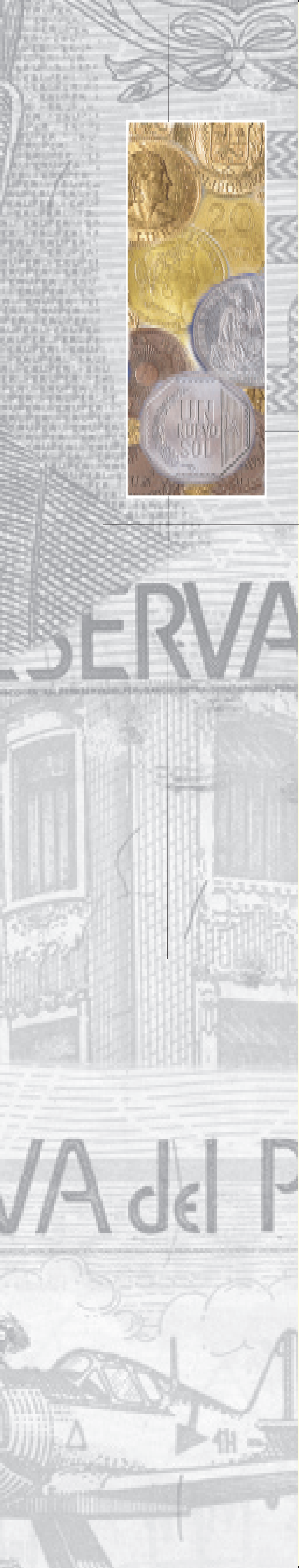

INFLATION REPORT

June 2009

Recent trends and macroeconomic forecasts 2009-2011

CENTRAL RESERVE BANK OF PERU

INFLATION REPORT:

Recent trends and macroeconomic forecasts 2009-2011

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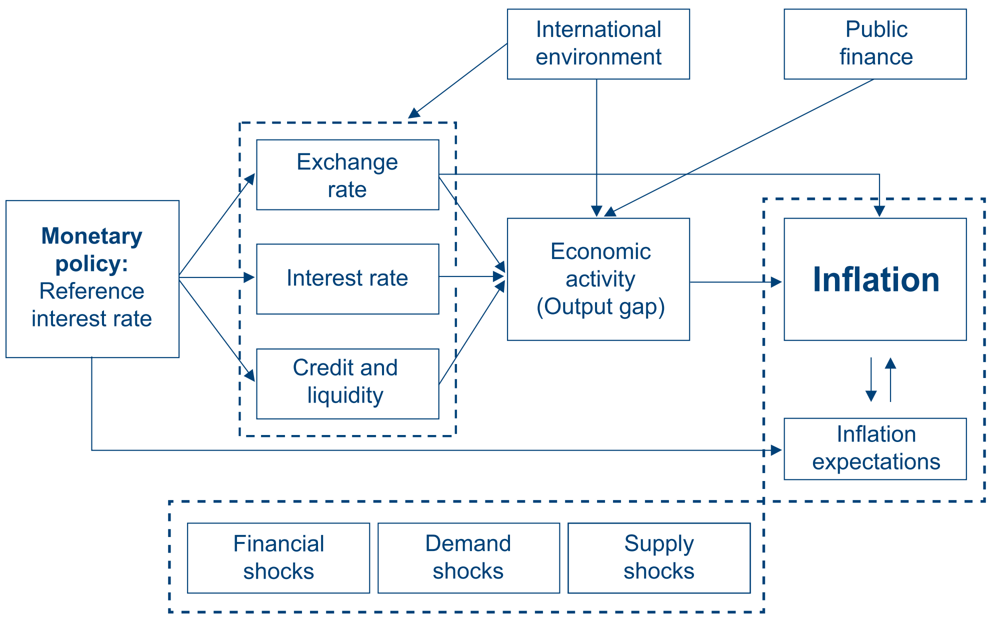

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INFLATION REPORT
Recent trends and macroeconomic forecast

Edition and Press Area
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BOXES

This ***Inflation Report*** was drawn up using preliminary data on gross domestic product, balance of payments, operations of the non-financial public sector and monetary accounts as of March 2009, and data on inflation, exchange, and financial markets as of May 2009.

Foreword

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

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

- Compliance with the inflation target is continuously evaluated; that is, the Central Bank considers the accumulated rate of inflation in each month and not only at year's end. In the event of any deviation of inflation from the target, the Central Bank implements the necessary measures to return inflation to the target considering monetary policy lags.

- 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 affects the entire array of domestic economic variables and inflation through several channels in different timeframes and, therefore, this rate has to be determined on the basis of macroeconomic forecasts and simulations

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

- This Inflation Report analyzes the evolution of the main economic developments observed in the first five months of 2009. The forecast scenario analyzed herein is consistent with monetary policy lags during the 2009-2011 macroeconomic horizon.

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

Summary

i. A deterioration of prospects for world growth in 2009-2010 continued to be observed in the international environment, in line with the significant decline of economic activity in the main developed countries and in most emerging economies. This reduction of world economic activity has been characterized by the contraction of foreign trade (at rates unobserved during the post war period) and by a generalized drop of inventories worldwide.

However, some indicators allow envisaging a gradual recovery of the global economy as from the second half of this year: the gradual recovery of global financial conditions and signals that China would be recovering its economic dynamism. Global GDP would decline 1.3 percent in 2009, instead of showing an almost nil growth rate as previously forecast in our March Inflation Report, recovering thereafter to growth rates of 2.5 and 3.6 percent in 2010 and 2011, respectively.

ii. Considering this deterioration of the international environment and the country's lower level of economic activity compared to the one forecast in our March Report, the forecast on GDP growth has been revised downwards from 5.0 percent to 3.3 percent for 2009. Economic activity grew 1.8 percent in Q1-2009, with real exports dropping 3.0 percent and domestic demand recording a drop of 0.8 percent. Like in the rest of the world, the strong downward adjustment of inventories greatly accounts for this lower production. Production levels should start recovering as inventory levels reach the new desired values. This process would be reinforced by the impact of monetary and fiscal stimulus measures and by the gradual recovery of the world economy. In line with the estimated growth of the potential output, growth rates of 5.5 and 5.7 percent are expected for 2010 and 2011, respectively.

iii. Inflation continued showing the downward trend initiated in December, falling from 6.7 percent in this month to 4.2 percent in May, since the pressures that pushed inflation upwards during the two previous years have subsided. In fact, the reversal of adverse conditions in terms of global agricultural supply has brought about a decline in the prices of imported inputs. Moreover, a clear downward trend has been observed in both core inflation and inflation expectations.

iv. Inflation should continue converging to the target in the rest of 2009 given that the following conditions are foreseen: a) a gradual recovery of the growth of economic activity; b) lower imported inflation; and c) a gradual return of inflation expectations towards the target. A rate of inflation close to the target level is expected for 2009-2010 as inflation expectations should be around 2.0 percent and economic activity should be consistent with the potential output.

v. The monetary policy stance continued responding to this context of lower inflation and lower inflationary pressures. To face the slowdown of domestic economic

activity and maintain inflation within the target range in the forecast horizon, the Central Bank started loosening its monetary stance at a faster pace to foster more favorable monetary and credit conditions. Thus, the Central Bank accelerated the pace of reductions of the reference interest rate, initiated in February 2009, accumulating a reduction of 350 basis points in this rate at June 2009.

These monetary policy actions have translated into lower interest rates in the financial system and in the capital market. Because communication on monetary policy decisions has emphasized that the Bank will continue to loosen its monetary policy position as long as inflation and its determinants continue converging to the target, interest rates with different terms have been declining in advance.

These actions have been complemented by measures aimed at loosening liquidity conditions, such as the reduction of reserve requirements and the introduction of new monetary injection instruments, since the deepening of the international financial crisis in September 2008.

vi. Until the end of February, the exchange rate increased significantly with portfolio movements in the forward market of dollars being led by expectations of depreciation. The reversal of this trend in the second week of March, explained initially by the higher supply of dollars in the exchange market as a result of the regularization of income tax, was reinforced thereafter by non-residents lower risk aversion regarding emerging markets. The Central Bank did not intervene in the exchange market during the months of March and April, and allowed Indexed Certificates of Deposit (CDRBCRP) to mature. This had a stabilizing effect that offset the impact of the reversal of the currency portfolio, which this time was oriented to the nuevo sol. However, due to the increased downward volatility recorded in the exchange rate in May, the BCRP bought US$ 77 million. Year-to-date, international reserves have remained stable: the balance of reserves has gone from US$ 31,196 million at end 2008 to US$ 31,189 million at the close of May.

vii. The projection on the 2009 current account deficit has been slightly adjusted from our previous estimate of 3.3 percent of GDP (Inflation Report of March) to 3.2 percent. This adjustment is explained by the better prices of exports and by the reduction of the growth of domestic demand, which is being reflected in a downward adjustment of imports. In 2010 the current account deficit should similar to the one recorded in 2009, considering stable international prices and a recovery of the external demand for our exports, as well as a higher economic growth and the drive this would have on the volume of imports. The current account would improve in 2011 and the deficit would decline to 2.6 percent of GDP due to the onset of operations of mining projects.

Long term private capital flows in the forecast horizon would exceed external requirements as they are expected to be over 5 percent of GDP, and would thus contribute to the sustainability of the current account.

viii. The projected fiscal deficit for 2009 and 2010 has been revised from 1.0 percent of GDP in both years to 1.8 and 1.7 percent of GDP in 2009 and 2010, respectively.

Even though this projection still considers the expansion of spending associated with the Economic Stimulus Plan announced by the government, the revised projection considers the lower revenue resulting from the drop of commodity prices and lower dynamism in economic activity. The current financial fiscal stance allows implementing a counter cyclical policy, the latter accounting importantly for the projected recovery of the economy in the second half of the year. A deficit equivalent to 1.5 percent of GDP is expected for 2011; in other words, the deficit would gradually decline to the 1.0 percent limit, as required by law.

ix. The main risks that could cause inflation to deviate from the central forecast scenario include the same risks considered in our previous Report and also include the risk of having higher food and fuel prices as an additional factor:

- **Increased deterioration of the global economy**. The baseline scenario considers a greater deterioration of the global economy than the one considered in our March Report, although offset by a lower decline of terms of trade. However, there is a probability of having a more prolonged global recession if credit conditions in developed countries do not normalize. This risk would imply lower economic growth and lower inflation rates than the one considered in the baseline scenario.

A more flexible monetary stance than the one considered in the baseline scenario would be adopted in this scenario.

- **Lower inflationary pressures due to lower domestic spending**. The central forecast on economic growth is subject to uncertainty factors, such as the level of deceleration of private investment, associated with the effect of the international crisis, the end of the process of inventory adjustments, and the implementation of the Economic Stimulus Plan. In this context, the growth of demand and economic growth could be lower than projected in the baseline scenario.

In this situation, the Central Bank would loosen its monetary policy without jeopardizing compliance with the inflation target.

- **Constraints in energy supply**. The supply of electricity continues to be close to the limit of its potential capacity, which increases the probabilities of failures in this service. Additionally, adverse climatic conditions could aggravate the balance between the supply and the demand of electric energy, which would generate increases in electricity rates or cause that more costly alternative energy sources be used.

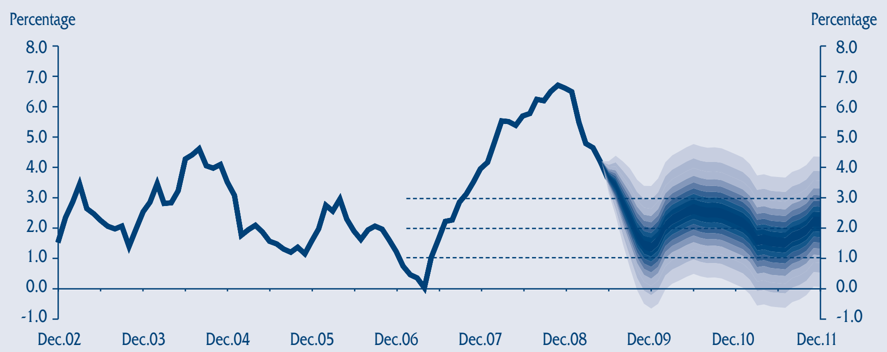
This factor would only imply changes in terms of monetary policy if it affected inflation expectations.

- **Higher prices of food and fuel commodities**. The baseline scenario considers a moderate increase in the prices of food and fuel simultaneously with the recovery of the world economy. However, a scenario of higher rises in these prices would lead the domestic prices of food and fuels above the levels considered in the central forecast.

  In this context, monetary policy would remain unchanged as long as inflation expectations are not affected and as long as the impact on inflation is transitory.

x. Weighing the above mentioned risks against the baseline scenario shows a neutral balance for the inflation forecast. In other words, there is the same probability that inflation will be above or below the level considered in the baseline scenario throughout the forecast horizon.

INFLATION FORECAST
(12-month % change)



Note:
The graph shows the inflation prediction bands along the forecast horizon. The darkest band around the central forecast represents a 10 percent probability of occurrence while all the other bands represent a 90 percent probability of occurrence.

I. International Environment

World growth

1. Since our last Inflation Report was published, the world economy has continued evolving in an unfavorable manner. Economic activity has dropped importantly in developed economies and slowed down significantly in emerging countries, with higher levels than expected in both cases. In line with this evolution, the forecasts on global growth for 2009 have been revised on the downside. However, given the recent evolution of some indicators, positive growth rates in the world economy may be foreseen as from the second half of this year. This trend would continue in 2010 and 2011.

TABLE 1
WORLD ECONOMIC GROWTH
(Annual % change)

			2009*		2010*		2011*
	2007	2008	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
Developed countries	**2.7**	**0.8**	**-2.4**	**-3.7**	**1.3**	**1.0**	**2.2**
1. USA	2.0	1.1	-2.6	-3.0	1.9	1.5	2.6
2. Eurozone	2.7	0.8	-2.0	-3.8	0.2	0.1	1.4
3. Japan	2.4	-0.7	-4.0	-6.3	1.0	0.8	1.6
4. United Kingdom	3.0	0.7	-2.5	-4.0	0.6	0.3	1.9
5. Canada	2.7	0.5	-1.0	-2.5	1.9	1.9	3.3
6. Other developed countries	4.7	1.4	-1.7	-3.3	2.2	1.9	3.1
Developing countries	**8.3**	**6.1**	**3.2**	**1.8**	**4.9**	**4.5**	**5.5**
1. Africa	6.2	5.2	3.4	2.0	4.9	3.9	5.2
2. Central and Eastern Europe	5.4	2.9	-0.4	-3.4	2.5	1.4	3.8
3. Community of Independent Countries	8.6	5.5	0.9	-4.6	3.8	2.7	3.8
Russia	8.1	5.6	1.1	-5.2	3.5	2.7	3.4
4. Developing Asia	10.6	7.7	5.5	5.3	6.7	6.7	7.3
China	13.0	9.0	7.3	7.3	8.3	8.4	9.0
5. Middle East	6.3	5.9	3.9	2.5	4.7	3.5	4.1
6. Latin America and the Caribbean	5.7	4.2	0.1	-1.6	2.5	2.2	3.5
World Economy	**5.2**	**3.1**	**0.2**	**-1.3**	**3.2**	**2.5**	**3.6**
Memo:							
BRICs	**10.5**	**7.6**	**4.8**	**3.8**	**6.2**	**6.2**	**6.7**
Peru's trading partners	**4.7**	**2.8**	**-0.4**	**-1.7**	**2.6**	**2.2**	**3.3**

IR: Inflation Report.
* Forecast.

2. Coupled by drastic declines in industrial production and exports, in Q1-09 the world economy would have contracted about 6 percent (annual change) compared

with the previous quarter, showing a similar growth rate than the one observed in Q4-08.

Despite improvements in money markets, the drop of GDP in all **developed countries** has been intensified by the persistence of unfavorable credit conditions. In the United States, investment recorded an important contraction in Q1, while the expansion of consumption was constrained by the deterioration of the labor market since January 2008. Europe was also affected by lower external demand, while Japan also experiences a deflationary process that continues affecting consumption and investment.

3. **Emerging economies** also showed an unfavorable evolution. As regards the trade channel, developed countries' actual imports have dropped. According to IMF estimates, the volume of global trade in 2009 would decline 11 percent, showing its first contraction since 1982. Although somewhat better, international financial conditions are still restrictive.

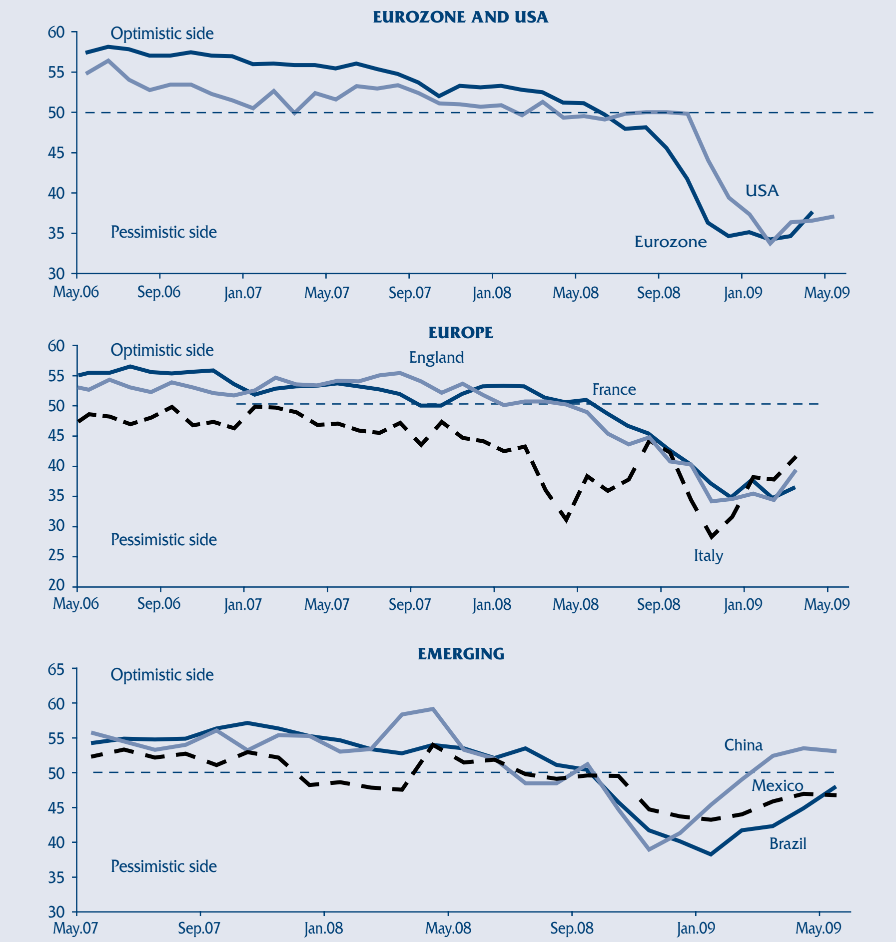
   China recorded its lowest growth rate in ten years, affected by the global decline of trade. The strong contraction of **European Emerging Economies** stands out in terms of the rest of emerging countries since the deterioration of international financial conditions aggravated macroeconomic imbalances in these countries (high current account deficits, accelerated expansion of credit, and currency mismatches). In **Asian Emerging countries**, the strong contraction of world trade has especially affected the economies that export manufactured goods, while in **Latin America** the drop of the demand for exports (particularly in the United States) and lower international prices have affected economic activity more than initially expected.

4. Some indicators on the world economy have been showing signs of some stabilization recently. First of all, retail sales, consumer confidence indices, and other sector indicators would be reflecting some stabilization in consumption or showing a modest recovery in some cases.

   In the second place, indicators of industrial production in developed countries are showing lower declines, and some emerging economies, like China and India, are showing an improvement in their indicators of industrial activity, as reflected in the Purchasing Managers' Index (PMI).

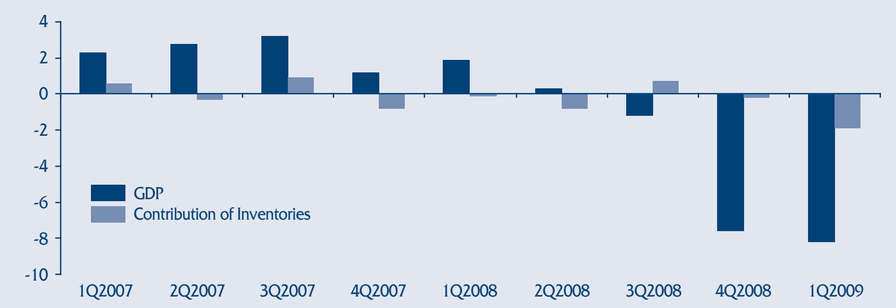
   Global recession in the last two quarters was intensified by the reduction of inventories. In a context of financial restrictions and declining demand, many firms have covered the demand for products through destocking, thus postponing production. In the United States, for instance, 40 percent of GDP's drop of 5.7 percent in Q1 is explained by the reduction of inventories, while in Canada this percentage climbs to 89 percent. In the United Kingdom, this by far accounted for the 6.1 percent drop of GDP in Q4-08.

Graph 1
MANUFACTURING ACTIVITY INDEX *



*Purchasing Managers'Index (PMI) or Institute for Supply Management (ISM). An index of below 50 indicates contraction, while an index of 50 or more indicates expansion.
Source: Bloomberg.

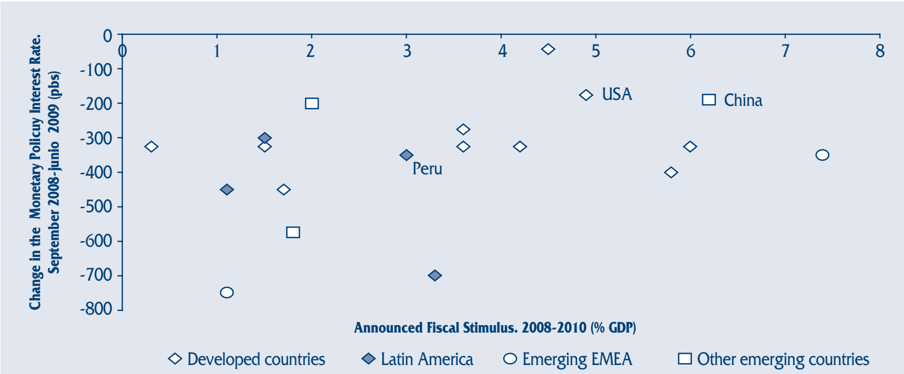
Graph 2
DEVELOPED COUNTRIES: CONTRIBUTION OF INVENTORY ADJUSTMENT TO GDP GROWTH
(%)



In the third place, China is expected to grow at higher rates than in the past two quarters. This projection is based on the growth of domestic credit, the high levels of domestic investment, and the fiscal and monetary stimulus plans adopted recently. The expansion of domestic demand has reflected in an increase of imports in the last months. Preliminary data for April show increases in imports of copper (62 percent), soy bean (55 percent), iron (33 percent), and crude (14 percent) compared to the same month in 2008.

Finally, in a context of lower inflationary pressures –associated with the contraction of domestic demand and the correction of commodity prices– most countries have adopted counter cyclical measures. Since the crisis deepened in August 2008, most central banks have reduced their interest rates, implementing simultaneously complementary measures to increase liquidity and prevent a further deterioration of credit conditions. On the fiscal side, expansionary policies estimated to be equivalent to 4 percent of global GDP have also been adopted for the 2008-2010 period. These counter cyclical policies would have a more significant impact on domestic demand, particularly as from the second half of 2009 and during 2010.

Graph 3
INTEREST RATE CHANGE AND FISCAL STIMULUS



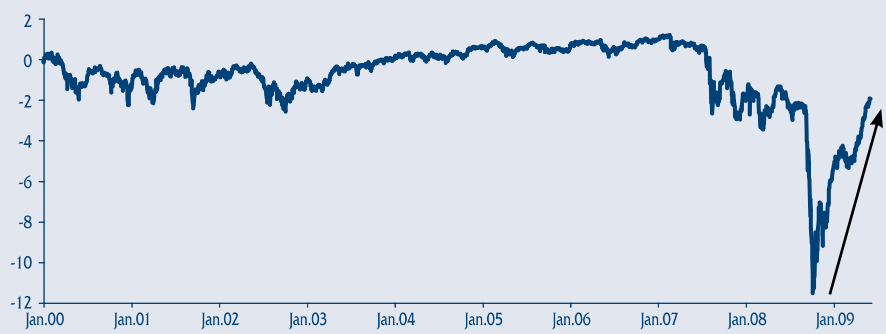
Source: IMF and Central Banks.

5. The recovery expected in growth rates since the second half of this year is based on the assumption that the monetary and fiscal stimulus plans mentioned above will be efficient in incentivizing domestic demand and will also dynamize consumption and private investment. This scenario also considers that international financial conditions –and especially in the United States– will tend to normalize, consolidating the improvements observed recently. In other words, that current credit conditions will revert, thus allowing that productive activities are adequately financed and banks' equity problems are solved.

Financial Markets

6. Capital markets have shown a favorable evolution so far in 2009. Liquidity conditions have improved substantially, but although credit conditions show improvements, they are still below the conditions observed before the deepening of the crisis (September 2008).

Graph 4
UNITED STATES: BLOOMBERG FINANCIAL CONDITION INDEX 1/



1/ Index of normalized financial conditions. This index combines money market spreads and indices of money, stock and bond markets. The value of the index represents the standard deviation from the average in the period 1992-June 2008.
Source: Bloomberg.

7. Despite this, however, uncertainty about the future of the financial sector and the success of the financial policies implemented by governments in the main developed countries remains. Success in normalizing credit conditions depends on the financial sector's health, and particularly on the health of the banking system in the main developed countries.

   Banks in the United States have recently shown signs of a better financial position (better operation results in Q1) and some banks (the most important ones) have even achieved a recent capitalization with private sector resources (given regulators' demands), generating optimism among investors.

8. Liquidity conditions have kept on improving as a result of the expansionary policies implemented by the FED and other central banks, as reflected by the reduction of short term rates in different currencies.

   In the particular case of the United States, since March the FED intensified its operations in order to restore the functioning of credit markets in general through direct bond purchases for the FED's portfolio. In this sense, two programs were announced: the purchase of mortgages from mortgage agencies (GSEs) and the acquisition of Treasury bonds.

