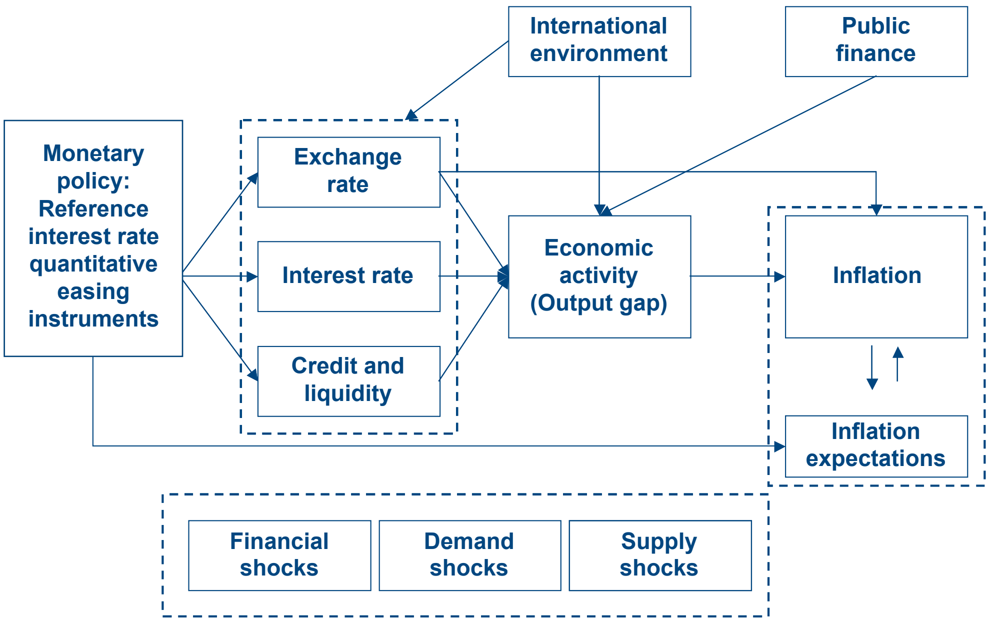
INFLATION REPORT:

Recent trends and macroeconomic forecasts 2010-2012

June 2010



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INFLATION REPORT
Recent trends and macroeconomic forecast

CENTRAL RESERVE BANK OF PERU

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CONTENT

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

Foreword

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

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

- Compliance with the inflation target is continuously evaluated; that is, the Central Bank considers the accumulated rate of inflation in each month and not only at year's end. The monetary policy of the BCRP is of a preventive nature and therefore aims at anticipating upward or downward inflationary pressures in order to prevent them. In the event of any deviation of inflation from the target, the Central Bank implements the necessary measures to return inflation to the target. The Central Bank also takes into account that inflation can be influenced by factors that are beyond the control of monetary policy, such as supply shocks or the prices of imported goods.

- 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. Additionally, the Central Bank manages other monetary policy instruments with which it can affect more directly the volumes of liquidity and credit, such as reserve requirements in domestic and foreign currency.

- 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 discusses the forecasts for 2012 as part of its forecast horizon.

- The Central Bank will publish its next Inflation Report in September 2010.

Summary

i. Without showing inflationary pressures, Peru recorded high economic growth and a high growth of domestic demand in the first months of the year. In fact, the country's level of economic activity is estimated to still be below its potential level in Q2. The rate of inflation returned to the target range in May after having fallen below this range for seven months. Core inflation has been showing levels close to the 2 percent target in the last months. In this context, the Central Bank raised the reference rate by 25 basis points in May and in June, after maintaining this rate at historical minimum levels (1.25 percent) for 9 months. The Central Bank's monetary policy communiqués have emphasized that the Board permanently oversees inflation forecasts and inflation determinants and stands ready to adopt future adjustments in the monetary stance to ensure that inflation remains around the target.

ii. The evolution of indicators of economic activity in the main developed countries remains favorable. Positive indicators have been observed in the last months in both this group of economies and in some emerging countries, especially in Asia, as reflected in the recovery of consumption and the level of inventories, the reduction of the rate of unemployment, and the increase of foreign trade flows. However, uncertainty in international financial markets has increased due to the severe fiscal problems being faced by some countries in the Eurozone. Additionally, increased risk aversion, which initially had concentrated in European debt markets, has extended to stock and commodity markets.

Despite the problems observed in these economies, the central forecast scenario of this Report considers an upward revision of global growth from 3.5 to 4.0 percent for 2010 given the execution of favorable economic data in the first part of the year. It is also considered that this level of growth would continue in the forecast horizon until 2012.

iii. With the level of economic activity observed in Q1, the Peruvian economy would be recording three consecutive quarters of growth of GDP in deseasonalized terms, which confirms that the Peruvian economy has been going through a stage of recovery since mid-2009. The evolution of advanced indicators of activity also shows that this recovery is mainly sustained by non primary sectors, which in turn have an important positive effect on employment. Private expenditure, especially investment, has been growing at two-digit rates, consistently with the increased growth of several investment projects which had reprogrammed their investment horizon in the previous year.

In line with this evolution, the forecast on GDP growth in 2010 has been increased from 5.5 to 6.6 percent, while growth rates of 6.0 percent are expected for 2011 and 2012. With this, the output gap –which became negative in 2009 due to the period of slowdown resulting from the financial crisis– would be gradually closing towards 2012, thus preventing that this foreseen pace of growth generate inflationary pressures.

iv. The fiscal result foreseen in the central forecast scenario considers the already announced fiscal restraint measures. The Central Bank maintains the forecasts considered in our previous Report of deficits of 1.6 percent and 1.0 percent of GDP in this year and 2010, respectively, given that the projection of the real growth of revenues has been revised upwards (from 10.1 to 14.0 percent), compensating the revision of the general government investment on the upside (from 15.0 to 18.7 percent). This evolution of the fiscal deficit is consistent with the reduction of the deficit considered in the Multiannual Macroeconomic Framework.

v. The evolution of the rate of inflation during the last three months has been in line with the projections of our previous Report. A slight upward trend has been observed in the evolution of the prices of some foodstuffs and fuels in the first months of the year.

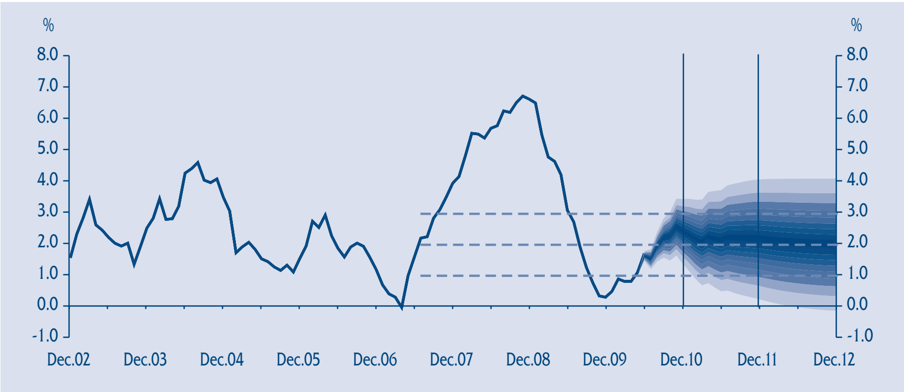
Inflation is expected to remain within the target range as a result of an output gap that is increasingly closer to its level of equilibrium, inflation expectations in line with the inflation target, and a moderate rate of imported inflation.

vi. The main risks that could deviate inflation from the base scenario base in the forecast horizon are the following:

- **Deterioration of the international environment**. The baseline scenario considers that global economic activity would recover and that terms of trade would maintain high although declining levels during the forecast horizon (2010 - 2012). However, this recovery could be offset if the difficult financial situation the Eurozone is going through is not resolved. An eventual deepening of the financial crisis affecting European countries would not only contract the demand of an important trading partner, but could also spread to international markets and slow down the growth of the world economy. This scenario would imply a lower global demand for commodities, lower prices for a great deal of our primary exports, unfavorable international credit conditions, and a subsequent slowdown of growth in the domestic economy. Should this risk crystallize, the Central Bank would maintain monetary stimulus for a longer period of time. The BCRP maintains a high level of international reserves and different liquidity injection mechanisms to face this contingency.

- **Higher growth in the domestic economy**. The baseline scenario considers a sustained growth path of domestic demand, without inflationary pressures. However, if private and public expenditure increase significantly above the levels considered in the baseline scenario, the Central Bank would reduce monetary stimulus more rapidly.

INFLATION FORECAST
(12-month % change)



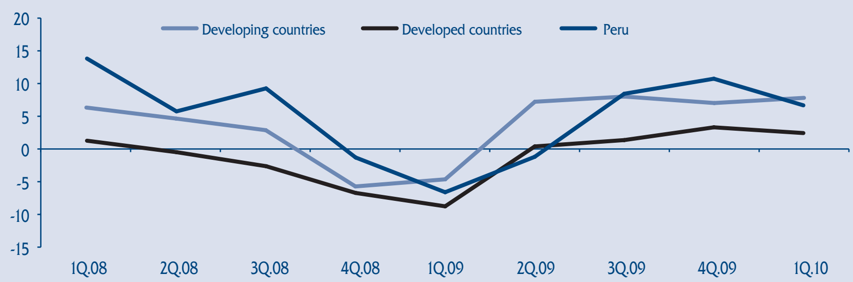
I. International environment

Global trends

1. So far this year, the main developed countries (United States, Japan, and Germany) and emerging economies (particularly, China and India) have had a positive evolution –which has been even better than foreseen– since our last Inflation Report was published.

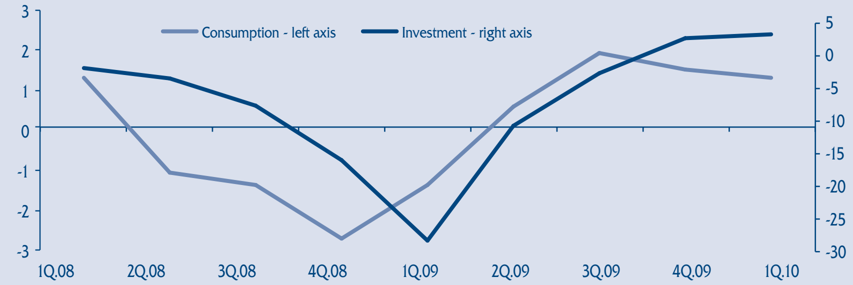
2. The aggregate estimate of global GDP shows that in Q1 the level of economic activity in developed economies has grown at an annual rate of 3.0 percent, despite the impact of a more severe winter in the northern hemisphere. This rate of growth would have reached 7.6 percent in emerging economies, with the dynamism of China and India being noteworthy. These results in Q1 show not only a higher demand for exports, but also a positive contribution of consumption and private investment.

Graph 1
GDP: SEASONALLY ADJUSTED ANNUALIZES QUARTERLY GROWTH
(%)



Source: JPMorgan, and BCRP.

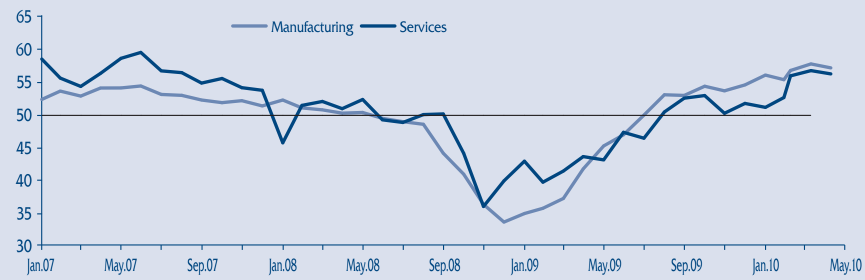
Graph 2
DEVELOPED COUNTRIES: GROWTH OF CONSUMPTION AND INVESTMENT
(Annualized quarterly variation)



Source: JPMorgan.

3. More specific indicators reflect a similar trend. The index of manufacturing activity –Purchasing Managers Index (PMI)– continued to be in the expansion area for the tenth consecutive month in May and reached its highest value in four years in April. Moreover, the index of services recorded its highest level since October 2007 and remains in the area of expansion since August 2009, which would be reflecting an improvement in domestic demand.

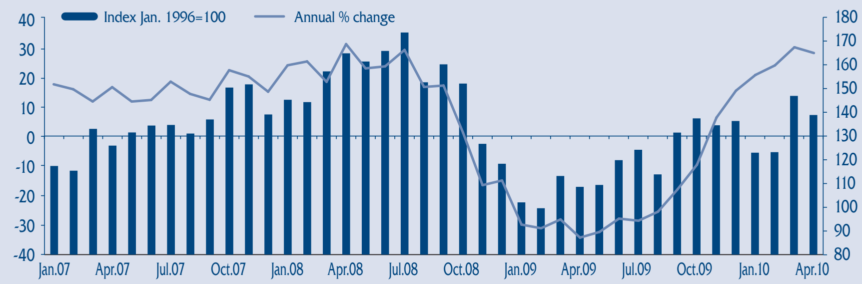
Graph 3
GLOBAL PURCHASING MANAGERS INDEX (PMI)



Source: JPMorgan.

4. Maintaining the trend described in our previous Report, international trade continued recovering. In terms of value, global trade, which contracted 23 percent in 2009, has been recovering at annual rates close to 25 percent, although without reaching yet the levels observed prior to the crisis. Even though part of this improvement is explained by the increase in the price of commodities in the first months of the year, higher volumes of trade have also been observed. This accounts for the growth of the economies of South East Asia and also of other economies with a strong export bias, such as Germany and Japan. The recovery of oil exporting countries such as Middle East countries and Russia is noteworthy.

Graph 4
WORLD EXPORTS
(Annual % change. Base index January 2006=100)



Source: OMC.

Graph 5
REUTERS COMMODITY INDEX
(CRB: Commodity Research Bureau)

Source: Bloomberg.

5. In line with this evolution, the growth of global GDP has been revised upwards from 3.5 to 4.0 percent for 2010. The rate of growth in 2011 and 2012 would be approximately 4 percent, lower than the one observed in the years prior to the international crisis.

TABLE 1
WORLD GROWTH
(Annual % change)

			2010			2011		2012
	2008	2009	1Q10*	IR Mar.10	IR Jun.10	IR Mar.10	IR Jun.10	IR Jun.10
Developed countries	**0.5**	**-3.2**	**3.0**	**2.1**	**2.3**	**2.4**	**2.4**	**2.3**
1. United States	0.4	-2.4	3.0	3.1	3.2	2.9	2.9	2.5
2. Eurozone	0.7	-4.1	0.8	0.9	0.8	1.6	1.3	1.5
Germany	1.3	-4.9	0.6	1.4	1.5	1.6	1.5	1.5
France	0.3	-2.6	0.5	1.2	1.2	1.9	1.5	1.7
3. Japan	-1.2	-5.2	5.0	1.5	1.9	1.9	1.9	1.9
4. United Kingdom	0.5	-4.9	1.2	1.2	1.1	2.2	2.0	2.4
5. Canada	0.4	-2.6	6.1	2.4	3.2	3.4	3.3	2.9
6. Other developed countries	1.7	-1.2	5.8	3.3	3.8	3.4	3.4	3.5
Developing countries	**6.2**	**2.4**	**7.6**	**5.3**	**5.9**	**5.8**	**6.0**	**6.0**
1. Africa	5.5	2.1	4.7	4.0	4.7	5.3	5.9	5.2
2. Central and Eastern Europe	3.1	-3.6	4.2	1.7	2.5	3.9	4.0	4.0
3. Community of Independent Countries	5.5	-6.6	2.4	2.9	3.5	4.0	3.9	4.2
Russia	5.6	-7.9	2.0	3.2	3.5	3.6	3.7	3.7
4. Developing Asia	8.0	6.6	10.8	7.6	8.0	7.7	7.8	7.9
China	9.6	8.7	13.1	9.2	9.5	9.2	9.2	9.2
India	7.5	5.7	10.4	6.5	7.1	6.5	7.0	7.0
5. Middle East	5.1	2.4	4.5	4.2	4.5	4.8	4.8	4.8
6. Latin America and the Caribbean	4.3	-1.8	5.8	3.5	4.0	3.7	3.8	3.8
Brazil	5.1	-0.2	11.3	4.8	5.5	3.5	4.0	4.1
World Economy	**3.0**	**-0.6**	**5.1**	**3.5**	**4.0**	**4.0**	**4.0**	**4.0**
Memo:								
BRICs 1/	8.0	4.8	10.9	7.2	7.7	7.1	7.4	7.3
Peru's trading partners 2/	2.7	-1.1	4.0	3.3	3.6	3.5	3.5	3.5

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

6. This positive outlook contrasts with the fiscal situation of some economies in the Eurozone. Greece's high financial requirements have significantly increased market uncertainty, which has led the Eurozone countries to adopt a financial support package of €110 billion that will allow it to meet its commitments in the next three years. In spite of this package and the establishment of a € 750 billion fund that would serve to support the economies in the Eurozone, there are still doubts about the fiscal sustainability of some European economies (basically Greece, Portugal, Ireland, and Spain).

TABLE 2
PUBLIC DEBT AND FISCAL DEFICIT: 2009
(% of GDP)

	Fiscal Result	Primary Result	Gross Public Debt	Nominal GDP (Billions of US$)	% of World GDP
Eurozone	**-6.3**	**-3.5**	**78.7**	**12,517**	**21.6**
Germany	-3.3	-0.7	73.2	3,353	5.8
France	-7.5	-5.2	77.6	2,676	4.6
Netherlands	-5.3	-3.0	60.9	795	1.4
Belgium	-6.0	-2.3	96.7	470	0.8
Austria	-3.4	-0.7	66.5	382	0.7
Finland	-2.2	-1.0	44.0	238	0.4
Slovakia Republic	-6.8	-5.3	35.7	88	0.2
Luxemburg	-0.7	-0.3	14.5	52	0.1
Slovenia	-5.5	-4.1	35.9	49	0.1
Cyprus	-6.1	-3.6	56.2	24	0.0
Malta	-3.8	-0.6	69.1	8	0.0
Italy	-5.3	-0.6	115.8	2,118	3.7
Spain	-11.2	-9.4	53.2	1,464	2.5
Greece	-13.6	-8.5	115.1	331	0.6
Portugal	-9.4	-6.6	76.8	228	0.4
Ireland	-14.3	-12.2	64.0	228	0.4

Source: Moody's, Eurostat and IMF.

The initial effects of the European crisis would be limited mainly to slower growth in these economies, which represent nearly 15 percent of GDP in the Eurozone and 4 percent of global GDP. This lower growth would be the result of the deterioration of external financing conditions and of the implementation of fiscal adjustment policies that may allow maintaining the sustainability of the public debt.

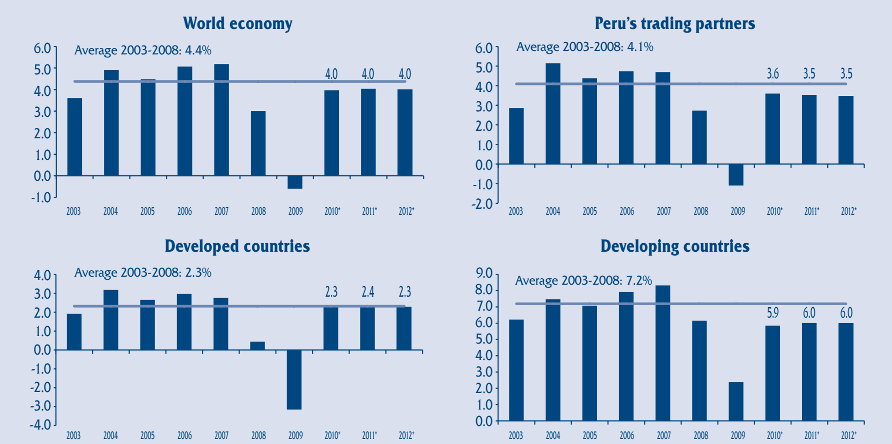
However, there is the risk that other economies may be affected. First of all, the fear that this might spread to other developed economies with high debt levels could lead to raise long tem interest rates or to withdraw fiscal stimulus earlier than expected, affecting the outlook on the global economy. There is also the risk of contagion through the financial channels given the exposure of the Eurozone countries –particularly France, Italy, and Germany– to the banks of the affected economies.

Recently, uncertainty about fiscal sustainability has spread to other economies in the European Community, such as Hungary. This has generated a strong volatility in financial markets, a decline in stock markets, a strengthening of the dollar, and a drop in commodity prices. In most of these variables, the events observed in the last month more than compensated the gains recorded in the previous months. These recent events introduce an element of uncertainty in the projection of global growth and the evolution of the different markets.

Global economic activity

7. So far this year, the economic evolution has been favorable both for developed economies and emerging economies. The former have been recovering from the 3.2 percent decline of 2009, with improvements being observed mainly in the major economies, in part as a result of the recovery of inventories.

Graph 6
WORLD GROWTH FORECAST



Source: IMF and BCRP.

8. In the **United States (USA),** economic activity grew 3.0 percent in Q1 supported by the recovery of private consumption and the accumulation of inventories, as in the previous two quarters (the contribution of both variables to growth was 2.4 and 1.7 percentage points, respectively). Moreover, the indicators of retail sales in April and May show a favorable evolution of private consumption.

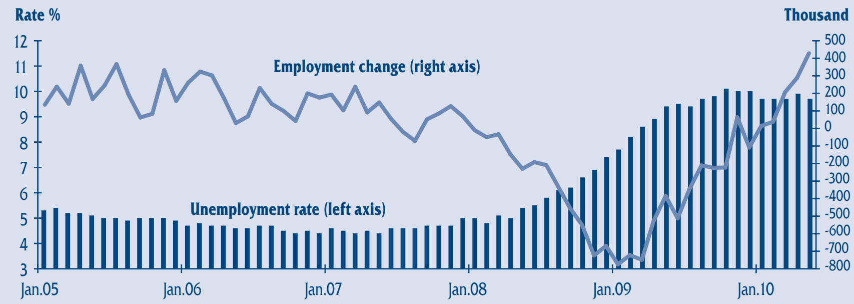
TABLE 3
USA: CONTRIBUTION TO GROWTH
(Seasonally adjusted annualized quarterly rates)

	1Q.09	2Q.09	3Q.09	4Q.09	1Q.10
GDP	**-6.4**	**-0.7**	**2.2**	**5.6**	**3.0**
Personal consumption	0.4	-0.6	2.0	1.2	2.4
Durable	0.3	-0.4	1.4	0.0	0.9
Non-durable	0.3	-0.3	0.2	0.6	0.6
Services	-0.1	0.1	0.4	0.5	1.0
Gross investment	-9.0	-3.1	0.5	4.4	1.7
Fixed investment	-6.6	-1.7	-0.2	0.6	0.0
Non-residential	-5.3	-1.0	-0.6	0.5	0.3
Residential	-1.3	-0.7	0.4	0.1	-0.3
Inventories	-2.4	-1.4	0.7	3.8	1.7
Net exports	2.6	1.7	-0.8	0.3	-0.7
Exports	-4.0	-0.5	1.8	2.4	0.8
Government expenditure	-0.5	1.3	0.6	-0.3	-0.4

Source: BEA.

The gradual recovery of private consumption is influenced by the stabilization of the labor market. The rate of unemployment fell 9.7 percent in May (versus 10 percent at end 2009) and 431 thousand new jobs were created.

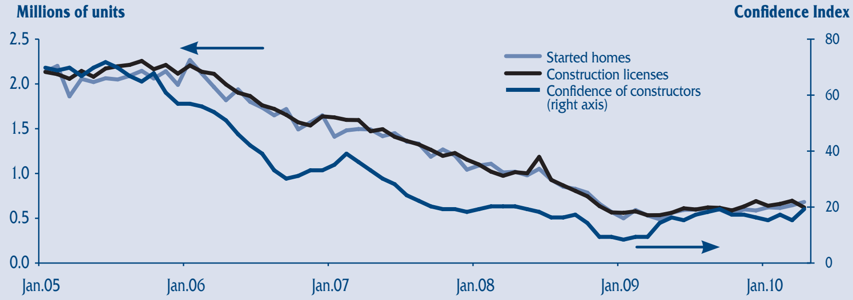
Graph 7
USA: NEW EMPLOYMENTS (thousand) AND UNEMPLOYMENT RATE (%)



Source: Bloomberg.

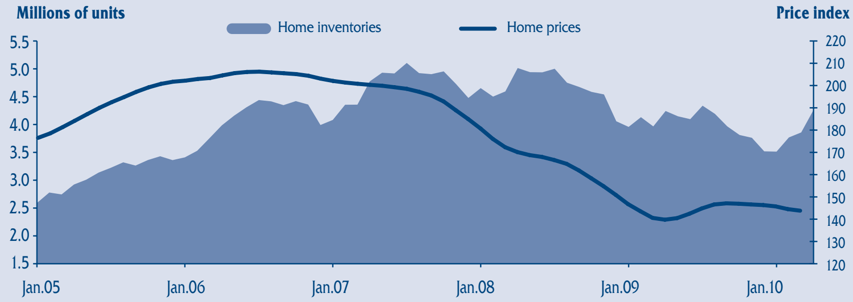
Likewise, the real estate market showed signs of recovery registering a favorable evolution in home sales and some stability in terms of prices. It should be pointed out, however, that the proximity of the expiration of tax incentives (April 2010) would have partly influenced this evolution.

Graph 8
USA: RESIDENTIAL CONSTRUCTION



Source: Bloomberg.

Graph 9
USA: HOMES' PRICES AND INVENTORIES IN THE REAL STATE MARKET



Source: Bloomberg.

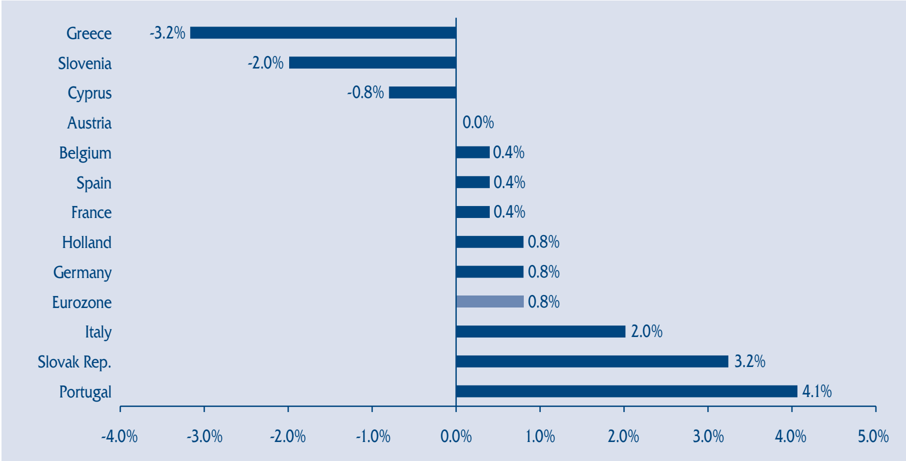
Inflation in USA appears to be under control. As of May, the consumer price index recorded an annual increase of 2.0 percent, while the core component of inflation showed a rate of 0.9 percent. Conditions in the labor market and the degree of utilization of installed capacity (currently at 73 percent) would be supporting this trend that could favor the maintenance of low monetary policy rates for an extended period of time. It is worth pointing out that credit conditions have improved in the consumer sector, but remain unchanged in the case of firms.

In line with this evolution, it is estimated that the U.S. economy would grow 3.2 percent in 2010 and 2.9 percent in 2011. The assumption behind this projection is that consumption and private investment would continue to improve and would allow compensating the likely culmination of the process of inventory recovery and the withdrawal of fiscal stimulus expected to take place next year.

9. The Eurozone, which recorded a growth rate of 0.8 percent in Q1, has also had a relatively favorable performance so far this year. The larger economies recorded

positive rates associated with the dynamism of the export sector (Germany and Holland) and domestic demand (France and Italy). In contrast, Greece recorded a contraction of 3.2 percent in Q1.

Graph 10
EUROZONE: GDP GROWTH 1Q.10
(Seasonally adjusted quarterly annualized rates)



Source: Eurostat.

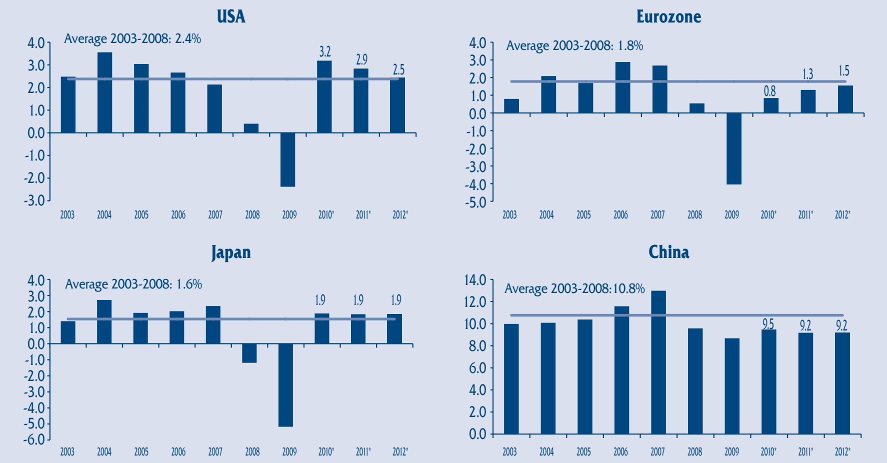
At the sector level, manufacturing has continued showing the positive trend observed in recent months: falling for eight consecutive months in the expansion area, the PMI index recorded a value of 55.8 in May.

However, fiscal problems in some European economies have affected growth prospects in the region. Therefore, a growth rate of 0.8 percent is estimated for 2010. Moreover, a recovery of 1.3 percent and of 1.5 percent is estimated for 2011 and 2012, respectively. These rates are slightly lower than the ones considered in our previous Report.

