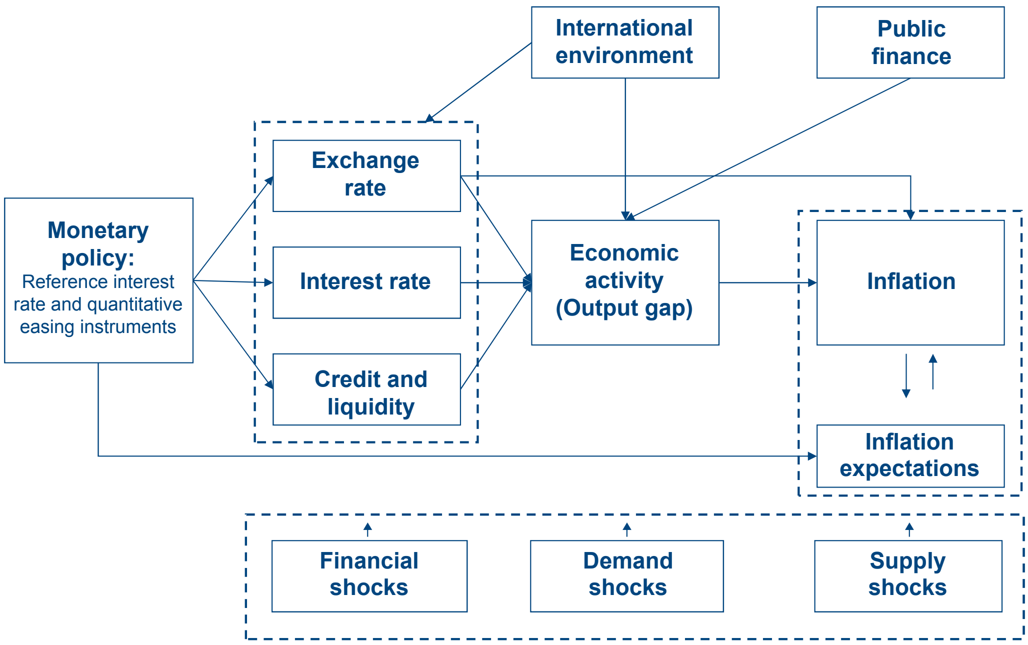
INFLATION REPORT:

Recent trends and macroeconomic forecasts 2011-2013

December 2011



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INFLATION REPORT
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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 2011, and data on monetary accounts, inflation, financial markets and exchange rate as of November 2011.

Foreword

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

- In order to consolidate this goal, monetary policy is implemented in the frame of an inflation targeting regime, 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 observed in developed countries and reflects the BCRP's permanent commitment with monetary stability.

- The nature of monetary policy is preventive and therefore is aimed at anticipating inflationary or deflationary pressures, taking into account that inflation may be influenced by factors beyond the control of the Central Bank, such as supply shocks or the prices of imported products, which may result in transitory deviations of inflation from the target. The Central Bank considers the annual increase in the consumer price index recorded in each month and not only at year's end.

- 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 monetary operational target, affects the rate of inflation through several channels in different timeframes and, therefore, is determined on the basis of macroeconomic forecasts and simulations.

- Additionally, the Central Bank implements preventive measures to preserve financial stability and monetary policy transmission mechanisms. Through interventions in the foreign exchange market, the Central Bank reduces excessive volatility in the exchange rate and accumulates international reserves, thus developing strengths to face negative events in an economy with still a high level of financial dollarization. The Central Bank also uses other monetary policy tools that affect the volume of liquidity and credit in a more direct manner, such as reserve requirements in domestic currency and in foreign currency.

- The forecasts on which monetary policy decisions are based are disseminated through the Inflation Report to show the consistency of the decisions adopted with the aim 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 2012.

Summary

i. The international scenario of economic slowdown, evidenced especially in Europe, and the risks of a generalized fiscal crisis in this area are the main factors that explain why the BCRP has maintained its reference rate at 4.25 percent since June of this year. This preventive pause in the current monetary policy stance of the Central Bank is consistent with inflation's convergence to the inflation target in 2012.

Since risks of a further global economic slowdown and a decline in commodity prices are still observed, the BCRP will continue to oversee the implications of the evolution of inflation and its determinants to adopt any measure on a timely basis as required.

ii. After recording an extraordinary growth rate of 8.8 percent in 2010, Peru's GDP has been declining from quarter to quarter in 2011. This slow down is associated with a more moderate pace of growth of domestic demand mainly as a result of the evolution of public expenditure and, to a lesser extent, of private investment.

However, given that the slowdown in Q3 was not as strong as expected due to the high growth of private consumption and the recovery of exports, the forecast on GDP growth for 2011 has been revised upwards from 6.3 percent in our last Report to 6.8 percent. On the other hand, considering the evolution of the international environment, the forecast on GDP growth in 2012 has been revised downwards from 5.7 to 5.5 percent, while the GDP growth forecast for 2013 remains unchanged at 6.3 percent.

iii. As a result of the recent developments of the Eurozone public debt crisis and the associated tightening of credit and liquidity conditions in Europe, the central forecast scenario considers a lower growth in the world economy in the next years and especially in 2012. The forecast also considers moderate growth rates in the other developed economies where the recovery of consumption would be constrained by deleveraging and high unemployment levels.

Growth in the emerging economies would also be affected by the trade channel –exports to developed countries– and by credit constraints in Europe affecting external bank credit, particularly in those financial systems with less liquidity and greater short term funding. Nonetheless, the economic slowdown in the emerging economies would not be as strong as in the developed economies.

iv. Between January and September 2011, the non financial public sector (NFPS) accumulated an economic surplus equivalent to 4.1 percent of GDP. This surplus, which is 2.8 percentage points higher than the one recorded in the same period in 2010, resulted, on the one hand, from the increase observed in the current revenues of the general government and, on the other hand, from the reduction of non financial expenditure, particularly capital expenditure, due mainly to the difficulties faced by subnational governments in their execution of spending.

    Given the execution of fiscal accounts, the surplus forecast for 2011 in the NFPS has been revised upwards from 1.0 percent of GDP (previous report) to 2.1 percent of GDP. In 2012 and 2013 the NFPS would show a surplus of 1.0 percent and 1.5 percent of GDP, respectively, reflecting a more moderate growth of the revenues of the general government relative to 2011 as well as higher spending in GDP terms, especially in 2012.

v. In 2011 the deficit in the current account would be equivalent to 1.5 percent of GDP, that is, lower than forecast in our Report of September (2.8 percent). This revision reflects the better-than-expected results obtained in Q3 as a result of better terms of trade and of a lower factor income.

    The forecast on the current account deficit for the next years has also been revised downwards from 2.6 to 2.2 percent of GDP in 2012 and from 2.3 to 2.1 percent of GDP in 2013 as a result of the lower growth anticipated and its impact on the demand for imports and also of a lower income factor associated with lower export prices.

vi. Between December 2010 and November 2011, annual inflation rose from 2.08 to 4.64 percent, above the target range. The acceleration of inflation is explained mainly by the impact of rises in commodity prices since late 2010 on domestic prices, as well as by the effect of domestic weather conditions on the supply of some perishable food products, especially between the months of August and November.

    Inflation is expected to converge gradually towards the target range by mid-2012, provided that the cost pressures generated by significant increases in commodity prices subside. As in our previous Inflation Report, this scenario is consistent with an evolution of economic activity without demand inflationary pressures in the forecast horizon.

vii. The main risks that could divert the inflation rate from the baseline scenario in the forecast horizon include the following:

a. **Uncertainty about the evolution of global economic activity:** Even though the baseline scenario considers a lower growth rate in global economic activity than the one considered in our Inflation Report of September due to uncertainty in international markets as a result of sovereign debt problems and fiscal constraints in Eurozone countries, this rate of growth could be lower. In such a case, this context would contribute to weaken external demand and affect the domestic economy through the financial and trade channels. A part of these effects (e.g. a decline in the terms of trade) have been observed since our last Report was published in September and have therefore been included in the baseline scenario.

   This scenario depicts an event similar in essence to the one that took place in the late months of 2008 when a strong drop in global economic activity, a decline in terms of trade, and capital outflows from emerging countries were observed. Increasing uncertainty may generate panic among investors and lead to a sudden stop –a sudden reversal in capital flows–, which may cause an abrupt depreciation in the exchange rate and increase the country risk indicator.

   Lower growth in global financial markets would lead to a global recession, which would reflect in lower growth in the economies of our trade partners and in lower external inflation. At the same time, the decline in terms of trade as a result of the drop of commodity prices would generate a greater weakening of domestic growth. In this context, international interest rates are expected to remain low for a longer period of time than the one considered in the baseline scenario.

   Should these risks materialize, the Central Bank would use its high level of international reserves and its various liquidity injection mechanisms to provide the financial system with liquidity in both domestic currency and foreign currency to minimize in this way the impact of this shock on domestic financial conditions and, if necessary, would ease monetary conditions.

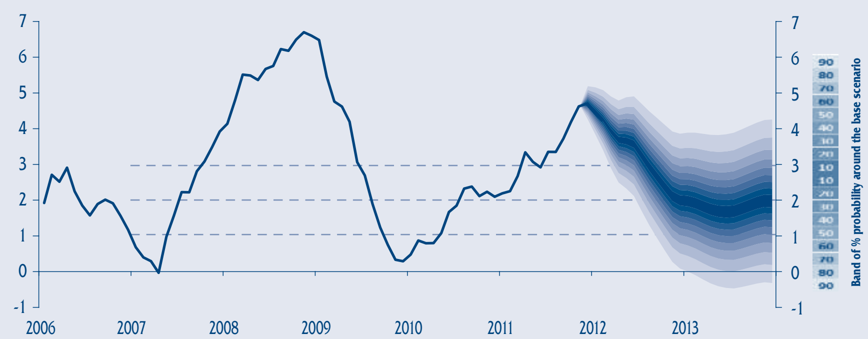
b. **Evolution of domestic demand.** In a scenario of increased uncertainty, there is the risk that domestic agents' expectations –particularly investment expectations– may deteriorate. If expectations about investment are affected, this could generate a lower dynamism in aggregate demand and a pace of growth below potential growth which would generate downward pressures on core inflation. In such a scenario, the Central Bank would increase monetary stimulus seeking to lead inflation to fall within the inflation target range.

c. **Imported inflation or adverse climate conditions:** Although the pace of rises in the prices of food commodities and fuels has stabilized, there is the risk that global inflationary pressures may be more persistent than currently estimated in the baseline scenario. Uncertainty about how policy makers are going to solve current challenges and uncertainty about the economic outlook in the future have a marked effect on the level of global economic activity. A more decisive and credible economic policy in most advanced economies may raise confidence faster than currently expected and generate a greater impulse in the global economy. If the shocks are persistent, they could affect the dynamics of domestic inflation through higher imported costs and lower margins for local firms, which could generate inflationary pressures. Moreover, although the baseline scenario also considers weather conditions that would normalize over the year, there is the risk of having to face adverse climatic conditions, such as a stronger La Niña event that could affect the availability of water. In these scenarios, the Central Bank would adjust its monetary stance only if these events translate into economic agents' expectations of inflation.

d. Higher expected inflation: this scenario considers the possibility that a slower reversal of inflation may exacerbate the risk that households and firms' expectations of inflation may remain persistently above the target, which could reflect on inflation through the higher costs and prices expected by firms. In this case, the Central Bank would adjust its monetary policy stance in order that the expectations of private agents are in line with the inflation target.

In summary, the **balance of these risks shows a downward bias** in the inflation forecast for end 2012.

INFLATION FORECAST: 2011 - 2013
(Last 12 month % change)



Memo: The graph shows the probability of ocurrence of future values of inflation, according to statistical analysis and the subjective perception of the BCRP.

I. International Environment

1. The development of the Eurozone sovereign debt crisis in the last months has generated high volatility in international financial markets and affected consumers and investors' confidence in Europe. Given this context of greater uncertainty, the central forecast scenario considers a lower growth in the world economy in the next years, particularly in 2012. This forecast also considers a moderate growth in other developed economies where the recovery of consumption would be constrained by deleveraging and high unemployment levels. In a context of contained inflationary pressures, this suggests that international interest rates would remain low for a prolonged period of time and increases the probability that non conventional monetary stimuli will be applied.

   Growth in the emerging economies would also be affected by the evolution of developed countries as well as by the persistence of inflationary pressures in the latter. However, the economic slowdown in emerging countries would be lower than in developed countries due to certain stability in commodity prices (given high international liquidity levels and supply constraints) and to the margin that exists for the application of countercyclical policies.

   As in our previous Report, the central forecast scenario continues to be marked by high uncertainty. The forecasts will be revised downwards if the problems of the debt crisis in the Eurozone should deteriorate further affecting agents' confidence and generating a strong credit crunch. The future evolution of the international environment depends to a great extent on how the Eurozone crisis will be dealt with and on how the situation of banks will evolve. Another recent risk factor is the lack of agreement regarding the fiscal measures that should be adopted in the US economy as from 2013, which would cause leaving tax incentives without effect and activating automatic spending cuts that could lead to a disorderly fiscal adjustment.

Global economic activity

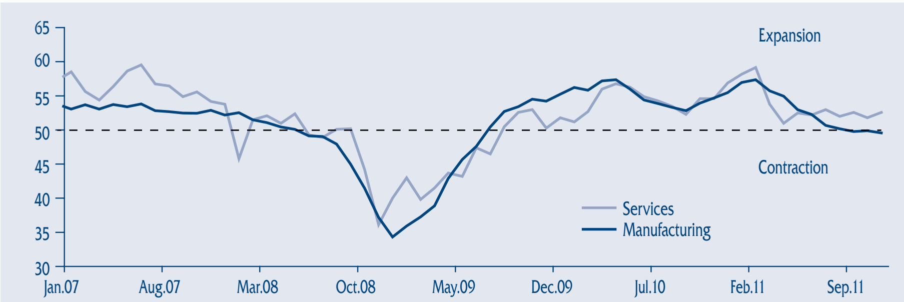
2. External conditions have deteriorated since the publication of our previous report due to the debt crisis in the Eurozone. What was basically a problem focused on small countries of the Eurozone until mid-2011 has extended to countries of significant weight in the global economy, such as Spain, Italy, and France. The generalized increase observed in European sovereign yields in recent months, which in many cases reached record levels, reflects the difficulties of European economies to obtain funds in the market.

Uncertainty about the solution of the crisis remains at the time of publishing this Report and the possibility that the crisis may have an impact on other developed economies like USA, the UK, and even some emerging economies cannot be ruled out.

3. The deterioration of external conditions has reflected, on the one hand, in lower global growth in the last months and, on the other hand, in the downward revision of growth forecasts for 2012 and a slight downward revision of growth forecasts for 2013.

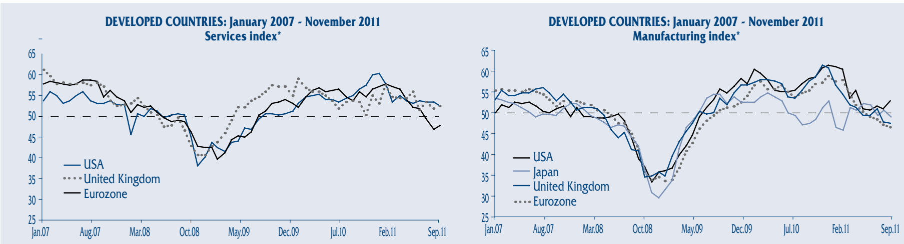
   As regards the lower growth rates being observed over this year, the world economy has experienced a significant and practically generalized slowdown that is reflected, at the sector level, in the deterioration of manufacturing and services indices. The indices of global activity –e.g. the PMI of JPMorgan– confirm this slowdown stemming basically from the evolution of activity in developed economies. After the effects of the earthquake in Japan in the first semester, the risk of a recession in Europe has been affecting the evolution of activity in the second semester. The index of global manufacturing activity reached a level of 50 in October, but the respective indices in the Eurozone and the United Kingdom were below this threshold. On the other hand, the global index of activity in services was slightly higher than 50, except in the Eurozone area.

Graph 1
JP MORGAN GLOBAL PMI MANUFACTURING AND SERVICES
(January 2007- November 2011)



Source: Bloomberg, PMI index elaborared by JP Morgan.

Graph 2



* PMI index.
Source: Bloomberg.

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Source: Bloomberg.

4. The forecasts on global growth for 2012 and 2013 have been revised downwards. It is estimated that the rate of global growth in 2012 would be 3.3 percent and that this rate would rise to 3.8 percent in 2013, in line with the data executed, the deterioration of consumers and investors' confidence, and less favorable international financial conditions. Moreover, the fiscal adjustment measures foreseen to be implemented in the countries with problems would be stronger than estimated in our September Report. The greater downward revisions have been made in the case of developed economies.

Table 1
WORLD GDP GROWTH: 2008 - 2013
(Annual % change)

	2008	2009	2010	2011		2012		2013	
				IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
Developed countries	**0.1**	**-3.7**	**3.1**	**1.6**	**1.6**	**1.9**	**1.3**	**2.2**	**1.9**
1. United States	-0.3	-3.5	3.0	1.5	1.7	2.0	1.8	2.4	2.1
2. Eurozone	0.4	-4.2	1.8	1.5	1.4	0.9	-0.6	1.3	0.9
Germany	1.1	-5.1	3.7	2.8	2.8	1.3	0.1	1.6	1.2
France	-0.1	-2.7	1.5	1.6	1.5	1.1	-0.3	1.4	0.8
3. Japan	-1.2	-6.3	4.0	-0.6	-0.4	2.2	2.0	1.9	1.9
4. United Kingdom	-1.1	-4.4	1.8	1.0	0.9	1.5	0.9	1.9	1.6
5. Canada	0.7	-2.8	3.2	2.3	2.3	2.2	1.9	2.4	2.2
6. Other Developed countries	1.6	-1.2	5.8	3.6	3.4	3.5	3.0	3.8	3.6
Developing countries	**6.0**	**2.8**	**7.3**	**6.0**	**5.8**	**5.8**	**5.5**	**5.9**	**5.8**
1. Sub-Saharan Africa	5.6	2.8	5.4	5.5	4.7	4.6	4.4	5.4	5.4
2. Central and Eastern Europe	3.1	-3.6	4.5	3.8	3.8	3.6	2.8	3.7	3.5
3. Community of Independent Countries	5.3	-6.4	4.6	4.6	4.2	4.3	4.0	4.3	4.1
Russia	5.2	-7.8	4.0	4.3	3.9	4.2	3.8	4.0	3.7
4. Developing Asia	7.7	7.2	9.5	7.8	7.6	7.7	7.4	7.7	7.6
China	9.6	9.2	10.3	8.8	8.8	8.6	8.2	8.6	8.4
India	6.2	6.8	10.1	7.9	7.7	7.7	7.5	7.7	7.7
5. Middle East and Northern Africa	4.6	2.6	4.4	3.8	3.5	3.5	3.4	4.0	4.0
6. Latin America and the Caribbean	4.3	-1.7	6.1	4.2	3.9	3.8	3.5	3.8	3.8
Brazil	5.2	-0.6	7.5	4.2	3.3	3.8	3.4	4.0	4.0
World Economy	**2.8**	**-0.7**	**5.1**	**3.7**	**3.6**	**3.7**	**3.3**	**3.9**	**3.8**
Memo:									
BRICs 1/	7.7	5.4	9.2	7.5	7.3	7.3	6.9	7.3	7.2
Peru's trading partners 2/	2.6	-1.4	4.5	3.2	3.2	3.2	2.7	3.3	3.1

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

Furthermore, the probability of a global recession has increased significantly in this scenario. This means that the contagion of the crisis to larger economies, like France and Italy, could worsen and even spread to other developed economies and generate a significant credit crunch. There is also the risk associated with the adoption of fiscal measures in USA and of a higher-than-expected slowdown in China. In this context, further monetary stimulus in the developed economies cannot be ruled out, which would imply that high international liquidity levels would continue to be observed for an extended period of time.

Graph 3

* Forecast.

5. The **US** economy has shown a better evolution since our previous report was published in September. After the weak growth recorded in the first semester, activity in the United States would have started to recover as reflected in recent encouraging indicators. GDP grew 2 percent in Q3 after having registered an average rate of 0.9 percent in the first semester. Private consumption, the main component of aggregate demand, recorded a growth rate of over 2 percent. The latest data of employment and retail sales indicate a positive evolution in the last quarter of the year: private consumption grew 2 percent in October, weekly requests for jobless aid have dropped to levels unobserved since April, and retail sales in November would have been significant [1].

1 Sales on Black Friday (November 25) grew 6.6 percent.

Graph 4
USA: REAL PERSONAL CONSUMPTION (12 month % change)
AND CONSUMER CONFIDENCE (Index of Univ. Michigan)

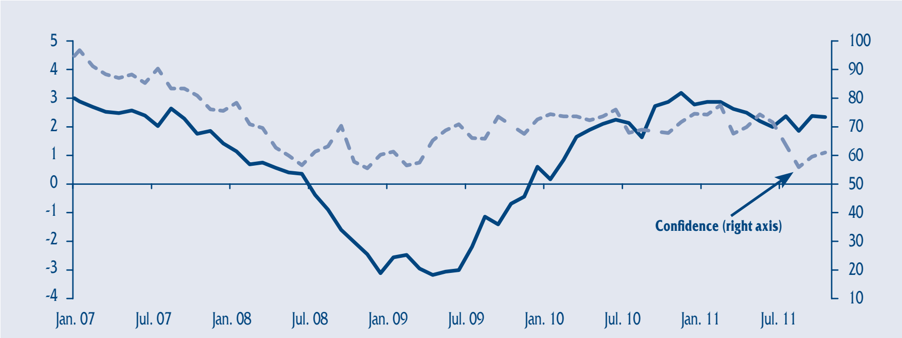


Table 2
USA: SEASONALLY ADJUSTED GDP GROWTH (1Q09 - 3Q11)
Quarterly annualized rates

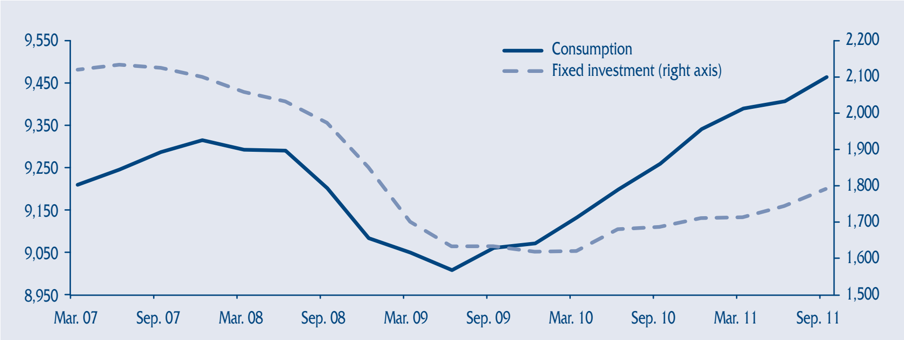
	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11
GDP	**-6.7**	**-0.7**	**1.7**	**3.8**	**3.9**	**3.8**	**2.5**	**2.3**	**0.4**	**1.3**	**2.0**
Personal consumption	-1.5	-1.9	2.3	0.4	2.7	2.9	2.6	3.6	2.1	0.7	2.3
Durable	2.4	-4.0	20.3	-4.8	9.9	7.8	8.8	17.2	11.7	-5.3	5.5
Non Durable	-1.0	-1.5	2.0	3.1	4.8	1.9	3.0	4.3	1.6	0.2	-0.6
Services	-2.3	-1.7	-0.1	0.4	1.0	2.5	1.6	1.3	0.8	1.9	2.9
Gross investment	-46.7	-22.8	2.9	36.8	31.5	26.4	9.2	-7.1	3.8	6.4	-0.9
Fixed investment	-32.2	-17.0	0.7	-3.8	1.2	19.5	2.3	7.5	1.2	9.2	12.3
Non Residential	-31.3	-15.8	-3.3	-3.7	6.0	18.6	11.3	8.7	2.1	10.3	14.8
Residential	-35.4	-21.3	17.8	-3.8	-15.3	22.8	-27.7	2.5	-2.4	4.2	1.6
Exports	-29.0	-0.5	13.9	23.5	7.2	10.0	10.0	7.8	7.9	3.6	4.3
Imports	-34.0	-15.0	16.3	17.4	12.5	21.6	12.3	-2.3	8.3	1.4	0.5
Government expenditure	-1.7	5.9	1.3	-0.9	-1.2	3.7	1.0	-2.8	-5.9	-0.9	-0.1

Source: BEA.

In contrast with consumption, gross private investment –which is 16 percent below the level it registered prior to the crisis– showed a negative evolution due to lower inventories and to the effect of the low prices of houses and negative financial conditions for the mortgages segment on residential investment. It should be pointed out that non residential investment, associated with equipment and software, has remained strong due in part to corporate gains which have been better than expected over the year.

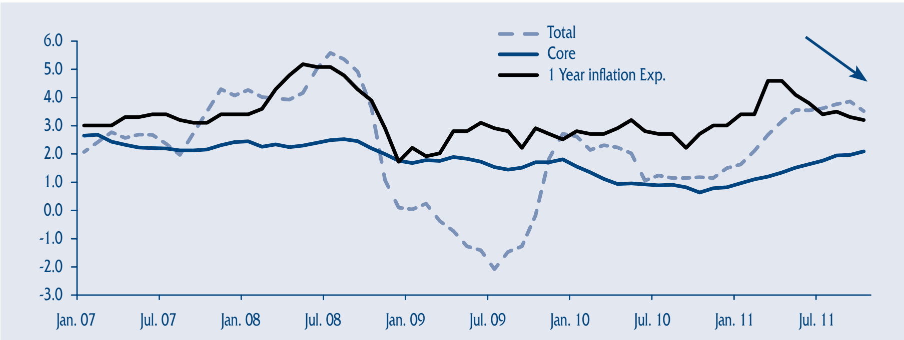
Government spending has also had a negative impact on growth. This trend is not expected to reverse in the next years given the estimated fiscal adjustment required to maintain the sustainability of the debt in the long term.

Graph 5
USA: PERSONAL CONSUMPTION AND INVESTMENT
(US$ Billions - 2005)



This slight recovery of US economic activity has taken place amidst declining inflationary pressures. In contrast with what happened in September (previous Inflation Report), the most important indicators –consumer prices, producer prices, and the personal consumption expenditure price deflator (PCE price deflator)– reflected a reduction of inflationary pressures in November due basically to the cost of energy, which reversed the trend observed since end 2010.

Graph 6
USA: TOTAL AND CORE CPI (12 month % change)
AND INFLATION EXPECTATIONS (Michigan Univ.)



In this context, the Federal Reserve (FED) reaffirmed in November that rates would remain low at least until mid-2013 and did not rule out the possibility of implementing an additional monetary stimulus in the future. It is worth mentioning that in its meeting of September 21, the FED launched an operation known as "twist", whereby short term bonds (with maturities of less than 3 years) are swapped by long-term bonds (with maturities of between 6 and 30 years). This operation would reduce the long-term rates and contribute to make more favorable financial conditions. Securities for a total amount of US$ 400 billion would be redeemed through this operation which will be in place until June 2012.

In this context, the growth forecast for the **US** economy for 2011 has been revised on the upside from 1.5 to 1.7 percent, in line with the data executed. On the other hand, the growth forecast for 2012 has been revised downwards from 2.0 to 1.8 percent, in line with the deterioration of the international environment and financial conditions.

6. In the **Eurozone** the growth outlook declined in the last semester of the year due to the worsening of financial conditions in the region, fiscal adjustments, and the deterioration of consumers and investors' confidence. At the sector level, this is reflected for the third consecutive month in the drop of the manufacturing indices (PMI) to below the threshold of 50.

The Eurozone is estimated to grow 1.4 percent in 2011 and to contract to 0.6 percent in 2012, when all the countries in the region, except Germany, would register negative growth rates. The contraction of growth estimated in the case of France, the second largest economy in the region, would be mostly explained by this country's exposure to assets of countries with debt problems.

According to BIS reports published in September, the exposure of French banks to countries with financial problems (Spain, Greece, Ireland, Portugal, and Italy) would have increased to 26 percent of total assets (US$ 0.84 trillion) from the 17 percent (US$ 0.80 trillion) reported previously. This would have generated fear among market agents who requested higher yields to acquire French bonds. In fact, the higher level of exposure was associated with the greater share of Italian and Spanish assets in the asset portfolio of French banks.

Table 3
BANKS´ EXPOSURE TO COUNTRIES WITH FINANCIAL PROBLEMS
(% of total assets)

	Spain	Greece	Ireland	Italy	Portugal	Total (PIIGS)	Total assets* (US$ trillions)
Germany	5.0	0.7	3.5	5.1	1.2	**15.4**	4.5
United States	2.3	0.5	1.3	3.2	0.6	**8.0**	9.1
France	5.6	2.0	1.7	15.2	1.0	**25.5**	3.3
Japan	1.0	0.0	0.8	1.6	0.1	**3.5**	2.9
United Kingdom	2.2	0.3	3.2	1.7	0.5	**8.0**	5.8
Switzerland	1.2	0.2	0.7	1.4	0.1	**3.6**	2.6

* Includes foreign assets and other potential exposures (derivatives, guarantees, etc.).
Source : BIS, September 2011.

Germany's growth forecast for 2012 was revised downwards (from 1.3 to 0.1 percent) due to the lower dynamism of industrial activity and the deterioration of consumer confidence, although both factors were partially offset by the evolution recorded by construction.

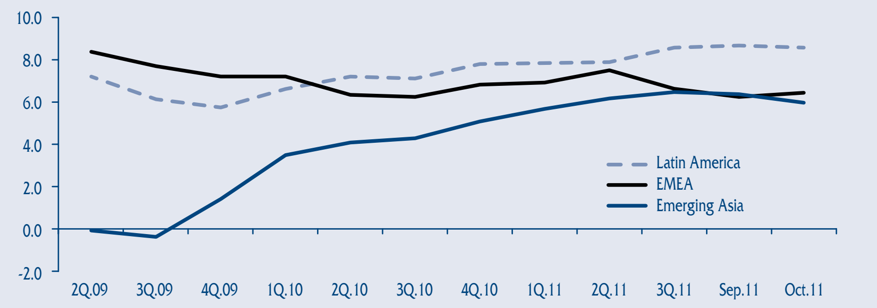
The increased risks of a recession in the Eurozone led the European Central Bank (ECB) to cut its rates by 25 bps to 1.25 percent in November. The ECB announced that it would buy € 40 billion in covered bonds with a minimum rating of BBB- and a maximum maturity of 10.5 years. These measures added onto the ones adopted in October, when the ECB announced 1-year liquidity injections with the aim of improving the financial conditions for banks.

7. After three consecutive quarters with negative growth rates, **Japan** grew 6 percent in Q3-2011 (annualized rate). This result would be reflecting the country's resumption of the growth path with the support of increased government spending in infrastructure after the natural disaster of March 2011.

   However, there are significant risk factors that could generate a setback in the economy. Exports to Asia declined in October due to problems in Thailand as a result of the floods that affected the routes used to transport goods in the Asian region. If these problems continued, their effects on growth could extend even until Q1-2012. The strong slowdown in Europe and energy constraints could also offset the recovery expected to take place in the coming years.

8. Led by the **emerging economies** of Asia (China and India) and Latin America, developing countries are expected to show growth rates close to 5.8 percent in 2011. **China** would grow at rates of over 8 percent, while **India** would register growth rates above 7 percent. **Latin America** would record rates of around 4 percent in 2011, but in contrast with the developed countries, amid high inflationary pressures despite the correction of food prices observed in September and October due to investors' liquidation of positions.

Graph 7
EMERGING ECONOMIES: 12 MONTH INFLATION



Source: Credit Suisse.

Even though **China** continues growing at high rates supported by both private and public investment and by the external sector, some deceleration is being observed given that the economy grew 9.1 percent in Q3-2011. This rate, which is not only lower than the one registered in the previous two quarters, but also the lowest rate recorded since Q2-2009, would be reflecting the lower dynamism observed in key sectors such as industry, manufacturing, and some tradable sectors.

This slowdown would be associated with the restrictive measures adopted by the government in the first half of the year in order to combat inflation and prevent an excessive growth of credit and the generation of price bubbles in sectors such as the real estate sector. As regards inflation, the consumer price index rose steadily until July (6.5 percent) slowing down thereafter to an annual rate of 4.2 percent in November. Because of this, after the adjustments of this year the Central Bank is expected to maintain its policy rate unchanged. The Bank of China even reduced the rate of reserve requirements last November.

Graph 8
CHINA: QUARTERLY GDP GROWTH AND REFERENCE RATE

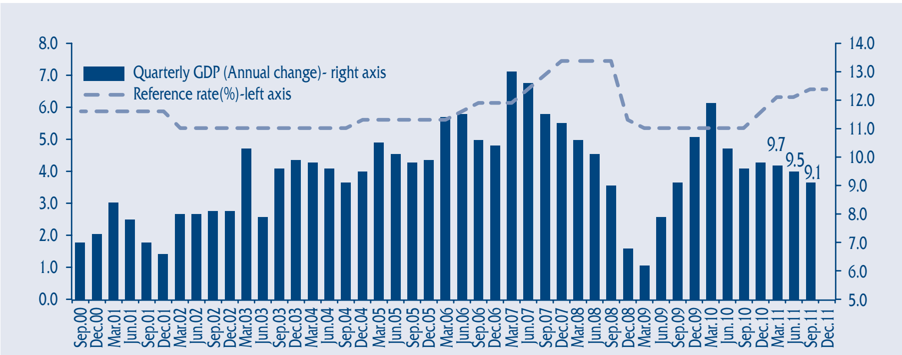


Table 4
INDICATORS OF ACTIVITY OF CHINA: 2010 - 2011

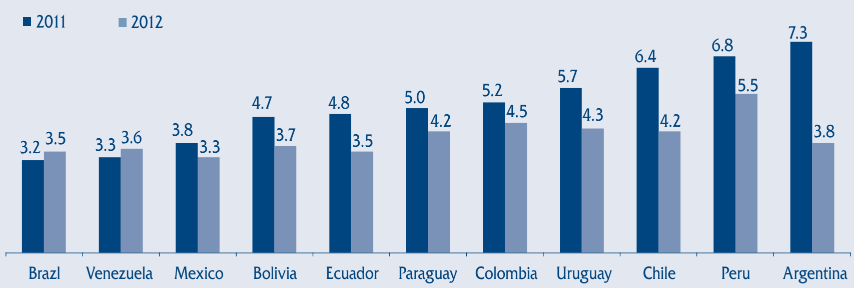
	2010	2011				
	December	July	August	September	Octubre	November
Manufacturing PMI	53.9	50.7	50.9	51.2	50.4	49.0
Industrial Production (12 month % change)	13.5%	14.0%	13.5%	13.8%	13.2%	12.4%
Inverstment in fixed assets (12 month % change)	24.5%	25.4%	25.0%	24.9%	24.9%	24.5%
Retail sales (12 month % change)	19.1%	17.2%	17.0%	17.7%	17.2%	17.3%
Exports (12 month % change)	17.9%	20.4%	24.5%	17.1%	15.9%	13.8%
Imports (12 month % change)	25.6%	22.9%	30.2%	20.9%	28.7%	22.1%
New loans (Billions of yuan)	481	493	549	470	587	562
CPI (12 month % change)	4.6%	6.5%	6.2%	6.1%	5.5%	4.2%
Food prices (12 month % change)	9.6%	14.8%	13.4%	13.4%	11.9%	8.8%

Source: Bloomberg.

In Q3 most **Latin American** countries registered lower growth rates than in the previous quarters. Although growth continued to be led by domestic demand, lower dynamism was observed in exports and in the industrial sector. This deceleration is expected to deepen in the next months. Moreover, the lower pace of growth has been coupled in many cases by a rebound in inflation rates.

Since the degree of economic slowdown has not been the same in all the countries of the region, various policy measures have been adopted in the region. While Brazil continued lowering its policy rate in October and November, Colombia –which does not show symptoms of contagion of the international environment– raised its policy rate by 25 bps to 4.75 percent in the last month. The region would grow 3.9 percent this year and 3.5 percent in 2012.

