CENTRAL RESERVE BANK OF PERU

Summary
Inflation Report

June 2020

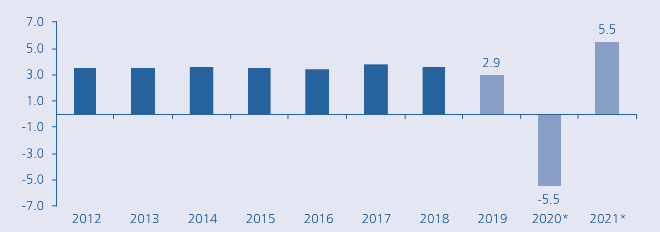
The COVID-19 pandemic has significantly changed both the global and the country's economic landscapes. The first indications of this in our economy were observed in the fall in commodity prices and in the disruption of global value chains due to the impact of COVID-19 on China earlier this year. The rapid spread of the virus to the rest of the world and measures of social isolation have caused an unprecedented severe abrupt contraction of **global economic activity**. A recovery is expected to begin as from mid-year, under a scenario of control of COVID-19 expansion, as a result of the reopening of economies and the monetary and fiscal stimuli implemented. In this scenario, global GDP is estimated to contract by 5.5 percent in 2020, mainly in the first half of the year, and to recover by 5.5 percent in 2021.

The deterioration of the world economy and greater risk aversion due to high uncertainty about the future evolution of the pandemic have generated a significant reduction in commodity prices, the price of oil reaching historical minimum levels in April. This will imply a reduction in export and import prices (4.0 and 6.0 percent respectively) and also an increase of 2.2 percent in the **terms of trade** in 2020 due to the effect of lower oil prices. This scenario considers that, towards the end of the projection horizon, price levels would remain below the ones observed before the COVID-19 crisis.

The **current account deficit** in the balance-of-payments in 2020 and 2021 (1.4 percent of GDP in both years) would remain at similar historical

This ***Inflation Report*** has been prepared using data on the balance of payments and the gross domestic product as of the first quarter of 2020, data on the operations of the non-financial public sector, inflation, financial markets, the exchange rate and monetary accounts as of May 2020.

WORLD ECONOMY: 2012 - 2021
(Average 2014-2018: 3.6)



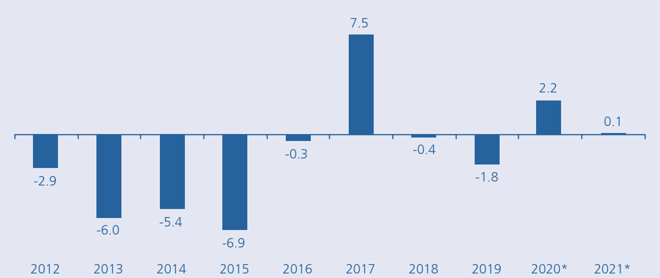
* Forecast.
Source: IMF and Consensus Forecasts.

TERMS OF TRADE: 2019 - 2021

	2019	2020*			2021*	
		Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
Terms of Trade						
Annual average % chg.	**-1.8**	**1.9**	**0.0**	**2.2**	**-0.9**	**0.1**
Price of exports						
Annual average % chg.	**-3.4**	**-0.8**	**0.7**	**-4.0**	**0.2**	**2.1**
Copper (US$ cents per pound)	273	256	277	253	280	262
Zinc (US$ cents per pound)	116	96	103	91	103	91
Lead (US$ cents per pound)	91	84	88	77	88	76
Gold (US$ per troy ounce)	1,392	1,583	1,480	1,667	1,480	1,690
Price of imports						
Annual average % chg.	**-1.7**	**-2.6**	**0.7**	**-6.0**	**1.1**	**2.0**
Oil (US$ per barrel)	57	46	56	35	53	37
Wheat (US$ per ton)	168	204	165	176	181	185
Maize (US$ per ton)	145	141	150	130	159	139

