CENTRAL RESERVE BANK OF PERU

Summary Inflation Report

September 2020

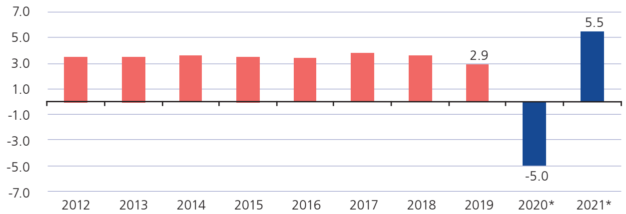
After a severe abrupt contraction of **global economic activity** to cope with the expansion of COVID-19 in the world, growth in the main economies has shown signs of a partial recovery as a result of the reopening of economic sectors and of the monetary and fiscal stimuli measures applied. In this context, global economic activity is estimated to contract by 5.0 percent in 2020. Considering a scenario in which the expansion of COVID-19 is controlled and positive vaccine developments are achieved, global GDP would recover by 5.5 percent in 2021

The recovery of global activity has been accompanied by favorable external financial conditions with the depreciation of the dollar in international financial markets and the recovery of commodity prices. In 2020, the **terms of trade** are projected to rise by 3.7 percent, a smaller reduction in average export prices (1.3 percent) being expected compared to the previous report due to higher prices of copper and gold. On the other hand, in 2021 the terms of trade would register a 1.7 percent reduction due to higher oil prices associated with the recovery of global demand.

In 2020, the **current account deficit** of the balance of payments would decrease to 0.1 percent of GDP due to the contraction of the profits of foreign direct investment companies (mainly mining, services, and industrial companies) and to the reduction of imports of goods associated with lower local economic activity. On the other hand, in 2021, the current account deficit is expected to increase to 1.6 percent of GDP –a level similar to that observed in recent years–, in line with the recovery of exports and imports of goods and the profits of foreign direct investment companies as a result of the normalization of activities and higher domestic demand.

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

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



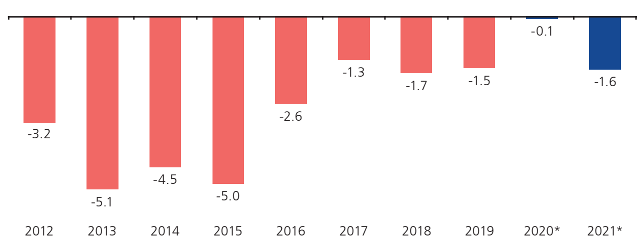
*Forecast.
Source: IMF and Consensus Forecasts.

TERMS OF TRADE: 2019 - 2021

	2019	2020*			2021*	
		S1	IR Jun.20	IR Sep.20	IR Jun.20	IR Sep.20
Terms of Trade *Annual average % chg.*	**-1.8**	**1.0**	**2.2**	**3.7**	**0.1**	**-1.7**
Price of exports *Annual average % chg.*	**-3.4**	**-4.8**	**-4.0**	**-1.3**	**2.1**	**2.1**
Copper (US$ cents per pound)	272	249	253	269	262	286
Zinc (US$ cents per pound)	116	93	91	98	91	100
Lead (US$ cents per pound)	91	80	77	82	76	84
Gold (US$ per troy ounce)	1,392	1,647	1,667	1,789	1,690	1,900
Price of imports *Annual average % chg.*	**-1.7**	**-5.7**	**-6.0**	**-4.8**	**-2.0**	**3.9**
Oil (US$ per barrel)	57	37	35	40	37	44
Wheat (US$ per ton)	168	174	176	168	185	171
Maize (US$ per ton)	145	132	130	129	139	141

* Forecast.
IR: Inflation Report.

CURRENT ACCOUNT: 2012-2021
(% GDP)



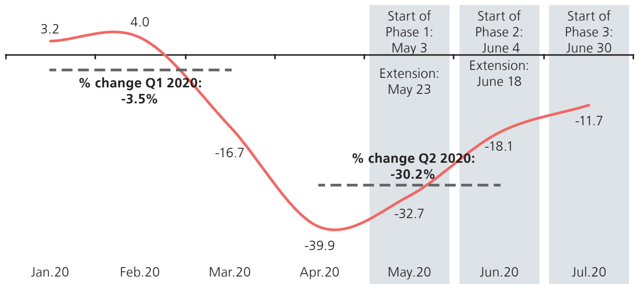
* Forecast.