Graph 9
LATIN AMERICA: GDP GROWTH FORECAST*



* Consensus Economics and BCRP (Peru).

In the recent months East Asian emerging countries have been showing a slowdown associated mainly with the weak performance of USA and the European Union (EU) and the persistence of global financial uncertainty. In this context, the growth forecasts for this year have been adjusted downwards (in the case of Thailand, this has been aggravated by the considerable impact of the floods that affected the country recently). Asian emerging economies have been less affected by the international environment than developed economies due to their lower exposure and openness and to the strong dynamism of their domestic demand.

Growth in Eastern Europe has also been revised downwards due to the lower growth registered by European developed economies, since the latter are the main destination for the exports of the former. Furthermore, the margin for the implementation of counter cyclical in these countries is reduced due to the deterioration of their fiscal accounts and to the increase in their financial costs.

Financial Markets

9. Volatility has risen noticeably in recent months with investors' liquidation of risky positions. Sovereign debt markets, money markets, foreign exchange markets and global stock Exchange markets have reflected this higher risk aversion, as reflected, for example, in the VIX indicator.

Graph 10
RISK AVERSION COEFFICIENT: VIX (S&P'500)
(January 2008 - November 2011)

Source: Bloomberg.

10. Financial conditions tightened in **sovereign debt** markets due to the discrepancies of the member countries of the Eurozone about how the crisis should be faced, political difficulties in Italy and Spain, and uncertainty about the form of private participation that should be applied in the rescue programs, which generated liquidations in positions of sovereign bonds in countries like Portugal, Spain, and Italy.

A rapid increase has been observed in the sovereign yields of the mayor economies as well as in CDS spreads in recent months. In Italy and Spain the yields on 10-year bonds reached a record level of 7.26 and 6.69 percent on November 25, which generated speculations about an imminent request of assistance to the IMF. Similarly, the spreads of CDS continued rising due to the rating cuts applied in the period and to conflicting positions regarding the greater capabilities of the European Financial Stability Facility (EFSF) and the participation of the European Central Bank in the solution of the crisis.

The liquidation of positions in Eurozone markets of sovereign bonds has extended as from September to securities of sound economies, such as Germany. The preference for lower risk sovereign securities has favored US markets of sovereign bonds and, since September, the UK markets.

Table 5
SOVEREIGN SPREADS OF DEVELOPED COUNTRIES

	End of period					Difference of November against to:			
	Dec.08	Dec.09	Dec.10	Aug.11	Nov.11	Aug.11	Dec.10	Dec.09	Dec.08
CDS (bps.)									
USA	67	38	42	50	51	1	9	13	-16
United Kingdom	107	83	74	59	92	32	18	9	-15
Germany	46	26	59	75	98	23	39	72	53
France	54	32	107	153	200	47	93	168	146
Spain	101	113	348	357	407	50	60	294	307
Italy	157	109	238	361	480	120	242	371	323
Greece	232	283	1,026	2,233	8,112	5,879	7,086	7,829	7,880
Portugal	96	92	497	914	1,066	152	568	974	969
Ireland	181	158	619	768	718	-50	99	560	537
10 Year Treasury yields (%)									
USA	2.21	3.84	3.29	2.22	2.07	-16	-123	-177	-14
United Kingdom	3.02	4.02	3.40	2.60	2.31	-29	-108	-170	-71
Germany	2.95	3.39	2.96	2.22	2.28	6	-68	-111	-67

Source: Bloomberg.

11. Latin American countries' debt markets continued being affected by higher global risk aversion in international financial markets during the months of September and October. Credit spreads in the region continued to rise from August until the first days of October, reaching record highs of this year.

Table 6
SOVEREIGN SPREADS OF EMERGING COUNTRIES

	End of period					Difference of November against to:			
	Dec.08	Dec.09	Dec.10	Aug.11	Nov.11	Aug.11	Dec.10	Dec.09	Dec.08
				EMBIG (bps.)					
Peru	509	165	165	186	227	41	62	62	-282
Brazil	429	189	189	197	229	32	40	40	-200
Chile	343	95	115	151	159	8	44	64	-184
Colombia	498	203	172	165	199	34	27	-4	-299
Emerging	724	294	289	354	413	59	124	119	-311
				CDS (bps.)					
Peru	303	124	113	156	167	11	53	42	-136
Brazil	299	123	111	143	164	21	53	41	-135
Chile	203	69	84	88	115	27	31	46	-88
Colombia	308	144	113	147	160	13	47	16	-148
Mexico	292	134	113	141	161	20	48	27	-131

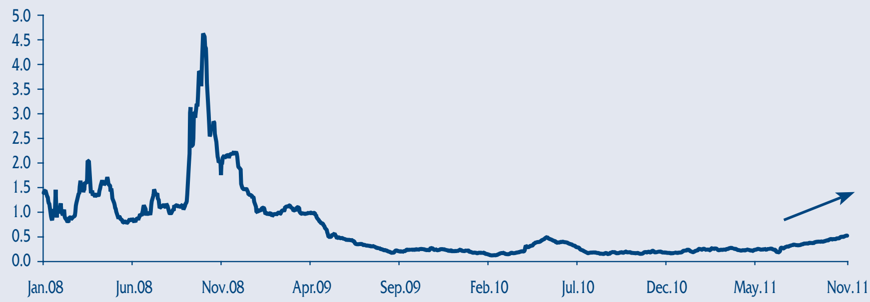
Source: Bloomberg.

12. Volatility in **money markets** has been differentiated and has affected mainly European banks' financing.

As reported in our September report, financing conditions in American markets not have been very affected basically due to American banks' lower exposure in

European peripheral economies. Since the crisis deepened, rates have risen slightly (as reflected in the evolution of the TED spread). However, if the risks of contagion materialized and affected some of the most important European economies (i.e. France, Italy, and Spain), banks' exposure would rise and affect their credit profile and financing conditions.

Graph 11
TED SPREAD (%)
(January 2008 - November 2011)



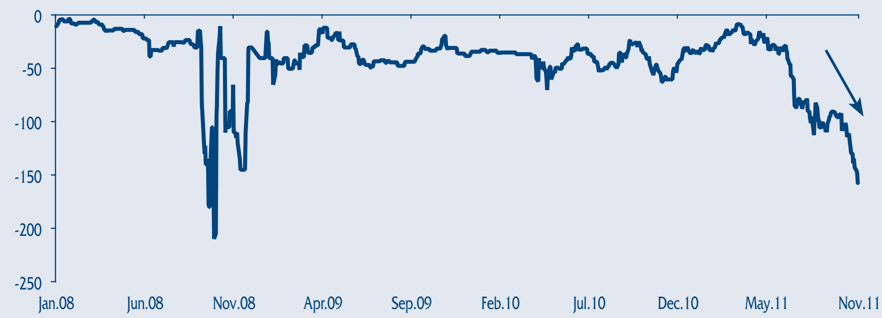
Source: Bloomberg.

In European markets, on the other hand, funding conditions for European banks have worsened significantly over the past few months. Access to markets has constrained and the risk of shortage of collaterals has risen given the increased use of insured markets. In addition, continuous rating cuts have made bank financing even more costly. The worsening of conditions in European markets has reflected in the rates of financing in euros. The spread between interbank rates (Euribor) and overnight swaps (OIS) has risen significantly. In the case of the financing in US dollars, the rates on currency swaps reflect the higher exchange rate risk that exists in swapping a variable rate debt in euros to a variable rate debt in dollars.

Graph 12
SPREAD BETWEEN THE 3-MONTH EURO LIBOR RATE (EURIBOR) AND O/N OF SWAP MARKET (OIS)
(January 2008 - November 2011)

Source: Bloomberg.

Graph 13
EURO / DOLLAR BASIC 3 MONTH SWAP
(January 2008 - November 2011)



Source: Bloomberg.

In this context, the ECB has adopted measures to ease conditions, including longer term injections of liquidity (e.g. 1 year) and lowering its policy rate. Most recently, in order to improve the liquidity in dollars, the six major banks in the developed economies (Eurozone, USA, UK, Japan, Switzerland, and Canada) decided to reduce the rate for swap lines in dollars by 50 bps (OIS rate +50 bps) until February 1, 2013. They also established temporary bilateral swap arrangements for operations in the currencies required in each jurisdiction. The conditions of financing in US dollars began to improve after these actions.

All these measures have resulted in the replacement of short term bank financing for the wholesale market by ECB funds. In the past four months (at October), funding from the ECB has increased and extended to France, Italy, and Spain. Despite this, this funding still accounts for a low percentage of the total bank assets of these countries (less than 5 percent on average), in contrast with what happens in the banks of Portugal, Ireland and Greece –countries with rescue programs–, where the ECB financing represents a high percentage of their assets (around 8, 14 and 20 percent, respectively).

In addition to the issue of financing, Europe faces also the problem of higher capital requirements for regulatory purposes to be met by June 2012, which could put pressure on the balance sheets of European Banks and generate a potential deleveraging (or credit crunch), which would increase even more the risks of recession in the Eurozone.

13. In the main **stock markets**, losses intensified with the deepening of the Eurozone debt crisis. Widespread for the most part except in USA, these losses are basically reflected in the banking sector, which has been the most affected sector due to banks' exposure in European economies. The US stock exchange

market has basically recovered due to the recent indicators of activity published in November.

In the Eurozone, Greece's stock exchange dropped by over 50 percent, Portugal's stock market fell 20 percent, and France's stock exchange dropped 18 percent. In Asia, the losses ranged between 4 percent (Thailand) and 21 percent (India), while in Latin America the stock market in Argentina recorded a decline of 27 percent, followed by the stock exchange of Brazil which dropped 18 percent.

14. In general, the **dollar** has intensified its appreciatory trend against most currencies over the past few months due basically to the European crisis.

    According to the currency basket elaborated by the FED (which considers the currencies of the main trading partners), the dollar has appreciated 7 percent between August and November of this year, and 3 percent year-to-date (figures at end of period).

Graph 14
INDEX OF DOLLAR BASKET
(January 2008 - November 2011)

* Increase in the index indicates an appreciation of the dollar.
Source: FED.

    Between August and November, the dollar has appreciated 7 percent against the euro, reaching levels similar to those observed at end 2010, as a result mainly of the deepening of the sovereign debt crisis in the Eurozone, the higher risks of a recession in European countries, and prospects of interest rate cuts in Europe.

    On the other hand, the appreciation of the dollar against the currencies used for the funding of carry-trade operations –i.e. the yen and the Swiss franc– is basically explained by the interventions of the Japanese and Swiss governments and central banks to reverse the appreciation of their currencies due to higher risk aversion.

15. On the contrary, most **Latin American currencies** have depreciated against the dollar. During the months of September and October, Latin American

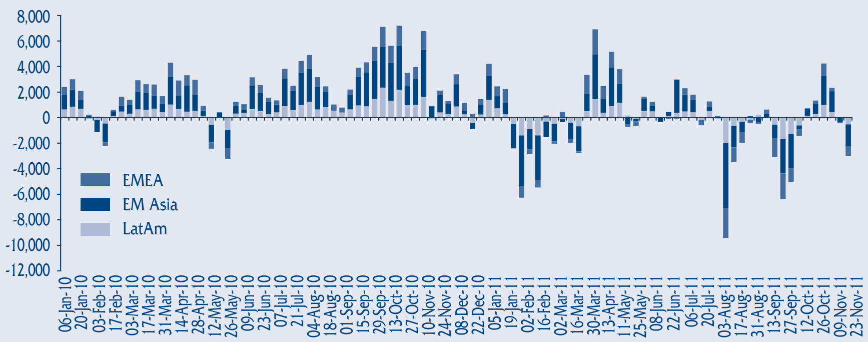
currencies weakened due to higher global risk aversion associated with Europe's debt crisis, the downward correction of commodity prices, and capital outflows (especially in October). It should be pointed out that these developments have taken place in a context of high volatility in the foreign exchange market.

Table 7
EXCHANGE RATES
(End of period)

	m.u. per US$						% Change against to	
	Dec.07	Dec.08	Dec.09	Dec.10	Aug.11	Nov.11	Aug.11	Dec.10
Canada	0.996	1.217	1.052	0.997	0.978	1.017	4.1	2.1
Japan	111.33	90.60	92.90	81.15	76.59	77.62	1.3	-4.3
United Kingdom (US$/m.u.)	1.985	1.463	1.616	1.560	1.605	1.570	-2.2	0.6
Eurozone (US$/m.u.)	1.459	1.398	1.432	1.338	1.451	1.344	-7.3	0.5
Switzerland	-	1.0669	1.0355	0.9335	0.8057	0.9132	13.3	-2.2
Brazil	1.779	2.313	1.743	1.659	1.589	1.809	13.8	9.0
Chile	497.7	635.5	507.2	467.8	461.1	515.8	11.9	10.3
Colombia	2,017	2,246	2,040	1,915	1,777	1,951	9.8	1.9
Mexico	10.89	13.65	13.06	12.36	12.34	13.63	10.5	10.3
Argentina	3.151	3.454	3.799	3.979	4.199	4.280	1.9	7.6
Peru	2.999	3.136	2.890	2.808	2.732	2.705	-1.0	-3.7
Hungary	172.83	188.30	187.96	208.15	188.42	225.89	19.9	8.5
Poland	2.47	2.96	2.86	2.96	2.87	3.35	16.6	13.4
Russia	24.57	30.53	30.31	30.57	28.83	30.70	6.5	0.4
Turkey	1.17	1.54	1.50	1.54	1.71	1.83	6.6	19.0
China	7.30	6.82	6.83	6.59	6.38	6.38	0.0	-3.2
India	39.38	48.58	46.40	44.70	45.79	52.12	13.8	16.6
Israel	3.85	3.78	3.79	3.52	3.56	3.76	5.7	6.8

Source: Bloomberg and Reuters.

Graph 15
PORTFOLIO FLOWS TO EMERGING MARKETS*
(Weekly flows, Millions of US$)



* Includes dedicated and undedicated funds.
Source: Barclays.

Monetary policy decisions

16. Over the past few months, most emerging economies have made a pause in the withdrawal of monetary stimulus given the context of global economic slowdown, despite the fact that inflationary pressures are still observed. Some countries, like Brazil and Thailand, have even lowered their interest rates. The exceptions in terms of making a pause in monetary adjustments have been India, where inflation remains around 10 percent, and in the region, Colombia, where economic activity continues to show dynamism and where inflationary pressures have rebounded.

    The **developed economies**, on the other hand, have maintained their rates over the year, with the exception of the Eurozone countries, Australia, Israel, and New Zealand. Given the current context of slowdown in most of these economies, interest rates are expected to remain low during the next year.

Table 8
MONETARY POLICY INTEREST RATE

	Sep.08	Dec.09	Dec.10	Sep.11	Oct.11	Nov.11	Difference (bps.)		
							Dec.10	Dec.09	Sep.08
India	9.00	4.75	6.25	8.25	8.50	8.50	225	375	-50
Chile	8.25	0.50	3.25	5.25	5.25	5.25	200	475	-300
Colombia	10.00	3.50	3.00	4.50	4.50	4.50	150	100	-550
Uruguay	7.25	6.25	6.50	8.00	8.00	8.00	150	175	75
Thailand	3.75	1.25	2.00	3.50	3.50	3.25	125	200	-50
Peru	6.50	1.25	3.00	4.25	4.25	4.25	125	300	-225
Polad	6.00	3.50	3.50	4.50	4.50	4.50	100	100	-150
Brazil	13.75	8.75	10.75	12.00	11.50	11.50	75	275	-225
China	7.20	5.31	5.81	6.56	6.56	6.56	75	125	-64
South Korea	5.25	2.00	2.50	3.25	3.25	3.25	75	125	-200
Israel	4.25	1.25	2.00	3.00	3.00	2.75	75	150	-150
Sweden	4.75	0.25	1.25	2.00	2.00	2.00	75	175	-275
Hungary	8.50	6.25	5.75	6.00	6.00	6.50	75	25	-200
Philippines	6.00	4.00	4.00	4.50	4.50	4.50	50	50	-150
ECB	4.25	1.00	1.00	1.50	1.50	1.25	25	25	-300
Iceland	15.50	10.00	4.50	4.50	4.50	4.75	25	-525	-1075
Malaysia	3.50	2.00	2.75	3.00	3.00	3.00	25	100	-50
Norway	5.75	1.75	2.00	2.25	2.25	2.25	25	50	-350
Taiwan	3.50	1.25	1.63	1.88	1.88	1.88	25	63	-163
Canada	3.00	0.25	1.00	1.00	1.00	1.00	0	75	-200
United States	2.00	0.25	0.25	0.25	0.25	0.25	0	0	-175
Japan	0.50	0.10	0.10	0.10	0.10	0.10	0	0	-40
Mexico	8.25	4.50	4.50	4.50	4.50	4.50	0	0	-375
Pakistan	13.00	12.50	14.00	14.00	14.00	14.00	0	150	100
United Kingdom	5.00	0.50	0.50	0.50	0.50	0.50	0	0	-450
South Africa	12.00	7.00	5.50	5.50	5.50	5.50	0	-150	-650
Switzerland	2.75	0.25	0.25	0.25	0.25	0.25	0	0	-250
Australia	7.00	3.75	4.75	4.75	4.75	4.50	-25	75	-250
Indonesia	9.25	6.50	6.50	6.75	6.50	6.00	-50	-50	-325
New Zealand	7.50	2.50	3.00	2.50	2.50	2.50	-50	0	-500
Turkey	16.75	6.50	6.50	5.75	5.75	5.75	-75	-75	-1100
Serbia	15.75	9.50	11.50	11.25	10.75	10.00	-150	50	-575

Source: Reuters, Bloomberg and central banks.

Price of commodities and terms of trade

17. Commodity prices have corrected downwards in the last months influenced by uncertainty about the situation of the global economy and the lower growth prospects. This was reflected in the liquidation of commercial positions, particularly in the month of September when the debt crisis in the Eurozone intensified. A series of supply factors, particularly in the case of basic metals, partially offset the lower demand.

    Despite this, the terms of trade in 2011 have increased about 5 percent because export prices have grown more than import prices, especially in the first semester of the year. The prices of exports registered an increase of 19 percent mainly as a result of the rise in the price of gold, which was favored by supply constraints and by investors' increased demand for this metal in a context of high international liquidity. On the other hand, the prices of imports increased 13 percent, the rises in the prices of crude and food products like maize and soybean oil being noteworthy.

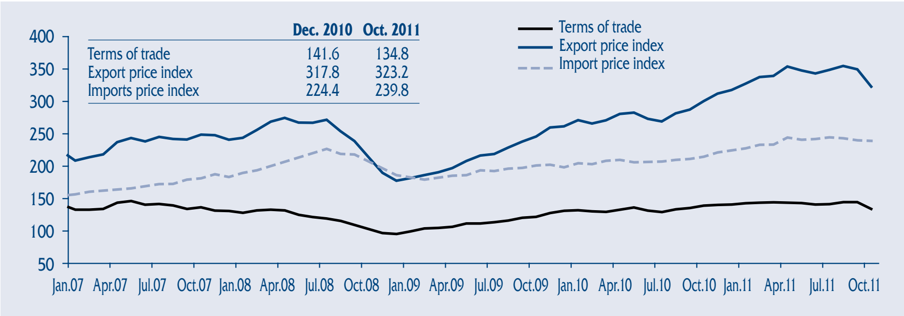
    In this context, it is estimated that prices will remain at similar levels than the ones currently observed, but that on average the price rise registered in 2011 will correct in 2012 due to the worsening of the prospects of global growth.

Table 9
TERMS OF TRADE: 2009 - 2013
(Annual average data)

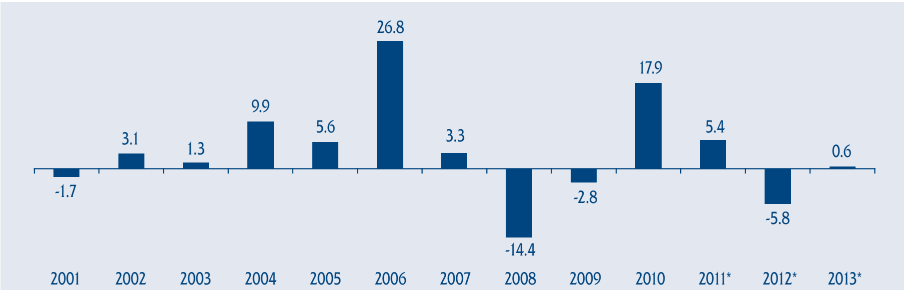
	Executed		2011		2012		2013	
	2009	2010	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
Terms of trade 1/	**-2.8**	**17.9**	**3.9**	**5.4**	**-3.2**	**-5.8**	**0.4**	**0.6**
Price of exports 1/	**-10.0**	**29.9**	**17.2**	**19.2**	**-2.0**	**-6.1**	**0.1**	**1.2**
Copper (ctv US$ per pound)	234	342	419	402	408	345	407	346
Zinc (ctv US$ per pound)	75	98	103	100	100	91	101	94
Lead (ctv US$ per pound)	78	98	114	109	109	94	108	97
Gold (US$ ounce)	974	1,225	1,565	1,577	1,700	1,675	1,700	1,675
Price of imports 1/	**-7.4**	**10.1**	**12.8**	**13.1**	**1.3**	**-0.3**	**-0.3**	**0.6**
Oil (US$ per barrel)	62	79	94	95	90	100	92	100
Wheat (US$ per ton)	193	195	304	281	332	249	329	259
Maize (US$ per ton)	139	157	280	263	293	232	259	221
Soybean oil (US$ per ton)	729	859	1,231	1,191	1,284	1,102	1,279	1,107
Rice (US$ per ton)	561	503	571	553	629	623	629	623
Memo:								
Index of external prices (average)	-2.6	3.3	8.8	7.5	3.8	2.0	2.0	3.1

1/ Average annual % change.

Graph 16
TERMS OF TRADE, EXPORT AND IMPORT PRICE INDICES: JANUARY 2007 - OCTUBRE 2011
(1994=100)



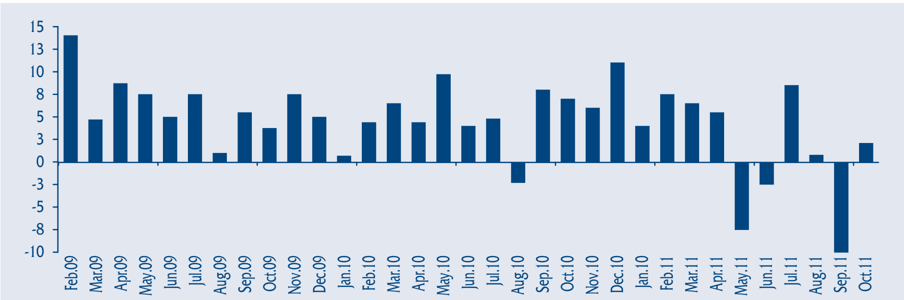
Graph 17
TERMS OF TRADE: 2001 - 2013
(% change)



(*) Forecast.

18. High international liquidity as a result of low interest rates allowed a higher demand for commodities as alternative investment and hedge assets in a context of increased financial uncertainty. In October a total of US$ 2.1 billion was received by the funds that administer investments in commodities, which represented a recovery relative to the contraction of US$ 10 billion recorded last September.

Graph 18
INVESTMENT FLOWS TO COMMODITIES
(Billions of US$)



Source: Bloomberg and Barclays Capital.

Copper

19. The price of copper corrected down the upward trend registered in the first half of the year given the lower prospects for global growth (Eurozone, USA, etc.). However, compared to year 2010, the price of copper price increased 17 percent, reaching an average price of US$ 4.0/pound (copper reached an all-time high of US$ 4.7 a pound in February). The rise in the price of this metal was associated with supply constraints in producing countries such as Chile, Indonesia, China, and Peru, where there were strikes, technical stoppages, and closures of mines due to environmental problems.

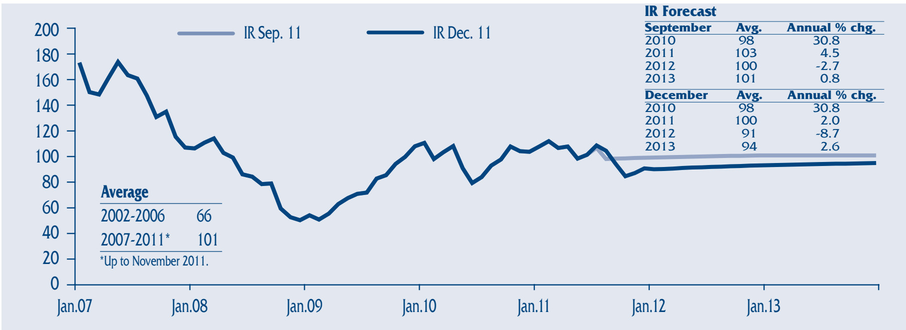
Factors influencing this evolution on the demand side included Japan's increased demand for this metal to rebuild the country after the earthquake of March and the demand of China which remained relatively stable throughout the year although showing some volatility due to the adjustment measures implemented to control inflation. The rising trend observed in the first part of the year was interrupted due to the uncertainty about global growth generated by the financial problems in Europe and USA. It is estimated that the price of copper would remain in the forecast horizon at similar levels to the ones currently seen (around US$ 3.50 a pound), which represents a downward revision in the projected price of copper, in line with the slowdown of global economic activity.

Graph 19
COPPER: JANUARY 2007 - DECEMBER 2013
(ctv. US$/pd.)

Zinc

20. In line with the evolution of basic metals, the price of zinc also dropped since Q3-2011 and therefore registers a moderate rise of 2 percent in 2011. The price of zinc is estimated to stabilize around US$ 1.0/pound in the forecast horizon. In contrast with copper, the zinc market does not show a tight balance on the supply side.

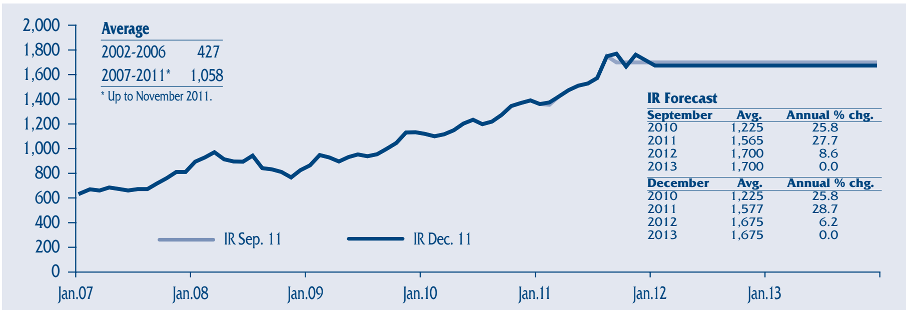
Graph 20
ZINC: JANUARY 2007 - DECEMBER 2013
(ctv. US$/pd.)



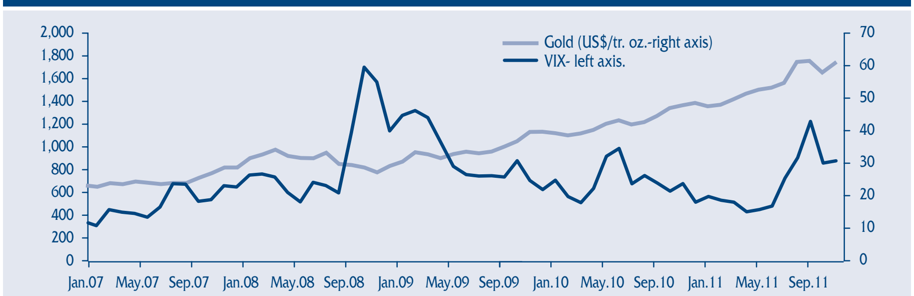
Gold

21. Contrasting with all the other commodities, gold maintained an upward trend during most of the year due to the increased demand for this metal as an alternative investment asset. The average price of gold in 2011 would reach US$ 1,577/troy ounce, which represents an increase close to 30 percent compared to 2010. In September, gold reached a historical maximum price of US$ 1,895 per troy ounce. It is estimated that the price of gold will remain high in the forecast horizon in a context of high uncertainty.

Graph 21
GOLD: JANUARY 2007 - DECEMBER 2013
(US$/tr.oz.)



Graph 22
GOLD PRICE AND VIX INDEX S&P-500
(January 2007 - November 2011)

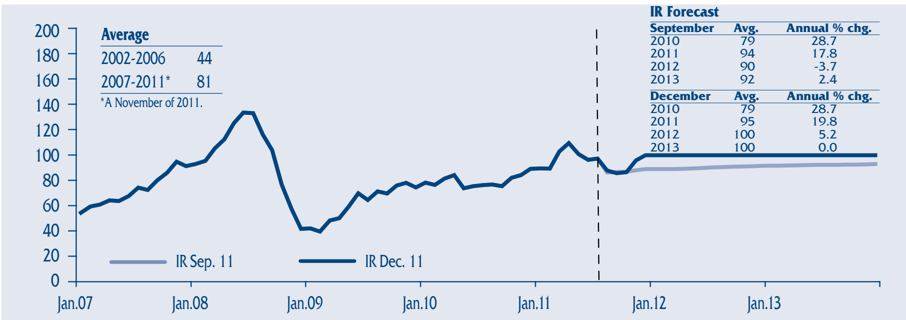


Source: Bloomberg.

Oil

22. The price of WTI oil rose 20 percent in 2011, reaching an average of US$ 95 (in April the price of oil climbed to a peak of US$ 114 per barrel). The rise in the price of crude was due to the increased demand of USA, Japan, and China as well as due to supply constraints associated with a lower production of OPEC countries (Libya's exit of the market) and geopolitical risks in the Middle East (tension between Israel and Iran, succession problems in Saudi Arabia, etc.) and Africa (terrorist attacks on Shell facilities in Nigeria). The rise in the price of WTI oil was offset by the increase of crude inventories in OECD countries.

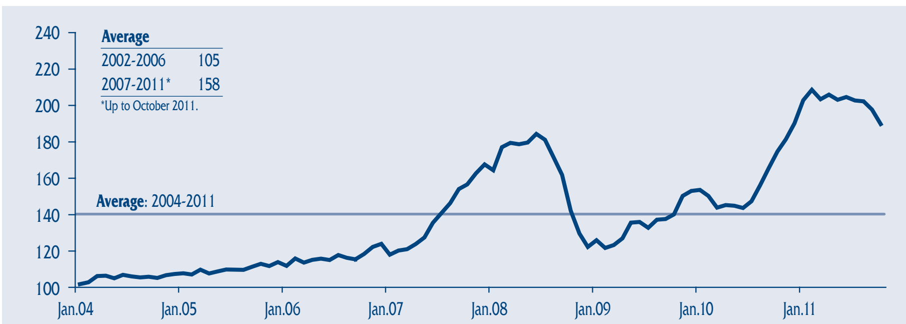
Graph 23
WTI OIL: JANUARY 2007 - DECEMBER 2013
(US$/bl)



Food commodities

23. The prices of food commodities were subject to high volatility. Like the rest of commodities, the prices of food commodities in September and October were affected by the deterioration of the balance of global risk which prompted investors to liquidate their positions in risky assets. Moreover, this effect was reinforced by expectations of increased supply. This explains why in those month the FAO index of real food prices registered monthly declines of 2.4 and 4.0 percent, respectively.

Graph 24
FAO REAL FOOD PRICE INDEX*
(Base 2002 - 2004 = 100)



* The real price index is the index of nominal prices deflated by the unit value of manufactures of the World Bank.

According to the latest Global Food Demand-Supply Balance of the United States Department of Agriculture (USDA), the following table describes the current situation in global food markets.

Table 10
USDA: BALANCE OF WORLD DEMAND AND SUPPLY
(Millions of tons)

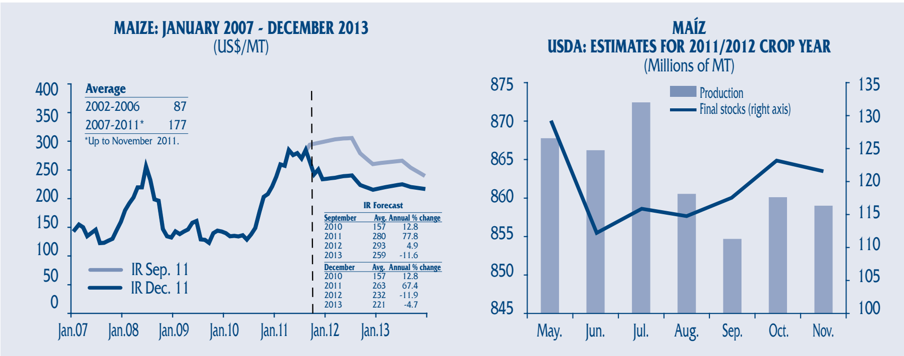
	2009/10 (3)	2010/11 (2)	2011/12 (1)	% change (2) / (3)	% change (1) / (2)
MAIZE					
Initial stock	147.2	144.1	129.0	-2.1	-10.4
Production	819.6	828.7	859.0	1.1	3.7
Global supply	**966.8**	**972.7**	**988.0**	**0.6**	**1.6**
Total Consumption	822.8	843.7	866.5	2.5	2.7
Final stock	144.1	129.0	121.6	-10.4	-5.8
WHEAT					
Initial stock	167.1	200.9	196.1	20.2	-2.4
Production	684.3	648.7	683.3	-5.2	5.3
Global supply	**851.4**	**849.6**	**879.4**	**-0.2**	**3.5**
Total Consumption	650.5	653.5	676.8	0.5	3.6
Final stock	200.9	196.1	202.6	-2.4	3.3
SOYBEAN OIL					
Initial stock	3.0	3.1	2.9	3.0	-4.9
Production	38.9	41.3	43.1	6.2	4.3
Global supply	**41.8**	**44.4**	**46.0**	**6.0**	**3.7**
Total Consumption	38.3	41.0	43.1	7.1	5.2
Final stock	3.1	2.9	2.4	-4.9	-17.2

Source: USDA-WASDE November 2011.

Maize

24. The average price of maize at November was US$ 243 per ton, as a result of which this price has accumulated a variation of 10 percent year-to-date. In September and October the price of maize showed a downward trend, in line with expectations of a higher supply –increased yields expected in USA– and the rapid progress of the harvest in USA, which showed a faster pace than the average pace in the last 5 years. In November, the prices remained stable compared to the previous month since the downward revision of global final inventories by the USDA boosted the prices offsetting the downward trend originated by continued global risk aversion. Maize is estimated to show lower prices in the forecast horizon than those considered in our Inflation Report of September, in line with the higher final global inventories foreseen by the USDA.

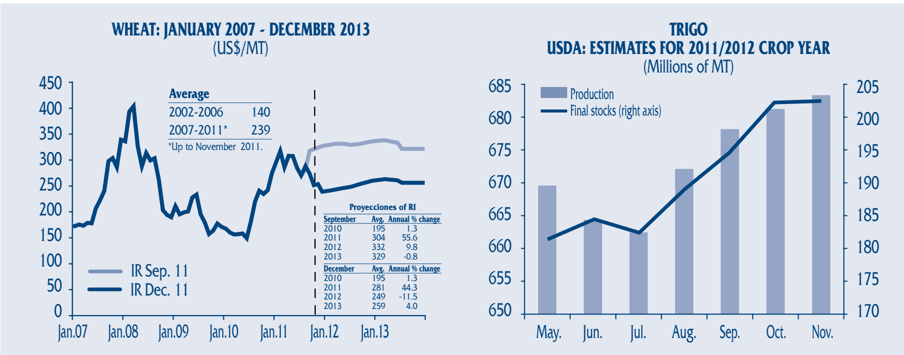
Graph 25



Wheat

25. The international price of wheat, which recorded an average price of US$ 244/ton at the close of November, has fallen 11 percent so far this year. After recovering in August (due to expectations of lower yields in USA), the price of wheat was subject to downward pressures given that estimates for the global market were revised on the upside after global supply in countries like Russia, Ukraine, Australia, and Kazakhstan were corrected upwards. The greater production of wheat of these countries has led to increased competition in international markets. In this context, wheat is estimated to register an average price of US$ 249/ton in 2012, lower than projected in the Inflation Report of September.

