



## Summary

## Inflation Report

June 2017

During the first quarter of 2017, the world economy continued to grow at moderate rates and in some cases, i.e. the Eurozone and Japan, at slightly higher rates than those estimated in the Inflation Report of March. In addition, favored by the better prices of commodities, the emerging market economies have been showing increased dynamism. Because of this, the global economy's growth forecast has been raised from 3.4 to 3.5 percent in 2017 and from 3.5 to 3.6 percent in 2018.

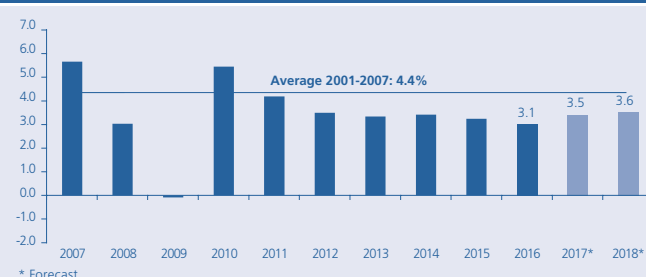
Since the information about commodity prices at May confirms the rising trend foreseen in our previous report, the **terms of trade** would increase by 5.5 percent in 2017 (vs. 5.4 percent projected in March). Moreover, the terms of trade would remain stable in 2018.

The deficit in the **current account of the balance of payments** fell from 5.5 percent of GDP in the first quarter of 2016 to 1.8 percent of GDP in the first quarter of this year, reflecting mainly the higher prices and the higher volumes of traditional exports, especially copper. In comparison with our March Report, the scenario in this report considers the positive impact that increased exports of fishmeal would have in 2017 after the announcement of the fishing quota established for the first fishing season of anchovy.

In line with these events, the projected balance of the current account has been revised from a deficit of 2.6 and 2.4 percent of GDP –estimated in our Report of March– to a deficit of 2.1 and 2.0 percent of GDP in 2017 and 2018, respectively. The long-term financial account, which will continue to be the main financing source of the balance of payments, will continue to exceed largely the current account requirements.

The lower **growth rate of GDP** in the first quarter (2.1 percent) reflected the negative impact of *El Niño Costero*, on the one hand, and the contraction of public and private investment, on the other hand, the latter resulting in part from the suspension of infrastructure projects due to investigations about corruption cases. In this context,

This **Inflation Report** was prepared using data on the Balance of Payments and GDP at Q1-2017 while data on the Monetary Accounts, operations of the Non-Financial Public Sector, Inflation, Financial Markets, and the Exchange Rate at May 2017.

