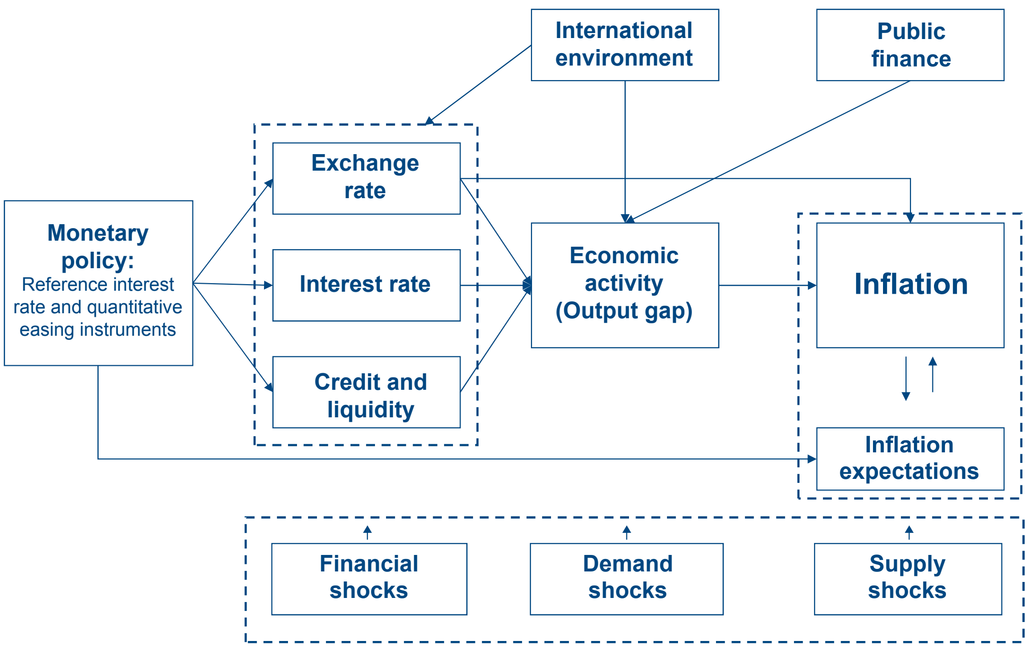
INFLATION REPORT:

Recent trends and macroeconomic forecasts 2014-2016

October 2014



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INFLATION REPORT
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CENTRAL RESERVE BANK OF PERU

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This ***Inflation Report*** was prepared using data on the Balance of Payments and Gross Domestic Product at Q2-2014 and data on the Non-Financial Public Sector, Monetary Accounts, Inflation, Financial Markets, and the Exchange Rate at September 2014.

Foreword

- According to the Constitution of Peru, 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.

- Each month, and according to a previously announced schedule, the Board of BCRP sets a reference rate for the interbank loan market. Since this interest rate, which is the monetary operational target, affects the rate of inflation through several channels in different timeframes, it is established on the basis of macroeconomic forecasts and simulations.

- The Central Bank anticipates inflationary or deflationary pressures, taking also into account that inflation may be influenced by factors beyond the control of monetary policy actions, such as domestic supply shocks or fluctuations in the prices of imported products, which may result in transitory deviations of inflation from the target. In its evaluations BCRP considers the annual increase in the consumer price index registered each month and not only end-of-year figures.

- 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, to avoid excessive credit or credit constraints.

- This Inflation Report includes macroeconomic forecasts that support the monetary policy decisions of BCRP as well as the risk factors that can modify these forecasts.

Summary

i. The forecast on **global growth** in 2014 has been revised downwards, from 3.1 to 3.0 percent, due mainly to lower growth in the Eurozone and Japan. The growth forecast for 2015 has been revised down to 3.6 percent, while the growth forecast for 2016 remains at 3.8 percent given that the world economy is still expected to show a recovery in that year.

ii. The country's **GDP growth** rates projected for 2014 and 2015 have been revised down, reflecting the deterioration of expectations –especially investors' expectations– as well as the economy's slower adjustment to the various external and domestic shocks observed over the year. In this context, a growth rate of 3.1 percent is forecast for this year and a rate of 5.5 percent is estimated for 2015 (4.4 and 6.0 percent, respectively, in our previous report). In 2016 GDP would grow 6.3 percent –as estimated in our previous report– since it is estimated that the current supply problems would subside and agents' expectations would improve.

iii. The forecast of the **current account of the balance of payments** for this year has been revised down to 4.7 percent of GDP. The onset or acceleration of the production of export goods, especially in the mining sector, would contribute to reduce the current account deficit, particularly in 2016 (3.5 percent).

iv. The forecast on the **economic balance of the operations of the non-financial public sector** in 2014 remains at 0.2 percent of GDP given that the lower revenue of the general government would be offset by a lower non-financial expenditure. Deficits of 0.3 and 0.5 percent are forecast for 2015 and 2016, respectively, which is consistent with a fiscal impulse of 0.2 and 0.3 percent of GDP in 2014 and 2015, respectively. The fiscal impulse in 2014 would be reflected in the last quarter of the year.

v. The Board of the Central Bank approved to lower the **monetary policy benchmark** interest rate from 3.75 to 3.50 percent in September. This level of the policy rate is consistent with inflation's convergence to 2.0 percent in 2015 in a context of a weaker-than-expected economic cycle. As forecast, the rate of inflation in the last 12 months returned to the target range in August. The BCRP also continued lowering the rate of required reserves in soles to provide greater sources of funding for credit in domestic currency. The most recent reduction in the rate of required reserves in soles –from 11.0 to 10.5 percent– became effective in October. Complementing this, the BCRP also continued injecting liquidity through auctions of repos with maturities ranging from 3 months to 2 years.

vi. Reflecting some rises in the prices of food, fuels, and electricity rates, the **rate of inflation** in September was within the target range. Inflation is expected to remain within the target range and to reach a rate of 2 percent in the 2015-2016 forecast horizon. This scenario considers that there would be no demand inflationary pressures in the forecast horizon and that inflation expectations would remain within the target range showing a declining trend towards 2 percent.

vii. As regards the inflation forecast, the events that could most likely divert the rate of inflation from the baseline scenario include higher volatility in international financial markets, a greater slowdown in domestic demand, lower global growth, and the occurrence of supply shocks.

a. Volatility in international financial markets

There is still the risk that the Federal Reserve's withdrawal of monetary stimulus will generate high volatility in international interest rates. In such a scenario, this would generate greater capital withdrawals from the emerging countries and depreciation pressures on their domestic currencies.

b. A slowdown in domestic demand

There could be a delay in the recovery of economic activity if the implementation of both public and private investment projects were to be postponed. This would lead to a more negative output gap and therefore to lower inflation in the forecast horizon.

c. Lower global growth

The baseline scenario considers a slower recovery in the world economy in 2014-2016 than the one estimated in our Inflation Report of July. However, if such recovery were to take even longer and if the terms of trade deteriorated even further, the expected external impulse would be lower and would translate into a higher reduction of the output gap and into lower inflation.

d. Supply shocks

The risk of being affected by a stronger El Niño event than the one considered in the baseline scenario remains, although the probability of this occurrence as well as the impact of such an event would be lower than estimated in our previous report.

viii. Because the risk factors affecting inflation on the downside are offset by the risk factors affecting inflation on the upside, **the balance of these risks is neutral** for the inflation forecast in the forecast horizon.

FORECAST SUMMARY

	2013	2014 1/		2015 1/		2016 1/	
		IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
Real % change							
1. GDP	5.8	4.4	3.1	6.0	5.5	6.3	6.3
2. Domestic demand	7.0	4.7	3.3	5.7	5.0	5.2	5.5
a. Private consumption	5.3	4.9	4.6	5.0	4.7	5.2	5.2
b. Public consumption	6.7	8.5	6.9	6.0	6.0	6.0	6.0
c. Private fixed investment	6.4	3.2	-0.4	6.2	5.2	6.5	6.3
d. Public investment	12.1	6.7	0.0	8.9	8.8	11.0	11.6
3. Exports (goods and services)	-0.9	-0.4	-3.3	5.5	6.5	10.8	9.4
4. Imports (goods and services)	3.6	1.0	-1.9	4.7	4.2	5.9	5.9
5. Economic growth in main trading partners	2.7	2.5	2.4	3.1	3.0	3.2	3.2
Memo:							
Output gap 2/ (%)	0.0	-1.0 ; +0.0	-2.0 ; -1.0	-0.5 ; +0.5	-2.0 ; -1.0	-0.5 ; +0.5	-1.0 ; 0.0
% change							
6. Inflation	2.9	2.5 - 3.0	3.0	1.5 - 2.5	1.5 - 2.5	1.5 - 2.5	1.5 - 2.5
7. Average price of crude oil	4.0	2.9	-0.4	-7.3	-7.8	-6.1	-3.6
8. Nominal exchange rate expected 3/	8.5	1.2	3.3	1.7	1.3	1.2	0.6
9. Real multilateral exchange rate 3/	0.7	-1.1	1.0	0.0	-1.1	1.5	0.2
10. Terms of trade	-4.7	-4.7	-5.1	0.4	1.2	-0.4	-0.5
a. Export price index	-5.5	-4.6	-5.7	-0.2	-0.6	0.2	0.2
b. Import price index	-0.8	0.1	-0.7	-0.6	-1.8	0.6	0.7
Nominal % change							
11. Currency in circulation	9.3	10.6	9.1	12.0	11.5	12.0	12.0
12. Credit to the private sector 4/	13.2	14.0	11.2	14.0	13.1	14.0	13.7
% GDP							
13. Gross fixed investment rate	26.6	26.8	25.8	26.9	25.7	27.3	26.1
14. Current account of the balance of payments	-4.5	-4.8	-4.7	-4.8	-4.3	-3.5	-3.5
15. Trade balance	0.0	-1.2	-1.4	-1.0	-0.7	-0.1	-0.1
16. Gross external financing to the private sector 5/	9.5	7.6	7.6	6.4	6.4	5.5	5.5
17. Current revenue of the general government	22.1	22.6	22.3	22.1	21.9	22.1	21.9
18. Non-financial expenditure of the general government	20.5	21.3	21.2	21.3	21.3	21.3	21.3
19. Overall balance of the non-financial public sector	0.9	0.2	0.2	-0.3	-0.3	-0.5	-0.5
20. Total public debt balance	19.6	19.2	19.2	18.6	18.7	18.0	18.2

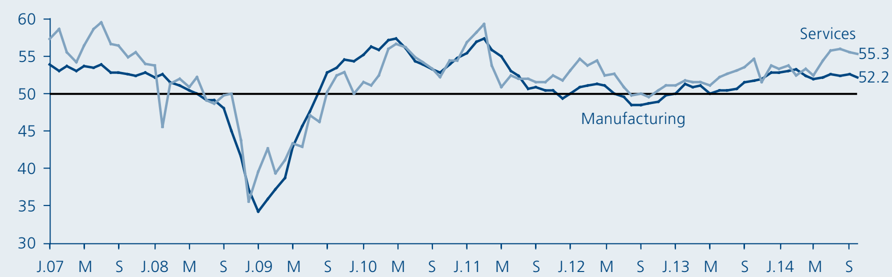
IR: Inflation Report.
1/ Forecast.
2/ Differential between GDP and potential GDP (%).
3/ Survey on exchange rate expectations.
4/ Includes loans made by banks' branches abroad.
5/ Includes Foreign Direct Investment, portfolio investment, and private sector's long-term disbursement.

I. International Environment

Output

1. The world economy has continued recovering at a slow uneven pace over the past few months. This is reflected in the global indices of both manufacturing and services, which have shown some stabilization in recent months but with a differentiated behavior by countries.

Graph 1
JP MORGAN GLOBAL PMI MANUFACTURING AND SERVICES*
January 2007 - September 2014

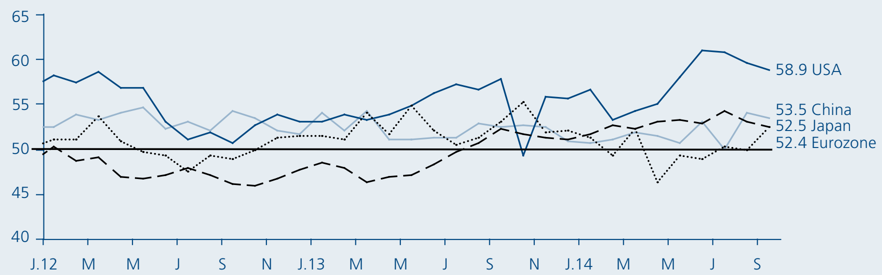


* PMI index.
Source: Bloomberg.

2. In the developed economies, the United States showed a moderate recovery, in line with expectations; on the other hand, indicators in Germany and Japan suggest lower growth than expected in our previous report.

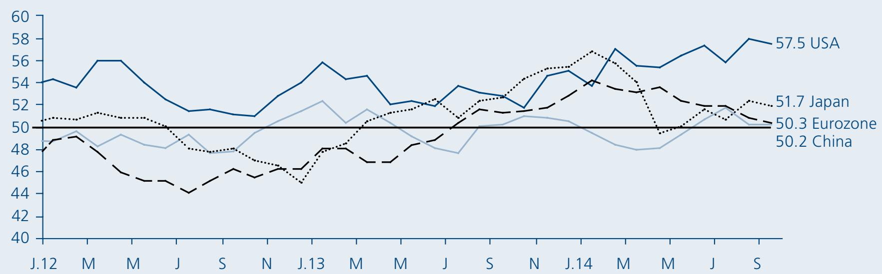
   This different evolution is reflected in activity rates. On the one hand, the United States has been growing supported by greater activity in services and a recovery in manufacturing due to the increase in consumption and investment resulting from the strengthening of economic conditions. On the other hand, in the Eurozone, the deterioration of confidence associated with the Russia-Ukraine conflict has brought about a decline in investment and a slowdown in consumption, as reflected in the stagnation of manufacturing and the deceleration of activity in services. Japan has shown a slight recovery recently, but with very moderate growth rates in services and manufacturing, both of which have been affected by the rise in the VAT.

Graph 2
JP MORGAN GLOBAL PMI SERVICES*
January 2012 - September 2014



* PMI index.
Source: Bloomberg.

Graph 3
JP MORGAN GLOBAL PMI MANUFACTURING*
January 2012 - September 2014



* PMI index.
Source: Bloomberg.

In the emerging economies, the growth forecast has been revised down mainly due to the economic slowdown registered in Latin America and, to a lesser extent, in China. The slowdown in Latin America, which has been greater than anticipated in our previous inflation report, reflects the impact of a series of external factors –a drop in the terms of trade and the depreciation of domestic currencies– and domestic shocks, while in the case of China, most recent indicators show a slowdown in activity which would be in part offset by the stimulus measures adopted in April and September. Activity indices in China show a stagnation in manufacturing, but at the same time a recovery in services after investment in the sectors of manufacturing and real estate slowed down.

3. In line with these developments, the forecast of global growth has been revised down from 3.1 to 3.0 percent for 2014 and from 3.8 to 3.6 percent for 2015, reflecting that worse conditions are anticipated in the Eurozone and Japan and that a slowdown is expected in some emerging economies.

The growth rate projected in the United States for 2014 has been revised up from 1.6 to 2.2 percent, whereas the projected growth in the Eurozone has been lowered from 1.1 to 0.7 percent for this year and from 1.5 to 1.2 percent for 2015. Similarly, the rate projected in Japan has been lowered from 1.4 to 1.1 percent for 2014. In the emerging economies, China's growth rate has been revised slightly to 7.2 percent for 2014-2015 and to 7 percent for 2016.

Table 1
WORLD GDP GROWTH
(Annual % change)

	PPP %	Executed		2014		2015		2016	
	2012	2012	2013	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
Advanced economies	**50.4**	**1.2**	**1.4**	**1.7**	**1.8**	**2.4**	**2.3**	**2.4**	**2.4**
Of which:									
1. United States	19.5	2.3	2.2	1.6	2.2	3.0	3.0	3.0	3.0
2. Eurozone	13.5	-0.7	-0.4	1.1	0.7	1.5	1.2	1.6	1.6
Germany	3.8	0.9	0.5	1.8	1.5	1.8	1.5	1.6	1.5
France	2.7	0.3	0.3	0.7	0.4	1.4	1.0	1.5	1.4
Italy	2.2	-2.4	-1.9	0.3	-0.3	1.1	0.4	1.1	1.1
Spain	1.7	-1.6	-1.2	1.1	1.1	1.5	1.5	1.5	1.5
3. Japan	5.5	1.4	1.5	1.4	1.1	1.3	1.3	0.9	0.9
4. United Kingdom	2.8	0.3	1.7	3.0	3.0	2.7	2.7	2.4	2.4
Emerging market and developing economies	**49.6**	**5.1**	**4.7**	**4.6**	**4.3**	**5.2**	**5.0**	**5.3**	**5.3**
Of which:									
1. Developing Asia	25.1	6.7	6.7	6.5	6.4	6.8	6.7	6.7	6.7
China	14.7	7.7	7.7	7.3	7.2	7.3	7.2	7.1	7.0
India	5.7	4.7	5.0	5.4	5.4	6.3	6.3	6.5	6.5
2. Commonwealth of Independent States	4.2	3.4	2.1	1.3	0.8	2.5	1.9	3.4	3.4
Russia	3.0	3.4	1.3	0.5	0.3	1.8	1.0	2.2	2.2
3. Latin America and the Caribbean	8.7	2.9	2.7	2.1	1.4	2.9	2.6	3.4	3.4
Brazil	2.8	1.0	2.5	1.5	0.3	2.0	1.3	2.7	2.7
World Economy	**100.0**	**3.1**	**3.1**	**3.1**	**3.0**	**3.8**	**3.6**	**3.8**	**3.8**
Memo:									
Peru's trading partners [1/]	64.1	2.7	2.7	2.5	2.4	3.1	3.0	3.2	3.2
BRICs [2/]	26.3	5.8	5.8	5.5	5.3	5.9	5.7	5.9	5.8

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

4. These growth forecasts imply some downward risks.

   a. **A disorderly adjustment in financial markets** following the Fed's normalization of its interest rates which could lead to depreciatory pressures in the emerging economies and deteriorate external financial conditions.

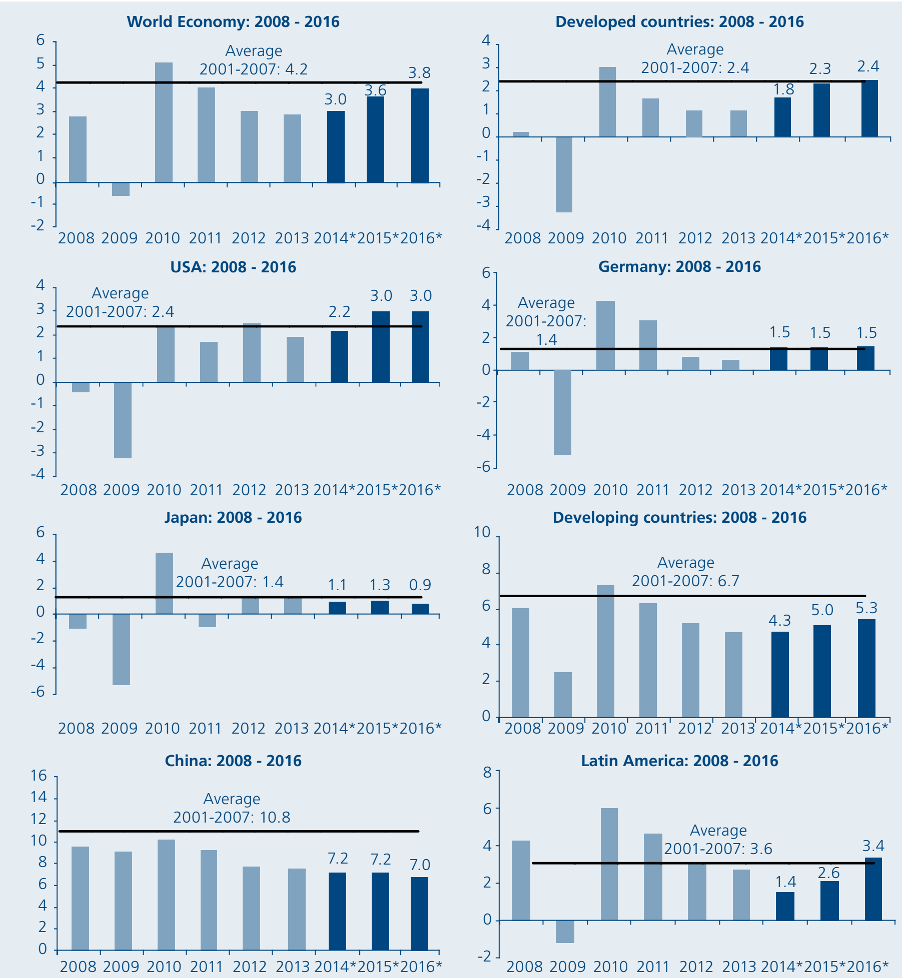
   b. **Higher deflationary pressures in the Eurozone and stagnation**. The recent evolution of inflation, high unemployment in the Eurozone peripheral countries, and the recent slowdown registered in Germany increase this risk compared to our previous report.

   c. **A greater-than-expected slowdown in China**. The central forecast scenario considers a deceleration in China's pace of growth, in line with recent indicators and the correction implemented in the real estate sector. A greater-than- expected slowdown could imply a greater decline in the terms of trade than the one considered in the baseline scenario.

d. **Intensification of geopolitical tensions**. The world economy has been recently affected by a series of geopolitical events. Apart from their global impact, the aggravation of these conflicts would also have specific impacts on the price of oil (conflicts in Iraq), on the recovery of the Eurozone (conflict between Ukraine and Russia), or on China's recovery and on the demand for commodities (protests in Hong Kong).

e. **Aggravation of global health conditions**, should deficiencies be observed in the measures aimed at preventing the spread of the Ebola virus to other continents.

Graph 4
GDP GROWTH
(Annual % change)



* Forecast.
Source: BCRP.

5. In the **United States**, the economy recovered in Q2 after having slowed down in Q1 due to the adverse climate effects. In Q2 the output grew at a quarterly annualized rate of 4.6 percent –the highest rate since 2011– showing higher non-residential investment and consumption and a positive accumulation of inventories. The housing market continues showing a slow recovery.

   Concentrated in durable goods, consumption grew 1.8 percent in Q2. Recent data on aspects such as consumer spending, retail sales, and consumer confidence would be indicating that consumption would grow at higher rates supported by low interest rates, controlled inflation pressures, consumer confidence levels showing record levels since 2007, and a growing household wealth driven by improvements in the labor market and high levels of stock indices. The recent increase in personal savings and the reduction in the level of household deleveraging would allow this growth in consumption.

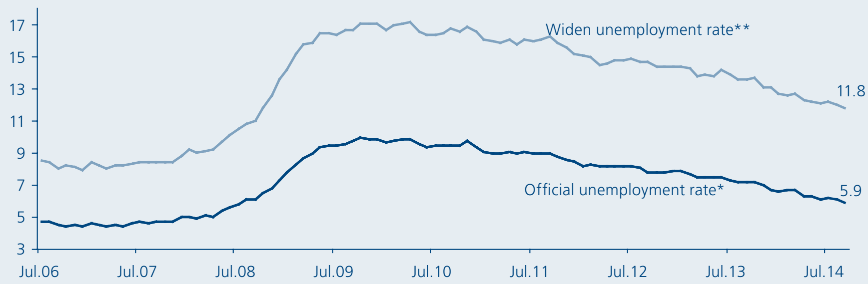
Table 2
USA: GDP
(Seasonally adjusted annualized quarterly rates)

	2013				2014	
	I	II	III	IV	I	II
Private consumption	3.6	1.8	2.0	3.7	1.2	2.5
Fixed investment	2.7	4.9	6.6	6.3	0.2	9.5
Change on inventories*	0.7	0.3	1.5	-0.3	-1.2	1.4
Net exports*	-0.1	-0.5	0.6	1.1	-1.7	-0.3
GDP	**2.7**	**1.8**	**4.5**	**3.5**	**-2.1**	**4.6**
Memo						
Unemployment rate**	7.5	7.5	7.2	6.7	6.7	5.9

* Contribution to growth.
** End-of-period.
Source: BEA, BLS, and JPM.

   In the labor market, the number of jobs created each month increased from an average of 194 thousand in 2013 to 227 thousand between January and September of 2014, while the rate of unemployment fell to 5.9 percent in September. Broader employment indicators show that there is still a large excess capacity: the underemployment rate was 11.8 percent in September –twice as much as the unemployment rate– and the labor participation rate has been at its lowest level in nearly three decades.

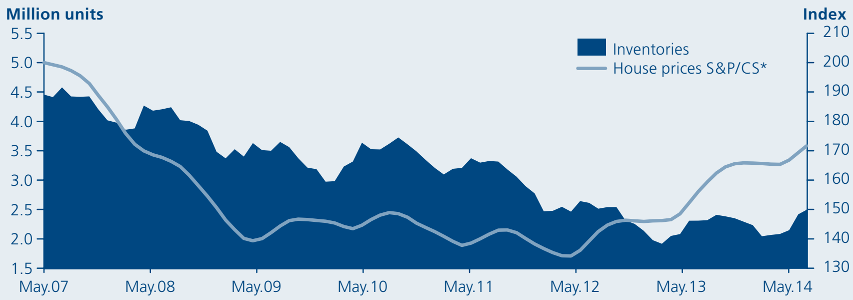
Graph 5
USA: UNEMPLOYMENT MEASURES
(%)



Memo:
* U-3: Total unemployed, as a percent of the civilian labor force (official unemployment rate).
** U-6 Total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all persons marginally attached to the labor force.
Persons marginally attached to the labor force are those who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the past 12 months.
Source: Bloomberg.

Investment was driven by non-residential investment and by inventory accumulation. Capital spending was favored by the rebound of corporate earnings after tax payments, which showed a quarterly increase of 8.6 percent in Q2 after having fallen 16.3 percent in Q1. Residential investment, on the other hand, continued showing a modest pace of recovery. Indicators show a slow recovery in recent months.

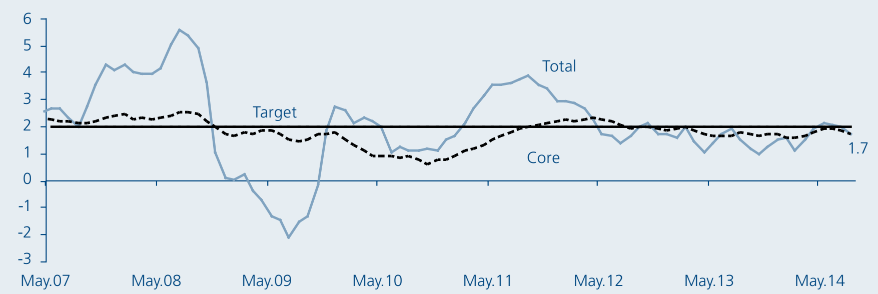
Graph 6
USA: HOUSE PRICES (S&P/CS*) AND INVENTORIES



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

Annual inflation fell from 2.1 percent in May to 1.7 percent in August, while core inflation –which excludes fuel and food– fell from 2.0 percent to 1.7 percent in the same period.

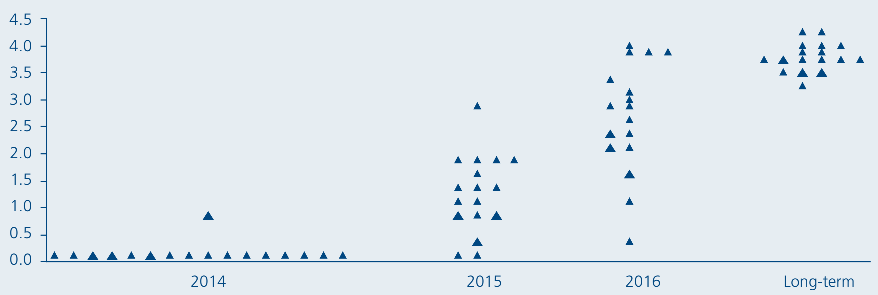
Graph 7
USA: CPI
(12 month % change)



Source: Bloomberg.

6. After buying bonds for a total of US$ 35 billion until July, the Fed continued reducing its monthly purchases of bonds –Quantitative Easing (QE)– and started buying bonds for a total of US$ 15 billion as of October. The Fed is expected to announce the end of its asset purchase program in the Federal Open Market Committee meeting that will take place in October. In order to give some guidelines to the market, in its September meeting the Fed announced the principles and plans it would adopt when it would start normalizing its policy, pointing out that the main tool it would use to start increasing interest rates would be the interest on excess reserves (IOER), that overnight reverse repos would be used as a secondary tool, and that the reduction of the balance sheet would follow the increase in rates.

Graph 8
FORECASTING FED POLICY RATE
IN SEPTEMBER 2014
(%)



* Each point represents the individual forecast of the Members of the Board of FED at the end of period. Median is 1.38% in 2015, 2.88% in 2015, and 3,75% in long-term.
Source: Fed.

7. The Fed has said that once it has completed its asset purchase program, there would be a "considerable period of time" before it starts implementing the cycle of rate adjustments. The Vice President of the Fed said that "considerable

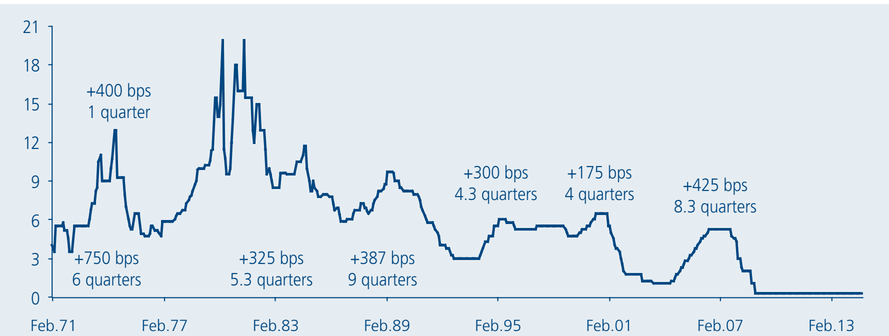
time" could mean from two months to a year, depending on the conditions of the economy. Therefore, even though it is estimated that the Fed would begin a cycle of rate adjustments by mid-2015, there are several uncertainty factors.

As some members of the Board of the Fed have said, on the one hand there is concern about the appreciation of the dollar in international financial markets and about the deterioration of U.S. exports. Together with some slowdown in the world economy, these factors could imply that the adjustment of rates would begin later than expected. On the other hand, other members of the Board of the Fed have said that the low rates could generate inflationary pressures in the short term or an overvaluation in some markets (such as the stock market).

8. It should be pointed out that when the Fed last raised its rates (June 2004 - June 2006), the yields on the 10-year bonds increased only 50 bps in response to an increase of 425 bps in the Fed rate and that the 10-year yields were even below the 2-year yields. Among other factors, this lower increase is explained by the greater demand for these bonds from institutional investors such as pension funds and central banks in Asia (particularly, China) and also by the changes in the Fed communiqué of January 2004 which prepared the market for the adjustments that were to be adopted and originated a portfolio re-composition months before the rates were raised.

The yields of Treasury bonds –which reached historic lows by the end of 2012– started to rise in May 2013 after Bernanke's statements and accumulated an increase of 127 bps during 2013. This upward trend has reversed mainly in 2014.

Graph 9
USA: FED INTEREST RATE
(%)



Source: Bloomberg.

Graph 10
USA: YIELDS ON 10-YEAR US TREASURY BONDS
(%)

Source: Bloomberg.

9. In line with the greater output growth observed in Q2, it is estimated that the U.S. economy will grow 2.2 percent in 2014, 3.0 percent in 2015 and 3.0 percent in 2016. This forecast considers that the economy would continue recovering in the next quarters of the year. However, the growth rates projected could change if the cycle of interest rate rises is modified by the factors mentioned above. Another downside risk is the one associated with political uncertainty if no agreement is reached on the debt limit or the 2015 fiscal budget next year.

10. In the **euro area**, recent economic indicators show a modest and lower-than-expected recovery. In addition, the risks of a prolonged period of very low inflation have increased compared to what was estimated in our previous report.

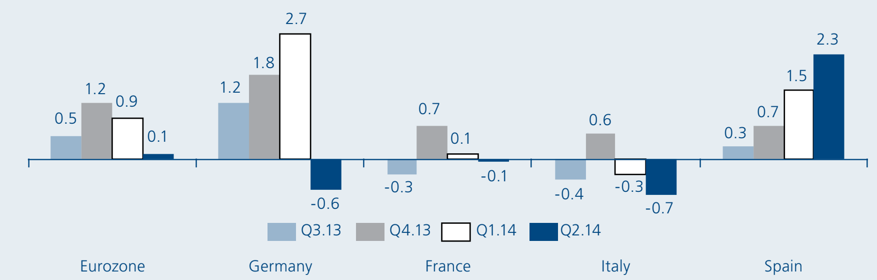
Table 3
EUROZONE: GDP GROWTH
(Seasonally adjusted annualized quarterly rates)

	2013				2014	
	I	II	III	IV	I	II
Private consumption	-0.9	0.6	0.6	0.3	0.7	1.2
Fixed investment	-6.2	0.5	1.9	3.8	0.9	-1.3
Change on inventories*	0.8	-0.7	1.2	-0.8	0.9	-0.8
Net exports*	-0.4	1.6	-1.6	1.2	-1.2	0.4
GDP	**-0.8**	**1.2**	**0.5**	**1.2**	**0.9**	**0.1**
Memo						
Unemployment rate**	12.0	12.0	12.0	11.8	11.7	11.5

* Contribution to growth.
** End-of-period.
Source: Eurostat.

After growing at moderate rates in the previous quarters, the GDP growth was almost nil in Q2 due mainly to the negative contribution of inventories and to a contraction of investment, particularly in construction. The drop of investment reflects the deterioration of business confidence in an unfavorable international context associated with the Ukraine-Russia crisis, tensions in the Middle East, and fears of a further slowdown in China. This has been offset by a modest growth of private consumption and net exports.

Graph 11
EUROZONE: QUARTERLY GDP GROWTH
(Seasonally adjusted annualized quarterly rates)



Source: Bloomberg.

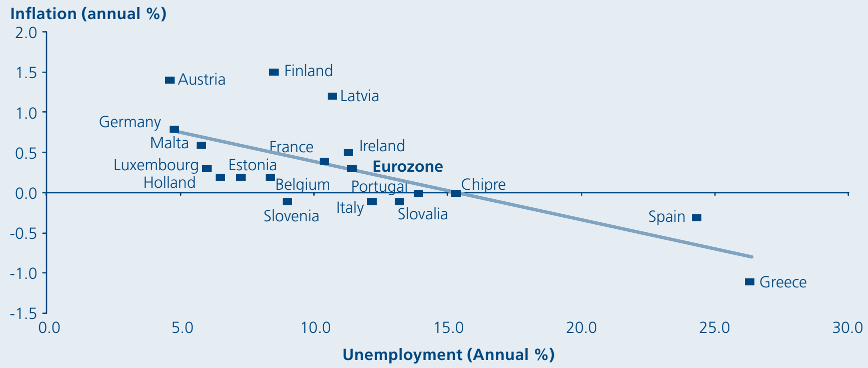
Recent indicators show that this weak evolution continues. Confidence indices give negative signals: business indices have fallen to levels unheard of since mid-2013 and consumer indices have shown a declining trend over the past four months. In addition to this, although the unemployment rate has stabilized around an annual rate of 11.5 percent at August, it is still high compared to the levels observed prior to the crisis due mainly to unemployment in the peripheral economies (particularly Spain and Greece). Moreover, after showing a declining trend since May, activity indices (PMI indices) have stabilized at low levels –similar to those observed at end 2013–, which would be indicating very low growth rates.

The evolution by countries is still heterogeneous. Germany still leads the evolution of the union despite the slowdown observed and France and Italy lag behind, affected by the delay in the implementation of structural reforms and political uncertainty. Spain, like Ireland, on the other hand, have been growing at increasingly higher rates, while the other peripheral countries (i.e. Portugal and Greece) are still affected by the adjustments implemented.

As in the period analyzed by our previous Report, this weak evolution has been accompanied by very low inflation rates and still restrictive credit conditions. Bank loans to the private sector, especially in the corporate segment, dropped again in August (-1.5 percent annually), thus recording 28 straight months of declines. At the country level, the drop continues to be concentrated in the peripheral economies (i.e. Italy, Spain, Portugal, Greece, and Ireland).

In September, annual inflation in the Eurozone showed a rate of 0.3 percent, as a result of which inflation remains below 1 percent for 12 consecutive months. Of the 19 countries of the union, five reported negative inflation rates and three reported rates above 1 percent. In addition, indicators of inflation expectations have declined significantly –the implicit indicators of forwards and swaps have dropped to record levels below 2 percent–, which has increased fears of deflation.

Graph 12
EUROZONE: INFLATION AND UNEMPLOYMENT RATE
(%)



Source: Bloomberg.

This evolution of inflation and the maintenance of fragmented credit conditions led the ECB to take measures to anchor inflation expectations and ease credit conditions:

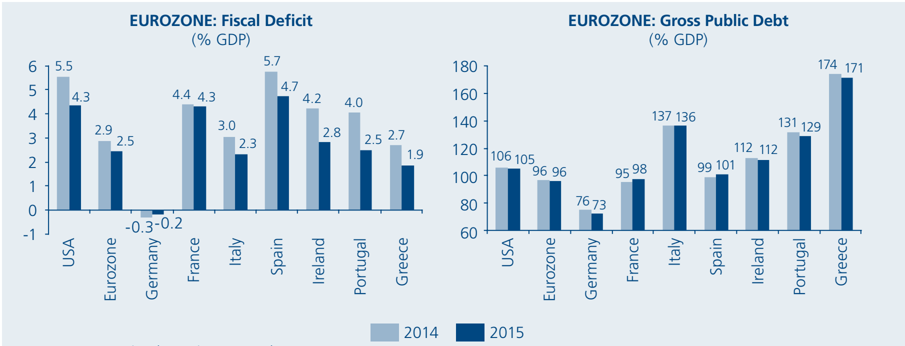
a. Interest rates were lowered by 10 bps to new historical minimum levels, which was something not really anticipated by the market. The main refinancing rate fell from 0.15 percent to 0.05 percent, the rate for marginal loans fell from 0.4 percent to 0.3 percent, and the deposits rate fell from -0.1 percent to -0.2 percent.

b. Two asset purchase programs, asset backed securities (ABS) and covered bonds (CB), were launched in October.

Although the size of the purchase programs has not been specified yet, the ECB President, Mario Draghi, said that, combined with long-term liquidity injections conditioned with the generation of credit (TLTRO), these measures will have a significant impact on the balance sheet of the ECB, which suggests an increase of €1 trillion (that would take the size of the balance to € 3 trillion). Draghi also restated that if the inflation outlook were to worsen, the ECB would take further (non-conventional) measures.

However, given the limited size of the first TLTRO in mid-September (€ 83 billion) and the potential securities that the ECB could buy, the impact of both measures may not be significant. Therefore, the markets have raised expectations that purchases include sovereign bonds by the end of this year or early next year in order to achieve the f balance increase goal.

