# INFLATION REPORT

*May 2015*

# Recent trends and macroeconomic forecasts 2015-2017

CENTRAL RESERVE BANK OF PERU

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## Recent trends
## and macroeconomic forecasts 2015-2017

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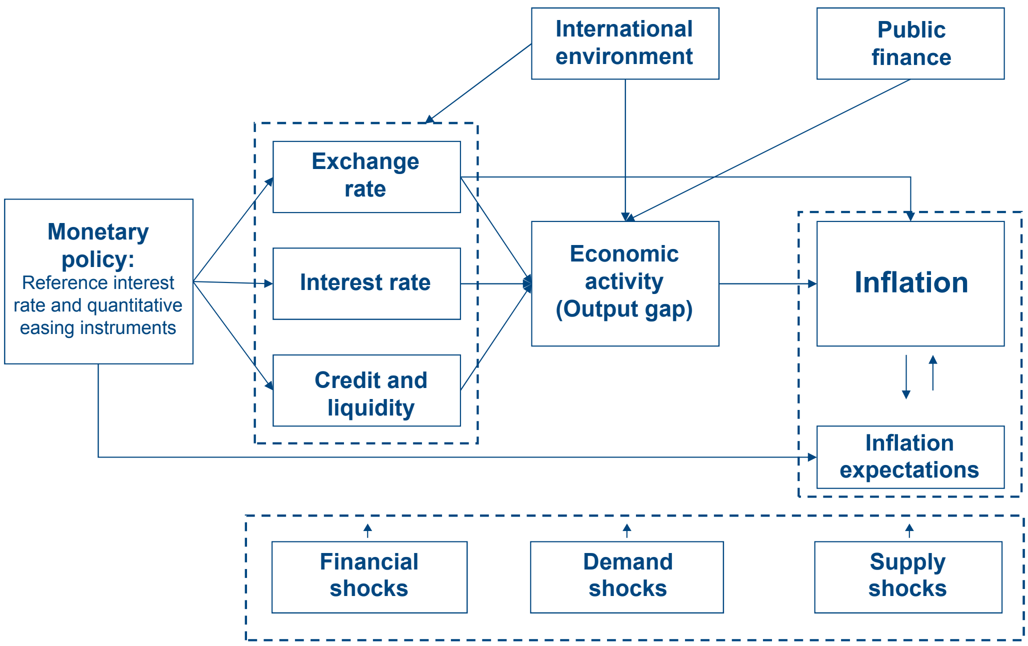



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## CONTENT

**Page**



**BOXES**



This ***Inflation Report*** was prepared using data on the Balance of Payments and Gross Domestic Product at Q1-2015 and data on the Non-Financial Public Sector, Monetary Accounts, Inflation, Financial Markets, and the Exchange Rate at April 2015.

# 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. The BCRP is responsible for regulating the money supply and credit in the financial system, for managing the country's international reserves, and for reporting on the nation's finances.

- 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 lending market. Since this interest rate, which is the monetary operational target, affects the rate of inflation through several channels in different timeframes, this rate is set based on inflation forecasts and forecasts of inflation determinants.

- The Central Bank takes into account that inflation may be influenced by factors beyond the control of monetary policy actions, such as shocks that may affect the supply of goods and services like fluctuations in the prices of imported products or climate factors, 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 actions 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 in periods of capital inflows or high export prices, 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 global economy continues to show moderate growth and heterogeneous paces of growth. On the one hand, the United States continues showing a gradual recovery and there are signs of recovery in the Eurozone, while on the other hand there is lower growth in China. The forecast of global growth in 2015 has been revised down from 3.5 to 3.2 percent, whereas a greater dynamism is estimated in the world economy for 2016 and 2017 with rates of 3.7 and 3.8 percent, respectively.

ii. Peru's pace of growth would recover in 2015 with a GDP rate of 3.9 percent as a result of a partial reversal of the supply shocks that affected the primary sector in 2014 (down 2.3 percent). The main difference with the growth rate forecast in our Report of January (4.8 percent) is the lower dynamism of investment during the first part of the year. The forecast also considers an improvement of economic activity during the second half of the year, especially as a result of a recovery of investment in sub-national governments, the positive impact of investment on the onset of infrastructure projects, and the strengthening of economic agents' confidence.

Moreover, GDP would show a faster pace of growth in 2016 and 2017 –with growth rates of 5.3 and 5.8 percent, respectively–, in line with an extraordinary growth in mining production, greater investment in infrastructure, and the total reversal of the negative supply shocks observed in 2014.

iii. In 2015 the current account deficit of the balance of payments would be equivalent to 3.9 percent of GDP, slightly lower than in 2014 (4.0 percent). The deficit is expected to be lower than the one estimated in our previous Inflation Report due mainly to a reduction in the demand for imports and to lower factor income payments. In 2016 and 2017 the current account deficit is expected to decrease to 3.3 and 2.0 percent, respectively, as a result of a recovery in mining exports associated with the onset of operations at Las Bambas and the expansion of Southern and Cerro Verde.

iv. A public sector deficit of 2.0 percent of GDP is estimated for 2015 (vs. a deficit of 0.3 percent in 2014), the increase in the deficit being explained by the fact that lower extraordinary revenues are anticipated as well as by the impact of the reduction of the income tax, the excise tax, and tariffs implemented at the end of 2014. This would be in part offset by lower public investment as a result of the contraction of subnational governments' expenditure in the first months of the year. In 2016 and 2017, the deficit would gradually decline to 1.8 and 1.5 percent, respectively, showing a similar path to the one foreseen in the Multi-annual Macroeconomic Plan 2016-2018.

v. After reducing the policy interest rate by 25 basis points in January, the Board of the Central Reserve Bank of Peru (BCRP) has maintained this rate at 3.25 percent. This level of the policy rate is compatible with an inflation forecast in which inflation gradually converges to 2.0 percent in the 2015-2017 forecast horizon. This level reflects an expansionary monetary stance that considers both the effect of a level of economic activity below its potential and the lagged effect of the increase registered in the exchange rate on the inflation rate.

   In addition, the BCRP also continued lowering the rate of reserve requirements in domestic currency. This policy is aimed at easing credit conditions in soles to banks in order to facilitate the expansion of credit in this currency, in a context in which deposits in soles have grown at a slower pace than credit. The most recent reduction in the rate of required reserves in soles –from 7.5 to 7.0 percent– came into effect in May 2015.

   Additionally, with the aim of strengthening the pass-through of the benchmark rate to other rates in the financial system and facilitate the expansion of credit in soles, the BCRP has been injecting liquidity into the financial system through currency repos with maturities of up to 4 years using both credit-expansion repos and credit-substitution repos. These operations have been recently complemented with auctions of part of the funds that the Treasury and Banco de la Nación have as deposits at the Central Bank.

   Moreover, in order to discourage the dollarization of deposits, the BCRP raised marginal reserve requirements on operations in foreign currency from 60 to 70 percent in March. The de-dollarization of credit has accelerated in the first months of the year, supported also by the actions taken by the BCRP at the end of 2014. In addition to this, the Central Bank has also established additional reserve requirements in soles according to the level of operations with currency derivatives to reduce the exchange rate volatility.

vi. In April 2015 the accumulated rate of inflation in the last 12 months was 3.0 percent, this rate reflecting mainly increases in food prices and electricity rates. The rate of inflation excluding food and energy –items with high volatility of prices– was 2.7 percent.

   Inflation is expected to gradually decline to 2.0 percent in the 2015-2017 forecast horizon. This scenario considers that there will be no demand inflationary pressures in the forecast horizon and that inflation expectations will remain within the target range, showing a downward trend towards 2 percent.

vii. As regards the inflation forecast, the events that could most likely divert the inflation rate 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.

a. **Lower global growth**

The baseline scenario considers a slower recovery in the world economy in 2015-2017 than the one estimated in our Inflation Report of January. 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.

b. **Slowdown in domestic demand**

Economic recovery could take longer than expected if the implementation of both public and private investment projects were to be postponed. This would lead to 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.

c. **Volatility in international financial markets**

This risk could occur if the Federal Reserve's withdrawal of monetary stimulus brought about volatility in international financial markets. In such a scenario, this could generate capital outflows from the emerging countries and depreciation pressures on the currencies of these economies.

d. **Supply shocks**

Greater uncertainty is being observed in international markets due to geopolitical tensions in the Middle East. A rise in the international prices of oil significantly higher than the price levels considered in the baseline scenario could generate inflationary pressures. Similarly, a more severe El Niño event than the one considered could generate upward pressures on the prices of some foods products.

viii. The evaluation of the above-mentioned risks results in a neutral balance for inflation, in contrast with the risk balance of our January Report which was tilted to the downside. This revision is explained mainly by increased volatility in international financial markets and in fuel prices.

## FORECAST SUMMARY

| | 2014 | 2015[1/] | | 2016[1/] | | 2017[1/] |
|---|---|---|---|---|---|---|
| | | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **Real % change** | | | | | | |
| 1. GDP | 2.4 | 4.8 | 3.9 | 6.0 | 5.3 | 5.8 |
| 2. Domestic demand | 2.2 | 4.7 | 3.8 | 5.2 | 4.4 | 4.6 |
| a. Private consumption | 4.1 | 4.5 | 3.7 | 4.8 | 4.1 | 4.3 |
| b. Public consumption | 6.4 | 6.6 | 8.3 | 6.0 | 4.0 | 4.0 |
| c. Private fixed investment | -1.6 | 3.0 | 1.0 | 5.2 | 4.4 | 5.4 |
| d. Public investment | -2.4 | 12.0 | 4.0 | 11.6 | 7.2 | 5.0 |
| 3. Exports (goods and services) | -1.0 | 3.4 | 1.7 | 9.4 | 8.4 | 9.4 |
| 4. Imports (goods and services) | -1.5 | 2.9 | 1.5 | 5.9 | 4.5 | 4.6 |
| 5. Economic growth in main trading partners | 2.4 | 2.7 | 2.3 | 3.0 | 2.8 | 2.8 |
| **Memo**: | | | | | | |
| Output gap [2/] (%) | -2.0 ; -1.0 | -2.0 ; -1.0 | -2.5 ; -1.0 | -1.0 ; 0.0 | -1.0 ; 0.0 | -1.0 ; 0.0 |
| **% change** | | | | | | |
| 6. Inflation | 3.2 | 1.5 - 2.5 | 2.0 - 3.0 | 1.5 - 2.5 | 1.5 - 2.5 | 1.5 - 2.5 |
| 7. Average price of crude oil | -4.9 | -45.1 | -40.9 | 13.5 | 12.7 | 2.8 |
| 8. Nominal exchange rate expected [3/] | 6.4 | 3.5 | 8.8 | 2.2 | 1.3 | 0.5 |
| 9. Real multilateral exchange rate [3/] | -0.6 | 0.7 | 4.0 | 0.7 | 0.4 | 0.1 |
| 10. Terms of trade [4/] | -5.4 | -0.7 | -2.1 | -1.0 | -1.1 | -0.6 |
| a. Export price index | -6.9 | -7.7 | -9.1 | 0.9 | 1.3 | 1.9 |
| b. Import price index | -1.5 | -7.1 | -7.2 | 1.9 | 2.4 | 2.5 |
| **Nominal % change** | | | | | | |
| 11. Currency in circulation | 11.2 | 10.8 | 9.0 | 11.5 | 9.0 | 9.0 |
| 12. Credit to the private sector [5/] | 10.4 | 12.0 | 10.5 | 13.0 | 11.5 | 11.5 |
| **% GDP** | | | | | | |
| 13. Gross fixed investment | 25.9 | 25.4 | 25.4 | 25.6 | 25.2 | 25.1 |
| 14. Current account of the balance of payments | -4.0 | -4.4 | -3.9 | -3.7 | -3.3 | -2.0 |
| 15. Trade balance | -0.6 | -1.3 | -0.8 | -0.9 | -0.2 | -0.7 |
| 16. Long-term external financing to the private sector [6/] | 7.2 | 5.9 | 5.3 | 5.2 | 4.5 | 4.1 |
| 17. Current revenue of the general government | 22.2 | 20.7 | 20.3 | 20.8 | 20.4 | 20.4 |
| 18. Non-financial expenditure of the general government | 21.5 | 21.7 | 21.4 | 21.8 | 21.0 | 20.6 |
| 19. Overall balance of the non-financial public sector | -0.3 | -2.0 | -2.0 | -2.0 | -1.8 | -1.5 |
| 20. Total public debt balance | 20.1 | 19.6 | 20.7 | 19.3 | 21.0 | 20.3 |

IR: Inflation Report.
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 Foreign Direct Investment, portfolio investment, and private sector's long-term disbursement.

# I. International Environment

## Output

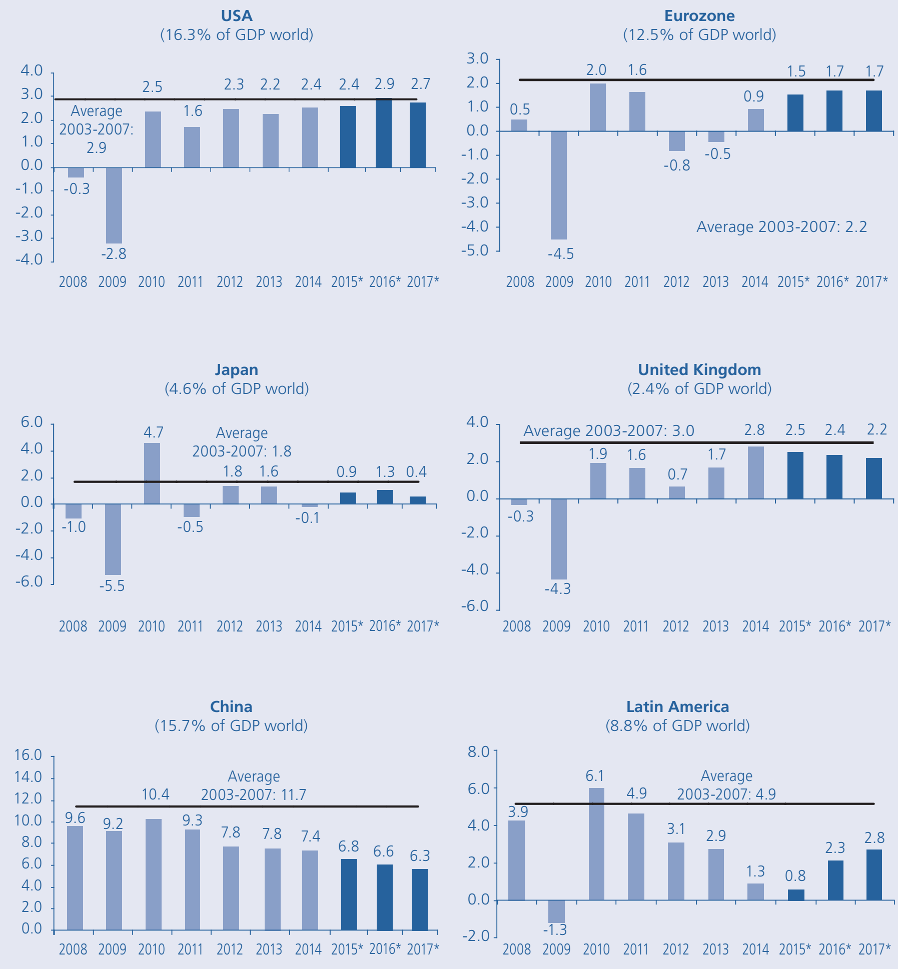
1. The estimated growth rate of global GDP in 2015 has been revised down from 3.5 to 3.2 percent in this report, while a recovery of growth is still foreseen for 2016 and 2017. Similarly, the projected level of economic activity in our major trading partners has been revised down from 2.7 to 2.3 percent this year. This downward revision of the growth projection is associated with the lower dynamism estimated in the economies of the United States (from 3.1 to 2.4 percent), China (from 7.0 to 6.8 percent), and Brazil (0.6 to -1.0 percent). In contrast, the projection of growth in the Eurozone and India is revised upwards (from 1.1 to 1.5 percent for the former and from 6.3 to 7.2 percent for the latter).

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

| | PPP% 2013 | 2014 | 2015* | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|
| | | | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **Advanced economies** | **43.8** | **1.8** | **2.3** | **2.1** | **2.3** | **2.4** | **2.2** |
| *Of which* | | | | | | | |
| 1. United States | 16.3 | 2.4 | 3.1 | 2.4 | 3.0 | 2.9 | 2.7 |
| 2. Eurozone | 12.5 | 0.9 | 1.1 | 1.5 | 1.5 | 1.7 | 1.7 |
| Germany | 3.5 | 1.6 | 1.1 | 1.6 | 1.5 | 1.6 | 1.5 |
| France | 2.5 | 0.4 | 0.9 | 1.2 | 1.3 | 1.5 | 1.7 |
| Italy | 2.0 | -0.4 | 0.3 | 0.6 | 1.0 | 1.2 | 1.2 |
| Spain | 1.5 | 1.4 | 1.7 | 2.7 | 1.7 | 2.2 | 2.0 |
| 3. Japan | 4.6 | -0.1 | 1.3 | 0.9 | 1.0 | 1.3 | 0.4 |
| 4. United Kingdom | 2.4 | 2.8 | 2.7 | 2.5 | 2.4 | 2.4 | 2.2 |
| **Emerging market and developing economies** | **56.2** | **4.6** | **4.4** | **4.1** | **4.9** | **4.7** | **5.0** |
| *Of which* | | | | | | | |
| 1. Developing Asia | 28.6 | 6.8 | 6.5 | 6.6 | 6.5 | 6.6 | 6.5 |
| China | 15.7 | 7.4 | 7.0 | 6.8 | 6.8 | 6.6 | 6.3 |
| India | 6.6 | 7.2 | 6.3 | 7.2 | 6.5 | 7.4 | 7.6 |
| 2. Commonwealth of Independent States | 4.8 | 1.0 | -1.7 | -2.1 | 0.7 | 0.7 | 2.0 |
| Russia | 3.4 | 0.6 | -4.0 | -4.2 | -1.5 | -0.4 | 1.0 |
| 3. Latin America and the Caribbean | 8.8 | 1.3 | 1.7 | 0.8 | 2.8 | 2.3 | 2.8 |
| Brazil | 3.1 | 0.1 | 0.6 | -1.0 | 2.0 | 1.2 | 2.3 |
| **World Economy** | **100.0** | **3.3** | **3.5** | **3.2** | **3.7** | **3.7** | **3.8** |
| **Memo:** | | | | | | | |
| Peru's trading partner 1/ | 59.4 | 2.4 | 2.7 | 2.3 | 3.0 | 2.8 | 2.8 |

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

**Graph 1**
**GDP GROWTH**
(Annual % change)




* Forecast.
Source: BCRP.

2. Like in the same period of 2014, in Q1-2015 the U.S. economy was affected by a colder than usual winter, to which added a drop in exports associated with the dollar's appreciation of 13 percent between April 2014 and March of this year and a significant reduction in investment in the hydrocarbon sector in Q1 as a result of the fall in the price of oil by 53 percent in the last twelve months.

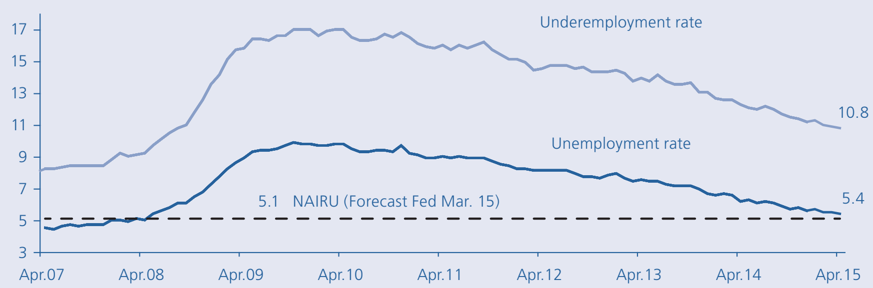
**Table 2**
**USA: GDP**
(Seasonally adjusted annualized quarterly rates)

| | 2013 | | | | 2014 | | | | 2015 |
|---|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 |
| Private consumption | 3.6 | 1.8 | 2.0 | 3.7 | 1.2 | 2.5 | 3.2 | 4.4 | 1.9 |
| Fixed investment | 2.7 | 4.9 | 6.6 | 6.3 | 0.2 | 9.5 | 7.7 | 4.5 | -2.5 |
| Change on inventories * | 0.7 | 0.3 | 1.5 | -0.3 | -1.2 | 1.4 | 0.0 | -0.1 | 0.7 |
| Net exports * | -0.1 | -0.5 | 0.6 | 1.1 | -1.7 | -0.3 | 0.8 | -1.0 | -1.3 |
| **GDP** | **2.7** | **1.8** | **4.5** | **3.5** | **-2.1** | **4.6** | **5.0** | **2.2** | **0.2** |
| **Memo:** | | | | | | | | | |
| Unemployment rate ** | 7.5 | 7.5 | 7.2 | 6.7 | 6.7 | 6.1 | 5.9 | 5.6 | 5.5 |

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

Labor market indicators in the United States show a continuous recovery: an average of 193 thousand new jobs have been created between January and April of this year while the unemployment rate has fallen from 5.6 percent in December 2014 to 5.4 percent in April 2015 and underemployment has dropped from 11.2 to 10.8 percent in the same period.

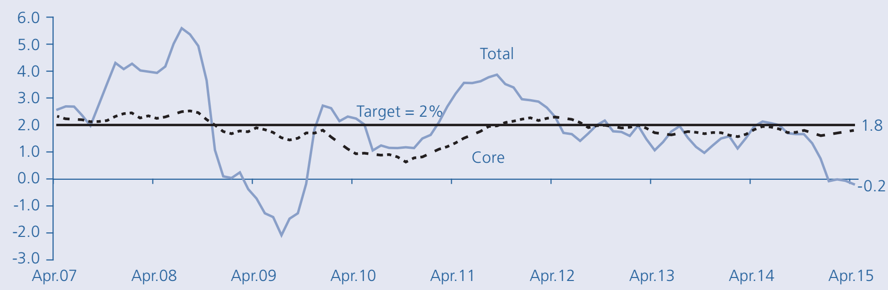
**Graph 2**
**USA: UNEMPLOYMENT MEASURES**
(%)




NAIRU: Non-Acelerating Inflation Rate of Unemployment. .
Source: Bloomberg.

The rate of core inflation in the United States –core inflation excludes the transitory effects of food and fuel prices– increased slightly (from 1.6 percent in December 2014 to 1.8 percent in April 2015), but remained below the 2 percent target of the Federal Reserve (Fed).

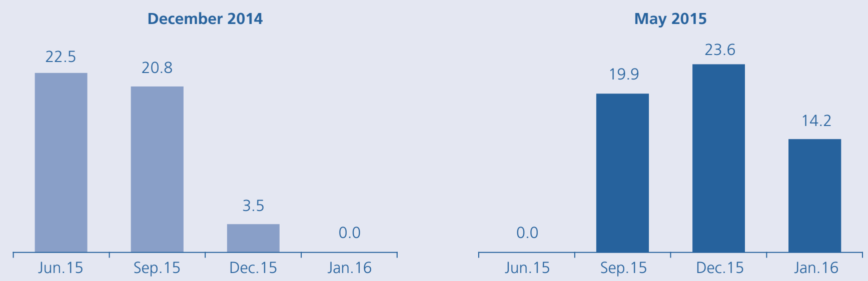
**Graph 3**
**USA: CPI**
(12 month % change)




Source: Bloomberg.

In this context of moderate growth and contained inflation, there is still uncertainty about when the Federal Reserve will start adjusting its interest rates. At the Federal Open Market Committee meeting of March, the Federal Reserve acknowledged the temporary slowdown in the economy, but remained optimistic about a recovery in the coming months. The Fed's decision to raise rates could be delayed if the appreciation trend of the dollar intensifies or if the economy continues to show a slow recovery in the following quarters. According to market expectations in December 2014, the most likely period for the first interest rate rise by the Federal Reserve was between June and September of 2015 and there was practically no probability that the first rate rise would take place in 2016. The data at May now would be indicating that the most likely period for the Fed to start the rate hikes is between September 2015 and January 2016.

**Graph 4**
**PROBABILITY OF FIRST FED POLICY RATE HIKE**
**IN THE NEXT FOMC MEETING**
(Measured by Overnight Indexed Swap)




FOMC: Federal Open Market Committee.

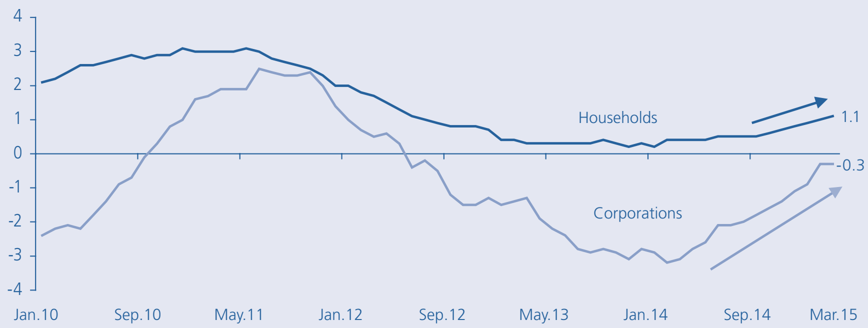
3. The Eurozone has been showing a boost in economic activity since Q4-2014 because of the positive impact of the lower international fuel prices, the depreciation of the euro, and better financial conditions in terms of interest rates and greater access to credit. In addition, it is worth highlighting the favorable effect that the actions taken by the European Central Bank, particularly the extension of the asset purchase program announced in January, has had on the recovery of activity.

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

| | 2013 | | | | 2014 | | | | 2015 |
|---|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 |
| Private consumption | -0.9 | 0.5 | 0.6 | 0.6 | 0.9 | 1.0 | 2.0 | 1.8 | 3.0 |
| Fixed investment | -8.6 | 2.8 | 2.6 | 2.0 | 1.8 | -2.1 | 0.0 | 1.6 | 1.5 |
| Change on inventories ** | 0.8 | -0.7 | 1.2 | -0.8 | 0.9 | -0.8 | -0.5 | -0.9 | 0.8 |
| Net exports ** | -0.4 | 1.6 | -1.6 | 1.2 | -1.2 | 0.4 | -0.1 | 0.8 | -1.3 |
| Government expenditure | 0.7 | 0.5 | 0.7 | 0.2 | 0.9 | 0.6 | 1.0 | 0.7 | 1.0 |
| **GDP** | **-1.5** | **1.4** | **0.7** | **1.1** | **1.1** | **0.3** | **0.7** | **1.3** | **1.6** |
| **Memo:** | | | | | | | | | |
| Unemployment rate *** | 12.0 | 12.1 | 12.0 | 11.9 | 11.7 | 11.6 | 11.5 | 11.4 | 11.3 |

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

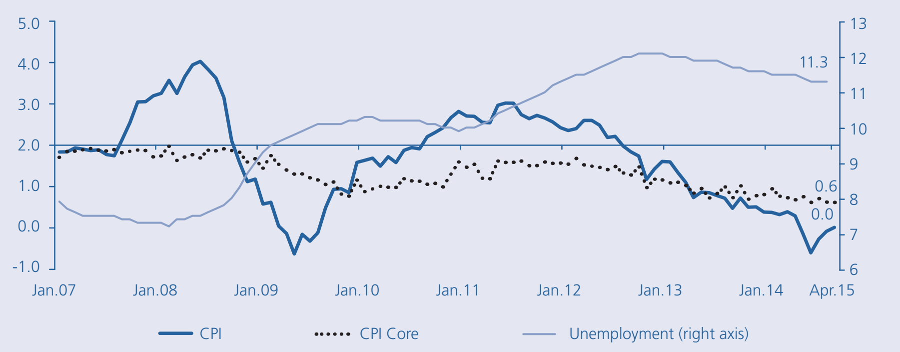
**Graph 5**
**EUROZONE: LOANS TO NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS**
(12 month % change)




Source: Bloomberg.

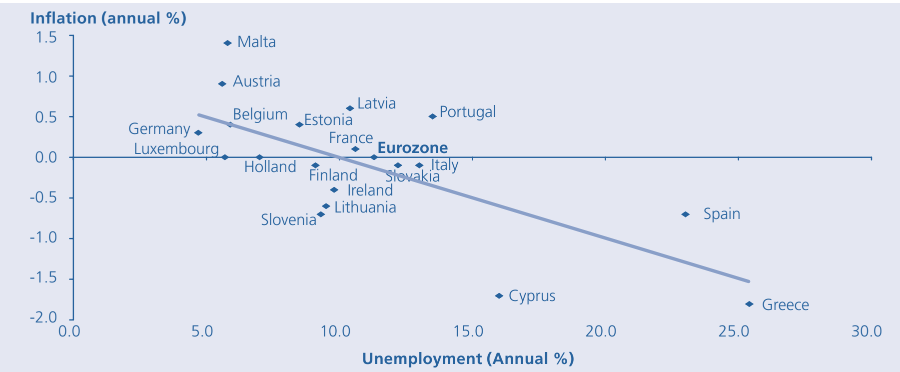
In April, the Eurozone registered an annual inflation rate of zero percent, with 9 countries showing negative rates (vs. 17 countries in January 2015). However, core inflation continues to show a relatively stable trend, the rate having declined from 0.7 percent in December 2014 to 0.6 percent in April 2015.

**Graph 6**
**EUROZONE: ANNUAL INFLATION AND UNEMPLOYMENT RATES**
(12 month % change)




Source: Bloomberg.

**Graph 7**
**EUROZONE: INFLATION AND UNEMPLOYMENT RATE**
(%)

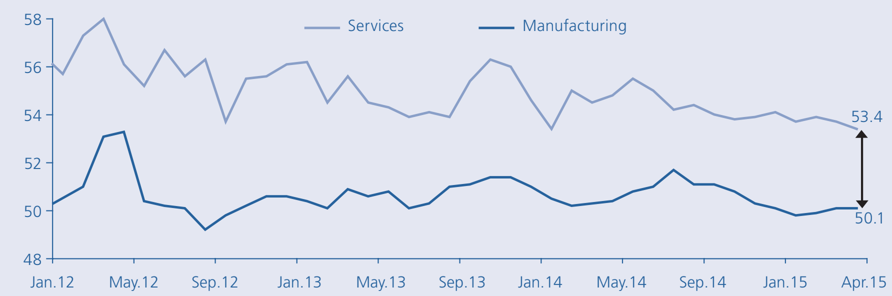



Source: Bloomberg.

In this scenario of gradual recovery of production and of moving away from the risk of deflation in the Eurozone, but with still high unemployment, the ECB confirmed in April that it will continue with its purchase program of sovereign bonds of up to a billion euros until it completion in September 2016.

4. China's GDP growth rate fell to 7.0 percent in Q1-2015 (7.4 percent in the previous quarter). At the sector level, greater dynamism is still observed in the sector of services with a monthly activity index (PMI) of 53.4, whereas the manufacturing sector remains affected by overcapacity in heavy industry (PMI of 50.1).

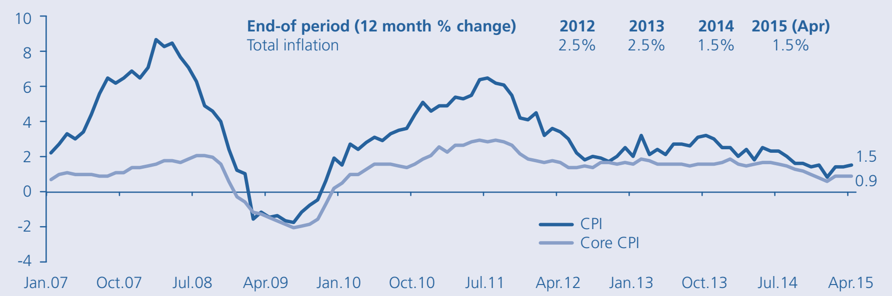
**Graph 8**
**CHINA:OFFICIAL PMI MANUFACTURING AND SERVICES INDICES**




Source: Bloomberg.

In April, core inflation in China remained low (0.9 percent), confirming the slower pace of activity observed. Because of this, the Central Bank cut reserve requirement rates and the monetary policy interest rate, expanded the range of collaterals eligible for its refinancing operations, and expanded the facility for medium-term loans for banks. As a result of this, bank credit has recovered and registered a growth rate of 14 percent at April 2015.

**Graph 9**
**CHINA: CPI AND CORE CPI**
(Annual % change)

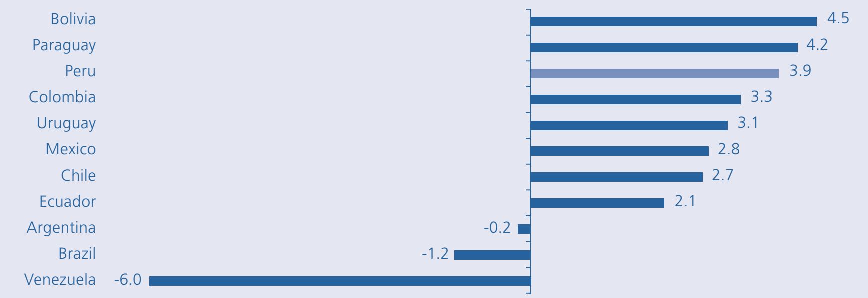



Source: Bloomberg.

5. During 2014, the main countries of **Latin America** with inflation targeting frameworks recorded lower-than-expected growth rates, with a significant economic slowdown being observed in Brazil, Chile, and Peru. Monthly indicators –i.e. industrial production, business and consumer confidence, aggregate indices of economic activity, among others– show that this trend continues in the first months of this year.

   This slowdown is explained by a lower impulse, both external and internal. Factors contributing to this on the external side include lower-than-anticipated growth in the region's main trading partners, notably China, as well as tighter financial conditions associated with the process of normalization of monetary policy in the United States. In addition to this, the average prices of the region's main export products continued falling during 2014, affecting the external accounts of most commodity-exporting countries. On the domestic side, most of the countries in the region saw a decline in the boost from domestic demand, particularly from investment and private consumption.

**Graph 10**
**LATIN AMERICA: GDP GROWTH 2015**
(% Change)




Source: Latin American Consensus Forecast (May 2015) and BCRP (Peru).

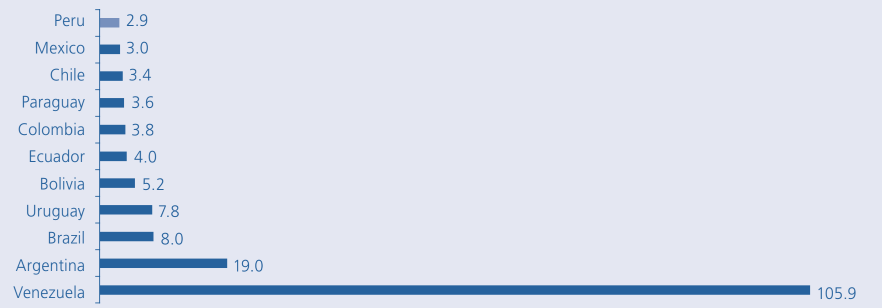
In the first four months of the year, the rate of inflation in the Latin American countries with inflation targeting was above the target range in Brazil, Chile, and Colombia due to the pass-through effect of the depreciation of their currencies. In Mexico, the inflation rate is close to the middle of its target range because the transitory shocks that raised prices in the previous year have disappeared. Lower inflation rates than in 2014 are expected for 2015, although this declining inflation trend would be offset by the effect that the appreciation of the dollar would have on domestic prices.

**Table 4**
**LATIN AMERICA: INFLATION**
(% change last 12 months)

| | Brazil | Chile | Colombia | Mexico | Peru |
|---|---|---|---|---|---|
| **Target range** | **2.5-6.5** | **2.0-4.0** | **2.0-4.0** | **2.0-4.0** | **1.0-3.0** |
| Dec.13 | 5.9 | 2.9 | 1.9 | 4.0 | 2.9 |
| Mar.14 | 6.2 | 3.9 | 2.5 | 3.8 | 3.4 |
| Jun.14 | 6.5 | 4.3 | 2.8 | 3.8 | 3.5 |
| Sep.14 | 6.8 | 4.9 | 2.9 | 4.2 | 2.7 |
| Dec.14 | 6.4 | 4.6 | 3.7 | 4.1 | 3.2 |
| Jan.15 | 7.1 | 4.5 | 3.8 | 3.1 | 3.1 |
| Feb.15 | 7.7 | 4.4 | 4.4 | 3.0 | 2.8 |
| Mar.15 | 8.1 | 4.2 | 4.6 | 3.1 | 3.0 |
| Apr.15 | 8.2 | 4.1 | 4.6 | 3.1 | 3.0 |

Source: Bloomberg.

**Graph 11**
**INFLATION: 2015**



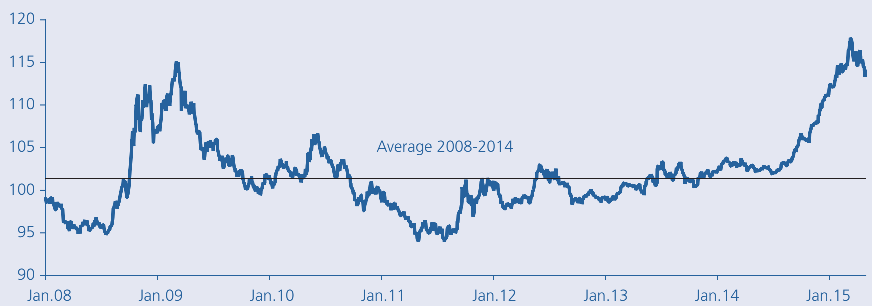

Source: Latin American Consensus Forecast (May 2015) and BCRP (Peru).

## Financial Markets

6. International financial markets were mainly affected by expectations about the date when the Fed would start raising its monetary policy interest rates, by the start of the ECB quantitative stimulus program, and, finally, by the arguments of Greece with its creditors.

The foreign-exchange markets reflected the divergent positions of the Fed and the ECB, since the euro depreciated 8.3 percent between January and April of this year after having dropped 11.9 percent in 2014. On the other hand, at April 2015 the dollar had appreciated 2.5 percent relative to a basket of currencies after having appreciated 9.0 percent in 2014. It should be pointed out that the price of the dollar declined 1.9 percent in April due to lower probabilities that the Fed would start its policy rate hikes in June.

**Graph 12**
**US DOLLAR INDEX***
(Base: January 1997 = 100)




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

Moreover, the currencies of the emerging countries have showed differentiated movements as a result of changes in the prices of their exports, the lower proportion of foreign investment in fixed-income and variable-income portfolios dedicated to these economies, and the correction of exchange rate overrides registered the previous year.

**Table 5**
**EXCHANGE RATE**

| | | Apr.2015 (1) | Dec.2014 (2) | Dec.2012 (3) | % change (1)/(2) | % change (1)/(3) |
|---|---|---|---|---|---|---|
| FED Index | C.U. per US$ | 114.07 | 111.29 | 99.21 | 2.5 | 15.0 |
| Eurozone | US$ per Euro | 1.122 | 1.210 | 1.319 | -7.2 | -14.9 |
| Japan | Yen | 119.34 | 119.68 | 86.74 | -0.3 | 37.6 |
| United Kingdom | US$ per Pound | 1.535 | 1.557 | 1.625 | -1.4 | -5.6 |
| Brazil | Real | 3.014 | 2.657 | 2.048 | 13.4 | 47.2 |
| Colombia | Peso | 2,381 | 2,388 | 1,766 | -0.3 | 34.8 |
| Chile | Peso | 611 | 606 | 478 | 0.8 | 27.8 |
| Mexico | Peso | 15.34 | 14.74 | 12.86 | 4.1 | 19.3 |
| Peru | Nuevo Sol | 3.13 | 2.98 | 2.55 | 5.1 | 22.7 |
| South Africa | Rand | 11.91 | 11.57 | 8.45 | 3.0 | 40.9 |
| Israel | Shekel | 3.86 | 3.88 | 3.88 | -0.6 | -0.5 |
| Turkey | Lira | 2.67 | 2.33 | 1.78 | 14.5 | 49.9 |
| China | Yuan | 6.20 | 6.20 | 6.23 | 0.0 | -0.5 |
| Indonesia | Rupia | 12,915 | 12,465 | 9,630 | 3.6 | 34.1 |
| Thailand | Bath | 33.01 | 32.90 | 30.58 | 0.3 | 7.9 |
| Malaysia | Ringgit | 3.56 | 3.50 | 3.06 | 1.9 | 16.5 |
| Philippines | Peso | 44.59 | 44.75 | 41.01 | -0.4 | 8.7 |

Source: Reuters and FED.

