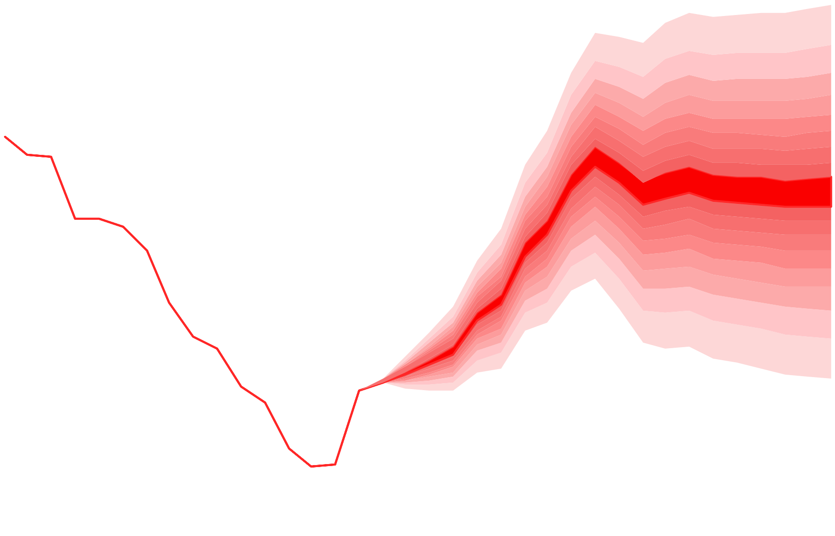
Inflation Report:

JUNE 2002



BANCO CENTRAL DE RESERVA DEL PERÚ

CONTENT

INFLATION REPORT

The Board of the Central Reserve Bank of Peru (BCR) has revised the economic perspectives for 2002, which indicate the compliance of the annual inflation target: 2,5 percent with a ±1 percent point margin. Additionally, the Board has announced that this will be the inflation target of the monetary policy from 2003 and beyond.

I FOREWORD

1. The 2002 Monetary Program, published last January, established that the Central Bank will conduct the monetary policy through an explicit inflation targeting regime. In this regard, the Bank informed that the policy actions would be oriented to reach an annual rate of inflation of 2,5 percent with a 1 percent margin (upward and downward).

II INFLATION AND EXCHANGE RATE

2. The core component of the Consumer Price Index which excludes high variability items gives a representative measure of the consumer price trend. This indicator increased 0,3 percent in the first half of the year, a sign of lower deflation risks.

Table 1
INFLATION
(Percentage change)

		Weight	2001	January-June 2002
I.	**CORE INFLATION**	**68.3**	**1.06**	**0.31**
	Goods	**41,8**	**0,66**	**-0,01**
	Foodstuffs and beverages	20,7	-0,60	-0,95
	Textiles and footwear	7,6	1,94	0,65
	Other processed goods	13,5	2,19	1,07
	Services	**26,6**	**1,65**	**0,83**
	Restaurants	12,0	1,29	0,36
	Education and health	6,4	3,78	2,24
	Other services	8,1	1,37	0,41
II.	**NON-CORE INFLATION**	**31.7**	**-2.82**	**1.26**
	Foodstuffs	14,8	-1,16	1,59
	Fuels	3,9	-13,14	5,14
	Transportation	8,4	-0,02	-0,67
	Public services	4,6	-2,73	0,35
III.	**CPI**	**100.0**	**-0.13**	**0.62**

- The prices of beverages and processed foodstuffs decreased 0,9 and 1,5 percent, respectively. Within foodstuffs, the prices of rice, noodles, oil and meat decreased 2,7; 1,5; 1,5 and 1,3 percent. In the case of rice, its price reduction was due to a seasonal higher supply (rice output increase 15 percent in the period January-May).

The reduction in the meat price resulted from a higher supply (15 percent in the period January-May), whereas the prices of bread and processed milk remained steady in the first half of the year.

The beverage price fall is explained by the beer's price reduction (4,7 percent) because of the reduction in the excise tax to beer in late 2001, which would contribute to a higher consumption. This evolution was partially offset by the increase in the sodas' price (1,9 percent).

- The prices of <u>textiles and footwear</u> increased 0,7 percent in the first half of the year. The former was associated with the beginning of the school year in April and seasonal factors (in January and June). In particular, it should be noted the increase in blankets (1,3 percent) as well as in men and children, baby and women and children garment prices (0,9; 0,6 and 0,5 percent, respectively).

- <u>Other processed good</u> prices increased 1,1 percent on average. Electrical appliances prices increased 1,4 percent, reflecting the increment in the exchange rate (1,3 percent). Other industrial good prices such as cleaning articles, medicines, and textbooks and learning material increased 3,9; 2,1 and 1,6 percent, respectively. Concerning cleaning articles, the prices of these items increased 3 percent in April despite the higher output of detergents and waxes, which grew 11 and 43 percent in the period January-April, respectively, whereas textbooks and learning material price increase is explained by seasonal factors in March and April.

- The prices of <u>services</u> included in the core inflation augmented 0,8 percent (the highest increases were recorded in education and health, 2,2 percent). Tuition and educational fees increased 2,4 percent reflecting the beginning of the academic year, whereas health services registered a price increase of 1,6 percent, reflecting higher medical fees (3,1 percent). Within other services, it should be noted the increase in rents (0,5 percent), in line with exchange rate depreciation.

Box 1
CORE INFLATION

Inflation is defined as the general and continuous increase of prices in the economy. The indicator usually used to measure inflation is the Consumer Price Index, however this index is subject to short-term fluctuations linked to agricultural supply factors, changes in international prices or price regulation measures taken by the respective competent authority.

Core inflation is the indicator widely used by the economists who try to comment the general trend of inflation beyond punctual aspects.

The measure of core inflation used by the BCR gathers 70 percent of the general index basket and do not deviate from the long-term inflation. In the period 1995-2001 both indices accumulate a 50 percent variation.

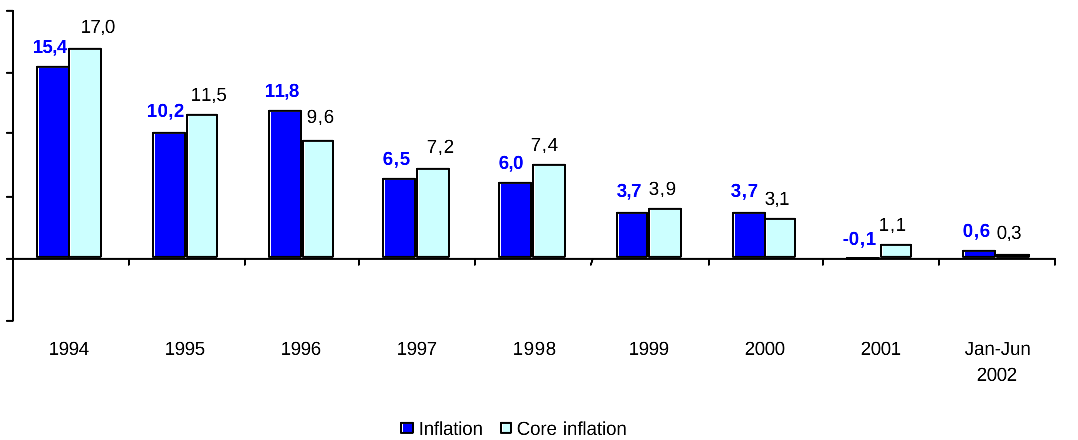
3. The non-core component of the Consumer Price Index which comprises those items with a higher price volatility related mainly to supply factors or international prices recorded an increase in the period January-June due to the increase in foodstuffs and oil prices.

- The 1,6 percent price increase in foodstuffs with high supply variability is due to the increase in fresh vegetables (41 percent), eggs (35 percent), vegetables (23 percent), onion (37 percent) and fish (8 percent), which were partially offset by the decrease in poultry (-9 percent), citrous fruits (-33 percent) and potato (-9 percent). These variations obey to seasonal supply factors such as the higher than normal temperature of coastal water. On the other hand, baby chicken production, an indicator of poultry supply, increased 4 percent in the first semester of the year, whereas potato sown surface has increased 9 percent over the current agriculture calendar.

- The increase in oil (gasoline and diesel) prices reflects the rising trend in international prices (24 percent in the year), as a consequence of the cutback of producer countries and the economic recovery of developed economies. Notwithstanding, transport fares decreased 0,7 percent due to seasonal factors.

- Public utilities augmented 0,4 percent in the first semester. The prices of water and electricity services grew 2,3 percent. In April, Sunass (the water regulator) authorized an adjustment of 2,8 percent (the fee was unchanged since November 2000); whereas electricity increased as a consequence of higher generation and transmission fees, as well as the result of the monthly update of variable costs. On the other hand, telephone fees decreased 4,4 percent after the application of the productivity factor, according to the schedule approved in September 2001.

Graph 1
INFLATION AND CORE INFLATION
(In percentage)



4. The rate of inflation measured with the General Price Index, in the first semester of 2002 was 0,6 percent. The prices of eggs, fresh vegetables, onion, other vegetables and education recorded an increase that were partially offset by the fall in the prices of poultry, citrous fruits, potato, rice and telephone fees.