Graph 13



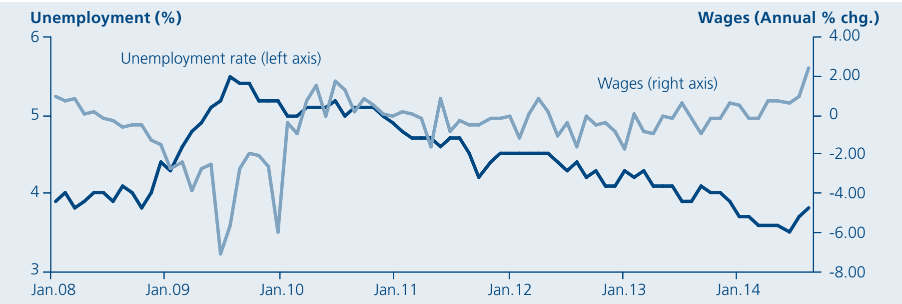
Source: IMF, "Fiscal Monitor", October 2014.

In this context of weak activity and limited impact of current stimulus policies in the short term, the growth forecast in the Eurozone has been revised slightly down, from 1.1 to 0.7 percent this year and from 1.5 to 1.2 percent in 2015 –with increased risk of lower growth being considered in both years–, while the growth rate projected for 2016 remains at 1.6 percent.

11. In **Japan**, after growing 6 percent in Q1, the output dropped 7.1 percent (annualized quarterly rate) in Q2. The domestic demand shrank 16.4 percent –the largest fall registered since 1974– due to the impact of the increase in the sales tax in April (up from 5 to 8 percent). The demand showed a widespread contraction at the level of all of its components, except government consumption. The fall of household expenditure (-19 percent in quarterly annualized terms) stands out, although this fall was in part offset with a positive accumulation of inventories and the decline in imports.

    The significant downturn in households expenditure observed in Q2 –which was higher than the one recorded when the sales tax was increased in 1997– would be affected by the lower real revenues obtained from the sales tax, which fell 7 percent in quarterly terms. Recent indicators on retail sales, car sales, and department store sales point to a modest recovery in consumption in Q3 despite the adverse weather in July and August. This recovery would be supported by an improvement in the labor market and by higher stock prices.

Graph 14
JAPAN: UNEMPLOYMENT RATE AND WAGES



Source: Bloomberg.

On the other hand, inflation –excluding fresh food– registered a rate of 3.1 percent in August. Excluding the impact of the sales tax increase, the rate of inflation was 1.1 percent, well below the Central Bank's 2 percent target. Despite this, the Central Bank maintains a positive outlook on economic recovery and on the end of the deflationary process.

In line with recent developments and recent indicators, the economy would grow 1.1 percent in 2014, 1.3 percent in 2015, and 0.9 percent in 2016. This projection considers that the domestic demand would show a modest recovery in Q3, driven also by the fiscal stimulus introduced at the beginning of year, and that the economy would continue showing a positive trend in the following quarters, supported by the policies and reforms implemented by the government.

The main risks to growth are a slower pace of growth in the Eurozone and China, an insufficient impact of the structural reforms implemented, and the lack of concrete fiscal measures compatible with the sustainability of the debt in the long-term. On the other hand, the approval of increasing the sales tax from 8 to 10 percent as from October 2015 constitutes a significant risk for growth in the next two years.

12. In general terms, the **emerging economies** have shown signs of a slowdown. Growth in these countries is estimated to reach 4.3 percent in 2014, slightly below what was estimated in our previous report. In 2015, the emerging economies would growth 5.0 percent.

13. After showing a positive evolution in Q2 with an annualized quarterly rate of 8 percent, growth in **China** seems to have slowed down in Q3, as suggested by recent indicators: the growth rate of industrial production shows levels not observed since the financial crisis and the rate of fixed investment is the lowest in 13 years. This is offset in part by an improvement in net exports.

At the sector level, a lower dynamism is observed in manufacturing, offset partially by the evolution of the service sector.

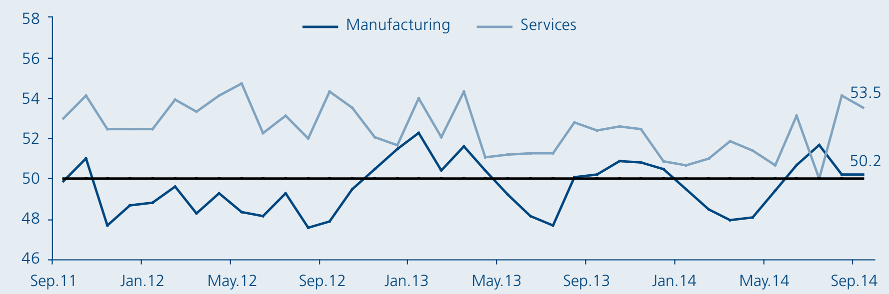
Table 4
CHINA'S ECONOMIC INDICATORS

Indicators	2013				2014			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Aug.	Sep.
Quarterly GDP (Seasonally adjusted annualized growth rates)	6.6	7.4	9.5	7.0	6.1	8.2	-.-	-.-
Quarterly urban unemployment rate (%)	4.1	4.1	4.0	4.1	4.1	4.1	-.-	-.-
Industry Production (12 month % change)	8.9	8.9	10.2	9.7	8.8	9.2	6.9	-.-
Investment in fixed assets (Accum. annual % change)	20.9	20.1	20.2	19.6	17.6	17.3	16.5	-.-
Retail sales (12 month % change)	12.6	13.3	13.3	13.6	12.2	12.4	11.9	-.-
Exports (12 month % change)	10.0	-3.1	-0.3	4.3	-6.6	7.2	9.4	15.3
Imports (12 month % change)	14.1	-0.8	7.5	8.3	-11.3	5.5	-2.4	7.0
Consumer Price Index (12 month % change)	2.1	2.7	3.1	2.5	2.4	2.3	2.0	1.6

Source: Bloomberg and Barclays.

14. The slowdown in investment would be explained by declining investment in manufacturing and real estate (whereas investment associated with infrastructure has expanded at high rates as a result of the government support measures). The slowdown of investment in the manufacturing sector is basically associated with heavy industries where there would be excess capacity. Moreover, the continued correction in the housing market has brought about a strong slowdown of investment in this sector.

Graph 15
CHINA: PMI MANUFACTURING AND SERVICES

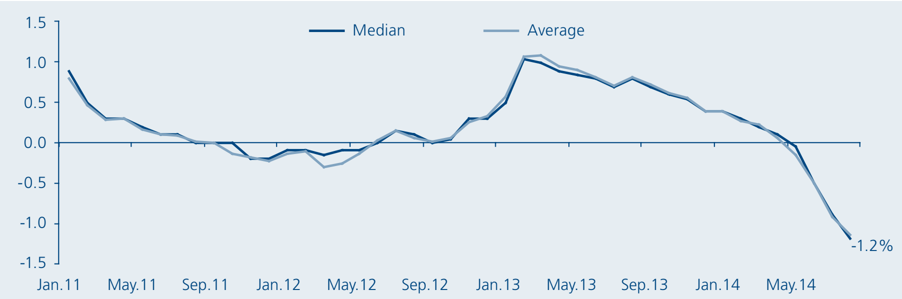


Source: Bloomberg.

In this context of slowdown, some of the actions adopted by the central bank included an injection of liquidity in September, reducing the rates in regular injection operations (the 14-day repo rate was lowered in July, September, and October, with an accumulated reduction of 40 basis points, to 3.4 percent) and some measures to boost activity in the real estate market. These measures add to the fiscal measures implemented in April.

It is worth pointing out that the authorities have recently announced that no new significant stimuli will be provided to support growth this year (the growth target for this year had been established around 7.5 percent). These announcements are in line with the government goal of growing perhaps at lower rates, but at rates reflecting that the growth pattern has been reoriented.

Graph 16
CHINA: HOUSE PRICES IN 70 MAIN CITIES:
(AVERAGE AND MEDIAN)
(Monthly % change)

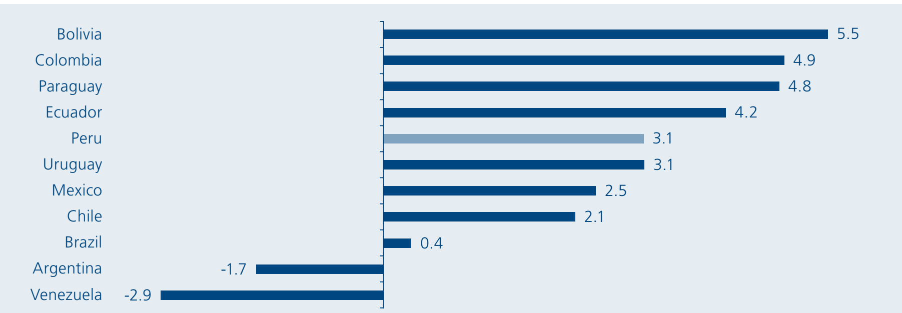


Source: Bloomberg.

15. With these developments the growth forecast for 2014 has been reduced slightly from 7.3 to 7.2 percent, which is consistent with signs of a moderation of growth in the second semester (at rates around 7 percent), as well as with revising down the projections for 2015 and 2016 from 7.3 to 7.2 percent and from 7.1 to 7.0 percent, respectively.

16. With the exception of Colombia, most **Latin American** countries have been experiencing an economic slowdown, mainly due to a minor boost of domestic demand. In the first half of the year, private consumption and investment registered a slower pace of growth in the countries of the region and in some cases (Chile, Brazil, and Mexico) there was even a contraction in investment.

Graph 17
LATIN AMERICA: GDP GROWTH 2014
(% change)

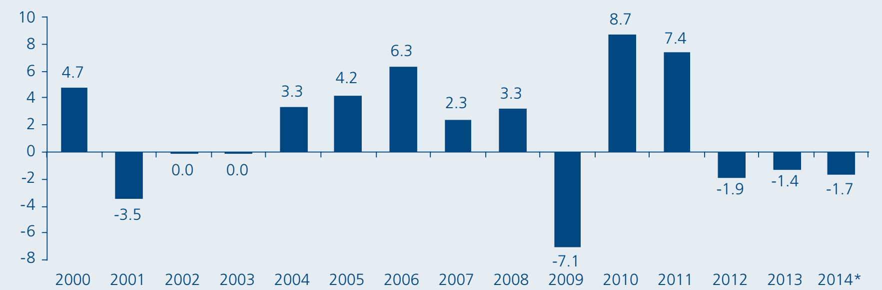


Source: Latin America Consensus Forecast (September 2014) and BCRP (Peru).

Part of this evolution is due to the fact that external conditions are more restrictive than in previous years as a result of the normalization of monetary policy in the

United States, the slow recovery of the Eurozone and fears about China's growth (and its impact on demand and the international prices of commodities). It is estimated that the terms of trade in the region would fall for the third consecutive year in 2014.

Graph 18
LATIN AMERICA: TERMS OF TRADE
(12 month % change)



* Forecast.
Source: IMF (World Economic Outlook October 2014).

17. Compared to Q2-2013, investment shrank in Q2-2014 in Brazil (11.2 percent), Chile (8.1 percent), and Mexico (0.5 percent). In addition, these countries are the ones that showed a sharper slowdown in private consumption. On the other hand, growth in Colombia was driven by an increase in investment (11.1 percent) as a result of increased spending on civil works.

Table 5
LATIN AMERICA: INVESTMENT GROWTH
(Annual % change)

	Brazil	Chile	Colombia	Mexico	Peru
Q2.13	7.7	10.2	0.5	0.8	12.8
Q3.13	6.7	-1.5	12.1	-3.7	6.7
Q4.13	4.0	-12.3	8.3	-3.0	1.4
Q1.14	-2.1	-5.5	15.2	-0.7	1.8
Q2.14	-11.2	-8.1	11.1	-0.5	-4.0

Source: Central banks and statistical institutions.

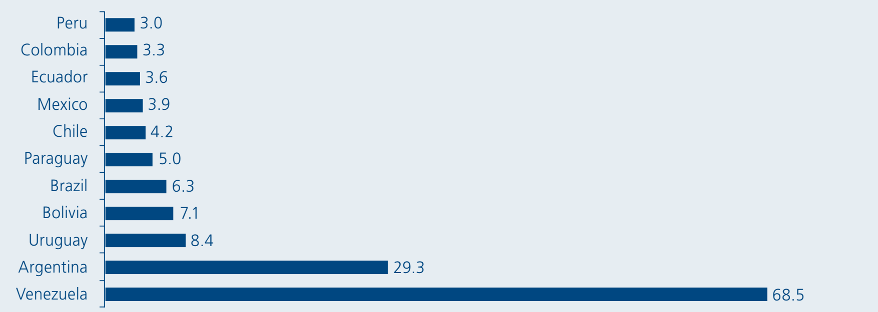
Table 6
LATIN AMERICA: PRIVATE CONSUMPTION GROWTH
(Annual % change)

	Brazil	Chile	Colombia	Mexico	Peru
Q2.13	2.8	4.0	4.1	4.0	5.3
Q3.13	2.4	2.9	4.4	2.9	5.1
Q4.13	2.5	1.4	4.9	1.4	5.9
Q1.14	2.2	1.5	5.4	1.5	5.1
Q2.14	1.2	1.2	5.2	1.2	4.2

Source: Central banks and statistical institutions.

18. Inflation in Latin American countries with inflation targeting schemes has shown an upward trend. In Chile and Mexico, inflation showed rates above their respective target ranges due to the effect of the depreciation of the peso, in the case of the former, and still affected by the tax reform and the rise in the price of gasoline in the case of the latter. Inflation in Brazil has stabilized in the upper band of the target range.

Graph 19
LATIN AMERICA: INFLATION 2014



Source: Latin America Consensus Forecast (September 2014) and BCRP (Peru).

In line with these developments, the growth rate of the region is revised down from 2.1 to 1.4 percent for 2014 and from 2.9 to 2.6 percent for 2015. A growth rate of 3.4 percent is estimated for 2016.

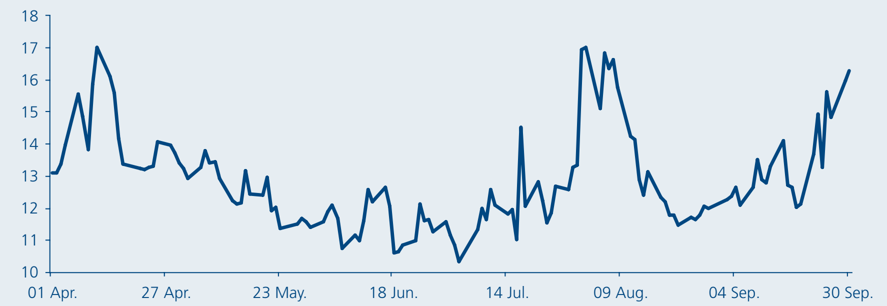
Financial Markets

19. In Q3-2014, international financial markets, particularly equity markets, had a less favorable evolution than in the previous months. Factors accounting for this included expectations that the Fed would raise its policy rate earlier than expected given that the U.S. economy continued showing signs of recovery, as well as negative indicators of activity in the Eurozone and China (which, in turn, generated expectations that their respective central banks would provide new further stimuli).

The performance of financial markets was also significantly affected by geopolitical tensions at the global level. At the beginning of the period, the sanctions imposed by the European Union and United States to Russia due to the conflict in Ukraine generated strong uncertainty. Other factors that generated uncertainty that subsided afterwards were the conflict in the Gaza Strip and the Referendum in Scotland. The conflict in Iraq (which has extended to other neighboring countries) is currently the major geopolitical event.

In this context, the level of risk aversion, measured by the VIX index, has shown a rebound since late August, after having reached its lowest level in July since the international financial crisis unfolded.

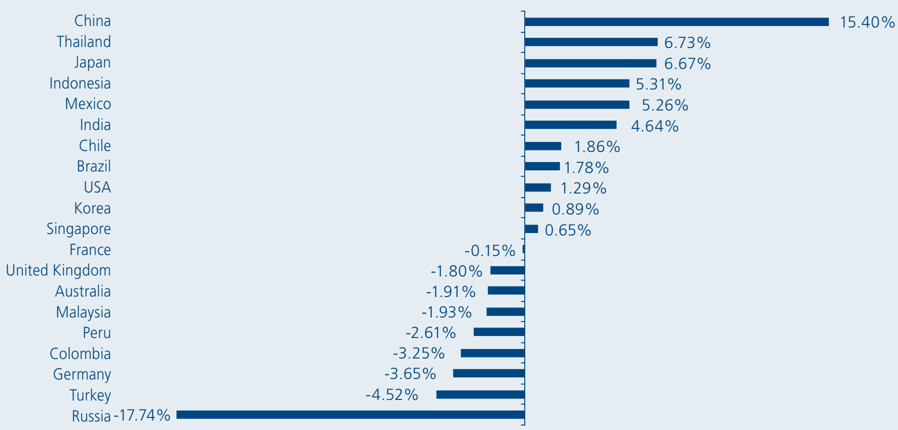
Graph 20
RISK AVERSION COEFFICIENT: VIX (S&P'500)
(April 2014 - September 2014)



Source: Bloomberg.

20. After several indices reached record levels in the previous quarter, **yields in stock markets** showed mixed levels in Q3-2014. European countries were affected by negative indicators of economic activity and inflation as well as by the conflict between Russia and Ukraine. Expectations that the European Central Bank (ECB) would give further stimuli offset the decline. The ECB has recently provided details about the beginning of its asset purchase program, but the market deemed this information as insufficient to revive the economy. On the other hand, in China negative activity data increased speculation that further monetary stimulus would be provided, which ended by pushing the stock market upwards (China's stock market rose 15 percent between July and September, the biggest rise observed among Asian economies).

Graph 21
STOCK MARKET YIELDS
(June 2014 - September 2014)



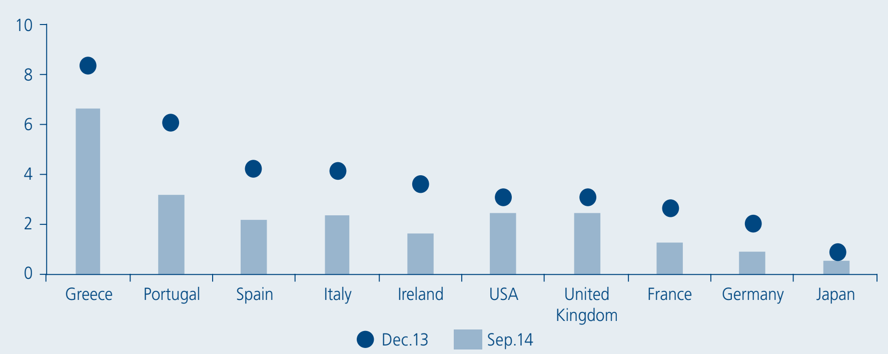
Source: Bloomberg.

21. Most of the **public debt markets** in the developed economies recorded an increased demand, which caused a reduction in yields in a context of less favorable prospects for the global economy and greater geopolitical uncertainty.

In the **U.S.**, despite speculation about an increase of rates by the Fed, yields continued showing the downward trend observed so far this year. This is explained in part by the demand of foreign investors (who sought to take advantage of the appreciation of the dollar) and by the demand for these securities as a hedge against the geopolitical events discussed above. This increased demand was offset by mostly positive indicators of activity.

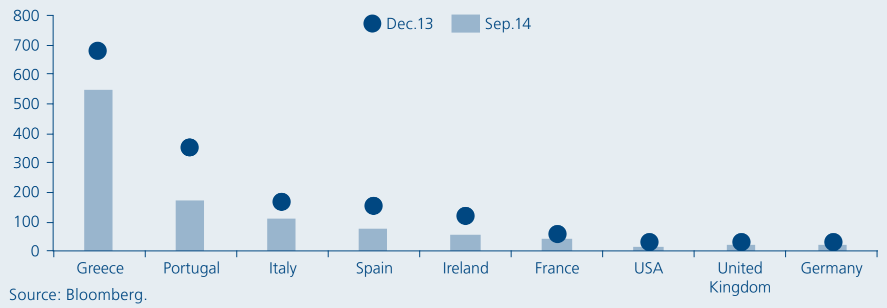
In the **Eurozone**, the negative indicators of activity and the conflict in Ukraine increased the demand for safe assets, such as German and French bonds whose yields continued showing the downward trend observed in the first half of the year. The yields of the bonds of the so-called peripheral economies (Portugal, Italy and Spain) also showed a reduction associated with the monetary stimulus provided by the ECB and by expectations that the ECB could include Eurozone sovereign bonds in its asset purchase program. In addition, expectations that the EU would ease fiscal targets through the flexibility provided by the stability and growth pacts also contributed to this. However, credit spreads (CDS) increased as a result of the less favorable conditions for growth in the Eurozone. In the case of Greece, both the CDS and yields increased influenced by political events.

Graph 22
DEVELOPED COUNTRIES: YIELDS ON 10-YEAR TREASURY BONDS
(%)



Source: Bloomberg.

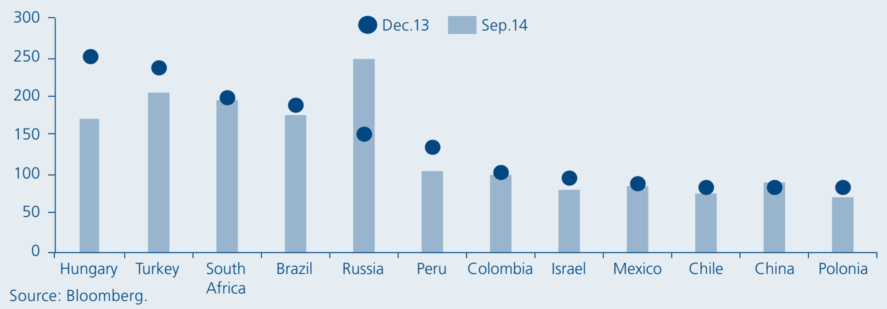
Graph 23
DEVELOPED COUNTRIES: 5-YEAR CDS
(Bps)



Source: Bloomberg.

In line with the other emerging economies, **Latin American** debt markets showed an unfavorable evolution due to the economic prospects of a slowdown in China and expectations that the Fed would raise its rates earlier than expected. The slowdown in the growth of most countries in the region associated with a minor boost from domestic demand also influenced this evolution. In this context, the credit spreads (CDS) showed a significant rise in Q3.

Graph 24
EMERGING COUNTRIES: 5-YEAR SOVEREIGN CDS



Source: Bloomberg.

Exchange Rates

22. According to the Fed index, the dollar appreciated 3.9 percent between July and September 2014 after having depreciated 0.8 percent the previous quarter. This took place amid a context of widespread appreciation of the dollar against its major counterparts (the euro, the pound and the yen) as well as against the emerging currencies due to speculations that the Fed would raise its rates given that the prospects for economic recovery continued in the United States, as well as by increased demand for the dollar as a hedge asset in view of the uncertainties generated by geopolitical tensions.

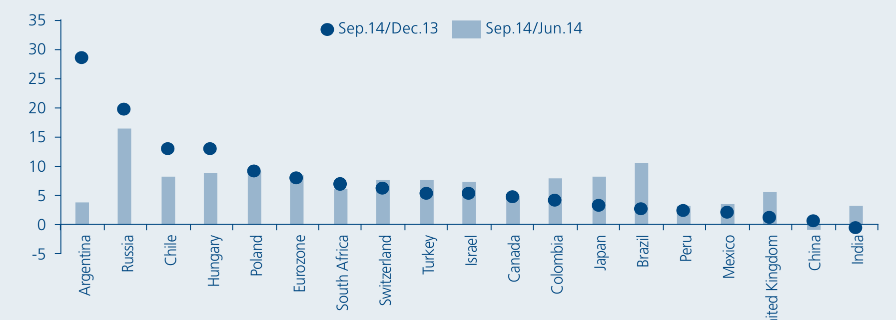
It is worth mentioning that the dollar strongly appreciated against the euro (7.7 percent) as a result of the divergence of monetary policies in both regions.

As regards Latin American currencies, most of them showed depreciation pressures in line with the rest of the emerging economies, with Brazil also being affected by political uncertainty prior to the presidential elections.

Graph 25
US DOLLAR INDEX*
(January 2008 - September 2014)

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

Graph 26
EXCHANGE RATE
(c.u./US$ - % chg.)



Source: Reuters.

Interest Rate Decisions

23. In the past three months, most central banks have maintained their interest rates unchanged. In the developed countries, the Eurozone and Sweden lowered their interest rates in a context of economic slowdown and downward pressures in prices. As noted above, the ECB rate reduction was accompanied by measures aimed at reactivating bank credit and by the announcement of asset purchase programs with the purpose of influencing long-term rates and encourage

monetary policy's transmission mechanism. In the group of the emerging markets, Israel, Chile, Romania and Hungary cut their interest rates due to a greater than expected economic slowdown.

On the other hand, some economies raised their interest rates. In some cases, this decision responded to a more favorable evolution of economic activity in which the output was close to its potential level, as in the case of Colombia and New Zealand. In other cases, this decision responded basically to pressures on prices or on the exchange rate.

Table 7
MONETARY POLICY INTEREST RATE: SEPTEMBER 2014

	Dec.12	Dec.13	Mar.14	Jun.14	Sep.14	Differences in basis points Sep.14 respect to:		
						Aug.14	Dec.13	Dec.12
Turkey	9.00	7.75	12.00	12.00	11.25	-75	350	225
Sweeden	1.00	0.75	0.75	0.75	0.25	-50	-50	-75
Israel	2.00	1.00	0.75	0.75	0.25	-50	-75	-175
South Korea	2.75	2.50	2.50	2.50	2.25	-25	-25	-50
Peru	4.25	4.00	4.00	4.00	3.50	-25	-50	-75
Chile	5.00	4.50	4.00	4.00	3.25	-25	-125	-175
Romania	5.25	4.00	3.50	3.50	3.00	-25	-100	-225
Hungary	5.75	3.00	2.60	2.30	2.10	-20	-90	-365
Eurozone	0.75	0.25	0.25	0.15	0.05	-10	-20	-70
Brazil	7.25	10.00	10.75	11.00	11.00	0	100	375
Pakistan	9.50	10.00	10.00	10.00	10.00	0	0	50
Serbia	11.25	9.50	9.50	8.50	8.50	0	-100	-275
India	8.00	7.75	8.00	8.00	8.00	0	25	0
Indonesia	5.75	7.50	7.50	7.50	7.50	0	0	175
Mexico	4.50	3.50	3.50	3.00	3.00	0	-50	-150
Australia	3.00	2.50	2.50	2.50	2.50	0	0	-50
Poland	4.25	2.50	2.50	2.50	2.50	0	0	-175
Thailand	2.75	2.25	2.00	2.00	2.00	0	-25	-75
Taiwan	1.88	1.88	1.88	1.88	1.88	0	0	0
Norway	1.50	1.50	1.50	1.50	1.50	0	0	0
Canada	1.00	1.00	1.00	1.00	1.00	0	0	0
United Kingdom	0.50	0.50	0.50	0.50	0.50	0	0	0
United States	0.25	0.25	0.25	0.25	0.25	0	0	0
Switzerland	0.00	0.00	0.00	0.00	0.00	0	0	0
South Africa	5.00	5.00	5.50	5.50	5.75	25	75	75
New Zealand	2.50	2.50	2.75	3.25	3.50	25	100	100
Malaysia	3.00	3.00	3.00	3.00	3.25	25	25	25
Philippines	3.50	3.50	3.50	3.50	4.00	25	50	50
Colombia	4.25	3.25	3.25	4.00	4.50	50	125	25

Source: Bloomberg and Reuters.

II. Economic Activity

Sector GDP

24. The Peruvian economy is estimated to have grown 2.8 percent in the first three quarters of the year (vs.5.3 percent during the same period in 2013). This lower output would have been mostly associated with the slower pace of growth registered in non-primary sectors in comparison to the same period in 2013, which would account for a contribution of 1.9 percentage points to the economic slowdown. This slower growth in some of these sectors would be explained by the worsening of external conditions (especially the deterioration of terms of trade) and by economic agents' less optimistic expectations. In addition to this, various supply shocks would have affected the economy, with greater intensity in the case of the primary sectors. Notwithstanding, an improvement is anticipated in the next two years in the conditions that negatively impacted the evolution of some of the primary sectors, which, together with the expected reversal of expectations and higher exports, would bring about a greater impulse on economic activity.

25. On the side of primary activities, the sector that would have contributed most to the slowdown is the sector of mining and hydrocarbons, particularly the sub-sector of metal mining due both to the ban decreed in Madre de Dios to counteract informal gold production and to the lower metal grades obtained in some of the country's major gold and copper mines. Given that the production of copper is expected to increase in 2016 as a result of the onset of operations of new projects and some mine expansions, the nature of this slower growth observed during 2014 would be transitory.

    On the side of non-primary sectors, the greatest contribution to the slowdown during the first three quarters of 2014 would come from the sectors of manufacturing and construction, with the branches of industrial services, textiles, and wood and furniture accounting particularly for this slowdown in the case of the former and the slow pace of physical progress of public works accounting for this in the case of the latter.

Graph 27
GDP GROWTH: JAN.-SEP. 2014 VS. JAN.-SEP.2013
(% Chg. and % contributions)

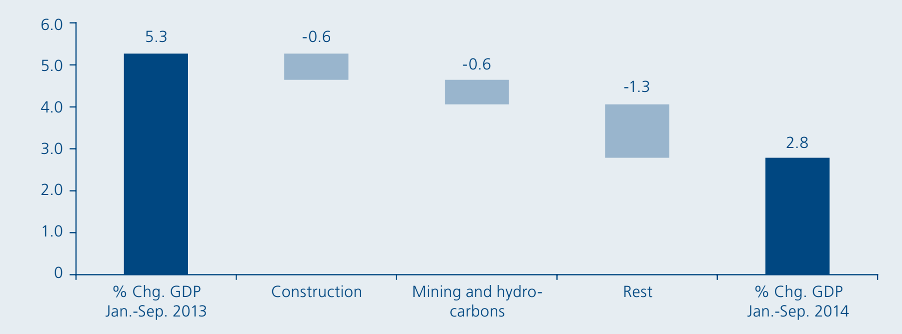


Table 8
GDP BY PRODUCTION SECTOR
(Real % change)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
Agriculture and livestock	**1.2**	**1.5**	**0.6**	**1.7**	**1.5**	**2.2**	**2.3**	**3.5**	**3.5**
Fishing	**-4.7**	**18.1**	**-2.6**	**-1.6**	**-6.8**	**-2.2**	**23.1**	**35.7**	**16.9**
Mining and hydrocarbons	**4.0**	**4.9**	**-0.7**	**0.3**	**-1.6**	**8.5**	**6.5**	**10.8**	**10.8**
Metallic mining	2.6	4.2	-1.6	-1.0	-2.8	9.0	6.5	10.7	12.3
Hydrocarbons	9.2	7.2	2.3	5.7	3.2	7.0	6.6	11.4	5.6
Manufacturing	**3.0**	**5.5**	**-0.8**	**2.7**	**-0.7**	**4.2**	**4.5**	**4.5**	**4.8**
Based on raw materials	0.1	8.7	0.6	2.1	-2.4	3.2	6.2	3.6	5.4
Non-primary industries	4.0	4.4	-1.1	2.8	0.2	4.5	4.0	4.8	4.7
Electricity and water	**5.4**	**5.5**	**5.0**	**5.7**	**5.4**	**6.1**	**5.5**	**6.3**	**6.1**
Construction	**11.2**	**8.9**	**1.0**	**5.0**	**2.9**	**8.0**	**7.0**	**7.5**	**7.5**
Commerce	**5.6**	**5.9**	**4.5**	**5.4**	**4.9**	**5.7**	**5.5**	**5.8**	**5.8**
Other services	**6.1**	**6.0**	**4.9**	**6.0**	**5.2**	**6.2**	**5.6**	**5.8**	**5.8**
GDP	**5.3**	**5.8**	**2.8**	**4.4**	**3.1**	**6.0**	**5.5**	**6.3**	**6.3**
Memo:									
Primary GDP	2.5	4.8	-0.2	0.9	-1.1	5.8	5.8	8.5	8.3
Non-Primary GDP	6.0	6.0	3.6	5.3	4.1	6.0	5.5	5.8	5.8

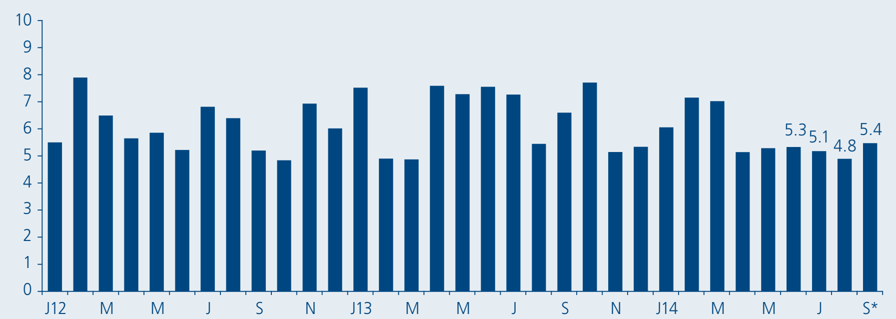
* Forecast.
IR: Inflation Report.

Graph 28
GDP: 2012 - 2014
(12 month % change)

26. Current and advanced indicators of economic activity show that the pace of growth of economic activity slowed down in Q2 and Q3 of 2014. Thus, the output in the first three quarters of the year accumulated a growth rate of 2.8 percent, whereas in the same period of 2013 is recorded a growth rate of 5.3 percent.

For instance, the production of electricity in January – September 2014 shows a growth rate of 5.6 percent, while in the same period in 2013 it grew 6.5 percent.

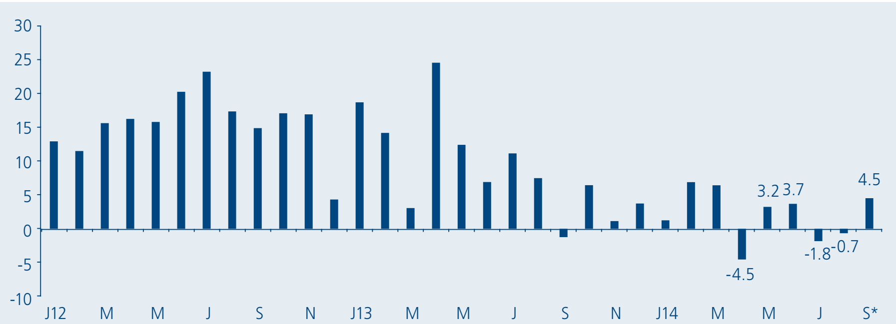
Graph 29
PRODUCTION OF ELECTRICITY: 2012 - 2014
(12 month % change)



* Preliminary.
Source: COES

Likewise, the accumulated growth rate of domestic consumption of cement in the first three quarters of 2014 (1.9 percent) would have been significantly lower than the one observed in the same period of 2013 (10.4 percent). However, the growth rate in September would have been the highest registered since March.

Graph 30
DOMESTIC CONSUMPTION OF CEMENT: 2012 - 2014
(12 month % change)

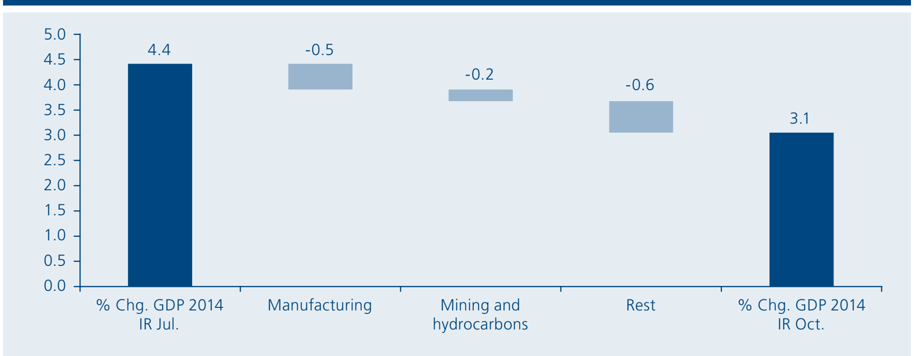


* Preliminary.
Source: ASOCEM and cement companies.

27. The GDP growth rate projected for 2014 has been revised down from 4.4 percent (Inflation Report of July 2014) to 3.1 percent. This downward revision is explained both by the lower growth forecast in the primary sectors in the second half of 2014 and by the lower growth estimated in the non-primary sectors for Q3.

Transitory factors that affected the sector of mining and hydrocarbons as well as the lower metal content of gold and copper obtained in some mines in the country account for the revision in the GDP growth rate projected for 2014. The growth rates of the sectors of services, non-primary manufacturing, and construction have also been revised to -0.4, -0.3, and -0.1 percent, respectively, due to economic agents' lower confidence.

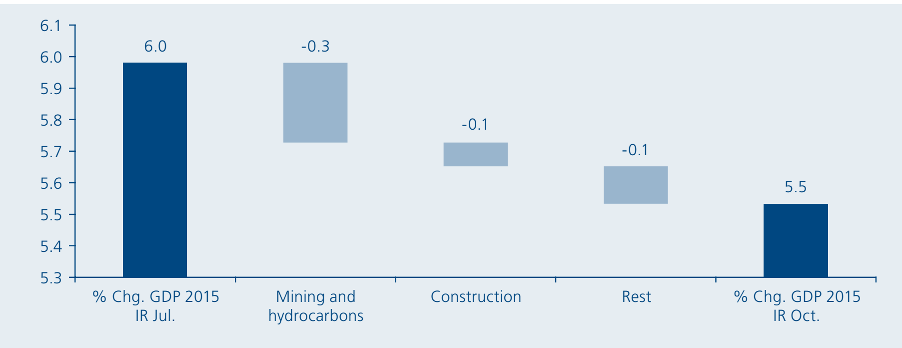
Graph 31
GDP GROWTH 2014: IR OCT VS. IR JUL
(% Chg. and % contributions)



28. The transitory factors that affected the performance of the economy during 2014 are expected to reverse for the most part in 2015. As regards climate factors, a recovery is expected in the fishing sector given that it is now estimated that the intensity of El Niño event would not be as strong as foreseen in our previous Inflation Report. As for the mining sector, Antamina would have a greater production of copper given that the metal content obtained by the end of 2015 and early 2016 is expected to be higher. Moreover, the production of Toromocho is expected to increase after the completion of the mine trial periods, which would have been extended in 2014. Furthermore, economic growth would be boosted by the strong recovery in public investment projected to take place in 2015 (public investment would rise from 0.0 percent in 2014 to 8.8 percent).

Despite that greater dynamism than in 2014 is expected in 2015, the projected GDP growth rate has been revised down to 5.5 percent from 6.0 percent (previous Inflation Report). Although growth in the mining sector would be higher in 2015, this sector would grow less than previously projected –the forecast has been revised from 9.0 to 6.5 percent–, due mainly to the lower copper production expected in the mines of Antamina, Constancia, Toromocho, and Cerro Verde. This would add onto a slower pace of growth in the non-primary sectors of construction and services, given that economic recovery would be slightly slower due to the temporary decline observed in business confidence during 2014.