7. **Public debt markets** in the developed economies saw a reduction in yields due to the stimulus programs implemented in Europe and Japan and due to the increased demand for low risk bonds with higher yields in the United States. This trend showed a partial reversal since the end of April.

Maintaining the trend observed in the previous years, bond yields in the **United States** continued to fall, recording their lowest levels since 2013 in January due to increased demand for these bonds because of their relative value in comparison with their counterparts in Europe (Germany) and Japan, which showed historic lows. However, there were periods of volatility associated with uncertainty regarding the beginning of the Fed interest rate hikes, with massive sales of securities that increased yields being observed in February. This situation reversed after the Fed gave signals that a prompt rise in the policy rate should not be expected.

In the **Eurozone**, the ECB stimulus programs –particularly the start of the purchase program of government bonds– have influenced a decreasing trend in the bloc's sovereign yields, especially in the case of less risky economies (which have a greater share in the ECB's capital). The yields of Germany and France's bonds –and the bond yields of other countries considered safe– reached minimum lows in mid-April, correcting upwards thereafter, in line with a better outlook for growth in the bloc. On the other hand, the evolution of the yields in the peripheral economies was offset by uncertainty about the situation in Greece. As for yields in Greece, they even reached the levels recorded during the worst moments of the debt crisis in 2012.

The debt markets in **Latin American** countries showed a slightly unfavorable evolution, affected by lower growth prospects given the decline in commodity prices associated with signs of a slowdown in China. However, expectations that the Fed would delay raising the policy rate favored the emerging markets in general, including those in the region. In these circumstances the credit spreads (CDS) showed a moderate increase, except in Brazil where the market was affected by the internal political crisis and by an unfavorable economic outlook.

**Table 6**
**YIELDS ON 10-YEAR TREASURY BONDS**
(%)

| | Apr.15 | Dec.14 | Dec.12 | Public debt (% GDP 2014) |
|---|---|---|---|---|
| USA | 2.03 | 2.17 | 1.76 | 105 |
| Germany | 0.36 | 0.54 | 1.31 | 73 |
| France | 0.64 | 0.82 | 1.99 | 95 |
| Italy | 1.50 | 1.88 | 4.49 | 132 |
| Spain | 1.46 | 1.60 | 5.23 | 98 |
| Greece | 10.35 | 9.42 | 11.68 | 177 |
| United Kingdom | 1.83 | 1.76 | 1.83 | 90 |
| Brazil | 12.80 | 12.36 | 9.17 | 65 |
| Colombia | 6.73 | 7.10 | 5.48 | 38 |
| Chile | 4.44 | 3.99 | 5.49 | 14 |
| Mexico | 5.90 | 5.83 | 5.36 | 50 |
| Peru | 5.68 | 5.41 | 4.09 | 21 |
| South Africa | 7.94 | 7.96 | 6.78 | 46 |
| Israel | 1.51 | 2.31 | 3.99 | 69 |
| Turkey | 9.13 | 7.86 | 6.55 | 33 |
| China | 3.44 | 3.65 | 3.59 | 41 |
| South Korea | 2.43 | 2.63 | 3.17 | 36 |
| Indonesia | 7.67 | 7.75 | 5.15 | 25 |
| Thailand | 2.47 | 2.69 | 3.51 | 47 |
| Malaysia | 3.85 | 4.12 | 3.50 | 57 |
| Philippines | 3.98 | 3.83 | 4.42 | 37 |

Source: Bloomberg and IMF.

## Terms of Trade

8. During Q1-2015, Peru's terms of trade index recorded an average level 5.6 percent lower than the one recorded in Q1-2014. The export price index fell 13.6 percent while the import price index fell 8.5 percent.

The sharp decline observed in the price of oil to nearly half of the value it registered in the same period of the previous year stands out in Q1-2015 in a context marked by an increase in the supply of crude oil –especially in the United States– as well as by prospects of a lower demand due to economic slowdown in the emerging countries. The fall in the oil price led to a reduction in the prices of foodstuffs, which were also affected by an ample global supply of grains as well as by a positive outlook for crops in the following farming season.

On the side of exports, the fall in the prices of basic metals is mainly explained by a lower outlook for global growth, particularly for China.

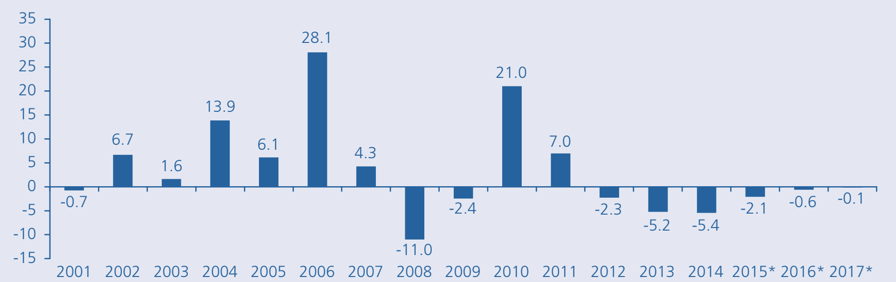
It is estimated that the terms of trade would decline 2.1 percent in 2015 and stabilize thereafter in the 2016-2017 horizon.

**Table 7**
**TERMS OF TRADE: 2013 - 2017**
(Annual average data)

| | 2013 | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|---|
| | | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **TERMS OF TRADE** | **-4.7** | **-10.4** | **-5.4** | **-5.6** | **-0.7** | **-2.1** | **-1.0** | **-0.6** | **-0.1** |
| **Price of exports** | **-5.5** | **-11.8** | **-6.9** | **-13.6** | **-7.7** | **-9.1** | **0.9** | **1.9** | **0.5** |
| Copper (US$ cents per pound) | 332 | 319 | 311 | 265 | 269 | 277 | 270 | 285 | 285 |
| Zinc (US$ cents per pound) | 87 | 92 | 98 | 94 | 98 | 100 | 99 | 102 | 102 |
| Lead (US$ cents per pound) | 97 | 95 | 95 | 82 | 87 | 88 | 90 | 90 | 90 |
| Gold (US$ per ounce) | 1,411 | 1,294 | 1,266 | 1,218 | 1,210 | 1,205 | 1,210 | 1,200 | 1,200 |
| **Price of imports** | **-0.8** | **-1.6** | **-1.5** | **-8.5** | **-7.1** | **-7.2** | **1.9** | **2.5** | **0.6** |
| Oil (US$ per barrel) | 98 | 99 | 93 | 49 | 51 | 55 | 58 | 64 | 64 |
| Wheat (US$ per ton) | 266 | 249 | 243 | 207 | 241 | 200 | 243 | 215 | 215 |
| Maize (US$ per ton) | 235 | 170 | 155 | 143 | 163 | 144 | 169 | 158 | 158 |
| Soybean oil (US$ per ton) | 992 | 830 | 812 | 700 | 717 | 713 | 718 | 733 | 733 |

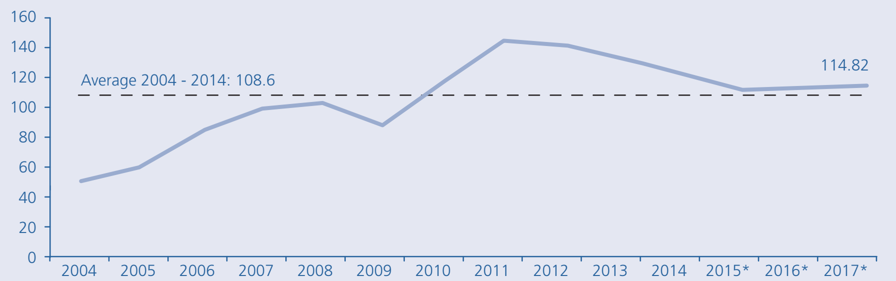
* Forecast.
IR: Inflation Report.
Source: BCRP.

Graph 13
TERMS OF TRADE 2001 - 2007
(% change)




* Forecast.
Source: BCRP.

Graph 14
PRICE OF EXPORT INDEX: 2004-2017




## Copper

9. The price of **copper** fell 6.4 percent in the first four months of 2015, closing in April with a monthly average price of US$ 2.73 per pound. The price of copper decreased rapidly to a minimum of US$ 2.44 per pound on January 29, recovering somewhat thereafter, although it remained at levels below those recorded in the previous year.

   The downward pressures on the price of copper are explained by the global oversupply observed in the first months of the year, associated basically with the contraction of China's demand[1]. Signals of lower dynamism in the Chinese economy were supported by the slowdown of GDP, especially the slowdown observed in its manufacturing activity, the fall of metal imports, the contraction of its investment in

1 The International Copper Study Group (ICSG) reported that China's use of copper declined 3.8 percent annually in January due to a sharp decline in its net imports of refined copper.

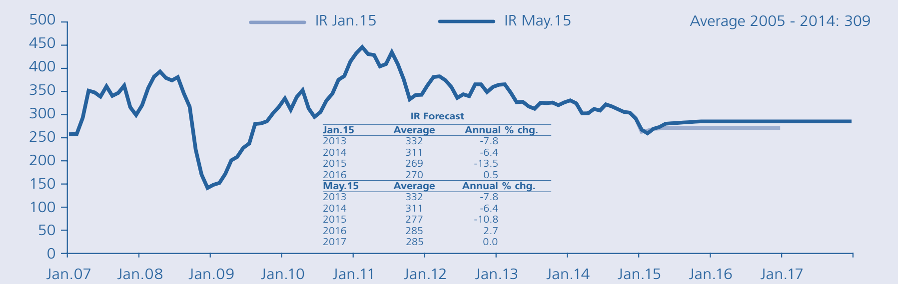
electricity infrastructure[2], and the slowdown in its real estate sector. The contraction in demand was coupled by a significant increase in copper production, despite unplanned supply cuts, especially in Chile. This was reflected in an increase in global inventories[3].

China's demand is estimated to recover in the forecast horizon due to the stimulus measures that would be implemented by the Government (i.e. support to the expansion of credit for industrial activity). A seasonal increase of investment in infrastructure is also expected (the growth of investment in the electricity sector would reach the new maximum level of investments announced for this year).

However, it is also estimated that there would be an increased availability of supply due to the onset of production in large projects as from the second half of the year (especially with greater production from Las Bambas, Sentinel, and Cerro Verde), which would counterbalance the production decline in mines with lower grades of ores.

In line with these developments, the price of copper in the forecast horizon has been revised slightly upwards.

**Graph 15**
**COPPER: JANUARY 2007 - DECEMBER 2017**
(US$ cents/pd.)



Source: Bloomberg and BCRP.

## Zinc

10. In contrast with copper, the mean price of **zinc** increased 1.1 percent in the first four months of the year, reaching a monthly average price of US$ 1.00 per pound in April 2015. It is worth mentioning, however, that the price of zinc started the year

2 In the first two months of the year.

3 Global stock exchange inventories increased 80 percent in the first four months of the year, the inventory rises observed in the LME and Shanghai Stock Exchange being particularly noteworthy. According to the CRU Group, non-custom inventories at the Shanghai Futures Exchange exceeded in March the historic peak reached in March 2012.

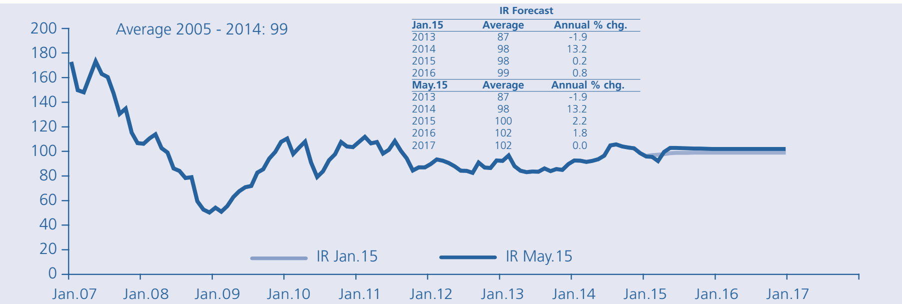
declining up to a minimum low of US$ 0.90 per pound on March 6 and that it then recovered up to a maximum price of US$ 1.07 a pound on April 30.

The recovery in the price of zinc was supported by expectations of a declining supply due to the closing of mines Century in Australia and Lisheen in Ireland scheduled for Q4. This trend contrasts with the supply surplus recorded in the first two months of the year[4] as a result of the slower growth of global demand associated particularly with the slowdown of steel production in China, as well as of the increased production of refined zinc, mainly in China.

The zinc market fundamentals point to a slightly tighter market in the last quarter of the year. It is estimated that the production of refined zinc would not grow at the same pace as consumption, thus generating price pressures on the upside.

Therefore, the international price of zinc is expected to show levels slightly above those estimated in the Inflation Report of January in the forecast horizon.

**Graph 16**
**ZINC: JANUARY 2007 - DECEMBER 2017**
(US$ cents/pd.)




IR Forecast

| Jan.15 | Average | Annual % chg. |
|---|---|---|
| 2013 | 87 | -1.9 |
| 2014 | 98 | 13.2 |
| 2015 | 98 | 0.2 |
| 2016 | 99 | 0.8 |
| **May.15** | **Average** | **Annual % chg.** |
| 2013 | 87 | -1.9 |
| 2014 | 98 | 13.2 |
| 2015 | 100 | 2.2 |
| 2016 | 102 | 1.8 |
| 2017 | 102 | 0.0 |

Source: Bloomberg and BCRP.

## Gold

11. The price of **gold** fell 0.3 percent in the first four months of 2015, closing April with a monthly average price of US$ 1,198 per troy ounce even though it initially showed a rising trend at the beginning of the year. The price of gold began to increase in

4 The International Zinc and Lead Study Group (ILZSG) reported a global supply surplus of 61 thousand tons in the first two months of the year due to the stagnation of global demand, associated especially with the contraction of China's demand.

early January and reached a maximum level of US$ 1,296/troy ounce on January 22, resuming the downward trend thereafter influenced by expectations that the Federal Reserve would start the process of interest rate rises.

The drop in the price of gold was mainly associated with the strengthening of the U.S. economy and the appreciation of the dollar, which caused a contraction in the physical demand for gold –especially in terms of the demand for investment in coins and bars– as well as lower purchases from central banks in Q1-2015. Jewelry demand also shrank due to China's lower purchases of this metal. The price fall was offset by increased seasonal demand for jewelry in India, although the increase was lower than expected by the market.

The price of gold in the forecast horizon is expected to be slightly below the level estimated in our previous report. The price of gold will continue to be affected by downward pressures because of the signals indicating that the Federal Reserve maintains its decision to raise its interest rate and expectations that the U.S. economy will continue to improve.

**Graph 17**
**GOLD: JANUARY 2007 - DECEMBER 2017**
(US$/tr.oz.)


Source: Bloomberg and BCRP.

## Crude Oil

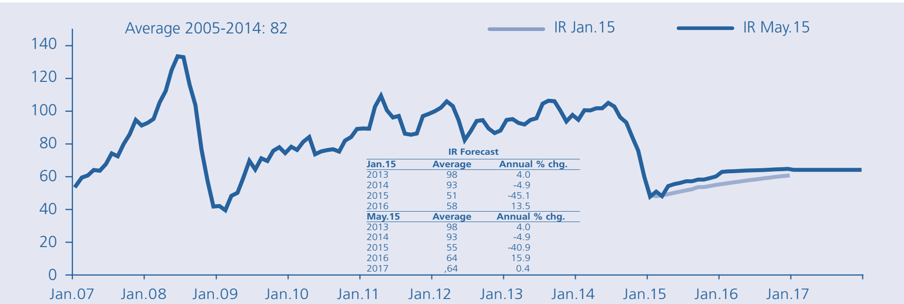
12. The price of WTI **oil** fell 9.6 percent in the first four months of 2015 and recorded a monthly average price of US$ 54.1/barrel in April, but showed a volatile evolution during the period.

 The declining conduct in the price of crude oil was associated with a global oversupply of crude resulting from an increase in the supply of non-OPEC member countries amid a slowdown of demand in OECD countries. It should be pointed out that the increased production of the United States reached record levels unheard of since November 1972, allowing inventories of crude oil to reach levels not seen since 1930. In addition to this, the production of OPEC countries remained above the quota set, with the increased production of Saudi Arabia and Iraq standing out.

Nonetheless, this situation would be temporary. The projections of several agencies indicate that the growth in the supply of crude oil would slow down due to a reduction in the production of non-conventional fuels as a result of their higher costs and low prices, especially in the United States. In addition to this, the demand would increase in response to the significant price fall and to the stimulus measures taken by the Eurozone, Japan, and China. Because of this, the price of WTI oil is expected to increase during the forecast period.

The risk factors remain high, both on the upside and on the downside. The likelihood of price increases remains high due to the recurring political tensions in the Middle East, while, on the other hand, the likelihood of falling prices is associated with the possibility that the U.S. production will not decrease to the extent anticipated and that the global demand for crude oil demand may be more inelastic than estimated.

**Graph 18**
**WTI OIL: JANUARY 2007 - DECEMBER 2017**
(US$/bl)




Source: Bloomberg and BCRP.

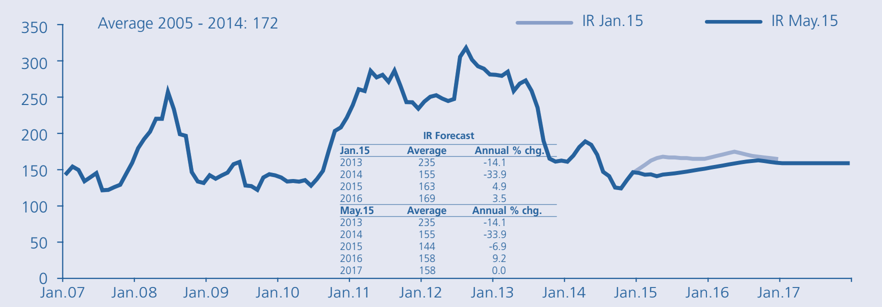
## Maize

13. In April, the average international price of **maize** was US$ 139.6 per ton, 3.9 percent lower than the average price at the end of December 2014. This variation reflects mainly price falls in the months of February and April (1.8 percent in each month).

In February, the price of maize was affected by the appreciation of the dollar, which cut off competitiveness to U.S. exports vis-à-vis European exports. In April the price fell due to the improvement of weather conditions, which favored the development and cultivation of delayed crops. Other factors that pushed the price down were the fall of the oil price since December 2014 and expectations that the demand for poultry would decrease due to an outbreak of avian influenza in some States of the USA. The fall in the price of maize was offset by the USDA's downward revision of its estimates of global inventories by 3.7 million tons between December 2014 and April 2015.

Because of these reasons, the price of maize is estimated to show lower levels than those foreseen in our previous report.

**Graph 19**
**MAIZE: JANUARY 2007 - DECEMBER 2017**
(US$/Ton)




Source: Bloomberg and BCRP.

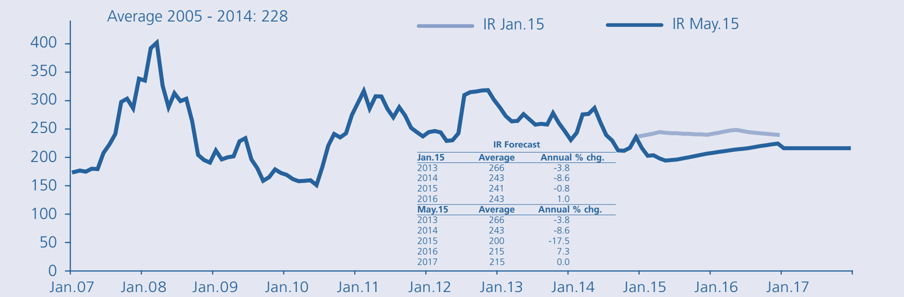
## Wheat

14. In April, the international price of **wheat** showed a decrease of 16.2 percent compared to December and closed April with an average level of US$ 197.0/ton.

Wheat quotes dropped significantly during the months of January and February (8.3 percent and 6.4 percent, respectively), influenced mainly by the appreciation of the dollar against the euro which reduced competitiveness of the U.S. exports in European markets. A factor that contributed to offset the decline in wheat prices was the downward revision of global final inventories (by 2.3 million tons) of this crop season between December and April.

Because of this, it is estimated that the price of wheat will show lower levels than those considered in the Inflation Report of January.

**Graph 20**
**WHEAT: JANUARY 2007 - DECEMBER 2017**
(US$/Ton)




Source: Bloomberg and BCRP.

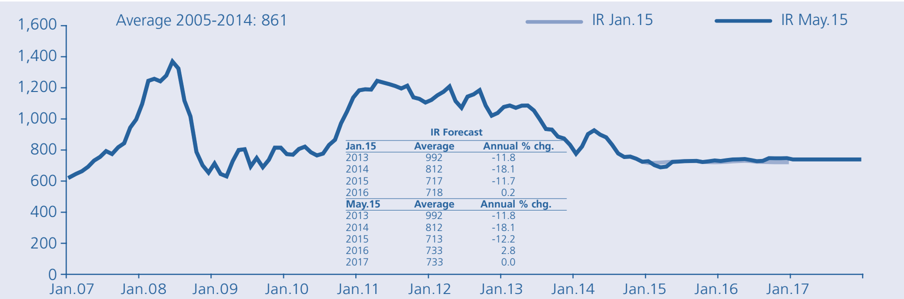
## Soybean Oil

15. The average price of **soybean oil** in April was US$ 685.8 per ton, 4.5 percent lower than in December 2014. This decline is mostly explained by price drops in the months of February (3.6 percent compared to October) and March (2.1 percent compared to November).

    The price of soybean oil was mainly affected by the fall in the price of oil. In addition to this, record crop yields in South America also added downward pressures on this price. In the last week of April, the prices dropped again due to an outbreak of avian influenza in the USA which has reduced the projected demand of soybean oil as poultry feed. In spite of this, however, the price of soybean oil is expected to recover in the following months in line with the anticipated evolution of the price of crude oil.

    Based on the factors discussed above, it is estimated that the prices of soybean oil will show slightly higher levels than those considered in our previous Inflation Report.

**Graph 21**
**SOYBEAN OIL: JANUARY 2007 - DECEMBER 2017**
(US$/Ton)




Source: Bloomberg and BCRP.

# II. Economic Activity

16. A recovery is projected in GDP growth for 2015 with a rate of 3.9 percent as a result of a partial reversal of the supply factors that affected the primary sector last year (down 2.3 percent). The difference between this projection and the one of our January report (4.8 percent) is mainly explained by the lower dynamism of investment in the first part of the year. This projection also considers an improvement in economic activity during the second half of the year, driven especially by a recovery of investment in the sub-national governments, by the positive impact of the beginning of the implementation of investments in infrastructure projects, and by a strengthening of economic agents' confidence.

## Sector GDP

17. GDP showed a slight recovery during Q1-2015, rising from 1.0 percent in Q4-2014 to 1.7 percent. The GDP in the primary sectors –agriculture, fishing, mining and hydrocarbons, and primary manufacturing– went from recording a negative rate of 7.3 percent in Q4-2015 to showing a positive rate of 0.6 percent in Q1-2015. On the other hand, however, the GDP in the non-primary sectors continued showing a slowdown in Q1, declining from 3.2 percent in Q4- 2014 to 2.0 percent.

**Table 8**
**GDP BY PRODUCTION SECTOR**
(Real % change)

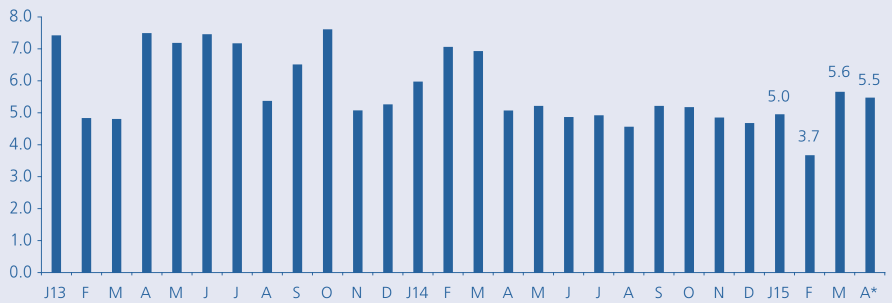
| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **Agriculture and livestock** | **1.3** | **1.4** | **0.4** | **2.6** | **1.6** | **3.5** | **4.4** | **3.8** |
| Agriculture | 0.5 | 0.2 | -2.6 | 2.3 | 0.3 | 3.8 | 5.1 | 4.0 |
| Livestock | 4.6 | 3.3 | 4.4 | 3.0 | 3.6 | 3.2 | 3.4 | 3.6 |
| **Fishing** | **-4.8** | **-27.9** | **-9.2** | **17.2** | **17.2** | **18.1** | **17.8** | **13.5** |
| **Mining and hydrocarbons** | **5.0** | **-0.8** | **4.1** | **5.6** | **4.2** | **10.5** | **11.6** | **14.8** |
| Metallic mining | 5.6 | -2.1 | 6.6 | 6.3 | 6.8 | 12.1 | 11.9 | 17.8 |
| Hydrocarbons | 3.0 | 4.0 | -4.2 | 3.2 | -5.2 | 5.0 | 10.6 | 1.9 |
| **Manufacturing** | **4.1** | **-3.3** | **-5.2** | **3.7** | **2.3** | **4.7** | **4.1** | **4.9** |
| Based on raw materials | 8.5 | -9.7 | -11.1 | 5.4 | 6.4 | 5.5 | 4.2 | 8.4 |
| Non-primary industries | 2.7 | -1.0 | -3.1 | 3.2 | 1.3 | 4.5 | 4.0 | 4.0 |
| **Electricity and water** | **5.7** | **4.9** | **4.6** | **5.3** | **5.1** | **6.1** | **6.0** | **6.0** |
| **Construction** | **5.2** | **1.7** | **-6.8** | **5.7** | **1.9** | **7.0** | **5.0** | **5.0** |
| **Commerce** | **5.2** | **4.4** | **3.6** | **4.9** | **4.4** | **5.5** | **4.4** | **4.4** |
| **Services** | **5.8** | **4.9** | **4.1** | **4.9** | **4.5** | **5.5** | **4.4** | **4.4** |
| **GDP** | **5.0** | **2.4** | **1.7** | **4.8** | **3.9** | **6.0** | **5.3** | **5.8** |
| **Memo:** | | | | | | | | |
| Primary GDP | 4.4 | -2.3 | 0.6 | 5.0 | 4.1 | 8.2 | 8.8 | 11.2 |
| Non-Primary GDP | 5.2 | 3.6 | 2.0 | 4.7 | 3.8 | 5.5 | 4.5 | 4.4 |

* Forecast.
IR: Inflation Report.

The sectors that showed a lower output in Q1 were fishing (-9.2 percent), hydrocarbons (-4.2 percent), primary manufacturing (-11.1 percent), non-primary manufacturing (-3.1 percent), and construction (-6.8 percent), these declines being explained by the climate shocks that affected the primary sectors and by lower private investment which affected non-primary manufacturing and construction. In addition, non-primary manufacturing was in turn affected by the negative impact of lower external demand for clothing.

18. Short-term indicators show mixed results during the first months of the year. On the one hand, the production of electricity shows some increase in the months of March and April, the rate recorded in the month of March (5.6 percent) being the highest rate in the last 12 months.

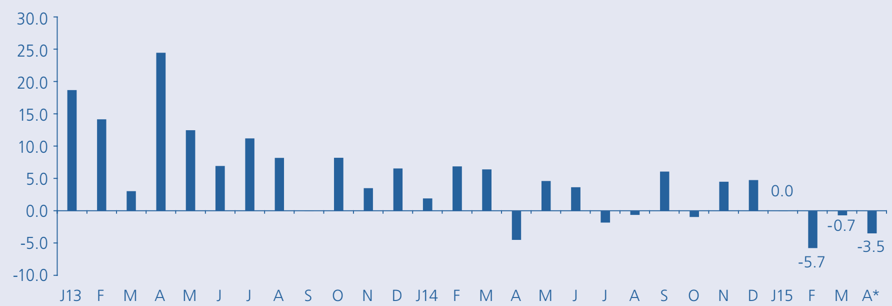
**Graph 22**
**PRODUCTION OF ELECTRICITY: 2013 - 2015**
(12 months % change)




* Preliminary.
Source: COES.

In contrast, domestic consumption of cement dropped 1.5 percent in Q1, the main reason explaining this being the lower dynamism of construction in the northern and southern areas of the country.

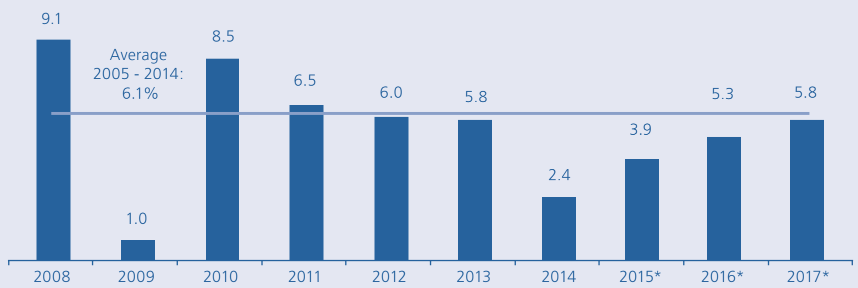
**Graph 23**
**DOMESTIC CONSUMPTION OF CEMENT: 2013 - 2015**
(12 months % change)




* Preliminary.
Source: ASOCEM and cement companies.

19. The GDP growth rate projected for 2015 has been revised down from 4.8 percent to 3.9 percent while the growth rate projected for 2016 has been revised down from 6.0 to 5.3 percent. By sectors, the growth rate in agriculture is revised from 2.6 to 1.6 percent due to the negative impact of climate conditions on crops like potatoes; the rate in hydrocarbons is revised down from 3.2 to -5.2 percent given that a lower production of oil and natural gas liquids is anticipated; the growth rate in non-primary manufacturing is revised from 3.2 to 1.3 percent due to the lower pace of growth of investment and the low dynamism of non-traditional exports, and the growth rate in construction is revised from 5.7 to 1.9 percent due to lower investment.

**Graph 24**
**GDP: 2008 - 2017**
(Real % change)




* Forecast.

20. The projection of growth in the primary sectors in 2015 shows a partial reversal of the supply shocks that affected output in 2014 since the projection considers a moderate impact of El Niño on agriculture and a recovery in the sectors of fishing and primary manufacturing due to an improvement in anchovy catch during the first half of the year. Moreover, metal mining would show greater growth, supported by a higher production of copper due to the increased growth of Toromocho, the recovery of ore grades at Antamina, the culmination of expansion works at Cerro Verde, and the start of operations at project Constancia.

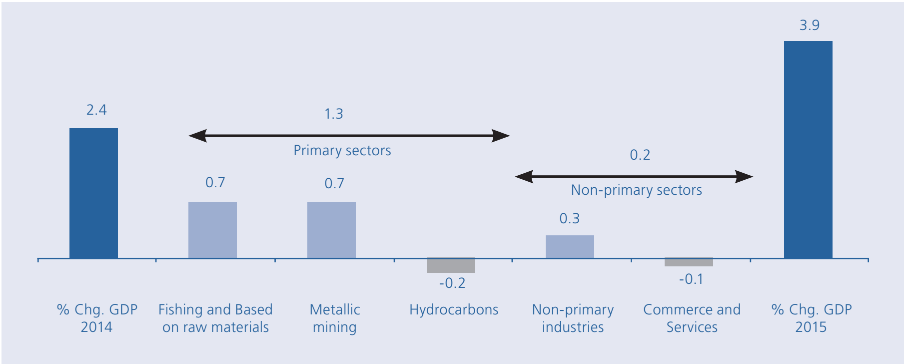
**Table 9**
**FORECAST OF GDP: 2015**
(% change)

| | 2014 | 2015* |
|---|---|---|
| **Supply shocks** | | |
| Rice | -5.6 | 3.5 |
| Anchovy | -52.6 | 55.2 |
| Fishoil and fishmeal | -63.0 | 60.0 |
| Gold | -10.4 | -3.9 |
| Copper | 0.7 | 10.3 |
| Zinc | -2.4 | 6.9 |

* Forecast.

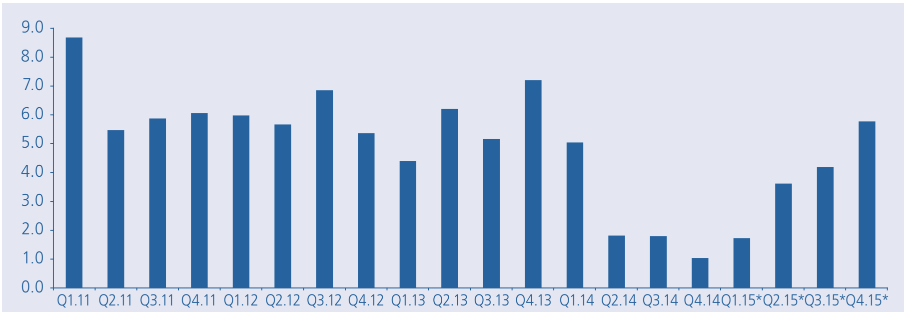
The gradual reversal of the supply shocks in 2015 would result in a growth rate of 4.1 percent in the primary sectors (vs. -2.3 percent in 2014), which would contribute with 1.3 percentage points to the GDP growth rate. On the other hand, it is estimated that the non-primary sectors would grow 3.8 percent –a slightly higher rate than the one recorded in 2014– due to greater production in the sectors of non-primary manufacturing.

**Graph 25**
**GDP GROWTH: 2015 vs 2014**
(% Chg. and % contributions)




21. Economic activity is foreseen to gradually recover dynamism in 2015, in line with the reversal of the negative effects of supply shocks and with the recovery of public and private investment associated with public-private partnership projects.

**Graph 26**
**GDP**
(12 months % change)




* Forecast.

22. On the sector side, the output is expected to show a faster pace of growth than in 2014 (3.9 percent vs. 2.4 percent) as a result of the recovery of the primary sectors,

specifically metal mining, primary manufacturing, and fisheries. The growth of metal mining would be mainly explained by increased copper production, while the sector of manufacturing based on raw materials would show a recovery due to increased production of fishmeal and fish oil as a result of the recovery of the fishing sector resulting from increased anchovy catch.

a) The growth forecast for the **agriculture sector** in 2015 is revised down (from 2.6 percent in the Inflation Report of January to 1.6 percent) due to the expected effects of El Niño on the flowering of some export-oriented crops, such as mangos, as well as due to the effects caused on the cultivation of potatoes in the central coast areas. Moreover, a lower production of grapes and olives would also contribute to this. However, the agriculture output is expected to grow 4.4 and 3.8 percent in 2016 and 2017, respectively, due to the normalization of climate conditions.

b) In spite of the result of the **fishing sector** in Q1, the growth forecast of our previous report for this sector in 2015 (17.2 percent) is maintained unchanged since a strong recovery is expected in the extraction of anchovy in Q2-2015. A quota of anchovy catch of 2.58 million tons –a similar quota to the one set for the first fishing season of 2014 (2.53 million tons)– has been established for the first fishing season of 2015, which began on April 9, but anchovy catch in 2015 is anticipated to reach 100 percent of the quota instead of 68 percent as happened in 2014.

   Based on the rate of anchovy captured in the month of April –with an average of 56 thousand tons of catch per day–, the total quota would be reached in the first days of June given that fishing companies have decided to complete their quotas earlier in anticipation of the arrival of warm Kelvin waves to Peruvian coasts, which could alter fishing conditions.

   In 2016 and 2017 the sector is expected to show high growth rates (17.8 and 13.5 percent, respectively) as a result of the gradual disappearance of the climatic anomalies that affected fishing in 2013 and 2014.

c) In Q1-2015 the **subsector of metal mining** grew 4.1 percent, 0.9 percentage points less than in Q1-2014 (5.0 percent), due to a fall in the pace of growth of copper production (from 18.2 percent to zero) as a result of lower production in Antamina and Cerro Verde.

   Despite this, however, the growth forecast of this subsector in 2015 is revised on the upside –from 6.3 percent in our previous report to 6.8 percent– since the decline in gold production would be lower this year (-3.9 percent vs. -5.4 percent).

In 2016 and 2017, metal mining would show a faster pace of growth –11.9 and 17.8 percent, respectively– since copper production is foreseen to show a strong increase (25.2 percent and 25.4 percent, respectively).

The **production of gold** grew 5.3 percent in Q1-2015 (vs. -7.6 percent in the same period of the previous year). This greater growth would be explained by a greater output in Barrick production (24.0 percent) due to the improvements made in the leaching process of the mining unit Lagunas Norte and due to better grades of ores in Yanacocha (11.6 percent). Even though a lower gold production is still projected for 2015, the growth forecast has been revised upwards (from -5.4 to -3.9 percent) due to the improvements carried out by Barrick at its mining unit Lagunas Norte.

The forecast for 2016 is revised slightly upwards (from -8.6 to -7.8 percent), since Yanacocha's lower production estimated for 2015 in this report would be causing a base effect on the projection for 2016. As for 2017, on the other hand, the onset of operations of mining projects Ollachea and San Gabriel and the growth of production at Shahuindo and Invicta projects -which would begin in 2016– are expected to offset the fall in Yanacocha's production (associated with the gradual process of closure of the mine) and result in a lower drop in the production of gold in comparison to the previous years (-1.0 percent).

The **production of copper** remained constant in Q1-2015, which contrasts with the 18.2 percent rate seen in the same period of the previous year. This slower growth is explained by a fall in the production of Antamina and Cerro Verde due to lower mineral grades, offset by an increased output at Toromocho after the gradual start of its operations in 2014 and the onset of operations at mine Constancia.

The projected growth of copper production in 2015 (10.3 percent) would be supported by the latter two projects. In spite of this, the forecast has been revised slightly down compared to our previous report since lower production is estimated from Cerro Verde and Milpo.

In 2016, on the other hand, the forecast has been revised up from 23.8 to 25.2 percent due to the anticipated growth of production at El Brocal (which would reach its maximum production capacity after its expansion) and the recovery of mineral contents at Antamina. In 2017, copper production is expected to grow 25.4 percent due to the growth of production at Las Bambas (which is due to start operations in mid-2016), to the onset of operations of Toquepala's expansion project, and to the fact that the expansion of Cerro Verde would reach its maximum production level.

Contrasting with the production fall of -12.1 percent observed in the same period of the previous year, **zinc production** grew 18.3 percent in Q1-2015. This better outcome was due to the recovery of ore grades at Antamina, the start of operations of the expansion project of El Brocal in the month of March (as a result of which the company has now a plant dedicated exclusively to zinc and lead production), and to Milpo's increased production. The forecast for the year has been revised down from 7.3 percent to 6.9 percent given that the recovery in the mineral content of ores at Antamina would be more gradual than estimated in the previous Inflation Report.

The growth rate of zinc production in 2016 is still estimated at 2.9 percent. In 2017 zinc production is expected to grow 1.9 percent, supported by the increased production of Milpo, Santander (Trevali), and El Brocal.

**Table 10**
**MINING PRODUCTION**
(% change)

| | 2014 | 2015* | 2016* | 2017* |
|---|---|---|---|---|
| Gold | -10.4 | -3.9 | -7.8 | -1.0 |
| Copper | 0.7 | 10.3 | 25.2 | 25.4 |
| Zinc | -2.4 | 6.9 | 2.9 | 1.9 |

* Forecast.

d) Production in the **subsector of hydrocarbons** during the first quarter of 2015 fell 4.2 percent (vs. an increase of 3.0 percent in the same period of the previous year). This decline is associated with a change in the business strategy of the oil companies, which would have chosen to modify their production and investment plans in order to maintain their margins given the lower international prices of crude oil.

