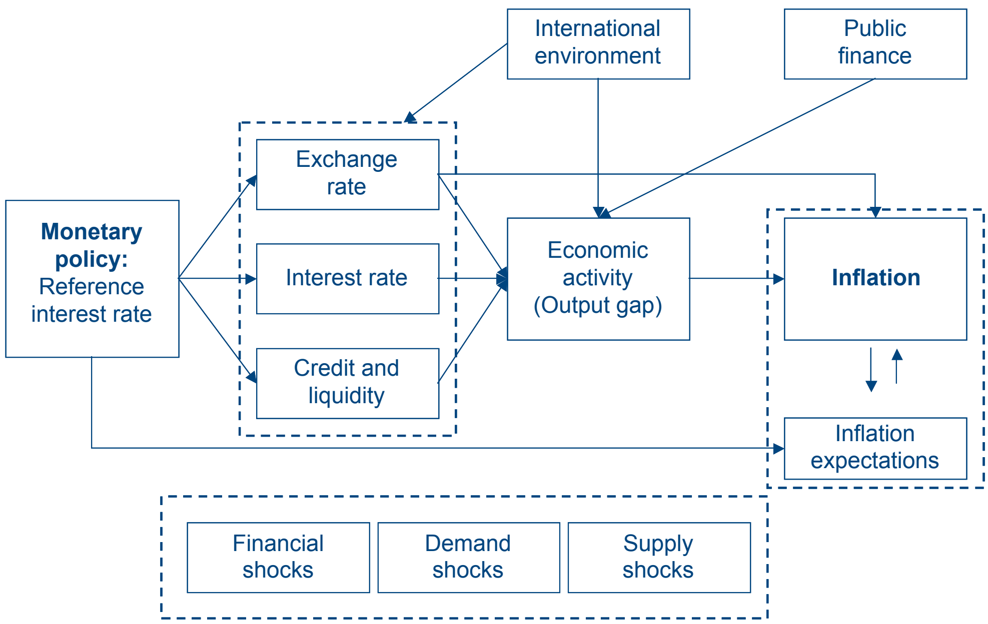
INFLATION REPORT:

Recent trends and macroeconomics forecasts 2009-2011

September 2009



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CENTRAL RESERVE BANK OF PERU

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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 July 2009, and data on monetary accounts, inflation, exchange rate, and financial markets as of August 2009.

Foreword

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

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

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

- Each month, and according to a previously announced schedule, the Board of the BCRP approves a reference rate for the interbank lending market. This interest rate affects the entire array of domestic economic variables and inflation through several channels in different timeframes and, therefore, this rate has to be determined on the basis of macroeconomic forecasts and simulations.

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

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

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

Summary

i. Recent indicators on economic activity and international financial markets would be indicating that the recovery phase of the global economy has started, which implies that the negative contribution of the cycle of inventory adjustments would have ended and that fiscal and monetary stimulus policies would have started reactivating the demand component. Given that the international crisis originated in solvency problems in the financial system of developed countries, the recovery of these economies is expected to be gradual.

   Slightly positive results in terms of growth in economies like Germany, France and Japan in Q2; the improvement of leading indicators of manufacturing and expectations about the future growth of the global economy, and the recovery of some trade flows and commodity prices would be reflecting the higher growth expected to occur in the second half of the year. On the side of financial markets, the strong injections of liquidity and the reduction of interest rates have achieved to stabilize money markets and reduce risk aversion, contributing also to improve access to capital markets and to generate a still slow normalization of credit conditions.

   In this context, global GDP is expected to fall 1.3 percent, in line with the projections of our June Report. A faster recovery is expected for 2010 and 2011 with growth rates of 3.0 and 3.7 percent, respectively.

ii. As pointed out in our June Report, the evolution of economic activity in our country during this year was associated with the dynamics of stock adjustments to the new levels desired by firms, to the recovery of global economic activity, and to the effect of domestic macroeconomic stimulus policies on demand. Indicators in the first semester show that both the correction of the inventory cycle and the slowdown of the global economy have been stronger than expected.

   Another factor that affected the evolution of economic activity in the first half of the year was a more negative evolution of private investment due to the re-profiling of the horizon of several investment projects. Likewise, the growth of public investment in the first semester was lower than expected. An acceleration of this variable is projected in the second half of the year.

   Considering these elements, the forecast on GDP growth for 2009 has been revised from 3.3 to 1.8 percent. A more pronounced recovery as from Q4 would be expected considering that the destocking cycle would have ended and that the impulse of domestic stimulus policies and external recovery should

start having positive effects on domestic demand. The expansion phase should continue during 2010 and 2011, with growth rates of 5.0 and 5.2 percent, respectively. This baseline scenario considers the occurrence of a mild Niño event.

iii. Inflation returned to the target range in July in a context of a weak economic cycle, lower inflation expectations, lower imported inflation, and the reversal of supply shocks in food prices. Thus, accumulated inflation in the last 12 months fell from 6.7 percent in December 2008 to 1.9 percent in August 2009. This declining dynamism of inflation would continue until early 2010, mainly due to transitory supply factors, and inflation would transitorily fall below the lower band of the target range between end 2009 and the first months of 2010.

    Except for the above mentioned short period, the inflation forecast in the 2009-2011 forecast horizon falls within the target range, considering the following evolution of inflation determinants: a) a moderate rise of imported inflation in line with improved expectations about the recovery of global economic activity, b) the positive effect on fiscal and monetary stimulus policies to sustain the growth of economic activity, and c) inflation expectations anchored to the target. This forecast is consistent with an evolution of economic activity in line with the potential output in the 2010-2011 forecast horizon.

iv. Since the publication of our June Report, the Central Bank has continued loosening its monetary policy stance by implementing additional reductions in the reference interest rate, maintaining in this way the monetary stimulus implemented in Q4-08 when, because of the international financial crisis, the BCRP reduced the rates of reserve requirements, introduced new monetary instruments, and extended the terms of other instruments in order to inject liquidity to the market. Since July, the reference interest rate has been reduced by 175 basis points, from 6.5 percent in February to the current rate of 1.25 percent.

    These monetary policy actions have allowed providing a greater availability of financing to private sector firms, generating downward pressures on the short and long-term interest rates –in a context of declining inflation– in order that the impulse on private spending may lead to the reversal of the weak economic cycle.

    Since the Peruvian economy has started showing some signals of recovery as a result of the high economic stimulus achieved, the Central Bank has announced in its last Monetary Policy Communiqués that no additional adjustments will be made in the reference interest rate unless important modifications are observed in inflation forecasts or in inflation determinants.

v. In this context of international financial crisis, the balance of payments has not been a risk factor as sustainable levels of deficit have been maintained together with important capital inflows oriented to finance productive activity, as well as with an appropriate level of international reserves at the Central Bank. The Central Bank has not intervened in the foreign exchange market since May. Year-to-date, international reserves have increased from a balance of US$ 31,196 million at end 2008 to a balance of US$ 31,955 million in August.

   The downward revision of the forecast on the deficit in the current account of the balance of payments from 3.2 to 2.1 percent for this year is based on both the improvement of terms of trade observed since Q2, especially in terms of exports, and on the low dynamism of domestic demand which has led to a higher than expected contraction of imports. Considering the result of the first semester (-0.8 percent), the forecast considers a recovery of imports towards the last months of the year, which is consistent with the impulse expected on the side of domestic demand. The forecast of the current account deficit for 2010 and 2011 has also been revised downwards to 2.4 and 2.5 percent, respectively (versus 3.1 and 2.6 percent according to our June Report) considering the faster recovery of the global economy of this forecast scenario and the better prices of our exports.

vi. The scenario of recovery in the second half of the year considers that the government will continue implementing measures to boost domestic demand through a more active expenditure policy, intensifying in this way the fiscal stimulus executed during the first half of the year. The projection on the fiscal deficit for this year has been revised from 1.8 to 2.0 percent due to lower tax revenue and higher current expenditure. The projected deficit for the next years has also been revised downwards (to 1.6 and 1.2 percent for 2010 and 2011, respectively) considering the better prospects for the prices of exports.

vii. Given the economic context, the forecasts are still subject to a high level of uncertainty. The main risks that could divert inflation from the central scenario forecasts include the risks discussed in our previous report, as well as the additional risk of having lower prices in terms of domestic foodstuffs:

   - **Increased deterioration of the global economy.** The baseline scenario considers a scenario where the global economy starts recovering. However, there is the risk of having a slower recovery or even a setback in this recovery. This risk would imply lower economic growth and lower inflation rates than the one considered in the baseline scenario.

     In this risk scenario, the monetary policy stance would be more flexible than the one considered in the baseline scenario. These actions would continue being complemented by monetary operations to facilitate a rapid pass-through to interest rates and maintain an appropriate liquidity position in both currencies. In case that the contingent scenario of international deterioration were coupled by excessive upward volatility in the exchange rate, the BCRP has ample international reserves to face this contingency and prevent the deterioration of the asset position of firms and the financial system.

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

  In this situation, monetary policy would maintain its countercyclical monetary stimulus stance for a longer period of time.

- **Lower prices of domestic foodstuffs.** A significant correction in the prices of foodstuffs due to the lower prices of imported food inputs and better conditions in the domestic supply of food has been observed so far this year. A lower level of prices in the forecast horizon than the one considered in the baseline scenario could imply that inflation remains for a longer period of time below the target range.

  In the same way as happened in the two previous years, when the prices of food increased, the Central Bank will not respond to transitory supply shocks, unless these may affect inflation expectations in an undesired manner.

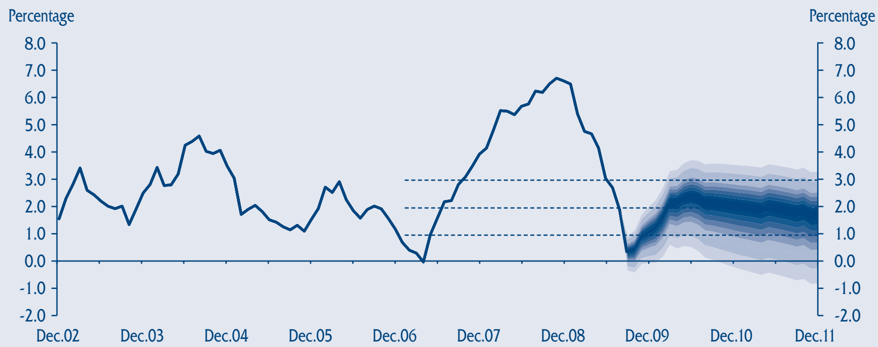
- **Constraints in energy supply.** The supply of electricity continues to be close to the limit of its potential capacity, which increases the probabilities of failures in this service. Additionally, climatic conditions could aggravate the balance between the supply and the demand of electric energy,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

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

viii. The risks associated with constraints in energy supply and higher prices of food commodities and crude are more inclined towards the optimistic side. On the other side, the risks associated with the deterioration of the world economy and lower domestic spending remain. Finally, a new risk has been included: the downward trend in the prices of domestic foodstuffs.

ix. Weighing the above mentioned risks against the baseline scenario shows a downward bias for the central inflation forecast, in contrast with our June Report, which showed a neutral balance.

INFLATION FORECAST
(12-month % change)



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

I. International Environment

1. After showing a severe deterioration in the first months of the year, global economic and financial activity are showing signs of stabilization and, in many cases, of improvement. This has increased expectations of a relatively rapid recovery of the world economy in the second half of the year, and would imply that the process of overcoming the greatest recession of the last 60 years has begun. In the particular case of the U.S., expectations point also to a recovery after a recession that, at August, had already prolonged itself for 20 months[1].

   These favorable prospects have generated lower risk aversion in the fixed and variable income markets, an improvement in the prices of commodities and terms of trade, and a depreciation of the dollar against the rest of currencies.

   However, this recovery still faces some potential risks. On the one hand, an important part of recent growth is due to the reversal of the destocking cycle and to the impact of monetary and fiscal stimulus, both of which are factors of a temporary nature which should be followed by a recovery of consumption (currently affected by high unemployment and high levels of indebtedness) and private investment. On the other hand, credit conditions are showing a slower pace of normalization in the main developed economies due, among other factors, to uncertainty about the treatment of banks' toxic assets.

Global growth

2. After a concurrent and unprecedented drop of the world economy in Q4-08 and in the first half of 2009, the global economy has started showing signs of a recovery since Q3-09[2]. It is estimated that this recovery would continue along 2009 and over the next two years.

   Global GDP is estimated to have fallen approximately between 2 and 3 percent in the first half of the year. Although developed economies have performed worse, the downward revision of growth rates in emerging economies has been significant.

   This drop in the first half of the year would counterbalance better market expectations in the rest of the year and, therefore, the projected drop of global GDP in 2009 would still be 1.3 percent, as pointed out in our June Report. A

1 The NBER shows that the peak of the last expansion cycle was in December 2007.

2 Some countries like France, Germany and Japan have already recorded growth since Q2-09.

generalized improvement in the growth outlook for 2010 and 2011 is estimated: the growth rates for those years have been revised upwards to 3.0 and 3.7 percent compared to our previous Report.

TABLE 1
WORLD ECONOMIC GROWTH
(Annual % change)

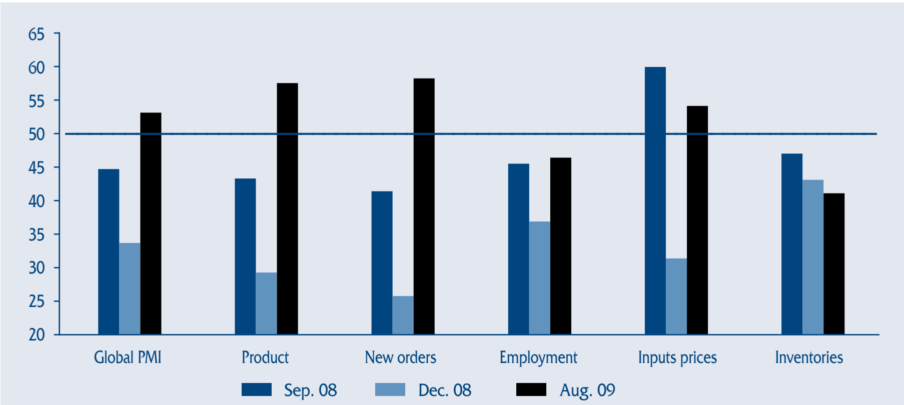
	2007	2008	2009		2010		2011	
			IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09
Developed countries	**2.7**	**0.5**	**-3.7**	**-3.4**	**1.0**	**1.7**	**2.2**	**2.3**
1. USA	2.1	0.4	-3.0	-2.7	1.5	2.2	2.6	2.9
2. Eurozone	2.7	0.6	-3.8	-3.9	0.1	0.9	1.4	1.5
3. Japan	2.4	-0.7	-6.3	-5.5	0.8	1.5	1.6	1.6
4. United Kingdom	3.0	0.7	-4.0	-4.4	0.3	1.2	1.9	1.9
5. Canada	2.7	0.4	-2.5	-2.3	1.9	2.1	3.3	3.3
6. Other developed countries	4.7	1.6	-3.3	-2.5	1.9	2.3	3.0	3.0
Developing countries	8.3	**5.9**	**1.8**	**1.6**	**4.5**	**4.7**	**5.5**	**5.5**
1. Africa	6.2	5.3	2.0	1.6	3.9	4.1	5.2	5.2
2. Central and Eastern Europe	5.4	2.9	-3.4	-4.2	1.4	1.7	3.8	3.8
3. Community of Independent Countries	8.6	5.5	-4.6	-6.4	2.7	2.1	3.8	3.9
Russia	8.1	5.6	-5.2	-7.2	2.7	1.5	3.4	3.5
4. Developing Asia	10.6	7.5	5.3	5.9	6.7	6.9	7.3	7.3
China	13.0	9.0	7.3	8.0	8.4	8.5	9.0	9.0
India	9.3	6.7	4.9	5.8	5.6	6.0	6.0	6.0
5. Middle East	6.3	5.2	2.5	2.2	3.5	3.7	4.1	4.1
6. Latin America and the Caribbean	5.7	4.1	-1.6	-2.5	2.2	2.7	3.5	3.5
Brazil	5.4	5.1	-1.0	-0.9	2.9	3.4	3.0	3.0
World Economy	5.2	**2.9**	**-1.3**	**-1.3**	**2.5**	**3.0**	**3.6**	**3.7**
Memo:								
BRICs	10.5	**7.5**	**3.8**	**4.1**	**6.2**	**6.2**	**6.7**	**6.7**
Peru's trading partners	4.7	**2.6**	**-1.7**	**-1.7**	**2.2**	**2.7**	**3.3**	**3.4**

IR: Inflation Report.
* Forecast.

3. The favorable outlook for growth as from the second semester is based on the maintenance of the positive trend of some indicators pointed out in our June Report. First of all, the leading indicator of industrial activity Purchasing Managers Index (PMI) has continued recovering. After reaching its lowest level in December 2008 (33.7), global PMI global has increased for 8 consecutive months to show, for the first time, an expansion of the manufacturing sector in August (53.1). This increase has been the greatest observed since June 2007. In terms of countries, the recovery has been practically generalized. It should be pointed out, however, that the components of global PMI showing the highest recovery are those associated with production and investment, which show levels are even higher than those recorded in September 2008, when the crisis deepened.

Graph 1
J.P. MORGAN: GLOBAL MANUFACTURING PMI
(November 2003 - August 2009)

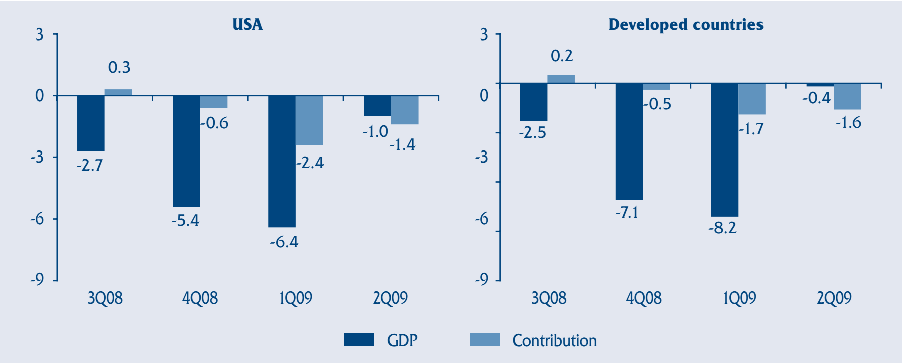
Graph 2
GLOBAL PMI AND ITS COMPONENTS
(Index)



Source: J.P. Morgan.

In the same sense, the recent evolution and favorable prospects are reflected in the change of expectations about the global economic outlook. A series of factors support this improvement in the outlook on growth. A first factor contributing to this is the significant monetary and strong fiscal impulse implemented not only by the main developed economies, but also by an important group of emerging economies, with China's fiscal package outstanding in terms the latter due to its importance and magnitude. Second, the expectation is that the negative contribution of the inventory cycle would be coming to an end. Even though the data at Q2 still show a negative contribution, it is much lower than the one recorded in the previous quarters.

Graph 3
CONTRIBUTION OF INVENTORY ADJUSTMENT TO GDP GROWTH
(Seasonally-adjusted annual rate, %)



4. Growth rates in **developed economies** in the first semester have been negative by approximately 3.0 - 4.0 percent, although favorable prospects for the next quarters are observed.

   In addition to the interest rate cuts and non conventional monetary policy measures implemented, the gradual recovery of confidence and the fiscal packages adopted particularly in the U.S., the Eurozone (Germany and France) and Japan, have had a significant impact on the industrial sector (especially in the automobile sector) in recent months, affecting activity in emerging economies. However, employment indicators –particularly in the U.S.– still do not show clear signs of improvement, which would be influencing the absence of vigor that consumption continues to show at the global level, despite the fact that it would have already stabilized.

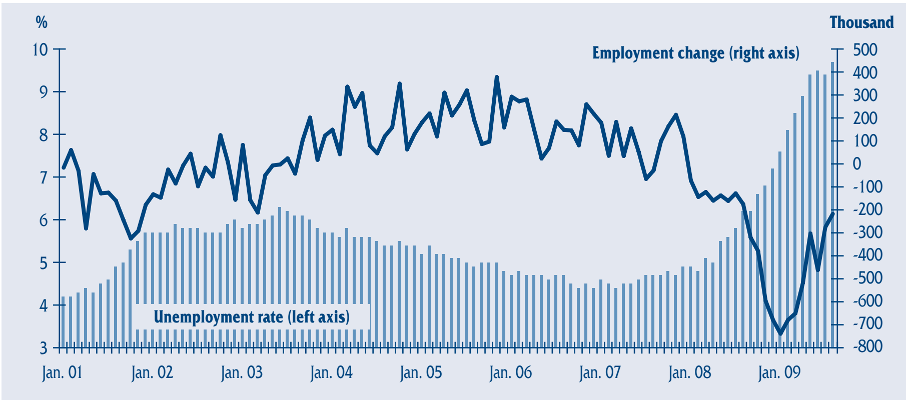
TABLE 2
GDP: EXECUTED FIRST SEMESTER 2009
(Annual % Seasonally-adjusted)

	1Q09	2Q09	1S09
USA	-6.4	-1.0	-2.1
Eurozone	-9.5	-0.5	-2.7
Germany	-13.4	1.3	-2.9
France	-5.3	1.3	-0.7
United Kingdom	-9.3	-2.6	-3.7
Japan	-15.2	2.3	-2.9

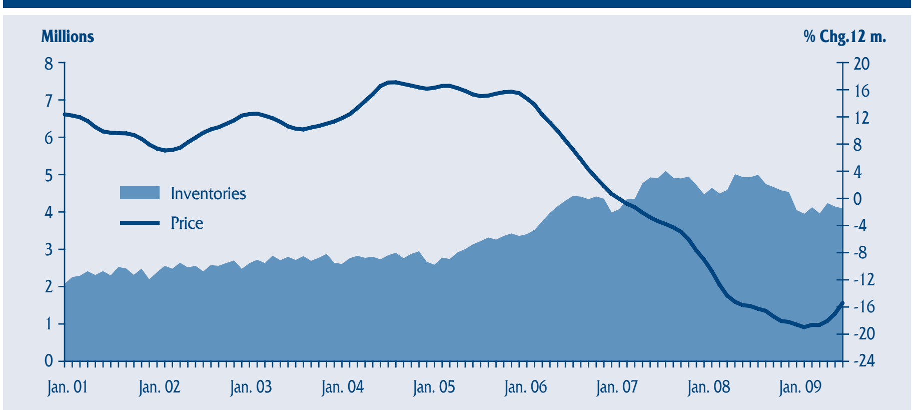
5. In the **U.S.**, the contraction of investment and destocking would have reached their lowest level in Q2 (when GDP fell 1 percent). It is estimated that GDP components other than consumption would lead recovery in the second semester.

The weak recovery of consumption would be explained by the impact of the crisis on families' wealth (drop of house prices and stock market losses) and by high unemployment (9.7 percent in August, a level unseen since 1983). The labor market has shown some signs of stabilization, but conditions in this market are still not sufficiently decisive to dynamize consumption significantly (consumption accounts for nearly two third parts of GDP). This is reflected, for example, in the volatility of retail sales.

Graph 4
USA: EMPLOYMENT (MONTHLY CHANGE IN THOUSANDS) AND UNEMPLOYMENT (%)



Graph 5
REAL STATE MARKET: PRICE AND INVENTORIES



6. In the **Eurozone,** where fiscal impulse has been especially significant given the relative weight of the public sector and the existence of automatic stabilizers, a slight global contraction was recorded in Q2 but with a slight growth of GDP in Germany and France. The recovery of the Eurozone would be led by these economies and by a higher contribution of net exports. In the **United Kingdom**,

where non conventional monetary stimulus was implemented with some delay, the results in the first semester have been worse than expected, basically due to the service sector (the main GDP component) and by the contraction of consumption (which represents over 70 percent of expenditure). However, activity in the last months has shown signs of stabilization and improvement. On the other hand, like Oceania, the most developed Asian economies (Japan and Korea) are largely benefiting from the higher recovery of demand in China.

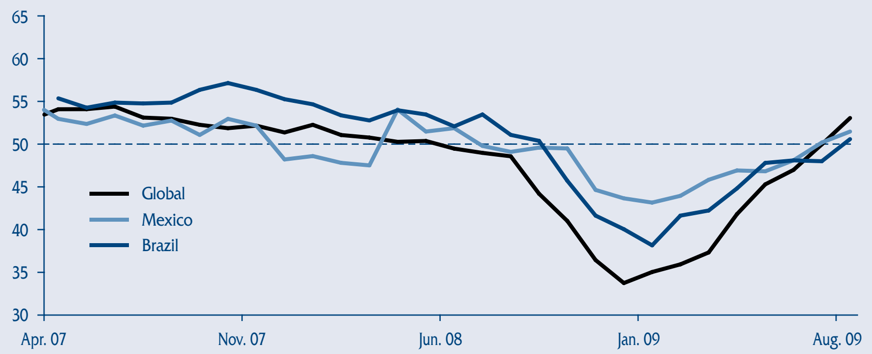
7. The best performance of global economic activity is being led by **emerging economies**, particularly by Asian emerging economies, after the drastic drop of GDP observed in the most open economies of the region in the first semester. These economies have been favored by the recovery of international trade.

   After the implementation of the fiscal and monetary stimulus plans to face the crisis, **China** recorded growth rates of 6.1 and 7.9 percent in Q1 and Q2, respectively. These policies could have resulted in an excessive growth of credit (23 percent in June 2009 relative to June 2008), which can generate a speculative bubble in the real estate sector or in the stock market. Therefore, the authorities have decided to constrain the growth of credit and have not implemented a second fiscal package (to prevent overheating and price bubbles in assets). In this context, the growth of domestic demand would moderate, partially compensating the expected recovery of exports. However, China would continue leading global growth and the demand for raw materials.

   Supported by the financial aid packages of multilateral organizations and by increased demand in the Eurozone, the economies of **European emerging** countries would stabilize, even though their recovery is expected to be slower due to their higher vulnerability. The economies of Central and Eastern Europe, which show a recessive scenario and a sharp drop this year, are expected to perform at lower levels than Asian emerging countries and Latin America. Common factors to these countries include a contraction of exports and a lower flow of capitals to the region. The recovery of these economies depends on the performance of Western Europe, the most important market for their exports (two thirds of total exports), as well as on the largest source of financial investment. However, the IMF has contributed to buffer the impact of the crisis through its financial aid programs. Latvia, Hungary, Romania, and Serbia have received financing, while Poland has received a contingent loan (Flexible Credit Line), which is provided to countries with sound macro economic fundamentals.

   After showing its greatest drop in the first semester, **Latin America** would be going into a recovery stage supported by increased global trade and by the higher prices of commodities. Consumption would also be showing a recovery, particularly in Brazil, as a result of fiscal support and the expansion of credit operations led by public banks. On the other hand, Mexico, whose economy highly depends on the U.S. cycle, would benefit from the improvement of the car industry and from the better prospects in the U.S.

Graph 6
MANUFACTURING PURCHASING MANAGERS INDEX (PMI)



Source: Bloomberg.

Graph 7
REUTERS COMMODITIES INDEX CRB (COMMODITY RESEARCH BUREAU)

Source: Reuters.

