	-1,318	-1,479	-1,533
Total (-1+2)	**5,010**	**9,620**	**7,797**	**12,555**	**14,347**	**9,322**	**10,668**	**9,325**	**11,168**
Memo:									
Percentage of GDP	*5.9*	*5.4*	*8.1*	*6.3*	*7.3*	*4.3*	*5.0*	*4.0*	*4.8*

IR: Inflation Report.
* Forecast.

In 2012 the long-term financial account of the private sector would amount to US$ 14.3 billion, a higher amount than the one estimated in our Report of June (US$ 12.6 billion). This upward revision is explained by higher than anticipated long-term loans of the non-financial sector and by local institutional investors' lower capital flows to other countries, taking into account the flows observed in the first semester of the year.

Graph 55
PRIVATE SECTOR EXTERNAL FINANCING 1/
(Billions of US$)

1/ Foreign direct investments plus long term disbursements.
* Forecast.

A positive flow of US$ 10.7 billion and US$ 11.2 billion is projected for 2013 and 2014, respectively, based on the increased requirement of external financing for the implementation of private investment projects, part of which is reinvestment, partially offset by purchases of assets abroad by local institutional investors.

43. In Q2-2012, the **financial account of the public sector** showed a positive net flow of US$ 289 million due to non-residents' purchase of sovereign bonds in the domestic market (US$ 436 million). Placements of bonds abroad are expected to increase in the rest of the year, which would result in a positive flow of US$ 2.2 billion at the end of the year. No new issuance of global bonds is considered in the forecast for 2013 and 2014.

44. On the other hand, the **short-term capital account** showed a positive net flow of US$ 908 million in Q2-2012. This balance was associated with the decline of the non-financial sector's deposits in foreign currency abroad and with the increase in banks' net external liabilities. A positive flow of US$ 1.5 billion is projected for the year, which would reflect banks' increased liabilities abroad.

45. Due to capital inflows and in order to avoid excessive volatility in the foreign exchange market, the Central Bank intervened in the foreign exchange market buying foreign currency for a total of US$ 1.84 billion in Q2 and thus accumulated net purchases amounting to US$ 7.40 billion in the first semester. Thus, at August 2012 international reserves amounted to US$ 59.77 billion, a level of reserves that gives the Peruvian economy a high capacity of response face potential financial and real shocks. This level of reserves is equivalent to 31.8 percent of GDP, backs up 95.4 percent of total liquidity in depository entities, and is equal to 6.1 times the obligations of the short-term public and private external debt. The levels of coverage of Peru's international reserves are among the highest in the region.

Table 20
NIR INDICATORS

	Aug.02	Aug.07	Aug.12
Net International Reserves (NIR, millions of US$)	9,886	24,069	59,771
BCRP International Position (Millions of US$)	3,202	15,277	41,494
NIR / GDP (%) 1/	17.7	24.2	31.8
NIR / Short term debt (# of times) 2/	2.0	2.3	6.1
NIR / Total Liquidity (%)	81.3	99.4	95.4

1/ Accumulated at the previous quarter.
2/ Includes short-term debt balance and amortizations in the next four quarters.

IV. Public finances

46. Based on the balances obtained in the first semester, the forecast for the economic balance for 2012 has been revised upwards to a fiscal surplus of 1.5 percent of GDP from the surplus of 1.1 percent of GDP estimated in our report of June. Moreover, the balance estimated for 2013 and 2014 is a surplus of 1.1 percent of GDP in both years –a similar figure to the one considered in our June report (1.0 percent in both years)– due mainly to the higher growth expected in current revenues as a result of the measures adopted with the aim of expanding the tax base. The level of nominal spending has referred to in the report of June has remained in both years.

Table 21
NON FINANCIAL PUBLIC SECTOR
(% of GDP)

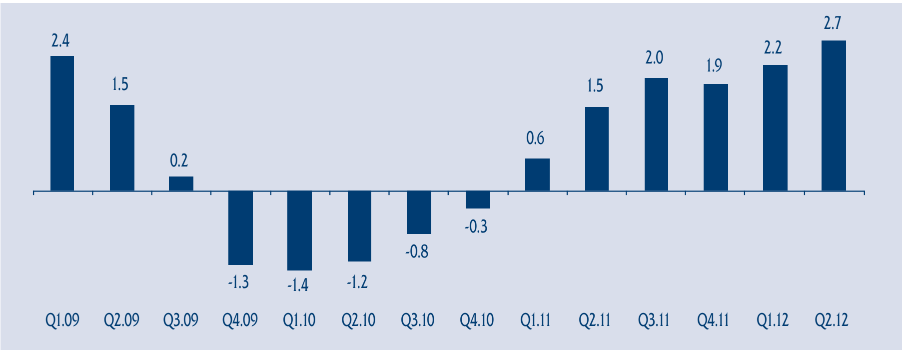
	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
1. General government current revenues 1/	**22.1**	**21.0**	**22.5**	**21.1**	**21.4**	**21.2**	**21.7**	**21.2**	**21.7**
Real % change	*16.2*	*13.6*	*6.4*	*4.7*	*5.2*	*6.0*	*6.6*	*6.6*	*6.7*
2. General government non financial expenditure	**15.3**	**18.1**	**15.0**	**19.1**	**19.1**	**19.2**	**19.5**	**19.3**	**19.6**
Real % change	*-0.8*	*1.7*	*2.1*	*9.6*	*8.8*	*6.8*	*7.8*	*6.8*	*7.3*
Of which:									
Current	11.9	13.0	11.3	13.0	13.2	12.9	13.4	12.8	13.3
Real % change	*5.6*	*7.1*	*-0.9*	*3.6*	*4.9*	*4.9*	*6.2*	*5.7*	*6.2*
Gross capital formation	3.1	4.7	3.5	5.7	5.6	6.0	5.7	6.1	5.9
Real % change	*-17.3*	*-8.1*	*16.0*	*25.5*	*22.3*	*10.9*	*8.6*	*9.3*	*10.6*
3. Others	**0.2**	**0.1**	**0.6**	**0.0**	**0.2**	**0.0**	**0.0**	**0.0**	**0.0**
4. Primary balance (1-2+3)	**6.9**	**3.0**	**8.1**	**2.1**	**2.6**	**2.0**	**2.2**	**1.9**	**2.1**
5. Interests	**1.2**	**1.2**	**1.1**	**1.1**	**1.1**	**1.0**	**1.1**	**1.0**	**1.0**
6. Overall Balance	**5.7**	**1.9**	**7.0**	**1.1**	**1.5**	**1.0**	**1.1**	**1.0**	**1.1**
Memo: (billions of S/.):									
1. General government current revenues	52.5	102.1	58.2	111.0	111.4	120.3	121.6	131.0	132.0
2. General government non-financial expenditure	36.5	87.8	38.8	100.0	99.1	109.3	109.3	119.2	119.2

1/ The central government includes the ministries, national universities, public agencies and regional governments. The general government has a wider coverage that includes the central government, social security, regulators and supervisors, government charity organizations and local governments.
IR: Inflation Report.
* Forecast.

Graph 56
ECONOMIC BALANCE OF THE NON FINANCIAL PUBLIC SECTOR: 2005-2014
(% of GDP)

* Forecast.

Graph 57
ECONOMIC BALANCE OF THE NON FINANCIAL PUBLIC SECTOR: Q1.09 - Q2.12
(% of GDP - accumulated in the last 4 quarters)



Graph 58
GENERAL GOVERNMENT CURRENT REVENUES: Q1.09 - Q2.12
(% of GDP - accumulated in the last 4 quarters)

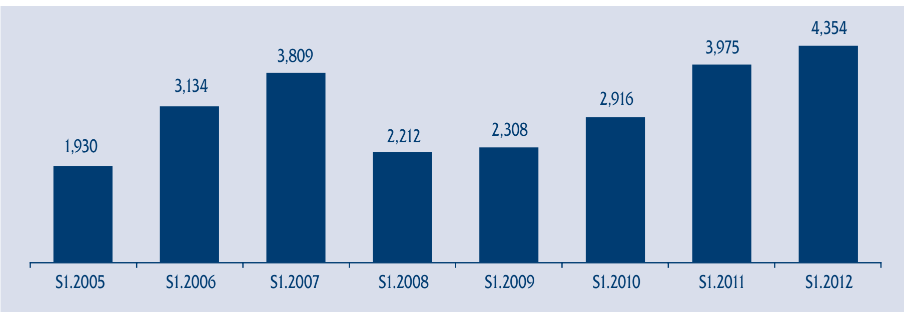
Graph 59
GENERAL GOVERNMENT NON FINANCIAL EXPENDITURE: Q1.09 - Q2.12
(% of GDP - accumulated in the last 4 quarters)

Evolution of tax revenues

47. In Q2-2012 the **current revenues of the general government** amounted to 22.5 percent of GDP (0.4 percentage points higher than the one recorded in the same period of 2011), which represents a growth of 5.0 percent in real terms. Tax revenues grew 4.1 percent in real terms, while non-tax revenue grew 7.1 percent in real terms.

48. Revenues from the income tax grew by a real 3.9 percent. The growth of revenues from individuals' income tax (19.6 percent) was noteworthy and reflected in part the growth of employment and payments for distribution of profits. On the other hand, revenues from the income tax of legal entities contracted 0.5 percent, reflecting the fall in revenues from the mining sector due to the lower prices of the main mining exports. It should be pointed out that revenues from the regularization of the income tax in the first semester of the year amounted to S/. 4.35 billion, a figure higher by S/. 379 million than the one observed in the same period of 2011 which sets a record for revenues from this tax source. The higher participation of revenues from the sector of services in this tax regularization is worth pointing out.

Graph 60
REGULARIZATION OF THE INCOME TAX: S1.2005 - S1.2012
(Millions of nuevos soles)



49. Driven by the dynamics of domestic demand, revenues from the domestic value added tax (VAT) registered an increase of 7.4 percent in Q2, which offset lower revenues from the external VAT (- 3.5 percent) due to the slowdown in the growth of imports. In real terms, the VAT grew 2.2 percent in this period.

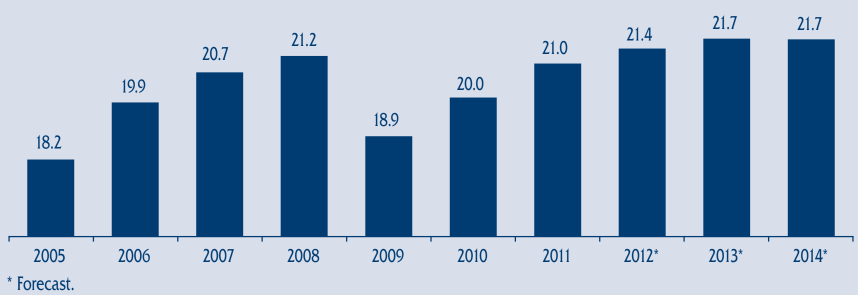
50. It is worth highlighting that revenues for a total of S/. 523 million was obtained in Q2-2012 from the new mining royalty, the special levy on mining activities, and the special tax to mining as a result of the modification of the tax treatment for the mining sector[4]. With this, revenues from this source in the first six months of the year amount to S/. 981 million, while a total of S/. 1.25 billion has been collected since these royalties and taxes were established.

Table 22
GENERAL GOVERNMENT CURRENT REVENUES
(% of GDP)

	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
TAX REVENUES	**16.8**	**15.9**	**17.1**	**16.0**	**16.2**	**16.0**	**16.5**	**16.1**	**16.4**
Income tax	7.8	6.9	8.1	7.0	7.0	6.9	7.2	6.9	7.2
Value added tax	8.3	8.3	8.3	8.4	8.4	8.5	8.6	8.5	8.6
Excise tax	1.0	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Import duties	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other tax revenues	1.4	1.4	1.6	1.5	1.6	1.5	1.6	1.5	1.7
Tax returns	-2.0	-2.0	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-2.2
NON TAX REVENUES	**3.4**	**3.3**	**3.5**	**3.3**	**3.3**	**3.3**	**3.3**	**3.3**	**3.3**
CONTRIBUTIONS	**1.9**	**1.9**	**1.9**	**1.9**	**1.9**	**1.9**	**1.9**	**1.9**	**1.9**
TOTAL	**22.1**	**21.0**	**22.5**	**21.1**	**21.4**	**21.2**	**21.7**	**21.2**	**21.7**

IR: Inflation Report.
* Forecast.

Graph 61
GENERAL GOVERNMENT CURRENT REVENUES: 2005 - 2014
(% of GDP)



4 The law amending the Law on Mining Royalties (Law N° 29788), the law establishing the Special Mining Tax (Law N° 29789), and the law establishing the legal framework for the Special Levy on Mining (Law N° 29790) were published on September 28, 2011.

51. In 2012 the current revenues of the general government would grow 5.2 percent in real terms, with which the ratio of current revenues-to-GDP would be 21.4 percent, higher than the ratio in 2011 (21.0 percent) and higher than the one estimated for 2012 in our June report (21.1 percent). In 2013 and 2014 the current revenues of the general government are expected to show growth rates of 6.6 and 6.7 percent, respectively. These growth rates would be close to the economy's potential growth rate and therefore would allow a current revenue-to-GDP ratio of 21.7 percent in both years. These estimates have been made considering the existing tax structure of the baseline scenario.

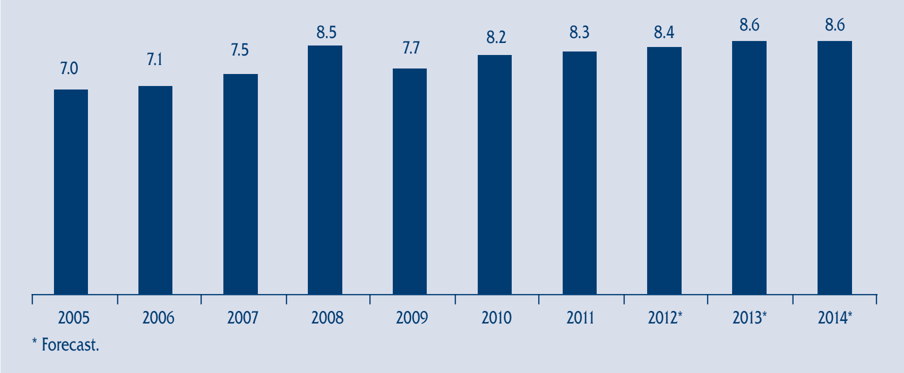
52. The revenues from the **income tax** would amount to 7.0 percentage points of GDP in 2012, which represents a slight growth of these revenues compared to 2011 (6.9 percent of GDP). This increase is mainly explained by higher revenues from incomes, given the growth observed in formal employment, as well as from increased profit distribution. The contribution of tax revenues from legal entities in GDP terms is estimated to remain at similar levels in the year, but would show a slight increase in 2013 and 2014 when it would rise to 7.2 percent of GDP due to the growth of extractive activities in that period.

Graph 62
INCOME TAX: 2005-2014
(% of GDP)

* Forecast.

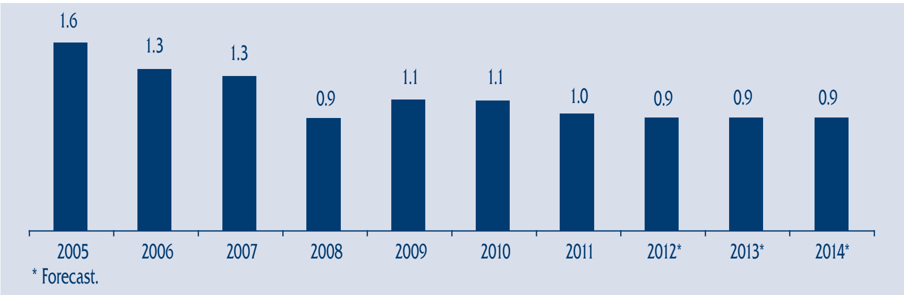
53. In 2012 revenues from the **value added tax (VAT)**, the main tax source of revenues, would be 8.4 percent of GDP, slightly higher than in 2011. A gradual increase is expected in revenues from this tax in the next years due to the higher growth of economic activity, as well as due to the administrative measures aimed at expanding the tax base, such as the incorporation of new goods in the tax debit system.

Graph 63
VALUE ADDED TAX: 2005 - 2014
(% of GDP)



54. The reduction established in the **excise tax** on fuels in mid-2011 caused revenues from this tax to decline by 0.1 percentage point to 0.9 percent of GDP in 2012. In 2013 and 2014 revenues from this tax are estimated to remain at 0.9 percent of GDP since no change is foreseen in the structure of this tax.

Graph 64
EXCISE TAX: 2005-2014
(% of GDP)



Evolution of public expenditure

55. In the **second quarter of 2012** the non-financial expenditure of the general government grew 1.2 percent in real terms, as a result of which the government expenditure-to-GDP ratio reached 15.8 percentage points. Like in Q1, the national government continued to show low levels of spending during this quarter, which led government expenditure to drop by a real 12.6 percent compared to the same period in 2011. On the other hand, regional and local governments increased their spending by 19.1 and 39.2 percent, respectively, after overcoming the management problems associated with the change of administration following the elections in 2011.

Table 23
GENERAL GOVERNMENT NON FINANCIAL EXPENDITURE
(Real % change)

	2011					2012	
	Q1	Q2	Q3	Q4	Year	Q1	Q2
CURRENT EXPENDITURE	**3.3**	**7.8**	**8.1**	**8.5**	**7.1**	**-3.2**	**1.3**
National government	6.8	9.6	11.3	3.5	7.6	-11.8	-4.2
Regional governments	-0.2	2.2	1.3	21.3	6.7	10.8	11.7
Local governments	-11.9	6.9	2.4	17.7	5.0	34.6	15.7
CAPITAL EXPENDITURE	**-22.5**	**-15.9**	**-21.5**	**5.4**	**-10.1**	**34.1**	**1.1**
National government	7.2	3.6	-6.5	-11.8	-3.9	-31.7	-39.5
Regional governments	-10.6	-26.4	-28.2	15.0	-9.4	44.0	41.9
Local governments	-59.8	-38.7	-30.5	19.4	-17.0	213.1	74.3
TOTAL EXPENDITURE	**-2.1**	**0.3**	**-1.2**	**7.3**	**1.7**	**3.1**	**1.2**
National government	6.8	8.1	7.8	-0.6	5.0	-14.6	-12.6
Regional governments	-2.3	-6.7	-8.5	18.9	1.6	17.0	19.1
Local governments	-34.8	-17.7	-17.3	18.8	-7.8	87.1	39.2

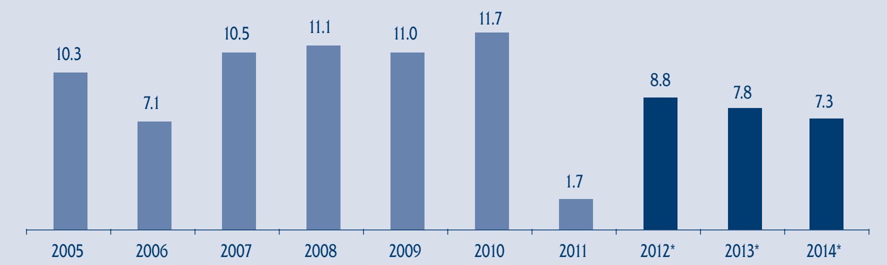
Table 24
GENERAL GOVERNMENT NON FINANCIAL EXPENDITURE
(Contribution to the real % change)

	2011					2012*	
	Q1	Q2	Q3	Q4	Year	Q1	Q2
CURRENT EXPENDITURE	**2.6**	**5.3**	**5.6**	**5.3**	**4.9**	**-2.6**	**0.9**
National government	3.7	4.4	5.2	1.5	3.5	-7.1	-2.1
Regional governments	0.0	0.3	0.2	2.4	0.9	1.6	1.5
Local governments	-1.1	0.6	0.2	1.4	0.4	2.8	1.5
CAPITAL EXPENDITURE	**-4.7**	**-5.1**	**-6.8**	**2.0**	**-3.2**	**5.7**	**0.3**
National government	0.6	0.6	-0.7	-1.9	-0.5	-3.1	-6.3
Regional governments	-0.4	-1.5	-1.9	1.1	-0.6	1.5	1.8
Local governments	-5.0	-4.1	-4.2	2.8	-2.1	7.3	4.8
TOTAL EXPENDITURE	**-2.1**	**0.3**	**-1.2**	**7.3**	**1.7**	**3.1**	**1.2**
National government	4.4	5.0	4.5	-0.4	3.0	-10.2	-8.4
Regional governments	-0.4	-1.3	-1.7	3.5	0.3	3.2	3.3
Local governments	-6.1	-3.5	-3.9	4.3	-1.6	10.1	6.3

56. A real growth of 8.8 percent is estimated in the non-financial expenditure of the general government in 2012, given the lower spending observed in the first semester of the year compared to the level considered in our previous report (9.6 percent). This projection considers higher rates of spending in all government levels in the remaining months of the year, including the national government, which would lead the expenditure-to-GDP ratio to register 19.1 percent at the end of the year.

