CENTRAL RESERVE BANK OF PERU

Summary Inflation Report

September 2019

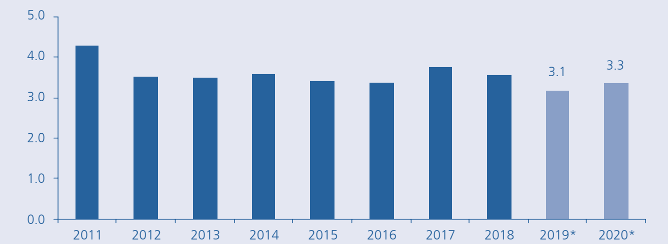
Global growth is expected to slow down from 3.6 percent in 2018 to 3.1 percent in 2019 (3.3 percent was estimated in the June Inflation Report) and to 3.3 percent in 2020 (3.4 percent estimated in the previous Report) as a result of the uncertainty caused by commercial tensions. However, this slower pace of global economic activity is expected to be accompanied by more favorable external financial conditions associated with more expansionary monetary positions in the central banks of the advanced economies and the emerging economies.

The **terms of trade** have been deteriorating due to the increase of trade tensions between the United States and China and to expectations of lower global growth, and are, therefore, projected to decline 2.6 percent in 2019 and 1.1 percent in 2020. Moreover, a lower annual average copper price (US$ 2.62 per pound) is projected for 2020 in this report (vs. US$ 2.75 in the previous report), while the annual average price of gold projected for this year is higher (US$ 1,495 per troy ounce vs. US$ 1,350 per ounce projected in the previous report).

Because of the lower value of exports compared to the one forecast in June, the projection of the **deficit in the current account of the balance of payments** has been revised up (from 1.6 to 1.9 percent of GDP in 2019 and from 1.9 to 2.1 percent in 2020). For the same reason, the trade balance surplus projected has been revised from US$ 6.3 billion in the June Report to US$ 5.7 billion in this Report. Counterbalancing this evolution in the trade of goods, the financial account flows show favorable trends amid an international environment with more flexible financing conditions, so capital inflows are expected to be higher than those projected in June. Moreover, at an aggregate level in the balance of payments, the increase in net international reserves has been revised up from US$ 6.0 billion in June to US$ 8.5 billion in this report.

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

WORLD ECONOMY: 2011 - 2020
(Annual average 2014-2018: 3.6%)



* Forecast.
Source: IMF and consensus forecast.

TERMS OF TRADE: 2018 - 2020

	2018	2019*			2020*	
		I Sem	IR Jun.19	IR Sep.19	IR Jun.19	IR Sep.19
Terms of Trade						
(Annual average % chg.)	**-0.2**	**-6.2**	**-2.8**	**-2.6**	**-0.7**	**-1.1**
Price of exports						
(Annual average % chg.)	**6.3**	**-7.2**	**-4.0**	**-3.6**	**0.7**	**-0.2**
Copper (US$ cents per pound)	297	280	276	271	275	262
Zinc (US$ cents per pound)	133	124	120	114	115	103
Lead (US$ cents per pound)	102	89	86	91	84	94
Gold (US$ per troy ounce)	1,269	1,307	1,328	1,393	1,350	1,495
Price of imports						
(Annual average % chg.)	**6.5**	**-1.0**	**-1.3**	**-1.1**	**1.5**	**0.9**
Oil (US$ per barrel)	65	57	57	58	55	56
Wheat (US$ per ton)	186	171	169	165	185	162
Maize (US$ per ton)	132	142	153	146	169	146
Soybean oil (US$ per ton)	637	623	617	628	620	642
Soybean grain (US$ per ton)	379	341	354	337	373	333

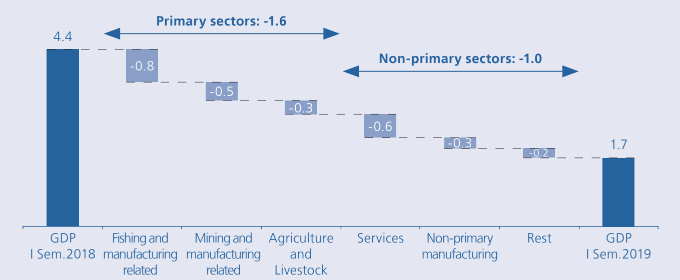
* Forecast.

