INFLATION REPORT

June 2017

Recent trends and macroeconomic forecasts 2017-2018

CENTRAL RESERVE BANK OF PERU

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Recent Trends and Macroeconomic Forecasts 2017 - 2018

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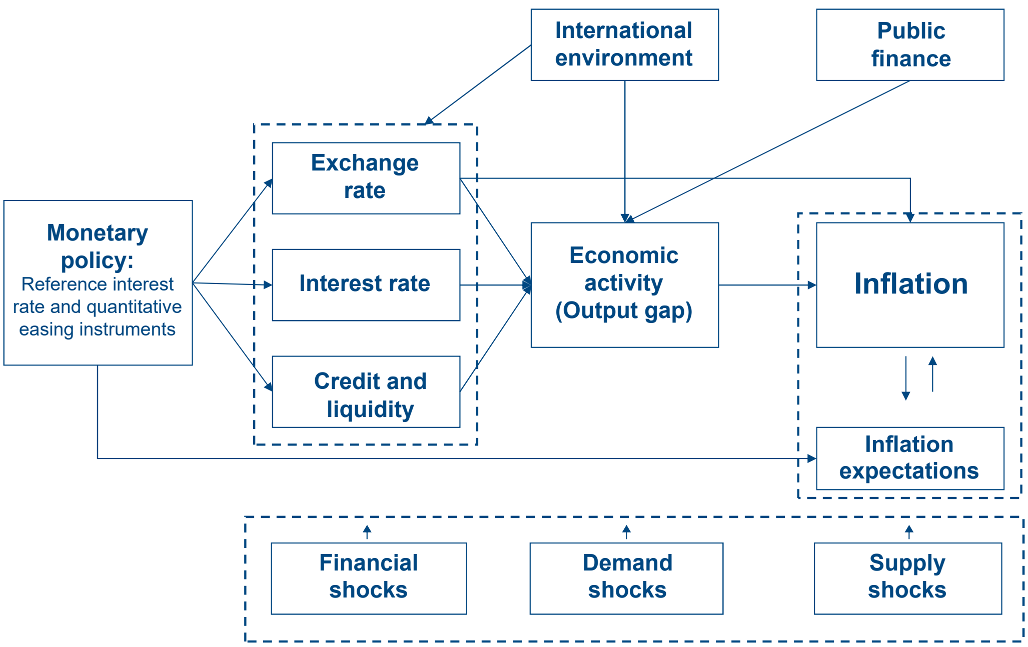

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This ***Inflation Report*** was prepared using data on the Balance of Payments and the Gross Domestic Product as of the first quarter of 2017, and data on Monetary Accounts, the operations of the Non-Financial Public Sector, Inflation, Financial Markets, and the Exchange Rate as of May 2017.

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 benchmark rate for the interbank lending market. Since this interest rate, which is the monetary operational target, affects the rate of inflation through several channels with time lags, this rate is set on the basis of inflation forecasts and forecasts of inflation determinants.

- Inflation may transitorily deviate from the target range due to shocks that may temporarily affect the supply of goods and services, such as fluctuations in the prices of imported products or domestic climate factors. It should also be pointed out that the effectiveness of monetary policy is also assessed in terms of the success in returning and maintaining inflation expectations within the target range.

- 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 and composition of 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 an analysis of the risk factors that can modify such forecasts.

- This Inflation Report was approved by the Board of Directors of BCRP on June 8, 2017.

Summary

i. 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.

ii. 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.

iii. 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, 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 the disasters generated 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.

iv. 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 path 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.

v. 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.

vi. **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.

vii. **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.

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[1/] IR Mar.17	2017[1/] IR Jun.17	2018[1/] IR Mar.17	2018[1/] IR Jun.17
Real % change							
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
Memo:							
	Output gap[2/] (%)	-1.5 ; -0.5	-1.5 ; 0.0	-1.5 ; 0.0	-1.7 ; 0.0	-1.0 ; 0.0	-1.2 ; 0.0
% change							
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[3/]	-	-	3.0	3.0	2.9	2.9
8.	Expected depreciation[3/]	-	-	-1.5	-2.7	1.7	1.5
9.	Terms of trade[4/]	-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
Nominal % change							
10.	Currency	3.8	6.5	5.0	5.0	5.9	5.9
11.	Credit to the private sector[5/]	8.0	5.6	5.5	5.0	6.2	6.2
% GDP							
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[6/]	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

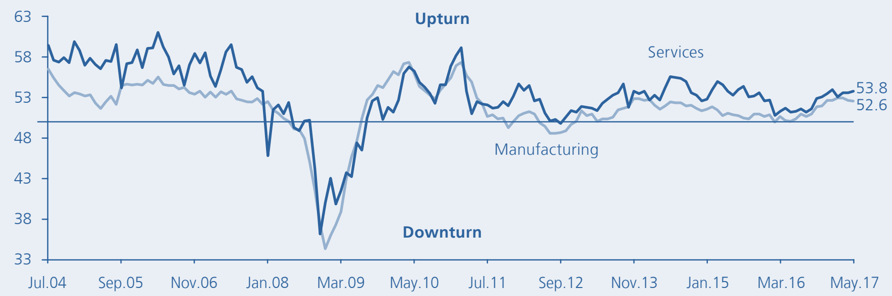
1/ Forecast.
2/ Differential between GDP and potential GDP (%).
3/ Survey on expectations to the economic agents.
4/ Average.
5/ Includes loans made by banks' branches abroad.
6/ Includes net direct investment, portfolio investment and private sector's long term disbursement.
IR: Inflation Report.

I. International environment

World economy

1. Quarterly and monthly data show that global economic activity continues to grow at moderate rates and that some economies, i.e. the Eurozone and Japan, are growing at slightly higher rates than those foreseen in our March Inflation Report. Reflecting this, both the PMI and the services indices remain in the expansion area, the performance observed in most developed economies being noteworthy.

Graph 1
JP MORGAN GLOBAL ACTIVITY INDICES



Services

	Dec.15	Mar.16	Jun.16	Sep.16	Dec.16	Mar.17	May.17
Global	**52.6**	**51.3**	**51.3**	**51.6**	**53.5**	**53.6**	**53.8**
USA	54.3	51.3	51.4	52.3	53.9	52.8	53.6
China	50.2	52.2	52.7	52.0	53.4	52.2	52.8
Eurozone	54.2	53.1	52.8	52.2	53.7	56.0	56.3
Japan	51.5	50.0	49.4	48.2	52.3	52.9	53.0

Manufacturing

	Dec.15	Mar.16	Jun.16	Sep.16	Dec.16	Mar.17	May.17
Global	**50.7**	**50.7**	**50.4**	**51.0**	**52.7**	**53.0**	**52.6**
USA	51.2	51.5	51.3	51.5	54.3	53.3	52.7
China	48.2	49.7	48.6	50.1	51.9	51.2	49.6
Eurozone	53.2	51.6	52.8	52.6	54.9	56.2	57.0
Japan	52.6	49.1	48.1	50.4	52.4	52.4	53.1

Source: Bloomberg and JP Morgan.

The world economy would grow at a slightly faster pace than projected in the March report, recording rates of 3.5 and 3.6 percent in 2017 and 2018, respectively, while the developed economies would register growth rates of 1.9 percent in both years. In addition, inflation has shown a rising trend in most cases and has therefore significantly reduced the likelihood of a deflationary scenario.

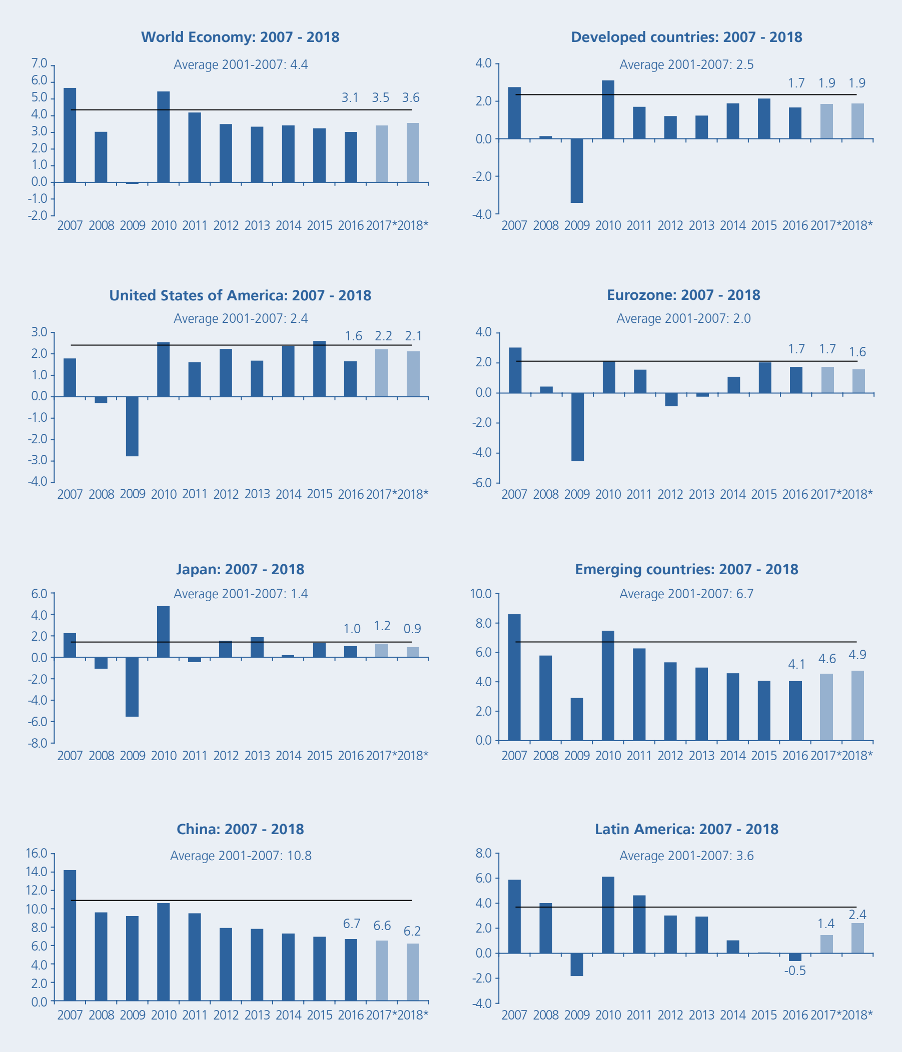
In the emerging economies, China's growth has been showing signs of a moderate slowdown from the second quarter, in line with expectations, whereas some emerging economies, on the other hand, are showing greater dynamism due to the better prices of raw materials and to the implementation of expansionary policies.

Table 1
WORLD GDP GROWTH
(Annual % change)

	PPP% 1/	Trading Peru % 1/	2016	2017* IR Mar.17	2017* IR Jun.17	2018* IR Mar.17	2018* IR Jun.17
Advanced economies	**41.9**	**47.3**	**1.7**	**1.9**	**1.9**	**1.9**	**1.9**
Of which:							
1. United States of America	15.5	18.0	1.6	2.2	2.2	2.1	2.1
2. Eurozone	11.8	11.2	1.7	1.5	1.7	1.6	1.6
Germany	3.3	2.7	1.8	1.5	1.6	1.5	1.5
France	2.3	0.7	1.2	1.2	1.3	1.5	1.5
Italy	1.9	1.7	0.9	0.8	0.8	0.9	0.9
Spain	1.4	2.6	3.2	2.2	2.6	2.1	2.1
3. Japan	4.4	3.1	1.0	1.0	1.2	0.9	0.9
4. United Kingdom	2.3	1.2	1.8	1.5	1.5	1.4	1.4
5. Canada	1.4	3.2	1.4	2.0	2.0	2.0	2.0
Emerging market and developing economies	**58.1**	**52.7**	**4.1**	**4.5**	**4.6**	**4.8**	**4.9**
Of which:							
1. Developing Asia	31.6	28.0	6.4	6.4	6.5	6.3	6.4
China	17.8	22.9	6.7	6.4	6.6	6.0	6.2
India	7.2	2.4	7.1	7.4	7.4	7.6	7.6
2. Commonwealth of Independent States	4.5	0.6	0.2	1.5	1.7	2.0	2.2
Russia	3.2	0.5	-0.2	1.2	1.4	1.6	1.7
3. Latin America and the Caribbean	7.9	21.9	-0.5	1.6	1.4	2.3	2.4
Brazil	2.6	4.5	-3.4	0.6	0.6	1.5	1.8
Chile	0.4	3.0	1.7	2.0	1.5	2.7	2.7
Colombia	0.6	2.6	1.6	2.7	1.8	3.7	3.2
Mexico	1.9	2.9	2.4	1.5	1.6	2.3	2.3
Peru	0.3	-	3.9	3.5	2.8	4.1	4.2
World Economy	**100.0**	**100.0**	**3.1**	**3.4**	**3.5**	**3.5**	**3.6**
Memo:							
Peru's trading partners 2016 2/	64.8		2.8	3.2	3.2	3.3	3.3

* Forecast.
1/ 2016.
2/ Basket of Peru's 20 main trading partners.
Source: Bloomberg. IMF. Consensus Forecast.

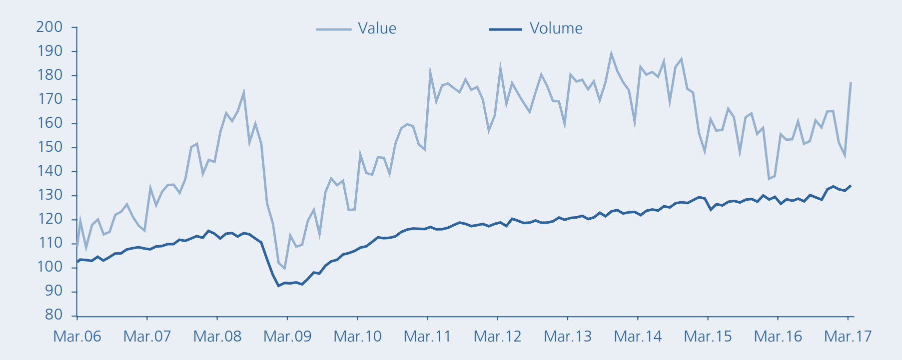
Graph 2
GDP GROWTH
(Annual % change)



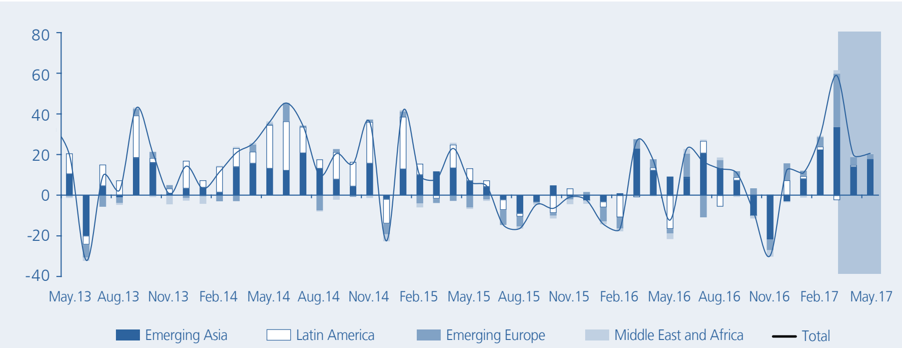
* Forecast.
Source: BCRP, IMF, and Consensus Forecast.

2. Increased volumes of trade and capital flows to the emerging economies have been reflecting favorable conditions for global growth.

Graph 3
WORLD EXPORTS: VALUE AND VOLUME
(Base index January 2006= 100)



Graph 4
TOTAL FLOWS OF NON-RESIDENT'S CAPITAL TO EMERGING COUNTRIES
(Billion US$)



Source: IIF.

3. The economy of the **United States** is estimated to grow 2.2 percent in 2017 and 2.1 percent in 2018. In recent months the U.S. economy has continued to register moderate growth rates, while the labor market has showed sound gains and inflation has remained at levels close to the 2 percent target. These results provide support to the likelihood that the Fed will continue with its cycle of gradual adjustment of rates in the second half of 2017.

   In the first quarter, the output grew 1.2 percent. This slowdown of growth in comparison with the previous quarter is explained by the slower growth observed in consumption (0.6 percent) and by a reduction of investment in inventories (which was equivalent to a contraction of 1.1 percentage points of the output). The slowdown in spending reflected transitory factors such as the low consumption of energy services due to an unusually mild winter and to the drop of car sales.

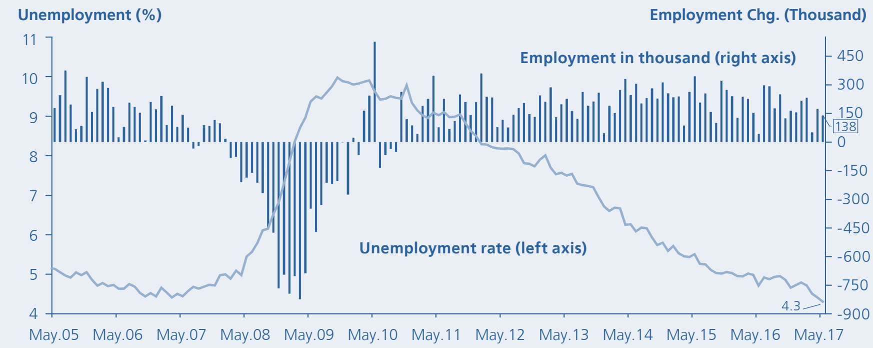
Table 2
USA: GDP
(Annual % change)

	2014	2015	2016					2017
			Q1	Q2	Q3	Q4	Year	Q1
Personal consumption	2.9	3.2	1.6	4.3	3.0	3.5	2.7	0.6
Gross fixed investment	4.5	5.0	-3.3	-7.9	3.0	9.4	-1.6	4.8
Change on inventories *	-0.1	0.2	-0.4	-1.2	0.5	1.0	-0.4	-1.1
Exports	4.3	0.1	-0.7	1.8	10.0	-4.5	0.4	5.8
Imports	4.4	4.6	-0.6	0.2	2.2	9.0	1.2	3.8
Government expenditure	-0.9	1.8	1.6	-1.7	0.8	0.2	0.8	-1.1
GDP	**2.4**	**2.6**	**0.8**	**1.4**	**3.5**	**2.1**	**1.6**	**1.2**

* In weighted contribution to growth.
Source: BEA.

This slowdown is perceived as temporary given the favorable evolution of indicators in the labor market and activity in the services sector (PMI index) during April and May. The latest report on employment showed that the labor market recorded positive job rates and tighter conditions. Year-to-date, the labor market has reached a monthly average of 162 thousand new jobs, this increase being driven by a greater demand for workers in the sectors of professional services, health care, and social care. The labor force participation rate has fallen to 62.7 percent and the rate of unemployment has fallen to 4.3 percent (its lowest level since February 2001). The average salary per hour increased by 2.5 percent in May.

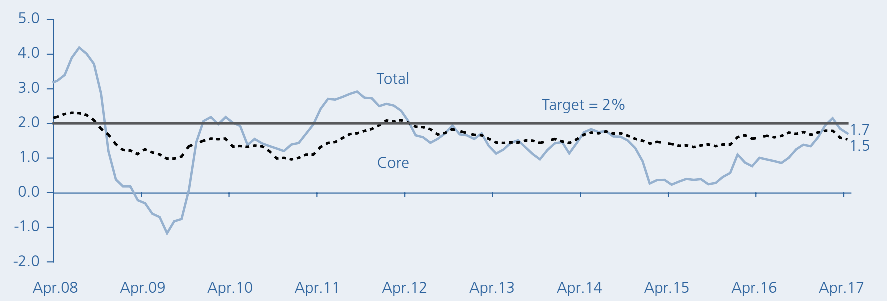
Graph 5
USA: EMPLOYMENT AND UNEMPLOYMENT RATE



Source: Bloomberg.

Moreover, personal consumption expenditures price index –or the PCE index– recorded an annual rate of 1.7 percent in April due to a positive contribution of goods and services related to energy (10.2 percent), while core PCE inflation showed an annual rate of 1.5 percent. Both measures are lower than in March (1.9 and 1.6 percent, respectively).

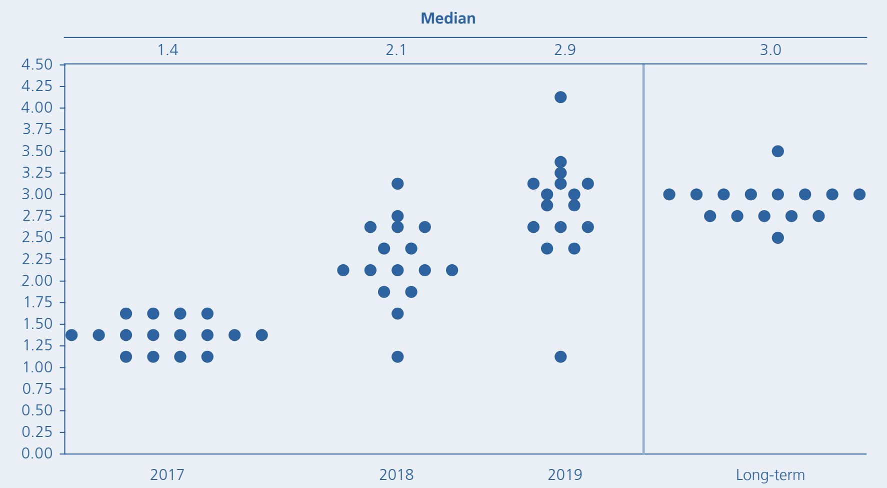
Graph 6
USA: PERSONAL CONSUMPTION EXPENDITURE (PCE)
(Annual % change)



Source: Bloomberg.

Based on these indicators, the Federal Reserve decided to raise its range of interest rates to 1.00-1.25 percent at its meeting of June 13 and 14. The projections of the Committee members showed a slight upward correction in growth rates, whereas inflation and unemployment were revised downward, in line with the latest data published. Moreover, the projected profile of interest rates showed no significant changes: a further rise is projected this year and three rate hikes are projected in each of the next two years.

Graph 7
FORECASTING FED POLICY RATE *
(%)



* Each point represents the individual forecast of the Members of the FED's Board about the median of interest rate in the range at the end-of-year.
Source: Fed.

Table 3
FED: FORECASTING*

	2017		2018		2019		Long-term	
	Mar.17	**Jun.17**	**Mar.17**	**Jun.17**	**Mar.17**	**Jun.17**	**Mar.17**	**Jun.17**
Growth	2.1	2.2	2.1	2.1	1.9	1.9	1.8	1.8
Unemployment rate	4.5	4.3	4.5	4.2	4.5	4.2	4.7	4.6
Inflation (PCE)	1.9	1.6	2.0	2.0	2.0	2.0	2.0	2.0
Core inflation (Core PCE)	1.9	1.7	2.0	2.0	2.0	2.0	-	-
Memo: Core PCE excluding food and energy.								
Interest rate (%)	1.4	1.4	2.1	2.1	3.0	2.9	3.0	3.0

* It adds data from 17 individual projections of the members of the Fed at end-of-period.

4. The growth projection for 2017 in the **Eurozone** has been revised slightly up, from 1.5 to 1.7 percent, and remains unchanged at 1.6 percent for 2018.

   As in previous quarters, growth in the union is explained by the evolution of domestic demand, which has been favored by lower levels of unemployment, the maintenance of an expansionary monetary policy, and the improvement of confidence levels in the private sector after the election results in France and the Netherlands. It is estimated that domestic demand will continue to be driven by these factors in the following quarters and that growth would tend to be more homogeneous at the level of countries and sectors.

   The risk factors in this scenario are related to the future negotiations of the Brexit, to political events (i.e. elections in Germany and Italy), and to the adjustment of banks, especially in Italy, where the banking system has been affected by high rates of non-performing loans and capitalization problems.

   Moreover, the fact that annual inflation in April registered 1.9 percent has not only reduced fears of a deflation, but has also resulted in the beginning of discussions about the process of withdrawal of monetary stimulus. In its meeting of May, the ECB decided to maintain its expansionary monetary policy.

5. After growing 1.6 percent in the fourth quarter of 2016, **Japan** recorded a GDP growth rate of 1.3 percent in the first quarter of 2017, with external demand standing out as the main source of expansion. Japan's growth projection for 2017 has been revised up, from 1.0 to 1.2 percent, whereas the growth projection for 2018 is maintained at 0.9 percent assuming that the fiscal stimulus will be withdrawn and that imports will show a recovery.

6. In **China**, the output grew 6.9 percent in the first quarter, a higher rate than in the fourth quarter of 2016 (6.8 percent). This higher growth was supported by

the momentum of public investment and, in terms of sectors, by manufacturing. Investment in fixed assets was 8.6 percent at May, slightly less than expected (8.8 percent). Retail sales grew 10.7 percent while industrial production maintained its dynamism with a growth rate of 6.5 percent. In line with these trends, the growth of China's GDP has revised been revised up to 6.6 percent in 2017 and to 6.2 percent in 2018.

Table 4
CHINA'S ECONOMIC INDICATORS

Indicators	2015				2016				2017	
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	May.
Annual GDP (Annual % change-last quarter)	7.0	7.0	6.9	6.8	6.7	6.7	6.7	6.8	6.9	-
Industrial Production (Annual % change)	5.6	6.8	5.7	5.9	6.8	6.2	6.1	6.0	7.6	6.5
Investment in fixed assets (Accum. annual % change)	13.5	11.4	10.3	10.0	10.7	9.0	8.2	8.1	9.2	8.6
Investment in infrastructure (Accum. annual % change)	23.1	19.1	18.1	17.2	19.6	20.9	19.4	17.4	23.5	20.9
Retail sales (Annual % change)	10.2	10.6	10.9	11.1	10.5	10.6	10.7	10.9	10.9	10.7
Copper imports 1/ (Volume, Accum. annual % change)	14.6	12.7	10.0	12.3	18.0	23.2	28.5	27.6	19.8	n.d.
Total new financing (Annual % change)	12.8	11.7	12.1	11.7	13.4	12.2	12.5	12.7	12.3	12.9
Consumer Price Index (Annual % change)	1.4	1.4	1.6	1.6	2.3	1.9	1.9	2.1	0.9	1.5

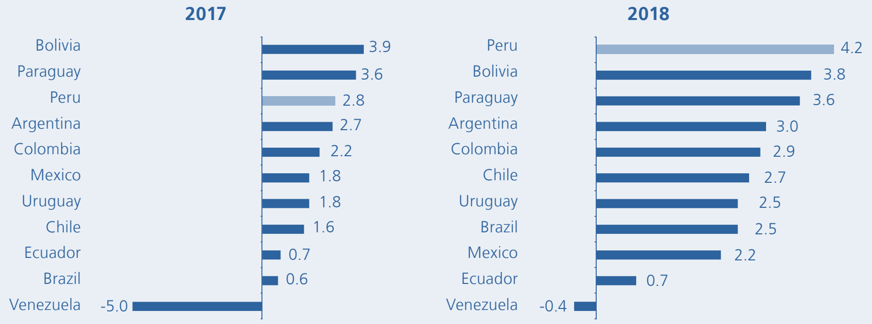
1/ Concentrated.
Source: Bloomberg and IMF.

7. Showing a recovery in comparison with the contraction of 0.5 percent they recorded in 2016, the **economies of Latin American countries** would grow 1.4 percent in 2017. Moreover, a growth rate of 2.4 percent is foreseen for 2018.

Economic activity in these countries has shown moderate and, in some cases, negative variations during the first quarter of 2017. Although the international environment has been relatively favorable, with capital inflows to the region and more stable commodity prices, growth in some countries has been limited by some domestic shocks. In **Colombia**, economic activity has been affected by the evolution of consumption, the fiscal adjustment, and in terms of sectors, by the dynamics of the industrial sector. In **Chile**, economic performance was limited by some transitory supply shocks (mining strike), the contraction of construction, and the deterioration of the labor market (which has constrained the expansion of consumption). The growth forecast for these countries in 2017 has been revised down, although a recovery is expected for the following years.

Brazil is expected to grow 0.6 percent (a similar rate was estimated in the March report). Data in recent months would be indicating that the economy would leave behind the recession experienced during 2016. On the other hand, **Mexico's** growth forecast for 2017 has been revised slightly up due to its better-than-expected economic performance and to lower external risks associated with potential protectionist measures.

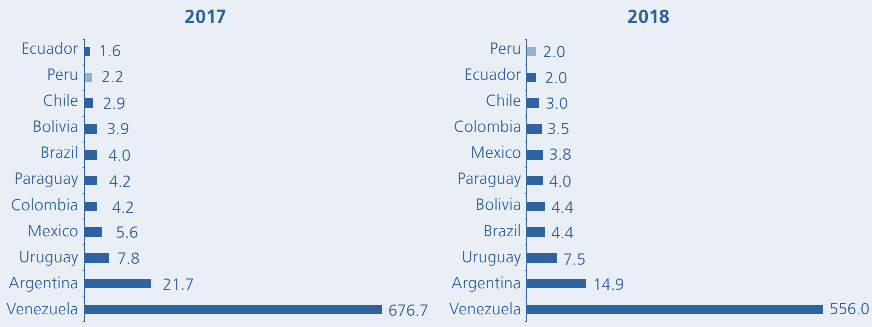
Graph 8
LATIN AMERICA: GDP GROWTH
(% change)



Source: Latin American Consensus Forecast (May 2017) and BCRP (Peru).

Inflationary pressures have decreased in recent months due to the fall of food prices, the depreciation of the dollar, and the weakness of domestic demand. These factors continue favoring inflation's convergence to the inflation targets, especially in Brazil and Colombia, the reduction of inflation and the evolution of inflation expectations having contributed to monetary policy easing in recent months. In contrast, the main upside risks for inflation in Mexico come from the liberalization of the prices of gasoline and the lag effect of the exchange rate.

Graph 9
LATIN AMERICA: INFLATION
(Dec./Dec.)



Source: Latin American Consensus Forecast (May 2017) and BCRP (Peru).

Financial Markets

8. **Variable-income markets** were driven upwards by the lower global risk aversion observed since May.

   Stock markets in the USA were favored also by mostly positive corporate results, while the European bourses were supported by a lower perception of political risks in the continent as well as by economic indicators confirming a widespread economic recovery and lower risks of a deflation.

