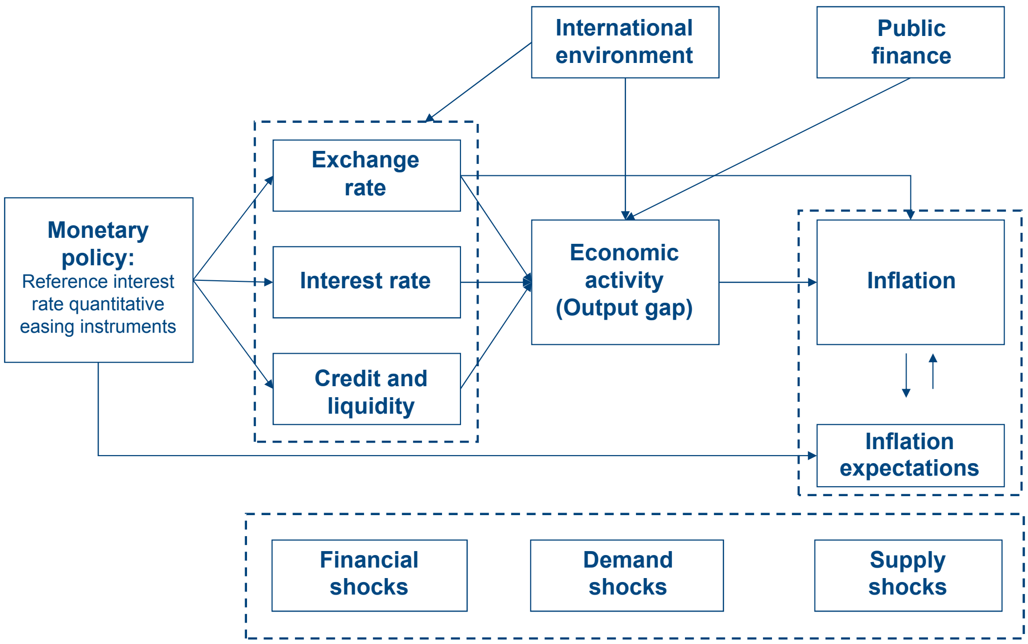
INFLATION REPORT:

Recent trends and macroeconomic forecasts 2010-2012

December 2010



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INFLATION REPORT
Recent trends and macroeconomic forecast

CENTRAL RESERVE BANK OF PERU

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CONTENT

This ***Inflation Report*** was drawn up using data on gross domestic product, balance of payments, and operations of the non-financial public sector as of September 2010, data on monetary accounts, inflation, and financial markets as of October 2010, and data on the exchange rate as of November 2010.

Foreword

- According to the Peruvian Constitution, the Central Reserve Bank of Peru (BCRP) is a public autonomous entity whose role is to preserve monetary stability.

- In order to consolidate this goal, the Bank's monetary policy is based on an inflation targeting scheme, with an inflation target of 2.0 percent, plus or minus one percentage point (between 1.0 percent and 3.0 percent). The Central Bank's inflation target is aimed at anchoring inflation expectations at a similar level to the inflation rate in developed countries and reflects the BCRP's permanent commitment with monetary stability.

- Compliance with the inflation target is continuously assessed; that is, the Central Bank considers the accumulated rate of inflation in each month and not only at year's end. The monetary policy of the BCRP is of a preventive nature and therefore aims at anticipating inflationary or deflationary pressures. The Central Bank also takes into account that inflation can be influenced by factors that are beyond the control of monetary policy, such as supply shocks or the prices of imported goods, which may lead inflation to transitorily deviate from the target.

- Each month, and according to a previously announced schedule, the Board of the BCRP approves a reference rate for the interbank lending market. This interest rate, which is the operational target of monetary policy, affects inflation through several channels in different timeframes and therefore it has to be determined on the basis of macroeconomic forecasts and simulations. The Central Bank also manages other monetary policy instruments with which it can affect more directly the volumes of liquidity and credit, such as reserve requirements in domestic and foreign currency

  Additionally, the Central Bank implements preventive measures to preserve financial stability and monetary policy transmission mechanisms. Through foreign exchange intervention it reduces excessive volatility in the exchange rate and accumulates international reserves, thus developing strengths against negative events in an economy which still shows a high degree of financial dollarization.

- The forecasts based on which monetary policy decisions are made are disseminated to generate the public's understanding of the consistency of the measures adopted and to ensure that economic agents' expectations take these forecasts into account. The Central Bank also disseminates the studies analyzing the risk factors that may cause deviations in the forecasts of the economic variables considered.

- The Central Bank will publish its next Inflation Report in March 2011.

Summary

i. Since May 2010 the Central Bank has been preventively withdrawing monetary stimulus by raising the reference rate (from 1.25 percent to 3.0 percent) and raising the rates of reserve requirements. In October, the BCRP decided to make a pause in the preventive adjustments being made in the reference rate, taking into account that core inflation remained around the 2 percent target. The respective monetary policy communiqués released since then have emphasized the idea that future adjustments in the reference rate will depend on the evolution of inflation determinants and on developments in the international environment.

ii. In January-February the global economy maintained high rates of growth rates, favored by increased economic activity in emerging countries, while most developed countries –except for Germany and Japan– continued showing a moderate rate of growth.

iii. Developed countries continue experiencing problems associated with high levels of unemployment, the slow recovery of credit and still high levels of household deleveraging. These problems are more intense in the European countries where corrective measures have or have had to be adopted to reduce high levels of fiscal deficits and public debt.

In emerging economies, after some adjustments were made in the monetary and fiscal policy positions considering the high rates of growth observed and after some preventive adjustments to maintain price stability, the pace of growth has been moderating as from the third quarter. However, this favorable growth coupled by increased liquidity in global markets and lower risk aversion has motivated an increased flow of capitals towards these economies, leading several central banks to respond to this by intervening in foreign exchange markets..

In this context, the forecast of global growth in 2010 has been revised from 4.2 to 4.5 percent while the forecast of growth in 2011 and 2012 remains at 3.7 percent –as estimated in our September report– due to the high level of uncertainty in the Eurozone and the moderation of growth observed in emerging countries.

iv. Domestic economic activity has continued growing in a robust manner driven by domestic demand, which grew 12.6 percent in the first nine months of the year, mainly as a result of the evolution of private expenditure in consumption and investment. In the case of consumption, the contribution of labor-intensive sectors has been significant due to their positive effects on employment and income

generation. As regards private investment, an increased number of ongoing projects and new announcements of projects to be implemented in 2010-2012 are being observed.

This growth trend is expected to continue in the future without significant inflationary pressures and with a level of economic activity that would record rates close to the economy's potential output. Considering these elements, the growth forecast has been revised from 8.0 to 8.8 percent in 2010 and from 6.0 to 6.5 percent in 2011.

v. The announced withdrawal of fiscal stimulus started being implemented in the last months of the year in the country. The current forecast scenario considers a real growth of non financial expenditure of 11.1 percent, lower than the 12.3 percent estimated in our September Report. The revenues of the general government are expected to grow by a real 18.7 percent, higher than the 16.6 percent forecasted in September. Because of this, the projected economic performance has been revised from a deficit of 1.5 percent to a deficit of 0.9 percent. This scenario is consistent with a recovery of the fiscal space to face adverse macroeconomic contigencies.

vi. Considering the growth of domestic demand and its effect on the volumen of imports in the next years, the projected deficit in the current account of the balance of payments has been revised slightly from 1.7 to 1.8 percent in 2010, while the deficit in 2011 and 2012 is estimated at 3.1 and 3.2 percent, respectively (versus 3.0 percent in both years in our September report). A reduction in terms of trade is also considered in the forecast scenario. It is worth pointing out that long term capital inflows more than compensated the deficit in the current account.

vii. Inflation is expected to remain within the target range in the following two years, although showing rates closer to the upper band of the target range during 2011 due to the transitory effect of rises in the prices of some food products as a result of supply shocks. This forecast is consistent with inflation expectations that remain anchored within the target range and with the reversal in 2012 of the transitory supply shocks that affected inflation during the second semester of 2010.

viii. The main risks that could deviate inflation from the baseline scenario in the forecast horizon include the following:

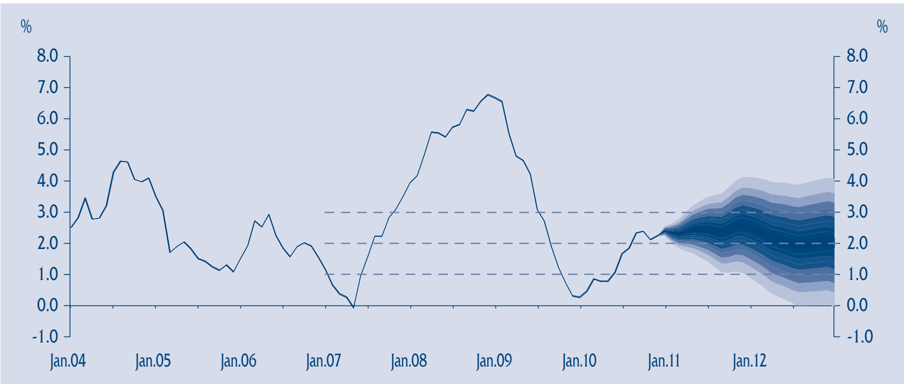
a. **Increased growth of aggregate demand**. Higher optimism, reflected in recent data of indicators of economic activity, and the high rates of GDP growth recorded during the first three quarters of 2010 could result in a higher output gap than the one considered in the central scenario. This would generate demand pressures on domestic prices, in which case monetary stimulus would be reduced more rapidly. This expansionary scenario could be magnified if decisions of increasing monetary stimulus in advanced economies generated a significant increase in short term capital inflows. In this case, the combination of macroprudential measures implemented by the BCRP and SBS, coupled by a tighter fiscal stance, would allow compensating the impact of these flows on domestic credit.

b. Uncertainty about the evolution of the global economy. The baseline scenario considers a recovery of global economic activity that would contribute to maintain terms of trade in levels favorable to the Peruvian economy. However, there is a contingent scenario of stagnation of the demand of our trading partners and lower prices for our exports, which would imply a slowdown in the domestic economy.

The Central Bank maintains a high level of international reserves and can use several liquidity injection mechanisms to face this contingency. Thus, should this risk materialize, monetary policy would maintain monetary stimulus for a longer period of time.

c. Rise in the prices of imported food products. The recent evolution of the prices of food commodities, such as wheat, maize, soybean oil, and sugar, shows that the probability of having higher prices in the future has increased. There is also uncertainty about domestic climatic conditions that typically affect food prices. In this scenario, the Central Bank would withdraw monetary stimulus more rapidly if higher imported inflation affected inflation expectations.

INFLATION FORECAST
(12-month % change)



I. International Environment

Recent trends

1. Global economic activity continued showing a low recovery trend in developed countries similar to the one described in the central scenario of our Inflation Report of September. Except for Germany and Japan, developed economies have been growing at lower rates than the ones observed in other post-crisis episodes and below their long term growth trends. On the other hand, emerging economies have been recording higher growth rates and, in many cases, higher growth rates than the ones registered in the period prior to the crisis..

Graph 1
GDP GROWTH

2. Growth in each of these regions is associated with a different source. In most developed economies, growth is mostly driven by fiscal and monetary stimulus programs. The exception to this has been Germany, where exports have been a significant source of expansion. In the emerging countries, the main determinants of growth have been associated with the drive generated by private domestic demand and the recovery of exports.

3. In terms of policy responses, developed countries maintain extraordinarily expansionary monetary and fiscal policies, even though some of them –e.g. European countires– have already started adopting measures aimed at reducing the fiscal deficit. The monetary policy interest rates in the major developed economies (United States, Eurozone and Japan) continue to be at minimum historical levels and are expected to remain low for a prolongued period of time.

   In addition to this, a new asset purchase program for US$ 600 billion was announced early in November in the case of the United States. Expectations associated with the announcement of this program have had a significant impact on a series of markets since our last report was published. the publication of our last report. Between end-August and October, stock markets have shown a significant recovery, the dollar has weakened against the currencies of other developed countries and of emerging economies, and speculative positions in commodities have increased, leading many of these commodities to reach historical records in nominal terms. Increasing uncertainty about the fiscal solvency of some Eurozone economies partially reversed this trend in November.

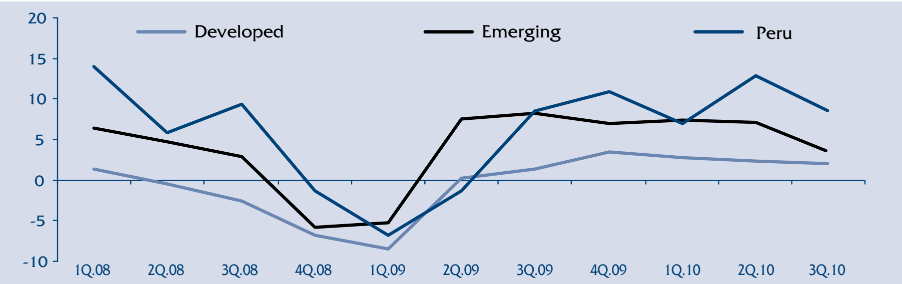
4. On the other hand, central banks in many emerging economies have gradually started withdrawing monetary stimulus given the recovery of economic activity and evidence of a rise of inflation due to food price pressures and, in some cases, due to the rise observed in the prices of assets.

   This widrawal of monetary stimulus has moderated recently due to uncertainty about the recovery of the global economy and particularly about the fiscal position of the Eurozone, the slow recovery of consumption in the United States, and a possible slowdown of growth in China, which has recently raised its interest rates due to the rise of inflation and risks of a bubble in the asset market.

Global growth

5. The global economy would grow 4.5 percent in 2010, higher than forecasted in our previous report, given that both developed and emerging economies have grown higher than expected in the January-September period.

Graph 2
GDP: SEASONALLY ADJUSTED ANNUALIZED QUARTERLY GROWTH
(%)



Source: JP Morgan and BCRP.

6. However, both developed and emerging economies have been recording a slowdown since Q3. In line with this trend, a moderation of global growth is still forecasted for 2011 and 2012 (with a growth rate of 3.7 percent in each year). Developed economies would record growth rates of 1.9 and 2.0 percent, while emerging economies would continue growing at significantly higher rates (5.9 and 5.8 percent, respectively).

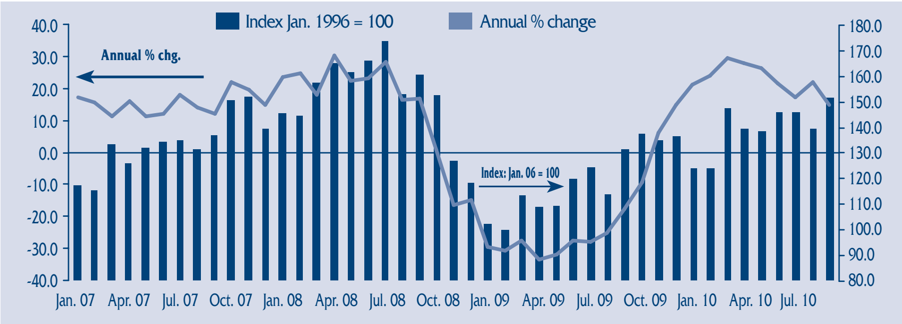
Table 1
WORLD GDP GROWTH
(Annual % change)

		2010*		2011*		2012*	
	2009	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
Developed countries	**-3.3**	**2.4**	**2.8**	**1.9**	**1.9**	**2.0**	**2.0**
1. United States	-2.6	2.7	2.8	2.4	2.4	2.4	2.4
2. Eurozone	-4.0	1.2	1.6	1.0	1.1	1.1	1.1
Germany	-4.7	2.4	3.5	1.5	1.7	1.2	1.3
France	-2.6	1.4	1.6	1.3	1.3	1.3	1.3
3. Japan	-5.2	2.4	3.5	1.0	1.0	1.4	1.4
4. United Kingdom	-5.0	1.4	1.7	2.0	2.0	2.0	2.0
5. Canada	-2.5	3.3	2.9	2.7	2.4	2.4	2.4
6. Other developed countries	-1.4	4.4	5.0	3.2	3.2	3.1	3.2
Developing countries	**2.5**	**6.2**	**6.6**	**5.8**	**5.9**	**5.8**	**5.8**
1. Sub-Saharan Africa	2.6	5.0	5.0	5.5	5.5	4.9	5.5
2. Central and Eastern Europe	-3.6	2.8	3.5	3.4	3.4	3.6	3.5
3. Community of Independent Countries	-6.5	4.1	4.2	4.0	4.2	4.2	4.2
Russia	-7.9	4.1	3.8	3.8	3.8	3.7	3.8
4. Developing Asia	6.9	8.3	8.6	7.6	7.6	7.6	7.6
China	9.1	9.5	9.7	8.9	8.9	8.8	8.8
India	5.7	7.5	8.3	6.9	7.2	6.9	7.2
5. Middle East and Northern Africa	2.0	4.5	4.1	4.7	4.9	4.8	4.8
6. Latin America and the Caribbea	-1.7	4.8	5.3	3.7	3.7	3.6	3.6
Brazil	-0.2	7.0	7.2	4.0	4.0	4.0	4.0
World Economy	**-0.6**	**4.2**	**4.5**	**3.7**	**3.7**	**3.7**	**3.7**
Memo:							
BRICs 1/	5.0	8.1	8.3	7.2	7.3	7.1	7.2
Peru's trading partners 2/	-1.1	3.7	4.1	3.3	3.2	3.2	3.2

IR: Inflation Report.
* Forecast.
1/ Brazil, Russia, India and China.
2/ Basket of Peru's 20 main trading partners.
Source: Bloomberg, IMF, Consensus Forecast.

7. Global trade continued recovering in Q3-2010, although registering lower rates. According to the World Trade Organization (WTO), global trade grew 23 percent between January and September, continuing with the recovery trend that started in Q2-2009. According to monthly data, global exports recovered in September after showing a decline in July and August.

Graph 3
WORLD EXPORTS
(Annual % change Base IndexJanuary 2006=100)



8. The forecasted slowdown of growth in 2011 and 2012 is based on various factors whose importance is similar to the one decribed in our previous report or has become even greater in recent months.

In the **developed economies** consumption does not show yet a similar growth to the one observed in other post-crisis periods due to families' deleveraging process, the low recovery of employment and the maintenance of credit constraints. Moreover, stagnation in the real estate markets has been affecting the recovery of consumption through the wealth effect, as well as residential investment. Finally, the withdrawal of fiscal stimulus initiated in the Eurozone economies, which includes more severe adjustments in some countries with fiscal problems, is another factor that is affecting the prospects for recovery.

Table 2
DEVELOPED ECONOMIES INDICATORS

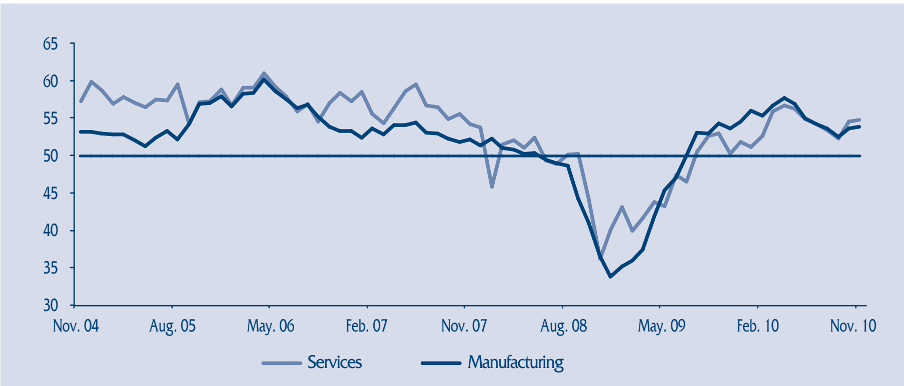
	Growth 2010			Unemployment		Inflation		Fiscal Deficit*		Public Debt*	
	Quarterly annualized rates			Annual rates				% of GDP			
	I	II	III	Dec. 09	Oct. 10	Dec. 09	Nov. 10	2010	2011	2010	2011
United States	3.7	1.7	2.5	10.0	9.6	2.7	1.1	10.5	8.8	89.4	94.7
United Kingdom	1.8	4.7	3.2	7.9	7.9	2.8	3.3	11.4	9.0	78.5	84.5
Eurozone	1.4	3.9	1.5	9.9	10.1	0.9	1.9	5.1	4.1	84.2	86.8
Germany	2.3	9.5	2.8	8.1	7.5	0.9	1.5	3.1	2.8	78.8	81.6
Japan	6.6	1.8	3.9	5.2	5.0	-1.7	0.2	9.6	8.9	225.0	232.5

* Moody's, November 2010. In the case of Japan, the inflation corresponds to Oct10.

In the case of the **emerging economies**, where economic activity has recovered at rates even higher than the ones observed prior to the crisis, the foreseen slowdown is associated in many cases with the gradual withdrawal of monetary and fiscal stimuls and with the adoption of measures aimed at preventing an excessive growth of credit and the formation of bubbles in the asset markets.

In terms of sectors, the aggregate index of manufacturing activity –the Purchasing Managers Index (PMI)– declined, even though it continues to be above the expansion threshold. In September, the manufacturing and the service indices recorded their lowest levels in 14 and 8 months, recovering thereafter in October and November.

Graph 4
JP MORGAN: GLOBAL PMI



9. Recent growth in the **United States** is based on personal consumption, the recovery of inventories and residential investment. Personal consumption has been rising slowly showing quarterly rates that still below 3 percent (2.8 percent in Q3). This recovery is substantially lower than the one observed in other post-crisis periods, which is explained by the high level of families' deleveraging, conditions in the labor market (with unemployment rates of 9.8 percent in November), and credit conditions which, in contrast with credit conditions for medium-size and large enterprises, are still tight for small businesses and households. On the other hand, residential investment and net exports register negative contributions to growth this year.

In this context of families' overindebtedness and moderation of the fiscal position, the economy is estimated to grow 2.4 percent in 2011 and 2012. The baseline scenario considers only the extension of the incentives introduced in 2001-2003.

Therefore, the main factor of uncertainty in terms of this forecast is the magnitude of the fiscal incentives that are currently being discussed in the US Congress. As regards the impact of the Federal Reserve's quantitative easing, there is some consensus about the fact that its impact would not be significant.

Table 3
USA: GDP GROWTH
(Annualized quarterly rates)

	3Q.08	4Q.08	1Q.09	2Q.09	3Q.09	4Q.09	1Q.10	2Q.10	3Q.10
GDP	**-4.0**	**-6.8**	**-4.9**	**-0.7**	**1.6**	**5.0**	**3.7**	**1.7**	**2.5**
Personal consumption	-3.5	-3.3	-0.5	-1.6	2.0	0.9	1.9	2.2	2.8
Durable goods	-12.0	-22.3	4.8	-3.1	20.1	-1.1	8.8	6.8	7.4
Non-durable goods	-5.5	-4.9	0.4	-0.7	1.7	3.1	4.2	1.9	1.8
Services	-1.3	0.6	-1.6	-1.7	-0.5	0.5	0.1	1.6	2.5
Gross investment	-12.5	-36.8	-42.2	-18.5	11.8	26.7	29.1	26.2	12.4
Fixed investment	-11.9	-24.9	-35.4	-10.1	0.7	-1.3	3.3	18.9	1.7
Non-residential	-8.6	-22.7	-35.2	-7.5	-1.7	-1.4	7.8	17.2	10.3
Residential	-22.6	-32.6	-36.2	-19.7	10.6	-0.8	-12.3	25.7	-27.5
Exports	-5.0	-21.9	-27.8	-1.0	12.2	24.4	11.4	9.1	6.3
Imports	-0.1	-22.9	-35.3	-10.6	21.9	4.9	11.2	33.5	16.8
Government expenditure	5.3	1.5	-3.0	6.1	1.6	-1.4	-1.6	3.9	4.0

Source: BEA.

10. In the **Eurozone**, prospects for growth in the following years are affected by the fiscal situation in some countries (Ireland, Greece, Portugal, and Spain) and by the adoption of fiscal measures aimed at reducing the high fiscal deficits observed. It should be pointed out that, so far this year, the economic evolution within the Eurozone has not been uniform. While the economies affected by uncertainty about their fiscal sustainability grew at negatives rates or close to zero, the favorable evolution of exports and domestic demand in Germany will allow this country to grow around 3 percent. In the next years the Eurozone would grow at rates slightly higher than 1 percent.

    Increased volatility started being observed in September in Greece after Eurostat revised fiscal accounts since 2006 and reported the small probability of meeting the fiscal target in 2010. In a context of contraction of activity, the implementation of an additional adjustment does not seem feasible and therefore it is likely that some sort of restructuring of the debt balance will be implemented.

Table 4
EUROPE INDICATORS
(% of GDP)

	2008	2009	2010*	2011 *
Ireland (GDP 2009: US$ 264.9 billion)				
Growth (%)	-3.6	-7.6	-0.5	1.2
Spreads CDS (Bps) 1/	181	158	605	-.-
Fiscal deficit	-7.3	-14.4	-31.6	-9.5
Public debt	44.3	65.5	98.0	113.0
Sovereign debt maturity (US$ billion) 2/	-.-	-.-	0.0	17.4
Banks debt maturity (US$ billion) 2/	-.-	-.-	2.7	10.7
Portugal (GDP 2009: US$ 233.5 billion)				
Growth (%)	0.0	-2.5	1.6	0.0
Spreads CDS (Bps) 1/	96	92	543	-.-
Fiscal deficit	-2.9	-9.3	-7.3	-5.0
Public debt	65.3	76.1	83.0	89.0
Sovereign debt maturity (US$ billion) 2/	-.-	-.-	4.0	38.9
Banks debt maturity (US$ billion) 2/	-.-	-.-	0.0	14.7
Spain (GDP 2009: US$ 1,467.9 billion)				
Growth (%)	0.8	-3.7	-0.3	0.0
Spreads CDS (Bps) 1/	101	113	364	-.-
Fiscal deficit	-4.2	-11.1	-9.1	-6.5
Public debt	39.8	53.2	64.0	70.0
Sovereign debt maturity (US$ billion) 2/	-.-	-.-	25.5	168.8
Banks debt maturity (US$ billion) 2/	-.-	-.-	10.7	111.2
Greece (GDP 2009: US$ 330.8 billion)				
Growth (%)	1.3	-2.3	-4.3	-2.7
Spreads CDS (Bps) 1/	232	283	965	-.-
Fiscal deficit	-9.4	-15.4	-9.4	-7.8
Public debt	110.3	126.8	141.0	152.0
Sovereign debt maturity (US$ billion) 2/	-.-	-.-	0.0	64.3
Banks debt maturity (US$ billion) 2/	-.-	-.-	1.3	17.4

1/ 2009: December, and 2010: November 30.
2/ For 2010 maturities corresponds to November and December.
Source: Moody's, Deutsche Bank, Barclays, JP Morgan and Eurostat.
* Investment banks forecasts.

In the case of Ireland, the increase of the fiscal deficit associated with the bailout of banks forced the country to request assistance from the International Monetary Fund (IMF)/European Union (EU). Irish banks have been severely affected by the correction of the bubble of real estate prices and, as a result of the government's bailout, have gradually become state banks.

These developments have generated uncertainty in other European economies, such as Portugal and Spain. The fiscal fiscal of Portugal intensified during the crisis due to the drop of tax revenues, the performance of automatic stabilizers, and the fiscal stimulus implemented by the government. Even though Portugal stands in a better position than other countries with fiscal financing issues, the low growth expected and the high deficit in the current account would make it more difficult for the country to face the debt problems.

Spain has relatively better fundamentals (debt and fiscal deficit levels), but shows macroeconomic and financial vulnerabilities. Its structural rigidities prevent it from implementing a competitiveness adjustment fast enough to return to a sustainable growth path. High unemployment (19.8 percent) hinders achieving the target of adjusting the 6 percent deficit in 2011 and there are risks in the banking system given its exposure to the real estate market and therefore to correcting the price bubble.

In the **United Kingdom** growth has been basically based on net exports, investment and domestic consumption. No substantial recovery is expected in terms of consumption or government expenditure, but rather a greater consolidation of investment and net exports is expected. With this, the UK would grow 1.7 percent this year. Given fiscal cuts and tax increase plans (the VAT would be raised from 17.5 to 20.0 percent as from 2011), as well as the little space for a higher monetary stimulus (inflation in October recorded 3.2 percent), growth would remain at around 2 percent in the next years.

Recent economic activity in **Japan** showed a significant recovery registering a growth rate of 3.9 percent in Q3, a rate higher than expected and higher than the one recorded in Q2 (1.6 percent). This growth is explained by the positive evolution of consumption, which increased in anticipation that a series of incentives will come to an end shortly. Therefore, growth in Q4 is foreseen to be lower due to the correction expected in the consumption of durable goods. Moreover, growth rates of around 1 percent are expected in the following years. In this context, the Central Bank of Japan announced a new asset purchase program and the Ministry of Finance approved a stimulus program of ¥ 5.1 trillion aimed at preventing deflation and controlling the appreciation of the yen.

11. In the emerging economies, **China** is expected to moderate its dynamism after the strong growth observed between January and September. Growth rates of 8-9 percent are expected in 2011 and 2012. A moderation of growth was already observed in Q3-2010 with a rate of 9.6 percent –after having recorded rates of 12 and 10 percent in Q1 and Q2–, which is closer to the average quarterly rate

of the decade. The indicators of consumption, investment and the external sector confirm this trend.

The evolution of growth in China is is part associated with the measures adopted by the government to maintain inflation under control, to curbe the growth of credit and prevent the formation of price bubble in some sectors like the real estate sector and the stock market. The consumer price index which has been rising steadily over the year, reached an annual rate of 5.1 percent in November, led mainly by the evolution of food prices (11.7 percent in November) which account for nearly a third of prices. In this context, since September the Central Bank has raised the rate of reserve requirements on three occasions and has also raised the interest rate for loans and deposits (the latter had not been raised since 2005).

Graph 5
CHINA: QUARTERLY GDP
(12-month % change)

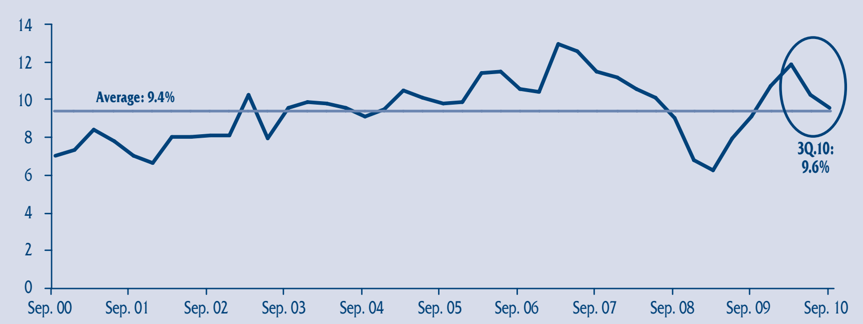


Table 5
CHINA: ACTIVITY INDICATORS

	June	July	August	September	October	November
Manufacturing PMI	52.1	51.2	51.7	53.8	54.7	55.2
Industrial production (12-month % change)	13.7%	13.4%	13.9%	13.3%	13.1%	13.3%
Investment in fixed assets (12-month % change)	25.5%	24.9%	24.8%	24.5%	24.4%	24.9%
Retail sales (12-month % change)	18.3%	17.9%	18.4%	18.8%	18.6%	18.7%
Exports (12-month % change)	43.9%	38.1%	34.4%	25.1%	22.9%	34.9%
Imports (12-month % change)	24.1%	22.7%	35.2%	24.1%	25.3%	37.7%
New loans (billions of yuan)	603	533	545	596	588	564
Inflation (12-month % change)	2.9%	3.3%	3.5%	3.6%	4.4%	5.1%
House prices*	11.4%	10.3%	9.3%	9.1%	8.6%	7.7%

Source: Bloomberg.
* Commision for development and national reform.

12. **Latin American** countries have also moderated their pace of expansion after the strong recovery observed early in the year. However, this slowdown was anticipated and would not imply a shift in the trend but would rather be pointing to a more gradual evolution in the following periods.

