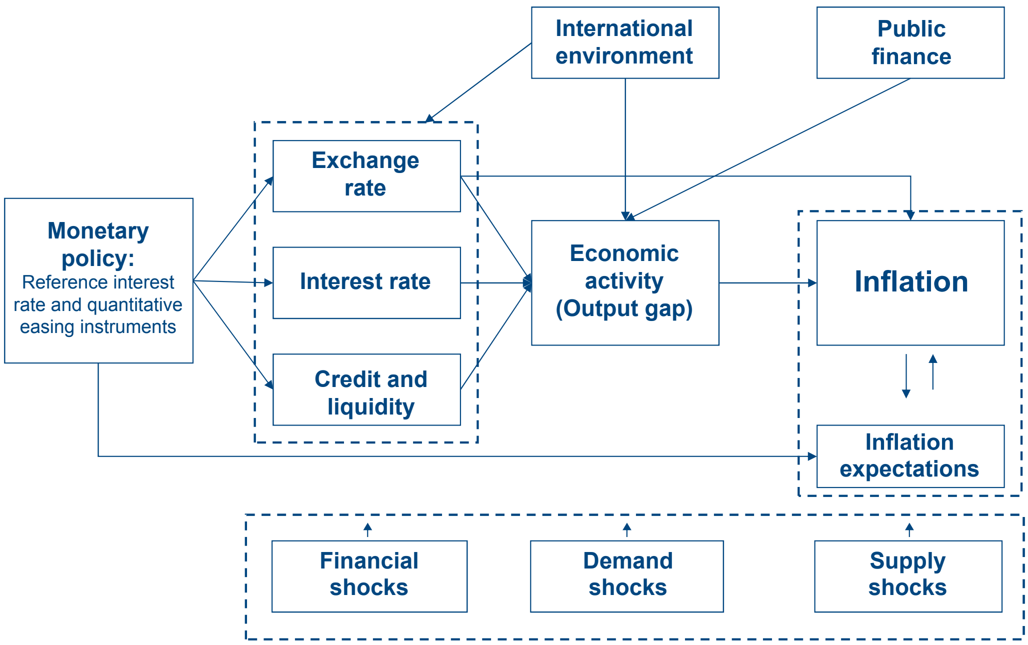
# INFLATION REPORT:

## Recent trends
## and macroeconomic forecasts 2013-2015

## *June 2013*




Central Reserve Bank of Peru
441-445 Antonio Miro Quesada. Lima 1
Telephone: 613-2000 - Fax: 613-2525
Mail: webmaster@bcrp.gob.pe

INFLATION REPORT
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CENTRAL RESERVE BANK OF PERU

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## CONTENT



**BOXES**



This ***Inflation Report*** was drawn up using data on the balance of payments at the first quarter of 2013, data on the gross domestic product and monetary accounts at April 2013, and data on the operations of the non-financial public sector, inflation, financial markets, and the foreign exchange rate at May 2013.

# 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 September 2013.

# Summary

i. Several new developments and risks unfolded in the **world economy** between April and June 2013. On the financial side, markets began to anticipate that the Federal Reserve would start withdrawing monetary stimulus in the United States, which led to an increase in the interest rates of developed countries' bonds and to a strengthening of the dollar.

On the side of economic indicators, the most important event for our economy was the slowdown that economic activity showed again in China in the first quarter, which was possibly the main cause of the fall in the prices of minerals (in addition to the liquidation of speculative positions) and of an increase of sovereign risk and the depreciation of the currencies of emerging countries.

In the group of developed economies, the United States continues showing a gradual but sustained recovery and Japan is growing at higher than expected rates as a result of the recently implemented monetary and fiscal stimuli. On the other hand, economic activity in the Eurozone has continued contracting, and in the emerging economies, growth in the first quarter has been lower than expected in most cases. These developments have taken place in a context of low inflation pressures worldwide.

In this context, the forecast on global growth in 2013 has been revised slightly downwards from our previous projection of 3.2 percent (Inflation Report of March) to 3.0 percent, in line with the data registered in China and in some Eurozone economies. The baseline scenario continues considering that expansionary monetary conditions will be maintained in developed economies, which would favor a recovery in the second half of the year, even though expectations of an earlier withdrawal of the FED's asset purchase program have increased, as mentioned above. Global growth rates of 3.7 and 4.0 percent are estimated for 2014 and 2015, respectively.

The projected levels of **terms of trade** in the period 2013 - 2015 maintain the declining trend observed since 2012, in line with the lower growth of China in this period. In the following years, since the terms of trade would show a moderate decline (less than an accumulated rate of 5 percent in the following 3 years), the level of terms of trade would still be quite higher than the average long-term trend rates.

The international environment had an impact on our economy mainly through lower terms of trade. The economy continued showing a pace of economic growth close to its potential growth rate due to the dynamism of domestic demand, which continued growing at rates of over 8 percent.

ii. In the first quarter of 2013 the **GDP** grew 4.8 percent compared to the same period in 2012, registering a lower rate than in previous quarters. This result was associated both with supply factors, which resulted in lower growth rates in primary sectors such as fishing, industries based on the processing of raw materials, and mining and hydrocarbons, and with a statistical effect caused by the fact that there were fewer business days in the first quarter of this year than in the previous one (leap year and Holy Week effect).

    The GDP growth projection for 2013 has been revised downwards from 6.3 percent (Inflation Report of March) to 6.1 percent given the fall observed in exports in the first quarter and the lower world growth projected. On the other hand, a GDP growth rate around the economy's potential level of growth (6.3 percent) is still considered in the central forecast scenario.

    Moreover, considering the onset of some investment projects, especially in the mining sector, a higher growth rate (6.8 percent) is estimated for 2015.

iii. The **current account deficit** in the balance of payments continued rising as a result of lower terms of trade, some transitory supply factors, lower external demand, and the growth of imports due to the dynamism of domestic demand. In the first quarter the current account recorded a deficit of 5.2 percent of GDP (US$ 2.7 billion), showing a higher level than that observed in the first quarter of 2012 when the deficit was 1.4 percent. The current account deficit continued being largely funded by long-term capital inflows (much of them destined to export projects, mostly mining projects), which amounted to US$ 7 billion in the first quarter (a figure equivalent to 13.7 percent of GDP).

    Considering the lower trade surplus foreseen for 2013, the current account deficit estimated for this year has been revised upwards from 4.0 percent of GDP in our previous Report to 4.4 percent of GDP. In 2014 the deficit in the current account is forecast to be higher than the one estimated in our Report of March –4.6 percent instead of 3.9 percent– due to the anticipated deterioration of terms of trade as a result of the slower recovery of the world economy. In 2015 the current account deficit is expected to decline to 4.3 percent of GDP due to the recovery of exports associated with the onset of mining projects such as Toromocho and Las Bambas, the effect of which would add onto higher non-traditional exports which would reflect the higher growth rates registered by our trading partners.

iv. Lower global growth and lower export prices would translate into lower fiscal revenues than the ones estimated in our Report of March. The expenditure of the general government is also estimated to grow at rates above the growth rate of the output in the following three years, in line with what has been foreseen in the Multi-Annual Macroeconomic Framework. As a result, the **surplus of the non-financial public sector** would show a declining path going from 2.2 percent in 2012 to 0.7 percent in 2013 and to 0.5 percent in 2015.

v. In line with our March report projections, in May **inflation** in the last 12 months continued to be within the target range with a rate of 2.46 percent, which reflected better supply conditions and the reduction in the prices of imported inputs. Inflation expectations continued declining and remained within the target range. In this context, the Board of the Central Bank decided to maintain the benchmark rate at 4.25 percent with a neutral bias in the BCRP monetary policy communiqués.

vi. The aim of the adjustments implemented in terms of reserve requirements was to maintain an orderly expansion of liquidity and credit in a context of unprecedented capital inflows in our economy. In view of the new international financial developments and given the composition of credit expansion, the latest reserve requirement measures have been oriented to encourage the use of credit in local currency, especially in the case of credit such as mortgage loans, which are highly risky when these loans are in foreign currency.

vii. In the central forecast scenario, inflation is expected to remain within the target range in all the forecast horizon (2013-2015) with an average rate of 2 percent. No major inflationary pressures associated with increases in the prices of commodities or with pressures in terms of aggregate demand are foreseen in this scenario, and monetary policy actions are expected to maintain inflation expectations anchored within the target range.

viii. Given that the effects of risk factors that generate downward pressures on inflation outweigh the effects of risk factors that generate upward pressures, the balance of these risks shows a **downward bias** for the projection of inflation in the 2013-2015 horizon. With the information available to date, the probability that inflation will be below the forecast considered in the baseline scenario is greater than the probability that inflation will be above the forecast level.

**INFLATION FORECAST: 2013-2015**
(12 months % change)


ix. The **downward risks** in the inflation forecast are external factors associated with the possible deterioration of the world economy, including a stronger slowdown in the growth of the emerging economies, and internal factors associated with the dynamics of expectations of business confidence.

**a. Deterioration of the international environment**

A lower rate of global growth than the one estimated in our Inflation Report of March is considered in the baseline scenario for 2013 and 2014. The recovery in the global economy expected to take place in the second half of this year could be interrupted by some negative event in any block of countries or important economy. The probabilities that the United States will go into recession or that the recession will deepen in Europe and Japan have declined compared to the probabilities considered in our last report. However, the probabilities that key emerging economies such as China may experience a greater slowdown have risen. The deepening of these risk conditions would entail lower global dynamism and a weakening of external demand, which would affect the domestic economy through financial and trade channels.

Since the end of 2013 it has been expected that the FED will start a progressive withdrawal of monetary stimulus. An earlier and less gradual withdrawal could bring about a rapid and disorderly adjustment in the exchange rate and in the interest rates of Treasury bonds in our economy given the high participation of non-resident investors in these domestic securities.

Should these risks materialize, the Central Bank would use the significant amount of international reserves the country has, as well as various liquidity injection mechanisms, both in national currency and in foreign currency, to offset the impact of these shocks on domestic financial conditions. If required, the Central Bank would respond by easing monetary conditions.

**b. Slowdown of domestic demand**

Business confidence is an important determinant of private investment, so if it deteriorated it would contribute to a lower dynamism in domestic demand, which would result in a lower output gap and consequently in lower inflation.

Should these risks materialize, the Central Bank would respond easing monetary conditions to maintain inflation within the target range.

On the other hand, there are scenarios of **upward risk** for inflation associated with the dynamics of commodity prices and other prices sensitive to supply factors.

**c. Imported inflation and adverse climate conditions**

The baseline scenario assumes a relative stability in the prices of commodities next year. In the external front, the risks considered include the risk of higher international prices of crude oil and its derivatives, and the risk of having food prices to which the products of the domestic CPI basket are particularly sensitive.

On the other hand, at the domestic level, the risk of facing adverse weather conditions that could affect the normal development of the production and supply of food products (mainly farming products) remains.

In this scenario, the Central Bank would adjust its monetary position only if these inflationary shocks were to affect and increase economic agents' expectations of inflation.

## SUMMARY OF INFLATION REPORT FORECASTS

| | 2012 | 2013 1/ | | 2014 1/ | | 2015 1/ |
|---|---|---|---|---|---|---|
| | | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **Real % change** | | | | | | |
| 1. GDP | 6.3 | 6.3 | 6.1 | 6.3 | 6.3 | 6.8 |
| 2. Domestic demand | 7.4 | 6.8 | 7.0 | 6.6 | 6.6 | 6.5 |
| a. Private consumption | 5.8 | 5.7 | 5.5 | 5.7 | 5.5 | 5.5 |
| b. Public consumption | 10.5 | 10.1 | 11.8 | 6.6 | 4.0 | 4.2 |
| c. Private fixed investment | 13.6 | 8.8 | 8.8 | 8.2 | 8.2 | 7.9 |
| d. Public investment | 20.8 | 15.0 | 13.2 | 11.4 | 17.0 | 14.6 |
| 3. Exports (goods and services) | 4.8 | 5.1 | 1.6 | 7.9 | 8.5 | 11.7 |
| 4. Imports (goods and services) | 10.4 | 7.8 | 7.0 | 8.9 | 8.9 | 8.9 |
| 5. Economic growth in main trading partners | 2.7 | 2.7 | 2.6 | 3.3 | 3.2 | 3.4 |
| **Memo**: | | | | | | |
| Output gap 2/ (%) | 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 | 2.6 | 1.5 - 2.5 | 1.5 - 2.5 | 1.5 - 2.5 | 1.5 - 2.5 | 1.5 - 2.5 |
| 7. Average price of crude oil | -0.9 | -1.7 | -0.3 | -0.5 | -0.7 | -2.3 |
| 8. Nominal exchange rate 3/ | -4.8 | -2.0 | 0.0 | -1.3 | -0.3 | -0.1 |
| 9. Real multilateral exchange rate 3/ | -7.3 | -3.3 | -2.1 | -1.1 | -0.5 | 0.3 |
| 10. Terms of trade | -4.9 | 0.3 | -2.3 | 0.0 | -1.2 | -0.7 |
| a. Export price index | -3.3 | -1.0 | -3.4 | 0.7 | -0.9 | 0.5 |
| b. Import price index | 1.7 | -1.3 | -1.2 | 0.7 | 0.3 | 1.2 |
| **Nominal % change** | | | | | | |
| 11. Currency in circulation | 18.3 | 15.5 | 16.0 | 13.2 | 13.4 | 13.0 |
| 12. Credit to the private sector 4/ | 15.5 | 14.5 | 14.0 | 12.0 | 13.0 | 11.5 |
| **% GDP** | | | | | | |
| 13. Gross fixed investment rate | 26.6 | 27.5 | 27.7 | 28.2 | 28.7 | 29.3 |
| 14. Current account of the balance of payments | -3.6 | -4.0 | -4.4 | -3.9 | -4.6 | -4.3 |
| 15. Trade balance | 2.3 | 1.3 | 0.3 | 1.2 | 0.0 | 0.7 |
| 16. Gross external financing to the private sector 5/ | 10.4 | 8.1 | 10.2 | 5.9 | 7.4 | 6.3 |
| 17. Current revenue of the general government | 21.6 | 21.6 | 21.3 | 21.6 | 21.4 | 21.5 |
| 18. Non-financial expenditure of the general government | 18.6 | 19.6 | 19.6 | 19.7 | 19.8 | 20.0 |
| 19. Overall balance of the non-financial public sector | 2.2 | 1.0 | 0.7 | 1.0 | 0.6 | 0.5 |
| 20. Total public debt balance | 19.7 | 18.2 | 17.7 | 17.2 | 16.9 | 15.8 |

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

1. Since March –when our last Inflation Report was published–, the world economy has shown moderate growth, although the levels of growth differ at the level of countries and regions. In the group of developed economies, United States continues showing a gradual recovery while Japan is growing at higher levels than expected in response to the recently implemented monetary and fiscal stimuli. In contrast, the Eurozone has continued showing negative growth rates while in the group of the emerging economies, China's growth in Q1 was lower than expected. These developments have taken place in a context of low inflationary pressures.

   The forecast of global growth in 2013 has been revised slightly downwards –from 3.2 percent to 3.0 percent–, in line with the data registered in Q1, particularly in China and some Eurozone countries. As in our previous report, the maintenance of monetary conditions in developed economies is expected to favor a recovery of global growth in the second half of the year, although expectations that the FED will withdraw its asset-purchase programs earlier than expected have increased compared to our previous report. Rates of global growth of 3.7 and 4.0 percent are estimated for 2014 and 2015, respectively.

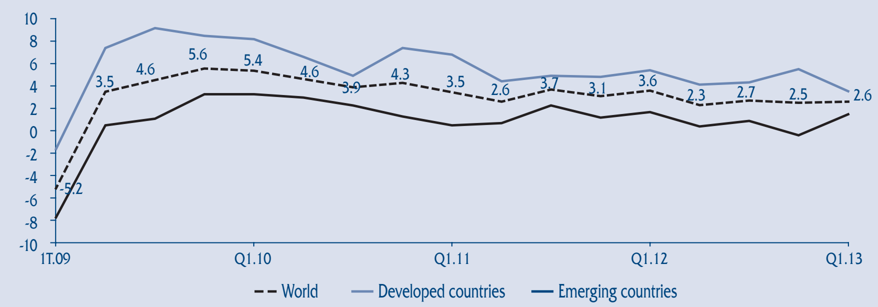
   This forecast is coupled by a reduction of the downside growth risks. The gradual normalization of conditions in the developed countries with debt problems and partial agreements about fiscal issues in the United States reduce the risks that come from the developed economies. However, some uncertainty factors remain. In the United States, an earlier-than-expected withdrawal of the accommodative monetary policy of the FED could affect the recovery of economic activity, particularly in the real estate sector, as well as negotiations on the debt limit to be resumed in Q4, which could generate some uncertainty as in 2011. In the Eurozone, the fragmentation of credit markets and the lack of progress in terms of the banking union could imply a slower growth in the economies with debt problems compared with the baseline scenario.

   In the group of the emerging economies, the countries which have been experiencing strong capital inflows and high current account deficits could be affected by an earlier-than-expected withdrawal of monetary stimulus by the FED. On the other hand, the risk of a sudden correction in the property market in China remains given the strong growth of prices despite the measures taken by the government.

## Global Growth

2. GDP data in Q1-2013 and indicators for the last few months confirm that, in aggregate terms, the global economy is showing moderate growth. The world output grew at around 2.6 percent in the first quarter. On average, developed economies show stronger growth than in Q4-2012 due to the evolution of Japan, whereas on the other hand the growth rate of emerging economies has dropped mainly due to the evolution of the economy in China and India.

**Graph 1**
**GDP: SEASONALLY ADJUSTED QUARTERLY GROWTH**
(% annualized rates)




Source: JP Morgan.

Other monthly indicators confirm this moderate recovery over the past few months. The Global Manufacturing Purchasing Managers Index (PMI) remains slightly above 50 (which indicates a slight expansion) and the Services PMI continues showing a sustained recovery.

3. In 2013 the world economy is estimated to grow 3.0 percent, a slightly higher rate than the one estimated in our Inflation Report of March. This result is explained by the downward revision of expected growth in some developed economies, like Germany and France, and in some emerging economies like China and India which show lower data than expected in the first quarter. This downward revision is partially offset by higher expected growth in Japan, where economic activity, especially consumption, has been recovering more than expected. It is worth pointing out that this forecast assumes that most economies would gradually recovering from the second semester. Growth rates of 3.7 percent and 4.0 percent are estimated for 2014 and 2015.

**Table 1**
**WORLD GDP GROWTH**
(Annual % change)

| | 2012 | 2013* | | 2014* | | 2015* |
|---|---|---|---|---|---|---|
| | | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **Developed countries** | **1.2** | **1.3** | **1.2** | **2.0** | **2.0** | **2.3** |
| **Of which:** | | | | | | |
| 1. United States | 2.2 | 1.9 | 1.9 | 2.4 | 2.4 | 3.0 |
| 2. Eurozone | -0.6 | -0.3 | -0.6 | 1.1 | 1.0 | 1.3 |
| Germany | 0.7 | 0.6 | 0.3 | 1.5 | 1.5 | 1.5 |
| France | 0.0 | -0.2 | -0.4 | 1.0 | 1.0 | 1.2 |
| Italy | -2.4 | -1.0 | -1.6 | 0.5 | 0.6 | 0.9 |
| Spain | -1.4 | -1.5 | -1.6 | 0.4 | 0.4 | 0.9 |
| 3. Japan | 2.0 | 1.0 | 1.5 | 1.4 | 1.4 | 1.1 |
| 4. United Kingdom | 0.3 | 1.1 | 0.9 | 1.5 | 1.5 | 1.8 |
| **Developing countries** | **5.1** | **5.3** | **5.0** | **5.7** | **5.5** | **5.7** |
| **Of which:** | | | | | | |
| 1. Developing Asia | 6.9 | 7.0 | 6.9 | 7.4 | 7.3 | 7.3 |
| China | 7.8 | 8.0 | 7.7 | 8.3 | 8.0 | 8.0 |
| India | 5.0 | 6.3 | 6.0 | 6.9 | 6.9 | 6.9 |
| 2. Central and Eastern Europe | 1.6 | 2.3 | 2.0 | 3.1 | 3.2 | 3.2 |
| 3. Latin America and the Caribbean | 3.0 | 3.5 | 3.3 | 3.8 | 3.7 | 3.8 |
| Brazil | 0.9 | 3.2 | 2.9 | 3.8 | 3.6 | 4.0 |
| **World Economy 1/** | **3.1** | **3.2** | **3.0** | **3.8** | **3.7** | **4.0** |
| **Memo:** | | | | | | |
| Peru's trading partners 2/ | 2.7 | 2.7 | 2.6 | 3.3 | 3.2 | 3.4 |

Source: IMF, official sources, and BCRP (Forecast).
1/ GDP weighted measured at purchasing power parity.
2/ Basket of Peru's 20 main trading partners.
* Forecast.

This forecast is accompanied by a reduction of the downside risks in the growth of the developed economies, based on the gradual normalization of conditions in the developed countries with debt problems and on the partial agreements reached in terms of the fiscal issues in the United States. However, other risks associated with the slowdown of growth in China, the fall in commodity prices, and eventual outflows of external capitals in the emerging economies are observed.

**Graph 2**
**GDP GROWTH**


* Forecast.
Source: BCRP.

4. **United States** continues showing moderate sustained growth. In Q1, GDP grew 2.4 percent (annualized quarterly rate), as a result of which, in contrast with what is observed in other developed economies, this country's output has exceeded by 3.2 percent the level registered prior to the crisis. Recent indicators –such as employment, confidence, and the real estate index– show that this trend would continue in the months of April and May. Moreover, the index of Leading Economic Indicators (LEI), which rose in May to its highest level since June 2008, signals better conditions in the economy in the future.

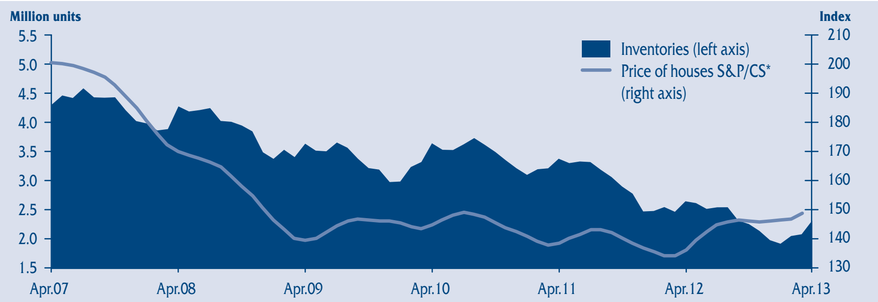
   This recovery is still being supported mainly by the greater dynamism of consumption, which in Q1 grew 3.4 percent (annualized quarterly rate). Although personal consumption expenditure (PCE) fell slightly in April, consumer confidence has been recovering and reached pre-crisis levels in May. On the other hand, retail sales have grown, although at a slow pace.

5. The improvement in consumption basically reflects a recovery in the labor market and households' greater wealth, which would have offset the negative impact of the increase in income taxes implemented in January of this year as part of the measures approved by Congress in the framework of fiscal negotiations.

    a. A total of 324 thousand non-farming new jobs were created in the months of April and May, as a result of which new jobs accumulated an increase of 942 thousand jobs in the year. First-time requests for unemployment benefits continued showing a downward trend, even though the unemployment rate increased slightly from 7.5 to 7.6 percent due to an increase in the number of people seeking employment. These figures confirm the gradual recovery observed in the labor market since early 2010.

    b. The data available at Q1 shows that household wealth has increased 4.5 percent to a record level. This greater wealth is mainly explained by the improvement in the price of financial assets and properties, effect which has continued to be seen in the months of April and May. In March the increase in the prices of houses has been the highest annual rate in 7 years (Source: SP/Case-Shiller).

**Graph 3**
**USA: PRICE OF HOUSES (S&P/CS) AND INVENTORIES**



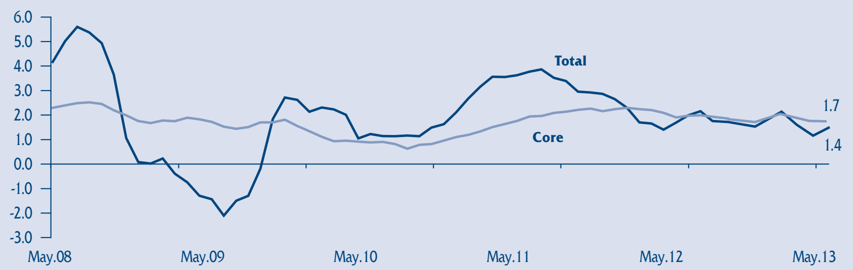

* S&P/CS: S&P/Case-Shiller Home Price Index.
Source: Bloomberg.

Households' debts have fallen 0.6 percent per annum, a lower level of mortgage debt being observed as a result of their amortization. On the other hand, student and car loans have increased.

On the investment side, residential investment continues to improve despite having slowed down compared to the previous quarter due to a colder weather. In May, new constructions increased 6.8 percent monthly; the number of building permits fell after having increased more than expected in April, and builders confidence improved reaching a level above 50 for the first time since April 2006, which suggests that the construction sector would continue recovering in the coming months. On the other hand, non-residential investment slowed down in Q1 (with a growth rate of 2.2 percent), after having grown 13.2 percent in the previous quarter, in line with the stagnation of the manufacturing sector as a result of weak external demand.

6. The favorable evolution of economic activity has increased expectations of an earlier withdrawal of monetary stimulus in a context of low inflation. The CPI in May showed an annual rate of 1.4 percent and core inflation registered an annual rate of 1.7 percent. This is explained in part by the correction in commodity prices, led by a drop in the price of oil.

**Graph 4**
**USA: CPI**
(12 month % change)




Source: Bloomberg.

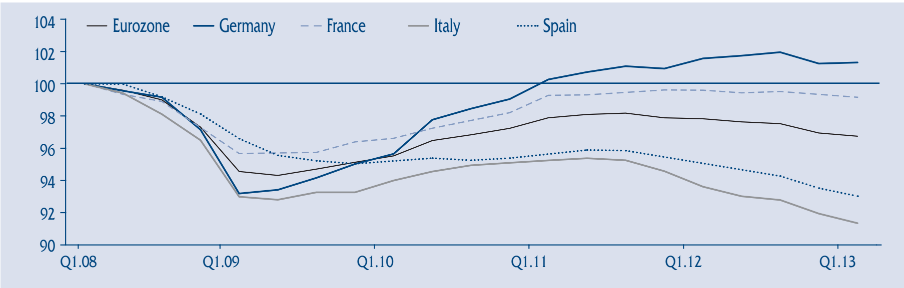
7. In this context, in its June policy meeting, the FED decided to maintain its expansionary policy, highlighting the improvement observed in the labor market and the reduction of the downside risks for this market and the economy, and said that it would increase or reduce its asset-purchase program according to the evolution of the labor market and inflation. The Chairman of the FED, Ben Bernanke, suggested that if the economy's performance was in line with the FED's projections, the FED would reduce its asset-purchase program by the end of 2013 and would end it by mid-2014. Moreover, the minutes of the meeting showed that some participants considered that the FED could start reducing the asset purchase program soon depending on the recovery of the economy.

8. In line with these developments, it is estimated that the US economy would grow 1.9 percent in 2013 and 2.4 percent in 2014. In 2015 it would grow 3.0 percent. Residential investment would show the highest growth rate and investment in equipment would recover, in line with the growth prospects and with favorable corporate profits. Consumption, on its side, would continue showing a gradual recovery.

The downside growth risks include an early withdrawal of the monetary stimulus, which may affect particularly the recovery of the real estate sector. In addition, the risks associated with the fiscal issue persist, although they have declined. The US Treasury estimates that an agreement about the debt limit would be reached by September or October, supported by the upward trend of tax revenues, the expected extraordinary payment of US$ 60 billion of Fannie Mae and Freddie Mac in June, and the beginning of "extraordinary" measures that would be implemented since May. On the other hand, the Congressional Budget Office (CBO) estimates that an agreement about the debt limit would be reached by October or November.

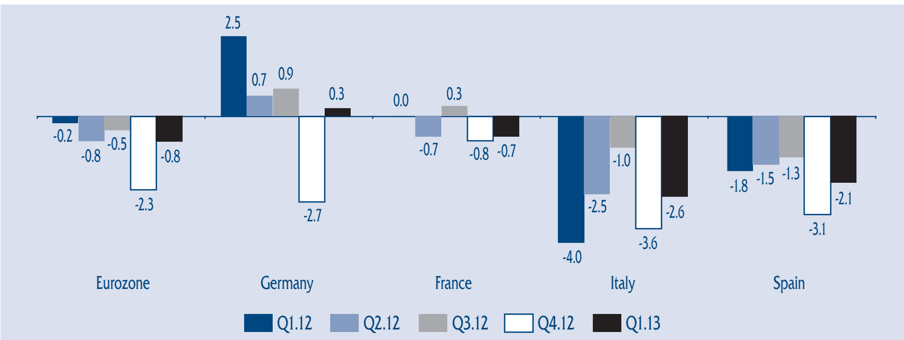
9. Year-to-date, activity in the **Eurozone** has remained stagnant. In Q1, GDP shrank for the sixth consecutive quarter, basically due to the balance sheet adjustments of the public sector implemented since mid-2010 and to the balance sheet adjustments implemented in the private sector (banks, non-financial corporate sector, and households) since 2011. As a result of this, the region has not been able to recover the output levels registered prior to the financial crisis of 2008.

**Graph 5**
**EUROZONE: GDP LEVEL**
(Q1.08 = 100)




Contrasting with what happened at the time of our previous report, this stagnation in the region today is coupled by less differences among countries. A slowdown of growth in the major economies, particularly in Germany, has added onto the weakness of the European economies with debt problems. Germany grew only 0.3 percent (annualized quarterly rate) in Q1. On the other hand, Spain and Italy have reduced their pace of contraction from rates of over 3 percent (Q4-2012) to rates around 2 percent.

**Graph 6**
**EUROZONE: QUARTERLY GROWTH**
(Seasonally adjusted annualized quarterly rates)



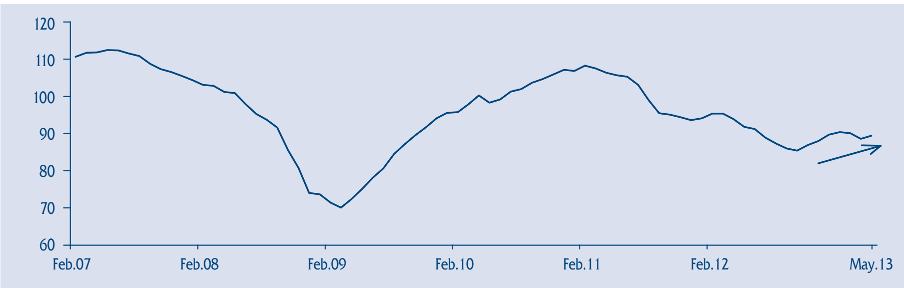
Recent indicators of activity, such as the PMI of May 2013, suggest that stagnation would continue affecting the Eurozone in Q2-2013. Despite the improvement observed since April, services and manufacturing activities remain in the contraction area, where they have been for 16 and 22 consecutive months, respectively. Moreover, the European Commission indices of economic confidence in the region show some recovery in recent months, although they are still well below their levels of 2009.

**Table 2**
**JP MORGAN: PURCHASING MANAGERS INDEX**

| Eurozone | Dec.10 | Dec.11 | Dec.12 | Jan.13 | Feb.13 | Mar.13 | Apr.13 | May.13 |
|---|---|---|---|---|---|---|---|---|
| **Composite** | **55.5** | **48.3** | **47.2** | **48.6** | **47.9** | **46.5** | **46.9** | **47.7** |
| **Services** | **54.2** | **48.8** | **47.8** | **48.6** | **47.9** | **46.4** | **47.0** | **47.2** |
| Germany | 59.2 | 52.4 | 52.0 | 55.7 | 54.7 | 50.9 | 49.6 | 49.7 |
| France | 54.9 | 50.3 | 45.2 | 43.6 | 43.7 | 41.3 | 44.3 | 44.3 |
| Italy | 50.2 | 44.5 | 45.6 | 43.9 | 43.6 | 45.5 | 47.0 | 46.5 |
| **Manufacturing** | **57.1** | **46.9** | **46.1** | **47.9** | **47.9** | **46.8** | **46.7** | **48.3** |
| Germany | 60.7 | 48.4 | 46.0 | 49.8 | 50.3 | 49.0 | 48.1 | 49.4 |
| France | 57.2 | 48.9 | 44.6 | 42.9 | 43.9 | 44.0 | 44.4 | 46.4 |
| Italy | 54.7 | 44.3 | 46.7 | 47.8 | 45.8 | 44.5 | 45.5 | 47.3 |

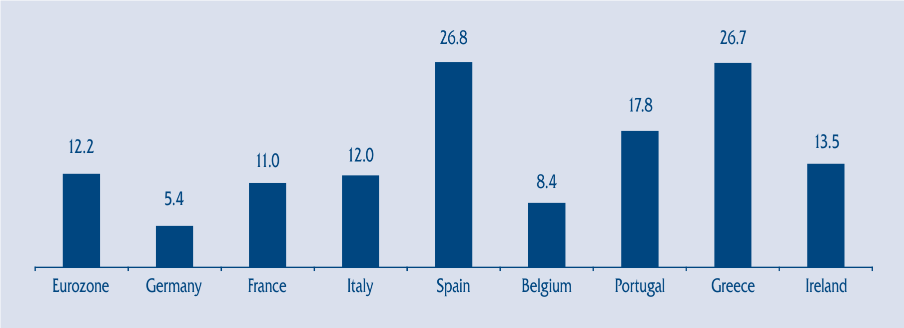
Source: Bloomberg.

**Graph 7**
**EUROZONE: INDICES OF ECONOMIC CONFIDENCE**



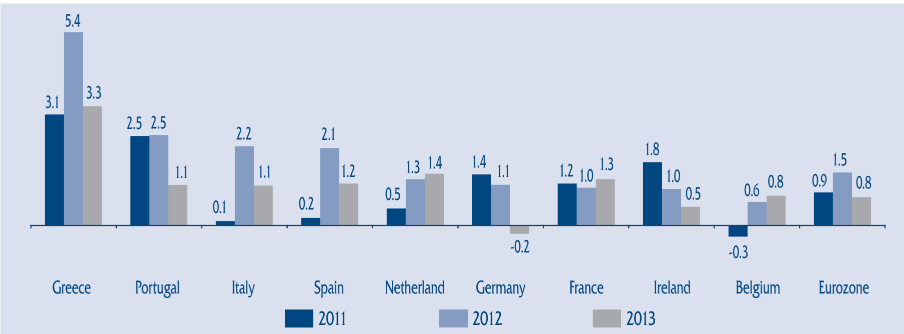

10. The weakness of the region is reflected in high levels of unemployment, particularly youth unemployment –Greece and Spain register youth unemployment rates of over 50 percent–, which has generated strong concern among European leaders.

**Graph 8**
**EUROZONE: UNEMPLOYMENT RATE (APRIL 2013, %)**




In this context, the European Union (EU) has refocused its requirements, from drastic measures of fiscal adjustment by to advances in reforms that boost long-term growth. Several countries have been able to extend by one or two years more the period established for them to meet the fiscal targets committed. Spain and France are the most recent examples of the change in the leaders' concern. Both countries have been granted an extension of two years –from 2014 to 2016– to achieve their fiscal deficit goals. According to IMF estimates (WEO, April 2013), the Eurozone would record a lower fiscal adjustment this year (less than 1 pp. of GDP versus 1.5 pp. in 2012).

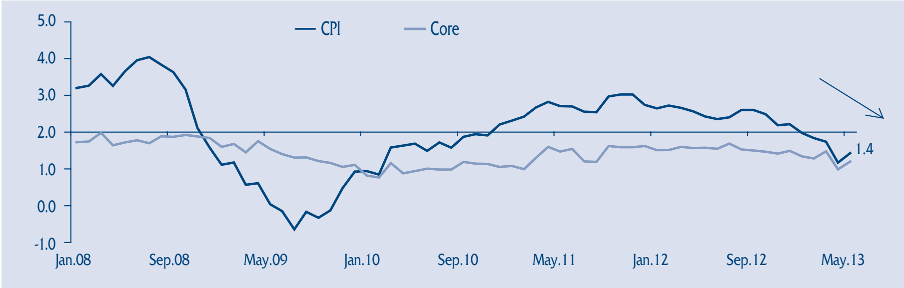
**Graph 9**
**EUROZONE: STRUCTURAL FISCAL ADJUSTMENT**
(% potential GDP)




Source: IMF, April 2013.

11. Given that economic weakness has added to the context of low inflationary pressures, the ECB decided to cut its rate by 25 bps to 0.50 percent at its meeting of May. The market does not rule out further rate cuts in the coming months of this year.

**Graph 10**
**EUROZONE: CPI**
(12 months % change)




12. In this context, the Eurozone is estimated to show a contraction of 0.6 percent in 2013, a higher contraction than the one estimated in our March report (-0.3 percent). In addition to this, the growth rate projected for 2014 has been slightly reduced –from 1.1 to 1.0 percent– and the growth rate estimated for 2015 is 1.3 percent.

    By countries, the most important corrections this year would be seen in Germany, France, Italy, and, to a lesser extent, in Spain. The region is expected to begin to grow as from the second half of the year, basically as a result of better financial conditions in several economies of the Eurozone.

13. Sovereign financial conditions have improved since June 2012 due to the non-conventional policy measures of the ECB (which corrected the problem of shortage of funds) and to the policies of European leaders supporting the banking union. Thus, the sovereign yields and credit spreads have declined significantly. The issuance of sovereign bonds of some peripheral countries have been significant, especially of long-term bonds.

    Better conditions for European banks have added to this improvement in sovereign financing. The latest ECB survey on bank lending conditions shows that most banks consider that there are better financing conditions today. Moreover, the flow of deposits to the periphery and banks' prepayments of 3-year loans[1] to the ECB (LTROs) suggest less fragmentation in financial markets.

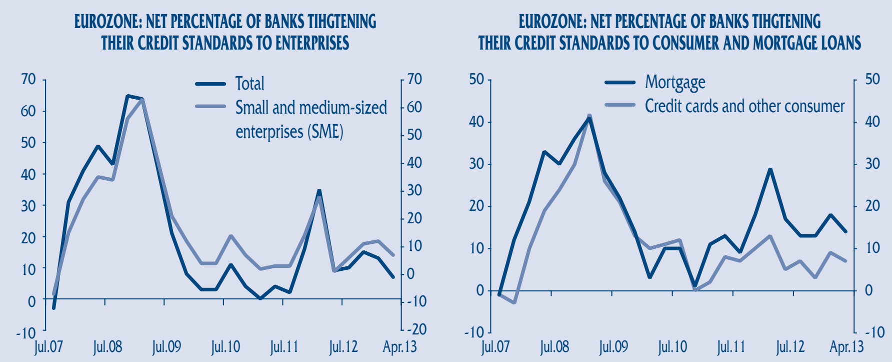
14. However, the correction in financial markets is still not reflected in bank credit markets, which are the main financing means for small and medium-sized businesses in the Eurozone. The region's still-fragmented banking market is the main factor explaining the contraction of activity and the main risk that could cause stagnation to extend longer than expected.