In the case of the former, announced initially in November 2008, the amounts assigned for the purchases that would be carried during this year were increased from US$ 600 billion to US$ 1.45 trillion on March 18, 2009. On the same date, the FED also announced a program of purchases of 2 to 10-year Treasury bonds for a total of US$ 300 billion to be carried out in the next 6 months, resuming these open market operations which it had not carried out since the 1960s. Because of their impact on the FED's balance, these measures are being implemented in the frame of "quantitative easing (QE)".

Credit conditions in the United States have also shown an improvement. Thus, for example, spreads in the U.S. corporate sector have recorded a reduction.

Graph 5
CREDIT DEFAULT SWAP (5 YEARS)
US corporations with investment grade spread

9. These improvements in cash and credit conditions have been coupled by a reduction in risk aversion, as reflected in the higher yields on Treasury bonds and in the recovery of the main stock markets.

10. Lower risk aversion and the recovery of stock markets have also been coupled by a depreciation of the dollar and by investors' return to other higher risk assets.

    Increased liquidity (as a result of the FED's monetary policy) and the financial requirements of the public sector (larger issuance of Treasury bonds) for the financial rescue programs and the fiscal stimulus package have generated depreciatory expectations on this currency.

11. The improvement of international financial conditions has also favored emerging economies. In the region, lower risk aversion has reflected in better financing conditions, in the reduction of spreads, in the reversal of depreciatory pressures, and in the improvement of stock markets. However, these indicators are still below the levels observed in August 2008.

Graph 6
DOLLAR / EURO EXCHANGE RATE

12. As regards capital flows, since the first months of the year a series of indicators have been showing that, after a net outflow in Q4, financing for emerging countries, and particularly for Latin America, has stabilized and has even been positive. In the first months of the year, Brazil, Colombia and Peru issued global bonds with yields of between 6.1 and 7.5 percent. Moreover, information at Q1 shows an increase in the flow of syndicated loans to corporations in Latin America compared to the previous quarter.

TABLE 2
US TREASURY BOND YIELDS
AND EMERGING MARKET SPREADS

						Change in bps.		
	Dec. 07 (1)	Aug. 08 (2)	Dec. 08 (3)	Mar. 09 (4)	May. 09 (5)	Mar. 09 (5)-(4)	Dec. 08 (5)-(3)	Aug. 08 (5)-(2)
US Treasury yield								
3-month	3.242	1.715	0.081	0.206	0.135	-7.1	5.4	-158.0
2-year	3.051	2.371	0.776	0.800	0.919	11.9	14.3	-145.2
10-year	4.025	3.813	2.229	2.665	3.461	79.6	123.2	-35.2
		PBS.						
EMBIG	**255**	**323**	**724**	**657**	**464**	**-193**	**-260**	**141**
Brazil	220	240	429	424	291	-133	-138	51
Colombia	195	223	498	486	311	-175	-187	88
Chile	151	169	343	286	193	-93	-150	24
Mexico	172	207	434	441	270	-171	-164	63
Argentina	410	671	1,704	1,894	1,291	-603	-413	620
Peru	178	204	509	425	278	-147	-231	74
CDS (Credit Default Swap) 5 year								
Brazil	103	130	338	323	190	-133	-148	60
Colombia*	-.-	207	310	403	221	-182	-89	14
Chile	46	62	216	208	150	-58	-66	88
Mexico	69	118	285	383	223	-161	-63	104
Argentina	462	791	4,550	4,196	2,585	-1,611	-1,965	1,794
Peru	114	125	335	389	217	-173	-119	92

* The data that appears as Aug. 08 corresponds to Sep. 08.
Source: Bloomberg and Reuters.

Spreads, measured by the EMBIG indicators, intensified their downward trend in the last months, declining by 193 bps between March and May. Reductions of over 90 bps were observed in all the countries in this period.

Additionally, currencies strengthened against the dollar, following the global trend and also as the result of lower risk aversion, which also reflected in the improvement of emerging exchange markets. The Colombian peso and the Brazilian real appreciated the most. However, most currencies and bourses still register losses compared with their levels in August 2008.

TABLE 3
LATIN AMERICA: EXCHANGE RATE AND STOCK INDICES

		Exchange rate (monetary units per US$)					Accumulated % chg. relative to		
		Dec. 07 (1)	Aug. 08 (2)	Dec. 08 (3)	Mar. 09 (4)	May. 09 (5)	Mar. 09 (5)/(4)	Dec. 08 (5)/(3)	Aug. 08 (5)/(2)
BRAZIL	Real	1.779	1.629	2.313	2.317	1.971	-14.9	-14.8	21.0
ARGENTINA	Peso	3.170	3.063	3.530	3.788	3.808	0.5	7.9	24.3
MEXICO	Peso	10.89	10.28	13.81	14.18	13.13	-7.4	-4.9	27.7
CHILE	Peso	498	513	636	582	561	-3.6	-11.7	9.5
COLOMBIA	Peso	2,017	1,936	2,246	2,543	2,061	-19.0	-8.2	6.5
PERU	Nuevo Sol	2.999	2.952	3.136	3.158	2.963	-6.2	-5.5	0.4
PERU	N. Sol per basket	0.559	0.556	0.555	0.551	0.546	-0.9	-1.6	-1.9
		Stock Indices					Accumulated % chg. relative to		
BRAZIL	Bovespa	63,886	55,680	37,550	40,926	53,189	30.0	41.6	-4.5
ARGENTINA	Merval	2,152	1,777	1,080	1,126	1,587	40.9	47.0	-10.7
MEXICO	IPC	29,537	26,291	22,380	19,627	24,332	24.0	8.7	-7.5
CHILE	IGP	14,076	13,776	11,324	11,862	14,684	23.8	29.7	6.6
COLOMBIA	IGBC	10,694	9,375	7,561	8,023	9,263	15.5	22.5	-1.2
PERU	IGBVL	17,525	13,287	7,049	9,238	13,392	45.0	90.0	0.8

Source: Bloomberg and Reuters.

BOX 1
FED: MONETARY POLICY AND EFFECTS ON THE BALANCE SHEET

The monetary stimulus policy being implemented by the FED has so far achieved favorable results in restoring liquidity to financial institutions and re-establishing the functioning of some credit markets. However, these measures have had a strong impact on the FED's balance sheet. At the close of April 2009, the FED's balance-sheet had risen from US$ 902 billion on August 8, 2007 –its level prior to the crisis– to US$ 2,143 billion, that is, it had increased by over US$ 1 trillion.

FED: BALANCE OF ASSETS AND LIABILITIES
Billions of US$ (daily average)

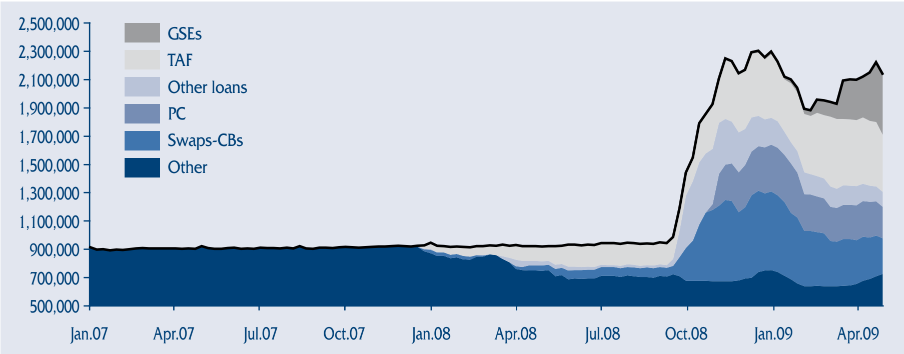
	8 Aug. 07	29 Apr. 09	Difference
Reserve Bank credit	**851**	**2,088**	**1,237**
US Treasuries	791	543	-248
GSE papers (Mortgage-backed securities)	0	434	434
Term auction facilities (TAF)	0	404	404
Other loans	19	105	86
Primary credit	19	50	31
Secondary credit	0	3	3
Term Asset-Backed Securities Loan Facilities (TALF)	0	6	6
AIG	0	44	44
Portfolio holdings of Commercial Paper	0	223	223
Portfolio holdings of Maiden Lane	0	72	72
Central bank liquidity swaps	0	250	250
Other credits	41	57	16
Gold	**11**	**11**	**0**
Other assets	**41**	**44**	**4**
Total assets	**902**	**2,143**	**1,241**
Currency in circulation	813	902	89
Reserve requirements	5	827	822
Deposits with foreign banks. other than reserve balances	12	291	279
Other	72	123	51
Total liabilities	**902**	**2,143**	**1,241**

Source: Bloomberg and FED.

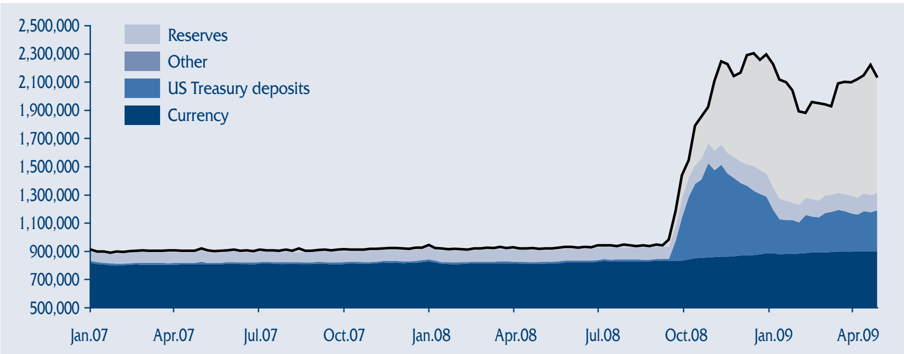
As may be seen from the table above, this increase in the balance of assets is basically explained by new short-term liquidity lines established with banks and foreign central banks (auctions of term loans and swaps with foreign central banks), credits granted to buy commercial papers (CP), and purchases of mortgage papers from agencies (mortgages and derivatives). Given the recent functioning of credit lines for asset backed securities (ABS), the magnitudes of these credit lines are still very small (similar levels to those of CP are expected). On the other hand, the Treasury Bonds item has declined significantly, basically due to the extension of the collaterals required by the FED for other assets besides the usual Treasuries. With the recent program of purchases of Treasury bonds, this account should show a recovery.

On the side of liabilities, the most important increase is explained by the balance of reserves, which has increased by over US$ 800 billion. In addition to this, the lower relative increase recorded in terms of Currency in Circulation also stands out.

FED: ASSET BALANCE
(Millions of US$)



FED: LIABILITIES BALANCE
(Millions of US$)

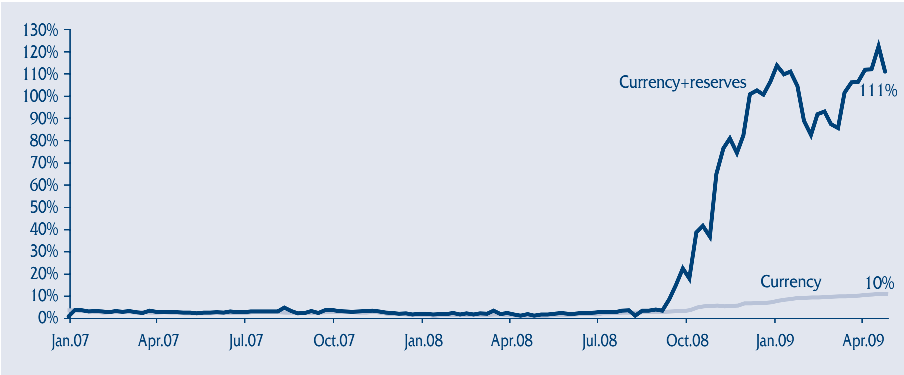


The strong increase observed in the FED's balance sheet has generated a great deal of uncertainty regarding both the possible inflationary effect of the measures implemented and the strategy that should be adopted to reverse these measures when this is required by market conditions.

First of all, there is no consensus among specialists on whether the measures may have inflationary effects or not in the current context of collapse of the main credit markets.

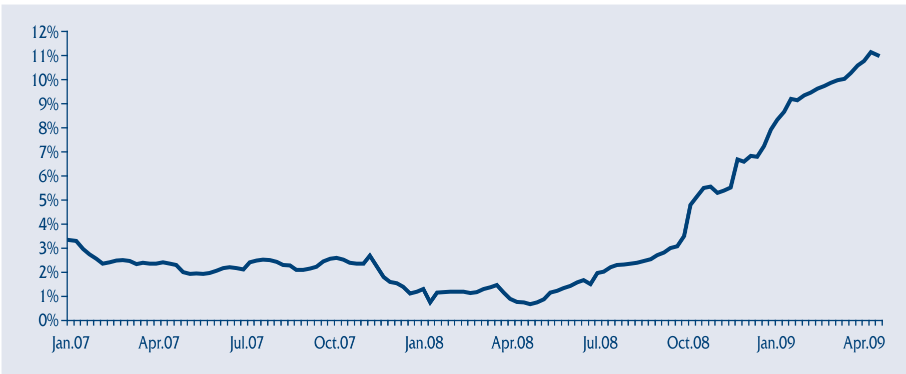
On the one hand, the strong increase in the FED's balance sheet would be compensating the deleveraging process in the main financial institutions and credit constraints in capital markets. Even more, some specialists say that the FED measures would not be inflationary since banks are not lending funds. This would be reflected in the strong increase observed in terms of the FED reserves – even though this could also be reflected in the decline of money velocity or in the GDP/M2 ratio. Banks' incapacity to provide loans is basically explained by the toxic assets they have in their balances. As long as these assets remain there, the bank multiplier would continue being inoperative.

FED: MONETARY BASE (CURRENCY + RESERVES)
(12-month % change)



However, uncertainty is also generated by the strong increase observed in terms of "currency", which has gone from growth rates of 2.5 percent to current levels of around 10 percent, according to the FED's latest balance report.

FED: CURRENCY
(12-month % change)



Although there is general consensus in that the FED's current measures imply a monetary policy of "quantitative easing", it is clear that there is no formal quantitative target. It is clear that the FED is aiming at a qualitative goal: to improve credit conditions in markets and to try to reduce the rates of consumer and business loans and, particularly, long-term rates. In this sense, it is worth pointing out that the FED itself has said that the expansion of its balance is a "credit easing" measure instead of the traditional "quantitative easing", and that its success would imply the reduction of credit spreads and the availability of credit.

Secondly, there is also consensus in that after market conditions are reestablished, a strategy will be required to reverse all the programs that have been implemented by the FED.

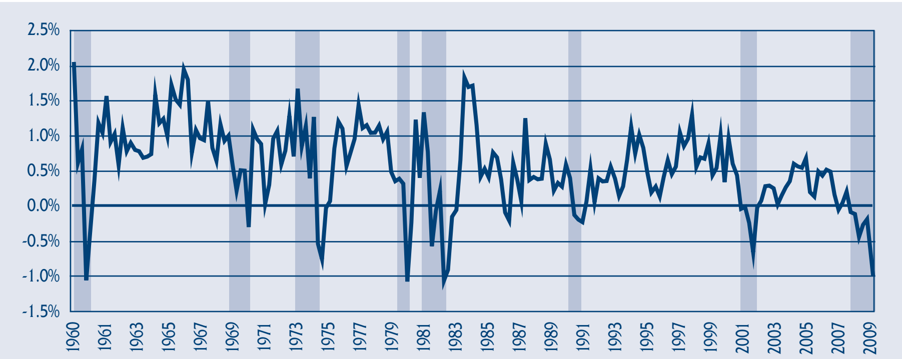
On the side of assets, short-term assets would generate no problem given their maturity. However, problems could arise in long-term, non-recourse loans (when the borrower's obligation of repaying a loan is only guaranteed by the collateral; basically TALF loans) and in the purchasing facilities of long-term Treasury bonds and mortgage assets. The FED would be limited to sell these securities (given the potential losses of the value of these assets) and would therefore need the government to issue bonds to carry out the necessary operations that will allow it to withdraw the excess of reserves when this is required.

BOX 2
THE STOCK CYCLE AND THE ECONOMIC CYCLE

The generalized stock adjustment observed in nearly all the areas of economic activity and in the different regions of the world has particularly attracted the attention of analysts due to the important role played by inventories in the current economic cycle. As a result of this, one of the most repeated variables in the market is destocking.

This phenomenon is not new. Evidence shows that in the recession stages of previous economic cycles the drop of inventories reflected in the reduction of GDP, although inventories generally represent a relatively low percentage of production. This is illustrated in the graph below in the case of the United States.

US RECESSION: CHANGE IN INVENTORIES / GDP
(Quarterly. 1960-2009)



Source: BEA, NBER.

In the last decades, technological advances –particularly those associated with information– have brought about significant improvements in terms of stock management, as a result of which firms have replaced the "just in case" criterion by the "just in time" one. In this sense, the stock cycle could have been expected to have a lower contribution or to have moderated the drop of the output, as illustrated in the case of the United States in the last two recession events.

INVENTORIES AND US RECCESIONS
(%)

Reccesion episodes	Real GDP change since the beginning to end of the episode	Change in GDP due to inventories	Change in GDP due to final sales
1952-53 to 1981-82	-2.0	-1.4	-0.6
1990-91	-1.3	-0.8	-0.5
2001	0.3	-0.7	1.1

Source: Is the Business Cycle Still an Inventory Cycle? J. Piger; Economic Synopses, 2005. N°2. St. Louis Fed.

However, in the case of today's recession, and particularly in Q1-09, the contribution of inventories to the drop of production has increased, bringing about an unprecedented destocking process and effect in many large global industries, including the automotive and the chemical industries, as well as retail sale businesses, among other industries.

The important impact that inventory adjustment has had on the drop of GDP in many countries in the last quarters – a generalized process worldwide– may be seen in the graph below.

CONTRIBUTION OF INVENTORY ADJUSTMENT TO THE GDP GROWTH
(%)

Source: JP Morgan.

Behind this is the severity of the current crisis which, as pointed out, is the greatest crisis experienced after the Great Depression of the 1930s. The credit channel has played a preponderant role in this crisis, particularly in developed countries, and the collapse of world trade, which for the first time since 1970 shows a decline of unprecedented levels (11 percent, according to the IMF) has also affected the stock cycle in emerging countries.

The financial position and the property of consumers, businesses, and the financial system are under great pressure all over the world. The private sector has been forced to reduce its debt and destocking –a part of this process– has deepened the economic cycle that had been experiencing a long period of boom, in which consumer spending had been particularly important. The economic cycle has now been drastically reduced due to the credit crunch.

It is expected that the global process of destocking will be lower in the next months and that this will now have a positive impact on the production of many industries. Together with fiscal stimulus packages (to compensate the adjustment of the private sector) and the renewal of the leveraging process in the financial system (and therefore, the reestablishment of the credit channel), this should contribute to stimulate global demand in the second half of this year.

II. Economic Activity

12. The forecast on GDP growth has been revised downwards from 5.0 percent (Inflation Report of March) to 3.3 percent considering the lower dynamism of economic activity observed in the first months of the year and the deterioration of the global economic growth outlook. Economic activity grew 1.8 percent in Q1-09 amid a strong deceleration of the global economy reflected in a lower demand for our export products. As a result of this, domestic demand contracted 0.8 percent in Q1, showing its first decline since Q2-01. As in the rest of the world, a strong downward inventory adjustment accounts for a great deal of this lower production.

    In fact, it is estimated that the contraction of inventories accounts for approximately four percentage points of the reduction of domestic demand. Production levels are expected to start recovering as inventory levels reach the new desired values. This process would be gradually reinforced by the impact of monetary and fiscal stimulus measures and by the gradual recovery of the world economy.

13. Domestic demand would grow 2.4 percent in 2009 –a growth rate of 5.0 percent was forecast in our March Report–, showing even lower growth levels than GDP due to the downward adjustment of inventories, which is also being reflected in lower imports. In terms of expenditure components, a lower increase is expected in private investment (2.5 percent) and private consumption (2.5 percent), although this would be partially offset by high dynamism in public investment (49.4 percent).

TABLE 4
DOMESTIC DEMAND AND GDP
(Real % change)

	2008		2009*			2010*		2011*
	1Q	Year	1Q.	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
1. Domestic demand	**11.9**	**12.3**	**-0.8**	**5.0**	**2.4**	**5.7**	**5.7**	**5.8**
a. Private consumption	8.4	8.7	3.7	5.5	2.5	5.2	3.6	4.2
b. Public consumption	3.0	1.8	8.2	2.6	6.8	4.5	3.4	3.6
c. Private investment	19.7	25.6	1.8	8.0	2.5	8.0	6.1	6.2
d. Public investment	68.8	42.8	22.2	51.1	49.4	13.2	14.7	11.4
2. Exports	14.1	8.2	-3.0	1.9	-1.3	6.6	5.5	9.6
3. Imports	21.4	19.9	-13.7	2.1	-4.7	5.1	6.2	9.2
4. GDP	**10.3**	**9.8**	**1.8**	**5.0**	**3.3**	**6.0**	**5.5**	**5.7**
Memo:								
Public expenditure	14.6	13.1	11.8	19.2	21.7	8.3	8.2	7.2
Public expenditure without inventories	10.8	12.5	3.2	6.2	2.5	5.9	4.2	4.7
Domestic demand without inventories	11.2	12.6	4.1	7.8	4.8	6.2	4.8	5.1

IR: Inflation Report.
* Forecast.

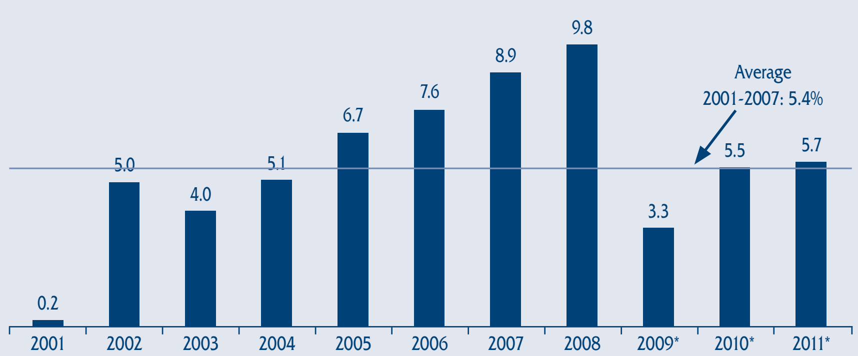
14. GDP is projected to grow 5.5 percent in 2010 and 5.7 percent in 2011 as part of the return path to the long term potential growth rate (estimated at between 5 and 6 percent for this period).

TABLE 5
GLOBAL DEMAND AND SUPPLY
(Contributions to real % change)

	2008			2009*		2010*	2011*
	3Q	4Q	Year	1Q	Year		
1. Domestic demand	13.9	9.2	12.5	-0.8	2.5	5.9	5.9
a. Private consumption	6.2	5.2	5.9	2.5	1.7	2.4	2.8
b. Public consumption	0.2	-0.1	0.2	0.6	0.6	0.3	0.3
c. Private investment	6.0	4.3	5.1	0.4	0.6	1.4	1.4
d. Public investment	1.8	1.3	1.4	0.6	2.1	0.9	0.8
e. Change in inventories	-0.3	-1.5	-0.1	-4.9	-2.5	0.9	0.7
2. Net exports (a+b)	-3.0	-2.7	-2.7	2.6	0.8	-0.3	-0.2
a. Exports (+)	1.4	0.4	1.6	-0.6	-0.3	1.0	1.8
b. Imports (-)	-4.4	-3.1	-4.3	3.2	1.1	-1.3	-2.0
3. GDP (1+2)	**10.9**	**6.5**	**9.8**	**1.8**	**3.3**	**5.5**	**5.7**
Memo:							
Public expenditure	2.0	1.2	1.6	1.2	2.7	1.2	1.1
Public expenditure without inventories	12.2	9.5	11.0	2.9	2.3	3.7	4.2
Domestic demand without inventories	14.2	10.7	12.6	4.1	5.0	4.9	5.2

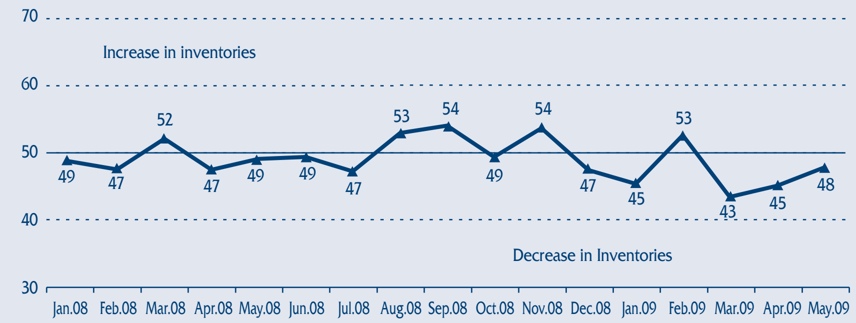
* Forecast.

Graph 7
GDP GROWTH RATE
(Real % change)



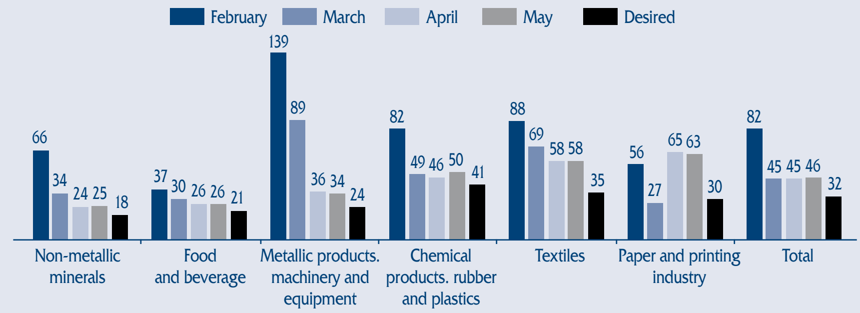
* Forecast.

Graph 8
LEVEL OF INVENTORIES OF FINAL GOODS RELATIVE TO THE PREVIOUS MONTH
Manufacturing Sector



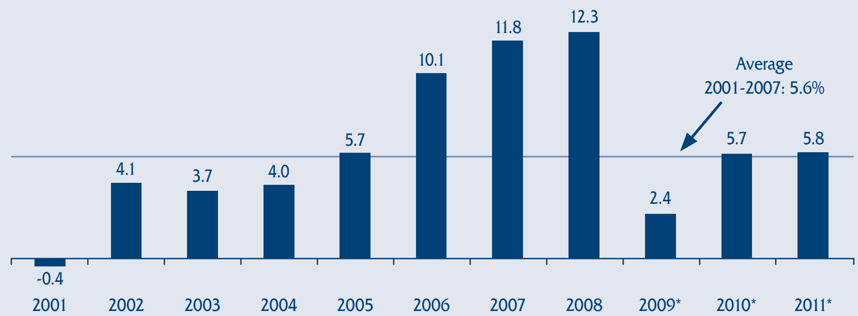
Source: BCRP Survey on Macroeconomic Expectations. May 2009.