10. Continuing with the positive trend observed since Q2-2009, **Japan's** economy grew 5.0 percent in Q1-2010. This trend is supported by both exports and domestic demand, as well as by a recovery of inventories. In terms of domestic demand, the favorable evolution of consumption –supported by a low rate of unemployment (5.0 percent, the lowest rate of unemployment recorded in the main developed countries)– is worth pointing out.

In line with this trend, Japan is estimated to grow 1.9 percent in 2010 and 2011 after the contraction of 5.2 percent registered in 2009. The factors that would offset a greater recovery include the fiscal situation, the presence of deflationary pressures, and the appreciation of the yen (the highest appreciation recorded by one of the currencies of developed countries). Moreover, the growth of investment is also constrained by the excess of installed capacity.

Graph 11
WORLD GROWTH FORECAST



Source: IMF and BCRP.

11. In terms of **other developed economies**, the evolution of Asian countries (Korea, Taiwan, Singapore, and Hong Kong) with annualized growth rates between 7.5 and 3.9 percent in Q1 stands out. Particularly, exports of electronic products have recovered significantly in a context of restoration of inventories along Asia's production chain. Non-electronic exports have also been showing a positive evolution in recent months, favored by the higher dynamism of developed countries and China.

    At the same time, this expansion has translated into higher employment –supported by the government job creation programs implemented in these countries– and therefore into a strengthening of domestic demand.

12. **Emerging economies** have also shown a positive evolution. The recovery of Asian economies, particularly China and India, and several Latin American economies has been noteworthy. The recovery of trade volumes and the increase of commodity prices until the month of May added onto the stimulus policies implemented in these countries.

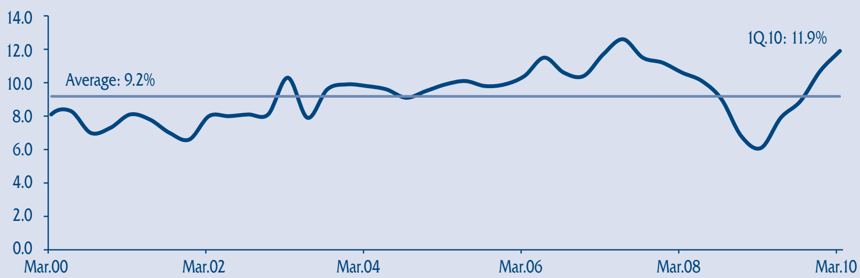
TABLE 4
GDP: QUARTERLY EXECUTION
(Growth rates compared to the same quarter of the previous year)

	Nominal GDP 2009 (Billions of US$)	2008 IV	2009 I	2009 II	2009 III	2009 IV	2010 I
Emerging Asia							
China	4,909	6.8	6.1	7.9	8.9	10.7	11.9
Korea	833	-3.3	-4.3	-2.2	1.0	6.0	7.8
India	1,236	5.8	5.8	6.1	7.9	6.5	8.6
Indonesia	539	5.3	4.5	4.1	4.2	5.4	5.7
Malaysia	191	0.1	-6.2	-3.9	-1.2	4.4	10.1
Latin America							
Brazil	1,574	0.8	-2.1	-1.6	-1.2	4.3	9.0
Chile	162	0.7	-2.1	-4.5	-1.4	2.1	1.0
Colombia	229	-1.0	-0.5	-0.3	-0.2	2.5	-.-
Mexico	875	-1.1	-7.9	-10.0	-6.1	-2.3	4.3
Peru	127	6.5	1.9	-1.2	-0.6	3.4	6.0

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

China's economy has continued showing a strong dynamism so far this year as a result of the growth of private investment and the recovery of the external sector. GDP grew 11.9 percent in Q1 compared to the same period in 2009 –a rate nearly 3 points higher than the average rate in the decade– after closing Q4-2009 with a growth rate of 10.7 percent.

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



Source: Bloomberg.

However, concerns about an overheating of China's economy continued. Several indicators of activity in May support these concerns: industrial production continued growing at rates close to 20 percent, CPI inflation reached an annual rate of 3.1 percent annual in May (2.8 percent in April), and home prices have increased by nearly an annual 13 percent in the same month. On the other hand, credit in the financial system has grown more than expected (639 billion yuan) in the last month.

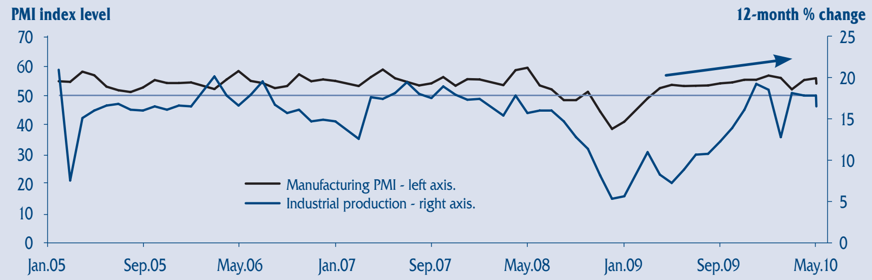
In this context, between January and May the Chinese authorities implemented a series of measures to stop the possible formation of a bubble in the real estate sector and restrict credit conditions in the economy. Among others, these measures include raising reserve requirements (with an accumulated increase of 150 bps. since February), establishing a quota system for bank loans, and regulatory measures in the real estate sector. Furthermore, a stress test considering a context of appreciation of the yuan was applied to banks.

TABLE 5
CHINA ACTIVITY INDICATORS

		Previous	Survey	Executed
Real GDP (% quarterly change vs previous year)	1Q.10	10.7%	11.7%	11.9%
Inflation (12-month % change)	May	2.8%	3.0%	3.1%
Manufacturing PMI	May	55.7	54.5	53.9
Industrial production (12-month % change)	May	17.8%	17.0%	16.5%
Investment in fixed assets (12-month % change)	May	26.1%	25.7%	25.9%
Retail sales (12-month % change)	May	18.5%	18.5%	18.7%
Trade balance (US$ billion)	May	1.7	8.2	19.5
Exports (12-month % change)	May	30.5%	32.0%	48.5%
Imports (12-month % change)	May	49.7%	44.7%	48.3%

Source: Bloomberg.

Graph 13
CHINA: MANUFACTURING PMI AND INDUSTRIAL PRODUCTION



Source: Bloomberg.

13. Year to date, the evolution of **Latin American** economies has been in general favorable, even though differences are observed in terms of the pace of recovery by countries. Inflation in most economies has reversed the downward trend observed in 2009 and inflation expectations for the end of the year are gradually increasing as activity resumes its dynamism. Growth is being driven

by consumption, investment, and external demand, in addition to the inventory component. The data on executed growth in Q1 were positive, but there are some exceptions. Activity in Chile was affected by the earthquake and Mexico recorded a slight contraction. The region is estimated to grow 4.0 percent in 2010 (0.5 points more than forecast in our March Report) and 3.8 percent in the next years.

In addition to the dynamism of domestic demand, external factors –particularly capital flows– would contribute to this expansion: the IMF estimates that net capital inflows, which amounted to US$ 32.3 billion in 2009, would increase to US$ 79 billion in 2010 and reach US$ 98 billion in 2011, with flows of foreign direct investment being worth pointing out. Moreover, the recovery of the volumes of trade –estimated at around 10 percent in the region in 2010– has influenced growth expectations, benefiting especially the countries with a higher diversification of exports, such as Brazil, Chile, and Peru, which have a considerable percentage of exports to China.

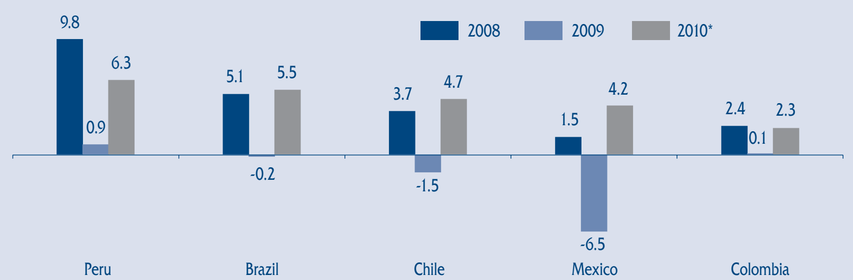
TABLE 6
LATIN AMERICA: ECONOMIC INDICATORS

Country	2009					2010	
	Terms of trade (% change)	Exports destination: China (% of total exports)	Exports destination: USA (% of total exports)	Exports destination: Eurozone (% of total exports)	Public Debt* (% GDP)	Inflation (% change)	GDP Growth (% change)
Argentina	-5.5	6.7	6.2	15.4	47.6	10.7	5.0
Brazil	-2.4	13.4	10.4	19.1	63.0	5.5	6.3
Chile	1.2	24.0	11.0	16.0	6.1	3.5	4.5
Colombia	-17.2	3.0	39.0	11.0	41.0	3.5	3.0
Costa Rica	6.7	6.3	27.6	12.7	27.8	8.1	3.7
Ecuador	-11.5	0.9	33.2	13.7	18.2	4.2	2.2
El Salvador	7.9	0.1	46.6	5.6	50.7	3.8	1.3
Mexico	-1.7	1.0	80.5	4.3	28.4	5.0	4.3
Peru	-5.5	15.3	17.4	13.5	25.7	2.5	5.7
Dominican Republic	3.4	2.0	61.9	8.2	28.4	7.7	4.4
Uruguay	4.7	4.3	3.3	11.8	49.8	6.4	4.5
Venezuela	-25.0	16.6	21.7	14.7	18.4	33.9	-2.9

*General government debt/GDP.
Source: BCRP, CEPAL, ALADI, UN Comtrade, Moody's, and Consensus Forecast.

In the region, the growth of Brazil stands out. All the demand components show levels of expansion and the ratio of utilized capacity has already reached the levels observed prior to the crisis. In this context, inflation expectations have been increasing, which has led the Central Bank to raise the interest rate on two occasions. Other countries which have also adjusted their interest rate have been Peru and Chile.

Graph 14
GDP GROWTH IN LATIN AMERICAN COUNTRIES
(%)



* World Economic Outlook forecast- IMF.

Financial markets

14. Until April, financial markets continued showing better conditions favored by the dissemination of corporate results in Q1, which exceeded expectations and confirmed the better evolution of global growth. However, tensions in debt markets intensified since May as a result of uncertainty about the possibilities of financing the fiscal debt of Greece and its eventual impact on other economies with similar problems (Ireland, Portugal, and Spain), as well as a result of uncertainty about the financial entities exposed to credit risk. Global financial markets experienced again disturbances due to risk aversion, which increased as a result of the rating cuts to the sovereign debt of Greece, Portugal, and Spain.

TABLE 7
CREDIT DEFAULT SWAP SPREAD (IN BPS) 1/

	Dec.07	Dec.08	Dec.09	Jan.10	Feb.10	Mar.10	Apr.10	May.10	3 Jun.10	8 Jun.10	9 Jun.10
Portugal	18	96	92	162	164	139	290	305	335	350	309
Italy	20	157	109	116	128	116	142	196	233	237	206
Ireland	n.d.	181	158	152	144	42	193	232	264	285	254
Greece	22	232	283	399	364	333	719	663	726	795	764
Spain	18	101	113	129	130	116	167	219	254	266	240
Germany	7	46	26	37	41	32	44	40	43	48	43
United Kingdom	9	107	83	82	85	77	76	80	87	93	89
France	10	54	32	51	58	46	63	69	84	100	90
Memo:											
Peru	116	303	124	144	131	127	121	134	133	146	144

Source: Bloomberg.
1/ The CDS is a financial instrument that works as an insurance that covers for the losses in case of default.

The financial support package for Greece (see Box 1) and the creation of a facility for the economies of the Eurozone partially reduced uncertainty, although specific events, such as the ban on short operations not covered by Germany, the intervention of CajaSur in Spain, and concerns about fiscal sustainability in Hungary, generated temporarily higher volatility in the markets.

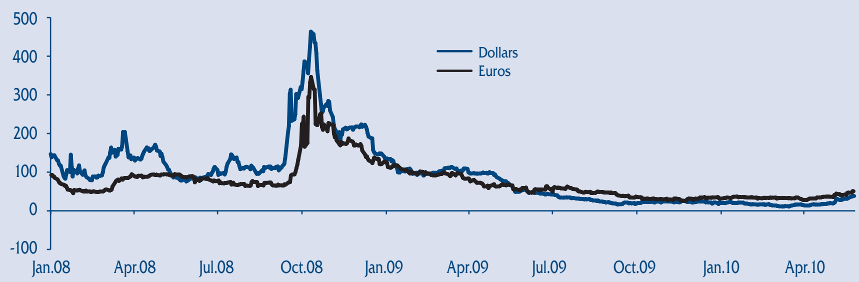
The sovereign debt crises in some countries of the Eurozone and fears of contagion increased risk aversion. The VIX index –which measures the volatility of stock markets– rose substantially in May, impacting on the money markets and affecting the main indicators in fixed-income and variable-income markets.

Graph 15
WORLD STOCKS INDEX (MSCI) AND VIX (S&P500) 1/

1/ VIX: Implicit volatility of the options market of the S&P500.
Source: Bloomberg.

15. In the **money market**, European banks experienced again liquidity constraints given their greater exposure to credit risk in terms of the European economies with fiscal problems. In the United States, there was also an increase in the spread between the Libor rate in dollars and the 3-month U.S. Treasury bonds (TED spread), in line with higher risk aversion, which reversed the downward trend observed in the first months of the year.

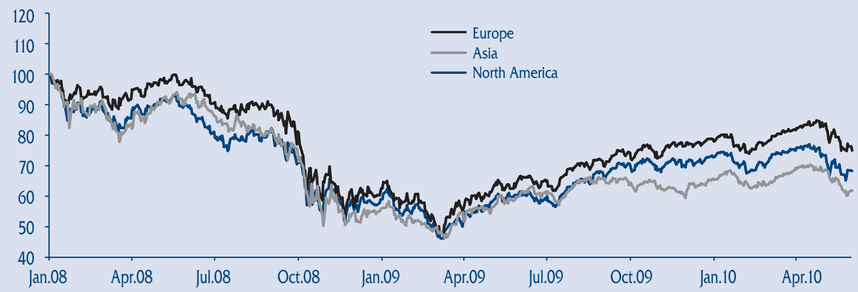
Graph 16
LIBOR RATE AND 3-MONTH TREASURY BOND SPREAD
(TED spread in basis points)



Source: Bloomberg.

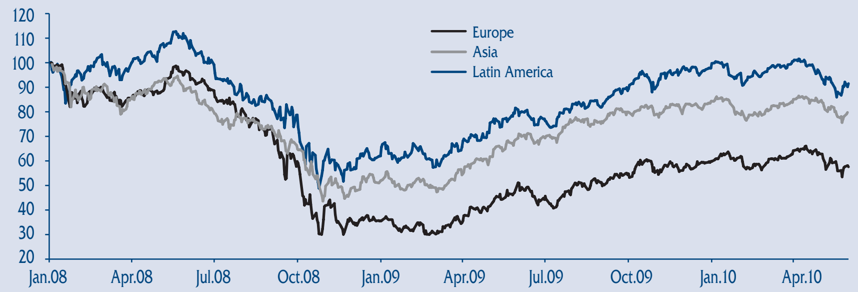
16. In **variable income markets**, the MSCI index[1], which reflects the aggregate evolution of stock markets, fell 10 percent in May showing lower levels than the ones recorded at the beginning of the year in both developed markets –France, Japan, and the UK recorded falls of 10, 9, and 4 percent– and in emerging markets (within the BRICs, the stock losses in Brazil and China reached 11 and 19 percent, respectively).

Graph 17
STOCK INDICES (MSCI)
Developed markets



Source: Bloomberg.

Graph 18
STOCK INDICES (MSCI)
Developing markets



Source: Bloomberg.

In the emerging debt markets, spreads also rose in line with increased risk aversion and reached levels above the ones observed in late 2009.

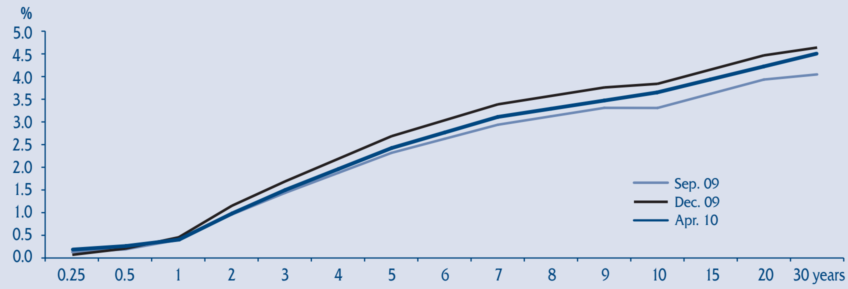
1 The MSCI is an index of developed stock markets that is elaborated by Morgan Stanley Capital.

Graph 19
EMERGING MARKETS BOND INDEX SPREAD: EMBIG

Source: Bloomberg.

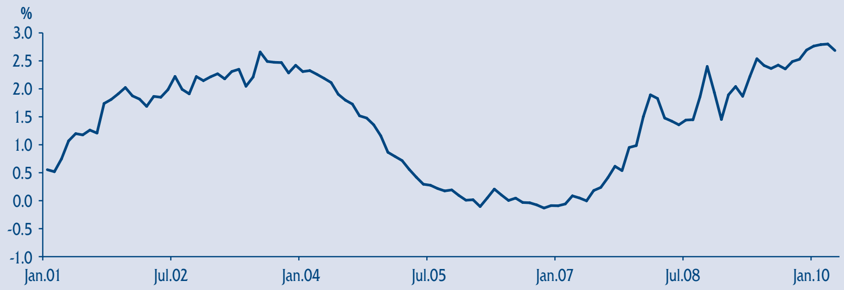
This increase in risk aversion was also reflected in a higher demand for assets perceived as less risky assets, such as the U.S. Treasury bonds. The yield on the 10-year bonds has declined by 56 basis points so far this year. A similar reduction is observed at each point along the yield curve.

Graph 20
YIELD CURVE: US TREASURY BOND YIELD
(End of period)



Source: Bloomberg.

Graph 21
US TREASURY BONDS:
Yield spread between 10 and 2 year bonds



Source: Bloomberg.

17. As regards **central banks' monetary policy interest rates**, the decisions adopted by central banks since our March Inflation Report was published have been mixed and some pause is observed in the process of adjustment due to uncertainty in international markets. In the region, Brazil was the first to start a cycle of rising interest rates, accumulating an increase of 150 bps. Brazil's monetary policy rate has been raised to 10.25 percent in a context where the trend of inflation and inflation expectations remain high. Subsequently, the central banks of Peru and Chile increased their interest rates. Canada was the first country of the G-7 to raise its interest rate, while Colombia, Iceland, Hungary, and the Czech Republic lowered them.

TABLE 8
MONETARY POLICY INTEREST RATE

	Sep.08	Sep.09	Dec.09	Mar.10	May.10	Jun.10	Chg (bps.) in 2010	Inflation 2010
Pakistan	13.00	13.00	12.50	12.50	12.50	12.50	0	n.d.
Brazil	13.75	8.75	8.75	8.75	9.50	10.25	150	5.5
Iceland	15.50	12.00	10.00	9.00	8.50	8.50	-150	n.d.
Indonesia	9.25	6.50	6.50	6.50	6.50	6.50	0	4.7
South Africa	12.00	7.00	7.00	6.50	6.50	6.50	-50	5.7
Turkey	16.75	7.25	6.50	6.50	6.50	6.50	0	9.2
China	7.20	5.31	5.31	5.31	5.31	5.31	0	3.3
Hungary	8.50	7.50	6.25	5.50	5.25	5.25	-100	4.4
India	9.00	4.75	4.75	5.00	5.25	5.25	50	8.4
Australia	7.00	3.00	3.75	4.00	4.50	4.50	75	2.8
Mexico	8.25	4.50	4.50	4.50	4.50	4.50	0	5.0
Philippines	6.00	4.00	4.00	4.00	4.00	4.00	0	5.0
Poland	6.00	3.50	3.50	3.50	3.50	3.50	0	2.4
Colombia	10.00	4.00	3.50	3.50	3.00	3.00	-50	3.5
New Zealand	7.50	2.50	2.50	2.50	2.50	2.75	25	2.4
Malaysia	3.50	2.00	2.00	2.25	2.50	2.50	50	2.1
Slovakia	4.25	2.50	2.50	2.50	2.50	2.50	0	n.d.
Norway	5.75	1.25	1.75	1.75	2.00	2.00	25	2.4
South Korea	5.25	2.00	2.00	2.00	2.00	2.00	0	2.9
Peru	6.50	1.25	1.25	1.25	1.50	1.75	50	2.5
Israel	4.25	0.75	1.25	1.50	1.50	1.50	25	2.7
Thailand	3.75	1.25	1.25	1.25	1.25	1.25	0	3.6
Taiwan	3.50	1.25	1.25	1.25	1.25	1.25	0	1.4
Eurozone	4.25	1.00	1.00	1.00	1.00	1.00	0	1.3
Chile	8.25	0.50	0.50	0.50	0.50	1.00	50	3.5
Czech Republic	3.50	1.25	1.00	1.00	0.75	0.75	-25	1.5
Canada	3.00	0.25	0.25	0.25	0.25	0.50	25	1.9
United Kingdom	5.00	0.50	0.50	0.50	0.50	0.50	0	2.9
United States	2.00	0.25	0.25	0.25	0.25	0.25	0	2.0
Sweden	4.75	0.25	0.25	0.25	0.25	0.25	0	1.3
Switzerland	2.75	0.25	0.25	0.25	0.25	0.25	0	1.0
Japan	0.50	0.10	0.10	0.10	0.10	0.10	0	-1.0

Source: Reuters, Bloomberg, and Consensus Forecast.

Foreign exchange markets

18. The recent developments in the Eurozone led to increased risk aversion and strengthened the dollar against the euro. In this way, the euro intensified the trend observed in the early months of the year and reached its lowest level in four years. However, the dollar weakened against the yen due to higher risk aversion and the subsequent reversal of carry trade operations. Latin American currencies also faced depreciatory trends following the events in the Eurozone. The drop of commodity prices added onto increased risk aversion. The Brazilian real, the Argentine peso, and Chilean peso have recorded the highest depreciations.

Graph 22
EXCHANGE RATE TO THE DOLLAR CURRENCY BASKET 1/
(Monetary units per US$)

1/ An increase in the index indicates an appreciation of the dollar.
Source: Bloomberg.

Terms of trade

19. The international prices of commodities continued recovering until April. In May, prices corrected downward and, in many cases, reversed the gains of the year due to the uncertainty generated by the fiscal problems of some countries in the Eurozone and due to fears that this might spread to other regions with a subsequent impact on the recovery of global demand. In this context, China continued playing an important role in terms of supporting the level of prices. In contrast with the prices of most commodities, the price of gold showed a sustained upward trend due to the demand for this metal as a hedge asset and store of value.

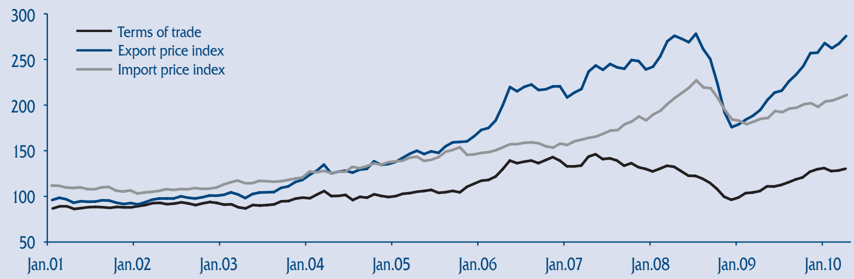
In this scenario, Peru's terms of trade are expected to maintain a growth close to 13 percent during 2010, a similar rate to the one forecast in our March Report. Most of the projected prices of exports and imports have been revised downwards. It is estimated that the prices of export and import products would stabilize around the current average levels in 2011 and 2012.

TABLE 9
TERMS OF TRADE
(% change and annual average prices)

	2009	2010			2011*		2012*
			IR Jun.10				
		IR Mar.10	Jan-May	Year*	IR Mar.10	IR Jun.10	IR Jun.10
Terms of trade	**-5.5**	**12.9**	**24.9**	**12.6**	**-2.9**	**-3.3**	**-1.3**
Export prices	**-12.5**	**17.2**	**41.0**	**20.7**	**-0.3**	**-1.5**	**0.6**
Copper (ctv per pound)	234	322	330	313	320	300	300
Zinc (ctv per pound)	75	102	102	96	101	90	90
Gold (US$ per ounce)	974	1,111	1,136	1,167	1,110	1,212	1,208
Import prices	**-7.4**	**3.8**	**12.9**	**7.2**	**2.6**	**1.9**	**2.0**
Oil (US$ per barrel)	62	80	79	75	83	76	77
Wheat (US$ per MT)	193	191	160	174	216	206	225
Maize (US$ per MT)	139	150	134	140	163	157	165
Soybean oil (US$ per MT)	729	850	786	813	903	867	879
Rice (US$ per MT)	561	537	524	462	530	440	448
Sugar (US$ per MT)	412	505	517	414	426	345	345

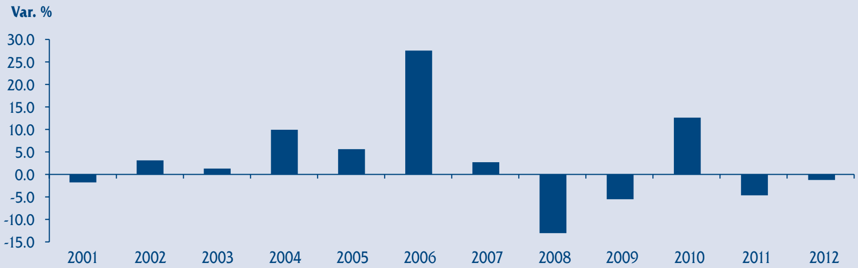
* Forecast.

Graph 23
TERMS OF TRADE, EXPORT AND IMPORT PRICE INDICES: JANUARY 1997 - APRIL 2010 (1994=100)



Source: BCRP.

Graph 24
TERMS OF TRADE
(% change)



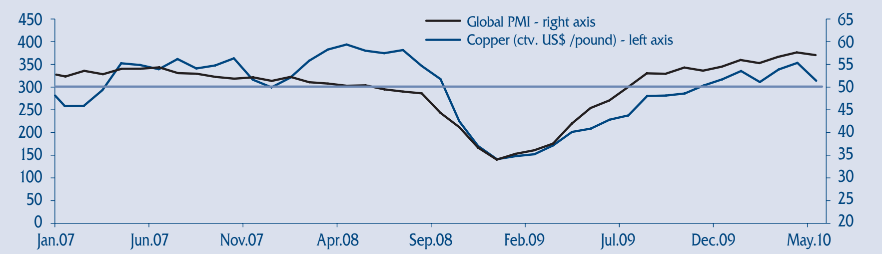
Source: BCRP.

Copper

20. Between January and April 2010 the price of copper rose by 12 percent (in 2009 it increased 127 percent) to an average of US$ 3.53/pound. This reflected the growing demand from emerging economies like China, supply constraints in the major producers (i.e. strikes, technical problems and earthquake in Chile), and renewed expectations of global growth, as evidenced in the indicators of activity. However, in May the markets recorded losses due to the financial situation in Europe. Thus, the price of copper in this month showed an average level of US$. 3.14, a similar level to that of December 2009.

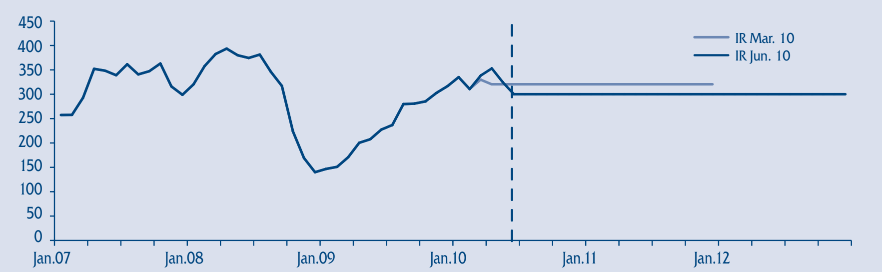
    It is estimated that the demand for copper will recover its dynamism in the second semester of 2010, in line with growth projections in the construction and industry sectors of several regions.

Graph 25
GLOBAL PMI AND COPPER PRICE



PMI: Purchasing Managers Index.
Source: JP Morgan and Bloomberg.

Graph 26
COPPER
(ctv. US$/pound)



Source: Bloomberg and BCRP.

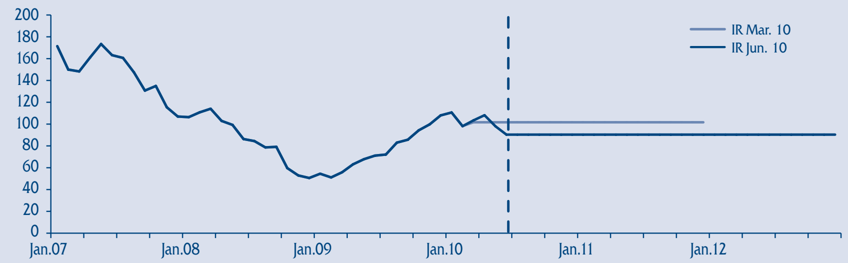
Zinc

21. The price of zinc showed a similar conduct. After rising by nearly 120 percent in 2009, the price of this metal increased slightly between January and April, falling

thereafter in May due to the turbulence observed in financial markets. Zinc reached an average price of US$ 108/pound in April and dropped to US$ 92/pound in May.

