CENTRAL RESERVE BANK OF PERU

Summary
Inflation Report

March 2021

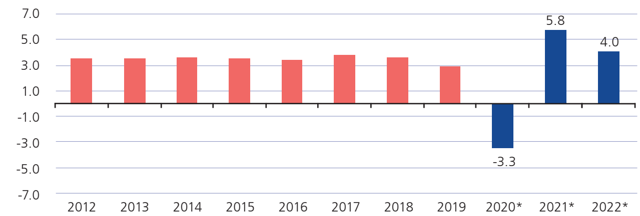
This ***Inflation Report*** has been prepared using data on the balance of payments and the gross domestic product as of the fourth quarter of 2020, data on the operations of the non-financial public sector, inflation, financial markets, and the exchange rate as of February 2021, and data on the monthly GDP, the trade balance, and monetary accounts as of January 2021

The advance of vaccination at a global level and the contained impact of the virus, despite the new COVID-19 strains, would drive a recovery in **world growth**. As a result, the growth projection for 2021 is revised up from 5.4 to 5.8 percent and a rate of 4.0 percent is projected for 2022. This will favor the outlook for external demand in the forecast horizon.

The progress achieved in vaccines against COVID-19, the outlook for economic recovery, particularly in China and the United States, and expectations of higher demand amid announcements of increased spending on infrastructure have led to an increase in the prices of commodities. The price of copper has reached its highest levels since 2011. Therefore, the **terms of trade** are revised up and are estimated to increase 6.4 percent this year and 2.2 percent in 2022.

The **current account** of the balance of payments registered a surplus of 0.5 percent in 2020 due to the impact of the contraction of local production on the profits of foreign direct investment companies, the effect of weak domestic demand on imports, and the positive impact of the terms of trade on exports. The current account is expected to register a null result in 2021 and a positive balance of 0.1 percent of GDP in 2022, supported by the positive balance of the trade balance.

WORLD ECONOMY: 2012-2022
Average 2014-2019: 3.5



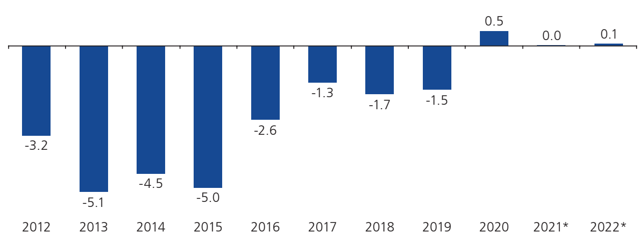
* Forecast.
Source: IMF and Consensus Forecast.

TERMS OF TRADE: 2020 - 2022

	2020	2021*		2022*	
		IR Dec.20	IR Mar.21	IR Dec.20	IR Mar.21
Terms of Trade					
Annual average % chg.	8.2	5.3	6.4	0.1	2.2
Price of exports					
Annual average % chg.	2.7	9.3	17.8	1.0	0.5
Copper (US$ cents per pound)	280	329	390	329	390
Zinc (US$ cents per pound)	103	123	127	124	129
Lead (US$ cents per pound)	83	90	95	91	97
Gold (US$ per troy ounce)	1,770	1,850	1,801	1,873	1,798
Price of imports					
Annual average % chg.	-5.1	3.8	10.7	0.9	-1.7
Oil (US$ per barrel)	40	43	58	44	54
Wheat (US$ per ton)	186	209	237	211	232
Maize (US$ per ton)	137	165	202	159	180

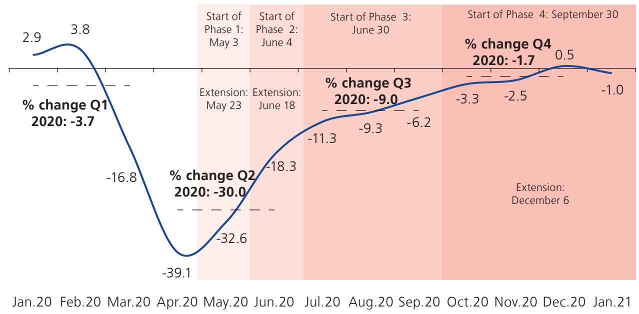
* Forecast.

CURRENT ACCOUNT: 2012-2022
(% GDP)



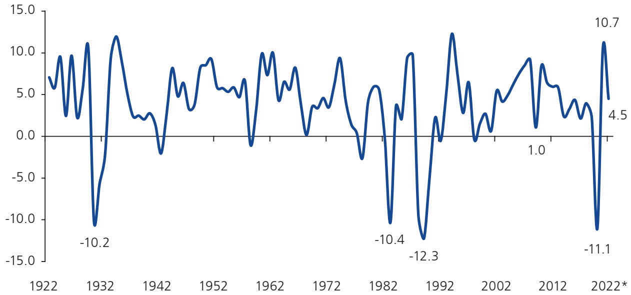
* Forecast.