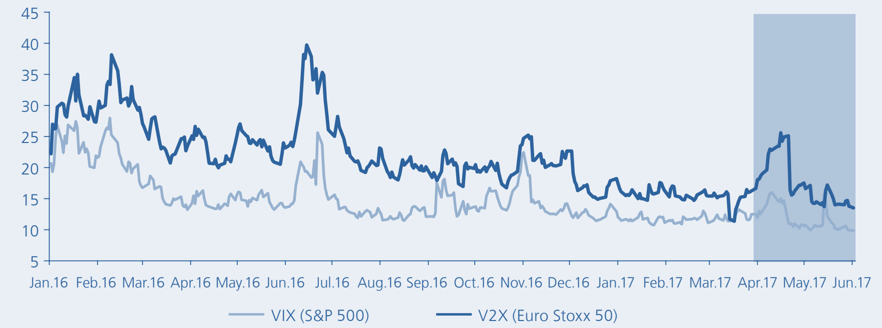
   Although most Latin America stock markets also showed this upward trend, the fall in commodity prices and political uncertainty regarding Brazil offset gains in the major markets.

Table 5
STOCK MARKETS

		Dec.16	Mar.17	Jun.17	Change (%)	
					Jun./Mar.	Jun./Dec.
VIX*	S&P 500	14.04	12.37	9.75	-2.6	-4.3
United States of America	Dow Jones	19,763	20,663	21,206	2.6	7.3
Brazil	Bovespa	60,227	64,984	62,511	-3.8	3.8
Argentina	Merval	16,918	20,265	22,519	11.1	33.1
Mexico	CPI	45,643	48,542	49,317	1.6	8.1
Chile	IGP	20,734	23,968	24,558	2.5	18.4
Colombia	IGBC	10,106	10,151	10,681	5.2	5.7
Peru	General index	15,567	15,757	15,911	1.0	2.2
United Kingdom	FTSE 100	7,143	7,323	7,548	3.1	5.7
Germany	DAX	11,481	12,313	12,823	4.1	11.7
France	CAC 40	4,862	5,123	5,343	4.3	9.9
Spain	IBEX 35	9,352	10,463	10,906	4.2	16.6
Italy	FTSE MIB	19,235	20,493	20,928	2.1	8.8
Greece	ASE	644	666	787	18.1	22.2
Switzerland	SMI	8,220	8,659	9,044	4.4	10.0
Russia	TRSI$	1,152	1,114	1,046	-6.1	-9.2
Turkey	XU100	78,139	88,947	98,868	11.2	26.5
South Africa	JSE	50,654	52,056	52,890	1.6	4.4
Nigeria	NSEAS	26,875	25,516	31,372	22.9	16.7
Japan	Nikkei 225	19,114	18,909	20,177	6.7	5.6
Indonesia	JCI	5,297	5,568	5,742	3.1	8.4
India	CNX Nifty	8,186	9,174	9,654	5.2	17.9
Hong Kong	HSI	22,001	24,112	25,924	7.5	17.8
China	Shangai C.	3,104	3,223	3,106	-3.6	0.1

* Change in percentage points.
Source: Bloomberg.

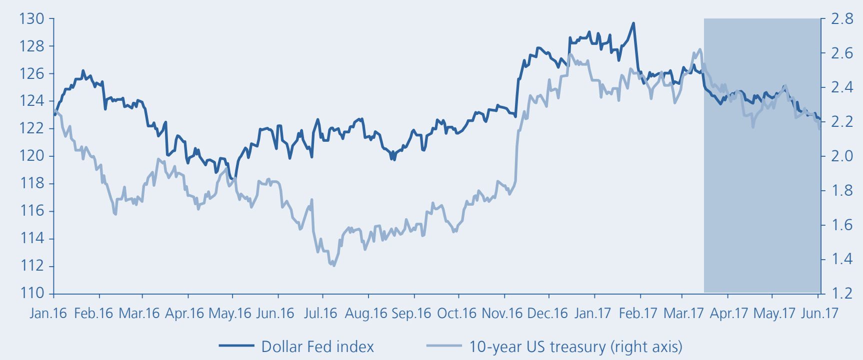
Graph 10
VOLATILITY OF STOCK INDICES: USA AND EUROPE
(January 2016 - June 2017)



Source: Bloomberg.

9. **Fixed-income markets** in the United States were affected by doubts about the capacity of the Trump administration to carry out a tax reform with little support in Congress. Moreover, some negative data of activity in USA and uncertainty about the way in which the Fed would reduce its holdings of assets in the future also contributed to this downward trend.

Graph 11
DOLLAR FED INDEX AND 10-YEAR US TREASURY YIELDS
(January 2016 - June 2017)



Source: Bloomberg and Fed.

In Europe, the sovereign bonds of Germany and the United Kingdom showed a similar behavior to the U.S. bonds, even though the results of the elections in France and the call for elections in the UK offset the fall in the yields of their sovereign securities. In addition, some Eurozone economies were favored by some specific factors (i.e. Greece was favored by progress in negotiations with creditors, while Portugal was favored by improvements in its fiscal position).

Table 6
10-YEAR TREASURY BOND YIELDS

	Dec.16	Mar.17	Jun.17	Change (bps)	
				Jun./Mar.	Jun./Dec.
United States of America	2.45	2.39	2.16	-23	-29
Germany	0.20	0.33	0.27	-5	7
France	0.68	0.97	0.71	-26	3
Italy	1.81	2.31	2.25	-6	44
Spain	1.38	1.65	1.56	-9	18
Greece	7.02	6.90	5.99	-91	-103
United Kingdom	1.24	1.14	1.04	-10	-20
Japan	0.04	0.07	0.05	-2	1
Brazil	11.40	10.06	10.84	77	-56
Colombia	7.11	6.65	6.17	-48	-93
Chile	4.28	4.03	3.93	-10	-35
Mexico	7.42	7.01	7.26	25	-16
Peru	6.36	5.78	5.44	-34	-92
South Africa	8.91	8.87	8.43	-44	-48
Israel	2.06	2.36	2.13	-22	7
Turkey	11.08	10.65	10.06	-59	-103
China	3.06	3.29	3.64	34	58
South Korea	2.07	2.19	2.20	1	13
Indonesia	7.91	7.02	6.93	-9	-98
Thailand	2.65	2.69	2.57	-11	-8
Malaysia	4.19	4.14	3.88	-26	-31
Philippines	4.63	5.06	4.73	-33	10

Source: Bloomberg.

10. Since March, when our last Inflation Report was published, the **dollar** (U.S. Dollar Index) has weakened by 3.6 percent, reflecting uncertainty about fiscal policy in the United States, among other factors. The behavior of the dollar has not been homogeneous, however: while the dollar has depreciated against most major currencies, it has strengthened against the currencies of the emerging market economies. It is worth pointing out that no significant changes have been observed in terms of expectations of rises in the Fed rates in recent months. The consensus is still that three rate rises should be expected during 2017 and the attention is focused on the measures relating to the reduction of the Federal Reserve balance sheet.

    The depreciation of the dollar against the euro stands out in terms of the currencies of the developed countries. The dollar weakened since the second week of May, influenced by the election results in France and the progress achieved in the negotiations between Greece and its creditors, and it weakened further thereafter due to the political events observed in the United States due to the controversy about the links between members of the Government and Russia. Moreover, the dollar showed a lower depreciation against the pound and the yen (3.2 and 1.3 percent, respectively).

    On the other hand, the dollar strengthened against the currencies of several emerging market countries. Latin American currencies were affected by the fall in the prices of most commodities as well as by the political events observed in Brazil, the depreciation of the real (3.1 percent) standing out.

Table 7
EXCHANGE RATE

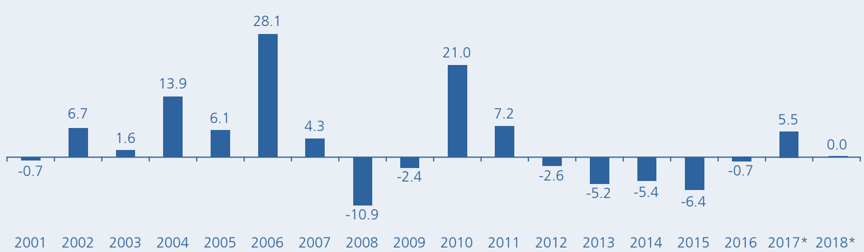
		Dec.16	Mar.17	Jun.17	Change (%)*	
					Jun./Mar.	Jun./Dec.
Dollar Index	US Dollar Index	102.21	100.41	96.72	-3.7	-5.4
Euro	Euro	0.951	0.937	0.887	-5.4	-6.8
Japan	Yen	116.92	111.94	110.43	-1.3	-5.6
United Kingdom	US$ per Pound	0.811	0.802	0.776	-3.2	-4.2
Brazil	Real	3.256	3.151	3.250	3.1	-0.2
Chile	Peso	670	664	671	1.1	0.1
Colombia	Peso	3,003	2,888	2,898	0.3	-3.5
Mexico	Peso	20.74	18.72	18.69	-0.2	-9.9
Peru	Sol	3.36	3.26	3.28	0.6	-2.4
Israel	Shekel	3.86	3.63	3.55	-2.3	-8.1
South Africa	Rand	13.75	13.30	12.83	-3.6	-6.7
Turkey	Lira	3.53	3.65	3.51	-3.9	-0.5
China	Yuan	6.95	6.89	6.81	-1.1	-1.9
Philippines	Peso	49.64	50.22	49.37	-1.7	-0.5
Indonesia	Rupee	13,455	13,330	13,295	-0.3	-1.2
Malaysia	Ringgit	4.49	4.42	4.28	-3.2	-4.6
Thailand	Bath	35.86	34.46	34.06	-1.2	-5.0

* Increase in the index means an US dollar appreciation.
Source: Reuters and Bloomberg

Terms of Trade

11. Showing a similar increase to that foreseen in the March report, the terms of trade of Peru's foreign trade are expected to increase 5.5 percent in 2017. The price of exports would increase 10.2 percent, while the price of imports would increase 4.5 percent.

Graph 12
TERMS OF TRADE: 2001 - 2018
(Annual average % change)



* Forecast.
Source: BCRP.

Even though the projections of some basic metals have been revised slightly down in line with a less tight market, the price of gold projected has been revised on the upside due to the weakening of the dollar, lower risks of deflation in the developed economies, and geopolitical tensions. On the side of imports, the price of oil has been revised slightly down. In 2018 the terms of trade would show the same levels as those observed in 2017.

Table 8
TERMS OF TRADE: 2014 - 2018
(Annual average data)

	Executed	2017*		2018*	
	2016	IR Mar.	IR Jun.	IR Mar.	IR Jun.
Terms of Trade (Annual % chg.)	**-0.7**	**5.4**	**5.5**	**-1.6**	**0.0**
Price of exports (Annual % chg.)	**-3.6**	**10.0**	**10.2**	**-0.2**	**0.6**
Copper (US$ cents per pound)	*221*	*264*	*259*	*264*	*262*
Zinc (US$ cents per pound)	*95*	*126*	*121*	*122*	*119*
Lead (US$ cents per pound)	*85*	*103*	*100*	*100*	*100*
Gold (US$ per troy ounce)	*1,248*	*1,217*	*1,242*	*1,210*	*1,258*
Price of imports (Annual % chg.)	**-3.0**	**4.4**	**4.5**	**1.5**	**0.6**
Oil (US$ per barrel)	*43*	*52*	*51*	*53*	*51*
Wheat (US$ per ton)	*143*	*171*	*146*	*192*	*167*
Maize (US$ per ton)	*135*	*148*	*143*	*158*	*158*
Soybean oil (US$ per ton)	*696*	*728*	*710*	*744*	*740*
Whole milk (US$ per ton)	*2,471*	*3,310*	*3,118*	*3,252*	*3,111*

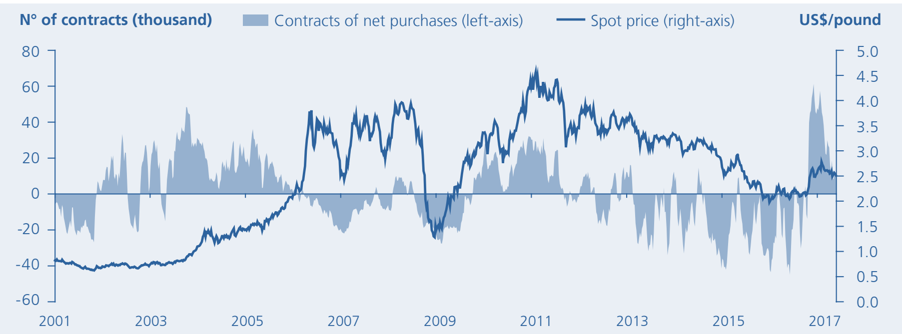
* Forecast.
Source: BCRP.

Copper

The price of copper fell 0.9 percent in the first five months of the year, reaching a monthly average of US$. 2.54 a pound in May. The price of copper has been falling since February, when copper was quoted at its peak level in the year (US$ 2.70 the pound) as a result of unforeseen production cuts.

The recent downward pressures are explained by changes in expectations about China's demand, although imports of refined copper of this country have moderated its pace of decline in May. In addition, a withdrawal of investors has been observed: non-commercial positions, which recorded an all-time high in December 2016, have been declining in response to expectations that the Federal Reserve will continue with its cycle of rate adjustments.

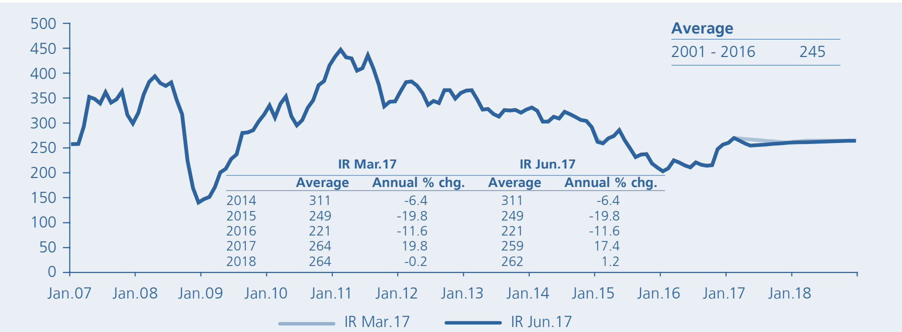
Graph 13
COPPER: NON-COMMERCIAL CONTRACTS



Source: Bloomberg.

The average price of copper is estimated to have grown 17.4 percent between 2016 and 2017, while between 2017 and 2018 it would grow 1.2 percent. The projection of the price of copper has been revised down from our previous report to 19.8 percent this year.

Graph 14
COPPER: JANUARY 2007 - DECEMBER 2018
(US$ cents/pd.)



Source: Bloomberg and BCRP.

Zinc

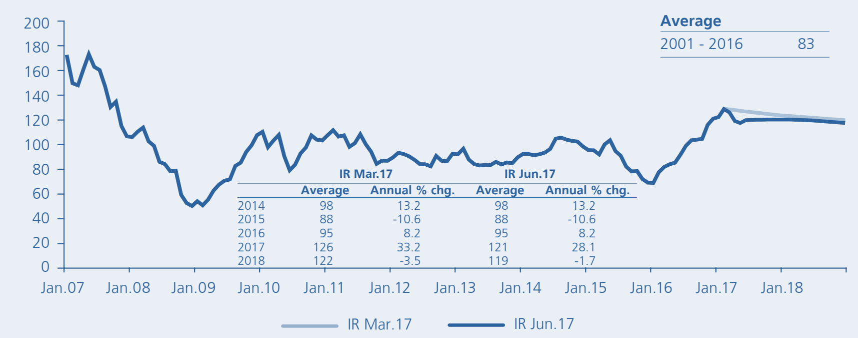
The average price of zinc fell 2.9 percent in the first five months of the year. After recording a maximum price of US$ 1.29 per pound in February –favored by a tight supply–, the price of zinc has dropped in the past three months and recorded a monthly average price of US$ 1.18 per pound in May. The recent decline in the price of zinc is explained by:

(i) A higher-than-expected supply of concentrate zinc in the first quarter and in the rest of the year, according to the International Zinc and Lead Study Group, among other sources), and

(ii) The emergence of hidden inventories that have eased the deficit in the global market of refined zinc.

The average price of zinc would show an increase of 28.1 percent in 2017 and a drop of 1.7 percent in 2018.

Graph 15
ZINC: JANUARY 2007 - DECEMBER 2018
(US$ cents/pd.)



Average	
2001 - 2016	83

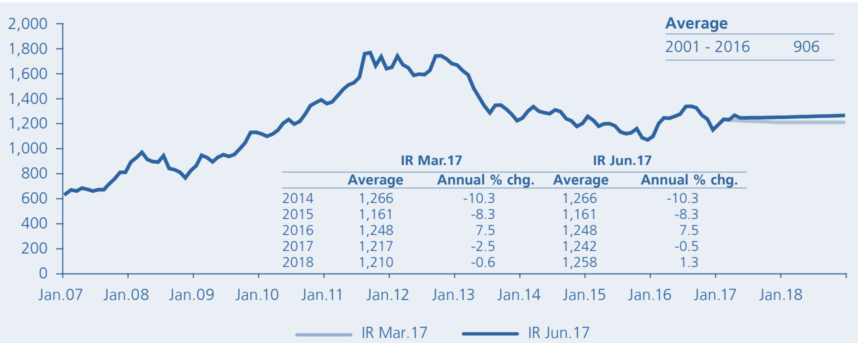
	IR Mar.17		IR Jun.17	
	Average	Annual % chg.	Average	Annual % chg.
2014	98	13.2	98	13.2
2015	88	-10.6	88	-10.6
2016	95	8.2	95	8.2
2017	126	33.2	121	28.1
2018	122	-3.5	119	-1.7

Source: Bloomberg and BCRP.

Gold

The price of gold increased 8.5 percent in the first five months of 2017 and reached an average monthly price of US$ 1,247 per troy ounce in May, but showed high volatility during this period. Gold registered a maximum price of US$/oz.tr 1,266 in April (in response to geopolitical events) and a significant correction in May, in line with the reduction of risk aversion.

Graph 16
GOLD: JANUARY 2007 - DECEMBER 2018
(US$/tr.oz.)



Average	
2001 - 2016	906

	IR Mar.17		IR Jun.17	
	Average	Annual % chg.	Average	Annual % chg.
2014	1,266	-10.3	1,266	-10.3
2015	1,161	-8.3	1,161	-8.3
2016	1,248	7.5	1,248	7.5
2017	1,217	-2.5	1,242	-0.5
2018	1,210	-0.6	1,258	1.3

Source: Bloomberg and BCRP.

The price of gold has been revised upwards due to its recent evolution and due to expectations of a gradual adjustment of the Fed interest rates.

Crude Oil

The price of **WTI oil** dropped 6.5 percent in the first five months of 2017, recording a monthly average price of US$ 49 a barrel in May. The price fall materialized in the past three months after reaching a maximum level of US$ 53 per barrel in February.

The drop in the price of crude oil was associated with growing concerns that the increase in the production of crude in the United States would offset the OPEC efforts to balance the global oil market. Oil production in the United States continued to increase during the year, reaching its highest level in nearly two years at the beginning of May. Together with the period with the lower seasonal demand in the first quarter, this generated an increase in inventories that reached record levels at the end of March. Furthermore, the oil production of Libya and Nigeria began to recover after the unplanned cuts these countries faced since the beginning of the year.

The price of WTI oil projected for the forecast horizon has been revised slightly down from the price estimated in the previous Inflation Report. The lower production costs of shale oil have continued to rise crude oil production in United States despite the fall in the global price of oil.

Graph 17
WTI OIL: JANUARY 2007 - DECEMBER 2018
(US$/bl)

Source: Bloomberg and BCRP.

Maize

In May, the average international price of **maize** increased 3 percent compared to December 2016 and reached a monthly average price of US$ 135 per ton.

The price of maize has been rising so far this year, supported by a global consumption that shows record levels in the current 2016-17 crop year. Important factors supporting this trend have been the strong growth in the demand for ethanol and the increased demand for maize as food for livestock. In addition to this, the bullish behavior of the price was reinforced by the first estimate of the U.S. Department of Agriculture (USDA) for the 2017-18 crop year, which reported lower world production and lower production in the United States, as well as lower inventories. The rise was offset by uncertainty about the possible renegotiation of the North American Free Trade Agreement –Mexico is the main importer of corn from the United States– and by the favorable outlook for harvests in Argentina and Brazil.

Graph 18
MAIZE: JANUARY 2007 - DECEMBER 2018
(US$/MT)

	IR Mar.17		IR Jun.17	
	Average	Annual % chg.	Average	Annual % chg.
2014	155	-33.9	155	-33.9
2015	141	-9.4	141	-9.4
2016	135	-4.3	135	-4.3
2017	148	9.9	143	6.2
2018	158	7.1	158	10.8

Source: Bloomberg and BCRP.

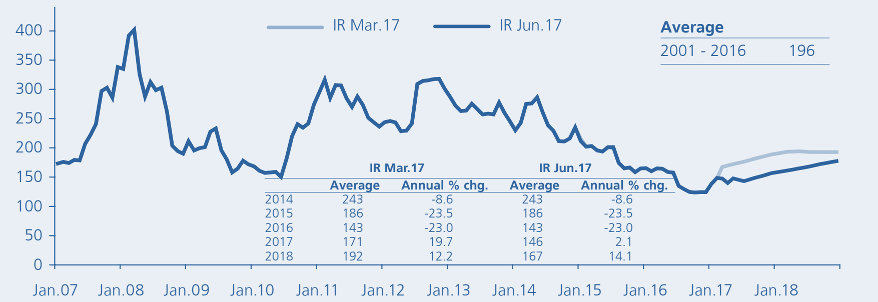
In line with these recent developments, it is estimated that the average price of maize will increase in 2017, but at a lower rate than anticipated in the March Inflation Report. The global production of maize is estimated to decrease in the following 2017-18 crop year due mainly to lower harvests in the United States, offset in part by increased production in the southern hemisphere, particularly in Brazil and Argentina.

Wheat

At May, the international price of **wheat** shows an increase of 19 percent compared to December 2016 and an average level of US$ 147 per ton, which means that the monthly average price of wheat has reversed in part the drop of 23.0 percent it accumulated in 2016.

The price of wheat rose in response to signals pointing to a sharp downturn in its new production cycle in the United States. The first estimate of the USDA for the 2017-18 crop year was that wheat production in the USA would drop by 21 percent, while the Chinese demand would remain relatively stable after declining marginally.

Graph 19
WHEAT: JANUARY 2007 - DECEMBER 2018
(US$/MT)



Source: Bloomberg and BCRP.

The price of wheat is estimated to increase in the forecast horizon, even though it would show lower levels than those foreseen in the previous report. Global inventories would reach their peak level in this 2016-17 crop year and would start declining thereafter in the 2017-18 crop year. Different estimates agree that there will be a reduction in wheat production in the United States in the following 2017-18 crop year.

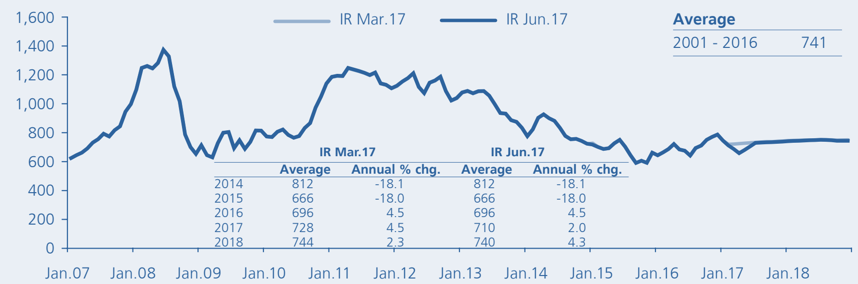
Soybean Oil

Reversing in part the rising trend it showed in 2016 when the average monthly price of soybean accumulated an increase of 19 percent, in May the average price of soybean oil was US$ 674 per ton, 14 percent lower than the average price in December 2016.

The drop in the price of soybean oil is explained by the fact that the production of palm oil (substitute product) started to recover and also by the high inventories of soybean in the United States, which recorded levels not seen since the 2006-07 crop year. Other factors that added on to this were the increased harvest levels projected in Brazil and Argentina as well as the abundant supply of soybean oil in Argentina and the United States resulting from the moderate demand for soya from oil producers, particularly for edible uses.

Because of these reasons, the price of soybean oil in the forecast horizon is expected to be lower than that estimated in our previous report, the increased supply of palm oil after its production recovered and the weak demand for soybean in the United States supporting this projection.

Graph 20
SOYBEAN OIL: JANUARY 2007 - DECEMBER 2018
(US$/MT)



	IR Mar.17		IR Jun.17	
	Average	Annual % chg.	Average	Annual % chg.
2014	812	-18.1	812	-18.1
2015	666	-18.0	666	-18.0
2016	696	4.5	696	4.5
2017	728	4.5	710	2.0
2018	744	2.3	740	4.3

Source: Bloomberg and BCRP.

II. Balance of Payments

Current Account

12. The deficit in the **current account of the balance of payments** showed a significant reduction declining from 5.5 percent of GDP in the first half of 2016 to 1.8 percent of GDP in the same period of 2017, due mainly to the increase observed in the prices and volumes of traditional exports, particularly copper.

    The scenario considered in this report considers also the positive impact resulting from increased exports of fishmeal, given that the quota for the first fishing season of anchovy has already been announced. In line with this, the projected balance in the current account has been revised from -2.6 to -2.1 percent of GDP in 2017 and from -2.4 to -2.0 percent of GDP in 2018.

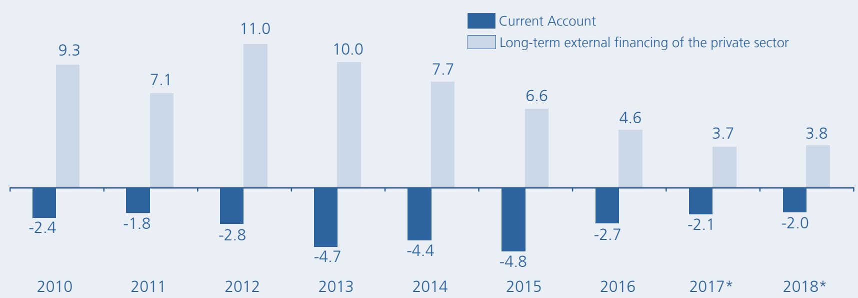
Table 9
BALANCE OF PAYMENTS
(Million US$)

	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
I. CURRENT ACCOUNT BALANCE	**-2,425**	**-5,303**	**-887**	**-5,565**	**-4,527**	**-5,447**	**-4,491**
% 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
II. FINANCIAL ACCOUNT	**1,955**	**5,472**	**1,515**	**6,865**	**6,354**	**7,147**	**6,491**
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
III. BALANCE OF PAYMENTS (=I+II)	**-470**	**168**	**629**	**1,300**	**1,827**	**1,700**	**2,000**
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.

It is estimated that long term private external capital will continue to be the main source of financing the balance of payments and that they would amount to 3.7 and 3.8 percent of GDP in 2017 and 2018, respectively, exceeding largely the current account requirements for this period.

Graph 21
CURRENT ACCOUNT AND LONG-TERM EXTERNAL FINANCING OF THE PRIVATE SECTOR: 2010-2018 1/
(% GDP)



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

Trade Balance

13. After recording an accumulated deficit of US$ 0.6 billion in the first quarter of 2016, the trade balance showed a surplus of US$ 1.2 billion in the same period of 2017. This reversal of the deficit is explained mostly by increased exports of traditional products. The projected trade balance for 2017 has been raised from US$ 4.0 to US$ 4.9 billion and the projection for 2018 has been raised from US$ 4.3 to US$ 6.2 billion.

Table 10
TRADE BALANCE
(Million US$)

	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
EXPORTS	**7,756**	**37,020**	**10,190**	**41,807**	**42,611**	**43,930**	**45,409**
Of which:							
Traditional products	5,258	26,137	7,504	30,657	31,015	32,086	33,297
Non-traditional products	2,478	10,782	2,652	11,043	11,483	11,731	11,993
IMPORTS	**8,387**	**35,132**	**8,993**	**37,846**	**37,736**	**39,662**	**39,209**
Of which:							
Consumer goods	2,044	8,614	2,086	9,039	9,185	9,199	9,414
Inputs	3,479	15,140	4,336	16,541	17,082	17,422	17,700
Capital goods	2,746	11,113	2,524	12,068	11,271	12,835	11,889
TRADE BALANCE	**-632**	**1,888**	**1,197**	**3,961**	**4,876**	**4,268**	**6,199**

* Forecast.
IR: Inflation Report.

Contrasting with the forecast of the March report, on the side of exports, the new projection considers that exports from the fishing sector would be favored by the recovery of the anchovy biomass in a context of normalization of sea temperatures. On the side of imports, on the other hand, imports would grow at rates below those considered in the previous report, in line with a more moderate growth of domestic demand.

The growth of exports in 2017 (15.1 percent) would be based on higher prices (10.2 percent), while in 2018 (6.6 percent), it would be based on higher volumes (5.9 percent).

Table 11
TRADE BALANCE
(% change)

	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
1. VALUE:							
Exports	-5.0	7.6	31.4	13.5	15.1	5.1	6.6
Traditional products	-2.2	11.5	42.7	17.9	18.7	4.7	7.4
Non-traditional products	-10.0	-1.0	7.0	2.9	6.5	6.2	4.4
Imports	-9.4	-5.9	7.2	7.8	7.4	4.8	3.9
2. VOLUME:							
Exports	8.8	11.6	11.3	3.2	4.4	5.2	5.9
Traditional products	17.9	16.6	14.7	3.3	4.7	5.7	7.2
Non-traditional products	-7.9	0.9	2.3	2.9	3.6	4.3	2.7
Imports	-2.9	-3.0	-0.1	3.1	2.8	3.3	3.3
3. PRICE:							
Exports	-12.5	-3.6	18.0	10.0	10.2	-0.2	0.6
Traditional products	-17.0	-4.3	24.4	14.2	13.3	-1.1	0.2
Non-traditional products	-2.4	-1.9	4.6	0.0	2.8	1.8	1.7
Imports	-6.7	-3.0	7.3	4.4	4.5	1.5	0.6

* Forecast.
IR: Inflation Report.

External Financing

14. In the first quarter of 2017 the net flow of private capital amounted to US$ 638 million, a sum US$ 376 million higher than that recorded in the same period of 2016, with higher reinvestment of mining profits accounting for this increase.

    In 2017, external financing to the private sector would be lower than estimated in the March report due to the financial and non-financial sectors' lower requirements of long-term net borrowing, explained by a lower demand for investment. In this scenario, most financing would be in the form of foreign direct investment through the reinvestment of profits. The forecast for 2018 considers that this trend would continue in this year.