BALANCE OF PAYMENTS
(Million US$)

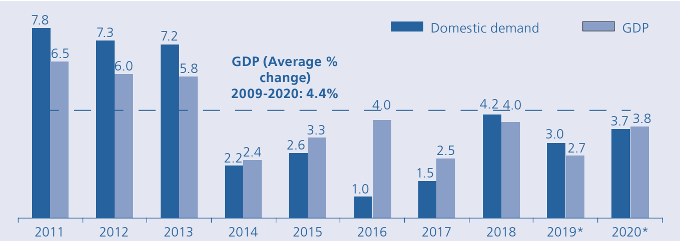
	2018	2019*			2020*	
		I Sem.	IR Jun.19	IR Sep.19	IR Jun.19	IR Sep.19
I. CURRENT ACCOUNT BALANCE	**-3,594**	**-2,748**	**-3,782**	**-4,347**	**-4,608**	**-4,960**
% GDP	*-1.6*	*-2.5*	*-1.6*	*-1.9*	*-1.9*	*-2.1*
1. Trade Balance	7,197	2,444	6,271	5,722	6,284	5,784
a. Exports	49,066	22,616	48,195	47,450	51,224	50,148
i) Traditional	35,638	16,074	34,023	33,473	35,611	34,731
ii) Non traditional	13,240	6,457	14,001	13,813	15,457	15,258
b. Imports	-41,870	-20,172	-41,924	-41,728	-44,940	-44,364
2. Services	-2,532	-1,205	-2,514	-2,521	-2,885	-2,935
3. Investment income	-11,814	-5,885	-11,303	-11,322	-11,883	-11,685
4. Current transfers	3,556	1,899	3,763	3,774	3,876	3,876
Of which: Remittances	3,225	1,645	3,382	3,382	3,551	3,551
II. FINANCIAL ACCOUNT	**94**	**9,139**	**9,818**	**12,882**	**6,292**	**6,644**
1. Private Sector	-2,028	3,298	3,235	6,916	3,213	3,655
a. Long-term	917	2,168	4,109	6,612	3,427	3,633
b. Short-term 1/	-2,946	1,131	-873	304	-214	22
2. Public sector 2/	2,122	5,840	6,582	5,966	3,080	2,989
III. CHANGE ON NIRs	**-3,500**	**6,391**	**6,035**	**8,535**	**1,684**	**1,684**

1/ Includes net errors and omissions, and NIR's effect valuation.
2/ Includes portfolio investment in sovereign bonds by non-residents.
* Forecast.
IR: Inflation Report.

GDP GROWTH BY SECTOR IN THE FIRST SEMESTER OF 2018 AND 2019
(% change and contribution to the growth)

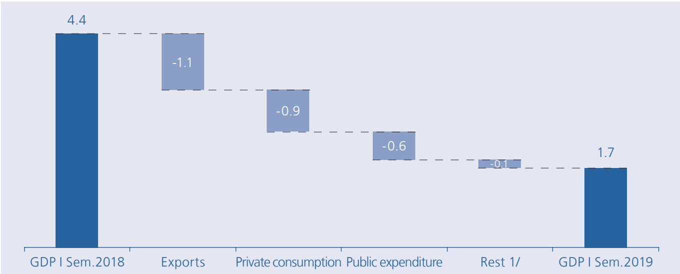


DOMESTIC DEMAND AND GDP: 2011-2020
(Real % change)



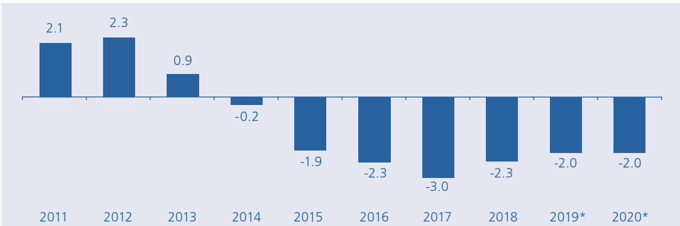
* Forecast.

GDP GROWTH BY EXPENDITURE IN THE FIRST SEMESTER OF 2018 AND 2019
(% change and contribution to the growth)



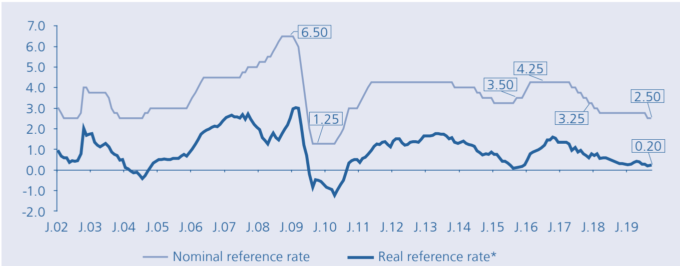
1/ Includes the effect of private investment, imports, and change on inventories over GDP growth.

