CENTRAL RESERVE BANK OF PERU

Summary Inflation Report

December 2016

The world economy has continued recovering in the third quarter of 2016. As a result of this, **global growth** would increase from 3.0 percent in 2016 to 3.4 percent in 2017 and to 3.5 percent in 2018.

Commodity prices have increased recently, in part due to expectations of greater spending in infrastructure in the United States –which would account for the increase in the price of basic metals– and due to an increase in speculative positions. Another factor contributing to this rise has been the recent agreement of the OPEC and other oil-producing countries to cut the production of crude. In line with these developments, the **terms of trade** are estimated to grow 3.9 percent in 2017 –a higher rate than that estimated in the Inflation Report of September (1.0 percent)– and to decline thereafter in 2018 (1.6 percent).

In the first nine months of 2016, the deficit in the **current account of the balance of payments** fell from 5.3 percent of GDP in the same period of 2015 to 3.6 percent, mainly as a result of lower imports and higher exports of copper. The current account deficit is projected to fall to 2.8 percent of GDP in 2017 and in 2018 due to the increase of mining exports and to the recent recovery of export prices. It is estimated that long term financing from private sources will continue exceeding the current account gap and will continue to be the main component of foreign direct investment.

The **trade balance** would show a surplus of US$ 0.6 billion in 2016 after having recorded a deficit of US$ 3.2 billion in 2015. In the next two years the trade surplus would continue increasing (to more than US$ 2 billion per year) due to the growth of commodity exports as a result of both higher volumes and higher prices.

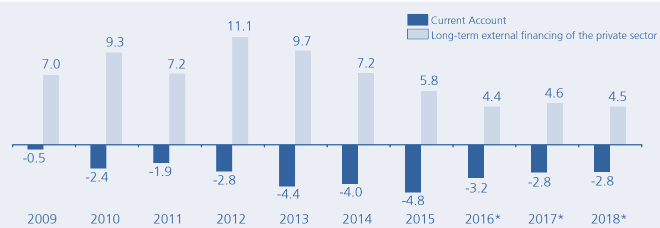
This **Inflation Report** was prepared using data on the Balance of Payments and Gross Domestic Product as of the third quarter of 2016, data on Monetary Accounts as of October, and data on the operations of the Non-Financial Public Sector, Inflation, Financial Markets, and the Exchange Rate as of November 2016.

WORLD GDP GROWTH
(Annual % change)

	Structure % 1/	Trading Peru % 1/	2015	2016* IR Sep.16	2016* IR Dec.16	2017* IR Sep.16	2017* IR Dec.16	2018* IR Sep.16	2018* IR Dec.16
Advanced economies	**42.4**	**47.4**	**2.1**	**1.5**	**1.6**	**1.7**	**1.8**	**1.9**	**1.9**
Of which:									
1. United States	15.8	17.5	2.6	1.5	1.6	2.1	2.2	2.0	2.0
2. Eurozone	11.9	11.0	2.0	1.6	1.7	1.4	1.5	1.5	1.5
Germany	3.4	2.8	1.5	1.7	1.7	1.4	1.5	1.4	1.5
France	2.3	0.9	1.3	1.3	1.3	1.2	1.2	1.5	1.5
Italy	1.9	1.7	0.8	0.8	0.8	0.9	0.9	1.0	1.0
Spain	1.4	2.5	3.2	2.9	3.1	1.9	1.9	1.9	1.9
3. Japan	4.3	3.0	0.5	0.5	0.6	0.8	0.8	0.8	0.9
4. United Kingdom	2.4	1.1	2.2	1.7	2.1	1.0	1.1	1.7	1.7
5. Canada	1.4	4.4	1.1	1.4	1.3	2.1	2.0	2.2	2.0
Emerging market and developing economies	**57.6**	**52.6**	**4.0**	**4.1**	**4.1**	**4.6**	**4.6**	**4.8**	**4.8**
Of which:									
1. Developing Asia	30.6	26.9	6.7	6.4	6.5	6.3	6.3	6.3	6.3
China	17.1	22.2	6.9	6.5	6.7	6.2	6.2	6.0	6.0
India	7.0	2.2	7.6	7.4	7.5	7.6	7.6	7.6	7.6
2. Commonwealth of Independent States	4.6	0.7	-2.8	-0.1	-0.2	1.4	1.5	1.9	2.0
Russia	3.3	0.5	-3.7	-0.6	-0.6	1.1	1.2	1.4	1.5
3. Latin America and the Caribbean	8.3	23.2	0.0	-0.4	-0.7	1.8	1.8	2.4	2.4
Brazil	2.8	4.1	-3.8	-3.4	-3.4	0.4	0.6	1.2	1.2
Chile	0.4	3.2	2.3	1.7	1.7	2.2	2.2	2.7	2.7
Colombia	0.6	3.0	3.1	2.2	2.1	2.9	2.7	3.7	3.7
Mexico	2.0	3.4	2.5	2.3	2.1	2.5	2.1	2.7	2.7
Peru	0.3	-	3.3	4.0	4.0	4.5	4.3	4.2	4.2
World Economy	**100.0**	**100.0**	**3.2**	**3.0**	**3.0**	**3.4**	**3.4**	**3.5**	**3.5**
Memo:									
Peru's trading partners 1/ 2/	65.7		3.1	2.7	2.8	3.1	3.1	3.2	3.2