Graph 9
LEVEL OF INVENTORIES OF FINAL GOODS BY DAYS OF PRODUCTION AND/OR SALES



Source: BCRP Survey on Macroeconomic Expectations.

Graph 10
DOMESTIC DEMAND GROWTH RATE
(Real % change)



* Forecast.

Deseasonalized GDP

15. Excluding the seasonality effect, economic activity showed its highest growth rate in this decade in Q1-09 and started moderating its growth thereafter. When the international financial crisis deepened in Q4-08, deseasonalized GDP recorded a growth rate of 0.5 percent, the lowest rate observed since 2004. The effects of the world recession were more severe in Q1-09, when deseasonalized GDP dropped 1.2 percent, the decline of inventories accounting importantly for this evolution.

Graph 11
SEASONALLY ADJUSTED GDP 1/
(% change compared with the same quarter of the previous year)

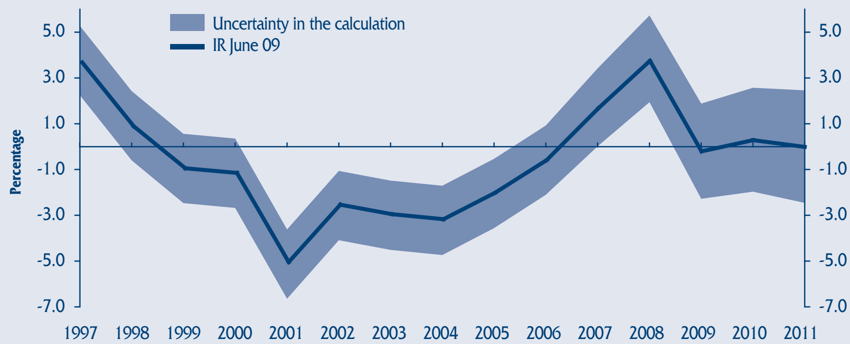
1/ Quarterly series elaborated based based on the aggregation of the monthly series of seasonally adjusted GDP, which is obtained through the program TRAMO-SEATS. This program considers the country´s holiday calendar.

Potential GDP

16. The forecast on GDP growth in the 2009-2011 period is consistent with a negative output gap this year; that is, with a lower GDP level than the potential GDP, particularly in the first half of the year. The economic recovery projected as from the second half of the year would reach a growth path consistent with the economy's potential GDP.

    Considering the lower investment projected and the lower growth of productivity associated with the international crisis, the estimated growth of potential GDP in the 2009-2011 forecast horizon would be between 5 and 6 percent,. Actions aimed at improving our productivity in different areas (infrastructure, commercial openness, development of the capital market, etc.) would allow maintaining or even increasing the high rates of growth of potential GDP projected herein.

Graph 12
OUTPUT GAP
(% of the potential GDP)



Note: Output gap estimated with information as of May 2009. The shadowed area represents existing uncertainty in the calculation and forecast of the output gap plus/minus one standard deviation.

Components of aggregate expenditure

17. Unlike the GDP concept, national disposable income considers the effect of international prices and remittances from Peruvians residing abroad. After growing 8.2 percent in 2008, the national disposable income would grow less this year (2.1 percent) due to lower terms of trade and due to the reduction of remittances from Peruvians living abroad. In this context, private consumption would grow 2.5 percent in 2009, which represents an important deceleration compared with the previous year (8.7 percent).

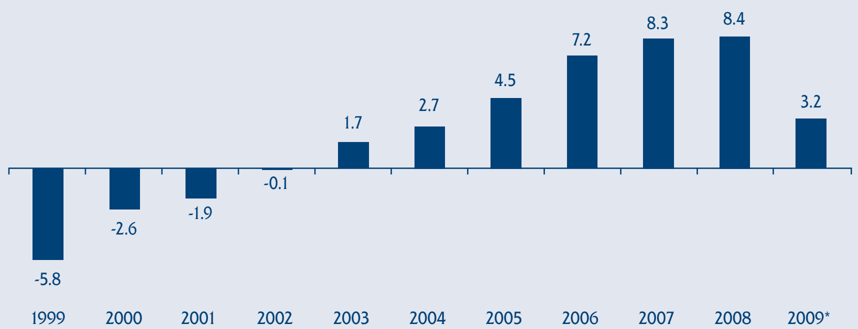
The national disposable income would grow 5.8 and 6.1 percent in 2010 and 2011, respectively, in line with the expected recovery in the economy. With this, private consumption would grow 3.6 percent in 2010 and 4.2 percent in 2011.

TABLE 6
NATIONAL DISPOSABLE INCOME
(Real % change)

	2008		2009*			2010*		2011*
	1Q.	Year	1Q.	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
1. GDP	**10.4**	**9.8**	**1.8**	**5.0**	**3.3**	**6.0**	**5.5**	**5.7**
2. Gross national product	8.7	12.2	4.5	9.1	5.2	5.3	5.9	6.1
3. Gross national income	8.4	8.5	-1.1	5.9	2.4	5.7	5.8	6.1
4. National disposable income 1/	**8.2**	**8.2**	**-1.2**	**5.8**	**2.1**	**5.6**	**5.8**	**6.1**

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

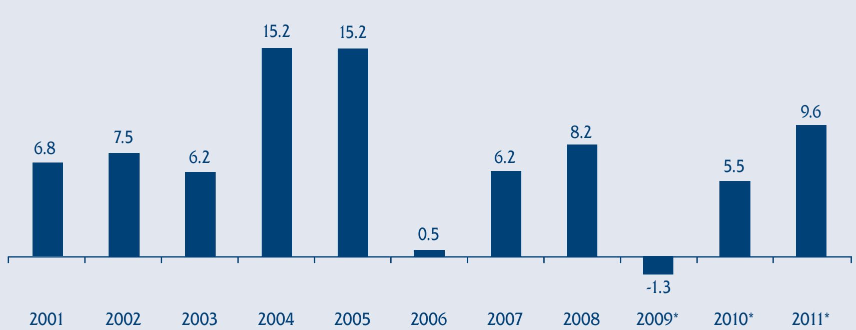
Graph 13
URBAN EMPLOYMENT IN COMPANIES WITH 10 OR MORE WORKERS
(Annual % change)



* Average January-April.

18. Actual exports of goods and services would decline 1.3 percent in 2009, mainly due to the lower dynamism of non traditional exports in a context of lower global demand. A recovery is expected in 2010 considering the prospects of better international prices and the recovery of external demand for our exports. Moreover, a high growth of exports is foreseen for 2011 due to higher volumes of mining and hydrocarbon products as a result of the onset of several mining projects. The forecast also considers a greater access to external markets due to trade agreements, which would favor exports of non traditional products.

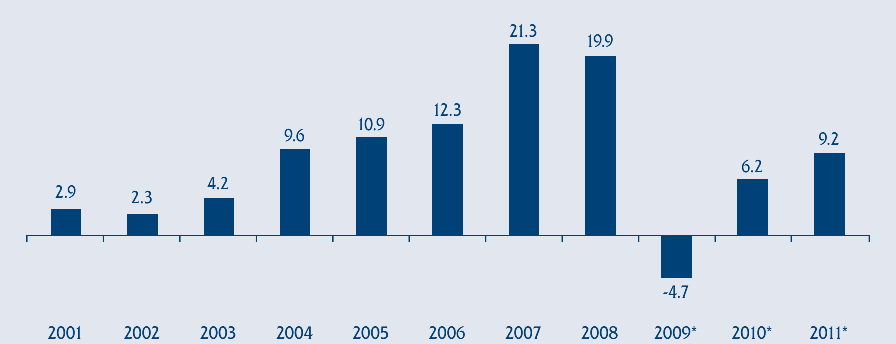
Graph 14
EXPORT GROWTH RATE OF GOODS AND SERVICES
(Real % change)



* Forecast.

19. Actual imports would show a deceleration in 2009 due to a lower pace of growth of imports of capital goods, associated with the inventory adjustment and with the lower growth of consumption and private investment. Actual imports of goods and services would record growth rates of 6.2 and 9.2 percent in 2010 and 2011, respectively, in line with the higher growth of the economy.

Graph 15
IMPORT GROWTH RATE OF GOODS AND SERVICES
(Real % change)



* Forecast.

20. Because of the important economic slowdown and uncertainty associated with the international economic crisis, private investment is projected to grow 2.5 percent this year. Once the domestic economy starts showing a recovery and uncertainty about the global economy subsides, private investment would is expected to grow at rates of 6 percent in 2010-2011. This pace of growth of investment increases capital equity and productivity in the economy, favoring the growth of potential output in the next years. Part of this growth would be driven by several projects, among which Peru LNG's Camisea II project (to export liquefied natural gas) and mining projects, such as Tía María (copper) and Antapaccay (copper) are worth highlighting.

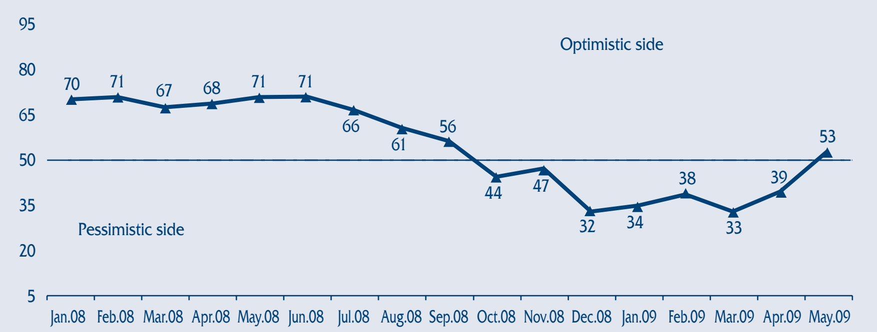
Graph 16
PRIVATE INVESTMENT GROWTH RATE
(Real % change)

* Forecast.

TABLE 7 MAIN INVESTMENT PROJECTS				
Sector	**2009**	**2010**	**2011**	**Total**
Mining and Hydrocarbons	3,039	5,243	7,574	15,856
Electricity	837	741	684	2,262
Transport and Telecommunications	596	446	189	1,231
Industry	817	1,361	999	3,177
Other Sectors	2,144	1,797	749	4,690
Total	**7,433**	**9,588**	**10,195**	**27,216**

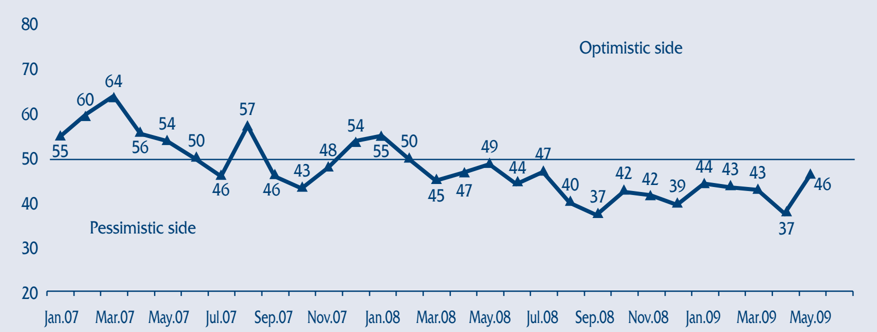
21. The business confidence index fell in the pessimistic area since October 2008 (below 50 points), recording its lowest level in December 2008 with 32 points. However, this negative trend has reverted in May, with the confidence index falling in the optimistic area, with 53 points.

Graph 17
BUSINESS CONFIDENCE INDEX
Economic situation



Source: BCRP Survey on Macroeconomic Expectations.

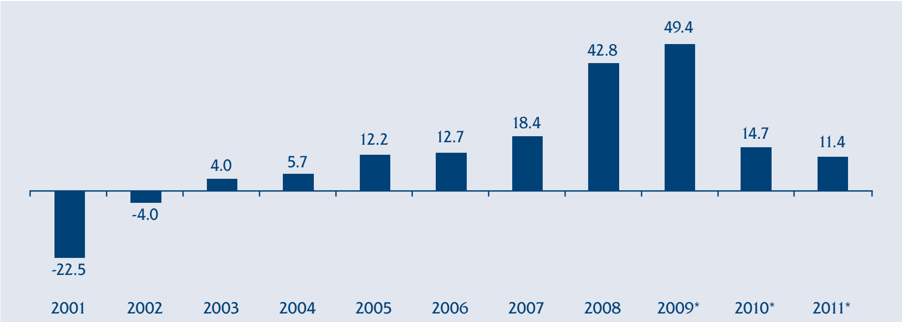
Graph 18
CONSUMER CONFIDENCE INDEX
Family's Economic Situation



Source: Ipsos APOYO.
Elaboration: BCRP.

22. Public investment would grow 49 percent in 2009, driven mainly by the central government spending. In 2010 and 2011, private investment would grow 15 percent and 11 percent, respectively.

Graph 19
PUBLIC INVESTMENT GROWTH RATE
(Real % change)



* Forecast.

23. The macroeconomic forecasts of the private sector project a GDP growth rate of between 3.0 and 4.0 percent for 2009, while this rate would range between 4.5 and 5.0 percent in 2010 and between 5.4 and 6.0 percent in 2011.

TABLE 8
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH
(%)

	September 2008	February 2009	May 2009
FINANCIAL ENTITIES			
2009	7.0	5.0	3.0
2010	6.5	5.5	4.5
2011		6.4	5.4
ECONOMIC ANALYSTS			
2009	7.0	5.0	3.2
2010	7.0	5.5	4.5
2011		6.0	5.5
NON-FINANCIAL FIRMS			
2009	7.2	5.0	4.0
2010	7.0	6.0	5.0
2011		6.0	6.0

Sector production

24. Growth in all the economic sectors declined in Q1-09 compared with the growth rates recorded in 2008. The global economic recession translated into a lower demand for non traditional exports, especially for those produced in the manufacturing sector, as well as in lower activity in medium mining, in a context of lower prices than the ones observed in Q1-08.

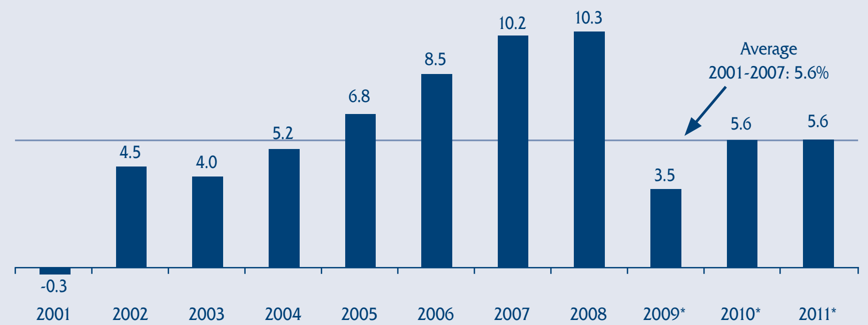
TABLE 9
GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS
(Real % change)

	2008		2009*			2010*		2011*
	1Q	Year	1Q	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
Agriculture and livestock	**3.9**	**7.2**	**3.9**	**2.7**	**2.9**	**5.2**	**5.2**	**5.2**
Agriculture	4.6	7.4	2.1	1.0	1.3	5.0	5.0	5.0
Livestock	2.9	7.0	6.1	4.6	5.5	5.5	5.6	5.5
Fishing	**6.6**	**6.2**	**-19.8**	**-4.1**	**-3.7**	**3.1**	**4.5**	**4.9**
Mining and hydrocarbons	**6.2**	**7.6**	**3.7**	**3.7**	**1.7**	**5.2**	**4.6**	**8.0**
Metallic mining	6.7	7.3	0.9	1.6	0.0	3.7	3.7	7.9
Hydrocarbons	2.0	10.3	30.4	22.7	13.7	16.0	11.8	9.0
Manufacture	**10.6**	**8.7**	**-5.1**	**4.6**	**-1.6**	**5.7**	**5.3**	**5.9**
Raw materials	12.5	7.6	1.6	4.3	4.1	6.3	6.3	5.6
Non-primary industries	10.2	8.9	-6.4	4.6	-2.9	5.5	5.0	6.0
Electricity and water	**9.3**	**7.7**	**1.2**	**4.6**	**2.5**	**5.6**	**6.0**	**6.0**
Construction	**19.2**	**16.5**	**5.1**	**9.8**	**7.4**	**10.2**	**8.9**	**7.5**
Commerce	**12.0**	**13.0**	**0.4**	**4.5**	**3.2**	**6.3**	**4.4**	**5.0**
Other services	**10.4**	**9.3**	**3.9**	**5.3**	**4.9**	**5.9**	**5.7**	**5.5**
GDP	**10.3**	**9.8**	**1.8**	**5.0**	**3.3**	**6.0**	**5.5**	**5.7**
Primary	**6.3**	**7.4**	**2.6**	**3.2**	**2.5**	**5.3**	**5.2**	**6.2**
Non-Primary	**11.2**	**10.3**	**1.6**	**5.4**	**3.5**	**6.2**	**5.6**	**5.6**

IR: Inflation Report.
* Forecast.

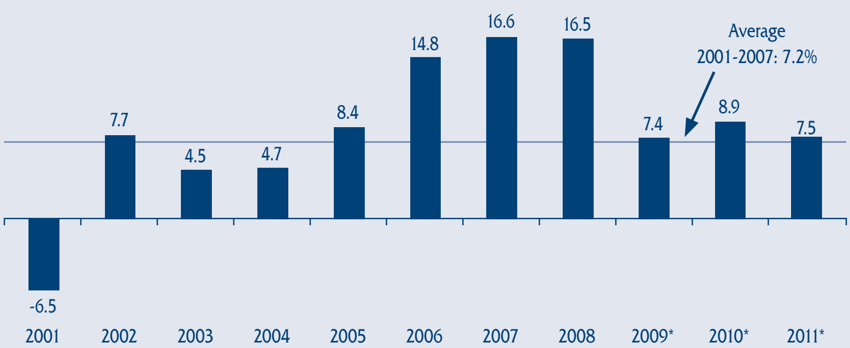
Non primary sectors recorded a slowdown in comparison with the pace of growth they showed last year. Production in non primary manufacturing declined 6 percent, with destocking and lower external demand accounting for this decline, which was offset by increased activity in construction, although showing lower rates than in previous quarters.

Graph 20
NON-PRIMARY SECTORS GROWTH RATE
(Real % change)



* Forecast.

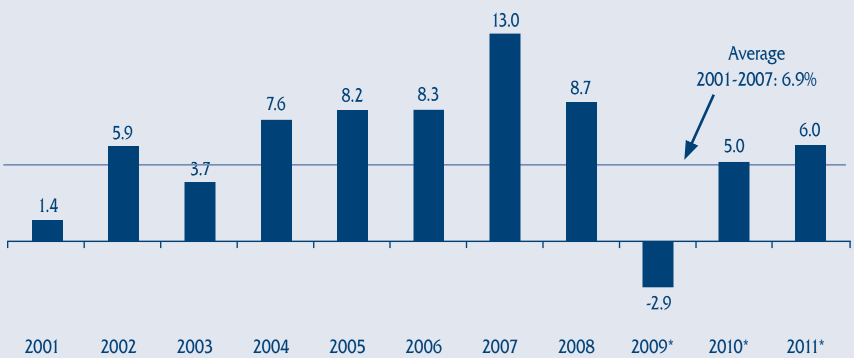
Graph 21
GROWTH RATE OF THE CONSTRUCTION SECTOR
(Real % change)



* Forecast.

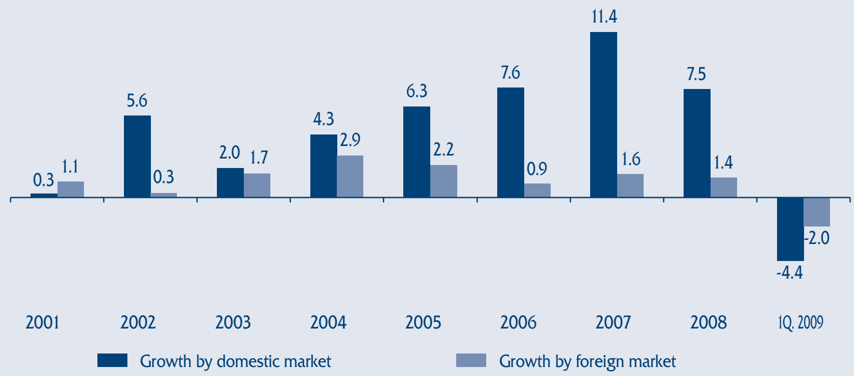
25. In 2009, growth in non primary sectors would decline to 3.5 percent (10.3 percent in 2008). This projection is based mainly on the drop of external demand for manufactured goods; on the still ongoing process of inventory adjustment, especially in the first semester, and on the effect of the lower growth of disposable income on families' demand for consumer goods. Construction would be the sector that would grow the most, especially in the second half of the year, considering the expected recovery of the economy and its effect on investment, as well as the effect of public spending (road construction, improvement and rehabilitation projects executed by the State in Q1 grew 51 percent).

Graph 22
GROWTH RATE OF THE NON-PRIMARY MANUFACTURING
(Real % change)



* Forecast.

Graph 23
NON PRIMARY MANUFACTURING: PERCENTAGE CONTRIBUTION TO GROWTH BY MARKET OF DESTINATION1/



1/ Non-including indirect effects.

The baseline scenario considers normal climatic conditions, without the occurrence of El Niño o La Niña events, for the following years. These conditions would allow the agricultural and fishing sectors to grow between 4 and 5 percent, given the investments made in these sectors and the development of export markets. In this sense, it is worth highlighting the onset of operations at Tía María (copper) in 2011 in the mining sector and Camisea II exports of liquefied natural gas since mid-2010 in the hydrocarbon sector.

III. Balance of Payments

26. The initial factors causing a general deterioration in the current account results included a lower global demand, the deterioration of terms of trade, and, to a lesser extent, the low growth of remittances from abroad. The prices of imports have also showed a downward correction during this period, which, together with the effect of the lower domestic demand on imports, has contributed to offset the impact of the crisis on the current account. Moreover, because of the recovery observed in the prices of exports so far this year, the trade balance has recorded a surplus of US$ 576 million in the January-April period.

27. Considering these factors, the projection on the current account deficit for 2009 has been revised from 3.3 percent of GDP in our March Inflation Report to 3.2 percent.

TABLE 10
BALANCE OF PAYMENTS
(Millions of US$)

	2007	2008		2009*			2010*		2011*
		1Q	Year	1Q	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
I. CURRENT ACCOUNT BALANCE	**1,220**	**-848**	**-4,180**	**-478**	**-4,061**	**-4,012**	**-4,332**	**-4,247**	**-3,951**
As percentage of GDP	*1.1*	*-2.8*	*-3.3*	*-1.7*	*-3.3*	*-3.2*	*-3.3*	*-3.1*	*-2.6*
1. Trade balance	8,287	1,505	3,090	446	-1,368	1,145	-397	1,013	1,406
a. Exports	27,882	7,771	31,529	5,313	23,576	24,596	26,696	27,097	30,568
b. Imports	-19,595	-6,265	-28,439	-4,867	-24,945	-23,451	-27,094	-26,084	-29,162
2. Services	-1,187	-412	-1,929	-278	-1,722	-1,587	-1,857	-1,741	-2,053
3. Investment income	-8,374	-2,598	-8,144	-1,266	-3,656	-6,103	-4,873	-6,272	-6,302
4. Current transfers	2,494	657	2,803	621	2,686	2,532	2,795	2,753	2,998
Remittances	2,131	572	2,437	536	2,334	2,183	2,430	2,395	2,611
II. FINANCIAL ACCOUNT	**9,195**	**6,735**	**7,686**	**211**	**1,061**	**4,113**	**3,832**	**4,847**	**4,551**
Of which:									
1. Private sector	9,148	4,392	7,657	1,208	4,536	4,452	4,405	4,728	4,129
2. Public sector	-2,473	-1,461	-1,404	923	257	1,204	-254	522	344
3. Short-term capital	2,630	2,724	1,118	-1,437	-2,827	-1,607	-448	-148	0
III. BALANCE OF PAYMENTS (=I+II)	**10,414**	**5,888**	**3,507**	**-266**	**-3,000**	**100**	**-500**	**600**	**600**
Memo:									
Gross long-term external private financing									
Millions of US$	9,779	3,264	7,130	2,112	5,852	6,871	6,079	7,555	7,888
Percentage of GDP	9.1%	10.8%	5.6%	7.6%	4.8%	5.4%	4.6%	5.5%	5.3%

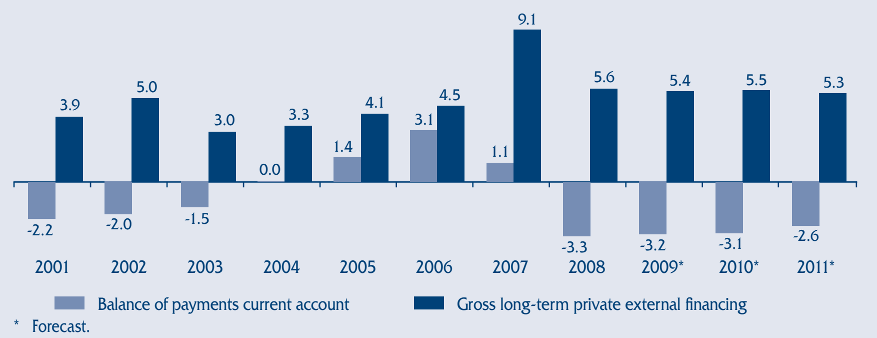
IR: Inflation Report.
* Forecast.

In Q1 the current account showed a deficit of 1.7 percent of GDP, lower than the 2.8 percent deficit observed in the same period last year. Lower income for exports and remittances was compensated by a strong reduction of imports and by the lower profits of companies with foreign shareholding.

A slight reduction in the current account deficit is foreseen for **2010** and **2011** considering stable international prices and a recovery of the external demand for our exports, as well as a higher growth in the domestic economy that would favor an increase in the volume of imports.

