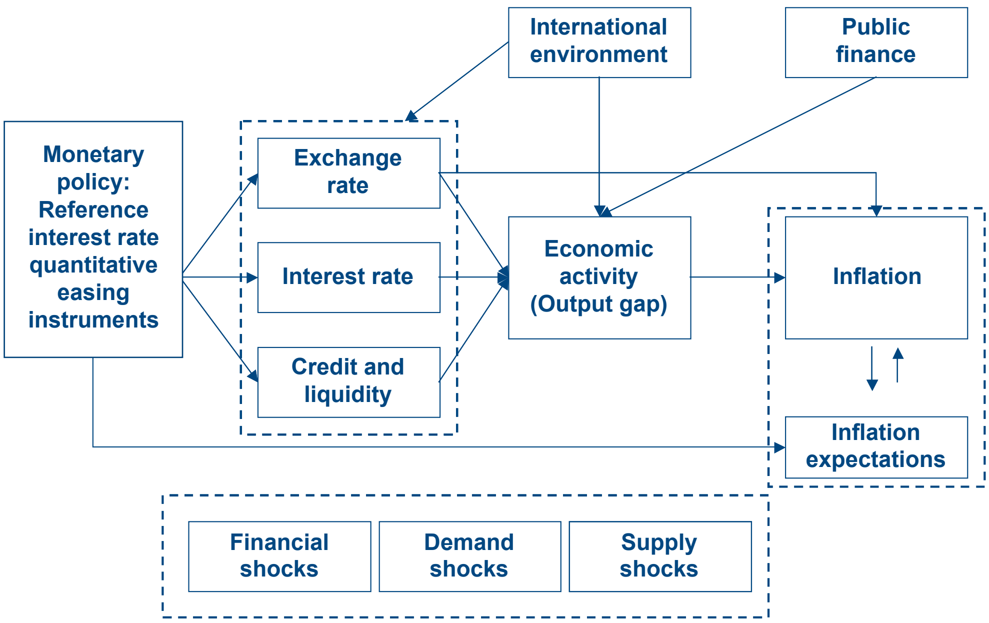
INFLATION REPORT:

Recent trends and macroeconomic forecasts 2010-2012

September 2010



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INFLATION REPORT
Recent trends and macroeconomic forecast

CENTRAL RESERVE BANK OF PERU

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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 June 2010, data on monetary accounts, inflation, exchange rate, and financial markets as of August 2010, and data on the exchange rate as of September 2010.

Foreword

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

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

- Compliance with the inflation target is continuously assessed; that is, the Central Bank considers the accumulated rate of inflation in each month and not only at year's end. The monetary policy of the BCRP is of a preventive nature and therefore aims at anticipating inflationary or deflationary pressures. The Central Bank also takes into account that inflation can be influenced by factors that are beyond the control of monetary policy, such as supply shocks or the prices of imported goods, which may lead inflation to transitorily deviate from the target.

- Each month, and according to a previously announced schedule, the Board of the BCRP approves a reference rate for the interbank lending market. This interest rate 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 Central Bank also manages other monetary policy instruments with which it can affect more directly the volumes of liquidity and credit, such as reserve requirements in domestic and foreign currency

  Additionally, the Central Bank implements preventive measures to preserve financial stability. Through foreign exchange intervention it reduces excessive volatility in the exchange rate and accumulates international reserves, thus developing strengths against negative events in an economy with a high degree of financial dollarization.

- The forecasts based on which monetary policy decisions are made are disseminated to generate the public's understanding of the consistency of the measures 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.

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

Summary

i. Since May the Central Bank has been withdrawing monetary stimulus, thus raising the reference rate from its historical minimum level of 1.25 percent to 3.0 percent in September. In the respective monetary policy communiqués, the Board has emphasized the preventive nature of these adjustments in the reference interest rate in a context characterized by the strong dynamism of domestic demand, with no inflationary pressures observed on the side of demand, with several indicators of economic activity showing a high growth, and with a rate of inflation within the target range.

   Inflation started converging towards the target range since May, reaching a rate of 2.3 percent in en August. Inflation is forecast to remain within the tolerance range in the next two years, although it would show a value closer to the upper band of this range in 2010 due to rises in the prices of some food products as a result of some supply shocks.

ii. The indicators of economic activity continued showing a strong dynamism. Domestic demand grew at a rate of 11.1 percent during the first semester –higher than foreseen in the June Report–, boosted by a significant recovery of private investment and private consumption, as well as by the fiscal impulse observed since last year. This rapid expansion has been associated mainly with the evolution of some non primary sectors which, because of their nature, have in turn a significant impact on the evolution of employment and incomes.

iii. Global economic activity showed more moderate growth rates during the second quarter of the year. In the case of developed economies this lower pace of growth is mainly explained by the low dynamism observed in the labor market, where high unemployment rates are still observed, as well as by the slow recovery of the credit market, particularly in a context of gradual deleveraging of the high levels of indebtedness that households still have.

   In the case of emerging economies, the rapid growth recorded in countries such as China, India and Brazil, together with the appearance of some inflationary pressures, has led to adjustments in the monetary policy stance in this group of economies, and therefore a lower pace of growth is also expected, although still at high rates of growth. Another factor that would also be having an impact on global growth, particularly in the Eurozone countries, is associated with the fiscal adjustment programs that, in some cases, have been already been implemented or to be implemented in other cases, due to the weak financial position observed in several economies.

In this context, the forecasts on global growth for 2011 and 2012 have been corrected slightly downwards, from 4.0 to 3.7 percent. On the other hand, growth in 2010 is estimated at 4.2 percent, a slightly higher rate than the one considered in our June Report (4.0 percent) due mainly to the better than expected execution observed in the first semester, particularly in Europe and in emerging economies.

iv. Considering that a more moderate outlook for global economic activity is expected in the forecast horizon and that monetary and fiscal stimulus will continue to be withdrawn in the domestic environment, the current pace of growth is expected to moderate towards the levels of potential GDP growth. Therefore, our economy is still forecast to grow at a rate of 6 percent in 2011 and 2012 –as considered in our June Report–, while the growth rate in 2010 has been revised from 6.6 to 8.0 percent.

v. The forecast on the real growth of public expenditure this year has been revised slightly from 9.8 to 12.3 percent in line with the estimates of the Multiannual Macroeconomic Framework and the forecast on the real growth of the revenues of general government has also been revised from 14.0 to 16.6 percent. A reduction of the fiscal impulse is expected in the forecast horizon as the fiscal stimulus is been withdrawn, which would allow going from a positive impulse estimated at 1.2 percent for this year to a more neutral position. This fiscal projection is consistent with an anti cyclical fiscal policy during the next years and with a sustainable path in public finances.

vi. Considering the projections of GDP growth and their effect on an increased demand for imports, as well as the evolution of terms of trade, the projected deficit in the current account of the balance of payments has been revised upwards, from 1.0 of GDP in our previous Report to 1.7 percent of GDP in 2010, and it is estimated that it would stabilize at 3.0 percent of GDP in 2011 and 2012.

vii. The main risks that could deviate the inflation rate from the baseline scenario in the forecast horizon include the following:

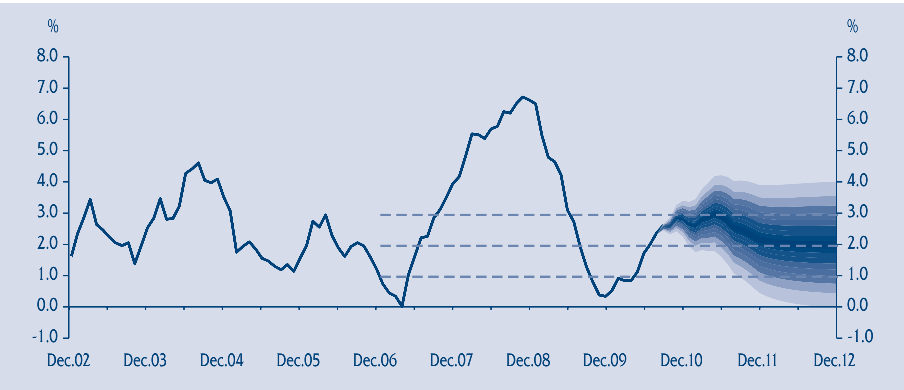
- **Deterioration of the international environment.** The baseline scenario considers that global economic activity would recover and that terms of trade would remain at high although declining levels during the forecast horizon (2010 - 2012). In this scenario, there would be a lower global demand for commodities, lower prices for a great deal of our primary exports, unfavorable credit conditions, and a subsequent slowdown in the domestic economy. If this risk materialized, monetary policy would maintain the monetary stimulus for a longer period of time. The Central Bank maintains a high availability of international reserves and has different liquidity injection mechanisms to face this contingency.

- **Increased dynamism in the domestic economy.** The baseline forecast scenario considers a sustained growth trend in terms of domestic demand, without inflationary pressures. However, if private and public spending increased significantly above the levels considered in the baseline scenario, monetary stimulus would be reduced more rapidly.

- **Increase in food prices.** The recent evolution in the price of food commodities such as wheat, maize, soy bean, and sugar shows that the probability of higher prices in the future has increased. In addition, there is uncertainty about climatic factors that could affect the domestic supply of food. These shocks would have a transitory effect on inflation. In this scenario, the Central Bank would withdraw monetary stimulus more rapidly only if the potential increase of inflation due to supply factors affects inflation expectations.

The current balance of risks in the inflation forecast is neutral.

INFLATION FORECAST
(12-month percentage change)



I. International environment

1. The global economy continued showing the positive evolution discussed in our previous Inflation Report, while financial markets were favored by lower uncertainty about the Eurozone peripheral countries.

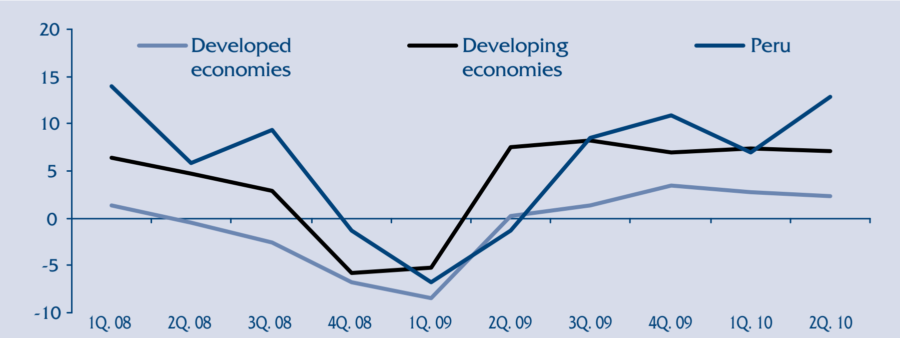
   However, a moderation of the rates of growth of domestic demand in the United States and other developed economies is being observed. Moreover, growth in emerging economies has been slowing down in a context of increasing inflationary pressures and lower dynamism in China. The central scenario considers an improvement in the rates of growth in 2010 given the results achieved in the first semester, while an economic slowdown is projected for the second semester on the basis of recent indicators. Likewise, the projection of global growth for 2011 has been revised slightly downwards. On the other hand, the projection of the prices of commodities has been revised upwards due to some supply factors and, in some cases, due to speculative demands as a result of high international liquidity.

   This central scenario shows risks on the downside. A lower dynamism of private consumption in developed economies is not ruled out if the labor market does not show dynamism or if credit conditions do not improve significantly. Moreover, a scenario of deflation could lead to a postponement of consumption. Finally, there is the risk of an increase of pressures on prices in emerging economies that can lead to adjustments –higher than expected– in the monetary and fiscal policy positions.

Global trends

2. The world economy has continued showing, in general terms, a positive evolution so far this year. Among other factors, this reflects the fiscal and monetary measures, the gradual normalization of financial conditions, and the recovery of international trade. In the case of developed economies, growth reached annualized rates of 2.8 and 2.4 percent in Q1 and Q2, respectively. In the case of emerging economies, growth rates of 7.4 and 7.1 percent were recorded.

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

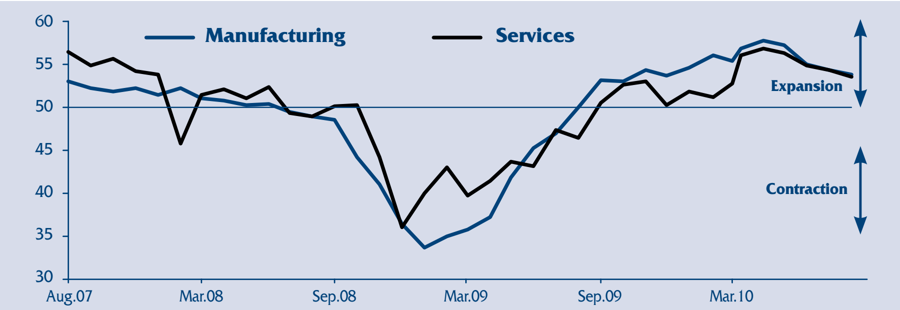


Source: JP Morgan and BCRP.

3. However, according to several indicators, growth in the global economy has been showing a moderate deceleration which, in turn, introduces a higher degree of uncertainty to the central scenario. Many economies have recorded lower growth rates in Q2 than in the previous quarter. In the United States, for example, economic activity grew 1.6 percent in Q2, a lower rate than in Q1 (3.7 percent).

4. Moreover, the aggregate index of manufacturing activity –the Purchasing Managers Index (PMI)– declined for four consecutive months, although it remains above the expansion threshold and in levels consistent with a moderate and sustained growth of activity. Other indicators of economic activity show mixed evidence for both developed and emerging economies, particularly in the case of Asian economies which have been slowing down from exceptionally high rates, influenced by China's lower growth.

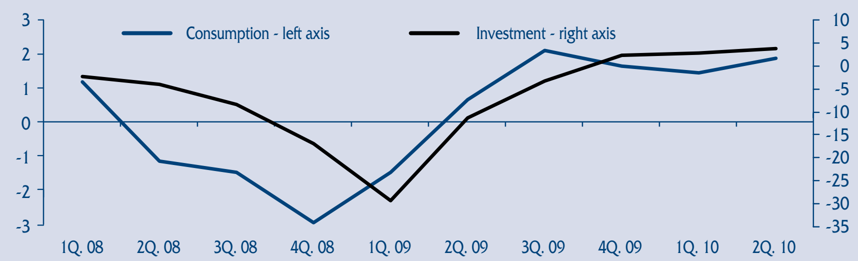
Graph 2
GLOBAL PURCHASING MANAGERS INDEX
(PMI)



Source: JP Morgan.

5. In the case of developed economies, this deceleration of growth rates is consistent with a slower recovery of consumption than the one foreseen in our previous Report, which would be partially compensated by the better evolution of investment and global trade. The reactivation of consumption has been constrained by the limited growth of the labor market, the slow recovery of the credit market, and by the still ongoing process of household deleveraging.

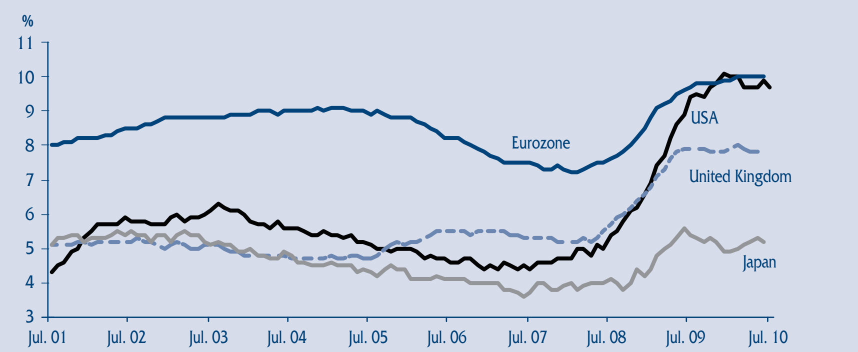
Graph 3
DEVELOPED COUNTRIES: GROWTH OF CONSUMPTION AND INVESTMENT
(Annualized quarterly variation)



Fuente: JPMorgan.

Thus, although at historically high levels, some stabilization is observed in the rate of unemployment in the case of the labor market. In the United States, the current rate is the highest recorded in three decades and the creation of new jobs has been more modest that in other periods after a recession. In the Eurozone, unemployment rates are close to 10 percent, while the economies where fiscal sustainability was recently in doubt (Greece, Ireland, and Spain) show significantly higher rates.

Graph 4
DEVELOPED COUNTRIES: UNEMPLOYMENT RATE



As regards credit conditions, scarce dynamism is observed in consumer credit, particularly in the United States where the recovery of credit concentrates in the business sector. Additionally, consumption continues being affected by the deleveraging process, especially in economies that show still high rates of private debts (e.g. United States, Spain, and the United Kingdom). In the United States, for example, the current levels of debt are only 6.5 percent lower than the maximum levels observed prior to the crisis.

Graph 5
UNITED STATES: FAMILIES' DEBT BALANCE
(Trillion US$)

Source: FED.

6. Other factors account for the prospects of lower growth in the case of **emerging economies**. Unlike developed countries, where the economies have not recovered the dynamism they had prior to the crisis, many emerging economies –including the largest ones, such as China, India and Brazil– have been growing strongly while simultaneously recording an increase in inflationary pressures, which has led them to adjust their monetary policy position. This is estimated to continue in the following quarters.

7. The **outlook for the global economy** shows a downward risk that could even lead to a new recession in some developed economies. Factors to be considered include: (i) the worsening of conditions in the labor and credit markets, which currently are constraining a greater recovery of consumption in developed economies, (ii) a deflation scenario that may lead to the postponement of consumption and imply positive real interest rates that affect economic recovery, and (iii) an increase of pressures in emerging economies (particularly BRICs[1]) that lead to higher than expected adjustments in the monetary and fiscal position.

   In the case of such a risk of slowdown or recession, the withdrawal of monetary and fiscal stimulus could be postponed or implemented more gradually than considered

1 Group of economies integrated by Brazil, Russia, India, and China.

a few months ago. The Federal Reserve (FED), the European Central Bank (ECB) and other central banks have left open the possibility of maintaining stimulus for a longer period of time while recovery consolidates and as long as inflationary pressures remain under control. In the same vein, it is possible that fiscal stimulus may be extended despite the doubts that exist about fiscal sustainability in many developed economies.

Economic activity

8. In this context, growth projections for 2011 have been revised slightly downwards. On the contrary, growth in 2010 would be somewhat higher than considered in our previous Inflation Report, basically due to the better than expected execution observed in the first semester, particularly in Europe and in the emerging economies.

Table 1
WORLD GROWTH
(Annual % change)

			2010		2011		2012	
	2008	2009	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
Developed countries	**0.3**	**-3.2**	**2.3**	**2.4**	**2.4**	**1.9**	**2.3**	**2.0**
1. United States	0.0	-2.6	3.2	2.7	2.9	2.4	2.5	2.4
2. Eurozone	0.5	-4.1	0.8	1.2	1.3	1.0	1.5	1.1
Germany	1.3	-4.9	1.5	2.4	1.5	1.5	1.5	1.2
France	0.2	-2.6	1.2	1.4	1.5	1.3	1.7	1.3
3. Japan	-1.2	-5.2	1.9	2.4	1.9	1.0	1.9	1.4
4. United Kingdom	-0.1	-4.9	1.1	1.4	2.0	2.0	2.4	2.0
5. Canada	0.4	-2.6	3.2	3.3	3.3	2.7	2.9	2.4
6. Other developed countries	1.7	-1.2	3.8	4.4	3.4	3.2	3.5	3.1
Developing countries	**6.2**	**2.4**	**5.9**	**6.2**	**6.0**	**5.8**	**6.0**	**5.8**
1. Sub-Saharan Africa	5.6	2.2	4.7	5.0	5.9	5.5	5.2	4.9
2. Central and Eastern Europe	3.1	-3.6	2.5	2.8	4.0	3.4	4.0	3.6
3. Community of Independent Countries	5.5	-6.6	3.5	4.1	3.9	4.0	4.2	4.2
Russia	5.6	-7.9	3.5	4.1	3.7	3.8	3.7	3.7
4. Developing Asia	8.0	6.6	8.0	8.3	7.8	7.6	7.9	7.6
China	9.6	8.7	9.5	9.5	9.2	8.9	9.2	8.8
India	7.5	5.7	7.1	7.5	7.0	6.9	7.0	6.9
Others	4.5	2.3	4.9	5.9	5.3	5.0	5.4	5.2
5. Middle East and Northern Africa	5.3	2.4	4.5	4.5	4.8	4.7	4.8	4.8
6. Latin America and the Caribbean	4.2	-1.8	4.0	4.8	3.8	3.7	3.8	3.6
Brazil	5.1	-0.2	5.5	7.0	4.0	4.0	4.1	4.0
World Economy	**2.9**	**-0.6**	**4.0**	**4.2**	**4.0**	**3.7**	**4.0**	**3.7**
Memo:								
BRICs 1/	8.0	4.8	7.7	8.1	7.4	7.2	7.4	7.1
Peru's trading partners 2/	2.6	-1.2	3.6	3.7	3.5	3.3	3.5	3.2

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

9. In the developed economies, **United States**' annualized growth rate of 1.6 percent in Q2 (3.7 percent in Q1) has maintained the uncertainty about the soundness of recovery.

