CENTRAL RESERVE BANK OF PERU

Summary Inflation Report

March 2017

The world economy has continued recovering in the fourth quarter of 2016 and in the first months of 2017, as a result of which **global growth** would increase from 3.0 percent in 2016 to 3.4 percent in 2017 and to 3.5 percent in 2018, as forecast in the Inflation Report of December.

Commodity prices have maintained their upward trend, favored in part by supply constraints. Because of this, the **terms of trade** are expected to increase 5.4 percent in 2017, a higher rate than that estimated in the Inflation Report of December (3.9 percent).

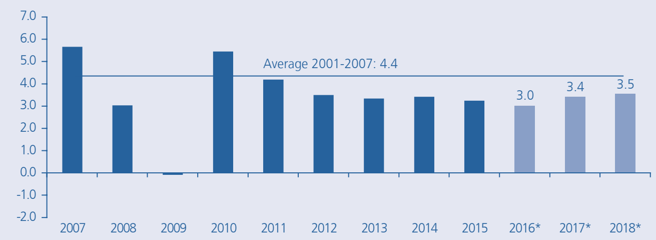
The deficit in the **current account of the balance of payments** fell from 4.9 percent of GDP in 2015 to 2.8 percent of GDP in 2016, mainly as a result of higher exports of copper. The current account deficit is projected at 2.6 percent of GDP in 2017 and at 2.4 percent of GDP in 2018 due to the increase of mining exports and to the recovery of export prices. It is estimated that long term financing from private sources will continue exceeding the current account gap and that foreign direct investment will continue to be the main component.

The **trade balance** moved from a deficit of US$ 3.2 billion in 2015 to a surplus of US$ 1.7 billion in 2016. In the next two years, the trade surplus would continue increasing and show yearly balances around US$ 4 billion as a result of the growth of exports, both in terms of volumes and prices.

In 2016, **GDP grew 3.9 percent**, driven mainly by the dynamism of traditional exports in a context marked by falling private investment (down 6.1 percent) and government spending (down 0.5 percent). The decline of private investment was associated with the contraction of mining investment after the completion of large investment projects that started their production phase and with the problems associated with the implementation of infrastructure projects.

This ***Inflation Report*** was prepared using data on the Balance of Payments and Gross Domestic Product as of the fourth quarter of 2016, data on Monetary Accounts, operations of the Non-Financial Public Sector, Inflation, Financial Markets, and the Exchange Rate as of February 2017. Besides, the projections contained in this Inflation Report have been developed using preliminary information of the impacts of the climatic events associated with El Niño.

WORLD ECONOMY: 2007-2018
(Annual % change)



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

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

* Forecast.
Source: BCRP.

TRADE BALANCE
(Million US$)

	2015	2016	2017*		2018*	
			IR Dec.16	IR Mar.17	IR Dec.16	IR Mar.17
EXPORTS	**34,236**	**36,838**	**40,252**	**41,807**	**41,986**	**43,930**
Of which:						
Traditional products	23,291	26,004	29,265	30,657	30,200	32,086
Non-traditional products	10,857	10,733	10,902	11,043	11,695	11,731
IMPORTS	**37,385**	**35,107**	**37,798**	**37,846**	**39,734**	**39,662**
Of which:						
Consumer goods	8,791	8,612	8,897	9,039	9,233	9,199
Inputs	15,923	15,115	16,350	16,454	17,143	17,330
Capital goods	12,007	11,116	12,269	12,068	13,061	12,835
TRADE BALANCE	**-3,150**	**1,730**	**2,454**	**3,961**	**2,252**	**4,268**

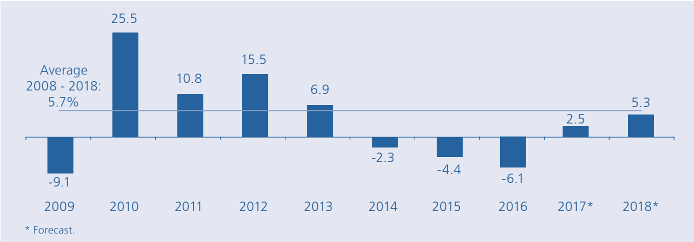
IR: Inflation Report.
* Forecast.