Graph 32
GDP GROWTH 2015: IR OCT VS. IR JUL
(% Chg. and % contributions)



a) The **agriculture sector i**s estimated to have grown 0.6 percent in the first three quarters of 2014 (vs. 1.2 percent in 2013). This lower rate is due mainly to a contraction of 0.5 percent in the agriculture output resulting from a lower production of rice (-9.9 percent) associated with water constraints early in the year and from a lower production of coffee (-19.7 percent) due to the effect of the yellow rust plague. On the other hand, the output in the livestock subsector is estimated to have grown 2.8 percent as a result of a higher production of poultry (5.0 percent).

The growth rate projected for 2014 has been revised slightly down due to the lower production of hard yellow maize (-0.2 percent) as a result of minor crops during the first half of the year. On the other hand, the growth rate in the agriculture sector projected for 2015 has been revised slightly upward –from 2.2 percent to 2.3 percent– given that a lower decline is expected in the production of olives since new areas with this crop will start production in Tacna. On the other hand, as the expansion of the coffee rust depends on climatic factors, the lower intensity now foreseen in El Niño event in Q2-2015 would imply a less negative impact on the production in 2015 (-10.0 percent instead of -12.0 in the previous report). However, coffee production would continue to be negatively affected by the yellow rust until 2016 despite the positive effects of the crop renovation and rehabilitation actions carried out by the government. In 2016, the agriculture sector is still estimated to grow 3.5 percent.

b) The output in the **fishing sector** would have dropped 2.6 percent in the first nine months of 2014 as a result of the lower catch of anchovy obtained during the first half of the year (-28.0 percent). This lower catch is explained mainly by the lower extraction obtained during the first fishing season –from April to August– associated with adverse climate factors such as the arrival of Kelvin waves of warm water. Because of this, the fishing season was extended from July 31 to August 10, but despite this, the number of tons of anchovy caught was far less than expected.

A lower- than-previously estimated catch of anchovy for industrial consumption is anticipated in the last quarter of the year. Because of this and because of the lower extraction of anchovy in the first fishing season, the projected growth rate in this sector for the year would be revised down, from -1.6 percent to -6.8 percent. The forecast could still be corrected downwards.

On the other hand, the growth forecast of the sector for 2015 would be revised up (from -2.2 percent to 23.1 percent) given that the expected intensity of El Niño event which would occur during Q2-2015 is now estimated to go from moderate to weak. A full recovery of the sector is expected for 2016 as the sea temperatures during 2015 would not affect the reproductive cycle of the anchovy. However, given that the recovery of the sector would now begin in 2015, a lower growth is projected for 2016 due to a base effect.

c) Contrasting with the 2.6 percent growth seen in the same period of the previous year, **metal mining production** in the first three quarters of 2014 would show a decline of 1.6 percent. This result is explained mainly by a fall of 15.7 percent in the production of gold due to the lower production of Yanacocha (-24.0 percent), which would be reaching the bottom of its annual mining plan, and due to the ban on illegal mining in Madre de Dios, which is estimated to have reduced the production of gold in this area by 57.7 percent. This result would be in part offset by an increase of 4.6 percent in the production of copper in the first nine months of the year due to the start of commercial operations at Toromocho in Q3-2014.

The forecast on the metal mining output in 2014 is revised from -1.0 to -2.8 percent. The production prospects for the major metals in 2014 and the following two years are discussed below.

The production of **gold** in 2014 would maintain a similar level to the one considered in our previous report. However, the projection for 2015 has been revised down from -4.9 percent to -6.0 percent, while the projection for 2016 has been revised down from -5.0 percent to -6.4 percent due to the lower gold production in the region of Madre de Dios, a situation which is expected to continue in the next few years. In addition to this, it is estimated that the gold extracted at mine Yanacocha would continue showing the lower metal contents observed during the first half of 2014 at least in the medium term.

The mining projects of Inmaculada and Shahuindo would initiate operations by 2015, the latter starting operations earlier than expected in Q4-2015 due to the better prospects resulting from the merger between Rio Alto and Sulliden. Moreover, the Invicta Project, which plans to start test extraction in Q3-2015, would start operating commercially in 2016.

The projected output for 2014 in the case of **copper** has been revised from 5.2 percent to 2.0 percent since the Toromocho project has reduced the estimated production for the year due to the delays generated by the extension of the test periods in this mine. The projected growth of copper production in 2015 is revised down, from 14.5 percent to 10.2 percent, due to the lower metal grades obtained at Antamina –a situation expected to improve by 2016– and to the lower estimated production of Toromocho, which would not reach its maximum production in 2015, but would postpone this goal until the following year. Copper production in 2016 would be boosted by the expansion of Cerro Verde and the Constancia project (up 23.8 percent), which together with the likely onset of Las Bambas would contribute to the upward growth of metal mining production in 2016 (from 10.7 percent to 12.3 percent).

As for **zinc**, the growth of production in 2014 has been revised up from -6.3 percent to -4.5 percent due to the higher production of Antamina during the month of August. However, the growth forecast for 2015 has been revised down from 8.6 percent to 5.1 percent given the lower metal content expected in this mine. In 2016 the output is expected to show a higher growth –the projected rate is revised up from 0.5 percent in our previous report to 1.8 percent– as a result of the expansion of El Brocal which would start operations in 2015 and reach its maximum production in 2016.

Table 9
MINING PRODUCTION
(% change)

	2013	2014*	2015*	2016*
Gold	-3.3	-13.3	-6.0	-6.4
Copper	7.4	2.0	10.2	23.8
Zinc	5.5	-4.5	5.1	1.8

* Forecast.

d) The production of **hydrocarbons** in January-September 2014 would grow 2.3 percent relative to the same period of 2013 due to the onset of crude production at Perenco's Lot 67. However, the growth forecast for this year has been revised down –from 5.7 percent to 3.2 percent– given that the expected greater production of natural gas liquids resulting from the onset of operations at Repsol's Lot 57 has been offset by capacity constraints in the pipeline this company shares with Pluspetrol.

The sector's growth in 2015 would be supported by Perenco's project in Lot 67 which would double its current production to 12 thousand barrels per day, while the positive impact of the gradual implementation of Camisea's plant, whose expansion would start at end 2015, would be seen in 2016. Despite this, the projected growth of the production of hydrocarbons in 2016 is revised down given that the production of Perenco's Lot 67 will not exceed 12 thousand barrels per day until the expansion of Oleoducto Ramal Norte is completed to allow direct access to Oleoducto Nor-Peruano, whereas a gradual increase was considered in production since 2016 in our previous report.

e) Production in the **manufacturing sector** would have dropped 0.8 percent in the first three quarters of the year due mainly to a decline of 1.1 percent in non-primary manufacturing, offset in part by a growth of 0.6 percent in manufacturing based on the processing of raw materials. The fall observed in primary manufacturing would be associated with a lower provision of industrial services as a result of the decline of investment. Moreover, a drop is also observed in the production of textiles due both to lower domestic and lower external demand, as well as in the production of wood and furniture due to the lower domestic demand for products such as mattresses.

Increased production in the case of primary manufacturing based on the processing of raw materials would be driven by an increased refining of non-ferrous metals given the higher production of copper anodes and cathodes of Southern and Cerro Verde in the first months of the year. On the other hand, the fishing industry would have had a negative contribution to the sector's output due to the lower production of fishmeal and fish oil resulting from a lower anchovy catch. However, this decline would have been offset by moderate increases in the output of oil refining and in the production of meat products.

The projected growth of manufacturing in 2014 has been revised down from 2.7 percent to -0.7 percent, while the projected output in the case of primary manufacturing would be revised from 2.1 percent to -2.4 percent given that this forecast would include the effect of interrupting production at Southern's plant due to maintenance in the month of October in addition to the effect of a lower fishing production and the closure of Doe Run considered in our previous Report. Production in the main branches of non-primary manufacturing would have been affected by lower domestic and external demand, so the forecast for 2014 is revised from 2.8 percent to 0.2 percent. Because the outlook for 2015 remains unchanged, the forecast is revised down from 4.5 percent to 4.0 percent. In the primary sector, the forecast is revised up from 3.2 percent to 6.2 percent due to the higher recovery of industrial fishing.

The growth rate forecast for manufacturing for 2016 has been revised up from 4.5 percent to 4.8 percent due to the primary sector, particularly to the increase in the refining of non-ferrous metals which would show a higher pace of growth due to the higher mining output projected for this year.

Expenditure-side GDP

29. The slow recovery of developed economies, the slowdown in emerging economies and the deterioration of terms of trade over the past two years are among the external factors that intensified a weak business cycle in the domestic economy. Together with the lower dynamism of public spending, the occurrence of a series of domestic transitory supply factors also had a negative impact on economic agents' expectations and, thus, on the growth rate of private investment. In this context, domestic demand is estimated to have grown 2.9 percent in the first nine months of the year, less than in the same period in 2013. This lower growth is consistent with lower private spending, which fell from 6.6 percent in January-September 2013 to 2.6 percent in the same period in 2014, as well as with lower public spending, which declined to 4.6 percent in the first nine months of the year from 10.7 percent in the same period of the previous year.

Table 10
GDP AND DOMESTIC DEMAND
(Real % change)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
I. Domestic demand	**7.2**	**7.0**	**2.9**	**4.7**	**3.3**	**5.7**	**5.0**	**5.2**	**5.5**
1. Private expenditure	**6.6**	**6.7**	**2.6**	**4.1**	**3.0**	**5.5**	**4.6**	**4.6**	**5.0**
Consumption	5.2	5.3	4.6	4.9	4.6	5.0	4.7	5.2	5.2
Private fixed investment	8.4	6.4	-2.2	3.2	-0.4	6.2	5.2	6.5	6.3
2. Public expenditure	**10.7**	**8.4**	**4.6**	**7.9**	**4.6**	**6.9**	**6.9**	**7.7**	**7.9**
Consumption	7.2	6.7	6.9	8.5	6.9	6.0	6.0	6.0	6.0
Investment	19.6	12.1	-0.6	6.7	0.0	8.9	8.8	11.0	11.6
II. Net external demand									
1. Exports	**-2.3**	**-0.9**	**-3.4**	**-0.4**	**-3.3**	**5.5**	**6.5**	**10.8**	**9.4**
2. Imports	**5.0**	**3.6**	**-2.5**	**1.0**	**-1.9**	**4.7**	**4.2**	**5.9**	**5.9**
III.GDP	**5.3**	**5.8**	**2.8**	**4.4**	**3.1**	**6.0**	**5.5**	**6.3**	**6.3**

* Forecast.
IR: Inflation Report.

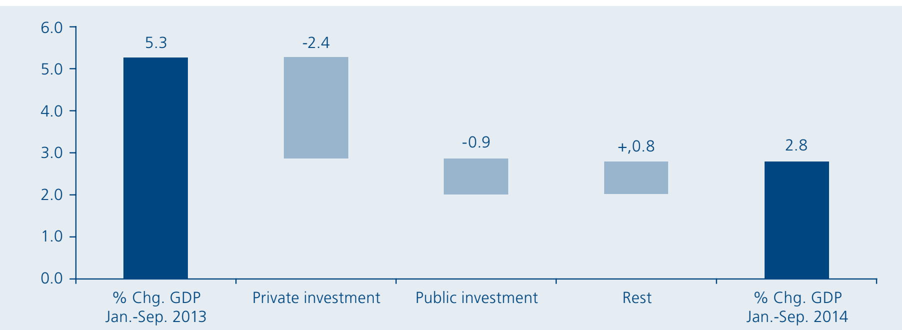
Table 11
GDP AND DOMESTIC DEMAND
(Contributions to the real % change)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
I. Domestic demand	**7.3**	**7.1**	**3.0**	**4.8**	**3.4**	**5.9**	**5.1**	**5.3**	**5.6**
1. Private expenditure	**5.7**	**5.7**	**2.2**	**3.5**	**2.6**	**4.7**	**3.9**	**3.9**	**4.2**
Consumption	3.2	3.3	2.8	3.0	2.8	3.0	2.9	3.1	3.2
Private fixed investment	1.9	1.4	-0.5	0.7	-0.1	1.4	1.1	1.5	1.4
Change on inventories	0.6	1.0	-0.1	-0.2	-0.1	0.2	-0.1	-0.7	-0.4
2. Public expenditure	**1.6**	**1.4**	**0.7**	**1.3**	**0.8**	**1.2**	**1.2**	**1.4**	**1.4**
Consumption	0.8	0.7	0.8	0.9	0.8	0.7	0.7	0.7	0.7
Investment	0.8	0.7	0.0	0.4	0.0	0.5	0.5	0.7	0.7
II. Net external demand									
1. Exports	**-0.6**	**-0.2**	**-0.9**	**-0.1**	**-0.8**	**1.3**	**1.5**	**2.6**	**2.3**
2. Imports	**1.4**	**1.0**	**-0.7**	**0.3**	**-0.5**	**1.2**	**1.1**	**1.5**	**1.5**
III. GDP	**5.3**	**5.8**	**2.8**	**4.4**	**3.1**	**6.0**	**5.5**	**6.3**	**6.3**

* Forecast.
IR: Inflation Report.

The weak growth of domestic demand in January-September would be associated with a contraction of private investment, which would have recorded a negative variation of 2.2 percent after having 8.4 percent in the first three quarters of 2013, and with the lower dynamism of public investment, which showed a negative growth rate of 0.6 percent (vs.19.6 percent in the same period of the previous year) due to lower investment at the level of subnational governments. On the other hand, private consumption is estimated to have grown at a moderate pace with a rate of 4.6 percent, while public consumption is estimated to have shown an expansion of 6.9 percent during the first nine months of the year, less than in the same period in 2013.

Graph 33
GDP GROWTH: JAN.-SEP. 2014 VS. JAN.-SEP.2013
(% Chg. and % contributions)



As regards external demand, showing a greater decline than in the same period of 2013, exports are estimated to have dropped 3.4 percent in the first three quarters of the year due to the fall of exports of traditional products. On the other hand, imports would show a decrease of 2.5 percent in the first nine months of the year after having grown 5.0 percent in the same period of the previous year, due to the lower dynamism of imports of capital goods and industrial supplies.

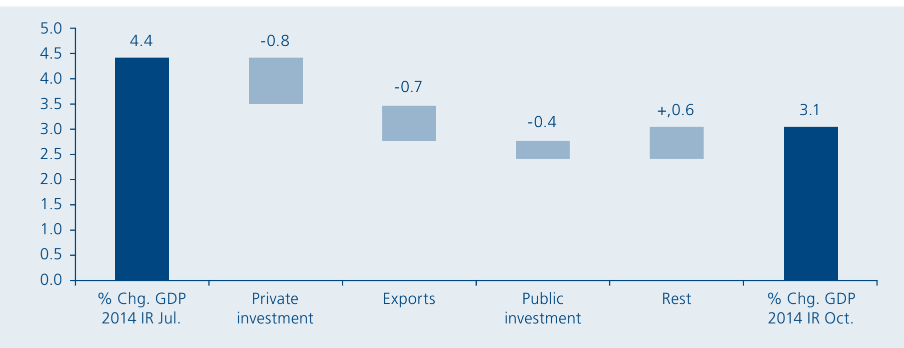
Even though both private and public investment are expected to improve in the last quarter of 2014 in comparison with their evolution in the first three quarters of the year, investment spending could continue to be weak, in which case the recovery of domestic demand would be gradual.

30. Consumers and producers' indicators of confidence continue to be on the optimistic side at September and show higher levels than in June 2014, which would be pointing to a recovery of spending in consumption and investment in the private sector in the coming months.

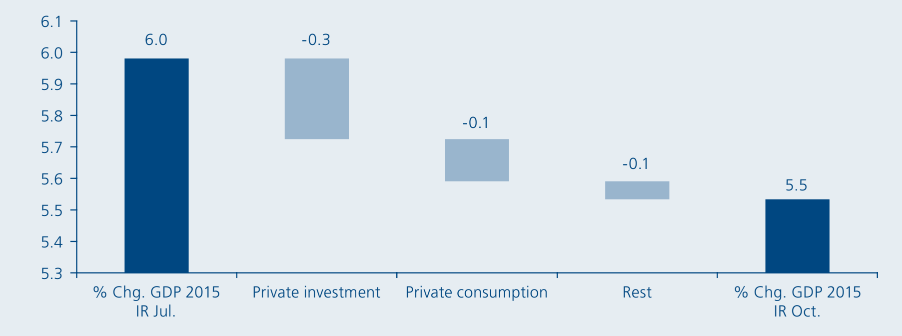
31. The growth forecast of domestic demand for 2014 has been revised down from 4.7 to 3.3 percent in this report. This revision is explained by the lower dynamism observed in private investment, whose growth rate has declined from 3.2 percent to -0.4 percent. In addition, the growth forecast for public spending has been revised to 4.6 percent, in line with the lower rate forecast for public investment especially at the level of subnational governments.

    Thus, the downward revision of the GDP growth rate –from 4.4 to 3.1 percent– is explained mainly by the collapse of private investment associated with the deterioration of economic agents' expectations and by the fall of exports, particularly exports of traditional products, which accounts for 0.7 percentage points of this revision. However, these trends are expected to reverse in 2015 with the reversal of the temporary supply shocks, the recovery of investor confidence, and the normalization of external conditions.

Graph 34
GDP GROWTH 2014: IR OCT VS. IR JUL
(% Chg. and % contributions)



Graph 35
GDP GROWTH 2015: IR OCT VS. IR JUL
(% Chg. and % contributions)

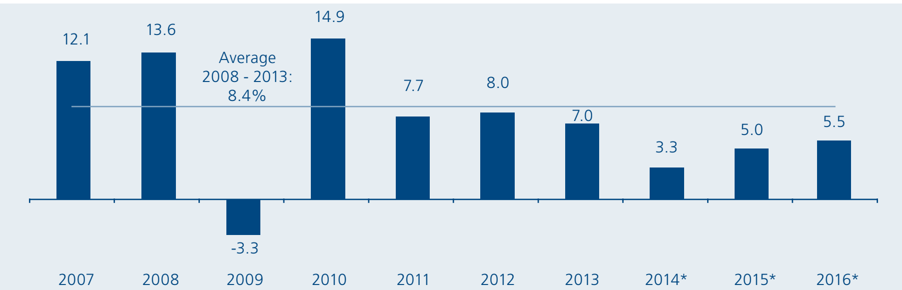


32. In 2015 domestic demand would grow 5.0 percent, less than estimated in the previous report, due mainly to the lower dynamism of private spending. In 2016, domestic demand is expected to grow 5.5 percent considering that private investment is estimated to grow 6.3 percent taking into account announced investment for the year as well as the projects that will be given in concession.

Graph 36
GDP: 2007 - 2016
(Real % change)

* Forecast.

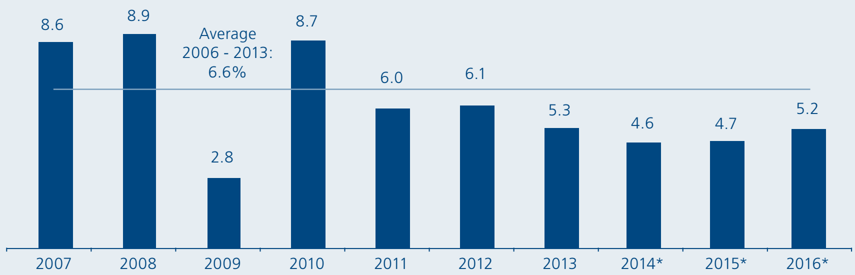
Graph 37
DOMESTIC DEMAND: 2007 - 2016
(Real % change)



* Forecast.

33. Private consumption continues to more moderate rates than the average rate recorded in 2007-2013. Private consumer spending is estimated to have grown 4.6 percent in the first nine months of 2014, less than in the same period of 2013. Recent information of several indicators reflects the evolution of private consumption. For example, consumer confidence in August remains in the optimistic segment and show a greater degree than in June; consumer loans to individuals continue to show more prudent expansion rates, and the indicator of purchases of family cars registered a positive variation of 1.5 percent in August after having declined for four consecutive months.

Graph 38
PRIVATE CONSUMPTION: 2007 - 2016
(Real % change)

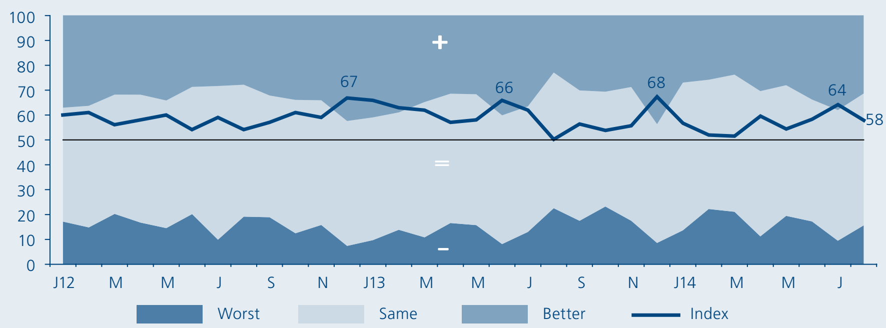


* Forecast.

Some indicators that reflect the dynamics of private consumer spending are provided below.

a. In August the consumer confidence index was on the optimistic side with a level of 58 points. This indicator has shown an average level of 57 points during January-August, lower than the one observed in the same period in 2013.

Graph 39
CONSUMER CONFIDENCE INDEX:
HOUSEHOLDS' ECONOMIC SITUATION?



Source: Apoyo.

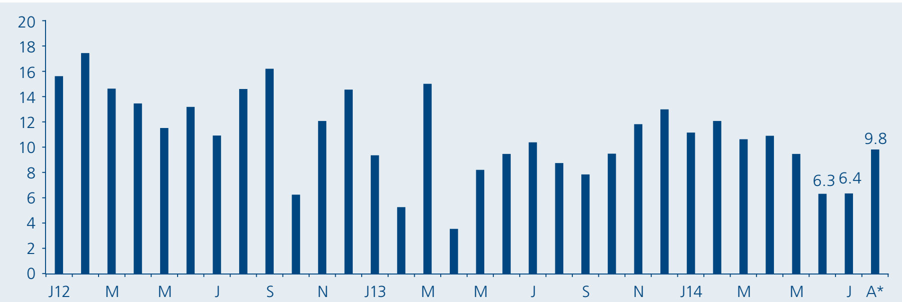
b. Sales in department stores grew 8.2 percent in September 2014, showing a higher rate than the one recorded in the same period of 2013 (7.0 percent). This pace of expansion would be reflecting a recovery in consumption, in line with families' higher purchasing power.

Graph 40
SALES IN DEPARTMENT STORES
(12 month % change)

* Preliminary.

c. Similarly, sales in supermarkets grew 9.8 percent in August, a higher rate than in the same period of 2013 (8.7 percent).

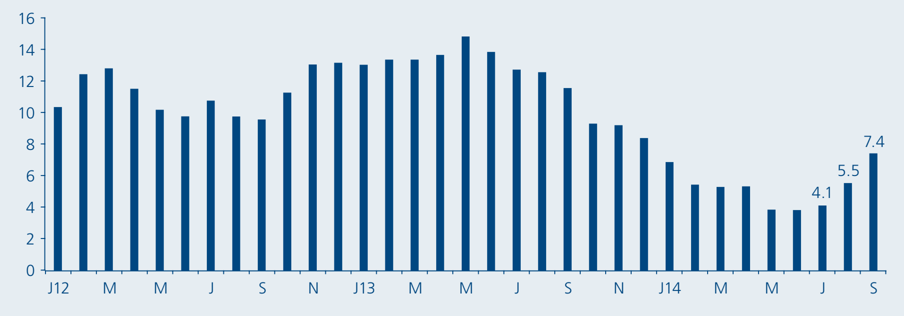
Graph 41
SALES IN SUPERMARKETS
(12 month % change)



* Preliminary.

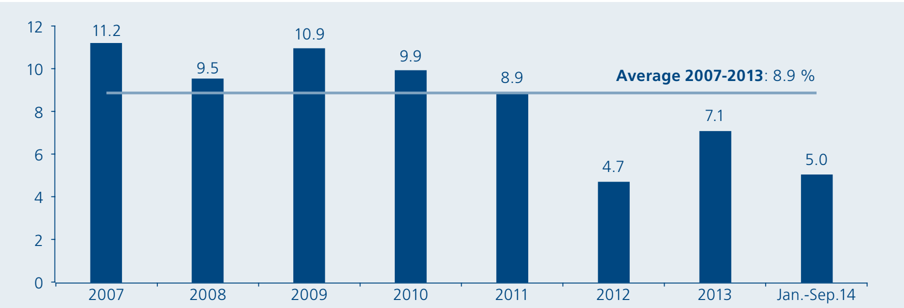
d. Currency recorded an annual average variation of 7.4 percent in September of this year. This increase reflects a greater availability of liquidity and lower inclination to saving, which would be reflected a moderate but sustained improvement in the dynamics of consumption at the aggregate level.

Graph 42
REAL CURRENCY IN CIRCULATION
(Annual % change)



e. The growth rate of the employed workforce in the period of January-September 2014 (5.0 percent) was lower than in the same period in 2013 (7.4 percent).

Graph 43
EAP EMPLOYED WORKFORCE: 2007- SEP.14
(12 month % change)



Source: INEI.

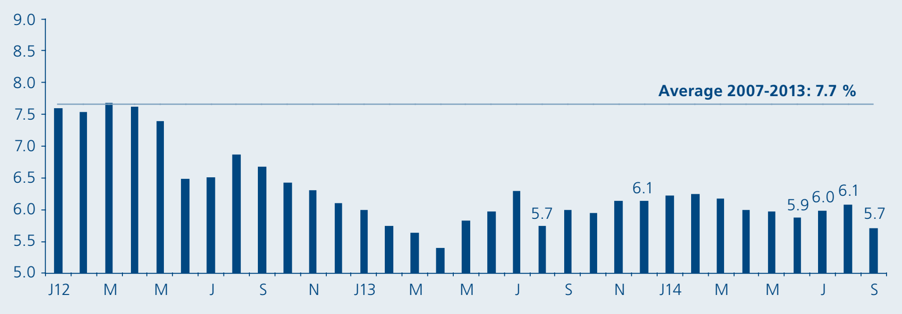
f. The growth rate of the salaried workforce in the period of January-September 2014 (1.9 percent) was lower than in the same period in 2013 (2.2 percent).

Graph 44
EAP SALARIED WORKFORCE - INEI QUARTERLY MOVING METROPPOLITAN LIMA
(12 month % change)

Source: INEI.

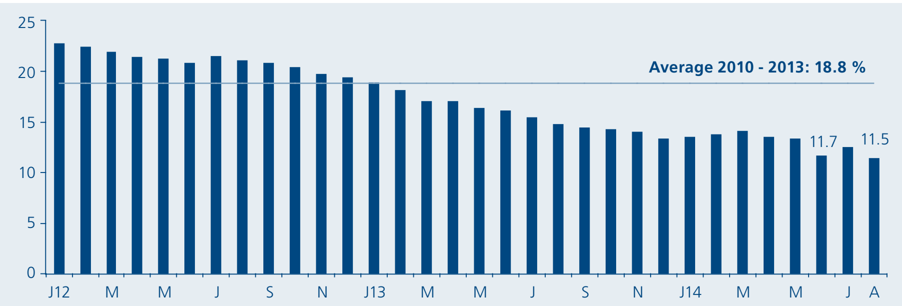
g. The unemployment rate, indicator reflecting the percentage of the total labor force who are unemployed and looking for a paid job, recorded 6.1 percent in the period of January-September 2014, a slightly higher level than the rate recorded in the same period of 2013. This result is explained by the fact that in this period the number of unemployed increased 1.8 percent, while the labor force grew only 1.1 percent.

Graph 45
UNEMPLOYMENT RATE: JAN.12 - SEP.14
(Seasonally adjusted- moving quarterly)



h. The growth of credit to individuals, which includes consumer loans and mortgages, grew 11.5 percent in August, showing a slightly lower rate than in June (11.7 percent).

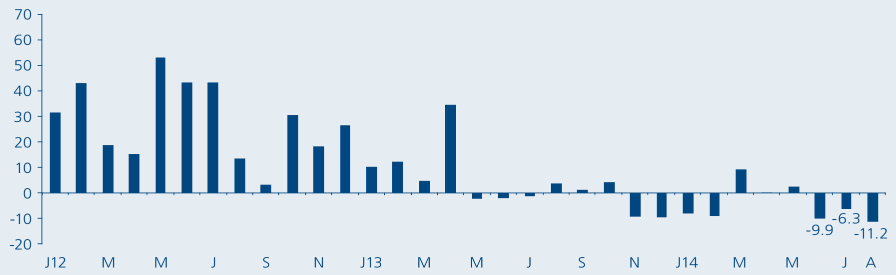
Graph 46
CREDIT TO INDIVIDUALS: JAN.12 - AUG.14
(12 month % change)



Source: BCRP.

i. The volume of imports of consumer goods, which has been showing a declining trend since early this year, dropped by 11.2 percent in August. Household tend to reduce their consumption in durable goods in periods of a weak economic cycle.

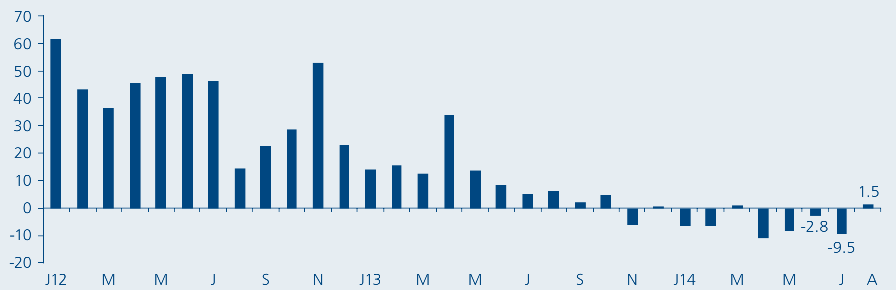
Graph 47
VOLUME OF IMPORTS OF DURABLE CONSUMER GOODS: JAN. 12 - AUG.14
(12 month % change)



Source: SUNAT.

j. Even though the sale of new family cars showed an increase of 1.5 percent in August, this indicator accumulates a decline of 5.4 percent between January and August, which would be reflecting families' greater caution in decisions of buying a new family car.

Graph 48
SALE OF FAMILY CARS: JAN.12 - AUG.14
(12 month % change)



Source: Araper.

k. The national disposable income is estimated to have grown 3.1 percent in the first three quarters of the year (versus 5.4 percent in the same period of 2013). In 2015 and 2016 the national disposable income is forecast to grow 5.4 and 6.5 percent, respectively, in line with the expected recovery of the output.

Table 12
NATIONAL DISPOSABLE INCOME
(Real % change)

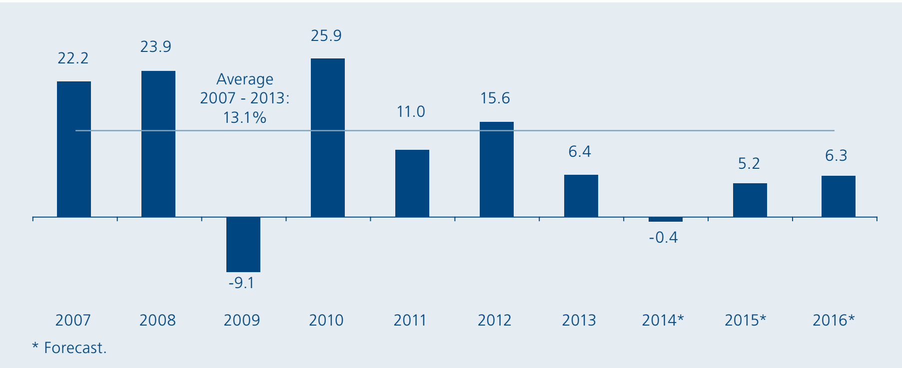
	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
1. Gross Domestic Product	5.3	5.8	2.8	4.4	3.1	6.0	5.5	6.3	6.3
2. Gross National Product	6.5	7.2	3.6	4.9	3.6	6.3	5.8	6.8	6.7
3. Gross National Income	5.6	6.0	2.3	4.1	2.7	6.3	6.0	6.7	6.6
4. National Disposable Income[1/]	**5.4**	**5.9**	**3.1**	**4.6**	**3.2**	**5.7**	**5.4**	**6.7**	**6.5**

1/ Including factor income, net profits by terms of trade, and net transfers received for non-residents.
* Forecast. IR: Inflation Report.

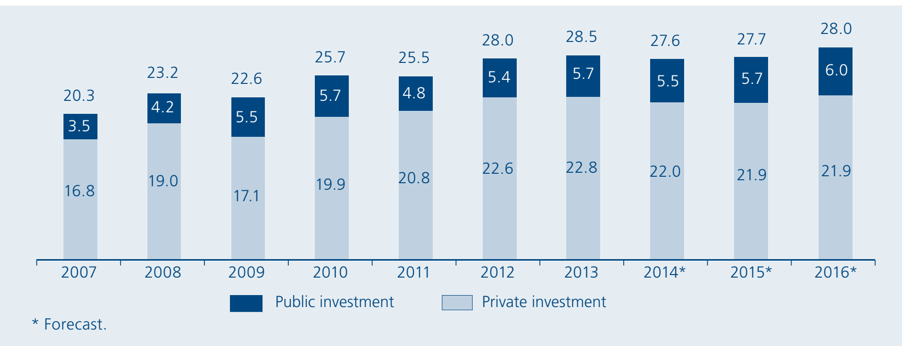
Based on these indicators, the forecast growth of private consumption in 2014 has been revised from 4.9 percent to 4.6 percent. A gradual increase is expected in this growth rate in the following years, in line with the anticipated evolution of income.

34. The growth of private investment projected for 2014 has been revised down from 3.2 to -0.4 percent. Taking into account the investment projects announced and the announcements of future concessions, in 2015 and 2016 private investment would grow at rates of 5.2 and 6.3 percent, respectively. Thus, the ratio of total gross fixed investment to GDP, which includes both the private and public sectors, would go from 27.6 percent in 2014 to 27.7 percent in 2015 and to 28.0 percent in 2016.

Graph 49
PRIVATE INVESTMENT: 2007 - 2016
(Real % change)



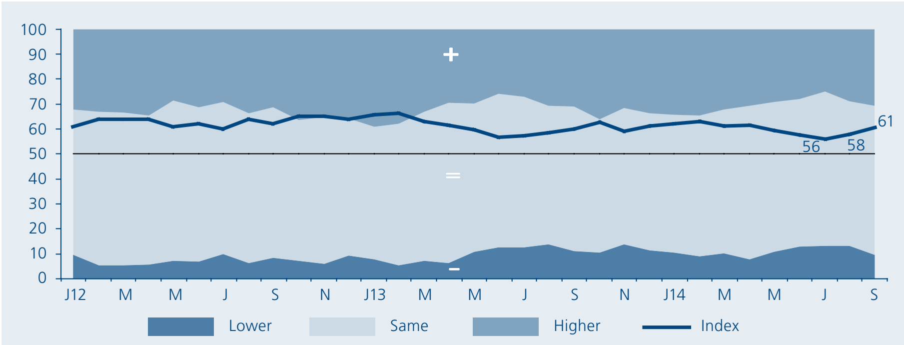
Graph 50
GROSS FIXED INVESTMENT: 2007 - 2016*
(% real GDP)



Some indicators that reflect the evolution of private investment are discussed below:

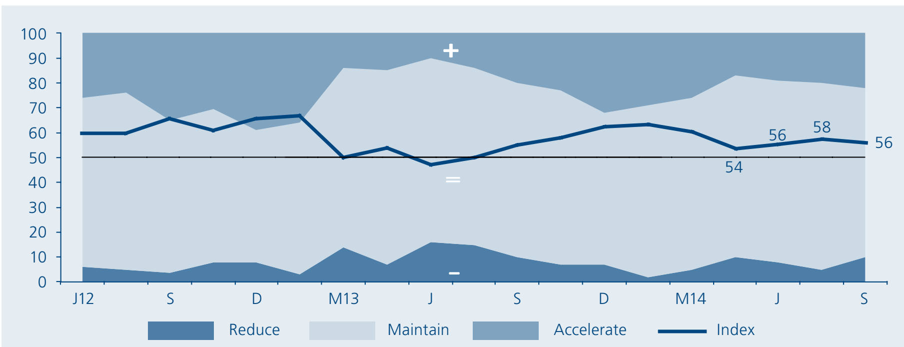
a. Expectations about demand in the three months ahead remain on the optimistic side with a level of 61 points in September, and showing a rise in the last three consecutive months. This indicator registers an average level of 60 points in the first nine months of 2014, 1 point less than the one observed in the same period of 2013.

Graph 51
EXPECTATION ABOUT DEMAND IN THE THREE MONTHS AHEAD



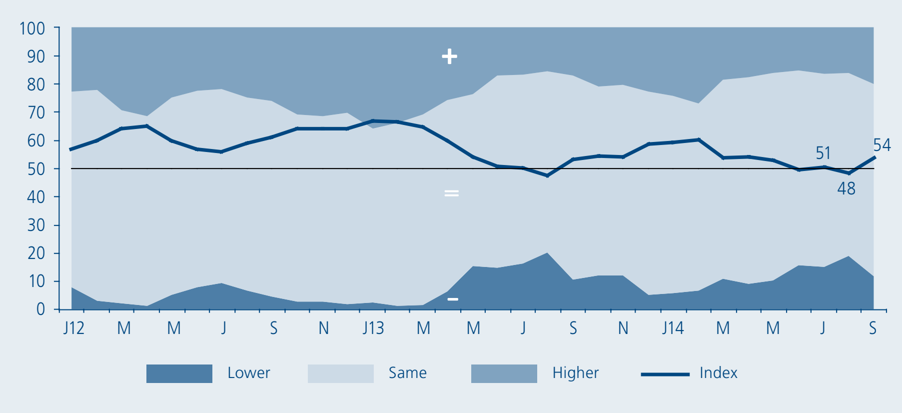
b. Expectations of investment in the following 6 months continued to be on the optimistic segment and registered a level of 56 points in September, a level higher than in June but lower than the one recorded in the first six months of the year.

Graph 52
EXPECTATIONS OF INVESTMENT IN THE SIX MONTHS AHEAD



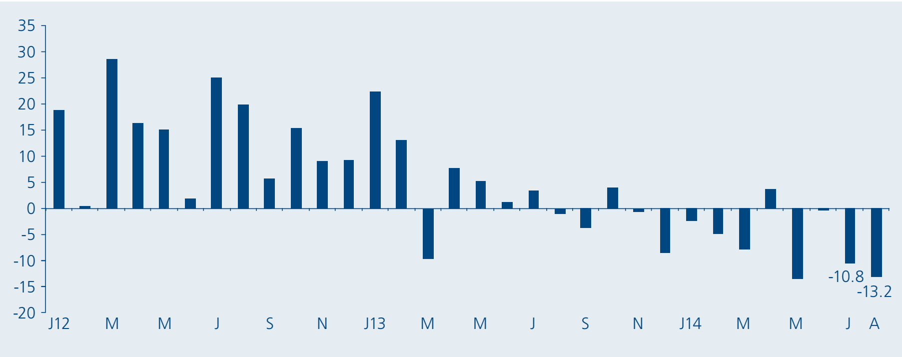
c. Business expectations on the economic situation in the three months ahead registered 54 points in September and are now located on the optimistic segment.