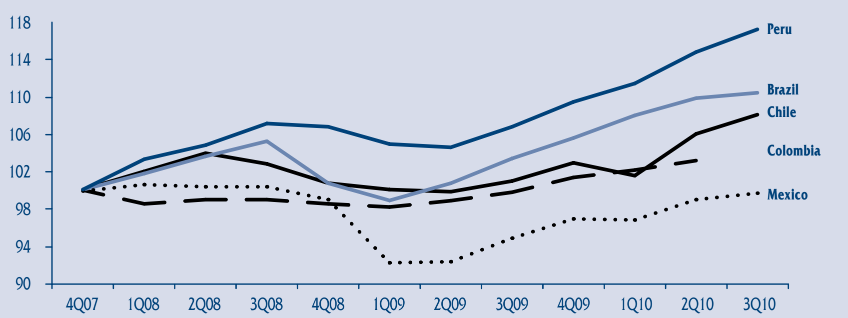
In Brazil the labor market mantains a low level of unemployment, while growth in Chile continues to be driven by consumption and investment. An improvement in consumer confidence and employment is expected in México in the following months. The region is estimated to grow 5.3 percent in 2010 and around 3.7 percent in the next two years, in line with a more moderate pace of expansion.

Table 6
GDP: QUARTERLY EXECUTION
(Growth rates compared to the same quarter of the previous year)

	2008				2009				2010		
	I	II	III	IV	I	II	III	IV	I	II	III
Emerging Asia											
China	10.6	10.1	9.0	6.8	6.2	7.9	9.1	10.7	11.9	10.3	9.6
Korea	5.5	4.4	3.3	-3.3	-4.3	-2.2	1.0	6.0	8.1	7.2	4.4
India	8.5	7.8	7.5	6.1	5.8	6.0	8.6	6.5	8.6	8.8	8.9
Indonesia	6.2	6.3	6.3	5.3	4.5	4.1	4.2	5.4	5.7	6.2	5.8
Malaysia	7.6	6.5	4.9	0.1	-6.2	-3.9	-1.2	4.4	10.1	8.9	5.3
Latin America											
Brazil	6.4	6.5	7.1	0.8	-3.0	-2.8	-1.8	5.0	9.3	9.2	6.7
Chile	3.7	5.1	5.2	0.7	-2.1	-4.5	-1.4	2.1	1.5	6.5	7.0
Colombia	5.1	4.5	3.1	-1.5	-0.4	-0.2	0.9	3.0	4.2	4.5	--
Mexico	2.6	3.0	1.6	-1.1	-7.9	-10.0	-6.1	-2.3	4.3	7.6	5.3
Peru	10.3	11.7	10.9	6.5	1.9	-1.2	-0.6	3.4	6.2	10.2	9.7

Source: Central banks and statistics institutes, IMF, and Bloomberg.

Graph 6
LATIN AMERICA: EVOLUTION OF GDP
(Seasonally adjusted data 4Q07=100)



Source: Central banks and statistics institutes.

Financial markets

13. Since the end of August markets were strongly influenced by expectations about a new monetary stimulus package (QE2) that would be implemented by the FED. This measure, announced in November, consists of a program of purchases of Treasury bonds for a total of US$ 600 billion that will be carried out until June 2011. The prospects of increased liquidity in dollars and lower risk aversion translated into a recovery of stock markets, a depreciation of the dollar in financial markets, and an increase in non commercial positions in commodity markets.

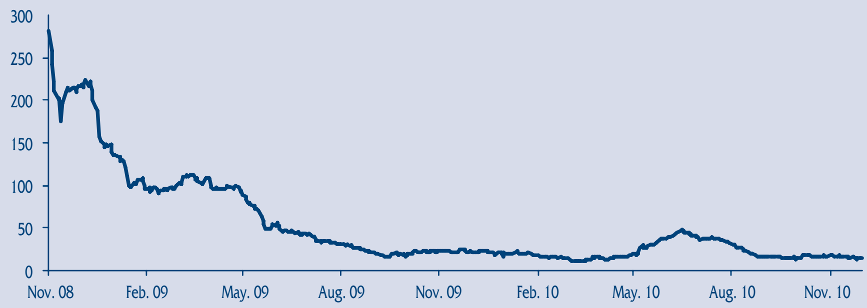
    However, this trend has been reversing in the last weeks as a result of concerns about the fiscal situation of some Eurozone countries and as a result of the implementation of restrictive measures in China. Moreover, international financial markets have also showed higher volatility, especially in terms of European markets and the price of the dollar against the euro.

Table 7
INTERNATIONAL MARKETS INDICATORS

						Monthly change		
ECONOMIC INDICATORS	Dec.09	Aug.10	Sep.10	Oct.10	Nov.10	Sep/Aug	Oct/Sep	Nov/Oct
							% change	
DOW JONES	10,428	10,428	10,788	11,118	11,006	3%	3%	-1%
EURO (US dollars per euro)	1.43	1.27	1.36	1.39	1.30	7%	2%	-7%
DOLLAR / BASKET	101.60	103.61	100.07	98.70	100.61	-3%	-1%	2%
GOLD - ($/Tr. oz.)	1,098.0	1,247.2	1,301.9	1,346.8	1,385.6	4%	3%	3%
COPPER - (US$/Pd)	3.33	3.34	3.65	3.73	3.80	9%	2%	2%
VIX	21.68	27.21	23.70	21.20	22.53	-13%	-11%	6%
							Bps change	
10-YEAR US TREASURY BOND (%)	3.84	2.47	2.51	2.60	2.80	4.2	8.9	19.8
3M LIBOR (%)	0.25	0.30	0.29	0.29	0.30	-1	0	1
SPR. EMBIG.Emerg Eco (bps)	165	191	174	136	180	-17	-38	44

14. Liquidity conditions in **money markets** have remained stable after the improvement observed between July and September. Interbank rates in dollars have remained in line with the low levels of the monetary policy rates of the major central banks of developed countries.

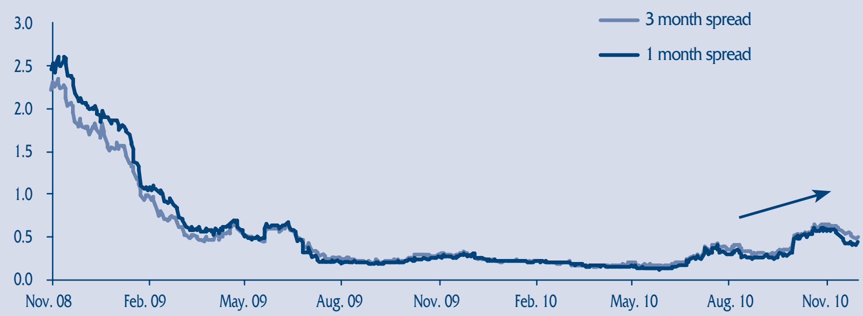
Graph 7
TED SPREAD (Basis points)
(Spread between the 3-month Libor and the Treasury bond)



Source: Bloomberg.

However, liquidity pressures have been observed in interbank markets since mid-November. In the case of liquidity in euros, banks' demand for resources of the European Central Bank (ECB) have increased, both in terms of amounts and in terms of the number of banks requesting them. In this context, in its monetary policy meeting of December, the ECB decided to extend the application of unconventional liquidity injection instruments that were previously supposed to end at the close of this year to the end of March of next year. In the case of liquidity in dollars, the liquidity pressures have reflected in the increase of the swap rate spreads (between dollars and euros).

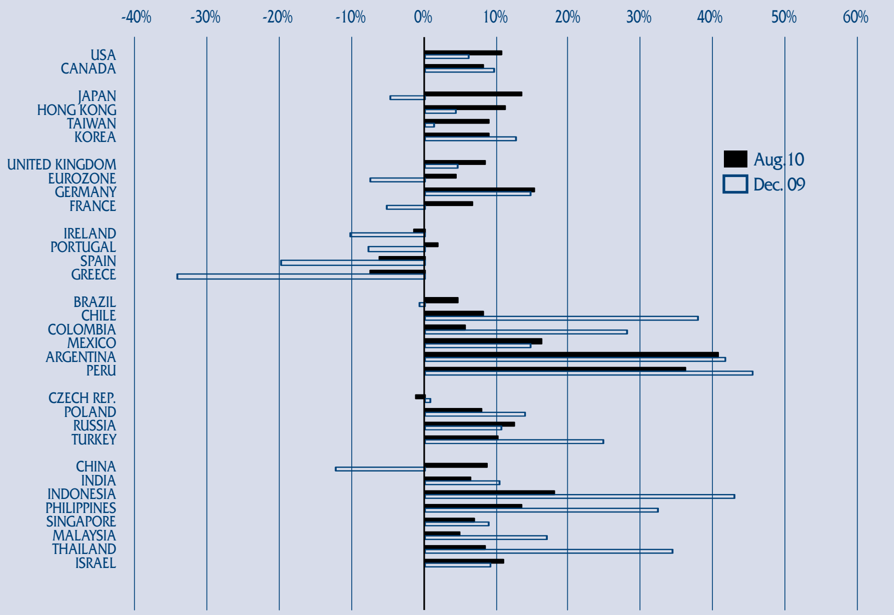
Graph 8
SPREAD BETWEEN SWAP RATES IN DOLLARS AND EUROS
(%)



Source: Bloomberg.

15. In **capital markets** the major bourses continued showing upward trends and most of the stock indices recorded gains. Better than expected corporate results in Q3 added onto expectations about the FED's quantitative easing, as a result of which many stock markets have already compensated the losses recorded during the international financial crisis.

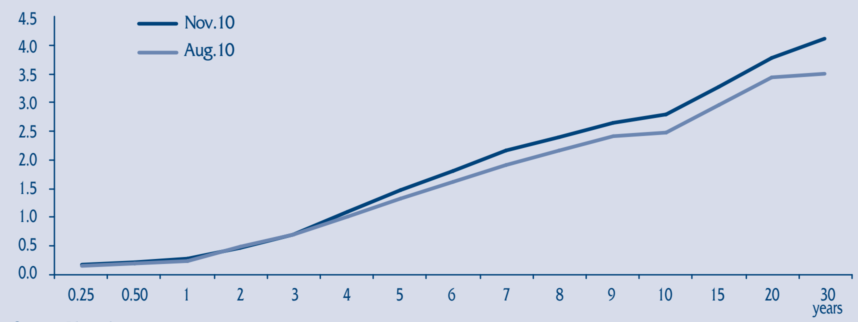
Graph 9
STOCK MARKETS
(% change Nov.10 respect to Aug.10 and Dec.09)



Source: Bloomberg.

16. In the **fixed income markets** the yields on Treasury bonds have remained low. The short tranche yields (up to 2 years) have reached minimum levels, but the longer tranche yields have corrected upwards, in line with the asset purchase program stipulated in the QE2 which gives a lower than expected weight to purchases of longer term bonds (over 10-year securities). The steepening of the yield curve would also reflect market expectations about the impact of the QE2 program on economic activity and future inflation.

Graph 10
US TREASURY BONDS YIELD CURVE



Source: Bloomberg.

17. As regards **credit spreads**, the spreads of corporate bonds of high investment US firms have declined significantly (they reached historical minimum levels in October), like the spreads of emerging economies. A slight reversal of this trend was observed in November.

On the other hand, the sovereign credit spreads of some Eurozone countries have risen significantly, in line with higher risks of contagion of Ireland's crisis to Portugal and Spain. In this context, since mid-November the ECB has intensifed its purchases of sovereign bonds of some Eurozone countries (after several weeks of consecutive declines).

Table 8
SPREAD OF CREDIT DEFAULT SWAP (CDS 5 YEARS, IN BPS.) 1/

	Dec.08	Dec.09	Mar.10	Jun.10	Sep.10	Oct.10	Nov.10
Corporate (senior debt)							
Investment grade USA	214	121	99	126	117	93	99
Investment grade Eurozone	178	76	78	129	111	98	117
Sovereign							
Portugal	96	92	139	310	409	379	543
Ireland	181	158	146	266	458	472	605
Greece	232	283	333	909	775	795	965
Spain	101	113	116	261	231	214	364
Germany	46	26	32	45	39	35	56
United Kingdom	107	83	77	76	65	54	77
France	54	32	46	90	79	70	105
Italy	157	109	116	190	197	171	268
Peru	303	124	127	136	119	108	130
Colombia	308	143	149	148	116	101	126
Chile	203	69	81	105	73	68	93
Mexico	292	133	117	134	121	106	127
Brazil	299	123	130	138	115	100	123

Source: Bloomberg.
1/ The CDS is a financial instrument that insures against loss to an event of default.

Non commercial positions have also increased in commodities markets and a rise has been observed in the prices of minerals and grains whose prices have become lower in terms of the domestic currency.

18. The depreciation of the dollar during the months of September and October is worth pointing out in terms of the foreign **exchange markets**. In this period the dollar depreciated 6 percent against a currency basket, reaching levels that had not been observed since August 2008. The dollar was traded at a minimum low

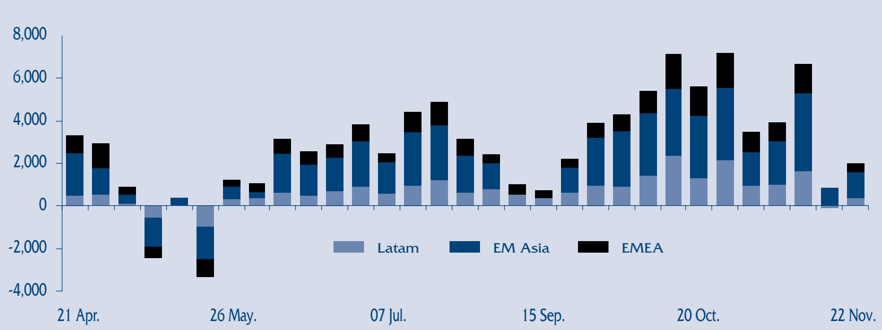
of US$ 1.42 against the euro on November 4, which represented a depreciation of 9 percent compared with August, while the yen depreciated somewhat less (6 percent) due to the unfavorable outlook for growth in Japan and due to the asset purchase program announced by its central bank. However, with the deepening of fiscal problems in Europe since end October, the dollar has started showing a slight reversal of this trend, particularly against the euro and the pound.

Graph 11
EXCHANGE RATE OF US CURRENCY BASKET 1/
(Monetary units per US$)

1/ An increase of the index implies US Dollar appreciation.
Source: FED.

Expectations of higher liquidity in dollars, lower risk aversion and the favorable outlook for growth in many emerging countries have led to increasing inflows of capitals to these economies, particularly in September and October, accentuating the appreciatory trend observed in most of the year.

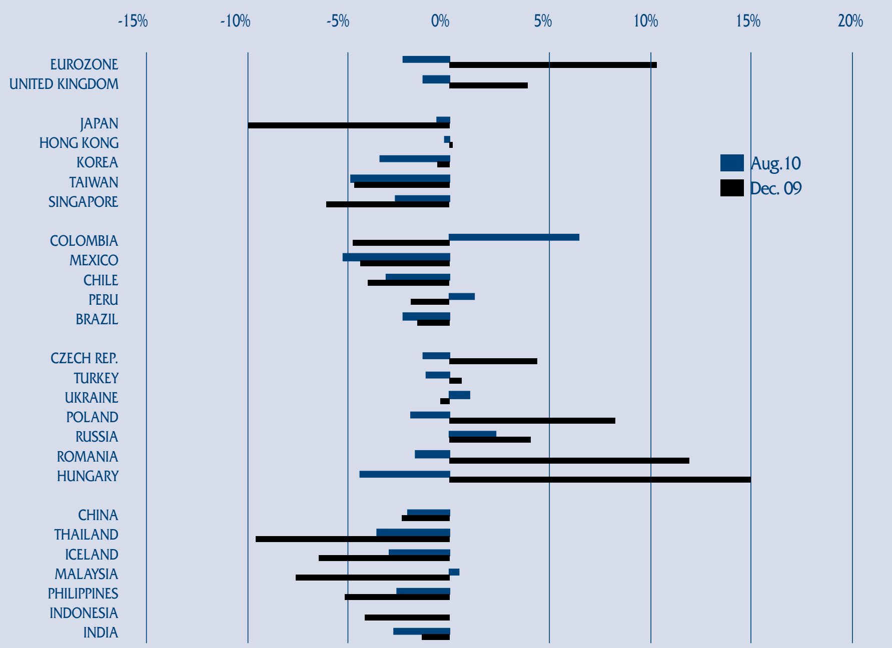
Graph 12
PORTOFOLIO FLOWS TO EMERGING ECONOMIES: 2010
(Weekly flows, US$ million)



Latam: Latin America. EMEA: Europe, Middle East and Africa. EM Asia: Emerging Asia.
Source: Barclays.

These appreciatory pressures on the currencies of emerging countries have generated several responses. Some central banks have intervened in the foreign exchange market, have implemented some type of restrictions to capital inflows or adopted measures to ease capital outflows. Additionally, tax measures and prudential regulations have been implemented to offset short term capital inflows. In addition to uncertaintly about the recovery of the global economy, these appreciatory pressures would also explain the moderation in the cycle of interest rate rises and the implementation of other measures, such as the increase of the rate of reserve requirements.

Graph 13
EXCHANGE RATE
(Monetary units per US$; % Chg. Nov.10 respect to Aug. 10 and Dec. 09)



Source: Reuters.

Rate decisions

19. Between September and November most central banks in developed economies maintained their interest rates unchanged. Only a few (Canada and Sweden) started or continued withdrawing monetary stimulus, but did so with rate levels that were historically low. Moreover, both the FED and the Bank of Japan announced asset-purchase programs (for US$ 600 billion and ¥5 trillion, respectively).

On the other hand, several emerging countries continued implementing a cycle of interest rate rises given the recovery of economic activity and the rise of inflationary pressures or some evidence of excessive growth of credit. This upward trend was more moderate in the last months due to some evidence of the moderation of economic growth and uncertainty in the international environment.

It should be pointed out that, in the context of strong appreciatory pressures, some central banks also resorted to reserve requirements to moderate the expansion of credit.

Table 9
MONETARY POLICY INTEREST RATE

									Accumulated change (bps.)		
	Sep.08	Dec.08	Dec.09	May.10	Jun.10	Jul.10	Aug.10	Nov.10	Aug.10	Dec.09	Sep.08
Countries that had kept rates unchaged											
BCE	4.25	2.50	1.00	1.00	1.00	1.00	1.00	1.00	0	0	-325
Brazil	13.75	13.75	8.75	9.50	10.25	10.75	10.75	10.75	0	200	-300
Colombia	10.00	9.50	3.50	3.00	3.00	3.00	3.00	3.00	0	-50	-700
Philippines	6.00	5.50	4.00	4.00	4.00	4.00	4.00	4.00	0	0	-200
United States	2.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0	0	-175
Indonesia	9.25	9.25	6.50	6.50	6.50	6.50	6.50	6.50	0	0	-275
Japan	0.50	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0	0	-40
Malaysia	3.50	3.25	2.00	2.50	2.50	2.75	2.75	2.75	0	75	-75
Mexico	8.25	8.25	4.50	4.50	4.50	4.50	4.50	4.50	0	0	-375
Norway	5.75	3.00	1.75	2.00	2.00	2.00	2.00	2.00	0	25	-375
New Zealand	7.50	5.00	2.50	2.50	2.75	3.00	3.00	3.00	0	50	-450
Poland	6.00	5.00	3.50	3.50	3.50	3.50	3.50	3.50	0	0	-250
United Kingdom	5.00	2.00	0.50	0.50	0.50	0.50	0.50	0.50	0	0	-450
Czech Republic	3.50	2.25	1.00	0.75	0.75	0.75	0.75	0.75	0	-25	-275
Switzerland	2.75	0.50	0.25	0.25	0.25	0.25	0.25	0.25	0	0	-250
Thailand	3.75	2.75	1.25	1.25	1.25	1.50	1.75	1.75	0	50	-200
Turkey	16.75	15.00	6.50	6.50	6.50	6.50	6.50	6.50	0	0	-1,025
Countries that had increased rates											
Australia	7.00	4.25	3.75	4.50	4.50	4.50	4.50	4.75	25	100	-225
Canada	3.00	1.50	0.25	0.25	0.50	0.75	0.75	1.00	25	75	-200
Chile	8.25	8.25	0.50	0.50	1.00	1.50	2.00	3.00	100	250	-525
China	7.20	5.31	5.31	5.31	5.31	5.31	5.31	5.56	25	25	-164
South Korea	5.25	3.00	2.00	2.00	2.00	2.25	2.25	2.50	25	50	-275
Hungary	8.50	10.00	6.25	5.25	5.25	5.25	5.25	5.50	25	-75	-300
India	9.00	6.50	4.75	5.25	5.25	5.75	5.75	6.25	50	150	-275
Israel	4.25	2.50	1.25	1.50	1.50	1.75	1.75	2.00	25	75	-225
Pakistan	13.00	15.00	12.50	12.50	12.50	13.00	13.00	14.00	100	150	100
Peru	6.50	6.50	1.25	1.50	1.75	2.00	2.50	3.00	50	175	-350
Sweden	4.75	2.00	0.25	0.25	0.25	0.50	0.50	1.00	50	75	-375
Taiwan	3.50	2.00	1.25	1.25	1.38	1.38	1.38	1.50	13	25	-200
Countries that had decreased rates											
South Africa	12.00	11.50	7.00	6.50	6.50	6.50	6.50	5.50	-100	-150	-650
Iceland	15.50	18.00	10.00	8.50	8.00	8.00	7.00	5.50	-150	-450	-1,000
Countries that had not decided											
Slovakia	4.25	2.50	2.50	2.50	2.50	2.50	2.50	2.50	0	0	-175

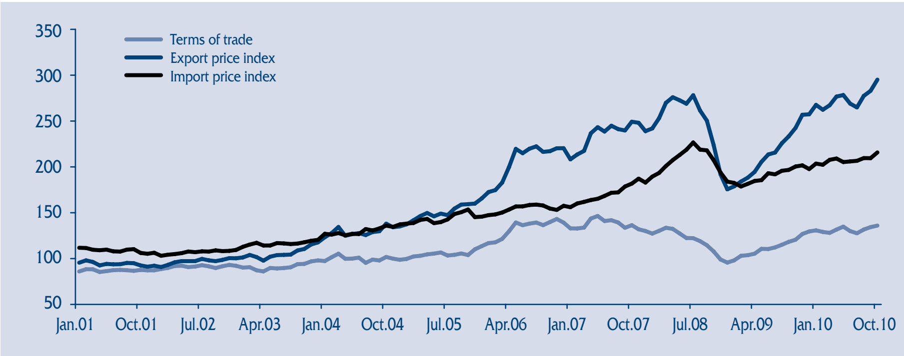
Source: Reuters and Bloomberg.

Terms of trade and commodity prices

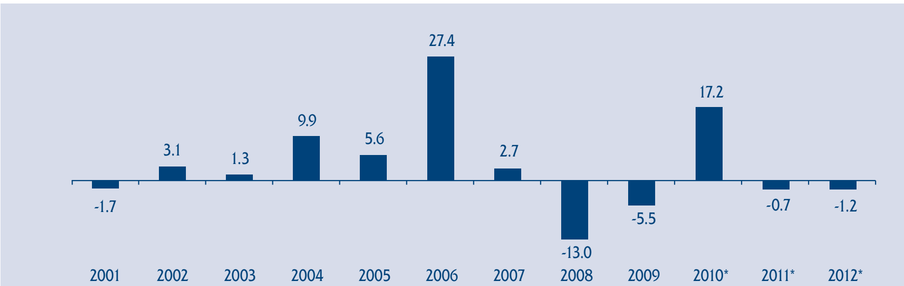
20. The prices of commodities continued recovering during 2010, driven by increased economic activity, the recovery of global trade, investors' higher demand, and some supply shocks, particularly in terms of food products. This recovery was intensified by expectations and subsequent announcement of the FED's QE2. Prices were later on affected by the fiscal situation in some European countries and by the measures implemented in China to moderate the growth of demand.

    As a result of this, terms of trade at end 2010 would record an increase of 17 percent, driven mainly by the recovery in the prices of our export products, while in 2011 and 2012 they are estimated to show a moderate decline.

Graph 14
TERMS OF TRADE, EXPORT AND IMPORT PRICE INDICES
(1994=100)



Graph 15
TERMS OF TRADE
(% change)



(*) Forecast.

Table 10
TERMS OF TRADE
(Average change and prices)

	Execution		2010		2011		2012	
	2009	A Oct.10	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
Terms of trade	**-5.5**	**20.3**	**13.8**	**17.2**	**-3.6**	**-0.7**	**-1.6**	**-1.2**
Export prices	**-12.5**	**31.9**	**24.4**	**28.4**	**-0.4**	**3.5**	**0.6**	**0.4**
Copper (cents per pound)	*234*	*331*	*324*	*339*	*325*	*380*	*325*	*380*
Zinc (cents per pound)	*75*	*97*	*93*	*98*	*90*	*98*	*90*	*98*
Gold (US$ per ounce)	*974*	*1,194*	*1,180*	*1,222*	*1,212*	*1,300*	*1,212*	*1,300*
Import prices	**-7.4**	**9.9**	**9.4**	**9.6**	**3.3**	**4.2**	**2.2**	**1.7**
Oil (US$ per barrel)	*62*	*78*	*76*	*79*	*75*	*86*	*75*	*86*
Wheat (US$ per MT)	*193*	*182*	*199*	*196*	*266*	*288*	*257*	*289*
Maize (US$ per MT)	*139*	*146*	*147*	*158*	*181*	*234*	*180*	*219*
Soybean oil (US$ per MT)	*729*	*812*	*817*	*858*	*910*	*1,123*	*926*	*1,133*
Rice (US$ per MT)	*561*	*496*	*483*	*500*	*450*	*518*	*450*	*515*
Sugar (US$ per MT)	*412*	*558*	*496*	*598*	*405*	*663*	*356*	*561*

21. After the announcement of QE2 in the US, increased liquidity in the market was oriented to investment funds in commodities. In October the flow of investments[1] in commodities –mainly in energy and agriculture– was US$ 7 billion and thus accumulated US$ 50 billion in the year. With this, total investments in commodities reached a record level of US$ 340 billion, the main flows towards non commercial positions being investments in copper, oil, and food (particularly maize and soybean). Moreover, the rise in food prices has been generating inflationary pressures in some countries.

Table 11
12-MONTH INFLATION: SELECTED COUNTRIES

	Brazil 1/		Russia		India 2/		China		Peru	
	Jun.10	Nov.10	Jun.10	Nov.10	Jun.10	Nov.10	Jun.10	Nov.10	Jun.10	Nov.10
CPI	4.8	5.6	5.8	8.1	10.3	7.5	2.9	5.1	1.6	2.2
Food CPI	9.2	12.6	4.5	11.2	20.1	13.0	6.8	11.7	2.5	3.0

1/ The Food CPI correspond to the food index of Sao Paulo city.
2/ The CPI corresponds to the Wholesale Price index.
Source: Bloomberg.

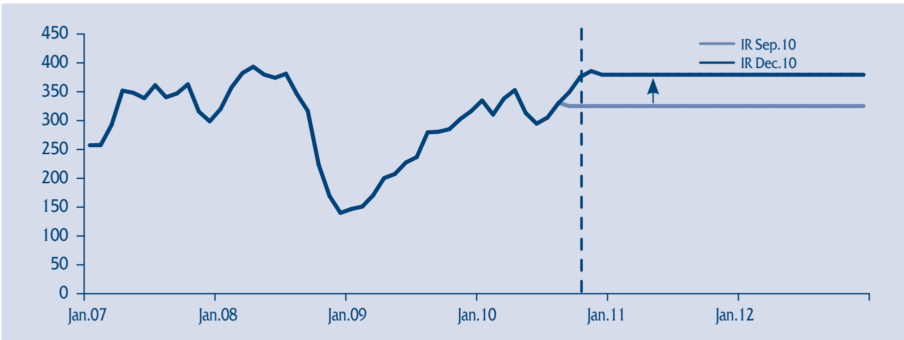
Copper

22. The price of copper continued showing an upward trend, interrupted in November due to the uncertainty generated by fiscal problems in Europe. Between January and

1 Includes institutional investors and retailers.

November 2010, the price of copper has recorded a rise of 22 percent, reaching a maximum level of US$ 4 on November 11 (a price level unobserved since mid-2008). Factors accounting for this upward trend included China and Japan's increased imports of concentrates and refined copper, the recovery of the industrial and manufacturing sectors in developed countries, and supply constraints in the major producing countries (strikes in Chile and closure of operations in mines in China). The price of copper is expected to remain high (around US$ 3.80/pound) during the forecast horizon.

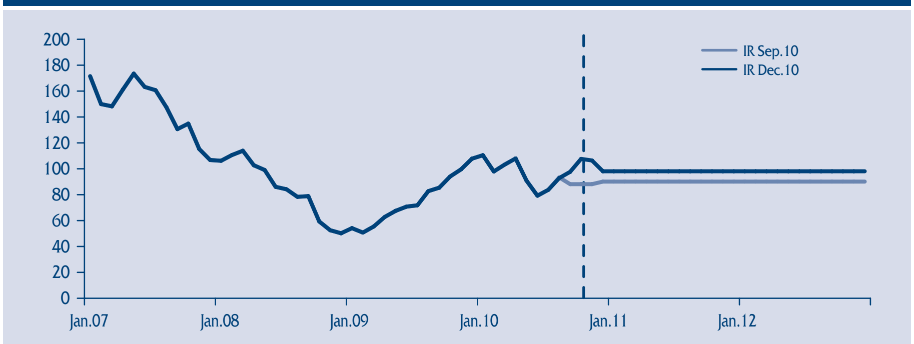
Graph 16
COPPER
(cts. US$/pd.)



Zinc

23. The price of zinc showed a similar trend to the one observed in most basic metals, although it did not recover the level registered at the close of 2009. Between January and November this price fell 1 percent to US$ 1.064/pound, after having declined until US$ 0.790/pound in June when uncertainty about global economic recovery increased and a higher production of concentrates was recorded in Australia, China, and India along with a higher production of refined zinc in Canada, China, and Belgium. Moreover, inventories in metal exchange markets increased during the year. The price of zinc would stabilize around US$ 1.0/pound as from 2011.

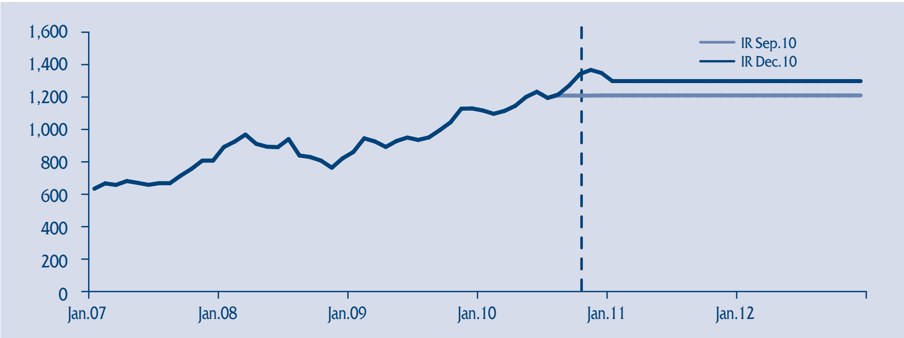
Graph 17
ZINC
(cts. US$/pd.)



Gold

24. The price of gold maintained a sustained upward trend during the year due to investors' increased demand given that they sought to diversify their portfolios in a context of uncertainty regarding global economic recovery. Gold closed at an average price of US$ 1,369/troy ounce in November, reflecting an increase of 21 percent relative to the close of 2009. On November 9, gold reached an historical maximum high of US$ 1,421/troy ounce, driven mainly by investors' higher demand in a context of fiscal problems in some Eurozone countries and concerns about its probable contagion to other economies. The price of this metal has stabilized thereafter around US$ 1,300/troy ounce and is expected to show high volatility during the forecast horizon.

Graph 18
GOLD
(US$/Troy ounce)



Crude

25. The price of oil has risen 14 percent so far this year, reaching an average level of US$ 84.3/barrel in November and showing a similar trend to the one observed in the case of basic metals. The price recorded in the last four months is explained by the favorable evolution of some developed countries and China, as well as by supply factors (Canada, USA, France) and geopolitical tensions between USA and Iran. However, the price of crude declined in the last two weeks of November, affected by concerns about the rise of interest rates in China and fears about the debt crisis in the Eurozone.

Nonetheless, crude inventories in the US have been increasing over the year. Inventories in mid-November were 10 percent higher than in December 2009.

Graph 19
WTI OIL
(US$/bl.)