DOMESTIC DEMAND AND GDP
(Real % change)

	2019	2020*			2021*	
		S1	IR Jun.20	IR Sep.20	IR Jun.20	IR Sep.20
Domestic demand	**2.3**	**-15.1**	**-11.9**	**-12.3**	**9.9**	**9.5**
Private consumption	3.0	-12.2	-9.4	-10.0	9.0	8.0
Public consumption	2.1	0.8	4.3	6.1	2.5	4.3
Private investment	4.0	-39.1	-30.0	-28.5	20.0	20.0
Public investment	-1.4	-39.2	-8.5	-19.0	9.0	11.0
Change on inventories (contribution)	-0.5	1.8	0.0	0.0	0.0	0.0
Exports	**0.8**	**-26.1**	**-18.9**	**-22.0**	**14.1**	**17.8**
Imports	**1.2**	**-18.2**	**-16.9**	**-21.1**	**7.5**	**11.7**
Gross Domestic Product	**2.2**	**-17.4**	**-12.5**	**-12.7**	**11.5**	**11.0**
Memo:						
Public expenditure	1.0	-9.4	0.7	-1.1	4.2	5.9
Domestic demand excluding inventories	2.9	-16.9	-11.7	-12.1	9.8	9.4

* Forecast.
IR: Inflation Report.

REAL GDP
(Annual % change)



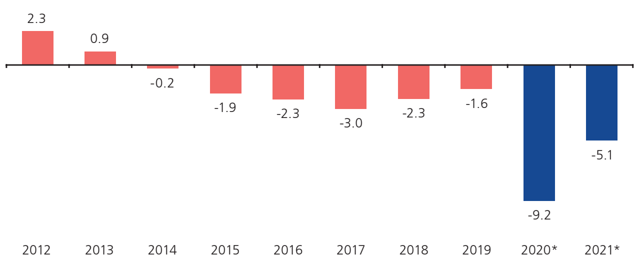
Memo: The beginning of the phases is based on the publication of the corresponding Supreme Decree. Extension refers to the date on which other activities came into operation.

GDP BY PRODUCTION SECTOR
(Real % change)

	2019	2020*			2021*	
		S1	IR Jun.20	IR Sep.20	IR Jun.20	IR Sep.20
Primary GDP	**-1.2**	**-12.2**	**-5.5**	**-7.0**	**8.0**	**9.6**
Agriculture and livestock	3.4	2.1	1.3	1.3	3.6	3.6
Fishing	-25.9	-15.6	9.5	3.0	8.5	8.5
Metallic mining	-0.8	-22.1	-10.2	-12.5	10.7	14.4
Hydrocarbons	4.6	-8.8	-14.4	-11.4	6.9	5.9
Based on raw materials	-8.8	-7.6	2.1	-1.3	7.7	7.7
Non-Primary GDP	**3.2**	**-18.9**	**-14.5**	**-14.4**	**12.6**	**11.5**
Non-primary industries	1.2	-27.9	-23.8	-18.5	16.9	16.9
Electricity and wate	3.9	-10.7	-7.9	-6.0	12.6	12.6
Construction	1.5	-42.0	-25.4	-22.2	23.2	23.2
Commerce	3.0	-27.5	-23.6	-17.8	17.4	17.4
Services	3.8	-13.3	-9.9	-12.3	10.1	8.2
GDP	**2.2**	**-17.4**	**-12.5**	**-12.7**	**11.5**	**11.0**

* Forecast.
IR: Inflation Report.

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



* Forecast.

Strict sanitary measures were adopted in the country since mid-March to contain the expansion of COVID-19, including mandatory confinement (quarantine) and the lockdown of activities considered non-essential. These measures led to a severe contraction in economic agents' income and to a massive loss of jobs, along with a profound deterioration in consumer and business confidence. As a result, in the first half of the year GDP contracted by 17.4 percent, with disruptions in the production of most economic sectors being noteworthy. On the other hand, domestic demand contracted by 15.1 percent during the same period due to the reduction of household spending and the interruption of private and public investment projects because of the restrictions imposed.

The extended lockdown of the economy from mid-March and throughout April led to an unprecedented drop in GDP in the latter month (-39.9 percent annually). With the beginning of the gradual reopening of the economy in 4 phases –at a rate of one phase per month since May for the first 3 phases– and an approach of more focused quarantines in regions and provinces, the economy began to register lower year-on-year contractions as more sectors restarted activities. As a result of this, the GDP in July was 11.7 percent below its level in the same month of 2019.

Under a synchronized scenario of efficient reopening of the economy, significant fiscal stimulus, maintenance of expansionary financial conditions, and the recovery of consumer and business confidence, GDP growth is expected to show a smaller reduction in the second half of the year (-8.4 percent). Thus, GDP is estimated to contract by 12.7 percent in 2020 and to grow by 11 percent in 2021.