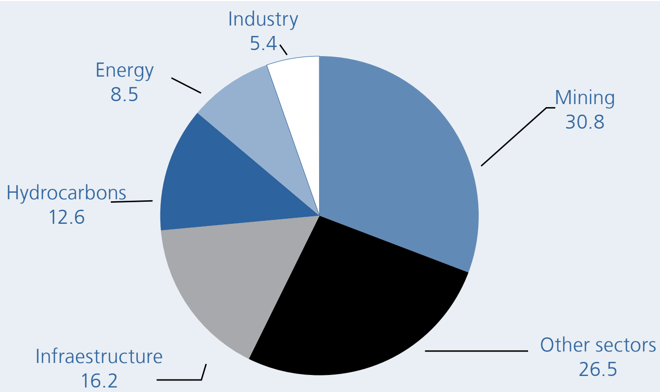
Table 12
FINANCIAL ACCOUNT OF THE PRIVATE SECTOR
(Million US$)

	2016		2017*			2018*	
	Q1	**Year**	**Q1**	**IR Mar.17**	**IR Jun.17**	**IR Mar.17**	**IR Jun.17**
PRIVATE SECTOR (A + B)	**262**	**2,815**	**638**	**3,040**	**959**	**5,038**	**3,617**
% GDP	*0.1*	*1.4*	*1.3*	*1.4*	*0.4*	*2.2*	*1.6*
A. LONG-TERM	**-214**	**3,709**	**42**	**3,040**	**1,479**	**5,038**	**3,617**
1. Assets	**-1,235**	**-966**	**-849**	**-1,760**	**-1,730**	**-1,783**	**-1,998**
2. Liabilities	**1,021**	**4,675**	**891**	**4,800**	**3,209**	**6,822**	**5,616**
Foreign direct investment in the country	1,276	6,863	2,051	5,204	6,100	5,723	6,109
Non-financial sector	308	-408	-268	846	-412	1,824	331
Long-term loans	262	15	-293	235	-796	648	-445
Portfolio investment	46	-423	25	610	384	1,176	776
Financial sector	-563	-1,771	-892	-1,250	-2,479	-726	-824
Long-term loans	-563	-1,698	-874	-1,311	-2,068	-776	-473
Portfolio investment	0	-73	-18	61	-411	50	-351
B. SHORT-TERM[1/]	**476**	**-894**	**596**	**0**	**-520**	**0**	**0**

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

According to the announcements of private investment projects to be carried out, all of which have an important component of external financing, the major projects will be implemented in the sectors of mining (31 percent of the sample), hydrocarbons (13 percent), and infrastructure (16 percent).

Graph 22
FORESEEN INVESTMENT PROJECTS: 2017-2018
(% share)



Source: Companies and media press.

Investment in **mining projects** in the next two years has been revised down due to the postponement of decisions regarding the start of construction of projects such as Quellaveco, Mina Justa, and San Gabriel, which imply an overall investment of around US$ 5.1 billion.

However, the construction of the expansion project of mine Toquepala, with a total investment is US$ 1.2 billion, is expected to continue. It should be pointed out that in the first quarter of this year, Southern reported that 58 percent of the construction of this project had been carried out with an accumulated investment of US$ 623 million and that it is estimated that the project will be completed in the second quarter of 2018.

In the **hydrocarbons sector**, Repsol would invest US$ 300 million in Lot 57 this year, in the construction of a gas compression plant, new transport pipelines, and in reactivating the well Sagari 4X.

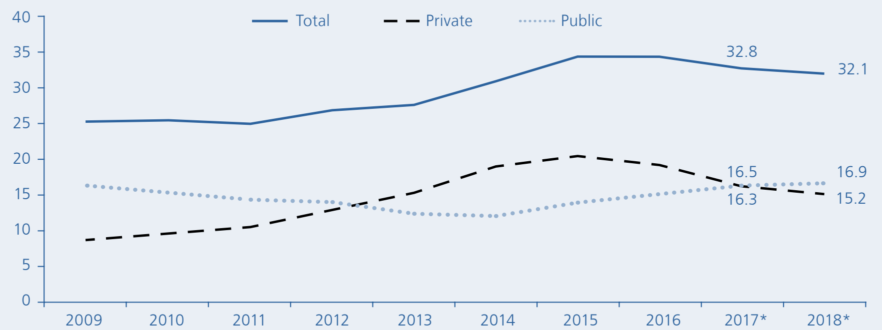
Projects in the **energy sector**, such as the thermal power station of Santo Domingo de los Olleros (combined cycle) and Central Termoeléctrica Pacífico Sur are expected to begin commercial operations in 2018.

15. The **financial account of the public sector** would show positive flows in 2017 and 2018 taking into account the funding obtained through issuance of bonds and the long-term loans that Petroperu would receive to develop the Talara Refinery. Moreover, the projection assumes a greater demand for sovereign bonds of non-residents, as a result of which the demand would grow from 37 percent in December 2016 to almost 42 percent at the end of 2017.

The total external debt has recently been reflecting the evolution of the private component, which at end 2016 rose to 19.4 percent of GDP, while the public component was equivalent to 15.2 percent of GDP.

The private debt is expected to show a downward trend in the forecast horizon, falling to slightly over 15 percent of GDP.

Graph 23
MEDIUM- AND LONG-TERM EXTERNAL DEBT: 2009-2018
(% GDP)



* Forecast.

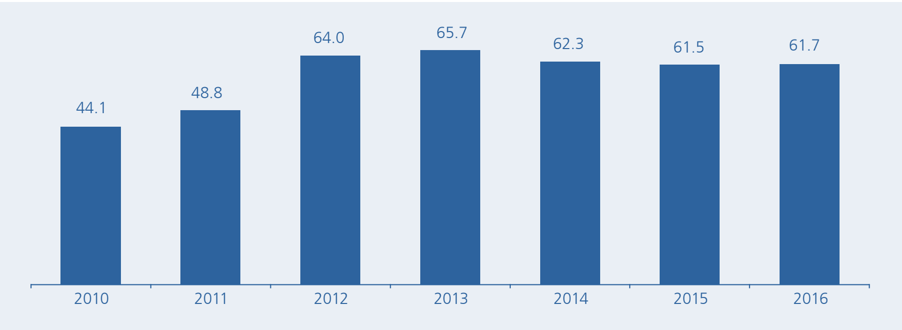
16. The soundness of the balance of payments to face negative events in the global economy is reflected in the position of Peru's international reserves relative to the balance of its short term external liabilities or comparing the total of these liabilities with the country's current account deficit. The high-levels the Peruvian economy shows in the region in terms of these indicators was pre-emptively achieved during a period of years characterized by capital inflows and high commodity prices.

Table 13
NIR INDICATORS

	2006	2011	2016
NIR as a % of:			
a. GDP	19.6	28.9	31.6
b. Short-term external debt [1/]	166	470	457
c. Short-term external debt plus Current account deficit	230	365	328
Medium- and long-term external debt (as a % GDP)	28.6	24.7	34.5
a. Private	4.0	10.4	19.4
b. Public	24.5	14.3	15.2

1/ Includes short-term debt balance plus redemption (1-year) of private and public sector.

Graph 24
NET INTERNATIONAL RESERVES
(Billion US$)



III. Economic Activity

Sector GDP

17. GDP grew 2.1 percent in the first quarter of 2017 after having grown 3.0 percent in the fourth quarter of 2016. Factors accounting for this lower growth in the first quarter of 2017 would include delays in the execution of some major infrastructure projects; a slowdown in mining production, which showed extraordinary rates of copper extraction in 2016 due to the onset of new projects, and the negative effects of *El Niño Costero* on the output of some primary sectors, including preventing the harvest of some crops in the agriculture sector and disrupting the flow of supplies to mines in the middle areas of the country. El Niño also affected output in the non-primary sectors: a reduction was observed in activity in the construction sector due to lower public investment; wholesale and retail trade were affected by distribution problems, and activities related to tourism, financial services, and business services also registered a slowdown.

    A normalization of agricultural production is expected after the conditions associated with this El Niño Costero event are reversed[1]. Growth in agriculture would be driven by an increased production of sugar cane, rice, and agro-export crops, while the good performance of anchovy fishing in the first fishing season and the anticipated recovery of biomass would explain the growth of the fisheries sector in the second quarter. The mining output would grow at a faster pace, driven by the extraction of copper and zinc, once the technical problems faced in the first quarter have been overcome. Recovery in the non-primary sectors would be more gradual, however, since their evolution depends on domestic demand, mainly on public spending.

18. As regards the forecasts contained in the March Inflation Report, the major corrections of projected economic activity in 2017 have been made in the sectors of metal mining and in the non-primary sectors of construction, trade, and services. The forecast of GDP growth in 2017 has been revised from 3.5 to 2.8 percent.

    The negative effects of El Niño Costero are expected to be completely reversed in the next few years, after which the positive effects of reconstruction, the unlock of

1 On June 12, the Multisectoral Committee for the National Study of El Niño (ENFEN Committee) released a communiqué saying that El Niño Costero event ended in May and that neutral sea conditions were expected in the rest of the year.

investment projects, fiscal stimulus, and lower interest rates should become more evident and reflect in a greater dynamism of private investment and consumption. In this scenario, in 2018 GDP is projected to grow 4.2 percent, slightly higher than estimated in our previous report.

Table 14
GDP BY PRODUCTION SECTOR
(Real % change)

	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
Agriculture and livestock	**2.5**	**2.0**	**-0.8**	**2.5**	**2.2**	**4.9**	**4.6**
Agriculture	3.0	0.7	-4.6	1.7	1.3	5.4	4.8
Livestock	1.8	3.9	4.2	3.7	3.5	4.2	4.2
Fishing	**1.8**	**-10.1**	**37.9**	**13.6**	**34.0**	**20.4**	**5.5**
Mining and hydrocarbons	**15.7**	**16.3**	**4.1**	**6.9**	**4.3**	**5.9**	**7.1**
Metallic mining	25.0	21.2	3.9	6.9	4.5	5.9	6.5
Hydrocarbons	-18.5	-5.1	5.3	6.8	3.5	6.4	9.8
Manufacturing	**-2.7**	**-1.5**	**1.7**	**2.2**	**2.3**	**3.8**	**3.2**
Based on raw materials	1.3	-0.5	11.5	6.8	11.8	6.7	4.0
Non-primary industries	-4.2	-2.0	-1.0	0.8	-0.9	3.0	3.0
Electricity and water	**10.3**	**7.3**	**1.0**	**4.6**	**3.1**	**4.5**	**4.5**
Construction	**2.1**	**-3.1**	**-5.3**	**1.8**	**-0.7**	**6.0**	**8.0**
Commerce	**2.8**	**1.8**	**0.1**	**2.4**	**1.7**	**3.3**	**3.5**
Services	**4.4**	**3.9**	**3.0**	**3.4**	**2.9**	**3.5**	**3.4**
GDP	**4.5**	**3.9**	**2.1**	**3.5**	**2.8**	**4.1**	**4.2**
Memo:							
Primary GDP	**10.3**	**9.8**	**4.4**	**6.0**	**5.3**	**6.0**	**6.1**
Non-Primary GDP	**3.0**	**2.3**	**1.4**	**2.9**	**2.0**	**3.6**	**3.7**

* Forecast.
IR: Inflation Report.

a) Output in the **agriculture sector** fell 0.8 percent during the first quarter of the year as a result of an adverse scenario for all the phases of farming activity: drought conditions were observed in the periods of planting and growth of crops, while various climate anomalies related to El Niño Costero affected the harvest phase.

   The most affected crops were those oriented to the domestic market, especially rice and corn, and lemon and onion to a lesser extent. Moreover, among the crops oriented to exports and agro-industry grown in the North, organic banana crops were affected by difficulties in harvesting and by the waterlogging of fields, sugar cane was affected by the damage caused in road infrastructure that prevented its transportation to sugar mills, and paprika crops were affected by warmer temperatures.

   A recovery of the sector is projected in the second half of the year: (i) sugarcane would show a greater production due to the incorporation of new cultivation areas as a result of the Olmos project; (ii) rice production would recover due to increased availability of water in the sowing period; and (iii) agro-export crops would recover since greater areas would be cultivated with crops such as avocados, grapes, cocoa, as well as due to the continuous recovery of areas where coffee is grown. Thus, the agricultural sector would grow 2.2 percent in the year.

Since a normalization of climatic conditions is expected, which would ensure the good performance of the sector, output in the agriculture sector would grow 4.6 percent in 2018.

b) In the first quarter of 2017 the **fishing sector** grew 37.9 percent, mainly as a result of higher landings of anchovy. Output in the sector was not affected by El Niño Costero in this period because the quota assigned to anchovy catch in the second fishing season of 2016 for the North-Central areas was reached in January 2017, before the anomalies generated by El Niño Costero consolidated towards the end of March. Moreover, fishing in the South areas was normal in this period as anomalies in sea surface temperatures did not affect these areas. In addition to this, favored by higher sea temperatures, increased catches of several species (mackerel, squid, and prawn) were observed in this quarter.

Furthermore, the first fishing season already shows an output of over 60 percent of the one anticipated which, in addition to the neutral sea conditions forecast, suggests that it will conclude successfully. Moreover, since the recovery of the biomass is foreseen to continue, it is expected that, as a result, a higher fishing quota will be authorized during the second fishing season of 2017. Therefore, the sector is projected to grow 34.0 percent. This better performance of the sector in 2017 implies a downward revision in the growth rate for 2018, which is now estimated at 5.5 percent.

c) **Metal mining** grew 3.9 percent in the first quarter of 2017, slowing down in comparison with the same quarter of 2016 (25.0 percent). This decline is explained mainly by a lower production of copper and gold due to a base effect resulting from the onset of the operation phases of new projects and, to a lesser extent, by several technical difficulties faced by the mining companies, including strikes (Cerro Verde), and difficulties in transporting the minerals to concentrator plants and an insufficient flow of mining supplies due to difficulties to access the central areas because of heavy rains.

It should be pointed out that the mining companies have already overcome the technical difficulties mentioned above and they have resumed normal production. Therefore, copper and zinc production are expected to contribute to the growth of the sector, while gold production would show a decrease due to the lower ore grades anticipated in Barrick and Yanacocha. As a result of this, metal mining would grow 4.5 percent in 2017 and 6.5 percent in 2018.

In the first quarter of 2017, the **production of copper** grew 10.3 percent, less than in 2016. This is consistent with the start of operations of the expansion project of Cerro Verde in early 2016 and with the recovery of copper production in Antamina at end 2015, both of which favored production data in the first quarter of 2016.

The production rate in 2017 would be supported by the increased production of Las Bambas and Cerro Verde, the latter having become the largest producer of copper in the country in 2016. Copper production would continue to show a growing trend in 2018 due to the expansion of Southern's mine Toquepala.

Table 15
COPPER PRODUCTION
(Thousand MTF)

	2015	2016	2017*	2018*
Antamina	412	444	427	440
Southern	298	288	304	366
Cerro Verde	208	473	535	538
Antapaccay	203	221	222	230
Toromocho	182	168	178	220
Constancia	106	133	115	130
Las Bambas	7	329	460	500
Rest	212	223	229	230
TOTAL	**1,628**	**2,280**	**2,469**	**2,655**

* Forecast.

Gold production fell 7.9 percent in the first quarter due to lower artisanal production and to the lower output obtained at Yanacocha as a result of lower mineral grades before the natural depletion of the mine. Production is expected to decrease 0.2 percent in 2017 due to the lower informal production and lower grades of the deposits of Yanacocha and Barrick, although this decline would be in part offset by the onset of operations in the new projects of Invicta and Tambomayo. As a result of these new projects, gold production is expected to grow 2.0 percent in 2018.

Table 16
GOLD PRODUCTION
(Thousand troy ounce)

	2015	2016	2017*	2018*
Yanacocha	918	668	600	500
Barrick Misquichilca	614	547	510	502
Madre de Dios 1/	391	549	464	464
Buenaventura	218	190	200	208
Inmaculada	59	163	164	162
Anama	74	87	88	89
Shahuindo	0	48	81	85
Invicta	0	0	42	118
Tambomayo	0	0	90	130
Rest	2,432	2,667	2,668	2,747
TOTAL	**4,707**	**4,919**	**4,908**	**5,004**

* Forecast.
1/ Corresponds informal production estimated by MINEM.

Zinc production grew 4.1 percent in the first quarter of 2017 due to the higher grades of ore obtained in Antamina, but would slow down in 2018 and show a growth rate of 4.3 percent.

Table 17
ZINC PRODUCTION
(Thousand MTF)

	2015	2016	2017*	2018*
Antamina	298	261	350	384
Volcan	180	169	165	186
Los Quenuales	103	29	30	31
Milpo	247	245	243	258
El Brocal	56	59	70	65
Administradora Chungar	100	109	106	108
Rest	437	462	457	449
TOTAL	**1,421**	**1,334**	**1,420**	**1,480**

* Forecast.

Table 18
MINING PRODUCTION
(% change)

	2016	2017*	2018*
Copper	40.1	8.4	7.4
Gold	4.5	-0.2	2.0
Zinc	-6.1	6.4	4.3

* Forecast.

d) Production in the **hydrocarbon sector** grew 5.3 percent in the first quarter of 2017, driven by the extraction of natural gas and natural gas liquids, which grew 5.9 and 15.3 percent, respectively. This growth rates are associated with a base effect caused by the rupture of the pipeline in January 2016. In contrast, oil production dropped 11.6 percent due to lower extraction at Pacific Stratus' Lot 192 as a result of problems associated with the operations of Oleoducto Norperuano. It is worth highlighting that the rupture of the pipeline in February 2016 caused Lot 192 to record production only until the first quarter of 2016.

The sector would record a growth rate of 3.5 percent in 2017 and then a rate of 9.8 percent in 2018, when Oleoducto Norperuano would be fully operational again.

e) **Non-primary manufacturing** showed a contraction of 1.0 percent in the first quarter of 2017. This subsector was affected both by lower domestic demand and by El Niño Costero event, which caused various damages to the infrastructure and machinery of some companies, as well as logistic problems that included shortages of supplies and problems to transport their products.

Manufacturing is expected to show positive growth rates in 2017, reversing the decline of the previous year. This recovery would be driven by the primary manufacturing branches, which would benefit from increased fishing activity. On the other hand, non-primary manufacturing would show a gradual recovery, in line with the recovery of domestic demand and exports.

Expenditure-side GDP

19. Economic activity slowed down again in the first quarter of 2017 recording a growth rate of 2.1 percent, reflecting the fall of domestic demand associated with the impact of the two shocks that the economy has been facing this year. The first shock results from the drop of public and private investment observed since the last quarter of 2016, which is associated in part with the suspension of major infrastructure projects as a result of investigations of corruption, while the second shock is related to the effects of El Niño Costero.

The fall of domestic demand in the first quarter of 2017 (down 1.1 percent) –a drop unheard of since the fourth quarter of 2009– was due, firstly, to the reduction of public spending (11 percent). Secondly, the weak growth of private consumption (2.2 percent) –the lowest rate recorded since the second quarter of 2009– reflected lack of dynamism in the labor market, the decline of confidence, and the negative wealth effect caused by the disasters generated by El Niño Costero. Thirdly, private investment, which had already been affected by the completion of the cycle of mega projects in the mining sector, was directly affected by the suspension and/or by delays in the execution of large infrastructure projects[2] that were being implemented as PPPs, as a result of which private investment accumulated 13 consecutive quarters of decline.

2 The main projects including, for example, Vías Nuevas de Lima (Concesionario Rutas de Lima); Vía Expresa Sur; IIRSA Norte Section Paita-Yurimaguas; Red Vial N° 5 Ancón-Huacho-Pativilca; and Lima Metro's Line 2.

Conversely, exports continued contributing positively to GDP growth, driven by the impulse of the copper mines that started their operation phase in late 2015. During the first quarter of 2017, the greater dynamism of exports (12.8 percent) was reflected in higher shipments of copper, fish meal, oil derivatives, and non-traditional exports (fisheries).

Table 19
GDP AND DOMESTIC DEMAND
(Real % change)

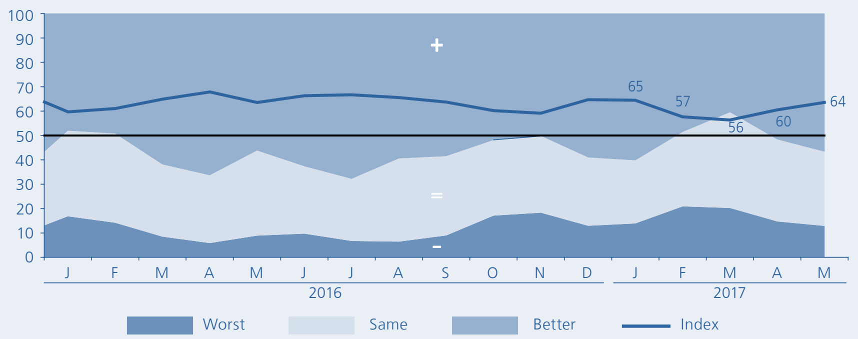
	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
I. Domestic demand	**1.8**	**0.9**	**-1.1**	**3.3**	**1.9**	**3.7**	**4.0**
1. Private expenditure	**-0.4**	**1.2**	**0.6**	**2.9**	**1.6**	**3.8**	**3.5**
Consumption	*3.8*	*3.4*	*2.2*	*3.1*	*2.5*	*3.4*	*3.0*
Private fixed investment	*-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*
2. Public expenditure	**16.7**	**-0.2**	**-11.0**	**5.4**	**3.6**	**3.0**	**6.5**
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 entitites	*132.4*	*30.0*	*-27.0*	*-16.6*	*-15.7*	*3.4*	*5.4*
II. Net external demand							
1. Exports	**8.5**	**9.5**	**12.8**	**4.2**	**5.9**	**5.0**	**4.4**
2. Imports	**-2.0**	**-2.2**	**0.2**	**3.2**	**2.9**	**3.4**	**3.5**
III. GDP	**4.5**	**3.9**	**2.1**	**3.5**	**2.8**	**4.1**	**4.2**
Memo:							
Public expenditure (contribution)	*2.2*	*0.0*	*-1.6*	*0.9*	*0.6*	*0.5*	*1.1*

* Forecast.
IR: Inflation Report.

20. During the first months of 2017, **private consumption** indicators showed mixed trends. On the one hand, credit to families, the market labor, and consumer confidence recorded favorable indicators, while, on the other hand, a fall was observed in the real income of the workforce employed. Moreover, contemporary indicators are still pointing to a negative evolution in **private investment**.

    a) The consumer confidence index recorded 60 points in April and 64 points in May, higher levels than the average level registered in the first quarter of 2017 (59 points). It should be pointed out that this increase in consumer confidence reflects in part the end of the disasters generated by El Niño Costero and the reversal of the shock of food prices.

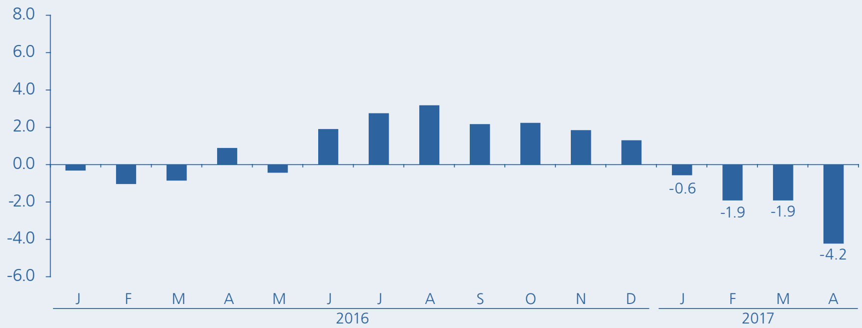
Graph 25
CONSUMER CONFIDENCE INDEX: HOUSEHOLDS' ECONOMIC SITUATION?



Source: Apoyo.

b) The real income of the workforce employed dropped 4.2 percent in April 2017 and accumulated four consecutive months of decline.

Graph 26
REAL INCOME OF EAP WORKFORCE EMPLOYED
(Quarterly moving - 12-month % change)

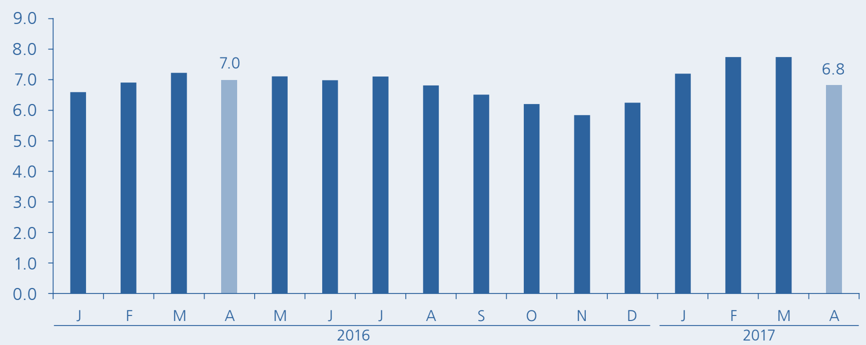


Source: INEI.

c) Recent indicators about the labor market have not been very favorable. Even though the rate of unemployment and the number of unemployed workers fell in April in comparison with the high levels recorded in March, the rate of underemployment increased in April.

The rate of unemployment in April was 6.8 percent, lower than in April 2016 (7.0 percent). It is worth mentioning that the recovery observed in the employed workforce in this month is explained by an increase of informal labor in the sector of trade.

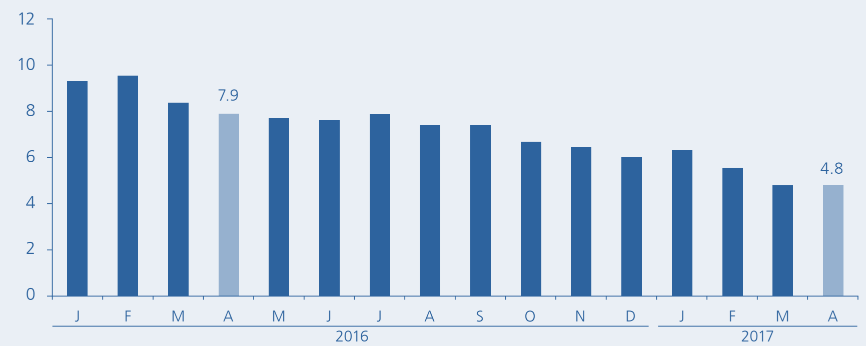
Graph 27
UNEMPLOYMENT RATE - METROPOLITAN LIMA
(Survey INEI - Quarterly moving, %)



Source: INEI.

d) Consumer loans have been slowing down, the annual growth rate declining from 7.9 percent in April 2016 to 4.8 percent in April 2017.

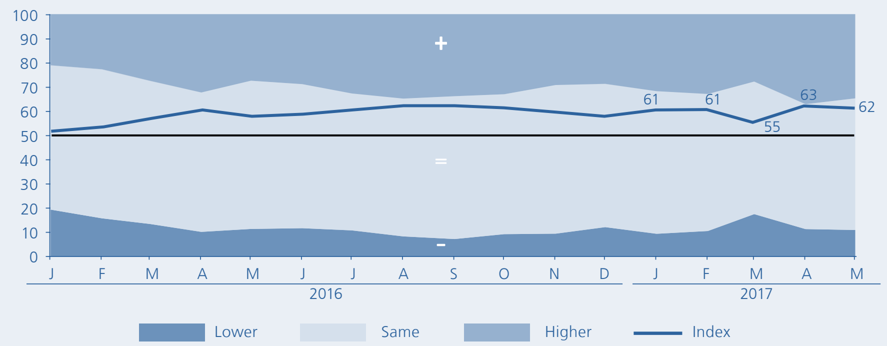
Graph 28
REAL CONSUMER LOANS
(12-month % change)



Source: BCRP

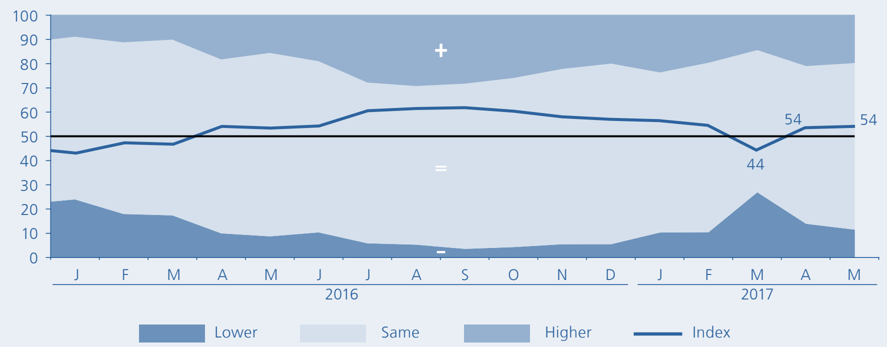
e) Firms' expectations of demand in three months' time remain on the optimistic side and recorded 62 points in May, a higher level than the average level observed in the first quarter of 2017 (59 points), although slightly lower than that recorded in April. Moreover, continuing with the rising path observed in March 2017, businessmen's expectations about the economic situation in three months' time registered 54 points in May. The indicator of expected investment in six months' time shows the same level as that recorded in December 2016 (57 points).

Graph 29
EXPECTATION ABOUT DEMAND IN THE THREE MONTHS AHEAD



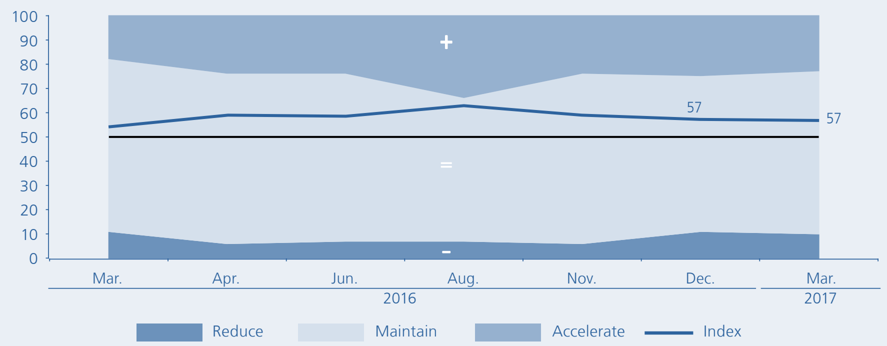
Source: Survey on Macroeconomic Expectation.