The adjustment in the projected rates in the subsector of hydrocarbons also considers unforeseen events during the first months of the year, such as lower production of crude oil in Pluspetrol's Lot 1-AB due to the suspension of operations because of social conflicts in the area. The production of natural gas liquids of Pluspetrol's lots 88 and 56 was also affected by a rupture in the transportation pipeline (which took 6 days to repair) and by maintenance work carried out in April, which lasted 15 days.

Because of the above, the growth rate in this sub-sector in 2015 is revised down to a fall of 5.3 percent, in contrast to the 3.2 percent increase estimated in January. However, this situation is expected to reverse in the next years, basically as a result of a greater production of natural gas at Lot 88 of Pluspetrol taking into account the projected effect of the expansion of the pipeline transport capacity. Thus, positive growth rates of 10.6 and 1.9 percent are estimated for 2016 and 2017, respectively.

e) **Manufacturing production** fell 5.2 percent in the first quarter of 2015. During Q1, production in the branches of primary manufacturing dropped 11.1 percent due mostly to a lower production in terms of refining of non-ferrous metals (copper cathodes and anodes) at Cerro Verde and to lower production of fishmeal and fish oil. On the other hand, production in the branches of non-primary manufacturing declined 3.1 percent in Q1-2015 (vs. 2.7 percent increase in the same period of the previous year). The branches with the higher contribution to the decline were food and beverages, paper and printing activities, and chemical products.

The projected growth in the manufacturing sector for 2015 has been revised down from 3.7 percent in the previous report to 2.3 percent. However, given that a recovery of non-primary manufacturing is expected in the next few years, in line with the recovery of economic activity, the manufacturing sector would register growth rates of 4.1 and 4.9 percent in 2016 and 2017, respectively.

f) The projected growth rate in **construction** in 2015 has been revised from 5.7 percent to 1.9 percent due mainly to a slower pace of public investment during 2015 as well as due to a lower implementation of projects during Q1.

23. The growth forecast for 2016 is revised from 6.0 percent in our previous report to 5.3 percent in this report. The lower growth rate projected since 2016 considers a more gradual adjustment of non-primary activities than the one estimated in our report of January because of the effect of factors such as a decline in the fiscal impulse, the lower dynamism of the global economy, and an environment in which expectations would recover more slowly.

The sectors with a higher contribution to GDP growth in 2016 would be the sectors of services, mining, and trade. The growth of trade and services would be associated with a greater dynamism of domestic demand, while the growth of mining would be associated with an increased production of the metal mining sub-sector, especially copper.

In 2017, GDP is expected to grow 5.8 percent, driven by a greater production of copper, like in the previous year. The main drivers of this growth would be increased production in Las Bambas and the expansions of Toquepala and Cerro Verde.

## Expenditure-side GDP

24. The external scenario still includes a deterioration in the terms of trade and a slowdown in the world economy. In the domestic arena, on the other hand, the slow decline of public investment associated with the management of some regional and local governments, the status of some social conflicts, and delays in starting the implementation of some mega projects are still affecting economic agents' expectations and consequently, the pace of growth of private investment.

    In 2015 GDP would grow 3.9 percent, which implies a recovery compared to the growth rate of 2014 (2.4 percent). The main factors accounting for this higher growth scenario would include the partial reversal of the supply shocks (climate anomalies and lower grades of mineral ores) that led to a further decline of the primary GDP (-2.3 percent) since 1992; the growth of private investment, which requires the timely implementation of the investment plan to develop infrastructure projects via concessions as well as actions to reduce barriers to investment, and a significant recovery of public investment, particularly at the level of sub-national governments. Reflecting the expected recovery of private and public investment, domestic demand is estimated to grow 3.8 percent in 2015, a rate 0.9 percentage points lower than the one expected in our previous report, but 2.2 percent higher than the one recorded in 2014.

**Table 11**
**GDP AND DOMESTIC DEMAND**
(Real % change)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **I. Domestic demand** | **3.5** | **2.2** | **2.8** | **4.7** | **3.8** | **5.2** | **4.4** | **4.6** |
| **1. Private expenditure** | **2.6** | **1.9** | **3.8** | **3.9** | **3.2** | **4.7** | **4.3** | **4.7** |
| Consumption | 5.2 | 4.1 | 3.6 | 4.5 | 3.7 | 4.8 | 4.1 | 4.3 |
| Private fixed investment | 0.6 | -1.6 | -3.9 | 3.0 | 1.0 | 5.2 | 4.4 | 5.4 |
| Change on inventories** | 0.2 | 0.6 | 2.0 | 1.4 | 0.7 | 1.2 | 0.8 | 0.9 |
| **2. Public expenditure** | **8.5** | **3.4** | **-2.6** | **8.3** | **7.0** | **7.9** | **5.0** | **4.4** |
| Consumption | 9.1 | 6.4 | 5.0 | 6.6 | 8.3 | 6.0 | 4.0 | 4.0 |
| Investment | 6.6 | -2.4 | -26.5 | 12.0 | 4.0 | 11.6 | 7.2 | 5.0 |
| **II. Net external demand** | | | | | | | | |
| 1. Exports | 5.0 | -1.0 | -3.1 | 3.4 | 1.7 | 9.4 | 8.4 | 9.4 |
| 2. Imports | -0.7 | -1.5 | 1.4 | 2.9 | 1.5 | 5.9 | 4.5 | 4.6 |
| **III. GDP** | **5.0** | **2.4** | **1.7** | **4.8** | **3.9** | **6.0** | **5.3** | **5.8** |

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

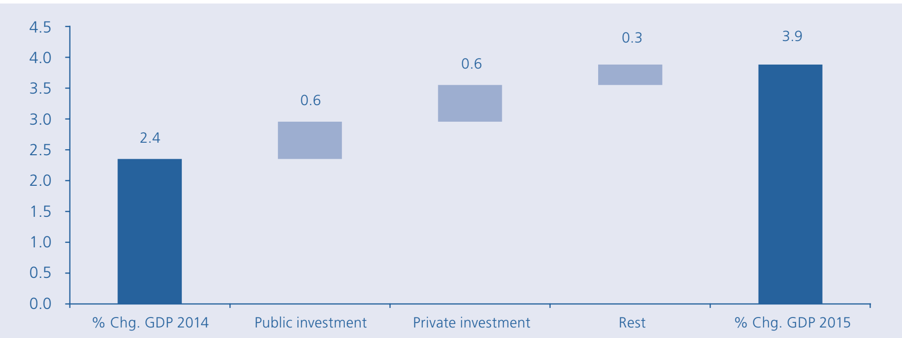
**Table 12**
**GDP AND DOMESTIC DEMAND**
(Contribution to the real % change)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **I. Domestic demand** | **3.6** | **2.2** | **2.9** | **4.8** | **3.9** | **5.3** | **4.5** | **4.7** |
| **1. Private expenditure** | **2.3** | **1.6** | **3.3** | **3.4** | **2.7** | **3.9** | **3.6** | **3.9** |
| Consumption | 3.3 | 2.5 | 2.3 | 2.8 | 2.3 | 3.0 | 2.6 | 2.6 |
| Private fixed investment | 0.1 | -0.4 | -0.9 | 0.6 | 0.2 | 1.1 | 0.9 | 1.1 |
| Change on inventories | -1.1 | -0.5 | 1.9 | 0.0 | 0.1 | -0.1 | 0.1 | 0.1 |
| **2. Public expenditure** | **1.2** | **0.6** | **-0.4** | **1.4** | **1.2** | **1.4** | **0.9** | **0.8** |
| Consumption | 1.0 | 0.7 | 0.6 | 0.8 | 1.0 | 0.7 | 0.5 | 0.5 |
| Investment | 0.2 | -0.1 | -1.0 | 0.6 | 0.2 | 0.7 | 0.4 | 0.3 |
| **II. Net external demand** | | | | | | | | |
| 1. Exports | 1.3 | -0.3 | -0.8 | 0.8 | 0.4 | 2.2 | 2.0 | 2.4 |
| 2. Imports | -0.2 | -0.4 | 0.4 | 0.8 | 0.4 | 1.5 | 1.2 | 1.2 |
| **III. GDP** | **5.0** | **2.4** | **1.7** | **4.8** | **3.9** | **6.0** | **5.3** | **5.8** |

* Forecast.
IR: Inflation Report.

25. The amounts of announced investment projects and of those awarded in concession would be reflecting a positive growth rate of private investment that implies a reversal of the decline observed in 2014. A gradual recovery of GDP is expected in 2016 and 2017, with growth rates of 5.3 and 5.8 percent, respectively, which is consistent with sustained growth in mining production, with greater investment in infrastructure, and with a recovery in domestic demand.

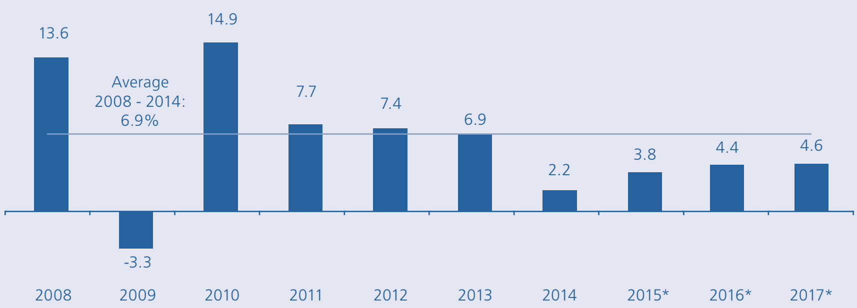
**Graph 27**
**GDP GROWTH: 2014 vs 2015**
(% Chg. and % contributions)




26. Moreover, a gradual recovery in the growth rate of domestic demand is foreseen in 2016 and 2017 with rates of 4.4 and 4.6 percent, respectively, taking into account

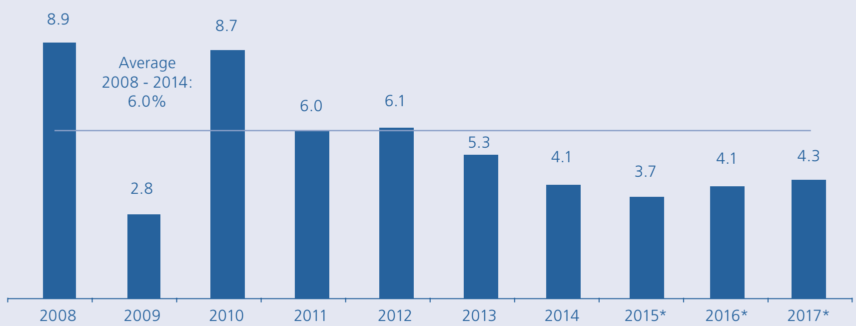
the impulse of private investment associated with the announced implementation of private investment projects and projects awarded in concession to be implemented.

Graph 28
**DOMESTIC DEMAND: 2008 - 2017**
(Real % change)




* Forecast.

Graph 29
**PRIVATE CONSUMPTION: 2008 - 2017**
(Real % change)

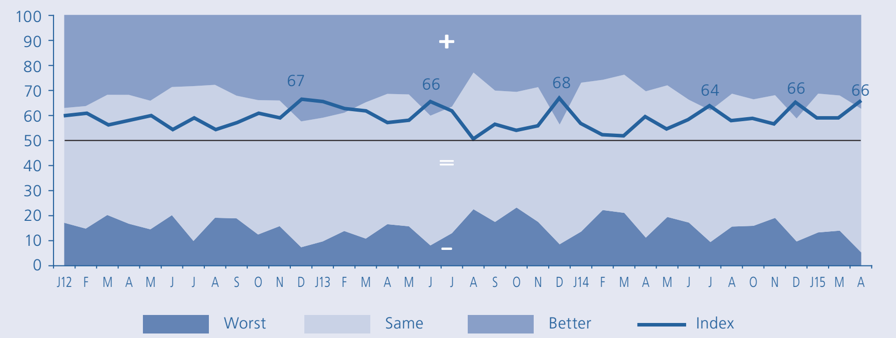



* Forecast.

Some indicators that reflect the recent evolution of private consumption are given below:

a. The consumer confidence index showed an optimistic level of 66 points in April 2015, a higher value than in April 2014 (60 points). In the period January-April, this indicator showed an average value of 61 points, a higher value than the one observed in the same period in 2014 (54 points).

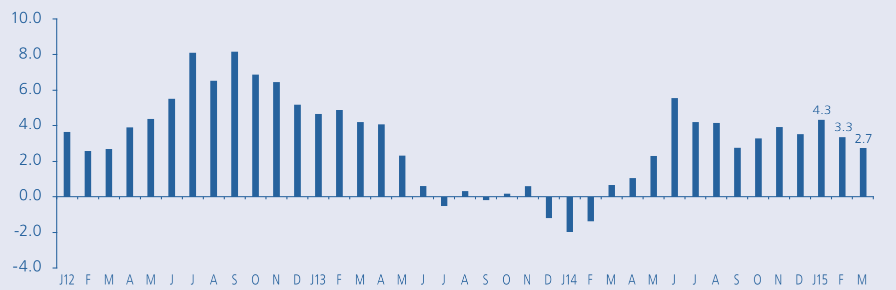
**Graph 30**
**CONSUMER CONFIDENCE INDEX: HOUSEHOLDS' ECONOMIC SITUATION?**




Source: Apoyo Consultoría.

b. The data of Instituto Nacional de Estadística e Informática (INEI) show that the growth rate of the salaried workforce in Q1-2015 (3.5 percent) was higher than in the previous year.

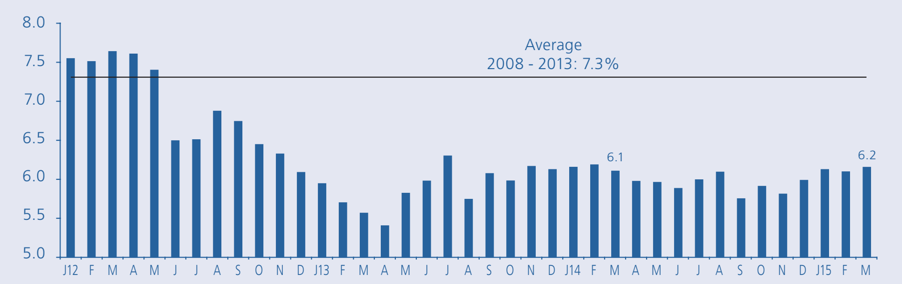
**Graph 31**
**EAP SALARIED WORKFORCE - INEI QUARTERLY MOVING METROPOLITAN LIMA**
(12 months % change)




Source: INEI.

c. The unemployment rate, indicator reflecting the percentage of the total labor force who are unemployed and looking for a paid job, registered 7.0 percent in Q1-2015, a slightly higher rate than in 2014 (6.9 percent). In Q1-2015 the number of unemployed people grew 1.3 percent and the labor force grew 0.2 percent.

**Graph 32**
**UNEMPLOYMENT RATE: JAN.12 - MAR.15**
(Seasonally adjusted- moving quarterly)



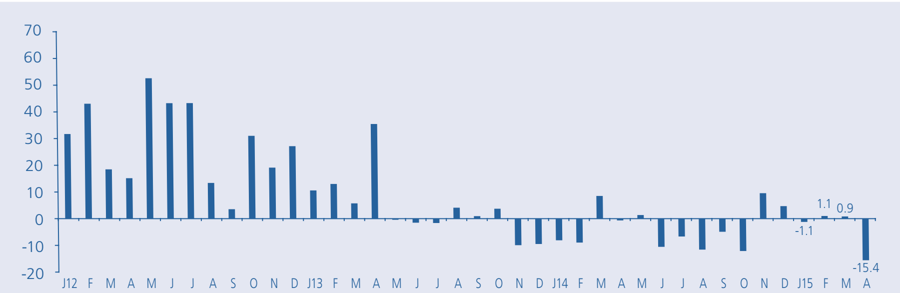

d. The growth of credit to individuals, which includes consumer loans and mortgages, continues to show a moderate pace of growth. Credit to individuals grew 11.9 percent in March 2015, while in the first quarter of the year it grew 12 percent, less than in 2014 (14 percent).

**Graph 33**
**CREDIT TO INDIVIDUALS: JAN.12 - MAR.15**
(12 months % change)


Source: BCRP.

e. The volume of imports of consumer durables accumulated a decline of 4.2 percent between January and April of this year.

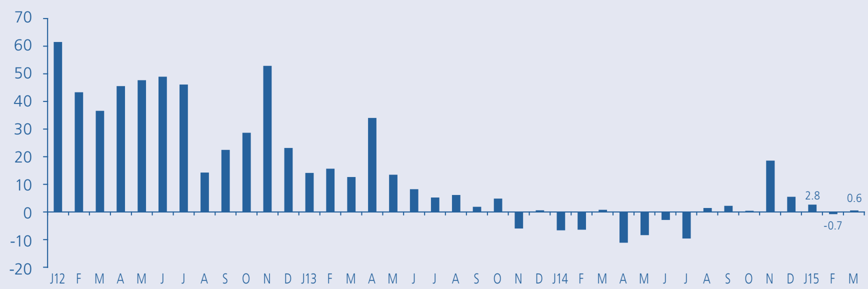
**Graph 34**
**VOLUME OF IMPORTS OF DURABLE CONSUMER GOODS: JAN. 12 - MAR.15**
(12 months % change)




Source: SUNAT.

f. Sales of new family cars recorded an increase of 0.9 percent in Q1-2015 after showing negative rates during 2014.

**Graph 35**
**SALE OF FAMILIAR VEHICLES: JAN.12 - MAR.15**
(12 months % change)




Source: Araper.

g. After having grown 2.2 percent in 2014, the national disposable income would grow 3.5 percent in 2015. In 2016 and 2017 the national disposable income is estimated to grow 5.0 and 6.2 percent, respectively, in line with the expected recovery of the output.

**Table 13**
**NATIONAL DISPOSABLE INCOME**
(Real % change)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| 1. GDP | 5.0 | 2.4 | 1.7 | 4.8 | 3.9 | 6.0 | 5.3 | 5.8 |
| 2. Gross National Product | 6.6 | 3.1 | 3.0 | 5.3 | 4.5 | 6.3 | 5.3 | 6.4 |
| 3. Gross National Income | 3.4 | 1.7 | 1.6 | 5.1 | 4.0 | 6.1 | 5.1 | 6.3 |
| **4. National Disposable Income [1/]** | **3.7** | **2.2** | **1.4** | **4.5** | **3.5** | **6.0** | **5.0** | **6.2** |

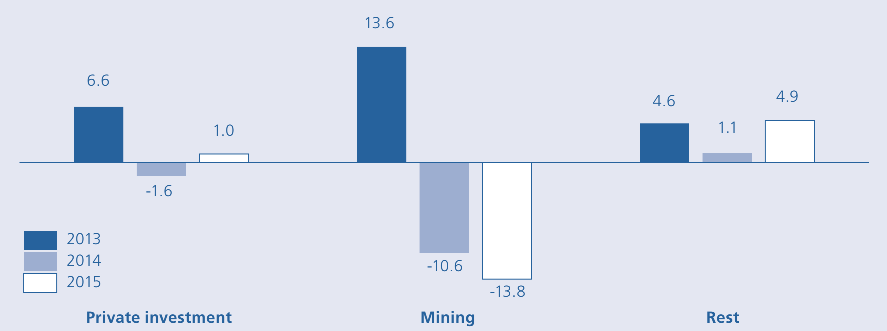
* Forecast.
1/ Including factor income, net profits by terms of trade, and net transfers received for non-residents.
IR: Inflation Report.

Based on these indicators, the estimated growth of private consumption in 2015 has been revised from 4.5 percent to 3.7 percent. A gradual increase of this growth rate is expected in the following years, in line with the anticipated evolution of income.

27. The growth rate of private investment in 2015 has been revised down to 1.0 percent due mainly to delays in some mining projects such as Zafranal, Haquira, and Los Chancas. Moreover, lower investment is also foreseen in the sector of hydrocarbons

as a result of the drop in oil prices and delays in energy projects. In addition to this, the evolution of private investment would also be affected by the reversal of the supply shocks that affected growth in most of the primary sectors and the decline in the terms of trade. On the other hand, investors' expectations remain on the optimistic side, but they continue to show lower levels than in previous years.

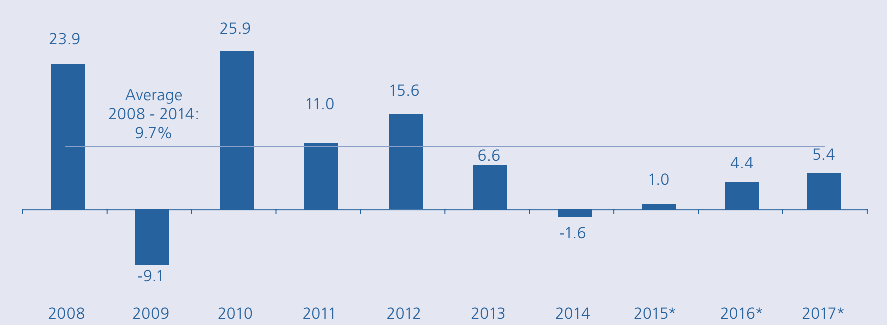
**Graph 36**
**PRIVATE INVESTMENT**
(Real % change)




Source: MINEM and company information.

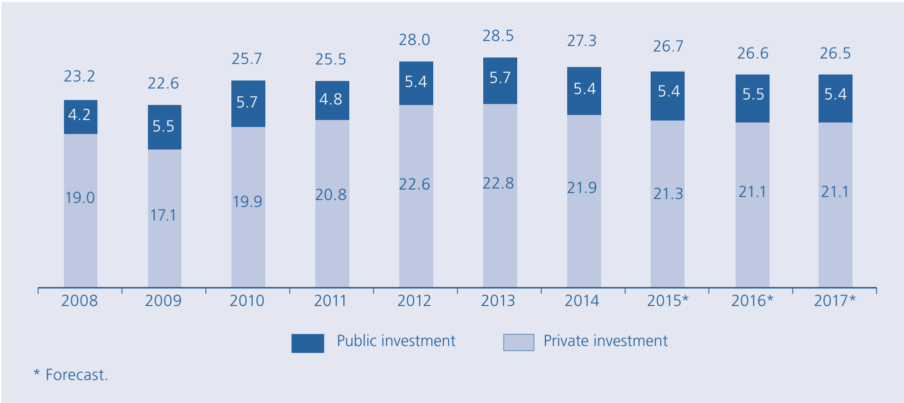
Private investment would show a recovery in 2016 and 2017, recording growth rates of 4.4 and 5.4 percent, respectively. This recovery would be associated with the impulse given by the investment projects announced and by the projects given in concession for their implementation. As a result, the ratio of total gross fixed investment to GDP, which includes both private investment and public investment, would go from 26.7 percent of GDP in 2015 to 26.6 percent in 2016 and to 26.5 percent in 2017.

**Graph 37**
**PRIVATE INVESTMENT: 2008 - 2017**
(Real % change)




* Forecast.

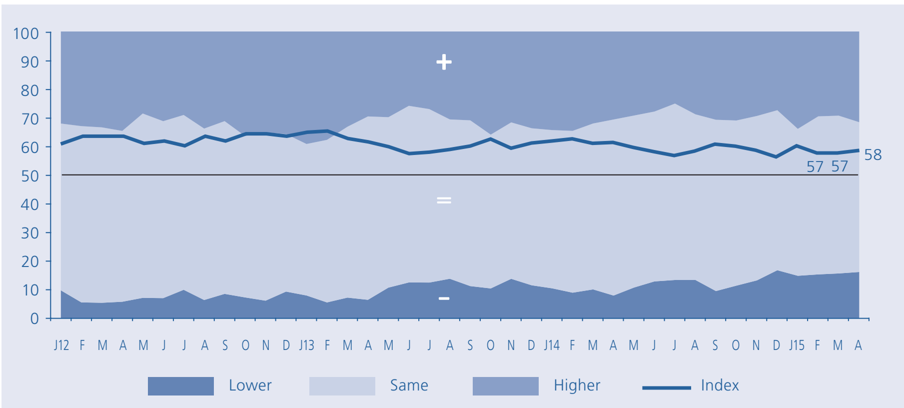
**Graph 38**
**GROSS FIXED INVESTMENT: 2008- 2017**
(% real GDP)




28. Some indicators reflecting the evolution of private investment are presented below:

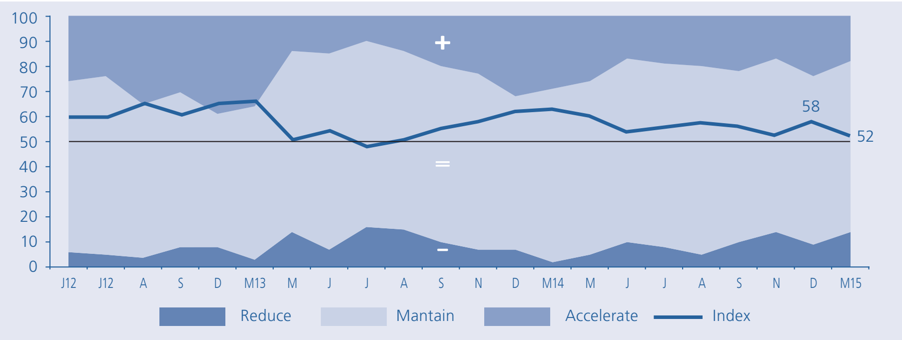
    a. Business expectations about demand in the three months ahead remain on the optimistic side with a level of 58 points in April. This indicator recorded an average level of 58 points in January-April 2015, a level 4 points lower than the one observed in the same period in 2014.

**Graph 39**
**EXPECTATION ABOUT DEMAND**
**IN THE THREE MONTHS AHEAD**



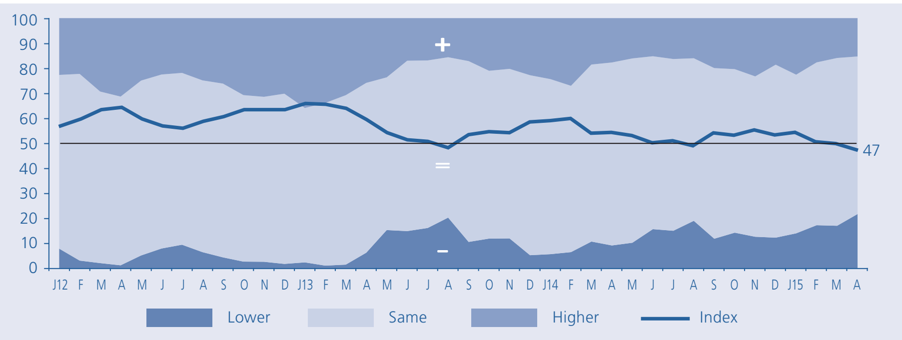

    b. Expectations of investment in the following 6 months continued to be on the optimistic segment with a level of 52 points in March, a lower level than the one recorded in December 2014.

**Graph 40**
**INVESTMENT EXPECTATIONS ON YOUR COMPANY IN THE SIX MOTNH AHEAD**




c. Business expectations on the economic situation in the three months ahead showed a level of 47 points in April.

**Graph 41**
**BUSINESS EXPECTATIONS ON THE SITUATION OF THE ECONOMY IN THE THREE MONTHS AHEAD**




d. The volume of imports of capital goods –indicator of the demand for investment– fell 14.1 percent in April 2015, which contrasts with the growth rate recorded in April 2014 (up 3.6 percent).

**Graph 42**
**VOLUME OF IMPORTS OF CAPITAL GOODS**
(12 months % change)

e. The survey on expectations of GDP growth in 2015 have been revised down: between January and May 2015, financial entities have revised down the GDP rate they expect from 4.5 to 3.0 percent; economic analysts have revised down their projections from 4.5 to 3.1 percent, and non-financial firms have revised their growth estimates from 4.5 to 3.5 percent.

**Table 14**
**SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH**
(% change)

| | Expectations about: | | |
|---|---|---|---|
| | **IR Oct.14** | **IR Jan.15** | **IR May.15** |
| **Financial entities** | | | |
| 2015 | 5.0 | 4.5 | 3.0 |
| 2016 | 5.5 | 5.0 | 4.0 |
| 2017 | | | 4.8 |
| **Economic analysts** | | | |
| 2015 | 5.3 | 4.5 | 3.1 |
| 2016 | 5.5 | 5.2 | 4.2 |
| 2017 | | | 5.0 |
| **Non-financial firms** | | | |
| 2015 | 5.0 | 4.5 | 3.5 |
| 2016 | 5.2 | 5.0 | 4.0 |
| 2017 | | | 4.5 |

IR: Inflation Report.

29. Private investment projects announced to be carried out in the period of 2015-2017 amount to US$ 40.1 billion.

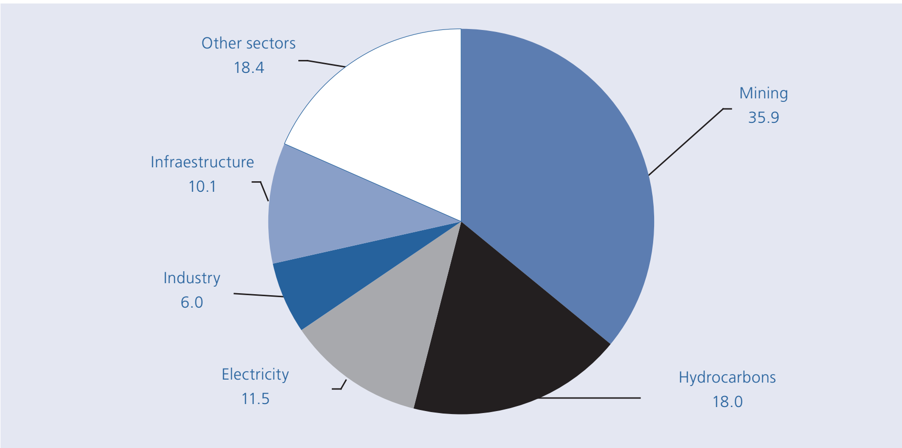
**Table 15**
**PRIVATE INVESTMENT PROJECTS ANNOUNCED: 2015-2017**
(Million US$)

| | **Total investment** | **Number of projects** |
|---|---|---|
| Mining | 14,408 | 34 |
| Hydrocarbons | 7,224 | 22 |
| Electricity | 4,617 | 34 |
| Industry | 2,408 | 14 |
| Infraestructure | 4,057 | 24 |
| Other sectors | 7,370 | 109 |
| **Total** | **40,084** | **237** |

Source: Press media and company information.

Investment projects for a total of US$ 21.6 billion would be carried out in the mining and hydrocarbons sector, which represents 53.9 percent of total investment projects announced for the period 2015-2017. According to the Ministry of Energy and Mines, investments in the mining sector at December 2014 amounted to US$ 8.65 billion, with the investments for the expansion of Cerro Verde (US$ 1.77 billion) and for the expansion of Constancia (US$ 736 million) standing out. It is expected that projects like Las Bambas, whose total investment is estimated at approximately US$ 7.10 billion, would be ready to start producing copper concentrates by early 2016. According to the company, 90 percent of the project has already been implemented and investments for US$ 1.9 to US$ 2.4 billion will be made until the project starts commercial operations.

**Graph 43**
**FORESEEN INVESTMENT PROJECTS: 2015-2017**
(% share)




In the hydrocarbons sector, Consorcio Gasoducto Sur Peruano began the stage of implementation and preliminary works of its project aimed at improving energy security in the country and developing the southern gas pipeline –Mejoras a la Seguridad Energética del País y Desarrollo del Gasoducto Sur–, which includes the purchase and installation of the first batches of pipes and logistics. On the other hand, Petrolera Monterrico submitted a semi-detailed environmental impact study (EIS) to get the permit to drill 115 wells in Lots II and XV in Talara.

In the electricity sector, projects due to start commercial operations in 2016 include the hydroelectric power plant Cerro del Águila, the 500 KV Mantaro-Marcona-Socabaya-Montalvo transmission line and associated substations, and the hydroelectric power plant Cerro de Chaglla and Cheves.

As for infrastructure projects, works carried out in Q1 included expropriating land and land preparation for the implementation of the first stage of works of Line 2 of Lima's Metro, whose construction should begin in mid-May of this year and conclude in 2020. Moreover, Consortium Kuntur Wasi will present a semi-detailed EIS and the final engineering study for the construction of the new International Airport of Chinchero in May. The construction of the new airport should start this year.

**Table 16**
**MAIN INVESTMENT PROJECTS ANNOUNCED: 2015-2017**

| SECTOR | COMPANIES | PROJECT |
|---|---|---|
| Mining | China Minmetal Corp | Las Bambas |
| | Freeport-Macmoran Copper | Expansion of Cerro Verde |
| | AQM Copper | Zafranal |
| | Jinzhao Mining | Pampa del Pongo |
| | Southern Perú Copper Corporation | Expansion of Toquepala |
| | Southern Perú Copper Corporation | Los Chancas |
| | Chinalco | Expansion of Toromocho |
| | Shougang Corporation | Expansion of Marcona |
| | Río tinto Plc. | La Granja |
| | Bear Creek Mining Corporation | Corani |
| | Compañía de Minas Buenaventura S.A.A. | San Gabriel (Ex Chupacapa) |
| 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 |
| | Karoon Gas Autralia; Vietnam American | Exploration: Lot Z - 38 (20 well) |
| | Pluspetrol Perú Corp. S.A. | Exploration of Lots 88 and 56 |
| | Graña y Montero Petrolera | Improving Lots III - IV |
| | Calidda Gas Natural del Perú | Massive use of Natural Gas |
| | China National Petroleum Corporation | Lot 58: 2D seismic lines |
| Electricity | Enersur; Kallpa Generación | Electric Node in the South of Peru |
| | Quimpac S.A.; Inkia Energy | Hydroelectric Power Plant of Cerro del Águila |
| | Interconexión Eléctrica Isa Perú SA. | 500 KV Mantaro - Marcona - Socabaya - Montalvo Transmission Line and associated substations |
| | Corsán-Corviam; Engevix and Enex | Hydroelectric Power Plant of Molloco |
| | Odebrecht S.A.C. | Hydroelectric Power Plant of Belo Horizonte |
| | Odebrecht S.A.C. | Hydroelectric Power Plant of Cerro Chaglla |
| | Isolux de México;Isolux Ingeniería de España | 220 KV Moyobamba - Iquitos Transmission Line |
| | Generación Eléctrica Las Salinas | Eolic Park Samaca |
| | Inevarante | Hydroelectric Power Plant of Acco Pucará |
| | Termochilca S.A.C. | Thermal Power Plant of Santo Domingo de Olleros - Combined cycle |
| Industry | Corporación JR Lindley | Expansion and new plants |
| | Repsol YPF S.A. | Expansion of La Pampilla plant |
| | Mitsubishi; Hochschild Mining PLC | Phospates projects |
| | Técnicas Reunidas S.A. | Modernization of Talara refinery |
| | Grupo Gloria | Investment projects 2011-2016 |
| | Grupo de Pilkington Limited | Manufacture plant of float glasses |
| 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 |
| | Covisol | Trujillo-Sullana: Sol Highway |
| | Consorcio Angostura | Majes Siguas II |
| | APM Terminal | Modernization of North pier |
| | Grupo Romero | Expansion of Matarani port |
| | Graña y Montero S.A. | South express way |
| | Dubai Ports World | Muelle Sur (Phase 2) |
| Other sectors | Grupo Telefónica | Investment plans 2014 - 2016 |
| | Grupo Telefónica | Satellite Broadband 4G |
| | Entel | Development of services |
| | Grupo Salinas | National Fiber Optics Backbone |
| | Grupo Falabella | Expansion and New shopping centers |
| | Grupo Interbank | Expansion and New shopping centers |
| | Grupo Romero | Storages for minerals |
| | Ingenieros Civiles Asociados | Fleet and equipments |
| | Olo | Expansion and facilities of net LTE-4G |
| | Holding Grupo Wong | Shopping center and land terminal |
| | Inmobiliaria S.A | Corporate offices: Stratego |
| | Grupo Gloria | Casagrande, Cartavio and San Jacinto - Olmos project |
| | Inmobiliaria Llaxta | Real Estate Project in Ica |
| | Ingenieros Civiles Asociados | Fleet and equipments |

Source: Press media and business information.

**Table 17**
**MAIN PROJECTS TO BE IMPLEMENTED THROUGH CONCESSION ARRANGEMENTS IN 2014-2015**
(Million US$)

| | Estimated investment 2014 | Estimated investment 2015 |
|---|---|---|
| **A. Awarded** | **9,979** | **215** |
| Line 2 and Faucett Ave. - Gambetta Ave. of the Basic Network of the Metro of Lima and Callao | 5,075 | |
| Improvements of the National Energy Security and development of the South Peruvian Pipeline | 3,643 | |
| International Airport of Chinchero - Cusco (AICC) | 537 | |
| 220 Kv Moyobamba - Iquitos Transmission Line and associated substations | 499 | |
| General San Martín ( Pisco) Port Terminal | 129 | |
| 220 kV Friaspata - Mollepata Transmission Line and Orcotuna Substation 220/60 kV | 39 | |
| 220 kV La Planicie - Industriales Transmission Line and associated substations | 35 | |
| Cable cars to Kuelap | 18 | |
| Provision of Technological Security Services in Prisons | 4 | |
| Broadband Installation for Integral Connectivity and Social Development of Ayacucho Region | | 55 |
| Broadband Installation for Integral Connectivity and Social Development of Huancavelica Region | | 49 |
| Broadband Installation for Integral Connectivity and Social Development of Apurimac Region | | 42 |
| 220 Kv Azangaro - Juliaca -Puno Transmission Line | | 37 |
| Comprehensive Broadband Connectivity for the Social Development of the Northern Zone of the Country- Lambayeque Region | | 32 |
| **B. To be called** | | **4,899** |
| Power Supply from New Hydroelectric Plants | | 2,750 |
| Headworks and Conduction for the Drinking Water Supply in Lima | | 600 |
| Massive Use of Natural Gas | | 350 |
| Longitudinal of the Sierra - Section 4 | | 340 |
| LNG Supply System for the Domestic Market | | 250 |
| LNG Supply System for Lima and Callao | | 250 |
| Quillabamba Thermal Power Plant | | 180 |
| Chillon river water supply works | | 80 |
| First Stage of the Carapongo Substation and Conexion Links to Associated Lines | | 48 |
| Choquequirao Cable car | | 43 |
| Huayday Ambara Mining Prospect | | 8 |
| **C. Total Projects (A) y (B)** | **9,979** | **5,114** |

Source: Proinversión.

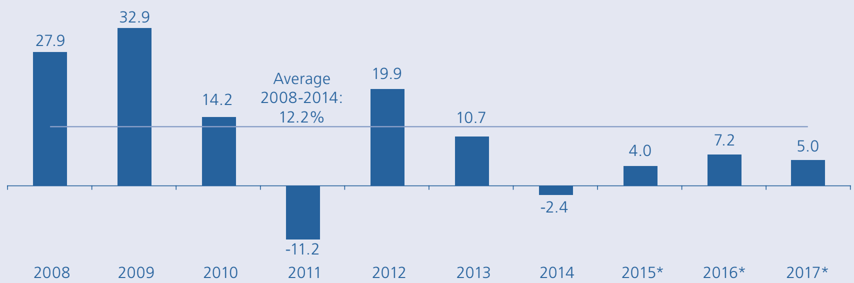
Other sectors continue making important announcements of the implementation of new projects at the national level and of project expansions. For example, Telefónica del Perú has invested US$ 600 million in internet broadband and 3G telephone services as part of its investment plan until 2016, which amounts to US$ 1.8 billion.

At April 2015, five projects amounting to US$ 215 million have been awarded in concession: Installation of Broadband Equipment to Enhance Connectivity and Social Development in the Regions of Ayacucho, Huancavelica, Apurimac and Lambayeque (US$ 179 million), and the 220 Kv Azangaro-Juliaca-Puno Transmission Line (US$ 37 million). Other 11 additional projects involving investments for nearly US$ 4.90 billion will be given in concession by PROINVERSION during 2015.