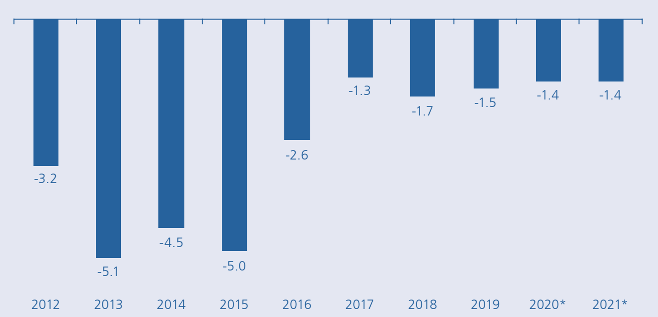
* Forecast.
IR: Inflation Report.

TERMS OF TRADE: 2012 - 2021
(Annual average % change)



* Forecast.

CURRENT ACCOUNT: 2012-2021
(% GDP)



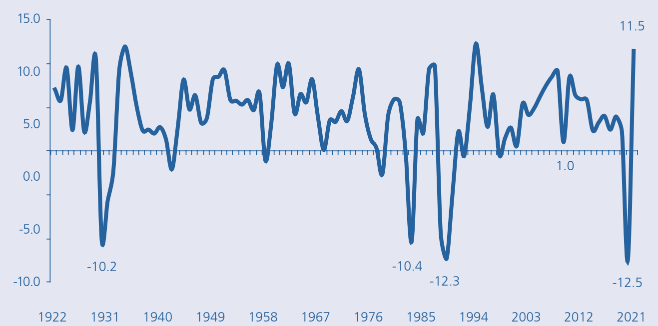
* Forecast.

GDP BY PRODUCTION SECTOR
(Real % change)

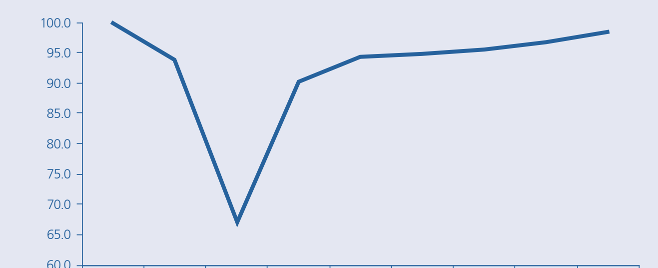
	Average 2014-2018	2019	2020*			2021*	
			Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
Primary GDP	**4.0**	**-1.3**	**-2.8**	**4.7**	**-5.5**	**3.7**	**8.0**
Agriculture and livestock	3.6	3.2	2.9	4.0	1.3	3.6	3.6
Fishing	3.0	-25.9	-15.3	23.0	9.5	-3.9	8.5
Metallic mining	7.1	-0.8	-6.3	3.6	-10.2	5.5	10.7
Hydrocarbons	-3.2	4.6	0.2	0.9	-14.4	0.2	6.9
Based on raw materials	0.9	-8.8	-0.8	9.3	2.1	0.9	7.7
Non-Primary GDP	**3.0**	**3.2**	**-3.5**	**3.6**	**-14.5**	**3.8**	**12.6**
Non-primary industries	-0.6	1.2	-12.3	2.7	-23.8	3.5	16.9
Electricity and water	4.7	3.9	-2.1	4.0	-7.9	4.5	12.6
Construction	0.0	1.5	-13.0	5.3	-25.4	5.1	23.2
Commerce	2.7	3.0	-6.2	3.5	-23.6	3.7	17.4
Services	4.2	3.8	-0.5	3.6	-9.9	3.7	10.1
GDP	**3.2**	**2.2**	**-3.4**	**3.8**	**-12.5**	**3.8**	**11.5**

* Forecast.
IR: Inflation Report.