Graph 30
BUSINESS EXPECTATIONS ON THE SITUATION OF THE ECONOMY IN THE THREE MONTHS AHEAD



Source: Survey on Macroeconomic Expectation.

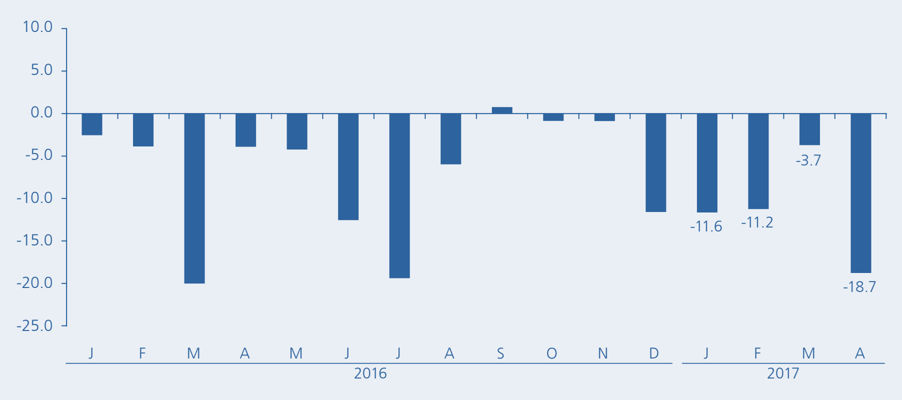
Graph 31
INVESTMENT EXPECTATIONS ON YOUR COMPANY IN THE SIX MOTNH AHEAD



Source: Survey on Macroeconomic Expectation.

f) The volume of imports of capital goods (excluding construction materials), indicator of the demand for investment, dropped 18.7 percent in annual terms in April 2017 and accumulated a fall of 11.6 percent in January - April 2017.

Graph 32
VOLUME OF IMPORTS OF CAPITAL GOODS
(12-month % change)



g) The results of the survey of expectations about GDP growth show adjustments on the downside for 2017. Financial entities and economic analysts have revised down the rates they expect from 3.5 percent in February 2017 to 2.6 percent in May, while the representatives of non-financial firms have revised them down from 3.8 to 3.0 percent. In 2018, economic agents expect an average GDP growth rate of 3.7 percent.

Table 20
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH
(% change)

		RI Dec.16	IR Mar.17	IR Jun.17
Financial entities				
	2017	4.2	3.5	2.6
	2018	4.0	4.0	3.6
Economic analysts				
	2017	4.2	3.5	2.6
	2018	4.2	3.8	3.6
Non-financial firms				
	2017	4.2	3.8	3.0
	2018	4.5	4.0	3.9

Source: Survey on Macroeconomic Expectation.

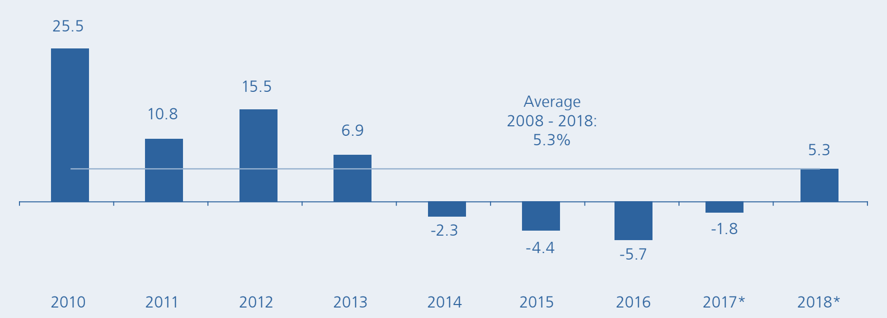
21. In 2017, the output would show a lower growth rate than that estimated in our previous due to the impact of the negative shocks mentioned above. Even though the anomalous conditions caused by El Niño Costero event were no longer observed since April, the event's negative impact on wealth will continue affecting the evolution of private consumption in the following quarters and the

suspension of infrastructure projects will continue to have a negative impact on private investment. On the other hand, however, public spending is expected to recover in the following quarters once the reconstruction process and the fiscal stimulus announced are underway. As estimated in the March report, in the short term, the growth of public investment spending would offset in part the fall expected in aggregate expenditure. Therefore, the GDP growth forecast for 2017 is revised down from 3.5 percent to 2.8 percent in this report. This forecast considers a slower pace of growth of public expenditure (given the evolution observed until May), a lower dynamism of private consumption, and a fall in private investment.

22. Given the impact of fiscal stimulus and the reconstruction process, in 2018 domestic demand is foreseen to show greater dynamism than in the previous year as well as greater dynamism than estimated in the March report due mainly to increased public expenditure in investment. Consumption and private investment would gradually return to a faster pace of growth, supported by the recovery of confidence and the resumption of operations in the major projects awarded in concession as well as by announcements of future investment projects. Thus, in 2018 GDP is expected to grow 4.2 percent (vs. 4.1 percent estimated in the previous report).

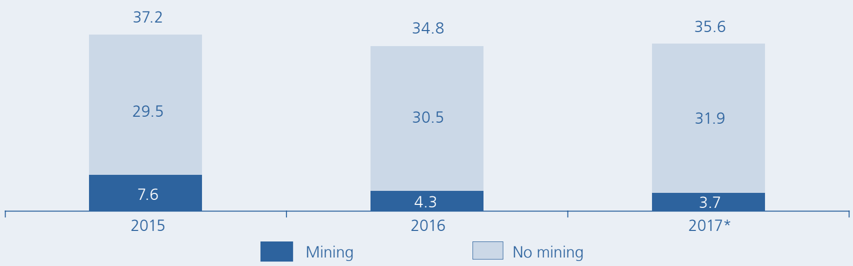
23. The growth forecast of **private investment** in 2017 has been revised down from 2.5 to -1.8 percent, mainly due to the suspension of infrastructure works and to the drop of mining investment after the completion of copper investment projects. Moreover, although investors' expectations remain on the optimistic side, they have fallen to lower levels than in previous years. Thus, considering the normalization of investment conditions reflected in the recovery of business confidence and the progress of the projects announced and granted in concession, in 2018 private investment would grow 5.3 percent.

Graph 33
PRIVATE INVESTMENT: 2010 - 2018
(Real % change)



* Forecast.

Graph 34
PRIVATE INVESTMENT
(Billion US$)



* Forecast.
Source: MINEM and BCRP.

Table 21
MAIN INVESTMENTS PROJECTS: 2017-2018

SECTOR	COMPANIES	PROJECT
Mining	Southern Perú Copper Corp.	Expansion of Toquepala
	Chinalco	Expansion of Toromocho
	Shougang Corporation	Expansion of Marcona
	Angloamerican	Quellaveco
	Bear Creek Mining corporation	Corani
Hydrocarbons	Repsol YPF S.A.	Lot 57: Kinteroni
	China National Petroleum Corporation	Exploration: Lot 58
	Calidda Gas Natural del Perú	Massive use of gas
	Karoon Gas Natural	Exploration: Lot Z - 38
Electricity	Corsán-Corvian	Hydroelectric Power Plant of Molloco
	Luz del Sur	Thermal power plant of South Pacific
	Termochilca	thermal power plant of Domigo Olleros - Combined cycle
Industry	Corporación Lindley	Storages and infraestructures
	Repsol YPF	Expansion of La Pampilla plant
	CMPC Tissue	Plant of Tissue
	Grupo Celepsa	Expansion plant in Pisco
	Precor	Plant in Chilca
Infrastructure	Grupo Volcan	Port Terminal Project: Chancay
	ADP	Improvement and new runways for landing
	Lima Airport Partners	Expansion of international airport (Jorge Chávez)
	Covisol	Trujillo-Sullana: Sol Highway
	APM Terminals	Modernization Muelle Norte
	Covi Perú	Road network No 6 Pucusana-Ica
	Consorcio Consierra II	Longitudinal de la Sierra Tranche 2
Other sectors	Grupo Telefónica	Expansion and facilities of net LTE-4G
	Entel	Development of services 4G
	America Movil	Expansion of net 4G
	Grupo Falabella	Expansion and new shopping centers
	Besalco	Real Estate projects
	Grupo Interbank	Expansion and new shopping centers
	Grupo Breca	Expansion and new hotels, medical centers and shopping malls.
	Cencosud	Shopping centers

Source: Information of companies and media press.

Private investment projects announced to be implemented in the period of 2017-2018 amount to US$ 16.6 billion. Lower dynamism in investment is expected due to delays in different mega-infrastructure investment projects in the context of ongoing investigations about corruption cases involving some of these projects.

Table 22
PRIVATE INVESTMENT PROJECTS ANNOUNCED: 2017-2018
(Million US$)

	IR Mar.17	IR Jun.17
Mining	5,480	5,125
Hydrocarbons	2,028	2,098
Energy	1,687	1,415
Industriy	1,350	895
Infraestructure	2,858	2,698
Other sectors	4,610	4,418
TOTAL	**18,013**	**16,649**

Source: media and Information of companies.

It is estimated that investment in projects awarded in concession between 2016 and 2017 would reach US$ 2.1 billion in May. Proinversión has announced that total investment of projects to be carried out under concession contracts in 2017-2018 amount to US$ 4.3 billion.

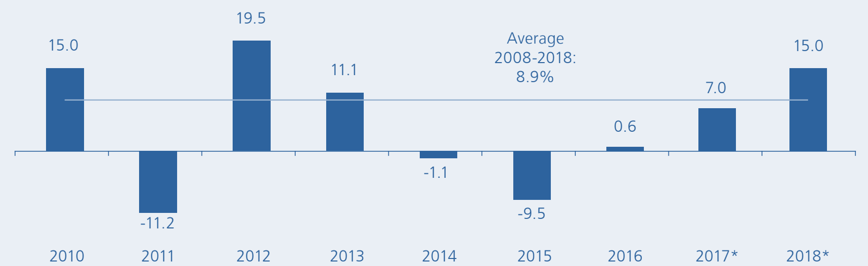
Table 23
MAIN PROJECTS TO BE IMPLEMENTED THROUGH CONCESSION ARRANGEMENTS IN 2016-2018
(Million US$)

	Estimated investment
A. Awarded	**2,088**
Nationwide 698-806 MHz band	1,680
Hydroelectric Power Plant San Gabán III	371
Aguaytía-Pucallpa 138 kV Electric Transmission Line	37
B. To award	**4,330**
B.1 Called	**2,281**
Headworks and Conduction for the Drinking Water Supply in Lima	600
500kV Mantaro - Nueva Yanango -Carapongo Connection and Nueva Yanango - Nueva Huanuco connection and associated sub stations	509
Longitudinal of the Sierra road project, Section 4	464
Liquid Petroleum Gas Supply System for multiple regions	350
Huancayo - Huancavelica Railway	204
The Amazon Waterway	95
220 kV Tintaya - Azangaro Transmission Line	59
B.2. To be called	**2,049**
Michiquillay Remnants Mining Project	1,950
Repowering up to 1000 MVA of 500 kV Carabayllo-Chimbote-Trujillo Transmission Line	64
Substation Planicie	25
New 220 kV Carhuaquero Substation	10

Source: Proinversión.

24. The growth forecast of **public investment** in 2017 has been revised down from 11.0 to 7.0 percent due mainly to the lower performance observed during the period January-May 2017. In 2018, the forecast considers a scenario where spending at the level of the executing units increases from 5.0 percent (Inflation Report of March) to 15.0 percent in this report, taking into account the expansionary fiscal policy designed by the Government for the reconstruction of infrastructure after the damage caused by El Niño Costero.

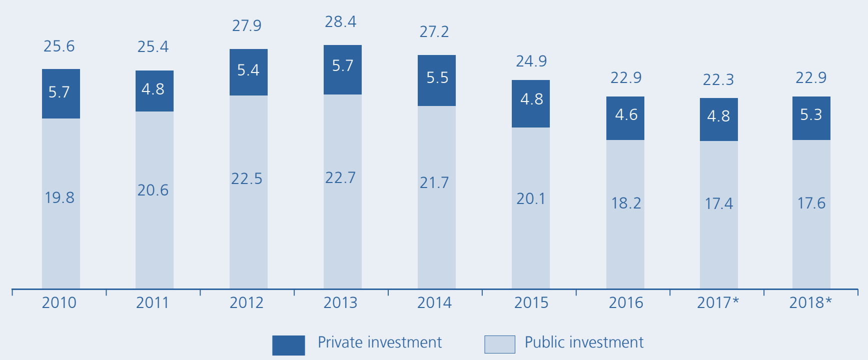
Graph 35
PUBLIC INVESTMENT: 2010-2018
(Real % change)



* Forecast.

Based on the expected evolution of private investment and public investment, the gross investment-to-GDP ratio would remain around 23 percent in 2018.

Graph 36
GROSS FIXED INVESTMENT: PRIVATE AND PUBLIC SECTORS 2010- 2018
(% real GDP)

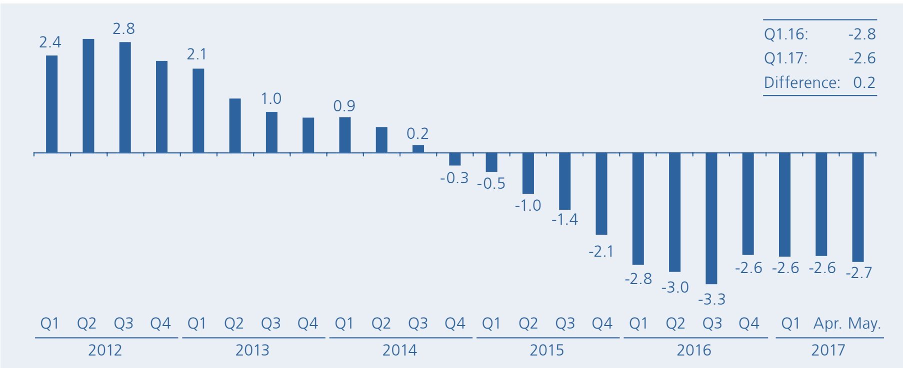


* Forecast.

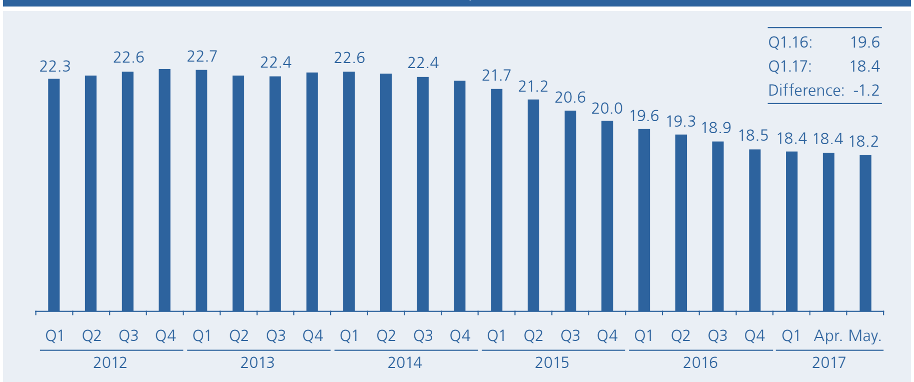
IV. Public Finances

25. Taking into account the data for the last 12 months at May 2017, the fiscal deficit is equivalent to 2.7 percent of GDP, with current revenues representing 18.2 percent of GDP, current expenditure amounting to 15.0 percent of GDP, and gross capital formation representing 3.9 percent of GDP.

Graph 37
ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR
(Accumulate last 4 quarters - % GDP)



Graph 38
CURRENT REVENUES OF THE GENERAL GOVERNMENT
(Accumulate last 4 quarters - % GDP)



Graph 39
CURRENT EXPENDITURE OF THE GENERAL GOVERNMENT
(Accumulate last 4 quarters - % GDP)

Graph 40
GROSS CAPITAL FORMATION OF THE GENERAL GOVERNMENT
(Accumulate last 4 quarters - % GDP)

26. The fiscal scenario considers a strong fiscal stimulus since the second half of 2017 and during 2018. This increased fiscal stimulus is consistent with the deficit targets proposed by the Government in Bill 1318, by which the deficit target is raised from 2.5 to 3.0 percent of GDP in 2017 and from 2.3 to 3.5 percent of GDP in 2018. The Bill also establishes the commitment of returning to the fiscal deficit of 1.0 percent of GDP by 2021.

    Because of this, it is estimated that the deficit levels would increase from those considered in our previous report from 2.8 percent to 3.0 percent in 2017 and from 2.6 percent to 3.5 percent of GDP in 2018. This increase in the deficit will allow maintaining a stable path in non-financial expenditure (whose ratio would increase from 20.0 percent of GDP in 2016 to 20.4 percent of GDP in 2018) so that there is fiscal space for higher spending for reconstruction.

Table 24
NON-FINANCIAL PUBLIC SECTOR
(% GDP)

	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
1. General government current revenue[1/]	**20.5**	**18.5**	**19.9**	**18.9**	**18.3**	**18.6**	**18.2**
Real % change	*-5.3%*	*-4.1%*	*0.3%*	*6.1%*	*2.1%*	*2.2%*	*3.7%*
2. General government non-financial expenditure[2/]	**17.7**	**20.0**	**16.8**	**20.5**	**20.2**	**20.1**	**20.4**
Real % change	*9.9%*	*-2.4%*	*-2.4%*	*7.0%*	*4.7%*	*1.4%*	*5.3%*
Of which:							
Current expenditure	*14.5*	*15.3*	*13.5*	*15.3*	*15.2*	*14.9*	*15.0*
Real % change	*10.2%*	*0.3%*	*-4.3%*	*3.9%*	*2.5%*	*1.4%*	*2.8%*
Gross capital formation	*2.7*	*4.1*	*2.3*	*4.5*	*4.3*	*4.6*	*4.8*
Real % change	*15.9%*	*-3.1%*	*-13.5%*	*15.0%*	*9.4%*	*5.2%*	*16.4%*
3. Others	**0.4**	**-0.1**	**-0.2**	**0.1**	**0.1**	**0.1**	**0.1**
4. Primary balance (1-2+3)	**3.1**	**-1.5**	**3.0**	**-1.5**	**-1.8**	**-1.4**	**-2.1**
5. Interests	**1.6**	**1.1**	**1.9**	**1.3**	**1.2**	**1.3**	**1.4**
6. Overall Balance	**1.5**	**-2.6**	**1.1**	**-2.8**	**-3.0**	**-2.6**	**-3.5**
Memo:							
Structural overall balance	*1.4*	*-2.5*	*0.8*	*-3.1*	*-3.1*	*-2.6*	*-3.4*

1/ The central government includes the ministries, national universities, public agencies and regional governments. The general government has a wider coverage that includes the central government, social security, regulators and supervisors, government charity organizations and local governments.
2/ Includes net accrued expenses to FEPC
* Forecast.
IR: Inflation Report.

Tax Revenues

27. In line with the slowdown in economic activity as well as with the higher tax rebates for exports and the tax cut measures adopted in recent years, the current revenues of the general government have shown a decreasing trend in GDP terms.

    In the period of January – May 2017, current revenues have fallen 0.8 percentage points of GDP from the level recorded in the same period of 2016. However, since this result is influenced by extraordinary income in each of these years, current revenues show a fall of 1.1 percentage points of GDP in January-May when such effect is isolated. This deterioration of revenue is explained mainly by the drop in revenue from the corporate income tax (-0.6 percent of GDP), which reflects not only the impact of the economic slowdown, but also the negative effect on this tax of the application of the tax regime for MSE, which implies lower payments on account of taxes for companies included under this scheme. Revenue from the VAT also dropped (-0.3 percent of GDP) due in part to the slower growth of domestic demand and due to the application of the *IGV*

Justo (Fair VAT) scheme since February of this year, which allows MSEs defer the VAT payment for three months. Finally, higher refunds of taxes were equivalent to 0.1 percent of GDP.

It is also worth mentioning that extraordinary revenue was recorded in this period due to the enforcement of the guarantee provided by Consorcio Gasoducto Sur Peruano (S/ 875 million) due to the company's breach of contract, which led to the termination of the contract thereafter.

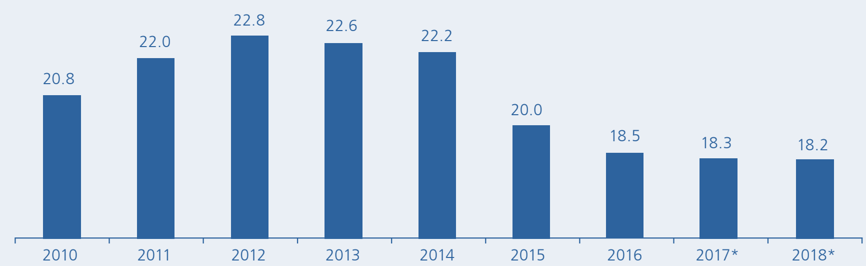
Taking into account the evolution of tax revenues, the forecast of current revenues has been revised down from 18.9 percent of GDP to 18.3 percent of GDP in 2017 and from 18.6 percent to 18.2 percent of GDP in 2018. This projection considers the effect of the package of measures approved between December 2016 and January 2017.

Table 25
CURRENT REVENUES OF THE GENERAL GOVERNMENT
(% GDP)

	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
TAX REVENUES	**15.9**	**14.0**	**14.3**	**14.1**	**13.6**	**14.0**	**13.7**
Income tax	7.4	5.6	6.6	5.3	5.1	5.4	5.2
Value added tax	8.7	8.0	8.3	7.8	7.8	7.9	7.9
Excise tax	1.0	0.9	1.0	0.9	0.9	0.9	0.9
Import duties	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Other tax revenues	1.3	1.7	1.2	2.1	2.0	1.8	1.8
Tax returns	-2.7	-2.5	-3.1	-2.2	-2.5	-2.2	-2.3
NON-TAX REVENUES	**4.6**	**4.5**	**5.7**	**4.8**	**4.8**	**4.6**	**4.6**
TOTAL	**20.5**	**18.5**	**19.9**	**18.9**	**18.3**	**18.6**	**18.2**

* Forecast.
IR: Inflation Report.

Graph 41
CURRENT REVENUES OF THE GENERAL GOVERNMENT: 2010-2018
(% GDP)



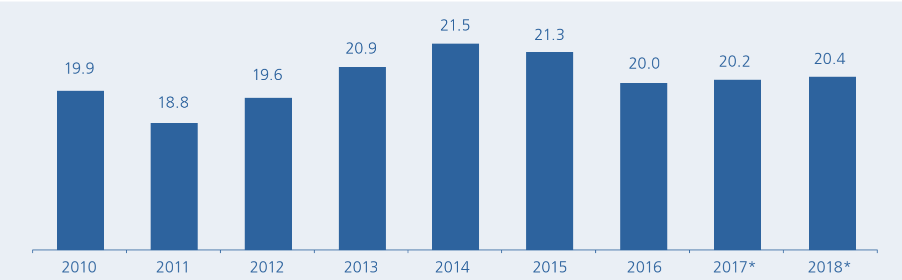
* Forecast.

Public Expenditure

28. Public spending has continued to drop in the three levels of government. In January-May, the drop was equivalent to 0.7 percentage points of GDP, particularly due to the fall in national current expenditure. This drop should reverse in the rest of the year once the fiscal stimulus and spending for post-disaster reconstruction (El Niño Costero) materialize. Therefore, the projection of public spending for 2017, particularly the projection of investment, has been revised slightly downward given the lag in the execution of expenditure in January-May. Thus, the growth of expenditure in gross capital formation has been revised from 15 percent (March Inflation Report) to 9.4 percent in real terms.

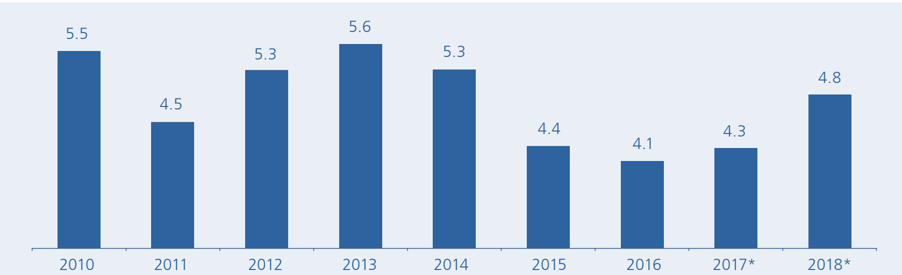
    In contrast, the projection of expenditure for 2018 in GDP terms has been raised slightly with respect to the previous report, with investment spending being expected to be higher due mainly to spending for reconstruction.

Graph 42
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT: 2010-2018
(% GDP)



* Forecast.

Graph 43
GROSS CAPITAL FORMATION OF THE GENERAL GOVERNMENT: 2010-2018
(% GDP)



* Forecast.

Table 26
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT
(% GDP)

	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
Current expenditure	**14.5**	**15.3**	**13.5**	**15.3**	**15.2**	**14.9**	**15.0**
National Government	10.2	10.5	9.2	10.5	10.4	10.3	10.3
Regional Governments	2.8	3.1	2.8	3.1	3.1	3.0	3.0
Regional Governments	1.6	1.7	1.5	1.6	1.6	1.6	1.6
Capital expenditure	**3.2**	**4.7**	**3.3**	**5.3**	**5.1**	**5.1**	**5.5**
Gross capital formation	**2.7**	**4.1**	**2.3**	**4.5**	**4.3**	**4.6**	**4.8**
National Government	1.1	1.4	0.7	1.6	1.5	1.6	1.7
Regional Governments	0.5	0.9	0.5	1.0	0.9	1.0	1.0
Regional Governments	1.1	1.8	1.1	1.9	1.9	2.0	2.1
Others	**0.5**	**0.6**	**1.0**	**0.8**	**0.7**	**0.6**	**0.6**
Total	**17.7**	**20.0**	**16.8**	**20.5**	**20.2**	**20.1**	**20.4**
National Government	11.8	12.5	11.0	12.9	12.6	12.5	12.7
Regional Governments	3.3	4.0	3.2	4.0	4.0	4.0	4.1
Regional Governments	2.7	3.5	2.6	3.6	3.6	3.6	3.7

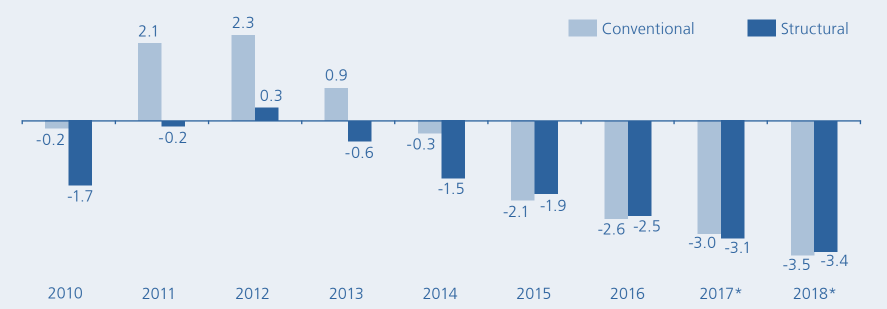
* Forecast.
IR: Inflation Report.

As established in the modified institutional budget (Presupuesto Institucional Modificado - PIM), General Government investment amounts to S/ 37.4 billion. The main projects of the national Government (38 percent of total projects) are projects developed in the sector of Transports (S/ 6.55 billion), including Line 2 of the Metro of Lima and Callao, the Puerto Bermudez-San Alejandro highway, and Integración Vial Tacna-La Paz. In addition, housing projects amount to S/ 1.29 billion, with the implementation of services for the new city of Olmos standing out.

Structural Economic Balance and Fiscal Impulse

29. The **structural economic balance** is an indicator that differs from the conventional economic balance in that it isolates from the latter the transitory effects of the business cycle and the effects of the prices of the commodities relevant to our economy. In 2016, the structural economic balance showed a deficit of 2.5 percent of GDP, while in 2017 and 2018 the structural deficit is estimated at 3.1 percent and 3.4 percent of GDP, respectively.

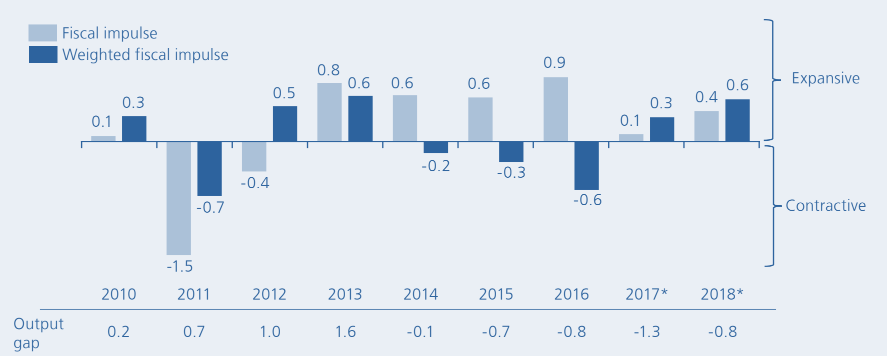
Graph 44
CONVENTIONAL AND STRUCTURAL ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2010-2018
(% GDP)



* Forecast.

30. In order to determine the effect of changes in the revenues and expenditures of the Treasury on the economic cycle, we take into account the multiplier effect of these variables. Thus, the 2016 weighted fiscal impulse was contractionary, while in 2017 the fiscal stance is expected to be slightly expansionary (0.3 percent of GDP) and concentrated in the second half of the year. This outcome would be associated with the greater multiplier effect of public investment. Because of this reason, the growth of public investment of 15 percent considered for 2018 implies a weighted fiscal impulse of 0.6 percentage points of GDP.

Graph 45
FISCAL IMPULSE AND WEIGHTED IMPULSE[1/]
(% Potential GDP)



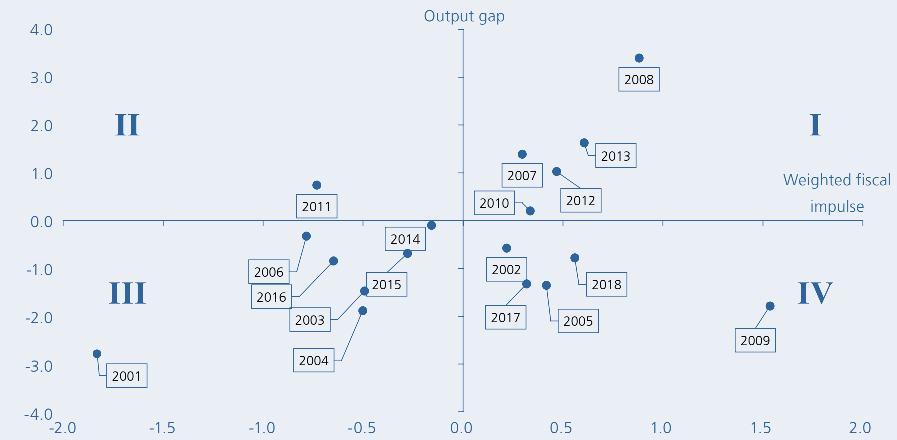
1/ The weighted impulse takes account the multiplier model of changes in the incomes, current expensives and public investment..
* Forecast.

