CENTRAL RESERVE BANK OF PERU

Summary

Inflation Report

September 2021

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

Global growth projections for 2021 have been revised slightly down, from 5.9 to 5.8 percent. While overall the economy is still recovering strongly, some recent indicators suggest a somewhat slower recovery given rising COVID-19 cases and the persistence of supply shocks mainly associated with the supply chain. At the country level, this revision is supported by slower growth in the United States and major emerging economies such as China and India. In contrast, the projection for 2022 has been revised up, from 4.2 to 4.4 percent, taking into account the increase in infrastructure spending in the United States starting in that year.

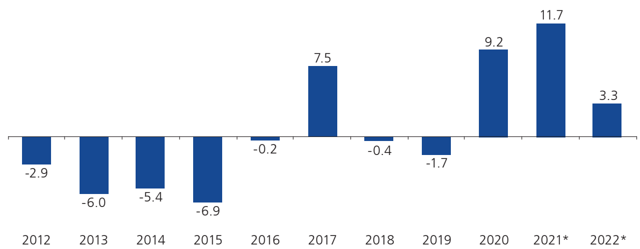
GLOBAL GDP GROWTH
(Annual % change)

	PPP*	2020	2021		2022	
			IR Jun.	IR Sep.	IR Jun.	IR Sep.
Developed economies	**42.5**	**-4.7**	**5.4**	**5.4**	**3.9**	**4.1**
Of which						
1. USA	16.0	-3.5	6.7	6.5	4.2	4.4
2. Eurozone	12.0	-6.6	4.7	4.8	4.3	4.6
3. Japan	4.0	-4.8	3.0	3.0	2.5	2.7
4. United Kingdom	2.3	-9.9	6.0	6.6	4.9	5.2
5. Canada	1.4	-5.4	6.1	6.1	4.1	4.2
6. Others	6.8	-4.1	4.9	4.9	3.2	3.4
Emerging economies	**57.5**	**-2.2**	**6.2**	**6.1**	**4.5**	**4.5**
Of which						
1. China	18.6	2.3	8.7	8.5	5.7	5.6
2. India	6.7	-8.0	10.5	9.5	6.5	6.5
3. Russia	3.1	-3.1	3.4	3.5	2.7	2.7
4. Latin America and the Caribbean	7.3	-6.9	4.3	5.4	2.8	2.7
Argentina	0.6	-9.9	5.1	5.8	2.2	2.2
Brasil	2.4	-4.1	3.5	5.0	2.1	2.1
Chile	0.4	-5.8	5.4	8.4	3.5	3.0
Colombia	0.6	-6.8	4.9	6.3	3.7	3.7
Mexico	1.9	-8.2	4.5	5.6	3.3	3.0
Peru	0.3	-11.0	10.7	11.9	4.5	3.4
5. Others	17.9	-4.0	4.9	4.9	4.5	4.5
Sub-saharan Africa	3.1	-1.9	3.3	3.3	3.8	3.9
World Economy	100.0	-3.3	5.9	5.8	4.2	4.4

* Base 2020
Source: IMF and Consensus Forecast.

The **terms of trade** increased by 19.5 percent in the first half of 2021, driven by the strong increase in copper prices following the rapid progress of the global vaccination process and the recovery of the world economy. However, the dynamism of mineral prices has moderated in recent months, so the projected growth of the terms of trade in 2021 has been revised downward from 13.0 percent in the previous Report to 11.7 percent. Terms of trade growth would continue in 2022 with an expansion rate of 3.3 percent (2.8 percent in the previous Report), mainly due to a reduction in import prices (-2.4 percent).

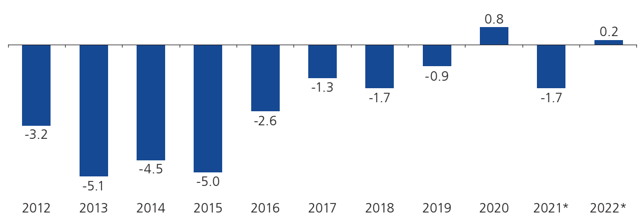
TERMS OF TRADE: 2012-2022
(Annual average % change)



* Forecast.

