CENTRAL RESERVE BANK OF PERU

Summary

Inflation Report

December 2015

This ***Inflation Report*** was prepared using data on the Balance of Payments and Gross Domestic Product at Q3-2015 and data on Monetary Accounts, Inflation, Financial Markets and the Exchange Rate at September 2015; and the Non - Financial Public Sector at November 2015.

GDP GROWTH
(Annual % change)

	PPP%	Trading Perú%	2014	2015		2016		2017	
	2013	2013		IR Sep.15	IR Dec.15	IR Sep.15	IR Dec.15	IR Sep.15	IR Dec.15
Advanced economies	**43.8**	**50.0**	**1.8**	**2.0**	**2.0**	**2.3**	**2.2**	**2.2**	**2.1**
Of which:									
1. United Stated	16.3	19.1	2.4	2.4	2.5	2.9	2.6	2.7	2.6
2. Eurozone	12.5	11.7	0.9	1.5	1.5	1.7	1.6	1.7	1.7
Germany	3.5	3.0	1.6	1.5	1.5	1.6	1.5	1.5	1.5
France	2.5	0.7	0.2	1.1	1.1	1.4	1.4	1.5	1.5
Italy	2.0	2.0	-0.4	0.8	0.7	1.2	1.2	1.2	1.2
Spain	1.5	2.9	1.4	3.1	3.1	2.4	2.5	2.0	2.1
3. Japan	4.6	4.2	-0.1	0.9	0.7	1.5	1.3	0.4	0.4
4. United Kingdom	2.4	1.1	2.9	2.4	2.4	2.4	2.4	2.2	2.2
5. Canada	1.5	3.9	2.4	1.0	1.1	2.1	2.1	2.2	2.2
Emerging market and developing	**56.2**	**50.0**	**4.6**	**3.9**	**3.8**	**4.6**	**4.3**	**4.9**	**4.7**
Of which:									
1. Developing Asia	28.6	21.7	6.8	6.4	6.5	6.4	6.4	6.5	6.2
China	15.7	18.2	7.3	6.7	6.9	6.5	6.4	6.3	5.9
India	6.6	1.5	7.3	7.1	7.1	7.4	7.4	7.6	7.6
2. Commonwealth of Independent States	4.8	0.6	1.0	-1.8	-2.5	1.1	0.7	2.0	1.9
Russia	3.4	0.5	0.6	-3.7	-3.9	0.2	-0.2	1.0	1.0
3. Latin American and Caribbean	8.8	24.4	1.3	0.2	-0.4	1.6	0.5	2.8	2.3
Brazil	3.1	4.7	0.1	-1.8	-3.5	0.5	-1.8	2.3	1.5
Chile	0.4	3.5	1.9	2.4	2.2	3.0	2.6	3.6	3.2
Colombia	0.6	2.7	4.6	2.9	2.9	2.8	2.5	3.7	3.5
Mexico	2.0	2.9	2.1	2.3	2.3	3.0	2.8	3.5	3.3
Perú	0.3	-	2.4	3.1	2.9	4.2	4.0	5.0	4.8
World Economy	**100.0**	**100.0**	**3.4**	**3.0**	**3.0**	**3.6**	**3.4**	**3.7**	**3.6**
Memo:									
Peru's trading partners 1/	59.4		2.4	1.9	1.8	2.6	2.1	2.8	2.5
Brics 2/	28.8		5.8	4.6	4.6	5.3	5.0	5.5	5.3

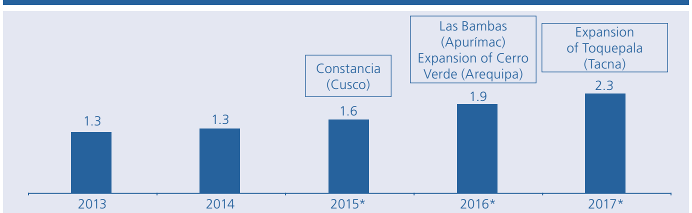
1/ Basket of Peru's 20 main trading partners.
2/ Brazil, Russia, India y China.
IR: Inflation Report
Source: Bloomberg, FMI y Consensus Forecast.