Financial markets

8. Financial conditions in international markets have improved significantly so far this year and particularly in Q2.

The money market has rapidly stabilized, supported by the significant injections of liquidity carried out by central banks. This is reflected in the higher yield on U.S. Treasury bonds, as evidenced by the TED spread indicator (which measures the spread between the 3-month Libor and the yield on Treasuries with the same maturity term), which has returned to levels similar to the ones recorded before the bankruptcy of Lehman Brothers. Risk aversion, measured by the VIX index (Chicago Board Options Exchange Volatility Index), which has also fallen significantly, shows a similar evolution.

Graph 8
TED SPREAD 1/

1/ It measures the differential between the 3 months LIBOR rate and the yield on the Treasury the same period.
Source: Bloomberg.

9. Progress has been made in the process of stabilization of the banking system in the main economies due to the different measures implemented by governments and better economic prospects. This has been coupled by important capital injections and has reflected in the financial statements of the banking system which were better than expected in Q2. However, there are no signs of a clear solution in terms of banks' toxic assets in the short term.

The strong intervention of central banks in markets through unconventional monetary policies, or quantitative easing, has positively contributed to reduce long term interest rates. Among the main developments in the last months, it is worth mentioning that the Bank of England (BoE) increased its bond purchase program by £ 50 billion (to a total of £ 175 billion). Likewise, as part of its program to purchase assets for a total of US$ 1.75 trillion (US$ 300 billion in Treasury bonds and US$ 1.45 trillion in agencies' mortgage papers, including derivatives), the U.S. Federal Reserve (Fed) has so far purchased assets for a total of US$ 1.1 trillion.

The FED has also extended its Term Asset-Backed Securities Loan Facility (TALF) –credit line for the purchase of new issuances of asset-backed securities (ABS) and commercial mortgage backed securities (CMBS)– for three more months, until the end of March 2010 (instead of end 2009), given that credit conditions in the market of securitized assets (residential non-mortgage loans would still have not normalized.

The improvement of financial conditions and lower risk aversion, which favors investment in alternative assets, has also reflected in the increased access of the corporate and government sectors to the capital markets. Emerging markets' issuances of fixed and variable income bonds abroad have recovered in Q1 and Q2 from the practically nil levels they showed at end 2008. This has also been coupled with a reduction of spreads, both in the case of emerging and corporate investment grade spreads.

Graph 9
EMERGING BONDS SPREAD: EMBIG

Source: Bloomberg.

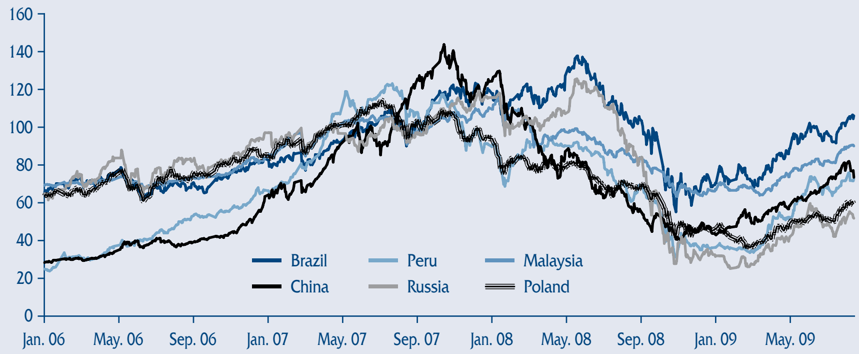
The pace of global injection of liquidity has declined as the markets have been stabilizing, as reflected, for example, in the lower increase observed in the balance of the FED, which in general terms has remained around US$ 2,100 billion (daily averages).

Thus, for example, between end-April and mid-September, a lower use of short term liquidity lines (mainly swaps to foreign central banks and auctions of term loans to banks –TAF-) and a lower balance of commercial papers has been observed. This has been compensated by higher purchases of assets, Treasury bonds and mortgages from agencies (including derivatives).

However, a higher increase in the balance is expected in the rest of the year given the amount allocated to the asset purchase facility (US$ 1.75 trillion) and the higher priority given to credit lines for issuances of ABS and CMBS (TALF), which to date have shown a lower pace of expansion.

10. Lower risk aversion has reflected in the depreciation of the dollar. This lower risk aversion and better results in corporate balances in developed countries, as well as the recovery of commodities in emerging countries have contributed to dynamize global stock markets.

Graph 10
MAIN EMERGING STOCKS EXCHANGE



Source: Bloomberg.

TABLE 3
MONETARY POLICY INTEREST RATE AND INFLATION
(%)

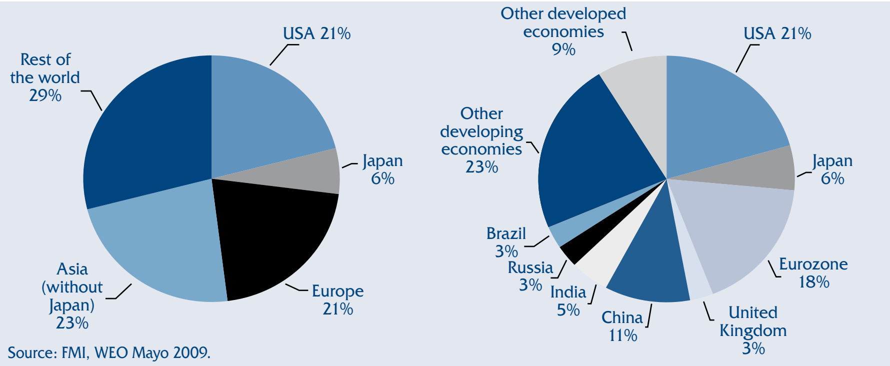
	Reference Interest Rate			Inflation
	Sep.08	Dec.08	Sep.09	12-month %
America				
Brazil	13.75	13.75	8.75	4.36
Canada	3.00	1.50	0.25	-0.80
Chile	8.25	8.25	0.50	-1.00
Colombia	10.00	9.50	4.50	3.13
United States	2.00	0.25	0.25	-1.50
Mexico	8.25	8.25	4.50	5.08
Peru	6.50	6.50	1.25	1.87
Europe/Africa				
Eurozone	4.25	2.50	1.00	-0.20
Hungary	8.50	10.00	8.00	5.00
Israel	4.25	2.50	0.75	3.10
Norway	5.75	3.00	1.25	1.90
Poland	6.00	5.00	3.50	3.70
United Kingdom	5.00	2.00	0.50	1.60
Czech Republic	3.50	2.25	1.25	0.20
Romania	10.25	10.25	8.50	4.96
South Africa	12.00	11.50	7.00	6.70
Sweden	4.75	2.00	0.25	-0.80
Switzerland	2.75	0.50	0.25	-0.80
Turkey	16.75	15.00	7.75	5.33
Asia/Pacific				
Australia	7.00	4.25	3.00	1.50
China	7.20	5.31	5.31	-1.20
South Korea	5.25	3.00	2.00	2.16
Indonesia	9.25	9.25	6.50	2.75
Japan	0.50	0.10	0.10	-2.20
Malaysia	3.50	3.25	2.00	-2.40
New Zeland	7.50	5.00	2.50	1.90
Thailand	3.75	2.75	1.25	-1.00
Taiwan	3.50	2.00	1.25	-0.81

Source: Bloomberg.

BOX 1
IS CHINA'S GROWTH SUFFICIENT TO MAINTAIN GLOBAL GROWTH?

China's share in global GDP has been increasing in recent years, reaching 11 percent in purchasing power parity terms in 2008. China is the third largest economy in the world, after the U.S. and the Eurozone. It is estimated that this trend would continue intensifying and that in 2025 China will represent nearly 20 percent of global GDP[3].

PARTICIPATION BY COUNTRY IN THE WORLD GDP 2008



Source: FMI, WEO Mayo 2009.

China's growth has been oriented to international trade, which has been strongly affected by the crisis[4]. To maintain its growth, China implemented a series of coordinated fiscal and monetary policies with the aim of stimulating the growth of domestic demand. The positive reaction of economic activity, particularly investment, to these stimuli has allowed China's GDP to grow practically 8 percent in annual terms in Q2-09, as the main indicators show.

CHINA: ECONOMIC INDICATORS

Indicator		Prior	Expected	Executed
Real GDP (% chg. 2Q09/2Q08)	2Q09	6.1%	7.8%	7.9%
Real GDP (% chg. quarterly adjusted)	2Q09	8.3%	-.-	14.9%
Manufacturing PMI	Aug.	53.3	-.-	54
Industry production (12-month % chg.)	Aug.	10.8%	11.8%	12.3%
Investment in fixed assets (12-month % chg.)	Aug.	32.9%	32.7%	33.0%
Activity leader indicator	Jul.	102.6	-.-	103.2
Retail sales (12-month % chg.)	Aug.	15.2%	15.3%	15.4%
Exports (12-month % chg.)	Aug.	-23.0%	-19.0%	-23.4%
Imports (12-month % chg.)	Aug.	-15.0%	-10.5%	-17.0%
M2 (12-month % chg.)	Aug	.28.4%	28.4%	28.5%
CPI (12-month % chg.)	Aug.	-1.8%	-1.3%	-1.2%
International Reserves (Billion US$)	Jun.	1.9	2.0	2.1

Source: Bloomberg.

3 In 1980, China accounted for only 2 percent of the global output in purchasing power parity terms.

4 Exports, which have been falling since October 2008, represent nearly 40 percent of China's GDP.

However, given the re-orientation of China's growth, it is worth analyzing the limits and risks associated with these policies. In other words, it is worth analyzing whether these policies are sustainable or not, as well as whether they are sufficient to support the growth of the global economy.

As regards the sustainability of these policies, some investment firms have been pointing out some potential risks in China's economy following the development and implementation of the fiscal and monetary measures. Firstly, the high growth of credit could originate a speculative bubble in the real estate sector and in the stock market, which would subsequently generate volatility in China's stock exchange. After recovering by over 80 percent between December 2008 and July 2009, the stock market has fallen over 20 percent since then. Moreover, increased credit can contribute to create pressures on the level of prices in the economy, although no increase has been observed so far in the general price level.

Secondly, some analysts point out the possibility that increased production may reflect not only public investment policies, but also sector incentives to production that may not have the corresponding correlate in terms of higher domestic demand. This could be generating excess capacity, particularly if global demand does not respond adequately.

For these reasons, the Chinese authorities would have ended their cycle of policies of monetary incentives and would consider that it is not necessary to implement a new fiscal stimulus package. Rather, they have initiated a series of legislative measures with the purpose of regulating the financial system, restraining the growth of credit, and preventing that speculative investment generates a price bubble. Therefore, economic activity is expected to moderate on the side of domestic credit in the second half of 2009.

Although China has become the most dynamic economy in the world today, its domestic sources –particularly consumption– still do not have an important share in global GDP. Consumption, which represents less than 40 percent of the country's GDP, is equivalent to one sixth of consumption in the U.S. Its growth in the medium term could be constrained by the lack of social reforms (education, social security, health) hindering households' reduction of savings. Since private investment, on the other hand, has been growing at rates of over 25 percent throughout the crisis period[5], it is quite unlikely that a significant additional expansion of this component –beyond the impulse given to expenditure in infrastructure– may generate an economic recovery.

Nevertheless, as the world's main buyer of raw materials and manufactured goods, China has played a key role in maintaining the dynamism of global economic activity during the crisis. Its main impact in this sense has been in Asia, where China's active participation in terms of intra regional trade[6] has allowed the region to be one of the first regions to emerge from the crisis. However, global recovery would require not only the growth of China, but also greater dynamism in developed economies, particularly in terms of consumption.

5 Investment in fixed assets has grown by over 30 percent in annual terms since April 2009.

6 China's imports from Asian countries amount to over US$ 660 billion and exports amount to US$ 650 billion.

II. Economic Activity

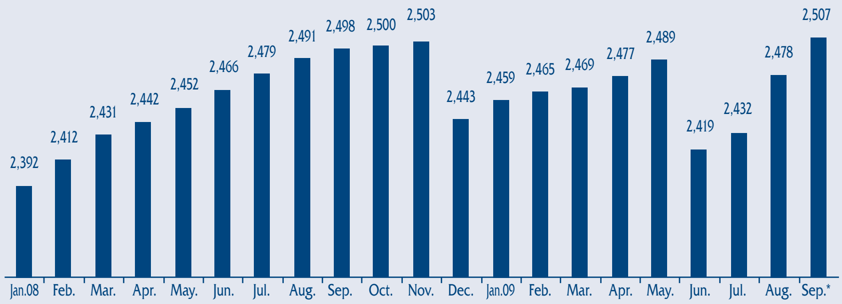
11. Considering that a faster recovery is expected in the global economy than initially foreseen and that the destocking cycle in domestic economic activity would have come to an end, growth in the second semester should adopt a faster pace in the second semester of this year, particularly as from Q4. This increased pace of activity would also reflect the impact of the monetary expansionary stance and fiscal policy, as well as consumers' and businesses greater confidence in the recovery of the economy in the next quarters. However, given the lower dynamism of economic activity recorded in the first semester, the forecast on GDP growth has been revised from 3.3 percent (June Report) to 1.8 percent. GDP is expected to grow 5.0 and 5.2 percent in 2010 and 2011, respectively.

12. Indicators on the first semester show that both the correction of the inventory cycle in the domestic market and the slowdown of the global economy have been stronger than expected. The process of inventory correction has extended to all the branches of industrial activity and it is estimated that inventory contraction would account for around 3.7 percentage points of the 3.2 percent reduction of domestic demand observed in the first semester. On the other hand, the deterioration of global economic activity is reflected in a lower demand for our export products, especially in the case of non primary manufacturing products.

    During the first semester, economic activity was also affected by a more negative evolution of private investment due to the re-profiling of the timeframe of several investment projects. Likewise, the dynamism of public investment in the first semester was lower than expected, even though an acceleration of this variable is foreseen for the second semester of the year. On the other hand, private consumption continued growing although at lower rates due to the reduction of national disposable income, while employment continued growing and recorded a growth rate of 1.1 percent at June.

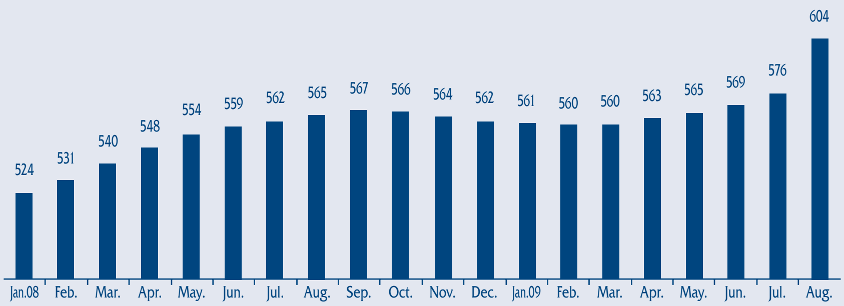
13. Recent indicators show positive signs of a recovery, including dispatches of cement, the demand for electricity, and the volume of imports.

Graph 11
SEASONALLY ADJUSTED ELECTRICITY INDICATOR
(GWH)



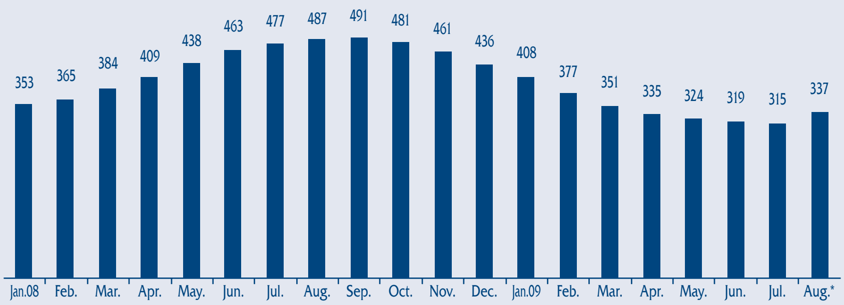
* As September 16.
Source: COES.
Elaboration: BCRP.

Graph 12
SEASONALLY ADJUSTED LOCAL DISPATCH OF CEMENT
(Thousand MT)



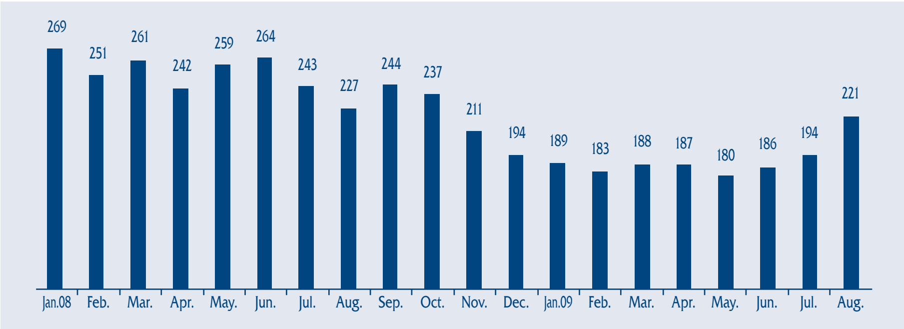
Source: Asocem.
Elaboration: BCRP.

Graph 13
SEASONALLY ADJUSTED CAPITAL GOODS IMPORTS
(Volume index)



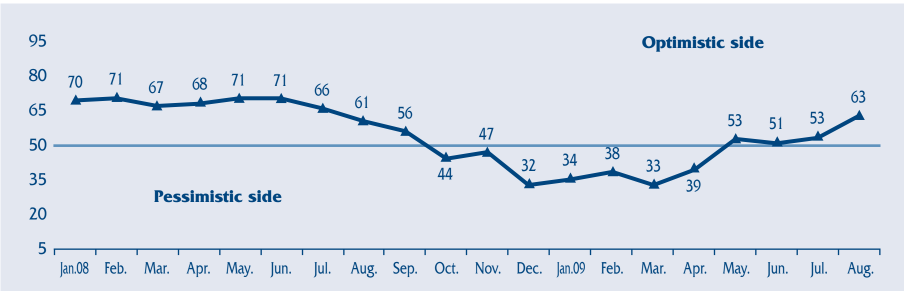
* Forecast.
Source: Sunat.
Elaboration: BCRP.

Graph 14
SEASONALLY ADJUSTED INPUTS IMPORTS
(Volume index)



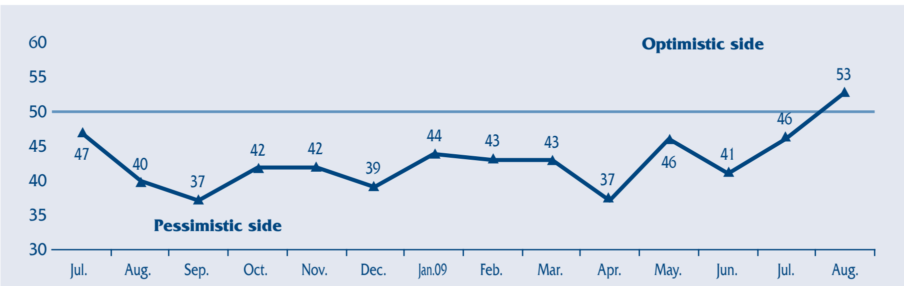
14. As regards business confidence, the negative trend recorded between October 2008 and April 2009 has reverted and business confidence has been on the optimistic side since May. Reflecting the recovery of confidence among entrepreneurs, this index rose to 63 points in August.

Graph 15
BUSINESS CONFIDENCE INDEX
Economic situation



Source: BCRP Survey on Macroeconomic Expectations.

Graph 16
CONSUMER CONFIDENCE INDEX
Family's Economic Situation



Source: Ipsos APOYO.
Elaboration: BCRP.

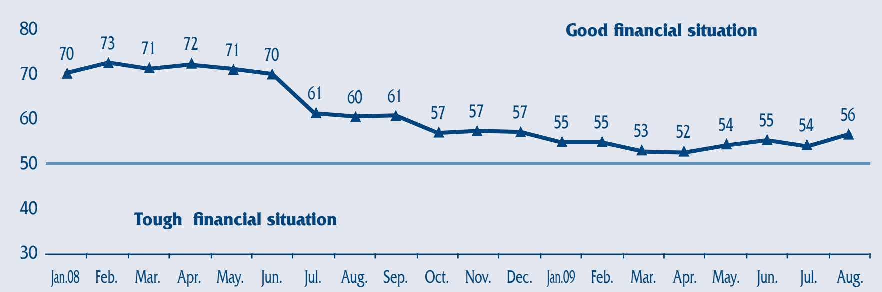
15. According to the macroeconomic projections of the private sector, GDP would grow between 1.8 and 2.5 percent in 2009. Growth forecasts for 2010 range between 4.0 and 4.3 percent, while for 2011 they range between 5.0 and 5.2 percent.

TABLE 4
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH
(%)

	June 2009	September 2009
FINANCIAL ENTITIES		
2009	3.0	2.0
2010	4.2	4.3
2011	5.0	5.2
ECONOMIC ANALYSTS		
2009	2.6	1.8
2010	4.0	4.0
2011	5.0	5.0
NON-FINANCIAL FIRMS		
2009	3.3	2.5
2010	4.5	4.0
2011	5.0	5.0

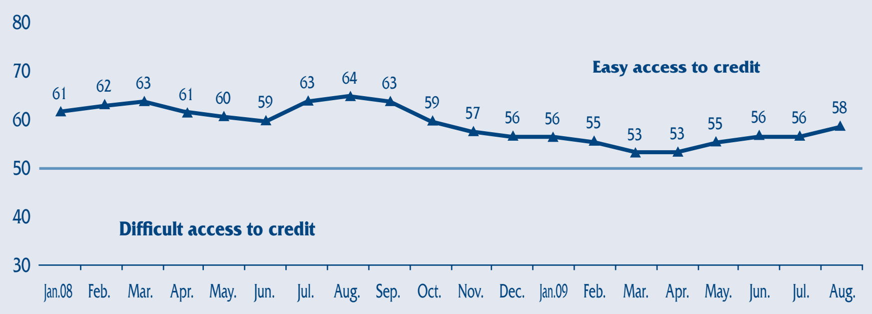
16. The financial situation index has remained at 54 points on average since the beginning of the year. According to the survey on Macroeconomic Expectations, most firms consider their financial situation to be good or normal. No problems are mentioned in terms of access to credit as this indicator continues to fall on the "easy" tranche. Moreover, according to the survey carried out with large enterprises, the percentage of firms with difficulties in terms of access to credit has been declining over the last three months.

Graph 17
FINANCIAL SITUATION INDEX



Source: BCRP Survey on Macroeconomic Expectations. August 2009.

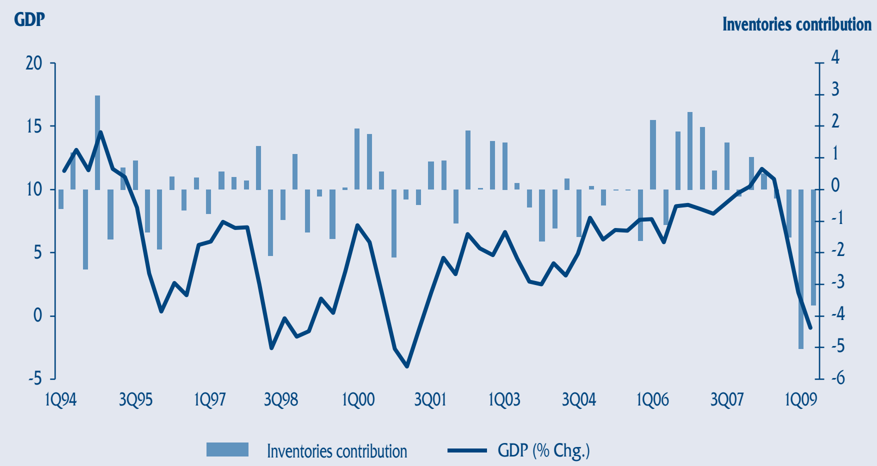
Graph 18
ACCESS TO CREDIT INDEX



Source: BCRP Survey on Macroeconomic Expectations. August 2009.

17. Domestic demand in 2009 is projected to fall 0.4 percent as a result of the downward adjustment of inventories, which is also reflected in lower imports. By expenditure components, a lower increase of private consumption (2.5 percent) and a drop of private investment (10.3 percent) are expected. This would be partially offset by a high dynamism in public investment (40.0 percent).

Graph 19
CHANGE OF INVENTORIES CONTRIBUTION TO GDP GROWTH
(Percentage Points)



18. GDP is expected to grow 5.0 percent in 2010 and 5.2 percent in 2011, resuming the path to return to the long term potential growth rate (estimated between 5 and 6 percent for this period).

TABLE 5
DOMESTIC DEMAND AND GDP
(Real % change)

	2008		2009*			2010*		2011*	
	I Sem.	Year	I Sem.	IR.Jun. 09	IR.Sep. 09	IR.Jun. 09	IR.Sep. 09	IR.Jun. 09	IR.Sep. 09
1. Domestic demand	13.3	12.3	-3.2	2.4	-0.4	5.7	5.9	5.8	5.7
a. Private consumption	8.8	8.7	3.0	2.5	2.5	3.6	3.3	4.2	4.2
b. Public consumption	3.3	1.8	6.4	6.8	9.5	3.4	4.0	3.6	3.0
c. Private investment	27.0	25.6	-10.4	2.5	-10.3	6.1	4.2	6.2	9.2
d. Public investment	63.5	42.8	16.7	49.4	40.0	14.7	15.6	11.4	7.2
2. Exports	12.7	8.2	-2.8	-1.3	-2.7	5.5	4.7	9.6	6.1
3. Imports	23.9	19.9	-18.6	-4.7	-11.6	6.2	9.2	9.2	8.3
4. GDP	11.1	9.8	0.3	3.3	1.8	5.5	5.0	5.7	5.2

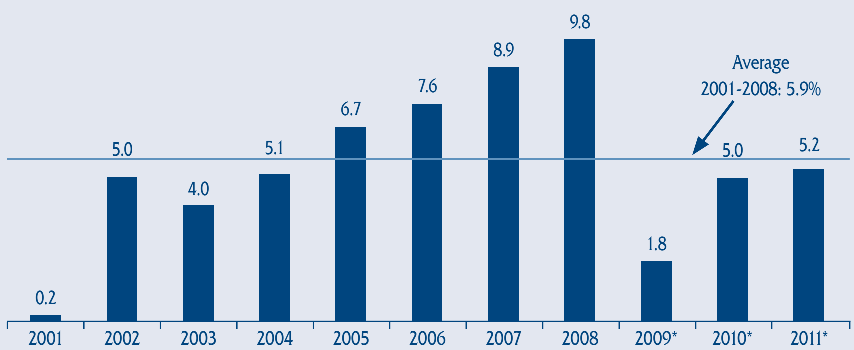
IR: Inflation Report.
* Forecast.

TABLE 6
CONTRIBUTION TO GDP GROWTH

	2008	2009*	2010*	2011*
a. Private consumption	5.9	1.7	2.2	2.8
b. Public consumption	0.2	0.8	0.4	0.3
c. Private investment	5.1	-2.3	0.8	1.8
d. Public investment	1.4	1.7	0.9	0.5
e. Change in inventories	-0.1	-2.3	1.6	0.4
f. Exports	1.6	-0.5	0.9	1.1
g. Imports	4.3	-2.7	1.9	1.8
GDP	**9.8**	**1.8**	**5.0**	**5.2**

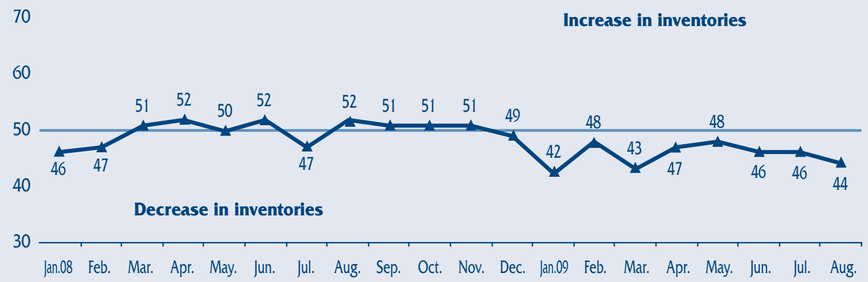
* Forecast.

