INFLATION REPORT

June 2020

Recent trends and macroeconomic forecasts 2020-2021

CENTRAL RESERVE BANK OF PERU

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Recent Trends and Macroeconomic Forecasts 2020 - 2021

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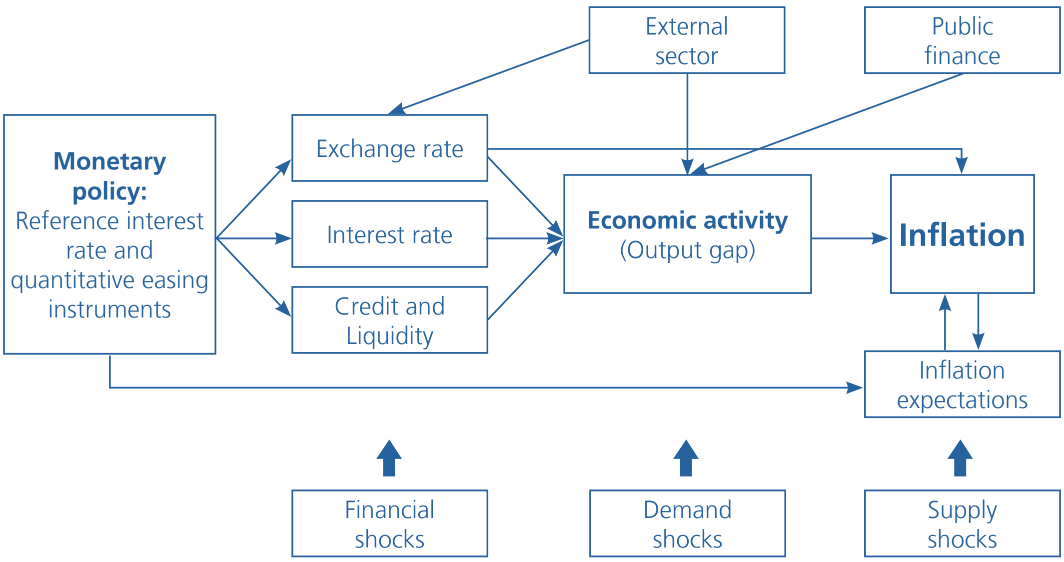

Central Reserve Bank of Peru
441-445 Santa Rosa. Lima 1
Telephone: 613-2000 - Fax: 613-2525
Mail: webmaster@bcrp.gob.pe

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BOXES

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 as of April 2020, and data on inflation, financial markets, the exchange rate and monetary accounts as of May 2020.

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 between 1 and 3 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 those originating in climate factors. It should 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. Thus, through reserve requirements and interventions in the foreign exchange market, the Central Bank reduces excessive volatility in the exchange rate and prevents excessive variations in the volume and composition, by currencies and terms, of credit in the financial system.

- This Report includes the macroeconomic forecasts that support the monetary policy decisions of BCRP as well as an analysis of the risk factors that can modify such forecasts.

- In March, in light of the high degree of uncertainty regarding the impact of the COVID-19 on the Peruvian economy, the Central Bank decided to postpone the publication of the Inflation Report until June 19. This would allow obtaining statistical information on GDP growth and the macroeconomic impact of COVID-19 in the months of social isolation in the different sectors of the economy, which is key to reducing uncertainty and improving the forecasts of GDP growth in the next two years.

- This Inflation Report was approved by the Board of Directors of BCRP on June 11, 2020.

- The following Inflation Report will be published on Friday, September 18, 2020.

Summary

i. 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.

ii. 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.

iii. 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 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.

iv. 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.

v. 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.

vi. 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 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.

vii. 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.

viii. 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.

ix. 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.

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
% 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 (as a percentage of 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.

I. External Sector

The crisis associated with COVID-19 and the shocks to global economic activity

1. The economic crisis caused by COVID-19 originates from negative shocks in both aggregate supply and demand. On the side of aggregate supply, workers cannot go to their workplaces due to the pandemic and to social confinement measures and, in addition, severe logistical limitations, particularly transportation, affect the economic activities that could continue operating. On the side of aggregate demand, a sharp drop is observed in private consumption due to the loss of income of unemployed workers and the self-employed who cannot run their current businesses. A second factor affecting household consumption is families' precautionary increased savings while they face difficulties in acquiring goods and services at the same time due to constraints on people's movements, which in some cases include home delivery services. Aggregate demand has also experienced a sharp setback as a result of the negative effect of greater uncertainty about the future of the economy on investment and durable consumption decisions. Public expenditure has contributed to offset in part these negative effects, especially through transfers to families, since confinement measures have also halted the public sector's processes of purchasing goods and services and investment. Finally, external purchases of export products have been adversely affected by a global synchronized recession.

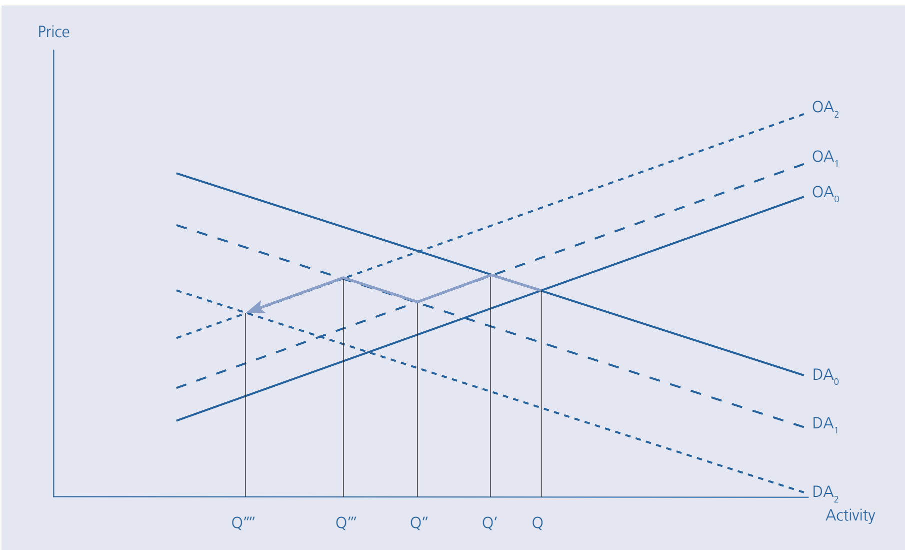
2. The deterioration of production activity could worsen in the event of business bankruptcies, which cause job destruction in the supply and a drop in expenditure. This situation worsens when the solvency of the financial system is involved, in which case, due to a loss of capability to take risks and

to the bankruptcy of some financial institutions, it ends up configurating a slowdown of greater proportion and duration, which is called economic depression.

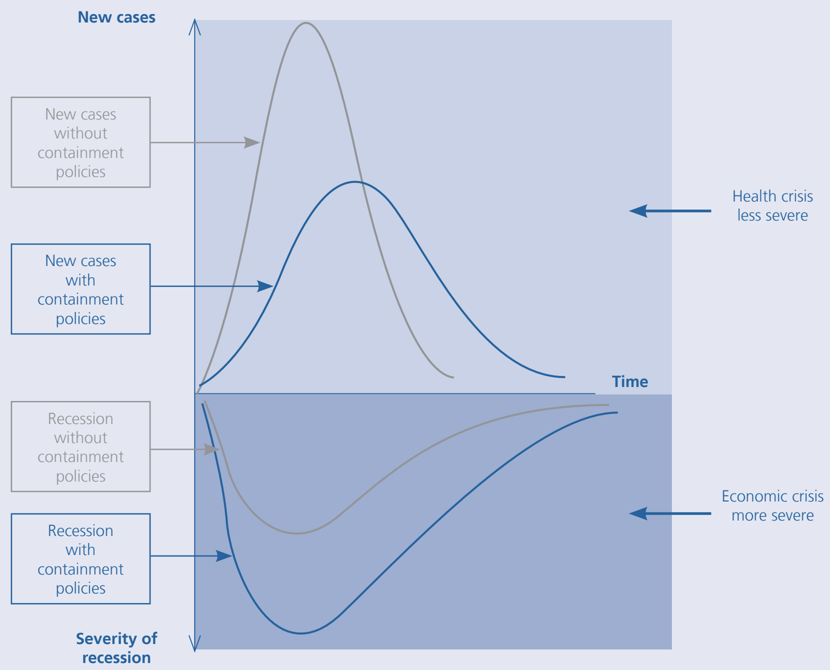
3. The efforts made to flatten the contagion curve and avoid a health crisis implied the implementation of virus containment policies, such as social distancing and confinement. This strategy also allowed health authorities to prepare for the dramatic increase in the need for beds in intensive care units and artificial respiration devices. The flattening of the contagion curve inevitably led to a contraction in production, employment and income. Because of this, governments have deployed different health and economic strategies to prioritize people's lives and their ability to subsist.

4. The huge challenges faced by governments in this context have led them to adopt government policies with integrated schemes that deal with the various fronts effectively, with the appropriate instruments and the necessary anticipation and dosage. At the same time, government authorities must have the flexibility to stop actions that do not work and take actions always guided by objective criteria supported by information and analysis, taking into account that short-term actions can generate adverse incentives in the long term. The experience of the 1929 Great Depression proved that an erroneous assessment of an early end of the crisis generated a second wave of recession.

Graph 1
AGGREGATE SUPPLY AND DEMAND DYNAMICS



Graph 2
FLATING TWO CURVES: COMPARISON OF THE SANITARY AND ECONOMIC CRISIS WITH AND WITHOUT CONTAINMENT MEASURES



Source: Baldwin & Weder di Mauro (2020). Mitigating the COVID Economic Crisis: Act Fast and Do Whatever It Takes.

Recent global economic developments

5. **During the first quarter of the year, economic activity contracted worldwide**. The containment measures and the lockdown of several activities (particularly in the services sector) reflected in a sharp drop in private consumption, a retraction in investment plans, and a significant drop in international trade. In the first quarter of 2020, the world economy is estimated to have contracted more than 10 percent, the greatest falls being observed mainly in the countries that adopted the most severe and prolonged social isolation measures.

In the developed economies, the United States showed a contraction of 5.0 percent in the first quarter –the sharpest contraction the fourth quarter of 2008–, the drop in the consumption of durable goods (-13.2 percent) and services (-9.7 percent) standing out, together with the contraction registered in non-residential investment (-7.9 percent). In the Eurozone, where activity contracted 13.6 percent, there was also a marked drop in domestic demand, the greatest falls being observed in Germany, Spain, France, and Italy.

Table 1
USA: GDP
(Annualized quarterly % change)

	Q1.18	Q2.18	Q3.18	Q4.18	Q1.19	Q2.19	Q3.19	Q4.19	Q1.20 2nd rev.
GDP	**2.5**	**3.5**	**2.9**	**1.1**	**3.1**	**2.0**	**2.1**	**2.1**	**-5.0**
Personal consumption	1.7	4.0	3.5	1.4	1.1	4.6	3.2	1.8	-6.8
Durable	2.3	8.0	3.6	1.3	0.3	13.0	8.1	2.8	-13.2
Non-durable	0.7	4.1	3.6	1.7	2.2	6.5	3.9	-0.6	7.7
Services	1.9	3.4	3.4	1.4	1.0	2.8	2.2	2.4	-9.7
Gross investment	6.2	-1.8	13.7	3.0	6.2	-6.3	-1.0	-6.0	-10.5
Fixed investment	5.5	5.2	0.7	2.7	3.2	-1.4	-0.8	-0.6	-2.4
Non-residencial	8.8	7.9	2.1	4.8	4.4	-1.0	-2.3	-2.4	-7.9
Residencial	-5.3	-3.7	-4.0	-4.7	-1.0	-3.0	4.6	6.5	18.5
Exports	0.8	5.8	-6.2	1.5	4.1	-5.7	1.0	2.1	-8.7
Imports	0.6	0.3	8.6	3.5	-1.5	0.0	1.8	-8.4	-15.5
Government expenditure	1.9	2.6	2.1	-0.4	2.9	4.8	1.7	2.5	0.8
Memo									
Contribution on inventories	0.1	-1.2	2.1	0.1	0.5	-0.9	0.0	-1.0	-1.4

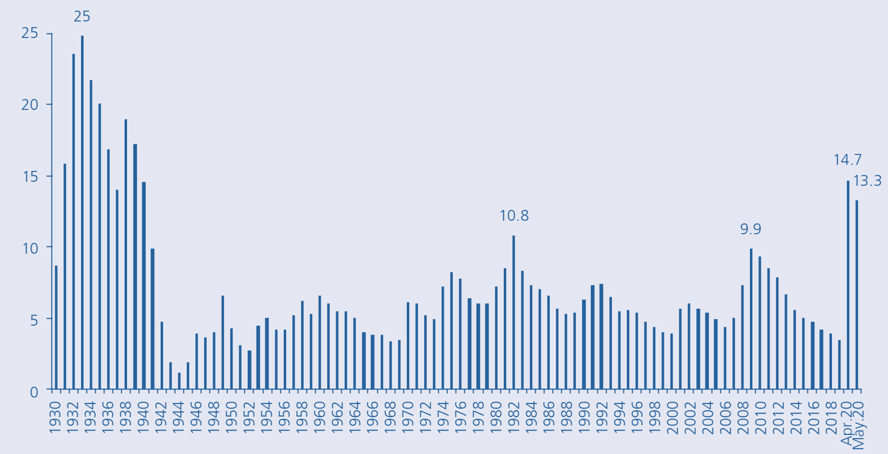
Source: Bureau of Economic Analysis (BEA).

The emerging economies have also been directly affected by the pandemic, with this impact adding onto the deterioration of external economic conditions reflected in a drop in the prices of commodities (particularly oil) and in capital outflows. Among these countries, China, the first country affected by the epidemic and the first to adopt social isolation measures, stands out with a 35 percent GDP contraction. An exception to this trend has been Chile whose growth is largely explained by the normalization of activities after the social protests that affected this country in the fourth quarter of 2019 as well as by the lack of severe social isolation measures to contain the spread of the Covid-19 epidemic during the first quarter of the year.

6. **So far in the second quarter of 2020, this drop in output has been accompanied by record increases in unemployment**. In the United States, for example, the unemployment rate increased from 3.5 percent in December 2019 to 14.7 percent in April –the highest rate since the Great Depression– and moderated thereafter to 13.3 percent in May. Moreover, the non-farm payroll registered a loss of 21 million jobs in April, a loss three times greater than that

recorded during the Great International Financial Crisis (2008-2009). In May, however, job creation rebound slightly and registered 2.5 million new jobs.

Graph 3
USA: UNEMPLOYMENT RATE AS OF DECEMBER: 1930-2020
(%)



Source: Bureau of Labour Statistics.

7. Significant deteriorations in the labor market are expected in the months of April and May in other countries, where social isolation measures have been more prolonged (i.e. Spain and Italy), which abruptly reverses the sustained decline in unemployment in developed economies over the past six years. The unemployment rate in Spain has risen from 13.7 percent in December 2019 to 14.8 percent in April 2020, while in France it has increased from 8.2 to 8.7 percent, from 3.3 to 3.5 percent in Germany, from 2.2 to 2.6 percent in Japan, and in the United Kingdom it has risen from 3.7 percent in December 2019 to 3.8 percent in February 2020.

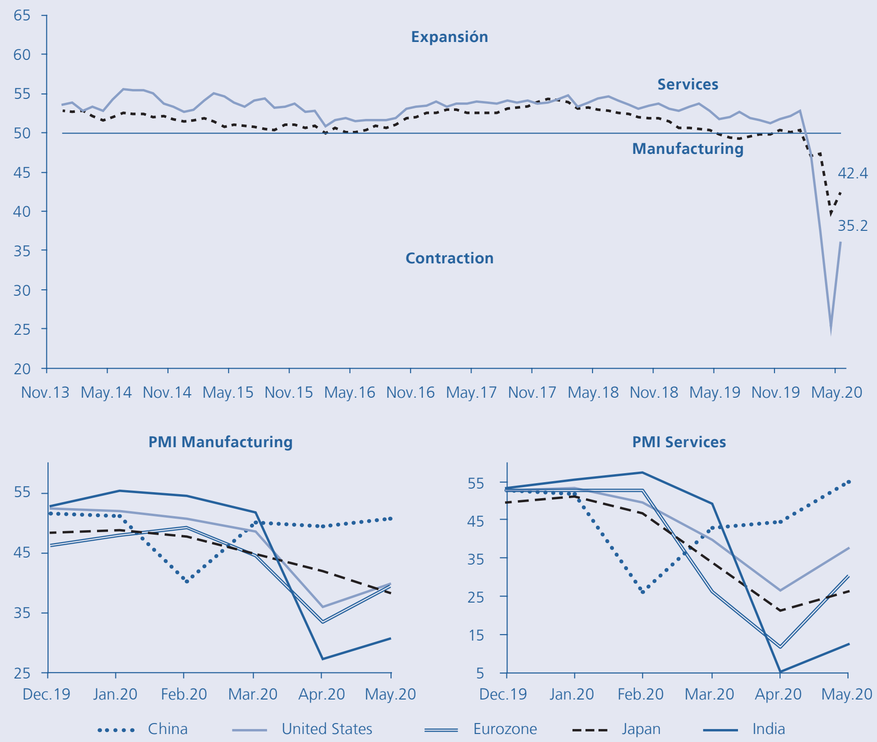
The increase in unemployment has generated a demand shock that reinforces the initial recession pressures (although some recovery is observed towards the month of May). This impact was observed mainly in April, where the global manufacturing and service production indices have shown a severe contraction, especially in the service sector. The composite PMI index (Markit source), which includes both sectors, has registered a record drop in several countries, standing in a contraction zone with historical minimum levels. However, some improvement was observed in the month of May, in line with the reopening of some economies, although the indicators clearly remain in the contraction zone.

Table 2
COMPOSITE PMI INDEX
(Manufacturing and Services)

	Brazil	USA	France	Germany	Ireland	Italy	Russia	Spain	UK	Japan	China	India
Dec.19	50.9	52.7	52.0	50.2	53.0	49.3	51.8	52.7	49.3	48.6	52.6	53.7
Apr.20	26.5	27.0	11.1	17.4	17.3	10.9	13.9	9.2	13.8	25.8	47.6	7.2
May.20	28.1	37.0	32.1	32.3	25.7	33.9	35.0	29.2	30.0	27.8	54.5	14.8

Source: JP Morgan.

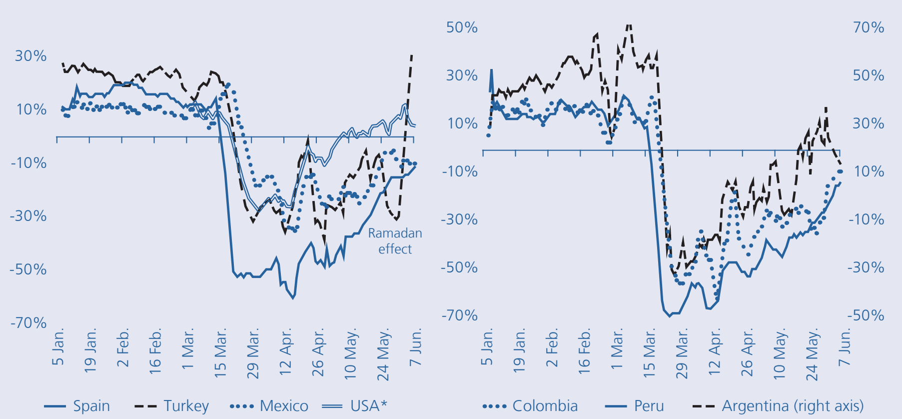
Graph 4
PMI GLOBAL MANUFACTURING AND SERVICES



Source: JP Morgan.

8. A similar trend to that reflected in the monthly manufacturing and services activity index (PMI) is observed in high-frequency information on total consumption with credit and debit cards. At the end of the first quarter of the year, the growth in total consumption with credit and debit cards fell to negative values, but since May there are already signs of a gradual rebound in card consumption, both in the developed and the emerging economies.

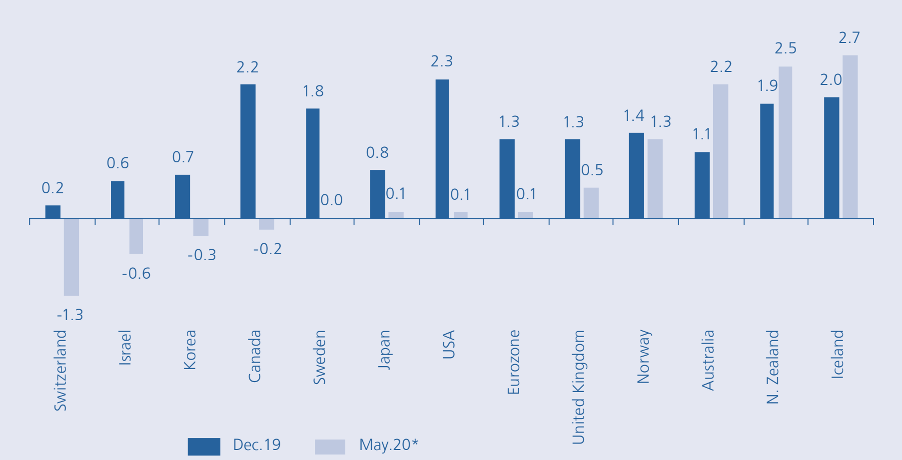
Graph 5
BIG DATA - CONSUMPTION INDEX
Total consumption per card, year-on-year percentage change (last 7 days) *



* As of June 11, 2020.
Source: BBVA.

9. **The sharp drop in economic activity has influenced the reduction of inflation in most developed countries**. Inflation has fallen significantly so far this year, particularly since March, reaching in many cases levels close to zero and below the inflation target. This reduction has also been associated with the sharp decrease in the price of oil which registered minimum record lows in the month of April.

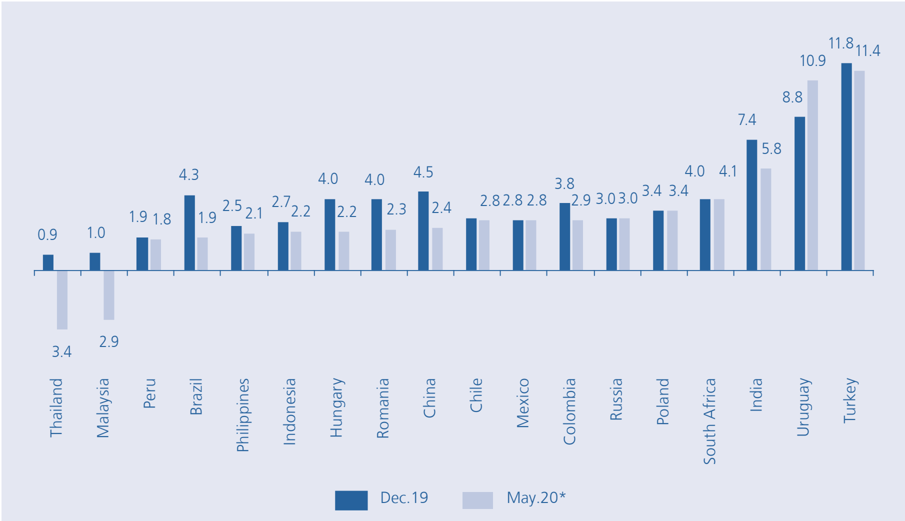
Graph 6
INFLATION RATES
(%)



* Data as of May 2020, except for Japan, Canada and Israel (April) and for Australia and New Zealand (March).
Source: Statistical Institutes and Central Banks.

On the other hand, inflation in the emerging economies does not show a uniform trend. Some countries have faced upward pressures, in part due to the effect of currency depreciation (especially in the month of March). It is worth mentioning that in the economies in the region with inflation targeting –Colombia, Brazil, Chile, Peru, and Mexico–, inflation is outside the target range and below the lower band only in Brazil at the end of April.

Graph 7
INFLATION RATES
(%)

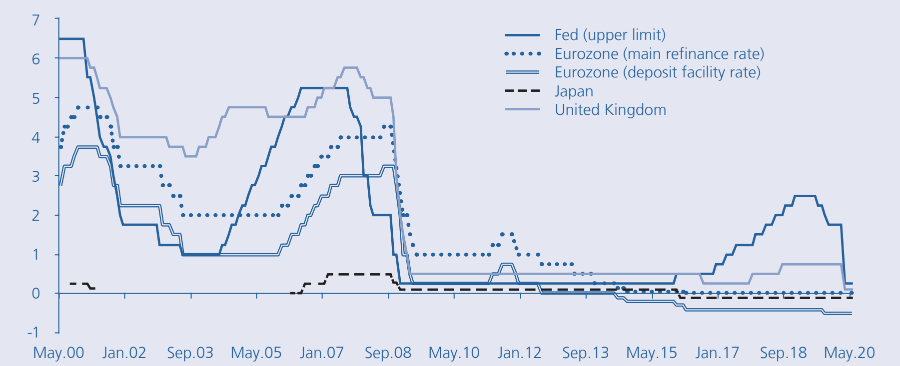


* Data as of May except for South Africa (March).
Source: Statistical Institutes and Central Banks.

10. **In this scenario of economic contraction and an abrupt drop in inflation, most countries have applied expansionary monetary and fiscal actions**.

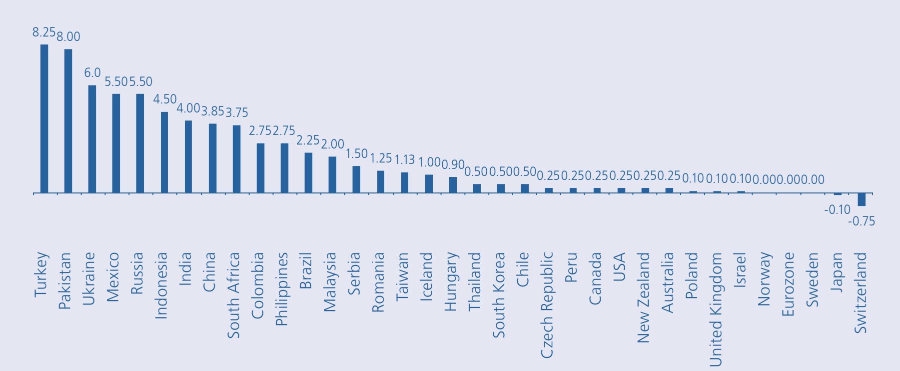
As regards monetary policy, most countries have reduced their interest rates, the exceptions being the countries that already had rates close to zero or equal to zero (Eurozone) and even negative rate levels (Japan and Switzerland) prior to the pandemic. In Latin American countries with inflation targeting, interest rates are at record low levels, with the exception of Mexico.

Graph 8
MONETARY POLICY RATES
(%)



Source: Reuters.

Graph 9
POLICY INTEREST RATES



Source: Statistical Institutes and Central Banks

11. In addition, central banks in the developed economies have resumed the purchase of assets (treasury bonds and other assets) on a larger scale and variety than during the Great Financial Crisis, establishing in this way measures to provide liquidity through credit facilities to families and companies. A line of dollar swaps was also established for central banks in the United States.

These actions represent an increase in the sizes of the balance sheets of developed economies. Thus, after the monetary stimulus measures, the major central banks have increased their balances by nearly 10 points of GDP in the first months of this year.

Graph 10
CENTRAL BANKS: TOTAL ASSETS
(Percentage GDP)

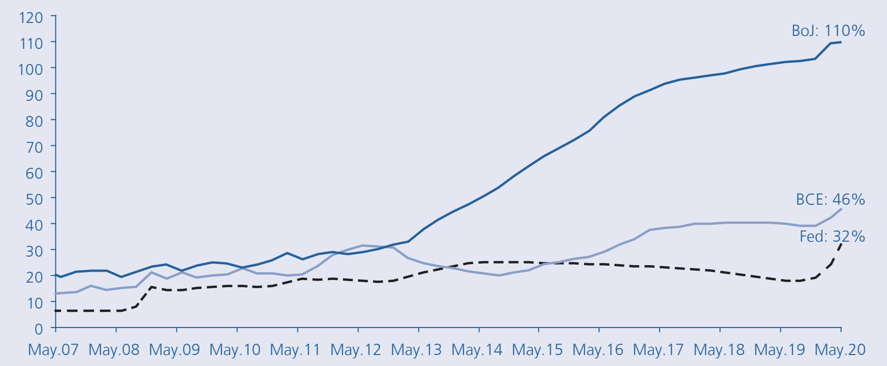


Table 3
DEVELOPED ECONOMIES: MAIN MONETARY POLICY MEASURES

	Fed (U.S)	ECB (Eurozone)	BoE (UK)	BoJ (Japan)
Interes rate	Reduction of 100 bps. to 0-0.25%	Maintained the interest rate	Rate reduction from 0.75% to 0.25%. Lowered it then to 0.1%.	Maintained the benchmark rate at -0.1% and the target rate bond yield to 10 years at 0%
Program of purchases of assets	The purchase of Treasury and MBS assets from $ 700 billion to a unlimited amount	Expansion of the Purchase of Assets (bonds sovereign and private for € 120 thousand millions)	Balance increase asset purchase public and private (from £ 435 to £ 745 thousand millions)	Extended purchase of assets ¥ 80 trillion from the Treasury to an unlimited amount. Increase the size and coverage of purchase of debt assets corporate (¥ 20 billion); Stock ETFs (¥ 12 billion); and title indices real estate (¥ 180 thousand millions)
Forward guidance	Keep rates low until that improves confidence in the economy and recover the labor market. There is not pressure concerns rising inflation	Expect interest rates stay on your levels current or lower (prospects inflation converge to a level close, but less than 2%).		Ultra monetary position expansive and greater coordination with the Treasury to launch new stimuli
Program of liquidity and measurements support credit	Increased operations from window. Greater swap lines operations of american dollars with banks foreign exchanges. Allow use of financial mattresses and regulatory flexibilities. Creation and extension of 9 new credit programs for a total of US $ 2.3 trillions to provide liquidity to businesses, homes and United States governments	Emergency Program with Pandemic-PEPP (€ 750 thousand millions). New liquidity line long-term (LTRO). Long loan extension TLTRO term (€ 1 billion), line additional for granting Bank loans. Asset flexibility considered (roles commercial). New liquidity operations long-term against pandemic (PE-LTROs)	Covid corporate financing facility (financing of financial securities miscellaneous: papers commercial). Term Funding Scheme (facility to banks for loans to SMEs for £ 100 billion. Ratio relaxation countercyclical liquidity of 1.0% to 0% (£ 190 thousand millions).	Increased operations window and programs loans to private banks. Dollar loans to the Fed by swaps lines. Allow use of financial mattresses. Create a program of credits for small business (¥ 30 billion).

Source: Central Banks.

12. Actions have also been taken in the emerging economies of the region to provide liquidity and prevent the disruption of the payments channel. In Latin America, the measures adopted include reducing the rate of bank reserve requirements, purchase of private and public debt programs, expanding the securities eligible as coverage for the liquidity facility mechanisms, and extending the maturity terms of repo operations. Instruments such as Non-Delivered Forwards (NDFs) and FX swaps have been used to provide liquidity in dollars and Mexico has used the Fed's 'swap line' for a total of US$ 10 billion out of a total available of $ 60 billion.

13. On the other hand, the fiscal policy measures include increasing expenditure to deal with the health emergency as well as additional expenditure for unemployment insurance and coverage, direct support to families, tax exemptions or postponing tax payments, and granting bank guarantees for credit lines. In addition, fiscal incentives also include government guarantees for bank loans.

Table 4
DEVELOPED ECONOMIES: MAIN MEASURES OF FISCAL POLICY

	Fiscal Stimulus	Measurements
USA	$ 2.9 billion (14% of GDP)	Tax refund payment to people. Unemployment insurance benefits expanded to more people as well as the amount of weekly payments. Direct loans and grants for industries in difficulties. Subsidized loans to SMEs. Facilities to provide credit to corporations and state and local governments. Higher spending on sanitary measures. These amounts do not include guarantees contemplated to lines of the Fed and others.
Germany	€ 205 thousand millions (5.8% of GDP)	Contingent fund for discretionary spending on capital injections (€ 100 billion) and loans to corporations through KfW (€ 100 billion). Package for € 130 thousand mlls. (cut of VAT and resources for investment in telecommunications infrastructure, trains and technologies in favor of the environment in the automotive sector (electric cars). Additionally it has considered guarantees (through KfW).
France	€ 110 thousand millions (4.7% of GDP)	Reprogramming of tax debt and social contribution of companies € 73 billion and the difference for discretionary spending. Consider announcements state guarantees for loan provision.
United Kingdom	£ 170 thousand millions (7.6% of GDP)	Additional resources for the national health system. Job retention scheme: 80% refund from workers and self-employed wages up to £ 2,500 per month; deferment of tax payments on income; deferral of collection of any VAT and plans to support SMEs; endorsement banks' ability to supply credit. Consider state guarantees.
Japan	¥ 234 billion (44% of GDP)	Increased direct loans and grants for struggling industries. Tax deferral of 1 year for companies. Increased funds for different levels of government and transfer to households. Increased spending on health issues.
Italy	€ 72 billion (4.0% of GDP)	Expenditure for the health sector € 3.5 billion and € 10 billion for labor subsidy. The government aims to mobilize up to € 340 billion. Freeze of SME debt repayment until 30-Sep. Considers guarantees in favor of small companies.
Spain	€ 47 billion (3.8% of GDP)	It includes a guarantee for state loans.

Outlook for global economic activity

14. The COVID-19 pandemic has significantly changed the outlook for global economic activity. At the beginning of the year, the growth rate forecast for 2020 (3.2 percent) was higher than the one recorded in the previous year due, among other factors, to favorable expectations after China and the United States signed a trade agreement. However, the measures taken to contain

the pandemic have caused a severe abrupt contraction of economic activity, as well as the disruption of global chains, increased unemployment, falling domestic demand, and the deterioration in consumer and investor's confidence. The deterioration in growth prospects and greater risk aversion have affected financial markets and led to a contraction in commodity prices (particularly oil) and to an outflow of capital from the emerging economies.

15. **These unprecedented global economic conditions imply extremely uncertain prospects for global growth**, the degree of uncertainty depending, to a large extent, on how the pandemic will evolve in the second half of the year and on whether some of the risks specified below materialize or not. This is reflected in the dispersion observed in the projections of investment houses, organizations and institutions.

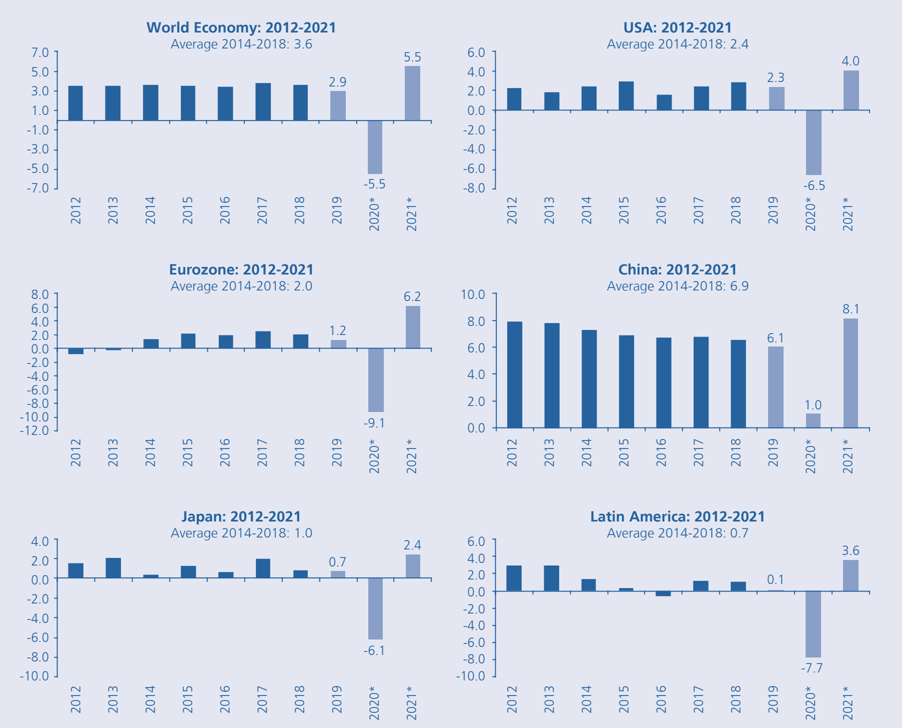
Assuming that the pandemic will be controlled from the second half of the year, the application of stimuli, and the cyclical recovery of the economy, it is estimated that the world economy will show a contraction of 5.5 percent during 2020. The developed countries would register a contraction of 7.9 percent, this contraction being particularly noteworthy in the countries where the pandemic has had the most severe impact (Spain and Italy). On the other hand, contrasting with what happened in the Great Financial Crisis (2008-2009), the emerging economies would show a contraction of 3.8 percent. Among the major emerging economies, only China, the world's largest economy, would register slightly positive growth (its lowest level in at least four decades). In 2021, the world economy is expected to show a rebound of 5.5 percent.

Table 5
GLOBAL GDP GROWTH
(Annual % change)

	PPP	2019	2020*		2021*	
			IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
Developed economies	**40.3**	**1.7**	**1.5**	**-7.9**	**1.6**	**4.7**
Of which						
1. USA	15.1	2.3	1.9	-6.5	1.8	4.0
2. Eurozone	11.2	1.2	1.0	-9.1	1.4	6.2
3. Japan	4.1	0.7	0.4	-6.1	0.5	2.4
4. United Kingdom	2.2	1.4	1.2	-10.4	1.4	6.2
5. Canada	1.3	1.6	1.7	-8.1	1.8	3.9
6. Other	6.4	1.7	2.0	-8.8	2.5	5.1
Developing economies	**59.7**	**3.7**	**4.5**	**-3.8**	**4.7**	**5.9**
Of which						
1. China	19.3	6.1	5.9	1.0	5.9	8.1
2. India	8.0	4.2	7.0	-3.7	7.0	7.3
3. Russia	3.1	1.3	1.5	-6.0	2.0	3.4
4. Latin America and el Caribe	7.3	0.1	1.3	-7.7	2.5	3.6
5. Other	18.2	3.1	4.5	-7.9	4.6	5.7
World Economy	**100.0**	**2.9**	**3.2**	**-5.5**	**3.4**	**5.5**

* Forecast.
Source: IMF, Consensus Forecast.

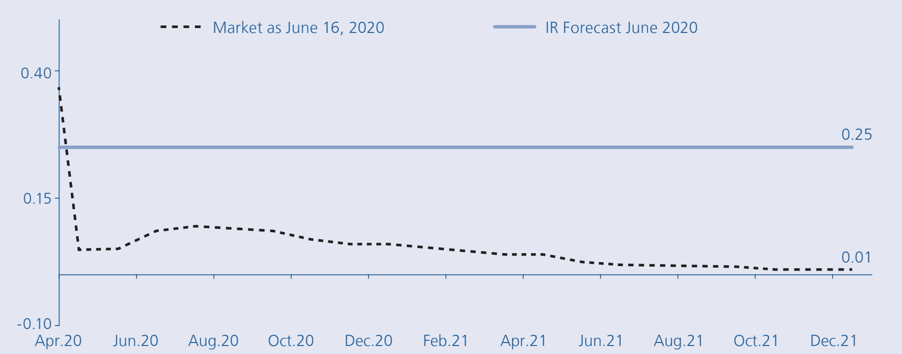
Graph 11
GDP GROWTH
(Real % change)



* Forecast.
Source: IMF and Consensus Forecast.

16. It is expected that the FED rate will remain at 0.25 percent during the current forecast horizon, despite the fact that markets expects a further reduction in the FED policy rate.

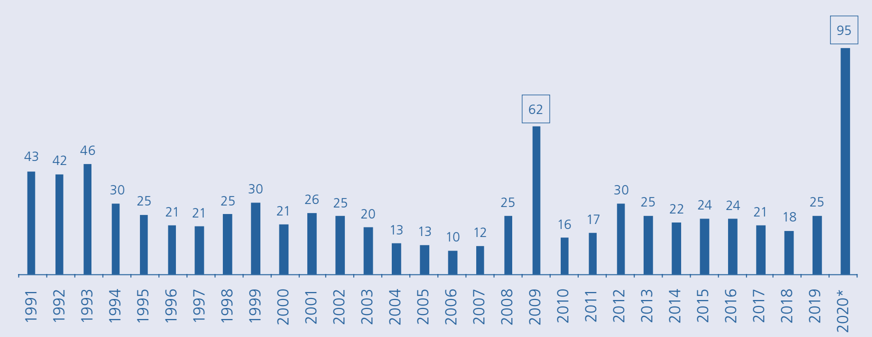
Graph 12
FED: FORECAST RATES * AND MARKET EXPECTATION



Source: Fed, BCRP and Reuters.