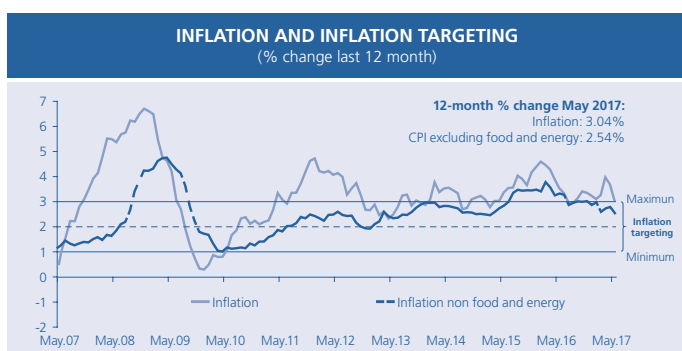
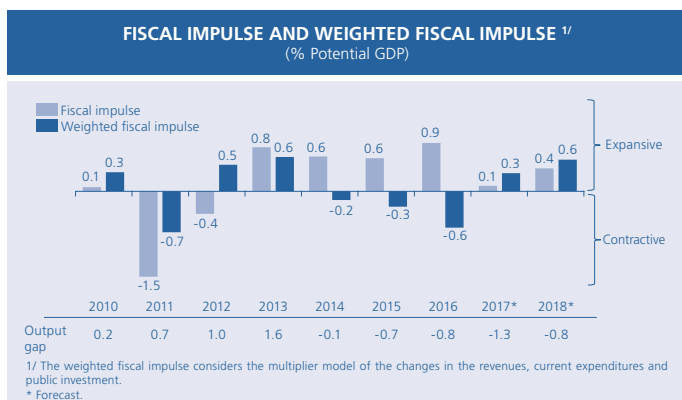
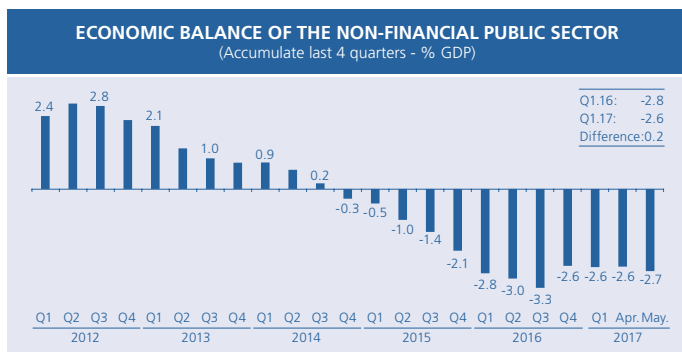
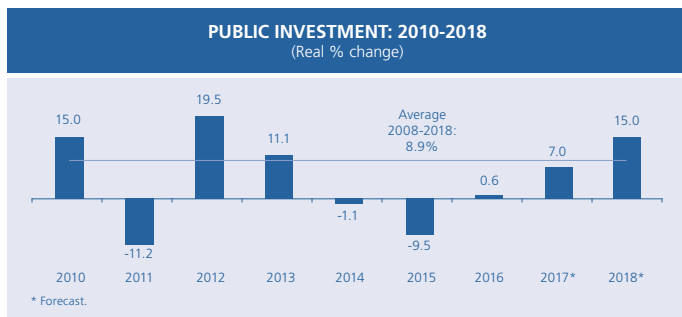
WORLD ECONOMY: 2007-2018  
(Annual % change)TERMS OF TRADE: 2001-2018  
(Annual average % change)BALANCE OF PAYMENTS  
(Million US\$)

	2016		2017*		2018*		
	Q1	Year	Q1	IR Mar:17	IR Jun:17	IR Mar:17	IR Jun:17
<b>I. CURRENT ACCOUNT BALANCE</b>	<b>-2,425</b>	<b>-5,303</b>	<b>-887</b>	<b>-5,565</b>	<b>-4,527</b>	<b>-5,447</b>	<b>-4,491</b>
% GDP	-5.5	-2.7	-1.8	-2.6	-2.1	-2.4	-2.0
1. Trade Balance	-632	1,888	1,197	3,961	4,876	4,268	6,199
a. Exports	7,756	37,020	10,190	41,807	42,611	43,930	45,409
b. Imports	-8,387	-35,132	-8,993	-37,846	-37,736	-39,662	-39,209
2. Services	-488	-1,974	-206	-1,928	-1,674	-2,124	-2,377
3. Investment income	-2,305	-9,184	-2,835	-11,196	-11,394	-11,264	-12,031
4. Current transfers	1,000	3,967	958	3,598	3,665	3,672	3,717
Of which: Remittances	672	2,884	706	2,981	2,979	3,024	3,134
<b>II. FINANCIAL ACCOUNT</b>	<b>1,955</b>	<b>5,472</b>	<b>1,515</b>	<b>6,865</b>	<b>6,354</b>	<b>7,147</b>	<b>6,491</b>
Of which:							
1. Private Sector	262	2,815	638	3,040	959	5,038	3,617
a. Long-term	-214	3,709	42	3,040	1,479	5,038	3,617
b. Short-term	476	-894	596	0	-520	0	0
2. Public Sector	1,693	2,657	877	3,825	5,395	2,109	2,874
<b>III. BALANCE OF PAYMENTS (=I+II)</b>	<b>-470</b>	<b>168</b>	<b>629</b>	<b>1,300</b>	<b>1,827</b>	<b>1,700</b>	<b>2,000</b>
Memo:							
Long-term external financing of the private sector (% GDP)	4.8	4.6	4.7	4.0	3.7	4.3	3.8

\* Forecast.  
IR: Inflation Report.