Graph 26



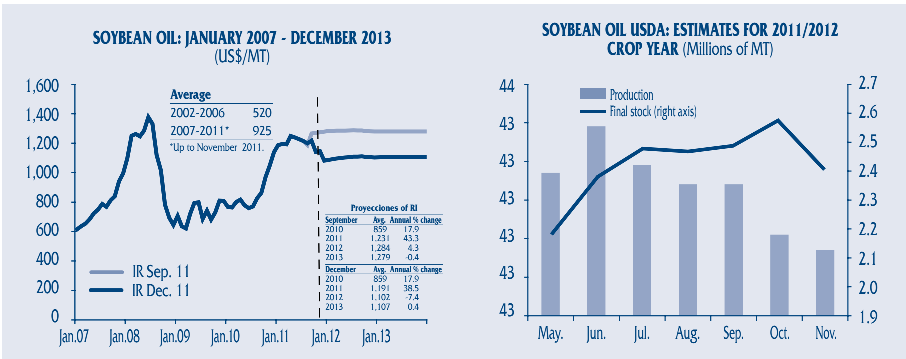
Soybean oil

26. The price of soybean oil recorded a decline of 1 percent during the first eleven months of the year, closing November at an average price of US$ 1,131 per ton. This slight variation is explained by the declining trend that the average price of soybean oil followed since May (except in September), which was offset by

the price increases registered in the first months of the year. The price declines intensified in October when the price of soybean dropped 6 percent due to a favorable harvest in USA.

Soybean oil is estimated to show similar prices to those currently observed. Like the prices of other food commodities, these prices would be lower than the ones considered in our previous Report.

Graph 27

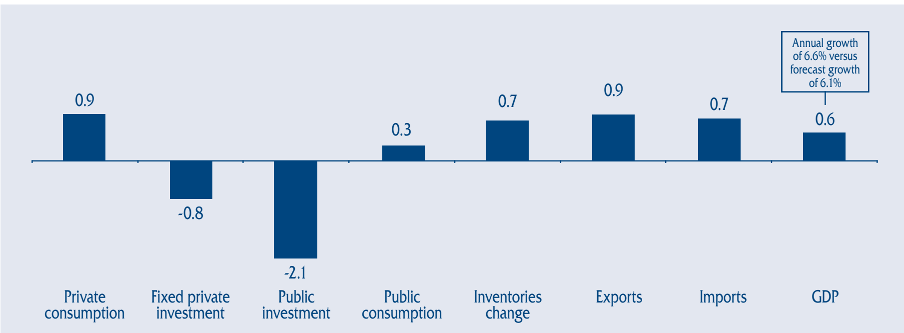


II. Economic activity

27. After recording a growth rate of 8.8 percent in 2010, the Peruvian economy has grown at more moderate rates during 2011, which reflects the convergence of Peru's GDP to rates closer to the potential output. So far in 2011, the GDP growth rate has moved from 8.9 percent in Q1 to 6.8 percent in Q2 and to 6.6 percent in Q3. This is associated with the moderation of growth in domestic demand, which is mainly explained by government investment –which accumulated a decline of 24 percent between January and September– and, to a lesser extent, by private investment.

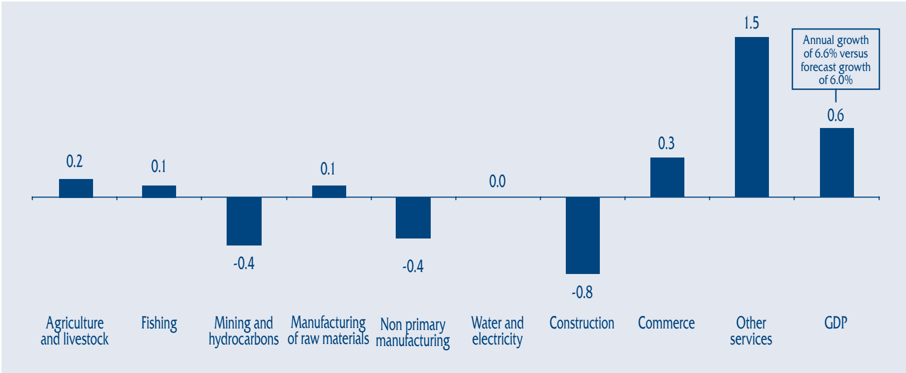
28. The slowdown of growth in Q3 was not as strong as anticipated due to the high growth of private consumption and exports. The former was reflected in the dynamism of consumption determinants, such as the growth of the national disposable income (7.9 percent vs. 5.5 percent in Q2), the high levels of consumer confidence, and the growth of credit of credit and employment. On the other hand, the growth of the latter was reflected in higher exports of non-traditional products –especially farming and chemical products–, which grew 24.5 percent in terms of volume. Thus, in Q3 the Peruvian economy recorded a growth rate that was 0.6 percentage points higher than the rate projected in our Inflation Report of December 2010.

Graph 28
GDP GROWTH BY EXPENDITURE: 3Q11
Contribution to growth gap relative to projected growth in IR Dec.2010
(% points)



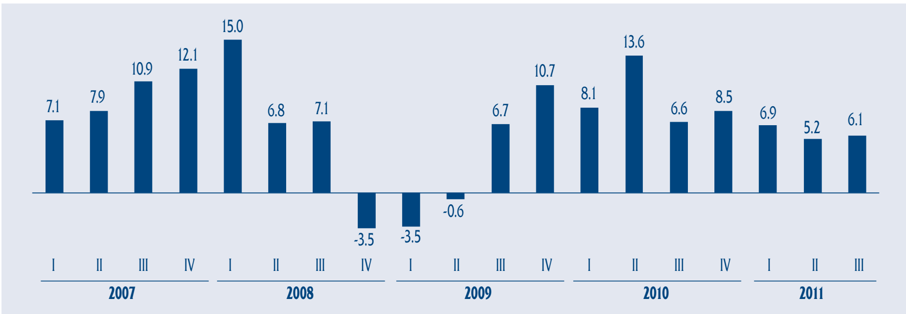
On the sector side, the difference in GDP growth in Q3 compared to what was estimated in our Inflation report of December 2010 is mainly explained by activity in the sectors of other services and trade, which also account for the most part of GDP growth in the first nine months of the year (5.6 percentage points of a rate of 7.4 percent). It should be pointed out that the growth rates in non-primary manufacturing and construction in Q3 were lower than expected, reflecting the evolution of public and private investment.

Graph 29
GDP GROWTH BY SECTORS: 3Q11
Contribution to growth gap relative to projected growth in IR Dec.2010
(% points)



29. In seasonally adjusted terms, GDP in Q3 recorded an annualized growth of 6.1 percent. While the primary sectors and construction showed a recovery compared to the second quarter, non primary manufacturing experienced a decline.

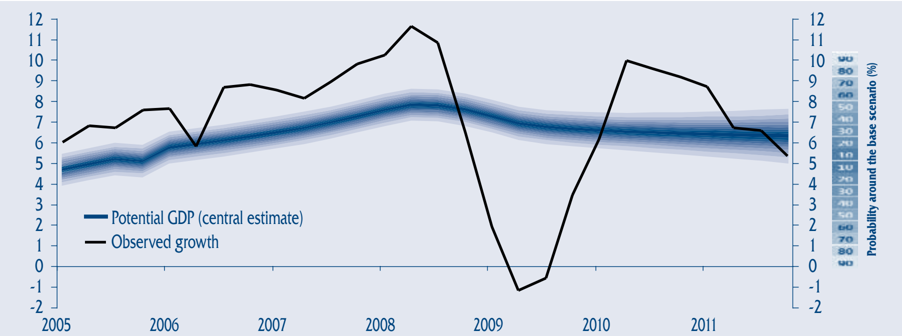
Graph 30
SEASONALLY ADJUSTED GDP: 2007 - 2011
(Annualized % change)



30. In view of this better than expected evolution, the forecast on GDP growth for 2011 has been revised from 6.3 percent (September IR) to 6.8 percent, considering a growth rate of 5.3 percent in Q4-2011. The central scenario for the next two years considers that the fiscal policy would go from the contractive position observed in 2011 to an expansionary position amid an international context of lower growth. Therefore, the growth forecast for 2012 has been revised downwards from 5.7 percent to 5.5 percent, while the growth forecast for 2013 remains at 6.3 percent.

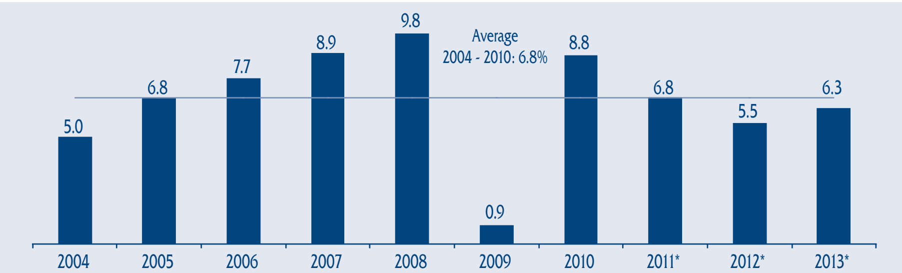
31. Given the evolution foreseen in the external environment, it is estimated that both GDP and domestic demand would register lower growth rates in the next two years than the growth rates recorded in the period of 2004-2010, in line with the economy's convergence towards its level of potential growth.

Graph 31
GDP: POTENTIAL GROWTH AND ACTUAL GROWTH: 2005-2011
(% change in the last 4 quarters)



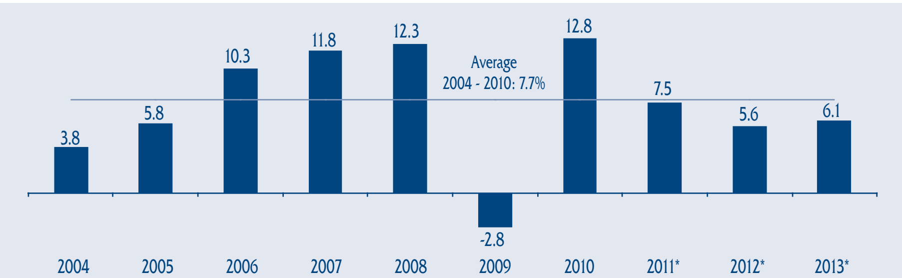
Memo: Potential GDP is not an observable variable and has to be estimated. Because of this, the graph shows uncertainty about its growth rate. As in the case of the output gap (Graph 103) and the inflation forecast (Graph 104), each band concentrates a probability of occurrence of 5% and total bands represent a probability of occurrence of 90%.
Potential growth is estimated using statistical methods of signals extraction simultaneously with the estimation of the output gap (see Graph 103).

Graph 32
GDP: 2004-2013
(Real % change)



* Forecast.

Graph 33
DOMESTIC DEMAND: 2004 - 2013
(Real % change)



* Forecast.

Forecast evolution of expenditure components

32. Domestic demand would grow 7.5 percent in 2011, recording a rate lower than the rate of 12.8 percent observed in 2010 due to the moderation of private spending and the reduction of government spending. On the side of the former, private investment would show lower growth as it would grow 12.0 percent in 2011 after having climbed 22.1 percent in 2010 (a year of recovery after the international financial crisis). This would be offset by the increased dynamism of private consumption, which has shown a faster pace of growth over 2011. On the other hand, on the side of the latter, the anticipated reduction of 19.7 percent in government investment would have a negative impact of 1.2 percentage points on GDP growth.

Table 11
GDP AND DOMESTIC DEMAND
(Real % change)

	2010		2011*			2012*		2013*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
1. Domestic demand	**12.7**	**12.8**	**8.3**	**7.5**	**7.5**	**5.6**	**5.6**	**6.0**	**6.1**
a. Private consumption	5.8	6.0	6.3	6.0	6.3	5.6	5.6	5.8	5.8
b. Public consumption	11.9	10.6	4.7	5.7	4.4	4.4	5.3	4.9	4.9
c. Private investment	21.3	22.1	13.1	10.7	12.0	9.0	7.0	8.3	8.3
d. Public investment	31.6	27.3	-24.2	-2.9	-19.7	11.4	33.1	10.0	7.3
2. Exports	**2.5**	**2.5**	**8.5**	**6.0**	**7.3**	**7.5**	**6.0**	**9.0**	**7.7**
3. Imports	**24.0**	**23.8**	**12.5**	**11.7**	**10.5**	**6.7**	**6.5**	**7.2**	**6.6**
4. GDP	**8.6**	**8.8**	**7.4**	**6.3**	**6.8**	**5.7**	**5.5**	**6.3**	**6.3**
Memo									
Government expenditure	*18.4*	*16.7*	*-5.9*	*2.3*	*-5.1*	*7.0*	*14.7*	*6.9*	*5.9*

IR: Inflation Report.
* Forecast.

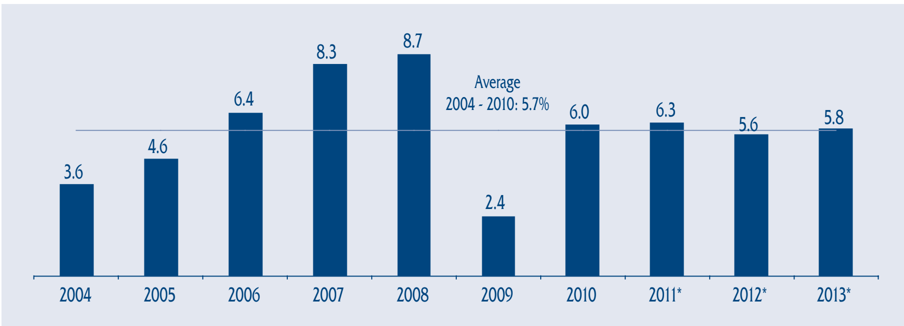
Table 12
GDP AND DOMESTIC DEMAND
(Contributions to the real % change)

	2010		2011*			2012*		2013*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
1. Domestic demand	**12.7**	**12.8**	**8.5**	**7.8**	**7.8**	**5.8**	**5.8**	**6.3**	**6.4**
a. Private consumption	4.0	4.1	4.3	4.0	4.2	3.7	3.7	3.8	3.8
b. Public consumption	1.0	1.0	0.4	0.5	0.4	0.4	0.5	0.5	0.5
c. Private investment	4.1	4.2	2.8	2.3	2.6	2.0	1.6	1.9	1.9
d. Public investment	1.4	1.5	-1.3	-0.2	-1.2	0.6	1.6	0.6	0.4
e. Inventory variation 1/	0.0	-0.1	2.0	0.9	1.5	0.0	0.2	-0.5	-0.2
2. Exports	**0.5**	**0.5**	**1.5**	**1.1**	**1.3**	**1.3**	**1.1**	**1.6**	**1.4**
3. Imports	**4.5**	**4.5**	**2.7**	**2.5**	**2.3**	**1.5**	**1.4**	**1.6**	**1.5**
4. GDP	**8.6**	**8.8**	**7.4**	**6.3**	**6.8**	**5.7**	**5.5**	**6.3**	**6.3**
Memo									
Government expenditure	*2.4*	*2.5*	*-0.8*	*0.4*	*-0.8*	*1.1*	*2.1*	*1.1*	*0.9*

IR: Inflation Report.
* Forecast. 1/ % of GDP.

33. The growth of private consumption is supported by the growth of income and employment and by higher consumer confidence. Since this level of growth would moderate in the next years, in line with the evolution of the national disposable income, **private consumption** in 2012 and 2013 is forecast to show a rate of 5.7 percent on average, which is a level representative of the rates observed in the period 2004-2010.

Graph 34
PRIVATE CONSUMPTION: 2004 - 2013
(Real % change)

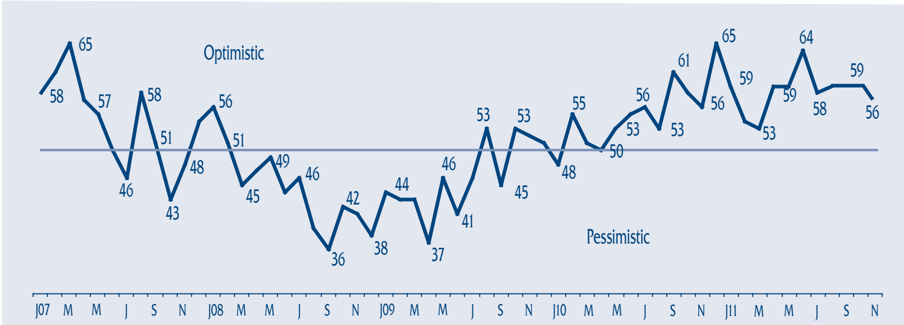


* Forecast.

Several indicators reflect the evolution of consumption:

a. The consumer confidence index continues to show a positive perception of households' economic situation and has been on the optimistic side for 20 consecutive months.

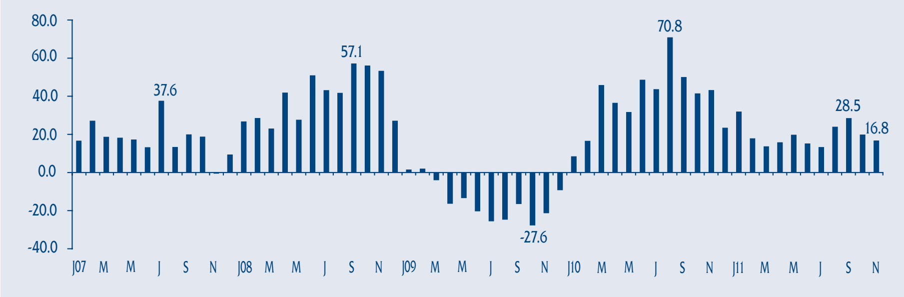
Graph 35
CONSUMER CONFIDENCE INDEX: 2007 - 2011
Households' economic situation



Source: Ipsos APOYO.
Elaboration: BCRP.

b. The volume of imports of durable consumer goods remains at a high level of growth, even though a slowdown has been observed recently: its growth rate declined from 28 percent in September to 20 percent in October and to 17 percent in November.

Graph 36
VOLUME OF IMPORTS OF DURABLE GOODS: 2007 - 2011
(12 month % change)



34. Slowing down in comparison to the first two quarters of the year when it recorded two-digit rates, **private investment** grew 8.5 percent in Q3. It is estimated that private investment would grow at a rate slightly higher in Q4, closing 2011 with an increase of 12.0 percent.

This projection is based on the following indicators:

a. Business expectations on the economic situation in three months have improved in September and October and have remained stable in November within the optimistic side.

Graph 37
EXPECTATIONS ABOUT THE ECONOMY IN THE NEXT 3 MONTHS: 2007 - 2013

Survey of Macroeconomic Expectations, BCRP. Survey conducted during the second fortnight of November.

b. The growth rate expected in 2011 is around 6.5 percent and above 5.0 percent in the next two years.

Table 13
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH
(%)

	Expectations up to:		
	IR Jun.11	IR Sep.11	IR Dec.11*
FINANCIAL ENTITIES			
2011	6.7	6.3	6.5
2012	6.2	5.8	5.5
2013	6.1	6.0	6.0
ECONOMIC ANALYSTS			
2011	6.6	6.1	6.8
2012	6.3	5.6	5.4
2013	6.5	5.9	5.5
NON-FINANCIAL FIRMS			
2011	6.5	6.0	6.5
2012	6.5	6.0	6.0
2013	6.5	6.0	6.0

* Survey made during the second half of November.

c. The production of electricity continues to show a strong dynamism although with a slight tendency to slowdown. This indicator's growth rate has declined from 9.6 percent in July to 7.7 percent in November.

Graph 38
ELECTRICITY PRODUCTION: 2007 - 2011
(12 month % change)

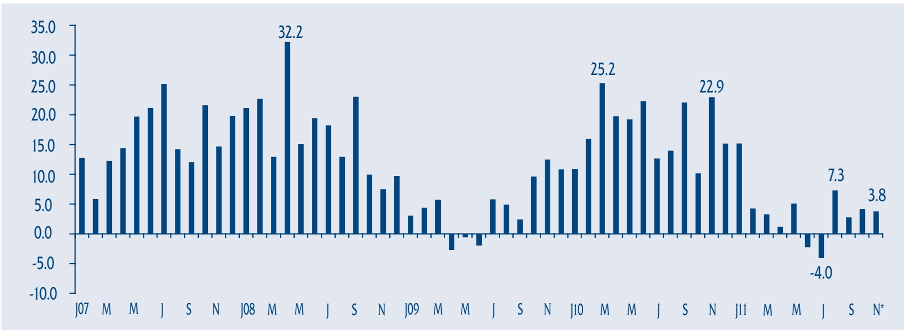
* Preliminary.

d. The volume of imports of capital goods registers lower growth rates.

Graph 39
VOLUME OF IMPORTS OF CAPITAL GOODS: 2007 - 2011
(12 month % change)

e. After falling for two consecutive months, construction has been recovering since August, as reflected in the domestic consumption of cement.

Graph 40
DOMESTIC CONSUMPTION OF CEMENT: 2007 - 2011
(Annual % change)



* Preliminary.

35. In view of the international scenario, the trend of private investment has been revised slightly downwards and a higher slowdown than previously foreseen is expected in 2012. Nonetheless, the growth rate for 2013 is still estimated at 8.3 percent, in line with the pace of implementation of programmed investment projects and with the global economic recovery anticipated.

Table 14
ANNOUNCED INVESTMENT PROJECTS
(Millions of US$)

	2011	2012	2013	2011 - 2013
Mining	4,993	7,360	7,857	20,210
Hydrocarbons	2,341	2,170	3,072	7,583
Electricity	2,022	2,714	2,224	6,960
Industry	1,167	1,040	640	2,847
Infrastructure	1,241	1,055	895	3,191
Other sectors	3,018	2,533	1,962	7,513
TOTAL	**14,782**	**16,872**	**16,650**	**48,304**

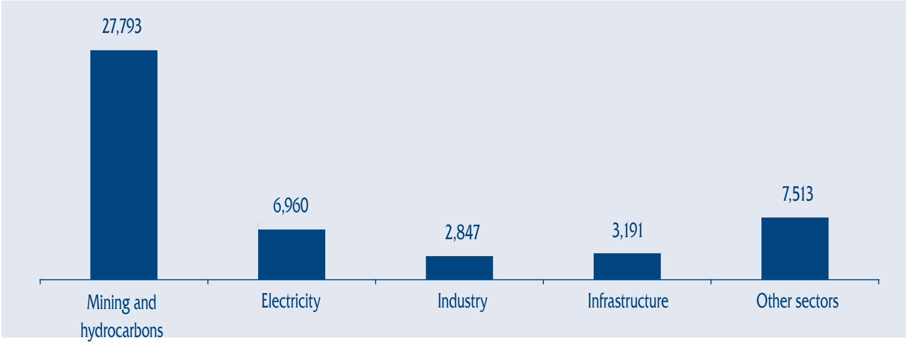
Source: Press media and information companies.

Private investment projects announced for 2012-2013 amount to US$ 33.5 billion, taking into account the temporary postponement of the Conga mining project.

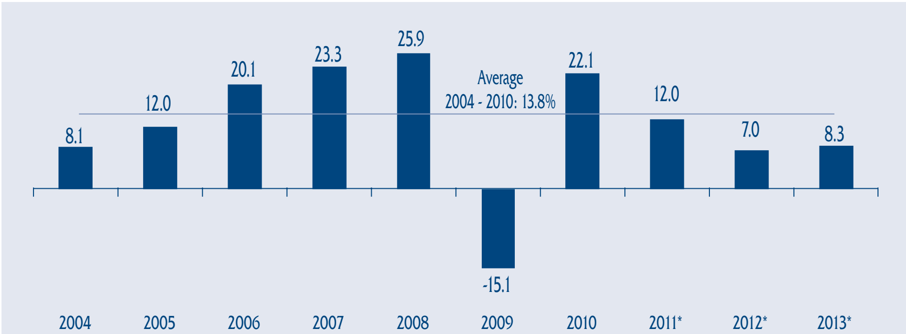
Table 15
ANNOUNCED MAIN INVESTMENT PROJECTS: 2011-2013

SECTOR	COMPANY	PROJECT NAME
Mining	Xstrata Perú S.A.	Las Bambas
	Minera Yanacocha S.R.L.	Minas Conga
	China Minmetals Corporation y Jiangxi Copper Company Limited	El Galeno
	Sociedad Minera Cerro Verde S.A.A.	Cerro Verde
	Jinzhao Mining Perú S.A.	Pampa of Pongo
	Xstrata Perú S.A.	Antapaccay
	Southern Perú Copper Corp. Sucursal of Perú	Los Chancas
	Compañía Minera Antamina S.A.	Expansion: Antamina
	HudBay Minerals Inc.	Constancia
	Candente Copper Perú S.A.	Cañariaco Norte
	Minera Chinalco Perú S.A.	Toromocho
	Marcobre S.A.C.	Mina Justa
	Shougang Hierro Perú S.A.A.	Marcona
	Southern Perú Copper Corp.	Toquepala
	Volcan Compañía Minera S.A.A.	Expansion: Volcan
	Minera Barrick Misquichilca S.A.	Expansion: Lagunas Norte
	Gold Fields La Cima S.A.A.	Chucapaca
	Minera Yanacocha S.R.L.	Chaquicocha
	Mitsui Mining & Smelting Co. Ltda. Sucursal of Perú	Quechua
	Southern Perú Copper Corp. Sucursal of Perú	Cuajone
	Sociedad Minera El Brocal S.A.A.	Colquijirca
	La Arena S.A.	La Arena
	Compañía Minera Milpo S.A.A.	Hilarión
	Sociedad Minera Cerro Verde S.A.A.	PAD 4 (Copper leaching)
Hydrocarbons	Savia Perú S.A.	Lot Z-2B: Perforation, exploration and others
	Petrobras Energía Perú S.A.	Lote 58 and Lote X
	Perenco Peru Limited	Exploration Lot 67 and pipeline
	Kuntur Transportadora de Gas S.A.C.	South Andin pipeline
	Pluspetrol Perú Corp. S.A.	Expansion of Malvinas, new wells Lot 88 and Lot 56
	Transportadora del Gas of Perú S.A. (TgP)	Expansion of gas and capacity of transportation
	Cálidda Gas Natural del Perú	Expansion of gas distribution
	SK Energy	Exploration Lot Z 46
	Pluspetrol Perú Corp. S.A.	Expansion of Pisco plant
	Repsol YPF S.A	Lot 57 - Kinteroni
	Cálidda Gas Natural del Perú	Expansion of main grid
Electricity	Generación Huallaga S.A.	Hydroelectric plant of Cerro de Chagila
	Kallpa Generación S.A.	Hydroelectric plant of Cerro del Águila
	Fénix Power Perú S.A.	Combined cycle thermal power plant (natural gas)
	Norwind	Wind energy park Cerro Chocan
	ENERSUR S.A.	Expansion of Chilca 1
	Kallpa Generación S.A.	Kallpa IV
	SN Power Perú S.A.	Hydroelectric plant of Belo Horizonte
	Asa Iberoamérica	Transmission line of Chilca-Marcona-Montalvo
	Energía Eólica S.A.	Wind energy plant of Cupisnique
	Luz del Sur S. A. A.	Grid and infraestructure expansion
	Enersur S.A.. Endesa	Cold reserve generation - Ilo
Industrial projects	Nitratos del Perú S.A.	Petrochemical plant
	Corporación Aceros Arequipa S.A.	Expansion of lamination plant (N° 2)
	Cementos Interoceánicos	Cement plant Puno
	BACKUS Y JOHNSTON S.A.	Expansion of plant
	Corporación JR Lindley	Expansion and new plants: Trujillo, Pucusana, Cusco, and Iquitos
	PepsiCo	Consolidation and expansion of operations in the local market
	Cementos Lima	Expansion of installed capacity
	Yura S.A.	New lines of production, among other projects
Infrastructure	Línea Amarilla S.A.C. (LAMSAC)	Parque Rimac express way (former Yellow Line express way)
	Tren Lima Línea 1	Parque Rimac express way (former Yellow Line express way)
	Terminal Internacional del Sur (TISUR)	Expansion of Port of Matarani
	CONCESIONARIA VIAL of SOL S.A.	Trujillo-Sullana Sol Highway
	Consorcio APM Terminals Callao	Modernization of North Pier
	Autopista of Norte SAC	Pativilca – Port of Salaverry Road Network No. 4
	Terminales Portuarios Euroandinos (TPE)	Expansion of Port Paita
	Desarrollo Vial de los Andes S.A.C	IIRSA Centro-Eje Amazonas: Section 2
	Consorcio La Chira	La Chira Residual Waters Treatment
Other sectors	Telefónica del Perú S.A.	Optical fiber project at Los Andes
	América Móvil Perú S.A.C.	Expansion of infrastructure, capacity and technological innovation
	Cencosud	15 supermarkets and 2 malls
	Corporación Miraflores	Ethanol plantl
	Grupo Posadas	Hotels
	Crystal Lagoons	La Jolla de Asia project

Graph 41
ANNOUNCED INVESTMENT PROJECTS: 2011-2013
(Millions of US$)

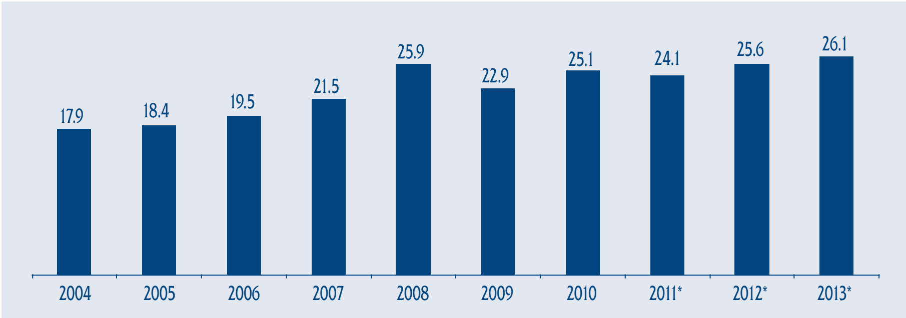


Graph 42
PRIVATE INVESTMENT: 2004 - 2013
(Real % change)



* Forecast.

Graph 43
GROSS FIXED INVESTMENT: 2004 - 2013
(% of GDP)



* Forecast.

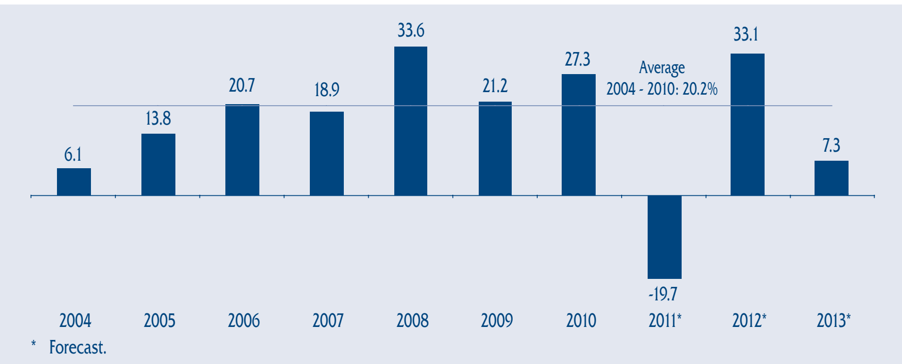
36. International evidence shows that maintaining a high investment-to-GDP ratio helps an economy to reach high levels of growth. The table below shows that countries with an investment-to-GDP ratio of 25 percent raise their rate of growth relative to the global average rate.

Table 16
GROSS FIXED INVESTMENT AND GDP GROWTH

Country	Year when investment reached 25% of GDP	Average growth 5 years later	World average growth 5 years later
Chile	1989	8.2	2.5
China	1980	12.2	3.1
India	1990	5.7	2.7
Korea	1980	9.4	3.1
Singapur	1980	5.9	3.1
Thailand	1980	5.3	3.1
Taiwan	1980	6.4	3.1

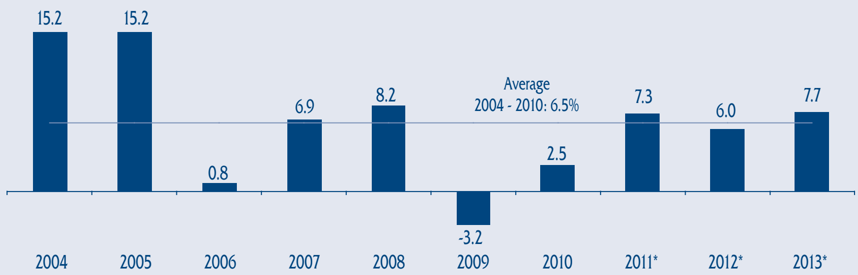
37. Government investment in Q3 was 23.3 percent lower than in the same period of 2010. This decline of investment, which was observed in all the government levels, was particularly noticeable in the case of local governments (-33.2 percent). Government investment is estimated to register a slighter decline in Q4 and to show a recovery in the next two years.

Graph 44
PUBLIC INVESTMENT: 2004 - 2013
(Real % change)



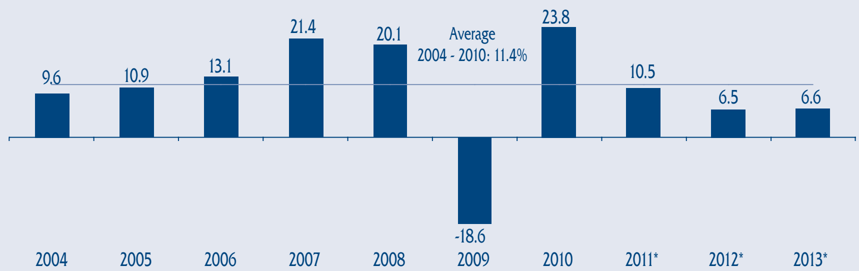
38. The growth of **exports** has been revised downwards for 2012 and 2013 given the current forecasts about the evolution of the international environment. However, exports are still expected to show a growing trend in 2013 as a result of the onset of operations of some investment projects, which would imply a growth rate of exports above the average rate in the period 2004-2010 in that year. Moreover, the lower growth projected in the economy would translate into a lower demand for **imports**, especially imports of capital goods, in line with the revised evolution of private investment.

Graph 45
EXPORTS OF GOODS AND SERVICES: 2004 - 2013
(Real % change)



* Forecast.

Graph 46
IMPORTS OF GOODS AND SERVICES: 2004 - 2013
(Real % change)



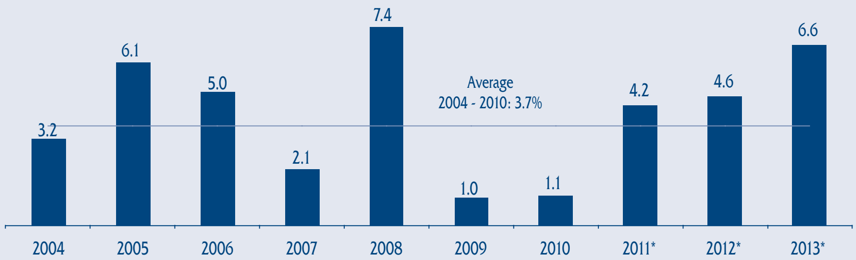
* Forecast.

GDP by sectors

39. In Q3, non primary sectors grew 6.6 percent, supported mainly by activity in trade and other services, which offset the slowdown observed in non primary manufacturing and construction. On the other hand, primary sectors grew 6.5 percent, showing a higher rate than in Q2 due to the contribution of the sectors of fishing and agriculture. In terms of contribution, the sectors of trade and other services account for the difference between the growth rate projected for Q3 and the growth rate achieved. These sectors also account for most of the expansion of GDP in the first nine months of the year (5.6 percentage points of a rate of 7.4 percent).

    Primary sectors are expected to grow 4.2 percent in 2011 and to show rising rates towards the end of the forecast horizon as a result of the onset of operations in mining projects. A rate of 6.6 percent is estimated for 2013.

Graph 47
PRODUCTION IN PRIMARY SECTORS: 2004 - 2013
(Real % change)



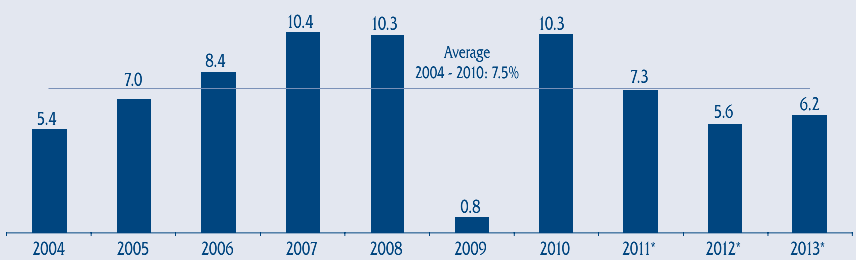
* Forecast.