30. Although it would grow less than estimated in our previous report (12.0 percent), **public investment** is expected to grow 4.0 percent in 2015 (vs. -2.4 percent in

2014). Government investment has had a meager performance during the first three months of the year, mainly because of the lower execution of investment at the level of subnational governments, but investment spending is expected to show a better evolution in the next months of the year due to the series of expansionary measures taken by the Ministry of Economy and Finance at end-2014. Because the rate of expenditure of the executing units would be greater in 2016 and 2017 than expected in 2015, public investment is projected to show a growth rate of 7.2 percent in 2016 and of 5.0 percent in 2017.

**Graph 44**
**PUBLIC INVESTMENT**
(Real % change)




* Forecast.

**Table 18**
**INVESTMENTS IN MAIN PROJECTS OF NATIONAL GOVERNMENT: 2015 1/**
(Million S/.)

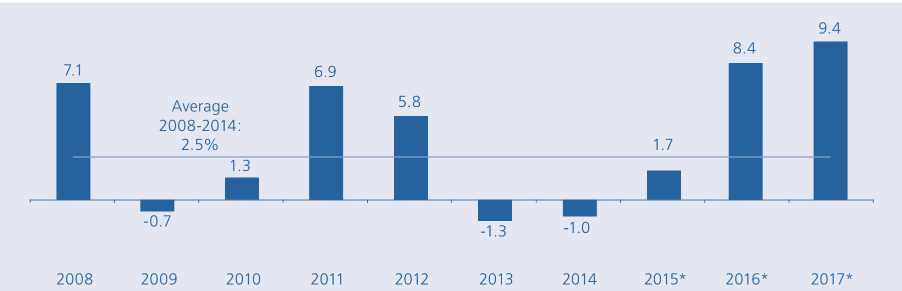
| Project | Amount |
|---|---|
| Line 2 and branch line of the Basic Network of the Metro of Lima and Callao | 1,195 |
| Construction of strategic health centers | 521 |
| Improvement of Road Néstor Gambetta - Callao | 454 |
| Restoration and improvement of Road Lima-Canta-La Viuda-Unish | 213 |
| Restoration and improvement of Longitudinal highway of the North Highlands | 212 |
| Electric public transport of Lima and Callao | 165 |
| Restoration and improvement of Road Quinua-San Francisco | 160 |
| Restoration and improvement of Road Huaura-Sayán-Churin | 158 |
| Construction and improvement of Road Camaná-Quilca-Matarani-Ilo-Tacna | 154 |
| Construction and equipment of educational institutions | 150 |
| Construction of Road section 2 Piura-Paita | 146 |
| Restoration and improvement of Road Chongoyape-Cochabamba-Cajamarca | 146 |
| Restoration of  Panamericana Norte highway km. 557-km. 886 | 129 |
| Restoration and improvement of Road Huancavelica-Lircay | 124 |
| Construction of section 2 Dv. Airport Pucallpa-Cementery Jardín del Buen Recuerdo | 118 |
| Restoration and improvement of Road Imperial Pampas | 113 |
| Installing the social rehabilitation service in the new prison in Ica | 107 |
| IInstalling the social rehabilitation service in the new prison Caraveli-Arequipa. | 104 |
| Restoration and improvement of Road Puerto Bermúdez-San Alejandro | 94 |
| Construction of Evitamiento Highway section 2 Piura - Panamericana Norte Km 988-km 1001 | 91 |

1/ PIM as of May 22, 2015.
Source: SIAF - MEF.

31. **Real exports** of goods and services fell 3.1 percent in Q1-2015 due mainly to the decrease observed in exports of fishmeal, coffee, and textiles. However, a gradual recovery is expected in exports in the following months of the year which would offset the fall registered in Q1. Exports are estimated to show a growth rate of 1.7 percent in 2015, which represents an improvement compared to the rate observed in 2014 (-1.0 percent). This improvement is based on increased mining exports due to a greater production in Toromocho, the onset of operations of the mining project Constancia, the recovery of the grades of mineral ores at Antamina, and increased exports of agricultural and fishing products.

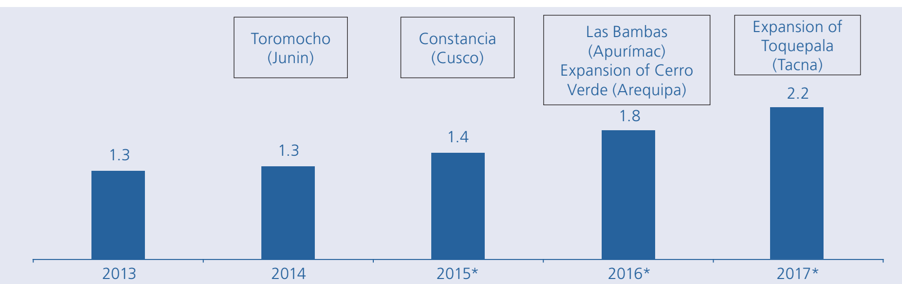
In 2016 the growth of exports would show a recovery associated with increased mining exports resulting from the entry into operation of mining project Las Bambas, the expansion of Cerro Verde, and from higher exports of non-traditional products. Moreover, a growth rate of 9.4 percent is projected for exports in 2017 due to increased mining exports as a result of the expansion of Toquepala.

**Graph 45**
**EXPORTS OF GOODS AND SERVICES: 2008-2017**
(Real % change)




* Forecast.

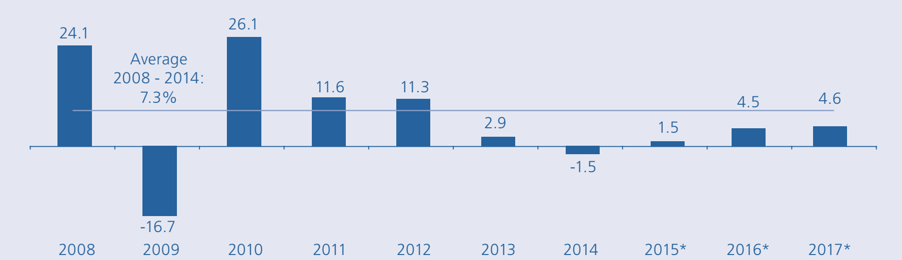
**Graph 46**
**COPPER PRODUCTION**
(Million FMT)




* Forecast.

32. On the other hand, **imports of goods and services** would grow 1.5 percent in 2015, less than expected in the previous report due mainly to the lower dynamism of imports of capital goods. In 2016 and 2017 imports are expected to show a gradual recovery, which is consistent with the projected growth of GDP.

**Graph 47**
**IMPORTS OF GOODS AND SERVICES: 2008-2017**
(Real % change)




* Forecast.

**Box 1**

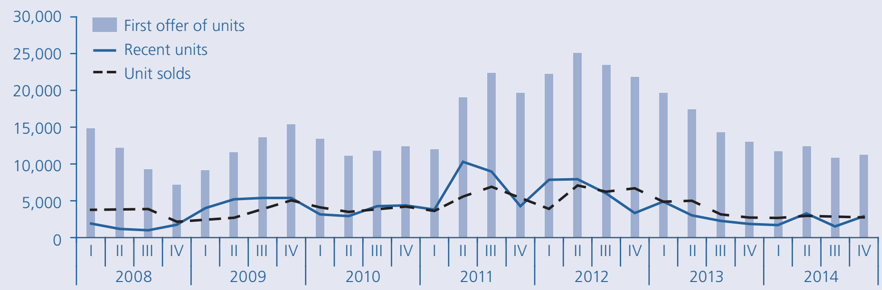
**BOOSTING THE CONSTRUCTION SECTOR**

**Overview of the Residential Real Estate Sector**

A slowdown has been observed in the dynamism of the residential real estate sector since 2011. The graph below shows the evolution of homes for sale and the number of units sold in Metropolitan Lima, as well as the initial offering of homes at the beginning of each quarter.

According to consulting firm Tinsa, the total number of new homes for sale in the market decreased by 66 percent between 2011 and 2014, from 27,465 units to 9,283 units in this period, whereas the number of homes sold during the same period declined by 49 percent, from 21,550 units to 11,049 units.

**DINAMIC OF BUILDINGS ENTRY OR EXIT FOR HOMES IN METROPOLITAN LIMA**
(Units)




Memo: Offers of units for sale, new units and sold units are shown at the beginning of one quarter. Those include units in various stages like closure of land, preliminary work, structural work, finishes and immediate delivery. The database is quarterly from 2008.Q1 to 2014.Q4.
Source: Report of Real Estate - Tinsa Peru.

**Real Estate: Supply**

On the supply side, the following would be the main obstacles affecting the sector of real estate construction in Peru:

a) Slowness in the procedures established to obtain construction permits, and
b) Little availability of urban land for construction projects due to the absence of urban development plans in Metropolitan Lima and other cities in the country, as well as difficulties to provide water and sanitation services due to inadequate infrastructure.
c) The parameters regulating the vertical growth of the city.

Obtaining a construction permit in Peru takes a long time because the paperwork and procedures are slow and because there are considerably more municipality requirements for construction permits than the ones established by Law 29090 and its regulations (Ley de regulación de habilitaciones urbanas y edificaciones, enacted in 2007), which precisely established unique procedures nationwide in order to simplify the requirements to get a construction permit.

The table below shows the average time required to obtain a construction permit in Metropolitan Lima. Getting a construction permit type C, which requires that the construction project is previously approved by a Technical Committee, takes 259 days on average in the district of La Molina and 156 days on average in the district of Los

Olivos, for example. Moreover, the aggregate average time required to get a construction permit type A or type B, in which the construction project is automatically approved, is 65 days and 117 days, respectively.[5]

**CONSTRUCTION PERMITS**

| Municipality | Type A | Type B | Type C |
|---|---|---|---|
| Jesús María | 17 | 92 | 72 |
| La Molina | 74 | 236 | 259 |
| Miraflores | 126 | 229 | 162 |
| San Juan de Miraflores | 129 | 115 | 8 |
| Santa Anita | 32 | 176 | 135 |
| Surco | 50 | 114 | 88 |
| Bustamante y Rivero | 117 | 134 | 165 |
| Victor Larco Herrera | 55 | 122 | 159 |
| Lima | 44 | 32 | 176 |
| Arequipa | 80 | 81 | 109 |
| Trujillo | 58 | 64 | 145 |
| Los Olivos | 3 | 13 | 156 |
| **Average** | **65** | **117** | **136** |

Memo: Average Duration (calendar days) of the process of construction permit in some districts of Lima in 2012.
Source: Law N0 3690 / 2014-PE.

As for the availability of urban land, the obstacles that have to be overcome to obtain or renew water and sanitation feasibility certificates in several districts of Lima (e.g. Carabayllo and the beach resorts south of Lima) delay and sometimes even prevent the development of formal real estate projects. In some cases, these problems even affect construction works. Palomino and Wong (2011)[6] point out that the main problem to increase the formal offer of low-cost housing is the absence of land suitable to develop large-scale projects (that is, homes oriented to socioeconomic levels C and D). Moreover, since the price of the land and the permits required represent around 30 percent of the cost of a house, it is difficult for property developers to build houses with a lower selling price than the limit of program Techo Propio of Fondo Mivivienda.[7]

The problem of water and sanitation provision is primarily associated with the technical and financial weaknesses of the companies that provide water and sanitation services in the different cities of the country –Empresas Prestadoras de Servicios de Saneamiento (EPS)– and, in Lima, the problem with SEDAPAL is that the company has not foreseen the growth of the formal real estate offer and has not adapted its investment plan accordingly, thus affecting the development of projects in areas where an important part of the real estate supply is concentrated. This situation affects not only real estate, but also the people who live in the urban areas involved who face the risk that some services will collapse.

**Final reflections**

Some of the following policies could be established to address the problems outlined above: a) standard requirements for construction permits nationwide, b) encourage the participation of the private sector in water and sanitation infrastructure projects, and c) design a new Metropolitan Urban Development Plan that allows for the city to expand more vertically.

5 Type A corresponds to lower works; type B higher works and it requires sign of responsible professional.

6 Palomino, Miguel and Wong, Rudy (2011). "Housing Finance in Perú: What is Holding It Back?" InterAmerican Development Bank.

7 When the paper by Palomino and Wong (2011) was published, the maximum value of a house of the program Techo Propio was equivalent to US$ 18,500 (today it is 20 tax units; that is, around US$ 24,400).

**Box 2**
**INCREASING MINING COMPETITIVENESS**

The Fraser Institute's mineral competitiveness index is an indicator that measures the attractiveness of economic jurisdictions –a province, a state, or a country– for mining investments. The index is based on the premise that, in order to attract investments, a jurisdiction must have mineral wealth as well as a regulatory framework that provides facilities for the extraction of mineral resources. In a context of fierce competition worldwide, the combination of these two factors makes a jurisdiction more attractive for investment.

The index is based on the results of a survey the Fraser Institute carries out since 1997 with the major mining and exploration companies, taking into account aspects such as the levels of mineral endowments and public policy factors that have an impact on mining conditions (i.e. taxation regimes, regulations, etc.). The survey results are compiled in a yearly report ranking the attractiveness of jurisdictions for mining investments.

**Survey Results**

Based on 485 responses of mining companies that evaluated 122 jurisdictions[8], the results of the survey conducted between August and November 2014 and published on February 24, 2015, show that Peru has moved up 7 spots relative to the ranking of the previous year, from place 37 to place 30.

Finland ranks first in this year's ranking, displacing Western Australia that dropped to fifth place. The top jurisdictions include the main mining regions of Canada, the United States, and Australia. It is worth pointing out that if the ranking considered only countries, Peru would rank 11th and would be preceded by the countries mentioned above –Finland, Canada, United States, and Australia– and by Ireland, Sweden, Chile, Argentina, Namibia, and Botswana.

In the Latin American region, Peru ranks fourth after Chile (place 13) and after the provinces of Salta and San Juan, in Argentina (places 17 and 24, respectively). It is followed closely by Mexico which ranks 33rd. .

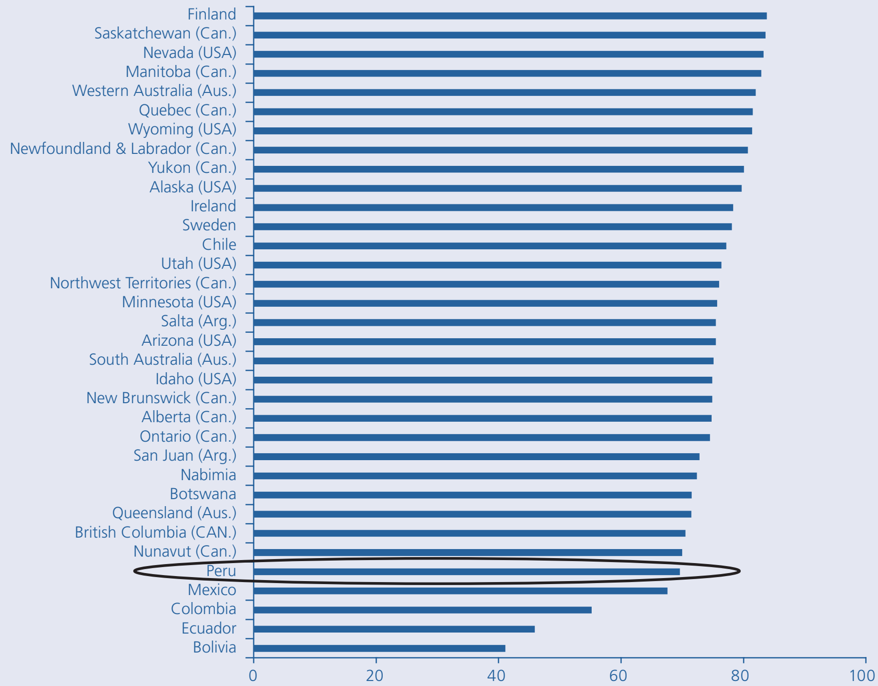
The table below shows the top 30 jurisdictions in the 2014 ranking of the Fraser Institute and a series of selected Latin American countries.

The average of two indexes are considered to determine the general ranking: the policy perception index, with a weight of 40 percent, and the mining potential index based on best practices, with a weight of 60 percent. It should be pointed out that, in order to evaluate the latter, respondents rate the jurisdiction on the basis of its mineral endowments (regardless of the policies applied in it).

Peru shows an improvement in both indexes, although the improvement in the index of mining potential is more evident because the country has moved up from spot 19 to spot 9, whereas in the policy perception index it has moved up from spot 56 to spot 52. Nonetheless, it is worth pointing out that the surveyed companies see an improvement in the latter component given that factors such as the quality of infrastructure, the availability of skilled labor, security against attacks on the infrastructure, and the quality of information are now considered factors of great importance in the country at the time of encouraging investment.

8 The 122 jurisdictions evaluated include 80 countries and 42 provinces located in Canada, Australia, the United States, and Argentina.

**FRASER INDEX: RANKING 2014**




Source: Fraser Institute.

When we compare this year's ranking with those of previous years (see table), we can also see a reversal in the decline in the ranking that Peru registered until 2012, this decline being explained by a lower score in the ranking of policy perception, which caused the country to lose ground in terms of mining competitiveness.

**FRASER INDEX EVOLUTION AND ITS COMPONENTS**

| | | Peru | | | | 2014 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | **2010** | **2011** | **2012** | **2013** | **Peru** | **Chile** | **Mexico** | **Colombia** |
| Total jurisdictions (a) | | 79 | 93 | 96 | 112 | 122 | 122 | 122 | 122 |
| General index | Rank (b) | 28 | 32 | 40 | 37 | 30 | 13 | 33 | 58 |
| | Score | 73.5 | 74.2 | 65.7 | 65.1 | 69.6 | 77.2 | 67.6 | 55.2 |
| | Percentile (b)/(a) | 35 | 34 | 42 | 33 | 25 | 11 | 27 | 48 |
| Policy potential | Rank (c) | 48 | 56 | 58 | 56 | 52 | 22 | 56 | 74 |
| | Score | 43.6 | 43.4 | 42.1 | 48.5 | 53.9 | 72.2 | 52.0 | 42.0 |
| | Percentile (c)/(a) | 61 | 60 | 60 | 50 | 43 | 18 | 46 | 61 |
| Mining potential | Rank (d) | 15 | 14 | 35 | 19 | 9 | 6 | 13 | 47 |
| | Score | 0.85 | 0.82 | 0.65 | 0.73 | 0.80 | 0.81 | 0.78 | 0.64 |
| | Percentile (d)/(a) | 19 | 15 | 36 | 17 | 7 | 5 | 11 | 39 |

Memo: The relative location or percentile (rank by countries) summarizes the relative position in the country worldwide and corrects the variation in the number of countries. Lower percentile value means better location worldwide.
Source: Fraser Institute.

The report points out that the gap between the general index and the index of mining potential –which assumes best policy practices– represents precisely the country's room for improvement. The gap of 21 spots that Peru registers today highlights the wide margin the country has to improve regulation aspects such as environmental standards, duplication of regulations, legislation, taxation, and uncertainty regarding protected areas, as well as other factors related to international trade barriers, political stability, quality of geological data, availability of human capital, among other subjects.

The fact that the gap in the case of Chile –the best ranked country in the region– is only 7 places implies that Peru lags behind in terms of public policy issues. Mexico is viewed similarly as Peru, even though its indices of policy perception and mining potential have lower scores, while Colombia, on the other hand, clearly lags behind its counterparts in the region.

The following table compares how mining companies perceive conditions for mining investment in Chile, Peru, and Colombia in terms of the 15 questions contained in the Fraser Institute's policy index. As we can see, investors' opinion about conditions in Peru is not as positive as their opinion about conditions in Chile, but it is better than their opinion about conditions in Colombia.

**FRASER INDEX: POLICY POTENTIAL INDEX 2014**

| Questions of Policy Potential Index | | Policy Potential Index* | | | |
|---|---|---|---|---|---|
| | | Peru | Chile | Mexico | Colombia |
| 1 | Uncertainty concerning the administration, interpretation, or enforcement of existing regulations | 60 | 68 | 59 | 53 |
| 2 | Uncertainty concerning environmental regulations | 54 | 54 | 57 | 48 |
| 3 | Regulatory duplication and inconsistencies | 51 | 60 | 53 | 48 |
| 4 | Legal system | 45 | 62 | 49 | 41 |
| 5 | Taxation regime | 52 | 59 | 48 | 50 |
| 6 | Uncertainty concerning disputed land claims | 43 | 57 | 52 | 39 |
| 7 | Uncertainty concerning what areas will be protected as wilderness, parks, or archeological sites, etc. | 48 | 53 | 48 | 41 |
| 8 | Infrastructure | 50 | 53 | 59 | 45 |
| 9 | Socioeconomic agreements/community development conditions | 41 | 54 | 54 | 42 |
| 10 | Trade barriers | 59 | 64 | 59 | 54 |
| 11 | Political stability | 52 | 67 | 53 | 50 |
| 12 | Labour regulations/employment agreements and labour militancy/work disruptions | 48 | 56 | 57 | 50 |
| 13 | Quality of the geological database | 62 | 64 | 67 | 44 |
| 14 | Level of security | 48 | 74 | 37 | 29 |
| 15 | Availability of labour/skills | 69 | 71 | 65 | 54 |

* The number indicates the difference between the percentage of responses "promotes investment in exploration" and the sum of responses "the factor is a strong deterrent to investment" and "wouldn't try to invest in exploration because of this factor". This number is around 50. Greater than 50 indicates a higher concentration of favorable responses. Also, higher values means better performance.
Source: Fraser Institute.

Finally, the report provides some specific comments on Peru: on the one hand, conditions have worsened because local relations in remote areas have gone from bad to worse based on NGOs organizing opposition groups; taxation on mining activity has increased via royalties, windfall tax, etc., and the method for the implementation of community consultation remains unclear. On the other hand, some improvements have been made: infrastructure has been built and made available to citizens and mining activity, and efforts are being made to streamline the permit process.

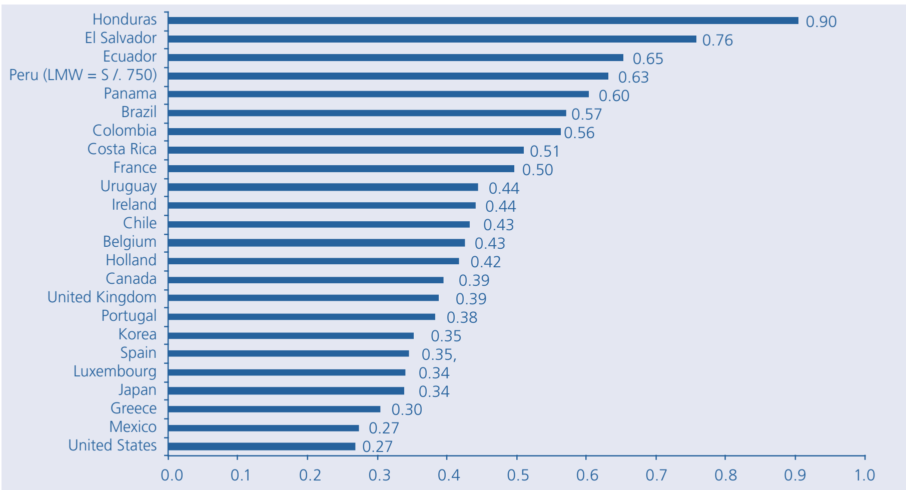
## Box 3
## SOME INSIGHTS ON THE MINIMUM WAGE IN PERU

The analysis of productivity –especially the analysis of labor productivity– is relevant to set the minimum wage. In general, economic theory suggests that the wage must be proportional to the value of its productivity, so deviations between these indicators will generate an inefficient allocation of resources (informality, for example).

However, given that the wage that is set is the minimum wage and not the mean wage, the wage set has to be associated with sectors that have low productivity and should represent a low percentage of the average wage.

According to the information provided by the National Survey of Households (ENAHO) and the OECD for 2014, the minimum wage (MW) in Peru represents about 63 percent of the average income in the country. This wage level is considerably higher than the one observed in Colombia, Chile, Mexico, and other OECD countries.

**LEGAL MINIMUM WAGE**
(% average income)*




* For OECD countries and contries in Latam (2013).
Source: OECD, OIT, and ENAHO.

On the other hand, according to the most recent issue of Doing Business, the ratio of minimum wage-to-added value per worker in Peru is 0.34, which is the median value of the distribution for this variable if one takes into account the rest of countries in the region and developed countries.

This evidence about the MW in Peru is consistent with the data on informality at the national level. Elaborated with data from the 2014 ENAHO survey, the following table shows the distribution of the workforce that is employed by type of work. The first thing that stands out is that 37 percent of the workforce employed has a lower income than the MW and that this percentage increases to 62 percent among the self-employed. Within the private sector, 27 percent of dependent workers earn less than the MW and this percentage rises to 46 percent in companies with 1 to 10 workers.

In other words, if we associate the cost of becoming "formal" with the MW for micro-enterprises, this cost would be above the productivity of the micro-enterprise's workers on average, which implies that migrating to the formal sector would not be attractive from the point of view of employers. This stylized fact contributes to explain why there are still high levels of informality despite the fact that there are special labor regimes with low non-wage labor costs (the MSE Law, for example).

**PERU: EAP EMPLOYED (2014)**

| | EAP employed (Thousands) | EAP employed (%) | Informality (%) * | Monthly average income (S/.) ** | Wage < 1 LMW (%) *** |
|---|---|---|---|---|---|
| **EAP employed** | **16,059** | **100** | **68** | **1,189** | **37** |
| Employers | 711 | 4 | 51 | 2,225 | 27 |
| Dependent workers | 7,616 | 47 | 53 | 1,356 | 23 |
| Public sector | 1,477 | 9 | 22 | 1,773 | 7 |
| Private sector | 6,139 | 38 | 60 | 1,254 | 27 |
| 1 to 10 | 2,948 | 18 | 90 | 846 | 46 |
| 11 to 50 | 1,181 | 7 | 57 | 1,254 | 18 |
| 51 to 100 | 386 | 2 | 35 | 1,654 | 7 |
| More than 100 | 1,624 | 10 | 20 | 1,807 | 6 |
| Self-employed | 5,621 | 35 | 87 | 759 | 62 |
| Unpaid family worker | 1,774 | 11 | 100 | n.a | n.a |
| Domestic worker | 336 | 2 | 91 | 562 | 73 |

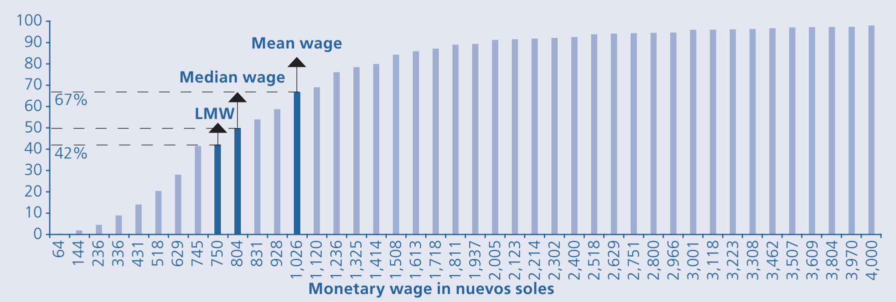
* Informality based on who provides the health insurance premiums for dependents. For employers and self-employed, INEI provides the definition of formal and informal sectors, so employees working in the formal sector are classified as formal workers. For those who work more than 24 hours per week.
** Salary or gross monthly wage. It doesn't include extraordinary or non-monetary income.
*** S/. 750.

Taking into account the modern sectors with lower productivity, trade and services (excluding telecommunications and financial services), the level of the MW is evaluated according to the density of the income distribution.

Thus, the graphs below show the density of the monthly income distribution of dependent workers in the sector of trade and services (excluding telecommunications and financial services). It should also be pointed out that these two low productivity sectors are the ones that have the highest ratio in terms of employed workers in urban areas.

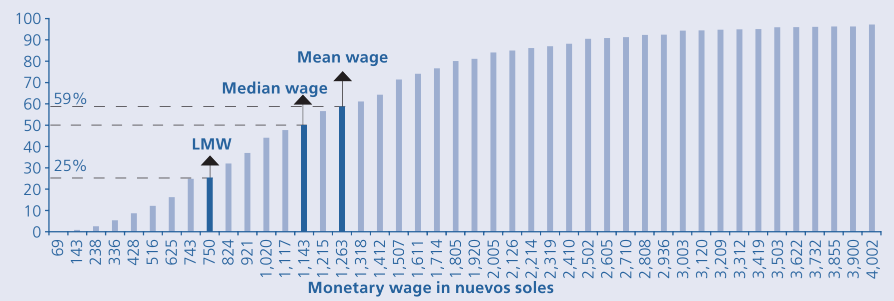
About 25 percent of the dependent workforce employed in the sector of services (excluding telecommunications and financial services) earns a monthly income below the MW and about 42 percent of the dependent workforce employed in the sector of trade earns a monthly income below the MW.

**ACCUMULATED DISTRIBUTION OF WAGES: DEPENDENT WORKFORCE EMPLOYED IN SECTOR OF COMMERCE[1]**




1/ Considers people who work 24 hours or more per week.

**ACCUMULATED DISTRIBUTION OF WAGES:
DEPENDENT WORKFORCE EMPLOYED IN SECTOR OF SERVICES[1]**




1/ Considers people who work 24 hours or more per week.

# III. Balance of Payments

## Trade Balance

33. In Q1-2015, the trade balance showed a deficit of US$ 1.09 billion –higher than the one recorded in the same period in 2014– due to a decline of 17.3 percent in exports, offset in part by a decline in imports of 7.8 percent. The decline in exports was mainly associated with a further contraction of export prices as well as with a decrease in the volume of exports, especially exports of traditional products.

34. The forecast on the trade balance in 2015 has been revised on the upside as the trade balance deficit is now estimated at US$ 1.69 billion (vs. US$ 2.81 billion in our previous report). The revision takes into account the effect of lower imports resulting mostly from a slower pace of growth in the volume of goods.

    In 2016 the deficit in the trade balance would show a gradual reduction, driven by an improvement in the volume of exports of traditional products such as mining exports (copper) and fishing exports (fishmeal). Traditional exports would continue to grow in 2017 due to the increased production capacity of some copper projects and to increased non-traditional exports, as a result of which the trade balance would register a substantial improvement in the next 2 years.

**Table 19**
**TRADE BALANCE**
(Million US$)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **Exports** | **9,780** | **39,533** | **8,091** | **36,090** | **36,326** | **39,871** | **40,099** | **44,248** |
| *Of which:* | | | | | | | | |
| Traditional products | 6,860 | 27,685 | 5,374 | 23,779 | 24,284 | 26,671 | 27,541 | 30,604 |
| Non-traditional products | 2,860 | 11,677 | 2,697 | 12,030 | 11,824 | 12,962 | 12,358 | 13,470 |
| **Imports** | **9,959** | **40,809** | **9,182** | **38,903** | **38,019** | **41,918** | **40,598** | **42,509** |
| *Of which:* | | | | | | | | |
| Consumer goods | 2,078 | 8,896 | 2,113 | 9,510 | 9,200 | 10,095 | 9,901 | 10,403 |
| Inputs | 4,677 | 18,815 | 3,765 | 15,045 | 14,737 | 16,251 | 15,770 | 16,713 |
| Capital goods | 3,173 | 12,913 | 2,944 | 12,513 | 12,153 | 13,692 | 13,170 | 13,659 |
| **TRADE BALANCE** | **-180** | **-1,276** | **-1,091** | **-2,813** | **-1,693** | **-2,047** | **-499** | **1,740** |

* Forecast.
IR: Inflation Report.

**Table 20**
**TRADE BALANCE**
(% change)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **1. Value:** | | | | | | | | |
| Exports | -6.9 | -7.8 | -17.3 | -5.0 | -8.1 | 10.5 | 10.4 | 10.3 |
| Traditional products | -13.0 | -12.3 | -21.7 | -9.3 | -12.3 | 12.2 | 13.4 | 11.1 |
| Non-traditional products | 12.7 | 5.5 | -5.7 | 4.4 | 1.3 | 7.8 | 4.5 | 9.0 |
| Imports | -2.6 | -3.4 | -7.8 | -4.7 | -6.8 | 7.8 | 6.8 | 4.7 |
| **2. Volume:** | | | | | | | | |
| Exports | 5.5 | -1.0 | -4.3 | 2.9 | 1.1 | 9.5 | 8.3 | 9.8 |
| Traditional products | 3.3 | -3.2 | -4.5 | 1.1 | -0.4 | 10.8 | 9.9 | 12.0 |
| Non-traditional products | 12.7 | 6.2 | -3.1 | 5.4 | 2.7 | 6.5 | 5.7 | 7.0 |
| Imports | -1.0 | -1.9 | 0.7 | 2.6 | 0.4 | 5.8 | 4.2 | 4.1 |
| **3. Price:** | | | | | | | | |
| Exports | -11.8 | -6.9 | -13.6 | -7.7 | -9.1 | 0.9 | 1.9 | 0.5 |
| Traditional products | -15.8 | -9.4 | -17.9 | -10.3 | -11.9 | 1.3 | 3.2 | -0.8 |
| Non-traditional products | 0.0 | -0.7 | -2.7 | -1.0 | -1.4 | 1.2 | -1.1 | 1.9 |
| Imports | -1.6 | -1.5 | -8.5 | -7.1 | -7.2 | 1.9 | 2.5 | 0.6 |

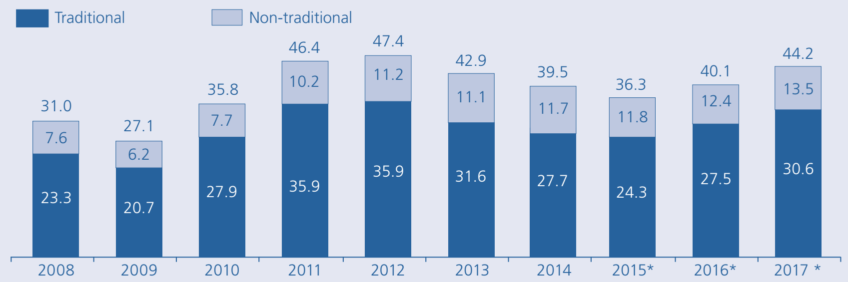
* Forecast.
IR: Inflation Report.

35. Exports in 2015 are foreseen to decline by 8.1 percent (vs. 5.0 percent estimated in the previous report). This decline would be mainly explained by lower traditional exports, particularly exports of oil and derivatives, in line with a lower production in oil companies such as Perenco and Savia (associated with the drop in the price of crude oil) and Pluspetrol (due to the suspension of activities in Lot 1-AB in Q1 because of social conflicts).

36. Exports in **2016** and **2017** would amount to US$ 40.1 billion and US$ 44.2 billion, respectively. Mining exports, especially copper exports, would show a recovery in the forecast horizon reflecting the positive impact on production of the onset of operations of copper projects such as Las Bambas, the expansion of Cerro Verde, the recovery of mineral grades at Antamina, and higher production levels at Constancia and Toromocho. In addition to this, fishing exports would also register a recovery given that weather conditions are expected to normalize this year.

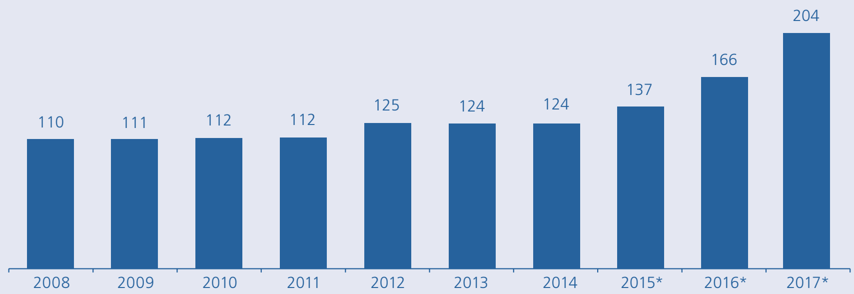
    Non-traditional exports would grow at a lower rate in **2015** than estimated in the Inflation Report of January due mainly to lower exports of textiles, in line with the trend observed in the first months of the year. Moreover, in **2016** and **2017** non-traditional exports would amount to US$ 12.4 billion and US$ 13.5 billion, reflecting the recovery of prices and volumes in a context with higher global growth.

**Graph 48**
**EXPORTS OF GOODS: 2008-2017**
(Billion US$)



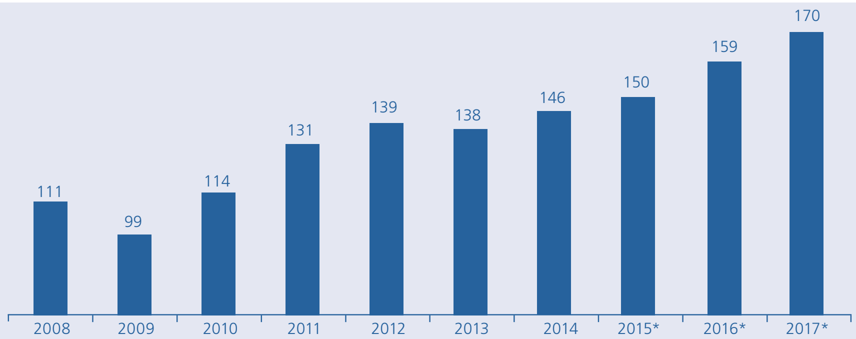

Memo: Total exports also includes other exports.
* Forecast.

**Graph 49**
**VOLUME OF COPPER EXPORTS: 2008-2017**
(Index 2007=100)




* Forecast.

**Graph 50**
**NON-TRADITIONAL EXPORTS VOLUME: 2008-2017**
(Index 2007=100)

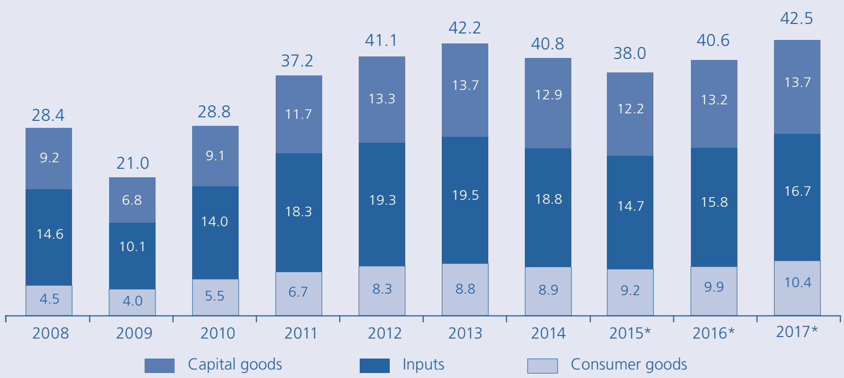



* Forecast.

37. Imports in **2015** would amount to US$ 38.0 billion, a lower figure than the one estimated in the Inflation Report of January. The forecast has been revised down due mainly to lower volumes of imports of industrial inputs (down from 5.5 to 1.8 percent) and capital goods (down from 3.4 to -1.0 percent), in line with the lower rate of economic activity foreseen.

In **2016** the volume of imports would recover as a result of increased growth in the sector of manufacturing and increased investment during the year. Furthermore, in **2017** imports would grow 4.1 percent, in line with the growth of domestic demand.

**Graph 51**
**IMPORTS OF GOODS: 2008-2017**
(Billion US$)




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

## Current Account Balance

38. In **2015** the deficit in the current account of the balance of payments is estimated to be equivalent to 3.9 percent of GDP, slightly lower than the one observed in 2014. The current account deficit would also be lower than forecast in our previous report due mainly to the decline of imports, given that the volume of imports would register a stronger drop than foreseen. The effect of lower payments for factor income would add to this.

A significant reduction is expected in the current account deficit in the forecast horizon (especially in 2017). In **2016** the current account deficit would be lower than in 2015 since the increase in net exports would offset the lower terms of trade (-0.6 percent). The current account deficit would also be lower in 2017 due to a strong increase in mining exports associated with higher production levels of copper at important mines such as Las Bambas, Southern, and Cerro Verde.