17. **As the pandemic is a global event, a high synchronization of the economic cycle is expected**. In its preliminary projections (June), the IMF estimated that around 95 percent of economies will register a contraction in GDP per capita, this percentage being higher than that observed during the Great Financial Crisis of 2008-2009 (62 percent). In Latin America, the impact of COVID-19 on the domestic economy is compounded by the drop in the price of commodities (particularly oil) and the strong outflow of capital.

Graph 13
COUNTRIES WITH A CONTRACTION OF GDP PER CAPITA
(%)



* Preliminary.
Source: IMF.

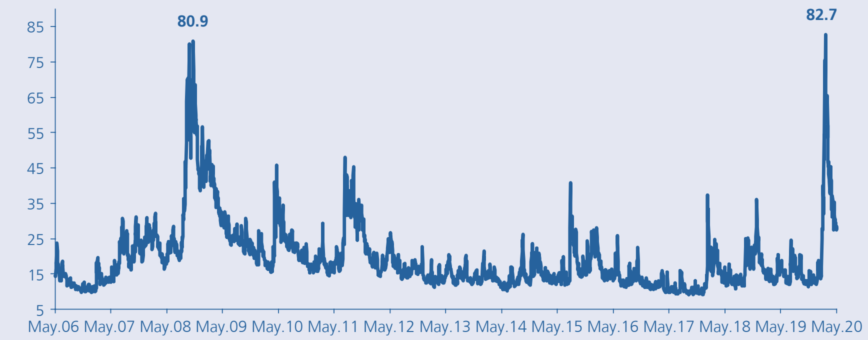
International financial markets

18. Year-to-day, financial markets have been affected by the outbreak and the spread of the COVID-19, particularly from the third week of January when the first case outside Asia was reported and fears of a pandemic increased. In addition to this, the deterioration in economic activity and the growing evidence of a global recession led investors to liquidate their positions in different riskier instruments, increasing the demand for safe assets (treasury bonds of developed economies, gold, the US dollar and the Japanese yen).

These corrections were observed in the markets mainly until March. Since then, markets have shown signs of some stabilization in the face of the monetary and fiscal stimuli announced, the reopening of China and several developed economies, and the progress made in the treatment of COVID-19.

In general, capital flows to the emerging economies reflected these events. The capital inflows registered at the beginning of the year, favored by the first trade agreements between China and the United States, reversed abruptly between the end of January and the end of March, especially in the equity markets. The capital outflow observed in March exceeded even the capital outflow levels recorded during the Great Financial Crisis of 2008-2009.

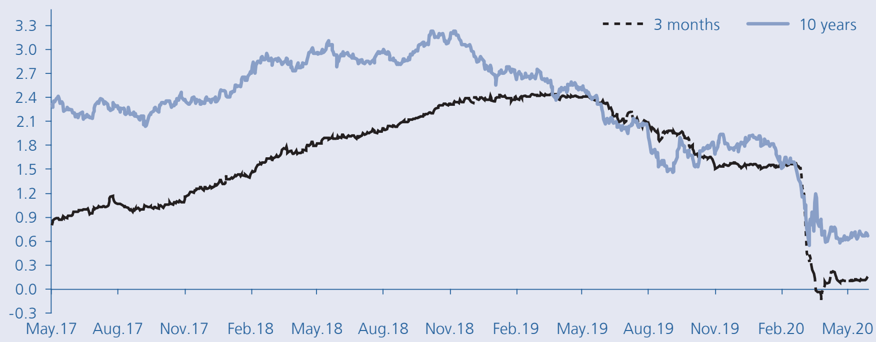
Graph 14
VIX INDEX (VOLATILITY OF USA)



Source: Reuters.

19. In **fixed income markets**, the yield on the 10-year US bond fell significantly and reached a record low of 0.54 percent on March 9, in a context marked by a greater demand for safe assets due to the spread of COVID-19 and fears of a global recession. The Fed's expansionary monetary policy contributed to this as well.

Graph 15
YIELDS ON US TREASURY BONDS
(2017-2020)



Source: Reuters.

In Europe, the decline in yields was also explained by the economic slowdown, as well as by noise in UK trade negotiations with the European

Union, and by the monetary stimulus of the region's main central banks.

In the emerging economies, until the first half of March, yields were influenced by upward pressures due to higher global risk aversion. Subsequently, after the announcements of expansionary policies in both the developed economies and the emerging economies, yields showed a sustained downward trend and closed, in most cases, at levels below those observed in December 2019. Some countries in which yield have increased so far this year are Brazil (high level of debt, health crisis and political noise), Turkey (geopolitical and political tensions), and Indonesia (less expansionary monetary policy than expected).

Table 6
YIELDS ON 10-YEAR SOVEREIGN BONDS

	May.19	Dec.19	May.20	Change May.2020/ May.2019 (pbs.)	Accumulated change 2020 (pbs.)
USA	2.13	1.92	0.67	-146	-125
Germany	-0.20	-0.19	-0.45	-25	-26
France	0.21	0.12	-0.08	-29	-19
Italy	2.67	1.41	1.47	-119	6
Spain	0.71	0.46	0.56	-15	10
Greece	2.89	1.43	1.50	-139	7
United Kingdom	0.89	0.82	0.18	-70	-64
Japan	-0.10	-0.02	0.00	10	2
Brazil	8.45	6.79	7.21	-125	42
Colombia	6.64	6.34	5.91	-73	-43
Chile	3.72	3.17	2.19	-153	-98
Mexico	8.00	6.89	6.14	-187	-75
Peru	5.05	4.21	3.85	-120	-36
South Africa	9.11	9.02	8.90	-22	-12
India	7.14	6.56	5.76	-137	-79
Turkey	18.04	11.97	12.19	-585	22
Russia	7.91	6.36	5.55	-236	-81
China	3.30	3.14	2.69	-60	-45
South Korea	1.67	1.67	1.37	-30	-31
Indonesia	7.93	7.04	7.30	-64	26
Thailand	2.36	1.47	1.15	-122	-33
Malaysia	3.78	3.31	2.80	-98	-51
Philippines	5.54	4.53	3.12	-241	-141

Made on May 29.
Source: Reuters.

20. In **variable income markets**, stock markets fell across the board, the stagnation of corporate profits in the first quarter of the year adding onto the effects of the pandemic and fears of a global recession. These events were reflected in the significant increase in risk aversion: the VIX index rose from a value of 13.8 in

December 2019 to a record high of 82.7 in mid-March. At the sector level, the biggest falls were observed in the banking and energy sectors (the latter being affected by the drop in the price of oil).

Risk aversion gradually decreased thereafter to 29.8 at the end of May, the technology and health sectors standing out among the sectors that promoted the recovery (various pharmaceutical companies show progress in the development of treatments to combat COVID-19). On the other hand, however, some firms were unable to overcome current conditions and resorted to debt restructuring through bankruptcy protection.

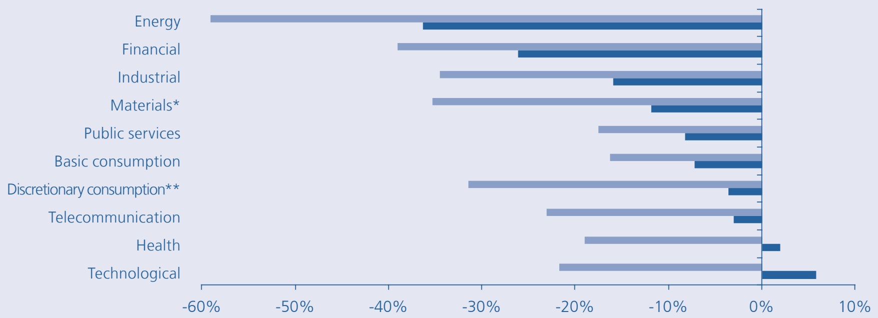
Stock markets In the emerging economies also fell, following the global trend of greater risk aversion. It is worth mentioning that stock market declines intensified in the commodity-dependent economies.

Table 7
STOCK EXCHANGE

		May.19	Dec.19	May.20	Change May.2020 May.2019 (%)	Accumulated change 2020 (%)
VIX*	S&P 500	18.71	13.78	29.76	11.1	16.0
USA	Dow Jones	24,815	28,538	25,144	1.3	-11.9
Germany	DAX	11,727	13,249	11,587	-1.2	-12.5
France	CAC 40	5,208	5,978	4,695	-9.8	-21.5
Italy	FTSE MIB	19,802	23,506	18,198	-8.1	-22.6
Spain	IBEX 35	9,004	9,549	7,097	-21.2	-25.7
Greece	ASE	830	917	653	-21.4	-28.8
United Kingdom	FTSE 100	7,162	7,542	6,077	-15.2	-19.4
Japan	Nikkei 225	20,601	23,657	21,878	6.2	-7.5
Brazil	Ibovespa	97,030	115,645	85,867	-11.5	-25.7
Colombia	IGBC	1,487	1,662	1,071	-28.0	-35.6
Chile	IGPA	4,977	4,670	3,610	-27.5	-22.7
Mexico	IPC	42,749	43,541	35,630	-16.7	-18.2
Argentina	Merval	33,950	41,671	38,574	13.6	-7.4
Peru	**General Index**	**19,923**	**20,526**	**15,601**	**-21.7**	**-24.0**
South Africa	JSE	55,650	57,084	50,483	-9.3	-11.6
India	CNX Nifty	11,923	12,168	9,580	-19.6	-21.3
Turkey	XU100	90,590	114,425	105,520	16.5	-7.8
Russia	RTS	1,287	1,549	1,220	-5.2	-21.3
China	Shangai C.	2,899	3,050	2,852	-1.6	-6.5
South Korea	KOSPI	2,042	2,198	2,030	-0.6	-7.6
Indonesia	JCI	6,209	6,300	4,754	-23.4	-24.5
Thailand	SET	1,620	1,580	1,343	-17.1	-15.0
Malaysia	FTS KLCI	1,651	1,589	1,473	-10.8	-7.3
Philippines	Psei	7,970	7,815	5,839	-26.7	-25.3

* Variation in basis points.
Made on May 29.
Source: Reuters.

Graph 16
PERFORMANCE OF THE STOCK MARKET SECTORS DEVELOPED AT THE AGGREGATE LEVEL IN 2020



* Material classification refers to real estate, mining, chemical firms, etc.
** Discretionary consumption classification refers to the sale of ostentatious goods such as vehicle firms, consumer durables, consumer services, wholesale consumption, etc.
Source: MSCI, Reuters.

21. In **foreign exchange markets**, greater risk aversion led to an appreciation of the dollar against the basket of major currencies, with the exception of the yen. The depreciation of the pound sterling, affected also by greater uncertainty in post-Brexit UK trade negotiations, stands out as well.

Table 8
STOCK EXCHANGE

		May.19	Dec.19	May.20	Change May.2020/ May.2019 (%)*	Accumulated change 2020(%)*
Dollar Index **	US Dollar Index	97.75	96.39	98.49	0.8	2.2
Euro	Euro	1.117	1.121	1.109	-0.7	-1.1
United Kingdom	Pound sterling	1.263	1.326	1.231	-2.5	-7.1
Japan	Yen	108.26	108.61	107.84	-0.4	-0.7
Brazil	Real	3.922	4.019	5.417	38.1	34.8
Colombia	Peso	3,375	3,285	3,726	10.4	13.4
Chile	Peso	709	752	805	13.5	7.1
Mexico	Peso	19.61	18.93	22.32	13.8	18.0
Argentina	Peso	44.69	59.86	68.53	53.4	14.5
Peru	**Sol**	**3.381**	**3.312**	**3.430**	**1.4**	**3.6**
South Africa	Rand	14.58	13.99	17.64	21.0	26.0
India	Ruppe	69.57	71.35	75.59	8.7	5.9
Turkey	Lira	5.84	5.95	6.83	17.1	14.9
Russia	Ruble	65.57	61.92	70.62	7.7	14.1
China	Yuan (onshore)	6.903	6.962	7.135	3.4	2.5
South Korea	Won	1,188	1,154	1,238	4.2	7.2
Indonesia	Rupee	14,270	13,880	14,575	2.1	5.0
Thailand	Bath	31.52	29.76	31.82	1.0	6.9
Malaysia	Ringgit	4.189	4.089	4.345	3.7	6.3
Philippines	Peso	52.09	50.65	50.56	-2.9	-0.2

* An increase (fall) in the index means an appreciation (depreciation) of the US dollar, except in the euro and pound.
** An increase (fall) in the index means an appreciation (depreciation) of the US dollar against currency basket (euro, yen pound, canadian dollar, Sweeden krone, Switzerland franc).
Made on May 29.
Source: Reuters.

The currencies of emerging countries, which also followed the global trend, were particularly affected by capital outflows during the month of March. Other factors that contributed to this were the reduction in domestic interest rates, the unfavorable prospects for economic growth and some idiosyncratic shocks. The greatest depreciations were observed especially in the currencies of commodity exporting countires (particularly oil) and in those with less favorable macroeconomic prospects.

22. The deterioration in the growth prospects and greater risk aversion affected financial markets, which led to a contraction in the **prices of commodities** (particularly oil).

a. Copper

In May, the price of copper reached a monthly average of US$ 2.38 the pound, 14 percent lower than in December 2019. China, which accounts for 50 percent of the global consumption of refined copper, imposed severe quarantine restrictions which affected the demand for machinery, household appliances, and automobiles, reducing substantially the consumption of copper in these sectors.

This fall in demand became more pronounced since March as the crisis intensified in the rest of the world forcing various governments to announce the closure of their industries and the lockdown of economic activity. Although the COVID-19 epidemic also affected the production of mines and refineries, the magnitude of the loss during the first months has been lower than the fall in demand, increasing the excess of supply already registered in the first two months of the year.

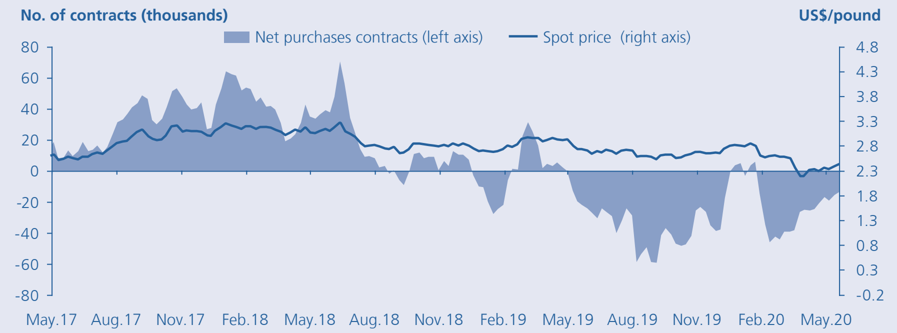
Table 9
SUPPLY AND DEMAND FOR REFINED COPPER
(Thousand metric ton)

	2016	2017	2018 2/	2019 2/	Jan./Feb. 2019	Jan./Feb. 2020	Var.%
Global Mining Production	20,402	20,082	20,577	20,553	3,187	3,248	1.9%
Global Refining Production (Primary + Secondary)	23,357	23,538	24,098	24,041	3,827	3,848	0.5%
Global Use of Refined Copper	23,492	23,710	24,488	24,455	3,798	3,720	-2.1%
Refined Balance 1/	-136	-171	-391	-414	29	129	

1/ Balance calculated using the total production of refined products minus the use of refining.
2/ May 2020 report.
Source: The International Copper Study Group (ICSG).

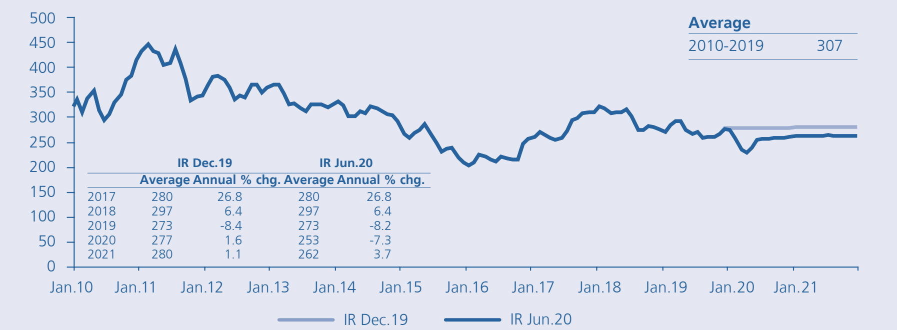
In this context, non-commercial positions in the copper market went from a net purchase position at the beginning of the year to a net sale position. It is worth mentioning, however, that between December 2019 and January of this year, net purchase positions had recovered as a result of market's favorable expectations after the trade agreement –called Phase 1– reached by China and the United States. In the current scenario of gradual economic recovery observed mainly in China and the developed economies, and a gradual normalization of production, it is assumed that prices would show a slight upward trend with respect to current levels during the second half of 2020 and in the next year. Despite this, the forecast in this report represents a downward revision with respect to the projection of the December Report.

Graph 17
COPPER: NON-COMMERCIAL CONTRACTS



Note: The Copper Speculative Net Positions of the Commodities Futures Trading Commission are reported weekly and reflect the difference between the total volume of the long position (or purchase) and short position (or sale) in the market and opened by non-commercial operators (speculative). This report only includes the future markets in the USA (Chicago and New York Stock Exchanges).
Source: Reuters and US Commodity Futures Trading Commission.

Graph 18
COPPER: JANUARY 2010 - DECEMBER 2021
(US$ cent/pd.)



	IR Dec.19		IR Jun.20	
	Average	Annual % chg.	Average	Annual % chg.
2017	280	26.8	280	26.8
2018	297	6.4	297	6.4
2019	273	-8.4	273	-8.2
2020	277	1.6	253	-7.3
2021	280	1.1	262	3.7

Source: Reuters and BCRP.

b. Zinc

So far this year, the international price of zinc has fallen 13 percent, reaching a price of US$ 0.90 the pound in May 2020. This price drop is in addition to the decline observed during 2019.

Like the prices of copper and other basic metals, the fall in the price of zinc is explained by the impact of the spread of COVID-19 on demand. Moreover, given the magnitude of the recession, the global demand for zinc would experience its worst decline since the Great Financial Crisis, the automotive and construction sectors being the most affected sectors because they are highly demanding sectors of this metal. The price of zinc had already been affected by the anti-dumping measures imposed by several countries against Chinese imports of galvanized steel and by the risk that more countries would introduce the same measure. The production cuts associated with the restrictive measures adopted because of the pandemic offset only in part this downward trend.

In this context, after four years of deficit, the market is expected to start showing global supply surpluses. In addition to the factors mentioned above, the entry of new refining capacity in China (with already adequate smelters according to the new government regulations) would also contribute to this. In line with these developments, the price of zinc is expected to stabilize around its current levels and below the levels estimated in the December Report.

Table 10
SUPPLY AND DEMAND FOR REFINED ZINC
(Thousand metric tons)

	2016	2017	2018	2019	Jan.-Feb. 2019	Jan.-Feb. 2020
Global Mining Production	12.60	12.61	12.76	12.86	2.98	2.97
Global Refining Production (Primary + Secondary)	13.56	13.49	13.10	13.50	3.21	3.31
Global Use of Refined Zinc	13.67	13.95	13.65	13.69	3.20	3.07
Refined Balance (in thousands)	-106	-467	-543	-192	9	239

Source: ILZSG. Reports on May and November 2020.

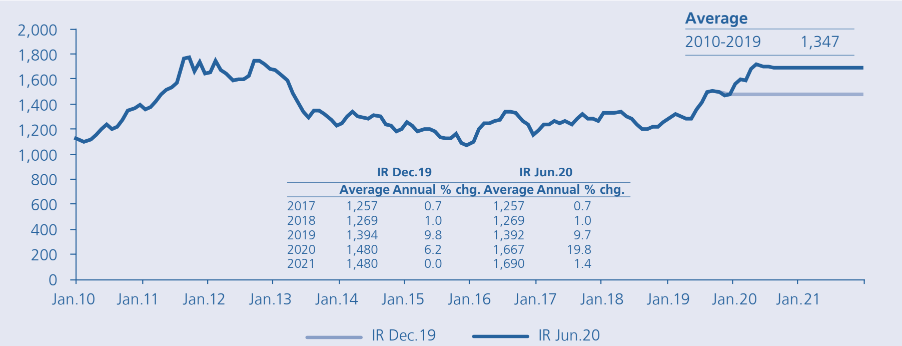
Graph 19
ZINC: JANUARY 2010 - DECEMBER 2021
(US$ cent/pd.)

Source: Reuters and BCRP.

c. Gold

In May, the average price of gold was US$ 1,717 a troy ounze, which implies a 16 percent increase so far this year, reflecting that the upward trend observed in the price of gold during 2019 (when it showed an increase of 18 percent) continues.

Graph 20
GOLD: JANUARY 2010 - DECEMBER 2021
(US$/tr. ounce)



	IR Dec.19		IR Jun.20	
	Average Annual	% chg.	Average Annual	% chg.
2017	1,257	0.7	1,257	0.7
2018	1,269	1.0	1,269	1.0
2019	1,394	9.8	1,392	9.7
2020	1,480	6.2	1,667	19.8
2021	1,480	0.0	1,690	1.4

Source: Reuters and BCRP.

The price of gold rose rapidly due to increased investment in Exchange Trade Funds (ETFs), influenced by the greater economic uncertainty caused by the COVID-19 pandemic which increased investors' preference for safe haven assets. In addition, uncertainty also increased towards the month of May due to the greater tensions between China and the United States, and monetary easing in several countries, particularly the United States, also favors greater investor demand. All of these factors have offset the drop in demand in the physical market, particularly the demand for jewelry. In line with these developments, the projection of the price of gold has been revised up with respect to the December Report.

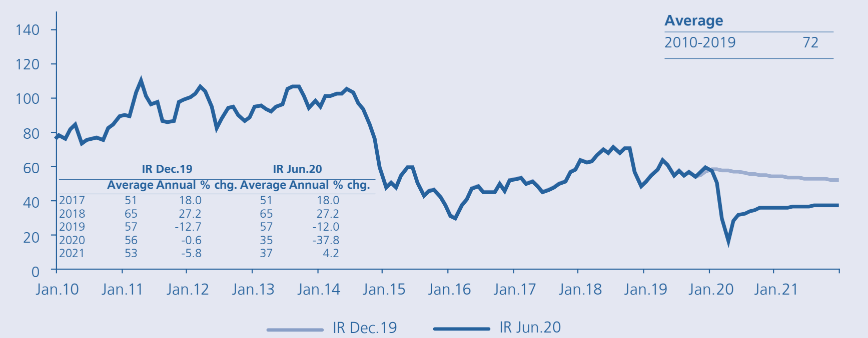
d. Oil

In May 2020, the average price of **WTI oil** dropped 52 percent compared to December, reaching a monthly average of US$ 29 the barrel. As a result of this, the price of oil has reversed the 22 percent increase it accumulated in 2019.

The perception of a balanced global oil market at the beginning of the year was disrupted by the unexpected drop in world demand due to COVID-19:

it is estimated that the measures adopted due to the pandemic would have represented a drop in consumption of around 30 percent. In addition to the lack of an appropriate agreement to restrict supply that led to a temporary price war, this drop in demand resulted in an unprecedented drop in prices. Moreover, in the particular case of WTI oil, the price was also affected by storage problems and by the expiration of the May contract, which led it to even be temporarily traded at negative price levels on April 20.

Graph 21
WTI OIL: JANUARY 2010 - DECEMBER 2021
(US$/bl.)



Source: Reuters and BCRP.

The gradual reopening of the economies is expected to lead to an increase in demand that will only compensate in part the drop recorded in the first half of the year. The International Energy Agency estimates a fall of 9 percent in 2020. On the supply side, producer countries (OPEC member countries and Russia, among others) agreed to establish a historical cut in production of 9.7 million barrels per day (equivalent to 10 percent of total supply) which would be in force as from May, as well as a cut reduction schedule. In line with these developments, prices are expected to stabilize around current levels (and below the prices projected in the previous Inflation Report).

e. Grains

After increasing 7 percent in 2019, the price of **maize** dropped 20 percent in the first five months of the year, reaching an average price of US$ 117 the ton in May.

The price of maize decreased as a result of the fall in demand associated with the COVID-19 and the prospects of greater supply. Consumption was affected by a sharp reduction in ethanol production (due to low oil prices) and by lower demand from the livestock sector. In addition, the spread of COVID-19 raised fears that China will not honor its commitment to make further purchases of US corn under the Phase 1-trade agreement signed in January. On the supply side, it is worth highlighting larger surpluses in Brazil and projections of record production levels in the United States in the 2020/21 crop year.

In line with these developments, the average price of maize projected for 2020 has been revised down. Aside from global risks, there is also uncertainty about compliance with the trade agreements between China and the United States and about the level of production in South America, where better weather conditions would favor a greater potential production.

Graph 22
MAIZE: JANUARY 2010 - DECEMBER 2021
(US$/ton)

	IR Dec.19		IR Jun.20	
	Average Annual	% chg.	Average Annual	% chg.
2017	131	-2.3	131	-2.3
2018	132	0.7	132	0.7
2019	145	9.9	145	10.0
2020	150	3.2	130	-10.8
2021	159	6.3	139	7.4

Source: Reuters and BCRP.

Since our last Report was published in December, the price of **wheat** increased 5 percent, reaching a monthly average price of US$ 174 the ton in May 2020. With this, the price of wheat partially reverses the 12 percent drop that it recorded in 2019. Various supply factors contributed to this price path: low production in Australia, adverse weather conditions for winter crops in Europe and in the Black Sea region, and Russia and Ukraine’s announcements of export restrictions. In this context of anticipated lower supply, it is estimated that the price of wheat will show levels above those projected in the previous Inflation Report. However, there are high risks that could affect this projection, most of which are associated with the impact that COVID-19 will have on global wheat demand and with the impact that weather conditions will have on planting in the northern hemisphere.

Graph 23
WHEAT: JANUARY 2010 - DECEMBER 2021
(US$/ton)

	IR Dec.19		IR Jun.20	
	Average Annual	% chg.	Average Annual	% chg.
2017	145	1.5	145	1.5
2018	186	28.0	186	28.0
2019	167	-10.3	168	-9.8
2020	165	-1.1	176	4.6
2021	181	9.7	185	5.5

Source: Reuters and BCRP.

As of May, the average price of **soybean oil** was US$ 556 a ton, 22 percent lower than in December 2019. This decline in the average price of soybean oil occurs after it increased 15 percent in 2019.

The price of soybean oil decreased, affected by the impact of the sharp drop in the price of oil on the demand for biodiesel, the weakening of global demand due to COVID-19, and increased milling of soybean in the United States. The price of soybean oil was also affected by uncertainty about China's ability to meet its commitments to purchase American products. The fall in the price of other vegetable oils, particularly the price of palm oil, also contributed to the decline in the price of soybean oil. Considering these recent events, the price of soybean oil is projected to be below the level estimated in the previous Inflation Report.

Graph 24
SOYBEAN OIL: JANUARY 2010 - DECEMBER 2021
(US$/ton)

	IR Dec.19		IR Jun.20	
	Average Annual	% chg.	Average Annual	% chg.
2017	707	1.5	707	1.5
2018	637	-9.9	637	-9.9
2019	636	-0.2	638	0.3
2020	697	9.7	604	-5.5
2021	724	3.8	613	1.6

Source: Reuters and BCRP.

Box 1
THE COVID-19 PANDEMIC

The rapid spread of the COVID-19 epidemic reversed the positive expectations on global growth generated by the progress observed in the trade negotiations between the US and China (which were reflected in the Phase 1 agreement between the two countries). Only two months passed since the first case was reported outside Asia and evidence of a global pandemic led most developed and emerging countries to adopt social isolation measures. This text summarizes the evolution of the corona virus epidemic and compares it with some previous epidemic events.

Timeline of the pandemic

The outbreak of the COVID-19 pandemic –name given to the pandemic by the World Health Organization (WHO) on February 11– began on December 31, 2019, when the municipal commission of Wuhan (Hubei Province) notified the WHO of several cases of pneumonia. The first death from the new coronavirus was recorded on January 11, a day after the WHO published a first set of recommendations. The virus initially spread to China's neighboring countries, Japan and South Korea, and the first confirmed case outside of China was registered in Thailand on January 13.

The first case outside Asia, an American citizen who arrived in Seattle from China, was identified on January 20. From then on, markets began to show greater concern about the possibility that the virus would spread outside the Asian continent. On January 21, the major exchange markets registered declines associated mainly with the shares of travel, transportation, and entertainment companies. Globalization and better transport systems raised fears that, despite the greater technological and health advances, this epidemic could spread rapidly.

Despite this, the virus spread first in Europe. The Lombardy region, in northern Italy, became the second major infectious focus. The government decreed quarantine status on March 9, when infections already totaled 9,172 cases and the death toll was 463. At that time, the number of infections worldwide exceeded 100,000. A few days later, Spain, the second most affected European country, declared quarantine status too.

Thereafter the outbreak spread rapidly to America. On March 11, the WHO noted that the current episode of COVID-19 could be declared a pandemic. Today, the US city of New York is considered the epicenter of the pandemic and the number of deaths and confirmed cases in the US represent a little over a quarter of the people affected by the pandemic in the world. Along with the US, Latin America emerges as a new epicenter of the pandemic due to the recent growth of infections. As of June 15, the number of cases worldwide amounted to 7.8 million and the number of deaths to 431 thousand. More than 200 hundred countries are affected by the pandemic, a number never seen before in history.

TIMELINE OF EVENTS: From the first case (Dec. 2019) to the declaration of a pandemic (Mar 2020)	
Date	**Event**
December 8	First patient develops coronavirus symptoms in Wuhan
December 31	Wuhan reports a cluster of pneumonia cases to the WHO.
January 7	Chinese authorities confirm that the virus has been identified as a new coronavirus.
January 10	The WHO publishes a first set of technical guidelines and recommendations for all countries.
January 11	The first death in Wuhan is confirmed.
January 13	The first case of COVID-19 outside China, in Thailand, is confirmed.
January 20	The first case of COVID-19 outside Asia, USA is confirmed.
January 22	A WHO mission confirms the human-to-human transmission of the virus.
January 23	Quarantine status is decreed in Hubei province, and Lunar New Year celebrations are canceled in major Chinese cities.
January 24	The first case of COVID-19 is confirmed in Europe, in France.
January 29	The first case of COVID-19 in Italy is confirmed.
January 30	The WHO declares the outbreak as a public health emergency of international concern.
February 2	The first death outside China is confirmed in the Philippines.
February 3	WHO publishes a strategic preparedness and response plan to help States with more fragile health systems protect themselves.
February 11	The WHO decided to call the new coronavirus as COVID-19, when the number of deceased exceeds 1,000 worldwide.
February 15	The first death in Europe is confirmed, in France.
February 22	The first death in Italy is confirmed.
February 26	The first case of COVID-19 in Latin America, in Brazil, is confirmed.
March 3	The first death in the USA is confirmed.
March 6	It exceeds 100,000 confirmed cases in the world.
March 7	The first case of COVID-19 in Peru is confirmed. The first death in Latin America is confirmed, in Argentina.
March 9	The state of quarantine is decreed in Italy.
March 11	The WHO determines that COVID-19 can be characterized as a pandemic.
March 16	The state of quarantine in Peru is decreed.
March 20	The first death in Peru is confirmed. The state of quarantine is decreed in New York, USA.

Evolution of the pandemic in the world

The global panorama of the pandemic shows three different behaviors, as described in the following graph. On the one hand, in the Asian countries that saw the first outbreaks, the number of active infections as well as the daily number of new infections are already decreasing. The pandemic in these countries is already being controlled.

A similar situation is observed in the industrialized countries, which has led these economies to soften their non-pharmaceutical intervention measures. For example, in Italy, the strictness index of intervention measures developed by the University of Oxford shows a general reduction, falling from a level of 93.5 to 63.0 points.

On the other hand, Latin America has become the new epicenter of the pandemic. As illustrated in the graph, active cases per million inhabitants continue to grow, while new cases continue to show a rising trend, in contrast with what is observed in the graphs for Asian countries and industrialized countries.

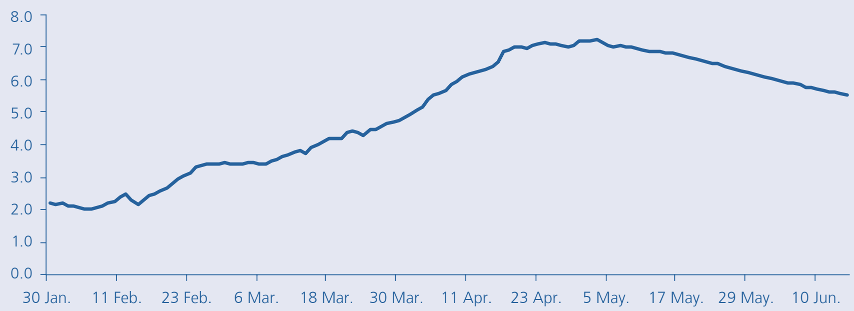
Comparison of COVID-19 with other pandemic events

The first studies of the virus linked this epidemic with two recent epidemics: SARS (Severe Acute Respiratory Syndrome) and MERS (Middle East Respiratory Syndrome), both caused by other types of coronaviruses.

The SARS epidemic occurred between 2002 and 2003. The outbreak, which was also first identified in China, spread to 30 countries, causing a total of 8,098 infection cases and 774 deaths. The MERS was first identified in Saudi Arabia in 2012. Although 80 percent of the cases were concentrated in this country, cases were reported in 27 countries. The limited contagion from person to person facilitated its control, although there are still cases today.

Of the two respiratory diseases, SARS is more similar to COVID-19 due to its similar origin (scientist suspect it was through an infected animal) and rapid transmission between people. The mortality rate of the COVID-19 pandemic (5.5 percent), which is lower than the mortality rate of SARS (9.6 percent), reached its highest point in the first week of May (7.3 percent) coinciding with the collapse of healthcare systems in several developed economies (i.e. Spain and Italy).

MORTALITY RATE
(%)



Information as of June 15.
Source: World Health Organization.

From a historical perspective, in the last 100 years other pandemics have exceeded by far the number of deaths caused by COVID-19 to date, which is explained by a lower mortality of the virus and by technological and healthcare improvements. However, as pointed out above, increased globalization and ease of contagion have caused an unprecedented global spread.

PANDEMICS IN THE LAST 100 YEARS

Pandemics	Period	Number of deaths*
Lethargic encephalitis	1915-1926	1,500,000
Spanish flu	1918-1919	50,000,000
Asian flu	1957-1958	2,000,000
Hong Kong flu	1968-1970	1,000,000
HIV AIDS	1981-presente	30,000,000
SARS	2002-2003	770
Flu A (H1N1)	2009-2010	203,000
Ebola	2014-2016	11,000
MERS	2015-presente	850

* Estimate.
Source: Deutsche Bank.

Recent experiences allow establishing some commonalities and some differences. Specialists point out the possibility that, as happened in the case of the Spanish flu, outbreaks may occur in the second half of 2020 and during 2021. The experience of St. Louis during the Spanish flu pandemic shows how a city that had effectively controlled the initial outbreak can be overwhelmed after it establishes the reopening of businesses.

On the other hand, in contrast with what happened with the HIV epidemic, the chances of developing a vaccine soon are much greater. Today, there are around 60 parallel projects and it is estimated that a vaccine could be available by the first half of next year. A vaccine would support the rapid restoration of social and economic relations to how they used to be prior to the pandemic.

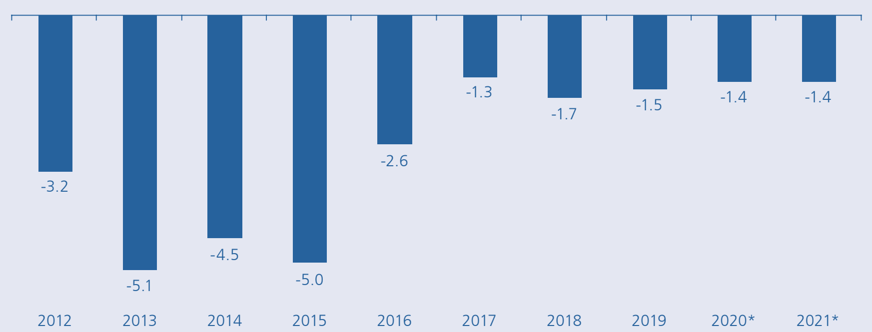
II. Balance of Payments

Current account

23. In the scenario marked by the COVID-19 pandemic, the current account of the balance of payments showed a deficit equivalent to 2.2 percent of GDP in the first quarter of 2020 (3.1 percent of GDP in the same period of 2019). This result mainly reflected the reduction in the deficit of factor income as a result of the lower profits of foreign direct investment companies (mining, services, and industrial companies), in line with the contraction of local production and the lower prices of commodities. To a lesser extent, this result was also influenced by lower imports of goods and services from other countries as a result of the contraction in domestic demand and the significant drop in the price of oil. Moreover, lower exports of goods and services were recorded amid a context of lower prices for basic metals, a contraction of local production and external demand, the closure of airports and borders, and higher international freight rates. Current transfers decreased as well, affected by the economic closedown and the loss of jobs in the main countries from which remittances come.

24. In this scenario, the current account deficit is expected to rise to 1.4 percent of GDP in **2020**, this level of deficit being estimated to continue in 2021. These current account levels are sustainable and lower than the average levels of the last 10 years. (2.8 percent). In **2021**, the economy would see a noteworthy rebound in exports of goods and in the profits of foreign direct investment companies in a context of both global and local economic growth.

Graph 25
CURRENT ACCOUNT: 2012-2021
(% GDP)



* Forecast.

Table 11
BALANCE OF PAYMENTS
(Million US$)

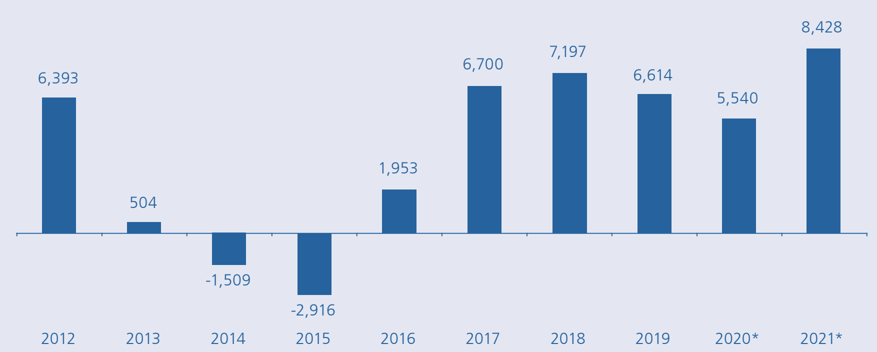
	2019	2020*			2021*	
		Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
I. CURRENT ACCOUNT BALANCE	**-3,531**	**-1,141**	**-3,845**	**-2,781**	**-4,092**	**-3,166**
% GDP	*-1.5*	*-2.2*	*-1.6*	*-1.4*	*-1.6*	*-1.4*
1. Trade Balance	6,614	832	7,040	5,540	7,086	8,428
a. Exports	47,688	10,008	49,761	39,051	52,149	44,793
Of which:						
i) Traditional	*33,751*	*6,919*	*34,658*	*28,064*	*35,615*	*31,885*
ii) Non traditional	*13,783*	*3,050*	*14,945*	*10,871*	*16,378*	*12,812*
b. Imports	-41,074	-9,176	-42,721	-33,512	-45,063	-36,365
2. Services	-3,114	-741	-2,809	-3,317	-3,186	-3,129
3. Investment income	-10,749	-1,837	-11,914	-8,234	-11,984	-11,089
4. Current transfers	3,718	606	3,838	3,230	3,992	2,624
Of which: Remittances	3,326	494	3,514	2,067	3,690	2,274
II. FINANCIAL ACCOUNT	**11,726**	**847**	**6,186**	**9,481**	**5,152**	**4,091**
1. Private Sector	7,309	231	2,802	1,564	3,180	466
a. Long-term	5,512	-842	2,752	759	3,180	466
b. Short-term [1/]	1,796	1,073	50	805	0	0
2. Public sector [2/]	4,417	616	3,385	7,917	1,972	3,625
III. CHANGE ON NIRs	**8,195**	**-294**	**2,341**	**6,700**	**1,060**	**925**

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

25. In the first quarter of 2020, the **trade balance** showed a surplus of US$ 832 million, US$ 452 million less than in the same period of 2019 (US$ 1.28 billion), due to the decline of exports associated with the local and global economic crises caused by the COVID-19 pandemic. Even though this reduction in the trade surplus would intensify in the following months (In January-April, it has fallen to US$ 169 million), a gradual reversal is expected from the second half of the year.