GDP AND DOMESTIC DEMAND (Real % change)							
	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
<b>I. Domestic demand</b>	<b>1.8</b>	<b>0.9</b>	<b>-1.1</b>	<b>3.3</b>	<b>1.9</b>	<b>3.7</b>	<b>4.0</b>
<b>1. Private expenditure</b>	<b>-0.4</b>	<b>1.2</b>	<b>0.6</b>	<b>2.9</b>	<b>1.6</b>	<b>3.8</b>	<b>3.5</b>
Consumption	3.8	3.4	2.2	3.1	2.5	3.4	3.0
Private fixed investment	-4.7	-5.7	-5.6	2.5	-1.8	5.3	5.3
Change on inventories (contribution)	-1.9	0.0	0.1	0.0	0.0	0.0	0.0
<b>2. Public expenditure</b>	<b>16.7</b>	<b>-0.2</b>	<b>-11.0</b>	<b>5.4</b>	<b>3.6</b>	<b>3.0</b>	<b>6.5</b>
Consumption	12.8	-0.5	-9.5	3.2	2.3	2.2	3.0
Investment	31.8	0.6	-16.0	11.0	7.0	5.0	15.0
General government	17.1	-3.3	-12.8	15.7	11.1	5.2	16.3
Public entities	132.4	30.0	-27.0	-16.6	-15.7	3.4	5.4
<b>II. Net external demand</b>							
<b>1. Exports</b>	<b>8.5</b>	<b>9.5</b>	<b>12.8</b>	<b>4.2</b>	<b>5.9</b>	<b>5.0</b>	<b>4.4</b>
<b>2. Imports</b>	<b>-2.0</b>	<b>-2.2</b>	<b>0.2</b>	<b>3.2</b>	<b>2.9</b>	<b>3.4</b>	<b>3.5</b>
<b>III. GDP</b>	<b>4.5</b>	<b>3.9</b>	<b>2.1</b>	<b>3.5</b>	<b>2.8</b>	<b>4.1</b>	<b>4.2</b>
Memo: Public expenditure (contribution)	2.2	0.0	-1.6	0.9	0.6	0.5	1.1

\* Forecast.  
IR: Inflation Report.



domestic demand fell 1.1 percent, while exports grew 12.8 percent, driven by increased volumes of exports of traditional goods and services.

The forecasts for 2017 and 2018 consider a recovery of public and private investment in the second half of the year, in line with the unlock and resumption of investment projects and the gradual increase in spending associated with the reconstruction of the damages caused by El Niño Costero. This gradual increase of spending would intensify during 2018. Therefore, taking into account the pace of growth registered in the first months of the year, the growth forecast for 2017 has been revised down from 3.5 to 2.8 percent, whereas the growth forecast for 2018 has been revised up from 4.1 to 4.2 percent.

Even though expenditure has been falling during the first months of the year, especially in the case of the national government expenditure, at May the **fiscal deficit** accumulated in the last 12 months was 2.7 percent of GDP, slightly higher than the deficit recorded in December 2016 (2.6 percent of GDP). This reduction in spending has not implied a reduction in the deficit due to the fall observed in revenue, especially due to the decline of revenues from the income tax and due to the increase recorded in tax rebates.

A gradual recovery is expected in spending in the following quarters of the year, although this recovery would show a slower pace than expected in the March Report. In addition, tax revenue would also reflect the effect of lower growth and higher tax rebates. Because of this, the fiscal deficits forecast for 2017 and 2018 have been raised to 3.0 and 3.5 percent of GDP (from 2.8 to 2.6 percent of GDP in our previous report). Moreover, this is in line with Bill 1318 proposed by the Executive which raises by 3.2 percentage points of GDP the trajectory of the fiscal deficit in the 2017-2020 period.

The fiscal position, measured by the weighted impulse indicator, would go from a contractionary stance in 2016 to an expansionary stance in both 2017 and 2018.

Decreasing since April, inflation recorded an annual rate of 3.04 percent in May, the lowest rate observed since August 2016 and close to the upper band of the target range. Moreover, expectations of inflation in 12 months, which show more moderate levels, are again within the target range. These results show that the price shock caused by El Niño Costero would be subsiding quickly due to the normalization of conditions of food transportation and food supply. In this context, in May the Board of BCRP lowered its **benchmark interest**

rate by 25 basis points, from 4.25 percent (where it remained since March 2016) to 4.0 percent. The Board also reiterated that it oversees inflation forecasts and its determinants to consider further adjustments in the benchmark interest rate.