After having declined in nearly all the regions, the demand for zinc would recover in 2010. This recovery would be especially noteworthy in Europe, where it fell by 25 percent in 2009, and in China, where big infrastructure projects are being implemented and where the automotive sector is expected to recover its dynamism.

Graph 27
ZINC
(ctv. US$/pound)



Source: Bloomberg and BCRP.

Gold

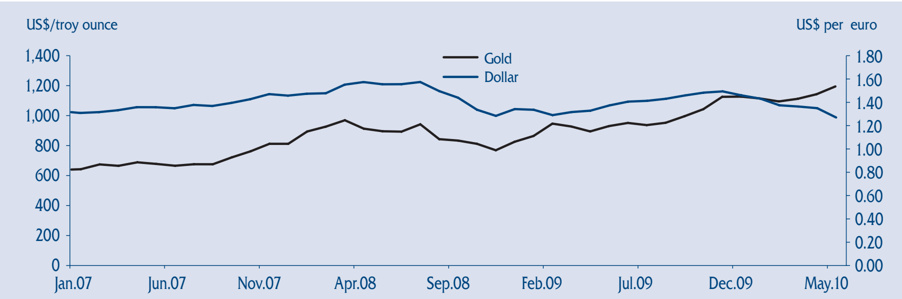
22. Between January and May, the price of gold recorded an increase of 6 percent, reaching an average price of US$ 1,202/troy ounce in May[2]. In contrast with other commodities, gold showed an upward trend in May due to its demand as a hedge asset and store of value in a context of financial uncertainty. On May 13, the price of gold reached a record level of US$ 1,240/troy ounce due to the events in Greece and fears of possible contagion to other European countries. Because of this, investors' demand for gold (non-commercial positions) increased by over 20 percent in May. So far in June, the price of gold records an average price of US$ 1,225/troy ounce (a new maximum level was posted on June 8: US$ 1,247/troy ounce).

It is estimated that the price of gold would slow down its upward trend as uncertainty about the fiscal and financial situation of the affected European countries subsides and global economic recovery consolidates. The IMF's announcement that it will sell 120 tons from its reserves[3] during 2010 would contribute to this correction.

2 In the first three months of 2010, the price of gold dropped by nearly 1 percent in line with the strengthening of the dollar, investors' "take-profit", estimates of a higher production in South Africa, and an increased supply from the IMF. The price of gold reached a minimum level of US$ 1,057/troy ounce on February 2.

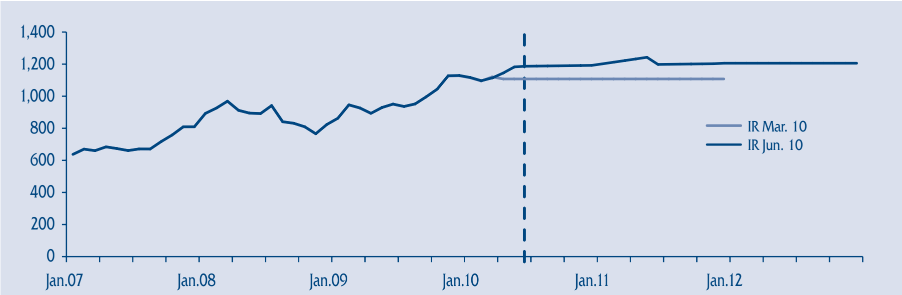
3 The IMF sold 24 tons of gold during the first quarter of the year.

Graph 28
GOLD PRICE AND US DOLLAR EVOLUTION



Source: Bloomberg.

Graph 29
GOLD
(US$/troy ounce)



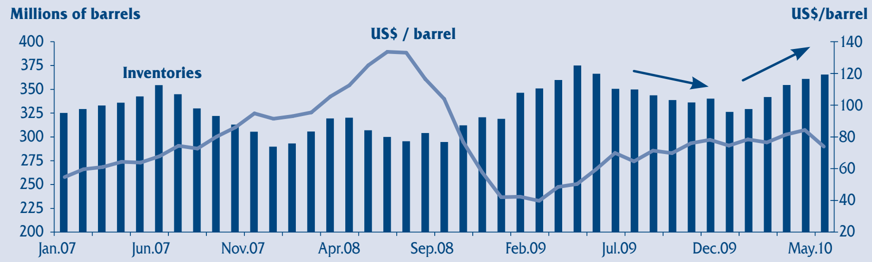
Source: Bloomberg and BCRP.

Oil

23. After accumulating an increase of 80 percent in 2009, the price of oil rose by 13 percent to US$ 81/barrel (average price in April) between January and April of this year. This rise took place in a context of expectations of a recovery of global demand, production constraints, and geopolitical problems in producer countries. Other factors contributing to this evolution were the US Energy Department and the OPEC's upward revision of projected global demand for crude and geopolitical problems in Iran, Iraq and Nigeria, and the peninsula of Korea.

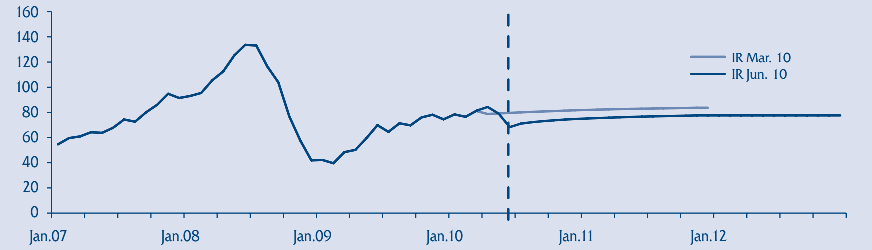
    However, in May, the average price of oil went from US$ 84 to US$ 74/barrel reflecting concerns of a delay in the recovery of global demand and as a result of the high availability of inventories of crude and refined crude in the United States.

Graph 30
OIL PRICE AND US INVENTORIES
(January 2007 - May 2010)



Source: Bloomberg, and US Department of Energy.

Graph 31
WTI OIL
(US$/bl)

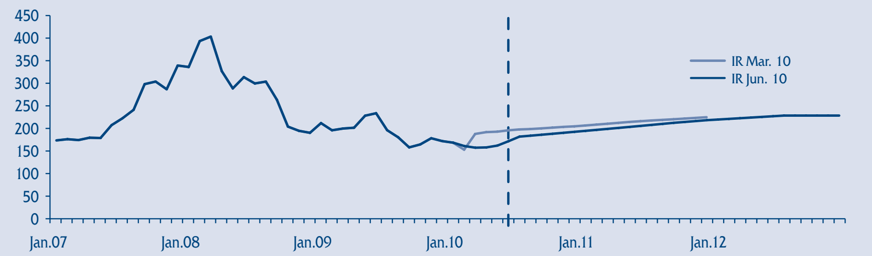


Source: Bloomberg and BCRP.

Wheat

Year-to-date, the price of wheat has maintained its downward trend due to the abundant supply observed in the market and confirmed by the monthly estimates of the US Department of Agriculture. Nonetheless, the price of wheat has not remained unaffected by the volatility of other commodity markets in a context of increased risk aversion associated with the uncertainty generated by Greece's debt crisis.

Graph 32
WHEAT
(US$/MT)

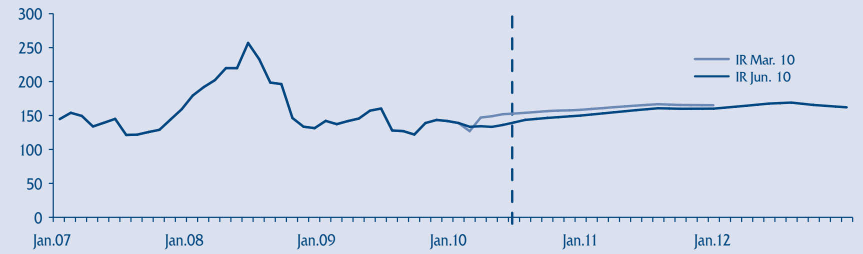


Source: Bloomberg and BCRP.

Maize

Since our last inflation report was published, the price of maize has been gradually increasing, driven mainly by China's higher demand. The government has auctioned off some of its reserves to curb the rising domestic prices of maize, because the domestic market was tight as a result of a drop in production due to unfavorable weather conditions. To cover these reserves, the government has increased its imports and it is estimated that these purchases will continue in the rest of the year. The price of wheat increased despite greater production in the United States not only compared to the previous year, when cultivation was affected by the delay of rain, but also compared to the average production in recent years.

Graph 33
MAIZE
(US$/MT)

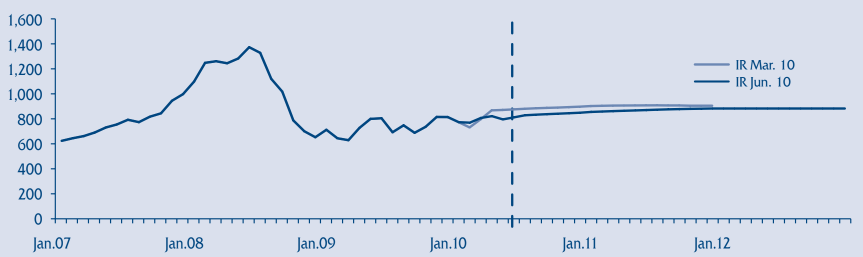


Source: Bloomberg and BCRP.

Soybean oil

Compared to the data included in our March Report, the price of soybean oil has fallen, in line with the decline of the price of crude, even though the price of soybean grains, on the other hand, has shown some upward trend due mainly to China's higher purchases (China's imports of soybean grains have increased by 9.9 percent between January and April compared to the same period in 2009). Nonetheless, there are no pressures on the side of supply since the outlook for production in Brazil and Argentina remains favorable.

Graph 34
SOYBEAN OIL
(US$/MT)

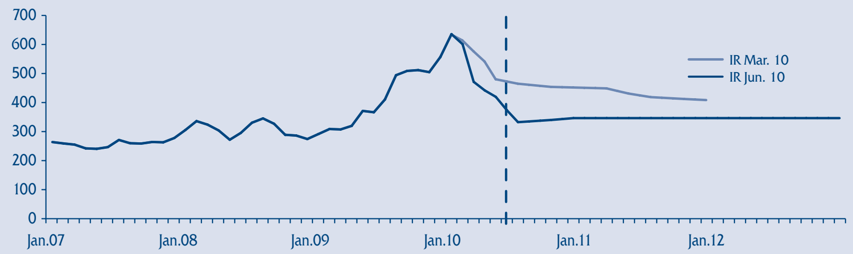


Source: Bloomberg and BCRP.

Sugar

The price of sugar has maintained the downward trend observed since February given the improvement of estimated production in India and Brazil. A normal monsoon is expected in India this year and production is developing well in Brazil. However, upward pressures were observed in recent weeks –even though the price of sugar did not reach the record levels registered in January– as a result of the volatility generated by the crisis in Greece, expectations that countries such as Pakistan would be considering the possibility of increasing their purchases of sugar to benefit from the low price levels, and possible delays in Thailand's exports due to domestic turmoil.

Graph 35
SUGAR
(US$/MT)



Source: Bloomberg and BCRP.

BOX 1
GREECE'S DEBT CRISIS

Doubts about the sustainability of Greece's debt have increased since the publication of our last Inflation Report. Markets showed their worst evolution in the first week of May: money markets experienced strong liquidity pressures, sovereign credit spreads increased, and fears of contagion of the crisis to Spain and Portugal rose. Moreover, the stock markets recorded losses and emerging spreads also increased as a result of higher risk aversion.

Rescue package for Greece

The support requested by Greece to the European Union (EU) and the IMF initially involved a package of € 45 billion (€ 30 billion would be contributed by EU country members through bilateral loans and the rest would be support funds from the IMF) to be provided in a period of three years and at an estimated average rate of 5 percent. This package implied the commitment that Greece would implement the Stability and Growth Pact (SGP) established in November 2009.

However, the positive effect of this package was temporary. Doubts on the austerity measures, consistent with a fiscal consolidation program, generated increased uncertainty in the markets, which intensified due to the delay in implementing the requirements for the execution of this package. Concerns increased after Standard & Poor's downgraded the ratings assigned to Portugal and Spain. These developments led to the announcement of a new package for € 110 billion (€ 80 billion as contribution of EU country members through bilateral loans and the rest as the IMF support).

Package for Europe markets

In addition to the package previously approved for Greece, new measures to stabilize Europe markets were jointly announced by the ECB, the EU, and the IMF on Sunday, May 9:

a. **Financial aid from the EU for up to € 500 billion for the state members requiring it.** Of this total, € 60 billion would be immediately available through the European Emergency Fund that the Commission would provide, in addition to the fund available for state members that are not part of the Eurozone. The rest would be available through the establishment of a Special Purpose Vehicle (SPV) that will be financed and guaranteed by the Eurozone state members.

b. **Provision of up to € 250 billion from the IMF through its regular programs.**

c. **ECB measures to restore monetary policy transmission mechanisms:**
   (i) Purchase of sovereign and private bonds at its discretion.
   (ii) Reactivation of unlimited 3-month liquidity lines at a fixed rate of 1 percent on May 26 and June 30 and a 6-month liquidity line at the average rate resulting from the minimum rates of the main liquidity operations offered by the ECB. The ECB has recently extended the 3-month auctions until September.
   (iii) In coordination with other central banks (Canada, UK, Japan, and Switzerland), reactivation of unlimited dollar swaps with the FED.

   So far, progress has been made in the implementation of these measures. The first disbursement of the financial aid for Greece (€ 14.5 billion from the EU and € 5.5 billion from the IMF), which covers the financing requirements for May and June, has been made, and the German parliament has approved the contribution to the support package for the Eurozone (up to € 148 billion of potential aid).

   As part of the package, the governments also committed themselves to adopting additional fiscal measures in 2010 and 2011 to ensure the region's fiscal consolidation. In this sense, Portugal approved new measures to reduce the fiscal deficit, including tax increases and the reduction of salaries in the public sector. Spain announced a package of public spending cuts that would imply a reduction in the wage bill, the suspension of the planned increase in pensions, the elimination of subsidies to new parents, and a reduction of public investment next year.

The first reaction to the packages has been favorable considering the size of the total fund (€ 750 billion). With data as of end 2009, the total package represents 10.6 percent of the sovereign debt of the Eurozone and 8.4 percent of its GDP (the immediately available fund, € 60 billion, constitutes 0.7 percent of GDP). In terms of the countries with fiscal problems (Greece, Ireland, Spain, and Portugal), the fund is equivalent to 70.6 percent of the sovereign debt (at end 2009) and covers 3 years of financing requirements. In this regard, it should be pointed out that estimates vary according to the levels of fiscal deficits considered.

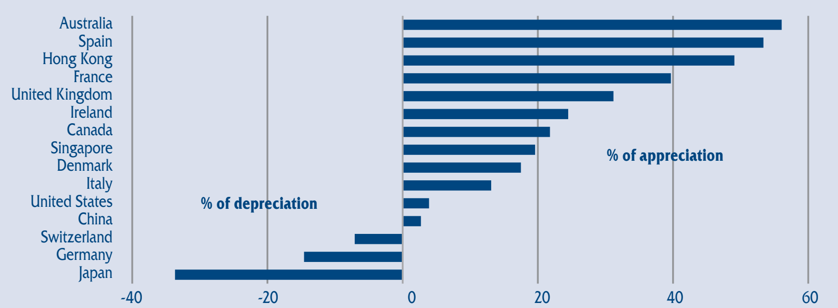
The evolution of the markets reversed again in the last weeks mainly due to new concerns about the viability of the rescue package and the effect of fiscal measures on growth in the Eurozone, as well as to concerns about the situation of banks.

BOX 2
PRICES IN THE REAL ESTATE SECTOR

Several developed and developing economies are experiencing price rises in the real estate sector, which has even led to discuss whether there is a bubble in some of them. Because of this, governments have started implementing a series of measures aimed at decelerating the growth of credit to the real estate sector, increasing the supply of land and buildings of the state, and restricting speculative investment by establishing limits on the purchase of properties.

A way of measuring how high the prices of properties are is comparing the price-rent ratio with its long term average level. According to this indicator, in Q1 the prices of real estate in Australia, Spain, and Hong Kong would be the ones that are more deviated from their long term levels, followed by the prices of real estate in France and the UK.

HOME PRICES: OVERVALUATION RATIO AT 1Q10
(Ratio price-rent compared to the historic average)



Source: The Economist.

A price correction of 6 and 4 percent was observed in Spain and France, respectively, in 2009 and is expected to continue in 2010, but prices have continued to increase in Australia and Hong Kong. In Australia, the recovery of activity after the crisis and the associated higher dynamism of demand have started pressuring the prices of some assets upwards. In the second case, the growth of China has generated higher investment in the countries of the region. Because of this, Australia decided to raise its interest rate on three occasions between January and April of 2010[4] and Hong Kong implemented a series of restrictions on bank loans and accelerated a program of auctions of state land and properties.

Moreover, according to the indicator used, real estate prices in USA and China show moderate deviations compared to their long term levels (4 and 3 percent, respectively). In USA, the prices of properties showed a 3 percent correction in 2009 and no major corrections are expected to occur in 2010. In China, the prices of houses have been rising since September 2009 and recorded a record growth of 13 percent in annual terms in April of this year.

The real estate sector in China

The prices of real estate in China is a particular case because, despite the fact that they do not seem to be very deviated from their long term levels, the authorities have started to implement a series of measures in the sector given that other indicators reflect the possibility that prices will continue rising in 2010. For example, inventories of unsold homes declined substantially in 2009 and the construction of new homes increased by 61 percent in Q1-2010.

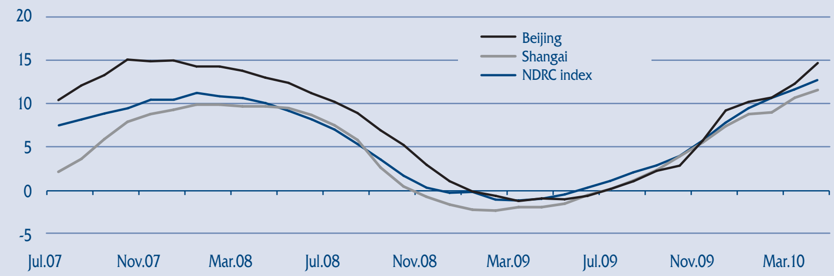
It is still unclear whether there is a bubble in the real estate sector in China or not. According to Roubini Global Monitor (RGE), there would be some focalized bubbles in some cities located in the Pacific coast, while according to JP Morgan the real estate market in China is not overvalued. The Economist Intelligence Unit says that if there is a bubble, the correction of this bubble would not affect consumption, but perhaps it would affect investment due to its impact on construction companies.

Using the NDRC index[5] of house prices for 70 cities of China, a price recovery has been observed since mid-2009 after the drops recorded during the most severe period of the crisis. However, the rise of prices has been substantial in some cities: in the island of Hainan and in Haikou prices have risen by over 50 percent and in cities like Beijing, by about 15 percent.

4 The Central Bank of Australia raised the interest rate by 25 bps. on each occasion.

5 The NDRC housing index is elaborated by the National Development and Reform Commission of China for 70 cities.

CHINA: HOME PRICES
(12-month % change)



Source: Bloomberg.

The Chinese authorities have adopted corrective measures in the sector to tighten the conditions observed prior to the crisis. The following measures are worth highlighting: i) a loan quota system for banks has been established, ii) the down payment on the sale of houses has been increased, iii) 78 state housing companies have been withdrawn from the market, iv) taxes on house sales have been increased in some regions, v) the acceleration of state programs of construction of houses for low income sectors, and vi) the prohibition of purchasing a third property.

II. Balance of Payments

24. The surplus in the balance of payments in 2010 is estimated to amount to US$ 6.7 billion, a lower sum than the one considered in the March Report (US$ 8.4 billion), due mainly to a higher growth of imports, in line with the higher growth of economic activity considered in this Report. The projection considers the recovery of external demand for our non traditional exports, as well as higher prices for traditional products. Our trade partners are expected to grow 3.6 percent in 2010, while trades of terms would increase by nearly 13 percent.

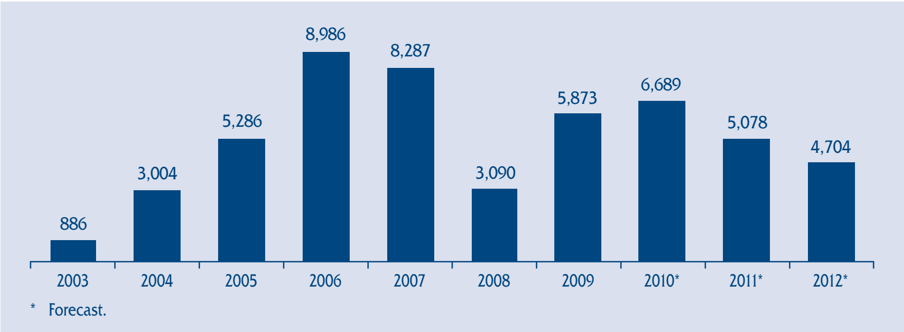
The surplus in the trade balance would decline to US$ 5.1 billion in 2011 and to US$ 4.7 billion in 2012, mainly due to higher imports of capital goods for the investment projects which would start being implemented in this period. It should be pointed out that with this projection the Peruvian economy would record eleven consecutive years with trade surpluses.

TABLE 10
TRADE BALANCE
(Millions of US$)

	2009		2010			2011*		2012*
	1Q	Year	1Q	IR Mar.10*	IR Jun.10*	IR Mar.10	IR Jun.10	IR Jun.10
EXPORTS	**5,396**	**26,885**	**7,832**	**33,409**	**33,162**	**35,392**	**34,767**	**37,820**
Of which:								
Traditional products	3,932	20,571	6,180	26,460	25,897	28,059	27,003	29,270
Non-traditional products	1,436	6,160	1,594	6,752	7,060	7,109	7,556	8,332
IMPORTS	**4,883**	**21,011**	**6,321**	**24,974**	**26,474**	**27,822**	**29,689**	**33,116**
Of which:								
Consumer goods	929	3,963	1,126	4,635	4,937	5,374	5,805	7,018
Inputs	2,072	10,077	3,160	12,089	13,212	13,304	14,412	15,598
Capital goods	1,848	6,850	1,969	8,206	8,192	9,094	9,331	10,333
TRADE BALANCE	**513**	**5,873**	**1,511**	**8,435**	**6,689**	**7,570**	**5,078**	**4,704**
Memo: (% change)								
Volume:								
Exports	-3.5	-3.3	0.2	6.0	2.2	6.3	6.3	8.1
Imports	-16.1	-20.0	13.9	15.2	17.6	8.7	10.2	9.3
Value:								
Exports	-30.6	-14.7	45.1	24.3	23.4	5.9	4.8	8.8
Imports	-22.1	-26.1	29.4	18.9	26.0	11.4	12.1	11.5

IR: Inflation Report.
* Forecast.

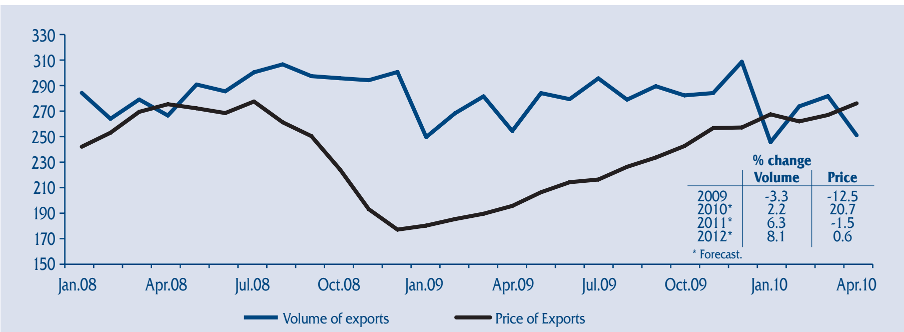
Graph 36
TRADE BALANCE
(Millions of US$)



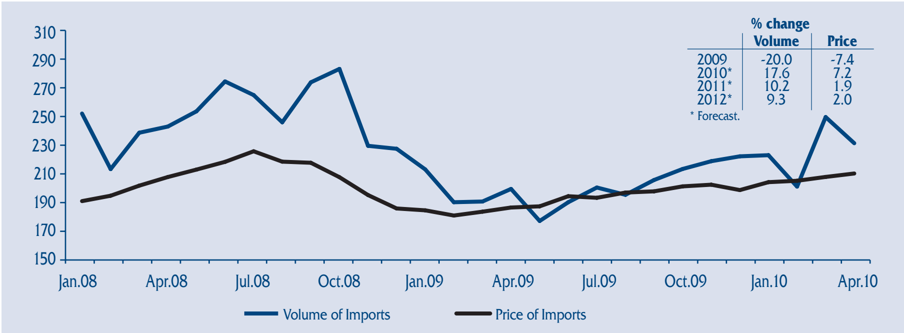
25. The volume of trade has shown an evolution in line with the indicators of economic activity in the world, while the growth of the domestic economy has increased the demand for imports. The prices of both exports and imports have also risen during the first months of the year.

In Q1-2010, the trade balance recorded a surplus of US$ 1.5 billion (US$ 0.5 billion in the same period in 2009). In the first three months of this year, exports grew 45.1 percent, mainly due to an increase of a similar proportion in terms of prices. The 1.8 percent decline in the volume of traditional exports was compensated by the 8.3 percent increase recorded in the volumes of exported non traditional goods, mainly farming, chemical, and iron&steel products. On the other hand, imports grew 29.4 percent, showing an increase of 13.9 percent in the volumes of inputs and consumer goods in the same period.

Graph 37
VOLUME ANF PRICE OF EXPORTS
(Index 1994=100)



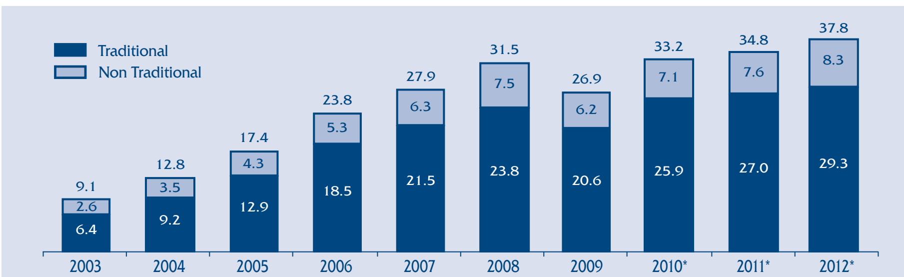
Graph 38
VOLUME AND PRICE OF IMPORTS
(Index 1994=100)



26. A significant recovery in the value of exports is projected for 2010. Exports would increase from US$ 26.9 billion in 2009 to US$ 33.2 billion as a result of the higher prices of metals, the onset of operations of Camisea II –which would increase the exports of hydrocarbons–, and the recovery of non traditional exports.

The rates of growth of exports in the next years would be higher than the ones considered for 2010. In 2012 the volumes of traditional products would increase due to the higher exports of copper associated with the expansions of Antamina and Toquepala and the onset of operations at Minas Justa. Non traditional exports –particularly farming products– would continue recovering in 2011 and 2012, in line with the forecasts of global economic recovery. This positive trend would be reinforced by the trade agreements established with various countries.

Graph 39
EXPORTS OF GOODS
(Billions of US$)

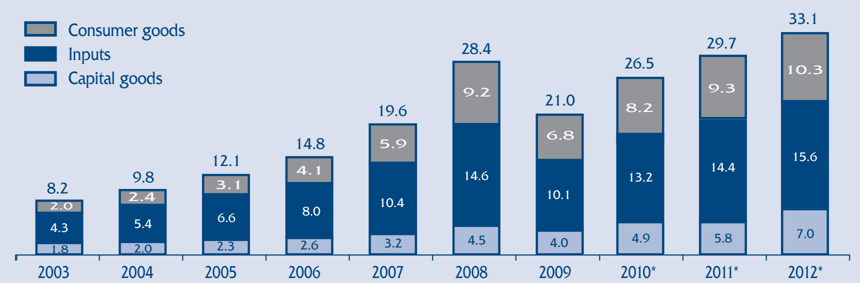


Memo: Total exports include other exports.
* Forecast.

27. The evolution of imports is associated with the conduct of GDP. A higher rate of recovery than the one foreseen in our previous report is expected in terms of the volume of imports, considering the higher pace of growth of the economy, in line with the evolution of private consumption and private investment. The growth of imports would gradually moderate in 2011 and 2012 with rates close to the growth rate of GDP. The highest dynamism in those years would be observed in imports of capital goods as a result of the construction stage of important investment projects.

Furthermore, imports of consumer goods would continue to grow, in line with the projected gradual increase of the growth rate of private consumption towards the end of the forecast horizon. This evolution would be reflected mainly in the growth of imports of durable consumer goods, in line with the growth of credit and bankarization in all of the country. The dynamism of non primary manufacturing, on the other hand, would be reflected in the increase of imports of inputs for this sector.

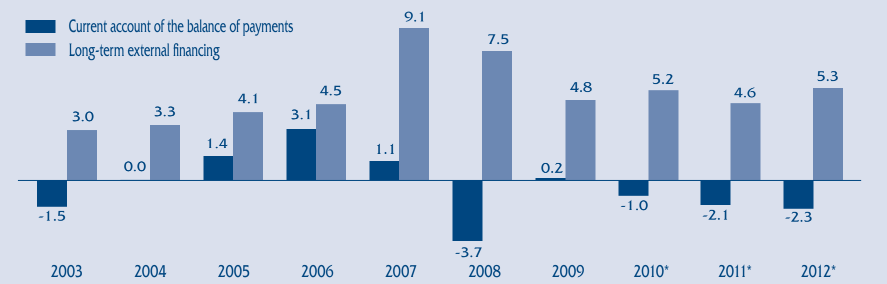
Graph 40
IMPORTS OF GOODS
(Billions of US$)



Memo: Total imports includes other imports.
* Forecast.

