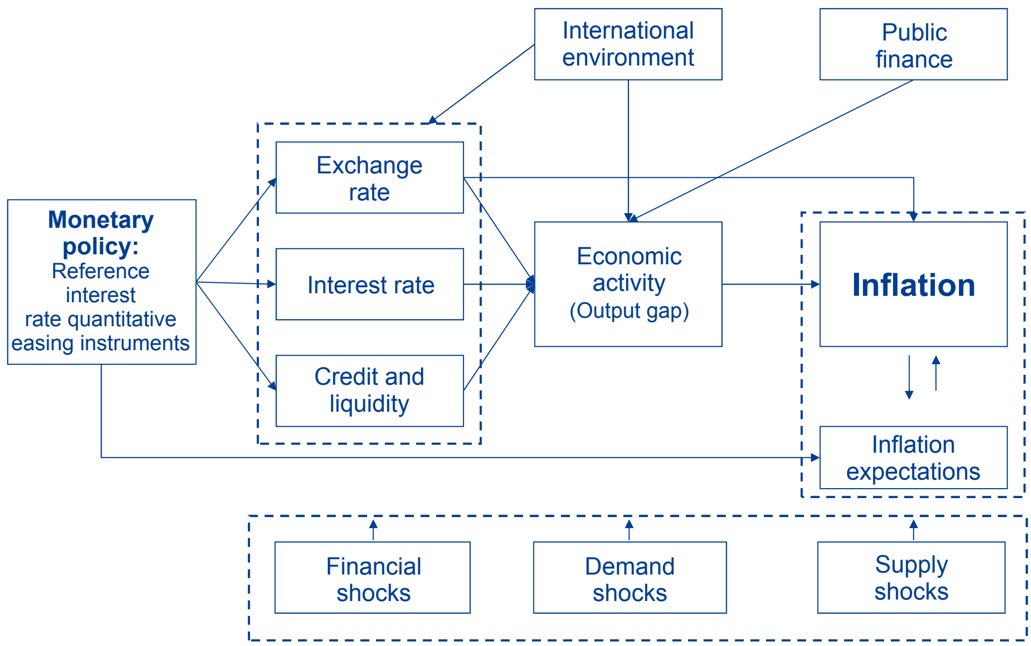
INFLATION REPORT:

Recent Trends and Macroeconomic Forecasts 2011-2012

March 2011



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CENTRAL RESERVE BANK OF PERU

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Content

BOXES

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 December 2010, and data on monetary accounts, inflation, financial markets and exchange rate as of February 2011.

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 nature of monetary policy is preventive and therefore is aimed at anticipating inflationary or deflationary pressures, taking into account that inflation may be influenced by factors beyond the control of the Central Bank, such as supply shocks or the prices of imported products, which may result in transitory deviations of inflation from the target.

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

- Additionally, the Central Bank implements preventive measures to preserve financial stability and monetary policy transmission mechanisms. Through interventions in the foreign exchange market, the Central Bank reduces excessive volatility in the exchange rate and accumulates international reserves, thus developing strengths to face negative events in an economy with still a high level of financial dollarization.

- The forecasts on which monetary policy decisions are based are disseminated through the Inflation Report to show the consistency of the decisions adopted with the aim that economic agents' expectations take these forecasts into account. The Central Bank also disseminates the studies analyzing the risk factors that may cause deviations in the forecasts of the economic variables considered.

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

Summary

i. In January the Board of the Central Bank decided to reinitiate the withdrawal of monetary stimulus, after the pause made during the last quarter of 2010. Rises in the reference rate continued being complemented with higher reserve requirements in nuevos soles and in dollars. These preventive measures are aimed at offsetting the impact of external food and energy supply shocks on inflation expectations in a context of high economic growth rates.

The reference interest rate was adjusted on three occasions between January and March, raising it by 25 basis points in each month, that is, from 3.0 to 3.75 percent. The mean rate of reserve requirements for deposits in both domestic and foreign currency was also raised by 0.25 percent on two occasions. These measures have been complemented with modifications in the regulations about reserve requirements for banks' branches abroad and with changes in the rate of reserve requirements for banks' short term external liabilities.

Thus, the Central Bank monetary communiqués in the first quarter have emphasized that any future adjustment in the reference interest rate will depend on new information about inflation and its determinants.

ii. Several **advanced indicators of economic activity** show that Peru's GDP would continue recording high growth rates in Q1-2011 amid positive business expectations about the future of the economy and a strong dynamism in private spending. Private investment continues showing an important growth, as reflected in the greater number of investment announcements and in the evolution of imports of capital goods and construction.

Based on this information, the growth forecast for 2011 and 2012 has been revised upwards to 7.0 and 6.5 percent, respectively (up half a point compared to the forecasts considered in our Inflation Report of December). This implies that the output gap would be slightly positive in 2011, after which it would start converging to a neutral position over the forecast horizon.

iii. The forecast scenario of **fiscal accounts** has been revised to include the impact that the recently implemented tax measures would have. Considering the higher growth of economic activity, the higher prices of commodities expected in the forecast horizon, and assuming that the level of non financial expenditure will continue to be the one set forth in the Multiannual Macroeconomic Framework of August 2010, a deficit of 0.3 percent of GDP is foreseen for 2011 and a nil deficit is foreseen for 2012.

iv. As regards the **international environment**, given the improvement observed in the indicators of activity in developed countries, the forecast on global growth has been revised from 3.7 to 4.1 percent for both 2011 and 2012. The recovery of global economic activity is not expected to be homogeneous. Growth in developed countries continues depending on the degree of fiscal and monetary stimulus in each country and in most cases inflationary pressures are under control. Emerging economies, on the other hand, are facing higher inflationary pressures due to the strong growth of domestic demand in a context of high prices of food and energy, as a result of which some of them have started withdrawing monetary stimulus.

v. The forecast deficit in the current account of the **balance of payments** has been revised from 3.1 to 3.3 percent for 2011 considering the higher growth foreseen in domestic demand and its impact on the volume of imports. In 2012 the deficit in the current account would rise from 3.2 to 3.5 percent due to the higher decline foreseen in terms of trade. It should be pointed out that long term capital inflows would more than compensate the deficit in the current account in both years.

vi. **Inflation** is expected to increase to around the upper band of the target by the end of 2011 mainly as a result of supply factors, reversing thereafter towards the target level in 2012. This forecast is based on inflation expectations anchored to the target range, additional adjustments in the monetary position, a moderation of fiscal stimulus, and the reversal of the supply shocks.

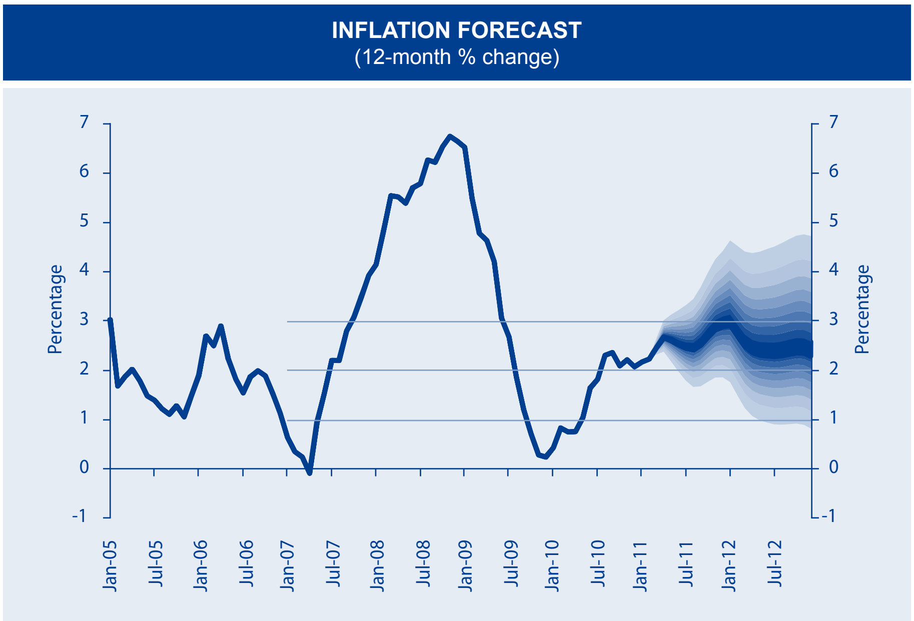
vii. The main risks that could cause inflation to deviate from the central scenario include the following:

- **Imported inflation associated with food and energy prices.** The recent evolution of the price of food commodities and fuel shows that the probability of having higher prices in the future has increased. In this scenario, the Central Bank would adjust its monetary position more rapidly if the possible increase of imported inflation affects inflation expectations.

- **Dynamism in the domestic economy.** Together with the high GDP growth rates recorded during 2010, increased optimism due to recent data of indicators of production could result in a higher output gap than the one considered in the central scenario. This would generate demand pressures, so in this scenario the monetary policy position would be adjusted more rapidly.

- **Uncertainty about the evolution of the global economy.** The baseline scenario considers the recovery of global economic activity, which would contribute to sustain favorable levels of terms of trade in the Peruvian economy. In addition to the risk factors pointed out in our December Report –fiscal sustainability in some Eurozone countries and the possibility of a higher slowdown in China–, now there is also the risk of a rise in the international prices of food and oil due to the recent conflicts in some countries in North Africa and the Middle East and also due to uncertainty about the impact of the earthquake in Japan. This contingent international context would imply a slowdown in the growth of the domestic economy and higher volatility in financial markets.

The Central Bank has a high level of international reserves, as well as several liquidity injection mechanisms to face this contingency. Thus, should this risk materialize, monetary stimulus would be maintained for a longer period of time.



INFLATION REPORT FORECAST SUMMARY

	2008	2009	2010	2011 1/		2012 1/	
				IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
Real % change							
1. GDP	9.8	0.9	8.8	6.5	7.0	6.0	6.5
2. Domestic demand	12.2	-2.8	12.8	7.6	8.1	6.1	6.5
a. Private consumption	8.7	2.4	6.0	5.0	5.6	4.6	5.3
b. Public consumption	2.1	16.5	10.6	5.0	5.0	2.7	2.7
c. Private fixed investment	25.8	-15.1	22.1	14.5	15.0	12.3	12.5
d. Public investment	42.8	25.5	26.5	8.8	8.8	4.4	4.4
3. Exports (goods and services	8.8	-3.2	2.5	5.2	5.2	8.4	8.4
4. Imports (goods and services	20.2	-18.6	23.8	10.6	11.2	8.0	8.0
5. Main trade partners' economic growth	2.6	-1.1	4.4	3.2	3.6	3.2	3.4
Memo:							
Output gap 2/ (%)	4.3	-1.6	-0.5 ; +0.5	0.0 ; +1.0	0.0 ; +1.0	-0.5 ; +0.5	-0.5 ; +0.5
% change							
6. Forecast inflation	6.7	0.2	2.1	1.5-2.5	2.5-3.5	1.5-2.5	2.0-3.0
7. Average price of crude oil	37.8	-38.1	28.7	8.9	22.3	0.0	1.7
8. Nominal exchange rate 3/	4.5	-7.6	-2.1	-0.6	-1.6	0.0	-1.4
9. Real multilateral exchange rate 3/	-4.8	0.9	-2.1	-1.6	1.4	0.3	-1.2
10. Terms of trade	-14.4	-2.8	17.9	-0.7	1.8	-1.2	-2.4
a. Export price index	3.5	-10.0	29.9	3.5	12.5	0.4	-0.7
b. Import price index	21.0	-7.4	10.1	4.2	10.4	1.7	1.8
Var.% nominal							
11. Currency in circulation	16.7	11.0	25.5	20.0	21.0	18.0	18.0
12. Credit to the private sector 4/	30.3	8.5	16.3	15.0	16.0	14.5	15.0
% of GDP							
13. Domestic investment rate	25.8	22.9	25.1	27.0	26.8	28.1	27.8
14. Current account of the balance of payments	-4.2	0.2	-1.5	-3.1	-3.3	-3.2	-3.5
15. Trade balance	2.0	4.7	4.4	2.9	3.7	2.5	3.0
16. Gross external financing to the private sector 5/	7.6	4.8	7.8	6.0	6.5	5.9	5.7
17. Current revenue of the general government	21.0	18.6	19.8	20.1	19.5	20.2	19.3
18. Non-financial expenditure of the general government	17.3	19.5	19.3	18.9	18.6	18.5	18.2
19. Overall balance of the non-financial public sector	2.1	-1.9	-0.6	0.0	-0.3	0.5	0.0
20. Total public debt	24.1	27.2	23.9	21.4	21.3	19.8	19.6

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

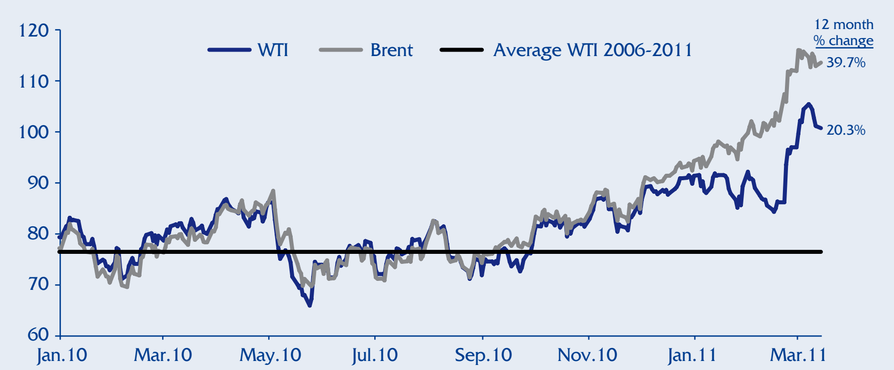
I. International Environment

1. After recovering significantly in 2010, global **economic activity** has been showing a series of positive indicators that have led us to revise upwards the growth forecast for 2011 and 2012. However, this recovery is not homogeneous. Growth in developed countries still depends strongly on fiscal and monetary stimulus and, with the exception of the UK, no inflationary pressures are observed in these countries. On the other hand, the dynamism observed in emerging countries occurs in a context of increased growth of domestic demand, credit, and higher inflationary pressures, factors which in many cases have led the authorities to initiate the withdrawal of monetary stimulus.

Graph 1
GDP GROWTH

2. Simultaneously, risk factors not only remain, but have also increased in some cases. The recent rise in the price of oil as a result of conflicts in North Africa and the Middle East has intensified the trend observed since August 2010 and introduces an additional factor of uncertainty about the outlook for global growth and inflation. The latter variable is also being affected by the rise in the international prices of food.

Graph 2
PRICE OF OIL WTI AND BRENT
(US$ per barrel)



WTI: West Texas Intermediate.

In the second place, in spite of the fiscal measures adopted during 2010, uncertainty about the fiscal sustainability of some **Eurozone** countries continues affecting financial conditions and growth prospects in that region. There is also the risk of a higher than expected deceleration in China as a result of the monetary and macro prudential measures implemented with the aim of reducing pressures on the prices of goods and assets, as well as of reducing the growth of credit. Finally, there is also uncertainty about the impact that the earthquake and tsunami that hit Japan on March 11 may have on the global economy.

Global growth

3. Continuing the trend observed in 2010, recent indicators of activity in manufacturing and services show a positive evolution so far this year. **Global GDP** is estimated to have grown 4.7 percent in 2010, developed economies are estimated to have grown 2.9 percent, and emerging economies would have grown 6.9 percent. These results are higher than the ones considered in our December Report.

   In 2011 and 2012 the global economy is expected to grow 4.1 percent, a higher rate than the one forecast in our previous report due in part to the better performance observed in the last year.

However, global growth in these years would be slightly lower than in 2010 due to the withdrawal of monetary stimulus and to the implementation of macro prudential measures in emerging economies with the aim of controlling demand pressures and moderating the inflationary pressures derived from the rise in commodity prices. Moreover, the recovery in developed countries would be limited by a lower fiscal impulse and a more severe adjustment would be observed in the Eurozone economies with debt problems.

TABLE 1
WORLD GDP GROWTH
(Annual % change)

	2009	2010	2011		2012	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
Developed countries	**-3.4**	**2.9**	**1.9**	**2.3**	**2.0**	**2.3**
1. United States	-2.6	2.8	2.4	3.0	2.4	2.8
2. Eurozone	-4.1	1.6	1.1	1.3	1.1	1.4
Germany	-4.7	3.5	1.7	2.2	1.3	1.5
France	-2.6	1.5	1.3	1.4	1.3	1.5
3. Japan	-6.3	3.9	1.0	1.4	1.4	1.7
4. United Kingdom	-4.9	1.3	2.0	1.7	2.0	2.0
5. Canada	-2.5	3.1	2.4	2.6	2.4	2.4
6. Other developed countries	-1.4	5.4	3.2	3.5	3.2	3.8
Developing countries	**2.5**	**6.9**	**5.9**	**6.1**	**5.8**	**6.1**
1. Sub-Saharan Africa	2.8	5.0	5.5	5.5	5.5	5.5
2. Central and Eastern Europe	-3.7	3.9	3.4	3.6	3.5	4.1
3. Community of Independent Countries	-6.5	4.4	4.2	4.5	4.2	4.5
Russia	-7.9	4.0	3.8	4.2	3.8	4.2
4. Developing Asia	7.0	9.2	7.6	7.9	7.6	7.9
China	9.2	10.3	8.9	8.9	8.8	8.8
India	5.7	9.0	7.2	8.0	7.2	8.0
5. Middle East and Northern Africa	1.8	3.9	4.9	4.6	4.8	4.6
6. Latin America and the Caribbean	-1.8	5.8	3.7	4.2	3.6	3.9
Brazil	-0.2	7.5	4.0	4.5	4.0	4.0
World Economy	**-0.7**	**4.7**	**3.7**	**4.1**	**3.7**	**4.1**
Memo:						
BRICs 1/	5.1	8.9	7.3	7.5	7.2	7.4
Peru's trading partners 2/	-1.1	4.4	3.2	3.6	3.2	3.4

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

4. **Developed economies** continue showing a significant growth that has extended to service activities. Like in 2010, this growth was strongly supported by the maintenance of monetary and fiscal stimulus (with the exception of Germany, where growth was led by exports) and in a context of low inflationary pressures (with the exception of the UK).

TABLE 2
DEVELOPED ECONOMIES INDICATORS

	Growth 2010 Quarterly annualized rates				Unemployment Annual rates			Inflation Annual rates			Fiscal Deficit* % of GDP	
	I	II	III	IV	Dec.10	Jan.11	Feb.11	Dec.09	Dec.10	Jan.11	2010	2011
United States	3.7	1.7	2.6	2.8	9.4	9.0	8.9	2.7	1.5	1.6	8.8	9.7
United Kingdom	1.2	4.1	2.8	-2.4	7.9	7.9	7.9	2.8	3.7	4.0	9.5	7.9
Eurozone	1.6	4.1	1.2	1.2	9.9	10.1	10.1	0.9	2.2	2.3	6.0	4.8
Germany	2.4	9.1	2.8	1.6	8.1	7.5	7.5	0.9	1.7	2.0	3.7	2.8
Japan	6.1	2.0	3.2	-1.2	5.2	5.0	5.0	-1.7	0.0	0.0	8.7	7.7

Source: Investment companies (March 2011).

A slight improvement has been observed in the labor market and in credit conditions in the **United States** and allowed personal consumption to grow (in Q4-2010 it was over the quarterly rate of 4 percent in annual terms).

However, the recovery of private demand has been slow and partial. The last indicators on construction and house sales dropped again in January, affecting the recovery of residential investment. Moreover, despite its recent evolution, private consumption is still limited by the strong leveraging of households (the debt-to-personal income ratio is over 105 percent), high unemployment (9.4 percent at end 2010), and relatively strict credit conditions.

TABLE 3
USA: GDP GROWTH
(Annualized quarterly rates)

	3Q.08	4Q.08	1Q.09	2Q.09	3Q.09	4Q.09	1Q.10	2Q.10	3Q.10	4Q.10
GDP	**- 4.0**	**-6.8**	**-4.9**	**-0.7**	**1.6**	**5.0**	**3.7**	**1.7**	**2.6**	**2.8**
Personal consumption	-3.5	-3.3	-0.5	-1.6	2.0	0.9	1.9	2.2	2.4	4.1
Durable goods	-12.0	-22.3	4.8	-3.1	20.1	-1.1	8.8	6.8	7.6	21.0
Non-durable goods	-5.5	-4.9	0.4	-0.7	1.7	3.1	4.2	1.9	2.5	4.8
Services	-1.3	0.6	-1.6	-1.7	-0.5	0.5	0.1	1.6	1.6	1.4
Gross investment	-12.5	-36.8	-42.2	-18.5	11.8	26.7	29.1	26.2	15.0	-22.1
Fixed investment	-11.9	-24.9	-35.4	-10.1	0.7	-1.3	3.3	18.9	1.5	4.8
Non-residential	-8.6	-22.7	-35.2	-7.5	-1.7	-1.4	7.8	17.2	10.0	5.3
Residential	-22.6	-32.6	-36.2	-19.7	10.6	-0.8	-12.3	25.7	-27.3	2.8
Exports	-5.0	-21.9	-27.8	-1.0	12.2	24.4	11.4	9.1	6.8	9.6
Imports	-0.1	-22.9	-35.3	-10.6	21.9	4.9	11.2	33.5	16.8	-12.4
Government expenditure	5.3	1.5	-3.0	6.1	1.6	-1.4	-1.6	3.9	3.9	-1.5

Source: BEA.

This situation has led to the renewal of monetary and fiscal stimulus through US$ 600 billion and US$ 858 billion, respectively, in a context of controlled inflationary pressures. The renewal of fiscal and monetary stimulus and higher corporate profits, which would stimulate investment and employment, account for the better prospects of the US economy in 2011 and 2012 in comparison with the figures considered in our December Report.

Europe continues showing a mixed performance. In the **Eurozone,** the largest economies showed a sound growth driven by exports (Germany) and by domestic demand (France). At the level of sectors, the Purchasing Managers Index (PMI) of manufacturing and services has recorded a positive evolution.

On the other hand, the economies affected by the debt crisis (basically Greece, Portugal, Ireland and Spain) registered mostly contractions in GDP growth due to the fiscal adjustment and the deterioration of private and public financing conditions, which has led the governments to discuss the possibility of a default of the sovereign debt.

In this context, after having grown 1.6 percent in 2010, the Eurozone would grow 1.3 and 1.4 percent in 2011 and 2012, respectively. The possibility of a better outlook in the Eurozone will depend on the measures being discussed to reform the financial system and on the possibilities that the extreme scenario of a sovereign default may be prevented.

The **United Kingdom** grew 1.7 percent in 2010, despite the contraction observed in the last quarter due in part to climatic conditions. Net exports (due to the previous depreciation of the pound), investment and domestic consumption account for the positive results observed.

In line with these developments, the UK is estimated to grow 1.7 and 2.0 percent in 2011 and 2012, respectively. Inflationary pressures, which would lead to rate adjustments during this year, and the increase of the VAT implemented at the beginning of the year, would prevent reaching higher growth rates.

Japan showed a significant growth in 2010, basically in the first semester, favored by tax incentives and better conditions in the labor market that stimulated consumption, as well as by increased non residential investment and net exports. However, after the strong earthquake that affected this country, growth expectations for 2011 are beginning to be adjusted.

Growth estimates for 2011 before the earthquake ranged between 1.6 and 2.2 percent. According to Barclays, the region affected by the seism in Japan represents about 6.5 percent of the country's GDP, 6.8 percent of its population, 7.2 percent of the private sector capital stock, and 6.5 percent of families' life insurances.

As regards economic activity, a decline of activity in the affected region may be expected in the next two quarters, followed by a recovery associated with the reconstruction of this area. A similar pattern was observed after the earthquake in Kobe in 1995. Reconstruction costs are estimated to be around 3 percent of GDP.

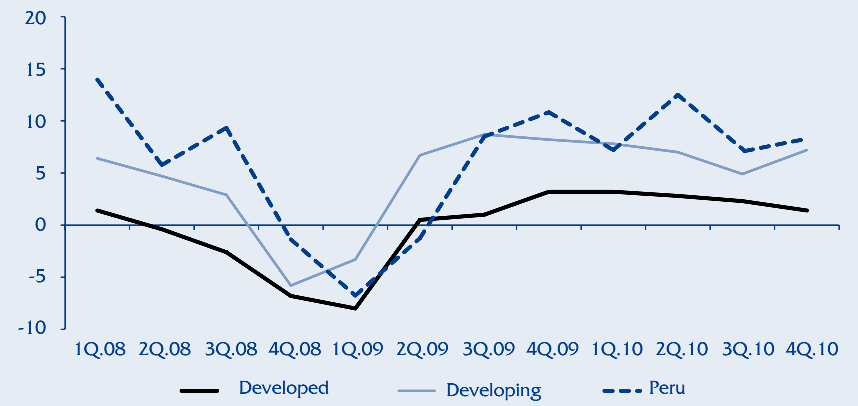
The interruption of economic activity, particularly industrial production, would have a negative impact on the demand for metals in the short term. However, the demand associated with the reconstruction process would more than compensate the initial decline. It is estimated that the products that would benefit the most would be copper and zinc. Moreover, given the difficulties to replace nuclear sources in the short term, the demand for coal –Japan's main source of energy–should increase in the next months (Japan accounts for 15 percent of global consumption of coal). In the longer term, given the damage experienced by Japan's nuclear plants, it is quite likely that a change will be observed in the energy matrix of the country, which will involve a higher participation not only of coal, but also of gas and even oil.

As regards the exchange rate markets, the yen is expected to face appreciatory pressures in the short run as a result of capital inflows associated with the reconstruction process, insurance payments, and the repatriation of capitals of Japanese companies. In the week after the earthquake, the yen appreciated 3 percent against the dollar. In the longer term, however, it is likely that this effect will be offset by the Bank of Japan's policies of maintaining an expansionary monetary policy. The Japanese authorities have recently announced that liquidity will be injected into the money market, that its asset purchase program will be increased, and that purchases of Treasury bonds will also be increased.

Finally, the damage of nuclear plants increased risk aversion significantly and would explain in part the drop of stock markets and the increased demand for US Treasury bonds. Japan's stock market accumulated a drop of 14 percent in the days following the earthquake, which affected also most stock exchange markets. The higher demand for 10-year US Treasury bonds, on the other hand, caused the yield on these bonds to decline by 25 bps. These drops in stock exchange markets are expected to be reflecting a market over-reaction, as was the case after the Kobe earthquake (even though there was no nuclear issue then).

5. The **emerging economies** continue growing at high rates. The 6.9 percent rate recorded in 2010, a rate even higher than the one registered in the period of 2001-2007, is associated with the dynamism of domestic demand and exports in a context of recovery of global trade. Recent indicators of production, industrial activity, and exports show that this trend continues in many economies.

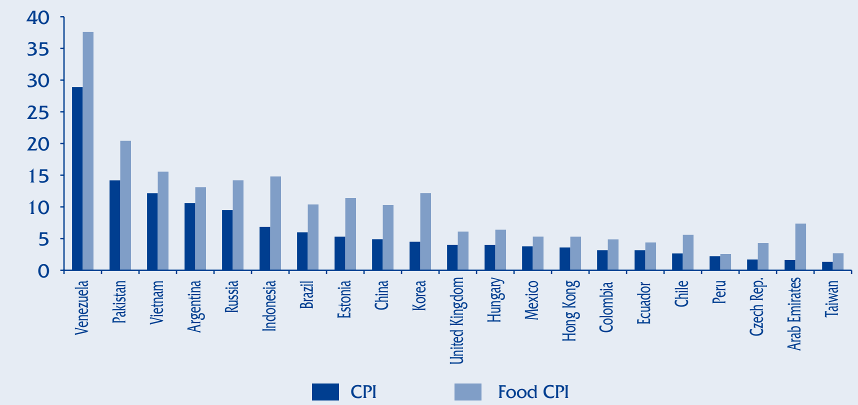
Graph 3
GDP: SEASONALLY ADJUSTED ANNUALIZED QUARTERLY GROWTH
(%)



Source: JP Morgan, BCRP.

This growth has been coupled by a lower output gap, a dynamic growth of credit, and by an increase of inflationary pressures, factors that in many cases have led authorities to initiate the withdrawal of monetary stimulus.

Graph 4
INFLATION AND FOOD CPI: LAST AVAILABLE DATA
(12-month % change)



Source: Bloomberg, central banks and statistics institutes.

After making a pause in their adjustments due to increased market volatility associated with the problems in the Eurozone, central banks reinitiated the normalization of monetary positions in Q4-2010 and have continued adjusting them so far this year. This explains the moderation of growth foreseen for 2011-12 in comparison with 2010.