Table 27 FISCAL IMPULSE				
	2015	**2016**	**2017***	**2018***
1. Fiscal impulse (a+b)	**0.6**	**0.9**	**0.1**	**0.4**
a. By revenues	0.9	1.6	-0.1	0.1
b. By expenditures[1/] (i+ii)	-0.3	-0.8	0.2	0.3
i. Current	0.1	-0.1	-0.2	-0.1
ii. Capital	-0.4	-0.7	0.4	0.5
2. Weighted fiscal impulse [2/]	**-0.3**	**-0.6**	**0.3**	**0.6**

* Forecast.
1/ Includes public enterprises.
2/ According to estimate of fiscal multiplier. If GDP gap is positive: Revenues 0; current expenditure 0.28; capital expenditure 0.73; and if GDP gap is negative: Revenues 0.25; current expenditure 0.93; capital expenditure 1,42.

The following graph shows the relationship between the weighted fiscal impulse and the GDP gap. The weighted fiscal impulse measures the impact that discretionary changes in revenue and public expenditure, weighed by an estimated multiplier effect, have on economic activity. A positive weighted fiscal stimulus implies that the fiscal stance is expansionary and stimulates aggregate demand.

Graph 46
OUTPUT GAP AND FISCAL IMPULSE
(% potential GDP)



I: Pro-cyclical - Expansive   II: Countercyclical - Contractive   III: Pro-cyclical- Contractive   IV: Countercyclical - Expansive

The graph shows four quadrants according to the (positive or negative) value of fiscal stimulus and the GDP gap. Quadrants I and III depict pro-cyclical fiscal positions given that fiscal policy is expansionary when the economy is booming (quadrant I) or contractionary when the economy is in a recession phase (quadrant III), which can enhance the economic cycle. On the other hand, quadrants II and IV correspond to countercyclical fiscal positions in which the fiscal position is contractionary when the economy is booming (quadrant II) and expansionary in periods of slower growth (quadrant IV), which corresponds to policies aimed at mitigating economic fluctuations.

The data for the past 16 years show that the fiscal policy has been pro-cyclical in 10 periods during this time and that, in contrast, the period of the 2017-2018 forecast horizon would be characterized by a countercyclical policy stance given that fiscal expansion policies would be implemented amid a context of lower growth.

Public Debt

31. The funding required to cover the fiscal deficit and the amortization of the public debt declined from S/ 32 billion in 2016 (since amortizations amounted to S/ 15 billion) to S/ 27 billion in 2017 and to S/ 33 billion in 2018. In GDP terms, this means that this financial requirement declines from 4.8 percent of GDP in 2016 to 3.9 percent of GDP in 2017 and rises then to 4.4 percent of GDP in 2018.

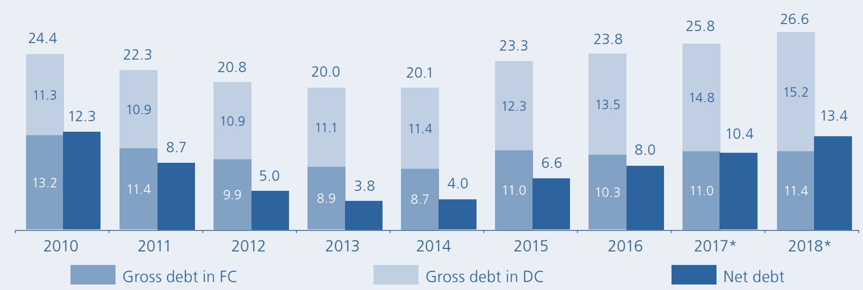
The gross debt of the non-financial public sector would be equivalent to 26.6 percent of GDP at the end of the forecast horizon, while the net debt would increase to 13.4 percent of the output by 2018.

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

	2016		2017*			2018*	
	Q1	Year	Q1	IR Mar.17	IR Jun.17	IR Mar.17	IR Jun.17
I. USES	**-1,185**	**31,751**	**-612**	**24,597**	**27,449**	**26,080**	**32,746**
1. Amortization	1,106	14,830	1,141	4,872	6,122	6,269	6,338
a. External	505	5,636	754	2,951	4,216	4,067	4,091
b. Domestic	601	9,195	386	1,921	1,905	2,202	2,247
Of which:							
Recognition bonds	*114*	*629*	*203*	*822*	*818*	*814*	*859*
2. Overall balance	-2,291	16,920	-1,753	19,725	21,327	19,811	26,408
(Negative sign indicates surplus)							
II. SOURCES	**-1,185**	**31,751**	**-612**	**24,597**	**27,449**	**26,080**	**32,746**
1. Disbursements and other	6,931	30,050	5,443	21,405	29,076	21,429	22,060
2. Change on deposits and other[1/]	-8,116	1,701	-6,056	3,192	-1,627	4,651	10,686
Memo:							
% GDP							
Gross debt balance	22.8	23.8	22.9	24.5	25.8	25.4	26.6
Net debt balance[2/]	6.2	8.0	7.4	9.9	10.4	12.0	13.4

* Forecast.
1/ A positive sign indicates a reduction of deposits.
2/ Defined as the difference between gross public debt and NFPS deposits.
IR: Inflation Report.

Graph 47
NON-FINANCIAL PUBLIC SECTOR DEBT: 2010-2018
(% GDP)



* Forecast.

Box 1

EXTRAORDINARY MEASURES FOR POST DISASTER-RECONSTRUCTION

The Peruvian Government has enacted Law 30556 to facilitate post-disaster reconstruction after the damage caused by El Niño Costero. This legal framework establishes that reconstruction actions will be based on a Comprehensive Plan, which will be prepared by Autoridad para la Reconstrucción con Cambios (ARCC) –a new authority especially appointed for this purpose– and approved by the Council of Ministers.

ARCC will be integrated by an Executive Director, who shall have the rank of Minister, and by a board of four Ministers that will be responsible for monitoring the actions taken in accordance with the comprehensive Plan. ARCC will use the resources of the Fund for Natural Disasters –Fondo para Intervenciones ante la ocurrencia de Desastres Naturales (FONDES)–, established by Law 30458, as well as donations from national and international cooperation agencies. The Law not only authorizes all public sector entities to transfer funds to FONDES to carry out the interventions contained in the Plan, but also exempts public agencies from the constraints set out in the budget law to make budget modifications.

Moreover, to accelerate the reconstruction process, the Law allows public agencies to use the following management tools to carry out the projects established in the Comprehensive Plan:

- *Simplified Award of Contracts*: Contracts for goods, services, or construction will be awarded through simplified procurement procedures, which are faster than the procedures of public tenders or conventional tenders.
- *Unit Price Tender*: This type of tender procedure allows the calling entity to buy the elaboration of the technical file and the execution of the work in a single process. In this system of unit prices, a price is proposed for each item considered in the costs or expenditure items of the work to be carried out.
- *Foreign suppliers*: Foreign suppliers are exempted from the requirement of registration in the National Register of Suppliers to submit their bids.
- *Agreements with International Organizations*: The execution of the contract may be entrusted to international organizations since this mechanism is faster than the conventional mechanism.
- *Works for tax deductions*: Reconstruction works can be carried out with this mechanism, its use being extended not only to investment projects, but also to investment optimization, marginal expansion, replacement and rehabilitation. In addition to the cost of the works, costs will also include a financial cost of 2 percent.
- *Administrative Facilities*: Every administrative procedure necessary to implement the Comprehensive Plan is free of charge and shall be carried out within a maximum period of 7 working days. Moreover, these procedures will be subject to positive administrative silence.
- *Availability of premises*: The land or premises of all the public agencies of the three levels of Government may be used by ARCC to implement the Plan.
- *High-risk areas*: People living in high-risk areas where risk cannot be mitigated must renounce their property to have access to any of the Plan benefits.

Approaches to reconstruction and successful experiences

The World Bank[3] distinguishes three institutional arrangements for the management of post-disaster reconstruction. Each of them has strengths and weaknesses and each of them has been successful when the institutional management option was appropriate for the characteristics of the country and for the disaster faced.

ORGANIZATIONAL MODELS FOR RECONSTRUCTION		
Strengths	**Weaknesses**	**Recommendations**
A: Create new dedicated organization to manage reconstruction		
Independent, focused; Provides mechanism for resource allocation, procurement, and staffing; Handles complex financial arrangements with donors; Simplifies consultation with government.	Risks duplicating efforts with line ministries; Takes time to clarify roles and responsibilities; May lack local ownership; Problematic exit strategy; will probably fight to survive; Expensive; requires premises, facilities, and staff Si se crea una para cada desastre no se acumula experiencia	Consider for large-scale disasters; Employ if government structure is affected by the disaster; "Sunset" clauses critical to avoid agency surviving beyond its mission.
B: Create dedicated organization drawn from existing line ministries		
Improves coordination with existing sectors; Clearly a temporary organization, since staff returns to previous government positions; Top executive may be drawn from outside bureaucratic ranks	Group may lack political authority; Can weaken line ministries; Proper expertise may not exist in line ministries; May find it difficult to get funding from international cooperation.	Disaster recovery lessons more likely to be applied by Ministry staff to improve future disaster operations.
C: Ministries manage recovery under national disaster plan		
Places sector responsibility with sector expertise; Full local ownership; Disaster risk reduction lessons carried back to normal operations; Increases probability government will apply disaster recovery lessons to future disaster operations.	Can overburden sub-national governments with inadequate capacity to manage large reconstruction program; Can overload line ministries (reconstruction and normal programs); Subnational governments may be incapable of reconstruction duties.	Effective, but needs detailed pre-disaster planning, staff training, and national disaster plan; Requires existing line ministries to be strengthened with experienced staff; Advisable option if sub-national governments are strong.

Source: Jha, A. et. al. (2010) "Safer Homes, Stronger Communities. A Handbook for Reconstructing After Natural Disasters" World Bank. Washington D.C.

In addition to determining the institutional management arrangement that will be used for reconstruction actions, the World Bank recommends following these general reconstruction guidelines:

- The government must lead efforts oriented to defining the reconstruction policy and coordinate its implementation. These policies should be communicated to the public.
- Institutional arrangements must reflect the reconstruction policy. The agency responsible for leading reconstruction actions should have a clear mandate, a flexible structure, and a defined operational plan.

3 Jha, A. et. al. (2010) "Safer Homes, Stronger Communities. A Handbook for Reconstructing After Natural Disasters" World Bank. Washington D.C.

- The lead agency, whether it is a new agency or a temporary committee, must work closely together with line ministries and other entities to fulfill its mandate.
- It should also establish mechanisms for coordinating the actions and funding of local, national, and international organizations involved in reconstruction and for ensuring that information is shared among them.
- Funding must be allocated equitably and stay within agreed-upon limits. Using a wide range of control mechanisms and careful monitoring of all funding sources minimizes corruption.

International practices show some successful experiences:

EXAMPLES OF SOME SUCCESSFUL RECONSTRUCTION EXPERIENCES

Country/ Year	Agency	Remarks
Colombia/1999 (Earthquake in Armenia)	Fondo para la Reconstrucción Económica y Social del Eje Cafetalero (FOREC)	New agency, with functional and regulatory independence. Board members included representatives of the central and local governments and the private sector. Early and detailed damage assessment was carried out, and intervention was planned to mitigate risks. Proper funding and use of pre-existing subnational capacities to manage the use of the land. Decentralized implementation based on NGOs and, to a lesser extent, on local governments. Proper temporary shelter coverage provided to victims gave time for planning intervention.
Iran/ 2003 (Earthquake in Bam)	Steering Committee	Task group based on line ministries. Committee included 5 ministers and the heads of several housing and culture-related organizations. Independence to define the reconstruction policy, which included redesigning the affected areas and the execution of reconstruction actions by the national housing agency.
Mexico / 1985 (Earthquake in Mexico D.F.)	Renovación Habitacional Popular (RHP)	New agency formed borrowing staff from government ministries, many without previous experience in reconstruction. After chaotic start, its capacity grew and the agency could plan the construction of multi-family housing for those affected. It had adequate funding and autonomy. 48 thousand homes were built in the two years of its mandate.

Source: Table prepared on the basis of information contained in Jha, A. et. al. (2010) "Safer Homes, Stronger Communities. A Handbook for Reconstructing After Natural Disasters" World Bank. Washington D.C.

In Peru, the reconstruction process associated with the Earthquake that hit Pisco in 2007 showed limitations because the agency that would lead coordination and decision-making was not defined from the very beginning. The members of the Board of FORSUR, the new agency created –(Law 29078)–, included not only the President of FORSUR, but also three regional governors, five ministers, and two businessmen. The allocation of funding was a collegial task of the board, while the President of FORSUR had the role of coordinating the actions of all stakeholders.

FORSUR was created as an executing unit of the Prime Minister's Office and was subject to public procedures not only for the approval of each project, but also to have access to funding. Most of its operations were carried out in Lima and the levels of coordination with local municipalities and communication with the public were low.

Moreover, since there was no rapid assessment of the damage and needs caused by the earthquake, efforts to support the population affected were not properly prioritized.

Because of these difficulties, the program execution of FORSUR was lower than anticipated, which made it necessary to restructure the agency in 2009 (D.U.089-2009). As a result of this, the board was replaced by an Executive President and the process of fund allocation to the implementing agencies was simplified.

In this sense, the creation of the new Autoridad para la Reconstrucción con Cambios (ARCC) for post-disaster reconstruction after El Niño Costero would be a better option than the approach used in the case of FORSUR because the Executive Director of ARCC has the rank of minister and will be in charge of preparing the reconstruction plan. In addition to this, procurement procedures will be simplified and sources of funding (FONDES) are clearly identified.

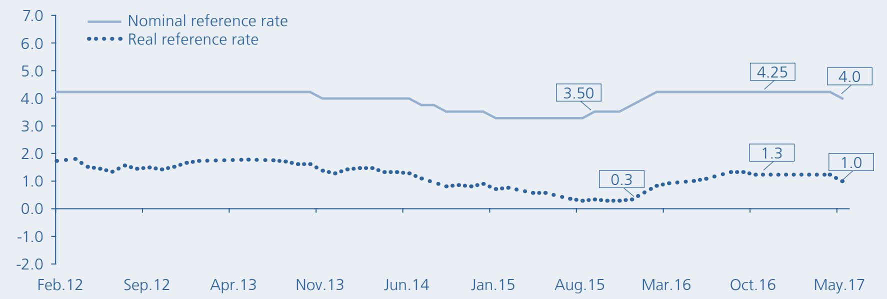
V. Monetary Policy and Financial Markets

Monetary Policy Actions

32. Since March, when our previous report was published, monetary policy faced the challenge of sustaining its expansionary position in a context marked by a transitory increase in prices generated on the side of supply, especially by the food supply. As a result, in March the monthly rate of inflation rate recorded its greatest increase in 19 years (1.3 percent), which led the year-to-year rate to rise to 3.97 percent. In this context, the Board of BCRP maintained the benchmark rate at 4.25 percent in April, but gave a clear signal that it would soon ease its monetary policy position, stating that the Board oversaw "*new data on inflation and inflation determinants, giving particularly close attention to data about the reversal being observed in terms of supply shocks, in order to ease the monetary policy stance in the short term*". The statement had an immediate impact on the interest rates of term operations in the money market, which showed a reduction from mid-April anticipating a cut in the benchmark rate in the very near future. In May, the Board of BCRP approved to reduce the monetary policy interest rate by 25 basis points to 4.0 percent, which led to a further reduction in money market rates.

    This transitory increase in inflation reversed mostly in April and May, when inflation showed negative rates of -0.26 and -0.42 percent, respectively. Thus, average monthly inflation in the quarter March to May showed a rate of 0.21 percent, which is equivalent to an annualized rate of inflation of 2.6 percent, within the target range. Inflation expectations in this period increased temporarily to 3.05 percent in April, falling thereafter to 2.92 percent in May, whereas inflation without food and energy –which excludes the most volatile components of the consumer basket– showed a clear downward trend and recorded a year-to-year rate of 2.54 percent in May.

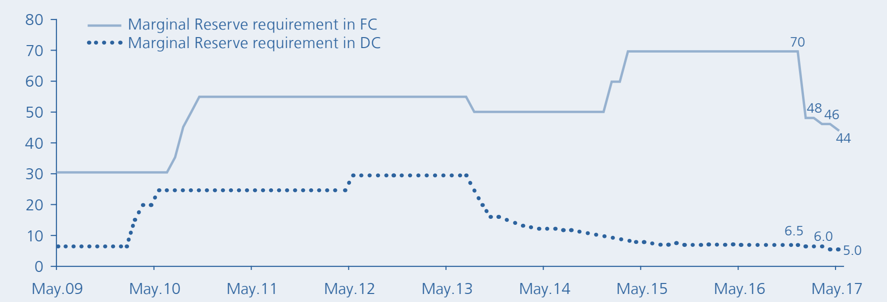
Graph 48
NOMINAL AND REAL* REFERENCE INTEREST RATE
(%)



* Considers expectation of inflation.

During April and May, BCRP continued with its policies of easing liquidity in dollars and soles implemented this year. As regards actions in soles, the Central Bank lowered the rate of reserve requirements in soles from 6.0 to 5.0 percent, injecting in this way about S/ 500 million in a context of slower growth of credit to the private sector. As for actions in foreign currency, in May BCRP reduced the maximum limit of the mean rate of reserve requirements and the marginal rate from 46 to 44 percent as a preemptive measure due to the increases anticipated in international interest rates.

Graph 49
RESERVE REQUIREMENT IN DOMESTIC AND FOREIGN CURRENCY
(As % banks' liabilities)



Monetary Operations

33. Between March and May, the Central Bank's monetary operations were oriented to maintaining adequate levels of liquidity in domestic currency in a period

characterized by an increased demand for domestic currency to pay income taxes and by institutional investors' greater appetite for government bonds. In this context, BCRP injected liquidity buying US$ 1.58 billion in the spot market and also through the partial renewal of currency repos and term security repos. It should be recalled that these operations were used during 2014 and 2015 as part of the Central Bank's program of de-dollarization of credit to offset potential pressure on money market interest rates. Since deposits in soles have been growing at higher rates than credit in this currency, banks' demand for these instruments has been a little lower.

As a result of these operations, between February and May the balance of repos fell from representing 11.7 percent to representing 11.1 percent of the net assets of BCRP. Moreover, public sector deposits, which continued to be the most important liability of BCRP, increased their ratio in terms of the BCRP net assets from 32.9 percent to 34.6 percent in the same period. This increased amount of public deposits reflects both the revenue associated with the period of payment of the income tax as well as the revenue obtained from the issuance of Treasury bonds. Between March and May, public sector deposits at BCRP increased by S/ 5.80 billion.

Table 29
SIMPLIFIED BALANCE SHEET OF THE BCRP
(As % of Net Assets)

	Dec.14	Dec.15	Dec.16	Feb.17	May.17
I. Net assets	**100%**	**100%**	**100%**	**100%**	**100%**
Net International Reserves	**94.9%**	**87.4%**	**87.8%**	**88.3%**	**88.9%**
	(US$ 62,307 mills.)	(US$ 61,485 mills.)	(US$ 61,686 mills.)	(US$ 62,291 mills.)	(US$ 63,414 mills.)
Repos	**5.1%**	**12.6%**	**12.2%**	**11.7%**	**11.1%**
II. Net liabilities	**100%**	**100%**	**100%**	**100%**	**100%**
1. Total public sector deposits	**36.9%**	**32.7%**	**34.0%**	**32.9%**	**34.6%**
In domestic currency	18.7%	13.0%	12.2%	11.6%	14.0%
In foreign currency	18.2%	19.7%	21.8%	21.3%	20.7%
2. Total financial system deposits	**27.0%**	**37.1%**	**33.4%**	**32.7%**	**31.6%**
In domestic currency	7.7%	4.5%	4.6%	4.0%	3.9%
In foreign currency	19.4%	32.6%	28.8%	28.8%	27.7%
3. BCRP instruments	**9.8%**	**10.0%**	**11.1%**	**14.0%**	**12.8%**
CD BCRP	8.0%	6.5%	9.9%	12.6%	12.0%
CDR BCRP	1.3%	3.0%	0.3%	0.1%	0.0%
Term deposits	0.0%	0.4%	0.0%	1.1%	0.7%
Overnight deposits	0.5%	0.1%	0.9%	0.2%	0.1%
4. Currency	**19.7%**	**15.7%**	**17.2%**	**16.1%**	**16.3%**
5. Others	**6.5%**	**4.5%**	**4.3%**	**4.3%**	**4.7%**

BCRP also continued carrying out regular auctions of 6-month, 12-month, and 18-month BCRP-CDs three times a week in order to regulate the amount of liquidity of banks as well as to contribute to develop the short-term yield curve in soles.

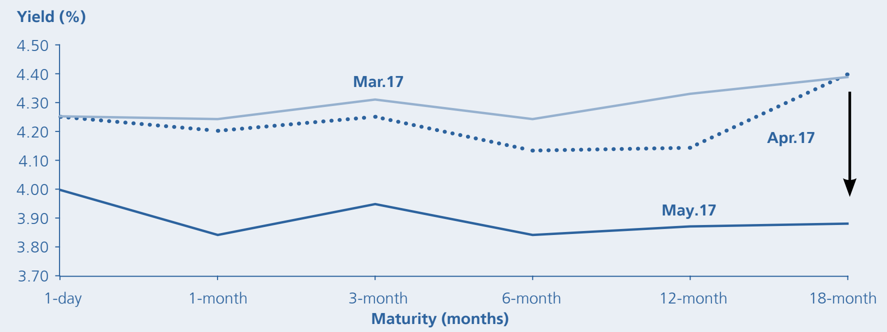
Table 30
INTEREST RATE OF AUCTIONS OF CD BCRP
(%)

	Term (months)				
	1	**3**	**6**	**12**	**18**
1-Mar-17					4.80
2-Mar-17				4.62	
6-Mar-17			4.45		
8-Mar-17		4.37			4.79
9-Mar-17	4.26	4.33		4.61	
10-Mar-17		4.32			4.73
13-Mar-17		4.31	4.44		4.75
14-Mar-17			4.43	4.55	
15-Mar-17			4.43	4.54	4.72
16-Mar-17			4.43	4.54	
17-Mar-17	4.26		4.43		
20-Mar-17			4.43	4.56	
22-Mar-17					4.71
23-Mar-17				4.60	
24-Mar-17	4.23			4.46	
27-Mar-17			4.33	4.40	4.47
28-Mar-17	4.12		4.24	4.34	
29-Mar-17	4.19				4.41
30-Mar-17	4.24			4.33	4.39
3-Apr.17			4.26		
5-Apr.17					4.40
10-Apr-17			4.15		
12-Apr.17					4.33
17-Apr.17			4.14	4.21	4.30
18-Apr.17			4.14	4.18	4.27
19-Apr.17			4.13	4.17	4.25
20-Apr.17			4.13	4.16	4.22
21-Apr.17				4.14	
24-Apr.17			4.13		
25-Apr.17			4.12	4.12	
26-Apr.17			4.12	4.11	4.20
27-Apr.17			4.10	4.11	
3-May-17					4.15
4-May-17				4.11	
8-May-17			4.05		
10-May-17			4.00	4.05	4.07
11-May-17			4.00	4.00	4.03
12-May-17			3.84	3.90	
15-May-17			3.86	3.91	
16-May-17	3.82	3.85	3.87		
17-May-17	3.84	3.95	3.87		3.92
18-May-17			3.90	3.91	
22-May-17			3.88		
24-May-17					3.92
25-May-17				3.87	
29-May-17			3.84		
31-May-17					3.88

Source: BCRP

The interest rates of primary emissions of CDBCRP dropped by 37 basis points on average between March and May 2017. In May, the yield curve showed an inverted shape for operations with terms between overnight and 1-month and between 3 months and 6 months, a behavior associated with market expectations of further reductions in the benchmark rate in the coming months.

Graph 50
YIELD CURVE OF CENTRAL BANK SECURITIES [1/]



1/ Yield of CDBCRP end of period. One day rate corresponds to reference rate. As of May 26, 2017.

Interest Rates

34. In line with the BCRP communiqué of April, interest rates in the money market in dollars anticipated the reduction of 25 basis points in the benchmark interest rate that was implemented by the Central Bank in May 2017. The interbank rate converged quickly to its new benchmark level of 4.0 percent and the corporate prime rate on lending decreased 31 basis points between March and May, in a context marked by banks' increased availability of funds that reflected the reserve requirement measures adopted recently. Similarly, interest rates in the credit market decreased in all segments (26 basis points on average), except for the rate of consumer loans due to the high level of non-performing loans observed in this segment. The segment of loans to small businesses registered the greatest rate reduction (48 basis points).

Moreover, between March and May the interest rates on deposits in soles fell by 20 basis points for terms of 31 to 180 days, while the rates for deposits with longer terms fell from 4.67 to 4.56 percent.

Table 31
INTEREST RATE IN DOMESTIC CURRENCY
(%)

		Dec.15	Sep.16	Dec.16	Mar.17	Apr.17	May.17
Pasive	Deposits up to 30-day	3.88	3.95	4.31	4.05	4.12	4.09
	On 31 to 180-day term deposits	4.53	4.47	4.73	4.42	4.60	4.22
	On 181 to 360-day term deposits	4.59	4.70	4.91	4.67	4.73	4.56
Active	Corporate	6.18	6.07	5.88	5.78	5.91	5.71
	Large companies	7.12	7.23	7.12	7.52	7.43	7.23
	Medium-sized enterprises	10.23	10.74	10.39	10.47	10.39	10.21
	Small businesses	20.45	21.59	21.65	21.54	20.32	21.06
	Consumer	44.03	44.01	46.77	45.24	45.81	46.32
	Mortgage	8.95	8.82	8.52	8.73	8.70	8.65

Source: BCRP and SBS.

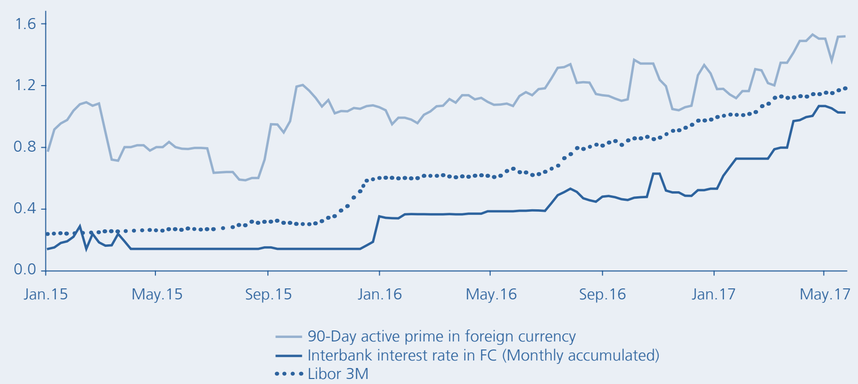
On the other hand, the interest rates on operations in dollars continued to increase in May, in line with the rises observed in international interest rates. Thus, the interbank rate rose from 0.82 to 1.06 percent, while the corporate prime rate on lending rose from 1.38 to 1.55 percent. By type of credit, most segments showed higher rates (increasing by 41 basis points on average), with the exception of the mortgage sector whose rate recorded 9 points below the level observed in March 2017. As regards deposit interest rates, the interest rate for deposits of up to 30 days increased from 0.50 to 0.63 percent, while the rates for deposits between 31 and 360 days increased by 18 basis points on average.

Table 32
INTEREST RATE IN FOREIGN CURRENCY
(%)

		Dec.15	Sep.16	Dec.16	Mar.17	Apr.17	May.17
Pasive	Deposits up to 30-day	0.16	0.22	0.23	0.50	0.58	0.63
	On 31 to 180-day term deposits	0.38	0.49	0.51	0.69	0.82	1.09
	On 181 to 360-day term deposits	0.56	0.53	0.60	0.80	0.92	0.84
Active	Corporate	2.33	3.00	2.47	3.03	3.11	3.19
	Large companies	5.54	5.18	5.02	5.12	5.05	5.28
	Medium-sized enterprises	8.06	7.37	6.91	7.07	6.97	6.86
	Small businesses	11.26	10.00	10.67	9.83	9.69	10.59
	Consumer	32.07	32.38	32.08	32.54	33.20	33.46
	Mortgage	6.71	6.46	6.14	6.35	6.27	6.26

Source: BCRP and SBS.

Graph 51
90-DAY CORPORATE PRIME, INTERBANK OVERNIGHT, AND LIBOR 3-MONTH RATE IN FOREIGN CURRENCY
(%)

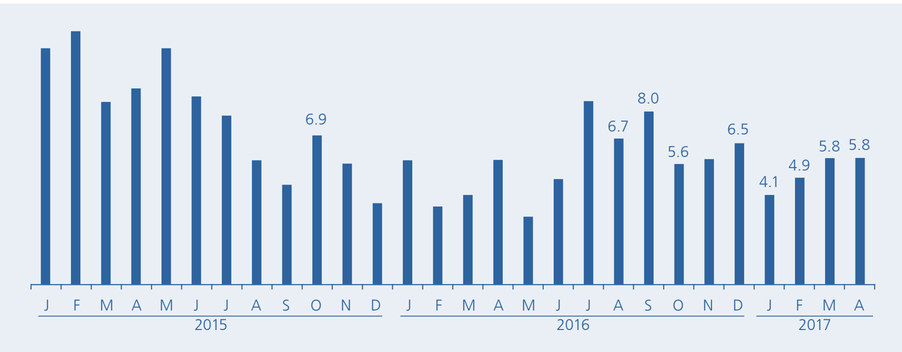


Source: SBS, BCRP, and Bloomberg.

Liquidity

35. Currency in circulation, the monetary aggregate more associated with transactions, showed a year-on-year growth rate of 6.0 percent in May 2017, a similar rate to that recorded in March (5.8 percent).