TOTAL GDP, 1922-2021
(Annual % change)



TOTAL GDP, 2019-2021
Seasonally adjusted index, Q4.19 = 100



	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21
Index	100	94	67	90	94	95	96	97	98
Annual % chg. 1/	1.8	-3.4	-31.9	-8.8	-5.7	-0.1	42.8	7.2	4.4

1/ % change seasonally adjusted index.

low levels to those observed in previous years. In 2020, exports of goods and services and the profits of foreign direct investment companies would register a noteworthy reduction as a result of the contraction in local production and external demand, lower prices for basic metals, and the closure of borders. Lower imports (18.4 percent) would reflect both the significant drop in domestic demand (11.9 percent) and lower import prices (6.0 percent). In 2021, on the other hand, exports and imports of goods and the profits of foreign direct investment companies are expected to recover in a context of reactivation of global and local economic growth.

The measures adopted in the country since mid-March –among the strictest measures in the world– to contain the pandemic and gain time to develop a health base to withstand the ravages of contagion affected production and employment throughout our country. In the first quarter of the year, **GDP** fell by 3.4 percent, with disruptions being observed in all production sectors, together with a contraction in private spending and exports.

The extension of confinement in the second quarter to face the pandemic, with a gradual and sectoral reopening of economic activities since May would lead to a significant contraction of activity of **12.5 percent** this year. The economic effects of the lockdown of economic activities have been reflected in lower household incomes, job losses, and the deterioration of consumption and investment expectations so far this year. Under a scenario of efficient reopening of the economy with adequate health controls, the country's GDP is expected to grow 11.5 percent in 2021, thus recovering its pre-crisis level (fourth quarter 2019) in the first quarter of 2022. A scenario of preservation of macroeconomic and financial stability is assumed in these projections, together with reforms aimed at achieving an adequate business environment that promotes job creation and investment.

On the supply side, recovery will depend on the rapid implementation of an appropriate business resumption plan and on companies' adaptation to the new business environment, especially in the sectors most affected by the containment measures, the non-primary sectors. At the same time, domestic demand would accompany the reopening of the economy with the partial recovery of citizens' spending capacity, the progressive recovery of consumer and business confidence, supported by extraordinary fiscal and monetary stimuli.

In addition to the higher government expenditure associated with attending to the health emergency and the state of national emergency, the Treasury made use of its ample fiscal space to mitigate the lower income of businesses (through tax deferral and tax breaks) and families (through monetary transfers), these measures being extended as the period of confinement was extended. As a result of the fiscal stimulus measures and lower economic activity, a **fiscal deficit** of 9.7 percent of GDP is projected for 2020 due to higher non-financial spending (25.2 percent of GDP) –mainly current expenditure– and lower revenues (17.5 percent of GDP).

The magnitude of the expansionary fiscal measures implemented to address the pandemic has been possible due to the low level of public debt existing prior to the pandemic (26.8 percent). It is estimated that the fiscal deficit in 2021 would be reduced to 4.2 percent of GDP, a level that would reflect lower current spending and a recovery in revenues, consistent with the expected recovery in activity and commodity prices. The fiscal consolidation process would continue in the following years with public debt showing a declining path from the level of 33.9 percent projected for this year to 33.1 percent in 2021, until it reaches again levels below 30 percent in the medium term.

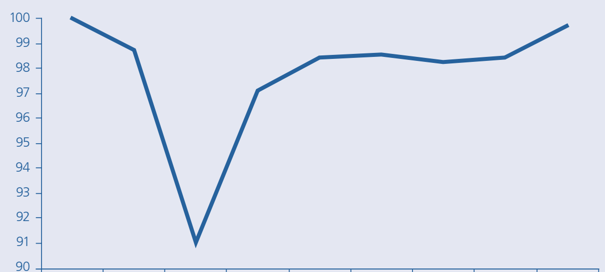
With the onset of the social isolation period, the Central Bank lowered the monetary policy benchmark interest rate by 100 basis points in March to 1.25 percent (a rate hitherto achieved only in 2009 during the international financial crisis), lowering it thereafter in April to an all-time low of 0.25 percent with the