Long term flows of private capitals in the forecast horizon, which are expected to be over 5 percent of GDP, would exceed external requirements and would therefore contribute to the sustainability of the current account.

Graph 24
CURRENT ACCOUNT
(Percentage of GDP)



28. Private spending in the forecast horizon would maintain an upward trend, which, together with long term capital flows will contribute to finance domestic investment. Domestic saving would be over 26 percent of GDP in 2011, three percentage points higher than the rate recorded at end 2008.

TABLE 11
SAVING - INVESTMENT GAP
(Percentage of GDP)

	2007	2008		2009*			2010*		2011*
		1Q	Year	1Q	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
Gross domestic investment 1/ = total savings	**22.9**	**25.9**	**26.9**	**23.0**	**27.4**	**26.5**	**27.7**	**28.0**	**29.1**
1. Domestic saving	**24.0**	**23.1**	**23.6**	**21.3**	**24.0**	**23.4**	**24.4**	**25.0**	**26.4**
a. Private sector	17.8	16.3	17.2	15.8	18.8	18.9	18.8	19.8	20.6
b. Public sector	6.2	6.8	6.4	5.5	5.2	4.5	5.6	5.2	5.8
2. External saving	**-1.1**	**2.8**	**3.3**	**1.7**	**3.3**	**3.2**	**3.3**	**3.1**	**2.6**

1/ Includes inventory flows.
IR: Inflation Report.
* Forecast.

Trade balance

29. The slowdown observed in global economic activity in Q1-09 has translated into a drop in the volumes of exports. This has also reflected in lower economic growth and in inventory adjustment, as well as in lower rates of growth of private consumption and private investment. As result of this, the demand for imports of both intermediate goods and consumer and capital goods has declined, contributing to a surplus in the trade balance. The forecast on the trade balance has been revised to a surplus of around US$ 1.1 billion, considering better prices for our exports and the decline being observed in both the volume and prices of imports. These factors would offset the impact of the lower world demand for non traditional export products.

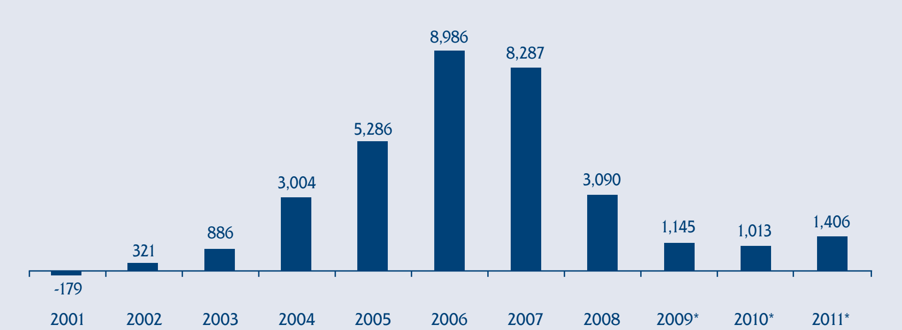
30. In 2010 and 2011 the trade balance would still show surpluses. This result would be influenced by the recovery of the global economy, which has a positive impact on the volume of non traditional exports, and as from 2011, by the onset of operations at mining and hydrocarbon projects –Tía María (copper) and Camisea II (liquefied natural gas)–, which are oriented to export activities.

TABLE 12
TRADE BALANCE
(Millions of US$)

	2007	2008		2009*			2010*		2011*
		1Q	Year	1Q	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
EXPORTS	**27,882**	**7,771**	**31,529**	**5,313**	**23,576**	**24,596**	**26,696**	**27,097**	**30,568**
Of which:									
Traditional products	21,464	5,951	23,796	3,870	16,742	18,069	19,451	20,069	22,834
Non-traditional products	6,303	1,792	7,543	1,415	6,663	6,334	7,065	6,812	7,488
IMPORTS	**19,595**	**6,265**	**28,439**	**4,867**	**24,945**	**23,451**	**27,094**	**26,084**	**29,162**
Of which:									
Consumer goods	3,192	976	4,527	934	4,499	4,420	4,984	4,762	5,755
Raw materials	10,435	3,438	14,553	2,043	10,915	10,569	11,879	12,284	13,461
Capital goods	5,861	1,821	9,239	1,850	9,423	8,323	10,114	8,932	9,817
TRADE BALANCE	**8,287**	**1,505**	**3,090**	**446**	**-1,368**	**1,145**	**-397**	**1,013**	**1,406**
Note: % Change									
Export volumes	2.5	13.2	8.1	-5.1	1.9	-2.1	6.8	5.5	10.3
Import volumes	19.3	21.3	19.6	-16.3	2.5	-5.5	5.2	6.2	9.1

IR: Inflation Report.
* Forecast.

Graph 25
TRADE BALANCE
(Millions of US$)



* Forecast.

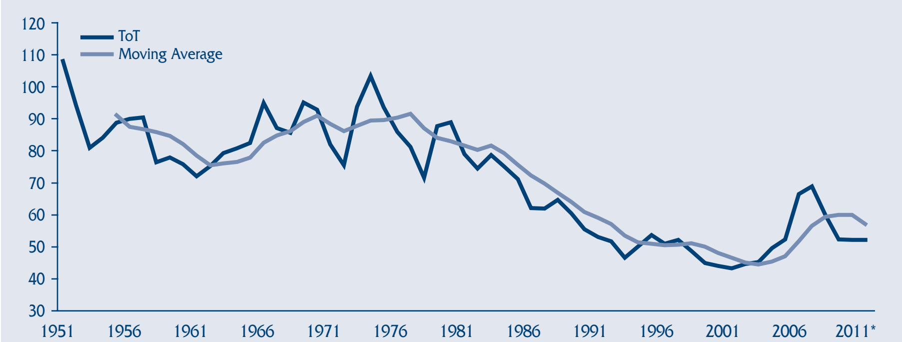
Terms of trade

31. On average, terms of trade would show a decline of 13 percent in 2009, even though recording an increase of 10 percent at end of period prices (December 2008-December 2009). The projections of export and import prices have been revised upwards, in line with the developments observed in terms of commodity prices in the first months of the year.

In general terms, commodity prices have been exposed to slight upward pressures due to the demand of some countries (particularly China) and to some supply specific conditions (particularly in the case of food commodities). In line with growth projections, commodities are expected to maintain their prices or show moderate rises as from the second half of the year.

Terms of trade should remain stable in 2010 - 2011.

Graph 26
TERMS OF TRADE
(Base 1950 = 100)



* Forecast.

Graph 27
TERMS OF TRADE, EXPORT AND IMPORT PRICE INDICES
(1994 = 100)

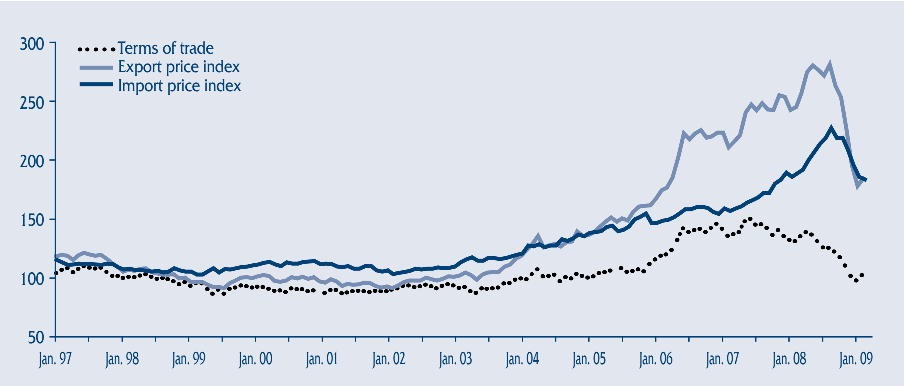


TABLE 13
TERMS OF TRADE
(Annual average data)

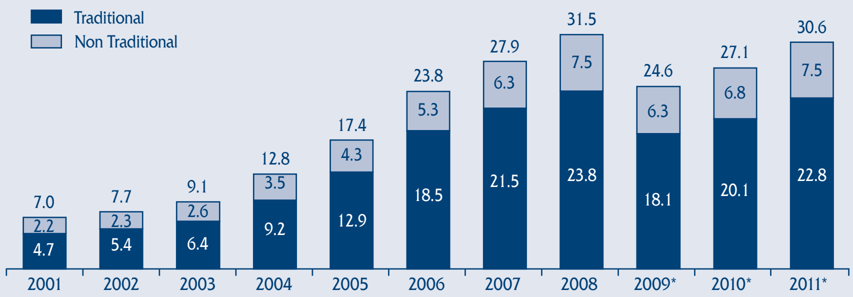
	2007	2008	2009*		2010*		2011*
			IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
Terms of trade (annual % change)	**3.6**	**-13.3**	**-14.6**	**-12.8**	**2.4**	**-0.2**	**-0.2**
Export prices (annual % change)	**14.0**	**5.1**	**-26.6**	**-20.3**	**6.1**	**4.4**	**2.3**
Of which:							
Copper (US$ per pound)	3.23	3.15	1.52	1.89	1.60	2.00	2.00
Gold (US$ per troy ounce)	697	872	881	920	890	935	948
Import prices (annual % change)	**10.0**	**21.2**	**-14.1**	**-8.7**	**3.6**	**4.7**	**2.5**
Of which:							
Petroleum (US$ per barrel)	72	100	49	54	59	65	69
Wheat (US$ per MT)	231	293	225	227	245	256	264
Maize (US$ per MT)	138	192	154	159	172	175	178
Soybean oil (US$ per MT)	768	1 092	731	782	777	868	869

IR: Inflation Report.
* Forecast.
Source: Bloomberg.

Exports

In 2009 exports would decline by US$ 7 billion relative to 2008 since traditional exports are expected to drop by US$ 6 billion and non traditional exports are expected to drop by US$ 1 billion. This would be associated with the lower average prices of metals in the case of the former and with the decline of external demand in the case of the latter. Traditional exports –mainly textiles, agricultural and iron and steel products, and jewelry– would decline due to lower economic activity in the United States, the European Union, and Japan, as has been observed since the end of 2008.

Graph 28
EXPORTS OF GOODS
(Billions of US$)



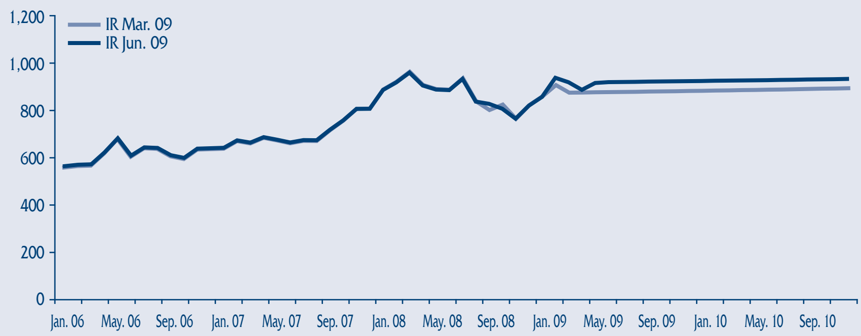
Note: Total exports include other exports.
* Forecast.

In 2010 exports would recover due to the onset of operations of Camisea II (exports of liquefied natural gas) as from the second half of the year. On the other hand, non traditional exports would increase due to the recovery foreseen in the main economies of the world and due to the trade agreements established with other countries. In 2011 Camisea II should be operating at full capacity and Southern's Tía María copper project should start operations.

Gold

32. The market balance shows downward pressures associated with the recovery of the world economy and, therefore, with the recovery of stock markets, as well as with a higher supply following three years of drops. However, it is estimated that upward pressures would prevail given that a global weakening of the dollar, fears of inflation, and a possible higher demand from China (as this country is seeking to restructure its reserve portfolio) and a higher demand for jewelry from Turkey and India are foreseen.

Graph 29
EVOLUTION AND FORECAST OF THE PRICE OF GOLD
(US$ per troy ounce)



Source: Bloomberg.

Copper

33. The international price of copper rose 48 percent in the first five months of the year to US$ 2.17 the pound on May 29, 2009, a level 57 percent higher than the minimum low recorded in the year (US$ 1.38 the pound on January 23).

    This recovery would be supported by China's increased demand. Because the market would be indicating a recomposition of inventories and strategic reserves, there is uncertainty about a price correction in the short term in a still tight market despite the drop observed in terms of consumption. The demand of developed countries, such as the European Union and the United States, would only start recovering at year end, but at a lower pace than China's imports of this metal.

Graph 30
EVOLUTION AND FORECAST OF THE PRICE OF COPPER
(US$ cents per pound)

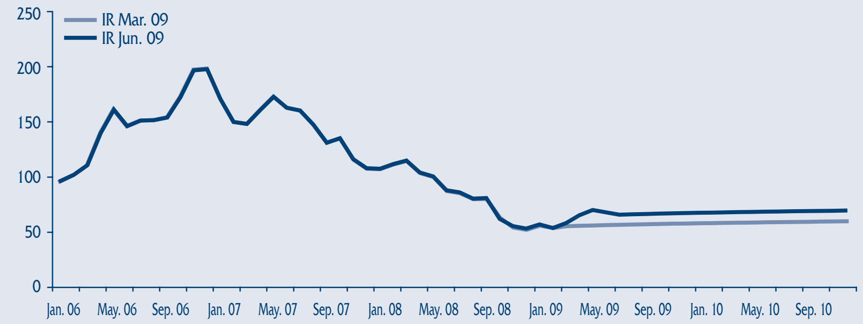
Source: Bloomberg.

Zinc

34. The average price of zinc has recovered 36 percent in the first five months of the year, the pound of zinc reaching US$ 0.68 on May 29, a price level 40 percent higher than the minimum observed in the year (US$ 0.48 the pound on February 20).

    The supply of zinc in the market has been contracting at a high pace due to the close of operations, production cuts and reprogramming of operations. Supply is estimated to drop 6 percent in 2009 given that production adjustments associated with this metal started long before the crisis began. On the other hand, the demand for zinc increased due to higher imports from China, which reached an historical record in March and its highest quarterly level since 1997. Because of this, the surplus generated in this market due to lower global consumption is low in comparison with previous cycles.

Graph 31
EVOLUTION AND FORECAST OF THE PRICE OF ZINC
(US$ cents per pound)

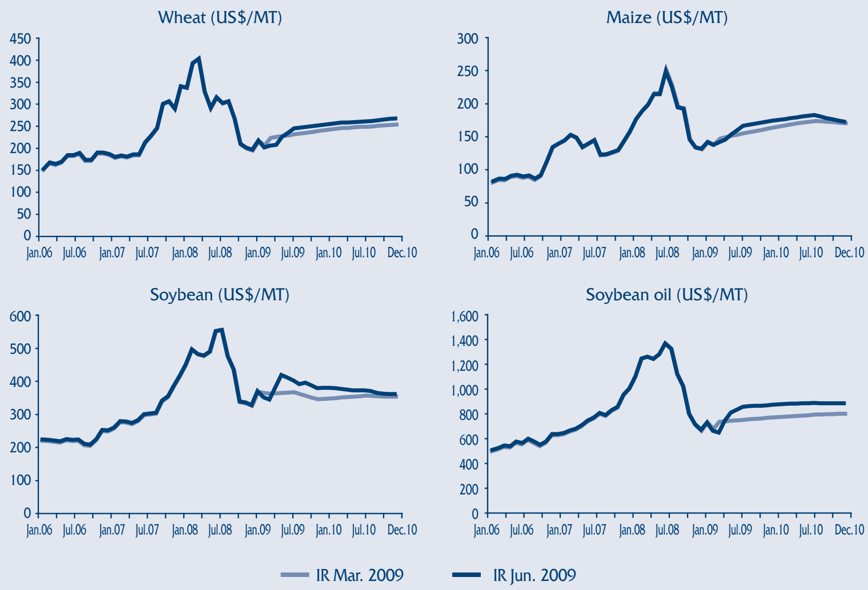


Source: Bloomberg.

Imports

35. Firms' adjustment of inventories during Q1-09 was reflected in the slowing of economic activity on the one hand, and in the lower demand for imports of both consumer and end goods, on the other hand. As a result, the volume of imports fell 16 percent in Q1. Together with lower prices (7 percent, mainly in consumer goods, food and fuels), this translated into a 23 percent drop in the value of imports (US$ 1.4 billion compared with the same period in 2008).

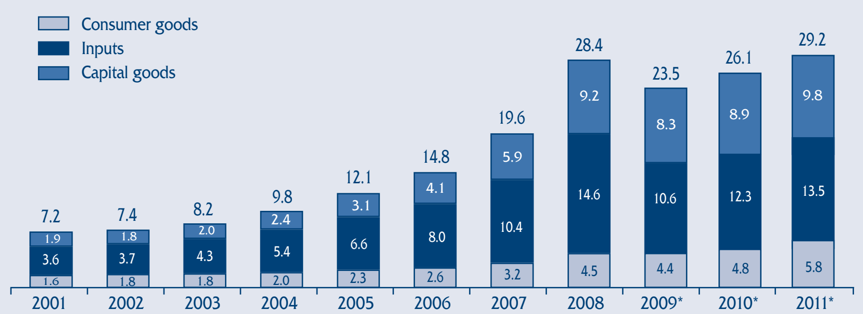
Graph 32
EVOLUTION OF THE PRICE OF FOOD



Source: Bloomberg.

Imports are expected to drop in terms of value in 2009 due to the adjustment of inventories and to the lower growth of private spending in terms of both consumption and investment. In line with the higher growth of the economy, imports should grow in 2010 y 2011, especially in the case of imports of inputs and capital goods.

Graph 33
IMPORTS OF GOODS
(Billions of US$)



Note: Total imports includes other imports.
* Forecast.

Financial account

36. In Q1-09, the financial account of the balance of payments amounted to US$ 1,208 million, a result almost entirely explained by the net inflow of external resources as Direct Foreign Investment (DFI), which amounted to US$ 1,386 million, as well as by the flow of long term disbursements net of amortization (US$ 509 million). On the other hand, outflows of national investors' capitals (especially of Private Administrators of Pension Funds (AFPs) which increased their preference for financial assets abroad) and lower holdings of Public Treasury bonds by non resident investors should be pointed out.

    Conversely, the flow of short term capitals was negative (US$ 1,437 million), this result being mainly explained by the lower holdings of BCRP certificates of deposit by non residents and by the reduction of short term liabilities held by non financial agents.

37. In 2009 the financial account of the private sector would record a net income of US$ 4,452 million, explained by a flow of DFI of US$ 3,887 million. This amount considers an increase in the investment portfolio compared to the one recorded in the previous Inflation Report (US$ 2,824 million), in line with some signs of economic recovery (higher prices for our exports as of March and better prospects for growth) as well as the current lower prices of inputs and materials.

TABLE 14
PRIVATE SECTOR FINANCIAL ACCOUNT
(Millions of US$)

	2007	2008	2009*			2010*		2011*
			1Q 09	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
I. DIRECT INVESTMENT AND LONG-TERM LOANS	**8,749**	**6,480**	**1,895**	**5,136**	**5,517**	**5,280**	**6,121**	**6,019**
1. Direct investment	5,425	4,079	1,386	2,824	3,887	4,005	3,689	4,473
2. Long-term loans	3,324	2,401	509	2,312	1,629	1,275	2,432	1,546
a. Dibursments	4,354	3,051	726	3,028	2,983	2,074	3,866	3,415
b. Amortization (-)	-1,030	-650	-217	-716	-1,354	-799	-1,435	-1,869
II. PORTFOLIO INVESTMENT	**398**	**1,177**	**-687**	**-600**	**-1,065**	**-875**	**-1,393**	**-1,890**
1. Bonds and capital participation	205	85	-84	0	-84	0	0	0
a. Bonds	135	0	0	0	0	0	0	0
b. Capital participation	70	85	-84	0	-84	0	0	0
2. Other external assets and liabilities	194	1,092	-603	-600	-981	-875	-1,393	-1,890
a. Assets (Residents investments abroad)	-485	1,102	-369	-600	-1,181	-930	-1,393	-1,890
b. Pasivos (Non-residents investments)	679	-10	-234	0	200	56	0	0
PRIVATE SECTOR FINANCIAL ACCOUNT (I+II)	**9,148**	**7,657**	**1,208**	**4,536**	**4,452**	**4,405**	**4,728**	**4,129**

* Forecast.

Moreover, among capital inflows it is worth highlighting the net flow of disbursements, which would be around US$ 1,629 million, the return of external capitals oriented to purchasing Public Treasury bonds. This would be partially compensated by the AFPs' increased acquisition of external assets.

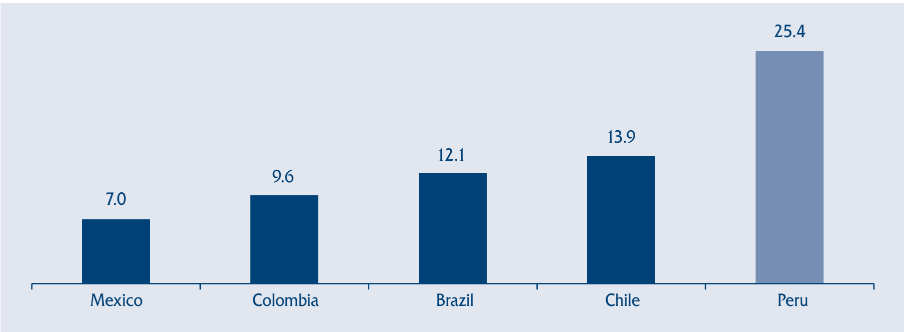
38. The flow of the financial account would be positive and amount to US$ 4,728 million and US$ 4,129 million in 2010 and 2011, respectively. This considers investments for a total of US$ 3,689 million and US$ 4,473 million, which include reinvestments and the contributions of parent companies (both of which are considered as DFI), in addition to long term external disbursements. Important investment flows are foreseen in the sectors of mining, hydrocarbons, telecommunications, electricity, road infrastructure, agro industry, among other sectors.

    Likewise, the long term disbursements of the private sector would be higher than the ones observed in 2009, in line with the greater dynamism of economic activity anticipated for these years. The process of net purchases of financial assets abroad by local institutional investors is also expected to continue.

39. At the close of May, net international reserves (NIRs) amounted to US$ 31 billion, which represents 25 percent in GDP terms and reflects the important level of coverage of our economy in terms of probable external capital constraints.

Another frequently used indicator of external vulnerability is the one measuring the level of capital outflows in the case of a massive run. This includes the short term debt, the long term debt maturing in a year or less, as well as non residents' deposits with less than 1 year-terms. In Peru, this represents 22 percent of NIRs, which indicates a very low dependence of short term capitals and, therefore, the effects of an eventual capital flight would be limited.

Graph 34
NET INTERNATIONAL RESERVES
(% of GDP)



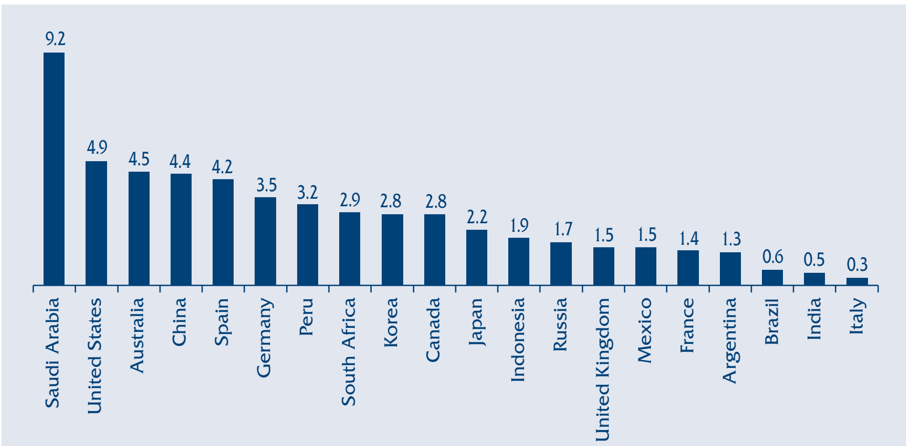
IV. Public Finance

Economic result

43. In the context of the rapid slowdown of economic activity generated by the international crisis, the coordinated response of governments and domestic macroeconomic policies is playing a key role to face this crisis. Fiscal policy actions have been oriented at offsetting the impact of the crisis on domestic demand. The possibility of implementing a counter cyclical fiscal policy has depended in many cases on the prudence with which fiscal policy has been executed in the previous years of global economic expansion.

44. The programs announced by governments in terms of fiscal stimulus involve the allocation of substantial resources aimed at financing spending.

Graph 35
ESTIMATED COST OF THE FISCAL STIMULUS PLAN: 2008-2010
(% of GDP)



45. Together with the lower tax revenue foreseen in a crisis scenario, announcements of higher spending would be increasing our projections regarding the fiscal deficit in the forecast horizon considered herein to higher levels than the ones established in the Fiscal Responsibility and Transparency Law. It should be pointed out that Law N° 29368 (enacted on May 29, 2009) has established the suspension of the applicability of macro fiscal regulations regarding the deficit and increase of public spending during 2009 and 2010.