1 These loan prepayments have reduced excess liquidity from the maximum level of € 812 billion observed in March 2012 to € 258 billion (data at April 2013).

Recent data from the ECB (at April 2013) show that bank lending has accelerated its annual contraction. Loans to the private sector have declined 0.5 percent and lending to non-financial corporations have fallen 3.0 percent per annum. At the country level, the fall of credit concentrates on peripheral countries: Spain, Italy, Portugal, Ireland, and Greece have reported negative rates. On the other hand, the evolution of the credit has been positive in Germany and France.

Credit rates for small and medium-sized companies continue to differ considerably by countries. While the spread between the lending rate for loans of less than one million euros (proxy of the loan for SMEs) does not exceed 50 bps in France (compared to the rate in Germany), in Italy and Spain this spread is around 300 and 350 bps, respectively. Moreover, the ECB survey on credit conditions carried out in April showed that banks maintain their tight financing conditions, especially in the case of credit for SMEs. In addition, banks reported that demand for credit remains stagnant, particularly credit for investment.

**Graph 11**




Source: BCE, Bank lending survey, April 2013.

15. The **United Kingdom** shows signs of a slow recovery. In Q1, consumption recorded the lowest growth rate in a year and a half, investment fell for the third consecutive quarter, and exports and imports fell for the second consecutive quarter. It is estimated that the economy would recover slightly in the second semester, supported by the real estate market. The prices of houses have recovered 1.1 percent so far this year and this trend is expected to continue due to the extension of the Funding for lending scheme. Consumer and business confidence have improved recently and an improvement is also observed in activity in services, manufacturing and construction. In line with these developments, the economy is estimated to grow 0.9 percent in 2013 and to show higher growth rates in 2014 (1.5 percent) and in 2015 (1.8 percent).

16. **Japan** would be showing a higher-than-expected recovery. Recording the highest rate in three quarters, the economy grew 4.1 percent (annualized quarterly rate) in Q1. The contributions of consumption (3.7 percent), residential investment (7.6 percent), and exports (16.1 percent) are worth pointing out. In addition to this, monthly indicators show an improvement in consumer confidence which would consolidate the recovery in consumption if the trend continues. On the other hand, indicators of business confidence and of machinery orders reflect some improvement in non-residential investment.

17. These developments are in line with the objectives and measures adopted by the Bank of Japan (BoJ) to strengthen growth and reverse the deflationary process. In January, the BoJ announced a 2 percent inflation target and in April it announced that it would expand its monetary base at a rate of 60-70 trillion yen per year. This monetary impulse would be supported by the fiscal stimulus announced at the beginning of the year, which would be implemented in the second semester. It should be pointed out that, according to various estimates, Japan would be the only major developed economy that would register an increase in its structural fiscal deficit in 2013.

    In line with recent indicators and with the expected impact of the measures implemented, the Japanese economy would grow 1.5 percent in 2013. This forecast, which is higher than the one estimated in our report of March, considers the consolidation of the favorable trend of consumption in the coming quarters and that private non-residential investment would have a positive contribution to growth after having registered five consecutive quarters of decline. This forecast also considers the positive impact that the depreciation of the yen would have on exports as well as the expected largest contribution of inventories after the drop registered in Q1. In 2014 and 2015, Japan is expected to grow 1.4 and 1.1 percent, respectively.

18. In **China**, the growth of GDP in Q1-2013 (7.7 percent relative to the same period in 2012) was lower than expected due mainly to the persistent weakness of global demand and the moderation of domestic demand, despite the spending-on-infrastructure program introduced by the government last year.

    The data of May confirm expectations that economic activity will continue to show a moderate pace. In general, the expansion of domestic demand was lower than expected. Moreover, foreign trade figures show a considerable decline (although this result is quite probably due not only to the deterioration in global demand, but also to the measures taken to resolve statistical distortions identified in the figures of the previous months). On the other hand, in line with the slower pace of demand, annual inflation fell to 2.1 percent. In view of these developments, China is expected to grow 7.7 percent in 2013 and to recover thereafter to 8.0 percent in 2014 and 2015.

**Table 3**
**CHINA'S ECONOMIC INDICATORS**

| | 2011 | 2012 | | | | 2013 | | |
|---|---|---|---|---|---|---|---|---|
| | Dec. | Mar. | Jun. | Sep. | Dec. | Mar. | Apr. | May. |
| Manufacturing PMI index (50 neutral level) | 50.3 | 53.1 | 50.2 | 49.8 | 50.6 | 50.9 | 50.6 | 50.8 |
| Industrial Production (12 month % change) | 12.8 | 11.9 | 9.5 | 9.2 | 10.3 | 8.9 | 9.3 | 9.2 |
| Investment in fixed assets (Annual % change) | 23.8 | 20.9 | 20.4 | 20.5 | 20.6 | 20.9 | 20.6 | 20.4 |
| Retail sales (12 month % change) | 18.1 | 15.2 | 13.7 | 14.2 | 15.2 | 12.6 | 12.8 | 12.9 |
| Exports(12 month % change) | 13.4 | 8.9 | 11.3 | 9.9 | 14.1 | 10.0 | 14.7 | 1.0 |
| Imports (12 month % change) | 11.8 | 5.3 | 6.3 | 2.4 | 6.0 | 14.1 | 16.8 | -0.3 |
| New loans (Billion yuans) | 641 | 1,010 | 920 | 623 | 454 | 1,060 | 793 | 667 |
| CPI (12 month % change) | 4.1 | 3.6 | 2.2 | 1.9 | 2.5 | 2.1 | 2.4 | 2.1 |

An emphasis of the government in the prevention of systemic risks has also been observed in recent months. Actions taken in this field include increased regulations to control the overheating of the real estate market; greater control over banks' use of higher risk asset management financial instruments; instructions to banks to improve credit rating, monitor nonperforming portfolios and limit lending to local governments given their high level of indebtedness; and increasing oversight to "shadow banking" operations (financial agents subject to less scrutiny than banks).

19. The exports of the rest of Asia's emerging economies would be affected by the depreciation of the yen and the slowdown of activity in China, as well as by Japan's lower investments. However, this effect would be offset in the countries that are part of the supply chain of Japanese exports (Malaysia and Indonesia mainly).

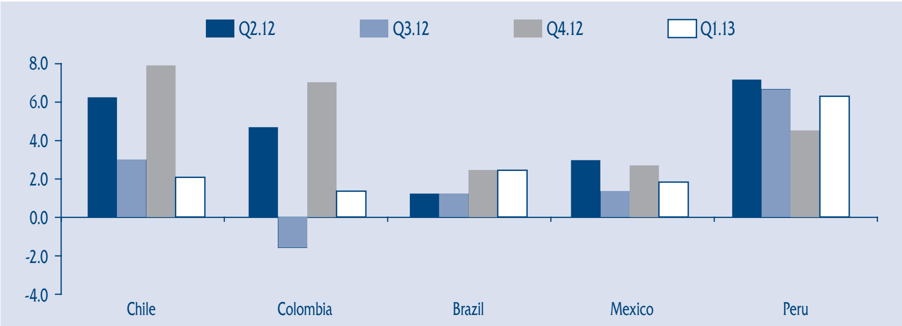
20. In **India**, activity has been growing at a lower pace than expected. In addition to a weak external demand, the economy continues to see the effect of the deterioration of the business climate on the domestic demand. The government has been promoting measures to encourage investment, but there is uncertainty about the possibility of making further progress in terms of fiscal consolidation (it is estimated that the consolidated public sector deficit in the fiscal year 2012-13 is 8.7 percent) and structural reforms. The Central Bank has recently lowered its policy rates, but has warned economic agents that inflation is still at high levels, which reduces the space for further monetary expansion. In this context, India is expected to grow 6.0 percent in 2013, supported by a moderate global recovery.

21. Year-to-day, most **Latin American** countries continue showing a lower pace of growth. This trend, which started at the end of 2012, is mainly explained by a moderation in domestic demand.

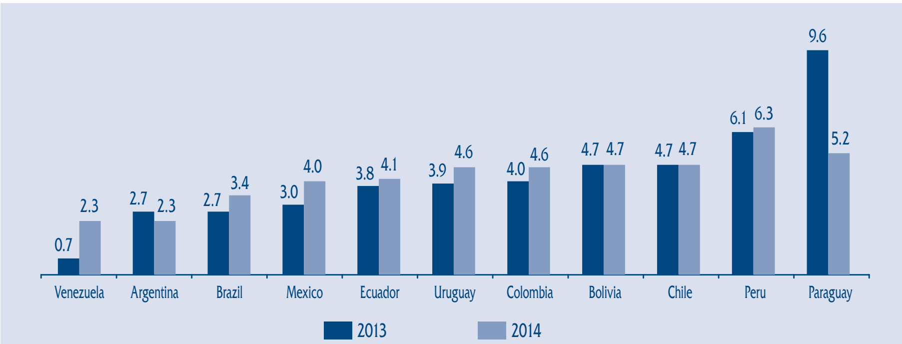
In most countries with inflation targeting, the rate of growth continued declining both as a result of a lower growth of domestic demand and of lower external stimulus. In Chile, the slowdown of domestic spending was led by investment. In Mexico, industrial activity and exports declined in line with the lower dynamism of the US manufacturing industry. In Colombia, the deceleration of growth is explained by the lower dynamism of consumption and by the drop of exports. On the other hand, a slightly faster pace of growth, led by private investment, is observed in Brazil, although this acceleration is lower than expected.

In 2013, the region is estimated to grow 3.3 percent, registering a higher rate than in 2012 (3.0 percent), although this recovery could be offset by growth in Brazil. In 2014, Latin America would grow 3.7 percent, in line with the recovery of the global economy, and in 2015 it would grow 3.8 percent.

**Graph 12**
**LATIN AMERICA: QUARTERLY GROWTH**
(Seasonally adjusted annualized quarterly rates)



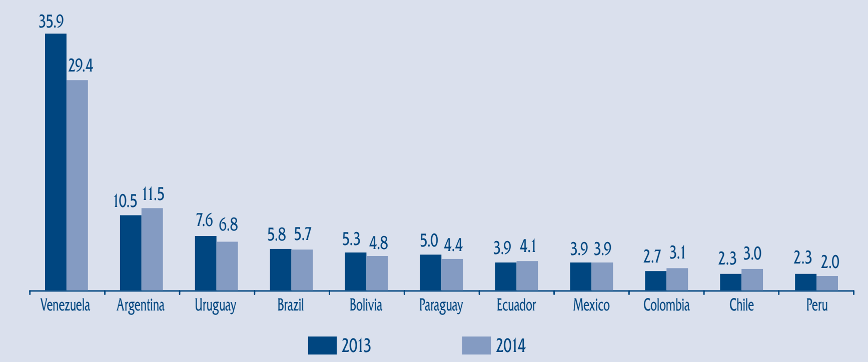

**Graph 13**
**LATIN AMERICA: GDP GROWTH FORECAST**




Source: Consensus Economics and BCRP (Peru).

As regards **inflation**, over the past two months the rates of inflation have risen in most of the countries with inflation targeting regimes, correcting the trend observed in Q1. In Brazil, the rate of inflation has been above the upper band of the inflation target (4.5 – 6.5 percent) since January, which has led the Central Bank to raise its policy rate recently. In Chile and Colombia, on the other hand, the annual rates of inflation remain near the lower band of the target range (2.0 – 4.0 percent in both cases), although it should be pointed out that the rate of annual inflation in Chile is 0.9 percent, below the lower band. On the other hand, inflation in Mexico has been above the target range (2.0 – 4.0 percent) since March due to transitory supply shocks which have led core inflation to increase as a result of the higher prices of farming products.

**Graph 14**
**LATIN AMERICA: INFLATION FORECAST**




Source: Consensus Economics and BCRP (Peru).

The forecasts on the growth of **East Europe** in 2013 have been revised down (from 2.3 to 2.0 percent) given that the larger economies in this region are experiencing a slowdown of activity. GDP growth is expected to stabilize around Q3 as a result of the better prospects for growth in Western Europe, especially in Germany and France.

Moreover, although the economy in Russia grew 1.6 percent in Q1, this rate was lower than the growth rates registered by this country since early 2010. The cooling of the economy stems mainly from the deceleration of private consumption, productive investment, and exports of crude. The prospects are on the downside for the rest of the year given that economic policy is constrained by high inflation and by a new rule enacted to control budget expenditure.

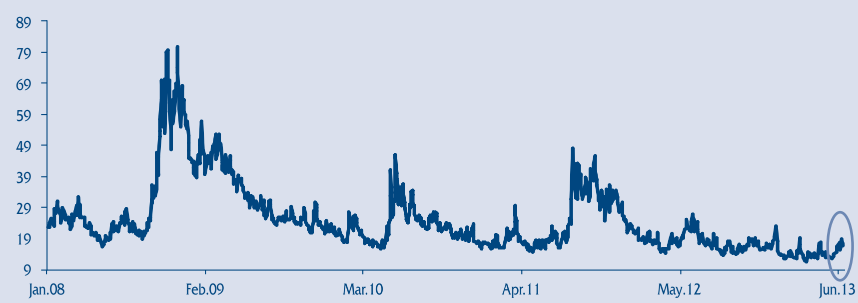
On the other hand, despite continuous interest rate cuts (200 bps since November 2012), Poland also shows weak growth rates (in Q1-2013 it registered the lowest growth rate in eleven years), having recorded negative rates in private consumption and private investment since mid-2012. Moreover, growth in Turkey also slowed down in 2012 due to the lower dynamism of consumption. The Turkish economy has been showing signals of a recovery so far this year, but this recovery shows downward risks associated with massive protests against the government. Except for Romania and Hungary, the projections on growth in the other countries of the region are on the downside compared to the estimates of our March report.

**Financial markets**

22. Conditions in financial markets remained stable until mid-March. At that time, the implied volatility index (VIX), which is a way of estimating risk aversion, had dropped to it lowest level (11.3 points) since February 2007. Since then, however, financial markets have been affected by various events which have increased risk aversion.

The last two weeks of March were marked by political uncertainty in Italy and the events that took place in Cyprus. Fears of a slowdown in world growth, and especially in China, prevailed in April after the publication of GDP growth data in the first quarter of 2013. In May, financial markets were affected by expectations of an earlier than anticipated withdrawal of monetary stimulus by the FED, and then, in the first weeks of June, by fears of slowdown in global growth following the publication of negative indicators of activity.

**Graph 15**
**RISK AVERSION COEFFICIENT: VIX (S&P'500)**
(March 2008 - June 2013)




Source: Bloomberg.

Greater volatility in financial markets has been slightly offset by some recent positive events, such as the monetary stimulus announced by the Bank of Japan (April 4), Cyprus' signing of a program with the EU/IMF, and the establishment of the new coalition government in Italy (both events took place in late April), the ECB policy rate cut (in the first week of May) and expectations of greater stimulus (during all the month of May and in beginning of June), the fiscal target easing in the European Commission, and the clarification of the Bank of Japan regarding its monetary easing program with the aim of curbing volatility in Japanese sovereign debt markets.

23. American and European **money markets** were not affected by this increased volatility and continued showing a stable evolution (as pointed out in our previous report), which reflected abundant international liquidity and banks' better conditions, especially among European banks.

In contrast, conditions in fixed income markets, particularly those of **sovereign bonds of the major developed countries**, were considerably affected. Increased expectations that the FED would withdraw monetary stimulus generated the liquidation of positions in long term bonds, particularly in the last week of May, due to fears that the FED would reduce its purchases of Treasury bonds. Furthermore, Japanese sovereign markets showed strong volatility in May due to uncertainty about whether the inflation target established by the BoJ could be achieved and uncertainty about the probability of reaching a sustainable recovery, which brought about a liquidation of Japanese debt sovereign bonds. Trying to correct this volatility, the BoJ explained its asset purchase program more clearly. It is worth pointing out that this trend has reversed recently as a result of fears of a slowdown in global economic growth, particularly in China, the USA and the Eurozone, after the publication of negative data of activity concentrated in the first week of June.

In this context, the yields on US 10-year Treasuries and 10-year bonds of Germany, Japan, and the UK have increased recently (particularly in May), whereas the better conditions observed in the Eurozone peripheral economies have implied a significant reduction in the credit spreads of various Eurozone countries. The progress made in terms of the political situation in Italy, in terms of fiscal issues in Greece, and in terms of the recapitalization of banks in Spain have implied a reduction in the sovereign spreads of these economies. It is worth pointing out that this evolution has been slightly affected by the liquidation of bonds of the major developed economies since the end of May.

**Table 4**
**SOVEREIGN SPREADS OF DEVELOPED COUNTRIES**

| | End of period | | | | | | | Difference in basis points | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec.08 | Dec.09 | Dec.10 (5) | Dec.11 (4) | Dec.12 (3) | Mar.13 (2) | Jun.13 (1) | Dec.10 (1)-(5) | Dec.11 (1)-(4) | Dec.12 (1)-(3) | Mar.13 (1)-(2) |
| **CDS (bps)** | | | | | | | | | | | |
| USA | 67 | 38 | 42 | 49 | 38 | 38 | 27 | -14 | -22 | -11 | -11 |
| United Kingdom | 107 | 82 | 74 | 98 | 41 | 45 | 47 | -27 | -51 | 6 | 2 |
| Germany | 46 | 26 | 59 | 102 | 42 | 37 | 27 | -32 | -75 | -15 | -10 |
| France | 54 | 32 | 108 | 220 | 93 | 83 | 71 | -37 | -149 | -23 | -13 |
| Spain | 101 | 114 | 350 | 380 | 300 | 302 | 252 | -99 | -129 | -48 | -50 |
| Italy | 157 | 109 | 240 | 484 | 289 | 306 | 260 | 20 | -225 | -29 | -46 |
| Greece 1/ | 232 | 286 | 1,010 | 8,786 | 4,265 | 3,890 | 1,148 | 138 | -7,639 | -3,117 | -2,742 |
| Portugal | 96 | 92 | 501 | 1,082 | 443 | 418 | 371 | -130 | -711 | -72 | -47 |
| Ireland | 181 | 158 | 609 | 724 | 220 | 190 | 160 | -449 | -564 | -60 | -30 |
| **10 Year Treasury yields (%)** | | | | | | | | | | | |
| USA | 2.21 | 3.84 | 3.29 | 1.87 | 1.76 | 1.85 | 2.13 | -116 | 26 | 37 | 28 |
| United Kingdom | 3.02 | 4.02 | 3.40 | 1.98 | 1.83 | 1.77 | 2.06 | -134 | 8 | 23 | 29 |
| Germany | 2.95 | 3.39 | 2.96 | 1.83 | 1.32 | 1.29 | 1.51 | -145 | -32 | 20 | 23 |
| Japan | 1.17 | 1.30 | 1.13 | 0.99 | 0.79 | 0.55 | 0.82 | -30 | -16 | 3 | 27 |

1/ After the first proceed from the Greek debt restructuring, the Greek spread was reduced to a level of 5,730 basis points. In January 2013, with the Greek debt repurchasing the index fell again.
Source: Bloomberg.

In Latin America, most countries' CDS spreads have increased since March, reflecting mainly uncertainty about an earlier-than-expected withdrawal of monetary stimulus by the FED and then expectations of lower global growth after the publication of indicators of activity below the levels expected.

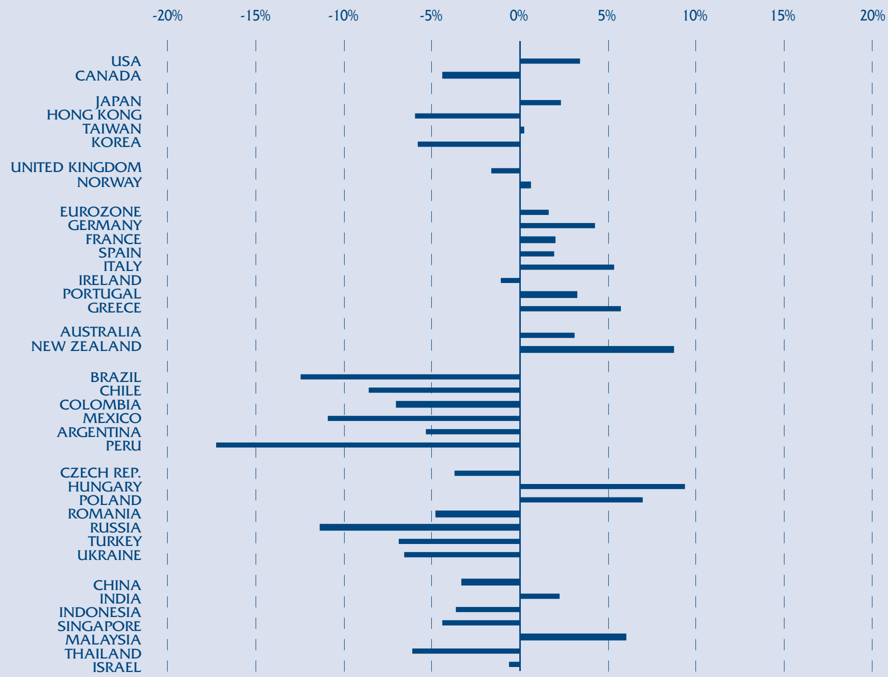
**Table 5**
**SOVEREIGN SPREADS OF LATIN AMERICA ECONOMIES**

| | End of period | | | | | | | Difference in basis points | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec.08 | Dec.09 | Dec.10 (5) | Dec.11 (4) | Dec.12 (3) | Mar.13 (2) | Jun.13 (1) | Dec.10 (1)-(5) | Dec.11 (1)-(4) | Dec.12 (1)-(3) | Mar.13 (1)-(2) |
| **CDS (bps)** | | | | | | | | | | | |
| Argentina | 3,905 | 961 | 610 | 923 | 1,401 | 3,108 | 3,224 | 2,615 | 2,302 | 1,824 | 116 |
| Brazil | 299 | 123 | 111 | 161 | 108 | 137 | 151 | 40 | -10 | 42 | 14 |
| Chile | 203 | 69 | 84 | 132 | 72 | 65 | 89 | 5 | -43 | 17 | 25 |
| Colombia | 308 | 144 | 113 | 154 | 96 | 99 | 121 | 8 | -33 | 25 | 22 |
| Mexico | 292 | 134 | 113 | 153 | 97 | 97 | 116 | 3 | -37 | 19 | 19 |
| Peru | 303 | 124 | 113 | 172 | 97 | 97 | 125 | 12 | -46 | 28 | 28 |

Source: Bloomberg.

24. The recomposition of the investment portfolio –from fixed-income assets towards the money market and variable income assets– has had an impact on the evolution of the major **stock markets**. Most of the stock exchanges in developed markets have accumulated gains between March and June, favored also by better corporate results.

**Graph 16**
**STOCK MARKETS**
(End of period; % chg. Jun.13 respect to Mar.13)




Source: Bloomberg.

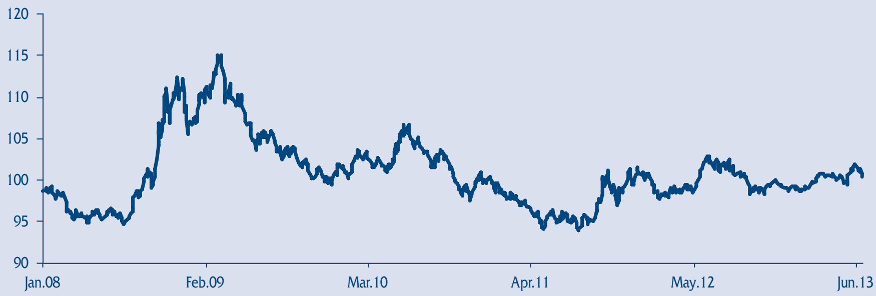
**Foreign exchange rate**

25. Compared with the close of March, the dollar has remained practically stable against a basket of currencies, reflecting, on the one hand, the depreciation of the US dollar against some strong currencies (e.g. the euro) and the appreciation of the dollar against the currencies of some emerging economies on the other hand.

The dollar has depreciated 4.1 percent against the euro due to the progress achieved by Eurozone economies in terms of fiscal issues (after the European Commission eased the fiscal targets for various countries in the region) and in terms of the recapitalization of banks. On the other hand, the dollar has remained relatively stable against the yen, even though year-to-date it accumulates an appreciation of 8.5 percent against the yen due to the stimulus measures announced by the BoJ.

Most **Latin American currencies** have depreciated over the past three months in a context of declining prices of commodities, a lower dynamism of exports, expectations of an earlier withdrawal of the FED's monetary stimulus (second week of May), and a deterioration of the outlook for global growth (first weeks of June). In the specific case of Brazil, persistent high rates of inflation have generated additional depreciatory pressures on the real, while in Chile the Chilean peso has weakened due to the drop in the price of copper.

**Graph 17**
**US DOLLAR INDEX***
(January 2008 - June 2013)




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

**Table 6**
**EXCHANGE RATE**

| | Dec.08 | Dec.09 | Dec.10 (5) | Dec.11 (4) | Dec.12 (3) | Mar.13 (2) | Jun.13 (1) | Jun.13 % chg. compared to: Dec.10 (1)/(5) | Dec.11 (1)/(4) | Dec.12 (1)/(3) | Mar.13 (1)/(2) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Canada | 1.22 | 1.05 | 1.00 | 1.02 | 0.99 | 1.02 | 1.02 | 2.0 | -0.3 | 2.5 | 0.0 |
| Japan | 90.60 | 92.90 | 81.15 | 76.94 | 86.74 | 94.19 | 94.07 | 15.9 | 22.3 | 8.5 | -0.1 |
| United Kingdom (US$/u.m.) | 1.46 | 1.62 | 1.56 | 1.55 | 1.63 | 1.52 | 1.57 | 0.6 | 1.1 | -3.4 | 3.3 |
| Eurozone (US$/u.m.) | 1.40 | 1.43 | 1.34 | 1.30 | 1.32 | 1.28 | 1.33 | -0.3 | 3.1 | 1.2 | 4.1 |
| Switzerland | 1.07 | 1.04 | 0.93 | 0.94 | 0.92 | 0.95 | 0.92 | -1.4 | -1.8 | 0.6 | -3.0 |
| Brazil | 2.31 | 1.74 | 1.66 | 1.86 | 2.05 | 2.02 | 2.15 | 29.7 | 15.5 | 5.1 | 6.3 |
| Chile | 636 | 507 | 468 | 519 | 478 | 471 | 492 | 5.2 | -5.2 | 2.9 | 4.4 |
| Colombia | 2,246 | 2,040 | 1,915 | 1,936 | 1,766 | 1,899 | 1,881 | -1.8 | -2.8 | 6.5 | -0.9 |
| Mexico | 13.65 | 13.06 | 12.36 | 13.95 | 12.86 | 12.31 | 12.70 | 2.8 | -8.9 | -1.3 | 3.2 |
| Argentina | 3.454 | 3.799 | 3.979 | 4.302 | 4.915 | 5.120 | 5.330 | 34.0 | 23.9 | 8.4 | 4.1 |
| Peru | 3.136 | 2.890 | 2.808 | 2.697 | 2.552 | 2.591 | 2.724 | -3.0 | 1.0 | 6.7 | 5.1 |
| Hungary | 188.3 | 188.0 | 208.2 | 243.3 | 220.2 | 236.9 | 217.75 | 4.6 | -10.5 | -1.1 | -8.1 |
| Poland | 2.96 | 2.86 | 2.96 | 3.44 | 3.08 | 3.2 | 3.25 | 9.9 | -5.6 | 5.3 | 2.4 |
| Russia | 30.53 | 30.31 | 30.57 | 32.19 | 30.55 | 31.07 | 31.72 | 3.8 | -1.5 | 3.8 | 2.1 |
| Turkey | 1.54 | 1.50 | 1.54 | 1.88 | 1.78 | 1.81 | 1.86 | 20.8 | -1.4 | 4.4 | 2.7 |
| China | 6.82 | 6.83 | 6.59 | 6.29 | 6.23 | 6.21 | 6.13 | -7.0 | -2.6 | -1.6 | -1.3 |
| India | 48.58 | 46.40 | 44.70 | 53.01 | 54.99 | 54.28 | 57.49 | 28.6 | 8.5 | 4.5 | 5.9 |
| Israel | 3.78 | 3.79 | 3.52 | 3.81 | 3.73 | 3.25 | 3.25 | -7.8 | -14.7 | -12.8 | -0.2 |
| FED Basket | 107.40 | 101.60 | 99.17 | 100.64 | 99.21 | 100.58 | 100.49 | 1.3 | -0.2 | 1.3 | -0.1 |

Source: Bloomberg and Reuters.

**Interest rate decisions**

26. Continuing with the trend described in previous inflation reports, most central banks have maintained their interest rates unchanged in recent months. Of a sample of 31 central banks, ten central banks –those of Turkey, Serbia, Hungary, Korea, Thailand, Australia, Poland, Israel, India, and the Eurozone– have lowered their interest rates between the months of April and June.

**Table 7**
**MONETARY POLICY INTEREST RATE**

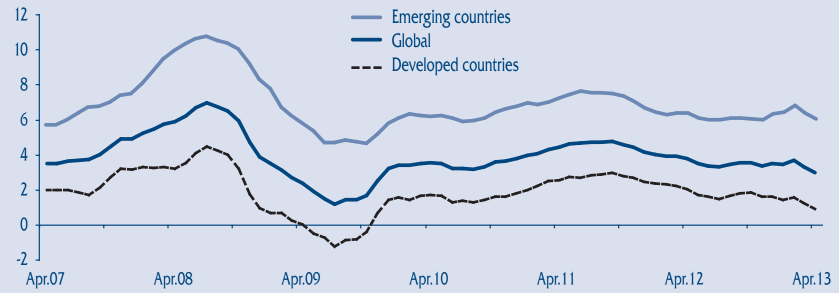
| | Dec.,11 | Dec.,12 | Mar.13 | Jun.13 | Acummulated variation (bps.) | | |
|---|---|---|---|---|---|---|---|
| | | | | | Mar.13 | Dec.12 | Dec.11 |
| Turkey | 5.75 | 5.50 | 5.50 | 4.50 | -100 | -100 | -125 |
| Serbia | 9.75 | 11.25 | 11.75 | 11.00 | -75 | -25 | 125 |
| Hungary | 7.00 | 5.75 | 5.00 | 4.50 | -50 | -125 | -250 |
| Poland | 4.50 | 4.25 | 3.25 | 2.75 | -50 | -150 | -175 |
| Israel | 2.75 | 2.00 | 1.75 | 1.25 | -50 | -75 | -150 |
| South Korea | 3.25 | 2.75 | 2.75 | 2.50 | -25 | -25 | -75 |
| European Central Bank | 1.00 | 0.75 | 0.75 | 0.50 | -25 | -25 | -50 |
| Thailand | 3.50 | 2.75 | 2.75 | 2.50 | -25 | -25 | -100 |
| Australia | 4.25 | 3.00 | 3.00 | 2.75 | -25 | -25 | -150 |
| India | 8.50 | 8.00 | 7.50 | 7.25 | -25 | -75 | -125 |
| Chile | 5.25 | 5.00 | 5.00 | 5.00 | 0 | 0 | -25 |
| USA | 0.25 | 0.25 | 0.25 | 0.25 | 0 | 0 | 0 |
| Mexico | 4.50 | 4.50 | 4.00 | 4.00 | 0 | -50 | -50 |
| Philippines | 4.50 | 3.50 | 3.50 | 3.50 | 0 | 0 | -100 |
| United Kingdom | 0.50 | 0.50 | 0.50 | 0.50 | 0 | 0 | 0 |
| Uruguay | 8.75 | 9.25 | 9.25 | 9.25 | 0 | 0 | 50 |
| South Africa | 5.50 | 5.00 | 5.00 | 5.00 | 0 | 0 | -50 |
| Pakistan | 12.00 | 9.50 | 9.50 | 9.50 | 0 | 0 | -250 |
| Peru | 4.25 | 4.25 | 4.25 | 4.25 | 0 | 0 | 0 |
| Switzerland | 0.25 | 0.25 | 0.00 | 0.00 | 0 | -25 | -25 |
| Taiwan | 1.88 | 1.88 | 1.88 | 1.88 | 0 | 0 | 0 |
| China | 6.56 | 6.00 | 6.00 | 6.00 | 0 | 0 | -56 |
| Canada | 1.00 | 1.00 | 1.00 | 1.00 | 0 | 0 | 0 |
| Iceland | 4.75 | 6.00 | 6.00 | 6.00 | 0 | 0 | 125 |
| Malaysia | 3.00 | 3.00 | 3.00 | 3.00 | 0 | 0 | 0 |
| Norway | 1.75 | 1.50 | 1.50 | 1.50 | 0 | 0 | -25 |
| New Zealand | 2.50 | 2.50 | 2.50 | 2.50 | 0 | 0 | 0 |
| Sweeden | 1.75 | 1.00 | 1.00 | 1.00 | 0 | 0 | -75 |
| Colombia | 4.75 | 4.25 | 3.25 | 3.25 | 0 | -100 | -150 |
| Indonesia | 6.00 | 5.75 | 5.75 | 6.00 | 25 | 25 | 0 |
| Brazil | 11.00 | 7.25 | 7.25 | 8.00 | 75 | 75 | -300 |

Source: Bloomberg and Reuters.

This has taken place in a context of low inflationary pressures in most developed economies, which has made it easier to maintain monetary stimulus.

However, the situation has been different in Brazil given that inflationary pressures have led the central bank to raise its policy rate by 75 bps since March.

**Graph 18**
**12 MONTHS INFLATION**
(%)

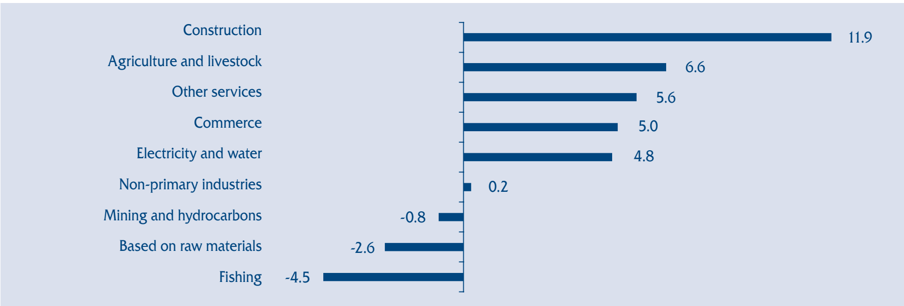



Source: Bloomberg.

# II. Economic Activity

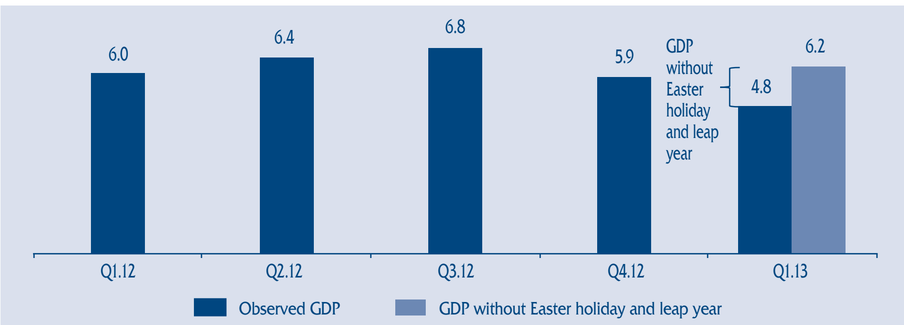
27. The economy continued to grow around its potential level of growth. Although **GDP** grew 4.8 percent in Q1-2013 compared to the same period in 2012, this lower rate may be explained by seasonal factors and transitory supply factors in some production sectors. By components, the downward pressure on the rate of growth was observed in primary sectors such as fishing, industries based on the processing of raw materials, and mining and hydrocarbons, whereas all the non-primary sectors, with the exception of manufacturing, registered positive growth rates of between 4.8 and 11.9 percent. The almost nil growth rate recorded by non-primary manufacturing (0.2 percent) is mainly associated with the decline observed in some items of non-traditional exports, such as textiles and chemicals.

**Graph 19**
**GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS: Q1.13**
(Real % change)




As regards seasonal factors, the lower rate of growth registered in Q1 is in part explained by the fact that 2012 was a leap year and by the fact that the Easter holidays this year were celebrated in March while last year they were celebrated in April. Isolating these two effects, it is estimated that the growth rate in Q1 would be 6.2 percent.

**Graph 20**
**GROSS DOMESTIC PRODUCT**
(Real % change)

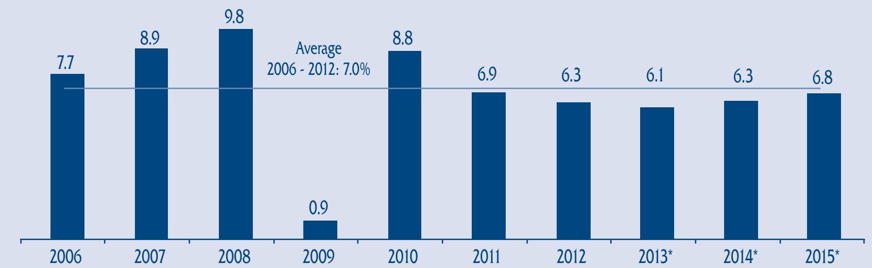


The composition of growth on the side of expenditure continued to be based on the dynamism of domestic demand with a rate above 8 percent, while net exports, on the other hand, continued to decline (exports dropped 10 percent in Q1).

28. The GDP growth rate forecast for **2013** has been revised down by 0.2 percentage points, from 6.3 percent (Inflation Report of March) to 6.1 percent in this Report, considering the lower growth foreseen in exports (1.6 percent versus 5.1 percent in our previous Report) given the drop observed in Q1 and the lower global growth estimated for this year.

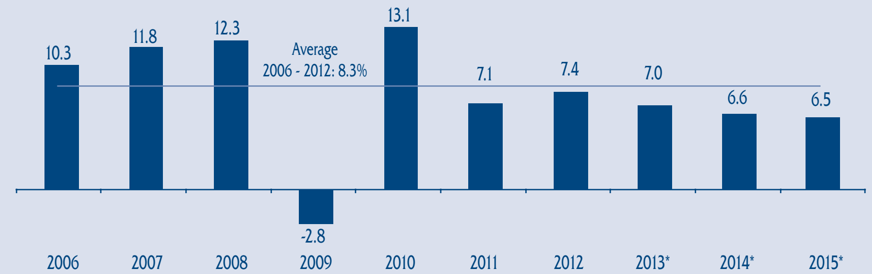
The central forecast scenario continues considering a GDP growth rate (6.3 percent) around the economy's level of potential output for **2014** and a higher growth rate (6.8 percent) is foreseen for **2015** due to the onset of operations of investment projects, especially in the mining sector.

**Graph 21**
**GDP: 2006-2015**
(Real % change)




* Forecast.

**Graph 22**
**DOMESTIC DEMAND: 2006 - 2015**
(Real % change)




* Forecast.

**Forecast of expenditure components**

29. Showing a higher growth rate than GDP, **domestic demand** grew 8.3 percent in Q1-2013. An important impulse was observed on the side of government expenditure, which grew 12.6 percent (public consumption grew 11.4 percent and public investment grew 15.0 percent), while a moderation of growth was observed in private consumption and in private investment. Private consumption fell from a growth rate of 5.8 percent in the three previous quarters to a rate of 5.5 percent, whereas private investment maintained the declining trend observed since Q3- 2012, fallling from a growth rate of 16.0 percent to a rate of 7.4 percent in this period.