Maize

26. The price of maize maintained an upward trend over the year and recorded an increase of 48 percent, reaching an average level of US$ 203/ton in November. This price was boosted by the reduction in the US Department of Agriculture's production estimate (the main reduction was observed in the US due to lower yields), which added onto the fact that China remained as a net importer of maize. These factors incentivated a higher demand for other food products, which led to an increase in most prices, a situation that was exacerbated by investors' increased speculative purchases. The price of maize is expected to show a downward correction as from mid-2011.

Graph 20
MAIZE
(US$/MT)

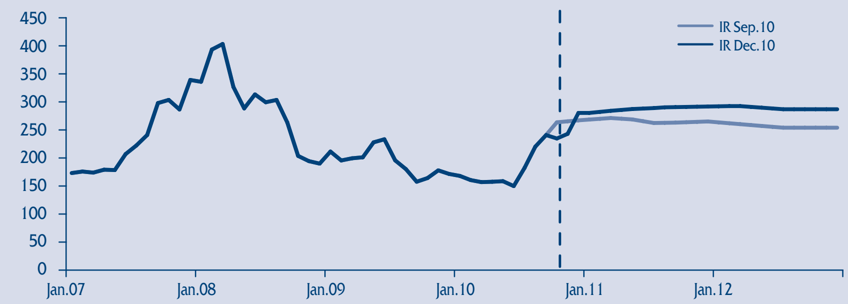
Source: Bloomberg and BCRP.

Wheat

27. The price of wheat increased 41 percent in November compared with December 2009, closing the month at an average price of US$ 240/ton. The upward trend observed in the price of wheat was associated with supply constraints due to the

severe drought experienced by Eastern Europe and the increase in the price of maize. The wheat supply was affected by the quota established by Ukraine on grain exports until the end of the year which, together with Russia's ban on wheat exports, generated upward pressures on this price. Ukraine's restrictions on exports had been observed for some months due to increased customs requirements. In this context, the price of wheat is expected to remain high in 2011 and 2012.

Graph 21
WHEAT
(US$/MT)



Source: Bloomberg and BCRP.

Soybean oil

28. The price of soybean oil has registered an increase of 29 percent year-to-date, reaching an average of US$ 1,047/ton. This increase is associated with China's strong demand for soybean grains (imports have grown 26 percent so far this year) and the upward trend of crude. In addition, it is speculated that lower rainfall in Brazil and drought in Argentina's producing areas (due to La Niña event) could have negative effects on the production of grains. Therefore, the price of soybean oil is expected to remain at high levels in the forecast horizon.

Graph 22
SOYBEAN OIL
(US$/MT)

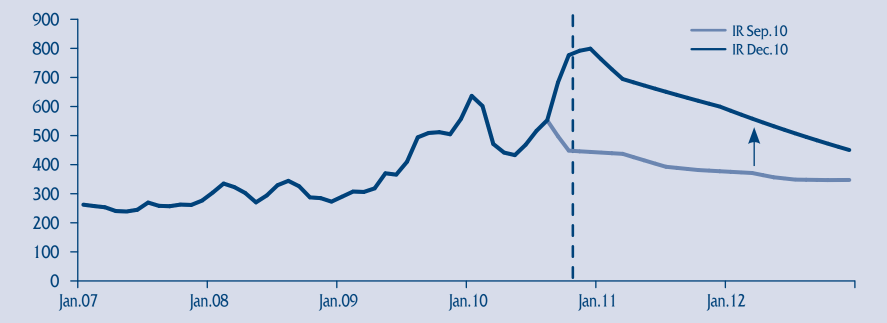
Source: Bloomberg and BCRP.

Sugar

29. Between January and November 2010, the price of sugar increased by 40 percent, closing the period at an average level of US$ 780/ton. Expectations of production cuts in Brazil due to lower-than-average rainfall generated price pressures (the price of sugar reached US$ 874/ton on November 9). The market is awaiting India's decision about the quantity of sugar that will be exported.

    Because climate conditions started improving in Brazil since mid-November, the price of sugar has begun correcting downwards. A substantial correction is expected after the beginning of the new commercialization year in Brazil (April 2011), in line with the improvement of climatic conditions.

Graph 23
SUGAR
(US$/MT)



Source: Bloomberg and BCRP.

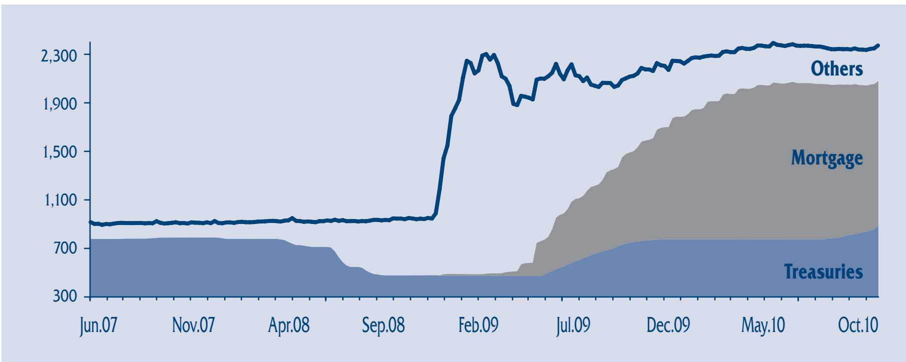
BOX 1
UNCONVENTIONAL MONETARY POLICY MEASURES:
THE FED'S QUANTITATIVE EASING

The international financial crisis generated unprecedented monetary policy responses. In a context of practically nil interest rates and ineffectiveness of monetary transmission channels, central banks implemented unconventional monetary measures, known as Quantitative Easing (QE), which implied the adoption of asset-purchase programs and therefore increased the balance of central banks. The main central banks that adopted these measures included the US Federal Reserve (FED), the Bank of England (BoE), the Bank of Japan (BoJ), and, to some extent, the European Central Bank (BCE).

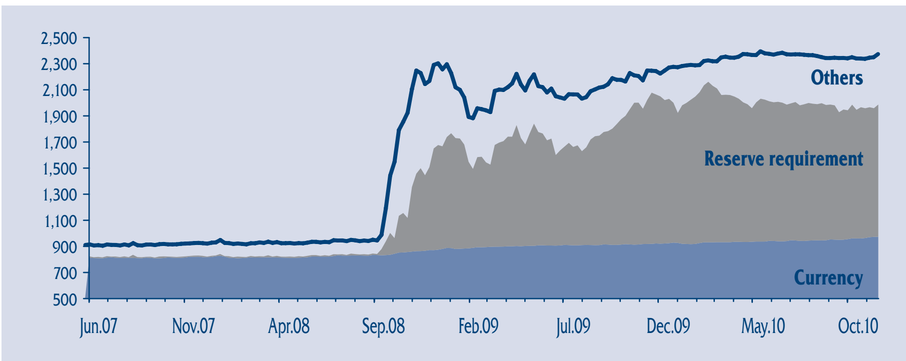
During the financial crisis, the FED announced an asset-purchase program (QE1) aimed basically at reducing long term interest rates and restoring liquidity in the markets that collapsed with the crisis. These programs implied purchases of mortgage securities for a total of US$ 175 billion, purchases of securitized mortgage securities for a total of US$ 1.25 trillion, and purchases of Treasury bonds for a total of US$ 300 billion. These programs were gradually completed in June 2010. Since then, the amount of these assets in the balance of the FED has been declining, basically as a result of the maturity of mortgage securities.

In August, the FED implemented the reinvestment of the maturities (and revenues and profits) of mortgage securities in long term government securities with the purpose of maintaining the balance of total holdings of these assets. The balance of these assets (Treasury bonds and mortgage debts) increased from US$ 0.5 trillion (July 2008) to US$ 2.0 trillion (August 2010), and the total of FED assets increased from US$ 0.9 to 2.4 trillion in the same period. Although the FED's balance has increased by more than twofold, the growth of public offering (OJO CK: emisión) since end 2009 has declined significantly to levels below zero at end November 2010.

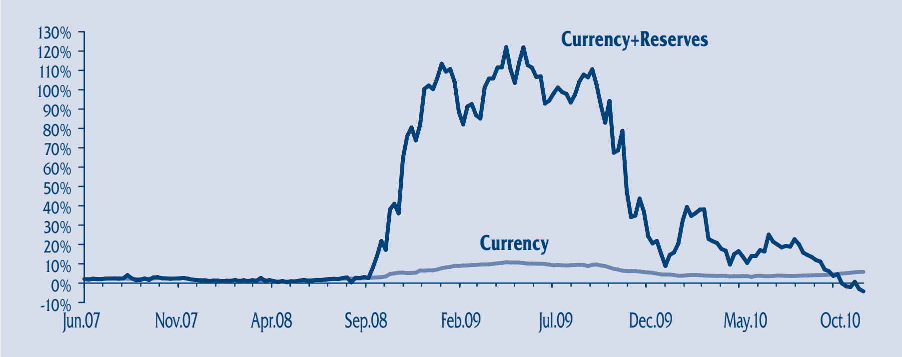
FED: ASSETS
(Billion US$)



FED: LIABILITIES
(Billion US$)



FED: MONETARY BASE (Currency + Reserves)
(12-month % change)



In the current context of economic slowdown and slow recovery of employment in the US, there is little space for fiscal policy measures and interest rates are close to zero. Because of this, the FED decided in its monetary policy meeting of November to extend its purchases of Treasury bonds (QE2) by US$ 600 billion, establishing a program of monthly purchases of Treasury bonds of US$ 75 billion in each month until June 2011. This measure was widely expected in the market. In its policy communiqué, the FED reaffirmed that it will maintain its current policy of reinvesting mortgage securities in Treasury bonds, as a result of which total monthly purchases would amount to US$ 110 billion. The distribution of purchases along the yield curve would be based on the following program:

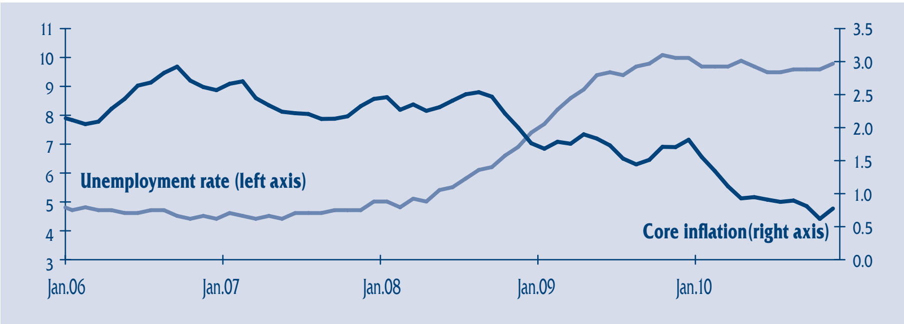
NOMINAL TREASURY BONDS							TIPS*
1½ -2½ years	2½-4 years	4-5½ years	5½-7 years	7-10 years	10-17 years	17-30 years	1½-30 years
5%	20%	20%	23%	23%	2%	4%	3%

* Securities indexed to inflation.

In contrast with previous communiqués, the FED has been more explicit about fears of deflation when it pointed out that inflation is “low” in terms of the inflation level consistent with long term growth. In this context, the implementación of QE2 would contribute to achieve the two goals of the FED. The program’s success would be based on the operational effectiveness/operability (CK with CP: operatividad) of transmission channels. In theory, this measure is expected to reduce the real yields of Treasury bonds and incentivize the demand for higher risk assets (stocks, corporate bonds, commodities). Together with higher inflationary expectations, this rise in the price of assets would result in a depreciation of the dollar.

Because it reduces the profitability of these assets, a side effect of this measure is that it leads investors to seek higher returns in other economies with better growth prospects. This potential effect has brought about a generalized concern about the formation of asset-price bubbles, particularly in the real estate markets of Asian emerging countries. In addition, it has also generated tensions in global foreign exchange markets in terms of a potential currency war that could result from countries' intents to prevent an appreciation of their currencies.

USA: INFLATION (12-month % chg.) AND UNEMPLOYMENT RATE (%)



Unconventional measures implemented by other central banks

The **BoE** implemented an asset-purchase program for a total of £ 200 billion which was completed in Q1-2010. The program has not been extended since then, in part due to the higher inflationary pressures experienced by England. Annual inflation has remained above the higher band of the inflation target (2%+/-1%) in the last 8 months (3.1 percent in October). Higher growth in Q3 (with a higher-than-expected quarterly rate of 0.8%) reduced expectations that this program would be increased, even though several members of the BoE policy committee had mentioned in October the possibility of expanding it due to the slowdown of growth and the expected effects of the fiscal adjustment that the government has already announced.

The **BoJ** decided to increase its program of government bond purchases from ¥ 1,4 trillion to ¥ 1.8 trillion each month. Due to clearer signals of an economic slowdown higher risks of deflation in the Japanese economy, in October 2010 the BoJ announced an asset-purchase program (Treasury bonds, corporate bonds, commercial securities and other assets) of ¥ 5 trillion (equivalent to US$ 60 billion).

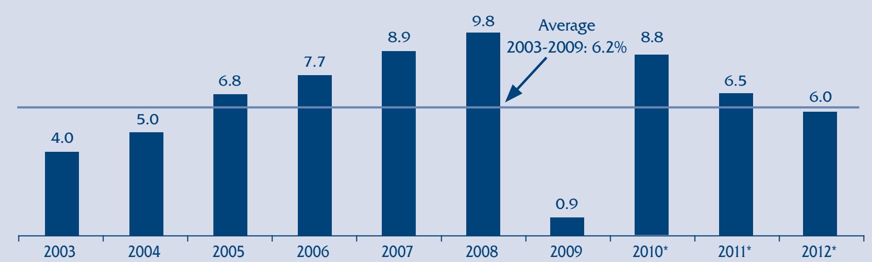
On its side, the **ECB** has said that it has not participated in any Quantitative Easing program that alters its monetary policy guidelines. During la financial crisis, the ECB established a program of purchases of covered bonds for a total of € 60 billion. In 2010, with the sovereign debt crisis being faced by some Eurozone economies since April, the ECB initiated a program of purchases of sovereign bonds of these economies with fiscal problems. The balance of these purchases currently amounts to € 67 billion. These purchases have not been completely sterilized without generating effects on the balance of the ECB assets.

II. Economic Activity

37. The forecast on GDP growth has been revised from 8.0 percent in our September Report to 8.8 percent given the dynamism of domestic economic activity observed during the first three quarters of the year (GDP and domestic demand have grown 8.7 and 12.6 percent, respectively). This evolution reflects the recovery of private consumption, the restocking process, and the expansion of private investment at rates similar to the ones registered prior to the international financial crisis in a contex of business confidence about the economic outlook.

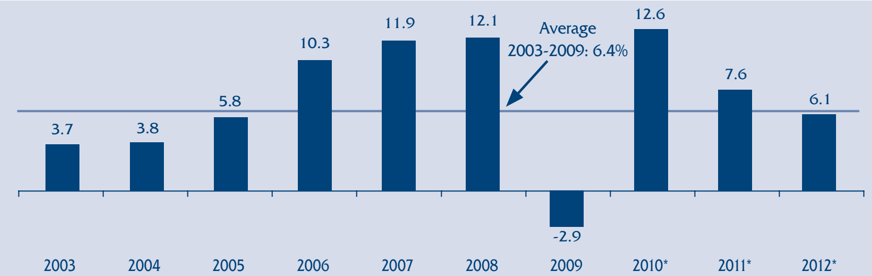
    GDP in 2011 and 2012 is expected to grow at annual rates of 6.5 and 6.0 percent, respectively. This foreseen slowdown of economic activity is in line with an estimated economic growth closer to that of the potential output after the economic recovery experienced this year. It is worth pointing out that the growth forecast in 2011 has been raised in comparison with the one considered in our Inflation Report of September (6.0 percent) due mainly to the higher expansion expected in terms of private investment.

Graph 24
GDP GROWTH RATE
(Real % change)



* Forecast.

Graph 25
DOMESTIC DEMAND GROWTH RATE
(Real % change)



* Forecast.

Table 12
DOMESTIC DEMAND AND GDP
(Real % change)

	2009		2010			2011*		2012*	
	Jan-Sep	Year	Jan-Sep.	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
1. Domestic demand	**-4.0**	**-2.9**	**12.6**	**11.4**	**12.6**	**6.9**	**7.6**	**6.0**	**6.1**
a. Private consumption	2.2	2.4	5.8	5.2	5.9	4.5	5.0	4.6	4.6
b. Public consumption	14.4	16.5	11.9	9.9	9.5	4.4	5.0	3.6	2.7
c. Private investment	-14.6	-15.1	21.4	16.7	22.4	11.1	14.5	11.8	12.3
d. Public investment	21.3	25.5	29.3	31.6	25.6	6.3	8.8	3.4	4.4
2. Exports	-2.8	-2.5	2.6	1.4	2.3	5.2	5.2	8.4	8.4
3. Imports	-20.0	-18.4	23.1	19.4	22.3	10.1	10.6	8.0	8.0
4. GDP	**0.0**	**0.9**	**8.7**	**8.0**	**8.8**	**6.0**	**6.5**	**6.0**	**6.0**
Memo:									
Public expending	16.6	19.6	17.7	17.8	15.4	5.2	6.5	3.5	3.4

IR: Inflation Report.
* Forecast.

Table 13
CONTRIBUTION TO GDP GROWTH

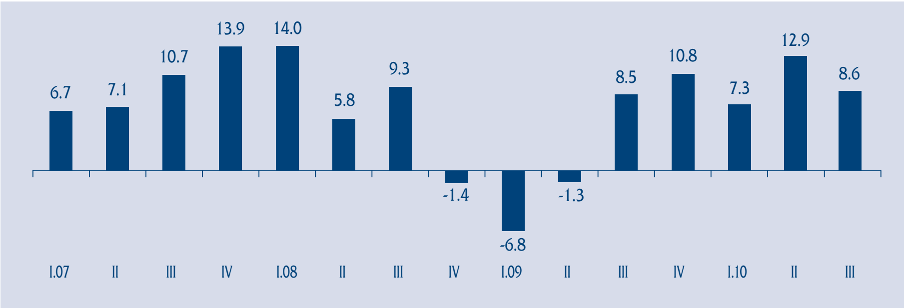
	2009		2010			2011*		2012*	
	Jan-Sep	Year	Jan-Sep	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
1. Domestic demand	-4.1	-3.0	12.5	11.4	12.5	7.1	7.9	6.2	6.3
a. Private consumption	1.5	1.6	4.0	3.5	4.0	3.0	3.3	3.0	3.0
b. Public consumption	1.1	1.3	1.0	0.9	0.9	0.4	0.5	0.3	0.2
c. Private investment	-3.3	-3.4	4.1	3.2	4.3	2.3	3.1	2.5	2.9
d. Public investment	0.8	1.1	1.3	1.7	1.4	0.4	0.5	0.2	0.3
e. Change in inventories	-4.2	-3.6	2.1	2.0	2.0	1.0	0.4	0.1	0.0
2. Exports	-0.6	-0.5	0.5	0.3	0.4	0.9	0.9	1.5	1.5
3. Imports 1/	-4.7	-4.3	4.3	3.7	4.2	2.1	2.3	1.7	1.8
GDP	**0.0**	**0.9**	**8.7**	**8.0**	**8.8**	**6.0**	**6.5**	**6.0**	**6.0**
Memo:									
Public expending	1.9	2.4	2.3	2.6	2.3	0.8	1.0	0.6	0.5

IR: Inflation Report.
* Forecast.
1/ (+) Indicates negative contribution, (-) Indicates positive contribution.

38. Excluding the seasonal effect, economic activity continues showing a sustained recovery since Q3-2009. This sound recovery is also reflected in

the evolution of indicators such as the production of electricity and local dispatches of cement.

Graph 26
SEASONALLY ADJUSTED GDP
(% change compared with the same quarter or the previous year)



Graph 27
ELECTRICITY PRODUCTION
(12-month % change)

Source: COES.

Graph 28
LOCAL DISPATCHES OF CEMENT
(12-month % change)

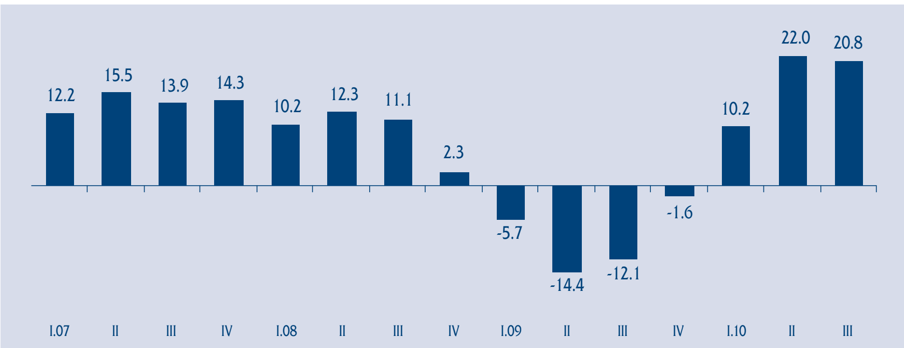
a. Economic analysts and financial entities estimate that GDP will grow 8.5 percent in 2010, while non financial firms forecast a growth of 8.0 percent. Growth forecasts in 2011 and 2012 are in the range of 6.0 and 6.6 percent.

Table 14
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH (%)

	IR Jun.10	IR Sep.10	IR Dec.10
FINANCIAL ENTITIES			
2010	6.0	7.0	8.5
2011	6.0	6.0	6.3
2012	6.0	6.0	6.0
ECONOMIC ANALYSTS			
2010	6.0	7.5	8.5
2011	5.5	5.7	6.0
2012	6.0	6.0	6.1
NON-FINANCIAL FIRMS			
2010	5.0	6.5	8.0
2011	5.5	6.0	6.6
2012	6.0	6.0	6.5

b. Manufacturing production, which has consolidated its strong recovery, recorded an expansion of 20.8 percent in Q3-2010.

Graph 29
NON-PRIMARY MANUFACTURING
(Real % change)

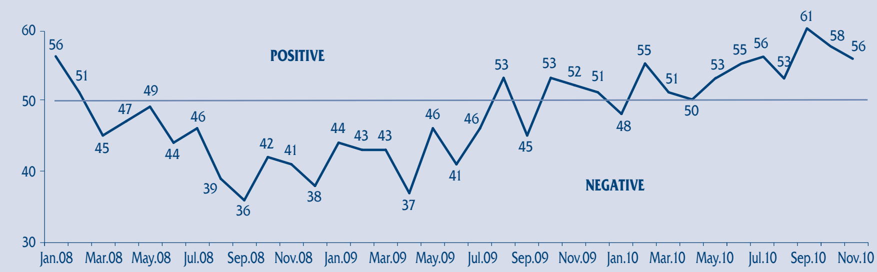


Forecasts of expenditure components

39. **Private consumption** grew 5.8 percent in January-September 2010. This evolution was associated with the better climate of consumer confidence, with the growth of employment and with a strong recovery in the national disposable income.

    a. The consumer confidence index remains in the positive tranche since February, reflecting the optimism of most of the consumers surveyed regarding the situation of their household economy in the near future. In November, the consumer confidence index reached 56 points.

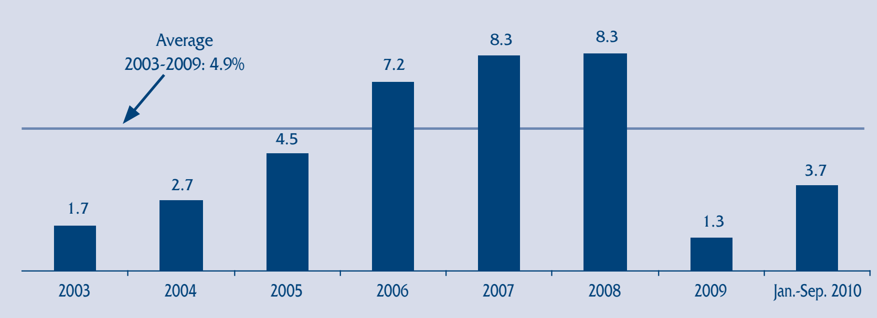
Graph 30
CONSUMER CONFIDENCE INDEX
Family economic situation



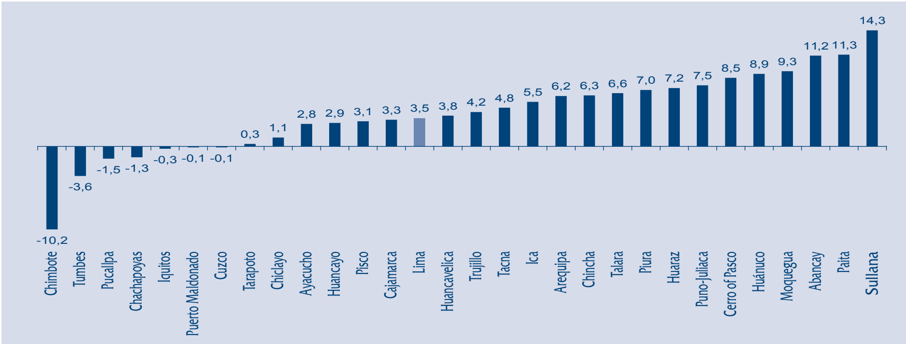
Source: Ipsos, APOYO.

    b. The growth of employment in the first 9 months of the year (3.7 percent) has influenced the dynamic growth of private consumption. The continuous growth of formal employment has contributed to maintain consumer confidence in positive levels. In annual terms, no declines have been observed in formal employment since 2001.

Graph 31
URBAN EMPLOYMENT
(% change)



Graph 32
EMPLOYMENT BY CIITIES
(Real % change)



40. In contrast with the concept of GDP, the concept of national disposable income also considers the effect of international prices and transfers of Peruvians residing abroad and deducts the profits generated by foreign investments, which provides us with a more accurate indicator of the economic transactions that generate incomes for the country. Due mainly to the expected evolution of GDP, the forecast of the national disposable income in 2010 has been revised upwards from 9.3 to 10.2 percent. In 2011 and 2012, the national disposable income is expected to grow 6.3 and 6.4 percent, respectively, registering higher rates than the ones considered in our Inflation Report of September as a result of the improvement of terms of trade.

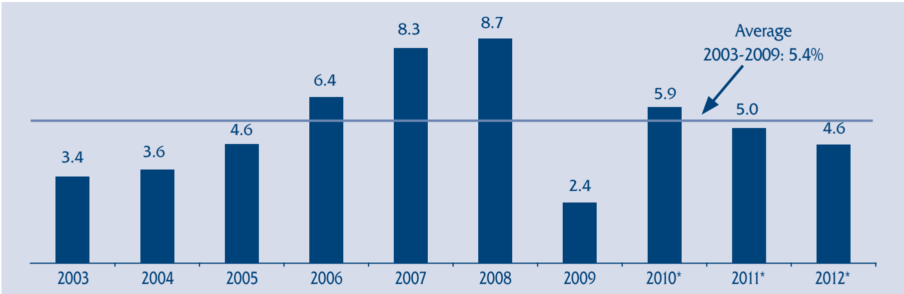
Table 15
NATIONAL DISPOSABLE INCOME
(Real % change)

	2009		2010			2011*		2012*	
	Jan-Sep	Year	Jan-Sep	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
1. GDP	**0.0**	**0.9**	**8.7**	**8.0**	**8.8**	**6.0**	**6.5**	**6.0**	**6.0**
2. Gross national product	3.2	2.1	7.3	7.4	7.5	6.2	6.6	6.2	6.6
3. Gross national income	0.1	1.0	11.0	9.7	10.6	5.2	6.4	6.0	6.4
4. National disposable income 1/	**0.1**	**0.9**	**10.7**	**9.3**	**10.2**	**5.2**	**6.3**	**6.0**	**6.4**

IR: Inflation Report.
* Forecast.
1/ Includes factor income, net gains and losses due to changes in terms of trade and net transfers to non-residents.

41. The growth forecast on private consumption in 2010 and 2011 has also been revised on the upside, from 5.2 and 4.5 percent to 5.9 and 5.0 percent, respectively, as a result of the higher growth of national disposable income. The forecast on the growth of private consumption in 2012 included in our Inflation Report of September remains unchanged.

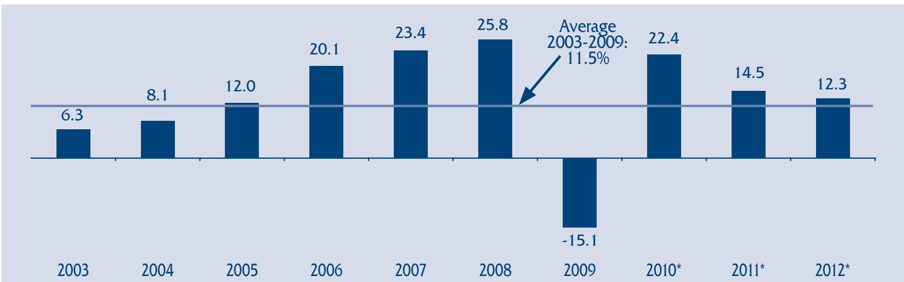
Graph 33
PRIVATE CONSUMPTION GROWTH RATE
(Real % change)



* Forecast.

42. Private investment grew 21.4 percent during the first three quarters of the year. This growth was associated with high business confidence and with the implementation of investment projects, which reflected in a strong expansion of imports and in the dynamic growth of construction. Given the important group of investment projects announced, the country's sound economic fundamentals, and optimistic business expectations, a higher growth of private investment is foreseen. Thus, private investment would grow 22.4, 14.5 and 12.3 percent in 2010, 2011 and 2012, respectively.

Graph 34
PRIVATE INVESTMENT GROWTH RATE
(Real % change)



* Forecast.

a. The business confidence index remained in the optimistic tranche, recording 70 points in November. This level of business confidence has been observed since July, which reflects the favorable outlook of the businessmen surveyed regarding the evolution of the economy in the near future.

Graph 35
BUSINESS CONFIDENCE INDEX
Economic situation

Source: BCRP Survey on Macroeconomic Expectations November 2010.

43. The growth of private investment is reflected in the greater number, size and pace of execution of the projects announced to be carried out in 2010-2012. Thus, for example, the announced amount of investment projects has increased by US$ 2,800 million compared to the one considered in our Inflation Report of September.

Projects worth pointing out in the **mining and hydrocarbon** sector include significant investment projects, such as Toromocho, Galeno, expansions in Antamina and Cerro Verde, Gasoducto Andino del Sur and Lot 67 (Perenco), as well as crude and gas prospection and production activities in lots Z-6, Z-33 and Z-2b. In terms of **infrastructure** it is worth mentioning projects associated with the road improvement and infrastructure directly associated with trade operations (piers, ports, and improvement of airports). Some of these projects have been given in concession and others would be also included in concession processes. Investment projects worth pointing out in terms of electricity include hydroelectrical plants, power generation plants, and transmission lines.

Table 16
ANNOUNCED INVESTMENT PROJECTS
(Millions of US$)

Sector	2010	2011	2012	Total
Mining	3,477	6,102	7,519	17,098
Hydrocarbons	2,446	2,078	2,186	6,711
Electricity	828	1,487	1,801	4,116
Industry	1,490	1,289	1,003	3,782
Infrastructure	2,437	1,208	796	4,440
Other Sectors	2,031	1,491	793	4,315
Total	**12,709**	**13,655**	**14,098**	**40,462**

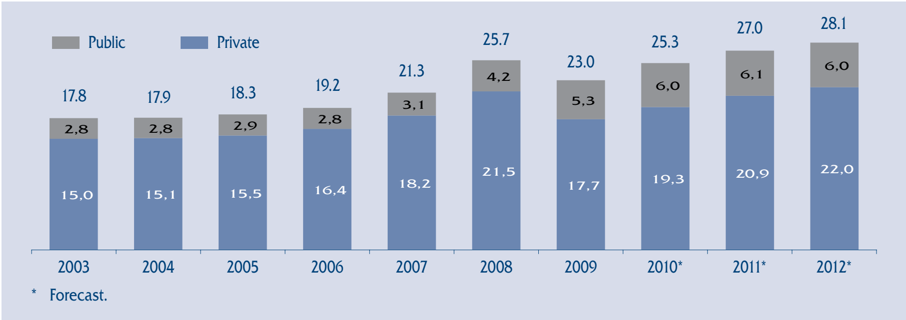
Source: Media and information of companies.

