CENTRAL RESERVE BANK OF PERU

# Summary
# Inflation Report

March 2019

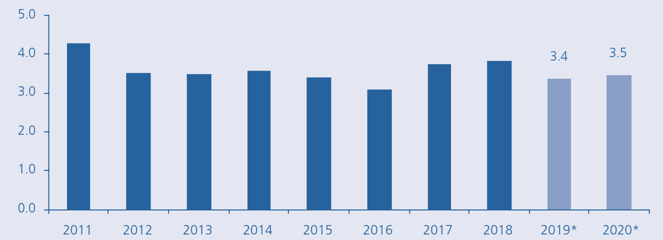
A more moderate pace of growth is expected this year in **global economic activity**, with the pace of global growth slowing down from 3.7 percent in 2018 to 3.4 percent due to the negative impact that trade tensions have had so far in the developed economies. However, this slowdown in global growth would be accompanied by more favorable external financial conditions than those foreseen in December as a result of lower expectations of monetary policy adjustments in the major central banks, particularly in the Fed. Moreover, a global growth rate of 3.5 percent is estimated for 2020 in a context in which global trade tensions would subside.

The **terms of trade** would show a moderate recovery in the 2019-2020 forecast horizon (with rates of 1.3 and 0.4 percent, respectively) after having registered a slight decline in 2018 (-0.1 percent). The prices of minerals would be slightly higher as a result of lower concerns of an economic slowdown in China. As it has been observed year-to-date, the progress achieved in U.S.-China trade negotiations and the stimulus measures adopted in the Chinese economy have led to a slight correction in the prices of the main commodities.

The correction of the terms of trade on the upside will imply a higher surplus in the trade balance and, consequently, a lower deficit in the **current account of the balance of payments** than that projected in the Inflation Report of December 2018. Current account deficits of 1.3 percent are now estimated for both 2019 and 2020. **Long-term external capital flows for the private sector** will continue to be the main source of financing the balance of payments, exceeding by far

This ***Inflation Report*** was prepared using data on the balance of payments and the gross domestic product as of the fourth quarter of 2018 and data on monetary accounts, the operations of the non-financial public sector, inflation, financial markets, and the exchange rate as of February 2019.

**WORLD ECONOMY: 2011 - 2020**
Average 2014-2018: 3.5



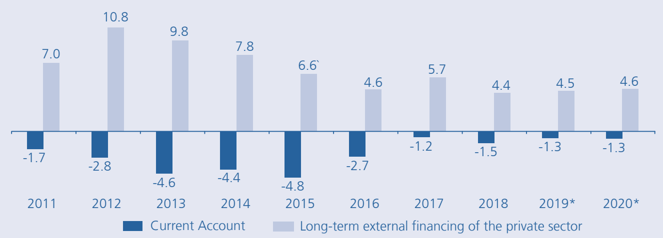

* Forecast.
Source: Bloomberg, IMF, and Consensus Forecasts.

**TERMS OF TRADE: 2017 - 2020**
(Annual average)

| | 2017 | 2018 | 2019* IR Dec.18 | 2019* IR Mar.19 | 2020* IR Dec.18 | 2020* IR Mar.19 |
|---|---|---|---|---|---|---|
| Terms of Trade (Annual % chg.) | 7.2 | -0.1 | -0.7 | 1.3 | -0.5 | 0.4 |
| **Price of exports (Annual % chg.)** | **13.0** | **6.5** | **-2.1** | **-0.5** | **1.2** | **2.6** |
| *Copper (US$ cents per pound)* | 280 | 297 | 280 | 286 | 281 | 289 |
| *Zinc (US$ cents per pound)* | 131 | 133 | 115 | 122 | 111 | 117 |
| *Lead (US$ cents per pound)* | 105 | 102 | 90 | 94 | 91 | 95 |
| *Gold (US$ per troy ounce)* | 1,257 | 1,269 | 1,244 | 1,319 | 1,281 | 1,358 |
| **Price of imports (Annual % chg.)** | **5.4** | **6.6** | **-1.4** | **-1.8** | **1.7** | **2.1** |
| *Oil (US$ per barrel)* | 51 | 65 | 60 | 58 | 60 | 59 |
| *Wheat (US$ per ton)* | 145 | 186 | 185 | 173 | 209 | 181 |
| *Maize (US$ per ton)* | 131 | 132 | 152 | 146 | 157 | 154 |
| *Soybean oil (US$ per ton)* | 707 | 637 | 627 | 662 | 642 | 682 |
| *Soybean grain (US$ per ton)* | 348 | 379 | 349 | 343 | 355 | 350 |