30. The forecast on the growth of domestic demand in 2013 has been increased from 6.8 to 7.0 percent given that the rate of public expenditure, especially consumption (11.8 percent versus 10.1 percent in our previous Report), has been revised upwards. The growth of domestic demand is still expected to moderate thereafter in the following two years and a recovery of exports would be observed as from the second semester of this year.

    In 2014 domestic demand is expected to grow at a higher rate (6.6 percent) than GDP (6.3 percent). Moreover, in 2015 the growth gap between GDP and domestic demand would be inverted given that a higher growth of GDP would be seen as a result of supply conditions (the onset of operations in several projects, especially in mining projects), whereas the growth of domestic demand would slow down towards a more sustainable level (6.5 percent).

**Table 8**
**GDP AND DOMESTIC DEMAND**
(Real % change)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **1. Domestic demand** | **4.7** | **7.4** | **8.3** | **6.8** | **7.0** | **6.6** | **6.6** | **6.5** |
| a. Private consumption | 6.0 | 5.8 | 5.5 | 5.7 | 5.5 | 5.7 | 5.5 | 5.5 |
| b. Public consumption | -0.8 | 10.5 | 11.4 | 10.1 | 11.8 | 6.6 | 4.0 | 4.2 |
| c. Private investment | 13.2 | 13.6 | 7.4 | 8.8 | 8.8 | 8.2 | 8.2 | 7.9 |
| d. Public investment | 39.4 | 20.8 | 15.0 | 15.0 | 13.2 | 11.4 | 17.0 | 14.6 |
| **2. Exports** | **19.4** | **4.8** | **-9.7** | **5.1** | **1.6** | **7.9** | **8.5** | **11.7** |
| **3. Imports** | **10.2** | **10.4** | **8.4** | **7.8** | **7.0** | **8.9** | **8.9** | **8.9** |
| **4. GDP** | **6.0** | **6.3** | **4.8** | **6.3** | **6.1** | **6.3** | **6.3** | **6.8** |
| Memo: | | | | | | | | |
| Government expenditure | 9.7 | 14.0 | 12.6 | 11.9 | 12.3 | 8.3 | 8.7 | 8.3 |

IR: Inflation Report.
* Forecast.

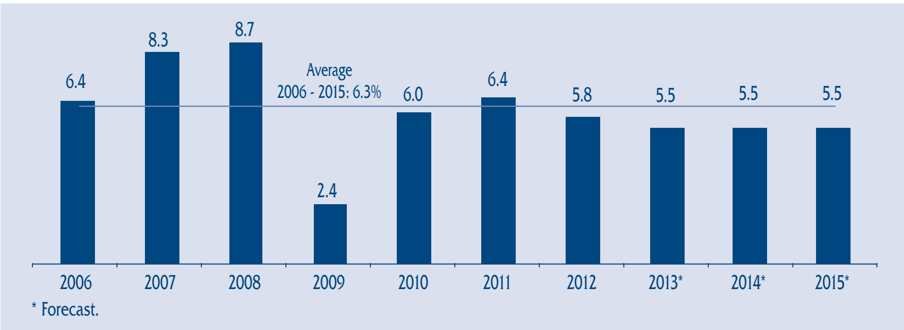
**Table 9**
**GDP AND DOMESTIC DEMAND**
(Contributions to the real % change)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **1. Domestic demand** | **4.9** | **7.7** | **8.6** | **7.2** | **7.4** | **7.0** | **7.0** | **6.9** |
| a. Private consumption | 4.1 | 3.9 | 3.7 | 3.7 | 3.7 | 3.7 | 3.6 | 3.6 |
| b. Public consumption | -0.1 | 1.0 | 0.9 | 1.0 | 1.2 | 0.7 | 0.4 | 0.4 |
| c. Private investment | 3.1 | 3.0 | 1.8 | 2.1 | 2.1 | 2.0 | 2.0 | 2.0 |
| d. Public investment | 1.2 | 1.0 | 0.6 | 0.8 | 0.7 | 0.7 | 1.0 | 0.9 |
| e. Inventory variation 1/ | -2.0 | 0.2 | -0.7 | -0.2 | 0.0 | -0.3 | -0.1 | -0.1 |
| **2. Exports** | **3.3** | **0.9** | **-1.9** | **0.9** | **0.3** | **1.4** | **1.4** | **2.0** |
| **3. Imports** | **2.2** | **2.3** | **1.9** | **1.8** | **1.6** | **2.1** | **2.1** | **2.1** |
| **4. GDP** | **6.0** | **6.3** | **4.8** | **6.3** | **6.1** | **6.3** | **6.3** | **6.8** |
| Memo: | | | | | | | | |
| Government expenditure | 1.2 | 2.0 | 1.6 | 1.8 | 1.9 | 1.3 | 1.4 | 1.4 |

1/ % GDP.
IR: Inflation Report.
* Forecast.

31. **Private consumption** grew 5.5 percent in Q1, registering a lower rate than in the previous quarter (5.8 percent). Several indicators evidence a more moderate growth of consumption in Q1-2013. For example, the sale of new family cars grew 14.1 percent in Q1 (versus 38.4 percent in Q4-2012) and consumer loans grew 13.7 percent (versus 15.4 percent in the previous quarter).

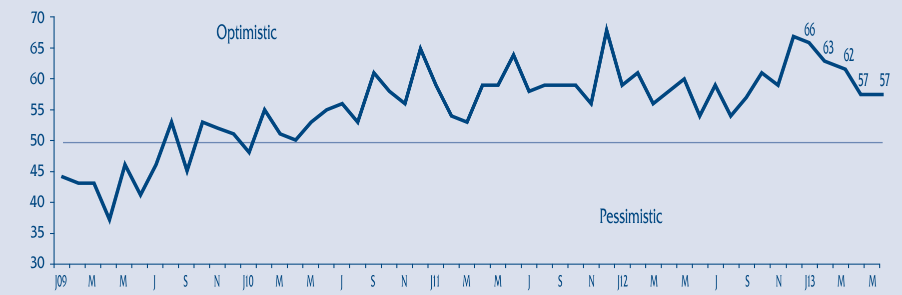
**Graph 23**
**PRIVATE CONSUMPTION: 2006-2015**
(Real % change)




Several indicators reflecting the recent evolution of private consumption are discussed below:

a. The Consumer Confidence Index remains on the optimistic segment. In Q1, it maintained an average level of 64 points, higher than the level recorded in Q4-2012 (62 points). However, this indicator has shown a slight deterioration in the first months of the year registering 57 points in May.

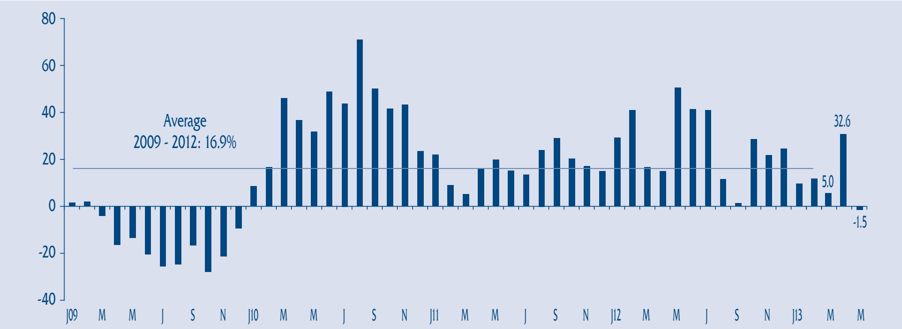
**Graph 24**
**CONSUMER CONFIDENCE INDEX: 2009 - 2013**
Households' economic situation




Source: Ipsos APOYO.
Elaboration: BCRP.

b. The volume of imports of durable consumer goods grew 11 percent in January-May, a lower rate than the annual growth rate registered over the past 4 years.

**Graph 25**
**VOLUME OF IMPORTS OF DURABLE CONSUMER GOODS: 2009 - 2013**
(12 months % change)




Source: SUNAT.

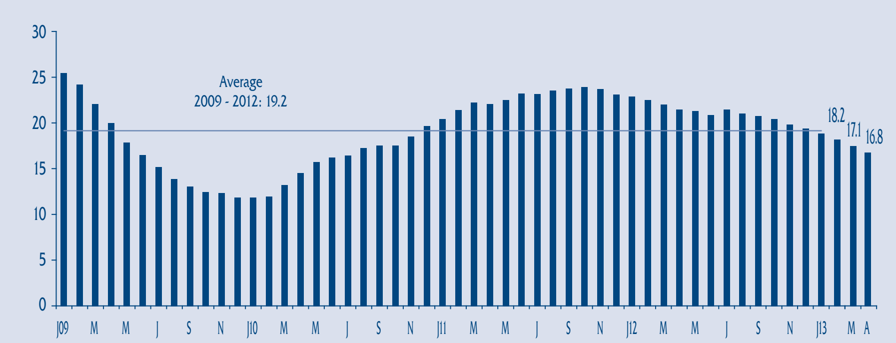
c. Urban employment in firms with 10 and more workers grew 3.8 percent in Q1-2013, showing a slightly higher rate than the average rate observed in 2009-2012, but slowing down compared to the growth rates recorded in 2011 and 2012.

**Graph 26**
**URBAN EMPLOYMENT IN FIRMS WITH 10 AND MORE WORKERS: 2009 - 2013**
(12 months % change)


Source: MTPE.

d. The rate of growth of personal loans, which include consumer loans and mortgage loans, has moderated compared to the rates observed in 2012.

**Graph 27**
**PERSONAL LOANS: 2009 - 2013**
(12 months % change)



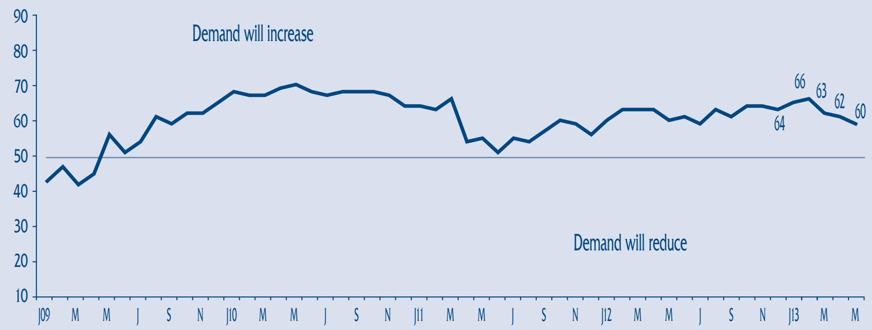

Source: BCRP.

Considering these indicators, the forecast on the growth of private consumption in 2013 has been revised from 5.7 percent to 5.5 percent. Similar growth rates are expected in the next years.

32. In Q1-2013 **private investment** grew 7.4 percent. In spite of registering a lower growth rate than in the previous quarter (11.8 percent), this indicator continues to show a greater dynamism than GDP. Thus, private investment in GDP terms maintains a rising trend since 2010. Several indicators reflect the evolution of private investment:

a. The expectations about demand in the three months ahead continue to be on the optimistic segment with a level of 60 points in May. However, this level is lower than the ones recorded in the first months of the year.

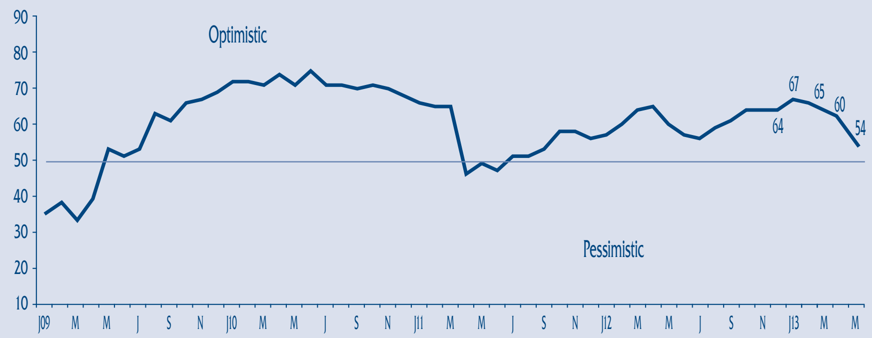
**Graph 28**
**EXPECTATIONS ABOUT DEMAND IN THE 3 MONTHS AHEAD: 2009 - 2013**




Source: Survey of Macroeconomic Expectations, BCRP. Survey conducted during the second fortnight of May 2013.

b. Business expectations on the situation of the economy in the three months ahead also remain on the optimistic segment and have registered 54 points in May. This level, however, is lower than the ones recorded in the first months of the year.

**Graph 29**
**EXPECTATIONS ABOUT THE ECONOMY IN THE 3 MONTHS AHEAD: 2009 - 2013**




Source: Survey of Macroeconomic Expectations, BCRP. Survey conducted during the second fortnight of May 2013.

c. Economic agents maintain their expectations about GDP growth unchanged at 6.0 percent in 2013. In 2014 GDP is expected to grow between 6.0 and 6.1 percent and in 2015 it is expected to grow 6.0 percent.

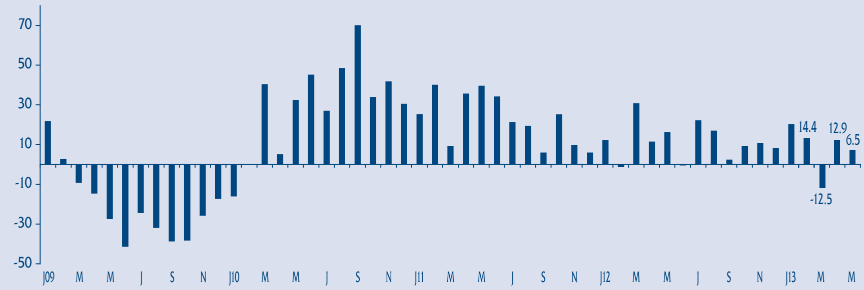
**Table 10**
**SURVEY ON MACROECONOMIC EXPECTATIONS : GDP GROWTH**
(%)

| | Expectations about: | | |
|---|---|---|---|
| | IR Dec.12 | IR Mar.13 | IR Jun.13* |
| **Financial entities** | | | |
| 2013 | 6.0 | 6.3 | 6.0 |
| 2014 | 6.0 | 6.1 | 6.0 |
| 2015 | -.- | -.- | 6.0 |
| **Economic analysts** | | | |
| 2013 | 6.0 | 6.3 | 6.0 |
| 2014 | 6.0 | 6.5 | 6.1 |
| 2015 | -.- | -.- | 6.0 |
| **Non-financial firms** | | | |
| 2013 | 6.0 | 6.1 | 6.0 |
| 2014 | 6.0 | 6.0 | 6.0 |
| 2015 | -.- | -.- | 6.0 |

IR: Inflation Report.
* Survey conducted during the second fortnight of May 2013.

d. The volume of imports of capital goods, indicator of investment demand, recorded a rate of 8.1 percent in the January-May period, a lower rate than the one registered last year (11.3 percent).

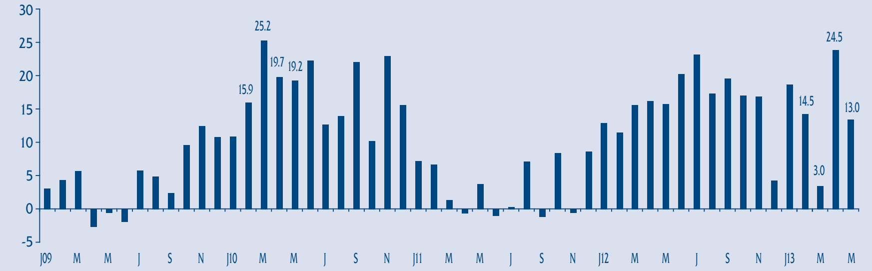
**Graph 30**
**VOLUME OF IMPORTS OF CAPITAL GOODS: 2009 - 2013**
(12 months % change)




Source: SUNAT.

e. The domestic consumption of cement continued growing at a two-digit rate in the January-May period (14.5 percent), although showing a lower rate than the one observed last year.

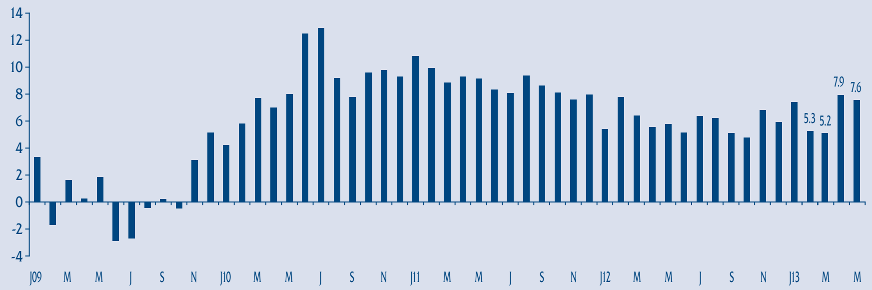
**Graph 31**
**DOMESTIC CONSUMPTION OF CEMENT: 2009 - 2013**
(12 months % change)




Source: ASOCEM and cement companies.

f. The production of electricity continues showing a considerable dynamism with an average growth rate of 6.7 percent in January-May (5.9 percent in 2012).

**Graph 32**
**PRODUCTION OF ELECTRICITY: 2009 - 2013**
(12 months % change)




Source: COES.

33. Announced private investment projects to be implemented in 2013-2015 amount to US$ 42.0 billion.

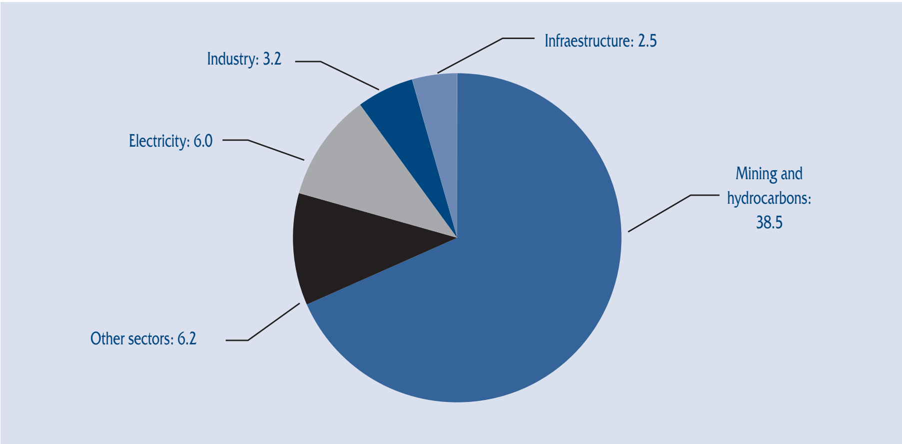
**Table 11**
**ANNOUNCED PRIVATE INVESTMENT PROJECTS**
(Million US$)

| | **2013 - 2015** |
|---|---|
| Mining | 20,346 |
| Hydrocarbons | 6,182 |
| Electricity | 4,804 |
| Industry | 2,347 |
| Infrastructure | 2,186 |
| Other sectors | 6,116 |
| **Total** | **41,981** |

Source: Daily reports and Media specialist.

Projects in the sectors of mining and hydrocarbons account for 38.5 percent of the total number of investment projects announced for the period 2013-2015. Projects such as Las Bambas, Toromocho, Constancia, and the expansion of Marcona which are currently being implemented represent a total investment of over US$ 11 billion. The contributions of the first three projects mentioned above will represent an increase of nearly 80 percent in the production of copper between 2012 and 2015. These projects will be coupled by Cerro Verde, which obtained the required permits to start its expansion works in March, and by Quellaveco, which is waiting for the approval of the investor company to begin its implementation. It should be pointed out that other projects would be in the process of being reconsidered due to the decline of the prices of metals and the high costs associated with higher exploration costs, delays in permits, and shortage of skilled labor. The assumption considered in the baseline scenario is that these projects would only start being implemented towards the end of the forecast horizon.

**Graph 33**
**FORESEEN INVESTMENT PROJECTS: 2013-2015**
(% share)




The sectors associated with construction, such as the real estate sector, the hotel sector and the health sector continue making important announcements about the implementation of new projects and the expansion and remodelling of already existing projects, both in Lima and in other cities in the provinces. Investment projects announced for 2013-2015 would amount to about US$ 2.6 billion. Moreover, the main operators of malls, department stores, and home improvement stores will invest more than US$ 1.5 billion.

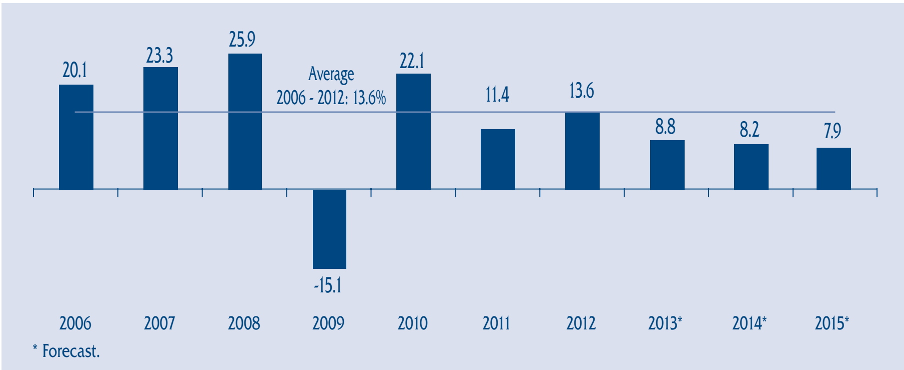
**Table 12**
**ANNOUNCED MAIN INVESTMENT PROJECTS: 2013-2015**

| SECTOR | COMPANIES | PROJECT NAME |
|---|---|---|
| Mining | Xstrata Copper | Las Bambas |
| | Freeport-Macmoran Copper | Expansion:Cerro Verde |
| | Anglo American Plc. | Quellaveco |
| | Antares Minerals Inc. | Haquira |
| | China Minmetals Corporation and Jiangxi Copper Company | El Galeno |
| | Aluminium Corp of China Ltd. | Toromocho |
| | Norsemont Mining Inc., HudBay Minerals Inc. | Constancia |
| | Cumbres Andinas, Korea Resources Corp. | Mina Justa |
| | Bear Creek Mining Corporation | Corani |
| | Grupo Milpo | Expansion: Cerro Lindo and El Porvenir |
| | Hochschild Mining International Minerals Corporation | Inmaculada |
| | Grupo Milpo | Pukaqaqa |
| | Grupo Milpo | Hilarión |
| | Southern Perú Copper Corp | Expansion: Cuajone |
| | Río Alto Mining Ltd. | La Arena |
| | Minera Gold Corp. | Expansion: Lagunas Norte |
| | Shougang Corporation | Expansion: Marcona |
| | Grupo Buenaventura | Expansion: Colquijirca |
| | Volcan Compañía Minera S.A.A. | Alpamarca - Río Pallanga |
| | Minera IRL Limited | Ollachea |
| Hidrocarburos | Savia Perú S.A. | Lot Z-2B: Perforation, exploration and other investments |
| | Pluspetrol Perú Corp. S.A. | Expansion of Pisco and Malvinas plants |
| | Perenco | Exploration Lot 67 and pipeline |
| | Pacific Rubiales Energy | Lots: Z1-135 - 137 - 116 - 138 |
| | Transportadora de Gas del Perú S.A. (TgP) | Expansion of gas and capacity of transportation |
| | Cálidda Gas Natural del Perú | Expansion of main grid |
| | Petrobras | Lot 58 and Lot X |
| | Pluspetrol Perú Corp. S.A. | Exploration Lots 88 and 56 |
| | SK Energy | Exploration Lot Z 46 |
| Electricity | Odebrecht S.A. | Hydroelectric plant of Cerro de Chaglla |
| | Inkia Energy Quimpac S.A. | Hydroelectric plant of Cerro del Águila |
| | Energía Azul S.R.L. | Hydroelectric plant Santa María |
| | Norwind | Wind energy park Cerro Chocan |
| | Inevarante | Hydroelectric plant Acco Pucará |
| | SN Power Perú S.A. | Hydroelectric plant Cheves |
| | GDF Suez | Hydroelectric plant Quitaracsa I |
| Industry | Siderperú | Modernization of plant |
| | SAB Miller | Investment 2012-2014 |
| | Grupo de Pilkington Limited | Manufacture plant of float glasses |
| | Corporación JR Lindley | Expansion and new plants |
| | Grupo Celepsa | Expansion of rolling mill (N° 2) |
| | Grupo Hochschild | New cemen plant in Piura |
| Infrastructure | OAS S.R.L. | Parque Rimac express way |
| | APM Terminal, Callao Port Holding , and Central Portuaria | Modernization of North Pier |
| | Covisol | Trujillo-Sullana: Sol Highway |
| | Autopista del Norte SAC | Pativilca – Port of Salaverry Road Network No. 4 |
| | Odebrecht | New highways in Lima |
| | Consorcio Transportadora Callao | Minerals Pier |
| Other sectors | Grupo Falabella | Mall Aventura: New malls |
| | Graña y Montero | Real state |
| | Holding Banmédica, Grupo Roe | Health center: San Felipe |
| | Besalco S.A. | Real state |
| | Inmobiliari S.A | Residential, Commercial and Offices Center in Surco |
| | Telefónica | Expansion and fiber optics in andean mountain |

Source: Press and information companies.

34. Based on the evolution of the current portfolio of investment projects, the forecast on the growth of private investment in 2013 is maintained at 8.8 percent, as in our previous Report. Likewise, the forecast of the increase of private investment in 2014 remains at 8.2 percent, while the growth rate of private investment estimated for 2015 is 7.9 percent. Thus, the ratio of private investment to GDP would increase from 21.4 percent in 2012 to 22.8 percent in 2015.

**Graph 34**
**PRIVATE INVESTMENT: 2006-2015**
(Real % change)

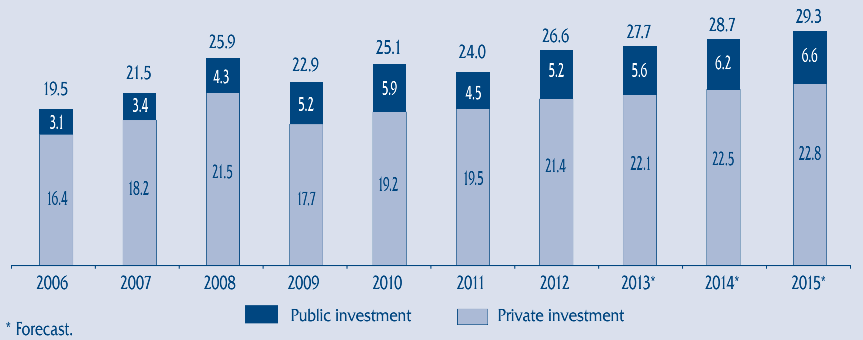



35. **Public investment** in Q1 grew 15.0 percent compared to the same period in 2012. This increase was observed mainly in the investment of the national government (49.1 percent) and state enterprises (32.6 percent). The most important investment projects in the case of the former were projects associated with the repair and improvement of road infrastructure and with the Electric Train project (Tren Eléctrico de Lima y Callao). In 2013-2015 public investment would follow a path consistent with the 2014-2016 Multiannual Macroeconomic Framework, which implies a downward revision of the growth rate in 2013 and an upward revision of this rate in 2014 relative to the rates estimated in our March report. With these rates, investment in GDP terms would increase from 5.2 percent of GDP in 2012 to 6.6 percent in 2015.

**Graph 35**
**PUBLIC INVESTMENT: 2006 - 2015**
(Real % change)

36. Considering the evolution foreseen in private investment and public investment, the ratio of gross fixed investment to GDP would be over 29 percent in 2015.

**Graph 36**
**GROSS FIXED INVESTMENT: 2006 - 2015**
(% GDP)




* Forecast.

37. The forecast considers that the increase in the ratio of investment to GDP would be financed mainly through higher domestic saving, which would continue to show the upward trend observed in recent years. Domestic saving would increase from 23.0 percent of GDP in 2012 to 25.1 percent in 2015, in line with the positive growth of income.

**Table 13**
**SAVINGS-INVESTMENT GAP**
(% GDP)

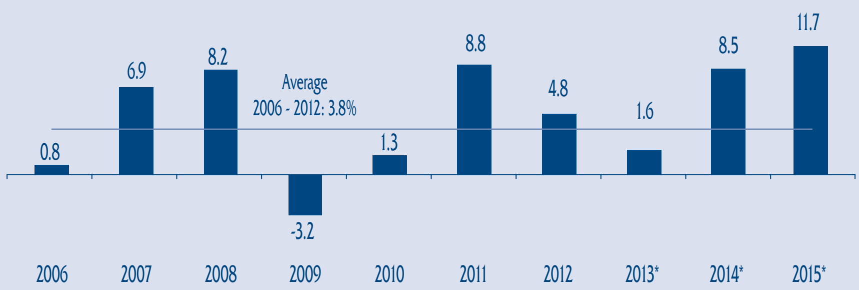
| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **1. Gross fixed investment** | **27.9** | **26.6** | **29.5** | **27.5** | **27.7** | **28.2** | **28.7** | **29.3** |
| a. Private | 24.1 | 21.4 | 25.2 | 21.7 | 22.1 | 22.0 | 22.5 | 22.8 |
| b. Public | 3.8 | 5.2 | 4.3 | 5.7 | 5.6 | 5.9 | 6.2 | 6.6 |
| **2. Net domestic savings 1/** | **26.5** | **23.0** | **24.3** | **23.5** | **23.3** | **24.3** | **24.0** | **25.1** |
| **3. External savings** | **1.4** | **3.6** | **5.2** | **4.0** | **4.4** | **3.9** | **4.6** | **4.3** |

1/ Excluding inventory variations.
IR: Inflation Report.
* Forecast.

38. **Exports** of goods and services in Q1 registered a drop of 9.7 percent, which reflected lower exports of traditional export products, mainly gold, copper, and fishmeal. A reduction was also observed in exports of some non-traditional products, such as textiles and chemicals, which are mainly exported to Latin American markets.

In 2013 exports would grow 1.6 percent, recording a lower rate than the one forecast in our previous Report (5.1 percent). As in our March Report, the central forecast scenario in this report considers that exports will follow a recovery path in 2014 and 2015, especially in the latter year, due mainly to the onset of operations of copper mining projects such as Toromocho, Las Bambas, and Constancia. Thus, in 2014 and 2015 exports are expected to show growth rates of 8.5 and 11.7 percent, respectively.

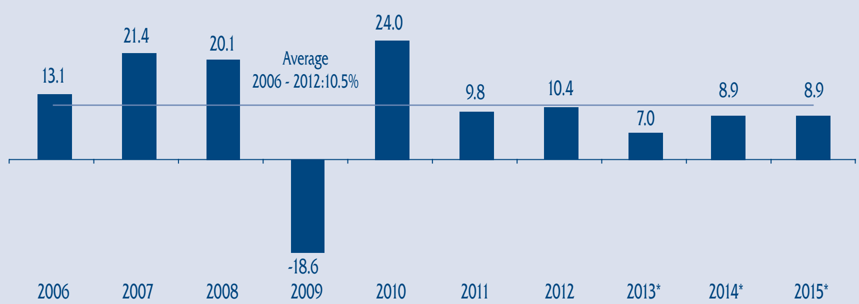
**Graph 37**
**EXPORTS OF GOODS AND SERVICES : 2006 - 2015**
(Real % change)




* Forecast.

39. On the other hand, **imports** of goods and services grew 8.4 percent in Q1 due to increased imports of input products and non-financial services. In the forecast horizon imports would grow at lower rates than in the previous years, in line with the slow down of growth registered in domestic demand. However, in 2014 and 2015 imports are estimated to grow at a rate of 8.9 percent in both years –a higher rate than the one registered in 2013 (7.0 percent)– taking into account the higher GDP growth rate expected for these years.

**Graph 38**
**IMPORTS OF GOODS AND SERVICES : 2006 - 2015**
(Real % change)




* Forecast.

## GDP by production sectors

40. In Q1-2013, GDP grew 4.8 percent. This growth rate may be broken down into an increase of 2.2 percent in the primary GDP and an increase of 5.2 percent in the non-primary GDP. The former result stems from the fact that the 6.6 percent growth rate registered in the agriculture sector and the 8.1 percent growth rate registerd in the sector of hydrocarbons were in part offset by drops of activity in the sector of fishing (-4.5 percent), metallic mining (-2.8 percent), and industries based on the processing of raw materials (-2.6 percent). The result in the case of the latter stems from the high growth in the construction sector (11.9 percent) which was in part offset by lower growth rates in other non-primary sectors, especially non-primary manufacturing which recorded a growth rate of only 0.2 percent.

**Table 14**
**GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS**
(Real % change)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **Agriculture and livestock** | **2.5** | **5.1** | **6.6** | **3.5** | **3.3** | **4.2** | **4.2** | **4.2** |
| **Fishing** | **-10.6** | **-11.8** | **-4.5** | **1.1** | **1.1** | **3.3** | **3.3** | **3.3** |
| **Mining and hydrocarbons** | **3.3** | **2.2** | **-0.8** | **5.0** | **3.3** | **12.7** | **14.1** | **16.2** |
| Metallic mining | 3.2 | 2.1 | -2.8 | 3.9 | 2.0 | 12.3 | 13.5 | 16.3 |
| Hydrocarbons | 3.7 | 2.3 | 8.1 | 9.6 | 9.0 | 14.4 | 16.7 | 15.8 |
| **Manufacturing** | **-0.7** | **1.3** | **-0.2** | **5.0** | **3.4** | **5.7** | **5.0** | **5.6** |
| Based on raw materials | -3.2 | -6.5 | -2.6 | 3.6 | 3.0 | 3.7 | 3.5 | 3.3 |
| Non-primary industries | -0.3 | 2.8 | 0.2 | 5.2 | 3.4 | 6.0 | 5.2 | 6.0 |
| **Electricity and water** | **6.3** | **5.2** | **4.8** | **5.9** | **5.9** | **6.1** | **6.1** | **6.1** |
| **Construction** | **12.5** | **15.2** | **11.9** | **10.5** | **11.6** | **8.2** | **8.2** | **8.0** |
| **Commerce** | **7.9** | **6.7** | **5.0** | **6.4** | **6.4** | **6.0** | **6.0** | **6.4** |
| **Other services** | **7.7** | **7.3** | **5.6** | **6.6** | **6.6** | **6.1** | **6.2** | **6.6** |
| **GDP** | **6.0** | **6.3** | **4.8** | **6.3** | **6.1** | **6.3** | **6.3** | **6.8** |
| Memo: | | | | | | | | |
| **Primary GDP** | **1.4** | **1.7** | **2.2** | **4.0** | **3.4** | **6.8** | **7.0** | **8.1** |
| **Non-Primary GDP** | **6.9** | **7.1** | **5.2** | **6.7** | **6.5** | **6.2** | **6.2** | **6.6** |

IR: Inflation Report.
* Forecast.

41. The forecast on the growth rate of **primary GDP** in 2013 has been revised down from 4.0 percent (Inflation Report of March) to 3.4 percent due mainly to the lower growth rate expected in metallic mining. In the next years primary GDP would show higher growth rates, in line with the higher growth rates foreseen in the mining sector as a result of the onset of operations of new mining projects.

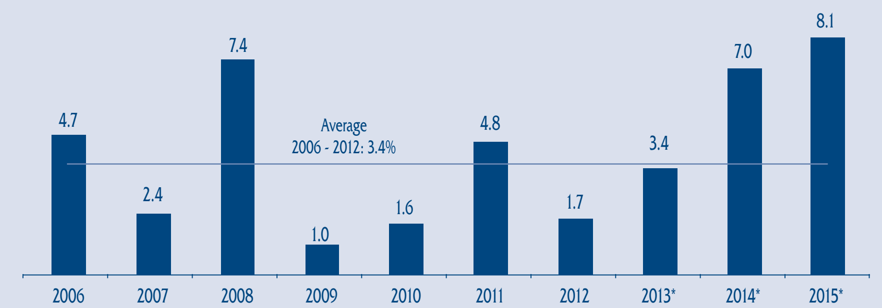
The **agriculture sector** would show a growth rate of 3.3 percent in 2013. This slightly lower rate than the one forecast in our March Report has been estimated considering the lower production of agro export products, such as asparagus and coffee, whose production has been affected by different factors. The production of coffee has been affected by the coffee rust plague, as well as by a lower demand from Colombia due to better crop conditions in that country.

As regards the **fishing sector**, the forecast for 2013 remains at 1.1 percent, since the slight increase foreseen in terms of anchovy catch –from 3.3 to 3.5 million tons– would be offset by the lower production of canned fish products for direct human consumption.

Production in the **metallic mining sector** dropped 2.8 percent in Q1 due to the lower production of gold, which dropped by 11.2 percent. The forecast on the growth of this sector in 2013 has been revised down relative to our previous Inflation Report (from 3.9 percent to 2.0 percent) as a result of the lower production of copper foreseen for this year –the estimated production of copper has been revised downwards from 1.3 million to 1.2 million fine metric tons–, in line with the lower production projected for this year in Antamina, Southern, and Cerro Verde. In 2014 and 2015 mining production, and especially copper production, would increase due to the onset of operations of important projects, such as Toromocho, Constancia, and Las Bambas, among other projects.

The **hydrocarbons sector** grew 8.1 percent in the first three months of the year due to the higher extraction of liquid hydrocarbons of natural gas obtained at Las Malvinas separation plant, where the natural gas of Pluspetrol's Lot 88 and Lot 56 was processed. In 2013 the sector would grow 9.0 percent, a rate slightly lower than the one forecast in our previous Report (9.6 percent), as a result of the lower production of crude oil expected to be obtained by Savia Perú in Lot Z-2B, in Piura, compared to the production projected in March. Moreover, the production of crude is expected to increase thereafter in 2014, when the sector would also reflect the impact of Camisea's compressor plant on the production of natural gas. Furthermore, in 2015 the sector's output would also reflect the effect of the enlargement of Camisea's "south loop" vent on the production of natural gas liquids.

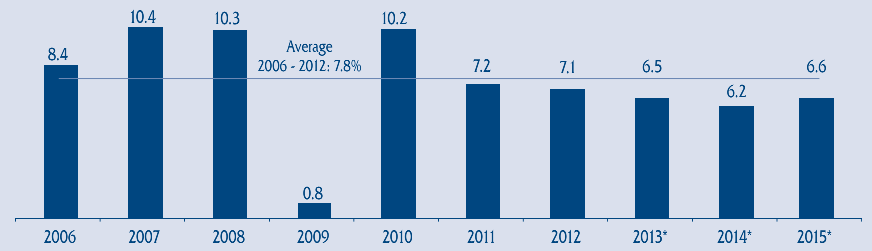
**Graph 39**
**PRODUCTION IN PRIMARY SECTORS: 2006 - 2015**
(Real % change)




* Forecast.