The **current account** of the balance of payments registered a deficit of 3.3 percent of GDP in the first half of 2021. Factors accounting for this result included the increase in imports and the deficit in factor income, in line with the recovery of domestic demand, the rise in international freight rates, and the contraction in travel

CURRENT ACCOUNT: 2012-2022
(% GDP)



* Forecast.

DOMESTIC DEMAND AND GDP
(Real % change)

		2021*				2022*	
	2020	S1 respect to: S1.20	S1.19	IR Jun.21	IR Sep.21	IR Jun.21	IR Sep.21
Domestic demand	**-9.4**	**21.5**	**3.2**	**10.3**	**12.5**	**4.0**	**3.0**
Private consumption	-8.7	14.0	0.1	8.5	9.2	4.8	4.0
Public consumption	7.2	19.5	17.9	7.0	9.0	1.0	1.5
Private investment	-16.5	80.2	14.8	15.5	24.5	2.5	0.0
Public investment	-15.5	94.1	17.2	19.0	20.0	4.5	4.5
Change on inventories (contribution)	-0.5	-4.5	-2.0	0.0	0.0	0.0	0.0
Exports	**-20.8**	**18.5**	**-13.0**	**13.5**	**11.9**	**6.4**	**6.4**
Imports	**-15.6**	**20.8**	**-1.2**	**11.8**	**14.5**	**4.4**	**4.9**
Gross Domestic Product	**-11.0**	**20.9**	**-0.1**	**10.7**	**11.9**	**4.5**	**3.4**
Memo:							
Public expenditure	0.8	32.4	17.7	9.9	11.6	1.9	2.2
Domestic demand excluding inventories	-8.7	26.2	5.3	10.0	12.2	3.9	2.9

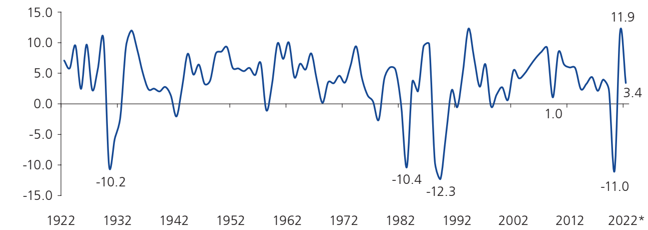
IR: Inflation Report.
* Last two columns correspond to the annual forecast of the previous and current Inflation Report.

GDP BY PRODUCTION SECTOR
(Real % change)

		2021*				2022*	
	2020	1er Sem.21 respecto a: 1er Sem.20	1er Sem.19	RI Jun.21	RI Set.21	RI Jun.21	RI Set.21
Primary GDP	**-7.7**	**11.4**	**-2.3**	**7.4**	**6.2**	**5.7**	**5.9**
Agriculture and livestock	1.4	-0.1	2.8	2.0	2.0	3.0	2.7
Fishing	4.2	27.3	7.9	7.2	5.4	4.7	4.4
Metallic mining	-13.8	21.3	-5.9	11.4	10.8	6.9	6.9
Hydrocarbons	-11.0	-7.3	-15.4	4.0	-3.8	9.0	13.4
Based on raw materials	-2.0	16.2	5.7	6.7	5.6	5.1	4.9
Non-Primary GDP	**-12.0**	**24.0**	**0.6**	**11.7**	**13.6**	**4.2**	**2.7**
Non-primary industries	-16.4	45.4	3.6	18.1	21.1	2.0	1.4
Electricity and water	-6.1	12.9	0.9	7.5	7.7	2.3	1.7
Construction	-13.9	100.2	17.9	17.4	30.6	3.0	0.0
Commerce	-16.0	33.4	-3.4	18.0	17.8	3.3	1.4
Services	-10.3	14.1	-1.0	8.9	9.9	4.9	3.6
Gross Domestic Product	**-11.0**	**20.9**	**-0.1**	**10.7**	**11.9**	**4.5**	**3.4**

IR: Inflation Report.
* Last two columns correspond to the annual forecast of the previous and current Inflation Report.