ECONOMIC BALANCE OF THE NON FINANCIAL PUBLIC SECTOR: 2011-2020
(Real % change)



* Forecast.

NOMINAL AND REAL* REFERENCE INTEREST RATE
(%)



* Exante real rate with expectation of inflation. The reference rate from January 2002 and August 2003 is the midpoint rounded in 25 basis ponts from interest rate band.

In the second quarter of 2019, **economic activity** increased by 1.2 percent, as a result of which GDP accumulated an expansion of 1.7 percent in the first half of the year. This slower pace of economic growth is explained by the impact of transitory events that affected primary production as well as by the slowdown of growth of non-primary production associated with the evolution of domestic demand. However, as from the second half of 2019, activity in the primary industries is expected to register a gradual normalization and a progressive recovery of growth is expected in the non-primary industries, with GDP growth being projected to reach 2.7 percent in 2019 and 3.8 percent in 2020 (3.4 percent in 2019 and 4.0 percent in 2020 projected in the previous Report).

On the side of expenditure components, the slowdown observed in the first half of the year reflects the evolution of traditional exports –which were affected by lower primary production– and the deterioration of economic conditions in the domestic and the international scenarios, which limited the growth of domestic demand. Factors accounting for the revision in the GDP growth rate include the delay in the normalization of primary activity –and thus of exports–, the lower-than-expected growth rate of public investment, and the moderation of labor market conditions, which have been affecting private consumption this year. In the forecast horizon, domestic demand is projected to show a gradual recovery in a context of political and social stability.

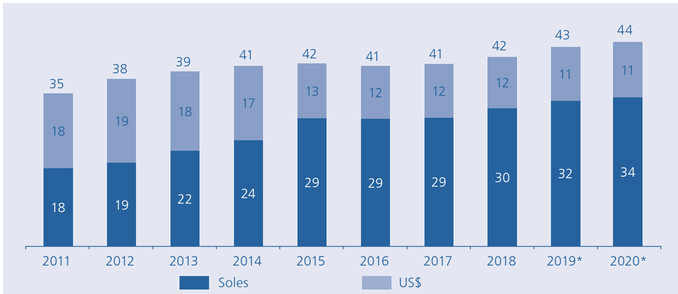
The **fiscal deficit** projected for 2019 has been revised slightly down, from 2.1 to 2.0 percent of GDP in this report, due to the higher revenues estimated. This deficit level is expected to remain in 2020, in line with the recovery foreseen in economic activity and in public investment.

The Board of BCRP lowered the **benchmark interest rate** by 25 basis points in August to 2.5 percent, in a context marked by a more gradual-than-expected closure of the output gap and a downward bias in the inflation forecast. With this, BCRP expands monetary stimulus, with a real interest rate of 0.2 percent.

In line with the expansionary monetary stance, **credit to the private sector** grew 8.1 percent year-on-year in August, this result reflecting mainly the growth of lending in the segment of personal loans (11.4 percent). In the forecast horizon, credit to the private sector as a percentage of GDP would increase from 42 percent in 2018 to 44 percent in 2020. The latter projection considers flexible monetary conditions and a more gradual recovery of the demand's rate of growth.

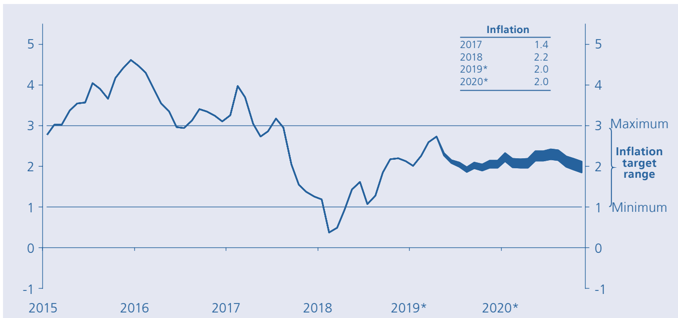
In August, year-on-year **inflation** declined from 2.3 percent in June to 2.0 percent, the midpoint of the inflation target range. Moreover, inflation expectations, which remain within the target range since March 2017, showed levels of 2.3 percent in August and are expected to decrease gradually in a context in which inflation is foreseen to remain around 2 percent in the forecast horizon.

RATIO CREDIT/ GDP
(%)



* Forecast.