GROSS DOMESTIC PRODUCT
(Real % change respect to the same period of previous year)

	2015	2016	2017* IR Dec.16	2017* IR Mar.17	2018* IR Dec.16	2018* IR Mar.17
Agriculture and Livestock	**3.2**	**1.8**	**2.8**	**2.5**	**5.0**	**4.9**
Agriculture	2.0	0.6	2.3	1.7	5.5	5.4
Livestock	5.2	3.6	3.6	3.7	4.2	4.2
Fishing	**15.9**	**-10.1**	**34.7**	**13.6**	**5.7**	**20.4**
Mining and Fuel	**9.5**	**16.3**	**7.4**	**6.9**	**5.1**	**5.9**
Metallic mining	15.7	21.2	7.5	6.9	5.0	5.9
Hydrocarbons	-11.5	-5.1	7.1	6.8	6.6	6.4
Manufacture	**-1.5**	**-1.6**	**3.5**	**2.2**	**4.0**	**3.8**
Based on raw materials	1.8	-0.5	10.0	6.8	4.1	6.7
Non-primary industries	-2.6	-2.0	1.7	0.8	4.0	3.0
Electricity and water	**5.9**	**7.3**	**5.5**	**4.6**	**5.0**	**4.5**
Construction	**-5.8**	**-3.1**	**3.6**	**1.8**	**5.5**	**6.0**
Commerce	**3.9**	**1.8**	**3.3**	**2.4**	**3.8**	**3.3**
Services	**4.2**	**3.9**	**3.9**	**3.4**	**3.8**	**3.5**
GDP Global	**3.3**	**3.9**	**4.3**	**3.5**	**4.2**	**4.1**
Note:						
Primary	**6.8**	**9.8**	**7.1**	**6.0**	**5.0**	**6.0**
Non-primary	**2.4**	**2.3**	**3.5**	**2.9**	**4.0**	**3.6**

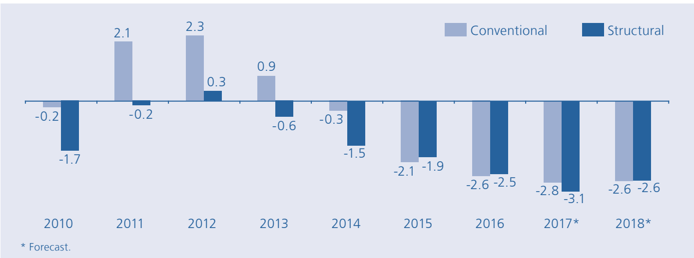
IR: Inflation Report.
Source: INEI and BCRP.

PRIVATE INVESTMENT: 2009-2018
(Real % change)



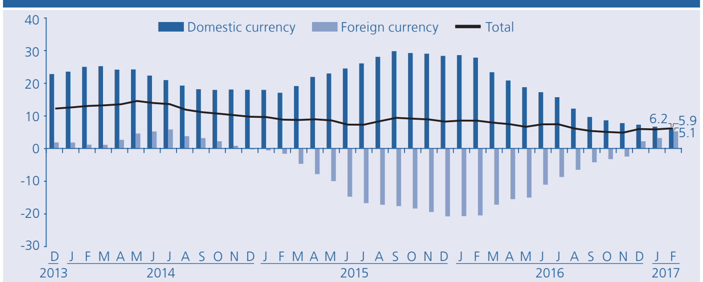
* Forecast.

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

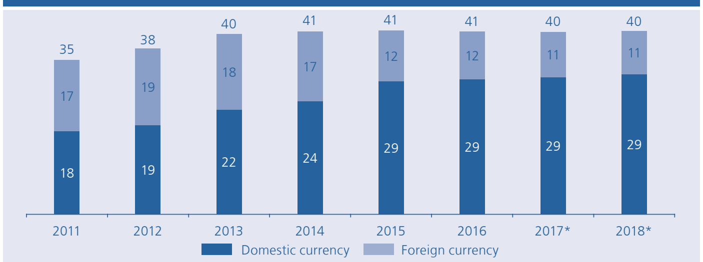


* Forecast.

CREDIT TO THE PRIVATE SECTOR
(Annual % change)



RATIO CREDIT / GDP
(% GDP)



* Forecast.

Government expenditure was influenced by the fiscal consolidation policy.

Lower growth rates are expected this year due to the delays registered in different infrastructure investment mega-projects due mainly to the investigation of corruption cases that are still under way. In addition to this, growth in the sectors of agriculture, fishing, primary manufacturing, and services would be negatively affected by the impacts of El Niño event. The recent measures taken by the government to boost public investment, which include the reconstruction works following the recent natural disasters, would in part offset the anticipated lower growth of private spending. Thus, considering a lower recovery of private investment than that estimated in the December report, GDP would grow 3.5 percent this year.