Table 17
ANNOUNCED MAIN INVESTMENT PROJECTS: 2010 - 2012

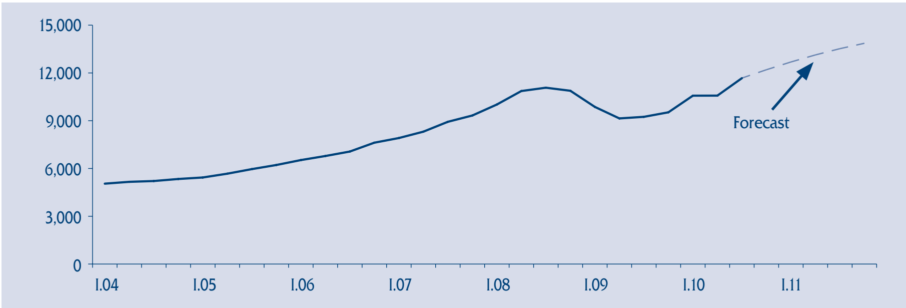
SECTOR	COMPANY	PROJECT NAME
Mining	Xstrata Peru	Las Bambas - Antapaccay
	Northern Peru Copper	Galeno
	Minera Peru Copper S.A.	Toromocho
	Anglo American	Quellaveco
	Minera Yanacocha S.R.L.	Minas Conga
	Antamina	Expansion of pit
	Shougang Group Hierro Perú	Marcona
	Norsemont Perú S.A.C.	Constancia
	Marcobre S.A.C.	Mina Justa
	Mitsui Mining & Smelting Co. Ltda. Suc. Perú	Quechua
	Southern Peru Copper	Refinery and funding Ilo - Toquepala - Cuajone
	Barrick Misquichilca	Expansion of Leaching plant:Lagunas Norte
	Volcan	Expansion
	Minera Yanacocha S.R.L.	Chaquicocha
	Compañía Minera Milpo	Hilarión
Hydrocarbons	Kuntur Transportadora of Gas	Pipeline Andino del Sur
	Pluspetrol	Expansion Malvinas, New wells Lot 88 and Lot 56
	Perenco Peru Limited	Exploration Lote 67 / Pipeline
	Savia Perú (Petro-Tech)	Lot Z-2B : Perforation, exploration and others
	Transportadora of Gas of Perú	Expansion transport capacity of Gas
	Petrobras	Exploration and explotation of oil and gas
	Cálidda Gas Natural of Perú	Expansion of main network
	Transcogas Peru	Ica pipeline
Electricity	Fenix Power Perú SA	Thermoelectric plant (natural gas combined cycle)
	Kallpa GJanración S.A.	Hydroelectric plant Cerro del Aguila. Kallpa IV
	Odebrecht	Hydroelectric plant Cerro del Chaglla
	Luz of Sur	Network Expansion and infrastructure development
	Janrsur / Endesa	Cold reserve of generation
	Asa Iberoamérica	Transmission line Chilca-Marcona-Montalvo
	SN Power	Hydroelectric plant Cheves
	Inevarante / Engel-Axil	Hydroelectric plant Acco Pucará
Industry	SIDERPERÚ	Modernization of plant
	Técnicas Reunidas	Modernization of Talara
	Aceros Arequipa	Expansion and modernization of plant
	Cementos Yura	Expansion of cement plant
	Cementos Pacasmayo	Phospates plant
	Vale do Rio Doce (CVRD)	Phospates of Bayóvar
	Votorantim Metais - Cajamarquilla S.A.	Cajamarquilla refinery expansion
	Cementos Lima	Expansion of installed capacity
	TASA	Plant modernization and ships purchase
	Cementos Otorongo	Construction of cement plant
	Cementos Portland	Cement plant
Infrastructure	OAS S.R.L	Express way, Yellow line
	Autopista del Norte SAC	Route Nº 4: Pativilca - Puerto Salaverry
	Santa Sofía Puertos	Ancon port
	Tren Eléctrico Lima	Electric train
	Intersur	IIIRSA SUR Tract 4: Azángaro - Inambari
	Terminales Portuarios Euroandinos (TPE)	Expansion of Paita port
	Conirsa	IIIRSA SUR Tract 2: Urcos - Pte Inambari
	Chancay Port	Multipurpose megaport
	Camargo Correa	Huachipa treatment plant
	ACS Servicios. Comunicaciones and Janrgía	La Taboada treatment plant
	Covi Peru	Red Vial Nº 6: Pucusana - Cerro Azul - Ica
	COVISOL	Highway of Sol : Trujillo - Sullana
	Odebrecht	IIRSA Norte: Paita Yurimaguas IIRSA Sur: Inambari-Iñapari
Other Sectors	Tracto Camiones USA EIRL	Purchase of 2000 units
	Consorcio La Chira	Treatment plant
	Malls Peru	Open Plaza Lima, Arequipa, Piura
	Grupo Interbank	Real Plaza Lima, Piura, Arequipa, Juliaca. Vea stores
	Telefónica del Perú	Movile phone network and broadband expansion
	Telmex	New services
	Corporación Miraflores	Ethanol plant
	Maple Etanol SRL	Ethanol plant

Source: Media and companies' information.

Graph 36
COMPOSITION OF GROSS FIXED INVESTMENT
(% of GDP)

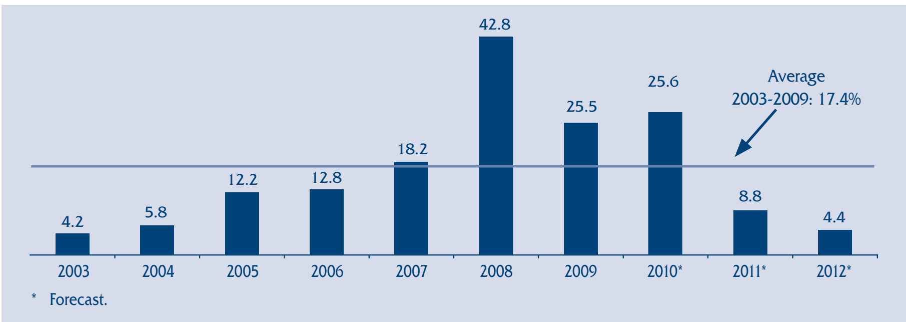


Graph 37
SEASONALLY ADJUSTED PRIVATE INVESTMENT
(Millions of nuevos soles of 1994)



44. The projected government expenditure in 2010 has been revised downwards, both in terms of public consumption and in terms of public investment. A higher expansion of both government current and capital expenditure is foreseen for 2011, while a lower growth of government expenditure is projected for 2012 given that a lower growth of government consumption is expected, reflecting the withdrawal of fiscal stimulus.

Graph 38
PUBLIC INVESTMENT GROWTH RATE
(Real % change)



In 2010 government investment would grow 25.6 percent, while in 2011 and 2012 the projected growth of government investment would be 8.8 and 4.4 percent, respectively.

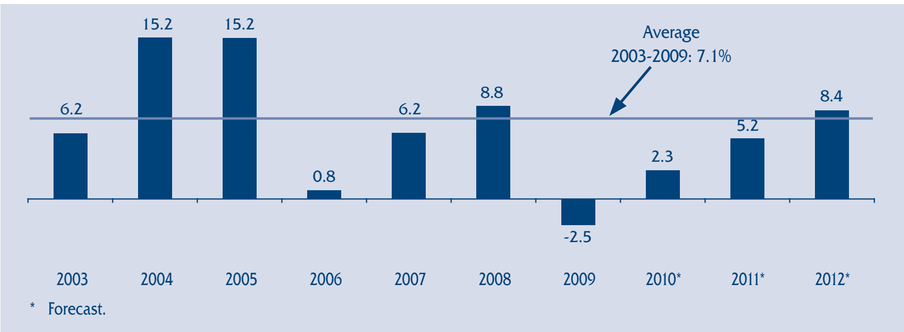
Table 18
PUBLIC INVESTMENT
(Real % change)

	2007	2008	2009	2010*	2011*	2012*
National Government	15.1	9.7	10.5	63.8	11.1	7.9
Regional Government	40.5	22.2	47.9	24.9	5.7	2.6
Local Government	9.1	98.5	32.2	11.7	6.8	1.7
State companies	34.3	32.1	36.9	-2.8	12.1	8.4
Total	**18.2**	**42.8**	**25.5**	**25.6**	**8.8**	**4.4**

* Forecast.

45. A higher growth of real exports of goods and services than the one considered in our Inflation Report of September is now projected for 2010 due to the higher volume of traditional exports. In 2011 and 2012 the projected growth of exports considered in our previous report of September remains unchanged.

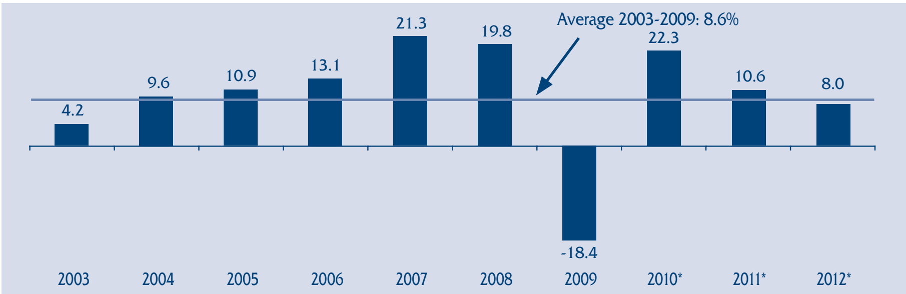
Graph 39
GROWTH RATE OF EXPORTS OF GOODS AND SERVICES}
(Real % change)



46. Real imports of goods and services in 2010 would show a faster pace of growth, in line with the current scenario of rapid recovery of the pace of growth of GDP, particularly private expenditure. The growth forecast for 2011 has been revised on the upside to 10.6 percent, due to the expected higher expansion

of production, whereas the growth forecast for 2012 remains unchanged at 8.0 percent.

Graph 40
GROWTH RATE OF IMPORTS OF GOODS AND SERVICES
(Real % change)



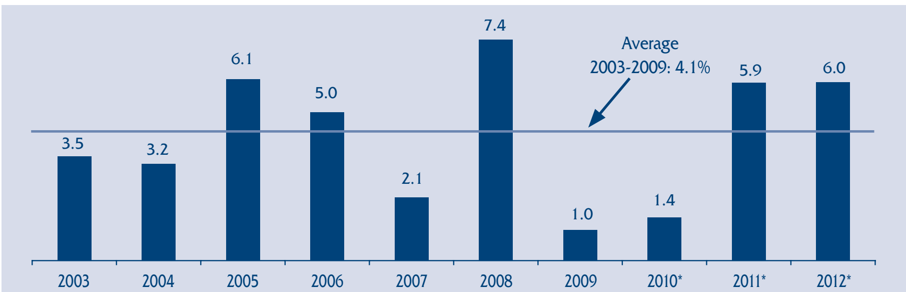
* Forecast.

GDP by sectors

47. In January-September 2010, in a context of accelerated growth of domestic demand, **non primary sectors** showed a substantial rebound, recording a growth rate of 10.3 percent. Factors worth pointing out included the recovery of non primary manufacturing (17.6 percent) and construction (18.2 percent).

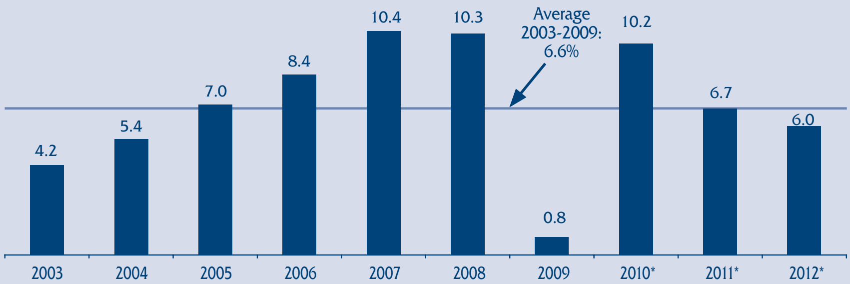
    On the other hand, **primary sectors** recorded a slight increase of 1.2 percent, in a context of production drops in the sectors of fishing, manufacturing based on raw materials, and metallic mining, which were not offset by the growth in the agriculture sector.

Graph 41
PRIMARY SECTORS GROWTH RATE
(Real % change)



* Forecast.

Graph 42
NON-PRIMARY SECTORS GROWTH RATE
(Real % change)



* Forecast.

Table 19
GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS
(Real % change)

	2009		2010			2011*		2012*	
	Jan-Sep	Year	Jan-Sep	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
Agriculture and livestock	**2.4**	**2.3**	**4.2**	**4.4**	**4.1**	**3.5**	**3.0**	**4.7**	**4.8**
Agriculture	0.9	0.9	3.7	4.4	3.5	3.3	1.9	4.8	4.8
Livestock	4.8	4.4	5.0	4.3	5.0	4.3	4.9	4.7	4.9
Fishing	**-5.6**	**-7.9**	**-14.3**	**-4.0**	**-15.5**	**5.4**	**21.8**	**2.6**	**2.6**
Mining and hydrocarbons	**1.4**	**0.6**	**-0.5**	**1.8**	**0.4**	**7.1**	**6.4**	**8.5**	**8.5**
Metallic mining	-0.8	-1.4	-3.8	-2.4	-3.5	4.7	3.1	10.0	10.0
Hydrocarbons	21.5	16.1	24.0	32.3	29.0	20.2	25.0	1.1	1.1
Manufacturing	**-8.8**	**-7.2**	**14.3**	**12.9**	**14.0**	**5.9**	**7.4**	**5.8**	**5.9**
Raw materials	2.3	0.0	-1.6	1.8	-1.2	5.4	11.3	4.9	4.9
Non-primary industries	-10.8	-8.5	17.6	15.1	17.1	6.0	6.7	6.0	6.0
Electricity and water	**0.4**	**1.2**	**7.8**	**7.6**	**8.0**	**5.3**	**6.1**	**5.3**	**5.3**
Construction	**3.0**	**6.1**	**18.2**	**14.4**	**16.5**	**9.3**	**10.9**	**12.0**	**10.6**
Commerce	**-1.2**	**-0.4**	**9.6**	**8.7**	**9.3**	**5.6**	**6.7**	**5.7**	**5.7**
Other services	**2.4**	**3.1**	**7.8**	**6.9**	**8.0**	**5.9**	**6.1**	**5.2**	**5.5**
GDP	**0.0**	**0.9**	**8.7**	**8.0**	**8.8**	**6.0**	**6.5**	**6.0**	**6.0**
Primary	**1.8**	**1.0**	**1.2**	**2.8**	**1.4**	**5.1**	**5.9**	**6.0**	**6.0**
Non-Primary	**-0.4**	**0.8**	**10.3**	**9.0**	**10.2**	**6.1**	**6.7**	**6.0**	**6.0**

IR: Inflation Report.
* Forecast.

48. The forecast on GDP growth in 2010 has been revised from 8.0 percent to 8.8 percent due to a higher-than-expected economic growth in Q3, as a result of which GDP has accumulated a growth rate of 8.7 percent at September. Non primary sectors are now expected to grow 10.2 percent and primary sectors are expected to grow 1.4 percent this year (versus 9.0 and 2.8 percent estimated in our Report of September).

    The primary sectors would record a lower growth than forecasted in our previous report due to the lower dynamism of metallic mining, which was affected by low contents of mineral in the extraction of gold and copper, as well as by the lower expansion expected in agriculture due to scarcity of water that has been affecting the production of rice and sugar. Moreover, production in the fishing sector would also drop more than initially expected given that the beginning of the second fishing season was delayed in comparison to beginning of this season in the previous year.

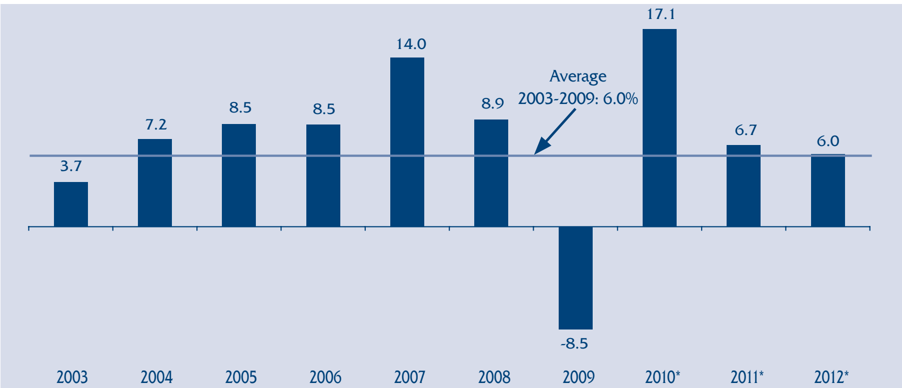
    The strong growth recorded in the non primary sectors would be reflecting the strong expansion observed in industry in Q2 and Q3 of this year (22.0 and 20.8 percent, respectively) due to the effect of the low comparison base –non primary industry dropped in the same periods in 2009–, although this effect would gradually disappear in the following periods when non primary manufacturing would converge to more sustainable growth rates in the medium term. Construction would close 2010 with an expansion of 16.0 percent, due to the impulse of both public and private construction works. Projects worth mentioning among the former include the "tren eléctrico" project and the expansion of the national road network, as well as the modernization of health care and education infrastructure, while the latter included both residential and non residential construction projects. This increased activity is in line with the higher growth of domestic demand recorded in comparison with growth estimated in our Inflation Report of September (11.4 to 12.6 percent).

49. In 2011, growth in the primary sectors would increase from 5.1 to 5.9 percent due to a strong recovery in the fishing sector as no climatic anomalies are expected to occur –production in this sector in 2009 was affected by a moderate El Niño event and in 2010 by the presence of La Niña), which would also allow a recovery in the anchovy quota. Activity in agriculture would grow 3.0 percent –revised downwards from the 3.5 percent expected in our previous Report– due to the effect of scarce rainfall on the August 2010 - July 2011 farming season, which would affect mainly the production of Andean crops such as potato, amylaceous maize, lima bean, peas, and olluco, although this would be in part offset by the strong dynamism observed in the livestock sub-sector. The growth estimated in the mining and hydrocarbon sector considers the onset of operations in gold projects such as La Zanja, Tantahuatay and Pucamarca; Milpo's expansion of operations in the extraction of lead and zinc, and a higher production of natural gas in Lot 56.

Growth in non primary sectors has been revised on the upside from 6.1 to 6.7 percent, mainly as a result of the increased dynamism foreseen in manufacturing and construction. The projected growth rate in manufacturing would increase from 6.0 to 6.7 percent, while the growth rate in construction would increase from 9.3 to 10.9 percent considering that this sector will continue to be driven by the development of public and private infrastructure projects.

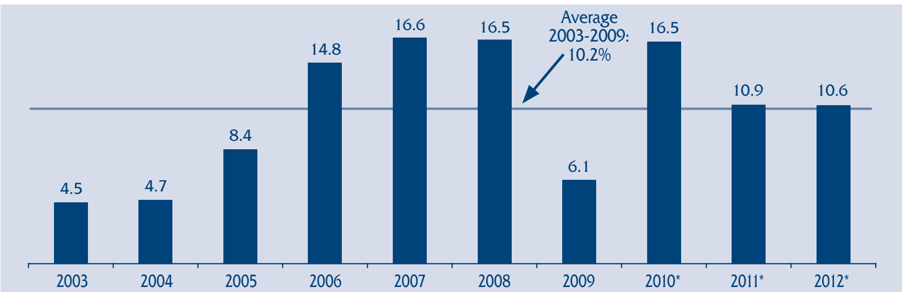
In 2012 economic activity is expected to grow in line with the trend observed in recent years. Important projects, particularly in the mining sectors such as the expansion of Shougang (iron), the onset of operations at La Arena and Pico Machay (gold), the expansion of Las Malvinas (natural gas), the expansions of Southern and Cerro Verde (copper), as well as other projects in the manufacturing sector, such as Maple and Comisa (production of ethanol) would contribute to this.

Graph 43
NON-PRIMARY MANUFACTURING GROWTH RATE
(Real % change)



* Forecast.

Graph 44
CONSTRUCTION SECTOR GROWTH RATE
(Real % change)



* Forecast.

Output gap

50. The output gap is the (unobservable) aggregate indicator of demand inflationary pressures. A zero gap indicates that economic activity is operating at its potential level, and therefore no demand inflationary pressures would be generated. New available information on the evolution of economic activity shows that the output gap would have closed during this year (from an initial point of around -2.0 percent on average in 2009) and would be close to zero during 2011 and 2012. Thus, an average gap of -0.3 percent is estimated for 2010 and an average gap of approximately 0.0 percent is estimated for 2011 and 2012.

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Graph 45
OUTPUT GAP
(% of the potential GDP)

* Forecast.

Memo: Output gap estimated with information as of September 2010. The shadowed area represents existing uncertainty in the calculation and forecast of the output gap plus/minus one standard deviation.

III. Balance of Payments

30. Considering the higher prices of exports and the results of the trade balance at Q3, the forecast on the trade surplus in 2010 has been revised upwards from US$ 4.9 billion (Inflation Report of September) to US$ 6.1 billion.

Graph 46
TRADE BALANCE
(Millions of US$)

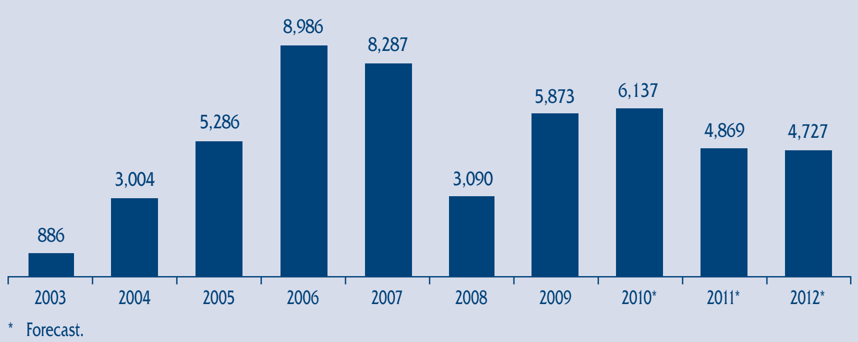


Table 20
TRADE BALANCE
(Millions of US$)

	2009		2010			2011*		2012*	
	Jan-Sep	Year	Jan-Sep	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
EXPORTS	**18,726**	**26,885**	**25,327**	**33,488**	**34,946**	**35,162**	**38,154**	**38,522**	**41,713**
Of which:									
Traditional products	14,214	20,571	19,845	25,958	27,399	26,978	29,672	29,390	32,356
Non-traditional products	4,413	6,160	5,303	7,307	7,307	7,979	8,242	8,920	9,110
IMPORTS	**15,040**	**21,011**	**20,762**	**28,546**	**28,809**	**32,447**	**33,285**	**36,295**	**36,986**
Of which:									
Consumer goods	2,843	3,963	3,876	5,396	5,332	6,632	6,789	8,008	8,065
Inputs	7,029	10,077	10,168	13,721	13,967	15,106	15,500	16,425	16,478
Capital goods	5,074	6,850	6,561	9,280	9,347	10,545	10,831	11,683	12,257
TRADE BALANCE	**3,686**	**5,873**	**4,565**	**4,942**	**6,137**	**2,715**	**4,869**	**2,227**	**4,727**

IR: Inflation Report.
* Forecast.

In 2011 and 2012 the trade balance would continue showing positive results, recording surpluses of US$ 4.9 and US$ 4.7 billion, respectively. These forecasts have also been revised on the upside in comparison with previous estimates (US$ 2.7 billion in 2011 and US$ 2.2 billion in 2012). The gradual reduction of the trade surplus in the following years relative to 2010 is explained by higher imports – especially of capital goods– foreseen for the execution of the investment projects announced in several sectors.

Table 21
TRADE BALANCE
(Real % change)

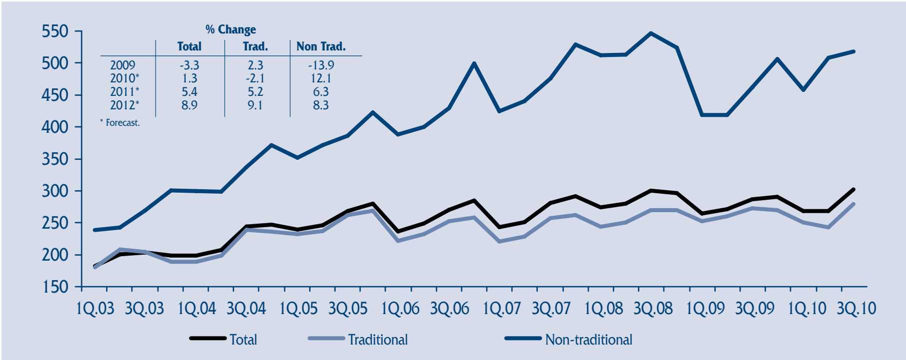
	2009		2010			2011*		2012*	
	Jan-Sep	Year	Jan-Sep	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10 1.
1. Value:									
Exports	-25.3	-14.7	35.3	24.6	30.0	5.0	9.2	9.6	9.3
Traditional products	-26.1	-13.6	39.6	26.2	33.2	3.9	8.3	8.9	9.0
Non-traditional products	-22.1	-18.3	20.2	18.6	18.6	9.2	12.8	11.8	10.5
Imports	-31.0	-26.1	38.0	35.9	37.1	13.7	15.5	11.9	11.1
2. Volume:									
Exports	-3.8	-3.3	1.9	0.1	1.3	5.4	5.4	8.9	8.9
Traditional products	3.1	2.3	-1.8	-3.5	-2.1	5.2	5.2	9.1	9.1
Non-traditional products	-17.5	-13.9	14.4	12.1	12.1	6.3	6.3	8.8	8.8
Imports	-22.7	-20.0	25.3	23.8	24.6	10.2	10.8	9.3	9.3
3. Price:									
Exports	-22.6	-12.5	33.2	24.4	28.4	-0.4	3.5	0.6	0.4
Traditional products	-28.6	-16.3	42.4	30.1	35.1	-1.5	2.9	0.1	0.0
Non-traditional products	-5.5	-5.1	5.0	5.8	5.8	2.8	6.1	2.8	1.6
Imports	-10.5	-7.4	10.1	9.7	9.6	3.2	4.2	2.3	1.7

IR: Inflation Report.
* Forecast.

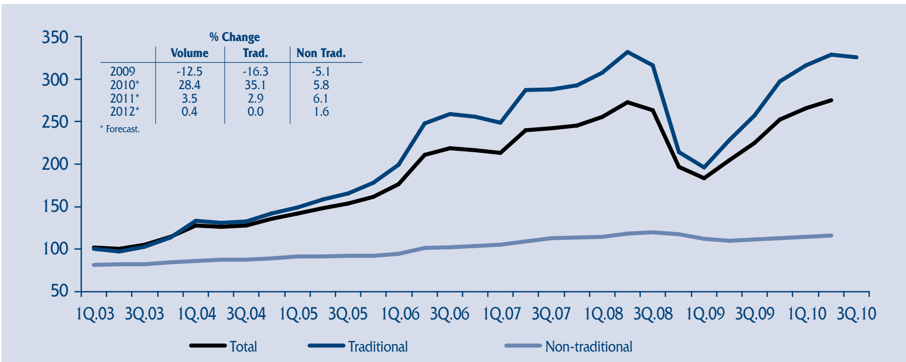
31. As regards the evolution of the volume de exports, after showing almost no growth during the first semester of the year, exports grew 5.5 percent in Q3 and thus accumulated growth in the first nine months of the year increased to 1.9 percent. Moreover, in Q4 the growth of traditional exports such as copper, zinc and coffee, and the growth of non traditional exports such as chemicals, iron and steel products, and farming products has been noteworthy. Taking this information into account, the volume of exports in 2010 has been revised upwards.

The evolution of imports during the year has been strongly associated with the path shown by the components of domestic demand, consumption and investment. Compared with the balance observed between January and September of 2009, when imports dropped by a real 23 percent, the volume of imports this year has increased 25 percent, mainly due to higher imports of durable consumer goods, industry inputs, and capital goods. Therefore, a higher volume of imports is estimated for 2010 in this Report.

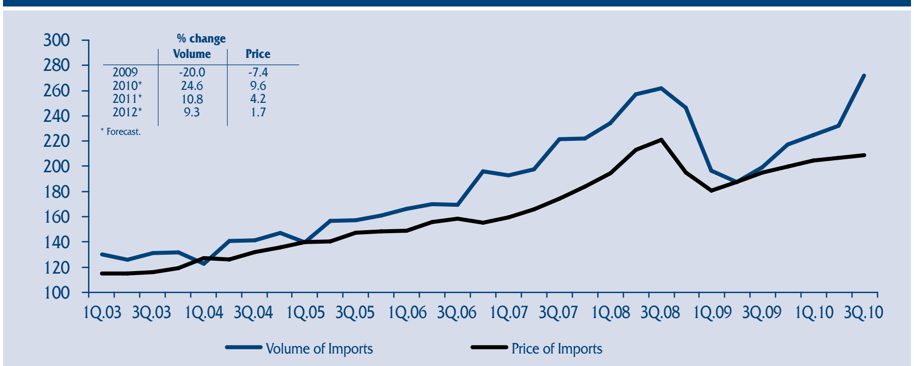
Graph 47
VOLUME OF EXPORTS
(Index 1994=100)



Graph 48
PRICE OF EXPORTS
(Índex 1994 = 100)



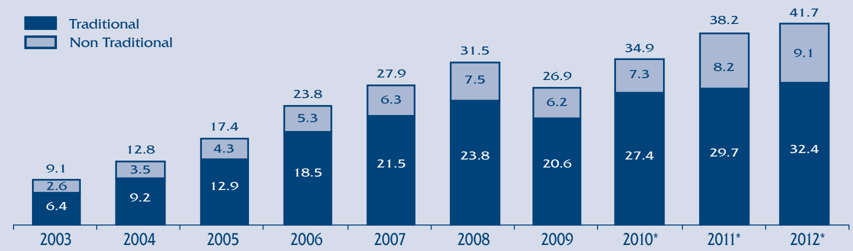
Graph 49
VOLUME AND PRICE OF IMPORTS
(Index 1994=100)



32. Based on the results achieved in the first nine months of the year and on the assumptions about the growth of the world economy and external prices, it is estimated that exports would grow 30 percent in terms of value in 2010, which would offset the 15 percent decline recorded in 2009. This amount of exports, estimated at around US$ 35 billion, would even be 11 percent higher than the one recorded in 2008 (US$ 31.5 billion), when the impacts of the deepening of the international crisis were not completely evident yet.

    Considering the evolution foreseen in the global economy, the forecasts on the growth of the volume of exports in 2011 and 2012 remain unchanged in this report. Therefore, given the higher prices of traditional and non traditional exports associated with the higher prices of metals and higher external inflation, these forecasts are consistent with a rising pace of growth of exports in the next years. Exports would amount to nearly US$ 42 billlion in 2012 as a result of exports of liquefied natural gas from Camisea II, fosfates from Bayóvar, copper from the expansions of Antamina and Toquepala, and as a result of the growth of non traditional exports in a context of positive growth rates in our trading partners in the forecast horizon.

Graph 50
EXPORTS OF GOODS
(Billions of US$)

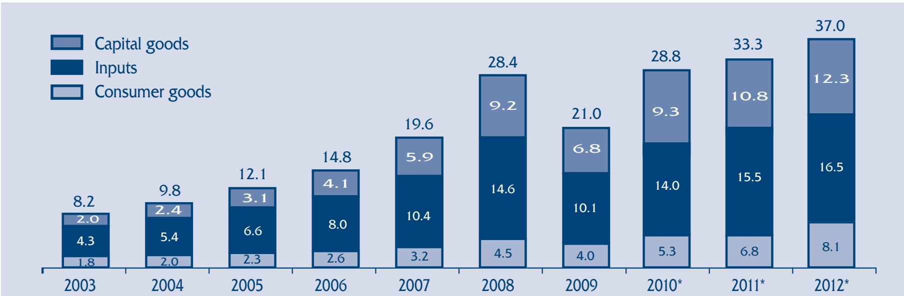


Memo: Total exports includes other exports.
* Forecast.

33. The value of imports would increase by 37 percent in 2010, thus offsetting the drop recorded in 2009. Imports of goods in 2010 would amount to nearly US$ 29 billion (versus US$ 28 billion in 2008 and US$ 21 billion in 2009). This forecast for 2010 has been revised on the upside considering the faster pace of growth of the volume of imports observed until Q3.

    Likewise, a higher volume of imports is also forecasted for 2011 considering that GDP growth has been revised upwards, in line with an increased demand for imported capital goods. In 2012 the growth of imports would show a more moderate path, in line with the forecasted growth of consumption and investment.