INFLATION FORECAST: 2015-2020
(Last 12-month % change)

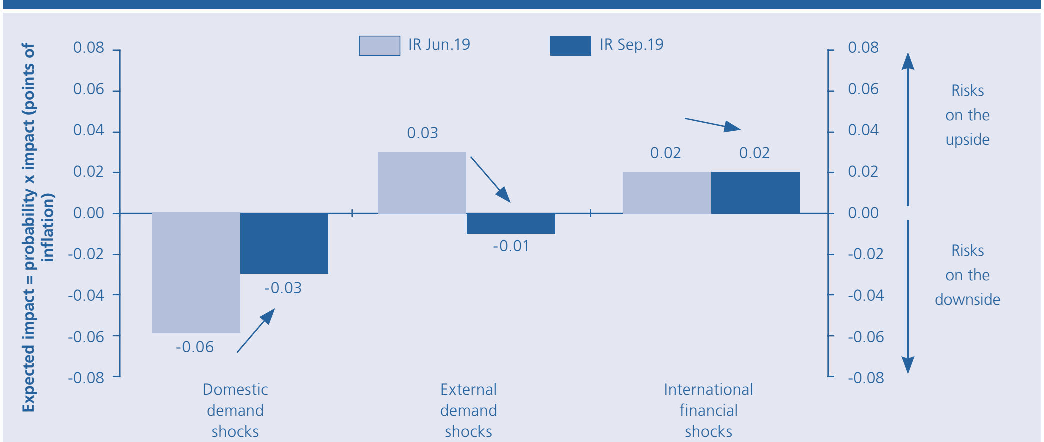


* Forecast.

Balance of risk

The balance of **inflation risk factors** considered in this Report –domestic demand shocks, external demand shocks, and international financial shocks– continues to show a bias on the downside in the inflation forecast. This bias considers a greater relative risk of a possible lower inflation resulting from a lower pace of growth in the demand.

BALANCE OF RISKS AGAINST THE BASE SCENARIO



IR: Inflation Report.

SUMMARY OF INFLATION REPORT FORECAST

	2017	2018	2019[1/]		2020[1/]	
			IR Jun.19	IR Sep.19	IR Jun.19	IR Sep.19
Real % change						
1. Gross Domestic Product	2.5	4.0	3.4	2.7	4.0	3.8
2. Domestic demand	1.4	4.2	3.3	3.0	4.0	3.7
a. Private consumption	2.6	3.8	3.5	3.0	3.7	3.7
b. Public consumption	0.5	0.8	2.0	2.0	2.5	2.5
c. Fixed private investment	0.2	4.2	3.8	4.4	5.5	4.5
d. Public investment	-1.8	6.8	1.0	0.5	5.0	5.0
3. Exports (good and services)	7.6	2.7	2.6	0.9	5.4	5.6
4. Imports (good and services)	4.0	3.4	2.1	1.8	5.5	5.6
5. Economic growth in main trading partners	3.7	3.7	3.3	3.1	3.3	3.2
Memo:						
Output gap [2/] (%)	-0.8	-0.4	-1.0 ; -0.3	-1.4 ; -0.9	-0.7 ; 0.2	-1.3 ; -0.4
% change						
6. Inflation	1.4	2.2	2.1	2.0	2.0	2.0
7. Expected inflation [3/]	2.8	2.1	2.5	2.2	2.5	2.4
8. Expected depreciation [3/]	-3.4	4.2	-1.2	0.3	0.8	-0.3
9. Terms of trade	7.5	-0.2	-2.8	-2.6	-0.7	-1.1
a. Export prices	13.4	6.3	-4.0	-3.6	0.7	-0.2
b. Import prices	5.4	6.5	-1.3	-1.1	1.5	0.9
% change						
10. Currency in circulation	6.7	7.9	6.0	5.7	6.0	6.0
11. Credit to the private sector	6.7	8.7	8.1	7.3	9.0	8.5
% GDP						
12. Gross fixed investment	21.9	22.4	22.3	22.6	22.7	22.8
13. Current account of the balance of payments	-1.2	-1.6	-1.6	-1.9	-1.9	-2.1
14. Trade balance	3.1	3.2	2.6	2.5	2.5	2.4
15. Long-term external financing of the private sector [4/]	1.8	2.0	2.7	2.7	2.1	2.1
16. Current revenue of the general government	18.1	19.3	19.6	19.7	19.5	19.7
17. Non-financial expenditure of the general government	20.0	20.2	20.2	20.2	20.0	20.1
18. Overall balance of the non-financial public sector	-3.0	-2.3	-2.1	-2.0	-2.1	-2.0
19. Balance of total public debt	24.9	25.8	26.5	26.5	26.9	27.1
20. Balance of net public debt	9.5	11.3	13.1	13.0	14.5	14.4

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