Graph 20
GDP GROWTH RATE
(Real % change)



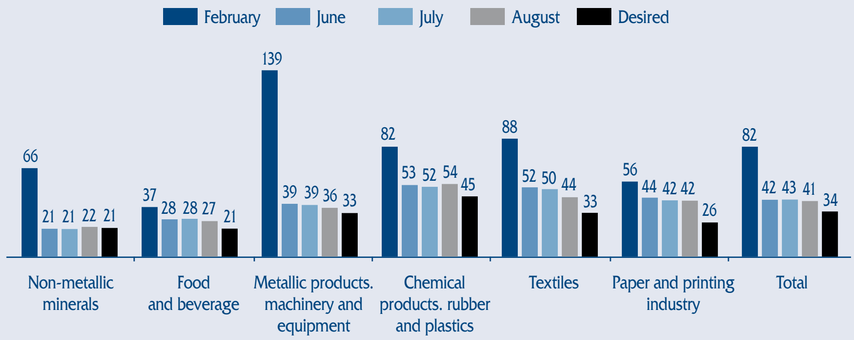
* Forecast.

Graph 21
LEVEL OF INVENTORIES OF FINAL GOODS RELATIVE TO THE PREVIOUS MONTH

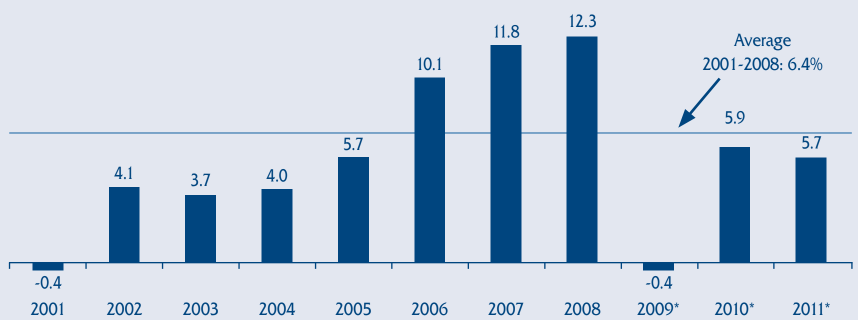


Source: BCRP Survey on Macroeconomic Expectations, August 2009.

Graph 22
MANUFACTURING INDUSTRY LEVEL OF INVENTORIES OF FINAL GOODS BY DAYS OF PRODUCTION AND/OR SALE



Graph 23
DOMESTIC DEMAND GROWTH RATE
(Real % change)

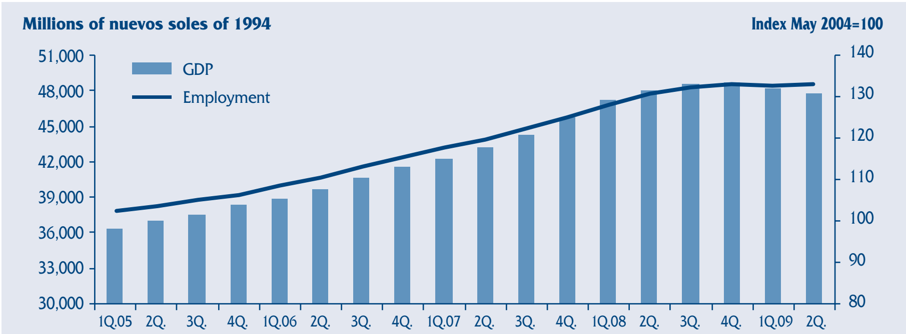


* Forecast.

Deseasonalized GDP

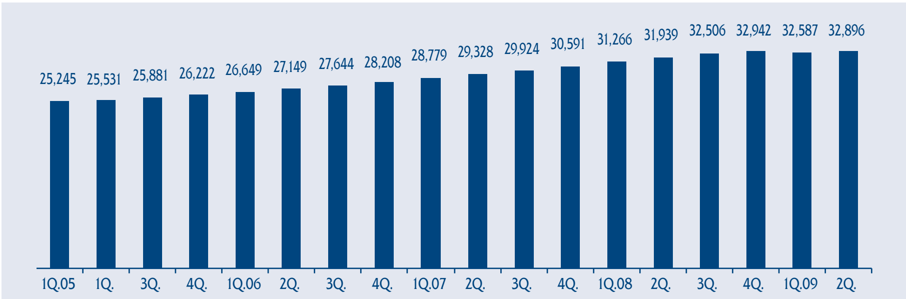
19. Excluding the seasonality effect, economic activity dropped during the first two quarters of the years reflecting the deepening of the international financial crisis. However, variables such as employment and consumption continue to show similar levels to the ones observed in 2008.

Graph 24
SEASONALLY ADJUSTED PRODUCTION AND EMPLOYMENT



Source: MTPE and INEI.

Graph 25
SEASONALLY ADJUSTED PRIVATE CONSUMPTION
(Millions of nuevos soles of 1994)

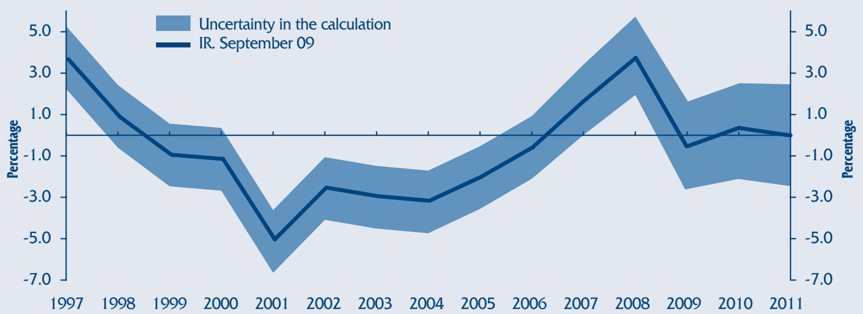


Graph 26
SEASONALLY ADJUSTED PRIVATE INVESTMENT
(Millions of nuevos soles of 1994)

Potential output

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

Graph 27
OUTPUT GAP
(% of the potential GDP))



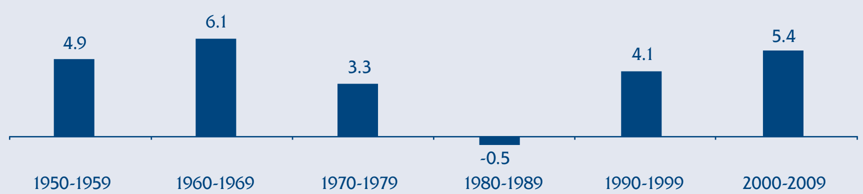
Note: Output gap estimated with information as of May 2009. The shadowed area represents existing uncertainty in the calculation and forecast of the output gap plus/minus one standard deviation.

GDP would have grown at an average rate of 5 percent in the 2000-2009 period –a higher average growth rate than in previous decades–, with private investment and productivity increases being the main factors accounting for this growth of the Peruvian economy.

TABLE 7
GROWTH ACCOUNTING
(Contributions %)

	Capital	PEA	Productivity	GDP
1980-1989	1.4	1.6	-3.5	-0.5
1990-1999	1.2	1.5	1.5	4.1
2000-2009	1.4	1.4	2.6	5.4

Graph 28
PERUVIAN ECONOMY AVERAGE GROWTH: 1950-2009
(Real % change)



The growth of private investment in the last ten years was favored by the development of a stable macroeconomic and legal environment, increased access to credit, new financing sources, and the deepening of the capital market. Moreover, together with increased private investment and the development of infrastructure, trade openness policies allowed significant improvements in terms of productivity during this period (productivity grew 2.6 percent, showing a much higher growth rate than in previous decades).

If the recovery of international markets materializes, the policies implemented in the last years with the purpose of developing a favorable business environment will encourage the growth of private investment. Likewise, actions aimed at improving productivity and reforms aimed at reinforcing human capital, efficiency in the labor market, the development of the capital market, and the reduction of over-costs associated with the poor quality of institutions and regulation imperfections, will increase capital returns and productivity. The benefits derived from infrastructure development achieved through both public investment and through the concession of ports, airports, railway lines and road networks will also contribute to this.

In this scenario, the growth path of the potential output would remain to be in the range of 5-6 percent in the next years.

Components of aggregate expenditure

21. In contrast with the concept of GDP, national disposable income also considers the effect of international prices and remittances from Peruvians residing abroad. After growing 8.2 percent in 2008, the national disposable income would grow less this year (1.0 percent) due to lower terms of trade and due to the reduction of remittances from Peruvians living abroad. In this context, private consumption would grow 2.5 percent in 2009, which represents an important deceleration compared with the previous year (8.7 percent).

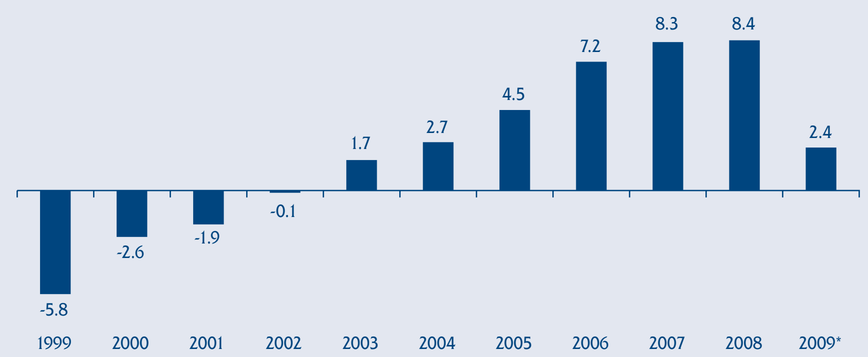
TABLE 8
NATIONAL DISPOSABLE INCOME
(Real % change)

	2008		2009*			2010*		2011*	
	I Sem.	Year	I Sem.	IR.Jun. 09	IR.Sep. 09	IR.Jun. 09	IR.Sep. 09	IR.Jun. 09	IR.Sep. 09
1. GDP	11.3	9.8	0.3	3.3	1.8	5.5	5.0	5.7	5.2
2. Gross national product	10.8	12.2	4.8	5.2	2.5	5.9	4.3	6.1	5.8
3. Gross national income	8.9	8.5	0.7	2.4	1.2	5.8	5.2	6.1	5.6
4. National disposable income 1/	8.7	8.2	0.6	2.1	1.0	5.8	5.2	6.1	5.7

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

The national disposable income would grow 5.2 and 5.7 percent in 2010 and 2011, respectively, in line with the expected recovery of the economy. In this context, private consumption would grow 3.3 percent in 2010 and 4.2 percent in 2011.

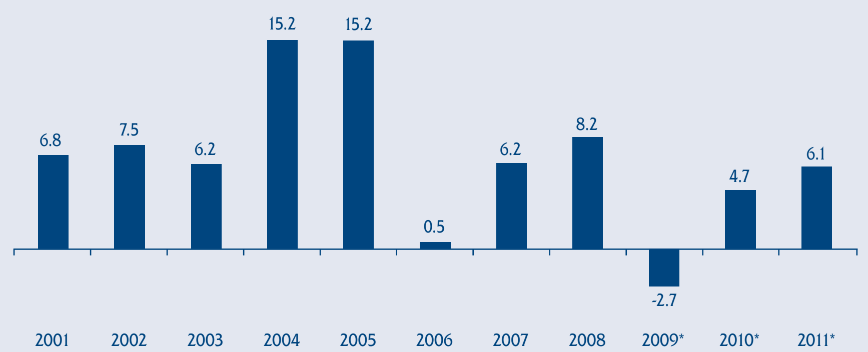
Graph 29
URBAN EMPLOYMENT IN COMPANIES WITH 10 OR MORE WORKERS
(Annual % change)



* Average January-June.

22. Real exports of goods and services would decline 2.7 percent in 2009, mainly due to the lower dynamism of non traditional exports in a context of lower global demand. Exports would recover in 2010-2011 considering the prospects of better international prices and the recovery of external demand for our exports. The forecast also considers a greater access to external markets due to trade agreements, which would favor exports of non traditional products.

Graph 30
EXPORT GROWTH RATE OF GOODS AND SERVICES
(Real % change)



* Forecast.

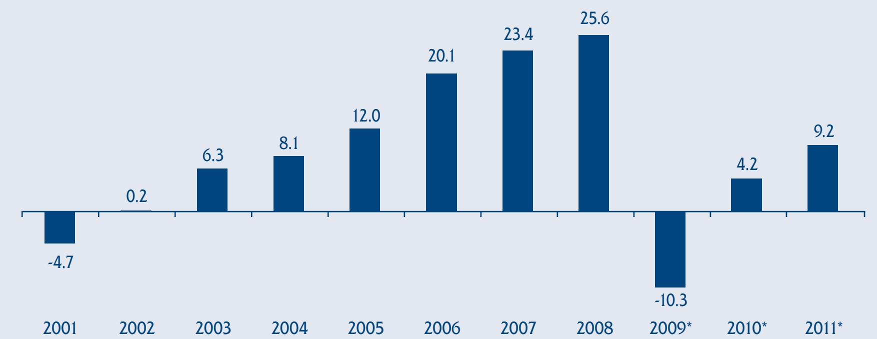
23. Real imports would show a deceleration in 2009 due to a lower pace of growth of imports of inputs capital goods, associated with the inventory adjustment and with the lower growth of consumption and private investment. Real imports of goods and services would record growth rates of 9.2 and 8.3 percent in 2010 and 2011, respectively, in line with the higher growth of the economy.

Graph 31
IMPORT GROWTH RATE OF GOODS AND SERVICES
(Real % change)

* Forecast.

24. In 2009 private investment would drop 10 percent, mainly as a result of the contraction recorded in the first semester due to the reprofiling of the timeframe of several investment projects associated with economic slowdown and with uncertainty generated by the international economic crisis. However, considering the foreseen recovery of both the global economy and the domestic economy as from the second semester, private investment should grow at rates of 4 and 9 percent in 2010 and 2011, respectively.

Graph 32
PRIVATE INVESTMENT GROWTH RATE
(Real % change)



* Forecast.

This pace of growth of investment will increase capital stock and productivity in the economy, favoring the growth of potential output in the next years. Part of this growth will be driven by several private investment projects announced to be implemented over the next five years. Foreseen concession projects announced by Proinversión will add to these. Investment projects amounting to a total of US$ 27 billion are expected to be implemented in 2009-2011.

TABLE 9
MAIN INVESTMENT PROJECTS
(Million US$)

	Total investments			
Sector	**2009**	**2010**	**2011**	**Total**
Mining and Hydrocarbons	3,079	5,243	7,082	15,404
Electricity	837	741	684	2,262
Transport and Telecommunications	691	466	209	1,366
Industry	846	1,332	999	3,177
Other Sectors	2,309	1,793	681	4,783
Total	**7,762**	**9,575**	**9,655**	**26,992**

TABLE 10
MAIN INVESTMENT PROJECTS IN CONCESSION

Project	**Sector**	**Location**	**Forecast investment (million US$)**
Pipeline to Chimbote (Natural Gas)	Energy	Center Highland / North Coast	1,300
Highway “del Sol”, track Trujillo - Sullana *	Transport	La Libertad, Lambayeque, Piura	170
Port Terminal of Paita *	Ports	Piura	233
Port Terminal of San Martin - Pisco	Ports	Ica	108
Port Terminal of Salaverry	Ports	La Libertad	134
Thermal Plant of 400-600 Mw in Las Malvinas	Energy	Cusco	500
Energy from New Hydropower Plants	Energy	National	650
Transmission Line el Zapallal - Trujillo 500 Kv	Telecommunications	Trujillo	300
Band 1900 Mhz	Telecommunications	National	350
Internet	Telecommunications	National	220

* Given in concession in 2009.

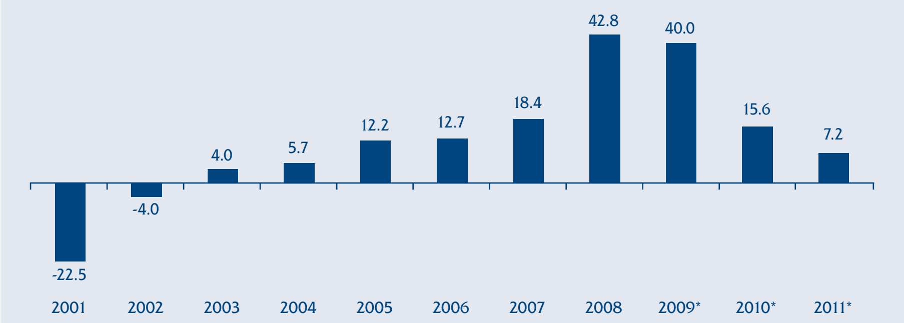
TABLE 11
MAIN PRIVATE INVESTMENT PROJECTS

SECTOR	COMPANY	COUNTRY	PROJECT NAME	MATURITY START OF CONSTRUCTION	MATURITY START OPERATIONS / PRODUCTION
Mining	Northern Peru Copper	China	Galeno	2011	2013
Mining	Minera Peru Copper S.A.	China	Toromocho	2010	2012
Mining	Anglo American Quellaveco S.A.	United Kingdom	Quellaveco	2010	2014
Mining	Rio Blanco Copper S.A.	China	Rio Blanco	2009	2014
Mining	Southern Peru Copper	Mexico	Molding and refining in Ilo - Toquepala - Cuajone	2008	2011
Mining	Shougang Group Hierro Peru	China	Marcona	2008	2011
Mining	Rio Tinto Minera Peru Limitada SAC	United Kingdom	La Granja	2009	2014
Mining	Southern Peru Copper	Mexico	Tia Maria	2008	2012
Mining	Xstrata Tintaya S.A.	Suiza	Antapaccay	2008	2011
Mining	Anglo American	United Kingdom	Michiquillay	2009	2015
Hydrocarbons	Peru LNG	USA	Camisea II	2007	2010
Hydrocarbons	Perenco Peru Limited	Singapur	Lot 67	2009	2013
Hydrocarbons	Petrobras - PetroPeru	Brazil	Petrochemical Plant	2009	2011
Hydrocarbons	Kuntur Transportadora de Gas	USA	South Andean Pipeline	2010	2012
Hydrocarbons	CF industries	USA	Petrochemical Plant	2010	2013
Electricity	ELECTROBRAS	Brazil	Five hydro-electric projects	2009	2014
Electricity	ENDESA	Spain	Hydroelectric Santa Rosa; Other	2008	2009
Telecommunications	Telefonica del Peru	Spain	Expansion of mobile and broadband network	2008	2010
Telecommunications	CLARO Peru S.A.C.	Mexico	Works in mobile phones	2008	2010
Infrastructure	Dubai Ports World Callao	Arab Emirates	South Pier	2008	2011
Infrastructure	Odebrecht	Brazil	IIRSA South and North	2008	2010
Infrastructure	Chancay Port	Peru	Multipurpose Megaport	2008	2011
Industry	SIDERPERÚ	Peru	Oven	2010	2012
Industry	Votorantim Metais - Cajamarquilla S.A.	Brazil	Refinery Cajamarquilla	2008	2011
Industry	Vale do Rio Doce (CVRD)	Brazil	Phosphates Bayovar	2008	2010
Industry	Aceros Arequipa	Peru	Expansion and modernization of plant	2008	2010

Source: Ministry of Energy and Mines, media and information from companies.

25. In 2009, public investment would grow 40 percent according to the projections of the Revised Multi Annual Macro Economic Framework (Marco Macroeconómico Multianual Revisado -MMM) published recently. In 2010, public investment would grow 16 percent, while in 2011 it would grow 7 percent.

Graph 33
PUBLIC INVESTMENT GROWTH RATE
(Real % change)



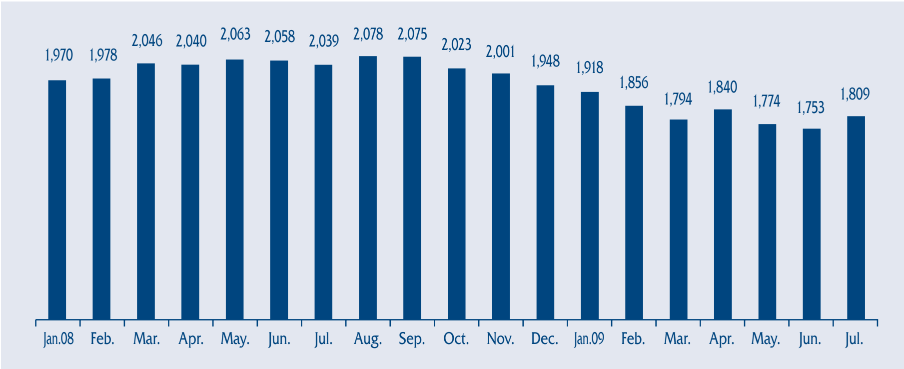
* Forecast.

Sector production

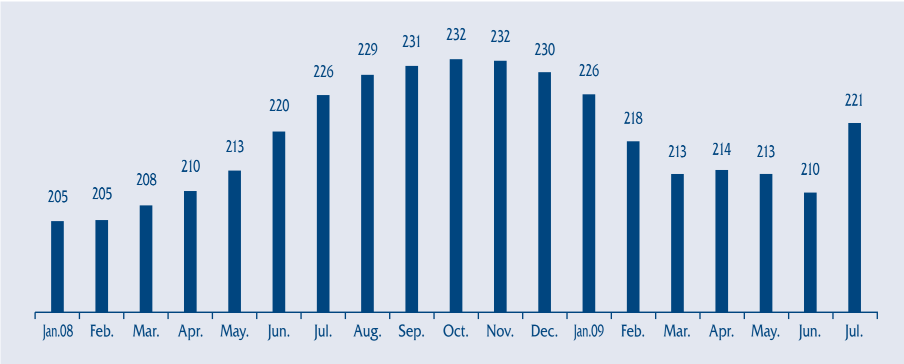
26. In the first semester of 2009, growth declined in all the economic sectors compared to the growth rates recorded in 2008. Global economic recession translated into lower demand for non-traditional exports –produced mainly in the manufacturing sector–, as well as into lower activity in medium mining, in a context of lower prices than the ones observed in the first semester of 2008.

    However, some indicators of activity start showing positive signs of recovery, especially in the sectors of non-primary manufacturing, manufacturing for construction, massive consumption goods, and the textile industry.

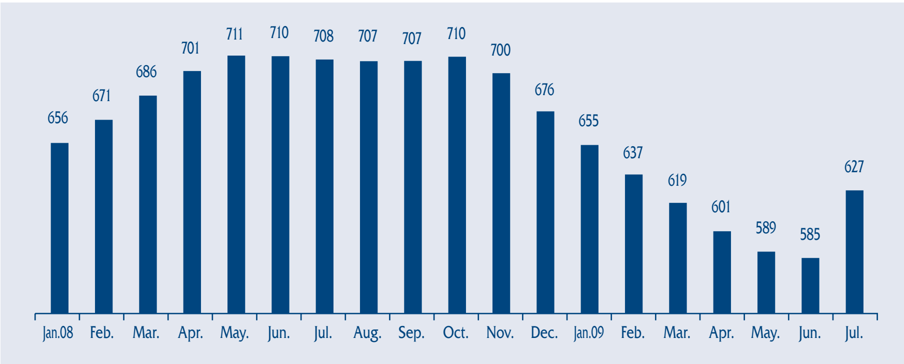
Graph 34
SEASONALLY ADJUSTED NON-PRIMARY MANUFACTURING
(Millions of nuevos soles of 1994)



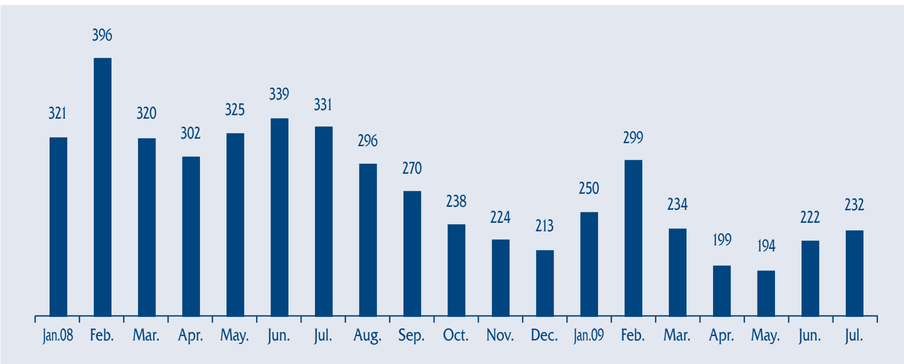
Graph 35
SEASONALLY ADJUSTED MANUFACTURING ORIENTED TO CONSTRUCTION
(Millions of nuevos soles at prices of 1994)



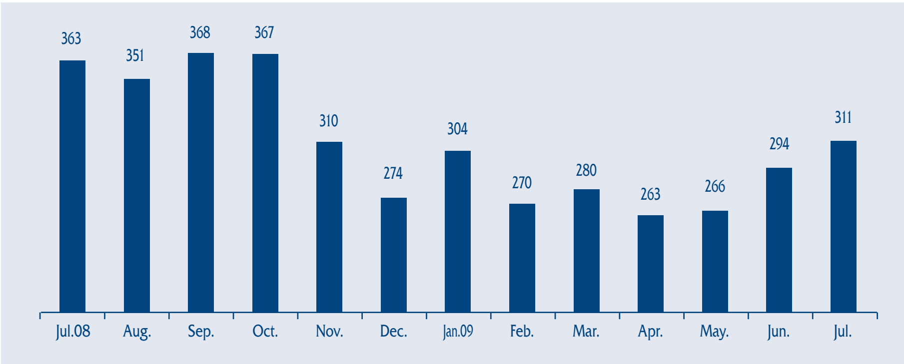
Graph 36
SEASONALLY ADJUSTED MASS CONSUMPTION GOODS
(Millions of nuevos soles at prices of 1994)



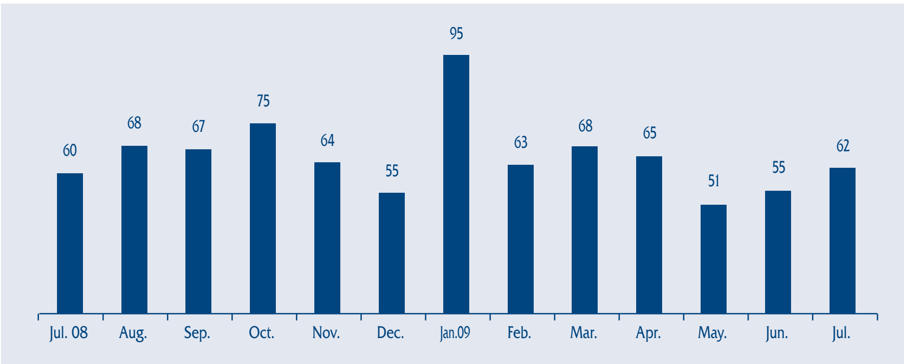
Graph 37
SEASONALLY ADJUSTED TEXTILE INDUSTRY
(Millions of nuevos soles with prices of 1994)