The government continued implementing **fiscal policy** measures to address the effects of COVID-19 and considering the anticipated lower revenues associated with the drop in economic activity, it is estimated that the fiscal deficit for this year would reach 9.2 percent, the highest deficit since 1989. The fiscal deficit forecast for 2020 has been revised down from 9.7 percent (Inflation Report of June) to 9.2 percent of GDP due to a lesser contraction of current income and a lower execution of public investment. Among the new measures adopted since our last Report was published in June, it is worth highlighting the Arranca

Peru program, which is aimed at economic reactivation and at providing economic support to the population through current spending and public investment, as well as the second Family Bonus, which will benefit a total of 8.5 million households.

Thus, the projection of non-financial expenditure includes higher current spending associated with the recent fiscal policy measures, offset by lower gross capital formation. It is assumed that the fiscal impulse would be observed in the following months, which is consistent and necessary to continue with the recovery of economic activity. On the other hand, the projection of the deficit for 2021 has been raised to 5.1 percent of GDP from the level foreseen in the previous Report due to lower current income associated with lower company profits.

Between June and September, BCRP **monetary and financial actions** continued to be aimed at promoting the proper functioning of markets, the focus of these measures being to reduce the cost of financing, provide liquidity to the financial system, and reduce the volatility of long-term interest rates and the exchange rate.

Since April, the Board of Directors of BCRP has maintained the monetary policy interest rate at 0.25 percent, its historical minimum level, emphasizing that "it considers it appropriate to maintain a strong expansionary monetary stance for a prolonged period of time and as long as the negative effects of the pandemic on inflation and its determinants persist".

To maintain the sustainability of the payment system and the flow of credit in the economy, the balance of liquidity injection operations increased to S/ 60.9 billion between June and August (with a flow of S/ 16.4 billion from June), with S/ 42.4 billion of this amount being repo operations guaranteed by the National Government. The magnitude of this monetary stimulus may be illustrated in that the total balance of liquidity injection operations (S/ 60.9 billion) is almost eight times the balance reached during the 2008-2009 crisis (S/ 7.9 billion million) and 1.9 times the balance reached during the period of falling commodity prices (2013-2016) and the de-dollarization program (S/ 31.8 billion)

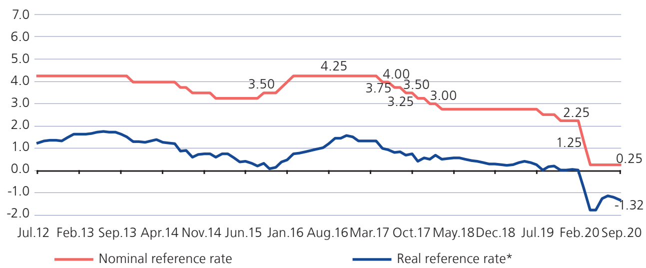
In line with the expansionary monetary stance, credit to the private sector showed an anti-cyclical behavior

NON-FINANCIAL PUBLIC SECTOR
(% GDP)

	2019	2020*			2021*	
		S1	IR Jun.20	IR Sep.20	IR Jun.20	IR Sep.20
1. General government current revenues	**19.7**	**20.2**	**17.5**	**18.0**	**19.5**	**18.7**
Real % change	*4.3%*	*-22.3%*	*-21.9%*	*-19.5%*	*24.0%*	*15.3%*
2. General government non-financial expenditure	**20.1**	**21.1**	**25.2**	**25.1**	**22.3**	**22.2**
Real % change	*1.3%*	*-0.5%*	*10.6%*	*10.8%*	*-1.8%*	*-2.3%*
Of which:						
Current expenditure	15.5	18.5	20.3	20.7	17.4	17.8
Real % change	*3.3%*	*7.9%*	*15.1%*	*17.9%*	*-4.3%*	*-4.4%*
Gross capital formation	4.0	2.1	4.2	3.6	4.2	3.7
Real % change	*-4.7%*	*-43.4%*	*-7.8%*	*-18.8%*	*12.6%*	*13.7%*
3. Other	**0.1**	**-0.9**	**-0.3**	**-0.4**	**0.2**	**0.1**
4. Primary balance (1-2+3)	**-0.2**	**-1.8**	**-8.0**	**-7.6**	**-2.5**	**-3.4**
5. Interests	**1.4**	**1.8**	**1.7**	**1.7**	**1.6**	**1.7**
6. Overall Balance	**-1.6**	**-3.7**	**-9.7**	**-9.2**	**-4.2**	**-5.1**

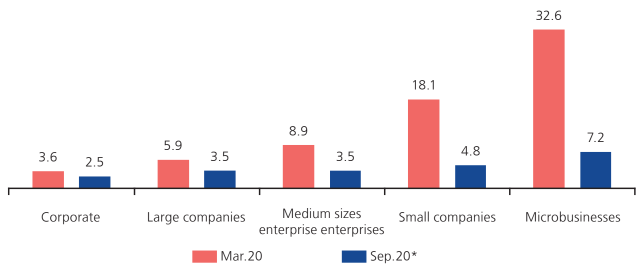
* Forecast.
IR: Inflation Report.