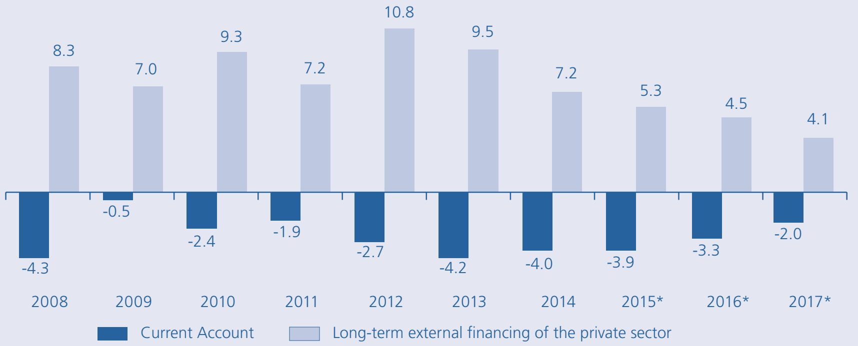
**Table 21**
**BALANCE OF PAYMENTS**
(Million US$)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **I. CURRENT ACCOUNT BALANCE** | **-2,198** | **-8,031** | **-2,623** | **-9,355** | **-7,967** | **-8,490** | **-7,309** | **-4,637** |
| % GDP | -4.6 | -4.0 | -5.7 | -4.4 | -3.9 | -3.7 | -3.3 | -2.0 |
| 1. Trade Balance | -180 | -1,276 | -1,091 | -2,813 | -1,693 | -2,047 | -499 | 1,740 |
| a. Exports | 9,780 | 39,533 | 8,091 | 36,090 | 36,326 | 39,871 | 40,099 | 44,248 |
| b. Imports | -9,959 | -40,809 | -9,182 | -38,903 | -38,019 | -41,918 | -40,598 | -42,509 |
| 2. Services | -474 | -1,800 | -500 | -1,572 | -1,536 | -1,506 | -1,467 | -1,615 |
| 3. Investment income | -2,435 | -9,328 | -1,792 | -8,604 | -8,230 | -8,702 | -8,956 | -8,516 |
| 4. Current transfers | 891 | 4,374 | 760 | 3,634 | 3,492 | 3,765 | 3,612 | 3,753 |
| *Of which: Remittances* | *633* | *2,639* | *627* | *2,860* | *2,847* | *2,968* | *2,948* | *3,056* |
| **II. FINANCIAL ACCOUNT** | **1,348** | **5,853** | **2,180** | **9,355** | **6,509** | **9,290** | **7,309** | **5,637** |
| *Of which:* | | | | | | | | |
| 1. Private Sector | 2,028 | 5,859 | 1,746 | 7,803 | 4,446 | 8,070 | 5,148 | 4,305 |
| a. Long-term | 2,505 | 6,490 | 2,416 | 7,787 | 4,563 | 8,079 | 5,148 | 4,305 |
| b. Short-term 1/ | -478 | -631 | -669 | 16 | -117 | -9 | 0 | 0 |
| 2. Public Sector 2/ | -680 | -6 | 434 | 1,552 | 2,063 | 1,220 | 2,161 | 1,332 |
| **III. BALANCE OF PAYMENTS (=I+II)** | **-850** | **-2,178** | **-443** | **0** | **-1,458** | **800** | **0** | **1,000** |
| Memo: | | | | | | | | |
| Long-term external financing of the private sector (% GDP) 3/ | 9.9 | 7.2 | 6.3 | 5.9 | 5.3 | 5.2 | 4.5 | 4.1 |
| GDP (Billion US$) | 47.9 | 202.6 | 45.9 | 212.7 | 203.7 | 229.5 | 220.2 | 237.1 |

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.

39. Moreover, private long-term financing is expected to show a decreasing trend in 2017 associated, on the one hand, with 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, with a scenario of higher external interest rates, in line with the interest rate adjustment of the Federal Reserve expected to take place in 2015. However, private long-term financing would continue to exceed the gap in the current account in 2015-2017, foreign direct investment being the main component.

**Graph 52**
**CURRENT ACCOUNT AND LONG-TERM EXTERNAL FINANCING OF THE PRIVATE SECTOR: 2008-2017 1/**
(% GDP)




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

40. Investment at end-2017, which is estimated to show a ratio of 25.1 percent in GDP terms, would be covered mainly by domestic private and public savings which together are projected to reach levels of around 23.2 percent of GDP in that year. Given that foreign savings would be lower towards the end of the forecast horizon, domestic savings are expected to increase their share as a financing source of investment and to cover more than 90 percent of investment.

**Table 22**
**SAVINGS -INVESTMENT GAP**
(% GDP)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **1. Gross fixed investment** | **24.8** | **25.9** | **23.3** | **25.4** | **25.4** | **25.6** | **25.2** | **25.1** |
| **2. Net domestic savings 1/** | **20.2** | **22.0** | **17.6** | **21.0** | **21.4** | **21.9** | **21.9** | **23.2** |
| a. Private | 10.5 | 16.7 | 9.7 | 17.1 | 17.9 | 17.7 | 18.0 | 19.0 |
| b. Public | 9.7 | 5.2 | 8.2 | 3.9 | 3.6 | 4.2 | 3.9 | 4.2 |
| **3. External savings** | **4.6** | **4.0** | **5.7** | **4.4** | **3.9** | **3.7** | **3.3** | **2.0** |

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

## External Financing

41. The net flow of private long-term external financing would amount to US$ 4.6 billion in **2015**, with residents' investments abroad amounting to US$ 4.3 billion and non-residents' investments in the country amounting to

US$ 8.9 billion. This level of net financing is lower than the one estimated in our previous report. This revision estimates mainly that the non-financial sector will receive lower flows of loans as well as lower foreign direct investment flows, in line with the revision of the growth of private investment on the downside.

A more gradual net inflow of long-term capital is projected for **2016-2017**, with positive net flows amounting to US$ 5.1 billion (2.3 percent of GDP) and US$ 4.3 billion (1.8 percent of GDP) in 2016 and 2017, respectively. A scenario with a gradual increase in international interest rates in the next few years is considered in this forecast.

**Table 23**
**FINANCIAL ACCOUNT OF THE PRIVATE SECTOR**
(Million US$)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **A. LONG-TERM** | **2,505** | **6,490** | **2,416** | **7,787** | **4,563** | **8,079** | **5,148** | **4,305** |
| *% GDP* | *5.2* | *3.2* | *5.3* | *3.7* | *2.2* | *3.5* | *2.3* | *1.8* |
| **1. ASSETS** | **-1,124** | **-4,548** | **-411** | **-2,759** | **-4,330** | **-2,258** | **-2,703** | **-3,792** |
| **2. LIABILITIES** | **3,629** | **11,038** | **2,826** | **10,546** | **8,893** | **10,337** | **7,851** | **8,097** |
| Foreign direct investment in the country | 2,565 | 7,885 | 2,818 | 7,685 | 7,620 | 7,754 | 5,618 | 5,600 |
| Non-financial sector | 859 | 3,023 | 187 | 2,361 | 1,001 | 2,083 | 1,233 | 1,497 |
| *Long-term loans* | *110* | *1,078* | *85* | *580* | *-146* | *308* | *-305* | *100* |
| *Portfolio investment* | *749* | *1,945* | *102* | *1,781* | *1,148* | *1,775* | *1,538* | *1,397* |
| Financial sector | 205 | 131 | -179 | 500 | 271 | 500 | 1,000 | 1,000 |
| *Long-term loans* | *-93* | *-593* | *-180* | *100* | *-30* | *0* | *500* | *450* |
| *Portfolio investment* | *298* | *723* | *1* | *400* | *301* | *500* | *500* | *550* |
| **B. SHORT-TERM [1/]** | **-478** | **-631** | **-669** | **16** | **-117** | **-9** | **0** | **0** |
| **C. PRIVATE SECTOR (A + B)** | **2,028** | **5,859** | **1,746** | **7,803** | **4,446** | **8,070** | **5,148** | **4,305** |

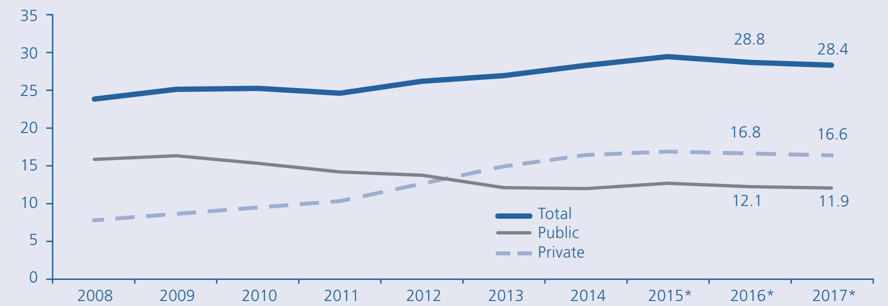
1/ Includes net erros and omissions.
* Forecast.
IR: Inflation Report.

42. The positive flow expected in the **financial account of the public sector** in the next 3 years (US$ 2.06 billion in 2015, US$ 2.16 billion in 2016, and US$ 1.33 billion in 2017) reflects major outlays destined to finance several investment projects such as the expansion of the refinery in Talara and the development of Line 2 of Lima's Metro in this period.

43. At end-2014, the external indebtedness of the private sector represented 16.6 percent of GDP, while the indebtedness of the public sector was equivalent to 11.8 percent of GDP. The level of external private debt would continue being higher than the level of the external public debt in the forecast horizon. Including sovereign

bonds held by non-residents, the latter is estimated to represent 11.9 percent of GDP at the end of 2017.

**Graph 53**
**MEDIUM- AND LONG-TERM EXTERNAL DEBT: 2007-2016**
(% GDP)




* Forecast.

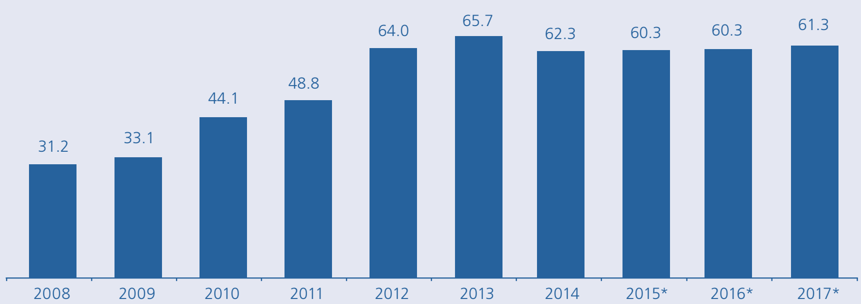
44. The soundness of the balance of payments face negative events in the global economy is reflected in the position of Peru's international reserves relative to the balance of its short term external liabilities or when one compares the total of these liabilities with the current account deficit. Moreover, Peru's high-level of indicators in the region has been improving over the years.

**Table 24**
**NIR INDICATORS**

| As a % of: | 2005 | 2010 | 2015* |
|---|---|---|---|
| GDP | 19.0 | 29.7 | 29.6 |
| Short-term external debt [1/] | 292.7 | 506.9 | 564.0 |
| Short-term external debt plus Current account deficit | 385.5 | 360.2 | 323.2 |

* Forecast.

**Graph 54**
**NET INTERNATIONAL RESERVES: 2008-2017**
(Billion US$)




* Forecast.

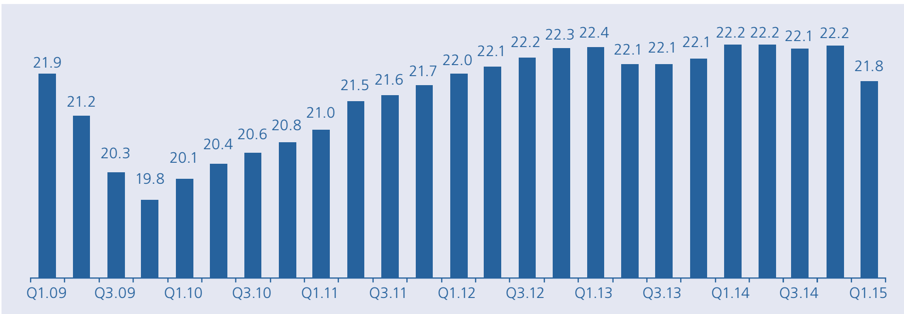
# IV. Public Finances

## Economic Balance

45. During the first months of the year, the annual economic balance of the non-financial public sector continued showing a declining trend (a fiscal deficit of 0.5 percent of GDP at March 2015). This balance is explained by the decline registered in the revenue of the general government associated with economic slowdown, the decline of terms of trade, and by the series of tax measures adopted by the end of 2014

**Graph 55**
**ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR**
(Accumulate last 4 quarters - % GDP)


**Graph 56**
**CURRENT REVENUES OF THE GENERAL GOVERNMENT**
(Accumulate last 4 quarters - % GDP)



**Graph 57**
**NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT**
(Accumulate last 4 quarters - % GDP)


**Graph 58**
**GROSS CAPITAL FORMATION OF THE GENERAL GOVERNMENT**
(Accumulate last 4 quarters - % GDP)

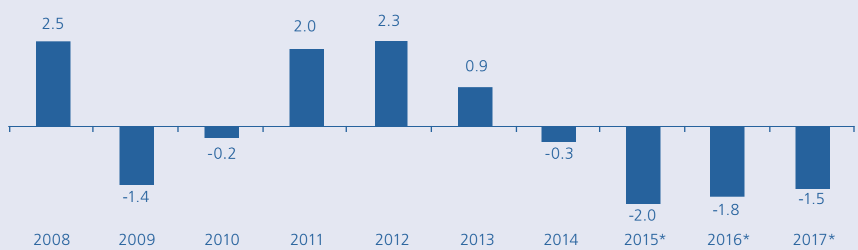

46. Like in the Inflation Report of January, a fiscal deficit of 2.0 percent is projected for **2015**. The deficit of the non-financial public sector would show a declining path in 2016 and 2017, with rates of 1.8 percent and 1.5 percent, respectively, as foreseen in the Macroeconomic Multiannual Framework for 2016-2018 (published on April 30, 2015). The balance projected for 2015 basically responds to the fiscal measures adopted in late 2014 which included a reduction in the income tax for companies and the income tax for individuals, as well as a reduction in the excise tax and tariffs, and changes in the systems of advance payments of the VAT. Moreover, the revenues projected have also been affected by the continued fall in the terms of trade and by the economic slowdown.

**Table 25**
**NON-FINANCIAL PUBLIC SECTOR**
(% GDP)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **1. General government current revenues** [1/] | **24.4** | **22.2** | **22.5** | **20.7** | **20.3** | **20.8** | **20.4** | **20.4** |
| *Real % change* | *6.3* | *2.4* | *-6.6* | *-2.7* | *-5.3* | *6.4* | *5.5* | *5.7* |
| **2. General government non-financial expenditure** [2/] | **16.9** | **21.5** | **16.6** | **21.7** | **21.4** | **21.8** | **21.0** | **20.6** |
| *Real % change* | *11.7* | *7.3* | *-0.6* | *6.2* | *2.8* | *6.2* | *3.4* | *3.6* |
| Of which: | | | | | | | | |
| Current | 13.2 | 15.6 | 13.5 | 15.6 | 15.7 | 15.4 | 15.5 | 15.0 |
| *Real % change* | *11.9* | *10.6* | *3.7* | *5.4* | *4.9* | *4.4* | *3.1* | *2.8* |
| Gross capital formation | 3.5 | 5.5 | 2.4 | 5.5 | 5.2 | 5.8 | 5.2 | 5.2 |
| *Real % change* | *9.4* | *-0.2* | *-29.0* | *5.6* | *-2.2* | *11.2* | *4.1* | *6.6* |
| **3. Others** | **0.0** | **0.1** | **0.8** | **-0.1** | **0.1** | **-0.2** | **-0.1** | **-0.2** |
| **4. Primary balance (1-2+3)** | **7.5** | **0.7** | **6.7** | **-1.1** | **-1.0** | **-1.2** | **-0.8** | **-0.4** |
| **5. Interests** | **1.5** | **1.1** | **1.5** | **0.9** | **1.0** | **0.9** | **1.0** | **1.1** |
| **6. Overall Balance** | **6.0** | **-0.3** | **5.1** | **-2.0** | **-2.0** | **-2.0** | **-1.8** | **-1.5** |

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

**Graph 59**
**ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2008-2017**
(% GDP)



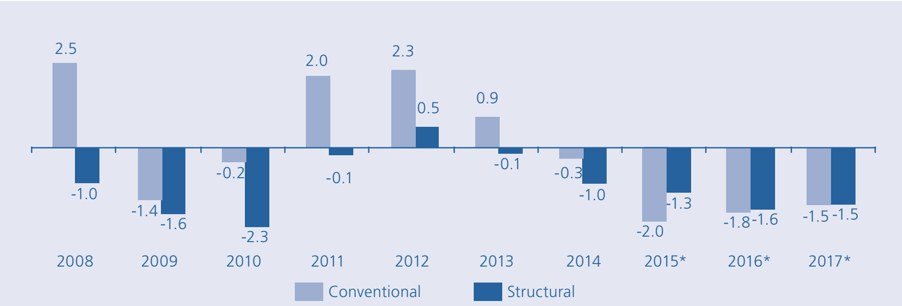

* Forecast.

## Fiscal Impulse

47. The **structural economic balance** –indicator of the long-term fiscal stance that shows the effect of fiscal policy decisions isolating the effects of the business cycle and the effects of the prices of the country's main mineral exports from the conventional economic balance– was 1.3 percent of GDP in 2015. Moreover, in 2016 and 2017 the structural balance would show a negative balance of 1.6 percent and 1.5 percent of GDP, respectively.

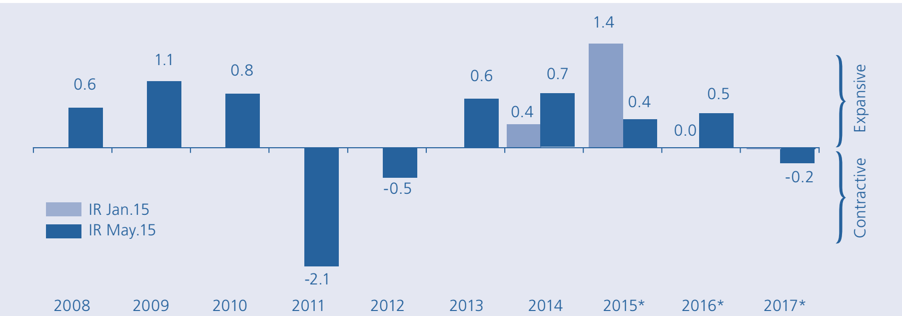
The variation in the structural balance determines the fiscal impulse. This indicator allows us to identify changes in the fiscal position isolating the effects of the business cycle. A fiscal impulse of 0.4 percent is projected in 2015 as a result of the tax measures taken. In 2016, the fiscal impulse would be 0.5 percent of GDP, higher than estimated in our previous report (a zero balance), while a negative fiscal impulse of 0.2 percent is estimated in 2017.

**Graph 60**
**CONVENTIONAL AND STRUCTURAL ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2008-2017**
(% GDP)




* Forecast.

**Graph 61**
**FISCAL IMPULSE 1/: 2008 - 2017**
(% 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.

## Tax revenues

48. Showing a decrease of 5.3 percent, the current revenues of the general government at end-2015 would amount to 20.3 percent of GDP. This projection considers a slight improvement in the balances that would be obtained in the second half of the year, but which would not be enough to reverse the negative balances

accumulated in the first half of 2015. In general, the three most important taxes in our tax structure –the VAT, the income tax, and the excise tax– would show lower levels in GDP terms at year-end than those recorded in 2014 because of the reasons discussed above. Another factor contributing to the decline in tax revenues in 2015 would be the exceptional revenues obtained during 2014 (0.6 percent of GDP) for income tax payments of non-domiciled taxpayers, which are not projected this year.

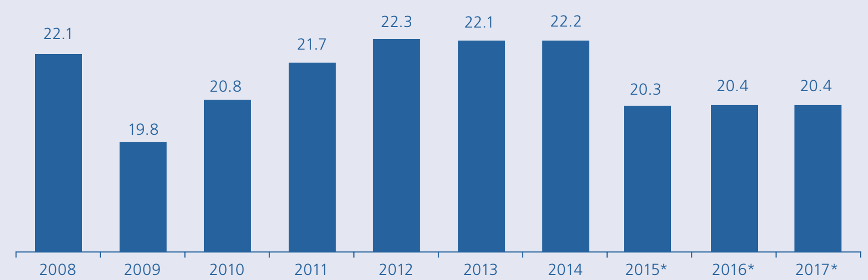
Tax revenues would show a recovery in **2016** and **2017** with growth rates of 5.5 percent and 5.7 percent, respectively, which is consistent with the growth of the economic activity anticipated for those years, which would imply a ratio of revenue of 20.4 percent in 2017.

**Table 26**
**CURRENT REVENUES OF THE GENERAL GOVERNMENT**
(% GDP)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **TAX REVENUES** | **18.6** | **17.0** | **17.2** | **15.6** | **15.4** | **15.7** | **15.4** | **15.4** |
| Income tax | 8.5 | 7.0 | 7.6 | 5.9 | 5.8 | 5.9 | 5.8 | 5.9 |
| Value added tax | 9.5 | 8.8 | 9.2 | 8.6 | 8.5 | 8.6 | 8.5 | 8.5 |
| Excise tax | 1.0 | 0.9 | 1.0 | 0.8 | 0.8 | 0.8 | 0.9 | 0.9 |
| Import duties | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Other tax revenues | 1.5 | 1.9 | 1.3 | 1.9 | 1.8 | 1.9 | 1.8 | 1.8 |
| Tax returns | -2.2 | -1.9 | -2.2 | -1.8 | -1.8 | -1.8 | -1.8 | -1.8 |
| **NON-TAX REVENUES** | **5.8** | **5.2** | **5.2** | **5.0** | **4.9** | **5.1** | **4.9** | **5.0** |
| **TOTAL** | **24.4** | **22.2** | **22.5** | **20.7** | **20.3** | **20.8** | **20.4** | **20.4** |

* Forecast.
IR: Inflation Report.

**Graph 62**
**CURRENT REVENUES OF THE GENERAL GOVERNMENT: 2008-2017**
(% GDP)




* Forecast.

## Evolution of Government Spending

49. During January-April 2015, non-financial government spending grew 0.9 percent. However, when we analyze this variation breaking it down in terms of current expenditure and capital expenditure, we see that the former grew 5.4 percent in this period, while the latter fell 13.8 percent in the same period. This fall in capital expenditure was strongly associated with the evolution of investment at the level of of subnational governments, which shrank 34.9 percent in the case of the regional governments and 43.8 percent in the case of local governments.

    This indicator is expected to recover in the following months as regional and local governments begin gradually to start solving the usual management problems faced by the new regional and municipal authorities given that new authorities were elected last year. To boost spending at these government levels, the Ministry of Economy has signed agreements with several regional governments in order that comprehensive technical assistance is provided to the new authorities by technical teams integrated by specialists in management and implementation of investment projects who will work in each of regional governments.

50. In 2015 non-financial government spending would grow 2.8 percent. This lower rate than the one estimated in the January Inflation Report (6.2 percent) is basically explained by a correction in the level of gross capital formation, which is projected to fall 2.2 percent instead of showing a growth rate of 5.6 percent. Thus, the level of spending in 2015 would be 21.4 percent of GDP –lower than expected in the January report (21.7 percent)–, which is consistent with an expected scenario that would show a less favorable international context and with the actions taken in terms of management of public finances and budget in order to speed up the process of efficient implementation of public spending at the level of subnational governments.

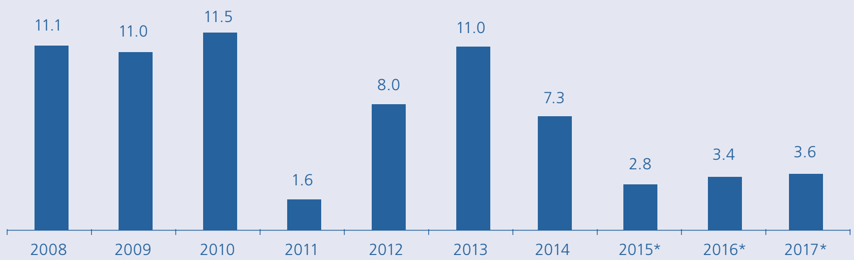
    By levels of government, the expansion of public spending will be driven by increased spending at the level of the national government, including both higher current expenditure and greater public investment. Increased spending is anticipated in the forecast horizon considering the implementation of projects such as Line 2 of the Metro of Lima and Callao and the modernization of the Talara refinery, as well as planned spending for the operation and maintenance of public infrastructure to maintain the current stock of public capital in good conditions in order to promote the growth of economic activity.

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

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **Current expenditure** | **13.2** | **15.6** | **13.5** | **15.6** | **15.7** | **15.4** | **15.5** | **15.0** |
| National Government | 8.8 | 10.7 | 9.5 | 10.6 | 10.9 | 10.5 | 10.6 | 10.3 |
| Regional Governments | 2.7 | 3.0 | 2.6 | 3.1 | 3.0 | 3.1 | 3.0 | 3.0 |
| Local Governments | 1.7 | 1.8 | 1.4 | 1.9 | 1.8 | 1.9 | 1.8 | 1.8 |
| **Capital expenditure** | **3.7** | **6.0** | **3.1** | **6.1** | **5.6** | **6.4** | **5.6** | **5.6** |
| **Gross capital formation** | **3.5** | **5.5** | **2.4** | **5.5** | **5.2** | **5.8** | **5.2** | **5.2** |
| National Government | 1.1 | 2.0 | 1.2 | 2.0 | 2.4 | 2.1 | 2.4 | 2.4 |
| Regional Governments | 1.0 | 1.1 | 0.5 | 1.1 | 1.0 | 1.2 | 1.0 | 1.0 |
| Local Governments | 1.4 | 2.4 | 0.7 | 2.4 | 1.8 | 2.5 | 1.8 | 1.9 |
| **Others** | **0.2** | **0.5** | **0.7** | **0.6** | **0.4** | **0.6** | **0.4** | **0.4** |
| **TOTAL** | **16.9** | **21.5** | **16.6** | **21.7** | **21.4** | **21.8** | **21.0** | **20.6** |
| National Government | 10.1 | 13.2 | 11.4 | 13.2 | 13.7 | 13.1 | 13.4 | 13.0 |
| Regional Governments | 3.8 | 4.1 | 3.1 | 4.1 | 4.0 | 4.2 | 4.0 | 4.0 |
| Local Governments | 3.1 | 4.3 | 2.1 | 4.3 | 3.7 | 4.4 | 3.7 | 3.7 |

* Forecast.
IR: Inflation Report.

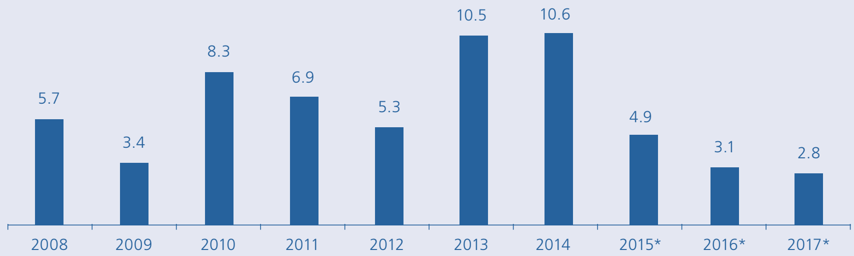
Graph 63
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT: 2008-2017
(Real % change)




* Forecast.

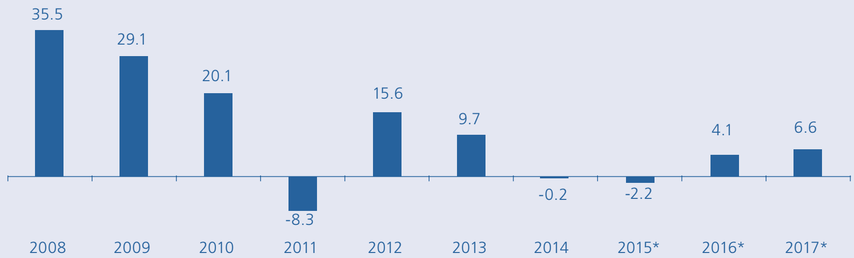
51. Non-financial spending is projected to grow 3.4 and 3.6 percent in 2016 and 2017, respectively. Within the levels of expenditure projected, current expenditure would grow at a lower rate –3.1 percent in 2016 and 2.8 percent in 2017– while gross capital formation would show a faster pace with a rate of 4.1 percent in 2016 and 6.6 percent in 2017. These projections consider that the new elected regional and local government authorities will soon overcome the management problems they usually have to deal with in the first year of their period in office.

**Graph 64**
**CURRENT EXPENDITURE OF THE GENERAL GOVERNMENT: 2008-2017**
(Real % change)




* Forecast.

**Graph 65**
**GROSS CAPITAL FORMATION OF THE GENERAL GOVERNMENT: 2008 - 2017**
(Real % change)




* Forecast.

## Public Debt

52. At the end of Q1-2015, the non-financial debt of the public sector would amount to 20.0 percent of GDP, which represents a ratio higher than the one recorded at Q1-2014 (18.2 percent). This balance includes the effect of the debt management operation carried out in March, which amounted to a total of S/. 6.08 billion. This operation involved the reopening of Sovereign Bond 2031, with bonds issued for a total of S/. 4.39 billion, the proceeds being used to finance bond swaps (S/. 2.14 billion), to repurchase debt bonds (S/. 1.32 billion), and to pre-finance fiscal requirements in 2016.

    Complementing this, the Peruvian Government reopened Global Bond 2050 placing bonds for a nominal value of US$ 545 million. The proceeds from this bond issuance in dollars will be allocated exclusively to pre-finance operations in year 2016. As a result of this operation, the average life of the debt portfolio has increased from 12.3 to 12.6 years and the profile of the debt maturities has improved.

53. The economic balance projected for 2015 (a deficit of 2.0 percent of GDP) implies that financial requirements would amount to S/. 20.6 billion. This amount would be covered with external disbursements and bond placements, and using some of the Treasury deposits this year.

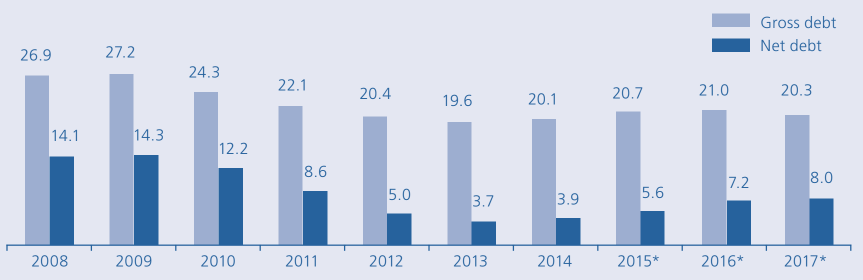
**Table 28**
**FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR AND ITS FUNDING**
(Million S/.)

| | 2014 | | 2015* | | | 2016* | | 2017* |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Year | Q1 | IR Jan.15 | IR May.15 | IR Jan.15 | IR May.15 | IR May.15 |
| **I. USES** | **-7,201** | **11,061** | **-2,648** | **17,310** | **20,552** | **18,455** | **18,169** | **21,375** |
| 1. Amortization | 864 | 9,059 | 4,563 | 4,943 | 8,071 | 4,814 | 6,031 | 10,591 |
| a. External | 343 | 4,207 | 2,376 | 2,481 | 3,671 | 3,140 | 3,374 | 2,670 |
| b. Domestic | 521 | 4,852 | 2,187 | 2,461 | 4,400 | 1,675 | 2,657 | 7,921 |
| Of which: | | | | | | | | |
| Recognition bonds | 137 | 692 | 122 | 801 | 655 | 797 | 631 | 709 |
| 2. Overall balance | -8,065 | 2,002 | -7,211 | 12,367 | 12,480 | 13,641 | 12,138 | 10,784 |
| (Negative sign indicates surplus) | | | | | | | | |
| **II. SOURCES** | **-7,201** | **11,061** | **-2,648** | **17,310** | **20,552** | **18,455** | **18,169** | **21,375** |
| 1. External | 103 | 2,654 | 1,199 | 6,451 | 7,701 | 5,493 | 5,581 | 4,910 |
| 2. Bonds 1/ | 423 | 13,002 | 6,658 | 3,427 | 8,846 | 5,002 | 9,261 | 9,165 |
| 3. Internal 2/ | -7,727 | -4,595 | -10,505 | 7,431 | 4,005 | 7,960 | 3,327 | 7,299 |
| Memo: | | | | | | | | |
| % GDP | | | | | | | | |
| Gross debt balance | 18.2 | 20.1 | 20.0 | 19.6 | 20.7 | 19.3 | 21.0 | 20.3 |
| Net debt balance 3/ | 2.0 | 3.9 | 3.2 | 5.0 | 5.6 | 6.8 | 7.2 | 8.0 |

* Forecast.
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.
IR: Inflation Report.

As a result of the above-described operations, the balance of the gross debt of the non-financial public sector is projected to amount to 20.3 percent of GDP at the end of the forecast horizon, while the net debt would increase to 8.0 percent of GDP by 2017. The latter is associated with the use in the following years of public treasury deposits to cover part of the financial requirements in these years.

**Graph 66**
**NON-FINANCIAL PUBLIC SECTOR DEBT: 2008-2017**
(% GDP)




* Forecast.

**Box 4**

**THE DYNAMICS OF SUBNATIONAL GOVERNMENTS' PUBLIC INVESTMENT**

The decentralization process has caused a major change in the composition of government investment: the share of public investment by the national government has fallen from 68 percent in 2000 to 38 percent in 2014, whereas the share of public investment by subnational governments (SNG) has risen from 32 percent in 2000 to 62 percent in 2014.

These investment rates reflect the effect of the system of intergovernmental transfers, which resulted in an increase in the resources available to regions and municipalities due to the increased funds SNG obtained from royalties and mining and oil royalties as well as from regular transfers from the national government agencies in a context of economic growth in the country and rising prices for mining and crude oil exports.

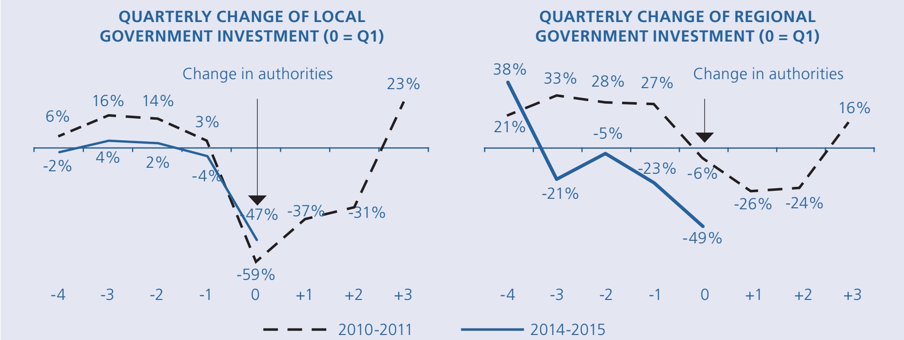
**COMPOSITION AND EXECUTION PROGRESS IN GENERAL GOVERNMENT INVESTMENT PROJECTS: 2007 -2014**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|
| **Composition** | | | | | | | | |
| National Government | 42% | 27% | 32% | 36% | 41% | 31% | 32% | 38% |
| Regional Government | 26% | 20% | 20% | 21% | 21% | 24% | 22% | 19% |
| Local Government | 33% | 53% | 48% | 43% | 38% | 45% | 46% | 43% |
| **TOTAL** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** |
| **Execution progress (Exec./PIM)** | | | | | | | | |
| National Government | 64% | 54% | 80% | 81% | 81% | 82% | 81% | 88% |
| Regional Government | 50% | 48% | 54% | 61% | 61% | 76% | 78% | 78% |
| Local Government | 42% | 55% | 58% | 73% | 59% | 63% | 66% | 73% |
| **TOTAL** | **52%** | **53%** | **63%** | **72%** | **67%** | **71%** | **73%** | **79%** |

Source: SIAF-MEF.

From the macroeconomic point of view, the increasing importance of SNGs in investment spending involves risks for the management of fiscal policy, for example, when new authorities and officials take office in local and regional governments after the elections of SNG. This cycle takes place every four years.

The following graphs show the annual quarterly nominal variation of investment in subnational governments. The data highlighted refers to the quarter in which new authorities take office and the graphs show the real growth of investment in the four quarters that preceded two election periods, 2010-2011and 2014-2015, as well as in the three quarters following the elections.




Source: SIAF.

As one can see, the change of authorities reduces significantly the rate of investment in both local governments and regional governments. The former showed a rate of investment of -47 percent in the quarter when the new authorities took office in the election period of 20144-2015 and a rate of investment of -59 percent in the same period of 2010-2011, recovering thereafter as from the second quarter and returning to positive growth values in Q4-2011. On the other hand, the effect in regional governments in both periods was similar, but registered greater intensity in 2014-2015 –investment dropped 49 percent vs. 6 percent in 2010-2011–given that investment in these government levels had been declining since 2014 due to corruption problems detected in some regions. Like in local governments, the rate of investment in regional governments in the period of 2010-2011 showed negative values until Q3-2011.

The impact of subnational elections on investment would be associated with the relatively low re-election rate observed among mayors and regional governors. The percentage of authorities reelected has decreased in the two election periods analyzed here. The rate of reelected authorities dropped from 24 to 16 percent in regional governments, from 34 to 17 percent in district local government, and from 28 to 11 percent in province local governments.[9]

This affects the management of regional and local governments given that greater learning and training is required by regional and local public servants in the jurisdictions where authorities were not reelected.[10]

Having new authorities also affects the management of public investment projects (PIP) to be implemented or being implemented because of the following reasons:

- New authorities are usually elected as a result of an electoral program based on a policy design that prioritizes giving immediate attention to certain issues, but lack long-term or regional scope. In other words, the programs are limited to making only temporary investments to immediately address a multiplicity of atomized specific issues difficult to reconcile with a coherent long-term investment program.

- There is a high level of inefficiency in the management of PIP, which is reflected in the low level of implementation of PIPs in comparison to their budget allocation as well as in the atomization of PIPs in the absence of medium- or long-term plans that include major high-impact projects for the region or province.

- There is a high level of staff turnover in most of the regional and local government administrative offices in which authorities were not reelected. This implies that the new personnel has to adjust to the new responsibilities and duties they are charged with after the former employees transfer their obligations to the new staff.

All of these factors –the adjustment of new officers, the modification of the administrative parameters or requirements, as well as the adjustment of ongoing projects to the new parameters of the new administration –limit the execution of investments projects.

9 Aragón, Jorge and José Luis Incio "La reelección de autoridades regionales y municipales en el Perú, 2006- 2014", in Revista Argumentos, Año 8, N° 5. December 2014. (http://www.revistargumentos.org. pe/reelecciónregionales.html)

10 It should be pointed out that recently passed Law 30305 bans the immediate re-election of regional governors and province mayors.

In order to mitigate this risk in the execution of public investment and macroeconomic fiscal policy, the MEF has implemented various management and budget measures to accelerate the learning process of new authorities and officers and facilitate public investment in SNG, such as training workshops on administrative systems for regional and local authorities, the transfer of multidisciplinary teams of the MEF to several areas of the country to expedite the implementation of PIPs, and the assistance of resident teams, financed and supervised by the MEF, in 24 regional governments.

# V. Monetary Policy and Financial Markets

## Monetary Policy Actions

54. The inflation forecast for the 2015-2017 horizon has increased slightly since our previous Inflation Report was published in January. The effect of an increased depreciation of the nuevo sol against the dollar on the prices of imported goods has generated a rise of inflation in the forecast horizon, while the supply shocks associated with climate factors have had a temporary effect on inflation. These effects are being partially offset by the output gap which remains negative, but which is expected to be lower in the near future.