GDP AND DOMESTIC DEMAND
(Real % change)

	2014		2015			2016		2017	
	Jan.-Set.	Year	Jan.-Sep.	IR Sep.15	IR Dec.15	IR Sep.15	IR Dec.15	IR Sep.15	IR Dec.15
I. Domestic demand	**2.2**	**2.2**	**2.7**	**2.7**	**2.5**	**3.1**	**3.0**	**3.7**	**3.8**
Domestic demand excluding inventories	**3.0**	**3.0**	**1.1**	**1.6**	**1.2**	**3.7**	**3.4**	**4.0**	**3.9**
1. Private expenditure	**1.6**	**1.4**	**3.0**	**2.5**	**2.7**	**2.5**	**2.2**	**3.6**	**3.7**
Consumption	4.3	4.1	3.4	3.5	3.4	3.5	3.5	3.8	3.8
Privated fixed investment	-2.3	-2.2	-5.4	-5.5	-5.5	2.0	0.0	4.4	4.0
Change on inventories*	1.0	0.3	2.9	1.3	1.6	0.8	1.3	0.6	1.1
2. Public expenditure	**5.9**	**6.0**	**0.9**	**3.9**	**1.6**	**6.2**	**6.8**	**4.3**	**4.3**
Consumption	8.6	10.1	6.3	6.5	7.4	5.3	5.3	4.0	4.0
Investment	-0.3	-2.0	-12.5	-2.0	-11.2	8.5	10.9	5.0	5.0
II. Net external demand									
1. Exports	**-0.4**	**-1.0**	**1.1**	**0.1**	**1.9**	**7.0**	**5.4**	**9.5**	**7.9**
2. Imports	**-2.3**	**-1.5**	**1.4**	**-1.3**	**0.6**	**2.6**	**1.3**	**4.2**	**4.0**
III. GDP	**2.8**	**2.4**	**2.6**	**3.1**	**2.9**	**4.2**	**4.0**	**5.0**	**4.8**

* % GDP.
IR: Inflation Report.

COPPER PRODUCTION
(Millions FMT)



* Forecast.

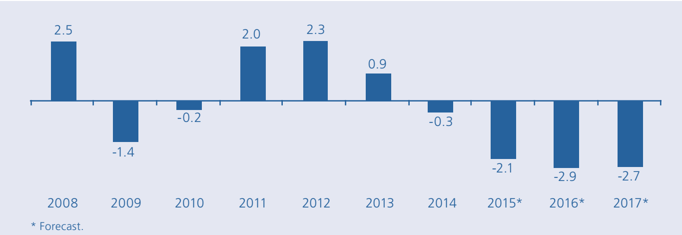
While the global growth forecast for 2015 remains unchanged at 3.0 percent, the global growth forecast for 2016 has been revised down from 3.6 to 3.4 percent. It is worth highlighting that the growth rates of the U.S. economy and China estimated for this year have been revised up from 2.4 to 2.5 percent and from 6.7 to 6.9 percent, respectively, which contrasts with the downward revision of growth rates in Russia (down from -3.7 to -3.9 percent) and Brazil (down from -1.8 to -3.5 percent). Moreover, it should also be pointed out that the forecast of economic activity in Peru's trading partners in 2015 has been revised down from 1.9 to 1.8 percent, the lowest rate estimated since 2009. The recovery of growth expected in the world economy in 2016 would show a more gradual pace (from 3.6 to 3.4 percent), especially in our trading partners (down from 2.6 to 2.1 percent), while in 2017, the world economy would continue recovering with a growth rate of 3.6 percent.

Peru's GDP this year is projected to show a recovery with a growth rate of 2.9 percent as a result of a partial reversal of the supply factors that affected the primary sector last year. The main difference of this forecast with that of our September Report (3.1 percent) is the slower pace of expansion of public spending. A weak performance is observed in public investment, whose growth rate in 2015 would be more negative than foreseen in our previous report due mainly to lower spending in gross capital formation at the levels of both the national government and local governments.

In 2016 and 2017, domestic demand would show greater dynamism as a result of an improvement in private expectations and a better management of spending by the subnational governments.