Graph 53
BUSINESS EXPECTATIONS ON THE ECONOMIC SITUATION IN THE THREE MONTHS AHEAD



d. The volume of imports of capital goods, indicator of the demand for investment, grew -6.4 percent in the period of January-August, less than during the same period of last year (4.6 percent).

Graph 54
VOLUME OF IMPORTS OF CAPITAL GOODS
(12 month % change)



e. The survey on economic expectations shows that economic agents have revised down their expectations of GDP growth in 2014. Thus, between July and September 2014, financial entities have revised down the GDP rate they expect from 4.8 to 3.7 percent; economic analysts have revised down their projections from 5.0 to 3.5 percent, and non-financial firms have revised them down from 5.0 to 4.0 percent.

Table 13
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH
(% change)

	Expectations about:		
	IR Apr.14	**IR Jul.14**	**IR Oct.14**
Financial entities			
2014	5.4	4.8	3.7
2015	5.5	5.4	5.0
2016	-.-	5.2	5.5
Economic analysts			
2014	5.4	5.0	3.5
2015	5.7	5.7	5.3
2016	-.-	6.0	5.5
Non-financial firms			
2014	5.2	5.0	4.0
2015	5.5	5.0	5.0
2016	-.-	5.5	5.2

Private investment projects announced to be carried out in the period of 2014-2016 total US$ 48 billion. This amount is 2.1 billion higher than the total considered in the Inflation Report of July.

Table 14
PRIVATE INVESTMENT PROJECTS ANNOUNCED
(Million US$)

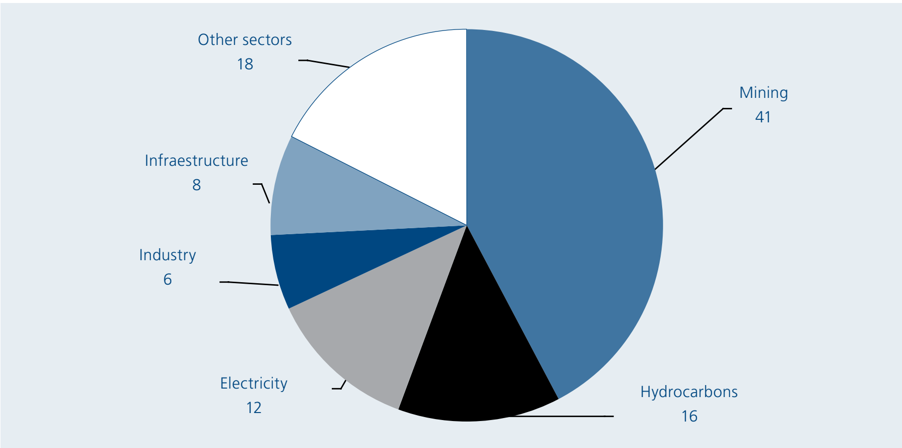
	IR Jul.14	**IR Oct.14**	**Differences**	
	Total investment	**Total investment**	**Total investment**	**Number of projects**
Mining	19,031	19,583	552	1
Hydrocarbons	6,226	7,525	1,299	2
Electricity	5,785	5,757	-28	3
Industry	2,932	2,932	0	0
Infraestructure	3,763	3,768	5	0
Other sectors	8,192	8,425	233	5
Total	**45,929**	**47,990**	**2,061**	**11**

IR: Inflation Report.

f. Investment projects announced to be carried out in the mining and hydrocarbons sectors represent 57 percent of total investment announced for the period 2014-2016. According to the Ministry of Energy and Mines, investments in the mining sector at July amounted to US$ 4.9 billion. It is worth pointing out the environmental impact study (EIS) of the mining project Tía María, suspended in 2011 due to social protests, was approved in August. The mining company has announced that the construction stage is expected to start at the end of 2014 and that commercial operations should begin in 2017. On its side, Shougang has said that the expansion of its Marcona mine would end in 2016 with an investment of US$ 1 billion and that the funding will be provided by its parent company China Shougang International Trade Engineering Corp. and a group of national and international banks led by Banco de Crédito del Perú and Citibank.

In August, the Chinese mining company MMG LIMITED completed the acquisition of Las Bambas copper project, located in Arequipa. According to the company, the additional investment required to complete the project would range between US$ 2.7 and US$ 3.2 billion.

Graph 55
FORESEEN INVESTMENT PROJECTS: 2014-2016
(% share)



In the hydrocarbons sector, Consorcio Gasoducto Sur Peruano formed by Odebrecht and Enagas, was awarded the implementation of the project responsible for improving energy security in the country and for the development of Gasoducto Sur Peruano, which was tendered by PROINVERSION. The aim of the project is to develop the infrastructure required to transport gas and liquids, which would have a direct impact on the development of the regions of Cusco, Arequipa, Moquegua, Puno, Apurimac and Tacna. The investment for this project is estimated around US$ 3.6 billion.

The large projects that have recently been awarded in concession are currently in the stage of completing detailed engineering studies, obtaining permits, and negotiating funding. Project like the Chinchero International Airport and the Molloco hydroelectric would start construction works in the second half of 2015. Line 2 of Lima's Metro cannot establish a schedule yet due to the difficulties associated with the expropriation of land. Obtaining permits is essential for these investments to materialize.

Table 15
MAIN PROJECTS TO BE IMPLEMENTED THROUGH CONCESSION ARRANGEMENTS IN 2014-2015
(Million US$)

	Estimated investment	
	2014	**2015**
A. Awarded	**9,938**	
Line 2 and Faucett Ave. - Gambetta Ave. of the Basic Network of the Metro of Lima and Callao	5,075	
International Airport of Chinchero - Cusco (AICC)	537	
Improvements of the National Energy Security and development of the South Peruvian Pipeline	3,643	
220 Kv Moyobamba - Iquitos Transmission Line and associated substations	499	
General San Martín (Pisco) Port Terminal	129	
Cable cars to Kuelap	18	
220 kV Friaspata - Mollepata Transmission Line and Orcotuna Substation 220/60 kV	38	
B. To be called	**613**	**3,941**
LNG Supply System for the Domestic Market	250	
Amazonía waterway	69	
220 Kv Azangaro - Juliaca -Puno Transmission Line	69	
Broadband Installation for Integral Connectivity and Social Development of Ayacucho Region	55	
220 kV and 60 kV Transmission Line and Nueva Lurin Substation 220/60 kV	50	
Broadband Installation for Integral Connectivity and Social Development of Huancavelica Region	47	
Broadband Installation for Integral Connectivity and Social Development of Apurimac Region	42	
Comprehensive Broadband Connectivity for the Social Development of the Northern Zone of the Country- Lambayeque Region	19	
Comprehensive Project for Water, MIning, Agriculture and Livestock for the Solution of the Informal Mining Problem in Piura	12	
Power Supply from New Hydroelectric Plants		2,700
Main works and conduction of drinkable water supply for Lima		400
Longitudinal of the Sierra road project		340
Quillabamba Thermal Power Plant		200
220 Kv New Córpac Substation And 220 Kv Industriales - Córpac Transmission Lines		148
Chillon river water supply works		70
Choquequirao Cable car		52
First stage substations Carapongo and associated line		31
C. Total Projects (A) + (B)	**10,551**	**3,941**

Source: Proinversión.

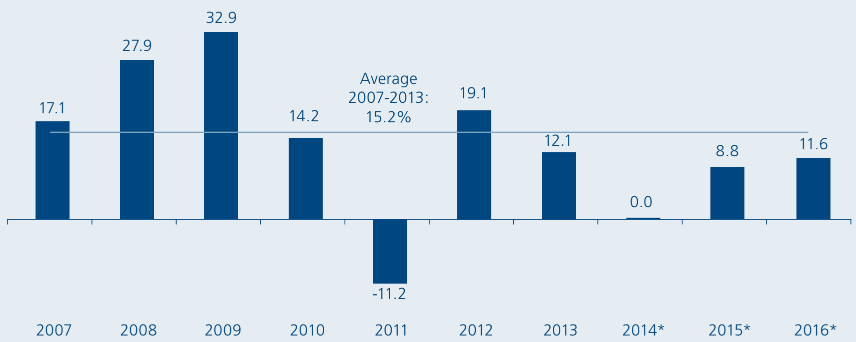
Table 16
MAIN INVESTMENT PROJECTS ANNOUNCED: 2014-2016

SECTOR	COMPANIES	PROJECT
Mining	Freeport-Macmoran Copper	Expansion of Cerro Verde
	Xstrata Copper	Las Bambas
	Antares Minerals Inc	Haquira
	Anglo American Plc.	Quellaveco
	AQM Copper	Zafranal
	Compañía de Minas Buenaventura S.A.A.	Chupacapa
	Aluminium Corp of China Ltd. (Chinalco)	Expansion of Toromocho
	Grupo Mexico S.A.B.	Tia Maria
	Shougang Corporation	Expansion of Marcona mine
	Grupo Mexico S.A.B. C.V.	Los Chancas
	Hudbay Minerals Inc.	Constancia
	Bear Creek Mining Corporation	Corani
Hydrocarbons	Enagas, Odebrecht S.A.C.	Enhance energy security country and development of pipeline in the south
	Savia Perú S.A.	Lot Z-2B: Perforation, exploration and other investments
	Petrobras Energia Peru S.A; Repsol YPF S.A.	Exploration of Lot 39 (21 well)
	Karoon Gas Autralia; Vietnam American	Exploration: Lot Z - 38 (20 well)
	Perenco	Exploration of Lot 67
	Pluspetrol Perú Corp. S.A.	Exploration of Lots 88 and 56
	Petrobras Energia Peru S.A; Repsol YPF S.A.	Lot 57 - Kinteroni
	Enagas;Transportadora de Gas del Perú S.A.	Expansion of gas and capacity of transportation
	Calidda Gas Natural del Perú	Supply System of LNG for the domestic market
	China National Petroleum Corporation	Exploration of Lot 58 and 2D seismic lines
Electricity	Energía Azul S.R.L.	Hydroelectric Power Plant of Santa María
	Odebrecht S.A.C.	Hydroelectric Power Plant of Cerro de Chaglla
	Quimpac S.A.; Inkia Energy	Hydroelectric Power Plant of Cerro del Águila
	Enersur; Kallpa Generación	Electric Node in the South of Peru
	Interconexión Eléctrica	500 KV Mantaro - Marcona - Socabaya - Montalvo Transmission Line and associated substations
Infrastructure	Consorcio Nuevo Metro de Lima	Line 2 Network Metro Lima (Electric Train)
	Odebrecht S.A.C.	New highways in Lima
	Consorcio Consierra II	Longitudinal de la Sierra road project, Section 2
	APM Terminal	Modernization of North pier
	Grupo Ronmero	Expansion of Matarani port
	Covisol	Trujillo-Sullana: Sol Highway
	OAS S.R.L.	Parque Rimac express way
	Graña y Montero S.A.	South express way
Industry	Repsol YPF S.A.	Expansion of La Pampilla plant
	Corporación JR Lindley	Expansion and new plants: Trujillo, Pucusana, Cusco, and Iquitos
	Mitsubishi; Hochschild Mining S.A.	Phospates projects
	Grupo Hochschild	New cement plant in Piura
	Técnicas Reunidas S.A.	Modernization of Talara refinery
	Grupo de Pilkington Limited	Manufacture plant of float glasses
	Grupo Gloria	Investment 2011-2016
Other sectors	Grupo Telefónica	4G mobile phone service
	Grupo Telefónica	Satellite Broadband 4G
	Grupo Gloria	Casagrande, Cartavio and San Jacinto - Olmos project
	Camposol	Investment in Crops: Arándanno
	Grupo Falabella	Expansion and New shopping centers
	Banmédica, British American Hospital, Grupo Brescia, Mapfre, Enfoca	Construction and expansion of health centers
	Grupo Interbank	Expansion and New shopping centers

Source: Press media and business information.

35. **Public investment** registered a negative annual change of 0.6 percent in January-September 2014 (vs. 19.6 percent in the same period of 2013). This result is explained by subnational governments' lower spending in investment. Because of this, the growth of public investment in 2014 is revised down from 6.7 percent to 0.0 percent. It is estimated that in 2015 and 2016 public investment will grow 8.8 and 11.6 percent, respectively, considering that the levels of investment would increase both in the national government and in regional governments.

Graph 56
PUBLIC INVESTMENT: 2007 - 2016
(Real % change)

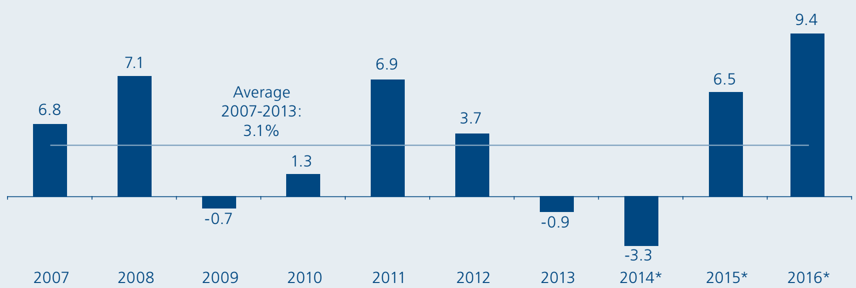


* Forecast.

36. In the first nine months of 2014 **real exports** of goods and services would register a decline of 3.4 percent due to the decline of exports of traditional products, particularly gold, copper, crude oil and derivatives, and coffee. On the other hand, the exports of non-traditional products such as agricultural and fishery products would have grown at positive rates, offsetting in part the fall in the volume of exports of traditional products.

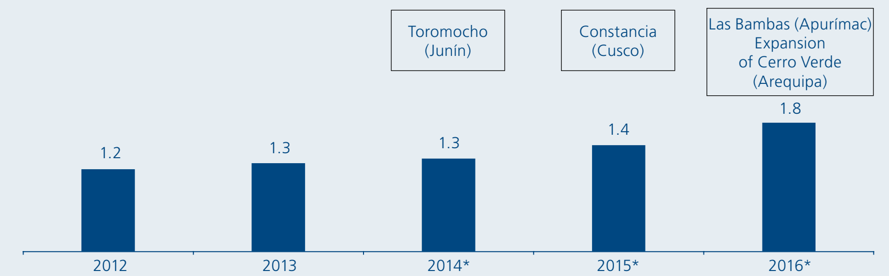
A decrease of 3.3 percent is estimated in exports for 2014 considering lower exports of traditional products, in line with the path foreseen in mining production and with the lower growth anticipated in the global economy. Exports would recover in 2015 showing a higher growth than expected in our previous report due to the recovery of the global demand for traditional products, the onset of operation of mining project Constancia and the expansion of Toromocho. In the last year of the forecast horizon, exports would grow at a rate of 9.4 percent, driven by the entry into operation of Las Bambas mining project and the expansion of Cerro Verde.

Graph 57
EXPORTS OF GOODS AND SERVICES : 2007-2016
(Real % change)



* Forecast.

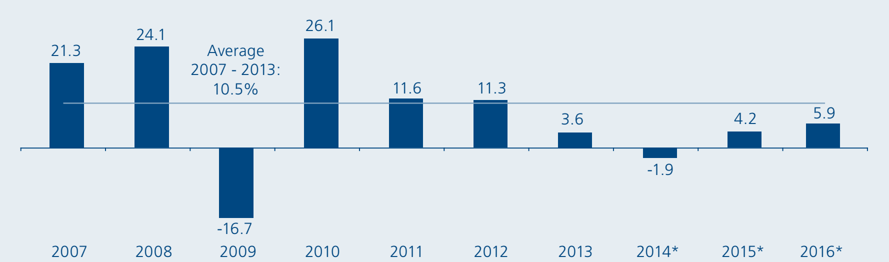
Graph 58
COPPER PRODUCTION
(Million FMT)



* Forecast.

37. **Imports** of goods and services are estimated to have fallen 2.5 percent in the first three quarters of 2014, mainly due to lower dynamism of imports of capital goods and industrial inputs. In 2014 imports would show a decline of 1.9 percent, recovering thereafter in 2015 when they would reach a growth rate of 4.2 percent, less than expected in our report of July, which is consistent with the GDP growth forecast for 2014. In 2016 imports are estimated to grow 5.9 percent, in line with the evolution of domestic demand.

Graph 59
IMPORTS OF GOODS AND SERVICES: 2007-2016
(Real % change)



* Forecast.

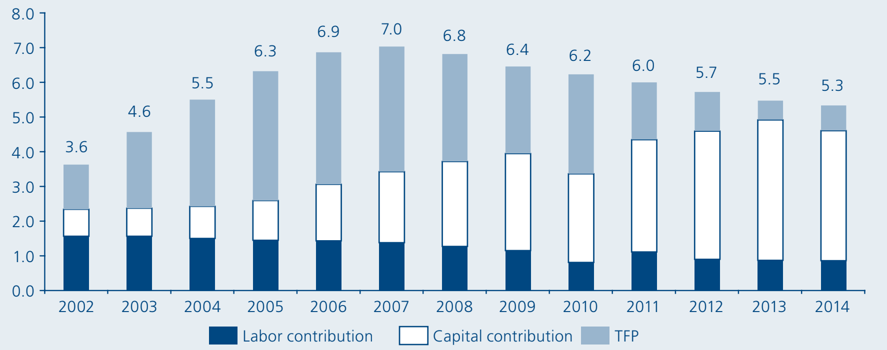
Box 1
INTERNATIONAL INDICATORS OF COMPETITIVENESS

Sustained economic growth is the main source to improve a nation's well-being because it raises the quality of living and reduces poverty levels. The capacity for sustained growth is measured in quantitative terms by the evolution of potential GDP, which can be broken down into the contributions of production factors, such as labor and capital, and the measurement of how efficiently we use these factors, which is known as total factor productivity (TFP).

During the past decade, Peru's potential GDP showed a continuous and significant increase in its growth rate, recording values close to 7 percent per annum until shortly before the international financial crisis unfolded. This greater growth is explained mainly by the improvement registered in TFP, whose annual contribution during the last five years of the past decade was around 3 percentage points. Another primary source for trend growth is the accumulation of capital.

On the other hand, the slowdown in the rate of potential growth is explained both by external factors, i.e. factors associated with lower export prices that discourage investment, and by internal factors that have restrained the advancement of productivity and competitiveness.

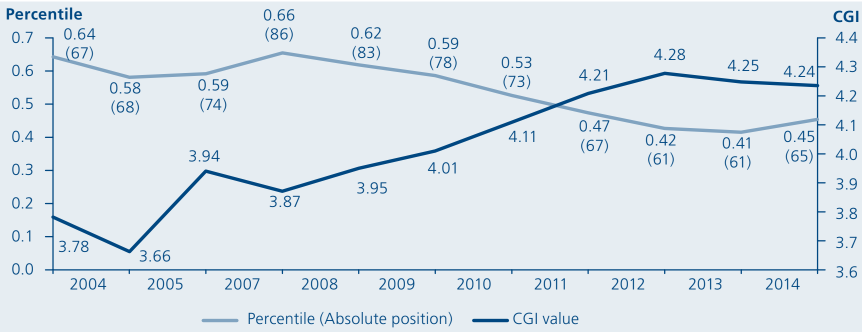
POTENCIAL GDP
(% change)



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Labor contribution	1.6	1.6	1.5	1.4	1.4	1.4	1.3	1.1	0.8	1.1	0.9	0.9	0.9
Capital contribution	0.8	0.8	0.9	1.1	1.6	2.0	2.5	2.8	2.6	3.2	3.7	4.0	3.8
TFP	1.3	2.2	3.1	3.7	3.8	3.6	3.1	2.5	2.9	1.6	1.1	0.5	0.7
Potential GDP	3.6	4.6	5.5	6.3	6.9	7.0	6.8	6.4	6.2	6.0	5.7	5.5	5.3

The Global Competitiveness Index (GCI) of the World Economic Forum (WEF) assesses competitiveness through 12 pillars of competitiveness, which in turn contain 114 primary indicators. Between 2004 and 2012, Peru climbed the GCI ranking, improving its relative position from percentile 64 to percentile 42 to position 61. In 2013, Peru remained in rank 61, but in the last year Peru has fallen 4 positions to rank 65. In the first period, the improvements in Peru's relative position in the GCI ranking were accompanied by a rise in the absolute value of this index.

PERU: GLOBAL COMPETITIVENESS INDEX AND RELATIVE POSITION[1/]
(2004-2014)



1/ The percentile (between number of countries since) summarizes the relative location of the country and corrects the effect of the variation of number of countries in the annual ranking, a lower value in the percentile implies a better location.

A first analysis of Peru's position in the 2014 ranking of 144 countries shows a lower performance in one-third of the pillars: institutions (118), innovation (117), health and primary education (94), infrastructure (88), and ability to harness the benefits of existing technologies (92). The table below indicates that the main pillars in which Peru's performance has contributed to the country's fall by 4 positions in the ranking of the GCI in the last year are: institutions (down 9 positions), technological readiness (down 6 positions), and efficiency in the labor market (down 3 positions).

PERU:
GLOBAL COMPETITIVENESS INDEX

Pillars	2014	2013	Differences*
1. Institutions	118	109	-9
2. Infraestructure	88	91	+3
3. Macroeconomic environment	21	20	-1
4. Health and primary education	94	95	+1
5. Higher education and training	83	86	+3
6. Goods market efficiency	53	52	-1
7. Labor market efficiency	51	48	-3
8. Financial market development	40	40	-
9. Technological readiness	92	86	-6
10. Market size	43	43	-
11. Business sophistication	72	74	+2
12. Innovation	117	122	+5
Peru	**65**	**61**	**-4**

* Positive number indicates a better position.
Source: WEF.

III.Balance of Payments

Trade Balance

38. In January-September 2014, the trade balance would show a deficit of US$ 2.92 billion –a higher deficit than the one recorded in the same period of 2013– due to a decrease of 11.2 percent in exports, offset in part by a decline of 3.3 percent in imports. The decrease in exports is mainly associated with a greater contraction of the terms of trade than the one observed in the same period of the previous year, which was coupled by the effect of a decrease in the volume of traditional products mainly.

39. The forecast on the trade balance in 2014 is revised to a deficit of US$ 3.0 billion due to lower exports (down 4.8 percent compared to the projection of July), offset in part by lower imports (down 3.6 percent compared to the projection of July) in a context of a greater fall anticipated in the terms of trade. The main factor explaining this downward revision is the reduction observed in the volume of exports of traditional products (8.6 percent vs. 3.8 percent projected in our previous report based on the data until August). The decline in copper exports is explained by the lower metal content obtained in the major mines and by the lower production of the Toromocho project foreseen for this year.

Table 17
TRADE BALANCE
(Million US$)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	**Year**	**Jan.-Sep.**	**IR Jul.14**	**IR Oct.14**	**IR Jul.14**	**IR Oct.14**	**IR Jul.14**	**IR Oct.14**
Exports	**31,425**	**42,177**	**27,914**	**39,836**	**37,914**	**41,846**	**40,182**	**46,751**	**44,286**
Of which:									
Traditional products	23,351	30,954	19,393	28,105	26,149	29,259	27,742	32,849	30,676
Non-traditional products	7,875	10,985	8,377	11,495	11,561	12,333	12,219	13,625	13,372
Imports	**31,886**	**42,217**	**30,834**	**42,447**	**40,924**	**44,044**	**41,804**	**46,952**	**44,588**
Of which:									
Consumer goods	6,492	8,837	6,497	9,113	8,780	9,569	9,048	10,278	9,635
Inputs	14,821	19,512	14,387	18,888	18,670	19,071	18,186	20,097	19,263
Capital goods	10,415	13,654	9,812	13,681	13,037	14,268	13,435	15,428	14,541
TRADE BALANCE	**-461**	**-40**	**-2,919**	**-2,611**	**-3,009**	**-2,198**	**-1,622**	**-202**	**-302**

* Forecast.
IR: Inflation Report.

Table 18
TRADE BALANCE
(% change)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
1. Value:									
Exports	-8.9	-9.0	-11.2	-5.6	-10.1	5.0	6.0	11.7	10.2
Traditional products	-10.5	-11.1	-17.0	-9.2	-15.5	4.1	6.1	12.3	10.6
Non-traditional products	-3.4	-1.9	6.4	4.6	5.2	7.3	5.7	10.5	9.4
Imports	4.2	2.6	-3.3	0.5	-3.1	3.8	2.2	6.6	6.7
2. Volume:									
Exports	-5.3	-3.8	-4.7	-1.0	-4.6	5.2	6.7	11.5	9.9
Traditional products	-6.0	-4.4	-8.7	-3.8	-8.6	4.6	7.5	13.1	11.1
Non-traditional products	-2.8	-1.5	6.8	3.7	5.7	6.2	5.4	7.2	7.0
Imports	4.8	3.5	-2.9	0.4	-2.4	4.4	4.0	5.9	5.9
3. Price:									
Exports	-3.8	-5.5	-6.8	-4.6	-5.7	-0.2	-0.6	0.2	0.2
Traditional products	-4.8	-7.0	-9.0	-5.6	-7.6	-0.5	-1.3	-0.7	-0.5
Non-traditional products	-0.6	-0.4	-0.4	0.9	-0.4	1.1	0.3	3.0	2.3
Imports	-0.5	-0.8	-0.4	0.1	-0.7	-0.6	-1.8	0.6	0.7

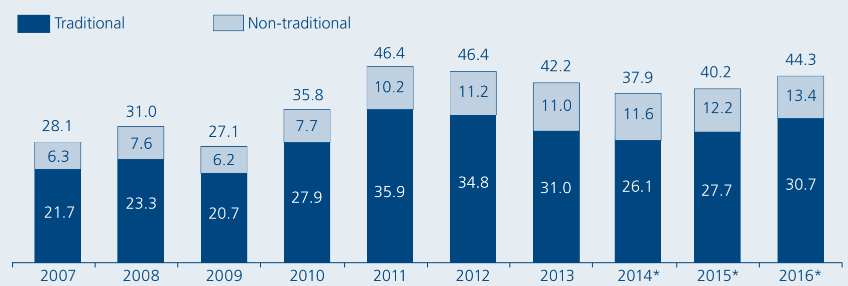
* Forecast.
IR: Inflation Report.

40. Exports in **2014** and **2015** would amount to US$ 37.9 billion and US$ 40.2 billion, respectively. Both amounts are lower than estimated in the July report (US$ 39.8 and US$ 41.8 billion, respectively). The downward revision for 2014 is explained mainly by lower mining and fishing exports, while the revision for 2015 considers that the effect of lower mining exports would persist, but that fishing exports would show a gradual recovery due to a greater extraction of anchovy given that the possible effects of El Niño event would be milder than those considered in our previous report. The forecasts for both 2014 and 2015 consider a lower production of copper due to the lower grades of the minerals obtained at the major mines as well as a slower pace of copper production and copper exports from Toromocho (Junín).

A recovery is expected in mining exports in **2016** as a result of the onset of operations of projects such as Las Bambas, the expansion of Cerro Verde's mining unit in Arequipa –which would allow a much greater production of copper–, and the recovery of copper production and copper exports in Toromocho, as well as due to increased exports of fisheries considering that climate conditions would be normal in the year.

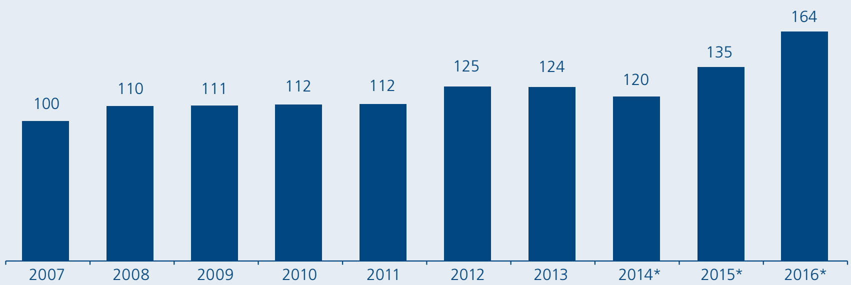
The growth rate of non-traditional exports projected for **2014** has been revised upwards, with greater volumes of exports of agricultural products being anticipated, in line with the trend observed in this sector until August and with the recovery foreseen in the United States, one of the country's major markets for these products. Steel and metallurgical products and chemical products are also expected to increase, but to a lesser extent. In **2015** and **2016** exports are expected to show a rising path, both in terms of volumes –associated with the expected recovery of our trading partners– and in terms of prices.

Graph 60
EXPORTS OF GOODS: 2007 - 2016
(Billion US$)



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

Graph 61
VOLUME OF COPPER EXPORTS
(Index 2007=100)



* Forecast.

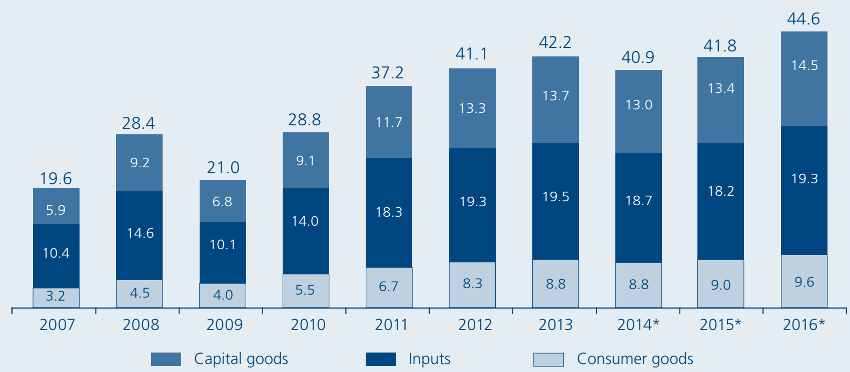
Graph 62
NON-TRADITIONAL EXPORTS VOLUME
(Index 2007=100)

* Forecast.

41. In **2014** imports are expected to amount to US$ 40.9 billion. This amount of imports, which is lower than the one estimated in July and also represents a decrease relative to 2013, reflects a fall in imports both in terms of volumes and in terms of prices. In contrast with our previous report in which imports were expected to show a slight increase, this report considers a reduction in the volume of imports due to a decrease of the volume of imports of inputs and capital goods, associated with the negative growth rates expected in manufacturing and private investment, as well as a decrease in imports of consumer goods, in line with the revision of private consumption.

In **2015** imports would amount to US$ 41.8 billion, which is consistent with a growth of 4.0 percent in the volume of imports –less than expected in the report of July–, in line with the lower growth anticipated in domestic demand. In **2016** imports would grow 6.7 percent, which is consistent with the growth rates estimated in line with the evolution recovery of economic activity.

Graph 63
IMPORTS OF GOODS: 2007 - 2016
(Billion US$)



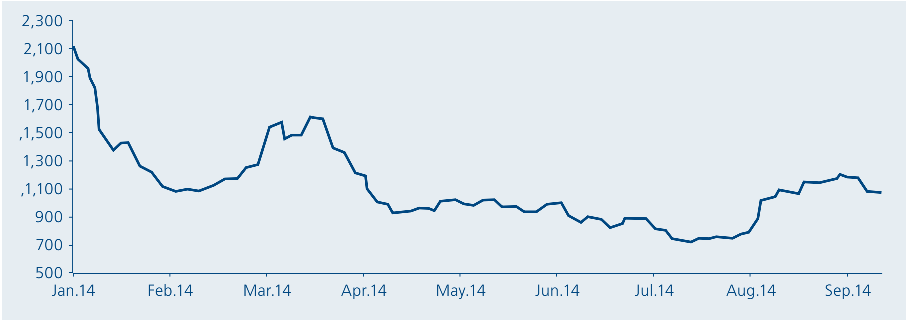
Memo: Total imports also includes other imports.
* Forecast.

Terms of Trade

42. At Q3-2014, the index of terms of trade showed an average of 99.6, a level 6.4 percent lower than in the same period of 2013 and 2.6 percent higher than the average level of the period 2004-2013. The index of export prices fell 6.8 percent while the index of import prices fell 0.4 percent during the same period. Gold was the export product that registered the greater price reduction due to the lower demand for this metal as a hedge asset as well as due to the appreciation of the dollar.

In line with these developments, the Baltic Dry Index (BDI), which does a follow-up of freight rates of dry cargo of commodities by ship, has dropped 52.9 percent so far this year.

Graph 64
BALTIC DRY INDEX



43. The projected variation of terms of trade for 2014 has been revised down from -4.7 percent to -5.1 percent, whereas an increase of 1.1 percent is projected for 2015 given that a further decline is expected in the prices of imported products. The average price of copper forecast for 2014 has been revised slightly downwards, from US$ 3.15 to US$ 3.14 per pound, due mainly to economic conditions in China and, to a lesser extent, to stagnation in the Eurozone. The forecast for the price of gold has been revised from US$ 1,288 per ounce to US$ 1,278 per ounce given the prospects for the appreciation of the dollar, in line with expectations that the FED will raise its rates. The price of zinc and lead have been revised slightly upward in a context of a tighter market for these metals.

The international prices of imports would fall 0.7 percent on average due mainly to the lower prices of agricultural products and crude given that a higher production is expected. Another factor contributing to this would be the lower inflation, associated in part with the appreciation of the dollar in international financial markets.

The price of oil is expected to decline in the forecast period and to reach an average price of US$ 98/barrel in 2014, US$ 90/barrel in 2015, and US$. 87/barrel in 2016, in a context of a growing supply of crude oil and shale gas, especially in the United States. The price levels are lower than the ones estimated in our previous report due to the higher production of the United States and the recovery of Libya and Iraq's production.

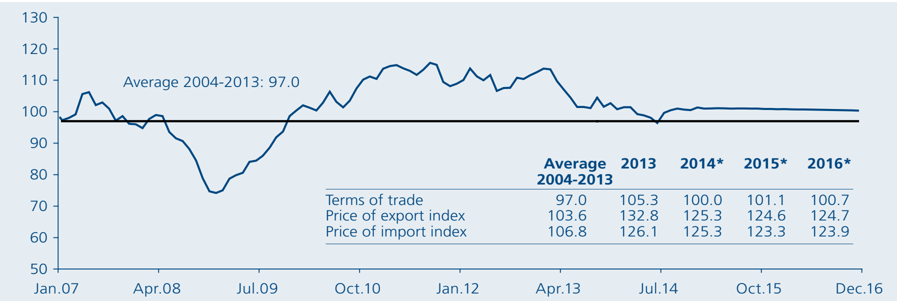
On the other hand, the prices of maize, wheat and soybean oil have been revised downwards because an increase is estimated in their final global inventories due to the increased production foreseen for the 2014/2015 crop year, which in some cases is estimated to show record levels due to increased yields. Moreover, the lower price of oil would lead to a lower demand for these crops to produce biofuels.

Table 19
TERMS OF TRADE: 2013 - 2016
(Annual average data)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
TERMS OF TRADE	**-3.3**	**-4.7**	**-6.4**	**-4.7**	**-5.1**	**0.4**	**1.2**	**-0.4**	**-0.5**
Price of exports	**-3.8**	**-5.5**	**-6.8**	**-4.6**	**-5.7**	**-0.2**	**-0.6**	**0.2**	**0.2**
Copper (US$ cents per pound)	335	332	315	315	314	315	310	315	308
Zinc (US$ cents per pound)	87	87	97	95	96	95	95	95	96
Lead (US$ cents per pound)	98	97	97	97	98	99	99	99	99
Gold (US$ per ounce)	1,457	1,411	1,289	1,288	1,278	1,280	1,255	1,280	1,255
Price of imports	**-0.5**	**-0.8**	**-0.4**	**0.1**	**-0.7**	**-0.6**	**-1.8**	**0.6**	**0.7**
Oil (US$ per barrel)	98	98	100	101	98	93	90	88	87
Wheat (US$ per ton)	267	266	251	263	241	265	213	266	220
Maize (US$ per ton)	259	235	163	175	154	181	141	181	149
Soybean oil (US$ per ton)	1,036	992	838	877	809	902	741	900	744

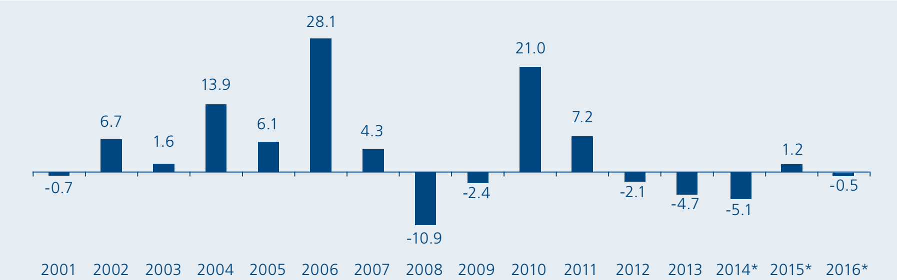
* Forecast.
IR: Inflation Report.
Source: Bloomberg.

Graph 65
TERMS OF TRADE INDEX: JAN.07 - DEC.16
(2007=100)



* Forecast.
Source: Bloomberg.

Graph 66
TERMS OF TRADE: 2001 - 2016
(% change)



* Forecast.
Source: Bloomberg.

Copper

44. The price of **copper** increased 1.0 percent in the last quarter, showing a 3.3 percent reduction in the past two months. With this, the price of copper accumulated a fall of 4.6 percent in the first nine months of the year, closing the month of September with an average monthly level of US$ 3.12 per pound.

On the demand side, the recent decline in the price of copper was influenced by the downward revision of economic outlook of China and the Eurozone. The main fear is associated with the weakness of the Chinese real estate market, which accounts for approximately one-third of the demand for copper in that country. Moreover, economic growth in the Eurozone stagnated in Q2-2014 and advanced indicators show unfavorable prospects. In addition, the demand for copper was also affected by the reduction of credit to import operations in China after the government decided to investigate the operations that used copper as a collateral.

The drop in the price of copper is also explained by the rapid growth of the production of refined copper in China, after the reopening of the refineries that had been closed for maintenance or due to breakdowns in the first half of the year. Another factor that has contributed to this has been the growth in the production of copper concentrates after the resumption of copper exports from the Grasberg mine in Indonesia once the mining company solved its problems with the government.

As for the rest of the forecast horizon, China's demand is expected to slow down in the rest of the year and to grow slightly next year, in line with the signals indicating some deceleration in its rates of economic growth to more sustainable levels. At the same time, the production of copper concentrates would grow faster that the demand in the next few years, generating a market surplus. In line with these developments, it is estimated that prices will decline relative to those considered in the last inflation report. However, unexpected supply cuts and economic recovery in the United States could give some support to the price in the short and medium term, respectively.

Graph 67
COPPER: JANUARY 2007 - DECEMBER 2016
(US$ cents/pd.)

Source: Bloomberg.

Zinc

45. During the last three months, the price of **zinc** rose 8.3 percent, closing September with an average monthly price of US$ 1.04/pound. The price of zinc accumulated an increase of 16.6 percent in the first nine months of the year.

The rise in the prices of zinc was associated with more restrictive conditions in the world market. The International Zinc and Lead Study Group (ILZSG) reported a greater-than-expected supply deficit and a reduction in global inventories during the first seven months of 2014[1]. Fears of a lower future supply due to expectations of a slowdown in mining production as a result of the lower grades of this mineral and a new underproduction were among the reasons for this market adjustment.

Another reason that contributed to the relative shortage of zinc was the growing demand registered in the United States and China. The ILZSG estimates that the consumption of refined zinc in the United States rose 8.7 percent in the first seven months of the year, reflecting a tight market. In the case of China, the prospects of demand are rising given that zinc is one of the metals less exposed to the contraction of the real estate sector in a context in which the production of refined and concentrated zinc is still relatively stable in on China.