Cuadro 2

Table 2
GDP: QUARTERLY EXECUTION
(Annualized quarterly growth rates)

	2009				2010	
	I	II	III	IV	I	II
United States	-4.9	-0.7	1.6	5.0	3.7	1.6
Japan	-16.6	10.4	-1.0	4.1	5.0	1.5
United Kingdom	-9.0	-2.8	-1.0	1.7	1.3	4.9
Eurozone	-9.8	-0.3	1.6	0.5	1.3	3.9

Source: JP Morgan.

Consumption, whose growth rates have not exceeded an annual 2 percent, shows a slow pace and also a lower growth than trend growth and the one observed in previous experiences of recovery. This has been offset by private investment which has shown a significant recovery in the first semester of the year. However, according to recent information, investment would slow down in the rest of the year, in part due to the stagnation of the real estate sector (associated with the expiration of tax incentives) and to the end of the inventory correction process. This evolution has implied revising the growth projection for this year from 3.2 to 2.7 percent and the growth projection for 2011 from 2.9 to 2.4 percent.

Table 3
UNITED STATES: GROWTH
(Quarterly annual rates)

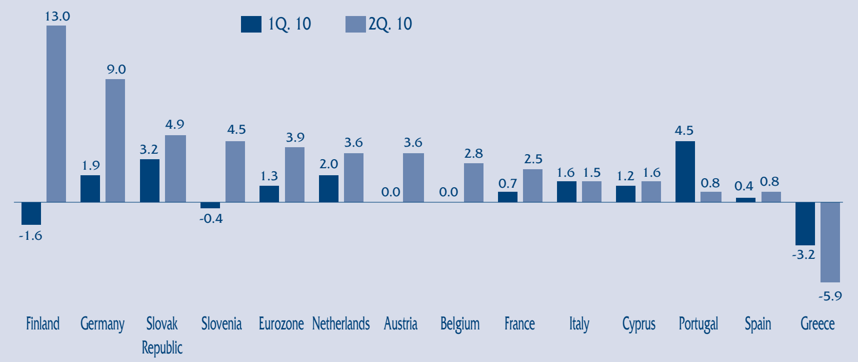
	1Q.09	2Q.09	3Q.09	4Q.09	1Q.10	2Q.10
GDP	-4.9	-0.7	1.6	5.0	3.7	1.6
Personal consumption	-0.5	-1.6	2.0	0.9	1.9	2.0
Durable goods	4.8	-3.1	20.1	-1.1	8.8	6.9
Non-durable goods	0.4	-0.7	1.7	3.1	4.2	2.1
Services	-1.6	-1.7	-0.5	0.5	0.1	1.2
Gross investment	-42.2	-18.5	11.8	26.7	29.1	25.0
Fixed investment	-35.4	-10.1	0.7	-1.3	3.3	19.5
Non-residential	-35.2	-7.5	-1.7	-1.4	7.8	17.6
Residential	-36.2	-19.7	10.6	-0.8	-12.3	27.2
Exports	-27.8	-1.0	12.2	24.4	11.4	9.1
Imports	-35.3	-10.6	21.9	4.9	11.2	32.4
Government expenditure	-3.0	6.1	1.6	-1.4	-1.6	4.3

Source: BEA.

The increase of risks of a lower growth has been reflected in the extension of the FED's non traditional monetary measures. In its last monetary policy meeting, the FED said that it will reinvest the maturities of its holdings of mortgage backed securities (MBS) in long term Treasury bonds, which will allow it to maintain the value of its papers in its balance of assets. Moreover, at end August the president of the FED clarified that only if economic conditions worsened significantly would additional measures be implemented, thus ruling out speculation of an impending new asset purchase program.

10. On the other hand, annualized growth in **Europe** in Q2 has been higher than in Q1. The rate of growth in the **Eurozone** was 3.9 percent (1.3 percent in Q1) and all of the main economies have shown a favorable evolution due to the strong dynamism of net exports, which has more than compensated the stagnation of domestic demand. Only some economies in the region (the ones affected by the sovereign debt crisis) have recorded a higher contraction than the one expected (mainly Ireland and Greece) and contagion to other economies in the region has been ruled out.

Graph 6
EUROZONE: QUARTERLY GROWTH
(Seasonally adjusted annualized quarterly rates)



Source: Eurostat.

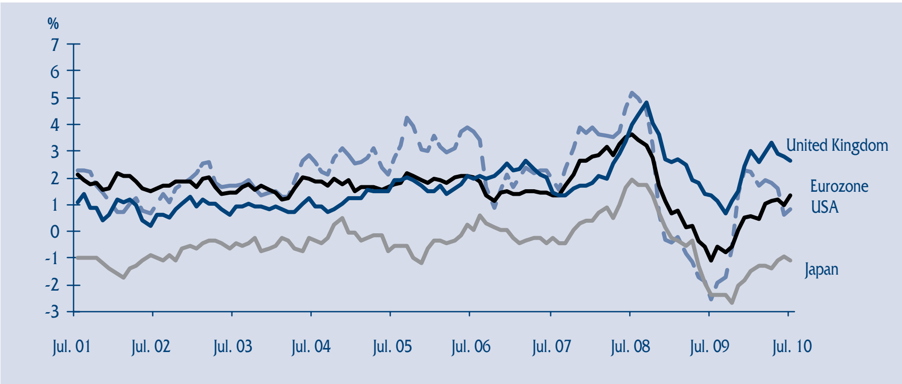
In the Eurozone economies, the growth of Germany stands out with an annualized rate of 9 percent (after having registered 1.9 percent in Q1). According to recent information, this growth would also be favored by the recovery of domestic private consumption.

In this context, the growth projection for the Eurozone for this year has been revised from 0.8 to 1.2 percent. However, despite the lower risks for growth due to the better financial conditions observed, the growth projection for the next year has been revised downwards due basically to the fiscal stabilization programs that most of the countries of the European Union have committed themselves to initiate. The growth projection for 2011 has been revised from 1.3 to 1.0 percent.

Growth in the **United Kingdom** in Q2 also exceeded expectations (4.9 percent after having recorded 1.3 percent in Q1). Nevertheless, according to recent information, growth is expected to slow down in the rest of the year due to the weakness of consumption (which is affected by unemployment, the tax rise, and the anticipation of the fiscal adjustment measures programmed for next year) and to the lower contribution of inventories. Private investment has shown an unfavorable evolution since Q2 and no significant changes are expected in this trend. In this context, the execution in the first semester would increase the growth projection for the year from 1.1 to 1.4 percent, while the projection for the next year remains at 2 percent.

11. The moderation of growth in **Japan** since Q2 has been significant. The annualized growth rate in Q2 was 1.5 percent (after 5.0 percent in Q1) and low growth rates are expected in the rest of the year basically due to the lower expected contribution of net exports, the effect on the deceleration of growth in Asian economies, and the appreciation of the yen. In contrast with Q1, private demand (consumption and investment) in Q2 declined and recent indicators show no changes in this trend. This evolution has also increased the risks of a deflation event.

Graph 7
DEVELOPED COUNTRIES: INFLATION RATE
(12-month change)



In this context, the government announced fiscal measures and the Bank of Japan has extended its credit line for ¥ 10 trillion (previously ¥ 20 trillion) for three to six more months and initiated a massive intervention in the foreign exchange market to try to prevent a higher appreciation of the currency. In this scenario the projection of growth in 2011 and 2012 has been revised downwards, while the projection for 2010 has been revised from 1.9 to 2.4 percent due to the execution observed in Q1.

12. The growth of Asian countries, particularly of South Korea and Singapore, which recorded annualized rates of 6.1 and 24.0 percent in Q2, respectively, is worth pointing out in terms of other developed economies. The expansion of manufacturing in Korea is mainly explained by the sectors of machinery and equipments, metal products, and automobiles. The extraordinary rates recorded in Singapore so far this year (annualized rate of 45.7 percent in Q1) are explained by an unusually high growth of pharmaceutical production with a high added value.

13. **Emerging economies** continued growing at significant rates, with many of them showing increased inflationary pressures. After growing nearly 12 percent in Q1, China recorded a growth rate of 10.3 percent in Q2, showing indications of a slight moderation of its pace of growth. This is corroborated by several indicators of activity such as industrial production, investment in fixed assets, and exports. This deceleration would be explained by the government's implementation of some measures aimed at preventing an overheating of the economy, an excessive growth of credit, and the generation of a price bubble in some sectors. These measures are also consistent with the rise of inflation which, between November 2009 and July 2010, went from an annual rate of 0.6 percent to 3.3 percent.

Graph 8
CHINA: QUARTERLY GDP
(12-months change)

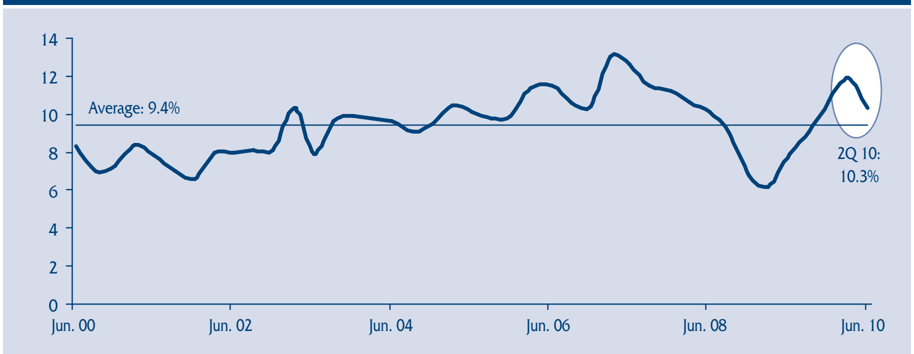


Table 4
CHINA: ACTIVITY INDICATORS

	Dec.09	Apr.10	May.10	Jun.10	Jul.10
Manufacturing PMI	56.6	55.7	53.9	52.1	51.2
Industrial production (12-month % change)	18.5%	17.8%	16.5%	13.7%	13.4%
Investment in fixed assets (12-month % change)	30.5%	26.1%	25.9%	25.5%	24.9%
Retail sales (12-month % change)	17.5%	18.5%	18.7%	18.3%	17.9%
Exports (12-month % change)	17.7%	30.5%	48.5%	43.9%	38.1%
Imports (12-month % change)	55.9%	49.7%	48.3%	24.1%	22.7%
New loans (billions of yuan)	380	774	639	603	533
Inflation (12-month % change)	1.9%	2.8%	3.1%	2.9%	3.3%
House prices	7.8%	12.8%	12.4%	11.4%	10.3%

Source: Bloomberg.

It is estimated that growth in China will stabilize around 9 percent as from 2011. The authorities have declared that they will gradually change the export oriented model of growth towards a model oriented to domestic demand.

Within the group of **Asian** emerging economies, Indonesia's growth stands out with an annualized rate of 11.7 percent in Q2, which reflects the dynamism of consumption and investment. The considerable recovery observed in other economies –e.g. Malaysia and Thailand– since the crisis has led the central banks in the region to gradually start withdrawing monetary stimulus, despite the fact that inflationary pressures remain moderate.

Table 5
GDP: QUARTERLY EXECUTION
(Growth rates compared to the same quarter of the previous year)

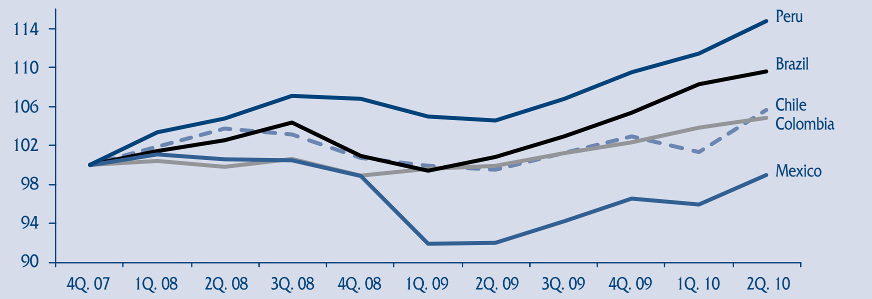
	2008	2009				2010	
	IV	I	II	III	IV	I	II
Emerging Asia							
China	6.8	6.2	7.9	9.1	10.7	11.9	10.3
Korea	-3.3	-4.3	-2.2	1.0	6.0	8.1	7.2
India	6.1	5.8	6.0	8.6	6.5	8.6	8.8
Indonesia	5.3	4.5	4.1	4.2	5.4	5.7	6.2
Malaysia	0.1	-6.2	-3.9	-1.2	4.4	10.1	8.9
Latin America							
Brazil	0.8	-2.1	-1.6	-1.2	4.3	9.0	8.8
Chile	0.7	-2.1	-4.5	-1.4	2.1	1.5	6.5
Colombia	-1.1	-0.9	0.1	0.7	3.4	4.4	5.0*
Mexico	-1.1	-7.9	-10.0	-6.1	-2.3	4.3	7.6
Peru	6.5	1.9	-1.2	-0.6	3.4	6.1	10.1

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

14. **Latin American** economies maintain their dynamism based on the recovery of employment and domestic demand, although some difference is observed in the pace of growth by countries. Brazil would have moderated its pace of expansion in comparison with Q1, while in Chile industrial production and retail sales would show a strong dynamism even in Q3.

Even though the initial impulse for the recovery of some economies came from external demand, the expansion of activity is being reflected in the reduction of unemployment, which in turn is allowing consumption to resume its dynamism. Nevertheless, there are still risks associated with the evolution of activity in the United States and its potential effect on Latin American economies, especially in those cases where the recovery has not consolidated yet in all the sectors. It is estimated that the region would grow 4.8 percent in 2010 –0.8 percentage points higher than considered in our June Report– and around 3.7 percent in the next two years.

Graph 9
LATIN AMERICA: EVOLUTION OF GDP
(Seasonally adjusted data 4Q07=100)



Source: Central banks and statistics intitutes.
Source of data for Colombia 2Q10 is JP Morgan forecast.

15. The economies of **Central and Eastern Europe**, on the other hand, were favored by the growth of their exports to Germany and Russia. Russia's growth in the first semester is associated with private consumption, exports and fiscal stimulus; however, drought and forest fires as a result of the heat wave have slowed down the economy and affected the production of wheat, generating also concerns about inflation.

Financial markets

16. The turbulence observed since May (due to the sovereign debt crisis in some countries of the Eurozone) stabilized as from July, even though it has not completely corrected vis-à-vis the signs of slowdown of global growth.

    Conditions in financial markets improved significantly as a result of the advance of fiscal adjustment policies and support programs for the economies with a debt crisis in the Eurozone, although the sovereign spreads of some countries remain above the levels observed in April. Since August, the dissemination of indicators of activity, particularly on the United States (which show a slow recovery of consumption and a slowdown of activity in the sector of services), has contributed to relatively increase risk aversion. In this context, the Bank of England, the European Central Bank, and the Federal Reserve, among others, have decided to extend their support programs for the money markets and maintain the size of their balances.

Table 6
CREDIT DEFAULT SWAP SPREAD 1/
(CDS. in bps.)

	Dec.07	Dec.08	Dec.09	Mar.10	Apr.10	May.10	Jun.10	Jul.10	Aug.10	13.Sep.10
Portugal	18	96	92	139	290	305	310	230	345	323
Italy	20	157	109	116	142	196	190	138	230	191
Ireland	n.d.	181	158	42	193	232	266	212	352	366
Greece	22	232	283	333	719	663	909	746	926	878
Spain	18	101	113	116	167	219	261	185	244	219
Germany	7	46	26	32	44	40	45	38	44	37
United Kingdom	9	107	83	77	76	80	76	58	71	64
France	10	54	32	46	63	69	90	66	82	74
Memo:										
Peru	116	303	124	127	121	134	136	108	116	123

Source: Bloomberg.
1/ The CDS is a financial instrument for protection against a default.

17. Liquidity conditions in money markets have been normalizing in the Eurozone. The favorable results of the stress tests on European banks and the corporate profits obtained in Q2-2010 have contributed to put banks in a better financial position. In this context, short term interbank interest rates have returned to the levels observed prior to the crisis and banks' demand for extraordinary liquidity lines from the ECB have declined substantially. Most of the increase of extraordinary liquidity concentrated in the banks of countries with sovereign debt crisis in the Eurozone.

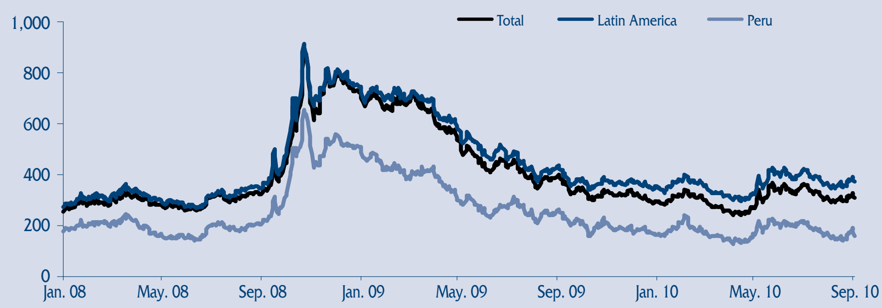
Graph 10
SPREAD BETWEEN THE 3-MONTH LIBOR AND THE TREASURY BOND
(TED spread in basis points)

Source: Bloomberg.

As regards the stress tests of the health of European banks, the results showed that out of the 91 banks assessed (which represent 65 percent of the assets of the banking system in the entire EU), only 7 banks (5 Spanish merged saving banks, the German Hypo Real Thiste, and the Greek Agricultural Bank) failed in maintaining the minimum regulatory capital ratios (Tier 1) of 6 percent under the adverse scenarios and therefore require to raise capital for a total of €3.5 billion (it was expected that 10 banks would fail the tests and that capital requirements would amount to € 37 billion). These results have been well received by the market because of the transparency message they give and due to the detailed information provided on each bank.

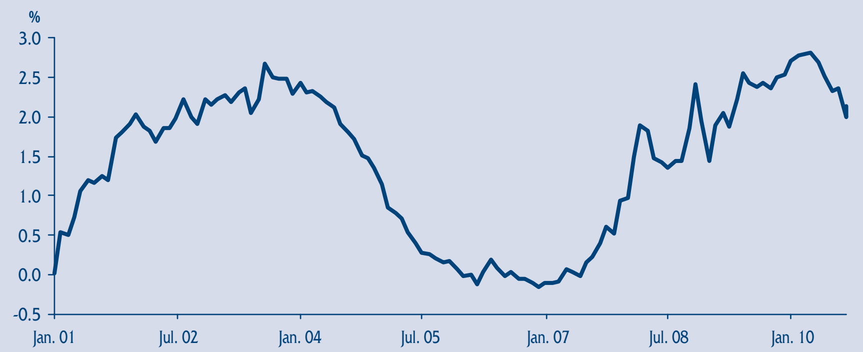
18. Conditions in capital markets have improved significantly, but without reaching the levels observed in April. Corporate credit spreads and the profitability of stock markets have showed improvements, but these have been constrained by increased evidence of a moderation of global growth. This factor has also influenced a reduction in the yields on US Treasury bonds, which were already experiencing downwards pressures as a result of the FED's announcement of purchases.