A differentiated conduct is foreseen in the primary sectors in 2012. Agriculture would grow as a result of the normalization of the rain cycle, while fishing would register a negative growth rate associated with lower fish catch assuming that the normal extraction levels will be resumed. The mining and hydrocarbons sector would register moderate growth rates despite increased production of copper due to the higher content of the metal in Southern' mine of Cuajone, the onset of operations at Xtrata's Antapaccay, and the expansion of Antamina.

The normal climate conditions expected for 2013 would allow a moderate growth in agriculture and the recovery of the fishing sector in that year. The growth of the mining and hydrocarbons sector would stand out in 2013 as a result of the onset of Chinalco's copper project of Toromocho and the development of the projects initiated in 2012. Moreover, the subsector of hydrocarbons would also grow as a result of a higher extraction of natural gas to increase supply in accordance with the expansion of the gas pipeline in the south of the country.

Non primary sectors would show a lower growth in 2012, in line with the evolution foreseen in domestic demand and in non primary manufacturing oriented to exports of non-traditional products, as a result of which the rate of growth of non primary GDP estimated for 2012 and 2013 would be below the average in the period 2004-2010.

Graph 48
PRODUCTION IN NON PRIMARY SECTORS: 2004 - 2013
(Real % change)



* Forecast.

Table 17
GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS
(Real % change)

	2010		2011*			2012*		2013*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
Agriculture and livestock	**3.7**	**4.3**	**3.9**	**3.2**	**3.6**	**5.2**	**5.2**	**4.3**	**4.3**
Agriculture	3.6	4.2	2.7	2.4	2.5	5.8	5.8	3.7	3.7
Livestock	3.8	4.4	5.8	5.2	5.3	4.8	4.8	4.8	4.8
Fishing	**-13.7**	**-16.4**	**27.8**	**29.8**	**28.2**	**-2.0**	**-2.0**	**2.8**	**2.8**
Mining and hydrocarbons	**0.1**	**-0.1**	**-0.6**	**0.5**	**-0.6**	**7.2**	**4.4**	**12.5**	**10.6**
Metallic mining	-4.0	-4.9	-4.9	-2.8	-4.1	6.9	4.3	12.9	9.7
Hydrocarbons	24.0	29.5	24.1	18.0	18.1	8.6	5.3	10.9	14.0
Manufacturing	**13.9**	**13.6**	**7.2**	**7.6**	**5.8**	**5.2**	**4.9**	**6.2**	**6.2**
Raw materials	-1.9	-2.3	12.6	15.4	12.7	2.9	4.0	6.3	6.3
Non-primary industries	17.2	16.9	6.2	6.2	4.6	5.6	5.1	6.2	6.2
Electricity and water	**7.8**	**7.7**	**7.5**	**6.6**	**7.3**	**5.5**	**5.5**	**5.6**	**5.6**
Construction	**18.2**	**17.4**	**3.3**	**3.4**	**3.5**	**8.7**	**8.8**	**7.6**	**7.6**
Commerce	**9.6**	**9.7**	**9.2**	**7.4**	**8.7**	**5.4**	**5.7**	**5.3**	**5.4**
Other services	**7.7**	**8.0**	**8.7**	**7.0**	**8.1**	**5.4**	**5.3**	**6.2**	**6.3**
GDP	**8.6**	**8.8**	**7.4**	**6.3**	**6.8**	**5.7**	**5.5**	**6.3**	**6.3**
Memo:									
Primary GDP	**1.1**	**1.1**	**4.4**	**4.9**	**4.2**	**5.3**	**4.6**	**7.3**	**6.6**
Non-Primary GDP	**10.2**	**10.3**	**8.0**	**6.6**	**7.3**	**5.7**	**5.6**	**6.1**	**6.2**

IR: Inflation Report.
* Forecast.

In January-October 2011, non primary manufacturing grew 5.4 percent, while in the same period of 2010 this sector grew 17.0 percent. The difference observed between both years in non primary manufacturing is mainly explained by lower activity in the textile industry, construction materials, and the paper and printing industry, all of which account for over two thirds of the difference of 11.5 percentage points.

The lower production of textiles resulted from both lower external demand –due mainly to the contraction of orders from the US market– and lower domestic demand, in a context of higher competition with imported products. The decline in the production of construction materials was influenced by the slowdown registered in construction.

Furthermore, the lower production in the paper and printing industry reflected corporate decisions of supplying the Peruvian market with the production of other plants located in the region.

Table 18
NON-PRIMARY MANUFACTURING CONTRIBUTION TO GROWTH
(% points)

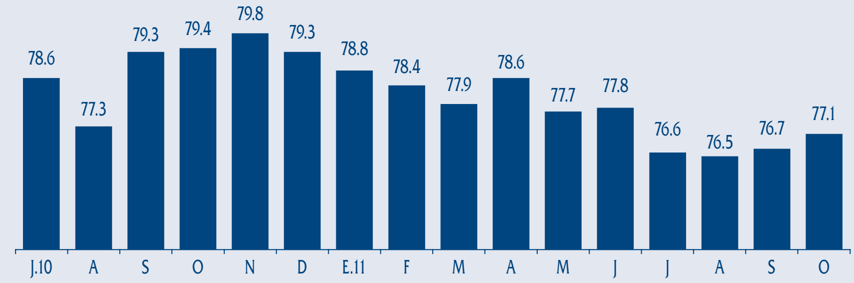
	% change		Contribution to growth		
	Jan. -Oct. 2010/2009 (1)	Jan. -Oct. 2011/2010 (2)	Jan. -Oct. 2010/2009 (3)	Jan. -Oct. 2011/2010 (4)	Difference (5)=(4)-(3)
Non Primary Manufacturing	**17.0**	**5.4**	**17.0**	**5.4**	**-11.5**
Textiles	36.6	6.9	4.5	0.9	-3.6
Other garmets	61.3	13.4	3.3	0.9	-2.4
Knitted garments	14.7	-6.0	0.4	-0.2	-0.6
Yarns, fabrics and clothes	21.9	7.8	0.6	0.2	-0.4
Paper and printing industries	17.9	10.0	2.0	1.0	-1.0
Publishing and printing activities	15.1	12.8	0.8	0.6	-0.2
Other articles of paper and cardboard	21.6	4.4	0.8	0.2	-0.6
Paper and cardboard	17.4	14.5	0.3	0.2	-0.1
Construction materials	23.5	8.0	4.8	1.6	-3.2
Cement	15.4	1.5	0.8	0.1	-0.8
Ceramics and other materials	22.5	-0.2	1.2	0.0	-1.2
Metal products	29.7	12.0	2.0	0.8	-1.2
Rest of branches	10.7	3.3	5.7	1.9	-3.8

Source: Ministry of Production.

40. After declining slightly during the months of July, August, and September, the indicator of the use of installed capacity –measured through the BCRP survey on macroeconomic expectations– reached a level of 77.1 in October. This rate was 0.5 percent higher than the level registered in Q3 which was 76.6 on average.

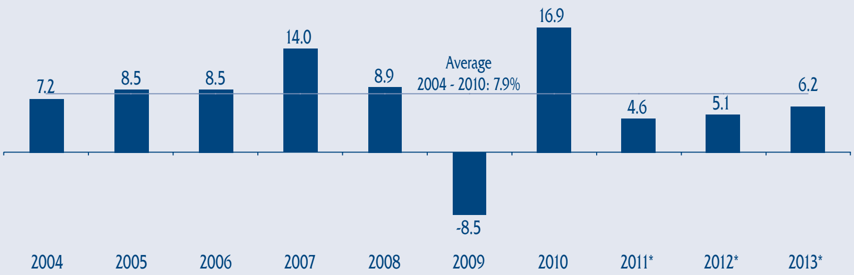
In line with the evolution seen in the case of the production of the non primary manufacturing sector, a decline of 2.3 percent is observed when we compare the level recorded in October 2011 to the level registered in October 2010.

Graph 49
RATE OF INSTALLED CAPACITY UTILIZATION OF NON PRIMARY MANUFACTURING
(%)



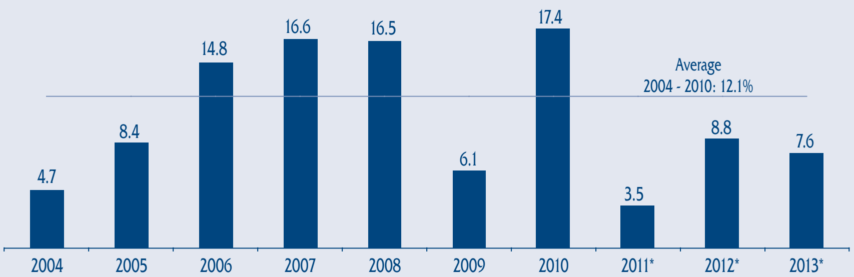
Source: Expectations Survey of the BCRP.

Graph 50
NON-PRIMARY MANUFACTURING: 2004 - 2013
(Real % change)



* Forecast.

Graph 51
CONSTRUCTION: 2004 - 2013
(Real % change)

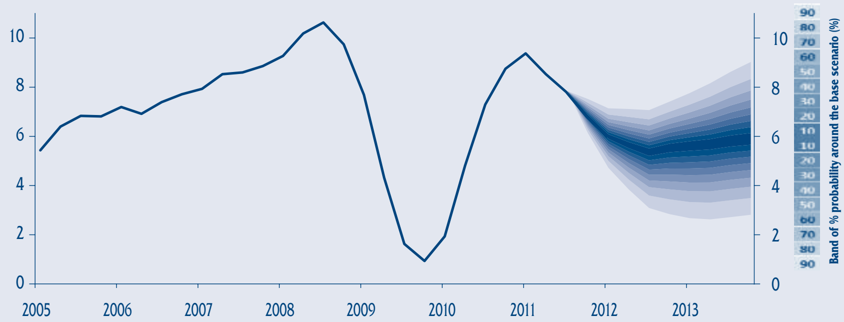


* Forecast.

41. Even though this baseline scenario already considers a deterioration of external conditions, a situation in which developments could cause the worsening of the external crisis could lead to the deterioration of agents' expectations and negatively

affect consumption and investment. In such scenario, lower global growth would affect exports, which would translate into lower domestic production. Furthermore, lower terms of trade would cause a negative income effect which would slow down consumption and investment even further.

Graph 52
FORECAST OF GDP GROWTH: 2011-2013
(Interanual % change)



Memo: The graph shows the probability of occurrence of GDP growth forecasts in the future, the values of which were established combining statistical analysis (using data as of September 2011) and the subjective perception of the BCRP. GDP growth is defined as the percentage change of the moving average in four quarters compared to the same quarter of the previous year. Thus, the figure in Q4 coincides with the GDP growth rate in the year.

The graph consists of 18 bands, each band with a probability of 5% that the projected value may fall within it. Thus, in each period of the forecast horizon, each pair of bands with the same shade concentrates a probability of 10%. This can be interpreted as that 10 of every 100 possible values of future GDP growth values are expected to fall within the darkest bands (located in the center), 10 are expected to fall within the clearer bands adjacent to the darkest ones, other 10 are expected to fall within the even clearer bands located above and below the second group of bands, and so on until 90 of the 100 values are distributed in the graph. The remaining 10 values would fall outside the bands.

The baseline scenario path is contained in the darker bands. The chapter on the balance of risks discusses the risk scenarios used for the inflation forecast in Graph 104. The balance of risks for GDP growth at end-2012 shows a slight downward bias, that is, the probability that GDP growth will be below the forecast considered in the baseline scenario is slightly higher than the probability that it will be above this forecast.

BOX
COMPETITIVENESS AND BUSINESS CLIMATE IN PERU: SITUATION AND AGENDA

Theoretical and empirical literature suggests that the growth of **total-factor productivity (TFP)** is the main source of a country's economic growth[2].

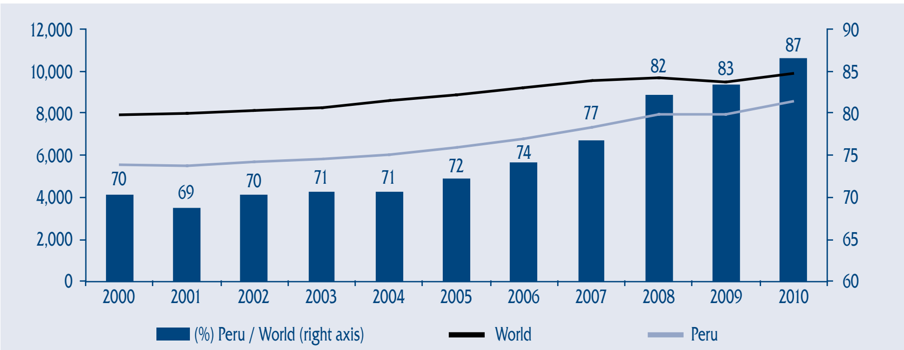
While the role of the accumulation of factors (capital and labor) is relevant to growth, a growing trend of the per capita income in the long term is based on the ability of generating higher value

2 According to the methodology proposed by R. Solow (1957), a country's economic growth may be broken down into the three basic components of the production function: capital, labor, and TFP. The latter measures efficiency in using the productive factors of labor and capital. For a constant level of capital and labor, a higher TFP would imply a higher level of production and, therefore, a greater efficiency in the use of factors.

added sustainably. Given that improved efficiency in the use of factors (TFP) expands the frontier of a country's production possibilities, the growth of TFP increases the potential output of the economy and is thus a determinant of economic growth.

Since 2000, the growth of TFP accounts for over 50 percent of the growth of the per capita income in Peru, which implies a higher average growth of TFP –an annual rate of 2.5 percent– than the one estimated for the last five decades. It should be pointed out that the annual growth of income per capita in Peru during the last decade (4.4 percent) nearly doubled the annual growth of global per capita GDP (2.3 percent) in the same period.

PERU AND THE WORLD: PER CAPITA GDP 2000-2010
(PPP, US$ of Year 2005)



Source: World Development Indicators Database (World Bank, 2011). Elaboration: BCRP

Because of this, Peru ranked 34 among 165 countries in terms of the growth of income per capita between 2000 and 2010, as a result of which GDP per capita in Peru as a percentage of global income per capita rose from 70 to 87 percent. During this decade, GDP per capita in Peru moved from position 75 to position 69 in the ranking of 165 countries.

This positive evolution of TFP and GDP per capita in Peru over the last decade is consistent with the reforms implemented in the country: the consolidation of first-generation reforms focused on macroeconomic stability, on the one hand, and the gradual introduction of second-generation reforms aimed at raising national competitiveness and easing conditions for doing business, on the other hand.

This connection between reforms, productivity and growth is consistent with the international empirical evidence showing the significant positive effects that the improvements made in the macroeconomic and microeconomic conditions for doing business have on the GDP per capita (World Economic Forum, 2008)[3].

3 Global Competitiveness Report 2008-2009 (World Economic Forum, 2008).

Sources of TFP growth

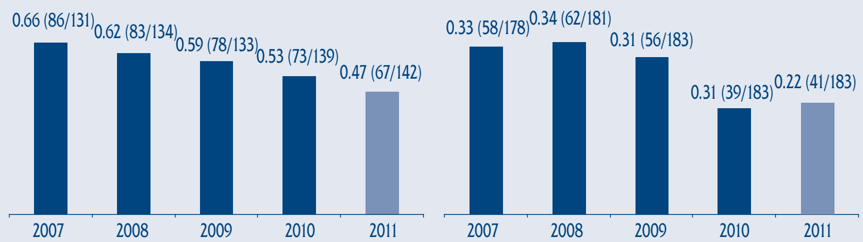
What explains the level and growth of TFP? Productivity is a variable of a multidimensional nature: macro factors, such as macroeconomic stability, and micro factors, such as the legal framework for doing business, complement each other in determining TFP. Taking this into account, several international indicators are used to analyze the evolution of **competitiveness** and the **business climate** in a country, as well as where the country stands in terms of competitiveness and business climate in comparison with other countries

The World Economic Forum (WEF) defines **competitiveness** as the set of institutions, policies and factors that determine a country's level of productivity. On the other hand, the World Bank (WB) defines the **business climate** as the set of institutional factors that induce the private sector to invest in socially desirable projects. Thus, strengthening competitiveness and the business climate is a condition required to promote sustained economic growth and prosperity.

Peru: Current situation and recent trends of sources of TFP growth

In the WEF Global Competitiveness Report 2011-12, released in September 2011, Peru ranked 67 among 142 countries and thus reached for the first time a position among the first half of countries in terms of the world ranking of competitiveness. Peru, which climbed 6 positions in the world ranking compared to the previous year, has escalated a total of 19 positions in the ranking since 2007.

PERU: GLOBAL COMPETITIVENESS INDEX AND EASINESS OF DOING BUSINESS
(Percentile, Relative position)



Memo: The percentile (between number of countries since) summarizes the relative position of the country and corrects the effect of the variation of number of countries in the annual ranking. The information shows the general location of Peru issued by the relevant annual report (not considered due to methodological changes-year adjustments).
Source: Global Competitiveness Report (various issues).

Memo: The percentile (between number of countries since) summarizes the relative position of the country and corrects the effect of the variation of number of countries in the annual ranking. The information shows the general location of Peru issued by the relevant annual report (not considered due to methodological changes-year adjustments).
Source: Doing Business Report (various issues).

The World Bank report Doing Business 2012, published in October 2011, placed Peru in position 41 in the world ranking of 183 countries considered in this report. Having climbed 17 positions over the past five years, Peru is located in the upper third in terms of business climate worldwide.

Competitiveness in Peru

While Peru ranks among the world top 50% of countries in competitiveness according to the WEF, the country shows mixed results in terms of its relative locations:

- Peru is in the world second quintile in four of the 12 pillars of competitiveness: financial market development (position 38), labor market efficiency (position 43), market size (position 48), goods market efficiency (position 50), and macroeconomic stability (position 52).

  Some of the aspects worth pointing out as the country's specific strengths, defined as the indicators where Peru ranks in the world top quintile, are: low inflation, the solvency of the financial system, protection for national and foreign investment, and flexibility to determine wages. An aspect particularly highlighted is that Peru shares the top position at the global level in the control of inflation with countries that recorded an average rate of annual inflation of 0.5 - 2.9 percent in 2010 (Peru recorded a rate of 1.5 percent, a level of inflation within the target range established by the BCRP).

- However, the country is included in the world fourth quintile in four of the 12 pillars tested: innovation (position 113), health and primary education (position 97), institutions (position 95) and infrastructure (position 88).

  The main weaknesses of the country, defined as the primary indicators where the country ranks in the world bottom quintile, concentrate on the pillars of institutions and human capital. Peru is assigned negative ratings in areas such as confidence in the political class, protection to intellectual property rights, public safety, judicial independence, government regulation, and quality of the education system. In addition to this, the high differential in the financial system interest rates contributes to weaken Peru's position in terms of competitiveness.

PERU: GLOBAL COMPETITIVENESS INDEX

GLOBAL COMPETITIVENESS INDEX	2011-2012	2010-2011	Improvement
(General location)	**67**	**73**	**6**
A. Basic requirements	**78**	**87**	**9**
1. Institutions	95	96	1
2. Infrastructure	88	88	0
3. Macroeconomic stability	52	75	23
4. Health and primary education	97	92	-5
B. Reinforcements to the efficiency	**50**	**56**	**6**
5. Higher Education and Training	77	76	-1
6. Efficiency of market of goods	50	69	19
7. Efficiency of labor market	43	56	13
8. Sophistication of financial markets	38	42	4
9. Technological readiness	69	74	5
10. Market size	48	48	0
C. Factors of innovation and sophistication	**89**	**89**	**0**
11. Business sophistication	65	71	6
12. Innovation	113	110	-3

Memo: Realtive position between 139 and 142 countries for 2010-2011 and 2011-2012, respectively.
Source: Global Competitiveness Report 2010-2011 y 2011-2012.

Business climate in Peru

Despite being part of the global top third in terms of ease of doing business, Peru recorded mixed results in its relative ranking:

- The country is in the top quintile globally in three of the 10 analyzed areas: protecting investors (position 17), registering property (position 22), and getting credit (position 24). Moreover, as a result of recent reforms, the Peru is currently among the top third globally in the areas of starting a business (position 55) and trading across borders (position 56).

- However, the country still lags behind internationally in five of the 10 areas: enforcing contracts (position 111), dealing with construction permits (position 101), closing a business (position 100), paying taxes (position 85), and access to electrical energy (position 82).

PERU: EASINESS OF DOING BUSINESS INDEX

EASINESS OF DOING BUSINESS INDEX	2011-2012	2010-2011 1/	Improvement
(General location)	**41**	**39**	**-2**
Investor protection	17	21	4
Registration of ownership	22	24	2
Access to credit	24	21	-3
Opening of business	55	53	-2
Easiness of foreign trade	56	56	0
Electric energy connections	82	83	1
Tax payment	85	93	8
Close of businness	100	102	2
Construction permits	101	96	-5
Enforcement of contracts	111	110	-1

1/The 2010-11 ranking shows the relative position that considers the current methodological adjustments of 2011-12 report.
Memo: Relative location between 183 countries.
Source: Doing Business 2011 and Doing Business 2012.

Peru's competitiveness and business climate at the regional level

According to the WEF Global Competitiveness Report, Peru is in position seven in terms of the 20 countries of the region (after holding position 14 in 2007-08). Along with Brazil, Peru is the country that has improved the most in competitiveness in the region over the past five years given that it has climbed seven positions.

On the other hand, according to the World Bank's Ease of Doing Business report, Peru is the second best country of the 32 countries of Latin America and the Caribbean in terms of favorable business climate, preceded only by Chile.

Final remarks

Over the past five years, Peru has made significant progress in the conditions required at both the macro and micro levels to improve competitiveness and the business climate. The recent positive performance it has shown in terms of competitiveness and ease of doing business is consistent with the economic growth the country has registered in the last decade.

However, in spite of the progress made in terms of sources of productivity growth, pending reforms need to be implemented to enable the country to improve the current relative position it holds in some areas. According to the WEF and the WB reports, opportunities for improvement that are necessary to sustain the growth of Peru include the consolidation of reforms in the following five key areas:

- **Institutions**: reinforce institutional quality, including some key factors such as political stability, property rights, and the solution of legal conflicts.
- **Human capital**: raise the quality of basic and higher education.
- **Infrastructure**: reduce the gaps in terms of physical infrastructure (transport infrastructure mainly).
- **Technology**: promote the adoption of new technologies and investment in R&D.
- **Regulations**: simplify procedures for paying taxes, closing a business, obtaining construction permits, and labor regulations for medium-sized and large firms.

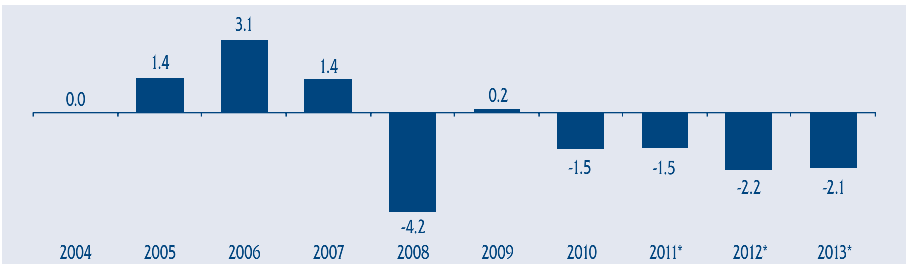
III. Balance of Payments

42. In a context marked by high levels of uncertainty in financial markets and prospects for lower global economic growth, Peru's external accounts continue to show adequate levels of current account deficit, together with significant flows of long-term private capitals which ensure the sustainability of the balance of payments in the medium term. Additionally, the high level of net international reserves held by the Central Bank is an important source of resources that allows the country to respond adequately and on a timely basis to any disturbance that could be caused by the deterioration of external economic conditions.

43. In **Q3-2011**, the current account of the balance of payments recorded a surplus of US$ 121 million (0.3 percent of GDP). The trade surplus was associated with the 8.4 percent rise registered in terms of trade and with a higher volume of exports. On the other hand, outlays for factor income, consisting mainly of corporate profits in companies with foreign shareholding, amounted to US$ 3.09 billion. With this, the current account recorded a deficit of US$ 1.82 billion in the period **January-September**. The trade surplus in this period was US$ 6.95 billion, while remittances from abroad amounted to US$ 1.99 billion. This was offset by the deficit in factor income which amounted to US$ 9.62 billion.

The current account deficit estimated for **2011** would be equivalent to 1.5 percent of GDP, that is, lower than the one forecast in our Report of September (2.8 percent). This downward revision of this deficit reflects the better results observed in Q3 relative to the ones estimated in our previous report due to the improvement registered in terms of trade and the lower factor income.

Graph 53
CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS: 2004-2013
(% of GDP)



* Forecast.

Our previous estimates (IR of September) of the current account deficit have been revised downwards from 2.6 to 2.2 percent of GDP in 2012 and from 2.3 to 2.1 percent of GDP in 2013 as a result of the lower growth foreseen in economic activity and the impact of this on the demand for imports, as well as a result of a lower factor income associated with the lower prices of exports.

Table 19
BALANCE OF PAYMENTS
(Millions of US$)

	2010		2011*			2012*		2013*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
I. CURRENT ACCOUNT BALANCE	**-1,784**	**-2,315**	**-1,816**	**-4,915**	**-2,675**	**-5,140**	**-4,258**	**-4,960**	**-4,418**
% of GDP	*-1.2*	*-1.5*	*-1.1*	*-2.8*	*-1.5*	*-2.6*	*-2.2*	*-2.3*	*-2.1*
1. Trade Balance	4,626	6,750	6,950	7,725	8,874	7,350	6,862	8,982	8,152
a. Exports	25,387	35,565	34,443	44,785	45,448	46,964	45,093	51,607	49,548
b. Imports	-20,761	-28,815	-27,494	-37,060	-36,574	-39,614	-38,231	-42,625	-41,397
2. Services	-1,457	-2,037	-1,510	-2,502	-2,160	-2,639	-2,342	-2,773	-2,489
3. Investment Income	-7,154	-10,053	-9,622	-13,353	-12,640	-13,298	-12,245	-14,683	-13,774
4. Current transfers	2,200	3,026	2,366	3,216	3,252	3,447	3,467	3,515	3,694
Of which: Remittances	1,833	2,534	1,989	2,752	2,750	3,001	2,955	3,068	3,181
II. FINANCIAL ACCOUNT	**11,113**	**13,285**	**4,863**	**10,414**	**8,175**	**7,640**	**7,058**	**7,459**	**7,218**
Of which:									
1. Private Sector (long and short term)	11,152	13,925	7,103	9,981	8,720	7,368	6,626	7,590	7,261
2. Public Sector	-617	-1,022	-177	142	-54	710	412	-48	-48
III. BALANCE OF PAYMENTS (=I+II)	**9,329**	**10,970**	**3,047**	**5,500**	**5,500**	**2,500**	**2,800**	**2,500**	**2,800**
Memo:									
Gross long-term external private financing									
Millions US$	8,624	12,053	8,657	10,754	10,760	10,772	8,873	11,810	11,080
% of GDP	5.8%	7.8%	5.0%	6.1%	6.1%	5.6%	4.6%	5.6%	5.3%
Balance of NIRs									
Millions US$		44,105		49,605	49,605	52,105	52,405	54,604	55,205
% of GDP		28.6%		28.3%	28.1%	26.9%	27.1%	25.9%	26.3%

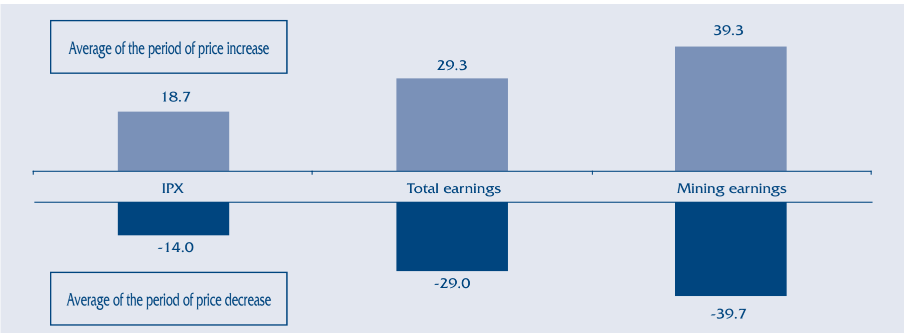
IR: Inflation Report.
* Forecast.

44. Even though these forecasts are in line with the baseline scenario, there are risks that could cause forecasts to divert from this scenario should they materialize.

These risks are mainly associated with the terms of trade, the demand of our main trading partners, and capital flows due to the negative effects of a deterioration of the global economy.

Due to uncertainty associated with the international environment, the current account of the balance of payments could be affected through the trade channel by variations in terms of trade. However, empirical evidence based on data over the past 5 years shows that the net effect of such variations in the trade balance on the current account is offset by the effect of the variations of external prices on factor income through profits. Thus, when we use the annual variation of the quarterly moving average between 2007 and 2011, we can see that in the periods with price rises the indices of export prices grew at an average rate of 18.7 percent, while mining profits grew 39.3 percent. Likewise, we can see that in the periods with price drops the indices of export prices declined on average 14.0 percent and mining profits declined 36.7 percent.

Graph 54
AVERAGE QUARTERLY MOVIL
(12 month % change)

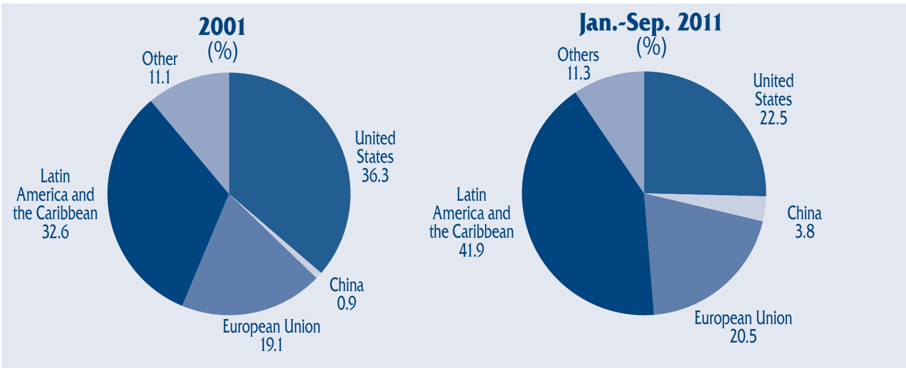


45. **Exports** grew 35.7 percent in Q3-2011 compared to the same period in 2010, reflecting the increase observed in both the volumes and average prices of exports. The volume of exports of traditional products grew 3.4 percent due to increased shipments of gold and coffee, while the volume of exports of non-traditional products grew 24.5 percent mainly due to higher exports of farming, fishing, and chemical products.

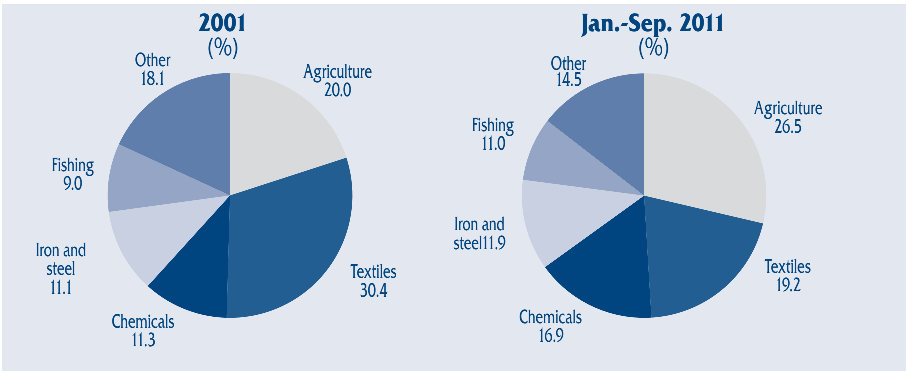
On the other hand, the average prices of exports grew 25.9 percent compared to Q3-2010 due to the higher prices of the major mining commodities –copper, gold, and zinc– and the higher prices of non-traditional products, especially textiles and steel & iron products.

In recent years the country's exports have shown an increasing diversification and Latin America has become the main destination of its non-traditional exports. Moreover, exports of agricultural and chemical goods have gained increased importance.

Graph 55
NON TRADITIONAL EXPORTS BY REGION



Graph 56
NON TRADITIONAL EXPORTS BY PRODUCT

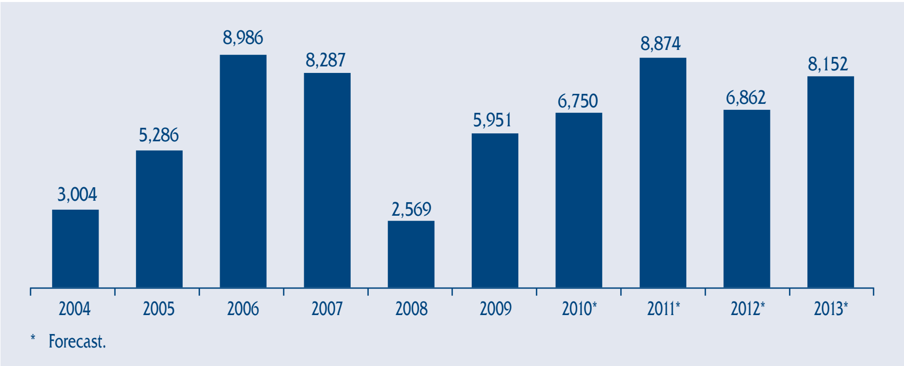


46. Imports, which amounted to US$ 9.73 billion in Q3, were 24.5 percent higher than in Q3-2010. The volume of imports grew 7.2 percent due to the increased acquisition of capital goods and consumer goods.

    The average price of imports grew 16.1 percent compared to the same period in 2010 due to the higher prices of food products classified as inputs (wheat, maize, and dairy products), oil, and industrial inputs.

47. The forecast surplus in the 2011 **trade balance** has been revised upwards from US$ 7.7 billion (Inflation Report of September) to US$ 8.9 billion considering a higher growth of terms of trade than the one estimated in our previous Report.

Graph 57
TRADE BALANCE 2004-2013
(Millions of US$)



The surplus in the trade balance in 2012, which would amount to US$ 6.9 billion, would be lower than foreseen in our previous Report due to lower than expected terms of trade and lower volume of trade. In 2013, the trade surplus would increase to US$ 8.2 billion in a context of stable terms of trade and a pace of growth in the global economy higher than in 2012.

Table 20
TRADE BALANCE
(% change)

	2010	2011*		2012*		2013*	
		IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
1. Value:							
Exports	31.9	25.9	27.8	4.9	-0.8	9.9	9.9
Traditional products	34.2	25.6	27.5	2.9	-3.6	9.5	9.1
Non-traditional products	23.5	27.4	29.2	11.5	8.5	11.5	12.5
Imports	37.1	28.6	26.9	6.9	4.5	7.6	8.3
2. Volume:							
Exports	1.9	7.5	7.2	7.0	5.6	9.8	8.6
Traditional products	-2.7	5.1	4.1	6.9	5.4	9.9	8.4
Non-traditional products	15.3	15.8	17.8	7.4	6.3	9.3	9.2
Imports	24.1	13.0	12.3	6.2	5.7	8.0	7.7
3. Price:							
Exports	29.9	17.2	19.2	-2.0	-6.1	0.1	1.2
Traditional products	37.8	19.5	22.5	-3.8	-8.6	-0.4	0.6
Non-traditional products	7.1	10.0	9.7	3.8	2.0	2.0	3.0
Imports	10.1	12.8	13.1	1.3	-0.3	-0.3	0.6

IR: Inflation Report.
* Forecast.