In the forecast period, the market fundamentals of zinc show an even tighter market due to the increase in demand and to fears of a lower future production, even though offset by China's slowdown and the high levels of global inventories. The international price of zinc is expected to be slightly above the levels estimated in the previous report in the forecast horizon.

Graph 68
ZINC: JANUARY 2007 - DECEMBER 2016
(US$ cents/pd.)

Source: Bloomberg.

1 The LZSG reported a global deficit of 248 thousand tons in the supply of zinc and a drop of 291 thousand tons in total inventories in the first seven months of the year.

Gold

46. In the past three months, the price of **gold** dropped 3.2 percent, partially reversing the upward trend registered in the first months of the year. With this, the price of gold accumulates an increase of 1.3 percent in the first nine months of 2014, closing September with a monthly average price of US$ 1,238.8 per ounce.

    The drop in the price of gold in recent months was associated with lower demand for this metal as a hedge asset after prospects for growth in the United States improved and with the appreciation of the dollar as a result of expectations that the Fed will raise its interest rates. The lower demand for investment in gold is reflected in the reduction of non-commercial positions in Comex and in the fall of ETF gold balances. Moreover, declining geopolitical risks after a ceasefire agreement was signed between the Government of Ukraine and the pro-Russian guerrillas contributed also to this. In addition, the physical demand was also significantly affected in the context of a slowdown in China and India.

    In this context, the price of gold would continue declining in the forecast horizon due mainly to the anticipated onset of the cycle of Fed interest rate increases and the improvement of economic activity in the United States. Both factors will contribute to the strengthening of the dollar, discouraging the demand for gold as an investment asset. In these circumstances, the gold price for 2015 is revised downwards.

Graph 69
GOLD: JANUARY 2007 - DECEMBER 2016
(US$/tr.oz.)

Source: Bloomberg.

Energy

47. In the last three months, the average monthly price of **WTI oil** dropped 11.3 percent, reaching an average price of US$. 93.4/barrel in September. Thus, the price of oil accumulated a decline of 4.5 percent in the first nine months of the year.

The prices of oil have fallen since the end of June due to an improvement in the global production of crude, especially in the United States, as well as due to the recovery of production in Libya and Iraq. Because the U.S. oil production has been greater than expected, its demand for crude oil imports has declined. In addition, it is estimated that the new pipeline infrastructure that will be used to take the production to the Cushing stores in Oklahoma will contribute to the recovery of inventories, pushing WTI oil prices down.

On the other hand, the demand for oil of the United States and China, the world's main importers of oil, has been revised down, with the rise in non-conventional oil (shale gas) production explaining the decline in the former and the slowdown in the Chinese economy explaining the decline in the latter.

Based on this scenario, WTI oil is expected to show lower price levels than those estimated in our previous report. However, both upward and downward risk factors remain high. The likelihood of price increases remains high due to the recurring political tensions in the Middle East and Ukraine. The main risks on the upside are the potential threat of production cuts in countries that are increasing their supply in a context of limited flexibility of the OPEC to counter the decline of such supply, and the likelihood that this price fall will lead the OPEC to cut its production quota.

On the other hand, the probability of declining prices is associated with a higher-than- expected crude oil production in the United States and with the early settlement of the conflicts in the Middle East. It should also be pointed that the "break even" tax price-price required to finance the fiscal accounts in many cases exceeds US$ 95 per barrel, which could limit the fall in the price of oil.

Graph 70
WTI OIL: JANUARY 2007 - DECEMBER 2016
(US$/bl)

IR Forecast

Jul.14	Average	Annual % chg.
2013	98	4.0
2014	101	2.9
2015	93	-7.3
2016	88	-6.1
Oct.14	**Average**	**Annual % chg.**
2013	98	4.0
2014	98	-0.4
2015	90	-7.8
2016	87	-3.6

Source: Bloomberg.

Maize

48. In September, the average international price of **maize** was US$ 127 per ton, 25.3 percent lower than the average price at the end of June 2014. This variation reflects mostly the price falls in the months of July (14.1 percent compared to May) and September (9.27 percent compared to August). This declining price trend was influenced by the better outlook for the global harvest of maize reported by the US Department of Agriculture (USDA) due to the good weather conditions expected during the pollination period in the U.S. producing region, which resulted in good and excellent outlook ratings for most crops in the U.S. as well as in expectations of reaching record yields. More recently, the appreciation of the dollar against the euro and the beginning of the harvest in the USA emphasized this downward pressure, leading maize to show its lowest price level since July 2010.

In line with these developments, between June and September, the USDA revised up their projections of global final inventories of maize for the 2014/2015 crop year from 182.7 million tons in June to 189.1 million tons in September due to the successive upward revisions of global harvest (up from 981.12 million tons in June to 987.52 million tons in September).

Based on these factors, the price of maize is estimated to show lower levels than those considered in our previous report.

Graph 71
MAIZE: JANUARY 2007 - DECEMBER 2016
(US$/MT)

Source: Bloomberg.

Wheat

49. At September, the international price of **wheat** showed a decrease of 18.1 percent compared to June and registered an average level of US$ 214 per ton at the close of September. As in the case of maize, this lower price reflects mainly the price falls observed in July (8.8 percent compared to May) and September (6.4 percent compared to August). Factors accounting for the decrease in the price of wheat include the upward revision of world production by the USDA –increased

yields in the United States, Russia, and the European Union– and lower concerns regarding shipments from the Black Sea associated with the geopolitical tensions between Russia and Ukraine. As in the case of maize, the appreciation of the dollar has also added pressure to the price of wheat recently.

The USDA revised up its projections of final inventories for the 2014/2015 crop year due mainly to estimates of a higher production –the estimated global harvest went from 701.62 million tons in June to 719.95 million tons in September. Because of this, the price of wheat would show lower levels than those considered in the Inflation Report of July.

Graph 72
WHEAT: JANUARY 2007 - DECEMBER 2016
(US$/MT)

Source: Bloomberg.

Soybean oil

50. The average price of **soybean oil** in September was US$ 747 per ton, 14.9 percent lower than in June. This decline was marked mainly by price drops in the months of July (5.6 percent compared to June) and August (6.9 percent compared to July).

The price of soybean oil was affected by the USDA upward revision of the global harvest of soybean –from 299.99 million tons in June to 311.13 million tons in September– for the 2014/2015 crop year. A record harvest of soybean is expected in the United States because of increased cultivated areas and good weather conditions. Other factors contributing to this price fall include the appreciation of the dollar against the euro, the lower price of oil –which would imply a lower demand for biofuels–, and the beginning of the harvest season in the producing area of the USA. It is worth mentioning that this trend was offset by expectations of a greater demand for U.S. soybean from China.

Because of the factors discussed above, the prices of soybean are expected to stabilize below the level estimated in our previous report in the forecast horizon.

Graph 73
SOYBEAN OIL: JANUARY 2007 - DECEMBER 2016
(US$/MT)

Source: Bloomberg.

Current Account Balance and Financing

51. The projected deficit in the current account of the balance of payments for this year is revised down to 4.7 percent. The deterioration foreseen for this year in the trade balance would be offset with a lower than expected deficit in services and income factors.

Table 20
BALANCE OF PAYMENTS
(Million US$)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	**Year**	**Jan.-Sep.**	**IR Jul.14**	**IR Oct.14**	**IR Jul.14**	**IR Oct.14**	**IR Jul.14**	**IR Oct.14**
I. CURRENT ACCOUNT BALANCE	**-8,031**	**-9,126**	**-8,201**	**-10,116**	**-9,840**	**-10,793**	**-9,712**	**-8,547**	**-8,462**
% GDP	*-5.4*	*-4.5*	*-5.4*	*-4.8*	*-4.7*	*-4.8*	*-4.3*	*-3.5*	*-3.5*
1. Trade balance	-461	-40	-2,919	-2,611	-3,009	-2,198	-1,622	-202	-302
a. Exports	31,425	42,177	27,914	39,836	37,914	41,846	40,182	46,751	44,286
b. Imports	-31,886	-42,217	-30,834	-42,447	-40,924	-44,044	-41,804	-46,952	-44,588
2. Services	-1,354	-1,801	-1,131	-1,802	-1,499	-1,824	-1,493	-1,913	-1,593
3. Investment income	-8,617	-10,631	-7,690	-10,183	-9,813	-10,398	-10,224	-10,218	-10,352
4. Current transfers	2,401	3,346	3,539	4,481	4,481	3,627	3,627	3,786	3,786
Of which: Remittances	1,999	2,707	2,047	2,933	2,823	3,014	2,900	3,142	3,024
II. FINANCIAL ACCOUNT	**11,725**	**12,033**	**6,738**	**10,975**	**8,587**	**11,793**	**10,712**	**10,547**	**10,462**
Of which:									
1. Private Sector	12,422	13,378	6,063	9,625	7,925	10,493	9,313	9,515	9,387
a. Long-term	14,508	14,881	5,757	10,649	8,312	10,344	9,610	9,380	9,373
b. Short-term 1/	-2,086	-1,503	306	-1,023	-387	148	-297	135	14
2. Public Sector 2/	-697	-1,345	675	1,350	662	1,300	1,399	1,032	1,075
III. BALANCE OF PAYMENTS (=I+II)	**3,694**	**2,907**	**-1,463**	**860**	**-1,254**	**1,000**	**1,000**	**2,000**	**2,000**
Memo:									
Long-term external financing of the private sector (% GDP) 3/	11.5	9.5	7.7	7.6	7.6	6.4	6.4	5.5	5.5
GDP (Billion US$)	148.6	202.3	150.8	209.2	207.8	225.9	224.3	244.8	242.9

1/ Includes net erros and omissions.
2/ Includes exceptional financing.
3/ Includes net foreign investments, portfolio investment and private sector's long-term disbursement.
* Forecast.
IR: Inflation Report.

Lower deficits are projected for 2015 and 2016 as a result of a recovery in exports associated with increased external demand, the onset of operations of mining projects in 2015 and 2016 (Constancia and Las Bambas), an increased production of copper at Cerro Verde due to the expansion of its mining unit, and the gradual recovery of production at Toromocho.

52. The decline of export prices has had a negative impact on the trade balance. If the volume of exports is valued using the average price index of 2011 –which is the year when consecutive price falls began to be recorded, accumulating a decrease of 12.9 percent–, the value of exports would be higher by 2.7 and 2.8 percentage points of GDP in 2014 and 2015, respectively. In addition, if the volume of imports is valued using the price average index of 2011 –1.7 percent above the level of 2014–, the value of imports would have been higher by 0.3 and 0.7 percentage points of GDP in 2014 and 2015, respectively. Thus, the deterioration of the trade balance explained by prices is equivalent to 2.4 and 2.1 percent of GDP in 2014 and 2015, respectively.

Table 21
TRADE BALANCE
(Billion US$)

	Forecast IR Oct. 2014 (A)			Prices of 2011 (B)			Difference (A) - (B)		
	Exports	Imports	Trade Balance	Exports	Imports	Trade Balance	Exports	Imports	Trade Balance
2014*	37.9	40.9	-3.0	43.5	41.6	1.9	-5.6	-0.7	-4.9
2015*	40.2	41.8	-1.6	46.4	43.3	3.1	-6.2	-1.5	-4.7

* Forecast.
IR: Inflation Report.

53. In line with the expected recovery of investment foreseen for the next two years, the ratio of investment to GDP would increase from 25.8 percent of GDP in 2014 to 26.1 percent in 2016. This increase is covered mainly by public and private domestic savings, which together would reach levels of 22.6 percent of GDP in 2016. Given the lower levels of deficit in the current account estimated for the forecast horizon, domestic saving is expected to increase its ratio as a source of financing investment, covering about 90 percent of investment.

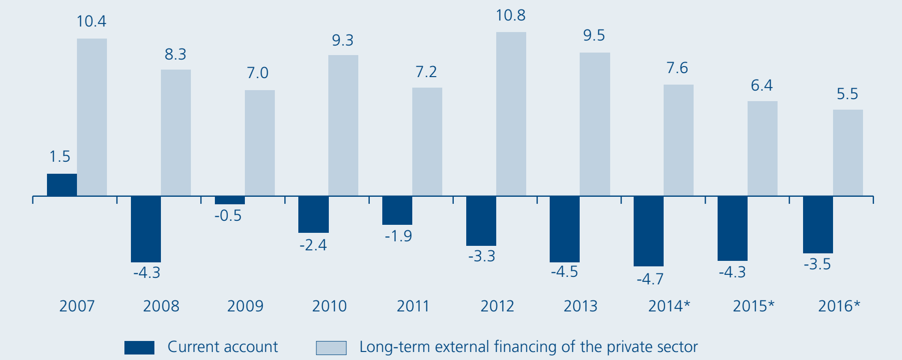
Table 22
SAVINGS -INVESTMENT GAP
(% GDP)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
1. Gross fixed investment	**26.0**	**26.6**	**25.1**	**26.8**	**25.8**	**26.9**	**25.7**	**27.3**	**26.1**
2. Net domestic savings[1/]	**20.6**	**22.1**	**19.6**	**21.9**	**21.1**	**22.1**	**21.4**	**23.8**	**22.6**
a. Private	12.3	15.4	12.4	15.7	15.2	16.3	15.9	17.8	16.9
b. Public	8.3	6.7	7.1	6.2	5.8	5.8	5.5	6.0	5.7
3. External savings	**5.4**	**4.5**	**5.4**	**4.8**	**4.7**	**4.8**	**4.3**	**3.5**	**3.5**

1/ Excluding change on inventories.
* Forecast. IR: Inflation Report.

54. Private sources are expected to show a decreasing trend in long-term financing by 2016 as a result, on the one hand, of the end of the cycle of large mining investments due in part to the end of the period of high growth rates in the prices of raw materials and, on the other hand, as a result of a context marked by higher international interest rates, in line with market expectations that the Fed will adjust its rates approximately by mid-2015. In spite of this, long-term financing will continue to exceed the gap in the current account in 2014-2016.

Graph 74
CURRENT ACCOUNT AND LONG-TERM EXTERNAL FINANCING OF THE PRIVATE SECTOR: 2007-2016 [1/]
(% GDP)



1/ Includes net foreign investments, portfolio investment, and private sector's long-term disbursement.
* Forecast.

55. The net flow of private long-term external financing would amount to US$ 8.3 billion in **2014**, including residents' investments abroad for a total of US$ 3.6 billion –with AFPs investments in securities standing out– and non-residents' investments in the country for a total of US$ 12 billion. The net inflow of long-term private capital has been revised down in this report considering a lower flow of external financing through financial and non-financial loans and a lower flow of foreign direct investment, partially offset by an increased flow of portfolio investment in a context in which external financial conditions are still favorable although less attractive than in 2013. Moreover, a greater acquisition of foreign assets by domestic investors would also be observed due in part to the increase in the limit of AFPs' investment abroad authorized by the BCRP.

Positive flows of US$ 9.6 billion and US$ 9.4 billion –equivalent to 4.3 and 3.9 percent of GDP– are projected for **2015** and **2016**, respectively. These amounts are consistent with the funding requirements reflected in the levels of current account deficits projected for those years.

Table 23
LONG-TERM FINANCIAL ACCOUNT OF THE PRIVATE SECTOR
(Million US$)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
A. LONG-TERM	**14,508**	**14,881**	**5,757**	**10,649**	**8,312**	**10,344**	**9,610**	**9,380**	**9,373**
% GDP	*9.8*	*7.4*	*3.8*	*5.1*	*4.0*	*4.6*	*4.3*	*3.8*	*3.9*
1. ASSETS	**-108**	**-1,291**	**-2,875**	**-2,815**	**-3,647**	**-2,874**	**-2,917**	**-2,529**	**-2,479**
2. LIABILITIES	**14,617**	**16,173**	**8,632**	**13,464**	**11,959**	**13,218**	**12,527**	**11,909**	**11,853**
Foreign direct investment in the country	8,338	9,298	6,524	10,092	9,259	8,200	8,010	8,200	8,174
Non-financial sector	4,606	5,551	1,463	2,172	1,856	3,518	3,018	2,709	2,678
Long-term loans	437	1,211	-207	217	-335	1,318	817	626	607
Portfolio investment	4,169	4,340	1,671	1,955	2,191	2,200	2,200	2,083	2,072
Financial sector	1,673	1,323	645	1,200	845	1,500	1,500	1,000	1,000
Long-term loans	139	-212	-174	78	-164	700	700	500	500
Portfolio investment	1,535	1,536	818	1,122	1,008	800	800	500	500
B. SHORT-TERM[1/]	**-2,086**	**-1,503**	**306**	**-1,023**	**-387**	**148**	**-297**	**135**	**14**
C. PRIVATE SECTOR	**12,422**	**13,378**	**6,063**	**9,625**	**7,925**	**10,493**	**9,313**	**9,515**	**9,387**

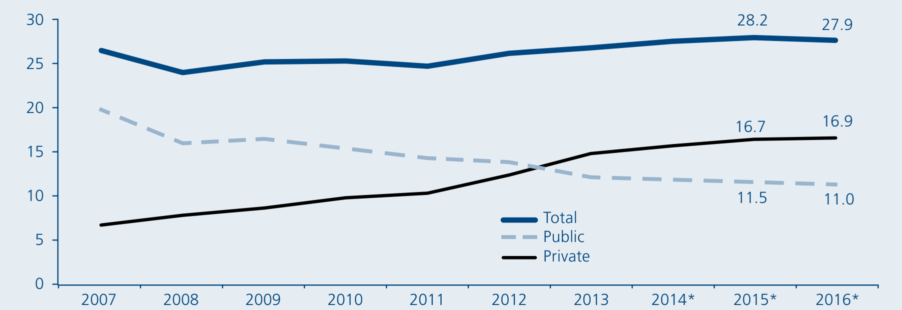
1/ Includes net errors and omissions.
* Forecast.
IR: Inflation Report.

56. The **financial account of the public sector** would show a positive flow of US$ 653 million –lower than projected in our previous report–, which is mostly explained by non-residents' lower holdings of sovereign bonds. Major outlays to finance several investment projects, such as the modernization of the refinery in Talara and the co-funding required for the implementation of Metro Line II are still considered in this report.

57. At end 2013, the external debt of the private sector represented 15 per cent of GDP, while the external debt of the public sector was equivalent to 11.9 percent of GDP.

    Of the total private debt, 44 percent is associated with credit from the financial sector and around 40 percent of this debt is associated companies operating in areas such as mining and hydrocarbons. The nature of the activities carried out by these companies reduces the risk of mismatches in the private external debt.

Graph 75
MEDIUM- AND LONG-TERM EXTERNAL DEBT: 2007-2016
(% GDP)



* Forecast.

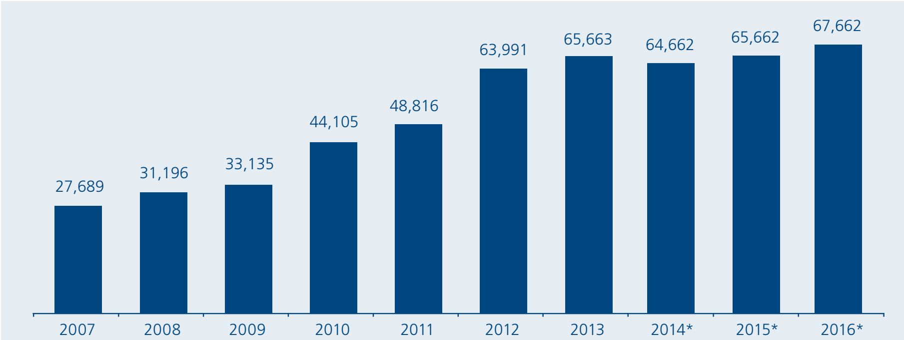
58. The soundness of the balance of payments face negative events in the world economy is reflected in the position of Peru's international reserves relative to the balance of its short-term external liabilities or comparing the total of these liabilities with the current account deficit. The high levels of Peru's indicators in the region, which have also been improving over the years, evidence the soundness of the Peruvian economy.

Table 24
NIR INDICATORS

As a % of:	**2004**	**2009**	**2014***
GDP	19.2	27.2	31.1
Short-term external debt	171.8	297.1	760.5
Short-term external debt plus current account deficit	173.2	281.6	352.5

* Forecast.

Graph 76
NET INTERNATIONAL RESERVES: 2007-2016
(Million US$)



* Forecast.

IV. Public Finances

Economic Balance

59. The economic balance of the non-financial public sector in January-September 2014 was equivalent to 2.4 percent of GDP –a lower ratio than the one recorded in the same period of 2013 (3.4 percent of GDP). This balance is explained by the growth of non-financial expenditure (19.3 percent of GDP) –up by 1.1 percentage points compared to September 2013–, while the ratio of revenue of the general government was equivalent to 22.8 percent of GDP, only 0.2 percentage points more than in the previous year.

    Moreover, in annual terms the economic balance of the non-financial public sector at September was equivalent to 0.3 percent of GDP, a lower balance than in the previous months due to the increase of public expenditure in Q3 in a context of stabilization of revenues due to the slowdown registered in the pace of growth of economic activity.

Graph 77
ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR
(Accumulate last 4 quarters - % GDP)

Graph 78
CURRENT REVENUES OF THE GENERAL GOVERNMENT
(Accumulate last 4 quarters - % GDP)

Graph 79
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT
(Accumulate last 4 quarters - % GDP)

By government levels, this lower economic balance in 2014 is explained mainly by the operations of the national government, whose balance declined from a surplus of 2.4 percent to a surplus of 1.2 percent. This was in part offset by a slight improvement in the balances of subnational governments, particularly in the balances of the regional governments which rose from a positive balance of 0.1 percent to a balance of 0.4 percent due to some difficulties in the implementation of their investment programs. The State-owned enterprises, on the other hand, showed a deficit of 0.1 percent, which contrasts with the surplus of 0.1 percent recorded in the first three quarters of 2013.

Graph 80
GROSS CAPITAL FORMATION OF THE GENERAL GOVERNMENT
(Accumulate last 4 quarters - % GDP)

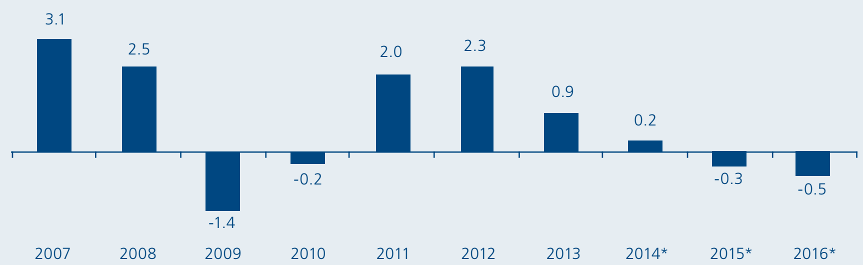
60. The economic balance of the non-financial public sector in **2014** is still projected to be equivalent to 0.2 percent of GDP –as estimated in the Inflation Report of July– given that the lower revenue of the general government would be offset by a lower non-financial expenditure. Current revenue would show a lower growth rate, declining from a real variation of 5.8 percent to a variation of 3.7 percent, in line with the lower dynamism of the economy. In **2015** and **2016**, the operations of the non-financial public sector would show negative balances of 0.3 and 0.5 percent, respectively.

Table 25
NON-FINANCIAL PUBLIC SECTOR
(% GDP)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
1. General government current revenues[1/]	**22.6**	**22.1**	**22.8**	**22.6**	**22.3**	**22.1**	**21.9**	**22.1**	**21.9**
Real % change	*2.5*	*3.7*	*3.8*	*5.8*	*3.7*	*3.4*	*3.8*	*6.1*	*6.2*
2. General government non-financial expenditure[2/]	**18.2**	**20.5**	**19.3**	**21.3**	**21.2**	**21.3**	**21.3**	**21.3**	**21.3**
Real % change	*12.4*	*11.2*	*9.0*	*7.8*	*6.5*	*6.3*	*6.1*	*6.1*	*6.3*
Of which:									
Current	13.2	14.3	14.3	15.0	15.1	15.0	15.2	14.7	14.9
Real % change	*10.0*	*10.6*	*11.9*	*8.7*	*8.2*	*5.6*	*6.4*	*4.4*	*4.4*
Gross capital formation	4.7	5.6	4.5	5.6	5.5	5.7	5.5	6.0	5.7
Real % change	*17.5*	*10.0*	*-0.8*	*3.4*	*-0.1*	*8.5*	*5.6*	*10.6*	*11.3*
3. Others	**0.3**	**0.3**	**0.0**	**-0.1**	**0.0**	**-0.1**	**-0.1**	**-0.2**	**-0.2**
4. Primary balance (1-2+3)	**4.7**	**2.0**	**3.6**	**1.2**	**1.1**	**0.7**	**0.6**	**0.5**	**0.4**
5. Interests	**1.3**	**1.1**	**1.1**	**1.0**	**1.0**	**1.0**	**0.9**	**1.0**	**0.9**
6. Overall Balance	**3.4**	**0.9**	**2.4**	**0.2**	**0.2**	**-0.3**	**-0.3**	**-0.5**	**-0.5**

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.
* Forecast.
IR: Inflation Report.

Graph 81
ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2007-2016
(% GDP)



* Forecast.

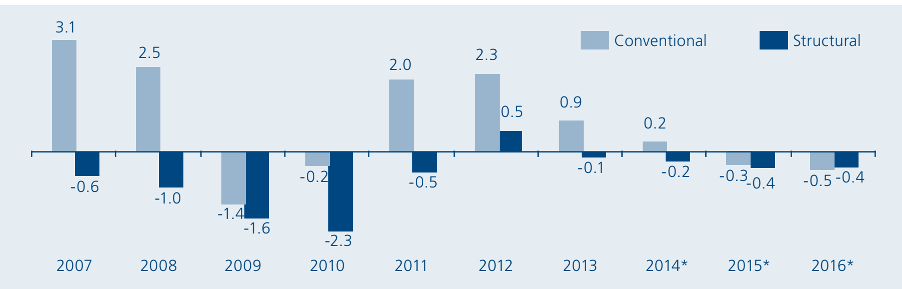
Fiscal Impulse

61. The **structural economic balance** is the balance that fiscal accounts would show if the output were at its trend level and if the international prices of the country's mining and hydrocarbon exports were at their long-term levels. The structural economic balance is calculated isolating the effect of the business cycle and of the higher prices of mining and hydrocarbon exports on the revenue of the general government. In 2014 the structural economic balance would show a deficit of 0.2 percent of GDP, while in 2015 and 2016 the structural deficit would be equivalent to 0.4 in both years.

The change in the structural balance determines the **fiscal impulse**. This indicator shows the effect of fiscal policy on domestic demand isolating the effects of the economic cycle. Although lower than expected in the Inflation Report of July, the fiscal impulse shows a counter-cyclical position in fiscal policy in 2014 and 2015, which would contribute to mitigate the lower dynamism of private spending.

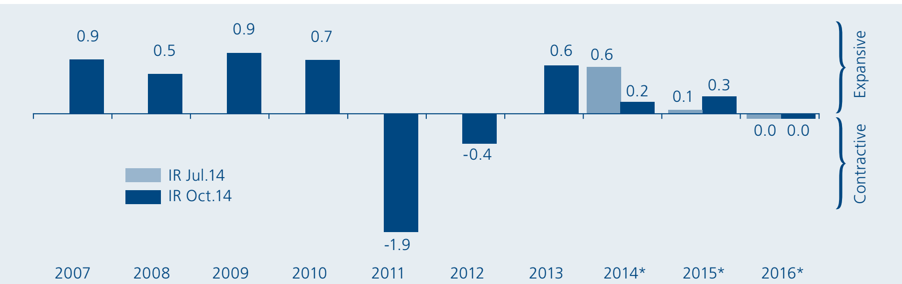
62. The fiscal projections included in this report are consistent with the rules set forth in the Accountability and Fiscal Transparency Reinforcement Act (Law 30099 dated October 31, 2013) which establishes that the balance of the non-financial public sector in **2014** cannot register a deficit, while the goal ex ante for the structural fiscal balance in **2015** and **2016** is a deficit of 1 percent of GDP. Ceilings consistent with the structural deficit rule have been established for the non-financial spending of the general government (Supreme Decree 084-2014-EF, dated April 25, 2014).

Graph 82
CONVENTIONAL AND STRUCTURAL ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2007-2016
(% GDP)



* Forecast.

Graph 83
FISCAL IMPULSE[1/]: 2007 - 2016
(% GDP)



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

Fiscal Revenues

63. In January-September 2014, the current revenue of the general government grew 3.8 percent compared to the same period in 2013. This increase is explained mainly by the growth of revenues from the income tax (5.5 percent) as a result of the regularization of tax payments, which in the period increased by 16.4 percent, as well as by some exceptional revenue associated with the income tax paid by non-residents for capital earnings generated by the sale of shareholdings of companies incorporated in the country. The payment of S/. 1.47 billion for the sale of a mining company made in the month of August stands out in this group. On the other hand, the pace of growth of revenues from the value added tax slowed down in this period, with revenues from the VAT even showing a negative growth rate (-1.5 percent) in Q3-2014.

Table 26
CURRENT REVENUES OF THE GENERAL GOVERNMENT
(Real % change)

	2013			2014
	Jan.-Sep.	Q4	Year	Jan.-Sep.
TAX REVENUES	**2.1**	**7.9**	**3.6**	**4.0**
Income tax	-5.8	-0.8	-4.7	5.5
Value added tax	5.3	6.5	5.6	2.9
Excise tax	10.6	1.9	8.4	-10.8
Import duties	7.9	10.7	8.7	3.7
Other tax revenues	20.4	35.1	24.7	-0.3
Tax returns	5.1	-1.9	3.5	-6.6
NON-TAX REVENUES	**3.6**	**5.9**	**4.2**	**3.1**
TOTAL	**2.5**	**7.5**	**3.7**	**3.8**

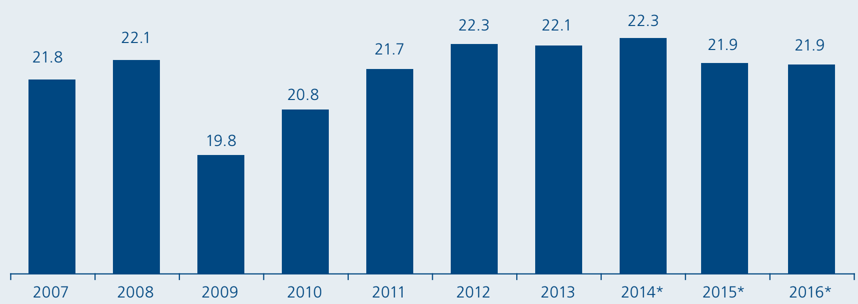
64. In 2014 current revenues would increase by 3.7 percent in real terms –less than estimated in the Inflation Report of July (5.8 percent)–, reflecting the lower dynamism of economic activity. This variation considers that, in the rest of the year, the treasury will continue receiving some extraordinary payments from the sale of shareholdings that would generate capital gains. Thus, a rate of 22.3 percent would be reached in 2014. In 2015 this ratio would decline to 21.9 percent given that no extraordinary revenue is foreseen, while in 2016 revenues would register a growth rate of 6.2 percent, which is consistent with the economy's pace of growth foreseen for that year and with a rate of 21.9 in current revenues.

Table 27
CURRENT REVENUES OF THE GENERAL GOVERNMENT
(% GDP)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
TAX REVENUES	**17.0**	**16.8**	**17.3**	**17.2**	**16.9**	**16.8**	**16.5**	**16.9**	**16.6**
Income tax	7.0	6.7	7.2	7.1	7.0	6.5	6.5	6.6	6.6
Value added tax	8.9	8.7	8.9	8.8	8.7	8.9	8.7	8.9	8.7
Excise tax	1.1	1.0	0.9	1.0	0.9	1.0	0.9	0.9	0.9
Import duties	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other tax revenues	2.0	2.1	1.9	2.0	2.0	2.0	1.9	1.9	1.9
Tax returns	-2.2	-2.1	-2.0	-1.9	-1.9	-1.8	-1.9	-1.8	-1.8
NON-TAX REVENUES	**5.6**	**5.4**	**5.6**	**5.4**	**5.4**	**5.3**	**5.4**	**5.2**	**5.4**
TOTAL	**22.6**	**22.1**	**22.8**	**22.6**	**22.3**	**22.1**	**21.9**	**22.1**	**21.9**

* Forecast.
IR: Inflation Report.

Graph 84
CURRENT REVENUES OF THE GENERAL GOVERNMENT: 2007 - 2016
(% GDP)



* Forecast.

Revenue from the income tax in **2014** would be equivalent to 7.0 percent of GDP –a higher ratio than in 2013 (6.7 percent), due mainly to the exceptional tax payments made during the year. On the other hand, the revenue from the VAT in 2014 is expected to remain at 8.7 percent of GDP.

Evolution of Public Spending

65. In the period of January-September 2014, the non-financial expenditure of the general government grew 9.0 percent, with higher current spending (11.9 percent) accounting for this growth rate, while spending in gross capital formation dropped by 0.8 percent. By levels of government, this growth was driven by spending in the national Government (13.7 percent), both current expenditures (14.4 percent) and spending in gross capital formation (4.2 percent). Moreover, spending in regional governments grew 5.4 percent due to increased current spending (up 10.1 percent), which contrasted with the decline observed in gross

capital formation (5.2 percent). On the other hand, spending in local governments fell 0.1 percent.

The slow implementation of investment expenditure, especially at the level of sub-national governments, is partly explained by the administrative measures taken to assess projects and improve spending in regional and local governments since the beginning of the year, which in the short term have generated a temporary lower pace of spending in project implementation. These measures required the executing unit to maintain project costs and project feasibility updated in the Integrated Financial Information System (IFIS) –Sistema Integrado de Información Financiera (SIAF)– in order that accrual expenses may be approved. Another factor that has contributed to this lower pace of spending has been the temporary suspension of the accounts of some sub-national governments.

Table 28
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT
(Real % change)

	2013			2014
	Jan.-Sep.	Q4	Year	Jan.-Sep.
Current expenditure	**10.0**	**11.9**	**10.6**	**11.9**
National Government	11.0	16.6	12.9	14.4
Regional Governments	10.6	5.1	8.8	10.1
Local Governments	4.5	-3.5	2.1	2.1
Capital expenditure	**19.1**	**4.0**	**12.6**	**1.4**
Gross capital formation	**17.5**	**0.2**	**10.0**	**-0.8**
National Government	18.7	1.3	11.0	4.2
Regional Governments	19.0	-13.1	4.5	-5.2
Local Governments	15.9	7.3	12.3	-1.8
Others	**43.7**	**71.9**	**54.7**	**27.5**
Total	**12.4**	**9.1**	**11.2**	**9.0**
National Government	12.8	15.7	13.8	13.7
Regional Governments	13.2	-2.5	7.5	5.4
Local Governments	10.5	3.4	7.9	-0.1

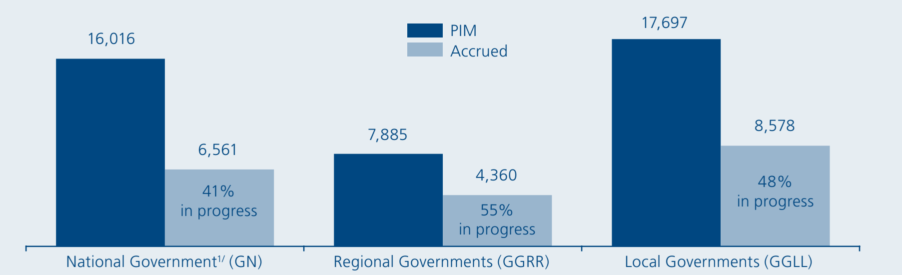
Non-financial expenditure accelerated in Q3 due to increased current spending at the national government and regional governments, associated mainly with measures related to salaries and pensions.

In July the Government enacted **Emergency Decree 001-2014** (dated July 11) which approved a supplementary credit of S/. 1.74 billion to pay accruals associated with the benefit authorized by Emergency Decree 037-94 and the payment of a special bonus in July. In addition, this decree also established that the agencies of the national, regional and local governments could reallocate budgeted investment spending to maintenance costs until August 15, 2014, and also authorized a program of up to S/. 400 million for the maintenance and furnishing of school infrastructure and premises through the reallocation of the budget spending that depends on the Ministry of Education. Finally, **Emergency Decree 002-2014** (of July 28) approved spending for S/. 1.21 billion, including the reallocation of S/. 710 million to advance some remuneration adjustments and benefits to members of the Armed Forces, the National Police, and health sector workers. The decree also allocated S/. 500 million for the family housing bonus (Bono Familiar Habitacional) and the good payer bonus (Bono del Buen Pagador) which will be funded by a loan of Banco de la Nación to Fondo Mivivienda.

In January-September, investment in the public sector amounted to S/. 19.50 billion, which represents 47 percent of the Presupuesto Institucional Modificado (S/. 41.60 billion). At present, regional governments show the higher rate of budget implementation with 55 percent, followed by the national Government with 48 percent, and local governments with 41 percent.

Of the total spending in investment implemented, subnational governments account for 66 percent, while the national government accounts for 34 percent.

Graph 85
PUBLIC INVESTMENT OF THE BUDGET: JAN. - SEP. 2014
(Million nuevos soles)



1/ National Government investment in the Budget differs from National Government investment in Fiscal Accounts, due to this latter includes Essalud and charities institutions and also excludes the investment of defense and interior sectors.

Public investment included in the Ministry of Economy's Integrated Financial Information System (IFIS) can be broken down into projects and activities. At September, the 2014 budget registers 38,838 projects that have a PIM (Modified Institutional Budget) and show a progress of 48 percent on average. The largest number of projects, 76 percent of the total, are projects carried out by local governments, although these are usually small projects given the amounts of funds involved.

Table 29
BUDGET INVESTMENT ON THE PUBLIC SECTOR
(Million nuevos soles)

	PIM	Devengado	% Advance
National Government	**16,016**	**6,561**	**41%**
Projects	**13,531**	**5,949**	**44%**
4, 004 projects in progress	13,033	5,737	44%
Projects management	145	102	70%
Pre-investment estudies	353	110	31%
Activities	**2,485**	**613**	**25%**
Regional Governments	**7,885**	**4,360**	**55%**
Projects	**7,544**	**4,250**	**56%**
5,322 projects in progress	7,180	4,024	56%
Projects management	134	86	64%
Pre-investment estudies	231	141	61%
Activities	**341**	**110**	**32%**
Local Governments	**17,697**	**8,578**	**48%**
Projects	**17,697**	**8,578**	**48%**
29,512 projects in progress	16,845	8,140	48%
Pre-investment estudies	498	261	52%
Activities	**354**	**177**	**50%**
TOTAL INVESTMENT	**41,598**	**19,499**	**47%**
Projects	**38,418**	**18,600**	**48%**
38,838 projects in progress	37,057	17,901	48%
Projects management	279	188	67%
Pre-investment estudies	1,081	511	47%
Activities	**3,180**	**899**	**28%**

Source: MEF.

At September, 4,004 projects of the **national government** have a PIM assigned in the 2014 budget. Of these projects, 40 percent of have been implemented by 10 percent or less. This group of projects represents about 31 percent of the PIM. In addition, another 23 percent of projects show a level of project implementation of over 90 percent, but they represent only 4 percent of the budget.