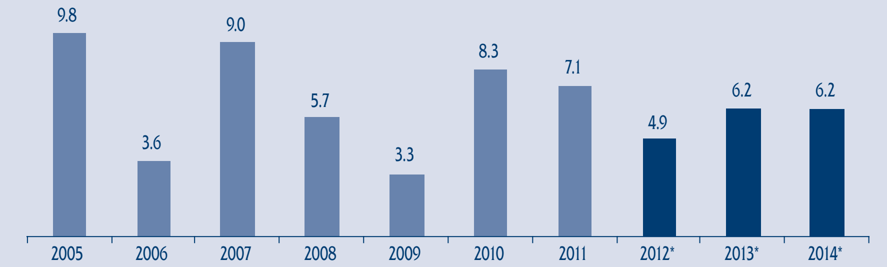
The same levels of nominal spending than the ones considered in our June are estimated here for 2013 and 2014. This would lead spending to grow 7.8 percent in 2013, while in 2014 the growth of spending would increase from 6.8 percent to 7.3 percent.

Graph 65
GENERAL GOVERNMENT NON FINANCIAL EXPENDITURE: 2005-2014
(Real % change)



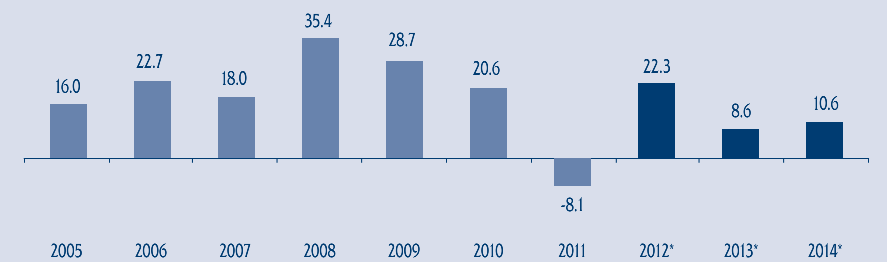
* Forecast.

Graph 66
GENERAL GOVERNMENT NON FINANCIAL CURRENT EXPENDITURE: 2005-2014
(Real % change)



* Forecast.

Graph 67
GENERAL GOVERNMENT GROSS CAPITAL FORMATION: 2005-2014
(Real % change)



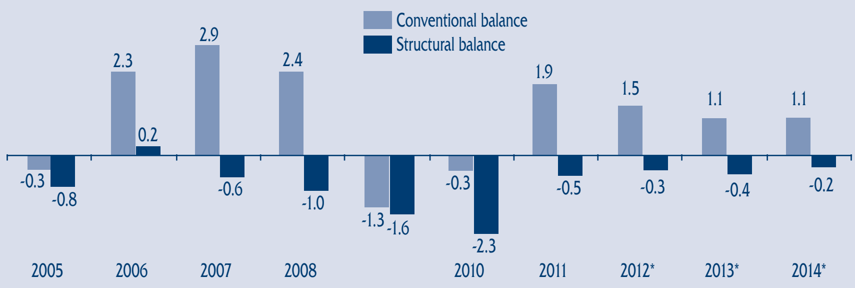
* Forecast.

Structural economic balance and fiscal impulse

57. The **structural economic balance**, indicator that shows the evolution of fiscal policy decisions because it deducts the effects of the economic cycle and the price effects of the major mining exports from the conventional economic balance, would be -0.3 percent of GDP in 2012. In 2013 the structural balance would show a negative rate of

0.4 percent of GDP, while in 2014 the structural deficit would decline to 0.2 percent of GDP.

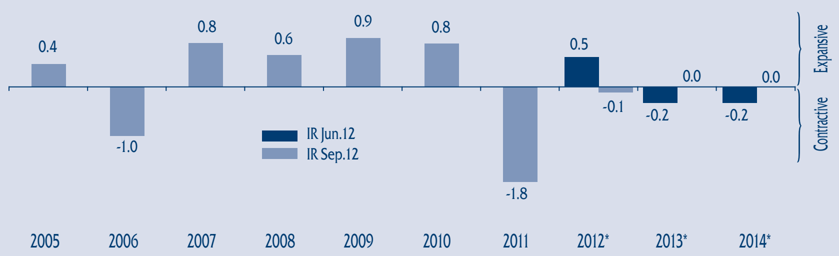
Graph 68
CONVENTIONAL AND STRUCTURAL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR: 2005-2014
(% of GDP)



* Forecast.

58. The variation in the structural balance determines the **fiscal impulse**. This indicator allows us to distinguish the effect of fiscal policy on domestic demand isolating the effects of the economic cycle. In 2012 the fiscal impulse would be negative (contractionary position) as a result of the slowdown in the growth of public spending, especially of capital spending, while the fiscal impulse would be zero in 2013 and 2014.

Graph 69
FISCAL IMPULSE[1/]: 2005-2014
(% of GDP)



* Forecast.
1/ The fiscal impulse is the change in the structural balance, which is an indicator of how the fiscal position affects the economic cycle.

Financial requirements

59. The financial requirements of the public sector in 2012 would be negative by S/. 3.68 billion; that is, the fiscal surplus would be higher than the payment of amortizations in the year. Negative financial requirements of S/. 1.96 billion and S/. 2.43 billion are also projected for 2013 and 2014, respectively, in line with the positive balances foreseen for the non-financial sector in these years.

Table 25
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR AND ITS FINANCING 1/
(Millions of US$)

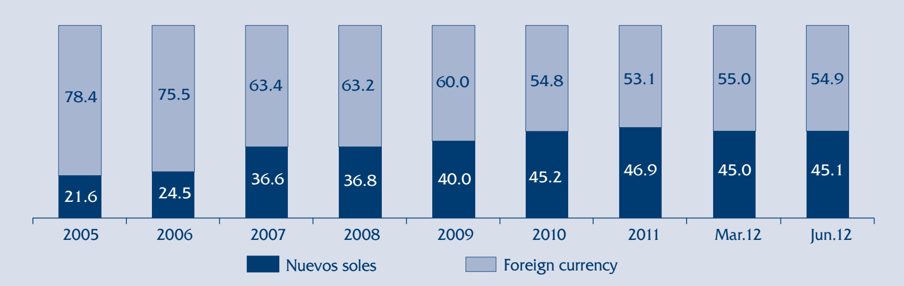
	2011		2012*			2013*		2014*	
	S1	Year	S1	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12	IR Jun.12	IR Sep.12
I. USES	**-11,808**	**-5,316**	**-15,470**	**-946**	**-3,710**	**-543**	**-2,147**	**-1,397**	**-2,648**
1. Amortization	1,830	3,762	2,673	4,572	4,373	4,887	4,240	4,582	4,557
a. External debt	1,206	2,291	1,917	3,257	3,082	3,121	2,485	3,232	3,233
Millions of US$	*433*	*831*	*717*	*1,164*	*1,164*	*1,184*	*943*	*1,226*	*1,226*
b. Domestic debt	624	1,471	756	1,315	1,291	1,766	1,755	1,350	1,325
Of which: Recognition bonds	*283*	*530*	*234*	*582*	*503*	*451*	*451*	*448*	*448*
2. Overall balance (negative sign indicates surplus)	-13,638	-9,077	-18,143	-5,518	-8,083	-5,430	-6,387	-5,979	-7,205
II. SOURCES	**-11,808**	**-5,316**	**-15,470**	**-946**	**-3,710**	**-543**	**-2,147**	**-1,397**	**-2,648**
1. External	1,166	2,807	393	2,250	1,444	3,029	2,457	2,365	2,133
Millions of US$	*419*	*1,023*	*147*	*804*	*551*	*1,149*	*932*	*897*	*809*
2. Bonds 2/	120	436	3,171	3,934	4,095	999	1,422	999	1,484
3. Internal 3/	-13,095	-8,559	-19,034	-7,130	-9,249	-4,571	-6,025	-4,761	-6,265
Memo:									
Balance of gross public debt									
Billions of S/.	96.6	103.3	100.4	101.9	104.1	103.4	104.7	103.6	105.2
% of GDP	21.4	21.2	19.8	19.4	20.0	18.2	18.6	16.8	17.2
Balance of net public debt 4/									
Billions of S/.	35.1	39.3	21.8	29.0	31.8	24.0	25.4	18.1	18.3
% of GDP	7.6	8.1	4.3	5.5	6.1	4.2	4.5	2.9	3.0

1/ The effect of exchanging treasury bonds for longer-maturity bonds, as well as the effect of placements made for the prepayment of both internal and external operations has been isolated in the case of amortization and disbursements.
2/ Includes domestic and external bonds.
3/ A positive sign indicates a withdrawal or overdraft and a negative sign indicates higher deposits.
4/ Defined as the difference between gross public debt and NFPS deposits.
IR: Inflation Report.
* Forecast.

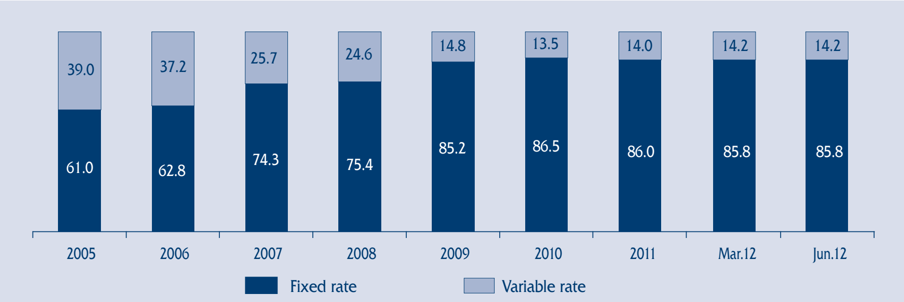
In order to meet the objective of establishing benchmark bonds for the local market in the middle segment of the yield curve, the first auction of sovereign bonds was carried out in June. Bonds for a total of S/. 216 million at a rate of 5.2 percent and maturing in 2023 were auctioned on this occasion. Only sovereign bonds are projected to be issued in the following years.

60. As regards the composition of the debt by currency and by interest rate, market risks are being gradually reduced given that the share of debt in foreign currency at June 2012 was 54.9 percent, while the share of fixed-rate debt was 85.8 percent.

Graph 70
PUBLIC DEBT BALANCE BY CURRENCY: 2005-Q2.2012
(%)

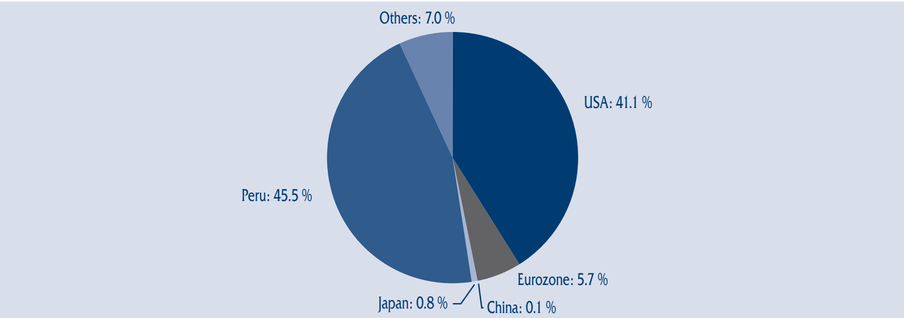


Graph 71
PUBLIC DEBT BALANCE BY RATE TYPE: 2005-Q2.2012
(%)



61. Furthermore, holdings of sovereign bonds by non-residents at June 30, 2012, was over 54 percent (S/. 16.78 billion). In terms of the origin of bondholders, it is worth pointing out that Americans rank first, with a share of 41.1 percent of the bonds held by non-residents, followed by the members of the Eurozone with a share of 5.7 percent.

Graph 72
HOLDINGS OF SOVEREIGN BONDS BY COUNTRY OF ORIGIN OF THE HOLDER
(%)



By category of sovereign bonds, the most demanded bond by non-residents is the 2020 bond. Foreign investors also show a preference for Global Depositary Notes (GDNs), which are debt instruments created by a depositary bank of Peruvian sovereign bonds abroad. The characteristic of this financial instrument is that those who acquire GDNs in the international market can repay the service of this debt in dollars, even though the underlying asset (the sovereign bonds) that backs up the issuance of GDNs is denominated in Peruvian nuevos soles (PEN) and is payable locally. Moreover, 61 percent of the total public debt held by non-residents is GDNs (S/. 10.22 billion), while the remaining 39 percent is sovereign bonds (S/. 6.56 billion).

Table 26
NON-RESIDENTS' HOLDINGS OF SOVEREIGN BONDS

Bond	Non residents balance	Sovereign bonds		GDN	
	Mill. of S/.	%	Mill. of S/.	%	Mill. of S/.
2013	495	60.6	300	39.4	195
2015	1,359	40.6	552	59.4	807
2017	720	55.3	399	44.7	322
2020	7,007	40.5	2,835	59.5	4,172
2024	98	100.0	98	0,.0	0
2026	2,228	43.2	962	56.8	1,266
2031	2,749	20.1	553	79.9	2,196
2035	35	100.0	35	0.0	0
2037	1,483	40.4	599	59.6	884
2042	609	37.8	230	62.2	378
TOTAL	**16,784**	**39.1**	**6,565**	**60.9**	**10,219**

Source: MEF.

62. Debt indicators continue showing positive results. The average life of the public debt reached 13 years in Q2-2012. The gross and the net debt continued declining in 2011 and are expected to follow the trend in the next three years. Considering both the increase in economic activity and the increase in public sector deposits, it is estimated that the gross debt would reach 20.0 percent of GDP at end 2012, while this ratio in 2014 would be 17.2 percent of GDP. Replicating the trend, the net debt would decline to 3.0 percent of GDP in 2014.

Graph 73
PUBLIC DEBT: 2005-2014
(% of GDP)

* Forecast.

BOX 4

INTERNATIONAL EXPERIENCES WITH STRUCTURAL FISCAL RULES

The use of fiscal rules, that is, the establishment of long-lasting limits on indicators of the fiscal position, has increased worldwide over the past 20 years [5]. These rules seek to eliminate the deficit bias resulting from the discretionary management of fiscal policy in order to avoid unnecessarily countercyclical or expansionary policies.

The experience of other countries with structural fiscal rules is discussed in this article. As mentioned above, fiscal rules set permanent limits[6] to a fiscal balance indicator which excludes transitory movements in the level of economic activity and to other relevant variables, such as the prices of export commodities, in order to determine the fiscal balance.

Switzerland offers a successful experience in the design and management of this kind of fiscal rule. Since 2003 the federal fiscal management in Switzerland is carried out using a structural balance rule known as the "debt brake"[7]. This structural rule is implemented in the following way: Every year, the national government spending established in the budget is determined on the basis of:

$$E_L = \hat{k}\hat{R}$$

where

$E_L =$ Cap for budgeted spending (non-financial spending and interest).

$\hat{k} =$ Economic cycle estimate for the budget year ($= \frac{\hat{K}_T}{\hat{Y}}$), where $\hat{K}_T$ is the estimated potential GDP or GDP trend and $\hat{Y}$ is the projected GDP.

$\hat{R} =$ Revenue projection for the budget year.

According to this mechanism, when the economy is expected to enter a period of low growth or recession, that is, when the projected potential output is higher than the projected GDP and $\hat{k} > 1$, then the budget spending will be higher than the revenue projected for that period. Likewise, when the economy is booming and GDP is higher than the potential GDP, then $\hat{k} < 1$ and the budgeted spending will be lower than the revenue projected in the budget ($\hat{R}$). In this way the structural balance ex-ante is equal to zero every year, which implies a neutral fiscal policy in the cycle.

Once the budget is executed, the limit on ex post spending (E_{xp}) consistent with a null structural balance: $E_{xp} = kR$ is estimated with the information available about the output gap and tax revenue at the end of the fiscal year. If executed expenditure (E) is higher than E_{xp}, then the

5 IMF (2009) "Fiscal Rules: Anchoring Expectations for Sustainable Public Finances". IMF. Washington DC. November 2009.

6 See Kopitz G. and S. Symansky(1998) "Fiscal Policy Rules" IMF Occasional Paper N° 162. Washington DC. 1998. Typically, fiscal rules impose limits on the fiscal deficit, public expenditure, or the accumulation of public debt.

7 Bodmer, F.(2006). "The Swiss Debt Brake: How it works and what can go wrong". Schweizerische Zeitschrift für Volkswirtschaft und Statistik. 2006. Vol. 142 (3) pg 307-330 and Geier, A. (2011) "The Debt Brake- The Swiss Fiscal Rule al the Federal level". Federal Finance Administration Working Paper N° 15, February 2011.

structural balance ex post has been negative, so the difference is paid to a notional account. When the balance in the notional account exceeds 6 percent of expenditure in the previous year, the government must establish adjustment to eliminate this balance in the following three years.

The rule contains escape clauses which can be applied in the case of severe recessions (or natural disasters) to make extraordinary expenses if required.

Because of the results obtained with this rule, other European countries such as Germany have amended their constitutions to adopt similar provisions to the Swiss "debt brake" to ensure a long-term structural equilibrium and mitigate the increase in the government debt[8].

In **Chile**, the structural rule also works as a limit or target for the expenditure of the central government. Given the estimated structural revenue for the budget period and the target for the structural balance, public expenditure is defined as:

$$E_t = E(SR_t) - SB_t$$

where

E_t	:	Expenditure for period t.
$E(SR_t)$	:	Projected structural revenue for period t.
SB_t	:	Structural balance target (initially 1 percent of GDP).

The adjustment in fiscal revenues to determine the structural balance consisted of adjusting CODELCO's revenues due to the discrepancies associated with the long-term prices of copper and molybdenum, as well as of adjusting the rest of revenues due to the cycle's impact on GDP[9].

To ensure the transparency and credibility of the rule, the government delegates the estimation of the long-term price of copper and the estimation of trend GDP to two committees integrated by independent experts, whereas the price of molybdenum is estimated as a moving average of 7 years.

Compliance with the rule is evaluated calculating the realized structural balance and comparing it with the target. Like in Switzerland, compliance with the rule is evaluated constructing the indicator of structural balance with data on the expenditure executed by the national government. However, the difference with the Swiss rule is that the Chilean fiscal rule does not have mechanisms to offset deviations from the target generated in the budget execution.

8 In Germany, the rule establishes that as from 2016 the structural deficit (at the federal level) cannot exceed 0.35 percent of GDP, while the limit for the deficit of the states is zero. Moreover, deviations from the target are accumulated in a notional account and the obligation of adopting adjustment measures is considered if the balance in this account exceeds 1.5 percent of GDP. The rule also establishes a Stability Council, integrated by the federal and state ministers of finance, which is responsible for monitoring public finances, for designing adjustment measures, and for informing the population of the fiscal performance.

9 The most recently methodology is discussed in Ministerio de Hacienda (2011), "Proyecto de Ley de Presupuestos para el año 2012" October 2011. The initial formulation of this is in Marcel, M. et al. (2001) "Balance Estructural of the government Central: Metodología y Estimaciones para Chile: 1987-2000". Estudios de Finanzas Públicas. Ministerio de Hacienda. Santiago. September 2001.

Nonetheless, the government has discretion to set the structural target for each period. It should be pointed out that the 2006 Fiscal Responsibility Act only establishes that every new Administration has the obligation to announce the impact of fiscal policy on the structural balance. The regulation does not specify a numerical target or the obligation that fiscal policy be oriented by the structural balance. In practice, governments have used a structural rule due to the existing consensus about the benefits it entails, but not because of a legal obligation.

Recently a committee of experts, appointed by the Chilean government, has suggested improvements to the fiscal rule, which would allow a counter-cyclical response when GDP deviations from its potential level of growth are significant:

$$m_t^* = m' + \beta(\alpha \text{ Output gap}_t)$$

Where m*t is the target for year t; m' is the target level defined as the government's policy target when an administration takes office; β is a dichotomous variable which takes the value of 1 when the output gap exceeds a threshold (measured as a percentage of the output gap), and α is the level of fiscal policy response to the economic cycle effects.

Structural and counter-cyclical fiscal rules

In 2011 the Colombian Congress[10] approved a proposal of the government to establish a fiscal rule that would provide space for countercyclical interventions while maintaining the financial stability of the government. In formal terms, the fiscal rule adopted in Colombia also takes the form of a spending rule:

$$g_t \leq T_t^e - \overline{re}_t^e + I(\{\gamma_y < \gamma_{\overline{y}} - 2\%\} \& \{y_t < \overline{y}_t\}\ 0.2(\overline{y}_t - y_t)$$

where T_t^e is the "structural" revenue of the national government, defined as tax revenues net of the effect of the economic cycle and of the transitory component obtained from mining and hydrocarbon activities, $\overline{re}_t^e$ is the target for the structural economic balance, which will follow a rising path until it reaches a deficit of 1 percent of GDP by 2022[11]; y_t and $\overline{y}_t$ are the real GDP and trend GDP, respectively, and γ_y and $\gamma_{\overline{y}}$ represent their growth rates and $I(.)$ represents the indicator function.