In 2015, the deficit expected in the account current of the balance of payments would be similar to that observed in 2014 (4.1 percent of GDP vs. 4.0 percent of GDP in 2014), but higher than that forecast in the previous report (3.2 percent) due to a context in which a further deterioration of the terms of trade has been observed. In 2016, on the other hand, the current account deficit (3.6 percent) would be lower than in 2015 given that larger volumes of exports would offset the lower terms of trade, while in 2017 a sharp increase of mining

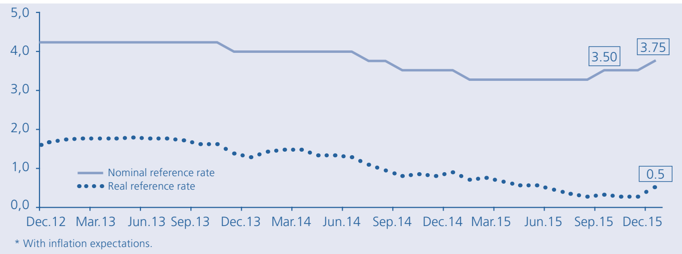
ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2008-2017
(% GDP)



INFLATION
(% change)

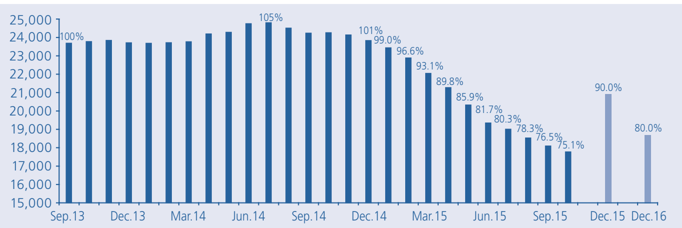
	Weight	2008	2009	2010	2011	2012	2013	2014	2015 Jan.-Nov.	2015 12 month
CPI	**100.0**	**6.65**	**0.25**	**2.08**	**4.74**	**2.65**	**2.86**	**3.22**	**3.93**	**4.17**
1. CPI excluding food and energy	**56.4**	**4.25**	**1.71**	**1.38**	**2.42**	**1.91**	**2.97**	**2.51**	**2.95**	**3.46**
a. Goods	21.7	3.21	2.31	1.07	2.37	1.60	2.62	2.43	3.28	3.51
b. Services	34.8	4.97	1.24	1.58	2.45	2.10	3.18	2.55	2.75	3.43
2. Food and energy	**43.6**	**8.58**	**-0.86**	**2.98**	**7.70**	**3.55**	**2.73**	**4.08**	**5.10**	**5.02**
a. Food and beverages	37.8	9.70	0.57	2.41	7.97	4.06	2.24	4.83	4.96	5.30
b. Fuel and electricity	5.7	1.65	-10.40	6.80	6.01	0.22	6.09	-0.85	6.10	3.12
Fuel	2.8	-0.04	-12.66	12.21	7.54	-1.48	5.95	-5.59	-5.55	-10.71
Electricity	2.9	6.31	-4.56	1.36	4.30	2.19	6.23	4.37	17.75	17.73

NOMINAL AND REAL REFERENCE INTEREST RATE*
(%)

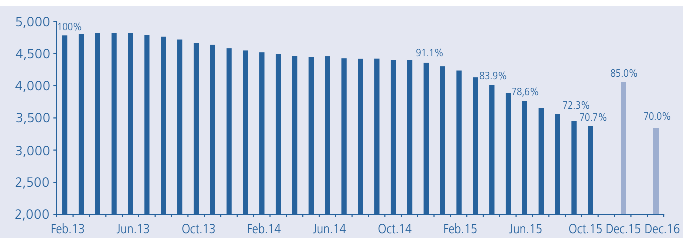


* With inflation expectations.

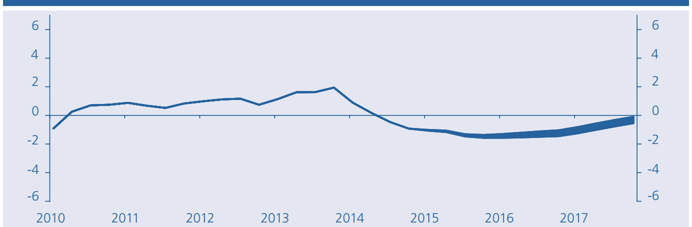
BANK'S CREDITS IN US$ EXCLUDING FOREING TRADE
(Million US$)



BANK'S LOANS IN US$: CAR AND MORTGAGE
(Million US$)



OUTPUT GAP: 2010-2017
(% potential GDP)



exports associated with higher production levels of copper in important mines such as Las Bambas and Cerro Verde would contribute to reduce the deficit to 2.6 percent of GDP.