Graph 51
IMPORTS OF GOODS
(Billions of US$)



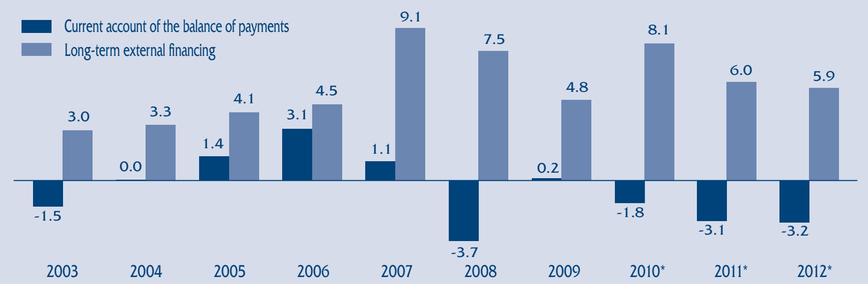
Memo: Total imports includes other imports.
* Forecast.

34. Given that the improvement in the value of traditional exports is associated with a higher price effect due to the rise in the prices of commodities –when we compare the data of our two last reports–, factor income has also been adjusted upwards absorbing part of the gain resulting from the higher surplus in the trade balance. Thus, the estimated factor income in 2010 has been raised from US$ 9 to US$ 10.2 billion.

35. The deficit in the current account increased from 1.2 percent of GDP in the first semester to 2.2 percent in Q3, mainly due the higher growth of imports. This was offset by higher revenues from export prices, net of profits generated by firms with foreign shareholding. With this, the deficit in the current account accumulated in the first nine months of 2010 is equivalent to 1.5 percent of GDP.

    Therefore, the current account deficit in 2010 has been revised slightly upwards to 1.8 percent of GDP (versus 1.7 percent of GDP in our Inflation Reporte of September). The deficit foreseen for 2011 has been increased from 3.0 percent to 3.1 percent of GDP due to the higher growth expected in economic activity and its impact on the demand for imports, as well as due to the slight decline of terms of trade. The deficit in the current account in 2012 is estimated at 3.2 percent of GDP considering a slight decline in terms of trade. Considering the investments announced in several sectors, long term flows of private capitals exceed the financing requirements in the current account during the forecast horizon.

Graph 52
CURRENT ACCOUNT AND LONG-TERM FINANCING
(% of GDP)



* Forecast.

Table 22
BALANCE OF PAYMENTS
(Millions of US$)

	2009		2010			2011*		2012*	
	Jan-Sep	Year	Jan-Sep	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
I. CURRENT ACCOUNT BALANCE	**-20**	**247**	**-1,733**	**-2,515**	**-2,738**	**-4,970**	**-5,314**	**-5,410**	**-5,955**
% of GDP	0.0	0.2	-1.5	-1.7	-1.8	-3.0	-3.1	-3.0	-3.2
1. Trade Balance	3,686	5,873	4,565	4,942	6,137	2,715	4,869	2,227	4,727
a. Exports	18,726	26,885	25,327	33,488	34,946	35,162	38,154	38,522	41,713
b. Imports	-15,040	-21,011	-20,762	-28,546	-28,809	-32,447	-33,285	-36,295	-36,986
2. Services	-790	-1,112	-1,231	-1,352	-1,669	-1,743	-2,124	-1,771	-2,315
3. Investment Income	-5,004	-7,371	-7,264	-9,034	-10,166	-9,086	-11,237	-9,280	-11,815
4. Current transfers	2,088	2,856	2,197	2,928	2,960	3,144	3,178	3,415	3,447
of which: Remittances	1,730	2,378	1,835	2,508	2,508	2,731	2,731	3,001	3,001
II. FINANCIAL ACCOUNT	**954**	**1,694**	**11,062**	**13,014**	**13,188**	**6,470**	**6,814**	**6,410**	**6,955**
of which:									
1. Private Sector (long and short term)	-1,506	-20	10,970	13,137	13,264	5,831	6,599	6,264	6,843
2. Public Sector	830	1,032	-618	-271	-1,024	175	385	-195	-68
III. BALANCE OF PAYMENTS (=I+II)	**934**	**1,940**	**9,329**	**10,499**	**10,450**	**1,500**	**1,500**	**1,000**	**1,000**
Memo:									
Gross long-term external private financing									
Millions of US$	5,709	6,108	9,301	9,151	12,480	8,840	10,099	10,289	11,051
% of GDP	6.2%	4.8%	8.2%	6.0%	8.1%	5.4%	6.0%	5.7%	5.9%

IR: Inflation Report.
* Forecast.

Financial account

51. In Q3 the long term financial account of the private sector recorded a net inflow of US$ 6,162 million, explained by disbursements of long term loans to the private sector and by flows of foreign direct investment (FDI) and portfolio investment. The disbursements of long term loans to the private sector amounted to US$ 2,951 million, of which US$ 1,593 million was for the financial sector and US$ 1,358 million for the non financial sector. FDI flows, which amounted to US$ 2,415 million, was mainly reinvestment and contributions to the mining sector and portfolio investment. Non residents' acquisition of government bonds for a total of US$ 1,060 million is worth pointing out in the case of the latter.

Table 23
PRIVATE SECTOR FINANCIAL ACCOUNT
(Millions of US$)

	2009		2010			2011*		2012*	
	Jan-Sep	Year	Jan-Sep	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
1. ASSETS	**-3,462**	**-4,106**	**461**	**-351**	**-444**	**-1,025**	**-1,982**	**-2,602**	**-2,503**
Direct investment abroad	-365	-396	-134	-87	-134	0	0	0	0
Portfolio investment abroad	-3,097	-3,711	595	-264	-310	-1,025	-1,982	-2,602	-2,503
2. LIABILITIES	**5,422**	**5,761**	**9,863**	**9,627**	**14,618**	**7,556**	**8,581**	**8,865**	**9,346**
Foreign direct investment in the country	4,466	4,760	5,965	7,457	8,079	6,544	8,004	7,142	8,312
Foreign portfolio investment in the country	-2	55	1,553	1,498	3,184	-75	-75	-106	-91
a. Capital participation	-65	47	-16	3	-16	0	0	0	0
b. Other liabilities	63	9	1,569	1,495	3,200	-75	-75	-106	-91
Long-term loans	958	946	2,346	672	3,355	1,087	652	1,829	1,125
a. Disbursements	1,607	1,744	3,470	1,780	4,535	2,296	2,096	3,147	2,739
b. Amortization	-649	-798	-1,124	-1,108	-1,180	-1,209	-1,443	-1,318	-1,614
3. TOTAL	**1,960**	**1,655**	**10,324**	**9,276**	**14,174**	**6,531**	**6,599**	**6,264**	**6,843**

IR: Inflation Report.
* Forecast.

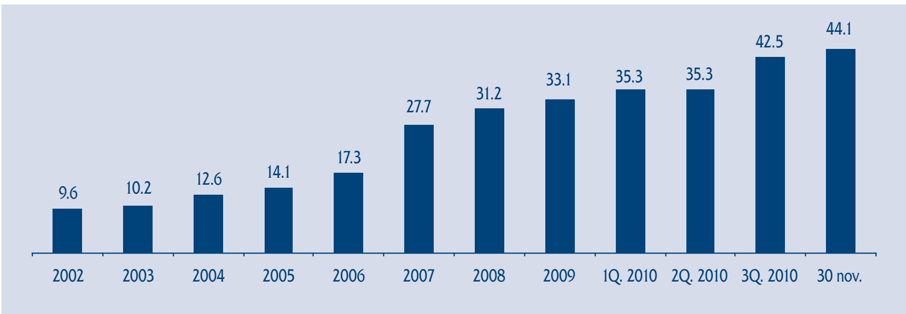
52. The forecasts consider that private pension funds (AFPs) will continue purchasing foreign assets and that FDI flows will maintain an upward trend.

Given that long term debt disbursements for a total of US$ 2,951 million (OJO: CK "million) were recorded in Q3-2010 (amount higher than the US$ 552 million estimated in our Report of September), the financial acount in 2010 is now expected to register inflows for a total of US$ 14.1 billion (US$ 9.3 billion was estimated in our previous report).

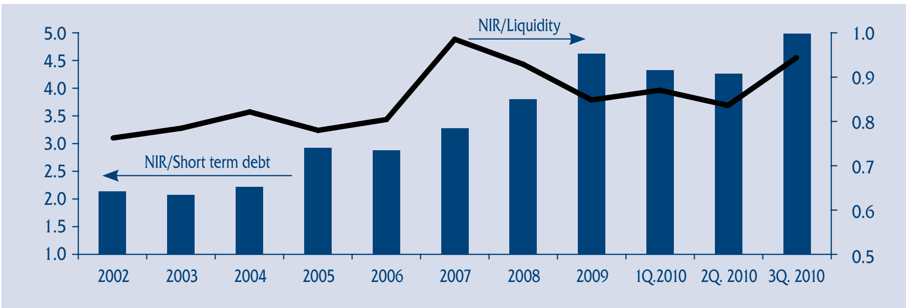
Reflecting confidence in the long term growth expected in the country, which would translate into the continuity of direct investment and long term disbursements, net positive capital inflows of US$ 6,599 million and US$ 6,843 million would be recorded in 2011 and 2012, respectively.

53. On November 30, net international reserves (NIRs) amounted to US$ 44 billion (30 percent of GDP in the last four quarters). Among the highest in the region and internationally, this level of reserves is a significant back-up to face contingencies in the event of a deterioration of the external environment and international financing constraints.

Graph 53
NET INTERNATIONAL RESERVES
(Millions of US$)



Graph 54
NIR RATIOS
(Number of times)



IV. Public Finances

54. Higher economic growth and a more moderate growth in government expenditure in the second semester would result in a fiscal deficit equivalent to 0.9 percent of GDP in 2010 (lower than the 1.5 percent deficit estimated in our September report). Lower fiscal impulse, associated with this improvement in fiscal accounts, is consistent with the announced withdrawal of fiscal stimulus in un context of rising domestic demand driven by the private sector and increased capital inflows.

55. A nil fiscal balance in 2011 and a surplus of 0.5 percent of GDP in 2012 are now considered in the forecast horizon (versus the deficits of 1.0 and 0.4 percent estimated previously for 2011 and 2012, respectively). In the current scenario, government expenditure would decline gradually.

    This counter cyclical conduct of fiscal policy will allow the economy to increase again the treasury balances and reduce the balance of the public debt in GDP terms, recovering in this way the fiscal space required to face adverse macroeconomic contingencies.

Graph 55
OVERALL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)

* Forecast.

Table 24
NON-FINANCIAL PUBLIC SECTOR
(% of GDP)

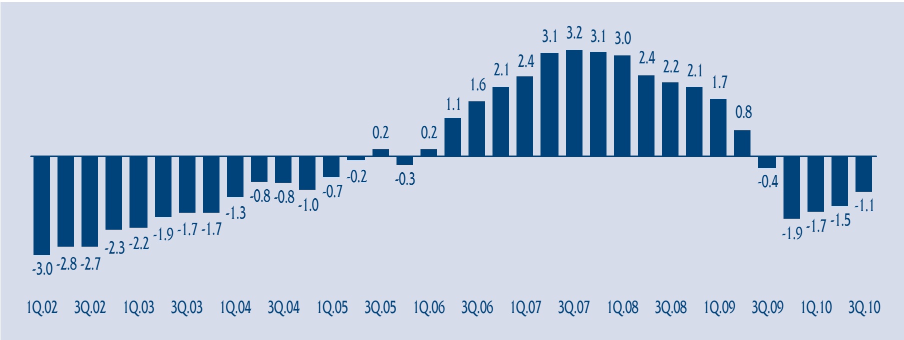
	2009		2010			2011*		2012*	
	Jan-Sep	Year	Jan-Sep	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
1. General government current revenue 1/	**19.0**	**18.6**	**20.1**	**19.7**	**19.8**	**20.0**	**20.1**	**20.1**	**20.2**
Real % change	*-14.1*	*-11.3*	*19.4*	*16.6*	*18.7*	*6.5*	*7.6*	*5.8*	*6.0*
2. General government non-financial expenditure	**17.7**	**19.6**	**17.7**	**19.9**	**19.5**	**19.8**	**18.9**	**19.3**	**18.5**
Real % change	*6.7*	*12.7*	*12.6*	*12.3*	*11.1*	*4.1*	*2.9*	*2.7*	*3.2*
Of which:									
a. Current	13.3	13.9	12.6	13.4	13.3	13.3	12.7	13.0	12.4
Real % change	*1.0*	*4.4*	*6.3*	*6.8*	*7.0*	*3.7*	*1.2*	*2.9*	*3.2*
b. Gross capital formation 2/	3.9	5.2	4.6	6.1	5.7	6.1	5.9	5.9	5.8
Real % change	*23.1*	*32.5*	*32.4*	*28.8*	*22.3*	*5.1*	*9.4*	*2.4*	*3.5*
3. Others	**0.5**	**0.4**	**0.0**	**-0.1**	**0.0**	**-0.1**	**0.0**	**-0.1**	**0.0**
4. Primary balance (1-2+3)	**1.8**	**-0.6**	**2.5**	**-0.4**	**0.3**	**0.1**	**1.2**	**0.7**	**1.7**
5. Interests	**1.4**	**1.3**	**1.3**	**1.2**	**1.2**	**1.2**	**1.2**	**1.1**	**1.2**
6. Overall Balance	**0.4**	**-1.9**	**1.2**	**-1.5**	**-0.9**	**-1.0**	**0.0**	**-0.4**	**0.5**
Memo:									
1. Central government current revenues	16.2	15.9	17.5	17.1	17.2	17.3	17.4	17.4	17.5
2. Central government non-financial expenditure	15.6	16.6	15.4	16.8	16.5	16.9	16.2	16.8	16.0
3. Fiscal impulse		1.1		1.2	0.7	-0.4	-0.8	-0.7	-0.4
4. Structural overall balance		-1.9		-3.3	-2.4	-2.8	-1.6	-2.1	-1.2

1/ The central government includes the ministries, national universities, public institutions and regional governments. The general government has a wider coverage that includes the central government, social security, regulators and supervisors, public charities and local governments.
2/ Gross capital formation of the general government need to be added the investment of public companies to obtained the public -investment.
IR: Inflation Report.
* Forecast.

56. Between January and September 2010 the operations of the non-financial public sector (NFPS) recorded an economic surplus equivalent to 1.2 percent of GDP (0.8 percentage points higher than the one registered in the same period in 2009).

It is worth pointing out that a downward trend is observed in the deficit of the NFPS in terms of the economic balance accumulated in the last four quarters. After having recorded a maximum deficit of 1.9 percent of GDP in 2009, this accumulated deficit is now equivalent to -1.1 percent of GDP in the period Q4-2009 – Q3-2010.

Graph 56
OVERALL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(Accumulated last 4-quarters - % of GDP)

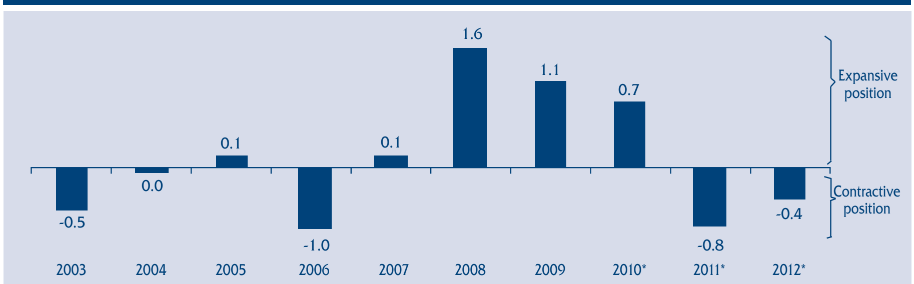


Structural economic balance and fiscal impulse

57. The structural economic balance, which is calculated deducting the effect of the economic cycle and the effect of the prices of mineral exports from the conventional economic balance, shows the performance of fiscal accounts in a scenario in which the output is permanently at its potential level. In 2010 this balance would show a deficit of 2.4 percent of GDP in 2010. A trend of improvement is observed in the following years, with a structural fiscal deficit of 1.6 percent in 2011 and a deficit of 1.2 percent of GDP in 2012. Despite the deceleration of expenditure considered in the forecast, the latter does not achieve the structural deficit recorded in 2008.

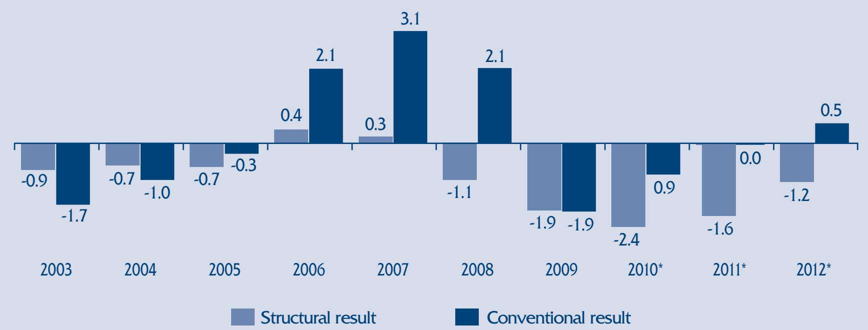
58. The fiscal impulse, which shows the net expansionary effect of fiscal policy on domestic demand, would represent 0.7 percent of GDP in 2010, which indicates that fiscal policy would continue to be expansionary in this year, although at a lower level than foreseen in the Report of September (1.2 percent of GDP). In the following years, there would be a counter cyclical fiscal position due to the expected slowdown of government expenditure, allowing for an accumulation of resources in the expansionary stage of the economic cycle.

Graph 57
FISCAL IMPULSE
(% of GDP)



* Forecast.

Graph 58
OVERALL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)



* Forecast.
Memo: The structural result incudes adjustments by the output gap and the terms of trade considering a 10 year period for the reference prices.

Evolution of fiscal revenues

59. The current revenues of the general government in January-September 2010 amounted to 20.1 percent of GDP, which represented an increase of 19 percent in real terms and reflected the positve performance of economic activity and better terms of trade in this period. This significant growth of current revenues was observed both in terms of tax revenues (22 percent) and in terms of non tax revenues (14 percent). Revenues from the most important taxes (income tax, value added tax, and excise tax) recorded the highest growth rates (26, 18 and 17 percent, respectively) in terms of tax revenues, while the growth of revenues from royalties (canon) and oil royalties is worth pointing out in the case of non tax revenues.

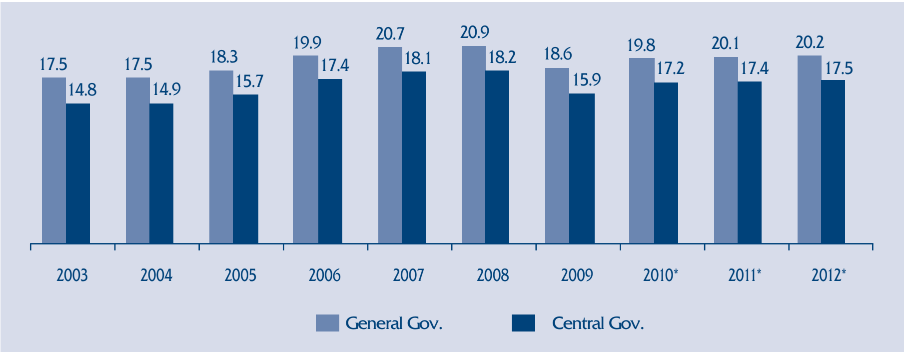
Table 25
GENERAL GOVERNMENT CURRENT REVENUE
(% of GDP)

	2006	2007	2008	2009	2010*	2011*	2012*
TAX REVENUES	**15.3**	**15.9**	**16.0**	**14.1**	**15.3**	**15.6**	**15.7**
Income tax	6.1	6.8	6.5	5.3	5.9	5.9	5.9
Value added tax	7.1	7.5	8.5	7.7	8.2	8.4	8.5
Excise tax	1.3	1.3	0.9	1.1	1.1	1.1	1.1
Import fares	0.9	0.7	0.5	0.4	0.4	0.4	0.4
Other tax revenues	1.4	1.4	1.5	1.5	1.4	1.4	1.4
Tax returns	-1.6	-1.8	-1.9	-1.9	-1.8	-1.7	-1.7
NON TAX REVENUES	**3.0**	**3.2**	**3.2**	**2.8**	**2.9**	**2.8**	**2.8**
CONTRIBUTIONS	**1.5**	**1.5**	**1.7**	**1.7**	**1.6**	**1.7**	**1.7**
TOTAL	**19.9**	**20.7**	**20.9**	**18.6**	**19.8**	**20.1**	**20.2**

* Forecast.

60. The revenues of the general government in 2010 would be higher than estimated in our Report of September due to the increasing dynamism of domestic demand and due to the fact that the prices of our main export products are higher than the ones considered in our previous report. Therefore, the revenues of the general government in 2010 are estimated to amount to 19.8 percent of GDP (1.2 percentage points higher than in 2009), which implies a real growth of 18.7 percent (16.6 percent estimated in the Inflation Report of September). It is worth pointing out that the tax revenues of the general government have been growing at two-digit rates since January.

Graph 59
GENERAL AND CENTRAL GOVERNMENT CURRENT REVENUES



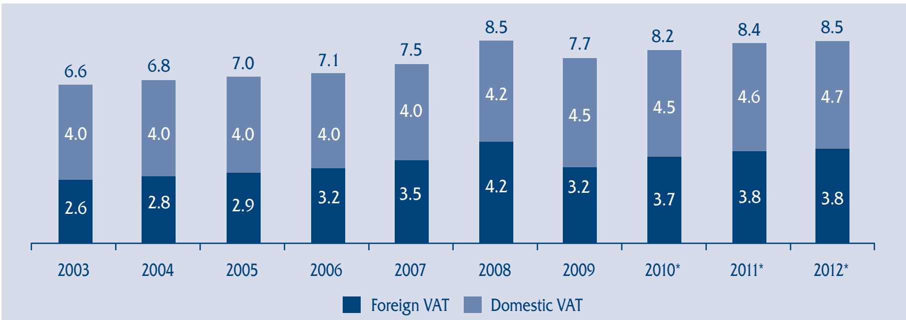
61. Revenues from the income tax would amount to 5.9 percentage points of GDP due to the dynamism of economic activity and to the better prices of export minerals. Another factor contributing to this was the gradual decline observed in the use of balances in favor of taxpayers that may be used for the payment of this tax.

Graph 60
INCOME TAX
(% of GDP)

* Forecast.

62. The value added tax (VAT), our main tax revenue, would also record a significant growth in 2010, rising from 7.7 to 8.2 percent of GDP due to higher imports and to increased taxed sales as a result of the recovery of economic activity and firms' restocking.

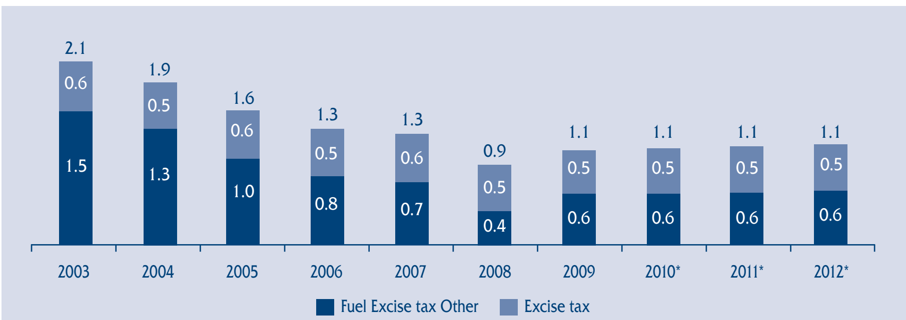
Graph 61
VALUE ADDED TAX
(% of GDP)



Memo: The addition of both components may differ from the total due to rounding.
* Forecast.

63. Revenues from the excise tax (ISC) would remain at levels around 1.1 percent of GDP in 2010, although showing a real positive growth of 13 percent despite the fact that the excise tax on the diesel fuel was reduced early this year to offset the higher price of the new diesel fuel (S/. 1.24 per gallon of the new low sulphur diesel fuel instead of S/. 1.44 per gallon of diesel B2).

Graph 62
EXCISE TAX
(% of GDP)



Memo: The addition of both components may differ from the total due to rounding.
* Forecast.

64. In 2011 and 2012 the current revenues of the general government would grow 7.6 and 6,0 percent of GDP, as a result of which the GDP ratios would be 20.1 and 20.2 percent, respectively, in line with the forecasts on the growth of economic activity in the following years, as well as with the prices of our main export products. No changes in the current tax structure are considered in this forecast scenario.

Evolution of government expenditure

65. In January-September 2010 the non financial expenditure of the general government represented 17.7 percent of GDP, a lower ratio than the one foreseen in our September Report (17.8 percent of GDP). The growth rate of expenditure in this period was 13 percent in real terms. Current expenditure grew 6 percent and gross capital formation grew 32 percent. By government levels, the non financial expenditure of local governments grew above the average (16 percent), while the expenditure of the national government and regional governments grew at a lower rate (12 percent in both cases).

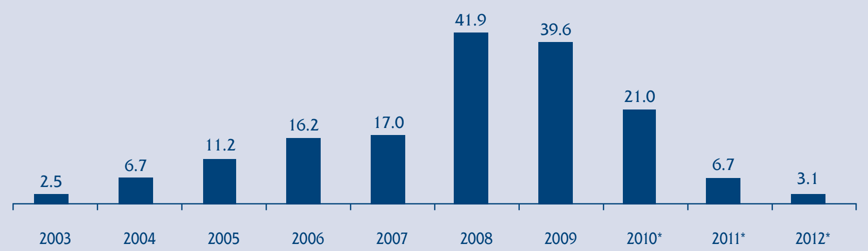
    The nominal value of expenditure considered in the revised Multiannual Macroeconomic Framework (MMF) of August is estimated to be reached in 2010, which implies a real growth of non financial expenditure of the general government of 11 percent, lower than the one considered in our previous Report (12 percent). By group of expenditure, current expenditure would increase by 7 percent and capital expenditure would increase by 22 percent, connfirming the trend observed in the last years during which investment has grown at a higher rate than current expenditure.

66. Government expenditure in the following years would show a more moderate growth as a result of a counter cyclical position. In 2011 and 2012 the non financial expenditure of the general government is expected to grow by a real 3 percent each year, which in 2011 would represent a decline of government expenditure in GDP terms (18.5 percent). This is consistent with the nominal amounts of expenditure considered for these years in the revised MMF, an evolution that reverses the growing trend recorded by government expenditure in GDP terms as a result of the implementation of the Fiscal Stimulus Plan.

67. The forecast consider that the annual fiscal rules of the Fiscal Responsibility and Transparency Act (FATA) about the fiscal deficit and growth of expenditure will be re-established in 2011 and 2012. According to this Act, the deficit cannot be higher than 1 percent of GDP and the central government's expenditure in consumption cannot increase by over 4 percent in real terms. The latter includes expenditure

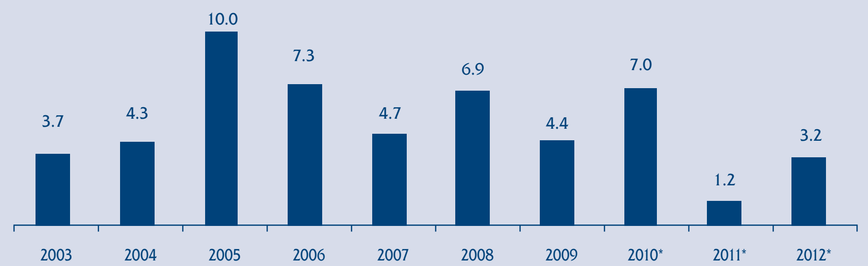
in salaries and wages, as well as expenditure in goods and services. The forecast also considers the provisions of the recently approved Financial Balance Bill that establishes the application of the fiscal rule according to which the balance of the operations of the NFPS in 2011, year of presidential elections, should show a surplus of at least 2 percent of GDP in that year.

Graph 63
GENERAL GOVERNMENT CAPITAL EXPENDITURE
(Real % change)



* Forecast.

Graph 64
GENERAL GOVERNMENT NON-FINANCIAL CURRENT EXPENDITURE
(Real % change)



* Forecast.

Financing requirements

68. The public sector's financial requirements in 2010 would amount to US$ 2,918 million, sum consistent with the fiscal deficit in the year (0.9 percent of GDP). The estimated financial requirements for 2011 and 2012 would be US$ 1,441 million and US$ 746 million, respectively, lower than projected in our previous Report given the better results expected in the 2010-2012 period.

Table 26
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR 1/
(Millions of US$)

	2009	2010			2011*		2012*	
		Jan-Sep	IR Sep.10*	IR Dec.10*	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
I. Uses	**3,838**	**-175**	**4,047**	**2,918**	**3,344**	**1,441**	**2,530**	**746**
1. Amortization	1,218	1,112	1,653	1,516	1,593	1,371	1,758	1,780
a. External debt	950	642	962	959	971	807	1,338	1,209
b. Domestic debt	268	471	690	557	622	564	420	571
Of which: Recognition bonds	91	206	324	273	294	258	241	287
2. Overall balance (negative sign indicates surplus)	2,620	-1,287	2,394	1,401	1,751	70	773	-1,035
II. Sources	**3,838**	**-175**	**4,047**	**2,918**	**3,344**	**1,441**	**2,530**	**746**
1. External	1,127	710	1,433	1,404	1,282	1,421	1,202	1,202
2. Bonds 2/	1,854	797	1,144	835	894	720	727	816
3. Internal 3/	857	-1,682	1,471	679	1,169	-700	601	-1,273
Memo:								
Balance of gross public debt								
Millions of US$	33,827	33,873	34,427	34,761	35,384	36,264	35,884	37,168
% of GDP	26.6	22.9	22.7	22.7	21.5	21.4	20.0	19.8
Balance of net public debt 4/								
Millions of US$	17,290	15,725	18,213	17,848	19,935	18,188	20,583	16,945
% of GDP	13.6	10.6	12.0	11.6	12.1	10.7	11.5	9.0

IR: Inflation Report.
* Forecast.
1/ The effect of exchanging treasury bonds by longer-maturity bonds, as well as the effect of placements made for the prepayment of both internal and external operations has been isolated in the case of amortization and disbursements.
2/ Includes domestic and external bonds.
3/ A positive sign indicates a withdrawal or overdraft and a negative sign indicates higher deposits.
4/ Defined as the difference between gross public debt and NFPS deposits.
Source: BCRP, MEF.

69. The debt management operations carried out in 2010 included the following: In April, Global Bonds with a nominal value of US$ 1,800 million maturing in 2012, 2014, 2015 and 2016 were withdrawn from the market. A total of US$ 1,385 million of these bonds were swapped by Global Bonds 2033 and bonds for a total of US$ 415 million were repurchased. In August, Sovereign Bonds maturing in 2011, 2012, 2016 and 2017 were swapped by Sovereign Bonds 2020. The total amount swapped through these operations was S/. 1,516 million (nominal value).

A third debt management operation was carried out in November with the placement of Global and Sovereign Bonds for a total of US$ 2,500 million, of which US$ 1,000 million would be used to prefinance financial requirements for 2011, while the remainder would be used for the prepayment of the external debt to multilateral and bilateral sources.

It should be pointed out that the operation carried out in November included the issuance of US$ 1,000 million of a global bond maturing in 2050 and with an annual coupon of 5.625 percent (the lowest rate in the history of regional issuances for a bond with such a long maturity). Moreover, the maturity of this bond is the second longest in the history of Global Bonds in Latin America[2]. Domestic offering included the reopening of Sovereign Bond 2020 for a total amount of US$ 1,500 million (equivalent to S/. 4,196 million). Approximately 65 percent of these bonds was purchased by non residents, which is the highest placement of local currency-denominated bonds issued by a Latin American issuer that has been acquired by international investors.

The aim of these operations is to reduce the payments of maturities in the next seven years, to extend the average life of the debt and to replace the debt denominated in dollars by a debt denominated in nuevos soles.

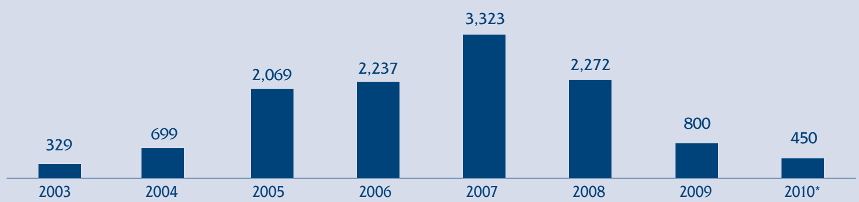
Table 27
BONDS ISSUANCE: NOVEMBER 2010

Characteristics	Global Bonds	Sovereign Bonds
Maturity (years)	40	10
Nominal Ammount (Millions of US$)	1,000	1,500
Coupon (%)	5.625	7.840
Yield (%)	5.875	5.750
Price (%)	96.160	114.718
Ammount received (Millions of US$) *	961.64	1,752.09
Demand (Millions of US$)	2,500	2,538

(*) Includes current interest for US$ 252 million.