The **Colombian** rule establishes that the spending of the national government shall not exceed the structural revenues adjusted by the target set for the structural balance, plus a counter-cyclical component which will not exceed 20 percent of the gap between the potential GDP and the actual GDP. This counter-cyclical component will be activated only in two cases: when the growth rate of GDP is lower than the growth rate of potential GDP by 2 or more percentage points, and when real GDP has a lower value than potential GDP. The law establishes that counter-cyclical expenditure should be transitory and should be eliminated in a period of two years, provided that the growth rate of real GDP exceeds the growth rate of potential GDP.

10 Comité Técnico Interinstitucional (2010). "Regla Fiscal para Colombia". Bogota, July, 2010.

11 The rule considers a target of -2.3 percent of GDP for 2014, a target of -1.9 percent of GDP for 2018, and a target of -1.0 percent of GDP as from 2022.

This rule allows the structural deficit to increase when the economy is in recession, thus allowing a counter-cyclical response for the fiscal authority. If the economic situation is booming, the rule establishes that the structural deficit will continue a downward trend (which implies a contractionary policy) until it reaches a level considered to be consistent with long-term fiscal solvency (1 percent of GDP). In addition, the Act includes an escape clause in the case of events which may compromise the country's macroeconomic stability.

An implication of this rule is that all the cyclical component of revenues of the national government must be saved by the government and that only the permanent component of these resources may be spent. Therefore, the Act provides for the creation of a Savings and Macroeconomic Stabilization Fund, administered by the Central Bank, which is funded by the surpluses of the national government and which can only be used only to pay off debt, finance counter-cyclical spending, and offset target deviations from the rule in exception cases.

This rule is supplemented by the creation of a technical and independent[12] Consultative Committee on the Fiscal Rule, which will advise on a non-binding basis on the methodology used to calculate the rule parameters, will express an opinion on the report of compliance with the rule which the government must submit each year, and will advise on the convenience of applying the escape clause.

The proposals discussed above show the interest different countries have in establishing fiscal rules that will favor adopting a timely countercyclical response without neglecting the need of maintaining a financially sustainable fiscal position.

In our country, the design of a fiscal rule should provide coverage against economic fluctuations and contribute to isolate government spending from the cyclical variations registered in international prices in order to mitigate the impact of fluctuations in the terms of trade on domestic demand and the real exchange rate.

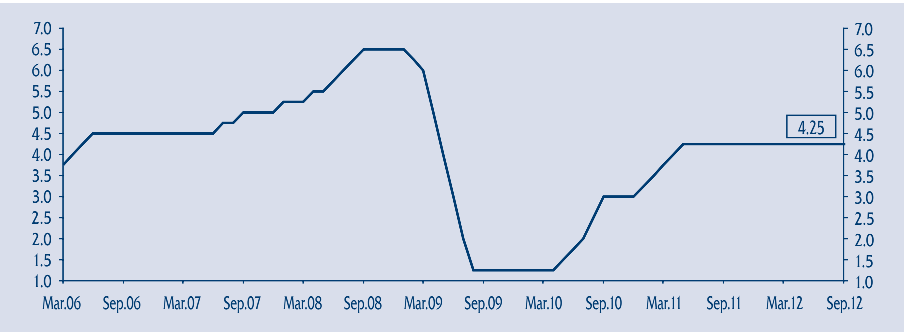
12 Formed by academics, members of research centres, experts and consultants of recognized prestige, and by the Presidents of the commissions of Economic Affairs of the Congress.

V. Monetary policy

63. Between June and September, the Board of the Central Bank approved to maintain the policy rate at 4.25 percent in a context of inflation's convergence towards the target range and an economic growth rate close to the economy's long-term sustainable level. This evolution of economic activity reflects a balance between lower external demand –associated with the global economic slowdown– and a dynamic growth of domestic demand, especially consumption and private investment.

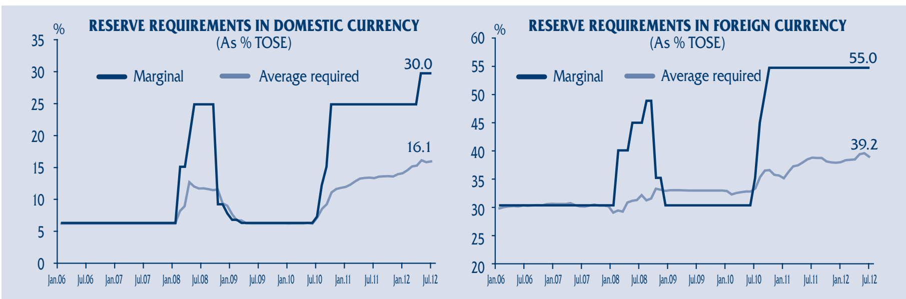
The Board of the Central Bank has also emphasized that it continues to oversee the evolution of inflation and its determinants to consider adjustments in monetary policy instruments.

Graph 74
BCRP REFERENCE INTEREST RATE
(%)



64. In May the Central Bank raised the rates of reserve requirements in soles and in dollars to offset the pace of expansion of domestic liquidity in a context of accelerating dedollarization of deposits, companies' increased borrowing in dollars, and low interest rates in foreign currency as a result of high levels of international liquidity.

Graph 75



In July, the Central Bank decided to update the base period of reserves from April to August of 2012 and to raise the average rates of reserve requirements in foreign currency and national currency by 0.5 percentage points. The Central Bank also changed the amount or percentage exempted from reserve requirements in domestic currency, establishing that as from September the new amount or percentage would be the lesser amount between 7.0 percent of the base and S/. 80 million instead of the lesser amount between 5.6 percent of the base and S/. 50 million.

Table 27
RESERVE REQUIREMENTS MEASURES

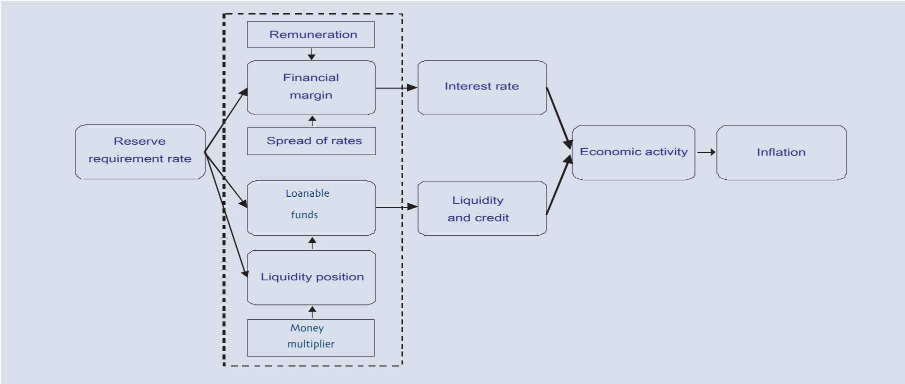
	Legal minimum reserve requirement	Domestic currency		Foreign currency		
				General regime		Foreign liabilities
		Marginal reserve requirements on deposits	Increase in the average reserve requirements	Marginal reserve requirements on deposits	Increase in the average reserve requirements	Short-term
Mar.09	6%			30%		0%
Feb.10	6%			30%		35%
Jul.10	7%			35%		40%
Aug.10	8%	12%		45%	0.1%	50%
Sep.10	8.5%	15%		50%	0.2%	65%
Oct.10 1/	9%	25%		55%	0.2%	75%
Nov.10	9%	25%		55%		75%
Dec.10	9%	25%		55%		75%
Jan.11 2/	9%	25%		55%		60%
Feb.11	9%	25%	0.25%	55%	0.25%	60%
Mar.11	9%	25%	0.25%	55%	0.25%	60%
Apr.11	9%	25%	0.50%	55%	0.50%	60%
May.12 3/	9%	30%	0.50%	55%	0.50%	60%
Sep.12 4/	9%	30%	0.50%	55%	0.50%	60%

1/ Since September 12, 2010, the rate of reserve requirements for short term debts was increased to 75 percent.
2/ The operations of local bank's branches abroad are subject to reserve requirements since January 2011.
3/ Since May 2012, the reserve requirements of 60 percents extended to new short term debts with less or equal terms to 3 years.
4/ Since September 2012, the base period for calculating the reserve requirements changed from April 2012 to August 2012.

These measures are aimed to preventively regulate the pace of growth of credit associated with short-term foreign capital inflows in a context of high international liquidity and exceptionally low international interest rates.

A first mechanism of transmission of reserve requirements is achieved by reducing the primary lending funds of financial institutions which must then accumulate more liquid positions. These lower lending funds will imply less liquidity and credit and will therefore have an influence on the level of aggregate expenditure and then on inflation. The lower the amount of liquid assets held by financial institutions, the more effective this mechanism will be.

Graph 76
TRANSMISSION MECHANISMS OF RESERVE REQUIREMENTS

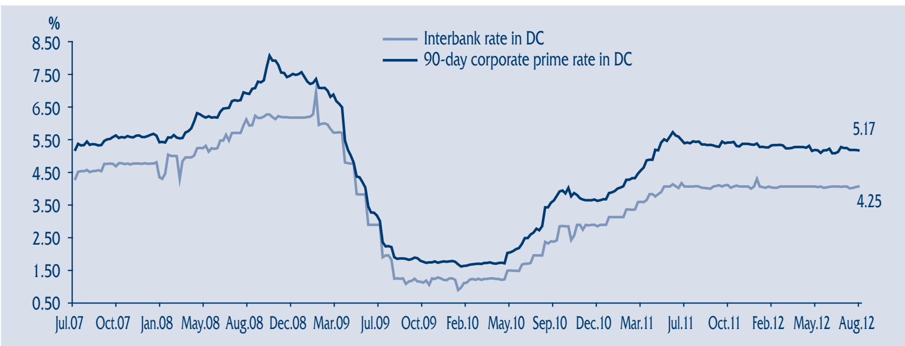


A second effect is the one obtained in the financial margin. An increase in reserve requirements reduces the financial margin of banks, which will seek to preserve this margin increasing the spread between the interest rate on the loans they grant and the interest rate on deposits. Banks can obtain this increase in the spread either raising their rates or reducing their deposit rates, or combining both measures. Higher market interest rates would induce economic agents to reduce their costs, thus reducing inflationary pressures.

65. Following the evolution of the reference rate, between May and August 2012 monetary conditions in soles remained flexible, while monetary conditions in dollars were slightly more accommodative.

The 90-day corporate prime rate in soles remained around 5.20 percent. Because it is a short-term rate with a lower premium for credit risk, this interest rate is the rate that has the highest connection with the monetary policy rate.

Graph 77
90-DAY CORPORATE PRIME RATE VERSUS INTERBANK OVERNIGHT RATE IN DOMESTIC CURRENCY: JULY 2007 - AUGUST 2012



66. Credit conditions continued to improve in most credit segments, reflecting both the rate of the policy interest rate and the evolution of credit risk conditions and increased competition in the respective credit markets. Thus, interest rates on credit for the corporate segment and small business declined, while the rates of credit to large and medium-sized companies remained stable around 7.5 and 11.0 percent. On the other hand, the interest rate for mortgage loans decreased from 9.3 to 9.0 percent, while the rate for consumer loans rose from 35.3 to 36.4 percent in the same period.

Table 28
INTEREST RATE BY TYPE OF CREDIT 1/
(%)

	Domestic currency						
	Corporate	Large companies	Medium-size firms	Small businesses	Microbusinesses	Consumption	Mortgages
Dec.10	4.6	5.9	10.3	23.3	27.2	40.7	9.3
Mar.11	5.4	7.5	11.1	24.6	32.5	38.4	9.4
Jun.11	6.4	8.1	10.9	23.6	31.9	39.9	9.7
Sep.11	6.1	7.9	10.9	23.6	32.9	36.1	9.6
Dec.11	6.0	7.4	11.2	23.2	33.0	38.5	9.4
Jan.12	5.9	7.4	11.4	22.9	32.9	37.3	9.4
Feb.12	6.0	7.2	11.4	23.7	33.1	35.7	9.4
Mar.12	6.1	7.0	11.2	23.4	32.9	35.6	9.4
Apr.12	6.0	7.1	10.8	23.0	32.9	35.4	9.3
May.12	6.0	7.3	11.0	22.9	33.1	35.3	9.3
Jun.12	6.0	7.3	11.2	23.1	33.0	34.9	9.3
Jul.12	5.8	7.3	10.7	22.9	32.4	35.7	9.1
Aug.12	5.8	7.5	11.1	22.8	32.3	36.4	9.0
	Accumulated change (bps)						
Aug.12-May.12	-17	20	7	-2	-81	110	-28
Aug.12-Dec.10	129	160	74	-46	514	-426	-32

1/ Annual active interest rates on the operations carried out in the last 30 working days.

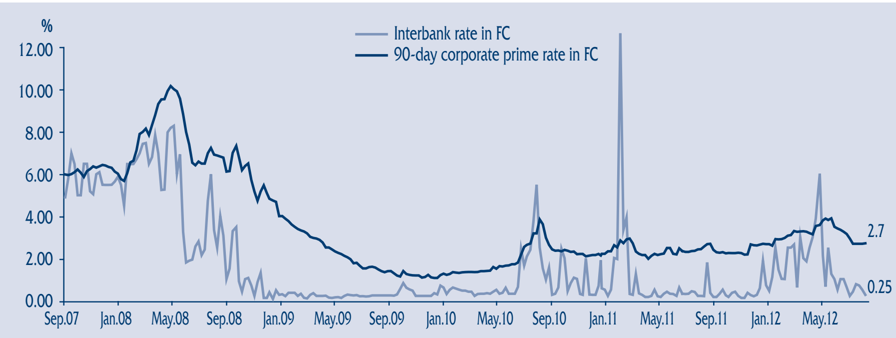
67. In line with these stable financial conditions in national currency, the short-term rates on deposits maintained similar levels to the ones observed in the previous quarter. The interest rate on 181-day to 360-day deposits declined slightly from 4.3 to 4.2 percent.

Table 29
INTEREST RATES IN NUEVOS SOLES
(%)

	Deposits up to 30 days	Rate on 31 to 180-day term deposits	Rate on 181 to 360-day term deposits
Dec.10	2.2	2.9	3.8
Mar.11	3.1	3.0	4.0
Jun.11	4.3	3.6	4.3
Sep.11	4.1	4.3	4.6
Dec.11	3.9	4.1	4.7
Jan.12	3.8	4.0	4.7
Feb.12	3.7	4.0	4.7
Mar.12	3.7	3.9	4.5
Apr.12	3.7	3.9	4.4
May.12	3.7	3.9	4.3
Jun.12	3.7	3.9	4.3
Jul.12	3.8	3.9	4.3
Aug.12	3.8	3.9	4.2
Accumulated change (bps)			
Aug.12-May.12	9	1	-13
Aug.12-Dec.10	152	103	44

68. As regards credit in foreign currency, greater liquidity was observed associated with banks' renewal of credit lines with banks abroad and the debt issuance of some private banks in the international capital market. The corporate prime rate in dollars fell to 2.7 percent in August (from 3.89 percent in May) and the interbank interest rate in dollars registered an average level of 0.8 percent in this quarter.

Graph 78
90-DAY CORPORATE PRIME RATE VERSUS INTERBANK OVERNIGHT RATE IN FOREIGN CURRENCY: SEPTEMBER 2007 - AUGUST 2012



69. The decline of the short-term rates in dollars was transmitted to a lesser extent to other lending interest rates in foreign currency, especially the corporate rate, the rate on credit for micro-businesses and mortgage rates. Thus, in this quarter, the interest rate for loans to micro-businesses fell from 20.1 to 19.8 percent, the rate on corporate loans fell from 4.0 to 3.8 percent, and the rate on mortgage loans declined from 8.0 percent to 7.9 percent.

Table 30
INTEREST RATE BY TYPE OF CREDIT 1/
(%)

	Foreign currency						
	Corporate	Large companies	Medium-size firms	Small businesses	Microbusinesses	Consumption	Mortgages
Dec.10	3.3	5.5	8.6	14.2	14.8	19.4	8.1
Mar.11	3.6	5.6	9.3	16.3	16.7	20.9	8.3
Jun.11	3.6	5.3	9.3	15.6	16.3	21.3	8.5
Sep.11	3.3	5.5	8.8	15.4	19.5	21.2	8.3
Dec.11	3.0	5.4	8.9	15.0	19.2	22.0	8.2
Jan.12	3.6	5.4	9.0	15.4	18.8	22.4	8.3
Feb.12	3.6	5.5	9.3	15.5	18.8	22.8	8.2
Mar.12	3.8	5.7	8.9	16.4	19.3	23.0	8.2
Apr.12	4.1	5.7	8.7	15.5	19.0	22.7	8.2
May.12	4.0	5.7	8.8	15.0	20.1	22.5	8.0
Jun.12	4.0	6.1	8.7	15.2	20.0	22.9	8.0
Jul.12	3.9	6.1	8.9	14.9	18.9	21.6	7.9
Aug.12	3.8	5.9	9.2	15.8	19.8	23.3	7.9
Accumulated change (bps)							
Aug.12-May.12	-13	24	38	77	-29	85	-3
Aug.12-Dec.10	52	44	59	152	502	395	-19

1/ Annual active interest rates on the operations carried out in the last 30 working days.

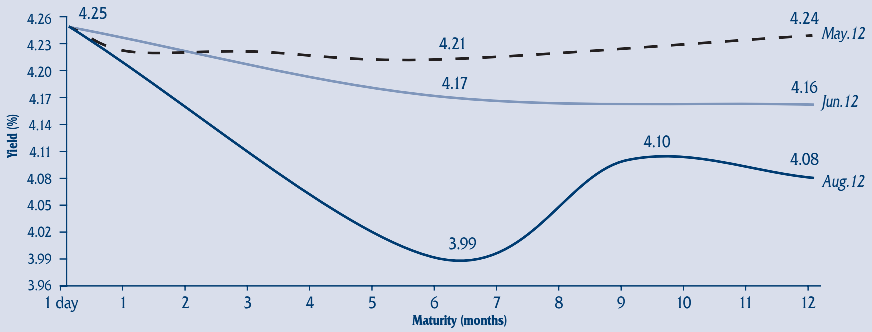
70. On the other hand, in the case of deposit interest rates in foreign currency, a decline was observed in the rate of up to 30-days deposits, while the other rates were stable in a context of greater liquidity in dollars. Thus, the average interest rates of up to 30-day deposits in foreign currency fell from 1.7 percent in June to 0.8 percent in August.

Table 31
INTEREST RATES IN US DOLLARS
(%)

	Deposits up to 30 days	Rate on 31 to 180-day term deposits	Rate on 181 to 360-day term deposits
Dec.10	0.9	1.2	1.7
Mar.11	1.4	1.1	1.7
Jun.11	0.5	1.1	1.7
Sep.11	0.8	1.0	1.6
Dec.11	0.7	1.0	1.6
Jan.12	0.9	1.1	1.6
Feb.12	1.0	1.1	1.6
Mar.12	1.3	1.2	1.6
Apr.12	1.4	1.2	1.6
May.12	2.1	1.1	1.6
Jun.12	1.7	1.2	1.6
Jul.12	1.1	1.2	1.6
Aug.12	0.8	1.2	1.6
Accumulated change (bps)			
Aug.12-May.12	-129	9	1
Aug.12-Dec.10	-12	3	-11

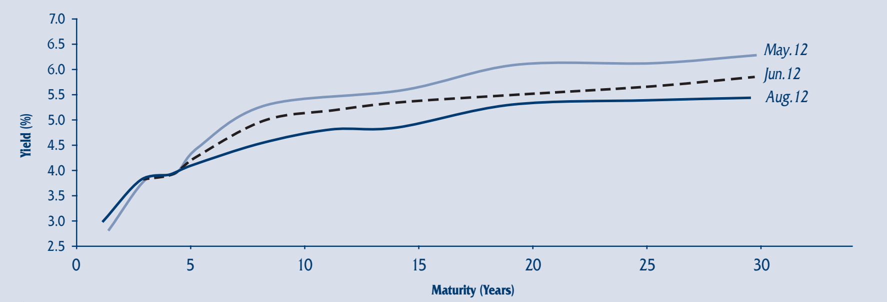
71. The market interest rates of sovereign bonds showed a stronger downward trend in the months of July and August due to investors' increased demand, which led to an increasing flattening in the yield curve, in line with what was observed in the emerging markets. On the other hand, the rates of return in the short segment of the curve (less than 5 years) are below the Central Bank's reference interest rate of 4.25 percent. Between May and August non-resident investors increased their holdings of sovereign bonds by around S/. 300 million, from S/. 15.20 billion to S/. 15.54 billion, which represents 50 percent of the balance of sovereign bonds issued.