The public sector deficit forecast for 2015 is revised down from 2.2 to 2.1 percent of GDP (0.3 percent in 2014), this result being mainly explained by non-financial expenditure which has been revised down (0.1 percentage points of GDP) from the level registered in the September report, taking account executed spending of November and lower expected spending in December, particulary, capital spending. On their side, revenue would show higher fall as a result of a slower pace in economic activity, lower mineral and hydrocarbon prices. Similarly, the growth of the general government revenue forecast for 2016 and 2017 is revised down from 20.0 percent of GDP in both years (IR of September) to 19.8 and 19.6 percent of GDP, respectively.

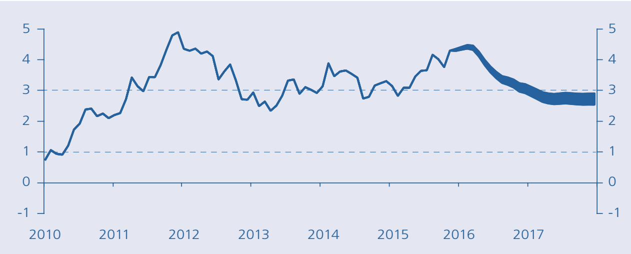
Inflation accumulated in the last twelve months rose from 3.22 percent in December 2014 to 4.17 percent in November 2015. Inflation without food and energy, that is, the inflation rate isolating the impact of these high-volatility prices, rose to 3.46 percent due mainly to the price rise observed in education costs and in water supply rates as well as in some items associated with the exchange rate, such as the prices of motor vehicles and house rents. In addition to this, it is worth mentioning that inflation expectations for 2016 have gradually increased to above the upper band of the target range.

In this context, the Board of the BCRP rose the benchmark interest rate on two occasions, to 3.50 percent in September and to 3.75 percent in December. The Board also reiterated that the BCRP oversees inflation forecasts and inflations determinants and stands ready to make further adjustments in the policy rate, if necessary, to lead inflation to converge to the target range.

In addition to this, in order to continue promoting the de-dollarization of credit, in November the BCRP expanded its credit de-dollarization program, adjusting the limits used to calculate the rate of additional reserve requirements based on the reduction of banks' balance of credit in foreign currency at December 2016. In the case of total credit in foreign currency, the minimum reduction required now is 20 percent of the balance banks registered in September, 2013, while in the case of car loans and mortgage loans, the minimum reduction required by 2016 is 30 percent of the balance recorded in February 2013. Thereafter, the reduction for car loans and mortgage loans will increase by 10 percentage points each year end.

A negative output gap is expected in 2015 due to the effects of lower business confidence and more deteriorated external conditions (growth of trading partners and terms of trade), even though these effects were offset by expansionary monetary conditions. Total inflation accelerated this year due

INFLATION FORECAST: 2010-2017
(Last 12-month % change)



to higher expectations of inflation and the effect of a greater depreciation of the sol, as well as due to transitory supply shocks. A similar output gap is expected for 2016, with a recovery in the quarterly pace of growth driven by greater public investment and a gradual recovery in business confidence being foreseen. This negative output gap reflects the absence of demand-pull inflationary pressures in the forecast horizon. The evolution of the output gap, accompanied by a lower depreciation of the sol and by the reversal of the supply shocks, would contribute to inflation's convergence towards the inflation target range in the forecast horizon.

Risk Balance

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

Lower global growth

The baseline scenario considers a slower recovery in the world economy in 2016-2017 than the one estimated in our Inflation Report of September, especially in the United States and in the emerging economies. However, if such recovery were to take even longer and if the terms of trade continued deteriorating, the resulting lower external impulse would translate into a lower output gap and into a lower inflation rate.

Slowdown in domestic demand

Economic recovery could take longer than expected if the implementation of both public and private investment projects were postponed, which would generate a more negative output gap (and to a reduction in the growth of the potential output) and, therefore, to lower inflation in the forecast horizon.

Volatility in international financial markets

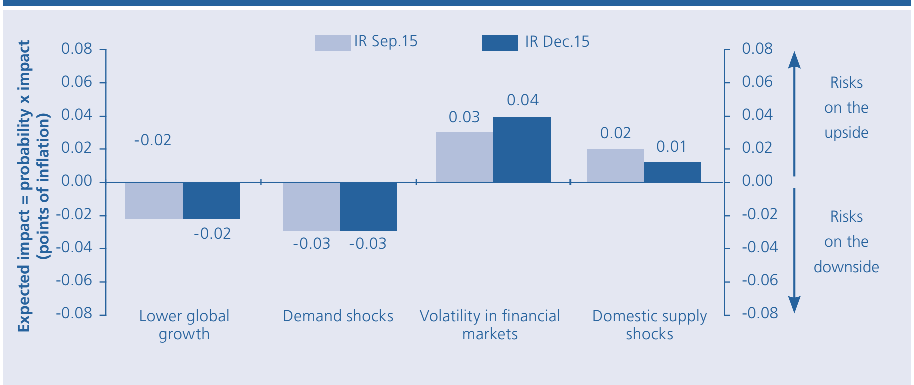
This risk could occur if the withdrawal of monetary stimulus by the U.S. Federal Reserve brought about volatility in international financial markets. Such a scenario could generate capital outflows from the emerging markets and depreciation pressures on the currencies of these countries. An additional rise in the exchange rate would lead to higher inflation in the forecast horizon.