REAL GDP
(Annual % chg.)



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

TOTAL GDP, 1922-2022
(Annual % change)



* Forecast.

DOMESTIC DEMAND AND GDP
(Real % change)

	2020	2021*		2022*	
		IR Dec.20	IR Mar.21	IR Dec.20	IR Mar.21
Domestic demand	**-9.8**	**10.2**	**9.6**	**4.1**	**4.6**
Private consumption	-8.7	8.8	8.5	4.7	4.8
Public consumption	7.5	5.7	3.5	-0.8	3.0
Private investment	-16.5	17.5	15.5	4.5	4.5
Public investment	-17.7	14.0	15.0	4.0	4.5
Change on inventories (contribution)	-0.9	0.0	0.0	0.0	0.0
Export	**-20.0**	**15.3**	**13.9**	**5.1**	**6.5**
Import	**-15.6**	**10.1**	**9.2**	**5.5**	**7.3**
Gross Domestic Product	**-11.1**	**11.5**	**10.7**	**4.0**	**4.5**
Memo:					
Public expenditure	0.3	7.7	6.2	0.4	3.4
Domestic demand excluding inventories	-8.8	10.0	9.3	4.0	4.5

* Forecast.
IR: Inflation Report.

NON-FINANCIAL PUBLIC SECTOR
(% GDP)

	2019	2020	2021*		2022*	
			IR Dec.20	IR Mar.21	IR Dec.20	IR Mar.21
1. General government current revenues	**19.7**	**17.9**	**18.8**	**19.0**	**19.7**	**19.9**
Real % change	*4.3%*	*-17.4%*	*17.4%*	*19.0%*	*9.3%*	*10.4%*
2. General government non-financial expenditure	**20.1**	**24.9**	**21.6**	**21.8**	**21.0**	**21.1**
Real % change	*1.3%*	*12.5%*	*-1.1%*	*-1.1%*	*1.6%*	*1.5%*
Of which:						
Current expenditure	15.5	20.4	17.1	17.2	16.4	16.3
Real % change	*3.3%*	*19.3%*	*-4.7%*	*-4.8%*	*0.0%*	*-0.1%*
Gross capital formation	4.0	3.7	3.8	3.9	3.9	3.9
Real % change	*-4.7%*	*-15.8%*	*16.8%*	*18.1%*	*6.8%*	*7.3%*
3. Others [1/]	**0.1**	**-0.4**	**0.0**	**0.0**	**0.0**	**0.0**
4. Primary balance (1-2+3)	**-0.2**	**-7.3**	**-2.8**	**-2.8**	**-1.3**	**-1.1**
5. Interests	**1.4**	**1.6**	**1.6**	**1.6**	**1.7**	**1.6**
6. Overall Balance	**-1.6**	**-8.9**	**-4.4**	**-4.4**	**-3.0**	**-2.8**
Memo:						
Structural primary balance [2/]	-0.1	-3.6	-1.0	-1.1	0.2	-0.1
Weighted fiscal impulse [2/]	-0.8	1.8	-1.0	-1.3	-0.3	-0.4

1/ Includes capital income of the general government and primary balance of the state-owned companies.
2/ As a percentage of trend GDP.
* Forecast.
IR: Inflation Report.

After 21 consecutive years of growth, **economic activity** contracted 11.1 percent in 2020 due to the strict sanitary measures adopted to contain the spread of COVID-19 in the first half of 2020. Even though the first half of the year was marked by the interruption of activities considered non-essential and by compulsory social immobility, the easing of sanitary measures, together with the progressive resumption of activities and fiscal and monetary stimuli, contributed to a greater-than-expected recovery of activity during the fourth quarter. It should be pointed out that the magnitude of the GDP contraction rate registered in 2020 had not been observed since 1989 (-12.3 percent).

In 2021 GDP is projected to grow 10.7 percent, in a context marked by a mass vaccination process, political and social stability, the maintenance of monetary and fiscal impulses, and the normalization of external demand. The projection has been revised down with respect to the previous Report (11.5 percent) and takes into account the effect of the second wave of COVID-19 infections and the new targeted measures aimed to stop it.

The economy would continue its recovery path in the forecast horizon, with a growth rate of 4.5 percent in 2022, associated with the normalization of spending habits and recovery of the service sector after the massive vaccination of the population. This, in a favorable context of economic and financial conditions, would boost employment and domestic demand, reaching with this pre-pandemic levels in the first half of 2022.