    In **2020**, the trade balance would reach a surplus of US$ 5.54 billion –US$ 1.08 billion less than in the previous year– as a result of lower exports of traditional products (US$ 5.69 billion), especially mining exports, and exports of non-traditional products (US$ 2.91 billion). On the other hand, in **2021** the trade surplus is expected to increase to US$ 8.43 billion with greater volumes of exports as a result of the rebound anticipated in both local production and international demand.

Graph 26
TRADE BALANCE: 2012-2021
(Million US$)



* Forecast.

26. In the first quarter of 2020, **exports** amounted to US$ 10.01 billion, which represented a reduction of 11.1 percent with respect to the result observed in the same period of 2019, mainly due to lower volumes of traditional mining, fishing, and hydrocarbon exports and, to a lesser extent, to lower volumes of non-traditional exports (except for agricultural exports, which grew). This contraction of exports was associated with the context of lockdown of all non-essential local economic activity, the impact of which was also reflected in foreign trade logistical operations such as the lower frequency of entry of ships and the lower availability of containers.

    Although this reduction in exports is expected to increase further in the second quarter of this year (by April, exports had already fallen by 56 percent compared to the same month of 2019), this trend would gradually reverse as from the second semester. Nonetheless, the value of exports in **2020** would decline mainly due to lower shipments of traditional mining and hydrocarbon products and non-traditional agricultural, fishing, and iron and steel products, in line with the projected contraction of local activity and world demand, the supply chain being affected in the context of the crisis associated with COVID-19.

In **2021**, the value of exports would recover mainly due to the higher growth projected in export volumes, reflecting the growth of local activity and global demand, as the impact of the pandemic is overcome.

27. In the first quarter of the year, **imports** totaled US$ 9.18 billion –8.0 percent less than in the same period of 2019– in a context of contraction in domestic demand and a significant reduction in the price of oil. The volume of imports decreased (5.5 percent) due to lower purchases of consumer goods (7.6 percent), affected by the reduction in income and formal employment, and imports of capital goods excluding construction materials (-8.0 percent), following the reduction in private investment. Moreover, the price of imports of inputs fell by 2.6 percent –with oil and oil derivatives falling -8.5 percent–, reflecting the international drop in the price of oil to record lows. In April 2020, imports fell 33 percent, intensifying the trend observed in the first quarter of the year.

Table 12
TRADE BALANCE
(% change)

	2019	2020*			2021*	
		Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
1. Value:						
Exports	-2.8	-11.1	4.9	-18.1	4.8	14.7
Traditional products	*-5.3*	*-12.9*	*3.6*	*-16.8*	*2.8*	*13.6*
Non-traditional products	*4.1*	*-6.6*	*8.4*	*-21.1*	*9.6*	*17.8*
Imports	-1.9	-8.0	4.5	-18.4	5.5	8.5
2. Volume:						
Exports	0.7	-10.3	4.2	-14.7	4.6	12.4
Traditional products	*-1.2*	*-12.7*	*3.3*	*-13.2*	*2.7*	*12.9*
Non-traditional products	*5.7*	*-4.8*	*7.2*	*-19.1*	*7.4*	*14.8*
Imports	-0.2	-5.5	3.8	-13.2	4.3	6.4
3. Price:						
Exports	*-3.4*	*-0.8*	*0.7*	*-4.0*	*0.2*	*2.1*
Traditional products	*-4.1*	*-0.2*	*0.3*	*-4.2*	*0.1*	*0.7*
Non-traditional products	*-1.6*	*-1.8*	*1.1*	*-2.5*	*2.0*	*2.6*
Imports	-1.7	-2.6	0.7	-6.0	1.1	2.0

* Forecast.
IR: Inflation Report.

Imports are expected to rise gradually as from July, following the rebound in domestic demand, although the evolution of imports in the first half of the year will influence the annual result. The contraction in domestic demand and the reduction in oil prices would account for the reduction in imports in **2020**, whereas the growth of imports in **2021** would be in line with the projection of recovery of domestic demand and oil prices.

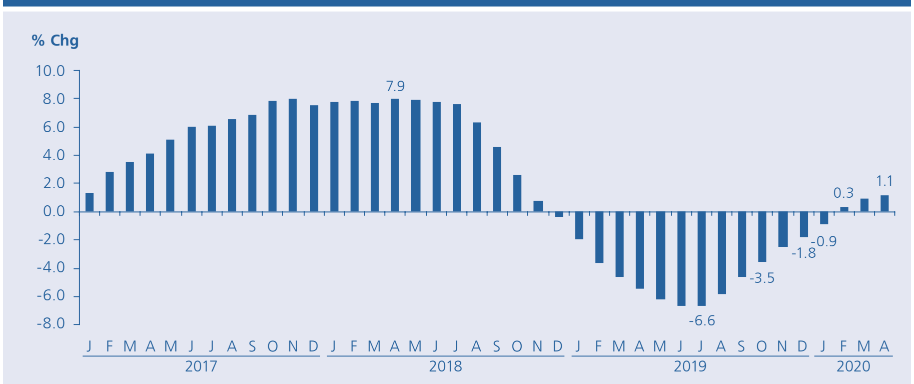
Terms of trade

28. As of April 2020, the terms of trade showed an increase of 1.1 percent in the last 12 months since the fall in the price of imports was higher than the one registered in exports (the price of oil reached a record low in April).

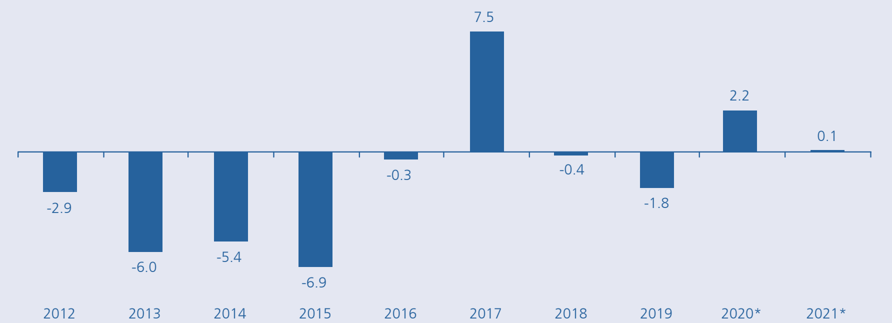
After the drastic reduction in April, the price of oil is expected to maintain a slight rebound in the remainder of the year, as has been observed since May. Thus, the terms of trade are projected to increase in **2020** (2.2 percent), the reduction of import prices (6.0 percent) being estimated to be higher than that of export prices (4.0 percent). The lower oil prices are associated with the negative impact of COVID-19 on oil demand, which together with the lack of an appropriate agreement to restrict supply, have resulted in an unprecedented drop in oil prices.

In **2021** a slow recovery in the prices of commodities would result in an increase in the terms of trade (0.1 percent), with the rebound in the price of oil being higher than the recovery in the prices of exports of basic metals.

Graph 27
TERMS OF TRADE
(Accumulated 12 month % change)



Graph 28
TERMS OF TRADE: 2012-2021
(Annual average % change)



* Forecast.

Table 13
TERMS OF TRADE: 2018 - 2020

	2019	2020*			2021*	
		Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
Terms of Trade						
Annual % chg. (average)	**-1.8**	**1.9**	**0.0**	**2.2**	**-0.9**	**0.1**
Price of exports						
Annual % chg. (average)	**-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 % chg. (average)	**-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

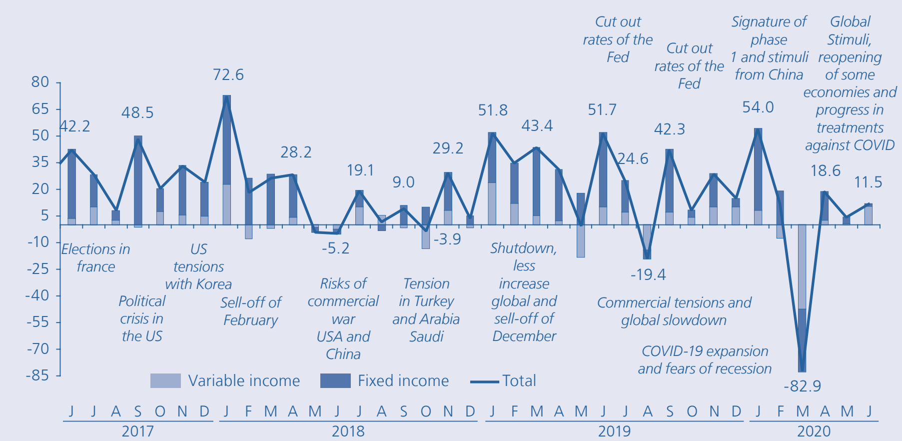
* Forecast.
IR: Inflation Report.

External financing

29. So far this year, the global spread of COVID-19 has significantly deteriorated global financial conditions, which led to a record capital outflow from the emerging economies in March. High uncertainty regarding the duration of the pandemic and its impact on activity was reflected in a recomposition of investors' portfolios with a preference for cash and lower-risk securities from developed countries, which affected demand and the price of the emerging economies' main assets.

However, this unfavorable external situation has been accompanied by the expansionary policies implemented by the central banks of both the developed and the emerging economies in response to the crisis generated by COVID-19, which have offset in part the worsening of external financing conditions. In this sense, international financial conditions have improved compared to March, with a reduction in interest rates and a rebound in the market value of financial assets.

Graph 29
FLOWS OF NON-RESIDENTS TO EMERGING MARKETS
(Billion US$)



* Data for June 2020 corresponds to the estimated value until June 9.
Source: IIF.

30. In this context, in the first quarter of the year the **private financial account** showed lower long-term capital inflows, with less foreign direct investment and higher loan amortizations, in line with the reduction in local private investment. In contrast, short-term loans rose, offsetting the impact on total external financing.

In the forecast horizon, foreign direct investment in the country would reflect the expected behavior of domestic private investment, contracting in **2020** and recovering partially in **2021**. On the other hand, portfolio investment and short-term capital would reflect the preference for lower risk assets in a context of reduction of the growth differential (and interest rates) between the emerging economies and the developed economies. Therefore, private external financing would remain at low levels at the end of the forecast horizon compared to the period prior to the crisis associated with COVID-19.

The forecast for this year considers a capital inflow of US$ 2.42 billion as a result of the liquidation of external assets, reflecting mainly the inflow of AFP funds to meet affiliates' extraordinary withdrawals of their funds after the approval of Law No. 3107.

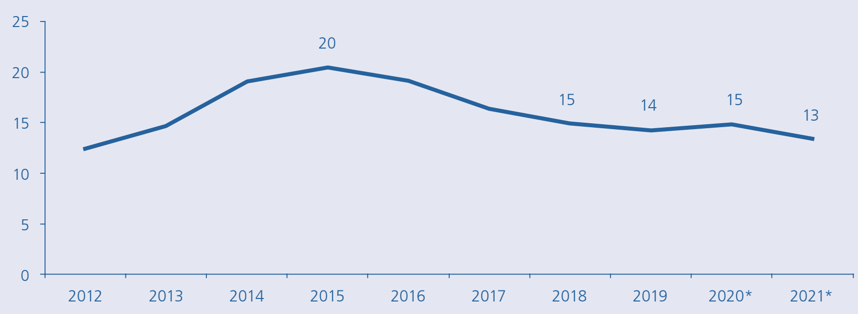
On the other hand, greater preference for domestic financing and in local currency would remain, so external indebtedness would continue to show its decreasing trend at the end of the forecast horizon.

Table 14
FINANCIAL ACCOUNT OF THE PRIVATE SECTOR
(Million US$)

	2019	2020*			2021*	
		Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
PRIVATE SECTOR (A + B)	**7,309**	**231**	**2,802**	**1,564**	**3,180**	**466**
% GDP	*3.2*	*0.4*	*1.2*	*0.8*	*1.2*	*0.2*
A. LONG-TERM	**5,512**	**-842**	**2,752**	**759**	**3,180**	**466**
1. ASSETS	**-2,424**	**-1,061**	**-2,752**	**2,417**	**-2,038**	**-974**
2. LIABILITIES	**7,936**	**219**	**5,504**	**-1,659**	**5,219**	**1,440**
Foreign direct investment in the country	8,892	670	5,292	1,552	4,979	2,460
Long-term loans	-2,224	-432	-425	-2,876	14	-1,765
Portfolio investment	1,268	-19	637	-335	226	744
B. SHORT-TERM 1/	**1,796**	**1,073**	**50**	**805**	**0**	**0**

1/ Includes net erros and omissions.
* Forecast.

Graph 30
BALANCE OF MEDIUM- AND LONG-TERM PRIVATE EXTERNAL DEBT: 2012-2021
(% GDP)



* Forecast.

31. The **public financial account** would reflect the greater financing requirements corresponding to greater fiscal deficits in the forecast horizon. In this context,

greater disbursements and issuances of global and sovereign bonds (held by non-residents) are expected this year.

Table 15
FINANCIAL ACCOUNT OF THE PUBLIC SECTOR
(Million US$)

	2019	2020*			2021*	
		Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
I. Disbursements [1/]	**1,863**	**37**	**2,126**	**6,781**	**1,005**	**1,771**
II. Amortization	**-2,205**	**-97**	**-254**	**-323**	**-531**	**-547**
III. Net external assets	**214**	**18**	**-140**	**16**	**-140**	**-140**
IV. Other transactions with Treasury bonds (IV=a-b)	**4,545**	**657**	**1,652**	**1,443**	**1,638**	**2,541**
a. Sovereign Bonds held by non-residentes	4,190	683	1,652	1,467	1,638	2,541
b. Global Bonds held by residentes	-355	26	0	24	0	0
V. TOTAL (V = I+II+III+IV)	**4,417**	**616**	**3,385**	**7,917**	**1,972**	**3,625**

1/ Includes bonds.
* Forecast.

32. The soundness of the balance of payments to face negative external events 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 Peruvian economy shows high-levels in these indicators in comparison with other emerging economies, thanks to the preemptive accumulation of international reserves.

Table 16
NIR INDICATORS

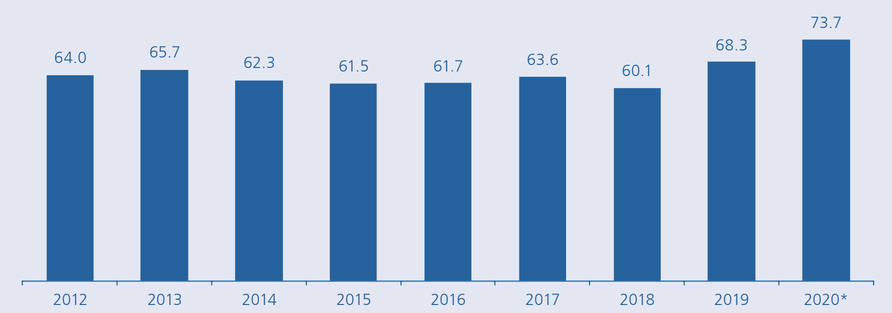
	2017	2018	2019	2020*	2021*
NIR as a % of:					
a. GDP	29.7	26.7	29.6	37.3	33.8
b. Short-term external debt [1/]	405	466	579	591	599
c. Short-term external debt plus current account deficit	344	360	446	485	479

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

33. As of June 15, the country's **net international reserves** (NIRs) have increased by US$ 5.40 billion to US$ 74 billion compared to the end of 2019. This increase is mainly explained by higher bank deposits at BCRP (up from US$ 16.61 billion to US$ 18.02 billion). During the same period, the exchange position of BCRP increased from US$ 42.62 billion to US$ 44.19 billion. NIRs are expected to remain stable at around US$ 76 billion at the end of the forecast horizon.

Despite the country's solid macroeconomic foundations and its strong external position reflected in the level of its international reserves, having resources that give greater support to the international position is deemed advisable due to the deepening of the pandemic and the impact of the COVID confinement measures on the economy. The risks are particularly high for the emerging and developing countries due to the impact of the pandemic on their balance of payments. In this context, at the end of May, the IMF approved **a Flexible Credit Line (LCF) of US$ 11 billion for two years**, which was requested by the Peruvian economic authorities for preventive purposes. This line reinforces the relevance of having an adequate level of international reserves.

Graph 31
NET INTERNATIONAL RESERVES: 2012-2020
(Billion US$)



* As of June 15.

III. Economic Activity

34. Great variability and a wide range of estimations for GDP growth prospects are observed in today's climate of uncertainty, with forecasts ranging from a fall of 4 percent to a contraction of more than 20 percent. There are even some entities that have not revealed their expectations for 2021.

Therefore, the growth projections in this Report consider complete explicit assumptions and a scenario of high uncertainty regarding the impact of the COVID-19 pandemic, as can be seen in the balance of risks and in the breadth of the fan charts contained in the chapter where the inflation risk balance is discussed.

Table 17
GDP GROWTH PROJECTIONS
(Real % change)

	2020	2021
Consensus Forecast June (average)	**-9.3**	**7.1**
HSBC	-4.0	3.0
CESLA (Klein-UAM)	-4.1	5.5
Euromonitor Int	-4.3	4.7
Citigroup	-5.0	4.8
AGPV	-5.0	5.6
Moody's Analytics	-8.3	4.8
Capital Economics	-8.5	11.0
Barclays	-8.5	9.5
Oxford Economics	-8.8	11.9
Scotiabank	-9.0	7.0
Econ Intelligence Unit	-9.2	8.0
IHS Markit	-9.9	4.7
Macroconsult	-11.8	8.9
JP Morgan Chase	-12.7	7.9
BBVA	-15.0	6.5
Deutsche Bank	-16.3	8.1
Larrain Vial	-16.9	9.5
Other local source		
Apoyo	-14 / -20	-.-
BCP	-11.0	-.-
Other international source		
Goldman Sachs. June	-8.0	6.3
BofA - MerrilL Lynch. June	-9.0	6.0
Morgan Stanley. June	-9.9	6.4
IMF WEO. April	-4.5	5.2
CAF, May	-8.4	7.1
World Bank, June	-12.0	7.0
Average	-9.2	6.9
Standard deviation	3.6	2.1
Coefficient of variation	39.4	30.8

Source: Reports.

Sector GDP

35. As a result of the mandatory confinement period decreed on March 16 and extended afterwards until June 30, economic activity in Peru has experienced an unprecedented abrupt fall. The period of confinement, a measure aimed at preserving people's health, implied both the total or partial suspension of most activities considered non-essential and the compulsory confinement of families. This measure caused Peru's GDP to show a contraction of 16.3 percent in March and a drop of 40.5 percent in April. With the Government's announcement of the four phases of economic reopening, the drop in May is expected to be lower due to the start of the first phase and the economy is expected to start its recovery, particularly from the third quarter of the year.

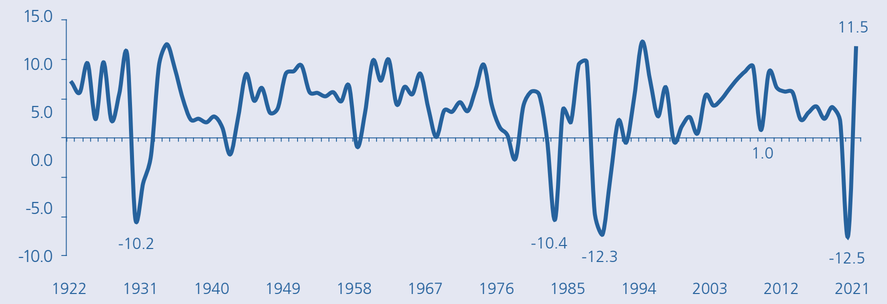
36. An adequate reopening of the economy and companies' adaptation to the new business environment (digitization, adjustment to health protocols, innovations in business production processes, etc.) would contribute to offset the drop of the output with a fall of 12.5 percent in 2020, rate not observed in the Peruvian economy in the last hundred years. Economic growth is expected to continue recovering, reaching a growth rate of 11.5 percent in 2021 and recovering its pre-crisis level (fourth quarter of 2019) in the first quarter of 2022. These projections consider a scenario of preservation of macroeconomic and financial stability, and reforms aimed at establishing an adequate business environment that promotes job creation and investment.

Table 18
GDP BY PRODUCTION SECTOR
(Real % change)

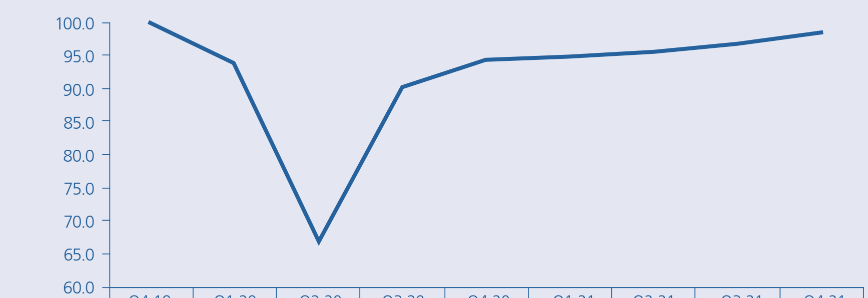
	Average 2014-2018	2019	2020*			2021*	
			Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
Primary GDP	**4.0**	**-1.3**	**-2.8**	**4.7**	**-5.5**	**3.7**	**8.0**
Agriculture and livestock	3.6	3.2	2.9	4.0	1.3	3.6	3.6
Fishing	3.0	-25.9	-15.3	23.0	9.5	-3.9	8.5
Metallic mining	7.1	-0.8	-6.3	3.6	-10.2	5.5	10.7
Hydrocarbons	-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.

Graph 32
TOTAL GDP, 1922-2021
(Annual % change)



Graph 33
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 unseasonally adjusted index.

a) The **agriculture sector** grew 3.2 percent in 2019, maintaining the upward trend it has shown for 15 years thanks to the record agricultural production levels of products for both the domestic market (potatoes, bananas, cassavas, lemons, tangerines, and pineapples) and for external markets (blueberries, mangos, cocoa, avocados, and olives), as well as the production of the livestock subsector (poultry and eggs).

Output in this sector accumulated a growth rate of 2.9 percent in the first quarter, both due to the growth of production in the agricultural subsector (3.4 percent), with growing export-oriented production (grapes, blueberries, avocados, and quinoa) and growing production for the domestic market (rice, potatoes, and onions), as well as due to the growth of production in the livestock subsector (2.4 percent) with a greater supply of chicken meat and eggs.

The compulsory confinement period declared in March coincided with the end of the period of large harvests of grapes, mangos, and blueberries at the beginning of the year, so the difficulties that affected the transport logistics chain (shortage of containers and higher freight rates) and the availability of labor did not have a significant impact on agro-exports in the first quarter of the year. The peaks of other agricultural export crops concentrate again in the second half of the year: blueberries and grapes (September-December), mangos (November-December), and avocados (May-September). The health emergency also coincided with the start of the large farming season of crops, such as potatoes, rice, and Andean products that are mostly oriented to the domestic market.

Output in this sector is expected to grow 1.3 percent in **2020**, given the impact that the supply shock resulting from compulsory confinement in the context of global pandemic had mainly on poultry production due to its link with the activity of food outside the home and tourism services. In 2021, after the pandemic scenario declines, based on the dynamism of agriculture oriented to both the external and domestic markets and on the activity of the livestock subsector, this sector is expected to grow 3.6 percent.

Because of uncertainty in the current global pandemic scenario, it is worth highlighting the strengths of Peruvian agro-export agriculture, including the adoption of new sanitary protocols and new varieties of crops that have greater acceptance in external markets (grapes and blueberries), young plantations with high yields (blueberries and avocados), continuity in the recovery of rice and lemon production in Piura with improvements in irrigation infrastructure (Poechos reservoir), and the gradual normalization of the supply of poultry, a product that enjoys national consumers' high preference.

b) In 2019, activity in the **fishing sector** dropped 25.9 percent due to lower anchovy catch in the anchovy fishing seasons as a result of the lower quota in the first season and the suspension of the second fishing season.

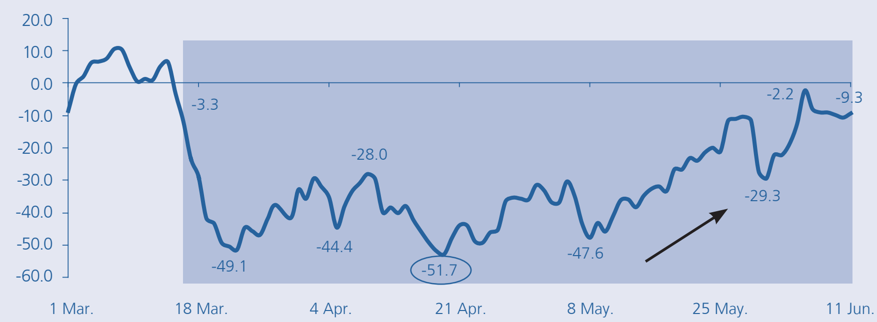
In the first quarter of 2020, the sector had a drop of 15.3 percent because the 2019 second fishing season in the North-Central Zone was suspenden in January 2020 and because of the lower output of frozen squid due to lower squid catch. The sector was not significantly affected by the COVID-19 emergency since the anchovy season had not yet started when quarantine was decreed in March. In addition, fishing activity was reopened together with the reactivation of some economic sectors in May.

This year, the first anchovy fishing season in the north-central zone began on May 13 and is being developed normally. As of June 12, nearly 40 percent of the assigned fishing quota has been captured, with an average daily landing of 33 thousand metric tons. Considering normal weather conditions, the sector is estimated to growth 9.5 percent in **2020** and 8.5 percent in **2021**.

c) Output in the **metal mining** sector decreased 0.8 percent in 2019 due to a lower production of (i) gold, because of lower production in Barrick and Buenaventura, and (ii) zinc, due to lower ore grades in Antamina. On the other hand, copper production increased 0.8 percent due to the higher production of Southern, which slightly offset the lower production of Cerro Verde, Toromocho, and Constancia.

The sector's production decreased 6.3 percent in the first quarter of 2020. The drop is explained by lower production in the month of March (-23.1 percent) due to the beginning of the quarantine since mid-March, the production of copper and gold decreasing the most in the first quarter (-12.7 percent and -14.3 percent, respectively). In contrast with what happened in other countries in the region, critical mining activities were allowed during the quarantine, including the treatment of tailings to protect the environment and the processing of already extracted minerals.

Graph 34
MINING COMPANIES' DAILY ELECTRICITY CONSUMPTION
(% change respect to same comparable day of the previous year)



	1-15 Mar.*	16-31 Mar.*	1-30 Apr.	1-31 May.	1-11 Jun.
% change	3.3	-39.3	-40.3	-30.2	-12.1

* Calculated respect to the comparable days of the previous year.

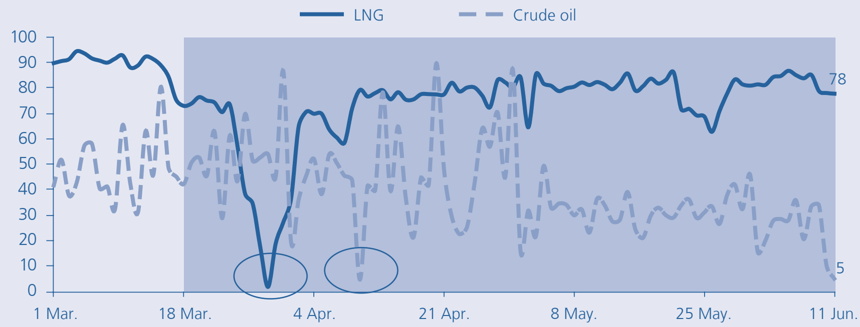
An indicator of mining activity during the state of emergency is mining companies' consumption of electrical energy. From the beginning of the quarantine until May 31, the demand for electricity in the mining sector decreased 35.9 percent, a rebound being observed in May compared to April due to the gradual restart of operations of the large mining companies within the framework of phase 1 of the economic recovery program started in May. The operations of medium and small formal mining companies should restart in June with the onset of phase 2.

In **2020**, the sector is expected to show a 10.2 percent drop, which represents a recovery of the sector during the third and fourth quarters, compared to the second quarter. The higher projected growth for 2021 (10.7 percent) is explained by the normalization of mining production and the entry into operation of Mina Justa and the expansion of Toromocho.

d) In 2019, the **hydrocarbons sector** grew 4.6 percent due to higher oil production (8.4 percent), driven by Lot 95 (which began operations in December 2018). During the first quarter, the sector grew 0.2 percent due to the greater production of Lot 95 and the recovery of production in Lot 192, offseting in part the lower production of natural gas and natural gas liquids associated with lower domestic demand.

Graph 35

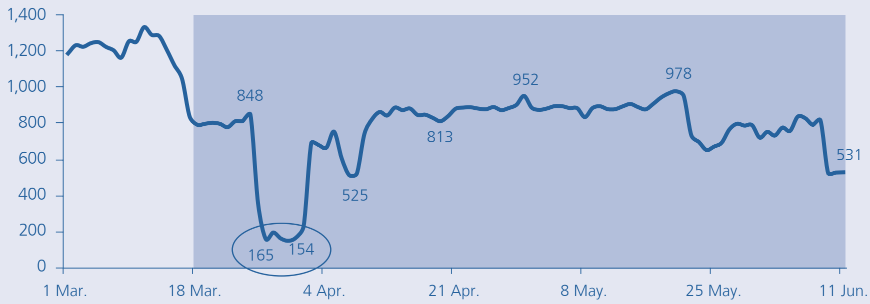
LIQUID HYDROCARBON PRODUCTION
(Thousand of barrels)



	1-15 Mar.	16-31 Mar.	1-30 Apr.	1-31 May.	1-11 Jun.
LNG (% chg.)	2.9	-38.5	-3.0	-0.8	-5.0
Crude oil (% chg.)	-5.4	2.0	-14.8	-44.2	-53.6

Memo: changes respect to the daily average of 2019.

PRODUCTION OF NATURAL GAS
(Milion of cubic feet)



	1-15 Mar.	16-31 Mar.	1-30 Apr.	1-31 May.	1-11 Jun.
% change	3.0	-50.0	-29.4	-22.1	-36.0

Memo: changes respect to the daily average of 2019.

During the state of emergency period, hydrocarbon production has remained below its normal levels. In April, Petroperú announced the suspension of oil transportation through the North Peruvian Pipeline since May 1, with which oil production in this month registered an average of 32 thousand barrels per day (which represents a drop of 44.2 percent compared to the previous year), mainly due to the stoppage of operations in lots 8, 95, 67, and 192. At the end of May, the oil lots located in Piura, such as Lot X, were operating.

The production of natural gas and natural gas liquids has decreased during the quarantine period mainly due to the lower production of Lot 88 (production for the domestic market). However, after reaching a drop floor in March, the extraction of natural gas and natural gas liquids has begun to rebound in the months of April, May, and June. Thus, this subsector would show a 14.4 percent drop in **2020**, and grow thereafter to 6.9 percent in 2021 due to a rebound in demand compared to the previous year.

e) Activity in the **primary manufacturing** subsector decreased 8.8 percent in 2019 due to lower production of fishmeal and fish oil. In the first quarter of 2020, production fell 0.8 percent due to the lower production of fishmeal (the 2019 second fishing season in the North-Central Zone was cancelled) and to lower oil refining (suspension of operations in the Talara refinery due to modernization works), which was in part offset by higher refining of non-ferrous metals (higher production due to plant maintenance the previous year).

Output in the primary manufacturing subsector would be partially affected by the COVID-19 pandemic, specifically due to less oil refining, less production of canned and frozen fish products, and less sugar production. Despite this, the subsector would show a growth rate of 2.1 percent in 2020 due to a higher production of fishmeal and higher refining of non-ferrous metals. Moreover, a growth rate of 7.7 percent is expected for 2021 due to the rebound of activity in the branches affected by the health emergency and to the reopening of the Talara refinery.

f) **Non-primary manufacturing** grew 1.2 percent in 2019 due to higher investment-oriented production (metal products for structural uses, transportation material, and cement) and a higher production of mass consumer goods (carbonated and alcoholic beverages, furniture, and dairy products).

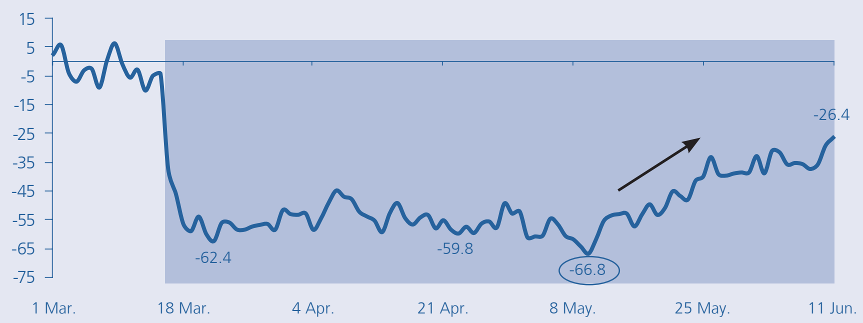
In the first quarter of 2020, output in non-primary manufacturing recorded a 12.3 percent drop due to the lockdown of many branches as of March 16, when quarantine was decreed, which affected especially the production of investment-oriented goods and export-oriented goods. In

2020, the subsector is expected to register a 23.8 percent drop, with a gradual rebound of consumer goods and inputs in Phase 1 of economic reopening, as well as a rebound in the production of other goods in the other phases. In 2021, non-primary manufacturing would continue to show a rebound (16.9 percent), but without reaching the pre-pandemic levels.

Manufacturing companies' daily electricity consumption reflect how consumption decreased dramatically when quarantine was decreed and how activity begins to recover when each reactivation phase starts. A sustained rebound is observed in manufacturing companies' consumption of electricity since the second half of May after it recorded a drop floor in the first third of the month.

The branches that were authorized to resume activities in Phase 1 included the branches of textiles, processed wood, paper and cardboard, basic chemical substances, plastics, pesticides, glass, cement, construction materials, metal products, machinery and equipment, and some industrial services, while the branches allowed to restart operation in Phase 2 are the oned manufacturign processed animal feed, beer and alcoholic beverages, footwear, prints, and repair of transport material and other equipment.

Graph 36
MANUFACTURING COMPANIES' DAILY ELECTRICITY CONSUMPTION
(% change respect to same comparable day of the previous year)



	1-15 Mar.*	16-31 Mar.*	1-30 Apr.	1-31 May.	1-11 Jun.
% change	-2.5	-55.3	-54.2	-51.4	-33.6

* Calculated respect to the comparable days of the previous year.

g) The GDP of the **construction sector** grew 1.5 percent in 2019, driven by greater private construction projects associated with greater investment in real estate and in shopping centers.

In the first quarter of 2020, construction decreased 13.0 percent due to the fall this sector recorded in March (-46 percent) as a result of the suspension of activities due to the quarantine decreed because of the COVID-19 pandemic. The sector was paralyzed in April and around 25 percent of activities were authorized to restart in May, so construction is expected to register the greatest fall of the year in the second quarter of the year. A gradual reinsertion of activities is expected for the next few months, with which the construction sector would show a decrease of 25.4 percent in **2020**.

In **2021**, the construction sector is estimated to continue recovering and to grow 23.2 percent, driven by greater public and private investment, although it would not reach pre-quarantine levels yet.

h) In 2019, activity in the **trade sector** grew 3.0 percent mainly as a result of both higher wholesale and retail sales, which grew 3.4 and 2.9 percent, respectively.

In the first quarter of 2020, the sector decreased 6.2 percent, this being explained by lower activity in the month of March due to the suspension of most activities, except for the trade of food, pharmacy, and toilet and cleaning products.

In **2020**, trade would drop 23.6 percent due to lower domestic demand, but in 2021, the sector is expected to grow 17.4 percent, in line with a gradual rebound in domestic demand.

i) The sector of **services** grew 3.8 percent in 2019 due to the increased activity in telecommunication services (5.6 percent), financial and insurance services (4.4 percent), and hotel and restaurant services (4.7 percent)).

During the first quarter of **2020,** the sector decreased 0.5 percent due to the decline of activity in the subsectors of accommodation and restaurants (-10.6 percent), transportation (-5.4 percent), and services provided to companies (-1.6 percent) associated with the confinement period.

In 2020, because most of the sector's activities require a high degree of personal interaction, growth in this sector would be constrained and it would show a drop of 9.9 percent in the year. In 2021, on the other hand, it is expected to show a recovery with a rate of 10.1 percent.

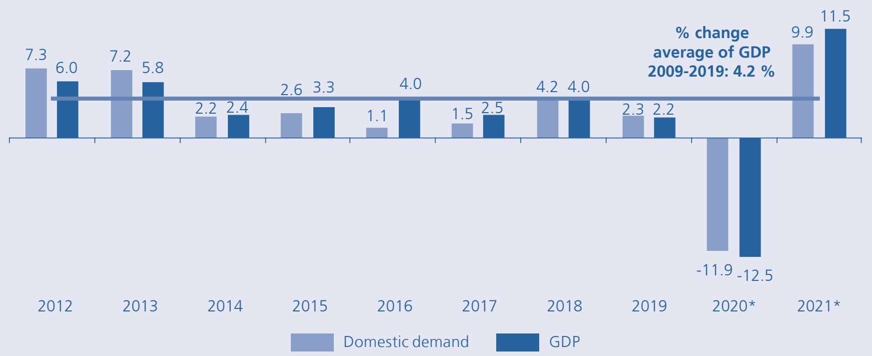
Expenditure-side GDP

37. On the side of demand, economic activity showed a contraction in private spending in the first quarter of 2020, explained by a drop of 16.9 percent

in investment and a 1.7 percent drop in consumption. On the one hand, the suspension of activities halted the execution of several investment projects, such as Quellaveco, the new Talara refinery, and the construction of housing complexes and shopping centers. On the other hand, the interruption of activities affected employment and household incomes, as well as their consumption decisions. On the external front, exports showed a negative performance (-11.1 percent) due to a slowdown in global demand and the constraints imposed to local mining, textile, and metal-mechanic production.

Given that households remained under confinement during the entire second quarter while companies had a limited level of operations, domestic demand is expected to register a greater drop in this period than that observed in the first quarter. If confinement measures are relaxed with adequate sanitary controls and fiscal and monetary measures are effective to sustain payment chains and stimulate demand, a reversal of this trend would be seen in the third quarter, supported by the gradual normalization of private expenditure and exports.

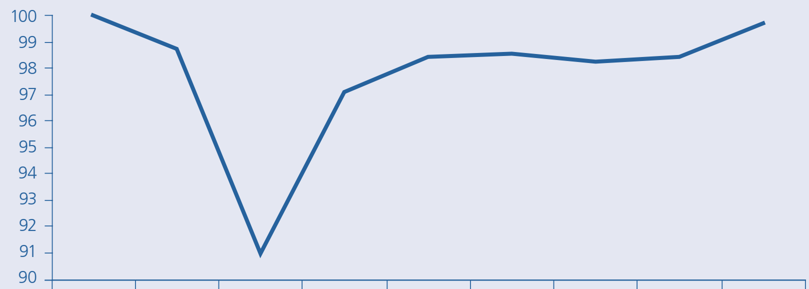
Graph 37
DOMESTIC DEMAND AND GDP: 2012-2021
(Real % change)



* Forecast.

The unique, unusual and unpredictable nature of the pandemic accounts for the correction in the GDP growth forecast for **2020** from a rate of 3.8 percent (estimated in the previous Report) to an expected GDP drop of 12.5 percent in this Report, the lowest drop observed since 1880. In 2021, supported by the positive effect of the stimulus measures on private spending, the recovery of confidence, and better conditions of the labor market and global demand, GDP is expected to grow 11.5 percent.

Graph 38
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 unseasonally adjusted index.

Table 19
DOMESTIC DEMAND AND GDP
(Real % change)

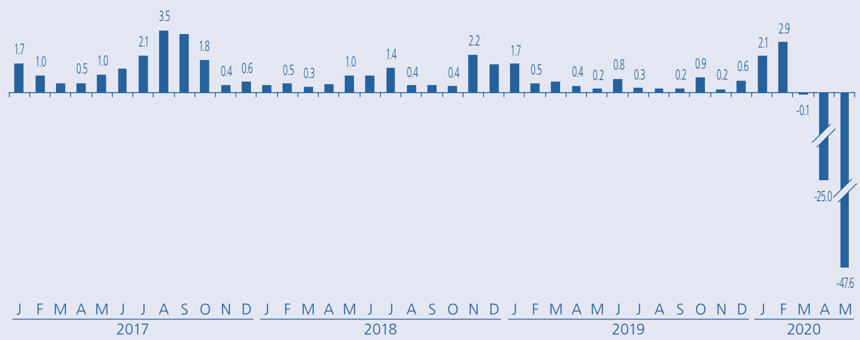
	2019	2020*			2021*	
		Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
Domestic demand	**2.3**	**-2.0**	**3.7**	**-11.9**	**3.8**	**9.9**
Private consumption	3.0	-1.7	3.5	-9.4	3.7	9.0
Public consumption	2.1	6.0	2.5	4.3	2.5	2.5
Private investment	4.0	-16.9	3.8	-30.0	4.0	20.0
Public investment	-1.4	15.8	6.0	-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.