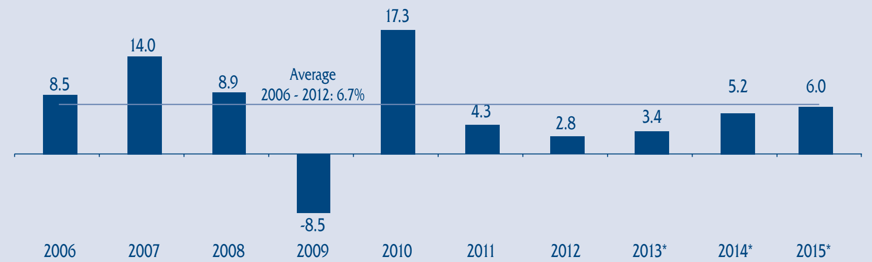
42. As forecast in our March Report, **non-primary GDP** is expected to show a gradual slowdown in 2013 and 2014, in line with the expected moderation of growth of domestic demand. The evolution of non-primary manufacturing would also be associated with the growth of non-traditional exports, which in turn depend on global demand. The latter is expected to recover in 2014 although at a lower rate than estimated in our previous Report. On the other hand, the construction sector would continue its growth path, although showing more moderate rates after having recovered in 2012 as a result of the increased construction of homes, malls, and the implementation of road and public infrastructure construction projects, both in Lima and in other cities of the country.

**Graph 40**
**PRODUCTION IN NON-PRIMARY SECTORS: 2006 - 2015**
(Real % change)



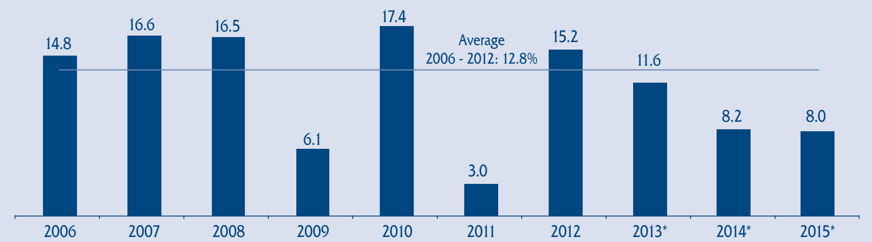

* Forecast.

**Graph 41**
**NON-PRIMARY MANUFACTURING: 2006 - 2015**
(Real % change)




* Forecast.

**Graph 42**
**CONSTRUCTION: 2006- 2015**
(Real % change)




* Forecast.

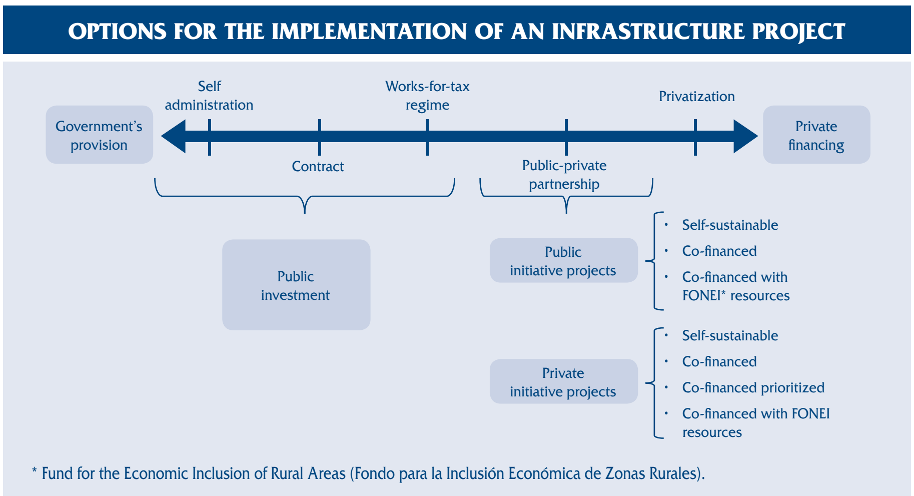
**Box 1**

**PUBLIC PRIVATE PARTNERSHIPS: AN ALTERNATIVE WAY OF PROVIDING INFRASTRUCTURE**

A public-private partnership (PPP) is a contractual relationship established between a government organization (agencies of the national government, regional governments and local governments) and a private company (a specific purpose vehicle, an investor/supplier, developer, or contractor) for the provision, operation, and maintenance of an infrastructure project. This partnership is a business opportunity for the private company contributes to the partnership with economic resources and expertise in technological innovation, while the government provides associative schemes, co-financing and instruments that facilitate private financing (guarantees), and a stable legal framework to support the viability of the project and make it sustainable in the long term.

The provision of infrastructure and services through PPPs increases not only private sector productivity, but also growth since the improvement in the coverage and the quality of services provided to users reduces companies' costs of operation and logistics. PPPs also ensure the maintenance of infrastructure, because in these schemes the concessionaire company has the contractual obligation of maintaining a the infrastructure project at a certain level of operability. Finally, if there is an adequate distribution of risks between the government and the concessionaire, PPPs imply greater gains in terms of efficiency than traditional public investment.

In Peru infrastructure is provided to users primarily through public investment and through PPPs[2], as illustrated in the following diagram:




In contractual terms, PPPs' efficient management in the provision of infrastructure differs from the government's provision of infrastructure in the following aspects:

2 Concessions are governed by Legislative Decree 839 (1996) and its amendments and since 2008 by Legislative Decree 1012, Legal Framework for Public-Private Partnerships.

| Public-Private Partnerships | Public works |
|---|---|
| **Long-term** contracts that combine the stages of design, construction, financing, operation and maintenance (bundling), and transfer the investment at the end of the contract. | **Short-term** (annual or biannual) contracts with incomplete contract designs for the period of construction and separated from operation and maintenance (unbundling). |
| Projects are financed through deferred payments according to the availability of investment in time, allowing that users pay a part of it directly to the private sector, if the payment of users has been considered. | Financed with government resources and paid at unit price or with advances. |
| The allocation of risks to the private sector is more efficient (especially risks associated with construction and demand and/or availability). | Most of the risks are assumed by the government. |
| Investment for PPP projects is established on a lump sum basis, which reduces the risk that the referential investment amount may be modified. | Public works imply that the investment is made through an initial disbursement and through several payments made as different stages of the works are completed. |
| PPPs ensure that the project is implemented and delivered according to the contractual conditions with optimal levels of operability during the term of the contract (long-term). | The constructor is paid according to the progress of the works, which does not eliminate the risk of failures in the works after they are delivered. |
| The payment schedule for the investment made is established at the beginning of the project's operation. | The beginning of the payment is established when the construction of the works begins. |
| Framework for the operation of PPS allows that studies be contracted promptly (without OSCE procedures). | The contracting of studies is pre-established and constrained by the operation framework established by the OSCE. |
| PROINVERSIÓN accumulates capacity and experience to carry out the promotion of PPP projects it is required to promote. | Government sectors and regional and local governments lack the expertise to manage the promotion of PPP projects. |

In Peru, the provision of infrastructure with private participation in the period 1991-2012 has generated investment commitments for a total of US$ 16.10 billion, with investment in transport infrastructure, and electricity and hydrocarbons standing out, together with the concessions administered by the Metropolitan Municipality of Lima and Essalud. These results reflect the lessons learned in terms of contractual schemes, structured negotiations, transparency, risk allocation, bankability, financing and co-financing mechanisms, political support, equal treatment to local and foreign investors, among other aspects.

**INVESTMENT COMMITMENTS IN CONCESSIONS: 1991-2012**
(Million US$)

| | 1991-1999 | 2000-2012 | Total |
|---|---|---|---|
| Transportation | 170 | 6,124 | 6,294 |
| Roads and highways | 157 | 2,765 | 2,922 |
| Ports | 8 | 1,736 | 1,743 |
| Airports | 6 | 1,623 | 1,628 |
| Electricity generation and distribution | 253 | 4,506 | 4,759 |
| Hydrocarbons 1/ | -.- | 1,230 | 1,230 |
| Telecommunications | -.- | 792 | 792 |
| Water and sanitation | -.- | 644 | 644 |
| Agriculture | -.- | 540 | 540 |
| Others 2/ | 7 | 180 | 186 |
| **PROINVERSIÓN Projects** | **431** | **14,015** | **14,446** |
| Metropolitan Municipality of Lima (3 projects) | -.- | 1,520 | 1,520 |
| ESSALUD (4 projects) | -.- | 137 | 137 |
| **TOTAL** | **431** | **15,672** | **16,103** |

1 / Camisea gas transportation project.
2 / Tourism and real estate sales.
Source: Proinversion, MML and Essalud.

However, a continuous flow of investment in infrastructure is necessary to allow productivity in the economy and maintain the level of expansion observed in recent years in order to ensure sustainable economic growth in the country.

In this context, the BCRP organized a forum with the participation of national and international experts[3] to discuss the policy alternatives that may be used to promote private public partnerships (PPPs) for this end. The main conclusions of this event are summarized below:

- **Implement a "single-window system"** so that there is only a single interlocutor between the concessionaire and the public administration so that will speed up the procedures for the development of PPPs.

- **Consider the packaging of projects:** be should standardize projects so that it is possible to lease them in group, as well as to develop complementary infrastructure projects package. This would reduce transaction costs and dynamic infrastructure investment.

- **Standardize the necessary documents for the transactions APP (contracts, requirements, etc).** Each type of infrastructure model should have a contract, reduce conflict and contain the reasons for modifying the contract as well as dispute settlement mechanisms. These documents must be in scope of all entities of the public sector.

- **Generate projects in infrastructure that are socially profitable for PPPs.** The State should produce good projects, complete studies, so that the allocation of risk between the private and the public sector is the most appropriate[4]. To do this, all public sector entities should develop a Bank of projects APP, with comprehensive studies, which could be through subcontracting of the studies of the projects.

- **PPP projects should be included in the government's investment strategy. I**n the fiscal framework of long-term (multi-year investment budget) and the (annual) budget of the Government, must make transparent and disseminate concessions Plan and establish the use of the limit of 7 percent of GDP for the firm and contingent debt of APP projects. This also implies, strengthen their knowledge in the assessment, prioritization and management of investment projects and ensure the consistency of projects with the objectives of economic and fiscal policy.

- **Relicitar expired concessions.** This implies that in case that not be renegotiated the concession term, find a new operator private at the end of the term of the concession, and in this way prevent infrastructure under the administration of the State at risk remain without proper maintenance.

3 The Forum was held on April 30, 2013, with the participation of public sector officials, business representatives, providers of public services, and researchers specialized in public policies, among others.

4 Very preliminary project profiles or pre-feasibility studies do not allow an appropriate allocation of risk in the implementation of infrastructure projects through concessions.

- **Invest in improving the human capital available in sectors and subnational entities that produce projects and are responsible for its promotion of public and private investment.** Also against the distrust of public officials to make decisions for fear that may eventually be controlled with civil and criminal consequences, you must set appropriate mechanisms to protect such officials from unfounded charges.

- **Complete the legal framework for the operation of PPPs:**

  - **Approve the methodologies to calculate the financial and non-financial guarantees**. Guarantees resulting from the processes of concessions are obligations since they are buying future flows of road services, hospitals, water and sanitation.

  - **Complete the regulation of new private initiatives.** This measure, pending since July 2011 when allowed private initiatives co-financed, will facilitate greater private participation in the APP. Recent regulations, posted in January 2013, is only part-financed private initiatives prioritized on the basis of the Bank's projects of the SNIP.

  - **Complete cost-benefit analysis methodology.** Currently approved an interim methodology applies to co-financed projects which are currently in the process of promotion. To the extent that the cost analysis benefit represents an allocation of risk between the State and the private partner, must invest in upgrading the capacity of the Treasury to assess and design schemes of allocation of risk, maintaining fiscal sustainability, are acceptable for private bidders.

# III. Balance of Payments

43. The reduction of terms of trade, the lower volume of exports, and the growth of imports driven by the strong dynamism of domestic demand led to an increase in the **current account** deficit of the balance of payments. In Q1-2013, the current account of the balance of payments recorded a deficit of 5.2 percent of GDP (US$ 2.7 billion), increasing compared to the deficit in Q1-2012 when it represented 1.4 percent of GDP.

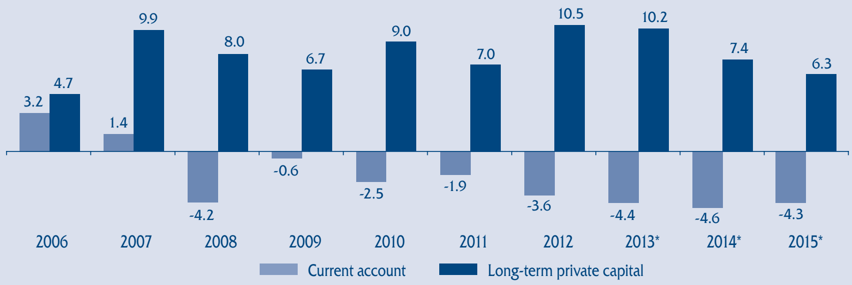
    The deficit continued to be funded mostly by external long-term capital inflows, which amounted to US$ 7 billion in Q1-2013. Thus, foreign direct investment associated mainly with the implementation of major investment projects amounted to US$ 4.1 billion, while the funds obtained via bond issuances amounted to US$ 2 billion, a figure considerably higher than that observed in Q1-2012.

**Table 15**
**BALANCE OF PAYMENTS**
(Million US$)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **I. Current account balance** | **-671** | **-7,136** | **-2,670** | **-8,877** | **-9,601** | **-9,385** | **-11,036** | **-11,160** |
| *% of GDP* | *-1.4* | *-3.6* | *-5.2* | *-4.0* | *-4.4* | *-3.9* | *-4.6* | *-4.3* |
| 1. Trade balance | 2,401 | 4,527 | -18 | 2,771 | 675 | 3,002 | 68 | 1,744 |
| a. Exports | 11,974 | 45,639 | 10,183 | 47,082 | 44,049 | 51,913 | 47,465 | 54,103 |
| b. Imports | -9,573 | -41,113 | -10,202 | -44,311 | -43,375 | -48,911 | -47,398 | -52,360 |
| 2. Services | -420 | -2,258 | -470 | -2,063 | -2,242 | -2,502 | -2,738 | -3,233 |
| 3. Investment incomes | -3,460 | -12,701 | -2,970 | -13,069 | -11,151 | -13,670 | -11,881 | -13,328 |
| 4. Current transfers | 808 | 3,296 | 789 | 3,485 | 3,117 | 3,784 | 3,516 | 3,657 |
| *Of which:* | | | | | | | | |
| Remittances | 678 | 2,788 | 660 | 2,964 | 2,651 | 3,218 | 2,991 | 3,105 |
| **II. Financial account** | **7,342** | **21,963** | **7,203** | **21,377** | **18,601** | **13,385** | **14,036** | **13,160** |
| *Of which:* | | | | | | | | |
| 1. Private sector | 5,759 | 20,277 | 6,986 | 21,168 | 18,655 | 13,172 | 13,917 | 12,902 |
| a. Long term | 5,325 | 16,236 | 5,992 | 16,999 | 16,799 | 11,072 | 12,106 | 11,397 |
| b. Short term 1/ | 433 | 4,042 | 994 | 4,169 | 1,856 | 2,100 | 1,811 | 1,505 |
| 2. Public sector 2/ | 1,583 | 1,685 | 217 | 209 | -54 | 213 | 118 | 258 |
| **III. Balance of payments (=I+II)** | **6,671** | **14,827** | **4,533** | **12,500** | **9,000** | **4,000** | **3,000** | **2,000** |
| Memo: | | | | | | | | |
| Long-term private capital inflow 3/ | 6,070 | 20,914 | 7,038 | 22,247 | 22,349 | 16,416 | 17,620 | 16,260 |
| GDP (Billion US$) | 47 | 200 | 51 | 221 | 219 | 240 | 238 | 260 |

1/ Includes errors and omissions.
2/ Includes exceptional financing.
3/ Includes foreign direct investments, portfolio investment and long-term disbursements.
IR: Inflation Report.
* Forecast.

**Graph 43**
**CURRENT ACCOUNT AND LONG-TERM PRIVATE CAPITAL INFLOWS 1/: 2006 - 2015**
(% GDP)




1/ Includes foreign direct investments, portfolio investment and long-term disbursements.
* Forecast.

44. The deficit on current account for **2013** is revised up from 4.0 percent of GDP (previous report) to 4.4 percent of GDP. This higher deficit is forecast due to the lower trade surplus estimated for the year in a context of declining terms of trade and a lower projected global growth, offset in part by lower capital outlays for factor income given the expected decline of profits in the mining sector. In **2014** the deficit on current account would be higher than that estimated in our March Report –4.6 percent of GDP instead of 3.9 percent of GDP– given the deterioration foreseen in terms of trade and given the slower recovery of the world economy.

    In **2015** the deficit is expected to decrease to 4.3 percent of GDP as a result of the recovery and growth of mining exports associated with the onset of operations at mines Toromocho and Las Bambas, whose production of copper is estimated at 275 and 325 thousand fine metric tons (FMT), respectively. Increased non-traditional exports would add onto this due to the higher rates of economic growth foreseen in our trading partners.

**Terms of trade and commodity prices**

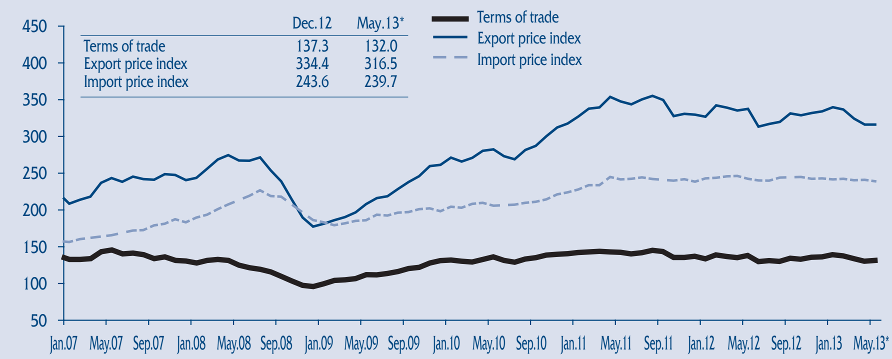
45. In the first five months of the year, terms of trade accumulate a decline of 1.5 percent, associated mainly with the lower prices of metals. In general terms, the prices of commodities have been affected by the slower pace of growth in China, as well as by fears of an earlier withdrawal of quantitative easing programs by the FED. The drop in the prices of minerals has been in part offset by the lower prices of imports, associated with the correction of the international prices of food commodities. The terms of trade are expected to continue declining in the rest of the year, which would result in an average drop of 2.3 percent compared to their level last year. In 2014 and 2015, the terms of trade are expected to continue declining by 1.2 and 0.7 percent, respectively.

**Table 16**
**TERMS OF TRADE: 2012 - 2015**
(Annual average data)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Jan.-May. | Year | Jan.-May.,1/ | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **Terms of trade** | **-4.6** | **-4.9** | **-1.5** | **0.3** | **-2.3** | **0.0** | **-1.2** | **-0.7** |
| **Price of exports** | **-1.5** | **-3.3** | **-2.9** | **-1.0** | **-3.4** | **0.7** | **-0.9** | **0.5** |
| *Copper (US$ cents per pound)* | 373 | 361 | 346 | 359 | 336 | 360 | 330 | 327 |
| *Zinc (US$ cents per pound)* | 91 | 88 | 89 | 91 | 87 | 93 | 90 | 91 |
| *Lead (US$ cents per pound)* | 94 | 94 | 99 | 103 | 96 | 103 | 97 | 99 |
| *Gold (US$ per ounce)* | 1,663 | 1,670 | 1,561 | 1,608 | 1,467 | 1,600 | 1,400 | 1,400 |
| ***Price of imports*** | **3.4** | **1.7** | **-1.4** | **-1.3** | **-1.2** | **0.7** | **0.3** | **1.2** |
| *Oil (US$ per barrel)* | 101 | 94 | 94 | 93 | 94 | 92 | 93 | 91 |
| *Wheat (US$ per ton)* | 238 | 276 | 273 | 276 | 275 | 280 | 280 | 275 |
| *Maize (US$ per ton)* | 248 | 273 | 275 | 256 | 253 | 222 | 222 | 224 |
| *Soybean oil (US$ per ton)* | 1,157 | 1,125 | 1,083 | 1,104 | 1,082 | 1,110 | 1,074 | 1,068 |

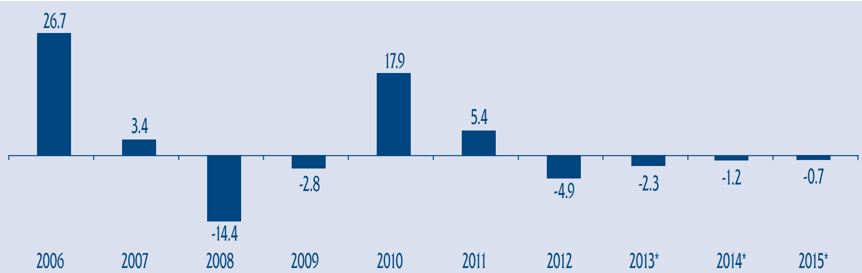
1/ Preliminary.
* Forecast.

**Graph 44**
**TERMS OF TRADE, EXPORT AND IMPORT PRICE INDICES: JANUARY 2007 - MAY 2013**
(1994=100)



* Preliminary.

**Graph 45**
**TERMS OF TRADE: 2006-2015**
(% change)



* Forecast.

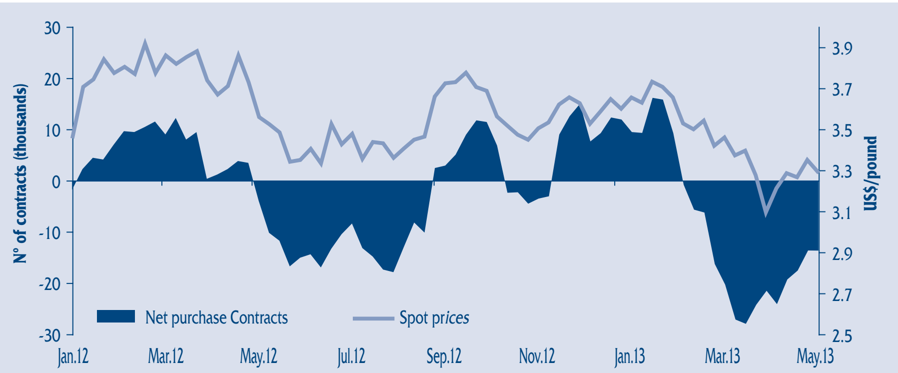
## Copper

The price of **copper** continued showing a declining trend during the first five months of the year and dropped 9 percent, closing the month of May with an average level of US$ 3.29 per pound. Moreover, copper registered a noteworthy price drop of 6 percent in April, when the monthly mean price fell to US$ 3.27/pound on average.

The declining trend of copper observed this year is explained mainly by lower activity in the first months of the year, particularly in China given that this economy grew less than expected in Q1. In addition, the liquidation of speculative positions in this mineral, especially during the months of March and April, also contributed to this declining trend.

However, this trend was interrupted in May as a result of supply problems. China's market of copper has tightened due to the lack of copper waste and scrap associated with the price drop[5] and fears of a lower supply have added onto this due to the suspension of production at the Grasgberg mine in Indonesia, the second largest copper mine in the world, as a result of a tunnel collapse and a landslide that would keep part of the mine operations closed for about three months.

**Graph 46**
**COPPER: NON-COMMERCIAL CONTRACTS**




Source: Bloomberg.

China's demand is expected to remain weak in the forecast horizon. In addition to this, the production of copper concentrates would increase its growth rate threefold in the next two years as a result both of the operations of new mining projects and the expansion of existing mines in 2013 - 2015[6], which would

5 In recent years, recycling accounts for about one third of the production of refined copper in China.

6 After the adjustments made for possible interruptions of operations, the International Copper Study Group (ICSG) estimates that mine production would grow 5.5 percent per annum in 2013 and 2014.

generate a market surplus. The supply of copper concentrates would grow at significantly greater rates than those recorded during the preceding 5 years[7]. However, unexpected cuts in supply and the economic recovery of the United States could give certain support to the price of copper in the short and medium term, respectively. In line with these developments, it is estimated that prices will decline in the forecast horizon compared to the level estimated in our last Inflation Report.

**Table 17**
**WORLD REFINED COPPER USAGE AND SUPPLY**
(Thousand metric tons)

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|
| World mine production | 15,569 | 15,943 | 16,053 | 16,076 | 16,700 | 17,561 | 18,541 |
| World refined production (Primary+Secondary) | 18,214 | 18,248 | 18,981 | 19,596 | 20,114 | 20,983 | 22,046 |
| World refined usage | 18,053 | 18,070 | 19,346 | 19,830 | 20,512 | 20,566 | 21,366 |
| Refined balance 1/ | 161 | 178 | -365 | -234 | -397 | 417 | 681 |
| Stock inventories | 378 | 697 | 573 | 552 | 593 | n.a. | n.a. |
| Consumption days | 7.6 | 14.1 | 10.8 | 10.2 | 10.6 | n.a. | n.a. |

1/ Not includes unreported inventories for China apparent usage.
Source: ICSG.

**Graph 47**
**COPPER: JANUARY 2007 - DECEMBER 2015**
(ctv. US$/pd.)


## Zinc

The price of **zinc** fell 14 percent between March and May 2013 and recorded an average price of US$ 0.83/pound at the close of May. With this, the price of zinc accumulates a drop of 10 percent so far this year.

7 The operations of PT Freeport in Indonesia, Collahuasi in Chile, and Antapaccay in Peru would account for over 50 percent of production increases this year.

This price drop reflects ample supply conditions in the world market. Recent projections show that the market of refined zinc products[8] in 2013 would show a global surplus for the seventh consecutive year. These results are consistent with the increase observed in the production of refined zinc, particularly the significant increase recorded in China's production despite the greater environmental controls implemented in this country. Since China will be self-sufficient to meet its needs, it will generate no market pressures this year. On the other hand, the expansion of the refinery of Porto Vesme in Italy would boost production in Europe, adding onto the increased production of refined products in Australia, Brazil, India, Japan, South Korea, and Peru.

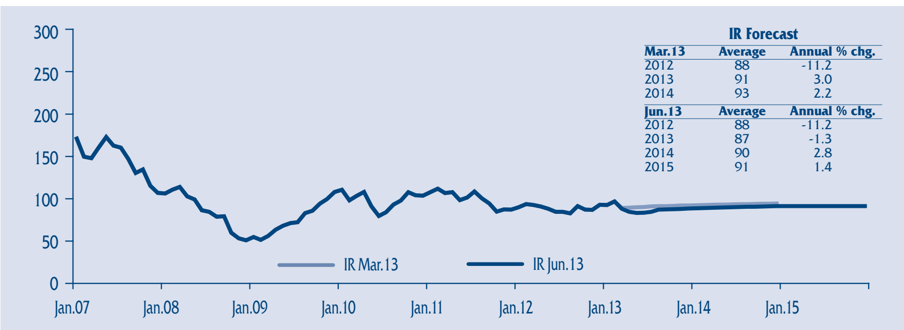
**Table 18**
**WORLD REFINED ZINC SUPPLY AND USAGE**
(Million metric tons)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|
| World mine production | 11.20 | 11.88 | 11.61 | 12.49 | 12.95 | 13.60 | 13.99 |
| World refined production | 11.35 | 11.77 | 11.28 | 12.89 | 13.12 | 12.66 | 13.25 |
| World refined usage | 11.23 | 11.57 | 10.92 | 12.64 | 12.75 | 12.40 | 12.98 |
| Refined balance (thousands) | 116 | 198 | 362 | 248 | 366 | 265 | 270 |

Source: ILZSG.

The fundamentals of the zinc market continue indicating a slack market, although in the medium term the production of refined zinc would not recover at the same rate as the growth in consumption, which would generate upward pressures on the price of zinc. In the forecast horizon, the international price of zinc is expected to be slightly below the levels estimated in the Inflation Report of March.

**Graph 48**
**ZINC: JANUARY 2007 - DECEMBER 2015**
(ctv. US$/pd.)



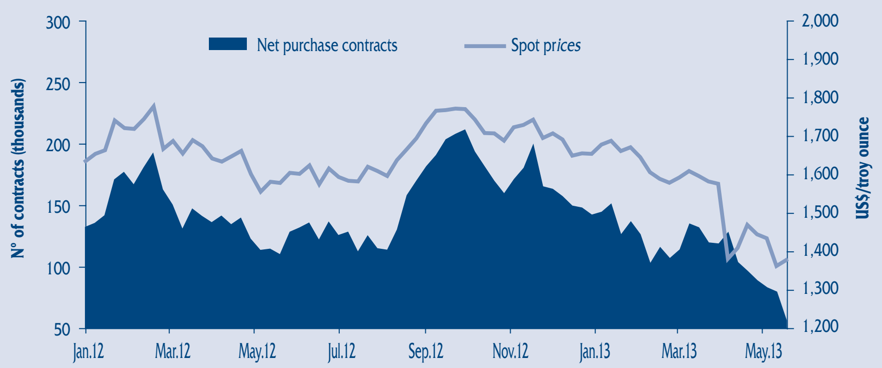

8 Forecast of the International Lead and Zinc Study Group (ILZG) for 2013.

## Gold

In the past three months, the price of **gold** fell 11 percent, affected by the change in the global economic outlook after the publication of data indicating an unexpected slowdown of the Chinese economy in Q1, lower inflation in the advanced economies, and fears of a withdrawal of the FED's monetary stimulus in the near future. With this, the price of gold has decreased 16 percent so far this year, having closed at an average price of US$ 1,414 per troy ounce in May.

This context affected the demand of investors, who continued liquidating their positions in gold, attracted by other more profitable investment options such as variable income assets, which showed higher profits in the first five months of the year. The non-commercial positions of Comex gold fell to their lowest level since December 2008, while exchange-traded funds (ETF) recorded net sales of gold, in contrast to the net purchases of gold made by these funds during 2012[9]. ETFs' liquidations of gold already represent 16 percent of the maximum balance recorded at the beginning of the year.

**Graph 49**
**GOLD: NON-COMMERCIAL CONTRACTS**




Source: Bloomberg.

However, the price fall was offset by an increase in the physical demand for gold, especially from Asian countries. The higher demand for jewelers gold was particularly noteworthy in India, China, and Hong Kong, and to a lesser extent in other Asian economies. On the other hand, central banks' demand for gold in Q1 was over 100 tons, slightly below the amount purchased in 2012[10].

9 According to Barclays, the net sales of gold of ETFs carried out between January and May 2013 amount to 454 tons, which contrasts with the net purchases of gold made in 2012 which amount to 279 tons. The World Gold Council reported that the ETFs sold US$ 9.3 billion in gold in Q1-2013.

10 Data provided by the World Gold Council.

It should be pointed out, however, that lower growth in China and India would also affect the demand for jewelry. Moreover, the tariff rate on gold imports in India has been increased to up to 8 percent (from 1 percent in January 2012).

**Table 19**
**WORLD GOLD SUPPLY AND USAGE**
(Tons)

| | 2011 | 2012 | Q1.12 | Q1.13 |
|---|---|---|---|---|
| World mine production | 2,849 | 2,817 | 662 | 685 |
| Gold recycling | 1,649 | 1,591 | 383 | 367 |
| **Total supply** | **4,498** | **4,408** | **1,045** | **1,052** |
| Jewelry | 1,975 | 1,895 | 491 | 551 |
| Technology | 452 | 408 | 106 | 102 |
| Investment | 1,699 | 1,526 | 396 | 201 |
| Central banks | 457 | 533 | 115 | 109 |
| **Gold demand 1/** | **4,582** | **4,362** | **1,108** | **963** |
| OTC investments and stock flows 2/ | -84 | 46 | -75 | 120 |
| **Total demand** | **4,498** | **4,408** | **1,033** | **1,083** |
| **Market balance** | **0** | **0** | **12** | **-31** |

1/ Net purchases.
2/ OTC- Over The Counter.
Source: World Gold Council.

The price of gold would continue to be affected by expectations of lower inflation given that the current price of gold appears to be discounting an inflationary increase which has not occurred. Furthermore, the dollar would continue strengthening due to better growth prospects in the United States compared to other developed economies. In this context, the forecast on the price of gold in the forecast horizon is revised downwards.

**Graph 50**
**GOLD: JANUARY 2007 - DECEMBER 2015**
(US$/tr.ou.)

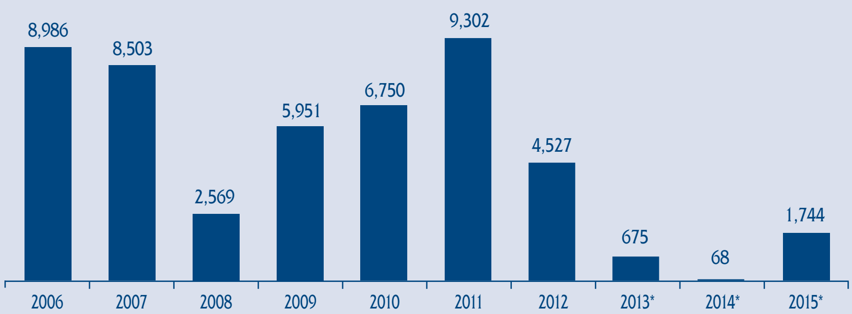

## Trade Balance

46. Considering the decline in terms of trade foreseen for 2013 in comparison with the slight increase estimated in our previous report, the forecast on the surplus of

the **trade balance** in 2013 has been revised down from US$ 2.77 billion (Inflation Report of March) to US$ 675 million. This forecast considers a lower volumen of traditional exports, in line with the evolution of exports registered in the first months of the year.

In 2014 the surplus in the trade balance would decline to US$ 68 million in a context of global slowdown, while in 2015 the trade surplus is projected to reach US$ 1.74 billion considering the onset of operations of copper mining projects.

**Graph 51**
**TRADE BALANCE: 2006-2015**
(Millions of US$)




* Forecast.

**Table 20**
**TRADE BALANCE**
(Million US$)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **EXPORTS** | **11,974** | **45,639** | **10,183** | **47,082** | **44,049** | **51,913** | **47,465** | **54,103** |
| Of which: | | | | | | | | |
| Traditional products | 9,251 | 34,247 | 7,588 | 35,179 | 32,605 | 38,564 | 35,115 | 40,499 |
| Non-traditional products | 2,633 | 11,047 | 2,615 | 11,504 | 11,095 | 12,920 | 11,989 | 13,214 |
| Other goods | 89 | 345 | 81 | 399 | 349 | 429 | 361 | 390 |
| **IMPORTS** | **9,573** | **41,113** | **10,202** | **44,311** | **43,375** | **48,911** | **47,398** | **52,360** |
| Of which: | | | | | | | | |
| Consumer goods | 1,846 | 8,247 | 1,984 | 9,184 | 8,863 | 10,560 | 10,093 | 11,679 |
| Inputs | 4,542 | 19,256 | 4,847 | 20,485 | 20,123 | 21,953 | 21,541 | 23,567 |
| Capital goods | 3,109 | 13,356 | 3,334 | 14,377 | 14,158 | 15,986 | 15,392 | 16,731 |
| Other goods | 76 | 253 | 36 | 265 | 231 | 412 | 371 | 383 |
| **TRADE BALANCE** | **2,401** | **4,527** | **-18** | **2,771** | **675** | **3,002** | **68** | **1,744** |

IR: Inflation Report.
* Forecast.

47. The forecast on exports in 2013 has been revised downwards to around US$ 44 billion, which represents a reduction of 3.5 percent compared to 2012. This revised

projection considers both lower export prices and lower volumes of exports, especially of traditional products, based on the evolution of exports observed in the first months of the year when exports of gold and copper declined due to the lower content of mineral obtained at the mines of Barrick, Yanacocha, and Antamina. Other traditional exports, such as coffee (which was affected by the coffee rust plague), decreased as well. Moreover, a decline in the rate of growth is considered in the case of non-traditional exports given the downward revision of global growth and the evolution of these exports in the first months of the year, when lower exports of textiles and chemicals to other Latin American countries was observed.

**Table 21, TRADE BALANCE**
(% change)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **1. Value:** | | | | | | | | |
| a. Exports | 18.5 | -1.4 | -15.0 | 3.2 | -3.5 | 10.3 | 7.8 | 14.0 |
| Traditional products | 19.0 | -4.4 | -18.0 | 2.7 | -4.8 | 9.6 | 7.7 | 15.3 |
| Non-traditional products | 16.9 | 9.1 | -4.5 | 4.1 | 0.4 | 12.3 | 8.1 | 10.2 |
| b. Imports | 16.7 | 11.2 | 6.6 | 7.8 | 5.5 | 10.4 | 9.3 | 10.5 |
| **2. Volume:** | | | | | | | | |
| a. Exports | 18.2 | 2.2 | -14.3 | 4.2 | -0.1 | 9.5 | 8.7 | 13.4 |
| Traditional products | 20.0 | 0.4 | -18.0 | 3.9 | -0.9 | 9.6 | 10.1 | 15.8 |
| Non-traditional products | 12.5 | 9.0 | -1.4 | 5.2 | 2.2 | 9.1 | 5.6 | 7.1 |
| b. Imports | 10.8 | 9.5 | 7.8 | 9.2 | 6.7 | 9.6 | 8.9 | 9.2 |
| **3. Price:** | | | | | | | | |
| a. Exports | 0.4 | -3.3 | -0.7 | -1.0 | -3.4 | 0.7 | -0.9 | 0.5 |
| Traditional products | -0.7 | -4.6 | 0.0 | -1.1 | -4.0 | 0.0 | -2.2 | -0.4 |
| Non-traditional products | 4.0 | 0.3 | -3.2 | -1.0 | -1.7 | 3.0 | 2.3 | 2.9 |
| b. Imports | 5.4 | 1.7 | -1.1 | -1.3 | -1.2 | 0.7 | 0.3 | 1.2 |

IR: Inflation Report.
* Forecast.

**Graph 52**
**EXPORTS OF GOODS: 2006-2015**
(Billion US$)


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

Exports in 2014 would amount to US$ 47 billion, which is a lower estimate than the one foreseen in our March report, due mainly to the lower prices of mining products such as gold, copper, and zinc. In 2015 exports would be around US$ 54 billion due to increased exports of mining products, especially copper, as a result of the onset of operations in mining projects such as Toromocho, Las Bambas, and Constancia.

**Graph 53**
**NON-TRADITIONAL EXPORTS VOLUME: 2006-2015**
(Index 1994=100)


* Forecast.

**Graph 54**
**VOLUME OF COPPER EXPORTS: 2006-2015**
(Thousand TMF)


* Forecast.

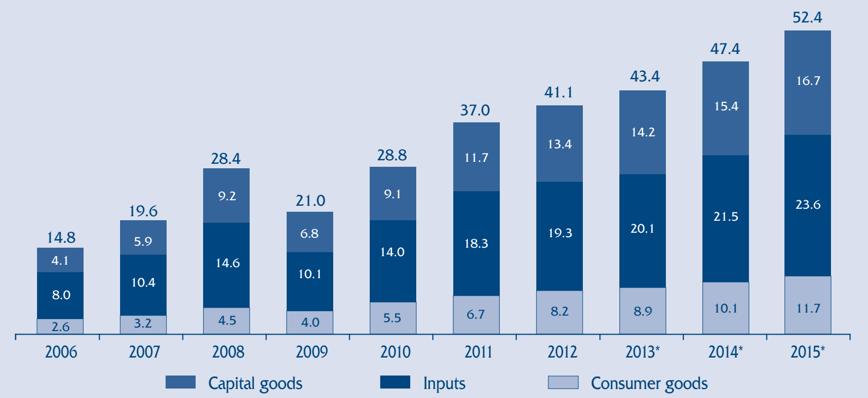
**Graph 55**
**VOLUME OF GOLD EXPORTS: 2006-2015**
(Thousand ounces)


* Forecast.