1/ 2015.
2/ Basket of Peru's 20 main trading partners.
* Forecast.
Source: Bloomberg, IMF, and Consensus Forecast.

CURRENT ACCOUNT AND LONG-TERM EXTERNAL FINANCING OF THE PRIVATE SECTOR: 2009 - 2018 1/
(% GDP)



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

TRADE BALANCE
(Million US$)

	2015 Jan.-Sep.	2015 Year	2016* Jan.-Sep.	2016* IR Sep.16	2016* IR Dec.16	2017* IR Sep.16	2017* IR Dec.16	2018* IR Sep.16	2018* IR Dec.16
EXPORTS	**25,029**	**34,236**	**25,749**	**35,299**	**36,062**	**38,524**	**40,252**	**40,675**	**41,986**
Of which:									
Traditional products	17,124	23,291	18,109	24,871	25,371	27,628	29,265	29,091	30,200
Non-traditional products	7,840	10,857	7,572	10,328	10,598	10,793	10,902	11,476	11,695
IMPORTS	**28,045**	**37,385**	**25,897**	**35,741**	**35,395**	**38,156**	**37,798**	**40,025**	**39,734**
Of which:									
Consumer goods	6,488	8,791	6,326	8,786	8,595	9,112	8,897	9,393	9,233
Inputs	12,151	15,923	11,127	15,157	15,225	16,405	16,738	17,252	17,585
Capital goods	8,975	12,007	8,230	11,426	11,297	12,580	12,269	13,297	13,061
TRADE BALANCE	**-3,017**	**-3,150**	**-148**	**-442**	**667**	**367**	**2,454**	**649**	**2,252**

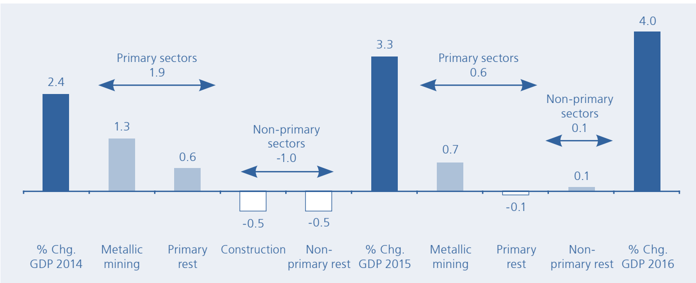
IR: Inflation Report.
* Forecast.

GDP AND DOMESTIC DEMAND
(Real % change)

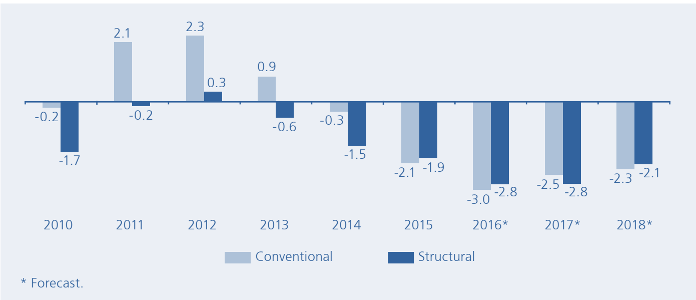
	2015		2016*			2017*		2018*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Sep.16	IR Dec.16	IR Sep.16	IR Dec.16	IR Sep.16	IR Dec.16
I. Domestic demand	**3.0**	**3.0**	**1.1**	**1.8**	**1.3**	**4.0**	**4.0**	**4.0**	**4.0**
1. Private expenditure	**3.1**	**2.7**	**0.0**	**0.7**	**1.1**	**4.1**	**3.8**	**3.9**	**4.2**
Consumption	3.3	3.4	3.6	3.5	3.5	3.8	3.5	4.0	4.0
Private fixed investment	-5.3	-4.5	-6.2	-4.3	-5.5	5.0	5.0	5.0	5.0
Change on inventories (contribution)	1.7	1.1	-1.1	-0.7	-0.2	0.1	0.0	-0.2	0.0
2. Public expenditure	**2.3**	**4.2**	**7.0**	**7.0**	**2.2**	**3.4**	**5.1**	**4.3**	**2.8**
Consumption	8.1	9.5	5.9	5.7	3.0	3.0	4.2	3.5	2.2
Investment	-12.2	-7.5	10.1	10.3	0.1	4.5	7.4	6.2	4.5
II. Net external demand									
1. Exports	0.9	3.5	9.6	6.9	8.6	5.5	4.7	4.6	4.6
2. Imports	1.6	2.1	-2.9	-1.7	-2.1	3.6	3.6	3.7	3.7
III.GDP	**2.8**	**3.3**	**4.2**	**4.0**	**4.0**	**4.5**	**4.3**	**4.2**	**4.2**

IR: Inflation Report.
* Forecast.