Since the publication of the last Report, spending measures have been expanded to face the second wave of COVID-19. Reflecting higher non-financial spending, the **fiscal deficit** has increased from 7.6 to 9.1 percent of GDP between November 2020 and February 2021. With respect to what was estimated in December, the projection of the fiscal deficit for 2021 remains at 4.4 percent of GDP, because higher spending to face the second wave of infections would be offset by higher current income as a result of the upward cycle in mineral prices. On the other hand, the projection of the deficit in 2022 has been lowered from 3.0 to 2.8 percent of GDP due to higher projected income as a result of the improvement in international metal prices and a greater recovery of economic activity in 2022.

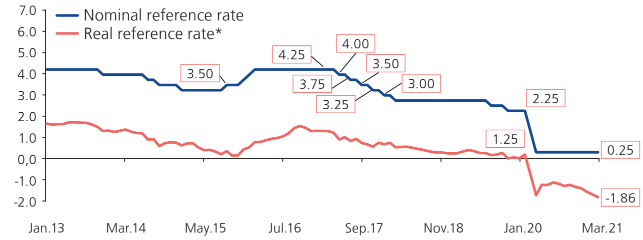
BCRP has maintained a historical minimum **benchmark interest rate** of 0.25 percent since April 2020, which in March 2021 is equivalent to a negative real rate of 1.86 percent. Given the magnitude of the shock associated with the pandemic, monetary impulse has been expanded through other monetary policy instruments.

BCRP has recently incorporated Operations Conditional on the Expansion of Long-Term Credit to its monetary instruments with the aim of strengthening the transmission of its monetary policy towards long-term interest rates.

In addition, BCRP has continued carrying out the necessary actions to sustain the payment system and the flow of credit in the economy. In line with this, the balance of liquidity injection operations through repos increased from S/ 61.5 billion at the end of November to S/ 62.9 billion on March 17. This total balance of liquidity injection operations is 8 times higher than the maximum balance of these operations during the international financial crisis of 2008-2009 (S/ 7.9 billion) and 2 times the balance reached during the period of decline of commodity prices (2013-2016) and the de-dollarization program (S/ 31.8 billion).

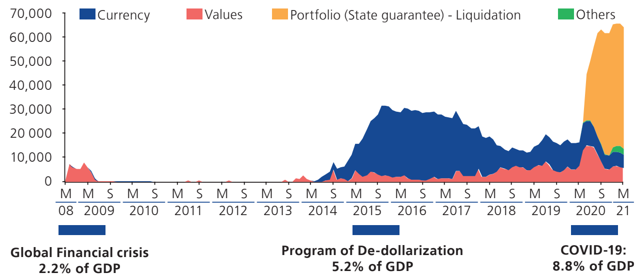
In line with the expansionary monetary stance, **credit to the private sector** had a clearly countercyclical behavior, counterbalancing the negative effects of the pandemic on economic activity and thereby facilitating its recovery. Thus, the year-on-year growth rate of credit accelerated from 6.9 percent in 2019 to 11.6 percent in January 2021, driven mainly by the loans associated with the Reactiva Peru program granted between May and December of last year. Taking into account the significant expansion of credit in 2020 and the beginning of the amortization of the loans granted under the Reactiva program, a more subdued credit growth of 3.0

REFERENCE INTEREST RATE
(%)



* With expectation on inflation.

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



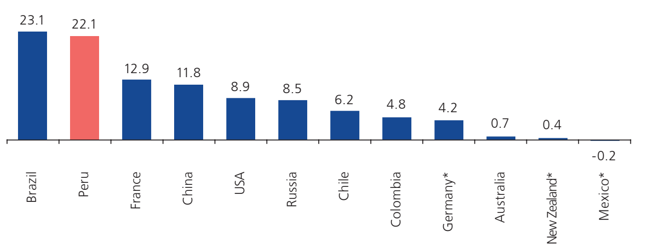
The item "Others" includes purchase of Public Treasury bonds, according to the article 61 of the Organic Law of the BCRP, and repo operations of credit portfolio.