48. The forecast on **imports** in 2013 has been revised down in line with the slowdown foreseen in economic activity and thus the value of imports is estimated at around US$ 43 billion, a figure 5.5 percent higher than in 2012. However, a lower value of imports than in our last report is foreseen for 2013 due to the downward revision of imports of inputs, in line with the lower production of consumer goods and the lower industrial production expected.

In 2014 the level of imports would amount to US$ 47 billion and in 2015 it would reach US$ 52 billion. The volumes of imports in the forecast horizon would continue showing rates close to 9.0 percent, which is consistent with the evolution of economic activity, although these levels are lower than those observed in 2011 and 2012.

**Graph 56**
**IMPORTS OF GOODS: 2006 - 2015**
(Billion US$)




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

## Financial account

49. In Q1-2013 the **long-term financial account of the private sector** recorded a balance of US$ 6 billion, which is equivalent to 11.7 percent of GDP. This balance was higher than the one registered in Q1-2012 due mainly to the increased financing of the non-financial sector through bonds issued in the international markets and, to a lesser extent, due to higher foreign direct investment in the country, which was in part offset by the increased flow of capitals invested by local institutional investors abroad.

**Table 22**
**LONG-TERM FINANCIAL ACCOUNT OF THE PRIVATE SECTOR**
(Million US$)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **1. ASSETS** | **-421** | **-2,477** | **-627** | **-4,209** | **-4,209** | **-4,396** | **-4,459** | **-3,778** |
| **2. LIABILITIES** | **5,746** | **18,712** | **6,619** | **21,209** | **21,008** | **15,468** | **16,566** | **15,175** |
| Foreign direct investment in the country | 3,576 | 12,240 | 4,126 | 10,841 | 11,108 | 9,404 | 9,400 | 9,435 |
| Non-financial sector | 1,509 | 3,598 | 2,007 | 7,002 | 6,708 | 4,397 | 5,666 | 5,340 |
| Long-term loans | 705 | 2,023 | 264 | 2,706 | 1,904 | 2,028 | 2,026 | 1,828 |
| Portfolio investment | 804 | 1,575 | 1,743 | 4,296 | 4,804 | 2,369 | 3,640 | 3,513 |
| Financial sector | 662 | 2,875 | 486 | 3,365 | 3,192 | 1,666 | 1,500 | 400 |
| Long-term loans | 729 | 2,092 | 186 | 1,865 | 1,692 | 1,170 | 892 | 200 |
| Portfolio investment | -67 | 783 | 300 | 1,500 | 1,500 | 496 | 608 | 200 |
| **3. NET FLOW (1+2)** | **5,325** | **16,236** | **5,992** | **16,999** | **16,799** | **11,072** | **12,106** | **11,397** |
| *% GDP* | *11.4* | *8.1* | *11.7* | *7.7* | *7.7* | *4.6* | *5.1* | *4.4* |

IR: Inflation Report.
* Forecast.

In **2013** the private long term financial account would show a balance of US$ 17 billion (a similar figure to the one estimated in our March Report). This forecast considers a shift in the composition of the non financial sector's external financing towards an increased foreign portfolio investment, mainly via greater issuances of bonds abroad. In fact, a greater amount of bonds issued abroad was observed until the month of April (US$ 4.8 billion), favored by a context of excess of liquidity in international markets and the lower country risk perceived by foreign investors in the first four months of the year. However, a lower flow of funds to the emerging economies was observed in March given that markets anticipated a withdrawal of monetary stimulus in the USA in a not too distant future. A greater flow of external financing is also expected through direct investment for some major investment projects.

Positive flows of US$ 12.1 billion and US$ 11.4 billion –equivalent to 5.1 and 4.4 percent of GDP– are estimated for **2014** and **2015**, respectively. This upward revision is consistent with the greater external financing required for the implementation of the private investment projects that have been programmed. On the other hand, the decrease in the estimated financing flows in 2015 relative to 2014 is explained in part by the culmination of the construction stage of some large investment projects which are due to start operating in 2014, as well as by the lower external long-term funding expected for the financial sector.

**Graph 57**
**LONG-TERM EXTERNAL FINANCING OF THE PRIVATE SECTOR: 2006-2015 1/**
(% GDP)

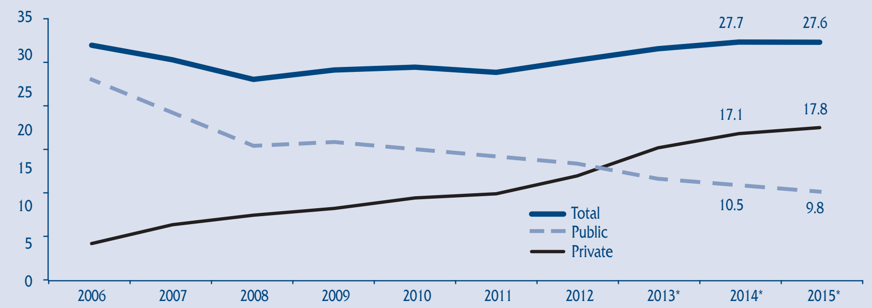

1/ Includes net foreign direct investment, foreign portfolio investment, and long-term disbursements.
* Forecast.

50. On the other hand, the **financial account of the public sector** showed a positive flow of US$ 216 million in Q1, explained mostly by the placement of MiVivienda Corporate Bonds (US$ 500 million). These operations were in part offset by the amortization of the public debt (US$ 578 million), which included the prepayment of US$ 423 million to the International Bank for Reconstruction and Development (IBRD).

    A negative flow of US$ 62 million is foreseen for 2013, which contrasts with the positive flow of US$ 201 million estimated in our March report. This downward revision is explained by fewer operations in the secondary market of debt securities as a result of a moderation in non-residents' demand for sovereign bonds given that the international financial markets have reacted to the likelihood that interest rates will rise sooner than expected in the USA. To a lesser extent, this downward revision is also explained by the lower disbursements foreseen for investment projects this year.

51. Thus, the balance of medium- and long-term external debt would increase from 25.2 percent of GDP in 2012 to 26.9 percent in 2013. The rising trend of the private sector's external indebtedness, which would increase from 12.0 percent of GDP in 2012 to 15.5 percent of GDP in 2013, would imply that, for the first time, the level of private indebtedness is higher than the level of public indebtedness given that the latter would continue showing a downward trend in 2014 and 2015. The external public debt, including domestic bonds held by non-residents, would decline from 13.2 percent of GDP in 2012 to 10.5 of GDP in 2014 and to 9.8 percent of GDP in 2015.

**Graph 58**
**MEDIUM- AND LONG-TERM EXTERNAL DEBT STOCK: 2006-2015**
(% GDP)




* Forecast.

52. In the first three months of 2013 the **flow of short-term external capitals** showed a positive balance of US$ 620 million, in contrast with Q1-2012 when it showed a deficit of US$ 336 million. A positive flow of US$ 2.5 billion is forecast for year 2013, a lower figure than the one estimated in our previous report due to the moderation anticipated in external funding as a result of the international context and of the reserve requirement measures adopted by the Central Bank to offset the impact of capital inflows on the growth of credit.

53. In view of capital inflows and in order to prevent excessive volatility in the foreign exchange market and continue reducing the economy's vulnerability face abrupt cuts in external funding, the Central Bank has intervened in the foreign exchange market purchasing US$ 4.37 billion in Q1. As a result, international reserves at the close of May amounted to US$ 66.77 billion. This amount of reserves represents 32.7 percent of GDP, covers more than 5 times the short term external debt, and backs up 96.8 percent of the financial system's total liabilities with the private sector (total liquidity).

**Graph 59**
**NET INTERNATIONAL RESERVES: 2005 - MAY.2013**
(Million US$)

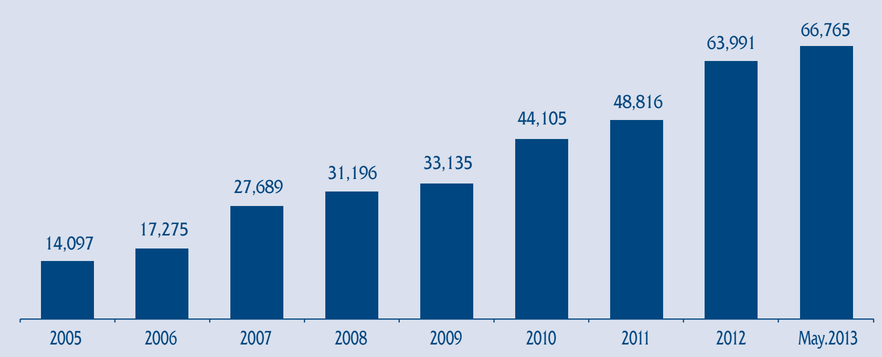


**Table 23**
**NIR INDICATORS**

| | May.03 | May.08 | May.13 |
|---|---|---|---|
| Net International Reserves (NIR, millions of US$) | 10 360 | 34 859 | 66 765 |
| BCRP International Position (Millions of US$) | 3 813 | 27 542 | 48 406 |
| NIR / GDP (%) 1/ | 17.9 | 30.6 | 32.7 |
| NIR / Short-term external debt (# of times) 2/ | 2.3 | 2.9 | 5.9 |
| NIR / Total Liquidity (%) | 83.9 | 109.2 | 96.8 |

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

## Box 2
## THE TRANS-PACIFIC PARTNERSHIP AGREEMENT: GENERAL ASPECTS

The Trans-Pacific Partnership Agreement (TPP), which will be established by 12 countries (Australia, Brunei, Canada, Chile, United States, Japan[11], Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam), is an economic integration initiative in the Asia-Pacific region. With more than 750 million people (11.2 percent of the world's population) and with a per capita average weighted income of US$ 33.4 thousand in terms of purchasing power parity (PPP), this region's market concentrates 31.8 percent of global GDP.

**TRANS-PACIFIC ALLIANCE: SELECTED INDICATORS**

| | GDP (% World) 2012 | GDP per cápita - PPP (Thousand US$) 2012 | Population (% World) 2012 | HDI (*) 2012 | GCI (*) 2012 | X - Goods (% World) 2012 | M - Goods (% World) 2012 | Average nominal tariff (%) 2011 | FDI inflow (% World) 2011 |
|---|---|---|---|---|---|---|---|---|---|
| Trans-pacific alliance | 31.8 | 33.4 | 11.2 | - | - | 23.8 | 28.1 | - | 30.0 |
| Peru | 0.4 | 10.7 | 0.4 | 77 | 61 | 0.2 | 0.2 | 3.7 | 0.3 |
| Australia | 1.2 | 42.6 | 0.3 | 2 | 20 | 1.4 | 1.4 | 2.8 | 2.4 |
| Brunei Darussalam | 0.0 | 54.4 | 0.0 | 30 | 28 | 0.1 | 0.0 | 2.5 | 0.1 |
| Canada | 1.8 | 42.7 | 0.5 | 11 | 14 | 2.5 | 2.6 | 4.5 | 2.9 |
| Chile | 0.4 | 18.4 | 0.2 | 40 | 33 | 0.4 | 0.4 | 6.0 | 0.8 |
| United States | 18.9 | 49.9 | 4.4 | 3 | 7 | 8.4 | 12.6 | 3.5 | 17.2 |
| Japan | 5.6 | 36.3 | 1.8 | 10 | 10 | 4.4 | 4.8 | 5.3 | 1.1 |
| Malaysia | 0.6 | 16.9 | 0.4 | 64 | 25 | 1.2 | 1.1 | 6.5 | 0.6 |
| Mexico | 2.1 | 15.3 | 1.6 | 61 | 53 | 2.0 | 2.1 | 8.3 | 1.5 |
| New Zealand | 0.2 | 29.7 | 0.1 | 6 | 23 | 0.2 | 0.2 | 2.0 | 0.4 |
| Singapore | 0.4 | 60.4 | 0.1 | 18 | 2 | 2.2 | 2.1 | 0.0 | 2.5 |
| Vietnam | 0.4 | 3.5 | 1.3 | 127 | 75 | 0.6 | 0.6 | 9.8 | 0.4 |

(*) Ranking in the Human Development Index (187 countries) and in the Global Competitiveness Index (144 countries).
Sources: IMF, UNDP, WEF, WTO, and UNCTAD.

The TPP is being built on the basis of the "Trans-Pacific Strategic Economic Partnership Agreement" (TPSEP or P4), a trade agreement established in 2006 and signed by Brunei, Chile, New Zealand, and Singapore, original signatories of the Trans-Pacific Partnership Agreement..

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11 Japan is in the process of officially requesting to join the TPP as a negotiating partner. The representative of the US Trade Office, USTR, reported on April 24, 2013, the U.S. intention of including Japan in the TPP negotiations.

Article 20.6 of the P4 provides for the possibility of accession of other APEC countries or other nations to promote the creation of a major strategic alliance for the liberalization of trade in the Asia-Pacific region. TPP negotiations are currently being carried out to extend the scope of the P4 and thus establish a future Free Trade Area in this region.

The TPP negotiations began in March 2010 in Melbourne, Australia. The 17th round took place in Lima last May and the next negotiation round will take place in Malaysia.

The TPP is a comprehensive commercial policy instrument which includes other aspects besides access to market and tariff measures. The TPP agreement includes measures and actions in the areas of access to markets; rules of origin; customs procedures; sanitary and phytosanitary measures; technical barriers to trade; government procurement; intellectual property; trade defense; competition policies; as well as policies in terms of cross-border trade in services; financial services; temporary immigration for business; telecommunications; e-commerce; investment; environment; labor; cooperation; regulatory consistency; small and medium-sized enterprises; competitiveness; development; institutional matters, and dispute resolution.

Today, Peru has already signed trade agreements with six of the countries participating in the TPP: Canada, Chile, United States, Mexico, and Singapore, and two trade agreements with Japan. None of these agreements will cease to be effective after the TPP enters into force.

**TRANS-PACIFIC PARTNERSHIP AGREEMENT: BILATERAL COMMERCIAL AGREEMENTS SIGNED BY PERU**

| Countries participating in the TPP | Agreement established with Peru | Name of current agreement with Peru | In force as of (dd-mm-yy) |
|---|---|---|---|
| Australia | No | - | - |
| Brunei | No | - | - |
| Canada | Yes | Canada-Peru Free Trade Agreement | 01/08/2009 |
| Chile | Yes | Chile-Peru Free Trade Agreement | 01/03/2009 |
| United States | Yes | The United States - Peru Trade Promotion Agreement | 01/02/2009 |
| Japan | Yes | Japan-Peru Economic Partnership Agreement<br>Article 16, Implementation Agreement | 01/03/2012<br>01/03/2012 |
| Malaysia | No | - | - |
| Mexico | Yes | Mexico-Peru Free Trade Agreement | 01/02/2012 |
| New Zeland | No | - | - |
| Singapore | Yes | Peru-Singapore Free Trade Agreement | 01/08/2009 |
| Vietnam | No | - | - |

The TPP consolidates Peru's policy of trade liberalization according to which commercial bilateral and regional agreements have already been signed with 52 countries –agreements with 49 countries are already effective and agreements with 3 countries will soon enter into force. Reflecting its increasing openness to other markets, this allows the country to be commercially integrated with a market of 3 billion people, which represents 43 percent of the world's population and concentrates 73 percent of global GDP.

As a result of this integration process, 90 percent of Peru's international trade is carried out today with countries with which Peru has already a trade agreement, with countries with which it has established a trade agreement that will enter into force shortly, or with countries with which a trade agreement is being negotiated.

The added value of the TPP for Peru lies in three main aspects:

a. The TPP will allow Peru to strengthen existing business opportunities and to include others which were not included in the trade agreements with the six countries with which Peru has bilateral agreements.

b. Have a greater access to the markets of Australia, Brunei, Malaysia, New Zealand, and Vietnam, taking advantage of the elimination of tariffs and of the regulations of non-commercial aspects aimed at strengthening investment and competitiveness.

c. Participate in a significant economic commercial bloc that will serve as a platform for economic integration in the Asia-Pacific region.

# IV. Public Finances

54. The international scenario was marked by lower commodity prices which affected the country's exports and reflected not only in a lower growth of GDP estimated for the year, but also in lower fiscal revenues than those forecast in our March report. As regards the general government spending, a similar government spending than the one considered in the last Multiannual Macroeconomic Framework and over 10 percent higher than the recorded in 2012 is estimated for 2013.

55. The economic balance in Q1-2013 shows a lower surplus than the one registered in the same period in 2012 (5.9 of GDP vs. 7.1 percent of GDP). This is explained by the higher growth rate of current expenses due to the salary increases implemented in the public sector and by the lower balance of state-owned enterprises in this period due to Petroperu's higher expenditure in goods and services. Current income and capital spending also grew in real terms, but at a slower pace than in Q1-2012.

**Table 24**
**NON FINANCIAL PUBLIC SECTOR**
(% GDP)

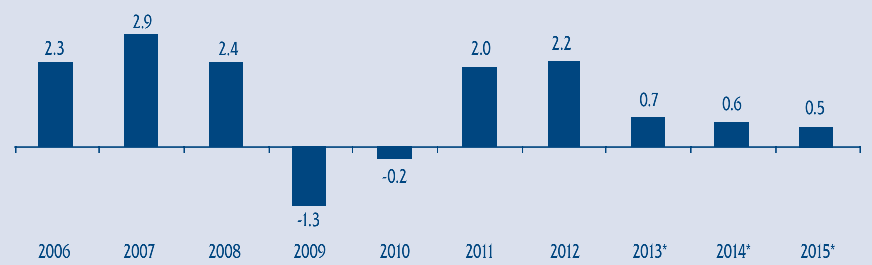
| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **1. General government current revenues 1/** | **22.4** | **21.6** | **22.6** | **21.6** | **21.3** | **21.6** | **21.4** | **21.5** |
| *Real % change* | *7.6* | *7.2* | *3.8* | *5.8* | *3.5* | *6.8* | *6.8* | *7.5* |
| **2. General government non-financial expenditure 2/** | **14.2** | **18.6** | **14.9** | **19.6** | **19.6** | **19.7** | **19.8** | **20.0** |
| *Real % change* | *3.3* | *8.1* | *8.2* | *11.2* | *10.4* | *7.1* | *7.5* | *8.2* |
| Of which: | | | | | | | | |
| Current | 11.1 | 13.1 | 11.6 | 13.6 | 13.7 | 13.5 | 13.5 | 13.3 |
| *Real % change* | *-2.9* | *5.4* | *7.6* | *9.8* | *9.9* | *5.9* | *4.5* | *5.2* |
| Gross capital formation | 3.1 | 5.5 | 3.3 | 6.0 | 5.9 | 6.2 | 6.3 | 6.8 |
| *Real % change* | *34.2* | *15.3* | *10.3* | *14.5* | *11.7* | *9.7* | *14.6* | *14.5* |
| **3. Others** | **0.2** | **0.3** | **-0.4** | **0.0** | **0.0** | **0.0** | **-0.1** | **-0.1** |
| **4. Primary balance (1-2+3)** | **8.5** | **3.2** | **7.3** | **2.0** | **1.7** | **1.9** | **1.5** | **1.3** |
| **5. Interests** | **1.4** | **1.1** | **1.5** | **1.0** | **1.0** | **0.9** | **0.9** | **0.8** |
| **6. Overall balance** | **7.1** | **2.2** | **5.9** | **1.0** | **0.7** | **1.0** | **0.6** | **0.5** |
| Memo: (billion S/.): | | | | | | | | |
| 1. General government current revenues | 28 | 114 | 30 | 123 | 120 | 134 | 131 | 144 |
| 2. General government current revenues | 18 | 98 | 20 | 112 | 111 | 122 | 122 | 134 |
| 3. Nominal GDP | 125 | 526 | 132 | 569 | 565 | 620 | 614 | 671 |

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.
2/ Includes accrued payments by Net payments of the Fuel Price Stabilization Fund.
IR: Inflation Report.
* Forecast.

The balances estimated for **2013** and **2014** have been revised downwards from 1.0 percent of GDP in both years to 0.7 and 0.6 percent of GDP, respectively. This lower balance is mainly explained by the expected impact of lower export prices on revenues in this forecast scenario. The economic balance in 2015 is foreseen at 0.5 percent of GDP in a context in which public investment is expected to increase. All public expenditure forecasts are consistent with the provisions established in the Multiannual Macroeconomic Framework for 2014-2016.

It is worth pointing out that the Financial Equilibrium Law passed this year establishes that the economic balance should show no deficit, which replaces the macro fiscal rules of the Fiscal Transparency and Accountability Act that established that the fiscal deficit should be lower than 1 percent of GDP and that the maximum increase in real expenditure in consumption was 4 percent.

**Graph 60**
**ECONOMIC BALANCE OF THE NON FINANCIAL PUBLIC SECTOR: 2006-2015**
(% GDP)




* Forecast.

### Evolution of tax revenues

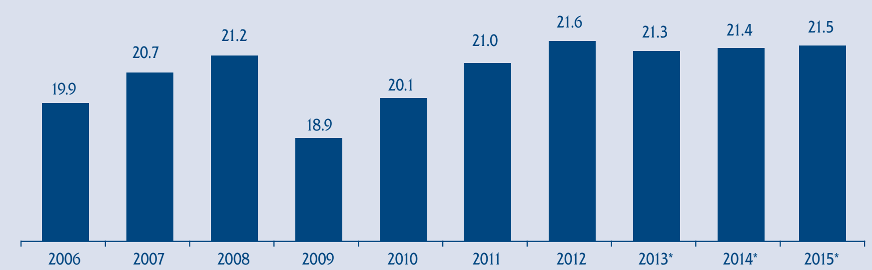
56. In **Q1-2013 the current revenues of the general government** amounted to 22.6 percent of GDP, a figure 0.2 percentage points higher than in Q1-2012, which represents a real growth of 3.8 percent. This balance results from the fact that non-tax revenues increased from 5.3 to 5.7 percent of GDP, while tax revenues declined from 17.2 percent to 17.0 percent of GDP. Non-tax revenues grew 10.7 percent, with the increase observed in social security contributions (11.9 percent) and in the Special Mining Levy (50 percent) standing out. The increase in the latter results from the difference in the payment system applied in 2013 and the one applied in early 2012.

**Table 25**
**GENERAL GOVERNMENT CURRENT REVENUES**
(% GDP)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **TAX REVENUES** | **17.2** | **16.4** | **17.0** | **16.2** | **16.1** | **16.3** | **16.2** | **16.3** |
| Income tax | 8.2 | 7.1 | 7.6 | 6.9 | 6.7 | 7.0 | 6.7 | 6.7 |
| Value added tax | 8.6 | 8.4 | 8.6 | 8.5 | 8.4 | 8.5 | 8.4 | 8.5 |
| Excise tax | 1.0 | 0.9 | 1.1 | 0.9 | 1.0 | 0.9 | 1.0 | 0.9 |
| Import duties | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Other tax revenues | 1.3 | 1.7 | 1.5 | 1.7 | 1.7 | 1.7 | 1.8 | 1.7 |
| Tax returns | -2.2 | -2.0 | -2.2 | -2.1 | -1.9 | -2.1 | -1.9 | -1.8 |
| **NON-TAX REVENUES** | **5.3** | **5.2** | **5.7** | **5.3** | **5.2** | **5.3** | **5.2** | **5.2** |
| **TOTAL** | **22.4** | **21.6** | **22.6** | **21.6** | **21.3** | **21.6** | **21.4** | **21.5** |

IR: Inflation Report.
* Forecast.

**Graph 61**
**GENERAL GOVERNMENT CURRENT REVENUES: 2006 - 2015**
(% GDP)



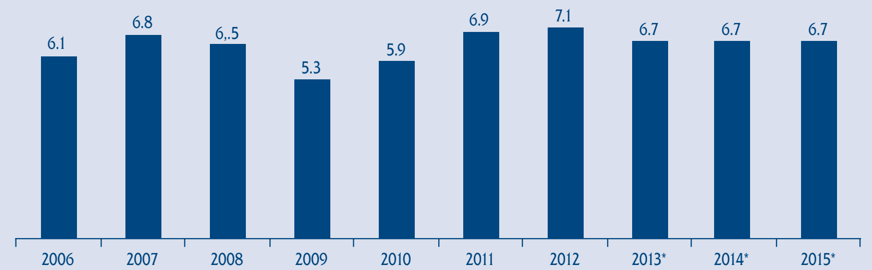

* Forecast.

The real growth of the current revenues of the general government in **2013** has been revised downwards from 5.8 percent (March Inflation Report) to 3.5 percent in this report, due mainly to the lower revenues expected for the regularization of tax income, in line with the mining sector's lower payments for such tax payment regularization. Thus, the ratio of current revenues to GDP in 2013 has been revised down from 21.6 percent estimated in March to 21.3 percent of GDP, while this ratio in **2014** has also been revised downwards by 0.2 percentage points. In 2015, this ratio of current revenues to GDP is foreseen to remain stable at 21.5 percent of GDP.

Revenues from the **income tax** in the forecast horizon would amount to 6.7 percent of GDP, less than estimated in March. A decline is foreseen in these revenues in 2013 relative to 2012 due to the lower tax payments expected as a result of the lower prices of minerals. This would be partially offset in the forecast horizon by higher income taxes in a context in which a greater growth of formal employment is expected.

Moreover, in Q1-2013 revenues from the **value-added tax** (VAT) increased 3.5 percent in real terms as a result of a 5.7 percent increase in revenues from the domestic VAT and a 0.5 percent increase in revenues from the external VAT. Revenues from the VAT are expected to increase by 0.1 percentage points of GDP between 2013 and 2015 and reach 8.5 points of GDP in 2015, in a context of dynamism of domestic demand and of measures implemented with the aim of enhancing the tax base. This path is consistent with a dynamic of growth with rates of over 7 percent between 2014 and 2015.

**Graph 62,**
**INCOME TAX: 2006 - 2015**
(% GDP)

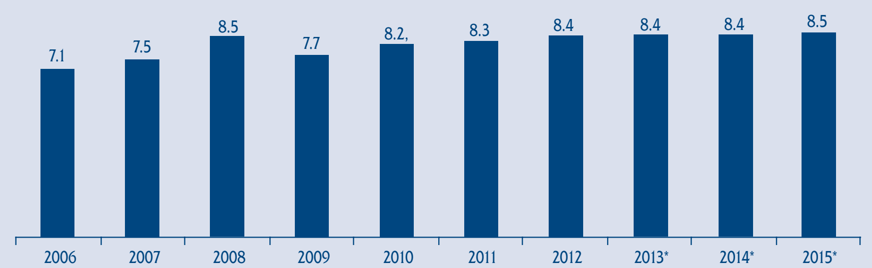



* Forecast.

**Graph 63,**
**INCOME TAX REGULARIZATION: 2006 - 2015**
(% GDP)


* Forecast.

**Graph 64,**
**VALUE ADDED TAX: 2006 - 2015**
(% GDP)




* Forecast.

In Q1-2013, revenues from the **excise tax** (ISC) recorded a positive growth rate of 16.2 percent in real terms, which resulted from an increase of 37.0 percent in revenues from the excise tax on fuels and an increase o f 1.7 percent on revenues from the excise tax on other items.

It should be pointed out that exceptional revenues were registered from this tax in Q1 of this year due to a payment made by Petroperu, which had to pay off due obligations after the tax court ordered the company to do so. In 2013, the ISC would increase to 8.3 percent in real terms, reflecting in part higher revenues as a result of modifications in the rates applicable to alcoholic beverages, maintaining thereafter rates of growth of around 5.5 percent in real terms. Thus, revenues from the excise tax are forecast to remain at 1.0 percent of GDP, declining slightly thereafter to 0.9 points of GDP in 2015.

Graph 65
EXCISE TAX: 2006 - 2015
(% GDP)


* Forecast.

**Evolution of public expenditure**

57. In **Q1-2013** the non-financial expenditure of the general government was equivalent to 14.9 percent of GDP, which represented an increase of 0.7 percentage points compared to the level of the non-financial expenditure of the general government in the same period of 2012 (14.2 percent). This balance corresponds to an increase 8.2 percent in real terms in the non-financial expenditure of the general government, which can be broken down into an increase of 7.6 percent in current expenditure and an increase of 10.3 percent in capital spending.

**Table 26**
**GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE**
(Real % change)

| | 2012 | | | | | 2013 |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Year | Q1 |
| **CURRENT EXPENDITURE** | **-2.9** | **1.5** | **2.7** | **16.9** | **5.4** | **7.6** |
| National government | -11.5 | -3.9 | -2.3 | 21.1 | 1.8 | 6.2 |
| Regional governments | 10.8 | 11.7 | 9.9 | 10.7 | 10.7 | 11.5 |
| Local governments | 34.6 | 15.7 | 19.0 | 6.3 | 16.7 | 8.2 |
| **CAPITAL EXPENDITURE** | **34.2** | **1.1** | **26.4** | **11.9** | **15.3** | **10.3** |
| National government | -31.8 | -39.6 | 2.4 | 8.2 | -13.0 | 20.0 |
| Regional governments | 44.0 | 41.9 | 43.4 | 33.0 | 38.3 | 15.3 |
| Local governments | 213.1 | 74.3 | 44.0 | 5.1 | 38.3 | 2.0 |
| **TOTAL EXPENDITURE** | **3.3** | **1.4** | **8.6** | **15.1** | **8.1** | **8.2** |
| National government | -14.4 | -12.4 | -1.5 | 18.0 | -1.2 | 7.7 |
| Regional governments | 17.0 | 19.0 | 18.7 | 19.0 | 18.5 | 12.4 |
| Local governments | 87.1 | 39.2 | 31.6 | 5.5 | 28.0 | 5.1 |

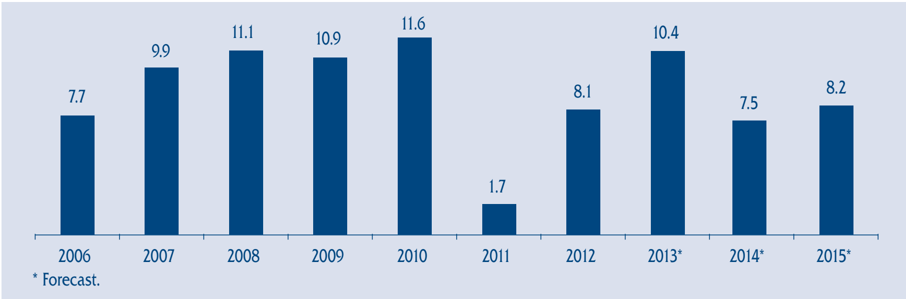
58. In **2013** the non-financial expenditure of the general government would grow by a real 10.4 percent of as a result of salary increases approved in the 2013 Budget, which would be allocated mainly to the sectors of Education, Interior, and Defence. Thus, in 2013 the non-financial expenditure of the general government would reach a level equivalent to 19.6 percent of GDP, a higher ratio than the one recorded in 2012 (18.6 percent). In the forecast horizon, as a percentage of GDP this aggregate is expected to follow a rising path and to reach a level of 20 percent of GDP in 2015, as a result of an increase in capital spending, especially in the case of sub-national governments.

**Table 27**
**GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE**
(% GDP)

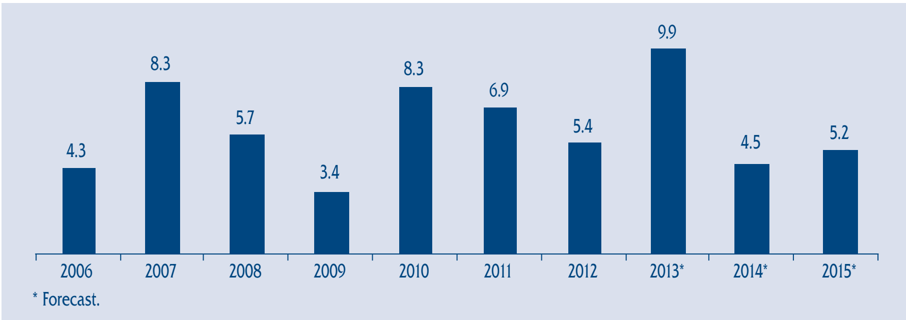
| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **CURRENT EXPENDITURE** | **11.1** | **13.1** | **11.6** | **13.6** | **13.7** | **13.5** | **13.5** | **13.3** |
| National government | 7.3 | 8.7 | 7.5 | 8.9 | 9.1 | 8.8 | 8.9 | 8.8 |
| Regional governments | 2.3 | 2.6 | 2.5 | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 |
| Local governments | 1.5 | 1.8 | 1.6 | 2.0 | 1.9 | 2.0 | 1.9 | 1.8 |
| **CAPITAL EXPENDITURE** | **3.1** | **5.5** | **3.3** | **6.0** | **5.9** | **6.2** | **6.3** | **6.8** |
| National government | 0.9 | 1.9 | 1.1 | 2.1 | 1.9 | 2.1 | 2.2 | 2.3 |
| Regional governments | 0.7 | 1.3 | 0.8 | 1.4 | 1.4 | 1.4 | 1.5 | 1.6 |
| Local governments | 1.5 | 2.4 | 1.5 | 2.5 | 2.5 | 2.7 | 2.7 | 2.9 |
| **TOTAL EXPENDITURE** | **14.2** | **18.6** | **14.9** | **19.6** | **19.6** | **19.7** | **19.8** | **20.0** |
| National government | 8.2 | 10.6 | 8.6 | 11.0 | 11.1 | 10.8 | 11.1 | 11.1 |
| Regional governments | 3.0 | 3.9 | 3.3 | 4.1 | 4.1 | 4.2 | 4.2 | 4.3 |
| Local governments | 3.0 | 4.2 | 3.1 | 4.5 | 4.4 | 4.7 | 4.5 | 4.7 |

* Forecast.

**Graph 66**
**GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE: 2006- 2015**
(Real % change)




**Graph 67**
**GENERAL GOVERNMENT NON-FINANCIAL CURRENT EXPENDITURE: 2006 - 2015**
(Real % change)



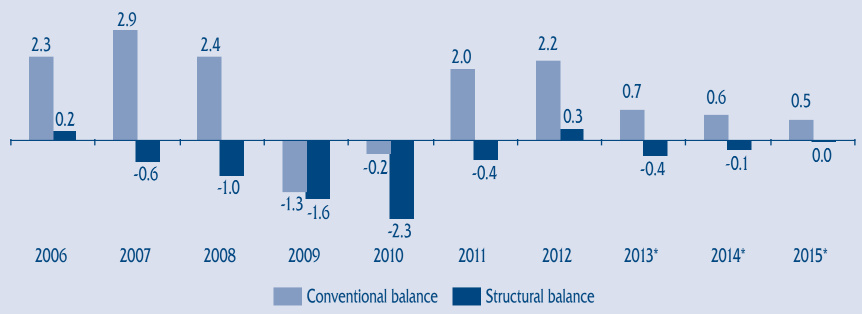

**Graph 68**
**GENERAL GOVERNMENT GROSS CAPITAL FORMATION: 2006-2015**
(Real % change)


## Structural economic balance and fiscal impulse

59. The **structural economic balance**, indicator of the long-term fiscal position that deducts the effects of the business cycle and the price effects of the major

mining exports from the conventional economic balance, was 0.3 percent of GDP in 2012. In 2013 the structural balance would show a negative rate of 0.4 percent of GDP, associated with higher spending in the general government, while in 2014 and 2015 the structural deficit would decline to levels close to zero.

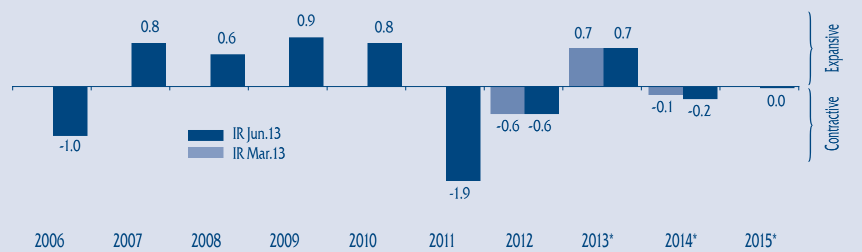
**Graph 69**
**CONVENTIONAL AND STRUCTURAL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR: 2006-2015**
(% GDP)




* Forecast.

60. The variation in the structural balance determines the **fiscal impulse**. This indicator allows us to identify changes in the fiscal position isolating the effects of the economic cycle. In 2013 the fiscal impulse would be 0.7 percent (expansionary position), in line with the salary increases that would be observed in the year, while in 2014 the fiscal impulse would be -0.2 percent of GDP, slightly lower than forecast in our March report, and would converge thereafter to zero in 2015.

**Graph 70**
**FISCAL IMPULSE 1/: 2006 - 2015**
(% GDP)




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

## Financial requirements and the non-financial public sector debt

61. The lower surplus estimated in the forecast horizon –revised down from 1.0 to 0.7 percent of GDP in 2013 and to 0.6 percent of GDP in 2014– would reduce the available sources of resources for the government, which would result in a lower accumulation of deposits than that considered in the March Inflation Report.

It should be pointed out that the debt management operations programmed to be carried out in 2013, which comprise the prepayment of external debt for a total of US$ 1.68 billion and the issuance of sovereign bonds for a total of S/. 3.09 billion are not included in these financial requirements. In line with this, in February the government issued bonds for a nominal value of S/. 1.91 billion, 85 percent of which was purchased by local investors.

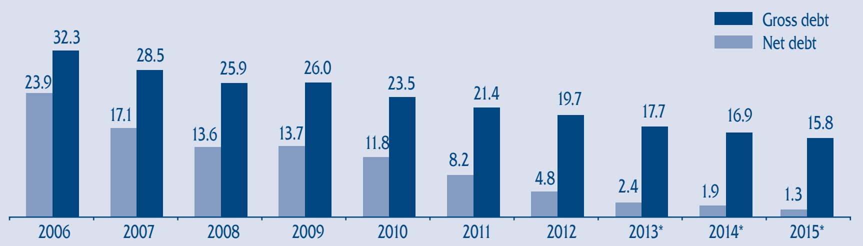
**Table 28**
**FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR AND ITS FINANCING 1/**
(Million S/.)

| | 2012 | | 2013* | | | 2014* | | 2015* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Mar.13 | IR Jun.13 | IR Mar.13 | IR Jun.13 | IR Jun.13 |
| **I. USES** | **-7,075** | **-6,968** | **-6,491** | **-2,506** | **-780** | **-2,483** | **-398** | **2,337** |
| 1. Amortization | 1,768 | 4,342 | 1,269 | 3,078 | 3,038 | 3,659 | 3,327 | 5,697 |
| a. External debt | 1,230 | 3,105 | 1,074 | 1,837 | 1,825 | 2,734 | 2,643 | 2,352 |
| *Million US$* | *459* | *1,177* | *417* | *712* | *706* | *1,060* | *1,025* | *912* |
| b. Domestic debt | 538 | 1,237 | 195 | 1,241 | 1,213 | 924 | 683 | 3,346 |
| *Of which:* | | | | | | | | |
| *Recognition bonds* | *92* | *509* | *8* | *223* | *190* | *240* | *168* | *168* |
| 2. Overall balance | -8,843 | -11,310 | -7,760 | -5,585 | -3,818 | -6,142 | -3,724 | -3,360 |
| (negative sign indicates surplus) | | | | | | | | |
| **II. SOURCES** | **-7,075** | **-6,968** | **-6,491** | **-2,506** | **-780** | **-2,483** | **-398** | **2,337** |
| 1. External | 216 | 1,224 | 64 | 2,491 | 2,303 | 2,633 | 2,633 | 3,655 |
| *Million US$* | *81* | *464* | *25* | *966* | *891* | *1,021* | *1,021* | *1,418* |
| 2. Bonds 2/ | 3,192 | 4,378 | 108 | 1,448 | 1,081 | 1,745 | 1,762 | 1,674 |
| 3. Internal 3/ | -10,484 | -12,569 | -6,662 | -6,445 | -4,163 | -6,861 | -4,793 | -2,992 |
| Memo: | | | | | | | | |
| NFPS gross debt | | | | | | | | |
| Billion S/. | 100.4 | 103.8 | 99.3 | 101.5 | 100.1 | 104.1 | 103.7 | 105.8 |
| % GDP | 20.2 | 19.7 | 18.6 | 17.8 | 17.7 | 16.8 | 16.9 | 15.8 |
| NFPS net debt 4/ | | | | | | | | |
| Billion S/. | 28.8 | 25.4 | 16.6 | 17.7 | 13.4 | 12.6 | 11.8 | 8.7 |
| % GDP | 5.8 | 4.8 | 3.1 | 3.1 | 2.4 | 2.0 | 1.9 | 1.3 |

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.