TOTAL GDP, 1922-2022
(Annual % change)



* Forecast.

NON-FINANCIAL PUBLIC SECTOR
(% GDP)

		2021*			2022*	
	2020	I Semester	IR Jun.21	IR Sep.21	IR Jun.21	IR Sep.21
1. General government current revenues	**17.8**	**21.2**	**19.3**	**20.1**	**20.1**	**20.0**
Real % change	*-17.4%*	*35.3%*	*23.7%*	*30.1%*	*9.8%*	*3.7%*
2. General government non-financial expenditure	**24.7**	**20.1**	**22.3**	**22.6**	**21.7**	**21.9**
Real % change	*12.8%*	*21.7%*	*2.7%*	*5.3%*	*2.7%*	*1.3%*
Of which:						
Current expenditure	20.2	15.8	17.3	17.8	16.7	16.7
Real % change	*19.4%*	*9.2%*	*-2.2%*	*1.2%*	*1.8%*	*-1.3%*
Gross capital formation	3.8	3.6	4.1	4.1	4.2	4.2
Real % change	*-13.2%*	*121.9%*	*23.9%*	*25.0%*	*7.7%*	*8.2%*
3. Other 1/	**-0.4**	**0.6**	**0.0**	**0.0**	**0.1**	**0.1**
4. Primary balance (1-2+3)	**-7.3**	**1.7**	**-2.9**	**-2.4**	**-1.5**	**-1.8**
5. Interests	**1.6**	**1.6**	**1.6**	**1.5**	**1.6**	**1.6**
6. Overall Balance	**-8.9**	**0.1**	**-4.5**	**-4.0**	**-3.1**	**-3.4**

1/ Includes capital income of the general government and primary balance from state-owned companies.
* Forecast
IR: Inflation Report.

revenues due to the slow recovery of inbound tourism. As a result, the current account projection for 2021 and 2022 is revised downward: from a surplus of 0.2 percent to a deficit of 1.7 percent of GDP in 2021, and from a surplus of 1.8 percent to a surplus of 0.2 percent of GDP in 2022.

Economic activity recorded a year-on-year growth rate of 19.7 percent in the period from January to July 2021, driven mainly by the dynamism of private expenditure and by a low comparative base (zero variation with respect to the same period of 2019). As a result, GDP would show a higher growth rate (11.9 percent) than that estimated in the previous Report (10.7 percent), explained by a better-than-expected result during the first half of the year following the higher execution of public spending and private investment. The projection for the 2021-2022 horizon assumes massive vaccination of the population during the second half of this year, an environment of political and social stability, recovery of business expectations, monetary and fiscal impulses, recovery of external demand, and highly favorable terms of trade. The projection also assumes a third wave of COVID-19 infections without significant economic impacts.

Under these conditions, the normalization of spending habits and the recovery of the service sector following the immunization of the population would boost employment and domestic demand. However, these boosts would be partially offset by the effect of lower business confidence in recent months, which would affect investment decisions and, consequently, future production plans. The economy would grow 3.4 percent in 2022, a lower rate than projected in the previous Report (4.5 percent). Economic activity is projected to reach sustained pre-pandemic levels in the first quarter of 2022.

The cumulative **fiscal deficit** over the last twelve months continued its downward trend and declined from 8.9 to 5.0 percent between December 2020 and August 2021. The fiscal deficit would continue declining during the rest of the year to reach 4.0 percent of GDP in 2021, favored mainly by the growth of current revenues as a result of a favorable international context, the recovery of economic activity, and the collection of extraordinary revenues. This decrease would be reinforced by a more moderate growth in non-financial expenditure compared to the increase in GDP and the recovery of public enterprises' results. Moreover, the fiscal consolidation process would continue in 2022, with a projected deficit of 3.4 percent of GDP.