REFERENCE INTEREST RATE
(%)



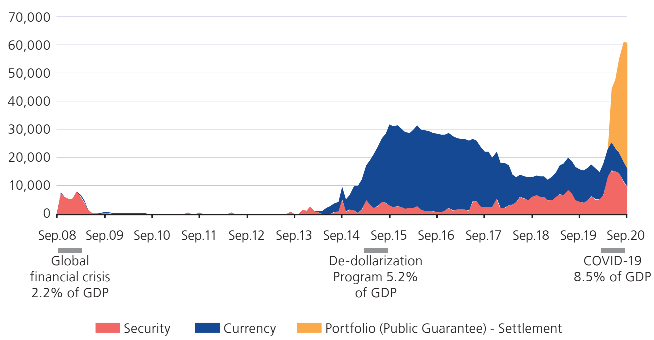
* With expectation of inflation.

INTEREST RATE IN DOMESTIC CURRENCY 1/
(In %)



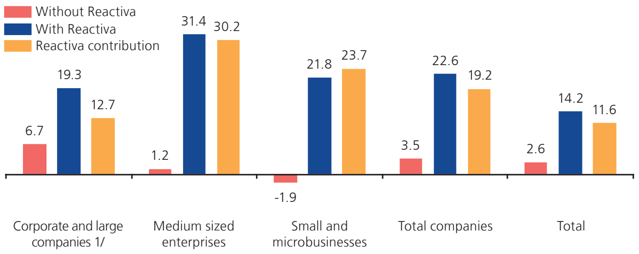
1/ Lending rates in annual terms of operations carried out in the last 30 business days for banks.
* Information as of September 17, 2020.
Source: SBS.

BALANCE OF REPO OPERATIONS*
(In million S/)



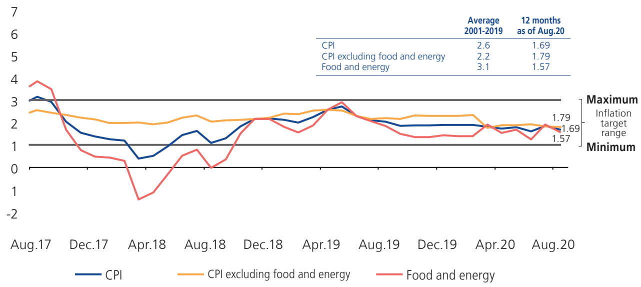
* As of September 17.

GROWTH OF CREDIT IN JULY 2020
(Annual % change)



Memo: The criteria for classifying business loans by credit segment according to the SBS is as follows:
Corporate: 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 for the last year.
Medium sized companies: Total indebtedness greater than S/ 300 thousand or annual sales not greater than S/ 20 million.
Small companies: Total indebtedness between S/ 20 thousand and S / 300 thousand.
Micro businesses: Total indebtedness without greater than S/ 20 thousand.

INFLATION
(Last 12-month % change)



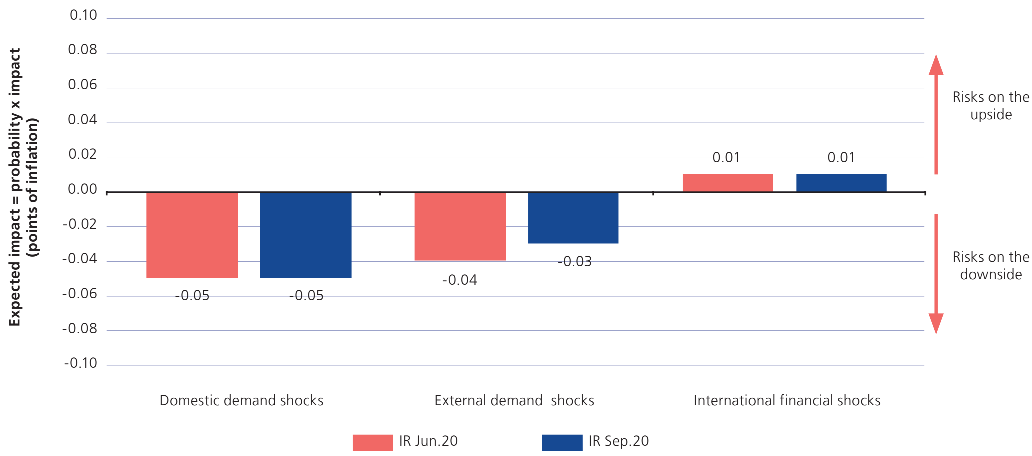
with an interannual rate of 14.2 percent in July, with higher relative growth rates being observed in credit to medium, small, and micro-enterprises in the context of the second phase of the Reactiva Peru Program. It is worth mentioning that the companies that have participated in the program generated 2.8 million jobs at the beginning of the pandemic. In the forecast horizon, credit to the private sector is estimated to grow 15 percent in 2020 and 3 percent in 2021, in line with the recovery of income in companies and families.