Table 2
INFLATION: JANUARY-JUNE 2002
(Percentage change)

Highest positive variations			Highest negative variations		
Items	Percentage change	Contribution Percentage points	Items	Percentage change	Contribution Percentage points
Eggs	34.6	0.26	Poultry	-8.8	-0.35
Fresh vegetables	40.6	0.17	Citrous fruits	-32.7	-0.22
Onion	36,9	0,16	Potato	-9,0	-0,14
Other vegetables	23,4	0,15	Rice	-2,7	-0,06
Tuition	2.4	0.12	Telephone fees	-4.4	-0.06
Total		**0.86**	**Total**		**-0.83**

Exchange rate

5. Between January and June, the exchange rate remained relatively stable, from S/. 3,437 in December to S/. 3,482 in June. It should be noted that in the first two months the exchange rate recorded a rising trend (reaching S/. 3,478 in February), however, it started to decline in response to a higher foreign currency supply associated to the redemption of forward operations carried out in June 2001 (US$ 155 million). The exchange rate recorded its minimum level on April 22 (S/. 3,429).

In May, the exchange rate reverted its decreasing trend reaching S/. 3,51 on June 26, This upsurge is explained by both domestic and external events. As of end-June, the balance of net sale forward operations increased US$ 281 million from December to US$ 868 million in June. On the other hand, the banks' exchange position rose US$ 50 million to US$ 637 million.

6. The Central Bank intervened in the exchange market 12 times in April through purchases of US$ 90 million over the counter, in order to smooth exchange rate variability given the concentration of redemption of forward sales. However, these exchange operations shall not be seen as compromising the floating scheme of the exchange rate. The following box shows the different foreign exchange rate arrangements according to the International Monetary Fund classification.

Box 2
FOREIGN EXCHANGE RATE ARRANGEMENTS
IMF classification

Exchange Arrangements with no Separate Legal Tender
The currency of another country circulates as the sole legal tender, or the member belongs to a monetary or currency union in which the same legal tender is shared by the members of the union.

Currency Board Arrangements
A monetary regime based on a explicit legislative commitment to exchange domestic currency for a specified foreign currency at a fixed exchange rate, combined with restrictions on the issuing authority to ensure the fulfillment of its legal obligation.

Conventional Pegged Arrangement
The country pegs its currency (formally or de facto) at a fixed rate to a major currency or a basket of currencies, where the exchange rate fluctuates within a narrow margin of at most ± 1 % around a central rate.

Pegged Exchange Rate within horizontal bands
The value of the currency is maintained within certain margins of fluctuations around a formal or de facto fixed peg. The margins are wider than ± 1 % around the central rate.

Crawling Peg
The currency is adjusted periodically in small amounts at a fixed, preannounced rate or in response to changes in selective quantitative indicators.

Crawling band
The currency is maintained within certain fluctuation margins around a central rate adjusted periodically at a fixed preannounced rate, or in response to changes in selective quantitative indicators.

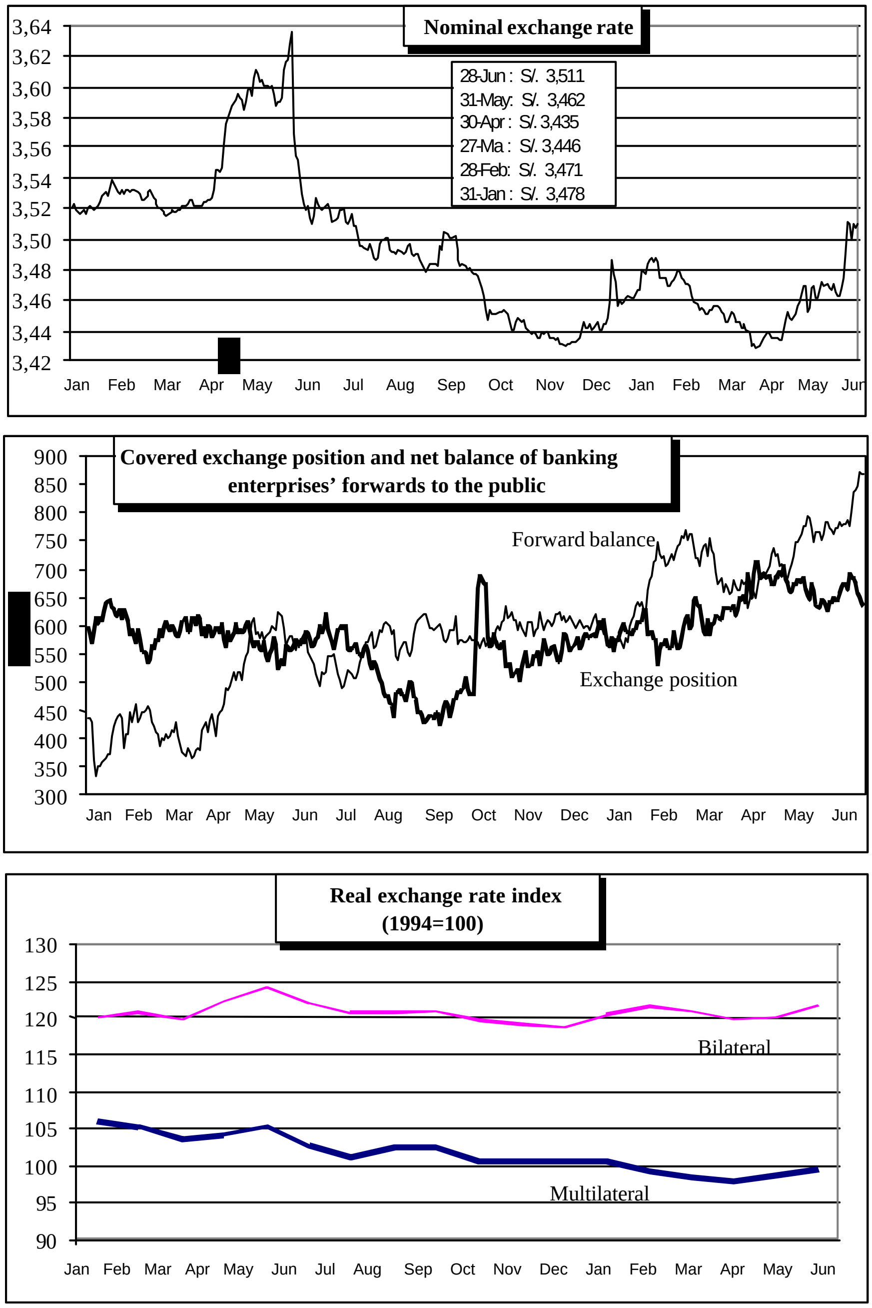
Managed Floating with no predetermined path for the exchange rate
The monetary authority influences the movements of the exchange rate through active intervention in the foreign exchange market without specifying, or precommitting to, a preannounced path for the exchange rate.

Independently Floating
The exchange rate is market determined, with any foreign exchange intervention aimed at moderating the rate of change and preventing undue fluctuations in the exchange rate, rather than at establishing a level for it.

Source: International Monetary Fund “Annual Report on Exchange Arrangements and Exchange Restrictions”, 2001

7. The bilateral real exchange rate increased 2,5 percent in the period January-June, given the 1,3 percent nominal depreciation and the difference between domestic inflation (0,6 percent) and US inflation (1,8 percent). On the other hand, the multilateral exchange rate fell 1,3 percent reflecting the depreciation of some trade partners’ currencies against the US dollar (the Argentine Peso, the Venezuelan Bolivar and the Brazilian Real).

Graph 2
EXCHANGE RATE INDICATORS
January 2001 – June 2002



Expectations and forecasts

8. Private sector outlook on 2002 and 2003 inflation is in line with Central Bank inflationary target. A survey among Investment banks and private consultants, compiled in the ***Consensus Forecast***, indicates that the expected rate of inflation for 2002 is 1,8 percent and 2,2 percent for 2003. These figures are close to that provided by the Central Bank survey on macroeconomic expectations of June. These forecasts are consistent with economic recovery scenario in which GDP would grow 3,3 percent in 2002 and 3,7 percent in 2003.

Table 3
MACROECONOMIC FORECASTS

	Consensus Forecasts 1/	Opinion poll to financial institutions 2/	Opinion poll to consultants 2/
		2002	
Inflation	1,8	2,0	1,7
GDP growth	3,3	3,0	3,0
Exchange rate as of December	3,54	3,53	3,50
Interbank rate in domestic currency as of December	-.-	3,0	2,8
		2003	
Inflation	2,2	2,5	2,1
GDP growth	3,7	3,5	3,9
Exchange rate as of December	3,66	3,60	3,60
Interbank rate in domestic currency as of December	-.-	-.-	3,5