38. **Private consumption** indicators showed a deterioration in the months of the Emergency period. The labor market remains affected by the lockdown of non-essential activities and job losses, which together with uncertainty about the future of the economy, has led to a contraction in consumer confidence. Other more recent indicators registered more frequently show an initial reversal in May, which would indicate that the most critical level of the crisis was observed in April.

    a) In the moving quarter of March through May, the employed population of Metropolitan Lima registered a drop of 47.6 percent, which is equivalent to a loss of 2.3 million jobs. This drop was observed mainly in the service sector and in companies with 1 to 10 workers.

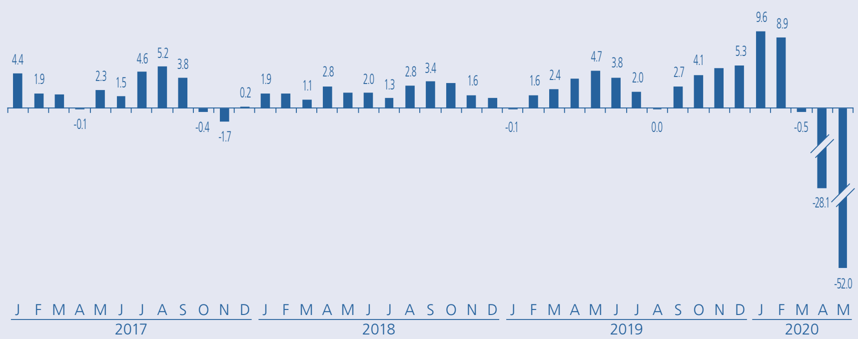
Graph 39
EMPLOYED POPULATION OF METROPOLITAN LIMA, MOVING QUARTER
(Annual % change)



Source: INEI.

b) The drop in employment and income led to a 52 percent contraction in the wage mass of Metropolitan Lima in the moving quarter of March through May.

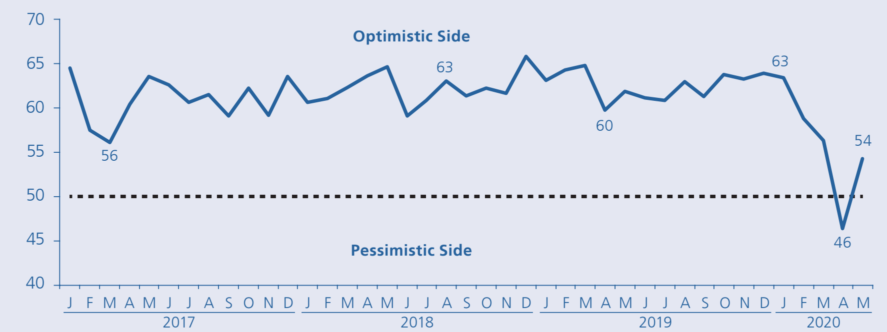
Graph 40
WAGE MASS OF METROPOLITAN LIMA, MOVING QUARTER
(Annual % change)



Source: INEI.

c) Consumer confidence, measured as agents' expectations about the future economic situation of their households in the next 12 months, moved to a pessimistic terrain in April, reflecting the deterioration in the labor market. However, the index reversed in May, fueled by optimism regarding the resumption of activities approved by the Government.

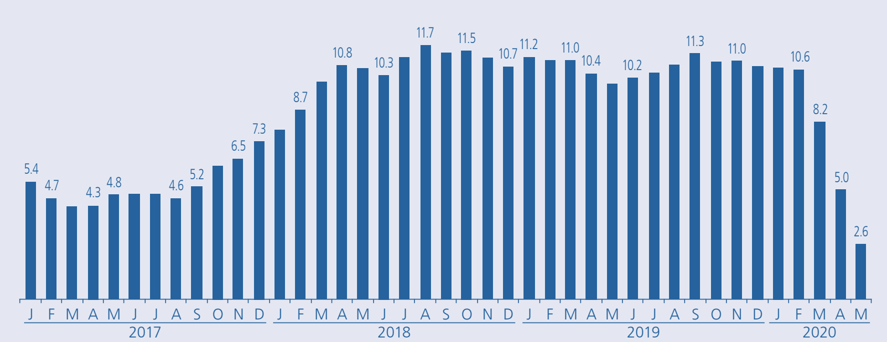
Graph 41
EXPECTATION ABOUT ECONOMIC SITUATION OF THE HOUSEHOLD IN 12 MONTHS, INDICCA METROPOLITAN LIMA
(Index)



Source: Apoyo.

d) Lower annual growth rates were observed in real consumer credit since March in comparison to the rates recorded in early 2020. This decline is moslty explained by the reduction in the rate of growth of car loans, in line with the restriction on sales of cars during quarantine, and the lower use of credit cards.

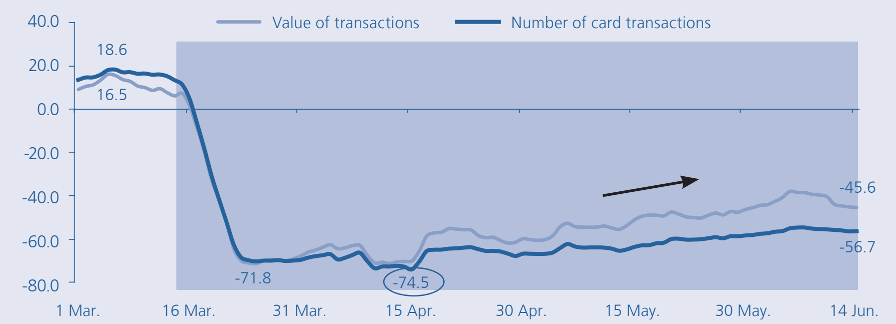
Graph 42
REAL CONSUMER LOANS
(Annual % change)



Source: BCRP.

e) Moreover, from March 16 to May 31, the value of card transactions showed a contraction of 59.1 percent, while the number of card transactions fell by 65.6 percent. The gradual reversal seen in this indicator is in line with the reopening of some activities at the end of May. Payments made with credit and debit cards had a drop floor in the first half of April, after which their fall has been moderating, first in puchases in supermarkets and pharmacies and more recently, in the first half of June, in purchases of household appliances, goods in department stores, and technology, among other products.

Graph 43
VALUE AND NUMBER OF CARD TRANSACTIONS 1/ 2/
(% change respect to same day of the previous year, moving average 7 days)

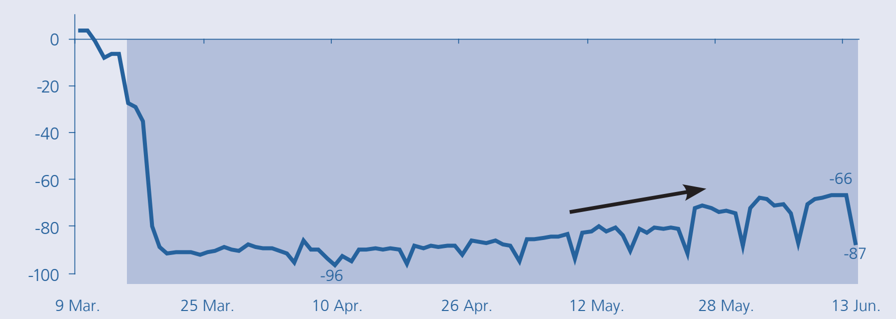


	% change respect to same day of the previous year						Moving average 7 days	
	1-15 Mar.	**16-31 Mar.**	**1-30 Apr.**	**1-31 May.**	**1-14 jun.**	**16 mar.-14 jun.**	**13 jun.**	**14 jun.**
Value	10.7	-67.4	-62.1	-51.8	-42.2	-56.5	-45.3	-45.6
Number	14.8	-66.9	-67.8	-62.8	-55.8	-64.1	-56.8	-56.7

1/ Comprise payments with credit and debit cards.
2/ % change respect to the comparable days of the previous year.
Source: BCRP.

f) The intensity of traffic congestion in the country decreased to levels of around 90 percent between the beginning of the quarantine and the end of April, compared to the first week of March. However, there has been a gradual increase in traffic from May, which continues in June and is only interrupted on Sundays, when confinement is still mandatory.

Graph 44
INTENSITY OF TRAFFIC CONGESTION
(Daily % change respect to the week 2-8 March)

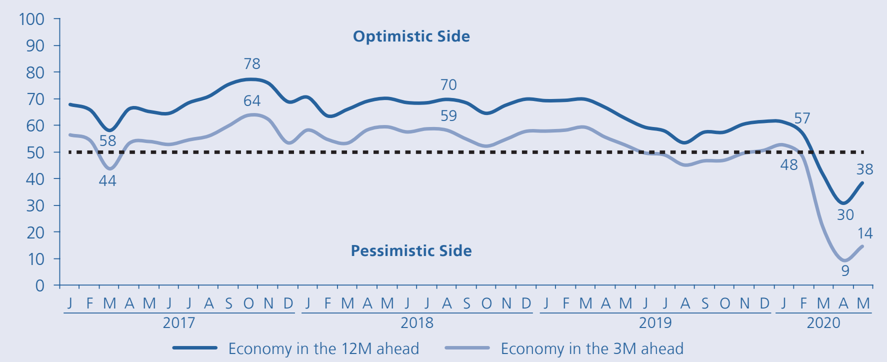


Source: BID.

39. Some indicators on **private investment** have reached historic lows, which suggests prospects for a significant contraction of this variable in the short and medium terms. Data as of May show an initial reversal in employers' expectations after they reached their most critical level in April.

a) Business confidence, measured as entrepreneurs' expectations about the future of the economy, reached its lowest level in April since it was first measured in the BCRP Survey of Macroeconomic Expectations (April 2004). In May, expectations about the future of the economy in 3 months and 1-year ahead showed an increase with respect to the previous data, specifically in the manufacturing and services companies surveyed, although the overall index still remains in the pessimistic terrain at historically low levels.

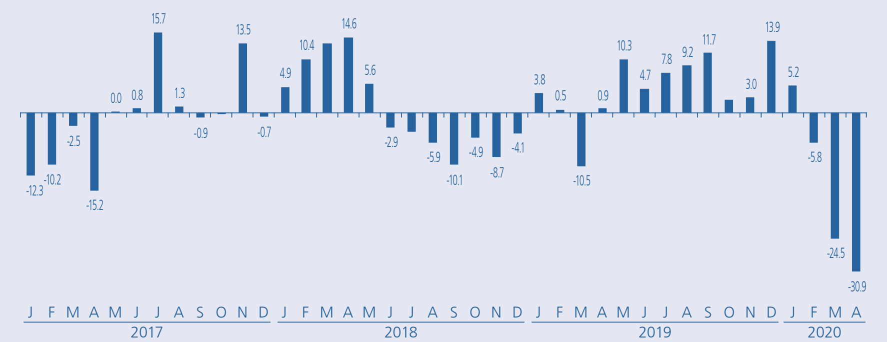
Graph 45
EXPECTATIONS ABOUT THE ECONOMY IN 3 AND 12 MONTHS AHEAD
(Index)



Source: BCRP.

b) As a result of the economy's lockdown and uncertainty about the future of the economy, imports of capital goods ,excluding construction materials and mobile phones, contracted by 30.9 percent in annual terms in April 2020.

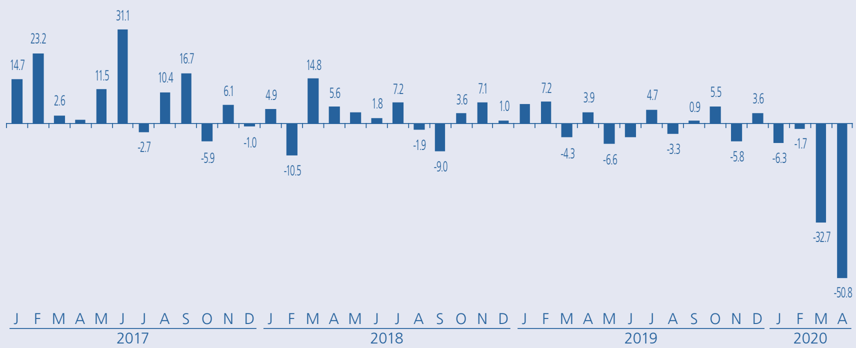
Graph 46
VOLUME OF IMPORTS OF CAPITAL GOODS*
(12 month % change)



* Excluding materials of construction and mobile phones.
Source: SUNAT.

40. In April, the volume of total exports dropped 50.8 percent, in line with the drop in global demand, the lockdown in non-essential sectors, and the logistical difficulties related to the pandemic. This reduction was observed in exports of both traditional goods (-52.6 percent) and non-traditional goods (-46.8 percent).

Graph 47
VOLUME OF TOTAL EXPORTS
(12 month % change)



Source: SUNAT.

41. There is a greater variance in the growth projection in this Report due to uncertainty about the impact of COVID-19, especially because the pandemic's expansion has not concluded yet. According to the latest **BCRP Survey of Macroeconomic Expectations**, the different economic agents estimate that GDP will drop between 1.8 and 9.5 percent in 2020 and that it will show a recovery of between 3.0 and 6.0 percent in 2021.

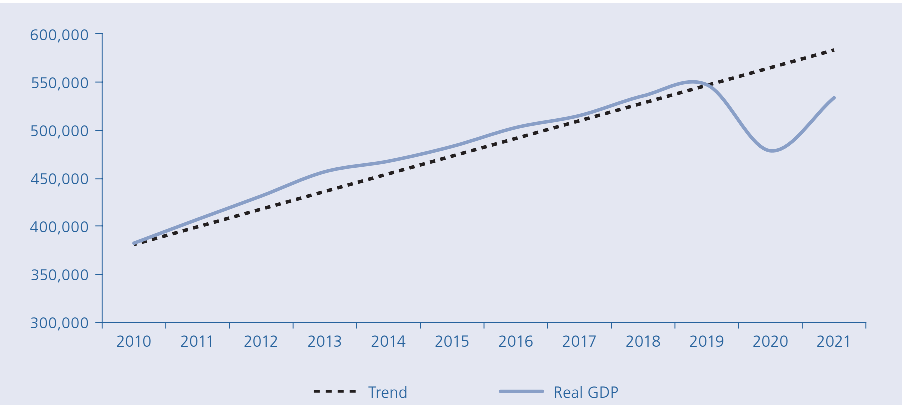
Table 20
MACROECONOMIC EXPECTATIONS SURVEY: GDP GROWTH
(% change)

	IR Sep.19	IR Dec.19	IR Jun.20*
Financial entities			
2020	3.3	3.0	-9.5
2021	----	3.3	5.3
Economic analysts			
2020	3.3	3.0	-9.0
2021	----	3.5	6.0
Non-financial firms			
2020	3.5	3.2	-1.8
2021	----	3.5	3.0

* Survey conducted on May 29.
Source: BCRP.

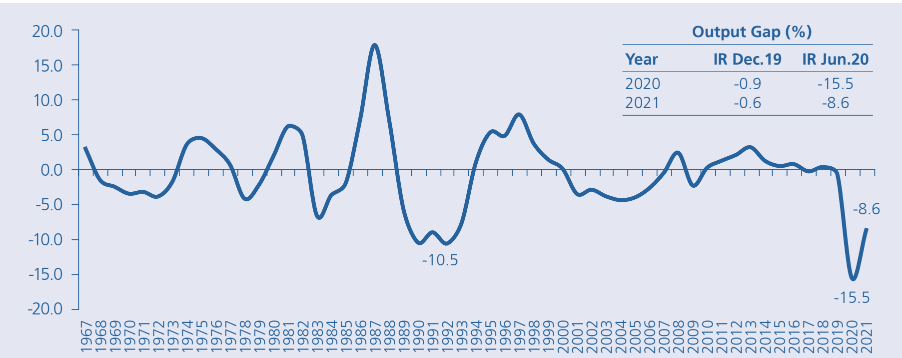
42. The aggregate supply and demand shocks have been generating an unprecedented contraction in the output gap –the difference between GDP and its long-term trend–, which has reached 15.5 percent in 2020, its worst historical record. The supply shocks (the reduction in the labor supply and logistical constraints) will be less persistent than the demand shocks (unemployment, falling income, and consumers and investors' pessimism).

Graph 48
REAL GDP AND TREND*
(Soles of 2007)



* Long-term trend of GDP is calculated using Hodrick-Prescot filter in annual frecuency.

Graph 49
OUTPUT GAP*
(% Potential GDP)



Output Gap (%)

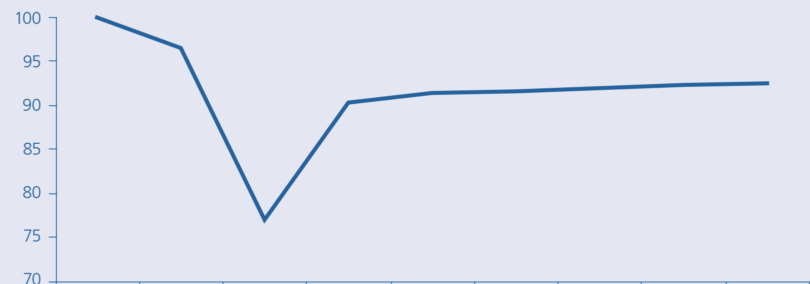
Year	IR Dec.19	IR Jun.20
2020	-0.9	-15.5
2021	-0.6	-8.6

* Long-term trend of GDP is calculated using Hodrick-Prescot filter in annual frecuency.

43. In 2020, **private consumption** would decrease 9.4 percent due to the effect of quarantine because it significantly reduced access to goods with a significant weight in household consumption (travel restrictions, less consumption of meals outside the home, or clothing purchase). Additionally, the loss of employment and income also reduces the consumption possibilities of a significant percentage of households, especially of those that only generate income through informal employment.

In 2021, private consumption is projected to grow 9.0 percent in a context of recovery of employment and income, and less social distancing measures. It should be pointed that, despite the end of social distancing measures, households are likely to maintain or increase their consumption of goods within the home because it is cheaper and safer to stay at home, or because of their fragile economic situation. Therefore, it is estimated that In this context, the levels prior to the health crisis would not be reached in 2021.

Graph 50
PRIVATE CONSUMPTION, 2019-2021
Seasonally adjusted index, Q4.19 = 100



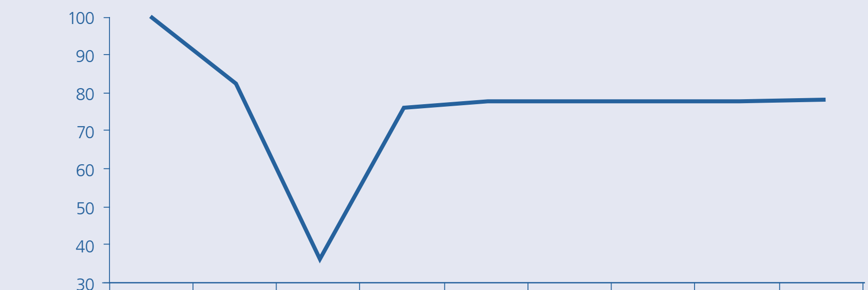
	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21
Index	100	97	77	90	92	92	92	92	93
Annual % chg. 1/	3.0	-1.7	-21.5	-9.0	-5.0	-1.0	26.0	9.0	4.5

1/ % change unseasonally adjusted index.

44. In 2020, private investment is expected to drop 30 percent due to lower economic expectations, which is mainly reflected in lower investment in the construction sector. It is worth pointing out that this drop is recorded mainly in the second quarter of the year due to the confinement measures decreed by the government.

This projection considers a significant positive effect of the fiscal, monetary, and regulatory measures aimed at sustaining the payments system and at injecting liquidity. Under these assumptions, a recovery of 20 percent is expected in private investment in 2021, although it would not yet reach the levels of 2019. This growth in 2021 will take place in the context of general elections, which could increase uncertainty about the economy in the first half of the year.

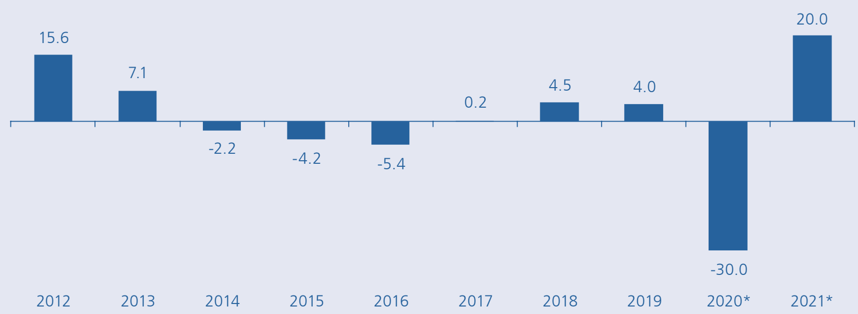
Graph 51
PRIVATE INVESTMENT, 2019-2021
Seasonally adjusted index, Q4.19 = 100



	Q4.19	Q1.20	Q2.20	Q3.20	Q4.20	Q1.21	Q2.21	Q3.21	Q4.21
Index	100	82	36	76	78	78	78	78	78
Annual % chg. 1/	0.9	-16.9	-64.2	-24.3	-14.8	0.0	128.4	10.0	2.9

1/ % change unseasonally adjusted index.

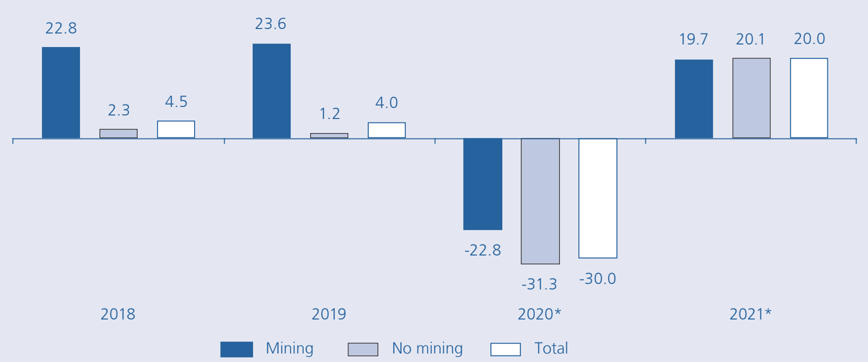
Graph 52
PRIVATE INVESTMENT: 2012 - 2021*
(Real % change)



* Forecast.

a. As regards investment in the **mining sector**, the forecast considers that activities in the mining sector would restart in phase 1 and lead to the resumption of investments in projects such as Quellaveco (US$ 5.3 billion of total investment), Mina Justa (US$ 1.6 billion), and the expansion of Toromocho (US$ 1.3 billion), which would boost mining activity in the coming years. In addition, projects such as Corani (US$ 0.6 billion of investment), Integración Coroccohuayco (US$ 0.6 billion), and San Gabriel (US$ 0.4 billion) are expected to begin their construction stage in the forecast horizon.

Graph 53
PRIVATE INVESTMENT
(Real % change)



* Forecast.

b. Investment in **infrastructure** is expected to continue in different projects with the gradual restart of activities in the construction sector, with investment in Line 2 of the Lima Metro standing out. According to OSITRAN, as of April this projects shows an implementation level of 31.3 percent. In addition, the Ministry of Transport and Communications approved the plan to resume works for the expansion of Jorge Chávez International Airport, and the addendum increasing the amount of the investment for the expansion of the South Dock of Callao to US$ 300 million was approved in February. Moreover, the construction of the San Martín Port Terminal is scheduled to finish in 2020, while the modernization of the North Dock of Callao is expected to continue and to culminate in 2022 with a capacity of 2.9 million containers and 9.9 million tons of annual cargo. Finally, the modernization works of the Port of Salaverry, a project involving an investment of US$ 270 million, started at the beginning of 2020.

Table 21
MAIN ANNOUNCEMENTS OF PRIVATE INVESTMENT PROJECTS: 2020-2021

SECTOR	INVESTOR	PROJECTS
MINING	Angloamerican Marcobre Chinalco Antapaccay Bear Creek	Quellaveco Justa Mine Expansion of Toromocho Mine Coroccohuayco Corani
INDUSTRY	Corporación Aceros Arequipa Precor	Expansion of Pisco Plant Mega factory in Chilca
INFRASTRUCTURE	Consorcio Nuevo Metro de Lima Lima Airport Partners Consorcio Transportadora Salaverry Grupo Volcan Consorcio Paracas APM Terminals DP World Covi Perú	Line 2 of the Metro network of Lima and Callao Expansion of International Airport (Jorge Chavez) Salaverry Port Chancay Port Terminal San Martin Port Terminal Modernization of Muelle Norte Expansion of Muelle Sur Pucusana-Ica road network

Source: Information on companies, newspaper and specialized media.

Moreover**, Proinversión** reports an investment portfolio of US$ 8.7 billion for the period 2020-2021.

Table 22
MAIN PROJECTS TO BE IMPLEMENTED THROUGH CONCESSION ARRANGEMENTS IN 2020-2021
(Million US$)

	Estimated investment
To be called	**8,718**
Peripheral Ring Road	2,000
Headworks and Conduction for the Drinking Water Supply in Lima	720
New San Juan de Marcona Port Terminal	540
Ancon Industrial Park	500
South highway: Ica desvio Quilca	472
Longitudinal of the Sierra road project, Section 4	464
Algarrobo Mining Project	350
Broadband AWS-3 and 2.3 GHz	291
Access to the airport and port in Pisco	282
Hipolito Unanue National Hospital	250
Schools in risk: Metropolitan Lima	227
North Lima desalination plant	227
Huancayo - Huancavelica Railway	227
South Lima desalination plant	202
Wide-Scale Use of Natural Gas in Central ad South Region	200
500 kV Transmission Line and Piura Nueva - Frontera Substation	164
Essalud Piura	148
Essalud Chimbote	144
Wastewater Treatment for effluent dumping or reuse, Trujillo	130
Huaycan Hospital	120
Treatment system for wastewater Huancayo	110
Modernization of regional electriciy company Electronoroeste	104
Other projects	846

Source: Proinversión.

45. There are important mining projects, which involve a total investment of US$ 24.83 billion, are halted due to social conflicts and red tape[1]. The implementation of these projects would generate 50 thousand jobs during the construction stage and 80 thousand direct and indirect jobs in the operation stage[2].

These projects would increase copper production by 1,690 thousand fine metric tons per year, with which exports could grow by US$ 9.4 billion per year[3] and contribute to the growth of GDP and employment in the following years.

Table 23

Project	Location	Amount of investment * (Mill. US$)
La Granja	Cajamarca	5,000
Conga	Cajamarca	4,800
El Galeno	Cajamarca	3,500
Los Chancas	Apurímac	2,800
Río Blanco	Piura	2,500
Haquira	Apurímac	1,860
Cotabambas	Apurímac	1,533
Cañariaco	Lambayeque	1,437
Tía María	Arequipa	1,400

* Projected.

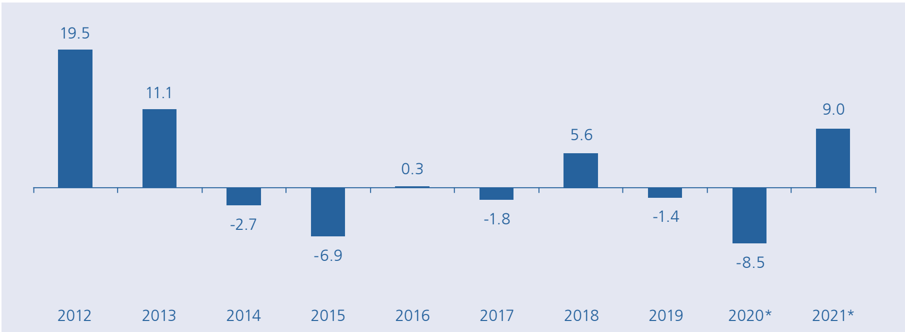
46. It is also estimated that the currently suspended projects of Chavimochic III, Olmos II Stage, and Majes Siguas II, associated with agro-exports, could expand exports by around US$ 5.1 billion per year, assuming a level of utilization of 75 percent of the new hectares that would benefit from these projects (102 of 136.5 thousand hectares), considering crops such as grapes, avocados, and blueberries, as well as the 2019 average prices.

47. The growth forecast for **public investment** is revised down from 6.0 to -8.5 percent for 2020, while an increase of 9.0 percent is projected for 2021. The downward revision in 2020 is explained by the interruption of activities since mid-March, which includes the construction sector. A significant rebound in public investment is expected in the second half of the year, but like in the other components of aggregate spending, the contraction caused by the confinement period would determine a negative figure for the year. The higher level of investment in 2021 would be explained by the continuation of projects such as Line 2 of the Lima Metro and the projects linked to the Reconstruction With

1 See Box 7 in the Inflation Report of December 2018: "Opinion Survey on Mining Projects", BCRP.
2 http://proyecta.minem.gob.pe/
3 Average price projected for 2021.

Changes program, as well as by the execution of local and regional investment projects carried out by sub-national governments.

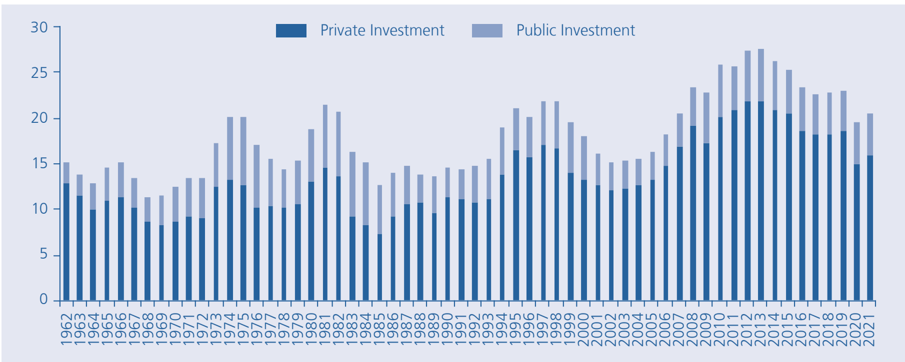
Graph 54
PUBLIC INVESTMENT: 2012-2021
(Real % change)



* Forecast.

48. **Fixed gross investment**, as a percentage of real GDP, would decrease by 2.5 percentage points of GDP in 2021 –compared to the 2019 level– to similar levels to those observed in 2007. The growth of investment is expected to continue recovering in the following years, once the economy recovers pre-crisis levels.

Graph 55
GROSS FIXED INVESTMENT: PRIVATE AND PUBLIC SECTORS, 1962-2021
(% Real GDP)



49. Incorporating the current forecast, external savings would decrease by 0.1 percentage point in 2020, as the reduction in private investment, discouraged

by the stoppage of activities and uncertainty regarding the pandemic, would outweigh the decrease in domestic savings. External savings in 2021 would remain at 1.4 percent of nominal GDP since the increase in private investment would be offset by higher public savings.

Table 24
SAVING-INVESTMENT GAP
(% of nominal GDP)

	2019	2020*			2021*	
		Q1	IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
1. Domestic Saving	19.9	17.9	19.7	16.5	19.8	17.6
1.1 Public Saving	3.0	2.1	3.0	-4.9	3.1	0.5
1.2 Private Saving	16.9	15.8	16.7	21.3	16.7	17.1
2. External Saving	1.5	2.2	1.6	1.4	1.6	1.4
3. Domestic Gross Investment 1/	21.4	20.1	21.3	17.8	21.5	19.0
3.1 Private Domestic Gross Investment 1/	16.8	16.9	16.5	13.0	16.7	14.3
3.2 Public investment	4.6	3.2	4.7	4.8	4.7	4.7

*Forecast.
1/ Includes change on inventories.
Source: BCR.

Box 2
ECONOMIC LOCKDOWN AND REOPENING

Economic lockdown in Peru and Latin America

The coronavirus outbreak has forced Latin American countries to take measures to prevent the spread of the virus among the population. According to the Stringency Index of government responses, prepared by the University of Oxford[4], Peru adopted some of the most severe measures in the world from March to the end of May to tackle the pandemic.

GOVERNMENT MEASURES SEVERITY INDEX AGAINST COVID-19 UPDATED ON JUNE 8, 2020
Monthly averages (index 0 to 100; 100 = more severe)

	Argentina	Brazil	Chile	Colombia	Ecuador	Mexico	Peru
January	3.2	0.5	0.0	3.0	1.1	0.0	0.0
February	11.1	5.6	0.0	9.1	5.6	0.2	0.0
March	51.7	44.0	32.7	43.6	54.1	19.9	58.5
April	98.0	75.0	73.2	87.0	93.5	82.4	94.4
May	88.9	80.5	76.6	87.6	86.8	82.4	93.2
May 31	90.7	81.0	78.2	87.0	86.1	82.4	89.8

Source: Blavatnik School of Government, University of Oxford.
Elaboration: BCRP.

In our country, the government decreed the beginning of the quarantine on March 16 and then extended it on several occasions until June 30. This measure aimed at preserving public health has had a negative impact on economic activity because it has implied a total or partial lockdown of most production sectors.

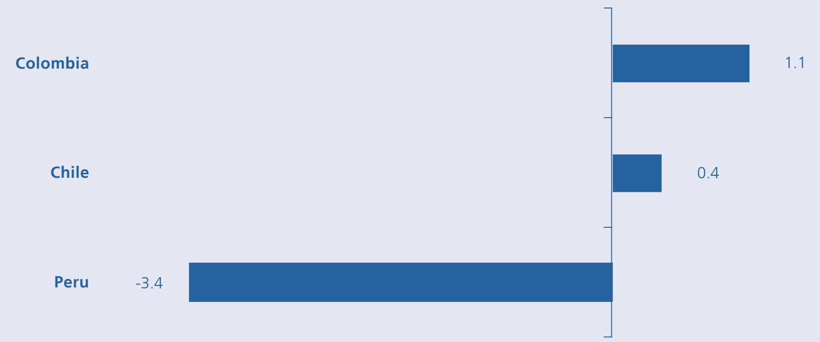
During the first weeks of confinement, a lockdown was established in all of the non-essential activities, including most non-primary activities and, to a lesser extent, primary activities. The activities related to food production and marketing (i.e. agriculture, fishing, manufacturing, and commerce) and those oriented to health services were the least affected due to their essential nature.

4 Composite index based on nine indicators with values from 0 to 100 (100 = stringest response). The nine indicators are closing of schools, closing of workplaces, cancelling public events, restrictions on gatherings, closing of public transport, "stay at home" requirements, restrictions on internal movement between cities/regions, international travel controls, and information campaigns.

Mining and related activities were excepted from the lockdown during the national emergency period so that critical activities, such as the treatment of tailings for environmental protection, could be carried out.

The contraction of Peru's GDP by 3.4 percent in the first quarter of the year contrasts with the results of neighboring countries. In Chile, the output grew 0.4 percent, driven by production in the mining and construction sectors, and on net exports on the side of spending, while in Colombia, the 1.1 percent growth rate is associated with the sectors of services and agriculture, as well as with an expansion of private consumption.

GDP: I QUARTER 2020
(Annual % change)



Operation of economic sectors in Latin America

During the first month of quarantine, the six countries allowed the continuity of essential economic activities such as food production (agricultural, livestock, fishing, and the manufacturing of their products); the provision of basic health services and electricity and water services; and also telecommunications, financial services, and government services.

As for the rest of activities, Chile was the country that imposed the least restrictions since only restaurant services and shows were cancelled. On the other hand, mining activities continued, along with the partial operation of the manufacturing and construction sectors. Colombia and Argentina are part of a second group with greater restrictions than Chile, particularly in the manufacturing branches, whereas Peru stands at the other end, with the most stringent measures.

After the first month of quarantine, Latin American countries started to adopt measures to gradually restart economic activity.

STOPPING ACTIVITIES DURING THE FIRST MONTH OF QUARANTINE

	Activities	Argentina	Chile	Colombia	Mexico	Peru
1	Agricultural crops (agriculture)	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
2	Animal husbandry (livestock)	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
3	Fishing and aquaculture	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
4	Extraction of crude oil and natural gas (hydrocarbons)	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
5	Extraction of metallic minerals (mining)	Not paralyzed	Not paralyzed	Not paralyzed	Paralyzed	Partially paralyzed
6	Processing and preserving meats	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
7	Manufacture of fishmeal and fish oil	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
8	Processing and preserving of fruits and vegetables	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
9	Manufacture of dairy products	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
10	Mill, noodles and other pasta	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
11	Bakery and pastry	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
12	Winemaking, other alcoholic beverages and tobacco	Paralyzed	Not paralyzed	Not paralyzed	Paralyzed	Paralyzed
13	Manufacture of clothing	Paralyzed	Partially paralyzed	Paralyzed	Not paralyzed	Paralyzed
14	Petroleum refining	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
15	Manufacture of plastic products	Paralyzed	Not paralyzed	Paralyzed	Paralyzed	Partially paralyzed
16	Manufacture of other non-metallic mineral products (cement and other construction materials)	Paralyzed	Partially paralyzed	Not paralyzed	Not paralyzed	Paralyzed
17	Basic iron and steel industry (steel industry)	Not paralyzed	Partially paralyzed	Paralyzed	Paralyzed	Paralyzed
18	Precious metals and non-ferrous metals industry (metal refining)	Paralyzed	Not paralyzed	Paralyzed	Paralyzed	Partially paralyzed
19	Manufacture of metal products for structural use	Paralyzed	Partially paralyzed	Paralyzed	Paralyzed	Paralyzed
20	Manufacture of electrical machinery and equipment	Not paralyzed	Partially paralyzed	Paralyzed	Partially paralyzed	Paralyzed
21	Other manufacturing industries	Partially paralyzed	Partially paralyzed	Paralyzed	Partially paralyzed	Paralyzed
22	Electricity and gas	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
23	Building	Partially paralyzed	Partially paralyzed	Partially paralyzed	Paralyzed	Paralyzed
24	Commerce	Partially paralyzed	Partially paralyzed	Partially paralyzed	Partially paralyzed	Partially paralyzed
25	Ground transportation	Partially paralyzed	Partially paralyzed	Partially paralyzed	Not paralyzed	Partially paralyzed
26	Air Transport	Paralyzed	Partially paralyzed	Partially paralyzed	Not paralyzed	Paralyzed
27	Complementary transport services	Paralyzed	Partially paralyzed	Partially paralyzed	Not paralyzed	Paralyzed
28	Restaurants	Partially paralyzed	Paralyzed	Partially paralyzed	Paralyzed	Paralyzed
29	Telecommunication	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
30	Financial services	Partially paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
31	Insurance	Not paralyzed	Not paralyzed	Not paralyzed	Paralyzed	Not paralyzed
32	services professionals, scientists and technicals	Not paralyzed	Not paralyzed	Partially paralyzed	Paralyzed	Paralyzed
33	Advertising and market research services	Not paralyzed	Not paralyzed	Partially paralyzed	Paralyzed	Paralyzed
34	Public administration and defense	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
35	Education (not face-to-face)	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
36	Private health	Not paralyzed	Not paralyzed	Not paralyzed	Paralyzed	Not paralyzed
37	Public health	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed	Not paralyzed
38	Shows and Recreation	Not paralyzed	Paralyzed	Paralyzed	Paralyzed	Paralyzed

Paralyzed   Partially paralyzed   Not paralyzed

* Unofficial information.
Source: Central Bank Survey.

Prior to the start of the pandemic, GDP was projected to grow 3.8 percent in 2020, but the health crisis is estimated to cause a loss of 15.6 percentage points in GDP compared to the pre-pandemic scenario, with a drop of 12.5 percent in the year. The greatest impact would be seen in the second quarter of the year, in line with strict virus containment measures, with which the output is estimated to register a loss of 34.5 percentage points and a contraction of 31.9 percent compared to the same quarter of the previous year.

GROSS DOMESTIC PRODUCT

	Q1.20	Q2.20	Q3.20	Q4.20	Year
Pre-pandemic projection (% change)	3.5	4.0	3.8	3.8	3.8
IR June (% change)	-3.4	-31.9	-8.8	-5.7	-12.5
Impact of the health crisis: (percentage points) 1/	6.6	34.5	12.0	8.8	15.6

1/ The impact was calculated as the difference between the pre-pandemic scenario and the June RI.

IV. Public Finances

50. **Confinement measures led the Government to use the wide fiscal space generated in the commodity boom period**. The fiscal measures implemented in the quarantine period were aimed at generating a health response to the spread of the virus and to mitigate the effects of confinement measures on households and businesses:

    i. Health prevention and business continuity measures (S/ 4.1 billion) to strengthen the health system, promote social distancing (through the use of teleeducation and management of areas of potential contagion such as markets), and control measures to preserve public order.