28. Considering the projections of growth of global growth and terms of trade, as well as the economy's higher growth, the projected deficit in the current account of the balance of payments for 2010 has been revised from 0.3 to 1.0 percent of GDP. The deficit in 2011 and 2012 is estimated at 2.1 and 2.3 percent of GDP, respectively, due to the expected increase of imports of capital goods for the construction stage of investment projects in several sectors. It is worth pointing out that long term flows of private capitals during the forecast horizon exceed the requirements of the current account, which contributes to the sustainability of the balance of payments.

Graph 41
CURRENT ACCOUNT AND LONG-TERM FINANCING
(% of GDP)



* Forecast.

TABLE 11
BALANCE OF PAYMENTS
(Millions of US$)

	2009		2010			2011*		2012*
	1Q	Year	1Q	IR Mar.10*	IR Jun.10*	IR Mar.10	IR Jun.10	IR Jun.10
I. CURRENT ACCOUNT BALANCE	**-391**	**247**	**-467**	**-473**	**-1,500**	**-1,822**	**-3,324**	**-4,000**
% of GDP	*-1.4*	*0.2*	*-1.3*	*-0.3*	*-1.0*	*-1.2*	*-2.1*	*-2.3*
1. Trade Balance	513	5,873	1,511	8,435	6,689	7,570	5,078	4,704
a. Exports	5,396	26,885	7,832	33,409	33,162	35,392	34,767	37,820
b. Imports	-4,883	-21,011	-6,321	-24,974	-26,474	-27,822	-29,689	-33,116
2. Services	-291	-1,112	-318	-1,557	-1,338	-1,913	-1,750	-1,788
3. Investment Income	-1,277	-7,371	-2,364	-10,200	-9,734	-10,579	-9,752	-10,285
4. Current transfers	665	2,856	705	2,848	2,884	3,100	3,100	3,368
of which: Remittances	543	2,378	585	2,494	2,494	2,716	2,716	2,985
II. FINANCIAL ACCOUNT	**124**	**1,694**	**2,600**	**3,973**	**4,999**	**3,322**	**4,824**	**5,000**
of which:								
1. Private Sector	1,269	1,655	2,334	2,745	5,024	3,016	4,232	5,335
a. Assets	-346	-4,106	667	-3,619	-1,419	-2,865	-1,544	-1,900
b. Liabilities	1,615	5,761	1,668	6,364	6,443	5,881	5,777	7,235
2. Public Sector	923	1,032	59	-134	-209	619	747	-242
a. Assets	-45	-317	-3	-126	-102	-123	-123	-116
b. Liabilities	968	1,349	63	-7	-107	742	870	-126
3. Short-term capital	-1,568	-1,675	563	1,400	418	-300	0	0
a. Assets	-65	-186	-595	-350	-440	0	0	0
b. Liabilities	-1,503	-1,489	1,158	1,750	858	-300	0	0
III. BALANCE OF PAYMENTS (=I+II)	**-266**	**1,940**	**2,133**	**3,500**	**3,500**	**1,500**	**1,500**	**1,000**
Memo:								
1. Gross long-term external private financing								
Millions of US$	2,052	6,108	1,924	7,579	7,579	7,254	7,184	8,971
% of GDP	7.4%	4.8%	5.5%	5.2%	5.1%	4.6%	4.6%	5.3%
2. NIRs balance end of period								
Millions of US$	30,929	33,136	35,269	36,636	36,636	38,136	38,136	39,136
% of GDP	24.7%	26.1%	26.2%	24.9%	24.9%	24.2%	24.4%	22.9%

IR: Inflation Report.

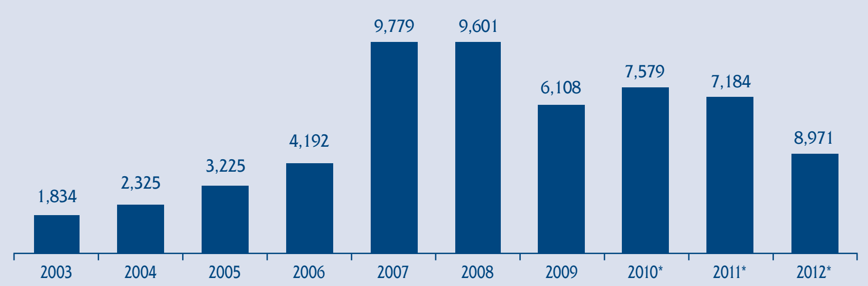
Financial account

29. In Q1-2010, the net flow of the financial account of the private sector of the balance of payments amounted to US$ 2,334 million, a higher figure than the one considered in our March Report. This amount is mainly explained by foreign direct investment (FDI), which reached its highest level in the last six quarters (US$ 1,824 million), with reinvestment operations of mining companies being noteworthy (US$ 828 million). A return of national investors' capitals (US$ 728 million) was also recorded.

    On the other hand, the short term financial account showed a surplus of US$ 563 million. This result was mainly associated with the increase of external liabilities held by banks (US$ 999 million) and was partially compensated by mining companies' higher deposits (US$ 370 million).

30. The projections on the financial account of the balance of payments in 2010-2012 are based on the assumption of a consolidation of global economic recovery and better growth prospects for domestic economic activity. This forecast scenario considers that inflows of foreign capitals will be mostly oriented to financing projects through FDI and long term loans. As regards capital outflows, it is expected that the main destination of the flow of domestic capitals, mainly pension funds, will continue to be the purchase of financial assets.

Graph 42
PRIVATE SECTOR EXTERNAL FINANCING
(Millions of US$)



* Forecast.

31. The financial account of the private sector in 2010 would show a positive net flow (US$ 5,024 million), the financing of investment projects being the main source of capital inflows through its two main components (FDI and long term loans). These

investments would be concentrated mainly in the mining and hydrocarbon sector and, to a lesser extent, in infrastructure and electricity.

The profile of domestic investments in external assets, especially investments of pension funds (AFPs), would remain unchanged –although showing a slower pace than the one considered in our previous Report– under the assumption that international financial markets would return to normal conditions in the next months.

TABLE 12
PRIVATE SECTOR FINANCIAL ACCOUNT
(Millions of US$)

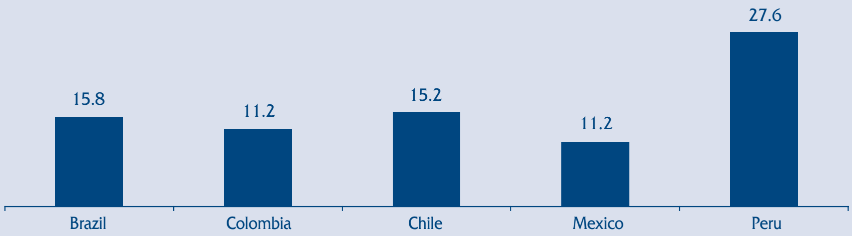
	2009		2010			2011*		2012*
	1Q	Year	1Q	IR Mar.10*	IR Jun.10*	IR Mar.10	IR Jun.10	IR Jun.10
1. Assets	**-346**	**-4,106**	**667**	**-3,619**	**-1,419**	**-2,865**	**-1,544**	**-1,900**
Direct investment abroad	-5	-396	-61	0	-61	0	0	0
Portfolio investment abroad	-341	-3,711	728	-3,619	-1,357	-2,865	-1,544	-1,900
2. Liabilities	**1,615**	**5,761**	**1,668**	**6,364**	**6,443**	**5,881**	**5,777**	**7,235**
Foreign direct investment in the country	1,331	4,760	1,824	4,895	5,296	4,124	4,159	5,395
Of which: Reinvestment	1,078	4,902	1,589	3,573	4,344	2,156	2,669	3,039
Foreign portfolio investment in the country	-227	55	107	38	52	-171	-315	-272
a. Capital participation	-84	47	15	0	15	0	0	0
b. Other liabilities	-143	9	92	38	37	-171	-315	-272
Long-term loans	511	946	-264	1,431	1,094	1,929	1,933	2,112
a. Disbursements	726	1,744	161	2,684	2,343	3,130	3,025	3,576
b. Amortization	-215	-798	-424	-1,253	-1,248	-1,201	-1,092	-1,464
3. TOTAL	**1,269**	**1,655**	**2,334**	**2,745**	**5,024**	**3,016**	**4,232**	**5,335**

* Forecast.

32. The trend of positive net capital flows would continue in 2011 and 2012 (with US$ 4,232 million and US$ 5,335 million, respectively). Private investment projects would continue to increase in those years, in line with the greater dynamism of economic activity. Additionally, the availability of external resources associated with the recovery of global activity would also allow the share of equity capital to recover as capital sources.

33. Moreover, the level of international reserves at the close of May amounted to US$ 35 billion, a sum equivalent to 28 percent of GDP in 2009. With this level of reserves, the economy stands in a good position to face adverse international contingencies in the process of global economic recovery.

Graph 43
NET INTERNATIONAL RESERVES*
(% of GDP)



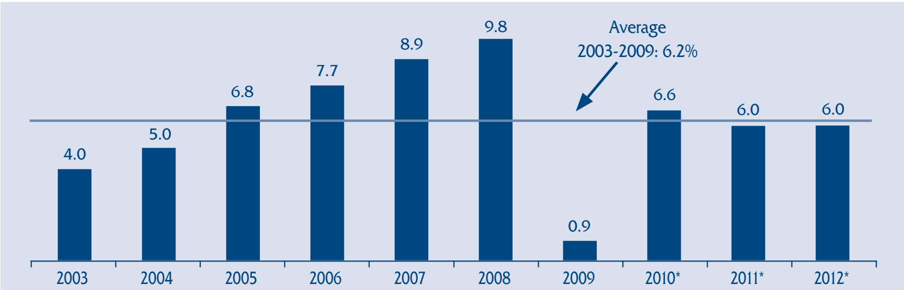
* NIR data as of May 2010 (only Colombia as of April). GDP 2009 for all the countries.
Source: Central banks and IMF-WEO.

III. Economic activity

34. In a context of a higher recovery of global economic activity and domestic activity than the one initially foreseen, the forecast on GDP growth in 2010 has been revised from 5.5 percent (Inflation Report of March) to 6.6 percent. In Q1-2010, GDP grew 6.0 percent, while domestic demand grew 8.1 percent. This evolution would be reflecting the completion of the process of inventory adjustments and the recovery of private investment amid improved business confidence regarding the prospects for the economy.

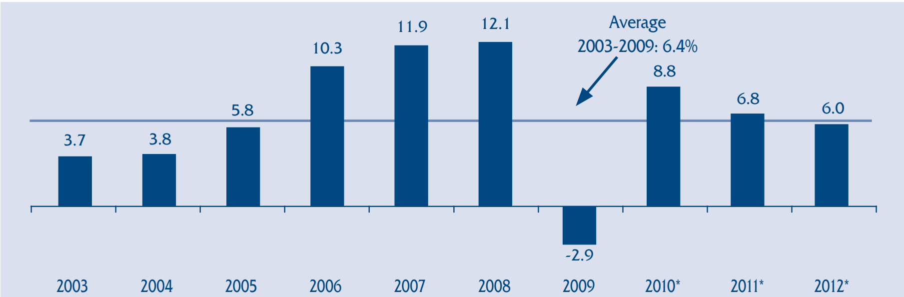
35. An annual growth rate of 6 percent with no inflationary pressures is expected in the next years. The growth forecast for 2011 has been raised from 5.5 percent (previous Inflation Report) to 6.0 percent considering that domestic demand would continue to grow at a higher rate than GDP in the forecast horizon, with private consumption and private investment showing a noteworthy dynamism.

Graph 44
GDP GROWTH RATE
(Real % change)



* Forecast.

Graph 45
DOMESTIC DEMAND GROWTH RATE
(Real % change)



* Forecast.

TABLE 13
DOMESTIC DEMAND AND GDP
(Real % change)

	2009		2010			2011*		2012*
	1Q	Year	1Q	IR Mar.10*	IR Jun.10*	IR Mar.10	IR Jun.10	IR Jun.10
1. Domestic demand	**-0.8**	**-2.9**	**8.1**	**6.8**	**8.8**	**6.3**	**6.8**	**6.0**
a. Private consumption	4.1	2.4	3.6	3.3	3.9	4.2	4.5	4.6
b. Public consumption	15.2	16.5	14.3	4.2	7.8	3.1	3.7	3.2
c. Private investment	1.8	-15.2	11.3	8.8	12.5	9.0	9.0	11.0
d. Public investment	24.8	25.9	16.7	19.8	23.9	6.0	7.3	6.5
2. Exports	-1.7	-2.5	0.2	5.5	3.0	5.7	5.7	7.9
3. Imports	-13.3	-18.4	10.6	11.9	14.5	9.9	10.1	8.0
4. GDP	**1.9**	**0.9**	**6.0**	**5.5**	**6.6**	**5.5**	**6.0**	**6.0**
Memo:								
Public expending	*17.7*	*19.8*	*15.0*	*9.9*	*13.7*	*4.2*	*5.1*	*4.5*

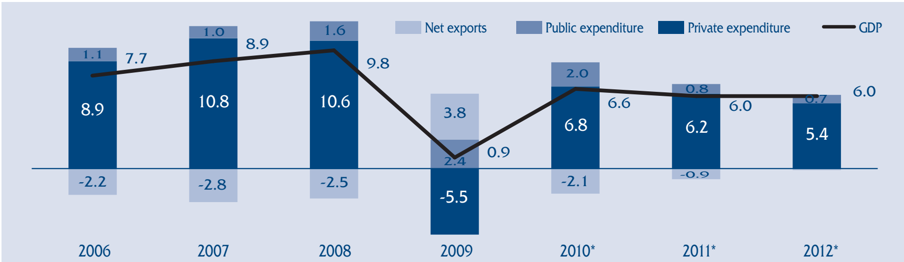
IR: Inflation Report.
* Forecast.

TABLE 14
CONTRIBUTION TO GDP GROWTH

	2009		2010			2011*		2012*
	1Q	Year	1Q	IR Mar.10*	IR Jun.10*	IR Mar.10	IR Jun.10	IR Jun.10
a. Private consumption	2.8	1.6	2.5	2.2	2.7	2.8	3.0	3.0
b. Public consumption	1.1	1.3	1.2	0.4	0.7	0.3	0.3	0.3
c. Private investment	0.4	-3.5	2.4	1.7	2.4	1.8	1.8	2.3
d. Public investment	0.7	1.1	0.5	1.1	1.3	0.4	0.5	0.4
e. Change in inventories	-5.8	-3.6	1.4	1.4	1.7	1.1	1.3	0.2
f. Exports	-0.3	-0.5	0.0	1.1	0.6	1.1	1.1	1.5
g. Imports 1/	3.1	4.3	-2.1	-2.3	-2.7	-2.0	-2.1	-1.7
GDP	**1.9**	**0.9**	**6.0**	**5.5**	**6.6**	**5.5**	**6.0**	**6.0**
Memo:								
Public expending	*1.8*	*2.4*	*1.8*	*1.5*	*2.0*	*0.7*	*0.8*	*0.7*

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

Graph 46
GDP GROWTH CONTRIBUTION

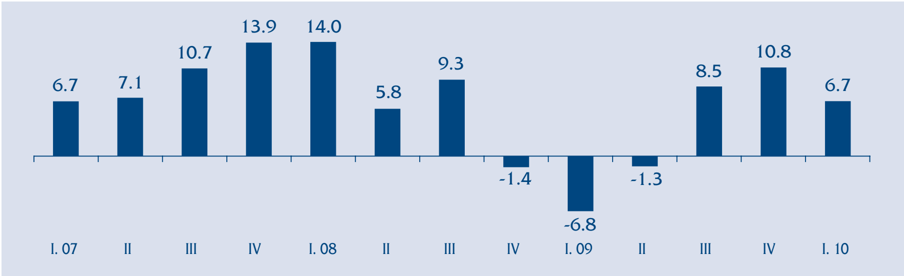


* Forecast.

Indicators of recovery

36. Isolating the effect of seasonality, economic activity has been showing a continuous recovery since Q3-2009.

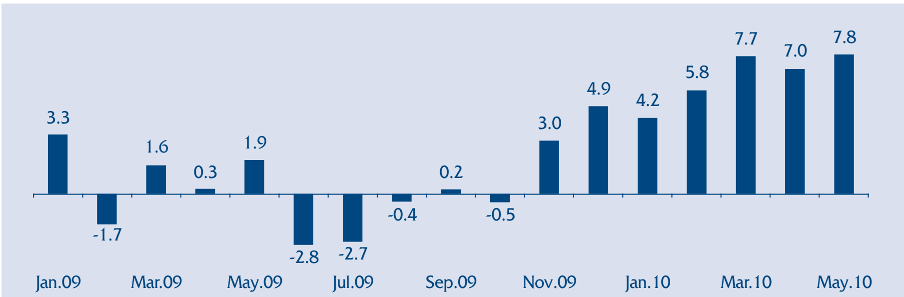
Graph 47
SEASONALY ADJUSTED GDP
(% change compared with the same quarter or the previous year)



37. Recent indicators of activity continue showing clear signs of a recovery:

    a. The production of electricity recorded an annual growth of 7.8 percent in May.

Graph 48
ELECTRICITY PRODUCTION
(Last 12-months % change)



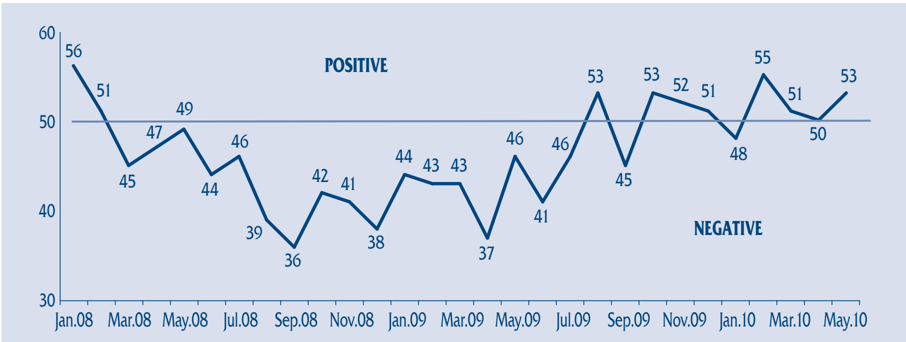
Source: COES.

b. Dispatches of cement in May grew 20.5 percent compared to the same month in 2009.

Graph 49
LOCAL DISPATCH OF CEMENT
(Last 12-months % change)

c. The consumer confidence index has been falling in the positive tranche since February, reflecting the optimism of most of the consumers surveyed regarding their household economy in the near future. In May, the consumer confidence index rose to 53 points.

Graph 50
CONSUMER CONFIDENCE INDEX
Family economic situation



Source: Ipsos, APOYO.

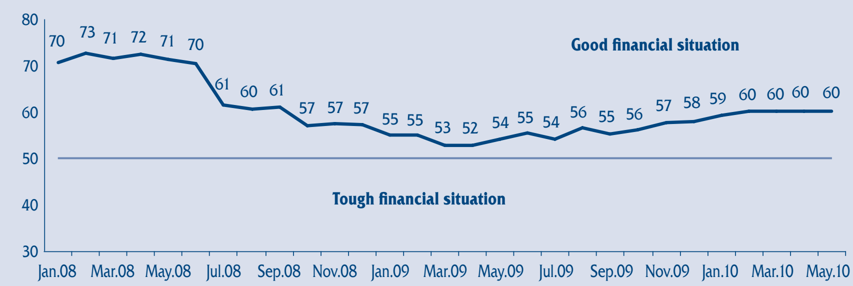
d. The business confidence index has not only recovered, but also shows higher levels than the ones observed prior to the crisis. In May, this index recorded 71 points –the second highest level in the year–, which reflects the optimistic views prevailing among the surveyed business groups regarding the evolution of the economy in the near future.

Graph 51
BUSINESS CONFIDENCE INDEX
Economic situation

Source: BCRP Survey on Macroeconomic Expectations May 2010.

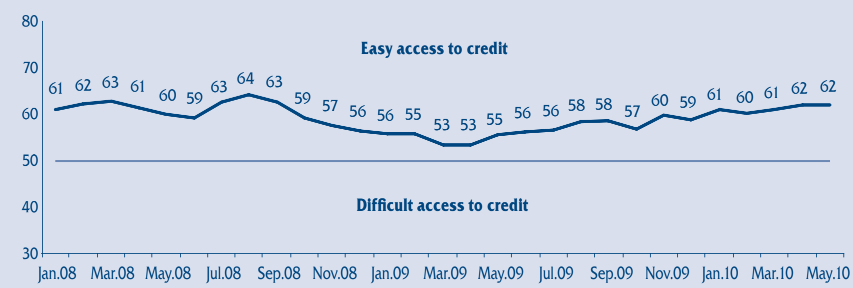
e. The positive financial situation of the larger firms continues to improve and the perception that having access to credit has become easier is increasing.

Graph 52
FINANCIAL SITUATION INDEX



Source: BCRP Survey on Macroeconomic Expectations May 2010.

Graph 53
ACCESS TO CREDIT INDEX



Source: BCRP Survey on Macroeconomic Expectations May 2010.

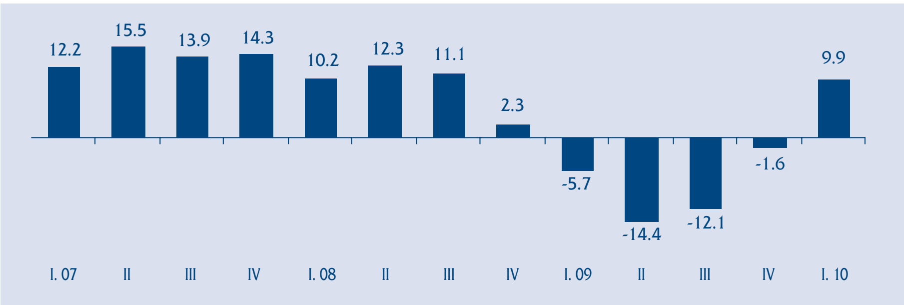
f. Economic analysts and financial entities expect GDP to grow 6.0 percent in 2010, while non financial firms estimate a growth rate of 5.0 percent. Growth projections for 2011 range between 5.5 and 6.0 percent, and a growth rate of 6.0 percent is estimated for 2012.

TABLE 15
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH (%)

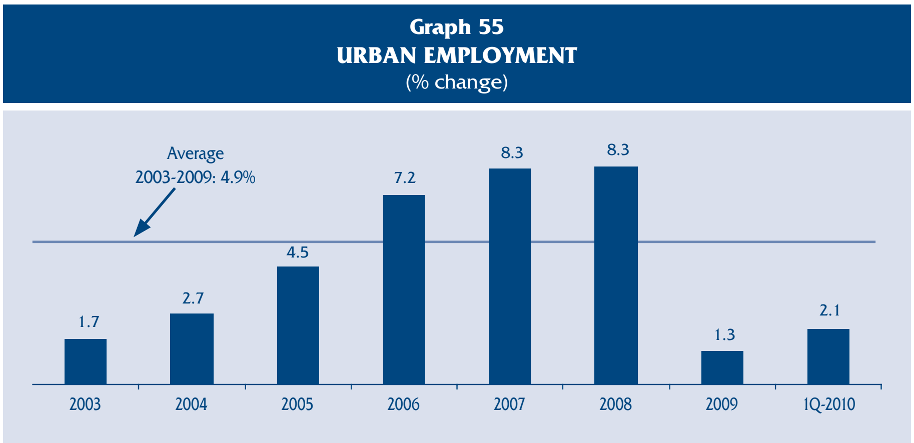
	November 2009	February 2010	May 2010
FINANCIAL ENTITIES			
2010	4.0	5.0	6.0
2011	5.0	5.0	6.0
2012	-	-	6.0
ECONOMIC ANALYSTS			
2010	4.0	4.5	6.0
2011	5.0	5.0	5.5
2012	-	-	6.0
NON-FINANCIAL FIRMS			
2010	4.0	4.5	5.0
2011	5.0	5.0	5.5
2012	-	-	6.0

g. Manufacturing, which continues showing a significant recovery, recorded an expansion of 10 percent in Q1-2010.

Graph 54
NON-PRIMARY MANUFACTURING
(Real % change)

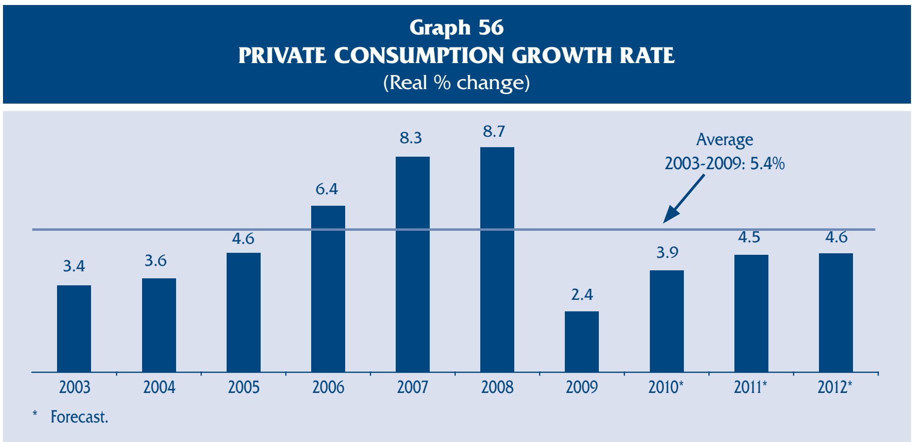


h. The growth of employment during the first quarter of 2010 (2.1 percent) has favored the dynamism of private consumption. The continuous growth of formal employment has contributed to maintain consumer confidence. No declines are observed in the levels of formal employment in annual terms since 2001.



Expenditure components

38. **Private consumption** grew 3.6 percent in Q1-2010. This evolution was associated with better consumer confidence levels, the growth of employment, and the recovery of national disposable income.



39. In contrast with the concept of GDP, the concept of national disposable income also considers the effect of international prices and remittances from Peruvians residing abroad, and deducts the profits generated by foreign investments. Thus, this is a more accurate indicator on the economic transactions that generate income for the country. The national disposable income would recover to 6.9 and 5.8 percent in 2010 and 2011, respectively, mainly as a result of the expected evolution of GDP and terms of trade. In 2012, the national disposable income is expected to grow 6.0 percent.

TABLE 16
NATIONAL DISPOSABLE INCOME
(Real % change)

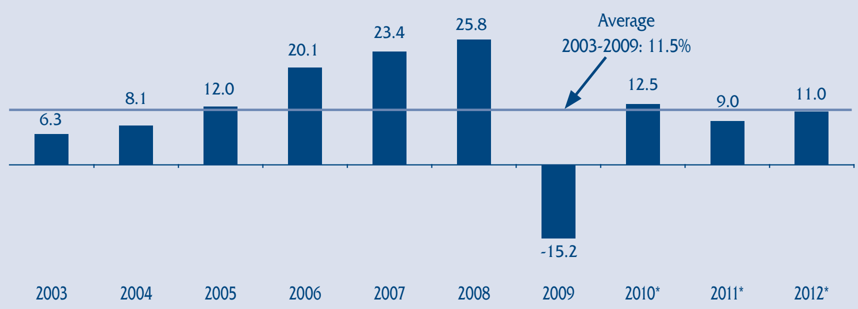
	2009		2010			2011*		2012*
	1Q	Year	1Q	IR Mar.10*	IR Jun.10*	IR Mar.10	IR Jun.10	IR Jun.10
1. GDP	**1.9**	**0.9**	**6.0**	**5.5**	**6.6**	**6.0**	**6.0**	**6.0**
2. Gross national product	7.6	2.1	2.2	3.8	4.9	6.0	6.4	6.6
3. Gross national income	2.0	1.0	6.7	6.3	7.2	5.4	5.8	6.0
4. National disposable income 1/	**2.0**	**0.9**	**6.3**	**6.0**	**6.9**	**5.4**	**5.8**	**6.0**

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.

40. The growth of private consumption is expected to accelerate from 2.4 percent in 2009 to 3.9 percent in 2010 and to 4.5 percent in 2011. This projection considers the recovery foreseen in terms of trade and its effect on the national disposable income. In 2012 private consumption would grow 4.6 percent.

41. Private investment tends to be one of the most volatile components of expenditure during the periods of expansion and contraction of the economic cycle. Given the important group of investment projects announced, the economy's sound economic fundamentals, and optimistic business expectations, a rapid recovery of private investment may be foreseen: private investment would grow 12.5 and 9.0 percent in 2010 and 2011, respectively. In 2012 private investment is expected to grow 11.0 percent.

Graph 57
PRIVATE INVESTMENT GROWTH RATE
(Real % change)



* Forecast.

TABLE 17
NOTICE OF EXECUTION OF INVESTMENT PROJECTS
(Millions of US$)

Sector	2010	2011	2012	Total
Mining	3,298	5,742	7,046	16,086
Hydrocarbons	2,344	2,388	2,657	7,390
Electricity	723	966	1,318	3,007
Telecommunications	291	239	46	577
Industry	1,147	1,004	888	3,039
Infrastructure	2,135	1,159	644	3,938
Other Sectors	1,297	644	401	2,342
Total	**11,235**	**12,143**	**13,000**	**36,377**

Source: Press media and companies information.

42. The increase of private investment would be associated with a faster pace in the implementation of projects and with favorable expectations about the future performance of the economy after a period where several projects were temporarily postponed because of the financial crisis and the global economic slowdown.