Graph 79
YIELD CURVE OF CENTRAL BANK SECURITIES 1/



1/ Yield of CDBCRP end of period. One day rate corresponds to reference rate.

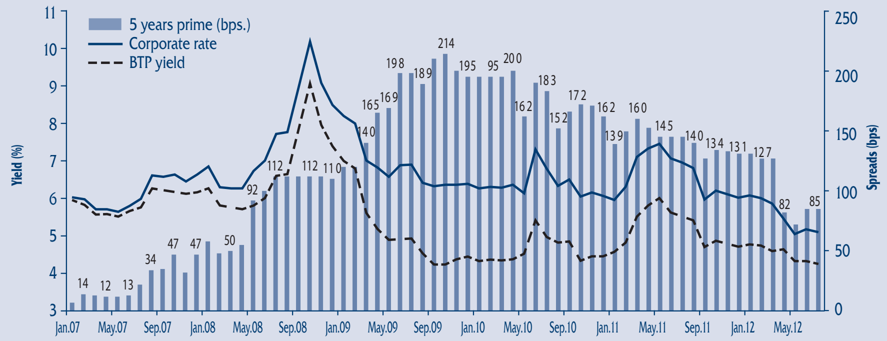
Graph 80
SECONDARY MARKET OF SOVEREIGN BONDS 1/



1/ End of month yield.

The decline in risk premiums paid by lower-risk bonds issued by private companies, which are 100 basis points below the sovereign bond, has been consolidating in this quarter.

Graph 81
RATES OF SOVEREIGN BONDS, AAA CORPORATE BONDS AND SPREADS1/: 5 YEARS



1/ The spread or premium of the risk free correspond to the difference between the yield of the sovereign bond and the 5 year AAA corporate bond.

It is worth pointing out that according to the BCRP Survey of Macroeconomic Expectations, economic agents expect the reference interest rate of the Central Bank to remain at the levels currently observed.

Table 32
SURVEY ON MACROECONOMIC EXPECTATIONS:
REFERENCE INTEREST RATE AT THE END OF YEAR
(%)

	Expectation		
	IR Mar.11	IR Jun.12	IR Sep.12*
Financial entities			
2012	4.00	4.25	4.25
2013	4.00	4.25	4.25
2014	4.00	4.25	4.25
Economic analysts			
2012	3.75	4.25	4.25
2013	4.00	4.25	4.25
2014	4.25	4.25	4.25

IR: Inflation Report. * Survey conducted during the second half of August, 2012.

Monetary operations

72. The operations of the Central Bank were aimed at maintaining appropriate levels of liquidity and at ensuring the flow of operations in the money market, in a context of ample availability of liquidity in banks which was reflected in the increased preference for CDBCRP with maturities of up to one year.

As a result of the above mentioned operations, the share of instruments issued by the Central Bank in its total liabilities increased from 16.4 percent of net international reserves (NIRs) in June to 17.5 percent in August of 2012. On the other hand, the share of total deposits of reserve requirements increased from 25.2 to 25.9 percent, due mainly to higher deposits of reserve requirements in national currency, which increased from 8.9 to 9.5 percent.

Table 33
SIMPLIFIED BALANCE SHEET OF THE BCRP
(As % of Net International Reserves)

Net Assets		Jun.12	Aug.12
I.	**Net International Reserves**	100% (US$ 57,225 mills.)	100% (US$ 59,771 mills.)
Net Liabilities			
II.	**Total public sector deposits**	**41.5%**	**40.4%**
	In domestic currency	26.4%	26.1%
	In foreign currency	15.1%	14.3%
III.	**Total reserve requirements**	**25.2%**	**25.9%**
	In domestic currency	8.9%	9.5%
	In foreign currency 1/	16.2%	16.4%
IV.	**BCRP Instruments**	**16.4%**	**17.5%**
	CD BCRP	13.5%	12.3%
	CDV BCRP	0.0%	0.0%
	CDR BCRP	1.0%	0.0%
	CDLD BCRP	0.0%	0.0%
	Term deposits	1.9%	5.2%
V.	**Currency**	**17.7%**	**18.1%**
VI.	**Other**	**-0.8%**	**-1.9%**
	Overnight deposits	0.4%	0.6%
	Rest	-1.2%	-2.5%

1/ Includes banks' overnight deposits at the Central Bank.

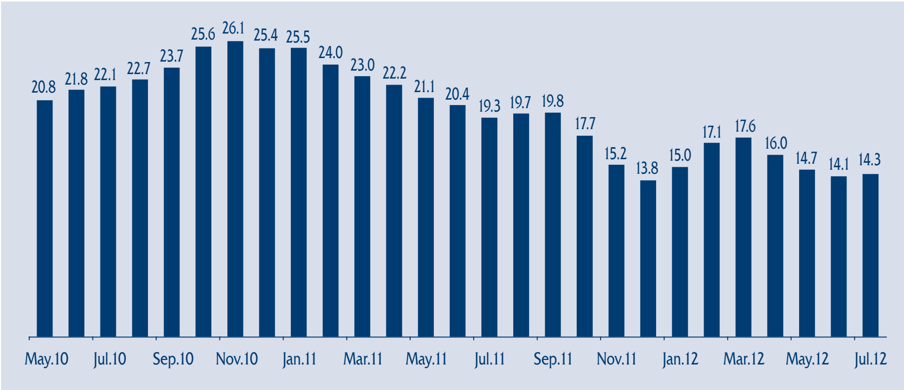
Between June 2012 and August of 2012, the Central Bank made net placements of its instruments for a total of S/. 2.22 billion, which included mainly term deposits for a total of S/. 5.20 billion. In the same period, net deposits of the public sector at the Central Bank totaled S/. 232 million.

Currency in circulation and credit

73. In July, average currency in circulation registered a growth rate of 14.3 percent in the last 12 months, in line with the evolution of economic activity which has

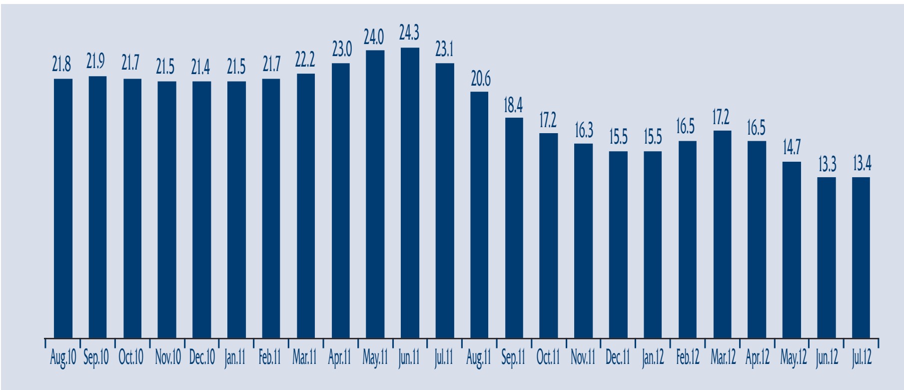
been close to its potential level over the past few months. In the rest of the year currency in circulation is expected to grow at a lower pace than projected in our previous Inflation Report, registering a close level to its level of stationary growth, in a context in which there is a growing use of electronic payment means to make transactions.

Graph 82
CURRENCY AVERAGE
(% change compared to the same period of the previous year)



74. Credit from depository institutions to the private sector grew at a slower pace during Q2, recording a last 12-month variation of 13.4 percent in July. A greater dollarization of credit was also observed, which would be mainly associated with the recovery of credit for foreign trade operations, especially in the month of July, as well as with a greater demand for mortgage loans in dollars. By type of financial institutions, credit of financial firms showed the higher growth rate.

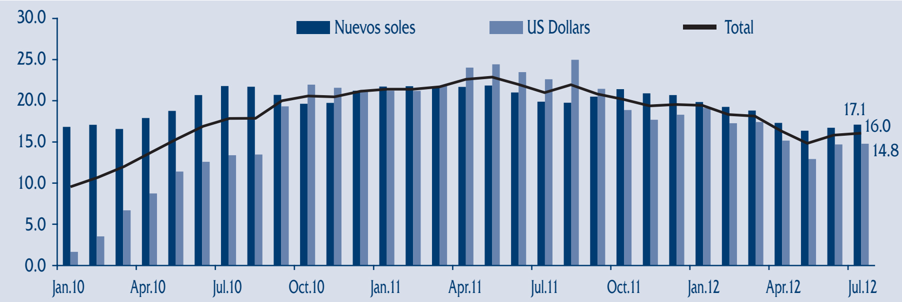
Graph 83
TENDENCY OF CREDIT TO THE PRIVATE SECTOR
(Annualized movil quarter % change)



The slowdown of credit would mainly reflect a lower demand for credit by businesses, which would be mainly associated with a replacement of bank loans by non-bank funding sources, especially credit lines from other countries and bond issuances in the domestic and the international capital markets. A lower slowdown is observed in the case of personal credit, which shows growth rates higher than the ones recorded by corporate credit.

By currencies, in July credit to the private sector in soles registered a rate of 17.1 percent in the last twelve months, while credit to the private sector in dollars grew 14.8 percent compared to July 2011. A recovery is observed in the annual growth rates of credit in both currencies after these rates recorded in May their minimum levels in 2012 (16.3 percent in soles and 12.9 percent in dollars). As a result of this, the dollarization ratio of credit increased by 0.2 percentage points compared to April –from 44.6 to 44.8 percent–, even though this rate was 0.5 points below the ratio registered in July of 2011, including in both cases the credit granted by banks' branches abroad. The higher level of dollarization observed in July would be reflecting the strong expansion of credit in dollars which more than doubled between this quarter and the previous quarter, rising from US$ 623 million to US$ 1.32 billion.

Graph 84
CREDIT TO THE PRIVATE SECTOR
(12-month % change)



	Crédito	Dec.09	Dec.10	Mar.11	Jun.11	Sep.11	Dec.11	Jan.12	Feb.12	Mar.12	Apr.12	May.12	Jun.12	Jul.12
Nuevos soles	Montly Flow (millions of S/.)	569	1,514	1,168	1,171	971	1,684	232	796	1,071	824	790	1,645	1,271
	Montly % change	1.0	2.2	1.7	1.6	1.3	2.1	0.3	1.0	1.3	1.0	0.9	1.9	1.4
	Annual % change	17.9	21.2	21.7	21.0	20.5	20.7	19.8	19.2	18.8	17.3	16.3	16.7	17.1
US Dollars	Montly Flow (millions of US$)	343	368	373	83	107	561	256	-164	473	314	463	505	352
	Montly % change	2.0	1.8	1.8	0.4	0.4	2.3	1.0	-0.7	1.9	1.2	1.8	1.9	1.3
	Annual % change	-0.1	21.3	21.8	23.4	21.4	18.3	19.1	17.2	17.4	15.1	12.9	14.7	14.8
Total	Montly Flow (millions of S/.)	1,495	2,506	2,176	1,394	1,259	3,198	922	352	2,348	1,672	2,040	3,009	2,221
	Montly % change	1.5	2.0	1.7	1.0	0.9	2.2	0.6	0.2	1.5	1.1	1.3	1.9	1.4
	Annual % change	9.0	21.2	21.8	22.1	20.9	19.6	19.5	18.3	18.2	16.3	14.8	15.8	16.0

75. In July, credit to individuals continued to show a strong dynamism even though registering rates below those observed in the previous quarter: consumer loans and mortgages showed annual rates of 18.4 and 25.7 percent, respectively. These

rates would be associated with more flexible credit conditions, especially in the case of mortgage loans, as well as with a greater level of risk assumed by banks, which is reflected in banks' acceptance of higher delinquency rates for consumer loans.

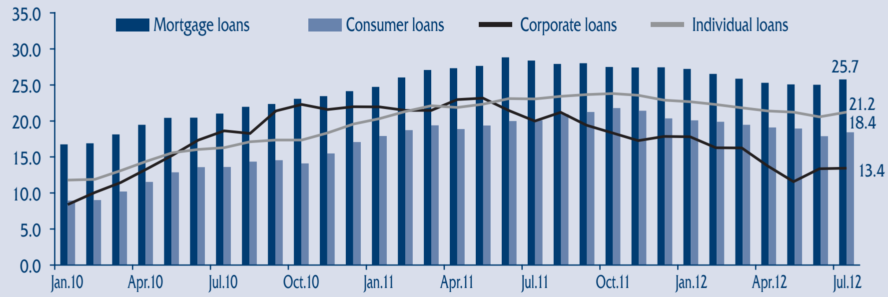
A relative slowdown was observed in the case of corporate credit since companies continue to resort to external credit lines and/or to issue debt in the domestic and international capital markets. This decline in this credit segment was offset by the recovery of credit for foreign trade operations, which accumulated a flow of S/. 1.90 billion in the last quarter –40 percent of the total flow of corporate credit (S/. 4.68 billion)– after having dropped by S/.400 million in the previous quarter.

The recovery of credit for foreign trade operations in the local financial system is in part a result of the reduction of the rate of reserve requirements for credit lines for foreign trade established by the Central Bank in July of this year. This reduction of reserve requirements from 60 to 25 percent was implemented in response to the significant reduction observed in credit for foreign trade which was inconsistent with the evolution of exports and imports, and also evidenced that the financing of these operations was being transferred from the local financial system to the international financial system. Thus, the reduction in the rate of reserve requirements for these operations did not involve a loosening of monetary conditions, but rather the recovery of banking operations that were being carried out abroad at lower interest rates.

Table 34
CREDIT BY TYPES AND CURRENCY
(Last 12 months % change)

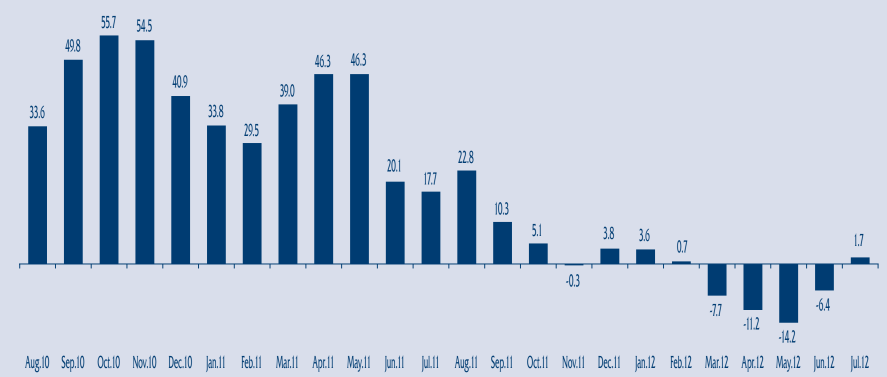
	Dec.10	Dec.11	Mar.12	Jun.12	Jul.12
Corporate credit					
Foreign trade					
In domestic currency	3.0	-8.4	-6.6	-21.5	3.2
In foreign currency	43.5	4.4	-7.7	-5.7	1.6
Rest					
In domestic currency	20.0	18.2	15.9	13.9	14.2
In foreign currency	20.5	20.6	21.8	17.2	15.3
Individual credit					
Consumer loans					
In domestic currency	18.5	21.1	20.0	18.1	18.1
In foreign currency	5.6	14.0	14.9	16.2	21.1
Of which:					
Car loans					
In domestic currency	38.7	-2.9	-5.1	-5.7	-7.4
In foreign currency	14.3	30.5	34.4	40.4	44.4
Mortgage loans					
In domestic currency	38.7	32.7	29.4	26.9	27.6
In foreign currency	12.8	22.3	22.3	23.0	23.8

Graph 85
CREDIT BY TYPE OF LOANS: JANUARY 2010 - JULY 2012
(12 month % change)



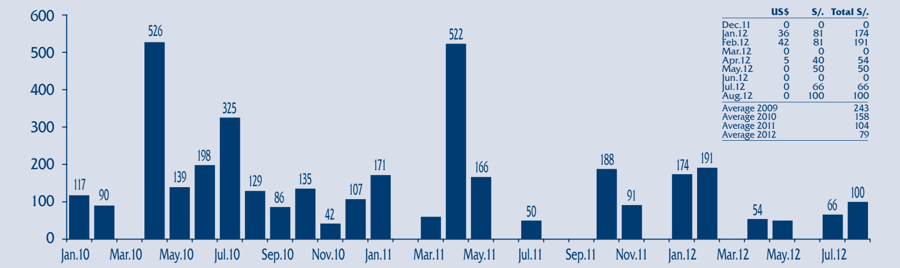
	Crédito	Dec.09	Dec.10	Mar.11	Jun.11	Sep.11	Dec.11	Jan.12	Feb.12	Mar.12	Apr.12	May.12	Jun.12	Jul.12
Corporate	Montly flows (millions of S/.)	1,016	1,494	1,282	407	399	2,235	368	-362	1,471	995	908	2,129	1,648
	Montly % changes	1.5	1.8	1.5	0.4	0.4	2.3	0.4	-0.4	1.5	1.0	0.9	2.1	1.6
	Annual % changes	7.7	22.0	21.6	21.5	19.4	17.9	17.8	16.3	16.2	13.7	11.5	13.3	13.4
Individual	Montly flows (millions of S/.)	479	1,012	894	987	860	965	553	714	877	676	1,133	880	573
	Montly % changes	1.4	2.5	2.1	2.1	1.8	1.9	1.1	1.4	1.6	1.2	2.1	1.6	1.0
	Annual % changes	11.6	19.6	22.2	23.2	23.7	23.0	22.7	22.4	21.9	21.5	21.3	20.6	21.2
Consumer	Montly flows (millions of S/.)	313	718	415	631	464	587	232	410	384	311	678	443	126
	Montly % changes	1.4	2.8	1.5	2.2	1.6	1.9	0.7	1.3	1.2	0.9	2.0	1.3	0.4
	Annual % changes	9.2	17.1	19.4	20.0	21.2	20.3	20.1	19.9	19.4	19.1	18.9	17.9	18.4
Mortgage	Montly flows (millions of S/.)	166	295	479	356	395	377	321	304	492	366	454	438	447
	Montly % changes	1.3	1.9	2.9	2.0	2.1	1.9	1.6	1.5	2.4	1.7	2.1	2.0	2.0
	Annual % changes	16.3	24.1	27.0	28.8	28.0	27.4	27.2	26.5	25.8	25.3	25.0	25.0	25.7

Graph 86
FOREIGN TRADE CREDIT
(Annual % change)



76. In Q2 bond issuances of non-financial companies not only recovered in the domestic bond market, but also continued in the international market. Thus, for example, Corporación de Empresas Azucareras del Perú (Cozazucar), a company of Gloria group, issued bonds for US$ 325 million with a return rate of 6.5 percent and a maturity of 10 years. Moreover, bond placements of private banks in July included a placement in dollars for a total of US$ 54 million and two placements of subordinated bonds in soles for a total of S/. 107 million.

Graph 87
BONDS ISSUANCE OF NON FINANCIAL FIRMS*
(Millions of nuevos soles)

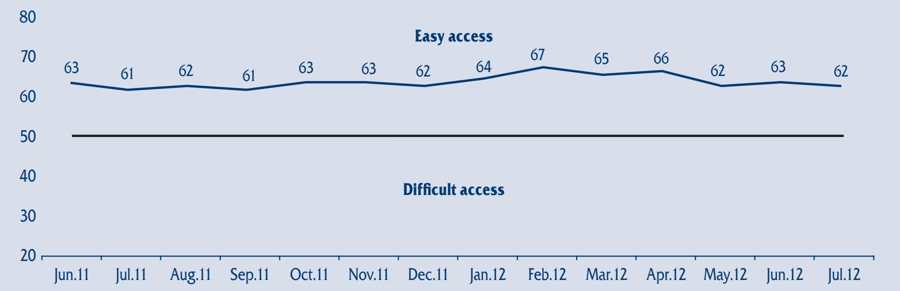


	US$	S/.	Total S/.
Dec.11	0	0	0
Jan.12	36	81	174
Feb.12	42	81	191
Mar.12	0	0	0
Apr.12	5	40	54
May.12	0	50	50
Jun.12	0	0	0
Jul.12	0	66	66
Aug.12	0	100	100
Average 2009			243
Average 2010			158
Average 2011			104
Average 2012			79

* Emissions are measured in dollars at the rate of change of last month. Includes titulization bonds.

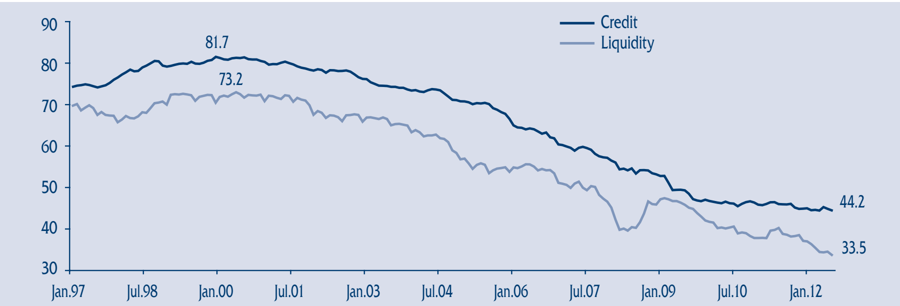
77. Reflecting the flexibility of monetary and credit conditions, the index of firms' access to credit remained in the positive segment between May and July.