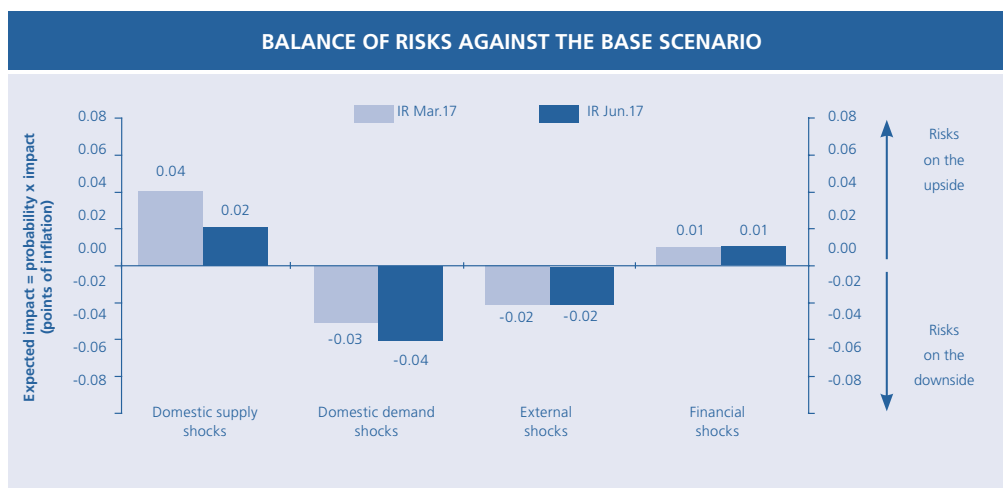
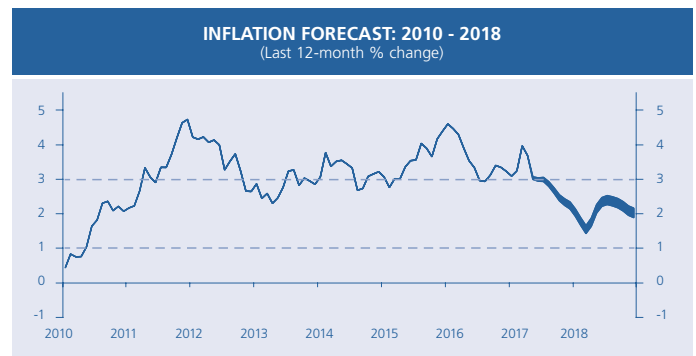
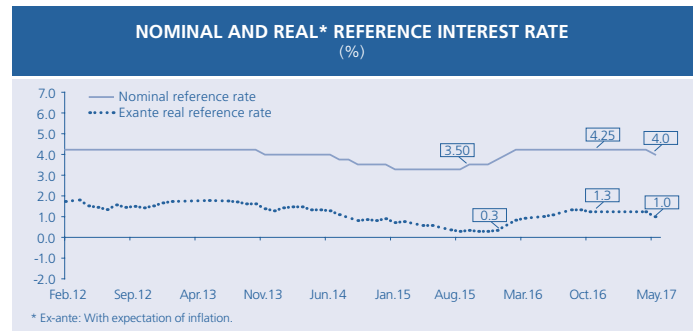
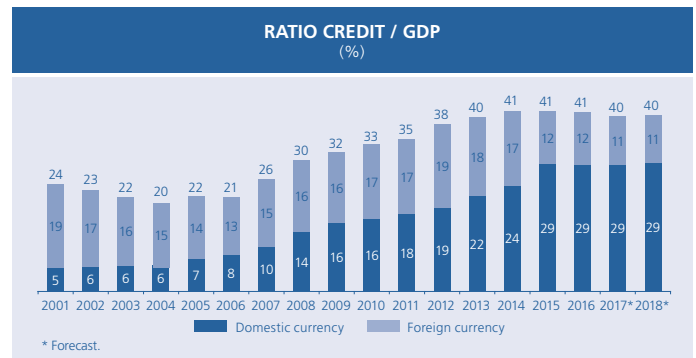
Isolating the expected inflation rate, the monetary policy interest rate has remained below 2 percent, in line with an expansionary monetary policy stance that takes into account inflation's convergence to the middle of the target range (1 - 3 percent) as well as a pace of economic activity that is lower than the potential growth of the output in 2017.