Table 21
TRADE BALANCE
(Millions of US$)

	2010		2011*			2012*		2013*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
Exports	**25,387**	**35,565**	**34,443**	**44,785**	**45,448**	**46,964**	**45,093**	**51,607**	**49,548**
Of which:									
Traditional products	19,872	27,669	26,955	34,750	35,283	35,741	34,011	39,120	37,117
Non-traditional products	5,336	7,641	7,264	9,735	9,875	10,850	10,709	12,103	12,048
Imports	**20,761**	**28,815**	**27,494**	**37,060**	**36,574**	**39,614**	**38,231**	**42,625**	**41,397**
Of which:									
Consumer goods	3,877	5,489	4,821	6,529	6,577	7,115	7,195	7,800	7,810
Inputs	10,171	14,023	13,613	18,786	17,900	18,435	18,033	19,133	19,078
Capital goods	6,551	9,074	8,769	11,574	11,723	13,857	12,564	15,477	14,048
TRADE BALANCE	**4,626**	**6,750**	**6,950**	**7,725**	**8,874**	**7,350**	**6,862**	**8,982**	**8,152**

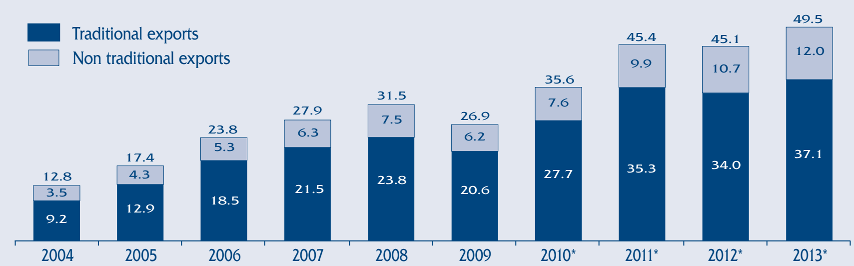
IR: Inflation Report.
* Forecast.

48. **Exports** in 2011 have been revised upwards and would amount to US$ 45.4 billion. This rise would be mainly associated with a price effect due to a rise in the prices of commodities higher than the one foreseen in our previous Report.

Exports would amount to US$ 45.1 billion and to US$ 49.5 billion in 2012 and 2013, respectively.

In terms of volume, exports in 2012 would grow 5.6 percent –showing a lower growth rate than in 2011 (7.2 percent)– due to lower volumes of exports of zinc, silver, and non-traditional products amid lower global growth rates. In 2013, exports would grow 8.6 percent, showing a lower growth rate than the one estimated in our Report of September (9.8 percent) due to lower volumes of exports of copper and zinc.

Graph 58
EXPORTS OF GOODS: 2004-2013
(Billions of US$)



Memo: Total exports also includes other exports.
* Forecast.

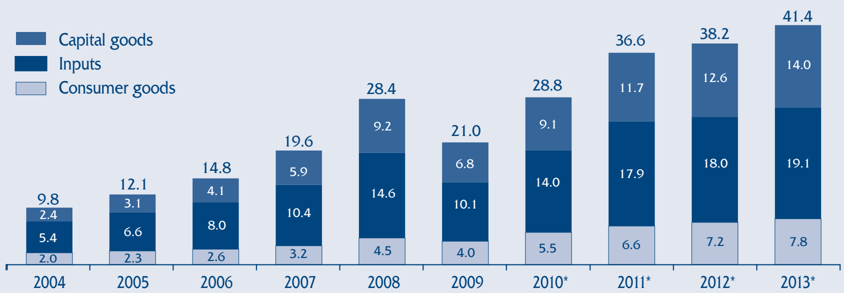
The volume of non-traditional exports in 2012-2013 is expected to grow at an average rate of 8 percent as a result of the recovery of the world economy and of Peru's increased access to international markets due to the effect of the trade agreements already signed or being negotiated. As a result, the volume of exports in 2013 would be 2.7 times the one recorded in 2003.

Graph 59
NON TRADITIONAL EXPORTS
Volume index (1994=100)

* Forecast.

49. **Imports** in 2011 would show a growth rate of 27 percent and amount to US$ 36.6 billion, the volume of imports recording a growth rate of 12 percent in the year. In 2012 and 2013, imports are estimated to have a lower growth in terms of volume than the one considered in our previous Report (5.7 and 7.7 percent versus 6.2 and 8.0 percent, respectively), in line with the more moderate pace of growth anticipated in economic activity.

Graph 60
IMPORTS OF GOODS: 2004 - 2013
(Billions of US$)



Memo: Total imports also includes other imports.
* Forecast.

Financial account

50. In Q3-2011 the private sector's long term financial account –consisting mainly of net loans between parent companies and firms with foreign shareholding– showed a balance of US$ 3.11 billion. Moreover, long term external loans amounted to US$ 1.12 billion. This higher inflow of private capitals was partially offset by a negative flow of short term capitals due to the financial and non financial sectors' increased assets abroad as well as due to the non financial sector's lower liabilities (US$ 1.05 billion).

Comparing the balance with the one recorded in the same period in 2010, between January and September 2011 the share of foreign direct investment flows in the country was lower and partially offset by a higher share of long terms loans. In 2011 the financial account is foreseen to show a balance of US$ 9.5 billion, a similar result to the one estimated in our Report of September (US$ 9.7 billion).

In 2012-2013 the financial account of the private sector would show lower flows than in 2011 as a result of lower reinvestment –in line with lower terms of trade– and the temporary postponement of investment projects.

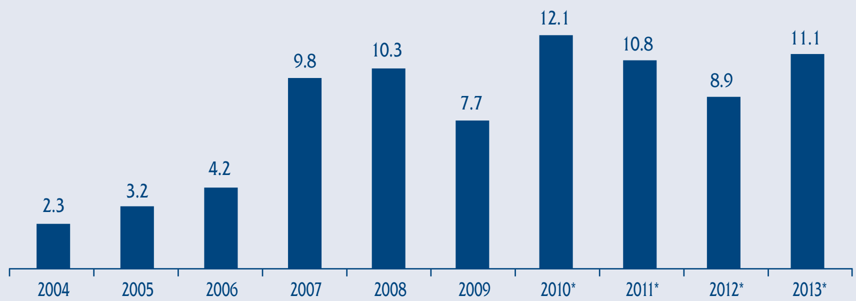
Long term external financing –net foreign direct investment plus disbursements– would be lower than considered in our September Report and would amount to US$ 10.8 billion in 2011 and to US$ 11.1 billion in 2013.

Table 22
PRIVATE SECTOR FINANCIAL ACCOUNT
(Millions of US$)

	2010		2011*			2012*		2013*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
1. ASSETS	**351**	**-1,041**	**-484**	**-519**	**-909**	**-2,759**	**-1,617**	**-3,594**	**-3,232**
Direct investment abroad	-134	-215	-178	31	-178	0	0	0	0
Portfolio investment abroad 1/	485	-826	-306	-550	-731	-2,759	-1,617	-3,594	-3,232
2. LIABILITIES	**9,230**	**14,365**	**8,579**	**10,216**	**10,446**	**10,127**	**8,243**	**11,184**	**10,493**
Foreign direct investment in the country	6,061	7,328	5,902	8,578	7,627	8,610	7,335	9,472	8,772
Foreign portfolio investment in the country	1,604	3,284	113	230	120	362	362	462	462
Long-term loans	1,566	3,752	2,564	1,408	2,699	1,155	546	1,250	1,259
Disbursements	2,697	4,940	2,933	2,145	3,311	2,162	1,538	2,338	2,308
Amortization	-1,131	-1,187	-370	-737	-612	-1,006	-992	-1,089	-1,050
3. Total	**9,581**	**13,324**	**8,095**	**9,697**	**9,537**	**7,368**	**6,626**	**7,590**	**7,261**

IR: Inflation Report.
* Forecast.

Graph 61
PRIVATE SECTOR EXTERNAL FINANCING 1/
(Billions of US$)



1/ Foreign direct investments plus long term dibursments.
* Forecast

51. Net international reserves **(NIRs)** at November 2011 amounted to US$ 49.05 billion. This level of reserves ensures the soundness of the Peruvian economy face possible real and financial shocks. Moreover, this level of reserves, which represents 28.6 percent of GDP, backs up 89.1 percent of total liquidity in depository institutions, and is equivalent to 5.3 times short term public and private external debt liabilities, provides the Peruvian economy with one of the highest levels of reserve coverage in the region.

Table 23
NIR INDICATORS

	2006	2010	Nov.11
Net International Reserves (NIR, millions of US$)	17,275	44,105	49,050
NIR/GDP* (%)	18.7	28.7	28.6
NIR/Short term debt* (# of times)	2.9	5.2	5.3
NIR/Total Liquidity (%)	80.2	90.6	89.1

* Accumulated at the previous quarter.

IV. Public Finances

52. The fiscal policy measures adopted over the year were aimed at withdrawing the fiscal stimulus that had been implemented since the end of 2008. The caps imposed on government spending, especially during the first semester of 2011, were oriented to recovering a fiscal space whose importance grew due to the context of increasing uncertainty observed in external markets as a result of the evolution of the current crisis affecting developed countries and particularly Europe. The effect of these measures, together with delays in the budget execution due to the change of subnational and national authorities after the elections, resulted in a higher than expected fiscal adjustment in this year, which has allowed offsetting to some extent the pressures of the strong dynamism of private expenditure on the economic cycle.

53. In January-September the operations of the non financial public sector (NFPS) accumulated an **economic surplus** of 4.1 percent of GDP, a balance higher by 2.8 percentage points than the one recorded in the same period in 2010 (1.3 percent). This positive balance stems, on the one hand, from the increase recorded in the current revenues of the general government (15.1 percent in real terms), and on the other hand, from the reduction of non financial expenditure (1.0 percent in real terms), particularly capital expenditure which declined 19.5 percent.

Table 24
GENERAL GOVERNMENT NON FINANCIAL EXPENDITURE
(Real % change)

	2010				2011			
	I Quarter	II Quarter	III Quarter	Jan-Sep.	I Quarter	II Quarter	III Quarter	Jan-Sep.
I. CURRENT EXPENDITURE	**5.4**	**8.6**	**4.1**	**6.0**	**5.8**	**4.3**	**9.0**	**6.5**
National government	2.6	8.7	3.2	4.8	10.4	4.4	12.7	9.2
Regional governments	6.0	3.7	2.7	4.1	-0.2	2.2	1.3	1.1
Local governments	24.2	16.1	11.5	16.7	-11.8	6.9	2.4	-0.1
II. CAPITAL EXPENDITURE	**25.6**	**49.0**	**21.3**	**31.7**	**-22.3**	**-15.9**	**-21.5**	**-19.5**
National government	31.2	85.8	25.6	48.2	7.3	3.6	-6.5	1.0
Regional governments	50.9	45.1	26.9	37.7	-10.4	-26.4	-28.2	-23.9
Local governments	11.7	17.0	15.6	15.3	-59.7	-38.7	-30.5	-39.5
III. TOTAL EXPENDITURE	**9.2**	**18.8**	**9.0**	**12.3**	**-0.3**	**-2.1**	**-0.7**	**-1.0**
National government	5.9	21.2	7.0	11.3	10.0	4.2	8.9	7.6
Regional governments	12.9	13.7	9.6	12.0	-2.3	-6.7	-8.5	-6.1
Local governments	17.9	16.6	13.9	15.9	-34.7	-17.7	-17.3	-21.7

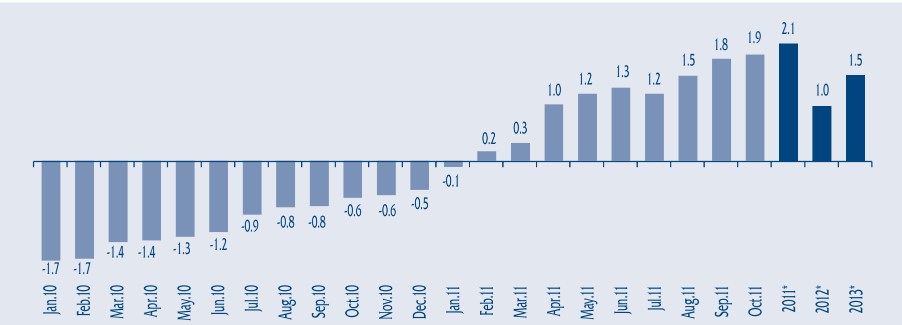
	2010				2011			
	I Quarter	II Quarter	III Quarter	Jan-Sep.	I Quarter	II Quarter	III Quarter	Jan-Sep.
I. CURRENT EXPENDITURE	**4.4**	**6.4**	**3.0**	**4.5**	**4.5**	**3.0**	**6.2**	**4.6**
National government	1.5	4.4	1.5	2.5	5.7	2.1	5.8	4.5
Regional governments	0.9	0.5	0.4	0.6	0.0	0.3	0.2	0.2
Local governments	2.0	1.5	1.0	1.5	-1.1	0.6	0.2	0.0
II. CAPITAL EXPENDITURE	**4.8**	**12.4**	**6.1**	**7.8**	**-4.8**	**-5.0**	**-6.8**	**-5.6**
National government	2.4	8.4	2.5	4.4	0.7	0.6	-0.7	0.1
Regional governments	1.4	2.1	1.6	1.7	-0.4	-1.5	-1.9	-1.3
Local governments	1.0	1.8	2.0	1.7	-5.1	-4.1	-4.2	-4.4
III. TOTAL EXPENDITURE	**9.2**	**18.8**	**9.0**	**12.3**	**-0.3**	**-2.1**	**-0.7**	**-1.0**
National government	3.9	12.8	4.0	6.9	6.3	2.6	5.0	4.6
Regional governments	2.4	2.7	2.0	2.3	-0.4	-1.3	-1.7	-1.2
Local governments	2.9	3.3	3.0	3.1	-6.1	-3.4	-3.9	-4.4

Table 25
GENERAL GOVERNMENT NON FINANCIAL EXPENDITURE
(Contribution to the real % change)

54. The evolution of non-financial spending, particularly at the local and regional levels, has been crucial in determining the balance of the January-September period. A decline of 21.7 percent was observed in the spending of local governments, in contrast with the increase of 15.9 percent it recorded in the same period last year. On the other hand, regional governments reduced their spending by 6.1 percent, which contrasts with the increase observed in this spending last year (12.0 percent). In both cases, spending dropped mainly in terms of capital expenditures due to a weak implementation of investment projects, even though in the case of local governments this drop also involved a slight decline in current expenditure.

Despite a number of measures adopted by the central government to increase the dynamism of spending in order to reach the goals of the Multiannual Macroeconomic Plan (MMP), executed expenditure during the months of October and November still shows a slower pace than the one expected for this period.

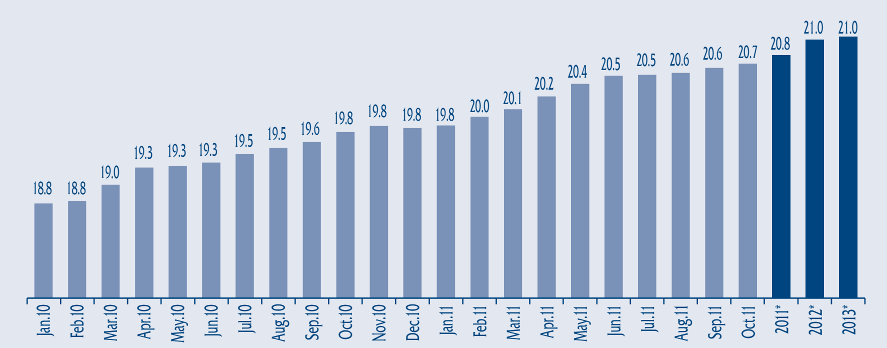
Graph 62
ECONOMIC BALANCE OF THE NON FINANCIAL PUBLIC SECTOR:
(Accumulated last 12 months- % of GDP)



* Forecast.

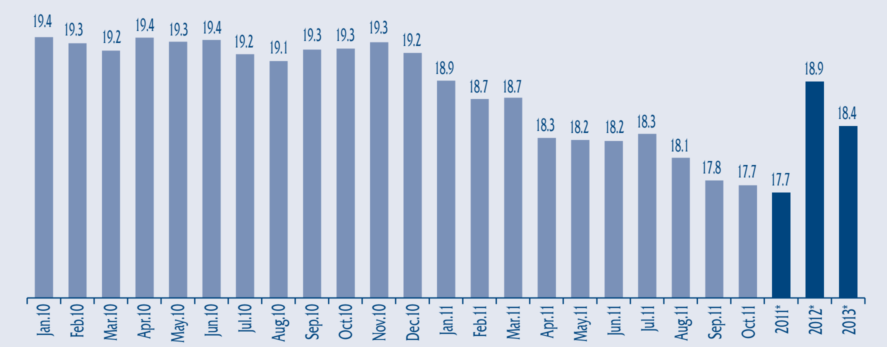
Considering that current revenues still maintain a relative dynamism and that government spending in Q4 would not show a positive variation, it is estimated that **in 2011 the NFPS will register a surplus of 2.1 percent of GDP**, a higher surplus than the one foreseen in our Report of September (1.0 percent of GDP).

Graph 63
GENERAL GOVERNMENT CURRENT REVENUES
(Accumulated last 12 months- % of GDP)



* Forecast.

Graph 64
GENERAL GOVERNMENT NON FINANCIAL EXPENDITURE
(Accumulated last 12 months- % of GDP)

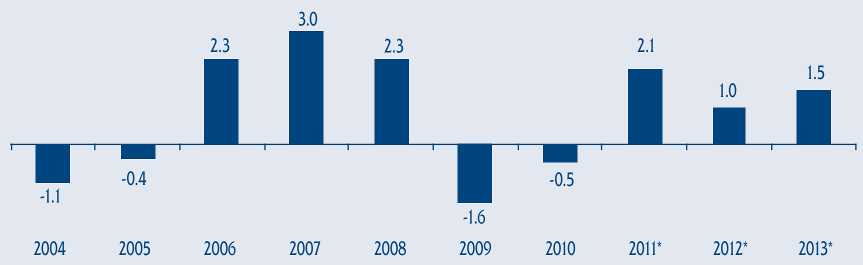


* Forecast.

Although they would be lower, fiscal surpluses are also estimated for the next years. The fiscal surplus in **2012** would be equivalent to **1.0 percent of GDP**, in line with the goals established in the MMP, and the surplus in **2013** would reach **1.5 percent of GDP**. These results would reflect a moderate growth of revenues due to lower terms of trade, as well as a growth of spending assuming that subnational governments will overcome the problems of budget execution they faced in 2011.

It should be pointed out that these forecasts are consistent with the baseline scenario. However, should the risks currently observed in the global economy materialize and affect the prices of our commodities and the demand for our exports, this would result in a deterioration of the results foreseen given that, on the one hand, the government revenues would be lower and, on the other hand, government spending would have to increase to reduce the possible negative effects of an eventual worsening of the international economic conditions.

Graph 65
ECONOMIC BALANCE OF THE NON FINANCIAL PUBLIC SECTOR: 2004-2013
(% of GDP)



* Forecast.

Table 26
NON FINANCIAL PUBLIC SECTOR
(% of GDP)

	2010		2011*			2012*		2013*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
1. General government current revenues 1/	**20.2**	**19.8**	**21.2**	**20.7**	**20.8**	**20.9**	**21.0**	**20.9**	**21.0**
Real % change	*19.1*	*18.4*	*15.1*	*12.4*	*13.4*	*6.0*	*4.6*	*6.5*	*6.6*
2. General government non financial expenditure 2/	**17.6**	**19.2**	**15.9**	**18.6**	**17.7**	**18.6**	**18.9**	**18.4**	**18.4**
Real % change	*12.3*	*10.7*	*-1.0*	*3.8*	*-0.7*	*4.9*	*10.7*	*5.4*	*3.6*
Of which:									
a. Current	12.5	13.2	12.2	13.0	13.0	12.5	12.8	12.2	12.4
Real % change	*6.0*	*6.9*	*6.5*	*6.1*	*6.2*	*1.0*	*2.6*	*3.9*	*3.1*
b. Gross capital formation	4.6	5.5	3.4	5.2	4.4	5.7	5.7	5.8	5.6
Real % change	*32.4*	*20.8*	*-18.8*	*1.3*	*-14.1*	*14.0*	*33.6*	*9.3*	*4.8*
3. Others	**0.1**	**0.1**	**0.1**	**0.0**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
4. Primary balance (1-2+3)	**2.6**	**0.7**	**5.4**	**2.2**	**3.2**	**2.4**	**2.1**	**2.6**	**2.6**
5. Interests	**1.3**	**1.2**	**1.3**	**1.2**	**1.2**	**1.2**	**1.2**	**1.1**	**1.1**
6. Overall Balance	**1.3**	**-0.5**	**4.1**	**1.0**	**2.1**	**1.2**	**1.0**	**1.4**	**1.5**
Memo:									
1. Central government current revenues (billions of S/.)	64.5	86.1	76.4	99.8	100.9	108.6	109.0	117.9	118.3
2. Central government non-financial expenditure (billions of S/.)	56.3	83.5	57.4	89.3	85.8	96.3	98.0	103.5	103.5

1/ The central government includes the ministries, national universities, public agencies and regional governments. The general government has a wider coverage that includes the central government, social security, regulators and supervisors, government charity organizations and local governments.
2/ Includes the compensation payment to the Fuel Price Stabilization Fund (FPSF)
IR: Inflation Report.
* Forecast.

Evolution of fiscal revenues

55. **In January-September 2011, the current revenues of the general government** amounted to 21.2 percent of GDP. Tax revenues grew 14.5 percent, with the income tax showing a significant growth (29 percent) due especially to the income tax paid by companies of the hydrocarbons and mining sectors in a context of rising prices for our commodities.

Table 27
THIRD CATEGORY INCOME TAX 1/
(Millions of nuevos soles)

	January - September		
	2010	2011	Real % change 1/
TOTAL REVENUES	**10,795**	**14,483**	**30.3**
Mining	3,633	4,934	31.9
Other Services 2/	3,326	4,213	23.0
Manufacturing	1,387	1,819	27.3
Comerce	1,382	1,799	26.4
Hydrocarbons	613	1,080	71.1
Construction	363	518	38.7
Fishing	71	78	6.6
Agriculture and livestock	19	41	109.5

1/ Non including income tax regularization, non residential rents.
2/ Includes real estate activities, of business and rent, telecommunications, financial intermediation, health, social services, tourism and hospitality, generation of electricity and water, and others.
Source: Sunat.

On the other hand, in January-September 2011, revenues from the VAT grew by a real 12.0 percent given that the revenues from the domestic VAT grew by 8.9 percent and the revenues from the external VAT grew by 15.8 percent, even though the rate for this tax was lowered from 19 to 18 percent since March 1. Non tax revenues also showed a positive evolution due to the higher revenues from oil, gas, and mining royalties, which were favored by the high prices of crude and minerals and together grew by a real 50 percent.

56. Considering the current economic scenario as well as the recent evolution of tax revenues, **the current revenues of the general government in 2011** (20.8 percent of GDP) would be higher than estimated in the Inflation Report of September (20.7 percent of GDP) due to higher economic activity and the higher prices of our commodities. The increase in the current revenues of the general government would be mainly associated with the evolution of the income tax, the VAT, and non tax revenues (oil, gas, and mining royalties).

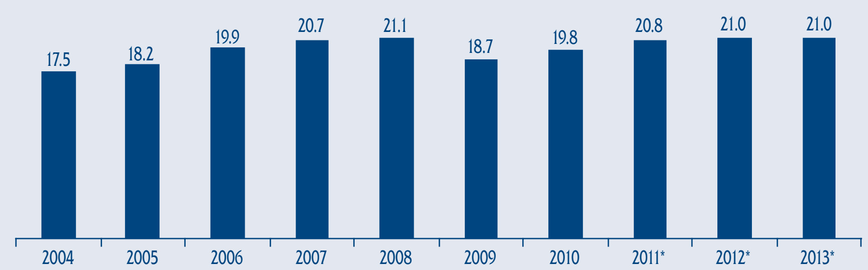
It is worth pointing out that the tax treatment for mining companies in terms of royalties was modified in September. The regulations published[4] then established a special mining levy for the mining companies that have signed tax stability agreements, while a special mining tax was created for the companies that have not signed agreements and a new regime of mining royalties that replaces the previous one was also established. In all three cases, the tax burden on the mining company depends on its operational usefulness (in contrast with the previous royalty system in which the royalty was paid based on the value of the mineral concentrate) and the amounts paid are deductible as an expense for income tax purposes. A gross annual revenue of 0.6 percentage points of GDP is estimated from these royalties.

Table 28
GENERAL GOVERNMENT CURRENT REVENUES
(% of GDP)

	2010		2011*			2012*		2013*	
	Jan-Sep	Year	Jan-Sep	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
TAX REVENUES	**15.5**	**15.2**	**16.1**	**15.8**	**15.9**	**15.7**	**15.8**	**15.7**	**15.8**
Income tax	6.2	5.9	7.3	7.0	6.9	6.9	6.7	6.8	6.7
Value added tax	8.1	8.2	8.3	8.3	8.3	8.4	8.5	8.4	8.5
Excise tax	1.1	1.1	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Import duties	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other tax revenues	1.4	1.4	1.4	1.3	1.4	1.3	1.5	1.3	1.5
Tax returns	-1.8	-1.8	-2.0	-2.1	-2.0	-2.1	-2.0	-2.1	-2.0
NON TAX REVENUES	**3.1**	**3.0**	**3.3**	**3.2**	**3.2**	**3.6**	**3.4**	**3.6**	**3.5**
CONTRIBUTIONS	**1.7**	**1.7**	**1.7**	**1.7**	**1.7**	**1.7**	**1.8**	**1.6**	**1.8**
TOTAL	**20.2**	**19.8**	**21.2**	**20.7**	**20.8**	**20.9**	**21.0**	**20.9**	**21.0**

* Forecast.

Graph 66
GENERAL GOVERNMENT CURRENT REVENUES: 2004-2013
(% of GDP)



* Forecast.

4 Law amending the Law of Mining Royalty (Law No. 29788 enacted on September 28, 2011), Law establishing the Special Tax to Mining (Law No. 29789 enacted on September 28, 2011) and the Law establishing the legal framework of the Special Levy for Mining (Law 29790 enacted on September 28, 2011).

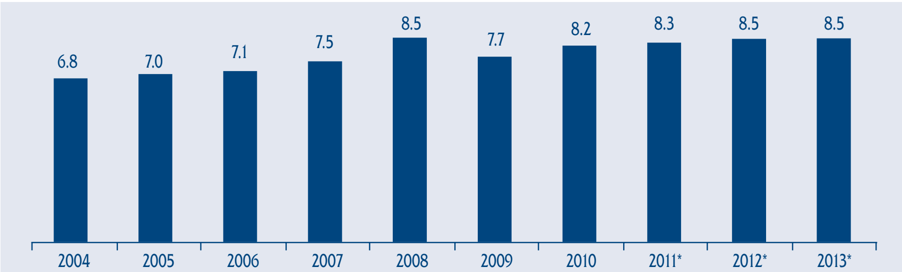
57. Showing a remarkable growth relative to 2010 when they represented 5.9 percent of GDP, the revenues from the **income tax** in 2011 would be equivalent to 6.9 percentage points of GDP. This growth would result from the higher income tax payments of mining companies, reflecting the increase registered in the prices of export metals compared to 2010, as well as from the higher ratios of firms' advanced payments on account[5] of income tax declared by firms in the 2011 tax regularization campaign.

Graph 67
INCOME TAX AND EXPORT PRICE INDEX: 2004-2013

* Forecast.

58. Revenues from the **value added tax (VAT)** –the main tax revenue– would increase slightly in 2011 in GDP terms (from 8.2 to 8.3 percent) even though the rate of this tax has been lowered by one percentage point (from 19 to 18 percent) since March 2011. The positive evolution of domestic demand, as well as a series of administrative measures –elimination of some tax exemptions on contracts of construction, gold, paprika, asparagus, and non gold metallic minerals– have offset the impact of the reduction of this tax rate.

Graph 68
VALUE ADDED TAX
(% of GDP)



* Forecast.

5 The monthly payments to be paid by companies or third category taxpayers as payment on account of the total income tax is determined applying a coefficient to the net income earned in the month. The coefficient, in this case, is obtained by dividing the total tax amount to be paid in 2010 between the net revenues earned in the same period.

59. Revenues from **tariffs on imports** would amount to 0.3 percent of GDP in 2011, a result reflecting the reduction of tariff rates implemented at end 2010[6] and in April of this year[7]. The effective tariff has gradually declined in recent years and is currently 1.3 percent.

Graph 69
IMPORT DUTIES AND EFFECTIVE RATE: 2004-2013

60. **In 2012** the current revenues of the general government are estimated to grow 4.6 percent, as a result of which the revenues-to-GDP ratio would be 21.0 percent, that is, slightly higher than in 2011 (20.8 percent). The pace of growth estimated here for the current revenues of the general government is lower than the one considered in our Report of September due to the lower prices foreseen for our main mineral exports. Moreover, this is also consistent with the anticipated moderation of GDP growth in 2012 relative to 2011. In addition to this, it should be pointed out that the impact of the tax measures adopted in 2011 would be fully observed only in the revenues of 2012. On the other hand, as already pointed out in our previous report, higher revenues would be obtained in 2012 from mining companies' payment of royalties due to the amendment of the regulations about the tax treatment for the mining sector in terms of royalties. In **2013** the current revenues-to-GDP ratio would remain at 21.0 percent in a context in which the economy is expected to grow at rates close to its potential growth level. The forecasts for these years are based on the current tax structure.

Evolution of government spending

61. In the **period January-September 2011**, the general government's non financial expenditure represented 15.9 percent of GDP (down 1.0 percent). This variation in non financial spending results from a growth of 6.5 percent in current expenditures and from a decline of 18.8 percent in gross capital formation in the period. As

6 (S.D. 279-2010-EF dated December 31, 2010).

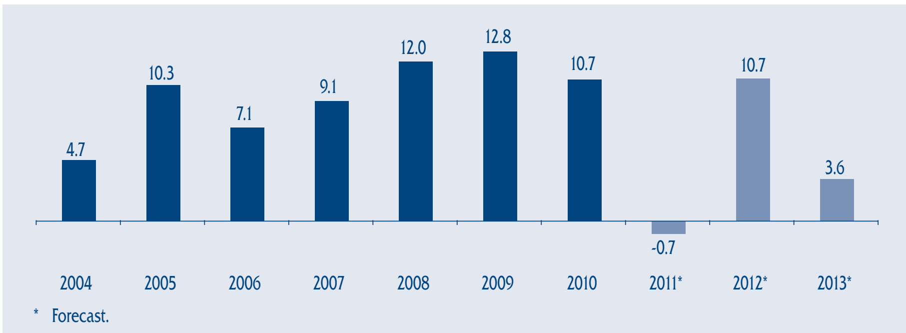
7 (S.D. 055-2011-EF dated April 10, 2011).

regards the latter, it should be pointed out that local governments reduced their investments by 41 percent, while regional governments reduced them by 24 percent. These figures evidence the difficulties faced by subnational governments in the implementation of their investment programs.

One factor that affected spending in the first semester of 2011 was the passing of Emergency Decree 012-2011 (dated March 31, 2011) which was enacted with the purpose of enforcing compliance with the fiscal rule established for this year in the Financial Balance Act, which established that an annual surplus of 2 percent of GDP should be achieved (about 4 percent of first semester's GDP). To reverse the declining trend of spending, in the second semester the government enacted two emergency decrees[8] to stimulate government spending. In this way, resources were committed mainly for spending in the maintenance of roads and infrastructure, investment projects for local and regional governments, and purchases of goods and services from the MYPES, among other projects.

Moreover, other measures adopted to dynamize spending not only in 2011 but also in 2012 included rescheduling for an earlier date the selection process of the projects to be carried out in 2012; approving the continuity of investments so that the resources for investment projects that had not been used by December 31, 2011, may be included in the 2012 budget, and implementing a technical assistance program for local and regional governments on the management of investment projects. Another measure worth mentioning is the creation of a special bonus for the effective execution of investments (S/. 400 million), which will provided to the local and regional governments that meet the budget execution goals and simplify the paperwork required to carry out works in 2012.

Graph 70
NON FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT: 2004-2013
(Real % change)



8 (Emergency decree N° 054-2011, dated September 20, and Emergency Decree N° 058-2011, dated October 26, 2011).

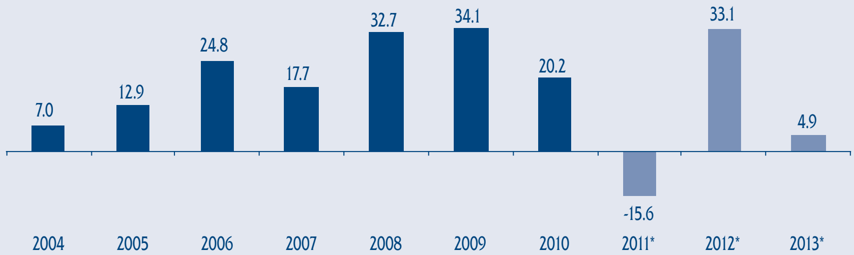
62. Budget execution in terms of investment at October 2011 was 46 percent, while in the same month last year it was 53 percent. Because of this, it is estimated that the nominal level of spending in **2011** would be below the level of spending projected in the Multiannual Macroeconomic Plan (MMP) revised in August. Therefore, spending is forecast to show a reduction of 0.7 percent this year.

63. Since the non financial government spending in **2012** would be the one projected in the MMP and given that an additional expenditure for the implementation of the fiscal contingency plan established in emergency decrees 054 and 058 is also considered for the year, spending is estimated to grow 10.7 percent. On the other hand, current expenditure in 2012 is estimated to grow 2.6 percent. However, if we deduct the effect of the Fuel Price Stabilization Fund, whose amount in 2012 will be quite lower than in 2011, current expenditure would actually grow 6.0 percent. In **2013** nominal expenditure would be the one considered in the MMP, which means that the variation in expenditure would be 3.6 percent. It is worth pointing out that the forecasts on government spending are consistent with the annual fiscal rules on the deficit and the growth of expenditure contained in the Fiscal Responsibility and Transparency Act (FRTA), which establishes that the central government's spending in consumption may not exceed 4 percent in real terms.

Graph 71
NON FINANCIAL CURRENT EXPENDITURE OF THE GENERAL GOVERNMENT: 2004-2013
(Real % change)

* Forecast.

Graph 72
GENERAL GOVERNMENT CAPITAL EXPENDITURE: 2004-2013
(Real % change)

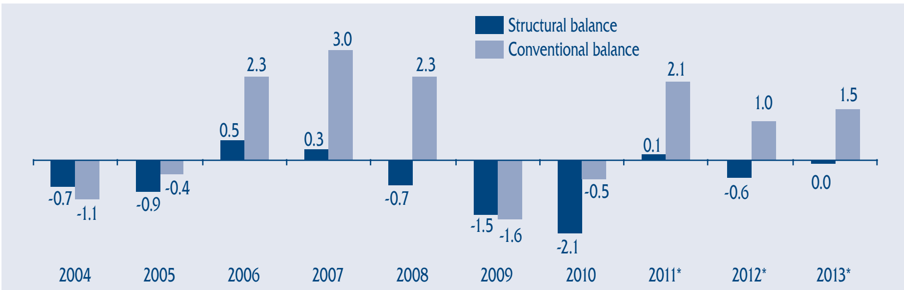


* Forecast.

Structural economic balance and fiscal impulse

64. The **structural economic balance** is an indicator that shows the evolution of fiscal policy decisions deducting the effects of the business cycle and the effects of commodity prices relevant to the economy from the conventional economic balance. Thus, a rise in actual revenues is not part of the structural revenues if this rise is the result of the business cycle or the result of a temporary rise in the prices of minerals. In 2011 this indicator would show a positive rate of 0.1 percent of GDP, whereas in 2012 this indicator is forecast to decline and to record a deficit of 0.6 percent of GDP. A nil result would be observed in 2013.