TABLE 4
MONETARY POLICY INTEREST RATE: 2007 - 2010
(%)

	Dec.07	Dec.08	Dec.09	Dec.10	Mar.11	Change (bps.) Mar.11/ Dec.10	Change (bps.) Mar.11/ Dec.09
Developed countries							
Sweden	4.00	2.00	0.25	1.25	1.50	25	125
Israel	4.25	2.50	1.25	2.00	2.50	50	125
Australia	6.75	4.25	3.75	4.75	4.75	0	100
South Korea	5.00	3.00	2.00	2.50	3.00	50	100
Canada	4.25	1.50	0.25	1.00	1.00	0	75
Taiwan	3.38	2.00	1.25	1.63	1.63	0	38
Norway	5.25	3.00	1.75	2.00	2.00	0	25
New Zealand	8.25	5.00	2.50	3.00	2.50	-50	0
Eurozone	4.00	2.50	1.00	1.00	1.00	0	0
Slovak Republic	4.25	2.50	2.50	2.50	2.50	0	0
United States	4.25	0.25	0.25	0.25	0.25	0	0
Japan	0.50	0.10	0.10	0.10	0.10	0	0
United Kingdom	5.50	2.00	0.50	0.50	0.50	0	0
Switzerland	2.75	0.50	0.25	0.25	0.25	0	0
Czech Republic	3.50	2.25	1.00	0.75	0.75	0	-25
Iceland	13.75	18.00	10.00	4.50	4.25	-25	-575
Developing countries							
Chile	6.00	8.25	0.50	3.25	4.00	75	350
Brazil	11.25	13.75	8.75	10.75	11.75	100	300
Peru	5.00	6.50	1.25	3.00	3.75	75	250
India	7.75	6.50	4.75	6.25	6.50	25	175
Pakistan	10.00	15.00	12.50	14.00	14.00	0	150
Thailand	3.25	2.75	1.25	2.00	2.50	50	125
Malaysia	3.50	3.25	2.00	2.75	2.75	0	75
China	7.47	5.31	5.31	5.81	6.06	25	75
Indonesia	8.00	9.25	6.50	6.50	6.75	25	25
Poland	5.00	5.00	3.50	3.50	3.75	25	25
Philippines	5.25	5.50	4.00	4.00	4.00	0	0
Mexico	7.50	8.25	4.50	4.50	4.50	0	0
Turkey	15.75	15.00	6.50	6.50	6.25	-25	-25
Colombia	9.50	9.50	3.50	3.00	3.50	50	0
Hungary	7.50	10.00	6.25	5.75	6.00	25	-25
South Africa	11.00	11.50	7.00	5.50	5.50	0	-150

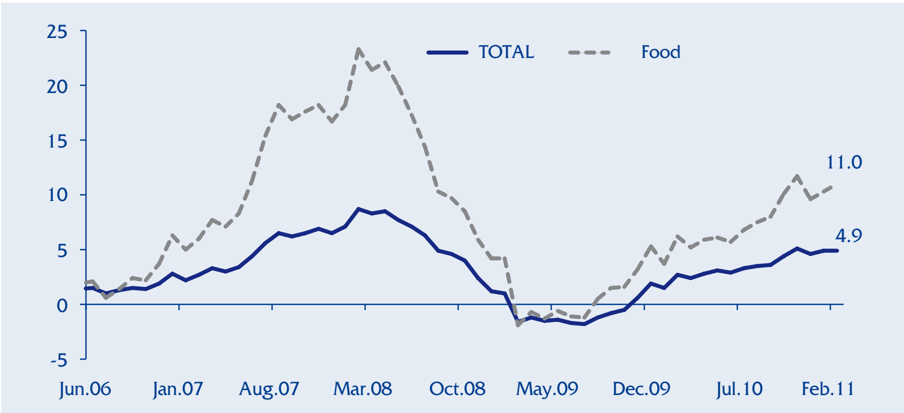
Source: Bloomberg and Reuters.

China stands out in the group of the emerging economies with a growth rate of 10.3 percent in 2010, driven mainly by investment and by the recovery of trade.

However, this pace of growth has been moderating since the second semester of last year due to the policy measures implemented to prevent the overheating of the economy and its inflationary pressures. Annual inflation rose from 2.7 percent in February 2010 to 4.9 percent in February 2011, affected also by food prices (which increased from 6.2 to 11 percent in the same period).

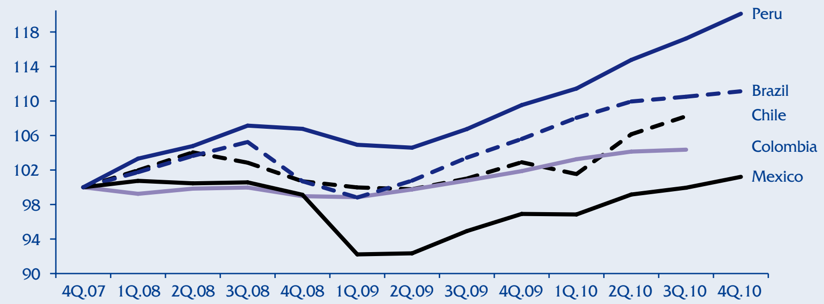
Measures were adopted during 2010 and until February 2011 to limit the excessive growth of liquidity and credit and to moderate the rise in the prices of houses. The measures included raising the rate of reserve requirements and the interest rate of the Central Bank (which remained unchanged since the end of 2008), establishing limits to bank loans, monthly loan quotas by entity, raising the rate on mortgage loans and on the down payment for the purchase of a second property, and prohibiting residents to purchase of a third property. Because of these measures, a lower growth is estimated for 2011-2012 (8.9 and 8.8 percent, respectively). However, together with India, China would continue leading global growth in the forecast horizon.

Graph 5
CHINA: TOTAL AND FOOD INFLATION
(12-month % change)



The rest of emerging economies have experienced a positive impact due to the recovery of international trade (particularly Asia), the increase of terms of trade (which offset the severe drought that affected Eastern Europe countries), and by the growth of domestic demand. **Latin American countries,** which grew 5.8 percent in 2010, have benefited from the growth of consumption and investment, as well as by the growth of external demand. Monthly indicators of activity and industrial production show that, in most cases, this trend continues so far this year.

Graph 6
GDP EVOLUTION IN LATIN AMERICA
(Seasonally adjusted data, 4Q07=100)



Source: Central banks and statistics institutes.

The strong pace of expansion has led some countries to start withdrawing monetary stimulus, which together with the rebound in inflation –particularly the food component– has generated expectations that the rate adjustment cycle will continue despite the evidence of appreciatory pressures, which have been faced through sterilized interventions.

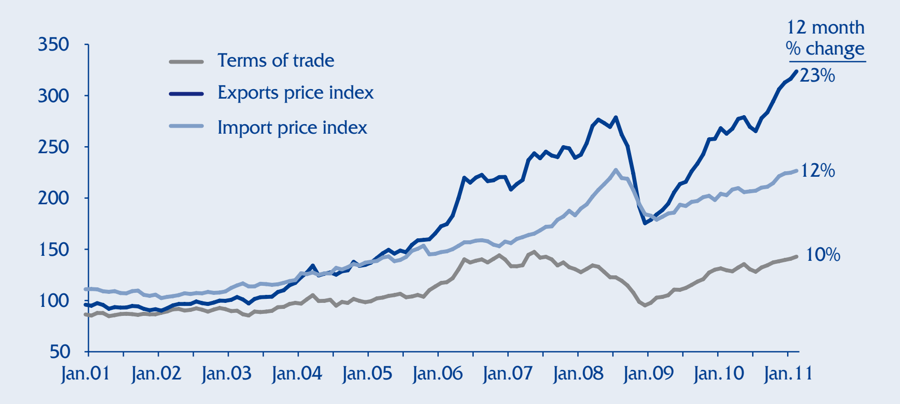
Terms of trade and commodity prices

6. International prices continued showing the upward trend observed since the second semester of 2010 until early March. In line with this, the forecasts on the main export and import products have been revised on the upside; in average terms it is expected that **terms of trade** will increase 1.8 percent in 2011 and that they would correct slightly downwards (2.4 percent) in 2012. This central scenario does not consider a deepening of the conflict in Arab countries which, should this be the case, would imply a higher volatility in international prices.

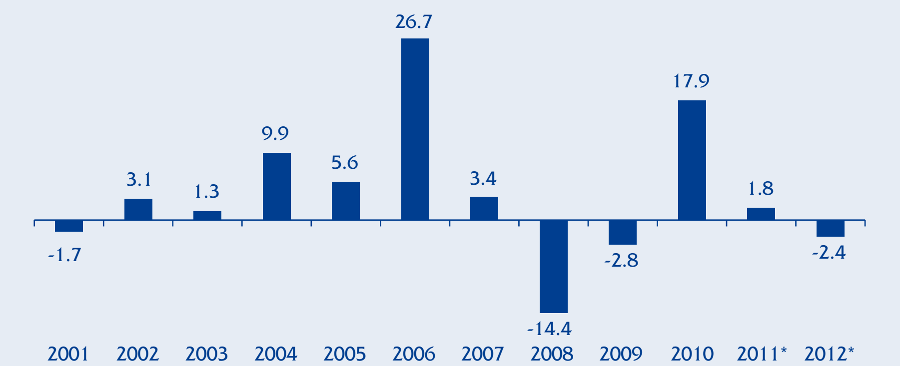
TABLE 5
TERMS OF TRADE
(Change and average prices)

	2009	2010	2011		2012	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
Terms of trade	**-2.8**	**17.9**	**-0.7**	**1.8**	**-1.2**	**-2.4**
Price of exports	**-10.0**	**29.9**	**3.5**	**12.5**	**0.4**	**-0.7**
Copper (ctv US$ per pound)	234	342	380	425	380	415
Zinc (ctv US$ per pound)	75	98	98	105	98	105
Gold (US$ per ounce)	974	1,225	1,300	1,369	1,300	1,370
Price of imports	**-7.4**	**10.1**	**4.2**	**10.4**	**1.7**	**1.8**
Oil (US$ per barrel)	62	79	86	97	86	99
Wheat (US$ per MT)	193	195	292	336	289	334
Maize (US$ per MT)	139	157	230	259	218	228
Soybean oil (US$ per MT)	729	859	1,133	1,260	1,133	1,262
Rice (US$ per MT)	561	503	530	535	515	524
Sugar (US$ per MT)	412	597	600	671	515	561

Graph 7
TERMS OF TRADE, EXPORT AND IMPORT PRICE INDICES
(1994=100)



Graph 8
TERMS OF TRADE
(% change)



*Forecast.

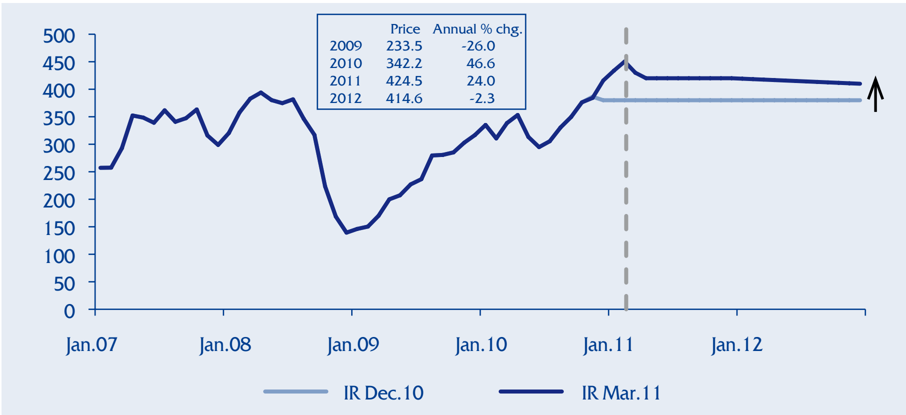
Copper

7. In the first two months of 2011, the price of **copper** recorded an increase of 7.6 percent, continuing with the trend observed in 2010 when this price rose 47 percent.

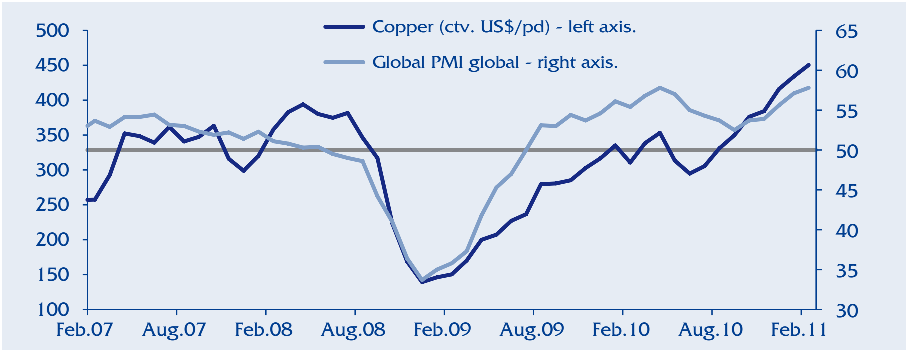
This price rise is associated with the growing tightness of the copper market due to emerging countries' increased demand (particularly China, despite the measures adopted to limit the demand) and to the better performance of industrial production in developed countries. On the side of supply, production is limited by the relative stagnation of production in Chile and in the United States due to the lower content of metal in copper concentrate and due to the increased number of strikes. Furthermore, the few new projects that are being developed are mostly located in vulnerable regions and have little infrastructure.

The copper market would continue showing a supply deficit during the next two years, which would reduce inventories to critical levels. In this context, prices are estimated to remain high in the forecast horizon.

Graph 9
COPPER
(ctv. US$/pd.)



Graph 10
PMI GLOBAL AND COPPER PRICE



PMI: Purchasing Managers Index.
Source: JP Morgan.

Zinc

8. In the first two months of 2011, the price of zinc showed an upward trend rising 8.1 percent. In 2010, it rose 31 percent. The evolution of the price of zinc, like in the case of other metals, has been subject to some volatility.

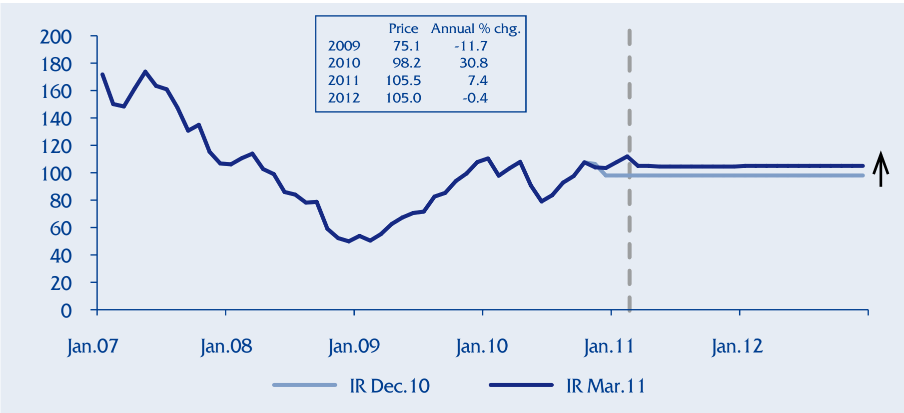
On the side of demand, an increase was recorded in the emerging economies, especially in China, and to a lower extent in developed countries.

However, there is uncertainty about the recovery path of this price given the weakness observed in the construction sector.

On the side of supply, the market of refined zinc showed an expansion that accounts for the increase in inventories for the fourth consecutive year. The positive balance in this market is explained by the higher production in mines and the higher production of refined metal, mainly in China, but also by noteworthy production increases in Australia, Eastern Europe, Brazil, India and Peru. These developments account for the lower increase in the price of zinc compared with the prices of other basic metals.

It is estimated that the price would stabilize around US$ 1.05/pound in the forecast horizon provided that the production in the old mines closed is replaced by the new projects foreseen.

Graph 11
ZINC
(ctv. US$/pd.)



Gold

9. The price of **gold** reached a nominal record of US$ 1,435/troy ounce on March 7 in a context of uncertainty due to the situation in the Middle East and North Africa and due to higher expectations of inflation derived from the rise in the price of oil and food. In 2010, the average price of gold increased 26 percent, reaching US$ 1,225 per troy ounce.

   This increase took place amid investors' increased risk aversion and demand to diversify portfolio costs, especially in the last month.

   It is estimated that the high volatility recorded in the last year will continue in 2011, influenced by possible re-compositions of international reserves that would favor this metal.

Graph 12
GOLD
(US$/tr.oz.)

Oil

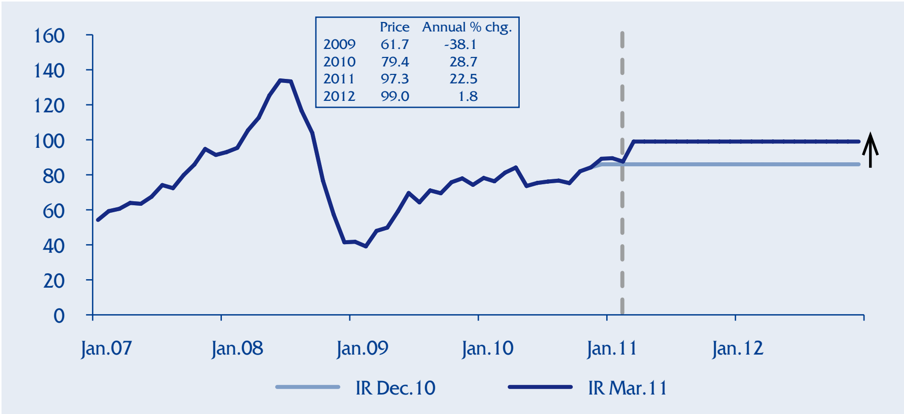
10. The price of **oil** continued with the upward trend observed in the second semester. Gold recovered from minimum levels in May 2010 (US$ 65.96/barrel on May 24) to a level of US$ 91.49/barrel at the end of the year (on December 28) and reached US$ 105.4/barrel on March 7, the highest level in 29 months.

    The increase in the price of oil was associated with three factors: On the side of demand, by a more favorable evolution of some developed economies and emerging countries, particularly China and India. On the side of supply, production constraints were observed in some countries such as Mexico, Norway, and the Middle East. Finally, this upward conduct was also intensified by investors' non commercial positions in oil, which increased over two-fold in the year.

    The volatility observed in 2010, associated in part with geopolitical tensions, temporary supply disruptions, and the situation of instability in Europe, has intensified so far this year due to the tensions in the Middle East and North Africa. The countries in that region that currently experience political problems represent 27 percent of the daily oil production and 61 percent of certified oil reserves.

    It is estimated that these factors would continue generating pressures on the price of oil in the forecast horizon.

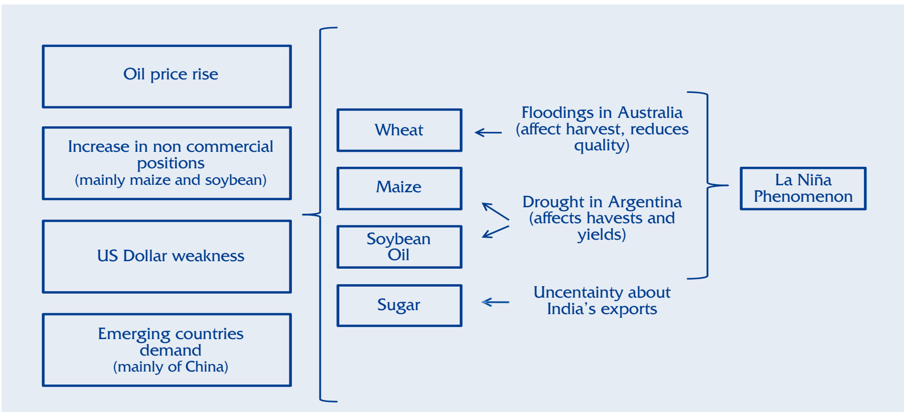
Graph 13
WTI OIL
(US$/bl)



Food

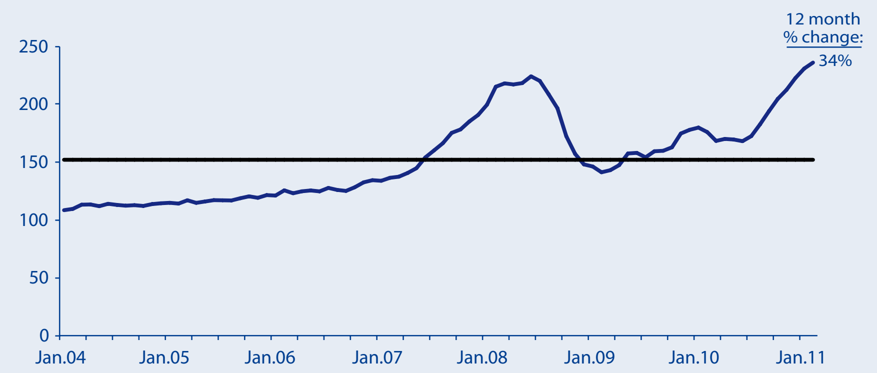
11. Food prices have been simultaneously affected by supply shocks and by demand factors in a context of low inventories of most of these products. The demand of emerging countries, particularly China, is still an important factor in all of the foodstuff markets. Supply factors are associated with the La Niña, which generated droughts in Argentina (affecting the production of maize and soy bean) and floods in Australia (which affected the supply of wheat and sugar). Given the global production constraints, many economies have been trying to accumulate inventories and to take measures to secure the supply for their domestic market, intensifying upward pressures even further.

Graph 14
FACTORS THAT AFFECT THE EVOLUTION OF FOOD PRICES



12. The FAO food price index has increased for eight consecutive months (with an accumulated increase of 40 percent since June 2010) and has reached its maximum high since the index was created, renewing fears of food-related inflationary pressures like the ones observed in 2007 – 2008.

Graph 15
FAO FOOD REAL PRICE INDEX
(2004=100)



Source: FAO.

Investors' increased non commercial positions have contributed to exacerbate volatility in a context of mostly tight markets which, together with the strong correlation with the prices of grains given their high degree of being substitutes for animal feed, have given greater support to these prices. The higher price of oil has also been influencing food prices due the growing use of some food products in the biofuel market.

Maize

13. The price of **maize** recorded an increase of 12.8 percent during 2010, reaching an average level of US$ 221.4/ton in December. This conduct continued during the first two months of 2011, when the price of maize rose 17.9 percent.

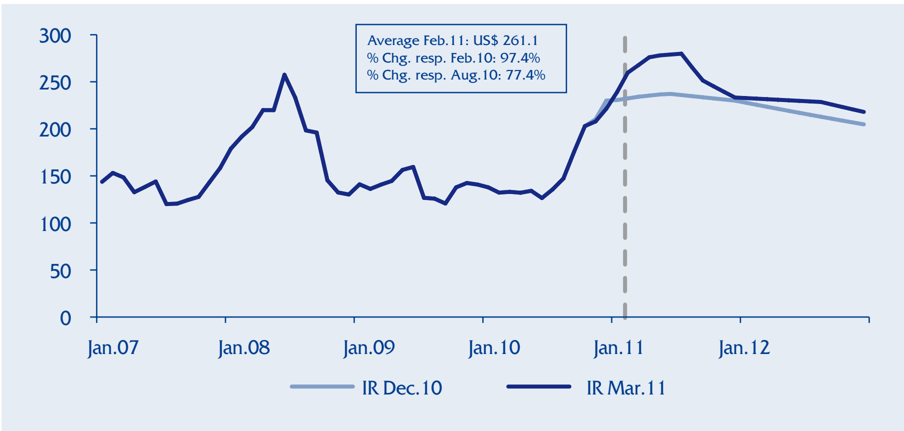
The demand of China, which continues to be a net importer and the increased demand for ethanol in the United States have added onto the supply factors that resulted in a tighter market in terms of the inventories-to-consumption ratio.

The supply factors worth pointing out include the climatic problems that caused lower yields in the production of the United States and the deepening of La Niña impacts towards the end of 2010 and the first months of 2011 which caused a drought in Argentina and generated adverse effects on the evolution of maize in that country. These developments encouraged higher speculative purchases from investors.

More recently, the pressure generated from the oil market has been affecting the spot price and futures of this grain given its utilization to produce ethanol. According to the US Department of Agriculture's World Agricultural Supply and Demand Estimates (WASDE) of February 2011, the demand for ethanol will represent 39.8 percent of production in the United States, the largest global producer and exporter of this grain. However, recent rains in Argentina, the world's second largest exporter, could improve the production outlook and partially offset the market tightness.

In line with what was pointed out above, in February the price of maize recorded higher levels on average terms than the maximum high registered in 2008. This price is expected to remain high in correlation with the increased demand for ethanol due to the rise in the price of oil.

Graph 16
MAIZE
(US$/MT)



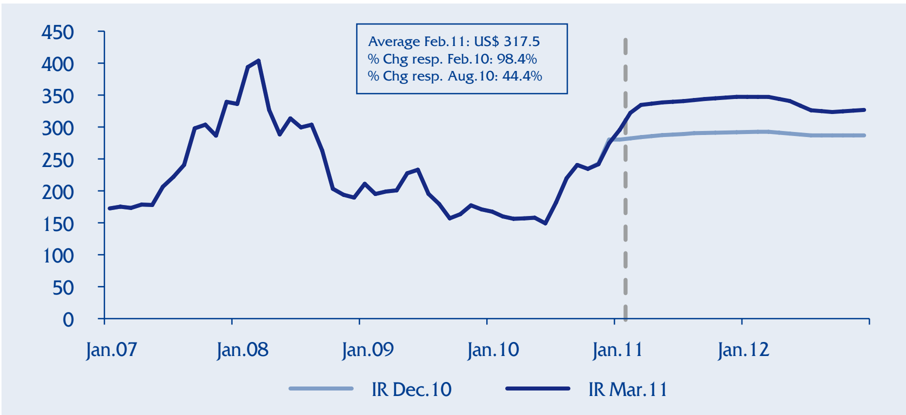
Wheat

14. The price of **wheat** registered an increase of 1.3 percent in 2010, closing the year with an average price of US$ 274.66/ton in December 2010. In the first two months of 2011, wheat increased 15.6 percent. This rising trend started as a result of unfavorable climatic conditions (high temperatures and drought) in Kazakhstan, Ukraine and Russia, and led Russia to prohibit wheat exports (until July 2011) and Ukraine to impose quotas.

Year-to-date, this price has continued rising due to the deepening of La Niña, which has severely affected Australia, the world's eighth largest producer and fifth exporter of wheat. Moreover, the dry weather in the US region of the Great Plains, particularly in Kansas, and the rise in the price of maize have had negative effects on wheat in winter.

In this context, the price of wheat is expected to remain high in 2011 and 2012, driven by the contagion associated with the maize market. It is worth mentioning that these products are substitutes for each other. If we exclude China and India, a significant reduction is observed in global inventories, which implies a more vulnerable market face new production losses in the 2010/2011 and 2011/12 crop years. Excluding China and India, the final inventories of the 2010/11 farming period would amount to 103.5 million tons, which implies a reduction of 18.5 percent compared with the previous crop year.

Graph 17
WHEAT
(US$/MT)



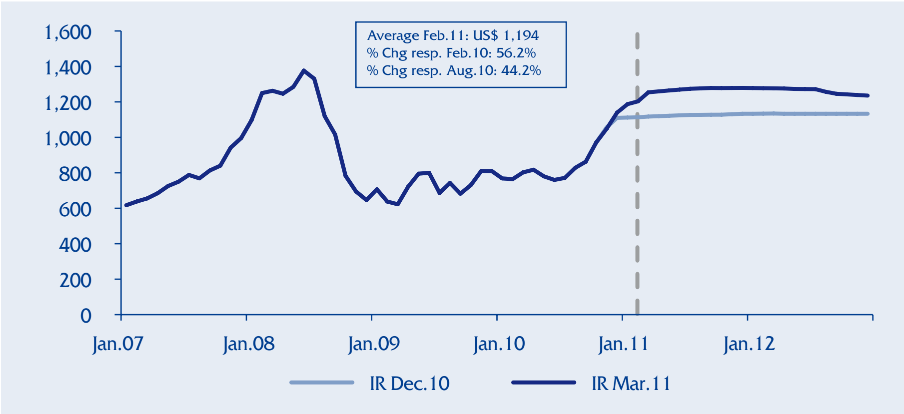
Soybean oil

15. The price of **soybean oil** recorded an average increase of 17.9 percent in 2010, closing December at an average price of US$ 1,139/ton. The rising trend of this price continued during the first months of the year. China's strong demand for soybean grains, the drought in Argentina, and the advance in the price of oil are the main factors accounting for this evolution.

Argentina, the world's largest exporter of soybean oil, is experiencing a severe drought in the producing areas (due to La Niña), which could negatively affect grain production. However, the recent rains are reversing expectations, both in Argentina and in Brazil.

Uncertainty about the evolution of the harvest of soybean in Argentina, the possibility that the price of oil will remain above US$ 100/barrel, and the dynamism of China's demand for soybean grain would sustain the price of soybean oil in high levels in the next months.

Graph 18
SOYBEAN OIL
(US$/MT)



Sugar

16. The price of **sugar**[1] recorded an increase of 45.0 percent in 2010, reaching an average level of US$ 798/ton in December. This price was affected by production cuts in India in the 2009/2010 farming period due to a weaker than expected monsoon and due to lower than normal rainfall in Brazil. These facts, which have contributed to maintain the sugar market tight (inventories are equivalent to 9.5 weeks of consumption), led this price to reach its maximum historical level in November 2010.