Table 30
PUBLIC INVESTMENT PROJECTS OF THE NATIONAL GOVERNMENT

% in progress	Number of projects	% of total projects	PIM (Million S/.)	% of total PIM
10% or less	1,602	40	4,002	31
10% - 50%	718	18	1,384	11
50% - 90%	778	19	7,065	54
Over 90%	906	23	581	4
Total	**4,004**	**100**	**13,033**	**100**

Source: MEF.

Regional Governments have 5,322 projects, of which 32 percent have an implementation of 10 percent or less, while those that an implementation of over 90 percent represent 32 percent of this total. In terms of the funds involved, the weight of the latter group of projects is only 25 percent, which means that the investment amounts are on average lower than the investments amounts in the rest.

Table 31
PUBLIC INVESTMENT PROJECTS OF THE REGIONAL GOVERNMENTS

% in progress	Number of projects	% of total projects	PIM (Million S/.)	% of total PIM
10% or less	1,701	32	1,626	23
10% - 50%	709	13	1,117	16
50% - 90%	1,206	23	2,641	37
Over 90%	1,706	32	1,795	25
Total	**5,322**	**100**	**7,180**	**100**

Source: MEF.

Projects being carried out by the **local governments** total 29,512, of which 26 percent has already been implemented by 10 percent or less, while projects implemented by 90 percent or more represent 38 percent of this total. In terms of fund amounts, the latter group represents 20 percent, which means that, just like in other government levels, the investment amounts of this group of projects are smaller than the rest on average.

Table 32
PUBLIC INVESTMENT PROJECTS OF THE LOCAL GOVERNMENTS

% in progress	Number of projects	% of total projects	PIM (Million S/.)	% of total PIM
10% or less	7,804	26	4,627	27
10% - 50%	3,651	12	3,593	21
50% - 90%	6,727	23	5,320	32
Over 90%	11,330	38	3,306	20
Total	**29,512**	**100**	**16,845**	**100**

Source: MEF.

66. In **2014** non-financial expenditure would grow by a real 6.5 percent, less than projected in the July report (7.8 percent). This projection considers that current spending would slow down and that the investment of the general government would grow in Q4, whereas public investment in the subnational governments would decline.

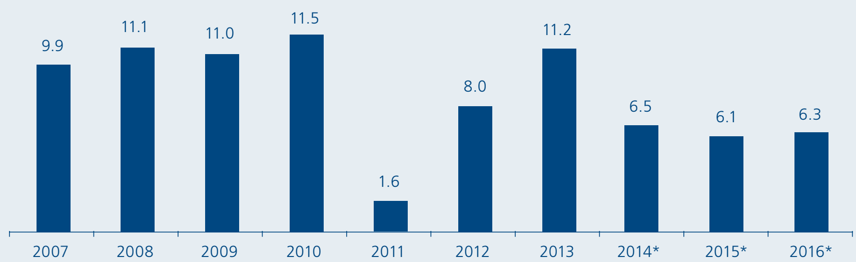
Table 33
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT
(% GDP)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
Current expenditure	**13.2**	**14.3**	**14.3**	**15.0**	**15.1**	**15.0**	**15.2**	**14.7**	**14.9**
National Government	8.7	9.7	9.7	10.3	10.3	10.3	10.3	10.1	10.1
Regional Governments	2.7	2.8	2.9	2.8	3.0	2.9	3.0	2.9	3.0
Local Governments	1.8	1.8	1.8	1.8	1.8	1.9	1.8	1.8	1.8
Capital expenditure	**5.1**	**6.1**	**5.0**	**6.2**	**6.1**	**6.3**	**6.1**	**6.6**	**6.4**
Gross capital formation	**4.7**	**5.6**	**4.5**	**5.6**	**5.5**	**5.7**	**5.5**	**6.0**	**5.7**
National Government	1.4	1.7	1.4	1.8	1.9	2.0	2.0	2.0	2.0
Regional Governments	1.1	1.3	1.0	1.3	1.2	1.2	1.1	1.3	1.2
Local Governments	2.1	2.6	2.0	2.5	2.4	2.5	2.4	2.7	2.5
Others	**0.4**	**0.5**	**0.5**	**0.6**	**0.6**	**0.6**	**0.6**	**0.6**	**0.6**
Total	**18.2**	**20.5**	**19.3**	**21.3**	**21.2**	**21.3**	**21.3**	**21.3**	**21.3**
National Government	10.4	11.9	11.5	12.7	12.7	12.8	12.9	12.7	12.7
Regional Governments	3.8	4.1	3.9	4.1	4.1	4.1	4.2	4.1	4.2
Local Governments	4.0	4.5	3.9	4.4	4.3	4.4	4.3	4.5	4.3

* Forecast.
IR: Inflation Report.

67. In **2015** the non-financial expenditure of the general government is estimated to be equivalent to 21.3 percent of GDP due mainly to increased current spending, whose ratio in GDP terms would rise from 15.1 percent in 2014 to 15.2 percent of GDP in 2015. It should be pointed out that the Accountability and Fiscal Transparency Reinforcement Act establishes that as from 2015 "the non-financial expenditure of the national government in permanent or temporary personnel, whatever their labor and pension regime, cannot be higher than the limit established by applying the potential GDP growth rate in nominal terms to the estimated limit of non-financial expenditure for personnel and pensions in the previous year". The projection of capital spending not only includes the resources allocated to public projects, but also includes those to be implemented as a result of public-private partnerships (PPPs), such as Chavimochic Stage III, Stretch 2 of Longitudinal de la Sierra, and Lima's Metro Line 2.

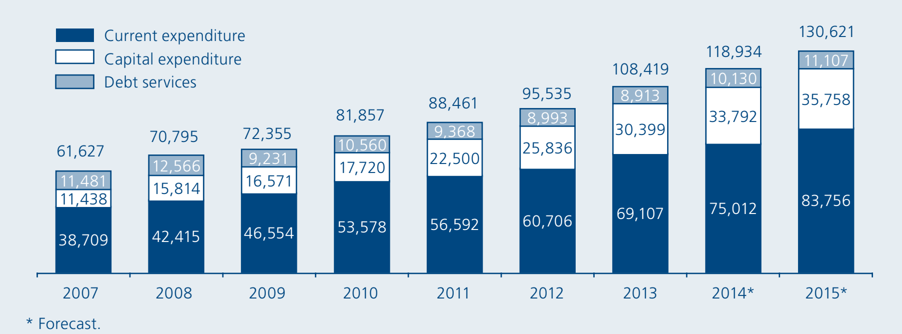
Graph 86
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT: 2007 - 2016
(Real % change)



* Forecast.

68. The Ministry of Economy and Finance (MEF) has submitted the Budget bill for 2015 to Congress. Total resources amount to S/. 130.62 billion, which represents a nominal increase of 9.8 percent compared to the initial budget for year 2014. Non-financial expenditure amounts to S/. 119.51 billion, a figure 9.8 percent higher than the one considered in the initial budget for 2014. The result-oriented budget for 2015 through 85 budget programs amounts to 58 percent of non-financial non-pension spending, which represents a step forward compared with the ratio of 51 percent registered in 2014. In terms of the funds involved, the most important public investment project included in the 2015 budget is the construction of Line 2 and the Av. Faucett-Gambetta stretch of the Basic Network of the Metro of Lima and Callao which amounts to S/. 1.14 billion. It should be pointed out that the budget differs from the fiscal accounts due to methodological differences in terms of institutional coverage. For example, the budget does not include the operations of EsSalud, public charity organizations, or non-financial public enterprises, among others. It is also worth pointing out that between 2007 and 2014 the resources considered in the opening institutional budget (OIB) have grown at a nominal rate of 10 percent on average, which is the same average growth rate of the revenue of the general government in the same period.

Graph 87
OPENING INSTITUTIONAL BUDGET: 2007 - 2015
(Million nuevos soles)



* Forecast.

Public Debt

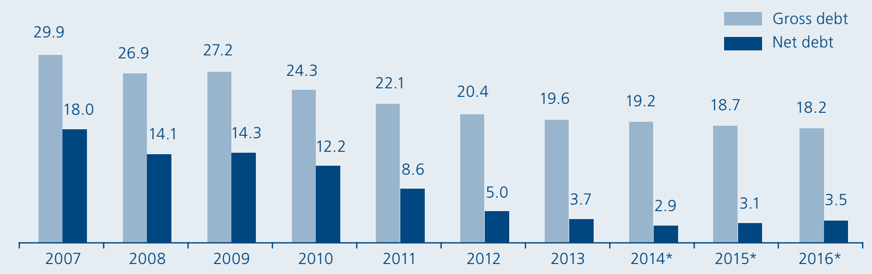
69. The economic balance projected for 2014 (0.2 percent of GDP) implies that financial requirements would amount to S/. 3.2 billion, a figure higher than the one estimated in the Inflation Report of July. These financing requirements will be met with external disbursements and bond placements, which cover the treasury's financial requirements and strengthen its financial position. Therefore, the balance of the gross debt of the non-financial public sector is expected to decline in the forecast horizon to 18.2 percent of GDP in 2016.

Table 34
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR AND ITS FUNDING
(Million nuevos soles)

	2013		2014*			2015*		2016*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14	IR Jul.14	IR Oct.14
I. Uses	**-6,267**	**3,028**	**-8,123**	**2,880**	**3,177**	**8,088**	**8,304**	**8,244**	**9,342**
1. Amortization	7,123	7,859	2,136	4,030	4,080	5,916	6,183	5,129	6,148
a. External	5,682	6,223	1,214	2,730	2,807	2,450	2,464	3,530	3,636
b. Domestic	1,441	1,637	923	1,300	1,273	3,466	3,720	1,599	2,512
Of which:									
Recognition bonds	342	448	407	600	594	548	768	565	763
2. Overall balance	-13,390	-4,832	-10,259	-1,150	-903	2,172	2,120	3,115	3,194
(Negative sign indicates surplus)									
II. Sources	**-6,267**	**3,028**	**-8,123**	**2,880**	**3,177**	**8,088**	**8,304**	**8,244**	**9,342**
1. External	571	954	1,544	3,306	2,611	5,795	5,278	4,154	4,719
2. Bonds 1/	3,499	4,025	3,127	3,682	3,484	2,350	2,883	5,220	4,951
3. Internal 2/	-10,337	-1,952	-12,793	-4,108	-2,919	-57	143	-1,131	-328
Memo:									
% GDP									
Gross debt balance	18.5	19.6	18.5	19.2	19.2	18.6	18.6	18.0	18.2
Net debt balance 3/	2.1	3.7	1.6	2.8	2.9	3.1	3.1	3.4	3.5

1/ Includes domestic and external bonds.
2/ A positive sign indicates a withdrawal or overdraft and a negative sign indicates higher deposit.
3/ Defined as the difference between gross public debt and NFPS deposits.
* Forecast.
IR: Inflation Report.

Graph 88
NON-FINANCIAL PUBLIC SECTOR DEBT: 2007 - 2016
(% GDP)



* Forecast.

Box 2
PUBLIC INVESTMENT MULTIPLIERS

A subject-matter discussed both in theoretical and empirical terms since the early beginnings of macroeconomics as a discipline has been the analysis of the impact of fiscal policy on macroeconomic variables. This discussion was taken up with renewed interest as a result of the international financial crisis.

The estimates of the size of the fiscal multiplier show differences depending on various factors: the structural characteristics of the economy (degree of openness, financial integration, exchange rate regime), the existing monetary and financial conditions in the economy, the degree of nominal and real rigidity in the economy, as well as the position of the economy. The multiplier is usually higher when the output gap is negative.

On the other hand, the multiplier shows significant differences depending on the fiscal policy instrument used, that is, depending on whether the expansionary measure is carried out by increasing current spending or public investment or reducing taxes.

The latest issue of the IMF's World Economic Outlook (WEO) estimates the public investment multiplier in infrastructure at the international level and says that this instrument generates a greater effect on economic activity because it generates:

- A short-term impact. Like other spending components, investment in infrastructure stimulates aggregate demand due to the short-term spending multiplier. It also generates positive impacts on private investment because it is complemented with infrastructure services.
- A medium-term impact. Greater infrastructure increases the productive capacity of the economy.

The WEO estimates show that the impact of the public investment multiplier is around 1.5 in the same year and around 3.0 in the medium term (4 years) during periods of slower growth in the advanced economies, but that the effect is not statistically different from zero in periods of higher growth,.

In Peru, as the Inflation Report of December 2012 showed, when the economy goes through an expansionary phase, one additional nuevo sol in public investment generates S/. 0.73 in the long term, whereas when the economy is going through the phase of slower growth, one additional nuevo sol in public investment generates S/. 1.42 in GDP terms in the long term.

MULTIPLIER FISCAL

	Taxes1/	Current expenditure2/	Capital expenditure2/
Boom			
Short-term (impact)	[-0.01,0.00]	0.24	0.49
Long-term3/		0.28	0.73
Recession			
Short-term (impact)	[0.1,0.25]	0.24	0.49
Long-term3/		0.93	1.42

1/ Sanchez and Galindo (2013).
2/ Inflation Report December 2012.
3/ Using a 4-year horizont to compare against WEO data.

These impacts are greater than those generated by current expenditure. The multiplier of long-term current spending reaches 0.28 in the expansion phase and 0.93 in the recessive phase.

Moreover, Sanchez and Galindo (2013)[2] quantify the multiplier of taxes and point out that its impact is smaller than that of public expenditure and that, as in the case of spending, the impact of a tax cut is greater in the contraction phase.

The lower magnitude of the tax multiplier compared to public spending multiplier is consistent with economic theory, as reflected in:

- The impact on the demand for spending and income. An increase in public procurement generates a direct impact on the demand for goods, while a tax reduction generates an income effect whose impact will depend on economic agents' propensity to consume goods.
- Ricardian Equivalence. In the case of rational agents without liquidity constraints, given the level of public spending, a tax cut will not generate an increase in their consumption, because their wealth remains unchanged: the lower taxes today will be offset by higher taxes in the future.

Thus, government spending, and particularly spending in infrastructure, is a more efficient instrument to boost demand in a phase of slower growth.

2 Sanchez, William and Hamilton Galindo. "Multiplicadores Asimétricos del Gasto Público y de los impuestos en el Perú". Ministerio de Economía y Finanzas. February 2013.

V. Money and Financial Markets

Monetary Policy Actions

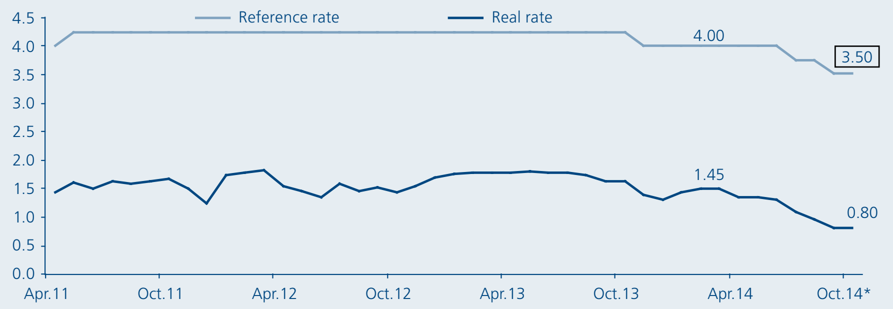
70. Since the publication of our last Inflation Report, the upward risks on the inflation forecast have declined substantially. On the one hand, the output gap shows no inflationary pressures on the side of demand and is now expected to be more negative and persistent than estimated in our report of July due to the slower pace of growth of investment and exports. Moreover, the supply factors that affected inflation in the first half of 2014 Q1 have continued subsiding and there is a lower risk that the country will be affected by an El Niño event. On the other hand, imported inflation has slowed down due to the decline observed in the international prices of the main food commodities and is expected to remain low in the forecast horizon.

    In this context, the Board of BCRP approved to reduce the benchmark interest rate from 3.75 to 3.50 percent in September, which in real terms was a reduction from 0.95 to 0.8 percent. This level of the benchmark rate is consistent with inflation's convergence to the 2.0 percent target in 2015, in a context of a weaker-than-expected economic cycle. As foreseen, the rate of inflation in the last 12 months returned to the target range in August.

    In addition to this, the Central Bank of Peru has continued adopting measures to ease its regime of reserve requirements in domestic currency in order to provide banks with liquidity in soles to facilitate the expansion of credit in this currency in a context in which deposits in soles showed a slower pace of growth than credit. The last reduction of the rate of required reserves –from 11.0 to 10.5 percent– came into effect in October. In addition and complementing this measure, the BCRP continued injecting liquidity into the financial system through auctions of 3-month to 24 month-FX-swaps and repos. These operations not only allow a better term matching between banks' assets and their liabilities, but also contribute to enhance the pass-through of the reduction of the policy interest rate to the other market interest rates.

71. The policy communiqués of the Board of the Central Bank in recent months have highlighted that the expected rates of inflation are within the target range and that the 12-month inflation rate will remain within the target range in the coming months as long as the supply conditions that affected inflation continue to normalize and that there are no demand pressures. The Board has also highlighted that the Central Bank oversees the inflation forecast and inflation determinants to take additional actions to ease its monetary policy instruments should this be required.

Graph 89
NOMINAL AND REAL REFERENCE INTEREST RATE
(%)



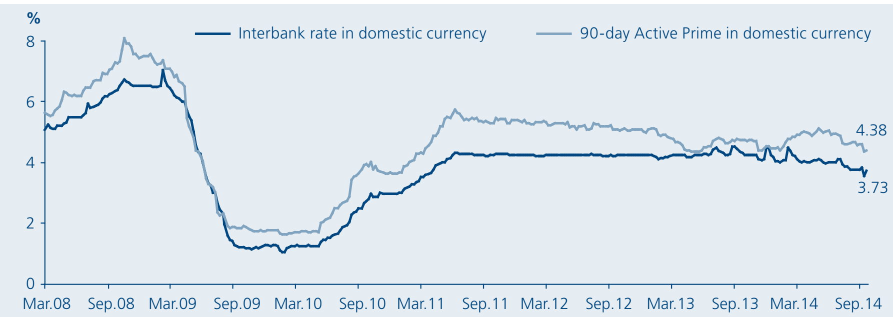
* Estimated.

Interest Rates and Monetary Operations

72. The interest rates in the money market during Q3 shrank, influenced by the two interest rate cuts of monetary policy rate adopted recently by the BCRP. The interest rate pass-through mechanism was reinforced through the injection of liquidity through repos with term securities and repos in foreign currency, which prevented greater upward pressures on the interbank interest rate in national currency derived from the high demand for loans in this currency.

    Thus, the interbank interest rate remained below (2 basis points), although very close to its reference level. On the other hand, after recording 4.92 percent at the end of June, the 90-day corporate prime rate fell 55 basis points and registered 4.38 percent at the end of September. This evolution of the lending short-term interest rates is consistent with the estimates of the pass-through effect analyzed in box 3.

Graph 90
90-DAY CORPORATE PRIME RATE VERSUS INTERBANK OVERNIGHT RATE IN DOMESTIC CURRENCY: MAR.08 - SEP.14



73. Moreover, the lending interest rates in domestic currency for the segment of large companies fell 60 basis points on average, from 7.5 to 6.9 percent, from the previous quarter, while the interest rates on mortgage and corporate loans fell 15 and 62 basis points, respectively. In contrast, the interest rates on loans for medium, small and micro enterprises and consumer loans increased, influenced by greater risk in these segments.

On the other hand, the interest rates on deposits in national currency for terms of less than 180 days fell between 12 and 16 basis points, while the interest rates on deposits with longer terms increased slightly (by 4 basis points). This reflects mainly the behavior of interest rates for corporate deposits, which are much more volatile than the interest rates for personal deposits, which have remained relatively stable in this period.

Table 35
INTEREST RATE BY TYPE OF LOANS IN DOMESTIC CURRENCY[1/]
(%)

	Corporate	Large companies	Medium-sized enterprises	Small businesses	Micro-businesses	Consumer	Mortgage
Dec.12	5.8	7.4	11.0	22.5	33.2	41.2	8.8
Dec.13	5.4	7.1	10.1	21.0	33.1	42.3	9.0
Jan.14	6.0	7.1	10.8	21.6	32.8	42.9	9.2
Mar.14	5.8	7.0	10.8	21.2	32.5	42.9	9.2
Jun.14	5.9	7.5	10.8	21.1	32.1	42.7	9.4
Jul.14	5.8	7.0	10.8	20.8	32.1	43.5	9.3
Aug.14	5.6	7.0	11.2	21.3	32.2	44.1	9.3
Sep.14	5.3	6.9	10.8	21.0	33.0	43.0	9.2
Accumulated change (bps)							
Sep.14-Jun.14	-62	-60	4	-8	85	35	-15
Sep.14-Dec.13	-12	-16	66	-5	-13	78	17
Sep.14-Sep.13	-24	-18	-6	-48	138	139	-9

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

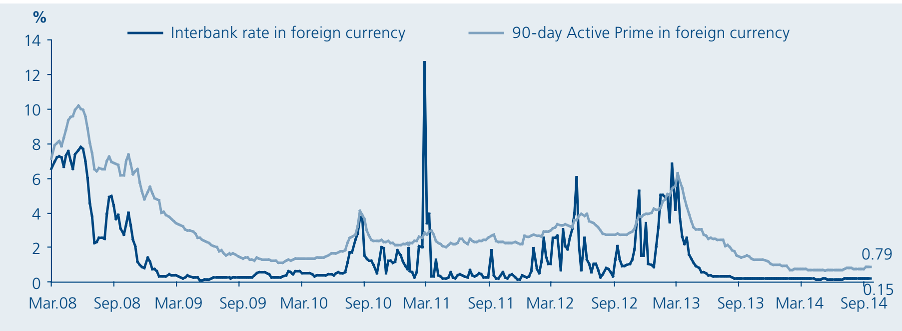
Table 36
INTEREST RATES IN NUEVOS SOLES
(%)

	Deposits up to 30 days	On 31 to 180-day term deposits	On 181 to 360-day term deposits
Dec.12	3.6	3.8	4.2
Dec.13	3.8	3.5	3.9
Jan.14	3.9	3.5	3.9
Mar.14	4.1	3.7	3.9
Jun.14	3.7	4.0	4.2
Jul.14	3.7	4.1	4.2
Aug.14	3.5	4.0	4.2
Sep.14	3.6	3.9	4.2
Accumulated change (bps)			
Sep.14-Jun.14	-16	-12	4
Sep.14-Dec.13	-20	39	37
Sep.14-Dec.12	-5	12	5

Source: BCRP.

74. Liquidity in foreign currency continued being widely available in Q3-2014, although the excess of liquidity in foreign currency dropped by US$ 480 million due to banks' greater use of FX-swap operations to obtain liquidity in local currency. The decline of liquidity in dollars was reflected in an increase of the interest rates on lending and deposit operations in dollars. Thus, the corporate prime interest rate for 90-day loans rose 17 basis points from June to a level of 0.79 percent.

Graph 91
90-DAY CORPORATE PRIME RATE VERSUS INTERBANK OVERNIGHT RATE IN FOREIGN CURRENCY: MAR.08 - SEP.14



However, the rates for loans in dollars declined compared to the previous quarter, especially the rates in the segments of mortgages (16 basis points), large enterprises (36 basis points), medium-sized companies (37 basis points), and small firms (2 basis points). The rates for consumer loans and loans to micro-enterprises continued to increase as a result of greater risk in these segment.

The interest rates on deposits in foreign currency also fell slightly, especially in the case of deposits with terms longer than 180 days (11 basis points).

Table 37
INTEREST RATE BY TYPE OF LOANS IN FOREIGN CURRENCY[1/]
(%)

	Corporate	Large companies	Medium-sized enterprises	Small businesses	Micro-businesses	Consumer	Mortgage
Dec.12	4.1	6.4	9.0	15.5	19.3	22.4	8.0
Dec.13	2.4	5.5	8.3	13.2	19.2	26.1	8.5
Jan.14	2.9	5.5	8.5	14.2	19.6	26.7	8.5
Mar.14	2.3	5.2	8.6	13.3	19.0	26.7	8.5
Jun.14	2.3	4.8	8.5	13.0	18.3	27.1	7.7
Jul.14	2.9	4.6	8.4	13.3	18.6	27.6	7.8
Aug.14	2.6	4.8	8.4	13.5	19.3	27.5	7.7
Sep.14	2.2	4.4	8.1	13.0	18.8	27.3	7.6
Accumulated change (bps)							
Sep.14-Jun.14	-5	-36	-37	-2	45	24	-16
Sep.14-Dec.13	-16	-106	-14	-22	-41	125	-88
Sep.14-Sep.13	-81	-161	-66	-75	235	177	-120

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

Table 38
INTEREST RATES IN US DOLLARS
(%)

	Deposits up to 30 days	On 31 to 180-day term deposits	On 181 to 360-day term deposits
Dec.12	1.8	1.3	1.7
Dec.13	0.2	0.7	1.3
Jan.14	0.1	0.7	1.2
Mar.14	0.1	0.5	1.1
Jun.14	0.1	0.5	1.0
Jul.14	0.2	0.5	0.9
Aug.14	0.2	0.5	0.9
Sep.14	0.2	0.5	0.9
Accumulated change (bps)			
Sep.14-Jun.14	6	0	-11
Sep.14-Dec.13	3	-24	-43
Sep.14-Dec.12	-158	-79	-79

Source: BCRP.

75. The operations of the Central Bank were mainly oriented to maintaining adequate levels of liquidity and reducing excessive volatility in the exchange rate. Thus, the BCRP injected liquidity placing FX-repos for a total of S/. 2.3 billion and 3-month repos for a total of S/. 3.25 billion. Most of the FX-repos operations, which had 3-month and 24-month maturities, were carried out in the months of July and September (S/. 700 million and S/. 1.5 billion, respectively). The average placement rate of these instruments was 3.8 percent. As regards the repos of securities, the distribution of the placements was similar, but the maturities ranged between one week and three months and the average rate of these instruments was 3.9 percent.

Table 39
INJECTION OPERATIONS
(Million nuevos soles)

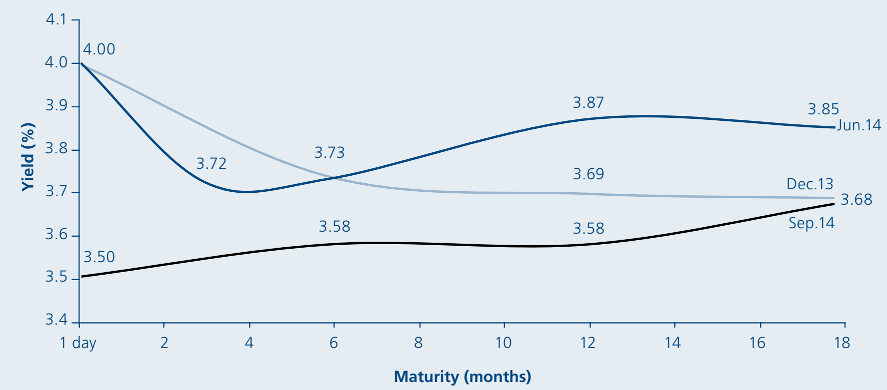
Date	Operation	Term	Amount	Average rate
Jul 3, 2014	REPO	3 months	200	4.35%
Jul 3, 2014	REPO - Currency	3 months	200	3.91%
Jul 4, 2014	REPO	3 months	200	4.36%
Jul 4, 2014	REPO - Currency	3 months	200	3.83%
Jul 11, 2014	REPO - Currency	24 months	300	3.67%
Aug 1, 2014	REPO	3 months	100	3.78%
Aug 1, 2014	REPO - Currency	3 months	100	3.82%
Aug 15, 2014	REPO	3 months	150	3.78%
Sep 4, 2014	REPO - Currency	3 months	300	3.84%
Sep 5, 2014	REPO - Currency	3 months	300	3.82%
Sep 8, 2014	REPO - Currency	3 months	300	3.73%
Sep 12, 2014	REPO	3 months	300	3.71%
Sep 12, 2014	REPO - Currency	3 months	300	3.75%
Sep 30, 2014	REPO	3 months	300	3.50%
Sep 30, 2014	REPO - Currency	3 months	300	3.92%
TOTAL			**3,550**	

The BCRP intervened in the foreign exchange market in August and September, with a net sale of US$ 516 million in the spot market. In addition to this, it placed BCRP-CDRs for an amount equivalent to US$ 1.61 billion.

The BCRP also continued with its regular auctions of 6-month, 12-month, and 18-month BCRP-CDs three times a week, placing CDs for a total of S/. 100 million each time in order to increase the volume of these certificates and provide more liquidity to the secondary market of CDs. Between July and September, the Central Bank placed CDs for a total of S/. 6.3 billion (S/. 1.22 billion in net terms).

The yield curve of the BCRP-CDs reflected the impact of the decline of the benchmark rate. Thus, the rate of the 6-month CDs and 12-month CDs fell from 3.73 to 3.58 percent and from 3.69 to 3.58 percent, respectively.

Graph 92
YIELD CURVE OF CENTRAL BANK SECURITIES[1/]



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

As a result of the these liquidity injection operations, the ratio of instruments issued by the BCRP relative to total liabilities of the Central Bank decreased from representing 13.2 percent of international reserves in December 2013 to 8.4 percent in September 2014. Moreover, the ratio of reserve requirements declined from 31.0 to 27.1 percent in the same period. The share of required reserves in soles dropped from 9.1 to 4.9 percent of NIRs, while the share of required reserves in dollars rose from 21.9 to 22.2 percent. Public sector deposits, which continued to be the largest source of sterilization, went from representing 36.3 percent of reserves in December 2013 to 43.6 percent of reserves in September.

Table 40
SIMPLIFIED BALANCE SHEET OF THE BCRP
(As % of Net International Reserves)

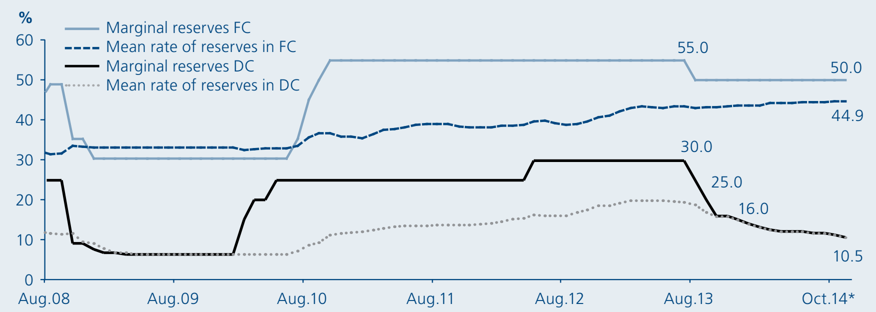
		Dec.13	Sep.14
Net assets			
I.	**Net International Reserves**	**100.0%** (US$ 65,663 mills)	**100.0%** (US$ 64,453 mills)
Net liabilities			
II.	**Total public sector deposits**	**36.3%**	**43.6%**
	In domestic currency	19.9%	27.0%
	In foreign currency (Million US$)	16.4%	16.6%
III.	**Deposits by reserve requirements**	**31.0%**	**27.1%**
	In domestic currency	9.1%	4.9%
	In foreign currency (Million US$)	21.9%	22.2%
IV.	**BCRP instruments**	**13.2%**	**8.4%**
	CD BCRP	10.3%	7.3%
	CDR BCRP	1.7%	3.2%
	Overnight deposits	1.7%	1.6%
	Repos - Currency[1/]	0.0%	-0.9%
	Repos - Certificates[1/]	-0.5%	-2.7%
V.	**Currency**	**19.2%**	**19.2%**
VI.	**Others**	**0.3%**	**1.7%**

1/ Negative sign indicates operation of liquidity injection.

Reserve Requirements

76. The BCRP has been easing its regime of reserve requirements in domestic currency in order to provide banks with liquidity in soles so that they can meet the increased demand for credit in soles in a context in which deposits in this currency have been growing at low rates. Thus, the Central Bank has gradually reduced mean reserve requirements from 20.0 percent in May 2013 to 10.5 percent in October 2014, releasing liquidity for approximately S/. 10.14 billion. In July the rate of mean reserve requirements in domestic currency was lowered from 12.5 to 11.5 percent, in September it was lowered from 11.5 to 11.0 percent, and in October it was lowered from 11.0 to 10.5 percent.

Graph 93
RATES OF RESERVE REQUIREMENTS IN DOMESTIC AND FOREIGN CURRENCY
(As % of total obligations subject to legal requeriments)



* Forecast.

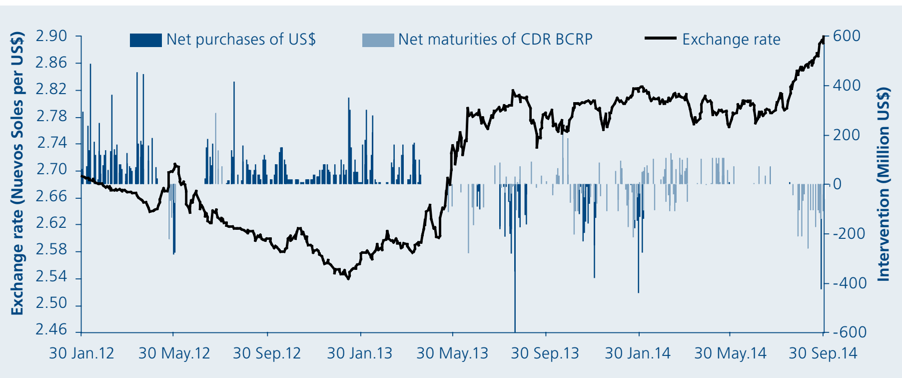
Table 41
RESERVE REQUIREMENTS MEASURES

	Domestic Currency			Foreign currency				
				General regime			Foreign liabilities	
	Marginal reserve requirement on deposits	Increase in the mean reserve requirement	Maximum of mean reserve requirement	Marginal reserve requirement on deposits	Increase in the mean reserve requirement	Maximum of mean reserve requirement	Short-term	Foreign trade
May.12	30%	0.50%		55%	0.50%		60%	60%
Sep.12	30%	0.50%		55%	0.50%		60%	25%
Oct.12	30%	0.50%		55%	0.50%		60%	25%
Nov.12	30%	0.75%		55%	0.75%		60%	25%
Jan.13	30%	0.25%		55%	0.75%		60%	25%
Feb.13	30%	-.-		55%	1.00%		60%	25%
Mar.13	30%	-.-		55%	0.50%		60%	25%
Apr.13	30%	-.-		55%	0.25%		60%	25%
May.13	30%	-.-		55%	-.-		60%	25%
Jun.13	30%	-.-	20%	55%	-.-		60%	25%
Aug.13	25%	-.-	19%	50%	-.-	45%	50%	20%
Sep.13	20%	-.-	17%	50%	-.-	45%	50%	20%
Oct.13	16%	-.-	16%	50%	-.-	45%	50%	20%
Dec.13	15%	-.-	15%	50%	-.-	45%	50%	20%
Jan.14	14%	-.-	14%	50%	-.-	45%	50%	14%
Feb.14	13%	-.-	13%	50%	-.-	45%	50%	13%
Mar.14	12.5%	-.-	12.5%	50%	-.-	45%	50%	0%
Apr.14	12%	-.-	12%	50%	-.-	45%	50%	0%
Jul.14	11.5%	-.-	11.5%	50%	-.-	45%	50%	0%
Sep.14	11.0%	-.-	11.0%	50%	-.-	45%	50%	0%
Oct.14	10.5%	-.-	10.5%	50%	-.-	45%	50%	0%

Exchange Rate and Intervention in the Foreign Exchange Market

77. During the first half of Q3-2014, the exchange rate fluctuated in line with the evolution of international markets which reflected the stabilization of risk aversion regarding the emerging economies. Between June and mid-August, the nuevo sol depreciated 0.14 percent, from S/. 2.800 per dollar at the end of June to S/. 2.804 per dollar at August 15. However, greater depreciatory pressures on the local currency were observed since the second week of August. As a result, the exchange rate went from S/. 2.804 per dollar in mid-August to S/. 2.888 per dollar in September (showing a variation of 3.0 percent), reflecting the strengthening of the dollar due to increased optimism regarding the recovery of the U.S. economy.

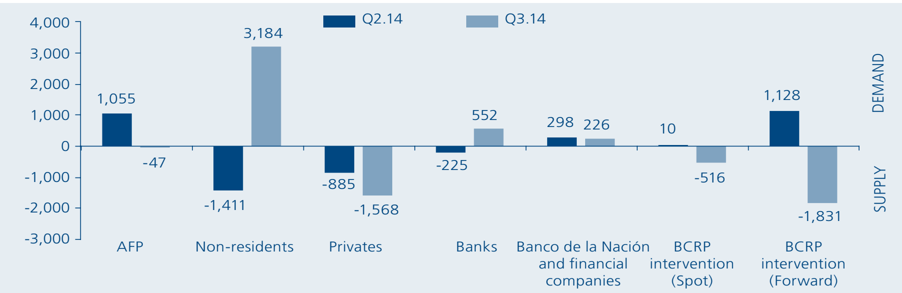
Graph 94
INTERVENTION IN THE FOREIGN EXCHANGE MARKET AND EXCHANGE RATE



In contrast with Q2, a net demand for dollars was observed in Q3. This demand, which amounted to US$ 2.35 billion, came mainly from non-residents who changed their selling position in Q2 (US$ 1.41 billion) for a buying position in Q3 (US$ 3.18 billion). This demand was mainly observed in the market of derivatives –US$ 2.44 billion– and reflected non-residents demand for foreign currency to cover their positions in treasury bonds in domestic currency.

In this context, the BCRP began its interventions with net placements of BCRP-CDR (US$ 1.83 billion) and also intervened to a lesser extent in the spot market, with net sales of FC amounting to US$ 516 million in Q3.

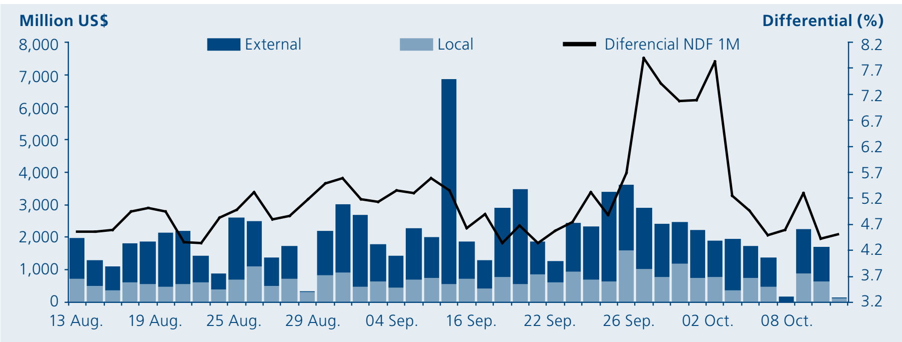
Graph 95
FOREX MARKET FLOWS - SPOT AND FORWARD
(Million US$)



As from October, the Central Bank started using FX Swaps –a new foreign exchange instrument–, auctioning FX swaps for a total of S/. 300 million in each auction and reaching a total sale of S/. 900 million at October 7. In this type of foreign exchange Swap, the BCRP undertakes to pay a fixed interest rate on a nominal amount of dollars while the participating entity undertakes to pay a variable interest rate on the nominal amount in soles. The advantage of this type of foreign exchange transactions is that they provide a hedge asset to financial entities' forwards without altering banks' liquidity in soles given that only net flows of interests are exchanged when these instruments mature.