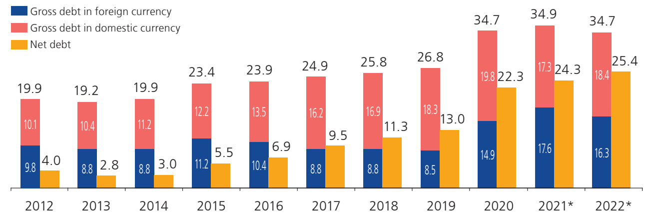
In 2021, the **gross debt** of the Non-Financial Public Sector would be equivalent to 34.9 percent of GDP before declining to 34.7 percent in 2022, while net debt would increase to 24.3 percent of output in 2021 and 25.4 percent in 2022.

From April 2020 to July 2021, BCRP maintained its **benchmark interest rate** at 0.25 percent –the lowest level of this rate since inflation targeting was implemented–, together with massive liquidity injection operations to expand monetary impulse. The BCRP Board of Directors decided to raise the benchmark interest rate by 25 basis points in August and by 50 basis points in September, this rate reaching a level of 1.0 percent in the context of recent increases in inflation expectations. These decisions imply maintaining an expansionary monetary policy stance, as the benchmark real interest rate remains at significantly negative levels (- 2.07 percent in September).

The balance of liquidity injection operations in domestic currency decreased from S/ 60.8 billion at the end of June to S/ 57.9 billion as of September 15. This balance is equivalent to 7.1 percent of GDP, of which S/ 44.5 billion corresponds to government-secured repos of credit portfolio (Reactiva Peru program). In comparative terms, the total balance of liquidity injection operations is 7.3 times higher than the balance of these operations during the 2008-2009 international financial crisis (S/ 7.9 billion) and 1.8 times the balance reached during the period of falling commodity prices (2013-2016) and the de-dollarization program (S/ 31.8 billion).

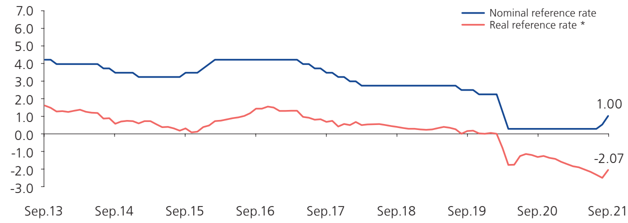
The growth of **credit to the private sector** slowed from an expansion rate of 9.3 percent in April 2021 to a year-on-year rate of 3.9 percent in July 2021. After recording a significant increase in the credit-to-GDP ratio in 2020, private sector credit demand is expected to moderate its growth in the projection horizon and

DEBT OF THE NON-FNANCIAL PUBLIC SECTOR: 2012-2022
(% GDP)



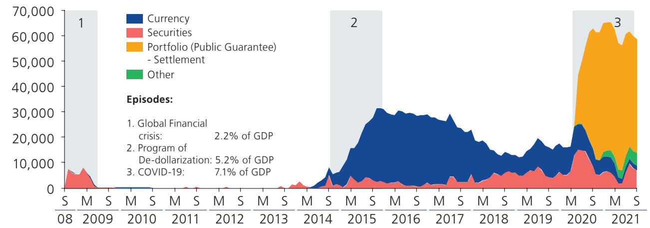
* Forecast.

REFERENCE INTEREST RATE
(%)



* With expectation on inflation.

BALANCE OF MONETARY INJECTION OPERATIONS OF BCRP
(Balance in mill. S/)



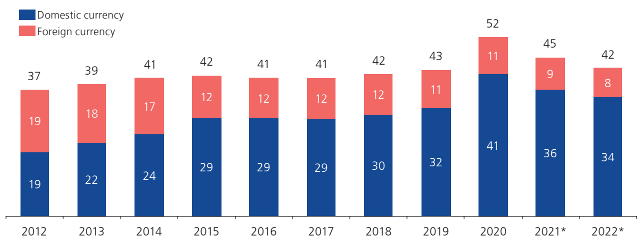
* As of September 15.