The gross debt and the net debt at March 2013 amounted to 18.6 percent and 3.1 percent of GDP, respectively. Given the positive balances in public finances, the expected increase of economic activity and the increase in public sector deposits will determine if the gross debt and the net debt will continue to decline and thus represent 15.8 percent and 1.3 percent of GDP, respectively, in 2015.

**Graph 71**
**PUBLIC DEBT**
(% GDP)

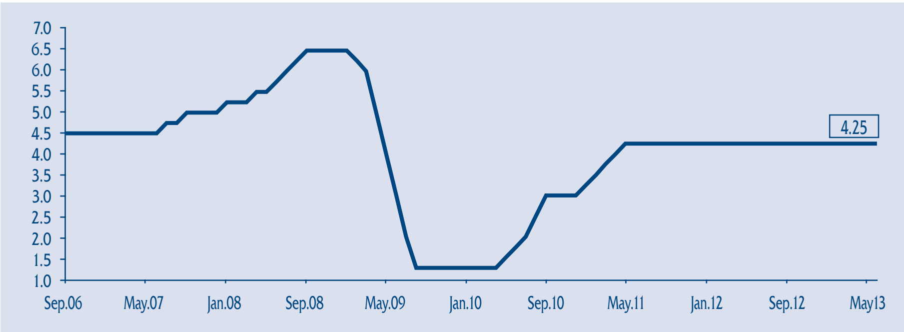



* Forecast.

# V. Monetary Policy

62. The BCRP has maintained the monetary policy interest rate at 4.25 percent since May 2011. The policy communiqués of the Board of the Central Bank in recent months have highlighted the reduction of inflation and its return to the target range (between 1 and 3 percent) due to the reversal of supply factors amid a domestic context characterized by an economic growth close to the economy's potential growth, expectations of inflation anchored to the target range, and an international context marked by uncertainty about the economic situation in the United States, Europe and China.

**Graph 72**
**BCRP REFERENCE INTEREST RATE**
(%)




**SUMMARY OF BCRP MONETARY POLICY COMMUNIQUÉS**

**April:** The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 4.25 percent.

This decision is based on the fact that the rate of inflation is within the target range in a context of economic growth close to the economy's potential level of growth. The Board oversees the inflation forecasts and inflation determinants to consider future adjustments in monetary policy instruments.

**May**: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 4.25 percent.

This decision is based on the fact that the rate of inflation is within the target range in a context of economic growth close to the economy's potential level of growth. The Board oversees the inflation forecasts and inflation determinants to consider future adjustments in monetary policy instruments.

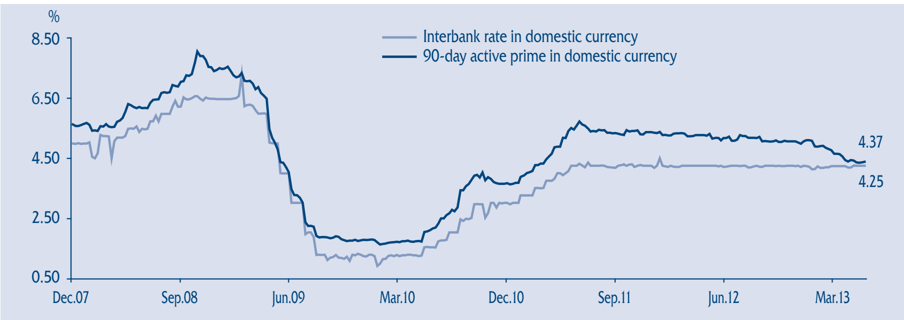
**June**: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 4.25 percent.

This decision is based on the fact that the rate of inflation is within the target range in a context of economic growth close to the economy's potential level of growth. The Board oversees the inflation forecasts and inflation determinants to consider future adjustments in monetary policy instruments.

## Interest rates in domestic currency

63. The 90-day corporate prime rate in soles has fallen by 18 basis points since the end of March to 4.37 percent. Because it is a short-term rate and because it has a lower premium for credit risk, this interest rate is the rate that has the highest connection with the monetary policy rate. Its evolution is consistent with an adequate situation of liquidity in local currency and with a reference interest rate which has been at 4.25 percent since May 2011.

**Graph 73**
**90-DAY CORPORATE PRIME RATE VERSUS INTERBANK OVERNIGHT RATE IN FOREIGN CURRENCY: DEC.07 - MAY.13**




64. On the other hand, the interest rates in national currency for corporate loans have declined between 25 and 38 basis points relative to their levels in Q1, in line with the evolution of short-term rates. In addition, the interest rate for mortgage loans in soles has fallen 19 basis points compared to March 2013. In contrast, the interest rate on consumer loans has continued showing the rising trend observed over the past few months –in May it increased by 265 basis points compared to the end of Q1–, which would be reflecting mainly the effect of higher delinquency rates in this segment of the credit market.

**Table 29**
**INTEREST RATE BY TYPE OF LOANS 1/**
(%)

| | Corporate | Large companies | Medium-size firms | Small businesses | Consumer | Mortgages |
|---|---|---|---|---|---|---|
| **Domestic currency** | | | | | | |
| Dec.10 | 4.6 | 5.9 | 10.3 | 23.3 | 40.7 | 9.3 |
| Dec.11 | 6.0 | 7.4 | 11.2 | 23.2 | 38.5 | 9.4 |
| Mar.12 | 6.1 | 7.0 | 11.2 | 23.4 | 35.6 | 9.4 |
| Jun.12 | 6.0 | 7.3 | 11.2 | 23.1 | 34.9 | 9.3 |
| Sep.12 | 5.7 | 7.5 | 11.1 | 22.9 | 38.0 | 8.9 |
| Oct.12 | 6.0 | 7.5 | 11.0 | 23.0 | 38.8 | 8.9 |
| Nov.12 | 6.2 | 7.6 | 10.9 | 23.0 | 38.6 | 8.8 |
| Dec.12 | 5.8 | 7.4 | 11.0 | 22.5 | 41.2 | 8.8 |
| Jan.13 | 6.0 | 7.4 | 11.0 | 22.2 | 40.9 | 8.9 |
| Feb.13 | 6.0 | 7.5 | 11.0 | 22.4 | 39.6 | 9.1 |
| Mar.13 | 5.8 | 7.4 | 10.8 | 22.0 | 39.3 | 9.2 |
| Apr.13 | 5.4 | 7.2 | 10.7 | 21.9 | 40.7 | 9.1 |
| May.13 | 5.4 | 7.2 | 10.8 | 21.7 | 41.9 | 9.0 |
| **Accumulated change (bps)** | | | | | | |
| May.13-Mar.13 | -38 | -25 | 1 | -35 | 265 | -19 |
| May.13-Dec.12 | -37 | -18 | -13 | -76 | 76 | 28 |

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

65. As regards deposits rates in national currency, a reduction of between 5 and 26 basis points compared to the end of Q1 is still observed in these rates for deposit terms of over 30 days, while the rate on 30-day deposits has risen by 24 basis points.

**Table 30**
**INTEREST RATES IN NUEVOS SOLES**
(%)

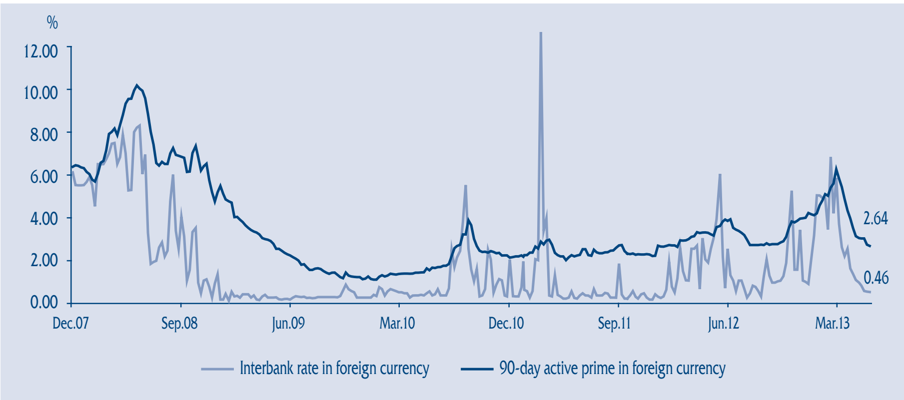
| | Deposits up to 30 days | Rate on 31 to 180-day term deposits | Rate on 181 to 360-day term deposits |
|---|---|---|---|
| Dec.10 | 2.2 | 2.9 | 3.8 |
| Dec.11 | 3.9 | 4.1 | 4.7 |
| Mar.12 | 3.7 | 3.9 | 4.5 |
| Jun.12 | 3.7 | 3.9 | 4.3 |
| Sep.12 | 3.7 | 3.8 | 4.3 |
| Dec.12 | 3.6 | 3.6 | 4.1 |
| Jan.13 | 3.4 | 3.6 | 4.0 |
| Feb.13 | 3.1 | 3.4 | 3.9 |
| Mar.13 | 3.0 | 3.3 | 3.8 |
| Apr.13 | 3.0 | 3.2 | 3.6 |
| May.13 | 3.2 | 3.2 | 3.5 |
| **Accumulated change (bps)** | | | |
| May.13-Mar.13 | 24 | -5 | -26 |
| May.13-Dec.12 | -36 | -41 | -51 |

This evolution of the interest rates in nuevos soles shows that monetary conditions in soles continue to be favorable, as foreseen in our Inflation Report of March 2013.

**Interest rates in foreign currency**

66. An increase was observed in the availability of liquidity in dollars compared to Q1, which was reflected in a decline of 222 basis points in the corporate prime interest rate since March to a level of 2.64 percent. Moreover, the interbank interest rate in foreign currency registered an average level of 0.46 percent in May, a level 169 basis points lower than the average level observed at the end of Q1.

**Graph 74**
**90-DAY CORPORATE PRIME RATE VERSUS INTERBANK OVERNIGHT RATE IN FOREIGN CURRENCY: DEC.07 - MAY.13**




Banks' greater availability of liquidity in foreign currency is due in part to the increased deposits in dollars received by banks in April (US$ 363 million) as a result of the corporate bonds issued abroad which amounted to US$ 1,86 billion in that month. Furthermore, banks have also replaced part of their short-term liabilities by long-term liabilities, reducing in this way the amount of their required reserves in April and May.

67. The lending interest rates for corporate loans in foreign currency show a similar evolution to that recorded by money market rates in dollars. These rates for corporate loans have declined between 27 and 120 basis points compared to the end of Q1, the decline in the rate for loans to corporations and large companies being noteworthy. The opposite has been observed in the case of interest rates on consumer loans and mortgages, which have increased by 16 and 15 basis points, respectively.

**Table 31**
**INTEREST RATE BY TYPE OF CREDIT 1/**
(%)

| | Foreign currency | | | | | |
|---|---|---|---|---|---|---|
| | Corporate | Large companies | Medium-size firms | Small businesses | Consumer | Mortgages |
| Dec.10 | 3.3 | 5.5 | 8.6 | 14.2 | 19.4 | 8.1 |
| Dec.11 | 3.0 | 5.4 | 8.9 | 15.0 | 22.0 | 8.2 |
| Mar.12 | 3.8 | 5.7 | 8.9 | 16.4 | 23.0 | 8.2 |
| Jun.12 | 4.0 | 6.1 | 8.7 | 15.2 | 22.9 | 8.0 |
| Sep.12 | 3.8 | 5.8 | 9.2 | 15.6 | 23.6 | 8.0 |
| Oct.12 | 3.7 | 5.9 | 9.2 | 15.5 | 24.0 | 8.1 |
| Nov.12 | 4.0 | 5.9 | 9.2 | 15.9 | 24.2 | 8.0 |
| Dec.12 | 4.1 | 6.4 | 9.0 | 15.5 | 22.4 | 8.0 |
| Jan.13 | 4.1 | 6.7 | 8.7 | 14.4 | 23.1 | 8.0 |
| Feb.13 | 4.3 | 6.8 | 9.4 | 13.8 | 24.0 | 8.3 |
| Mar.13 | 4.6 | 7.5 | 10.1 | 14.8 | 24.1 | 8.2 |
| Apr.13 | 4.1 | 7.0 | 9.2 | 14.4 | 24.1 | 8.3 |
| May.13 | 3.5 | 6.3 | 9.2 | 14.5 | 24.3 | 8.3 |
| Accumulated change (bps) | | | | | | |
| May.13-Mar.13 | -109 | -120 | -92 | -27 | 16 | 15 |
| May.13-Dec.12 | -57 | -10 | 19 | -100 | 190 | 34 |

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

68. A reduction is also observed in deposit interest rates in foreign currency for terms of less than 180 days. These rates have fallen between 100 and 216 basis points since the end of Q1, in line with the evolution of interbank rates, while the interest rates on deposits of 181 to 360 days have increased slightly (by 11 basis points).

**Table 32**
**INTEREST RATES IN US DOLLARS**
(%)

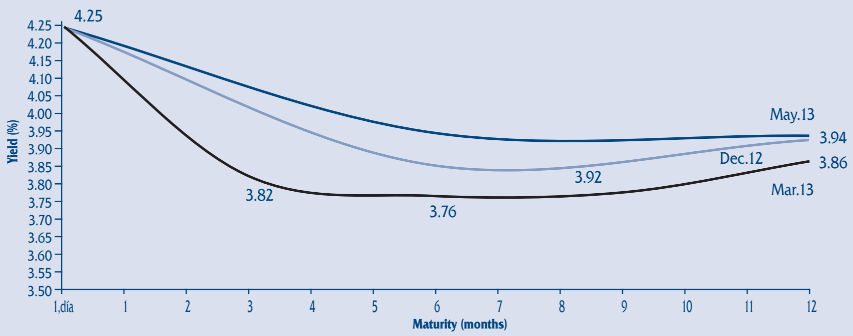
| | Deposits up to 30 days | Rate on 31 to 180-day term deposits | Rate on 181 to 360-day term deposits |
|---|---|---|---|
| Dec.10 | 0.9 | 1.2 | 1.7 |
| Dec.11 | 0.7 | 1.0 | 1.6 |
| Mar.12 | 1.3 | 1.2 | 1.6 |
| Jun.12 | 1.7 | 1.2 | 1.6 |
| Sep.12 | 0.9 | 1.1 | 1.6 |
| Dec.12 | 1.7 | 1.6 | 1.6 |
| Jan.13 | 2.3 | 1.5 | 1.5 |
| Feb.13 | 3.0 | 2.0 | 1.3 |
| Mar.13 | 2.5 | 2.2 | 1.5 |
| Apr.13 | 1.0 | 1.9 | 1.7 |
| May.13 | 0.4 | 1.2 | 1.6 |
| Accumulated change (bps) | | | |
| May.13-Mar.13 | -216 | -100 | 11 |
| May.13-Dec.12 | -132 | -41 | -3 |

This evolution of the interest rates in dollars shows that there is some flexibility in the monetary and credit conditions in foreign currency. Because of this, the interest rates in dollars are somewhat lower than those estimated in our Inflation Report of March 2013.

**Monetary operations**

69. The operations of the Central Bank were aimed mainly at maintaining appropriate levels of liquidity and at ensuring the flow of operations in the money market, in a context of ample in banks. With this aim, the Central Bank issued CDBCRP with maturities of up to one year. The yield curve of these securities continues to show a negative slope, which reflects banks' abundant availability of liquidity.

**Graph 75**
**YIELD CURVE OF CENTRAL BANK SECURITIES 1/**




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

Between March and May 2013, the Central Bank made net placements of BCRP certificates of deposit (CDBCRP) for a total of S/. 4.05 billion –certificates of deposit for a total of S/. 4.30 billion were placed in April–, which was more than offset by a greater amount of net maturities of time deposits, which amounted to S/. 4.50 billion. In the same period, the public sector deposits at the Central Bank increased by S/. 4.39 billion.

As a result of these operations, the share of BCRP instruments decreased in terms of its total liabilities. Thus, the monetary instruments of the BCRP declined from representing 19.7 percent of the international reserves in March to representing 18.9 percent in May 2013, while the share of total deposits of required reserves increased from 27.9 to 29.0 percent, mainly due to higher deposits of reserves in domestic currency, which increased from 12.4 to 13.3 percent. Public sector deposits continued to be the main source of sterilization of foreign exchange interventions, with a share of 36.6 percent of the total liabilities of the BCRP.

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

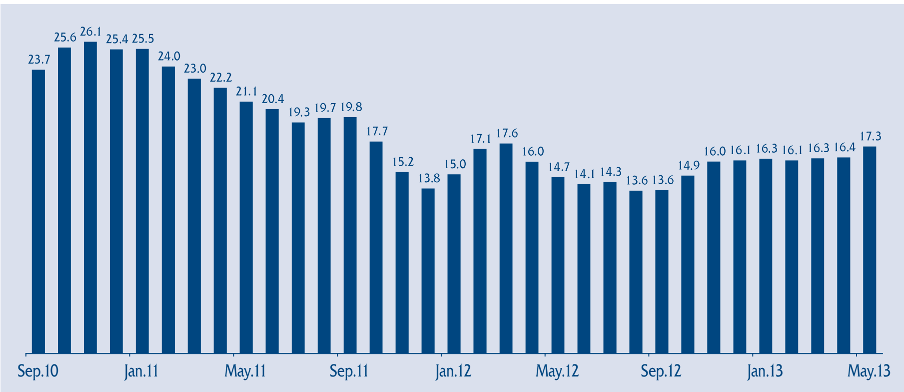
| Net assets | Mar.13 | May.13 |
|---|---|---|
| I. Net International Reserves | 100% (US$ 67,918 mills.) | 100% (US$ 66,765 mills.) |
| **Net liabilities** | | |
| **II. Total public sector deposits** | **35.4%** | **36.6%** |
| In domestic currency | 21.3% | 23.9% |
| In foreign currency | 14.2% | 12.7% |
| **III. Total reserve requirements** | **27.9%** | **29.0%** |
| In domestic currency | 12.4% | 13.3% |
| In foreign currency 1/ | 15.5% | 15.7% |
| **IV. BCRP Instruments** | **19.7%** | **18.9%** |
| CD BCRP | 12.7% | 15.2% |
| CDR BCRP | 0.0% | 0.3% |
| Term deposits | 6.9% | 3.4% |
| **V. Currency** | **17.2%** | **17.2%** |
| **VI. Other** | **-0.1%** | **-1.7%** |

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

## Currency in circulation

70. Mean currency grew at an annual rate of 17.3 percent between March and April 2013, in line with the evolution of economic activity in the country which has been close to its potential level of growth in recent months. In Q2 currency in circulation is expected to grow at a higher rate than in Q1, which is consistent with the evolution of advanced indicators of economic activity that point to a higher growth of the economy in Q2 than in Q1.

**Graph 76**
**AVERAGE CURRENCY**
(% change respect to the similar period of previous year)



## Reserve requirements

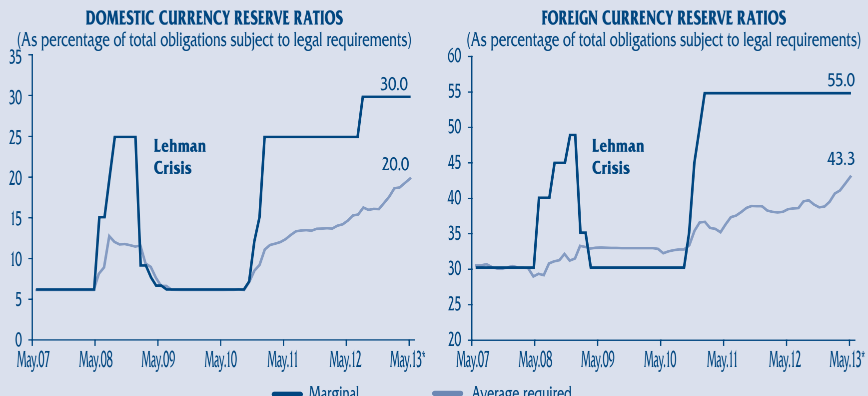
71. In addition to this, in order to maintain an orderly growth of credit and liquidity, and to encourage a greater replacement of credit in dollars by credit in soles, the Central Bank has increased reserve requirements in both currencies but with a greater emphasis on required reserves in dollars. Thus, year-to-day the rate of reserve requirements in dollars has been raised on 4 occasions: 75 basis points in January, 100 basis points in February, 50 basis points in March, and 25 basis points in April, that is, by a total of 250 basis points, whereas the rate of reserve requirements in soles has only been raised by 25 basis points in January.

    Moreover, in order to encourage a substitution of mortgage and vehicle loans in dollars by loans in soles, as of March the Central Bank has established an additional requirement of reserves of 0.75 percent (1.50 percent) to financial institutions whose credit balance exceeds 10 percent (20 percent) of their balance at February 2013.

    Furthermore, with the aim of complementing this measure and allow banks to have more funds in nuevos soles so that they can provide mortgage loans in this currency and in this way give banks incentives to replace the funding they obtain through loans and bonds issued abroad in dollars by funding in soles, in May the BCRP increased the ceiling on long-term external obligations exempted from reserve requirements from 2.2 to 2.3 times the regulatory capital at September 30, 2012, or by S/. 400 million, whichever amount is higher, provided that the amount of obligations in foreign currency does not exceed 2.0 times this equity.

72. With these measures, the mean required reserves in domestic currency rose from 18.8 percent in December, 2012, to 20.0 percent in May, while mean reserves in dollars rose from 41.2 percent in December to 43.3 percent in May.

**Graph 77**




* Forecast.

In June, in order to reduce the dispersion of mean reserves between the financial entities and thus reduce the heterogeneity in entities' cost of funding, the BCRP established a maximum limit of 20 percent on the mean rate of required reserves. As a result of this measure, about S/. 500 million of the required reserves of smaller financial institutions, which are the entities that mostly register mean reserve rates higher than 20 percent, have been released from reserve requirements.

**Box 3**

**RATIONALITY OF THE RECENT RESERVE REQUIREMENT MEASURES ADOPTED BY THE BCRP**

The reserve requirements measures that the BCRP has implemented recently are preventive in nature and seek to maintain an orderly evolution of liquidity and credit. In recent years, the Peruvian economy has been experiencing high growth rates in a context of great global financial uncertainty and high international liquidity associated with the monetary expansion policies of central banks in the developed economies. As a result of this, the emerging economies, and particularly Peru, are experiencing unprecedented capital inflows.

In this context, there is the risk that vulnerabilities may be generated in the financial system if credit –particularly credit in dollars– grows at very high rates, since a strong depreciation of the exchange rate in dollarized economies like the Peruvian economy can adversely affect the financial situation of companies and households that take these loans in dollars, but do not generate income in this currency.

To prevent these risks, the BCRP has modified the reserve requirements regime on several occasions in the last year. Thus, in order to **prevent the excessive growth of credit and at the same time encourage the replacement of loans in dollars by loans in soles**, the BCRP has increased the rate of required reserves in soles and dollars on 5 occasions, accumulating an increase of 225 basis points in the rate of required reserves in both currencies during 2012. So far this year, the rate of reserve requirements in soles has been raised once (25 basis points in January), while the rate of reserve requirements in dollars has been on 4 occasions (in January, February, March and April by a total of 250 basis points).

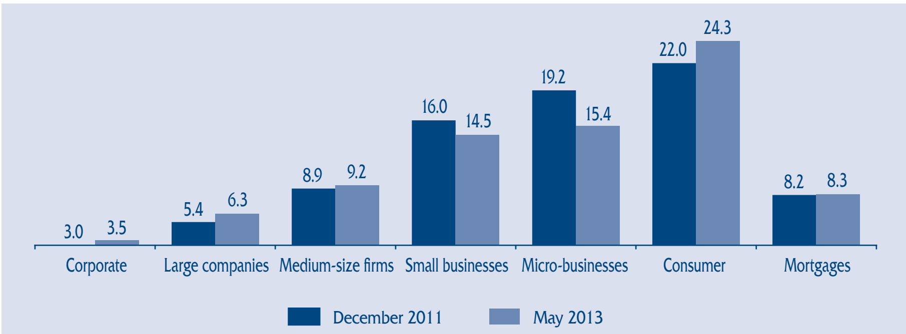
In addition, **to moderate the expansion of mortgage and vehicle loans in dollars and encourage their substitution by credit in soles**, in March 2013 the BCRP increased by 75 (150) bps the rate of reserve requirements in dollars if the balance of the mortgage loan and the car loan in this currency exceeds by 1.1 (1.2) times the balance as of February 2013, or 20% (25%) of the regulatory capital at end-2012, whichever amount is higher. This measure is also designed to prevent future currency mismatches, because this is an incentive for families to borrow in soles since loans in foreign currency become more costly.

Moreover, **in order to also avoid excessive leverage in dollars in the financial system and encourage greater funding in soles**, the BCRP increased the limit of the liabilities and foreign bonds not subject to reserve requirement from 2.2 to 2.3 times the equity of a financial entity, provided that the long-term external liabilities in dollars do not exceed 2.0 times the regulatory capital.

**More recently, in order to reduce the dispersion of the rate of reserve requirements in domestic currency in financial institutions**, the BCRP established a maximum limit of 20 percent for the mean rate of reserve requirements in June 2013. This measure will contribute to eliminate or reduce the financial entities' heterogeneity in terms of the cost of funding, which could affect their ability to compete.

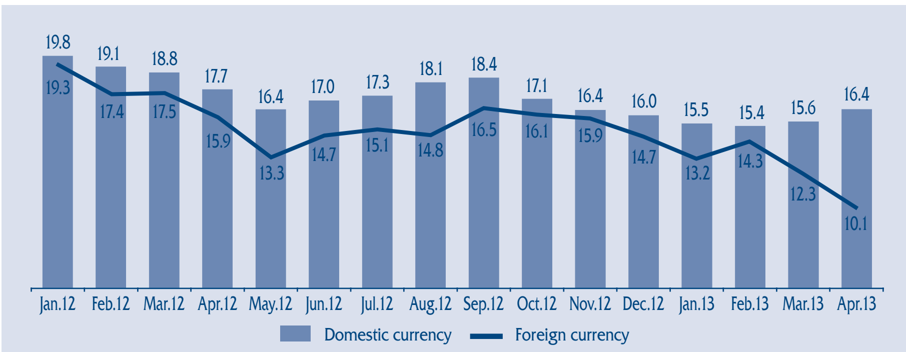
These increases in the rates of reserve requirements have induced increases in interest rates in most segments of credit in dollars. Thus, the interest rate on corporate loans in dollars has risen from 3.0 percent in December 2011 to 3.5 percent in May 2013, while the interest rates on loans to large and medium-sized enterprises have risen from 5.4 to 6.3 percent and from 8.9 to 9.2 percent, respectively.

**INTEREST RATE BY LOANS IN US$**
(%)



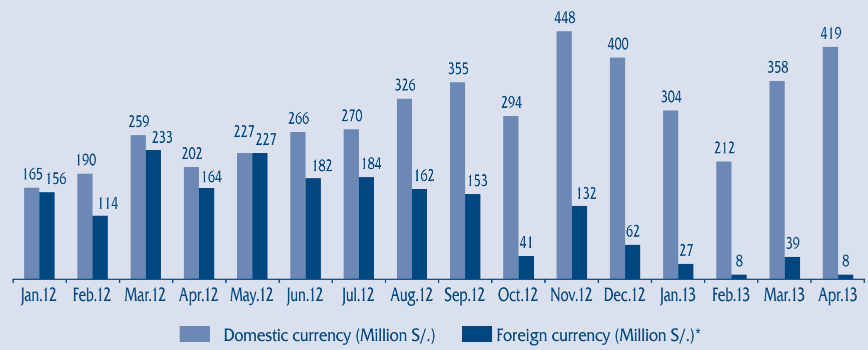

Furthermore, the measures adopted by the Central Bank have contributed to reduce the rate of growth of loans in dollars and have induced a greater substitution of credit in dollars by credit in soles. Thus, a slowdown has been observed in the growth rate of credit in dollars in the last 12 months since October 2012, while credit in domestic currency has maintained growth rates of over 15 percent. This is explained in part by a replacement of credit in dollars by credit in soles.

**CREDIT TO THE PRIVATE SECTOR**
(12 months % change)



The pace of growth of mortgage loans in dollars has fallen from 15.4 percent in February 2013 to 11.6 percent in April 2013. Additionally, a significant change has been observed in the composition of mortgage loans by currencies in March - April 2013, which is the period in which the new measure of reserve requirements on mortgage and vehicle loans has been in force, encouraging borrowing in soles: 98.3 percent of the loans granted (S/. 777 million) were loans in soles and only a total of US$ 18 million was granted as loans in foreign currency.

**MORTGAGE LOANS**
(Flow by currency)




* To constant exchange rate.

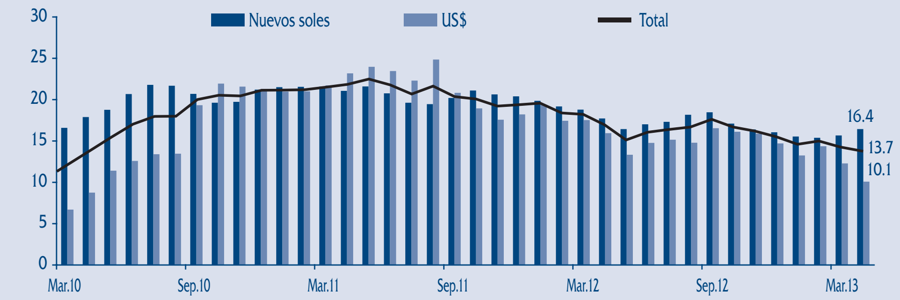
Together with a more sustainable pace of credit growth, a lower degree of dollarization of credit, such as the one already observed in mortgage loans, contributes to stability in the financial system and therefore to monetary stability.

## Credit to the private sector

73. Credit to the private sector has moderated its pace of growth, registering an annual variation of 13.7 percent in April (versus a rate of 14.2 percent at the end of Q1 and a rate of 15.4 percent in 2012), due mainly to the slowdown in the growth of credit in foreign currency, which grew 10.1 percent. By type of loans, corporate loans and consumer loans show a greater slowdown: the rate of growth in the former has declined from 12.6 percent in Q1-2013 to 11.9 percent in April, while the rate of growth in the latter has declined from 12.7 percent at the end of March to 12.3 percent in April.

    The slower pace of growth of corporate loans is explained in part by companies' lower demand for credit given that they have increased their use of external financing by issuing bonds in the international market. So far this year, corporate bonds issued abroad amount to US$ 3.56 billion.

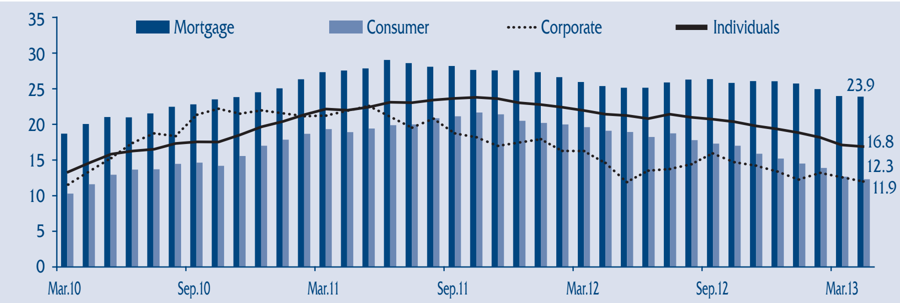
**Graph 78**
**CREDIT TO THE PRIVATE SECTOR**
(12 months % change)




| Credit | | Dec.09 | Dec.10 | Dec.11 | Jan.12 | Feb.12 | Mar.12 | Apr.12 | Jan.13 | Feb.13 | Mar.13 | Apr.13 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Nuevos soles | Monthly flows (Million S/.) | 569 | 1,514 | 1,669 | 301 | 733 | 1,129 | 821 | -92 | 720 | 1,538 | 1,626 |
| | Monthly % change | 1.0 | 2.2 | 2.1 | 0.4 | 0.9 | 1.3 | 1.0 | -0.1 | 0.7 | 1.6 | 1.7 |
| | Annual % change | 17.9 | 21.2 | 20.4 | 19.8 | 19.1 | 18.8 | 17.7 | 15.5 | 15.4 | 15.6 | 16.4 |
| US$ | Monthly flows (Million S/.) | 343 | 368 | 570 | 272 | -164 | 473 | 314 | -51 | 93 | 11 | -215 |
| | Monthly % change | 2.0 | 1.8 | 2.3 | 1.1 | -0.7 | 1.9 | 1.2 | -0.2 | 0.3 | 0.0 | -0.8 |
| | Annual % change | -0.1 | 21.3 | 18.2 | 19.3 | 17.4 | 17.5 | 15.9 | 13.2 | 14.3 | 12.3 | 10.1 |
| Total | Monthly flows (Million S/.) | 1,444 | 2,451 | 3,121 | 995 | 314 | 2,335 | 1,621 | -221 | 956 | 1,567 | 1,078 |
| | Monthly % change | 1.4 | 2.0 | 2.2 | 0.7 | 0.2 | 1.6 | 1.1 | -0.1 | 0.6 | 0.9 | 0.6 |
| | Annual % change | 9.3 | 21.2 | 19.4 | 19.6 | 18.4 | 18.2 | 16.9 | 14.5 | 14.9 | 14.2 | 13.7 |

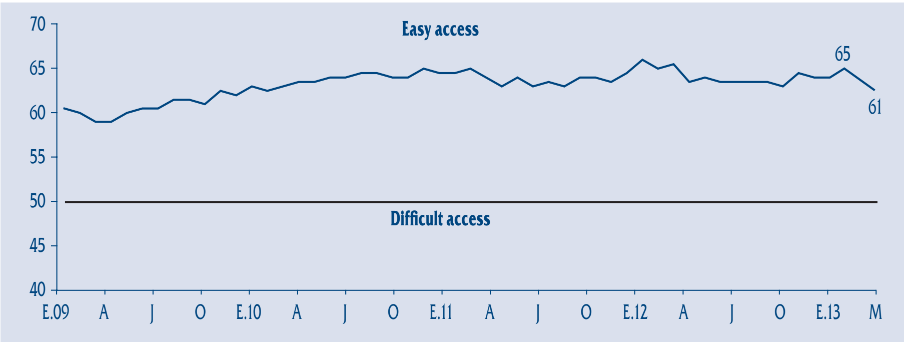
On the other hand, mortgage loans have maintained a high rate of growth (23.9 percent), with a similar rate to that observed in March (24.0 percent). The greater growth of credit in domestic currency stands out with a rate of 35 percent in April, while credit in foreign currency grew 11.6 percent in the same period. This evolution of mortgage loans has contributed to a faster pace of dedollarization than the one observed in previous months, which has been positive given that dollarization generates significant risks associated with currency mismatches, especially in the case of personal loans, and that these currency mismatches could make the financial system more vulnerable to episodes of capital outflows.

**Graph 79**
**CREDIT BY TYPE OF LOANS: MARCH 2010 - APRIL 2013**
(12 months % change)



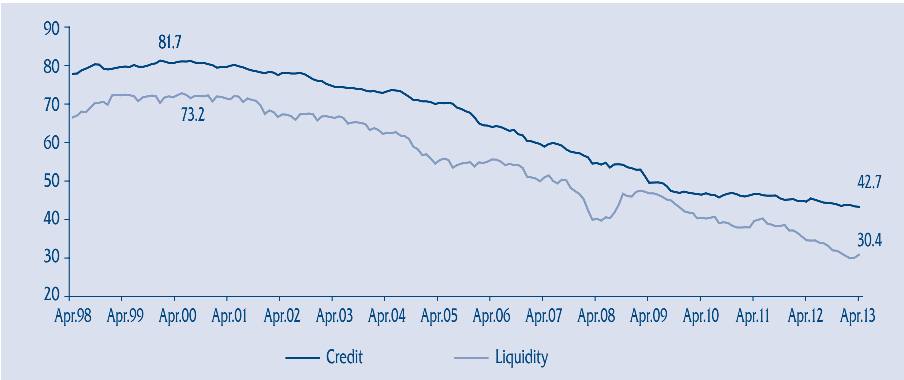

| Credit | | Dec.09 | Dec.10 | Dec.11 | Jan.12 | Feb.12 | Mar.12 | Apr.12 | Jan.13 | Feb.13 | Mar.13 | Apr.13 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Corporates | Monthly flows (Million S/.) | 965 | 1,478 | 2,162 | 451 | -392 | 1,466 | 964 | -592 | 466 | 1,125 | 431 |
| | Monthly % change | 1.5 | 1.9 | 2.3 | 0.5 | -0.4 | 1.5 | 1.0 | -0.5 | 0.4 | 1.0 | 0.4 |
| | Annual % change | 8.0 | 22.0 | 17.5 | 17.9 | 16.3 | 16.2 | 14.6 | 12.2 | 13.1 | 12.6 | 11.9 |
| Individuals | Monthly flows (Million S/.) | 479 | 973 | 959 | 544 | 705 | 870 | 658 | 371 | 490 | 443 | 646 |
| | Monthly % change | 1.4 | 2.4 | 1.9 | 1.1 | 1.4 | 1.7 | 1.2 | 0.6 | 0.8 | 0.7 | 1.0 |
| | Annual % change | 11.8 | 19.7 | 23.1 | 22.8 | 22.5 | 22.0 | 21.5 | 18.8 | 18.2 | 17.1 | 16.8 |
| Consumer | Monthly flows (Million S/.) | 314 | 687 | 593 | 231 | 407 | 390 | 301 | 42 | 271 | 47 | 220 |
| | Monthly % change | 1.4 | 2.7 | 1.9 | 0.7 | 1.3 | 1.2 | 0.9 | 0.1 | 0.7 | 0.1 | 0.6 |
| | Annual % change | 9.3 | 17.0 | 20.5 | 20.2 | 20.0 | 19.6 | 19.1 | 14.5 | 13.9 | 12.7 | 12.3 |
| Mortgages | Monthly flows (Million S/.) | 165 | 287 | 366 | 313 | 298 | 480 | 356 | 330 | 219 | 395 | 427 |
| | Monthly % change | 1.4 | 1.9 | 1.9 | 1.6 | 1.5 | 2.4 | 1.7 | 1.3 | 0.9 | 1.6 | 1.7 |
| | Annual % change | 16.8 | 24.5 | 27.5 | 27.3 | 26.6 | 25.9 | 25.3 | 25.7 | 24.9 | 24.0 | 23.9 |

**Graph 80**
**STATUS OF ACCESS TO CREDIT OF THE COMPANIES**




74. The dollarization of credit continued declining and fell from 43.2 percent in February to 42.7 percent in April, while the dollarization of liquidity increased slightly, from 29.4 percent in February to 30.4 percent in April.