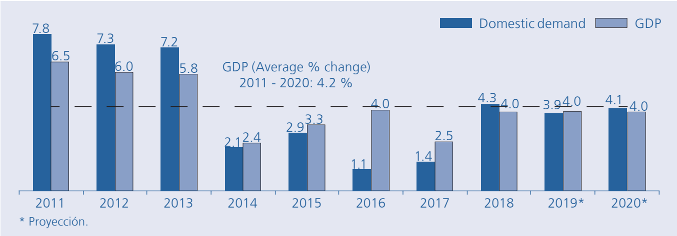
IR: Inflation Report.
* Forecast.
Source: BCRP.

**CURRENT ACCOUNT AND LONG-TERM EXTERNAL FINANCING OF THE PRIVATE SECTOR: 2011-2020[1/]**
(% GDP)




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

**DOMESTIC DEMAND AND GDP: 2011-2020**
(Real % change)

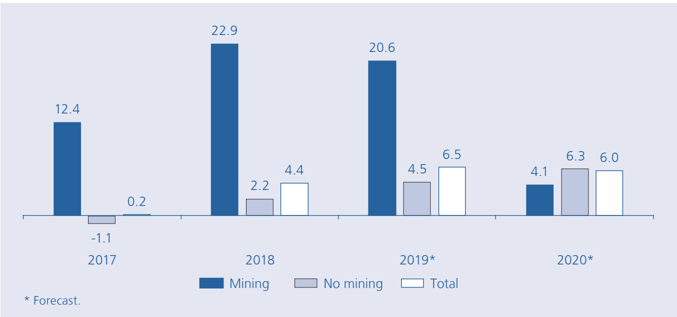



**GDP AND DOMESTIC DEMAND**
(Real % change)

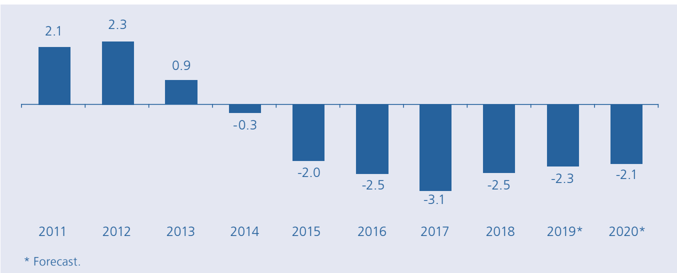
| | 2017 | 2018 | 2019* | | 2020* | |
|---|---|---|---|---|---|---|
| | | | IR Dec.18 | IR Mar.19 | IR Dec.18 | IR Mar.19 |
| **Domestic demand** | **1.4** | **4.3** | **3.9** | **3.9** | **4.0** | **4.1** |
| Private consumption | 2.6 | 3.8 | 3.7 | 3.8 | 3.9 | 3.9 |
| Public consumption | 0.5 | 2.0 | 2.9 | 2.5 | 1.8 | 2.2 |
| Private investment | 0.2 | 4.4 | 6.5 | 6.5 | 6.0 | 6.0 |
| Public investment | -2.3 | 8.4 | 2.8 | 1.0 | 3.4 | 5.0 |
| Change on inventories (contribution) | -0.3 | 0.3 | -0.2 | -0.2 | 0.0 | 0.0 |
| **Exports** | **7.8** | **2.5** | **4.7** | **4.6** | **4.8** | **5.7** |
| **Imports** | **4.1** | **3.4** | **4.3** | **4.4** | **5.1** | **6.2** |
| **GDP** | **2.5** | **4.0** | **4.0** | **4.0** | **4.0** | **4.0** |

* Forecast.
IR: Inflation Report.