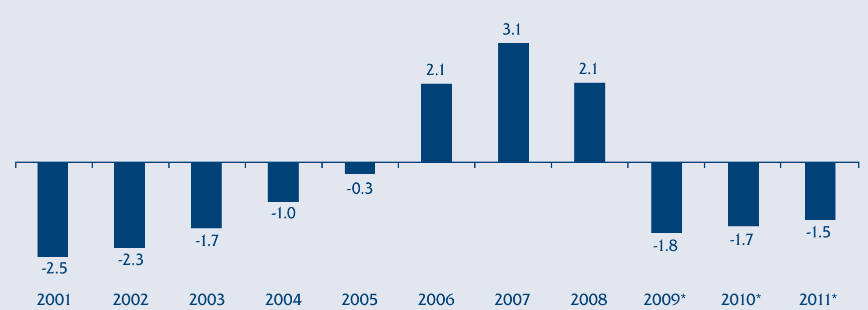
TABLE 15
NON-FINANCIAL PUBLIC SECTOR
(% of GDP)

	2008		2009*			2010*		2011*
	1Q	Year	1Q	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
1. General government current revenue	**20.9**	**20.8**	**19.3**	**19.4**	**18.5**	**19.1**	**18.7**	**19.0**
Real percentage change	*12.6*	*5.8*	*-10.6*	*-5.6*	*-10.0*	*5.2*	*6.1*	*7.6*
2. General government non-financial expenditure	**14.3**	**17.3**	**16.6**	**19.1**	**19.3**	**18.9**	**19.2**	**19.4**
Real percentage change	*16.3*	*13.5*	*12.0*	*12.5*	*13.2*	*5.2*	*5.0*	*6.5*
Of which:								
a. Current	12.1	13.2	13.5	13.1	13.3	12.6	12.8	12.6
Real % change	*9.9*	*6.9*	*7.9*	*1.1*	*1.9*	*2.5*	*1.9*	*3.5*
b. Gross capital formation	2.1	3.9	2.8	5.8	5.9	6.1	6.2	6.5
Real % change	*70.6*	*45.8*	*28.4*	*51.7*	*51.7*	*11.8*	*12.2*	*11.1*
3. Others	**-0.2**	**0.1**	**1.2**	**0.1**	**0.3**	**0.0**	**0.3**	**0.2**
4. Primary balance (1-2+3)	**6.4**	**3.7**	**3.9**	**0.4**	**-0.4**	**0.3**	**-0.3**	**-0.2**
5. Interests	**2.1**	**1.6**	**1.8**	**1.4**	**1.4**	**1.3**	**1.4**	**1.3**
6. Overall Balance	**4.3**	**2.1**	**2.2**	**-1.0**	**-1.8**	**-1.0**	**-1.7**	**-1.5**
Central government current revenues	18.0	18.2	16.4	16.7	15.9	16.4	16.0	16.3
Central government non-financial expenditure	11.4	14.7	13.8	16.0	16.2	15.9	16.1	16.3

IR: Inflation Report.
* Forecast.

46. In 2009 the deficit of the non financial public sector (NFPS) would be equivalent to 1.8 percent of GDP, higher than forecast in our Inflation Report of March (1.0 percent). This deterioration is basically explained by the decline of tax revenue associated with lower economic growth and, to a lesser extent, by the increase of current expenditure, specifically in public consumption given that the Economic Stimulus Plan includes spending in infrastructure maintenance in this line of expenditure.

Graph 36
OVERALL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)



* Forecast.

In Q1-09 the NFPS recorded a surplus of 2.2 percent of GDP, a result 2.1 percent lower than the one recorded in Q1-08, due to the decline of the current revenue of the central government as a result of lower economic activity and higher public spending to counter the effects of the international crisis.

47. A downward trend in the fiscal deficit is expected for 2010 and 2011 (1.7 and 1.5 percent of GDP, respectively). This improvement would be explained by a moderate growth of the revenue of the general government associated with the recovery of economic growth in terms of its long term trend and with the increase of the international prices of metals and hydrocarbons.

Structural economic result

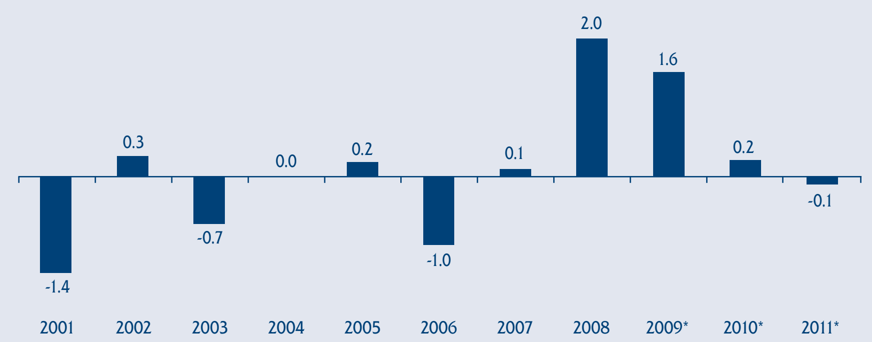
48. The structural economic result –measurement isolating the effect of the economy's position in the economic cycle and the impact of the higher prices of exports of minerals and the price of crude on fiscal revenue– would be negative in the next two years.

Graph 37
PRIMARY STRUCTURAL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)

* Forecast.

The fiscal impulse, indicator that shows the impact of fiscal policy decisions on aggregate demand, suggests that the fiscal policy would be expansionary in 2009 and 2010, when the stimulus plan is implemented. In contrast, the fiscal impulse in 2011 would be negative due to the lower growth of public spending, which would be more in line with the potential growth of the economy.

Graph 38
FISCAL IMPULSE
(% of GDP)



* Forecast.

49. It should be pointed out that, in contrast with the public spending executed in the last years, the projections on fiscal accounts exceed the caps established by the Fiscal Responsibility and Transparency Law. The regulation suspending the application of macro fiscal regulations establishes that the annual fiscal deficit of the NFPS cannot be higher than 2 percent of GDP (previously 1 percent) and that the annual increase of the central government expenditure cannot be higher than 10 and 8 percent of GDP in 2009 and 2010, respectively (previously 4 percent). This suspension has been established in a context of global recession, which requires a timely counter cyclical fiscal policy response, which implies that several projects will have to be implemented before originally scheduled and that several programs will have to be carried out in order to contribute to sustain domestic demand.

50. This higher fiscal spending oriented to mitigating the effects of the global crisis on the real sector of the economy is centralized in the Economic Stimulus Plan, whose purpose is to propitiate the convergence of the growth rate to its long term trend and to generate employment through higher public spending in these years of crisis.

    Thus, the government has announced several measures with a total spending of S/. 12,561 million –equivalent to 3.2 percent of GDP–, of which S/. 7,821 million will be for infrastructure works; S/. 3, 459 million for programs directly supporting economic activity; S/. 1,242 million for social programs supporting the economic sectors most severely affected by the crisis, and S/. 40 million for other programs. At end May, 21 percent of this total has been executed, with emphasis in impulse of economic activity (37 percent), followed by social protection (32 percent). It is worth pointing out that this higher spending does not compromise the sustainability of fiscal accounts given the temporary and extraordinary nature of most of these measures.

TABLE 16
MAIN MEASURES OF THE ECONOMIC STIMULUS PLAN
(Millions of nuevos soles)

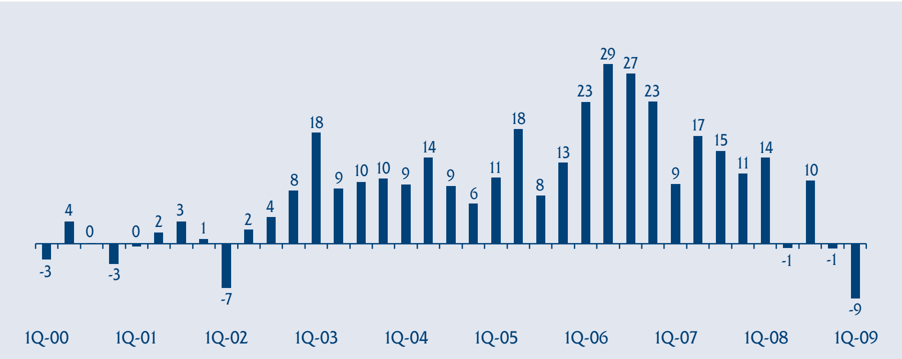
Concept	Law	Mill. Nuevos Soles	
1. Impulse to Economic Activity		**3,459**	
- Oil Price Stabilization Fund	UD 06 and 09-2009	1,000	
- Purchases of uniforms and school furniture from SMES	UD 015-2009	150	
- Workforce Retraining Program	UD 021-2009	100	
- Business Guarantee Fund (FOGEM)	UD 024-2009	300	
- Construyendo Peru - Projoven programs	SD 016-2009-EF	76	
- Temporary increase of Drawback	SD 018-2009-EF	360	
- Credit and guarantes of Agroperu Fund	UD 027-2009	210	
- Strengthening of SMES	UD 019-2009	5	
- Foncomun Drawdowns	Law 29332	450	
- Accelerated depreciation in construction	Law 29342	808	
2. Infrastructure Works		**7,821**	
- Investment projects	UD 010-2009	1,967	1/
- Infrastructure investment Fund - COFIDE	UD 018-2009	320	
- IIRSA Sur	UD 025-2009	773	
- Regional trusts	UD 028-2009	2,600	
- Costa Verde Project	SD 019-2009-EF	16	
- Investment continuity	SD 013 and 017-2009-EF	1,765	2/
- Investment continuity - Tarma	UD 039-2009	60	
- Road maintenance	SD 034-2009-EF	300	
- Santiago de Chuco-Shorey highway	Law 29321	20	
3. Social Protection Programs		**1,242**	
- Maintenance of educational institutions	UD 003 and 011-2009	290	3/
- FORSUR	UD 005-2009	146	
- Maintenance and equipment of health facilities	UD 016 and 022-2009	165	4/
- Maintenance of irrigation infrastructure	UD 016 and 054-2009	153	
- Basic infrastructure for local governments	UD 016 and 050-2009	318	
- Social investment - Equality Fund	Law 29322	105	
- Supplementary Food Program	SD 022-2009-EF	64	
4. Other		**40**	
Total Stimulus Plan		**12,561**	

1/ Net of projects considered under investment continuity (S/. 108 million).
2/ Includes priority projects (S/. 108 million).
3/ Priority projects of UD 010-2009 includes S/. 270 million considered in UD 011-2009.
4/ Equipment S/. 51 million and maintenance S/. 114 million.

Evolution of fiscal revenue

51. In Q1-09, the current revenue of the general government amounted to 19.3 percent of GDP, which represented a reduction of 10.6 percent in real terms compared to the same period in 2008. The tax revenue of the central government declined 9 percent in this quarter, showing the strongest drop since Q3-1999. This contraction is due to the lower dynamism of economic activity which had already had a negative impact on tax revenue since Q4-08. The most strongly affected revenue were those associated with profits, imports, and the prices of minerals and hydrocarbons.

Graph 39
CENTRAL GOVERNMENT TAX REVENUES
(Real % change)



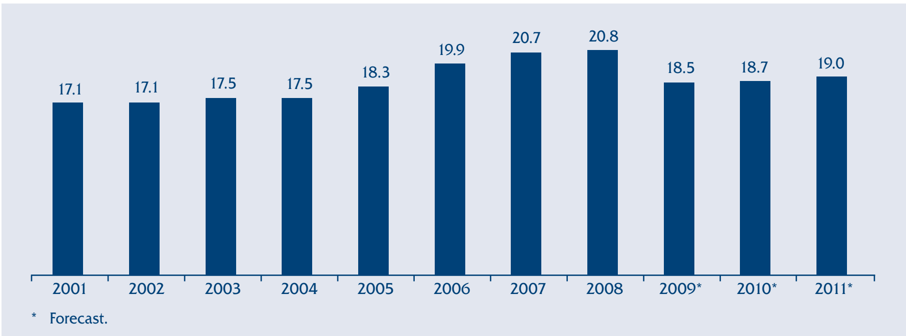
52. Revenue from income tax showed a total contraction of 13 percent, despite the higher regularization of this tax observed in March (21 percent). The sectors whose tax payments declined most heavily in Q1 were the sectors of mining and hydrocarbons (revenue from these sectors fell 73 and 33 percent in real terms, respectively), reflecting the strong drop in the prices of our mining and crude exports. Even though total revenue from value added tax (VAT) fell only 1 percent in real terms, the VAT on imports showed a contraction of 12 percent due to our lower purchases of goods and services abroad. Likewise, revenue from mining royalties (canon) and royalties fell 38 and 50 percent in real terms due to the lower international prices of minerals and hydrocarbons.

TABLE 17
THIRD CATEGORY INCOME TAX
(Millions of nuevos soles)

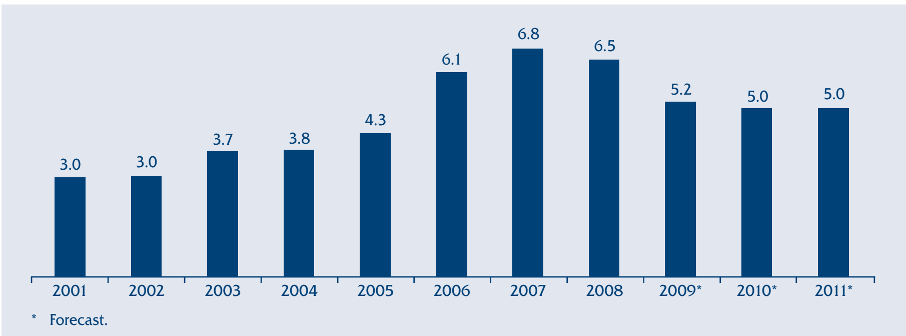
	2007	1Q. 08	2Q. 08	3Q. 08	4Q. 08	2008	1Q. 09	Real. % chg 1Q. 09/08
Advanced payments	**13,258**	**3,769**	**3,872**	**4,093**	**3,187**	**14,921**	**2,896**	**-27.2**
Mining	6,439	1,425	2,021	1,787	822	6,056	407	-72.9
Commerce	1,364	458	422	491	527	1,898	538	11.2
Manufacturing	1,450	464	436	490	466	1,856	486	-0.9
Financial Intermediation	646	365	183	222	241	1,011	407	5.6
Hydrocarbons	792	202	213	305	201	921	144	-32.5
Other services	2,208	742	520	713	833	2,808	794	1.3
Others	360	111	77	85	97	371	119	1.4
Regularization	**3,829**	**472**	**1,536**	**89**	**151**	**2,248**	**595**	**19.3**
Total	**17,087**	**4,241**	**5,408**	**4,182**	**3,338**	**17,169**	**3,490**	**-22.1**

Source: Sunat.

Graph 40
GENERAL GOVERNMENT CURRENT REVENUE
(% of GDP)



Graph 41
INCOME TAX
(% of GDP)



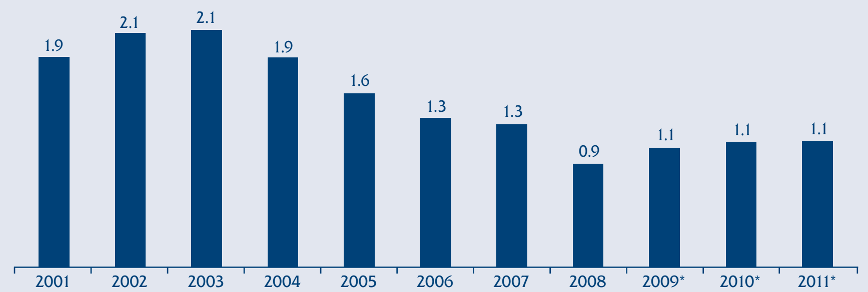
53. In 2009, the revenues of the general government are projected to be equivalent to 18.5 percent of GDP, which represents a real reduction of 10.0 percent relative to the previous year. This drop would reflect the lower dynamism of economic

Graph 42
VALUE ADDED TAX
(% of GDP)

activity and the lower prices of our products in international markets as a result of the global crisis, as well as the lower rates of the Tax on Financial Transactions -ITF- (reduced from 0.07 to 0.06 percent) and the Temporary Tax on Net Assets -ITAN- (reduced from 0.5 to 0.4 percent) in force since January of this year.

54. Revenue from income tax would decline from 6.5 percent of GDP in 2008 to 5.2 percent in 2009. Among other aspects, this ratio would reflect the lower payments that firms would make on account of this tax during the year due to the lower ratios resulting from fiscal year 2008 and the application, as from the month of April, of available balances in their favor. The VAT, which is currently our main tax revenue, would fall from 8.5 percent of GDP in 2008 to 8.0 percent this year, mainly due to its imported component which would decline from 4.2 to 3.5 percent of GDP due to the strong drop of our imports. The only tax that would record an increase in GDP terms is the excise tax (ISC), which would go from 0.9 to 1.1 percent of GDP, basically as a result of the impact of the higher rates of the excise tax on fuels approved in October and November of 2008.

Graph 43
EXCISE TAX
(% of GDP)



* Forecast.

Graph 44
REVENUE FROM IMPORT DUTIES
(% of GDP)

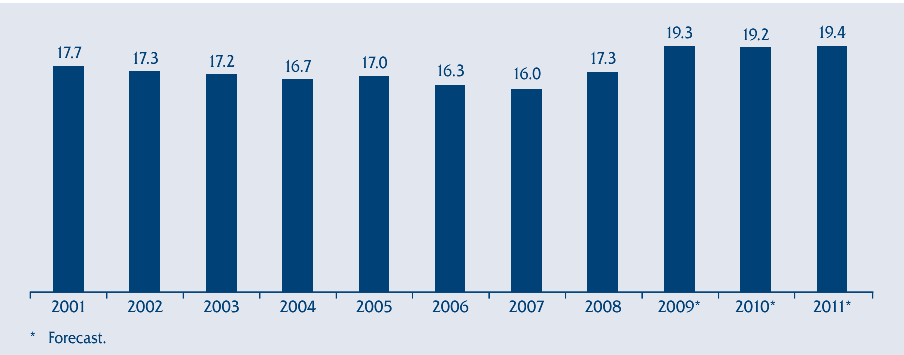
* Forecast.

55. Projections for 2010 and 2011 consider current revenues of 18.7 and 19.0 percent of GDP, respectively. These levels are consistent with the recovery of growth in terms of economic activity and with the recovery of the international prices of our export products.

Evolution of fiscal expenditure

56. In Q1-09, the non financial expenditure of the general government was equivalent to 16.6 percent of GDP, that is, it increased 12 percent in real terms. This variation recorded mainly in higher spending in investment (28 percent) is associated with the stimulus programs aimed at offsetting the effects of the global crisis on demand and with the facilities provided to subnational governments in order to accelerate the implementation of investment projects. Thus, higher dynamism was seen in investment in regional governments (which recorded an increase of 82 percent in real terms), as well as in the investment executed by the different levels of the national government (36 percent), and, to a lesser extent, in the investment executed by local governments (17 percent).

Graph 45
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(% of GDP)



Graph 46
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(Real % change)

On the other hand, the current expenditure of the general government increased 7.9 percent in real terms. This variation is mainly explained by transfers to the Fuel Price Stabilization Fund (S/. 1,000 million), which allowed reducing the liabilities with refineries and fuel importers. Deducting this effect, current expenditure would have declined 1.1 percent.

In 2009 expenditure is projected to increase 13 percent, mainly due to the evolution of investment which would maintain the initial impulse of anti-crisis measures during the year and increase by about 50 percent in real terms. A real increase of 5 and 7 percent is expected in the non financial expenditure of the general government in **2010** and **2011**, respectively. This increase would concentrate again in expenditure in investment, which would go from a level of 3.9 percent of GDP in 2008 to 6.5 percent at the end of the forecast horizon.

Financing requirements

57. Higher financing requirements resulting from a negative economic result in the next years will be covered through higher public indebtedness and through deposits at the BCRP.

Given the favorable market conditions observed at the time, in March 2009 the government decided to issue international bonds for a total of US$ 1,064 million. Bonds amounting to US$ 1,000 million were placed in the external market at a price of 99.5 percent, with a coupon of 7.125 percent and a 10-year maturity term. The great interest this bond generated in the market is reflected in the fact that the demand for this bond was 5 times higher than the bond placement. This was Peru's first external bond issue after having been assigned an investment grade, as well as the first bond issuance after two years of not resorting to financing through issues of global bonds. It should be pointed out that the placement rate has been the second lowest to date after the issue of 30-year global bonds (6.550 percent coupon) and that this is nearly 258 basis points lower than coupon of the 2012 global bond, a 12 year-bond which was the last bond Peru issued internationally.

Graph 47
COUNTRY RISK
(In basis points)

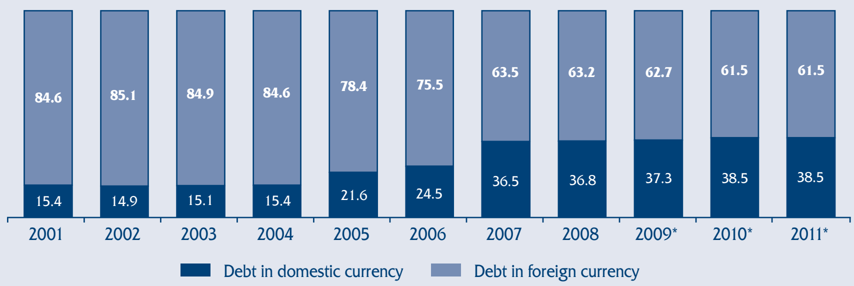
TABLE 18
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR 1/
(Millions of US$)

	2008		2009*			2010*		2011*
	1Q	Year	1Q	IR Mar.09	IR Jun.09	IR Mar.09	IR Jun.09	IR Jun.09
I. Uses	**-458**	**-827**	**-301**	**2,459**	**3,617**	**2,766**	**3,730**	**4,053**
1. Amortization	842	1,971	300	1,203	1,221	1,381	1,397	1,787
a. External	737	1,449	207	949	925	1,108	1,069	1,102
b. Internal	105	522	93	254	296	273	328	686
Of which: Pension bonds	20	94	18	122	138	125	154	129
2. Overall balance (negative sign indicates surplus)	-1,300	-2,798	-601	1,256	2,396	1,385	2,332	2,266
II. Sources	**-458**	**-827**	**-301**	**2,459**	**3,617**	**2,766**	**3,730**	**4,053**
1. External	185	1,100	-76	936	1,364	1,104	1,840	1,626
2. Bonds 2/	111	473	1,064	881	1,780	462	1,015	888
3. Internal 3/	-755	-2,400	-1,290	642	474	1,200	875	1,540
Memo:								
Balance of gross public debt								
Millions of US$	31,350	30,648	30,595	31,132	32,496	31,125	34,260	35,040
As percentage of GDP	27.5	24.0	24.4	25.6	25.6	23.5	24.8	23.5
Balance of net public debt 4/								
Millions of US$	18,537	15,701	14,517	17,071	17,317	18,072	19,685	21,765
As percentage of GDP	16.3	12.3	11.6	14.0	13.6	13.6	14.3	14.6

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

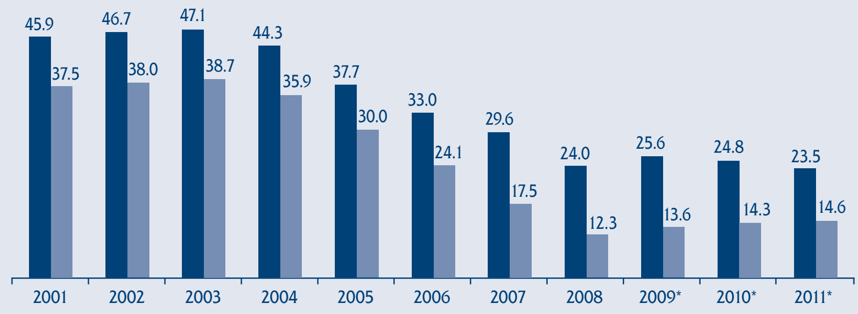
Peru's financing requirements in the next years are expected to be covered mainly through external loans from international organizations and by issues of long-term sovereign bonds. This will contribute to reduce exchange and interest rate-related risks through greater issues of fixed rate bonds in soles and through the extension of the public debt, which currently has an average life of 11.2 years (9.3 years in the case of the external debt and 16.3 years in the case of the domestic debt).

Graph 48
PUBLIC DEBT BY CURRENCY
(% participation)



* Forecast.

Graph 49
PUBLIC DEBT
(% of GDP)



* Forecast.

In 2008 two factors contributed to significantly reduce the gross debt and the net debt (indicator of the position of net liabilities and of the public sector's solvency): an appropriate debt strategy that included prepayments to the Paris Club and the Corporación Andina de Fomento, and a substantial accumulation of assets associated with the high rates of growth of the Peruvian economy.

In 2009 the gross debt and the net debt are expected to reach levels equivalent to 25.6 percent and 13.6 percent of GDP, respectively. It is also expected that the use of deposits will be prioritized to finance the public sector. In this way, the level of the gross debt would decline to 23.5 percent, while the net debt would increase to 14.6 percent in 2011.

V. Monetary Policy

58. Since our last Inflation Report was published in March, the outlook for the global economy has become more unfavorable. Continuous downward revisions of growth projections are confirming a more profound recession in developed countries and a higher slowdown of economic activity in most emerging countries in 2009. The greater deterioration of the international environment has increased risks of a faster slowdown of the domestic economy, which has reflected in the lower growth of economic activity during Q1-09. Moreover, the downward trend of inflation and inflation expectations would be indicating a lower inflationary risk in the forecast horizon.

    In this scenario, the Central Bank adopted a faster pace in loosening its monetary policy stance to foster more favorable monetary and credit conditions. For this, it accelerated the pace of reference rate reductions, initiated in February 2009, accumulating a reduction of 350 basis points in this rate in June 2009. These monetary policy actions have translated into lower interest rates in both the financial system and in the capital market, generating more flexible credit and monetary conditions that are expected to sustain aggregate demand.

59. The BCRP's monetary policy position is established through the reference rate for loans in the interbank market, which affects inflation through different channels. Monetary operations regulating liquidity in the financial system are aimed at steering the interbank interest rate to permanently remain as close as possible to the reference interest rate. The interbank rate acts a guide for the rest of rates in nuevos soles, affecting especially lower risk and shorter-term operations since this type of operations depend less on other factors, such as credit risk or expectations of inflation in the long run. However, in situations of high volatility and uncertainty, the BCRP uses complementary instruments to inject liquidity to the system in order to guarantee the normal operation of the payment system. Moreover, the foreign exchange operations carried out by the Central Bank are aimed at reducing excessive volatility in the exchange rate to prevent negative effects on economic agents' financial positions.

    In this sense, since September 2008, the Central Bank has been implementing measures to maintain the dynamism of the money market in order to prevent the interruption of the process of financial intermediation. These measures have included a rapid reduction of reserve requirements, the inclusion of new collaterals for the BCRP's injection of liquidity, extending the terms of monetary injection operations, and repos of BCRP certificates. Together, these actions have allowed the Central Bank to inject liquidity for a total equivalent to 7.5 percent of GDP.

TABLE 19
MONETARY INJECTION OPERATIONS
(In millions of nuevos soles)

	Balance		Flows
	Aug. 08 (a)	Apr. 09 (b)	(b) - (a)
Total	**-39,002**	**-11,188**	**27,814** [1/]
Repos		4,039	4,039
BCRP CDs [2/]	-34,024	-13,515	20,509
Swap		600	600
Reserve requirement	-4,978	-2,312	2,666

1/ This flow is equal to 7.5 percent of the 2008 GDP.
2/ Includes CD BCRP. CD BCRP-NR and CDR BCRP.