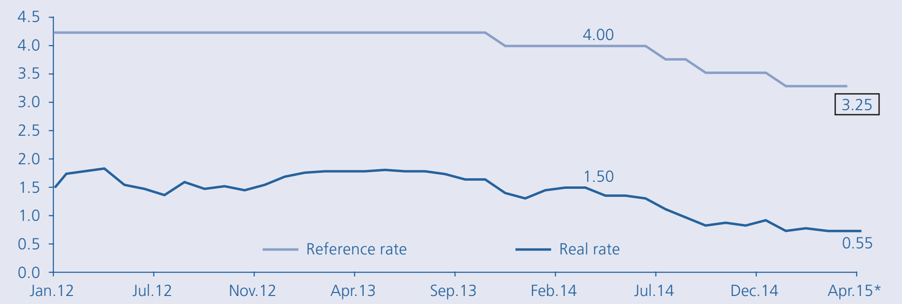
    In this context, the BCRP has maintained the benchmark interest rate at 3.25 percent since January. This level of the policy rate is compatible with an inflation forecast in which inflation converges to the 2.0 percent target in the 2015-2017 horizon and reflects a monetary policy stance that takes into account the impact of inflation on a level of economic activity below its potential in a context of greater volatility in financial markets and changes that increase the risk of higher inflation in the short run due to the exchange rate-to-prices pass-through effect.

    The BCRP has also continued easing 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 have grown at a slower pace than credit. The rate of reserve requirements was last lowered from 7.5 to 7.0 percent in May 2015.

    Additionally, with the aim of discouraging the dollarization of deposits, the BCRP raised the rates of the general regime of reserve requirements in foreign currency from 60 to 70 percent in March. The BCRP also established new additional reserve requirements in soles according to the level of operations of forwards in foreign currency through foreign exchange derivatives with the aim of offsetting the foreign exchange volatility generated in this market.

55. In recent months, the BCRP policy communiqués have highlighted that the expected rates of inflation are within the target range and that the inflation rate will decline while the supply conditions that affected inflation continue to subside and there are no demand pressures. The Board has also highlighted that the Central Bank oversees the inflation forecast and inflation determinants and will evaluate adjusting its monetary policy instruments should this be required.

**Graph 67**
**NOMINAL AND REAL REFERENCE INTEREST RATE**
(%)

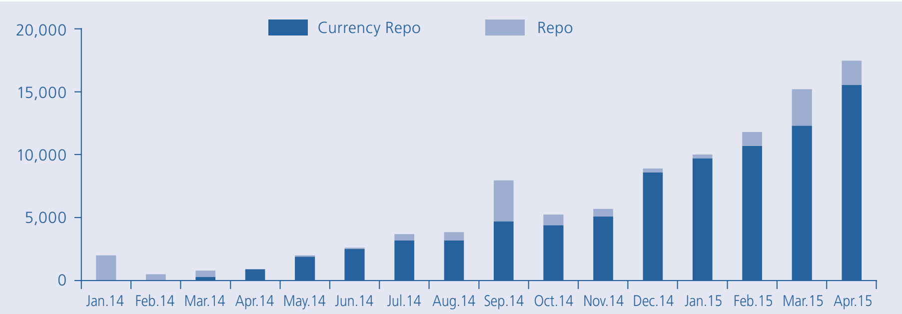



* Estimate.

## Interest Rates and Monetary Operations

56. Interest rates in the money market declined in Q1, influenced by the reduction of the Central Bank's policy rate by 25 basis points in January. However, some volatility was still observed in some interest rates due to pressures on liquidity in domestic currency as a result of increased demand for soles to buy foreign currency, in a context of increased demand for the latter in the corporate sector to hedge against exchange rate risks. To mitigate the effects of this greater demand for soles, the BCRP sought to reinforce the interest rate pass-through mechanism and to preserve monetary conditions in soles through the injection of liquidity via repos with term securities and repos in foreign currency.

**Graph 68**
**BALANCE OF REPO OPERATIONS: TERM AT THE END OF MONTH**
(Million S/.)




57. The Board approved to lower the rates for window operations in the monetary program for May. The rate for overnight deposits was lowered by 5 basis points to 2.00 percent and the rate for direct repo operations was lowered by 25 basis points to 3.80 percent. This reduction contributes to a better distribution of liquidity among the financial entities of the system, which in turn improves the BCRP management of the interbank rate.

58. In addition to the instruments being used by BCRP to inject liquidity in soles, in May the BCRP established an agreement with the Treasury and with Banco de la Nación to carry out auctions and inject liquidity using the funds these entities hold at the Central Bank. The Treasury deposits at the BCRP currently amount to S/. 34 billion, while the deposits of Banco de la Nación amount to S/. 7 billion. So far, placements of Treasury deposits for a total of S/. 300 million have been made and one placement of Banco de la Nación funds has been made for a total of S/. 300 million, both with 1-year maturities.

59. With these liquidity injection operations, the BCRP was able to reverse the temporary increase in the interbank interest rate and in the corporate prime rate. The interbank interest rate has fallen 28 basis points during the last quarter and the corporate prime rate has fallen 36 basis points compared to Q4-2014.

**Graph 69**
**90-DAY CORPORATE PRIME RATE VS. INTERBANK OVERNIGHT RATE IN DOMESTIC CURRENCY: JAN.08 - APR.15**

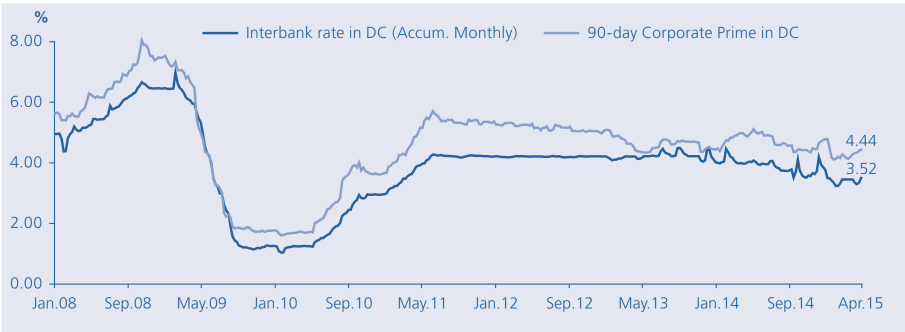



**Table 29**
**INTEREST RATE IN DOMESTIC CURRENCY**
(%)

| | Dec.14 | Apr.15 |
|---|---|---|
| Corporate loans | 5.61 | 4.99 |
| Corporate loans (To 3-months ) | 4.80 | 4.44 |
| Deposits up to 30-days | 3.80 | 3.70 |
| Deposits of legal entitiy up to 3-moths | 3.80 | 3.64 |

60. The declining trend of money market rates has influenced lending interest rates in domestic currency, which decreased in most of the credit segments during Q1-2015. In the segments of consumer loans, corporate loans, mortgages, and large enterprises, lending interest rates declined by 226, 62, 51, and 21 basis points, respectively. On the other hand, the interest rates for the segments of micro-businesses, small businesses, and medium-sized companies increased, in line with the increase registered in the delinquency rate in these segments of the credit market.

On the other hand, the interest rates on deposits in national currency for terms of less than 30 days declined by 14 basis points, while the rates on 31 to 180-day deposits and deposits with terms between 181 days and 360 days remained stable. An additional decline is expected in the following months in the lending rates as a result of the term liquidity injection operations in domestic currency that are being carried out by the BCRP.

**Table 30**
**INTEREST RATE BY TYPE OF LOANS IN DOMESTIC CURRENCY 1/**
(%)

| | Corporate | Large companies | Medium-sized enterprises | Small businesses | Microbusinesses | 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 |
| 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 |
| Sep.14 | 5.3 | 6.9 | 10.8 | 21.0 | 33.0 | 43.0 | 9.2 |
| Oct.14 | 5.5 | 7.1 | 10.6 | 20.9 | 32.8 | 42.7 | 9.1 |
| Nov.14 | 5.8 | 7.1 | 10.5 | 21.2 | 32.8 | 42.4 | 9.0 |
| Dec.14 | 5.6 | 6.8 | 9.5 | 20.6 | 33.0 | 43.3 | 9.0 |
| Jan.15 | 5.2 | 6.6 | 9.5 | 20.4 | 32.5 | 42.3 | 8.9 |
| Feb.15 | 5.1 | 6.7 | 10.0 | 20.5 | 32.2 | 40.5 | 8.9 |
| Mar.15 | 5.2 | 6.6 | 9.8 | 21.2 | 34.4 | 40.6 | 8.5 |
| Apr.15 | 5.0 | 6.6 | 9.8 | 21.3 | 35.1 | 41.1 | 8.5 |
| **Accumulated change (bps)** | | | | | | | |
| Apr.15-Dec.14 | -62 | -21 | 30 | 74 | 218 | -226 | -51 |
| Apr.15-Dec.13 | -42 | -46 | -39 | 28 | 204 | -121 | -58 |
| Apr.15-Dec.12 | -79 | -77 | -121 | -114 | 199 | -11 | -31 |

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

**Table 31**
**INTEREST RATES IN NUEVOS SOLES**
(%)

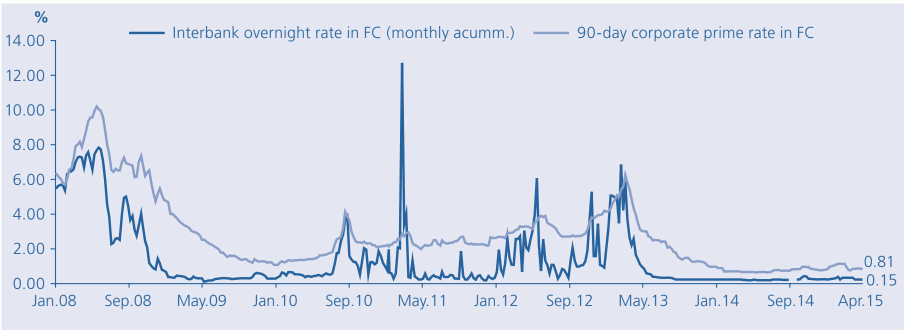
| | Deposits up to 30-day | On 31 to 180-day term deposits | On 181 to 360-day term deposits |
|---|---|---|---|
| Dec.12 | 3.6 | 3.8 | 4.2 |
| Dec.13 | 3.8 | 3.5 | 3.9 |
| Jan.14 | 3.9 | 3.5 | 3.9 |
| Mar.14 | 4.1 | 3.7 | 3.9 |
| Jun.14 | 3.7 | 4.0 | 4.2 |
| Jul.14 | 3.7 | 4.1 | 4.2 |
| Aug.14 | 3.5 | 4.0 | 4.2 |
| Sep.14 | 3.6 | 3.9 | 4.2 |
| Oct.14 | 3.5 | 3.8 | 4.2 |
| Nov.14 | 3.6 | 3.8 | 4.1 |
| Dec.14 | 3.8 | 3.8 | 4.3 |
| Jan.15 | 3.6 | 3.8 | 4.4 |
| Feb.15 | 3.3 | 3.7 | 4.4 |
| Mar.15 | 3.5 | 3.8 | 4.4 |
| Apr.15 | 3.7 | 3.8 | 4.4 |
| **Accumulated change (bps)** | | | |
| Apr.15-Dec.14 | -14 | 5 | 5 |
| Apr.15-Dec.13 | -9 | 30 | 50 |
| Apr.15-Dec.12 | 6 | 4 | 17 |

Source: BCRP.

61. As for the interest rates for operations in dollars, most of the lending and deposit rates declined despite the fact that commercial banks used their excess of liquidity

in foreign currency to do currency repos with the BCRP. Thus, the corporate prime interest rate for 90-day loans rose 5 basis points compared to December, recording a level of 0.81 percent, whereas the interbank interest rate fell 1 basis point.

**Graph 70**
**90-DAY CORPORATE PRIME RATE VS. INTERBANK OVERNIGHT RATE IN FOREIGN CURRENCY: JAN.08 - APR.15**




The lending interest rates in dollars showed mixed conducts compared with the previous quarter. On the one hand, the rates for the segments of small businesses, mortgages, corporate loans, and large enterprises declined by 67, 44, 41, and 31 basis points, respectively. On the other hand, the interest rates for the segments of consumer loans, microenterprises, and medium-sized companies increased by 338, 298, and 5 basis points, respectively, like the respective rates for operations in nuevos soles.

**Table 32**
**INTEREST RATE BY TYPE OF LOANS IN FOREIGN CURRENCY [1/]**
**(%)**

| | Corporate | Large companies | Medium-sized enterprises | Small businesses | Microbusinesses | 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 |
| 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 |
| Sep.14 | 2.2 | 4.4 | 8.1 | 13.0 | 18.8 | 27.3 | 7.6 |
| Oct.14 | 2.1 | 4.6 | 7.6 | 12.6 | 20.0 | 27.5 | 7.6 |
| Nov.14 | 2.6 | 4.7 | 7.8 | 12.7 | 18.0 | 28.2 | 7.5 |
| Dec.14 | 2.5 | 5.1 | 8.3 | 12.3 | 16.9 | 27.3 | 7.6 |
| Jan.15 | 2.5 | 5.2 | 8.1 | 11.5 | 17.9 | 28.1 | 7.6 |
| Feb.15 | 3.6 | 5.3 | 8.3 | 12.0 | 18.1 | 29.9 | 7.7 |
| Mar.15 | 2.6 | 4.9 | 8.2 | 13.5 | 14.9 | 30.9 | 7.4 |
| Apr.15 | 2.1 | 4.8 | 8.3 | 11.6 | 19.9 | 30.6 | 7.1 |
| **Accumulated change (bps)** | | | | | | | |
| Apr.15-Dec.14 | -41 | -31 | 5 | -67 | 298 | 338 | -44 |
| Apr.15-Dec.13 | -32 | -71 | 6 | -158 | 70 | 459 | -134 |
| Apr.15-Dec.12 | -199 | -160 | -69 | -388 | 58 | 824 | -85 |

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

Moreover, the interest rates on deposits in foreign currency for terms of less than 30 days fell 4 basis points and the interest rates on deposits with terms between 181 days and 360 days fell 6 basis points, whereas the interest rates on deposits with terms between 31 days and 180 days increased by 5 basis points.

**Table 33**
**DEPOSIT INTEREST RATES IN US DOLLAR**
(%)

| | Deposits up to 30-day | 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 |
| Oct.14 | 0.2 | 0.5 | 0.8 |
| Nov.14 | 0.2 | 0.5 | 0.8 |
| Dec.14 | 0.2 | 0.5 | 0.8 |
| Jan.15 | 0.3 | 0.5 | 0.8 |
| Feb.15 | 0.3 | 0.5 | 0.8 |
| Mar.15 | 0.2 | 0.5 | 0.8 |
| Apr.15 | 0.1 | 0.5 | 0.7 |
| **Accumulated change (bps)** | | | |
| Apr.15-Dec.14 | -4 | 5 | -6 |
| Apr.15-Dec.13 | -2 | -23 | -55 |
| Apr.15-Dec.12 | -163 | -78 | -90 |

Source: BCRP.

62. The monetary operations of the Central Bank were mainly oriented to maintaining adequate levels of liquidity in a context of a strong demand for liquidity from banks and expectations of a depreciation. To do so, the BCRP increased the frequency and the amounts of its liquidity injection operations, especially repos and currency repos. Thus, between January and April 2015, the balance of its term repos increased by S/. 1.60 billion, while the balance of currency repos increased by S/. 6.95 billion (placements amounting to S/. 7.25 billion and maturities amounting to S/. 300 million), S/. 3.90 billion through credit expansion repos and S/. 2.15 billion through credit substitution repos.

**Table 34**
**BCRP MONETARY POLICY INSTRUMENTS**

| | Instrument | Goal | Type and term | Basic concepts |
|---|---|---|---|---|
| INJECTION | Repo in soles [1/] | Provisional injection of soles | Auctions and Direct overnight and 1-week | Accept securities issued by BCRP or Treasury bonds as collaterals, in terms usually overnight up to one year. When is directly, the interest rate is 55 bps above the policy rate. In the form of direct purchase, corporate bonds in soles issued by non-financial companies will be accepted. |
| | Regular currency repo [1/] | Provisional injection of soles | Auctions and Direct overnight, 1-week, 6-motnh, and 1-year | Central Bank temporarily purchase foreign currency to financial institutions with a commitment of re-purchasing in a future date. |
| | Repo for credit-expansion [1/] | Provisional injection of soles | Auctions and Direct 1 and 5-year | This instrument has been designed to support the growth of credit in domestic currency. |
| | Repo for credit substitution: [1/] | Provisional injection of soles | Auctions and Direct 1 and 5-year | The purpose of this instrument is to support the conversion of loans in foreign currency into loans in domestic currency |
| | Repo in US$ [2/] | Provisional injection of US$ | Auctions and Direct | In order to give temporarily dollars for soles or other securities that the Central Bank announced in each operation. |
| | Repo with portfolio of securities [2/] | Provisional injection of soles or US$ | Auctions and Direct | Auction of repos using as collateral the loan portfolio of securities. By increased credit risk, a discount (Haircut) of 20% is applied. |
| | Repo with Trust Fund Contracts [2/] | Provisional injection of soles | Auctions and Direct | Instrument accepts as collateral senior certificates issued for Trust Fund Contracts. |
| | Auctions of Treasury deposits and Banco de la Nación deposits [5/] | Provisional injection of soles | Auctions 6, 12, and 18-month | Auctions of public deposits placed in the BCRP. It aims to provide liquidity in soles without requiring collateral. |
| STERILIZATION | CD BCRP [3/] | Sterilization | Auctions | Terms up to 18 months at a fixed rate, placed at a discount. Fee of 0.01% is applied for transfers of ownership of certificates. |
| | CDV BCRP [4/] | Sterilization | Auctions 3, 6, and 9-month | Certificates are denominated in nuevos soles and indexed to the Monetary policy interest rate |
| | Term deposits [2/] | Sterilization | Auctions overnight | To withdraw liquidity |
| | Overnight deposits in soles and US$ [2/] | Sterilization | Window facilities overnight | Financial entities will obtain a 125 bps lower than policy interest rate. BCRP stablished daily interest rate for foreign currency |
| INTERVENTION | Purchase/sale spot US$ [5/] | Foreign exchange intervention | | In order to prevent excessive volatility in the exchange rate and reduces the negative effects of currency mismatches |
| | CDR BCRP [3/] | Foreign exchange intervention (sale) | Auctions 2 and 3-month | Securities which represent a liability for the latter in favor of the buyer. These certificates are denominated in nuevos soles, issued at discount and indexed to the variation of the exchange rate |
| | CDLD BCRP [4/] | Foreign exchange intervention (purchase) | Auctions 2 and 3-month | The CDLD BCRP are denominated in soles and issued at a discount. The BCRP CDLD is paid and redeemed in dollars at the rate of exchange in effect at the time of the contract and of the maturity date. |
| | FX Swap [5/] | Foreign exchange intervention (purchase/ sale) | Auctions 2, 3, and 6-month | **FX swap purchase**, used in appreciation pressures associated with forward purchasing of banks covered in the spot market. Equivalent to buy dollars in the foreign exchange derivatives market in which the Central Bank would pay a variable interest rate in soles and receive a fixed rate is US$.<br>FX **swap sale**, used in depreciation pressures associated with forward sales of banks covered in the spot market. Equivalent to sell dollars in the foreign exchange derivatives market in which the Central Bank would pay fixed interest rate in US$ and receive a variable rate in soles. |

**ATTENDEES**
1/ Banks, Financial entities, and Municipal banks.
2/ Financial entities that take deposits from people, referred to in Paragraph A of Article 16 of Law No. 26702.
3/ By own and third account: banks, financial entities, and brokerage firms. And only on its own, insurance companies, AFPs, mutual funds, investment funds, Deposit Insurance Fund, Municipal Banks, Rural Banks, Essalud, Mivivienda, and Consolidated Pension Reserve Fund.
4/ List of entities authorized to participate Will be announced by BCRP.
5/ Banks.

**Table 35**
**CURRENCY REPO OPERATIONS**
(Million S/.)

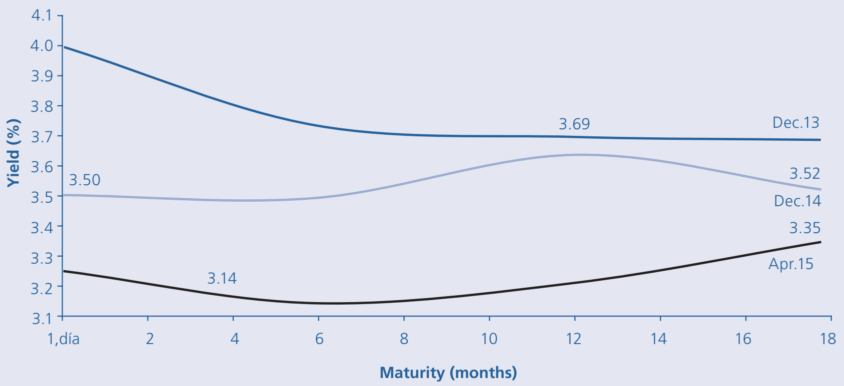
| Date | Operation | Term | Amount | Average rate |
|---|---|---|---|---|
| 05-Jan-15 | Regular | 18 Months | 300 | 3.94% |
| 16-Jan-15 | Expansion | 2 Year | 300 | 4.02% |
| 23-Jan-15 | Expansion | 2 Year | 300 | 3.81% |
| 30-Jan-15 | Substitution | 3 Year | 200 | 3.56% |
| 06-Feb-15 | Expansion | 2 Year | 300 | 3.83% |
| 13-Feb-15 | Substitution | 4 Year | 200 | 3.50% |
| 20-Feb-15 | Expansion | 2 Year | 500 | 3.75% |
| 27-Feb-15 | Substitution | 4 Year | 300 | 3.67% |
| 06-Mar-15 | Expansion | 2 Year | 300 | 3.87% |
| 13-Mar-15 | Substitution | 4 Year | 400 | 3.62% |
| 20-Mar-15 | Expansion | 3 Year | 500 | 4.04% |
| 27-Mar-15 | Substitution | 4 Year | 400 | 3.68% |
| 01-Apr-15 | Expansion | 3 Year | 500 | 4.22% |
| 10-Apr-15 | Substitution | 4 Year | 500 | 3.53% |
| 14-Apr-15 | Regular | 1,Year | 300 | 4.50% |
| 15-Apr-15 | Regular | 1,Year | 300 | 4.25% |
| 17-Apr-15 | Expansion | 3 Year | 600 | 4.53% |
| 22-Apr-15 | Substitution | 3 Year | 150 | 3.25% |
| 24-Apr-15 | Regular | 18 Months | 300 | 4.65% |
| 30-Apr-15 | Expansion | 3 Year | 600 | 5.23% |
| **TOTAL** | | | **7,250** | |

In the foreign exchange market, the proximity of the tentative date when the Federal Reserve would start the process of increasing its monetary policy interest rate generated depreciation pressures on the main currencies of the emerging economies, including the nuevo sol. In this context, the BCRP intervened in the spot market selling foreign currency for a net amount of US$ 3.98 billion and continued carrying out interventions in the market of derivatives through FX swaps, an instrument introduced in late 2014. Net placements of FX swaps for a total of US$ 2.85 billion were made in the 4-month period. These placements of swaps replaced in part net maturities of BCRP-CDRs for a total equivalent to US$ 785 million.

The BCRP also continued with its regular auctions of 6-month, 12-month, and 18-month BCRP-CDs three times a week, placing CDs between S/. 50 million and S/. 100 million each time in order to increase the volume of these certificates and provide more liquidity to the secondary market of BCRP-CDs to contribute to the development of the short-term yield curve in soles. Between January and April, the Central Bank placed BCRP-CDs for a total of S/. 7.13 billion and maturities amounted to S/. 7.25 billion, as a result of which the balance of BCRP-CDs decreased by S/. 121 million.

The yield curve of BCRP-CDs decline 32 basis points on average compared to Q4-2014 due to the reduction of 25 basis points in the BCRP policy rate.

**Graph 71**
**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. On the other hand, the ratio of banks' deposits increased from 28.4 to 36.5 percent in the same period due to both the increase of banks deposits for reserve requirements in dollars and the deposits associated with currency repos. Public sector deposits, which continued to be the largest source of sterilization, went from representing 38.8 percent of international reserves in December to 42.3 percent in April.

**Table 36**
**SIMPLIFIED BALANCE SHEET OF THE BCRP**
(As % of Net International Reserves)

| | Dec.13 | Dec.14 | Apr.15 |
|---|---|---|---|
| **Net assets** | | | |
| **I. Net International Reserves** | **100%** (US$ 65,663 mills.) | **100%** (US$ 62,307 mills.) | **100.0%** (US$ 61,626 mills.) |
| **Net liabilities** | | | |
| **II. Total public sector deposits** | **36.3%** | **38.8%** | **42.3%** |
| In domestic currency | 19.9% | 19.7% | 21.5% |
| In foreign currency | 16.4% | 19.1% | 20.7% |
| **III. Total financial system deposits** | **31.0%** | **28.4%** | **36.5%** |
| In domestic currency | 9.1% | 8.1% | 5.4% |
| In foreign currency | 21.9% | 20.4% | 31.1% |
| **IV. BCRP instruments** | **13.2%** | **5.0%** | **-1.3%** |
| CD BCRP | 10.3% | 8.4% | 8.0% |
| CDR BCRP | 1.7% | 1.4% | 0.2% |
| Overnight deposits | 1.7% | 0.5% | 0.4% |
| Currency repos | 0.0% | -4.6% | -8.1% |
| Repos | -0.5% | -0.7% | -1.8% |
| **V. Currency** | **19.2%** | **20.9%** | **19.1%** |
| **VI. Others** | **0.3%** | **6.9%** | **3.4%** |

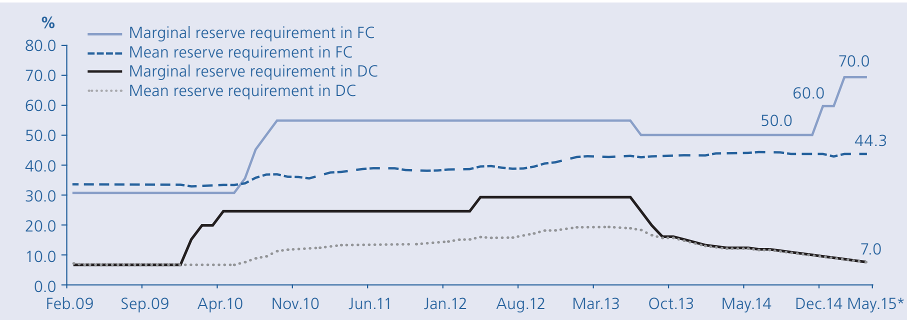
## Reserve Requirements

63. During Q1-2015, the BCRP continued lowering the rate of reserve requirements in domestic currency in order to ease credit conditions in soles, contributing in this way to make it possible for financial intermediaries to meet the increased demand for credit in soles, in a context in which deposits in this currency had been growing at low rates relative to the dynamism of credit in this currency. In this way, the Central Bank has gradually reduced mean reserve requirements from 9.0 percent in January 2015 to 7.0 percent in May 2015.

    The BCRP also reduced the minimum requirement in current account for reserve requirement funds from 2.0 percent to 0.75 percent in April 2015 in order to make the cuts in the rate of mean reserve requirements effective and not generate upward pressures on interest rates in soles. As a result of all these measures, liquidity for a total of about S/. 13.22 billion has been released between June 2013 and April 2015.

64. As for reserve requirements in foreign currency, the BCRP has adopted several measures to discourage credit in dollars and accelerate the process of de-dollarization of credit. Among these measures, it is worth pointing out that the BCRP increased the rate of marginal reserve requirements from 60 percent to 70 percent in March. These measures seek to increase banks' incentives to attract deposits in soles.

**Graph 72**
**RATES OF RESERVE REQUIREMENTS IN DOMESTIC AND FOREIGN CURRENCY**
(As % of total obligations subject to legal requeriments)




* Forecast.

65. As for the actions taken to contribute to the dedollarization of credit, given that the BCRP modified these measures at end-2014, the month of December of 2014 may be used as the time reference for their application. Thus, as from June 2015, additional reserve requirements in dollars will be established for banks that do not reduce their credit balance in dollars (excluding foreign trade loans and loans of

over 3 years and amounts exceeding US$ 10 million) by at least 5 percent of their balance of loans in foreign currency at September 30, 2013, or by 8 percent of their balance at December 2014. The additional reserve requirements will be 30 percent of the percentage deviation relative to this threshold on total liabilities in foreign currency.

A similar change has been established for additional reserve requirements associated with the balance of car loans and mortgage loans in foreign currency, which will be applied to financial institutions that by June 2015 have not reduced their balance of such loans by 10 percent relative to their balance at February 2013 or by 15 percent relative to their balance at December 2014. The banks that have not reduced their balances as required will have additional reserve requirements equivalent to 15 percent of the percentage deviation from the threshold applied to total liabilities in foreign currency.

The threshold for both schemes of additional reserve requirements will become more demanding as from December 2015. In the case of total loans, banks will be required to reduce their balance by at least 10 percent relative to the balance at September or by 14 percent relative to the balance at December 2014, while in the case of car loans and mortgage loans, their balances must show a reduction of 15 percent relative to the balance at February 2013 or a reduction of 25 percent relative to the balance at December 2014.

These measures have been successful in reducing credit in dollars so far this year. At April 2015, many commercial banks have managed to reduce their balances of credit in foreign currency, in line with these measures. In aggregate terms, the balance of total credit in foreign currency, excluding foreign trade operations, is 8.2 percent lower than in September 2013, while the balance of car loans and mortgage loans is 16.1 percent lower than in February 2013.

**Graph 73**
**BANK'S CREDIT IN US$**
**EXCLUDING FOREIGN TRADE**
(Million US$)

Graph 74
CAR AND MORTGAGE BANK'S
LOANS IN US$
(Million US$)

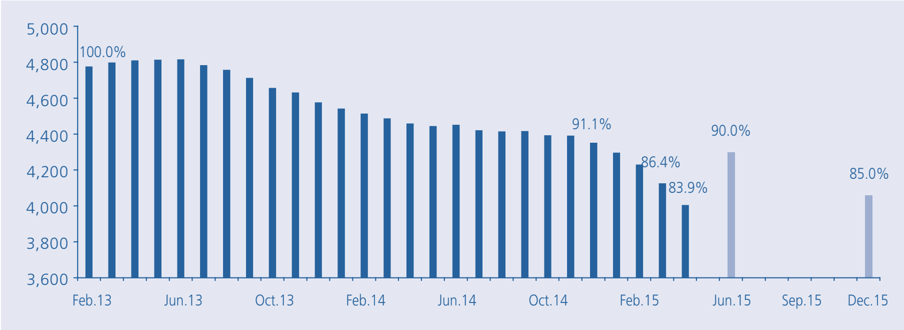


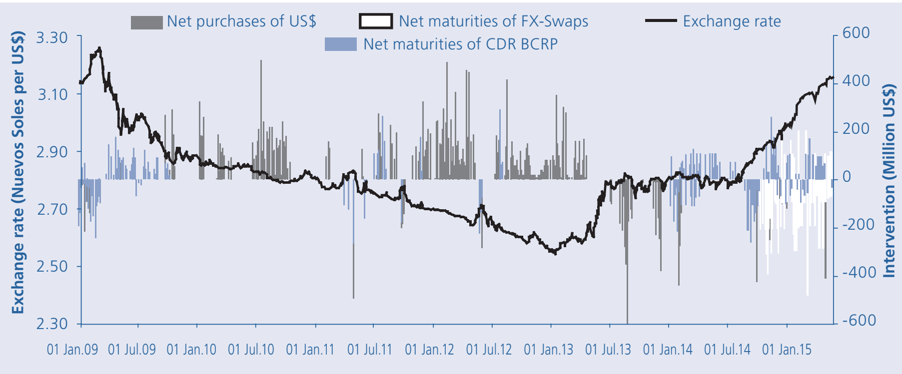

Table 37
RESERVE REQUIREMENTS MEASURES

| | Domestic Currency | | | Foreign currency<br>General regime | |
|---|---|---|---|---|---|
| | Reserve requirement | Deposits on current account | Minimum legal reserve requirement | Marginal reserve requirement on deposits | Maximum of reserve requirement |
| Dec.12 | 19% | 3.00% | 9.0% | 55% | |
| Jan.13 | 19% | 3.00% | 9.0% | 55% | |
| Feb.13 | 20% | 3.00% | 9.0% | 55% | |
| Mar.13 | 20% | 3.00% | 9.0% | 55% | |
| Apr.13 | 20% | 3.00% | 9.0% | 55% | |
| May.13 | 20% | 3.00% | 9.0% | 55% | |
| Jun.13 | 20% | 3.00% | 9.0% | 55% | |
| Aug.13 | 19% | 3.00% | 9.0% | 50% | 45% |
| Sep.13 | 17% | 3.00% | 9.0% | 50% | 45% |
| Oct.13 | 16% | 3.00% | 9.0% | 50% | 45% |
| Dec.13 | 15% | 3.00% | 9.0% | 50% | 45% |
| Jan.14 | 14% | 3.00% | 9.0% | 50% | 45% |
| Feb.14 | 13% | 3.00% | 9.0% | 50% | 45% |
| Mar.14 | 12.5% | 3.00% | 9.0% | 50% | 45% |
| Apr.14 | 12% | 3.00% | 9.0% | 50% | 45% |
| Jul.14 | 11.5% | 3.00% | 9.0% | 50% | 45% |
| Sep.14 | 11.0% | 3.00% | 9.0% | 50% | 45% |
| Oct.14 | 10.5% | 3.00% | 9.0% | 50% | 45% |
| Nov.14 | 10.0% | 3.00% | 9.0% | 50% | 45% |
| Dec.14 | 9.5% | 2.50% | 9.0% | 50% | 45% |
| Jan.15 | 9.0% | 2.00% | 9.0% | 60% | -.- |
| Feb.15 | 8.5% | 1.50% | 8.5% | 60% | -.- |
| Mar.15 | 8.0% | 1.00% | 8.0% | 70% | 60% |
| Apr.15 | 7.5% | 0.75% | 7.5% | 70% | 60% |
| May.15 | 7.0% | 0.75% | 7.0% | 70% | 60% |

## Exchange Rate and BCRP Intervention in the Foreign Exchange Market

66. During the first four months of the year, the exchange rate maintained its upward trend due to the strengthening of the dollar worldwide and due to the lower terms of trade. The US dollar/nuevo sol exchange rate went from S/. 2.980 per dollar at the end of December 2014 to S/. 3.145 per dollar in the first week of May 2015, which represents a depreciation of 5.5 percent.

**Graph 75**
**INTERVENTION IN THE FOREIGN EXCHANGE MARKET AND EXCHANGE RATE**




67. In this period, the most important currencies in the region registered different levels of depreciation. The Colombian peso showed a slight appreciation of 0.3 percent, while the Chilean peso recorded a slight depreciation of 0.8 percent. The Mexican peso depreciated 3.9 percent while the Brazilian real depreciated 13.2 percent.

**Graph 76**
**EXCHANGE RATE INDICES - C.U. PER US$**
(December 2008 =100)

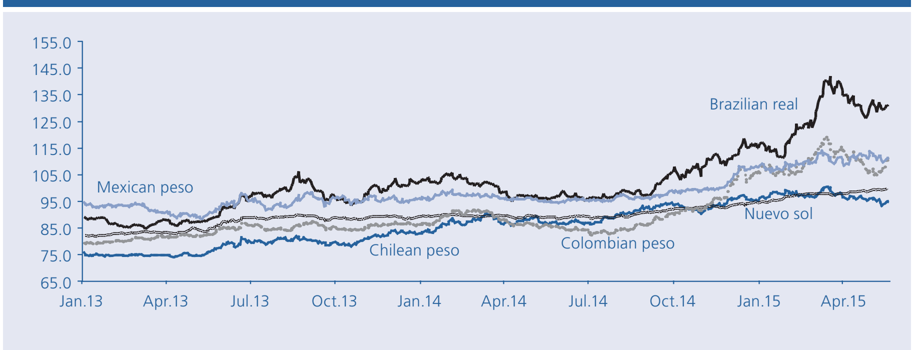



**Table 38**
**EXCHANGE RATE: PERCENTAGE CHANGE**

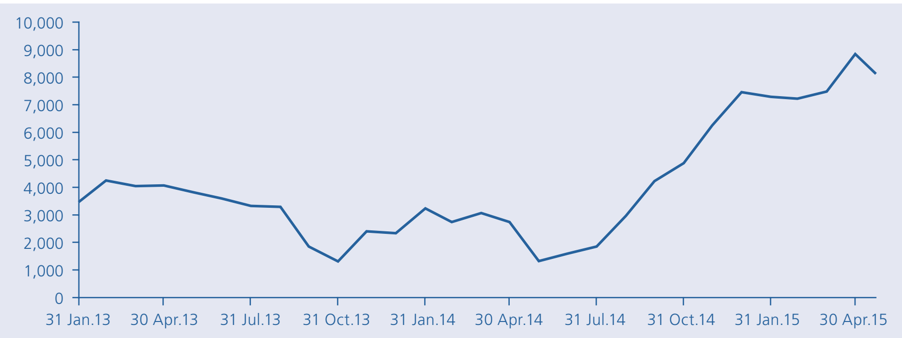
| | Dec.14 to May.15 | Dec.12 to May.15 |
|---|---|---|
| Peru | 6% | 23% |
| Mexico | 3% | 18% |
| Chile | 0% | 26% |
| Colombia | 4% | 40% |
| Brazil | 14% | 48% |
| Euro | 9% | 19% |
| US Dollar (Basket) | 6% | 19% |

68. The net demand for dollars observed in the first four months of the year (US$ 6.73 billion) was lower than the one registered in the last four months of 2014 (US$ 8.76 billion). The demand came mainly from the non-mining private sector (US$ 5.85 billion in the period), followed by non-residents' demand (US$ 1.86 billion) and by AFPs (US$ 1.21 billion). On the other hand, the mining sector and the BCRP generated the supply in the market.

69. In this context, the BCRP intervened in the foreign exchange market selling US$ 4.68 billion in the spot market, of which US$ 693 million was sales of FC associated with currency substitution repos. The Central Bank also continued carrying out interventions in the forward market through placements of FX swaps (US$ 2.85 billion), offset in part by net maturities of BCRP-CDR (US$ 785 million).

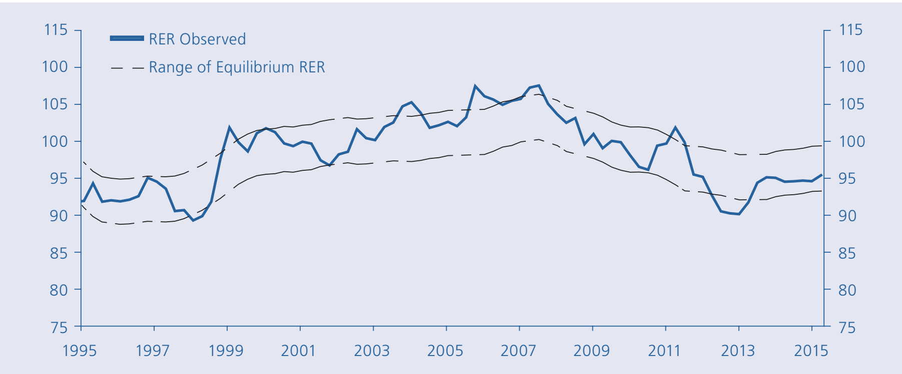
The reserve requirement measures on currency derivatives implemented since January 2015 have contributed to keep banks' balances of forward sales below the levels observed in December 2014, thus contributing to reduce volatility and upward pressures on the exchange rate associated with swaps and forwards transactions.

**Graph 77**
**SALE NET BALANCE OF ND FORWARDS FROM NON-RESIDENTS**
(Million US$)




70. The multilateral real exchange rate index rose 1.3 percent between December 2014 and April 2015. The current level of the real exchange rate is within the range around the estimated long term equilibrium level, which reflects fundamentals that support the sustainability of the external accounts.

**Graph 78**
**MULTILATERAL RER AND BAND OF EQUILIBRIUM RER**




## Liquidity and Credit

71. The average level of currency in circulation grew 9 percent in April 2015 in annual terms –less than in Q4-2014–, in line with the lower level of economic activity observed in recent quarters. In 2015 currency would show an annual rate around 10 percent, reflecting a recovery in the pace of growth of economic activity.