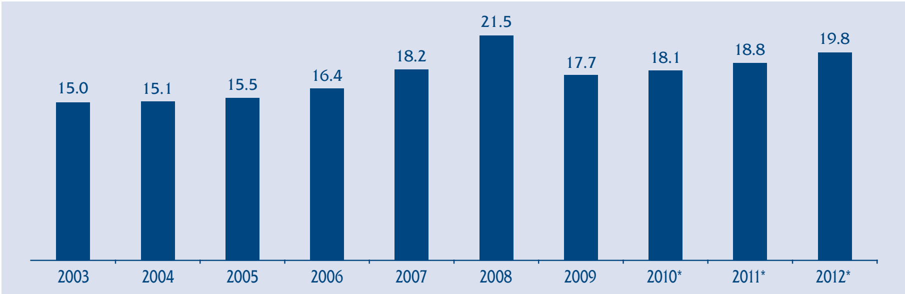
Investment projects worth pointing out in the sector of **mining and hydrocarbons** include Toromocho, Galeno, the expansion of Antamina, Cerro Verde, and Lot 67 (Perenco), and crude and gas exploration and production activities in lots Z-6, Z-33, and Z-2b. In the **infrastructure** sector, projects such as the expansion of transportation capacity of Gasoducto Andino del Sur and projects aimed at improving the roads and infrastructure directly associated with trade operations (piers, ports, and improvement of airports) are worth being highlighted. Some of these projects have been given in concession and others are currently in this process. Investment projects that should be pointed out in terms of electricity infrastructure include hydroelectrically plants, power generation plants, and transmission lines.

Two characteristics of the rest of investment projects that were consolidating prior to the deepening of the financial crisis should be pointed out. First, their **diversification in different sectors**, which is reflected in the dynamism of sectors such as the modern retail sector, tourism, residence and office constructions, non primary industry, among other sectors. Second, their **geographic diversification**, reflected in the number of new malls and hotel infrastructure to be implemented in cities like Piura, La Libertad, Arequipa, Chimbote, Juliaca, and Cuzco, among other cities.

TABLE 18
NOTICE OF EXECUTION OF INVESTMENT PROJECTS: 2010 - 2012

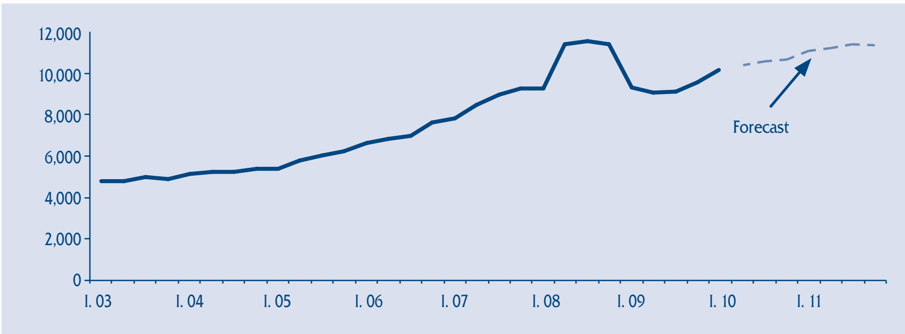
SECTOR	COMPANY	PROJECT NAME
Mining	Xstrata Peru	Las Bambas
	Northern Peru Copper	Galeno
	Minera Peru Copper S.A.	Toromocho
	Anglo American	Quellaveco
	Minera Yanacocha S.R.L.	Mines Conga
	Antamina	Expansion of pit
	Xstrata Peru	Antapaccay
	Sociedad Minera Cerro Verde	Cerro Verde Expansion
	Shougang Group Hierro Perú	Marcona
	Norsemont Perú S.A.C.	Constancia
	Marcobre S.A.C.	Mina Justa
	Barrick Misquichilca	Expansion of Leaching plant
	Mitsui Mining & Smelting Co. Ltda. Suc. Perú	Quechua
	Southern Peru Copper	Refinery and funding Ilo - Toquepala - Cuajone
	Minera Yanacocha S.R.L.	Chaquicocha
Hydrocarbons	Perenco Peru Limited	Lot 67
	Kuntur Transportadora de Gas	Pipeline Andino of Sur
	Pluspetrol	Malvinas Expansion
	Savia Perú (Petro-Tech)	Lote Z-2B
	Transportadora of Gas de Perú	Expansion transport capacity of Gas
	Petrobras	Exploration of oil and gas
	Perú LNG	Camisea II
	Cálidda Gas Natural del Perú	Expansion of main network
Electricity	Fenix Power Perú SA	Thermoelectric plant (natural gas combined cycle)
	Odebrecht	Hydroelectric plant Cerro de Chaglla
	Luz del Sur	Network Expansion and infrastructure development
	Asa Iberoamérica	Transmission line Chilca-Marcona-Montalvo
	SN Power	Hydroelectric plant Cheves
	Inevarante / Engel-Axil	Hydroelectric plantAcco Pucará
Industry	SIDERPERÚ	Plant modernization
	Petroperú	Modernization of Talara Refinery
	Aceros Arequipa	Additions and modernization of plant
	Cementos Yura	Cement plant
	Vale do Rio Doce (CVRD)	Bayóvar phospates
	Votorantim Metais - Cajamarquilla S.A.	Cajamarquilla refinery expansion
	Cementos Lima	Expansion of installed capacity
	Cementos Otorongo	Cement plant construction
	Cementos Portland	Cement plant
	Cementos Andino	Tarma plant expansion
	Corporación JR Lindley	New plantt
Infrastructure	Dubai Ports World Callao	South pier
	OAS S.R.L	Freeway. Yellow line
	Autopista of Norte SAC	Highway Nº 4
	Santa Sofía Puertos	Ancón port
	Tren Eléctrico Lima	Electrict train
	Terminales Portuarios Euroandinos (TPE)	Expansion of Paita port
	ACS Servicios. Comunicaciones y Energía	Treatment plant La Taboada
	Covi Peru	Red Vial Nº 6
	Concesionaria Vial del Sol S.A. - COVISOL	Highway del Sol
	Odebrecht	IIRSA SUR:Tract 4: Azangaro - Inambari
	Odebrecht	IIRSA SUR: Tract 5: Matarani - Azangaro
	Operadora Portuaria S.A. (OPORSA)	Port Terminal Ventanilla
Other Sectors	NDG Perú	Real state projects
	Telefónica del Perú	Movile phone network and broadband expansion
	Telmex	New services
	Maple Etanol SRL	Ethanol plant

Graph 58
PRIVATE FIXED INVESTMENT
(% of GDP)



* Forecast.

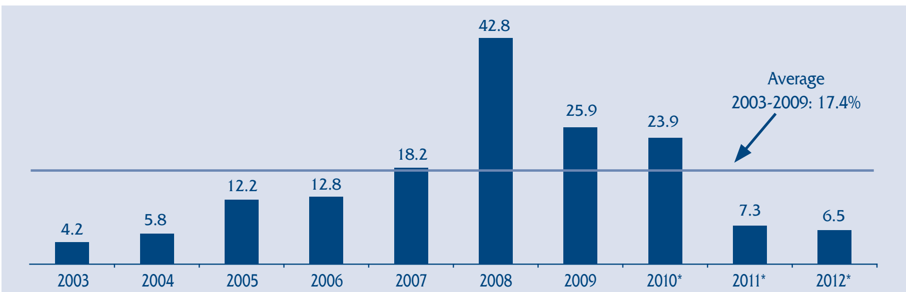
Graph 59
SEASONALLY ADJUSTED PRIVATE INVESTMENT
(Millions of nuevos soles of 1994)



43. The projection on government expenditure in 2010 and 2011 has been revised upwards both in terms of public consumption and in terms of public investment.

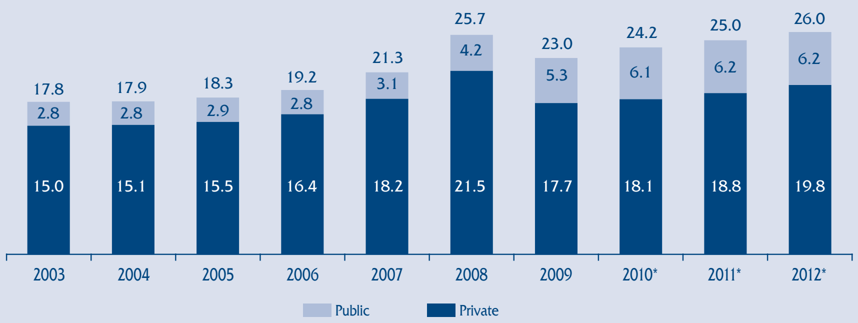
44. Public investment would grow 23.9 percent in 2010 and 7.3 and 6.5 percent in 2011 and 2012, respectively.

Graph 60
PUBLIC INVESTMENT GROWTH RATE
(Real % change)



* Forecast.

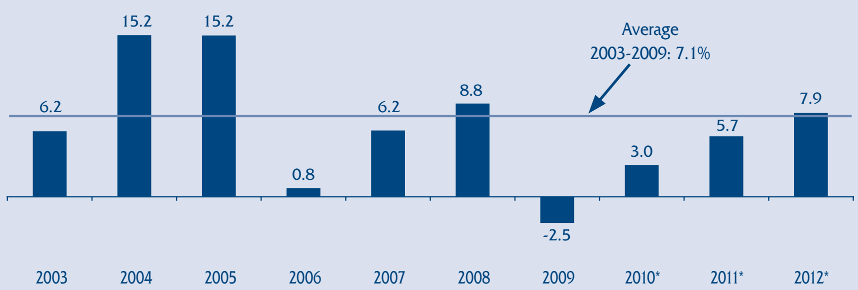
Graph 61
COMPOSITION OF GROSS FIXED INVESTMENT
(% of GDP)



* Forecast.

45. In 2010-2012, actual exports of goods and services would show a continuous recovery considering an improvement in the growth rate in a context of increased global demand. This evolution would be reinforced as a result of the increased access to foreign markets resulting from trade agreements and the full operation of hydrocarbon projects that will boost traditional exports.

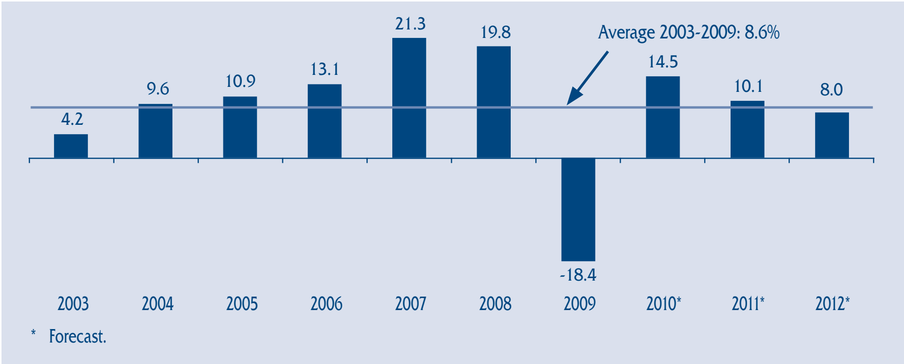
Graph 62
EXPORTS OF GOODS AND SERVICES GROWTH RATE
(Real % change)



* Forecast.

46. Actual imports of goods and services are expected to show a faster pace of growth in 2010, in line with a context of recovery of the pace of growth of the product, particularly private investment. Imports would grow at rates of 10.1 and 8.0 percent in 2011 and 2012, respectively.

Graph 63
EXPORTS OF IMPORTS AND SERVICES GROWTH RATE
(Real % change)

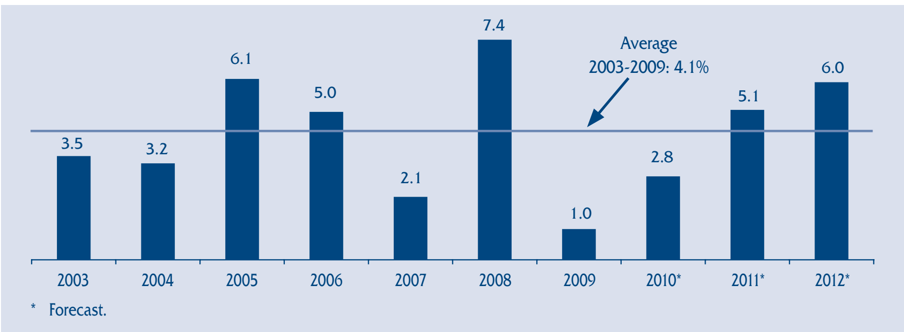


GDP by sectors

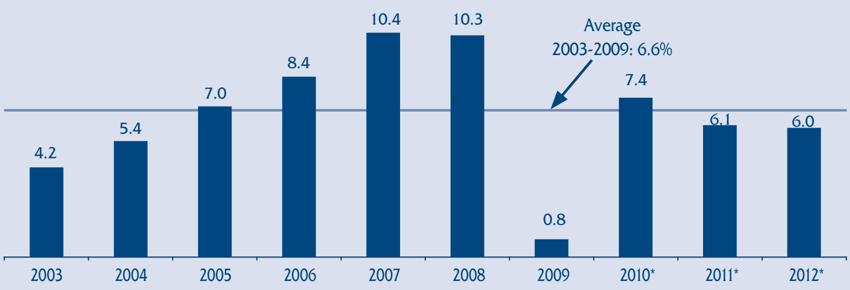
47. In a context of recovery of the dynamism of domestic demand, **non primary sectors** showed a substantial rebound in Q1-2010, recording a growth rate of 7.2 percent. The recovery of non primary manufacturing (9.9 percent) was noteworthy after having recorded negative rates for four quarters. Likewise, construction recovered the dynamism observed in the quarters prior to the international financial crisis, recording a two-digit rate of expansion (16.8 percent).

    Primary sectors registered a slight increase of 0.3 percent in a context of growth declines in the sectors of fishing and metallic mining, which were not offset by the growth observed in the agriculture sector.

Graph 64
PRIMARY SECTORS GROWTH RATE
(Real % change)



Graph 65
NON-PRIMARY SECTORS GROWTH RATE
(Real % change)



* Forecast.

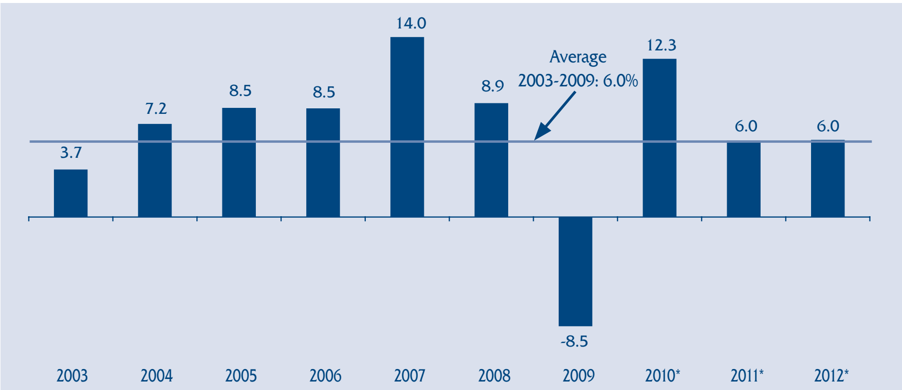
Table 19
GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS
(Real % change)

	2009		2010			2011*		2012*
	1Q	Year	1Q	IR Mar.10*	IR Jun.10*	IR Mar.10	IR Jun.10	IR Jun.10
Agriculture and livestock	**4.4**	**2.3**	**3.8**	**2.7**	**4.2**	**3.5**	**3.5**	**4.7**
Agriculture	3.6	0.9	3.9	1.4	4.4	3.4	3.3	4.8
Livestock	5.6	4.4	3.5	4.2	3.8	4.2	4.3	4.7
Fishing	**-14.2**	**-7.9**	**-14.2**	**0.3**	**-1.7**	**2.6**	**5.3**	**2.6**
Mining and hydrocarbons	**3.7**	**0.6**	**0.1**	**2.8**	**1.4**	**7.9**	**7.0**	**8.5**
Metallic mining	0.9	-1.4	-1.3	-0.3	-2.4	5.7	4.6	10.0
Hydrocarbons	30.4	16.1	11.0	28.4	29.2	20.6	20.6	1.1
Manufacturing	**-4.2**	**-7.2**	**7.3**	**6.5**	**10.7**	**5.3**	**5.9**	**5.8**
Raw materials	3.9	0.0	-5.6	2.7	2.5	6.4	5.3	4.9
Non-primary industries	-5.7	-8.5	9.9	7.3	12.3	5.0	6.0	6.0
Electricity and water	**1.2**	**1.2**	**6.4**	**4.9**	**6.6**	**5.3**	**5.3**	**5.3**
Construction	**5.1**	**6.1**	**16.8**	**12.5**	**13.9**	**9.3**	**9.3**	**12.0**
Commerce	**0.4**	**-0.4**	**8.1**	**5.1**	**8.3**	**5.0**	**5.6**	**5.7**
Other services	**3.7**	**3.1**	**4.9**	**5.4**	**5.1**	**5.3**	**5.9**	**5.2**
GDP	**1.9**	**0.9**	**6.0**	**5.5**	**6.6**	**5.5**	**6.0**	**6.0**
Primary	**3.5**	**1.0**	**0.3**	**2.6**	**2.8**	**5.4**	**5.1**	**6.0**
Non-Primary	**1.6**	**0.8**	**7.2**	**6.1**	**7.4**	**5.5**	**6.1**	**6.0**

IR: Inflation Report.
* Forecast.

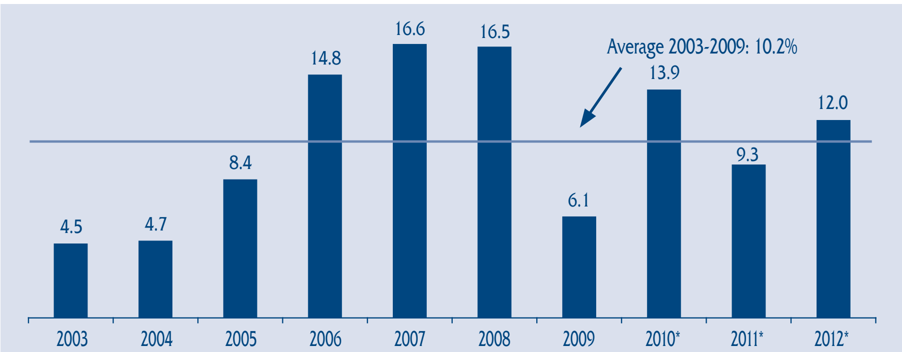
48. The upward revision of the growth rate of GDP from 5.5 percent to 6.6 percent in 2010 considers a significant increase in the dynamism of both primary and non primary sectors. The former would show a higher growth (increasing from 2.6 to 2.8 percent) as a result of greater activity in the sub-sector of agriculture, which would offset the declines foreseen in fishing and metallic mining considering the evolution of these sectors in Q1. On the other hand, the latter would record a higher rate of growth (7.4 percent) than the one considered in our previous Report (6.1 percent), in line with the higher growth expected in terms of domestic demand (up from 6.8 to 8.8 percent).

Graph 66
NON-PRIMARY MANUFACTURING GROWTH RATE
(Real % change)



* Forecast.

Graph 67
GROWTH RATE OF THE CONSTRUCTION SECTOR
(Real % change)



* Forecast.

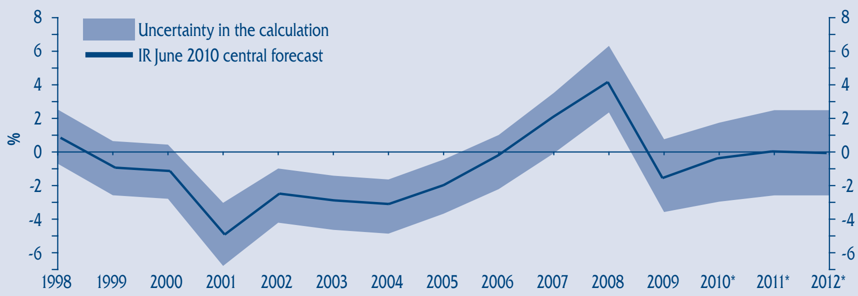
A significant recovery of primary sectors is expected in the next years assuming normal climatic conditions for agriculture and fishing activities, as well as a rebound of the mining sector in 2012. The latter would be mainly associated with a higher production of copper as a result of the expansion of Antamina and Toquepala and the onset of operations of Minas Justa. On the other hand, the annual growth rate of non primary sectors would stabilize around 6 percent, with construction leading this growth with a rate of between 9 and 12 percent, in line with the expected expansion of private investment.

Output gap

49. The output gap is the aggregate indicator of demand pressures that may translate into a higher rate of inflation. The output gap would be located near equilibrium in the next two years.

The slowdown of the economy in 2009 led the estimated gap between GDP and the potential GDP to go from a level of 4.4 percentage points in 2008 to a negative level of 1.6 percent in 2009. This situation would gradually reverse due to the recovery of economic activity foreseen for the next years. Thus, higher growth during 2010 would reduce the output gap to -0.4 percent, leading the output gap to reach levels close to equilibrium since 2011.

Graph 68
OUTPUT GAP
(% of the potential GDP)



* Forecast.

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

BOX 3
POTENTIAL GROWTH AND FACTOR PRODUCTIVITY

One of the most outstanding macroeconomic phenomena observed in the country in the last decade has been the significant growth of GDP. Between 2001 and 2009, GDP recorded an annual growth rate of 5.3 percent on average, which implies an accumulated growth rate of 59.6 percent. Three questions of interest may be asked in relation to this: Is this growth based on the effective improvement of productivity in the economy or is it mainly explained by short term factors? What was effect of the recent international financial crisis on this growth? And finally, has this growth path had any impact on the country's income per capita?

An accounting exercise in terms of potential or long term growth, understood as the pace of growth associated with the expansion of productive capacities in the economy, was carried out in order to answer these questions. Since this growth is explained by supply-related factors and since it does not consider short-term demand pulls, it may also be understood as the pace of growth prevailing in a situation where inflation is equal to its long term value (in other words, it is a non-inflationary growth). The standard methodology used to calculate the potential GDP is the method of the production function explained in detail by Carranza et al. (2003) and Miller (2003).

Long term growth can be broken down into the contributions of the aggregate three productive factors: work (the labor effectively used, that is, the employed economically active population), capital (adjusted by the rate of utilization of installed capacity), and total factor productivity (TFP). While labor reflects demographic trends and the dynamics of the labor market, the accumulation of capital reflects how expenditure in fixed gross investment is transformed, after a certain period of installation and learning, into productive capital[6].

Figure 1 shows the breakdown composition of potential growth for the average growth of the 80s and 90s and for the period 2000-2009. An important change in the dynamics of growth is observed in the decade of 2000: potential growth shows an average annual value of 5.4 percent, a figure substantially higher than the 3.1 percent registered in the 90s and to the 0.3 percent recorded in the 80s. Moreover, even though capital contribution accounts for a great deal of potential growth in the decade of 2000 –which reflects increased investment especially since 2005–, the growth of TFP was particularly noteworthy. In the decade of 2000, TFP recorded an average rate of 2.2 percent and reached a maximum rate of 3.6 percent in 2008, showing significantly higher levels than the (negative) rates observed in previous decades.

6 An implicit assumption when considering total fixed gross investment in the accumulation of capital is that government investment is as productive as private investment. This assumption does not alter results significantly. If gross government investment is excluded (that is, if we assume on the contrary that government investment is not productive), the average growth observed in terms of total productivity factors in the decade of 2000 is 2.3 percent, a figure close to the one reported in Figure 1.

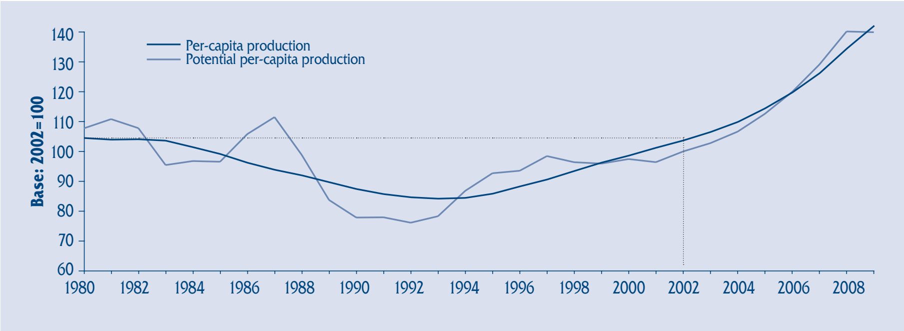
Potential growth slowed down in 2009 as a result of the recent international financial crisis, but continued recording higher levels (6.9 percent) than the average rate in the decade. It maintained its dynamism mainly due to the investment boom of the previous years, which translated into a capital contribution of 3.7 percent. The highest adjustment was observed in TFP, which went from a growth rate of 3.6 percent in 2008 to a rate of 1.8 percent in 2009. However, and in spite of the fact that this has been one of the most severe crises ever recorded, the growth rate of 1.8 percent is quite significant in terms of a historical perspective. This would account for the vigorous recovery of GDP growth recorded in Q1 despite the maintenance of uncertainty regarding the evolution of the international context.

Moreover, TFP measures the level of efficiency in the use of physical productive factors, which means that, given certain levels of labor and capital stocks, a higher potential growth is necessarily associated with productivity increases. Conceptually, FPF is promoted by technological changes that generate increased useful knowledge and better procedures in the production process and, therefore, it is associated with structural factors, such as the level of development of human capital, the political and macroeconomic stability of the country, the soundness of the financial system, the depth of the credit market, and the country's integration to international trade, among other factors. In addition to boosting the growth of TFP, these factors have contributed to reduce the volatility of the economic cycle, as shown in Figure 2 (see Castillo et al., 2006).

In GDP per capita terms, the sequence of growth observed in the decade 2000 (see Figure 2) was of such magnitude that, after recovering the levels of potential GDP per capita growth recorded at end-70s only in 2002, this level had increased 37.1 percent by 2009 (with an average annual growth of 4.6 percent). This confirms the positive impact of the evolution of growth on this measurement of average income, which is explained mainly by the growth of TPF in a context in which the aggregate contribution of labor to growth remains stable.

Figure 1
ACCOUNTABILITY OF POTENTIAL GDP

Figure 1
PER CAPITA PRODUCTION OBSERVED AND POTENTIAL SINCE 1980



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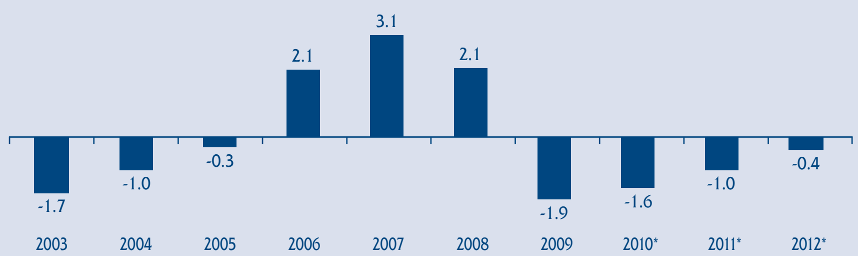
IV. Public finances

50. The baseline forecast scenario considers a gradual withdrawal of fiscal stimulus. In this context, in 2010 the non financial public sector (NFPS) would record a deficit of 1.6 percent, a similar rate than the one considered in our previous report. This result is also in line with the results projected in the last Multiannual Macroeconomic Framework (MMF).

51. The current revenues of the general government would amount to 19.5 percent of GDP –0.5 percentage points higher than the result considered in our March Report– mainly as a result of the higher level of activity expected for this year. A higher level of non financial expenditure than the one considered in March (0.4 percentage points) is also projected given the increased execution of expenditure in the first months of the year.

Graph 69
OVERALL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)



* Forecast.

52. Law N° 29368 (of May 29, 2009) suspended the application of the macro fiscal rules for the deficit and increase of government expenditure (which established that the deficit should not exceed 1 percent and expenditure in consumption should be lower than 4 percent) in 2009 and 2010. As an exception, in these years the deficit shall not exceed 2 percent, while the increase in expenditure in consumption shall be lower than 10 and 8 percent in 2009 and 2010, respectively. In order to meet the projected expenditure level in 2010, the government has approved a series of measures extending to national government entities (Decreto de Urgencia 037-2010) that are aimed at limiting the growth of the general government expenditure.

53. A declining path of fiscal deficit is foreseen for 2011 and 2012 (1.0 and 0.4 percent of GDP, respectively). This improvement would be explained by a moderate increase

of the general government revenue associated with the economic growth expected in the next years, as well as with a declining trend in non financial expenditure, even though with the characteristic that the share of capital expenditure increases, reducing the pace of expansion of current expenditure.

54. The non financial public sector (NFPS) recorded an economic surplus of 2.8 percent of GDP in Q1-2010, a result 0.2 percentage points higher than the one observed in Q1-2009. This increase in the economic result was recorded in the general government whose surplus increased from 1.5 to 3.3 percent of GDP, although this improved was offset by the result of state enterprises which posted a deficit of 0.5 percent (in contrast with the 1.1 percent surplus recorded in Q1-2009). By government levels, the national government registered a surplus of 2.6 percent of GDP; local governments showed a surplus of 0.6 percent of GDP, and regional governments a surplus of 0.1 percent of GDP.