70. It is worth mentioning that although a total of S/. 4,196 million of bonds denominated in nuevos soles were placed, these bonds were paid in dollars, which means that this operation actually implied a placement in nuevos soles and a purchase of dollars. The treasury's demand for foreign currency amounted to US$ 450 million between January and November.

Graph 65
PUBLIC TREASURY PURCHASES OF FOREIGN CURRENCY
(Millions of US$)

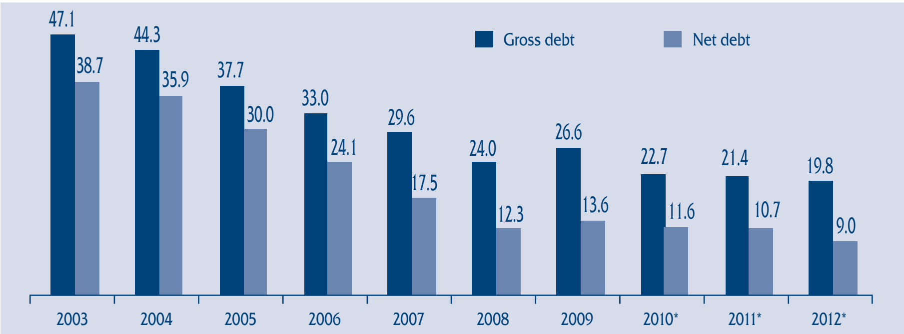


* January-November.

2 In October 2010 México issued a global bond for US$ 1,000 million with a 100-year maturity, a coupon of 5.750 percent and a yield of 6.1 percent.

71. The debt management operations carried out during 2010 will allow to reprofile liabilities and reduce market risks (exchange rate risks and interest rate fluctuations), as well as to reduce the risks of refinancing the public debt in the future. On the other hand, the process of reducing the debt will continue. At end 2010 the gross debt to GDP ratio would be 22.7 percent and the net debt ratio would be 11.6 percent. The forecasts for the following years consider a lower rate of indebtedness associated with increased economic activity.

Graph 66
PUBLIC DEBT
(% of GDP)



* Forecast.

BOX 2
COUNTER CYCLICAL FISCAL RULES

The use of fiscal rules –that is, permanent restrictions on fiscal policy expressed in numeric limits to some indicators of fiscal activity[3]– has extended considerably in both emerging and developed countries. According to the International Monetary Fund (IMF)[4], approximately 80 countries currently use this mechanism to manage their public finances in both the national and subnational levels.

The main purpose of this type of institutional arrangement is to reduce the bias toward deficit in fiscal policy discretional management and to favor a predictable and sustainable performance of public finances. However, one of the main criticisms to the use of fiscal rules is that it can induce a procyclical conduct in fiscal policy.

3 Kopitz G. and S. Symansky (1998) "Fiscal Policy Rules", IMF Occasional Paper N° 162. Washington DC. 1998. Fiscal rules typically set limits to the fiscal deficit, public expenditure or the accumulation of public debt.

4 FMI(2009) "Fiscal Rules: Anchoring Expectations for Sustainable Public Finances". IMF. Washington DC. November 2009.

This could take place, for example, if a country has a fixed fiscal deficit target that forces the economic authorities to adjust government expenditure when tax revenues show changes associated with the economic cycle: thus, in a recession the government would have to reduce public expenditure, which would contribute to enhance the shocks that affect the economy instead of mitigating them.

Therefore, an appropriate design of fiscal rules is essential to achieve a balance between simplicity (which favors credibility of rules as this contributes to compliance with rules) and flexibility so that the possibility of following procyclical rules that can have a very high cost in terms of welfare and economic growth is minimized. A poorly designed fiscal rule may lead to the use of "creative" accounting or to a discretionary use of its escape clauses and to having no impact on fiscal performance[5].

This article discusses two types of fiscal rules aimed at maintaining solvency in government operations which also provide space for the implementation of counter cyclical policies in addition to the "automatic stabilizers" used in the tax and social benefit systems. One of the characteristics of these rules is that they associate a fiscal policy instrument or indicator with measures in the economic cycle in a similar way as the monetary policy rules associate the reference interest rate with the state of the economy and inflation following Taylor's proposal[6].

Fiscal rule proposed for Colombia

A fiscal rule proposal[7] to provide Colombia with a fiscal rule that will allow the country to maintain financial stability in its government operations and provide space for counter cyclical interventions was submitted in July.

In formal terms, this fiscal rule may be expressed as:

$$rp_t = rp^* + \lambda(y_t - \overline{y}) + (tp_t - \overline{tp})$$

Where rp^* is the target for the primary balance of the central government (measured as a percentage of GDP), $y_t - \overline{y}$ is the gap between the actual GDP and its potential level (measured as percentage deviation), and $tp_t - \overline{tp}$ is the cyclical component of the fiscal revenues derived from oil production (basically income tax and dividends paid by Ecopetrol and the income tax paid by private oil companies measured as a percentage of GDP).

This rule establishes that if the economy and revenues from the hydrocarbon sector remain in their trend levels ($y_t = \overline{y}$ and $tp_t = \overline{tp}$), then the primary balance of the central government should

5 Cáceres, C., A. Corbacho and L. Medina(2010) "Structural Breaks in Fiscal Performance: Did Fiscal Responsibility Laws Have Anything to Do with Them?" IMF Working Paper N° 10/248. Washington DC. November 2010.

6 Taylor(2000) "Reassessing Discretionary Fiscal Policy". Journal of Economic Perspectives. Volume 14 N° 3 Summer 2000.

7 Comité Técnico Interinstitucional(2010) "Regla Fiscal para Colombia" Bogota, July 2010.

correspond with the medium term level required so that there is a stable (or declining) government debt to GDP ratio over time; in other words, so that this guarantees fiscal solvency.

However, if economic activity is below its potential level, then the government can reduce the primary balance of the national government to stimulate the economy. The magnitude of the counter cyclical response depends on the value of the paremeter λ. The criterion for the selection of this value is based on the acknowledment that fiscal revenues depend automatically on the level of economic activity and therefore the value assigned to λ must be higher than the one associated with the impact of automatic stabilizers in the treasury's primary balance.

The rule also implies that every cyclical component of the revenues generated by the hydrocarbon sector must be saved by the government and that only the permanent component of this source of revenues may be spent. The main purpose of this measure is to mitigate the impact of the price cycles of crude on aggregate demand and on the exchange rate. This rule would contribute to accumulate resources in a sovereign wealth fund, thus favoring greater inter-generational equity.

The rule includes escape clauses: the rule does not apply in the cases of external war, natural disasters or significant shocks that may affect GDP, the exchange rate, the interest rate or inflation.

The proposal also considers the establishment of a deliberative body in charge of overseeing compliance with the rule and of determining if a situation requires the application of the escape clauses. This Comité Externo de Evaluación de la Regla Fiscal, which will be integrated by three members designated jointly by the Central Bank, the Ministry of Finance and the National Planning Department, will be in charge of estimating the output gap and the cyclical components of the revenues from the hydrocarbon sector, as well as of periodically reviewing the rule parameters.

Fiscal rule proposed for Turkey

The proposal[8] of fiscal rule elaborated by the government of Turkey with the aim of promoting the predictability of the country's public finances and ensure a prudential management of the fiscal deficit in the medium term is currently being discussed in the Turkish parliament.

These proposal may be expressed as:

$$\Delta d_t = -\alpha(d_{t-1} - d^*) - \beta\,(g^y_t - \overline{g^y})$$

Where Δd_t is the change in the overall fiscal deficit of the general government in the current period, measured as a percentage of GDP; d_{t-1} is the fiscal deficit in the previous period (% of GDP);

8 Undersecretariat of Treasury (2010) "Main Elements of the Draft Law on Fiscal Rule". May 2010. See also IMF(2010) "Turkey: Staff Report for the 2010 Article IV Consultation and Post-Program Monitoring" IMF Country Report N° 10/278. Washington DC September 2010.

d^* is the target level of the overall deficit; g^y_t is the growth rate of real GDP in the current period, and $\overline{g^y}$ is the growth rate of the potential GDP. Parameter α measures the velocity at which the fiscal deficit adjusts to the target level and parameter β measures the fiscal policy counter cyclical policy incorporated to the rule.

This proposal shows that a change in the fiscal deficit must have two components: the first one is associated with the adjustment of public sector accounts to a level consistent with fiscal sustainability d^* and the other one is associated with the response to the economic cycle. The deficit can increase when the economy is growing at a lower rate than the potential output and must be reduced when the economy grows faster than the potential output. The amount generated by the rule is considered to be a cap or maximum deficit variation, which means that if other macoeconomic aims (such as promoting the external adjustment of the economy) require a greater fiscal constraint, the growth of the deficit can be lower than considered in the rule.

All the rule parameters are established in legislation. Thus, the proposal being discussed in the Turkish parliament considers an overall deficit target of 1 percent of GDP, the velocity of adjustment to the deficit target is one third (α =1/3), the counter cyclical response is also one third (β =1/3), and the rate of growth of the potential output is 5 percent. The proposal also includes transparency measures that favor the monitoring of compliance with the fiscal rule.

Finally, in case of natural disasters, epidemics or economic and financial crises, every additional expenditure used to relieve the emergency situation will be considered an exception to the rule.

The proposals discussed above reflect countries' interest in establishing conduct rules for the fiscal authority that will favor the adoption of a timely counter cyclical response without neglecting the need of maintaining a financially sustainable fiscal position.

This is particularly important for countries such as Peru in which fiscal accounts are vulnerable to variations in the prices of export products. A fiscal rule in Peru has to provide coverage to offset economic fluctuations and isolate government expenditure from cyclical variations in international prices in order to mitigate the impact of fluctuations in terms of trade on domestic demand and the real exchange rate.

BOX 3
SOVEREIGN WEALTH FUNDS OF COMMODITY-EXPORTING COUNTRIES

Countries whose exports have a high component of commodities face specific challenges in terms of the design of the institutions associated with fiscal management due to the price volatility of these products and to the fact that they are usually non-renewable resources (as minerals and hydrocarbons).

The high price volatility of these products is usually transmitted to fiscal revenues through changes in the amount of revenues from the income tax and royalties paid to the State by private companies or through changes in the amounts of the dividends and transfers made by the sector's state enterprises to the national government.

This higher volatility of fiscal revenues hinders the planning of government expenditure and increases fiscal vulnerability: in periods with low prices, the treasury may be forced to reduce government expenditure, while in periods with high prices there are usually domestic pressures for using these resources, especially when a country has severe gaps in terms of infrastructure or public services, which can negatively affect the quality of expenditure.

Moreover, since it is difficult in practice to distinguish the permanent components of changes in international prices from transitory changes, if fiscal revenues increase temporarily, the treasury may react increasing permanent components of government expenditure, which increases the vulnerability of the State vis-à-vis adverse shocks in terms of trade and hinders the possibility of establishing financially sustainable policies, which is turn translates into a more costly access to the capital market.

In addition to fiscal vulnerability and a lower quality of government expenditure, the effect of volatility in commodity prices is also reflected in the real exchange rate: periods with high commodity prices are associated with real appreciations of the exchange rate, which makes it more difficult to diversify the base of export products, because an increase in terms of trade acts as an improvement in the real income of a country's residents. When this higher income is spent, the demand for non tradable goods increases and so do the relative prices of these goods compared with the prices of tradable goods, which generates a real appreciation.

On the other hand, since revenues from non renewable resources are not actually income, but rather the transformation of natural wealth into financial assets, the country is faced with the problem of having to design mechanisms to ensure that not only today's generation of citizens can benefit from the exploitation of the country's resources but also future generations.

An institutional response of several commodity-exporting countries has been the creation of "sovereign wealth funds" (SWF). These sovereign funds can be defined as "government investment vehicles financed by external revenues in dollars, but separated from international reserves." SWF differ from international reserves in terms of aims and portfolios. International reserves have historically been invested in highly rated and highly liquid securities (usually fixed income sovereign bonds) for the purpose of making interventions in the foreign exchange market, while SWF are usually invested with a longer term approach in international variable income assets, commodities, and private sector fixed income securities that are used to reach a country's strategical and financial long term goals[9].

9 Lowery, C. (2007). "Sovereign Wealth Funds and the International Financial System". Remarks at the Federal Reserve Bank of San Francisco's Conference on the Asian Financial Crisis Revisited. US Treasury Washington DC. June 2007.

The use of SWF have extended over time since the first fund was created in the fifties. The recent rise observed in the international price of crude and in several metals has led to a considerable increase in the assets managed by these entities. According to the Sovereign Wealth Fund Institute, the main SWF with assets generated from commodity incomes would be currently managing assets for approximately US$ 2.4 trillion.

SOVEREIGN WEALTH FUNDS FROM COMMIDITIES

Country	Fund name	Assets in billions (US$)	Date of creation	Origin
United Arab Emirates – Abu Dabi	Abu Dhabi Investment Authority	627.0	1976	Oil
Norway	Government Pension Fund – Global	512.0	1990	Oil
Saudi Arabia	SAMA Foreign Holdings	439.1	n/a	Oil
Kuwait	Kuwait Investment Authority	202.8	1953	Oil
Russia	National Welfare Fund	142.5	2008	Oil
Qatar	Qatar Investment Authority	85.0	2005	Oil
Libya	Libyan Investment Authority	70.0	2006	Oil
Algeria	Revenue Regulation Fund	56.7	2000	Oil
Kazakhstan	Kazakhstan National Fund	38.0	2000	Oil
United States – Alaska	Alaska Permanent Fund	37.0	1976	Oil
Brunei	Brunei Investment Agency	30.0	1983	Oil
Iran	Oil Stabilisation Fund	23.0	1999	Oil
Chile	Fondo of Estabilización Económica and Social	21.8	2006	Copper
Azerbaijan	State OilFund	21.7	1999	Oil
United Arab Emirates – Dubai	Investment Corporation of Dubai	19.6	2006	Oil
Canada	Alberta's Heritage Fund	14.4	1976	Oil
United Arab Emirates – Abu Dabi	International Petroleum Investment Company	14.0	1984	Oil
United Arab Emirates– Abu Dabi	Mubadala Development Company	13.3	2002	Oil
Bahrain	Mumtalakat Holding Company	9.1	2006	Oil
Oman	State GJanral Reserve Fund	8.2	1980	Oil and Gas
Botswana	Pula Fund	6.9	1994	Diamonds and Minerals
East Timor	Timor-Leste Petroleum Fund	6.3	2005	Oil and Gas
Saudi Arabia	Public Investment Fund	5.3	2008	Oil
United States – Wyoming	Permanent Wyoming Mineral Trust Fund	4.7	1974	Minerals
Trinidad and Tobago	Heritage and Stabilization Fund	2.9	2000	Oil
United Arab Emirates – Ras Al Khaimah	RAK Investment Authority	1.2	2005	Oil
Venezuela	FEM	0.8	1998	Oil
Nigeria	Excess Crude Account	0.5	2004	Oil
Kiribati	Revenue Equalization Reserve Fund	0.4	1956	Phospates
Mauritania	National Fund for Hydrocarbon Reserves	0.3	2006	Oil and Gas

Source: Sovereign Wealth Fund Institute.

he table below summarizes the sources and use of resources of some SWF[10]:

10 Davis, J. et al. (2001) "Stabilization and Savings Funds for Nonrenewable Resources". IMF Occasional Paper 205. IMF Washington DC. 2001.

CHARACTERISTICS OF SOME SOVEREIGN WEALTH FUNDS

Country	Name	Goals	Date of Creation	Rule of Accumulation	Rule of Use	Entity Responsable
Chile	Fondo de Estabilización Económica y Social	Finance deficit pay debt	2006	Fiscal surplus after payout to pension fund and Central Bank	In the case of deficit do not use debt	Public treasury managed by the Central Bank
Norway	State Oil Fund	Stabilization and saving	1990	Fiscal revenues from oil	Transfers approved by Parliament	Ministry of Finance
Kuwait	General Reserve Fund	Stabilization and saving	1960	Fiscal surplus	Discretional transfers	Ministry of Finance and Central Bank
Oman	General State Reserve Fund	Saving	1980	Oil income over the budget	Discretional transfers	Autonomous Agency

Source: IMF.

In general, these funds are used to contribute to achieve the following aims:

- Isolate government expenditure from terms-of-trade volatility: The fund contributes to this because governments can save excess incomes in good times and these savings may be used in difficult times. A more government expenditure contributes to reduce the range and volatility of the economic cycle, which favors higher sustainable growth.

- Favor intergenerational equity: Saving part of the revenues obtained from the exploitation of non renewable resources imples that the current and future generations may benefit from higher government expenditure. Moreover, if the country has to face strong social demands for pensions in the future, it has to accumulate funds to finance these social costs.

- Mitigate the appreciation of the exchange rate: The temporary boom of an export sector associated with natural resources usually leads to a real appreciation of the local currency and generates adverse effects in the economy's competitiveness (Dutch disease). This may be prevented sterilizing the inflow of dollars associated with exports of non renewable resources through a fund with investments abroad.

- Self-insurance against the risk of illiquidity: Having a fund accumulated during boom periods prevents governments from having to resort to public debt in financially disadvantageous conditions in times of recession and from having to default as a result of an unanticipated loss of their acess to the international capital market.

SWF are not usually used for short term domestic macroeconomic policies, except in two cases[11]: (i) transfers to the budget due to exceptional focalized needs, and (ii) fund withdrawals to support the Central Bank in the case of exceptional requirements to support the balance of payments and monetary policy.

Finally, it is worth pointing out that it is desirable that the allocation of SWF resources does not imply higher investment expenditure in the same period. As mentioned above, SWF are mainly a mechanism to promote government saving and these funds should be managed through investments abroad until they are required to be used due to a drop in commodity prices or due to the exhaustion of a resource. If these funds were used to finance local investment, this could generate undesired macroeconomic effects such as the following:

- Higher inflation: Increased capital expenditure would be equivalent to an increase in domestic demand that would generate upward pressures on prices, particularly on the prices of non tradable goods.

- Appreciation of the exchange rate: The accumulation of resources in SWF contributes to sterilize the flows of FC of the surplus of the balance of payments. The use of these funds would imply the conversion of these funds to the local currency, which would reverse the policies that led to an accumulation of reserves.

- Fiscal risks: Financing public projects that should be part of the ordinary budget with SWF may generate accounting and transparency problems, as well as fiscal risks.

- Greater vulnerability in the economy: The economy would have a lower capacity to respond to reversals in the high prices of commodities and to capital outflows.

11 Hammer et al. (2008) “Sovereign Wealth Funds: Current Institutional and Operational Practices” IMF Working Paper 08/254. IMF Washington DC. November 2008

V. Monetary Policy

72. Between May and September 2010, in a context of strong growth of domestic economic activity, the Central Bank implemented a policy of preventive withdrawal of monetary stimulus, raising the reference interest rate from a historical minimum of 1.25 to 3.0 percent. Between October and December the BCRP made a pause in the withdrawal of monetary stimulus given the evolution of inflation and inflation expectations, which reflected the absence of inflationary pressures, and given the slower-than-expected recovery observed in the global economy due to the uncertainty generated by the high levels of debt registered in some Eurozone economies.

    Inflation has been declining in the last months. After recording negative rates in September and October (-0.03 and -0.14 percent, respectively) due mainly to the decline of food prices, the rate of inflation in November was 0.01 percent, as a result of which annual inflation recorded 2.22 percent (around the 2 percent target). Inflation expectations for 2011 and 2012 are also around the inflation target. Economic activity, on the other hand, continues showing a strong dynamism with a growth rate of 8.7 percent at October 2010.

    New rates of reserve requirements in nuevos soles and in dollars were established in October in order to contain the growth of credit and liquidity in a context of capital inflows and expectations of appreciation of the exchange rate. The following measures were implemented:

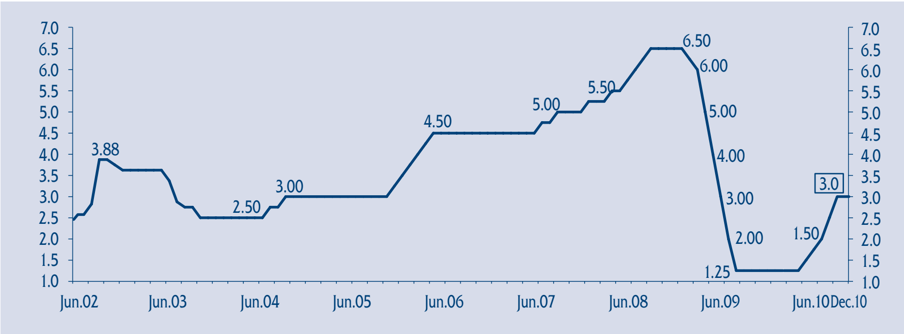
    - The rate of minimum legal reserves was raised from 8.5 to 9.0 percent, with an exemption of S/. 50 million or 6.0 percent of total liabilities subject to reserve requirements, the lower amount.

    - The rate of marginal reserves in domestic currency was raised to 25 percent.

    - The rate of marginal reserves in foreign currency was raised from 50 to 55 percent.

    - The rate of average reserves in foreign currency was raised by 0.5 percentage points relative to the implicit rate of reserves during the period July 1 to July 31, 2010.

Graph 67
BCRP INTEREST REFERENCE RATE
(%)



REFERENCE INTEREST RATE: RECENT MEASURES
September – December 2010

September: The Board of the Central Reserve Bank of Peru approved to raise the monetary policy reference rate from 2.5 percent to 3.0 percent.

This measure is mainly preventive in a context of strong dynamism of domestic demand, a situation in which withdrawing monetary stimulus is advisable in order to maintain inflation within the target range. However, future adjustments in the reference rate will depend on new information on the evolution of inflation and its determinants.

October: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 3.0 percent.

This decision takes into account the recent evolution of inflation and its determinants, which advises to make a pause in the preventive adjustments of the reference rate initiated in May of this year. Current and advanced indicators of activity show a slight moderation in the growth of economic activity, in line with the forecasts of our Inflation Report. Future adjustments in the reference rate will depend on new information on the evolution of inflation and its determinants.

November: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 3.0 percent.

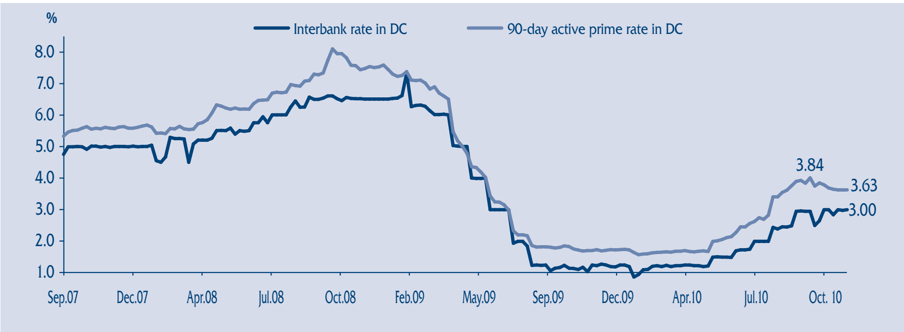
This decision takes into account the recent evolution of inflation and its determinants, which advises to continue with the pause made in implementing the preventive adjustments of the reference rate initiated in May of this year. Core inflation remains around the 2 percent target, while total inflation has been declining in the last two months due to the reversal of supply shocks. Future adjustments in the reference rate will depend on new information on the evolution of inflation and its determinants, as well as on the evolution of the international financial environment.

December: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 3.0 percent.

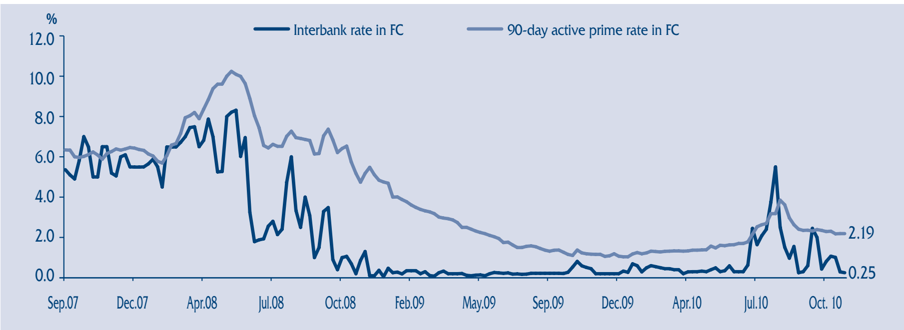
This decision takes into account the evolution of inflation and its determinants, as well as uncertainty about the evolution of the global economy. Core inflation and total inflation remain around the 2 percent target. Future adjustments in the reference rate will depend on new information on the evolution of inflation and its determinants, including information on the evolution of the international financial environment.

73. In October and November the 90-day prime rates in nuevos soles declined due to lower expectations of rises in the reference rate and due to the pause made by the BCRP in the adjustment of its monetary policy position. Thus, the 90-day loan rates declined from 3.84 percent in September to 3.63 percent in November and the prime rates in foreign currency declined from 2.35 to 2.19 percent in the same period.

Graph 68
INTERBANK AND CORPORATE PRIME INTEREST RATES IN DOMESTIC CURRENCY



Graph 69
INTERBANK AND CORPORATE PRIME INTEREST RATES IN FOREIGN CURRENCY



74. By type of placements, the rates in domestic currency for loans to medium-size enterprises and loans to micro businesses recorded increases. Thus, the former rose from 8.7 percent in September to 10.1 percent in November, while the latter rose from 30.9 to 31.5 percent. On the other hand, the rates on consumer loans declined from 39.5 to 37.8 percent and mortgage rates declined from 9.6 to 9.5 percent in the same period. The interest rates on other types of loans remained stable.

Except for the rates on loans to micro businesses which increased from 15.5 percent in September to 15.8 percent in November, the interest rates on loans in foreign currency for all the types of credit declined.

Table 28
INTEREST RATES BY TYPE OF CREDIT IN DOMESTIC AND FOREIGN CURRENCY 1/ 2/
(%)

	Domestic Currency							
	Commercial	Corporate	Big businesses	Middle businesses	Small businesses	Microbusiness	Consumption	Mortgages
Dec.08	11.0	-	-	-	-	35.3	37.8	11.4
Dec.09	6.1	-	-	-	-	32.7	45.1	9.8
Aug.10	8.5	-	-	-	-	30.5	42.1	9.7
Sep.10	-	5.5	6.4	8.7	23.6	30.9	39.5	9.6
Oct.10	-	5.6	6.3	9.5	23.2	31.3	38.4	9.5
Nov.10 2/	-	5.1	6.1	10.1	23.7	31.5	37.8	9.5
	Foreign Currency							
	Commercial	Corporativos	Big businesses	Middle businesses	Small businesses	Microbusiness	Consumption	Mortgages
Dec.08	9.3	-	-	-	-	23.9	20.8	10.8
Dec.09	6.7	-	-	-	-	22.4	21.2	9.1
Aug.10	7.0	-	-	-	-	16.3	21.5	8.6
Sep.10	-	4.3	5.5	9.5	15.0	15.5	21.3	8.4
Oct.10	-	3.8	5.5	9.3	14.7	15.5	22.0	8.3
Nov.10 2/	-	3.2	5.3	9.1	14.3	15.8	20.9	8.2

1/ Annual active interest rates on the operations carried out in the last 30 working days.
2/ Firms' reports to the SBS include more segmented information about the average interest rates on corporate loans, credits to large, medium-size, small and micro businesses, acording to the definitions established in SBS Resolution 11356-2008 and complementary regulations. Theses rate segments are published when the SBS acummulates 30 days data.
Source: SBS.

The borrowing rates on 30-day deposits in DC declined from 2.5 to 2.1 percent, while the rates on 30-day deposits in FC declined from 1.4 to 0.8 percent between September and November.

Table 29
INTEREST RATES IN NUEVOS SOLES AND US DOLLARS
(%)

	Nuevos Soles		Dollars		Difference (bps) (Sep-Nov.10)	
	Sep.10	Nov.10	Sep.10	Nov.10	Nuevos Soles	Dollars
1. Deposits up to 30 days	2.5	2.1	1.4	0.8	-40	-64
2. Rate on 31 to 180-day term deposits	2.5	2.8	1.2	1.3	30	10
3. Rate on 181 to 360-day term deposits	3.2	3.7	1.7	1.7	52	0
4. Corporate prime rate	3.8	3.7	2.9	2.1	-10	-80
5. TAMN / TAMEX	18.3	18.8	8.7	8.6	51	-13

Monetary operations

75. The operations of the BCRP were aimed at ensuring adequate liquidity levels to maintain a smooth flow of operations in the money market, in a context of a higher availability of liquidity in banks and lower exchange rate volatility that reduced the need for BCRP interventions in the foreign exchange market. In October 2010, the Board of the Central Bank approved new monetary sterilization tools to increase the effectiveness of monetary control in a a context of persistent inflows of short term capitals. Thus, since October 11, placements of CDBCRP were replaced by placements of term deposits (DP BCRP), a facility available to banks only.

Term deposits (DP BCRP) are a new instrument in nuevos soles used to sterilize excess liquidity in the financial system, which in contrast to the BCRP certificates of deposit (CDBCRP), can only be purchased by the financial entities operating directly with the Central Bank. Therefore, they are used only as a monetary control mechanism. The rate on term deposits, which can be overnight or have up to 4-month maturities, is determined on an auction basis. These instruments have become the Central Bank's main sterilization tool since they were established.

76. The Central Bank also started issuing Certificates Payable in Dollars (CDLD BCRP), an instrument which reduces in part the need of making direct purchases of dollars. Through this instrument the Central Bank buys dollars from financial entities and simultaneously sterilizes the amount purchased by issuing a certificate of deposit in nuevos soles, which can be either at a fixed rate (CDBCRP) or at a variable rate (CDVBCRP). At the maturity of the instrument, the BCRP sells the the amount of dollars of the certificate to banks, as a result of which it is not longer necessary to carry out this operation in the foreign exchange market.

Between October and November, in a context of lower pressures in the foreign exchange market, direct purchases of dollars were lower (US$ 227 million) and placements of CDLD BCRP amounted to S/. 450 million. Moreover, to prevent downward pressures on the interbank interest rate due to higher liquidity in banks as a result of the maturity of S/. 28,598 million in CDBCRP, excess liquidity was sterilized through the placement of 1-day to 4-month Term Deposits for a total of S/. 24,067 million.

In addition to this, in order to withdraw excess liquidity in longer terms, the Central Bank established Variable Rate Certificates of Deposit (CDV BCRP) whose yield varies in accordance with the BCRP reference rate. This instrument is aimed at encouraging banks' purchases of longer term certificates without the interest rate risk. Placements of 3 to 6 month- CDV BCRP for a total of S/. 2,123 million have been made.

Increased demand for currency (S/. 960 million) in October-November reflected the greater dynamism of economic activity. Public sector deposits at the BCRP in this period amounted to S/. 1,131 million.