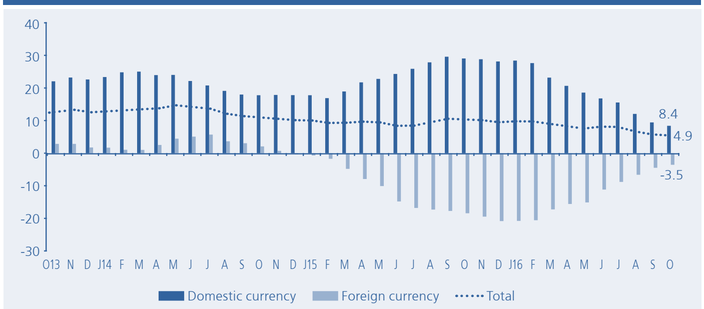
GDP GROWTH: 2016 VS 2014
(% Chg. and % contributions)



ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2010-2018
(% GDP)



CREDIT TO THE PRIVATE SECTOR
(Annual % change)



The **GDP** has been showing **growth rates** closer to the potential output and recorded a rate of 4.2 percent in January-September, this pace of growth being associated mainly with the dynamism of traditional exports. Private investment, on the other hand, continued to decrease in this period (-6.2 percent), the fall being particularly noteworthy in mining investment (-45.0 percent). Business confidence surveys continue showing positive business expectations in a context of implementation of deregulation measures in the economy.

The growth of the GDP over the year is explained mainly by the growth of metal mining, driven mostly by copper production at Las Bambas and Cerro Verde. As a result of this, GDP would show a faster pace of growth in 2016, rising from 3.3 percent in 2015 to 4.0 percent in 2016, the latter being the same rate forecast in the Inflation Report of September although with changes in terms of composition (higher exports, and lower investment and lower public expenditure). GDP's projected growth rate in the period 2016-2018 is consistent with a gradual declining trend in the output gap reflecting that activity is reaching its potential level. In 2016, GDP would grow 4.0 percent, while in 2017 and 2018, it would grow 4.3 and 4.2 percent, respectively, this growth trend being sustained by the dynamism of private investment that would start recovering in the next two years with rates of 5 percent.

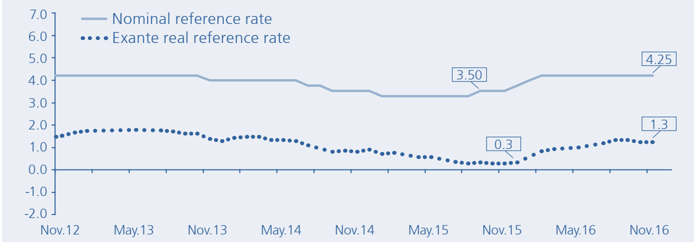
The **fiscal deficit** decreased in recent months in the context of the fiscal measures taken by the Government since 2016 to promote a downward trend in the fiscal deficit, as a result of which the accumulated deficit in the last twelve months fell from 3.4 percent of GDP in September to 3.1 percent of GDP in November. Thus, like in September, the deficit is projected at 3.0 percent of GDP. A gradually declining fiscal deficit that would reach 2.5 percent of GDP in 2017 and 2.3 percent of GDP in 2018 is projected for the next two years, which is consistent with the forecasts of the current Revised Multiannual Macroeconomic Framework.

Credit to the private sector grew at a year-on-year rate of 4.9 percent in October, a lower rate than at end 2015 (9.4 percent), this slowdown being explained by the lower dynamism of private investment. In the 2017-2018 forecast horizon, credit to the private sector is expected to resume again growth rates close to the nominal growth rate of GDP, with credit in domestic currency showing greater dynamism.

In recent months **inflation** has registered rates above the upper band of the inflation target, reflecting the rises observed in the prices of some perishable food products and fuels. Expectations of twelve-month inflation remain within the target range. In this context, the Board of BCRP has maintained its ***policy interest rate*** at 4.25 percent and has reiterated that it oversees inflation forecasts and inflation determinants to evaluate the convenience of making additional adjustments in the monetary policy rate.