A greater dynamism is expected in domestic demand in 2018, which implies the recovery of private investment. Thus, in 2018 GDP would grow 4.1 percent, slightly less than projected in the previous report, and this rate would be accompanied by lower dispersion among the growth rates of the different economic sectors.

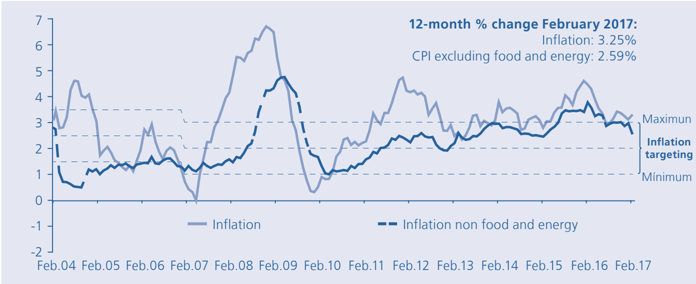
The **fiscal deficit** in 2016 decreased to 2.6 percent as a result of the fiscal consolidation measures taken, which implied a significant adjustment of expenditure, particularly in the last quarter of the year. The deficit projected in the following two years has been revised up from 2.5 to 2.8 percent of GDP in 2017 and from 2.3 to 2.6 percent of GDP in 2018. This path is consistent with the tax measures adopted through the legislative powers granted by Congress (considered in our previous report) and with the recent fiscal stimulus program aimed at accelerating growth, particularly through a greater investment spending. Part of the latter would be used in the reconstruction of the areas affected by the El Niño event.

Credit to the private sector grew at a year-on-year rate of 5.9 percent in February, a slightly higher rate than that recorded at end 2016 (5.6 percent), but lower than the one registered in 2015 (8.0 percent). This evolution of credit is associated with the slowdown of domestic demand, particularly the slowdown of private investment, which has reflected in a lower growth of credit to the corporate segment and the segment of large enterprises and, to a lesser extent, in the lower growth of personal loans. Credit to micro and small businesses (which is almost totally in domestic currency) showed a significant recovery last year. In the 2017-2018 forecast horizon, credit to the private sector is expected to grow in accordance with the pace of growth of the nominal growth rate of the output, with credit in domestic currency showing greater dynamism.

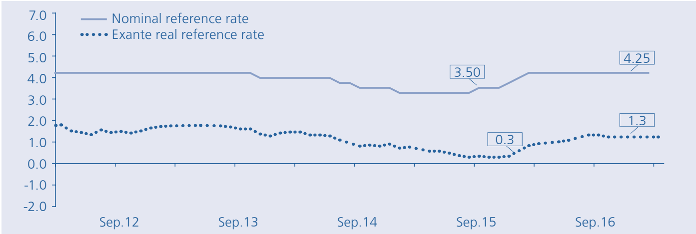
Reflecting the rises observed in the prices of some perishable food products, **inflation** has shown rates above the inflation target range since September 2016, although expectations of twelve-month inflation remain within the target range. In this context, the Board of BCRP has maintained its **policy interest rate** at 4.25 percent and reiterated that the Central Bank oversees inflation forecasts and inflation determinants to evaluate the convenience of making adjustments in the monetary policy rate.

Given the transitory nature of restrictions affecting the food supply, **inflation** is projected to show rates around the upper band of the target range during the first half of the year and then to converge to the target range in the second half of 2017 and to 2 percent early in 2018. The forecast considers higher food prices due to the water deficit registered in the last months of 2016 and due to the adverse climatic factors associated with El Niño (excessive rainfall and floods) that have been affecting several parts of the country during the first quarter of 2017.

INFLATION AND INFLATION TARGETING
(% change last 12 month)

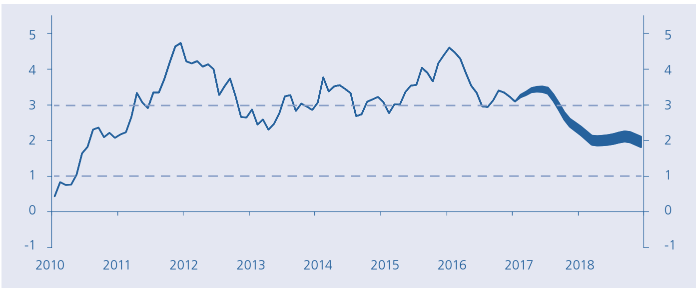


NOMINAL AND REAL* REFERENCE INTEREST RATE
(%)



* Ex-ante: With expectation of inflation.