Graph 52
CURRENCY
(Annual % change)



The year-on-year growth rate of private sector deposits increased from 4.5 percent in March to 6.5 percent in April. By currencies, the growth rate of deposits in soles rose from 13.4 percent to 13.8 percent in the same period, while the growth rate of deposits in dollars dropped from -5.8 to -2.0 percent. This result was consistent with a greater preference for saving in domestic currency in a context of lower expectations of depreciation of this currency, which makes saving in soles more appealing.

Graph 53
DEPOSITS OF THE PRIVATE SECTOR BY CURRENCY
(Annual % change)

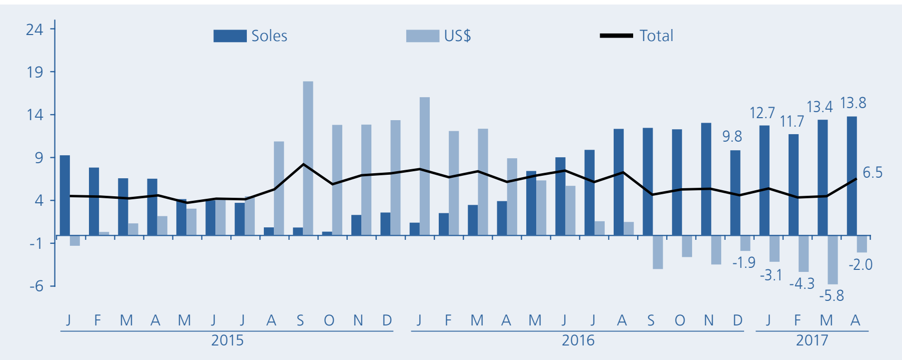


Table 33
MONETARY AND CREDIT ACCOUNTS OF THE DEPOSITORY CORPORATIONS
(Annual % change)

	Dec.15	Mar.16	Jun.16	Sep.16	Dec.16	Mar.17	Apr.17
1 Currency	3.8	4.1	4.9	8.0	6.5	5.8	5.8
2 Deposits in domestic currency	2.6	3.5	9.0	12.4	9.8	13.4	13.8
3 Total deposits 1/	7.2	7.4	7.5	4.6	4.6	4.5	6.5
4 Broad money in domestic currency	3.0	4.1	8.4	11.1	9.0	11.4	11.0
5 Total broad money 1/	6.5	7.1	7.5	5.1	5.0	4.6	5.9
6 Credit to the private sector in domestic currency	28.0	23.1	17.0	9.5	7.2	5.7	5.0
7 Credit to the private sector 1/	8.0	7.7	7.1	5.0	5.6	5.4	5.1

1/ Balances in foreign currency are valuated at constant exchange rate on December 2016.

The ratio of dollarization of deposits remained at 49 percent in April. By type of deposits, dollarization has decreased in personal deposits (mainly in demand deposits and term deposits). On the other hand, the ratio of dollarization of corporate deposits declined in the case of demand deposits, but increased in the case of saving and term deposits.

Table 34
DOLLARIZATION RATIO OF DEPOSITS
(%)

	Dec.14	Dec.15	Sep.16	Dec.16	Jan.17	Feb.17	Mar.17	Apr.17
Business	**50.7**	**55.5**	**56.2**	**54.3**	**53.5**	**53.3**	**52.8**	**53.5**
Demand deposits	47.1	50.6	53.5	52.2	53.6	50.5	50.3	49.9
Savings deposits	63.6	68.9	62.1	57.6	68.4	66.2	64.5	67.3
Term deposits	61.8	71.7	65.0	62.7	49.4	61.9	59.0	63.2
Individuals	**33.7**	**40.3**	**37.6**	**36.3**	**36.3**	**36.2**	**36.1**	**36.2**
Demand deposits	48.0	50.6	53.5	52.2	53.1	50.5	50.3	49.9
Savings deposits	35.2	40.7	41.3	40.0	40.0	40.2	39.6	39.7
Term deposits	30.8	38.5	32.0	30.7	30.6	30.1	29.8	29.5
CTS	33.9	33.6	32.4	30.1	29.8	29.8	29.9	29.9
Others terms	29.5	40.3	31.8	31.0	30.9	30.2	29.8	29.3
Pension funds	**62.0**	**68.3**	**58.9**	**56.9**	**57.6**	**57.4**	**57.1**	**56.9**
Mutual funds	**60.5**	**67.4**	**62.5**	**63.4**	**63.2**	**64.1**	**63.4**	**63.4**
TOTAL	**49.2**	**54.9**	**50.8**	**49.1**	**49.2**	**49.1**	**48.9**	**49.0**

In 2017-2018, the process of de-dollarization of liquidity is expected to go on since lower expectations of depreciation of the sol, together with higher interest rates in soles than in dollars, would make saving in domestic currency more attractive. Therefore, deposits in domestic currency are foreseen to show growth rates of over 10.0 percent in the next two years.

Credit to the Private Sector

36. Lending to the private sector grew 5.4 percent in annual terms in April, with personal loans (6.5 percent) and loans to the corporate sector and to large enterprises (6.1 percent) accounting mainly for this growth rate. As regards personal credit, mortgage loans and other consumer loans maintain rates close to those observed at end 2016 (4.9 percent and 10.2 percent, respectively). Moreover, mortgage loans continue to reflect the process of de-dollarization, with mortgage loans in dollars recording a year-to-year negative variation rate of 8.0 percent.

Graph 54
CREDIT TO THE PRIVATE SECTOR
(Annual % change)

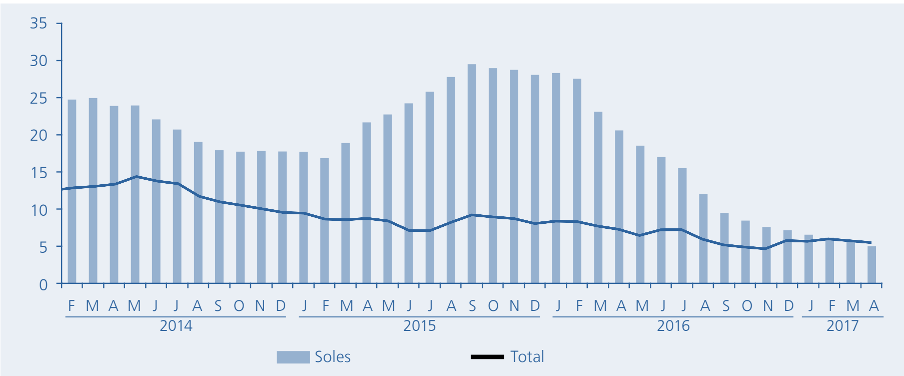


Table 35
CREDIT TO THE PRIVATE SECTOR
(Annual % change)

	Apr.16	Dec.16	Apr.17
Domestic currency	20.6	7.2	5.0
Foreign currency	-15.5	2.1	6.2
Total	**7.2**	**5.6**	**5.4**

As for credit to business, this segment showed greater dynamism in April than in 2016 (except in the case of loans to medium-sized companies), the growth rate of credit in the segment of corporations and large enterprises standing out (6.1 percent vs. 4.7 percent in 2016). However, this greater dynamism of credit to business is concentrated in loans in dollars (16.3 percent) and, to a lesser extent, in credit to small and micro businesses.

Table 36
CREDIT TO THE PRIVATE SECTOR
(12-month % change)

	Dec.14	Dec.15	Dec.16	Mar.17	Apr.17
Businesses	**8.6**	**6.2**	**4.8**	**4.9**	**4.7**
Corporate and large companies	9.6	12.7	4.7	5.7	6.1
Medium-sized enterprises	13.1	-2.5	2.6	0.1	-1.4
Small business and Microbusinesses	1.5	2.7	7.7	8.9	8.6
Individuals	**11.4**	**11.4**	**7.1**	**6.8**	**6.5**
Consumer	11.3	14.5	8.7	8.1	7.8
Car loans	5.8	-8.0	-7.4	-8.0	-7.8
Credit cards	14.9	23.7	8.2	5.8	5.3
Rest	9.9	11.6	10.2	10.7	10.4
Mortgage	11.6	7.3	4.9	5.0	4.8
TOTAL	**9.6**	**8.0**	**5.6**	**5.6**	**5.4**

Moreover, the slowdown in lending to medium-sized enterprises and the lower dynamism of credit via credit cards have contributed to the slight reduction registered in the growth of credit at April, whose year-to-year growth rate is slightly lower than that recorded in 2016 (5.6 percent). Furthermore, the greater dynamism of credit in foreign currency stands out (6.2 percent in April vs. 2.1 percent December 2016), in contrast with the reduction observed in lending in soles (5.0 percent in April vs. 7.2 percent in December 2016).

In the 2017-2018 forecast horizon, the growth rates of credit to the private sector and liquidity are expected to evolve in line with the rate of growth of nominal GDP, with placements in domestic currency showing greater dynamism. In 2017, total credit would grow 5.0 percent, with lending in soles showing a growth rate of 6.1 percent and lending in dollars a growth rate of 2.3 percent, mainly as a result of the growth of credit to corporations and large enterprises observed in the first half of the year. Moreover, because this growth of lending is supported by the recovery of economic growth in the primary sectors, it is foreseen that the ratio of credit to GDP will remain at 40 percent during 2017.

Graph 55
RATIO CREDIT/GDP
(%)

* Forecast.

De-dollarization of Credit

37. Considering a constant exchange rate, the ratio of dollarization at April remained at 29 percent. In addition to this, personal loans continue to show a declining trend in terms of dollarization, especially in mortgage loans and car loans, in accordance with the objectives of the de-dollarization program implemented.

Table 37
DOLLARIZATION RATIO OF CREDIT TO THE PRIVATE SECTOR
(%)

	Dec.14	Dec.15	Dec.16	Mar.17	Apr.17
Businesses	**48.4**	**38.7**	**38.3**	**38.3**	**38.2**
Corporate and large companies	59.8	46.5	49.3	49.8	49.7
Medium-sized enterprises	59.3	47.6	42.9	42.2	42.0
Small business and Microbusinesses	11.5	8.8	7.0	6.3	6.1
Individuals	**20.0**	**15.9**	**13.3**	**12.6**	**12.5**
Consumer	9.5	7.9	6.9	6.6	6.6
Car loans	68.9	44.6	26.8	24.1	23.7
Credit cards	6.6	6.4	6.4	6.3	6.5
Rest					
Mortgage	33.9	26.8	22.4	21.1	20.9
TOTAL	**38.2**	**30.5**	**29.2**	**28.8**	**28.7**
At constant exchange rate	*41.1*	*30.2*	*29.2*	*29.4*	*29.5*

In the case of lending to business, the process of de-dollarization has continued to be observed in the case of loans to micro, small, and medium-sized businesses, whereas loans to the corporate sector and to large enterprises show an increase in the rates of dollarization, from 49.3 to 49.7 percent between December 2016 and April 2017. This would be reflecting the perception of a lower exchange rate risk for the companies in this market segment, particularly in the short term, in view of the appreciation of the sol observed.

Non-Performing Loans

38. In April, the ratio of non-performing loans was 3.4 percent, slightly higher than in December 2016 (3.1 percent). The credit segments that showed higher rates of non-performing loans were credit to medium-sized businesses and credit to micro and small businesses, these type of companies registering a decline in their pace of growth.

Table 38
CREDITS DELINQUENCY INDEX

	%				
	Dec.14	**Dec.15**	**Dec.16**	**Mar.17**	**Apr.17**
Businesses	**3.14**	**3.12**	**3.28**	**3.57**	**3.64**
Corporatie and large companies	0.37	0.47	0.41	0.47	0.54
Medium-sized enterprises	4.79	5.28	6.10	6.82	7.01
Micro and Small businesses	7.82	7.46	7.16	7.61	7.72
Individuals	**2.46**	**2.65**	**3.05**	**3.19**	**3.21**
Consumer	3.34	3.32	3.66	3.79	3.83
Credit cards	4.23	4.10	4.86	5.19	5.29
Car loans	4.25	4.41	5.60	5.86	5.96
Mortgage	1.44	1.84	2.28	2.45	2.44
Average	**2.91**	**2.87**	**3.09**	**3.31**	**3.37**

Moreover, lending in soles has shown a slightly greater increase in the delinquency rates than lending in dollars, with the deterioration of the rates of non-performing loans being especially noteworthy in the segments of credit to medium-sized enterprises, credit cards, and car loans. However, the delinquency rates in the latter are still lower than the corresponding rates of lending in dollars, especially the delinquency rates observed in personal loans and loans to micro and small businesses.

As for lending in dollars, delinquency rates have increased particularly in the lending portfolios of micro and small businesses, and car loans. Despite this, delinquency rates have remained slightly stable in the segments of corporate loans, mortgage loans, and the rest of consumer loans, which would be supporting the dynamism of credit in the rest of the forecast horizon.

Table 39 CREDITS DELINQUENCY INDEX : DOMESTIC CURRENCY					
	%				
	Dec.14	Dec.15	Dec.16	Mar.17	Apr.17
Businesses	**4.03**	**3.30**	**3.63**	**4.01**	**4.11**
Corporative and large companies	0.24	0.22	0.20	0.26	0.29
Medium-sized enterprises	5.63	5.04	6.07	6.81	7.07
Micro and small businesses	7.65	6.90	6.63	7.10	7.20
Individuals	**2.57**	**2.53**	**2.90**	**3.05**	**3.07**
Consumer	3.33	3.23	3.57	3.70	3.74
Credit cards	4.31	4.20	5.03	5.35	5.46
Car loans	4.61	1.91	2.58	3.11	3.26
Mortgage	1.33	1.46	1.87	2.08	2.07
Average	**3.40**	**2.87**	**3.18**	**3.45**	**3.51**

Table 40 CREDITS DELINQUENCY INDEX: FOREIGN CURRENCY					
	%				
	Dec.14	Dec.15	Dec.16	Mar.17	Apr.17
Businesses	**2.14**	**2.84**	**2.72**	**2.85**	**2.89**
Corporative and large companies	0.45	0.78	0.64	0.70	0.79
Medium-sized enterprises	4.22	5.55	6.15	6.83	6.93
Micro and small businesses	9.39	15.70	19.58	21.61	22.83
Individuals	**2.06**	**3.28**	**4.08**	**4.19**	**4.22**
Consumer	3.42	4.58	5.29	5.40	5.39
Credit cards	3.07	2.62	2.59	2.81	2.81
Car loans	4.09	7.52	13.86	14.55	14.64
Mortgage	1.64	2.88	3.70	3.82	3.85
Average	**2.13**	**2.87**	**2.84**	**2.98**	**3.04**

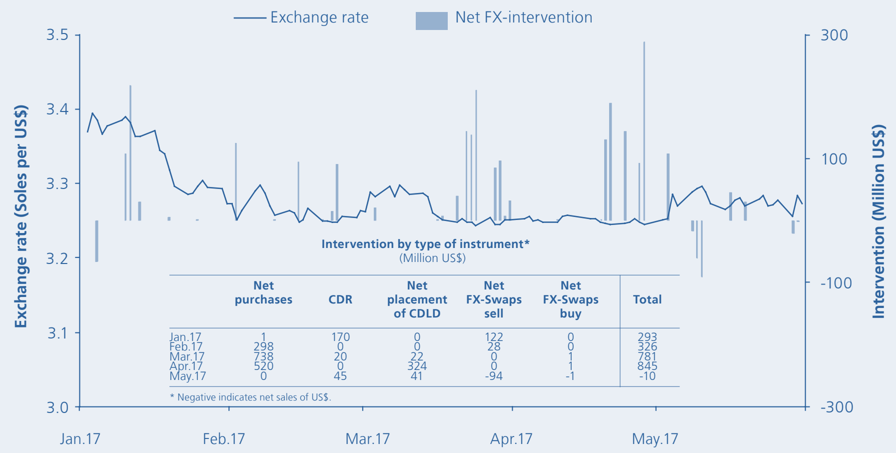
Exchange Rate and Intervention of BCRP in the Forex Market

39. In the period of March to May 2017, the PEN recorded a slight depreciation of 0.2 percent against the US dollar (from S/ 3.263 to S/ 3.271 per dollar) and thus shows an appreciation of 2.6 percent against the dollar year-to-date. However, the US dollar-PEN exchange rate showed differentiated movements within this period.

    Between March and April, the PEN appreciated 0.6 percent due to the global depreciation of the dollar, the inflow of capital, and companies' sales of dollars to meet payments of tax regularization. Subsequently, the sol declined 0.8 percent in May, affected by the fall in prices of commodities (crude oil) and by expectations of a rise in the interest rates of the U.S. Federal Reserve.

    In this context, BCRP bought dollars for a total of US$ 1.26 billion between March and April and placed Currency swaps-sell for a net amount of US$ 94 million in May.

Graph 56
INTERVENTION IN THE FOREIGN EXCHANGE MARKET AND EXCHANGE RATE[1/]



Intervention by type of instrument*
(Million US$)

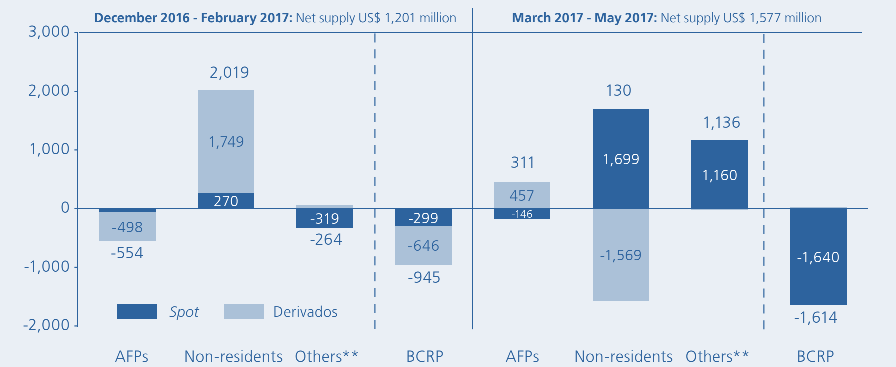
	Net purchases	CDR	Net placement of CDLD	Net FX-Swaps sell	Net FX-Swaps buy	Total
Jan.17	1	170	0	122	0	293
Feb.17	298	0	0	28	0	326
Mar.17	738	20	22	0	1	781
Apr.17	520	0	324	0	1	845
May.17	0	45	41	-94	-1	-10

* Negative indicates net sales of US$.

1/ Includes net purchases of US$, net maturities of CDR BCRP, net maturities of FX-Swaps , net placements of CDLD, and net purchases for substitution repo.

As for currency flows in the local foreign exchange market, the net supply of dollars between March and May 2017 was US$ 1.58 billion, with the supply of mining companies and retailers accounting for US$ 2.86 billion and the supply of the AFPs accounting for US$ 311 million, offset by the demand of the private sector (US$ 1.46 billion)

Graph 57
QUARTERLY TOTAL FLOW TO THE FOREIGN EXCHANGE MARKET*
(Million US$)



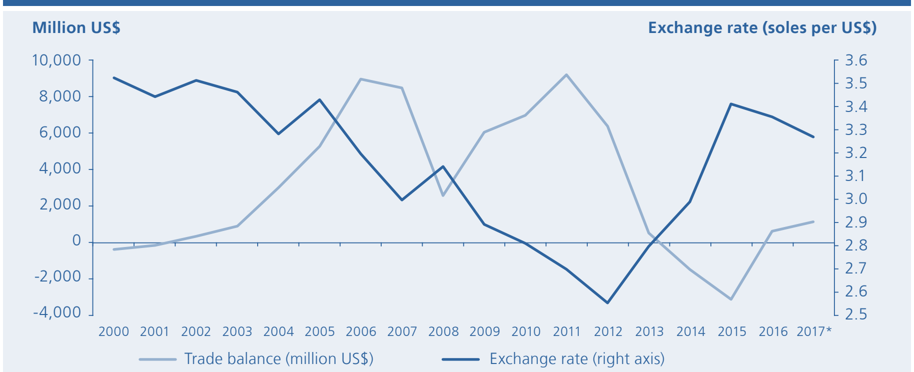
* Negative flows means net demand of US$ in the period.
** Includes Banco de la Nación, Financial institutions, Mining sector, Retail clients, and Privates.

It is worth pointing out that although non-resident investors' supply of dollars in the spot market amounted to US$ 1.70 billion due to an increased appetite for assets in soles, these investors demanded a total of US$ 1.57 billion in the market of derivatives mainly to obtain a foreign exchange hedge for these positions in domestic currency.

The Central Bank's demand for dollars in the same period amounted to US$ 1.64 billion. BCRP acquired dollars mainly through purchases of dollars in the spot market (US$ 1.26 billion) and through the placement of certificate of deposits payable in dollars –Certificado de Depósitos Liquidable en Dólares (CDLD) – for a total of US$ 407 million. The balances of BCRP foreign exchange instruments have remained at low levels and the BCRP exchange position has increased by US$ 2.60 billion between January and April.

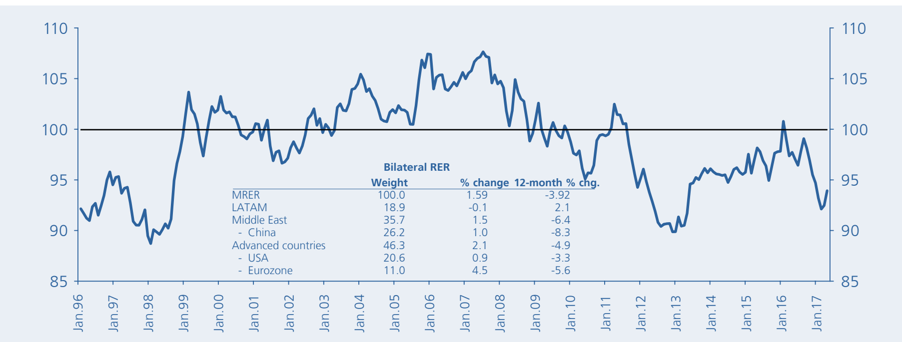
40. In May the multilateral real exchange rate index (RER) showed a level of 93.9 relative to the 2009 base period, which is a level 3.9 percent lower than that recorded in May 2016. The decline of the RER index in the last 12 months is associated mainly with the drop of the real exchange rate relative to the currencies of East Asian countries (6.4 percent) and developed countries (4.9 percent), offset in part by the increase of the exchange rate relative to Latin American currencies (2.1 percent). This trend was observed in a context of improvement of the external accounts.

Graph 58
TRADE BALANCE AND EXCHANGE RATE
(Annual data)



* Trade balace data disposable to the end of Q1 and exchange rate at the end of May

Graph 59
MULTILATERAL RER
(Index 2009=100)



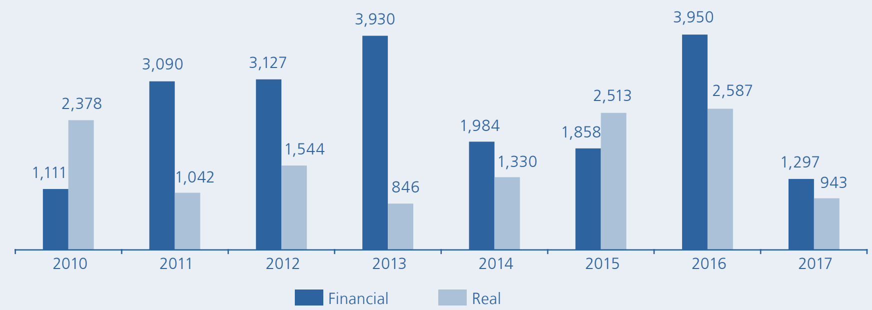
Bilateral RER

	Weight	% change	12-month % chg.
MRER	100.0	1.59	-3.92
LATAM	18.9	-0.1	2.1
Middle East	35.7	1.5	-6.4
- China	26.2	1.0	-8.3
Advanced countries	46.3	2.1	-4.9
- USA	20.6	0.9	-3.3
- Eurozone	11.0	4.5	-5.6

Financial Markets

41. Placements of securities issued in the local capital market by private companies in the months of April and May 2017 amounted to S/ 622 million, with the share of securities issued by non-financial companies standing out (56 percent of the total debt). Furthermore, the issuance of bonds in the first half of 2017 shows higher levels than the average level recorded in the last 7 years (S/ 448 million versus S/ 382 million per month).

Graph 60
BONDS ISSUED IN SOLES BY ECONOMIC SECTORS
(Million S/)



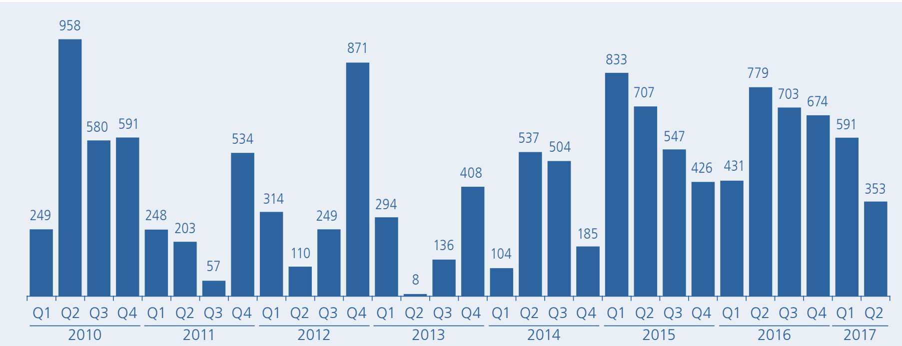
Source: Bloomberg and SMV.

Peruvian companies continued to prefer to issue securities denominated in soles (62 percent of the total), although the issuance of dollar-denominated securities increased in the last two months from US$ 9 million in the first quarter of 2017 to US$ 73 million, this increase being explained by the appreciation trend of the PEN and by its lower volatility, which is perceived by issuers as a reduction in the inherent foreign exchange risk. However, the increase observed in emissions of securities in dollars has not been accompanied by an extension in the average term of placement. The latter declined from 5 years in the first quarter of 2017 to 3.4 years in the second quarter of 2017, amid expectations of increases in interest rates in dollars worldwide. On the other hand, the average term of placement in soles rose from 8.5 years to 9.8 years during the same period, reflecting a more prudent management of the corporate bonds of these companies.

The demand for local debt has also been very high so far in the second quarter of 2017, the bid to cover average ratios being 1.9 in soles and 1.8 in dollars (versus 1.7 in soles and 1.1 in dollars in the first quarter of 2017). By type of rate, 73 percent of bonds will pay fixed-rate coupons, while 27 percent of the total of bonds issued are zero coupon short-term instruments.

Year-to-date, the financing obtained by non-financial companies in the capital market has grown 27 percent compared to the same period in 2016. A total of twelve companies have issued securities, the bonds issued in soles by Hermes Transportes Blindados in March of this year standing out due to the amount (S/ 400 million) and the maturity (13 and 28 years).

Graph 61
BONDS ISSUED BY NON-FINANCIAL FIRMS IN DOMESTIC MARKET*
(Million S/)



* Emissions are measured in dollars at the rate of change of last month. Includes titulization bonds at May 2017.

In the international market, Peruvian company Orazul Energy Egenor conducted its first bond issuance for a total of US$ 550 million to refinance their credit lines. The bonds were placed on April 25 with a maturity term of 10 years and a coupon rate of 5.625 percent. The credit rating of the issuance was BB (S&P and Fitch) and the market spread assigned was 246 basis points above that of the equivalent Peruvian global bond and 329 basis points above the 10-year US Treasury bond.

At May 2017, the balance of bonds issued by Peruvian companies in the international market amounts to US$ 20.18 billion, 36 percent of which correspond to bonds issued by financial entities.

Furthermore, BCRP approved to raise the operating limit of investment abroad for the administrators of private pension funds (AFP) from 42 percent to 44 percent. The aim of this measure, which will be effective gradually between the months of May and June, is to allow AFPs a greater diversification of their investment portfolios.

Table 41
BONDS ISSUED IN THE INTERNATIONAL MARKET

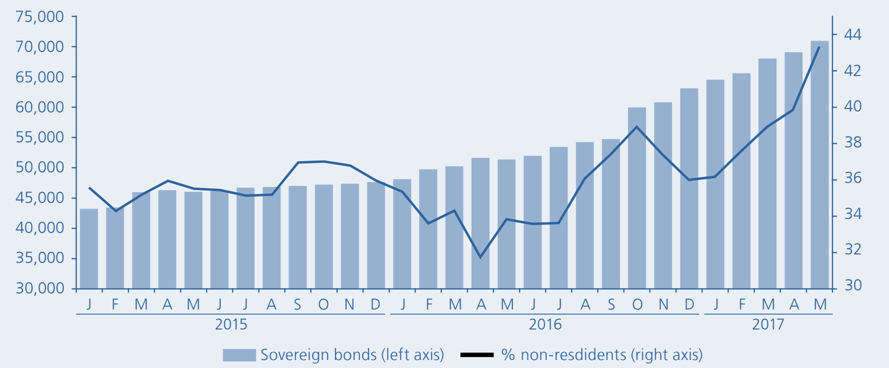
Business	Emission date	Amount (Million US$)	Maturity (Years)	Rate
YEAR 2014		**5,510**		
Non-financial sector		**3,306**		
Compañía Minera Ares	15 Jan.	350	7	7.75%
Minsur	31 Jan.	450	10	6.25%
Abengoa Transmisión Sur	8 Apr.	432	29	6.88%
Camposol	24 Apr.	75	3	9.88%
Rutas de Lima**	27 Jun.	370	22	8.38%
Rutas de Lima***	27 Jun.	150	25	5.25%
InRetail Shopping Mall	1 Jul.	350	7	6.50%
InRetail Consumer	7 Oct.	300	7	5.25%
Unión Andina de Cementos	28 Oct.	625	7	5.88%
Energía 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	1 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	8 Jul.	300	5	3.25%
COFIDE	8 Jul.	300	15	5.25%
YEAR 2015		**4,510**		
Non-financial sector		**3,361**		
GyM Ferrovias***	3 Feb.	206	25	4.75%
Southern Copper Corporation	17 Apr.	500	10	3.88%
Southern Copper Corporation	17 Apr.	1,500	30	5.88%
Consorcio Nuevo Metro de Lima	10 Jun.	1,155	19	5.88%
Financial sector		**1,149**		
Private financial sector		349		
Intercorp	3 Feb.	250	10	5.88%
Interbank**	3 Feb.	99	15	7.66%
Public financial sector		800		
COFIDE	7 Jul.	200	4	3.25%
COFIDE	7 Jul.	600	10	4.75%
YEAR 2016		**797**		
Non-financial sector		**497**		
Kallpa Generación	19 May.	350	10	4.88%
Camposol	20 May.	147	5	10.50%
Financial sector		**300**		
Private financial sector		300		
Banco de Crédito del Peru	20 Oct.	300	3	2.25%
YEAR 2017		**1,155**		
Non-financial sector		**550**		
Orazul	25 Apr.	550	10	5.63%
Financial sector				
Public financial sector		605		
Fondo MiVivienda**	7 Feb.	455	6	7.00%
Fondo MiVivienda	7 Feb.	150	7	3.50%

*Emission in Swiss Franc.
** Emission in Soles.
*** Emission in Soles VAC.
Source: Bloomberg and SMV.