**Graph 81**
**DOLLARIZATION RATIO: 1998 - 2013**
(%)




As pointed out above, by credit components, the dollarization of mortgage loans fell from 43.8 to 43.6 percent. By credit flows, in April mortgage loans in soles amounted to S/. 419 million whereas mortgage loans in dollars amounted only to US$ 2.9 million. Another indicator that stands out is that the dollarization of corporate loans dropped from 53.7 percent in March to 53.4 percent. The reserve requirement measures adopted this year and last year are aimed at reinforcing this process of dedollarization in a context of persistent high capital inflows.

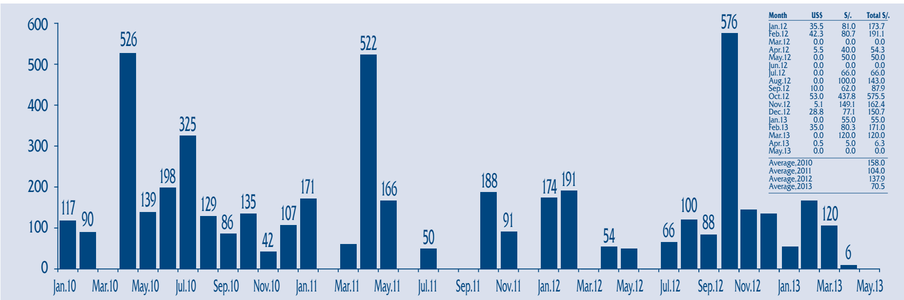
| Table 34<br>RATIO OF DOLLARIZATION OF CREDIT TO THE PRIVATE SECTOR 1/ | Dec.08 | Dec.09 | Dec.10 | Dec.11 | Dec.12 | Jan.13 | Feb.13 | Mar.13 | Apr.13 |
|---|---|---|---|---|---|---|---|---|---|
| Corporate credit | 62.0 | 55.8 | 56.0 | 55.0 | 53.8 | 54.2 | 54.2 | 53.7 | 53.4 |
| Individual credit | 34.3 | 29.1 | 26.4 | 25.1 | 23.9 | 24.1 | 24.0 | 23.9 | 24.1 |
| Consumer loans | 15.1 | 12.2 | 10.7 | 9.8 | 9.7 | 9.9 | 10.0 | 10.0 | 10.2 |
| Car loans | 80.5 | 68.9 | 64.0 | 69.7 | 76.5 | 77.1 | 77.3 | 77.2 | 77.7 |
| Credit cards | 8.8 | 7.7 | 7.2 | 6.3 | 6.4 | 6.6 | 6.7 | 6.7 | 6.9 |
| Mortgage loans | 67.9 | 58.0 | 52.2 | 49.2 | 44.8 | 44.6 | 44.3 | 43.8 | 43.6 |
| **TOTAL** | **53.0** | **46.8** | **46.1** | **44.7** | **43.0** | **43.2** | **43.2** | **42.9** | **42.7** |
| Memo:<br>Dollarization to constant exchange rate | 47.8 | 43.7 | 43.7 | 43.3 | 43.0 | 43.0 | 42.8 | 42.5 | 41.9 |

1/ Includes banks' branches from abroad.

## Capital market

75. Issuances of bonds by non-financial firms in the local capital market slowed down considerably in Q1 and no bonds were placed by non-financial firms in May. On the other hand, bonds issued by financial entities in this period amounted to S/. 140 million.

**Graph 82**
**ISSUANCES OF BONDS BY NON-FINANCIAL FIRMS***
(Millions of nuevos soles)




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

However, a greater dynamism was observed in bonds issued by non-financial companies in the international market, particularly in March and April. Year-to-date, bond issuances in this market amount to US$ 3.56 billion and the bonds issued between March and so far in June amount to US$ 1.86 billion.

It should be pointed out, however, that no bond issuances were observed in May, which could be explained in part by the increase registered in the yields of emerging economies' sovereign bonds, associated with market expectations that the Federal Reserve of the United States would withdraw monetary stimulus earlier than expected.

Additional bond issuances amounting to US$ 780 million have been announced for 2013, the bond issuances of Nexus Capital Partner II and Andean Investment Holding standing out.

**Table 35**
**ISSUANCES OF BONDS IN THE INTERNATIONAL MARKET**

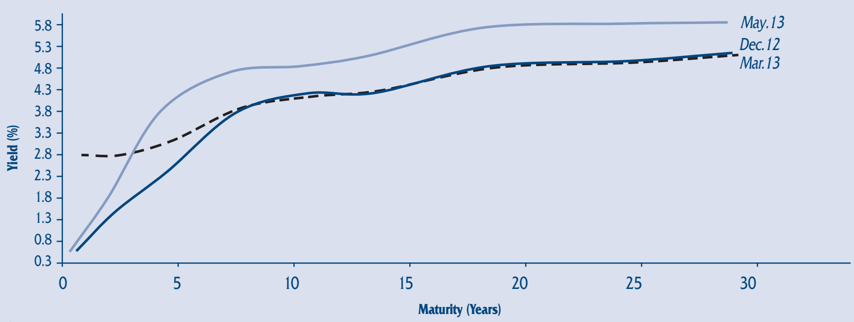
| Companies | Amount (Millions of US$) | Maturity (years) | Rate |
|---|---|---|---|
| **Year 2012** | **2,960** | | |
| **Non-financial sector** | **1,810** | | |
| Volcan | 600 | 10 | 5.38% |
| Camposol | 125 | 5 | 9.88% |
| Terminales Portuarios Euroandinos | 110 | 25 | 8.13% |
| Ajecorp | 450 | 10 | 6.50% |
| Coazucar (Grupo Gloria) | 325 | 10 | 6.38% |
| Maestro | 200 | 7 | 6.75% |
| **Financial sector** | **1,150** | | |
| BBVA Banco Continental | 500 | 10 | 5.00% |
| Interbank | 250 | 8 | 4.80% |
| Scotiabank Peru | 400 | 15 | 4.50% |
| **Year 2013** | **6,351** | | |
| **Non-financial sector** | **3,555** | | |
| Copeinca | 75 | 5 | 9.00% |
| Exalmar | 200 | 7 | 7.38% |
| Cementos Pacasmayo | 300 | 10 | 4.63% |
| Alicorp | 450 | 10 | 3.88% |
| Gas Natural de Lima y Callao - Cálidda | 320 | 10 | 4.38% |
| Compañía Minera Milpo | 350 | 10 | 4.63% |
| Corporacion Lindley | 260 | 10 | 4.63% |
| Ferreyrcorp | 300 | 7 | 4.88% |
| Transportadora de Gas del Peru | 850 | 15 | 4.25% |
| Consorcio Transmantaro | 450 | 10 | 4.38% |
| **Financial sector** | **2,016** | | |
| BBVA Banco Continental | 300 | 4 | 2.31% |
| Fondo MiVivienda | 500 | 10 | 3.50% |
| BBVA Banco Continental | 500 | 5 | 3.38% |
| Banco de Crédito | 716 | 10 | 4.25% |
| **Announced issuances** | **780** | | |
| Chinalco | 130 | | |
| Andino Investment Holding | 150 | | |
| Nexus Capital Partner II | 500 | | |

In line with the evolution of global fixed-income markets, the interest rates of sovereign bonds showed a reversal of the downward trend observed during 2012 and in Q1-2013. Between March and May, interest rates rose 70 basis points on average, in a context of increased supply of non-resident investors and AFP. The rates of return in the short section of the curve (less than 5 years) continue to be below the Central Bank's benchmark rate of 4.25 percent. The yield on PERU 2037 sovereign bonds has increased by 88 basis points from April to May 2013, while the yield on PERU 2037 global bond has increased by 61 basis points in the same period. As stated in our March report, this would be an indicator of the reversal of appreciation expectations that are being observed.

| Table 36<br>PERU GLOBAL AND SOVEREIGN BOND YIELDS<br>AND US TREASURY BONDS BY MATURITY<br>(At the end of period, in percentage points) | | | | | |
|---|---|---|---|---|---|
| | | | | Variation (In bps) | |
| | Dec.12<br>(3) | Apr.13<br>(2) | May.13<br>(1) | May.13 / Apr.13<br>(1)-(2) | May.13 / Dec.12<br>(1)-(3) |
| **Sovereign bonds (S/.)** | | | | | |
| PERU 2013 | 2.70 | 1.40 | 2.05 | 65 | -65 |
| PERU 2015 | 2.71 | 1.70 | 2.35 | 65 | -36 |
| PERU 2017 | 3.05 | 2.80 | 3.60 | 80 | 55 |
| PERU 2020 | 3.80 | 3.87 | 4.90 | 103 | 110 |
| PERU 2023 | 4.09 | 4.13 | 4.92 | 79 | 83 |
| PERU 2026 | 4.24 | 4.28 | 5.05 | 77 | 81 |
| PERU 2031 | 4.79 | 4.83 | 5.75 | 92 | 96 |
| PERU 2037 | 4.90 | 4.92 | 5.80 | 88 | 90 |
| PERU 2042 | 5.10 | 5.04 | 5.85 | 81 | 75 |
| **Global bonds (US$)** | | | | | |
| PERU 2015 | 0.82 | 0.19 | 1.06 | 87 | 24 |
| PERU 2016 | 1.10 | 1.07 | 1.70 | 63 | 60 |
| PERU 2019 | 1.84 | 1.76 | 2.44 | 69 | 60 |
| PERU 2025 | 3.00 | 3.06 | 3.70 | 65 | 71 |
| PERU 2033 | 3.64 | 3.75 | 4.48 | 72 | 83 |
| PERU 2037 | 3.70 | 3.97 | 4.58 | 61 | 88 |
| **US Treasury** | | | | | |
| Bond 2 Years | 0.25 | 0.21 | 0.30 | 9 | 5 |
| Bond 3 Years | 0.35 | 0.31 | 0.49 | 18 | 14 |
| Bond 5 Years | 0.71 | 0.68 | 1.02 | 34 | 31 |
| Bond 10 Years | 1.70 | 1.67 | 2.13 | 46 | 43 |
| Bond 30 Years | 2.87 | 2.88 | 3.28 | 40 | 41 |

Source: Bloomberg.

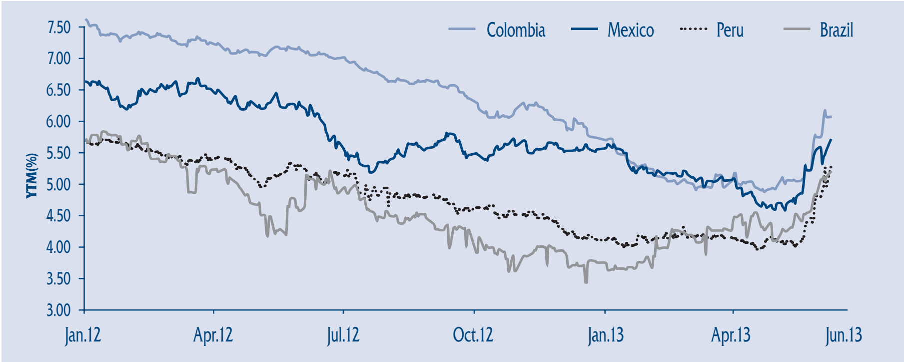
**Graph 83**
**SECONDARY MARKET OF SOVEREIGN BONDS 1/**




1/ End of month yield.

However, it is worth mentioning that the increase in the yields of sovereign bonds reflects a price correction of these securities, whose yields had reached their historical lows over the past few months.

**Graph 84**
**LATAM YIELD CURVE OF 10 YEARS SOVEREIGN BOND**




76. In the last quarter, the spreads of Peru's 5-year to 10-year sovereign debt, measured by credit default swaps (CDS), have had a mixed behavior. The 5-year risk premium remained stable, while the 10-year risk premium increased slightly (by 3 basis points), following the trend of other countries in the region.

**Graph 85**
**CREDIT DEFAULT SWAPS OF SOVEREIGN PUBLIC DEBT**
(Basis points)


77. The administrators of private pension funds (AFP) have increased their investments abroad by US$ 655 million compared to the end of Q1-2013 and by US$ 1.70 billion compared to December 2012. Thus, the percentage of AFPs' investment abroad has risen from 29.4 percent in December 2012 to 31.6 percent in March 2013 and to 33.9 percent in April. The rest of their investments in dollars have increased by US$ 157 million. This evolution of the AFPs' portfolio would allow a higher degree of diversification in their investments, which has a positive impact on their risk and return profiles.

Table 37
CONSOLIDATED PORTFOLIOS MANAGED
BY FINANCIAL INSTRUMENTS AND AFP
(Million nuevos soles)

| | Dec.11 | | Dec.12 | | Apr.13 | |
|---|---|---|---|---|---|---|
| | Amount | % | Amount | % | Amount | % |
| **I. DOMESTIC INVESTMENT** | **58,185** | **71.1** | **68,055** | **70.3** | **66,461** | **66.1** |
| **1. Government** | **13,915** | **17.0** | **16,939** | **17.5** | **16,446** | **16.4** |
| Certificates and term depostis of BCRP (1) | 886 | 1.1 | 2,830 | 2.9 | 3,105 | 3.1 |
| Bonds of Central Government | 13,029 | 15.9 | 14,109 | 14.6 | 13,341 | 13.3 |
| **2. Financial system** | **14,333** | **17.5** | **16,268** | **16.8** | **17,152** | **17.1** |
| Shares and Securitised Shares | 5,294 | 6.5 | 5,572 | 5.8 | 5,625 | **5.6** |
| **3. Non-financial firms** | **23,175** | **28.3** | **26,058** | **26.9** | **24,357** | **24.2** |
| Shares and Securitised Shares | 16,881 | 20.6 | 19,272 | 19.9 | 17,167 | 17.1 |
| **4. Fund managers** | **3,000** | **3.7** | **3,680** | **3.8** | **3,615** | **3.6** |
| **5. Securitization companies** | **3,763** | **4.6** | **5,111** | **5.3** | **4,891** | **4.9** |
| **II. FOREIGN INVESTMENTS** | **23,437** | **28.6** | **28,512** | **29.4** | **34,058** | **33.9** |
| **1. Government** | **949** | **1.2** | **1,705** | **1.8** | **3,198** | **3.2** |
| **2. Financial entities** | **2,738** | **3.3** | **2,640** | **2.7** | **3,326** | **3.3** |
| **3. Non-financial firms** | **8,220** | **10.0** | **6,249** | **6.5** | **6,070** | **6.0** |
| **4. Fund managers** | **11,529** | **14.1** | **17,918** | **18.5** | **21,464** | **21.3** |
| **5. Securitization companies** | **-** | **-** | **-** | **-** | **-** | **-** |
| **III. OPERATIONS IN TRANSIT** | **260** | **0.3** | **286** | **0.3** | **26** | **0.0** |
| **TOTAL** | **81,881** | **100.0** | **96,853** | **100.0** | **100,546** | **100.0** |
| **Foreign investment / Portfolio managed** | **28.6%** | | **29.4%** | | **33.9%** | |

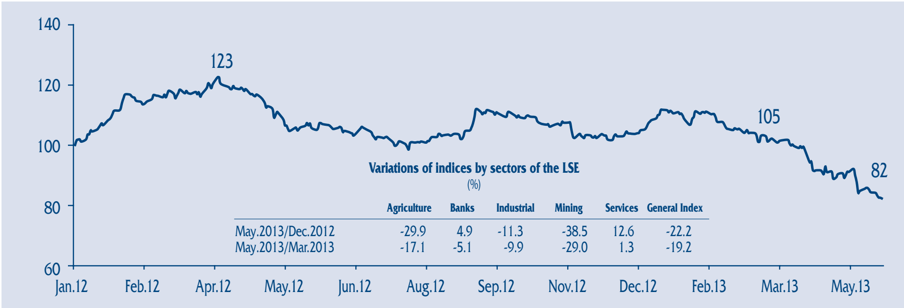
1/ Includes Overnight deposits and BCRP Certificates of Deposit with Restricted Negotiation (CDBCRP-NR).
Source: SBS.

Table 38
AFP: INVESTMENT
(Million US$)

| | Total | |
|---|---|---|
| Date | Abroad | In US$ |
| Dec.12 | 11,184 | 16,656 |
| Jan.13 | 11,698 | 16,868 |
| Feb.13 | 11,821 | 16,711 |
| Mar.13 | 12,111 | 16,865 |
| Apr.13 | 12,766 | 17,023 |

78. In the variable-income market, the General Index of the Lima Stock Exchange (IGBVL) dropped 19.2 percent in May relative to March as a result of uncertainty in international financial markets and the evolution of mineral prices. By sectors, the adverse international scenario affected mainly the shares of mining companies and to a lesser extent industrial share. On the other hand, the stocks of companies in the sector of services have increased 12.6 percent so far this year favored by the evolution of domestic demand.

**Graph 86**
**LSE: GENERAL INDEX**
(January 2, 2012=100)



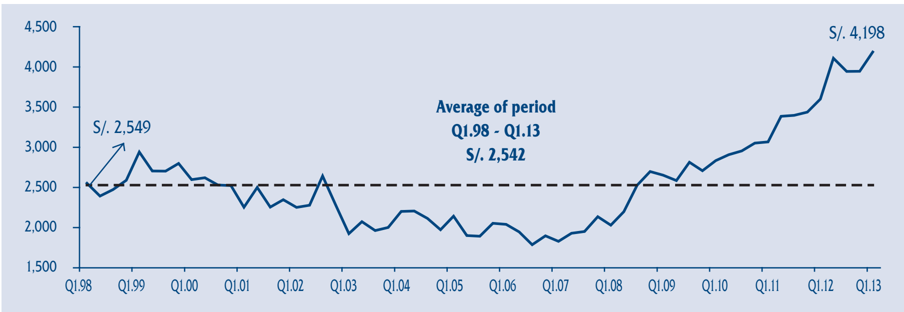

Variations of indices by sectors of the LSE
(%)

| | Agriculture | Banks | Industrial | Mining | Services | General Index |
|---|---|---|---|---|---|---|
| May.2013/Dec.2012 | -29.9 | 4.9 | -11.3 | -38.5 | 12.6 | -22.2 |
| May.2013/Mar.2013 | -17.1 | -5.1 | -9.9 | -29.0 | 1.3 | -19.2 |

## Real estate market

79. In Q1-2013, the prices per square meter of land in constant soles in the five districts of the sample increased 7.0 percent compared to Q4-2012 and 24.5 percent compared to the same quarter of the previous year, in line with the growth of the demand for houses financed with mortgages. The graph below shows the evolution of median quarterly sale prices of apartments per square meter in constant soles of 2009.

**Graph 87**
**MEDIANS OF QUARTERLY SALE PRICES**
**PER SQUARE METER OF APARTMENTS**
La Molina, Miraflores, San Borja, San Isidro and Surco (Base 2009=100)




### Sale price / Income for annual rent ratio (price to earnings ratio - PER):

The price to earnings ratio (PER) shows the number of years of rent required to recover the purchasing value of a property. At Q1-2013, the sale price of an apartment is equivalent on average to a rental income of 15.3 years.

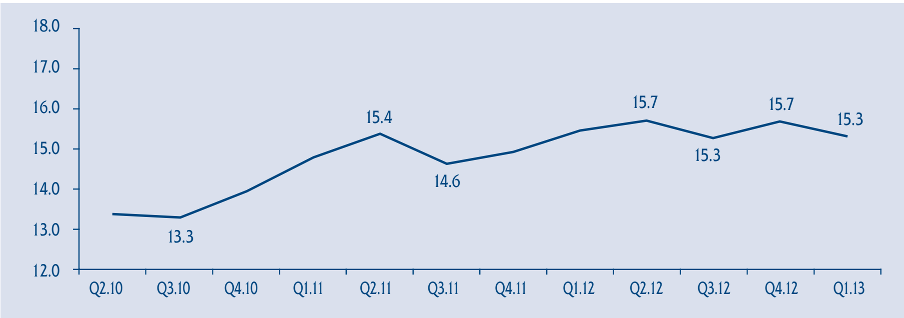
**Table 39**
**PER: PRICE TO EARNING RATIO**

| Medians 1/ | Q1.11 | Q2.11 | Q3.11 | Q4.11 | Q1.12 | Q2.12 | Q3.12 | Q4.12 | Q1.13 |
|---|---|---|---|---|---|---|---|---|---|
| Jesús María | 12.6 | 13.1 | 12.9 | 13.0 | 13.0 | 15.7 | 15.5 | 14.9 | 15.0 |
| La Molina | 16.5 | 17.2 | 15.2 | 15.8 | 12.7 | 10.7 | 12.4 | 11.6 | 13.7 |
| Lince | 14.3 | 15.6 | 16.5 | 14.1 | 13.9 | 14.2 | 14.2 | 16.4 | 14.1 |
| Magdalena | 11.6 | 13.7 | 12.7 | 12.5 | 14.5 | 14.1 | 13.1 | 16.0 | 14.0 |
| Miraflores | 12.9 | 14.0 | 15.6 | 15.7 | 19.0 | 17.0 | 15.3 | 15.0 | 14.8 |
| Pueblo Libre | 15.6 | 15.6 | 15.0 | 15.3 | 15.4 | 16.5 | 15.2 | 16.0 | 14.1 |
| San Borja | 15.3 | 17.2 | 16.6 | 17.2 | 15.3 | 19.5 | 16.8 | 18.2 | 18.6 |
| San Isidro | 15.6 | 15.9 | 14.9 | 16.7 | 19.7 | 17.7 | 17.2 | 18.4 | 18.0 |
| San Miguel | 17.7 | 15.9 | 13.7 | 12.8 | 14.8 | 15.3 | 16.1 | 15.6 | 14.4 |
| Surco | 15.9 | 15.8 | 13.3 | 16.3 | 16.6 | 16.7 | 17.1 | 15.0 | 16.8 |
| **Aggregated** | | | | | | | | | |
| Average | 14.8 | 15.4 | 14.6 | 14.9 | 15.5 | 15.7 | 15.3 | 15.7 | 15.3 |

1/ Rates have been calculated using the sale price median and rent of each district.
Source: BCRP.
According to the PER index, Global Property Guide classifies the real estate market in properties with Undervalued Prices (5.0-12.5), Normal Prices (12.5-25.0), and Overvalued Prices (25.0-50.0).

Although this ratio has shown a rising trend in recent years, according to Global Property Guide it remains within the ranges considered normal, that is, within values between 12.5 and 25.

**Graph 88**
**PER: PRICE TO EARNING RATIO**

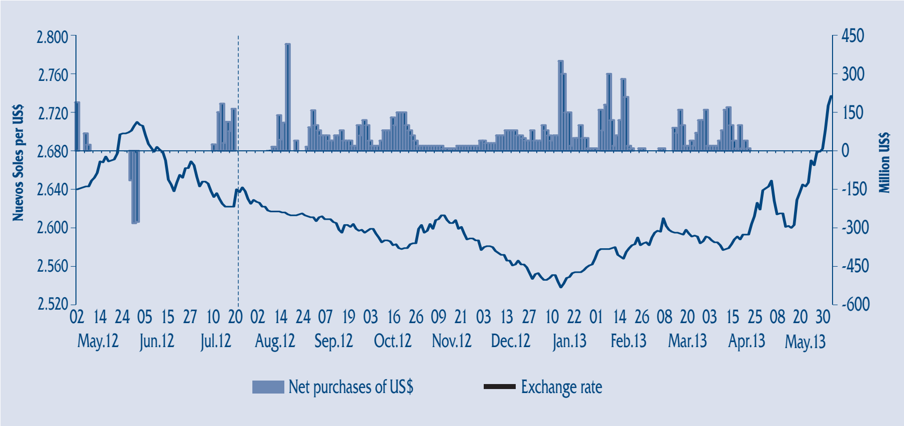



### Foreign exchange rate

80. In Q2-2013, the nuevo sol has continued showing the depreciation trend observed since late January. At the end of May, the exchange rate rose 5.63 percent compared to the end of Q1 and 7.25 percent compared to 2012. This evolution has been influenced by uncertainty in the local market and by a greater perception of global risk associated with the possibility of an earlier-than-expected withdrawal of monetary stimulus by the Federal Reserve, which led economic agents to increase

their demand for dollars and non-residents to reduce their exposure in securities denominated in nuevos soles.

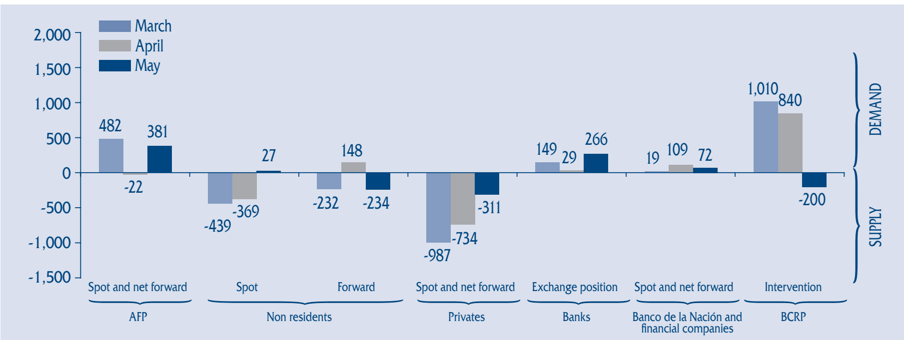
**Graph 89**
**INTERVENTION IN THE FOREIGN EXCHANGE MARKET AND EXCHANGE RATE**




In response to this new situation in international financial markets, the BCRP ceased to intervene in the foreign exchange market as a buyer of foreign currency (the last intervention of the BCRP in this market was on April 19). In May and until June 20, the Central Bank issued 2-month CDR –certificates of deposits indexed to the exchange ratere– for a total of S/. 1.41 billion (approximately US$ 513 million) to moderate the volatility of the exchange rate. This was carried out on 4 occasions.

The supply of dollars in the period of March-April came mainly from private agents, particularly from mining companies and retail customers. This supply was offset by the demand of the AFPs, banks and the BCRP. In May, the AFPs and banks continued to be the agents that had a greater demand for dollars.

**Graph 90**
**FOREX MARKET FLOWS**
(Million US$)



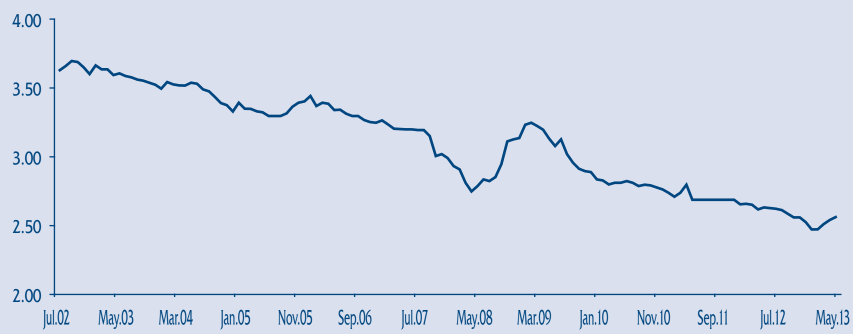
81. The BCRP survey on macroeconomic expectations shows that financial entities and economic analysts have reversed their expectations about an appreciation of the exchange rate due to uncertainty about the global economic outlook.

**Table 40**
**SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE**
(Nuevos Soles per US$)

| | Expectations about: | | |
|---|---|---|---|
| | IR Dec.12 | IR Mar.13 | IR Jun.13* |
| **Financial entities** | | | |
| 2013 | 2.55 | 2.50 | 2.55 |
| 2014 | 2.50 | 2.45 | 2.55 |
| 2015 | -.- | -.- | 2.55 |
| **Economic analysts** | | | |
| 2013 | 2.53 | 2.50 | 2.56 |
| 2014 | 2.50 | 2.45 | 2.54 |
| 2015 | -.- | -.- | 2.50 |
| **Non-financial firms** | | | |
| 2013 | 2.60 | 2.55 | 2.60 |
| 2014 | 2.60 | 2.55 | 2.60 |
| 2015 | -.- | -.- | 2.63 |
| **Average** | | | |
| 2013 | 2.56 | 2.52 | 2.57 |
| 2014 | 2.53 | 2.48 | 2.56 |
| 2015 | -.- | -.- | 2.56 |

Source: Survey conducted during the second fortnight of May 2013.

**Graph 91**
**EXCHANGE RATE EXPECTATION FOR THE NEXT YEAR***
(Nuevos Soles per US dollar)




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

82. The multilateral real exchange rate index rose from 88.0 to 88.8 between March and May 2013, which represents a real depreciation of 0.93 percent in the period. This depreciation results from a rise of 1.12 percent in the nominal exchange rate relative to the basket of currencies of Peru's major trading partners during this period.

**Graph 92**
**MULTILATERAL RER**
(Index 2009=100)


**Box 4**
**EVOLUTION OF SOVEREIGN BOND YIELDS**

Expectations that the FED would withdraw monetary stimulus earlier than expected have generated liquidations in the markets of fixed-income bonds of emerging markets and an increased demand for variable income assets in the United States and Germany. Thus, most of the emerging markets currencies depreciated, the prices of some commodities fell, and bond yields in emerging bond rose.

The 10-year US Treasury bond rose from 1.67 to 2.22 percent in May and in Latin America the sovereign bonds of Brazil, Colombia, and Mexico in domestic currency and with similar maturities rose by 144, 157, and 104 basis points, respectively. In Peru, the yield of sovereign bonds rose by 127 basis points, from 4.11 to 5.38 percent.

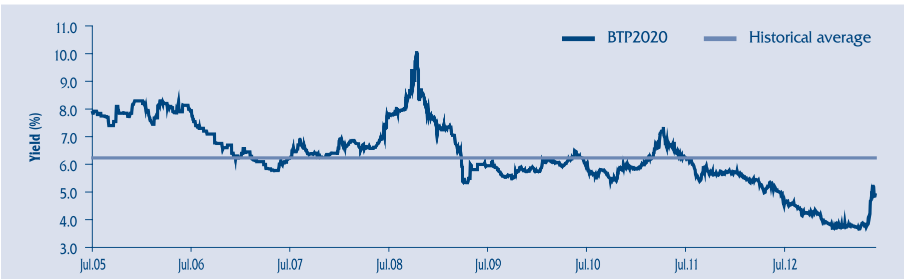
**10 YEARS SOVEREIGN BOND YIELDS**

| | Quotation YTM (%) | | | | | Variation YTM (bps) | | | |
|---|---|---|---|---|---|---|---|---|---|
| Country | 30/12/2012 | 30/04/2013 | 04/06/2013 | 10/06/2013 | 11/06/2013 | Daily | Weekly | Apr.2013 | Dec.2012 |
| Peru,2023 | 4.10 | 4.11 | 4.89 | 5.28 | 5.38 | 10 | 49 | 127 | 128 |
| Colombia 2024 | 5.70 | 4.91 | 5.81 | 6.06 | 6.48 | 42 | 67 | 157 | 78 |
| Mexico 2023 | 5.49 | 4.59 | 5.32 | 5.70 | 5.63 | -7 | 31 | 104 | 14 |
| Brazil 2023 | 3.74 | 4.09 | 5.08 | 5.20 | 5.53 | 33 | 45 | 144 | 180 |
| USA 2023 | 1.70 | 1.67 | 2.15 | 2.21 | 2.20 | -3 | 4 | 51 | 48 |
| Germany 2023 | 1.31 | 1.22 | 1.54 | 1.60 | 1.60 | 0 | 6 | 39 | 29 |
| Japan 2023 | 0.79 | 0.60 | 0.88 | 0.84 | 0.88 | 5 | 1 | 28 | 9 |
| Average | | | | | | 11 | 29 | 93 | 69 |
| JP Morgan Index | 292 | 302 | 295 | 290 | 289 | -1 | -6 | -12 | -2 |

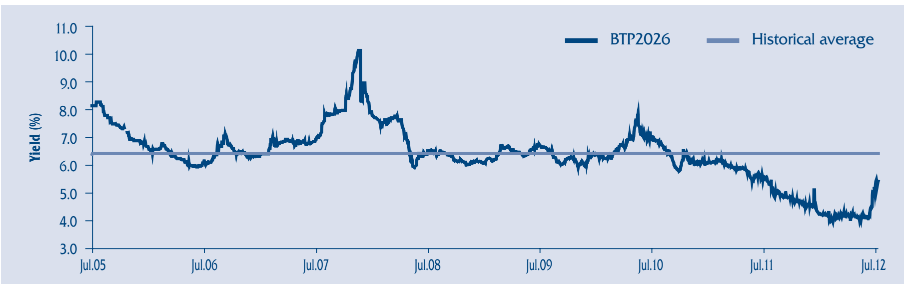
| 10 YEARS USD GLOBAL BOND YIELDS | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Quotation YTM (%) | | | | | Variation YTM (bps) | | | |
| Country | 30/12/2012 | 30/04/2013 | 04/06/2013 | 10/06/2013 | 11/06/2013 | Daily | Weekly | Apr.2013 | Dec.2012 |
| Peru 2025 | 3.06 | 3.08 | 3.62 | 3.72 | 3.76 | 4 | 15 | 69 | 71 |
| Colombia 2024 | 2.97 | 2.97 | 3.88 | 3.92 | 4.16 | 24 | 28 | 119 | 119 |
| Mexico 2022 | 2.82 | 2.94 | 2.55 | 2.55 | 2.54 | 0 | -1 | -39 | -28 |
| Brazil 2024 | 2.60 | 2.69 | 3.64 | 3.86 | 3.95 | 9 | 31 | 126 | 135 |
| Average LATAM | | | | | | 9 | 18 | 69 | 74 |

These increases in the yields of sovereign bonds represent a reversal of the minimum levels reached in early 2013 (3.7 percent in the case of the BTP 2020 and 4.0 percent in the case of BTP 2026). Thus, since it was issued in July 2005 and until June 2013, the BTP 2020 shows an historical average of 6.26 percent and a standard deviation of 1.18, its maximum historical value being 10.05 percent, while the BTP 2026 shows an historical average of 6.40 percent –with a standard deviation of 1.01– and a maximum value of 10.13 percent since it was issued in June 2006.

**EVOLUTION OF BTP 2020 YIELD**




**EVOLUTION OF BTP 2026 YIELD**

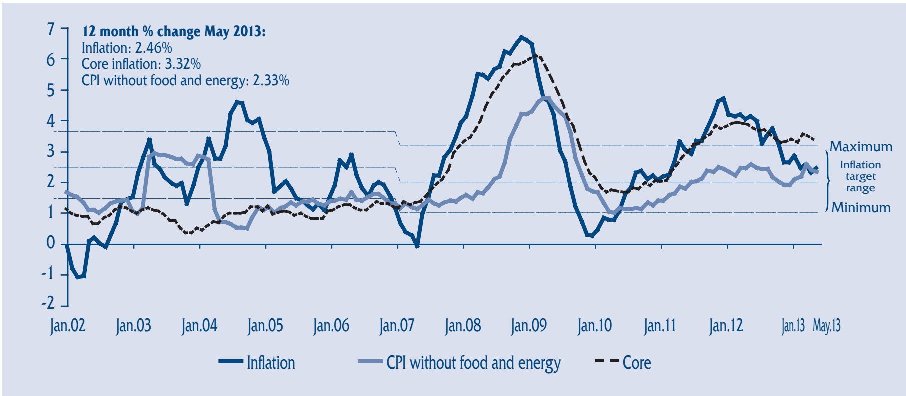



It is worth pointing out that even though the yields of Peruvian bonds and emerging economies' bonds were affected the FED's quantitative easing measures, their recent evolution reflects, in part, the improvement observed in the fundamentals of these economies, particularly, a lower sovereign risk, consistent macroeconomic policies, and a financial system that has remained sound throughout the recent period of global financial crisis.

# VI. Inflation

83. The forecast scenario for 2013-2015 considers that inflation would continue converging towards the 2 percent inflation target, in line with the country's economic growth without demand inflationary pressures in the following years and with inflation expectations adequately anchored around the target. The lower external impulse associated with the slowdown of global economic growth, particularly with the deceleration of growth in China, has caused a reduction in the international prices of food inputs and crude oil. Together with a greater domestic supply of agricultural products, this has led to a slower growth of food prices, contributing to a decline in the rate of inflation in the last twelve months which fell from 2.65 percent in December to 2.46 percent in May. Since no major inflationary pressures are foreseen on the side of external prices or on the side of aggregate demand, and given that expectations are within the target range, inflation is estimated to remain within the range of between 1.5 and 2.5 percent in the 2013-2015 period.

**Graph 93**
**INFLATION AND INFLATION TARGET**
(12 months % change)




84. **Core inflation**, indicator that excludes the most volatile items from the calculation of the CPI index, recorded an annual growth of 3.3 percent in May (the same rate recorded in December). On the other hand, the higher prices observed in services, especially in education and health, led inflation without food and energy to rise from 1.9 percent in December to 2.3 percent in May.

85. After overcoming the effect of the supply shocks that led the international food prices to rise in 2011 as well as due to the drop in the prices of fuels,

which recorded an annual decline of 7.4 percent at May, **non-core inflation** continued to show a downward trend, falling from an annual rate of 1.5 percent in December 2012 to 0.9 percent in May 2013. In aggregate terms, the non-core component of inflation contributed only with 0.31 percentage points to the 2.46 percentage point increase registered by inflation in the last twelve months.