TABLE 20
NON-FINANCIAL PUBLIC SECTOR
(% of GDP)

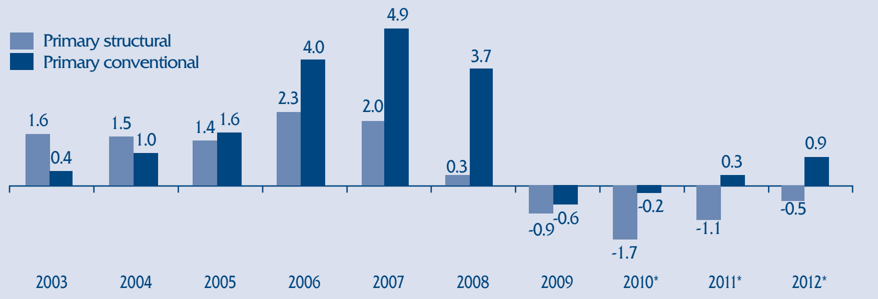
	2009		2010			2011 *		2012 *
	1Q	Year	1Q	IR Mar.10*	IR Jun.10*	IR Mar.10	IR Jun.10	IR Jun.10
1. General government current revenue 1/	**19.8**	**18.6**	**20.8**	**19.0**	**19.5**	**19.4**	**19.7**	**19.9**
Real % change	*-8.6*	*-11.3*	*17.8*	*10.1*	*14.0*	*7.1*	*6.2*	*6.6*
2. General government non-financial expenditure	**16.6**	**19.6**	**16.3**	**19.4**	**19.8**	**19.3**	**19.4**	**19.0**
Real % change	*12.1*	*12.7*	*9.5*	*7.1*	*9.8*	*4.3*	*3.2*	*3.3*
Of which:								
a. Current	13.5	13.9	12.8	13.4	13.7	13.3	13.3	12.9
Real % change	*7.9*	*4.4*	*5.9*	*4.6*	*7.1*	*3.6*	*2.2*	*2.3*
b. Gross capital formation 2/	2.8	5.2	2.9	5.5	5.7	5.7	5.9	5.9
Real % change	*28.2*	*32.5*	*16.3*	*15.0*	*18.7*	*7.3*	*8.5*	*5.6*
3. Others	**1.2**	**0.4**	**-0.1**	**0.2**	**0.0**	**0.2**	**0.0**	**0.0**
4. Primary balance (1-2+3)	**4.4**	**-0.6**	**4.5**	**-0.2**	**-0.2**	**0.2**	**0.3**	**0.9**
5. Interests	**1.8**	**1.3**	**1.7**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**
6. Overall Balance	**2.6**	**-1.9**	**2.8**	**-1.6**	**-1.6**	**-1.0**	**-1.0**	**-0.4**
Memo:								
Central government current revenues 1/	16.5	15.9	18.1	16.4	17.0	16.7	17.1	17.3
Central government non-financial expenditure	13.8	16.6	14.2	16.4	16.9	16.3	16.5	16.3

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

Structural economic result

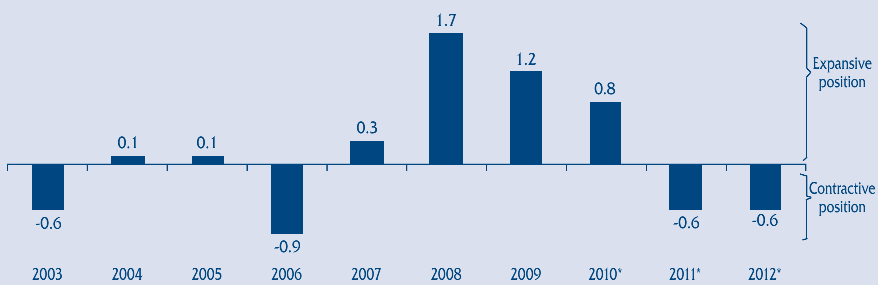
55. The structural economic result is calculated isolating the effect of the economic cycle and the higher prices of exports of minerals and hydrocarbons on the general government revenues. In other words, the structural economic result is the one that would be obtained if GDP showed its trend level and if the prices of mining and hydrocarbon exports were at their long term levels. The change in the structural result determines the fiscal impulse. This indicator allows identifying the effect of fiscal policy on domestic demand, isolating the effects of the economic cycle. In 2009 and 2010, when the Economic Stimulus Plan (ESP) was implemented, there is an expansionary fiscal position. The opposite position is foreseen for 2011 and 2012 due to a deceleration in the growth of government expenditure towards more sustainable long term values. Given the higher growth of public expenditure projected for 2010 in comparison to the one considered in our March Report, the fiscal impulse would increase from 0.5 to 0.8 percentage points.

Graph 70
PRIMARY RESULT OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)



* Forecast.

Graph 71
FISCAL IMPULSE
(% of GDP)



* Forecast.

Evolution of fiscal revenues

56. During Q1-2010 the current revenues of the general government amounted to 20.8 percent of GDP, which represented an increase of 17.8 percent in real terms. This increase was observed both in terms of tax revenues (18 percent) and non tax revenues (31 percent). The increase in the case of the former was mainly associated with the increase of revenue from income tax and value added tax (VAT), while the increase in the case of the latter was mainly associated with the transfer of profits of the Central Reserve Bank and increased revenues from royalty payments (canon) and oil royalties.

TABLE 21
CENTRAL GOVERNMENT TAX REVENUES
(% of GDP)

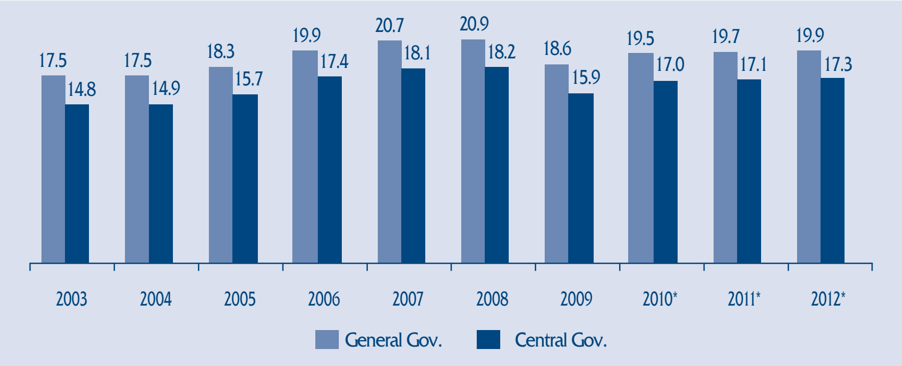
	2006	2007	2008	2009	2010*	2011*	2012*
Income tax	6.1	6.8	6.5	5.3	6.0	5.9	5.9
Value added tax	7.1	7.5	8.5	7.7	8.1	8.4	8.5
Excise tax	1.3	1.3	0.9	1.1	1.1	1.1	1.2
Import fares	0.9	0.7	0.5	0.4	0.4	0.4	0.4
Other tax revenues	1.1	1.1	1.2	1.2	1.1	1.1	1.1
Tax returns	-1.6	-1.8	-1.9	-1.9	-1.9	-1.9	-1.9
Total	**15.0**	**15.6**	**15.6**	**13.8**	**14.8**	**15.0**	**15.2**

* Forecast.

57. In 2010 the revenues of the general government are projected to increase to 19.5 percent of GDP, which represents a real increase of 14 percent. This projection is consistent with the faster pace of growth of economic activity being observed, which has translated into significant positive variations in terms of the VAT and the income tax so far this year. As a result of this, the revenues of the national government have recorded two-digit 12-month growth rates between January and April of this year.

Graph 72
NATIONAL GOVERNMENT TAX REVENUES
(Real % change)

Graph 73
GENERAL GOVERNMENT CURRENT REVENUE
(% of GDP)



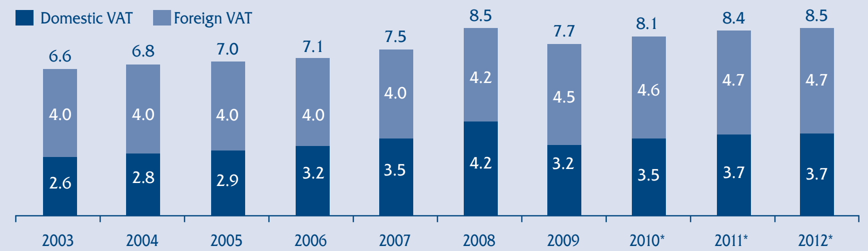
58. In 2010 the income tax would show a recovery due to the increased regularization of this tax achieved. As a result of this, revenue from this tax in January-April 2010 was higher by S/. 574 million than the one recorded in the same period in 2009. Additionally, payments on account from legal entities are also expected to increase due to the higher incomes recorded in the period.

Graph 74
INCOME TAX
(% of GDP)

* Forecast.

59. Revenues from the VAT would amount to 8.1 percent of GDP at end 2010 –up 0.4 percentage points relative to 2009– due, on the one hand, to increased taxable sales resulting from the recovery of the level of activity and to firms' restocking, both situations with a positive effect on the domestic VAT, and on the other hand, to the greater dynamism expected from our imports, which would lead the external VAT to increase from 3.2 to 3.5 percent, thus reaching a similar level to the one observed in 2007.

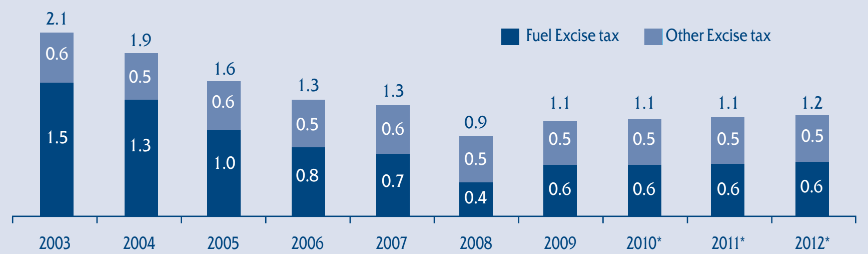
Graph 75
VALUE ADDED TAX
(% of GDP)



Memo: The addition of both components may not be the same as the total due to rounding.
* Forecast.

60. The excise tax would remain at levels of 1.1 percent of GDP in 2010, but showing a real positive growth of 12 percent despite the reduction of the excise tax on diesel fuel implemented early this year –the excise tax on diesel was reduced from S/. 1.47 to S/. 1.27 per gallon (with an estimated cost of S/. 150 million)–, given the statistical effect resulting from having modified the payment modality (from weekly payments to monthly payments) in January 2009. This originated that the amounts collected from the excise tax in that month showed minimum levels, thus reducing the comparison base.

Graph 76
EXCISE TAX
(% of GDP)



Memo: The addition of both components may not be the same as the total due to rounding.
* Forecast.

61. The projections for 2011 and 2012 consider current revenues of 19.7 and 19.9 percent of GDP, respectively, levels consistent with the recovery of economic activity and of the international prices of our export products. The maintenance of the current tax structure is also considered for these years.

Evolution of fiscal expenditure

62. In Q1-2010 the non financial expenditure of the general government was equivalent to 16.3 percent of GDP, which represented an increase of 10 percent in real terms.

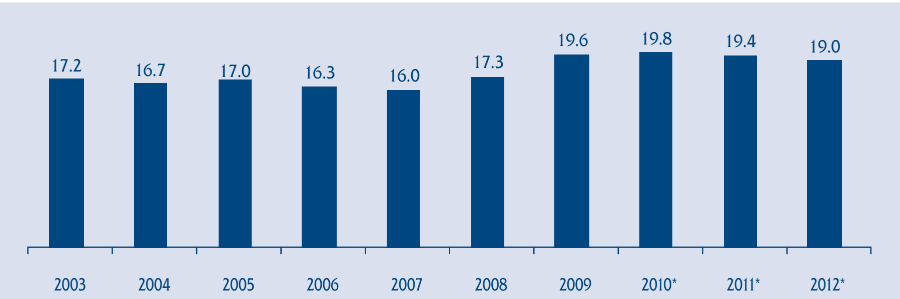
Moreover, 6 percent of this growth is explained by current expenditure and 16 percent by gross capital formation. However, deducting the effect of transfers to the Fuel Price Stabilization Fund in both Q1-2010 (S/. 175 million) and in Q1-2009 (S/. 1 billion), the total increase of non financial expenditure would be 16 percent and the increase of current expenditure would be 14 percent in real terms.

Non financial expenditure would grow by a real 10 percent in 2010, considering an increase of 19 percent in the general government's investment. This projection of expenditure is consistent with the salary policy considered in the government budget, which includes selective salary adjustments and considers increasing the school allowance and "fiestas patrias" bonus by S/. 100 per public servant.

63. In order to meet the projected level of expenditure in 2010, the government has approved a series of mandatory measures that apply also to national government entities (Emergency Decree 037-2010), according to which –with some exceptions– accrued expenditure in goods and services in 2010 shall not be higher than 3 percent in these entities. This decree also establishes that government entities can only execute up to 25 percent of the funds allocated to projects which had no expenditure execution at the time when this regulation was published. Moreover, the use of contingency reserves has been limited by 75 percent. The regulation also establishes that regional and local governments shall approve measures aimed at reducing current expenditure in goods and services.

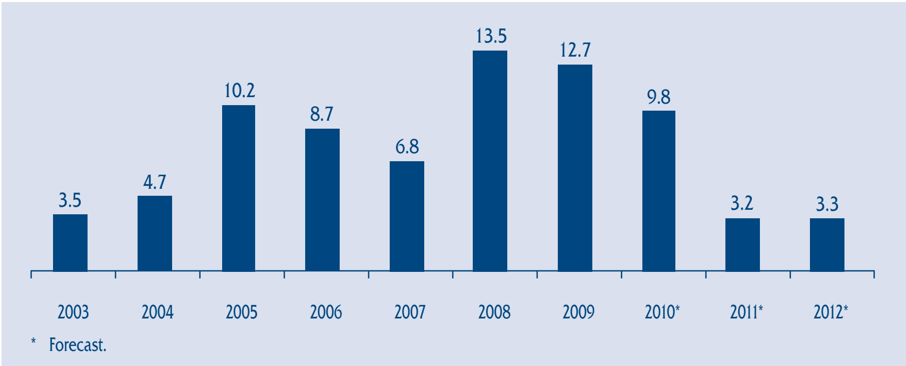
In 2011 the non financial expenditure of the general government would grow by 3 percent. This growth is lower than the one considered for 2010 since the execution of the Economic Stimulus Plan will have concluded by then and so will the election process to designate the new political authorities that will come to office in the regional and local governments in 2011. However, the general government investment, which is expected to grow by 9 percent in 2011, will continue to be the most dynamic component of expenditure.

Graph 77
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(% of GDP)



* Forecast.

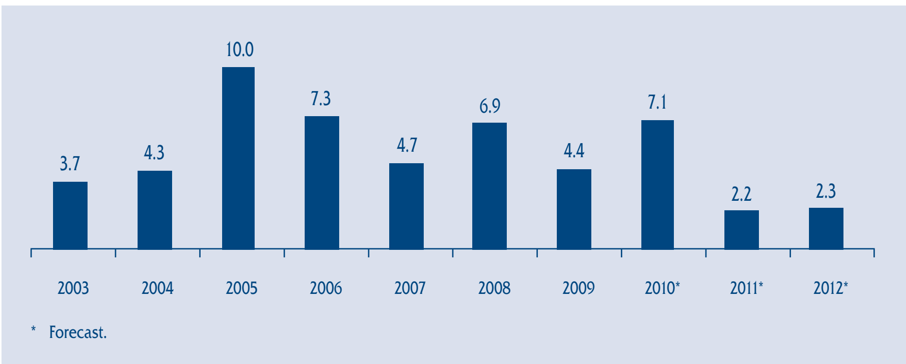
Graph 78
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(Real % change)



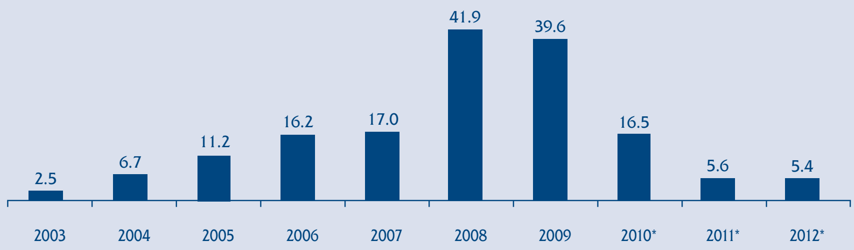
64. The expenditure of sub-national governments, especially capital expenditure, would remain dynamic in 2010 due to the Municipal Modernization Program (S/. 600 million), the Incentive Plan for Municipal Improvement (S/. 700 million), and the placement of bonds to finance infrastructure projects in regional governments (S/. 2,600 million).

65. The projections on the growth of current expenditure in 2011 and 2012 also consider the caps established by the Fiscal Responsibility and Transparency Act, according to which the increase in the central government expenditure in consumption shall not be higher than 4 percent in real terms, including in this expenditure the corresponding expenditure for salaries, pensions, and expenditure in goods and services.

Graph 79
GENERAL GOVERNMENT NON-FINANCIAL CURRENT EXPENDITURE
(Real % change)



Graph 80
GENERAL GOVERNMENT CAPITAL EXPENDITURE
(Real % change)



* Forecast.

Financial requirements

66. The financing requirement of the public sector in 2010 would amount to US$ 3,688 million, reflecting the fiscal deficit of 1.6 percent of GDP. Lower requirements of US$ 3,231 million and US$ 2,452 million are projected for 2011 and 2012, respectively. These requirements may be covered with external and domestic sources.

Table 22
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR 1/
(Millions of US$)

	2009		2010			2011*		2012*
	1Q	Year	1Q	IR Mar.10*	IR Jun.10*	IR Mar.10	IR Jun.10	IR Jun.10
I. Uses	**-435**	**3,838**	**-567**	**3,560**	**3,688**	**3,138**	**3,231**	**2,452**
1. Amortization	292	1,218	405	1,274	1,435	1,479	1,628	1,773
a. External	207	950	157	944	967	962	967	1,334
b. Domestic	85	268	249	330	469	517	661	439
Of which: Pension bonds	*18*	*91*	*41*	*189*	*208*	*150*	*305*	*273*
2. Overall balance (negative sign indicates surplus)	-727	2,620	-972	2,286	2,253	1,658	1,602	679
II. Sources	**-435**	**3,838**	**-567**	**3,560**	**3,688**	**3,138**	**3,231**	**2,452**
1. External	-74	1,127	243	1,061	1,503	1,342	1,375	1,188
2. Bonds 2/	1,064	1,854	221	974	1,104	1,105	1,366	702
3. Internal 3/	-1,425	857	-1,032	1,525	1,082	691	490	561
Memo:								
Balance of gross public debt								
Millions of US$	30,952	33,827	33,577	34,414	34,447	35,553	35,842	36,156
% of GDP	24.7	26.6	25.0	23.4	23.4	22.5	22.9	21.2
Balance of net public debt 4/								
Millions of US$	14,874	17,370	16,488	19,191	19,093	20,555	20,598	21,087
% of GDP	11.9	13.6	12.3	13.1	13.0	13.0	13.2	12.4

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 and MEF.

67. Continuing with its debt management policy, in April 2010 the Peruvian government swapped global bonds maturing in 2012, 2014, 2015, and 2016 by global bonds 2033 that were issued for this purpose.

The total amount of Global Bonds offered for debt swaps and repurchases amounted to US$ 3,366 million, and bonds for a nominal value of US$ 1,800 million were withdrawn from the market, of which US$ 1,385 million were swapped and US$ 415 million were repurchased. As a result of this, the new balance of Global Bonds included in the operation is US$ 1,566 million.

At market value, the transaction amounted to US$ 2,210 million. This was financed through the issuance of Global Bonds 2033, Sovereign Bonds 2042, and treasury resources. The table below summarizes the debt management operations made.

TABLE 23
SOURCES FOR FINANCING OPERATIONS
(Millions of US$)

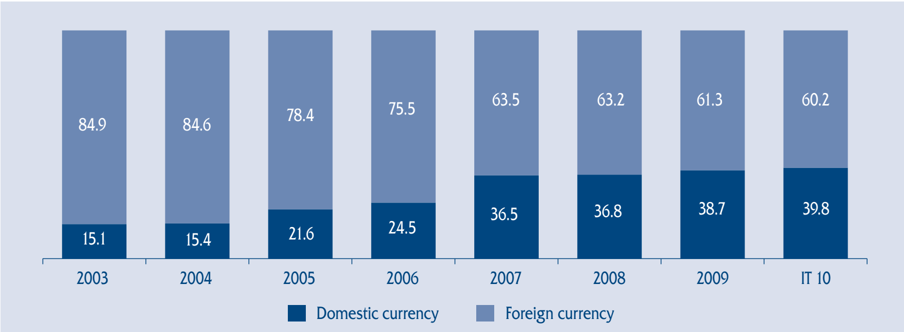
Financing	Nominal	Effective *
Exchange	**1,261**	**1,712**
2033 Global Bond	1,261	1,712
Re-purchase	**493**	**498**
2042 Sovereign Bond	334	324
Public Treasury Resources	159	174
Total	**1,754**	**2,210**

* The actual amount corresponds to the nominal value of the bonds and market prices of equity includes US$ 112 million (market value) for the unused balance of sovereign bond issues of 2017 and 2031 placed in the Year 2009.

This operation increased the average life of the total debt from 11.4 years to 12.7 years as a result of exchanging liabilities whose average life increased from 5.1 to 25.3 years.

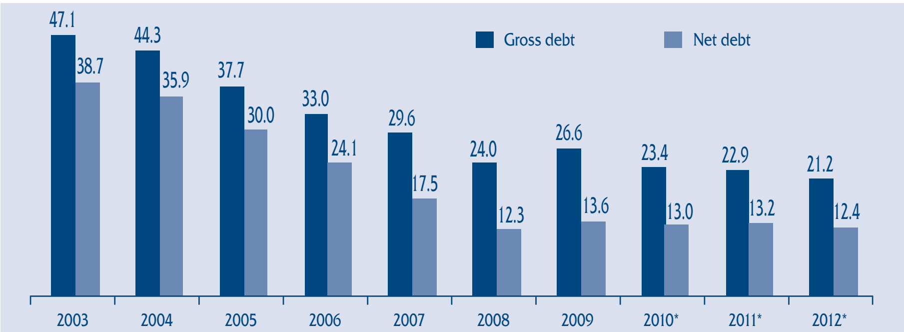
68. The debt's composition in term of currencies has been reducing market risks associated with exchange rate fluctuations given that the share of the overall debt in foreign currency has been reduced. The debt management operation carried out in April has also contributed to this since approximately US$ 540 million of the debt denominated in foreign currency has been transformed into domestic debt in domestic currency.

Graph 81
PUBLIC DEBT BY CURRENCY
(% of total)



69. Both the total gross debt and the total net debt showed a reduction in Q1 when they recorded 25 and 12.3 percent, respectively. These ratios are expected to continue declining in the next years: the gross debt should reach a level of 21.2 percent and the net debt should reach a level of 12.4 percent in 2012 as a result of the government debt strategy and the growth of economic activity.

Graph 82
PUBLIC DEBT
(% of GDP)



* Forecast.

V. Monetary policy

70. The Central Bank continued with its monetary stimulus policy in the first months of the year in response to the global financial crisis, during which the rate of inflation in Peru tended to fall below the inflation target and economic activity grew below it potential level of growth. Thus, until April the reference rate remained at 1.25 percent, which contributed to restore the dynamism of private spending in an effective manner. As a result of the significant monetary and fiscal stimulus implemented and of the recovery of the global economy, economic activity in the country has been showing a rapid recovery and has accumulated a growth rate of about 7 percent in the first 4 months of the year.

71. In this context where having such a significant monetary stimulus is no longer necessary, the Central Bank decided to raise the reference rate by 25 basis points to 1.50 percent in May and raised it again to 1.75 percent in June. This rate adjustment has been implemented preventively since no inflationary pressures are observed and inflation expectations are within the target range.

Graph 83
BCRP INTEREST REFERENCE RATE
(%)

72. The Central Bank permanently assesses its monetary policy stance in order to adjust it to its inflation target through the reference rate, its monetary policy operational target. The adjustments made in this rate are based on the information available on inflation determinants and inflation-related risks. In this sense, if the risk of an increased deterioration of the international context considered in the balance of risks crystallized, the Central Bank would adopt a more gradual pace of withdrawal of monetary stimulus. On the contrary, in a context of a higher growth of domestic demand, the pace of withdrawal of monetary stimulus will be faster.

73. Even though the indicators of domestic economic activity show a substantial recovery, which clearly evidences the need for lower monetary stimulus, the recovery of the main economies still poses some risks in the external sphere.

BOX 4
RECENT MONETARY POLICY MEASURES:
April – June 2010

April: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference rate at 1.25 percent.

The decision of maintaining monetary stimulus is made considering that the recent evolution of inflation is basically the result of the transitory impact of supply shocks and seasonal factors.

May: The Board of the Central Reserve Bank of Peru approved to raise the monetary policy reference rate from 1.25 percent to 1.50 percent.

The nature of this measure is mainly preventive given that the clear indicators about the growth of production, in a context without inflationary pressures, allow reducing monetary stimulus.

This decision does not necessarily imply the beginning of a sequence of rises in the reference interest rate, which will depend on the evaluation of inflation determinants.

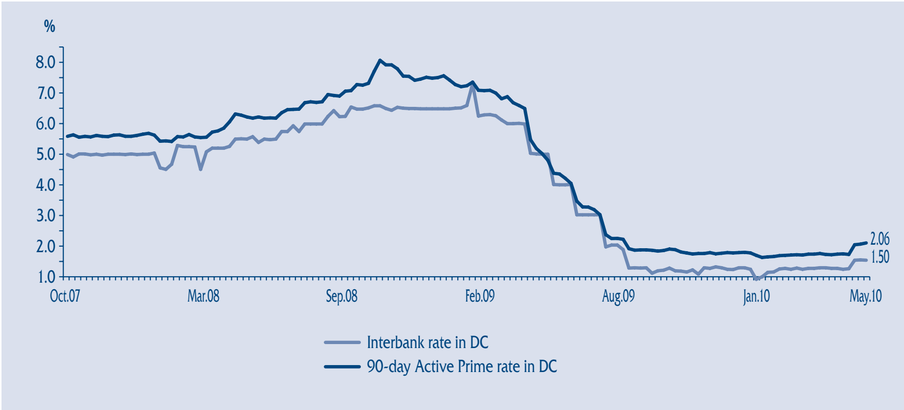
June: The Board of the Central Reserve Bank of Peru approved to raise the monetary policy reference rate from 1.50 percent to 1.75 percent.

This measure is mainly preventive given the strong dynamism of domestic demand and implies maintaining monetary stimulus in a context in which no inflationary pressures are observed.

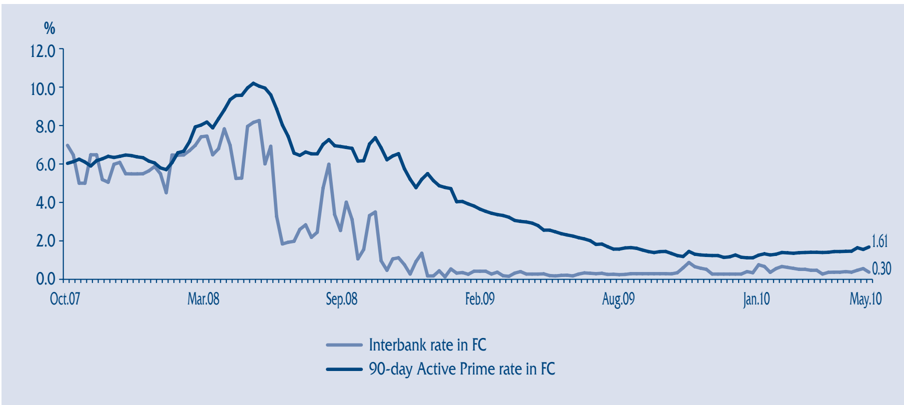
This decision does not necessarily imply the beginning of a sequence of rises in the reference interest rate, which will depend on the evaluation of inflation determinants.

74. The magnitude of the rises (25 basis points) implemented in the reference rate in May and June has not substantially modified credit conditions in the economy. Information in May shows that the interest rates on corporate loans in nuevos soles increased from 1.71 percent in March to 2.06 percent in May and that these rates on loans in dollars have increased from 1.32 to 1.61 percent in the same period.

Graph 84
INTERBANK AND CORPORATE PRIME INTEREST RATES IN DOMESTIC CURRENCY



Graph 85
INTERBANK AND CORPORATE PRIME INTEREST RATES IN FOREIGN CURRENCY



75. The average rate of bank loan operations (FTAMN), which was 20 percent at May, remained in the levels observed since Q3-2009, reflecting the conduct of commercial interest rates which have not been affected by the withdrawal of monetary stimulus yet, in part due to the lag of the rise in the reference rate.

The interest rates on loans for micro enterprises and consumer loans, whose evolution is more closely linked to credit risks, have been increasing, in part due to the higher levels of delinquency observed in these segments.

TABLE 24
NON-PERFORMING LOANS IN BANKS BY TYPE OF CREDIT 1/
(%)

	Commercial	Microbusiness	Consumption	Mortgages
Mar-08	0.90	3.32	2.68	0.87
Jun-08	0.74	3.11	2.53	0.80
Sep-08	0.76	3.14	2.40	0.72
Dec-08	0.82	3.34	2.74	0.74
Mar-09	1.00	3.77	2.85	0.78
Jun-09	1.18	4.70	3.08	0.85
Sep-09	1.05	5.17	3.05	0.87
Dec-09	1.00	5.50	3.02	0.88
Jan-10	1.10	5.63	3.23	0.92
Feb-10	1.12	5.78	3.17	0.89
Mar-10	1.16	6.19	3.25	0.94
Apr-10	1.09	6.28	3.43	0.95

1/ The non-performing loans is the addition delayed loans of and legal collection.
Source: SBS.

As regards passive interest rates, the rates on 181-to-360-day deposits declined from 2.9 to 2.5 percent. The rate on these deposits in foreign currency also fell from 2.0 to 1.7 percent.