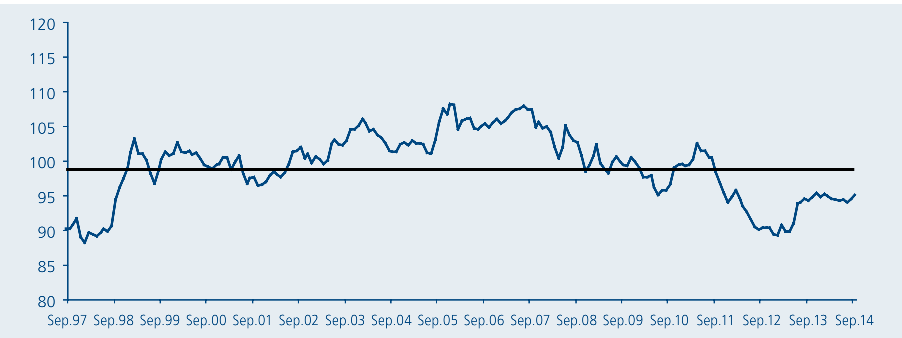
The BCRP intervention in the forward market through the new FX-Swap has contributed to reduce the spread between the interest rates implicit in 1-month forwards-purchase from 7.1 percent at the end of September to 4.5 percent at October 13.

Graph 96
TRADING AMOUNT OF FORWARD PEN AND DIFFERENTIAL NDF 1M PURCHASE



78. Between December 2013 and September 2014, the index of the multilateral real exchange rate remained stable around 95. Compared to September 2013, the multilateral real exchange rate index has depreciated 0.9 percent as a result of a higher depreciation of the nuevo sol.

Graph 97
MULTILATERAL RER
(Index 2009 = 100)



Liquidity and Credit

79. Between June and September 2014, the rate of mean currency in circulation grew slightly, increasing from 7.4 to 10.3 percent in annual term, which would be reflecting a faster pace of economic activity than in the previous months. The demand for currency is expected to increase over the next months to levels

closer to 10 percent, reflecting a recovery in the pace of growth of economic activity, while in 2015 it is expected to grow around 12 percent in annual terms.

Liquidity in domestic currency recovered in Q3, recording an annual growth rate of 8.1 percent in August (5.6 percent in June). This was associated with the increase observed in the rate of growth of currency in circulation and deposits in domestic currency, especially individuals' savings and term deposits.

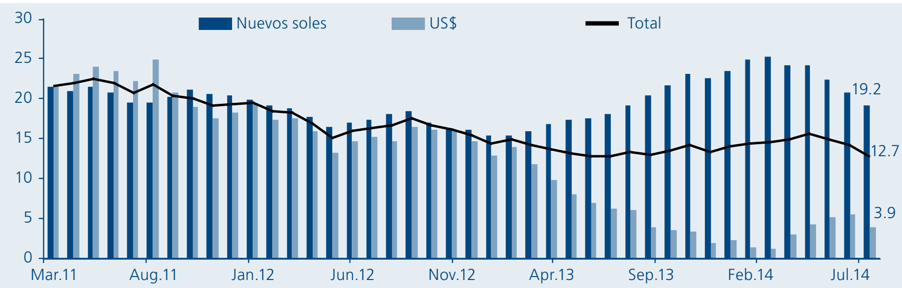
Table 42
MONETARY ACCOUNTS (END-OF-PERIOD)
(12 month % change)

	Dec.09	Dec.10	Dec.11	Dec.12	Mar.13	Jun.13	Sep.13	Dec.13	Mar.14	Jun.14	Aug.14
Currency in circulation	11.0	25.4	13.0	18.3	17.6	16.2	13.3	9.3	8.5	7.7	8.6
Deposits in domestic currency	16.7	32.3	17.7	24.8	23.6	21.1	13.9	11.2	4.4	5.0	7.7
Broad money in domestic currency	14.4	30.7	16.6	23.1	22.7	20.3	14.1	10.8	5.7	5.6	8.1
Broad money[1/]	10.9	23.2	16.8	14.1	13.9	13.8	13.8	11.3	10.2	8.5	6.6
Credit to the private sector in domestic currency	17.9	21.2	20.4	16.0	15.9	17.6	20.3	22.5	25.3	22.4	19.2
Credit to the private sector	8.9	21.2	19.4	15.4	14.1	12.8	12.8	13.2	14.6	14.9	12.7

1/ Includes foreign currency.

80. So far in Q3, credit to the private sector shows a slower pace of growth. In August, credit to the private sector grew 12.7 percent, with credit in soles showing greater dynamism (19.2 percent). Credit in dollars grew 3.9 percent. The slowdown in the expansion of credit reflects mainly the lower dynamism of economic activity observed in Q2.

Graph 98
CREDIT TO THE PRIVATE SECTOR
(12 month % change)



		Dec.12	Mar.13	Jun.13	Sep.13	Dec.13	Mar.14	Jun.14	Jul.14	Aug.14
Nuevos soles	Monthly flows (Million S/.)	1,660	1,748	2,330	2,675	1,430	2,619	1,060	687	1,369
	Monthly % change	1.8	1.8	2.3	2.5	1.2	2.2	0.8	0.5	1.1
	Annual % change	16.0	15.9	17.6	20.3	22.5	25.3	22.4	20.8	19.2
US$	Monthly flows (Million US$)	370	-13	298	-186	-23	-62	532	268	-223
	Monthly % change	1.3	0.0	1.1	-0.6	-0.1	-0.2	1.8	0.9	-0.7
	Annual % change	14.7	11.8	7.1	3.8	2.0	1.3	5.1	5.5	3.9
Total	Monthly flows (Million S/.)	2,697	1,710	3,164	2,154	1,366	2,445	2,551	1,436	745
	Monthly % change	1.6	1.0	1.7	1.1	0.7	1.2	1.2	0.7	0.3
	Annual % change	15.4	14.1	12.8	12.8	13.2	14.6	14.9	14.2	12.7

81. The most dynamic segments of credit included credit to medium-sized companies, which grew 19.7 percent in the year, and the segment of corporate loans and loans to large enterprises, which grew 15.4 percent in August. On the other hand, the least dynamic segment was credit to small- and medium-sized enterprises.

Personal loans recorded more modest growth rates. This was particularly noteworthy in the case of car loans, which grew 7.6 percent. On the other hand, showing a higher level than the other segments of personal loans, mortgage loans grew 13.2 percent.

Table 43
CREDIT TO THE PRIVATE SECTOR
(12 month % change)

	Dec.12	Jun.13	Sep.13	Dec.13	Mar.14	Jun.14	Aug.14
Businesses	**13.3**	**10.9**	**11.9**	**13.1**	**14.9**	**16.0**	**12.9**
Corporate and large companies	8.5	10.6	17.2	21.6	22.4	22.3	15.4
Medium-sized enterprises	18.4	11.7	9.2	10.5	15.6	21.8	19.7
Small business and Microbusinesses	16.7	10.6	5.8	2.2	2.0	0.0	1.7
Individuals	**19.4**	**16.2**	**14.5**	**13.4**	**14.1**	**13.0**	**12.4**
Consumption	**15.3**	**12.1**	**11.3**	**11.5**	**12.8**	**12.2**	**11.8**
Car loans	25.2	23.2	18.7	14.5	10.6	8.8	7.6
Credit cards	13.4	7.5	8.2	8.2	10.2	12.2	11.5
Mortgage	**25.7**	**22.3**	**19.0**	**16.2**	**15.9**	**14.1**	**13.2**
Total	**15.4**	**12.8**	**12.8**	**13.2**	**14.6**	**14.9**	**12.7**

In comparison with the end of Q2, credit to small and micro businesses recovered slightly in August due to the higher pace of growth observed in non-banking loans (10.3 percent in August vs. 6.4 percent in June). This was particularly the case of credit in soles which increased significantly, from 7.6 percent in June to 11.7 percent in August, offset in part by a lower rate of growth of bank credit (-7.4 percent in August). On the other hand, credit in foreign currency continued declining in both sources of credit.

Table 44
LOANS TO SMALL BUSINESSES AND MICROBUSINESSES

	Annual flows				Growth rate (12 month % change)			
	Dec.13	Mar.14	Jun.14	Aug.14	Dec.13	Mar.14	Jun.14	Aug.14
Banks	-698	-1,168	-1,083	-1,162	-4.4	-7.4	-6.9	-7.4
DC	141	-255	-575	-731	1.1	-2.1	-4.6	-5.8
FC	-300	-326	-181	-154	-23.8	-26.8	-16.3	-14.1
Rest	1,436	1,724	1,089	1,699	9.0	10.8	6.4	10.3
DC	1,640	1,795	1,184	1,763	11.3	12.3	7.6	11.7
FC	-73	-25	-34	-23	-13.7	-5.1	-6.9	-4.8
Total	738	556	6	537	2.3	1.8	0.0	1.7
DC	1,781	1,540	609	1,032	6.6	5.7	2.2	3.7
FC	-373	-351	-215	-177	20.8	-20.6	-13.4	-11.3

In August, the delinquency ratios registered in depository institutions continued showing an upward trend. The default rate of credit to businesses rose from 3.04

percent in June to a level of 3.11 percent in August. In this segment, credit to medium-sized companies showed the greatest increase in the default rate for the second consecutive quarter, climbing from 4.07 percent in June to 4.39 percent in August, while this rate in credit to small businesses rose from 8.87 percent in June to 9.17 percent in August while in the case of micro businesses it rose from 5.86 percent in June to 6.04 percent in August. Moreover, the default rate registered in credit to individuals also continued rising and reached a level of 2.63 percent in August –a higher level than the 2.55 percent level registered in June this year–, with the increase of 14 basis points recorded in the default rate of credit cards standing out.

Graph 99
CREDITS: DELINQUENCY RATES
(As % of portfolio)

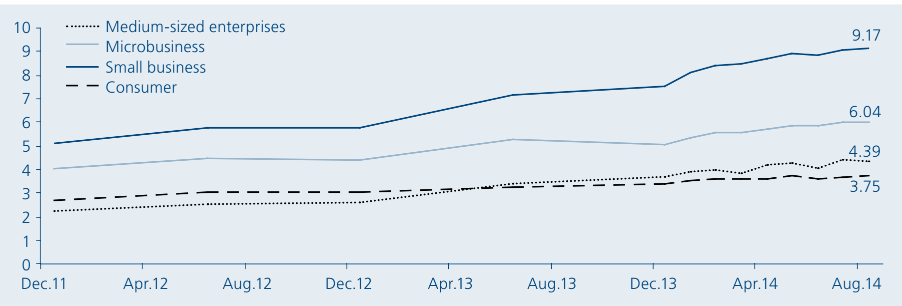


Table 45
CREDITS DELINQUENCY INDEX OF THE DEPOSITORY CORPORATIONS

	Dec.11	Dec.12	Jun.13	Sep.13	Dec.13	Mar.14	Jun.14	Jul.14	Aug.14
Business	**1.88**	**2.28**	**2.81**	**2.90**	**2.81**	**3.10**	**3.04**	**3.16**	**3.11**
Corporate	0.04	0.00	0.01	0.00	0.00	0.02	0.13	0.01	0.00
Large companies	0.21	0.40	0.37	0.39	0.38	0.54	0.43	0.55	0.67
Medium-sized enterprises	2.18	2.60	3.40	3.64	3.72	3.88	4.07	4.48	4.39
Small business	5.05	5.75	7.14	7.73	7.56	8.54	8.87	9.08	9.17
Microbusiness	4.00	4.36	5.27	5.52	5.08	5.57	5.86	6.00	6.04
Individuals	**1.89**	**2.08**	**2.21**	**2.24**	**2.32**	**2.51**	**2.55**	**2.60**	**2.63**
Consumption	2.64	3.05	3.28	3.30	3.39	3.66	3.64	3.69	3.75
Car loans	2.84	2.79	2.97	3.25	3.37	3.76	4.90	4.91	4.98
Credit cards	3.40	4.10	4.42	4.39	4.71	5.07	3.99	4.11	4.14
Mortgage	0.85	0.82	0.90	0.96	1.02	1.15	1.26	1.31	1.33
Average delinquency	**1.84**	**2.16**	**2.54**	**2.60**	**2.57**	**2.82**	**2.88**	**2.97**	**2.95**

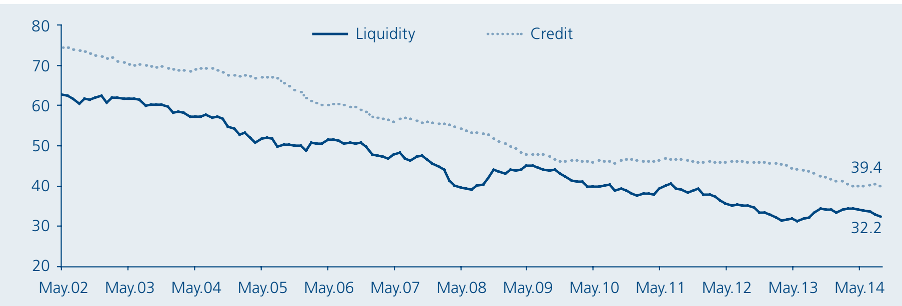
82. In 2014 credit is projected to grow around 11.2 percent, driven primarily by credit in domestic currency which is foreseen to continue being the most dynamic type of credit. This projected evolution of credit is consistent with an estimated GDP growth rate of 3.1 percent in 2014 and with the forecast that the use of direct external financing by the corporate sector would be lower in 2014 than in 2013. Should the growth rate of deposits in soles continue to decrease, the BCRP will evaluate

the possibility of continue reducing the rate of required reserves in soles with the aim of providing a more permanent source of expansion of liquidity in order that banks' interest rates for operations in domestic currency are not affected. In 2015, credit would grow 13.2 percent, driven mainly by credit in soles. Thus, the ratio of credit-to-GDP is expected to continue increasing during 2014.

Graph 100
RATIO CREDIT / GDP
(%)

83. The ratio of dollarization of credit declined from 39.8 percent in June to 39.4 percent in August, in line with the trend observed over the year. The dollarization of liquidity decreased from 33.4 to 32.2 percent in the same period. This reverses the trend observed in Q1 and the ratio is now below the level observed in December 2013 (33.0 percent).

Graph 101
DOLLARIZATION RATIO: 2002 - 2014
(%)



By type of credit, mortgage loans continue showing a de-dollarization trend (down from 35.0 to 34.6 percent between June and August of 2014), which would be reflecting in part the reserve requirement measures conditional to the expansion of mortgage loans and car loans in foreign currency that the BCRP implemented in March 2013. On the other hand, the ratio of dollarization in the case of credit to businesses remained stable at 50.5 percent, reflecting the counter effect of a lower dollarization rate in the case of corporate loans and credit to large enterprises, whereas the rate of dollarization increased slightly in credit to medium-sized companies and small firms.

Table 46
DOLLARIZATION RATIO OF CREDIT TO THE PRIVATE SECTOR

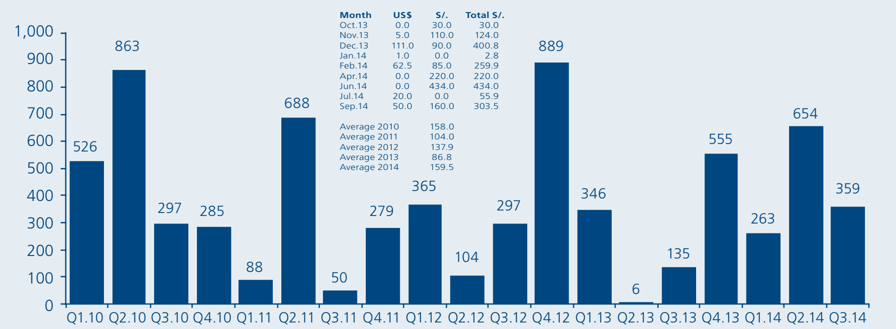
	Dec.11	Dec.12	Jun.13	Sep.13	Dec.13	Mar.14	Jun.14	Aug.14
Business	**55.9**	**56.1**	**54.2**	**52.4**	**51.2**	**49.6**	**50.5**	**50.5**
Corporate and large companies	71.4	74.2	72.3	67.4	65.7	62.6	64.1	63.5
Medium-sized enterprises	68.8	68.0	65.5	64.0	62.3	61.0	60.2	60.3
Small business and Microbusiness	17.1	15.8	13.8	13.4	12.2	11.8	11.9	12.0
Individuals	**25.8**	**25.6**	**24.4**	**23.2**	**22.0**	**21.1**	**20.3**	**20.2**
Consumption	10.2	10.5	10.5	10.1	9.8	9.6	9.5	9.5
Car loans	70.4	78.1	78.5	77.1	74.8	72.8	71.7	71.3
Credit cards	6.5	7.0	7.3	7.1	6.8	6.8	6.8	6.9
Mortgage	50.1	47.1	43.6	41.0	38.5	36.5	35.0	34.6
TOTAL	**45.6**	**45.3**	**43.4**	**42.0**	**40.8**	**39.5**	**39.8**	**39.7**

Capital Market

84. In Q3-2014, non-financial companies issued bonds for a total of S/. 359 million in the local market. The lower dynamism of securities issued by non-financial companies contrasted with the high amounts issued by financial companies.

Between July and September, corporate bond issuances in the international market amounted to US$ 1.13 billion –US$ 1.31 billion in the previous quarter–, with coupon rates ranging between 2.75 percent and 5.25 percent in dollars and maturities ranging between 4 and 15 years.

Graph 102
BONDS ISSUED BY NON-FINANCIAL FIRMS*
(Million S/.)



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

Table 47 BONDS ISSUED IN THE INTERNATIONAL MARKET			
Business	**Amount (Million US$)**	**Maturity (Years)**	**Rate**
Year 2013	**6,389**		
Non-financial sector	**4,153**		
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%
Corporación 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%
Inkia Energy	150	8	8.38%
San Miguel Industrias	200	7	7.75%
Andino Investment Holding	115	7	11.00%
Planta de Reserva Fría de Generación de Eten	133	20	7.65%
Financial sector	**2,236**		
Private financial sector	**1,736**		
BBVA Banco Continental	300	4	2.31%
Banco de Crédito	716	10	4.25%
BBVA Banco Continental	500	5	3.25%
Banco de Crédito	170	14	6.13%
Interbank	50	10	7.50%
Public financial sector	**500**		
Fondo MiVivienda	500	10	3.50%
Year 2014	**4,381**		
Non-financial sector	**2,177**		
Compañía Minera Ares	350	7	7.75%
Minsur	450	10	6.25%
Abengoa Transmisión Sur	432	29	6.88%
Camposol	75	3	9.88%
Rutas de Lima**	370	22	8.38%
Rutas de Lima***	150	25	5.25%
InRetail Shopping Mall	350	7	6.50%
Financial sector	**2,204**		
Private financial sector	**1,025**		
Banco de Crédito	200	13	6.13%
Interbank	300	15	6.63%
Banco de Crédito	225	4	2.75%
BBVA Banco Continental	300	15	5.25%
Public financial sector	**1,179**		
Fondo MiVivienda	300	5	3.38%
Fondo MiVivienda*	279	4	1.25%
COFIDE	300	5	3.25%
COFIDE	300	15	5.25%

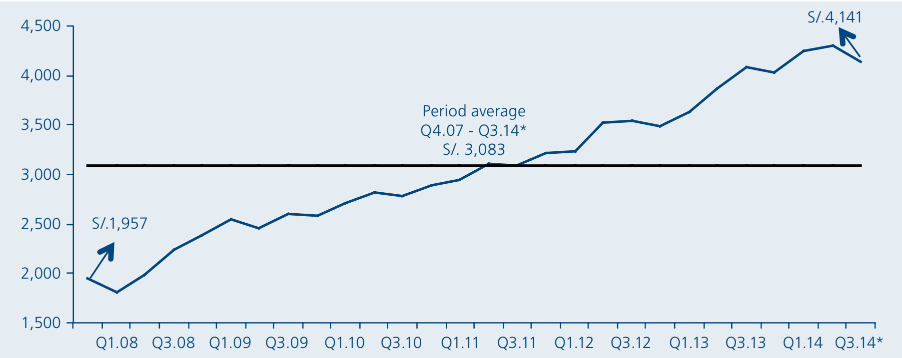
* Emission in Swiss Franc.
** Emission in Nuevos Soles.
*** Emission in Nuevos Soles VAC.

Real Estate Market

85. In Q3-2014, real estate prices per square meter in constant soles fell 4.0 percent in the ten districts of the sample (La Molina, Miraflores, San Borja, San Isidro, Surco,

Jesús Maria, Lince, Magdalena, Pueblo Libre, and San Miguel) compared to the previous quarter. The graph shows the evolution of the quarterly median sales prices of departments (per square meter) in 2009 constant soles.

Graph 103
MEDIANS OF QUARTERLY SALE PRICES PER SQUARE METER OF APARTMENTS
(Base 2009 = 100)



* Preliminary.

The price to earnings ratio (PER), which shows the number of years that a property would have to be rented in order to recover its acquisition value, has been stable and remained within the normal range in recent years, according to the criteria considered by Global Property Guide[3].

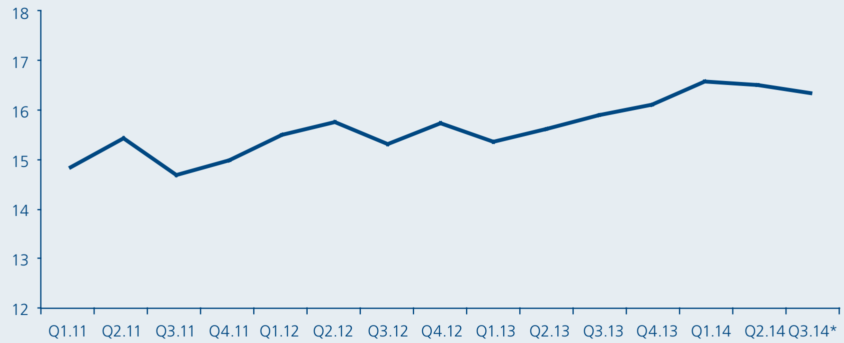
Table 48
PER: PRICE TO EARNING RATIO[1/]

	2012-Q3	2012-Q4	2013-Q1	2013-Q2	2013-Q3	2013-Q4	2014-Q1	2014-Q2	2014-Q3*
Jesús María	15.5	14.9	15.0	15.6	15.7	16.2	16.9	16.0	15.5
La Molina	12.4	11.6	13.7	14.7	15.5	16.4	17.2	16.9	16.2
Lince	14.2	16.4	14.1	14.6	15.4	15.5	16.2	15.2	15.2
Magdalena	13.1	16.0	14.0	14.5	15.1	15.0	15.0	15.0	15.3
Miraflores	15.3	15.0	14.8	16.5	16.3	15.9	16.8	17.4	15.8
Pueblo Libre	15.2	16.0	14.1	14.3	15.3	16.1	16.3	16.5	15.9
San Borja	16.8	18.2	18.6	17.5	17.1	16.7	17.2	17.9	18.8
San Isidro	17.2	18.4	18.0	17.2	17.3	17.7	17.8	18.2	17.5
San Miguel	16.1	15.6	14.4	14.8	14.7	15.0	15.5	14.7	15.0
Surco	17.1	15.0	16.8	16.3	16.5	16.6	17.0	17.6	18.5
Aggregated									
Average	15.3	15.7	15.3	15.6	15.9	16.1	16.6	16.5	16.4

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

3 Global Property Guide ranks the real estate market following the PER Index as Undervalued (5.0-12.5), Normal (12.5-25.0) and Overvalued (25.0-50.0).

Graph 104
PER: PRICE TO EARNING RATIO



* Preliminary.

Box 3
THE INTEREST RATE CHANNEL AND MONETARY POLICY'S EFFECTIVENESS

Monetary policy's effectiveness in affecting the real sector can be measured through its more immediate transmission channel: the interest rate channel. The evidence in the Peruvian economy shows that the impact of changes in the policy interest rate affecting other market interest rates –which is known as the "pass-through effect"– increased since the adoption of inflation targeting in Peru and that this channel has not been interrupted after the international financial crisis of 2008.

Lahura (2005) finds that the pass-through effect in the long-term is incomplete; that is, that changes in the benchmark interest rate do not translate completely into market interest rates. However, the pass-through effect would have increased after the Central Bank announced the policy interest rate band in 2001, increasing thereafter its velocity and magnitude following the formal adoption of inflation targeting in 2002.

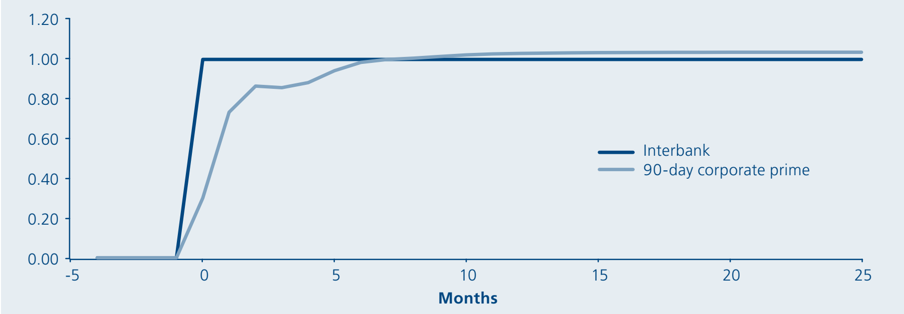
Using a more recent sample, Rodriguez (2009) found that although the interest-rate pass-through effect is not complete, it has increased since 2001 in the case of both lending interest rates and deposit interest rates, and that the speed of adjustment has increased in deposit rates. The interest rate pass-through effect on both rates was robust even when the benchmark interest rate was lowered in the first half of 2009 in response to the international financial crisis.

Using a sample of interest rates broken down by maturities and by different types of loans and deposits, Rostagno and Castillo (2010) found that in the period of 2002-2010, even though the pass-through effect is not complete, it is significantly relevant in most of the interest rates considered, except in the case of those associated to loans to microenterprises, consumer and mortgage loans, and CTS deposits. In addition to this, there is no difference between the pass-through effect in the lending and deposit rates considered, the effect being greater in short-term interest rates. Finally, the authors find that the pass-through effect has continued during the period of monetary expansion following the international financial crisis, and that the magnitude of this effect has been greater in the short term rates of both lending and deposit rates.

The results discussed below were obtained assessing the pass-through effect of a larger sample of interest rates (2001-2014) using a similar methodology to the one used by Rodriguez. Estimating a cointegration vector and an error-correction model between the interbank interest rate and different market interest rates, we simulated the response of different market interest rates to changes in the interbank interest rate, which is directly affected by the Central Bank. .

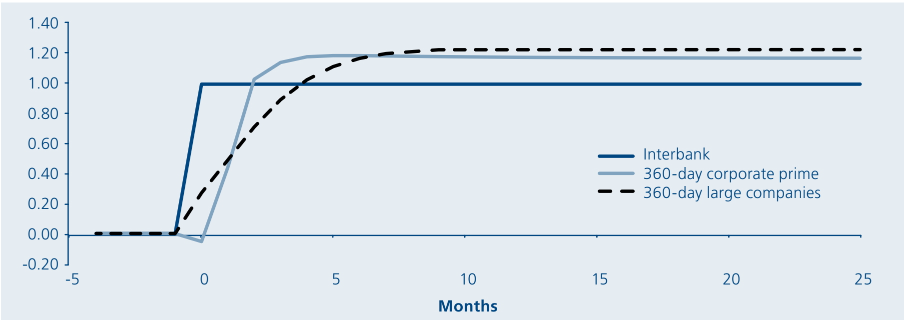
The lending interest rates show greater long term responses than the increase in the interbank interest rate. For instance, the 90-day corporate interest rate shows an overall effect of 104 basis points in response to an increase of 100 bps of the interbank rate. In this case, it takes 7 months for the rate to increase the first 100 bps.

RESPONSE OF 90-DAY CORPORATE PRIME RATE TO CHANGES IN ONE PERCENTAGE POINTS IN INTERBANK INTEREST RATE



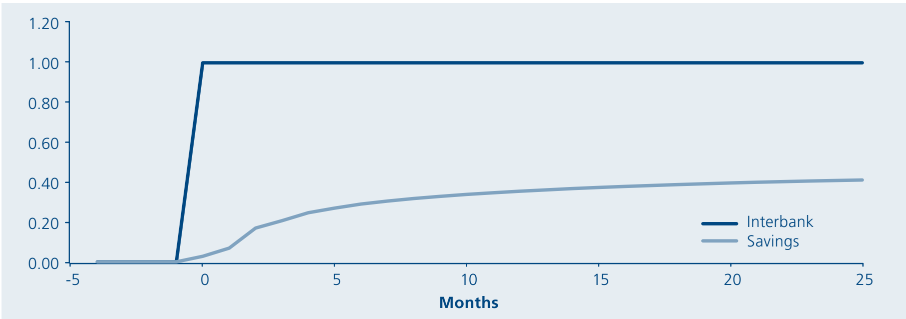
Even though it is not possible to analyze other lending interest rates for the same period due to methodological differences in the estimation of such rates, we can still carry out an analysis with a sample starting in mid-2010. With this sample we can see that lending interest rates show even greater changes in response to changes in the interbank rate. The lending rates for corporate loans of up to 360 days show a total effect of 117 bps while the lending rate for large enterprises increases by 123 bps. Moreover, the pass-through is also faster in these rates: the corporate rate registers an increase of over 100 bps just 2 months after the shock.

RESPONSE OF 360-DAY CORPORATE PRIME AND LARGE COMPANIES RATE TO CHANGES IN ONE PERCENTAGE POINTS IN INTERBANK INTEREST RATE



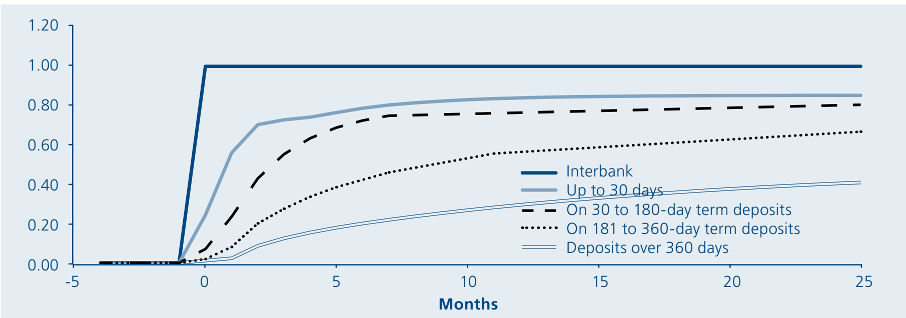
Furthermore, the results for deposit rates confirm that the pass-through is not complete in these rates. An increase of 100 basis points in the interbank interest rate generates a total increase of 45 bps in the interest rate paid by banks for savings deposits. This pass-through is not immediate; it takes 4 months until we see an increase of 50 bps and 21 months to get an impact of 90 percent of the total pass-through effect.

RESPONSE OF SAVINGS DEPOSITS RATE TO CHANGES IN ONE PERCENTAGE POINTS IN INTERBANK INTEREST RATE



Similarly, the pass-through of interest rates to term deposits is not a complete pass-through. The rate on 30-day deposits increases only 85 bps when the interbank rate rises 100 bps. In this case the pass-through is faster: it takes only 6 months until 90 percent of the long term effect becomes effective. We can see that the pass-through effect is lower in longer-term interest rates. The overall effect is of 81 bps for 30-day to 90-day deposits, 69 bps for 181- to 360-day deposits, and 51 bps for longer term deposits.

RESPONSE OF TERM DEPOSITS RATE TO CHANGES IN ONE PERCENTAGE POINTS IN INTERBANK INTEREST RATE



Based on this analysis, we can conclude that the pass-through effect on interest rates occurs with different magnitudes and in different timeframes depending on the interest rate. In the case of deposit rates, the longer the term, the lower the total effect. We can also see that the pass-through effect seems to be more important in lending rates than in deposit rates. This could be associated with the difference between the market of deposits and the loans market or also with the interaction between the rate of required reserves and the pass-through of interest rates.

LONG-TERM PASSTHROUGH			
	Rodriguez (2010)		IR October 2014
	Pre-crisis sample	Complete sample	Complete sample (2014)[1/]
Loan rates			
90-day corporate prime	1.07	1.04	1.04
360-days loans	0.65	0.68	
360-day corporate prime			1.17
360-day large companies			1.23
Liability rates			
Savings	0.53	0.46	0.45
Deposits up to 30 days	0.82	0.86	0.85
Deposits up to 180 days	0.81	0.81	0.81
Deposits up to 360 days	0.74	0.70	0.69

1/ Sample begins in August 2010 for corporate and large companies loans.

Box 4
EMPIRICAL EVIDENCE ABOUT DYNAMIC IMPACTS OF RESERVE REQUIREMENTS IN PERU

In the context of the international financial crisis and of the expansionary policy responses implemented by developed countries, since 2008 the BCRP has been using the average and marginal reserve requirement rates in soles and in dollars in a cyclical manner as part of its monetary policy actions to maintain an orderly adjustment of liquidity and credit. Recent studies based on banks' data and counter-factual estimates suggest that reserve requirement policy actions in Peru have been effective in reducing the volatility of the credit cycle.

This article provides additional evidence on the effects of reserve requirements obtained by estimating a VAR model with signs and zero restrictions following the methodology recently proposed by Arias, Rubio-Ramirez, and Waggoner (2014). This methodology is sufficiently comprehensive and general so as to allow taking into account both the theoretical effects proposed by different models and the effects of reserve requirement expected by the BCRP in the identification of reserve requirement shocks.

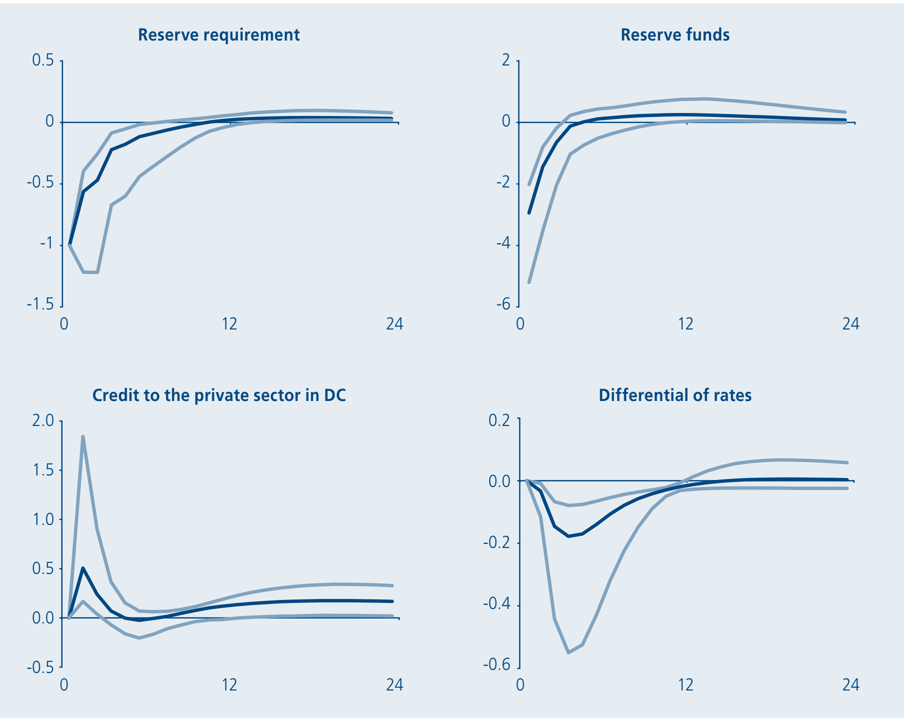
One of the advantages of a vector autoregressive (VAR) system is that it allows breaking down each macroeconomic variable of interest pertaining to the model into exogenous variables or structural shocks. One of these structural shocks can be classified as a reserve requirements shock. In order to identify this shock and simulate its effects on credit, the condition is that a negative reserve requirement shock will reduce the average reserve requirement rate, reserve funds, and the spread between lending and deposit rates, all of this within the first months after the shock has occurred. The other variables in the model, such as credit, are not restricted.

Monthly data of banks' required reserves in soles, the interbank exchange rate, the interbank interest rate, mean reserve requirements in soles, credit to the private sector in soles, lending rates and deposit rates in soles –TAMN, TIPNMN–, the consumer price index, and the real gross domestic product for the period 1995-2013 are used to make the estimates. The model also considers external variables as exogenous controls.

The Transmission Mechanism of Reserve Requirements in Peru

To illustrate the transmission mechanisms of reserve requirements, we simulate the estimated model considering a reduction of 1 percent in the average reserve requirement rate. The results are shown in the graph below:

DINAMIC EFFECTS OF RESERVE REQUIREMENTS (68% MORE LIKELY): PEREZ FORERO AND VEGA (2014)



As we can see in the graphs, a reduction in the rate of reserves increases credit in domestic currency and reduces the spread between lending and deposits rates. The transmission mechanism of required reserves is as follows: when there is a rate cut, this reduces the reserve funds that banks hold at the central bank, which increases the availability of loanable funds and thus the supply of credit. The increased credit supply generates downward pressures on lending interest rates due to banks' competition in the financial system. Similarly, reducing intermediation costs affects the deposit rate, because this allows banks to offer more attractive rates for savings.

These assumptions are in line with the findings of Den Haan, Ramey and Watson (2003), who say that the interest rates agreed between banks and their customers are the result of negotiations that determine how the benefits of each transaction will be distributed between the parties. Lower intermediation costs are distributed between the banks and their customers (savers and borrowers), generating a reduction in the spread of lending and deposit rates. The impact of reserve requirements in reducing the spread will reflect the gain obtained by users for reducing the costs of intermediation. On their side, banks will get a greater financial leeway if the costs are lower and the volume of loans is greater, all of which leads to a reduction in the interest rate spread (lending rates minus deposit rates).

Thus, the graph shows an increase in credit to the private sector in the short term. As we can see, a reduction of 100 points in the average reserve requirement rates generates an increase of 0.5 percent in bank credit in domestic currency. The effect is fairly persistent and is also reflected in the spread between lending and deposit interest rates. It should be pointed out that these effects are based on a single shock. Therefore, the reported results show that a change in the average reserve requirement rate in soles generates a significant effect on credit to the private sector in soles, thus complementing and reinforcing the impact of changes in the monetary policy benchmark interest rate.

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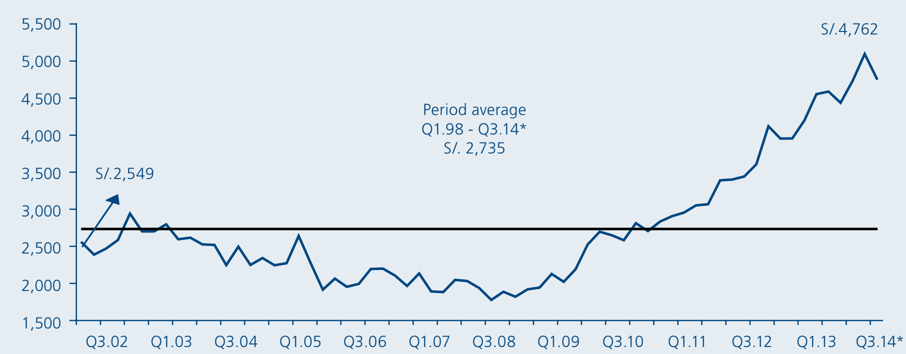
Box 5
REAL ESTATE PRICES IN PERU AND IN OTHER COUNTRIES

The analysis of real estate prices in Peru since the late 90s shows that the rising trend of prices in this sector has been consistent with the evolution of their economic fundamentals.