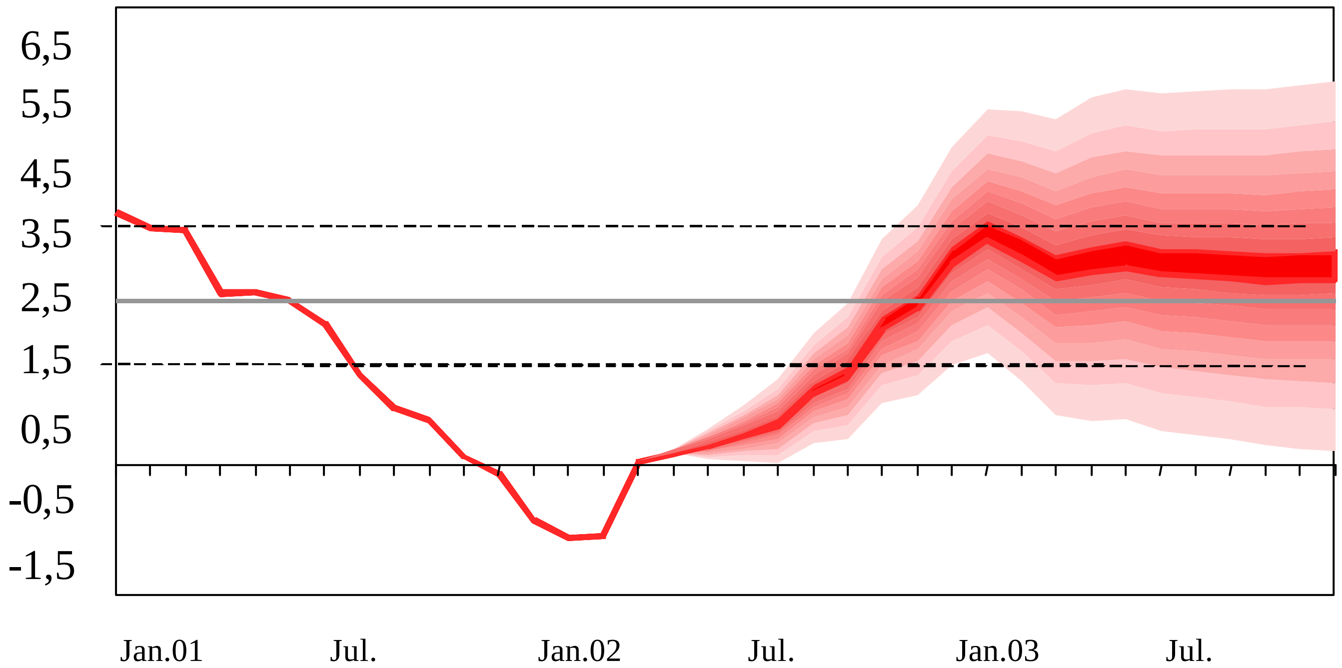
1/ Source: Consensus Economics (May 2002).
2/ Survey (June 2002)

9. Graph 3 indicates that in the years 2002 and 2003 forecasted inflation will be within the range targeted by the Central Bank, considering the actual monetary stance. The darkest band shows the most likely scenario with a 10 percent probability. Each successive band covers an additional 10 percent until 90 percent is covered by the shaded area. The bands widens as long as the forecast period is longer, reflecting a higher uncertainty in predicting inflation.

Graph 3

Inflation forecast 2002-2003

(Last 12 month)



III OUTPUT, INCOME AND DEMAND

10. During the first quarter, seasonally adjusted GDP growth was 4,3 percent in annual terms. This recovery was observed mainly in the primary industries that grew 6,6 percent reflecting the good performance in agriculture and livestock, fishing and primary manufacturing industries. On the other hand, non-primary sectors grew 3,7 percent due to the expansion in construction, that offset the lower activity of the non-primary industry.

Table 4
SEASONALLY ADJUSTED GDP
(Annualized quarterly change)

		2001				2002
		I	II	III	IV	I
I.	GDP Primary Sectors	-10,8	13,3	24,6	-3,6	6,6
	Agriculture and Livestock	-11,1	3,9	11,4	3,1	9,6
	Fishing	-15,4	-1,6	-40,1	-56,4	52,1
	Mining and oil	-14,2	24,2	90,3	11,1	-3,5
	Raw material processors	-3,7	24,7	-10,0	-32,5	15,2
II.	GDP Non-Primary Sectors	7,7	5,1	-5,3	3,1	3,7
	Non-primary industry	4,0	6,4	-12,5	7,8	-0,3
	Construction	0,9	11,0	-2,2	21,6	11,4
	Commerce	3,3	-2,7	4,8	1,3	-3,7
	Other Services	10,5	6,5	-6,6	1,0	6,1
III.	GDP	3,9	6,5	-0,2	1,8	4,3

11. Seasonally adjusted disposable national income grew 4 percent with respect to the last quarter of 2001. Similarly, domestic demand for goods and services grew 7,4 percent in the first quarter of 2002 due to the increase in private and public consumption and public sector investment. Conversely, private investment decreased 13,5 percent in annual terms.

Table 5
SEASONALLY ADJUSTED DISPOSABLE NATIONAL INCOME
(Annualized quarterly change)

		2001				2002
		I	II	III	IV	I
I.	**Gross Domestic Product**	**3,9**	**6,5**	**-0,2**	**1,8**	**4,3**
II.	Gross National Product 1/	6,4	8,5	-1,7	5,2	1,4
III.	Gross National Income 2/	7,4	9,4	-12,7	9,3	4,4
IV.	**Disposable National Income** 3/	**7,5**	**9,0**	**-12,7**	**8,9**	**4,0**

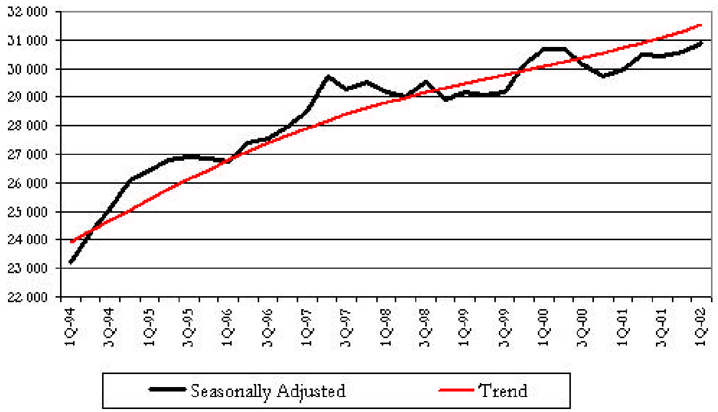
1/ Excludes the net income paid to non-resident factors.
2/ External transactions are valued at current international prices. The GDP and GNP are insulated from changes in terms of trade.
3/ Gross national income plus net transfers from non-residents.

Table 6
SEASONALLY ADJUSTED GDP
(Annualized quarterly change)

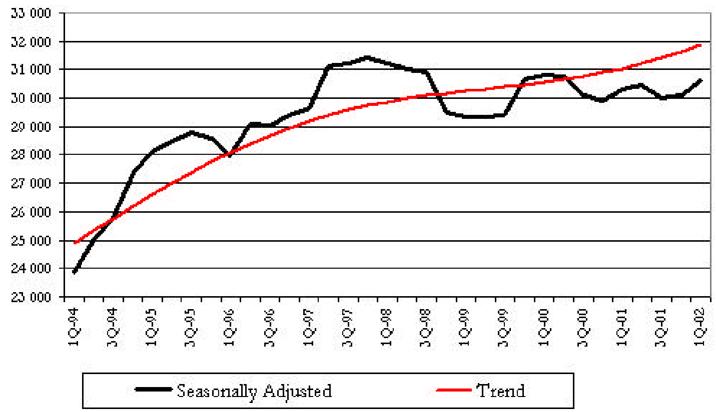
	2001				2002
	I	II	III	IV	I
I. GLOBAL DEMAND (1 + 2)	**4,2**	**2,5**	**0,4**	**0,2**	**3,8**
1. Domestic Demand	5,7	1,7	-5,3	0,9	7,4
a. Private Consumption	0,4	1,1	1,6	2,0	3,5
b. Public Consumption	-21,3	39,5	11,1	-13,6	11,4
c. Gross Domestic Investment	-9,7	-9,6	-0,4	5,1	-8,5
- Private	-5,1	-10,8	0,2	2,4	-13,5
- Public	-28,3	-3,4	-3,0	18,2	16,9
2. Exports	-4,4	7,2	39,7	-3,2	-13,8
II. GLOBAL SSUPPLy (3 + 4)	**4,2**	**2,5**	**0,4**	**0,2**	**3,8**
3. Gross Domestic Product	**3,9**	**6,5**	**-0,2**	**1,8**	**4,3**
4. Imports	5,4	-18,1	3,9	-8,5	1,2

12. The recovery in output, income and demand indicators during the first quarter of the year is also shown in the lower gaps between these indicators and their trends. Graphs 4, 5, 6 and 7 reveal these gaps declining, indicating the reversion of the recessionary conditions along the business cycle.

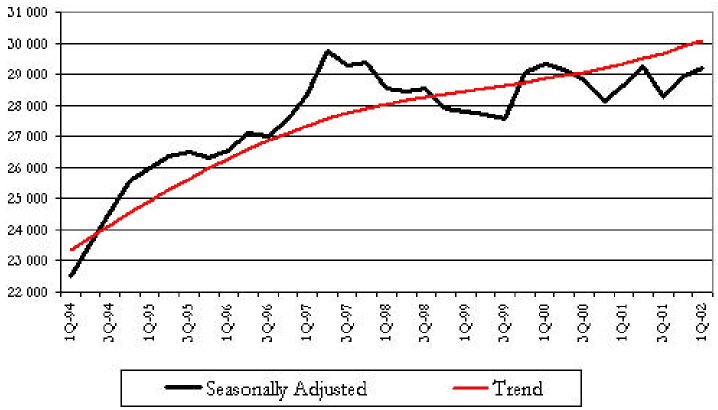
Graph 4
GROSS DOMESTIC PRODUCT
(Millions of 1994 nuevos soles)



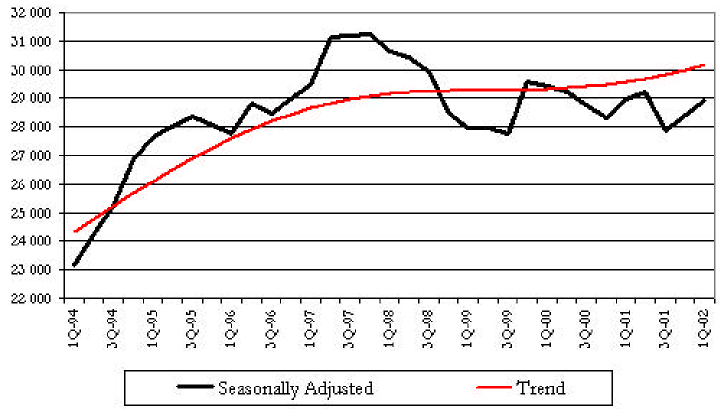
Graph 5
DOMESTIC DEMAND
(Millions of 1994 nuevos soles)



Graph 6
DISPOSABLE NATIONAL INCOME
(Millions of 1994 nuevos soles)



Graph 7
ABSORPTION
(Millions of 1994 nuevos soles)



13. The increase in employment in firms with 10 and 100 or more workers in urban areas[1] confirms a moderate recovery. Employment in firms with 10 or more workers increased 0,2 percent in seasonal-adjusted terms, between the fourth quarter of 2001 and the first quarter of 2002. The employment in firms with 100 or more workers expanded 0,1 percent. The unemployment rate reached 10,6 percent in the first quarter of this year.