CREDIT TO THE PRIVATE SECTOR [1/]
(Annual growth rate)

	Dec.18	Mar.19	Jun.19	Sep.19	Dec.19	Mar.20	Jun.20	Sep.20	Dec.20	Jan.21
Businesses	**7.0**	**7.3**	**5.3**	**4.9**	**4.2**	**6.6**	**20.0**	**24.6**	**21.7**	**22.1**
Corporate and large companies	9.1	8.9	6.3	6.4	4.4	9.6	21.8	14.2	8.3	10.1
Medium-sized enterprises										
Small business and Micro business	4.8	5.4	4.3	3.3	4.1	3.0	17.8	37.0	37.4	36.1
Individuals	**11.5**	**11.7**	**11.4**	**11.7**	**11.3**	**9.3**	**2.8**	**-1.3**	**-3.1**	**-4.1**
Consumer	13.1	13.5	13.0	13.4	12.8	10.2	1.6	-4.2	-7.1	-8.9
Car loans	-3.5	2.7	6.9	8.5	11.9	6.9	0.9	-3.1	-2.5	-4.3
Rest	13.7	13.9	13.2	13.5	12.9	10.3	1.7	-4.2	-7.3	-9.0
Mortgage	9.0	9.1	9.1	9.1	9.0	8.0	4.6	3.1	3.2	3.3
TOTAL	**8.7**	**9.0**	**7.6**	**7.5**	**6.9**	**7.6**	**13.2**	**14.3**	**11.8**	**11.6**

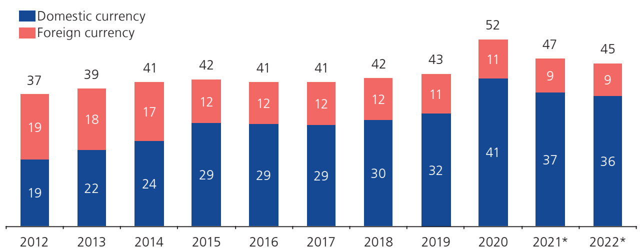
1/ Balances are valuated at constant exchange rate on December 2019.

ANNUAL GROWTH OF CREDIT TO THE PRIVATE COMPANIES: JANUARY 2021
(In percentage changes)



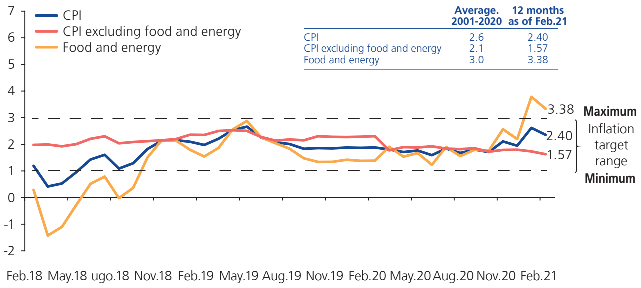
* Data as of December 2020.
Source: Central banks.

RATIO CREDIT/GDP
(%)

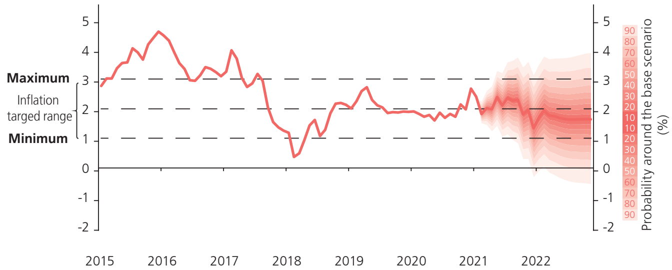


* Forecast.

INFLATION
(Last 12-month % change)



INFLATION FORECAST: 2020 - 2022
(Last 12-month % change)



percent is projected in 2021 and 2022. With this, the ratio of credit to the private sector relative to GDP would increase from 43 percent in 2019 to 45 percent in 2022.

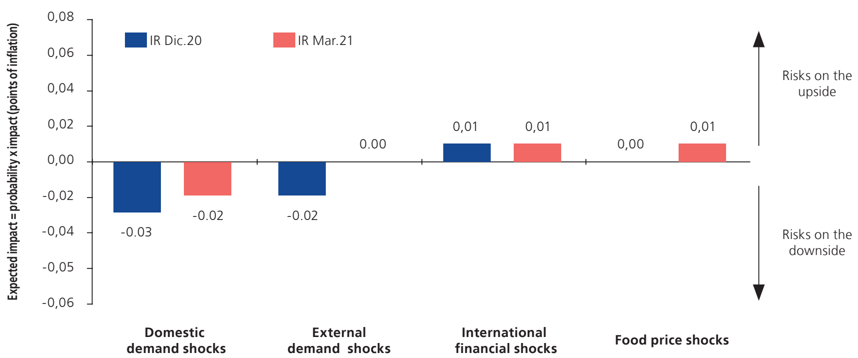
Year-on-year **inflation** increased from 2.14 percent in November to 2.40 percent in February, driven by supply factors of some food goods, the rise in the exchange rate, and higher fuel prices. In this context, 12-month inflation expectations rose from 1.68 percent to 2.11 percent in the same period. The trend indicators of inflation remain in the lower part of the target range. Inflation in 2021 would register 2.0 percent due to temporary supply effects (increase in fuel prices and some food goods) and then would lie in the lower part of the target range during 2022. This projection considers that inflation expectations will remain around the average value of the target range (2.0 percent), in a context in which the output gap will gradually close as the aggregate economy recovers its pre-pandemic level.