    In the first months of 2011 the price of sugar has been declining given the better outlook for global production in the 2010/2011 crop year. Even though these expectations are being confirmed (with Brazil and India's increased production, which accounts for over 50 percent of the global production of sugar cane), the price has been recently affected by the following factors:

    a. Strong increase in demand, which reflects in part the need of several countries –particularly Asian countries– to increase their local inventories due to concerns about a new unexpected drop in global supply.

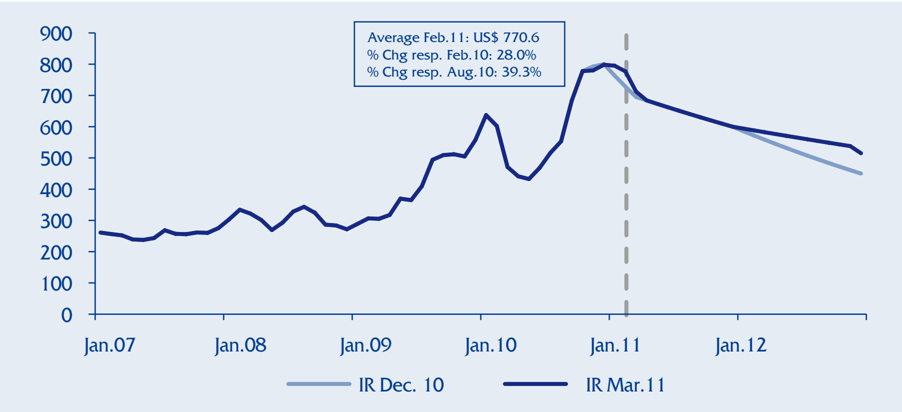
    b. Absence of an export policy in India. It is speculated that the government would delay the authorization to export sugar due to domestic inflationary pressures.

    c. Increased demand for ethanol in a context of higher prices of oil associated with the tensions in the Middle East and North Africa.

1 Contract number 11.

After the normalization of rains in Brazil, a correction is expected with the beginning of the new commercialization year in this country (April 2011), in line with the improvement in climatic conditions.

Graph 19
SUGAR
(US$/MT)



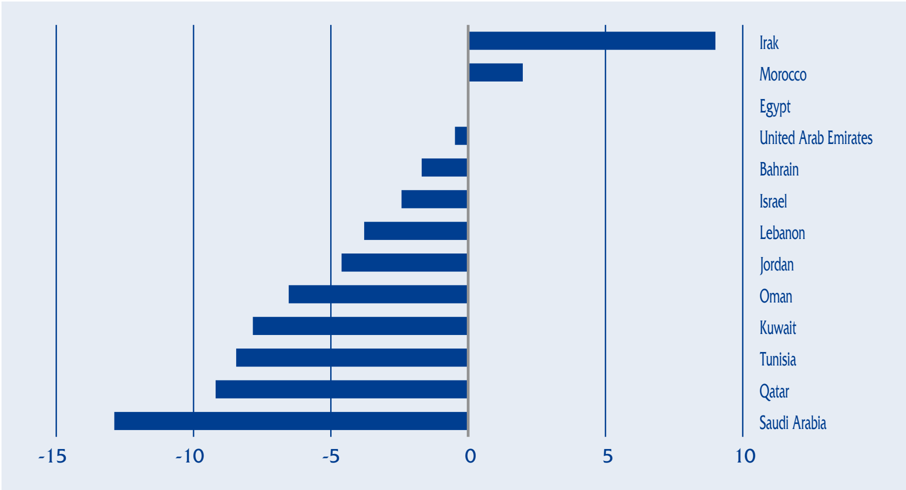
Financial markets

17. Before the Japan earthquake, in 2011 financial markets continued showing the trend toward normalization observed in 2010. This trend was supported by the favorable evolution of economic activity, the implementation of the Federal Reserve's second asset purchase program, the new fiscal package in the United States, and the high levels of international liquidity maintained, all of which reflected in the recovery of investors' confidence and in increased demand for risky assets.

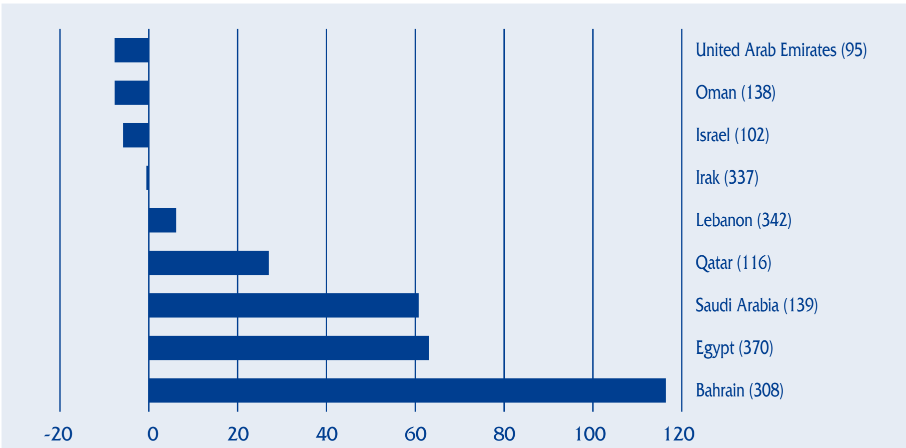
    In line with this, the stock indices in the major developed economies registered rises, the corporate credit spreads in developed economies and the sovereign spreads in the main emerging economies declined, and the returns on US Treasury bonds increased.

18. However, recent geopolitical tensions in some Middle East and North African countries have been generating upward pressures on the price of oil and increased geopolitical risks. So far, the effects of these tensions have basically been limited to losses in the financial markets in that region, to the rise in the international prices of fuels and in the price of gold, and to moderate losses in some emerging stock markets. However, an extension of the duration and magnitude of the conflict could limit the recovery of global growth and affect financial markets in general.

Graph 20
STOCK INDICES
(% Change, March against January 2011)



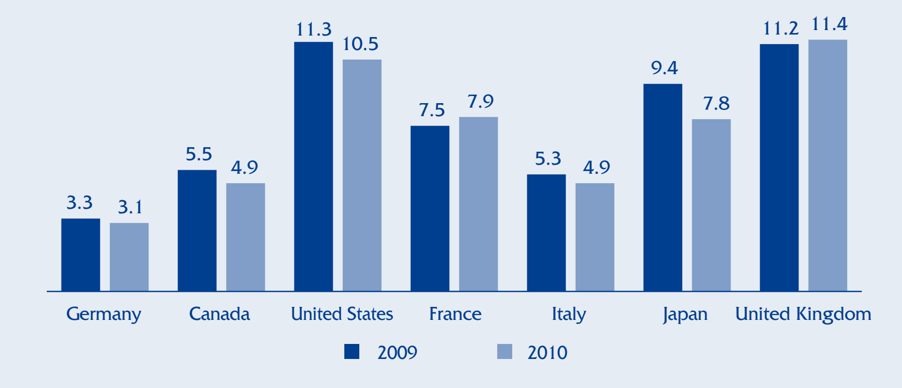
Graph 21
CREDIT DEFAULT SWAPS (CDS) 1/
(Change in pbs, March against January 2011)



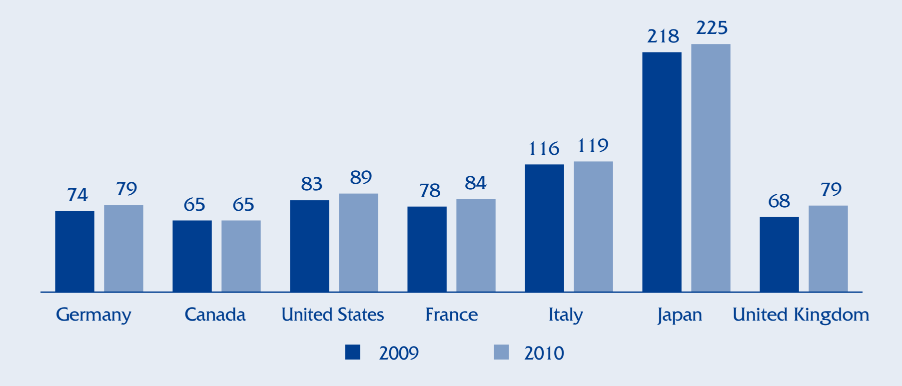
1/ Insurance premium in case of default.
Memo: Parentheses indicates CDS levels as of March.

Another risk factor is the still delicate fiscal situation in some Eurozone economies. The measures adopted during 2010 (rescue programs, creation of facilities, and purchase program of sovereign bonds of the countries with debt problems, as well as the reactivation of the provision of unlimited liquidity lines) have generated some improvement in the financial conditions of these economies, but they are still far from the conditions observed prior to the crisis.

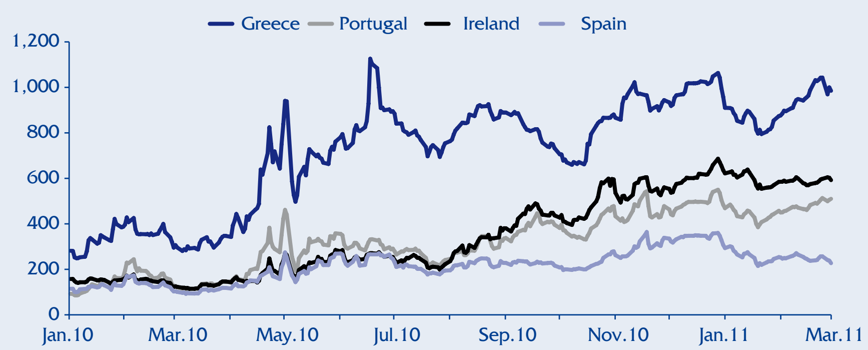
Graph 22
FISCAL DEFICIT: DEVELOPED COUNTRIES
(% of GDP)



Graph 23
GENERAL GOVERNMENT DEBT: DEVELOPED COUNTRIES
(% of GDP)



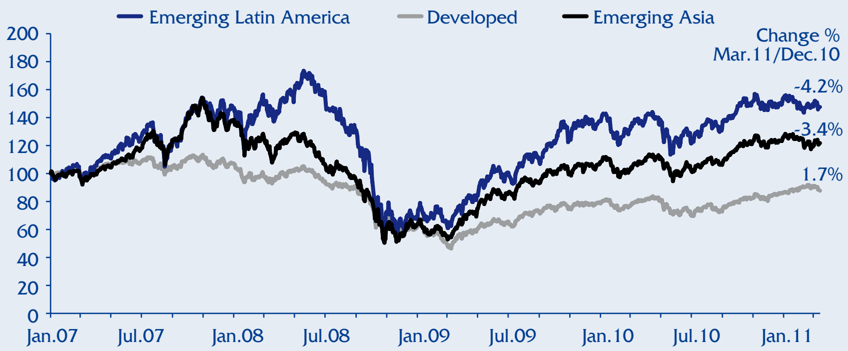
Graph 24
CREDIT DEFAULT SWAPS (CDS) OF EUROPEAN COUNTRIES 1/
(Bps)



Source: Bloomberg.
1/ Insurance Premiun in case of default.

19. **Stock markets** recorded rises in a context of higher commodity prices. The Dow Jones reached the levels observed in September 2008 while most European stock markets close the year recording gains. This situation has continued in 2011 in a context of favorable economic indicators in the major developed economies.

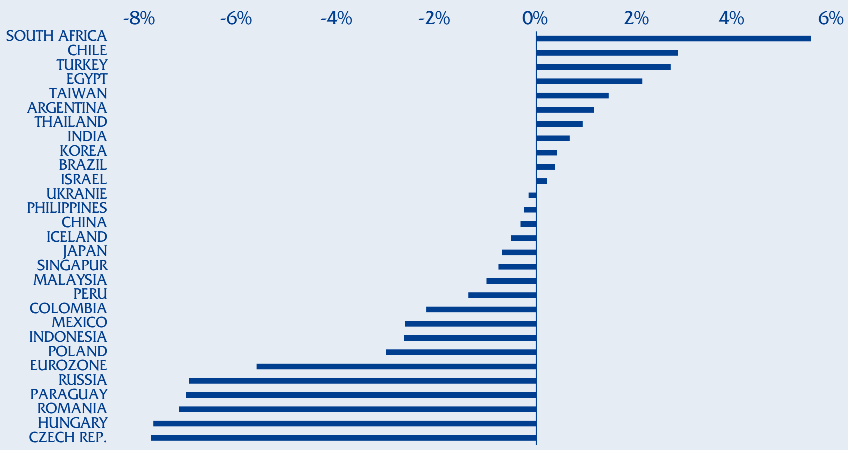
Graph 25
STOCK INDICES FOR DEVELOPED AND DEVELOPING COUNTRIES
(Base: Jan.07 = 100)



Source: Bloomberg.

20. As regards the exchange rate markets, expectations that the Eurozone and the UK will withdraw monetary stimulus before the FED does have contributed to the recent depreciation of the dollar against the euro and the pound, reversing the trend observed during 2010.

Graph 26
EXCHANGE RATE
(Monetary units per US$: % Chg Mar.11 respect to Dec.10)

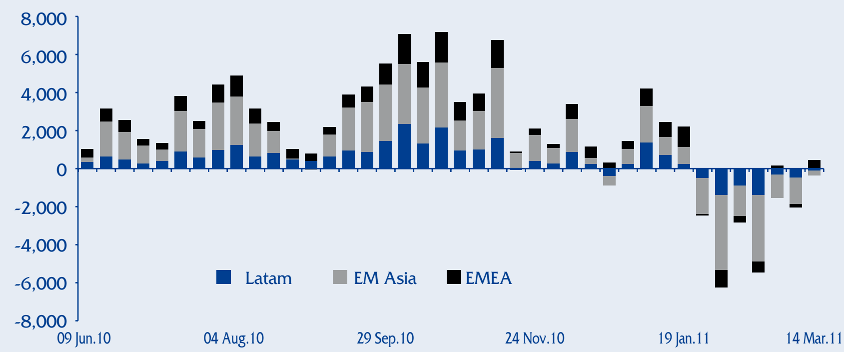


Source: Reuters.

The currencies of emerging economies continued showing an appreciatory trend in 2011, but at a slower pace due to reports showing favorable indicators in developed economies, as well as due to uncertainty about the situation in the Middle East and North Africa. In 2010, most emerging economies faced increased capital inflows given the rise of interest rates, leading central banks to intervene in the exchange rate market and to adopt administrative and macro prudential measures to discourage these inflows.

21. During 2010 the average weekly portfolio flows amounted to US$ 2,300 million. Portfolio flows were positive at the beginning of 2011, but reversed thereafter due to the conflicts in the Middle East and North Africa. However, they have showed a positive evolution again in the second week of March.

Graph 27
PORTFOLIO FLOWS TO DEVELOPING COUNTRIES
(Monthly flows, US$ millions)

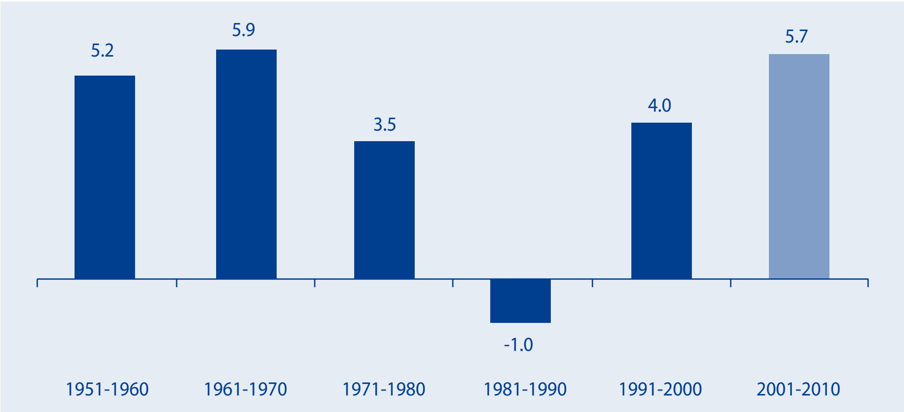


Latam: Latin America, EMEA: Europe, Middle East and Africa, EM Asia: Emerging Asia.
Source: Barclays.

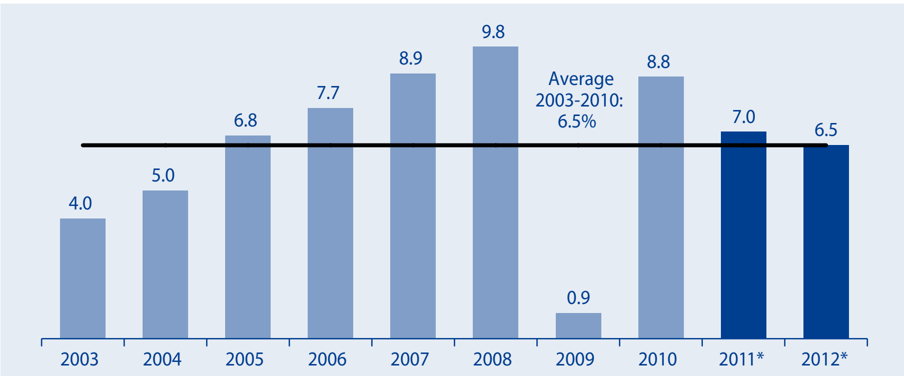
II. Economic activity

22. In 2010 **GDP** grew 8.8 percent, as a result of which the Peruvian economy closed the decade with an average growth of 5.7 percent, a rate comparable with the one recorded in the fifties and sixties. The growth forecast for 2011 has been raised from 6.5 percent (Inflation Report of December) to 7.0 percent due to the recovery of domestic demand. Likewise, the growth forecast for 2012 has been raised from 6.0 percent to 6.5 percent.

Graph 28
GDP
(Average % change)



Graph 29
GDP GROWTH RATE
(Real % change)

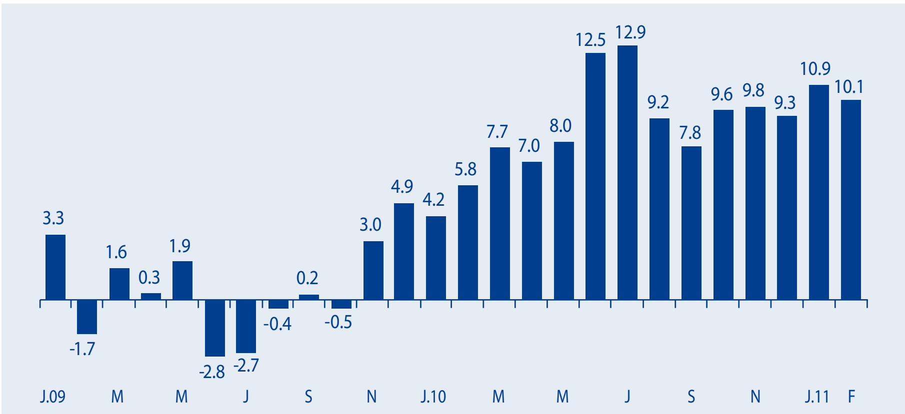


* Forecast.

23. **Recent indicators of activity and demand** continue showing clear signs of high growth:

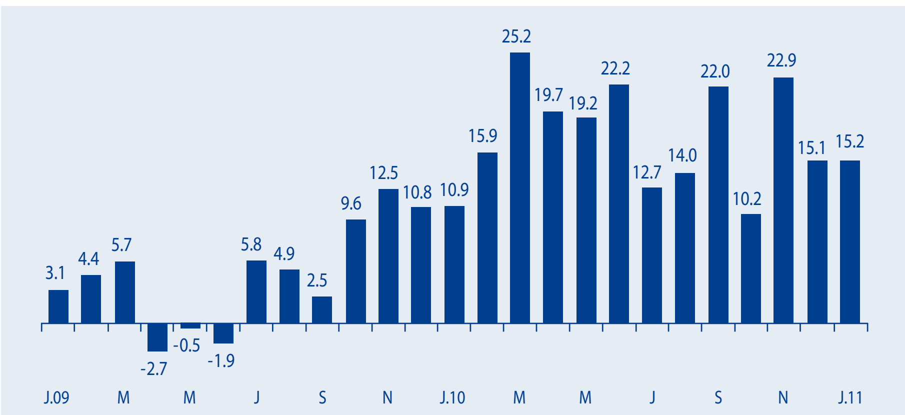
   a. In February 2011, the **production of electricity** recorded a growth rate of 10.1 percent compared with the same month in the previous year. A long term unit elasticity between the growth of GDP and electricity is estimated.

Graph 30
ELECTRICITY PRODUCTION
(% Change respect to the same month of the previous year)



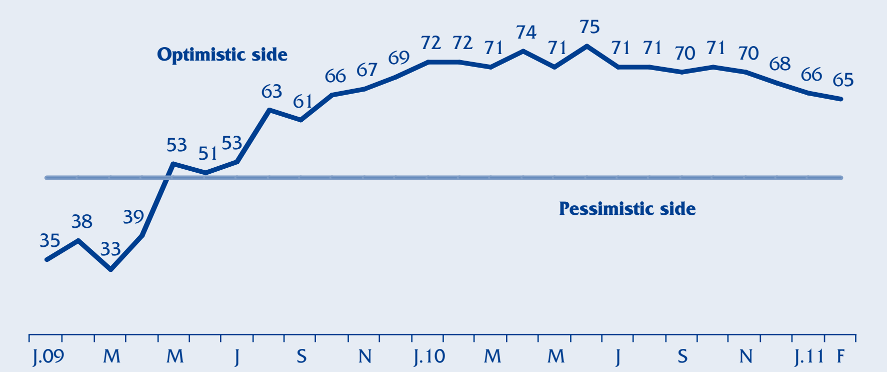
   b. **Domestic consumption** of cement grew 15.2 percent in January 2011 compared to the same month in 2010, which would be indicating that construction maintains a high pace of growth.

Graph 31
DOMESTIC CONSUMPTION OF CEMENT
(% Change respect to the same month of the previous year)



c. The **business confidence index** continues to be on the optimistc tranche. Moreover, business confidence, measured by the index on the situation of the economy in the next three months, has remained around 70 points on average during the last 18 months, reflecting confidence in the economy's continuous growth in future months.

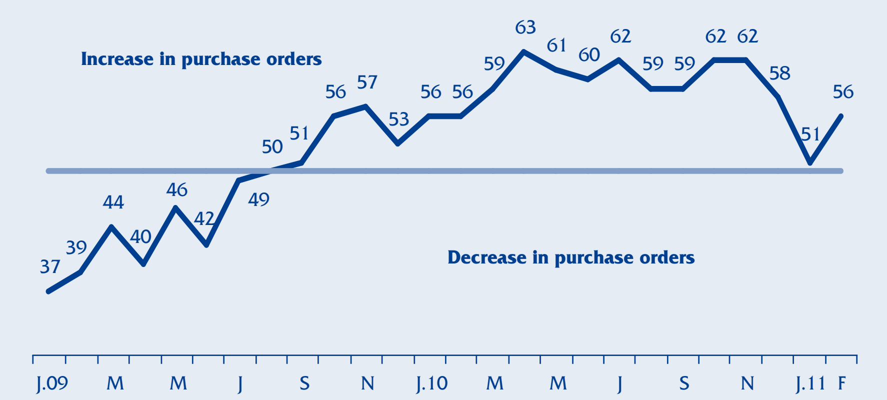
Graph 32
BUSINESS CONFIDENCE INDEX
Economic situation



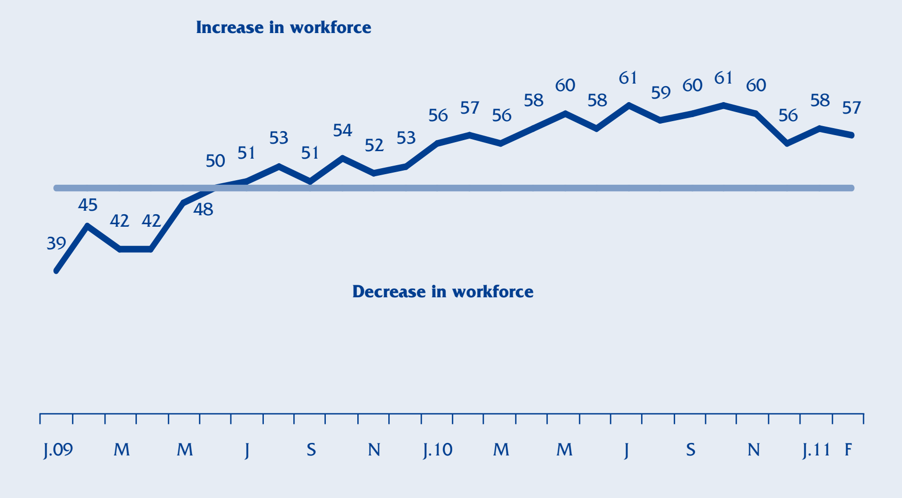
Source: Survey of Macroeconomic Expectations, BCRP.

In this context, firms also expect an increased demand for their products. Furthermore, firms also express that purchase orders at February continue rising and that additional personnel will be hired, which constitutes a positive environment for the growth of their production and for employment.

Graph 33
PURCHASE ORDERS RESPECT TO THE PREVIOUS MONTH



Graph 34
HIRING EXPECTATIONS FOR THE 3 MONTHS



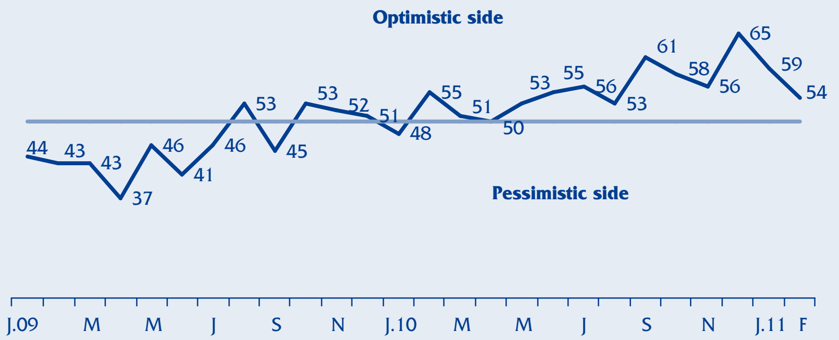
d. **Economic agents** have been revising their forecasts on GDP growth for 2011 and 2012 on the upside. A growth rate of 7.0 percent –higher than the one considered in our previous Report (6.3 percent on average)– is expected in 2011, while the expected growth rate in 2012 has increased, on average, from 6.2 to 6.6 percent.

TABLE 6
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH (%)

	IR Dec.10	IR Mar.11
FINANCIAL ENTITIES		
2011	6.3	7.0
2012	6.0	6.3
ECONOMIC ANALYSTS		
2011	6.0	7.0
2012	6.1	6.5
NON-FINANCIAL FIRMS		
2011	6.6	7.0
2012	6.5	7.0

e. The **consumer confidence index** recorded 54 points in February and remains within the optimistic tranche.

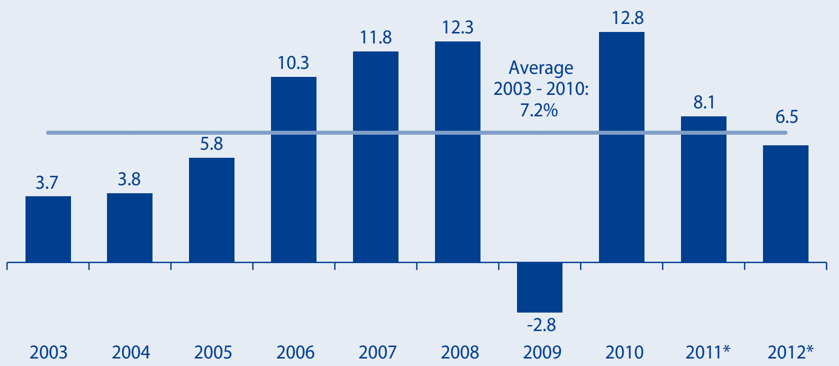
Graph 35
CONSUMER CONFIDENCE INDEX
Family economic situation



Source: Ipsos APOYO.
Elaboration: BCRP.

24. Reversing the 2.8 percent decline observed in 2009, **domestic demand** grew 12.8 percent in 2010. This growth was associated with the recovery of private expenditure in consumption and investment, which grew 6.0 and 22.1 percent, respectively, as well as with the process of inventory re-composition. In 2011, domestic demand is estimated to grow 8.1 percent –a higher rate than the 7.6 percent rate projected in the Inflation Report of December–, while in 2012 it would grow 6.5 percent (higher than the 6.1 percent considered in our previous report). In both cases, these higher estimates are based on the improvement observed in expectations, which would reflect in increased private spending in consumption and investment.

Graph 36
DOMESTIC DEMAND GROWTH RATE
(Real % change)



*Forecast.

On the other hand, the growth rate of **real government expenditure** showed a deceleration, declining from 19.6 percent in 2009 to 16.4 percent in 2010. Given that the moderation of government expenditure is expected to continue, rates of 6.5 and 3.4

percent are expected in 2011 and 2012, respectively, which would be consistent with the projected expenditure level considered in the Revised Multiannual Macroeconomic Framework (August 2010) of the Ministry of Economy and Finances.