Graph 11
EMERGING MARKETS BOND INDEX SPREAD: EMBIG



Source: Bloomberg.

Graph 12
US TREASURY BONDS: YIELD SPREAD BETWEEN 10 AND 2 YEAR BONDS



Source: Bloomberg.

Central banks' decisions

19. Since our last Inflation Report was released, most central banks have maintained or raised their interest rates given evidence of a higher growth and, in the case of emerging economies, of rising inflationary pressures. Thus, for example, in the emerging economies, the rates in Brazil and Chile have been raised by 200 bps in each case between May and September.

In the case of developed economies, Canada was the first country that raised its rates (with three rate increases of 25 bps.) in the G-7 group. Other economies that raised their interest rates between June and September were Korea, Taiwan, and Sweden. It should be pointed out that, in many economies, this upward trend of interest rates has recently moderated given uncertainty about the international environment. In other economies where the evidence of a recovery of growth is weaker –e.g. the United States, some countries in the Eurozone, and Japan–, interest rates have not been modified and are expected to remain at low levels for a long period of time.

Table 7
MONETARY POLICY INTEREST RATE

	Levels					Chg. respect to:		Inflation*
	Sep.08	Dec.09	Mar.10	May.10	Sep.10	May.10	Dec. 09	2010
Pakistan	13.00	12.50	1.25	12.50	12.50	0	0	n.d.
Brazil	13.75	8.75	8.75	9.50	10.75	125	200	5.4
Iceland	15.50	10.00	9.00	8.50	7.00	-150	-300	n.d.
Indonesia	9.25	6.50	6.50	6.50	6.50	0	0	4.9
South Africa	12.00	7.00	6.50	6.50	6.00	-50	-100	5.2
Turkey	16.75	6.50	6.50	6.50	6.50	0	0	8.6
China	7.20	5.31	5.31	5.31	5.31	0	0	2.9
Hungary	8.50	6.25	5.50	5.25	5.25	0	-100	4.7
India	9.00	4.75	5.00	5.25	6.00	75	125	9.6
Australia	7.00	3.75	4.00	4.50	4.50	0	75	3.0
Mexico	8.25	4.50	4.50	4.50	4.50	0	0	4.6
Philippines	6.00	4.00	4.00	4.00	4.00	0	0	4.3
Poland	6.00	3.50	3.50	3.50	3.50	0	0	2.5
Colombia	10.00	3.50	3.50	3.00	3.00	0	-50	3.4
New Zealand	7.50	2.50	2.50	2.50	3.00	50	50	2.6
Malaysia	3.50	2.25	2.25	2.50	2.75	25	50	1.9
Slovakia	4.25	2.50	2.50	2.50	2.50	0	0	n.d.
Norway	5.75	1.75	1.75	2.00	2.00	0	25	2.3
South Korea	5.25	2.00	2.00	2.00	2.25	25	25	2.8
Peru	6.50	1.25	1.25	1.50	3.00	150	175	2.5
Israel	4.25	1.50	1.50	1.50	1.75	25	25	2.5
Thailand	3.75	1.25	1.25	1.25	1.75	50	50	3.5
Taiwan	3.50	1.25	1.25	1.25	1.38	13	13	1.3
Chile	8.25	0.50	0.50	0.50	2.50	200	200	3.6
Czech República Checa	3.50	1.00	1.00	0.75	0.75	0	-25	1.6
Canada	3.00	0.25	0.25	0.25	1.00	75	75	1.8
United Kingdom	5.00	0.50	0.50	0.50	0.50	0	0	3.0
United States	2.00	0.25	0.25	0.25	0.25	0	0	1.6
Sweden	4.75	0.25	0.25	0.25	0.75	50	50	1.3
Switzerland	2.75	0.25	0.25	0.25	0.25	0	0	0.8
Japan	0.50	0.10	0.10	0.10	0.10	0	0	-1.0

* Consensus Forecast.

Terms of trade

20. The international prices of commodities continued rising in the first semester of the year, in line with the recovery of global economic activity and global trade. The prospects of increased demand, the lower production observed in some products and investors' high demand for hedge operations, non commercial positions, etc. are among the main factors that continued providing support to prices. However, some moderation was observed in this trend between May and June due to the financial problems observed in Europe, the delay in the recovery of consumption in the United States, and the signs of slowdown observed in some demand indicators in China. Commodities resumed their upward trend in July and August as financial conditions began to normalize.

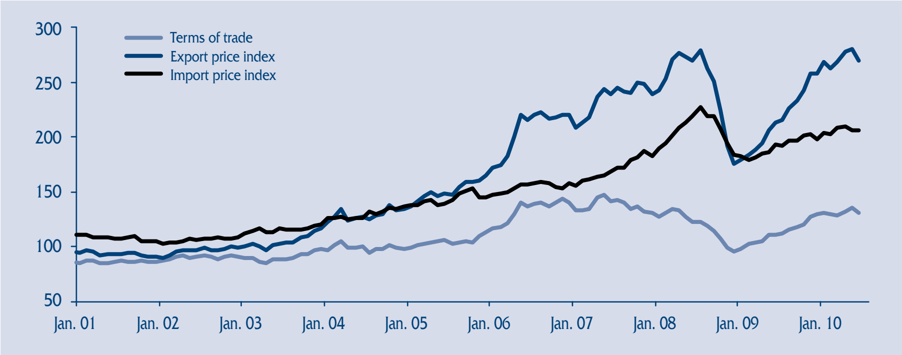
    In this context, the projection of the growth of terms of trade in 2010 remains around 13 percent. Most of the prices of our exports and imports have been revised slightly upwards. It is estimated that the prices of export products in 2011 and 2012 will stabilize around the current average levels and the prices of food imports have been revised slightly upwards.

Table 8
TERMS OF TRADE
(% change and annual average prices)

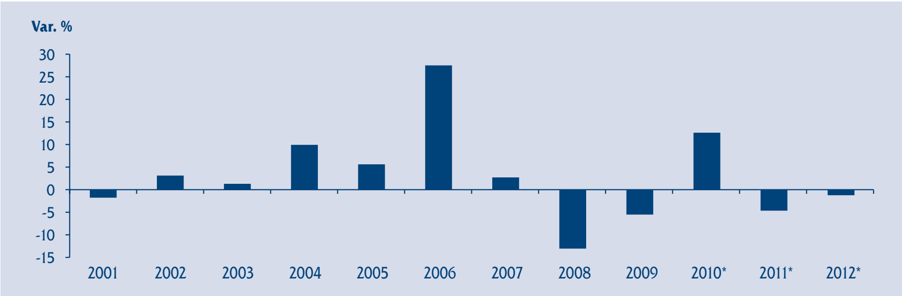
	Execution		2010*		2011*		2012*	
	2009	Jan.-Jun.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
Terms of trade	**-5.5**	**25.0**	**12.6**	**13.8**	**-3.3**	**-3.6**	**-1.3**	**-1.6**
Export prices	**-12.5**	**39.5**	**20.7**	**24.4**	**-1.5**	**-0.4**	**0.6**	**0.6**
Copper (cents per pound)	234	324	313	324	300	325	300	325
Zinc (cents per pound)	75	98	96	93	90	90	90	90
Gold (US$ per ounce)	974	1,152	1,167	1,180	1,212	1,212	1,208	1,212
Import prices	**-7.4**	**11.7**	**7.2**	**9.4**	**1.9**	**3.3**	**2.0**	**2.2**
Oil (US$ per barrel)	62	78	75	76	76	75	77	75
Wheat (US$ per MT)	193	158	174	199	206	266	225	257
Maize (US$ per MT)	139	133	140	147	157	181	165	180
Soybean oil (US$ per MT)	729	782	813	817	867	910	879	926
Rice (US$ per MT)	561	512	462	483	440	450	448	450
Sugar (US$ per MT)	412	509	414	496	345	405	345	356

* Forecast.

Graph 13
TERMS OF TRADE, EXPORT AND IMPORT PRICE INDICES:
(1994=100)



Graph 14
TERMS OF TRADE
(% change)



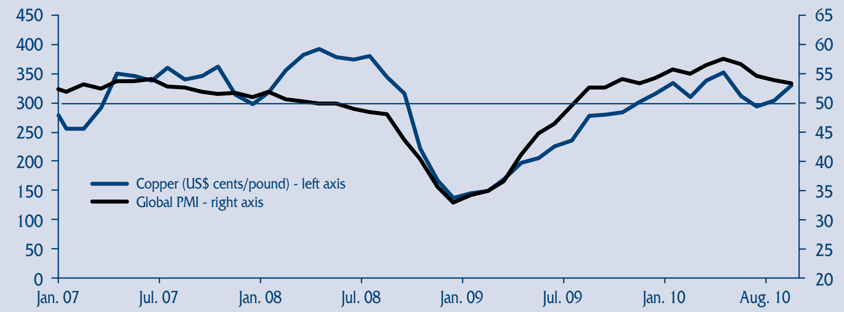
(*) Forecast.

Copper

21. The price of copper rose 5 percent between January and August 2010. However, copper has not shown a clear upward trend so far this year. Between January and April the price of this metal reached US$ 3.53 a pound and then fell to US$. 2.95 in June. It recovered slightly thereafter, closing August at US$ 3.31 a pound. The good outlook for global demand observed during the first months of the year reversed due to the financial problems of some European countries, the delayed recovery of consumption in the United States, and signs of a deceleration of growth in China.

The recent recovery of the prices of copper is in line with reports of a lower production in Chile and China and with favorable indicators on industry and manufacturing in Europe. Japan and China's demand for refined copper also provided support to the international price of copper.

Graph 15
GLOBAL PMI AND COPPER PRICE

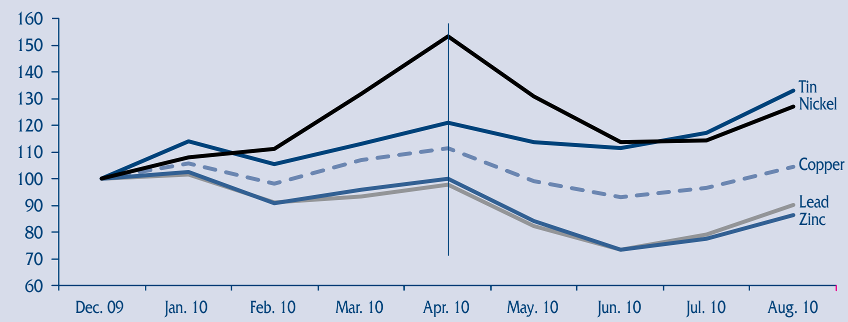


PMI: Purchasing Managers Index.
Source: JP Morgan.

Zinc

22. The evolution of the price of zinc so far this year was similar to the one observed in the case of copper and the other basic metals, although this price did not fully recover compared to its level in December 2009. The price rose until the month of April when it recorded US$ 1.079 and fell thereafter to US$ 0.790 in June. In July and August zinc rose again to US$ 0.930 as the average price in August, which represents a decline of 14 percent compared with the average price in December 2009. This evolution is explained by the same factors that affected the price of the other basic metals. However, in contrast with copper, zinc inventories in the metal exchange markets have remained at high levels.

Graph 16
EVOLUTION OF PRICES OF BASIC METALS
(December 2009 = 100)



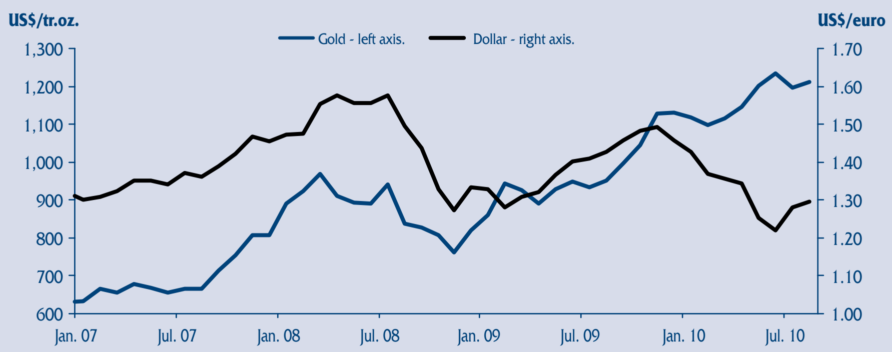
Gold

23. Between January and August of this year, the international price of gold registered an increase of 7 percent, posting an average of US$ 1,212/troy ounce in August.

The demand for gold reached maximum levels between May and June when the financial problems of some European countries deepened. In contrast with other commodities, gold has maintained its upward trend during most part of the year because it is considered a safe harbor asset, a hedge, and a reserve of value and, therefore, is a financial asset that is a substitute for the dollar, which has been losing value over the year.

It is estimated that the price of gold would remain around the currently observed values due to the persistence of uncertainty about global economic recovery and due to the financial problems observed in several regions of the world, as well as due to India and Turkey's increased demand for gold for jewelry in the second half of the year.

Graph 17
PRICE OF GOLD AND EVOLUTION OF US DOLLAR



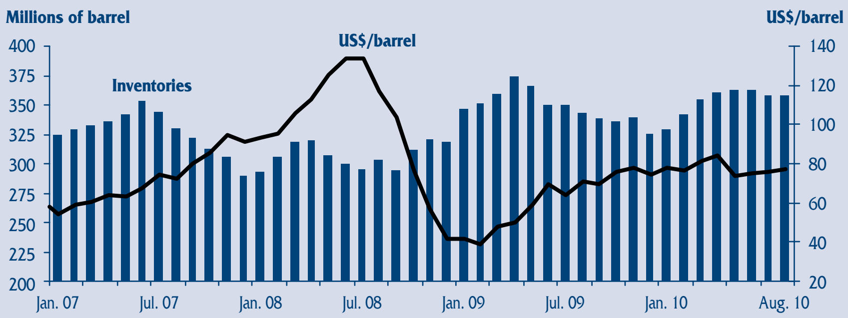
Source: Bloomberg.

Oil

24. Year to date, the price of crude has increased 4 percent, showing an average level of US$. 77.5 per barrel. The price of oil showed a similar conduct to that of basic metals. The prospects for the recovery of the global demand for crude and supply constraints in some producer countries accounted for this price increase, especially in January-April when the international price of crude reached US$ 84/barrel. Fears of a delay in the recovery of global demand reversed this trend and the price dropped to a minimum low of US$ 65/barrel at end May.

The price of crude has been recovering since July due to the high demand of China, whose imports of oil reached record levels in July. However, inventories of crude in the United States at the close of August are 10 percent higher than at the close of December 2009. It is estimated that this price will be in the range of US$ 75-US$ 80 in the rest of the year.

Graph 18
OIL PRICE AND US INVENTORIES

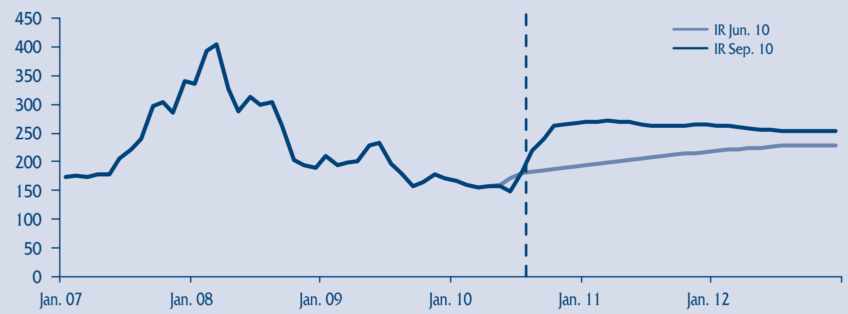


Source: Bloomberg and US Energy Department.

Wheat

25. The price of wheat recorded a downward trend in the first semester of the year, reversing in the last two months –period in which it accumulated an increase of 47 percent– due to problems in global supply. High temperatures and the absence of rains have led Russia to face the worst drought in over a hundred years, as a result of which the projection for the production in the 2010/2011 farming period have gradually corrected downwards. In this context, on August 5 Russia announced a ban on grain exports until the end of the year, which exacerbated this trend. The price of wheat has remained volatile in the last weeks, even though for the time being no other restrictions have been announced by countries Kazakhstan and Ukraine, which have also been affected by climatic factors. Because of these developments, the projection has been revised upwards in the forecast horizon.

Graph 19
WHEAT
(US$/MT)



Source: Bloomberg and BCRP.

Maize

26. In the case of maize, the projection was revised on the upside due to expectations of a higher demand for maize as a substitute for wheat as animal feed, a factor that has been pushing the price upwards and generated an increase of 16 percent since June. This pressure due to higher demand is evidenced in the higher pace of US exports in the last month. The recent increase of China's imports would also be supporting current prices.

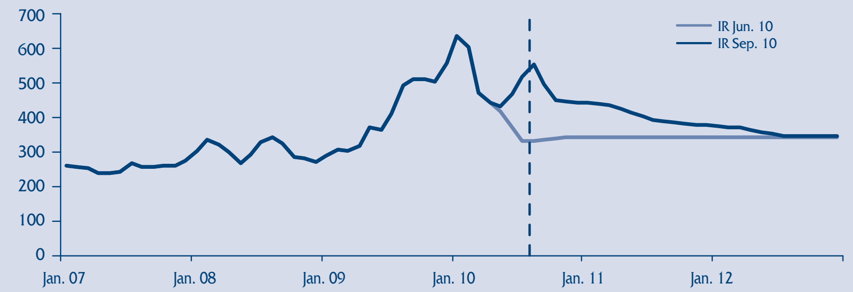
Graph 20
MAIZE
(US$/MT)

Source: Bloomberg and BCRP.

Sugar

27. Between June and August, the price of sugar increased 18 percent, reversing the downward trend observed since February (due to better production prospects in India and Brazil). The beginning of the monsoon season in India expected in July was delayed and generated market concerns due to the current low levels of inventories. Logistic problems in Brazilian ports and the increase of speculative positions (in all of the commodity markets) added to this. Climatic conditions in India have been normalizing so far, although without reaching normal levels yet. The sugar market will continue showing volatility until there is clear evidence of a recovery of production.

Graph 21
SUGAR
(US$/MT)

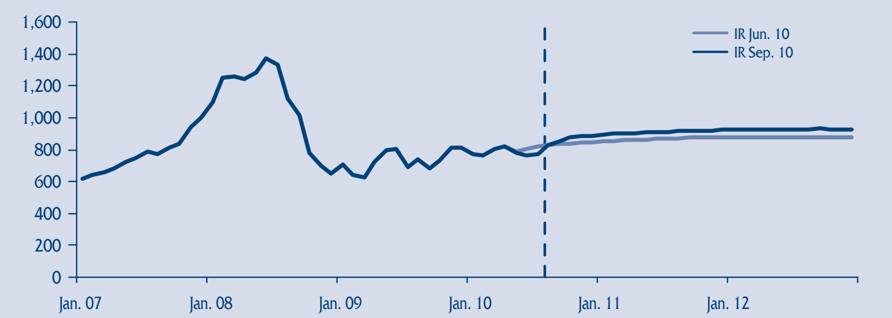


Source: Bloomberg and BCRP.

Soybean oil

28. The average price of soybean oil has accumulated an increase of 9 percent in the last two months, but remains below the levels observed in December 2009. The evolution of soybean oil has been linked to the evolution of crude; the upward trend observed in the last months coincides with the increase observed in the latter. In line with this, the projection of the price of this product has been revised slightly upwards.

Graph 22
SOYBEAN OIL
(US$/MT)



Source: Bloomberg and BCRP.

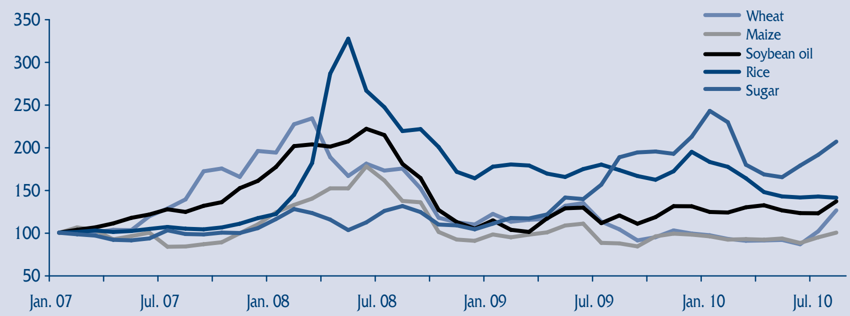
BOX 1
FOOD PRICES: A COMPARISON WITH THE 2007-2008 EPISODE

The recent increase of the international prices of food products has generated concern about the possibility that what happened in 2007-2008, when prices rose sharply in a context of growing demand, could take place again.