       Actions standing out in these areas included the purchase of supplies and expenditure in the health system personnel by MINSA, the regions, and Essalud (S/ 1.42 billion); the purchase of tests to detect COVID-19 (S/ 224 million); expenditure allocated to improve hygiene levels in public schools, prisons, markets and urban transport, and personal protection equipment (S/ 511 million); expenditure for teleeducation (S/ 681 million), and expenditure for the police and armed forces to supervise compliance with the obligatory social distancing measures (S/ 396 million).

    ii. Provide liquidity to businesses in a situation in which their sales were affected by confinement measures.

       Other measures standing out within this group of actions included the postponement of tax payments for a total of S/ 7.40 billion. This postponement was extended to include companies with annual sales of less than 5,000 tax units (or S/ 21.5 million) and also during the quarantine period. The payment on account of income tax was also reduced for companies that registered a drop in sales. These postponements would have no impact on the economic balance of 2020 since the taxes will be paid this year.

Additionally, it was established that the payment of tax debts could be fractioned until August with a grace period of 6 months and for a period of 3 years at a monthly interest rate of 0.4 percent.

Moreover, subsidies were granted to firms for their payroll and to microenterprise workers who were included in the mechanism of perfect suspension of work to avoid mass layoffs during the period of lockdown. On the other hand, liquidity was granted to companies to replenish their working capital to restart operations through governement-backed loans granted through the Reactiva Peru program.

It was established that the depreciation rate of buildings and constructions will be 20 percent per year until their total depreciation (the general regime is 5 percent). This will be applicable to construction projects built or acquired from January 1, 2020 to December 31, 2022, provided that the progress of the construction work is at least 80 percent on that date, but does not apply to property built completely or in part before January 1, 2020. The depreciation rate of other assets has also been increased.

The maximum period for carrying forward the losses generated this year has been extended to 5 years (it is normally 4 years). Thus, companies will be able to compensate the loss generated in 2020 against the results of FY 2021 to 2025. It is worth mentioning that this measure applies only to companies that opted for the total compensation scheme for losses.

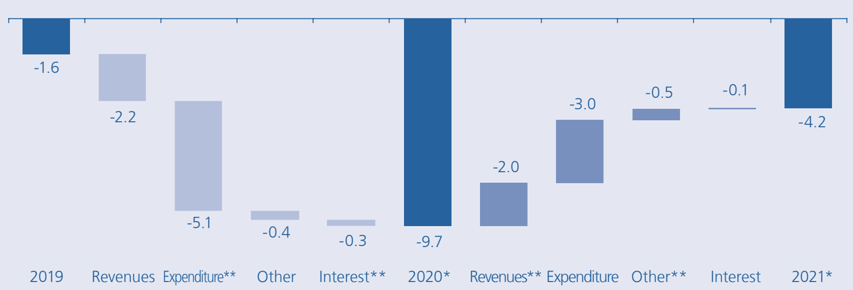
iii. Support was granted to households, with resources amounting to S/ 6.7 billion, of which S/ 6.1 billion were transfers in cash and in-kind transfers. In addition, the payment of taxes was postponed for natural persons, particularly the payment of the regularization of the income tax for FY 2019, which provided taxpayers with a temporary relief estimated at S/ 592 million.

iv. Additionally, in order to support household consumption, the government approved workers's use of regulated savings for an estimated amount of S/ 14.3 billion.

51. In this context, the projected **fiscal deficit** for 2020 has been revised up to 9.7 percent of GDP from a deficit of 1.6 percent of GDP the previous year. This deficit is the largest deficit since 1989, when it registered 11.3 percent of GDP. The main explanatory factor for this greater deficit is the increase in current expenditure (from 15.5 to 20.3 percent of GDP) due to the actions and activities implement to combat the pandemic. Other factors adding to this deficit include a significant deterioration in the current revenues of the General Government (from 19.7 to 17.5 percent of GDP), as well as the higher primary deficit of state-owned companies, lower capital income, and the higher debt interest payments.

In 2021, it is estimated that the fiscal deficit would fall to 4.2 percent of the output, reflecting lower current expenditure after this year's extraordinary expenditure to control the pandemic, as well as the recovery of revenues, in line with the expected recovery of economic activity and commodity prices.

Graph 56
EVOLUTION: ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR
(% GDP)



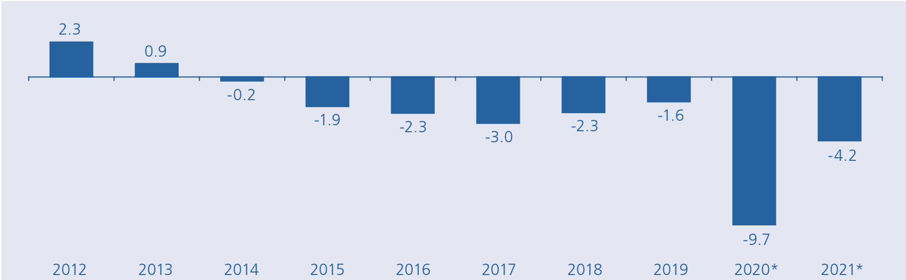
Note: The sum of the partials may not exactly match the totals due to rounding.
Other: Capital revenue of the general government and primary balance of stated-owned enterprises.
* Forecast.
** Negative sign means an increase.

Table 25
NON-FINANCIAL PUBLIC SECTOR
(% GDP)

	2019	2020*		2021*	
		IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
1. General government current revenues	**19.7**	**20.0**	**17.5**	**19.9**	**19.5**
2. General government non-financial expenditure	**20.1**	**20.3**	**25.2**	**20.3**	**22.3**
Of which:					
Current expenditure	*15.5*	*15.5*	*20.3*	*15.5*	*17.4*
Gross capital formation	*4.0*	*4.2*	*4.2*	*4.3*	*4.2*
3. Other	**0.1**	**-0.1**	**-0.3**	**0.2**	**0.2**
4. Primary balance (1-2+3)	**-0.2**	**-0.3**	**-8.0**	**-0.2**	**-2.5**
5. Interest	**1.4**	**1.4**	**1.7**	**1.5**	**1.6**
6. Overall Balance	**-1.6**	**-1.7**	**-9.7**	**-1.6**	**-4.2**
External financing	*0.6*	*0.8*	*3.2*	*0.2*	*0.7*
Domestic financing	*1.0*	*0.9*	*6.5*	*1.4*	*3.5*
Memo:					
% GDP					
Gross public debt balance	*26.8*	*27.3*	*33.9*	*27.3*	*33.1*
Net public debt balance	*13.0*	*13.7*	*23.6*	*14.6*	*25.3*
Public deposits balance	*13.8*	*13.6*	*10.3*	*12.7*	*7.8*

Memo: The sum of the partials may not exactly match the totals due to rounding.
* Forecast.
IR: Inflation Report.

Graph 57
ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2012 - 2021
(% GDP)



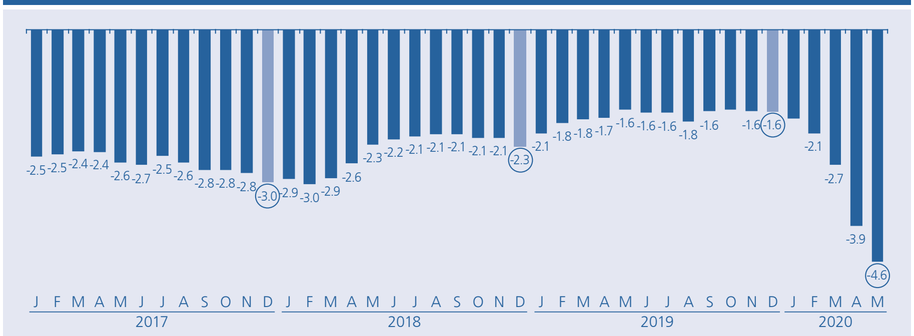
* Forecast.

Recent developments

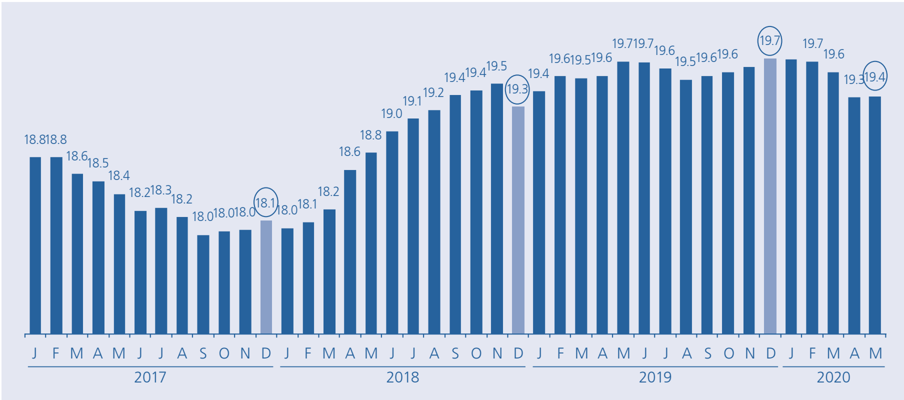
52. The current global crisis associated with the COVID-19 pandemic is significantly, albeit temporarily, affecting the public finances of the general government with lower current revenues and higher levels of expenditure. These results reflect the impact of the crisis on: (i) tax revenues, mainly on revenues from the income tax and VAT as a result of the measures to contain the virus as well as the tax deferral measures, and (ii) the level of fiscal stimulus that is being implemented to face the health crisis and to lessen and reverse the negative impacts on activity.

In this context, the **fiscal deficit** accumulated in the last twelve months as of May 2020 is 4.6 percent of GDP, 3.0 percentage points of GDP higher than the deficit accumulated in the last twelve months as of December 2019. This balance results mainly from the higher non-financial expenditure of the general government (1.9 percentage points of GDP), lower income (0.3 percentage points of GDP), and the higher primary deficit of state-owned companies (0.5 percentage points of GDP).

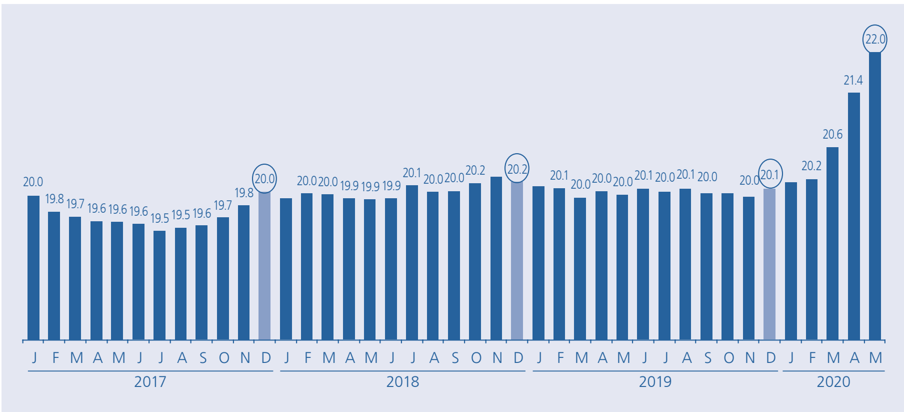
Graph 58
ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2017 - 2020
(Accumulated last 12 months - % GDP)



Graph 59
CURRENT REVENUES OF THE GENERAL GOVERNMENT: 2017 - 2020
(Accumulated last 12 months - % GDP)



Graph 60
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT: 2017 - 2020
(Accumulated last 12 months - % GDP)



Current Income

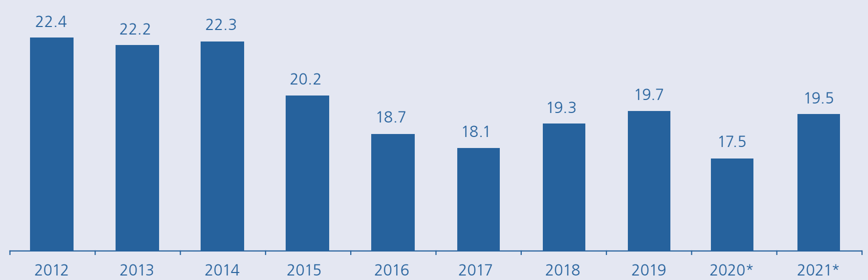
53. In 2020, **current revenues** would represent 17.5 percent of GDP, while in 2021 they would be 19.5 percent of GDP. Current revenues in 2020 would show a real decrease of 21.9 percent, mainly due to lower tax revenues, in line with the slowdown of economic activity. In 2021, the recovery in activity and the higher commodity prices projected for the this year would explain the recovery in current income. It is worth mentioning that the level of current income in 2020 would be the lowest since 1993, when GDP showed a level of 16.8 percent.

Table 26
CURRENT REVENUES OF THE GENERAL GOVERNMENT
(% GDP)

	2019	2020*		2021*	
		IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
TAX REVENUES	**14.8**	**15.1**	**13.1**	**15.1**	**15.0**
Income tax	5.7	5.9	5.1	5.7	5.4
Value Added Tax	8.2	8.4	7.2	8.6	8.1
Excise tax	1.1	1.1	1.0	1.0	1.0
Import duties	0.2	0.2	0.2	0.2	0.2
Other tax revenues	1.9	1.8	1.9	1.8	2.3
Tax returns	-2.3	-2.2	-2.2	-2.1	-2.1
NON-TAX REVENUES	**5.0**	**4.9**	**4.4**	**4.8**	**4.5**
Contributions to social security	2.2	2.2	1.8	2.3	2.2
Own resources and transfers	1.7	1.7	1.8	1.6	1.6
Royalties and likely	0.6	0.6	0.5	0.6	0.4
Other	0.5	0.4	0.3	0.4	0.3
TOTAL	**19.7**	**20.0**	**17.5**	**19.9**	**19.5**

Memo: The sum of the partials may not exactly match the totals due to rounding.
* Forecast.
IR: Inflation Report.

Graph 61
CURRENT REVENUES OF THE GENERAL GOVERNMENT: 2012 - 2021
(% GDP)



* Forecast.

Non-Financial Expenditure

54. The projection of non-financial expenditure for **2020** is increased to 25.2 percent of GDP, while this ratio in 2021 would be 22.3 percent of GDP, both levels reflecting the transitory increase anticipated in current expenditure due to the fiscal incentives adopted to face the COVID-19 pandemic.

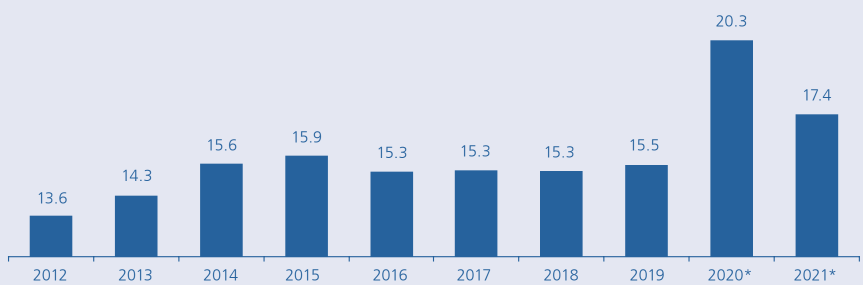
Expenditure projections consider that, due to the length of the confinement measures, a new bonus of S/ 760 is granted to low-income families (in the 4 programs already granted), which would imply an additional expenditure of S/ 4.7 billion. This will provide greater support to the recovery of aggregate demand and economic activity in the following months.

Table 27
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT
(% GDP)

	2019	2020*		2021*	
		IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
Current expenditure	**15.5**	**15.5**	**20.3**	**15.5**	**17.4**
National Government	10.5	10.6	14.2	10.6	11.7
Regional Governments	3.5	3.4	4.3	3.4	4.0
Local Governments	1.6	1.5	1.8	1.5	1.7
Capital expenditure	**4.6**	**4.7**	**4.9**	**4.8**	**4.8**
Gross capital formation	**4.0**	**4.2**	**4.2**	**4.3**	**4.2**
National Government	1.5	1.6	1.6	1.6	1.7
Regional Governments	0.8	0.8	0.9	0.8	0.9
Local Governments	1.6	1.7	1.7	1.8	1.7
Other	**0.6**	**0.6**	**0.8**	**0.6**	**0.6**
Total	**20.1**	**20.3**	**25.2**	**20.3**	**22.3**
National Government	12.6	12.7	16.5	12.7	14.0
Regional Governments	4.3	4.2	5.1	4.2	4.8
Local Governments	3.2	3.3	3.6	3.4	3.4

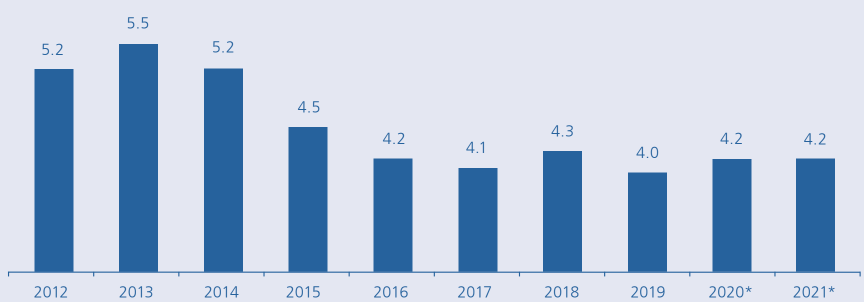
Memo: The sum of the partials may not exactly match the totals due to rounding.
* Forecast.
IR: Inflation Report.

Graph 62
CURRENT EXPENDITURE OF THE GENERAL GOVERNMENT: 2012 - 2021
(% GDP)



* Forecast.

Graph 63
GROSS CAPITAL FORMATION OF THE GENERAL GOVERNMENT: 2012 - 2021
(% GDP)

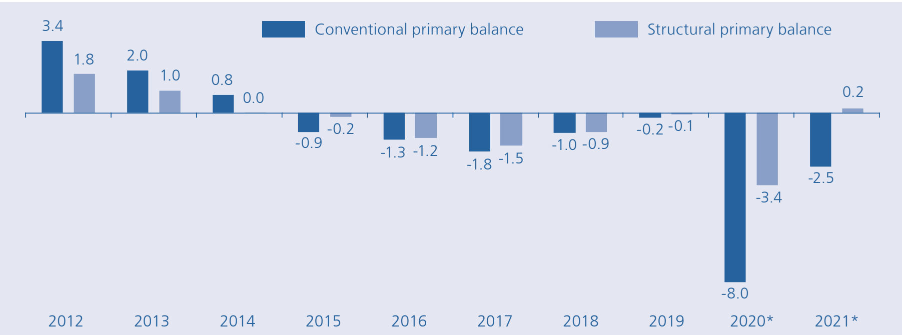


* Forecast.

55. The **primary structural balance** is an indicator that isolates the effects of factors outside the government's control, such as export prices or the stage of the business cycle, on fiscal aggregates, particularly on tax revenues. It is estimated that this indicator in 2019 was negative (- 0.1 percent), that it will be negative in 2020, and that it will be positive in 2021. Thus, in 2020, the primary structural balance would show a deficit of 3.4 percent, while in 2021 it would register a surplus of 0.2 percent.

The change observed in a year's structural balance compared to the previous year shows to what extent fiscal policy has been expansionary or contractionary. Between 2019 and 2020, there was a reduction of 0.8 points of the potential output in the structural primary deficit, which implies that fiscal policy in 2019 may be characterized as contractionary. In 2020, however, fiscal policy would be expansionary by 3.3 points of the potential output, while in 2021 fiscal policy would be contractionary by 3.6 points of GDP, which would be consistent with the need to initiate fiscal consolidation and an economy that is recovering from the COVID-19 crisis.

Graph 64
CONVENTIONAL AND STRUCTUTRAL PRIMARY BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2012 - 2021
(% GDP and % Potential GDP)



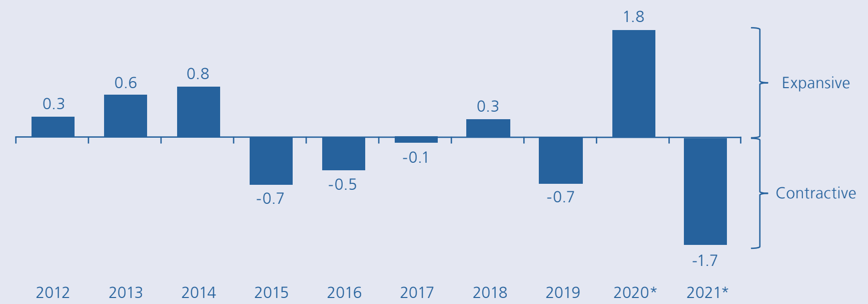
* Forecast.

56. If the changes in structural incomes, current and capital expenditures are weighted by their respective multipliers, we obtain the weighted fiscal impulse, which shows qualitatively similar results. In this case, the conclusion remains unchanged: the fiscal policy is contractionary in 2019 and expansionary in 2020 (1.8 percent of potential output), which together with an expansionary monetary policy stance, would contribute to offset the negative shock of the Covid-19. The fiscal position in 2021 would be contractionary (1.7 percent of the potential output).

It is worth mentioning that due to the differences in the value of the multipliers, the effect on activity measured by the weighted momentum is lower than the increase in the structural deficit. This is explained by the fact that part of the fiscal stimulus results from the reduction in income (1.9 points of GDP), from the increase in current expenditure, and the deficit of state-owned companies

(2.0 percentage points), which have less impact than that of capital expenditure, which declines by 0.4 percentage points of GDP.

Graph 65
FISCAL 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.

57. Compared to 2019, greater **financing requirements** are foreseen for 2020 and 2021 due to the higher deficits projected, which would be financed mainly with Public Treasury deposits and, to a lesser extent, with disbursements. Thus, compared to the Inflation Report of December, the projection of the balance of public deposits is revised from 13.6 percent to 10.3 percent of GDP for 2020 and from 12.7 to 7.8 percent of GDP for 2021.

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

	2019	2020*		2021*	
		IR Dec.19	IR Jun.20	IR Dec.19	IR Jun.20
I. USES	**32,022**	**16,976**	**68,924**	**16,913**	**34,656**
1. Amortization	19,491	2,752	2,655	2,788	2,839
a. External	4,524	744	986	1,690	1,741
b. Domestic	14,967	2,008	1,669	1,098	1,098
Of which: Recognition bonds	*622*	*550*	*479*	*550*	*550*
2. Overall Balance	12,531	14,224	66,269	14,125	31,817
(Negative sign indicates surplus)					
II. SOURCES	**32,022**	**16,976**	**68,924**	**16,913**	**34,656**
1. Disbursements and other	36,704	19,018	28,501	14,935	23,618
a. External	3,709	7,204	12,898	3,421	6,021
b. Bonds	32,995	11,813	15,603	11,513	17,597
2. Change on deposits and other[1/]	-4,682	-2,042	40,423	1,979	11,038
Memo:					
% GDP					
Gross public debt balance	26.8	27.3	33.9	27.3	33.1
Net public debt balance	13.0	13.7	23.6	14.6	25.3
Public deposits balance	13.8	13.6	10.3	12.7	7.8

1/ A positive sign indicates a reduction of deposits.
* Forecast.
IR: Inflation Report.

Instead of resorting to new debt operations, the greater financial requirement this year should be covered mainly with the use of financial assets, which amount to 14.8 percent of GDP as of April. This would allow reducing financial costs, freeing up resources, and improving the fiscal position.

These resources, which are deposits in the local financial system (13.8 percent of GDP), are mainly deposits in the BCRP. The holders of these deposits are both the Public Treasury and a broad set of public entities, which makes it difficult to have an efficient management of total public assets and liabilities. However, some measures have recently been issued to allow the Treasury to use public resources, the following measures standin out:

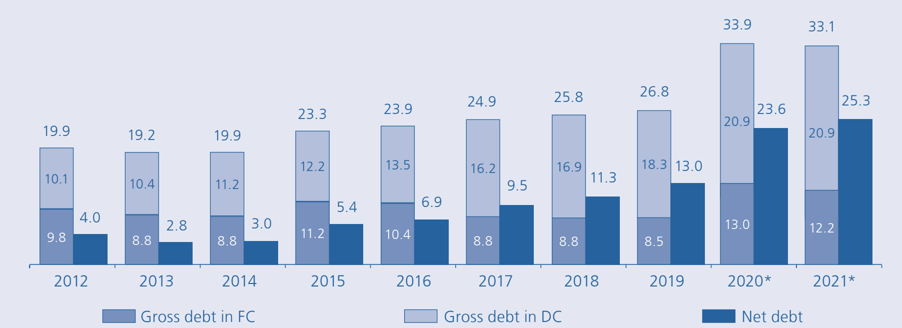
- **Allow the use of deposits to replace resources originally budgeted as resources obtained from credit operations**. Since the funds used through this mechanism are at the immediate disposal of the holder when required, the General Directorate of the Public Treasury (DGTP) is empowered to place sovereign bonds that will be charged to the balances of sovereign bonds issuances approved in the corresponding debt laws, whose issuance is still pending.

- **Transfer the non-budgeted surplus resources of companies, Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE), and other public entities to the Treasury.** This measure establishes the gradual transfer of FONAFE resources for up to S/ 1.5 billion, as well as the transfer of Funds and Resources Directly Raised from public entities that are not budgeted. The publication of a supreme decree determining the amounts to be transferred in the latter case is pending.

It is necessary to develop other similar measures that allow increasing the fungibility of public sector financial assets to meet financing needs.

58. **Public sector debt net of public sector deposits** would increase from 13.0 to 23.6 percent of GDP between 2019 and 2020, recording a level of 25.3 percent of GDP at the end of the forecast horizon. In gross terms, the debt would increase from 26.8 to 33.9 percent of the output between 2019 and 2020, and to 33.1 percent of the output in 2021, with new disbursements and debt issuances to finance fiscal deficits accounting for the increase of the gross debt. Together with the reduction in public deposits (for the same purpose), this would explain the increase in net debt.

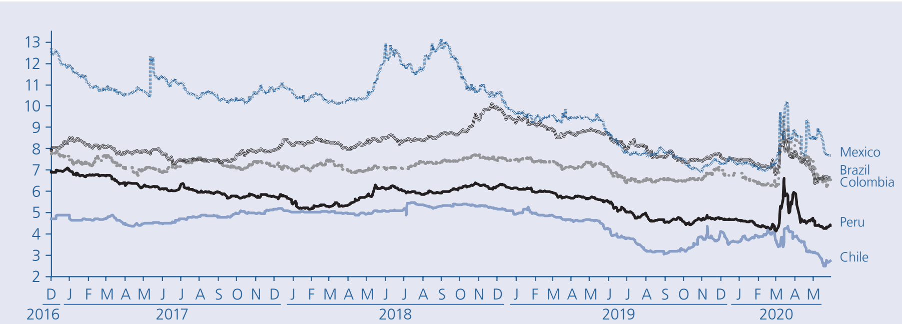
Graph 66
NON-FINANCIAL PUBLIC SECTOR DEBT: 2012 - 2021
(% GDP)



* Forecast.

59. Between December 2019 and June 2020, the **interest rates on 10-year government bonds in local currency** in Brazil, Chile, Colombia, Mexico, and Peru showed high volatility. First, between December 2019 and February 2020, interest rates showed a downward trend, decreasing 24 basis points on average. Then, the expansion of the COVID-19 pandemic in March caused bonds to devalue considerably, credit spreads increased, and country risk indicators deteriorated, in line with the greater global risk aversion. In April and May, central banks' liquidity injection measures contributed to reduce significantly interest rates (an average reduction of 44 basis points seen between December 2019 and June 2020). In Peru, the interest rate decreased from 4.23 to 3.90 percent and non-resident investors' demand for bonds increased after the reduction recorded in March 2020.

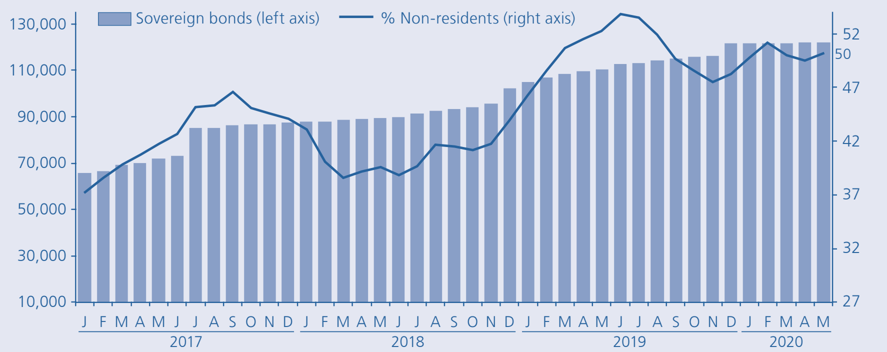
Graph 67
YIELDS ON 10-YEARS SOVEREIGN BONDS IN DOMESTIC CURRENCY
(%)



Source: MEF.

As of May 2020, the balance of **sovereign bonds** amounts to S/ 121.79 billion. On the demand side, the participation of non-resident investors increased from 48 to 50 percent between the end of 2019 and May of this year, their holdings increasing from S/ 58.67 billion in December 2019 to S/ 61.12 billion in May 2020. On the other hand, compared to February 2020, a month before the quarantine began in the country, sovereign bond holdings by non-residents decreased by S/ 1.14 billion.

Graph 68
BALANCE OF SOVEREIGN BONDS AND SHARE OF NON-RESIDENT INVESTORS
(Amounts in million S/ and shares in %)



Source: MEF.

Box 3
HOUSEHOLD SUPPORT MEASURES TO TACKLE THE COVID-19 CRISIS

Faced with the economic crisis caused by the new coronavirus pandemic, the Government has issued a set of measures to ensure the flow of payments and the stability of the financial system, on the one hand, and the viability of the compulsory social distancing, on the other hand. The first two objectives are aimed at preventing a recessionary circle that results in layoffs and massive bankruptcies that hinder future economic recovery. On the other hand, the third objective has been formulated recognizing that a successful containment of the virus depends on economic incentives that contribute to respect social distancing measures.

From the household perspective, the fundamental mechanism to prevent a contraction in spending and to ensure at the same time an optimal compliance with quarantine is to provide households with liquidity in the short term. An increase in families' disposable income stimulates present consumption, but it also reduces the need to go out to work and generates better expectations about the future situation of the family and other households.

The Government is providing liquidity to families through both direct and indirect liquidity provision mechanisms. The first type of actions include: (i) cash and in-kind transfers to households; (ii) the suspension of obligatory discounts to the gross salary (e.g. workers' contribution to AFPs), and (iii) the possibility to withdraw cash from forced savings accounts (i.e. pension funds and contingency funds for unemployment). The indirect liquidity provision mechanisms include measures aimed to reduce different household expenses, such as the tax relief and the fractionation in the payment of public services (electricity, natural gas, water and sanitation, and telecommunications).

Additionally, the injection of liquidity has been accompanied by an extension of the social protection network to provide families with some coverage against the contingencies of the crisis. The main focus of this extension has been people's access to health care (support network for the aged and people with disabilities, continuity of EsSalud benefits for workers affected by the "perfect suspension of work", among others), and benefits for the temporary cut of income (subsidy to MYPE workers affected by the "perfect suspension of work").

Given the limitation of fiscal resources, direct liquidity provision was initially focused on the most vulnerable households. In the context of the crisis, the most vulnerable households are those with little economic protection against loss of income and whose source of income is sensitive to quarantine due to the nature of their activities. Therefore, in the first 15 days of the State of Emergency, liquidity provision began through subsidy programs for households in poverty in the health emergency zones ("Stay at home" Bonus, ED 027-2020 of March 16) and low-income non-poor households that depend on an independent worker (*Bono Independiente*, DU 033-2020 of March 27). In addition to this, a little over a month after the quarantine started, a third subsidy was implemented for rural households in poverty (*Bono Rural*, DU 042-2020 of April 19). These three types of households fit into the vulnerable group profile established according to the aforementioned criteria.

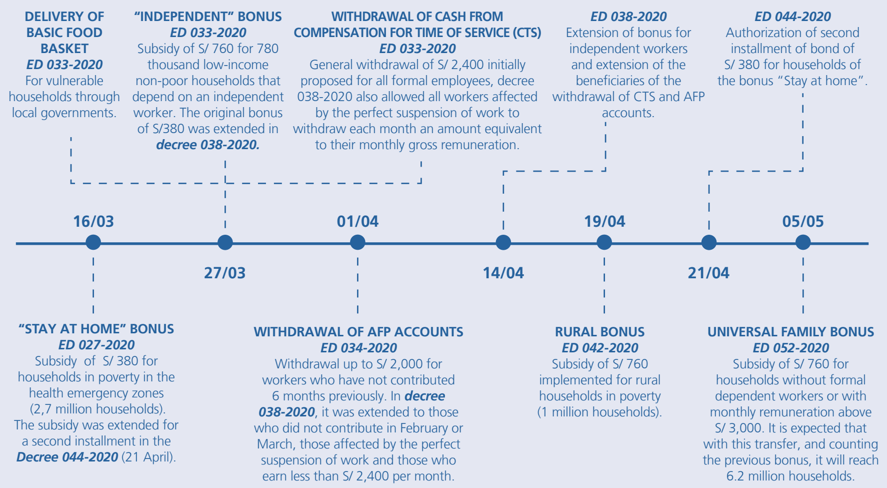
Besides implementing the first subsidies, the Government also authorized the withdrawal of funds from forced savings accounts in order to mitigate the impact of the loss of income. The withdrawal of cash from Compensation for Time of Service (CTS) accounts and AFP Accounts was allowed for the first time during the State of Emergency through E.D. 033-2020 and E.D. 034-2020, respectively. Although these measures benefit households with formal workers, who are, on average, the least vulnerable group in the face of the crisis, they serve to alleviate the contraction in economic activity. The intervention is particularly relevant in the case of the CTS funds since the funds serve as a substitute for unemployment insurance and should respond to these contingencies. Thus, for example, in addition to the general withdrawal of S/ 2,400 initially proposed for all formal employees, decree 038-2020 also allowed all workers affected by the perfect suspension of work to withdraw each month an amount equivalent to their monthly gross remuneration. On the other hand, the government has not allowed withdrawals from pension savings account as this could affect the sustainability of the pension system.[5]

In a second moment, recognizing the limitations to identify all vulnerable households, the government changed its strategy to privilege coverage over targeting. According to the 2019 ENAHO, around 40 percent of non-poor households in Peru are integrated only by informal workers. Since there is no complete information on their income level and type of occupation, targeting vulnerable households within this group becomes impossible and extending aid to ensure macroeconomic and social stability requires accepting a high level of leakage. In this context, the government implemented the Universal Family Bond (E.D 052-2020 of May 5), aimed at delivering a monetary subsidy to all households that: (i) have not been previous beneficiaries of another bond, (ii) do not have with a household member on the private or public sector payroll, and (iii) do not have a household member with income above S/ 3,000 according to the information available in the financial and tax system.[6] The graph below illustrates the sequence of direct liquidity provision measures:

5 Initially, this measure only included workers who had stopped contributing to their pension funds up to six months before quarantine (a proxy for being unemployed or having migrated to the informal sector), but it was afterwards extended to more beneficiaries (E.D. 038-2020 allowed the withdrawal of funds to workers who did not contribute to their pensions in February or March, to those who earn less than S/ 2,400, and to those affected by the perfect suspension of work). In addition, the Congress of the Republic published Law 31017 that allows the withdrawal of up to 25 percent of the funds for all workers.

6 This strategy of identifying beneficiaries through a discard method implies a high leakage, but also a faster provision of aid while ensuring greater coverage.

TIMELINE FOR ADOPTION OF LIQUIDITY PROVISION MEASURES



Direct subsidies per household amount to S/ 760 –the cost of a basic monthly food basket for four people– and will cover a total of 6.2 million households (70 percent of the total). [7,8] The subsidy amount has been determined based on the fact that households in Peru are integrated by 3.5 people on average. This implies, however, that there are households that would be receiving more or less aid per capita because the size of the household is not considered when allocating resources (although addressing this issue would require even greater targeting efforts). In addition, doubts remain as to whether the amount is sufficient to modify incentives (especially, considering the extension of the State of Emergency for more than 90 days).

On the other hand, although the coverage of 6.2 million households is extensive, in practice there have been delays in the approval of the registers of beneficiaries and the delivery of subsidies, which could reduce effectiveness if aid is not provided on a timely basis and household members are forced to go out to work. For example, the second Bono Independiente took two weeks to become effective since it was announced; the Bono Rural began to be paid on May 13 (it was announced on April 19), and the Bono Universal Familiar began to be implemented with an incomplete registry two weeks after it was made official by an emergency decree. According to MIDIS, around 5.1 million households would have received a bond as of June 14, which means that the delivery of the bond was pending for almost more than 15 percent of beneficiaries. The table bellow summarizes the progress in bond deliveries:

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7 The amount of the first two subsidies ("I stay at home" and "Independent") was initially S/ 380 when the State of Emergency was still expected to last less than a month. Then a second payment was enabled to complete S/ 760 through ED 036-2020 and ED 044-2020.

8 The number of 6.2 million households is obtained from the budget assigned for the delivery of bonds, which is around S/ 4.7 million.

MONETARY SUBSIDY DURING THE STATE OF EMERGENCY

Subsidy	Responsible	Legal law	Beneficiaries (thousands)		Payment start 1/		Collection advance (%)
			According ED	According final pattern 2/	First stage	Second stage	
"Stay at home" Bonus	MIDIS	ED 027-2020 ED 044-2020	2,749	2,727	26-Mar.	Starting May	92%
Independent Bonus	MTPE	ED 033-2020 ED 036-2020	780	773	8-Apr.	28-Apr.	87%
Rural bonus	MIDIS	ED 042-2020	1,098	980	13-May.		61%
Universal Family Bonus	MTPE/MIDIS	ED 052-2020	1,613	1,596	20-May.		
Urban	*MTPE*		*606*	*594*			*77%*
Rural	*MIDIS*		*263*	*258*			*78%*
Social programs	*MIDIS*		*743*	*743*			*94%*

Memo: Own elaboration based on information from the MIDIS press release. Information as of June 14.
1/ The "Stay at home" and Independent Bonus had two tranches of S/ 380. In the rest of Bonus, it was a single installment of S/ 760. The Family Universal Bonus will have a second tranch, extending the pattern.
2/ This is the number of beneficiaries indicated in the MIDIS press release.
Link of press release: https://www.gob.pe/institucion/midis/noticias/186819-mas-de-5-1-millones-de-hogares-ya-cobraron-el-bono-de-s-760.

Finally, the delivery of subsidies will also serve to improve the information systems for targeting social assistance, facilitating a faster and more effective response in the future. The first three subsidies showed that the information available was insufficient to carry out a rapid identification of the households with the available databases. The register of recipients of the "I stay at home" bond approved by MIDIS used the Household Targeting System (SISFOH), and the register of beneficiaries of the Rural Bond also used this database together with the information managed by MINAGRI. On the other hand, MTPE targeted the distribution of the Bono Independiente combining information from SUNAT, INEI, SBS, SIS, and EsSalud. Processing all this information was costly in terms of time, and therefore, RENIEC is now in charge of creating a National Registry of Households to consolidate and systematize the information of all beneficiary households.

Box 4
SUSPENSION OF FISCAL RULES

The health emergency caused by the COVID-19 pandemic required the deployment of a fiscal response based on increased public spending and the postponement of tax payments. In this context, it was necessary to relax the fiscal rules applicable in the 2020 and 2021 fiscal years.

In general, fiscal rules must balance the need to establish precise limits on fiscal aggregates that guarantee responsible behavior and the necessary flexibility to deal with negative shocks that affect the economy. In the Peruvian macro fiscal framework, this flexibility is established in the exception clause of the Framework Law on Fiscal Rules[9], which provides that, exceptionally, in cases of significant disaster or external shock events that affect government revenues, or when the economic balance has to be modified because of exogenous factors, it is possible to suspend the application of the macro-fiscal rules.

As shown in the following table, this clause was used to modify the fiscal rules in 2017 due to the considerable damage caused in various regions of the country by El Niño Costero event. During the parliamentary interregnum, the deficit adjustment path was modified with an emergency decree to prevent an overly contractionary adjustment in 2021.