Balance of risk

The balance of **inflation risk factors** in this report is neutral, which means that the probability of occurrence of a downward or an upward deviation of inflation is the same. The risks in the projection consider the contingency of a slower-than-expected recovery of local activity if some of the following adverse scenarios should occur: (i) greater persistence in the duration of the second wave or later a new wave of infections later (due to new virus variants, for example); (ii) delays in the vaccination process; and (iii) a weak recovery in consumer and business confidence and a possible delay in the execution of public investment if situations of political uncertainty should arise. Due to the recent increase in the international price of food, the pass-through of this factor to domestic inflation is considered an upside risk to inflation in this Report.

The probability that the risks linked to COVID-19 will materialize has decreased in the last month due to the progress made in the vaccination process at the global level.

BALANCE OF RISKS AGAINST THE BASE SCENARIO



IR: Inflation Report.

SUMMARY OF INFLATION REPORT FORECAST

	2019	2020	2021[1/]		2022[1/]	
			IR Dec.20	IR Mar.21	IR Dec.20	IR Mar.21
Real % change						
1. Gross Domestic Product	2.2	-11.1	11.5	10.7	4.0	4.5
2. Domestic demand	2.4	-9.8	10.2	9.6	4.1	4.6
a. Private consumption	3.0	-8.7	8.8	8.5	4.7	4.8
b. Public consumption	2.1	7.5	5.7	3.5	-0.8	3.0
c. Fixed private investment	4.0	-16.5	17.5	15.5	4.5	4.5
d. Public investment	-1.4	-17.7	14.0	15.0	4.0	4.5
3. Exports (good and services)	0.7	-20.0	15.3	13.9	5.1	6.5
4. Global economic growth	1.2	-15.6	10.1	9.2	5.5	7.3
5. Crecimiento del PBI Mundial	2.9	-3.3	5.4	5.8	4.0	4.0
Memo:						
Output gap [2/] (%)	-0.6	-13.6	-11.0;-1.0	-11.0;-2.0	-9.0;0.0	-9.0;0.0
% change						
6. Inflation	1.9	2.0	1.5	2.0	1.7	1.6
7. Expected inflation [3/]	2.3	1.5	1.7	2.1	2.0	2.2
8. Expected depreciation [3/]	-0.3	7.4	-2.0	-2.1	-1.0	-1.4
9. Terms of trade	-1.8	8.2	5.3	6.4	0.1	2.2
a. Export prices	-3.4	2.7	9.3	17.8	1.0	0.5
b. Import prices	-1.7	-5.1	3.8	10.7	0.9	-1.7
Nominal % change						
10. Currency in circulation	4.6	37.3	4.0	10.0	3.0	3.0
11. Credit to the private sector	6.9	11.8	3.0	3.0	3.0	3.0
% GDP						
12. Gross fixed investment	22.6	21.1	21.3	21.8	21.3	21.7
13. Current account of the balance of payments	-1.5	0.5	0.1	0.0	0.0	0.1
14. Trade balance	2.9	3.8	5.8	6.4	5.6	6.3
15. Long-term external financing of the private sector [4/]	2.4	0.3	-1.3	-1.3	-0.5	-0.4
16. Current revenue of the general government	19.7	17.9	18.8	19.0	19.7	19.9
17. Non-financial expenditure of the general government	20.1	24.9	21.6	21.8	21.0	21.1
18. Overall balance of the non-financial public sector	-1.6	-8.9	-4.4	-4.4	-3.0	-2.8
19. Balance of total public debt	26.8	35.0	34.4	34.4	34.4	34.3
20. Balance of net public debt	13.0	22.4	24.0	24.1	25.7	25.3

IR: Inflation Report
1/ Forecast.
2/ Differential between GDP and trend GDP (in % of trend GDP).
3/ Survey on expectations to the analysts and financial entities carried out at the time of publication of the respective Inflation Report. Data observed in the case of depreciation for 2019 and 2020. and the average of expectations throughout year in case of inflation have been considered.
4/ Includes net direct investment. portfolio investment and private sector's long term disbursement.