Until the middle of the past decade, the prices of houses in Peru showed a declining trend in a context characterized by a slow increase of mortgage loans, a low level of terms of trade, and low external financing.

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



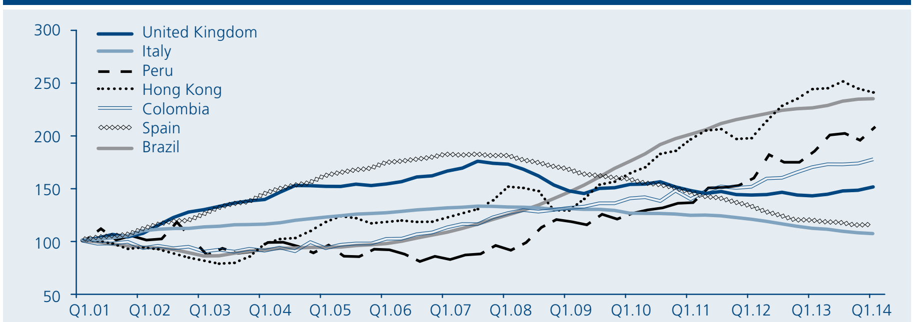
* Preliminary.

Since 2006 the expansionary cycle registered in the global economy brought about an improvement in the terms of trade and a greater capital flow to the emerging economies. During this period, the credit market became more active, in line with the greater dynamism of economic activity.

In addition to these factors, the evolution of real estate prices in Peru has been associated with the growth of population. In Peru, the latter has been characterized by a higher growth of young population –between 20 and 40 years of age– who looking for housing in a context marked by constraints in the supply of land for the construction of houses and buildings.

Price increases in the real estate sector as the ones registered in Peru have also been observed in other economies. For example, while prices increased by 110 percent in Peru between 2001 and Q1-2014, in Brazil they grew 137 percent and in Hong Kong they grew 142 percent in the same period. A different situation was observed in Spain, where real estate prices experienced a significant correction after recording an increase of 121 percent between 1997 and 2007.

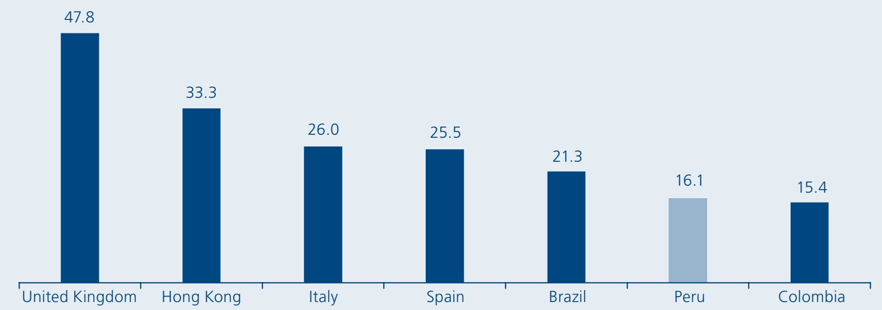
HOUSE PRICES
(Q1.01 = 100)



A useful tool to assess prices in the real estate market is the PER (Price to Earnings) ratio, which represents the relationship that exists between the cost of purchasing a home and the cost of renting one. According to Global

Property Guide, the PER is a reference indicator, which should show a normal ratio of 12.5 to 25.0, because countries in which the housing market is not very developed register lower PER levels.

PRICE TO EARNING RATIO
Year 2013



Source: Global Property Guide, BCRP.

VI. Inflation

Report to September

86. In September the consumer price index (CPI) for Metropolitan Lima showed a variation of 2.74 percent relative to September 2013 and a variation of 2.75 percent relative to December 2013.

87. The rate of inflation reflected mainly rises in the prices of food, fuels, and electricity rates. The component of food and energy increased by 4.0 percent between January and September and 2.9 percent in the last 12 months. On the other hand, inflation without food and energy –i.e., isolating the impact of these goods that have high price volatility– showed a rate of 1.75 percent between January and September and a rate of 2.57 percent in the last 12 months.

Graph 105
INFLATION AND INFLATION TARGET
(12 month % change)

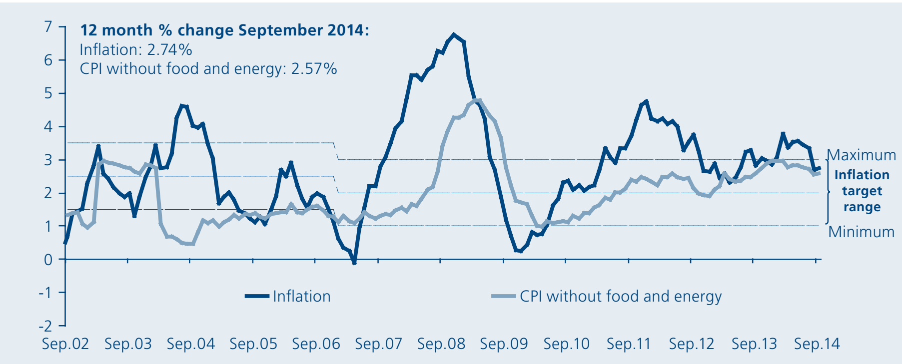


Table 49
INFLATION
(% change)

	Weight	2010	2011	2012	2013	2014		
						Sep.	Jan.-Sep.	12 Months
CPI	**100.0**	**2.08**	**4.74**	**2.65**	**2.86**	**0.16**	**2.75**	**2.74**
1. CPI without food and energy	**56.4**	**1.38**	**2.42**	**1.91**	**2.97**	**0.09**	**1.75**	**2.57**
a. Goods	21.7	1.07	2.37	1.60	2.62	0.14	1.82	2.47
b. Services	34.8	1.58	2.45	2.10	3.18	0.07	1.70	2.63
2. Food and energy	**43.6**	**2.98**	**7.70**	**3.55**	**2.73**	**0.24**	**3.96**	**2.93**
a. Food and beverages	37.8	2.41	7.97	4.06	2.24	0.29	4.29	3.09
b. Fuel and electricity	5.7	6.80	6.01	0.22	6.09	-0.12	1.79	1.92
Fuel	2.8	12.21	7.54	-1.48	5.95	-0.14	1.27	1.31
Electricity	2.9	1.36	4.30	2.19	6.23	-0.09	2.36	2.59

88. The items that contributed most to increase inflation in the period of January-September 2014 were meals outside the home, education costs, chicken meat, onions, and eggs.

Table 50
ITEM WITH THE HIGHEST WEIGHTED CONTRIBUTION TO INFLATION: JANUARY - SEPTEMBER 2014

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Meals outside the home	11.7	3.6	0.46	Citric fruits	0.5	-16.5	-0.11
Education (fees and tuition)	8.8	4.6	0.43	Potato	0.9	-9.2	-0.08
Poultry meat	3.0	11.3	0.33	National transportation	0.3	-11.0	-0.04
Onion	0.4	73.4	0.18	Avocado	0.1	-14.8	-0.02
Eggs	0.6	20.4	0.11	Internet services and other	0.8	-2.2	-0.02
Fresh and frozen fish	0.7	11.8	0.09	Soft-drink	0.2	-6.5	-0.01
Purchases of vehicles	1.6	5.5	0.08	Tomato	0.2	-4.6	-0.01
Carrots	0.1	64.7	0.07	Telephone rates	2.9	-0.4	-0.01
Electricity	2.9	2.4	0.07	Airplane fares	0.4	-2.3	-0.01
Corn	0.1	48.7	0.07	Olluco and alike	0.1	-9.5	-0.01
Total			**1.89**	**Total**			**-0.32**

The item with the highest weighed contribution to inflation was **meals outside the home** (3.6 percent), which accounts for 0.46 percentage points of the increase accumulated in inflation between January and September. In the last twelve months, the prices of meals outside the home have increased 4.7 percent, a higher increase than the ones recorded by the prices of food consumed in the household (2.3 percent) and the general price index (2.7 percent).

Education costs –tuition and fees– increased by 4.6 percent. As in other years, this increase was observed in the month of March (3.8 percent), at the beginning of the school year. Other rises were observed in the tuition fees of universities and higher education institutes in the following months. Education costs show a variation of 4.6 percent in the last twelve months.

Among food items, the highest increase was observed in the price of **poultry** (11.3 percent). This increase was associated with the irregular supply of fish –the main substitute of chicken meat– as well as with the increase in the cost of importing hard yellow maize –one of the major production costs of poultry– whose price in domestic currency showed a variation of approximately 29 percent relative to December 2013, even though the international price of hard yellow maize dropped by 21.4 percent. This lower international price did not translate into a lower price due to the price formation mechanism governing this product (see Box 6).

The price of **onions** increased 73.4 percent in January-September and 51.8 percent in the last twelve months. The higher rises were recorded in the months of March and April, reflecting supply problems due to lower crops in Arequipa –down 11 percent in the August-January crop year compared to the previous year– as a result of climate changes (deficit of humidity and warmer daytime conditions). The supply improved later on due to Camana's onion production and prices declined from June.

Other agricultural products that showed significant increases were **corn** (48.7 percent) and **carrots** (64.7 percent). The highest rises were recorded since the month of July, which is when the production from the coast gets to markets. The supply of these products was affected by lower crops due to climate uncertainties and by low farm prices. Sown areas in Ica declined 15 percent in the August-July crop year compared to the previous crop season and the production in Lima declined 9 percent in August due to lower crops in the valleys of Canta and Cañete. On the other hand, the production of carrots in Lima decreased 18.5 percent in January-August compared with the same period of the previous year.

The price of **eggs** increased 20.4 percent in January- September and 6.1 percent in the last twelve months. This rise was associated with increased demand given that eggs showed the lowest relative price in comparison to other food products with a high protein content.

Fresh and frozen fish showed an increase of 11.8 percent in January- September and an increase of 2.4 percent in the last twelve months, due to supply irregularities. Climatic alterations and anomalous waves affected the availability of fish species and fishing operations. The highest rise was recorded in April (7.9 percent), when climate problems added onto the greater demand for fish associated with Easter.

The prices of **cars** were affected by the exchange rate and showed an accumulated increase of 5.5 percent and increase of 5.7 percent in the past 12 months. These increases were higher than the depreciation of the exchange rate (2.8 percent in the period and 3.1 percent in the last twelve months).

Electricity rates rose 2.4 percent in January-September and 2.6 percent in the last 12 months. The largest increases, which were recorded in the months of February and April, were associated with the incorporation of new transmission lines, as well as with the update of generation costs. In August the regulatory body lowered rates by 4.3 percent based on the update of the transmission system tolls as well as on the price reduction established in the contracts between energy generating companies and distributing companies.

Some of the items that showed price falls were citrus fruits (-16.5 percent) and **potatoes** (-9.2 percent). In the case of the former, which showed a negative variation of 13.3 percent in the last twelve months, the biggest declines were recorded between March and June due to the greater supply of "satsuma" tangerines that came from the valleys of Lima. In January-August, the accumulated production of tangerines in the region of Lima increased 11.4 percent compared to the same period of 2013.

As for potatoes, the prices of this tuber decreased in the first months of the year due to greater cultivated areas in Huánuco and Lima in the period of July-November 2013. As from July 2014, potato prices showed again negative growth rates since the production of the coast areas added onto the production of the regions of Junín and Ayacucho, where this crop continued being harvested due to favorable climatic conditions.

In September, there was a greater supply of potatoes from Ica as a result of increased cultivated areas and colder temperatures during most of the crop season. Because of this increased supply, the price of potatoes registered a negative change in the last twelve months (-27.0 percent).

Table 51
ITEM WITH THE HIGHEST WEIGHTED CONTRIBUTION TO INFLATION: OCTOBER 2013 - SEPTEMBER 2014

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Meals outside the home	11.7	4.7	0.61	Potato	0.9	-27.0	-0.31
Education (fees and tuition)	8.8	4.7	0.44	Citric fruits	0.5	-13.3	-0.09
Urban fare	8.5	2.7	0.22	Telephone rates	2.9	-1.5	-0.03
Onion	0.4	51.8	0.14	Internet services and other	0.8	-2.2	-0.02
Medicine products	2.1	4.2	0.09	Soft-drink	0.2	-5.6	-0.01
Purchases of vehicles	1.6	5.7	0.08	Garlic	0.1	-11.0	-0.01
Electricity fares	2.9	2.6	0.07	Beans	0.1	-6.0	-0.01
Toiletries	4.9	1.5	0.07	Ice cream	0.3	-3.2	-0.01
Beef	1.2	5.5	0.07	Spices and seasonings	0.5	-1.3	-0.01
Corn	0.1	46.6	0.06	Sweet potato	0.1	-7.8	-0.01
Total			**1.85**	**Total**			**-0.51**

Box 6
RIGIDITIES IN THE TRANSMISSION OF INTERNATIONAL PRICE DROPS

Although a significant reduction has been observed in the prices of imported food and fuels this year, this decline has only partially translated in our country into lower consumer prices due to the existence of compensatory mechanisms, such as the Price Band System, which applies to some food products and the fuel prices set by oil refining companies.

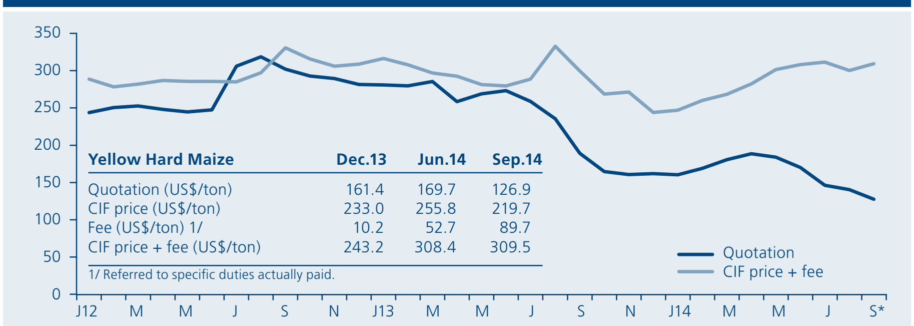
Food Prices

The price band system (PBS) was introduced with the aim of softening the effects of price fluctuations in a group of agricultural products –maize, rice, sugar, and milk– through the application of price bands.

The price band is calculated using the information of prices in the past five years, so the current benchmark prices are based on the high levels of prices recorded between 2008 and 2013. Thus, for example, although the price of maize has dropped by 26 percent between December 2013 and September this year (from US$ 161 to US$ 127 per ton, the import price –CIF price plus surcharge– has climbed 27 percent (from US$ 243 to US$ 310 per ton). The tariff surcharge paid today is equivalent to 43 percent, whereas no surcharge was paid in 2010 even though the prices were similar to those currently observed.

This gap between the quotes and the price of importing these products to the country has a negative effect on consumers' income that is equivalent to a tax amounting to up to S/. 1.2 billion in annual terms. If this price gap were eliminated, this would generate a price reduction of 1 nuevo sol per kilo –or 11 percent– in the price of chicken, for example.

YELLOW HARD MAIZE
(US$ per ton)



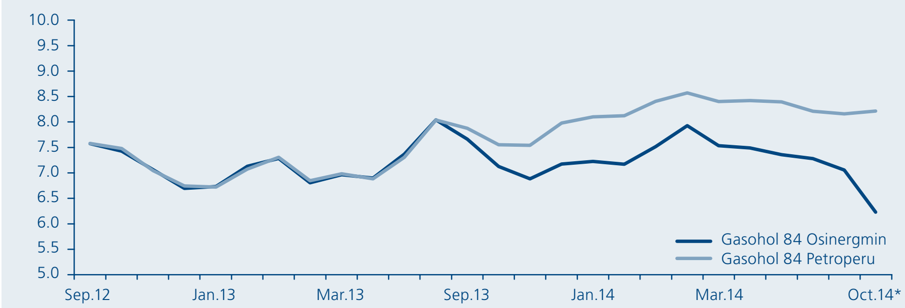
Yellow Hard Maize	Dec.13	Jun.14	Sep.14
Quotation (US$/ton)	161.4	169.7	126.9
CIF price (US$/ton)	233.0	255.8	219.7
Fee (US$/ton) 1/	10.2	52.7	89.7
CIF price + fee (US$/ton)	243.2	308.4	309.5

1/ Referred to specific duties actually paid.

Fuel Prices

Since 2003, OSINERGMIN has been responsible for publishing each week the benchmark prices of fuels derived from crude oil and biofuels in order that these price levels be used in the local market as indicators that reflect the variations in the international prices of fuels, as well as transport and import costs. For gasohol and diesel fuels, the benchmark price represents the value of an efficient operation of importing fuel.

OSINERGMIN REFERENCE PRICE VS. PETROPERU PRICE
Monthly average price of Gasohol 84



* Price in October 15, 2014
Source: OSINERGMIN PETROPERU.

As regards gasohols, after this kind of fuels were withdrawn from the Fuel Price Stabilization Fund, the prices set by Petroperu were initially aligned to the benchmark prices. However, as from September 2013, Petroperu prices have been above the benchmark prices.

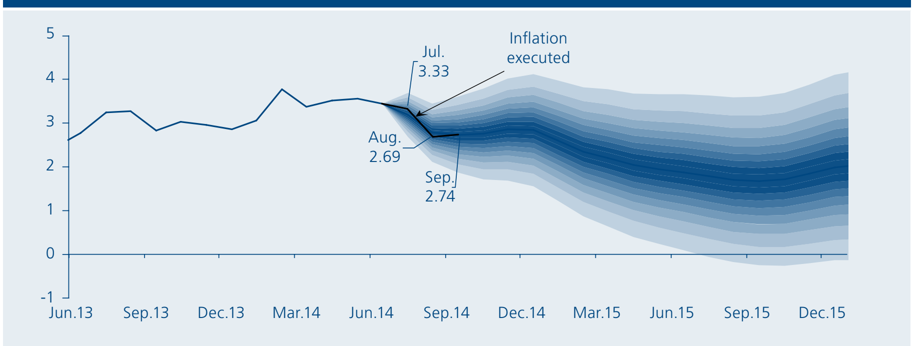
Thus, for example, Petroperu's price for 84-octane gasohol at October 15, 2014, was 32 percent higher than the parity price. In other words, if the price paid to Petroperú were the parity price, the price of each gallon of gasohol would be S/. 2 lower which, given the mean national consumption of this fuel –380 thousand gallons per day, or 9.05 thousand barrels per day– means that consumers would save up to S/. 276 million per annum. If the other gasohols are included, total savings would amount to S/. 566 million per annum.

VII. Monetary Policy and Inflation Forecast

89. The BCRP decides the monetary policy actions it will take based on forecasts prepared using recent macroeconomic information. A confidence interval is also estimated for the forecasts to quantify the degree of uncertainty associated with each of them. As it is usually specified in a Taylor-type interest rate rule, it is necessary to have a forecast of the rate of inflation and the output gap in which the interest rate is a linear function of the two aforementioned variables to guarantee inflation's convergence to the target range. It is worth mentioning that the output gap is the difference between GDP and GDP's potential level. Thus, when GDP falls below its potential value, the output gap shows a negative value, which suggests a cut in the policy rate to anticipate deflationary pressures. Therefore, the BCRP sets the interest rate on the basis of these forecasts using all the information available.

90. The inflation forecast for Q3-2014 in our Inflation Report (IR) of July was that inflation would show an annual average rate of 2.91 percent, which is a rate quite close to the actual rate registered in this period (2.92 percent). This slight difference is explained by a higher imported inflation resulting from a greater-than-expected nominal depreciation, which was in part offset by a more negative output gap and by lower external prices lower than the ones forecast.

Graph 106
INFLATION EXECUTED AND FORECAST IR JUL.14
(12 month % change)



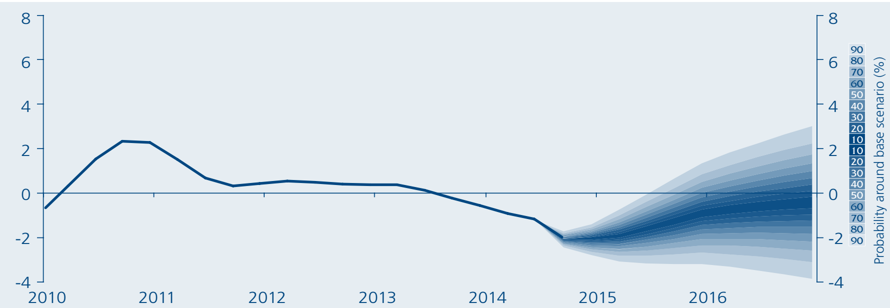
91. Annual inflation is expected to rise to the upper limit of the target range at end-2014 with a rate of 3.0 percent and to converge by 2015 to 2 percent.

Inflation without food and energy would show a rate of 2.4 percent this year. Moreover, the depreciation of the exchange rate observed recently should start affecting the component of imported inflation, although with higher incidence by 2015.

The **inflation** forecast is estimated on the basis of the evolution of inflation's main determinants:

- The **output gap**, which reflects the existence of demand pressures in the economy. The estimated value of the output gap has been revised down both in terms of the value recorded so far and in terms of its forecast value. Based on the new information available at September 2014, the range of the output gap in Q3 is estimated between -2.4 and -1.7 percent, with a confidence interval of 70 percent (vs. a range between -1.5 and -0.6 percent estimated in the IR of July). A similar scenario is foreseen for Q4. The value of the output gap estimated in this report is below that estimated in our previous report.

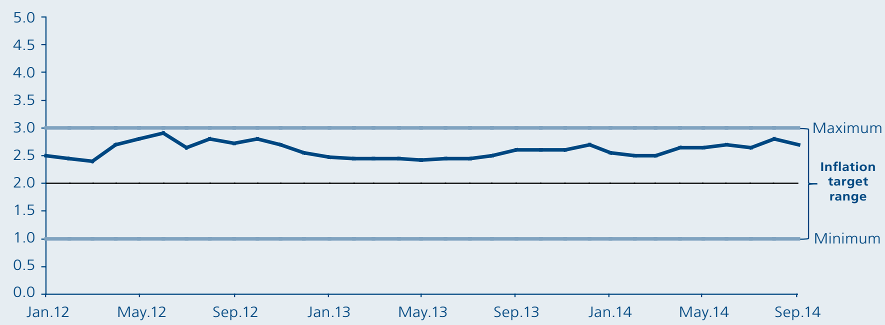
Graph 107
OUTPUT GAP: 2008 - 2016
(% potential GDP)



Memo: In the case of the output gap, each pair of bands concentrate a probability of occurrence of 10% and total bands represent a probability of occurrence of 90%. The risk scenario to the output gap forecast is in the chapter of balance of risk and are used for the inflation forecast.

- **Expectations of inflation**, which are revised slightly downwards. The BCRP Survey on Macroeconomic Expectations shows that expectations are within the target range and that inflation is forecast to decline gradually to 2 percent in the 2015-2016 forecast horizon. A suitable monetary policy position contributes to maintain inflation expectations anchored within the target range, especially in the context of persistent significant shocks that affect sensitive products of the CPI basket.

Graph 108
EXPECTATIONS OF INFLATION FOR THE NEXT YEAR*
(%)



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

- **Imported inflation**, which reflects the evolution of import prices and the evolution of the exchange rate. The downward trend observed in the international prices of commodities is expected to continue, offset by the impact of the recent trend observed in the exchange rate.

As regards exchange rate expectations, the BCRP survey shows that all economic agents expect a moderate depreciation of the nuevo sol this year and next year, but that the depreciation anticipated would be higher than estimated in the previous inflation report. Financial entities have raised the depreciation level they expect at the end of 2014, increasing their estimates of the exchange rate from S/. 2.83 per dollar in June (IR of July) to S/. 2.89 per dollar at the end of September (IR of October), which is consistent with the dynamics observed in the foreign exchange market in Q3.

Table 52
SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE
(Nuevos Soles per US$)

		Expectations about:		
		IR Dec.13	IR Jul.14	IR Oct.14*
Financial entities				
	2014	2.85	2.83	2.89
	2015	2.85	2.88	2.90
	2016	-.-	2.90	2.95
Economic analysts				
	2014	2.90	2.84	2.90
	2015	2.90	2.88	2.95
	2016	-.-	3.03	2.95
Non-financial firms				
	2014	2.82	2.80	2.85
	2015	2.85	2.85	2.90
	2016	-.-	2.90	2.90
Average				
	2014	2.86	2.82	2.88
	2015	2.87	2.87	2.92
	2016	-.-	2.94	2.93

* Survey conducted during the second fortnight of September 2014.
IR: Inflation Report.

- The **supply shocks** affecting inflation through their impact on food and energy prices. It is estimated that these prices would show an average increase of 3.6 percent in 2014, due mainly to climate conditions and to the depreciation of the nuevo sol, affecting mainly energy prices (4.7 percent) –including fuel prices and electricity rates–, while food prices would grow 3.4 percent. No additional supply shocks are anticipated in the baseline forecast horizon, so inflation is estimated to converge to the 2 percent target.

92. The evolution of the **output gap** is determined by external, monetary, and fiscal conditions as well as by economic agents' confidence in the course of the economy, among other factors. The previous graph shows that the further decline in the output gap in the second half of the year are explained by business confidence, external conditions and, to a lesser extent, by monetary conditions in foreign currency (higher expectations of a depreciation), this decline being in part offset by the favorable monetary conditions in domestic currency. Furthermore, the external conditions are associated with fluctuations in the terms of trade and with our trading partners' output gap.

93. A gradual reversal is foreseen in the output gap in the 2015-2016 forecast horizon. This forecast is mainly based on the following determinants:

    - **Business confidence** is expected to rise supported by economic recovery and by the implementation of projects (Line 2 of Lima's Metro, the pipeline, etc.) as well as by the reforms undertaken to increase economic efficiency.

    - **External conditions** should gradually improve in the forecast horizon, in line with the forecasts of global growth and terms of trade in the next two years.

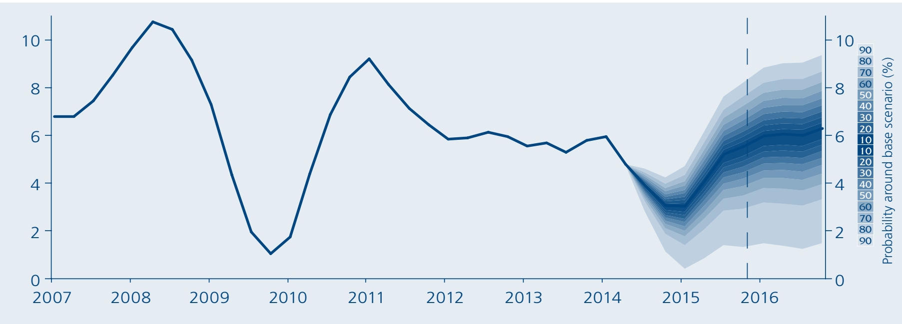
    - The **fiscal impulse** estimated for this year would be equivalent to 0.2 percent of GDP and would be lower than foreseen in our previous IR due to the lower levels of spending in investment registered in subnational governments.

    - **Monetary conditions**: Monetary conditions in soles are still one of the factors that have a positive contribution to the level of the output gap, and reflect the impact of the decisions taken recently by the Central Bank. On the other hand, monetary conditions in dollars are expected to show a contraction by 2015 due to the withdrawal of monetary stimulus by the U.S. Federal Reserve and the beginning of series of increases anticipated in its monetary policy rate.

94. In 2014 the Peruvian economy would grow 3.1 percent, which is consistent with the evolution of the potential output estimated at around 5.3 percent and

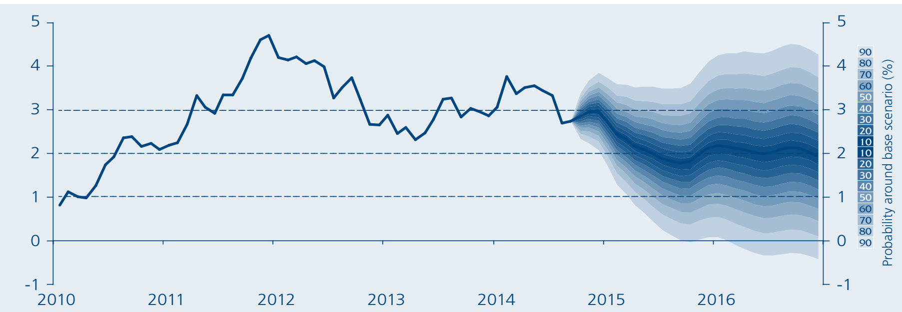
with the change in the output gap. This forecast is explained by the slowdown observed in the growth of private investment and exports, which has generated a negative output gap. Moreover, lower productivity was observed in the primary sector, which is expected to reverse by 2015 as large-scale investment projects are carried out in the mining sector favored by improvements in the legal frameworks. On the other hand, the non-primary sector would grow at moderate growth rates as a result of greater dynamism in the construction sector given the wide range of works to be implemented in the next years. In 2015, the GDP is forecast to grow 5.5 percent.

Graph 109
GDP GROWTH FORECAST: 2014 - 2016
(Interanual % change)



95. As for the inflation forecast, the risks factors on the upside have declined since our last inflation report was published. On the one hand, the output gap shows no inflationary pressures on the demand side, the supply factors that affected inflation in the first semester have slowed down, and the risk of being affected by a severe El Niño event in the following months are now lower. On the other hand, imported inflation has decelerated during this period due to the decline observed in the international prices of the main food commodities.

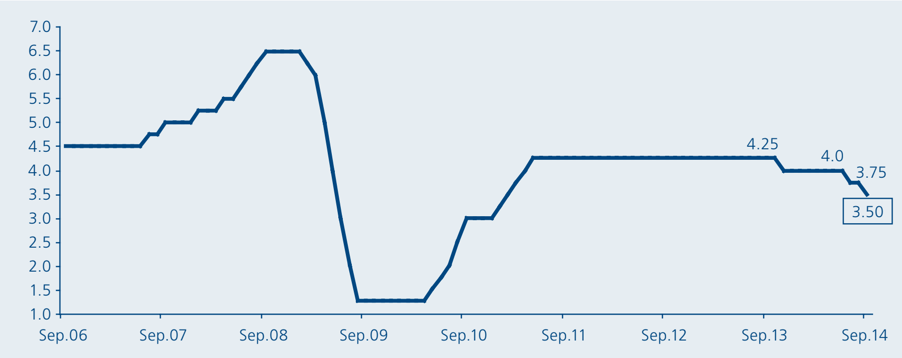
Graph 110
INFLATION FORECAST: 2014 - 2016
(Last 12 months % change)



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.

96. In this context, the Board approved to lower the policy interest rate from 3.75 to 3.50 percent in September. The lower output gap estimated in the Q3-2014–Q4-2015 forecast horizon implied a lower inflation forecast in this horizon, consistent with a lower policy rate. The monetary policy response of the BCRP has been consistent with a scenario of greater downside inflation risk.

Graph 111
BCRP REFERENCE INTEREST RATE
(%)



Box 7
METHOD OF ESTIMATING THE OUTPUT GAP

In the framework of inflation targeting, the Central Bank changes its monetary policy rate based on the projected evolution of the output gap since this indicator allows identifying inflationary pressures in the medium term. Thus, the Central Bank maintains the inflation rate within the target range, which is one of the means through which it accomplishes its main goal of preserving price stability.

The output gap is the difference between GDP and the "natural output" or alternatively the "potential output". These two indicators are measurements of long-term or optimal growth. While the former is associated with economic growth when there are no rigidities to determine prices and wages, the latter is associated with the economy's long-term growth or trend growth.

The output gap can therefore be understood as an indicator that alerts the central bank about the presence of inflationary or deflationary pressures that affect the economy. For this reason, the output gap is continuously monitored by several central banks, and particularly by those with inflation targeting regimes. It is worth pointing out, however, that the evolution of the output gap does not have a perfect correlation with GDP changes because the latter also reflects changes in the potential output. Therefore, changes in GDP growth reflecting transitory changes in supply, or changes in the potential output, will not necessarily lead to changes in the monetary policy position.

Monetary policy will have a contractionary response if the output gap is positive, given that a positive gap anticipates future inflationary pressures, whereas, on the other hand, the monetary policy response will be expansionary if the output gap is negative given that this anticipates future deflationary pressures.

Because this indicator cannot be observed directly, different estimation techniques have been developed. Some of the estimation methods found in economic literature include the following:

1. **Univariate filter methods:** These are statistical methods used to break down the series observed into a trend or smoothing component and a cyclical component. Among them we find the filters developed by Hodrick and Prescott (1980) and Kaiser and Maravall (1999).

2. **Spectral analysis methods:** Spectral techniques are used to obtain cyclical components with certain frequencies. Examples of these methods are the ones designed by Baxter and King (1999), and Christiano and Fitzgerald (2001).

3. **Estimates based on semi-structural models:** These methods use models with explanatory equations for the output gap and inflation. The assumption is that the output gap is affected by variables such as economic expectations, fiscal spending, monetary policy, and external factors. The model is then estimated considering the output gap as a un-observable variable. Using the Kalman filter we can estimate an output gap consistent with the model proposed.

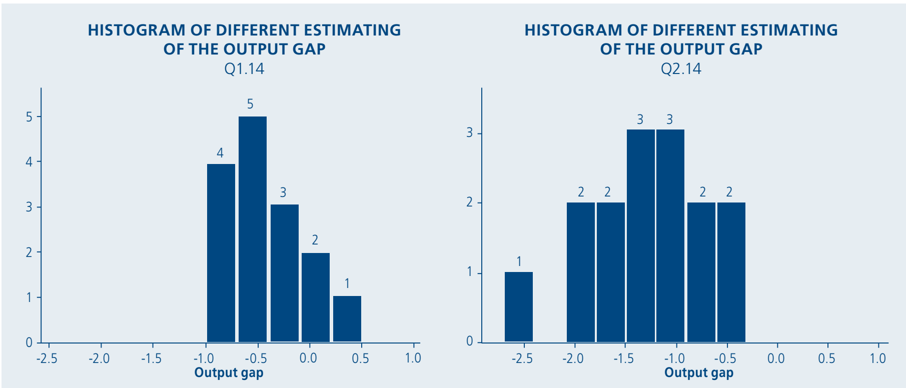
It is also important to determine the information that is relevant to calculate this indicator. Aoki (2001) develops a New-Keynesian model with two sectors that have different levels of price rigidities and shows that in this case the

Central Bank has an optimum behavior paying more attention to the inflation generated in the sector with greater price rigidities. In Peru, we can assume that the primary sector output shows flexible prices because the prices of commodities are determined in competitive markets. In contrast, the non-primary output is shown as a sector with more important price rigidities because it is formed by different services and manufactured goods whose prices do not vary as much as commodity prices.

That is the reason why we consider estimates in which the output gap corresponds only to the gap of the non-primary sector and others in which only a small part of the output gap is generated in the primary sector. These specifications are included in the semi-structural models used to obtain new measures of the output gap through the Kalman filter.

Estimates of the Output Gap in 2014

The different methods described here were used to estimate the output gap. The median of the estimated gaps is -0.5 in Q1 and -1.2 in Q2. All of our specifications for this latter period showed negative output gaps, which would be indicating negative inflation pressures. Therefore, an expansionary position of the monetary policy position is recommended.



In conclusion, the monetary policy stance of the Central Bank does not depend directly on the evolution of GDP, because GDP growth responds to factors that do not affect the future evolution of inflation. Instead, the Central Bank takes into account the evolution of future determinants of inflation, such as the output gap, among others.

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VIII. Balance of Risks

97. Every growth 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 GDP growth rate than the one forecast originally.

    A scenario of domestic risks could include adverse demand shocks which could lead to lower public investment or to a slower recovery of private investment, which could be negatively affected by a decline in business confidence. Moreover, the probability that the recovery in the world economy will be slower or that it will take longer remains high. Recent signs point to a slowdown of growth in the emerging economies as well as to the likelihood that the Fed will raise its benchmark rate earlier than expected.

    The balance of risks for 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.

98. As for the inflation forecast, the main risks that could divert the rate of inflation from the baseline forecast scenario include greater volatility in international financial markets, a greater slowdown in domestic demand, lower global growth, and the occurrence of supply shocks.

    a. **Volatility in international financial markets**

       There is still the risk that the withdrawal of monetary stimulus by the U.S. Federal Reserve will generate high volatility in international interest rates. Such a scenario would generate greater capital withdrawals in the emerging countries, which would cause greater depreciation pressures on the domestic currencies of these countries.

    b. **Slowdown in domestic demand**

       There could be a delay in the recovery of economic activity if the implementation of both public and private investment projects were to be postponed. This would lead to a more negative output gap and therefore to lower inflation in the forecast horizon.

c. **Lower global growth**

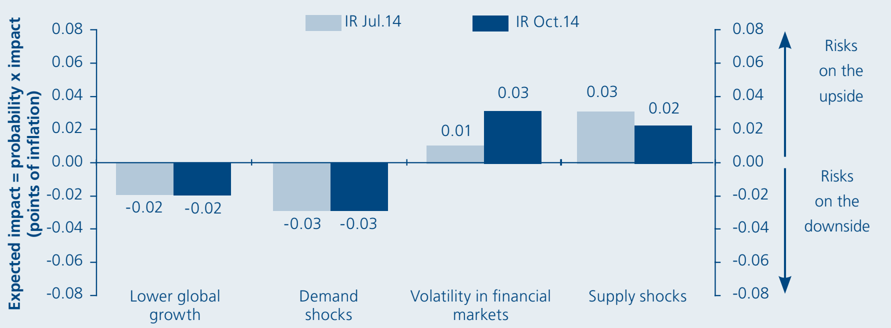
The baseline scenario considers a slower recovery in the world economy in 2014-2016 than the one estimated in our Inflation Report of July. However, if such recovery were to take even longer and if the terms of trade deteriorated even further, the expected external impulse would be lower and would translate into a higher reduction of the output gap and into lower inflation.

d. **Supply shocks**

The risk of being affected by a stronger El Niño event than the one considered in the baseline scenario remains, although the probability of this occurrence as well as the impact of such an event would be lower than estimated in our previous report.

99. Because the risk factors affecting inflation on the downside are offset by the risk factors affecting inflation on the upside, the **balance of these risks is neutral** for the inflation forecast in the forecast horizon.

Graph 112
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 is neutral: The probability that inflation will be below the forecast considered in the baseline scenario is the same than the probability that inflation will be above the forecast level. So, the addition of bars is equal to zero.

Conclusion

100. Inflation is expected to continue declining in the following months and reach a rate of 2 percent in the 2015-2016 forecast horizon, which is consistent with expectations of lower inflation, the culmination of the reversal of supply shocks, and the gradual closing of the negative output gap in the 2014-2016 forecast horizon.

    The Central Bank will continue to pay careful attention to developments in the world economy and in the domestic economy, as well as to inflation expectations. If it is necessary, the Central Bank stands ready to adjust its monetary stance to ensure that inflation remains within the inflation target range.