FLEXIBILITY OF THE FISCAL DEFICIT RULE
(% GDP)

	2019	2020	2021	2022	2023	2024
Legislative Decree 1276, December 2016. Macro Fiscal Framework Law	2.0%	1.5%	1.0%	1.0%	1.0%	1.0%
Law No. 30637, August 2017. Exception clause for Fenómeno del Niño Costero	2.9%	2.1%	1.0%	1.0%	1.0%	1.0%
Emergency Decree 032-2019, December 2019. Gradual return to the fiscal deficit rule no higher than 1% of GDP		2.1%	1.8%	1.6%	1.3%	1.0%
Legislative Decree 1457, April 2020. Temporary suspension due to health emergency COVID 19		suspended	suspended			
Execution of the fiscal deficit	1.6%					

This year, due to the spread of COVID 19, the Executive requested the new Congress to approve the delegation of legislative powers to the Executive to modify fiscal rules, among other issues. Thus, Legislative Decree 1457[10] temporarily and exceptionally suspended the

9 Legislative Decree 1276, Ley Marco de la Responsabilidad y Transparencia Fiscal del Sector Público No Financiero.

10 Legislative Decree 1457, which approves the temporary and exceptional suspension of the fiscal rules for the non-financial public sector for FY 2020 and 2021 and establishes other provisions, was published on April 12, 2020. The rule was approved within the framework of Law 31011, which delegated legislative powers to the Executive.

fiscal rules for the non-financial public sector for FYs 2020 and 2021 to ensure timely fiscal policies in response to the health and economic emergencies, including the suspension of the rules regarding debt, deficit, and growth of expenditu:

TAX RULES SUSPENDED FOR 2020 AND 2021

	2019 (Limit)	2019 (Execution)	2020	2021
Public debt not greater than:	30% %GDP	26.9% %GDP	30% %GDP	30% %GDP
Fiscal deficit not greater than:	2.9% %GDP	1.6% %GDP	2.1% %GDP *	1.8% %GDP *
Growth of non-financial expenditure of the General Government *(Limited in a range +/- 1 p.p. of the real growth GDP of 20 years: 15 before, 1 present and 4 after the elaboration of the MMF)*	Not apply	Not apply	4.9% real **	3.7% real **
Growth of current expenditure of the General Government, without maintenance expenditure *(Not higher than the average annual real growth GDP of 20 years, which is reduced by 1.5 p.p. in the years 2020 and 2021)*	4.2% real	2.9% real	3.5% real **	3.0% real **

* Established by ED 029-2020, gradual return of tax rules.
** Estimated in the MMM 2020-2023 published in August 2019.

Thus, there is no limit to the fiscal deficit or to the growth of the general government's non-financial spending in FYs 2020 and 2021, and the public debt can exceed the 30 percent ceiling of GDP established in the fiscal rule[11].

In addition to this, it was established that the Multi-Annual Macroeconomic Framework to be published in August 2020 will serve as the basis for preparing the bills of the annual budget, indebtedness, and balance for 2021.

This suspension of fiscal rules was implemented through a norm with the rank of Law, which was enacted by the Executive within the framework of delegated powers. This, in principle, complies with the objective of the procedure indicated in the exception clauses of the Framework Law on Fiscal Rules.

With this measure, the government has been able to implement an economic plan to face the COVID-19 emergency and its effects on the local economy with resources involving nearly 15 percent of GDP to date. The resources will be used to improve response capacity, provide financial support to vulnerable sectors, provide tax relief to families and companies, and implement liquidity measures that prevent the loss of sources of employment and the breakdown of the payment channel, among other actions.

11 It is worth pointing out that the rule allows that, in conditions of financial volatility and as long as the rest of the rules are complied with, the debt may temporarily increase to 34 percent of GDP.

The transitory nature of the current expansionary fiscal policy –which is appropriate to the emergency situation the country is going through– must be ensured so that it is clear that the deficits of 9.7 percent of GDP in 2020 and 4.2 percent of GDP in 2021, contained in the base scenario of this Report, will be reduced once the crisis is over. This is reflected in the fact that spending measures do not imply an increase in rigid spending, which is why the latter should return quickly to pre-pandemic levels. Likewise, it must be clear that the income measures implemented are only temporary reliefs to support companies' liquidity, without affecting long-term tax revenues.

This is important as it is a signal to the market of the fiscal authority's medium-term commitment with a prudent policy stance that will allow to recompose over time the fiscal space used in the current emergency, which ensures the country's financial soundness. Therefore, although the norm approved does not explicitly consider an adjustment path that shows the gradual return to the fiscal rule limits, the nature of the measures implemented will facilitate its convergence.

In these circumstances, it is necessary to quantify the fiscal adjustment necessary to stabilize the debt-to-GDP ratio and ensure the solvency of the government. An easy way to approach this matter is to ask yourself about the primary balance that in a steady state stabilizes the debt. The following table shows results for different levels of public debt (30 and 35 percent of GDP) and for different interest rates on gross debt.

FISCAL ADJUSTMENT NECESSARY TO STABILIZE THE DEBT-TO-GDP RATIO 1/
(% GDP)

		Gross debt	
		30%	**35%**
Implicit nominal interest rate	4.5%	-0.30%	-0.38%
	5.5%	-0.02%	-0.05%
	6.5%	0.26%	0.28%

1/ Assumes inflation of 2% and real GDP growth of 4%.

The table shows that at the implicit interest rate on the public debt in force in 2019 (about 5.5 percent), if the economy grows at a trend rate of 4.0 percent per year, it would suffice to reach equilibrium in the public sector's primary balance to stabilize long-term public debt at 30 or 35 percent of GDP. An important part of the convergence would take place in 2021 by reducing the primary deficit from around 8.0 to 2.5 percent of GDP. Thus, an efficient way to ensure fiscal sustainability is through structural reforms that raise the potential growth rate to 4 percent in the coming years, the possible reforms including formalizing the labor market through greater flexibility in the market, reducing logistics costs, and simplifying regulation to encourage private investment. Moreover, actions in the short term should include unlocking irrigation and mining projects.

It may be risky to consider stabilizing the public debt at levels above 35 percent of GDP as this could make it more likely that the Peruvian government will have difficulties servicing the debt and the debt could go into an explosive path.

A recent paper[12] discusses the concept of *debt limit* as the level of public debt from which the Treasury cannot service the debt with certainty, so the country's default risk premium rises and leads the debt ratio to an explosive and unsustainable dynamics. This debt limit is a random variable whose distribution depends on the shocks that affect the Peruvian economy and on how the Treasury reacts to them. Through simulations, the author calculates this distribution and finds that the probability that the debt limit is less than 35 percent of GDP is 17 percent.

Stabilizing the public debt at higher levels increases the vulnerability of public finances to the shocks faced by the Peruvian economy. For example, if the debt stabilizes at 40 percent of GDP, the probability that the debt limit will be less than this figure and that the country faces fiscal solvency problems doubles to 34 percent.

12 Colonia, Henry (2019) "Límite de deuda y sostenibilidad de la deuda pública peruana". Paper presented at the BCRP Encuentro de Economistas in October 2019.

V. Monetary Policy and Financial Conditions

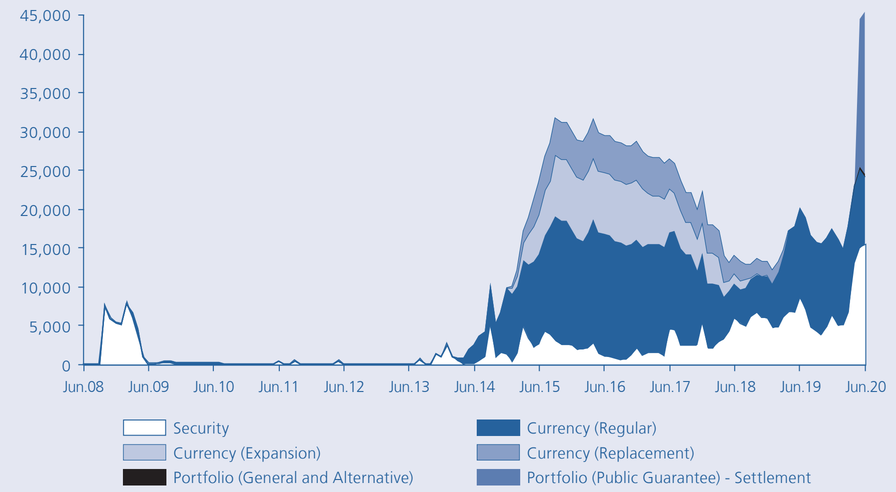
60. Since the national State of Emergency was declared in the country to contain the expansion of COVID-19, BCRP has taken monetary and financial measures with the aim of supporting the proper functioning of markets. The focus of these measures has been to reduce the cost of financing, to provide liquidity to the financial system, and to reduce volatility in long-term interest rates and the exchange rate.

Thus, in a context of strong contraction in domestic demand and in an international environment of global recession, the expansionary monetary policy BCRP has applied has led it to cut the policy benchmark rate to its historical minimum of 0.25 percent. However, given the magnitude of the shock, monetary impulse is being expanded through unconventional quantitative monetary policy measures. The actions adopted by BCRP are summarized below:

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.

61. As of June 16, 2020, BCRP's injection operations totaled S/ 45.4 billion (6.4 percent of GDP), of which S/ 24.4 billion are security, currency, and portfolio repo operations, and S/ 21 billion is the liquidated amount of government-backed credit repos. In addition, BCRP has released financial entities' reserve funds for an estimated total of S/ 2 billion.

Graph 69
BALANCE OF REPO OPERATIONS*
(Balance in mill. S/)



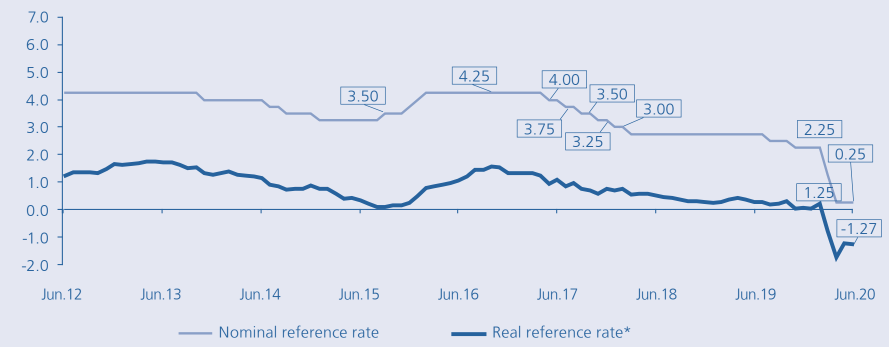
* As of June 18.

62. Central banks worldwide have been easing monetary and financial conditions, cutting their policy interest rates and carrying out injection operations, reducing reserve requirements and easing current financial restrictions. Furthermore, several countries are implementing credit support programs for businesses with the support of their central banks. Although there may be differences among countries in terms of the operational mechanisms used the purpose is to sustain the flow of credit and promote orderly behavior in financial markets.

BCRP monetary policy actions and measures against the Coronavirus pandemic

63. With the beginning of the confinement period, the Board of BCRP decided to cut the monetary policy interest rate, lowering it between March 19 and April 9 by 200 basis points, from 2.25 to 0.25 percent, its historical minimum.

Graph 70
REFERENCE INTEREST RATE
(%)



* Exante real rate with expectation of inflation

64. This decisions were made in light of the following indicators:

- The annual inflation projection approaching the lower band of the target range in the forecast horizon
- Inflation expectations in the middle of the target range.
- Economic activity severely affected temporarily by simultaneous shocks of aggregate supply and demand.
- Increased risks in terms of global economic growth, including the possibility of an economic recession in the first half of the year.

65. In its policy statements, the Board of BCRP has emphasized that "BCRP will continue to take all necessary actions to sustain the payments system and the credit channel in the economy" and that "it considers it appropriate to maintain a strong expansionary monetary stance for an extended period and while the negative effects of the pandemic on inflation and its determinants persist". In this way, the BCRP has given guidelines on the future monetary policy stance, providing the market with more information to form expectations. BCRP has also pointed out that "the Central Bank pays close attention to new information and stands ready to extend monetary stimulus under different modalities."

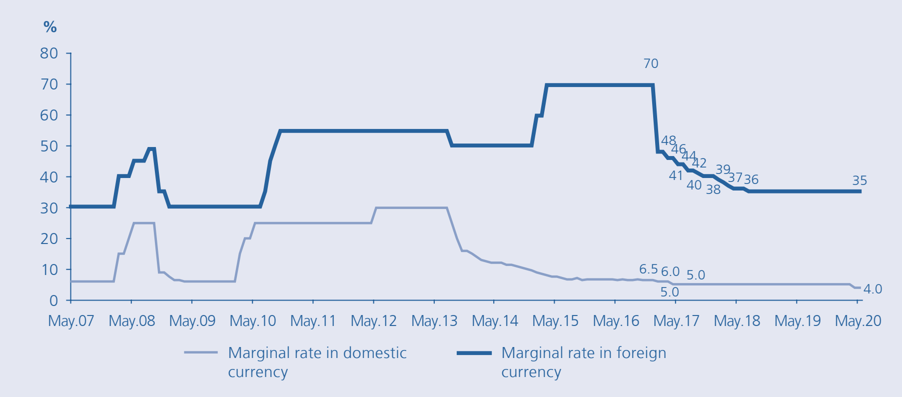
66. With the purpose of releasing loanable funds protected in financial institutions' current reserve accounts and contribute in this way to easing financial conditions, BCRP has also adopted the following measures that are effective as from the April reserve period[13]:

13 Circulars 0010-2020-BCRP and 0011-2020-BCRP (March 31, 2020).

a. The rate of minimum legal reserve in soles was lowered from 5 to 4 percent.
b. The minimum current account requirement of total obligations subject to reserve requirements in soles was lowered from 1 percent to 0.75 percent.
c. The rate of reserve requirements for obligations in foreign currency with foreign financial entities with average maturity terms of 2 years or less was reduced from 50 percent to 9 percent.
d. Additional reserve requirements for credit in foreign currency was suspended for the remainder of 2020.

As a result of these reserve requirements measures, funds equivalent to S/ 2 billion were released to financial institutions (S/ 1.13 billion as a result of the reduction of reserve requirements in domestic currency).

Graph 71
RESERVE REQUIREMENTS RATE IN DOMESTIC AND FOREIGN CURRENCY
(As % of total deposits)



Additional measures of BCRP to face the Covid-19 pandemic

67. The reduction of the monetary policy interest rate was accompanied by the extension of the amounts and maturity terms (up to 3 years) of the security and currency repos with the aim of reducing interest rates along the yield curve as well. This, together with the liquidation of government-backed portfolio repos from May, has caused the balance of liquidity injection operations to increase from S/ 14.75 billion to S/ 45.59 billion between March and June, a figure six times higher than the maximum balance that these operations reached during the 2008-2009 crisis (S/ 7.88 billion) and nearly 1.5 times the balance reached during the de-dollarization program (S/ 31.79 billion).

Table 29
BALANCE OF BCRP REPO OPERATIONS*
(Million S/)

Episodie	Date	Values	Currency (Regular)	Currency (Expansion)	Currency (Substitution)	Portfolio (General and Alternative)	Government-backed portfolio repo liquidation	Total
Financial Crisis 2008-2009	Oct.08	7,383	300	0	0	0	0	7,683
	Nov.08	5,959	30	0	0	0	0	5,989
	Dec.08	5,412	0	0	0	0	0	5,412
	Jan.09	5,239	0	0	0	0	0	5,239
	Feb.09	7,877	0	0	0	0	0	7,877
	Mar.09	5,989	735	0	0	0	0	6,724
De-dolarization Program	Dec.14	1,300	8,600	0	0	0	0	9,900
	Mar.15	4,900	8,600	2,200	1,500	0	0	17,200
	Jun.15	2,631	11,500	5,100	4,305	0	0	23,536
	Sep.15	3,034	16,050	7,900	4,805	0	0	31,789
	Dec.15	2,500	14,900	7,900	4,805	0	0	30,105
Covid-19 Crisis	Feb.20	5,100	9,650	0	0	0	0	14,750
	Mar.20	6,675	11,150	0	0	0	0	17,825
	Apr.20	13,015	10,030	0	0	250	0	23,295
	May.20	15,060	10,145	0	0	260	19,017	44,482
	Jun.20	15,517	8,745	0	0	260	21,070	45,592

* As of June 18.

68. Credit portfolio repo operations have also been carried out for the first time in this period. This is a liquidity injection mechanism through which institutions receive liquidity from BCRP using part of their loan portfolio as collateral. At the end of May, the balance of these operations amounted to S/ 260 million. This instrument was created in 2009 in the context of the international financial crisis, but was used for the first time in April 2020. It is worth mentioning that the set of guarantees and collaterals to carry out these operations[14] was expanded at the beginning of April:

a. Expansion of the spectrum of collaterals for portfolio repos, including the invoices discounted by financial institutions (Factoring).

b. The minimum risk rating required by financial entities to be able to participate in the alternative scheme of repos with securities rated "A" to "B+" was modified.

c. The minimum amount of credits that financial entities can use as collateral in portfolio repo operations in the alternative scheme was lowered from S/ 500,000 to S/ 300,000.

69. Furthermore, in order to provide additional liquidity facilities to financial entities, on March 19, 2020, BCRP eliminated the limit that financial institutions had to

14 Circular 0014-2020-BCRP (April 3, 2020).

carry out direct repos at the window interest rate –10 direct repos in a 12-month period– (Special Monetary Program).

70. In the context of the abrupt drop in economic activity due to quarantine, the Government created Government-Backed Portfolio Credit Repos within the framework of the Reactiva Peru Program. This is a new liquidity injection instrument that is aimed to contribute to replenish companies' working capital and thereby ensure the operation of the payments and the credit channels. A total of up to S/ 30 billion was initially programmed to be placed through the program, but this amount was subsequently increased to S/ 60 billion due to the extension of the confinement period.

71. In addition to this, a National Government Guarantee Program for the credit portfolio of financial entities has also been established recently to provide financial institutions with the liquidity necessary to maintain the flow of credit to the most affected sectors and thereby maintain continuity in the payments channel. Financial institutions may use their credit portfolio to obtain a guarantee from the National Government to carry out repo operations with BCRP. The program's amount is S/ 7 billion, which may be extended up to an additional 20 percent.

72. Furthermore, the Board of Directors of BCRP has also approved the creation of repos that promote credit rescheduling to promote that lower interest rates and longer terms be set. Through the use of these operations, the financial entities will be able to obtain liquidity in exchange for the sale of first quality securities, foreign currency, or credit portfolio, as long as they comply with refinancing the credits of their clients in periods ranging between 6 to 48 months and at lower interest rates than those initially agreed.

    The amount refinanced must be equivalent to the amount obtained through the operation. Moreover, this category also includes credits purchased from other financial institutions for reprogramming purposes.

    A characteristic of the aforementioned repos is that they will be directly placed, following the guidelines established for securities, currency and credit portfolio in the respecitve BCRP circulars. Although these operations are voluntary and carried out at the request of a financial company, this mechanism is expected to generate a coordination effect and to extend to all financial entities.

    The effects of these operations should be reflected in better conditions for debtors in the financial system, who will pay lower partial repayments and will also benefit from the context of low interest rates since last April, paying lower interest charges as well. With this, these debtors will be able to recover more quickly from the negative shock observed in the local economy.

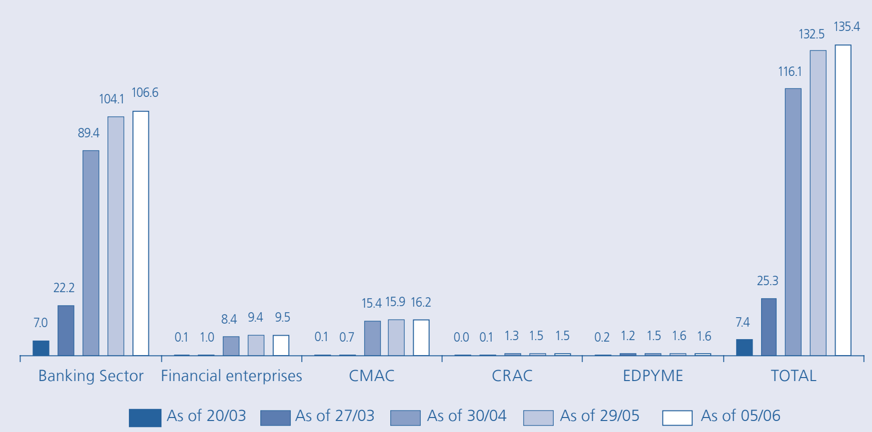
SBS Actions

73. The Superintendencia de Banca, Seguros y AFP (SBS). empowered the entities of the financial system to adopt exceptional measures so that the debtors (natural persons and companies) affected by the state of emergency could comply with the payment of the loans they have. The measure seeks to reduce pressure on compliance with obligations, preventing companies and families that do not have a positive cash flow from falling into default.

74. As a result, financial entities can modify the contractual conditions of the various credit modalities in general without having to contact each client individually and without this modification implying a refinance or a deterioration in clients' credit rating as long as the total term of the credit does not extend for more than six months from the original term (this term was later extended to 12 months) and as long as that the debtors were not behind their debt payments on the date when the emergency was declared.

75. As of June 5, loans have been rescheduled for the total capital balance of S/ 135 billion, which represents 33 percent of the financial system's total portfolio (S/ 351 billion).

Graph 72
TOTAL LOANS RESCHEDULED
(Billion S/)



Source: SBS.

76. Other measures complementing these measures included extending the deadline for protesting the securities held by financial entities until June 30, 2020 (the term was previously extended twice) and easing provisions for loans from the Reactiva Peru program and FAE MYPE.

77. It was established that the extension of the terms as a result of reprogramming revolving consumer loans and mortgage loans (in the context of a state of emergency) does not increase the weighting factor of effective equity requirement due to credit risk with respect to that in force on February 29, 2020. In addition, financial entities were empowered to use the additional effective equity accumulated by the business cycle component.

78. The exposures part covered by the guarantee of the Reactiva Peru Program and the Business Support Fund for SMEs (FAE-MYPE) has subsequently been excluded from the calculation of provisions related to the risk of over indebtedness of retail debtors and from additional provisions for credit exchange risk when credit guarantee substitution applies. Additionally, the limit that applies to the total coverage granted by the Business Support Fund for SMEs to the same financial entity has been exceptionally been established at fifty percent of the effective assets of the financial system entities.

79. The application of limits of liquidity coverage ratios in domestic currency and in foreign currency was temporarily suspended until further notice.

80. In addition, the limits of operations to be carried out through simplified electronic money accounts and basic accounts were extended. A temporary and trust-substitute mechanism was also established to support electronic money.

BCRP Monetary Operations

81. The **operations of the Central Bank** between December 2019 and May 2020 were aimed at ensuring adequate levels of liquidity in the interbank market. With the emergence of the Covid-19, the BCRP actions focused on maintaining the flow of payments and loans in the economy by injecting term liquidity through various monetary instruments. Thus, in this period, the bank injected liquidity through net placements of security repos (S/ 8.71 billion), Government-backed portfolio repos (S/ 19.28 billion), and portfolio repos (S/ 260 millions). These operations were offset in part by the maturity of curency repos operations (S/ 905 million).

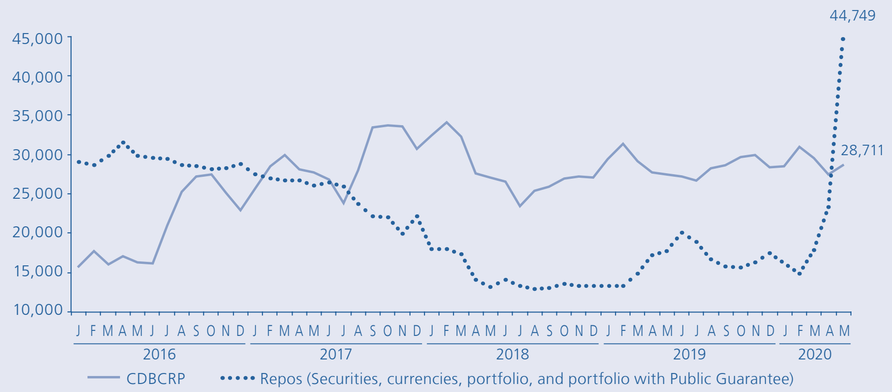
82. Moreover, in order to maintain adequate levels of short-term liquidity, excess liquidity was sterilized through the net placement of time deposits and overnight deposits (S/ 24.58 billion), CDBCRP (S/ 346 million), and CDRBCRP (S/ 630 million). As a result, the balance of repo operations went from S/ 17.40 billion in December 2019 to S/ 44.75 billion at the end of May 2020, while the balance of CDBCRP went from S/ 28.37 billion in December to S/ 28.71 billion in May.

Table 30
BALANCE OF BCRP MONETARY OPERATIONS

	Balance (Mill. S/)			Average interest rate of the balance (%)		
	Dec.18	Dec.19	May.20	Dec.18	Dec.19	May.20
Monetary sterilization						
1. CDBCRP	27,061	28,365	28,711	2.70	2.50	2.01
2. CDRBCRP	0	0	630	1.50	1.00	0.10
3. Term and overnight deposits	1,802	2,115	26,691	1.50	1.00	0.24
Monetary injection						
4. Currency repos	7,358	11,050	10,145	3.80	3.85	3.13
5. Security Repos	5,950	6,350	15,060	3.95	3.31	1.87
6. Portfolio Repos	0	0	260	n.d.	n.d.	0.62
7. Government-backed portfolio repos *	0	0	19,284	n.d.	n.d.	0.50
8. Public Treasury fund auctions	4,000	4,100	4,100	4.22	3.85	3.64

* The disbursed amount of the instrument to date is considered.

Graph 73
BALANCE OF REPO OPERATIONS AND CDBCRP
(Balance in mill. S/)



Thus, the balance of repo operations increased to 15.1 percent of the BCRP's net assets, from 7.1 percent in December. On the side of BCRP liabilities, the ratio of BCRP certificates of deposit in terms of BCRP net liabilities decreased to 9.8 percent from 11.6 percent in December 2019, while time deposits increased their participation to 9.0 percent from 0.9 percent in December 2019. On the other hand, Public Sector deposits decreased their participation to 26.6 percent, from 30.5 percent in December 2019, although they remained as the most important BCRP liability.

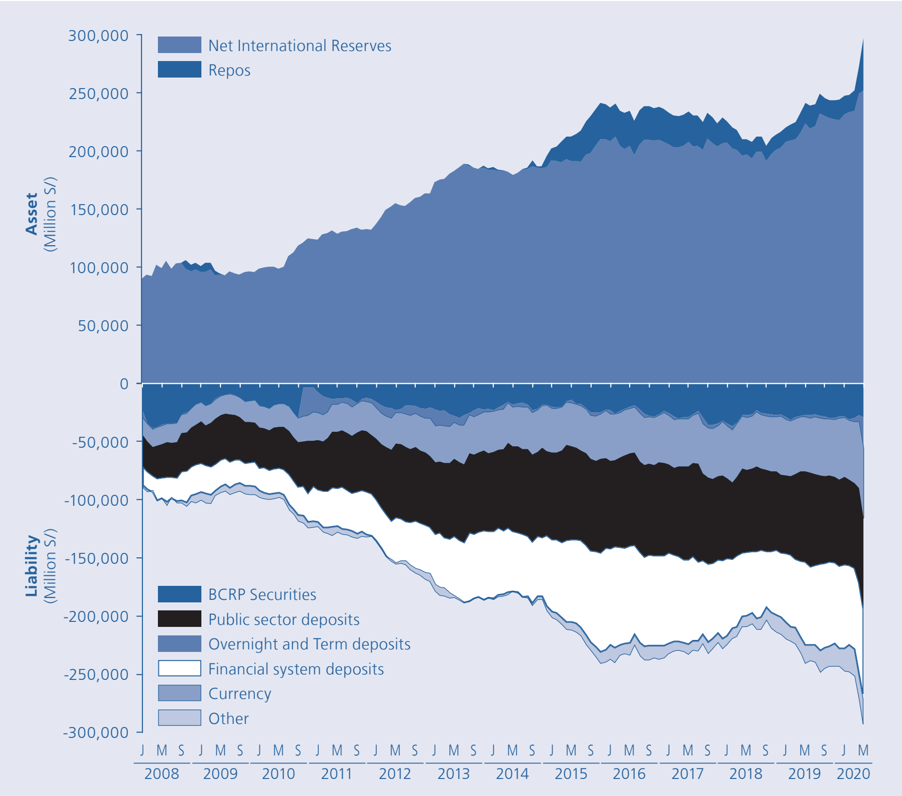
Table 31
SIMPLIFIED BALANCE SHEET OF THE BCRP*
(As % of Net Assets)

	Dec.18	Dec.19	31 May.20
I. Net assets	**100%**	**100%**	**100%**
Net International Reserves	93.8%	92.9%	84.9%
	(US$ 60,121 mills.)	(US$ 68,315 mills.)	(US$ 73,439 mills.)
Repos	6.2%	7.1%	15.1%
II. Net liabilities	**100%**	**100%**	**100%**
1. Total public sector deposits	**31.0%**	**30.5%**	**26.6%**
In domestic currency	18.3%	18.8%	13.8%
In foreign currency	12.7%	11.7%	12.8%
2. Total financial system deposits	**25.6%**	**29.1%**	**26.0%**
In domestic currency	5.4%	5.1%	4.2%
In foreign currency	20.2%	24.0%	21.7%
3. BCRP instruments	**13.4%**	**12.5%**	**18.9%**
CD BCRP	12.5%	11.6%	9.8%
CDR BCRP	0.0%	0.0%	0.2%
Term deposits	0.0%	0.0%	7.9%
Overnight deposits	0.8%	0.9%	1.1%
4. Currency	**23.1%**	**21.4%**	**20.0%**
5. Other*	**7.0%**	**6.5%**	**8.5%**

* Includes assets and other accounts.

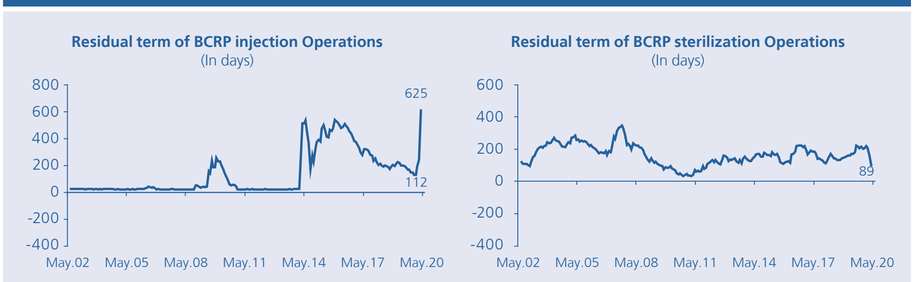
The result of these operations is reflected in the change in the size and composition of the Central Bank's balance sheet. Thus, as of May 2020, the BCRP assets amount to S/ 296.65 billion, which is equivalent to 41.8 percent of GDP and higher than the balance observed in 2015 during the de-dollarization program (39.3 percent of GDP). The greater injection of liquidity carried out in recent months is reflected in the increasing contribution of repos operations in the the Central Bank assets.

Graph 74
EVOLUTION OF THE BCRP BALANCE SHEET: 2008 - 2020



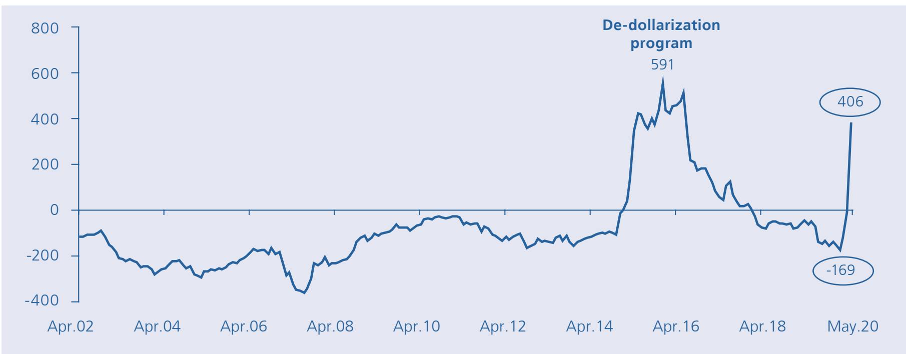
The greater forward injection is reflected in the increase in the residual term of these operations, which increased to 625 days in May from 112 days in February. Along the same lines, with the aim of increasing liquidity in the financial system, the Central Bank has been carrying out sterilization operations at shorter terms. As a result, the residual term of the sterilization operations was reduced to 89 days in May from 221 days in February.

Graph 75



The BCRP's net residual term of operations[15] reflects the expansionary stance of the BCRP on the yield curve. The yield curve is flattened and the net residual term is longer when long-term liquidity is injected and short-term is sterilized. Therefore, a high net residual term reflects greater liquidity in the financial system since there are liquid assets close to maturity (CDBCRP) and the repos assets have to be repurchased in the long term. As of May, the net residual term of BCRP operations is 406 days and this term is expected to continue rising in the following months as the announced liquidity injection programs are carried out.

Graph 76
NET WEIGHTED RESIDUAL TERM OF BCRP OPERATIONS
(In days)



Financial Markets

83. The effects of the shock associated with the COVID-19 pandemic on the Peruvian economy, especially during the period of social confinement, have been reflected in financial markets, which showed: i) greater volatility in the exchange rate , the stock market indices, and the yields of government bond, ii) an increase in credit spreads, iii) a greater demand for liquidity in the financial system, and iv) a decrease in non-residents' participation in the debt and equity markets. Thus, although this global shock had already been generating a higher level of uncertainty since January, the impact in Peru began to be observed in March, particularly from the start of the state of emergency. The measures implemented by the Central Reserve Bank of Peru (BCRP) have contributed to mitigate the impact of the health crisis on local financial markets.

15 The net residual term is the difference between the residual term of injection and sterilization operations, weighted by the balance of each instrument. It is calculated according to the following formula: $\text{Net Residual Term} = \frac{\text{Injection balance}}{\text{Sterilization balance}} \times \text{RT Injection} - \text{RT Sterilization}$, where *RT* refers to the residual terms of the injection and sterilization operations, respectively.

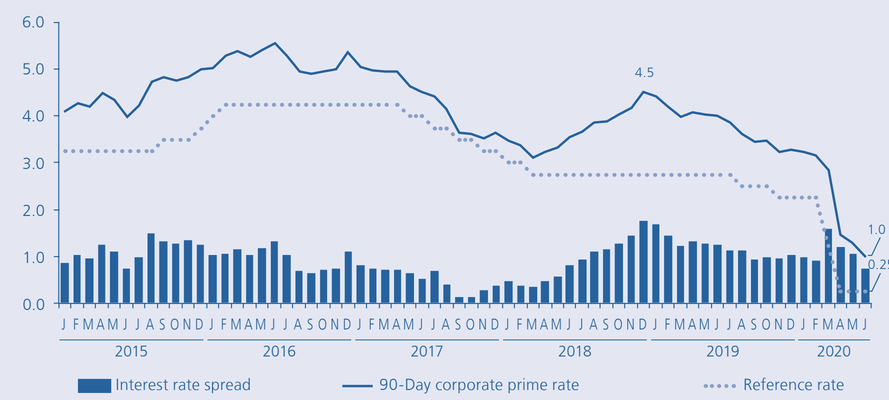
Interest Rates

84. Between December 2019 and February 2020, interest rates in soles showed a downward stable trend, but in March 2020, they began to show an upward trend due to banks' preference for maintaining short-term liquidity and greater aversion to credit risk.

85. The initial impact of COVID-19-related financial stress on monetary conditions was reversed as of March through up to 3-year liquidity injection operations in soles, as well as through the reduction of the rate of reserve requirements and the reduction of the reference interest rate. Moreover, government-backed repo operations were carried out since the end of April, which not only has energized credit to the private sector, but has also accelerated the pass-through of the reduction of the reference interest rate to the rest of interest rates in the financial system.

The interbank interest rate has not deviated from its benchmark level, and the corporate prime rates on lending and deposits have decreased by an average of 216 and 232 basis points, respectively, between December 2019 and June 2020. Furthermore, influenced by the low interest rates of the Reactiva Peru Program, in June 2020 the interest rates on loans to small and medium-sized firms show record low levels unheard of since September 2010.

Graph 77
INTEREST RATE IN S/: 90-DAY CORPORATE PRIME AND REFERENCE RATE
(%)



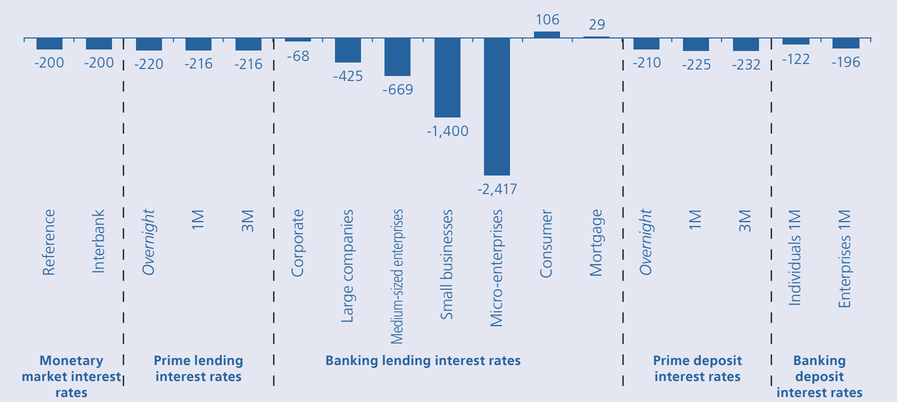
* As of June 18.
Source: BCRP and SBS.

Table 32
INTEREST RATE IN DOMESTIC CURRENCY
(%)

		Dec.18	Jun.19	Sep.19	Dec.19	Feb.20	Mar.20	Jun.20
Pasive	Deposits up to 30-day	3.1	2.9	2.3	2.3	2.1	2.0	0.1
	On 31 to 180-day term deposits	4.0	3.4	2.9	2.8	2.7	2.6	1.1
	On 181 to 360-day term deposits	4.2	3.9	3.4	3.3	3.2	3.0	1.8
Active	90-day corporate prime	4.5	4.0	3.4	3.3	3.2	2.8	1.0
	Corporates	4.9	4.5	3.6	3.8	3.4	3.6	2.7
	Large companies	6.4	6.3	6.2	6.0	6.1	5.9	1.8
	Medium-sized enterprises	9.8	9.9	9.9	9.3	9.6	8.9	2.9
	Small businesses	18.5	18.8	18.8	18.0	18.3	18.1	4.3
	Consumer	44.9	41.1	39.8	40.9	38.1	39.3	39.1
	Mortgage	7.6	7.7	7.2	7.0	7.0	6.7	7.3

Memo: Annual rates for operations in the last 30 working days.
* As of June 18.
Source: SBS.

Graph 78
CHANGE OF INTEREST RATES IN SOLES: FEB. TO JUN. 2020
(Basis points)

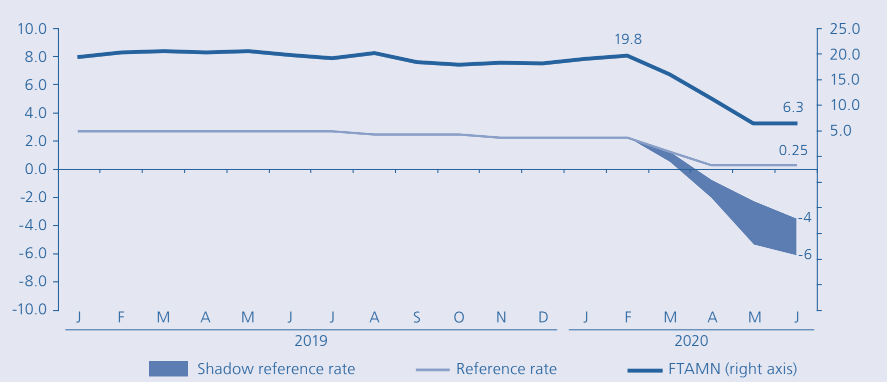


As of June 18.
Source: BCRP and SBS.

86. The average interest rate on lending operations in domestic currency carried out in the last 30 days (FTAMN) decreased to 6.5 percent in June 2020 from 19.8 percent in February 2020. This reduction in the FTAMN reflects the effect of the set of monetary easing measures implemented by BCRP, which includes the reduction of the politicy interest rate and liquidity injection measures. According to preliminary estimates, this reduction observed in the FTAMN is consistent with a reduction in the "shadow" reference interest rate to negative levels in the range of [-6; -4] in the month of June. The "shadow" reference interest rate is defined as the equivalent of the policy interest rate –without restricting that

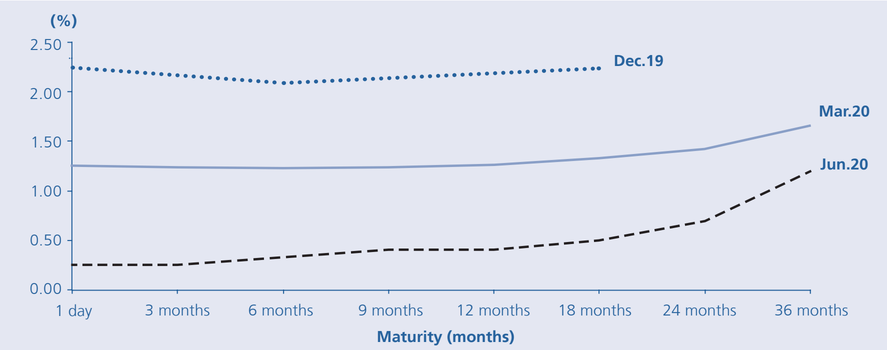
it may have negative values– that is generated by the same monetary stimulus taking into account all its modalities, including non-conventional quantitative monetary policy measures.