TABLE 7
GLOBAL DEMAND AND SUPPLY
(Real % change)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
1. Domestic demand	**-2.8**	**12.8**	**7.6**	**8.1**	**6.1**	**6.5**
a. Private consumption	2.4	6.0	5.0	5.6	4.6	5.3
b. Public consumption	16.5	10.6	5.0	5.0	2.7	2.7
c. Private investment	-15.1	22.1	14.5	15.0	12.3	12.5
d. Public investment	25.5	26.5	8.8	8.8	4.4	4.4
2. Exports	**-3.2**	**2.5**	**5.2**	**5.2**	**8.4**	**8.4**
3. Imports	**-18.6**	**23.8**	**10.6**	**11.2**	**8.0**	**8.0**
4. GDP	**0.9**	**8.8**	**6.5**	**7.0**	**6.0**	**6.5**
Memo:						
Public expending	19.6	16.4	6.5	6.5	3.4	3.4

*Forecast.

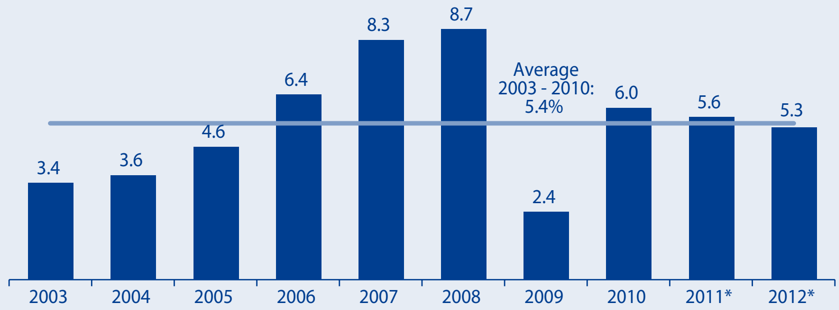
TABLE 8
GLOBAL DEMAND AND SUPPLY
(Contributions to the real % change)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
1. Domestic demand	**-2.9**	**12.8**	**7.9**	**8.4**	**6.3**	**6.8**
a. Private consumption	1.6	4.1	3.3	3.8	3.0	3.5
b. Public consumption	1.3	1.0	0.5	0.5	0.2	0.3
c. Private investment	-3.4	4.2	3.1	3.2	2.9	2.9
d. Public investment	1.1	1.4	0.5	0.6	0.3	0.3
e. Inventories change	-3.5	2.1	0.4	0.4	0.0	-0.1
2. Exports	**-0.6**	**0.5**	**0.9**	**0.9**	**1.5**	**1.5**
3. Imports	**-4.4**	**4.5**	**2.3**	**2.4**	**1.8**	**1.8**
4. GDP	**0.9**	**8.8**	**6.5**	**7.0**	**6.0**	**6.5**
Memo:						
Public expending	2.4	2.4	1.0	1.0	0.5	0.5

* Forecast.

25. **Private consumption** grew 6.0 percent in 2010, a higher rate than the decade's average rate (5.0 percent). This rate of growth in the year was associated with the growth of national disposable income (10.6 percent), the growth of employment (4.2 percent), and with a better confidence climate (the confidence index reached 59 points in December, 4 points higher than the average in 2010). In a context of expectations of growth and income improvements, private consumption is expected to grow 5.6 percent in 2011 and 5.3 percent in 2012. These rates, which reflect increased growth expectations, are higher than the ones forecast in our December Report (5.0 percent in 2011 and 4.6 percent in 2012).

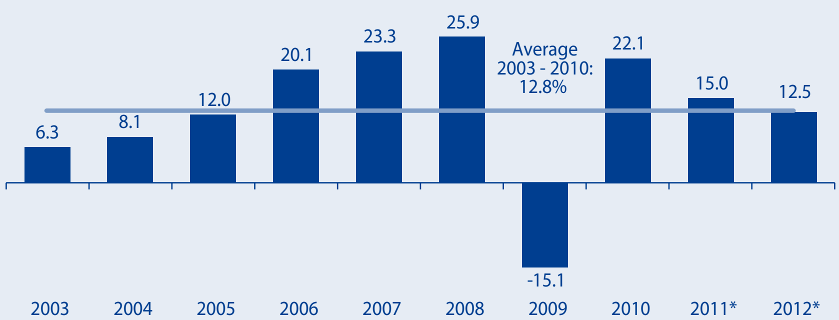
Graph 37
PRIVATE CONSUMPTION GROWTH RATE
(Real % change)



*Forecast.

26. In addition to being very sensitive to the evolution of terms of trade, **private investment** tends to be one of the most volatile components of expenditure during the periods of expansion and contraction of the economic cycle. In a context of high uncertainty like in 2009, the implementation of some investment projects was postponed during 2010, which caused private investment to drop by 15.1 percent. Nonetheless, a rapid recovery was observed (22.1 percent) due to the significant number of announced investment projects and to optimistic business expectations. Therefore, private investment is expected to continue growing and to record growth rates of 15.0 and 12.5 percent in 2011 and 2012, respectively. These growth rates are higher than the ones foreseen in our December report (14.5 and 12.3 percent in 2011 and 2012, respectively).

Graph 38
PRIVATE INVESTMENT GROWTH RATE
(Real % change)



*Forecast.

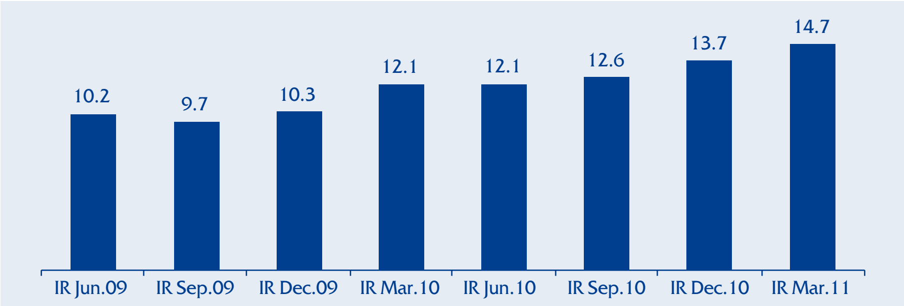
27. Private investment is reflecting the favorable expectations regarding the evolution of economic activity in the country. Announced investment projects to be implemented in 2011-2012 have increased by US$ 3 billion compared to the investment amount estimated in our Inflation Report of December 2010. The projects announced to be implemented in 2011-2012 amount to a total of US$ 30.7 billion.

TABLE 9
ANNOUNCED INVESTMENT PROJECTS
(Millions of US$)

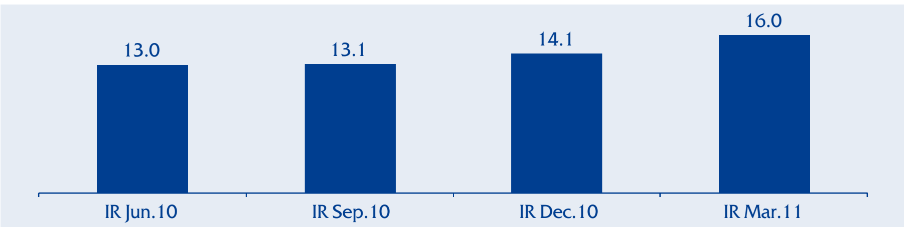
	2011	2012	2011 - 2012
Mining	5,834	8,128	13,962
Hydrocarbons	2,406	2,468	4,874
Electricity	1,797	2,306	4,103
Industry	1,559	1,358	2,917
Infrastructure	1,296	846	2,142
Other Sectors	1,816	898	2,715
Total	**14,708**	**16,004**	**30,712**

Source: Media and information of companies.

Graph 39
EVOLUTION OF ANNOUNCED INVESTMENT PROJECTS: 2011
(Billions of US$)



Graph 40
ANNOUNCED INVESTMENT PROJECTS: 2012
(Billions of US$)

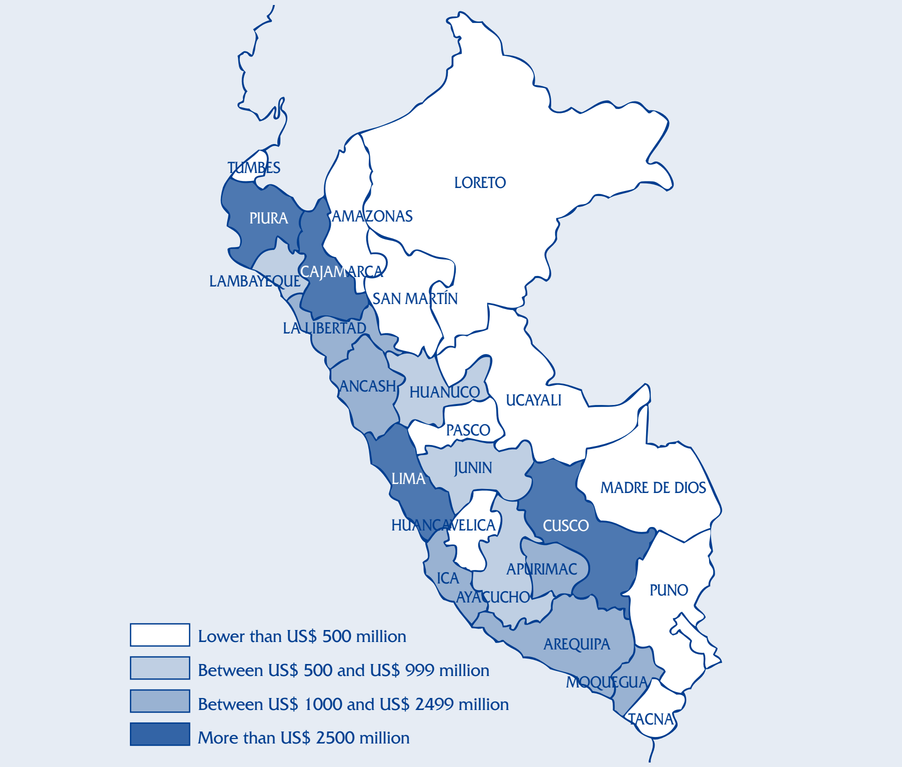


28. Investment projects in the **mining and hydrocarbon sector** include Toromocho, Galeno, expansion projects at Antamina and Cerro Verde, Las Bambas, Conga, Gasoducto Andino del Sur and Lot 67 (Perenco) and oil and gas exploration and production activities in Lots 56, Z-2b, and Z 46. Noteworthy infrastructure projects include the execution of projects aimed at improving the roads and infrastructure directly associated with trade (piers, ports, and airports), while noteworthy energy projects include the implementation of hydro electrical and power generation plants and transmission lines, as well as the implementation of wind plants in the departments of La Libertad and Piura (the Environmental Impact Study for the latter was approved by the Ministry of Energy in the first quarter of 2011).

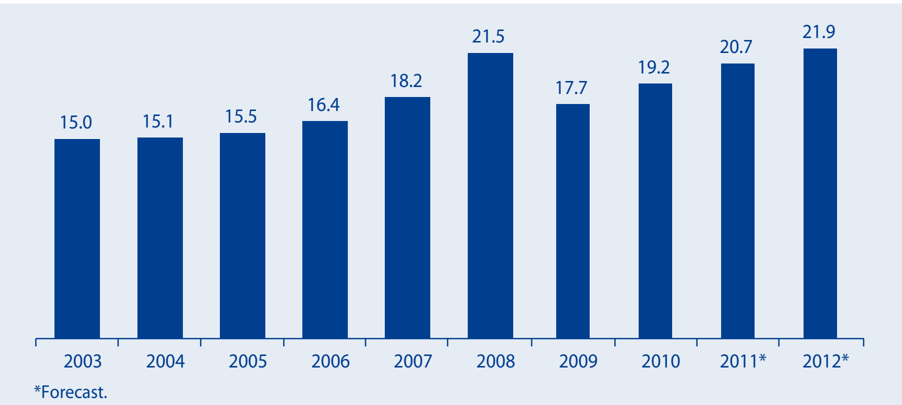
TABLE 10
ANNOUNCED MAIN INVESTMENT PROJECTS: 2011 - 2012

SECTOR	COMPANY	PROJECT NAME
Mining	Xstrata Peru	Las Bambas
	Northern Peru Copper	Galeno
	Anglo American	Quellaveco
	Minera Yanacocha S.R.L.	Minas Conga
	Xstrata Peru	Antapaccay
	Nanjinzhao Group Co.. Ltd.	Pampa del Pongo
	Antamina	Expansion of pit
	Minera Peru Copper S.A.	Toromocho
	Sociedad Minera Cerro Verde	Expansion of Cerro Verde
	Shougang Group Hierro Peru	Expansion of Marcona
	Marcobre S.A.C.	Mina Justa
	HudBay (Norsemont Peru S.A.C.)	Constancia
	Barrick Misquichilca	Expansion of Leaching plant
	Southern Peru Copper	Refinery and funding Ilo - Toquepala - Cuajone
	Volcan	Expansion of Volcan
	Mitsui Mining & Smelting Co. Ltda. Suc. Peru	Quechua
	Minera Yanacocha S.R.L.	Chaquicocha
	Compañia Minera Milpo	Hilarion
	Sociedad Minera El Brocal S.A.	Colquijirca
Hydrocarbons	Kuntur Transportadora de Gas	Andino del Sur Pipeline
	Pluspetrol	Expansion of Malvinas, New wells Lot 88 and Lot 56
	Savia Perú (Petro-Tech)	Lot Z-2B : Perforation, exploration and others
	Transportadora de Gas del Perú	Expansion transport capacity of Gas
	Petrobras	Exploration and explotation of oil and gas
	Nitratos del Perú	Petrochemical plant
	Perenco Peru Limited	Exploration Lot 67 / Pipeline
	SK Energy	Exploration Lot Z 46
	Cálidda Gas Natural del Perú	Expansion of main network
Electricity	Fenix Power Perú S.A.	Thermoelectric plant (natural gas combined cycle)
	Kallpa Generación S.A.	Hydroelectric plant Cerro del Águila
	Kallpa Generación S.A.	Kallpa IV
	Odebrecht	Hydroelectric plant Cerro de Chaglla
	Asa Iberoamérica	Transmission line Chilca-Marcona-Montalvo
	Luz del Sur	Network Expansion and infrastructure development
	Energía Eólica	Eolic central Cupisnique
	Chungar	Hydroelectric plant Belo Horizonte
	SN Power	Hydroelectric plant Cheves
	Enersur / Endesa	Cold reserve of generation - Ilo
	Chungar	Hydroelectric plant Chancay
Industry	SIDERPERÚ	Modernization of plant
	Técnicas Reunidas	Modernization of refinery Talara
	Cementos Interoceánicos	Cement plant
	Cementos Pacasmayo	Phospates plant
	Aceros Arequipa	Expansion and modernization of plant
	Yura S.A.	Expansion of cement plant
	Corporación JR Lindley	Expansion and new plants: Trujillo,Pucusana, Cusco, Iquitos
	Cementos Otorongo	Construction of cement plant
	Americas Potash Peru	Phospates plant
	Cementos Lima	Expansion of installed capacity
	Cementos Pacasmayo	New cement plant, expansion and bricks plant
Infrastructure	OAS S.R.L.	Express way, Yellow line
	Autopista del Norte S.A.C.	Route Nº 4: Pativilca - port Salaverry
	Santa Sofía Puertos	Ancon port
	Concesionaria vial del Sol	Carretera del Sol: Trujillo - Sullana
	Terminales Portuarios Euroandinos (TPE)	Expansion of Paita port
	Transportadora del Callao	Mineral Pier
	ACS Servicios. Comunicaciones and Energía	La Taboada treatment plant
	Covi Peru	Route Nº 6: Pucusana - Cerro Azul - Ica
	Chancay Port	Multipurpose megaport
	OAS S.R.L.	Water transfer Huascacocha
	Consorcio Desarrollo Vial del Perú	IIRSA Centro - Eje Amazonas Centro: Tramo 2
	Intersur	IIRSA SUR - Tract 4: Pte Inambari - Azángaro
Other Sectors	Tracto Camiones USA E.I.R.L.	Purchase of 2000 units
	Aricsa (Grupo Ruttini)	Real state projects
	Consorcio La Chira	Treatment plant
	Miranda Constructores	Housing projects
	Tiendas Oeschle	New stores
	Corporación Miraflores	Ethanol plant
	Telefónica del Perú	Movile phone network and broadband expansion

Graph 41
ANNOUNCED INVESTMENT PROJECTS PER REGION: 2011-2012
(Millons of US$)



Graph 42
PRIVATE INVESTMENT
(% of GDP)



29. In contrast with the concept of GDP, the concept of **national disposable income** also considers the effect of international prices and transfers of Peruvians residing abroad, and deducts the profits generated by foreign investments, which provides

us with a more accurate indicator on the country's incomes. After declining to a rate of 1.0 percent in 2009, the national disposable income recorded a growth rate of 10.6 percent in 2010. In 2011 and 2012, it is expected to show rates of 6.8 and 6.4 percent, respectively.

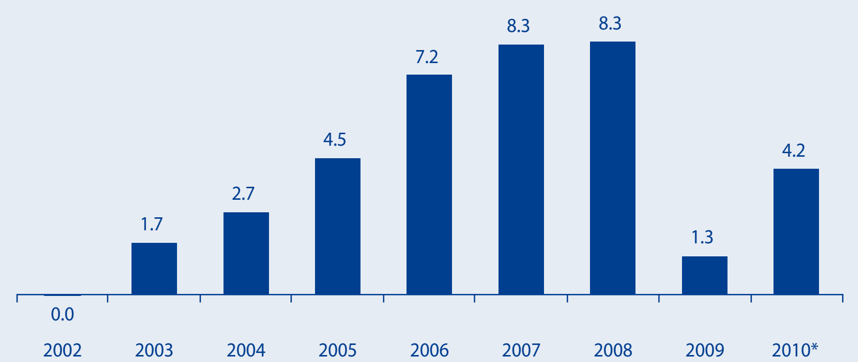
TABLE 11
NATIONAL DISPOSABLE INCOME
(Real % change)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
GDP	**0.9**	**8.8**	**6.5**	**7.0**	**6.0**	**6.5**
Gross national product	2.0	7.7	6.6	7.0	6.6	6.8
Gross national income	1.1	11.0	6.4	6.9	6.4	6.4
National disposable income	**1.0**	**10.6**	**6.3**	**6.8**	**6.4**	**6.4**

* Forecast.

30. After slowing down to a rate of 1.3 percent, **employment** recovered in 2010 when employment in urban areas recorded a growth rate of 4.2 percent. This trend of employment, which is expected to continue, will have a positive effect on national disposable income and private consumption.

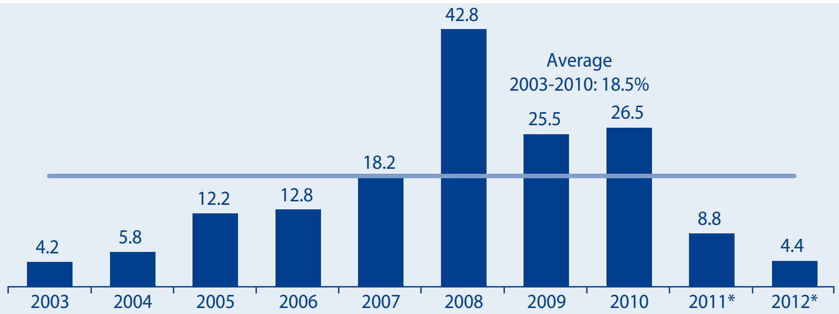
Graph 43
URBAN EMPLOYMENT
(% change)



* Preliminary.

31. **Government investment,** which grew 26.5 percent in 2010, is estimated to grow 8.8 percent in 2011 and 4.4 percent in 2012. These rates are consistent with a government investment to GDP ratio of about 6 percent and with a moderation of government expenditure in a context of high growth of private expenditure.

Graph 44
PUBLIC INVESTMENT GROWTH RATE
(Real % change)



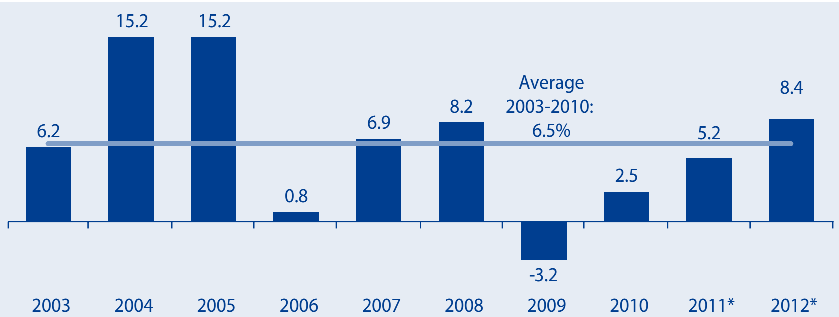
*Forecast.

TABLE 12
PUBLIC INVESTMENT
(Real % change)

	2007	2008	2009	2010	2011	2012
National Government	15.1	9.7	7.5	75.4	9.9	3.9
Regional Government	40.5	22.0	44.3	20.3	10.1	3.6
Local Government	9.1	98.1	28.5	8.1	7.4	3.8
State companies	34.3	32.3	32.5	-1.6	9.8	7.9
TOTAL	**18.2**	**42.8**	**25.5**	**26.5**	**8.8**	**4.4**
% of GDP	*3.1*	*4.2*	*5.3*	*6.0*	*6.1*	*6.0*

32. **Real exports of goods and services** grew 2.5 percent in 2010. These exports are forecast to improve in 2011 and 2012 (to 5.2 and 8.4 percent, respectively) in a context of higher global demand. The latter would also be favored by increased access to other markets as a result of the trade agreements established and by the full operation of hydrocarbon projects which will contribute to boost traditional exports.

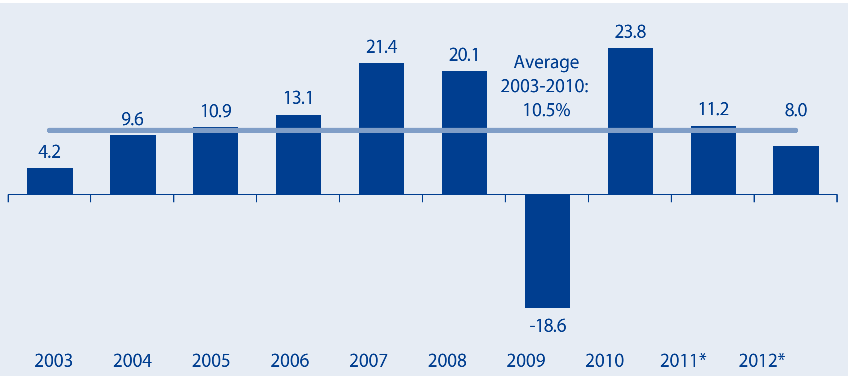
Graph 45
GROWTH RATE OF EXPORTS OF GOODS AND SERVICES
(Real % change)



*Forecast.

33. **Real imports of goods and services** grew 23.8 percent in 2010, driven by an increased domestic demand for both consumer goods and for capital goods for plant expansions and oil, energy, and mining projects, among others. Real imports, which are expected to continue growing in 2011 and 2012 in a context of economic growth and increased private investment, would grow 11.2 percent in 2011 and 8.0 percent in 2012.

Graph 46
GROWTH RATE OF IMPORTS OF GOODS AND SERVICES
(Real % change)



*Forecast.

GDP by sectors

34. The GDP growth forecast for 2011 has been raised from 6.5 percent of GDP (Inflation Report of December) to 7.0 percent given the increased impulse of non primary sectors such as non primary manufacturing and construction (associated with better expectations of growth in terms of domestic demand).

35. In 2011 **primary sectors** would grow 5.4 percent –a lower rate than the one considered in our Report of December (5.9 percent)–, reflecting the lower dynamism of metallic mining due to lower metal contents in the extraction of gold and to a lower production of zinc. This forecast considers the onset of operations in gold mining projects such as La Zanja, Tantahuatay and La Arena, as well as an increased production of natural gas in Lot 56.

    The growth forecast in the case of **agriculture** remains unchanged, considering the effect that water scarcity would have on the farming period of August 2010-July 2011 and particularly on the production of Andean crops such as potatoes, amylaceous maize, lima beans and peas, as well as on crop rotation in the case of crops such as coffee and olives. Likewise, the growth forecast in the sector of fishing remains unchanged due to the recovery observed in this activity. Since no climatic anomalies are foreseen (in contrast with 2009 and with 2010, when fishing was affected by the presence of a moderate El Niño and by the presence of La Niña, respectively), a greater availability of anchovy is expected.

The lower growth in primary sectors would be more than compensated by the growth in **non primary sectors**. Factors accounting for the latter include the expansion registered in non primary manufacturing, which grew 16.9 percent in 2010 and is expected to grow 7.1 percent in 2011 and 6.5 percent in 2012, as well as the growth of construction, which would close 2011 with an expansion of 11.3 percent due to the impulse of both government and private projects. This increased activity would be in line with an higher growth in domestic demand compared with the rate estimated in our December report.

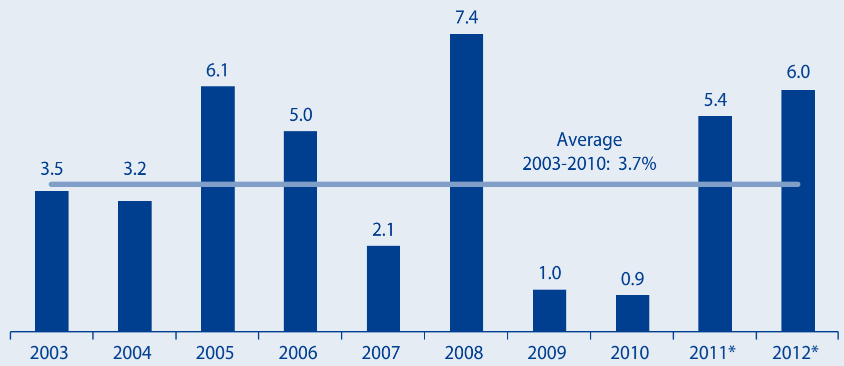
36. The upward revision of the GDP growth forecast for 2012 –from 6.0 to 6.5 percent– is based on the higher expected growth in **non primary sectors** (6.6 vs. 6.0 percent) as a result of the increased dynamism being observed in non primary manufacturing, commerce, and services. The growth forecast in primary sectors remains unchanged at 6.0 percent considering the onset of operations of gold, copper, and iron projects, as well as other projects in the manufacturing sector, such as Maple and Comisa, associated with the production of ethanol.

TABLE 13
GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS
(% change respect to the same period of the previous year)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.011	IR Dec.10	IR Mar.11
Agriculture and livestock	2.3	4.3	3.0	3.0	4.8	4.8
Agriculture	0.9	4.2	1.9	1.9	4.8	4.8
Livestock	4.4	4.4	4.9	4.9	4.9	4.9
Fishing	-7.9	-16.4	21.8	21.8	2.6	2.6
Mining and hydrocarbons	0.6	-0.8	6.4	4.7	8.5	8.5
Metallic mining	-1.4	-4.9	3.1	1.5	10.0	8.3
Hydrocarbons	16.1	29.5	25.0	22.5	1.1	8.6
Manufacturing	-7.2	13.6	7.4	7.7	5.9	6.3
Raw materials	0.0	-2.3	11.3	11.3	4.9	5.2
Non-primary industries	-8.5	16.9	6.7	7.1	6.0	6.5
Electricity and water	1.2	7.7	6.1	6.8	5.3	5.6
Construction	6.1	17.4	10.9	11.3	10.6	10.6
Commerce	-0.4	9.7	6.7	7.1	5.7	6.3
Other services	3.1	8.1	6.1	6.8	5.5	6.2
GDP	**0.9**	**8.8**	**6.5**	**7.0**	**6.0**	**6.5**
Memo:						
Primary GDP	1.0	0.9	5.9	5.4	6.0	6.0
Non-Primary GDP	0.8	10.4	6.7	7.2	6.0	6.6

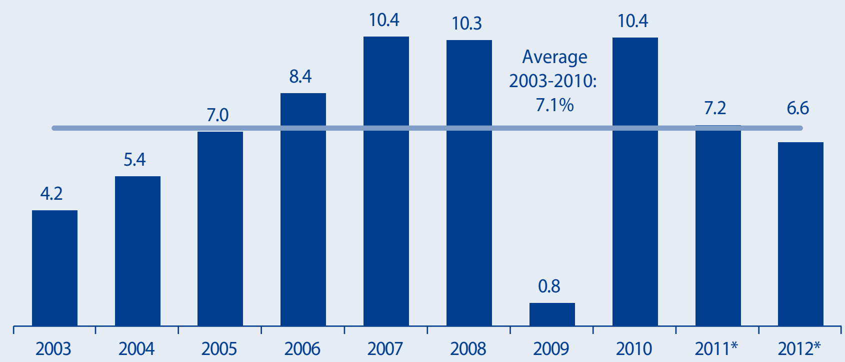
*Forecast.