Graph 73
CONVENTIONAL AND STRUCTURAL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR: 2004-2013
(% of GDP)

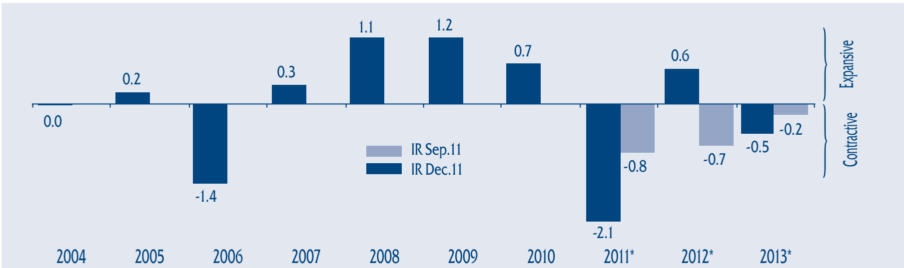


* Forecast

Memo: The structural balance includes adjustments in the output gap and the terms of trade considering a period of 10 years for the reference price, as in Nota de Estudios No. 51 (2008). Moreover, the structural economic balance discounts the payments made to the Fuel Price Stabilization Fund and includes accruals (net compensation) for this expenditure.

The **fiscal impulse**, which shows the net growth effect of fiscal policy on domestic demand, would be -2.1 percent of GDP in 2011, which indicates a contractive fiscal stance. In 2012 the fiscal policy would be expansionary due to the projected growth of spending, while 2013 would register a negative fiscal impulse of 0.5 percent.

Graph 74
FISCAL IMPULSE: 2004-2013
(% of GDP)



* Forecast.

Memo: The fiscal impulse is the charge in the structural balance, which is an indicator of how the fiscal position affects the economic cycle.

Financial requirements

65. **The financing requirements of the public sector** in the next years would be negative, in line with the positive fiscal balances projected for these years. In 2011 financial requirements would be negative by US$ 2.19 billion, while these requirements in 2012 and 2013 are estimated to amount to US$ 136 million and US$ 1.60 billion, respectively.

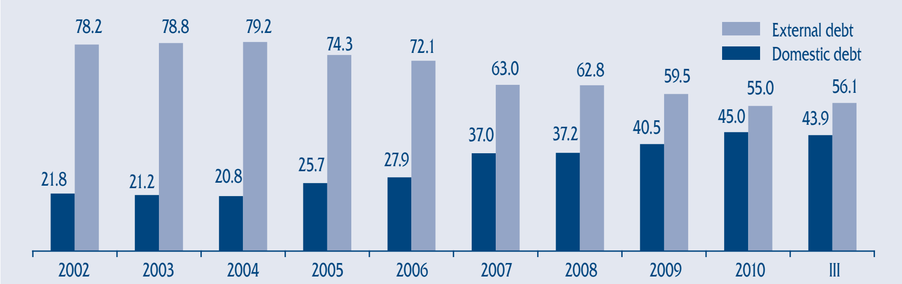
Table 29
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR AND ITS FINANCING 1/
(Millions of US$)

	2010		2011*			2012*		2013*	
	Jan.-Sep.	Year	Jan.-Sep.	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
I. Uses	**-375**	**2,310**	**-4,390**	**-326**	**-2,193**	**-652**	**-136**	**-1,480**	**-1,595**
1. Amortization	1,112	1,496	990	1,352	1,351	1,673	1,672	1,567	1,566
a. External debt	642	952	571	815	824	1,170	1,170	946	946
b. Domestic debt	470	543	420	538	527	503	503	620	620
Of which: Recognition bonds	206	263	133	217	210	255	255	210	210
2. Overall balance (negative sign indicates surplus)	-1,487	814	-5,380	-1,678	-3,543	-2,325	-1,809	-3,047	-3,161
II. Sources	**-375**	**2,310**	**-4,390**	**-326**	**-2,193**	**-652**	**-136**	**-1,480**	**-1,595**
1. External	712	1,532	526	1,153	948	1,323	1,221	1,130	1,130
2. Bonds 2/	797	835	314	647	436	1,488	1,487	577	576
3. Internal 3/	-1,883	-56	-5,229	-2,125	-3,577	-3,463	-2,843	-3,187	-3,302
Memo:									
Balance of gross public debt									
Billions of US$	33.6	36.2	35.9	37.5	37.4	39.2	38.8	39.3	39.0
% of GDP	23.7	23.5	21.8	21.4	21.2	20.2	20.1	18.6	18.6
Balance of gross public debt 4/									
Billions of US$	15.7	17.9	12.9	16.5	14.4	14.1	12.4	10.4	8.6
% of GDP	11.1	11.7	7.8	9.4	8.2	7.3	6.4	4.9	4.1

IR: Inflation report.
* Forecast.
1/ The effect of exchanging treasury bonds for 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.

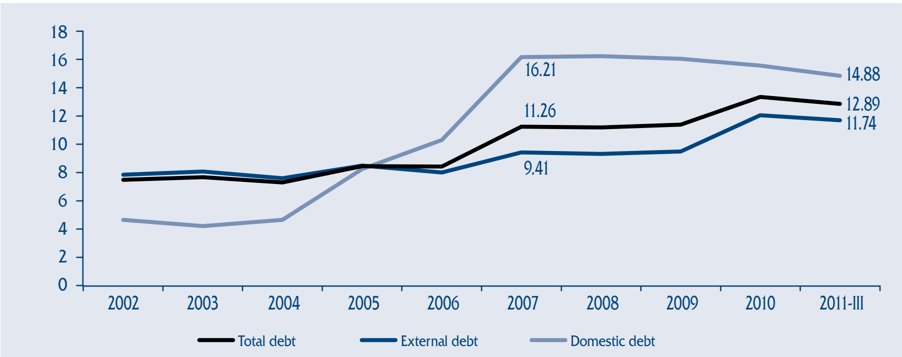
Because of the government's lower financial requirements in 2011, no external debt had to be issued in the year to obtain financing. The domestic debt issued at November (S/. 1.15 billion) were bonds placements aimed at, on the one hand, reinforcing the short part of the yield curve, for which purpose nearly 60 percent of the sovereign bonds issued were bonds maturing between 2013 and 2015, and on the other hand, continue extending the average life of the debt to a level of 12.9 years, for which purpose 40 percent of the rest of sovereign bonds issued were bonds maturing in 2042. This increase in the issuance of domestic debt has resulted in a reduction of the share of external debt in terms of the total debt from 78.2 percent in the early years of the decade of 2000 to 56.1 percent in September 2011. In this way, maintaining 44 percent of the debt in local currency, the BCRP has contributed to reduce the exchange rate risk associated with the debt.

Graph 75
PUBLIC DEBT COMPOSITION
(%)



* Forecast.

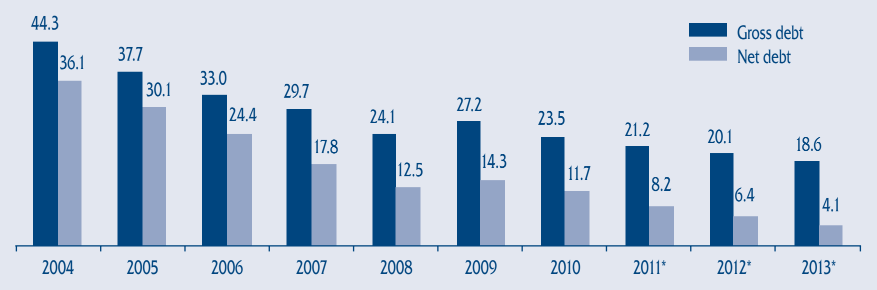
Graph 76
AVERAGE MATURITY OF PUBLIC DEBT
(Years)



As shown in the above graphs –average life of the debt, debt in nuevos soles, and fixed-rate debt (85.6 percent)–, no significant variations are observed in the risk indicators given that no debt management operations were carried out during the year.

Both the gross and the net debt are foreseen to continue declining due to increased economic activity and higher public sector's deposits. Thus, at end 2011 the gross debt is expected to amount to 21.2 percent of GDP and to gradually decline thereafter to 18.6 percent of GDP in 2013. The net debt would also replicate this trend, intensifying its reduction in the following years when it would fall from 8.2 percent of GDP in 2011 to 4.1 percent of GDP in 2013.

Graph 77
PUBLIC DEBT: 2004-2013
(% of GDP)

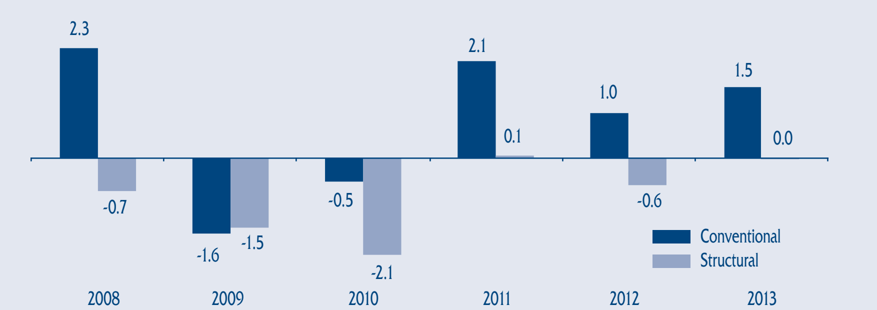


* Forecast.

BOX 2
FISCAL CONSOLIDATION 2012-2013

After the implementation of the Economic Stimulus Plan in 2009 and 2010[9], public sector accounts are undergoing a process of consolidation. The aim of this process, outlined by the MEF in the Multiannual Macroeconomic Plan (MMP) 2012-2014, is to rebuild "fiscal space", that is, to accumulate the resources required to enable the government to apply discretionary countercyclical policies in the event of a significant deterioration of international economic conditions

OVERALL BALANCE OF THE PUBLIC SECTOR: 2008 - 2013
(% of GDP)



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9 A total of S/. 11.38 billion (3.0 percent of GDP in 2009) has been executed within the framework of the Economic Stimulus Plan (S/. 7.49 billion in 2009 and S/. 3.89 billion in 2010).

As shown in the graph, the fiscal balance is expected to continue showing surpluses large enough in 2012 and 2013 so as to allow a structural balance close to zero, like in 2011. These fiscal surpluses will generate government savings, which translated into a lower level of net public debt would imply a reduction of this debt from 11.7 percent of GDP at the end of 2010 to a level of 4.1 percent at December 2013.

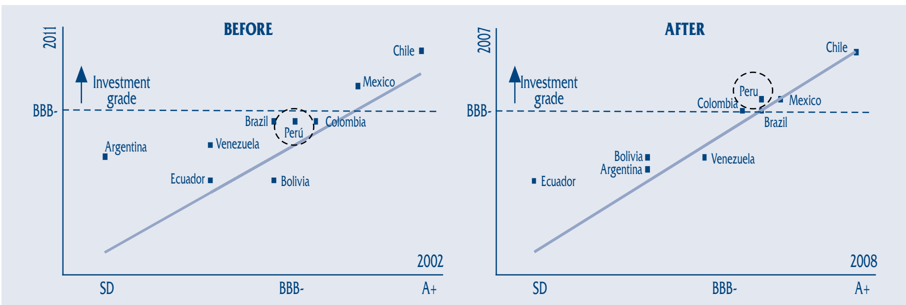
These fiscal savings would allow the government to finance contingent economic stimulus programs similar to the ones adopted to date –which amount to S/. 3 billion (about 0.6 percent of GDP)– and to mitigate through these programs the negative effects of a possible resurgence of the international financial crisis on domestic economic activity.

A greater capacity of response to deal with external events that may affect the performance of the local economy may be consolidated by maintaining low debt levels and generating sufficient tax savings. On the one hand, this reduces the financial cost of contracting new debt given that it reduces the risk perception that the government may fail to repay its debt and, on the other hand, this facilitates the government's access to international debt markets in the event it would have to resort to additional funding to implement macroeconomic stabilization programs. It is worth pointing out that the accumulation of savings is a measure of partial protection against the imperfections of the international capital market, which usually shows stricter conditions for access to credit in periods of lower growth, making it harder for a country to maintain a stable path of spending –both public and private– that can contribute to mitigate the economic cycle.

Peru's gradual consolidation of public savings has enabled the country to obtain a better credit ranking for its sovereign debt in foreign currency.

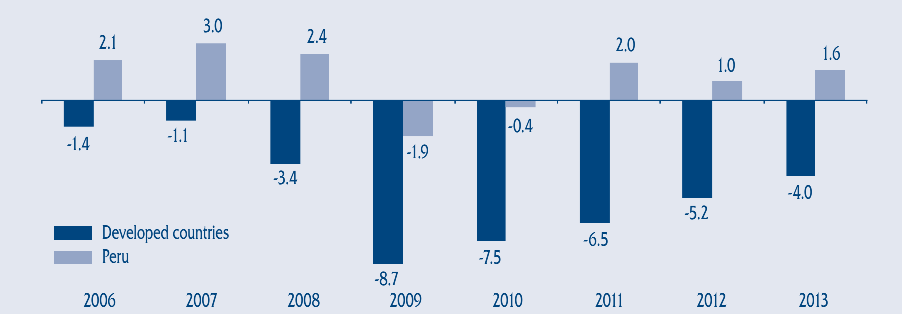
The graphs below illustrate the evolution of the Peru's credit rating according to the rating agency Standard and Poor's. The graph on the left shows that, between 2002 and 2007, Peru improved its rating (reaching a level similar to that of Brazil or Colombia, below that of Mexico and Chile), while the graph on the right shows that despite the international crisis, Peru's credit rating improved in 2008-201, reaching an Investment Grade with a rating similar to the one assigned to Mexico.

RANKING S&P: SOVEREING DEBT IN FOREIGN CURRENCY



This would be reflecting that, in contrast to the developed economies, the Peruvian economy has had an adequate response to the first phase of the international crisis due to its low level of debt and to the savings generated in the years prior to the crisis, among other factors.

ECONOMIC RESULT OF THE GENERAL GOVERNMENT
(% of GDP)

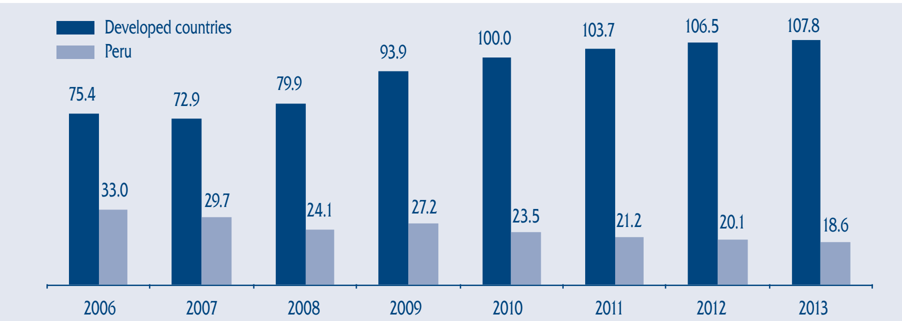


Source: World Economic Outlook (IMF) and BCRP.

In the years prior to the crisis, the developed economies registered recurring fiscal deficits at the level of the general government (1.4 percent in 2006 and 1.1 percent in 2007), while Peru showed surpluses (2.1 percent in 2006 and 3 percent in 2007). Thus, in 2007 the balance of the public debt represented 72.9 percent of GDP for developed economies and 29.7 percent for Peru.

When the crisis unfolded, the developed economies had to expand public spending by 2 percent of GDP and revenues contracted by 0.4 percent of GDP, as a result of which the fiscal deficit rose from 1.1 percent in 2007 to 3.4 percent in 2008 and the balance of the debt rose from 72.9 percent of GDP to 79.9 percent. In 2009, because of the crisis, the tax revenues of the developed economies fell by 1.3 percent of GDP but their spending grew by 4 percent of GDP. As a result of this, the deficit increased to 8.7 percent of GDP and the balance of the debt increased to 93.9 percent of GDP.

BALANCE OF PUBLIC DEBT
(% of GDP)



Source: World Economic Outlook (IMF) and BCRP.

During 2010 and 2011, these economies implemented countercyclical policies to offset the negative effects of the financial crisis, but the degree at which they were implemented became increasingly lower because their margin of action was constrained by their strong level of debt and reduced level of fiscal savings. It is estimated that in 2012 and 2013 these countries would be able to reduce their fiscal deficits at the expense of a sharp contraction of public expenditure.

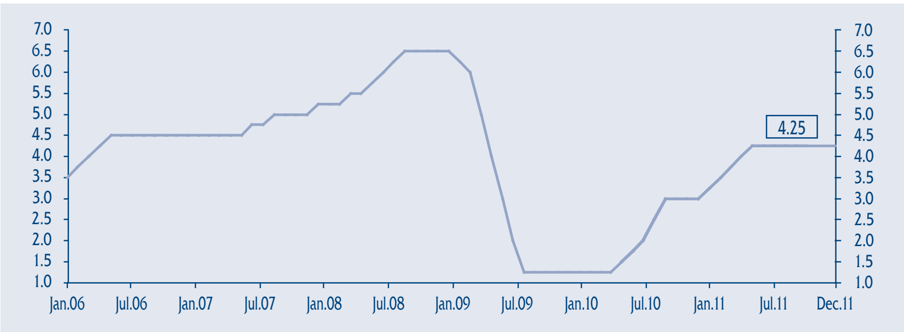
On the other hand, during those years and despite the fiscal impulse implemented, Peru only incurred in a moderate public sector deficit (1.6 and 0.5 percent of GDP in 2009 and 2010, respectively), since the fiscal balance found in 2008, at the beginning of the crisis, was a fiscal surplus of 2.3 percent of GDP. Moreover, higher fiscal surpluses are expected to be generated in the next years in order to increase the fiscal authorities' capacity to respond to external shocks (fiscal surpluses of 2.1, 1.0, and 1.5 percent of GDP are estimated for 2011, 2012 and 2013, respectively).

These projected fiscal surpluses consider a growth of 5.7 percent in the revenues of the general government in 2012-2013 resulting mainly from improvements in tax administration, the impact of the country's economic growth, and greater taxes to the mining sector. Furthermore, the fiscal surpluses are consistent with maintaining a real positive growth rate in government spending (a real growth of 7.1 percent on average for the non-financial expenditure of the general government is estimated for 2012-2013). This would not only provide the appropriate basis for the implementation of the new social programs –Cuna más, Pensión 65 and Beca 18, among others–, but also allow extending the coverage of spending for results-oriented budget programs, contributing in this way to improve both the quality of spending and the well-being of the families who receive the services provided by the State.

V. Monetary policy

66. The Central Bank has maintained its policy rate at 4.25 percent over the past 6 months in a context of moderation in the pace of economic growth, a deepening of the European crisis, and lower prospects for growth in the global economy. In this scenario of high uncertainty, the pause made in the BCRP current monetary policy stance is preventive and consistent with inflation's convergence to the target range in 2012.

Graph 78
BCRP REFERENCE INTEREST RATE (%)



RECENT EVOLUTION OF THE POLICY INTEREST RATE:
September – December 2011

September: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 4.25 percent

This decision takes into account the slowdown being observed in economic activity and the intensification of international financial risks. Should these trends continue, the Central Bank will change its monetary policy stance.

October: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 4.25 percent.

This decision takes into account the slowdown being observed in economic activity and the intensification of international financial risks. Should these trends continue, the Central Bank will change its monetary policy stance.

November: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 4.25 percent.

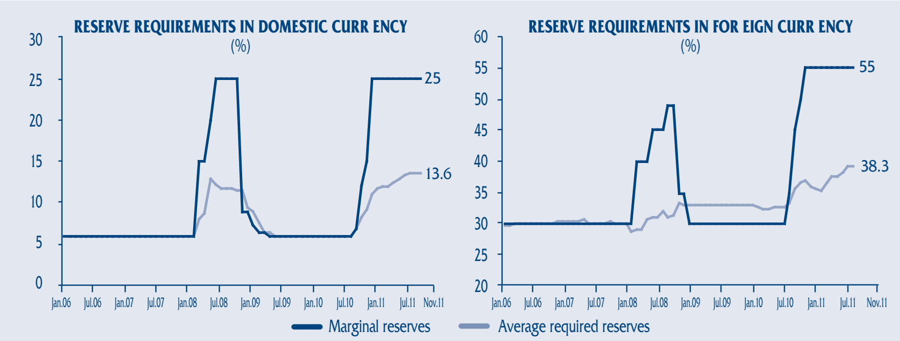
This decision takes into account the lower growth being recorded by some components of expenditure, as well as the intensification of international financial risks. Should these trends continue, the Central Bank will change its monetary policy stance.

December: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 4.25 percent.

This decision takes into account the lower growth being recorded by some components of expenditure, the current international financial risks, and the rise of inflation associated mainly with temporary supply factors. Future adjustments in the reference interest rate will depend on the evolution of inflation and its determinants.

67. The BCRP has also maintained the rates of reserve requirements unchanged since May 2011. The current average levels of reserves in nuevos soles and in dollars (13.6 and 38.3 percent, respectively), which reflect the high liquidity levels observed in the domestic financial system, could be used to offset the impact of a severe constraint of liquidity on the country's financial system in the event that the European crisis should deepen. The average rate of reserve requirements in domestic currency has remained stable since September, while the average rate of reserve requirements in foreign currency has declined slightly given that banks' short term external accruals have been replaced by other forms of funding.

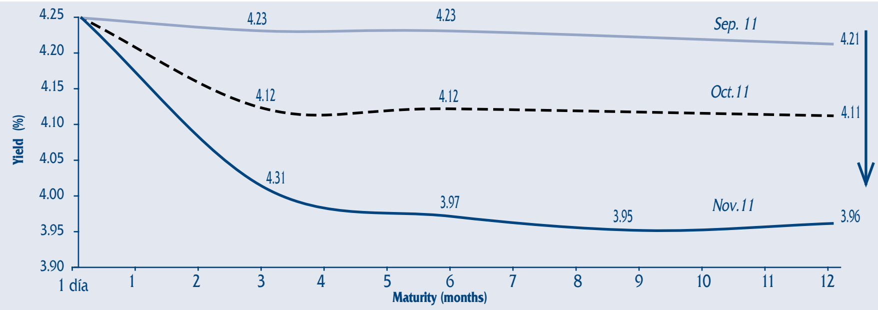
Graph 79



Average required reserves includes short term loans.
November data is preliminary.

68. Reflecting agents' expectations of cuts in the Central Bank's policy rate in the following months, the rates on short term BCPR Certificates of Deposit (CDBCRP) continued declining since September. Thus, the interest rates on primary placements of 3-, 6-, and 12-month certificates of deposits recorded levels below the reference rate (inverted yield curve) since September.

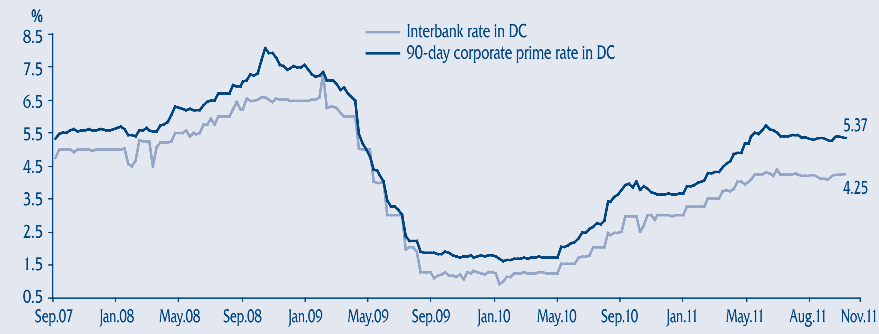
Graph 80
YIELD CURVE OF CENTRAL BANK SECURITIES [1/]



1/ Yield of CDBCRP end of period. One day rate corresponds to reference rate.

69. Of all the interest rates in the financial system, those with short terms and lower credit risks –such as the corporate prime rate and the interest rates for loans to large and medium-sized enterprises– are the ones that show a greater response to changes in the policy interest rate. Thus, the 90-day corporate prime rate in domestic currency fell from 5.44 percent in October to 5.37 percent in November, reflecting expectations of reductions in the policy rate implicit in the yield curve of CDBCRP.

Graph 81
90-DAY CORPORATE PRIME RATE VERSUS INTERBANK OVERNIGHT RATE IN DOMESTIC CURRENCY: SEPTEMBER 2007 - NOVEMBER 2011



70. Moreover, the interest rates for loans to large and medium-sized companies have fallen from 6.1 to 6.0 percent and from 7.9 to 7.4 percent, respectively. The other rates in the financial system, particularly the rates for credit segments with a higher credit risk or with longer terms –such as the interest rates for loans to micro businesses– are more influenced by the evolution of credit risk and by the market competition for these segments. In the period analyzed herein, these rates have shown a mixed evolution. The rate for loans to small businesses has declined from 23.6 to 23.0 percent, while the rate for consumer loans has risen from 36.1

percent in September to 38.3 percent in November and the rate for mortgage loans has remained stable around 9.5 percent.

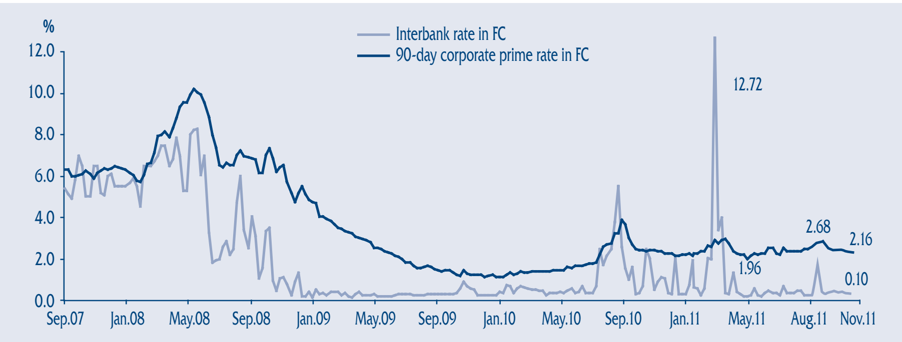
Table 30
INTEREST RATE BY TYPE OF CREDIT [1/]
(%)

	Domestic currency [2/]						
	Corporate	Large enterprises	Medium-size firms	Small businesses	Microbusinesses	Consumption	Mortgages
Dec.10	4.6	5.9	10.3	23.3	27.2	40.7	9.3
Mar.11	5.4	7.5	11.1	24.6	32.5	38.4	9.4
Jun.11	6.4	8.1	10.9	23.6	31.9	39.9	9.7
Jul.11	6.4	8.0	11.0	23.3	33.8	40.1	9.8
Aug.11	6.3	7.9	11.2	23.3	33.5	37.4	9.7
Sep.11	6.1	7.9	10.9	23.6	32.9	36.1	9.6
Oct.11	6.0	7.8	10.8	23.2	32.8	37.2	9.6
Nov.11	6.0	7.4	11.1	23.0	32.9	38.3	9.5

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, mediumsize, small and micro businesses, according to the definitions included in SBS Resolution 11356-2008 and complementary regulations. The information of corporate credits to large, medium-size, and small businesses is reported since September 2010.
Source: SBS.

71. As regards interest rates in foreign currency, the short term rates and those with lower credit risk reflect mainly the evolution of international interest rates and sovereign risk. With the deepening of the financial crisis in Europe and the demand of a lower leveraging in the region's banks, a contraction has been observed in European banks' supply of credits to Latin America. Although this has affected the cost of short term credit in dollars in countries like Colombia, Chile, and Mexico, it has not affected the cost of short term credit in FC in Peru. Thus, the corporate prime rate in dollars declined from 2.68 percent in September to 2.16 percent in November.

Graph 82
90-DAY CORPORATE PRIME RATE VERSUS INTERBANK OVERNIGHT RATE IN DOMESTIC CURRENCY: SEPTEMBER 2007 - NOVEMBER 2011



72. A similar evolution has been observed in the case of the interest rates for loans to corporate, large, and medium-sized enterprises: these rates have declined from 3.3 to 3.1 percent, from 5.5 to 5.3 percent, and from 8.8 to 8.6 percent, respectively. On the other hand, the rate for consumer loans has risen from 21.2 percent in September to 22.4 percent in November. The low impact of European banks' contraction of their supply of short-term credits in Peru would be reflecting, on the one hand, the country's minimum level of short-term external liabilities –which today represent less than 10 percent of total external liabilities– and, on the other hand, the low share of European banks in the total supply of external short term credits to Peru.

Table 31
INTEREST RATE BY TYPE OF CREDIT [1/]
(%)

	Foreign currency [2/]						
	Corporate	Large enterprises	Large firms	Small businesses	Microbusinesses	Consumption	Mortgages
Dec.10	3.3	5.5	8.6	14.2	14.8	19.4	8.1
Mar.11	3.6	5.6	9.3	16.3	16.7	20.9	8.3
Jun.11	3.6	5.3	9.3	15.6	16.3	21.3	8.5
Jul.11	3.2	5.6	9.0	15.3	18.2	21.7	8.4
Aug.11	3.2	5.5	9.4	15.2	19.4	22.0	8.4
Sep.11	3.3	5.5	8.8	15.4	19.5	21.2	8.3
Oct.11	3.0	5.3	8.4	15.1	19.0	21.7	8.2
Nov.11	3.1	5.3	8.6	15.4	17.4	22.4	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, according to the definitions included in SBS Resolution 11356-2008 and complementary regulations. The information of corporate credits to large, medium-size, and small businesses is reported since September 2010.
Source: SBS.

73. Deposit rates in domestic currency registered a mixed evolution. The interest rates on deposits for less than 180 days declined, while the rates on deposits for over 180 days rose in part as a result of banks' increased competition for capturing longer term deposits. The interest rates on up to 30-day deposits fell from 4.1 to 4.0 percent, while the interest rates for 31- to 180-day deposits fell from 4.3 to 4.2 percent. All the rates on deposits in foreign currency registered declines, which reflects the adequate availability of liquidity in foreign currency.

Table 32

INTEREST RATES IN NUEVOS SOLES
(%)

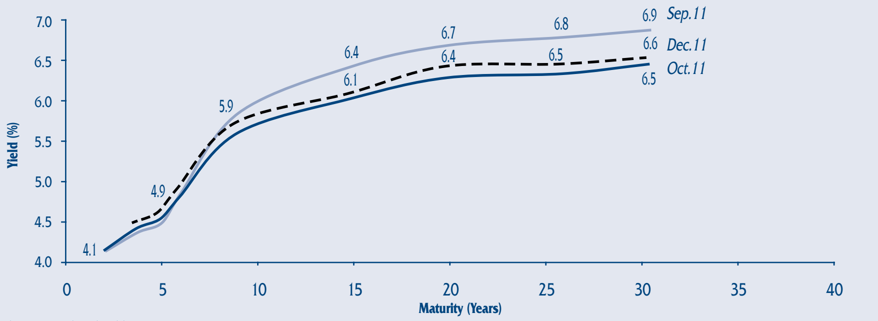
	Deposits up to 30 days	Rate on 31 to 180-day term deposits	Rate on 181 to 360-day term deposits
Dec.10	2.2	2.9	3.8
Mar.11	3.1	3.0	4.0
Jun.11	4.3	3.6	4.3
Jul.11	4.2	3.9	4.5
Aug.11	4.1	4.2	4.6
Sep.11	4.1	4.3	4.6
Oct.11	4.1	4.3	4.7
Nov.11	4.0	4.2	4.7
Difference (bps) (Nov.11-Sep.11)	-8.0	-11.5	6.9

INTEREST RATES IN US DOLLARS
(%)

	Deposits up to 30 days	Rate on 31 to 180-day term deposits	Rate on 181 to 360-day term deposits
Dec.10	0.9	1.2	1.7
Mar.11	1.4	1.1	1.7
Jun.11	0.5	1.1	1.7
Jul.11	0.6	1.0	1.7
Aug.11	0.7	1.0	1.6
Sep.11	0.8	1.0	1.6
Oct.11	0.6	1.0	1.6
Nov.11	0.6	1.0	1.6
Difference (bps) (Nov.11-Sep.11)	-26.7	-3.3	-1.2

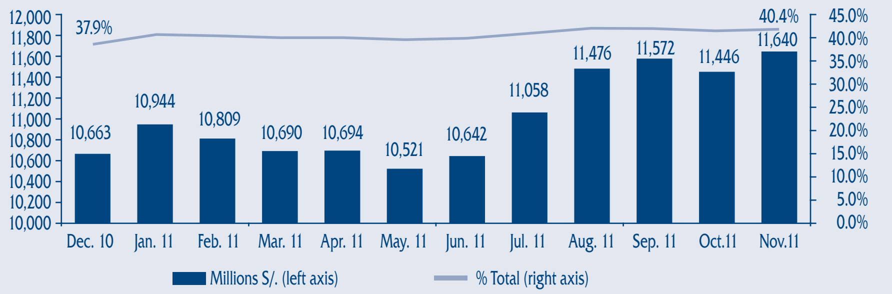
74. The yield curve on sovereign bonds (BTP) reflected two aspects: i) the interest rates in the short tranche of the maturity structure remained low due to expectations that the current rates will decline, and ii) a decline was registered in the yields of the medium and long tranche of the curve following the upward over-reaction recorded in September due to higher uncertainty associated with Europe's debt crisis. The flow of non resident investors in the sovereign bond market was not affected in this period. On the contrary, it even increased, which would have contributed to push the yields downwards. It is worth mentioning that the yields on sovereign bonds in Chile and Colombia rose in this period. Thus, the yield on the 10-year Peruvian bond declined from 5.85 percent at the close of September to 5.67 percent at the end of November, while the yield on the 10-year sovereign bond of Colombia rose from 6.88 in September to 7.64 percent in November and the yield on the 10-year bond of Chile rose from 5.30 en September to 5.50 percent in November.

Graph 83
SECONDARY MARKET OF SOVEREIGN BONDS 1/



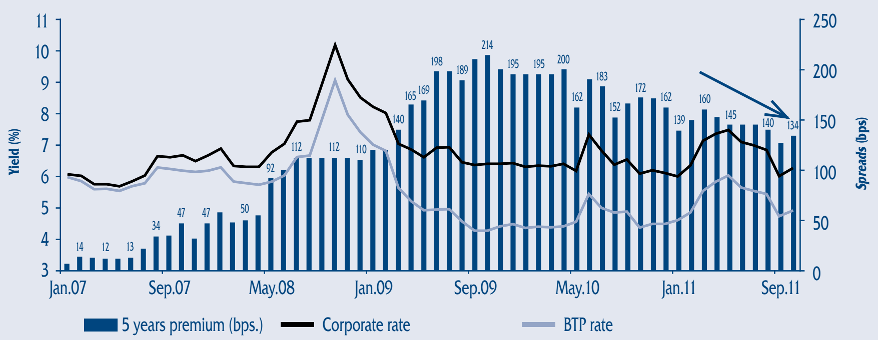
1/ Up to 12 -12-11. End of month yield.

Graph 84
SOVEREIGN BOND (BTP) HOLDINGS BY NON RESIDENTS



75. The lower interest rates on the BTP have been translating into lower rates on the corporate bonds issued in the domestic market, a reduction being also observed in the premium paid for these bond issuances which makes it easier for firms to finance their investment projects at a lower cost.

Graph 85
RATES OF SOVEREIGN BONDS, AAA CORPORATE BONDS AND SPREADS[1]: 5 YEARS



1/ The spread or premium of the risk free correspond to the difference between the yield of the sovereign bond and the 5 year AAA corporate bond.

Monetary operations

76. The BCRP monetary operations in the period were influenced by the international environment. Because of the downward pressures on the domestic currency, in the second half of September and in the first days of October, the BCRP sold FC for a total of US$ 613 million, placed CDR BCRP for a total of US$ 212 million, and paid the maturities of its CDBCRP to inject liquidity. Then, since the depreciatory pressures reversed at end October and during the month of November, the BCRP purchased FC for a total of US$ 594 million and allowed the maturity of CDR BCRP for a total of US$ 212 million. This was complemented with placements of CD BCRP with maturities of 1, 3, 4, 5, 6, and 12 months.

These operations reflected in the balance of the BCRP. The share of public sector deposits in net international reserves (NIRs) increased from 37.9 percent in September to 39.2 percent in November. In the same period, the public sector made net deposits for a total of S/. 1.49 billion in the Central Bank and the share of reserve requirements increased from 27.6 to 28.0 percent. In this context, the Central Bank allowed the net maturity of instruments amounting to S/. 1.11 billion –CDV BCRP (S/. 7.51 billion) and CDR BCRP (S/. 590 million)– and made a net placement of CD BCRP for a total of S/. 3.62 billion and placements of Term Deposits for a total of S/. 3.32 billion. As a result of this, the share of BCRP instruments in the Central Bank's balance declined from 12.8 to 12.0 percent.