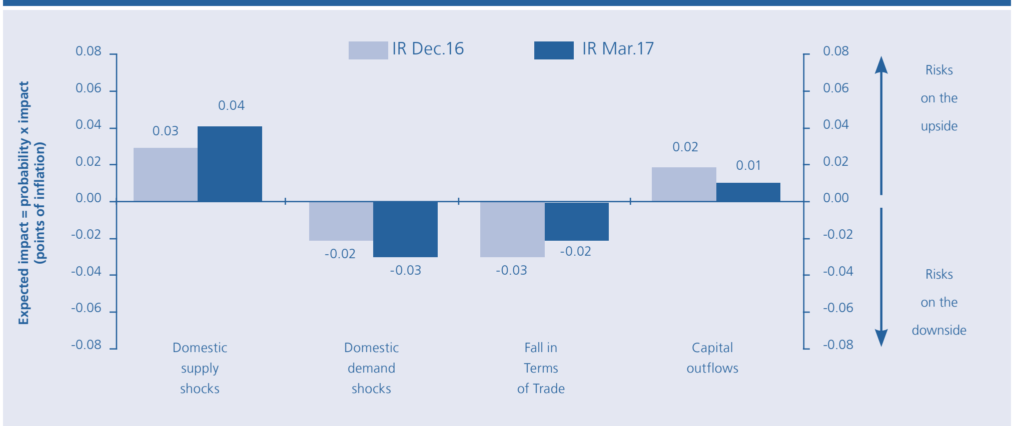
INFLATION FORECAST: 2010 - 2018
(Last 12-month % change)



Risk Balance

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

BALANCE OF RISKS AGAINST THE BASE SCENARIO



SUMMARY OF INFLATION REPORT FORECAST

	2015	2016	2017[1/]		2018[1/]	
			IR Dec.16	IR Mar.17	IR Dec.16	IR Mar.17
Real % change						
1. Gross Domestic Product	3.3	3.9	4.3	3.5	4.2	4.1
2. Domestic demand	3.1	0.9	4.0	3.3	4.0	3.7
a. Private consumption	3.4	3.4	3.5	3.1	4.0	3.4
b. Public consumption	9.8	-0.5	4.2	3.2	2.2	2.2
c. Fixed private investment	-4.4	-6.1	5.0	2.5	5.0	5.3
d. Public investment	-7.3	-0.4	7.4	11.0	4.5	5.0
3. Exports (good and services)	3.5	9.7	4.7	4.2	4.6	5.0
4. Imports (good and services)	2.5	-2.3	3.6	3.2	3.7	3.4
5. Economic growth in main trading partners	3.2	2.8	3.1	3.2	3.2	3.3
Memo:						
Output gap [2/] (%)	-1.5 ; -0.5	-1.5 ; 0.0	-1.0 ; 0.0	-1.5 ; 0.0	-0.5 ; 0.0	-1.0 ; 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/]	-	-	2.9	3.0	2.8	2.9
8. Expected depreciation [3/]	-	-	1.6	-1.5	1.4	1.7
9. Terms of trade [4/]	-6.3	-0.8	3.9	5.4	-1.6	-1.6
a. Export prices	-14.9	-3.8	7.3	10.0	-0.1	-0.2
b. Import prices	-9.2	-3.0	3.2	4.4	1.6	1.5
Nominal % change						
10. Currency in circulation	3.8	6.5	5.5	5.0	6.0	5.9
11. Credit to the private sector [5/]	8.0	5.6	6.5	5.5	6.5	6.2
% GDP						
12. Gross fixed investment	24.3	22.5	23.0	22.2	23.3	22.5
13. Current account of the balance of payments	-4.9	-2.8	-2.8	-2.6	-2.8	-2.4
14. Trade balance	-1.6	0.9	1.2	1.9	1.0	1.9
15. Long-term external financing of the private sector 6/	5.8	4.6	4.6	4.0	4.5	4.3
16. Current revenue of the general government	20.0	18.5	19.0	18.9	18.7	18.6
17. Non-financial expenditure of the general government	21.2	20.0	20.3	20.5	19.7	20.1
18. Overall balance of the non-financial public sector	-2.1	-2.6	-2.5	-2.8	-2.3	-2.6
19. Balance of total public debt	23.3	23.8	24.9	24.5	26.2	25.4
20. Balance of net public debt	6.6	7.9	11.6	9.9	13.6	12.0

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.