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

	Dec.19	Mar.20	Jun.20	Sep.20	Dec.20	Mar.21	Jun.21	Jul.21
Businesses	**4,2**	**6,6**	**20,0**	**24,6**	**21,7**	**18,6**	**8,0**	**5,6**
Corporate and large companies	4,4	9,6	21,8	14,2	8,3	3,3	-2,0	-0,3
Medium-sized enterprises, small and micro business	4,1	3,0	17,8	37,0	37,4	37,6	19,9	12,3
Individuals	**11,3**	**9,3**	**2,8**	**-1,3**	**-3,1**	**-4,5**	**-0,4**	**0,6**
Consumer	12,8	10,2	1,6	-4,2	-7,1	-10,6	-5,7	-4,5
Car loans	11,9	6,9	0,9	-3,1	-2,5	-8,3	-0,4	1,1
Rest	12,9	10,3	1,7	-4,2	-7,3	-10,6	-5,9	-4,7
Mortgage	9,0	8,0	4,6	3,1	3,2	4,8	7,5	8,0
TOTAL	**6,9**	**7,6**	**13,2**	**14,3**	**11,8**	**9,5**	**5,0**	**3,9**

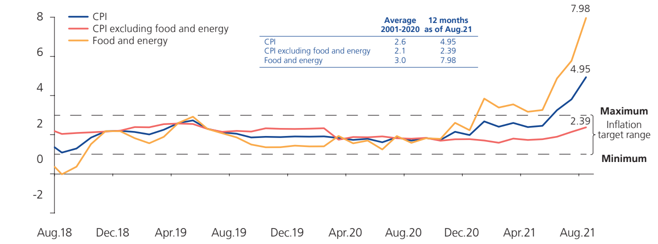
1/ Balances are valuated at constant exchange rate on December 2019.

RATIO CREDIT/GDP
(%)

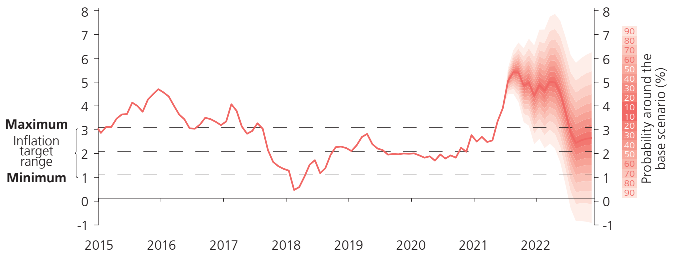


1/ Balances are valuated at constant exchange rate on December 2019.
* Forecast.

INFLATION
(Last 12-month % change)



INFLATION FORECAST: 2021 - 2022
(Last 12-month % change)



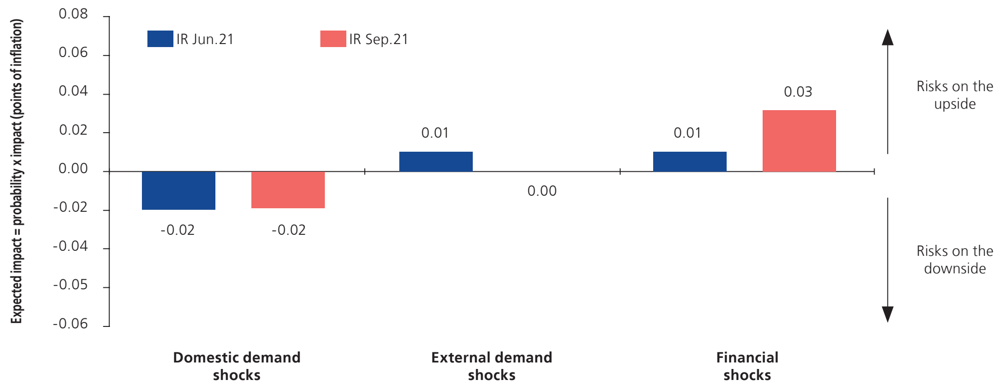
increase at a slower pace than nominal GDP: 3.0 percent in both 2021 and 2022. This would bring the ratio of private sector credit to GDP to 42 percent at the end of the forecast horizon.