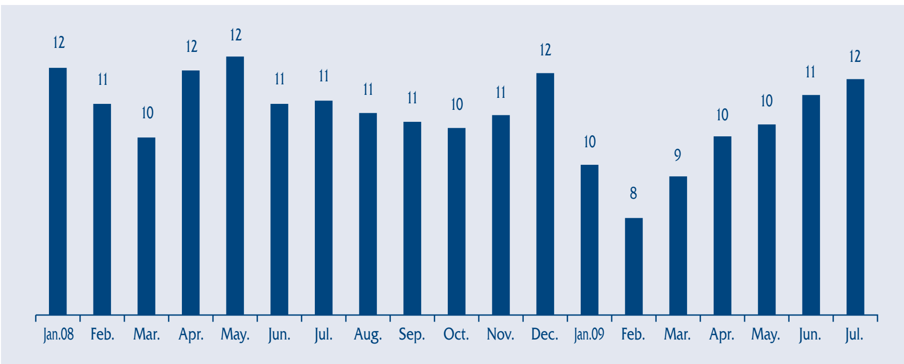
Graph 38
SEASONALLY ADJUSTED CHEMICAL PRODUCTS, RUBBER AND PLASTICS
(Millions of nuevos soles at prices of 1994)



Graph 39
SEASONALLY ADJUSTED DIVERSE MANUFACTURING
(Millions of nuevos soles at prices of 1994)



Graph 40
PAPER AND CARDBOARD CASES
(Millions of nuevos soles at prices of 1994)



Graph 41
PAPER AND CARDBOARD
(Millions of nuevos soles at prices of 1994)

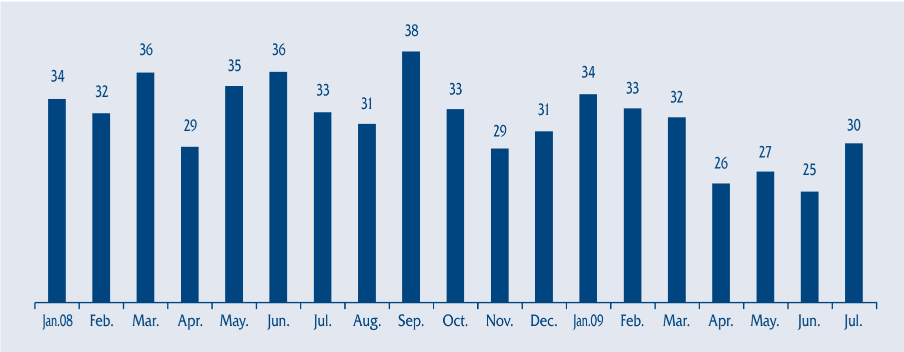


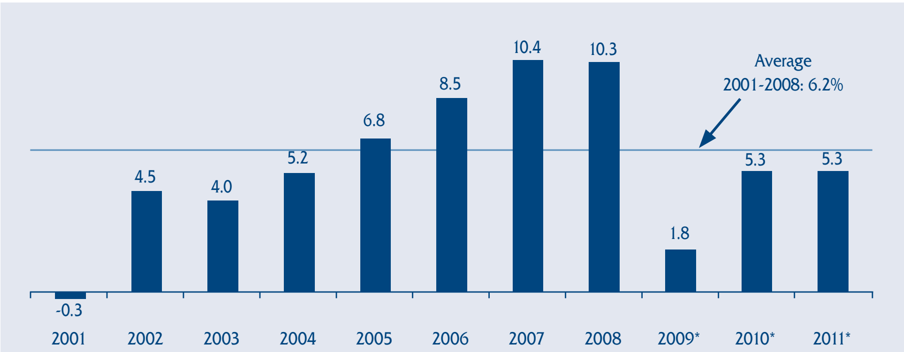
TABLE 12
GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS
(Real % change)

	2008		2009*			2010*		2011*	
	I Sem	Year	I Sem.	IR.Jun. 09	IR.Sep. 09	IR.Jun. 09	IR.Sep. 09	IR.Jun. 09	IR.Sep. 09
Agriculture and livestock	**6.3**	**7.2**	**2.5**	**2.9**	**3.2**	**5.2**	**3.4**	**5.2**	**3.6**
Agriculture	7.0	7.4	1.3	1.3	2.6	5.0	2.9	5.0	3.5
Livestock	5.1	7.0	4.7	5.5	4.1	5.6	4.2	5.5	4.2
Fishing	**5.3**	**6.2**	**-12.5**	**-3.7**	**-6.5**	**4.5**	**0.1**	**4.9**	**0.4**
Mining and hydrocarbons	**8.1**	**7.6**	**2.1**	**1.7**	**0.2**	**4.6**	**3.3**	**8.0**	**6.9**
Metallic mining	8.7	7.3	-0.2	0.0	-1.6	3.7	2.0	7.9	3.1
Hydrocarbons	3.5	10.3	23.2	13.7	16.4	11.8	35.8	9.0	13.1
Manufacture	**10.9**	**8.7**	**-8.3**	**-1.6**	**-4.7**	**5.3**	**5.0**	**5.9**	**5.5**
Raw materials	8.6	7.6	1.4	4.1	2.3	6.3	3.6	5.6	4.4
Non-primary industries	11.3	8.9	-10.2	-2.9	-6.0	5.0	5.7	6.0	5.5
Electricity and water	**8.8**	**7.7**	**0.7**	**2.5**	**0.8**	**6.0**	**4.6**	**6.0**	**5.5**
Construction	**20.3**	**16.5**	**1.9**	**7.4**	**7.4**	**8.9**	**8.4**	**7.5**	**8.9**
Commerce	**14.0**	**13.0**	**-1.0**	**3.2**	**0.5**	**4.4**	**4.9**	**5.0**	**5.0**
Other services	**10.6**	**9.3**	**2.9**	**4.9**	**3.7**	**5.7**	**5.0**	**5.5**	**4.8**
GDP	**11.1**	**9.8**	**0.3**	**3.3**	**1.8**	**5.5**	**5.0**	**5.7**	**5.2**
Primary	**7.2**	**7.4**	**1.7**	**2.5**	**1.7**	**5.2**	**3.3**	**6.2**	**4.8**
Non-Primary	**11.9**	**10.3**	**0.0**	**3.5**	**1.8**	**5.6**	**5.3**	**5.6**	**5.3**

IR: Inflation Report.
* Forecast.

Non-primary sectors showed a strong slowdown in comparison with the pace of growth observed last year due to the decline of non-primary manufacturing and commerce, as well as to the sharp deceleration of construction. Production in non primary manufacturing dropped 10 percent, with firms' destocking to adjust production to the new conditions of lower demand due to the international financial crisis and the subsequent lower external demand accounting for this.

Graph 42
NON-PRIMARY SECTORS GROWTH RATE
(Real % change)



* Forecast.

Graph 43
GROWTH RATE OF THE CONSTRUCTION SECTOR
(Real % change)

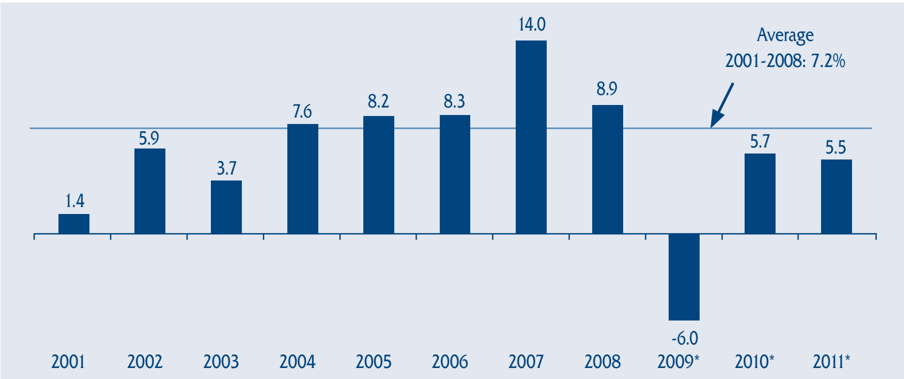
* Forecast.

27. In 2009, growth in non primary sectors would decline to 1.8 percent (versus 10.3 percent in 2008). This projection is based mainly on the drop of external demand for manufactured goods, on the process of inventory adjustment that extended over the first semester, and on the effect of the lower growth of disposable income on

families' demand for consumer goods. A gradual recovery of domestic and external demand is expected as from the second semester. Construction would show greater dynamism in the second half of the year, considering the expected recovery of the economy and its effect on investment, as well as the effect of public spending.

In 2010 and 2011 non-primary manufacturing would grow between 5.5 and 5.7 percent, in each year, due to the recovery of domestic and external demand in a context of recovery of the global economy.

Graph 44
GROWTH RATE OF THE NON-PRIMARY MANUFACTURING
(Real % change)



* Forecast.

In 2009, a slowdown is foreseen in the agricultural sector due to the lower growth of production for the external market and the production of agroindustry.

The baseline scenario for 2010-2011 considers the occurrence of a mild "Niño" event. In the mining sector, Yanacocha's production would stabilize, and the production of liquid hydrocarbons in Lot 56 and in Lot Z-1 would increase. A higher production of natural gas at Camisea's Lot 88 is also expected, since the latter would reach its maximum operations in 2010.

BOX 2
COMPETITIVENESS: PROGRESS MADE AND PENDING AGENDA

According to the World Bank's Doing Business 2010 ranking on business climate, Peru ranks 56 out of 183 economies, marking strong progress considering that this country ranked 65 last year. In the same sense, the Peruvian economy has improved its position by 5 ranks in the competitiveness ranking of World Economic Forum, ranking 78 out of 133 countries analyzed.

Despite the methodological differences between these two rankings, their complementary analysis is a useful tool to describe Peru's improvements in terms of competitiveness[7] .

Doing Business 2010

Business climate is defined as the set of institutional factors determining incentives for private sector investments in socially desirable projects. Published since 2004, today the World Bank's Doing Business ranking is considered the international standard for the analysis of the business climate at the micro economic level. This ranking monitors ten micro economic specific areas including the different stages of a business's life, from starting a business to closing one.

PERU: DOING BUSINESS

	Easiness to do business (General position)	2009	2010	Improvement
	(General position)	**65**	**56**	$\boxed{9}$
PROS	Access to credit	12	15	-3
	Protection to the investor	19	20	-1
	Property registration	40	28	12
Areas to improve	Tax payment	84	87	-3
	Easiness to foreign trade	98	91	7
	Closure of businesses	99	99	0
	Opening of business	117	112	5
	Hiring	161	112	49
	Enforcing contracts	119	114	5
	Building Permits	114	116	-2

Note: Relative location between 183 countries. The ranking for 2009 was recalculated and methodological changes include the addition of two countries. The indicators that Peru will improve their relative positions are highlighted.

Compared to last year, Peru has improved its ranking in five areas: employing workers (49 positions), registering property (12 positions), trading across borders (7 positions), enforcing contracts, and starting a business (5 positions in each case). Moreover, no significant deterioration is observed in Peru' relative position in any of the areas analyzed by Doing Business.

Peru's overall better ranking is mainly explained by the progress made in the area of employing workers, where the country has improved by 49 ranks compared to last year due to the reforms introduced by the regulations for medium-sized and small companies, or MYPE Law (lower cost of worker dismissal and reduction of the vacation period, among other reforms). It is worth pointing out that improvement in this area has been significant since "employing workers" was the indicator where Peru showed the highest relative lag.

Likewise, Doing Business highlights other five reforms implemented recently: i) electronic payment of municipal taxes, ii) using port cranes at the port of Callao, iii) the availability of electronic forms

7 The BCRP Nota de Estudios 01-2008 provides a general description of the methodology used for each ranking.

and use of electronic payroll systems, iv) introduction of deadlines to speed up the execution of the stages of judicial processes, and electronic judicial notification, and v) access to a free software to pay the value-added tax.

As regards the country's relative ranking, Peru is ranked among the top fifth group of countries in three areas: access to credit (rank 15), investor protection (rank 20), and registering property (rank 28). Moreover, there is still margin for improvement in seven areas: tax payments (rank 87), trading across borders (rank 91), closing a business (rank 99), setting up a business (rank 112), employing workers (rank 112), enforcing contracts (rank 114), and dealing with construction permits (rank 116).

Additionally, Doing Business monitors the reforms aimed at eliminating microeconomic obstacles that hinder a favorable business climate. In contrast with previous years when hardly any reforms were observed, Peru was part of a global reforming trend and implemented six significant reforms in the period analyzed (June 2008-May 2009). Thus, Peru ranked fifth worldwide as the country that implemented more reforms in the previous year and third in the region as the country that implemented more reforms between 2004 and 2009.

Global Competitiveness Report 2009-2010

Elaborated by the World Economic Forum since 2005, the Global Competitiveness Index (GCI) is an annual indicator elaborated with the aim of capturing the macro and micro economic fundamentals of country competitiveness. The GCI measures a country's level of competitiveness based on the analysis of three sub-indices: i) basic requirements, ii) reinforcements for efficiency, and iii) innovation and sophistication factors. These three sub-indices are made of twelve competitiveness pillars and 110 indicators which are the primary source used to construct them.

PERU: GLOBAL COMPETITIVENESS

Global Competitiveness Index	2008-2009	2009-2010	Improvement
(General position)	83	78	5
A. Basic Requirements	**94**	**88**	**6**
1. Institutions	101	90	11
2. Infrastructure	110	97	13
3. Macroeconomic stability	67	63	4
4. Health and elementary education	95	91	4
B. Reinforcement to efficiency	**69**	**59**	**10**
5. Higher education and capacitation	89	81	8
6. Goods markets efficiency	61	66	-5
7. Labor market efficiency	75	77	-2
8. Financial market sophistication	45	39	6
9. Technological preparation	87	77	10
10. Market size	50	46	4
C. Innovation and sophistication factors	**83**	**85**	**-2**
11. Business sophistication	67	68	-1
12. Innovation	110	109	1

Peru's improvement in the last year is explained by the progress made in terms of basic requirements (6 positions) and in terms of reinforcing efficiency (10 positions). The pillars showing greater progress were: infrastructure (13 positions), institutions (11 positions), technological readiness (10 positions), higher education and training (8 positions), and sophistication and openness of the financial market (6 positions).

As regards the country's relative position, Peru positively stands out in the sub-index of reinforcements for efficiency (rank 59). However, it is ranked in the fourth quintile in the sub-indices of basic requirements and innovation and sophistication (ranks 88 and 85, respectively) at the global level. In terms of competitiveness pillars, Peru is well-ranked in five pillars, even though it stands behind in seven of the twelve pillars analyzed (institutions, infrastructure, health and primary education, higher education and training, labor market, technological readiness, and innovation).

Final considerations

The country's improvements in terms of competitiveness make it more appealing for investment and entrepreneurial development, elements that translate into higher productivity and higher potential economic growth.

Despite the competitiveness improvements attained last year, Peru's relative position in global terms (between the second and third quintile at the global level) require speeding up the implementation of structural reforms.

The progress achieved to date and the public policies that the government intends to implement in the short term in the areas of stimulating public investment, infrastructure concessions, and improving the business climate should be complemented by the implementation of reforms in seven key structural areas:

i. Institutional strengthening and institutional reforms (political institutions, property rights, solution of legal conflicts, among other reforms).
ii. Reducing infrastructure gaps.
iii. Improving the provision of health care services.
iv. Improving the quality of primary and higher education.
v. Increasing the flexibility of the labor market.
vi. Promoting on-the-job training.
vii. Promoting greater capacity in technological adoption and investment in research and development.

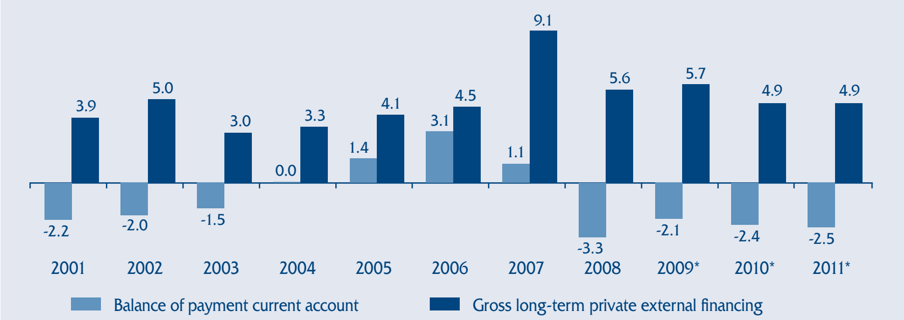
III. Balance of Payments

28. Considering the recovery of terms of trade during Q2-09, the forecast on the current account has been revised to a lower deficit for all the forecast horizon. Even though projections of global demand for **2009** continue to be negative, an improvement is observed compared with the projections made in June, which would be indicating a lower decline of non traditional exports. Hence, the forecast on the current account deficit in 2009 has been revised from 3.2 percent of GDP (June Inflation Report) to 2.1 percent. This forecast considers that the improvement in terms of exports would be offset by the recovery of imports towards the end of the year, driven by domestic demand.

29. In **2010** the current account deficit would increase relative to 2009, considering the higher growth of the domestic economy and its impulse on the volume of imports. This would be offset by better international prices, by the recovery of external demand for non traditional exports, and by the onset of the export stage of Camisea's liquefied natural gas. In **2011** the current account deficit would remain stable due to the onset of operations in mining projects (including Southern's expansion projects), as well as to the operation of Camisea's export project during a complete year. These factors would compensate the higher demand for imports –especially of capital goods– oriented to important investment projects in the mining sector, which would be carried out during the forecast horizon.

    The current account result would be sustainable due to the financial account, given that flows of long term capitals would be around 5 percent of GDP in the forecast horizon, exceeding the amount of external financing requirements.

Graph 45
CURRENT ACCOUNT
(Percentage of GDP)



* Forecast.

TABLE 13
BALANCE OF PAYMENTS
(Millions of US$)

	2008		2009*			2010*		2011*	
	I Sem.	Year	I Sem.	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09
I. CURRENT ACCOUNT BALANCE	**-2,429**	**-4,180**	**-374**	**-4,012**	**-2,634**	**-4,247**	**-3,356**	**-3,951**	**-3,710**
Percentage of GDP	-3.7	-3.3	-0.6	-3.2	-2.1	-3.1	-2.4	-2.6	-2.5
1. Trade balance	2,425	3,090	1,728	1,145	3,723	1,013	4,376	1,406	3,951
a. Exports	16,241	31,529	11,436	24,596	26,025	27,097	30,057	30,568	32,422
b. Imports	-13,815	-28,439	-9,708	-23,451	-22,302	-26,084	-25,680	-29,162	-28,471
2. Services	-858	-1,929	-541	-1,587	-1,510	-1,741	-1,789	-2,053	-2,092
3. Investment income	-5,363	-8,144	-2,836	-6,103	-7,441	-6,272	-8,764	-6,302	-8,640
4. Current transfers	1,366	2,803	1,274	2,532	2,595	2,753	2,820	2,998	3,070
Of which:									
Remittances	1,186	2,437	1,100	2,183	2,251	2,395	2,468	2,611	2,689
II. FINANCIAL ACCOUNT	**10,259**	**7,686**	**-31**	**4,113**	**3,934**	**4,847**	**4,256**	**4,551**	**5,110**
Of which:									
1. Private sector	6,674	7,657	1,309	4,452	3,802	4,728	3,899	4,129	3,633
2. Public sector	-1,454	-1,404	730	1,204	2,344	522	706	344	1,149
3. Short-term capital	3,540	1,118	-2,447	-1,607	-2,874	-148	-100	0	0
III. BALANCE OF PAYMENTS (=I+II)	**7,830**	**3,507**	**-405**	**100**	**1,300**	**600**	**900**	**600**	**1,400**
Memo:									
Gross long-term external private financing									
Millions of US$	5,705	7,130	4,027	6,871	7,227	7,555	6,772	7,888	7,196
Percentage of GDP	8.8%	5.6%	6.7%	5.4%	5.7%	5.5%	4.9%	5.3%	4.9%

IR: Inflation Report.
* Forecast.

30. The forecast on private saving for 2009 has been revised downwards, considering the lower projections of GDP growth. Private sector saving in the next years would maintain a growing trend which, together with external long term capital flows, would contribute to finance domestic investment.

TABLE 14
SAVING - INVESTMENT GAP
(Percentage of GDP)

	2008	2009*		2010*		2011*	
		IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09
Gross domestic investment 1/ = total savings	**26.9**	**26.6**	**23.6**	**28.1**	**25.4**	**29.2**	**26.7**
1. Domestic saving	**23.6**	**23.4**	**21.6**	**25.0**	**23.0**	**26.5**	**24.2**
a. Private sector	17.2	18.9	17.6	19.9	18.0	20.7	18.7
b. Public sector	6.4	4.5	4.0	5.2	5.0	5.8	5.5
2. External saving	**3.3**	**3.2**	**2.1**	**3.1**	**2.4**	**2.6**	**2.5**

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

Current account

31. In Q2 the current account showed a surplus of US$ 36 million, equivalent to 0.1 percent of GDP. The higher international prices of commodities –metals and crude– led to an improvement in terms of exports, which was offset by the increase observed in the profits of firms with foreign shareholding. At the same time, imports reached similar levels to the ones recorded in Q1, which represented an improvement in terms of the trade balance. On the other hand, remittances from abroad increased 5.2 percent relative to Q1.

Trade balance

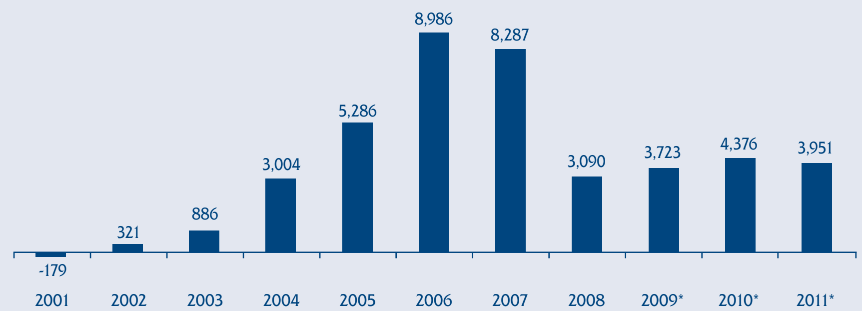
32. During Q2-09 the volume of exports dropped 4 percent in real terms, mainly due to the decline of non traditional products as a result of the deterioration of global economic activity. Real exports fell after almost 8 years of consecutive expansion. Except for metal-mechanic products, all non traditional exports dropped. This was particularly noteworthy in the groups manufacturing steel and iron products, textiles, wood and paper, and non-metal products. Additionally, lower volumes of exports of traditional products, such as copper (-1.9 percent) and silver (-66.2 percent), were also recorded in Q2.

33. This drop of exports was more than compensated by the reduction of imports, which improved the result in the current account. The drop of imports, which reflected lower economic activity levels, was especially noteworthy in the case of imports of durable consumer goods (-20.5 percent in nominal terms) and inputs for industry (-32.8 percent).

34. With this, the trade surplus accumulated in the first semester amounted to US$ 1.7 billion. Considering the better prices for exports, offset by the expected recovery of imports, the surplus in 2009 should amount to US$ 3.7 billion.

35. A higher surplus in the trade balance than the one recorded in 2009 is projected for 2010 and 2011, considering that the recovery of non traditional exports and better terms of trade would be offset by the impulse of the recovery of domestic demand on imports, especially capital goods and inputs.

Graph 46
TRADE BALANCE
(Millions of US$)



* Forecast.

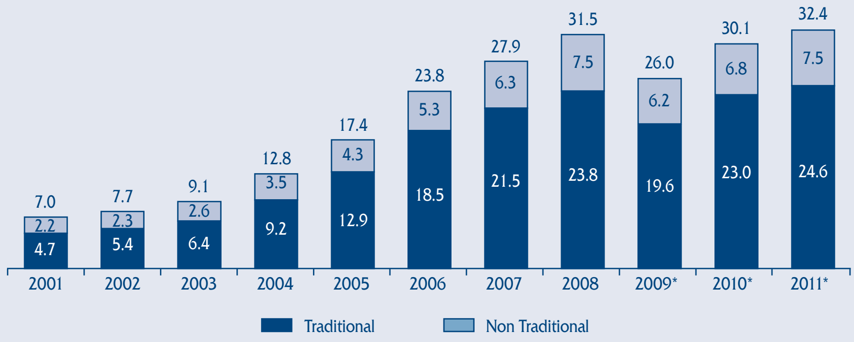
TABLE 15
TRADE BALANCE
(Millions of US$)

	2008		2009*			2010*		2011*	
	I Sem.	Year	I Sem.	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09
EXPORTS	**16,241**	**31,529**	**11,436**	**24,596**	**26,025**	**27,097**	**30,057**	**30,568**	**32,422**
Of which:									
Traditional products	12,513	23,796	8,552	18,069	19,610	20,069	23,015	22,834	24,633
Non-traditional products	3,654	7,543	2,818	6,334	6,233	6,812	6,821	7,488	7,540
IMPORTS	**13,815**	**28,439**	**9,708**	**23,451**	**22,302**	**26,084**	**25,680**	**29,162**	**28,471**
Of which:									
Consumer goods	2,076	4,527	1,833	4,420	4,258	4,762	4,968	5,755	5,558
Raw materials	7,464	14,553	4,374	10,569	10,008	12,284	12,046	13,461	13,326
Capital goods	4,216	9,239	3,439	8,323	7,822	8,932	8,574	9,817	9,474
TRADE BALANCE	**2,425**	**3,090**	**1,728**	**1,145**	**3,723**	**1,013**	**4,376**	**1,406**	**3,951**
Note: % Change									
Export volumes	12.4	8.1	-4.0	-2.1	-4.2	5.5	4.1	10.3	6.0
Import volumes	25.6	19.6	-22.2	-5.5	-13.2	6.2	9.2	9.1	8.1

IR: Inflation Report.

* Forecast.

Graph 47
EXPORTS OF GOODS
(Billions of US$)



Note: Total exports include other exports.
* Forecast.

Terms of trade

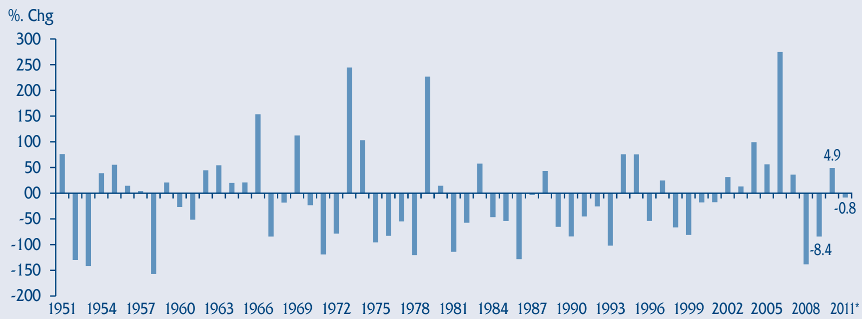
36. The terms of trade in 2009 would fall 8.4 percent on average, but would record an increase of close to 20 percent considering data as of the end of the period. The change in terms of trade is being revised on the upside in line with the better prices observed in terms of our exports.