TABLE 25
INTEREST RATES IN NUEVOS SOLES AND IN DOLLARS
(%)

	Nuevos Soles		US Dollars		Difference (pbs)(May-Feb)	
	Feb-10	May-10	Feb-10	May-10	Nuevos Soles	US Dollars
1. Deposits up to 30 days	1.2	1.4	0.7	0.5	17	-14
2. Rate on 31-day to 180-day	1.8	1.7	1.1	1.0	-6	-15
3. Rate on 181-day to 360-day term deposits	2.9	2.5	2.0	1.7	-43	-29
4. Corporate prime rate	1.6	1.9	1.3	1.5	27	19
5. Average rate on loans up to 360 days	11.0	10.7	6.2	5.7	-21	-51
6. TAMN /TAMEX	19.8	19.2	8.4	7.9	-58	-54
7. Average lending rate constant structure	14.6	14.3	8.4	8.0	-29	-42
8. Active commercial average	8.0	7.8	7.1	6.6	-28	-51

76. The active interest rates of municipal and rural saving banks have also been declining between February and April 2010, and especially in the case of the rates on commercial loans (down from 27.0 to 25.5 percent in municipal saving banks and from 23.7 to 22.2 percent in rural saving banks). This could be explained by the increased competition of financial entities in this sector, despite the higher rate of delinquency observed in the segment of loans for small businesses.

TABLE 26
INTEREST RATES BY TYPE OF CREDIT IN NATIONL CURRENCY 1/
(%)

	MUNICIPAL CREDIT BANKS				RURAL CREDIT BANKS			
	Commercial	Microbusiness	Consumption	Mortgage	Commercial	Microbusiness	Consumption	Mortgage
Dec-08	25.3	41.5	28.8	13.7	20.6	42.0	29.4	23.9
Mar-09	27.4	42.1	29.9	13.5	23.0	41.8	28.9	-
Apr-09	26.9	41.6	29.7	14.2	23.3	42.2	28.2	15.3
May-09	26.2	41.8	29.4	13.6	23.8	42.1	27.9	23.9
Jun-09	26.5	42.0	29.3	13.8	23.5	42.6	27.7	18.7
Jul-09	26.4	41.4	29.1	13.2	23.1	42.0	27.8	26.8
Aug-09	27.0	41.8	28.3	13.7	23.5	41.3	27.8	21.3
Sep-09	26.3	41.6	28.5	14.0	23.7	40.4	26.9	16.6
Oct-09	26.5	40.7	27.6	13.7	22.5	38.5	26.8	17.4
Nov-09	26.0	40.3	27.4	13.9	21.8	38.7	26.5	19.9
Dec-09	25.9	40.5	26.7	13.1	21.2	40.6	27.2	17.9
Jan-10	27.3	40.7	27.6	13.1	23.1	40.6	26.9	18.1
Feb-10	27.0	40.6	27.2	14.4	23.7	40.7	26.5	19.4
Mar-10	25.4	40.4	26.9	13.7	21.4	39.6	26.8	20.4
Apr-10	25.5	39.8	27.2	13.9	22.2	38.9	26.6	17.9

1/ Annualized active interest rates of the operations carried out in the last 30 days.
Source: SBS.

TABLE 27
NON-PERFORMING LOANS OF THE MUNICIPAL BANKS BY TYPE OF CREDIT 1/
(%)

	Commercial	Microbusiness	Consumption	Mortgage
Mar-08	5.06	6.42	2.09	1.75
Jun-08	4.47	5.90	2.30	1.81
Sep-08	4.02	5.59	2.36	1.72
Dec-08	4.09	5.11	2.38	1.67
Mar-09	5.08	5.83	2.60	1.85
Jun-09	5.67	6.39	2.87	1.85
Sep-09	5.71	6.69	2.91	1.59
Dec-09	5.72	6.57	2.91	1.39
Jan-10	7.44	7.47	3.11	1.46
Feb-10	7.76	7.74	3.14	1.36
Mar-10	7.60	7.67	3.10	1.44

1/ The non-performing loans is the addition delayed loans of and legal collection.
Source: SBS.

Monetary operations

77. Increased demand for currency (S/. 575 million) in the April-May period reflects mainly the greater dynamism of economic activity. So far this year, currency has grown by 21 percent (a flow equivalent to S/. 199 million). This growth, which

is explained by higher purchases of foreign currency by the Central Bank's front office (US$ 2,655 million), was compensated by increased placements of CD-BCRP (S/. 3,613 million) and higher public sector deposits (S/. 5,685 million).

Between April and may, the increase recorded in the Central Bank's exchange position reflects the purchase of US$ 315 million in the front office, while the increase observed in terms of net domestic assets is mainly associated with the maturity of CD-BCRP for S/. 4,019 million. This was offset by higher public sector deposits (S/. 4,468 million), associated with the period of regularization of income tax in April, and the placement of S/. 1 billion in sovereign bonds.

TABLE 28
MONETARY OPERATIONS
(Millions of nuevos soles)

	FLOWS				BALANCE		
	2009	2010			31-Dec-09	31-Mar-10	31-May-10
	Annual	1Q	Apr-May	Jan- May			
I. NET INTERNATIONAL POSITION	**4,381**	**6,205**	**336**	**6,541**	**66,436**	**71,476**	**71,814**
(Millions of US$)	**1,623**	**2,179**	**119**	**2,298**	**22,988**	**25,168**	**25,287**
A. Foreign Exchange Operations	**-48**	**2,329**	**315**	**2,644**			
1. Over the counter operations	108	2,340	315	2,655			
2. Net swap auctions in FC	102	-13	0	-13	102	89	89
3. Public Sector	-261	0	0	0			
4. Others	3	2	0	3			
B. Rest of operations	**1,671**	**-150**	**-196**	**-345**			
II. NET INTERNAL ASSETS	**-2,476**	**-6,581**	**239**	**-6,342**	**-47,195**	**-52,611**	**-52,374**
A. Monetary operations	**1,023**	**-8,143**	**-584**	**-8,728**	**-36,323**	**-44,466**	**-45,051**
1. Sterilization operations	**6,436**	**-8,143**	**-584**	**-8,728**	**-36,323**	**-44,466**	**-45,051**
a. BCRP Certificates of Deposit CDBCRP	-6,399	-7,632	4,019	-3,613	-14,121	-21,753	-17,733
b. Overnight Deposits	-819	757	-42	716	-842	-85	-127
c. Public Sector Deposits in soles	2,561	-1,217	-4,468	-5,685	-21,006	-22,224	-26,692
d. Other operations	185	-51	-94	-145	-354	-405	-499
2. Injection operations	**-5,412**	**0**	**0**	**0**	**0**	**0**	**0**
B. Reserve Requirements in DC *	**668**	**497**	**169**	**666**	**-4,307**	**-3,810**	**-3,641**
C. Rest	**-4,167**	**1,065**	**654**	**1,720**	**-6,565**	**-4,335**	**-3,683**
III. CURRENCY *	**1,905**	**-376**	**575**	**199**	**19,241**	**18,865**	**19,440**
(12-month change)					11.0%	17.6%	21.1%

* Preliminary data.

Monetary aggregates

78. Credit to the private sector has shown strong dynamism. In April 2010, it increased at an average monthly rate of 1.6 percent and at an annualized rate of 13.6 percent. By type of credit, the segments of micro businesses and mortgages showed the highest growth rates (23.9 and 20.6 percent, respectively).

TABLE 29
CREDIT TO THE PRIVATE SECTOR BY TYPE OF LOAN 1/
(12-month % change)

	Dec.08	Dec.09	Jan.10	Feb.10	Mar.10	Apr.10
1. Corporate	28.7	5.3	5.6	7.6	9.4	11.6
a. Foreign trade	15.7	-29.6	-25.7	-19.7	-15.0	-5.8
b. Domestic activities	31.2	12.5	12.1	12.7	13.8	14.9
2. Microbusinesses	52.9	23.8	22.8	22.3	23.0	23.9
3. Consumption	27.1	8.6	8.4	8.5	9.4	10.2
4. Mortgage	23.4	17.3	17.8	17.9	19.2	20.6
Total	**29.9**	**9.2**	**9.3**	**10.4**	**11.9**	**13.6**

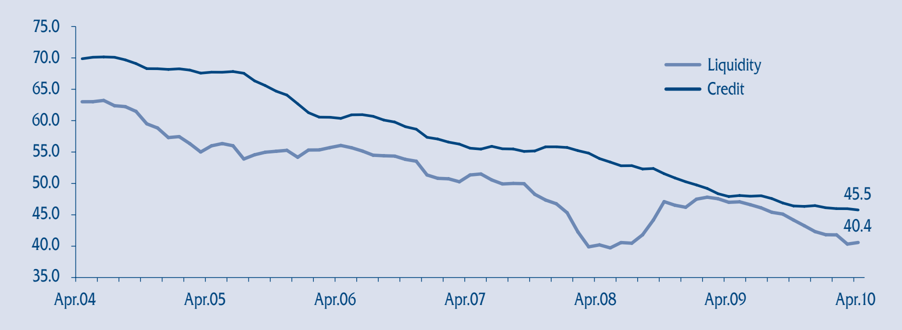
1/ At constant exchange rate.

Graph 86
SEASONALLY ADJUSTED CREDIT TO THE PRIVATE SECTOR
(Millions of nuevos soles)

CREDIT	Dec-07	Dec-08	Jun-09	Sep-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10
Balance in millions of soles	75,326	97,818	100,782	102,078	106,812	107,386	108,870	110,720	112,555
Monthly flow in millions of soles	2,102	1,317	494	13	1,034	575	1,483	1,850	1,834
12-month % change	33.1%	29.9%	19.2%	13.1%	9.2%	9.3%	10.4%	11.9%	13.6%

79. The overall evolution of credit in nuevos soles and credit in dollars has reflected in a reduction of the ratio of dollarization of credit to the private sector, which declined from 45.7 percent in February 2010 to 45.5 percent in April 2010.

Graph 87
DOLLARIZATION
(%)



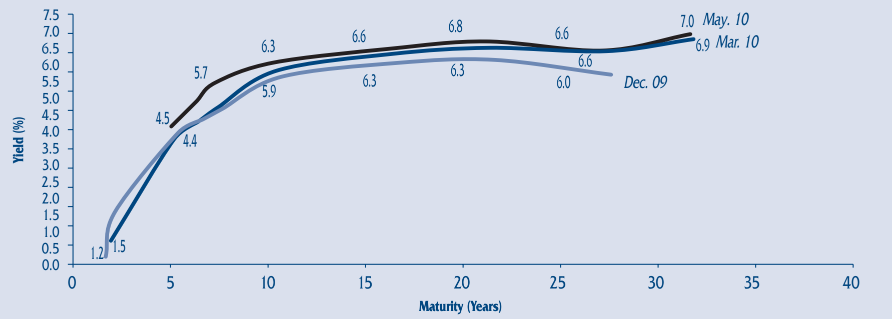
80. By type of financial entity, commercial banks showed a higher pace of dedollarization between February and April 2010 (down from 51.9 to 51.7 percent). Moreover, by type of credit, mortgages continued showing the higher pace of dedollarization (down from 56.4 to 55.9 percent) in the same period.

TABLE 30
DOLLARIZATION OF CREDIT TO THE PRIVATE SECTOR

	Dec.07	Dec.08	Mar.09	Jun.09	Sep.09	Nov.09	Dec.09	Jan.10	Feb.10	Mar.10	Apr.10
By type of loan											
Corporate	72.6	68.9	66.7	65.7	63.9	63.7	64.4	64.1	64.1	64.3	64.0
Microbusiness	21.2	13.2	12.2	11.3	10.8	10.2	10.0	9.8	9.6	9.4	9.4
Consumption	18.1	16.6	16.1	15.0	14.2	13.9	13.6	13.4	13.3	13.1	13.0
Mortgage	79.4	70.2	68.6	65.2	61.6	59.9	59.4	58.4	57.3	56.4	55.9
By type of institution											
Banks	61.9	56.7	55.5	54.4	52.3	52.0	52.4	52.0	51.9	51.9	51.7
State-owned Banks	1.5	1.8	1.8	1.7	1.6	1.5	1.5	1.4	1.4	1.3	1.3
Microfinance institutions	26.6	20.4	17.6	15.3	14.4	13.8	13.7	13.8	13.6	13.5	13.4
TOTAL	**56.6**	**52.2**	**50.4**	**48.8**	**46.6**	**46.0**	**46.2**	**45.9**	**45.7**	**45.7**	**45.5**

81. Conditions of access to the capital market remain relatively stable, showing a slight upward displacement in the yield curve as a result of having raised the reference rate by 25 bps. in May. The steepening in the short term yield continues reflecting an expansionary position of monetary policy, which is expected to reverse in the medium term.

Graph 88
SECONDARY MARKET OF PUBLIC TREASURY SOVEREIGN BOND 1/

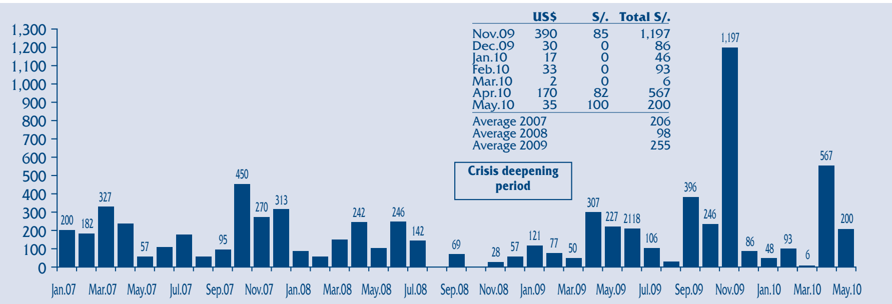


1/ Average yield auctioned in the period.

It is worth pointing out that in April the government issued S/. 947 million in sovereign bonds maturing in 2042 and with an average yield rate of 7.1 percent. The resulting amount of this operation was used to finance the payments of investors who opted for cash in the swap of global bonds denominated in dollars. This swap allowed extending the average maturity of the public debt and also reducing the debt's level of dollarization.

82. Private issuances of non financial firms have increased substantially since April following increased economic growth and the recovery of private investment associated with infrastructure and communication projects. Average issuances in the first 5 months of the year are higher than the ones observed in the last 2 years and similar to the ones recorded in the same period of 2007, prior to the international crisis.

Graph 89
BONDS ISSUED BY NON-FINANCIAL COMPANIES
(Millions of nuevos soles)



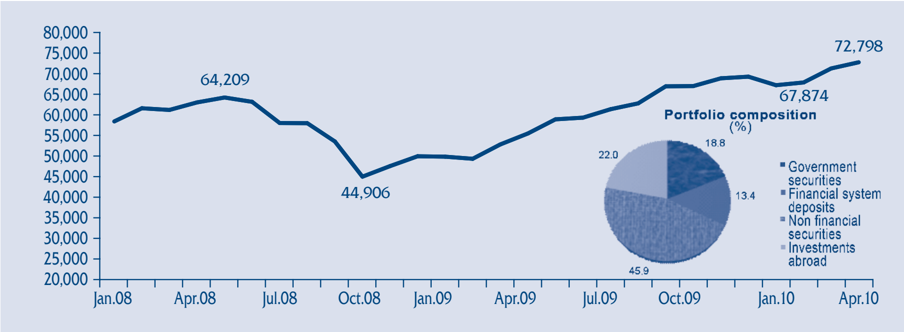
	US$	S/.	Total S/.
Nov.09	390	85	1,197
Dec.09	30	0	86
Jan.10	17	0	46
Feb.10	33	0	93
Mar.10	2	0	6
Apr.10	170	82	567
May.10	35	100	200
Average 2007			206
Average 2008			98
Average 2009			255

* Primary public offers in dollars are valued at last month exchange rate. Includes titulization bonds.

83. After the unfavorable results they recorded due to the international financial crisis, private pension funds (AFPs) have continued recovering, in line with the evolution of the Peruvian and global security markets. Thus, the portfolio administered by

these funds increased from S/. 67,874 million in February to S/. 72,798 million in April 2010. Furthermore, the share of investments abroad has been increasing and currently represents 22 percent of this portfolio. However, the break down of AFP investments by currencies shows that 45 percent of these investments are investments in foreign currency. This is possible because the limit for AFP investments abroad, which is currently 24 percent, does not include restrictions in terms of currencies.

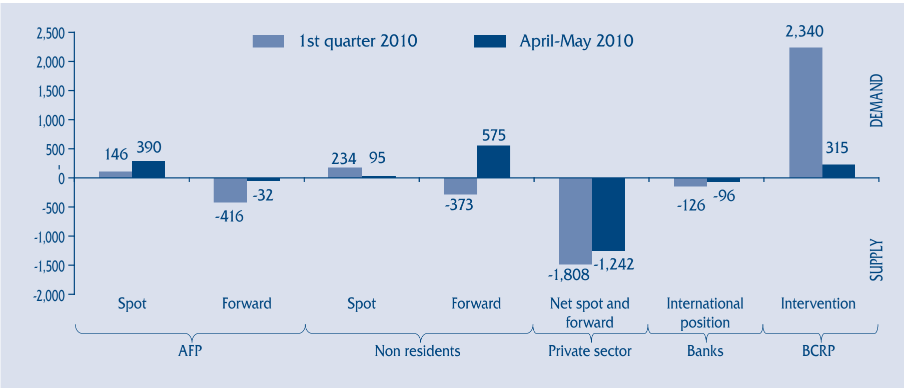
Graph 90
TOTAL PORTFOLIO MANAGED BY PRIVATE PENSION FUNDS
(Millions of nuevos soles)



Exchange rate

84. Between March and May 2010, the nominal exchange rate depreciated 0.2 percent, reflecting the strengthening of the dollar in a context of investors' increased risk aversion associated with fears that fiscal problems in the Eurozone (Greece, Spain, Portugal, Italy, and Ireland) might worsen and the portfolio movements of non resident and institutional investors.

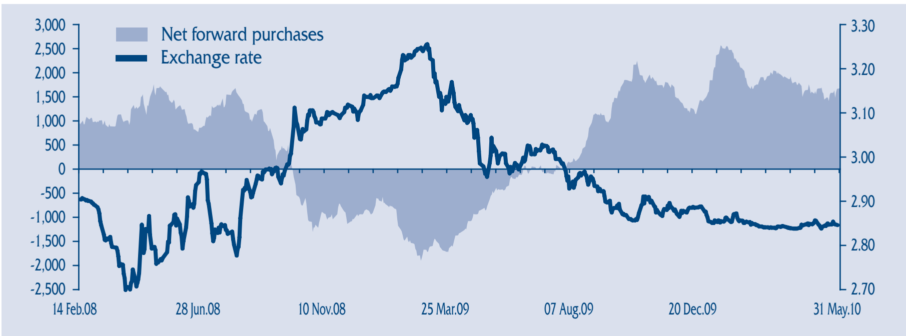
Graph 91
EXCHANGE RATE MARKET FLOWS
(Millions of US$)



In the April-May period, private agents generated a net supply in the exchange market –spot and forward– of US$ 1,242 million, while banks decided to reduce their foreign exchange position generating an additional supply of US$ 96 million. On the other hand, private pension funds (AFPs) and non residents generated a net demand of US$ 1,028 million (spot and forward) in the same period, causing a downward pressure of US$ 315 million that was buffered by the purchases of foreign currency made by the Central Bank at its front office.

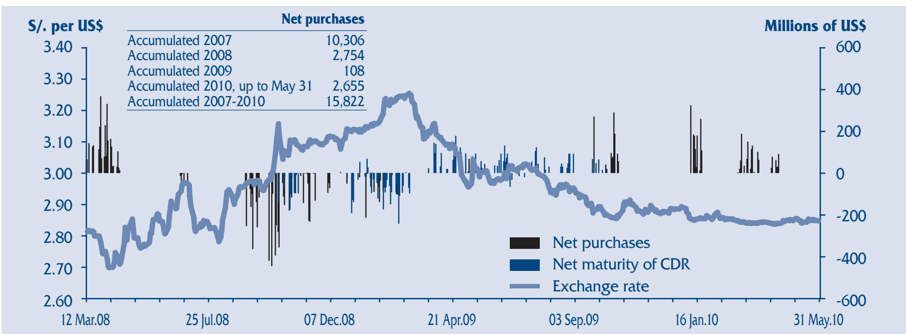
85. Between March and May 2010, the balance of net forward purchases declined by US$ 246 million, from US$ 1,913 million to US$ 1,667 million. This decline was coupled by a relatively stable conduct of the exchange rate, which reflected in the lower intervention amount recorded during this period (US$ 315 million versus US$ 2,340 million in Q1).

Graph 92
BCRP NET FORWARD PURCHASES AND EXCHANGE RATE
(Exchange rate S/. per US$ and balance in millions of US$)



86. The BCRP intervened in the foreign exchange market only in the first two weeks of April with the purpose of reducing the excessive volatility of the exchange rate by purchasing US$ 315 million.

Graph 93
BCRP NET PURCHASES, EXCHANGE RATE AND NET MATURITY OF CDR
(Exchange rate S/. per US$ and maturity in millions of US$)



The BCRP has not intervened in the exchange market since the third week of April. On the other hand, the fiscal problems experienced by some countries of the Eurozone started generating concerns about a possible debt crisis that could reverse the expectations of recovery of the world economy. As a result of the recent developments observed in the Eurozone, the dollar continued strengthening against the euro and against the currencies of emerging markets.

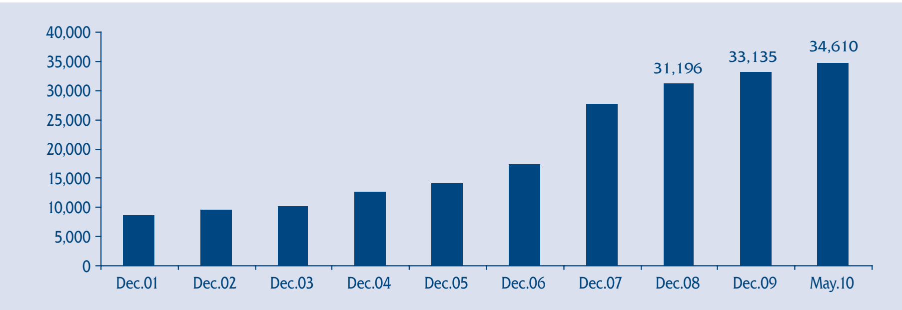
87. Between February and May, expectations regarding the exchange rate in 2010 and 2011 continued declining, as reflected in the evolution of the dollar in the exchange markets. According to economic analysts and financial entities, the exchange rate would close the year at S/. 2.80. The same exchange rate is expected in 2011 by these economic agents.

TABLE 31
SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE
(Nuevos soles per US dollar)

	Feb.10	Mar.10	Apr.10	May.10
FINANCIAL ENTITIES				
2010	2.80	2.80	2.80	2.80
2011	2.82	2.78	2.80	2.80
ECONOMIC ANALYSTS				
2010	2.85	2.80	2.80	2.80
2011	2.82	2.80	2.80	2.80
NON-FINANCIAL FIRMS				
2010	2.90	2.85	2.85	2.85
2011	2.95	2.90	2.90	2.90

88. On the other hand, as a result of the withdrawal of foreign currency from the public sector, mainly for the purpose of paying global bonds, between March and May international reserves declined by US$ 658 million to a balance of US$ 34,610 million, a level of reserves higher by US$ 1,475 million than the one recorded in 2009.

Graph 94
NET INTERNATIONAL RESERVES
(Millions of US$)



BOX 5

NON-CONVENTIONAL MONETARY POLICY INSTRUMENTS

The recent international financial crisis has evidenced the capacity of central banks to implement an expansionary monetary policy even when money markets cease to operate properly. In most cases, this response has implied using non-conventional monetary policy instruments. In normal times, when markets operate appropriately, changes in the monetary interest rate are effectively transmitted to the other rates in the financial system through a process of market arbitrage. These mechanisms constitute the most effective monetary policy instrument.

However, these transmission mechanisms stop operating when markets lose liquidity and become segmented, as happened in Q4-2008 with the collapse of interbank markets in USA and Europe and with the abrupt decline of the prices of the public debt and value of currencies of emerging countries. In all of these cases, the common denominator of these market failures was the loss of liquidity, which makes it impossible to buy or sell assets without affecting significantly their prices due to increased perception of risk and fear of contagion. In the case of the money markets of developed countries, for example, banks paralyzed interbank loans given the impossibility to identify which financial entities were highly exposed to the subprime crisis. Something similar happened later in emerging economies, where increased risk aversion led a great number of investors to liquidate their positions in government bonds, thus generating a collapse of their prices and, with this, an abrupt leap in yield curves.

In this type of scenarios and given the need to provide liquidity to the system, most central banks chose to use **non-conventional monetary policy instruments**, which basically consist of monetary operations using higher credit risk instruments and/or participating in markets where central banks usually do not participate[7]. When central banks use non-conventional monetary instruments, they temporarily replace the mechanisms of transmission of the interest rate by directly participating in the credit and capital markets. The international experience in response to the financial crisis shows that developed countries have been the economies that have made a better use of these tools and the ones which, therefore, have expanded their balances the most by taking a higher credit risk.

The FED, for example, increased its balance by over 2 times between 2007 and 2009[8]. Similar measures were adopted by other central banks, such as the European Central Bank, the Bank of England, and the Bank of Japan. A summary of these measures is offered in the table below.

7 For example, the U.S. Federal Reserve (FED) launched an aggressive program of purchases of several securities, including long term US Treasury bonds, commercial papers, and even subprime loans, seeking to prevent the collapse of the prices of these securities.

8 This change reflected the implementation of programs of short term loans to financial entities, such as the extension of the terms of repo operations, currency swaps, special liquidity facilities for money wholesalers, targeted loan programs, such as funds for commercial securities, and the facility for purchases of loan-backed assets, as well as large scale purchases of assets: US$ 1.25 trillion in mortgage-backed assets, US$ 175 billion in government agencies' debts, and up to US$ 300 billion in Treasury bonds.

RESPONSE OF CENTRAL BANKS TO THE CRISIS

AIM	MEASURES ADOPTED	Fed	ECB	BoE	BoJ	BoC	RBA	NSB
Implement official monetary policy	Exceptional adjustment measures	✓	✓	✓	✓	✓	✓	✓
	Changes in minimum reserve requirements	✓						
	Reduced the fluctuation band of the overnight interest rate	✓	✓	✓				
	Reserve remuneration	✓			✓			
	Increased Treasury deposits	✓				✓		
	Central bank short-term deposits or securities		✓	✓	✓		✓	✓
Influence interbank market conditions	Modified discount window facility	✓		✓				
	Exceptional long term operations	✓	✓	✓	✓	✓	✓	✓
	Increased admissible guarantees	✓	✓	✓	✓	✓	✓	✓
	Increased the number of counterparts	✓		✓	✓	✓	✓	
	Currency swap lines between central banks	✓	✓	✓	✓	✓	✓	✓
	Introduced or eased conditions of security loans	✓		✓	✓	✓		
Influence conditions in the credit market and in the financial system in general	Rediscount/purchase/acceptance of commercial papers as collaterals	✓		✓	✓	✓	✓	
	Rediscount/purchase/acceptance of ABS as collaterals	✓	✓	✓			✓	
	Rediscount/purchase/acceptance of corporate debt papers as collaterals			✓	✓	✓		✓
	Purchase of government debt papers	✓		✓	✓			✓
	Purchase of other private debt papers				✓			✓

Source : BIS
Fed: U.S- Federal Reserve; ECB: European Central Bank; BoE: Bank of England; BoJ: Bank of Japan; BoC: Bank of Canada; RBA: Royal Bank of Australia.
NSB: National Swiss Bank.

In all of the cases, central banks transitorily replaced the market. In the emerging economies, and particularly in the case of Latin America, both the scale and the moment when non-conventional monetary policies measures were implemented differ significantly from what was observed in developed economies. In Latin America, liquidity injection was prioritized over the reduction of monetary policy interest rates as the first line response to the crisis. Only when markets stabilized and inflation expectations showed a clear downward reversal did central banks initiate a rapid and significant reduction of their monetary policy interest rates.

Liquidity injection measures in the countries of the region involved using a broad set of non-conventional instruments. The particular type of non-conventional instrument used was associated with the most vulnerable market segments in terms of the crisis. Thus, in economies with non-collateralized money markets and where a significant process of segmentation that reduced the flow of funds to smaller or higher risk entities was observed as a result of the crisis, central banks responded increasing both the number of authorized participants in terms of liquidity injection facilities and the type of assets accepted as collaterals, seeking in this way to ensure the availability of liquidity to these more vulnerable segments in a direct manner.

In those countries where financial entities' terms of funding or important segments of the bond market shortened significantly, central banks responded extending the term of their repo operations and purchasing corporate or government securities directly so that interest rates in these markets would not increase abruptly. In Peru, the term for repo operations was extended to up to one year and the list of acceptable collaterals was extended to foreign currency and portfolio representative securities.

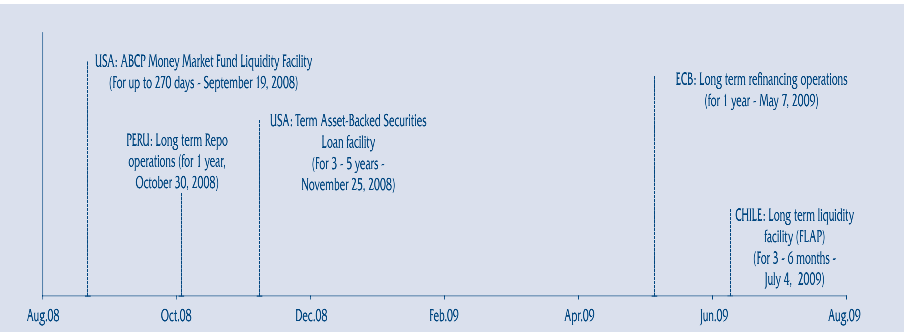
In those countries of the region where the availability of external credit for banks and export companies constrained strongly, central banks responded increasing the availability of international liquidity, either by reducing reserve requirements or establishing special credit lines, and though repo operations in dollars and swaps.