Graph 88
STATUS OF ACCESS TO CREDIT OF THE COMPANIES



78. The dollarization of credit continued to decline in July although at a lesser extent than the dollarization of liquidity. The dollarization ratio of credit fell from 44.6 percent in June to 44.2 percent in July, while the dollarization ratio of liquidity fell to 33.5 percent in July from 34.3 in June.

Graph 89
DOLLARIZATION RATIO: 1997 - 2012
(%)



On the side of credit, the reduction of the dollarization ratios in the segments of credit to individuals was lower than in segments of credit to business.

Table 35
PRIVATE SECTOR CREDIT DOLLARIZATION COEFFICIENT 1/

	Dec.08	Dec.09	Dec.10	Jul.11	Dec.11	Jun.12	Jul.12
Corporate credit	**62.0**	**55.8**	**55.9**	**56.0**	**54.9**	**55.3**	**54.7**
Credit to individuals	**34.3**	**29.1**	**26.5**	**25.3**	**25.1**	**25.1**	**25.0**
Consumer loans	15.1	12.2	10.8	9.9	9.8	9.7	9.7
Mortgage loans	67.9	58.0	52.2	49.7	49.2	48.5	48.0
TOTAL	**53.0**	**46.8**	**46.1**	**45.7**	**44.6**	**44.6**	**44.2**

1/ Includes banks' branches from abroad.

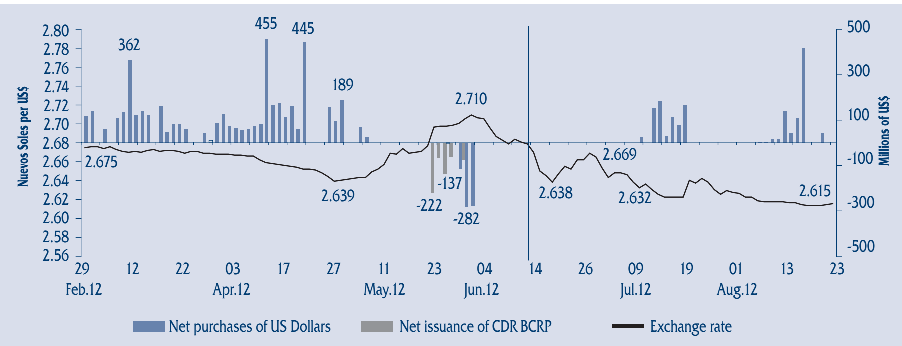
Exchange rate

79. Between the end of May and August, a nominal appreciation of 3.5 percent was recorded in the nuevo sol/dollar exchange rate (from S/. 2.710 to S/. 2.614 per dollar), although a differentiated behavior was observed in the evolution of the exchange rate in this period. Between May 31 and June 19 the exchange rate appreciated 2.65 percent, reaching S/. 2.638 per dollar on June 19 due to non-residents' increased supply of dollars associated with the lower global risk aversion observed at the time, which contributed to the strengthening of most currencies in the region.

However, the trend reversed rapidly as from June 20 due to the rise in global risk associated with the Eurozone problems (notably Greece, Spain, and Italy), which led the main participants in the foreign exchange market to make changes in their portfolios and non-resident investors to increase their demand for forwards to hedge their positions in soles. Between June 19 and 28, the sol depreciated 1.02 percent.

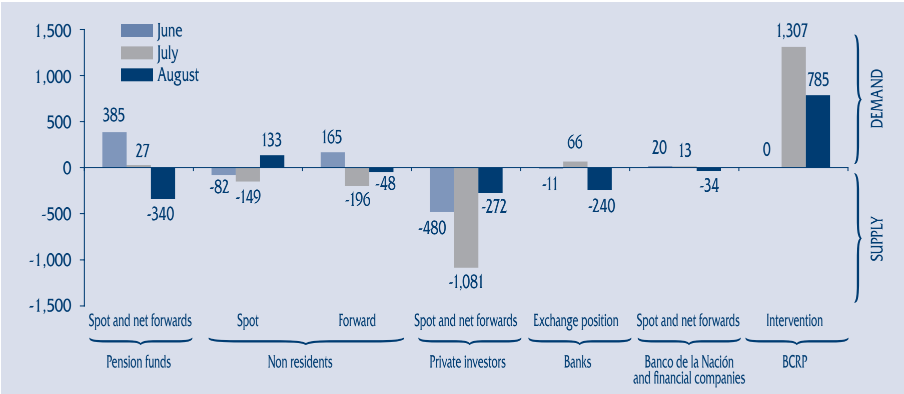
In July, the dollar returned to a downward trend and the nuevo sol strengthened, leading non-resident investors to change their portfolio profile and to increase their offer of forwards. Since they expected an appreciation of the Nuevos Soles and a greater supply of dollars from mining companies and retail operations. In this period, the Central Bank intervened in the foreign exchange market buying US$ 1.53 billion.

Graph 90
INTERVENTION IN THE FOREIGN EXCHANGE MARKET AND EXCHANGE RATE



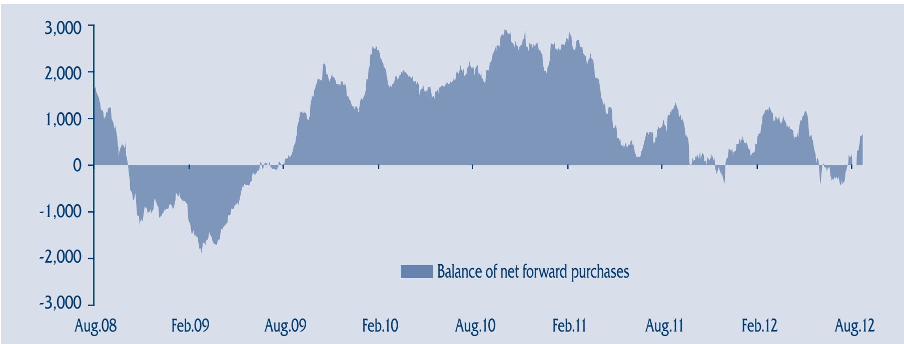
Graph 16 shows that the exchange rate appreciated in a context of a high supply of dollars of private agents, mainly mining companies and retailers, even though in June there was a greater demand for dollars from institutional investors (AFPs) and non-residents, especially in the market of forwards. This was offset by the supply of private agents, which continued in July and August.

Graph 91
FOREX MARKET FLOWS
(Millions of US$)



80. In the forward market, banks' net purchases of dollars increased since the end of July. Between July 20 and August 21, the balance of net purchases of forwards increased by US$ 810 million, from a negative balance of US$ 130 million to a positive balance of US$ 680 million.

Graph 92
BALANCE OF NET FORWARD PURCHASES
(Millions of US$)



81. The survey of expectations shows that financial entities and economic analysts expect the exchange rate to remain relatively stable, while non-financial firms expect the dollar to depreciate.

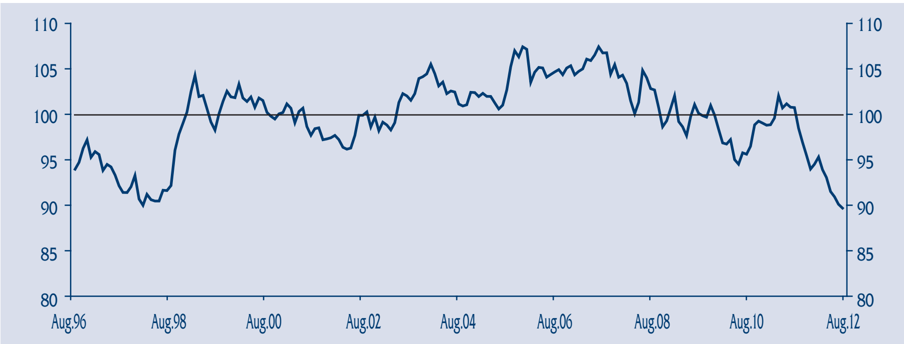
Table 36
SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE
(S/. per US$)

	Expectation of:		
	IR Mar.12	IR Jun.12	IR Sep.12*
Financial entities			
2012	2.65	2.65	2.60
2013	2.65	2.61	2.59
2014	-.-	2.60	2.58
Economic analysts			
2012	2.65	2.65	2.61
2013	2.64	2.62	2.60
2014	-.-	2.60	2.60
Non-financials firms			
2012	2.68	2.65	2.62
2013	2.69	2.70	2.65
2014	-.-	2.70	2.67
Average			
2012	2.66	2.65	2.61
2013	2.66	2.64	2.61
2014	-.-	2.63	2.62

IR: Inflation Report.
* Survey conducted during the second half of August, 2012.

82. Between May and August the real multilateral exchange rate fell from 91.3 to 89.4, which represented a real appreciation of 2.05 percent in the period. This real appreciation corresponds to a reduction of 2.3 percent in the nominal rate between May and July.

Graph 93
MULTILATERAL RER
(Index 2009=100)



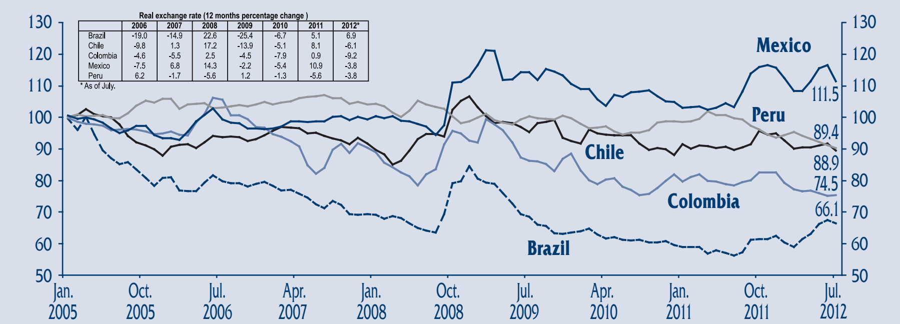
BOX 5

REAL EXCHANGE RATE AND FISCAL POSITION

Latin American countries with inflation targeting regimes have shown steady growth in recent years. On average, Brazil, Chile, Colombia, Mexico, and Peru have grown about 4.5 percent per year between 2005 and 2011. This good economic performance is due in part to favorable external conditions, notably high terms of trade and substantial inflows of foreign capital, which have resulted in real appreciatory pressures on the currencies of the economies of this region.

In fact, with the exception of Mexico, the currencies of Latin American economies show an appreciatory trend since 2005, as the following graph shows, although the differentiated conduct of the exchange rate in Chile and Peru, on the one hand, with a lower real appreciation, and in Brazil and Colombia, with a higher rate of appreciation, on the other hand, are worth pointing out. These differences can be explained by several factors, the fiscal policy position standing out among them.

REAL EXCHANGE RATE INDEX: 2005-2012
(January 2005 = 100)



Source: Bank of International Settlements. BIS effective exchange rate indices (August 15, 2012).

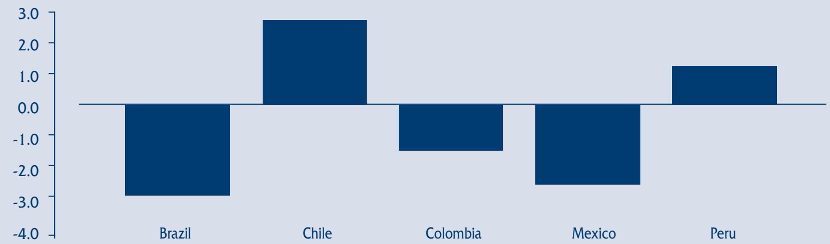
In theory, the government may exacerbate appreciatory pressures in a favorable external context because usually the surpluses generated in good times that can be administered by the Treasury are used to expand public spending, creating in this way a domestic stimulus, especially in the non-tradable sector (for example, in services and construction). The increased demand for non-tradable products generates an upward pressure of the prices of this sector, creating finally a real appreciation.

However, in the recent experience of Peru and Chile, the government has behaved differently. In both cases, fiscal policy has sought to generate surpluses in good times. The higher fiscal savings have been mostly used to accumulate foreign assets and to pay public debt[13]. Thus, fiscal surpluses have redirected to alternative uses, avoiding in this way to generate demand pressures in the non-tradable sector. This illustrates how prudent fiscal policies can offset appreciatory pressures in the real exchange rate.

13 According to Moody's Country Credit Statistical Handbook, Peru and Chile are the countries that have declining public debt-to-GDP ratios in the region and have registered minimum levels in 2011. On the other hand, Brazil, Colombia, and Mexico show more stable relatively high ratios.

The following graph shows the evolution of the fiscal balance of Peru in comparison with the fiscal balance of Peru's trading partners. We can see that Peru has maintained an average surplus position of 1.2 percent of GDP in the period of analysis, while our trading partners have an average deficit of 3.0 percent. This public savings has allowed Peru to reduce its net public debt in GDP terms from 31.3 percent in 2005 to 8.1 percent in 201, and has certainly eased the appreciatory pressures on the Nuevo sol.

FISCAL RESULT AS A % OF GDP
(Annual average)



Source: World Economic Outlook (July 16, 2012).

BOX 6
STERILIZED FOREIGN EXCHANGE INTERVENTION INSTRUMENTS

Because of the high levels of financial dollarization that still exist in the Peruvian economy (in both deposits and loans), the Central Reserve Bank intervenes in the foreign exchange market in order to ease the volatility of the exchange rate and soften the impact of this volatility on the financial position of economic agents, thus preserving financial stability in the economy.

Foreign exchange interventions have traditionally been carried out through sterilized purchases or sales of dollars. However, in recent years the Central Bank has designed two types of sterilized foreign exchange intervention instruments: the Certificados de Depósito Reajustables (CDR BCRP) and the Certificados de Depósito Liquidables en Dólares (CDLD BCRP).

Created in 2002 (Circular N ° 020-2002-EF90), the CDR BCRP are securities issued by the Central Reserve Bank of Peru, which represent a liability for the latter in favor of the buyer. These certificates are denominated in nuevos soles, issued at discount and indexed to the variation of the exchange rate between the time of the contract and the certificate's maturity date. In other words, these certificates ensure the purchaser a return in dollars. This instrument is used in times of high upward volatility in the exchange rate.

On the other hand, the CDLD BCRP, which were created in October 2010 (Circular N ° 037-2010-BCRP), are securities issued by the Central Reserve Bank of Peru, which represent liabilities for the latter in favor of the buyer. The BCRP CDLD are also denominated in soles and issued at a discount. The main difference between the BCRP CDR and the BCRP CDLD is that the latter are paid and redeemed in dollars at the rate of exchange in effect at the time of the contract and of the maturity date.

To see more clearly how the BCRP CDR and CDLD BCRP operate, we can compare them with two scenarios of direct interventions in the foreign exchange market: (i) a sterilized sale of dollars, and (ii) a sterilized purchase of dollars.

Sterilized sale of dollars. In a context of depreciatory pressures, let's assume that there is a demand for dollars for a total of US$ 100 million in the foreign exchange market. In order to avoid an abrupt rise in the exchange rate rise, the Central Bank intervenes in the market to provide the necessary liquidity of dollars and sells US$ 100 million receiving in exchange S/. 261 million[14]. To cancel the effect of the withdrawal of liquidity in soles, the BCRP buys certificates of deposit (CD BCRP) for a total of S/. 261 million. Therefore, the balance sheets of both the Central Bank and the private bank (through which liquidity is channelled) reflect these operations in the following way:

	BCRP		Private bank	
	Asset	**Liability**	**Asset**	**Liability**
Sale of US$	-US$ 100 MM	- Issue (S/. 261 MM)	+US$ 100 MM -S/. 261 MM	
Sterilization		-CD BCRP (S/. 261 MM) +Issue (S/. 261 MM)	+S/. 261 MM -CD BCRP (S/. 261 MM)	

In this case, the BCRP reduces its assets by US$ 100 million and reduces the base money (liability) by S/. 261 million, while the private bank on the other hand increases its exchange position.

Using CDR BCRP. In the same context of depreciation, the Central Bank places CDR BCRP. Since these instruments are indexed to variations in the exchange rate between the contract date and the certificate's maturity, the holder of the certificate is guaranteed a profit in dollars. The BCRP sells these certificates at a nominal value of S/. 261 million, amount equivalent amount to US$ 100 million at the time of the purchase. When the CDR BCRP are sold, the balance sheets of the Central Bank and the private will reflect these operations in the following way:

BCRP		Private bank	
Asset	**Liability**	**Asset**	**Liability**
	+CDR BCRP (S/. 261 MM) - Issue (S/. 261 MM)	+CDR BCRP (S/. 261 MM) -S/. 261 MM	

The BCRP increases its obligations by S/. 261 million and reduces its base money by the same amount. The private bank acquires an asset, which is denominated in soles, but which guarantees the holder a profit in dollars. The bank's account is deducted from its current account at the Central Bank the amount of S/. 261 million. The adjustment at the time of the certificate's maturity will be in the following way: let's suppose that the exchange rate on the maturity date is S/. 2.65 per dollar. The adjustment is then:

$$Adjustment = 261 \times \frac{2{,}65}{2{,}61} - 1 \quad = 4$$

Therefore, the BCRP will pay the holder of the CDR BCRP a compensation proportional to the variation of the exchange rate, which in this case is S/. 4 million.

14 The exchange rate implicit is S/. 2.61 per US dollar.

Sterilized purchase of dollars. Let's suppose now a scenario of capital inflows, which generates a situation of downward pressures on the exchange rate. To smooth out the volatility of the exchange rate, the Central Bank intervenes in the foreign exchange market buying dollars to withdraw the excess liquidity. Using the same amounts as in the previous example, the Central Bank buys US$ 100 million in the foreign exchange market and deposits S/. 261 million in the current account of the private bank at the Central Bank. Then to sterilize this intervention, it auctions CD BCRP for a total of S/. 261 million and withdraws the soles previously injected –discounted from banks' current accounts at the Central Bank. The balance sheets of the Central Bank and the private bank would register these operations in the following way:

	BCRP		Private bank	
	Asset	**Liability**	**Asset**	**Liability**
Purchase of US$	+US$ 100 MM	+Issue (S/. 261 MM)	-US$ 100 MM +S/. 261 MM	
Sterilization		+CD BCRP (S/. 261 MM) -Issue (S/. 261 MM)	-S/. 261 MM +CD BCRP (S/. 261 MM)	

Using CDLD BCRP. In the same situation of volatile appreciation, the BCRP decides to use the BCRP CDLD to drain excess liquidity in the foreign exchange market and prevent a rapid decline in the exchange rate. The Central Bank auctions the BCRP CDLD at S/. 261 million and the private bank must pay the equivalent price in dollars at the current exchange rate at the time of the contract. In our example, with an exchange rate of S/. 2.61 per dollar, the private bank pays US$ 100 million. The balance sheet of the Central Bank and the private bank will reflect these operations as follows:

BCRP		Private bank	
Asset	**Liability**	**Asset**	**Liability**
+US$ 100 MM	+CDLD BCRP (S/. 261 MM)	+CDLD BCRP (S/. 261 MM) -US$ 100 MM	

As we can see, using the CDLD BCRP the Central Bank does not have to sell CD BCRP, which can save transaction costs.

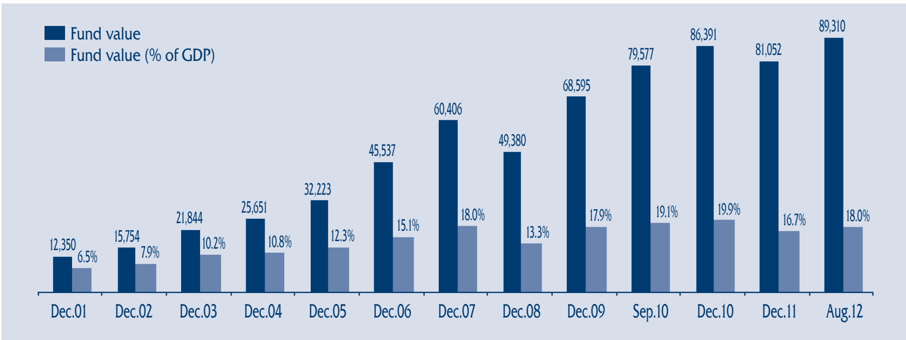
BOX 7
DYNAMISM OF PRIVATE PENSION FUNDS

The main purpose of the private pension system (PPS) created in 1993 is to provide members a pension according to their contributions to individual accounts and according to the profitability generated from the management of this portfolio. In this way, the pension amount which could be obtained from the PPS was disconnected from the rigidities of the public budget, which is finally the source from which the deficits in the national pension system are paid.