    Deposits in domestic currency continued showing lower dynamism recording a rate of 7.6 percent in April 2015 (vs. 9.5 percent in December 2014), while liquidity in domestic currency showed a similar evolution, declining from a rate of 10.1 percent in December 2014 to a rate of 7.9 percent in April 2015.

**Table 39**
**MONETARY ACCOUNTS (END-OF-PERIOD)**
(12 months % change)

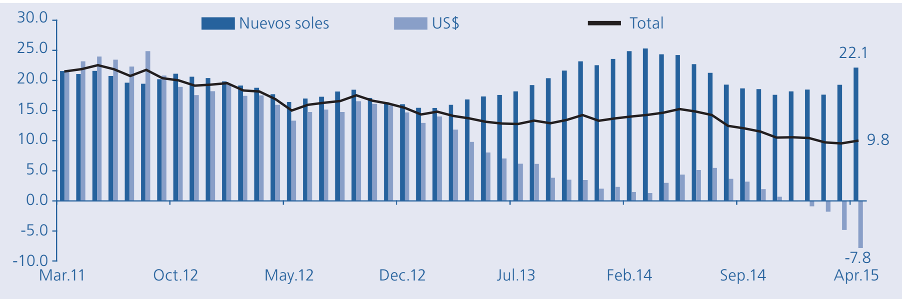
| | Dec.09 | Dec.10 | Dec.11 | Dec.12 | Dec.13 | Dec.14 | Apr.15 |
|---|---|---|---|---|---|---|---|
| Currency | 11.0 | 25.4 | 13.0 | 18.3 | 9.0 | 11.5 | 9.0 |
| Deposits in domestic currency | 16.7 | 32.3 | 17.7 | 28.6 | 11.3 | 9.5 | 7.6 |
| Broad money in domestic currency | 14.4 | 30.7 | 16.6 | 23.1 | 10.9 | 10.1 | 7.9 |
| Total broad money [1/] | 10.9 | 23.2 | 16.8 | 13.7 | 11.5 | 6.5 | 5.7 |
| Credit to the private sector in domestic currency | 17.9 | 21.2 | 20.4 | 16.0 | 22.3 | 18.2 | 22.1 |
| Credit to the private sector | 8.9 | 21.2 | 19.3 | 15.4 | 12.9 | 10.4 | 9.8 |

1/ Includes foreign currency.

72. Credit to the private sector also continued showing a slower pace of growth (9.8 percent in April 2015 vs. 10.4 percent in December 2014). This slowdown in the pace of growth of credit reflects mainly the lower dynamism of economic activity observed in the last quarter. By currencies, credit in domestic currency continued to

be more dynamic, with an annual growth rate of 22.1 percent, while credit in foreign currency dropped 7.8 percent, reflecting the process of de-dollarization of credit driven by the measures adopted by the BCRP at end-2014. In 2015 credit to the private sector is expected to show a faster pace of growth, in line with the increased dynamism projected in the economy.

**Graph 79**
**CREDIT TO THE PRIVATE SECTOR**
(12 months % change)




73. By type of loans, in the group of loans to businesses, the segment of corporate loans and loans to large enterprises grew 14.7 percent in April, while the segments of credit to medium-sized companies and loans to small- and micro businesses grew at levels around 2.9 percent and 1.9 percent, respectively.

The marked slowdown in the expansion of credit to small and micro businesses reflects in part a lower supply of credit for this credit segment from non-bank financial institutions, offset in part by the higher growth rate of credit observed in banks' credit. In both cases, credit in foreign currency for this credit segment continued declining.

**Table 40**
**CREDIT TO THE PRIVATE SECTOR**
(12 months % change)

| | Dec.12 | Dec.13 | Dec.14 | Apr.15 |
|---|---|---|---|---|
| **Businesses** | **13.4** | **12.6** | **9.7** | **8.4** |
| Corporate and large companies | 8.7 | 20.2 | 11.6 | 14.7 |
| Medium-sized enterprises | 18.4 | 10.1 | 13.7 | 2.9 |
| Small business and Microbusinesses | 16.6 | 2.4 | 1.6 | 1.9 |
| **Individuals** | **19.4** | **13.4** | **11.8** | **12.4** |
| **Consumer** | **15.4** | **11.8** | **11.4** | **13.3** |
| Car loans | 25.8 | 14.3 | 6.7 | 1.6 |
| Credit cards | 13.4 | 8.3 | 15.0 | 19.9 |
| **Mortgage** | **25.4** | **15.7** | **12.4** | **11.3** |
| **Total** | **15.4** | **12.9** | **10.4** | **9.8** |

**Table 41**
**LOANS TO SMALL BUSINESSES AND MICROBUSINESSES**

| | 12 months % change | |
|---|---|---|
| | Dec.14 | Apr.15 |
| **SMALL AND MICROBUSINESSES** | | |
| Banks | -8.4 | 11.0 |
| Domestic currency | -7.1 | 19.4 |
| Foreign currency | -14.4 | -27.1 |
| Rest | 10.4 | -5.6 |
| Domestic currency | 11.5 | -5.5 |
| Foreign currency | -1.6 | -6.5 |
| Total | 1.6 | 1.9 |
| Domestic currency | 3.4 | 5.1 |
| Foreign currency | -10.2 | -20.1 |

74. On the other hand, personal loans continued growing at similar rates as the ones observed in December 2014. The more dynamic segment within this type of credit was credit cards, which grew 19.9 percent. On the other hand, car loans continued slowing down.

In April, the default rate of credit to businesses rose from 3.14 percent in December 2014 to 3.30 percent. The default rate of credit to small and medium-sized companies showed the highest increase within this segment, given that the former climbed by 80 basis points to 9.76 percent and the latter rose by 37 basis points to a ratio of 5.19 percent. The default rate in credit to individuals also increased by 8 basis points to 2.54 percent in April, reflecting the increase of 35 basis points in the default rate of credit using credit cards. In addition to this, the default rate in mortgage loans rose 10 basis points.

**Graph 80**
**CREDITS: DELINQUENCY RATES**
(As % of portfolio)

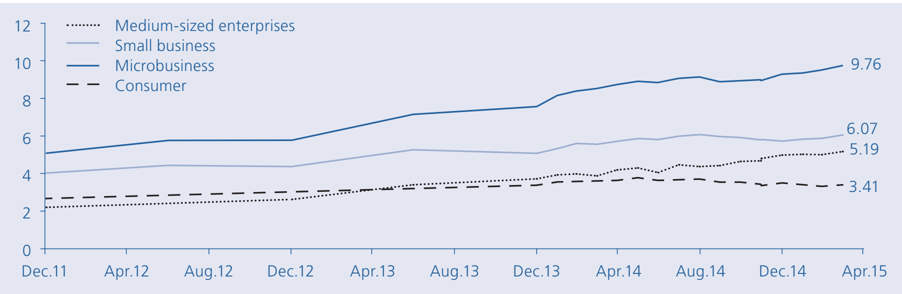
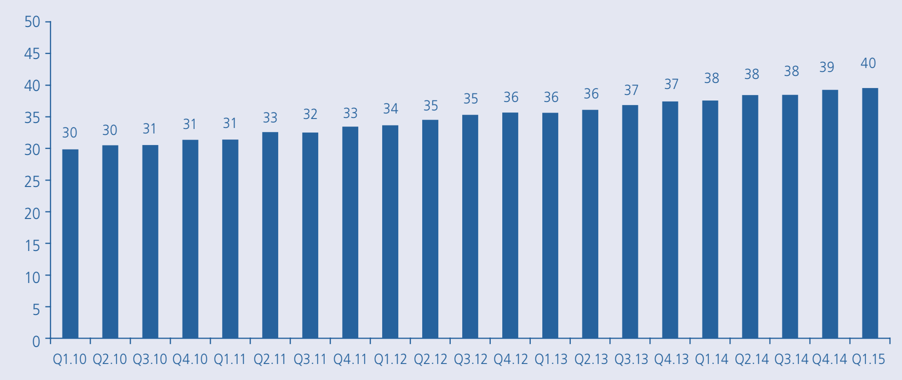


**Table 42**
**CREDITS DELINQUENCY INDEX OF THE DEPOSITORY CORPORATIONS**

| | Dec.13 | Dec.14 | Apr.15 |
|---|---|---|---|
| **Business** | **2.70** | **3.14** | **3.30** |
| Corporate | 0.00 | 0.00 | 0.02 |
| Large companies | 0.38 | 0.68 | 0.88 |
| Medium-sized enterprises | 3.72 | 4.82 | 5.19 |
| Small business | 7.56 | 8.97 | 9.76 |
| Microbusiness | 5.08 | 5.83 | 6.07 |
| **Individuals** | **2.32** | **2.46** | **2.54** |
| Consumption | 3.39 | 3.37 | 3.41 |
| Car loans | 3.37 | 4.23 | 4.20 |
| Credit card | 4.71 | 4.25 | 4.60 |
| Mortgage | 1.04 | 1.44 | 1.54 |
| **Average delinquency** | **2.57** | **2.96** | **3.04** |

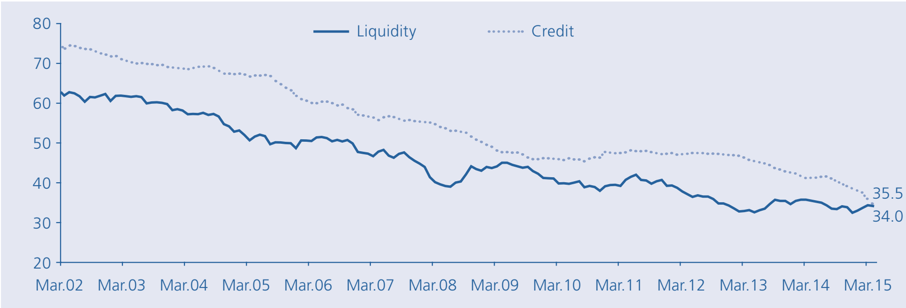
75. In 2015 credit is estimated to grow 10.5 percent: credit in soles would grow 23.8 percent while credit in dollars would decrease by 11 percent, in line with a greater preference for credit in soles and with the effect of the actions taken by the BCRP to promote the dedollarization of credit. Deposits in domestic currency are projected to grow 8.1 percent in the year. Thus, the ratio of credit-to-GDP is expected to continue increasing during 2015.

**Graph 81**
**RATIO CREDIT / GDP**
(%)




76. As a result of the BCRP actions taken with the aim of de-dollarizing credit, the ratio of dollarization of credit has declined from 38.3 percent in December 2014 to 35.5 percent in April 2015.

**Graph 82**
**DOLLARIZATION RATIO: 2002 - 2015**
(%)




77. By type of credit, a decline in the ratio of dollarization is observed in each segment of credit. The dollarization ratio in mortgage loans decreased from 33.9 to 31.7 percent between December 2014 and April 2015, which would be reflecting in part the reserve requirement measures conditional to the expansion of mortgage loans and car loans in foreign currency implemented by the BCRP in February 2013. The new reserve requirement measures established as of this year are associated with the reduction of credit in foreign currency and are aimed at consolidating the process of dedollarization.

**Table 43**
**DOLLARIZATION RATIO OF CREDIT TO THE PRIVATE SECTOR**

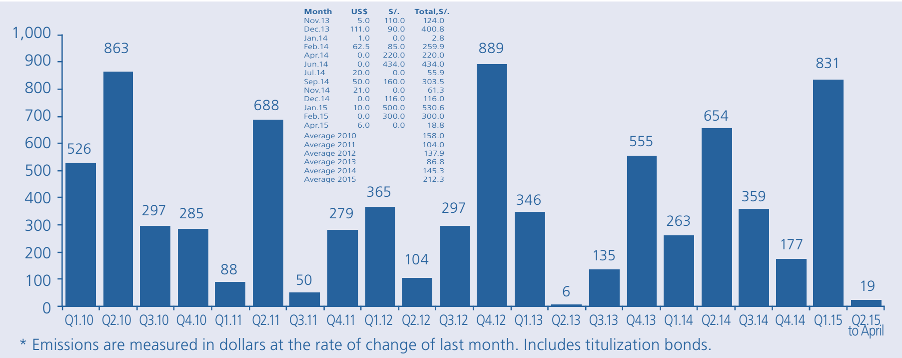
| | Dec.13 | Dec.14 | Apr.15 |
|---|---|---|---|
| **Business** | **52.9** | **48.5** | **44.9** |
| Corporate and large companies | 67.4 | 59.9 | 54.8 |
| Medium-sized enterprises | 63.7 | 59.3 | 54.1 |
| Small business and Microbusiness | 13.0 | 11.5 | 10.2 |
| **Individuals** | **23.1** | **20.0** | **18.7** |
| Consumer | 10.5 | 9.5 | 8.9 |
| Car loans | 75.9 | 68.9 | 61.8 |
| Credit cards | 7.2 | 6.6 | 6.5 |
| Mortgage | 40.0 | 33.9 | 31.7 |
| **TOTAL** | **42.4** | **38.3** | **35.5** |

## Capital Market

78. In Q1-2015, non-financial corporate bond issuances in the local market amounted to S/. 831 million, the largest level observed since 2012. Volatility in the foreign exchange market in recent months has led non-financial companies to issue bonds

in domestic currency. Thus, in Q1-2015 nearly 96 percent of total bonds issued was securities in nuevos soles. In annual terms, the average of bond issuances in the first four months of 2015 is higher than the one recorded in the last five years.

**Graph 83**
**BONDS ISSUED BY NON-FINANCIAL FIRMS***
(Million S/.)




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

79. Bonds issued by Peruvian enterprises in the international market between January and April amounted to US$ 2.55 billion, a higher amount than the one recorded in the previous quarter. Peruvian companies took advantage from signals indicating that the Federal Reserve would postpone raising its policy interest rate to obtain long term credit at low interest rates. The main issuers of bonds in the international market were non-financial firms, whose issuances in terms of amounts represent 86 percent of the total amount issued. Southern Copper Corporation stands out with an issuance of US$ 2 billion. In terms of currencies, most of the bonds were issued in dollars (88 percent), followed by bonds in inflation-indexed nuevos soles (8 percent) and bonds in nuevos soles (4 percent).

In the same period, corporate bond issuances in Argentina, Brazil, Chile, Colombia, Paraguay, and Peru amount to US$ 6.45 billion, with Peru standing out as the main issuer of securities with 40 percent of total bonds issued, followed by Chile and Argentina, with 23 percent each. In 2014 the region issued securities in the international market for a total of US 25.54 billion, the main participants being Chilean companies (40 percent of total) and Brazilian companies (28 percent of total).

**Table 44**
**BONDS ISSUED IN THE INTERNATIONAL MARKET**

| Business | Emission date | Amount (Million US$) | Maturity (Years) | Rate |
|---|---|---|---|---|
| **Year 2014** | | **5,510** | | |
| **Non-financial sector** | | **3,306** | | |
| Compañía Minera Ares | 15-Jan | 350 | 7 | 7.75% |
| Minsur | 31-Jan | 450 | 10 | 6.25% |
| Abengoa Transmisión Sur | 08-Apr | 432 | 29 | 6.88% |
| Camposol | 24-Apr | 75 | 3 | 9.88% |
| Rutas de Lima** | 27-Jun | 370 | 22 | 8.38% |
| Rutas de Lima*** | 27-Jun | 150 | 25 | 5.25% |
| InRetail Shopping Mall | 01-Jul | 350 | 7 | 6.50% |
| InRetail Consumer | 07-Oct | 300 | 7 | 5.25% |
| Unión Andina de Cementos | 28-Oct | 625 | 7 | 5.88% |
| Janrgia Eólica | 15-Dec | 204 | 20 | 6.00% |
| **Financial sector** | | **2,204** | | |
| Private financial sector | | 1,025 | | |
| Banco de Crédito | 15-Jan | 200 | 13 | 6.13% |
| Interbank | 11-Mar | 300 | 15 | 6.63% |
| Banco de Crédito | 01-Jul | 225 | 4 | 2.75% |
| BBVA Banco Continental | 15-Sep | 300 | 15 | 5.25% |
| Public financial sector | | 1,179 | | |
| Fondo MiVivienda | 26-Mar | 300 | 5 | 3.38% |
| Fondo MiVivienda* | 15-May | 279 | 4 | 1.25% |
| COFIDE | 08-Jul | 300 | 5 | 3.25% |
| COFIDE | 08-Jul | 300 | 15 | 5.25% |
| **Year 2015** | | **2,555** | | |
| **Non-financial sector** | | **2,206** | | |
| GyM Ferrovias*** | 03-Feb | 206 | 25 | 4.75% |
| Southern Copper Corporation | 17-Apr | 500 | 10 | 3.88% |
| Southern Copper Corporation | 17-Apr | 1,500 | 30 | 5.88% |
| **Financial sector** | | **349** | | |
| Private financial sector | | 349 | | |
| Intercorp | 03-Feb | 250 | 10 | 5.88% |
| Interbank** | 03-Feb | 99 | 15 | 7.66% |

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

**Box 5**

**PROGRESS IN THE DEDOLLARIZATION OF CREDIT**

A high degree of credit dollarization implies risks to the financial system, because a significant depreciation of the domestic currency can result in an unsustainable increase in the liabilities of firms and households with currency mismatches between their assets and obligations. Furthermore, this can also generate a situation of insolvency among these firms and households, which may extend to other agents (i.e. banks, suppliers, creditors) even if the latter have no currency mismatches.

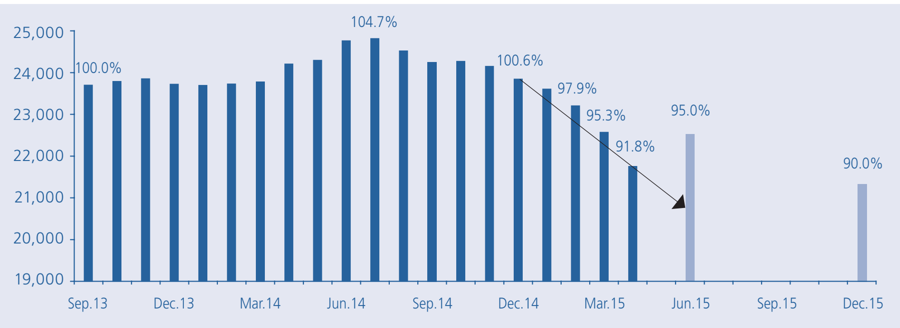
In order to reduce the vulnerability of the Peruvian economy, in December 2014, the BCRP implemented a program to consolidate the process of de-dollarization of credit introducing additional reserve requirements in foreign currency according to the evolution of credit in dollars.

Effective as from June 2015, there are two types of additional reserve requirements in dollars. The first one consists of a rate of reserve requirements of 30 percent of the percentage deviation relative to the larger amount of these two balances: 95 percent of the balance of total loans in foreign currency at September 2013 or 92 percent of the balance of total loans in foreign currency of December 2014, excluding loans for trade operations and loans exceeding US$ 3 million and for terms longer than 10 years. The second one is additional reserve requirements of 15 percent of the percentage deviation relative to the larger amount between 90 percent of the balance of car loans and mortgage loans at February 2013 and 85 percent of the balance of car and mortgage loans at December 2014.

Following the announcement of the de-dollarization scheme, financial institutions have accelerated the pace of the de-dollarization of credit, which has been reflected in a rapid reduction of the balance of credit in dollars. At April 2015, the balance of credit in foreign currency –excluding foreign trade operations– was US$ 21.76 billion, equivalent to 91.8 percent of the balance at September 2013, which represented a decrease of US$ 2.09 billion in the first four months of the year (US$ 522 million per month, on average).

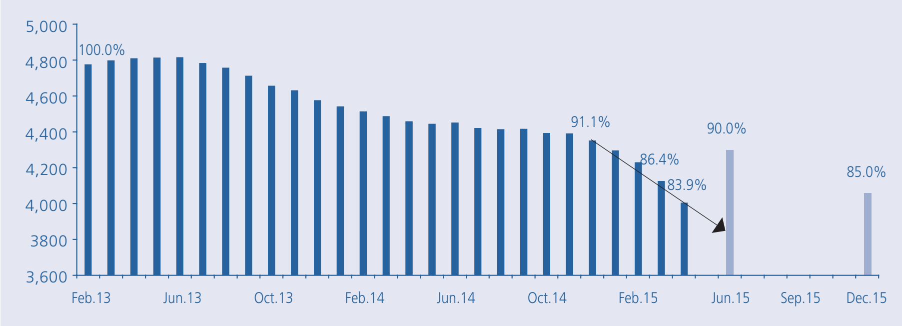
If this rate of reduction continues –2 percentage points on average per month–, the balance of these loans at the end of June would be around 88 percent of the balance recorded at September 2013; that is, below the balance expected at December 2015. Year-to-date, all of the banks have already met the de-dollarization target for June 2015.

**BANK'S CREDIT IN US$ EXCLUDING FOREIGN TRADE**
(Million US$)



Total car and mortgage loans amounted to US$ 4.00 billion in April, a sum equivalent to 83.9 percent of the balance of February 2013 (the balance required at June is 90 percent of the balance at February 2013). In other words, car and mortgage loans have decreased by US$ 346 million in the first 4 months of 2015. With this rate of 1.8 percentage points decrease on average per month, at the end of June the balance of these credits would be at a level around 80 per cent of the balance of February 2013, 5 percentage points below the balance required to December 2015 (85 percent of the balance in February 2013). To date, all of the banks have already met the de-dollarization target set for June 2015.

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




As a result of this, the ratio of dollarization of credit has declined 2.8 percentage points in the last 4 months –down to 35.5 percent at the end of April from 38.3 percent in December 2014–, which is a significant achievement considering that the ratio of de-dollarization of credit when the scheme was first implemented was about 7 percentage points throughout 2015.

**BANKS CREDIT DOLLARIZATION RATIO**

| Economis sectors | Sep. 13 | Dec. 14 | Mar. 15 | Apr. 15 |
|---|---|---|---|---|
| **Credit to companies** | **58.0** | **53.5** | **49.5** | **47.8** |
| Agriculture, livestock and forestry | 64.9 | 64.2 | 60.5 | 60.0 |
| Fishing | 93.0 | 87.5 | 86.8 | 87.5 |
| Mining | 86.6 | 74.6 | 70.7 | 69.3 |
| Manufacture | 65.5 | 55.4 | 51.2 | 49.0 |
| Electricity, Gas and Water | 86.6 | 86.4 | 88.2 | 82.9 |
| Construction | 60.2 | 59.8 | 51.2 | 50.9 |
| Commerce | 48.7 | 46.9 | 40.7 | 39.7 |
| Hotels and Restaurants | 46.4 | 43.7 | 39.5 | 38.3 |
| Transportation, storage and communications | 60.6 | 53.9 | 49.7 | 46.9 |
| Real estate, renting and business activities | 59.4 | 58.5 | 57.6 | 53.9 |
| Public Administration and Defense | 5.2 | 1.9 | 1.7 | 2.1 |
| Social and Health Services | 32.5 | 26.1 | 23.6 | 23.1 |
| Other community services | 34.8 | 37.2 | 37.9 | 36.8 |
| Private households with domestic workers and agencies Offshore | 24.3 | 27.2 | 29.2 | 26.2 |
| **Mortgage credits** | **41.7** | **34.7** | **33.3** | **32.4** |
| **Consumer credits** | **11.5** | **10.4** | **9.6** | **9.3** |
| **Total credits - Banks** | **47.1** | **42.9** | **40.0** | **38.6** |
| **Total credits - Depository corporations** | **41.8** | **38.3** | **36.6** | **35.5** |

On the industry side, a reduction in the ratio of dollarization has been observed in the sectors of construction, trade, transportation, real estate, among others, although there is still room for a further reduction. Moreover, on the side of households, the de-dollarization of mortgage loans has been significant since it has declined about 9 percentage points between September 2013 and April 2015. The degree of dollarization of consumer loans, on the other hand, is not very high, except in the case of car loans, but the latter have fallen 7 percentage points in the last 4 months.

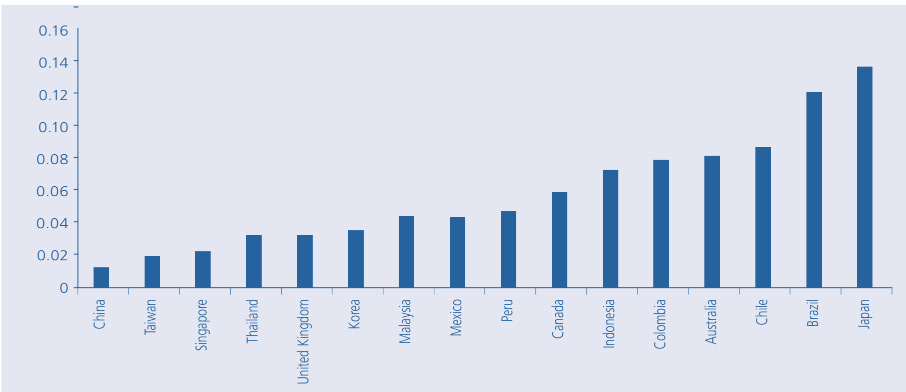
Furthermore, credit in the sectors of fisheries and mining remain highly dollarized (87.5 and 69.3 percent, respectively). However, given that these are export-oriented industries –oriented to foreign trade–, the firms operating in these sectors are not expected to show currency mismatch problems.

Reducing the ratio of dollarization of credit in the Peruvian economy, particularly in non-tradable sectors, is a major achievement that will contribute significantly to reducing the vulnerability of the economy to a higher volatility in the exchange rate, especially if this reduction continues in the coming months. Not only does the Peruvian economy become more resistant to adverse external scenarios; the perception of country risk decreases as well.

## Box 6
## FOREIGN EXCHANGE INTERVENTION AND EXCHANGE RATE VOLATILITY IN PERU

Peru has a floating exchange rate regime in which the Central Bank intervenes in the foreign exchange market to reduce excessive volatility in the exchange rate. With this intervention, the Central Bank offsets the negative effects of abrupt exchange rate adjustments on the creditworthiness of companies and families with currency mismatches. As a result of this intervention, the dollar-nuevo sol exchange rate tends to fluctuate less than the exchange rate of other currencies in the region, which tend to show sharp reactions in periods of high uncertainty in international markets. When we analyze the coefficients of variability of several currencies in the period 2012-2015, we see that the nuevo sol shows an average level of volatility compared with other currencies.

**RATIO OF VARIABILILITY OF THE EXCHANGE RATE**
(2012-2015)




This lower volatility is observed not only in daily exchange rate variations, but also in the evolution of the exchange rate in longer terms. Contrasting with the currencies of other countries that tend to depreciate more quickly in periods of volatility and appreciate thereafter, the nuevo sol does not show the same pattern. When we analyze the exchange rate of the Chilean peso, the Colombian peso, the Brazilian real or the Mexican peso, we see that these currencies have very different variations from the ones registered by the nuevo sol in some moments of the cycle. However, these differences decrease drastically when we look at the complete cycle. An example of this are the episodes of depreciation and appreciation observed after the global financial crisis of 2008-2009.

**EXHANGE RATE VARIATIONS BETWEEN 31/07/2008 AND 31/07/2011**

| | Initial ER | Maximum ER | Last ER | Maximum depreciation | Appreciation | Total depreciation |
|---|---|---|---|---|---|---|
| Peru | 2.81 | 3.26 | 2.74 | 16% | 16% | -3% |
| Chile | 505 | 683 | 458 | 35% | 33% | -9% |
| Brazil | 1.57 | 2.51 | 1.55 | 61% | 38% | -1% |
| Mexico | 10.0 | 15.6 | 11.7 | 55% | 25% | 17% |
| Colombia | 1797 | 2609 | 1778 | 45% | 32% | -1% |

The maximum depreciation of the Peruvian currency after the crisis was just 16 percent, whereas the depreciation of the currencies of other countries in the region reached 61 percent (Brazil) or 45 percent (Colombia), even though these currencies appreciated significantly afterwards (the Brazilian real appreciated 38 percent, for example). At the end of the period, the sol appreciated similarly to other currencies, which reflects that in Peru the exchange rate volatility associated with the effect of high volatility in international financial markets was moderate and did not affect the long-term trend of the exchange rate.

A similar conduct is observed in the currencies of the region since 2013. Together with the Mexican peso, the nuevo sol has recorded one of the lowest levels of depreciation in the region in this period. This has implied that the Peruvian currency do not appreciate in recent months as much as other currencies in the region, especially as those that showed the greater levels of depreciation in the previous two years (i.e. the Colombian peso and the real).

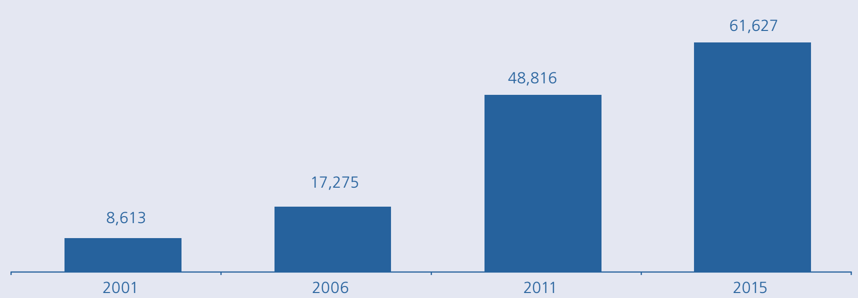
**EXHANGE RATE VARIATIONS BETWEEN 31/12/2012 AND 13/05/2015**

| | Initial ER | Maximum ER | Last ER | Maximum depreciation | Appreciation | Total depreciation |
|---|---|---|---|---|---|---|
| Peru | 2.55 | 3.15 | 3.15 | 19% | 0% | 19.0% |
| Chile | 479 | 643 | 602 | 25% | 7% | 20.4% |
| Brazil | 2.05 | 3.29 | 3.04 | 38% | 8% | 32.5% |
| Mexico | 12.9 | 15.6 | 15.3 | 18% | 2% | 15.8% |
| Colombia | 1767 | 2688 | 2389 | 34% | 12% | 26.0% |

This lower exchange rate volatility does not affect the flexibility of the exchange rate, so negative external shocks, such as declines in the terms of trade and shifts in the destination of capital flows, can be absorbed by the exchange rate. As discussed in Box, the real exchange rate (RER) is around its level of equilibrium, which is consistent with its fundamentals.

Central banks' capacity to moderate this volatility depends on banks' resources, basically on their level of reserves. The BCRP has a significant amount of international reserves. In the region, Peru is the country with the largest volume of reserves in terms of the size of the Peruvian economy and in terms of the country's imports and short-term external debt. Thus, if required, the surplus of international reserves may be used to mitigate in an effective way pressures on liquidity in dollars in the financial system, as the Central Bank of Peru did in 2008-2009 to face the international financial crisis.

**PERU: NET INTERNATIONAL RESERVES**
(Million US$)




* Forecast.

**NIR INDICATORS [1]**
(%)

| | Short-term debt/NIR [2] | NIR/GDP | Months of imports |
|---|---|---|---|
| Peru | 10.5 | 30.4 | 19 |
| Chile | 44.7 | 15 | 7 |
| Colombia | 25.5 | 12.3 | 9 |
| Mexico | 55.3 | 15.2 | 6 |

1/ NIR (data from April 2015) and imports (Up to March 2015).
2/ Not including debts placements originally in long-terms.
Source: Bloomberg, IMF, and World Bank.

Moreover, this level of reserves reflects the purchases of dollars made preemptively by the BCRP. Between 2006 and 2009, the BCRP bought foreign currency for a total of US$ 17 billion in the foreign exchange market. Additionally, after the crisis, between 2010 and 2012, the BCRP bought a net total of US$ 26 billion. Having sold around US$ 9 billion between 2014 and 2015, the BCRP has a balance of net international reserves of US$ 61.6 billion, which gives Peru a wide availability of international liquidity that reinforces the soundness of the Peruvian economy to face risk scenarios in international financial markets.

Box 7

## UPDATE ON THE ESTIMATION OF THE EQUILIBRIUM REAL EXCHANGE RATE

In our Inflation Report of January 2015, we discussed the results of the estimation of the equilibrium real exchange rate (ERER) using the Behavioral Effective Exchange Rate (BEER) methodology and data as of Q4-2014. This box offers an update of these estimates using data as of Q1-2015.

As pointed out in our previous Inflation Report, there is some consensus in the literature on the fundamental variables of the ERER based on different theoretical models (see Caputo et al. (2007) for various references on this matter). Four fundamentals of the ERER are considered for Peru in this article: relative productivity, terms of trade, trade liberalization, and government spending.

- Relative productivity: An improvement in domestic productivity relative to the level of external productivity would lead to an increase in the demand for labor and, therefore, to higher real wages. In turn, higher wages would lead to an increase in the demand for local goods that would increase domestic prices and result in a real appreciation of the local currency.

- Terms of trade: In a primary export-oriented economy, an increase in the terms of trade translates into higher incomes that tend to increase aggregate demand. This pushes the price of domestic goods upwards and, given the prices of foreign goods, there is a real appreciation.

- Trade liberalization: the effect of this fundamental is ambiguous. First, an increase in trade liberalization associated with a reduction of tariffs generates an increase in the demand for importable goods and hence pushes prices upwards. Since the prices of these goods are determined in external markets, a real depreciation would be expected. Second, the import-price elasticity may be low, in which case there would be a positive income effect that would increase the demand for domestic goods which would induce a real appreciation.

- Government spending: Public sector purchases are typically oriented to goods produced in the country. Thus, a fiscal expansion would generate demand pressures for these goods, increase their price, and would tend to appreciate the currency.

### Recent Trend of the Equilibrium Real Exchange Rate

Given the degree of uncertainty characteristic of econometric estimations to measure the average impact of fundamentals in the ERER, we estimate several specifications of the ERER model to make these estimations more robust. The results provided in the table below are averages of the estimates of all the specifications used.

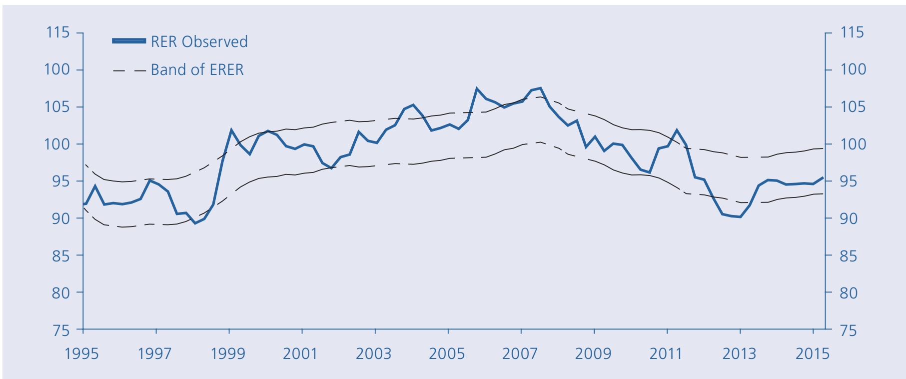
**ESTIMATED AVERAGE ELASTICITY OF FUNDAMENTALS IN THE EQUILIBRIUM REAL EXCHANGE RATE (ERER)1/**

| Variable | Estimated levels of elasticity to: | |
|---|---|---|
| | IR Jan.15 | IR May.15 |
| Relative productivity Peru/Trading partners 2/ | -0.63 | -0.61 |
| Terms of trade | -0.09 | -0.08 |
| Trade liberalization 3/ | -0.04 | -0.03 |
| Government spending / GDP | -0.08 | -0.08 |

1/ Average of the estimates of all models tested.
2/ Relative productivity Peru / Trading partners: Ratio of GDP per person employed in Peru on partners.
3/ Indicator tariff effective as import duties / total imports. An increase in trading openness would drop in the tariff indicator.

The estimated levels of elasticity do not show significant changes relative to those provided in our previous Inflation Report. The fundamental with the greatest impact on the ERER is relative productivity, followed by the terms of trade and public spending, both of which have lower impacts. For example, when relative productivity in our economy grows one percentage point, it generates a reduction of 0.61 percent in the ERER. As we can see in Figure, the real exchange rate (RER) was below its equilibrium level in 2012. However, since 2013 the RER has increased and converged towards its equilibrium level. The estimates for 2014 and 2015 show that the RER is within the confidence bands in the estimates made.

**MULTILATERAL REAL EXCHANGE RATE AND BAND OF EQUILIBRIUM REAL EXCHANGE RATE**



# VI. Inflation

## Report to April 2015

80. The rate of inflation accumulated in the last twelve months decreased from 3.22 percent in December 2014 to 3.02 percent in April 2015.

    The inflation rate reflected mainly rises in the prices of food products and electricity rates, the food and energy component increasing by 3.35 percent. Inflation without food and energy –that is, the rate of inflation isolating the impact of these goods with high price volatility– registered 2.74 percent in April.

**Graph 84**
**INFLATION AND INFLATION TARGETING**
(Last 12 month % change)

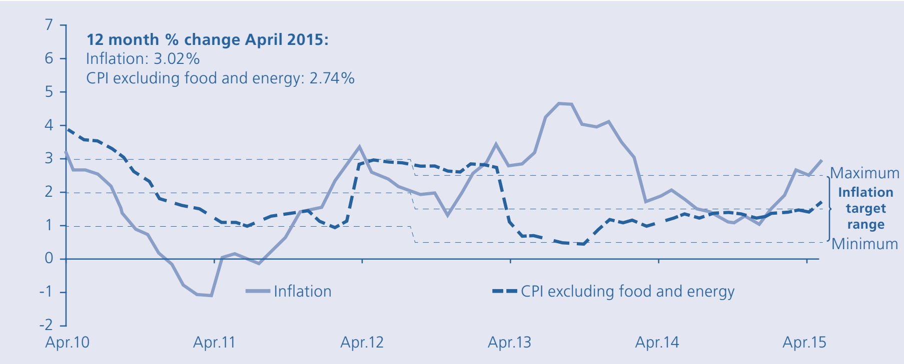
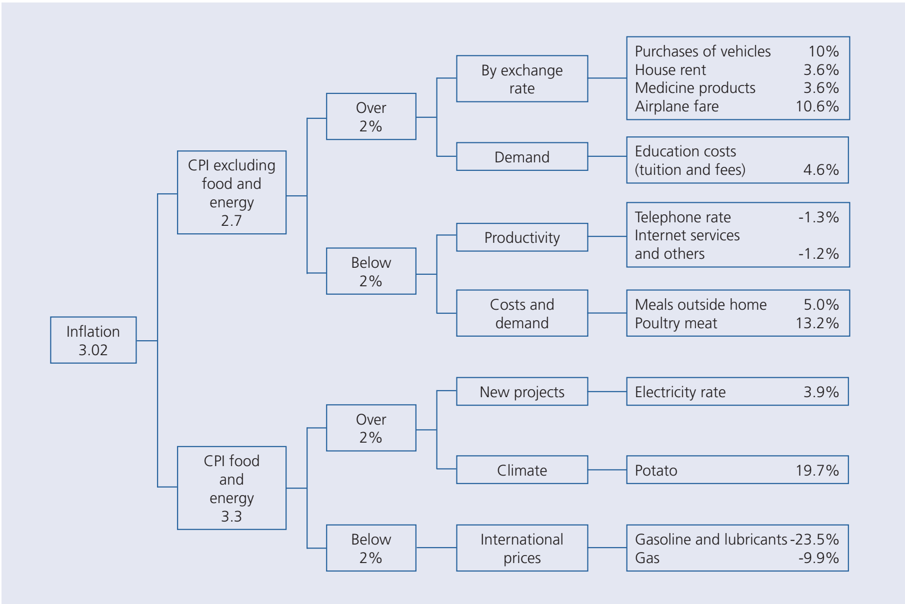



**Table 45**
**INFLATION**
(% change)

| | Weight | 2010 | 2011 | 2012 | 2013 | 2014 | April 2015 Accum. | April 2015 Year |
|---|---|---|---|---|---|---|---|---|
| **CPI** | **100.0** | **2.08** | **4.74** | **2.65** | **2.86** | **3.22** | **1.64** | **3.02** |
| **1. CPI excluding food and energy** | **56.4** | **1.38** | **2.42** | **1.91** | **2.97** | **2.51** | **1.42** | **2.74** |
| a. Goods | 21.7 | 1.07 | 2.37 | 1.60 | 2.62 | 2.43 | 1.37 | 2.82 |
| b. Services | 34.8 | 1.58 | 2.45 | 2.10 | 3.18 | 2.55 | 1.45 | 2.69 |
| **2. Food and energy** | **43.6** | **2.98** | **7.70** | **3.55** | **2.73** | **4.08** | **1.90** | **3.35** |
| a. Food and beverages | 37.8 | 2.41 | 7.97 | 4.06 | 2.24 | 4.83 | 2.37 | 4.90 |
| b. Fuel and electricity | 5.7 | 6.80 | 6.01 | 0.22 | 6.09 | -0.85 | -1.37 | -6.63 |
| Fuel | 2.8 | 12.21 | 7.54 | -1.48 | 5.95 | -5.59 | -8.43 | -16.44 |
| Electricity | 2.9 | 1.36 | 4.30 | 2.19 | 6.23 | 4.37 | 5.69 | 3.93 |

81. The items that have contributed more to increase inflation at April have been those influenced by the exchange rate, the demand, costs, and weather conditions.