In the market of government bonds, the balance of bonds issued by Peru increased from S/ 67.99 billion in March to S/ 70.90 billion in May 2017. According to the report of the Ministry of Economy (MEF) entitled "Estrategia de Activos y Pasivos 2016-2019" the balance of bonds issued by Peru at December 2017 could be within a range of S/ 73.36 billion to S/ 86.35 billion. The increase in the debt balance has been accompanied by an increase in the participation of non-resident investors in the domestic debt market, which in net terms amounts to S/ 2.39 billion (82 percent of the total issued during April and May).

Similarly, the flow of bonds in the emerging market economies have shown a positive trend in the last four months, influenced mainly by changes in expectations regarding the trajectory of rises in the Federal Reserve interest rates. The risk factors that could change the recent trend include geopolitical problems between the United States and North Korea; the reduction in the Federal Reserve balance sheet, and a less gradual normalization of monetary policy in the United States.

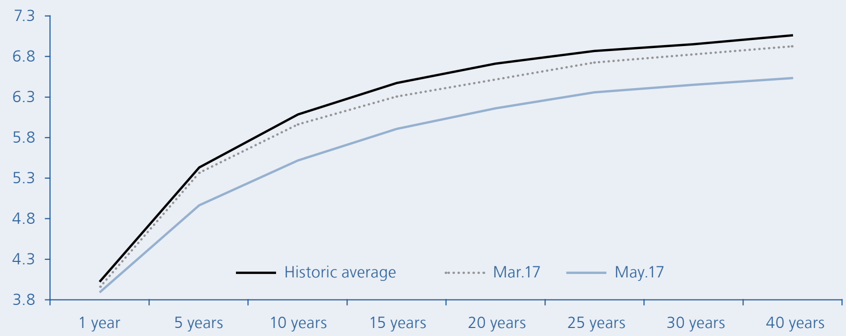
Graph 62
BALANCE OF SOVEREIGN BONDS AND PARTICIPATIONS ON NON-RESIDENT INVESTORS
(Amount in million S/ and partcipation in %)



Source: MEF.

Moreover, the yield curve of sovereign bonds has registered significant valuations in the past two months –an average reduction of 33 basis points in interest rates–, in line with the recovery observed in the demand for emerging markets' assets. In May, the yield curve showed a level 46 basis points below the historical average level.

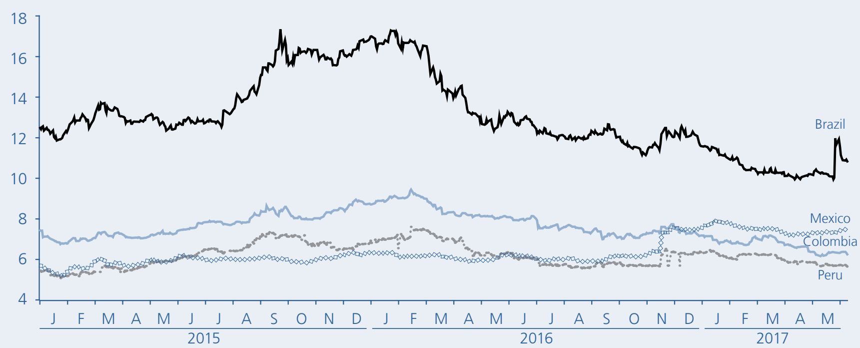
Graph 63
YIELD CURVE OF CENTRAL BANK SECURITIES
(%)



* Historic average correspond to the monthly average rate since 2005.

Mixed behaviors were observed In the Latin American market of global government bonds in domestic currency between March and May 2017. On the one hand, the 10-year bond showed a positive performance in Peru and Colombia due to the recovery of copper and oil prices as well as due to the reduction of the respective monetary policy rates in these countries. On the other hand, the rate in Mexico increased by 25 basis points, in line with the rise in the interest rate of the Central Bank of Mexico. In Brazil, the rate increased from 10.1 to 10.9 percent, influenced by the increase of geopolitical risk in this country.

Graph 64
10-YEAR TREASURY BOND YIELDS IN DOMESTIC CURRENCY
(%)



Source: MEF and Bloomberg.

Box 2

SURVEY ON CREDIT CONDITIONS IN THE FIRST QUARTER OF 2017

Between March 27 and April 10, 2017, the Central Bank conducted the XXII Survey of Credit Conditions (SCC) among representatives of the risk, commercial, and financial areas of different banks of the country. The SCC includes questions about the behavior of the supply and the demand for credit in the last quarter as well as questions about expectations regarding these variables in the next three months.

The questions about the behavior of the supply and the demand for credit were as follows:

- **Supply**: How have the criteria used by your organization for the approval of loans changed in the last 3 months?
- **Demand**: How has your clients' demand for loans changed in the last 3 months?

The questions about expectations were as follows:

- **Supply**: How will the criteria used by your organization for approving loans change in the next 3 months?
- **Demand**: How do you think your clients' demand for loans will change in the next 3 months?

Results of the Survey of Credit Conditions (SCC)

The survey results show that banks perceive a deterioration in the conditions of the supply and the demand for credit (with the exception of the supply of mortgage loans) and that they expect this situation to continue in the second quarter.

RESULTS OF SURVEY OF CREDIT CONDITIONS 2017

	Q1.16	Q2.16	Q3.16	Q4.16	Q1.17		
PERCEPTIONS							
Loans supply - Businesses	34.1	40.0	47.7	50.0	37.5	⬇	<
loans demand - Businesses	37.5	42.5	55.0	47.5	38.9	⬇	<
Loans supply - Individuals - consumer loans	39.6	50.0	38.6	47.7	47.5	⬇	<
Loans demand - Individuals - consumer loans	52.1	60.0	56.8	59.1	47.5	⬇	<
Loans supply - Individuals - mortgage loans	40.6	46.4	42.9	42.9	50.0	⬆	=
Loans demand - Individuals - mortgage loans	53.1	46.4	50.0	53.6	50.0	⬇	=
EXPECTATIONS							
Loans supply - Businesses	38.6	44.4	50.0	47.5	40.0	⬇	<
loans demand - Businesses	39.6	38.9	32.5	50.0	50.0	⇨	=
Loans supply - Individuals - consumer loans	43.8	45.0	47.7	45.5	42.5	⬇	<
Loans demand - Individuals - consumer loans	60.4	70.0	59.1	65.9	55.0	⬇	>
Loans supply - Individuals - mortgage loans	50.0	46.4	53.6	42.9	50.0	⬆	=
Loans demand - Individuals - mortgage loans	56.3	64.3	60.7	50.0	50.0	⇨	=

1 / Survey includes commercial banks. The evolution index of the conditions of loans supply is formed from the difference in the percentage of the entities that have "relaxed" the approval criteria of the credits less the percentage of the companies that have "restricted" it. This index fluctuates between 0 and 100; In this way, values above 50 indicate a "relaxation" of credit conditions, while values below 50 indicate a "tightening" of credit conditions. Also, an index value of 50 reflects a neutral position, with no change in credit conditions.

Loans to businesses

The respondents of the banks surveyed also consider that changes in credit supply conditions are reflected in restrictions on the guarantees required and in adjustments in the limit of credit lines.

On the side of the demand, they say that the demand for loans has declined in the first quarter, and that the lower need for financing fixed assets and working capital are the main factors that explain this decline, in line with the slowdown of domestic demand.

In the second quarter, banks expect the supply of credit to businesses to continue deteriorating, while the demand would continue to show similar levels to those observed in the first quarter.

The financial institutions surveyed perceive that the deterioration of current supply and demand conditions is reflected in all of the business loan segments. In the particular case of loans to developers of infrastructure projects, respondents say that banks' conditions have become harder in terms of both guarantees and credit lines and that the demand for loans for this type of business has decreased.

Consumer loans

Respondents also say that the supply of consumer loans has tightened slightly in the first quarter of 2017 and that this is reflected in a further adjustment of credit lines, associated with higher levels of non-performing loans and with an increase in risk in economic activity in general. Banks also perceive a severe decline in the demand for consumer loans in the first quarter, conditions shifting from easing to hardening.

Financial entities expect a moderate constraint in the supply of consumer loans in the second quarter of the year and expect the demand for this type of loans to continue declining.

Mortgage loans

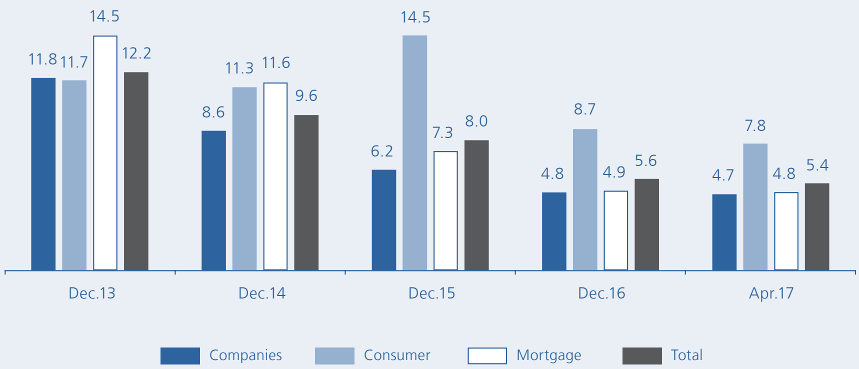
With regard to the demand for mortgage loans, banks say they perceive a deterioration in the first quarter of the year (conditions shifting from easing to neutral), whereas supply conditions have improved and gone from the pessimistic side to a neutral position. Banks expect the demand to remain stable and the supply of this type of loans to improve in the second quarter.

Factors explaining the deterioration perceived in the supply and the demand for redit

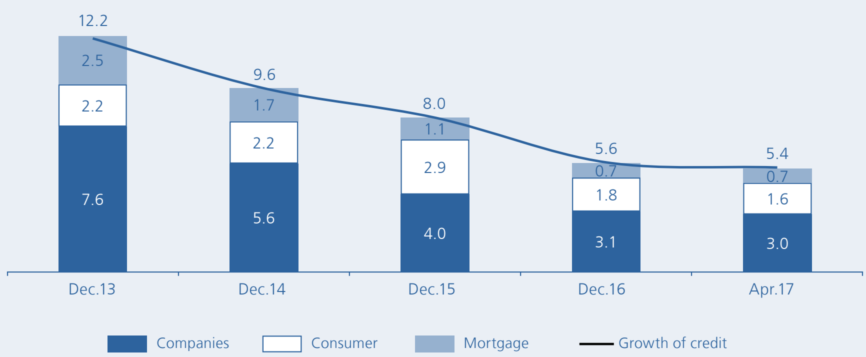
In recent years the growth rate of credit to the private sector has decreased significantly, this slowdown being observed in all credit segments (business, consumption, and mortgage loans). In

2013-2015, this slowdown was stronger especially in the segments of corporate and mortgage loans, while consumer loans remained stable and even showed a faster pace of growth at end 2015 (due to the greater profitability of this segment and the stabilization of delinquency rates). From early 2016 to date, the decline of credit has spread to all the segments.

EVOLUTION OF CREDIT TO THE PRIVATE SECTOR
(Annual growth rate)



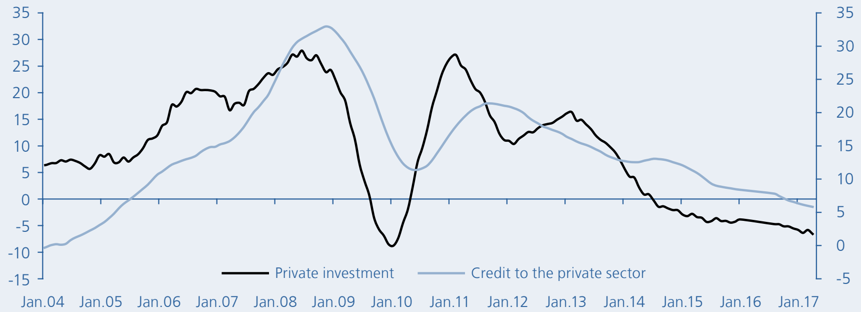
CONTRIBUTION TO THE GROWTH OF THE CREDIT TO THE PRIVATE SECTOR
(In % points)



When one analyzes the contribution of each segment to the growth rate of credit in the period discussed herein, the slowdown of credit is explained mainly by the lower contribution of business and mortgage loans.

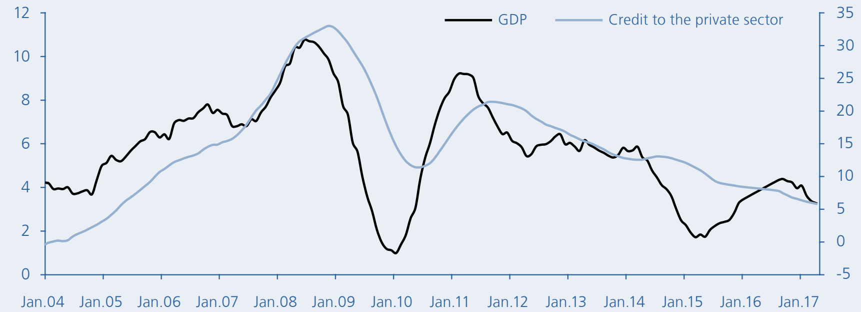
The main factor determining the recent trend observed in credit to the private sector is the slowdown of economic activity and the drop of private investment. There is a close relationship between GDP growth and the growth of private investment and credit, the growth of GDP and private investment preceding statistically the growth of credit.

GROWTH OF CREDIT TO THE PRIVATE SECTOR AND PRIVATE INVESTMENT
(12-month % change)*



* Smoothed by 12-month moving average

GROWTH OF CREDIT TO THE PRIVATE SECTOR AND GDP
(12-month % change)*



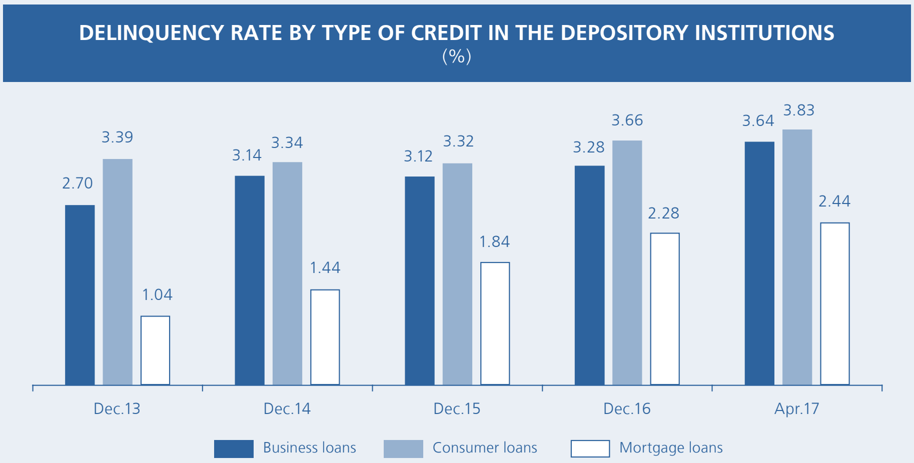
* Smoothed by 12-month moving average

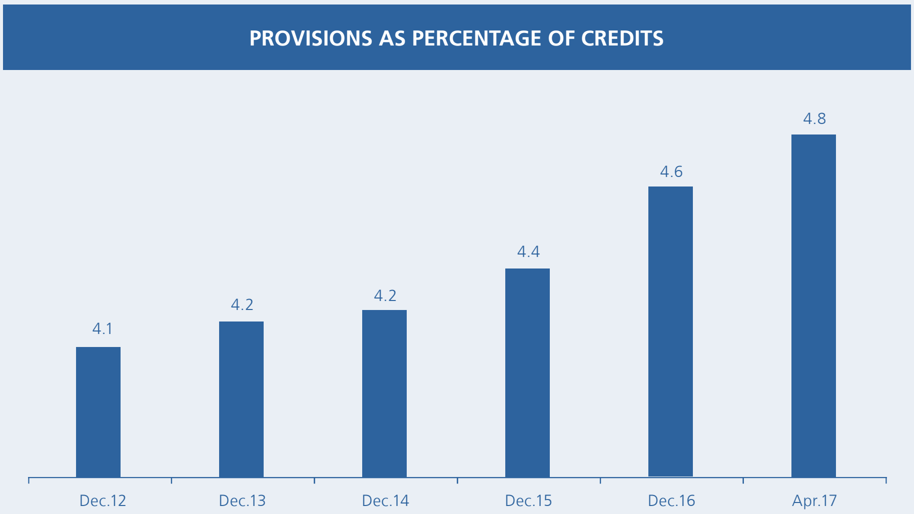
TEST OF GRANGER CAUSALITY BETWEEN GDP GROWTH AND GROWTH OF CREDIT

Null hypothesis	F-Statistic	Prob.	Conclusion
GDP doesn't Granger cause to credit	11.97	0.00	The null hypothesis is rejected
Credit doesn't Granger cause to GDP	1.27	0.28	The null hypothesis is not rejected
Private investment doesn't Granger cause to credit	11.03	0.00	The null hypothesis is rejected
Credit doesn't Granger cause to private investment	2.65	0.07	The null hypothesis is not rejected

The economic slowdown observed in most production sectors has been reflected in a process of deleveraging of credit by production sectors, particularly in the last two years.

This slowdown has generated a lower demand for credit to finance production (drop of credit to business) as well as lower incomes that have constrained the demand for consumer and mortgage loans. The economic slowdown has also had a negative effect on the quality of the credit portfolio –reflected in a sustained increase in delinquency rates–, which has implied an increase in the ratio of loan loss provisions as a percentage of credit in all the segments and has led financial entities to adopt stricter criteria for granting new loans, as reflected in the Survey of Credit Conditions.



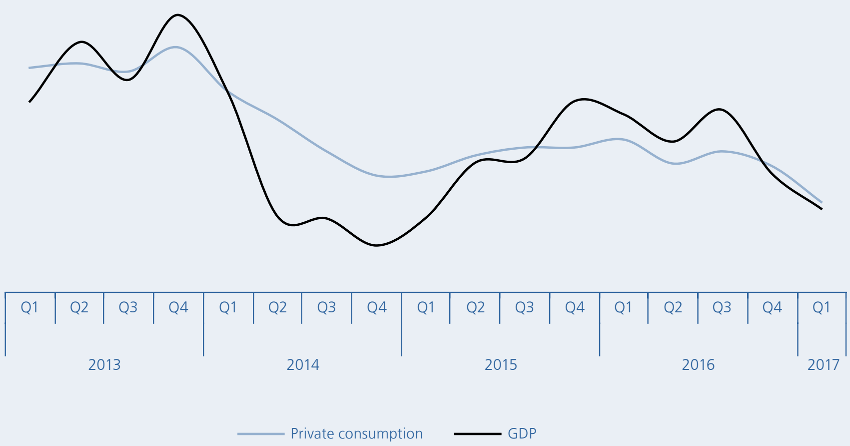


Moreover, there are some additional factors that have exacerbated the slowdown of credit to the private sector.

In the case of consumer loans, the persistent growth of private consumption was a factor that delayed the slowdown of this segment despite the weak dynamism of economic activity. However, the recent slowdown recorded in consumption and the increase in delinquency rates (after this indicator stabilized in the period of 2013-2015) have influenced a slower pace of growth in consumer loans in the last two years, particularly in the segment of credit cards, this segment showing the highest drop and the greatest portfolio deterioration.

Other factors affecting consumer loans include changes in the policies of some financial entities that reoriented their loans via credit cards to borrowers with higher levels of income, reducing credit lines, or by means of regulatory measures. It is worth mentioning that consumer loans have slowed down in a context in which the average debt of borrowers has increased.

GDP GROWTH AND GROWTH OF PRIVATE CONSUMPTION

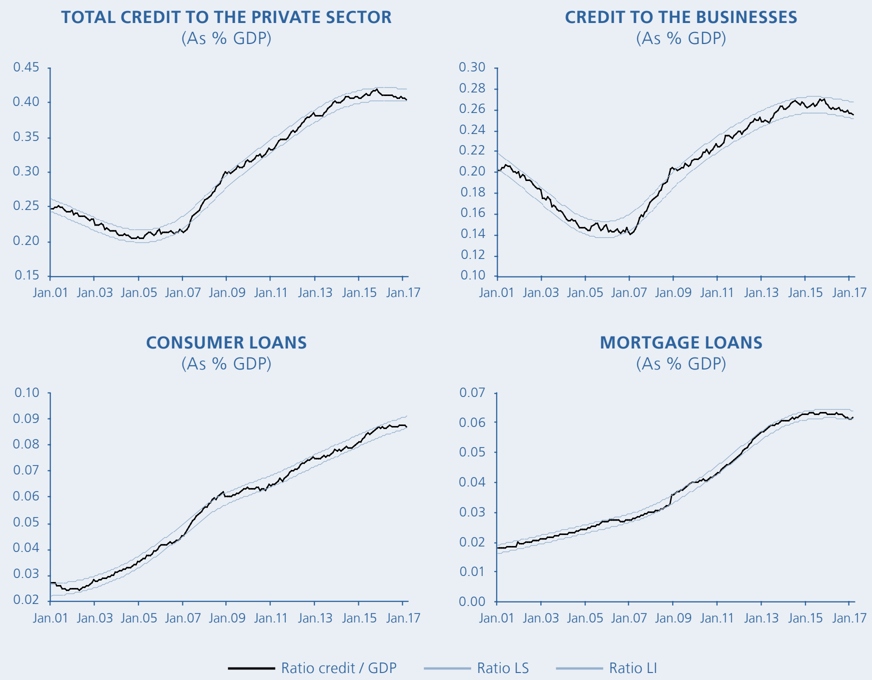


In the case of mortgage loans, the passing of Law 30478, which allows members of private pension funds to use up to 95.5 percent of the funds accumulated in their individual capitalization account, generated prepayments of mortgage loans amounting approximately to S/ 1.46 billion. This intensified the drop in the balance of mortgage loans and the slowdown in their pace of growth.

Episodes of credit "boom" and credit "depression"

In order to assess whether the episode of credit slowdown being observed recently is an atypical event of a decline in the growth of credit or "credit depression", we did the analysis suggested by Mendoza y Terrones (2008) estimating the long-term credit-to-GDP ratio using a HP filter and setting limits of 2 times the standard deviation of the cyclical component.

Using this methodology, we found that the recent episode of slowdown of credit to the private sector and its components is consistent with the levels of output growth. This is reflected in that the ratio of credit has not yet exceeded the lower limits, neither at the aggregate level nor by components.


TOTAL CREDIT TO THE PRIVATE SECTOR
(As % GDP)
0.45
0.40
0.35
0.30
0.25
0.20
0.15
Jan.01 Jan.03 Jan.05 Jan.07 Jan.09 Jan.11 Jan.13 Jan.15 Jan.17
CREDIT TO THE BUSINESSES
(As % GDP)
0.30
0.28
0.26
0.24
0.22
0.20
0.18
0.16
0.14
0.12
0.10
Jan.01 Jan.03 Jan.05 Jan.07 Jan.09 Jan.11 Jan.13 Jan.15 Jan.17
CONSUMER LOANS
(As % GDP)
0.10
0.09
0.08
0.07
0.06
0.05
0.04
0.03
0.02
Jan.01 Jan.03 Jan.05 Jan.07 Jan.09 Jan.11 Jan.13 Jan.15 Jan.17
MORTGAGE LOANS
(As % GDP)
0.07
0.06
0.05
0.04
0.03
0.02
0.01
0.00
Jan.01 Jan.03 Jan.05 Jan.07 Jan.09 Jan.11 Jan.13 Jan.15 Jan.17
Ratio credit / GDP
Ratio LS
Ratio LI

VI. Inflation Forecast and Balance of Risks

Inflation at May 2017

42. In May 2017, the consumer price index (CPI) recorded a year-on-year growth rate of 3.04 percent. Inflation without food and energy continued showing the declining trend observed since May 2016 (3.33 percent) and registered 2.54 percent (2.59 percent in February this year). Food and energy inflation decreased from 4.01 percent in February to 3.62 percent in May. This fall in inflation is explained mostly by the reversal in the prices of perishable foodstuffs observed between April and May after food prices experienced an extraordinary increase in March as a result of the impact caused by El Niño Costero.

Graph 65
INFLATION AND INFLATION TARGETING
(Last 12-month % change)

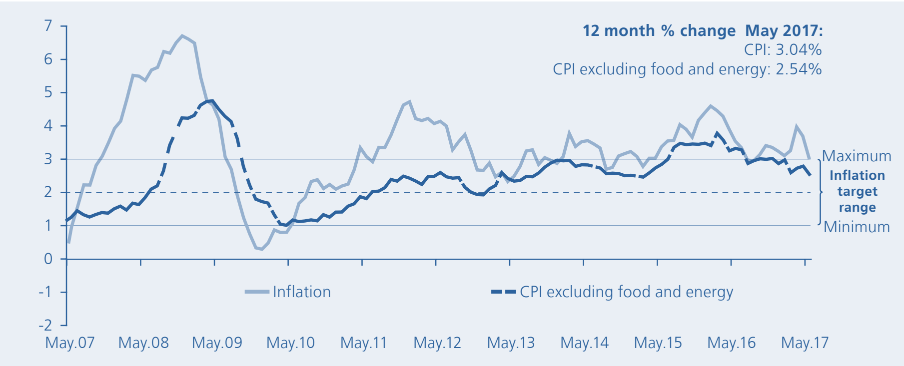


Table 42
INFLATION
(% change)

	Weight	2012	2013	2014	2015	2016	2017 Jan.-May.	2017 12-month
CPI	100.0	2.65	2.86	3.22	4.40	3.23	1.18	3.04
1. CPI excluding food and energy	**56.4**	**1.91**	**2.97**	**2.51**	**3.49**	**2.87**	**1.19**	**2.54**
a. Goods	21.7	1.60	2.62	2.43	3.57	3.41	0.71	2.47
b. Services	34.8	2.10	3.18	2.55	3.44	2.54	1.48	2.58
2. Food and energy	**43.6**	**3.55**	**2.73**	**4.08**	**5.47**	**3.66**	**1.17**	**3.62**
a. Food and beverages	37.8	4.06	2.24	4.83	5.37	3.54	1.82	3.74
b. Fuel and electricity	5.7	0.22	6.09	-0.85	6.20	4.48	-3.29	2.79
Fuel	2.8	-1.48	5.95	-5.59	-6.33	0.61	1.08	6.44
Electricity	2.9	2.19	6.23	4.37	18.71	7.53	-6.52	0.06

Table 43
INFLATION
(% contribution)

	Weight	2012	2013	2014	2015	2016	2017 Jan.-May.	2017 12-month
CPI	100.0	2.65	2.86	3.22	4.40	3.24	1.18	3.04
1. CPI excluding food and energy	**56.4**	**1.05**	**1.62**	**1.37**	**1.89**	**1.54**	**0.64**	**1.36**
a. Goods	21.7	0.34	0.54	0.50	0.73	0.69	0.14	0.50
b. Services	34.8	0.71	1.08	0.87	1.16	0.85	0.49	0.86
2. Food and energy	**43.6**	**1.60**	**1.24**	**1.86**	**2.51**	**1.69**	**0.54**	**1.67**
a. Food and beverages	37.8	1.59	0.89	1.91	2.15	1.43	0.74	1.52
b. Fuel and electricity	5.7	0.01	0.35	-0.05	0.36	0.26	-0.19	0.16
Fuel	2.8	-0.05	0.18	-0.18	-0.18	0.02	0.03	0.16
Electricity	2.9	0.06	0.17	0.12	0.54	0.25	-0.21	0.00

43. In the first months of this year, the prices of perishable farming foodstuffs rose above their historical high rates due to the impact of adverse weather conditions on agriculture late last year (water deficit) and in the early months of this year due to El Niño Costero. The latter also generated problems for the marketing of these goods due to the damage caused in roads.

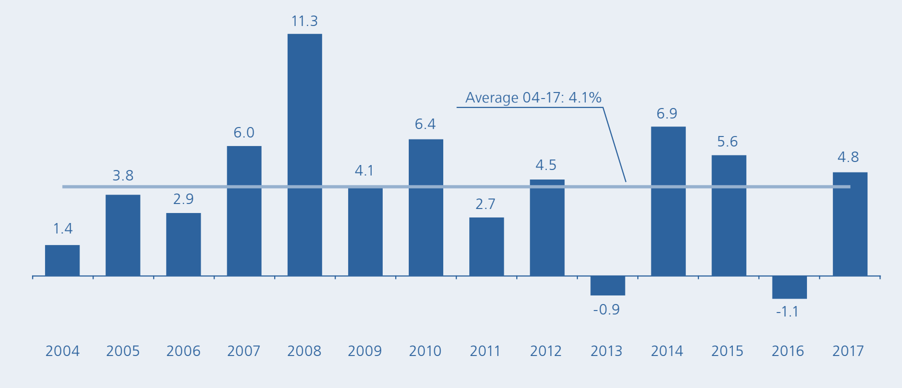
The prices of perishable farming food products rose between January and March (15.7 percent) and reversed thereafter between April and May, when they accumulated a drop of 9.4 percent.

In comparison with what happened following previous El Niño events, the price correction after El Niño Costero was faster because this event was short-lived (in contrast, for example, with the 1998 El Niño event) and did not affect the areas cultivated with many crops. In addition to this, the price correction of some products –which were severely affected in March– was favored by increased seasonal production afterwards.

Table 44
CPI AND PERISHABLE FOODS
(Monthly average %)

	Jan. - May
2002-2016	
CPI	0.31
Perishable foods	0.90
2016	
CPI	0.27
Perishable foods	-0.22
2017	
CPI	0.24
Perishable foods	0.95

Graph 66
PERISHABLE FOOD
(% change, January- May)



44. Since foodstuffs were especially affected by the adverse weather conditions that generated supply shocks, most of the products with greater contribution to inflation both on the upside and on the downside are part of the food component.