DOMESTIC DEMAND AND GDP
(Real % change)

	2019	2020*			2021*	
		Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
Domestic demand	**2.3**	**-2.0**	**3.7**	**-11.9**	**3.8**	**9.9**
Private consumption	3.0	-1.7	3.5	-9.4	3.7	9.0
Public consumption	2.1	6.0	2.5	4.3	2.5	2.5
Private investment	4.0	-16.9	3.8	-30.0	4.0	20.0
Public investment	-1.4	15.8	6.0	-8.5	4.0	9.0
Change on inventories (contribution)	-0.5	1.4	0.0	0.0	0.0	0.0
Exports	**0.8**	**-11.1**	**4.5**	**-18.9**	**4.8**	**14.1**
Imports	**1.2**	**-6.5**	**4.0**	**-16.9**	**4.8**	**7.5**
Gross Domestic Product	**2.2**	**-3.4**	**3.8**	**-12.5**	**3.8**	**11.5**
Memo:						
Public expenditure	1.0	8.0	3.5	0.7	3.0	4.2
Domestic demand excluding inventories	2.9	-3.4	3.6	-11.7	3.7	9.8

* Forecast.
IR: Inflation Report.

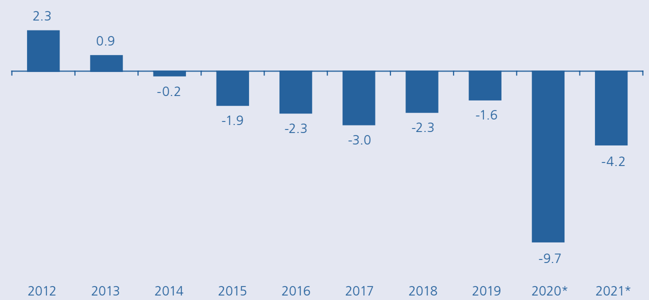
DOMESTIC DEMAND, 2019-2021
Seasonally adjusted index, Q4.19 = 100



	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21
Index	100	99	91	97	98	99	98	98	100
Annual % chg. 1/	1.9	-2.0	-30.2	-10.2	-4.6	-0.9	36.2	5.5	5.2

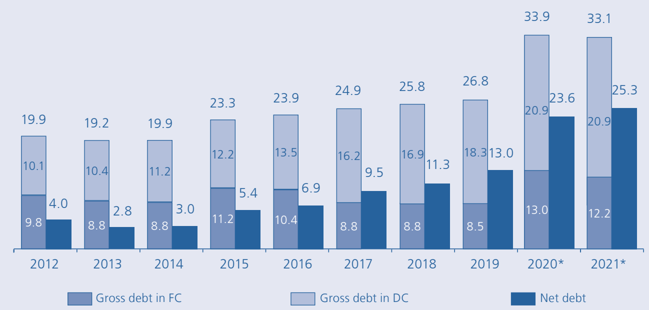
1/ % change seasonally adjusted index.

ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2012 - 2021
(% GDP)



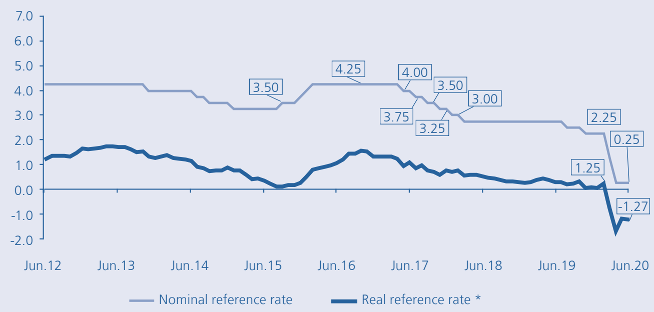
* Forecast.

NON-FINANCIAL PUBLIC SECTOR DEBT: 2012 - 2021
(% GDP)



* Forecast.

REFERENCE INTEREST RATE
(%)



* With expectation of inflation.