Graph 47
PRIMARY SECTORS GROWTH RATE
(Real % change)



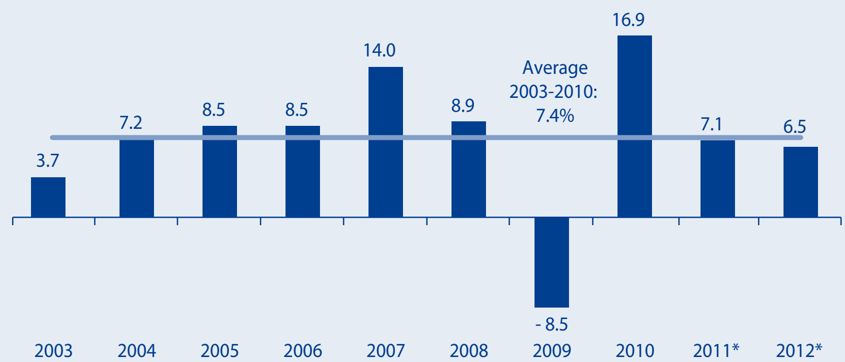
*Forecast.

Graph 48
NON-PRIMARY MANUFACTURING GROWTH RATE
(Real % change)



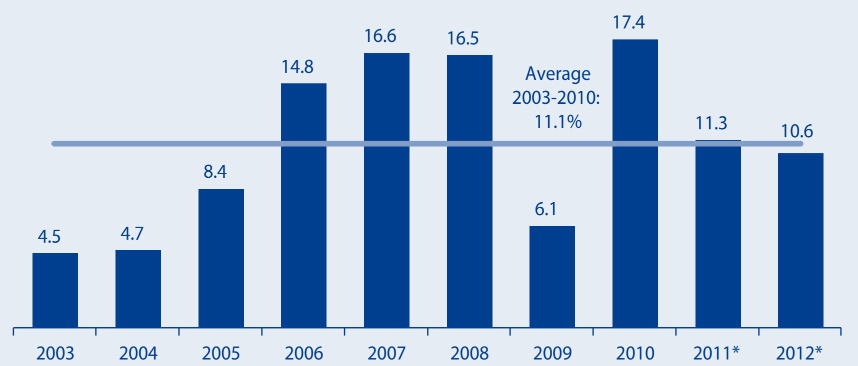
*Forecast.

Graph 49
NON-PRIMARY MANUFACTURING GROWTH RATE
(Real % change)



*Forecast

Graph 50
CONSTRUCTION SECTOR GROWTH RATE
(Real % change)

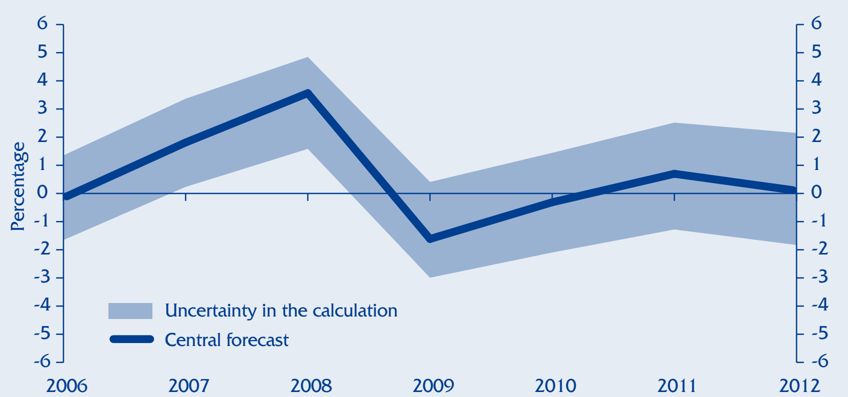


*Forecast.

Output gap

37. The **output gap** is an aggregate indicator of demand pressures which measures the difference between GDP and its potential level. The available information on the evolution of economic activity and inflation shows that the output gap would have closed in 2010, after showing negative levels of about 2.0 percent on average during 2009. It is estimated that the output gap will be positive in 2011 and that there will be a nil output gap in 2012. This evolution considers a positive demand impulse associated with high terms of trade and a higher fiscal impulse in 2011 than the one considered in our last Inflation Report, as well as monetary policy adjustments in the forecast horizon.

Graph 51
OUTPUT GAP
(Percentage of Potential GDP)



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

III. Balance of Payments

38. The estimated deficit in the **current account** in 2011 has been revised upwards, from 3.1 percent of GDP (Inflation Report of December) to 3.3 percent of GDP in this Report. This revision is based on the expected higher growth of economic activity and on its impact on the demand for imports, as well as on the effect of the upward revision of import prices and an effect on non financial services, while a great deal of the rise in export prices is absorbed by factor income.

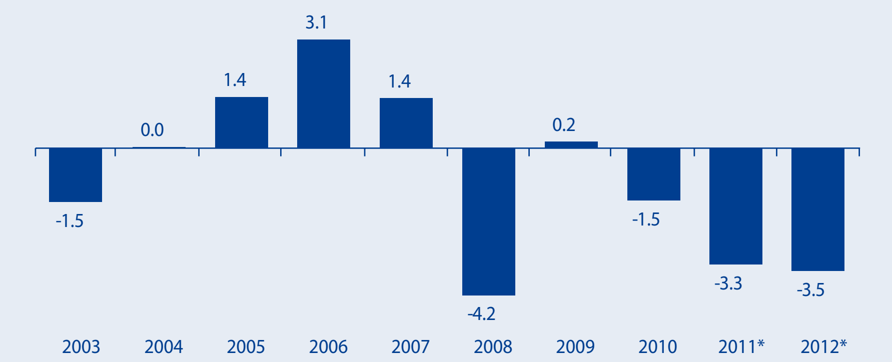
A higher current account deficit of 3.5 percent of GDP is projected for 2012 considering an increased decline foreseen in terms of trade.

TABLE 14
BALANCE OF PAYMENTS
(Millions of US$)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
I. CURRENT ACCOUNT BALANCE	**211**	**-2,315**	**-5,314**	**-5,745**	**-5,955**	**-6,757**
% of GDP	0.2	-1.5	-3.1	-3.3	-3.2	-3.5
1. Trade Balance	5,951	6,750	4,869	6,287	4,727	5,723
a. Exports	26,962	35,565	38,154	41,700	41,713	45,192
b. Imports	-21,011	-28,815	-33,285	-35,413	-36,986	-39,469
2. Services	-1,144	-2,037	-2,124	-2,610	-2,315	-2,743
3. Investment Income	-7,484	-10,053	-11,237	-12,601	-11,815	-13,184
4. Current transfers	2,887	3,026	3,178	3,178	3,447	3,447
of which: Remittances	2,409	2,534	2,731	2,731	3,001	3,001
II. FINANCIAL ACCOUNT	**1,728**	**13,285**	**6,814**	**8,245**	**6,955**	**7,757**
of which:						
1. Private Sector (long and short term)	467	13,587	6,599	8,220	6,843	7,930
2. Public Sector	1,032	-1,004	385	83	-68	-187
III. BALANCE OF PAYMENT (=I+II)	**1,939**	**10,970**	**1,500**	**2,500**	**1,000**	**1,000**
Memo:						
Gross long-term external private financing						
Millions of US$	6,108	12,053	10,099	11,169	11,051	11,000
% of GDP	4.8%	7.8%	6.0%	6.5%	5.9%	5.7%

IR: Inflation Report.
*Forecast.

Graph 52
CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS
(% of GDP)

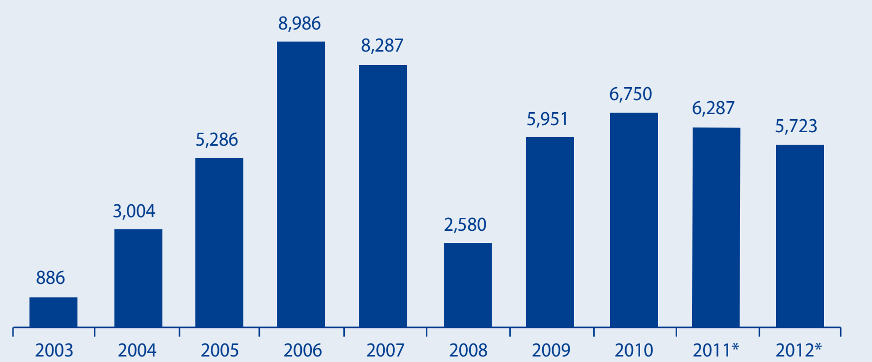


*Forecast.

39. In the case of the **trade balance,** the forecast surplus has been revised on the upside considering the improvement in terms of trade, which would compensate by far the increase in the volume of imports associated with domestic demand. The trade surplus in 2011 is now estimated at US$ 6.3 billion (vs. US$ 4.9 billion in the Inflation Report of December).

    The trade balance would continue showing a surplus in 2012, which is estimated to reach US$ 5.7 billion. The gradual reduction of the trade surplus in the next years relative to 2010 is explained by increased imports, particularly purchases of capital goods for the implementation of the investment projects announced in several sectors.

Graph 53
TRADE BALANCE
(Millions of US$)



*Forecast.

TABLE 15
TRADE BALANCE
(Millions of US$)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
EXPORTS	**26,962**	**35,565**	**38,154**	**41,700**	**41,713**	**45,192**
Of which:						
Traditional products	20,622	27,669	29,672	32,675	32,356	35,145
Non-traditional products	6,186	7,641	8,242	8,711	9,110	9,725
IMPORTS	**21,011**	**28,815**	**33,285**	**35,413**	**36,986**	**39,469**
Of which:						
Consumer goods	3,962	5,489	6,789	6,849	8,065	8,156
Inputs	10,076	14,023	15,500	17,488	16,478	18,431
Capital goods	6,850	9,074	10,831	10,901	12,257	12,699
TRADE BALANCE	**5,951**	**6,750**	**4,869**	**6,287**	**4,727**	**5,723**

IR: Inflation Report.
*Forecast.

TABLE 16
TRADE BALANCE
(% change)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
1. Value:						
Exports	-13.1	31.9	9.2	17.3	9.3	8.4
Traditional products	-11.4	34.2	8.3	18.1	9.0	7.6
Non-traditional products	-18.2	23.5	12.8	14.0	10.5	11.6
Imports	-26.1	37.1	15.5	22.9	11.1	11.5
2. Volume:						
Exports	-3.3	1.9	5.4	4.3	8.9	9.1
Traditional products	2.3	-2.3	5.2	3.4	9.1	9.1
Non-traditional products	-14.8	15.3	6.3	7.3	8.8	9.0
Imports	-20.0	24.1	10.8	11.3	9.3	9.5
3. Price:						
Exports	-12.5	29.5	3.5	12.5	0.4	-0.7
Traditional products	-16.3	37.3	2.9	14.2	0.0	-1.5
Productos no tradicionales	-4.0	7.1	6.1	6.2	1.6	2.4
Imports	-7.4	10.1	4.2	10.4	1.7	1.8

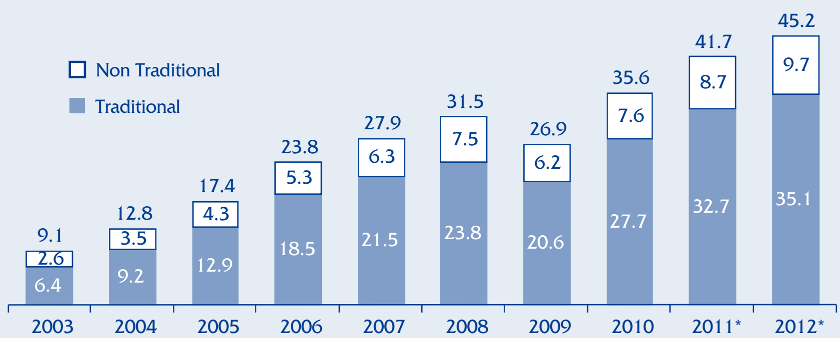
IR: Inflation Report.
*Forecast.

40. The recovery of global production during 2010 has favored the growth of exports both in terms of volume and international prices. Likewise, imports have also been recovering due to the increased dynamism of domestic demand and the rise in the prices of imported products.

41. **Exports** would amount approximately to US$ 42 billion in 2011 and to over US$ 45 billion in 2012 as a result of Camisea II's exports of liquefied natural gas, Bayovar's phosphates, and copper exports produced by the expansions of Antamina and Toquepala. A lower volume of traditional exports than the one considered in our Inflation Report of December is foreseen due to the lower production of gold and zinc (4.4 vs. 5.2 percent).

Non traditional exports would increase by 7.3 percent in terms of volume –6.3 percent was estimated in the December report– in a context of foreseen higher growth rates in our trading partners during the forecast horizon.

Graph 54
EXPORTS OF GOODS
(Billions of US$)

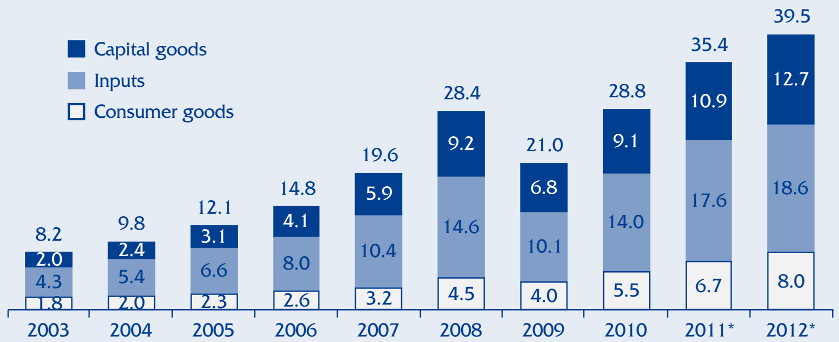


Memo: Total exports includes other exports.
*Forecast.

42. **Imports** in 2011 would grow 23 percent and amount to US$ 35 billion, a higher value than the one estimated in our Report of December. This higher result would be mainly associated with an increased price effect, particularly of oil, which not only directly affects the imports of crude and its derivatives, but also indirectly affects the costs of other goods (higher international inflation) and freight services. The average price of WTI oil for 2011 has been revised from US$ 86 per barrel (Inflation Report of December 2010) to US$ 97 per barrel in this Report.

The volume of imports is expected to continue showing high growth rates in the forecast horizon (11.3 percent in 2011 and 9.5 percent in 2012), in line with the evolution of domestic demand (estimated to grow at rates of 8.1 and 8.6 percent in 2011 and 2012, respectively).

Graph 55
IMPORTS OF GOODS
(Billions of US$)



Memo: Total imports includes other imports.
*Forecast.

43. Given that the expected rise in the value of **traditional exports** in 2011 would be associated with a higher price effect due to the rise in the prices of commodities, factor income has been revised upwards –absorbing part of the gains resulting from the higher surplus in the trade balance– from US$ 11.2 billion (inflation Report of December 2010) to US$ 12.6 billion.

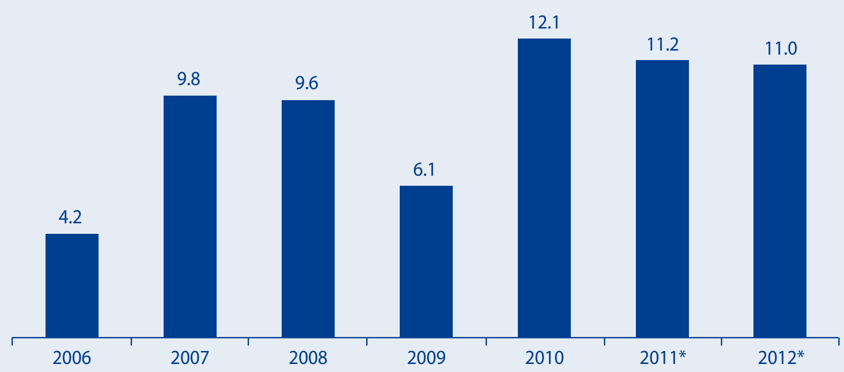
Financial account

44. The **long term financial account of the private sector** amounted to US$ 13,324 million in 2010. In terms of liabilities, it is worth highlighting loan disbursements for a total of US$ 4,940 million; the flow of foreign direct investment for a total of US$ 7,328 million and non residents' acquisition of securities issued in the local market for a total of US$ 3,198 million, while in terms of assets it is worth pointing out institutional investors' acquisition of securities abroad for a total of US$ 1,816 million.

45. In 2011 and 2012 the private **financial account** would register positive capital flows of US$ 8,220 million and US$ 7,930 million, respectively. As in our December Report, the flows in the private financial account are estimated to be lower in 2011 and 2012 than the ones registered in 2010. Non residents' acquisition of securities issued in the domestic market and long term disbursements to finance investment projects would be lower given that part of these projects would be financed by institutional investors.

46. **Long term external funding** (net foreign direct investment plus disbursements) in 2011 and 2012 would amount to US$ 11.2 billion and US$ 11.0 billion, respectively (higher amounts than the ones foreseen in our December Report). These new estimates consider a higher global economic recovery and consequently an increased availability of resources.

Graph 56
PRIVATE SECTOR FINANCING
(Billions of US$)



*Forecast.

TABLE 17
PRIVATE SECTOR FINANCIAL ACCOUNT
(Millions of US$)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
1. ASSETS	**-4,102**	**-1,041**	**-1,982**	**-1,541**	**-2,503**	**-1,402**
Direct investment abroad	-398	-215	0	0	0	0
Portfolio investment abroad 1/	-3,704	-826	-1,982	-1,541	-2,503	-1,402
2. LIABILITIES	**6,783**	**14,365**	**8,581**	**9,761**	**9,346**	**9,332**
Foreign direct investment in the country	5,576	7,328	8,004	8,169	8,312	8,500
Foreign portfolio investment in the country	55	3,284	-75	30	-91	183
Capital participation 2/	47	87	0	0	0	0
Other liabilities 3/	9	3,198	-75	30	-91	183
Long-term loans	1,151	3,752	652	1,562	1,125	649
Disbursements	2,075	4,940	2,096	3,000	2,739	2,500
Amortization	-923	-1,187	-1,443	-1,438	-1,614	-1,851
3. TOTAL	**2,680**	**13,324**	**6,599**	**8,220**	**6,843**	**7,930**

*Forecast.
1/ Includes mainly stocks and other assets from abroad by the financial and non financial sector. Negative sign indicates increase in assets.
2/ Considers net purchases of stocks from non residents through Lima Stock Exchange (BVL), recorded at CCavali S.A. ICLV.
3/ Includes bonds, credit notes and securitization, among others, in net terms (issuance minus redemption).

IV. Public Finances

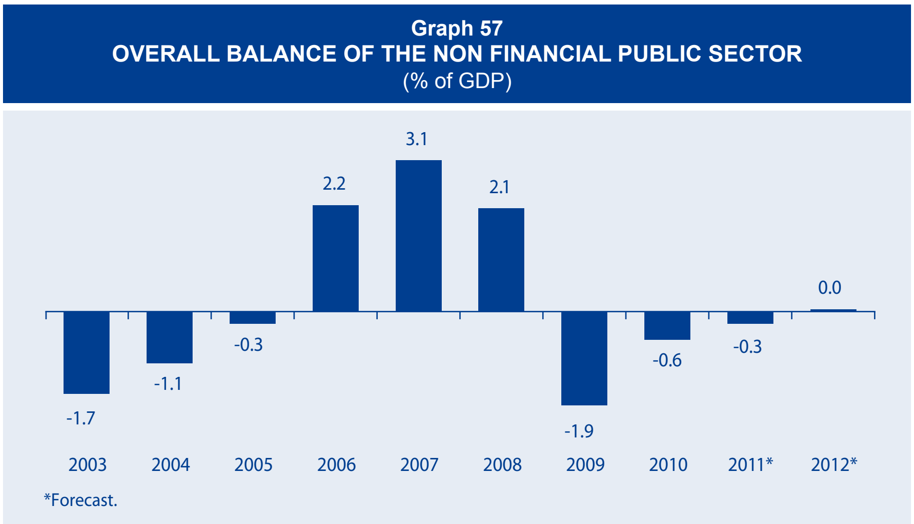
47. The fiscal scenario in this Report considers the tax changes approved in the first quarter of the year. Assuming that the general government will maintain the level of non financial expenditure established in the Multiannual Macroeconomic Framework of August 2010, the new central forecast scenario estimates a positive fiscal impulse in 2011.

48. In 2010 the operations of the non financial public sector (NFPS) recorded an **economic deficit** of 0.6 percent of GDP, a deficit lower by 1.3 percentage points than the one registered in 2009. The deficit of the general government declined from 2.1 to 0.4 percent of GDP, although this improvement was offset by the balance of state enterprises which showed a deficit of 0.1 percent, in contrast with the 0.2 percent recorded in 2009. Breaking down the balance of the general government, the national government recorded a surplus of 0.2 percent of GDP, while local and regional governments recorded deficits equivalent to 0.4 and 0.2 percent of GDP, respectively. In 2011 the fiscal deficit would amount to 0.3 percent, while in 2012 the fiscal balance would show a nil result.

TABLE 18
OVERALL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
1. General government current revenue 1/	**18.6**	**19.8**	**20.1**	**19.5**	**20.2**	**19.3**
Real % change	-11.3	19.6	7.6	5.5	6.0	4.8
2. General government non-financial expenditure	**19.5**	**19.3**	**18.9**	**18.6**	**18.5**	**18.2**
Real % change	12.7	10.7	2.9	3.5	3.2	2.9
Of which:						
a. Current	13.8	13.2	12.7	12.4	12.4	12.2
Real % change	*4.4*	*7.1*	*1.2*	*0.7*	*3.2*	*3.6*
b. Gross capital formation 2/	5.2	5.6	5.9	5.9	5.8	5.7
Real % change	*32.5*	*20.1*	*9.4*	*13.0*	*3.5*	*2.0*
3. Others	**0.4**	**0.1**	**0.0**	**0.1**	**0.0**	**0.0**
4. Primary balance (1-2+3)	**-0.6**	**0.6**	**1.2**	**0.9**	**1.7**	**1.2**
5. Interests	**1.3**	**1.2**	**1.2**	**1.2**	**1.2**	**1.2**
6. Overall Balance	**-1.9**	**-0.6**	**0.0**	**-0.3**	**0.5**	**0.0**
Memo:						
1. Central government current revenues (Billions of S/.)	71.0	86.2	94.6	93.2	102.4	100.0
2. Central government non-financial expenditure (Billions of S/.	74.7	83.9	89.0	89.0	93.9	93.9

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.



Evolution of fiscal revenues

49. The **current revenues of the general government** in 2010 amounted to 19.8 percent of GDP, which represented an increase of 20 percent in real terms, due to the positive performance of domestic economic activity and to a more favorable international context which determined higher commodity prices than the ones observed in 2009. These factors favored especially revenues from the income tax and the value added tax (VAT), which increased by a real 25 and 19 percent, respectively. This was also coupled by higher non tax revenues, which showed an increase of 20 percent, given higher revenues from royalties (canon) and oil royalties.

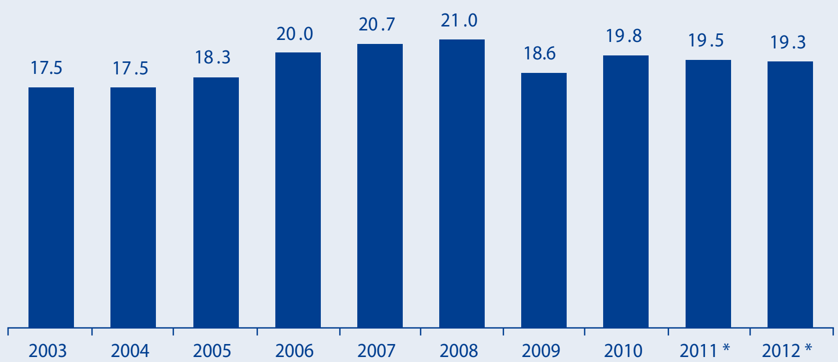
TABLE 19
GENERAL GOVERNMENT CURRENT REVENUES
(% of GDP)

	2009	2010	2011*		2012*	
			IR Dic.10	IR Mar.11	IR Dec.10	IR Mar.11
TAX REVENUES	**14.1**	**15.2**	**15.6**	**14.8**	**15.7**	**14.6**
Income tax	5.3	5.9	5.9	6.0	5.9	6.0
Value added tax	7.7	8.2	8.4	8.0	8.5	8.1
Excise tax	1.1	1.1	1.1	1.1	1.1	1.0
Import fares	0.4	0.4	0.4	0.3	0.4	0.3
Other tax revenues	1.5	1.4	1.4	1.2	1.4	1.2
Tax returns	-1.9	-1.8	-1.7	-1.8	-1.7	-1.9
NON TAX REVENUES	**2.8**	**3.0**	**2.8**	**3.1**	**2.8**	**3.0**
CONTRIBUTIONS	**1.7**	**1.7**	**1.7**	**1.7**	**1.7**	**1.7**
TOTAL	**18.6**	**19.8**	**20.1**	**19.5**	**20.2**	**19.3**

* Forecast.

50. The **current revenues of the general government** in 2011 (19.5 percent of GDP) would be lower than the ones estimated in our Inflation Report of December (20.1 percent of GDP) as a result of the tax measures that have been adopted in the last months, whose overall annual cost is estimated to represent approximately 1 percent of GDP. The measures already approved include the reduction of tariffs on 3,401 tariff items; the law for the Promotion of Trade of Services abroad, which modifies and enhances the operations of export services that may receive a refund for the VAT on said operations; the reduction of the VAT rate (from 19 to 18 percent), and the reduction of the tax rate on financial transactions (from 0.05 percent to 0.005 percent). Therefore, the estimated growth of the general government revenues in 2011 would be 5.5 percent, lower than the one considered in our Report of December (7.6 percent).

Graph 58
GENERAL GOVERNMENT CURRENT REVENUES
(% of GDP)



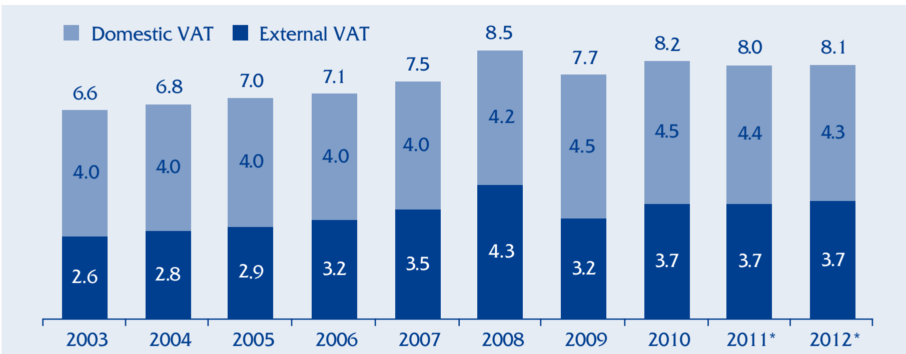
*Forecast.

51. Showing a slight growth in GDP terms compared to 2010, revenue from the **income tax** would be equivalent to 6.0 percentage points of GDP in 2011 as a result of the continuous dynamism of economic activity, as well as of the high levels of the prices of export minerals which would more than compensate the negative effect of the modifications implemented in terms of the depreciation of buildings and constructions. It is worth mentioning here that a special regime was established in 2009 for the depreciation of buildings and constructions whose construction was started between January 1, 2009 and December 31, 2010 and had been implemented by at least 80 percent. The annual depreciation of these building as from 2010 was established at 20 percent, which replaced the rate applied in the general regime (5 percent since 2010 versus the 3 percent in force in 2009).

Graph 59
INCOME TAX AND EXPORT PRICE INDEX

52. Revenue from the **value added tax (VAT)** –the main tax revenue–, which recorded significant growth in 2010 rising from 7.7 to 8.2 percent of GDP, would decline in 2011 in GDP terms as a result of the reduction of this tax rate by one percentage point. However, a series of measures to offset the impact of this reduction have already been implemented and others are foreseen. The former consist basically of including certain goods and services in a special system of tax withholding on sales (sistema de detracciones). Thus, since December 1, 2010, gold, paprika and asparagus, as well as construction contracts, have been included in this system.

Graph 60
VALUE ADDED TAX
(% of GDP)



Memo: The addition of components may not fit due to round up problem.
*Forecast.

53. In 2012 the **current revenues of the general government** would grow 4.8 percent, which would result in a ratio of 19.3 percent in GDP terms, a ratio slightly lower than in 2011 (19.5 percent). This is mainly explained by the fact that the impact of the recently

implemented measures would fully reflect in tax collection only in 2012, in contrast with 2011 when these measures will affect tax collection only since certain months.

Evolution of government expenditure

54. In 2010 the **non financial expenditure of the general government** represented 19.3 percent of GDP (growth rate of 11 percent). Current expenditure grew 7 percent and capital expenditure grew 19 percent. By government levels, the non financial expenditure of the national government grew slightly over the average rate –12 percent–, while the non financial expenditure of local governments grew 11 percent and the non financial expenditure of regional governments recorded a lower rate of 7 percent. It also worth pointing out that the capital expenditure of the national government grew 33 percent in 2010.