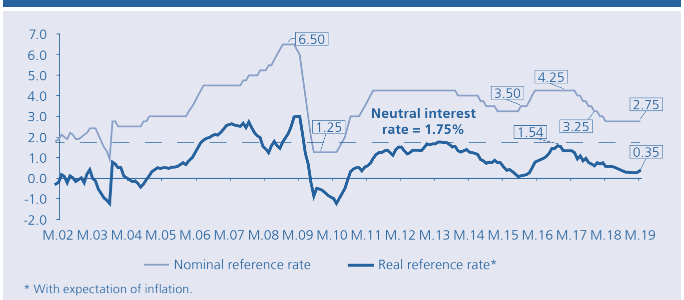
**PRIVATE INVESTMENT**
(Real % change)




**OVERALL BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2011-2020**
(% GDP)




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




the requirements of the current account as well as the flows projected in the Report of December.

In 2018 **economic activity** grew 4.0 percent, supported by the positive evolution of private mining investment and by the sustained growth of private consumption. In addition to this, public investment reversed the decline observed in 2017 as a result of the amounts invested in the PanAmerican Games and local governments' investment in road infrastructure.

The Peruvian economy would maintain a GDP growth rate of 4.0 percent in 2019 and in 2020. The slowdown of public expenditure this year, associated with the change of subnational authorities, will be offset by higher private spending, in a context of improvement of the terms of trade and business confidence. In 2020, the increased growth of mining production will add to the dynamism of domestic demand due to the progress of mining megaprojects and infrastructure works. As a result, the output gap will tend to close gradually in the forecast horizon.

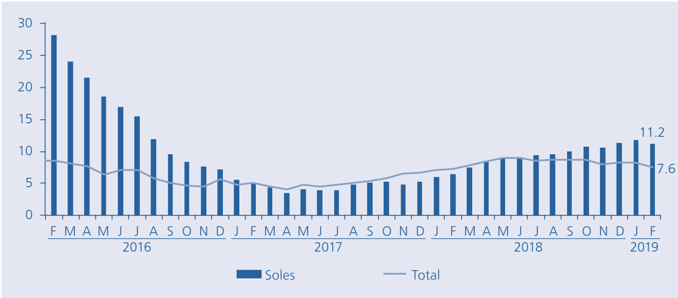
The **fiscal deficit** projected for this year has decreased from 2.6 percent of GDP in our Report of December 2018 to 2.3 percent of GDP in this Report, with estimated lower non-financial expenditures –down from 20.4 to 20.2 percent of GDP– accounting for this change considering the higher decline observed in public investment so far this year. The decreasing trend registered in the fiscal deficit that began in 2018 is foreseen to continue in 2020 with a deficit of 2.1 percent, in line with the fiscal consolidation process. This projection implies a positive weighted fiscal impulse for 2018 and a negative one for 2019 and 2020, which would coincide with greater private expenditure and with the reduction of the output gap.

The BCRP Board has maintained the **benchmark interest rate** at 2.75 percent since March 2018, which is compatible with an expansionary monetary policy stance (real rate of 0.35 percent) in a context of inflation of around 2.0 percent since November and a negative output gap which is projected to continue closing gradually in the forecast horizon.

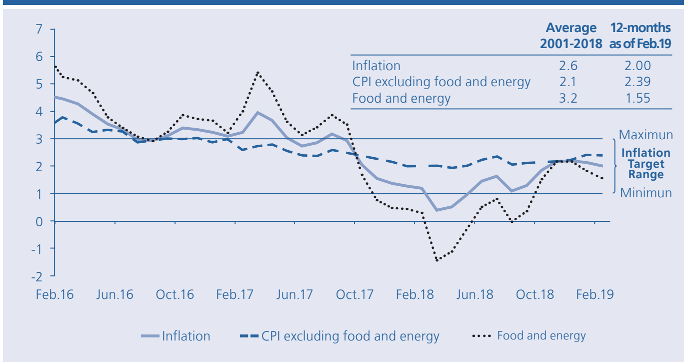
In line with the expansionary monetary stance of BCRP, **credit to the private sector** grew at a year-on-year rate of 7.6 percent in February, this growing trend being observed in all of the credit segments, especially in the segment of personal loans. In the forecast horizon, the ratio of credit to the private sector-to GDP would increase from 42 percent in 2018 to 44 percent in 2020. This projection takes into account flexible monetary conditions and the recovery of the pace of growth of domestic demand.

Year-on-year **inflation** fell from 2.2 percent in November to 2.0 percent in February 2019, around the midpoint of the target range. Inflation expectations, which have remained within the target range since March 2017, showed a rate of 2.4 percent in February and are estimated to decrease gradually towards 2 percent in the forecast horizon.