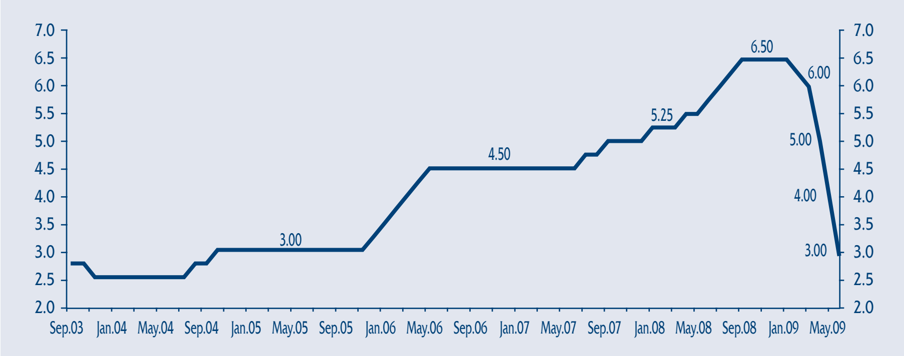
60. Moreover, these actions have contributed to buffer the impact of the global financial crisis on domestic credit conditions as they have allowed a rapid convergence of the interest rates for the money market, the financial system's prime rates, and the bond market, as well as sustaining the normal flow of credit. This rapid improvement of credit conditions and credit in the money market has generated the conditions for a greater and more rapid loosening of the monetary policy stance.

61. Since the publication of our March Inflation Report, the projections on global growth and inflation have been successively revised downwards due to the higher than expected deterioration of actual external conditions and to inflation's faster convergence to its target range. This scenario has led the Central Bank to adopt stronger monetary stimulus measures –considered in the risk scenarios discussed in our last Inflation Report– in order to buffer the impact of the greater slowdown of the global economy on domestic demand and to guarantee inflation's convergence to the inflation target.

    Thus, since April this year, the Central Bank has reduced the reference interest rate on three successive occasions (by 100 basis points each time) –an unprecedented decision since inflation targeting was implemented in 2002. This has complemented the rate reductions carried out in February and March, as a result of which the reference rate has accumulated a reduction of 350 basis points so far this year.

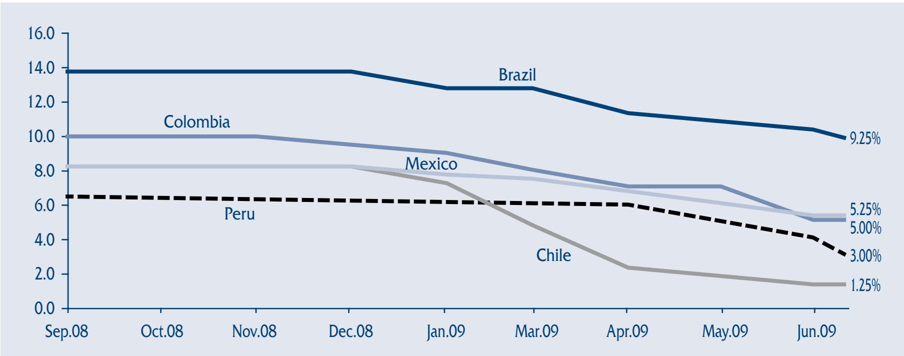
    This greater loosening of the monetary stance has been implemented due to the faster transmission of the deepening of the world recession to the domestic economy, in a context characterized by a greater slowing of economic activity (the economy grew 1.8 percent in Q1-09) and the reduction of inflation (from 6.7 percent in December to 4.2 percent in May) and of inflation expectations.

Graph 50
REFERENCE RATE



In terms of countries with Inflation targeting schemes in Latin America, Peru has one of the lowest monetary rates, preceded only by Chile, which has a monetary rate of 1.25 percent.

Graph 51
REFERENCE RATE BY COUNTRIES



SUMMARY OF THE BCRP COMMUNIQUÉS ON THE MONETARY PROGRAM: March 2009 – June 2009

March: The Board of the Central Reserve Bank of Peru approved to reduce the monetary policy reference interest rate from 6.25 to 6.0 percent. With this decision, the Central Bank continues to loosen its monetary policy stance given that lower inflationary pressures and declining inflation expectations are being observed in a context of lower growth in the global economy.

The Board continues to oversee the evolution of inflation and its determinants, particularly in terms of the development of domestic demand and of the international economic and financial situation.

April: The Board of the Central Reserve Bank of Peru approved to reduce the monetary policy reference interest rate from 6.0 to 5.0 percent, thus accumulating a reduction of 150 basis points in this rate so far this year. The decision of accelerating the reduction of the reference interest rate is based on the reduction of inflationary pressures, as a result of which the rate of inflation has declined from 6.7 percent in December to 4.8 percent in March, as well as on the deceleration observed in private spending due to inventory adjustments and the deterioration of the global economy. Should this trend persist, the Bank will continue to loosen its monetary policy stance.

May: The Board of the Central Reserve Bank of Peru approved to reduce the monetary policy reference interest rate for the fourth consecutive month, from 5.0 to 4.0 percent, as a result of which this rates accumulates a reduction of 250 basis points so far this year.

With this decision, the Central Bank continues loosening its monetary policy stance based on the reduction of both inflation –which has declined from 6.7 percent in December to 4.6 percent in April– and inflation expectations, as well as on the higher deceleration observed in private spending due to inventory adjustments and the deterioration of the global economy. Should this trend persist, the Bank will continue loosening its monetary policy stance.

June: The Board of the Central Reserve Bank of Peru approved to reduce the monetary policy reference interest rate for the fifth consecutive month, from 4.0 to 3.0 percent, as a result of which this rates accumulates a reduction of 350 basis points so far this year.

This decision is based on the sustained reductions observed in the rate of inflation –as a result of which this rate has declined from 6.7 percent in December to 4.2 percent in May– and in inflation expectations, as well as on the slowdown observed in economic activity.

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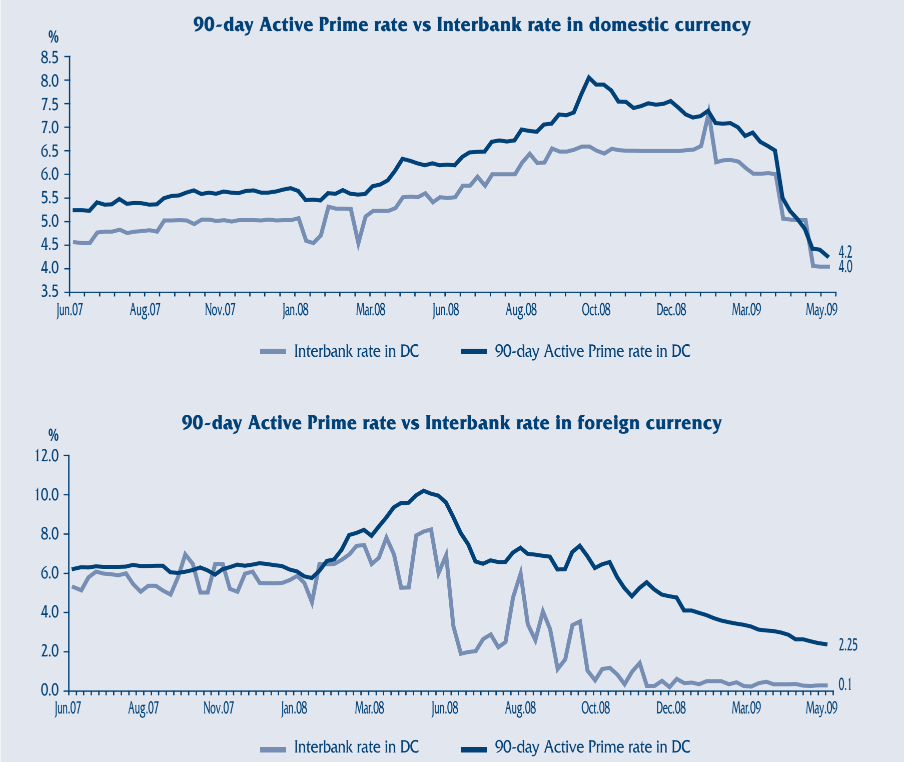
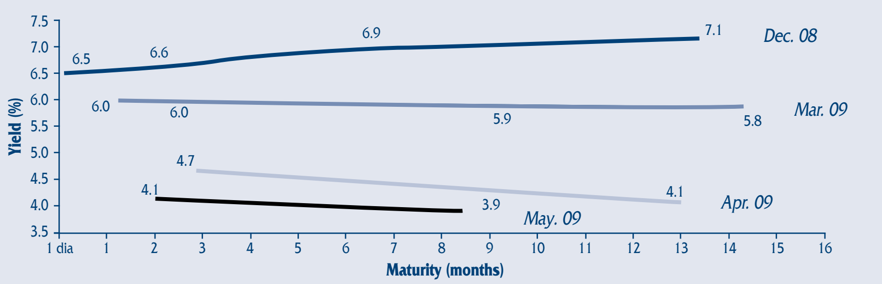
62. As a result of the measures implemented by the Central Bank, the corporate prime rate declined from 6.69 to 4.20 percent between March and May, in line with the reduction of the reference rate. Thus, the spread between the interbank rate and the corporate rate in nuevos soles was around 27 basis points, a level below the one recorded in April (54 basis points) which reflected expectations of greater reductions in the reference rate.

Graph 52
INTERBANK AND CORPORATE PRIME INTEREST RATES



63. In the last months, the interest rates on the certificates of the Central Bank negotiated in the secondary market have been reflecting expectations that short term rates will continue showing a downward trend in 2009, as expressed in an inverted yield curve with higher overnight rates than longer-term rates.

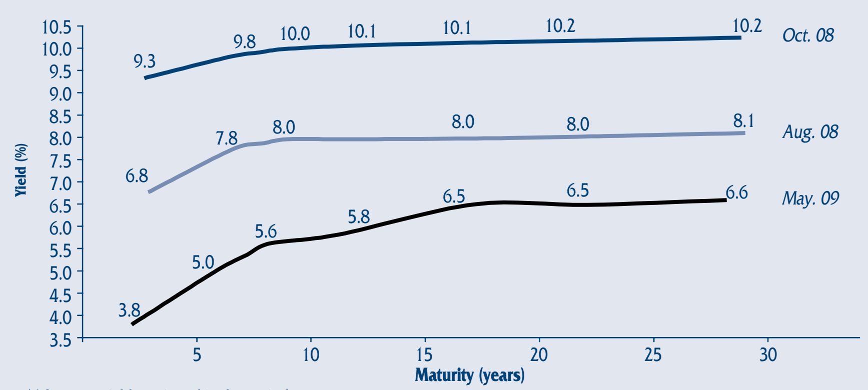
Graph 53
SECONDARY MARKET OF BCRP SECURITIES 1/



1/ Average yield of negotiated CD BCRP and CD BCRP-NR . The CD BCRP-NR are negotiated in the secondary market since April 18,2008.

64. Together with lower inflation expectations and the decline of the country risk, the loosening of monetary policy has generated a downward movement in the yield curve, which reached levels even lower than the ones observed in the rates of August 2008, before the deepening of the global crisis.

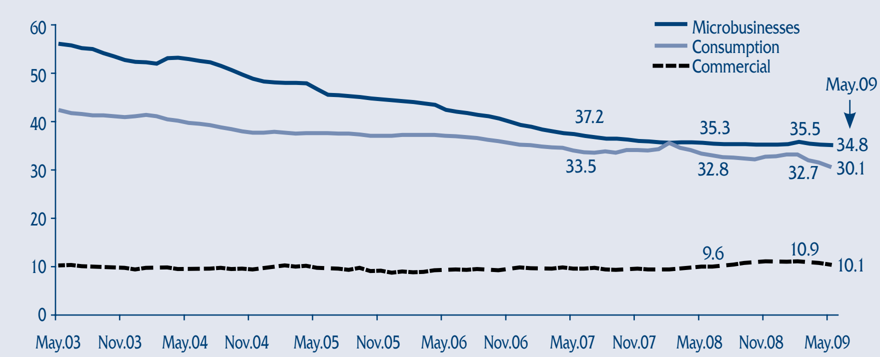
Graph 54
SECONDARY MARKET OF PUBLIC TREASURY SOVEREIGN BOND 1/



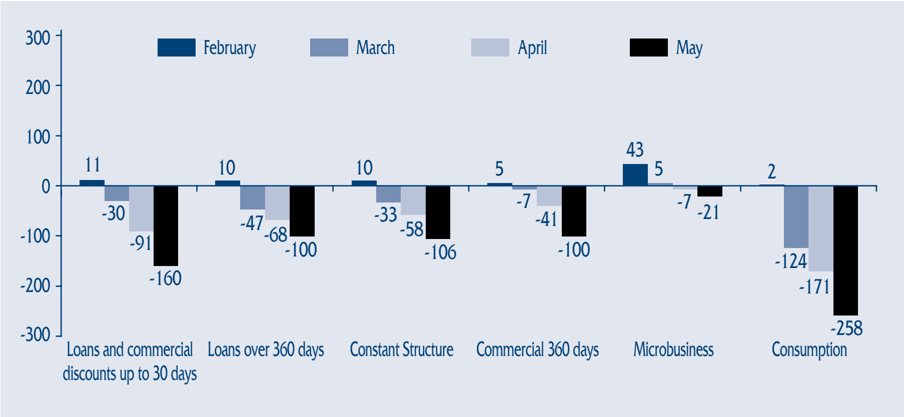
1/ Average yield auctioned in the period.

65. Looser conditions in the money and capital markets have also influenced on the downward evolution of both active and passive rates in the financial system. Thus, between February and May the interest rates on loans to micro businesses declined from 35.5 to 34.8 percent, while the rates on consumer loans and on commercial loans declined from 32.7 to 30 percent and from 10.9 to 10 percent, respectively.

Graph 55
INTEREST RATES IN NUEVOS SOLES OF COMMERCIAL. MICROBUSINESS AND CONSUMPTION CREDITS
(%)

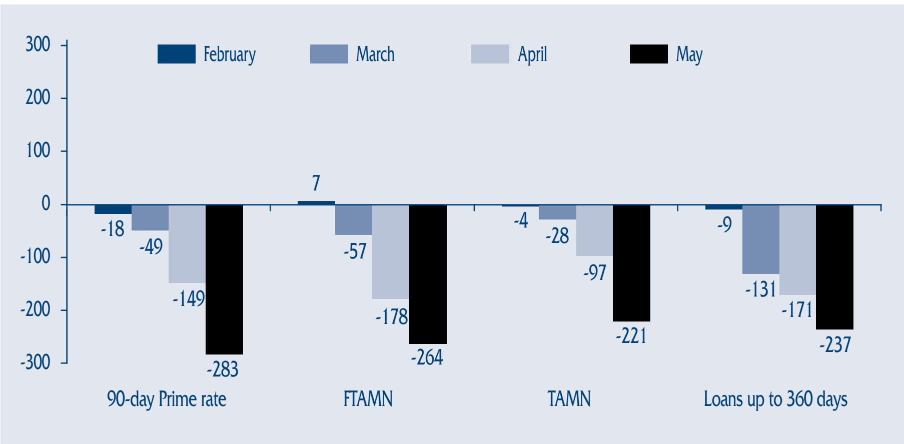


Graph 56
ACCUMULATED DECREASE IN THE ACTIVE INTEREST RATES BY MODALITY
(Change February-May 2009. in basis points)



66. The average rates on bank loans carried out in this period (FTAMN) declined by 264 bps, from 23.0 percent in February 2009 to 0.4 percent in May. The highest reductions of interest rates on active operations were observed as from April, when a faster pace was seen in the reduction of the reference rate.

Graph 57
ACCUMULATED DECREASE IN THE ACTIVE INTEREST RATES
(Change February-May 2009. in basis points)



67. As regards passive interest rates, the rates on 30-day and 180-day deposits fell from 6.6 to 3.9 percent and from 6.5 to 5.5 percent, respectively. Similarly, the rate on 181 to 360-day deposits declined from 6.5 to 6.0 percent.

TABLE 20
INTEREST RATES IN NUEVOS SOLES AND IN DOLLARS
(%)

	Nuevos Soles		Dollars		Dif. (bps) (may-feb)	
	Feb. 2009	May. 2009	Feb. 2009	May. 2009	Nuevos Soles	Dollars
1. Deposits up to 30 days	6.6	3.9	0.6	0.4	-267	-23
2. Rate on 31-day to 180-day	6.5	5.5	2.9	2.1	-99	-83
3. Rate on 181-day to 360-day term deposits	6.5	6.0	4.4	4.0	-53	-43
4. Corporate prime rate	7.2	4.5	3.3	2.4	-265	-94
5. Average rate on loans up to 360 days 13	15.4	13.1	9.3	8.6	-228	-67
6. Average lending rate. constant structure 1	17.4	16.2	10.0	9.7	-116	-25
7. Active commercial average	10.9	10.1	9.2	8.9	-75	-32

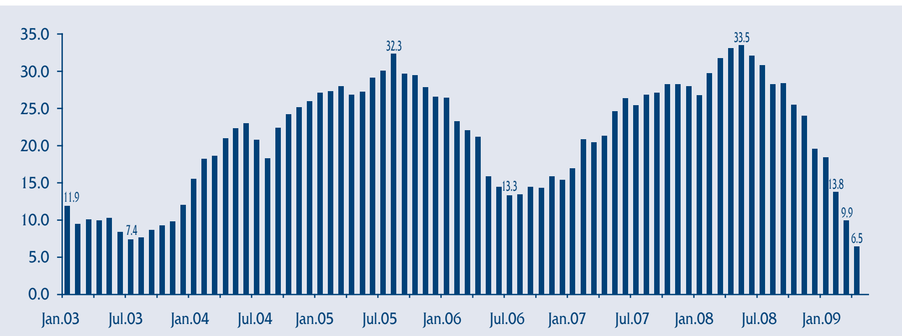
68. Interest rates in foreign currency have also fallen in line with the decline of country risk and with the lower international interest rates. Thus, in the case of active rates, the corporate prime rate fell from 3.3 to 2.4 percent and the average 360-day rate fell from 9.3 to 8.6 percent, while in the case of passive rates, the rate on 31 to 180-day deposits fell from 2.9 to 2.1 percent and the rate on 181 to 360-day deposits fell from 4.4 to 4.0 percent.

69. In summary, the evolution of interest rates in both the financial system and in the capital market show more flexible credit conditions. These better credit conditions are expected to sustain the demand for credit and to impulse the evolution of aggregate demand.

Broad money and credit

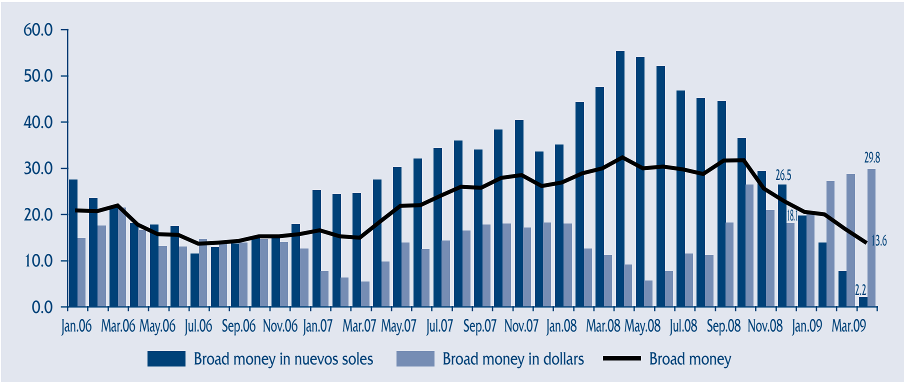
70. The slowdown of economic activity and increased dollarization have reflected in a lower growth of currency in circulation, which has gone from 13.8 percent in February to 6.5 percent in April.

Graph 58
CURRENCY
(12-month % change)



71. Year to date, broad money in dollars in the private sector has maintained its pace of growth, while the growth of broad money in nuevos soles has slowed down. Thus, between December and April 2009, the growth rate of the former has increased from 18.1 to 29.8 percent, while the latter has declined from 26.5 to 2.2 percent. Thus, like in the case of currency, the pace of growth of broad money in the private sector at a constant exchange rate has declined, reflecting lower growth in terms of economic activity.

Graph 59
BROAD MONEY IN THE PRIVATE SECTOR
(12-month % change)



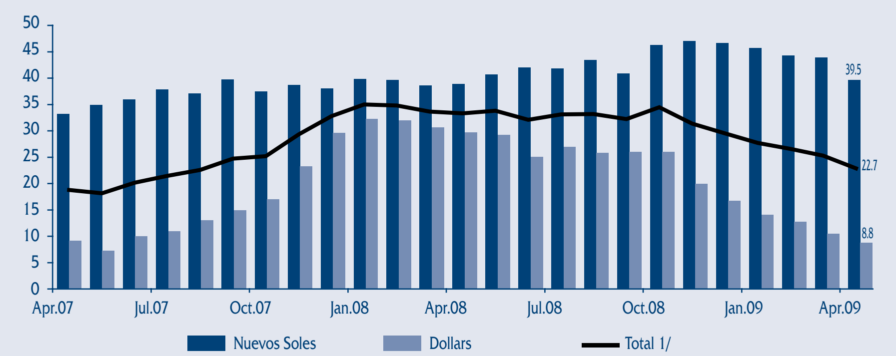
72. After the rapid process of dollarization seen in deposits as from September 2008, associated with generalized uncertainty as a result of the deepening of the international financial crisis, the dollarization ratio of broad money has remained close to the levels recorded at end 2007. It is worth pointing out that as from January 2008, dollarization declined in a context characterized by an important inflow of capitals and strong appreciatory pressures on the nuevo sol before the crisis unfolded.

Credit to the private sector

73. Credit to the private sector in nuevos soles grew at an annual rate of 39.5 percent in April 2009 (44.1 percent in February), while credit to the private sector in dollars continued showing the trend observed since September 2008 and its growth declined to 8.8 percent in April 2009. The evolution of credit in both currencies was reflected in the lower dynamism of overall credit, which grew 22.7 percent.

74. The monthly average flow of overall credit between October 2008 and March 2009 was S/. 1,275 million, lower than the average recorded between January 2008 and September 2008 (S/. 1,680 million). This lower growth of credit to the private sector is mainly explained by the lower level of economic activity and to the statistical effect on the high growth of credit observed during 2008. It is worth

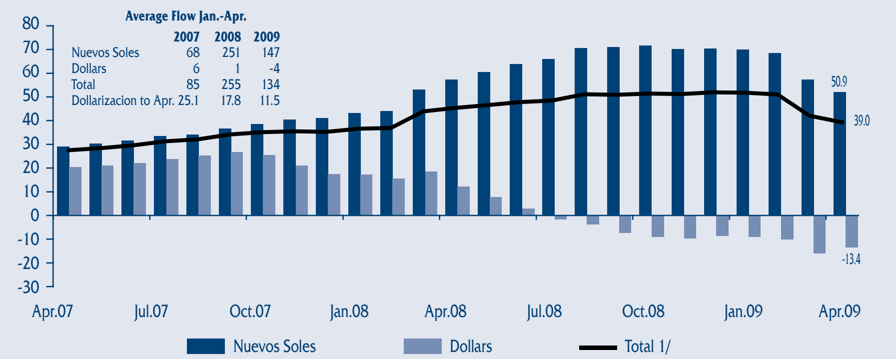
Graph 60
CREDIT TO THE PRIVATE SECTOR
(Annual % change)



1/ Constant exchange rate.

pointing out that credit has especially slowed down in the corporate segment –due to substitution of credit by funding from the capital market– and not so significantly in the segment of micro businesses. However, in the last two months, dynamism in the latter segment has declined.

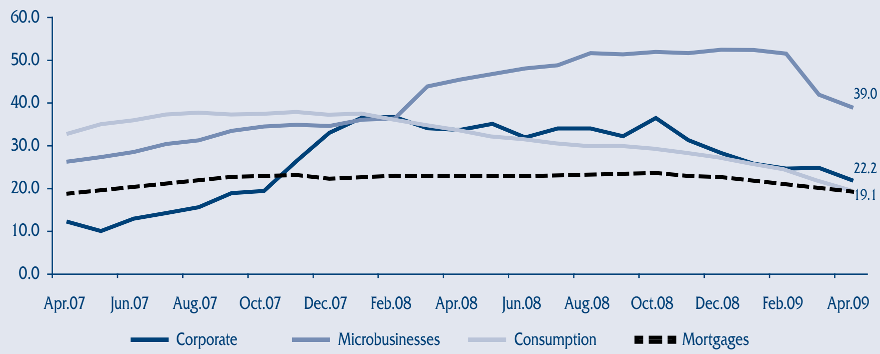
Graph 61
CREDIT TO MICROBUSINESSES
(Annual % change)



1/ Constant exchange rate.

75. By type of credit, consumer loans have continued slowing down: their growth rate in the last 12 months fell from 24.1 percent in February 2009 to 19.1 percent in April 2009. Likewise, credit to micro businesses showed an important reduction in their last 12-month growth rate which reached 39.0 percent, a lower rate than the one observed in previous months. Moreover, corporate loans and mortgages showed rates of 22.2 and 19.1 percent, respectively.

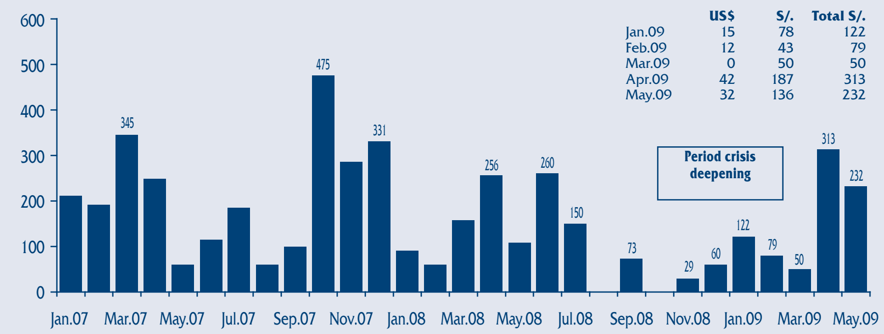
Graph 62
CREDIT TO THE PRIVATE SECTOR BY TYPE OF LOAN



1/ Constant exchange rate.

76. After a period of uncertainty about the evolution of the economy, a significant recovery has been observed in private issues of corporate bonds of non financial entities in the last months, which is indicative that conditions of liquidity in the economy and firms' investment plans are maintained, especially in the case of those associated with domestic demand.