**Credit to the private sector** grew 5.4 percent year on year in April, slightly less than at the end of 2016 (5.6 percent). This evolution of credit is associated with the slowdown of domestic demand (private consumption and private investment), reflected in the slowdown observed in lending to medium-sized enterprises and consumer loans via credit cards. The growth of credit to the private sector in the 2017-2018 forecast horizon is expected to be in line with the rate of growth of nominal GDP.

**Inflation** is projected to show rates around the upper band of the target range in the following months and then to show a clear declining path in the last months of the year. The forecast considers a higher-than-expected reversal in the food prices affected by El Niño Costero during the first quarter of 2017.

**Risk Balance**

The risk factors considered in this Report –supply shocks, demand shocks, greater volatility in international financial markets, and a decline in the terms of trade– have a downward bias on the inflation forecast. In other words, the impact of factors that imply a fall in prices is higher than the impact of factors that could affect inflation on the upside.



SUMMARY OF INFLATION REPORT FORECAST						
	2015	2016	2017 <sup>1/</sup>		2018 <sup>1/</sup>	
			IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
<b>Real % change</b>						
1. Gross Domestic Product	3.3	3.9	3.5	2.8	4.1	4.2
2. Domestic demand	2.9	0.9	3.3	1.9	3.7	4.0
a. Private consumption	3.4	3.4	3.1	2.5	3.4	3.0
b. Public consumption	9.8	-0.5	3.2	2.3	2.2	3.0
c. Fixed private investment	-4.4	-5.7	2.5	-1.8	5.3	5.3
d. Public investment	-9.5	0.6	11.0	7.0	5.0	15.0
3. Exports (good and services)	4.1	9.5	4.2	5.9	5.0	4.4
4. Imports (good and services)	2.4	-2.2	3.2	2.9	3.4	3.5
5. Economic growth in main trading partners	3.2	2.8	3.2	3.2	3.3	3.3
<b>Memo:</b>						
Output gap <sup>2/</sup> (%)	-1.5 ; -0.5	-1.5 ; 0.0	-1.5 ; 0.0	-1.7 ; 0.0	-1.0 ; 0.0	-1.2 ; 0.0
<b>% chg.</b>						
6. Inflation	4.4	3.2	2.0 - 2.5	2.0 - 2.5	2.0 - 2.2	2.0 - 2.2
7. Expected inflation <sup>3/</sup>	-	-	3.0	3.0	2.9	2.9
8. Expected depreciation <sup>3/</sup>	-	-	-1.5	-2.7	1.7	1.5
9. Terms of trade <sup>4/</sup>	-6.4	-0.7	5.4	5.5	-1.6	0.0
a. Export prices	-15.0	-3.6	10.0	10.2	-0.2	0.6
b. Import prices	-9.2	-3.0	4.4	4.5	1.5	0.6
<b>Nominal % chg.</b>						
10. Currency in circulation	3.8	6.5	5.0	5.0	5.9	5.9
11. Credit to the private sector <sup>5/</sup>	8.0	5.6	5.5	5.0	6.2	6.2
<b>% GDP</b>						
12. Gross fixed investment	24.3	22.6	22.2	21.6	22.5	22.3
13. Current account of the balance of payments	-4.8	-2.7	-2.6	-2.1	-2.4	-2.0
14. Trade balance	-1.5	1.0	1.9	2.3	1.9	2.7
15. Long-term external financing of the private sector <sup>6/</sup>	6.6	4.6	4.0	3.7	4.3	3.8
16. Current revenue of the general government	20.0	18.5	18.9	18.3	18.6	18.2
17. Non-financial expenditure of the general government	21.3	20.0	20.5	20.2	20.1	20.4
18. Overall balance of the non-financial public sector	-2.1	-2.6	-2.8	-3.0	-2.6	-3.5
19. Balance of total public debt	23.3	23.8	24.5	25.8	25.4	26.6
20. Balance of net public debt	6.6	8.0	9.9	10.4	12.0	13.4
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.						