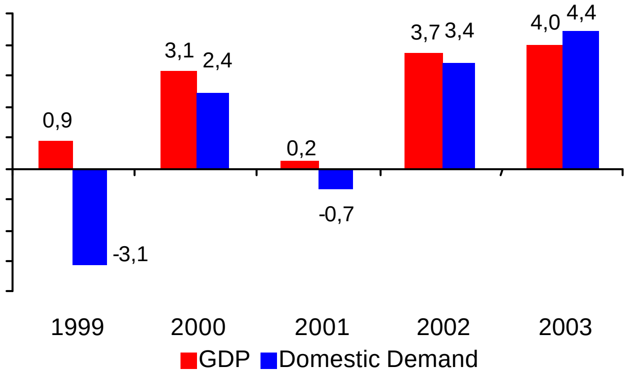
Forecasts

14. In the years 2002 and 2003 the domestic demand is projected to grow 3,4 and 4,4 percent, respectively, whereas GDP 3,7 and 4,0 percent. Private investment would increase 4 percent in 2002 and 8 percent in 2003. As a result, gross investment relative to GDP will increase from 18 percent in 2001 and 2002 to 19 percent in 2003.

15. Capital accumulation is a necessary condition to ensure sustainable growth in productive activities and employment. The latter requires policies that favour macroeconomic stability and an adequate business environment. In this area, two fundamental aspects are a export-oriented productive activity and the development of national infrastructure.

Graph 8

GDP AND DOMESTIC DEMAND: 1999-2003
(Real changes)

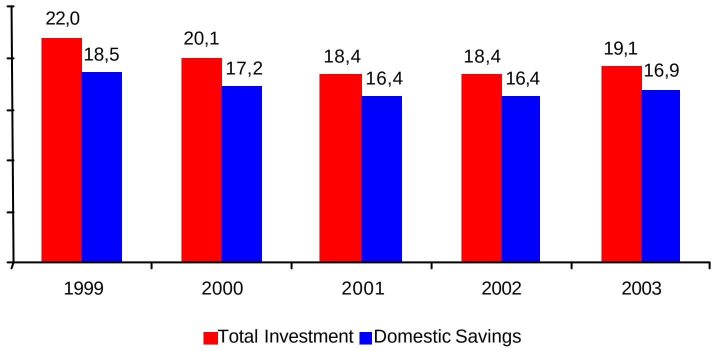


[1] The source is the Ministry of Labor and Social Promotion. Since March 2001 monthly data on employment and unemployment is provided by the National Institute of Statistics and Data Processing.

Graph 9

DOMESTIC SAVINGS AND TOTAL INVESTMENT

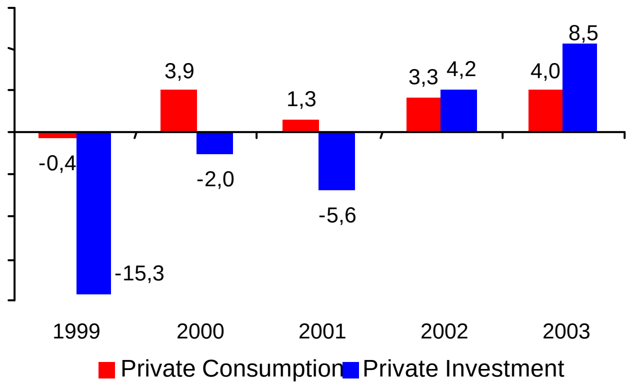
(% of GDP)



Graph 10

PRIVATE CONSUMPTION AND INVESTMENT: 1999-2003

(Percentage changes at constant prices)

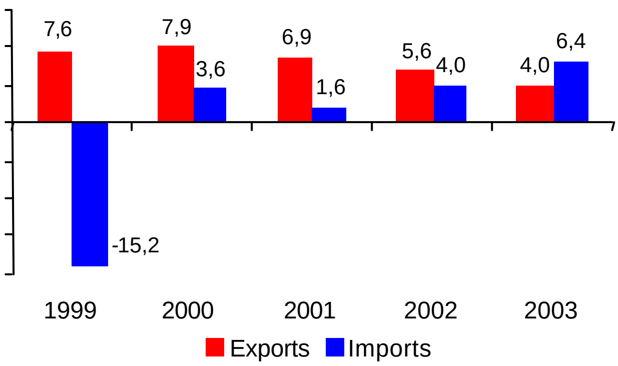


16. Exports will continue supporting the productive activity and they are expected to grow in real terms 5,6 percent in 2002 and 4,0 percent in 2003. The lower rate of expansion in 2003 reflected the end of the expansive effect generated by the start-up of Antamina mining project.

Graph 11

EXPORTS AND IMPORTS OF GOODS AND NON-FINANCIAL SERVICES: 1999-2003

(Percentage changes at constant prices)



IV WORLD ECONOMIC ACTIVITY

17. After the generalized slowdown in world economic activity during 2001, world output is showing signals of recovery resulting from the expansionary stance of developed countries' central banks.

According to the *Consesus Economics* surveys, the average GDP growth of the main 20 Peruvian trade partners is expected to increase from 1,6 percent in 2001 to 2,0 percent in 2002 and 3,4 percent in 2003. This fact could led to an interest rates increase in developed countries' central banks.

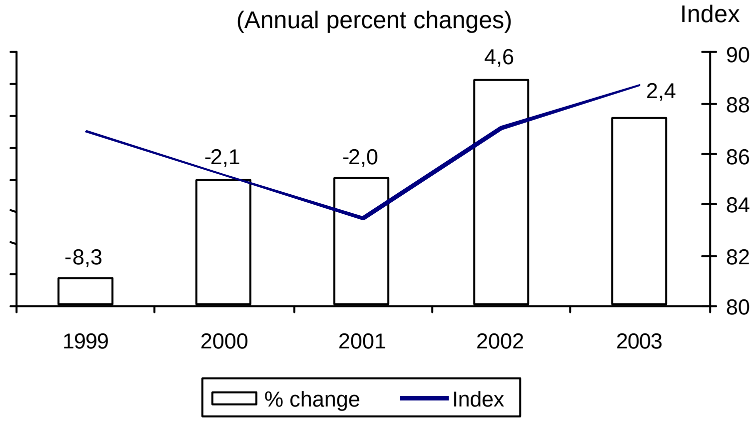
Table 7
GDP GROWTH FORECASTS OF THE MAIN PERUVIAN TRADE PARTNERS

	Percent weight 1/	2001	2002	2003
United States	33,6	1,2	2,8	3,5
United Kingdom	9,2	2,2	1,8	2,8
Chile	6,6	2,8	2,9	4,7
Japan	6,3	-0,4	-1,0	1,1
China	5,1	7,3	7,3	7,7
Brazil	4,6	1,5	2,1	3,6
Germany	4,1	0,6	1,0	2,5
Colombia	3,7	1,5	2,0	3,2
Spain	3,5	2,8	2,1	3,2
Venezuela	3,0	2,7	-2,6	0,8
South Korea	2,7	3,0	5,6	6,0
Mexico	2,7	-0,3	1,7	4,5
Argentina	2,4	-3,7	-12,2	1,2
Italy	2,4	1,8	1,3	2,7
Canada	2,2	1,5	3,0	3,7
France	2,1	2,0	1,4	2,8
Belgium	1,6	1,1	1,3	2,6
Taiwan	1,5	-1,9	3,0	3,9
Bolivia	1,4	1,0	2,0	3,4
Netherlands	1,3	1,1	1,3	2,8
Trade Partners	**100,0**	**1,6**	**2,0**	**3,4**
North America	38,5	1,1	2,7	3,6
Europe	24,1	1,8	1,6	2,8
Asia	15,7	2,6	3,2	4,4
Latin America	21,7	1,4	0,1	3,2

1/ According to the foreign trade share in 2001 (excluding oil).
Source: *Consensus Economics* (May 2002)

18. This favourable trend in world economic activity will benefit Peruvian terms of trade. In this regard, it is expected that export prices will grow 4,9 percent in 2002 and 4,2 percent in 2003, which lead to an improvement of 4,6 and 2,4 percent in terms of trade in 2002 and 2003, respectively.

Graph 12
TERMS OF TRADE
(Annual percent changes)



19. Following the improvement in the world economic activity, the expected raise in international interest rates could have a negative effect in the size of the external debt service. In the first case, considering that the floating interest rate debt represents 42 percent of the total debt, it can be expected that a 1 percent raise in the international interest rate would increase the cost of annual external public debt service in 0,2 percentage points of GDP (US$ 80 million).