Graph 79
FTAMN , REFERENCE RATE AND SHADOW REFERENCE RATE
(Percentage points)



87. The yield curve of BCRP securities has also incorporated the reduction of 200 basis points in the reference rate since December 2019. Thus, the interest rates on 3-month and 12-months bonds have decreased by an average of 99 basis points between December 2019 and June 2020. It is worth pointing out that the issuance of 2-year and 3-year securities was resumed since January 2020 to complete the short section of the yield curve of long-term securities, thereby promoting the development of the fixed income market.

Graph 80
YIELD CURVE OF CENTRAL BANK SECURITIES[1/]



1/ Yield rate in the primary and secondary market.
As of June 19.
Source: BCRP.

88. Interest rates in dollars also show lower levels in June 2020 compared to last year, in line with the reduction of 150 basis points in the Federal Reserve's policy rate. Like in the money market in soles, there was a shortage of global liquidity in dollars in March 2020 that was mitigated by the stimulus and coordinated actions announced by various governments and central banks. Thus, as of June 2020, the interbank rate on operations in foreign currency has decreased from 1.75 to 0.25 percent, a level similar to the policy rate of the Federal Reserve.

89. In the foreign currency money market, the interbank rate fell in line with the reduction in the U.S. monetary policy rate. However, the lending prime rates charged by banks to their main clients increased as from March 16, the spread over the interbank rate increasing by 83 basis points between March 11 and March 18.

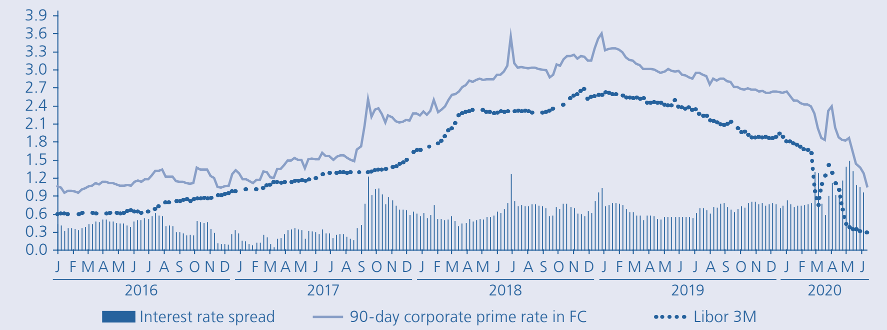
90. On the other hand, the prime interest rates on 1-month to 6-month lending and deposit operations decreased on average by 158 and 133 basis points, respectively, and similarly, the interest rates paid on time deposits decreased by an average of 84 basis points. In the credit market, interest rates showed mixed behaviors. The spread of the 3-month corporate prime interest rate with respect to the interbank interest rate has increased by 2 basis points since the beginning of the social confinement period.

Table 33
INTEREST RATES IN FOREIGN CURRENCY
(%)

		Dec.18	Jun.19	Sep.19	Dec.19	Mar.20	Jun.20
	Deposits up to 30-day	1.9	1.7	1.6	1.5	1.0	0.1
Pasive	On 31 to 180-day term deposits	2.0	2.0	1.7	1.3	1.1	0.6
	On 181 to 360-day term deposits	1.9	1.9	1.5	1.4	1.0	0.9
	90-day corporate prime	3.6	2.9	2.8	2.7	1.9	1.1
	Corporates	4.0	3.6	3.1	3.2	2.7	3.0
	Large companies	5.5	5.6	5.4	5.5	4.8	5.3
Active	Medium-sized enterprises	6.9	6.8	7.3	6.6	6.7	6.5
	Small businesses	9.9	9.9	8.0	8.8	7.7	4.8
	Consumer	36.1	35.2	35.8	36.1	36.1	37.4
	Mortgage	6.1	5.9	5.8	5.6	5.9	5.5

Memo: Annual rates for operations in the last 30 working days.
*As of June 18.
Source: BCRP and SBS.

Graph 81
INTEREST RATE IN US$: 90-DAY CORPORATE PRIME AND LIBOR 3-MONTH
(%)

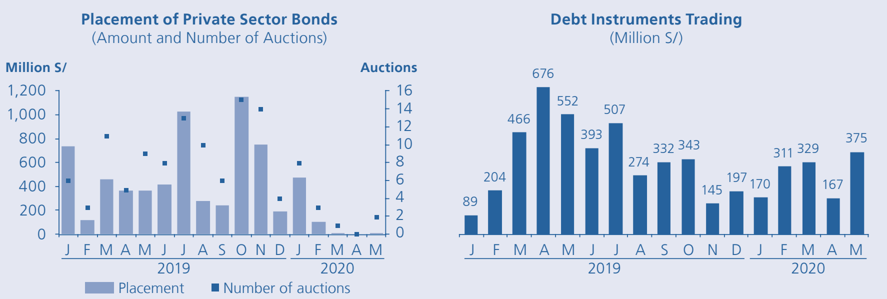


* As of June 18.
Source: BCRP.

Private Sector Fixed Income Market

91. In the private sector debt market, placements though public offerings have registered their lowest levels in the last 14 months (S/ 14 million in March, no issuances in April, and S/ 4 million in June). In the secondary market, the trading of debt instruments at the Lima Stock Exchange (LSE) fell from S/ 676 million in April 2019 to S/ 167 million in April 2020 and showed a rebound in May (S/ 375 million). Furthermore, the participation of non-resident investors in local securities decreased slightly between May and June.

Graph 82
PRIVATE SECTOR FIXED INCOME MARKET



Source: SMV.

92. As regards debt issued by Peruvian companies in the foreign market, the last placements were a bond issuance of US$ 380 million in January 2020 and another one for US$ 500 million in June, which brings the balance of securities

issued abroad to US$ 23.60 billion. In addition, US$ 969 million in Peruvian company securities[16] will mature in the coming months.

Foreign Exchange Market

93. Between December 2019 and June 2020, the sol depreciated 5.7 percent, from S/ 3.314 to S/ 3.503 per dollar. The PEN was affected in March 2020 by i) a general sell-off of financial assets associated with the rapid expansion of COVID-19 after the WHO declared the corona virus pandemic; ii) the increase in global risk aversion to historical levels after the rapid spread of the virus outside China; iii) the fall in the international price of oil, and iv) increased fears of a global recession.

94. An additional source of volatility in the local market resulted after the withdrawal of 25 percent of AFP funds by affiliates was proposed. Despite this, the sol showed the lowest foreign exchange-related volatility in the region. Then, in April, the exchange rate showed a slight appreciation trend. As of June 15, the PEN shows a depreciation trend associated with fears of a new Covid-19 outbreak.

    Between January and June 2020, the BCRP intervened in the foreign exchange market, mainly in the derivatives market, through auctions of foreign exchange swaps (S/ 12.07 million), placements of Indexed Certificates of Deposits (S/ 1.78 billion), and operations in the spot market (buying US$ 32 million in April and selling US$ 7 million in May). Since April, banks have carried out unwind operations of foreign exchange swaps for a total of S/ 2.77 billion (US$ 799 million).

95. In addition to this, in April 2020 BCRP authorized the AFPs to carry out foreign currency sale operations with the aim of reducing the volatility in the exchange rate associated with the potential sale of foreign currency to finance affiliates' withdrawal of their pension funds.

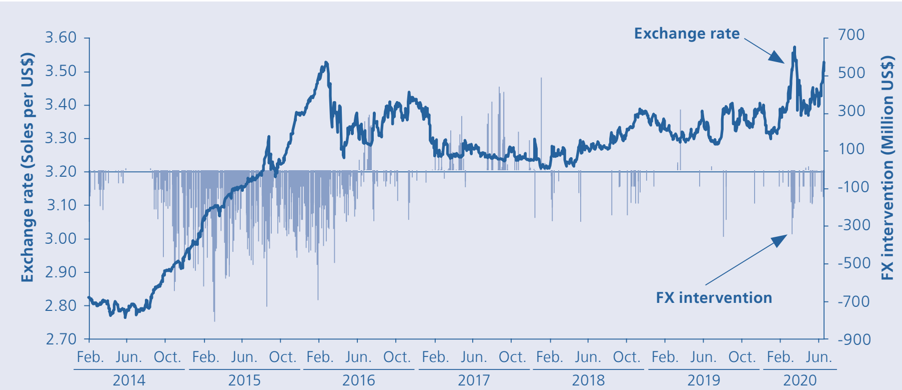
Table 34
FOREIGN EXCHANGE INTERVENTION

	Trading days	Number of intervention days						SD of the Exchange Rate (Annual % change)
		Spot Market	Placement of derivatives and indexed instruments	Total (spot and/or placement)	% of days with intervention			
					Spot	Instruments	Total	
2016	250	50	119	134	20%	48%	54%	7.3%
2017	249	55	26	64	22%	10%	26%	4.5%
2018	245	4	27	30	2%	11%	12%	3.4%
2019	249	4	6	10	2%	2%	4%	4.4%
2020*	119	4	29	31	3%	24%	26%	8.8%

* As of June 19.

16 Securities of non-financial firms. The maturity term of securities amounting to US$ 339 million (of which US$ 336 million have been issued by non-financial entities) will expire in 2021.

Graph 83
EXCHANGE RATE AND FX INTERVENTION[1/]

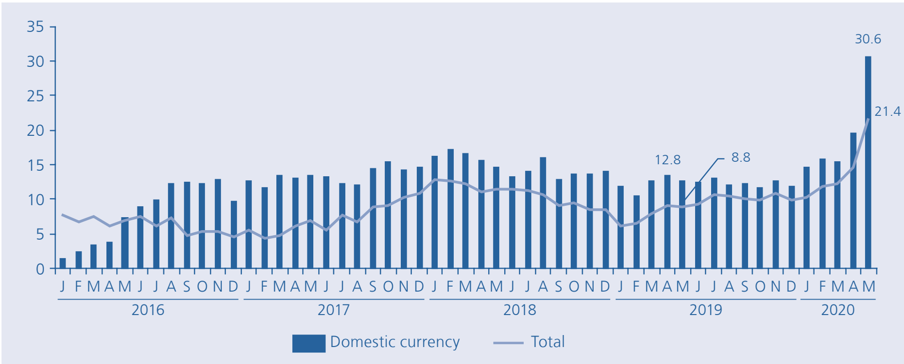


1/ Includes Net purchases of US$ in the spot market and placement of CDLD BCRP, CDR BCRP, and FX swaps.

Liquidity

96. Private sector deposits showed a year-on-year growth rate of 21.4 percent in May 2020. By currencies, deposits in soles grew 30.6 percent year-on-year, while deposits in dollars grew 5.8 percent, reflecting people's greater preference for saving in domestic currency.

Graph 84
DEPOSITS OF THE PRIVATE SECTOR BY CURRENCY
(Annual % change)



The dollarization ratio of deposits fell from 35.8 percent in 2019 to 32.3 percent in May 2020, this fall being explained by a decrease in the dollarization ratio of both personal deposits (from 30.1 to 28.0 percent) and corporate deposits (from 45.9 to 38.9 percent).

In 2020 and 2021, deposits would continue to grow at a higher rate than credit to the private sector.

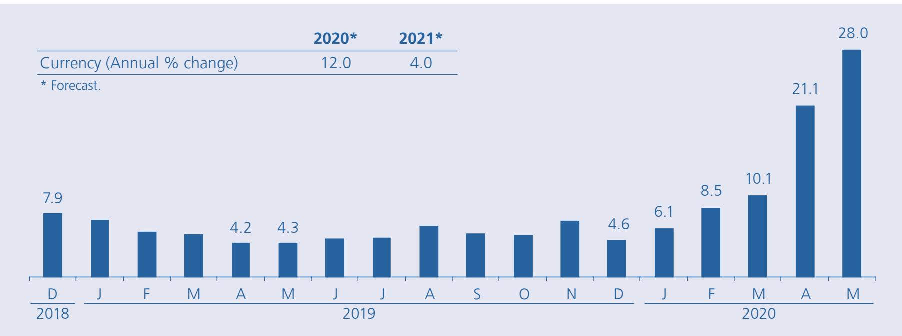
Table 35
MONETARY AND CREDIT ACCOUNTS
OF THE DEPOSITORY CORPORATIONS (END-OF-PERIOD) 1/
(Annual % change)

	Dec.18	Mar.19	Jun.19	Sep.19	Dec.19	Mar.20	Apr.20	May.20	Dec.20*	Dec.21*
Currency in circulation (End-of-period)	7.9	5.3	4.8	5.4	4.6	10.1	21.1	28.0	12.0	4.0
Deposits in domestic currency	14.1	12.7	12.5	12.4	11.9	15.4	19.7	30.6	38.9	1.7
Total deposits 1/	8.4	7.9	9.3	10.0	10.0	13.3	14.6	21.4	26.2	1.7
Broad money in domestic currency	12.2	11.3	10.7	10.8	10.2	13.4	19.2	28.8	33.0	2.2
Total broad money 1/	8.2	7.4	8.5	9.3	9.4	11.5	15.5	22.0	24.0	2.0
Credit to the private sector in domestic currency	11.6	11.7	10.7	10.4	9.7	9.7	9.9	18.4	20.2	0.0
Credit to the private sector 1/	**8.7**	**8.4**	**7.6**	**7.5**	**6.9**	**8.3**	**8.3**	**13.7**	**15.0**	**0.0**

1/ Balances are valuated at constant exchange rate on December 2019.
* Forecast.

97. **Currency in circulation** would grow 12 percent in 2020 and 4 percent in 2021, the faster pace of growth in 2020 being explained by people's precautionary greater accumulation of banknotes and coins. The increase in circulation is associated with the greater transactional and precautionary demand caused by the effects of the State of Emergency beause of the COVID-19 pandemic. Restrictions on economic activity and the implementation of monetary subsidies for low-income people to cover their basic needs would have led a significant segment of the population to use cash in their transactions and also to keep it for precautionary reasons.

Graph 85
CURRENCY
(Annual % change)



98. It is worth pointing out that there is a greater relative demand for 50 soles and 100 soles banknotes than for banknotes of other values and that this greater demand accounts for 93 percent of the total change observed in currency. Moreover, from March to May 2020, the demand for 100 soles banknoted for transactions represented 7 times the demand registered in the same period of 2019.

Credit to the Private Sector

99. **Credit to the private sector** showed a faster pace of growth, accelerating from a rate of 6.9 percent in 2019 to a year-on-year rate of 13.7 percent in May, in the context of the implementation of the Reactiva Peru Program. By segments, credit to businesses grew 19.2 percent –vs 4.2 percent in December 2019–, while credit to individuals slowed from a rate of 11.3 percent in 2019 to 5.1 percent in May. The greatest deceleration in credit to individuals was observed in car loans and credit cards (2.6 and -0.9 percent, respectively), while on the business credit side, the segments with the highest growth rates are loans to corporations and large companies (24.0 percent), followed by loans to medium-sized companies (15.7 percent), and by loans to small and micro-enterprises (11.4 percent). Moreover, external funding and funding from the local capital market –resources typically accessed by the corporate sector and by large companies– were also lower in this period.

    Credit in soles continues to grow close to two-digit rates, driven mainly by the Reactiva Peru program. On the other hand, the growth of credit in dollars has slowed down due to the greater preference for local funding and for interest rates in soles, which have remained below their historical average levels. Thus, in May, credit in soles grew 18.4 percent, while credit in dollars grew 0.8 percent in the same period.

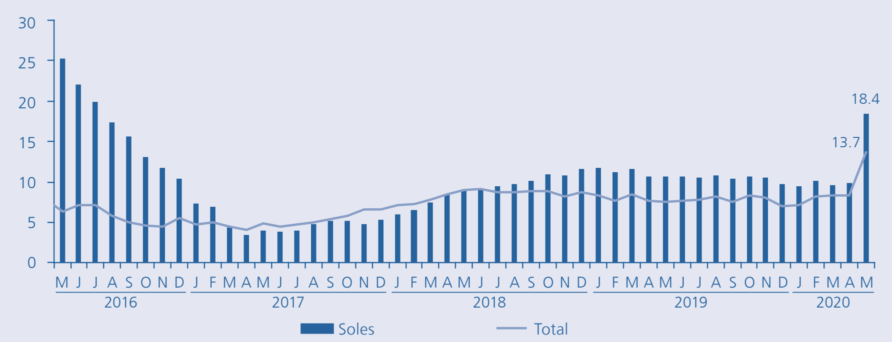
100. The strong acceleration in the annual growth of credit is a reflection of the measures taken by BCRP described at the beginning of this chapter. The loans granted under the Reactiva Perú Program are used as working capital, which has allowed to sustain the economy's payment channel. A credit crunch scenario, in which the conditions of access to credit tighten and where a second-round negative effect is generated in the economy, is quite frequent in periods of deep crisis. It is precisely this scenario that has been avoided through the aforementioned measures taken by BCRP, which have allowed the easing of financial conditions in different ways.

Table 36
CREDIT TO THE PRIVATE SECTOR 1/
(Annual growth rate)

	Dec.18	Mar.19	Jun.19	Sep.19	Dec.19	Mar.20	Apr.20	May.20
Businesses	**7.0**	**7.3**	**5.3**	**4.9**	**4.2**	**7.7**	**9.1**	**19.2**
Corporate and large companies	9.1	8.9	6.3	6.4	4.4	11.7	15.8	24.0
Medium-sized enterprises	3.8	3.9	1.6	0.1	0.5	0.6	-0.9	15.7
Small business and Microbusinesses	5.9	7.0	7.1	6.6	7.7	5.5	4.1	11.4
Individuals	**11.5**	**11.7**	**11.4**	**11.7**	**11.3**	**9.3**	**7.0**	**5.1**
Consumer	13.1	13.5	13.0	13.4	12.8	10.2	6.8	4.5
Car loans	-3.5	2.7	6.9	8.5	11.9	6.9	3.3	2.6
Credit cards	11.9	14.7	14.8	16.0	13.4	8.9	2.6	-0.9
Rest	14.7	13.4	12.3	12.3	12.6	11.0	9.2	7.4
Mortgage	9.0	9.1	9.1	9.1	9.0	8.0	7.1	6.1
TOTAL	**8.7**	**9.0**	**7.6**	**7.5**	**6.9**	**8.3**	**8.3**	**13.7**

1/ Balances are valuated at constant exchange rate on December 2019.

Graph 86
CREDIT TO THE PRIVATE SECTOR
(Annual % change)



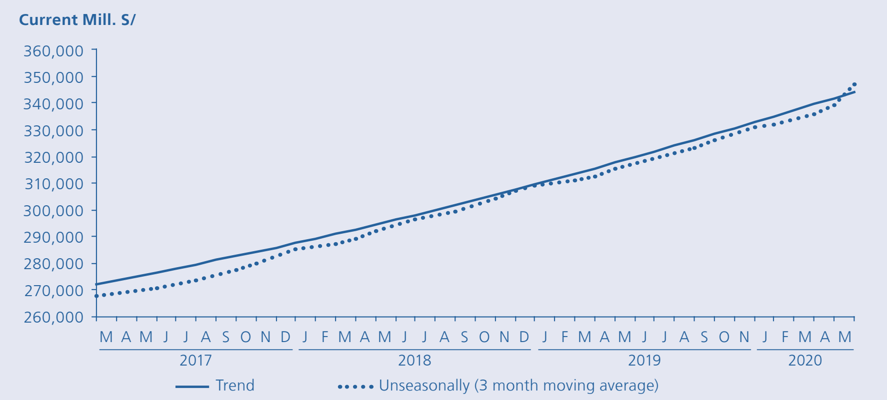
101. The balance of total credit to the private sector has continued evolving in line with its long-term trend, which is consistent with flexible financial conditions for the provision of credit.

Table 37
CREDIT AL PRIVATE SECTOR 1/
(Annual % change)

	Dec.18	Mar.19	Jun.19	Sep.19	Dec.19	Mar.20	Apr.20	May.20
Domestic currency	11.6	11.7	10.7	10.4	9.8	9.7	9.9	18.4
Foreign Currency	1.9	2.4	0.2	0.3	-0.4	4.6	4.1	0.8
Total	**8.7**	**9.0**	**7.6**	**7.5**	**6.9**	**8.3**	**8.3**	**13.7**

1/ Balances are valuated at constant exchange rate on December 2019.

Graph 87
UNSEASONALLY CREDIT TO THE PRIVATE SECTOR AND TREND



Dollarization of Credit and Liquidity

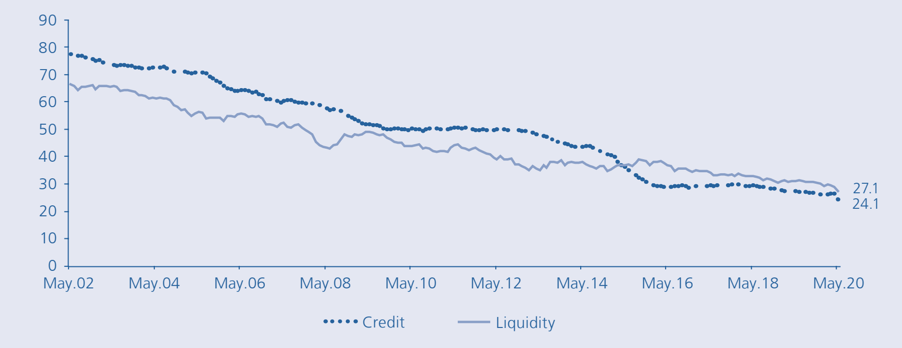
102. The ratio of dollarization of credit measured at a constant exchange rate was 24.1 percent in May, lower than in December (25.9 percent). This reduction results mainly from a lower dollarization of credit to companies, which decreased from 37.3 to 33.1 percent in this period, while the dollarization of credit to individuals continued to show its downward trend. Thus, the dollarization ratio in the segment of mortgage loans ment went from 13.3 percent to 12.6 percent in May, while the dollarization ratio of consumer loans decreased from 6.0 percent to 5.5 percent in the same period.

Table 38
RATIO OF DOLLARIZATION OF CREDIT TO THE PRIVATE SECTOR 1/
(%)

	Dec.18	Mar.19	Jun.19	Sep.19	Dec.19	Mar.20	Apr.20	May.20
Businesses	**38.7**	**38.2**	**38.4**	**38.1**	**37.3**	**37.8**	**37.4**	**33.1**
Corporate and large companies	51.9	51.2	51.8	51.3	50.5	50.4	49.2	44.2
Medium-sized enterprises	40.1	39.9	39.7	39.4	38.5	38.7	38.7	32.3
Small business and Microbusinesses	6.2	5.9	5.7	5.7	5.7	5.6	5.4	5.1
Individuals	**10.4**	**10.0**	**9.7**	**9.4**	**8.9**	**8.5**	**8.4**	**8.3**
Consumer	6.4	6.2	6.2	6.2	6.0	5.7	5.5	5.5
Car loans	13.9	13.4	14.2	14.8	14.8	14.9	15.0	14.7
Credit cards	7.1	7.2	7.4	7.4	7.1	6.6	6.0	5.7
Rest	5.6	5.4	5.3	5.1	5.0	4.9	4.9	5.0
Mortgage	16.3	15.5	14.9	14.2	13.3	12.7	12.7	12.6
TOTAL	**27.8**	**27.2**	**27.1**	**26.7**	**25.9**	**26.3**	**26.2**	**24.1**

1/ Balances are valuated at constant exchange rate on December 2019.

Graph 88
RATIO OF DOLLARIZATION OF CREDIT AND LIQUIDITY: 2002 - 2020
(%)



Non-Performing Loans

103. The ratio of non-performing loans was 3.37 percent in May, 0.09 percentage points higher than at the end of 2019. It should be pointed out that the ratio of non-performing loans in credit to businesses has decreased by 0.18 percentage points compared to December 2019, while the ratio of non-performing loans in personal loans has increased by 0.45 percentage points.

Table 39
NON-PERFORMING LOANS INDEX
(%)

	Dec.18	Mar.19	Jun.19	Sep.19	Dec.19	Mar.20	Apr.20	May.20
Businesses	**3.59**	**3.66**	**3.68**	**3.70**	**3.57**	**3.68**	**3.82**	**3.39**
Corporate and large companies	0.58	0.61	0.64	0.57	0.62	0.63	0.67	0.66
Medium-sized enterprises	7.84	8.10	8.25	8.67	8.24	9.00	9.54	7.79
Small business and Microbusinesses	7.60	7.52	7.57	7.52	7.13	7.41	7.52	7.08
Individuals	**3.18**	**3.10**	**3.24**	**3.17**	**3.15**	**3.33**	**3.69**	**3.60**
Consumer	3.32	3.19	3.37	3.28	3.27	3.47	3.84	3.71
Credit cards	5.32	5.27	5.52	5.49	5.47	5.79	6.32	5.88
Car loans	4.45	3.92	3.97	3.97	3.75	3.86	4.30	4.43
Rest	1.54	1.56	1.59	1.66	1.68	1.83	2.09	2.24
Mortgage	3.01	2.98	3.07	3.02	2.98	3.15	3.50	3.46
Average	**3.44**	**3.46**	**3.52**	**3.50**	**3.28**	**3.41**	**3.62**	**3.37**

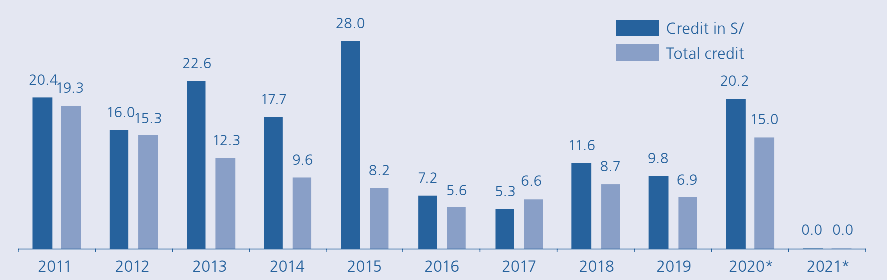
Projection of credit to the private sector

104. In the forecast horizon (2020-2021), **credit to the private sector** is expected to grow at higher rates than the nominal output, with which the ratio of credit

to the private sector-to-GDP would increase from 43 in 2019 to 50 percent in 2021. This projection also takes into account the implementation of the Reactiva Peru program, through which government-backed loans for up to S/ 60 billion are being granted to support the economic reactivation of the country.

Moreover, credit to the private sector in domestic currency is projected to grow 20.2 percent in 2020 and to maintain this level in 2021, considering the beginning of the amortization of credits granted under the Reactiva Perú program. Thus, total credit would grow 15.0 percent in 2020 and would remain constant in 2021. With this, the dollarization ratio of credit would continue to decrease, reaching a level of 23 percent at the end of 2021.

Graph 89
CREDIT TO THE PRIVATE SECTOR
(% change)



* Forecast.

Box 5
THE REACTIVA PERU PROGRAM

The Reactiva Peru Program

The COVID-19 pandemic has brought about a sudden, transitory and large-scale shock to both the global economy and the local economy. The effects of this shock on demand are reflected in: i) the contraction of the global economy, which has negative impacts on our exports; ii) loss of income, which reduces the purchasing power of households, and iii) uncertainty, which damages consumer and business confidence. On the other hand, the effects on supply are reflected in: i) disruption in the supply chain and ii) necessary social isolation measures to control the spread of the disease, which affect production. This has generated a significant drop in families' income and in the cash flows of companies, limiting the ability to meet already contracted obligations, such as the payment of workers' wages, rents, debts with suppliers, etc.

In such a context, non-performing loans and credit risk increase, making access to financing more difficult and further amplifying the negative effects of the disruption of the payments chain. Because of this, it is necessary to have a mechanism to grant financing to companies and provide them with working capital during the necessary period of confinement in order to increase companies' probability of survival and limit the risk of a disruption in the payments system.

Moreover, there are externalities that increase the probability of such a disruption. For example, financial institutions do not internalize that, because their aversion to the risk of lending increases due to fear that companies will be unable to repay their loans, they also make it more likely that they themselves will not be able to fulfill their previous obligations either.

That is why it is necessary to have a mechanism for intervention and channeling of resources that: i) prevents the breakdown of the payments channel and, at the same time, ii) provides the necessary liquidity to the financial system in order to offset the negative effects of the current crisis and thereby mitigate the impact of external and domestic shocks that could affect stability in the financial system.

Characteristics of the Reactiva Peru Program

Several characteristics of this program ensure that very low-cost financing may reach companies quickly:

1. To allow massive coverage, Reactiva Peru was created as a program of government-backed credit guarantees of S/ 30 billion (recently expanded to S/ 60 billion);

2. To determine each company's financing needs in a simple way, the loan amount is equivalent to 3 months of the company's contributions to EsSalud or to the sales declared to SUNAT in 1 month in 2019, which is associated with the needs of working capital. In the second stage of the program, these criteria in the case of micro-businesses were expanded to 3 months of declared sales or 2 times the debt balance;

3. To reduce financial institutions' credit risk, the National Government's guarantee granted is 80 percent for loans of up to S/ 10 million and 98 percent for loans of up to S/ 30 thousand. The coverage of this government-backed guarantee, which acts as a risk absorption mechanism in the face of these exceptional conditions, was expanded on June 1;

Guarantee percentage	Credit by company (in soles)	
	Before June 1, 2020	As of June 1, 2020
98%	Up to 30,000	Up to 90,000
95%	From 30,001 to 300,000	From 90,001 to 750,000
90%	From 300,001 to 5.000,000	From 750,001 to 7.500,000
80%	From 5.000,001 to 10.000,000	From 7.500,001 to 10.000,000

4. To encourage the access of companies that were sound before the COVID-19 shock to the program, prerequisites for companies include conditions such as having a good record as taxpayer and borrower prior to this event, which is information easy to corroborate through the SUNAT and SBS databases; and

5. To ensure favorable financial conditions for companies, BCRP provides long-term funding to financial institutions at very favorable conditions (interest rate of 0.5 percent), using an auction mechanism to assign the funds to the financial entities that offer the lower interest rates and the longer maturity terms for their final clients (i.e. 36 months with 12 months grace period).

BCRP Funding

BCRP provides funds to the financial institutions participating in the Reactiva Peru program through Government-backed Credit Repos. This is a new BCRP instrument whereby liquidity is provided to financial institutions and the part part of the loans from the Reactiva Peru Program that is guaranteed by the National Government is received as collateral. In other words, BCRP provides the funding in exchange for the loan granted as collateral. Thus, upon maturity of the loan, the financial institution repurchases the portfolio from BCRP in exchange for the principal of the operation plus the respective interests. The participating financial institutions are the financial institutions legally allowed to accept deposits from the public with which BCRP carries out operations (banks, finance companies, and municipal and rural savings banks).

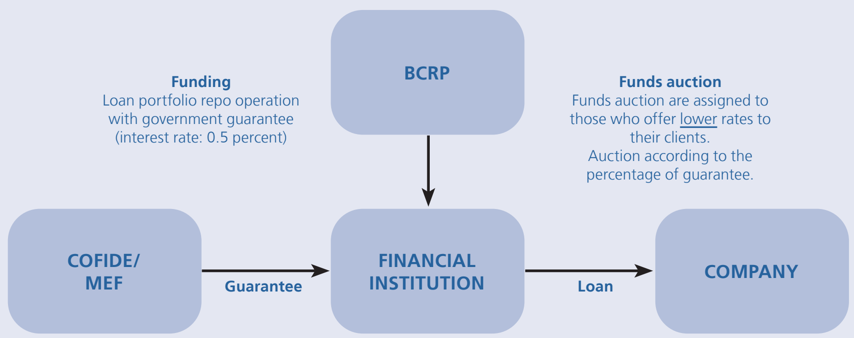
The operation is as follows:

1° The funds auctioned to financial institutions by BCRP are assigned to the participating entities that offer the lowest interest rate for their clients;

2° The winning financial institution submits the information of the loan applications to COFIDE (the program administrator). COFIDE verifies that the prerequisites are met, the loan amount and the auction interest rate, among other conditions, and if the loan is approved, it provides the Government Guarantee to the loan; and

3° Having the Government Guarantee, the financial institution subsequently requests the operation funds from BCRP and disburses the loan to the company.

FLOW OF FUNDS OF THE REACTIVA PERU PROGRAM



It is worth mentioning that BCRP can carry out these operations under two modalities: i) the regular scheme, through which BCRP directly accepts government-backed loan portfolios as collateral for the operation, and ii) the special scheme, in the which a trust is used. This modality is preferred for smaller loans to reduce the operation's administrative costs.

Timeline of the Reactiva Peru Program

The process of creating the Reactiva Peru Program began at BCRP in mid-March 2020 when the first cases of COVID-19 were registered in Peru. After adopting several previous actions, such as the easing of monetary conditions by reducing the reference interest rate to its historical minimum and the reduction of reserve requirements, on March 26 the Board of BCRP approved the creation of the new liquidity injection instrument: Credit Repos Guaranteed by the National Government. Moreover, because contracts were necessary to carry out these operations with financial institutions, the process of signing contracts also had to be adapted to the conditions of the national emergency as notaries were not authorized to function and the process was simplified.

The following table outlines all the steps involved in the creation of the program. The first auction of funds in Government-Backed Credito Portfolio Repos was carried out by BCRP on April 23 and subsequently, the first disbursement of a loan associated with the Reactiva Peru program was made on May 5.

<table>
<tr><th colspan="4">THE PROCESS OF CREATING THE REACTIVA PERU PROGRAM</th></tr>
<tr><th></th><th colspan="2">BCRP</th><th>OTHER INSTITUTIONS</th></tr>
<tr><td>March 12</td><td colspan="2">The design of the injection channel begins.</td><td></td></tr>
<tr><td>March 19</td><td colspan="2">Decrease of the Reference interest rate by 100 basis points to 1.25 percent.</td><td></td></tr>
<tr><td>March 26</td><td colspan="2">Decrease of reserve requirements and approval of a new liquidity injection instrument (Loan portfolio repo operation with National Government Guarantee).</td><td></td></tr>
<tr><td>March 29</td><td colspan="2">Announcement of a plan to avoid a disruption in the payment system.</td><td></td></tr>
<tr><td>April 3</td><td colspan="2">Simplification for signing contracts during National Emergency (Circular 014-2020-BCRP).</td><td></td></tr>
<tr><td>April 6</td><td rowspan="7">Signature of Framework Contracts with Financial Institutions</td><td></td><td>Creation of the National Government Guarantee Program for S/ 30 billion, to avoid a disruption in the payment system (LD 1455), modified on April 12 (LD 1457).</td></tr>
<tr><td>April 9</td><td>Decrease of the Reference interest rate by 100 basis points to 0.25 percent.</td><td></td></tr>
<tr><td>April 13</td><td></td><td>Publication of the Rules of Procedure (MR N° 134-2020-EF/15).</td></tr>
<tr><td>April 14</td><td>Creation of the instrument, Loan portfolio repo operation with National Government Guarantee (Circular 017-2020-BCRP)</td><td></td></tr>
<tr><td>April 17</td><td>The interest rate for these injection operations is set at 0.5 percent</td><td></td></tr>
<tr><td>April 21</td><td></td><td>Previous report of the General Controllership of the Republic.</td></tr>
<tr><td>April 22</td><td></td><td>Approval of the Constitutive Act of the Securitization Trust and the Reactiva Peru Trust Commission and the administration commission to COFIDE (MR No. 140-2020-EF/52), modified on April 29 (MR No. 140-2020-EF/52).</td></tr>
<tr><td>April 23</td><td colspan="2">First repos auction in the Reactiva Peru framework</td><td></td></tr>
<tr><td>April 27</td><td colspan="2"></td><td>SBS eases provision requirements under Reactiva Peru program (Res. SBS 1314-2020).</td></tr>
<tr><td>May 4</td><td colspan="2"></td><td>COFIDE signs Guarantee Contracts with financial institutions.</td></tr>
<tr><td>May 5</td><td colspan="2"></td><td>Disbursement of the first Reactiva Peru loan by a financial institution.</td></tr>
<tr><td>May 10</td><td colspan="2"></td><td>Expansion to S/ 60 billion the maximum amount guaranteed for the granting of the loans guarantee by the National Government to the Credits of the Reactiva Peru Program (LD 1485).</td></tr>
<tr><td>May 11</td><td colspan="2"></td><td>The SMV is authorized to regulate the activities that COFIDE carries out as a securitization company (art. 8 LD 1508).</td></tr>
<tr><td>May 17</td><td colspan="2"></td><td>The SMV approves the provisions applicable to COFIDE, to act as a securitization company (Resolution of Superintendent No. 041-2020-SMV/02).</td></tr>
<tr><td>June 1</td><td colspan="2"></td><td>Modification of the Rules of Procedure of the “Reactiva Peru” Program, expanding the guarantee hedge for loans (MR 165-2020-EF/15).</td></tr>
</table>

Program Results

As of June 11, after seventeen BCRP auction sessions, funds for a total of S/ 30 million have been assigned through Government-Backed Portfolio Repo operations at an average interest rate of 1.12 percent (the lowest rate being 0.5 percent and the highest 3.60 percent). It should be pointed out that if the amount of unsecured credit is also considered, loans for more than S/ 34 billion may be financed through these funds.

So far, these repos have been assigned to 23 financial entities, including nine banks, ten municipal savings banks, three financial companies, and one rural savings bank, which represent 95 percent of the credit to companies as of April 2020.

OPERATIONS AUCTION OF PORTFOLIO REPO WITH NATIONAL GOVERNMENT GUARANTEE 1/

Guarantee percentage	Loan range	Amount in millions of soles: Guaranteed amount: Placed 1/	Settled 2/	Placement interest rate (%): Minimum	Maximum	Average
80	S/ 5.000,001 - S/ 10.000,000	8,718	6,674	0.79	1.49	1.11
90	S/ 300,001 - S/ 5.000,000	14,006	10,772	0.90	2.00	1.08
95	S/ 30,001 - S/ 300,000	6,098.1	3,341	0.54	2.50	1.13
98	Up to S/ 30,000	973.8	195	0.50	3.50	1.44
98 (special)	Up to S/ 10,000	204.1	87	2.50	3.60	3.41
Total		**30,000**	**21,070**	**0.50**	**3.60**	**1.12**

1/ As of June 11 (last auction date).
2/ Information as of June 17, preliminary and subject to change.

According to Cofide information, the amount of guaranteed loans as of May 29 is S/ 24.748 million. Moreover, loan recipients total 71,533 companies, the highest proportion being micro and small companies (MSE) (70.2 percent), followed by medium-sized companies (26.4 percent), while corporate and large companies represent 3.4 percent.

REACTIVA LOANS BY COMPANY SIZE 1/

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

1/ Prepared with MEF information as of May 29, 2020. For the classification of company size, the definition of the SBS is used according to the Consolidated Credit report (CCR). On the other hand, for companies that are not listed in the CCR, the classification is based on the amount of REACTIVA debt.
Memo: The criteria for classifying the loans to companies by credit segment according to the SBS is as follows:
Corporate companies: Annual sales over 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 higher than S/ 300 thousand or annual sales not higher than S/ 20 million.
Small businesses: Total indebtedness between S/ 20 thousand and S/ 300 thousand.
Microbusinesses: Total indebtedness not higher to S/ 20 thousand.

By company size, the participation of companies in total REACTIVA credits is proportional to their contribution to total sales. Thus, the corporations and large companies that have accessed Reactiva –which account for 64 percent of total sales– have received 51 percent of the amount of loans, while small and micro businesses, which account for 14 percent of sales, have received 18 percent of loans.

REACTIVA LOANS BY COMPANY SIZE 1/

	Credit Amount		Average Sale	
	(Million S/)	Participation (%)	(Million S/)	Participation (%)
Corporate and large companies	12,625	51.0	20,731	63.8
Medium-sized enterprises	7,593	30.7	7,162	22.0
Small businesses and Microbusinesses	4,529	18.3	4,623	14.2
Total	**24,748**	**100.0**	**32,516**	**100.0**

1/ Prepared with MEF information as of May 29, 2020. For the classification of company size, the definition of the SBS is used according to the Consolidated Credit report (CCR). On the other hand, for companies that are not listed in the CCR, the classification is based on the amount of REACTIVA debt.
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Small businesses: Total indebtedness between S/ 20 thousand and S/ 300 thousand.
Microbusinesses: Total indebtedness not higher to S/ 20 thousand.