The PPS currently comprises four private administrators of pension funds (AFP) with over 5 million members whose accounts total a fund of S/. 89.31 billion.

As shown in the graph below, private pension funds have had a significantly high growth in recent years, increasing from a total value of S/. 12.35 billion at end December 2001 (6.5 percent of GDP) to a total accumulated fund of S/. 89.31 billion at August 31, 2012 (18 percent of GDP). This growth is the result of both the contributions of members, estimated at about S/. 500 million per month, and the profitability generated by the AFPs, which has reached an annual 13.1 percent, on average, in the same period.

PENSION FUND VALUE
(Millions of Nuevos Soles)



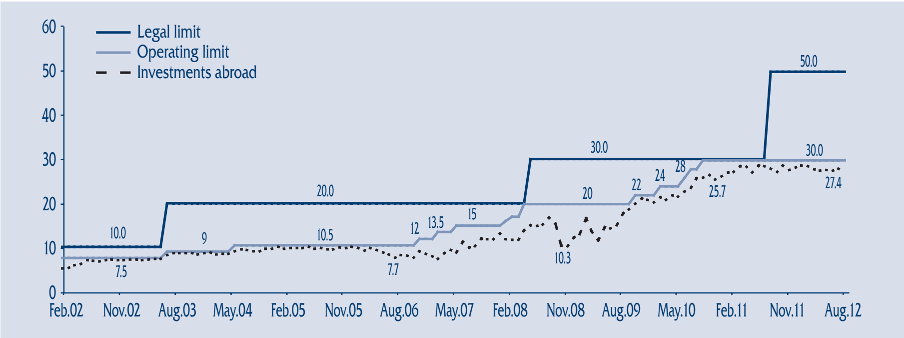
PRIVATE PENSION SYSTEM: INVESTMENT
(Millions of Nuevos Soles)

	2006	2007	2008	2009	2010	2011	Aug.2012
I. Fund value	**45,547**	**60,406**	**49,380**	**68,595**	**86,391**	**81,052**	**89,310**
(In millions of US$)	**14,260**	**20,155**	**15,761**	**23,768**	**30,067**	**30,064**	**34,232**
II. Composition of investment portfolio							
Domestic investment	**41,629**	**52,436**	**43,299**	**54,144**	**63,628**	**57,934**	**64,831**
a. Government securities	8,689	13,252	12,456	13,778	13,940	13,774	15,614
Central government securities	7,732	12,471	12,013	13,416	13,940	12,897	13,729
Central Bank securities	610	782	444	361	-	877	1,886
b. Financial institutions	5,315	4,889	8,607	8,014	13,269	11,654	14,577
Deposits in domestic currency	2,233	1,260	2,144	1,258	4,328	3,085	3,224
Deposits in foreign currency	261	188	1,823	501	1,029	559	2,496
Shares	386	954	777	1,870	2,175	1,576	1,723
Bonds	1,110	1,428	2,081	2,305	2,896	3,294	3,842
Other instruments	1,371	999	1,783	2,149	2,841	3,139	3,292
c. Non-financial institutions	27,625	34,295	22,236	32,352	36,420	32,507	34,639
Common and investment stocks	18,944	24,011	11,323	20,098	25,192	20,632	20,842
Corporate bonds	5,486	7,876	8,999	9,753	8,198	8,058	8,681
Other instruments	3,240	2,468	1,914	2,570	3,029	3,817	5,116
Investment abroad	**3,873**	**7,970**	**6,130**	**14,382**	**22,763**	**23,118**	**24,480**
Foreign debt securities	993	211	1,167	840	2,134	940	2,335
Deposits	-	366	404	740	877	596	773
Foreign mutual funds	2,860	6,270	3,175	4,013	6,410	11,412	13,036
Foreign shares	18	147	386	3,724	5,073	4,096	3,868
American Depositary Shares (ADS)	-	145	338	3,498	4,337	2,287	405
Others	-	891	661	1,636	3,845	3,787	4,063

Because of the relatively small size of our capital market relative to the size of the Pension Fund, the AFPs concentrate a significant part of the total bonds issued in some securities. For example, the AFPs hold Treasury bonds for a total of S/. 13.73 billion, which represents 47 percent of the total Treasury bonds issued (S/. 29.14 billion). The same situation is observed in the case of private bonds, with the AFPs holding S/. 12.25 billion (S/. 8.68 billion in securities issued by non-financial companies and S/. 3.84 billion in securities issued by financial entities), which represents 60 percent of the total issued (S/. 20.87 billion).

As the following graph shows, the operating limit for investment abroad has been increasing in recent years as the AFPs' investments have come close to this limit. Today, AFPs' investments abroad account for 27.4 percent of the AFP fund portfolio, most of which is invested in mutual funds abroad (53 percent) and in foreign stocks (16 percent).

AFP´S INVESTMENTS ABROAD
(As a % of total portfolio)



Loosening the limits on pension fund investments has allowed to prevent a concentration in the AFP portfolio risk, which will finally contribute to preserve the benefits that the members of the private pension system can obtain since they may get higher pensions in the future as a result of greater profitability. Therefore, the increase of 30 to 50 percent in the legal limit for the AFP investments abroad established by Law No. 29759 on July 21, 2011, is a positive step in this direction.

It is worth pointing out as a reference that in the region, both Chile and Colombia still have more flexible foreign investment limits than Peru. In Chile, the limit goes from 35 to 100 percent, and in Colombia, from 40 to 70 percent, depending on the type of fund.

BOX 8
INDICATORS OF THE REAL ESTATE MARKET

The Central Bank does a follow-up on the price of houses as well as on different indicators and variables used to analyze the appearance or existence of bubbles in the real estate market. The main indicators of the real estate market in the second quarter of 2012 are discussed below.

1. **Sale price / Income for annual rent ratio (price to earnings ratio - PER):**

   The value of this ratio indicates the number of years of rent required to recover the purchasing value of the property. This quarterly ratio is constructed with information of the sale and rental price of apartments per square meter in the districts of Jesús Maria, La Molina, Lince, Magdalena, Miraflores, Pueblo Libre, San Borja, San Isidro, San Miguel, and Surco, which is gathered by the Central Bank through surveys. The ratios for each district and the average aggregate indicator elaborated on the basis of this information are shown in the table below.

PER: PRICE TO EARNING RATIO

MEDIANS 1/	2010 - Q2	2010 - Q3	2010 - Q4	2011 - Q1	2011 - Q2	2011 - Q3	2011 - Q4	2012 - Q1	2012 - Q2
Jesús María	11.8	10.5	11.9	12.6	13.1	12.9	13.0	13.0	15.3
La Molina	13.0	15.7	16.1	16.5	17.2	15.2	15.8	12.7	10.7
Lince	15.9	14.2	14.8	14.3	15.6	16.5	14.1	13.9	14.2
Magdalena	10.6	11.7	10.9	11.6	13.7	12.7	12.5	14.5	14.1
Miraflores	10.9	12.1	13.3	12.9	14.0	15.6	15.7	19.0	17.1
Pueblo Libre	14.5	13.6	14.1	15.6	15.6	15.0	15.3	15.4	16.5
San Borja	15.8	15.5	14.7	15.3	17.2	16.6	17.2	15.3	18.8
San Isidro	14.4	13.6	13.8	15.6	15.9	14.9	16.7	19.7	17.7
San Miguel	13.6	12.0	14.8	17.7	15.9	13.7	12.8	14.8	15.3
Surco	12.8	13.8	14.7	15.9	15.8	13.3	16.3	16.6	16.7
Aggregated Average	**13.3**	**13.3**	**13.9**	**14.8**	**15.4**	**14.6**	**14.9**	**15.5**	**15.7**

1/ Rates have been calculated using the sale price median and rent of each district.
Source: BCRP Real State Sector.

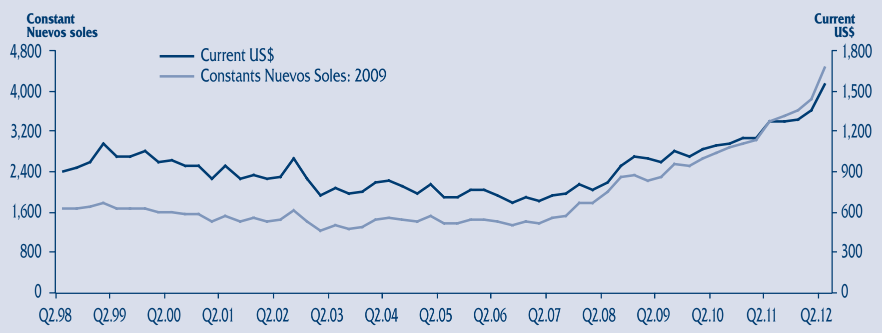
Even though the average aggregate indicator has registered a rising trend in recent quarters, the levels of this indicator show that the prices of apartments have remained in the range of 12.5-25, which is considered to be a normal range by Global Property Guide.

2. Sale prices per square meter in constant nuevos soles and in current dollars:

The prices of apartments located in the districts of La Molina, Miraflores, San Borja, San Isidro, and Surco are calculated on the basis of the median sale prices in constant soles of 2009 and in dollars.

An upward trend is observed since Q4-2006 both in constant soles and in dollars. The prices of apartments in constant soles increased 21.4 percent in Q2-2012 compared with Q2-2011, while the variation in the price in dollars was 32 percent.

MEDIANS OF QUARTERLY SALES PRICES PER SQUARE METER OF APARTMENTS
(La Molina, Miraflores, San Borja, San Isidro and Surco)

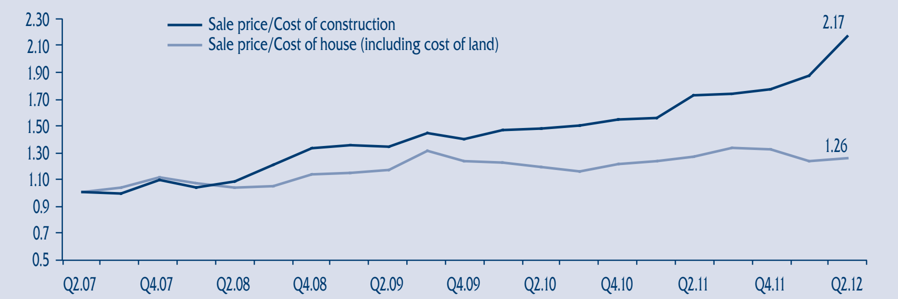


Source: BCRP.

3. Ratio of sale price index/total house cost index:

The following graph shows the ratio between the index of the sale price on the construction cost and the total house cost index. According to BBVA's Reporte de Situación Inmobiliaria of August 2009, the total cost of a home is the sum of the cost of construction materials (40 percent), labor (30 percent), and the price of land (30 percent). The cost of construction includes the first two components.

RATIO OF SALE PRICE INDEX / TOTAL HOUSE COST INDEX IN NUEVOS SOLES PER SQUARE METER
La Molina, Miraflores, San Borja, San Isidro and Surco



Source: BCRP.

In Q2-2012, the ratio calculated with the house cost index –which includes the cost of land– is lower than the ratio based only on the construction cost index. The former shows a less pronounced growing path given that land prices have shown a significantly faster pace of growth in recent years.

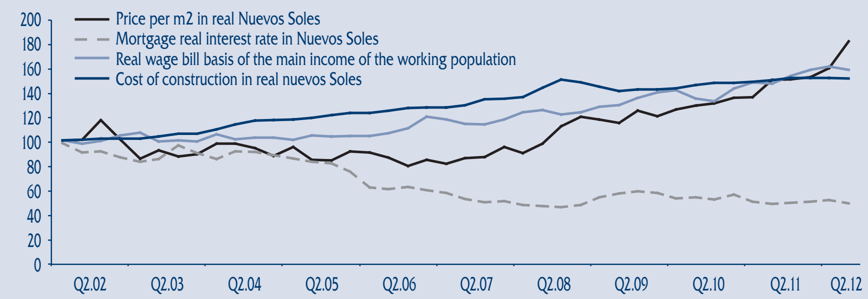
4. Fundamentals of apartment prices

In general terms, a housing bubble is said to exist when the prices of properties grow above their fundamentals. The variables whose evolution explains the behavior of apartment prices includes the real wage bill and mortgage loans (interest rate and amounts), among other variables.

The real wage bill –calculated on the basis of the main income of the working population– has been growing in real terms, thus increasing families' possibilities to have access to mortgage loans. In the same vein, the significant reduction of the actual mortgage interest rates has contributed to improve families' access to this type of loan because the cost of credit has declined. In line with the increase in the prices of real estate, construction costs are also increasing in real terms.

Thus, to some point the sale prices of apartments would be reflecting the evolution of their fundamentals. Other factors that explain the increase in housing prices are the higher prices of land, the rising potential demand, and demographic factors.

PRICE OF APARTMENTS AND ITS FUNDAMENTALS



Source: BCRP-SBS and INEI.

5. International scenario

Despite the rapid increase observed in the sale prices of apartments in recent years, prices are still below the level of prices in other Latin American cities. The table below shows the prices of apartments in other countries as reported by Global Property Guide. It is worth pointing out that the statistical data collected by the BCRP shows that the selling price of apartments in Q2-2012 was US$ 1,678 per square meter and that in Q4-2011 it was US$ 1,355.

INTERNATIONAL INDICATORS 2011 1/

	Sale price per m2
United Kingdom	15,187
Japan	13,855
USA	13,428
Canada	6,179
Argentina	3,144
Brazil	3,836
Uruguay	1,959
Mexico	2,085
Chile	1,794
Costa Rica	1,642
Colombia	2,102
Panama	2,128
El Salvador	1,189
Peru	**1,306**
Ecuador	958

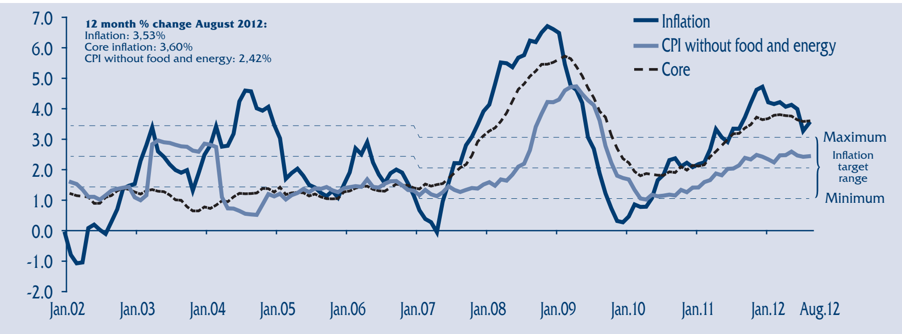
1/ According to Global Property Guide.

In conclusion, although an upward trend is observed in real estate prices, it cannot be said that there is a bubble in this market. Nonetheless, the evolution of property prices and its financing must be monitored to mitigate potential risks that may affect the stability of other sectors of the economy.

VI. Inflation

83. The rate of inflation in the last 12 months fell from 4.7 percent in December 2011 to 3.5 percent in August, remaining above the target range. The decline of inflation until August is explained by the smaller increase in food prices, especially in those with imported inputs due to the lower prices of food commodities despite the rise registered in these prices since July as a result of climate problems in the major producing countries. At August, core inflation showed a rate of 3.6 percent in the last twelve months, while the CPI without food and energy showed a rate of 2.4 percent.

Graph 94
INFLATION AND INFLATION TARGET
(Last 12 month % change)



Because of seasonal factors – the seasonality of the prices of agricultural perishable food products–, inflation is usually higher between January and August than between September and December. However, an atypical increase of the prices of these goods was observed between August and November in 2011 due to climatic anomalies. The reversal of these anomalies is expected to be reflected in the rate of inflation as from October 2012.

Table 37
CPI AND PERISHABLE AGRICULTURAL FOOD
(Annualized average change of period 2001 - 2011)

	January-August	September-December	Year
CPI	2.8	2.0	2.5
Perishable agricultural food	7.5	-2.2	4.2

84. Even though inflation in August was influenced by internal shocks, non-core inflation dropped from an annual rate of 6.8 percent in December 2011 to 3.4 percent in August 2012, reflecting the deceleration observed in food prices which declined from

11.5 percent to 4.9 percent. The highest deceleration of prices was registered in the prices of food products that use imported inputs.

The annual rate of core inflation, which excludes the effects of shocks, fell slightly from 3.7 to 3.6 percent, while the rate of inflation without food and energy remained at 2.4 percent.

Table 38
INFLATION
(% change)

	Weight 2009=100	2006	2007	2008	2009	2010	2011	2012 Jan.-Aug.	2012 12 months
I. INFLATION	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.08**	**4.74**	**2.14**	**3.53**
II. CPI WITHOUT FOOD AND ENERGY	**56.4**	**1.28**	**1.49**	**4.25**	**1.71**	**1.38**	**2.42**	**1.51**	**2.44**
III. CORE INFLATION	**65.2**	**1.37**	**3.11**	**5.56**	**2.35**	**2.12**	**3.65**	**2.55**	**3.60**
Goods	32.9	0.97	3.30	5.32	2.17	1.53	3.17	1.84	2.94
Services	32.2	1.85	2.88	5.86	2.56	2.72	4.13	3.25	4.26
IV. NON CORE INFLATION	**34.8**	**0.83**	**5.07**	**8.11**	**-2.54**	**2.00**	**6.79**	**1.39**	**3.38**
Food	14.8	2.06	7.25	10.97	-1.41	1.18	11.50	2.88	4.86
Fuels	2.8	-1.50	6.45	-0.04	-12.66	12.21	7.54	-0.99	1.00
Transportation	8.9	1.12	0.82	5.86	0.19	1.94	3.61	-0.35	3.15
Utilities	8.4	-3.22	0.24	7.48	-4.56	0.01	1.50	1.36	1.67
Memo:									
Total food	37.8	1.76	6.02	9.70	0.57	2.41	7.97	3.21	5.19

Table 39
INFLATION
(Weighted contribution)

	Weight 2009=100	2006	2007	2008	2009	2010	2011	2012 Jan.-Aug.	2012 12 months
I. INFLATION	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.08**	**4.74**	**2.14**	**3.53**
II. CPI WITHOUT FOOD AND ENERGY	**56.4**	**0.58**	**0.67**	**1.88**	**0.74**	**0.78**	**1.36**	**0.83**	**1.34**
III. CORE INFLATION	**65.2**	**0.79**	**1.80**	**3.20**	**1.34**	**1.38**	**2.38**	**1.65**	**2.34**
Goods	32.9	0.31	1.05	1.69	0.68	0.50	1.04	0.59	0.95
Services	32.2	0.48	0.75	1.52	0.66	0.88	1.34	1.05	1.39
IV. NON CORE INFLATION	**34.8**	**0.35**	**2.13**	**3.44**	**-1.09**	**0.69**	**2.36**	**0.49**	**1.19**
Food	14.8	0.48	1.69	2.63	-0.35	0.17	1.68	0.45	0.75
Fuels	2.8	-0.09	0.36	0.00	-0.68	0.34	0.23	-0.03	0.03
Transportation	8.9	0.10	0.07	0.51	0.03	0.17	0.32	-0.03	0.27
Utilities	8.4	-0.14	0.01	0.30	-0.09	0.00	0.12	0.11	0.13
Memo:									
Total food	37.8	0.63	2.17	3.56	0.21	0.91	3.03	1.26	2.02

85. Between January and August, the items that contributed most to the rise in inflation were education services and meals outside the home. Other items that stand out for their prices rises include onions, other vegetables, and citrus fruits. On the other hand,

the items that contributed most to reduce inflation were chicken, telephone services, and national transport.