The 2007-2008 scenario

Food prices showed a significant and sustained increase between 2007 and mid-2008. This trend was also observed in other commodities which even reached historical record levels. In many emerging economies that experienced an accelerated growth above their potential growth, this brought about pressures on other prices in the economy, which led central banks to raise their interest rates.

FOOD PRICES
(Index January 2007 = 100)



Source: Bloomberg. Reuters.

Several factors account for the upward pressures on the prices of these commodities during the period of 2007/2008:

a. The demand of emerging economies, particularly China, which generated pressures on nearly all of the commodities.
b. The global biofuel policies, which increased the demand for maize. Approximately a third of the production of this product in the United States is oriented to the production of biodiesel. The upward pressures were also intensified by the increase in the price of crude which reached an historical high of US$ 145.3 per barrel in July.
c. The depreciation of the dollar, which favored the demand for commodities as alternative investment assets. Between January 2007 and July 2008, the dollar depreciated 23 percent against the euro. Speculative positions in nearly every commodity increased significantly in this period.
d. Specific supply factors, such as the restrictions on the international trade of rice established by the main consumer countries (with the exception of Thailand and Pakistan), unfavorable climatic conditions for soybean (China and United States), and the reduction of areas cultivated with maize (United States) also contributed to this.

Current scenario

As a result of the financial crisis and increased risk aversion, the prices of food commodities recorded a significant correction. Despite the recent rise of prices observed, the current levels of prices are significantly lower than the maximum prices registered in that period, with the exception of sugar. In this context, there is a lower possibility that food prices will show increases similar to the ones observed in 2007/08 due to the following reasons:

FOOD PRICES

	Observed change		Maximun level reached (US$/MT)	
	2007/2008 *	2010**	2007/2008	2010
Wheat	135%	46%	406	218
Maize	115%	15%	257	144
Rice	228%	0%	1,054	589
Sugar	45%	15%	343	637
Soybean oil	123%	11%	1,376	846

Calculation based on the monthly average price.
* Variation between the maximun level of 2008 and the minimun level of 2007.
** Growth in the last 12 months.

a. The supply-related problems are expected to be transitory, even though it is worth pointing out that this central scenario could be affected by an intensification of La Niña event.

b. The inventories of some food commodities, such as wheat and rice, resulting from the 2010/11 farming year are higher than the ones observed in 2007/08, even if measured in terms of consumption days. The only exception in this sense is maize, which shows similar levels of inventories to the ones observed in that period.

c. Some factors present in the 2007/08 scenario, such as the sharp increase in the price of oil and the weakening of the dollar, are not observed in the current episode.

However, prices in the medium term find support in some factors that were present in the episode of 2007/2008. Thus, it is estimated that the block of emerging economies would grow at an annual rate of over 6 percent during 2010-2015, and that biofuel policies, which increase the demand for maize and soybean oil, will continue to be developed.

DETERMINANTS OF FOOD PRICES

Factor	2007/2008 Episode	Today
Price of oil	Raise 187 % (reaching a maximun of US$ 145/barrel)	US$ 73/barrel, prospect for moderate increases.
US$/euro	US$ depreciated 23% against the euro (up to US$ 1.594 per euro).	Dollar is stable (US$ 1.2795 per euro), prospects for moderate variations.
Inventories	Different products registered 30 year minimum levels.	Low inventory levels in most of the products.
Speculative positions	Generalized increase (particularly in the case of soybean, sugar and maize).	Speculative positions have recovered, but are below the levels observed in 2007/2008.

II. Balance of Payments

29. The greater dynamism projected for economic activity in 2010 would imply a higher growth of imports than the one projected in our June Inflation Report. Therefore, the projected surplus in the trade balance for 2010 has been revised downwards from US$ 6.7 billion to US$ 4.9 billion.

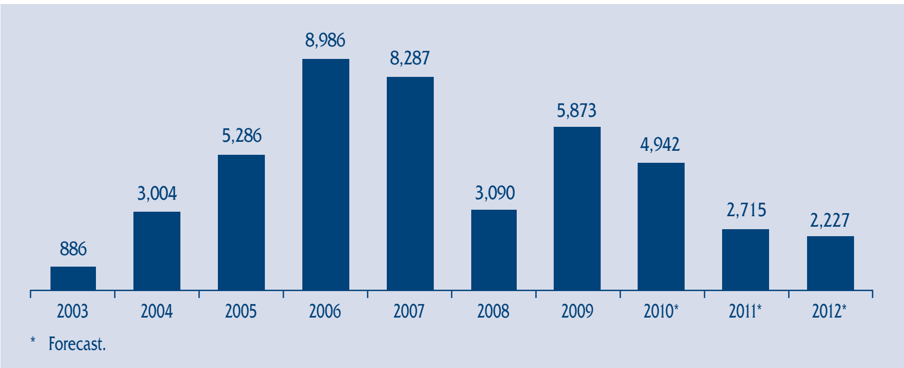
    The trade balance would continue showing positive results in the forecast horizon, closing 2012 with a balance of US$ 2.2 billion. This trajectory is explained by the anticipated execution of important investment projects, which would require greater imports of capital goods. Moreover, a slight downward trend in the evolution of terms of trade foreseen as from next year would also contribute to this evolution.

Table 9
TRADE BALANCE
(Millions of US$)

	2009		2010*			2011*		2012*	
	I Sem.	Year	I Sem.	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
EXPORTS	**11,557**	**26,885**	**16,033**	**33,162**	**33,488**	**34,767**	**35,162**	**37,820**	**38,522**
Of which:									
Traditional products	8,654	20,571	12,521	25,897	25,958	27,003	26,978	29,270	29,390
Non-traditional products	2,838	6,160	3,385	7,060	7,307	7,556	7,979	8,332	8,920
IMPORTS	**9,710**	**21,011**	**12,944**	**26,474**	**28,546**	**29,689**	**32,447**	**33,116**	**36,295**
Of which:									
Consumer goods	1,832	3,963	2,376	4,937	5,396	5,805	6,632	7,018	8,008
Inputs	4,374	10,077	6,427	13,212	13,721	14,412	15,106	15,598	16,425
Capital goods	3,439	6,850	4,030	8,192	9,280	9,331	10,545	10,333	11,683
TRADE BALANCE	**1,847**	**5,873**	**3,089**	**6,689**	**4,942**	**5,078**	**2,715**	**4,704**	**2,227**
Memo: ((% change)									
Volume:									
Exports	-3.3	-3.3	-2.9	2.2	0.1	6.3	5.4	8.1	8.9
Imports	-22.0	-20.0	18.3	17.6	23.8	10.2	10.2	9.3	9.3
Value:									
Exports	-28.8	-14.7	38.7	23.4	24.6	4.8	5.0	8.8	9.6
Imports	-29.7	-26.1	33.3	26.0	35.9	12.1	13.7	11.5	11.9

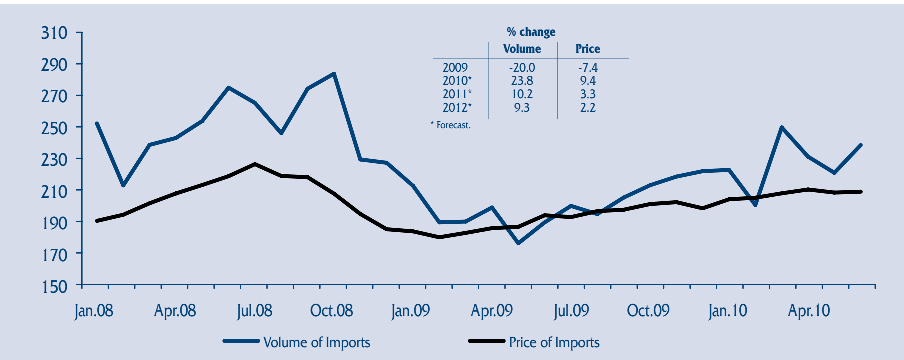
RI: Inflation Report.
* Forecast.

Graph 23
TRADE BALANCE
(Millions of US$)



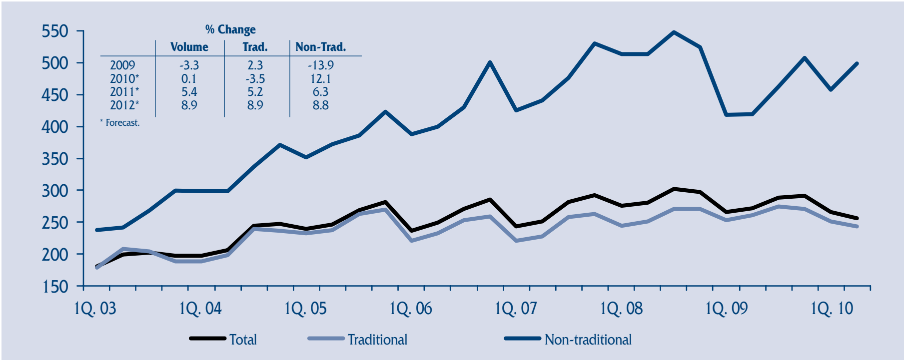
30. During the first semester of 2010, the volume of imports increased by 18.3 percent, in contrast with the 22 percent decline observed in the same period of 2009. This recovery of imports, observed mainly in the case of industrial inputs, such as iron and steel and textile inputs, and in durable consumption goods in consistent with the evolution of domestic demand.

Graph 24
VOLUME AND PRICE OF IMPORTS
(Index 1994=100)

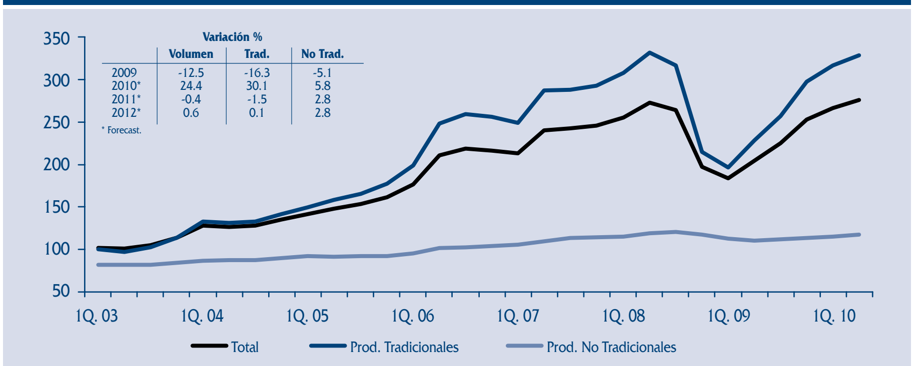


On the other hand, exports declined 2.9 percent in the first semester, due to lower volumes of gold, copper, coffee, and fishmeal, although this was offset by the increase observed in non traditional exports, especially agricultural, chemical, and iron and steel products.

Graph 25
VOLUME AND PRICE OF EXPORTS
(Index 1994=100)



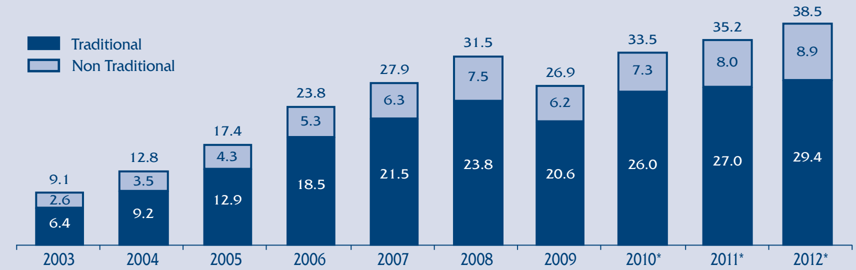
Graph 26
PRICE OF EXPORTS
(Índice 1994 = 100)



31. The value of exports is expected to recover and increase from US$ 26.9 billion in 2009 to US$ 33.5 billion in 2010. This projection considers the higher prices of metals so far this year, the onset of operations at Camisea II (which will increase the exports of hydrocarbons), the exports of Bayovar phosphate project, and the continuous pace of recovery of non traditional exports observed over the year.

    Exports are projected to show an upward trend in 2011 and 2012 as a result of an increase in the volumes of copper associated with the expansions of Antamina and Toquepala, the onset of operations at Minas Justa, and higher exports of gas from Camisea II and of phosphates from Bayovar. Exports of other non traditional products, especially farming products, would continue recovering in 2011 and 2012, favored by the advantages associated with trade agreements.

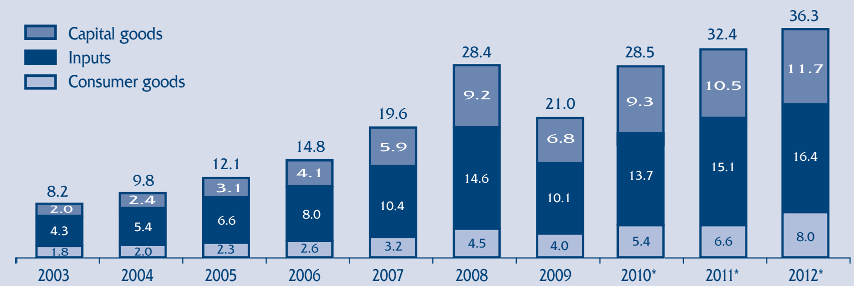
Graph 27
EXPORTS OF GOODS: 2003-2012
(Billions of US$)



Memo: Total exports includes other exports.
* Forecast.

32. The growth of the volume of imports in 2010 has been revised upwards, in line with the projected evolution of economic activity and with the trend observed so far this year. The pace of growth of the volume of imports accelerated from 14.5 in Q1 to 24.2 percent in Q2. In 2011 and 2012, the growth of imports would moderate gradually, in line with the smoother trajectory that private consumption and investment are foreseen to show.

Graph 28
IMPORTS OF GOODS: 2003-2012
(Billions of US$)



Memo: Total imports includes other imports.
* Forecast.

33. During the first semester of the year, the deficit in the current account represented 1.1 percent of GDP. The trade surplus and higher remittances from abroad were compensated by the deficit in the balance of services and by the higher profits generated by mining, oil, and financial companies with foreign shareholding.

34. Considering the projections of GDP growth and their effect on a higher demand for imports, as well as the evolution of terms of trade and the growth of our trading

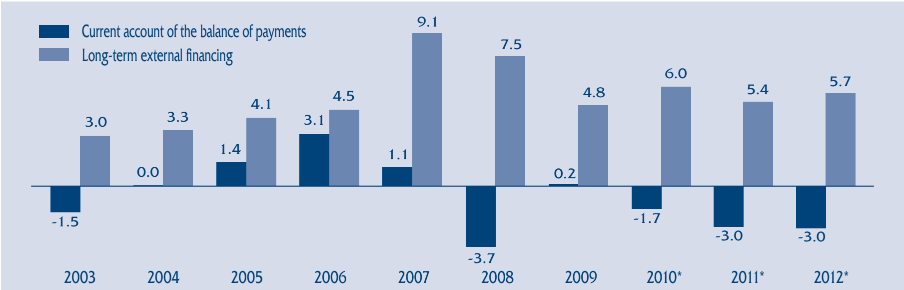
partners, the projection of the deficit in the balance of payments for 2010 has been revised upwards from 1.0 of GDP to 1.7 percent of GDP and is expected to stabilize at 3.0 percent of GDP in 2011 and 2012. As the following graph shows, the flows of long term capitals –which include foreign direct investment and disbursements of long terms loans– represent more than two times the financial requirements of the current account in the forecast horizon, which contributes to its sustainability.

Table 10
BALANCE OF PAYMENTS
(Millions of US$)

	2009	2010*		2011*		2012*	
	Year	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
I. CURRENT ACCOUNT BALANCE	**247**	**-1,500**	**-2,515**	**-3,324**	**-4,970**	**-4,000**	**-5,410**
% of GDP	0.2	-1.0	-1.7	-2.1	-3.0	-2.3	-3.0
1. Trade Balance	5,873	6,689	4,942	5,078	2,715	4,704	2,227
a. Exports	26,885	33,162	33,488	34,767	35,162	37,820	38,522
b. Import	-21,011	-26,474	-28,546	-29,689	-32,447	-33,116	-36,295
2. Services	-1,112	-1,338	-1,352	-1,750	-1,743	-1,788	-1,771
3. Investment Income	-7,371	-9,734	-9,034	-9,752	-9,086	-10,285	-9,280
4. Current transfers	2,856	2,884	2,928	3,100	3,144	3,368	3,415
of which: Remittances	2,378	2,494	2,508	2,716	2,731	2,985	3,001
II. FINANCIAL ACCOUNT	**1,694**	**4,999**	**13,014**	**4,824**	**6,470**	**5,000**	**6,410**
of which:							
1. Private Sector	1,655	5,024	9,276	4,232	6,531	5,335	6,264
a. Assets	0	-1,419	0	-1,544	0	-1,900	0
b. Liabilities	1,655	6,443	9,276	5,777	6,531	7,235	6,264
2. Public Sector	1,032	-209	-271	747	175	-242	-195
a. Assets	-317	-102	16	-123	-126	-116	-116
b. Liabilities	1,349	-107	-287	870	302	-126	-79
3. Short-term capital	-1,675	418	3,861	0	-700	0	0
a. Assets	-186	-440	173	0	-700	0	0
b. Liabilities	-1,489	858	3,688	0	0	0	0
III. BALANCE OF PAYMENTS (=I+II)	**1,940**	**3,500**	**10,499**	**1,500**	**1,500**	**1,000**	**1,000**
Memo:							
1. Gross long-term external private financing							
Millions of US$	6,108	7,579	9,151	7,184	8,840	8,971	10,289
% of GDP	4.8%	5.1%	6.0%	4.6%	5.4%	5.3%	5.7%
2. Balance of NIRs at end period							
Millions of US$	33,136	36,636	43,635	38,136	45,135	39,136	46,135
% of GDP	26.1%	24.9%	28.8%	24.4%	27.5%	22.9%	25.7%

RI: Inflation Report.
* Forecast.

Graph 29
CURRENT ACCOUNT AND LONG-TERM FINANCING
(% of GDP)



* Forecast.

Financial account

35. In the first semester of 2010, the private financial account recorded a net capital inflow of US$ 4,120 million, explained mainly by flows of foreign direct investment (FDI) and portfolio investment in the country.

Table 11
PRIVATE SECTOR FINANCIAL ACCOUNT
(Millions of US$)

	2009		2010*			2011*		2012*	
	I Sem	Year	I Sem	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
1. ASSETS	**-1,730**	**-4,106**	**427**	**-1,419**	**-351**	**-1,544**	**-1,025**	**-1,900**	**-2,602**
Direct investment abroad	-5	-396	-87	-61	-87	0	0	0	0
Portfolio investment abroad	-1,725	-3,711	514	-1,357	-264	-1,544	-1,025	-1,900	-2,602
2. LIABILITIES	**3,391**	**5,761**	**3,692**	**6,443**	**9,627**	**5,777**	**7,556**	**7,235**	**8,865**
Foreign direct investment in the country	2,802	4,760	3,444	5,296	7,457	4,159	6,544	5,395	7,142
Of which: Reinvestment	2,398	4,902	2,910	4,344	4,674	2,669	4,238	3,039	3,689
Foreign portfolio investment in the country	-210	55	480	52	1,498	-315	-75	-272	-106
a. Capital participation	-71	47	3	15	3	0	0	0	0
b. Other liabilities	-139	9	477	37	1,495	-315	-75	-272	-106
Long-term loans	800	946	-231	1,094	672	1,933	1,087	2,112	1,829
a. Disbursements	1,265	1,744	499	2,343	1,780	3,025	2,296	3,576	3,147
b. Amortization	-465	-798	-731	-1,248	-1,108	-1,092	-1,209	-1,464	-1,318
3. TOTAL	**1,661**	**1,655**	**4,120**	**5,024**	**9,276**	**4,232**	**6,531**	**5,335**	**6,264**

* Forecast.