37. Since March, the prices of the main commodities have been supported by increased expectations of economic recovery, the higher growth of investors' demand[8], the weakness of the dollar, the recovery of some countries' demand (China and India), and the tightness of supply conditions in the case of some commodities. It should be pointed out, however, that this tendency has also been affected by volatility associated with fluctuations in the different indicators of global demand that have been reported. Additionally, the evolution of the prices of some products, like food and crude mainly, has also been affected by idiosyncratic factors associated particularly with supply, such as the evolution of climate, strikes, and political events.

38. In line with the projections of recovery of global activity, it is estimated that this tendency would continue and that terms of trade would record a greater recovery next year amid better prospects of global economic recover, remaining relatively stable thereafter.

8 Includes portfolio diversification, risk coverage, non commercial positions, Exchange Traded Funds (ETF), etc.

Graph 48
TERMS OF TRADE
(Percentage change)



* Forecast.

Graph 49
TERMS OF TRADE, EXPORT AND IMPORT PRICE INDICES
(1994=100)

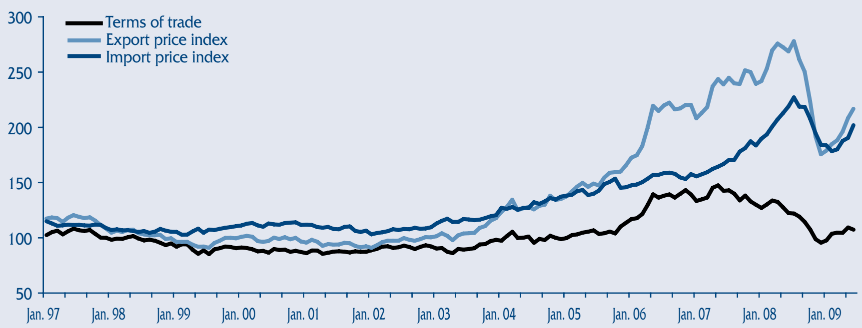


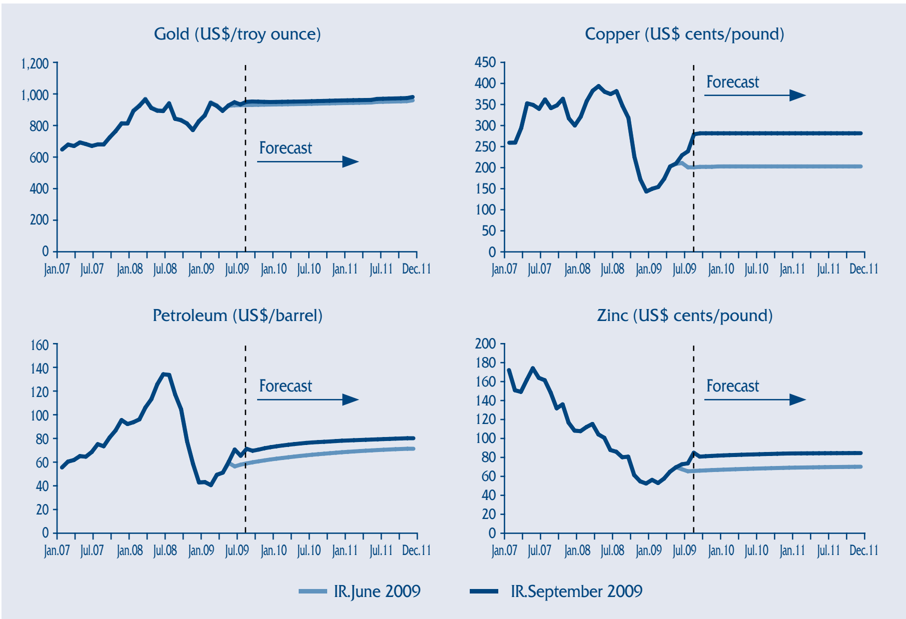
TABLE 16
TERMS OF TRADE
((Annual percentage change)

	Executed		2009*		2010*		2011*	
	2007	2008	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09
Terms of trade	**3.6**	**-13.8**	**-12.8**	**-8.4**	**-0.2**	**4.9**	**-0.2**	**-0.8**
Export prices	**14.0**	**4.9**	**-20.3**	**-13.9**	**4.4**	**11.0**	**2.3**	**1.7**
Annual average prices								
Copper (US$ cents per pound)	323	315	189	228	200	280	200	280
Zinc (US$ cents per pound)	147	85	61	69	66	81	68	82
Gold (US$ per troy ounce)	697	872	920	933	935	956	948	971
Import prices	**10.0**	**21.7**	**-8.7**	**-5.9**	**4.7**	**5.8**	**2.5**	**2.6**
Annual average prices								
Petroleum (US$ per barrel)	72	100	54	60	65	75	69	78
Wheat (US$ per MT)	231	293	227	199	256	205	264	233
Maize (US$ per MT)	138	192	159	137	180	140	180	158
Soybean oil (US$ per MT)	768	1,092	782	744	868	833	869	828
Rice (US$ per MT)	337	685	522	532	501	475	486	471

IR: Inflation Report.
* Forecast.

39. Factors influencing the growing trend observed in the case of the main metals include the recovery of global economic activity, increased expectations of higher demand, and some countries' policies of accumulating inventories. These factors have also been coupled by some supply-related problems, such as maintenance stoppages and mine strikes. However, because of the better prices of metals, some projects have become profitable again, which has led to the reopening of mines and refineries in some regions of the world, thus partially offsetting the growing trend of metal prices.

Graph 50

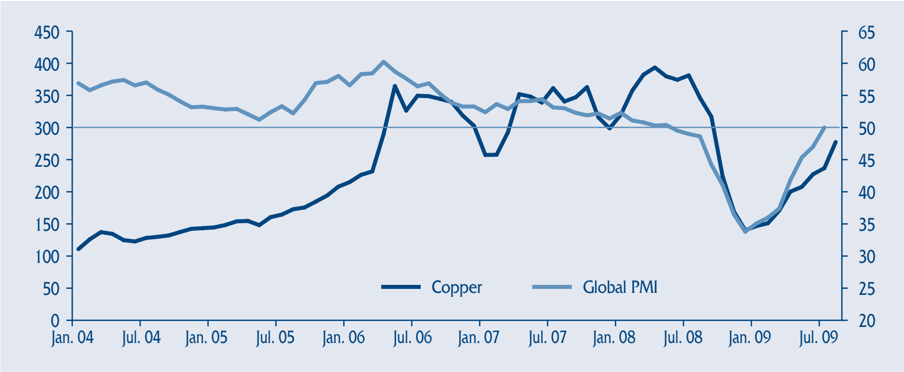


Copper

40. At September, the international price of copper has increased over 100 percent relative to its average level in December 2008, reaching US$ 2.8 a pound. The price of copper recorded its minimum low on January 23 (US$ 1.4 a pound).

Both global economic recovery and China's higher demand for copper concentrates and refined copper have favored the rise of the price of this metal. Due both to its policy of accumulating strategic reserves and to the implementation of its fiscal stimulus plan and spending in infrastructure program, China has maintained the dynamism of consumption of copper. Some supply constraints were also observed during the year due to temporary operation stoppages in mines in Chile (Collahuasi and La Escondida) and Canada (Voisey´s Bay) due to maintenance operations, low content of minerals, and mining strikes.

Graph 51
GLOBAL PMI AND PRICE OF COPPER
(US$ cents per pound)



Zinc

41. Zinc is another basic metal whose price has recorded significant increases so far this year. The price of zinc rose over 60 percent between December 2008 and September 2009, when it reached an average price of US$ 0.85 per pound. Zinc recorded its minimum price level (US$ 0.48 a pound) on February 20.

The higher price of zinc is associated with China's increased demand for refined zinc (during the first semester, the latter has increased 12.1 percent relative to the levels observed in the first semester of 2008). On the side of supply, during the first semester of the year the global production of zinc would have fallen 7.1 percent compared with the same period in 2008, basically due to lower production in Australia, China, Peru, and the United States.[9]

The increase in the international price of zinc has contributed to make some projects profitable again, as a result of which several mines and refineries have re-initiated operations (mainly in China). This would partially offset the upward trend in the price of zinc.

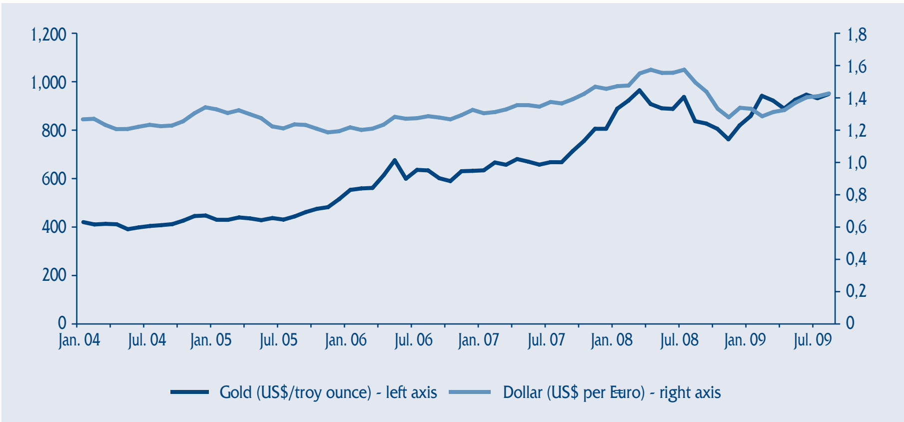
Gold

42. The price of gold continued to show an upward trend during the first nine months of the year. Although moderate, volatility was not absent from this trend. Gold recorded an average price of US$ 930 the troy ounce at September 2009 (a level 7 percent higher than the average price in 2008). The highest volatility was seen in Q1 when the price of gold reached a minimum low of US$ 811 per troy ounce in January and a maximum high of US$ 996 per troy ounce in February. The upward trend in the price of gold moderated in Q2 as risk aversion started declining in financial markets.

9 International Lead and Zinc Study Group (ILZG).

In addition to the gold market's own fundamentals, several factors have been affecting the price of this metal. One of the main factors was the weakening of the dollar (which depreciated 6 percent in the year) and risk aversion in financial markets. A second factor that fueled the demand for gold was associated with investment funds which assumed non commercial positions to use gold as value asset and as a hedge against risk (portfolio diversification). On the side of market fundamentals, it is worth pointing out the low dynamism of demand for gold for jewelry in India and Turkey. It is also worth highlighting that the correlation between the dollar and the price of gold has been increasing.

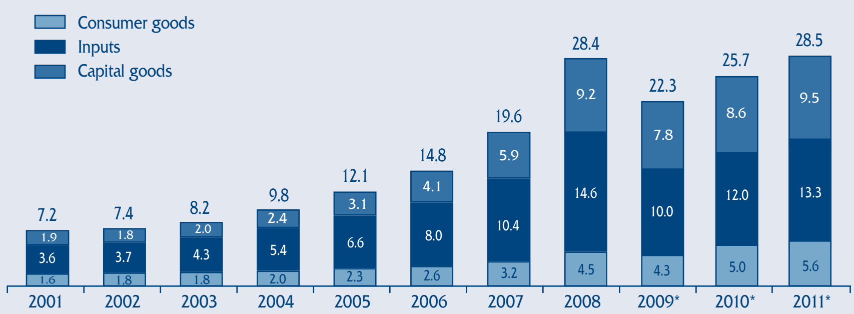
Graph 52
PRICE OF GOLD AND US DOLLAR EVOLUTION



43. It is estimated that the inventory adjustment carried out by firms in the first semester would revert in the second half of the year. The recovery of external demand and its impact on exports and domestic production, as well as the recovery of consumer and business confidence would encourage demand and firms are expected to recover their inventory levels. This would imply greater domestic activity and increased demand for imports of both inputs and end-goods. As a result of this, the volume of imports would recover in the second semester of the year, although closing the year with negative rates.

A significant recovery in the volume of imports is expected in **2010**, in line with the projected recovery of growth in the economy –mainly private investment– and its effect on imports of inputs and capital goods. Imports in **2011** would maintain their upward trend as a result of increased demand for consumption, investment, and intermediate goods to meet the needs of domestic production.

Graph 53
IMPORTS OF GOODS
(Billions of US$)



Note: Total imports includes other imports.
* Forecast.

Financial account

44. During the first semester of 2009, the private financial account recorded a net capital flow of US$ 1,309 million. This positive result, although lower than forecast in our previous Report, was due to the higher net inflows of direct foreign investment –DFI– (US$ 2,764 million), mostly as a result of reinvested earnings, as well as a result of total net amortization disbursements (US$ 797 million). These effects were partially counterbalanced by higher investments abroad by domestic financial entities (US$ 1,892 million), especially Administrators of Pension Funds (AFPs) and banks, as well by the lower amounts of Public Treasury bonds held by non resident investors (the latter declined by US$ 288 million).

    Conversely, the short term financial account recorded a net capital outflow of US$ 2,447 million, due mostly to higher deposits abroad and accounts receivable of mining firms, as well as to the lower amounts of BCRP Certificate of Deposits held by non residents.

45. In 2009 the financial account would record a positive capital flow of US$ 3,802 million. This sum is lower than the one considered in our previous Report (US$ 4 452 million), due mainly to financial entities' portfolio recomposition, which has translated into a higher acquisition of external assets (most of which has already been executed). On the other hand, total direct foreign investment would maintain a similar level to the one considered in our June Report, although the current projection includes the effect of the capital outflow associated with the investment projects to be carried out by local groups abroad (estimated at US$ 660 million).

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

	2008		2009*			2010*		2011*	
	I Sem.	Year	I Sem.	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09
I. DIRECT INVESTMENT AND LONG-TERM LOANS	**8,749**	**6,480**	**3,561**	**5,517**	**6,289**	**6,121**	**5,623**	**6,019**	**5,805**
1. Direct investment	5,425	4,079	2,764	3,887	4,196	3,689	3,366	4,473	3,834
2. Long-term loans	3,324	2,401	797	1,629	2,093	2,432	2,257	1,546	1,971
a. Dibursments	4,354	3,051	1,262	2,983	3,030	3,866	3,406	3,415	3,362
b. Amortization (-)	-1,030	-650	-465	-1,354	-937	-1,435	-1,149	-1,869	-1,391
II. PORTFOLIO INVESTMENT	**398**	**1,177**	**-2,252**	**-1,065**	**-2,487**	**-1,393**	**-1,724**	**-1,890**	**-2,172**
1. Bonds and capital participation	205	85	-71	-84	-71	0	0	0	0
a. Bonds	135	0	0	0	0	0	0	0	0
b. Capital participation	70	85	-71	-84	-71	0	0	0	0
2. Other external assets and liabilities	194	1,092	-2,180	-981	-2,416	-1,393	-1,724	-1,890	-2,172
a. Assets (Residents investments abroad)	-485	1,102	-1,892	-1,181	-2,222	-1,393	-1,860	-1,890	-2,308
b. Liabilities (Non-residents investments)	679	-10	-288	200	-194	0	136	0	135
PRIVATE SECTOR FINANCIAL ACCOUNT (I+II)	**9,148**	**7,657**	**1,309**	**4,452**	**3,802**	**4,728**	**3,899**	**4,129**	**3,633**

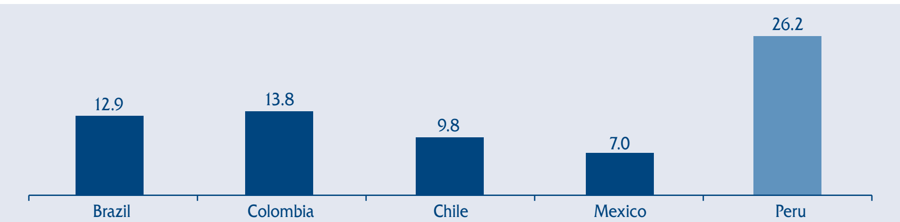
IR: Inflation Report.
* Forecast.

46. In 2010 and 2011 the financial account would show a positive flow of US$ 3,899 million and US$ 3,633 million, respectively. These estimates consider investments of around US$ 3,366 million and US$ 3 834 million, respectively, mostly as a result of new investments given that similar levels of reinvestment to the ones observed early this year are not expected.

Likewise, long terms disbursements would maintain a stable tendency. The process of net purchases of external financial assets by local institutional investors is also expected to continue.

47. On the other hand, the balance of net international reserves at the close of August amounted to US$ 32 billion, a sum equivalent to 26 percent of GDP, which represents a sufficient level of reserves against possible future constraints of external capitals, especially considering the recent signals of stabilization or economic recovery and improvement of financial indicators in most industrialized countries.

Graph 54
NET INTERNATIONAL RESERVES
(Percentage of GDP)



Source: Central Banks, WEO, FMI.

IV. Public Finance

Economic result

48. With an adverse external scenario, fiscal policy actions in the last months have been aimed at buffering the impact of global recession on domestic economic growth. An expansionary fiscal policy has been adopted to contribute to generate conditions that will allow economic growth as from the second semester of the year. This type of fiscal polices may be implemented because of the prudential management of public finances in the years prior to the crisis.

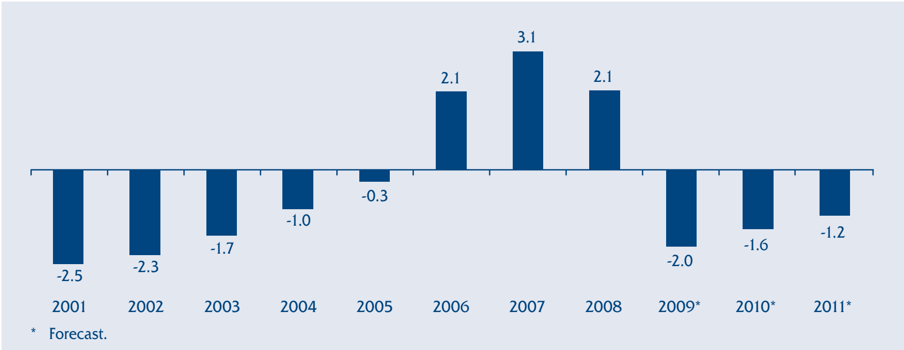
TABLE 18
NON-FINANCIAL PUBLIC SECTOR
(Percentage of GDP)

	2008		2009 *			2010 *		2011 *	
	I Sem.	Year	I Sem.	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09
1. General government current revenue	**21.4**	**20.8**	**19.1**	**18.5**	**18.4**	**18.7**	**19.0**	**19.0**	**19.3**
Real percentage change	6.9	5.8	-14.6	-10.0	-11.4	6.1	9.1	7.6	7.0
2. General government non-financial expenditure	**14.7**	**17.3**	**16.6**	**19.3**	**19.3**	**19.2**	**19.2**	**19.4**	**19.1**
Real percentage change	18.1	13.5	8.0	13.2	11.9	5.0	5.4	6.5	4.6
Of which:									
a. Current	12.0	13.2	13.0	13.3	13.5	12.8	12.9	12.6	12.7
Real % change	10.7	6.9	3.3	1.9	2.4	1.9	1.7	3.5	3.3
b. Gross capital formation	2.6	3.9	3.3	5.9	5.5	6.2	6.0	6.5	6.1
Real % change	69.1	45.8	21.5	51.7	41.5	12.2	15.7	11.1	6.5
3. Others	**-0.2**	**0.1**	**0.6**	**0.3**	**0.2**	**0.3**	**0.1**	**0.2**	**0.0**
4. Primary balance (1-2+3)	**6.4**	**3.7**	**3.0**	**-0.4**	**-0.6**	**-0.3**	**-0.2**	**-0.2**	**0.2**
5. Interests	**1.6**	**1.6**	**1.3**	**1.4**	**1.4**	**1.4**	**1.4**	**1.3**	**1.4**
6. Overall Balance	**4.9**	**2.1**	**1.7**	**-1.8**	**-2.0**	**-1.7**	**-1.6**	**-1.5**	**-1.2**
Memo:									
Central government current revenues	18.8	18.2	16.2	15.9	15.7	16.0	16.4	16.3	16.7
Central government non-financial expenditure	11.9	14.7	14.1	16.2	16.2	16.1	16.0	16.3	15.9

IR: Inflation Report.
* Forecast.

In the **first semester** the result of the non financial public sector (NFPS) was equivalent to 1.7 percent of GDP, a lower rate than the one recorded in the first semester of 2008 (4.9 percent). This result is explained both by a contraction of tax revenue and by the increase of the non financial expenditure of the general government. By levels of government, the national government shows a surplus of 1.1 percent of GDP (versus 4.7 percent in the first semester of 2008), local governments record a surplus of 0.1 percent, and regional governments show a balanced result. State enterprises record a surplus of 0.5 percent of GDP.

Graph 55
OVERALL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(Percentage of GDP)



In **2009** the deficit of the public sector would amount to 2.0 percent of GDP due to the stimulus measures implemented and to lower revenue. This result considers a projected growth of the general government investment of 41.5 percent over the year, which implies that investment should grow 59 percent in August-December compared to the same period in 2008.

The fiscal deficit in **2010** and **2011** is projected to show a downward path (1.6 and 1.2 percent of GDP, respectively), as previously reported (June Inflation Report). This improvement would be explained by a gradual recovery of the revenue of the general government associated with higher economic activity and with the rise of the international prices of metals and hydrocarbons.

49. It is worth pointing out that new caps for 2009 and 2010 have been established by macro fiscal regulations. The annual deficit of the NFPS shall not be higher than 2 percent of GDP (previously 1 percent) and the annual increase of the central government expenditure in consumption shall not be higher than 10 and 8 percent of GDP in 2009 and 2010, respectively (previously 4 percent). In a context of global recession, this measure has been adopted in order that fiscal policy may act as a counter cyclical instrument to favor the economy's return to its level of potential growth. Moreover, this also allows the projected deficits in the forecast horizon to be above the levels established in the Fiscal Responsibility and Transparency Law.

50. As explained in our June Report, a high component of the Economic Stimulus Plan –measures to offset the impact of the crisis– is aimed at giving impulse to public investment. With updated figures, the Plan considers a total expenditure of S/. 13,643 million, which represents 3.6 percent of GDP. The main modification is the one made in terms of social protection to the sectors affected by the crisis (S/. 2,024 million versus S/. 1,242 million previously considered). At end August, 30 percent of this total spending has been executed, with greater dynamism in

the lines of "other expenditure" (89 percent), since this includes the additional payment of the mid-year bonus (fiestas patrias), and "impulse to economic activity" (48 percent), which includes S/. 1 billion for the Fuel Price Stabilization Fund. Expenditure in infrastructure has been executed by 17 percent. In line with the aims of the revision of the Multi Annual Macro Economic Framework for 2010-2012 carried out in August 2009, the execution of the Plan should show greater dynamism in the second semester of this year.

TABLE 19
MAIN MEASURES OF THE ECONOMIC STIMULUS PLAN
(Millions of nuevos soles)

Concept	Norm	Mill. Soles	
1. Impulse to Economic Activity		**3,459**	
- Oil Price Stabilization Fund	UD 06 and 09-2009	1,000	
- Purchases of uniforms and school furniture from SMES	UD 015-2009	150	
- Workforce Retraining Program	UD 021-2009	100	
- Business Guarantee Fund (FOGEM)	UD 024-2009	300	
- Construyendo Peru - Projoven programs	SD 016-2009-EF	76	
- Temporary increase of Drawback	SD 018-2009-EF	360	
- Credit and guarantes of Agroperu Fund	UD 027-2009	210	
- Strengthening of SMES	UD 019-2009	5	
- Foncomun Drawdowns	Law 29332	450	
- Accelerated depreciation in construction	Law 29342	808	
2. Infrastructure Works		**7,824**	
- Investment projects	UD 010-2009	1,967	1/
- Infrastructure investment Fund - COFIDE	UD 018-2009	320	
- IIRSA Sur	UD 025-2009	773	
- Regional trusts	UD 028-2009	2,600	
- Costa Verde Project	SD 019-2009-EF	20	
- Investment continuity	SD 013 and 017-2009-EF	1,765	2/
- Investment continuity - Tarma	UD 039-2009	60	
- Road maintenance	SD 034-2009-EF	300	
- Santiago de Chuco-Shorey highway	Law 29321	20	
3. Social Protection Programs		**2,024**	
- Maintenance of educational institutions	UD 003 and 011-2009	290	3/
- FORSUR	UD 005-2009	180	
- Maintenance and equipment of health facilities	UD 016 and 022-2009	165	4/
- Maintenance of irrigation infrastructure	UD 016 and 054-2009	153	
- Basic infrastructure for local governments	UD 016 and 050-2009	318	
- Social investment - Equality Fund	Law 29322	105	
- Supplementary Food Program	SD 022-2009-EF	64	
- Municipal Sanitation Projects	SD 007-2009-VIV and 100, 101, 102 Y 128-EF	610	
- Other Municipal Project	SD 048, 087 and 111-2009-EF	60	
- Municipal Educative Infrastructure	SD 006-2009-ED and 131-2009-EF	79	
4. Others		**335**	
Total Stimulus Plan		**13,643**	
(Percentage of GDP)		***3.6%***	

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

Structural economic result

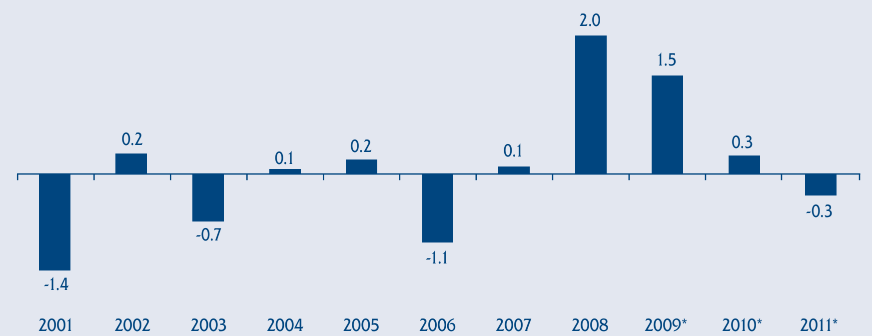
51. The structural economic result –measurement isolating the effect of the economic cycle and the impact of the higher prices of exports of minerals and the price of crude on fiscal revenue– would be negative in the next two years.

Graph 56
PRIMARY STRUCTURAL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(Percentage of GDP)

* Forecast.

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

Graph 57
FISCAL IMPULSE
(Percentage of GDP)



* Forecast.

Evolution of fiscal revenue

52. In the first semester of the year, the current revenue of the general government were equivalent to 19.1 percent of GDP, which represented a reduction of 14.6 percent in real terms compared to the same period in 2008. This contraction was associated with the lower dynamism of economic activity, as well as with the lower international prices of crude and minerals. The more affected revenues were the income tax, import-related taxes, and oil royalties.

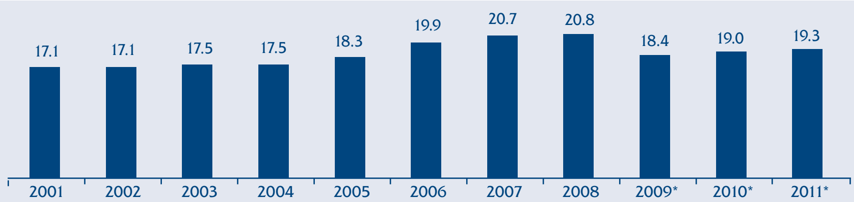
TABLE 20
THIRD CATEGORY INCOME TAX
(Millions of nuevos soles)

	2008		I Sem. 09	
	I Sem.	Year	Mill. S/.	Real % chg
Advanced payments	**7,641**	**14,921**	**4,972**	**-37.9**
Mining	3,446	6,056	816	-77.4
Commerce	880	1,898	910	-1.4
Manufacturing	900	1,856	804	-14.8
Financial Intermediation	548	1,011	622	8.4
Hydrocarbons	415	921	230	-47.1
Other services	1,262	2,808	1,366	3.3
Others	188	371	224	13.4
Regularization	**2,008**	**2,248**	**2,088**	**-0.8**
Total	**9,649**	**17,169**	**7,060**	**-30.2**

Source: Sunat.