1

REDUCTION OF THE MONETARY POLICY INTEREST RATE

a. Reduction of the reference interest rate from 2.25 % in March to 0.25 % in April, its lowest level.

b. Guidelines: The Board of BCRP has emphasized that it considers it appropriate to maintain a strong expansionary monetary stance for an extended period and that it stands ready to extend monetary stimulus under different modalities if necessary.

2

EASING OF RESERVE REQUIREMENTS

a. The rate of reserve requirements in soles was lowered from 5% to 4% and the rate of reserve requirements for obligations in dollars with foreign financial entities with maturity terms of 2 years or less was lowered from 50 % to 9 %.

b. The minimum current account requirement in soles of banks at BCRP was lowered from 1 % to 0.75 %.

c. Suspension of additional reserve requirement for credit in dollars.

3

PROVISION OF LIQUIDITY TO THE FINANCIAL SYSTEM

a. Maturity terms of 6 months to 3 years for security repos and currency repos.

b. Easing of alternative scheme of portfolio repos (including factoring, entities with ratings of up to B+, reduction of the minimum amount of collateral to S/ 300,000).

c. Easing of the window facility (the limit of operations was eliminated).

d. New liquidity facilities: (i) Government-backed credit repos (Reactiva Perú); (ii) repos conditioned to the refinancing of the credit portfolio, and (iii) Program of Government guarantee to the credit portfolio of financial entities

4

REDUCTION OF VOLATILITY IN LONG-INTEREST RATES AND IN THE FOREIGN EXCHANGE RATE

a. Foreign exchange intervention through derivatives mainly (maximum balance of FX swaps-sell since the state of emergency began: US$ 2 279.1 million on April 15).

b. Expansion of the limits for additional reserves in soles associated with the banks' sales of foreign exchange derivatives.

c. Security repos with sovereign bonds and direct puchase of foreign currency between BCRP and AFPs allowed.

LOANS OF REACTIVA PERÚ BY COMPANY SIZE 1/

	Amount (Million S/)	N° of companies (Units)	Share of N° of companies (%)
Corporate and large companies	12,625	2,457	3.4
Medium-sized enterprises	7,593	18,861	26.4
Small business and Microbusinesses	4,529	50,235	70.2
Total	**24,748**	**71,553**	**100.0**

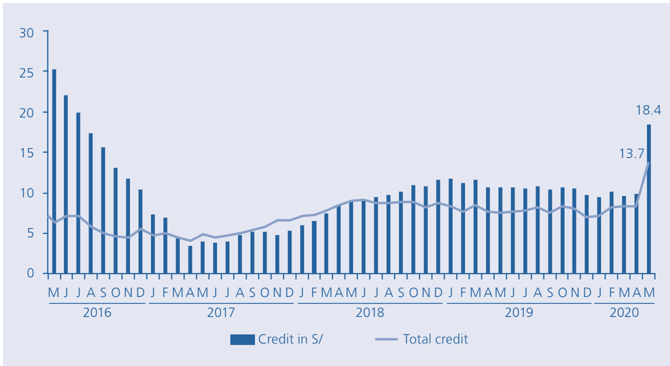
1/ Made by MEF's data as of May 29, 2020. For the classification of company size, the definition of the SBS is used according to the Consolidated Credit Report (RCC). For companies that are not listed in the RCC, the classification based on the amount of Reactiva Peru.
Memo: The criteria for classifying business loans by credit segment according to the SBS is as follows:
Corporate: Annual sales more than S/ 200 million.
Large companies: Annual sales between S/ 20 million and S/ 200 million; or maintain issues in the capital market in the last year.
Medium-sized enterprises: Total indebtedness greater than S/ 300,000 or annual sales not greater than S/ 20 million.
Small business: Total indebtedness between S/ 20,000 and S/ 300,000.
Microbusinesses: Total indebtedness not greater than S/ 20,000.

first extension of the quarantine. This almost zero level of the monetary policy rate –the lowest policy rate of the emerging economies at the time of its implementation– responded to the extraordinary magnitude of the contraction of economic activity and was feasible because of the high credibility of monetary policy.