TABLE 20
NON FINANCIAL EXPENDITURE OF GENERAL GOVERNMENT
(Real % change)

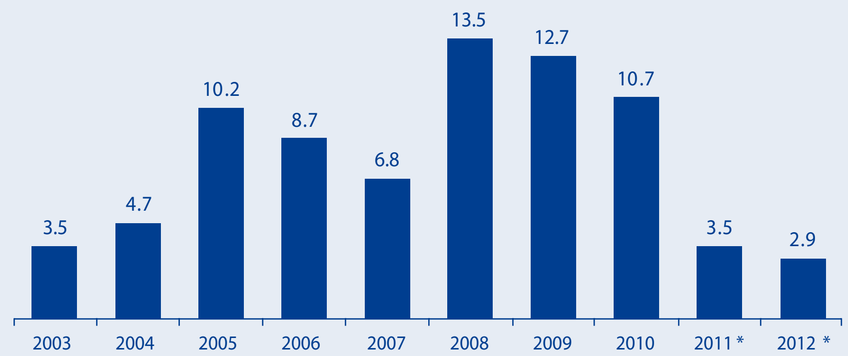
	2008	2009	2010
CURRENT EXPENDITURE	**6.9**	**4.4**	**7.1**
National government	7.0	6.6	6.9
Regional government	0.8	5.3	3.2
Local government	16.8	-8.1	15.0
CAPITAL EXPENDITURE	**41.9**	**39.6**	**19.4**
National government	6.0	61.3	32.6
Regional government	29.4	33.2	17.6
Local government	96.5	27.4	8.5
NON FINANCIAL EXPENDITURE	**13.5**	**12.7**	**10.7**
National government	6.9	13.7	11.6
Regional government	6.6	12.2	7.4
Local government	47.7	10.2	11.1

55. It is estimated that expenditure in 2011 would reach the nominal level of expenditure set forth in the Multiannual Macroeconomic Framework (MMF) of the Ministry of Economy revised in the month of August 2010. This implies a real growth in the non financial expenditure of the general government of 3.5 percent. By group of expenditure, current expenditure would grow 0.7 percent and capital expenditure would grow 9.7 percent, which reflects the priority given to the growth of investment over the growth of current revenue in this scenario. In 2012 the government expenditure would continue growing at a moderate pace, in accordance with the levels projected in the MMF, which implies a real growth of 2.9 percent in non financial expenditure in that year.

It is worth pointing out that the annual fiscal rules on the deficit and growth of expenditure set forth in the **Fiscal Responsibility and Transparency Law** are fully re-established in 2011 and 2012, which means that the deficit cannot be higher than 1 percent of GDP and the central government's expenditure in consumption cannot increase by over 4 percent in real terms. The latter includes expenditure in salaries and pensions, as well as expenditure in goods and services.

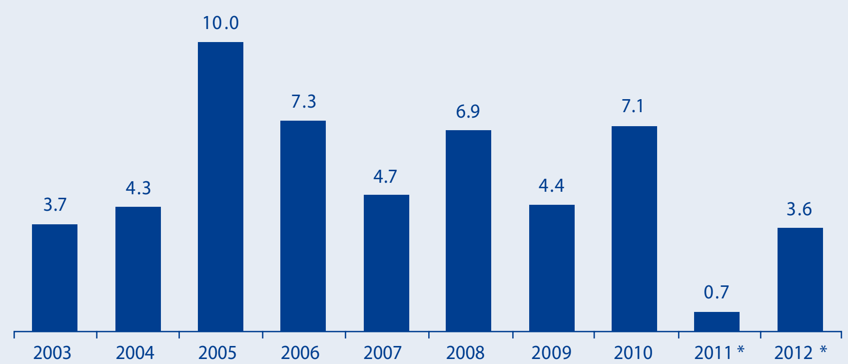
Moreover, certain specific rules will also apply given that general elections will take place in 2011. Thus, the non financial expenditure of the general government during the first seven months of the year shall not exceed 60 percent of the non financial expenditure budgeted for the year and the fiscal deficit in the first semester shall not exceed 50 percent of the annual deficit. It should also be pointed out that the **Financial Equilibrium Law** introduced a new fiscal rule for 2011 that establishes that a annual surplus of 2 percent of GDP should be generated in the first semester of the year (approximately 4 percent of the first semester's GDP)

Graph 61
NON FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT
(Real % change)



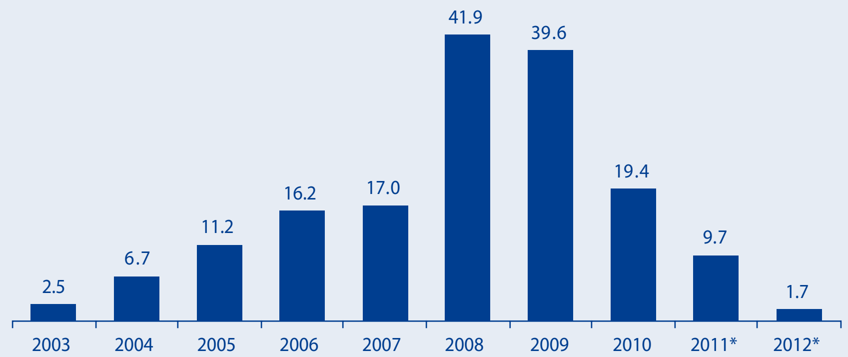
*Forecast.

Graph 62
NON FINANCIAL CURRENT EXPENDITURE OF THE GENERAL GOVERNMENT
(Real % change)



*Forecast.

Graph 63
CAPITAL EXPENDITURE OF THE GENERAL GOVERNMENT
(Real % change)



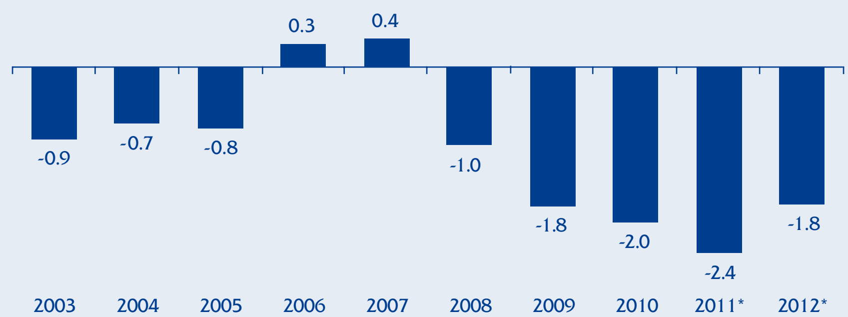
*Forecast.

Structural economic balance and fiscal impulse

56. The **structural economic balance**, indicator that shows the evolution of fiscal policy decisions since the effects of the economic cycle and of the prices of the main mineral exports are deducted from the conventional economic balance, was negative by 2.0 percent of GDP in 2010.

A **structural deficit** of 2.4 percent of GDP is estimated for 2011 due basically to the recently adopted tax measures. This balance is expected to improve to 1.8 percent of GDP in 2012, in line with the moderation of the growth of government expenditure foreseen in our last Report.

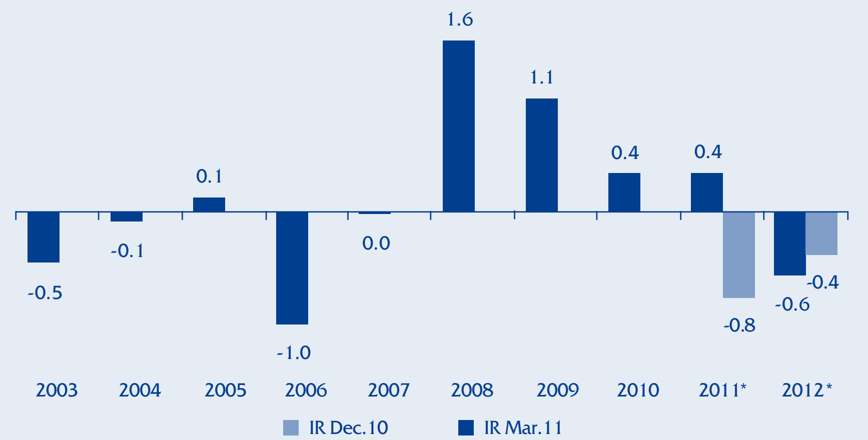
Graph 64
STRUCTURAL RESULT OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)



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

57. The **Fiscal impulse**, which shows the net expansionary effect of fiscal policy on domestic demand, would represent 0.4 percent of GDP in 2010, which would be indicating that fiscal policy was expansionary during this year. In 2011 the fiscal impulse would be equivalent to 0.4 percent of GDP, while in 2012 it would show a contractive stance with an impulse equivalent to 0.6 percent of GDP.

Graph 65
FISCAL IMPULSE
(% of GDP)



*Forecast.

Financial requirements

58. In 2010, the **public sector's financial requirements** amounted to US$ 2,408 million, a sum consistent with the fiscal deficit in the year (0.6 percent of GDP). Financial requirements in 2011 and 2012 would be higher than projected in the December Report due to the deterioration of the results expected in these years and would amount to US$ 1,873 million and US$ 1,667 million, respectively.

The total public debt at December 2010 amounted to US$ 36.8 billion (23.9 percent of GDP), of which 46 percent corresponds to domestic debt. Moreover, 64 percent of this amount was financed with bonds.

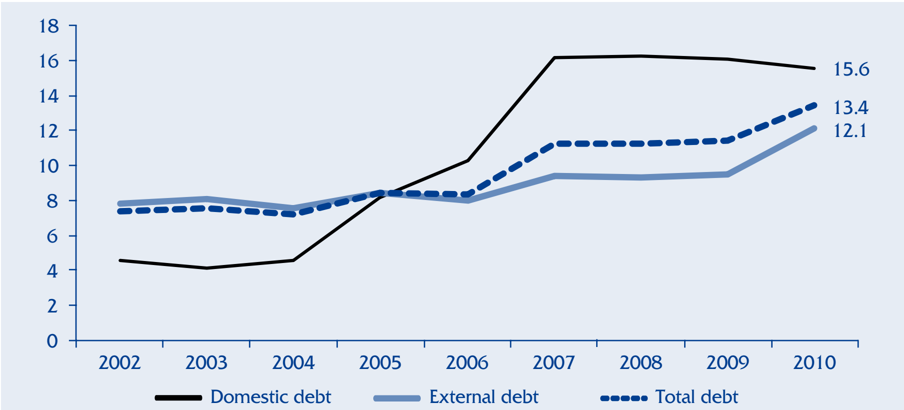
TABLE 21
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR 1/
(Millions of US$)

	2009	2010	2011*		2012*	
			IR Dec.10	IR Mar.11	IR Dec.10	IR Mar.11
I. Uses	**3,838**	**2,408**	**1,441**	**1,873**	**746**	**1,667**
1. Amortization	1,218	1,496	1,371	1,329	1,780	1,762
a. External debt	950	952	807	788	1,209	1,191
b. Domestic debt	268	543	564	541	571	571
Of which: Recognition bonds	91	263	258	253	287	287
2. Overall balance (negative sign indicates surplus)	2,620	912	70	545	-1,035	-96
II. Sources	**3,838**	**2,408**	**1,441**	**1,873**	**746**	**1,667**
1. External	1,127	1,532	1,421	1,119	1,202	1,065
2. Bonds 2/	1,854	835	720	739	816	815
3. Internal 3/	857	41	-700	15	-1,273	-214
Memo:						
Balance of gross public debt						
Billions of US$	34.6	36.8	36.3	36.7	37.2	37.5
% of GDP	27.2	23.9	21.4	21.3	19.8	19.6
Balance of net public debt 4/						
Billions of US$	18.2	18.5	18.2	17.7	16.9	17.2
% of GDP	14.3	12.0	10.7	10.3	9.0	9.0

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

59. Another indicator that measures the debt risk is the average life of the debt portfolio. This indicator at November 2010 is 13.4 years (12.1 years in the case of the external debt and 15.6 years in the case of the domestic debt), one of the longest debt average lives in the region.

Graph 66
AVERAGE MATURITY OF PUBLIC DEBT
(In years)



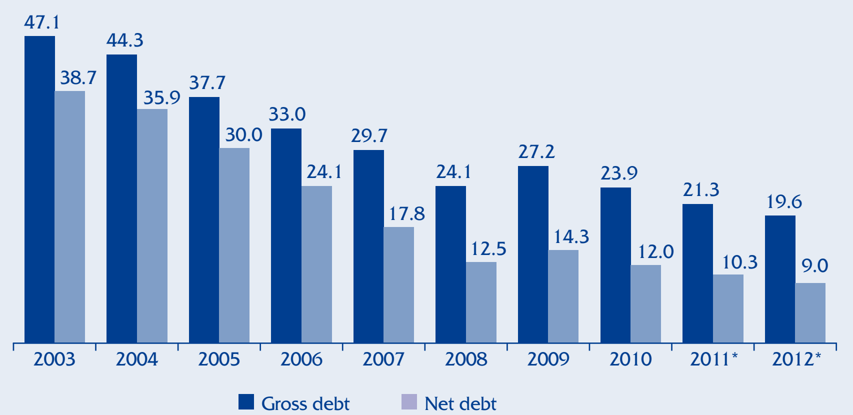
60. In 2011 priority will be given to finance investment projects through the use of the resources of Multilateral Organizations in order to benefit from both the favorable financial conditions of this sources and from the technical assistance provided the entities executing these projects.

According to the Ministry of Economy and Finance (MEF), the government will only resort to the domestic market to obtain resources through bond issuances, given that global bonds for a total of US$ 1 billion have already been placed to finance the debt service of 2011.

As regards debt management, it is foreseen that the government will continue with the policy of replacing the contracted debt at less favorable conditions than the current ones and to increase the fixed rate and the nuevos soles-denominated portfolio in order to mitigate market risks.

61. The **gross and net debts** have recorded considerable reductions both as a result of increased economic activity and of the growth of public sector deposits. In 2010, the gross debt declined from 27.2 percent to 23.9 percent relative to 2009 and the net debt dropped from 14.3 to 12.0 percent. Financing requirements are expected to decline in the next years as a result of an improvement in the treasury's economic balance which will in turn allow it to increase its level of assets. Thus, the gross debt and the net debt in 2012 are estimated to decline to 19.6 and 9.0, respectively.

Graph 67
PUBLIC DEBT
(% of GDP)



*Forecast.

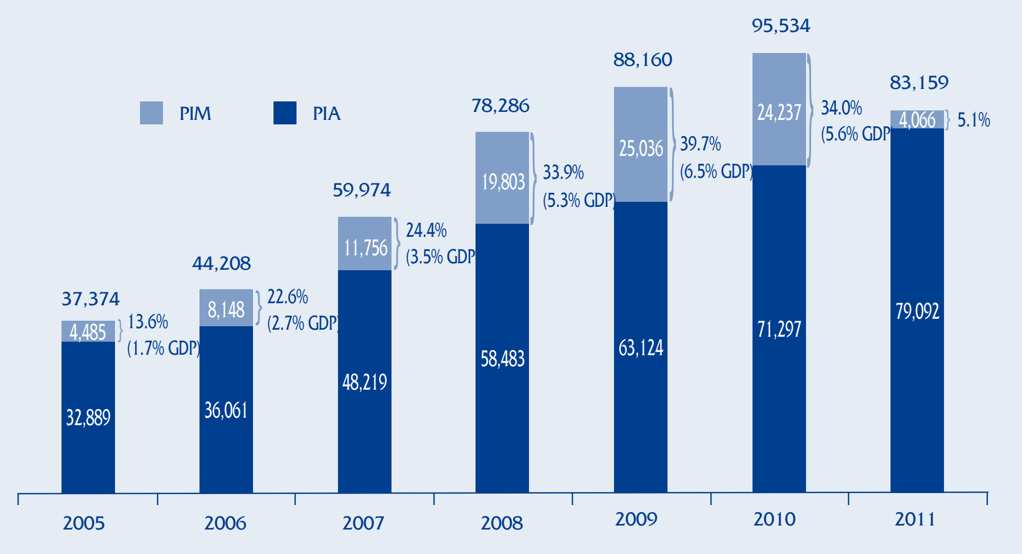
BOX

BUDGET EXECUTION AND SUPPLEMENTARY CREDITS

Peruvian government agencies initiate the phase of budget execution on the first of January of each year with an initial budget denominated Institutional Opening Budget (Presupuesto Institucional de Apertura - PIA). This budget is usually amended over the year through the approval of supplementary credits and transfers to budget items. Since supplementary credits increase the PIA, it is thereafter called Institutional Amended Budget (Presupuesto Institucional Modificado - PIM). These budget extensions may be approved by law or by emergency decrees. In the case of ministries, supplementary credits of government funds administered by a ministry are approved by the respective minister.

Between 2007 and 2010, budget extensions have increased the PIA by over a third of the initial budget, which represents 5.2 percent of the average annual GDP.

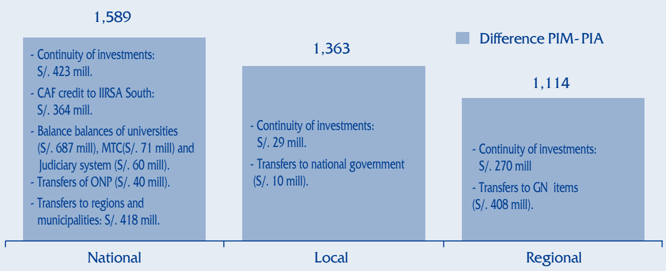
EVOLUTION OF NON FINANCIAL EXPENDITURE BUDGET*
(Millions of nuevos soles)



* PIM up to March 2, 2011. Includes the continuity of investments 2011 (DS 032-2011-EF)
In 2005 and 2006 does not include municipalities.

After the first two months of 2011, the institutional amended budget is 5.1 percent higher than the opening budget. This budget increase, which is observed especially in the case of sub national government agencies, is mainly the result of including the unspent balances of previous fiscal years in the 2011 Budget.

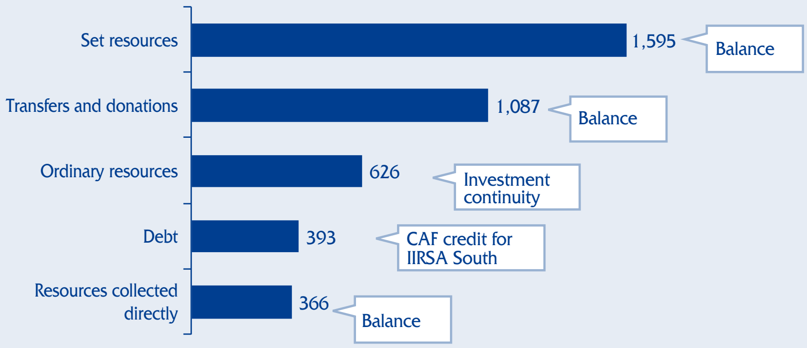
INCREASE IN THE BUDGET OF NON FINANCIAL EXPENDITURE 2011 BY GOVERNMENT LEVEL*
(Millons of nuevos soles)



* Up to March 2, 2011. Includes continuity of investment 2011 (DS 032-2011-EF).

By funding source, these increased supplementary credits come from the resources allocated and from grants and transfers. In both cases, these supplementary credits have to be approved by the corresponding minister.

INCREASE IN THE BUDGET BY SOURCE OF FUNDING 2011*
(Millions of nuevos soles)



* Up to March 2, 2011.

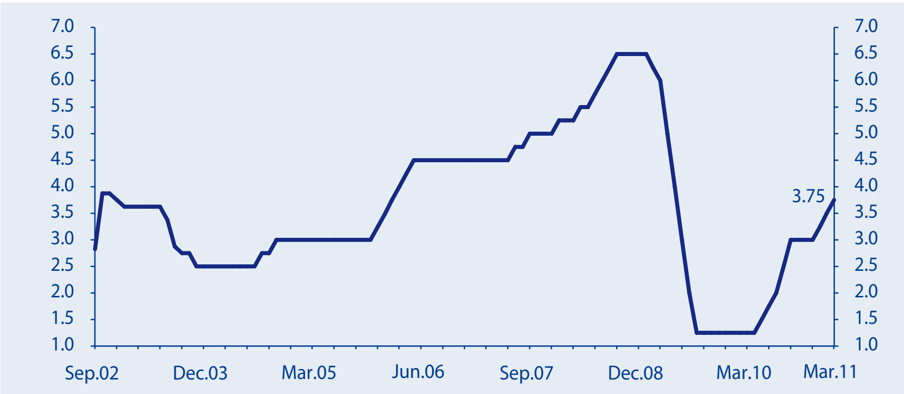
V. Monetary Policy

62. Since January 2011 the Central Bank resumed the withdrawal of monetary stimulus given the dynamism of domestic activity, driven mainly by domestic demand, the better evolution of developed economies and the high dynamism of emerging economies with commodity prices at historical high levels. Thus, the **reference interest rate** was raised from 3.0 percent in December 2010 to 3.75 percent in March, by 25 basis points each month.

    The **withdrawal of monetary stimulus** was coupled by rises in the average rate of reserve requirements in domestic currency and in foreign currency (0.25 percentage points in February and 0.25 percentage points in March 2011). Reserve requirements were also extended to cover the liabilities of domestic banks' branches abroad and the rate of reserve requirements on short term external liabilities was reduced from 75 to 60 percent, given that the new regulations of the Superintendence of Banks, Insurance Companies and Private Administrators of Pension Funds (SBS) for forward operations which establishes a limit for banks' net position in derivatives of 40 percent of a bank's equity (or S/. 400 million, the higher amount).

63. It is worth mentioning here that, between September and December 2010, the Central Bank had made a pause in the withdrawal of monetary stimulus being implemented since May 2010 given that inflation and inflation expectations were around the 2.0 percent target and given a lower than expected recovery of the global economy. However, since significant short term capital inflows were observed and with the purpose of moderating the dynamism of credit and liquidity, since October the Central Bank raised legal reserves from 8.5 to 9.0 percent, marginal reserves in nuevos soles to 25 percent and marginal reserves in dollars from 50 to 55 percent, and increased mean reserve requirements in foreign currency by 0.5 percentage points.

Graph 68
BCRP REFERENCE INTEREST RATE
(%)



64. Falling quite close to the target, inflation in 2010 recorded a rate of 2.08 percent. In January and February 2011, inflation showed rates of 0.39 and 0.38 percent, respectively, reflecting the seasonal rises in some food products and increases in fuel prices in accordance with the fuel price adjustment schedule established. As a result of this, annual inflation registered 2.17 percent, a level around the target (2 percent).

POLICY RATE MEASURES:
December 2010 – March 2011

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

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

January: The Board of the Central Reserve Bank of Peru approved to raise the monetary policy reference rate from 3.0 percent to 3.25 percent.

The nature of this rise in the reference rate is mainly preventive given the current growth of domestic demand in a context of rising international food and energy prices. This measure is aimed at preventing that inflation expectations will be influenced by these supply factors. Future adjustments in the reference rate will depend on new information on the evolution of inflation and its determinants.

February: The Board of the Central Reserve Bank of Peru approved to raise the monetary policy reference rate from 3.25 to 3.5 percent.

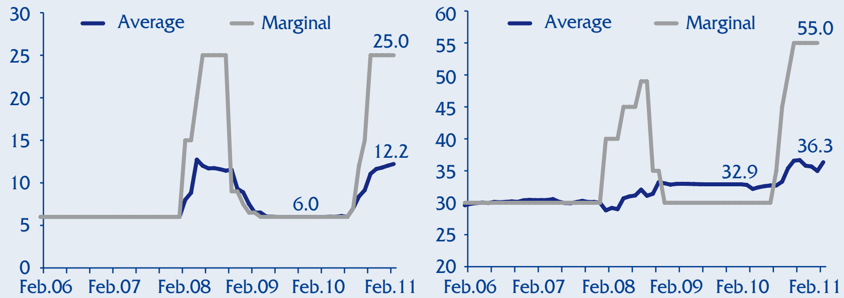
The nature of this rise in the reference rate is mainly preventive in a context of rising international food and energy prices. This measure is aimed at offsetting the potential impact of these supply factors on inflation expectations in a context of growth of domestic demand. Future adjustments in the reference rate will depend on new information on the evolution of inflation and its determinants.

March: The Board of the Central Reserve Bank of Peru approved to raise the monetary policy reference rate from 3.50 to 3.75 percent.

The nature of this rise in the reference rate is mainly preventive in a context of rising international food and energy prices. This measure is aimed at offsetting the potential impact of these supply factors on inflation expectations in a context of growth of domestic demand. Future adjustments in the reference rate will depend on new information on the evolution of inflation and its determinants.

Graph 69

RESERVE REQUIREMENT IN DOMESTIC CURRENCY (% of TOSE) | **RESERVE REQUIREMENT IN FOREIGN CURRENCY 1/** (% of TOSE)



1/ For deposits (General regime).

TABLE 22
RECENT RESERVE REQUIREMENTS POLICIES

	Domestic Currency				Foreign currency			
					General regime		Foreign liabilities	
	Legal minimun reserve requirement	Marginal reserve requirement for deposits	Increase in the average reserve requirement	Non residents reserve requirement	Marginal reserve requirement for deposits	Increase in the average reserve requirement	Short term	Long term
Mar-09	6.0%			35%	30%		0%	0%
Feb-10	6.0%			35%	30%		35%	0%
Jul-10	7.0%			40%	35%		40%	0%
Aug-10	8.0%	12%		50%	45%	0.1%	50%	0%
Sep-10	8.5%	15%		120%	50%	0.2%	65%	0%
Oct-10	9.0%	25%		120%	55%	0.2%	75%	0%
Nov-10	9.0%	25%		120%	55%		75%	0%
Dec-10	9.0%	25%		120%	55%		75%	0%
Jan-11,1/	9.0%	25%		120%	55%		60%	0%
Feb-11	9.0%	25%	0.25%	120%	55%	0.25%	60%	0%
Mar-11	9.0%	25%	0.25%	120%	55%	0.25%	60%	0%

1/ Since January 2011 the reserve requirement area of effect has widened to liabilities of the branches of local brands abroad.

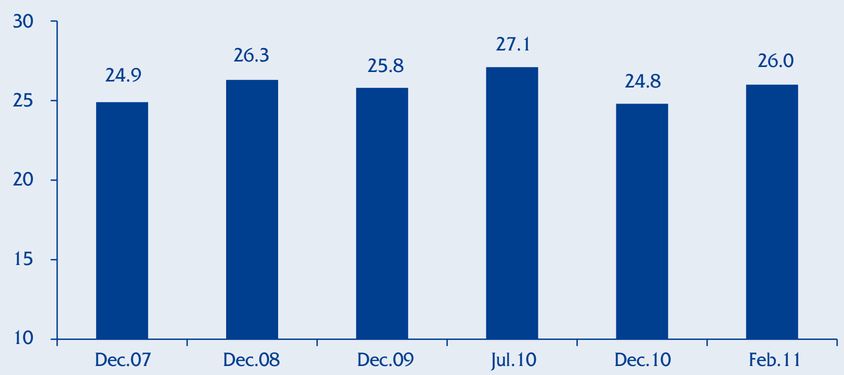
65. In January, the Central Bank decided that the liabilities of local banks' branches abroad would also be included in **total liabilities subject to reserve** requirements. This decision was adopted given the increased volume of bank branches' credit operations with local non financial firms observed since August 2010, which were financed with liabilities not subject to reserve requirements, and which reflected in

the reduction of the mean global rate of reserve requirements in foreign currency[2] from 27.1 percent in July to 24.8 in December 2010.

An additional effect of including bank branches' liabilities as part of total liabilities subject to reserve requirements is the homogeneous treatment of monetary regulation to all the banks. Moreover, this also implies the same tax treatment and banking oversight for reserves, regardless of whether it is bank or a bank branch.

66. During the same period, the rate of reserve requirements on short term liabilities was reduced from 75 to 60 percent, considering the effect of the new SBS regulations which establishes a limit for banks' net position in derivatives equivalent to 40 percent of a bank's equity (or S/. 400 million, the higher amount). Having established this prudential limit, it was no longer necessary to have such a high rate of reserve requirements on short term liabilities, whose aim had been to discourage forwards by making the use of external credit lines for these operations more costly.

Graph 70
EVOLUTION OF GLOBAL RESERVE REQUIREMENT IN FOREIGN CURRENCY 1/
(%)

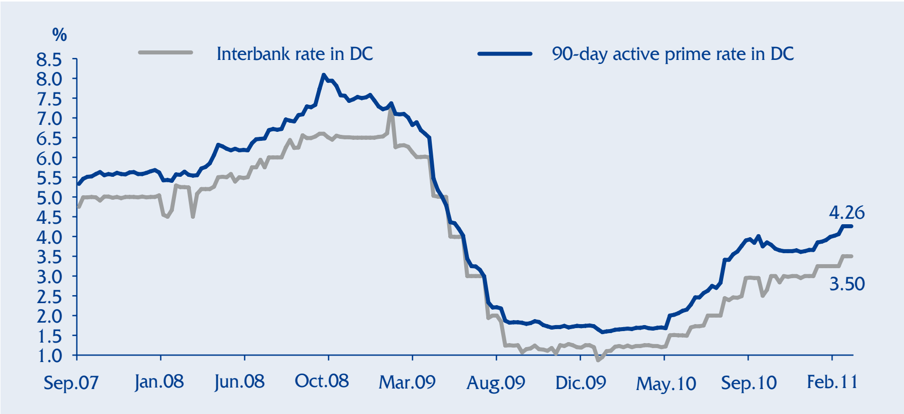


1/ The average reserve requirement rate considers the total liabilities in foreign currency of the banks.