**Table 41**
**INFLATION**
(% change)

| | Weight 2009=100 | 2010 | 2011 | 2012 | 2013 Jan.-May. | 2013 12 months |
|---|---|---|---|---|---|---|
| **I. INFLATION** | **100.0** | **2.08** | **4.74** | **2.65** | **1.39** | **2.46** |
| **II. CPI WITHOUT FOOD AND ENERGY** | **56.4** | **1.38** | **2.42** | **1.91** | **1.48** | **2.33** |
| **III. CORE INFLATION** | **65.2** | **2.12** | **3.65** | **3.27** | **1.92** | **3.32** |
| Goods | 32.9 | 1.53 | 3.17 | 2.56 | 1.21 | 2.49 |
| Services | 32.2 | 2.72 | 4.13 | 3.97 | 2.62 | 4.14 |
| **IV. NON-CORE INFLATION** | **34.8** | **2.00** | **6.79** | **1.52** | **0.39** | **0.89** |
| Food | 14.8 | 1.18 | 11.50 | 2.36 | 0.38 | 0.62 |
| Fuels | 2.8 | 12.21 | 7.54 | -1.48 | 0.89 | -1.76 |
| Transportation | 8.9 | 1.94 | 3.61 | 1.99 | 0.20 | 2.89 |
| Utilities | 8.4 | 0.01 | 1.50 | 0.54 | 0.45 | 0.28 |
| **Foodstuffs** | **37.8** | **2.4** | **8.0** | **4.1** | **1.4** | **3.2** |

**Table 42**
**INFLATION**
(Weighted contribution)

| | Weight 2009=100 | 2010 | 2011 | 2012 | 2013 Jan.-May. | 2013 12 months |
|---|---|---|---|---|---|---|
| **I. CPI** | **100.0** | **2.08** | **4.74** | **2.65** | **1.39** | **2.46** |
| **II. CPI WITHOUT FOOD AND ENERGY** | **56.4** | **0.78** | **1.36** | **1.05** | **0.81** | **1.27** |
| **III. CORE INFLATION** | **65.2** | **1.38** | **2.38** | **2.11** | **1.25** | **2.15** |
| Goods | 32.9 | 0.50 | 1.04 | 0.82 | 0.39 | 0.80 |
| Services | 32.2 | 0.88 | 1.34 | 1.29 | 0.86 | 1.35 |
| **IV. NON-CORE INFLATION** | **34.8** | **0.69** | **2.36** | **0.54** | **0.14** | **0.31** |
| Food | 14.8 | 0.17 | 1.68 | 0.37 | 0.06 | 0.10 |
| Fuels | 2.8 | 0.34 | 0.23 | -0.05 | 0.03 | -0.06 |
| Transportation | 8.9 | 0.17 | 0.32 | 0.18 | 0.02 | 0.25 |
| Utilities | 8.4 | 0.00 | 0.12 | 0.04 | 0.03 | 0.02 |
| **Foodstuffs** | **37.8** | **0.91** | **3.03** | **1.59** | **0.56** | **1.27** |

86. The **imported component** of the CPI had an annual growth of 0.15 percent in May, which largely reflected the effect of the appreciation observed in the period (0.9 percent on average) and the lower prices of fuels (at May the price of fuels recorded a drop of 1.8 percent in annual terms).

**Graph 94**
**DOMESTIC AND IMPORTED INFLATION**
(12 months % change)

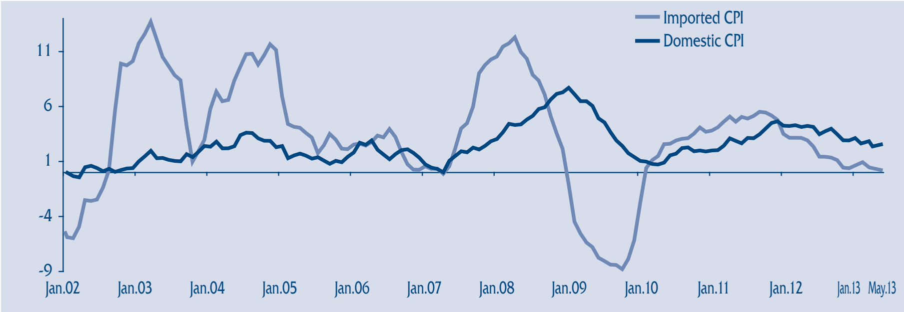
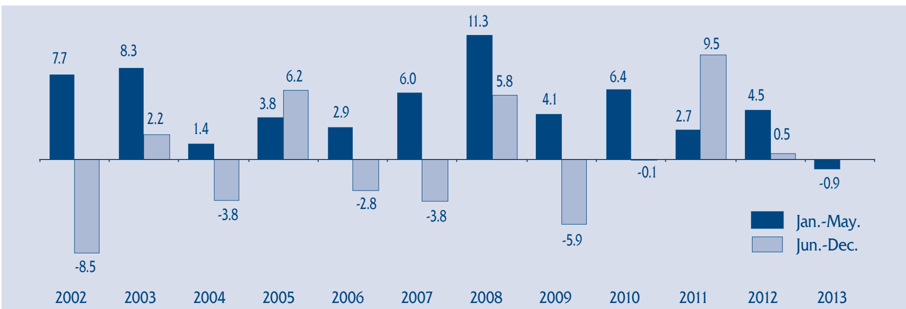



**Table 43**
**DOMESTIC AND IMPORTED INFLATION: 2006 - 2013**
(% change)

| | Weight 2009=100 | 2010 | 2011 | 2012 | 2013 Jan.-May. | 2013 12 months |
|---|---|---|---|---|---|---|
| **I. IMPORTED CPI** | **10.8** | **3.78** | **4.87** | **0.41** | **0.75** | **0.15** |
| Food | 3.0 | 0.76 | 9.59 | 1.99 | 0.01 | 1.44 |
| Fuels | 2.8 | 12.21 | 7.54 | -1.48 | 0.89 | -1.76 |
| Electric appliances | 1.3 | -0.58 | -1.13 | -2.44 | -0.63 | -2.20 |
| Other | 3.7 | 1.20 | 0.83 | 1.73 | 1.72 | 1.55 |
| **II. DOMESTIC CPI** | **89.2** | **1.87** | **4.72** | **2.92** | **1.46** | **2.74** |
| **III.CPI** | **100.0** | **2.08** | **4.74** | **2.65** | **1.39** | **2.46** |
| **Exchange rate** | | **-2.15** | **-4.24** | **-4.80** | **3.04** | **-0.91** |

87. In contrast with what happened in the period of 2002-2012, the prices of **perishable agricultural food products** decreased 0.9 percent between the months of January and May. The climate changes that usually affect the supply of food in the first quarter of the year were offset by an increased supply of some farming products whose cultivation was favored in the last months of 2012 by higher prices and better climate conditions.

**Graph 95**
**PRICE OF PERISHABLE AGRICULTURAL FOOD**
(% change)



88. In terms of their **contribution to inflation**, the items that contributed the most to the rise in inflation in the January-May period included education costs (tuition and fees), meals outside the home, fish, carrots, and eggs. In contrast, the items that contributed the most to a decline of inflation in the first five months of the year were sugar, potatoes, citrus fruits, national transportation, and corn.

**Table 44**
**ITEM WITH THE HIGHEST WEIGHTED CONTRIBUTION TO INFLATION: JANUARY - MAY 2013**

| Positive | Weight | % Chg. | Contribution | Negative | Weight | % Chg. | Contribution |
|---|---|---|---|---|---|---|---|
| Education (fees and tuition) | 8.8 | 4.7 | 0.43 | Sugar | 0.5 | -13.2 | -0.09 |
| Meals outside the home | 11.7 | 2.4 | 0.30 | Potato | 0.9 | -8.3 | -0.08 |
| Fresh and canned fish | 0.7 | 21.9 | 0.15 | Citrus fruits | 0.5 | -7.2 | -0.05 |
| Carrots | 0.1 | 65.8 | 0.08 | National transportation | 0.3 | -11.9 | -0.05 |
| Eggs | 0.6 | 15.1 | 0.08 | Corn | 0.1 | -21.4 | -0.04 |
| Urban fares | 8.5 | 0.7 | 0.06 | Papaya | 0.2 | -13.2 | -0.03 |
| Other fresh fruits | 0.4 | 12.3 | 0.05 | Pepper | 0.1 | -29.7 | -0.02 |
| Water rates | 1.6 | 2.9 | 0.05 | Grapes | 0.1 | -15.6 | -0.02 |
| Car purchases | 1.6 | 3.3 | 0.05 | Poultry meat | 3.0 | -0.6 | -0.02 |
| Toiletries | 4.9 | 0.8 | 0.04 | Avocado | 0.1 | -13.7 | -0.02 |
| **Total** | | | **1.29** | **Total** | | | **-0.42** |

**Table 45**
**ITEM WITH THE HIGHEST WEIGHTED CONTRIBUTION TO INFLATION: JUNE 2012 - MAY 2013**

| Positive | Weight | % Chg. | Contribution | Negative | Weight | % Chg. | Contribution |
|---|---|---|---|---|---|---|---|
| Meals outside the home | 11.7 | 5.5 | 0.69 | Sugar | 0.5 | -22.5 | -0.17 |
| Education (fees and tuition) | 8.8 | 5.3 | 0.49 | Gasoline and oil | 1.3 | -7.4 | -0.12 |
| Urban fares | 8.5 | 3.1 | 0.26 | Onion | 0.4 | -20.4 | -0.09 |
| Poultry meat | 3.0 | 7.0 | 0.20 | Papaya | 0.2 | -26.7 | -0.07 |
| Fresh and canned fish | 0.7 | 13.0 | 0.10 | Telephone rates | 2.9 | -2.0 | -0.05 |
| Water rates | 1.6 | 5.6 | 0.10 | Tomato | 0.2 | -12.5 | -0.03 |
| Evaporated milk | 1.6 | 5.7 | 0.09 | Eggs | 0.6 | -4.4 | -0.03 |
| Potato | 0.9 | 9.7 | 0.08 | Other legumes | 0.4 | -5.1 | -0.03 |
| Toiletries | 4.9 | 1.4 | 0.07 | Electricity rates | 2.9 | -0.9 | -0.02 |
| Citrus fruits | 0.5 | 12.0 | 0.06 | Rice | 1.9 | -1.3 | -0.02 |
| **Total** | | | **2.14** | **Total** | | | **-0.63** |

## Components of inflation at May 2013

89. **Education costs** (tuition and fees) showed a variation of 4.7 percent, the greatest variation being observed in March (4.1 percent) when the school year begins. It is worth pointing out that the component that weigh the most within this category is tuition in private education centers (universities and schools).

**Meals outside the home** continued showing the rising trend observed over the past five years. In the period January-May, this item registered an accumulated change of 2.4 percent, higher than change observed in the general CPI index (1.4 percent) and in the total of food and beverages consumed in the home (1.0 percent). However, a reduction has been observed in the monthly growth rate of prices in this category in the past two months (from 0.5 percent in March to 0.3 percent in April and May).

The prices of **fresh and frozen fish** rose 21.9 percent as a result of anomalous sea conditions (waves and below-normal temperatures) which resulted in a reduced availability of species, such as tuna and mackerel, whose prices rose 21.4 percent and 18.8 percent, respectively. The rise in the price of perico (up 73.4 percent) due to a lower supply of this species in the months of April and May also stands out.

The price of **carrots** increased by 65.8 percent in the first five months of the year, the largest increases being observed in January (21 percent) and May (35 percent). The decline of the supply from Junín in this time of the year was due to higher production costs associated with combating the carrot rust fly pest.

The price of **eggs** rose 15.1 percent, favored by an increased seasonal demand that exceeded a higher supply of eggs. In January-April, the domestic production of eggs registered an increase of 11.5 percent compared to the same period of 2012. Moreover, placements of egg-laying hens in May was also 6 percent higher than in May 2012.

The price of **sugar** dropped 13.2 percent as a result of a higher level of supply and of the lower international prices of sugar (the price of No. 5 contract fell from US$ 516/ metric ton in December 2012 to US$ 482/metric ton in May 2013). In addition to the good weather conditions that favored the production of sugar cane in the period of January-May, technical stoppages were postponed for the second half of the year in the main sugar companies, which resulted in an increase of 12.5 percent in the production of refined sugar.

The price of **potatoes** fell 8.3 percent as a result of better climate conditions in producing areas, especially in Huanuco, which offset the negative impact of excessive rainfall recorded until the month of March, mainly in Ayacucho and Pasco. Appropriate temperature conditions in the Sierra region contributed to increase production in the following months. The domestic production of potatoes grew 8.4 percent in the period of January-April compared to the same period in the previous year. Moreover, production in Huanuco and Junin, Lima's major supplier areas, increased 8.5 and 1.3 percent, respectively.

### Inflation forecast

90. In line with the forecast of our March report, inflation in the last 12 months fell within the target range in May with a rate of 2.46 percent. The central forecast scenario considers that inflation will remain within the target range during all the forecast horizon (2013-2015). No major inflationary pressures associated with

increases in the prices of commodities or with aggregate demand are foreseen in this scenario, which also considers that inflation expectations will remain anchored around the target in the forecast horizon as a result of monetary policy actions.

**Table 46**
**INFLATION 2009-2013**
(12 month % change)

| | Weight | 2009 | 2010 | 2011 | 2012 | 2013* | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | May | IR Mar.13 | IR Jun.13 |
| **CPI** | **100.0** | **0.2** | **2.1** | **4.7** | **2.6** | **2.5** | **2.0** | **2.3** |
| **Food and energy** | **43.6** | **-0.9** | **3.0** | **7.7** | **3.6** | **2.6** | **2.4** | **2.6** |
| a. Food | 37.8 | 0.6 | 2.4 | 8.0 | 4.1 | 3.2 | 2.2 | 2.4 |
| b. Energy | 5.7 | -10.4 | 6.8 | 6.0 | 0.2 | -1.3 | 3.7 | 4.3 |
| **CPI without food and energy** | **56.4** | **1.7** | **1.4** | **2.4** | **1.9** | **2.3** | **1.7** | **2.1** |

* Forecast.

91. The rate of **inflation** is estimated to be slightly higher than 2 percent in 2013 as a result of recent adjustments in the exchange rate (an inflation rate of 2 percent was estimated in the previous report).

Moreover, the main factors affecting the trajectory of inflation include local agricultural supply conditions, the output gap, imported inflation, and inflation expectations. The central scenario considers a GDP growth rate close to the growth of the economy's potential output in the 2013-2015 forecast horizon, which is consistent with a neutral economic cycle. Therefore, no major demand inflationary pressures are expected on inflation during this period. Furthermore, the evolution of the component of imported inflation is expected to normalize in the forecast horizon, which would have a positive effect on inflation. Finally, inflation expectations would remain within the target range and would gradually converge towards the 2 percent target in the forecast horizon.

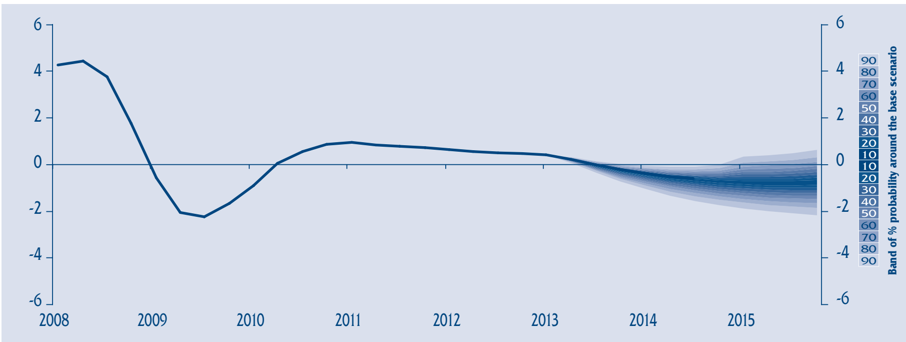
## Output gap

92. The **output gap** reflects cyclical fluctuations in economic activity that become inflationary pressures on the demand side. This 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 external impulse is expected to be lower due to the downward revision of the projected growth rate of our commercial partners and the corresponding reduction in terms of trade. In addition, this forecast scenario also considers a negative fiscal impulse of 0.7 percent in 2013, in line with a higher growth of public expenditure. Thus, in 2013 the negative contribution of the external impulse on the output gap would be offset by the fiscal impulse. In 2015, both the fiscal impulse and the external impulse would be close to zero.

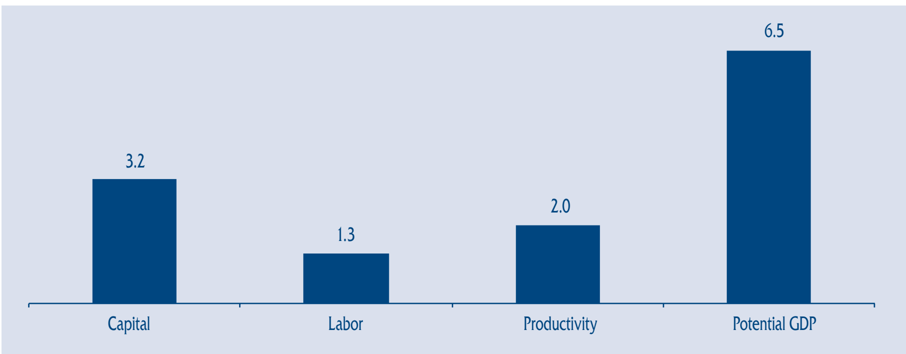
The baseline scenario also considers that the reduction of business confidence observed during the first months of the year is transitory and that business confidence would improve in the second half of 2013. Therefore, both private investment and private consumption are expected to maintain their dynamism in the year, which would translate into a neutral private impulse in the forecast horizon.

**Graph 96**
**OUTPUT GAP: 2008 - 2015**
(% potential GDP)




The potential growth between 2010 and 2012 has been around 6.5 percent and it is estimated that the growth of the potential GDP in the next two years would remain at similar levels. This forecast is consistent with a greater accumulation of capital, derived from the significant growth rates of gross fixed investment in 2012 and the growth rates foreseen for 2013-2015.

**Graph 97**
**SOURCE OF POTENCIAL GDP GROWTH**
(Average 2010-2012)



**Economic activity**

93. The central forecast scenario considers that in 2013 the Peruvian economy would grow 6.1 percent, recording a lower rate than the one forecast in the March report (6.3 percent). This revised forecast is explained by the slower pace of growth observed in private economic activity during the first months of 2013, together with a deterioration in both terms of trade and business confidence, partially offset by a more dynamic public spending. Since these factors are considered to be transitory, GDP is forecast to grow within the range of 6.1 to 6.5 percent in 2014 (a similar rate was estimated in the March report).

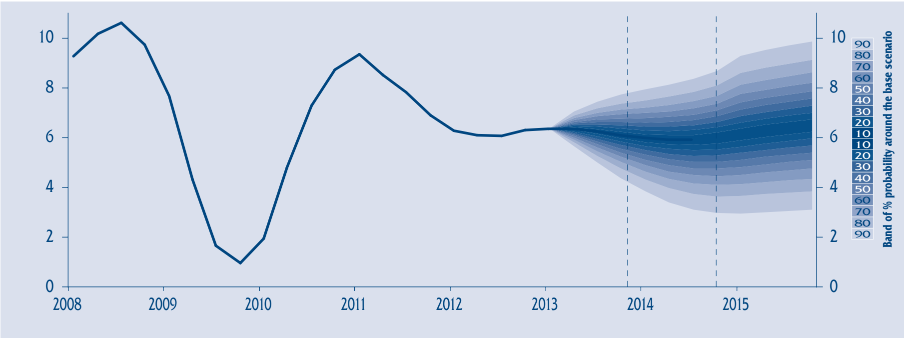
    Every forecast is subject to the occurrence of unanticipated events that may divert it from its central scenario. In this context of uncertainty, the materialization of some risks could imply a different rate of growth of GDP than the one projected originally. The risk scenarios considered in this report are described in the chapter of Balance of Risks.

    Adverse demand shocks connected to obstacles that hinder private investment could be observed in a risk scenario of domestic risks and negatively affect business confidence. The decline in business confidence in such a scenario is more persistent. In addition, uncertainty about the evolution of the global economy remains high and would contribute to a deterioration in macroeconomic conditions. Recent signs pointing more and more clearly to a possible slowdown in major emerging economies such as China stand out.

    On the other hand, the withdrawal of monetary stimulus in developed countries could promote the outflow of foreign capital and have a negative impact on credit to the private sector and ultimately on economic growth. The opposite situation, in which external monetary stimulus remains, has become less and less likely. In this scenario, capital inflows searching for profitable investment options in emerging economies like the Peruvian economy would continue to grow.

    The balance of risks in the case of GDP growth is on the downside. In other words, the probability that the growth of GDP will divert below the forecast in the baseline scenario is higher than the probability that it will divert above this forecast.

Graph 98
FORECAST OF GDP GROWTH 1/, 2013 - 2015
(Interanual % change)




## Energy and food prices

### a. Energy

94. The price of WTI oil increased 7 percent in the first five months of 2013, showing an average price of US$ 94.7 per barrel in May. The price of crude has remained volatile so far this year. The recovery in the price of crude oil was associated with the reduction of the OPEC's high levels of actual production in 2012 after Saudi Arabia decided to reduce its production which had been kept at maximum levels during most of 2012. The unexpected stagnation of the oil production of the African members of the OPEC (Algeria, Angola, Libya and Nigeria), which followed the disturbances caused by the so-called "Arab spring" and brought about a deterioration of infrastructure and a contraction of private investment, added onto this.

    Additionally, the price of crude found support on fears generated by tensions in the Middle East, particularly the domestic conflict in Syria, tensions between Israel and Syria, and the escalation of sectarian violence in Iraq, which threatens to cause a civil war. Attacks have repeatedly paralyzed the operation of the Kirkuk-Ceyhan pipeline, which carries crude oil to Turkey.

    However, the rise in the price of crude was offset by the continuous upward revision of production in the United States to levels unheard of for at least 15 years[12] and by the downward revision of the projected world oil demand[13], particularly by the weak performance of demand in China and Europe, offset by a higher demand of Japan (due to the shutdown of nuclear power plants). Moreover, unprogrammed cuts in the production of crude oil in countries which are not members of the OPEC dropped fifty percent. All of these factors have contributed to maintain the oil supply, offsetting the impact of supply constraints.

12 The US production of crude oil has increased due to the unexpected boom of non-conventional crude.

13 By the International Energy Agency.

**Table 47**
**OIL AND LIQUID FUELS SUPPLY AND DEMAND**
(Million barrels per day)

| | 2012 | 2013 | 2014 |
|---|---|---|---|
| Supply | 89.2 | 89.7 | 91.6 |
| OPEP | 36.4 | 35.9 | 35.9 |
| Non-OPEP | 52.7 | 53.9 | 55.6 |
| | | | |
| Consumption | 89.1 | 89.9 | 91.1 |
| OECD | 45.9 | 45.5 | 45.3 |
| Non-OECD | 43.2 | 44.5 | 45.9 |
| | | | |
| Market balance | 0.1 | -0.2 | 0.4 |
| | | | |
| Inventories at the end of period (million barrels) | | | |
| Inventories in USA | 1,111 | 1,094 | 1,095 |
| Inventories in OECD | 2,648 | 2,648 | 2,705 |

Source: Short Term Energy Outlook, May 2013.

The price of WTI oil is expected to show slightly higher levels than those estimated in the previous Inflation Report, which implies revising upwards the increase in fuel prices (gasoline and LPG). In the medium term, the price of crude is expected to fall slightly due to an increased production of shale gas in the United States. The likelihood of price increases remains high due to the recurring political tensions in the Middle East. Conversely, the likelihood of a further decline in prices is associated with a greater-than-expected global slowdown.

**Graph 99**
**WTI OIL: JANUARY 2007 - DECEMBER 2015**
(US$/bl)


## b. Imported food products

95. Year-to-date, FAO's real price index has increased 1.5 percent due to the price rises recorded since February which corrected the falls in the prices of food products accumulated since October 2012. The rises registered in March and April are mainly explained by the upturn in the prices of dairy products, associated with the decline of the production of New Zealand due to unfavorable weather conditions. Other components, especially the cereals price index, showed a downward behavior in this period.

**Graph 100**
**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.

According to the U.S. Department of Agriculture's World Agricultural Supply and Demand Estimates report of May 2013, the global production of most food products will increase in the 2013/14 season compared to production in 2012/13 as a result of harvests that would reach near-record levels in South American and European producer countries, as well as due to the recovery of the U.S. production. Based on the world final inventories, better market conditions are foreseen in the corn and wheat markets, but tighter market conditions are expected for soybean oil.

**Table 48**
**USDA: BALANCE OF GLOBAL SUPPLY AND DEMAND**
(Million tons)

| | 2011/12 | 2012/13 | 2013/14 | % change | |
|---|---|---|---|---|---|
| | (3) | (2) | (1) | (2)/(3) | (1)/(2) |
| **MAIZE** | | | | | |
| Initial stock | 128.1 | 132.2 | 125.4 | 3.2 | -5.1 |
| Production | 883.0 | 857.1 | 965.9 | -2.9 | 12.7 |
| **Global supply** | **1,011.1** | **989.3** | **1,091.4** | **-2.1** | **10.3** |
| Total consumption | 878.9 | 863.9 | 936.7 | -1.7 | 8.4 |
| Final stock | 132.2 | 125.4 | 154.6 | -5.1 | 23.3 |
| **WHEAT** | | | | | |
| Initial stock | 199.2 | 199.5 | 180.2 | 0.1 | -9.7 |
| Production | 697.2 | 655.6 | 701.1 | -6.0 | 6.9 |
| **Global supply** | **896.4** | **855.1** | **881.3** | **-4.6** | **3.1** |
| Total consumption | 696.2 | 674.9 | 694.9 | -3.1 | 3.0 |
| Final stock | 199.5 | 180.2 | 186.4 | -9.7 | 3.4 |
| **SOYBEAN OIL** | | | | | |
| Initial stock | 3.7 | 3.9 | 3.4 | 5.1 | -12.3 |
| Production | 42.4 | 42.9 | 44.6 | 1.3 | 3.9 |
| **Global supply** | **46.1** | **46.8** | **48.0** | **1.7** | **2.5** |
| Total consumption | 41.7 | 43.0 | 44.3 | 3.1 | 3.0 |
| Final stock | 3.9 | 3.4 | 3.3 | -12.3 | -4.7 |

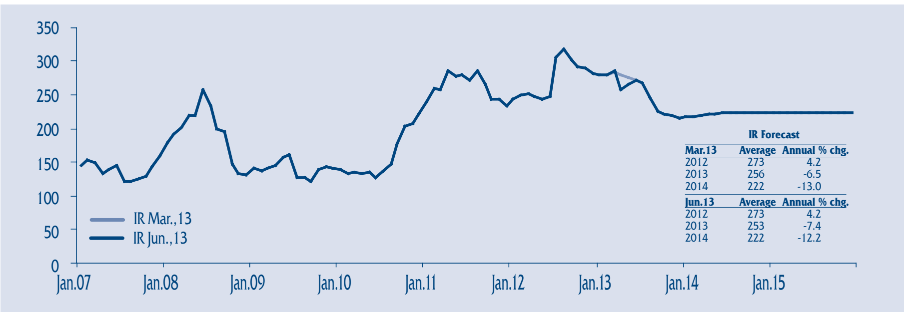
Source: USDA - WASDE May 2013.

## Maize

In May, the average international price of maize was US$ 269/metric ton, 5 percent lower than the average price at the close of December 2012. This variation reflects mainly the price drop observed in the month of April, when the average price fell 9.4 percent, affected by higher production in the United States and expectations of increased inventories in this country. However, in May, the price of maize increased due to excessive rainfall in U.S. producing areas which delayed planting and raised expectations of lower crop yields in this country.

Despite risks that the U.S. production could be lower than initially projected, the world production of maize will recover relative to the previous year (when it was strongly affected by a severe drought in the USA). Moreover, the production of South American countries will also register significant improvements. On the other hand, China's demand would be offset by a lower-than-expected growth. In line with this, in the forecast horizon the price of food is expected to correct downwards in the second half of 2013.

**Graph 101**
**MAIZE: JANUARY 2007 - DECEMBER 2015**
(US$/MT)



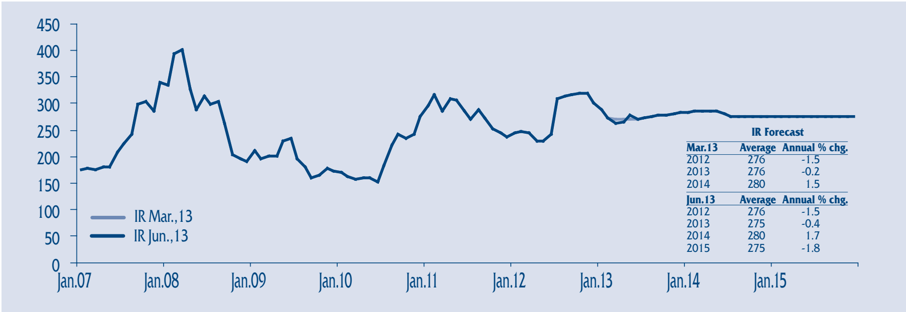

## Wheat

At May, the international price of wheat has accumulated a decline of 9 percent, closing May at an average level of US$ 276/ton. This accumulated decline reflects the price drops recorded in Q1, associated mainly with expectations of less tight conditions in the U.S. market for this crop year.

However, the price of wheat has been increasing since April due to worries that the U.S. production could be lower than projected. On the one hand, persistent rains –which are normalizing humidity conditions in the agricultural areas of USA– have generated delays in wheat planting in the spring season; on the other hand, this excessive rainfall has deteriorated wheat conditions in the winter season.

Fears of lower crops in the USA are offset by expectations of an increased supply from European countries and the Black Sea production zones (Russia and Ukraine). As in the March Inflation Report, prices are expected to remain relatively stable over the forecast horizon.

**Graph 102**
**WHEAT: JANUARY 2007 - DECEMBER 2015**
(US$/MT)

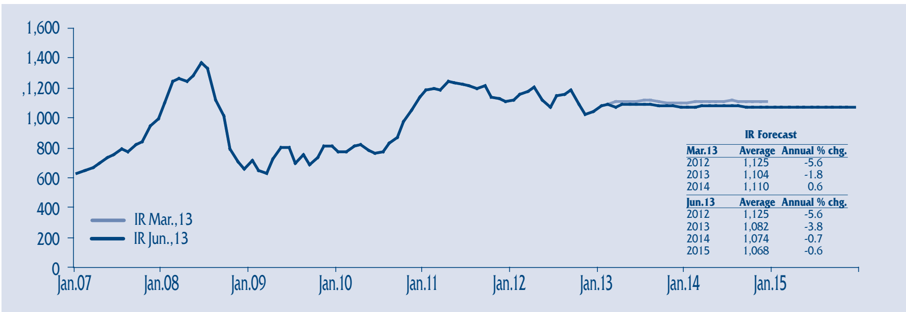



## Soybean oil

The average price of soybean oil was US$ 1,087/ton in May, 5 percent higher than at end-2012. This price has been rising since April due to unfavorable climate factors in the USA which have affected the planting of soybean tasks in that country.

On the other hand, a significant production is expected to be provided by Brazil and Argentina, and global demand is expected to be constrained by the slowdown of growth in China. Considering these factors, it is estimated that the price of soybean oil will register lower levels than those considered in the previous Inflation Report.

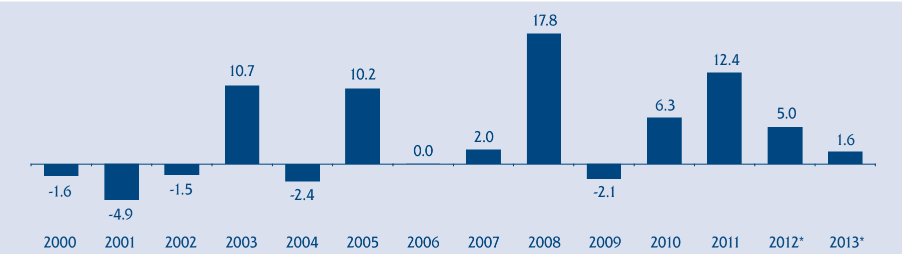
**Graph 103**
**SOYBEAN: JANUARY 2007 - DECEMBER 2015**
(US$/MT)



### c. Perishable food products

96. In 2013 the prices of perishable agricultural food would accumulate an increase of 1.6 percent, less than in previous years, due mainly to the lower increase registered in the January-May period as a result of better weather conditions than in 2012. Moreover, a decline in the prices of chicken and sugar is also forecast.

**Graph 104**
**PRICE OF PERISHABLE AGRICULTURAL FOOD**
(% change)




* Forecast.

### Expectations of inflation

97. Economic agents' expected levels of inflation for 2013 and 2014 continue to be within the Central Bank's inflation target range. A rate of inflation of between 2.5 and 2.7 percent is expected in 2013 and the expected level of inflation declines thereafter in the forecast horizon to rates between 2.3 and 2.8 percent in 2014 and 2015 (within the target range).

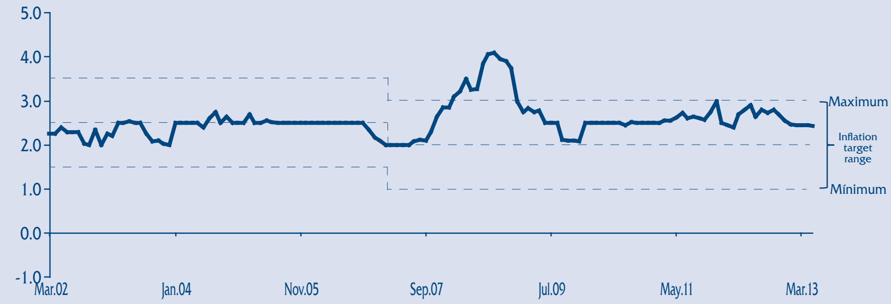
**Table 49**
**SURVEY ON MACROECONOMIC EXPECTATION: INFLATION END OF PERIOD**
(%)

| | Expectations about: | | |
|---|---|---|---|
| | IR Dec.12 | IR Mar.13 | IR Jun.13* |
| **Financial entities** | | | |
| 2013 | 2.6 | 2.7 | 2.5 |
| 2014 | 2.5 | 2.5 | 2.5 |
| 2015 | -.- | -.- | 2.5 |
| **Economic analysts** | | | |
| 2013 | 2.8 | 2.5 | 2.5 |
| 2014 | 2.5 | 2.4 | 2.4 |
| 2015 | -.- | -.- | 2.3 |
| **Non-financial firms** | | | |
| 2013 | 3.0 | 3.0 | 2.7 |
| 2014 | 3.0 | 3.0 | 2.8 |
| 2015 | -.- | -.- | 2.8 |

Source: Survey conducted during the second fortnight of May 2013.

Moreover, according to the BCRP survey on macroeconomic expectations, the expected rate of inflation in 2014 also shows a declining trend in the last months of the year and remains within the target range.

**Graph 105**
**INFLATION EXPECTATIONS FOR THE NEXT YEAR***
(%)




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

Finally, the baseline forecast scenario considers a monetary policy position which would not be substantially different in the short term 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 and indicators of economic activity. Inflation in 2013-2015 is forecast to be within the range of 1.5 and 2.5 percent, with an average rate of 2 percent in this period.

**Forecast**

98. 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.

In the graph below, 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.

Based on data at February 2013, the probability that inflation will be within the target range in 2013 - 2015 is approximately 65 percent, while the probability that it will be below 3 percent is 70 percent.

**Graph 106**
**INFLATION FORECAST: 2013-2015**
(12 months % change)


**Memo:** The graph shows the probability of occurrence of inflation values in the future: These values were established combining statistical analysis and the balance of risk of 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 scenario trajectory.

# VII. Balance of Risks

99. 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 necessarily included 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, in the long run, 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 each risk scenario. Together, these two factors determine the bias of the inflation forecast in the balance of risks.

As in our March Report, 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 impact of commodity prices in international markets, and adverse climate conditions. The balance of these risks shows today a downward bias.

The **downward risks** in the inflation forecast are external factors associated with the possible deterioration of the world economy, including a stronger slowdown in the growth of the emerging economies, and internal factors associated with the dynamics of expectations of business confidence.

**a. Deterioration of the international environment**

A lower rate of global growth than the one estimated in our Inflation Report of March is considered in the baseline scenario for 2013 and 2014. The recovery in the global economy expected to take place in the second half of this year could be interrupted by some negative event in any block of countries or important economy. The probabilities that the United States will go into recession or that the recession will deepen in Europe and Japan have declined compared to the probabilities considered in our last report. However, the probabilities that key emerging economies such as China may experience a greater slowdown have risen. The deepening of these risk conditions would entail lower global dynamism and a weakening of external demand, which would affect the domestic economy through financial and trade channels.

Since the end of 2013 it has been expected that the FED will start a progressive withdrawal of monetary stimulus. An earlier and less gradual withdrawal could bring about a rapid and disorderly adjustment in the exchange rate and in the interest rates of Treasury bonds in our economy given the high participation of non-resident investors in these domestic securities.

Should these risks materialize, the Central Bank would use the significant amount of international reserves the country has, as well as various liquidity injection mechanisms, both in national currency and in foreign currency, to offset the impact of these shocks on domestic financial conditions. If required, the Central Bank would respond by easing monetary conditions.

**b. Slowdown of domestic demand**

Business confidence is an important determinant of private investment, so if it deteriorated it would contribute to a lower dynamism in domestic demand, which would result in a lower output gap and consequently in lower inflation.

Should these risks materialize, the Central Bank would respond easing monetary conditions to maintain inflation within the target range.

On the other hand, there are scenarios of upward risk for inflation associated with the dynamics of commodity prices and other prices sensitive to supply factors.

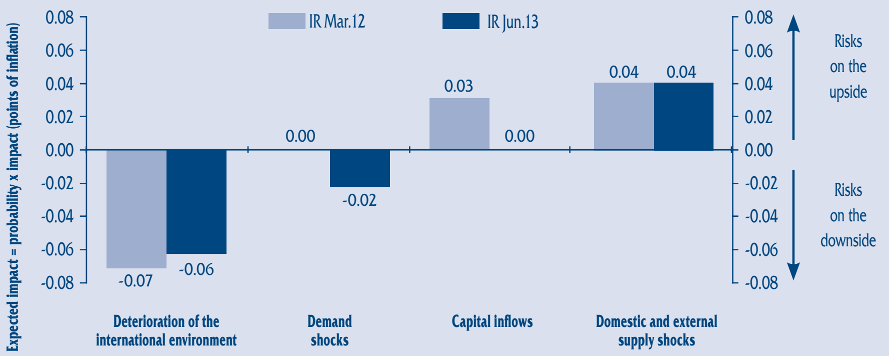
**c. Imported inflation and adverse climate conditions**

The baseline scenario considers a relative stability in the prices of commodities next year. In the external front, the risks include the risk of higher international prices of crude oil and its derivatives, and the risk of having food prices to which the products of the domestic CPI basket are particularly sensitive. On the other hand, at the domestic level, the risk of facing adverse weather conditions that could affect the normal development of the production and supply of food products (mainly farming products) remains.

In this scenario, the Central Bank would adjust its monetary position only if these inflationary shocks were to affect and increase economic agents' expectations of inflation.

Given that the effects of risk factors that generate downward pressures on inflation outweigh the effects of risk factors that generate upward pressures, **the balance of these risks shows a downward bias** for the projection of inflation until mid-2015. With the information available to date, the probability that inflation will be below the forecast considered in the baseline scenario is greater than the probability that inflation will be above the forecast level.

**Graph 107**
**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.

The balance of these risks shows a downward bias for the projection of inflation: The probability that inflation will be below the forecast considered in the baseline scenario is greater than the probability that inflation will be above the forecast level. The sum of the bars in the graph is lower than zero.

## Conclusion

100. With an annual rate of inflation within the target range, inflation expectations within the target range, a GDP growth rate close to the economy's potential level of growth, and a dynamic evolution of domestic demand, inflation is forecast to remain within the target range throughout the 2013-2015 forecast horizon showing an average rate of 2.0 percent. The balance of risks shows a downward bias.

The Central Bank will continue to oversee inflation and inflation determinants to adjust, if required, its monetary stance to ensure that inflation remains within the target range. Moreover, in order to contribute to an orderly evolution of liquidity and credit as well as in order to reduce the vulnerabilities associated with dollarization, the Central Bank will continue to take action with measures such as changes in the rates of reserve requirements.