Graph 63
BONDS ISSUED BY NON-FINANCIAL COMPANIES
(Millions of nuevos soles)



	US$	S/.	Total S/.
Jan.09	15	78	122
Feb.09	12	43	79
Mar.09	0	50	50
Apr.09	42	187	313
May.09	32	136	232

* Primary public offers are valued in dollars at constant rate of exchange of S/. 3.0 per US$.
Source: Nota Semanal BCRP.

77. The bond market is one of the mechanisms of direct financing that large firms have used in the last years to finance long term investment projects and complement the financing obtained in the banking system. Factors contributing to this development of the corporate bond market include the presence of institutional investors, the development of a sovereign yield curve, and macroeconomic stability.

In Q4-08, issues of corporate bonds were affected by the uncertainty generated as a result of the impact of the international financial crisis, which was reflected in substantial increases in the levels of interest rates. Thus, the yield on the 2037

Sovereign Bond increased from 8.09 percent in August 2008 to a peak of 10.24 percent on October 27 of the same year.

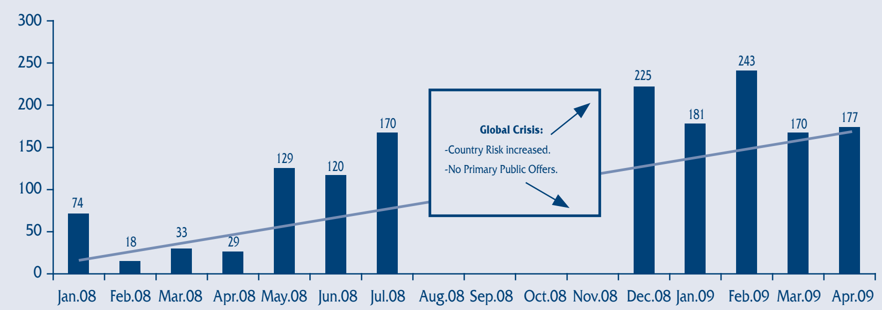
A recovery of issues of corporate bonds associated with non financial firms has been observed since end 2008 and so far this year, together with a significant reduction of interest rates on placements, in line with the decline of sovereign long term rates. The improvement of credit conditions in the capital market reflect in part the result of the Central Bank policy actions adopted in Q4-08 with the aim of injecting liquidity to the money and bond markets in order to buffer the effect of the deterioration of external credit conditions in these markets. Moreover, the normalization of liquidity and functioning of these markets would be favoring a greater pass-through of the reduction of the reference rate to long term rates.

High liquidity in the capital market is also favoring private bond issues. In the last issues of corporate bonds, this has translated into a demand for bonds that has by far exceeded the supply, favoring especially large companies associated with the domestic sector.

Spreads should continue declining in the next months, in line with lower uncertainty regarding the evolution of the economy, lower inflation expectations, a more expansionary monetary policy stance, and with investors' increased demand for these instruments. This higher dynamism of financing in the capital market is also expected to contribute to further reduce active rates in the financial system as firms substitute bank financing for financing in the capital market.

78. The evolution of direct financing is complemented with the growth of credit to the private sector, which still shows rates of over 20 percent, reflecting the effect of the slowdown of economic activity and adequate liquidity levels in the markets.

Graph 64
3-YEAR CORPORATE BONDS AAA SPREAD IN NUEVOS SOLES 1/
(Basis points)



1/ Difference in the yield of the 3-year AAA Bonds in nuevos soles against the sovereign bonds on the same maturity.

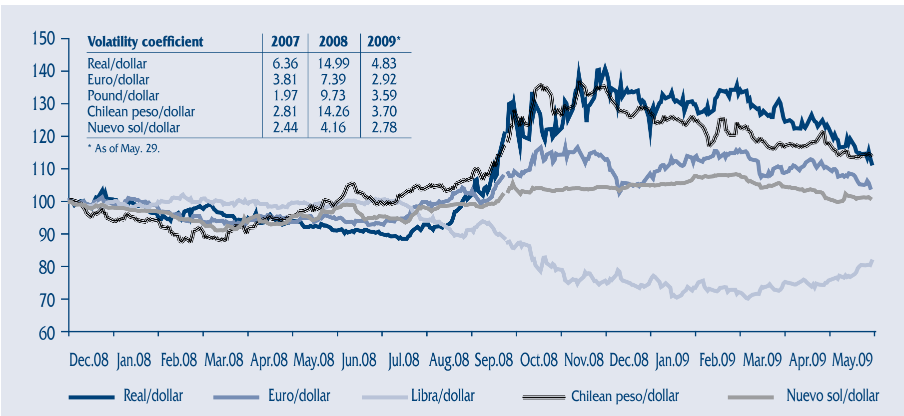
Exchange rate

79. At the close of May the nominal exchange rate had appreciated 7.9 percent compared with the close of February, although it had showed a depreciatory trend until the end of February. The reversal of this trend, which started in the second week of March, was initially explained by the higher supply of dollars in the forex market due to the regularization of income tax and banks' sale of dollars to reduce their exchange position. This trend was later reinforced by increased expectations regarding the international financial crisis which led to lower risk aversion among non resident investors in terms of emerging markets.

The decline of the exchange rate has not been an isolated development in the Peruvian economy. The currencies of other countries, such as Brazil (-17.6 percent), Colombia (-16.1 percent), Mexico (-13.9 percent), and Chile (-5.8 percent) also appreciated.

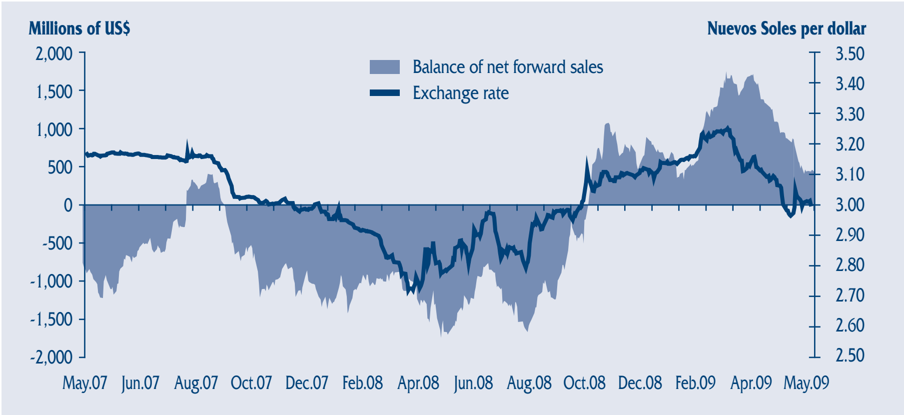
Appreciatory expectations were also observed in the forward market. Until the end of February, agents' expectations of depreciation were reflected in the increase of

Graph 65
EXCHANGE RATE INDEX
(December 2007=100)



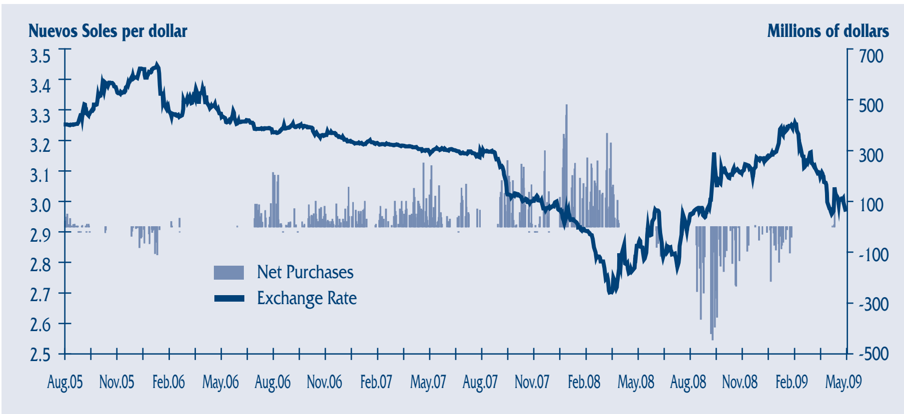
the balance of net forward sales, which reached a maximum of US$ 1,751 million on February 26. Then, lower risk aversion in emerging markets generated a decline in the balance of net forward sales as a result of both new contracts of forward purchases and of the maturity of forward sale contracts that were not renewed. Thus, the balance of net forward sales fell from US$ 1,654 million at end February to US$ 386 million at end May.

Graph 66
BALANCE OF NET FORWARD SALES AND EXCHANGE RATE
(Millions of US$ and Nuevos Soles per dollar)



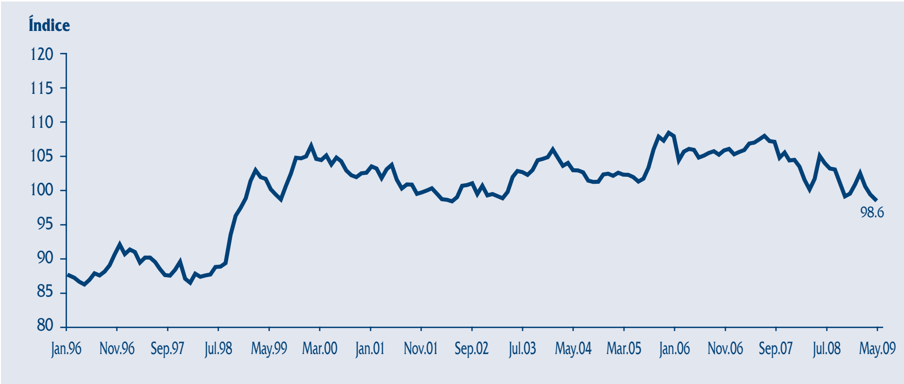
In March and April the BCRP did not intervene in the forex market. However, due to the increased volatility of the exchange rate observed thereafter, in May the BCRP purchased a total of US$ 77 million. The actions carried out by the BCRP so far this year have allowed NIRs to remain stable: the balance of NIRs has gone from US$ 31,196 million at end 2008 to US$ 31,189 million at the close of May 2009.

Graph 67
BCRP NET PURCHASES AND EXCHANGE RATE



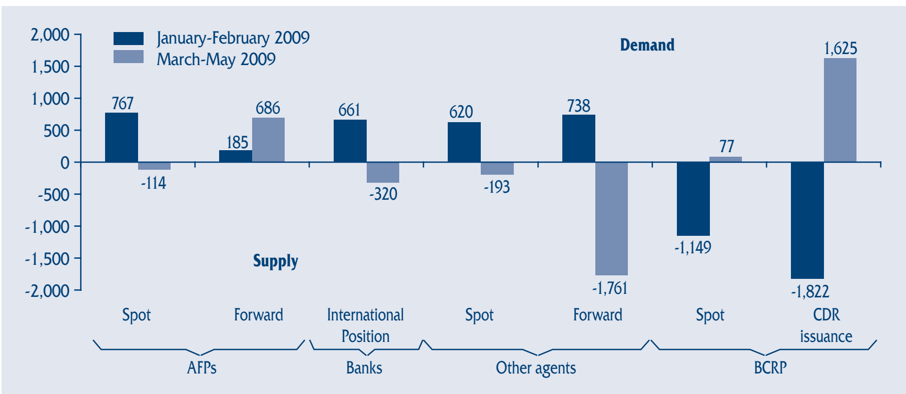
The real exchange rate has maintained a stable evolution in the last years due to the sound fundamentals of the Peruvian economy, such as a positive fiscal position, low debt levels, and a sustainable current account.

Graph 68
REAL EXCHANGE RATE INDEX



Agents' currency portfolio was influenced by international developments associated with the international financial crisis (fiscal stimulus plans in the United States, the corporate results of financial entities in the international level, the evolution of activity indicators in the United States, etc). Private administrators of pension funds (AFPs) reduced their net demand for dollars compared with the levels observed in January and February, and a net supply of dollars was recorded in the forward market.

Graph 69
BANKS' FOREX OPERATIONS: JANUARY-MAY 2009
(Millions of US$)



BOX 3
PASS-THROUGH FROM THE REFERENCE RATE TO OTHER INTEREST RATES IN NUEVOS SOLES

The magnitude and velocity with which variations in the monetary rate are conveyed to the rest of rates in the financial system are crucial aspects for the effectiveness of monetary policy. The greater and faster the pass-through, the greater impact of monetary policy.

This pass-through depends on the level of development of money and capital markets, and on the effectiveness of the Central Bank in communicating monetary policy actions. In developed markets, where participants have the capacity of effectively arbitraging between different credit and deposit markets, changes in the reference interest rate are more rapidly reflected in the interest rates of these markets. Likewise, if the Central Bank is more effective in communicating its monetary policy actions, it can induce greater changes in interest rates when, for example, variations in the reference rate are expected to follow the same direction in several periods.

In the case of Peru, econometric estimates show that this pass-through has been increasing significantly in the last years. The table below shows the estimates of the degree of pass-through of interest rates for different sub-periods, which are based on the updated information provided by Lahura (2006) and by the results included in Box 1 our Inflation Report of January 2004, the latter of which reported the pass-through effect for the sub-sample covering the period of February 2001 - March 2003. For comparison purposes, the results of this sub-sample are also included in the following table.

	IMPACTS (percentage points)			AVERAGE LAG OF THE IMPACT (months)		
	Apr.95-Jan.01	Feb.01-Mar.03	Feb.01-May.09	Apr.95-Jan.01	Feb.01-Mar.03	Feb.01-May.09
Interest rates						
Loans						
Up to 360 days	0.11	0.46	0.56	4.6	4.6	2.1
More than 360 days	0.61	0.61	0.64	9.1	9.1	8.3
90-days Corporate Prime Rate*	n.a.	n.a.	1.00	n.a.	n.a.	0.6
Deposits						
Savings	0.04	0.25	0.46	0.3	1.5	3.1
Up to 30 days	0.18	0.61	0.82	0.0	0.6	1.1
Between 31-179 days	0.06	0.44	0.78	0.2	2.3	3.0
Between 180-360 days	0.21	0.21	0.67	3.0	3.0	3.7
More than 360 days	0.13	0.13	0.48	6.0	6.0	6.3

* This series is available since October 2000. Because no information is avaliable for some periods, the estimation of the pass-through effect of this rate is calculated based on the period of February 2001 - May 2009.

The table shows that the degree of pass-through has considerably increased since 2001 in the case of all the interest rates considered. Thus, for example, in the most recent period, the variation of one percentage point in the interbank rate has had an impact of 0.56 percentage points on the 360 day-loan rate in an average period of 2 months –a higher impact than the 0.46 percentage points of pass-through estimated for the period extending to March 2003.

A similar evolution is observed in the pass-through of variations in the reference rate to passive rates. Thus, for instance, the pass-through effect in the case of saving deposits has increased from 0.25 percentage points to 0.46 percentage points. The same may be observed in the case of term deposits, and more clearly, in the case of 180 to 360 day-term deposits.

The table also shows the average duration of the impact, which indicates how long it takes for other rates to record the maximum impact of a variation in the reference rate. Thus, in the case of active rates, this duration would have declined to only 2 months in the case of up to 360 day-loans, that is, to less than half of the previous estimate.

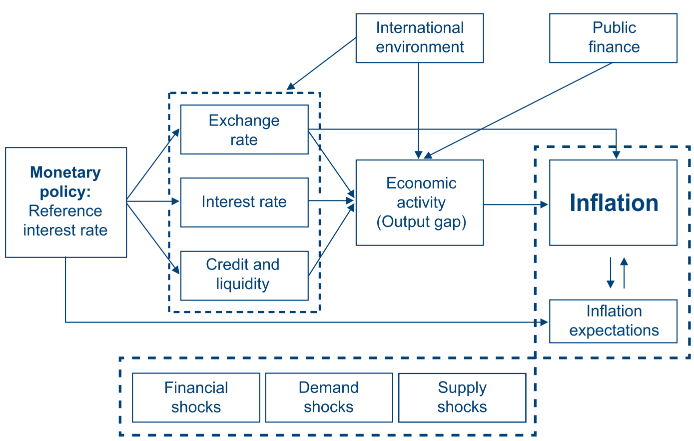
The increased pass-through effect of the reference rate estimated is consistent with what has been observed in terms of the evolution of interest rates in the financial market, especially in the case of 90 day-corporate prime rates, which have fallen almost in the same proportion as the 350 basis point reduction recorded in the interbank reference rate since February 2009. This is consistent with the pass-through ratio in the case of the 90 day corporate prime rate, which is equal to 1, and, therefore, predicts a perfect pass-through with a mean impact duration of 0.6 months (or 18 days).

BOX 4
MONETARY POLICY TRANSMISSION MECHANISMS

Monetary policy actions, reflected in movements of the reference level for the interbank interest rate, affect economic activity and inflation through several transmission channels. Thus, monetary policy affects several variables and markets in different terms and with different intensities.

The chart below illustrates the transmission process in a small, open and partially dollarized economy like the Peruvian economy:

TRANSMISSION OF MONETARY POLICY ACTIONS



For example, a monetary expansion –which is expressed in the reduction of the interbank interest rate– has direct effects on the market short term rates and increases inflation expectations, reducing the actual interest rates on longer term operations. This generates higher spending in consumption and investment and increases aggregate demand. This mechanism is called the “interest rate channel”.

The reduction of the interest rate generates depreciatory pressures in the very short term, inducing two results: an increase in the prices of imports and, through the effect on the actual exchange rate, higher net exports that entail an increase of aggregate demand. This mechanism is known as the “exchange rate channel”. On the other hand, the short term depreciatory effect on the exchange rate induces an expected appreciation in the future, determining a reduction of actual rates in dollars that reinforces the effect of the increase of aggregate demand.

Moreover, the effects of this transmission process may be enhanced by the “credit channel”, that is, by a higher supply of bank credits given a more expansionary monetary policy.

Finally, the “expectations channel” links the credibility of the Central Bank directly to economic agents’ decisions in terms of expenditure planning, which depends on their expectations about future inflation. If inflation expectations are consistent with the Central Bank’s inflation target, the effectiveness of monetary policy in terms of preserving price stability will be greater.

Monetary policy in risk contexts

The management of monetary policy and the transmission of this policy through the channels discussed above are exposed to risk contexts resulting from several sources of shocks (for example, financial shocks) that may have a domestic origin or, like in the case of the recent financial crisis, have an external origin. The implications of some of these risk contexts and the policy actions implemented in response to these episodes are discussed below.

• High volatility of exchange

Excessive volatility of exchange causes negative effects in partially dollarized economies, like the Peruvian economy, due to the vulnerability of economic agents’ balances with dollarized liabilities. When there is an important percentage of credits in foreign currency –their repayment is affected by the exchange rate–, net borrowers are subject to high variability in the repayment of their obligations, which has a detrimental effect on their expenditure. Because of this, monetary policy can be less effective in affecting expenditure and in controlling inflation.

In episodes of high volatility of exchange, the BCRP intervenes in the forex market buying or selling foreign currency and places Indexed Certificates of Deposit (CDR) in order to reduce the volatility of exchange. Varying the rates of reserve requirements in foreign currency can also contribute to achieve this aim. These actions allow offsetting the negative effects caused by the existence of dollarized liabilities and normalize the functioning of monetary transmission mechanisms.

• Liquidity constraints

The international financial crisis increased the risk that a world credit contraction could be reproduced domestically in the money, credit and capital markets in the form of a contraction of financing.

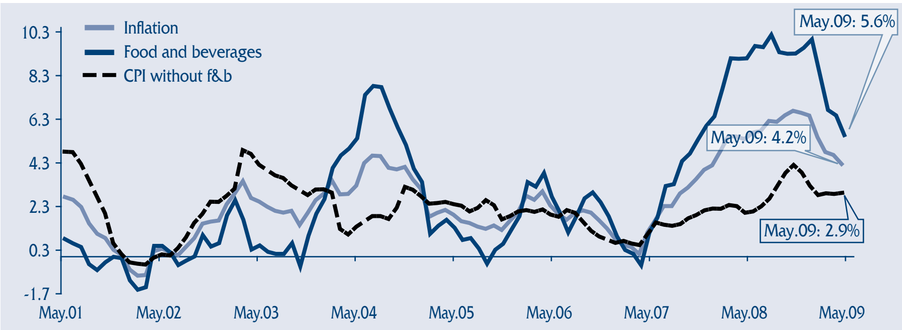
On the one hand, these episodes of liquidity constraints are translated into a weakening of the credit channel as the availability of loanable funds becomes limited. On the other hand, the mismatch generated between the Central Bank's reference rate and the interbank rate has a negative effect on monetary transmission through the interest rates channel. A detrimental effect on this channel also occurs because longer term rates are disconnected from the expected evolution of the reference rate (that is, this generates an excessive upward shift in the yield curve of the money market).

In this risk context, the Central Bank actions are oriented to guaranteeing the availability of the liquidity required for the normal functioning of the monetary market and the payment chain. The BCRP uses different instruments to do this: repo operations and swaps in domestic and foreign currency with different terms, the repurchase of Certificates of Deposits (CDs) and CDRs, and reductions of reserve requirements in domestic currency and foreign currency.

VI. Inflation

80. The price rises of imported raw materials that originated supply shocks in domestic and imported food products in 2008 have been reverting between January and May of this year. This trend has translated into a decline in the prices of foodstuffs and beverages from 9.7 percent in December 2008 to 5.6 percent in May. Additionally, the prices of fuels have fallen due to the reduction of the international price of crude. Both effects have reflected in a significant reduction of the inflationary trend, with last 12 month-inflation declining from 6.65 percent in 2008 to 4.21 percent at May.

Graph 70
OVERALL CONSUMER PRICE INDEX AND FOOD AND BEVERAGES CPI
(Last 12-month % change)



The items contributing most heavily to accumulated inflation in January - May 2009 included meals outside the home, education costs (tuition and fees), onion, carrot, chicken meat, and cleaning items. On the other hand, the items that contributed to reduce inflation were kerosene, gasoline, potato, rice, edible oils, and gas.

TABLE 21
WEIGHTED CONTRIBUTION TO INFLATION
JANUARY - MAY 2009

Items	Weight	% Chg.	Positive contribution	Items	Weight	% Chg.	Negative contribution
Meals outside the home	12.0	2.0	0.23	Kerosene	1.2	-17.8	-0.37
Education costs	5.1	3.9	0.21	Gas and oil	1.5	-18.8	-0.35
Onion	0.4	35.7	0.20	Potato	1.5	-10.8	-0.23
Carrot	0.2	53.7	0.11	Rice	2.3	-7.3	-0.18
Chicken meat	4.0	2.7	0.10	Cooking oil	0.8	-11.0	-0.11
Cleaning articles	1.4	6.7	0.10	Gas	1.3	-6.6	-0.09
Total			**0.95**				**-1.33**

A downward trend in the last 12 month variations of the prices of food and beverages and fuels is observed at May 2009. The group of "other goods and services" shows an upward trend until March, reverting thereafter as from April.

TABLE 22
INFLATION

	Weight	2006	2007	2008	2009	
					Jan.-May.	12-month
Inflation	100.0	1.14	3.93	6.65	0.37	4.21
1. Food and beverages	47.5	1.76	6.02	9.70	1.30	5.59
2. Rest of components	52.5	0.61	2.02	3.86	-0.55	2.88
a. Fuels and electricity	6.2	-3.16	5.21	1.65	-9.82	-6.77
Fuels	3.9	-1.50	6.45	-0.04	-15.31	-15.58
Electricity	2.2	-7.30	1.92	6.31	4.42	19.45
b. Transport	8.4	1.12	0.82	5.86	-0.86	5.43
c. Public services	2.4	1.22	-1.44	8.68	-0.06	8.15
d. Other goods and services	35.5	1.28	1.89	3.51	1.61	4.07
Memo:						
Core inflation	60.6	1.37	3.11	5.56	1.60	5.11
Core inflation excluding food and beverages	35.5	1.28	1.89	3.51	1.61	4.07

81. The evolution of the items that contributed most heavily to inflation is discussed below:

Meals outside the home:

This rise (2.0 percent) is associated with the increase observed in the prices of food and beverages (1.3 percent).

Education costs (tuition and fees):

The 3.9 percent increase observed in education costs is explained by the higher costs of school tuitions (2.1 percent in private schools and 0.2 percent in public schools), and by the higher education fees in private schools (5.4 percent).

Onion:

The 35.7 percent increase in the price of onion is mainly due to the reduction of sown areas in Arequipa, which is the main producer area of this crop (production declined 33 percent in August-November compared with the previous crop period). The yield was also affected by climatic alterations (lack of rainfall in the first months and then heavy rains). The production of onion in the January-April period dropped 11 percent compared to the same period in 2008.

Carrot:

The strong increase recorded in the price of carrot (53.7 percent) reflects mainly the rises observed in the months of January and February (14 and 20 percent) due to the rains and mudslides that affected the harvest and commercialization of this crop in the Sierra Central. Supply to Lima fell 10 percent in January-May compared to the same period in 2008.

Chicken meat:

This increase (2.7 percent) was associated with the lower supply of substitute products, especially yellow mackerel (-47 percent compared with the January-May 2008 period). Although a series of price fluctuations were observed, an extraordinary increase (8.9 percent) was recorded in May in connection of celebrations of Mother's Day. Other factors contributing to this evolution were the lower supply of yellow mackerel and fears of eating pork due to the AH1N1 flu.

Higher production costs also contributed to this increase. After posting a minimum price of US$/ton 106 on December 5, the international price of maize increased sustainedly and recorded a rise of 19 percent in the first five months of the year. This was associated with projections of a higher global consumption of this cereal due to increased demand for animal feed and to produce ethanol, as well as with a lower global production of maize in the 2009-2010 crop year.

Cleaning items:

Cleaning items increased 6.7 percent due to the strong increase of production costs in 2008. This was the case of detergents containing additives, such as trisodium phosphate and dodecyl benzene, whose prices increased 44 and 50 percent, respectively, in 2008. However, year to date, the increases in the prices of these inputs have reverted.