This expansionary stance was reinforced by a series of actions aimed at maintaining the credit channel and the payments system. To this end, ample liquidity (equivalent to S/ 2 billion) has been released into the financial system by reducing the rate of reserve requirements in soles and in dollars); extending the amount and maturity terms of security and currency repo operations for up to 3 years, with a balance of S/ 25.2 billion at the end of May; and conducting portfolio repo operations for the first time, with a balance of S/ 260 million at the end of May. Since the end of April, these actions were complemented with government-backed portfolio repo operations for an initial maximum amount of S/ 30 billion with the aim of contributing to replenish companies' working capital. This amount was later doubled with the extension of the social isolation period. This guarantee scheme staggered according to the size of the company's sales and the auction scheme, carried out by the central bank based on the lowest interest rate offered to the company, allowed for a historically low interest rate of 1.1 percent for loans under the program called Reactiva Perú until June 11. It is worth mentioning that 50,235 micro and small enterprises (MYPES) have received loans from Reactiva Perú as of May 29, this number of companies being equivalent to 70 percent of the total number of benefited companies. Moreover, the amount of the loans granted to MYPES is proportional to the percentage of the sales of these companies, which reflects the Program's support for this sector.

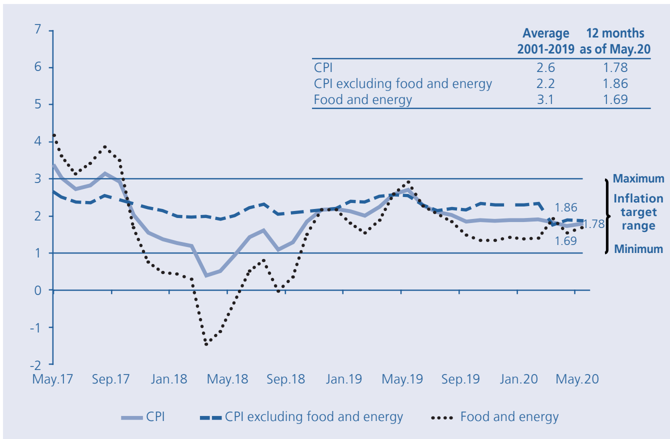
In line with the Central Bank's expansionary monetary stance, **credit to the private sector** grew by a year-on-year rate of 13.7 percent in May, mainly as a result of the increase in credit to businesses (19.2 percent) in the context of the implementation of the first phase of the Reactiva Perú program. In the forecast horizon, credit to the private sector as a percentage of GDP is estimated to increase from 43 percent in 2019 to 50 percent in 2021. This projection considers the implementation of the Reactiva Peru program, through which guarantees of up to S/ 60 billion are granted to loans aimed to support the country's economic reactivation, in addition to providing also a substitution effect to funding from other countries and from the local capital market.

CREDIT TO THE PRIVATE SECTOR
(Annual % change)



Year-on-year **inflation** has remained slightly below the center of the target range since September 2019, showing an annual rate of 1.8 percent in May. Moreover, one-year-ahead expected inflation fell to 1.5 percent in April (from 2.0 percent in March) in a context of a significant weakening in domestic demand generated by the COVID-19 crisis. The effect of this reduction in demand, together with lower imported inflation (for fuels, for example), is projected to lead to a zero inflation rate this year, with inflation reversing partially thereafter to a rate of 0.5 percent in 2021 and converging to the target range in 2022.