20. It is worth mentioned that the world output recovery is subject to the risk of an US international assets demand reduction, which would lead to a quick reduction in its external current account deficit (-4,5 percent of GDP in 2002). In such scenario, the dollar would decline, the international interest rates would rise and the world output would weaken.

V BALANCE OF PAYMENTS

21. In the first quarter, the current account deficit was US$ 343 million (2,6 percent of GDP), down US$ 145 million from the same quarter a year ago, due to the lower trade balance deficit.

Table 8
TRADE BALANCE
(Millions of U.S. dollars)

	2001					2002
	I	II	III	IV	Year	I
1. EXPORTS	**1 663**	**1 740**	**1 915**	**1 790**	**7 108**	**1 575**
Traditional products	1 049	1 218	1 280	1 196	4 743	1 045
Non-traditional products	536	497	587	560	2 181	510
Other	77	25	49	33	184	20
2. IMPORTS	**1 848**	**1 760**	**1 849**	**1 740**	**7 198**	**1 616**
Consumer goods	361	374	398	434	1 567	363
Intermediate goods	887	897	973	850	3 607	802
Capital goods	556	461	460	435	1 911	435
Other	45	29	18	21	113	16
3. TRADE BALANCE	**-186**	**-20**	**67**	**49**	**-90**	**-41**

22. Concerning the financing of the current account, the financial account recorded an inflow of US$ 406 million, US$ 157 million above from the first quarter in 2001. This is explained by public sector's capital inflows that amounted US$ 494 millions, due to the sovereign bond issuance of US$ 500 million. On the other hand, private sector financial account was negative in US$ 101 million, because of the prepayment of securities made by a mining enterprise. Nonetheless, foreign direct investment inflow was of US$ 220 million during the first quarter.

Table 9
BALANCE OF PAYMENTS
(As a percentage of GDP)

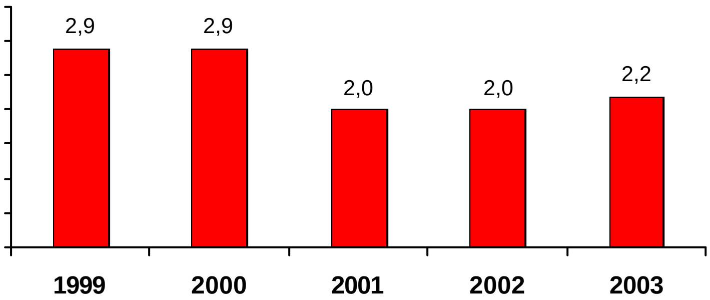
	2001					2002
	I	II	III	IV	Year	I
I. CURRENT ACCOUNT BALANCE	**- 3,8**	**- 2,0**	**- 0,9**	**- 1,5**	**- 2,0**	**- 2,6**
II. FINANCIAL ACCOUNT	**1,9**	**4,0**	**0,6**	**1,1**	**2,0**	**3,8**
1. Private sector	2,3	2,4	2,1	1,7	2,1	- 0,1
2. Public sector	0,1	2,0	0,6	0,1	0,7	3,7
3. Short-term capital	- 0,5	- 0,5	- 2,0	- 0,6	- 0,9	0,1
III. EXCEPTIONAL FINANCING	**0,2**	**0,0**	**0,0**	**0,0**	**0,1**	**0,0**
IV. BCR NET INTERNATIONAL RESERVES FLOW	**0,3**	**- 1,6**	**- 2,3**	**0,3**	**- 0,8**	**- 0,8**
V. NET ERRORS AND OMISSIONS	**1,4**	**- 0,4**	**2,5**	**0,0**	**0,8**	**- 0,4**
Note :						
Direct investment without privatization	1,5	0,4	2,1	2,0	1,5	1,7

23. For year 2002, it is projected a current account deficit of US$ 1 123 millions (2,0 percent of GDP). On one hand, the trade balance would have a positive result (US$ 380 millions), thanks to an annual growth of

exports of 10 percent, which includes the effect of higher export prices (4,9 percent).

The forecast for year 2003 considers a current account deficit of US$ 1 310 million (2,2 percent of GDP). The recovery of the world economy would have a positive effect on trade balance (a higher surplus in US$ 77 millions with respect to 2002), related to a positive effect on metal prices and to a greater demand for non-traditional products. Exports would growth 8 percent while imports in 7 percent. However, this improvement would be offset by a higher deficit in services, due to higher freight costs and a greater deficit in investment income, resulting from higher profits of foreign owned enterprises.

Graph 13
CURRENT ACCOUNT DEFICIT
(% of GDP)



24. In 2002, private sector foreign investment flows would correspond mainly to the mining sector: Antamina (US$ 138 millions), the enlargement of Yanacocha (US$ 140 millions) and Camisea (US$ 488 millions). For 2003, investment flows would go to the mining sector, including the project of Southern's smelting plant in Ilo (US$ 150 millions), as well as Camisea (US$ 500 millions).

25. External accounts show a solid position, supported by an adequate level of net international reserves relative to short-term liabilities. Moreover, the fiscal stance contributes to the reduction of the debt-to-GDP ratio, allowing a lower burden for external debt service. It is important to emphasize that the current account gap reflects reserves outflows associated to the investment phase of various projects. Economic activity related to foreign investment is a key element in the sustained recovery of production.

Table 10
EXTERNAL VULNERABILITY INDICATORS

	2001	2002	2003
Balance of Net International Reserves (NIR) (Millions of US$)	8 613	9 463	9 673
NIR / debt due within a year (number of times) 1/	1,5	1,8	1,8
NIR (months of imports of goods)	14	14	15
Total external debt (as a % of GDP)	51	49	48
Total external debt / exports of goods and services (number of times)	3,2	3,0	2,8
Public external debt (as a % of GDP)	35	34	33
Public external debt / exports of goods and services (number of times)	2,2	2,1	2,0
Total external debt service (% of exports of goods and services) 2/	39	34	36
Public external debt service (% exports of goods and services) 2/	24	21	22

1/ Short-term debt plus amortization of medium and long term debt due in the next 12 months.
2/ In year 2002 excludes the debt swap operation.

VI PUBLIC FINANCE

26. During the first quarter of 2002, deficit in the overall balance of the Non-Financial Public Sector was 1,2 percent of GDP, level consistent with the targets of the Economic Program. Financing requirement of the public sector amounted to US$ 333 millions, covered with the domestic issuance of bonds (US$ 138 millions), external disbursements (US$ 643 millions) and privatization receipts (US$ 39 millions).

Table 11
NON-FINANCIAL PUBLIC SECTOR OPERATIONS
(As a percentage of GDP)

	2001					2002
	I	II	III	IV	Year	I
1. Current revenue	**14,9**	**13,6**	**14,2**	**13,8**	**14,1**	**13,3**
2. Non-financial current expenditure	**-13,4**	**-14,3**	**-15,2**	**-16,7**	**-14,9**	**-13,3**
3. Others	**1,6**	**0,6**	**0,4**	**0,0**	**0,7**	**0,8**
4. Primary Balance	**3,1**	**0,0**	**-0,5**	**-2,9**	**-0,1**	**0,7**
5. Interests	**-2,3**	**-2,1**	**-2,2**	**-2,3**	**-2,2**	**-2,0**
Million of US$	*-$ 257*	*-$ 263*	*-$ 257*	*-$ 269*	*-$1 046*	*-$ 230*
6. Overall Balance	**0,8**	**-2,2**	**-2,7**	**-5,2**	**-2,3**	**-1,2**
Million of US$	***$ 101***	***-$ 305***	***-$ 361***	***-$ 712***	***-$1 277***	***-$ 166***
7. Amortization	**-$ 189**	**-$ 214**	**-$ 225**	**-$ 272**	**-$ 900**	**-$ 167**
Internal	-$ 18	-$ 17	-$ 42	-$ 54	-$ 131	-$ 18
External	-$ 170	-$ 197	-$ 183	-$ 218	-$ 768	-$ 149
8. Financing Requirement	**$ 87**	**$ 519**	**$ 586**	**$ 985**	**$2 177**	**$ 333**
External disbursements	*$ 223*	*$ 492*	*$ 330*	*$ 274*	*$1 319*	*$ 643*
Domestic bonds	*$ 28*	*$ 70*	*$ 115*	*$ 131*	*$ 344*	*$ 138*
Privatization	*$ 47*	*$ 23*	*$ 21*	*$ 236*	*$ 328*	*$ 39*
Others	*-$ 211*	*-$ 66*	*$ 120*	*$ 344*	*$ 187*	*-$ 487*

27. In the first quarter of 2002, central government's current revenues declined 7 percent in real terms, due to the negative evolution of import taxes, as well as lower income from Extraordinary Solidarity Tax (IES) and the Special Tax Amnesty Regime. It should be noted that this

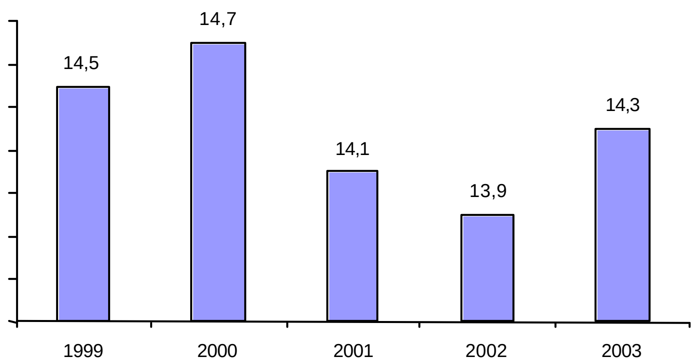
reduction was influenced by the tariff reduction enacted in April 2001 and the reduction in the IES from 5 to 2 percent in August 2001.