Year-on-year **inflation** has remained in the lower tranche of the target range since September 2019 with a rate of 1.69 percent per year in August, while one-year ahead expected inflation was also in that tranche (1.57 percent in August) in the last few months. Moreover, in the following quarters, year-on year inflation is expected to be temporarily below the lower band of the target range due to the weakening of domestic demand.

Balance of risks

The balance of **inflation risk factors** continues to be significantly skewed downwards, although slightly less than estimated in the June Report. The risks in the projection include the possibility of a further weakening of both domestic demand and global demand due to the effects of COVID-19 and health emergency measures. The base scenario considers a context with a recovery of consumer and business confidence, but situations that generate economic uncertainty may delay the economic recovery process.

BALANCE OF RISKS AGAINST THE BASE SCENARIO



SUMMARY OF INFLATION REPORT FORECAST

	2018	2019	2020[1/]		2021[1/]	
			IR Jun.20	IR Sep.20	IR Jun.20	IR Sep.20
Real % change						
1. Gross Domestic Product	4.0	2.2	-12.5	-12.7	11.5	11.0
2. Domestic demand	4.2	2.3	-11.9	-12.3	9.9	9.5
a. Private consumption	3.8	3.0	-9.4	-10.0	9.0	8.0
b. Public consumption	0.1	2.1	4.3	6.1	2.5	4.3
c. Fixed private investment	4.5	4.0	-30.0	-28.5	20.0	20.0
d. Public investment	5.6	-1.4	-8.5	-19.0	9.0	11.0
3. Exports (good and services)	2.4	0.8	-18.9	-22.0	14.1	17.8
4. Imports (good and services)	3.2	1.2	-16.9	-21.1	7.5	11.7
5. Global economic growth	3.6	2.9	-5.5	-5.0	5.5	5.5
Memo:						
Output gap 2/ (%)	0.4	-0.6	-20 ; -10	-20 ; -10	-13.0 ; -3.0	-13.0 ; -3.0
% change						
6. Inflation	2.2	1.9	0.0	0.8	0.5	1.0
7. Expected inflation 3/	2.1	2.3	1.3	1.2	1.9	1.8
8. Expected depreciation 3/	3.6	-0.3	1.3	3.8	-0.4	-1.0
9. Terms of trade	-0.4	-1.8	2.2	3.7	0.1	-1.7
a. Export prices	6.3	-3.4	-4.0	-1.3	2.1	2.1
b. Import prices	6.7	-1.7	-6.0	-4.8	2.0	3.9
Nominal % change						
10. Currency in circulation	7.9	4.6	12.0	25.0	4.0	4.0
11. Credit to the private sector	8.7	6.9	15.0	15.0	0.0	3.0
% GDP						
12. Gross fixed investment	22.4	22.6	19.2	19.0	20.3	20.3
13. Current account of the balance of payments	-1.7	-1.5	-1.4	-0.1	-1.4	-1.6
14. Trade balance	3.2	2.9	2.8	3.7	3.7	4.3
15. Long-term external financing of the private sector 4/	0.4	2.4	0.4	-0.5	0.2	-0.6
16. Current revenue of the general government	19.3	19.7	17.5	18.0	19.5	18.7
17. Non-financial expenditure of the general government	20.2	20.1	25.2	25.1	22.3	22.2
18. Overall balance of the non-financial public sector	-2.3	-1.6	-9.7	-9.2	-4.2	-5.1
19. Balance of total public debt	25.8	26.8	33.9	34.3	33.1	34.8
20. Balance of net public debt	11.3	13.0	23.6	22.8	25.3	25.6

IR: Inflation Report
1/ Forecast.
2/ Differential between GDP and potential GDP (%). Gap with GDP trend prior to the shock of the COVID-19.
3/ Survey on expectations to the analysts and financial entities.
4/ Includes net direct investment, portfolio investment and private sector's long term disbursement.