Revenue from FDI amounted to US$ 3,444 million, with the component of profit reinvestment, especially in the case of mining companies, maintaining its importance in this total. A similar positive evolution is observed in portfolio investment (US$ 480 million in the first semester), which is mainly explained by non resident investors' acquisition of Public Treasury Bonds and by foreign participation in public-private projects. Additionally, net incomes for a total of US$ 514 million were recorded due to the lower pace of acquisition of external assets by domestic entities, especially banks and non financial entities.

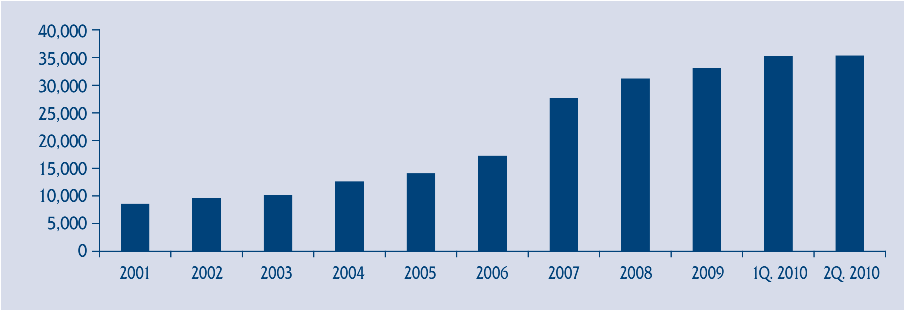
36. The projections for 2010 - 2012 continue considering a recovery in the global economy –although at a more moderate pace– and a higher dynamism of domestic economic activity. This would translate into an increase in the use of foreign resources to finance projects through direct investment and long term loans. Domestic financial entities, particularly private pension funds (AFPs), on the other hand, would resume their dynamism in the acquisition of external assets due to the increase observed in terms of pension funds. Thus, in 2010 the private financial account would register a positive flow of US$ 9,276 million.

A significant inflow of capitals was recorded during Q2-2010 due to banks' increased acquisition of external assets, as a result of which the flow at year end would amount to US$ 3,861 million, higher than the one considered in our previous Report.

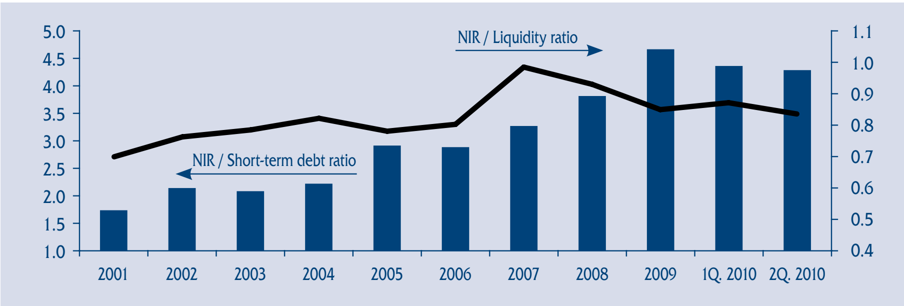
Positive net capital flows for a total of US$ 6,531 million and US$ 6,264 million would be registered in 2011 and 2012, respectively, as a result of confidence in the sustainability of the country's economic growth, which would translate into growing levels of direct investment and long term disbursements.

37. At end August, the level of international reserves reached US$ 40.7 billion, which is equivalent to 32 percent of GDP in 2009 (up 29 percent of GDP in the last four quarters). This is one of the highest levels recorded in the region, even after deducting our liabilities in foreign currency with residents (reserve requirements and public sector deposits), in which case this would represent 23 percent. This level of reserves is a significant back-up in the case of eventual constraints in terms of international financing and an additional source of confidence of foreign investors regarding the stability of the economy.

Graph 30
NET INTERNATIONAL RESERVES*
(Millions of US$)



Graph 31
INDICATORS OF EXTERNAL VULNERABILITY



III. Economic activity

38. The projected GDP growth of 6.6 percent of our June Report has been revised to 8.0 percent given the significant dynamism shown by domestic economic activity during the first semester (GDP and domestic demand have grown 8.2 and 11.1 percent, respectively). This evolution reflects the process of accumulation of inventories and the expansion of consumption and private investment to rates similar to the ones recorded prior to the international financial crisis in a context of improved consumer and business confidence regarding the prospects for the economy.

    The projection of the growth of production for this year (8.0 percent) considers a slight deceleration in the second semester to rates closer to the potential growth of the economy for this period (6-7 percent).

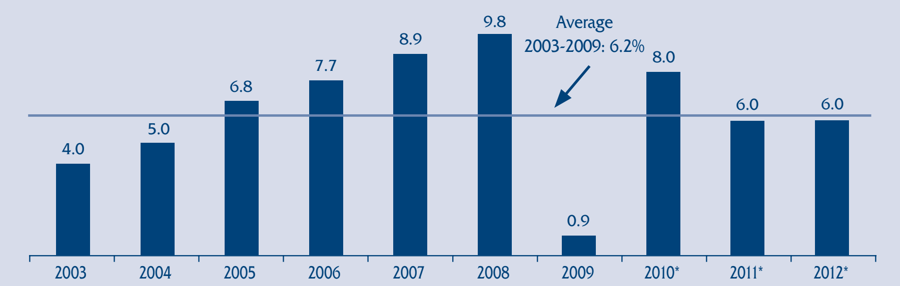
39. Production in the next years is expected to grow at an annual rate of 6.0 percent –a similar rate to the one considered in our June Inflation Report–, without demand inflationary pressures. This projection considers a growth rate of domestic demand higher than the growth rate of GDP based on a higher expansion of private investment and a lower growth of government expenditure.

Table 12
DOMESTIC DEMAND AND GDP
(Real % change)

	2009		2010*			2011*		2012*	
	I Sem.	Year	I Sem.	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
1. Domestic demand	**-3.5**	**-2.8**	**11.1**	**8.8**	**11.4**	**6.8**	**6.9**	**6.0**	**6.0**
a. Private consumption	2.8	2.4	5.6	3.9	5.2	4.5	4.5	4.6	4.6
b. Public consumption	14.4	16.5	13.2	7.8	9.9	3.7	4.4	3.2	3.6
c. Private investment	-10.3	-15.1	17.7	12.5	16.7	9.0	11.1	11.0	11.8
d. Public investment	18.5	25.5	33.1	23.9	31.6	7.3	6.3	6.5	3.4
2. Exports	-1.8	-2.5	0.7	3.0	1.4	5.7	5.2	7.9	8.4
3. Imports	-18.6	-18.4	16.6	14.5	19.4	10.1	10.1	8.0	8.0
4. GDP	**0.3**	**0.9**	**8.2**	**6.6**	**8.0**	**6.0**	**6.0**	**6.0**	**6.0**
Memo:									
Public expending	15.6	19.6	19.2	13.7	17.8	5.1	5.2	4.5	3.5

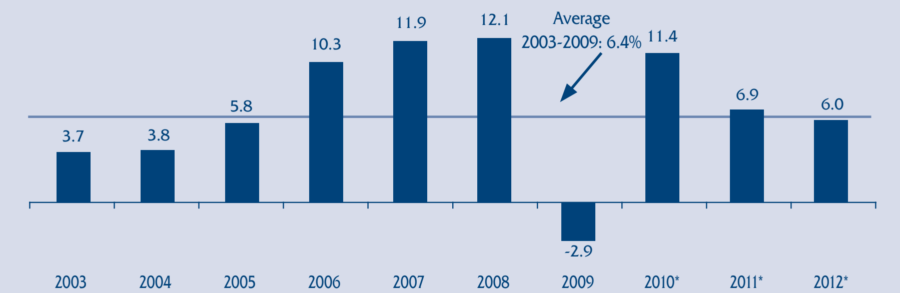
RI: Inflation Report.
* Forecast.

Graph 32
GDP GROWTH RATE
(Real % change)



* Forecast.

Graph 33
DOMESTIC DEMAND GROWTH RATE
(Real % change)



* Forecast.

Table 13
CONTRIBUTION TO GDP GROWTH

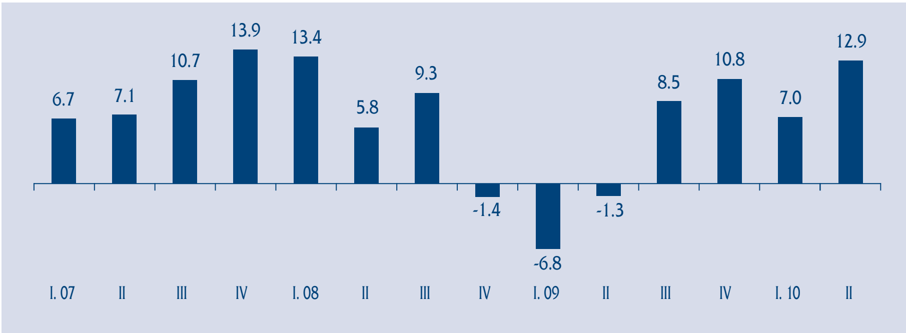
	2009		2010*			2011*		2012*	
	I Sem.	Year	I Sem.	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
a. Private consumption	1.9	1.6	3.9	2.7	3.5	3.0	3.0	3.0	3.0
b. Public consumption	1.1	1.3	1.1	0.7	0.9	0.3	0.4	0.3	0.3
c. Private investment	-2.2	-3.4	3.4	2.4	3.2	1.8	2.3	2.3	2.5
d. Public investment	0.6	1.1	1.2	1.3	1.7	0.5	0.4	0.4	0.2
e. Change in inventories	-4.9	-3.6	1.4	1.7	2.0	1.3	1.0	0.2	0.1
f. Exports	-0.3	-0.5	0.1	0.6	0.3	1.1	0.9	1.5	1.5
g. Imports 1/	-4.2	-4.3	3.0	2.7	3.7	2.1	2.1	1.7	1.7
GDP	**0.3**	**0.9**	**8.2**	**6.6**	**8.0**	**6.0**	**6.0**	**6.0**	**6.0**
Memo:									
Public expending	1.6	2.4	2.3	2.0	2.6	0.8	0.8	0.7	0.6

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

Indicators of recovery

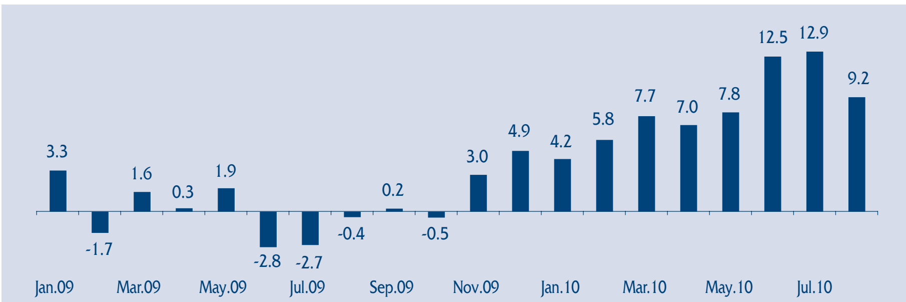
40. Excluding the effect of seasonality, economic activity has been showing a sound recovery since Q3-2009 in a context of implementation of significant monetary and fiscal stimuli.

Graph 34
SEASONALLY ADJUSTED GDP
(% change compared with the same quarter or the previous year)



41. Recent indicators of activity continue showing the consolidation of economic activity:
    a. During August the production of electricity recorded an annual growth of 9.2 percent.

Graph 35
ELECTRICITY PRODUCTION
(12-month % change)



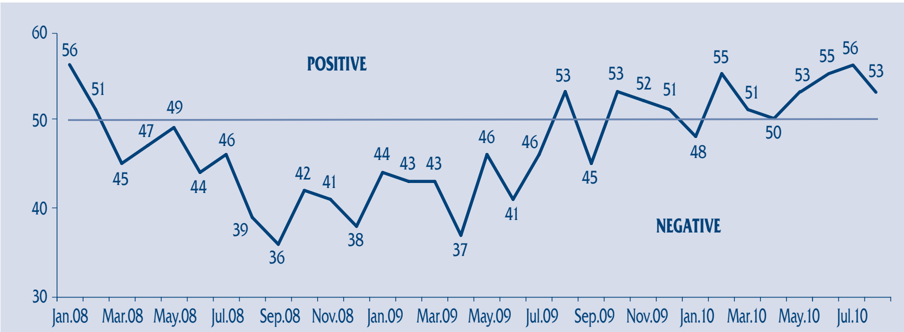
Source: COES.

    b. In August, cement dispatches 11.1 percent compared with the same month in 2009.

Graph 36
LOCAL DISPATCHES OF CEMENT
(12-month % change)

c. The consumer confidence index has remained in the positive tranche since February, reflecting the optimism of most of the consumers surveyed about the evolution of their family economy in the near future. In August, the consumer confidence index registered 53 points.

Graph 37
CONSUMER CONFIDENCE INDEX
Family economic situation



Source: Ipsos, APOYO.

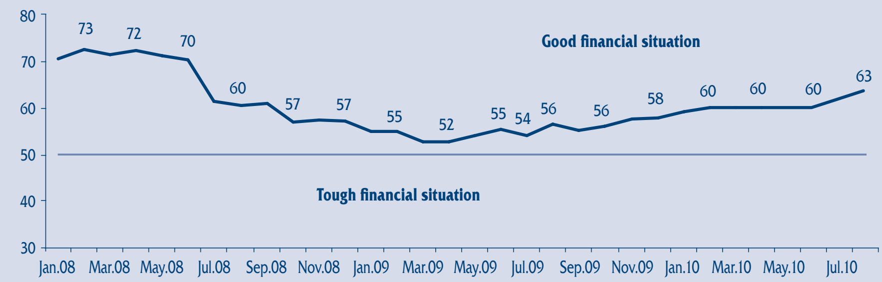
d. The business confidence index has not only recovered, but also shows higher levels than the ones observed prior to the international financial crisis. In August, this index reached 71 points and in June it recorded its highest level in the year, which reflects the optimism of most of businessmen about the economy in the near future.

Graph 38
BUSINESS CONFIDENCE INDEX
Economic situation

Source: BCRP Survey on Macroeconomic Expectations August 2010.

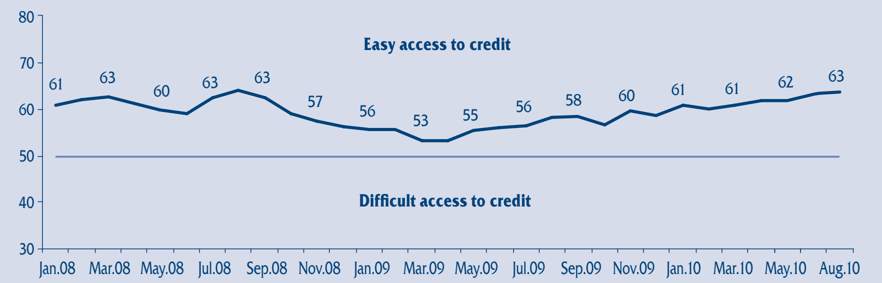
e. The good financial situation of the larger businesses shows a sustained improvement and there is also the perception that it is becoming easier to have access to credit.

Graph 39
FINANCIAL SITUATION INDEX



Source: BCRP Survey on Macroeconomic Expectations August 2010.

Graph 40
ACCESS TO CREDIT INDEX



Source: BCRP Survey on Macroeconomic Expectations August 2010.

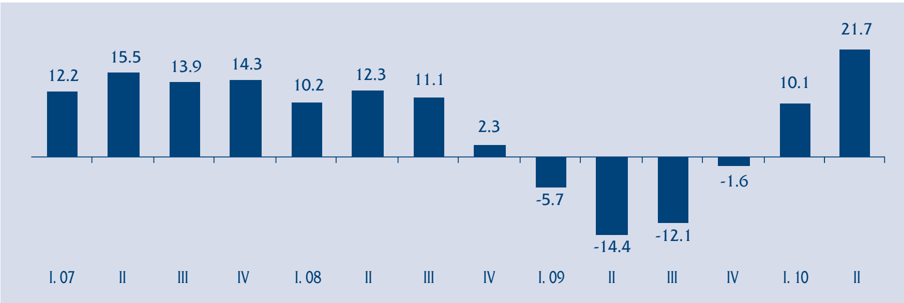
f. Economic analysts and financial entities foresee a GDP growth of 7.0 and 7.5 percent, respectively, while non financial firms expect a growth rate of 6.5 percent. Estimates for 2011 range between 5.7 and 6.0 percent, whereas a growth rate of 6.0 percent is expected for 2012.

Table 14
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH (%)

	May 2010	June 2010	July 2010	August 2010
FINANCIAL ENTITIES				
2010	6.0	6.0	6.8	7.0
2011	6.0	5.5	5.5	6.0
2012	6.0	6.0	6.0	6.0
ECONOMIC ANALYSTS				
2010	6.0	6.5	6.8	7.5
2011	5.5	6.0	5.9	5.7
2012	6.0	6.0	6.0	6.0
NON-FINANCIAL FIRMS				
2010	5.0	6.0	6.0	6.5
2011	5.5	6.0	6.0	6.0
2012	6.0	6.0	6.0	6.0

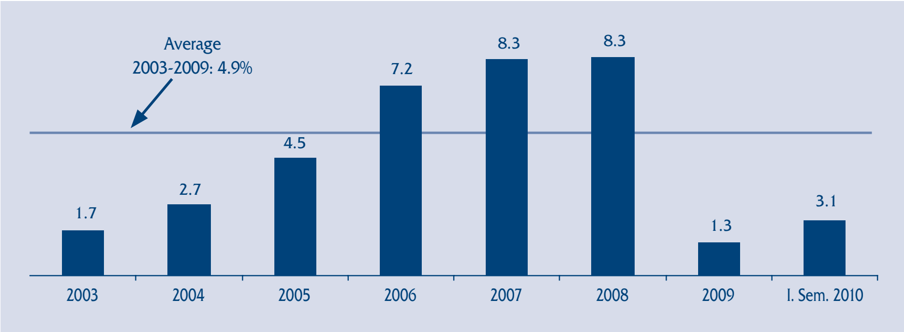
g. Manufacturing production continues showing a significant recovery and recorded an expansion of 21.7 percent in Q2-2010.

Graph 41
NON-PRIMARY MANUFACTURING
(Real % change)



h. The growth of employment during the first semester of 2010 (3.1 percent) has favored the dynamism of private consumption. Moreover, the continuous growth of formal employment has contributed to maintain consumer confidence. In annual terms, formal employment has not declined since 2001.

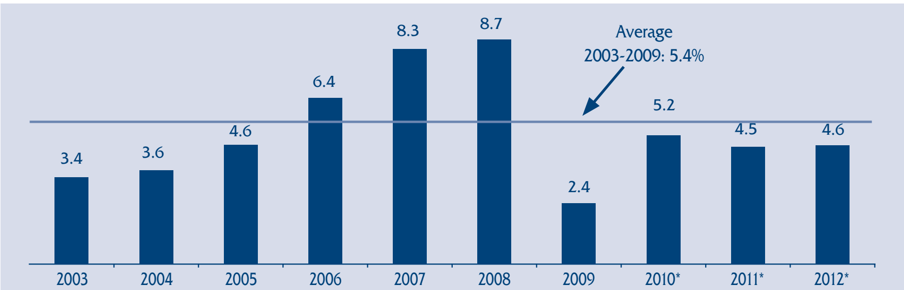
Graph 42
URBAN EMPLOYMENT
((% change)



Projection of expenditure components

42. **Private consumption** grew 5.6 percent in the first semester of 2010. This evolution was associated with a better climate of consumer confidence, with the growth of employment, and with the significant recovery observed in terms of the national disposable income.

Graph 43
PRIVATE CONSUMPTION GROWTH RATE
(Real % change)



* Forecast.

43. In contrast with the concept of GDP, the concept of national disposable income also considers the effect of international prices and transfers of Peruvians residing abroad, and deducts the profits generated by foreign investments. Thus, this is a more accurate indicator of the economic transactions that generate income for the country. The estimated growth of the national disposable income in 2010 has been revised upwards from 6.9 to 9.3 percent, mainly as a result of the expected evolution of GDP and of better international prices. In 2011 and 2012, the national disposable income would grow 52 and 6.0 percent, respectively.