Central government's non-financial expenditures registered a real growth of 4 percent, mainly reflecting the increase in wages and pensions granted to the civil servants in September 2001, whereas capital expenditure dropped 9 percent.

28. For the period June-December 2002 it is expected the application of tax measures in order to obtain annual current revenues equivalent to 13,9 percent of GDP. These measures emphasize improvements in tax administration through mechanisms of tax retentions, as well as policies oriented to improve the efficiency in the tax administration. As a result, current revenues would grow 3 percent in real terms in 2002 and 7 percent in 2003.

Graph 14

CENTRAL GOVERNMENT'S CURRENT REVENUES
(% of GDP)



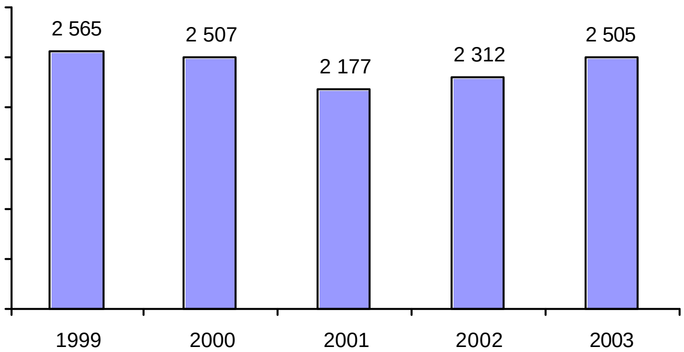
29. Non-financial expenditure would be S/. 29,0 billion in 2002 (real growth of 3 percent), of which, S/. 24,4 billons correspond to non-financial current expenditure (increase of 2 percent) and S/. 4,6 billons to capital expenditure (increase of 4 percent). Following the Multiannual Macroeconomic Framework of the Ministry of Economy and Finance, in 2003 the non-financial expenditure will grow 5 percent: non-financial current expenditure 4 percent and capital expenditure 6 percent.

30. The public sector borrowing requirement in 2002 will amount to US$ 2 300 million, of which US$ 1 500 million will come from external disbursements, US$ 430 million from domestic bonds, and other sources such as privatization receipts.

Graph 15

GROSS FINANCING REQUIREMENT OF THE CONSOLIDATED PUBLIC SECTOR: 1999-2003

(Millions of US$)

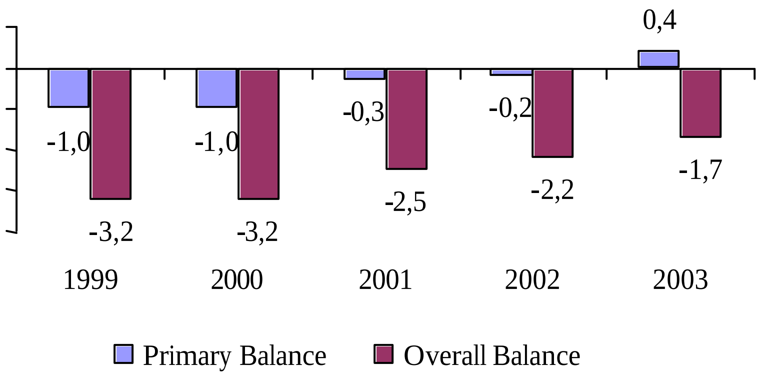


31. For 2003, financing requirement would amount to US$ 2 500 millions, higher than the level in 2002 due to the higher amortization of domestic debt. The financing requirements may be covered by disbursements of external debt for US$ 1 650 millions. Likewise, US$ 580 millions would be in the form of domestic bonds, whereas other sources such as privatization receipts will finance the rest.

Graph 16

OPERATIONS OF THE NON-FINANCIAL PUBLIC SECTOR

(% of GDP)



VII OPERATING TARGET AND INTEREST RATES

32. In January 2002, the Central Bank adopted an Explicit Inflation Targeting scheme, by which it was announced a target of 2,5 percent with a 1 percent point margin upward and downward. In order to attain this target the Central Bank appeals to a set of selective indicators of future inflation as well as the announcement, at the beginning of each month, of monetary policy decisions referred to the banks' liquidity and to the interest rates of Central Bank operations with banks.

33. In the first semester of 2002, the Central Bank maintained a flexible monetary policy stance, a process that started in the second semester of

2001. In this way, the BCR guided the monetary policy in order to dissipate the risks of deflationary pressures and to achieve the announced inflation target.

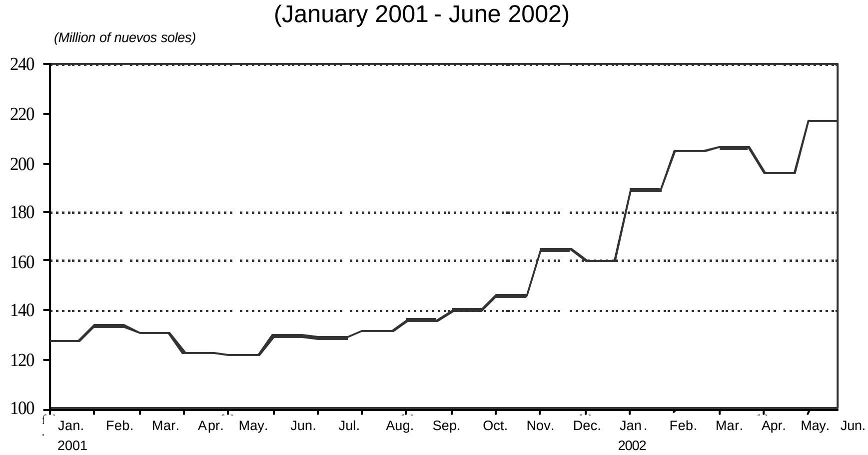
This flexibilization was carried out by a gradual increase of the Monetary Policy operational target, that is, the announced range for the Bank's current account daily average balance held at the Central Bank. In line with the expansion of the liquidity target, the interest rates of Central Bank's monetary operations were reduced.

Table 12
Operational target of the Banks' current account and reference interest rates approved by the Central Bank

	2001	2002					
	December	January	February	March	April	May	June
1. Operational target: current account of banks							
(In million of S/.)							
Range	150-160	160-170	160-170	185-195	205-215	205-215	195-205
Actual	165	160	189	205	206	196	217
2. Reference interest rates							
(In percentage)							
a. Rediscount facility in nuevos soles	5	4	3,5	3	3	3	3
b. Overnight deposits in nuevos soles	2	2	1,9	1,9	1,9	1,9	1,9
Note:							
Interbank interests rates in domestic currency	3,1	2,7	2,6	2,5	2,5	2,5	2,6

34. It should be noted that the deviations in the execution of the operative target recorded over this semester were in line with the changes in the composition of banks' reserves. These adjustment made possible the stability in the level of the interbank interest rate during this period.

Graph 17
OPERATING TARGET
(January 2001 - June 2002)



35. In the year, Monetary Policy has induced a reduction of the interbank interest rate from 3,1 percent in December of 2001 to 2,6 percent in June, as well as a decrease in its variability (the standard deviation declined from 2,0 percentage points in 2001 to 0,1 percentage points in June of 2002).

Table 13
INTERBANK INTEREST RATE VARIABILITY
(In percentage)

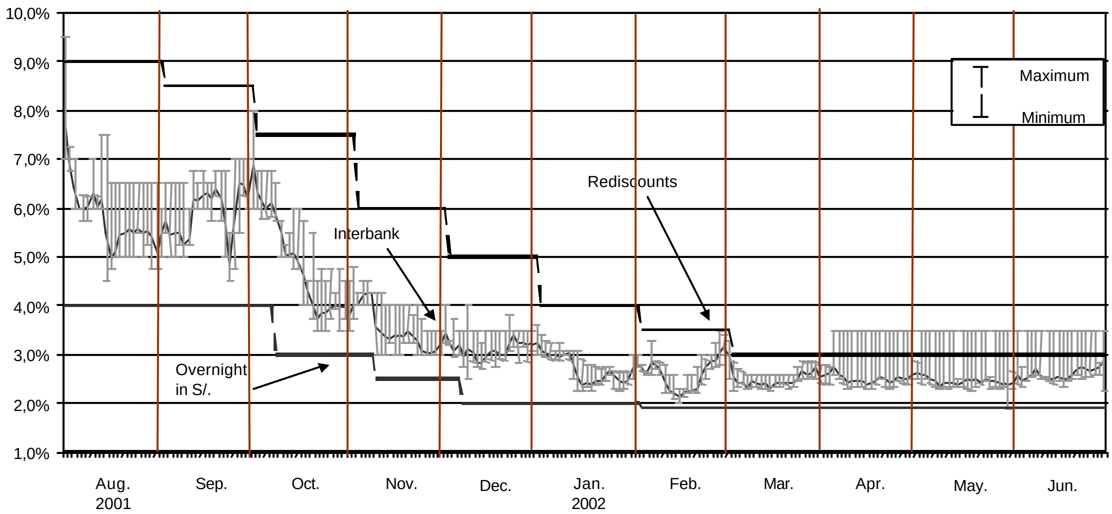
	Average interest rate	Standard deviation	Variability Coefficient
Year 2001 1/	8,6	2,0	23,2
Jan. 2002	2,7	0,3	9,4
Feb.	2,6	0,3	12,1
Mar.	2,5	0,1	4,6
Apr.	2,5	0,1	3,3
May.	2,5	0,1	2,7
Jun.	2,6	0,1	4,4

1/ Year standard deviation is computed as the average of monthly deviations.