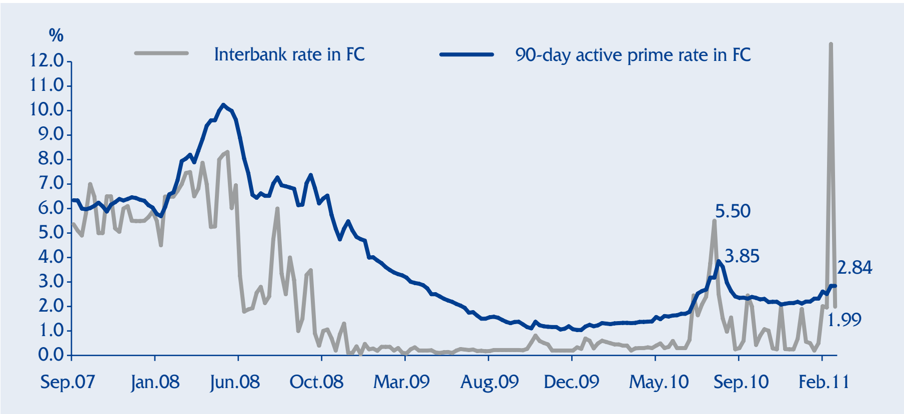
67. In January and February the 90-day prime **lending interest rates** in nuevos soles rose in line with the 50 bps. increase in the reference rate during the same period. Thus, 90-day lending rates increased from 3.66 in December to 4.26 percent in February. Moreover, the prime rates in foreign currency rose from 2.14 to 2.84 percent in the same period due to the increase in reserve requirements. The interbank rate in dollars showed a higher volatility towards the end of February.

2 Measured considering also bank branches liabilities abroad and long term external liabilities.

Graph 71
INTERBANK AND CORPORATE PRIME INTEREST RATES
IN DOMESTIC CURRENCY



Graph 72
INTERBANK AND CORPORATE PRIME INTEREST RATES
IN FOREIGN CURRENCY



68. By **type of placements**, interest rates on business loans in domestic currency recorded increases. Thus, the rates on loans for micro enterprises rose from 27.2 percent in December to 31.5 percent in February, while the rates on loans for small business rose from 23.3 to 24.6 percent, for medium-sized business from 10.3 to 10.7 percent, for large business from 5.9 to 6.9 percent, and corporate loans from 4.6 to 5.4 percent. On the other hand, the rates on consumer loans declined from 40.7 to 38.2 and mortgage loans remained around a level of 9.3 percent.

69. The **interest rates on all the loans in foreign currency** increased, except for the rates on corporate loans which declined from 5.5 to 5.3 percent between December and February 2011.

TABLE 23
INTEREST RATES BY TYPE OF CREDIT IN DOMESTIC AND FOREIGN CURRENCY 1/
(%)

Domestic Currency

	Corporate	Big businesses	Middle businesses	Small businesses	Microbusiness	Consumption	Mortgages
Sep-10	5.5	6.4	8.7	23.6	30.9	39.5	9.6
Oct-10	5.6	6.3	9.5	23.2	31.3	38.4	9.5
Nov-10	5.1	6.1	10.1	23.7	31.5	37.8	9.5
Dec-10	4.6	5.9	10.3	23.3	27.2	40.7	9.3
Jan-11	4.8	6.2	10.5	23.1	24.5	39.6	9.3
Feb-11 2/	5.4	6.9	10.7	24.6	31.5	38.2	9.3

Foreign Currency

	Corporate	Big businesses	Middle businesses	Small businesses	Microbusiness	Consumption	Mortgages
Sep-10	4.3	5.5	9.5	15.0	15.5	21.3	8.4
Oct-10	3.8	5.5	9.3	14.7	15.5	22.0	8.3
Nov-10	3.2	5.3	9.1	14.3	15.8	20.9	8.2
Dec-10	3.3	5.5	8.6	14.2	14.8	19.4	8.1
Jan-11	3.5	5.5	8.6	14.2	14.1	21.0	8.1
Feb-11 2/	3.5	5.3	8.8	15.6	17.0	21.4	8.2

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

70. The **deposit rates** on 30-day deposits in domestic currency rose from 2.2 to 3.0 percent and the interest rates on 30-day deposits in foreign currency rose from 0.9 to 1.3 percent between December and February as a result of the increase of the reference rate and lower liquidity in dollars in the financial system.

TABLE 24
INTEREST RATES IN NUEVOS SOLES AND US DOLLARS
(%)

	Nuevos Soles		Dollars		Difference (bps) (Dec.10-Feb.11)	
	Dec.10	Feb.11	Dec.10	Feb.11	Nuevos Soles	Dollars
1. Deposits up to 30 days	2.2	3.0	0.9	1.3	0.7	0.4
2. Rate on 31 to 180-day term deposits	2.9	3.0	1.2	1.1	0.1	-0.1
3. Rate on 181 to 360-day term deposits	3.8	4.0	1.7	1.7	0.2	0.0
4. Corporate prime rate	3.6	4.2	2.1	2.5	0.6	0.4
5. TAMN / TAMEX	18.7	18.6	8.5	8.3	-0.1	-0.2

Monetary operations

71. The **BCRP operations** were aimed at maintaining appropriate liquidity levels and at contributing to maintain the flow of operations in the money market, in a context of higher liquidity in banks and increased exchange rate volatility associated with the resurgence of short term capitals and uncertainty in international markets due to the problems in North Africa and the Middle East. Thus, in order to ensure liquidity and distribute excess liquidity in the following months, the Central Bank used the following monetary instruments:

    – BCRP **Term Deposits**: this instrument, which can only be acquired by the financial entities that operate directly with the Central Bank (average placement of S/.13,161 million between December 2010 and February 2011), was used especially when higher capital inflows were observed.

    – **BCRP Variable Rate Certificates Of Deposit** (CDV BCRP): this instrument, whose yield varies according to the Central Bank reference rate (average placement of S/. 3,028 million between December 2010 and February 2011), is used to facilitate monetary sterilization.

    Additionally, in order to distribute liquidity at longer terms and simultaneously contribute to develop the capital market through the continuous formation of the yield curve, the Central Bank resumed placements of 6-month and 12-month BCRP Certificates of Deposit (CD BCRP), which amounted to S/. 490 million at February. Moreover, to offset high volatility events in the exchange rate, the Central Bank intervened in the foreign exchange rate market through direct purchases of dollars and net placements of **CDLD BCRP** (nominal certificates denominated in nuevos soles and payable in dollars). These certificates are paid and redeemed in US dollars at the average US dollar/nuevos soles exchange rate on the day of the corresponding operation.

72. Furthermore, in order to reduce the exchange rate volatility, between December 2010 and February 2011 the BCRP made **sterilized interventions** in the foreign exchange rate market through net placements of CDLD BCRP (BCRP Certificates of deposit payable in dollars) for a total of S/. 541 million and direct purchases of foreign currency for a total of US$ 497 million. To prevent pressures on the interbank interest rate and distribute the excess of liquidity associated with the maturity of BCRP sterilization instruments, purchases of dollars and the growth of bank deposits, Term Deposits were auctioned to sterilize liquidity in the short term, while BCRP Variable Rate Certificates of Deposit (CDV BCRP) and BCRP Certificates of Deposit (CD BCRP) were used to sterilize liquidity in the long term.

    In the same period, the higher demand for currency (S/. 1,281 million) continues reflecting the increased dynamism of economic activity. The public sector has accumulated deposits at the BCRP for a total of S/. 368 million, which has contributed to sterilize excess liquidity.

TABLE 25
MONETARY OPERATIONS
(Millions of nuevos soles)

	FLOWS				BALANCE		
	2010	4Q.10	Dec.10-* Feb.11	Accumu-lated 2011*	30-Sep-10	31-Dec-10	28-Feb-11
I. FOREIGN EXCHANGE OPERATIONS	**25,362**	**1 054**	**1 841**	**1 846**			
(Millions of US$)	**9,010**	**378**	**665**	**667**			
1. Over the counter operations	8,963	227	497	497			
2. Public Sector	-50	0	-25	-25			
3. Other operations 1/	96	151	193	195			
II. MONETARY OPERATIONS	**-15,899**	**7,152**	**281**	**-5,775**	**-59,267**	**-51,893**	**-58,114**
1. Sterilization operations	-15,899	7,152	281	-5,775	-59,267	-51,893	-58,114
a. BCRP instruments	-10,343	5,304	821	-2,526	-29,768	-24,463	-26,989
CDBCRP	14,091	29,738	680	-460	-29,768	-30	-490
CDLD BCRP	-450	-450	-541	-541	0	-450	-991
CDV BCRP	-3,196	-3,196	-7,933	-6,860	0	-3,196	-10,056
Term deposits	-20,788	-20,788	8,615	5,335	0	-20,788	-15,453
b. Public sector deposits in DC	-5,720	2,162	-368	-3,660	-28,888	-26,726	-30,387
c. Other monetary operations 2/	163	-313	-173	412	-611	-704	-738
2. Injection operations	0	0	0	0	0	0	0
III. RESERVE REQUIREMENTS IN DC	**-5,747**	**-5,166**	**-1,277**	**2,518**	**20,801**	**24 154**	**23,027**
IV. OTHERS 3/	**1,198**	**312**	**436**	**284**			
V. CURRENCY **	**4,913**	**3,353**	**1,281**	**-1,127**	**20,801**	**24,154**	**23,027**
(Monthly change)					-0.6%	11.1%	0.1%
(Accumulated change)					8.1%	25.5%	-4.7%
(12 month change)					24.6%	25.5%	24.6%

* Up to February 28, 2011.
** Preliminary data.
1/ Includes repos in FC, CDLD operations and over-the-counter operations.
2/ Includes overnight deposits and Deposit Insurance Funds.
3/ Includes BCRP operational expenses, interest for deposits in the BCRP (overnight, term, and special deposits), net interest for placements of CDBCRP

73. **Credit to the private sector** continued showing high growth rates, in line with increased economic activity. Credit to the private sector in the last 12 months grew 21.0 percent in January. By type of financial entity, commercial banks and state banks' placements showed a higher growth in January (0.9 and 0.8 percent)

TABLE 26
TOTAL CREDIT TO THE PRIVATE SECTOR BY FINANCIAL INSTITUTION

	Balance in millions of nuevos soles			Growth rates (%)		
	Jan-10	Dec-10	Jan-11	Dec-10/ Dec-09	Jan-11/ Jan-10	Jan-11/ Dec-10
Banks (*)	91,467	109,074	110,042	20.0	20.3	0.9
State bank	3,025	3,506	3,533	19.1	16.8	0.8
Microfinance Institutions	14,339	18,029	18,135	25.8	26.5	0.6
Of which:						
Municipal banks	6,936	8,515	8,502	22.6	22.6	-0.2
TOTAL	**108,831**	**130,609**	**131,711**	**20.7**	**21.0**	**0.8**

(*) Includes loans made by banks branches abroad.

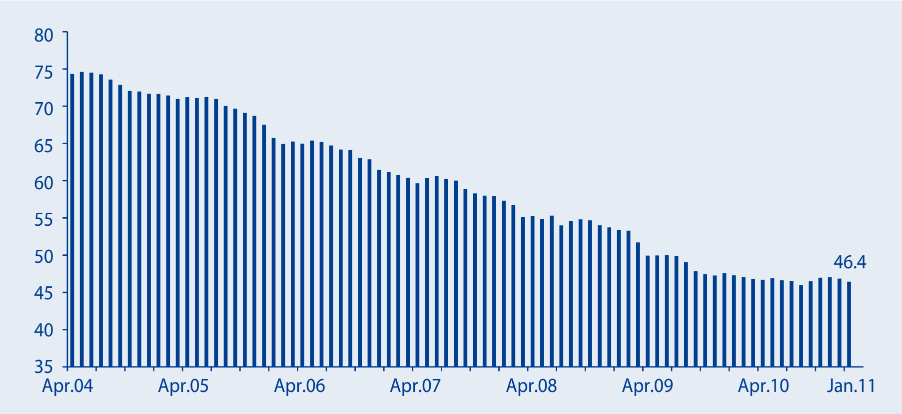
By currencies, credit to the private sector in nuevos soles in the last 12 months grew 21.1 percent, while credit to the private sector in foreign currency in the last 12 months grew 20.9 percent.

Graph 73
CREDIT TO THE PRIVATE SECTOR INCLUDING BRANCHES 1/
(12-month growth rates)

1/ Includes banks branches abroad.

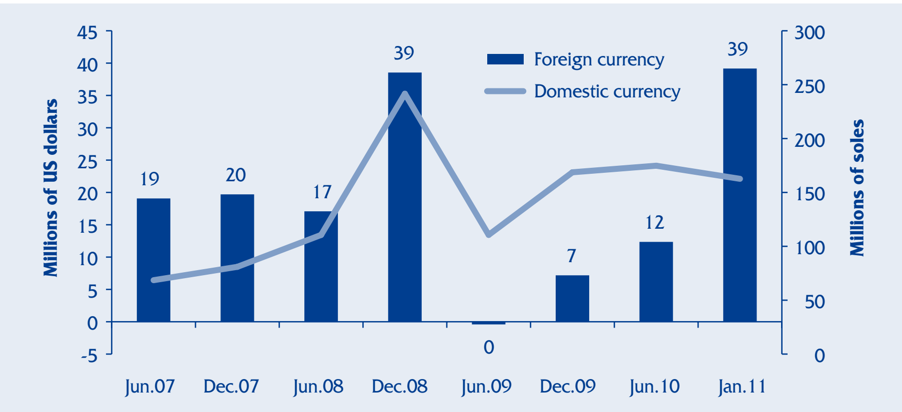
74. The evolution of credit to the private sector reflected in lower **dollarization** levels. In January 2011 the ratio of dollarization of credit to the private sector was 46.4 percent.

Graph 74
DOLLARIZATION OF CREDIT OF THE PRIVATE SECTOR
(%)



However, this evolution has not been homogeneous. For example, a lower pace of dedollarization is observed in mortgage loans. As the graph below shows, the monthly average flow of mortgage loans in dollars increased from US$ 12 million in the first semester of 2010 to US$ 39 million in the second semester. Should this trend persist, it could lead to a greater mismatch in the exchange rate since this could increase financial entities' exchange rate-credit risks given the nontradable nature of the assets used to back mortgages.

Graph 75
MORTGAGE
(Average month flow of the quarter)

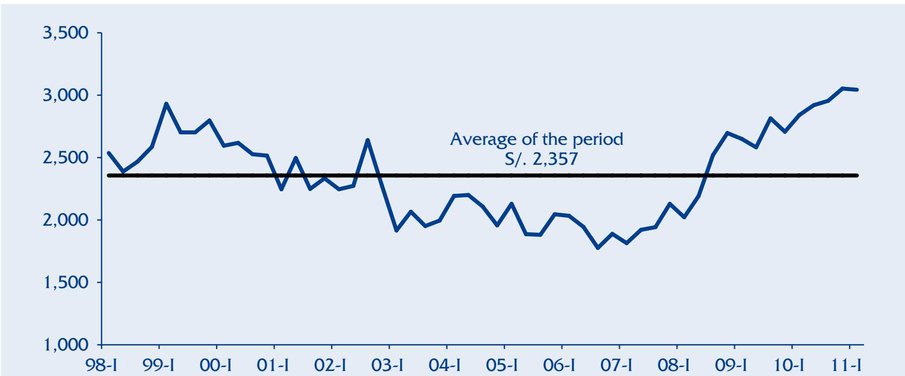


75. The **credit to the private sector/GDP ratio** recorded a level of 30 percent in January 2011 (28 percent in January de 2010).

Graph 76
CREDIT TO THE PRIVATE SECTOR
(% of GDP)

76. In the **real estate market**, the median of apartment sale prices per square meter maintained the upward trend observed since early 2006. During the first quarter, sale prices increased in real terms.

Graph 77
PRICES IN CONSTANT SOLES OF 2009 PER M² OF APARTMENTS
La Molina, Miraflores, San Borja, San Isidro and Surco



Source: Real state Sector BCRP, March 2011.

The **real estate price to earnings ratio** (PER), indicator equivalent to the stock price/earnings ratio in the stock market, which shows the number of years a property would have to be rented to recover the value of the property, increased slightly in January-February compared to the previous bimester. According to the classification of Global Property Guide, these levels in aggregate terms are in the normal prices interval (interval 12.5 to 25.0).

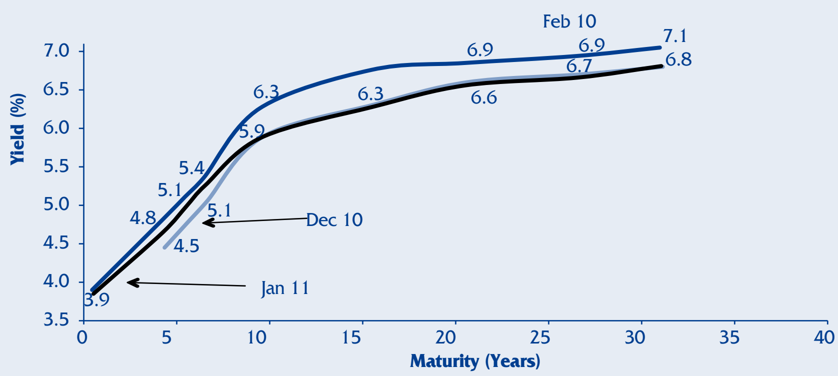
TABLE 27
PER: SALE PRICE / ANNUAL RENT IN US$ PER M2

MEDIANS 1/	May-June	July-August	September-October	November-December	January - February 11
Jesús María	11.8	10.6	10.8	14.7	15.2
La Molina	13.0	13.1	13.7	14.4	13.5
Lince	15.9	14.7	15.4	13.9	11.9
Magdalena	10.6	10.7	11.3	11.2	12.2
Miraflores	10.9	11.8	13.2	13.1	12.3
Pueblo Libre	14.5	14.6	13.2	13.9	14.7
San Borja	15.8	16.7	15.4	14.6	15.5
San Isidro	14.4	13.1	14.6	13.8	15.2
San Miguel	13.6	14.2	13.8	15.2	16.0
Surco	12.8	12.4	12.8	13.5	14.0
Aggregated					
Average	13.3	13.2	13.4	13.8	14.0

1/ The ratios had been calculated based on the sale price and rent median of each district.
Source: Real state sector BCRP, March 2011.

77. The **yield curve** of sovereign bonds was adjusted upwards, especially in the longer tranche of the curve due to local and foreign investors' lower demand for longer term bonds. Moderate increases were also observed in the shorter term tranche, following the Central Bank reference rate.

Graph 78
SECONDARY MARKET OF SOVEREIGN BONDS 1/



1/ Average yield at end of each month.

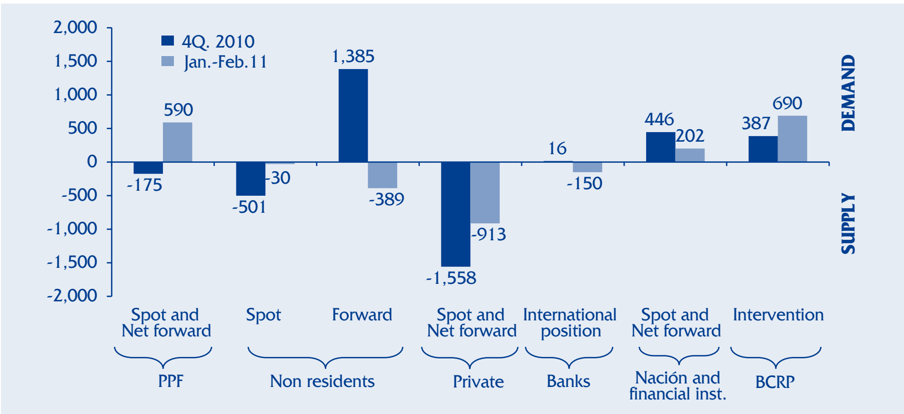
Exchange rate

78. Between December 2010 and February 28 of 2011, the average **nominal exchange rate** appreciated 2.0 percent, showing a differentiated conduct. In January the nuevo sol appreciated 1.3 percent, mainly as a result of non residents' increased supply of

FC in the forward market (US$ 566 million) which was partially offset by AFP's higher demand for dollars (US$ 275 million). On the other hand, in February the nuevo sol depreciated 0.2 percent, reflecting both increased risk aversion due to the conflicts in the Middle East and the effect of the limits established on financial entities' forward operations and the taxes on capital earnings with financial derivatives, which led forward operations with non residents to decline.

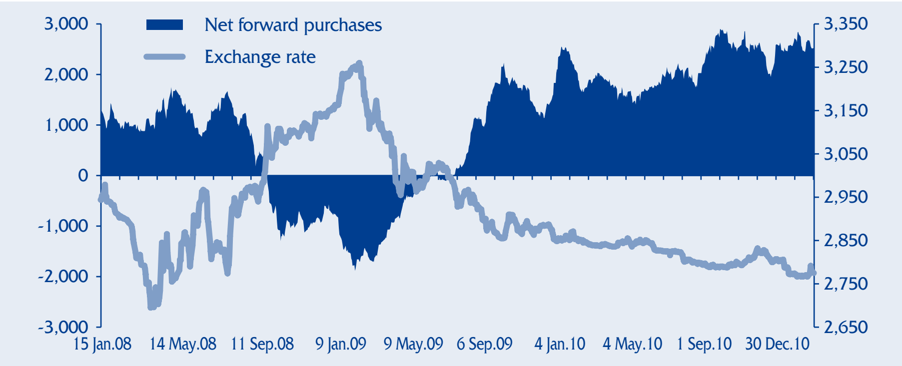
Higher appreciatory pressures were observed especially between January and mid-February with a net supply of US$ 690 million. The increased supply came mainly from private agents in the spot market, mainly from mining companies and retail operations. An additional supply came from non resident investors (US$ 389 million in the forward market and US$ 30 million in the spot market) and from the reduction of banks' exchange rate position by US$ 150 million. This supply was partially offset by AFP's demand, which amounted to US$ 590 million (US$ 228 million in the spot market and US$ 362 million in the forward market). The Central Bank intervened in the exchange rate market with a net placement of CDL BCRP and purchasing FC in the spot market for a total of US$ 690 million until mid-February.

Graph 79
FLOWS IN THE FOREIGN EXCHANGE MARKET
(Millions of US$)

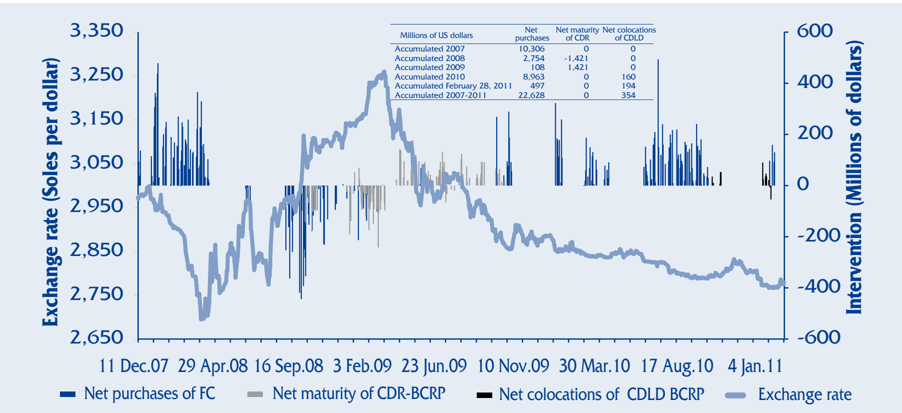


79. Between December 2010 and February 2011, **banks' purchases of forwards** declined by US$ 73 million, reaching a balance of US$ 2,520 million at February 28. Factors accounting for this decline include the higher costs of FC funds associated with reserve requirements, banks' reduction of their exchange rate position, and the new regulation of the SBS, in force as from January 2011, which limits banks' net position in financial derivatives in FC to 40 percent of a bank's effective equity (or to S/. 400 million, whichever is higher). Moreover, Law 29663, which extends the 30 percent income tax to all non residents' earnings resulting from financial derivatives traded with residents, regardless of the maturity terms, was enacted in February 2011.

Graph 80
NET FORWARD PURCHASES AND EXCHANGE RATE
(In millions of US$ and US$ / S/. exchange rate)



Graph 81
EXCHANGE RATE AND FOREX MARKET INTERVENTION



80. The **expectations about the exchange rate** for 2011-2012 have declined slightly on average. This would be reflecting the uncertainty that exists regarding the evolution of this variable given that financial entities, non financial firms and economic analysts have corrected them downwards.

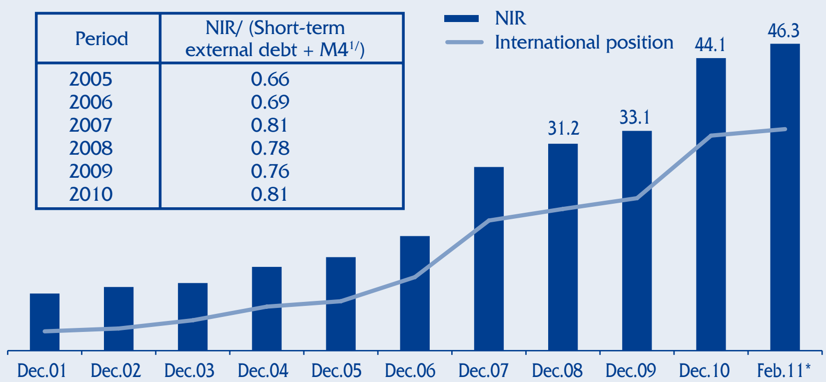
TABLE 28
SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE
(Nuevos soles per US dollar)

	Sep.10	Oct. 10	Nov. 10	Dec. 10	Jan. 11	Feb. 11
FINANCIAL ENTITIES						
2011	2.79	2.76	2.75	2.75	2.75	2.75
2012	2.80	2.79	2.75	2.75	2.70	2.70
ECONOMIC ANALYSTS						
2011	2.78	2.80	2.78	2.75	2.75	2.75
2012	2.72	2.78	2.72	2.70	2.75	2.69
NON-FINANCIAL FIRMS						
2011	2.82	2.80	2.82	2.81	2.80	2.80
2012	2.90	2.86	2.88	2.87	2.82	2.80
AVERAGE						
2011	2.80	2.79	2.78	2.77	2.77	2.77
2012	2.81	2.81	2.78	2.77	2.76	2.73

81. **International reserves** have increased by US$ 2,163 million between December 2010 and February 28 of 2011, mainly as a result of banks' higher deposits at the BCRP and its intervention in the foreign exchange rate market through direct purchases of dollars and placements of CDLD. Net international reserves (NIRs), which amounted to US$ 46,268 million on February 28 of 2011, represent 81 percent of short term external liabilities plus total liquidity.

Graph 82
NET INTERNATIONAL RESERVES
(Billions of US$)

Period	NIR/ (Short-term external debt + M4[1/])
2005	0.66
2006	0.69
2007	0.81
2008	0.78
2009	0.76
2010	0.81



1/ Corresponds to total liquidity of deposit societies.

BOX
POLICY RESPONSES TO HIGH CAPITAL INFLOWS

Capital inflows, particularly long term inflows, are one of the most important factors that explain the process of growth in developing countries because: a) they complement the funding of expenditure in investment, especially when domestic savings and initial capital stocks are relatively low; b) they may enhance the development of capital markets as an additional source of private funding since they generate a higher demand for the securities issued in the domestic market, and c) they can contribute to increase technological transfer through foreign direct investment, thus favoring long term growth.

However, history shows that capital inflows are an important challenge in terms of macroeconomic management, particularly in small open economies. Empirical evidence suggests that the excessive volatility of these flows, especially short term flows, can threaten macroeconomic stability by inducing high levels of leverage that may lead to an excessive growth of domestic credit or to bubbles in the financial asset markets and to currency mismatches in economic agents' financial positions, weakening the soundness of financial systems. Nonetheless, the balance of these impacts will be positive if the macroeconomic and macro-prudential policies implemented can minimize the risks associated with persistent capital inflows while preserving their positive effects.

After the financial crisis of 2007-2009, capital inflows in emerging economies have been growing considerably as a result of their sound financial and macroeconomic fundamentals, in a context in which these economies show better growth prospects and higher terms of trade than the ones observed in developed countries, whose recent performance has been characterized by persistent uncertainty about the sustainability of their growth and the difficult fiscal situation in some Eurozone countries.

In Latin America, the increased dynamism of net capital inflows shows, in general, a relatively more stable component in the form of foreign direct investment, coupled in some cases (e.g. Brazil and Argentina) by relatively significant portfolio flows. An important growth is also observed in Chile and Peru in private pension funds' investments abroad, which has contributed to offset the net flow of capitals, especially portfolio flows. Moreover, a greater diversification of maturity terms is also observed in external funding in Bolivia, Chile, and Peru, with an increasing participation of long term capitals.