Revenue from income tax declined 21 percent, mostly due to the strong drop observed in terms of revenue from payments on account of third category income tax (38 percent). The sectors whose tax payments on account declined most heavily in the first semester were the sectors of mining and hydrocarbons. Revenue from these sectors fell 77 and 47 percent in real terms, respectively, reflecting the sharp drop of the prices of our mining exports and crude. Total revenue from VAT fell 7 percent due to the drop of the VAT on imports, which showed a reduction of 21 percent. Moreover, revenue from the oil canon and oil royalties fell 38 and 53 percent in real terms due to the lower international price of crude.

Graph 58
GENERAL GOVERNMENT CURRENT REVENUE
(Percentage of GDP)



* Forecast.

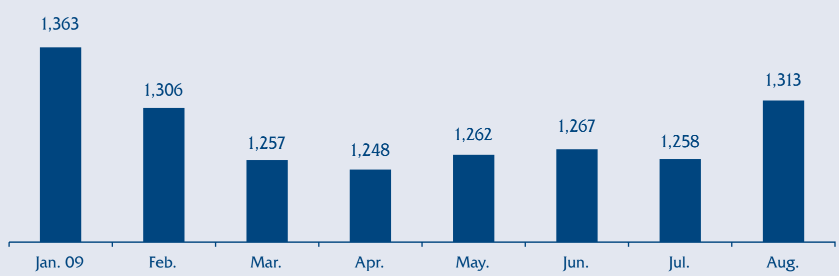
The revenue of the general government in 2009 would amount to 18.4 percent of GDP, which represents a real decline of 11 percent compared to last year. As previously pointed out, this would be reflecting the lower impulse of economic activity and the lower prices for our products in international markets due mainly to the adverse international context.

Graph 59
INCOME TAX
(Percentage of GDP)

* Forecast.

After reaching record levels in 2007 (6.8 percent of GDP), income tax would decline to 5.2 percent of GDP in 2009. Among other aspects, this would be reflecting the lower payments on account made by firms during the year due to the lower ratios obtained in 2008, which in some cases have even been corrected downwards as from August. However, it should be pointed out that, as already observed in the months of July and August, revenue from this tax should start increasing significantly as the balances in favor of firms come to an end and as growth expectations for the second semester begin to materialize.

Graph 60
SEASONALLY ADJUSTED VALUE ADDED TAX COLLECTION
(Millions of nuevos soles of 1994)

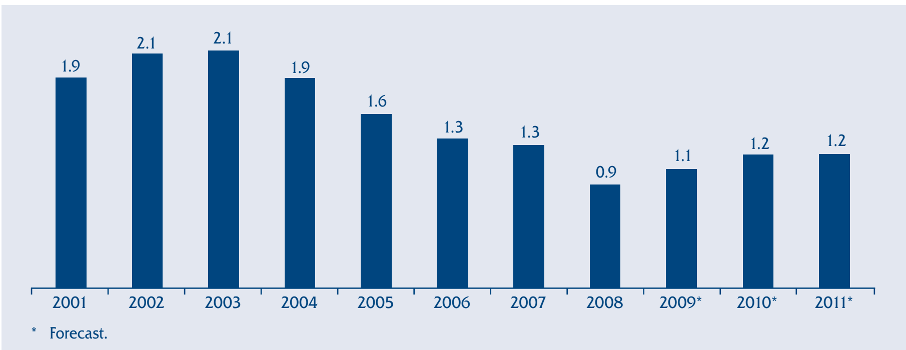


The VAT also shows some signs of recovery. Thus, in deseasonalized terms, revenue from the VAT has increased 4 percent in August relative to July, reverting the trend observed in the last months. Despite this, revenue from VAT would drop from 8.5 percent of GDP in 2008 to 7.9 percent this year, basically due to the imported component which would decline from 4.2 to 3.4 percent of GDP as a result of the strong drop of imports.

Graph 61
VALUE ADDED TAX
(Percentage of GDP)

Revenue from the excise tax (ISC) would grow in GDP terms –from 0.9 to 1.1 percent of GDP– due to the increase of the excise tax of fuels revenue (from 0.4 to 0.6 percent) as a result of the increases on the rate of excise tax on fuels implemented in Q4-08.

Graph 62
EXCISE TAX
(Percentage of GDP)



The forecasts for **2010** and **2011** consider current revenues of 19.0 and 19.3 percent of GDP, respectively, in line with the recovery of economic activity and the international prices of our exports.

Evolution of fiscal expenditure

53. In the first semester of 2009, the non financial expenditure of the general government was equivalent to 16.6 percent of GDP, which represents an increase of 8.0 percent in real terms. This increase is mainly explained by the general government's higher investment (22 percent) associated with the stimulus programs and regulations implemented to stimulate investment, especially in sub-national governments. Thus, investment in regional governments increased 47 percent in real terms, while investment in the national government increased 27 percent and investment in local governments increased 10 percent.

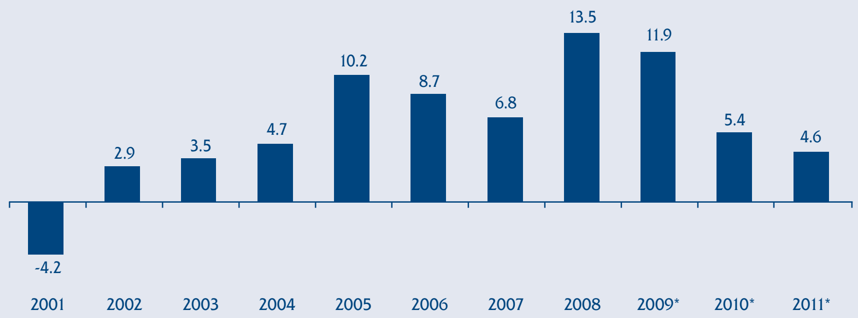
Graph 63
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(Percentage of GDP)

* Forecast.

On the other hand, the current expenditure of the general government increased 3.3 percent in real terms. However, this increase falls to 1.7 percent if the effect of transfers to the Fuel Price Stabilization Fund (S/. 1 billion this year and S/. 600 million in the first semester of 2008) is deducted.

At end 2009 non financial expenditure would record a real increase of 11.9 percent, in line with the projections of the Revised Multi Annual Macro Economic Framework, which considers a growth of 40 percent in public investment (general government and state enterprises). However, this increase is lower than the one projected in our previous Report, because despite the emphasis given by the government to accelerating public investment projects, some limitations persist that would prevent reaching the original goal in terms of the growth of investment (around 50 percent in real terms).

Graph 64
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(Real % change)



* Forecast.

In **2010** and **2011** the non financial expenditure of the general government would grow around 5 percent, mainly due to expenditure in public investment, which in GDP terms would increase from 4.2 percent in 2008 to 6.5 percent in 2011, including the investment of state enterprises.

Financing requirements

54. The negative economic result of the next years will generate financial requirements that will be met through public debt and the use of public sector deposits in the financial system.

Global bonds 2025 for a total of US$ 1 billion were issued on July 6, 2009. The bond's coupon is 7.35 percent and its yield is 6.95 percent. Risk rating agencies have assigned a similar rating to the one assigned to Peru' long term debt in foreig currency to this bond issuance (Moody's BA1, Fitch BBB-, and Standard & Poors BBB-).

The resources obtained through this issuance will be used for the prepayment of the debt with the Paris Club; more precisely with France (US$ 662 million) and Italy (US$ 190 million). Once this prepayment has been made, the debt with the Paris Club will amount to US$ 3,036 million, of which 88 percent correspond to the concessional debt.

As a result of this operation, amortization payments have been relieved for around US$ 140 million per year until 2015; the average life term of the debt has been extended from 3 years to 16 years, and the financial cost of prepaying liabilities at a FC rate of around 7.10 percent with resources obtained at a cost of 6.95 percent has been reduced.

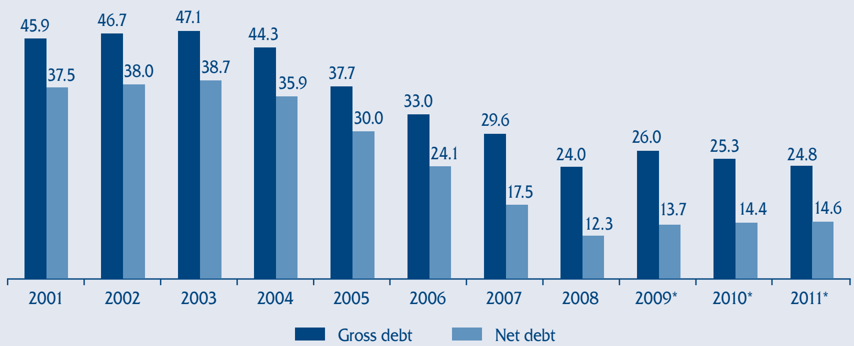
TABLE 21
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR 1/
(Millions of US$)

	2008	2009 *			2010 *		2011 *	
		I Sem.	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09	IR.Jun.09	IR.Sep.09
I. Uses	**-827**	**-438**	**3,617**	**3,799**	**3,730**	**3,440**	**4,053**	**3,491**
1. Amortization	1,971	589	1,221	1,184	1,397	1,249	1,787	1,733
a. External	1,449	467	925	927	1,069	950	1,102	962
b. Internal	522	122	296	257	328	299	686	771
Of which: Pension bonds	94	47	138	131	154	169	129	142
2. Overall balance (negative sign indicates surplus)	-2,798	-1,027	2,396	2,615	2,332	2,191	2,266	1,758
II. Sources	**-827**	**-438**	**3,617**	**3,799**	**3,730**	**3,440**	**4,053**	**3,491**
1. External	1,100	107	1,364	1,458	1,840	1,904	1,626	1,777
2. Bonds 2/	473	1 280	1 780	1 956	1 015	907	888	1 400
3. Internal 3/	-2,400	-1,825	474	384	875	630	1,540	314
Memo:								
Balance of gross public debt								
Millions of US$	30,648	31,898	32,496	33,199	34,260	35,258	35,040	36,598
As percentage of GDP	24.0	26.0	25.6	26.0	24.8	25.3	23.5	24.8
Balance of net public debt 4/								
Millions of US$	15,701	14,777	17,317	17,503	19,685	20,104	21,765	21,611
As percentage of GDP	12.3	12.1	13.6	13.7	14.3	14.4	14.6	14.6

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

At end 2009 the gross debt would amount to 26.0 percent of GDP, while the net debt would be equivalent to 13.7 percent of GDP. A reduction of 24.8 percent should be achieved in the level of the gross debt in 2011.

Graph 65
PUBLIC DEBT
(Percentage of GDP)



* Forecast.

V. Monetary Policy

55. Considering that inflationary pressures have declined and that inflation expectations are within the target range, the Central Bank decided to continue with its monetary impulse and approved additional reductions in its reference rate between July and August. Accumulating a reduction of 525 basis points since February, the reference rate was reduced by 175 basis points to 1.25 percent, thus reaching a minimum historical level. This decision is aimed at continuing to ease firms' access to credit and to stimulate higher private spending to support the reversal of the weak economic cycle that started in 2008 and deepened due to the global financial crisis.

56. Monetary policy loosening has been translating into lower short- and medium-term rates that facilitate firms' access to credit at a lower cost, both in the banking system and in the capital market.

    Long term rates for private credit, basically mortgage loans and credit for investment projects, continue showing a downward trend due to the reduction of domestic and international risk factors, which is translated into the lower risk premiums that private firms have to pay for credit.

57. The financial system has been quite liquid in Q3. Like interest rate expectations, the interbank rate showed a downward trend –although lower than the one observed in previous months–, reflecting that agents expect no additional adjustments in the monetary reference rate.

58. Increased monetary policy loosening is currently reflected in a reference interest rate of 1.25 percent, the lowest rate recorded since the implementation of inflation targeting.

Graph 66
REFERENCE RATE
(Percentage)

59. The level of this rate implies a significant monetary stimulus which, together with other liquidity injection measures implemented by the Central Bank (e.g. swaps), should contribute to a rapid recovery of the growth path of economic activity. In contrast with other economies, credit to the private sector has at no point contracted and is showing increasingly lower interest rates.

To reinforce this process, in July the Central Bank extended the term of foreign currency swaps to one year. These operations were mostly used by micro-finance entities. Before this, swaps had only been used as a mechanism to inject short term liquidity (with overnight to 3-month terms) and only with banks. The purpose of this injection mechanism is to improve the distribution of liquidity in soles in a longer term to ease credit operations in entities that have no liquidity in domestic currency. Given that the lowest interest rate on 1-year swaps is currently 1.35 percent –a rate quite close to the short term reference rate–, this is aimed at reducing more rapidly the interest rate for longer tranches of the yield curve.

SUMMARY OF MONETARY PROGRAM COMMUNIQUÉS: June – September 2009

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

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

July: The Board of the Central Reserve Bank of Peru approved to reduce the monetary policy reference interest rate from 3.0 to 2.0 percent. This is the sixth month of consecutive reductions, as a result of which this rates accumulates a reduction of 450 basis points so far this year.

This decision is based on the sustained reduction observed in the rate of inflation –from 6.7 percent in December to 3.06 percent in June–, on the reduction of inflation expectations to 2 percent, and on the slowdown observed in terms of economic activity.

With this new reduction, the reference interest rate has reached a historical minimum, thus consolidating a significant monetary stimulus. The implementation of future adjustments in this rate will depend on the evolution of the main macroeconomic indicators.

August: The Board of the Central Reserve Bank of Peru approved to reduce the monetary policy reference interest rate for the seventh consecutive month. This rate has been reduced from 2.0 to 1.25 percent, as a result of which this rates accumulates a reduction of 525 basis points so far this year.

This decision is based on the sustained reduction observed in the rate of inflation –from 6.7 percent in December to 2.68 percent in July– and on the continuous reduction of inflation expectations. The Central Bank does not foresee inflationary pressures in the next months.

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

This decision to maintain the monetary stimulus unchanged is based on the sustained reduction of annual inflation –inflation has declined from 6.65 percent in December to 1.87 percent in August– and on the continuous reduction of inflation expectations.

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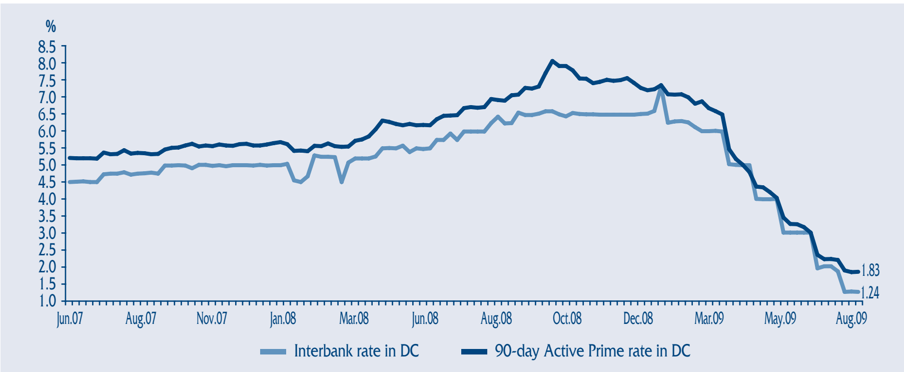
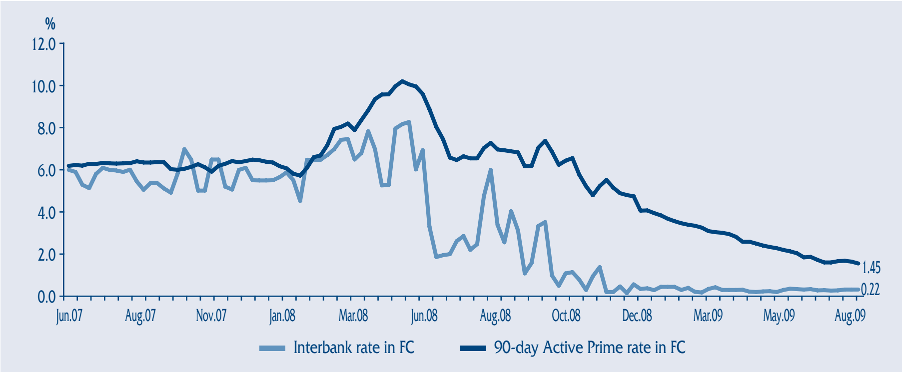
60. As a result of the Central Bank measures, the corporate prime rate in domestic currency has declined from 3.24 to 1.83 percent between June and August, in line with the reduction of the reference rate. It should be pointed out that the spread between the corporate rate and the interbank rate in foreign currency continued to fall to 123 basis points (below the level of 170 basis points recorded in June).

Graph 67
INTERBANK AND CORPORATE PRIME INTEREST RATES IN DOMESC CURRENCY

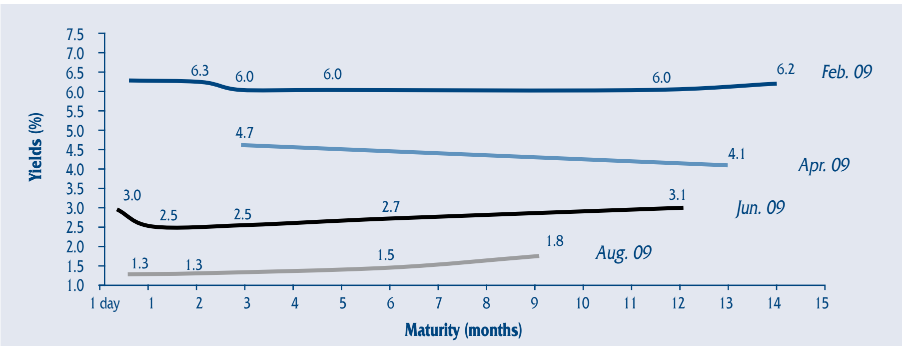


Graph 68
INTERBANK AND CORPORATE PRIME INTEREST RATES IN FOREIGN CURRENCY



61. The interest rates on Central Bank Certificates continued declining as a result of the successive reductions of the reference rate. However, since July, the yield curve has resumed a positive trend, reflecting that no further reductions of the reference rate are expected in the next months and that the cycle of monetary loosening would be coming to an end. As regards the amounts negotiated in these instruments, after strongly increasing between May and June due to expectations of cuts in short term rates (and consequently, of a price increase), the amounts negotiated have returned to previous levels as from July.

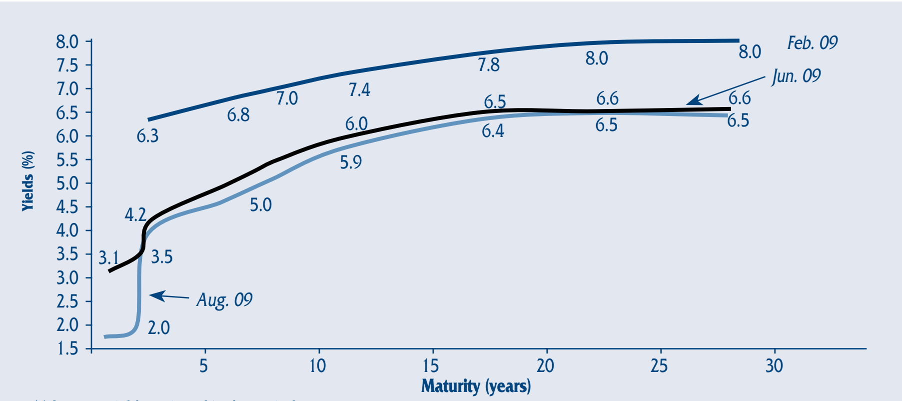
Graph 69
BCRP SECURITIES YIELD CURVE 1/



1/ Yields CD of CD-NR.

62. The monetary loosening measures implemented since our last Inflation Report was published have been mainly affecting interest rates in the short tranche (up to 2-years) of the yield curve of sovereign bonds. Longer term rates have also been declining although at a lower extent, following the trend of long term inflation expectations and the country risk indicator.

Graph 70
SECONDARY MARKET OF PUBLIC TREASURY SOVEREIGN BOND 1/

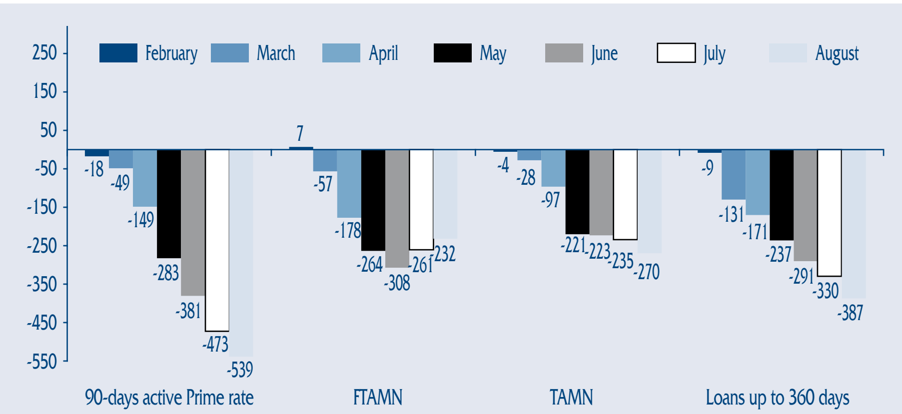


1/ Average yield auctioned in the period.

63. The pass-through of sovereign rates to lower corporate and mortgage rates has also shown a faster pace over the last months due to the reduction of credit risk premiums given the stabilization of macroeconomic credit conditions.

64. The average rates on banks' credit operations carried out between February and August (FTAMN) fell by 232 bps, from 23.0 percent in February to 20.7 percent in August 2009. The higher cuts of active interest rates implemented since April –after a faster pace was adopted in the reduction of the reference rate– were mainly reflected in the prime interest rate, which accumulated a reduction of 539 bps since February.

Graph 71
ACCUMULATED DECREASE IN THE ACTIVE INTEREST RATES
(Change February-August 2009, in basis points)



As regards passive interest rates, the rates on 30-day and 180-day deposits fell from 3.0 to 1.5 percent and from 5.0 to 3.4 percent, respectively. In the same sense, the rate on 181 to 360-day deposits fell from 5.9 to 5.4 percent.

TABLE 22
INTEREST RATES IN NUEVOS SOLES AND IN DOLLARS
(%)

	Soles		Dollars		Dif. (bps) (Aug.-Jun.)	
	Jun.09	Aug.09	Jun.09	Aug.09	Jun.09	Aug.09
1. Deposits up to 30 days	3.0	1.5	0.3	0.3	-153	-3
2. Rate on 31-day to 180-day	5.0	3.4	1.8	1.6	-163	-29
3. Rate on 181-day to 360-day term deposits	5.9	5.4	3.8	3.5	-51	-24
4. Corporate prime rate	3.6	2.0	2.1	1.5	-158	-61
5. Average rate on loans up to 360 days	12.6	11.6	8.3	7.5	-97	-75
6. Average lending rate. constant structure	16.1	15.6	9.6	9.2	-49	-38
7. Active commercial average	9.9	9.2	8.7	8.2	-75	-51

65. On the other hand, although low levels are still observed given the magnitude of the external shock, the delinquency rate has climbed for the different loan types, which has led some banks to increase their interest rates.

Graph 72
EVOLUTION OF THE LATE PAYMENT RATIO OF BANKS
(%)

66. Between August 2008 and July 2009, the active interest rates of municipal and rural deposit banks on loans for micro businesses and for consumption have declined, in line with the reductions of the BCRP reference rate, even though a dispersion is still observed in the interest rates offered by the different financial entities.

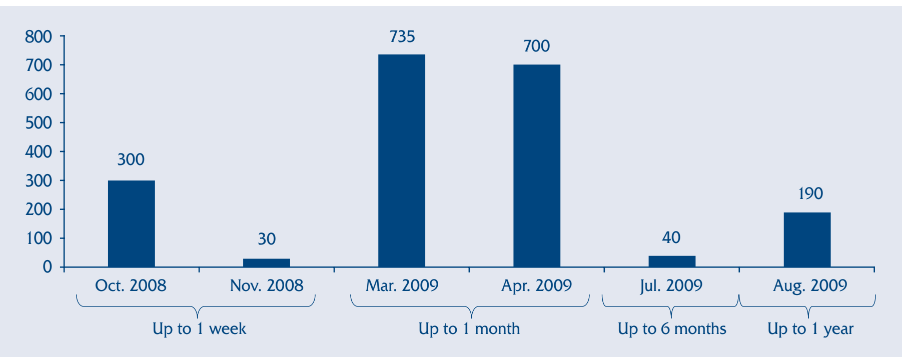
Monetary operations of the BCRP

67. Between June and August 2009, the interbank market continued showing appropriate liquidity levels, as reflected in the greater stability of the interbank rate. During this period, the BCRP re-oriented its operations from a liquidity injection strategy to a sterilization strategy, given that banks recorded higher liquidity surpluses due to the maturity of BCRP certificates, and with the purpose of preventing volatility in the interbank interest rate. Since June 2009, the BCRP started carrying out overnight, 1-week, 3-month, 4-month and 6-month sterilization operations, thus reducing the residual maturity of Certificates of Deposit (CDBCRP and CD BCRP-NR) from 106 to 85 days between June and end-August.

    Moreover, between July and August the Central Bank started making auctions of 6 month- and 1 year swaps (the balance of which to date is S/. 190 million), with participants including not only banks, but also Municipal Banks (Cajas Municipales). Through this mechanism, financial entities obtain funds in soles for the respective term in exchange of the dollars they provide as a guarantee. This type of operations is appealing for the financial entities that have liquidity surpluses in foreign currency, but prefer lending in domestic currency. In this way, the BCRP contributes to stimulate credit through longer term BCRP swaps, as well as to the dedollarization of credit.

68. In 2007 the Central Bank introduced the swap in foreign currency. This instrument is used to inject soles to the financial system and to withdraw dollars from it. The main advantage of the swap is that it allows a greater number of entities in the financial system (EFS) to have access to the funds offered by the BCRP, particularly when the availability of BCRP certificates (CDBCRP) and treasury bonds (BTPs) for the EFS is limited, as in the case of financial entities whose securities are not eligible for REPOS, but do have dollars.

Graph 73
BCRP SWAPS
(Balance, in millions of nuevos soles)



69. During the period of international financial turbulence (October 2008-February 2009), the BCRP used swaps in foreign currency as a complementary mechanism to inject soles for up to 3 month-terms, partly to meet the demand for this type of operations which was not covered by the interbank market. As from June 2009, the BCRP decided to extend the maturity of swaps in foreign currency with the purpose of providing funds in soles at longer terms (the terms were first extended to 6 months and, as from July, to 1 year).

Since the alternative cost of the swap –which is a fund source with a collateral– is higher for those entities that have greater difficulties in obtaining financing in soles, as is the case of financial entities engaged in microfinance, these entities are the ones that have been awarded with a relative higher amount of the swap auctions carried out by the BCRP. Thus, financial firms specializing in microfinance and municipal and rural banks have obtained 1-year funds at a rate of 1.35 percent –a similar rate to the one banks have access to in the non-collaterized money market–, which in addition to improving the distribution of liquidity in soles in the financial system, contributes to reduce the passive and active rates charged by these entities.