36. The announcements of the monthly operational target and the interest rates of the Central Bank's monetary operations have guided the evolution of the interbank interest rate. Thus, since August 2001 the daily average interest rate has been within the corridor defined by the interest rates of the BCR's monetary operations. The volatility of this rate has also recorded a decrease. It should be noted that interbank transactions at rates out of the corridor has been negligible.

Graph 18

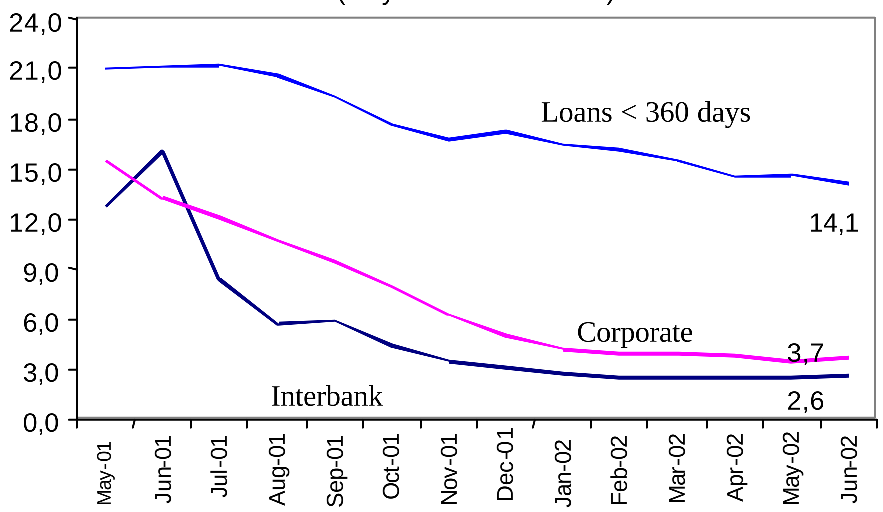
INTEREST RATES IN DOMESTIC CURRENCY
(August 2001 - June 2002)



Interest rates

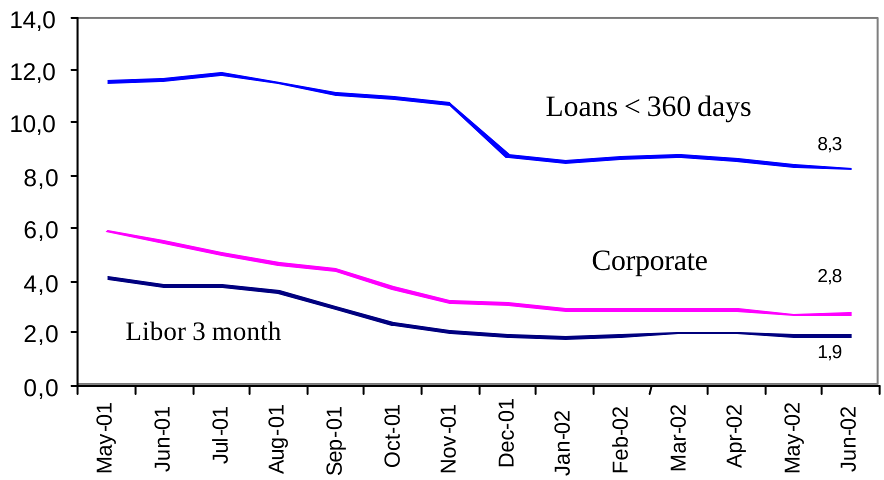
37. The stance of the Monetary Policy was reflected in decreasing interest rates in domestic currency. Thus, the corporate prime interest rate for loans in domestic currency up to 90 days decreased from 5 percent in December of 2001 to 3,7 percent in June of 2002. Similarly, the interest rate for loans up to 360 days declined from 17 percent to 14 percent in the same period.

Graph 19
NOMINAL INTEREST RATES IN DOMESTIC CURRENCY
(May 2001 - June 2002)



38. The corporate prime interest rate for loans up to 90 days in dollars diminished from 3,1 percent in December 2001 to 2,8 percent in June 2002, whereas the interest rate for loans up to 360 days dropped from 8,7 percent to 8,3 percent in the same period. The evolution of these rates would be reflecting the stability in international interest rates (3-month Libor remained at 1,9 percent).

Graph 20
NOMINAL INTEREST RATES IN FOREIGN CURRENCY
(May 2001 - June 2002)



39. The interest rate of the Certificates of Deposits issued by the Central Bank (CDBCRP) decreased from 3,9 percent in December 2001 to 3,0 percent in June 2002. It is worth to mention that the CDBCRP interest rates at different terms have followed a decreasing trend until February 2002. In March and April these interest rates were relatively stable, whereas in May they started to grow.

In the case of longer term operations (two and three years) represented by the Treasury bonds, the falling tendency of interest rates started to revert in March 2002.

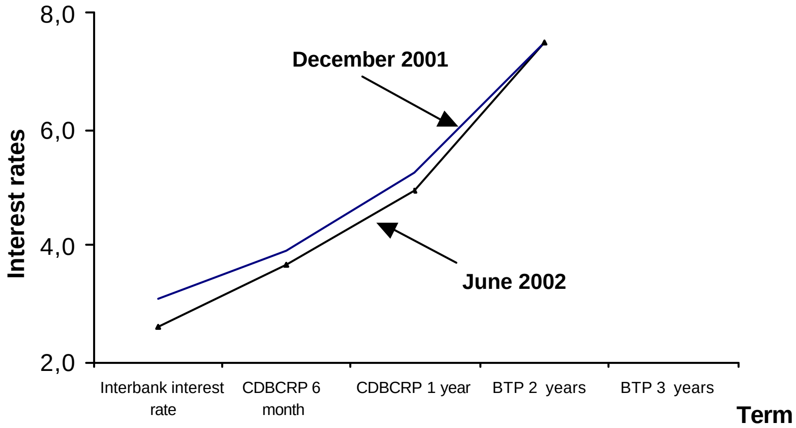
Table 14
INTEREST RATES
(In percentage)

	Interbank	CDBCRP			Treasury bonds	
		6 month	9 month	1 year	2 years	3 years
December 2001	3,1	3,9		5,3	7,5	
January 2002	2,7	3,5	4,1	4,5	6,4	7,8
February	2,6		3,8		6,0	7,2
March	2,5	3,3	3,8	4,0	6,8	7,9
April	2,5	3,3	3,8			
May	2,5	3,4	4,0		7,3	
June	2,6	3,7		4,9	7,5	

40. The CDBCRP and the Treasury bonds yield-curve shift downwards, which reveals a general descent of the interest rates at several terms, in line with the evolution of the monetary policy stance. However, recent indicators show that the long term interest rates had a increasing tendency, reflecting a change of the conditions that drove down the domestic currency interest rates. In particular, financial markets forestall a revert in the declining trend in international and domestic interest rates.

Graph 21

YIELD CURVE OF CDBCRP AND TREASURY BONDS (BTP)



VIII MONEY AND CREDIT

Monetary base

41. In the first half of the year the Central Bank carried out mainly operations of monetary sterilization. Thus, end-of-period monetary base balance decreased S/. 200 million between December 2001 and June 2002. It

should be noted that a lower monetary base demand is recorded in the first months of the year, following the increase of end-of-year holidays.

42. The main monetary operations carried out during the first semester of the year were:

a. CDBCRP auctions by S/. 225 million. As a consequence, the balance of CDBCRP passed from S/. 1 840 million in December of 2001 to S/. 2 065 million in June of 2002 (35 percent of the monetary base).

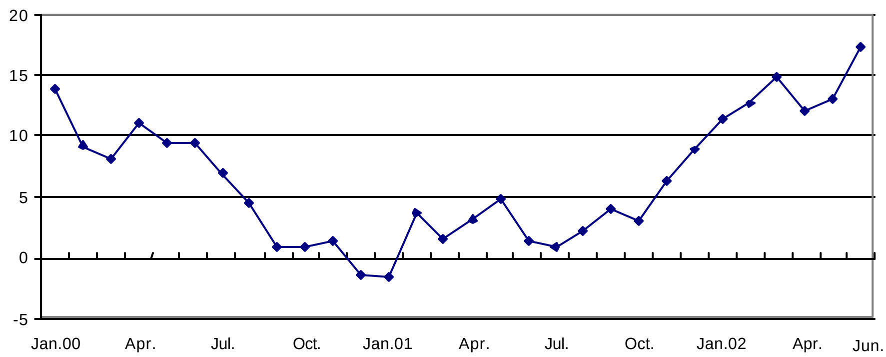
b. Increase of Public Sector deposits held at the Central Bank by S/. 498 million. This evolution was related to the income tax regularization in April and transfers of public sector entities' profits.

c. Purchases of foreign currency by S/. 309 million (US$ 90 million) in April in order to reduce the foreign exchange rate volatility.

43. The 12-months rate of growth of the monetary base average balance during the first quarter of 2002 continued the increasing trend observed since November 2001. It grew 6 percent in November 2001, 11 percent in January and 15 percent in March. In April, the annual rate of growth was lower than in the previous months (12 percent); however it grew again in May (to 13 percent) and in June (to 17 percent). It is expected that the velocity at which monetary base grow diminishes in the second semester.