Supply shocks

A more severe El Niño episode than the one considered could generate upward pressures on the prices of some food products, especially in the first half of 2016.

Even though the balance of the risks mentioned above remains neutral in the inflation forecast, there is a higher risk of having a scenario of high volatility in financial and foreign exchange markets as well as a lower risk of occurrence of an extremely severe El Niño episode.

BALANCE OF RISKS AGAINST THE BASE SCENARIO



SUMMARY OF INFLATION REPORT FORECAST

	2014	2015 1/		2016 1/		2017 1/	
		IR Sep.15	IR Dec.15	IR Sep.15	IR Dec.15	IR Sep.15	IR Dec.15
Real % change							
1. Gross Domestic Product	2.4	3.1	2.9	4.2	4.0	5.0	4.8
2. Domestic demand	2.2	2.7	2.5	3.1	3.0	3.7	3.8
a. Private consumption	4.1	3.5	3.4	3.5	3.5	3.8	3.8
b. Public consumption	10.1	6.5	7.4	5.3	5.3	4.0	4.0
c. Fixed private investment	-2.2	-5.5	-5.5	2.0	0.0	4.4	4.0
d. Public investment	-2.0	-2.0	-11.2	8.5	10.9	5.0	5.0
3. Exports (good and services)	-1.0	0.1	1.9	7.0	5.4	9.5	7.9
4. Imports (goods and services)	-1.5	-1.3	0.6	2.6	1.3	4.2	4.0
5. Economic growth in main trading partners	2.4	1.9	1.8	2.6	2.1	2.8	2.5
Memo:							
Output gap 2/ (%)	-1.0 ; 0.0	-1.5 ; 0.0	-1.5 ; 0.0	-1.5 ; -0.0	-1.5 ; -0.0	-1.0 ; 0.0	-1.0 ; 0.0
% change							
6. Inflation	3.2	3.5 - 4.0	4.1	2.5 - 3.0	2.5 - 3.0	2.0 - 2.5	2.0 - 2.5
7. Average price of crude oil	-4.9	-46.5	-47.3	-3.6	-6.8	8.5	7.8
8. Expected nominal exchange rate 3/	6.4	12.5	14.7	3.0	2.9	0.5	0.2
9. Real multilateral exchange rate	-0.6	3.2	3.7	4.2	1.2	1.4	-0.7
10. Terms of trade 4/	-5.4	-4.4	-5.8	-4.5	-4.0	0.2	1.7
a. Export price index	-6.9	-13.4	-14.6	-4.5	-6.4	2.3	3.5
b. Import price index	-1.5	-9.4	-9.4	-0.1	-2.5	2.0	1.8
Nominal % change							
11. Currency in circulation	11.2	8.0	8.0	8.0	8.0	8.0	8.0
12. Credit to the private sector 5/	10.4	9.0	9.5	9.5	9.0	9.5	9.0
% GDP							
13. Gross fixed investment	25.8	24.2	24.0	24.2	23.8	24.2	23.9
14. Current account of the balance of payments	-4.0	-3.2	-4.1	-3.1	-3.6	-2.3	-2.6
15. Trade balance	-0.6	-1.1	-1.5	-1.0	-1.3	0.0	-0.3
16. Gross external financing of the private sector 6/	7.2	3.9	5.0	3.8	3.9	3.9	4.0
17. Current revenue of the general government	22.2	20.0	20.0	20.0	19.8	20.0	19.6
18. Non-financial expenditure of the general government	21.5	21.3	21.2	21.5	21.3	21.2	21.0
19. Overall balance of the non-financial public sector	-0.3	-2.2	-2.1	-2.7	-2.9	-2.6	-2.7
20. Total public debt balance	20.1	22.4	22.6	24.2	24.8	24.2	24.2

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