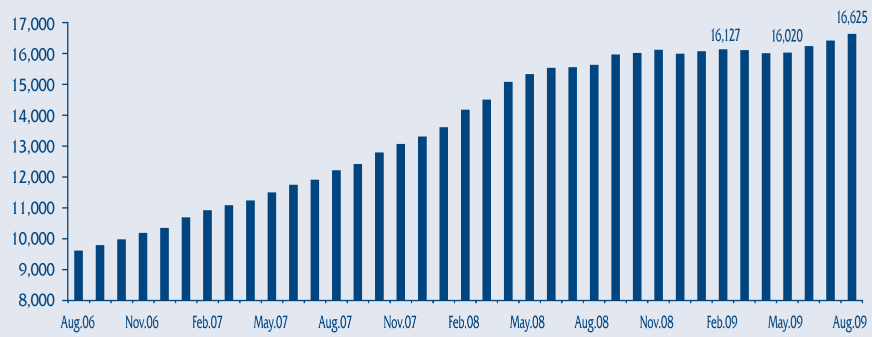
Additionally, swaps have a temporary impact on dedollarization and on the dynamic of credit among smaller financial entities, given that they can substitute the FC funding of their credit by the DC funding obtained through swaps. The EFS specialized in consumption loans and loans for micro businesses are less prone to lending their FC liquidity surpluses –relative to their funds in DC– since credit in FC generates a higher credit risk associated with the exchange risk and increases their currency mismatch.

Because it allows a greater flow of soles in the economy –as a complement of the traditional instruments used by the Central Bank–, the swap reinforces the pass-through of the reference rate cuts to interest rates in the segments of consumer loans and loans for micro businesses, thus reinforcing the effectiveness of monetary policy.

Liquidity and credit

70. A recovery of the demand for currency in circulation at monthly rates of between 1.1 and 1.3 percent has been observed since June, which reflects the reactivation of economic agents' transactions.

Graph 74
SEASONALLY ADJUSTED AVERAGE CURRENCY
(Balance in millions of nuevos soles)

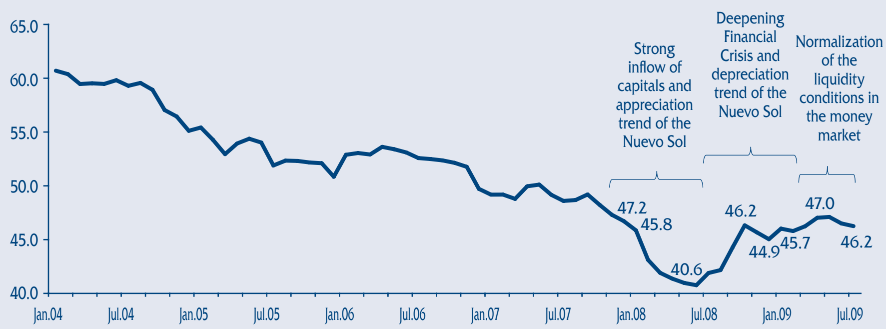


CURRENCY	Dec.07	Jun.08	Jul.08	Aug.08	Dec.08	Jun.09	Jul.09	Aug.09
Balance in millions of Soles	13,309	15,529	15,550	15,625	15,985	16,230	16,409	16,625
Monthly flow in millions of Soles	240	204	21	75	-127	210	179	216
Monthly % change	1.8	1.3	0.1	0.5	-0.8	1.3	1.1	1.3
12-month % change	28.5	32.1	30.5	27.9	20.1	4.5	5.5	6.4

71. Likewise, an increase of liquidity in the private sector, consistent with the signs of economic recovery, has been observed in recent months.

72. With the reduction of uncertainty in international markets, the ratio of dollarization of liquidity has stabilized, moving from 47.0 to 46.2 between April and July. It should be pointed out that after the rapid process of dollarization of deposits as from September 2008 –associated with generalized uncertainty as a result of the deepening of the crisis–, the ratio of dollarization of liquidity has remained close to the levels recorded at end 2007.

Graph 75
DOLLARIZATION OF LIQUIDITY 1/
(Percentage)



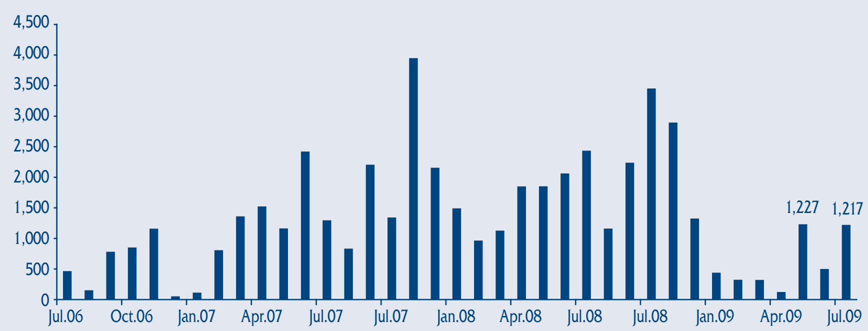
1/ Dollarization ratio at constant exchange rates.

73. The evolution of deseasonalized credit shows that, even during the deepening of the global financial crisis, credit to the private sector has continued growing sustainedly as a result of an appropriate liquidity position in the financial system, reflecting that there has been no credit constraint in Peru. The monthly flow of this indicator has been climbing since June and preliminary data at August 2009 indicates that this is a sustained trend.

Graph 76
CREDIT TO THE PRIVATE SECTOR
(Seasonally adjusted balance in millions of nuevos soles)

CREDIT TO THE PRIVATE SECTOR	Dec.07	Jun.08	Jul.08	Aug.08	Dec.08	Jun.09	Jul.09	Aug.09
Balance in millions of nuevos soles	75,996	86,114	88,675	90,537	98,391	102,532	103,926	104,798
Monthly flows millions of Soles	2,002	1,843	2,561	1,863	1,126	317	1,395	872
Monthly % change	2.7	2.2	3.0	2.1	1.2	0.3	1.4	0.8
12-month % change	32.9	32.5	33.4	33.6	29.5	19.1	17.2	15.8

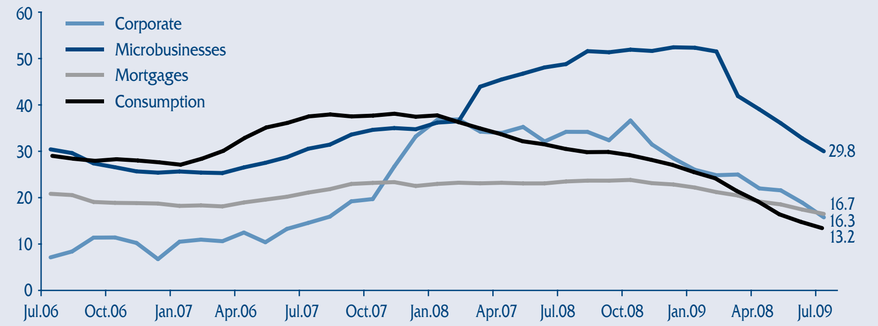
Graph 77
CREDIT TO THE PRIVATE SECTOR 1/
(Monthly flows)



1/ Constant exchange rate S/. 3.0 per dollar.

74. By type of credit, higher dynamism is observed in the growth rate of credit for micro businesses, which has continued expanding at rates of over 29 percent. On the other hand, commercial loans and mortgages have grown moderately, recording rates of 16.7 and 16.3 percent, respectively.

Graph 78
CREDIT TO THE PRIVATE SECTOR BY TYPE OF LOAN
(Annual % change)



1/ Constant exchange rate S/. 3.0 per dollar.

The overall evolution of credit in soles and credit in dollars is reflected in a moderate increase of the dollarization ratio (from 48.5 percent in April to 48.7 percent in July).

By type of financial institution, the greater velocity of de-dollarization in the last 12 months has been recorded in microfinance entities (down from 21.4 percent in July 2008 to 15.3 percent in July 2009). By type of credit, the greater ratio of de-dollarization has been recorded in mortgage loans (from 72.3 percent to 64.3 percent).

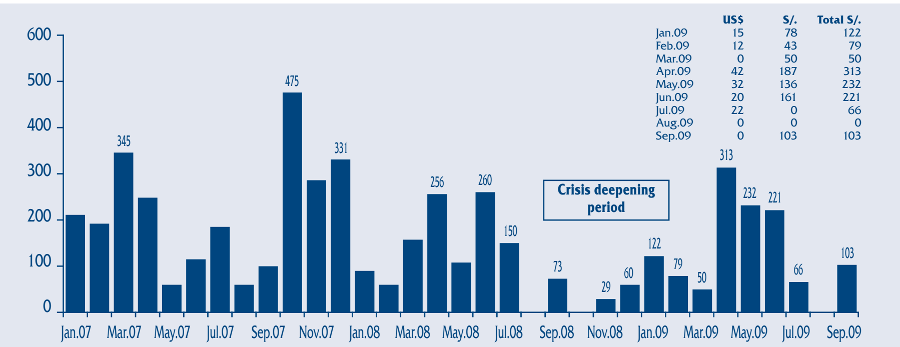
TABLE 23
DOLLARIZATION OF CREDIT TO THE PRIVATE SECTOR

	Jul. 08	Dec. 08	Apr. 09	Jun. 09	Jul. 09
By type of loan					
Corporate	69.1	68.9	65.0	65.8	65.6
Microbusiness	15.0	13.2	11.5	11.3	11.2
Consumption	16.4	16.6	15.2	15.1	15.0
Mortgage	72.3	70.2	66.7	65.3	64.3
By type of institution					
Banks	56.8	56.7	54.1	54.4	54.3
State-owned Banks	1.5	1.8	1.7	1.7	1.7
Microfinance institutions	21.4	20.4	15.9	15.5	15.3
TOTAL	**52.1**	**52.2**	**48.5**	**48.8**	**48.7**

75. After a period of uncertainty about the evolution of the economy at the beginning of the year, private issuances of corporate bonds by non financial companies recorded a strong dynamism in Q2, exceeding the ones made in the same period of 2008 before the global financial crisis unfolded. Private issuances of bonds would have declined in July and August due to the better conditions offered by the financial

system, despite the existing high demand for these instruments and despite the fact that the bond issuances registered at CONASEV until August 2009 are by far higher than the ones registered in the same period in 2008 (65 percent higher). However, a recovery of the amounts issued has been observed in September, which would imply that the number of issuances will continue increasing in the next months given better expectations of economic growth.

Graph 79
BONDS ISSUED BY NON-FINANCIAL COMPANIES
(Millions of nuevos soles)

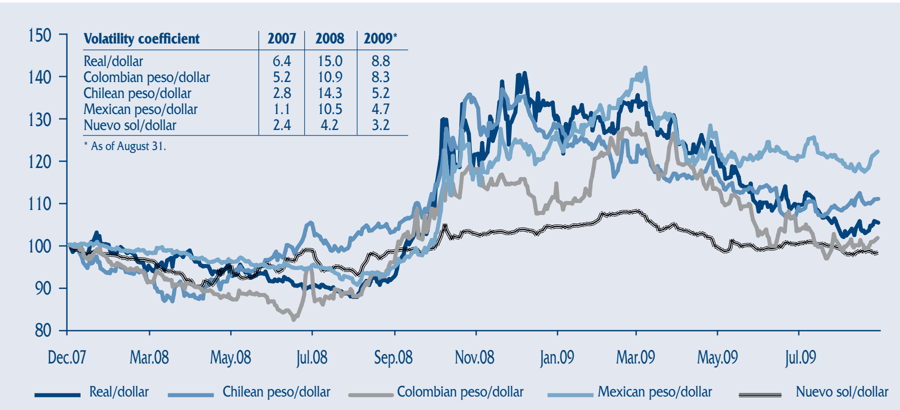


* Primary public offers are valued in dollars at constant rate of exchange of S/. 3.0 per US$.
Source: Weekly Report BCRP.

Exchange rate

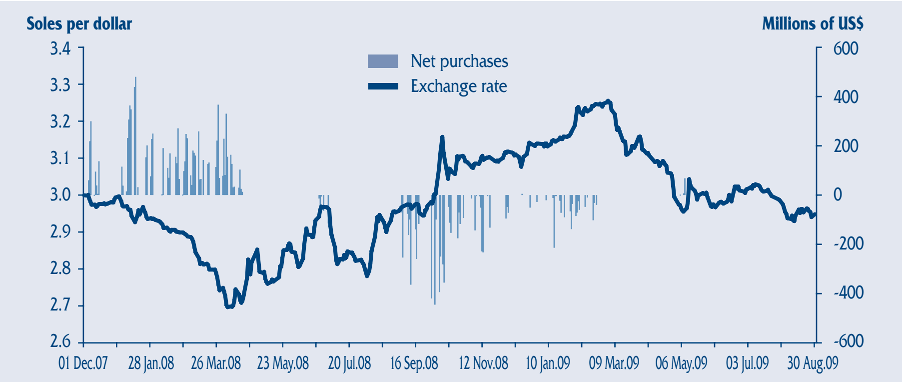
76. Between June and August, the nuevo sol was the most stable currency in the region, reflecting the rapid normalization of financial conditions in the domestic foreign exchange market. Because of the lower volatility of the exchange rate, the Central Bank did not intervene in the exchange market.

Graph 80
EXCHANGE RATE INDEX
(December 2007=100)



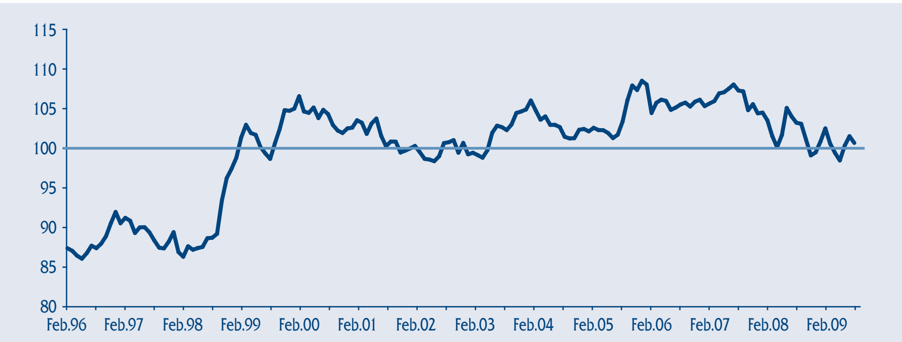
77. Thus, between June and July the BCRP made no exchange operations and only issued indexed certificates of deposits (CDR BCRP) for a total of US$ 134 million, a sum significantly lower than the one issued in Q1 (US$ 2,912 million). The higher demand for dollars associated with the maturing of CDR BCRP (US$ 1,404 million) and with AFPs' purchase of US$ 653 million in the spot market was covered with the maturities of forward operations (US$ 1,196 million), with the reduction of banks' exchange position (US$ 289 million), and with sales of FC of other economic agents (US$ 573 million).

Graph 81
BCRP NET PURCHASES AND EXCHANGE RATE
(Exchange rate S/. per US$ and purchases in millions of US$)



78. The real exchange rate also shows the same stability observed since the first months of the year and is similar to the average level recorded in the last 10 years. This reflects not only the current stability based on sound fundamentals (fiscal discipline, the reduction of the external debt, and a sustainable balance of payments), but also that the relative profitability of our exports remains stable.

Graph 82
REAL EXCHANGE RATE INDEX
(Dec. 2001 = 100)



BOX 3
RATIONALITY OF THE BCRP FOREIGN EXCHANGE INTERVENTION

One of the first lessons of the international financial crisis is that fluctuations in the prices of financial assets are important determinants of credit cycles and of the financial fragilities they generate. In emerging economies, and particularly in those with high financial dollarization, the most relevant price of financial assets in terms of the financial stability of the financial system is the exchange rate, in contrast with developed countries where the price of shares or real estate is relatively more important.

Thus, in dollarized economies like the Peruvian economy, abrupt fluctuations in the exchange rate are costly because they weaken the financial position of firms and families with debts in dollars. For this reason, the BCRP's inflation targeting strategy considers interventions in the forex market to reduce transitory and abrupt fluctuations of the exchange rate as part of its monetary strategy. These actions are particularly important in periods with high pressures in the money and exchange markets such as those observed between September 2008 and February 2009, because they contribute to stabilize monetary and credit conditions and prevent the enhancement of adverse external shocks.

Ex post, one can see that both the strong appreciatory pressure on the nuevo sol in Q1-08 and the depreciatory pressure observed between October 2008 and March 2009 were transitory phenomena that did not reflect sustainable trends in the exchange rate. Thus, the current exchange rate is similar to the one recorded in February 2008. In this sense, had the BCRP not intervened in the forex market in the magnitude and timely manner it did intervene, the volatility of exchange would have been much higher and would have generated real costs in the economy and in the financial system's stability. Even if the depreciations of the exchange rate had been permanent, the exchange intervention aimed at offsetting extreme volatilities would have eased absorbing the external shocks and reduced the risk of weakening firms' equity position. The table below shows the lower relative volatility of our currency compared to other currencies in the region and the evolution of the exchange rates.

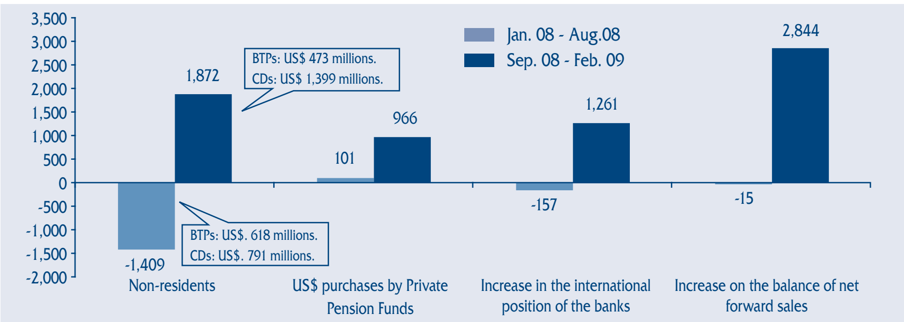
EXCHANGE RATE EVOLUTION DURING THE INTERNATIONAL FINANCIAL CRISIS
(% change)

	Brazil	Mexico	Colombia	Chile	Peru
Capital inflow period and commodity price boom August 07 / August 08	-17.9	-8.4	-10.5	-1.4	-8.4
Exchange rate turbulence period September 08 / February 09	29.0	37.3	21.0	13.6	9.1
Market stabilization period March 09 / August 09	-20.2	-11.1	-18.3	-7.5	-7.1

A difference between Peru and other countries in the region is that none of the latter is dollarized, and thus higher volatility in the exchange rate is desirable in their economies. Nevertheless, in spite of not being dollarized, some of these economies were initially affected by the negative impact of exchange volatility, because important firms had projected the appreciation of the respective local currencies and therefore recorded currency mismatches.

It is worth remembering that the pressure in the forex market was significant in Peru. As illustrated in the graph below, the exchange pressure reflected an important change in the portfolio of both resident and non resident agents towards long FC positions. Thus, between September 2008 and February 2009, the exchange position of banks increased by US $ 1,261 million; the demand of the public, particularly institutional investors, increased by US $ 966 million, and the demand of non residents increased by US $ 1,872 million. The demand in the forward market amounted to US $ 2,844 million. The overall upward pressure of exchange that the Central Bank faced amounted to US $ 6,943 million and was buffered by sales of FC and placements of CDRBCRP.

FOREX MARKET: PORTFOLIO MOVEMENT



The BCRP was able to respond to this situation due to the important level of international reserves accumulated in the years prior to the deepening of the financial crisis. As shown in the following table, between 2007 and year-to-date, the BCRP has accumulated reserves for a total of US $ 11,989 million. The lower exchange volatility achieved due to the Central Bank's policy is one of the factors contributing to maintain more flexible monetary and credit conditions. Together with the monetary stimulus achieved by reducing the reference rate from 6.5 percent in January 2009 to the current rate of 1.25 percent, the lower volatility of the exchange rate will allow a more rapid and sustained recovery of economic activity.

BCRP EXCHANGE RATE OPERATONS
(Million of US$)

	Purchases*
2007	10,306
January - April 2008	8,728
May - December 2008	-5,974
Accumulated 2008	2,754
Accumulated 2009, as of August 31	-1,072
Accumulated 2007 - 2009	11,989

* Negative sign indicates net sales of US$.

BOX 4
MONETARY MEASURES IMPLEMENTED BY THE BCRP TO FACE THE INTERNATIONAL CRISIS

Since the deepening of the international financial crisis in September 2008, several measures have been implemented by the Central Bank to face this crisis. The timely use of a series of monetary policy instruments to ensure the continuity of the credit chain and prevent an exchange crisis has contributed to offset the adverse impacts of the crisis.

Since September 2008, the BCRP has injected liquidity for over S/. 35 billion –a sum equivalent to nearly 9% of GDP– to prevent the interruption of credit and a strong depreciation of the nuevo sol that would negatively affect firms' financial soundness. Reserve requirements were reduced and new liquidity injection mechanisms were implemented, including 1-year Repos, currency swaps, and repurchases of BCRP CDs, among other mechanisms. This not only prevented the paralyzation of credit, but also allowed banks to have enough resources to keep financing economic activity. Additionally, since September 2008, the BCRP sold FC for a total of US$ 6,843 million in order to reduce the volatility of the exchange rate. This was possible because the BCRP had purchased US$ 23,333 million since 2006.

In February 2009, once the period of strong international turbulence was over, the Central Bank started reducing the reference interest rate. If this measure had been implemented earlier, the risk that inflation expectations did not decline would have been very high. Moreover, there would also have been the risk of having an exchange crisis and a contraction of credit, since any abrupt change in the exchange rate of a dollarized economy like the Peruvian economy can imply that individuals and firms with debts in dollars do not pay their obligations, which entails a reces sionary effect in the economy. Thus, when inflation expectations were controlled and upward pressures on the exchange rate subsided in March 2009, the BCRP increased the pace of reference interest rate cuts since April, leading this rate to its current level of 1.25%, its lowest historical level and the second lowest rate in emerging countries.

As from July 2009, the BCRP has carried out 1-year swaps of foreign currency with the purpose of reducing the cost of funding in soles for financial entities, especially for those specializing in microfinance, as well as for the purpose of propitiating a more rapid decline of the interest rates on loans in this segment.

MEASURES TO PREVENT THE INTERRUPTION OF CREDIT FLOWS: Sept.2008-Feb.2009

Macroeconomic context

1. Collapse of the financial system of developed economies. The most severe financial crisis since the Great Depression of 1929.
2. Upward pressures on the exchange rate: 12% between September 2008 and February 2009.
3. Inflation expectations fall above the target range until February 2009.

REDUCTION OF THE REFERENCE RATE: February-August 2009

Macroeconomic context

1. Inflation and inflation expectations declined.
2. Lower volatility of exchange.
3. Appropriate levels of liquidity in DC and FC in banks.

Monetary policy measures 1. Inject liquidity for over S/. 35 billion into the financial system to prevent the paralysis of the financial system (equivalent to approx, 9% of GDP). 2. Sales of dollars to reduce the volatility of exchange. 3. BCRP monetary operations to reduce interest rates for the bond market.	**Monetary policy measures** 1. Lower the reference interest rate from 6.5% to 1.25% to maintain inflation within the target range. 2. Monetary operations to provide greater liquidity to the financial system and accelerate the reduction of interest rates.
Results 1. Normal functioning of the payment chain. 2. Appropriate levels of liquidity in DC and FC. 3. Reduction of the volatility of the exchange rate.	**Results** 1. Inflation returned to the target range as from July 2009. 2. Normal functioning of the financial system. 3. Reduction of long term interest rates.

BOX 5
MACROPRUDENTIAL REGULATION AND SUPERVISION: FIRST LESSONS FROM THE INTERNATIONAL FINANCIAL CRISIS

The current global financial crisis has generated growing consensus among academics and economic authorities on the importance of strengthening the macroprudential approach to financial regulation and supervision in order to contribute to financial stability.

The macroprudential approach to financial regulation and supervision focuses on the financial system as a whole, with the objective of reducing the macroeconomic costs of episodes of financial distress. In contrast, the microprudential approach focuses on individual financial institutions. The main difference between these two approaches is that the former considers aggregate risk as dependent on the collective behavior of financial institutions, that is, as endogenous to the individual decisions of financial institutions, whereas the latter focuses on individual financial institutions and considers aggregate risk as independent of their actions.

Because of the high costs that financial instability generates in economic activity and in the well-being of individuals[10], it is important to implement a macroprudential approach to regulation and supervision in the financial system. Moreover, if the soundness of financial institutions is evaluated

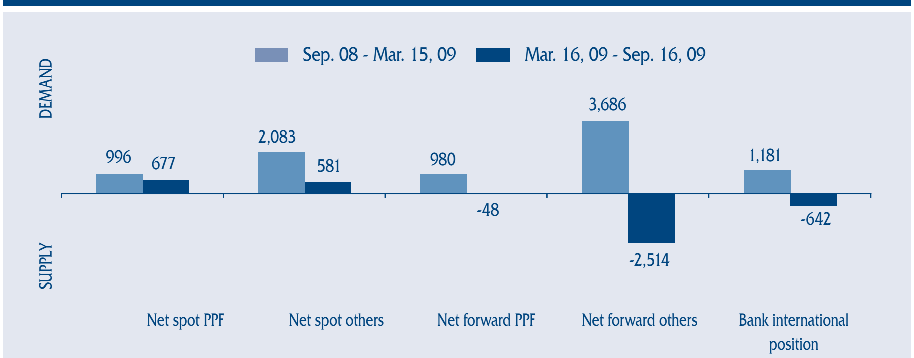
10 For example, Hoggarth and Saporta (2001) estimate an average loss of between 16.3 percent and 16.9 percent of GDP for 43 episodes of bank crises.

on an individual basis, an important risk factor would be neglected since very often financial institutions are exposed to the same or to common risk factors.

In Peru, the importance of having macroprudential regulations that prevent the individual decisions of financial institutions from generating negative impacts on the society's well-being, particularly in a dollarized economy like the Peruvian economy, has been clearly evidenced in this last episode of financial turbulence (September 2008-February 2009). In emerging countries, and especially in those with high financial dollarization, the most relevant price of a financial asset in terms of financial stability is the exchange rate, in contrast with developed countries where the price of shares and real estate are relatively more important.

The graph below shows how banks' and AFPs decisions of increasing their FC positions when the international financial crisis deepened in September 2008 generated pressures on the forex market. Between September 2008 and March 2009, AFPs increased their FC positions by nearly US$ 2 billion, while banks increased them by nearly US$ 1 billion.

FOREX MARKET FLOWS
(Millions of US$)



In contrast with other countries, banks' exchange position in Peru may show a long position in dollars involving 100 percent of their equity, although this should not exceed the dollarization ratio of their assets, which is around 50 percent. In Chile and Colombia, for example, banks have an exchange position limit equivalent to 20 percent of their equity.

Moreover, in contrast with Chile, in Peru there is no prudential limit for AFPs' exposure to exchange risk as no regulations in this sense have been established. Therefore, it is recommended that the convenience of establishing a limit on the long or uncovered position of AFPs in dollars is evaluated.

The development of the capital market also requires the existence of long term securities to fund banks' long term loans. Therefore, it is important to create mortgage loans in soles as long term instruments whose main characteristic is the safety this provides to investors. This would allow a less costly funding for banks, due to lower risk, as well as a currency match in their mortgage loan operations. Moreover, this would also provide long term instruments for AFPs and insurance companies.