Table 40
ITEM WITH THE HIGHEST WEIGHTED CONTRIBUTION TO INFLATION: JANUARY - AUGUST 2012

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Meals outside the home	11.7	4.2	0.52	Poultry	3.0	-2.7	-0.08
Education (fees and tuition)	8.8	4.7	0.42	Telephone rates	2.9	-2.6	-0.06
Onion	0.4	117.8	0.35	National transportation	0.3	-12.6	-0.05
Other vegetables	0.4	23.6	0.10	Gasoline and oil	1.3	-2.6	-0.04
Water rates	1.6	5.2	0.09	Carrots	0.1	-20.7	-0.04
Electricity	2.9	3.0	0.08	Apparatus of recreation and culture	0.9	-3.9	-0.03
Toiletries	4.9	1.7	0.08	Rice	1.9	-1.3	-0.02
Evaporated milk	1.6	3.6	0.06	Fresh and frozen fish	0.7	-2.7	-0.02
Sodas	1.3	4.3	0.06	Papaya	0.2	-7.8	-0.02
Citrics	0.5	8.4	0.06	Pepper	0.1	-24.9	-0.02
Total			**1.82**	**Total**			**-0.38**

Table 41
ITEM WITH THE HIGHEST WEIGHTED CONTRIBUTION TO INFLATION: SEPTEMBER 2011 - AUGUST 2012

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Meals outside the home	11.7	6.3	0.77	Poultry	3.0	-6.0	-0.18
Education (fees and tuition)	8.8	5.4	0.49	Telephone rates	2.9	-3.3	-0.09
Onion	0.4	127.6	0.36	Fresh and frozen fish	0.7	-5.6	-0.05
Urban fares	8.5	3.2	0.27	Rice	1.9	-2.5	-0.05
Citrics	0.5	41.5	0.21	Apparatus of recreation and culture	0.9	-4.7	-0.04
Toiletries	4.9	3.0	0.15	Pumpkin	0.1	-23.4	-0.03
Electricity	2.9	4.7	0.13	Garlic	0.1	-22.2	-0.02
Sodas	1.3	8.6	0.11	Televisions	0.5	-2.8	-0.01
Water rates	1.6	5.2	0.09	Rent	2.4	-0.6	-0.01
Evaporated milk	1.6	4.9	0.08	Pepper	0.1	-17.8	-0.01
Total			**2.66**	**Total**			**-0.49**

Inflation components at August 2012

86. The items that contributed the most to increase inflation in the period of January - August were meals outside the home and education. Meals outside the home continued showing the growing trend this item has recorded over the past five years, reaching an accumulated rate of 4.2 percent in January-August 2012, a higher rate than the overall rate (2.1 percent) and higher than the rate of total food and beverages consumed in the household (3.4 percent).

On the other hand, education (tuition and fees) recorded a growth rate of 4.7 percent, which mainly reflects the increase in education costs in the month of March (3.4 percent) associated with the beginning of the school year. Private schools increased tuitions by 5.3 percent on average and education fees by 7.5 percent. Moreover, the increases registered in the months of April, May, and August in tuitions in universities and private higher education institutes added to this.

Rises in food prices that stand out included the rise in the price of onions, a product that has been strongly affected by weather anomalies. This price increase (117.8 percent) is explained mainly by climate problems in Arequipa, Lima's main supplier of onions. The heavy rains in the region affected crops in the first months of the year, generating an irregular supply of this product. Likewise, climate alterations affected cultivation (down 5.3 percent in the August-March crop season compared to the previous season), as well as crops and yields, which gave rise to new price increases in the months of July and August.

The increases in water and electricity rates also had an impact on inflation. Water rates increased 5.2 percent in the January-August period, in line with the increases authorized by Superintendencia Nacional de Servicios de Saneamiento (Sunass). An increase of 2.5 percent was registered in May due to the update of the water rate in accordance with the General Law of Sanitation Services, which establishes that water companies can adjust the rates whenever the variation in the wholesale CPI is higher than 3 percent (a 3.1 percent variation was recorded in the period of May 2011 - March 2012). An increase of 1.7 percent was also registered in August due the rate rise approved by Sunass at end July in order that Sedapal may cover the costs of La Chira project.

As regards electricity rates, the increase of 3 percent in the January-August period resulted from the adjustments determined by the regulator, Osinergmin. The average rise of 1 percent in January responded to the update of the transmission price as a result of new tender contracts and the onset of the commercial operation of the Conococha-Huallanca line. The increase in February (2.9 percent) resulted mainly from the quarterly setting of generation rates and from the increase in the prices of oil, natural gas, as well as from increases in the wholesale price index. These increases were in part offset with a 2.3 percent rate reduction in May as a result of the revision of generation and transmission prices. The decline in July (-1.3 percent) was associated with the update of the rate formula, which includes changes in the prices of fuels, copper, aluminum, as well as in the wholesale price index and the exchange rate, while the rise in August (1.7 percent) reflected mainly the quarterly adjustment of prices of generation components, as well as the update of additional electricity charges included in the main transmission toll.

87. Compared to June, economic agents have reduced their expectations of inflation for 2012 and 2013. Inflation in 2012 is now expected to show a rate between 3.0 and 3.2 percent and to decline thereafter in the forecast horizon to values between 2.5 and 3.0 percent in 2013 and 2014, that is, to fall within the target range.

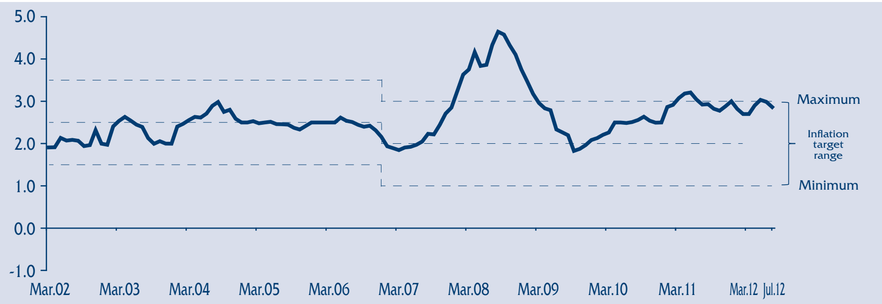
Table 42
SURVEY ON MACROECONOMIC EXPECTATION: INFLATION END OF PERIOD
(%)

	Survey conducted for:		
	IR Mar.12	IR Jun.12	IR Sep.12*
Financial entities			
2012	2.7	3.2	3.0
2013	2.5	2.8	2.8
2014	-.-	2.5	2.5
Economic analysts			
2012	2.8	3.2	3.0
2013	2.4	2.8	2.8
2014	-.-	2.5	2.5
Non-financial firms			
2012	3.0	3.2	3.2
2013	3.0	3.0	3.0
2014	-.-	3.0	3.0

IR: Inflation Report.
*Survey conducted during the second half of August, 2012.

According to the survey of expectations of the Central Bank, Inflation expectations for the next year have also shown a downward behavior in recent months and fall within the target range.

Graph 95
INFLATION EXPECTATIONS FOR THE NEXT YEAR*
(%)



* Corresponds to the average of the expectations of the financial system and economic analysts.

Inflation forecast

88. At August, inflation in the last 12 months shows a rate of 3.5 percent, above the upper limit of the target range. In the central forecast scenario, inflation is expected to gradually converge towards the upper limit of the target range by the end of the year (3.0 percent) once the inflationary pressures associated with significant increases in commodity prices have disappeared. This inflation forecast takes into account the recent dynamism observed in the prices of fuels and food due to tensions in the Middle East, the drought in the United States, and domestic supply shocks that have generated transitory increases in the prices of some perishable food products. In 2013 inflation would show a rate of between 1.5 percent and 2.5 percent.

89. Inflation without food and energy is an indicator that excludes the effects of external and internal shocks. External shocks are associated with the evolution of the prices of commodities (grains and oil), while domestic shocks result from abnormal weather conditions that affect the supply of perishable food products.

Table 43
INFLATION: 2006 - 2013
(Last 12 month % change)

	Estructure	2009	2010	2011	2012		2013*
					August	Year*	
CPI	**100.0**	**0.2**	**2.1**	**4.7**	**3.5**	**3.0**	**2.0**
Food and energy	43.6	-0.9	3.0	7.7	4.9	4.1	2.3
Food	37.8	0.6	2.4	8.0	5.2	4.5	2.2
Energy	5.7	-10.4	6.8	6.0	2.7	1.8	2.9
CPI without food and energy	56.4	1.7	1.4	2.4	2.4	2.1	1.6

* Forecast.

a. External shocks

Prices of imported food inputs

Among the main international commodities with greater impact on the consumer basket we can mention maize, wheat, and soybean oil, all of which began to show rises since July due to climate factors that have been affecting crops in the United States and other regions of the world.

In line with the increase in the international prices of food products, it is estimated that the effect of imported food inputs on domestic prices will continue in the next few months.

Table 44
FOODSTUFFS: INTERNATIONAL AND CONSUMER PRICES
End of period

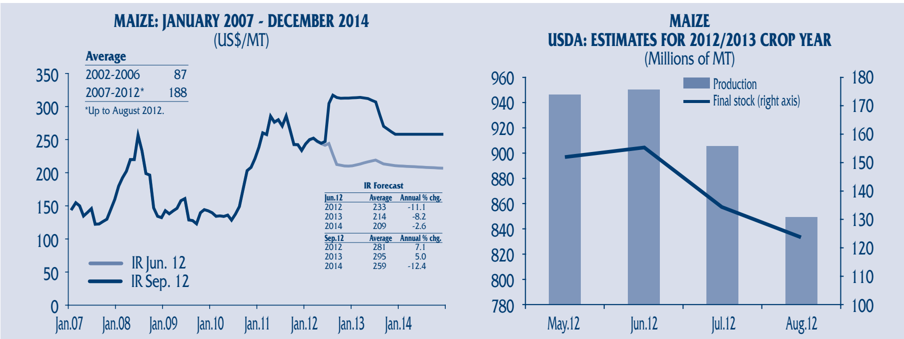
	2006	2007	2008	2009	2010	2011	Aug.2012
Wheat							
Price (US$ per MT)	180	339	189	171	275	236	315
% change	*28.4*	*89.0*	*-44.2*	*-9.8*	*60.6*	*-14.0*	*9.3*
Bread (Pan francés) (Nuevos Soles per kg)	4.9	5.9	5.9	5.8	5.9	6.2	6.3
% change	*3.6*	*19.3*	*0.7*	*-1.4*	*0.9*	*5.8*	*1.9*
Noodle (Nuevos Soles per kg)	3.4	3.9	4.1	4.00	4.0	4.3	4.4
% change	*-1.2*	*16.4*	*4.9*	*-2.4*	*0.3*	*7.0*	*5.4*
Maize							
Price (US$ per MT)	138	158	130	141	221	234	319
% change	*93.5*	*14.4*	*-17.8*	*8.1*	*57.3*	*5.7*	*11.1*
Eviscerated chicken (Nuevos Soles per kg)	5.9	5.9	6.8	7.1	6.1	7.2	7.0
% change	*16.2*	*0.3*	*15.4*	*3.7*	*-13.2*	*17.2*	*-6.0*
Soybean							
Price (US$ per MT)	610	996	646	810	1,139	1,107	1,150
% change	*31.7*	*63.3*	*-35.1*	*25.3*	*40.7*	*-2.9*	*-4.1*
Bottled vegetable oill (Nuevos Soles per liter)	4.5	5.6	7.1	5.9	5.9	6.9	6.9
% change	*-1.1*	*25.6*	*25.2*	*-15.9*	*-1.3*	*18.3*	*0.9*

Maize

90. In the first eight months of the year, the price of maize, which closed at end of August at an average level of US$ 319 per ton, has increased 36 percent. This increase reflects mainly the rise observed in July, when the international price of maize increased 24 percent and reached an all-time high of US$ 332/ton, in line with expectations of a lower production in the USA.

According to the U.S. Weather Bureau, United States has been experiencing the most severe drought since 1956. The persistent weather conditions have affected the expected crop yields so intensely that the percentage of crops in good conditions has declined from 63 percent in June to 23 percent at the end of August. Because of this, the US Department of agriculture (USDA) has revised down the global production of maize by 100 million metric tons. In the next years the price of maize is expected to stabilize at levels close to the one currently observed, but above the one estimated in the Inflation Report of June 2012.

Graph 96



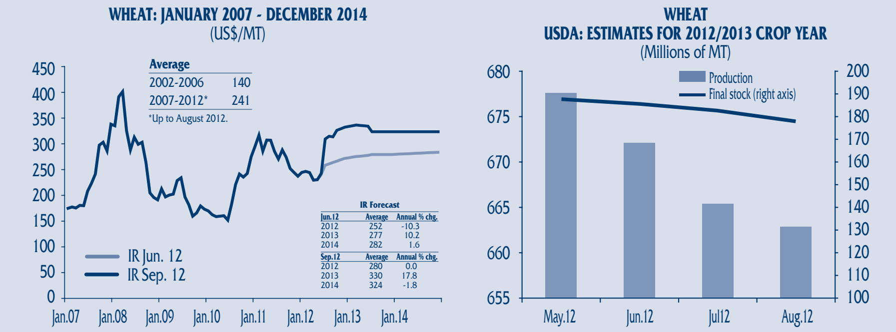
Source: USDA.

Wheat

91. Wheat closed at August with an average international price of US$ 315 per ton, reflecting an accumulated increase of 33 percent in the year. In July, the price of wheat showed an average increase of 28 percent, in line with the rising trend of maize –its substitute– and with expectations of lower global supply due to lower production and lower exports in the Black Sea areas (especially in Russia) and, to a lesser extent, in USA.

Even though the drought in Russia is not as severe as the one that occurred in 2010, the lower production has decreased the exportable balance and generated fears that the Russian government will implement controls or limits on exports in the last quarter of the year, as it did in 2010. In this context, the price of wheat is expected to follow a slightly rising conduct and to show higher levels than those estimated in our previous report.

Graph 97



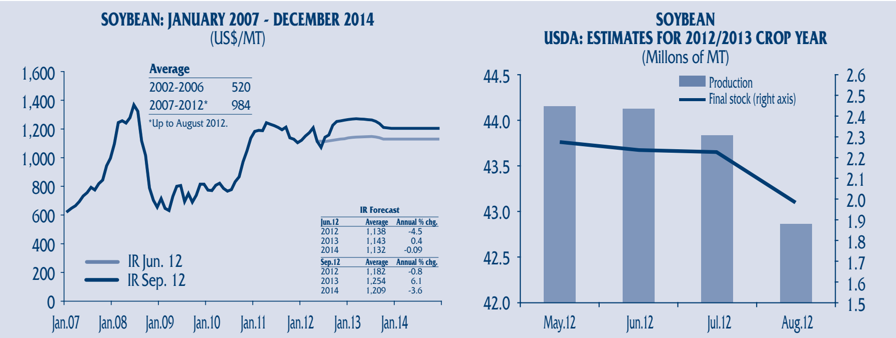
Source: USDA.

Soybean oil

92. The price of soybean oil has registered an average increase of 5 percent so far this year, closing with an average price of US$ 1,161/ton in August. In the last two months of Q2, the price of soybean oil fell along with the price of crude, but increased thereafter together with the rest of food commodities in the month of July, following the recovery of oil.

    The scenario in the case of soybean oil is not critical as in the case of maize, given that weather conditions in Argentina, the world's major exporter which is also the country where most of our imports of soybean come from, are not unfavorable. However, in its latest monthly food report, the USDA has said again that tighter market conditions are foreseen for this season due to the lower initial inventories resulting from the slowdown of global production in the previous season of 2011/12. Based on this, the price of soybean oil is expected to register slightly higher levels than those considered in the previous Inflation Report.

Graph 98



Source: USDA.

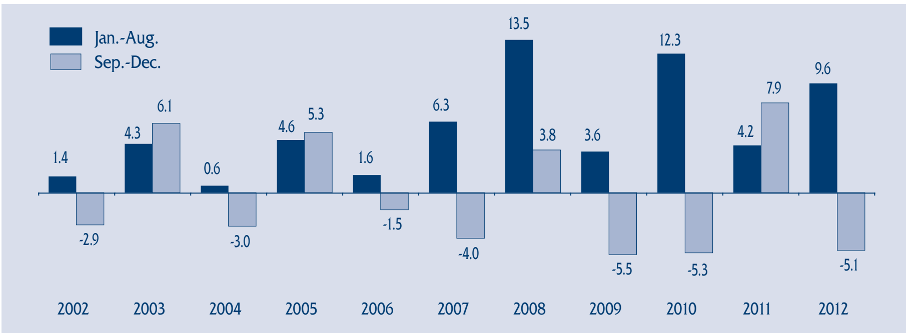
Oil

The price of oil is expected to remain constant in the forecast horizon. In 2012 the energy component reflects the fall in the prices of gasoline, but this would not be observed in 2013. The increase in other components of the consumption basket would be in line with a growth rate close to the rate of potential growth.

b. Domestic shocks

The weather anomalies experienced until the month of August have affected the supply of perishable food products, such as lemon and onion, which has resulted in a price increase of 9.6 percent between January and August. A partial reversal of these price increases is expected as from October.

Graph 99
PRICE OF PERISHABLE AGRICULTURAL FOOD
(%)



93. The factors affecting the current price and the expected price of some perishable food products are discussed below:

Potato

An increase of potato prices is anticipated in the months of September to December of this year given that cultivated areas in Lima and Huánuco, the main suppliers of Lima in these months, have declined. Moreover, the slightly warm conditions registered on the central coast until the month of July of this year would result in lower yields of this crop.

Graph 100
PRICE OF POTATO
(%)

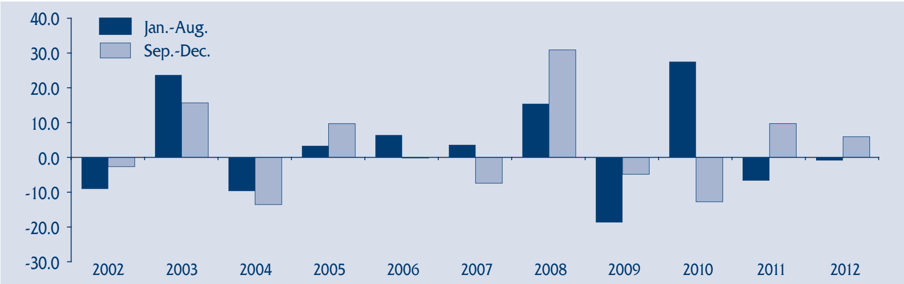


Table 45
CROPS OF POTATO IN THE CENTRAL AREAS
(Hectares)

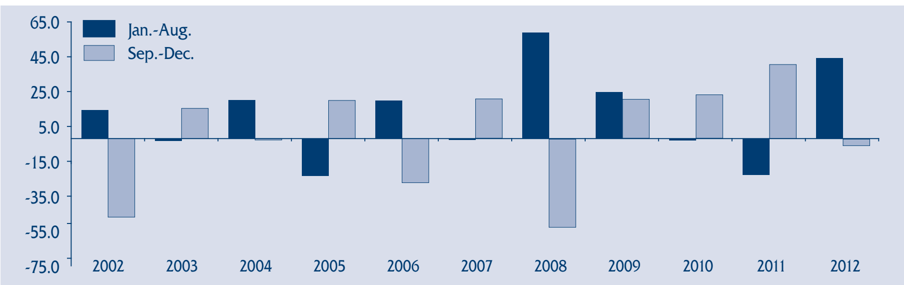
	April - June		Variation 2012 / 2011	
	2011	**2012**	**%**	**Absolute**
Ayacucho	262	438	67.2	176
Huancavelica	1,335	804	-39.8	-531
Huánuco	15,343	15,068	-1.8	-275
Ica	2,200	2,453	11.5	253
Junin	3,584	3,626	1.2	42
Lima	5,772	5,111	-11.5	-661
Pasco	962	248	-74.2	-714
Total	**29,457**	**27,748**	**-5.8**	**-1 709**

Source: MINAG.
Elaboration: Huancayo branch.

Lemon

Lemon crops over the past months have been affected by higher than normal temperatures, which have generated a decreased flowering. This situation would gradually reverse since October with the normalization of weather conditions.

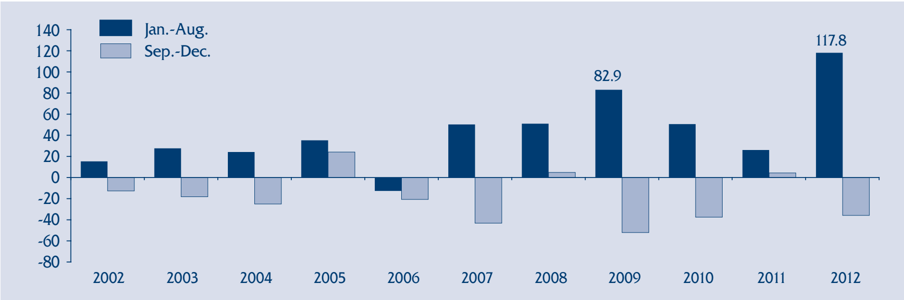
Graph 101
PRICE OF LEMON
(%)



Onion

The number of sown areas in Arequipa for the supply of onion in the September-November period is similar to the number of sown areas observed in the same period of last year. A relatively warmer climate is expected, which could translate into higher yields and a greater supply since October.

Graph 102
PRICE OF ONION
(%)



Fresh legumes

The supply of green pea would decline as from September due to lower cultivation in Junín as a result of lower market prices in earlier months. However, this could be offset in part with increased cultivation in Huánuco.