Table 15
NATIONAL DISPOSABLE INCOME
(Real % change)

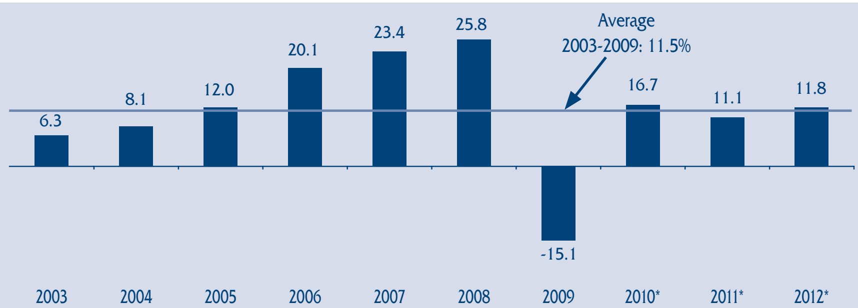
	2009		2010*			2011*		2012*	
	I Sem.	Year	I Sem.	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
1. GDP	**0.3**	**0.9**	**8.2**	**6.6**	**8.0**	**6.0**	**6.0**	**6.0**	**6.0**
2. Gross national product	5.0	2.1	6.4	4.9	7.4	6.4	6.2	6.6	6.2
3. Gross national income	0.7	1.0	10.6	7.2	9.7	5.8	5.2	6.0	6.0
4. National disposable income [1/]	**0.7**	**0.9**	**10.2**	**6.9**	**9.3**	**5.8**	**5.2**	**6.0**	**6.0**

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

44. Private consumption is expected to show a faster pace of growth and to increase from 2.4 percent in 2009 to 5.2 percent in 2010, in line with the higher expansion of national disposable income. The projection for 2011 and 2012 included in our June Report remains unchanged.

45. Private investment tends to be one of the most volatile components of expenditure during the periods of expansion and contraction of the economic cycle. Given the important group of investment projects announced, the economy's sound economic fundamentals, and optimistic business expectations, a more rapid recovery of private investment may be foreseen. Thus, private investment would grow 16.7 percent in 2010, 11.1 percent in 2011, and 11.8 percent in 2012.

Graph 44
PRIVATE INVESTMENT GROWTH RATE
(Real % change)



* Forecast.

Table 16
ANNOUNCED INVESTMENT PROJECTS: 2010 - 2012
(Millions of US$)

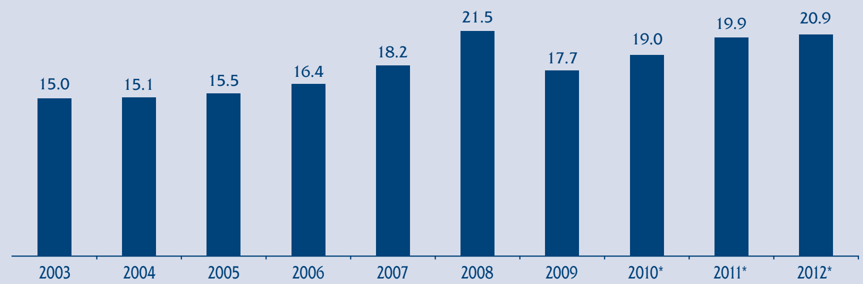
Sector	2010	2011	2012	Total
Mining	3,218	5,868	7,259	16,345
Hydrocarbons	2,396	2,051	2,146	6,594
Electricity	778	1,267	1,611	3,656
Telecommunications	441	239	46	727
Industry	1,436	1,164	953	3,553
Infrastructure	2,348	1,113	626	4,086
Other Sectors	1,450	848	419	2,718
Total	**12,067**	**12,550**	**13,060**	**37,677**

Source: Media and information of companies.

46. The growth of private investment has been reflected in an increased number, size, and pace of implementation of the projects announced for the 2010-2012 period. The announced amount of investment projects has increased by US$ 1,300 million relative to the one considered in our June Report.

Investment projects worth pointing out in the sector of **mining and hydrocarbons** include Toromocho, Galeno, the expansions of Antamina and Cerro Verde, Gasoducto Andino del Sur and Lot 67 (Perenco), and crude and gas prospecting and production activities in lots Z-6, Z-33, and Z-2b. Projects standing out in the **infrastructure** sector include projects aimed at improving the roads and infrastructure directly associated with trade operations (piers, ports, and improvement of airports). Some of these projects have been given in concession and others would be also included in concession processes. Moreover, investment projects that should be pointed out in terms of electricity infrastructure include hydro electrical plants, power generation plants, and transmission lines.

Graph 45
PRIVATE FIXED INVESTMENT
(% of GDP)



* Forecast.

Table 17
ANNOUNCED INVESTMENT PROJECTS: 2010 - 2012

SECTOR	COMPANY	PROJECT NAME
Mining	Xstrata Peru	Las Bambas
	Northern Peru Copper	Galeno
	Anglo American	Quellaveco
	Minera Yanacocha S.R.L.	Mines Conga
	Minera Peru Copper S.A.	Toromocho
	Xstrata Peru	Antapaccay
	Antamina	Expansion of pit
	Sociedad Minera Cerro Verde	Cerro Verde Expansion
	Shougang Group Hierro Perú	Marcona
	Mitsui Mining & Smelting Co. Ltda. Suc. Perú	Quechua
	Norsemont Perú S.A.C.	Constancia
	Marcobre S.A.C.	Mina Justa
	Southern Peru Copper	Refinery and funding Ilo - Toquepala - Cuajone
	Barrick Misquichilca	Expansion of Leaching plantn
	Minera Yanacocha S.R.L.	Chaquicocha
	Río Alto	La Arena
	Compañía Minera Milpo	Pukaqaqa
	Compañía Minera Milpo	Hilarión
	Gold Fields La Cima	Cerro Corona
	Sociedad Minera El Brocal S.A.	Colquijirca
Hydrocarbons	Perú LNG	Camisea II
	Savia Perú (Petro-Tech)	Lot Z-2B
	Perenco Peru Limited	Lot 67 exploration / Pipeline
	Kuntur Transportadora of Gas	Pipeline Andino of Sur
	Pluspetrol	Malvinas Expansion
	Petrobras	Exploration and explotation of oil and gas
	Transportadora of Gas of Perú	Expansion transport capacity of Gas
	Cálidda Gas Natural of Perú	Expansion of main network
	Transcogas Perú	Ica pipeline
Electricity	Kallpa Generación S.A.	Cerro of Águila Hydroelectric plant
	Fenix Power Perú SA	Thermoelectric plant (natural gas combined cycle)
	Odebrecht	Cerro of Chaglla Hydroelectric plant
	Kallpa Generación S.A.	Kallpa IV
	SN Power	Cheves Hydroelectric plant
	Abengoa Perú	Carhuamayo – Paragsha – Conococha – Huallanca – Cajamarca – Cerro Corona – Carhuaquero
	Luz of Sur	Network Expansion and infrastructure development
	Asa Iberoamérica	Transmission line Chilca-Marcona-Montalvo
	Interconexión Eléctrica (ISA)	Transmission line Zapallal (Lima - Trujillo)
	Luz of Sur	Santa Teresa Hydroelectric plant
Industry	Técnicas Reunidas	Modernization of Talara Refinery
	Vale do Rio Doce (CVRD)	Bayóvar phospates
	Cementos Yura	Cement plant
	Votorantim Metais - Cajamarquilla S.A.	Cajamarquilla refinery expansion
	Aceros Arequipa	Expansion and modernization of plant
	Cementos Pacasmayo	Phospates plant
	Backus & Johnston	Expansion of plant
	Cementos Lima	Expansion of installed capacity
	Cementos Portland	Cement plant
	Cementos Andino	Tarma plant expansiona
Infrastructure	Dubai Ports World Callao	South pier
	Conirsa	IIRSA Sur: Tract 2
	OAS S.R.L	Express way, Yellow line
	Odebrecht	IIRSA SUR Tract 3: Inambari - Iñapari
	Intersur	IIRSA SUR Tract 4: Azángaro - Inambari
	Chancay Port	Multipurpose megaport
	Autopista of Norte SAC	Red Vial Nº 4
	COVISOL	Highway of Sol
	Odebrecht	IIrsa Norte Tract Paita-Yurimaguas
	Santa Sofía Puertos	Ancon port
	Tren Eléctrico Lima	Electric train
	Covi Peru	Red Vial Nº 6: Pucusana - Cerro Azul - Ica
	Terminales Portuarios Euroandinos (TPE)	Expansion of Paita port
	Odebrecht	IIRSA SUR: Tract 5: Matarani - Azángaro
	ACS Servicios. Comunicaciones and Energía	Treatment plant La Taboada
	Odebrecht	Olmos transfer
Other Sectors	NDG Perú	Real state projects
	Telefónica of Perú	Movile phone network and broadband expansion
	Telmex	New services
	Maple Etanol SRL	Ethanol plant

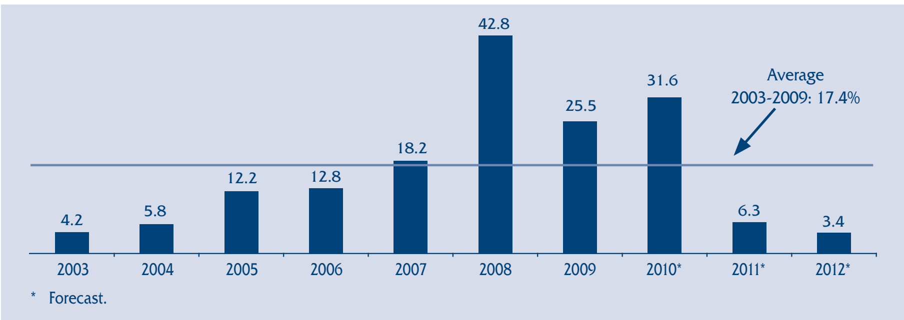
Source: Media and companies' information.

Graph 46
SEASONALLY ADJUSTED PRIVATE INVESTMENT
(Millions of nuevos soles of 1994)

47. The projection of government expenditure in 2010 has been revised upwards both in terms of public consumption and in terms of public investment. The projected growth of government expenditure in 2011 remains unchanged and a lower growth is projected for 2012 due to the lower increase expected in terms of public investment.

Public investment in 2010 would grow 31.6 percent and is projected to grow 6.3 and 3.4 percent in 2011 and 2012, respectively.

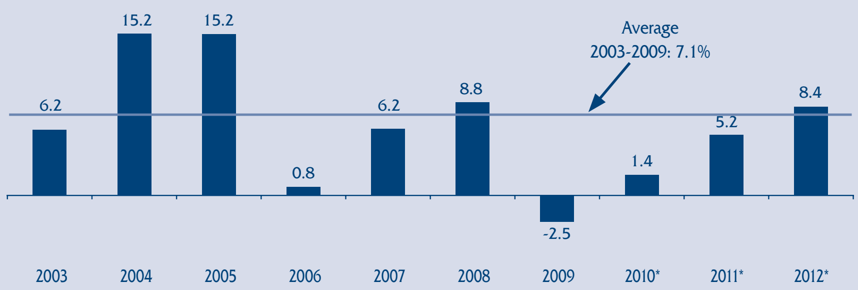
Graph 47
PUBLIC INVESTMENT GROWTH RATE
(Real % change)



Graph 48
COMPOSITION OF GROSS FIXED INVESTMENT
(% of GDP)

48. In 2010-2012, actual exports of goods and services would grow at a lower rate than considered in our June Report due to the lower volume of traditional exports. In 2012, exports would show a higher recovery considering an improvement in the growth rate in a context of increased global demand, which would be reinforced by the increased access to foreign markets resulting from trade agreements and the full operation of hydrocarbon projects that will boost traditional exports.

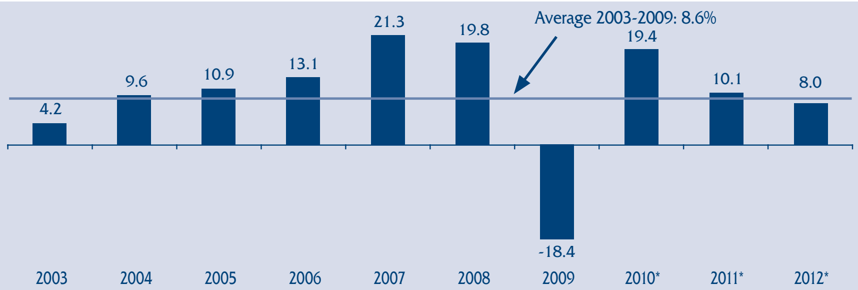
Graph 49
GROWTH RATE OF EXPORTS OF GOODS AND SERVICES
(Real % change)



* Forecast.

49. Actual imports of goods and services are expected to show a faster pace of growth in 2010, in line with the current scenario where a faster pace of GDP growth is observed, particularly in terms of private investment. Imports in 2011 and 2012 would grow at rates of 10.1 and 8.0 percent, respectively.

Graph 50
GROWTH RATE OF IMPORTS OF GOODS AND SERVICES
(Real % change)



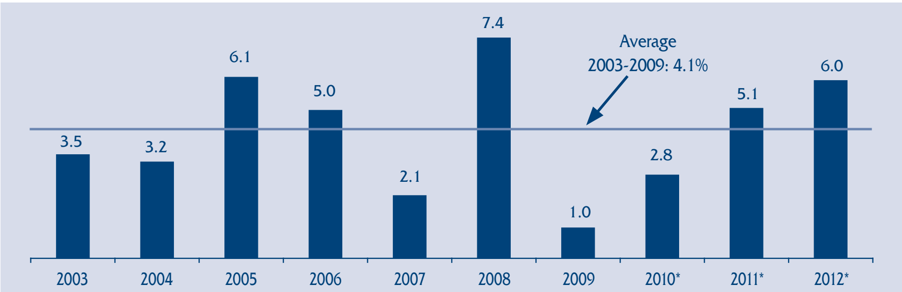
* Forecast.

GDP by sectors

50. In the first semester of 2010, in a context of accelerated recovery of the dynamism of domestic demand, **non primary sectors** showed a substantial rebound, recording a growth rate of 9.7 percent. Factors worth pointing out that contributed to this result included the recovery of non primary manufacturing (15.8 percent) after having recorded negative rates in two semesters and the recovery of dynamism in the construction sector, which showed levels similar the ones observed in the semesters prior to the international financial crisis and recorded a two-digit rate of expansion (19.2 percent).

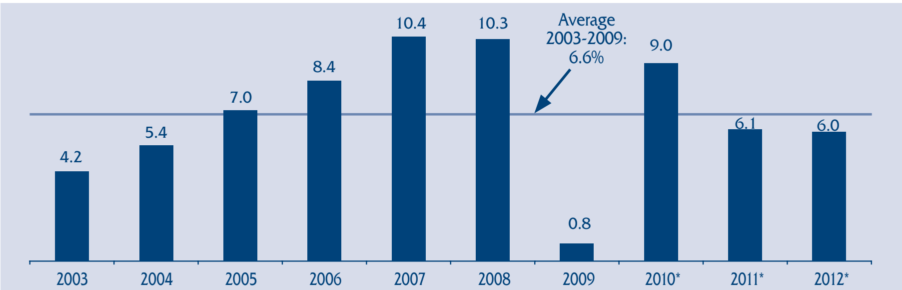
    Primary sectors registered a slight increase of 1.5 percent in a context of growth declines in the sectors of fishing, manufacturing based on raw materials, and metallic mining. The agriculture sector was the only sector that recorded some growth (4.6 percent).

Graph 51
PRIMARY SECTORS GROWTH RATE
(Real % change)



* Forecast.

Graph 52
NON-PRIMARY SECTORS GROWTH RATE
(Real % change)



* Forecast.

Table 18
GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS
(Real % change)

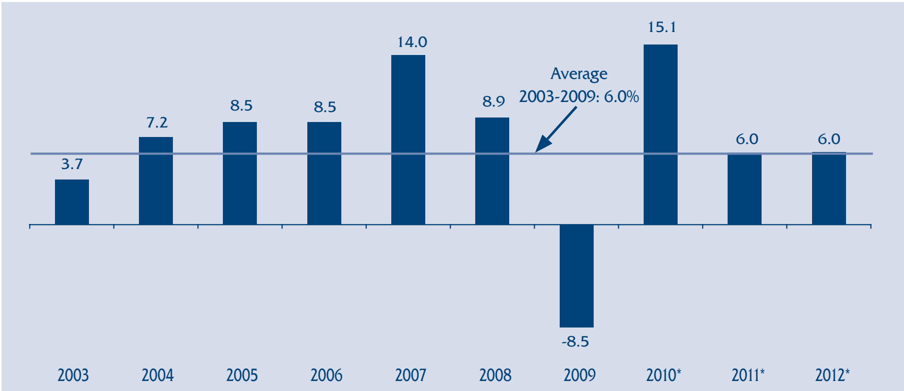
	2009		2010*			2011*		2012*	
	I Sem.	Year	I Sem.	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
Agriculture and livestock	**2.4**	**2.3**	**4.6**	**4.2**	**4.4**	**3.5**	**3.5**	**4.7**	**4.7**
Agriculture	1.1	0.9	4.7	4.4	4.4	3.3	3.3	4.8	4.8
Livestock	4.9	4.4	4.5	3.8	4.3	4.3	4.3	4.7	4.7
Fishing	**-5.4**	**-7.9**	**-11.1**	**-1.7**	**-4.0**	**5.3**	**5.4**	**2.6**	**2.6**
Mining and hydrocarbons	**2.1**	**0.6**	**0.6**	**1.4**	**1.8**	**7.0**	**7.1**	**8.5**	**8.5**
Metallic mining	-0.1	-1.4	-1.5	-2.4	-2.4	4.6	4.7	10.0	10.0
Hydrocarbons	23.2	16.1	16.4	29.2	32.3	20.6	20.2	1.1	1.1
Manufacturing	**-8.0**	**-7.2**	**12.2**	**10.7**	**12.9**	**5.9**	**5.9**	**5.8**	**5.8**
Raw materials	3.0	0.0	-3.8	2.5	1.8	5.3	5.4	4.9	4.9
Non-primary industries	-10.2	-8.5	15.8	12.3	15.1	6.0	6.0	6.0	6.0
Electricity and water	**0.8**	**1.2**	**7.5**	**6.6**	**7.6**	**5.3**	**5.3**	**5.3**	**5.3**
Construction	**1.9**	**6.1**	**19.2**	**13.9**	**14.4**	**9.3**	**9.3**	**12.0**	**12.0**
Commerce	**-1.0**	**-0.4**	**9.6**	**8.3**	**8.7**	**5.6**	**5.6**	**5.7**	**5.7**
Other services	**2.7**	**3.1**	**7.0**	**5.1**	**6.9**	**5.9**	**5.9**	**5.2**	**5.2**
GDP	**0.3**	**0.9**	**8.2**	**6.6**	**8.0**	**6.0**	**6.0**	**6.0**	**6.0**
Primary	**2.2**	**1.0**	**1.5**	**2.8**	**2.8**	**5.1**	**5.1**	**6.0**	**6.0**
Non-Primary	**-0.1**	**0.8**	**9.7**	**7.4**	**9.0**	**6.1**	**6.1**	**6.0**	**6.0**

RI: Inflation Report.
* Forecast.

The upward revision of the GDP growth rate in 2010, from 6.6 percent to 8.0 percent, considers a significant increase in the dynamism of non primary sectors, given the execution observed in the first semester. Non primary sectors would show a higher growth (9.0 percent) than the one considered in our previous Report (7.4 percent), which is consistent with the higher growth considered in terms of domestic demand. On the other hand, primary sectors would grow 2.8 percent due to increased activity in the sub sector of livestock. This would offset the greater decline foreseen in metal mining and the lower expansion of the agricultural sub sector and of manufacturing based on raw materials, considering the execution observed in the first semester.