Table 33
SIMPLIFIED BALANCE SHEET OF THE BCRP
(As % of Net International Reserves)

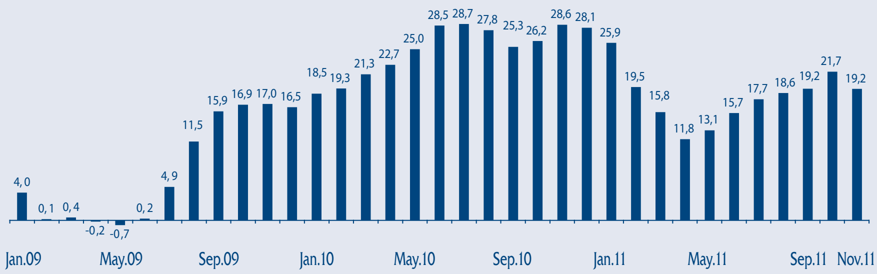
	Sep. 11	Nov. 11
Net Assets		
I. Net International Reserves	100% (US$ 48,068 mills.)	100% (US$ 49,050 mills.)
Net Liabilities		
II. Total public sector deposits	**37.9%**	**39.2%**
In domestic currency	23.6%	25.5%
In foreign currency	14.3%	13.8%
III. Total reserve requirements	**27.6%**	**28.0%**
In domestic currency	7.2%	7.7%
In foreign currency 1/	20.4%	20.3%
IV. BCRP Instruments	**12.8%**	**12.0%**
CD BCRP	6.1%	8.8%
CDV BCRP	6.2%	0.6%
CDR BCRP	0.4%	0.0%
CDLD BCRP	0.0%	0.0%
Term deposits	0.0%	2.5%
V. Currency	**18.6%**	**18.8%**
VI. Other	**3.2%**	**1.9%**

1/ Includes banks' overnight deposits at the Central Bank.

77. In seasonally adjusted terms, average currency in circulation recorded a monthly growth rate of 0.3 percent in November (versus 0.7 percent in October) and a rate of 19.2 percent in the last 12 months (a lower rate than the one recorded in the previous month). In terms of quarterly moving averages, currency declined from a

last-12 month growth rate of 21.7 percent in October to a rate of 19.2 percent in November. This evolution of currency is associated with the lower rates of growth recorded in economic activity in the last months.

Graph 86
CURRENCY: QUARTERLY SEASONALLY ADJUSTED MOVING AVERAGE: JANUARY 2009 - NOVEMBER 2011
(Variación porcentual trimestral anualizada)



CURRENCY	Dec.07	Dec.08	Jun.09	Dec.09	Jun.10	Dec.10	Mar.11	Jun.11	Oct.11	Nov.11*
Original series (millions of soles)	13,971	16,705	15,926	18,342	19,394	23,007	22,606	23,356	24,733	24,789
Annual % change (millions of soles)	28.0	19.6	4.3	9.8	21.8	25.4	23.0	20.4	17.7	15.2
Seasonally adjusted series (millions of soles)	13,324	16,006	16,238	17,531	19,773	22,059	22,732	23,813	25,203	25,278
Monthly seasonally adjusted % change	2.0	-0.6	1.4	0.7	2.0	0.5	0.5	1.3	0.7	0.3
Quarterly annualized seasonally adjusted % change	31.9	8.3	0.2	16.5	28.5	28.1	15.8	15.7	21.7	19.2

* Preliminary.

Credit

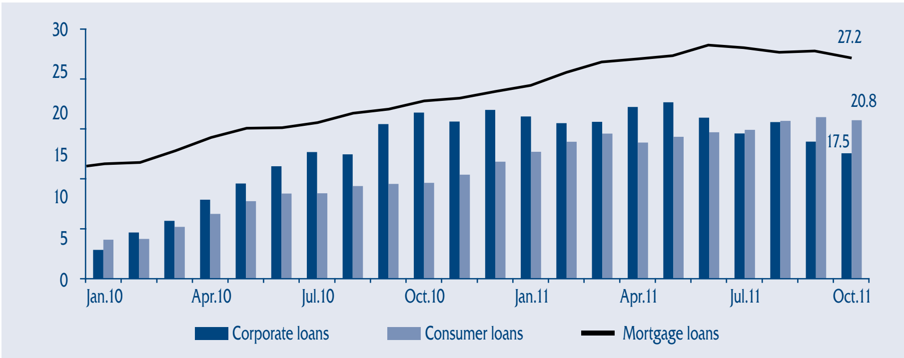
78. In seasonally adjusted terms, credit to the private sector grew 0.8 percent in October, showing lower growth rates than in September (1.0 percent) and in August (2.1 percent). Considering the variation in the last 12 months, the growth of credit slowed down from a rate of 21.6 percent in August to a rate of 19.4 percent in October. This lower growth is mainly explained by a moderation in the credit for foreign trade operations, whose annual growth rate dropped from 17.8 percent in July to 5.1 percent in October. By currencies, credit to the private sector in nuevos soles recorded an annual growth rate of 20.9 percent, while credit to the private sector in dollars recorded a growth rate of 17.7 percent.

Graph 87
CREDIT TO THE PRIVATE SECTOR
(12-month growth rate)

	Credit	Dec.07	Dec.08	Dec.09	Dec.10	Mar.11	Jun.11	Jul.11	Aug.11	Sep.11	Oct.11
Total	Monthly flow	1,977	1,346	1,275	2,751	2,209	1,390	1,653	1,278	1,163	1,812
	Annual % change	31.4	30.5	8.6	21.0	21.2	21.7	20.6	21.6	20.3	19.4
	Seasonally adjusted monthly % change	2.4	1.1	1.0	1.8	1.8	0.8	0.9	2.1	1.0	0.8
	Monthly % change	2.7	1.4	1.2	2.1	1.7	1.0	1.1	0.9	0.8	1.2

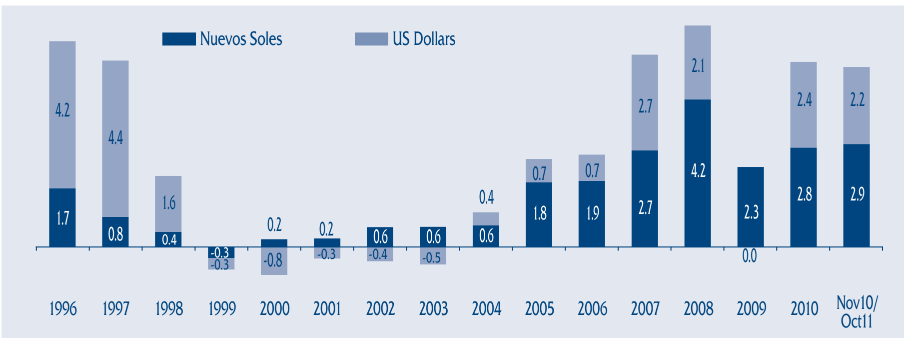
79. By type of credit, the dynamism of consumer loans and mortgages stands out. Even though mortgage loans continued showing a strong dynamism in October with a growth rate of 27.2 percent, their pace of growth has been gradually declining since June when they recorded a rate of 28.4 percent. On the other hand, consumer loans have continued growing over the year and recorded an annual growth rate of 20.8 percent in October.

Graph 88
CREDIT BY TYPE OF LOANS: JANUARY 2010 - OCTUBRE 2011
(12 month % change)



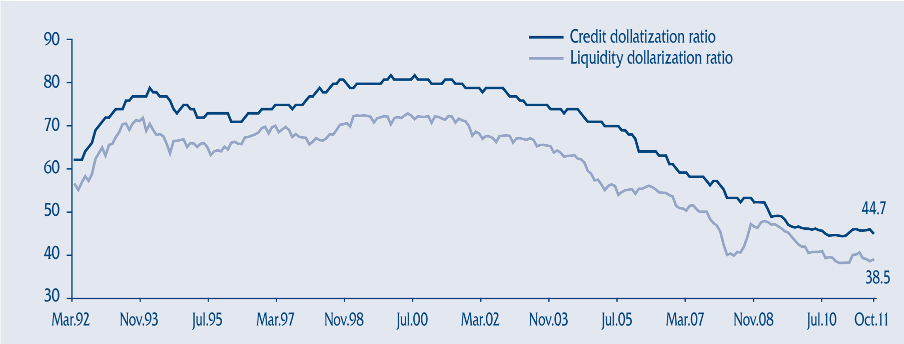
80. Showing a similar level to the one observed in 2010, the accumulated flow of credit to the private sector in the last 12 months as a percentage of GDP at October 2011 remains above 5.0 percent. By currencies, credit in nuevos soles increased from 2.8 percent in 2010 to 2.9 percent at October 2011, while credit in dollars declined from 2.4 to 2.2 percent. This evolution suggests that credit conditions have remained stable during the year.

Graph 89
ANNUAL FLOW OF CREDIT TO THE PRIVATE SECTOR
(% of GDP)



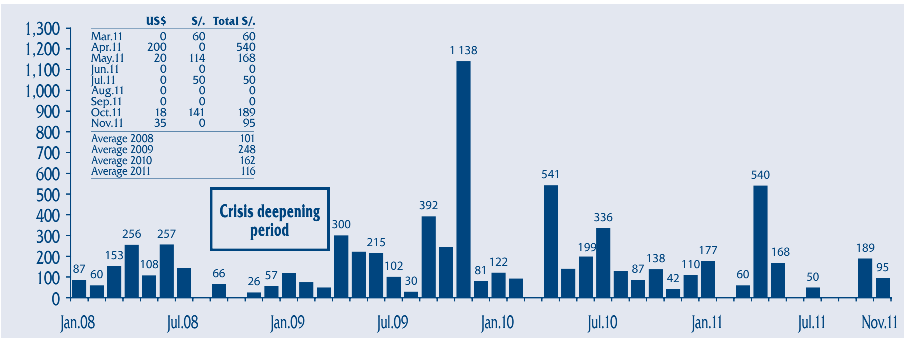
81. The dollarization of credit reached 44.7 percent in October, while the dollarization of liquidity fell 0.4 percentage points between July and October to 38.5 percent.

Graph 90
DOLLARIZATION COEFFICIENT:: MARCH 1992 - OCTUBRE 2011
(%)



82. Corporate bond issuances were resumed in October in the local market basically by non financial companies associated with public utilities and energy services. As in the case of credit, companies showed a preference for issuing debt in foreign currency, both in the domestic and the foreign markets. For example, on November 18 Corporación Lindley placed 10-year corporate bonds for a total of US$ 320 million and obtained a rate of 6.75 percent (a spread of 482 bps with the US Treasury bonds).

Graph 91
BONDS ISSUANCE OF NON FINANCIAL FIRMS*
(Millions of nuevos soles)



	US$	S/.	Total S/.
Mar.11	0	60	60
Apr.11	200	0	540
May.11	20	114	168
Jun.11	0	0	0
Jul.11	0	50	50
Aug.11	0	0	0
Sep.11	0	0	0
Oct.11	18	141	189
Nov.11	35	0	95
Average 2008			101
Average 2009			248
Average 2010			162
Average 2011			116

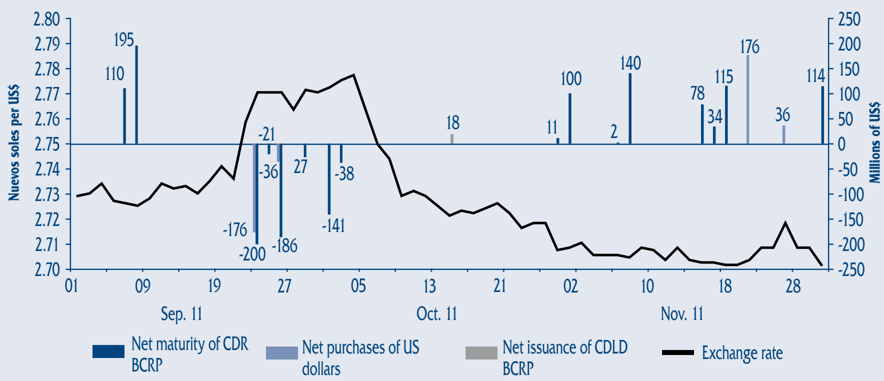
* Emissions are measured in dollars at the rate of change of last month. Includes titulization bonds.

Exchange rate

83. Between September and November, the exchange rate showed a volatile evolution. Between late August and October 4, the nuevo sol depreciated rapidly against the dollar and the exchange rate increased from S/. 2.727 to S/. 2.778 per dollar (up 1.9 percent), amid higher turbulence in international financial markets. The exchange

rate reversed later the previous upward trend and resumed the appreciatory trend observed in Q3 with an appreciation of 2.8 percent and closing at S/. 2.701 per dollar. The latter took place in a context of stabilization in international financial markets and amid increased preference for the debt of emerging economies, which favored an appreciation of the exchange rate of 0.3 percent at the end of November.

Graph 92
INTERVENTION IN THE FOREIGN EXCHANGE MARKET AND EXCHANGE RATE

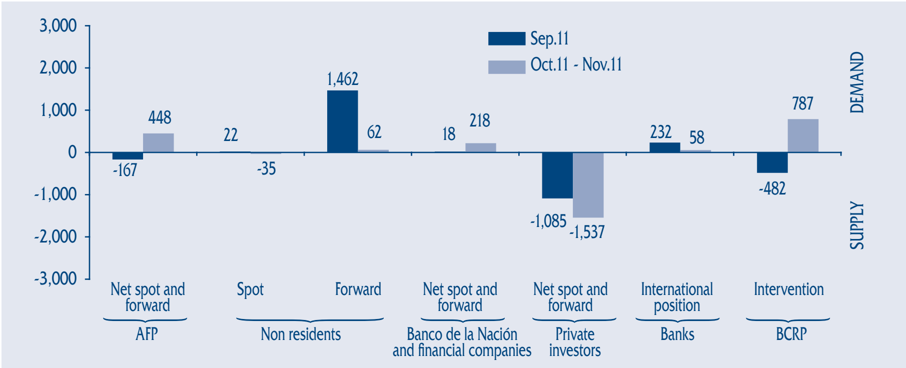


* Negative (positive) sign indicates supply (demand) by the Central Bank in the foreign exchange market.

The increased demand for dollars in the foreign exchange market during September pushed the exchange rate upwards and the nuevo sol depreciated 1.9 percent. This increased demand for dollars originated in the forward market, mainly as a result of the net forward operations (US$ 1.46 billion) carried out by non-resident investors. Moreover, banks increased their foreign exchange position and generated an additional demand for dollars (US$ 232 million). On the other hand, private economic agents offered US$ 1.09 billion, mainly in the spot market. In this context, the BCRP intervened in the foreign exchange market selling US$ 270 million and issuing CDR BCRP for a total of US$ 212 million.

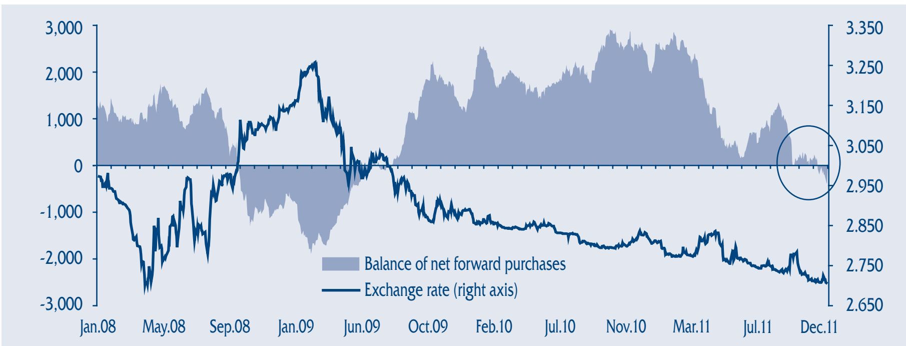
Between October and November, the main supply of dollars in the foreign exchange market (US$ 1.54 billion) was provided by private agents. This supply was offset by the demand for dollars of pension funds (US$ 448 million), financial companies and Banco de la Nación (US$ 218 million), and by banks' increase in their foreign exchange position (US$ 58 million). In this context, the BCRP intervened in the foreign exchange market purchasing US$ 556 million, placing US$ 18 million in CDLD BCRP and injecting liquidity through the maturity of US$ 212 million in CDR BCRP.

Graph 93
FOREX MARKET FLOWS
(Millions of US$)



84. Net forward purchases of foreign currency showed an erratic evolution in the period since they were affected by the volatile conduct of the exchange rate. Thus, in September the balance of net forward purchases dropped by US$ 1.10 billion –from US$ 1.19 billion to US$ 94 million–, reflecting the increased demand for dollars that pushed the exchange rate upwards. On the other hand, between October and November, the balance of net forward purchases continued declining and dropped from US$ 94 million to a negative balance of US$ 163 million even though a reversal was observed in the upward trend of the exchange rate in September.

Graph 94
BALANCE OF NET FORWARD PURCHASES AND EXCHANGE RATE
(Balance in millions of US$ and exchange rate in soles / US dollar)



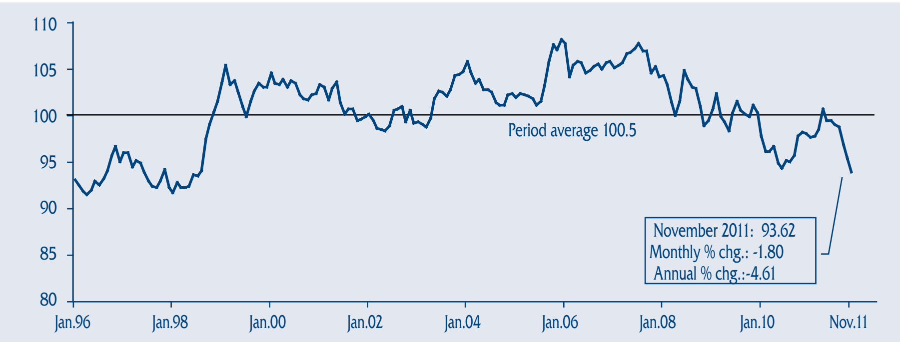
85. The survey on macroeconomic expectations for 2011-2013 indicates that the levels of exchange rate expected by financial entities, economic analysts, and non financial firms have been declining.

Table 34
SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE
(Nuevos Soles por US$)

	Survey as of:			
	Mar. 11	**Jun. 11**	**Sep.11**	**Nov.11**
Financial entities				
2011	2.75	2.75	2.74	2.70
2012	2.75	2.76	2.72	2.70
2013	2.72	2.77	2.70	2.70
Economic analysts				
2011	2.74	2.79	2.71	2.70
2012	2.70	2.75	2.70	2.70
2013	2.70	2.75	2.70	2.67
Non-financial firms				
2011	2.80	2.80	2.75	2.70
2012	2.80	2.80	2.76	2.75
2013	2.81	2.85	2.80	2.78
Average				
2011	2.76	2.78	2.73	2.70
2012	2.75	2.77	2.73	2.72
2013	2.74	2.79	2.73	2.72

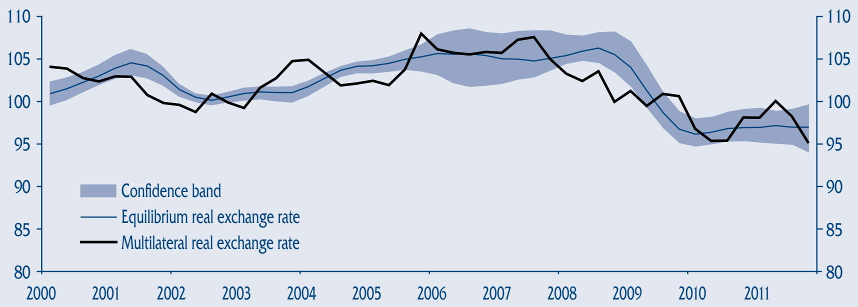
86. Compared to November 2010, the real multilateral exchange rate fell 4.6 percent given that the nominal appreciation of the nuevo sol relative to the currency basket of our main trading partners (4.3 percent) and domestic inflation (4.6 percent) could not be offset by the higher external inflation (4.3 percent).

Graph 95
MULTILATERAL RER
(Index December 2001=100)



87. The recent dynamics of the real multilateral exchange rate is consistent with the evolution of its fundamentals. Estimates of the real equilibrium exchange rate show that there are no significant misalignments (that is, differences between the values observed and the values of the real equilibrium exchange rate).

Graph 96
REAL AND EQUILIBRIUM EXCHANGE RATE: 2000 - 2011



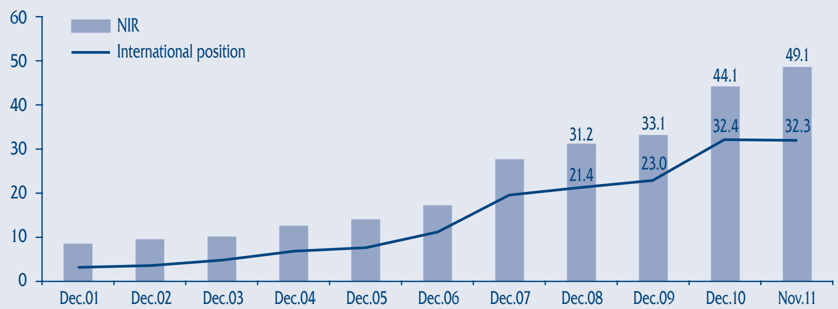
Memo: The equilibrium real exchange rate (ERER) is not an observable variable and has to be estimated. The ERER is defined as the level of real exchange rate whose fluctuations result exclusively from movements in the following key variables: net external liabilities, terms of trade, trade liberalization, Peru's productivity (measured as GDP per capita) relative to the productivity of our trade partners, and government expenditure as a percentage of GDP.

There is uncertainty about how these variables relate to the ERER. Therefore, a large number of linear regressions are estimated in which the observed real exchange rate is explained by different combinations of the above-mentioned fundamentals and then statistics describing these forecasts are provided. The graph shows the path of the median of ERER estimates and the bands include percentiles 20 to 80 of total estimates.

Source: Rodríguez, D. and D. Winkelried (2011): "¿Qué explica la evolución del tipo de cambio real de equilibrio en el Perú? 1992-2009", Revista Moneda No. 147, pp. 9 – 14, Banco Central de Reserva del Perú.

88. Between September and November, net international reserves (NIRs) at the Central Bank increased by US$ 982 million, showing a balance of US$ 49.05 billion at November 30, 2011. This high level of NIRs provides the Peruvian economy with sufficient international liquidity to adequately face shocks in the event of scenarios of turbulence in international financial markets. By sources, this increase in NIRs was mainly the result of purchases of foreign currency. Furthermore, in terms of composition, it is worth pointing out that at the close of November the foreign exchange position of the BCRP represent 65 percent of NIRs, while the deposits of financial institutions and of the public sector represent 21 percent and 14 percent of NIRs, respectively.

Graph 97
NET INTERNATIONAL RESERVES: 2001-2011
(Billions of US$)



BOX 3
PERU'S ECONOMIC STRENGTHS FACE
AN EVENTUAL DEEPENING OF THE EUROZONE DEBT CRISIS

The sound macroeconomic and macro-financial foundations of the Peruvian economy have allowed the country to absorb the effects of the deepening of the global financial crisis that unfolded since September 2008 with the bankruptcy of Lehman Brothers. In response to the acute constraint that the crisis generated in terms of international financial liquidity, the BCRP activated a series of its operating procedures which allowed it to provide the domestic financial system with the necessary liquidity required to preserve the operation of the system of payments and the normal flow of credit, thus preventing a credit crunch. Then, after showing a slightly positive economic growth in 2009, the dynamism of the money and credit markets allowed for a rapid recovery of economic activity in 2010 and 2011.

The strength of the Peruvian economy is based on a sustained macroeconomic stability supported by price stability –with an average inflation rate of 2.3 percent over the past 10 years–, an economic growth which is become widespread in all the country's regions, an adequate availability of international reserves, a sound fiscal position, and a liquid and well capitalized financial system.

If we compare the indicator levels of the current soundness of the Peruvian economy with the ones registered prior to the subprime crisis of 2008, we see that they have even improved. The country's position of international liquidity has increased significantly due to the rise of international reserves, whose level has increased from representing 25.8 percent of GDP in December 2007 to represent 28.6 percent of GDP in November 2011. The ratio of net international reserves (NIRs) to short term external liabilities plus the financial system's obligations with the public rose from 1.2 times to 1.6 times in the same period. This greater availability of international liquidity constitutes one of the strengths that allows the Central Bank to respond adequately and on a timely basis to a possible deterioration of international financial conditions associated with the Eurozone debt crisis.

MACROECONOMIC INDICATORS

		2007	2008					2009	2010	2011		
			1Q	2Q	3Q	4Q	Year			1Q	2Q	3Q
Current Account /GDP	%	1.4	-3.2	-5.3	-4.5	-3.6	-4.2	0.2	-1.5	-2.0	-2.5	0.3
NIR / STEL	Times	2.9	2.8	3.0	2.9	3.4	3.4	2.9	5.7	6.0	5.7	6.1
NIR / (STEL+LQFC)	Times	1.2	1.3	1.4	1.3	1.2	1.2	1.1	1.6	1.6	1.5	1.6
NIR / GDP	%	25.8	29.5	29.3	27.4	24.5	24.5	26.0	28.7	28.9	28.5	28.1
Total public debt / GDP	%	29.7	27.6	25.3	23.9	24.1	24.1	27.1	23.4	22.4	21.7	20.9
Net total public debt/ GDP	%	17.8	16.4	13.2	11.8	12.5	12.5	14.2	11.5	9.7	7.7	7.1
Overall balance[1] /GDP	%	3.0	3.0	2.5	2.3	2.3	2.3	-1.6	-0.5	0.3	1.3	1.8
Dollarization of credit	%	57	53	53	53	52	52	46	44	45	45	46
Provisions / Non performing loans	%	278	258	268	264	259	259	242	246	243	242	241
Global Capital Ratio	%	11.7	12.9	12.2	11.9	11.8	11.8	13.5	13.6	13.5	13.6	13.4
Average reserve requirement in DC	%	6.0	8.8	11.7	11.4	8.9	8.9	6.0	11.8	12.9	13.4	13.7
Average reserve requirement in FC	%	30.0	29.0	31.1	31.4	32.8	32.8	32.9	35.7	37.4	39.1	38.9

STEL: Short term external loans.
LQFC: Liquidity in Foreign Currency of the Banking system.
1/ Economic Result of the Public Sector last four quarters to avoid seasonal effects.

The solvency of the financial system has also improved, its greater economic strength being reflected in a ratio of capital which rose from 11.7 to 13.4 percent between December 2007 and September 2011. Banks' liquidity position is reflected in the levels of average reserves, which in a context of high dynamism of liquidity and credit have increased from 11.6 percent in August 2008 to 13.7 percent in October 2011 in the case of reserves in domestic currency and from 31.1 to 38.3 percent in the case of reserves in foreign currency.

The fiscal position has been strengthened with the reduction of the long term external debt, which declined from 18.7 to 11.8 percent of GDP between December 2007 and September 2011, as well as with the reduction of the total public debt –both external and domestic–, which fell from 29.7 to 20.9 percent in the same period. The Treasury's deposits in the banking system amount to the equivalent of 11 percent of GDP, which implies that the net public debt represents only 9 percent of GDP. In this context of lower external debt which has also favored the Peruvian economy with the better credit ratings assigned to it by risk rating agencies, this fiscal discipline guarantees the country with an adequate availability of public resources to respond to any indication of a decline of economic activity on a prompt and timely basis.

The strengthening of economic agents' financial position is also reflected in the reduction of the economy's levels of dollarization, which have fallen from 57 to 46 percent between 2007 and October 2011, thus reducing the possible impact of the crisis on the agents' financial position through the volatility of the exchange rate. On the other hand, banks' levels of average reserves, both in domestic currency and in foreign currency, are higher than the ones recorded in September 2008, which implies that the economy is in better conditions to provide the financial system with liquidity should this be required in the event of a deepening of the global crisis.

BOX 4
CICLYCAL MACROPRUDENTIAL POLICY TOOLS

The recent global financial crisis has highlighted, with greater emphasis this time, the need to implement preventive macro-financial policies aimed at preserving financial stability to ensure the benefits of monetary stability and economic growth. A new set of macro prudential regulatory instruments is required to complement both the conventional instrument of the monetary policy interest rate as well as microprudential requirements, the latter of which are aimed at ensuring the individual solvency of the financial entities operating in the financial system. Among the prudential instruments used by the Peruvian Superintendency of Banks, Insurance Companies and Administrators of Pension Funds –Superintendencia de Banca y Seguros y AFP (SBS)– to promote financial stability and protect the solvency of commercial banks, it is worth highlighting the use of **effective equity requirements due to the business cycle**.

The rule that activates and deactivates effective equity requirements due to the economic cycle is the same that activates and deactivates the pro-cyclical component of provisions. In order to estimate the effective equity requirements due to the business cycle, firms will calculate credit risk-weighted assets (CRWAs) under stress in accordance with the risk assessment method that is being used. In the case of companies that are using the standard method, the effective equity requirement has two components: the first is equivalent to the credit risk-weighted assets (CRWAs) under stressful situations minus the base CRWAs. The effective equity requirement due to the economic cycle in this case is equal to multiplying the overall limit established by the General Law by the rise in CRWAs as a result of stress weights. The other component is the company's contingent exposures.

When the rule is active, the amount of effective equity that firms must maintain should be above the minimum established by the overall limit, by the amount obtained by applying the methodology of effective equity requirements due to the corresponding economic cycle. However, firms may benefit from only having to comply with a requirement of 75 percent of the effective equity requirement provided that they undertake to capitalize, at least, 50 percent of the profits generated in the period.

Additionally the SBS has issued the following regulations:

- Capital requirement for three risk concentration levels: individual, sector, and regional risks.
- Capital requirement for interest rate risks.
- Capital requirement for exposure in foreign currency. An additional capital requirement for foreign currency exposures (2.5 percent of firms' exposure to credit exchange rate risk) was implemented in July 2010 to help financial institutions to internalize the risks of credit in foreign currency associated with loans to clients without coverage. Given the level of dollarization of our economy, the exposure to credit risk in foreign is very important, particularly for businesses and families that are exposed to currency mismatches. Because this could generate systemic risks, it is strongly recommended that the impact of this measure is continuously monitored to determine its effectiveness and to modify the 2.5 percent adjustment, if required or deemed appropriate.

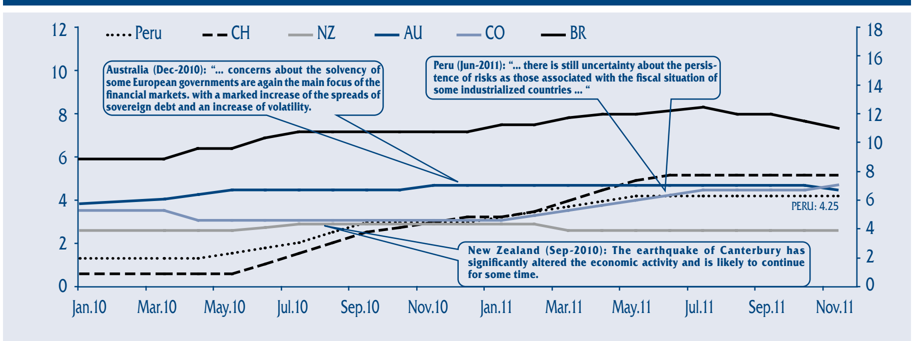
BOX 5
MONETARY POLICY IN SCENARIOS OF UNCERTAINTY

In today's context of global financial and economic interconnection, with the persistence of global imbalances and with industrialized countries and emerging countries going through differing economic cycle phases, events of high global uncertainty associated with the debt crisis or the financial crisis in developed countries can rapidly spread to the rest of the world. For this reason, emerging economies, which are currently experiencing a high level of dynamism in economic activity, have to assess current global conditions thoroughly with a risk balance approach to be able to design appropriate economic policies that will minimize the impact of such events on the economic well-being of their people.

The current scenario suggests the economy world will continue to grow, but at a slower pace in a context of high volatility in financial markets and commodity prices. Low growth is expected in the United States, while Europe could go into recession. There is also great uncertainty about the possibility that a credible and viable solution to the Eurozone debt crisis will be reached. Meanwhile, with the purpose of controlling pressures in global money markets through the extension of a line of credit swaps in dollars, the coordinated action of central banks –the Federal Reserve, the Bank of England, the European Central Bank, the Bank of Japan, the Bank of Canada, and the Swiss National Bank– seeks to prevent the risks of a constraint in international financial liquidity by implementing an additional innovation in the form of bilateral swap lines in the currency agreed by the counterpart countries. This innovation would also control extreme liquidity constraints in specific regions or countries and reduce associated foreign exchange risks.

This context complicates the design of monetary policy in emerging economies, where central banks have been adopting a risk management approach to combine macro-financial and monetary policies. This approach is especially relevant in the process of assessing and measuring the risks that could be faced in order to determine the most appropriate instruments and the degree of monetary and macro-prudential policy actions that should be implemented

PAUSE IN THE POLICY RATES DUE TO EUROPEAN CRISIS



Therefore, several central banks of emerging countries have decided to make a pause in the monetary policy adjustments they had been implementing after the previous phase of monetary stimulus translated into a rapid recovery in the level of economic activity. Meanwhile, efforts are being made in these banks to quantify the risks associated with a possible deepening of the Eurozone debt crisis in terms of international liquidity constraints in the first place and, should this be the case, then in terms of the subsequent actual impact this would have on the level of economic activity. The Central Bank of Australia, the first bank to make such a pause in December 2010, has argued concerns about the solvency of a number of European governments and about a marked rise in the sovereign debt spreads of some Eurozone countries. In Latin America, the dynamism of economic activity and inflation expectations led central banks to continue with their policy adjustments until mid-2011. Peru started making this pause in June 2011, Chile did so in July, and Colombia has made a pause in monetary adjustments since August, although the Central Bank recently raised its policy by 25 pbs.

BOX 6
REINFORCING THE POTENTIAL FOR FINANCIAL INCLUSION: PAYMENTS THROUGH MOBILES

With the aim of promoting financial inclusion in rural areas, **Bill 4168/2009-PE of electronic money was submitted to the Peruvian Congress in its previous term**. This draft proposes the establishment of Issuers of Electronic Money in the domestic financial system. Issuers of Electronic Money are companies which can provide payment services, but cannot grant credit for the funds received.

Electronic money originates with a money payment in cash made by a user in an authorized agency. Then, if the user wishes to use these funds to make transfers to other persons or companies, he simply has to send a payment order to the company from his mobile phone. Thus, users can make remittances and make payments of goods and services, among other payments, without having to having to go physically from one place to another. Moreover, if a user needs cash, he can simply go to the closest authorized agent and withdraw the required amount.

The provision of basic financial services (coin exchange, storage, transfers) at lower costs benefits poor people (BIS 2011) and the use of mobile phones to have access to such services reduces their cost since the cost involved in sending or receiving money, making payments for goods and services, etc. through this means is lower. In a country whose population is geographically dispersed, this not only frees time to carry out productive activities, but also increases safety in transactions and reduces risks since electronic money is stored and users do not have to handle cash, and transactions are carried out through virtual means under the proper security measures. Finally, after getting familiarized with simple operations of payments and transfers made through the electronic means of these supervised institutions, citizens will be more inclined to use other financial services such as deposits, loans, and insurances, which will contribute to improve the levels of financial inclusion in the country.

The development of communications and information technology has made the provision of these services profitable in a decentralized manner, while also facilitating the access of majorities to these services. The most successful system internationally is the M-PESA system developed in Kenya. With the support of the UK Department for International Development, this system which originated in Vodafone (a communications company), has made it possible to include 50 percent of Kenya's adult population –who previously only used cash– in a low value payments system (transfers) based on the use of cell phones.

In Peru there is a clear opportunity to benefit from this form of payment system if we consider how extensively and widespread the use of mobile technology is (around 25 million phone lines are in service). This contrasts with the number of financial service channels, which are still concentrated in the major cities of the country.

The bill is currently being perfected and will be sent back to Congress during this legislative term.