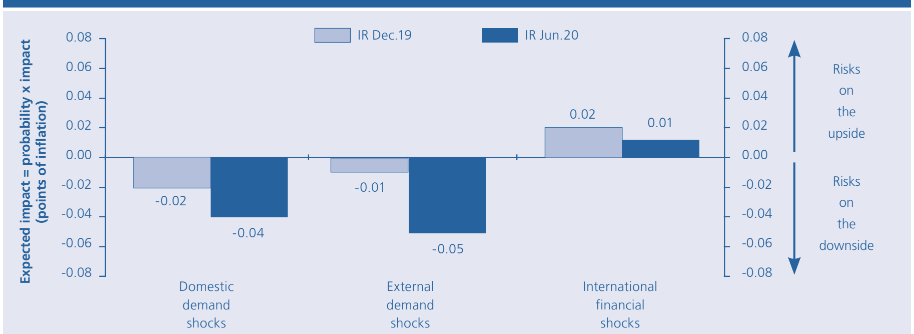
INFLATION
(Last 12-month % change)



Balance of risks

The balance of **inflation risk factors** has a downward bias considering the possibility of a slower-than-expected recovery of domestic demand or global demand due to the effects of COVID-19. The macroeconomic scenario assumed is that the expansion of the pandemic will be controlled in the second half of this year and that both the country's economy and the global economy will return to normal conditions, although with changes in consumption patterns. However, until the COVID-19 has been controlled, there is still the risk of a resurgence of the pandemic that could again affect aggregate demand and imported inflation, and in this way, inflation.

BALANCE OF RISKS AGAINST THE BASE SCENARIO



IR: Inflation Report.

SUMMARY OF INFLATION REPORT FORECAST

	2018	2019	2020 1/		2021 1/	
			IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
Real % change						
1. Gross Domestic Product	4.0	2.2	3.8	-12.5	3.8	11.5
2. Domestic demand	4.2	2.3	3.7	-11.9	3.8	9.9
a. Private consumption	3.8	3.0	3.5	-9.4	3.7	9.0
b. Public consumption	0.1	2.1	2.5	4.3	2.5	2.5
c. Fixed private investment	4.5	4.0	3.8	-30.0	4.0	20.0
d. Public investment	5.6	-1.4	6.0	-8.5	4.0	9.0
3. Exports (good and services)	2.4	0.8	4.5	-18.9	4.8	14.1
4. Imports (good and services)	3.2	1.2	4.0	-16.9	4.8	7.5
5. Global economic growth	3.6	2.9	3.2	-5.5	3.4	5.5
Memo:						
Output gap 2/ (%)	0.4	-0.6	-1.3 ; -0.4	-20 ; -10	-0.9 ; 0.0	-13.0 ; -3.0
% change						
6. Inflation	2.2	1.9	2.0	0.0	2.0	0.5
7. Expected inflation 3/	2.1	2.3	2.2	1.3	2.4	1.9
8. Expected depreciation 3/	3.6	-0.3	0.1	1.3	-0.4	-0.4
9. Terms of trade	-0.4	-1.8	0.0	2.2	-0.9	0.1
a. Export prices	6.3	-3.4	0.7	-4.0	0.2	2.1
b. Import prices	6.7	-1.7	0.7	-6.0	1.1	2.0
Nominal % change						
10. Currency in circulation	7.9	4.6	6.0	12.0	6.0	4.0
11. Credit to the private sector	8.7	6.9	8.5	15.0	8.5	0.0
% GDP						
12. Gross fixed investment	22.4	22.6	22.5	19.2	22.7	20.3
13. Current account of the balance of payments	-1.7	-1.5	-1.6	-1.4	-1.6	-1.4
14. Trade balance	3.2	2.9	2.9	2.8	2.8	3.7
15. Long-term external financing of the private sector 4/	0.4	2.4	1.1	0.4	1.3	0.2
16. Current revenue of the general government	19.3	19.7	20.0	17.5	19.9	19.5
17. Non-financial expenditure of the general government	20.2	20.1	20.3	25.2	20.3	22.3
18. Overall balance of the non-financial public sector	-2.3	-1.6	-1.7	-9.7	-1.6	-4.2
19. Balance of total public debt	25.8	26.8	27.3	33.9	27.3	33.1
20. Balance of net public debt	11.3	13.0	13.7	23.6	14.6	25.3

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.