Graph 103
PRICE OF FRESH LEGUMES
(%)

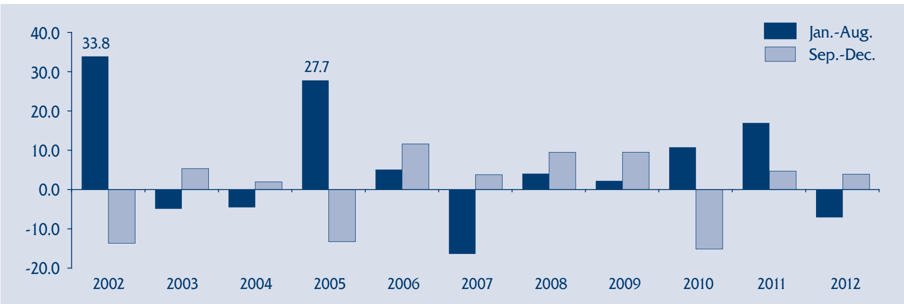


Table 46
PRICE OF FRESH LEGUMES
(%)

	Aug-12	Accumulated	12 months
American green peas	1.4	-10.2	-1.2
American green beans	-4.5	-4.2	-12.2
Lima green peas	6.2	-9.7	-0.9

Tomato

The cultivation of tomato has been favored by above-normal high and low temperatures registered on the central coast until June, which reflected a weak El Niño episode. A drop was observed in yields in July, which is associated to the decline of the temperature. The supply would increase again as from October with the spring season.

Graph 104
PRICE OF TOMATO
(%)

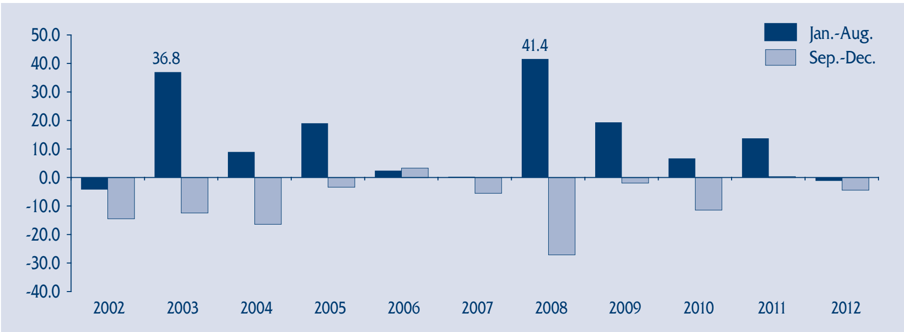


Table 47
YIELDS IN THE VALLEYS OF LIMA
(MT per hectares)

	2010	2011	2012
January	28.2	32.2	32.0
February	29.9	33.4	34.3
March	29.3	31.2	38.0
April	25.9	35.9	43.3
May	27.8	31.3	34.5
June	31.6	35.5	36.0
July	35.6	31.9	28.8
August	29.6	29.4	
September	29.5	26.9	
October	26.3	26.6	
November	27.8	25.7	
December	26.2	26.2	

Source: MINAG.

Corn

Increased cultivation in Ica would contribute to generate a higher suppy of corn, adding onto the yield improvement associated with the higher temperatures usually registered in the spring.

Graph 105
PRICE OF CORN
(%)

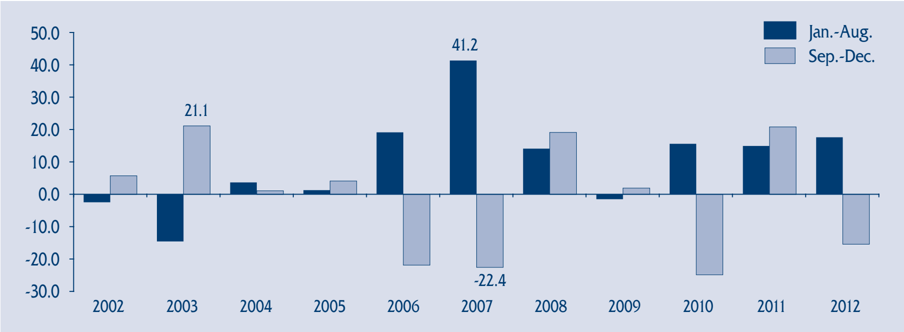


Table 48
CROPS OF AMYLACEOUS MAIZE - HARVEST MONTH
(Hectares)

	January - August			September - November		
	2011	**2012**	**% chg.**	**2011**	**2012**	**% chg.**
Ancash	14,865	14,173	-4.7	370	293	-20.8
Lima	1,732	1,339	-22.7	877	887	1.1
Ica	230	207	-10.1	1,652	1,914	15.9

Carrot

A 17 percent production increase is projected in the period August - September based on the information of carrot cultivation in the valleys of Lima (an increase of 16.4 percent is estimated relative to the previous season). However, the weather conditions observed until the month of September could reduce yields.

Graph 106
PRICE OF CARROT
(%)

Garlic

Between September and December, garlic is mainly supplied by Arequipa. However, garlic crops in this region corresponding to the supply for the September-to-November period show a negative variation of 15 percent.

Graph 107
PRICE OF GARLIC
(%)

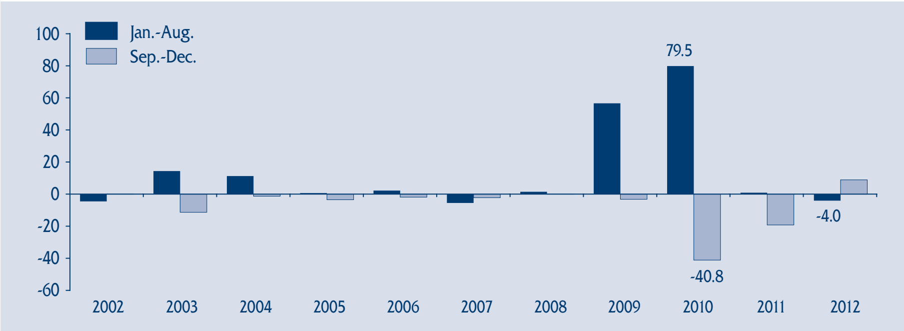


Table 49
CROPS OF GARLIC - HARVEST MONTH
(Hectares)

	September - November		
	2011	**2012**	**% chg.**
Arequipa	3,023	2,580	-14.7
Lima	417	305	-26.9

94. The main factors that affect the path of core inflation are the output gap, the exchange rate (and its impact on imported inflation), and inflation expectations.

In the forecast horizon, the central scenario considers a growth of GDP close to its potential growth level, which is equivalent to a neutral economic cycle. Therefore, no major demand inflationary pressures are expected in this period.

Moreover, the evolution of the exchange rate in the central forecast horizon is expected to partially offset the increases foreseen in external inflation. Thus, the component of imported inflation would show a relatively rapid normalization that would have a favorable impact on core inflation.

Finally, the expected rate of inflation would continue to decline, falling from a rate of 3 percent to a rate close to 2 percent in the next two years. The increase observed in inflation expectations so far this year reflects the rates of inflation recorded as a result of persistent supply shocks on the prices of food and fuels.

However, inflation is expected to closer to 2 percent as soon as the effects of these shocks subside.

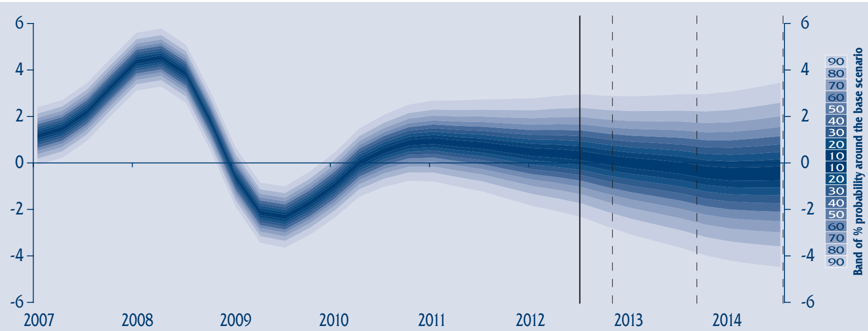
95. The **output gap** is affected by various kinds of impulses: the external impulse, the fiscal impulse, the private impulse, and the monetary impulse.

On the external front, the impulse is expected to be lower due to the downward revision of our commercial partners' growth rate as well as to the anticipated higher reduction in terms of trade. This forecast scenario also considers a negative fiscal impulse of 0.1 percent in 2012, in line with a lower growth of public expenditure, particularly in the first semester, which would reverse in part in the second half of 2012 and in 2013, year when a nil fiscal impulse is estimated.

The negative contribution of the external impulse and the fiscal impulse on the output gap would be offset by the private boost, since both private investment and private consumption are expected to maintain the dynamism observed recently in the forecast horizon.

Finally, the baseline forecast scenario considers a monetary policy position in the short term which will not be substantially different from the one observed today. A suitable monetary policy position contributes to maintaining inflation expectations anchored, especially in the context of persistent significant shocks that affect sensitive products of the CPI basket. It should be pointed out that economic and financial analysts project a reference interest rate of 4.25 percent for the period 2012-2014. The Central Bank keeps a close watch on world and local economic developments and stands ready to adapt its monetary policy position if it is necessary to so in order to ensure inflation's convergence to the target range.

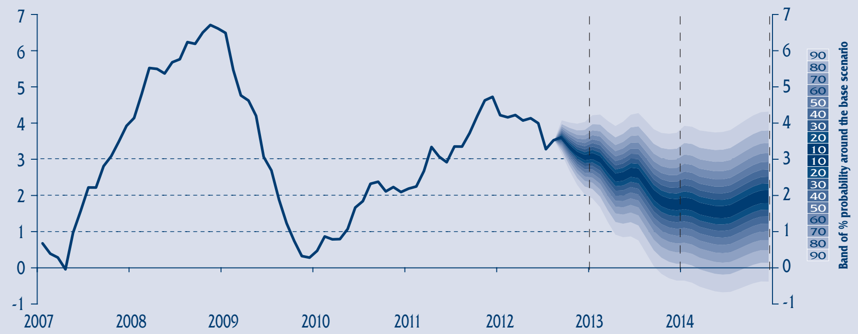
Graph 108
OUTPUT GAP: 2007-2014
(% of potential GDP)



Memo: The output gap is not an observable variable and has to be estimated. Because of this, the graph shows uncertainty about its value, even in periods for which there is information on GDP (up to the second quarter 2012). Each band concentrates a probability of occurrence of 10% and total bands represent a probability of occurrence of 90%.

96. The evolution of the variables described above affect the trajectory of inflation in the baseline scenario. However, due to uncertainty about future developments in the domestic economy and in the global economy, other scenarios that incorporate alternative projection assumptions which divert inflation from its path in the baseline scenario are also evaluated. The darker bands contain the path of inflation in the baseline scenario, which shows a probability of occurrence of about 70 percent. The alternative forecast scenarios, which are described in the section of balance of risks, have a total occurrence probability of 30 percent.

Graph 109
INFLATION FORECAST: 2012-2014
(Last 12 month % change)



Memo: The graph shows the probability of occurrence of inflation values in the future: These values were established combining statistical analysis and the subjective perception of the BCRP. Thus, in each period of the forecast horizon, each pair of bands with the same shade concentrates a probability of 10%. This can be interpreted as that 10 of every 100 possible future values of inflation are expected to fall within the darkest bands (located in the center), that contain the baseline escenario trajectory.

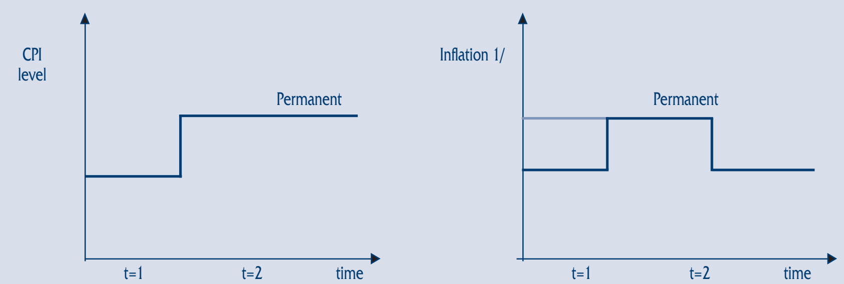
BOX 9
PERMANENT AND TRANSITORY SHOCKS IN THE LEVEL OF PRICES

Inflation is an economic phenomenon characterized by a widespread and continuous increase in consumer prices. When there is a single price increase, there is no permanent impact on the inflation rate, but only on the price level in a period. In other words, the rate of variation of the consumer price index will register an increase only in the period in which prices rose, this rate returning rapidly to its previous pace of growth thereafter.

There is no permanent effect on inflation either, when the price increase is transitorily and reverts after some time. In such case, the growth rate of prices increases for some period of time and then temporarily declines below its initial level, as a result of which there would be no permanent effect on inflation.

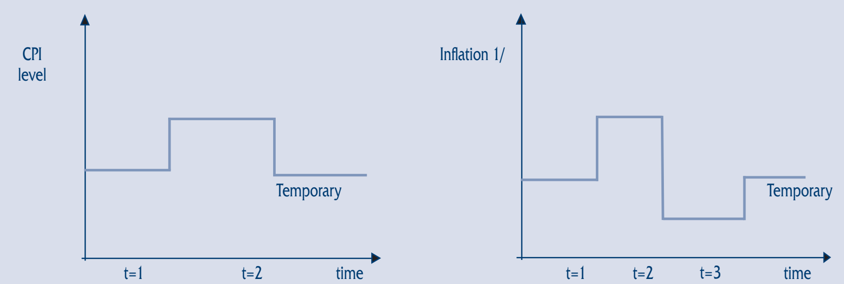
THE EFFECTS OF SHOCKS ON THE PRICE LEVEL ON THE RATE OF CHANGE				
	Increase in the price level		Change of price	
	1st. Period	2nd. Period	1st. Period	2nd. Period
Permanent increase in the price level	Increase	No change	Increase	No change
Temporary increase in the price level	Increase	Decrease	Increase	Decrease

The following graphs illustrate the path of the price level –the consumer price index (CPI)– and of the rate of inflation due to a permanent shock –a one-time or non-recurring shock– and a transitory shock. In the first case, the price level rises in period 1 and then remains constant. The rate of inflation rises temporarily during this period and then returns to its initial level.



1/ Inflation last 12 months.

In the second case, the price level increases transitorily during period 1, as a result of which the rate of inflation increases during period 1. In period 2 the price level decreases and returns to its previous value. The price reduction translates into a decline in inflation –measured as the change registered in the CPI in the last twelve months–, which will temporarily fall below its initial value. Once the price level is stabilized, inflation rises to its value prior to the shock.



Source: IR Sep. 07

1/ Inflation last 12 months.

VII. Balance of risks

97. The baseline scenario for the inflation forecast takes into account relevant data on macroeconomic and financial variables as well as information on the domestic and international environment that is complemented with qualitative information not considered in statistical data.

    Given that the forecast process is not free from uncertainty about future developments in the domestic and in the global economies, other scenarios including shocks that divert inflation from the baseline scenario are also evaluated in the balance of risks.

    The balance of risks results from assessing the relative significance that each of the risk factors has on the inflation forecast. The expected impact of a risk factor on inflation depends on two components: first, the magnitude of deviation of the inflation forecast in the risk scenario compared to the baseline scenario, and second, the probability of occurrence assigned to the risk scenario. Together, these two factors determine the bias of the inflation forecast in the balance of risks.

98. The main risks that could divert the rate of inflation from the baseline scenario in the forecast horizon are associated with uncertainty about the evolution of the global economy and the international flow of capitals, the evolution of domestic demand and the impact of commodity prices in international markets, and adverse climate conditions. The expected impact of each of these risk factors on the inflation forecast at end 2012 is shown in Graph 110.

    The **downward risks** in the inflation forecast are both external and domestic. The former are associated with the possibility that an international financial crisis may unfold and the latter are associated with a contingent scenario of lower growth of domestic demand due to the postponement of investment projects.

    a. Deterioration of the international environment

    The baseline scenario considers a gradual recovery of global economic activity as from Q4-2012. A contingent scenario of deterioration of international conditions implies that this recovery would not take place and that there could even be a greater economic slowdown or decline of GDP in different regions of the world given growing uncertainty in international markets. This would contribute to weaken external demand, affecting the Peruvian economy through the financial and trade channels.

In this scenario, an increase in global uncertainty and the drop of commodity prices could generate panic among investors and lead to a sudden reversal of capitals that would bring about a real depreciation of currencies and an increase in the country risk indicator in emerging economies like Peru.

If these risks materialized, the Central Bank would use some of its considerable amount of international reserves and several liquidity injection mechanisms in both national and foreign currency to offset the impact of this shock on domestic financial conditions. Even more, should this be the case, the Central Bank would respond easing monetary conditions.

b. Lower growth of domestic demand

This scenario analyzes the possibility that investment projects are either postponed or cancelled. This would generate less dynamism in the aggregate demand and lead, in the short term, to a rate of economic growth below the economy's potential growth which would generate downward pressures on inflation. In this scenario, the Central Bank would increase the monetary stimulus with the aim of leading inflation to fall within the target range in the forecast horizon.

On the other hand, there are two scenarios of **upward risk** for inflation associated mainly with an increase in capital inflows and a rise in commodity prices.

c. Increased capital inflows

Together with the scarce options attractive for investment in a context of great global uncertainty, the highly significant amount of liquidity that would be available in international markets as a result of the implementation of new quantitative easing measures by the central banks of developed countries could promote a flow of foreign capitals to the emerging economies. This would be an event similar to the one observed in the second half of 2010 following the FED's announcement and implementation of QE2. The recently announced monetary expansion program (QE3) would include monthly purchases of US$ 40 billion, even though the total amount to be purchased is still unknown. A greater capital inflow would accelerate the growth of credit, stimulating aggregate demand and inflation, and would also exert appreciatory pressures on the nuevo sol, which would translate into lower inflation. A rise in inflation is estimated due to the effect of an increased capital inflow and the higher imported inflation this scenario entails.

In this scenario, the Central Bank would adjust its monetary position and use macroprudential policy instruments such as the rates of reserve requirements.

d. Domestic and external supply shocks

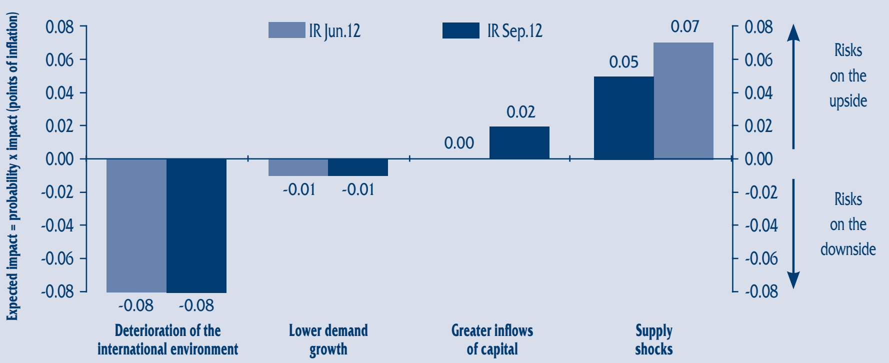
Even though the recent rise in the prices of food commodities and fuels has been considered in the baseline scenario, there is the risk that global inflationary pressures will be more persistent. For example, the impact of the drought in the United States on the international price of maize is an important risk factor and a rise in the tensions affecting the Middle East could lead to an increase in the price of crude. If they are persistent, these shocks could affect the evolution of inflation through higher imported costs and lower margins for local businesses, which could generate inflationary pressures.

In the domestic arena, even though the probabilities are lower, there is still the risk of having to face adverse climatic conditions associated with a possible El Niño event, which could affect the normal development of the production and supply of food products (especially fishing and farming products).

In this scenario, the Central Bank would adjust its monetary position only if these inflationary shocks increase inflation expectations.

99. The **balance of risks for the inflation forecast is neutral** in the forecast horizon. In other words, based on the information available today, the probability that inflation will fall below the projection in the baseline scenario is the same as the probability that it will fall above this projection.

Graph 110
BALANCE OF RISKS AGAINST THE BASE SCENARIO



Memo: The risk assessment describes how exogenous factors would affect the rate of inflation forecast for 2 years ahead if such risks materialized. Each bar in the graph illustrates the magnitude and direction of the effect of these factors, i.e., the expected impact in alternative forecast scenarios. This impact is calculated as the difference between the inflation forecast in the baseline scenario and inflation projections in several scenarios considering different assumptions, multiplying this difference by the probability of occurrence assigned to such alternative assumptions. The sum of the bars –the risk balance– indicates how these risk factors as a whole would divert inflation from the baseline scenario in the medium term.

CONCLUSION

100. The recent and projected evolution of the output gap and inflation expectations would favor inflation's convergence to the target range. Moreover, the cost pressures generated by price increases in some commodities are expected to decline in the short term and conditions in the local supply of food products are expected to reverse. With this, inflation would decline from its current level above the target range to a level of around 3 percent in 2012 and to around 2 percent in 2013. The balance of risks is neutral and shows lower probabilities of downward risks than in our Inflation Report of June.

GDP will continue registering growth rates close to its potential level, with a strong evolution of domestic demand that will offset the effects of the global economic slowdown on Peru's economy.

The Central Bank will continue to oversee global and domestic economic developments as well as inflation expectations to adjust, if required, its monetary stance to ensure inflation's convergence to the target range.