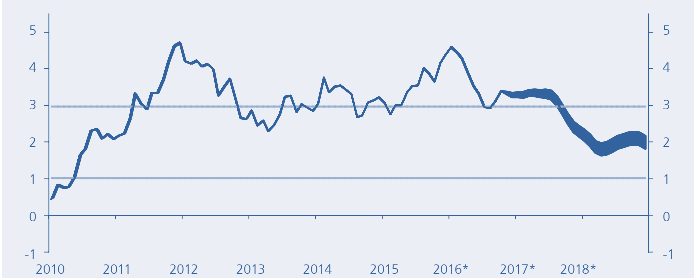
In this context, inflation is forecast to converge to 2 percent in the 2017-2018 horizon, although at a slower pace than that foreseen in the Inflation Report of September. This slower pace in inflation's convergence to the inflation target results mainly from unexpected rises in food and energy prices in the last two months, and would reflect expectations of inflation that have declined more slowly. This convergence of inflation is consistent with a projected scenario of economic growth without inflationary pressures on the side of demand, falling expectations of inflation in the forecast horizon, and with no new supply shocks affecting prices.

NOMINAL AND REAL* REFERENCE INTEREST RATE
(%)



* Ex-ante: With expectation of inflation.

INFLATION FORECAST: 2010 - 2018
(Last 12-month % change)



* Forecast.

Risk Balance

The risk factors considered in this report (supply shocks, demand shocks, greater volatility in international financial markets, and lower global growth) have a **neutral balance** on the inflation forecast, so the impact of factors that could increase inflation is equal to the impact of factors that imply a fall in prices.

BALANCE OF RISKS AGAINST THE BASE SCENARIO

SUMMARY OF INFLATION REPORT FORECAST

	2015	2016[1/]		2017[1/]		2018[1/]	
		IR Sep.16	IR Dec.16	IR Sep.16	IR Dec.16	IR Sep.16	IR Dec.16
Real % change							
1. Gross Domestic Product	3.3	4.0	4.0	4.5	4.3	4.2	4.2
2. Domestic demand	3.0	1.8	1.3	4.0	4.0	4.0	4.0
a. Private consumption	3.4	3.5	3.5	3.8	3.5	4.0	4.0
b. Public consumption	9.5	5.7	3.0	3.0	4.2	3.5	2.2
c. Fixed private investment	-4.5	-4.3	-5.5	5.0	5.0	5.0	5.0
d. Public investment	-7.5	10.3	0.1	4.5	7.4	6.2	4.5
3. Exports (good and services)	3.5	6.9	8.6	5.5	4.7	4.6	4.6
4. Imports (good and services)	2.1	-1.7	-2.1	3.6	3.6	3.7	3.7
5. Economic growth in main trading partners	3.1	2.7	2.8	3.1	3.1	3.2	3.2
Memo:							
Output gap [2/] (%)	-1.5 ; -0.5	-1.5 ; 0.0	-1.5 ; 0.0	-1.0 ; 0.0	-1.0 ; 0.0	-0.5 ; 0.0	-0.5 ; 0.0
% change							
6. Inflation	4.4	2.6 - 3.1	3.0 - 3.3	2.0 - 2.2	2.0 - 2.5	2.0 - 2.2	2.0 - 2.2
7. Expected inflation [3/]	-	2.9	3.1	2.8	2.9	2.7	2.8
8. Expected depreciation [3/]	-	0.4	1.7	2.3	1.6	1.2	1.4
9. Terms of trade [4/]	-6.3	-2.2	-1.5	1.0	3.9	-0.1	-1.6
a. Export prices	-14.9	-4.8	-4.4	3.7	7.3	1.2	-0.1
b. Import prices	-9.2	-2.6	-2.9	2.7	3.2	1.3	1.6
Nominal % change							
10. Currency in circulation	3.8	5.4	4.1	6.0	5.5	6.0	5.9
11. Credit to the private sector [5/]	9.4	6.5	5.5	7.0	6.5	6.5	6.5
% GDP							
12. Gross fixed investment	24.3	23.4	22.7	23.7	23.0	24.1	23.3
13. Current account of the balance of payments	-4.8	-3.8	-3.2	-3.4	-2.8	-3.3	-2.8
14. Trade balance	-1.6	-0.2	0.3	0.2	1.2	0.3	1.0
15. Long-term external financing of the private sector [6/]	5.8	4.5	4.4	4.9	4.6	4.7	4.5
16. Current revenue of the general government	19.9	18.9	18.3	19.2	19.0	19.4	18.7
17. Non-financial expenditure of the general government	21.2	20.8	20.1	20.5	20.3	20.4	19.7
18. Overall balance of the non-financial public sector	-2.1	-3.0	-3.0	-2.5	-2.5	-2.3	-2.3
19. Balance of total public debt	23.3	25.4	24.5	25.9	24.9	27.5	26.2
20. Balance of net public debt	6.5	9.2	9.2	11.7	11.6	13.8	13.6

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