Table 30
MONETARY OPERATIONS
(Millions of nuevos soles)

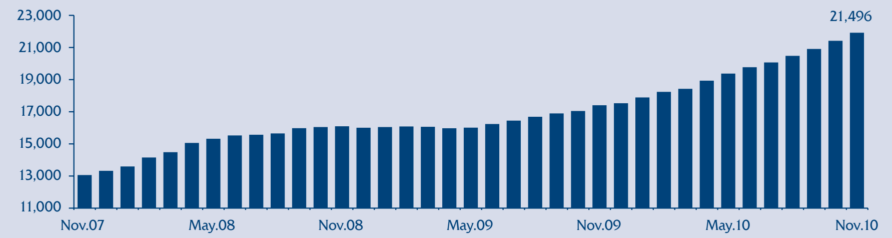
	FLOWS				BALANCE		
	I Sem	3Q.10	Oct-Nov*	Annual accumulated*	31 Dec.09	30 Jun.10	30 Nov.10
I. FOREIGN EXCHANGE OPERATIONS	**9,033**	**15,275**	**1,059**	**25,367**			
(Millions of US$)	**3,180**	**5,452**	**380**	**9,011**			
1. Over the counter operations	3181	5,556	227	8,963			
2. Public Sector	0	-50	0	-50			
3. Other operations 1/	-1	-54	153	98			
II. MONETARY OPERATIONS	**-9,742**	**-13,566**	**1,019**	**-22,289**	**-36,323**	**-46,065**	**-58,612**
1. Sterilization operations	-9,756	-13,552	1,019	-22,289	-36,323	-46,079	-58,612
a. BCRP instruments	-3,450	-12,197	1,957	-13,690	-14,121	-17,570	-27,810
CDBCRP	-3,450	-12,197	28,598	12,951	-14,121	-17,570	-1,170
CDLD BCRP	0	0	-450	-450	0	0	-450
CDV BCRP	0	0	-2,123	-2,123	0	0	-2,123
Term deposits	0	0	-24,067	-24,067	0	**0**	-24,067
b. Public sector deposits in DC	-6,817	-1,065	-1,131	-9,013	-21,006	-27,823	-30,019
c. Other monetary operations 2/	511	-290	193	413	-1,196	-685	-783
2. Injection operations	14	-14	0	0	0	14	0
a. REPOS	14	-14	0	0	0	14	0
b. Redisounts	0	0	0	0	0	**0**	**0**
II. RESERVE REQUIREMENTS IN DC	**262**	**-837**	**-1,356**	**-1,931**	**-4,307**	**-4,045**	**-6,239**
II. OTHERS 3/	**808**	**334**	**238**	**1,380**			
III. CURRENCY **	**361**	**1,205**	**960**	**2,526**	**19,241**	**19,602**	**21,7671**
(Monthly change)					10.3%	0.8%	1.5%
(Accumulated change)					29.5%	31.9%	13.1%
(12 month change)					11.0%	21.2%	24.8%

* Up to November 30, 2010.
** Preliminary data.
1/ Includes repos in FC, CDLD operations and over-the-counter operations.
2/ Includes overnight deposits and Deposit Insurance Funds.
3/ Includes BCRP operational expenses, interest for deposits in the BCRP (overnight, term, and special deposits), net interest for placements of CDBCRP.

Monetary aggregates

77. In November, average deseasonalized currency in circulation recorded a monthly growth rate of 2.3 percent, accumulating in this way a rate of 26.2 percent in the last 12 months. In October, currency registered a monthly growth rate of 2.4 percent and an annual rate of 25.8 percent. The evolution of currency reflects the dynamism of economic agents' transactions and the level of economic activity.

Graph 70
SEASONALLY ADJUSTED AVERAGE CURRENCY
(Millions of nuevos soles)

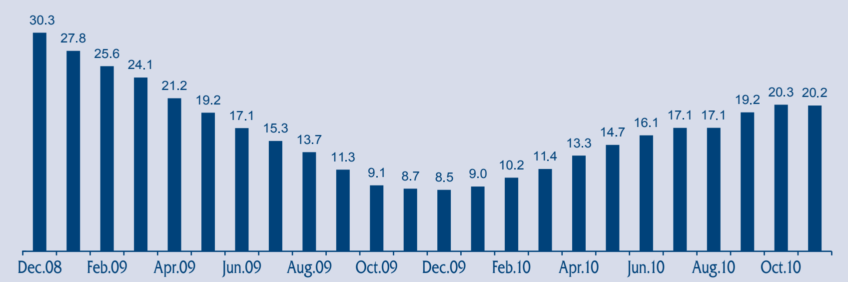


CURRENCY	Dec.07	Dec.08	Mar.09	Jun.09	Sep.09	Dec.09	Mar.10	Jun.10	Sep.10	Oct. 10	Nov. 10*
Original series (Millions of soles)	13,971	16,705	15,987	15,926	16,656	18,342	18,383	19,394	20,610	21,047	21,496
12-month % change	28.0	19.6	9.9	4.3	5.8	9.8	15.0	21.8	23.7	25.8	26.2
Seasonally adjusted (Millions of nuevos soles)	13,324	16,006	16,065	16,238	16,897	17,531	18,428	19,773	20,910	21,418	21,920
Seasonally adjusted monthly % change	2.0	-0.6	-0.1	1.4	1.2	0.7	1.0	2.0	2.1	2.1	2.3

* Preliminary.

78. Credit to the private sector also showed a growth in line with higher economic activity. An extraordinary increase was observed in terms of placements of foreign bank branches in this period (CK). Including these placements, credit to the private sector in the last 12 months grew 20.2 percent in November, 3.3 percentage points higher than the growth rate of credit to the private sector without including the placements of bank branches. It is worth mentioning that these credits from bank branches have been financed in part with placements of bonds abroad. Moreover, banks' external short term funding is also being replaced by long term funding.

Graph 71
CREDIT TO THE PRIVATE SECTOR WITH BRANCHES
(12-months growth rates)



By type of financial institution, microfinance entities and commercial banks showed a higher rate of placements (2.4 percent), while state banks increased their placements by 0.4 percent.

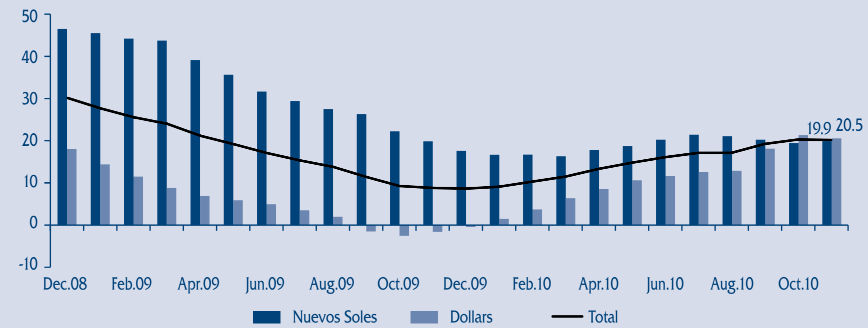
Table 31
TOTAL CREDIT TO THE PRIVATE SECTOR BY FINANCIAL INSTITUTION

	Balance in millions of nuevos soles			Growth rates (%)		
	Nov.09	Oct.10	Nov.10	Oct.10/ Oct.09	Nov.10/ Nov.09	Nov.10/ Oct.10
Banks (*)	91,473	106,537	109,062	19.0	19.2	2.4
State Bank	2,153	2,735	2,745	29.0	27.5	0.4
Microfinance Institutions	13,982	17,175	17,581	28.1	25.7	2.4
of which:						
Municipal banks	6,870	8,170	8,382	21.5	22.0	2.6
TOTAL	**108,312**	**127,210**	**130,175**	**20.3**	**20.2**	**2.3**

(*) Includes loans made by banks branches abroad.

79. By currencies, credit to the private sector in nuevos soles grew 19.9 percent in the last 12 months, while credit to the private sector in foreign currency grew 20.5 percent in the last 12 months.

Graph 72
CREDIT TO THE PRIVATE SECTOR 1/

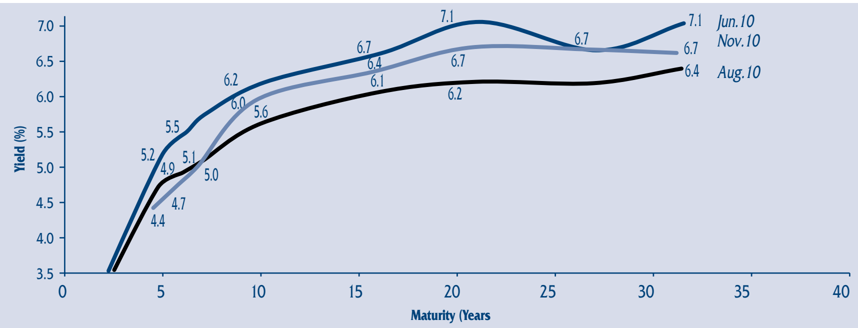


1/ Includes loans made by banks branches abroad.

80. In the capital market, the interest rates on the short tranche of the yield curve remained relatively stable in the quarter, following the reference rate.

It is worth mentioning that the participation of non resident investors increased substantially by mid-November because the government placed bonds BTP 2020 for a total of S/. 4,196 million (US$ 1,500 million) in the international market on November 10 –the bonds were issued and registered on November 18– as Global Depositary Notes (GDN). A Global Depositary Note (GDN) is a debt instrument created by a foreign bank (depositary bank) that evidences ownership of a local currency-denominated debt security. GDNs trade, settle, and pay interest and principal in U.S. dollars, withouth affecting domestic liquidity when placed among non residents.

Graph 73
SECONDARY MARKET OF SOVEREIGN BONDS 1/



1/ Average yield at end of each month.

Table 32
HOLDINGS OF NON-RESIDENT INVESTORS OF SOVEREIGN BONDS (BTP)
(Millions of nuevos soles)

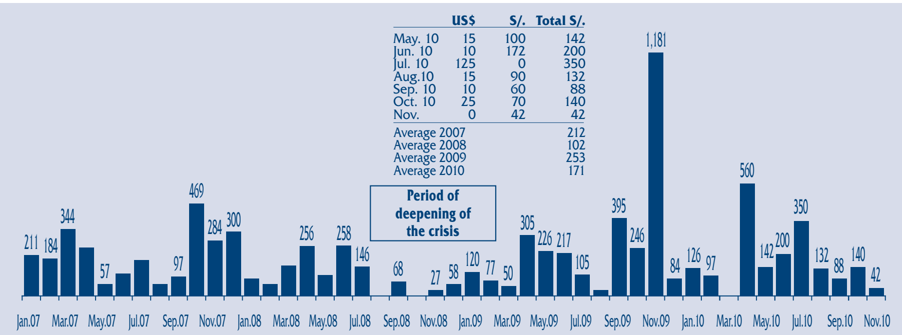
Date	BTP	Change	% Balance of BTP
Dec.07	5,042		27
Dec.08	5,189	147	27
Dec.09	4,053	-1,136	19
Jun.10	4,643	644	20
Jul.10	5,653	1,010	24
Aug.10	6,650	997	28
Sep.10	7,535	885	32
15-Oct-10	7,928	393	33
31-Oct-10	8,015	87	33
17-Nov-10	8,230	215	34
18-Nov-10	12,428	4,198	44
30-Nov-10	12,181	-247	43

* In November 18, 2010 where issued on the international market Global Depositary Notes for S/. 4,196 millions (US$ 1,500 million).

On the same date, the government placed 40-year global bonds (maturing in 2050) in the international market. The maturity of this bond is the second longest of a bond issued by a Latin American government, after the 100-year bond issued by Mexico. The amount placed was US$ 1,000 million in a context in which demand was 2.5 times higher than the offer. The yield rate was 5.875 percent (160 basis points higher than the yield on the US Treasury bond).

81. Private issuances by non financial firms declined significantly in the last quarter and showed a slight upward trend in terms of interest rates and relatively stable risk premiums.

Graph 74
BONDS ISSUED BY NON-FINANCIAL COMPANIES
(Millions of nuevos soles)



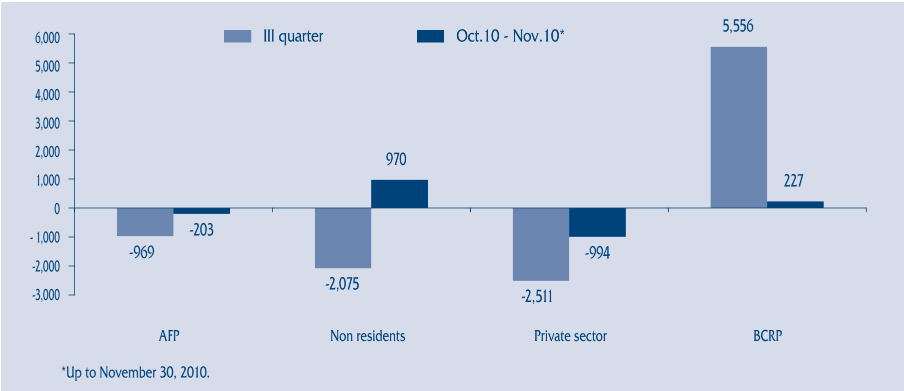
1/ Bonds issued in FC are valued at the exchange rate value at the end of the month. Securitization bonds.

Exchange rate

82. Between September and November 30, 2010, the average nominal exchange rate depreciated 1.6 percent reflecting international uncertainty associated with fiscal solvency problems in the Eurozone and non resident investors' portfolio movements in the forward market.

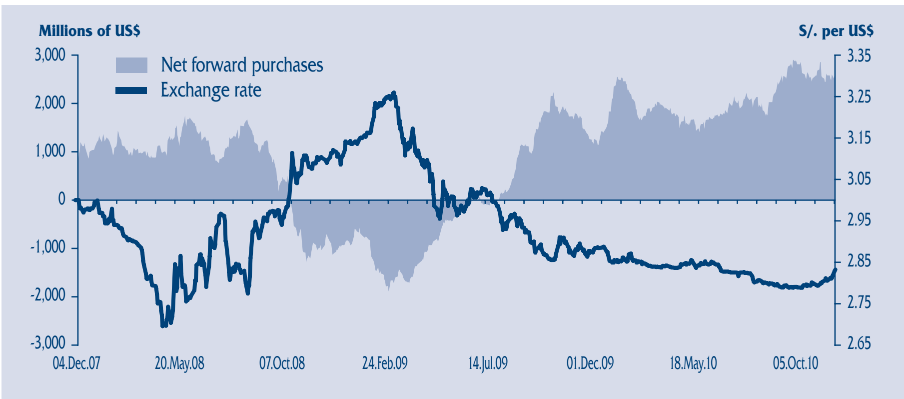
This relative depreciation was mainly the result of the reduction of capital flows to the economy, which reflected in the supply of dollars in the foreign exchange market which declined from from US$ 5,875 million in Q3 to US$ 2,116 million between October and November. This lower supply of dollars, which was associated with the lower participation of non resident investors and AFPs, was offset with the supply of the rest of private agents.

Graph 75
FLOWS IN THE FOREIGN EXCHANGE MARKET
(Millions of US$)



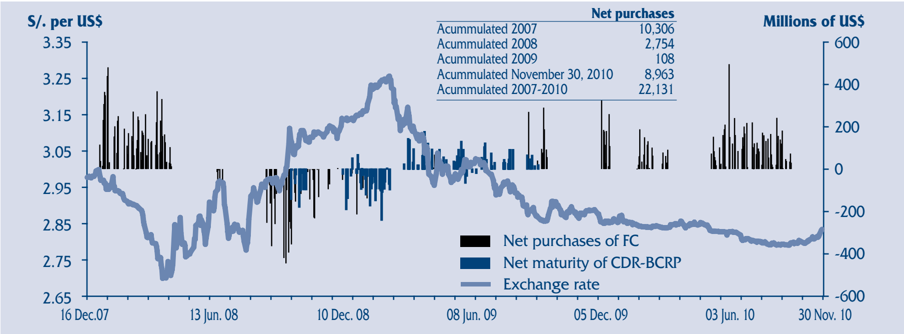
83. In October and November the balance of banks' forward purchases of FC declined by US$ 146 million, recording a balance of US$ 2,586 million at November 30. Factors accounting for this would have included the higher cost of funding in FC resulting from the higher rate of reserve requirements, uncertainty in international markets, the issuance of sovereign bonds payable in FC and the publication of the draft proposed by the Superintendency of Banks, Insurance Companies and AFPs (SBS) to limit banks' forward position.

Graph 76
NET FORWARD PURCHASES AND EXCHANGE RATE
(In millions of US$ and US$ / S/. exchange rate)



84. After the significant inflows of capitals observed since June till September of this year, which required the BCRP to intervene in the foreign exchange market purchasing US$ 6,082 million to contain excessive volatility in the exchange rate, a lower capital inflow was registered between October and November due mainly to fiscal solvency problems and uncertainty in the Eurozone, which accounted for the lower purchases of dollars made by the BCRP in this period (US$ 227 million).

Graph 77
EXCHANGE RATE, NET PURCHASES OF FC AND NET MATURITIES OF CDR-BCRP
(Exchange rate S/. per US$ and maturities in millions of US$)



Additionally, since October 20 the BCRP started placing CDLD BCRP (payable in dollars) as a complementary instrument to direct interventions in the foreign exchange market. Placements of CDLD BCRP amounted to S/. 450 million at November.

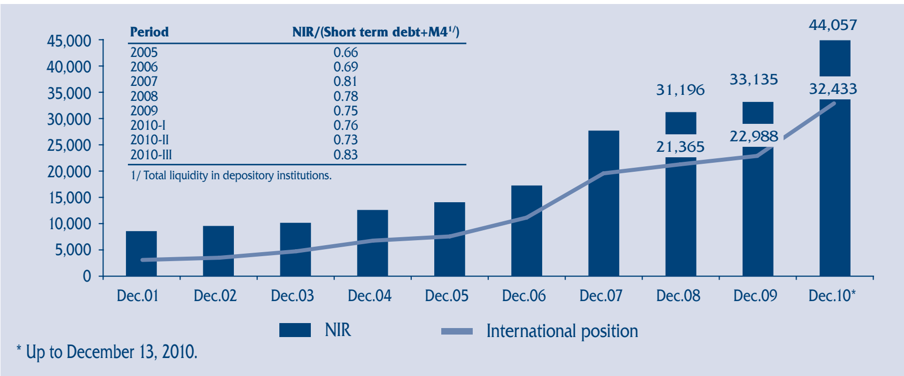
85. Although on average the exchange rate is expected to be lower in the period 2010-2012, the expectations of economic agents differ. Economic analists now expect a higher exchange rate, while financial entities and non financial firms expect a lower exchange rate.

Table 33
SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE
(Nuevos soles per US dollar)

	Jul.10	Aug.10	Sep.10	Oct.10	Nov.10
FINANCIAL ENTITIES					
2010	2.80	2.78	2.77	2.77	2.80
2011	2.80	2.80	2.79	2.76	2.75
2012	2.80	2.80	2.80	2.79	2.75
ECONOMIC ANALYSTS					
2010	2.80	2.77	2.75	2.76	2.80
2011	2.80	2.75	2.78	2.80	2.78
2012	2.80	2.74	2.72	2.78	2.72
NON-FINANCIAL FIRMS					
2010	2.82	2.80	2.80	2.80	2.80
2011	2.90	2.88	2.82	2.80	2.82
2012	2.95	2.90	2.90	2.86	2.88
AVERAGE					
2010	2.81	2.78	2.77	2.78	2.80
2011	2.83	2.81	2.80	2.79	2.78
2012	2.85	2.81	2.81	2.81	2.78

86. International reserves (NIRs) have increased by US$ 1,593 million between September and December 13, mainly as a result of public sector higher deposits in FC associated with the resources obtained from the placement of sovereign and global bonds abroad. As a result of this, the balance of NIRs amounted to US$ 44,057 million on December 13, 2010 (which represents approximately 83 percent of total short term external liabilities and total liquidity).

Graph 78
INTERNATIONAL RESERVES
(Millions of US$)



Period	NIR/(Short term debt+M4 1/)
2005	0.66
2006	0.69
2007	0.81
2008	0.78
2009	0.75
2010-I	0.76
2010-II	0.73
2010-III	0.83

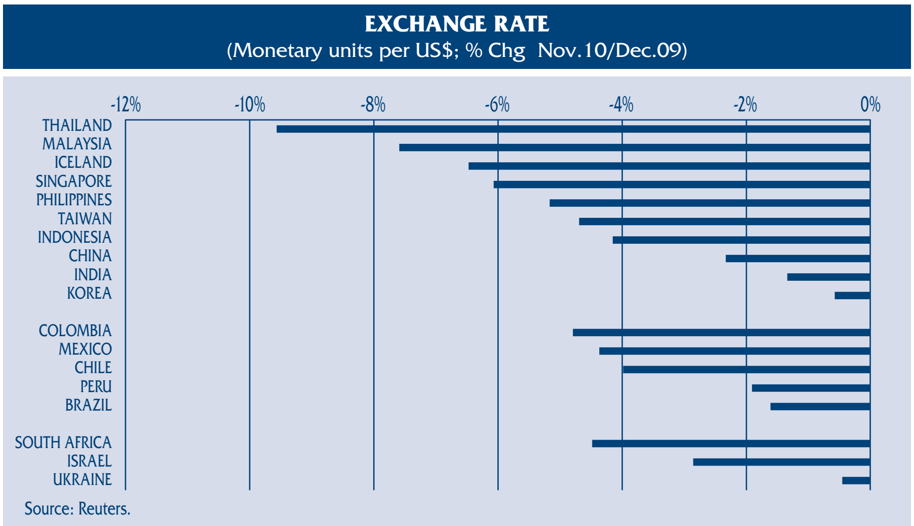
1/ Total liquidity in depository institutions.

* Up to December 13, 2010.

BOX 4
APPRECIATORY PRESSURES IN EMERGING MARKETS

The FED's decision of establishing a new stage of monetary easing (QE2) has generated expectations of increased liquidity in dollars and generated depreciatory pressures on the dollar, as well as tensions in global foreign exchange markets. These pressures have not only affected strong currencies, like the euro and the yen, but also the currencies of emerging countries and particularly the currencies of the countries that show better macroeconomic fundamentals that have been face higher capital inflows.

In response to these pressures, emerging countries have adopted several measures which range from a "verbal" intervention (Chile) to a higher intervention in the foreing exchange market (Brazil, Korea, Thailand, Israel, Peru), as well as several measures to prevent/incentivize capital inflows/ouflows.

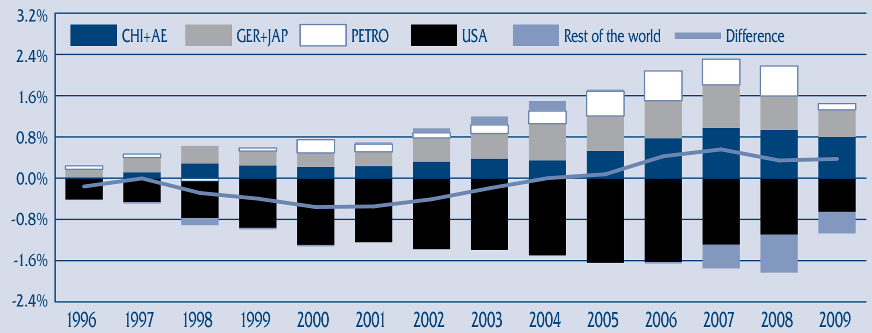


In the region, Brazil raised the tax on external capital investments in fixed income securities and the tax on guarantee margins for foreign investments in the futures market, and also extended the authorization for Treasury purchases of FC for an amount equivalent to the payment of the external debt in the following 4 years (2 years previously). Colombia agreed with Ecopetrol to maintain dividends abroad. In Asia, Indonesia established a minimum term of one month for non residents holdings of Central Bank securities, extende the maturity terms of its securities and imposed restrictions to banks' net open positions in FC. Taiwan has imposed a 1-week term for the investment or repatriation of foreign capital inflows and has announced that credit operations will be reviewed to identify speculators, while Korea lowered the limits for holdings of derivatives in FC.

It is worth pointing out that the FED's implementation of QE2 has taken place in a context in which there are still high global imbalance levels. Global imbalances reflect excess expenditure which translates into high current account deficits that are financed through increased levels of indebtedness. USA stands out in this sense with the successive current account deficit observed in the last decade that has led the country's liability position to increase from US$ 0.8 to US$ 2.9 trillion. On the other hand, there are countries that have recorded surpluses, such as China and South East Asian economies (Singapore and Taiwan), oil-exporting countries, and Germany and Japan in the group of developed countries.

Due to the global deleveraging process resulting from the crisis, the countries with deficits have to adjust domestic demand to reduce their debts, but the countries with surpluses are not willing to appreciate their currencies significantly to reduce their surpluses or do not have consumption structures that are ready enough to rely less on exports.

GLOBAL IMBALANCES 1/
(Current account % world GDP)



Source: IFS.
1/ CHI+AE: China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand. GER+JAP: Germany, Japan. PETRO: Oil exporters. USA: United States.

Most of the rest of emerging countries, which do not have an important participation in terms of the global imbalance, are basically trying to offset capital inflows and appreciatory pressures. Therefore, efforts should be made to reduce global imbalances in the medium term in order to avoid greater tensions in the exchange rate markets and to prevent that these tensions generate in the short term an upsurge of protectionism and a trade war that may intensify the risks of global deflation and recession.

BOX 5
MACROPRUDENTIAL INSTRUMENT

The unfolding of the recent global financial crisis has evidenced the need for preserving financial stability to guarantee the benefits derived from monetary stability and economic growth. A new set of macroprudential regulation instruments is required to do so in order to complement both the conventional instrument of the monetary interest rate and the microprudential requirements aimed at ensuring the individual solvency of entities in the financial system.

According to Borio (2009)[12], the aim of macroprudential regulation is to limit the systemic risk of financial stress episodes and to contain their macroeconomic costs in terms of GDP losses. Because of the preventive nature of this approach, the joint participation of fiscal authority, the financial regulation body and the central bank is required in order to monitor the financial system as a whole, identify possible sources of financial instability and respond to these scenarios.

12 Claudio Borio, “Implementing the macroprudential approach to financial regulation and supervision”, Bank of France. Financial Stability. September, 2009.

Furthermore, new macroprudential tools have to be developed to limit systemic risks and ensure financial stability.

According to the Bank of England[13], two are the main sources of systemic risk:

- Financial entities, households, and firms' collective tendency to take higher risks in the expansion stage of the economic cycle and to show higher risk aversion during recession stages.

- Individual financial entities that lack all the elements required to assess the collateral effects that their actions may have upon the risks of other entities in the financial system.

Therefore, the macroprudential measures required to offset these two sources of systemic risks imply:

- Moderating the procyclical evolution of the financial cycle, limiting the formation of financial imbalances over time, and

- Reinforcing the financial system's resilience to contagion risks and to different sources of financial interrelationships associated with endogenous or exogenous shocks.

The monetary policy of the BCRP has been designed to include actions aimed at offsetting the economy's risks derived from its still high financial dollarization ratio (44 percent in the case of credits). The reference interest rate –the monetary operational target– is complemented by the use of reserve requirements in both DC and FC and by sterilized interventions in the foreign exchange market.

Reserve requirements are a useful tool to face short term capital inflows. The latter increase the economy's vulnerability vis-à-vis a financial crisis since they can generate an excessive growth of credit in which both lenders and borrowers do not take into account or underestimate exchange rate and liquidity risks. In these situations, the BCRP prudentially raises the rates of reserve requirements in DC and FC and the rates of short term external liabilities, reducing in this way the vulnerability of the economy and the financial system. The BCRP also raises the rates of marginal reserve requirements for liabilities in FC due to the economy's high degree of dollarization and to the higher risk this implies.

The effectiveness of this instruments in periods of strees was evidenced in the recent financial crisis when, after the capital outflow observed as a result of the collapse of Lehman Brothers in September 2008, the BCRP lowered the rates of reserve requirements in DC and FC –which had

13 Bank of England, "The role of macroprudential policy", Discussion paper, November 2009.

been preventively been raised in the first half of 2008 in response to capital inflows and the growth of credit– releasing resources to maintain banks' liquidity. Since June of this year, the BCRP has increased the rates of reserve requirements in DC and FC to complement the rise in the reference rate in a context of capital inflows and high growth of economic activity.

The BCRP also participates in the foreign exchange market through sterilized interventions to reduce extreme exchange rate volatilities which, in a partially dollarized economy, may affect economic agents' assets positions and deteriorate the balances of financial entities. The use of this instrument has proved to be effective in reducing exchange rate volatility in recent periods of turbulence and in offsetting the impact of the exchange rate risk in the banking system.

As a microprudential regulator, the Superintendency of Banks and Insurance Companies (SBS) establishes the minimum requirements of capital and liquidity by currencies, as well as limits to the overall position in FC with the aim of preventing risks and strengthening resilience in the financial system. With the same aim and also in order to moderate the financial cycle, the SBS also applies a rule for the preventive accumulation of funding of a dynamic nature in order that the financial system accumulates greater funding during the periods of higher economic growth which can be used later in recessive periods.

Each of the prudential instruments of the SBS are used to guarantee the financial stability and the soundness of individual commercial banks. The characteristis of these instruments are discussed below:

- **Minimum liquidity requirements** (short term liquid assets/liabilities): this tool is used with the purpose of reducing the risks associated with maturity mismatches between financial assets and liabilities. Because this risk could also be higher in a context of financial dollarization due to currency mismatches, the rate of minimum liquidity in DC is 8 percent and rate of minimum liquidity in FC is 20 percent.

- **Minimum capital requirements** (effective risk-weighted equity/assets): this instrument is aimed at maintaining appropriate capital reserves or effective equity in banks as a back-up against credit, market and operational risks derived from financial operations. The rate of minimum capital requirements since July 2010 is 9.8 percent and would rise to 10 percent in July 2011 –higher than the ratio required by Basel II regulations (8 percent).

- **Limits to the overall position in FC**: the aim of this measure is to limit banks' equity exposure to the exchange rate risk. In November 2010, the SBS lowered the limit to banks' long position to 60 percent of their effective equity –close to the financial system's dollarization ratio– and maintained the limit of banks' short position at 15 percent.

- **Dynamic funding for credit risk**: this instrument is designed to accumulate funding for credit risk during the expansion stages of the economic cycle and is automatically deactivated during the contraction stages of the economic cycle. The funds accumulated through this mechanism are used to cover higher specific funding requirements during periods of increased delinquency. Dynamic funding varies according to the types of credit: 0.45 percent for commercial loans, 0.5 percent for loans to micro enterprises, 0.4 percent for mortgages, and 1 percent for consumer loans.

- **Funding for credit risks associated with exchange rate mismatches**: Up to 1 percent of the direct loans in FC for the financial entities that in the opinion of the SBS do not adequately assess the credit risk associated with exchange rate mismatches.

In line with current international regulation standards, the SBS has recently pre-published two new regulations aimed at reducing systemic risks for their evaluation. The first regulation establishes a limit to the absolute value of banks' net position in financial derivatives, and the second is the new regulation on additional effective equity requirements according to the economic cycle, as well as according to risks of individual, sector, and market concentration.

Moreover, the possibility of incorporating new macro prudential regulations to the series of instruments used to reduce the potential appearance of systemic risks is currently being discussed as part of the proposed reforms that would be adopted in the international financial system. Although many of these instruments are currently used with banking regulation purposes, it has been proposed that they are also used to reduce the volatility in the economic cycle and particularly the procyclical nature of credit and the prices of financial assets.

BOX 6
INDICATORS ON THE REAL ESTATE MARKET[14]

This article analyzes three indicators of the supply of apartments in Metropolitan Lima elaborated on the basis of data collected directly by the BCRP to discuss the evolution of the real estate market in this city.

1. **Price to earnings ratio (PER):** Equivalent to the price/earnings ratio of stocks, this ratio expresses the number of years a property would have to be rented to recover its sale value.

14 For additional detailed information, refer to Nota de Estudios Nº 55, BCRP.

The information used for this indicator was the sale and rent prices of properties in terms of US$/square meter in the districts of Jesús María, La Molina, Lince, Magdalena, Miraflores, Pueblo Libre, San Borja, San Isidro, San Miguel, and Surco. The median of sale prices and the median of rent prices for the periods of May-June, July-August, and September-October was calculated for each district. Aggregate indicators for Metropolitan Lima were obtained from the average prices for each period calculated on the basis of the ratios of each district.

The ratios of each district and the average aggregate indicator are detailed below in Table N°1.

HOUSE PRICE / ANNUAL RENT IN US$ PER M^2)

MEDIANS 1/	May-June	July-August	September-October
Jesús María	11.8	10.6	10.8
La Molina	13.0	13.1	13.7
Lince	15.9	14.7	15.4
Magdalena	10.6	10.7	11.3
Miraflores	10.9	11.8	13.2
Pueblo Libre	14.5	14.6	13.2
San Borja	15.8	16.7	15.4
San Isidro	14.4	13.1	14.6
San Miguel	13.6	14.2	13.8
Surco	12.8	12.4	12.8
Accumulated			
Average	13.3	13.2	13.4

* 1/ The ratios have been calculated using the sale price median and rent of each district.
Source: BCRP Real State sector, October 2010.

According to the classification of Global Property Guide[15] included in the following table, apartment prices are in the 12.5 – 25 interval, which is considered to be a normal price level.