Year-on-year inflation increased from 2.45 percent in May to 4.95 percent in August due to supply factors such as higher international fuel and grain prices, higher import freight rates, and the depreciation of the sol. In this context, 12-month inflation expectations rose from 2.43 percent to 3.07 percent in the same period of time. Trend inflation indicators remain within the target range. In the remainder of 2021 and the first half of 2022, inflation is projected to be above the target range due to transitory supply effects (increases in fuel prices, some food items, and the exchange rate). This projection considers that inflation expectations will gradually decrease towards the target range in a context in which the output gap will close as the economy continues its recovery.

Balance of risks

The balance of **inflation risk factors** has been revised from neutral to risk skewed to the upside. Risks in the projection consider mainly the following contingencies: (i) a lower level of local activity if business and consumer confidence do not recover or due to a new wave of COVID-19 contagions with high economic impact, and (ii) upward pressures on the exchange rate due to higher international interest rates or delay in the normalization of recent volatility in local financial markets.

BALANCE OF RISKS AGAINST THE BASE SCENARIO



SUMMARY OF INFLATION REPORT FORECAST

	2019	2020	2021[1/]		2022[1/]	
			IR Jun.21	IR Sep.21	IR Jun.21	IR Sep.21
Real % change						
1. Gross Domestic Product	2.2	-11.0	10.7	11.9	4.5	3.4
2. Domestic demand	2.1	-9.4	10.3	12.5	4.0	3.0
a. Private consumption	3.0	-8.7	8.5	9.2	4.8	4.0
b. Public consumption	2.2	7.2	7.0	9.0	1.0	1.5
c. Fixed private investment	4.5	-16.5	15.5	24.5	2.5	0.0
d. Public investment	-1.5	-15.5	19.0	20.0	4.5	4.5
3. Exports (good and services)	1.6	-20.8	13.5	11.9	6.4	6.4
4. Imports (good and services)	1.2	-15.6	11.8	14.5	4.4	4.9
5. Global economic growth	2.8	-3.3	5.9	5.8	4.2	4.4
Memo:						
Output gap [2/] (%)	-0.7	-13.3	-11.0;-2.0	-9.0;-2.0	-9.0;0.0	-6.0;0.0
% change						
6. Inflation	1.9	2.0	3.0	4.9	2.0	2.6
7. Expected inflation [3/]	2.3	1.5	2.5	3.7	2.3	2.8
8. Expected depreciation [3/]	-0.3	7.4	-0.2	13.7	0.3	0.6
9. Terms of trade	-1.8	9.2	13.0	11.7	2.8	3.3
a. Export prices	-3.4	3.7	26.3	27.2	1.0	0.9
b. Import prices	-1.7	-5.0	11.8	13.9	-1.7	-2.4
Nominal % change						
10. Currency in circulation	4.7	37.3	10.0	12.5	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	22.7	21.1	21.8	23.2	21.2	22.3
13. Current account of the balance of payments	-0.9	0.8	0.2	-1.7	1.8	0.2
14. Trade balance	3.1	4.0	7.4	6.8	8.0	7.5
15. Long-term external financing of the private sector [4/]	1.7	-0.5	0.7	2.7	-1.4	-0.8
16. Current revenue of the general government	19.7	17.8	19.3	20.1	20.1	20.0
17. Non-financial expenditure of the general government	20.0	24.7	22.3	22.6	21.7	21.9
18. Overall balance of the non-financial public sector	-1.6	-8.9	-4.5	-4.0	-3.1	-3.4
19. Balance of total public debt	26.8	34.7	34.4	34.9	34.4	34.7
20. Balance of net public debt	13.0	22.3	24.3	24.3	25.4	25.4

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.