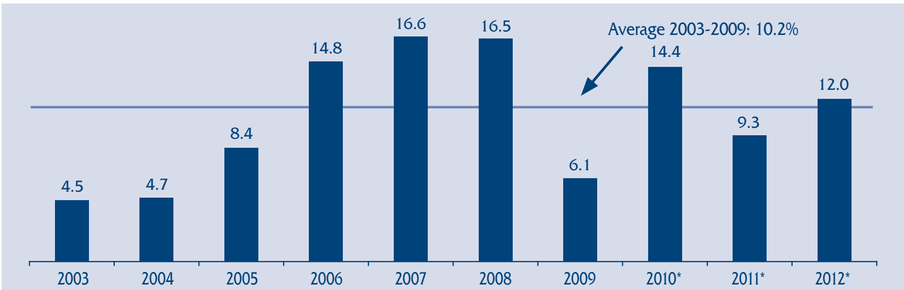
A significant recovery of primary sectors is expected in the next years considering normal climatic conditions for agriculture and fishing activities, as well as a rebound of the mining sector in 2012. On the other hand, the annual growth rate of non primary sectors would stabilize around 6 percent, with construction leading this growth. This is consistent with the expected pace of expansion of private investment.

Graph 53
GROWTH RATE OF NON-PRIMARY MANUFACTURING
(Real % change)



* Forecast.

Graph 54
GROWTH RATE OF THE CONSTRUCTION SECTOR
(Real % change)



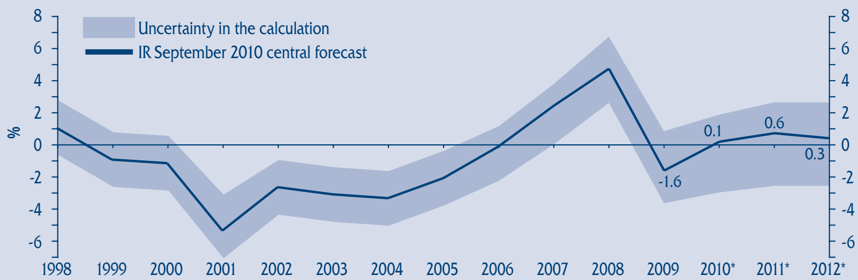
* Forecast.

Output gap

51. New available information on the evolution of economic activity shows that the output gap would be closing at a faster pace than foreseen in the Inflation Report of June. Thus, with this new information the projection of the average output gap is revised upwards, from -0.4 to a nil gap in 2010 and a slightly positive gap in 2011. The output gap is the aggregate indicator of demand inflationary pressures.

A zero gap indicates that economic activity is growing at its potential or trend level, without generating demand inflationary pressures.

Graph 55
OUTPUT GAP
(% of the potential GDP)



* Forecast.

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

BOX 2
PERU: EVOLUTION OF PRODUCTIVITY AND PENDING AGENDA

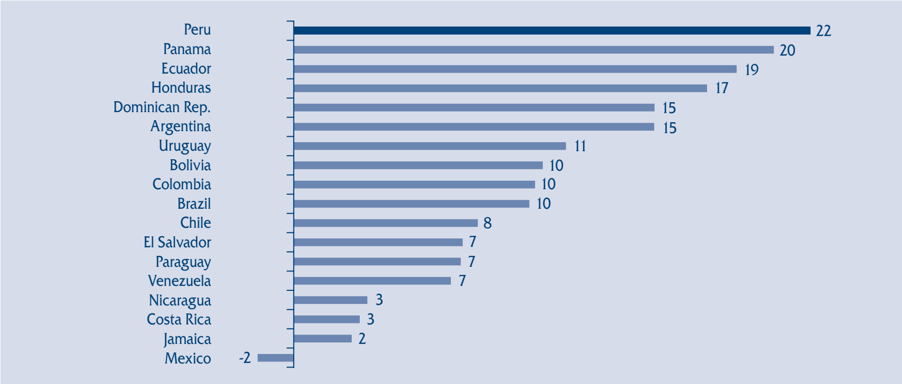
Growth accounting allows us to break down the rate of growth of a country into the contributions of three aggregate production factors: labor, capital, and total factor productivity (TFP). Labor reflects demographical and labor market trends, while capital reflects the accumulation of investment expenditure in productive capital. On the other hand, TFP measures the efficiency in the use of these production factors.

A growth accounting exercise was carried out using comparable macroeconomic information –World Development Indicators (World Bank) and Penn World Table 6.3 (University of Pennsylvania[2]), available until 2007)– with the purpose of comparing the evolution of productivity in Latin American and Caribbean countries so far in this decade (2000-2007)[3].

2 A. Heston, Summers R & Aten B, Penn World Table 6.3, Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania (2009).

3 For comparison purposes, the exercise considers that all the countries analyzed have homogeneous technologies (Cobb-Douglas function with constant returns to scale), standard technological parameters (GDP elasticity to capital stock = 0.33 and depreciation rate = 0.07), and capital stock estimated using the perpetual inventory method and the Easterly and Levine (2001) method to calculate the initial stock. These assumptions coincide with the ones used in the IDB document On the Role of Productivity and Factor Accumulation in Economic Development in Latin America (IDB, 2010). Moreover, the labor factor does not include adjustments in human capital due to the lack of data on comparable returns on education between countries in the period analyzed.

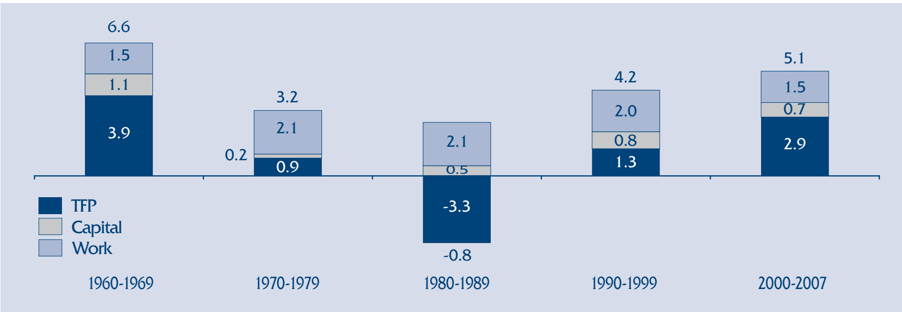
GROWTH OF TOTAL FACTOR PRODUCTIVITY
(2000-2007. %)



The results show that Peru is the country with the highest growth of productivity in the region with an increase of TFP of 22 percent between 2000 and 2007 (annual rate of 2.9 percent)[4]. Thus, the increase of TFP was the main factor that contributed to the country's economic growth (55 percent) during this period. Among other reasons, the noteworthy performance of productivity in Peru observed recently would be explained by the positive externalities resulting from macroeconomic stability, growing openness to trade, increased financial deepening, declining dollarization, and higher private investment.

However, given the historically irregular performance of TFP in Peru, the pending agenda to achieve a sustained growth of productivity in Peru is still ample. For example, the results of the growth accounting exercise carried out suggest that TFP in Peru has grown at an average annual rate of 1.0 percent since 1960 as a result of the erratic historic evolution of this variable (intensified during the 1980s when this rate declined to a negative annual rate of 3.3 percent).

CONTRIBUTION TO GROWTH: PERU. 1960-2007
(% points)



4 Data for countries in the region with a population of over one million inhabitants (18 countries).

Considering the information provided by several international diagnostic studies on growth determinants[5], the pending policy agenda includes reforms in six structural areas to complement what has already been achieved in terms of productivity:

i. Institutional strengthening, which includes reinforcing political stability, property rights, and solving judicial conflicts, among other aspects.
ii. Reduce infrastructure gaps.
iii. Improve the provision of health care services.
iv. Improve the quality of basic and higher education.
v. Ease labor market conditions and promote on the job training.
vi. Increase the capacity for technological adoption and foster investment in research and development.

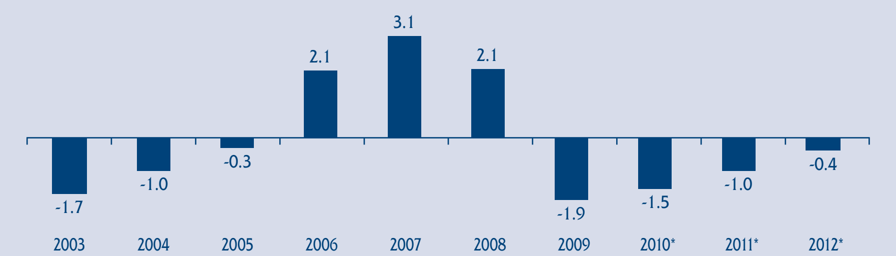
5 Global Competitiveness Report 2009-10 (World Economic Forum) and Doing Business 2010 (World Bank), among others.

IV. Public Finances

52. The central forecast scenario considers that fiscal stimulus, indicator of the fiscal position in the economic cycle, would continue being positive this year. Even though the faster pace of growth of economic activity and the growth of imports translated into increased tax revenues, the actual expenditure of the general government also increased compared with the level considered in our June Report (from 9.8 a 12.3 percent). Therefore, the estimated fiscal deficit in 2010 has been slightly reduced, from 1.6 to 1.5 percent, although the evolution of the fiscal impulse shows an increase from the 0.8 points of GDP estimated in our previous Report to 1.2 points of GDP in this report.

    A fiscal deficit of 1.0 and 0.4 percent is estimated for 2011 and 2012, respectively. These fiscal results are consistent with a gradual withdrawal of fiscal stimulus and with a reduction of the public debt as a percentage of GDP to 20 percent of the product in 2012, which contributes to improve the long term sustainability of public finances.

Graph 56
OVERALL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)



* Forecast.

53. Law N° 29368 (enacted on May 29, 2009) suspended the application of the macro fiscal rules regulating the deficit and increase of government expenditure (which establishes that the deficit should not exceed 1 percent and expenditure in consumption should be lower than 4 percent) during 2009 and 2010. Therefore, as an exception, in 2010 the deficit shall not exceed 2 percent, while the increase in expenditure in consumption shall be lower than 8 percent. In order to meet the projected expenditure level in 2010, the government approved a series of measures that apply to national government entities (Decreto de Urgencia 037-2010). It was also established that Regional and Local Governments should approve measures aimed at reducing current expenditure in goods and services.

Table 19
NON-FINANCIAL PUBLIC SECTOR
(% of GDP)

	2009	2010*		2011*		2012*	
		IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
1. General government current revenue 1/	18.6	19.5	19.7	19.7	20.0	19.9	20.1
Real % change	-11.3	14.0	16.6	6.2	6.5	6.6	5.8
2. General government non-financial expenditure	19.6	19.8	19.9	19.4	19.8	19.0	19.3
Real % change	12.7	9.8	12.3	3.2	4.1	3.3	2.7
Of which:							
a. Current	13.9	13.7	13.4	13.3	13.3	12.9	13.0
Real % change	4.4	7.1	6.8	2.2	3.7	2.3	2.9
b. Gross capital formation 2/	5.2	5.7	6.1	5.9	6.1	5.9	5.9
Real % change	32.5	18.7	28.8	8.5	5.1	5.6	2.4
3. Others	0.4	0.0	-0.1	0.0	-0.1	0.0	-0.1
4. Primary balance (1-2+3)	-0.6	-0.2	-0.4	0.3	0.1	0.9	0.7
5. Interests	1.3	1.3	1.2	1.3	1.2	1.3	1.1
6. Overall Balance	**-1.9**	**-1.6**	**-1.5**	**-1.0**	**-1.0**	**-0.4**	**-0.4**
Memo:							
Central government current revenues 1/	15.9	17.0	17.1	17.1	17.3	17.3	17.4
Central government non-financial expenditure	16.6	16.9	16.8	16.5	16.9	16.3	16.8

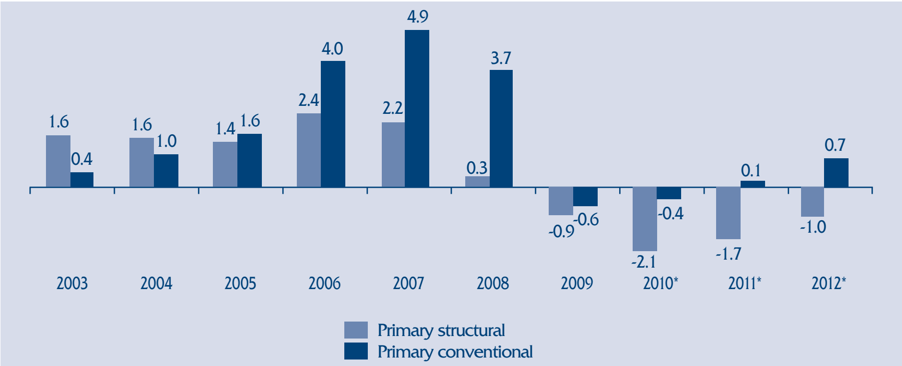
1/ The central government includes the ministries, national universities, public institutions and regional governments. The general government has a wider coverage that includes the central government, social security, regulators and supervisors, public charities and local governments.

2/ Gross capital formation of the general government need to be added the investment of public companies to obtained the public -investment.
RI: Inflation Report.
* Forecast.

Fiscal impulse

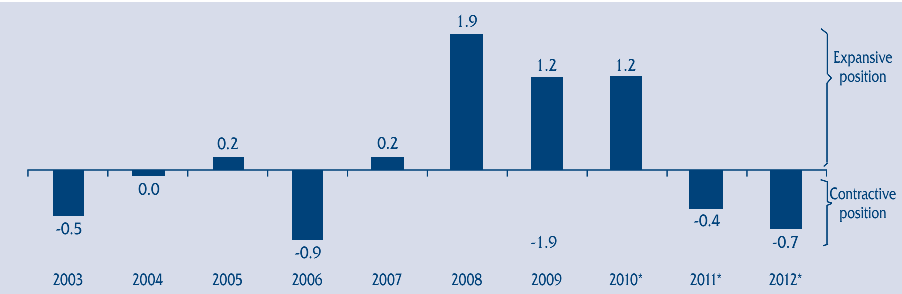
54. The indicator that allows identifying the effect of fiscal policy on domestic demand deducting the effects of the economic cycle and terms of trade is fiscal impulse, which is measured as the change in the structural primary result. The structural primary result is calculated isolating the effect of the economic cycle and the higher prices of exports of minerals and hydrocarbons on the general government revenues. An expansionary fiscal position continues being observed in 2010 as a result of the implementation of the Economic Stimulus Plan (ESP). However, a counter cyclical fiscal position is expected for 2011 and 2012 as a result of a deceleration of the growth of government expenditure towards more sustainable long term values. Considering that the growth of public expenditure projected for 2010 is higher than the one foreseen in our June Report, fiscal impulse in this Report would increase from 0.8 to 1.2 percentage points (a similar impulse to the one observed in 2009).

Graph 57
PRIMARY RESULT OF THE NON FINANCIAL PUBLIC SECTOR
(% of GDP)



* Forecast.

Graph 58
FISCAL IMPULSE
(% of GDP)



* Forecast.

Evolution of fiscal revenues

55. In the first semester of 2010 the current revenues of the general government amounted to 20.7 percent of GDP, which represented an increase of 19.3 percent in real terms. Current revenues increased both in terms of tax revenues (22 percent) and in terms of non tax revenues (16 percent). Revenues from the most important taxes (income tax, value added tax, and excise tax) recorded two-digit growth rates in all the cases. On the side of non tax revenues, the increase observed in terms of royalties (canon) and oil royalties is worth pointing out.

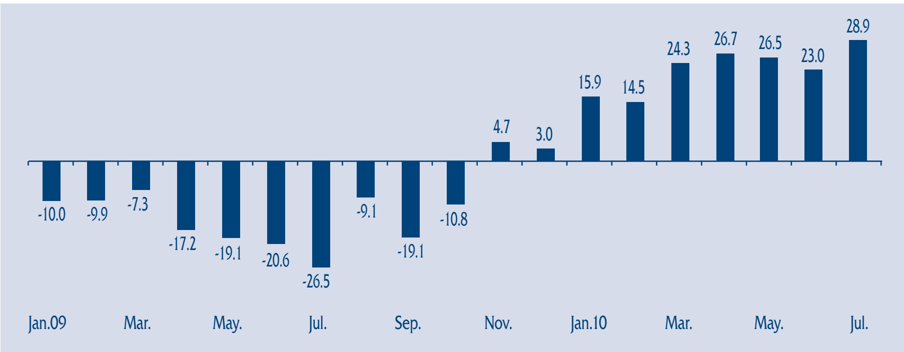
Table 20
CENTRAL GOVERNMENT TAX REVENUES
(% of GDP)

	2006	2007	2008	2009	2010*	2011*	2012*
Income tax	6.1	6.8	6.5	5.3	6.0	5.8	5.8
Value added tax	7.1	7.5	8.5	7.7	8.2	8.4	8.5
Excise tax	1.3	1.3	0.9	1.1	1.1	1.2	1.2
Import fares	0.9	0.7	0.5	0.4	0.4	0.4	0.4
Other tax revenues	1.1	1.1	1.2	1.2	1.1	1.1	1.1
Tax returns	-1.6	-1.8	-1.9	-1.9	-1.8	-1.7	-1.7
Total	**15.0**	**15.6**	**15.6**	**13.8**	**14.9**	**15.2**	**15.3**

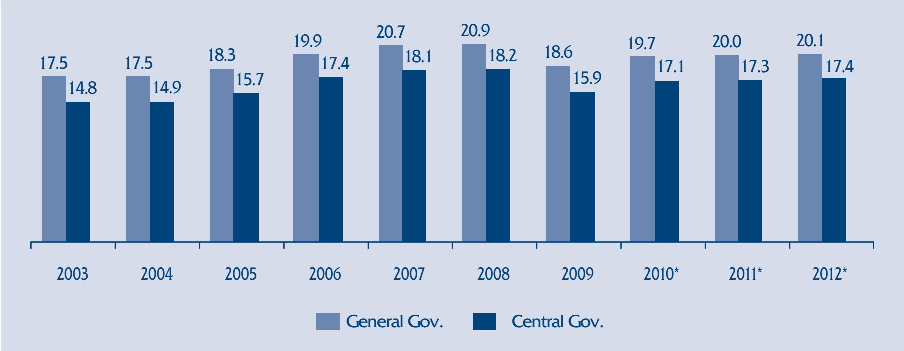
* Forecast.

56. The projection of the revenues of the general government in 2010 has been revised on the upside due to the higher growth of domestic demand and the higher prices of our export products. Thus, it is estimated that the revenues of the general government in 2010 will amount to 19.7 percent of GDP –1.1 percentage points higher than in 2009–, which implies a real growth of 16.6 percent (14.0 percent in the June Report). Both the VAT and the income tax showed two-digit growth rates during the first semester of 2010.

Graph 59
NATIONAL GOVERNMENT TAX REVENUES
(Real % change)



Graph 60
GENERAL GOVERNMENT CURRENT REVENUES



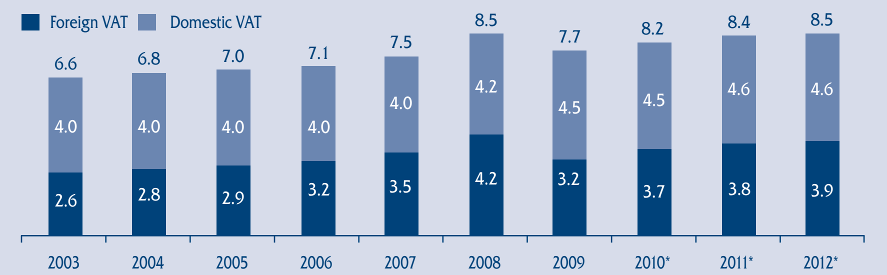
57. In 2010 the income tax would register a recovery of 0.7 points of GDP as a result of the higher payments for tax regularization payments and higher payments on account from legal entities, especially mining companies, given the improvement observed in the prices of minerals. The reduction in the use of available balances in favor of taxpayers for tax payment purposes would also contribute to this.

Graph 61
INCOME TAX
(% of GDP)

* Forecast.

58. The value added tax (VAT), our main tax income, would represent 8.2 percent of GDP in 2010 (a value 0.5 percentage points higher than the one recorded in 2009) as a result of higher taxed sales due to the recovery of economic activity and firms' restocking, as well as due to the higher level of imports observed.