CENTRAL BANKS' REPOS

COUNTRY OR REGION	REGULAR REPOS	EXCEPTIONAL REPOS		
		1 - 3 MONTH REPOS	3 - 6 MONTH REPOS	6 - 12 MONTH REPOS
Chile 1/	Term: 1-14 days	✓	✓	
	Collaterals: Treasury bonds, Central Bank securities and mortgage bills.	Collaterals: Treasury bonds, Central Bank securities and mortgage bills.	Collaterals: Treasury bonds, Central Bank securities and mortgage bills.	
Peru 2/	Term: 1-14 days	✓	✓	✓
	Collaterals: Treasury bonds, Central Bank Certificates, foreign currency, and credit portfolio represented in securities.	Collaterals: Treasury bonds,Central Bank Certificates, foreign currency, and credit portfolio represented in securities.	Collaterals: Treasury bonds,Central Bank Certificates, foreign currency, and credit portfolio represented in securities.	Collaterals: Treasury bonds, Central Bank Certificates, foreign currency, and credit portfolio represented in securities.
USA 3/	Term: 1-14 days	✓		
	Collaterals: Treasury bonds, bonds of government agencies, and mortgage-backed securities	Collaterals: Treasury bonds, bonds of government agencies, and mortgage-backed securities		
Europe 4/	Term: 1-14 days	✓	✓	✓
	Collaterals: Low-risk securities issued by the government and by the private sector	Collaterals: Low-risk securities issued by the government and by the private sector	Collaterals: Low-risk securities issued by the government and by the private sector	Collaterals: Low-risk securities issued by the government and by the private sector

1/. Exceptional 3 to 6-month repo operations were implemented since July 2009. Morgage bills are accepted as collaterals since March 2006.
2/. Repos operations were implemented in September 1997. Exceptional repos with up to 1-year maturities were made since October 2008. Loan portfolios represented in securities are accepted as collaterals since July2009.
3/. The US Federal Reserve used instruments other than REPOS to inject long-term liquidity: Term Securities Lending Facility, ABCP Money Market Fund Liquidity Facility, Commercial Paper Funding Facility, Term Asset-Backed Securities Loan Facility.
4/. The European Central Bank injected long term liquidity through long term refinancing operations (LTRO). The maturity of these operations was extended to up to 1 year in May 2009.

IMPLEMENTATION OF LONG TERM LIQUIDITY INJECTION MEASURES



A substantial part of central banks' response –especially in highly dollarized economies– was also reflected in interventions in the foreign exchange market through the direct sale of foreign currency or through the issuance of indexed securities in order to prevent abrupt depreciations of the local currency.[9]

In none of the Latin American countries where this series of measures were implemented did they imply a substantial increase in the size of the balances of central banks. Nor did central banks assume a substantially higher credit risk for these operations. This is in part explained because the impact of the crisis on the markets of the region was lower and also because the financial systems were sounder and more liquid.

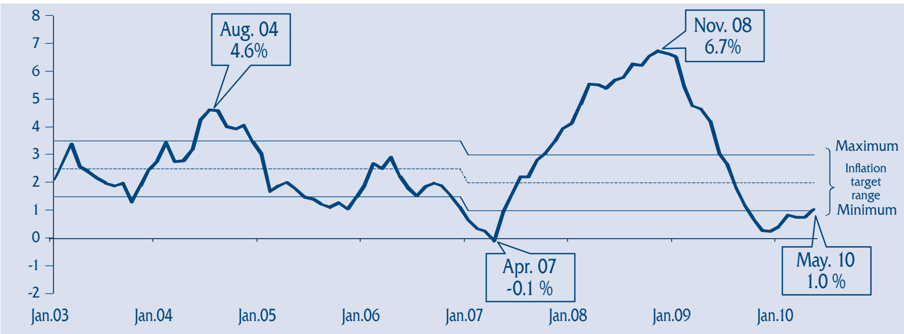
In summary, the recent experience of central banks shows that non-conventional monetary policy instruments have been not only effective, but also have allowed the implementation of an expansionary monetary policy when financial market stopped operating adequately. In the case of the economies of the region, the use of interventions in the forex market and massive liquidity injections enabled central banks to isolate, at least partially, domestic credit markets from the deterioration of international financial markets. In the case of developed economies, a greater collapse of financial markets was prevented.

9 This was possible due to the high availability of international liquidity which allowed central banks to face not only capital outflows and the reduction of credit to local banks, but also abrupt depreciatory pressures by promptly and effectively injecting liquidity in foreign currency through several mechanisms. The high levels of international reserves were accumulated in the years prior to the crisis due to high terms of trade and to the strengthening of the fiscal position.

VI. Inflation

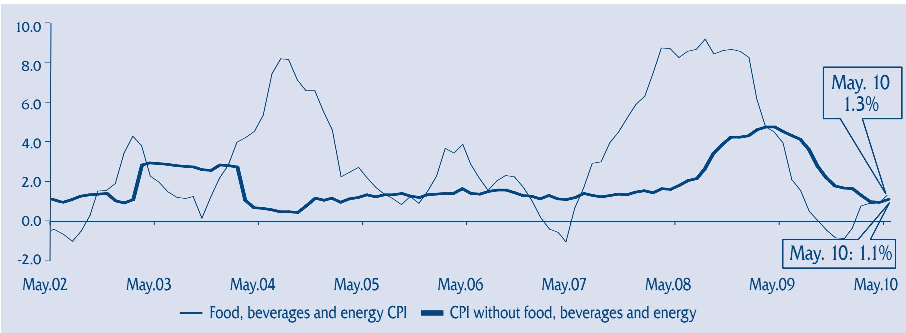
89. In May 2010, annual inflation returned to the target range for the first time since September 2009. The effect of the rise in commodity prices started reversing since November 2008 and reached its minimum level in December 2009. A slight upward trend has been observed since then, mainly due to the evolution of the prices of some foodstuffs and fuels.

Graph 95
INFLATION AND TARGET RANGE
(12-month % change)



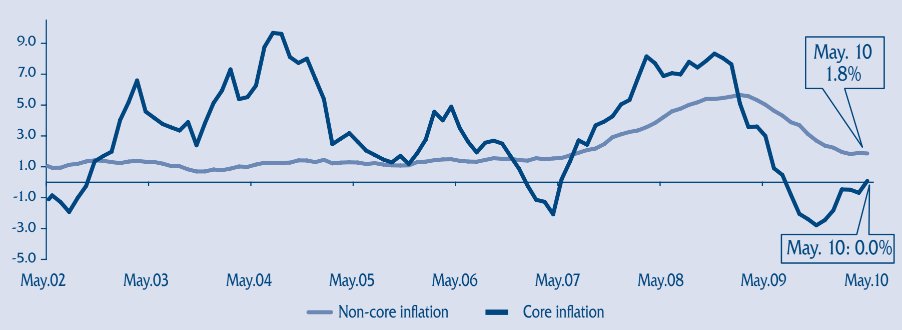
An increase in the accumulated last-12 month growth of the prices of food and energy is observed between January and May 2010 (from -0.9 percent in December to 1.3 percent in May), while inflation excluding food and energy shows a downward trend (it declined from 1.7 percent in December to 1.1 percent in May).

Graph 96
FOOD, BEVERAGES AND ENERGY CPI
(12-month % change)



90. Accumulated core inflation in the last twelve months declined from 2.3 percent in December to 1.8 percent in May 2010. Non-core inflation, which includes perishable foodstuffs and fuels, went from -2.5 percent in December to 0.0 percent in May.

Graph 97
CORE INFLATION AND NON-CORE INFLATION
(12-month % change)

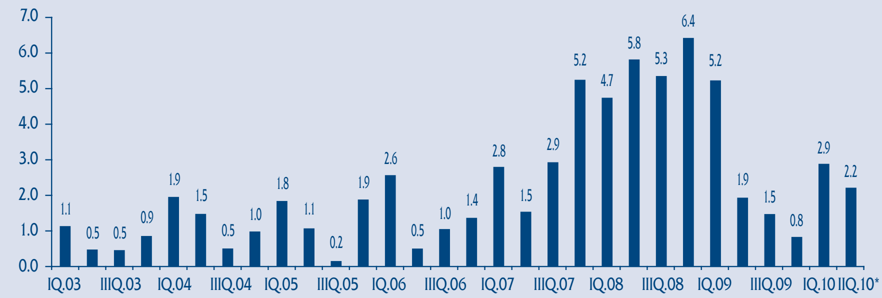


91. The rate of accumulated inflation between January and May was 1.2 percent, mainly due to non-core foodstuffs (2.3 percent) and fuels (6.8 percent). Accumulated core inflation in the same period was 1.1 percent, mainly as a result of the higher prices of education (2.6 percent), meals outside the home (1.7 percent), and sodas (3.8 percent).

TABLE 32
INFLATION

	Weight		Jan.-May. 2009		Jan.-May. 2010	
	Dec.01=100	2009=100	% Chg	Contribution	% Chg	Contribution
I. CPI	**100.0**	**100.0**	**0.37**	**0.37**	**1.17**	**1.17**
II. CORE INFLATION	**60.6**	**65.2**	**1.60**	**0.91**	**1.08**	**0.70**
Goods	34.0	32.9	1.48	0.46	0.79	0.26
Services	26.6	32.2	1.76	0.45	1.37	0.44
III. NON-CORE INFLATION	**39.4**	**34.8**	**-1.27**	**-0.55**	**1.34**	**0.46**
Food	22.5	14.8	1.01	0.25	2.28	0.34
Fuel	3.9	2.8	-15.31	-0.82	6.78	0.19
Transportation	8.4	8.9	-0.86	-0.07	-0.51	-0.05
Public services	4.6	8.4	2.19	0.09	-0.21	-0.02

Graph 98
CORE INFLATION
(Annualized quarterly change)



* Includes Junes estimate.

TABLE 33
INFLATION
(% change)

		Weight 2009=100	2006	2007	2008	2009	2010 Jan.-May.	2010 12-month
I.	**INFLATION**	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**1.17**	**1.04**
II.	**CORE INFLATION**	**65.2**	**1.37**	**3.11**	**5.56**	**2.35**	**1.08**	**1.81**
	Goods	32.9	0.97	3.30	5.32	2.17	0.79	1.48
	Services	32.2	1.85	2.88	5.86	2.56	1.37	2.17
III.	**NON-CORE INFLATION**	**34.8**	**0.83**	**5.07**	**8.11**	**-2.54**	**1.34**	**0.04**
	Food	14.8	2.06	7.25	10.97	-1.41	2.28	-0.18
	Fuel	2.8	-1.50	6.45	-0.04	-12.66	6.78	10.12
	Transportation	8.9	1.12	0.82	5.86	0.19	-0.51	0.72
	Public services	8.4	-3.22	0.24	7.48	-4.56	-0.21	-4.61

92. The items that contributed the most to the growth of inflation between January and May were education (fees and tuition), meals outside the home, sugar, gasoline, and soda beverages, while the items that contributed most heavily to reduce inflation were chicken meat, citrus fruits, grapes, domestic transport, telephone rates, and corn.

The increase in the case of education is seasonal and was observed mainly between the months of March and April, while the increase in the case of meals outside the home was mainly observed in the month of May, associated with Mother's Day celebrations.

The higher prices of fuels reflect the rise in the international price of oil and the lower funds allocated to the Fuel Price Stabilization Fund. The price of WTI oil recorded an average level of US$ 73.6 per barrel in May 2010, which, although lower than in April (US$ 84.2), represented a recovery compared to the price in May 2009 (US$ 59.2).

TABLE 34
WEIGHTED CONTRIBUTION TO INFLATION: JANUARY - MAY 2010
(Percentage points)

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
School tuition	8.8	2.7	0.24	Chicken meat	3.0	-9.6	-0.30
Meals outside the home	11.7	1.7	0.20	Citrus fruits	0.5	-14.9	-0.09
Sugar	0.5	24.6	0.16	National Transportation	0.3	-15.4	-0.06
Gasoline and oil	1.3	11.1	0.15	Telephone	2.9	-1.7	-0.05
Soda	1.3	7.2	0.09	Corn	0.1	-20.5	-0.03
Eggs	0.6	18.4	0.09	Avocado	0.1	-19.5	-0.03
Carrots	0.1	92.1	0.09	Vehicules	1.6	-1.5	-0.02
Other fresh fruits	0.4	23.7	0.09	Electricity	2.9	-0.8	-0.02
Fresh vegetables	0.2	32.3	0.08	Cleaning items	0.9	-2.3	-0.02
Other vegetables	0.4	19.5	0.07	Aji	0.1	-26.9	-0.02
Total			**1.26**	**Total**			**-0.64**

The rise in the price of sugar was associated with the increase of the price of this product in the international market which, even though it has been declining, is 17 percent higher than the one recorded in May 2009 (the price of the Sugar N° 11 Contract in May 2009 was US$ 369.7/ton and US$ 432.5/ton in May 2010). The lower domestic production of sugar cane (-8.6 percent in the January-April period) due to climatic problems, labor conflicts, and technical stoppages in recent months added onto this.

In the first months of the year, the supply of farming products was affected by heavy rains in the producer areas of the Central Sierra, as well as by mudslides that interrupted the access to the Central Selva areas. Even though harvests and the commercialization of most products normalized in the following months, the climatic alterations of the earlier months affected the productivity of some crops (i.e. peas and tomato, the latter of which is grown in the Central Coast areas).

This situation was in part offset by the improvement recorded in the production of rice in the valleys of the North Coast of the country and the high level of supply of livestock products, such as poultry, which generated a strong reduction in the price of chicken meat. Placements of baby chicken, the main indicator of supply, were 12.7 percent higher in January-May 2010 relative to the same period in 2009. The lower price of Eastern Pacific bonito (-4.3 percent), a fish species of popular consumption, also contributed to this result.

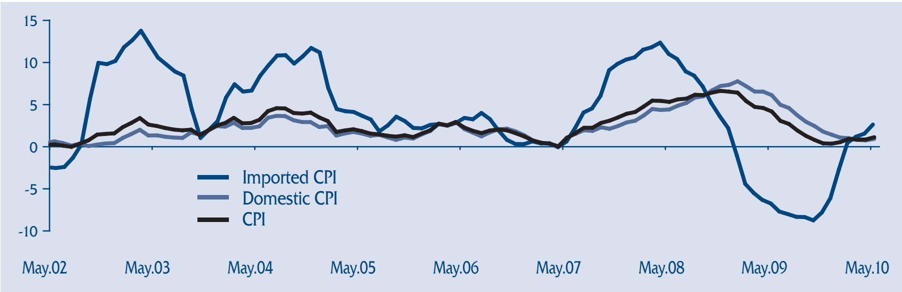
Imported inflation

93. Imported inflation recorded an accumulated growth of 1.9 percent between January and March, reflecting the evolution of imported fuels (6.8 percent) and imported foodstuffs (0.4 percent).

TABLE 35
DOMESTIC AND IMPORTED INFLATION
(Accumulated % change)

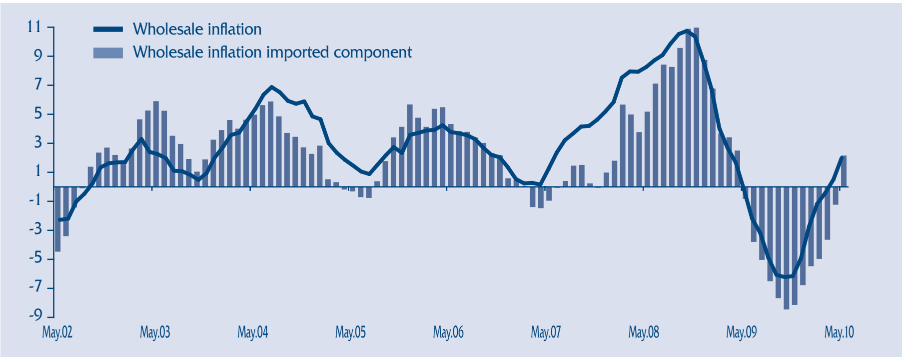
		Weight 2009=100	2006	2007	2008	2009	2010 Jan.-May.	2010 12-month
I.	**IMPORTED CPI**	**10.8**	**0.27**	**10.46**	**2.20**	**-6.25**	**1.94**	**2.63**
	Food	3.0	2.08	18.83	4.75	-3.07	0.44	0.06
	Fuels	2.8	-1.50	6.45	-0.04	-12.66	6.78	10.12
	Electric appliances	1.3	-1.29	-1.50	-0.06	-2.39	-0.06	-1.50
	Others	3.7	0.64	0.47	0.46	-0.34	0.08	-0.73
II.	**DOMESTIC CPI**	**89.2**	**1.28**	**2.84**	**7.44**	**1.35**	**1.08**	**0.83**
III.	**CPI**	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**1.17**	**1.04**
Exchange rate			**-6.40**	**-7.00**	**4.47**	**-7.59**	**-1.12**	**-4.95**

Graph 99
DOMESTIC AND IMPORTED INFLATION
(12-month % change)



94. The wholesale price index increased by 2.2 percent between January and May, reflecting the evolution of its domestic and imported components (2.1 percent and 2.7 percent, respectively). In the last 12 months, wholesale prices increased 2.0 percent, with the domestic and imported components recording increases of 1.9 and 2.2 percent, respectively.

Graph 100
WHOLESALE PRICE INDEX
(12-month % change)



Inflation expectations

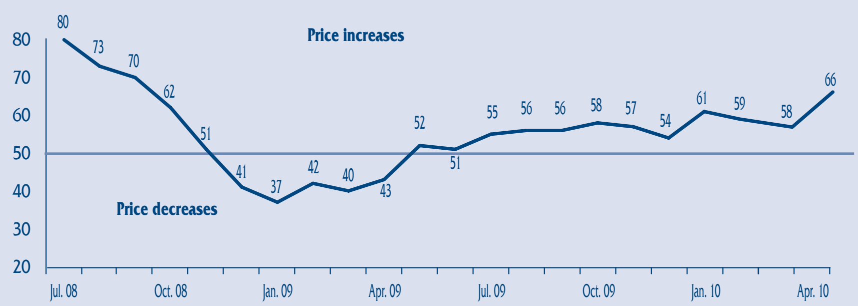
95. Economic agents' expectations of inflation for 2010 have increased relative to the information included in our March Report. The inflation expectations of surveyed groups for 2011 and 2012 fall, in general, within the target range (between 2.0 and 3.0 percent).

TABLE 36
SURVEY ON MACROECONOMIC EXPECTATIONS: INFLATION (%)

	February 2010	May 2010
FINANCIAL ENTITIES		
2010	2.11	2.50
2011	2.50	2.50
2012	-	2.50
ECONOMIC ANALYSTS		
2010	2.20	2.50
2011	2.50	2.50
2012	-	2.50
NON-FINANCIAL FIRMS		
2010	2.00	2.20
2011	2.50	2.50
2012	-	2.50

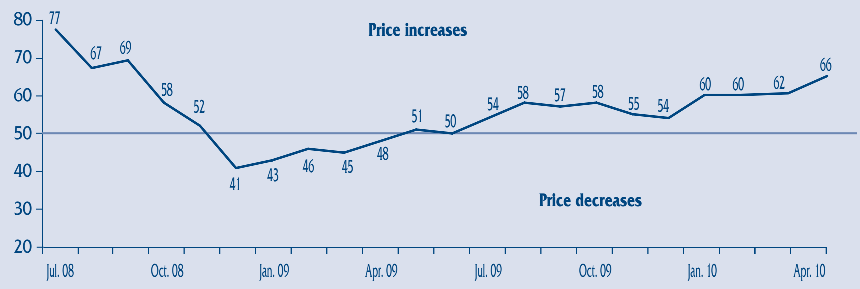
As regards the average prices of inputs and sale prices in the next 3 to 4 months, the index of expected average prices of inputs has increased from 59 (March Inflation Report) to 66, given that the percentage of firms expecting a reduction in the prices of inputs has declined. Likewise, the index of expected average sale prices has increased from 60 to 66 since our previous report was published.

Graph 101
AVERAGE INPUT PRICE INDEX: Next 3 - 4 months
Manufacturing sector



Source: BCRP Survey on Macroeconomic Expectations, April 2010.

Graph 102
AVERAGE SALE PRICE INDEX: Next 3 - 4 months
Manufacturing sector



Source: BCRP Survey on Macroeconomic Expectations. April 2010.

Inflation forecasts

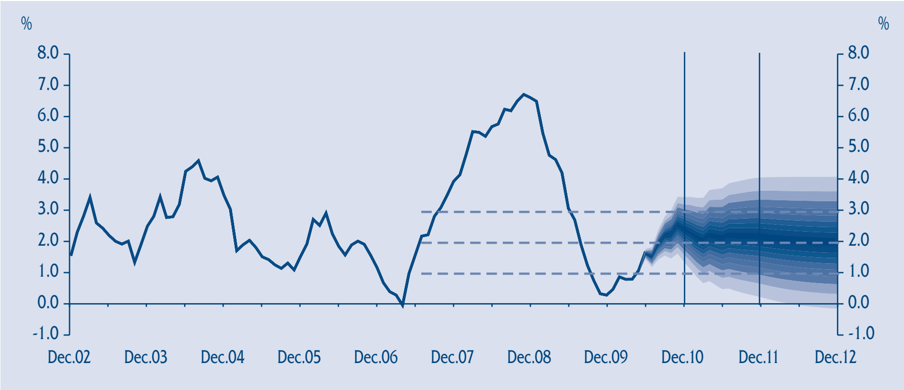
96. The data on inflation observed since our Inflation Report of March 2010 have been in line with the projections contained in said Report. The data show that inflation started converging towards the target range, recording a rate of 1.04 percent in May. Moreover, the revision and up-date of data on the main factors that would affect the rate of inflation during the next years have generated slight changes in the central forecast scenario compared to the one considered in our previous Report.

    Thus, the central inflation forecast for 2010 and 2011 is close to the one considered in our Inflation Report of March 2010. Inflation would remain within the target range due to an output gap increasingly closer to its level of equilibrium, inflationary expectations in line with the inflation target, and the reversal of the transitory shocks that affected both wholesale price inflation and imported inflation in the first semester of 2010.

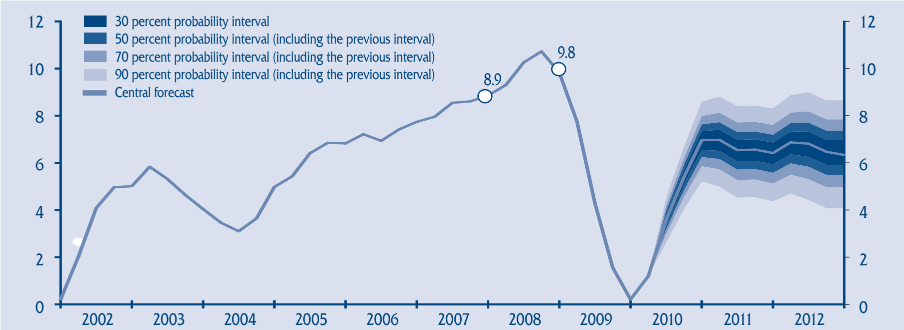
97. The baseline forecast scenario considers that the monetary stimulus adopted in September 2008, together with the fiscal impulse resulting from the Fiscal Stimulus Program, will contribute to recover the dynamism of economic activity in 2010. As a result of this, the rate of GDP growth would increase from 0.9 percent in 2009 to an annual growth rate of about 6.6 percent in 2010.

    Furthermore, the central scenario is compatible with the gradual withdrawal of monetary and fiscal stimulus until neutral positions are reached as a result of an output gap that would be closing towards the end of 2010 and a rate of inflation that would continue to be within the target range. Thus, the rate of growth of GDP would be around 6.0 percent in 2011 and 2012, with figures close to the potential growth of the economy. In line with this, inflation would remain within the target range during these years.

Graph 103
INFLATION FORECAST
(12-month % change)



Graph 104
GDP GROWTH FORECAST: 2010 - 2012
(Annual % change of GDP in each quarter)



Memo: 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.

Table 37

APPENDIX

	2008	2009	2010 1/		2011 1/		2012 1/
			IR Mar.09	IR Jun.10	IR Mar.09	IR Jun.10	IR Jun.10
Real % change							
1. GDP	9.8	0.9	5.5	6.6	5.5	6.0	6.0
2. Domestic demand	12.1	-2.9	6.8	8.8	6.3	6.8	6.0
a. Private consumption	8.7	2.4	3.3	3.9	4.2	4.5	4.6
b. Public consumption	2.1	16.5	4.2	7.8	3.1	3.7	3.2
c. Private fixed investment	25.8	-15.2	8.8	12.5	9.0	9.0	11.0
d. Public investment	42.8	25.9	19.8	23.9	6.0	7.3	6.5
3. Exports (goods and services)	8.8	-2.5	5.5	3.0	5.7	5.7	7.9
4. Imports (goods and services)	19.8	-18.4	11.9	14.5	9.9	10.1	8.0
5. Main trade partners' economic growth	2.6	-1.1	3.3	3.6	3.5	3.5	3.5
Memo:							
Output gap 2/ (%)	4.3	-1.6	-1 ; 0	-1 ; 0	-0.5 ; +0.5	-0.5 ; +0.5	-0.5 ; +0.5
% change							
6. Forecast inflation	6.7	0.2	1.5-2.5	2.0-2.5	1.5-2.5	1.5-2.5	1.5-2.5
7. Average price of crude oil	38.5	-38.2	26.0	22.2	6.0	1.4	1.3
8. Nominal exchange rate 3/	4.5	-8.0	-1.0	-2.1	0.5	0.6	1.2
9. Real multilateral exchange rate 3/	-4.8	0.9	0.0	-2.2	0.8	0.2	1.1
10. Terms of trade	-13.0	-5.5	12.9	12.6	-2.9	-3.3	-1.3
a. Export price index	5.1	-12.5	17.2	20.7	-0.3	-1.5	0.6
b. Import price index	20.8	-7.4	3.8	7.2	2.6	1.9	2.0
Nominal % change							
11. Currency in circulation	16.7	11.0	18.0	22.0	18.0	19.0	18.5
12. Credit to the private sector 4/	29.9	9.2	15.0	17.0	15.5	16.0	16.5
% of GDP							
13. Domestic investment rate	26.7	20.6	22.6	23.6	24.4	25.6	26.8
14. Current account of the balance of payments	-3.7	0.2	-0.3	-1.0	-1.2	-2.1	-2.3
15. Trade balance	2.4	4.6	5.7	4.5	4.8	3.2	2.8
16. Gross external financing to the private sector 5/	7.5	4.8	5.2	5.1	4.6	4.6	5.3
17. Current revenue of the general government	20.9	18.6	19.0	19.5	19.4	19.7	19.9
18. Non-financial expenditure of the general government	17.3	19.6	19.4	19.8	19.3	19.4	19.0
19. Non-financial public sector overall balance	2.1	-1.9	-1.6	-1.6	-1.0	-1.0	-0.4
20. Total public debt balance	24.0	26.6	23.4	23.4	22.5	22.9	21.2

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.

VII. Balance of risks

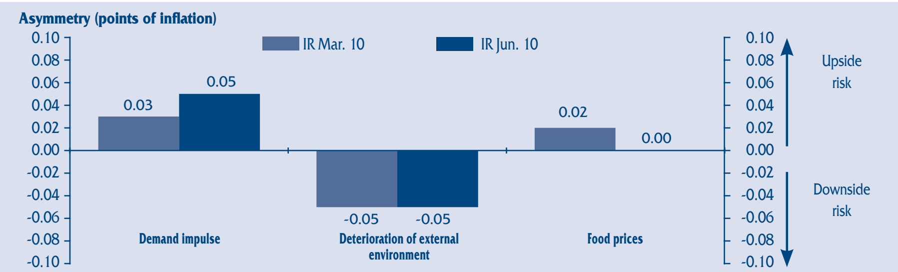
98. The balance of risks remains neutral. In other words, based on the information available to date, it is estimated that there is the same probability that the rate of inflation will be above or below the baseline forecast scenario.

99. The main risks that could deviate the rate of inflation from the baseline scenario in the forecast horizon are:

- **Deterioration of the international environment.** The baseline scenario considers that global economic activity would recover and that terms of trade would maintain high although declining levels during the forecast horizon (2010 - 2012). However, this recovery could be offset if the difficult financial situation the Eurozone is going through is not resolved. An eventual deepening of the financial crisis affecting European countries would not only contract the demand of an important trading partner, but could also spread to international markets and slow down the growth of the world economy. This scenario would imply a lower global demand for commodities, lower prices for a great deal of our primary exports, unfavorable international credit conditions, and a subsequent slowdown of growth in the domestic economy. Should this risk crystallize, the Central Bank would maintain monetary stimulus for a longer period of time. The BCRP maintains a high level of international reserves and different liquidity injection mechanisms to face this contingency.

- **Higher growth in the domestic economy.** The baseline scenario considers a sustained growth path of domestic demand, without inflationary pressures. However, if private and public expenditure increase significantly above the levels considered in the baseline scenario, the Central Bank would reduce monetary stimulus more rapidly.

Graph 105
INFLATION FORECAST: BALANCE OF RISKS
(2 year-ahead inflation deviations in % points)



Memo: 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.

CONCLUSION

100. The rate of inflation in the last months maintained a gradual trend towards the target range and finally returned to the target range in May. Inflation is projected to remain in this range during the forecast horizon (2010-2012). This projection is determined by the following factors: an output gap that would close from its current negative level as a result of the greater dynamism of economic activity; the reversal of the supply shocks that affected the prices of imported products, and inflationary expectations anchored to the target range.