This increased dynamism in capital inflows has been coupled by active economic policies in the region, including both a change in the orientation of macroeconomic policies from a stimulus position to a more neutral position and the adoption of a wide range of macro prudential measures aimed at preserving financial stability.

	Policies\ Countries		Argentina	Bolivia	Brazil	Chile	Paraguay	Peru	Uruguay
Forex interventions	Intervention in the forex market	Spot	√	√	√	√	√	√	√
		Forward	√		√				√
		Swaps operations			√				
Macroprudential policies	Reserve requirements			√	√			√	
	Change in the limit of the Net International Position in foreign currency			√	√ 1/		√ 2/	√ 3/	
	Change in the capital requirement				√				
	Increase in the investment limit abroad	PPF				√		√	
		Insurance companies		√					
	Capital inflows/outflows taxes, commisions and quotas	Inflows		√					
		Outflows	√	√					
	Taxes and commision of the holding of domestic asssets	Central bank securities						√	
		Fixed income securities			√				
		Variable income securities			√				
		FC derivates						√	
	Non remunerated deposits as percentage of the capital inflow		√						
	Limits to the capital permanency		√						

1/ Límits of US$ 3 bills. or regulated equity in the short position of FC (Foreign currency), the lowest.
2/ Increase in the ratio of Net international position in FC respect to effective equity.
3/ Decrease in the global position of overpurchases of FC and the international position of derivates in FC respect to the effective equity.
Source: Central Bank webpages and other publications.

Exchange rate interventions in the spot market have been the most commonly used policy implemented in the region. In Argentina, Brazil and Uruguay, this has been complemented with direct interventions in the forward market. Brazil, Bolivia and Peru have also used bank reserve requirements and Bolivia, Paraguay and Peru have modified the limits for banks' net positions in foreign currency. Moreover, Bolivia, Chile and Peru have raised the limits for private pension funds and insurance companies' investments abroad as a way to reduce net capital inflows. Bolivia and Brazil have used commissions and taxes on capital inflows and/or outflows, while Argentina established a limit for the permanence of capitals in the country.

These economic policy responses have reflected not only in a significant increase in the region's international reserves, but also in a higher cost for non residents' positions in domestic securities, which in some cases –Peru, for example– have contributed to reorient short term capital inflows towards the long term.

NET INTERNATIONAL RESERVES 1/
(% of GDP)

	Brazil	Chile	Argentina	Uruguay	Paraguay	Peru	Bolivia
2005	6.1	14.3	15.5	17.7	17.2	17.8	17.9
2006	7.9	13.3	15.1	15.6	18.3	18.7	27.6
2007	13.2	10.3	17.7	17.2	20.0	25.8	40.3
2008	12.5	13.6	14.3	20.4	16.9	24.4	45.1
2009	15.0	15.5	15.7	25.3	27.0	26.1	49.1
2010	13.9	13.9	14.6	19.7	23.7	28.8	50.6

Source: Webpage of the Central Banks of the region.
1/. Net international reserves include the international position of the Central Banks, net deposits in foreign currency of the Public sector and the financial entities in the Central Banks.

The high dynamism of capital inflows has not generated substantial macroeconomic imbalances in the region. The deficits in the current account of the balance of payments are considered to be within manageable ranges in most countries and some countries even show current account surpluses. Even though showing greater growth than in 2009, credit to the private sector in the last year has been growing at lower rates than the ones observed prior to the 2007-2009 global financial crisis, with the exception of Argentina and Paraguay –where credit shows annual growth rates of over 30 percent–, and Bolivia, which shows rates close to 20 percent. Inflation also registers low levels in the region, despite the recent impact of the higher international prices of food and fuels.

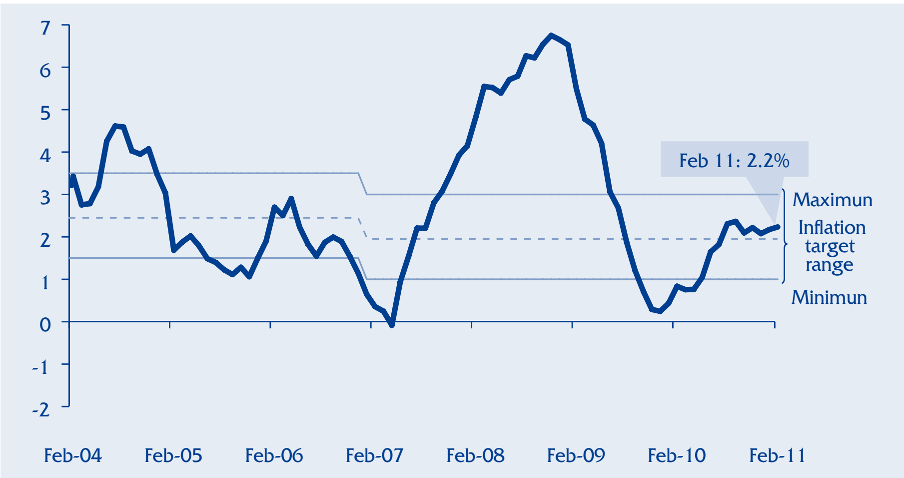
However, the absence of significant macroeconomic imbalances in the region's economic performance does not necessarily imply that capital inflows cannot generate specific potential risks in each country as a result of currency mismatches or the excessive leverage of some agents, factors that are not observed at the aggregate level. Because of this, it is important that the economic authorities remain alert and permanently assess the different impact channels of the various modalities of capital inflows, particularly at the sector level, in order that they may act with the prudence and anticipation required to prevent these risks.

VI. Inflation

82. **Inflation** has fallen within the target range since March 2010, recording a rate of 2.08 percent at December 2010 and a rate of 2.2 percent at February 2011.

Like in other emerging economies, the rise in the international prices of food and fuels has been generating pressures on costs, but this has not translated into higher end prices because firms have reduced their profit margins, there has been a favorable local food supply –especially of agricultural products–, and the Fuel Price Stabilization Fund continues to operate. However, this situation could reverse if the contribution of these factors declines.

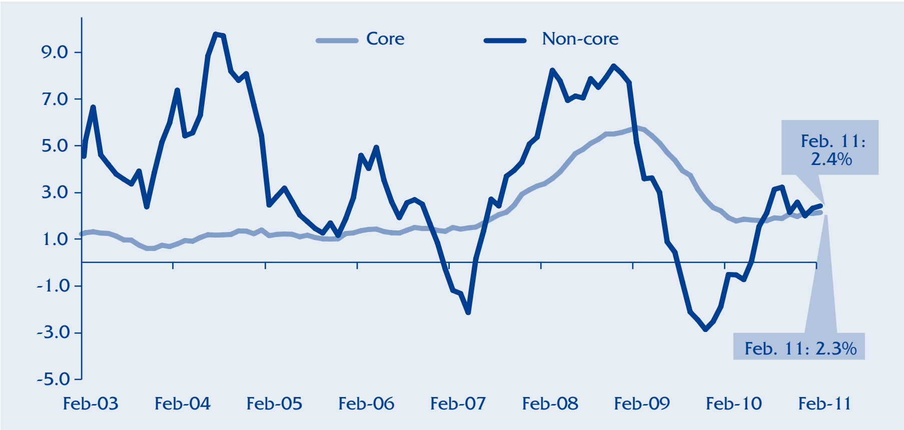
Graph 83
INFLATION AND INFLATION TARGET
(12-month % change)



83. Annual **core inflation**[3] rose from 1.9 percent in September 2010 to 2.1 percent in December and remained in this level in January and February 2011, with expectations anchored within the target range. Non core inflation, which includes agricultural food products and fuels, declined from 3.2 percent in September to 2.0 percent in December and rose slightly to 2.4 percent in February.

3 Core inflation excludes from the CPI the items showing the highest variability in the monthly percentage growth of prices. Other items, such as fuels (gasoline and propane gas), utilities, and urban and interurban transportation prices are excluded regardless of their degree of variability.

Graph 84
CORE INFLATION AND NON -CORE INFLATION
(12-month % change)

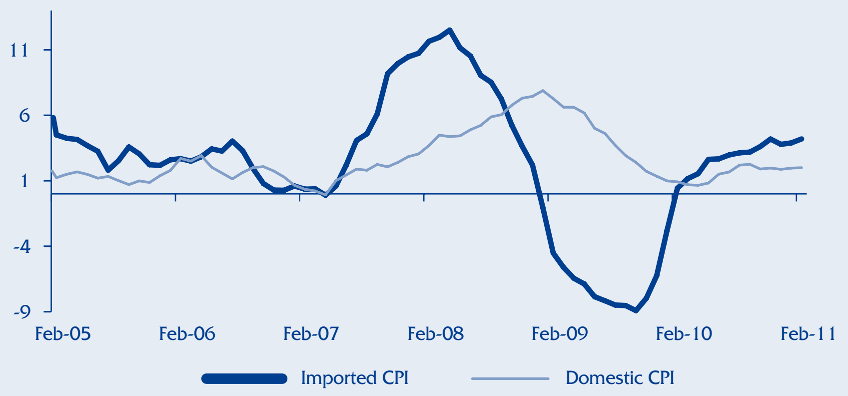


84. **Imported inflation** recorded an annual growth of 3.8 percent in 2010 and of 4.2 percent at February 2011, the rises in the prices of fuels (12.2 percent in 2010 and 11.4 percent at February 2011) and food (0.8 percent in 2010 and 4.1 percent at February 2011) being worth mentioning. Between January and February imported inflation registered a rate of 1.5 percent, reflecting the evolution of the prices of food (3.8 percent) and fuels (2.8 percent).

TABLE 29
DOMESTIC AND IMPORTED INFLATION
(Accumulated % change)

	Weight 2009=100	2006	2007	2008	2009	2010	2011 Jan.-Feb.	2011 12 month
I. IMPORTED CPI	**10.8**	**0.27**	**10.46**	**2.20**	**-6.25**	**3.78**	**1.48**	**4.19**
Food	3.0	2.08	18.83	4.75	-3.07	0.76	3.78	4.09
Fuel	2.8	-1.50	6.45	-0.04	-12.66	12.21	2.77	11.42
Electric appliances	1.3	-1.29	-1.50	-0.06	-2.39	-0.58	-0.70	-1.25
Others	3.7	0.64	0.47	0.46	-0.34	1.20	-0.75	0.37
II. DOMESTIC CPI	**89.2**	**1.28**	**2.84**	**7.44**	**1.35**	**1.87**	**0.69**	**2.00**
III. CPI	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.08**	**0.77**	**2.23**
Exchange rate		**-6.40**	**-7.00**	**4.47**	**-7.59**	**-2.15**	**-1.71**	**-3.03**

Graph 85
DOMESTIC AND IMPORTED INFLATION
(12-month % change)



85. The rate of accumulated inflation between January and February was 0.8 percent, with the rise in the prices of non core food products (2.7 percent) and fuels (2.8 percent) accounting mainly for this rate. Accumulated core inflation between January and February showed a rate of 0.4 percent which is associated mainly with the rise in the prices of health care (1.0 percent) and meals outside the home (1.1 percent).

TABLE 30
INFLATION
(% change)

	Weight 2009=100	2006	2007	2008	2009	2010	2011 Jan.-Feb.	2011 12 month
I. INFLATION	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.08**	**0.77**	**2.23**
II. CORE INFLATION	**65.2**	**1.37**	**3.11**	**5.56**	**2.35**	**2.12**	**0.40**	**2.14**
Goods	32.9	0.97	3.30	5.32	2.17	1.53	0.27	1.30
Services	32.2	1.85	2.88	5.86	2.56	2.72	0.53	2.99
III. NON CORE INFLATION	**34.8**	**0.83**	**5.07**	**8.11**	**-2.54**	**2.00**	**1.48**	**2.42**
Foods	14.8	2.06	7.25	10.97	-1.41	1.18	2.74	1.98
Fuels	2.8	-1.50	6.45	-0.04	-12.66	12.21	2.77	11.42
Transportation	8.9	1.12	0.82	5.86	0.19	1.94	-0.79	1.76
Public services	8.4	-3.22	0.24	7.48	-4.56	0.01	1.24	0.73
Memo:								
CPI without food and energy	56.4	1.28	1.49	4.25	1.71	1.38	0.13	1.57

TABLE 31
INFLATION
(% change)

	Weight 2009=100	2006	2007	2008	2009	2010	2011 Jan.-Feb.	2011 12 month
I. IPC	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.08**	**0.77**	**2.23**
II. CORE INFLATION	**65.2**	**0.79**	**1.80**	**3.20**	**1.34**	**1.38**	**0.26**	**1.39**
Goods	32.9	0.31	1.05	1.69	0.68	0.50	0.09	0.43
Services	32.2	0.48	0.75	1.52	0.66	0.88	0.17	0.96
III. NON-CORE INFLATION	**34.8**	**0.35**	**2.13**	**3.44**	**-1.09**	**0.69**	**0.51**	**0.84**
Food	14.8	0.48	1.69	2.63	-0.35	0.17	0.40	0.30
Fuel	2.8	-0.09	0.36	0.00	-0.68	0.34	0.09	0.33
Transportation	8.9	0.10	0.07	0.51	0.03	0.17	-0.07	0.16
Utilities	8.4	-0.14	0.01	0.30	-0.09	0.00	0.10	0.06
Memo:								
CPI without food and beverages, and energy	56.4	0.58	0.67	1.88	0.74	0.78	0.07	0.88

86. The items that contributed most to inflation in the first two months of the year were poultry, meals outside the home, citrus fruit, gasoline, papaya, and edible oils. On the other hand, the items that contributed most to reduce inflation were fish, national transportation, hot pepper, spices and seasonings, and purchases of vehicles.

TABLE 32
WEIGHTED CONTRIBUTION TO INFLATION 2010

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Meals outside the home	11.7	3.9	0.47	Poultry	3.0	-14.2	-0.44
Education (fees and tuition)	8.8	3.5	0.31	Telephone rates	2.9	-3.8	-0.11
Gasoline and oil	1.3	16.4	0.22	Eggs	0.6	-6.4	-0.03
Sugar	0.5	25.1	0.16	Cleaning items	0.9	-2.8	-0.03
Urban fares	8.5	1.8	0.15	Recreation and cultural items	0.9	-2.5	-0.02
Gas	1.4	8.8	0.12	Corn	0.1	-13.0	-0.02
Fresh and frozen fish	0.7	15.7	0.12	Chicken giblets and others	0.1	-10.7	-0.02
Potatoes	0.9	11.2	0.09	Onion	0.4	-5.8	-0.01
Water consumption	1.6	4.5	0.07	Fresh vegetables	0.2	-5.9	-0.01
Garmets for men and kids from 12 year old	1.5	4.5	0.07	Tomato	0.2	-5.4	-0.01
Total			**1.78**	**Total**			**-0.70**

TABLE 33
WEIGHTED CONTRIBUTION TO INFLATION: JANUARY - FEBRUARY 2011

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Poultry	3.0	6.0	0.16	Fresh and frozen fish	0.7	-11.5	-0.10
Meals outside the home	11.7	1.1	0.13	National transportation	0.3	-11.6	-0.05
Citrics	0.5	15.6	0.10	Chili pepper	0.1	-35.7	-0.03
Gasoline and oil	1.3	4.8	0.07	Spices and seasoners	0.5	-5.4	-0.03
Papaya	0.2	38.6	0.06	Vehicle purchases	1.6	-1.9	-0.03
Edible oils	0.5	10.9	0.05	Grapes	0.1	-18.5	-0.03
Water consumption	1.6	3.1	0.05	Urban fares	8.5	-0.3	-0.02
Bread	1.9	2.7	0.05	Peaches	0.1	-19.7	-0.02
Fresh vegetables	0.2	21.8	0.05	Avocado	0.1	-12.4	-0.02
Electricity	2.9	1.7	0.05	Apple	0.2	-7.0	-0.02
Total			**0.77**	**Total**			**-0.35**

TABLE 34
WEIGHTED CONTRIBUTION TO INFLATION: MARCH 2010 - FEBRUARY 2011

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	CContribution
Meals outside the home	11.7	4.3	0.51	Poultry	3.0	-8.3	-0.26
Education (fees and tuition)	8.8	3.5	0.31	Telephones	2.9	-3.8	-0.11
Gasoline and oil	1.3	16.5	0.23	Fresh Vegetables	0.2	-23.5	-0.08
Citrics	0.5	36.0	0.20	Fresh and frozen fish	0.7	-5.6	-0.05
Urban fares	8.5	1.7	0.14	Eggs	0.6	-8.6	-0.04
Sugar	0.5	20.8	0.14	Spices and seasoners	0.5	-7.4	-0.04
Water consumption	1.6	7.8	0.13	Other vegetables	0.4	-7.1	-0.03
Gas	1.4	7.1	0.10	Vehicle purchases	1.6	-2.0	-0.03
Garmets for men and kids from 12 year old	1.5	5.3	0.08	Garlic	0.1	-21.4	-0.02
Bread	1.9	3.7	0.07	Cleaning items	0.9	-2.4	-0.02
Total			**1.91**	**Total**			**-0.68**

Poultry

87. A higher supply than the one recorded in 2009 was observed in 2010, which reflected in a 7 percent increase in placements of baby chickens. Sales in Metropolitan Lima's distribution centers increased from 500 thousand units/day in 2009 to 539 thousand units/day in 2010 (8 percent). This high level of supply contributed to reduce prices by 14 percent.

However, between December 2009 and December 2010, the international price of maize –the main input in this industry– rose from US$ 140.8 to US$ 221.4 a ton.

More recently, the placements of baby chickens in the last two weeks of February have declined 5 percent compared to the ones recorded in January. The higher production costs and the lower number of placements have resulted in a 6 percent rise in the consumer price in the January-February 2011 period.

Meals outside the home

88. Showing a higher increase than the one observed in the CPI (2.08 percent) and in the item of food and beverage consumption at home (1.6 percent), inflation in meals outside the home rose 3.9 percent in 2010, a result associated with the increased dynamism of domestic demand. In the first two months of 2011, this item grew 1.1 percent. This item ranks second in terms of higher weighed contribution to inflation, after poultry.

Gasoline and lubricants

89. The 16.4 percent increase in gasoline and lubricants CPI observed in 2010 reflected the rise in the international price of crude and the revision of price bands in the Fuel Price Stabilization Fund. The contract price of Texas Intermediate Oil (WTI oil) recorded an average value of US$ 89.2/barrel in December 2010, which represented a recovery in this price relative to the price at end 2009 (US$ 74.3 in December 2009) and in 2008 (US$ 41.4 in December 2008). In January and February 2011 the average price of WTI oil was US$ 88.54/barrel.

    The rise registered so far this year (4.8 percent) reflects the price rise implemented by refineries in the frame of the provisions of decree 083-2010 (Decreto de Urgencia N°083-2010), which extends the operation of the Fuel Price Stabilization Fund and authorizes an adjustment of 7 percent in fuel end prices if parity prices are 15 percent higher than the upper band or the lower band. This measure was rescinded in February (Decreto de Urgencia 009-2011).

Electricity

90. The rise of 1.4 percent registered in energy prices in 2010 reflects the rises established by OSINERGMIN mainly in the months of February and November with the purpose of updating the costs of electricity generation, transmission and distribution, which were affected by the rises in the prices of fuels and metals, such as aluminium and copper. These rises were offset by the price reduction of May (2.8 percent) resulting from the update of the toll on the transportation of natural gas and the elimination of the unit charge on generation.

TABLE 35
ELECTRIC TARIFFS
(Annual % change)

	2008	2009	2010	2011			
				Jan.	Feb.	Acumm.	12 months
Electric tariffs	6.3	-4.6	1.4	4.6	-2.8	1.7	1.5

Source: INEI.

Electricity rates increased 1.7 percent in the first two months of 2011. The rise in these rates in January (4.6 percent) was due to the generation price increase established in the contracts resulting from tenders (rise in fuel prices). An adjustment was also observed in distribution rates due to the higher prices of aluminum and copper.

This rise was offset by the rate reduction of February (2.8 percent) associated with the generation price update that OSINERGMIN carries out every three months. Generation costs, the main component of this rate, include the prices of power, electricity prices for on-peak hours, and electricity prices for off-peak hours. The reduction of additional generation charges included in the main transmission grid also contributed to this rate reduction.

Edible oil, bread and sugar

91. The rise in the price of **edible oils** was associated with the increase in the price of soybean oil –the main input used to produce oils–, whose international price rose from US$ 810.0/ton in December 2009 to US$ 1,139.4/ton in December 2010, while the rise in the price of **bread** was associated with the rise in the price of flour elaborated using imported wheat, whose price increased 60.6 percent between December 2009 and December 2010.

Moreover, the rise in the price of **sugar** (25.1 percent) was associated with the rise of its international price, which went from US$ 557.4 to US$ 779 por TM between December 2009 and 2010 due to lower global supply and to India's higher imports. Another factor that contributed to the rise in the price of sugar was the lower local production of sugar cane (2.8 percent) resulting mainly from climatic problems and strikes.

The 2.8 percent rise observed in this price in January was associated with the evolution of the international price of sugar, which rose from US$ 557.4/ton in December 2009 to US$ 798.2/ton in December 2010 and declined slightly to US$ 787.2/ton in January 2011.

Expectations

92. Compared to our last Report, an increase is observed in the **rate of inflation** expected this year by economic analysts and banks (up from 2.5 to 3.0 percent), while non financial firms estimate the same inflation rate as in our last Report. On the other hand, the expected rate of inflation in 2012 remains at 2.5 percent in the three groups. It is worth pointing out that all the forecasts fall within the target range.

TABLE 36
SURVEY ON MACROECONOMIC EXPECTATIONS INFLATION (%)

	RI Sep.10	RI Dec.10	RI Mar.11
FINANCIAL ENTITIES			
2011	2.5	2.5	3.0
2012	2.5	2.5	2.5
ECONOMIC ANALYSTS			
2011	2.4	2.5	3.0
2012	2.0	2.5	2.5
NON-FINANCIAL FIRMS			
2011	2.5	2.5	2.5
2012	2.5	2.5	2.5

The rise in the international prices of commodities has also implied an upward revision in the expected prices of inputs in the next 3 months. This index now records 69 points, a lower level than the one observed in 2008. A similar situation is observed in the case of the expected prices of end goods, given that a higher cost in inputs would translate later into a higher price in end goods.

Graph 87
AVERAGE PRICE EXPECTATIONS INPUTS TO 3 MONTHS
Manufacturing sector

Graph 86
AVERAGE PRICE EXPECTATIONS INPUTS TO 3 MONTHS
Manufacturing sector

Inflation forecast

93. The evolution of inflation since our last Report has been in line with the forecasts included therein. Inflation has remained within the target range, reaching a level of 2.2 percent in February. The revision and update of data on the main factors that would affect the rate of inflation during the next months indicates that inflation would remain near the upper band of the target range by end 2011, returning to the target level in 2012. This would be reflecting the impact of the higher food and fuel prices on non core inflation, the evolution of the output gap, and inflation expectations anchored within the target range.

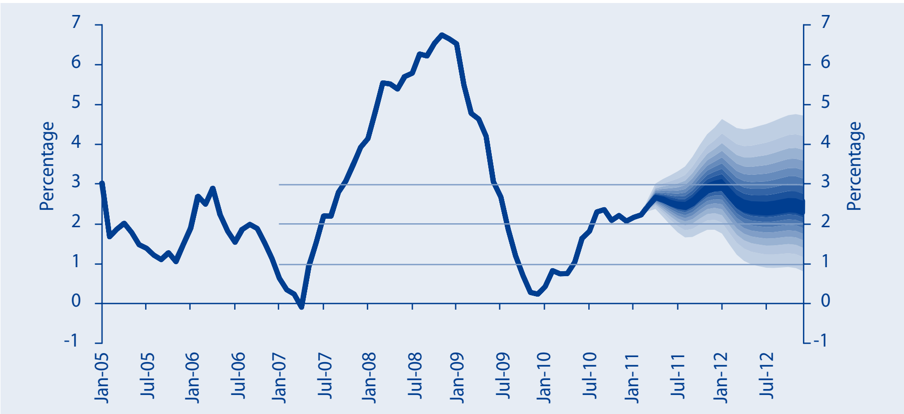
94. The baseline forecast scenario considers that the evolution of the output gap would be influenced by high terms of trade and by fiscal policy, the latter being offset by the withdrawal of monetary stimulus. Thus, the output gap is expected to go from a nil level in 2010 to an average level of between 0 and 1.0 percent in 2011 and to return to a neutral position in 2012.

    Inflation expectations would remain within the target range over the entire forecast horizon, which would contribute to contain the possible second round effects of the international prices of food and fuels together with the withdrawal of monetary stimulus.

95. In line with the evolution of its determinants, core inflation would increase slightly during 2011, but would remain within the target range during the forecast horizon, converging thereafter towards the 2 percent level by end 2012.

96. Non core inflation would reach a rate above the target range in 2011 reflecting the impact of the rise in the international prices of oil and food observed in the last months. The forecast also considers the effects that climatic conditions may have on the yields of some agricultural products. Non core inflation would fall around the inflation target in 2012 once the conditions in the global food supply normalize.

Graph 88
INFLATION FORECAST
(12-month % change)



97. The **forecast on GDP growth** in 2011 is revised on the upside to 7.0 percent. In 2012 GDP would grow around 6.5 percent –figure close to the country's potential growth–, which would contribute to maintain inflation within the target range during these years.

Graph 89
FORECAST GDP GROWTH
(Annual % change of GDP in each quarter)

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

VII. Balance of Risks

98. The inflation forecast shows a **balance of risks on the upside**, with a higher probability that inflation will fall above the level considered in the baseline scenario.

99. Three risk sources that could affect inflation in the forecast horizon were considered in our Inflation Report of December. Even though only part of these risks have materialized in recent months, these risks are now perceived as factors that could cause inflation to divert from the central forecast scenario. The main risks are:

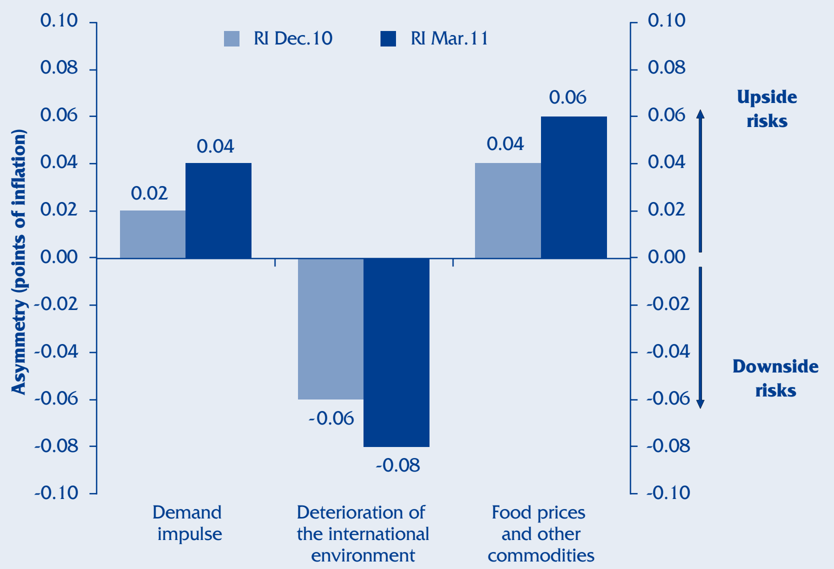
- **Imported inflation associated with food and energy prices.** The recent evolution of the price of food commodities and fuel shows that the probability of having higher prices in the future has increased. In this scenario, the Central Bank would adjust its monetary position more rapidly if the possible increase of imported inflation affects inflation expectations.

- **Dynamism in the domestic economy.** Together with the high GDP growth rates recorded during 2010, increased optimism due to recent data of indicators of production could result in a higher output gap than the one considered in the central scenario. Because this would generate demand pressures, in this scenario the monetary policy position would be adjusted more rapidly.

- **Uncertainty about the evolution of the global economy.** The baseline scenario considers the recovery of global economic activity, which would contribute to sustain favorable levels of terms of trade in the Peruvian economy. In addition to the risk factors pointed out in our December Report – fiscal sustainability in some Eurozone countries and the possibility of a higher slowdown in China–, now there is also the risk of a rise in the international prices of food and oil due to the recent conflicts in some countries in North Africa and the Middle East and also due to uncertainty about the impact of the earthquake in Japan. This contingent international context would imply a slowdown in the growth of the domestic economy and higher volatility in financial markets.

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

Graph 90
INFLATION FORECAST: BALANCE OF RISKS
(2 year-ahead inflation deviations in % points)



Memo: This graph shows changes in risk perception compared with the prior Inflation Report December 2010. The size and sign of bars show the asymmetry of each risk factor in the distribution of the inflation forecast.

CONCLUSION

100. The recent evolution of inflation does not provide evidence of the existence of demand pressures yet. Nonetheless, the recent evolution of international food and fuel prices has increased the probability that inflation may fall above the forecast in the baseline scenario compared with our last Inflation Report. Inflation expectations that remain anchored within the target range and the adjustment of the monetary position will contribute to maintain inflation within the target range over the forecast horizon.