Today, most of the pensions of the private pension system are paid in dollars, since only two pension options are available: pensions in dollars or inflation-indexed pensions. Due to the scarcity of inflation-indexed papers (VAC) allowing an adequate match, insurance companies offer mostly only the dollar option to members of pension plans, which has generated important losses for retired people as a result of the appreciation of the exchange rate. Compared legislation (including partially dollarized economies) shows that retirement pensions are paid in the country's local currency.

These series of macroprudential regulation measures are essential in a dollarized economy like the Peruvian economy not only to prevent that the soundness of the financial system is affected by individual decisions, but also to achieve a greater development of the capital market, as well as in order that the private pension system may effectively serve to provide better future pensions to its members.

VI. Inflation

79. Inflation returned to the target range in July in a context of a weak economic cycle, lower inflation expectations, lower imported inflation, and the reversal of supply shocks in the prices of foodstuffs. This downward trend of inflation should continue until early next year due mainly to transitory supply-related factors. Inflation would transitorily fall below the lower band of the inflation target between end 2009 and the first months of 2010.

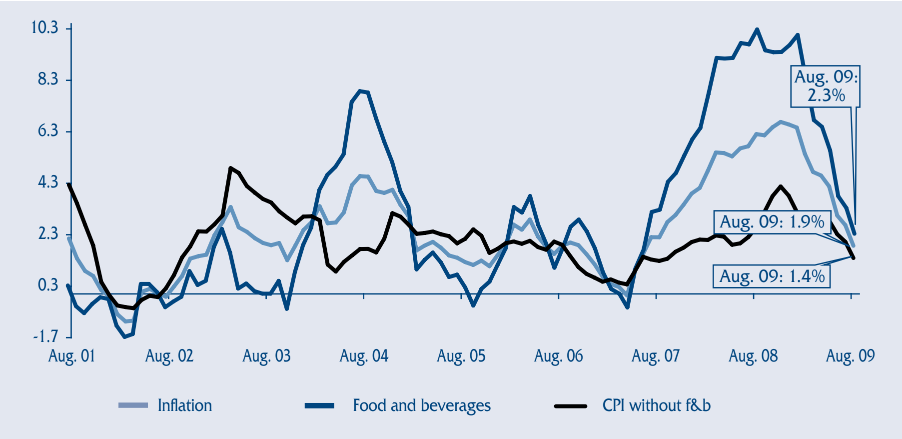
80. Returning to the target range, accumulated inflation in the last 12 months recorded a rate 1.9 percent at August 2009 (versus 6.65 percent at December 2008). This strong deceleration of inflation is due to the reversal of the rises in the prices of commodities in a context of international crisis.

    Despite the recovery observed in the last months, the price of crude in August was 45 percent lower than the average price in 2008. This has been reflected in the prices of fuels, which showed a last 12 month-variation of -18.4 percent in July 2009 (versus -0.04 percent in December 2008).

81. The reduction of the prices of the main food inputs (wheat, maize, and soy bean) contributed to reduce the prices of foodstuffs, although this was not entirely reflected in the prices of end goods. The prices of foodstuffs were also affected by climatic factors in producing areas and by speculative positions. The last 12 month-variation of food prices moved from 9.7 percent in December 2008 to 2.3 percent in August 2009.

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

Graph 84
OVERALL CONSUMER PRICE INDEX AND FOOD AND BEVERAGES CPI
(Last 12-month % change)



82. Considering the evolution of prices in the last three months (June-August), inflation declined 0.36 percent, with foodstuffs accounting mostly for this decline during this period. Around 0.7 points of this result is explained by the prices of chicken meat, potato and carrot.

TABLE 24
WEIGHTED CONTRIBUTION TO INFLATION
(Percentage points)

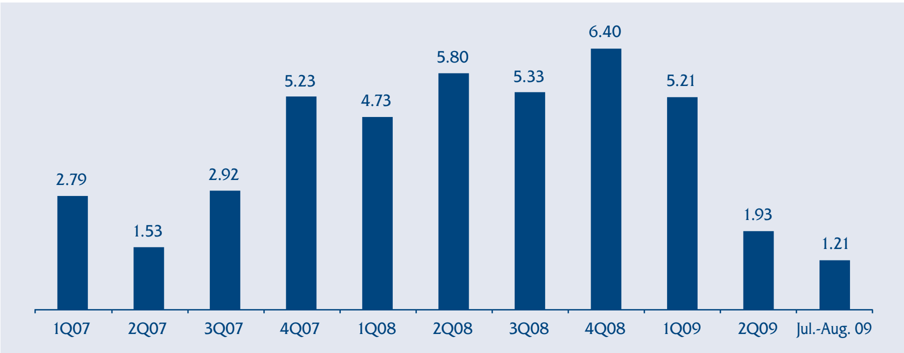
Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Onion	0.44	34.8	0.26	Chicken meat	4.0	-10.7	-0.42
Tomato	0.32	36.2	0.09	Potato	1.5	-8.7	-0.17
Sugar	1.38	6.2	0.07	Carrot	0.2	-35.8	-0.12
Meals outside the home	10.23	0.6	0.06	Electricity	2.2	-5.1	-0.11
Corn	0.23	22.2	0.06	Eggs	0.7	-7.6	-0.08
Other vegetables	0.63	6.5	0.05	Pumpkin	0.2	-25.3	-0.08
Total			**0.59**	**Total**			**-0.97**

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

TABLE 25
INFLATION

	Weight	2006	2007	2008	2009 Jan.-Aug.	2009 12-month
Inflation	**100.0**	**1.14**	**3.93**	**6.65**	**0.01**	**1.87**
1. Food and beverages	47.5	1.76	6.02	9.70	0.51	2.34
2. Rest of components	52.5	0.61	2.02	3.86	-0.49	1.39
a. Fuels and electricity	6.2	-3.16	5.21	1.65	-11.00	-11.37
Fuels	3.9	-1.50	6.45	-0.04	-14.91	-18.85
Electricity	2.2	-7.30	1.92	6.31	-0.86	11.50
b. Transport	8.4	1.12	0.82	5.86	-0.94	3.95
c. Public services	2.4	1.22	-1.44	8.68	0.01	5.82
d. Other goods and services	35.5	1.28	1.89	3.51	1.98	3.45
Memo:						
Core inflation	60.6	1.37	3.11	5.56	1.97	3.93
Core inflation excluding f&b	35.5	1.28	1.89	3.51	1.98	3.45

Graph 85
CORE INFLATION
(Annualized quarterly change)



83. In line with the reduction of domestic demand and inflation expectations, core inflation has declined from annualized rates of over 5 percent in Q1 to 1.2 percent in the July-August period.

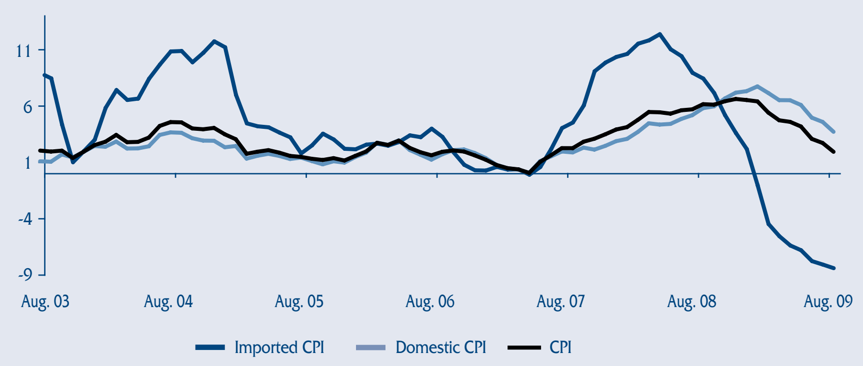
Imported inflation

84. Imported inflation at August recorded an accumulated change of -6.9 percent. This drop is explained by the evolution of the imported fuels and foodstuffs (-14.9 percent and -2.7 percent, respectively).

TABLE 26
DOMESTIC AND IMPORTED INFLATION
(Accumulated % change)

	Weight	2006	2007	2008	2009 Jan.-Aug.	2009 12-month
I. IMPORTED CPI	**12.1**	**0.27**	**10.46**	**2.20**	**-6.87**	**-8.49**
Food	5.4	2.08	18.83	4.75	-2.71	-3.14
Fuels	3.9	-1.50	6.45	-0.04	-14.91	-18.85
Electric appliances	1.0	-1.29	-1.50	-0.06	-1.99	-1.51
Other items	1.8	0.64	0.47	0.46	-0.17	1.60
II. DOMESTIC CPI	**87.9**	**1.28**	**2.84**	**7.44**	**1.17**	**3.70**
III. CPI	**100.0**	**1.14**	**3.93**	**6.65**	**0.01**	**1.87**
Exchange rate		**-6.40**	**-7.00**	**4.47**	**-5.25**	**2.00**
Imported CPI excluding food	6.7	-1.02	4.31	0.06	-10.52	-13.07
Food and beverage domestic CPI	42.1	1.72	4.14	10.53	1.03	3.23
Domestic CPI excluding food	45.8	0.89	1.64	4.53	1.32	4.18

Graph 86
DOMESTIC AND IMPORTED INFLATION
(Last 12-month % change)



Inflation expectations

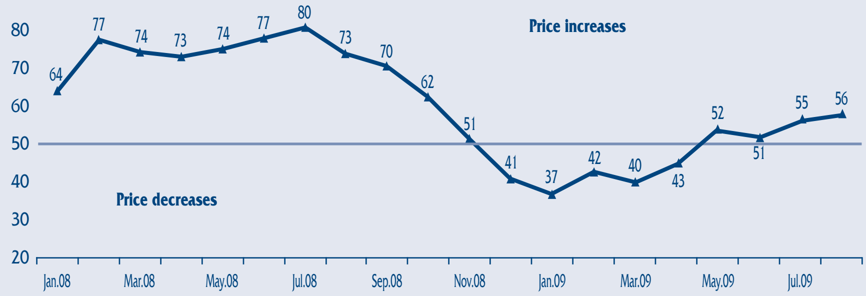
85. Economic agents' expectations about inflation in 2009 have declined relative to the information provided in our June Report. In general, the economic agents surveyed expect inflation to be within the target range this year. In 2010 and 2011, inflation would be between 2.5 and 3.0 percent.

TABLE 27
URVEY ON MACROECONOMIC EXPECTATIONS: INFLATION (%)

	June 2009	September 2009
FINANCIAL ENTITIES		
2009	2.8	1.5
2010	3.0	2.5
2011	3.0	2.9
ECONOMIC ANALYSTS		
2009	2.8	1.7
2010	2.6	2.5
2011	2.8	2.8
NON-FINANCIAL FIRMS		
2009	3.4	2.5
2010	3.0	3.0
2011	3.4	3.0

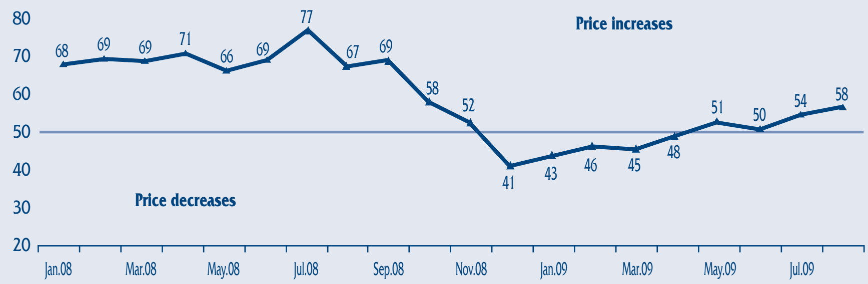
86. As regards the average prices of inputs and sale prices in the following 3-4 months, the index of expected average prices of inputs climbs from 52 (June Report) to 56, given that the percentage of firms expecting lower input prices has declined. Similarly, the index of expected average sale prices has increased from 51 to 58 since our last Report, basically due to a reduction in the percentage of firms expecting lower sale prices.

Graph 87
AVERAGE INPUT PRICE INDEX: Next 3 - 4 months
Manufacturing sector



Source: BCRP Survey on Macroeconomic Expectations, August 2009.

Graph 88
AVERAGE SALE PRICE INDEX: Next 3 - 4 months
Manufacturing sector



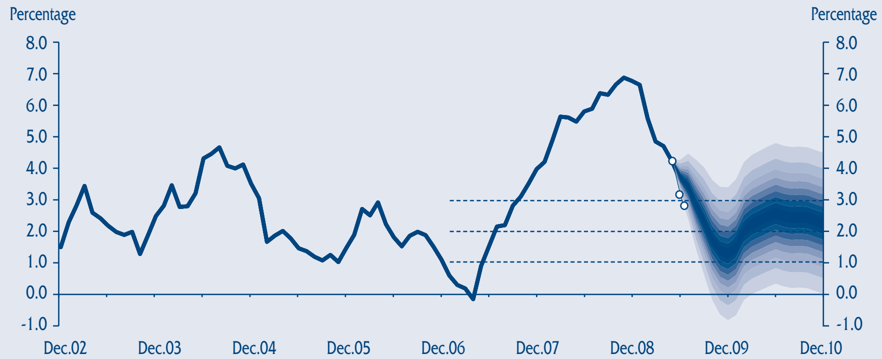
Source: BCRP Survey on Macroeconomic Expectations. August 2009.

Inflation forecast

87. The inflation forecast for 2009 has been revised downwards relative to our June Report due to the lower growth of economic activity and to lower inflation expectations. Inflation at July 2009 returned to the target, and would transitorily fall close to the lower band of the target range at end 2009 due to the reversal of supply shocks affecting the prices of imported food and fuels.

    Inflation's downward trend has been confirmed in the first months of the year. Thus, 12 month-inflation has declined from 6.5 in January to 1.9 percent in August. In terms of annualized quarterly variations, inflation has declined from 1.4 in the March-May quarter to -1.2 percent in the June–August period, while core inflation has declined from 4.3 to 1.7 percent in the same period.

Graph 89
INFLATION FORECAST INCLUDED IN THE INFLATION REPORT OF JUNE 2009 AND OBSERVED INFLATION

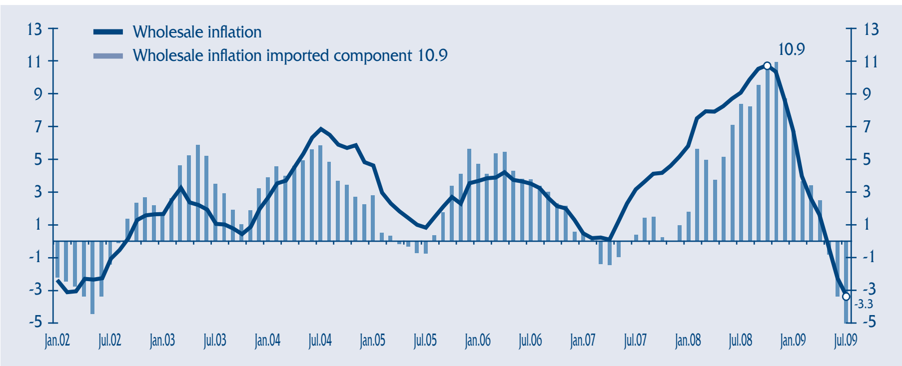


This result is explained by the strong drop of imported inflation, as well as by the lower dynamism of economic activity associated with the global recession. In this context, expectations of future inflation have declined, which has also contributed to the deceleration of the inflationary pace.

88. The severe deterioration of global economic conditions has affected the dynamism of domestic economic activity. This impact on the domestic economy has been enhanced by the strong inventory adjustment, as a result of which the deceleration of the growth of GDP in the first semester of 2009 was higher than the one projected in the baseline scenario of our June Report and closer to the risk scenario of increased deterioration of domestic demand considered in said Report. This lower initial point in the forecast affects the forecast on the growth path of GDP on the downside.

89. The lower initial point in Q3-09 is also characterized by a lower imported inflation than the one considered in our previous Report. This is explained by the negative impacts of the international recession on the prices of imported inputs, such as oil derivatives, foodstuffs, and inputs for construction, as well as by the reversal of depreciatory pressures on the nuevo sol. The impact of these two factors is reflected in the recent downward evolution of the wholesale price index and its imported component.

Graph 90
WHOLESALE PRICE INDEX
(Last 12-month % change)



90. An upward gradual correction is projected in the prices of commodities, in line with expectations of a recovery of the global economy in 2010 and 2011. Thus, a moderate upward contribution of imported inflation would be seen in terms overall inflation.

91. The forecast on the decline of global GDP in 2009 remains at 1.3 percent due to the impact of the global economic crisis, which implies a direct negative effect on

exports. The forecast on the drop of terms of trade has been revised from -12.8 to -8.7 percent in 2009, due to the improved forecast on growth in larger developing countries (e.g. India and China) and to the recovery of manufacturing in developed countries. Because the forecast on growth in the rest of economies in the region, particularly Latin American countries, is on the downside, the projected decline of global GDP remains at 1.3 percent. On the other hand, a gradual recovery of the global economic context is expected as from 2010.

92. The baseline forecast scenario considers that monetary policy loosening and the implementation of the expansion of public expenditure associated with the Economic Stimulus Plan will contribute to sustain economic growth along the forecast horizon, especially during the second semester of 2009 and throughout 2010.

93. In overall terms, the external and domestic determinants of economic activity imply a gradual improvement of the output gap (measured as the differential between GDP and potential GDP). However, given the recent evolution of this indicator, demand pressures on inflation would continue being negative in 2009 and slightly positive thereafter.

    The forecast on GDP growth is corrected from 3.3 to 1.8 percent in 2009, from 5.5 to 5.0 percent in 2010, and from 5.5 to 5.2 percent in 2011.

VII. Balance of Risks

94. The risk factor considered in our June Inflation Report that materialized was the one associated with domestic spending, which was lower than expected, mainly due to the adjustment of inventories.

95. Given the economic context, the forecasts are still subject to a high level of uncertainty. The main risks that could divert inflation from the central scenario forecasts include the risks discussed in our previous report, as well as the additional risk of having lower prices in terms of domestic foodstuffs:

- **Increased deterioration of the global economy.** The baseline scenario considers a scenario where the global economy starts recovering. However, there is the risk of having a slower recovery or even a setback in this recovery. This would imply lower economic growth and lower inflation rates than the ones considered in the baseline scenario.

  In this risk scenario, the monetary policy stance would be more flexible than the one considered in the baseline scenario. These actions would continue being complemented by monetary operations to facilitate a rapid pass-through to interest rates and maintain an appropriate liquidity position in both currencies. In case that the contingent scenario of international deterioration were coupled by excessive upward volatility in the exchange rate, the BCRP has ample international reserves to face this contingency and prevent the deterioration of the asset position of firms and the financial system.

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

  In this situation, monetary policy would maintain its countercyclical monetary stimulus stance for a longer period of time.

- **Lower prices of domestic foodstuffs.** A significant correction in the prices of foodstuffs due to the lower prices of imported food inputs and better conditions in the domestic supply of food has been observed so far this year. A lower level of prices in the forecast horizon than the one considered in the baseline scenario could imply that inflation remains for a longer period of time below the target range.

  In the same way as happened in the two previous years, when the prices of food increased, the Central Bank will not respond to transitory supply shocks, unless these may affect inflation expectations in an undesired manner.

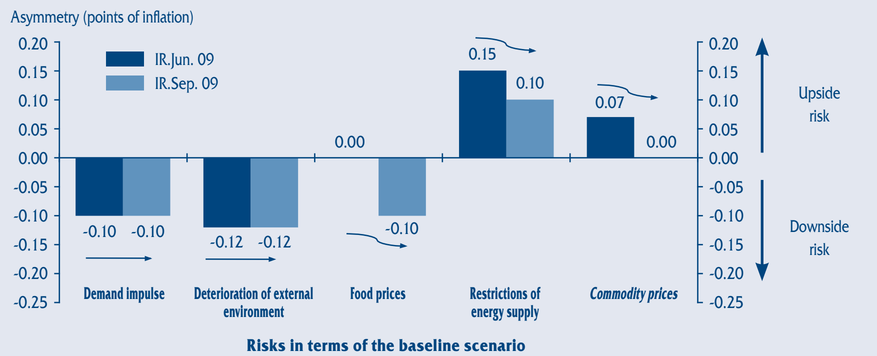
- **Constraints in energy supply.** The supply of electricity continues to be close to the limit of its potential capacity, which increases the probabilities of failures in this service. Additionally, climatic conditions could aggravate the balance between the supply and the demand of electric energy,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

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

96. The risks associated with constraints in energy supply and higher prices of food commodities and crude are more inclined towards the optimistic side. On the other side, the risks associated with the deterioration of the world economy and lower domestic spending remain. Finally, a new risk has been included: the downward trend in the prices of domestic foodstuffs.

97. Weighing the above mentioned risks against the baseline scenario shows a downward bias for the central inflation forecast, in contrast with our June Report, which showed a neutral balance.

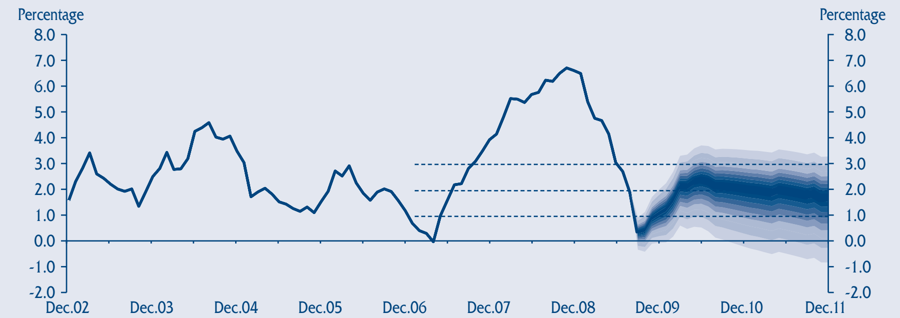
Graph 91
INFLATION FORECAST: BALANCE OF RISKS 1/
(2 year-ahead inflation deviations in % points)



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

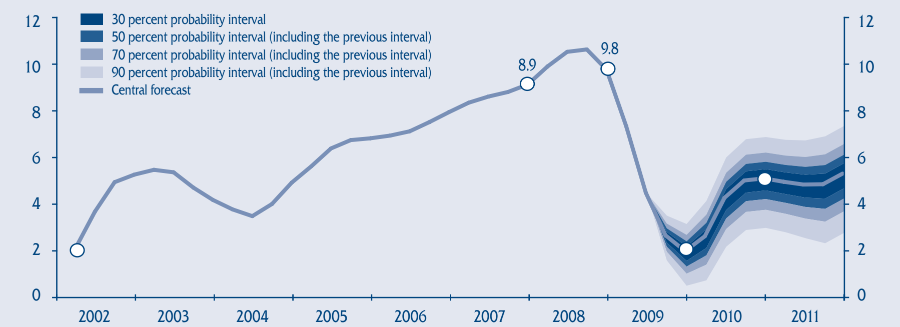
98. This implies a density forecast of inflation of an asymmetric nature. This means that there is a higher probability that inflation will be below the level considered in the baseline scenario throughout the forecast horizon. The balance of risks in terms of GDP growth is also considered asymmetric and with a downward bias. This result is similar to the one of our June Inflation Report, which also showed a balance with a downward bias.

Graph 92
INFLATION FORECAST
(12-month % change)



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

Graph 93
GDP GROWTH FORECAST
(Annual % change of GDP in each quarter)



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

CONCLUSION

99. At end 2009, inflation would transitorily fall near the lower band of the target range due to the reversal of supply shocks that affected the prices of imported foodstuffs and fuels. This projection is consistent with the downward trend of inflation observed since end 2008 and with the evolution expected in the macroeconomic determinants of inflation in the 2009-2011 forecast horizon.

100. Furthermore, in the current context of a deepening of global recession and deceleration of domestic demand, the Central Bank has been loosening its monetary policy stance in order to ensure that price stability is consistent with sustained economic growth. Weighing the risk factors against the baseline inflation forecast shows a balance of risks with a downward bias.

APPENDIX

	2007	2008	2009 1/		2010 1/		2011 1/	
			IR.Jun. 09	IR.Sep. 09	IR.Jun. 09	IR.Sep. 09	IR.Jun. 09	IR.Sep. 09
Real % change								
1. GDP	8.9	9.8	3.3	1.8	5.5	5.0	5.7	5.2
2. Domestic demand	11.8	12.3	2.4	-0.4	5.7	5.9	5.8	5.7
a. Private consumption	8.3	8.7	2.5	2.5	3.6	3.3	4.2	4.2
b. Public consumption	4.5	1.8	6.8	9.5	3.4	4.0	3.6	3.0
c. Private fixed investment	23.4	25.6	2.5	-10.3	6.1	4.2	6.2	9.2
d. Public investment	18.4	42.8	49.4	40.0	14.7	15.6	11.4	7.2
3. Exports (goods and services)	6.2	8.2	-1.3	-2.7	5.5	4.7	9.6	6.1
4. Imports (goods and services)	21.3	19.9	-4.7	-11.6	6.2	9.2	9.2	8.3
5. Main trade partners' economic growth	4.7	2.6	-1.7	-1.7	2.2	2.7	3.3	3.4
Memo:								
Output gap 2/ (%)	1.7	3.8	-1 , 0	-1 , 0	-1, +1	-1, +1	-1, +1	-1, +1
% change								
6. Forecast inflation	3.9	6.7	1.0-2.0	0.0 - 1.0	1.5-2.5	1.5-2.5	1.5-2.5	1.5-2.5
7. Average price of crude oil	9.4	38.5	-46.1	-39.7	20.2	24.8	6.9	4.3
8. Nominal exchange rate 3/	-7.0	4.5	-0.2	-4.2	1.5	2.0	0.3	0.8
9. Real Multilateral exchange rate 3/	-1.7	-4.8	-7.7	-3.4	2.2	1.6	0.3	0.5
10. Terms of trade	3.6	-13.8	-12.8	-8.4	-0.2	4.9	-0.2	-0.8
a. Export price index	14.0	4.9	-20.3	-13.9	4.4	11.0	2.3	1.7
b. Import price index	10.0	21.7	-8.7	-5.9	4.7	5.8	2.5	2.6
Nominal % change								
11. Currency in circulation	27.1	16.7	7.0	10.0	8.5	12.5	9.0	14.0
12. Credit to the private sector 4/	33.0	29.6	9.0	7.0	11.5	10.5	12.5	11.5
% of GDP								
13. Domestic savings rate	22.9	26.9	26.6	23.6	28.1	25.4	29.2	26.7
14. Current account of the balance of payments	1.1	-3.3	-3.2	-2.1	-3.1	-2.4	-2.6	-2.5
15. Trade balance	7.7	2.4	0.9	2.9	0.7	3.1	0.9	2.7
16. Gross external financing to the private sector 5/	9.1	5.6	5.4	5.7	5.5	4.9	5.3	4.9
17. Current revenue of the general government	20.7	20.8	18.5	18.4	18.7	19.0	19.0	19.3
18. Non-financial expenditure of the general government	16.0	17.3	19.3	19.3	19.2	19.2	19.4	19.1
19. Non-financial expenditure of the general government	3.1	2.1	-1.8	-2.0	-1.7	-1.6	-1.5	-1.2
20. Total public debt balance	29.6	24.0	25.6	26.0	24.8	25.3	23.5	24.8

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