CRITERIA OF VALUATION FOR THE REAL STATE MARKET

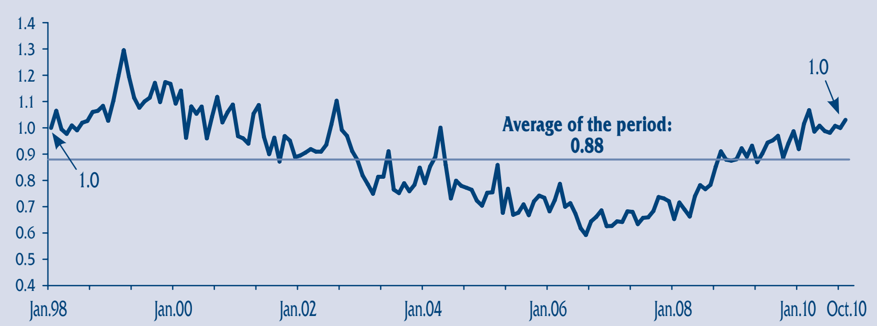
Ratio Price/Income from rent	Profit from rents (%) 1/	Clasification
5.0 - 12.5	20.0 - 8.0	Undervalued price
12.5 -25.0	8.0 - 4.0	Normal price
25.0 - 50.0	4.0 - 2.0	Overvalued price

1/ Defined as the annual rent divide by the sale price. Is the reverse from PER.
Source: Global Property Guide.

15 Property Recommendations is an annual report published by Global Property Guide analyzing which parts of the world are more attractive for property investments. See www.globalpropertyguide.com

2. **Sale price index / Construction cost index**: this ratio is an indicator on the joint evolution of these two variables. The indicator was constructed using INEI's Indices of Construction Materials and Labor Costs (Índice de Materiales de Construcción and Costo Unificado de Mano de Obra) and the monthly medians of the sale prices in nuevos soles/square meter of apartments located in the districts of La Molina, Miraflores, San Borja, San Isidro, and Surco.

INDEX OF RATIO SALE PRICE / COST OF CONSTRUCTION IN NUEVOS SOLES BY M²
(La Molina, Miraflores, San Borja, San Isidro, and Surco)



Source: BCRP Real State sector, October 2010.

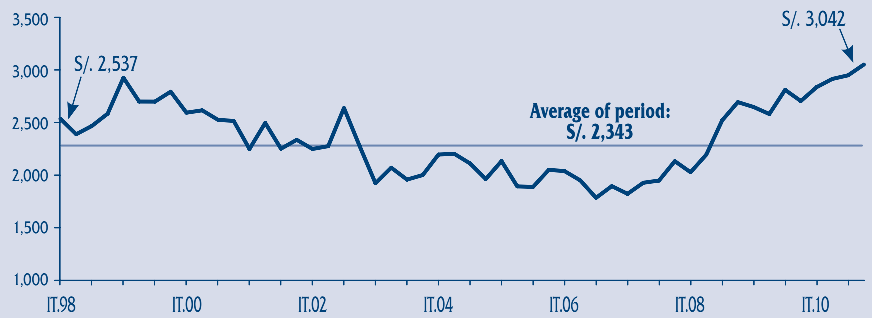
The ratio declined since the beginning of the perio until August 2006 because the prices in nuevos soles/square meter remained stable, while construction costs showed an upward trend. Since then, the ratio has been rising due to higher sale prices, recording a higher level than the average level in the period.

3. **Quarterly index of sale prices in constant nuevos soles and current dollars per square meter:** this indicator, which includes apartments for sale in the districts of La Molina, Miraflores, San Isidro, San Borja and Surco, was calculated using the medians of sale prices in constant nuevos soles as of 2009 and in US dollars.

The quarterly prices of apartments expressed in constant nuevos soles as of 2009 have been recovering since Q3-2006, when they reached their lowest level since 1998.

Apartment prices in these districts have accumulated a growth rate of 19.5 percent between Q1-1998 and Q4-2010. These prices showed a downward trend until mid-2006, recovering thereafter and recording higher prices than the ones observed at the beginning of the period only since Q4-2008.

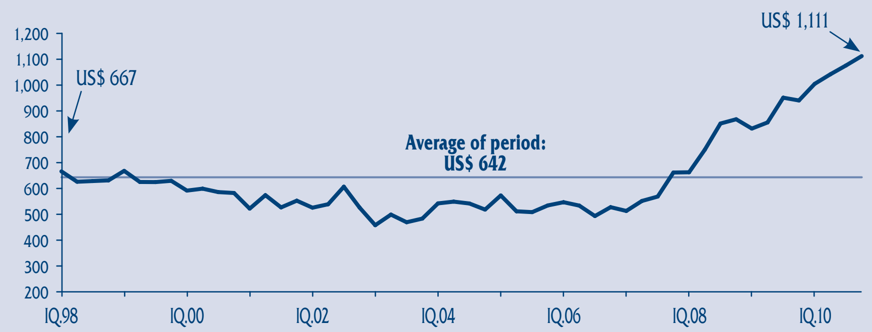
MEDIANS OF QUARTERLY SALE PRICES IN CONSTANT SOLES OF 2009 BY M² OF APARTMENTS
(La Molina, Miraflores, San Borja, San Isidro and Surco)



Source: Sector Inmobiliario BCRP. October of 2010.

The sale prices of apartments in terms of US$/square meter accumulated an increase of 66.7 percent in the same period. In contrast with the prices in constant nuevos soles, the prices in dollars remained stable until Q3-2006, increasing thereafter like the prices expressed in constant nuevos soles.

MEDIANS OF QUARTERLY PRICES IN CURRENT US DOLLARS BY M² OF APARTMENTS HIGHER SECTOR
(La Molina. Miraflores. San Borja. San Isidro and Surco)

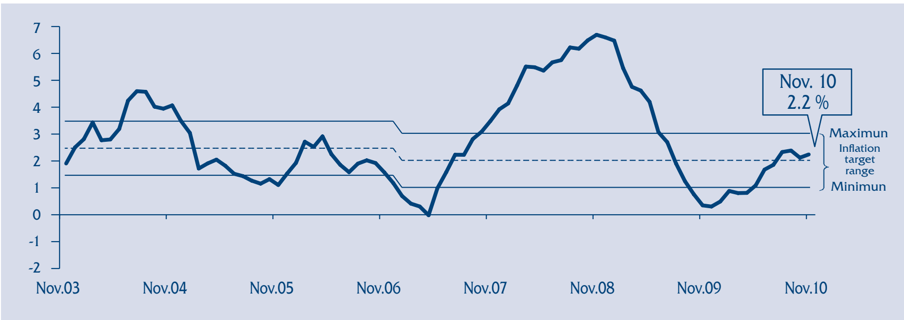


Source: BCRP Real State sector, October 2010.

VI. Inflación

87. The rate of inflation in the last 12 months in November 2010 was 2.2 percent, slightly higher than the inflation target (2.0 percent). Although inflation maintained un upward trend between October 2009 and September 2010, associated mainly with supply factors (higher prices of some food products and fuels), inflation in the last months has been recording lower levels than the peak observed in September (2.4 percent) due to the reversal of food supply shocks.

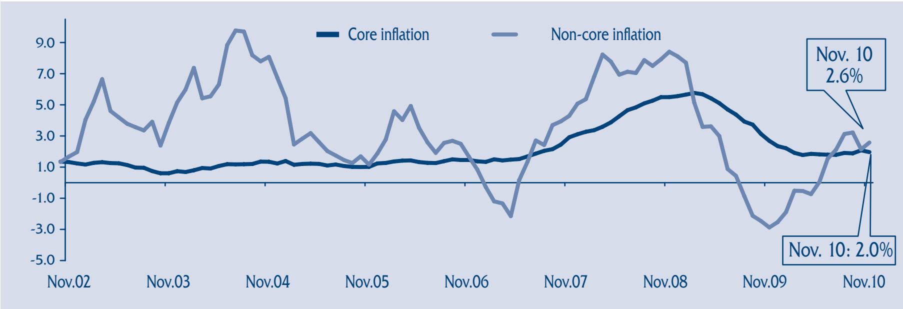
Graph 79
INFLATION AND INFLATION TARGET
(12-month % change)



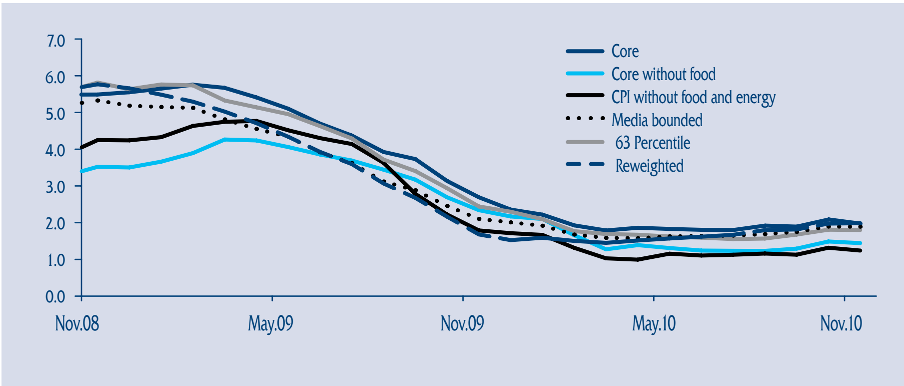
88. The core component of inflation, known as core inflation, is an indicator obtained by isolating from the consumer basket the prices affected mainly by supply factors. Because of its nature, this indicator tends to be less volatile than total CPI. Movements in the prices of this group of goods reflect mainly inflationary pressures on the side of demand. In November core inflation recorded a rate of 2.0 percent (after having registered 2.1 percent in the previous month). Core inflation has shown a relatively stable conduct since the beginning of the year, with rates between 1.9 and 2.1 percent, which reflects stable inflation expectations in line with the inflation target.

A similar result is obtained when we observe other indicators of core inflation based on different groups of goods or calculated using different statistical criteria. These indicators show a relatively stable conduct of core inflation so far this year with a growth range of between 1.2 and 2.0 percent at November.

Graph 80
CORE INFLATION AND NON -CORE INFLATION
(12-month % change)



Graph 81
MEASUREMENTS OF CORE INFLATION
(Last 12-month change)



89. Inflation showed lower rates between September and November due to the decline registered in food prices (especially chicken meat, due to higher supply) and to the higher seasonal supply of the main farming products (potatoes and onions, among others).

Graph 82
CONTRIBUTIONS TO THE CHANGE OF MONTHLY CPI
(% points)

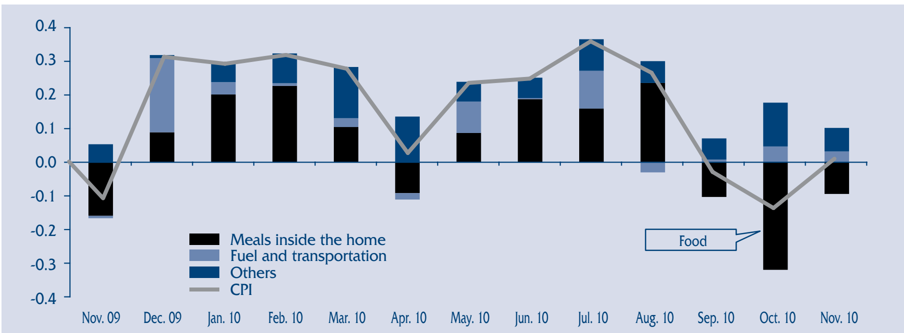


Table 34
INFLATION
(% change)

	Weight 2009 = 100	2006	2007	2008	2009	2010 Jan.-Nov.	2010 12 month
I. INFLATION	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**1.89**	**2.22**
II. CORE INFLATION	**65.2**	**1.37**	**3.11**	**5.56**	**2.35**	**1.89**	**1.96**
Goods	32.9	0.97	3.30	5.32	2.17	1.31	1.37
Services	32.2	1.85	2.88	5.86	2.56	2.48	2.57
III. NON-CORE INFLATION	**34.8**	**0.83**	**5.07**	**8.11**	**-2.54**	**1.90**	**2.58**
Food	14.8	2.06	7.25	10.97	-1.41	2.30	2.69
Fuel	2.8	-1.50	6.45	-0.04	-12.66	11.92	14.51
Transportation	8.9	1.12	0.82	5.86	0.19	-0.18	1.15
Utilities	8.4	-3.22	0.24	7.48	-4.56	0.02	-0.87
Memo:							
CPI without food and beverages, and energy	56.4	1.28	1.49	4.25	1.71	0.91	1.23

Table 35
CONSUMER PRICE INDEX
(Weighted contribution to inflation)

	Weight 2009 = 100	2006	2007	2008	2009	2010 Jan.-Nov.	2010 12 month
I. CORE INFLATION	**65.2**	**0.79**	**1.80**	**3.20**	**1.34**	**1.23**	**1.27**
Goods	32.9	0.31	1.05	1.69	0.68	0.43	0.45
Services	32.2	0.48	0.75	1.52	0.66	0.80	0.83
II. NON-CORE INFLATION	**34.8**	**0.35**	**2.13**	**3.44**	**-1.09**	**0.66**	**0.94**
Food	14.8	0.48	1.69	2.63	-0.35	0.34	0.43
Fuel	2.8	-0.09	0.36	0.00	-0.68	0.34	0.44
Transportation	8.9	0.10	0.07	0.51	0.03	-0.02	0.10
Utilities	8.4	-0.14	0.01	0.30	-0.09	0.00	-0.03
III. INFLACIÓN	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**1.89**	**2.22**
Memo:							
CPI without food and beverages, and energy	56.4	0.58	0.67	1.88	0.74	0.51	0.65

90. Between January and November, the items that contributed most to the rise of inflation were meals outside the home, education (fees and tuition), gasoline, fish, and sugar. On the other hand, the items that contributed most to the decline of inflation were poultry, telephone rates, domestic transportation, corn, leisure and culture.

Table 36
WEIGHTED CONTRIBUTION TO INFLATION: JANUARY - NOVEMBER 2010
(% points)

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Meals outside the home	11.7	3.6	0.42	Poultry	3.0	-11.6	-0.36
Education (fees and tuition)	8.8	3.5	0.31	Telephone rates	2.9	-3.6	-0.10
Gasoline and oil	1.3	16.3	0.22	National transportation	0.3	-15.4	-0.06
Fresh and frozen fish	0.7	24.1	0.18	Corn	0.1	-15.8	-0.02
Sugar	0.5	20.1	0.13	Recreation and cultural items	0.9	-2.6	-0.02
Potatoes	0.9	15.3	0.12	Cleaning items	0.9	-2.4	-0.02
Gas	1.4	8.3	0.12	Tomato	0.2	-10.5	-0.02
Water consumption	1.6	4.5	0.07	Fresh vegetables	0.2	-7.4	-0.02
Other vegetables	0.4	17.0	0.06	Vehicles purchase	1.6	-1.0	-0.02
Sodas	1.3	4.8	0.06	Edible oils	0.5	-3.1	-0.02
Total			**1.69**	**Total**			**-0.66**

The rise in the price of fuels (16.3 percent so far this year) was associated with the rise in the international price of crude and with the lower resources allocated to the Fuel Price Stabilization Fund. It is worth mentioning that S.D. No 027-2010 established that the price bands of all the products will be updated simultaneously every two months, provided that the international parity price is above the upper band level or below the lower band level. The updating of the band of each product will imply a variation not higher than 5 percent in the final price, except in the case of PLG which will have a maximum variation of 1.5 percent in its final price. The WTI contract price has increased from an average of US$ 74.5 per barrel in December 2009 to US$ 84.21 in November 2010.

The rise in the price of sugar (20 percent year to date) reflected mainly the evolution of the international price of this product, whose contract price increased from an average of US$ 557.4 per ton on December 11, 2009 to US$ 780.2 per ton in November (40 percent). The domestic price was also influenced by other factors associated with production interruptions due to labor conflicts and technical stoppages.

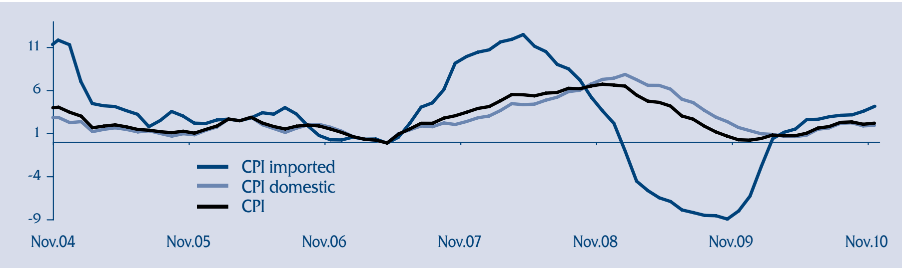
Imported inflation

91. The imported component of the consumer basket registered a variation of 3.48 percent associated mainly with the impact of the rise in the international price of crude (13.2 percent in November 2010 compared with December 2009). The nominal exchange rate appreciated 2.5 percent in this period.

Table 37
DOMESTIC AND IMPORTED INFLATION: 2006 - 2010
(Accumulated % change)

	Weight 2009 = 100	2006	2007	2008	2009	2010 Jan.-Nov.	2010 12 months
I. IMPORTED CPI	**10.8**	**0.27**	**10.46**	**2.20**	**-6.25**	**3.48**	**4.18**
Food	3.0	2.08	18.83	4.75	-3.07	0.42	0.25
Fuels	2.8	-1.50	6.45	-0.04	-12.66	11.92	14.51
Electric appliances	1.3	-1.29	-1.50	-0.06	-2.39	-0.49	-0.58
Others	3.7	0.64	0.47	0.46	-0.34	0.79	-0.03
II. DOMESTIC CPI	**89.2**	**1.28**	**2.84**	**7.44**	**1.35**	**1.71**	**1.97**
III. CPI	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**1.89**	**2.22**
Exchange rate		**-6.40**	**-7.00**	**4.47**	**-7.59**	**-2.51**	**-2.75**

Graph 83
DOMESTIC AND IMPORTED INFLATION
(12-month % change)



Inflation expectations

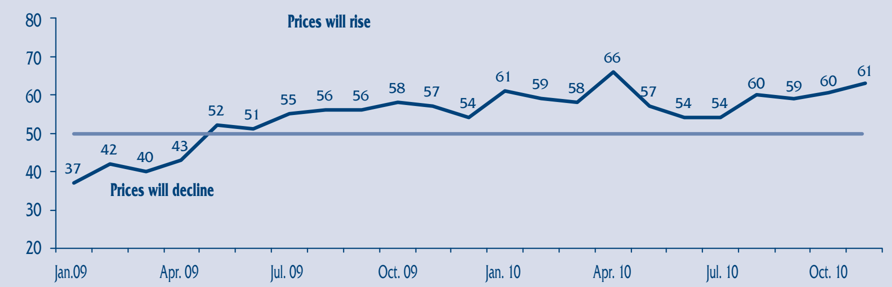
92. Economic agents' expectations of inflation in 2010 have declined compared with the expected rate of inflation described in our Inflation Report of September. In general the surveyed groups expect inflation to fall within the target range (between 2.0 and 3.0 percent) in 2011 and 2012.

Table 38
SURVEY ON MACROECONOMIC EXPECTATIONS
INFLATION (%)

	August 2010	November 2010
FINANCIAL ENTITIES		
2010	2.7	2.4
2011	2.5	2.5
2012	2.5	2.5
ECONOMIC ANALYSTS		
2010	2.9	2.5
2011	2.4	2.5
2012	2.0	2.5
NON-FINANCIAL FIRMS		
2010	2.5	2.5
2011	2.5	2.5
2012	2.5	2.5

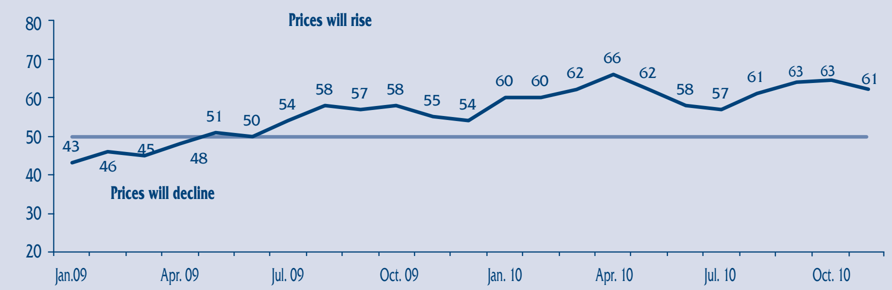
The survey results on the average prices of inputs and sale prices expected in the following 3-4 months shows no change in the percentage of firms expecting a rise in the prices of the inputs they use or in their sale prices in the following months.

Graph 84
INDEX OF EXPECTED AVERAGE PRICES OF INPUTS IN THE NEXT 3-4 MONTHS
Manufacturing sector



Source: BCRP Survey on Macroeconomic Expectations, November 2010.

Graph 85
EXPECTED AVERAGE SALE PRICES IN THE NEXT 3-4 MONTHS
Manufacturing sector



Source: BCRP Survey on Macroeconomic Expectations, November 2010.

Inflation forecasts

93. The evolution of inflation since our last Inflation Report was published in September 2010 has been in line with the forecasts included in that report. Inflation has remained within the target range since May of this year, recording a rate of 2.2 percent in November. Moreover, the revision and updating of data on the main factors that could affect the rate of inflation in the next years has generated minor changes in the central forecast scenario relative to the one considered in our last Report.

94. This scenario considers that the output gap would have closed in 2010, moving from levels of between -2.5 and -1.5 percent early this year to slightly positive values at the beginning of the baseline scenario consided in this report. This dynamic is explained by the expansionary effects of the growth of terms of trade on aggregate demand, the fiscal impulse observed during the first semester of 2010, and the monetary stimulus implemented since 2009.

    The evolution of the output gap also reflects the recovery of economic growth after the slowdown experienced in 2009, as well as the absence of signals of inflationary pressures. Thus, the profile of the output gap is consistent with the rate of core inflation observed, which has remained close to the middle of the target range throughout 2010.

95. The output gap in 2011 and 2012 would remain around zero –its equilibrium value– and would not generate upward pressures on inflation as a result of the disappearance of the impulse of terms of trade, as well as a result of a negative fiscal impulse. Moreover, like in 2010, moderate growth rates in our trading partners during the forecast horizon would not contribute to accelerate the pace of growth in the domestic economy.

    The baseline forecast scenario also considers a gradual withdrawal of monetary stimulus in response to the balanced evolution of the output gap and inflation, which indicates a lower need for significant monetary stimulus.

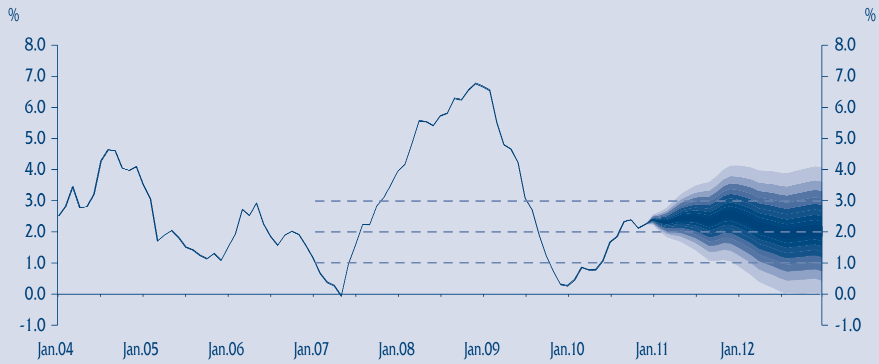
96. Core inflation is forecast to be close to 2.0 percent in 2011 and 2012, which is consistent with inflation expectations that remain anchored within the target range and with the dynamic observed in terms of the output gap.

    Moreover, the rate of non core inflation would be close to 3.0 percent in 2011, reflecting the impact of the rises observed in the prices of commodities in recent months. This forecast considers the effects that some climate alterations could have on the yields of some farming products. Non core inflation would fall around the inflation target in 2012 after the normalization of the conditions of global food supply in that year.

    Inflation would remain in the target range in the next two years, although it would fall closer to the upper band of the inflation target in 2011 due to the transitory effect of price rises in some commodities as a result of supply shocks.

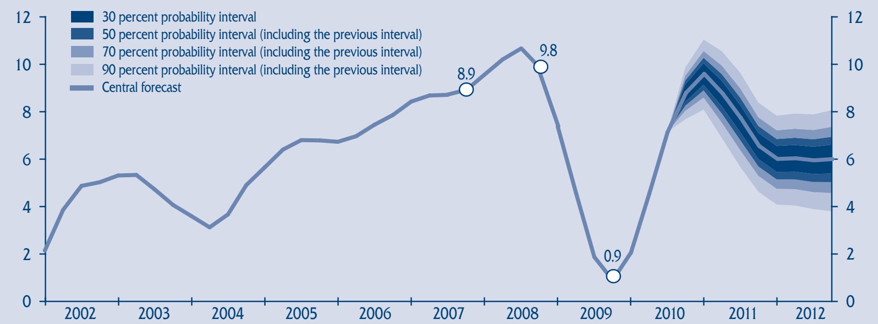
97. The forecast on GDP growth in 2010 has been revised upwards to 8.8 percent. In 2011 and 2012 GDP would grow around 6.5 and 6.0 percent, respectively –rates close to the potential growth of the economy–, which would contribute to maintain inflation within the target range in these years.

Graph 86
INFLATION FORECAST
(12-month % change)



Note: The graph shows the inflation forecast bands over the forecast horizon. The darkest band around the central forecast has a 10 percent probability of occurrence, while all the bands together have a 90 percent probability of occurrence.

Graph 87
FORECAST GDP GROWTH
(Annual % change of GDP in each quarter)



Memo: The graph shows the inflation forecast bands over the forecast horizon. The darkest band around the central forecast has a 30 percent probability of occurrence, while all the bands together have a 90 percent probability of occurrence.

Table 39
INFLATION REPORT FORECAST SUMMARY

	2008	2009	2010 1/		2011 1/		2012 1/	
			IR Sep. 10	IR Dec.10	IR Sep.10	IR Dec.10	IR Sep.10	IR Dec.10
Real % change								
1. GDP	9.8	0.9	8.0	8.8	6.0	6.5	6.0	6.0
2. Domestic demand	12.1	-2.9	11.4	12.6	6.9	7.6	6.0	6.1
a. Private consumption	8.7	2.4	5.2	5.9	4.5	5.0	4.6	4.6
b. Public consumption	2.1	16.5	9.9	9.5	4.4	5.0	3.6	2.7
c. Private fixed investment	25.8	-15.1	16.7	22.4	11.1	14.5	11.8	12.3
d. Public investment	42.8	25.5	31.6	25.6	6.3	8.8	3.4	4.4
3. Exports (goods and services)	8.8	-2.5	1.4	2.3	5.2	5.2	8.4	8.4
4. Imports (goods and services)	19.8	-18.4	19.4	22.3	10.1	10.6	8.0	8.0
5. Main trade partners' economic growth	2.6	-1.1	3.7	4.1	3.3	3.2	3.2	3.2
Memo:								
Output gap 2/ (%)	4.3	-1.6	-0.5 ; +0.5	-0.5 ; +0.5	0.0 ; +1.0	0.0 ; +1.0	-0.5 ; +0.5	-0.5 ; +0.5
% change								
6. Forecast inflation	6.7	0.2	2.5-3.0	2.5-3.0	1.5-2.5	1.5-2.5	1.5-2.5	1.5-2.5
7. Average price of crude oil	37.8	-38.1	23.6	27.4	-1.6	8.9	0.0	0.0
8. Nominal exchange rate 3/	4.5	-7.6	-3.3	-3.1	1.0	-0.6	0.1	0.0
9. Real multilateral exchange rate 3/	-4.8	0.9	-3.0	-4.0	1.6	-1.6	0.9	0.3
10. Terms of trade	-13.8	-5.5	13.8	17.2	-3.6	-0.7	-1.6	-1.2
a. Export price index	4.9	-12.5	24.4	28.4	-0.4	3.5	0.6	0.4
b. Import price index	21.7	-7.4	9.4	9.6	3.3	4.2	2.2	1.7
Nominal % change								
11. Currency in circulation	16.7	11.0	25.0	26.8	19.0	20.0	18.5	18.0
12. Credit to the private sector 4/	30.3	8.5	19.0	20.0	14.0	15.0	14.0	14.5
% of GDP								
13. Domestic investment rate	25.7	23.6	24.9	25.3	26.8	27.0	27.8	28.1
14. Current account of the balance of payments	-3.7	0.2	-1.7	-1.8	-3.0	-3.1	-3.0	-3.2
15. Trade balance	2.4	4.6	3.3	4.0	1.7	2.9	1.2	2.5
16. Gross external financing to the private sector 5/	7.5	4.8	6.0	8.1	5.4	6.0	5.7	5.9
17. Current revenue of the general government	20.9	18.6	19.7	19.8	20.0	20.1	20.1	20.2
18. Non-financial expenditure of the general government	17.3	19.6	19.9	19.5	19.8	18.9	19.3	18.5
19. Overall balance of the non-financial public sector	2.1	-1.9	-1.5	-0.9	-1.0	0.0	-0.4	0.5
20. Total public debt	24.0	26.6	22.7	22.7	21.5	21.4	20.0	19.8

IR: Inflation Report.
1/ Forecast.
2/ Differential between GDP and potential GDP (percentage).
3/ Survey of exchange rate expectations to economic agents.
4/ Includes loans made by banks branches abroad.
5/ Includes foreign direct investment or and private sector's long term disbursements.

VII. Balance of Risks

98. The inflation forecast shows a neutral balance of risks, which means that there is the same probability that the rate of inflation will be above or below the baseline scenario forecast.

99. Three sources of risk that could affect inflation in the forecast horizon were considered in our Inflation Report of September. Even though only part of these risks have materialized in recent months, they are still perceived as factors that could cause inflation to deviate from the trend considered in the central forecast scenario. The main risks would include the following:

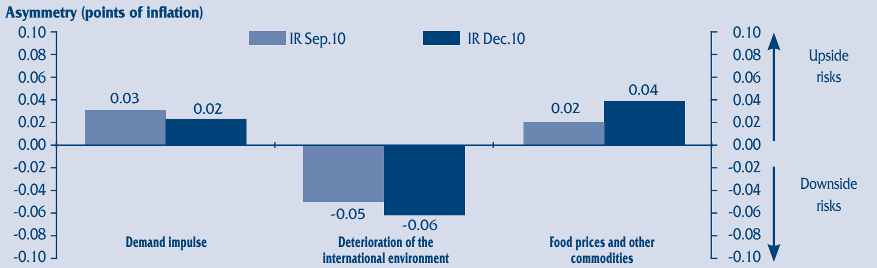
- **Increased growth of aggregate demand**. Higher optimism, reflected in recent data of indicators of economic activity, and the high rates of GDP growth recorded during the first three quarters of 2010 could result in a higher output gap than the one considered in the central scenario. This would generate demand pressures on domestic prices, in which case monetary stimulus would be reduced more rapidly. This expansionary scenario could be magnified if decisions of increasing monetary stimulus in advanced economies generated a significant increase in short term capital inflows. In this case, the combination of macroprudential measures implemented by the BCRP and SBS, coupled by a tighter fiscal stance, would allow compensating the impact of these flows on domestic credit.

- **Uncertainty about the evolution of the global economy.** The baseline scenario considers a recovery of global economic activity that would contribute to maintain terms of trade in levels favorable to the Peruvian economy. However, there is a contingent scenario of stagnation of the demand of our trading partners and lower prices for our exports, which would imply a slowdown in the domestic economy.

  The Central Bank maintains a high level of international reserves and can use several liquidity injection mechanisms to face this contingency. Thus, should this risk materialize, monetary policy would maintain monetary stimulus for a longer period of time

- **Rise in the prices of imported food products.** The recent evolution of the prices of food commodities, such as wheat, maize, soybean oil, and sugar, shows that the probability of having higher prices in the future has increased. There is also uncertainty about domestic climatic conditions that typically affect food prices. In this scenario, the Central Bank would withdraw monetary stimulus more rapidly if higher imported inflation affected inflation expectations.

Graph 88
INFLATION FORECAST: BALANCE OF RISKS
(2 year-ahead inflation deviations in % points)



Memo: This graph shows changes in risk perception compared with the prior Inflation Report (September 2010). The size and sign of bars show the asymmetry of each risk factor in the distribution of the inflation forecast. Adding all the effects results in a neutral balance of risks.

CONCLUSION

100. Inflation is expected to remain within the target range in the forecast horizon. This forecast is based on the projection of an output gap in equilibrium, inflation expectations that remain anchored to the target range, a gradual reversal of monetary stimulus, a moderation of fiscal stimulus, and the reversal of the supply shocks that affected the prices of imported products in 2010.