The 71,553 companies that received Reactiva loans as of May accounted for 1,881,000 jobs before quarantine, which represents 49.5 percent of formal employment in the private sector.

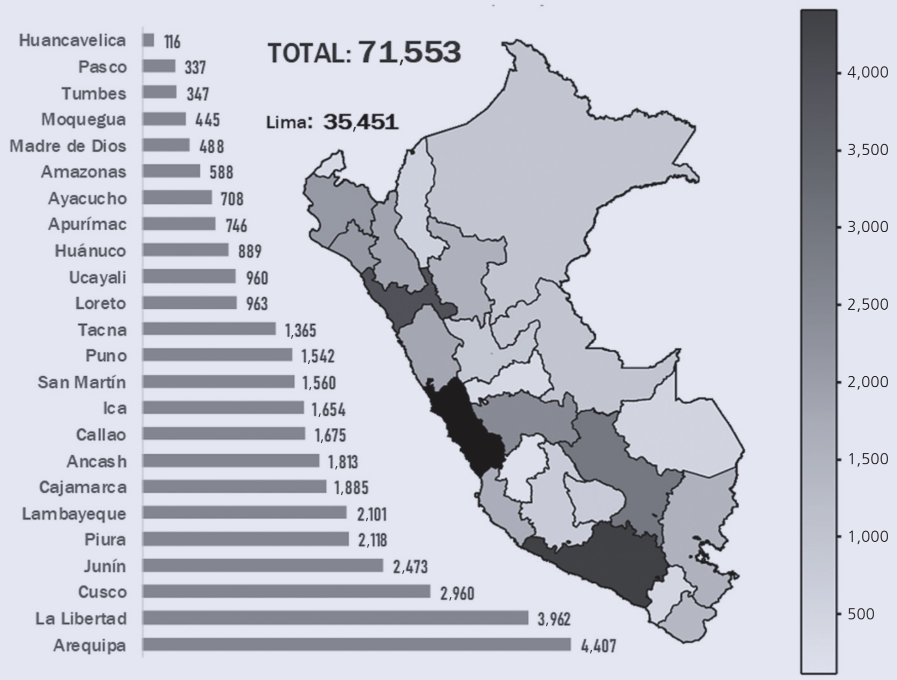
COMPANIES IN REACTIVA PROGRAM AND EMPLOYMENT 1/ 2/
(Number of companies and thousands of job places)

	Reactiva companies	%	Job places	%
Total	**71,553**	**100**	**1,881**	**100**
Corporate and large companies	2,457	3.4	1,046	55.6
Medium-sized enterprises	18,861	26.4	460	24.5
Small businesses and Microbusinesses	50,235	70.2	375	19.9

1/ With information from the Electronic Payroll corresponding to January 2020. Companies are classified according to the SBS definition.
2/ Includes 16,604 companies without information in the Electronic Payroll. For these companies, the average employment is considered according to the company size.
Source: Sunat, SBS and MEF.

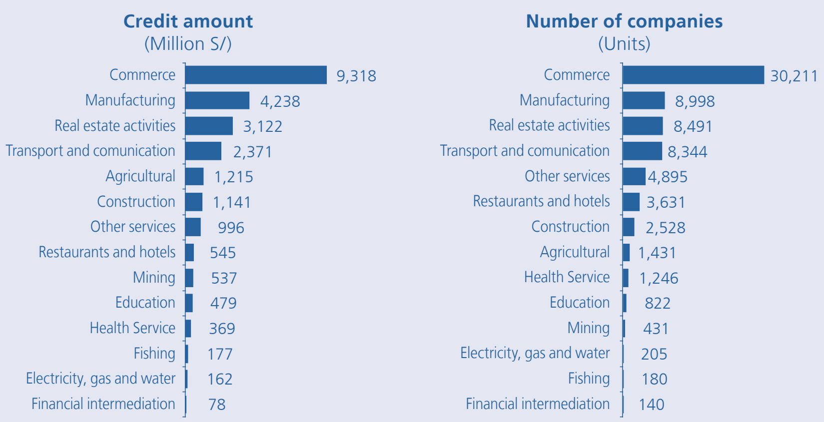
When the geographical location of the loan recipient companies is analyzed, we see that Lima region concentrates the highest proportion, with a total of 37,126 companies (51.9 percent), followed by Arequipa with 4,407 companies (6.2 percent), La Libertad with 3,962 companies (5.5 percent), Cusco with 2,960 companies (4.1 percent), and Junín with 2,473 companies (3.5 percent).

NUMBER OF COMPANIES BY REGION



Moreover, when we look at the distribution of the program loans by economic sector, we see that the loans have been allocated mainly to companies in the sectors of commerce, services, and manufacturing, this being reflected not only in the greater loan amounts received, but also in the number of recipient companies. It is also worth mentioning that companies in the transport and communications sub-sector as well as business activities stand out within the services sector.

NUMBER OF COMPANIES AND CREDIT AMOUNT BY ECONOMIC SECTOR



Some of the impacts of this program are already reflected in the financial system's interest rates. At end-May and so far in the month of June 2020, a significant reduction is observed in the interest rates on new loans to medium-sized, small and micro companies in comparison with the month of April.

LOAN INTEREST RATES IN DOMESTIC CURRENCY 1/

	Dec.19	Feb.20	Mar.20	Apr.20	May.20	Jun.20*
Reference	2.25	2.25	1.25	0.25	0.25	0.25
Interbank	2.25	2.24	1.84	0.61	0.24	0.25
Prime	3.26	3.20	3.05	2.35	1.29	1.00
Corporate	3.80	3.40	3.63	4.01	2.94	2.65
Large companies	6.01	6.09	5.86	5.48	1.98	1.79
Medium-sized enterprises	9.28	9.57	8.86	8.11	2.42	2.75
Small businesses	18.03	18.27	18.14	18.16	3.17	4.09
Microbusinesses	31.32	31.36	32.56	33.13	7.02	7.19
Consumer	40.85	38.08	39.30	41.38	40.41	39.32
Mortgage	7.00	6.99	6.72	6.77	7.31	7.30

1 / Loan rates in annual terms of the operations carried out in the last 30 days (flow).
* Information as of June 16, 2020.
Source: SBS and BCRP.

Experiences in other countries

As a containment strategy for Covid-19, several countries are implementing credit programs to support business and economic activity, in some cases supported by their central banks. These countries include Chile, the United States, the United Kingdom, Sweden, and Switzerland.

In Chile, the government created a loan program with guarantees ranging between 60 and 85 percent so that financial institutions have access to credit lines from the Central Bank and charge their clients an interest rate of 3.5 percent.

In the United States, the government has established the government-funded Paycheck Protection Program (PPP), which guarantees 100 percent loans for amounts equivalent to eight weeks of the companies' main expenses. Loans can be forgiven if certain conditions are met, such as using the credit to pay the payroll and that all employees continue to work for eight weeks.

The Bank of England has a scheme whereby the amount allocated increases if the final loan recipient is a small or medium business. The interest rate on the final loan is also determined by the financial institution.

On the other hand, the Central Bank of Sweden has a double scheme, in which the Central Bank funding and the government guarantee scheme are separate. The funds are allocated based on the amounts requested by financial institutions (and not by interest rates) and there is a penalty if the auctioned funds are not used. After allocating the funds, the entities are free to determine the interest rates they will charge for their loans and to which clients they will assign them.

The Swiss Government established the SNB COVID-19 refinancing facility (CRF) which operates together with a government guarantee program of up to 100 percent for business loans.

Because an excessive administrative burden can delay the allocation of funds, a common element in these credit suport programs is that the state guarantee that in some cases reaches 100 percent and the simple formulas to determine the loan amount and program eligibility are key elements to ensure that funds are distributed quickly. Thus, for example, the requirement to demonstrate the absence of alternative sources of credit was eliminated in the United Kingdom, while the use of funds was made more flexible in the United States.

Conclusions

In sum, the Reactiva Peru program has prevented the disruption of the payments system and the credit channel while contributing to provide the financial system with the necessary liquidity. As a result, loans for more than S/ 34 billion have been assigned to companies to date, including both the guaranteed and the non-guaranteed tranches. The program's amount of repo operations is equivalent to 4.2 percent of GDP –or 8.4 percent of GDP with the Program extension– and the loans are granted for a period of up to 36 months with a grace period of 12 months, without a payment of principal or interest during that period. To date, 70 percent of the companies benefiting from the program have been small and micro-enterprises, which have received 18 percent of the total credit, an amount proportional to the value of their sales (14 percent of the total).

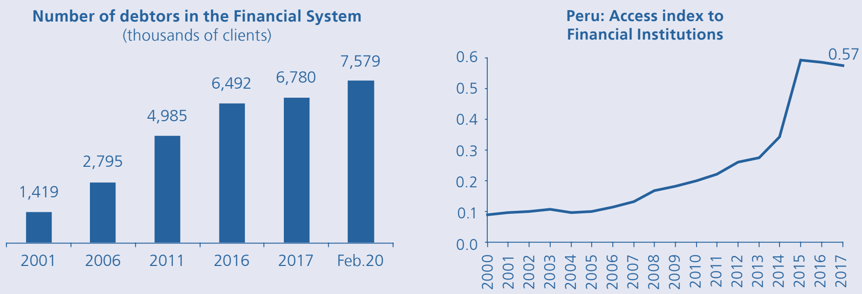
The program of fund auctions has made it possible to channel resources appropriately so that businesses have access to credit under very favorable conditions, particularly in terms of the interest rates charged by financial institutions to their clients. The program has also improved significantly the liquidity position of financial institutions, which in turn reduces the risks that compromise financial stability. In addition, this has also contributed to accelerate the pass-through effect of the reduction of the BCRP reference interest rate to the rest of interest rates in the financial system. Furthermore, the impact of this liquidity injection program on credit conditions will be amplified as it extends in the economy's payment system.

Box 6
INTEREST RATE CAPS

The implications of setting caps on interest rates in the financial system is analyzed herein. Interest rates in the Peruvian financial system are determined by free competition. Article 9 of the General Law of the Financial System and Insurance System and the Organic Law of Superintendencia de Banca y Seguros (SBS) as well as Article 52 of the Organic Law of the Central Reserve Bank of Peru (BCRP) establish that BCRP can only exceptionally set maximum and minimum interest rates for the purpose of regulating the market[17]. However, this is not the case for interest rates in the financial system since there are no barriers to the entry of new financial companies and borrowers have multiple credit options given the large number of financial products that banks offer today.

Greater competition in the credit market, reflected in interest rates, has contributed to increase the degree of financial inclusion. According to the IMF's Index of Access to Financial Institutions (IMF), this indicator in Peru has increased from 0.09 in 2000 to 0.57 in 2017. This greater financial inclusion is also observed through the number of debtors in the financial system[18], which has increased from 1.2 million in 2000 to 7.6 million in February 2020.

FINANCIAL INCLUSION



Source: SBS.

Source: International Monetary Fund.

Since the process of financial deepening observed in the country in recent years has eased access to credit for low-income sectors[19], it is considered that the establishment of

17 In accordance with article 51 of its Organic Law, BCRP establishes the maximum compensatory, moratorium and legal interest rates for operations outside the financial system.

18 Number of consolidated debtors. In other words, a debtor is considered a single debtor even if the debtor has different types of loans (consumer loans, mortgage loans, loans to micro businesses, small companies, medium-sized companies, large companies and corporations) in the same entity in the financial system.

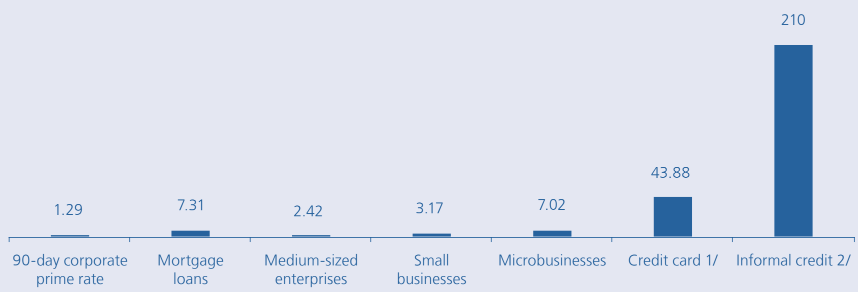
19 Miller, T. and Black, H. (2016). Examining arguments made by interest cap advocates. In: Pierce, H. and Klutsey, B. eds., Reframing Financial Regulation: Enhancing Stability and Protecting Consumers (pp. 342-387).

interest caps could directly affect consumers with lower incomes by limiting their access to debt in the credit market[20]. Thus, if a sufficiently low interest cap level were set, financial institutions would find it difficult to recover the costs associated with credit and would probably grow less rapidly, which could reduce the provision of services to sectors of the population with greater credit risk.

On the other hand, one of the main arguments mentioned to support the setting of interest rates is the high differential existing between interest rates in the financial system[21], which benefits banks much more than consumers. In this regard, it should be pointed out that the differential between the credit card interest rate and the interest rate paid on less than 360-day bank deposits has been decreasing steadily in recent years[22].

Interest rates in the financial system reflect heterogeneity in default risk and higher operating costs for smaller loan amounts. Consequently, clients with a credit history have access to lower interest rates than those who enter the financial system for the first time. As of May 2020, banks' lending interest rates show historical minimum levels in various credit segments, which is mainly associated with the BCRP easing of monetary conditions with its policy interest rate at 0.25 percent as well as with the effect of new credits associated with the Reactiva Perú Program. It is worth mentioning that the interest rate in the case of informal credit in 2013 was close to 210 percent[23]. A general low level of interest rates is expected in the coming months.

AVERAGE INTEREST RATE BY CATEGORY
(Annual percentage in domestic currency)



1/ maximum rate of 152%
2/ maximum rate of 792% for consumer loans.
Source: SBS. Information as of May 29, 2020 and Asbanc (2013).

20 For further information, see: Nivín, Rafael, 2018. "Topes a las tasas de interés: Cuando la cura puede ser más grave que la enfermedad," Revista Moneda, Banco Central de Reserva del Perú, 173, pp. 14-19.

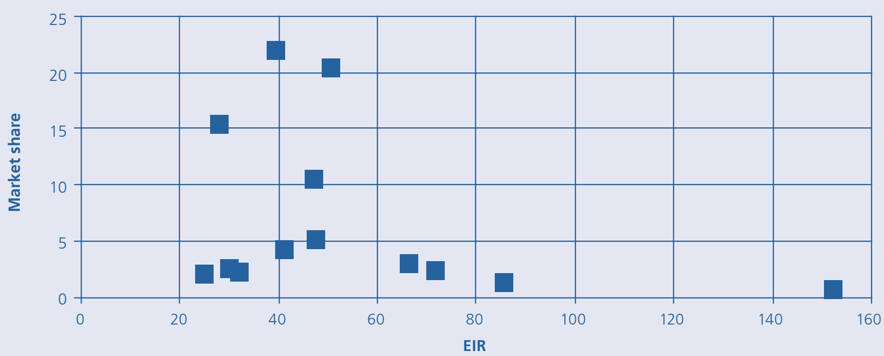
21 Difference between the lending interest rate (the interest rate charged by financial institutions on credit) and the deposit interest rate (the interest rate paid by financial institutions for deposits).

22 From 102 percent in 2012 to 43 percent in May 2020.

23 Asbanc, 2013, "Los Topes a las tasas de interés".

On the other hand, there is a high dispersion in the effective interest rates (EIR) charged by banks on credit cards. In June 2020, the institutions with the largest participation in the market were the ones that charge lower interest rates, which would indicate that few entities charge high interest rates and affect a low number of credit users.

CREDIT CARD: TEA AND MARKET SHARE
(%)

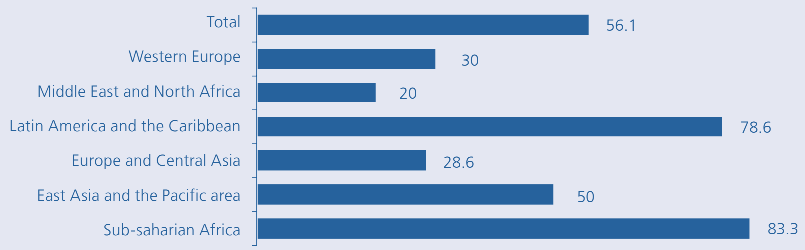


Source: SBS. As of June 1, 2020.

Moreover, experiences in other countries show that there are other more effective mechanisms to improve credit conditions in an economy, with the promotion of the financial culture among consumers, the development of the microcredit market, improving the institutionality of the credit market, and the promotion of competition in new markets such as Fintech (new financial companies with platforms based on new financial technologies) standing out among them. According to the World Bank (2014)[24], financial inclusion shows levels below the regional average in those countries where interest rate caps exist. In Latin America and the Caribbean, 79 percent of the countries with rate caps have a lower financial inclusion levels than those with free competition in interest rates.

24 Maimbo, Samuel Munzele; Henriquez Gallegos, Claudia Alejandra. 2014. Interest Rate Caps around the World: Still Popular, but a Blunt Instrument. Policy Research Working Paper; No. 7070. World Bank Group, Washington, DC.

PERCENTAGE OF COUNTRIES WITH INTEREST RATE CAPS THAT HAVE FINANCIAL INCLUSION INDICATORS BELOW THE REGIONAL AVERAGE



Source: World Bank (2014).

In conclusion, the Central Bank of Peru considers that the imposition of interest rate caps is not the appropriate way to reduce interest rates and improve families' access to the formal credit market. This position is based on the fact that this price control instrument generates rationing in the credit market and therefore excludes lower-income families since meeting the demand for credit of lower-income consumers is more expensive due to their risk profile and to the small size of this credit. Furthermore, recent experiences in other countries show that it also reduces financial intermediation and increases other financial costs. On the other hand, competition, with adequate information and free participation of banks and their clients, allows developing a process of financial inclusion among economic agents who do not have access to financing or for whom informal credit is the only option.

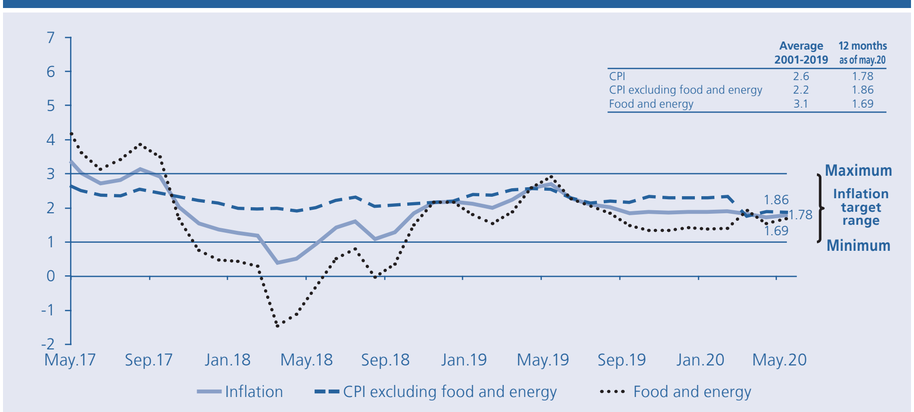
VI. Inflation and Balance of Inflation Risks

Recent Inflation Trends

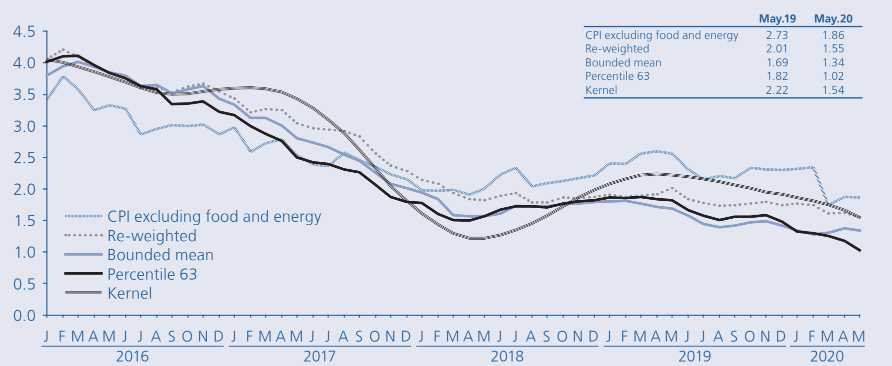
105. The annual CPI inflation rate decreased from 1.90 percent in February to 1.78 percent in May, showing a more pronounced decrease in core inflation (CPI excluding food and energy prices), which fell from 2.34 percent in February to 1.86 percent in May. The social confinement measures decreed since mid-March, and the resulting drop in economic activity, brought about a decrease in income as well as less pressure from demand on prices. In general, the annual growth rate of the CPI as well as all the inflation trend indicators showed values in the lower band of the target range.

Annual inflation is projected to decrease in the following months due to negative demand shocks, falling below the lower band of the target range in late 2020. Lower consumption would continue to push prices down, generating lower prices in imported food supplies as well. In addition, declining international oil prices have also been seen in recent months.

Graph 90
INFLATION
(Last 12-month % change)



Graph 91
MEASUREMENTS OF THE INFLATIONARY TREND
(Last 12 months % change)



Memo:
1. CPI excluding food and energy: CPI excluding food, fuel and electricity.
2. Re-weighted: Reduces the weight of items with greater volatility, considers the original weights of each item between the standard deviation of their monthly percentage changes.
3. Bounded mean: Weighted average of the percentage change of prices between the 34th and 84th percentiles.
4. Percentil 63: Corresponds to the percentage changes of the item located in the 63th percentile.
5. Kernel: Corresponds with the trend from a weighted moving average of current, past and forecast inflation, where the weights are calculated from an inverted parabolic function called kernel. Weights are obtained for 6 periods of past inflation and 6 periods of forecast inflation.

106. The state of emergency declared in the country due to the coronavirus outbreak has made it difficult to collect data on a regular basis due to mobility restrictions. In addition, compliance with the quarantine has also generated a reduced availability of goods and services due to the temporary closure of the businesses that sell goods, especially durable goods, and most of the consumer services required by households.

Since the second half of March and during the months of April and May, INEI has collected prices for 113 items out of a total of 174, which is equivalent to 64 percent of the consumer basket. Of these available items, 80 items belong to the food and energy group and 33 items to other goods and services. In line with the methodology used by other countries when prices are unavailable, INEI has proceeded to repeat the prices of the goods and services that are not available.

Table 40
INFLATION
(Available items)

	Total		Available	
	Number of items	Weight	Number of items	Weight
CPI	**174**	**100.0**	**113**	**64.4**
1. CPI excluding food and energy	**89**	**56.4**	**33**	**32.6**
Goods	52	21.7	26	15.9
Services	37	34.8	7	16.7
2. Food and energy	**85**	**43.6**	**80**	**31.8**
Food and beverages	80	37.8	76	26.1
Energy	5	5.7	4	5.7

Inflation in April was 0.10 percent and in May it showed a monthly rate of 0.20 percent monthly, while the average monthly growth of all the available prices was 0.17 percent and 0.33 percent in April and May, respectively. When the behavior of unavailable prices is analyzed in a context of crisis in which family incomes have been affected, a drop is estimated in the prices not observed, which in this case include both meals outside the home and most of the components of core inflation (CPI excluding food and energy prices), such as education, tourism, among others. Consequently, in the context of less available data, it is estimated that the CPI registers an upward bias.

Recent Developments

107. Since March, the conduct of prices has been associated mostly with the measures taken in response to the coronavirus outbreak. At first, the declaration of a state of sanitary emergency and social isolation measures led to a sharp increase in demand for food and certain cleaning products, which led to a rise in prices. Subsequently, the prices of some products decreased due to the impact of social confinement measures and to the lower income of the population.

108. Between January and May 2020, the general price level increased 1.15 percent, at an average monthly rate of 0.23 percent. The CPI excluding food and energy prices grew 0.95 percent, while food and energy prices increased at a higher rate of 1.39 percent. Food and beverage prices increased 2.03 percent, while energy prices decreased 2.72 percent.

Table 41
INFLATION
(% change)

	Peso	2019	2020	
			Jan. May.	12 months
CPI	**100.0**	**1.90**	**1.15**	**1.78**
1. CPI excluding food and energy	**56.4**	**2.30**	**0.95**	**1.86**
a. Goods	21.7	1.39	0.50	1.09
b. Services	34.8	2.86	1.23	2.32
2. Food and energy	**43.6**	**1.43**	**1.39**	**1.69**
a. Food and beverages	37.8	1.00	2.03	2.13
b. Fuel and electricity	5.7	4.32	-2.72	-1.19
Fuel	2.8	-0.39	-5.14	-6.21
Electricity	2.9	8.04	-0.96	2.64

109. In the last twelve months, the services that showed the highest price increases were education (2.1 percent), although they recorded a lower rate than the annual average rate of the last ten years (4.6 percent). The other services, i.e. health services, meals outside the home, and "other personal services",

a category that includes domestic and cleaning services, among others, also showed lower rates than in the 2010-2019 period.

Table 42
INFLATION
(Annual % change)

	Weight	2019	2020 Jan. May.	2020 12 months
CPI	**100.0**	**1.90**	**1.78**	**2.86**
Education	**9.1**	**5.22**	**2.13**	**4.62**
Health	**1.1**	**1.47**	**1.04**	**3.22**
Meals outside the home	**11.7**	**1.69**	**1.23**	**4.40**
Other personal services	**3.3**	**1.35**	**0.80**	**1.80**
Of which:				
Household employees	2.1	0.81	0.32	0.78
Housekeeping	0.2	1.45	0.63	2.49
Various repair	0.1	0.52	-0.06	3.02
Radio and TV repair	0.0	0.00	0.00	2.55
Home repair and maintenance services	0.1	1.21	0.82	3.01

110. In January-May 2020, the items with the highest positive contribution to inflation were education (tuition and fees), tomatoes, sugar, eggs, and urban fares, while the items with the highest negative contribution to inflation were chicken meat, potatoes, gasoline and gas.

Table 43
ITEM WITH THE HIGHEST WEIGHTED CONTRIBUTION TO INFLATION: MAY 2020

Positive	Weight	% chg.	Contribution	Negative	Weight	% chg.	Contribution
Education costs (tuition and fees)	8.8	2.0	0.21	Chicken meat	3.0	-12.9	-0.32
Tomato	0.2	83.5	0.18	Potato	0.9	-14.6	-0.16
Sugar	0.5	31.1	0.15	Gasoline and lubricants	1.3	-6.5	-0.08
Eggs	0.6	30.4	0.15	Gas	1.4	-4.4	-0.06
Urban fare	8.5	1.7	0.14	Avocado	0.1	-24.9	-0.05
Onion	0.4	32.9	0.10	National transport	0.3	-9.2	-0.03
Show tickets	1.7	5.9	0.09	Electricity	2.9	-1.0	-0.03
Other vegetable	0.4	18.7	0.09	Tangerine	0.2	-13.4	-0.03
Beef	1.2	5.5	0.07	Lemon	0.2	-14.2	-0.03
Fresh vegetable	0.2	25.3	0.07	Olluco and other similar	0.1	-17.3	-0.02
Total			**1.25**	**Total**			**-0.81**

111. The increase in the category "**education**" (2.0 percent) was associated with the adjustment of education prices made at the beginning of the school year, which was lower than in the previous year (4.4 percent). Some schools reduced their tuition and fees due to the lower cost of online and distance education compared to the cost of face-to-face classes.

In the food group, the rise in the price of **tomatoes** (83.5 percent) was noteworthy as this crop was affected by variable weather conditions (which causes a lower supply of the first quality tomatoes) as well as by factors related to the state of health emergency, including the increased cost and scarcity of the packaging required to transport this crop as well as the increase in freight rates.

The price of **sugar** increased 31.1 percent. The demand for this product increased sharply at the start of the state of emergency, with factors contributing to this rise including mainly the lower supply of some sugar mills paralyzed due to maintenance and repairs in their facilities and the lower provision of inputs for the production process in others after the quarantine started.

The rise in the price of **eggs** (30.4 percent) reflected an increase in demand observed mainly in low-income sectors given the lower relative price of eggs compared to other high protein food products. Another element that contributed to this rise was some irregularity in the supply associated with companies' adjustment to measures adopted during the state of emergency (changes in office hours and higher expenses in health and transportation of personnel).

Urban fares increased 1.7 percent mainly due to the higher taxi fares associated with the reduction of transport services as the capacity of buses and minibuses was limited and only the circulation of taxis authorized by the Urban Transport Authority was allowed in the framework of the restrictions implemented during the state of emergency.

The price of **onions** rose 32.9 percent since its production and quality in Arequipa were affected by heavy rains in the first months of the year. In addition, the price was also affected by the increase in freight rates associated mostly with greater traffic control on the roads.

On the other hand, the price of **chicken meat** fell 12.9 percent. The health emergency measures led to a lower demand for chicken shops and restaurants and, in addition, transportation restrictions made it difficult for people to access wholesale distribution centers.

The price of **potatoes** dropped 14.6 percent. The price decline in the first months of the year was consistent with increased harvests and greater potato supplies from the central and southern highlands, mainly from the regions of Junín and Ayacucho, but thereafter the lower price reflected the decrease in demand due to the closure of restaurants, especially traditional food restaurants and chicken shops.

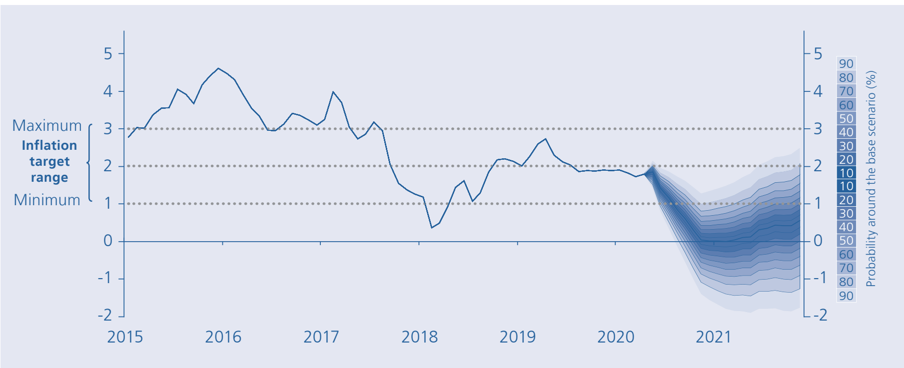
The price of **gasoline and lubricants** fell 6.5 percent on average, in line with the lower international price of crude oil and the lower prices of gasoline on the Gulf Coast, in the context of a world economic slowdown due to the effect of the pandemic. The price reduction of oil in the domestic market was partial given the validity of previously agreed fuel import contracts and the pricing policy of local refineries and retailers.

Forecasts

111. BCRP monetary policy actions are taken on the basis of inflation forecasts and projections of inflation determinants elaborated using all the macroeconomic information available at the time of decision making. Key indicators include inflation expectations, imported inflation (including the impact of the foreign exchange rate), and demand inflationary pressures which are reflected in the output gap on the side of aggregate demand. The demand gap, an indicator of demand pressures on inflation, differs from the trend output gap in that the latter also considers the supply factors associated with the compulsory confinement measures. Thus, the width of the demand gap would be lower than that of the trend output gap.

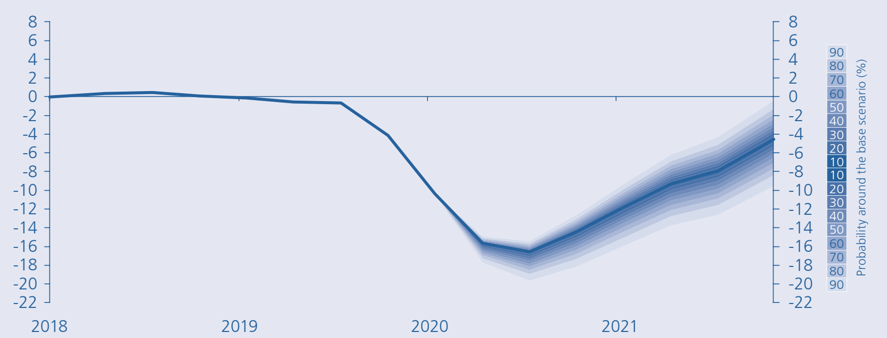
112. Based on the information available and taking into account, on the one hand, the negative supply shock experienced by the local economy as a result of the state of emergency and, on the other hand, the significant weakening of domestic demand, year-on-year inflation is expected to be temporarily below 1.0 percent (lower band of the target range) during the forecast horizon. This forecast is mainly explained by lower imported inflation and by a negative demand gap, which is expected to gradually close as the aggregate economy rebounds, while inflation expectations would remain close to the lower band of the inflation target range.

Graph 92
INFLATION FORECAST: 2020 - 2021
(Last 12-month % change)



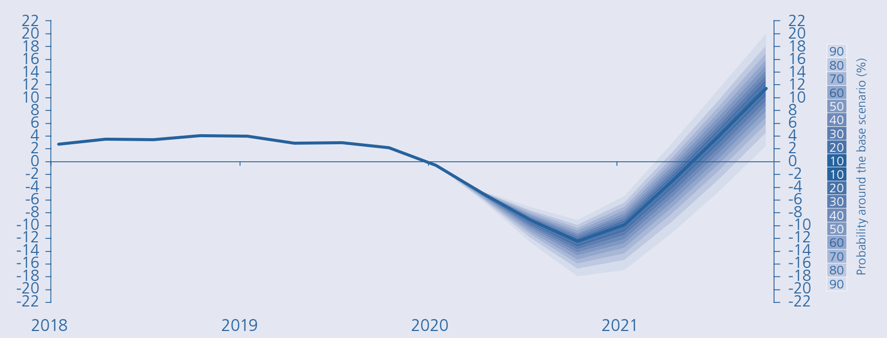
113. The economic contraction foreseen for 2020 would be sustained by the weakening of our trading partners' economies, by lower business confidence, and by the contracting effects of quarantine, offset in part by expansionary fiscal and monetary policy measures. A gradual improvement in economic growth is expected for 2021, associated mainly with an improvement in business confidence and in the pace of growth of our main trading partners. Thus, although a gradual economic rebound is expected, it would show a downward bias in the level of economic activity.

Graph 93
OUTPUT GAP: 2018 - 2021*
(% potential GDP)



*The gap is estimated as a deviation from a trend calculated using an HP filter.

Graph 94
GDP GROWTH FORECAST: 2020 - 2021
(Last 12-month % change)



114. Inflation expectations estimated on the basis of surveys conducted with financial and non-financial firms and economic analysts reveal that inflation is expected to show rates between 1.0 and 2.0 percent in 2020 and rates between 1.8 and

2.2 percent in 2021, remaining close to the midpoint of the target range. Thus, one-year-ahead expected inflation registered 1.52 percent in May 2020 and is expected to remain close to this level in the forecast horizon.

Graph 95
EXPECTATIONS OF INFLATION FOR THE NEXT YEAR
(% points)

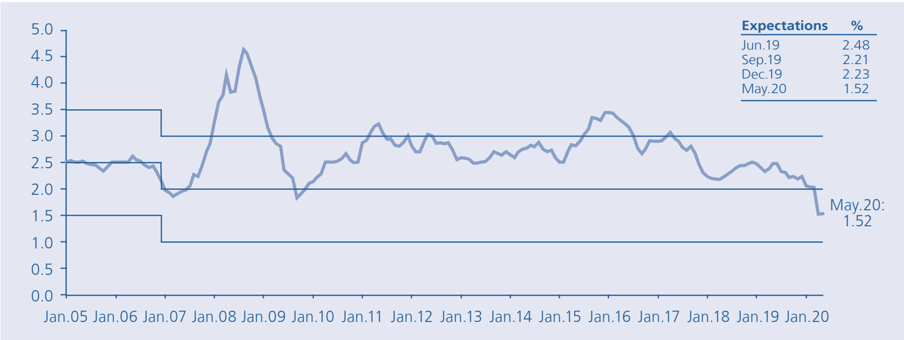


Table 44
SURVEY ON INFLATION EXPECTATIONS:
(%)

	IR Jun.19	IR Sep.19	IR Dec.19	IR Jun.20*
Financial entities				
2019	2.40	2.20	2.00	
2020	2.50	2.30	2.20	1.00
2021			2.30	1.80
Economic analysts				
2019	2.50	2.20	2.00	
2020	2.50	2.40	2.20	1.50
2021			2.50	2.00
Non-financial firms				
2019	2.50	2.40	2.20	
2020	2.50	2.50	2.40	2.00
2021			2.50	2.20

* Survey conducted during May 29.
IR: Inflation Report.

115. Another determinant of inflation is its imported component, which combines the effect of the international prices of goods we import –such as crude, wheat, soybean and maize, among other products– with the effect of exchange rate variations.

Average import prices are projected to drop by 6.0 percent in 2020, mainly due to the lower prices of commodities such as maize and soybean, as well as the prices of crude. On the other hand, a 2.0 percent increase is expected in 2021. Moreover, the surveys on expectations about the US/PEN exchange rate show expected levels of S/ 3.40 per dollar for 2020 and levels between S/ 3.37 and S/ 3.40 at the end of 2021.

Table 45
SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE
(S/ per US$)

	IR Jun.19	IR Sep.19	IR Dec.19	IR Jun.20*
Financial entities				
2019	3.35	3.37	3.38	
2020	3.35	3.35	3.37	3.40
2021			3.35	3.37
Economic analysts				
2019	3.35	3.40	3.36	
2020	3.37	3.40	3.38	3.40
2021			3.37	3.40
Non-financial firms				
2019	3.35	3.35	3.37	
2020	3.37	3.38	3.40	3.40
2021			3.40	3.40

* Survey conducted during May 29.
IR: Inflation Report.

116. Taking the projections of economic activity and inflation into account, the Taylor rule suggests a more expansionary monetary impulse, which in this case is reflected in a negative trajectory for the reference interest rate. However, the effective lower limit for the reference rate implies that greater monetary impulse must materialize through non-conventional monetary policy quantitative measures.

Balance of Risks

117. The balance of inflationary or deflationary risks in this Report continues to be skewed towards the down side, although the risk is greater than in December 2019. The expected impact of lower inflation has increased due to a probable greater economic slowdown resulting from the weakening of both local and global demand and supply factors associated with the effects of the COVID-19 pandemic.

- **Domestic demand shocks**

  The risk of lower economic growth prospects (a decline in business confidence) and, consequently, lower levels of private investment, is considered in the forecast horizon, as well as the risk of potential delays in economic reopening, the execution of public spending, and in credit disbursements in phase 2 of the Reactiva Peru program. Lower public and private expenditure would imply a more negative output gap.

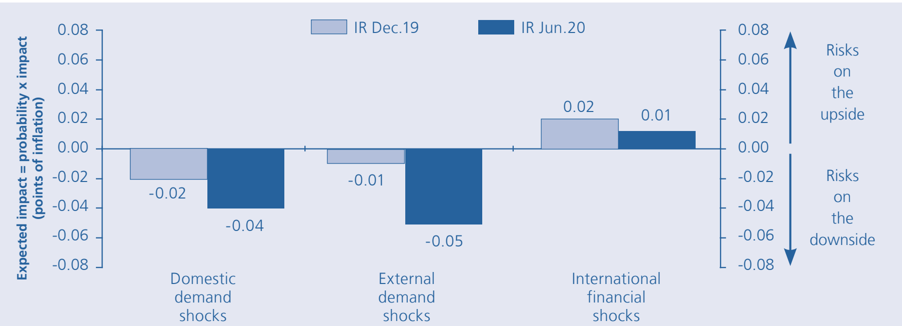
- **External demand shocks**

  The disruption of trade flows due to the spread of the coronavirus (COVID-19) could significantly reduce global economic growth and the global output. On the other hand, lower prospects for household incomes could contract global demand further. This lower world growth would be reflected in a reduction in the external demand for Peruvian exports and, in particular, a lower demand for minerals, which would bring about a contraction in commodity prices. A greater risk perception on world growth, and in particular on the performance of emerging economies, could motivate a greater demand for safe assets and favor an appreciation of the dollar.

- **Financial shocks**

  Part of this risk has decreased after the spread of COVID-19 due to the expansionary monetary policy response implemented in developed countries, although the possibility of an abrupt correction in asset prices in the United States remains, which would produce a increase in global financial risk and lead towards greater demand for safe assets. This greater perception of risk would also affect the emerging economies, causing capital outflows and the strengthening of the dollar globally. The latter would put upward pressure on inflation due to the effect of higher imported inflation.

Graph 96
BALANCE OF RISKS AGAINST THE BASE SCENARIO



IR: Inflation Report.