**Graph 85**
**INFLATION IN APRIL: 12 MONTH PERCENTAGE CHANGE**




**Education costs –tuition and fees–** increased by 4.2 percent, reflecting mostly the adjustments made in March in private schools (6.4 percent) and private universities (3.6 percent).

The rise recorded in **meals outside the home** (2.3 percent) was associated with higher food prices (2.4 percent).

**Electricity rates** increased 5.7 percent, due mainly to the update of generation and distribution costs affected by the increase in the exchange rate. Another factor that contributed also to this rise was the higher costs associated with transmission tolls, as well as the quarterly settlement of the compensation to regulated users made in February given the contracts between generation and distribution companies.

The prices of **vehicles** rose 5.2 percent as a result of the depreciation of the nuevo sol against the dollar (5.3 percent).

The prices of **gasoline and lubricants** decreased 7.9 percent due to the lower international price of crude oil. The price of WTI oil fell from US$ 59 per barrel in

December 2014 to US$ 47.6 per barrel in January, rising thereafter to US$ 54.2 in April, a price level still below the price registered in April 2014 (US$ 102.2 per barrel).

The price of **gas** for domestic use –bottled LPG– dropped 9.5 percent. This item is included within the scope of the Fuel Price Stabilization Fund. The price band of gas was updated in January given the reduction of the price of oil, which translated into a price reduction of 20.5 percent in the ex-plant price of bottled gas compared to December, which was reflected in part in the consumer price.

**Foodstuffs**

82. **Perishable farming food** products such as potatoes, tomatoes, onions, and carrots were affected by weather anomalies in the period of January-April.

The price of **potatoes** rose 20.5 percent. Warmer conditions on the coast and low farm prices discouraged the cultivation of potatoes in Lima, which had a negative impact on the supply of this crop early in the year. Heavy rains in the central highlands caused an irregular supply later on. In addition to this, the supply was also disrupted by interruptions on the main highway because of landslides.

The price of **tomatoes** showed an increase of 40.3 percent. The supply of tomatoes in Metropolitan Lima fell 10 percent in January-April given that higher temperatures and pests in the valleys of Lima and Ica resulted in a lower supply in the months of January and February. Cultivation in Ica was also lower seeding due to a decline in the demand for the region's industry. Irregular harvest associated with climatic changes and the lower quality of tomatoes continued to affect supply in March and April.

In the case of **onions**, the price rise of 20.6 percent was associated with heavy rains in Arequipa –the main producer region– which resulted in an irregular yield. The crop was affected by higher humidity which reduced the supply of first-quality onions.

The price of **carrots** rose 38.2 percent due to fewer cultivated areas in Junín –the main supplier region– during the first half of the year. The crop was affected by a plant disease whose treatment raised production costs.

The production of **other vegetables** was affected by warmer temperatures in the valleys of Lima and led to a price increase of 15.3 percent on average. Produce like broccoli, lettuce, and leek showed the highest price rises. The warm temperatures also affected these perishable products during the marketing period.

On the other hand, the prices of citrus fruits, avocadoes, and grapes fell given that warmer weather conditions, good farming practices and greater external demand favored yields in these crops.

The prices of **citrus fruits** fell 9.7 percent on average. The production of lemons was favored by warmer temperatures on the North Coast which resulted in a shorter crop cycle and an increased supply. Consequently, the price fell by 25.8 percent. The price of tangerines also decreased (-16.6 percent) due to greater supply in the period January-March (up 7.0 percent). The latter was associated not only with seasonal factors, but also with pest eradication campaigns in the valleys of Lima.

**Table 46**
**WEIGHTED CONTRIBUTION TO INFLATION: JANUARY-APRIL 2015**

| | Weight | % chg. | Weighted cont. |
|---|---|---|---|
| **INFLATION** | **100.0** | **1.6** | **1.64** |
| **Foodstuffs** | **37.8** | **2.4** | **0.95** |
| **Associated to international prices** | **10.0** | **0.8** | **0.08** |
| *Of which* | | | |
| Poultry meat | 3.0 | 1.5 | 0.05 |
| **Associated to domestic supply shocks** | **4.95** | **8.3** | **0.44** |
| *Of which* | | | |
| Potato | 0.9 | 20.5 | 0.17 |
| Tomato | 0.2 | 40.3 | 0.07 |
| Other vegetables | 0.4 | 15.3 | 0.07 |
| Onion | 0.4 | 20.6 | 0.06 |
| Carrots | 0.1 | 38.2 | 0.05 |
| **Meals outside the home** | **11.7** | **2.3** | **0.30** |
| **Rest** | **11.1** | **1.1** | **0.13** |
| **Gasoline, urban fare, and electricity** | **14.3** | **-0.6** | **-0.09** |
| Gasoline | 2.8 | -8.4 | -0.24 |
| Urban fare | 8.5 | -0.2 | -0.01 |
| Electricity | 2.9 | 5.7 | 0.16 |
| **Associated to exchange rate** | **4.5** | **3.0** | **0.12** |
| *Of which* | | | |
| Purchase of vehicles | 1.6 | 5.2 | 0.08 |
| House rent | 2.4 | 1.5 | 0.03 |
| **Education** | **9.85** | **4.3** | **0.45** |
| *Of which* | | | |
| Education costs (tuition and fees) | 8.8 | 4.2 | 0.39 |
| **Rest** | **33.58** | **0.7** | **0.21** |

**Table 47**
**CPI AND FARMING PERISHABE FOOD**
(Annual average change)

| | January-April | May-December | Year |
|---|---|---|---|
| **2001-2014** | | | |
| CPI | 4.1 | 1.8 | 2.6 |
| Farming perishable foods | 15.6 | -1.3 | 4.0 |
| **2014** | | | |
| CPI | 5.6 | 2.0 | 3.2 |
| Farming perishable foods | 23.9 | 1.7 | 8.6 |
| **2015** | | | |
| CPI | 5.0 | | |
| Farming perishable foods | 21.4 | | |

## Forecast

83. The BCRP monetary policy actions are based on inflation forecasts and on projections of inflation determinants prepared using the macroeconomic information available at the time a policy action is decided. These forecast also include a confidence interval, which quantifies the degree of uncertainty associated with each of them. Indicators standing out as inflation determinants include the evolution of inflation expectations, imported inflation, and demand inflationary pressures, all of which are quantified through the concept of the output gap –that is, the difference between GDP and GDP's potential level. Because this indicator anticipates the evolution of demand-pull inflation, the output gap is an indicator that allows the BCRP to adjust its monetary policy stance on a timely basis.

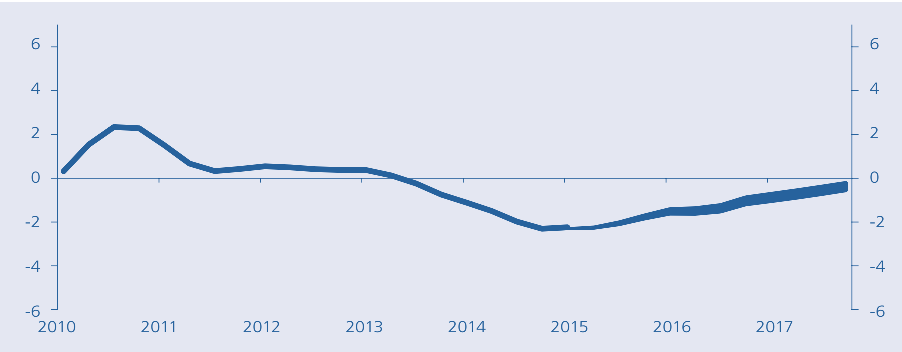
84. Inflation is forecast to gradually converge to 2.0 percent in the 2015-2017 forecast horizon, but showing a slower convergence path than that projected in the Inflation Report of January. This slower pace of convergence to the target would be mainly associated with higher imported inflation due to a greater-than-expected nominal depreciation of the nuevo sol and to higher external prices, offset in part by an output gap that remains negative and which is recovering more slowly than estimated in our previous report. The reduction of inflation in the forecast horizon is coupled by a reversal of inflation expectations to 2 percent.

85. Some aspects of the determinants of the inflation forecast are discussed below:

    a) The **output gap** has remained negative in Q1-2015 and is expected to recover gradually, although at a slower pace than considered in the Inflation Report of January. The lower gap would be explained by the effect of lower terms of trade, lower business confidence (reflected in lower investment and private consumption), and lower growth rates among our trading partners (which has an adverse impact on our non-traditional exports).

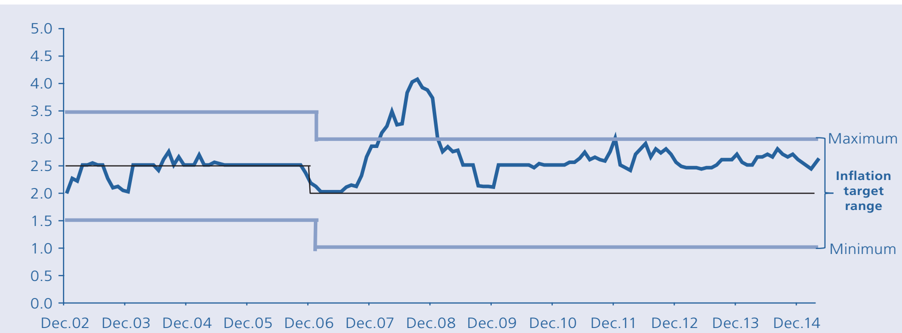
The factors that will have a positive impact on the output gap during 2015 include expansionary monetary conditions in soles and a slightly lower fiscal impulse than the one observed in 2014. Together with the recovery of GDP in the primary sectors –especially in the sectors of mining and fishing–, these two effects are expected to favor a gradual recovery in business confidence and consequently, in investment in the following quarters.

**Graph 86**
**OUTPUT GAP: 2010 - 2017**
(% potential GDP)




b) **Expectations of inflation** remain within the target range, even though the level of expected inflation this year has increased slightly but shows a declining trend in the forecast horizon (2015-2017). It should be pointed out that the Central Bank will continue to pay close attention to changes in long-term inflation expectations and will take appropriate monetary policy measures that contribute to maintaining inflation expectations within the target range.

**Graph 87**
**EXPECTATIONS OF INFLATION FOR THE NEXT YEAR***
(%)




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

**Table 48**
**SURVEY ON MACROECONOMIC EXPECTATIONS: INFLATION**
(%)

| | Expectation about: | | |
|---|---|---|---|
| | IR Oct.14 | IR Jan.15 | IR May.15 |
| **Financial entities** | | | |
| 2015 | 2.6 | 2.5 | 2.9 |
| 2016 | 2.5 | 2.5 | 2.8 |
| 2017 | | | 2.9 |
| **Economic analysts** | | | |
| 2015 | 2.8 | 2.7 | 2.9 |
| 2016 | 2.6 | 2.5 | 2.6 |
| 2017 | | | 2.5 |
| **Non-financial firms** | | | |
| 2015 | 3.0 | 3.0 | 3.0 |
| 2016 | 3.0 | 3.0 | 3.0 |
| 2017 | | | 3.0 |

c) **Imported inflation** reflects the evolution of **import prices** and the evolution of the exchange rate. With regard to international prices, a partial reversal of the price drop observed in Q1 is foreseen in the prices of the main imported goods, especially in the price of crude. In addition to this, the recent trend observed in the exchange rate would have an upward effect on inflation due to the pass-through effect. The latter is greater when there is a depreciation of the sol against the dollar resulting from changes in the exchange rate than when there is an appreciation.

The BCRP survey on expectations about the dollar-nuevo sol exchange rate shows that all of the economic agents expect a moderate depreciation of the nuevo sol this year and next year and that they consider that the depreciation observed so far is a transitory event reflecting market anticipation of the withdrawal of monetary stimulus by the Federal Reserve.

**Table 49**
**SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE**
(Nuevos Soles per US$)

| | | IR Dec.13 | IR Jul.14 | IR Oct.14 | IR Jan.15 | IR May.15 |
|---|---|---|---|---|---|---|
| **Financial entities** | | | | | | |
| | 2015 | 2.83 | 2.88 | 2.90 | 3.10 | 3.25 |
| | 2016 | 2.85 | 2.90 | 2.95 | 3.15 | 3.30 |
| | 2017 | | | | | 3.30 |
| **Economic analysts** | | | | | | |
| | 2015 | 2.87 | 2.88 | 2.95 | 3.10 | 3.22 |
| | 2016 | 2.90 | 2.90 | 2.95 | 3.15 | 3.25 |
| | 2017 | | | | | 3.25 |
| **Non-financial firms** | | | | | | |
| | 2015 | 2.85 | 2.85 | 2.90 | 3.00 | 3.20 |
| | 2016 | 2.86 | 2.90 | 2.90 | 3.10 | 3.25 |
| | 2017 | | | | | 3.30 |
| **Average** | | | | | | |
| | 2015 | 2.85 | 2.87 | 2.92 | 3.07 | 3.22 |
| | 2016 | 2.87 | 2.90 | 2.93 | 3.13 | 3.27 |
| | 2017 | | | | | 3.28 |

d) The following factors may be mentioned among the **supply shocks** that affect inflation: i) the recovery of oil prices, ii) the annual revision of electricity rates, and iii) the impact of El Niño. The combination of these factors would cause a greater increase on **food and energy prices**, which is estimated at 3.2 percent in 2015. This increase would be due mostly to the evolution of energy prices (4.6 percent) –including fuel prices and electricity rates–, since food prices would increase 3.0 percent.

86. The evolution of the **output gap** is determined by developments in external conditions, the monetary policy stance, the fiscal impulse, and by economic agents' confidence in the course of the economy. In 2014, external factors such as the decline of the terms of trade, lower growth in our trading partners, and less expansionary monetary conditions in dollars, had a negative effect on the output gap.

A gradual reversal is foreseen in the output gap in the 2015-2017 forecast horizon. This forecast is mainly based on the following determinants:

a) **Business confidence**: a slower recovery is foreseen in business confidence because of uncertainty regarding the evolution of external factors and because of the lower dynamism of public and private investment.

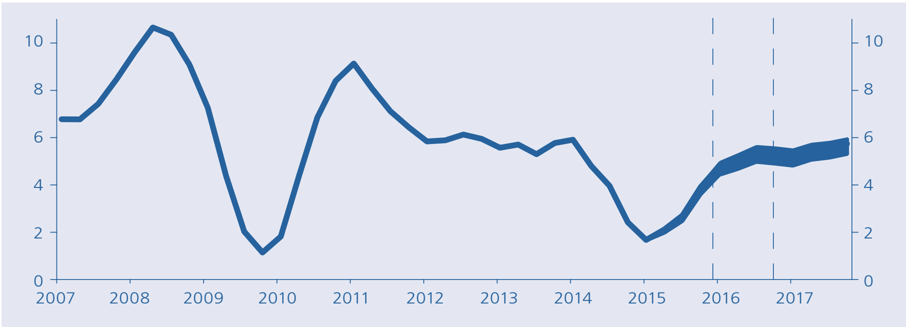
b) **External conditions**: a slower pace of recovery is estimated in terms of global growth due mainly to the weak level of economic activity observed in the United States, the Eurozone, and the emerging economies. Moreover, lower terms of trade than the ones foreseen in the IR of January are now considered, in line with the recent trend observed in the prices of raw materials.

c) **The fiscal impulse** estimated for this year would be equivalent to 0.4 percent of GDP (vs. 1.4 percent estimated in the IR of January) due mainly to the delay in the implementation of public investment projects by the subnational governments.

d) **Monetary conditions**: Monetary conditions in soles are still one of the factors that have a positive contribution to the level of the output gap. On the other hand, monetary conditions in dollars are expected to show a contraction in 2015 due to the withdrawal of monetary stimulus by the U.S. Federal Reserve and the beginning of a series of anticipated rises in its monetary policy rate.

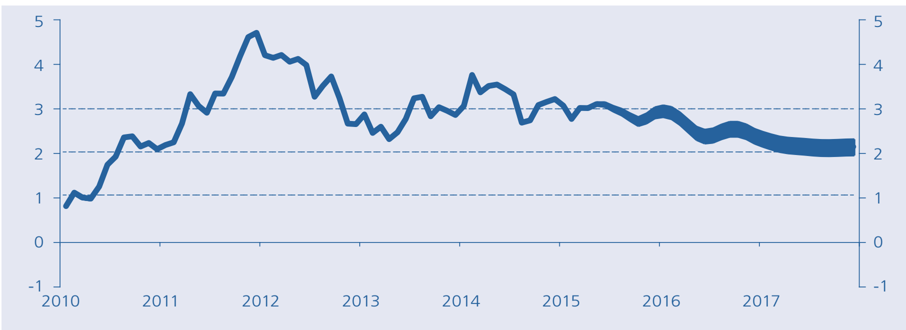
87. The growth forecast for the 2015-2017 horizon (3.9, 5.3, and 5.8 percent) is consistent with a gradual recovery of the output gap and the potential output.

**Graph 88**
**GDP GROWTH FORECAST: 2007 - 2017**
(Annual % change)




88. Given that the risk factors that imply higher inflation have materialized, particularly the risks of higher food prices due to external factors, a faster reversal in the international price of oil, and a greater exchange rate-to-inflation pass-through, inflation is foreseen to show a slower convergence to the 2 percent target in the forecast horizon.

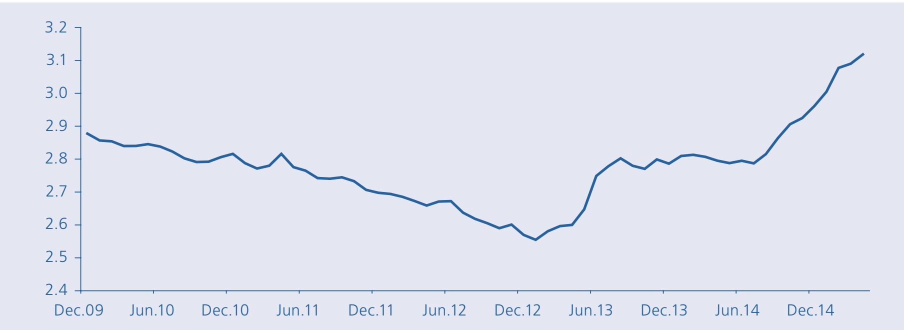
**Graph 89**
**INFLATION FORECAST: 2010 - 2017**
(Last 12 months % change)



## Box 8
## EXCHANGE RATE AND INFLATION

The dollar/nuevo sol exchange rate has been rising since 2013, recording a variation of 21.6 percent between January 2013 and April 2015. In the same period, inflation has accumulated a rate of 7.9 percent. The relationship between the exchange rate and inflation in our country is analyzed in this box. First, we analyze the existing correlation between the exchange rate and the different items included in the consumer price index (CPI) at a disaggregated level, and then we provide some recent econometric estimates of the exchange rate-to-total inflation pass-through.

**EXCHANGE RATE: SOLES PER US$**




**Correlation Analysis between the Exchange Rate and the CPI**

To approach the direct impact of exchange rate variations on the consumer price index, we first estimated the correlations between the monthly percentage changes in the exchange rate and the price indices of the various items included in the CPI basket of goods in the period January 1995 - April 2015. Correlations were estimated for moving timeframes of 24 months. In this way, we started analyzing the period from January 1995 to December 1997, then the period from February 1995 to January 1998, and so on until we covered the period between May 2013 and April 2015. This method captures changes in the relationship between variations in the exchange rate and prices over time.

**ITEMS THAT SHOWED THE HIGHEST CORRELATION BETWEEN PRICE AND EXCHANGE RATE**

| | Weight | Maximum correlation 1/ | Correlation May.13-Apr.15 |
|---|---|---|---|
| **Goods** | | | |
| Appliances | 1.3 | 0.96 | -0.23 |
| Equipment for recreation and culture | 0.9 | 0.93 | -0.18 |
| Jewelry | 0.1 | 0.92 | 0.08 |
| Purchase of vehicles | 1.6 | 0.89 | 0.60 |
| Recreational items | 0.7 | 0.86 | -0.16 |
| Vehicle spare parts | 0.2 | 0.69 | -0.09 |
| **Services** | | | |
| House rent | 2.4 | 0.99 | 0.90 |
| Hotel expenses | 0.1 | 0.74 | 0.13 |
| Airplane tickets | 0.4 | 0.71 | 0.49 |
| Tourist tour | 0.0 | 0.72 | 0.24 |

1/ Highest correlation using Cmoving timeframes of 24 months since January 1995 until April 2015.

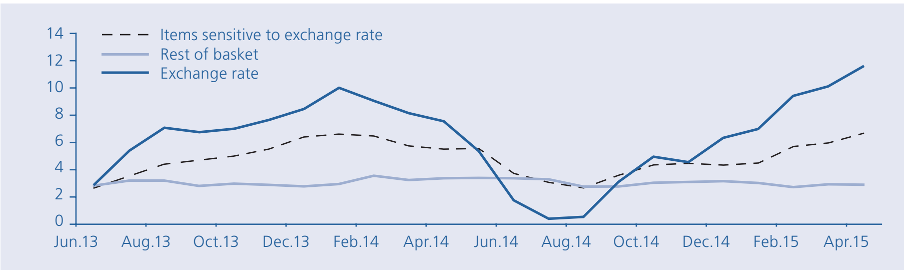
The items that showed the highest correlation between price variations and exchange rate variations in the past 24 months were house rents, car sales, airplane tickets, and tourist tour, all of which account for 4.5 percent of the CPI basket.

The nuevo sol appreciated 21.6 percent between January 2013 and April 2015. In this period, the group of goods highly sensitive to a variation in the exchange rate recorded an average price increase of 14.4 percent and contributed with 0.56 percentage points to the inflation rate in this period (7.9 percent). In 2013 and 2014 these goods contributed with 0.25 and 0.18 percentage points to inflation, respectively. In the first four months of 2015, the nuevo sol appreciated 5.3 percent, while the prices of these goods rose 3.0 percent on average, contributing with 0.12 percentage points to the inflation rate of the period (1.6 percent).

**INFLATION AND EXCHANGE RATE**
(Annual % Change)

| | Weight | 2013 | 2014 | Jan.-Apr.2015 | Total |
|---|---|---|---|---|---|
| CPI | 100.0 | 2.9 | 3.2 | 1.6 | 7.9 |
| Items highly sensitive to a variation in the exchange rate | 4.5 | 6.5 | 4.3 | 3.0 | 14.4 |
| Rest of items | 95.5 | 2.7 | 3.2 | 1.6 | 7.7 |
| Exchange rate | | 8.5 | 6.4 | 5.3 | 21.6 |

**INFLATION AND EXCHANGE RATE**
(Last 12 month % change)




It should be pointed out that there are various indirect transmission channels not captured by this method because the correlation analysis only estimates the direct impact of exchange rate variations on prices. In addition to this, it does not consider the effect of the exchange rate on the commodity prices that depend significantly on third variables, such as international prices.

**Estimates of the pass-through effect**

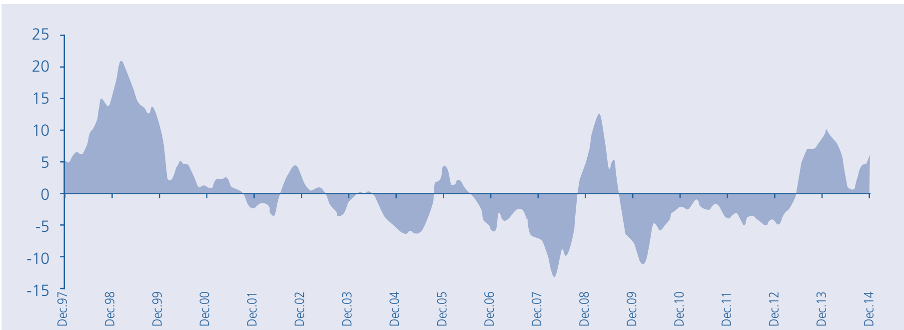
We then carried out econometric estimates of the pass-through effect of the exchange rate to prices (ERTP) at the aggregate level. In small open economies, variations in the exchange rate affect the evolution of inflation due to the effect these changes generate in the prices of goods and imported inputs. This is a relevant topic for both the projection of inflation and for the design of monetary policy since changes in the ERTP can modify the effect of monetary policy actions aimed at controlling inflation in the short term.

Because the ERTP is dynamic, this variable is estimated using VAR models. There is evidence of statistically significant ERTP for Peru using VAR models, although of low magnitude.[11] The ERTP effect can also be variable and significant in partially dollarized economies like the Peruvian economy, in which not only imported goods are affected by the exchange rate but also household items with prices in dollars.

Supplementary evidence on the estimation of the ERTP pass-through effect in Peru considering the possibility that this pass-through is asymmetric is provided below. The aim is to answer whether prices respond in the same way to depreciations and to appreciations or not. The question arises after having noticed that the evidence of a low or even decreasing ERTP is based mainly on episodes of persistent appreciation, with some periods of depreciation. This type of asymmetry observed in price reactions is discussed by Ball (1994) as well as by Pollard and Coughlin (2004). For example, a strong depreciation may negatively affect the profit margin of companies that use imported inputs, which would generate incentives to raise prices (if the company has enough power in the market). However, an appreciation would result in an increase in the profit margin, so the firm will not necessarily decide to change its prices on the downside. This will also depend on the elasticity of demand in each market. On the other hand, other studies for Peru associated asymmetry with periods of expansion and recession, characterizing it through smooth transition models (see Winkelried (2003); Bigio and Salas (2006).

As we may see in the following graph, periods of sharp depreciation as well as periods of persistent appreciation have been observed over the past 18 years, including, for instance, the depreciations of 1998 or 2008, and the appreciation registered between 2002 and 2005, or between 2009 and mid-2013. Therefore, there is enough information to carry out a differentiated analysis between these two scenarios.

**RATE OF ANNUAL DEPRECIATION OF NUEVO SOL**



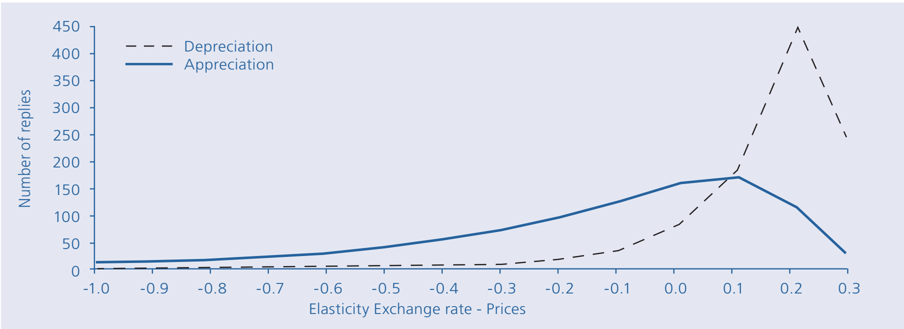

**Estimation of an asymmetric pass-through effect**

There are models of time series that consider asymmetric dynamic responses based on whether a variable is positive or negative. For example, nonlinear Impulse/Response equations are estimated through conditional projections in the literature of oil prices.

11 For example, see Winkelried (2013), Miller (2003) and Maertens Odría et al. (2012).

The following graph shows the distribution of the pass-through of the exchange rate to prices after 12 months. As we can see, the most likely or modal value is different in the case of a depreciation (0.2) and in the case of an appreciation (0.1). It should be pointed out that this analysis is based on transitory exchange rate shocks (a one-time shock) and therefore do not imply a future sequence of shocks. Coincidentally, the value of 0.1 is associated with the previous evidence, based precisely on the sample of cases with a persistent appreciation. We can therefore conclude that the most probable values in both scenarios differ and also maintain a ratio of 2 to 1. Thus, the conclusion is that prices respond in different ways to depreciations and appreciations and that the reaction is stronger in the case of a depreciation in Peru.

**EXPERIMENTIAL DISTRIBUTION OF THE PASS-THROUGH OF THE EXCHANGE RATE TO PRICES AFTER 12 MONTHS**




It is also worth highlighting that distribution is much more concentrated in the modal value in the case of a depreciation than in the case of an appreciation. Thus, this does not only reflect a movement, but also a change in the distribution of probabilities. This result is relevant to the design of monetary policy under inflation targeting because it provides more light regarding the reaction of prices in different stages of the evolution of the exchange rate. In other words, the effect on inflation would be higher in episodes of rapid depreciation than in periods of appreciation.

**Box 9**

**THE PRICE BAND SYSTEM FOR AGRICULTURAL PRODUCTS**

The price band system (PBS) was created as a mechanism of stabilization of symmetrical prices to minimize the effects of fluctuations in the international prices of selected agricultural products in the following cases:

a. When the international benchmark price exceeds the ceiling price, a tariff reduction is applied.

b. When the price is lower than the floor price, a tariff is applied.

The PBS affects four groups of products: maize, rice, sugar, and milk.[12] It includes a total of 47 tariff items, of which 26 items are dairy products, 10 are products related to maize, 7 are sugar and related items, and 4 are rice items.

However, tariff reductions implemented in recent years with the aim of improving the economy's competitiveness have led the PBS to become an asymmetric mechanism which only activates in episodes in which tariff duties must be paid.

Today, almost all of these items –44 out of 47– have a zero tariff so a tariff reduction is no longer possible when prices exceed the ceiling price.[13]

In nominal terms, the PBS involves the application of high tariffs that generate disturbances to consumers' wellbeing. For example, in the first half of April, the tariff on maize was 46 percent, the tariff on rice was 32 percent, and sugar and milk were subject to tariffs of 70 percent and 43 percent, respectively, as the following table shows.

**PRICE BAND - SPECIFIC VARIABLE CUSTOM TARIFFS**
(US$/Ton)

| | Maize | Rice* | Sugar | Milk |
|---|---|---|---|---|
| **Reference Quote **** | **197** | **441** | **393** | **2,769** |
| **Effective band (Nov.2014 - May.2015)** | | | | |
| Floor = Average (5 years) | 287 | 582 | 668 | 3,949 |
| Ceiling = Average + 1 S.D. | 342 | 658 | 795 | 4,600 |
| Additional customs tariff | 90 | 141 | 275 | 1,180 |
| Additional customs tariff (% CIF price) | 46 | 32 | 70 | 43 |

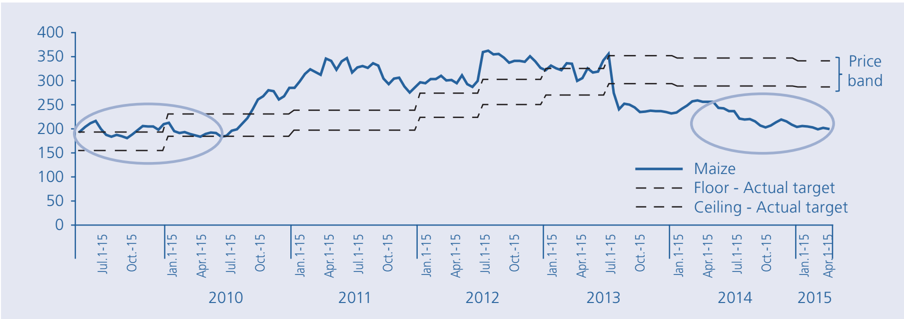
** Milled rice. There is also a table for paddy rice.
** Reference CIF prices for the period 1 -15 April 2015. Products: Rice (White Rice 100% Grade B), Maize (US No. 2 yellow maize), milk (powder unsweetened) and Sugar (Contract No. 5).
S.D. = Standard Deviation.

12 The price band has a broad spectrum for each product: the marker is the agricultural product whose international price is used for the calculation of the price band and the related-items are products obtained by processing or mixing marker products or that may replace the marker product in industrial uses or in consumption.

13 Only 3 maize-related tariff items have a tariff of 6 percent: corn starch (1108 12 00 00), potato starch (1108 13 00 00), and dextrin and other modified starches (3505 10 00 00).

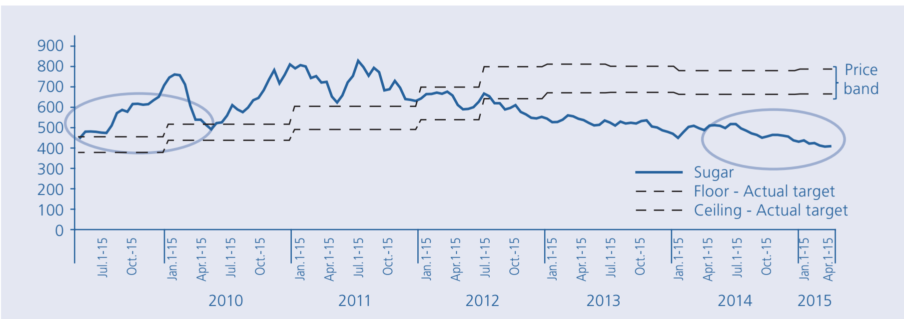
It is worth pointing out that the methodology used to calculate the average prices for the past 5 years to determine the band floor has implied the application of tariffs even though current prices are similar to those recorded 5 years ago, when the price band mechanism established that international prices were above the floor price and, therefore, tariffs did not apply.

**MAIZE**
(Quotation and price band, US$ per ton)

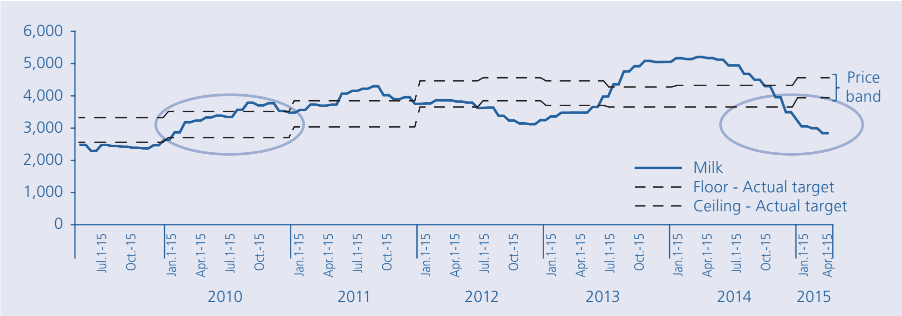



**RICE**
(Quotation and price band, US$ per ton)


**SUGAR**
(Quotation and price band, US$ per ton)



**MILK**
(Quotation and price band, US$ per ton)




However, the implementation of specific tariff duties is not uniform as differences arise according to the country of origin. This differentiated treatment introduces incentives to trade diversion. Thus, the countries of the Andean Community and the United States[14] are excluded from the application of the price band, which generates impacts in the case of maize and sugar.

**Modifying the PBS**

Supreme Decree 103-2015-EF enacted on May 1, 2015, establishes that the sum of additional variable tariff duties of the PBS and CIF ad valorem rights shall not exceed 20 percent of the CIF value of the goods in the case of 43 dairy, sugar, and maize items included in the PBS.

Therefore, because the new additional tariff duties would be substantially lower than the previous ones, the implicit price plus the tariff would also be lower, except in the case of rice whose price system has not been changed (see table below), which would have a direct benefit on consumers.

**CHANGES TO THE PRICE BAND SYSTEM**
(US$ per ton)

| | | Maize | Rice | Sugar | Milk |
|---|---|---|---|---|---|
| **I.** | **Current benchmark prices* (1)** | **197** | **441** | **393** | **2,769** |
| | Floor price | 287 | 582 | 668 | 3,949 |
| | Ceiling price | 342 | 658 | 795 | 4,600 |
| **II.** | **Previous specific custom tariffs (2)** | **90** | **141** | **275** | **1,180** |
| | Implicit rate | 46 | 32 | 70 | 43 |
| **III.** | **New specific custom tariffs** (3)** | **39** | **141** | **79** | **554** |
| **Price and specific custom tariffs** | | | | | |
| | Previous situation (1) + (2) | 287 | 582 | 668 | 3,949 |
| | Current Situation (1) + (3) | 236 | 582 | 472 | 3,323 |
| | **% change** | **-18** | **0** | **-29** | **-16** |

* First half of April 2015.
** Custom tariff up to 20 percent according to S.D. No. 103-2015-EF.

14 Imports from the Andean Community are not subject to the price band system, while imports from the United States have quotas and tariff limits. For example, the quota for imports of maize in 2015 is 709 thousand tons and the maximum tariff is 10.4 percent.

# VII. Balance of Risks

89. Every forecast is subject to the occurrence of unanticipated events that may divert the forecast from the central scenario. In a context of uncertainty, the materialization of some risks may imply a different rate of inflation than the one forecast originally.

**Balance of Risks in the 2015 – 2017 Horizon**

90. As regards the inflation forecast, the events that could most likely divert the inflation rate 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.

**a. Lower global growth**

The baseline scenario considers a slower recovery in the world economy in 2015-2017 than the one estimated in our Inflation Report of January. 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.

**b. Slowdown in domestic demand**

Economic recovery could take longer than expected if the implementation of both public and private investment projects were to be postponed. This would lead to 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.

**c. Volatility in international financial markets**

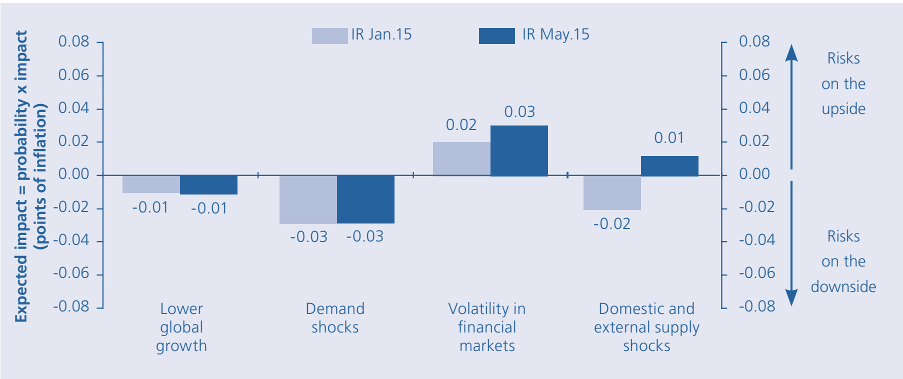
This risk could occur if the Federal Reserve's withdrawal of monetary stimulus brought about volatility in international financial markets. In such a scenario, this could generate capital outflows from the emerging countries and depreciation pressures on the currencies of these economies.

### d. Supply shocks

Greater uncertainty is being observed in international markets due to geopolitical tensions in the Middle East. A rise in the international prices of oil significantly higher than the price levels considered in the baseline scenario could generate inflationary pressures. Similarly, a more severe El Niño event than the one considered could generate upward pressures on the prices of some foods products.

91. The evaluation of the above-mentioned risks results in a neutral balance for inflation, in contrast with the risk balance of our January Report which was tilted to the downside. This revision is explained mainly by increased volatility in international financial markets and in fuel prices.

**Graph 90**
**BALANCE OF RISKS AGAINST THE BASE SCENARIO**




## Conclusions

92. The forecast is still that inflation will continue declining in the following months and that it will reach a rate of 2 percent in the 2015-2017 horizon, which is consistent with expectations of declining inflation, fewer supply shocks, and the gradual closing of the negative output gap in the 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. The BCRP stands ready to adjust its monetary stance if required in order to ensure inflation's convergence to the inflation target range.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