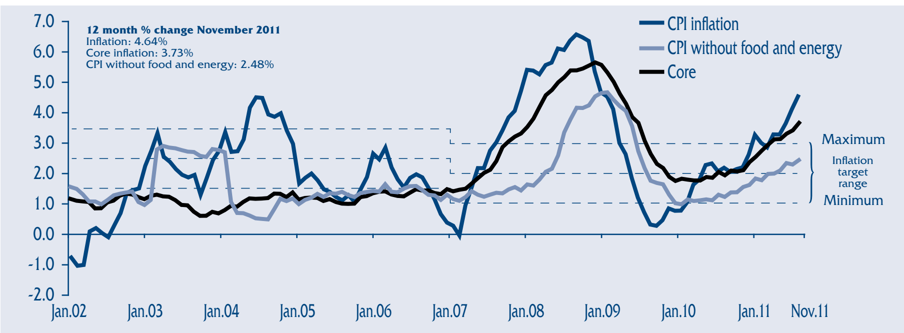
VI. Inflation

89. Between December 2010 and November 2011, the rate of annual inflation rose from 2.08 to 4.64 percent, thus recording levels above the target range. This rise of inflation is mainly explained by the impact of the rises registered in the prices of commodities since the last months of 2010, as well as by domestic climate factors that affected the supply of some perishable food products, especially between the months of August and November.

As mentioned in previous sections, the prices of food products in global markets showed high volatility due to uncertainty about the economic recovery of USA, the crisis in some European countries, and the slowdown of economic activity in China. The supply of food commodities like wheat and maize was also affected by climate problems in USA, Argentina, and Brazil. Expectations of a higher supply in the months of September and October allowed a downward correction of prices, although this trend reversed in November.

Like the prices of food, the price of crude increased in 2011 due to the higher demand for oil observed in the United States and China, a trend that intensified as a result of the conflicts that affected Arab countries. All of these factors influenced the evolution of the prices of fuels and the rates of electric energy.

Graph 98
INFLATION AND INFLATION TARGET
(Last 12 month % change)



90. Non core inflation –indicator of short term price variations that are beyond the control of monetary policy– showed a rapid pace of growth since the early months of the year, rising from an annual rate of 2.0 percent in December 2010 to 6.4 percent in November 2011. This rise was mainly driven by the effect of increases in the prices of food products (up from 1.2 to 10.4 percent), such as chicken, bread, and cooking oil due to the higher prices of imported inputs.

In addition to this, the increase in the prices of fuels (7.9 percent) and electricity (4.5 percent) also contributed to this rise. Excluding these effects, the annual rate of core inflation rose from 2.1 percent in December 2010 to 3.7 percent in November.

Accumulated inflation between January and November registered a rate of 4.46 percent, with the rise observed in non core inflation of food (11.6 percent) and fuels (7.6 percent) accounting mainly for this result. Accumulated core inflation between January and November showed a rate of 3.5 percent, a result associated mainly with the price rises of food and beverages consumed inside the home (4.5 percent) and with meals outside the home (6.4 percent).

Table 35
INFLATION
(% change)

	Weight 2009=100	2006	2007	2008	2009	2010	2011 Jan.-Nov.	2011 12 month
I. INFLATION	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.08**	**4.46**	**4.64**
II. CORE INFLATION	**65.2**	**1.37**	**3.11**	**5.56**	**2.35**	**2.12**	**3.50**	**3.73**
Goods	32.9	0.97	3.30	5.32	2.17	1.53	3.06	3.28
Services	32.2	1.85	2.88	5.86	2.56	2.72	3.94	4.19
III. NON CORE INFLATION	**34.8**	**0.83**	**5.07**	**8.11**	**-2.54**	**2.00**	**6.26**	**6.35**
Food	14.8	2.06	7.25	10.97	-1.41	1.18	11.61	10.39
Fuels	2.8	-1.50	6.45	-0.04	-12.66	12.21	7.63	7.91
Transportation	8.9	1.12	0.82	5.86	0.19	1.94	1.34	3.49
Utilities	8.4	-3.22	0.24	7.48	-4.56	0.01	1.47	1.46
Memo:								
CPI without food and energy	56.4	1.28	1.49	4.25	1.71	1.38	2.00	2.48

Table 36
INFLATION
(Weighed contribution)

	Weight 2009=100	2006	2007	2008	2009	2010	2011 Jan.-Nov.	2011 12 month
I. CPI	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.08**	**4.46**	**4.64**
II. CORE INFLATION	**65.2**	**0.79**	**1.80**	**3.20**	**1.34**	**1.38**	**2.29**	**2.44**
Goods	32.9	0.31	1.05	1.69	0.68	0.50	1.00	1.07
Services	32.2	0.48	0.75	1.52	0.66	0.88	1.28	1.36
III. NON CORE INFLATION	**34.8**	**0.35**	**2.13**	**3.44**	**-1.09**	**0.69**	**2.17**	**2.21**
Food	14.8	0.48	1.69	2.63	-0.35	0.17	1.70	1.54
Fuels	2.8	-0.09	0.36	0.00	-0.68	0.34	0.24	0.24
Transportation	8.9	0.10	0.07	0.51	0.03	0.17	0.12	0.31
Utilities	8.4	-0.14	0.01	0.30	-0.09	0.00	0.12	0.12
Memo:								
CPI without food and energy	56.4	0.58	0.67	1.88	0.74	0.78	1.12	1.39

91. Inflation without food and energy showed a rate of 2.0 percent in the same period. Food products contributed with 2.97 percentage points to the inflation rate, while fuels contributed with 0.43 percentage points.

Table 37
WEIGHTED CONTRIBUTION TO INFLATION DECEMBER 2010 - NOVEMBER 2011

Item	Weight	% change	Weighted contribution
INFLATION	**100.0**	**4.64**	**4.64**
Food	**37.8**	**7.6**	**2.88**
International price effects	**10.0**	**10.6**	**1.03**
Poultry	3.0	13.9	0.38
Bread	1.9	7.7	0.15
Rice	1.9	12.6	0.22
Sugar	0.5	6.2	0.05
Noodles	0.5	4.6	0.02
Edible Oil	0.5	23.8	0.11
Canned milk	1.6	6.6	0.10
Domestic supply shocks	**4.9**	**11.3**	**0.57**
Of which:			
Papaya	0.2	89.2	0.13
Eggs	0.6	23.1	0.11
Carrots	0.1	87.3	0.09
Onion	0.4	23.7	0.06
Fresh Vegetables	0.2	27.7	0.06
Tomato	0.2	31.3	0.06
Pumplin	0.1	67.1	0.05
Other fresh vegetables	0.4	12.6	0.05
Corn	0.1	32.8	0.04
Meals outside home	**11.7**	**6.8**	**0.82**
Other foodstuff	**11.1**	**4.1**	**0.47**
Fuels and urban fares	**11.3**	**4.7**	**0.54**
Others	**50.9**	**2.4**	**1.22**

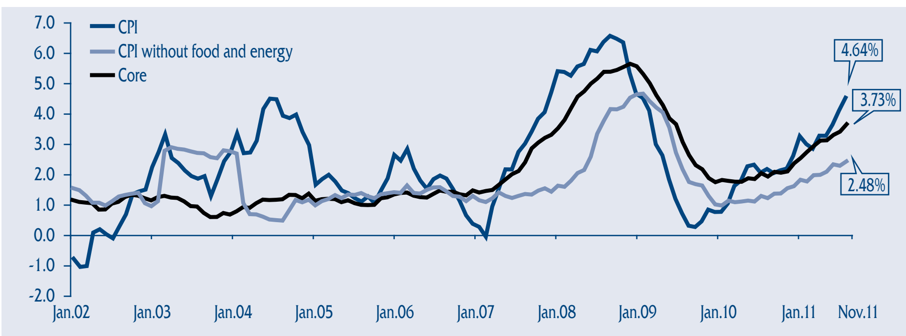
92. The prices of food inputs had been rising since mid-2010 due to the lower production of these inputs obtained because of climate problems in the main producing countries (i.e. drought in Russia and presence of La Niña event in Argentina, Australia, and Canada). The growth of China and India added onto this effect due to the higher demand for food of these countries. However, the upward trend registered by these prices began to reverse in Q2 as a result of the slowdown of global demand and the improvement of production in the main exporting countries.

These developments had an impact on the price of food products with a considerable weight in the consumer basket (i.e. chicken, bread, oil, and rice), which registered the highest rises in the period January-September.

In addition to this, the prices of perishable food products were affected by a decline in the number of sown areas due to the low prices of some of these crops and the higher prices of fertilizers, as well as due to the lower yields obtained mainly in the central coast as a result of climate problems. The group of "other food products", which includes perishable food products, recorded the highest variation observed since 2002.

The higher production of papaya, pumpkin, and carrot stands out in the group of other food products since these crops recorded growth rates of over 70 percent. The highest rates were observed between August and November, when these food products usually register seasonal price drops.

Graph 99
CPI, CORE CPI AND WITHOUT FOOD AND ENERGY
(Last 12 month % change)



93. Imported inflation at November 2011 showed an annual variation of 5.3 percent, the rise in the price of food products standing out with a rate of 9.8 percent, the second highest rate recorded since 2005.

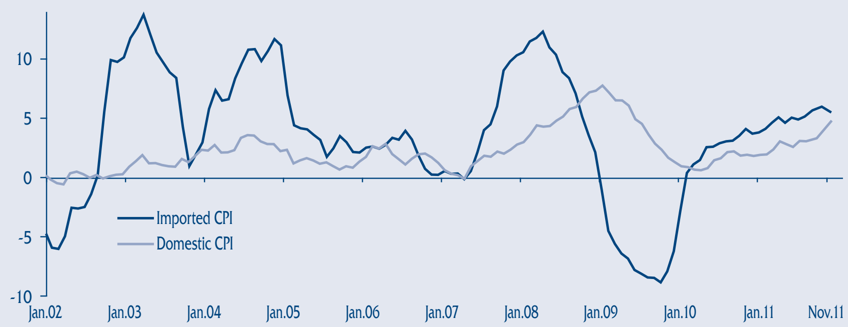
Reflecting the evolution of food (9.5 percent) and fuels (7.6 percent), imported inflation between January and November reached 5.0 percent.

The evolution of the exchange rate –which in November registered a nominal appreciation of 3.6 percent in the last 12 months– contributed to some extent to offset the impact of the rise in the international prices on domestic prices. For example, the prices of electrical appliances fell 1.10 percent in the last 12 months.

Table 38
DOMESTIC AND IMPORTED INFLATION: 2006 - 2011
(Accumulated % change)

	Weight 2009=100	2006	2007	2008	2009	2010	2011 Jan.-Nov.	2011 12 month
I. IMPORTED CPI	**10.8**	**0.27**	**10.46**	**2.20**	**-6.25**	**3.78**	**4.98**	**5.28**
Food	3.0	2.08	18.83	4.75	-3.07	0.76	9.45	9.82
Fuels	2.8	-1.50	6.45	-0.04	-12.66	12.21	7.63	7.91
Electric appliances	1.3	-1.29	-1.50	-0.06	-2.39	-0.58	-1.02	-1.10
Other	3.7	0.64	0.47	0.46	-0.34	1.20	1.14	1.55
II. DOMESTIC CPI	**89.2**	**1.28**	**2.84**	**7.44**	**1.35**	**1.87**	**4.39**	**4.56**
III. CPI	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.08**	**4.46**	**4.64**
Exchange rate		**-6.40**	**-7.00**	**4.47**	**-7.59**	**-2.15**	**-3.93**	**-3.58**

Graph 100
DOMESTIC AND IMPORTED INFLATION
(Last 12 month % change)



The items that contributed most to the rise of inflation between January and November were meals outside the home, chicken, education (tuition and fees), gasoline, and rice, while the ítems that contributed most to reduce inflation were telephone rates, urban fares, personal care items, olluco, and house rents.

Table 39
ITEM WITH THE HIGHEST WEIGHTED CONTRIBUTION TO INFLATION:
December 2010 - November 2011

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Meals outside the home	11.7	6.8	0.82	Telephone rates	2.9	-3.6	-0.10
Education (fees and tuition)	8.8	4.3	0.39	Chilli pepper	0.1	-37.0	-0.05
Poultry	3.0	13.9	0.38	Potatoes	0.9	-3.2	-0.03
Urban fares	8.5	3.5	0.29	Cleaning items	0.9	-2.8	-0.02
Gasoline and oil	1.3	14.6	0.22	Fresh and frozen fish	0.7	-2.4	-0.02
Rice	1.9	12.6	0.22	Spices and seasonings	0.5	-2.6	-0.02
Toiletries	4.9	3.7	0.18	Garlic	0.1	-16.3	-0.01
Bread	1.9	7.7	0.15	Avocado	0.1	-6.5	-0.01
Garment for men and kids				Rent	2.4	-0.4	-0.01
aged 12 or older	1.5	9.1	0.14	Televisions	0.5	-2.1	-0.01
Papaya	0.2	89.2	0.13				
Total			**2.92**	**Total**			**-0.28**

Meals outside the home

Like in 2010, the price levels in this item continued to grow due mainly to the higher prices of food. In November 2011 this item recorded an annual growth rate of 6.8 percent.

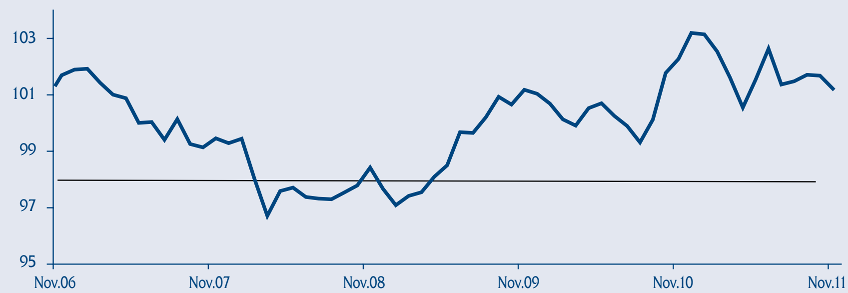
According to the results of a survey conducted with the managers of restaurants and fast food establishments, an additional factor that would have contributed to the rise observed in this item is the increase of the minimum salary.

Table 40

Last 12 month % change

	Weight	2007	2008	2009	2010	Nov.11
Meals outside the home	11.7	3.9	8.3	3.3	3.9	6.8

Graph 101
RELATIONSHIP MEALS OUTSIDE THE HOME / MEALS INSIDE THE HOME*
(Index 2009 = 100)



(*) Indicator of price pressures of meals outside the home prices to food prices.

Chicken meat

In the period of January-November the price of chicken rose 17.4 percent due to higher production costs. The price of maize rose from US$ 221/ton in December 2010 to US$ 252/ton in November 2011 (up 14 percent).

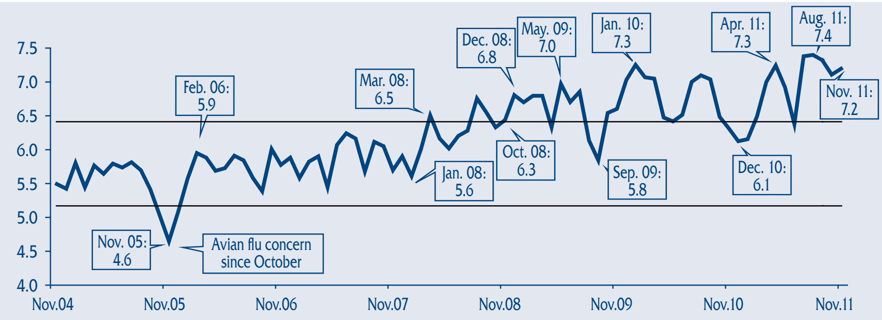
The fluctuations in the price of chicken were associated with the higher or lower availability of fish. On the side of supply, the placements corresponding to the supply in the January-November period were approximately 6 percent higher than the ones recorded in the same period in 2010.

Table 41

Last 12 month % change

	Weight	2007	2008	2009	2010	Nov.11
Poultry	3.0	1.2	15.6	3.1	-14.2	13.9
Maize price (US$/MT)		14.4	-17.8	8.1	57.3	21.2

Graph 102
PRICE OF CHICKEN
(Nuevos soles per kg)



Urban fares

At November, urban fares accumulated a rise of 2.2 percent due mainly to the increase of 1.38 percent recorded in September, which led to an increase of 1.5 percent in taxi fares and to an increase of 1.4 percent in bus and microbus fares (1.4 percent).

Table 42

Last 12 month % change	Weight	2007	2008	2009	2010	Nov.11
Urban fares	8.5	0.5	6.1	0.2	1.8	3.5
Diesel		6.4	0.4	-20.3	21.0	22.3
Gasoline	1.3	10.7	-6.1	-15.8	16.4	14.6

Education (tuition and fees)

Education prices rose 4.3 percent in January-November. In additional to the price rise recorded in March (2.2 percent) at the beginning of the school year, other rises of 0.4 percent were observed in the months of June, August and September due to increases in the rates of tuition in universities and higher education institutes.

Table 43

Last 12 month % change	Weight	2007	2008	2009	2010	Nov.11
Education (fees and tuition)	8.8	3.6	3.9	4.6	3.5	4.3

Fuels

As a result of the update of the Fuel Price Stabilization Fund price band, prices in this item rose 7.9 percent on average in the period January-November, a rise of 14.6 percent being registered in the price of gasoline. In the same period the price of crude not only showed an average level of US$ 94.6/barrel –higher than the one recorded in the previous two years (US$ 61.7 in 2009 and US$ 79.4 in 2010)–, but also showed higher rise rates compared to previous years. As the table below shows, the price of WTI oil in 2010 rose 79.4 percent, while in 2011 it rose 94.6 percent.

Table 44
PRICE OF FUELS
(Annual % change)

	2008	2009	2010	2011	
				Jan.-Nov.	12 month
Fuels	**0.0**	**-12.7**	**12.2**	**7.6**	**7.9**
Gasoline	-6.1	-15.8	16.4	14.5	14.6
Gas	2.7	-4.6	8.8	1.0	1.5
WTI (US$ per barrel) 1/	99.6	61.7	79.4	94.6	94.2

1/ Period average. Source: INEI.

Rice

In January-November, the price of rice increased 11.7 percent, mainly due to the lower production obtained in the north of the country as a result of the drought that affected this area. Compared to the previous year, sown areas in the August-July crop year dropped 7 percent at the national level and 26 percent in Lambayeque, Lima's main supplier area. As a result of this, the production of unhusked rice at the national level in the January-October period recorded a fall of 6 percent relative to the same period in the previous year. Even though there were sufficient stocks to supply the demand of Lima, the prospects of lower production resulted in gaps in the marketing of rice. The latter were in part offset by higher imports of rice, as a result of which the share of imports of rice increased from 7 percent in November 2010 to 19 percent in November 2011.

Table 45

Last 12 month % change	Weight	2007	2008	2009	2010	Nov.11
Rice	1.9	7.5	12.8	-16.6	1.7	12.6
Internation price of rice (US$/MT)		18.7	40.1	19.0	-12.5	18.7

Personal care items

At November this item accumulates a variation of 3.58 percent due to the higher costs of the inputs associated with the evolution of the price of crude. The products that had a greater effect on this variation were shampoo, toilette soap, and disposable napkins.

Table 46

Last 12 month % change	Weight	2007	2008	2009	2010	Nov.11
Toiletries	4.9	0.7	3.8	3.0	0.6	3.7

Bread

The price of bread rose 7.7 percent due to the increase in the price of wheat flour until August and due to the effects of the rise of the minimum salary since September.

The price of wheat flour rose 10 percent between December 2010 and August 2011, declining thereafter between September and November. The price of wheat showed an upward trend until May (12.2 percent relative to December), when it started to fall. At November it accumulated a decline of 8 percent (US$ 254/ton in November).

Table 47

Last 12 month % change

	Weight	2007	2008	2009	2010	Nov.11
Bread	1.9	19.2	1.6	-1.1	1.1	7.7
International price of wheat (US$/MT)		89.0	-44.2	-9.8	60.6	5.0

Eggs

This item recorded a rise of 28.2 percent, reflecting mainly the increases observed in the first four months of the year (18.0 percent) due to the seasonal greater demand. An increase in production costs as a result of the higher international prices of hard yellow maize –the main input in birds' feeding– added onto this.

Table 48

Last 12 month % change

	Weight	2007	2008	2009	2010	Nov.11
Eggs	0.6	33.1	21.7	-18.1	-6.4	23.1

Clothing for men and children

The greatest increases, which reflected mainly an increase in production costs, were observed in garments such as pants, shirts, and polo shirts. The international price of cotton (short fiber) rose from US$ 85 in the period January-August 2010 to US$ 184 in the same period in 2011.

Table 49

Last 12 month % change

	Weight	2007	2008	2009	2010	Nov.11
Garment for men and kids aged 12 or older	1.5	3.8	4.0	1.8	4.5	9.1
Cotton CIF price (US$/MT)		19.5	9.7	-1.3	27.5	82.2

Inflation forecast

94. Inflation is expected to gradually converge to the target range towards mid-2012 provided that the cost pressures generated by the significant increases registered in the prices of commodities subside.

In fact, non core inflation is projected to record a rate close to 6.4 percent in 2011 and to decline thereafter. In 2012 non core inflation is expected to fall within the target range after the reversal of food supply shocks.

95. However, the presence of climate alterations could hamper a quick reversal of the prices of perishable food in the first part of the year.

The lower availability of water on the north coast would be affecting the cultivation of products such as rice, with the risk of hampering the completion of the farming process. As regards the crops that are grown in the Sierra –some vegetables and tubers–, the development of crops could be affected by the delay in the rains or by the frost seen so far, which would result in lower yields.

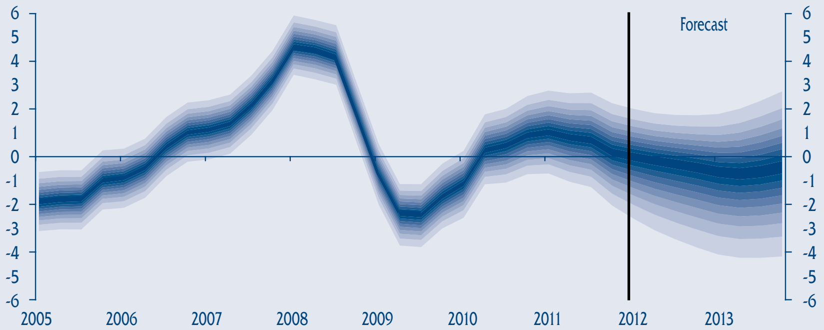
In addition to this, the sea currently shows colder than normal temperatures. This situation which could last until the Q1-2012 could affect the ripening of certain fruits.

96. Another factor that will contribute to a lower rate of inflation in the forecast horizon is an output gap which will be slightly negative during 2012 and 2013. This evolution of the output gap is consistent with the expected lower growth and lower terms of trade and with a slightly expansionary fiscal policy. Thus, no major demand pressures are expected to affect inflation in the forecast horizon.

Moreover, it is foreseen that inflation expectations would converge from their current levels of 2.5 – 3.0 percent to a level of 2.0 percent and that they would then remain anchored to levels within the inflation target range.

97. The baseline forecast scenario does not consider any substantial change in the monetary policy position in the short term. An adequate monetary policy stance contributes to maintain inflation expectations anchored, especially in a context in which persistent significant shocks that affect sensitive items in the consumer basket are observed. Therefore, the Central Bank will continue to closely oversee global and domestic economic developments and stands ready to adjust its monetary policy position should this be required to guarantee inflation's convergence to the target range.

Graph 103
OUTPUT GAP. 2005 - 2013
(% of potential GDP)

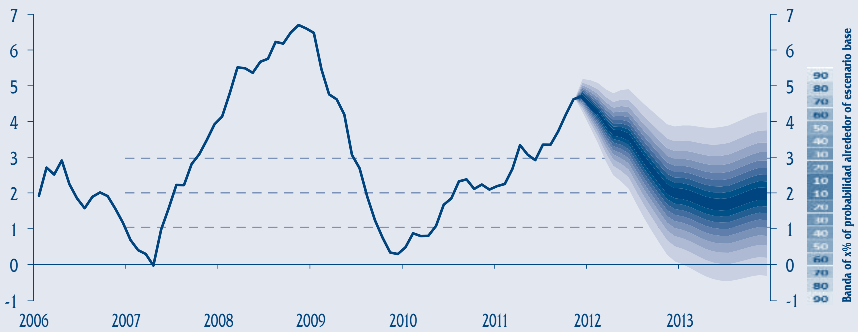


Memo: The output gap is not an observable variable and has to be estimated. Because of this, the graph shows uncertainty about its value, even in periods for which there is information on GDP (e.g. until Q3-2011). As in Graph 104, each band concentrates a probability of occurrence of 5% and total bands represent a probability of occurrence of 90%.

The output gap is estimated using statistical methods of signals extraction. A set of equations that relate unobservable variables with observed data are specified. Two equations should be pointed out: the first one is the identity that equates (the logarithm of) GDP with the sum of (the logarithm of the) potential GDP plus the output gap; the second is an equation of aggregate supply (known as the Phillips curve) that describes inflation as a function of several determinants, the output gap among them. Therefore, the output gap is interpreted as the transitory component of GDP that is more closely related to inflation over the economic cycle.

The chapter on the balance of risks discusses the risk scenarios used to forecast the output gap on which the inflation forecast illustrated in Graph 104 is based.

Graph 104
INFLATION FORECAST, 2011 - 2013
(Last 12 month % change)



Memo: The graph shows the probability of occurrence of inflation values in the future: These values were established combining statistical analysis and the subjective perception of the BCRP.

The graph consists of 18 bands, each band with a probability of 5% that the projected value may fall within it. Thus, in each period of the forecast horizon, each pair of bands with the same shade concentrates a probability of 10%. This can be interpreted as that 10 of every 100 possible future values of inflation are expected to fall within the darkest bands (located in the center), 10 are expected to fall within the clearer bands adjacent to the darkest ones, other 10 are expected to fall within the even clearer bands located above and below the second group of bands, and so on until 90 of the 100 values are distributed in the graph. The remaining 10 values would fall outside the bands.

The baseline scenario path is contained in the darker bands. The chapter on the balance of risks discusses the risk scenarios underlying the inflation forecast in this graph. The balance of risks for inflation at end-2012 shows a slight downward bias, that is, the probability that inflation will be below the inflation forecast considered in the baseline scenario is slightly higher than the probability that it will be above this forecast.

SUMMARY OF INFLATION REPORT FORECASTS

	2010	2011,1/		2012,1/		2013,1/	
		IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11	IR Sep.11	IR Dec.11
Real % change							
1. GDP	8.8	6.3	6.8	5.7	5.5	6.3	6.3
2. Domestic demand	12.8	7.5	7.5	5.6	5.6	6.0	6.1
a. Private consumption	6.0	6.0	6.3	5.6	5.6	5.8	5.8
b. Public consumption	10.6	5.7	4.4	4.4	5.3	4.9	4.9
c. Fixed private investment	22.1	10.7	12.0	9.0	7.0	8.3	8.3
d. Public investment	27.3	-2.9	-19.7	11.4	33.1	10.0	7.3
3. Exports (goods and services)	2.5	6.0	7.3	7.5	6.0	9.0	7.7
4. Imports (goods and services)	23.8	11.7	10.5	6.7	6.5	7.2	6.6
5. Economic growth in main trading partners	4.5	3.2	3.2	3.2	2.7	3.3	3.1
Memo:							
Output gap 2/ (%)	0.0	-1.0 ; 0.0	-0.5 ; 0.5	-1.0 ; 0.0	-1.0 ; 0.0	-0.5 ; +0.5	-0.5 ; +0.5
% change							
6. Forecast inflation	2.1	3.5-4.0	4.5-5.0	2.0-3.0	1.5-2.5	1.5-2.5	1.5-2.5
7. Average price of crude	28.7	19.0	19.8	-4.3	5.2	2.2	0.0
8. Nominal exchange rate 3/	-2.1	-3.1	-3.5	-0.4	0.0	-0.4	0.4
9. Real multilateral exchange rate 3/	-2.1	1.1	-3.0	-1.0	1.0	0.4	0.4
10. Terms of trade	17.9	3.9	5.4	-3.2	-5.8	0.4	0.6
a. Export price index	29.9	17.2	19.2	-2.0	-6.1	0.1	1.2
b. Import price index	10.1	12.8	13.1	1.3	-0.3	-0.3	0.6
Nominal % change							
11. Currency in circulation	25.4	17.5	16.0	15.5	14.5	12.5	11.5
12. Credit to the private sector 4/	21.0	16.5	17.0	14.5	13.5	11.5	11.5
% of GDP							
13. Gross fixed investment rate	25.1	25.0	24.1	26.2	25.6	26.7	26.1
14. Current account of the balance of payments	-1.5	-2.8	-1.5	-2.6	-2.2	-2.3	-2.1
15. Trade balance	4.4	4.4	5.0	3.8	3.6	4.3	3.9
16. Gross external financing to the private sector 5/	7.8	6.1	6.1	5.6	4.6	5.6	5.3
17. Current revenue of the general government	19.8	20.7	20.8	20.9	21.0	20.9	21.0
18. Non-financial expenditure of the general government	19.2	18.6	17.7	18.6	18.9	18.4	18.4
19. Overall balance of the non-financial public sector	-0.5	1.0	2.1	1.2	1.0	1.4	1.5
20. Total public debt	23.5	21.4	21.2	20.2	20.1	18.6	18.6

IR: Inflation Report.
1/ Forecast.
2/ Differential between GDP and potential GDP (%).
3/ Survey on exchange rate expectations.
4/ Includes loans made by banks' branches abroad.
5/ Includes foreign direct investment and private sector's long term disbursement.

VII. Balance of Risks

98. The baseline scenario of the inflation forecast considers relevant information on macroeconomic and financial variables as well as relevant information on the domestic and international environments, which is complemented with qualitative information not considered in statistical data.

    The forecast process is not free from uncertainty about future developments in the domestic and in the global economy. Therefore, alternative scenarios that include shocks that could divert inflation from the path considered in the baseline scenario are also assessed through a balance of risks.

    The balance of risks results from assessing the expected impact or relative significance that each of the risk factors has on the inflation forecast. This depends on two components: first, the magnitude of deviation of the inflation forecast in the risk scenario compared to the forecast scenario, and second, the probability of occurrence assigned to the risk factor in the risk scenario. Together, these two factors determine the bias of the inflation forecast in the balance of risks.

99. The main risks that could divert the inflation rate from the baseline scenario in the forecast horizon are associated with uncertainty about the evolution of the global economy, the evolution of domestic demand, the impact of commodity prices, and expectations of inflation.

    Downward risks in the inflation forecast include both external factors, which could cause the unfolding of an international financial crisis, and internal factors, which have brought about a context of lower growth of demand due to the postponement of some investment projects.

    a. **Uncertainty about the evolution of global economic activity**: Even though the baseline scenario considers a lower growth rate of global economic activity than the one considered in our Inflation Report of September due to uncertainty in international markets as a result of sovereign debt problems and fiscal constraints in Eurozone countries, this rate of growth could be lower. In such a case, this context would contribute to weaken external demand and affect the domestic economy through the financial and trade channels. A part of these effects (e.g. a decline in the terms of trade) have been observed since our last Report was published in September and have therefore been included in the baseline scenario.

This scenario depicts an event similar in essence to the one that took place in the late months of 2008 when a strong drop in global economic activity, a decline in terms of trade, and capital outflows from emerging countries were observed. Increasing uncertainty may generate panic among investors and lead to a sudden stop –a sudden reversal in capital flows–, which may cause an abrupt depreciation in the exchange rate and increase the country risk indicator.

Lower growth in global financial markets would lead to a global recession, which would reflect in lower growth in the economies of our trade partners and in lower external inflation. At the same time, the decline in terms of trade as a result of the drop of commodity prices would generate a greater weakening of domestic growth. In this context, international interest rates are expected to remain low for a longer period of time than the one considered in the baseline scenario.

Should these risks materialize, the Central Bank would use its high level of international reserves and its various liquidity injection mechanisms to provide the financial system with liquidity in both domestic currency and foreign currency to minimize in this way the impact of this shock on domestic financial conditions and, if necessary, would ease monetary conditions.

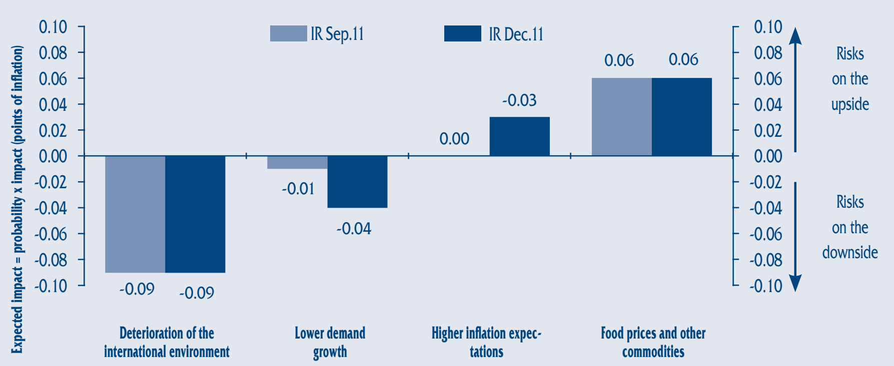
b. **Evolution of domestic demand:** In a scenario of increased uncertainty, there is the risk that domestic agents' expectations –particularly investment expectations– may deteriorate. If expectations about investment are affected, this could generate a lower dynamism in aggregate demand and a pace of growth below potential growth which would generate downward pressures on core inflation. In such a scenario, the Central Bank would increase monetary stimulus seeking to lead inflation to fall within the inflation target range.

c. **Imported inflation or adverse climate conditions:** Although the pace of rises in the prices of food commodities and fuels has stabilized, there is the risk that global inflationary pressures may be more persistent than currently estimated in the baseline scenario. Uncertainty about how policy makers are going to solve current challenges and uncertainty about the economic outlook in the future have a marked effect on the level of global economic activity. A more decisive and credible economic policy in most advanced economies may raise confidence faster than currently expected and generate a greater impulse in the global economy. If the shocks are persistent, they could affect the dynamics of domestic inflation through higher imported costs and lower margins for local firms, which could generate inflationary pressures. Moreover, although the baseline scenario also considers weather conditions that would normalize over the year, there is the risk of having to face adverse climatic conditions, such as a stronger La Niña event that could affect the availability of water. In these scenarios, the Central Bank would adjust its monetary stance only if these events translate into economic agents' expectations of inflation.

d. **Higher inflation expected:** this scenario considers the possibility that a slower reversal of inflation may exacerbate the risk that households and firms' expectations of inflation may remain persistently above the target, which could reflect on inflation through the higher costs and prices expected by firms. In this case, the Central Bank would adjust its monetary policy stance in order that the expectations of private agents are in line with the inflation target.

In summary, **the balance of these risks shows a downward bias** in the inflation forecast for end 2012.

Graph 105
BALANCE OF RISKS AGAINST THE BASE SCENARIO



Memo: The risk assessment describes how exogenous factors would affect the rate of inflation forecast for December 2012 if such risks materialized. Each bar in the graph illustrates the magnitude and direction of the effect of these factors, i.e., the expected impact in alternative forecast scenarios. This impact is calculated as the difference between the inflation forecast in the baseline scenario and inflation projections in several scenarios considering different assumptions, multiplying this difference by the probability of occurrence assigned to such alternative assumptions. The sum of the bars –the risk balance– indicates how these risk factors as a whole would divert inflation from the baseline scenario in December 2012.

The risk balance in this report is negative, which indicates that there is a higher probability that inflation will fall below the forecast considered in the baseline scenario. Therefore, the bands in Graph 104 show a slightly downward asymmetry.

CONCLUSION

100. The recent evolution of the output gap and of inflation expectations indicate that the risks of demand pressures are subsiding. On the other hand, it is also expected that the cost pressures generated by the price rises of some commodities and the domestic prices of some food products due to local climate conditions will be offset in the short term. As a result of this, inflation would reverse its current path –above the target range– and would converge towards the target range by mid-2012.

    The Central Bank will continue to oversee both global and domestic economic developments and inflation expectations, and stands ready to adjust its monetary policy position should this be required to guarantee inflation's convergence to the target range.