The items contributing negatively to inflation included the following:

Fuels:

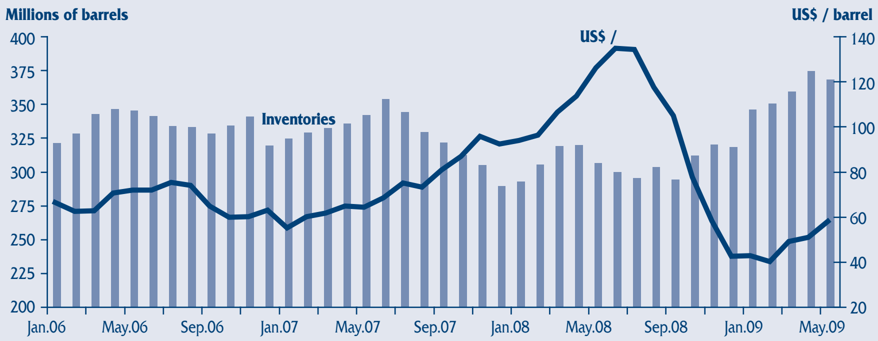
The drop of the prices of fuels (15.3 percent) was due to the drop of the international price of crude, which fell from US$ 133.9 a barrel in June 2008 to US$ 39.1 in February 2009. In the first months of 2009, the price of crude was volatile and fluctuated around US$ 40 the barrel. Since March the price of oil increased gradually in line with the recovery of global demand, recording a level of over US$ 61 a barrel on May 22 –nearly twice as much as the minimum low of US$ 33.9/barrel recorded on February 12.

TABLE 23
FUEL PRICES
(Annual % change)

	2006	2007	2008	2009	
				Jan.-May.	12-month
Fuels	**-1.5**	**6.4**	**0.0**	**-15.3**	**-15.6**
Gasoline	-6.2	10.7	-6.1	-18.8	-23.8
Gas	0.3	1.3	2.7	-6.6	-4.7
Kerosene	2.2	5.8	4.2	-17.8	-14.4
Price of WTI oil (end period)					
US Dollars	62.0	91.4	41.4	56.4	
Nuevos soles	198.8	272.4	129.1	168.9	

Source: INEI. Bloomberg.

Graph 71
CRUDE PRICES AND INVENTORIES IN USA



Source: Bloomberg. US Department of Energy.

Potato:

The decline of the price of potato (10.8 percent) basically reflects the price drops recorded in February and March (5.4 and 6.9 percent) due to the higher supply of this produce from the Sierra Central, mainly from Junín, associated with higher yields of this crop as a result of rainfall in the area which contributed to accelerate its maturity process.

Rice:

The price of rice fell 7.3 percent due to an increase of supply of nearly 10 percent in the January-May period compared with the same period in 2008. Greater availability of water in the northern areas of the country and favorable prices for this grain in 2008 contributed to this. The national production of rice increased 25 percent in January-April compared with the same period last year.

Edible oils

The drop of oil prices was associated with lower import costs (FOB price fell 29 percent in May relative to December 2008 and the exchange rate declined 3.7 percent). The reduction of antidumping rights for rice imports from Argentina established by the Indecopi in February added also contributed to this price drop.

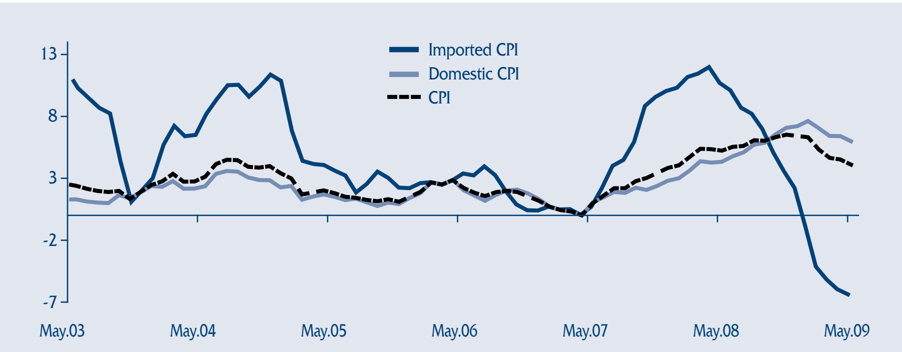
Imported inflation

82. At May imported inflation recorded an accumulated variation of -6.9 percent. This decline is explained by the evolution of the component of imported fuels (-15.3 percent) and food (-2.7 percent).

TABLE 24
DOMESTIC AND IMPORTED INFLATION
(Accumulated % change)

	weight	2006	2007	2008	2009	
					Jan.-May.	12-month
I. IMPORTED CPI	**12.1**	**0.27**	**10.46**	**2.20**	**-6.89**	**-6.88**
Food	5.4	2.08	18.83	4.75	-2.70	-3.10
Fuels	3.9	-1.50	6.45	-0.04	-15.31	-15.58
Electric appliances	1.0	-1.29	-1.50	-0.06	-0.96	-0.42
Other items	1.8	0.64	0.47	0.46	0.44	3.09
II. DOMESTIC CPI	**87.9**	**1.28**	**2.84**	**7.44**	**1.60**	**6.17**
III. CPI	**100.0**	**1.14**	**3.93**	**6.65**	**0.37**	**4.21**
Exchange rate		**-6.40**	**-7.00**	**4.47**	**-3.86**	**6.74**
Imported CPI excluding food	6.7	-1.02	4.31	0.06	-10.56	-10.22
Food and beverage domestic CPI	42.1	1.72	4.14	10.53	1.94	7.04
Domestic CPI excluding food	45.8	0.89	1.64	4.53	1.26	5.32

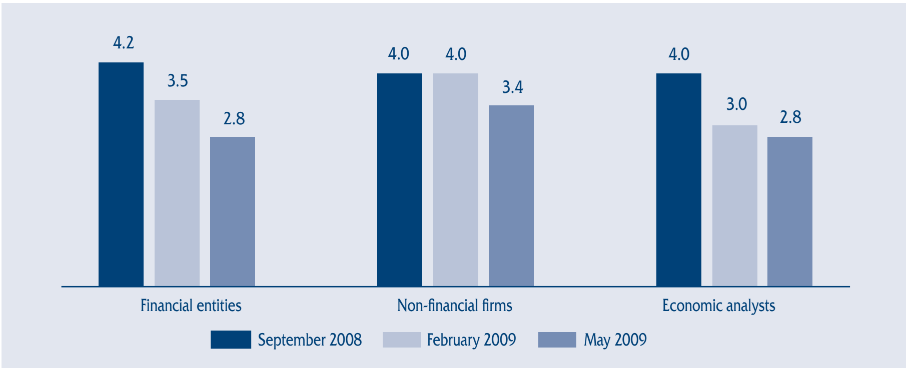
Graph 72
DOMESTIC AND IMPORTED INFLATION
(Last 12-month % change)



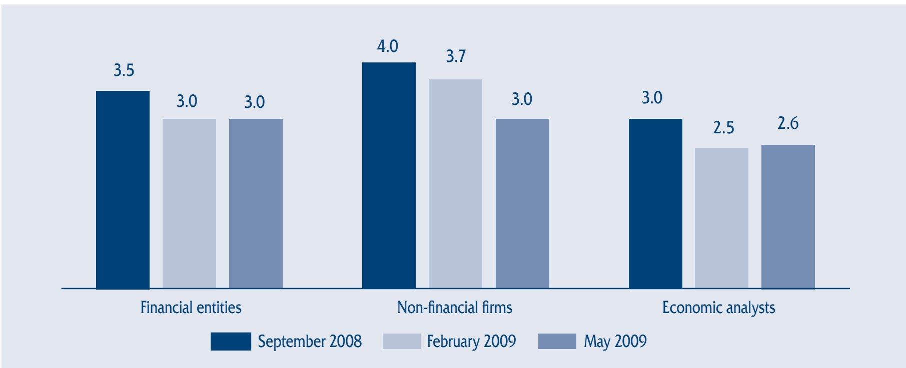
Inflation expectations

83. Economic agents' expectations of inflation in 2009 have adopted a downward trend relative to the data provided in our last Inflation Report as a result of the slowing of the annualized inflation rate observed since December. The inflation expectations of financial entities and economic analysts for this year fall within the target range. On the other hand, although the inflation expectations of non financial firms for this year are still above the target range, they have declined by 0.6 percentage points (from 4.0 to 3.4 percent). Inflation expectations for 2010 fall within the target range, even though financial entities and non financial firms expect inflation to be in the upper band level (3 percent). However, the inflation expectations of non financial firms for 2011 are still outside the target range, even though they are lower than the ones reported in our March Inflation Report.

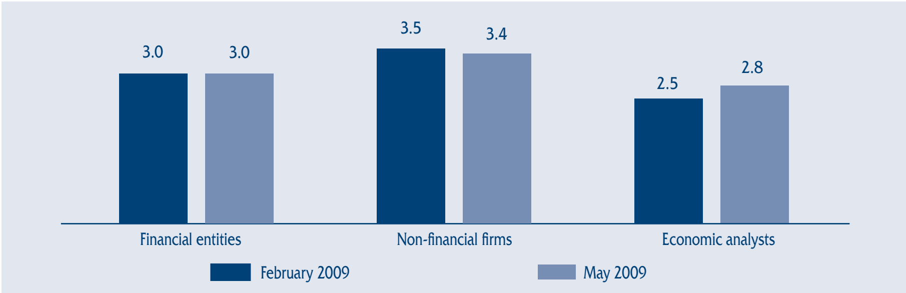
Graph 73
INFLATION EXPECTATIONS FOR 2009



Graph 74
INFLATION EXPECTATIONS FOR 2010

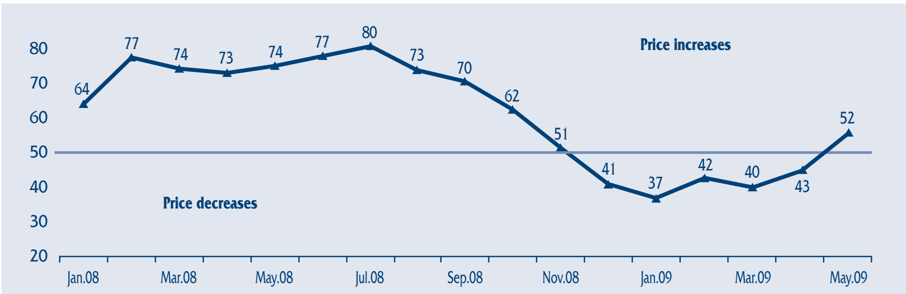


Graph 75
INFLATION EXPECTATIONS FOR 2011



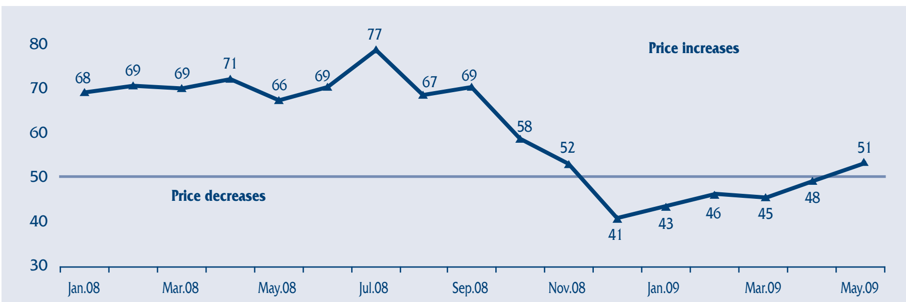
84. As regards expectations about the average prices of inputs and average sale prices in the next 3-4 months, the index of average expected input prices has increased from 42 in our March report to 52 in this report, given that the percentage of firms expecting a reduction in the prices of inputs has declined. Similarly, the index of average expected sale prices has increased from 46 to 51 in the same period, which is basically explained by the fact that a lower percentage of firms expect a reduction in sale prices.

Graph 76
AVERAGE INPUT PRICE INDEX: Next 3 - 4 months
Manufacture sector



Source: BCRP Survey on Macroeconomic Expectations. May 2009.

Graph 77
AVERAGE SALE PRICE INDEX: Next 3 - 4 months
Manufacture sector



Source: BCRP Survey on Macroeconomic Expectations. May 2009.

Inflation forecasts

85. The inflation forecast for 2009 has been revised on the downside compared with our March report due to the lower growth of economic activity and to lower expectations of inflation. Inflation is expected to converge to the target range during Q3-09.

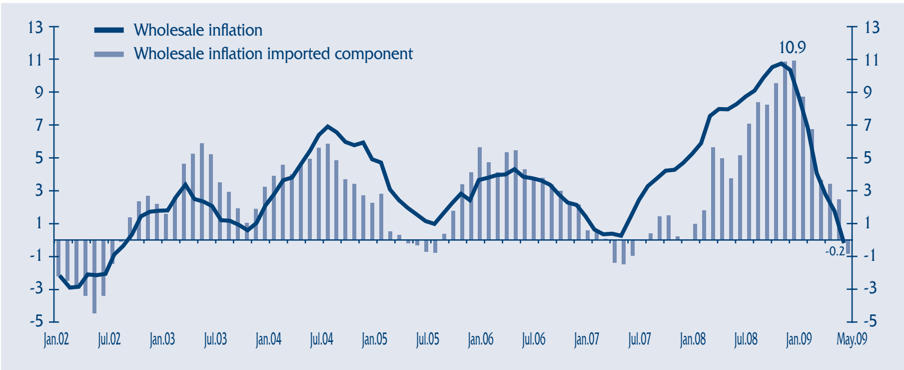
86. The downward trend of inflation has been confirmed in the first months of this year. As previously stated, last 12-month inflation has fallen from 6.5 percent in January 2009 to 4.2 percent in May. In terms of annualized quarterly variations, inflation has declined from 3.3 percent in the December 2008 - February 2009 quarter to 1.4 percent in the March - May 2009 period, while core inflation has dropped from 5.6 to 4.3 percent in the same period.

    This result is explained by the strong decline of inflation with an external origin, as well as by the lower growth of economic activity associated with the global recession. In this context, expectations of future inflation have declined, which has also contributed to a reduction in the inflationary pace.

Graph 78
INFLATION FORECAST INCLUDED IN THE INFLATION REPORT OF MARCH 2008 AND OBSERVED INFLATION

87. The forecasts are based on an initial point (Q2-09) characterized by a lower than expected imported inflation as a result of the negative impact of the international recession on the prices of imported inputs, such as crude, and also as a result of the reversal of depreciatory pressures on the nuevo sol. The impact of these two factors is reflected in the recent downward evolution of the wholesale price index and of its imported component.

Graph 79
WHOLESALE PRICE INDEX
(Last 12-month % change)



88. The projection points to a gradual upward correction of commodity prices in line with expectations of an improvement of the global economy between 2010 and 2011. Thus, higher imported inflation would have a moderate contribution on overall inflation.

89. The severe deterioration of global economic conditions has deteriorated the dynamism of domestic economic activity. This impact on the domestic economy has been enhanced by the strong adjustment of inventories. As a result of this, the slowdown of GDP growth in Q1-09 was higher than forecast in the base scenario of our March Inflation Report and closer to the risk scenario of increased deterioration of the global economy considered in said report. This lower initial point of the forecast has a downward effect on the forecast on the trend of GDP growth.

90. Global growth in 2009 has been revised downwards (from 0.2 to -1.3 percent) due to the impact of the world economic crisis. This implies a direct negative effect on exports, as well as a lower projection of terms of trade, which would decline by an average of 12.8 percent in 2009. In contrast, on the financial side, the effects of the crisis on the domestic context would be subsiding given the dynamism of the capital market, the sustained flow of credit, and the reduction of interest rates. Moreover, a gradual improvement of the global economic outlook is expected as from 2010.

91. The baseline scenario considers that the favorable results of the loosening of monetary policy and the execution of higher public spending associated with the Economic Stimulus Plan will contribute to sustain economic growth throughout the forecast horizon, especially in the second half of 2009 and during 2010.

92. On the whole, the external and domestic determinants of economic activity imply a gradual improvement of the output gap (measured as the deviation of GDP vis-à-vis the potential output). However, given the recent evolution of this indicator,

demand pressures on inflation would continue to be negative during 2009 and slightly positive thereafter.

The forecast on GDP growth is corrected from 5.0 to 3.3 percent in 2009 and from 6.0 to 5.5 percent in 2010. A growth rate of 5.7 percent is estimated for 2011.

93. Moreover, there is evidence that economic agents will reduce their inflation expectations. In a context of reduction of inflationary rates and of deceleration of demand, these expectations should continue declining sustainedly and gradually converge to the 2 percent target.

VII. Balance of Risks

94. Two of the risk factors considered in our previous report materialized: on the one hand, the global economy deteriorated more than expected in the central forecast scenario and, on the other hand, domestic expenditure was lower than anticipated, mainly due to the inventory adjustment.

95. Given the macroeconomic context, the forecasts are still subject to a great deal of uncertainty. The main risks that could cause inflation to deviate from the central forecast scenario include the same risks considered in our previous Report and also include the risk of having higher food and fuel prices as an additional factor:

- **Increased deterioration of the global economy.** The baseline scenario considers a greater deterioration of the global economy than the one considered in our March Report, although offset by a lower decline of terms of trade. However, there is a probability of having a more prolonged global recession if credit conditions in developed countries do not normalize. This risk would imply lower economic growth and lower inflation rates than the one considered in the baseline scenario.

  A more flexible monetary stance than the one considered in the baseline scenario would be adopted in this scenario.

- **Lower inflationary pressures due to lower domestic spending.** The central forecast on economic growth is subject to uncertainty factors, such as the level of deceleration of private investment, associated with the effect of the international crisis; the finalization of the process of inventory adjustments, and the implementation of the Economic Stimulus Plan. In this context, the growth of demand and economic growth could be lower than projected in the baseline scenario.

  In this situation, the Central Bank would loosen its monetary policy without jeopardizing compliance with the inflation target.

- **Constraints in energy supply.** The supply of electricity continues to be close to the limit of its potential capacity, which increases the probabilities of failures in this service. Additionally, adverse climatic conditions could aggravate the balance between the supply and the demand of electric energy, which would generate increases in electricity rates or cause that more costly alternative energy sources be used.

  This factor would only imply changes in terms of monetary policy if this affected inflation expectations.

- **Higher prices of food and fuel commodities.** The baseline scenario considers a moderate increase in the prices of food and fuel simultaneously with the recovery of the world economy. However, a scenario of higher rises in these prices would lead the domestic prices of food and fuels above the levels considered in the central forecast.

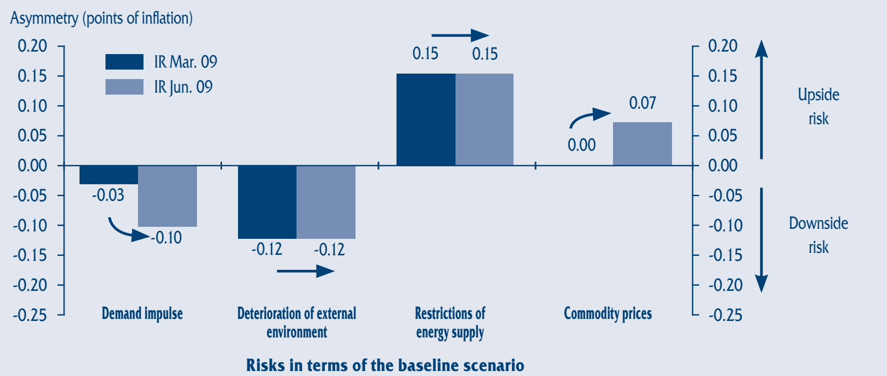
  In this context, monetary policy would remain unchanged as long as inflation expectations are not affected and as long as the impact on inflation is transitory.

96. The risks have shifted more towards the pessimistic side with respect to domestic spending. Moreover, the risks of a greater deterioration of the global economy and of energy supply constraints persist. Likewise, the risk of higher prices of commodities and crude induces a positive bias (CK) on the forecast.

97. Weighing the above mentioned risks against the baseline scenario shows a neutral balance for the inflation forecast, like in the case of our March Inflation Report.

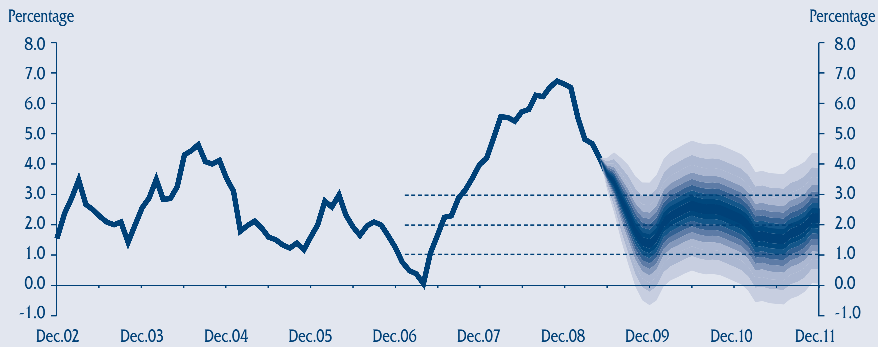
98. This implies a density forecast of inflation of a symmetric nature. This means that there is the same probability that inflation will be above or below the level considered in the baseline scenario throughout the forecast horizon. The balance of risks in terms of GDP growth is considered asymmetric and with a downward bias.

Graph 80
INFLATION FORECAST: BALANCE OF RISKS 1/
(2 year-ahead inflation deviations in % points)



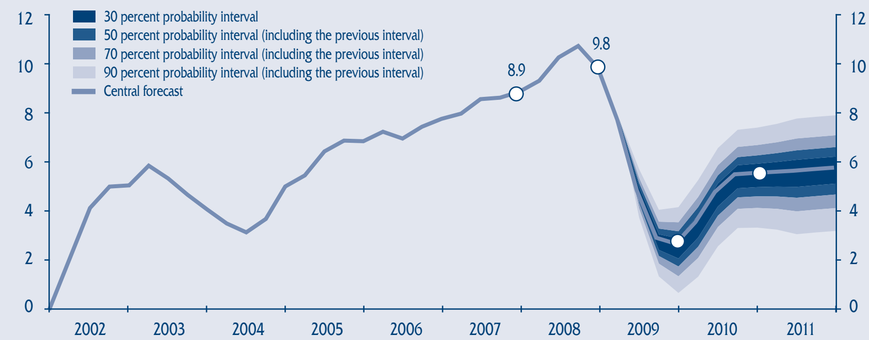
1/ This graph shows changes in risk perception compared with the September 2008 Inflation Report. The size and sign of bars show the asymmetry of each risk factor in the inflation forecast distribution. In contrast with the previous report. added total effects generated a slightly downward asymmetry in the inflation forecast.

Graph 81
INFLATION FORECAST
(12-month % change)



Note: The graph shows the inflation prediction bands along the forecast horizon. The darkest band around the central forecast represents a 10 percent probability of occurrence. while all the other bands represent a 90 percent probability of occurrence.

Graph 82
GDP GROWTH DENSITY FORECAST
(Annual % change of GDP in each quarter)



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

CONCLUSION

99. Last 12 month-inflation should fall within the target range in Q3-09 and should record a rate of less than 2 percent at the end of the year, fluctuating thereafter around 2 percent in the forecast horizon.

100. The forecasts included in this report consider the impact of the loosening of monetary policy in a context of world recession and of deceleration of domestic demand, and maintain a neutral balance of risk in terms of the baseline inflation forecast.

APPENDIX
INFLATION REPORT FORECAST

	2007	2008	2009 1/ IR Mar.09	2009 1/ IR Jun. 09	2010 1/ IR Mar.09	2010 1/ IR Jun. 09	2011 1/ IR Jun. 09
Real % change							
1. GDP	8.9	9.8	5.0	3.3	6.0	5.5	5.7
2. Domestic demand	11.8	12.3	5.0	2.4	5.7	5.7	5.8
a. Private consumption	8.3	8.7	5.5	2.5	5.2	3.6	4.2
b. Public consumption	4.5	1.8	2.6	6.8	4.5	3.4	3.6
c. Private fixed investment	23.4	25.6	8.0	2.5	8.0	6.1	6.2
d. Public investment	18.4	42.8	51.1	49.4	13.2	14.7	11.4
3. Exports (goods and services)	6.2	8.2	1.9	-1.3	6.6	5.5	9.6
4. Imports (goods and services)	21.3	19.9	2.1	-4.7	5.1	6.2	9.2
5. Main trade partners' economic growth	4.7	2.8	-0.4	-1.7	2.6	2.2	3.3
Note:							
Output gap 2/ (%)	1.7	3.8	0.5 to 1.0	-1 to 0	0 to 0.5	-1 to 1	-1 to 1
% change							
6. Forecast inflation	3.9	6.7	1.75-2.25	1.0-2.0	1.75-2.25	1.5-2.5	1.5-2.5
7. Average price of crude oil	9.4	38.5	-50.8	-46.1	19.9	20.2	6.9
8. Average price of wheat	45.2	26.7	-23.3	-22.7	9.1	13.1	2.8
9. Nominal exchange rate 3/	-7.0	4.5	5.1	-0.2	-0.2	1.5	0.3
10. Real Multilateral exchange rate	-1.7	-4.8	-3.7	-7.7	0.3	2.2	0.3
11. Terms of trade	3.6	-13.3	-14.6	-12.8	2.4	-0.2	-0.2
a. Export price index	14.0	5.1	-26.6	-20.3	6.1	4.4	2.3
b. Import price index	10.0	21.2	-14.1	-8.7	3.6	4.7	2.5
Nominal % change							
12. Currency in circulation	27.1	16.7	13.0	7.0	13.5	8.5	9.0
13. Credit to the private sector 4/	33.0	29.6	13.0	9.0	15.0	11.5	12.5
% of GDP							
14. Domestic savings rate	24.1	23.6	24.0	23.4	24.4	25.0	26.4
15. Domestic investment rate	22.9	26.9	27.4	26.5	27.7	28.0	29.1
16. Current account of the balance of payments	1.1	-3.3	-3.3	-3.2	-3.3	-3.1	-2.6
17. Trade balance	7.7	2.4	-1.1	0.9	-0.3	0.7	0.9
18. Gross external financing to the private sector 5/	9.1	5.6	4.8	5.4	4.6	5.5	5.3
19. Current revenue of the general government	20.7	20.8	19.4	18.5	19.1	18.7	19.0
20. Non-financial expenditure of the general government	16.0	17.3	19.1	19.3	18.9	19.2	19.4
21. Overall balance of the non-financial public sector	3.1	2.1	-1.0	-1.8	-1.0	-1.7	-1.5
22. Total public debt balance	29.6	24.0	25.6	25.6	23.5	24.8	23.5

IR: Inflation Report
1/ Forecast.
2/ Differential between GDP and potential GDP (percentage).
3/ Expectations of economic agents about the exchange rate expectations according to the survey on macroeconomic expectations.
4/ Constant exchange rate.
5/ Includes foreign direct investments and private sector's long term disbursements.