**CREDIT TO THE PRIVATE SECTOR**[1/]
Annual % change




**INFLATION**
(% change last 12-month)




## Balance of risks

The balance of **inflation risk factors** considered in this Report –external demand shocks, international financial shocks, and domestic demand shocks– translates into a neutral bias in the inflation forecast, which contrasts with the bias on the upside considered in the Inflation Report of December.

**BALANCE OF RISKS AGAINST THE BASE SCENARIO**

## SUMMARY OF INFLATION REPORT FORECAST

| | 2017 | 2018 | 2019[1/] | | 2020[1/] | |
|---|---|---|---|---|---|---|
| | | | IR Dec.18 | IR Mar.19 | IR Dec.18 | IR Mar.19 |
| **Real % change** | | | | | | |
| 1. Gross Domestic Product | 2.5 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| 2. Domestic demand | 1.4 | 4.3 | 3.9 | 3.9 | 4.0 | 4.1 |
| a. Private consumption | 2.6 | 3.8 | 3.7 | 3.8 | 3.9 | 3.9 |
| b. Public consumption | 0.5 | 2.0 | 2.9 | 2.5 | 1.8 | 2.2 |
| c. Fixed private investment | 0.2 | 4.4 | 6.5 | 6.5 | 6.0 | 6.0 |
| d. Public investment | -2.3 | 8.4 | 2.8 | 1.0 | 3.4 | 5.0 |
| 3. Exports (good and services) | 7.8 | 2.5 | 4.7 | 4.6 | 4.8 | 5.7 |
| 4. Imports (good and services) | 4.1 | 3.4 | 4.3 | 4.4 | 5.1 | 6.2 |
| 5. Economic growth in main trading partners | 3.5 | 3.8 | 3.5 | 3.4 | 3.4 | 3.4 |
| **Memo:** | | | | | | |
| Output gap[2/] (%) | -1.4 ; -0.8 | -0.9 ; -0.2 | -0.6 ; 0.2 | -0.6 ; 0.2 | -0.5 ; 0.5 | -0.5 ; 0.5 |
| **% change** | | | | | | |
| 6. Inflation | 1.4 | 2.2 | 2.1 | 2.0 | 2.0 | 2.0 |
| 7. Expected inflation[3/] | - | - | 2.5 | 2.4 | 2.5 | 2.5 |
| 8. Expected depreciation[3/] | - | - | 0.3 | -1.6 | 0.4 | 0.9 |
| 9. Terms of trade[4/] | 7.2 | -0.1 | -0.7 | 1.3 | -0.5 | 0.4 |
| a. Export prices | 13.0 | 6.5 | -2.1 | -0.5 | 1.2 | 2.6 |
| b. Import prices | 5.4 | 6.6 | -1.4 | -1.8 | 1.7 | 2.1 |
| **Nominal % change** | | | | | | |
| 10. Currency in circulation | 6.7 | 7.9 | 8.5 | 8.1 | 8.5 | 8.5 |
| 11. Credit to the private sector[5/] | 6.7 | 8.3 | 9.0 | 9.0 | 9.0 | 9.0 |
| **% GDP** | | | | | | |
| 12. Gross fixed investment (nominal) | 21.8 | 22.4 | 23.0 | 22.7 | 23.4 | 23.1 |
| 13. Current account of the balance of payments | -1.2 | -1.5 | -1.6 | -1.3 | -1.7 | -1.3 |
| 14. Trade balance | 3.1 | 3.1 | 2.7 | 3.4 | 2.6 | 3.4 |
| 15. Long-term external financing of the private sector[6/] | 5.7 | 4.4 | 4.1 | 4.5 | 3.8 | 4.6 |
| 16. Current revenue of the general government | 18.1 | 19.3 | 19.3 | 19.3 | 19.4 | 19.4 |
| 17. Non-financial expenditure of the general government | 20.1 | 20.4 | 20.4 | 20.2 | 20.0 | 20.0 |
| 18. Overall balance of the non-financial public sector | -3.1 | -2.5 | -2.6 | -2.3 | -2.1 | -2.1 |
| 19. Balance of total public debt | 24.9 | 25.7 | 26.7 | 26.3 | 26.9 | 26.4 |
| 20. Balance of net public debt | 9.5 | 11.4 | 13.0 | 13.2 | 14.0 | 14.3 |

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