In January-May 2017, several produce, such as onions, sugar, tomatoes, and other vegetables, showed increases. The prices of other products, such as lemons, which showed strong price increases at the time of the emergency, dropped thereafter when their supply normalized. Moreover, it is worth mentioning that potatoes, chicken, citrus fruits, and avocados were among the foodstuffs with the higher negative contribution to inflation in this period.

Moreover, other (non-food) items with a greater positive contribution to inflation included education costs (tuition and fees) and meals outside the home, while electricity rates, on the other hand, was among the items with a greater negative contribution to inflation.

Table 45
ITEM WITH THE HIGHEST WEIGHTED CONTRIBUTION TO INFLATION: JANUARY - MAY 2017

Positive	Weight	% chg.	Contribution	Negative	Weight	% chg.	Contribution
Education costs (tuition and fees)	8.8	4.6	0.45	Potato	0.9	-24.0	-0.31
Meals outside the home	11.7	2.2	0.30	Poultry meat	3.0	-7.9	-0.24
Onion	0.4	79.7	0.23	Electricity rates	2.9	-6.5	-0.22
Other green vegetable	0.4	31.9	0.15	Citrus fruits	0.5	-11.3	-0.07
Sugar	0.5	14.3	0.09	Avocado	0.1	-31.0	-0.06
Eggs	0.6	12.5	0.06	National transportation	0.3	-15.4	-0.06
Banana	0.3	16.5	0.06	Airplane fare	0.4	-11.7	-0.04
Other fresh fruits	0.4	15.6	0.06	Grapes	0.1	-11.1	-0.01
Tomato	0.2	25.7	0.06	Purchase of vehicles	1.6	-0.8	-0.01
Water consumption	1.6	3.2	0.05	Fresh and frozen fish	0.7	-1.6	-0.01
Total			**1.51**	**Total**			**-1.03**

Items which contributed more to increase inflation in January-May 2017

Education

Prices in the category "Education: tuition and fees" registered a variation of 4.6 percent due to the increases in the tuitions and fees to be paid for the new school year.

Tuition in public schools increased 4.3 percent in February (vs. 11.8 percent in February 2016) while tuition in private schools increased 5.9 percent (vs. 7.4 percent in February 2016). Tuitions were also increased in private universities (1.7 percent) as well as in public universities (0.9 percent). Moreover, in March, the education costs in private schools increased by 6.9 percent (vs. 8.0 percent in March 2016 and 6.4 percent in March 2015). In addition, tuition and fees were also raised in private universities (3.1 percent) and in higher technical education institutes (2.1 percent).

In the last twelve months, prices in this category have increased 4.8 percent –a higher rate than the variation observed in the general price index (3.04 percent)– not only as a result of the increases registered at the beginning of the school year, but also as a result of tuition adjustments recorded in higher education institutes throughout the period.

Meals Outside the Home

Prices in the category "meals outside the home" continued to be among those with the highest contribution to inflation. In January-May, prices in this category increased 2.2 percent, a higher rate than that recorded in food consumed at home (1.6 percent). In the last twelve months, prices in this category increased 3.9 percent –a similar rate to the one observed in food consumed in the household (3.7 percent)–, reflecting a more moderate pace of growth in comparison with recent years.

Onions

The item with the greatest contribution to inflation was onions, a produce whose price reached a cumulative change of 79.7 percent in January-May (43.9 percent in the last twelve months), the biggest rise being recorded in the month of March (42.2 percent). Crops and the quality of onions were affected by heavy rains in Arequipa, the main producing region, since late December, affecting the regularity of supply to Lima as well. In addition to marketing and transportation problems (floods and mudslides), this resulted in a strong rise in the wholesale price (up 79 percent in March).

The price of onions continued showing a rising trend in April (18.6 percent), influenced by the end of the farming season in some valleys of Arequipa. This situation reversed in May, when the price was corrected downwards by 3.5 percent. A seasonal supply of some varieties of onions that are marketed with a shorter drying period contributed to this price correction.

Other Vegetables

Prices in the category "Other vegetables" (lettuce, broccoli, leek, among other vegetables) recorded an average increase of 31.9 percent in January-May and an increase of 16.3 percent in the last twelve months. Farming production was affected by warmer temperatures in the valleys of Lima where these crops are grown. In May, prices fell by 7.6 percent due both to lower seasonal demand and to the decline of temperature which contributed to increase the supply of some products, such as iceberg lettuce and broccoli.

Sugar

The price of sugar rose 14.3 percent in the period January-May and 20.8 percent in the last twelve months. The biggest increases were recorded in the months of March (4.9 percent) and April (8.3 percent) as a result of the lower supply observed in Lima of sugar from La Libertad and Lambayeque, where plantations had been affected by floods and by increasing temperature. This was offset in part by a greater supply of imported sugar, which reached an increase of 58 percent in January-May compared to the same period in 2016.

Tomatoes

The price of tomatoes increased by 25.7 percent in January-May, the highest rise being observed in the month of March (33.6 percent). The price of tomatoes show a variation of 2.5 percent in the last twelve months.

Factors accounting for this rise included smaller cultivation areas in Lima (-29 percent in the period of November-March in comparison to the previous crop year), as well as lower yields due to the high temperatures recorded. Marketing problems caused by mudslides and floods in the valleys of Cañete, Huaral, and Canta contributed also to this increase. In the months of April and May, the price dropped 15.8 and 6.0 percent, respectively, the greater supply of tomatoes that came from Arequipa contributing also to this decline.

Potatoes

In January-May the price of potatoes fell and showed an accumulated variation of -24.0 percent. This fall was influenced by an increased supply of potatoes that comes mainly from the regions of Huanuco and Junin at this time of year (up 9 percent compared to January-May 2016).

Sowing increased by 20 percent in Huánuco and by 2.0 percent in Junín in August-March. Crops in Huánuco increased as a result of sporadic rains that favored preparing the land and sowing as from September following the drought that had affected crops during most of the crop year. In addition, crop production was also favored in December by regular intensity rainfall. In Junín, the negative impact of frosts in November was countered in part by rain in the high lands, which favored cultivation and yield.

Chicken Meat

In January-May, the price of chicken meat dropped 7.9 percent and accumulated a negative variation of 4.4 percent in the last twelve months. This result was influenced mainly by the lower prices of the main substitute products (fish such as tuna and mackerel, which have an increased demand in the lower income strata). This was in part offset by the price rises registered since the end of February. In

March, the price rose 5.9 percent as a result of a lower supply influenced by the lower weight of farm poultry: 2.62 Kg per unit versus 2.73 Kg in February (lower feed due to high temperatures) and the problems associated with the floods and disruption of roads that affected some poultry farms. The irregularity in the supply of fish, the main substitute of poultry, contributed also to the changes in the price of chicken meat.

From April, the price decreased again due to a greater supply in wholesale distribution centers (671 thousand tons a day versus 637 thousand tons in March), which reflected that the problems that had affected farms in March had been overcome (hot weather that made it difficult for poultry to feed and disruption of roads). The greater weight of the birds also contributed to increase the supply (1,909 tons a day versus 1,670 tons a day in March). Furthermore, the greater availability of fish, particularly mackerel whose price fell 5.2 percent in the month, influenced also the decline in the price of chicken meat.

Electricity Rates

In January-May, electricity rates decreased 6.5 percent (0.06 percent in the last twelve months). In the first months of the year, the rate falls reflected mainly the suspension of the portion of the rate charged for "Strengthening of energy security", which was destined to financing the Gasoducto Sur Peruano and implied an increase of approximately 2.5 percent in the rates paid by consumers.

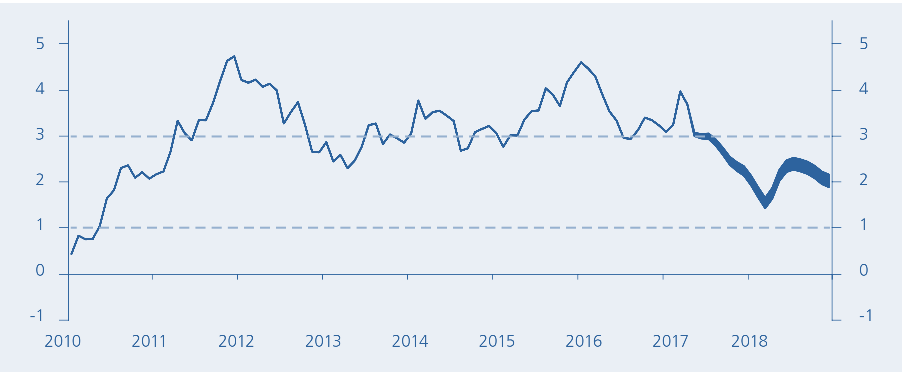
Additionally, electricity rates were lowered again in May (-3.6 percent) mainly as a result of the quarterly update of generation prices after the adjustment of the contracts between the energy generating companies and energy distribution companies. Finally, the different costs added to transmission costs were also revised taking into account the levels they had in the previous rate adjustment (February 2017).

Forecast for 2017-2018

45. BCRP monetary policy actions are taken anticipating the most likely scenarios on the basis of inflation forecasts and projections of inflation determinants elaborated based on the information available at the time of decision making. Indicators standing out as key indicators for monetary policy actions include inflation expectations, imported inflation (including the effect of the foreign exchange rate), and demand inflationary pressures, all of which are quantified through the concept of the output gap (the difference between GDP and its potential level).

46. **Inflation** is forecast to converge towards 2 percent in the 2017-2018 forecast horizon, showing a path that would be around the upper band of the target range during the second quarter of 2017, but converging thereafter towards the target at a faster pace than estimated in the Inflation Report of March 2017. This forecast takes into account the faster-than-expected reversal in the prices of the food products affected by adverse climatic factors caused by El Niño Costero (severe rainfall) in the first quarter of 2017.

Graph 67
INFLATION FORECAST: 2010 - 2018
(Last 12-month % change)



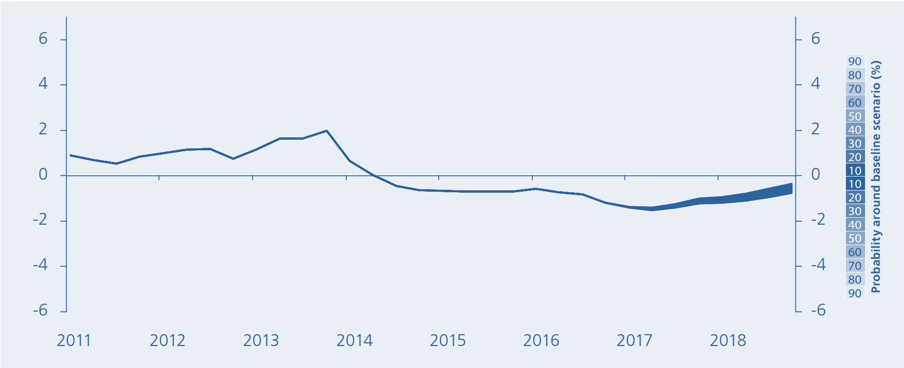
Inflation without food and energy has been showing a faster decline than that estimated in the Inflation Report of March, recording a rate of 2.54 percent in May and is expected to show rates around 2.2 percent at the end of 2017 and around 2.0 percent in 2018. This faster reduction is favored by two factors: (i) a dollar-PEN exchange rate that fell 2.0 percent in the first two months of the year and which is expected to be relatively stable in the rest of the year, in line with the favorable evolution anticipated in the terms of trade and in the trade balance, and (ii) a somewhat more negative output gap, which is expected to recover in the second half of this year, although at a more gradual pace than previously estimated due to the lower growth of consumption and the delay in the recovery of investment.

The lower rates of inflation forecast as from the second half of the year are consistent with a sustained decline of inflation expectations during the forecast horizon, with the continued reversal of supply shocks on food prices, and with economic growth without inflationary pressures on the side of demand.

47. The **determinants of the inflation forecast** are discussed below:

a) The economic slowdown in recent months has led to a somewhat more negative output gap in the first half of the year than that estimated in the Inflation Report of March due to the postponement of infrastructure projects, lower public spending, and the effects of El Niño Costero.

Graph 68
OUTPUT GAP: 2011 - 2018
(% potential GDP)

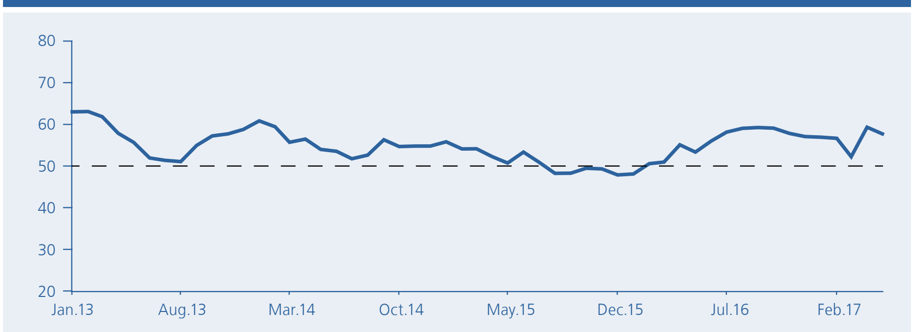


In 2017 the economy is estimated to recover in the second half of 2017 and to grow at higher growth rates than those of the potential output in 2018, in line with a recovery of the **output gap**. This recovery of the output gap considers a greater fiscal stimulus in the second half in 2017, the effect of higher terms of trade, and still expansionary monetary conditions in domestic currency.

Based on the information available to date, it is estimated that the economy will head towards a neutral economic cycle in the forecast horizon. The main determinants of the forecast of the **output gap** include the following:

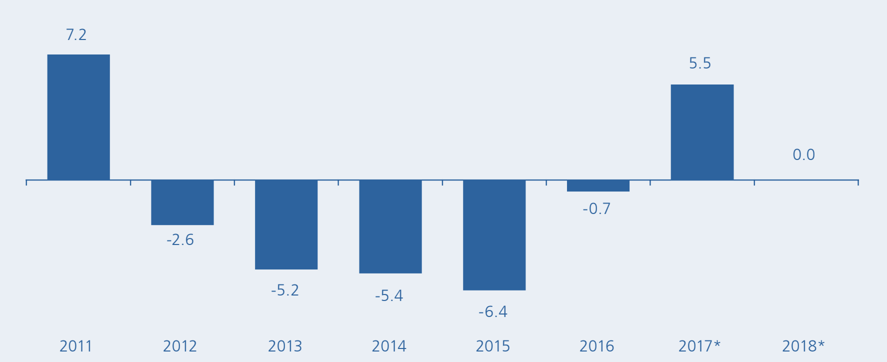
- **Business confidence**: Business confidence is expected to remain within the optimistic side in 2017, although showing more moderate levels than those observed in the previous report, reflecting the recent evolution of the domestic economy,

Graph 69
EXPECTATION ABOUT THE SECTOR 3-MONTHS AHEAD
(Jan.2013 – May.2017)



- **External conditions**: More favorable external conditions than those considered in the Inflation Report of March are foreseen. Peru's terms of trade in the forecast horizon are expected to be higher, which would have a positive impact on private investment and consumption.

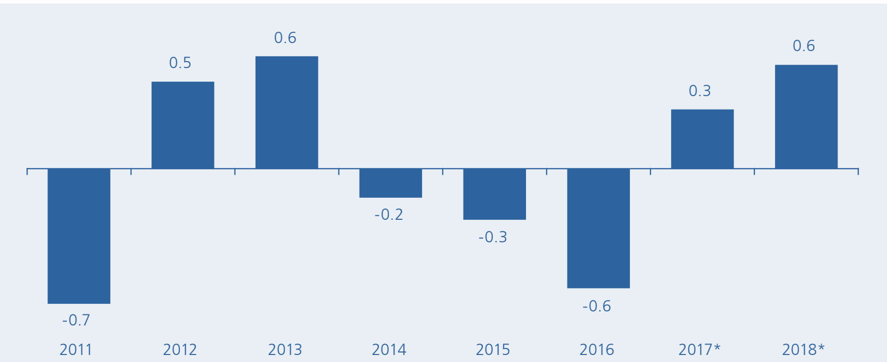
Graph 70
TERMS OF TRADE: 2011-2018
(Annual % change)



* Forecast.

- **Fiscal impulse:** The weighed fiscal impulse estimated for 2017 would be positive and would be concentrated in the second half of the year, in line with the delay observed in the execution of public investment. A significant fiscal impulse associated with the reconstruction of the infrastructure affected by El Niño Costero is expected in 2018.

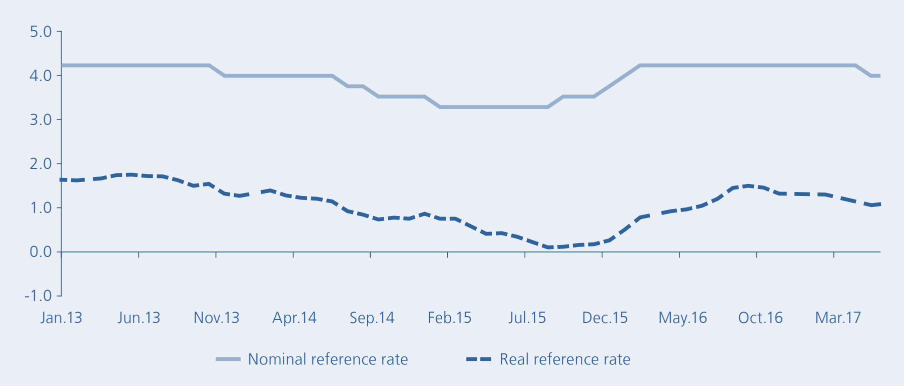
Graph 71
WEIGHTED FISCAL IMPULSE: 2011-2018
(% potential GDP)



* Forecast.

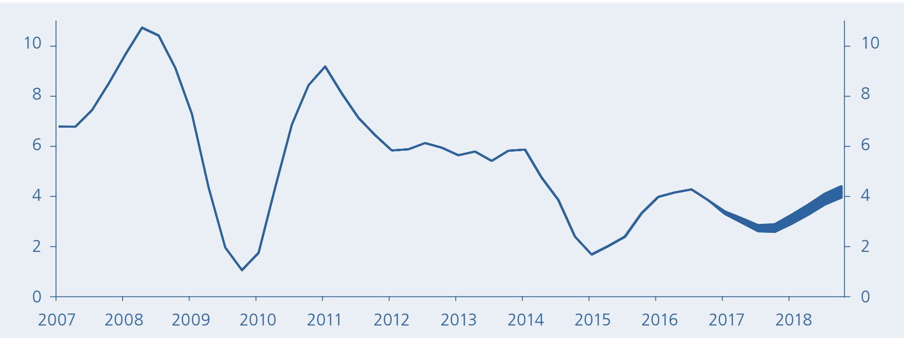
- **Monetary conditions**: Taking into account the cut in the benchmark interest rate in May, monetary conditions in soles are still expansionary (real rate lower than 2 percent) and contribute to the recovery of the output gap. Moreover, conditions in dollars are expected to be similar to those foreseen in our previous report. Although higher Fed interest rates are anticipated, the effects of these higher rates would be in part offset by the reductions of reserve requirements in dollars adopted by BCRP and by more moderate expectations of depreciation.

Graph 72
REFERENCE INTEREST RATE, JAN.2013 - MAY.2017



It is worth pointing out that the growth forecast for the 2017-2018 forecast horizon is consistent with a growth rate of the potential output of around 3.7 percent, a lower rate than that estimated previously (3.8 percent) due to the lower investment foreseen in 2017.

Graph 73
GDP GROWTH FORECAST: 2007 - 2018
(Annual % change)



b) **Expectations of inflation in 12 months** are foreseen to remain within the inflation target range during the forecast horizon and to show a declining trend following the reversal of the supply shocks that affected inflation during the first quarter.

Graph 74
EXPECTATIONS OF INFLATION FOR THE NEXT YEAR
(% points)

Table 46
SURVEY ON MACROECONOMIC EXPECTATIONS: INFLATION
(% change)

	IR Sep.16	IR Dec.16	IR Mar.17	IR Jun.17*
Financial entities				
2017	2.6	2.8	2.9	3.0
2018	2.5	2.5	2.7	2.8
Economic analysts				
2017	2.8	3.0	3.0	3.0
2018	2.6	2.8	2.9	2.8
Non-financial firms				
2017	3.0	3.0	3.0	3.1
2018	3.0	3.0	3.0	3.0

*Survey conducted during May 28, 2017.

c) **Imported inflation** reflects the evolution of import prices and the evolution of the exchange rate. At end-2017, imported inflation is estimated to be lower than projected in the Inflation Report of March due mainly to forecasts indicating a lower exchange rate in nominal terms at end 2017 and in 2018. The forecasts are consistent with market expectations.

The latest survey on expectations regarding the dollar-PEN exchange rate shows that economic agents expect lower levels during the forecast horizon. The higher surplus observed in the trade balance and increased inflows of portfolio capital allow us to foresee a lower depreciation of the exchange rate, although this effect could be offset in part by the effect of the rise in the rate of the Fed.

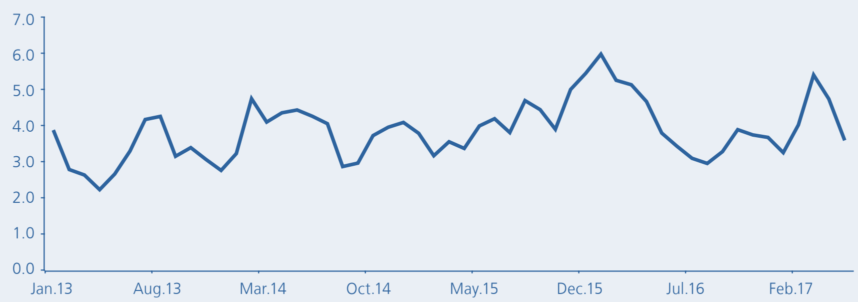
Table 47
SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE
(S/ per US$)

	IR Sep.16	IR Dec.16	IR Mar.17	IR Jun.17*
Financial entities				
2017	3.48	3.50	3.41	3.35
2018	3.53	3.60	3.45	3.40
Economic analysts				
2017	3.45	3.50	3.37	3.35
2018	3.53	3.50	3.40	3.40
Non-financial firms				
2017	3.50	3.50	3.40	3.35
2018	3.50	3.55	3.50	3.40

*Survey conducted during May 28, 2017.

d) The **supply shocks** that affected inflation in the first months of the year have been reversing at a faster pace than anticipated in the Inflation Report of March. Based on the data observed in May, food and energy prices have returned to the levels recorded in February. Thus, food and energy inflation is projected to register a rate of 2.3 percent in 2007 and a rate of 2.0 percent at end 2018.

Graph 75
CPI FOOD AND ENERGY 2013-2017
(12-month % change)



Balance of Risks in the 2017 – 2018 Horizon

48. 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. The main factors that could divert the inflation forecast from the baseline scenario include the following:

a. **Negative shocks on domestic supply**
The risk of a delay in the reversal of supply shocks during the forecast horizon that could slow down inflation's convergence to the target range has decreased significantly and the probability of being affected by a severe climate event has also decreased.

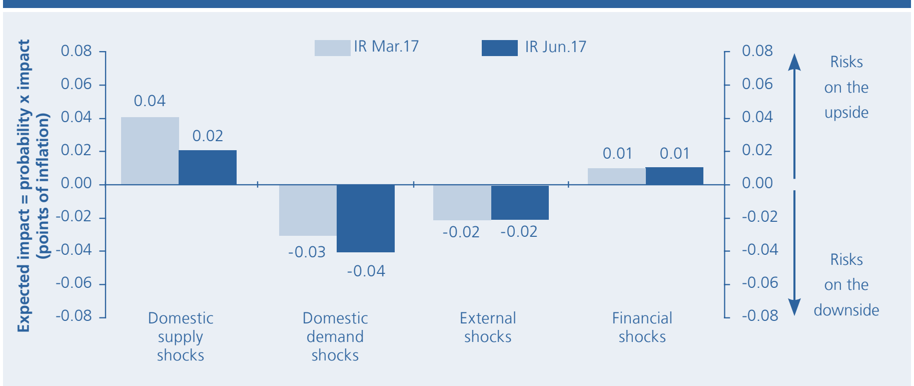
b. **Negative shocks on domestic demand**
Economic recovery could be more gradual if public and private investment grew at lower rates than expected, which would imply a more negative output gap and for a longer period of time. As a result of this, inflation would tend to show rates below the baseline scenario. This risk of this scenario has increased due to the postponement of infrastructure projects and to the delay observed in the recovery of public investment.

c. **Negative external shocks**
The baseline scenario considers an external context favorable to our economy. However, a drop in commodity prices would mean a more negative output gap and a rate of inflation below the one considered in the baseline scenario.

d. **Volatility in international financial markets**
A faster pace of hikes in the Fed rates than that foreseen could generate abrupt adjustments in the interest rates of long-term bonds and increased capital flows to the United States, which would push the exchange rate upwards and could increase inflation in the short-term.

49. The balance of risks on the inflation forecast shows a bias on the downside, so the impact of factors that could decrease inflation is higher than the impact of factors that imply a rise in prices.

Graph 76
BALANCE OF RISKS AGAINST THE BASE SCENARIO



Conclusions

50. Inflation is still forecast to converge to the inflation target range in the 2017-2018 forecast horizon, which is consistent with economic growth without demand inflationary pressures and with a continued decline in inflation expectations in this horizon.

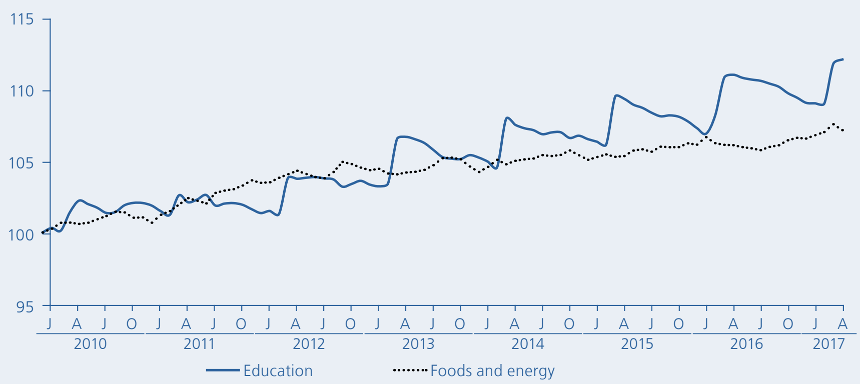
The Central Bank will continue to pay careful attention to the evolution of inflation expectations and other inflation determinants. BCRP stands ready to adjust its monetary stance, should it be necessary, to ensure that inflation converges to the inflation target range and remains within the target range.

Box 3
SUPPLY SHOCKS AND RECENT INFLATION TRENDS

Inflation is defined as a sustained increase in the general level of prices for goods and services. Inflation can sometimes register temporary deviations due to factors that are not associated with demand pressures and, therefore, these price deviations are not *sustained rises in the general level* of the prices of goods and services.

These factors, also called supply shocks, include changes in relative prices caused by climatic phenomena or by changes in the preferences of consumers. They can be persistent and have an impact on inflation's volatility because they may alter the cost structure of firms and their profit margin. The following graphs show the evolution of prices in the category of education and the category of food and energy in comparison to other goods and services in the economy. As depicted in the graph, a strong change in the relative prices of education services and food was observed during the period of analysis (2010-2017).

RELATIVE PRICE INDEX TO TOTAL INFLATION
(Dec. 2009 =100)

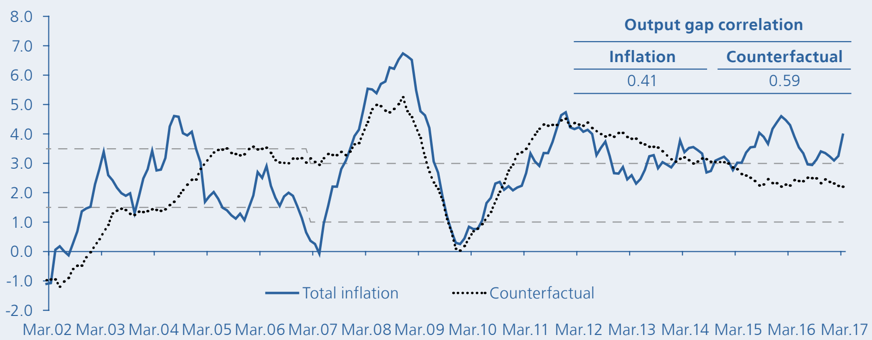


Although inflation is temporarily affected by changes in persistent relative prices, the monetary authority should not react to this kind of inflation deviations unless they end up affecting the formation of inflation expectations. This box identifies the effect of these changes on relative prices in the recent trends of inflation and provides evidence of its importance in the economy. We used a vector autoregressive model that includes exogenous control variables (VARX) to identify different structural shocks, including those associated with the evolution of changes in relative prices.

The variables used in the VARX model are the inflation rate, a measurement of inflation relative to the prices of educational services, GDP growth, the interbank interest rate, the annual growth rate of total liquidity, and the rate of nominal depreciation of the sol against the US dollar. In addition, we included the following variables as control variables: the 3-month Libor rate, the yield rate of the 10-year US Treasury bonds, the index of Industrial production and inflation in the United States, and the price indices of commodities and crude oil (WTI). We identified the VAR model through the Cholesky factorization method and used the data from December 1996 to March 2017. This Bayesian estimation is perfomed through Gibbs sampling and using informative *priors*. All the variables were included both in annual terms and in percentages.

Then we calculated an alternative path of inflation isolating supply shocks, the shocks of relative prices of education, and exchange rate shocks with the aim of obtaining a counterfactual trajectory of inflation representing what would have happened with inflation if these shocks of supply and change of relative prices (education and exchange rate) had not arisen.

TOTAL INFLATION AND EVOLUTION OF COUNTERFACTUAL PATH
(Last 12-month % change)



The first result we see is that, in the absence of these shocks, inflation would have been less volatile and would have shown rates within the target range of 1-3 percent since 2014, which evidences the importance of supply shocks and shocks of relative prices in the recent evolution of inflation.

As mentioned previously, when identified shocks affect inflation temporarily, no monetary policy responses are required. However, when they are persistent, they may affect the formation of expectations, in which case monetary policy response is required to mitigate the second-round effects of these shocks on price formation in the economy. Therefore, a greater persistence of supply shocks, which in turn causes more persistent inflation, implies that it is necessary to oversee the evolution of inflation expectations with special attention so that the central bank can respond appropriately to these shocks and offset this longer-lasting effects of changes in relative prices on inflation.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