The higher demand for monetary base over the last months is explained mainly by the reduction in interest rates and economic recovery. For example, the savings interest rate in domestic currency diminished from 6,2 percent in August 2001 to 1,7 percent in June 2002, decreasing the opportunity cost of cash holding. As a consequence, the rate of growth of the monetary base would not represent risks of inflationary pressures. However, the Central Bank will continue monitoring the path of the monetary base demand determinants.

Graph 22
MONETARY BASE
(Annual rates of variation)



44. Considering the levels of the monetary base between January and June, it is projected that the monetary base average balance of 2002 would increase 12,5 percent, which means a revision of the projection

published in the Annual Monetary Program (7 percent). This new projection is based on a 4,5 percent nominal growth of the GDP (a real growth of 3,7 percent), a decrease of the velocity of circulation of 9,6 percent and an increase of 2,7 percent of the banking multiplier. The new projection considers a higher decrease of the velocity of circulation as well as a minor secondary expansion of the banking multiplier.

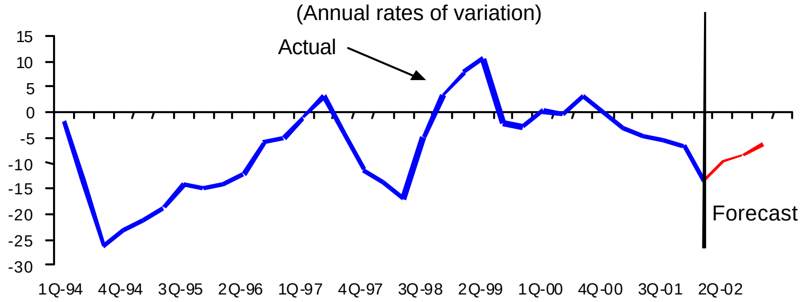
Table 15
DETERMINANTS OF MONETARY BASE AVERAGE GROWTH IN 2002 [1/]

	Factors	Forecasted variation		Comments
		Monetary Program January	Revision June	
A	Nominal GDP	4,5	4,5	The assumption of economic activity dynamism holds.
B	Velocity of circulation	-6,3	-9,6	Higher demand for soles in a context of higher exchange and financial stability.
C	Banking multiplier	4,2	2,7	The lower growth of banking multiplier is due to higher cash requirements, reflecting the reduction of interest rates.
D	Monetary base	7,0	12,5	

1/ $$D = \frac{\left(1+\frac{A}{100}\right)}{\left(1+\frac{B}{100}\right)\cdot\left(1+\frac{C}{100}\right)} - 1$$

45. The greater confidence in the domestic currency has been reflected in a 13 percent fall of the Nuevo Sol velocity of circulation during the first quarter of 2002 with respect to the same quarter in the previous year. This greater remonetization has not been registered since the first semester of 1998. It is expected that during the year the velocity of circulation will decline 10 percent.

Graph 23
VELOCITY OF CIRCULATION OF LIQUIDITY IN DOMESTIC CURRENCY
(Annual rates of variation)

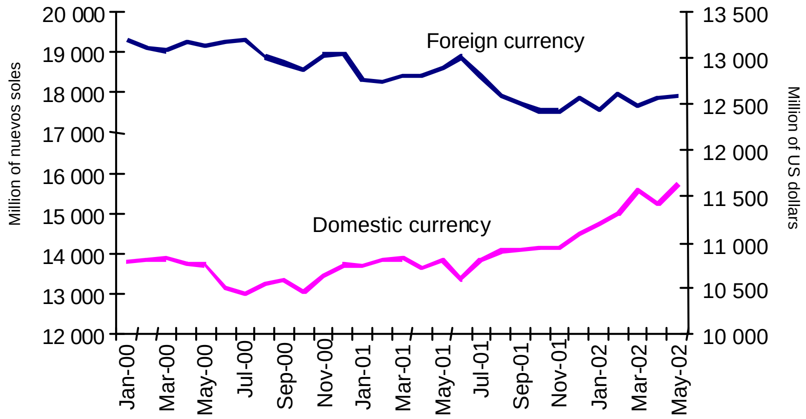


Credit to the private sector

46. The financial system credit to the private sector, a comprehensive concept of financing that includes loans and investments of the bank and non-bank system, increased 0,9 percent as of end-May with respect to

December 2001. The rate of growth in credit in domestic currency was 1,1 percent, and 0,2 percent in foreign currency.

Graph 24
CREDIT OF FINANCIAL INSTITUTIONS TO THE PRIVATE SECTOR
(January 2000 - May 2002)



47. In this year, the financial intermediaries with greater growth were institutional investors (7 percent or S/. 250 millions) and financial specialized institutions in micro finance (with a 5 percent growth equivalent to S/. 173 millions).

Table 16
CREDIT OF FINANCIAL INSTITUTIONS TO THE PRIVATE SECTOR

	Dec. 2001	May. 2002	May.02/Dec.01 Var.%
Banking enterprises 1/	43 617	43 571	-0,1
Banco de la Nación	347	483	39,2
micro financial institutions	**3 382**	**3 555**	**5,1**
Banks (Trabajo and MiBanco)	627	703	12,1
Regional credit unions	855	897	4,9
Rural credit unions	242	241	-0,4
Credit and savings unions	621	630	1,4
Edpymes	177	190	7,3
Financial institutions	860	894	4,0
Institutional investors 2/	**3 665**	**3 915**	**6,8**
AFPS	2 293	2 374	3,5
Insurance companies	341	397	16,4
Mutual funds	1 031	1 144	11,0
Leasing enterprises and others	**3 396**	**3 351**	**-1,3**
Total	**54 407**	**54 875**	**0,9**

1/ Excludes Banco del Trabajo and MiBanco.
2/ Comprises investments in fixed income issued by the private sector.

IX FINAL REMARKS AND BALANCE OF RISKS

48. The assessment of macroeconomic conditions both domestic and external, brings as a conclusion the diminishing risks of a deflation and the compliance of the inflation target.

49. The economy is confronting risks due to domestic and external events:

- Concerning domestic events, it is necessary to take into account the effects of a continuous depressed private investment on the long-run growth perspectives. To this respect, monetary policy has little room to operate. On the other hand, a weak economic activity would affect the evolution of public finances as well as confidence of economic agents, which in turn would imply higher financing costs.

- In the external front, the risk of contagion from the financial crisis in Argentina has been low so far. However, there is still a cautious position in foreign investors and a risk perception in the other economies of the region. In this regard, precautionary actions such as prudent macroeconomic policies and a solid international reserve position allow to reduce the contagion risk to our economy.

50. In order to adopt a medium term perspective, the Central Bank Board of Directors approved an inflation target of 2,5 percent with a 1 percent margin upward and downward for 2003 and beyond.

Annex 1
GROSS DOMESTIC PRODUCT
(Annual rates of growth)

		2001					2002
		I	II	III	IV	Year	I
I.	Primary sectors	-3,4	-0,2	6,8	5,1	1,9	9,4
	Agriculture and livestock	-1,7	-2,8	1,4	1,5	-0,6	7,4
	Fishing	-6,6	2,3	-20,6	-34,7	-13,3	-22,1
	Mining and oils	-3,5	3,6	21,2	22,9	11,2	23,7
	Raw material processors	-6,3	2,4	0,1	-7,9	-2,9	-3,6
II.	Non-primary sectors	-2,2	-1,0	0,0	2,6	-0,2	1,6
	Non-primary industry	-2,3	0,0	-1,0	1,1	-0,6	0,0
	Construction	-15,7	-6,0	-8,3	6,9	-6,0	10,3
	Trade	-0,2	-2,4	0,8	2,0	0,0	-0,1
	Other services	-1,3	-0,3	0,9	2,6	0,4	1,6
III.	GDP	-2,4	-0,8	1,2	3,0	0,2	3,0

Annex 2
DISPOSABLE NATIONAL INCOME
(Annual rates of growth)

		2001					2002
		I	II	III	IV	Year	I
I.	Gross domestic product (GDP)	-2,4	-0,8	1,2	3,0	0,2	3,0
II.	Gross national product (GNP)	-2,0	0,0	0,9	4,7	0,9	3,2
III.	Gross national income (IN)	-2,4	0,6	-1,5	2,8	-0,2	1,9
IV.	Disposable national income (DNI)	-2,4	0,6	-1,6	2,6	-0,2	1,5
V.	Absorption	-1,6	0,2	-3,2	0,0	-1,1	-0,5

Annex 3
GROSS DOMESTIC PRODUCT
(Annual rates of growth)

	2001					2002
	I	**II**	**III**	**IV**	**Year**	**I**
I. GLOBAL DEMAND (1 + 2)	**-1,2**	**-0,6**	**1,7**	**1,8**	**0,4**	**1,6**
1. Domestic demand	-1,6	-1,2	-0,3	0,6	-0,7	1,0
a. Private consumption	2,0	1,2	1,0	1,1	1,3	2,4
b. Public consumption	-6,9	-3,0	0,5	7,1	-0,5	3,7
c. Gross domestic investment	-12,2	-8,5	-6,2	-4,8	-8,0	-6,0
Gross fixed investment	-11,2	-12,4	-7,4	-2,2	-8,3	-5,6
- Private	-6,4	-7,7	-4,7	-3,7	-5,6	-5,7
- Public	-31,9	-28,7	-18,5	3,7	-19,0	-4,5
2. Exports	1,8	3,0	13,2	8,7	6,9	5,4
II. GLOBAL SUPPLY (3 + 4)	-1,2	-0,6	1,7	1,8	0,4	1,6
3. Gross domestic product	-2,4	-0,8	1,2	3,0	0,2	3,0
4. Imports	**6,4**	**0,7**	**4,7**	**-4,7**	**1,6**	**-5,9**