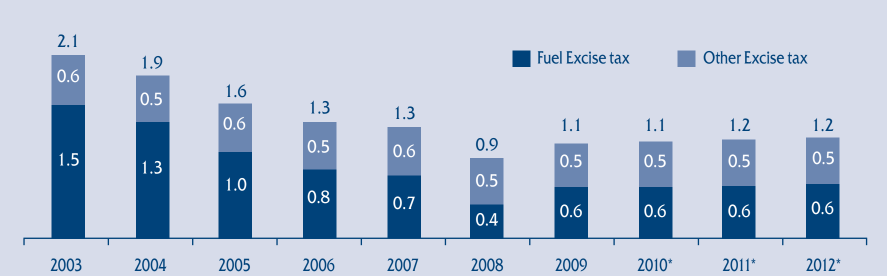
Graph 62
VALUE ADDED TAX
(% of GDP)



Memo: The addition of both components may differ from the total due to rounding.
* Forecast.

59. The excise tax would remain at levels around 1.1 percent of GDP in 2010, although recording a real positive growth of 13 percent. It should be pointed out that a regulation establishing the obligatory use of Diesel B2-S50 instead of Diesel B2 as fuel for vehicles in Metropolitan Lima came into force in January, which in practice implies a lower rate of excise tax (S/. 1.24 per gallon of the new low sulfur diesel fuel instead of S/. 1.44 per gallon of diesel B).

Graph 63
EXCISE TAX
(% of GDP)



Memo: The addition of both components may differ from the total due to rounding.
* Forecast.

60. Higher current revenues of the general government are estimated for 2011 and 2012 (20.0 and 20.1 percent of GDP, respectively). These levels are consistent with the dynamism that economic activity would show in the next years, as well as with the international prices of our export products.

Evolution of fiscal expenditure

61. In the first semester of 2010 the non financial expenditure of the general government amounted to 16.9 percent of GDP, which represented a real growth of 15 percent. By type of expenditure, 7 percent of this growth is explained by current expenditure and 40 percent by expenditure in gross capital formation. It should be pointed out, however, that if one deducts the effect of transfers to the Fuel Price Stabilization Fund in both the first semester of this year (S/. 475 million) and in the first semester of last year (S/. 1,000 million), the increase in total non financial expenditure would be 17 percent and the increase in current expenditure would be 10 percent in real terms.

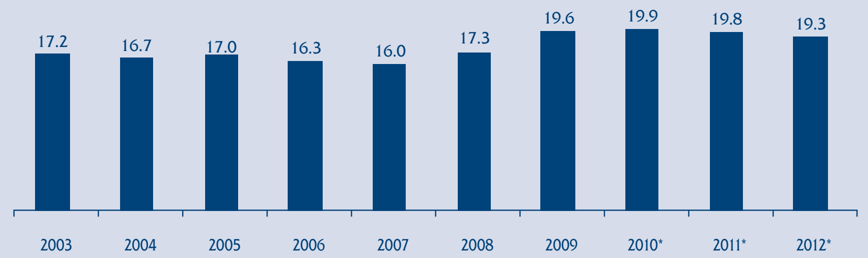
    By government levels, the non financial expenditure of local governments grew above the average (17 percent), while the non financial expenditure of the national government and regional governments grew at a lower rate (14 percent in both cases).

62. In line with the revision of the Multiannual Macroeconomic Framework carried out in August, the projected growth of the real non financial expenditure of the general government has been revised upwards to 19.9 percent of GDP in 2010 –0.3 percentage points higher than in 2009–, which implies a growth of 12.3 percent in real terms (9.8 percent was considered in the June Report). A deceleration from 15 percent in the first semester to 11 percent in the second semester is considered in the pace of growth of expenditure.

63. In order to contribute to meet the projected expenditure level in 2010, in May the government approved a series of mandatory measures that apply to national government entities (Decreto de Urgencia 037-2010), according to which accrued expenditure in goods and services in 2010 shall not exceed 3 percent in these entities. This decree also establishes that government entities can only execute up to 25 percent of the funds allocated to projects which had no expenditure execution at the time when this regulation was published.

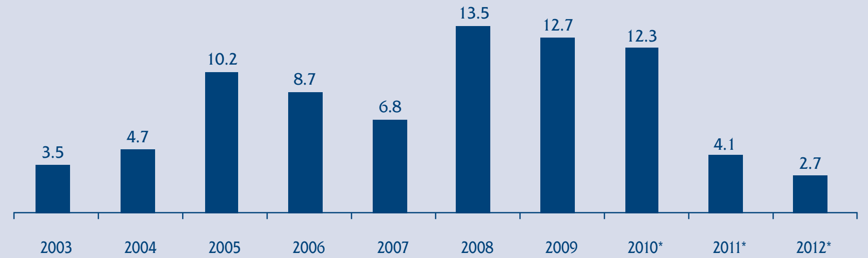
64. In 2011 and 2012 the non financial expenditure of the general government would grow by 4 and 3 percent, respectively. This growth is lower than the one considered for 2010 –year in which part of the Economic Stimulus Plan (ESP) was still executed– given that this projection considers the effects of the completion of the implementation of the ESP and that the fiscal rules on the fiscal deficit and growth of expenditure established in the Fiscal Accountability and Transparency Act will be again in force. The Act establishes that the increase in the central government expenditure in consumption cannot by higher than 4 percent in real terms, including expenditure in wages and salaries, pensions, and goods and services.

Graph 64
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(% of GDP)



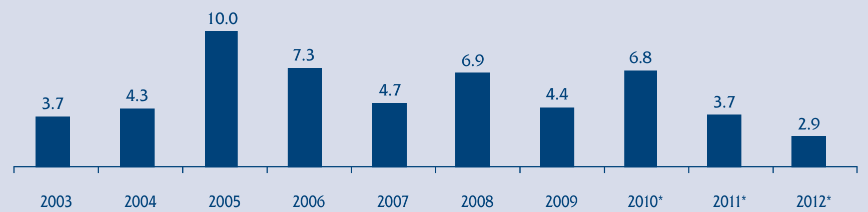
* Forecast.

Graph 65
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(Real % change)



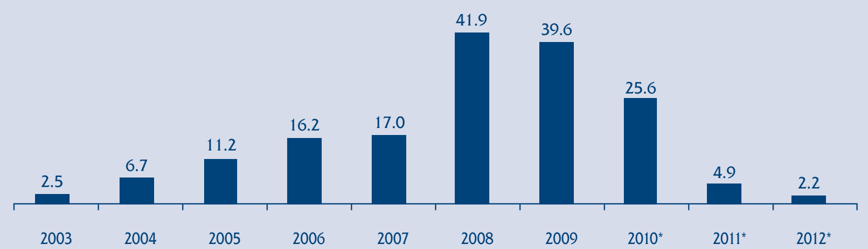
* Forecast.

Graph 66
GENERAL GOVERNMENT NON-FINANCIAL CURRENT EXPENDITURE
(Real % change)



* Forecast.

Graph 67
GENERAL GOVERNMENT CAPITAL EXPENDITURE
(Real % change)



* Forecast.

Financial requirements

65. The financing requirement of the public sector in 2010 would amount to US$ 4,052 million, a figure consistent with the year's fiscal deficit of 1.5 percent of GDP. Financial requirements of US$ 3,344 million and US$ 2,530 million are projected for 2011 and 2012, respectively. These requirements would be covered with both external and domestic sources.

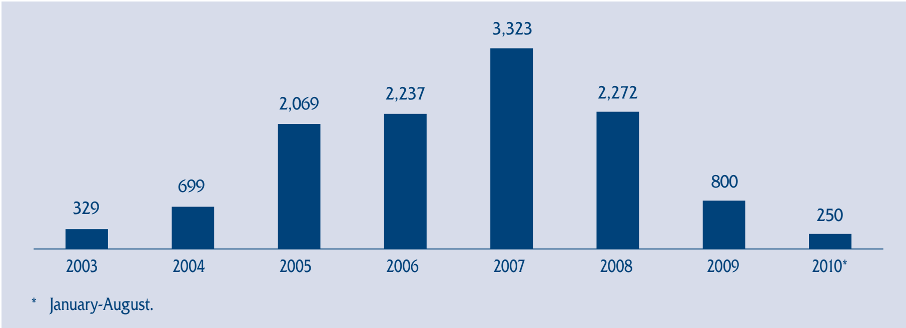
Table 21
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR 1/
(Millions of US$)

	2009	2010*		2011*		2012*	
		IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10	IR Jun.10	IR Sep.10
I. Uses	**3,838**	**3,688**	**4,047**	**3,231**	**3,344**	**2,452**	**2,530**
1. Amortization	1,218	1,435	1,653	1,628	1,593	1,773	1,758
a. External debt	950	967	962	967	971	1,334	1,338
b. Domestic debt	268	469	690	661	622	439	420
Of which: Recognition bonds	91	208	324	305	294	273	241
2. Overall balance	2,620	2,253	2,394	1,602	1,751	679	773
(negative sign indicates surplus)							
II. Sources	**3,838**	**3,688**	**4,047**	**3,231**	**3,344**	**2,452**	**2,530**
1. External	1,127	1,503	1,433	1,375	1,282	1,188	1,202
2. Bonds 2/	1,854	1,104	1,144	1,366	894	702	727
3. Internal 3/	857	1,082	1,471	490	1,169	561	601
Memo:							
Balance of gross public debt							
Millions of US$	33,827	34,447	34,427	35,842	35,384	36,156	35,884
% of GDP	26.6	23.4	22.7	22.9	21.5	21.2	20.0
Balance of net public debt 4/							
Millions of US$	17,290	19,093	18,213	20,598	19,935	21,087	20,583
% of GDP	13.6	13.0	12.0	13.2	12.1	12.4	11.5

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

66. The treasury's demand for foreign currency so far this year has been US$ 250 million, a much lower amount than the average one observed in the last 5 years (US$ 2,140 million).

Graph 68
PUBLIC TREASURY PURCHASES OF FOREIGN CURRENCY
(Millions of US$)

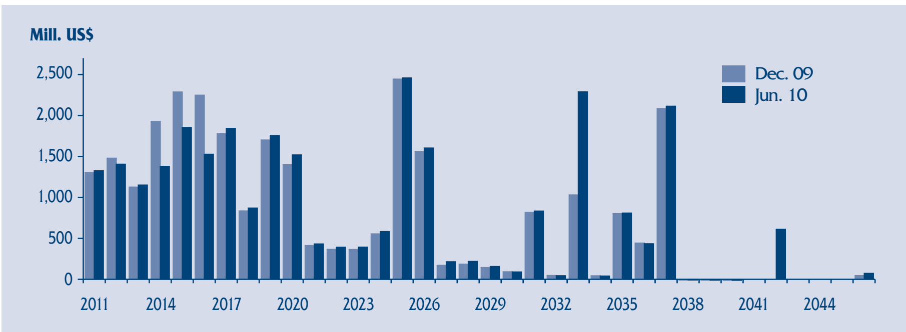


67. A swap of sovereign bonds was carried out in the domestic market in August 2010. Bonds maturing in 2011, 2012, 2016 and 2017 were swapped by sovereign bonds redeeming in 2020. Bonds included in this debt swap operation amounted to a total of S/ 1,516 million, 46.4 percent of the amount offered, and 2020 sovereign bonds for a total of S/. 1,494 million were placed.

This debt management operation was mainly aimed at reducing the number of basis points in the fixed rate yield curve and consolidating liquidity in bonds with 10 year maturities. The service of amortizations in the next years was also reduced. It is worth pointing out that 36.3 percent of the total exchanged was carried out by foreign investors.

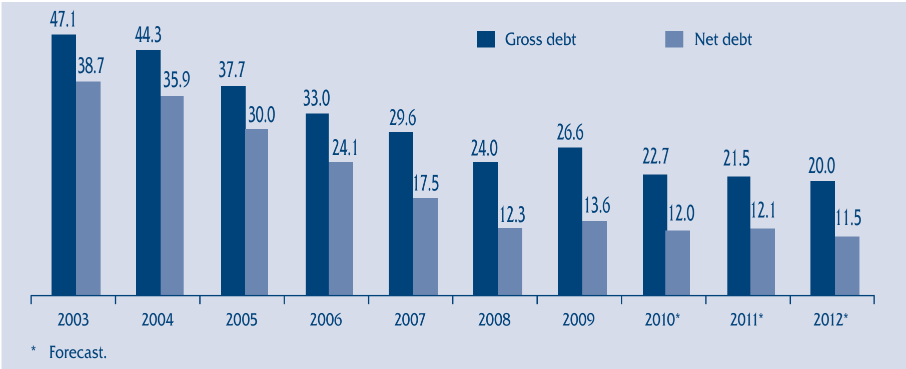
68. Two debt swaps have been carried out in this year: the one referred to in the paragraph above and another swap operation carried out in April, through which global bonds for a total of US$ 1,800 million were swapped and repurchased. As a result of these operations, the concentration of debt payments, especially during 2014-2017 has been reduced and these payments have been replaced by debts maturing in 2020 and 2033.

Graph 69
PROFILE OF DEBT AMORTIZATION
(Millions of US$)



69. The ratios of the gross and net debt would continue declining in the next years and would reach levels of 20.0 percent in the case of the former and 11.5 percent in the case of the latter in 2012 as a result of the reduction of the fiscal deficit and the growth of economic activity.

Graph 70
PUBLIC DEBT
(% of GDP)



BOX 3
STRUCTURAL ECONOMIC RESULT AND FISCAL IMPULSE

The structural economic result is an indicator that allows us to analyze the fiscal policy position. It differs from the conventional economic result in that it excludes the effects of fiscal policy decisions and the economic conditions that affect government revenues and government expenditure.

In small, open, commodity-producing economies, fiscal accounts reflect not only the cycle of the domestic economy, but also the volatility of the international prices of export products, which translate into government accounts through their impact on the fiscal revenues (taxes and royalties, for example) associated with export activities.

A specific factor that should be considered in the case of Peru is the budget impact of the Fuel Price Stabilization Fund (FPSF). The FPSF is recorded on a cash basis, that is, at the time when it is paid to companies and not when earned in the form of final lower prices to consumers.

Taking this into account, the structural economic result is defined as the one that would be obtained with the country's economic activity at its potential level, with "normal" or "medium term" international prices of the main export products (minerals and crude in the case of Peru), and recording the subsidies provided though the FPSF in the government expenditure on an accrual basis.

An improvement in the structural result can be the result of higher revenues due to policy measures (higher rates, base or taxes) or to lower expenditure, which is equivalent to a less expansionary or contractive fiscal policy. Likewise, a reduction in the structural economic result would be indicating an expansionary fiscal policy position. The change of the economic structural result is an indicator of the fiscal policy position in the economic cycle and is known as “fiscal impulse”.

This is a not directly observable variable that has to be estimated on the basis of available information. The method used to estimate it consists of adjusting the general government revenue for GDP deviations from its trend (output gap), as well as for deviations in the prices of mineral and oil exports from the long-term average value. Moreover, the non financial expenditure of the general government and the primary result of state enterprises are adjusted to reflect the impact of the FPSF on an accrual basis.

The elasticity of revenues in GDP terms has to be estimated to adjust revenues to the output gap. This estimate is the weighted average of the elasticity of the main components of the current revenues of the general government. The elasticity of each type of tax (income tax, VAT, and other revenues) was estimated.

The adjustment in terms of economic cycle considers that the general government current revenues react with a constant elasticity to GDP, and therefore the cyclical component of revenues is:

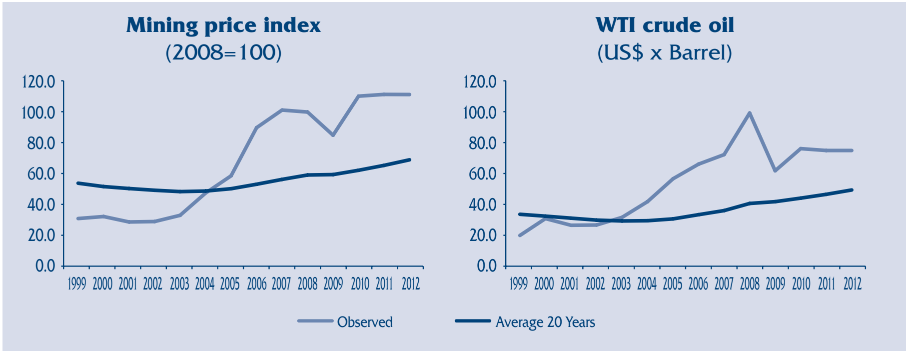
$$Adjustment = R\left[\left(\frac{\overline{Y}}{Y}\right)^{\beta} - 1\right]$$

Where:

R Revenues of the general government.
$\overline{Y}$ Trend GDP.
Y Observed GDP.
β Elasticity of current revenues in GDP terms (1.09).

The level of long term prices of minerals and oil[6] is the average value of the real prices of these products in a period of 20 years. These real prices were obtained by deflating the nominal prices by the US consumer price index. This average is finally expressed in current dollars, the value corresponding to the “normal” price in each year of the sample. Thus, the cyclical component of the prices of mineral exports is the difference between the price observed and the “normal” or reference price.

6 In the case of mineral exports, the international price is the implicit FOB export price, while in the case of oil, the international price is the price of WTI oil.



The impact of the international prices of minerals on the income tax associated with mining activity is considered to make the adjustment for the international prices of minerals. In the case of oil, we consider the impact on the income tax of the hydrocarbon sector and the income from oil royalties.

Revenue (R_t) from income tax in every year includes payments on account of the fiscal year (PC_t) and the regularization of the previous fiscal year, which is equal to the difference between tax liabilities generated in the previous fiscal year (G_{t-1}) and the corresponding payments on account (PC_{t-1}), which is expressed as:

$$R_t = PC_t + (G_{t-1} - PC_{t-1})$$

If we consider that payments on account and the liability generated by the tax depend on the current level of the prices of exports (IPX_t) as well as on their level of production (Q_t), this equation indicates that revenues from income tax in each period depend on export prices (IPX) in this period and in the previous period, among other variables (i.e. production level). That is, we can say that:

$$R_t = R(IPX_t, IPX_{t-1}, Q_t, Q_{t-1}, \dots)$$

Equations[7] connecting the payment on account and the tax generated by the international prices to estimate the adjustment were used in this exercise. The adjustment for export prices applied to fiscal accounts is the difference between the theoretical revenue from the international prices observed (IPX_t) and the one corresponding to the average prices used as reference ($\overline{IPX}_t$), maintaining all the other variables constant.

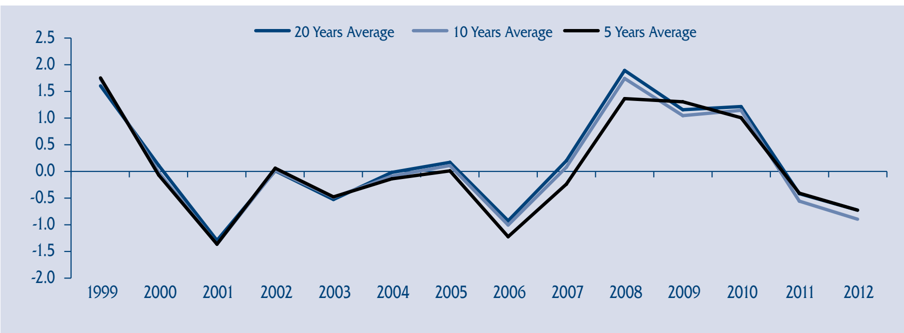
7 Log lineal regressions between tax revenues, international prices, and the level of production.

STRUCTURAL PRIMARY BALANCE OF THE NFPS (% of potential GDP)	2007	2008	2009	2010	2011	2012
1. Conventioanl Primary Balance	5.0	3.8	-0.6	-0.4	0.1	0.7
2. Cyclical adjustment and mining	-2.7	-3.5	-0.6	-1.6	-1.8	-1.7
due to cycle	-0.5	-0.9	0.3	0.0	-0.1	-0.1
due to mining and hydrocarbons	-2.3	-2.5	-0.9	-1.6	-1.7	-1.6
3. Adjustment FPEF	-0.2	-0.1	0.2	0.0	0.0	0.0
4. Structural Primary Balance	2.2	0.3	-0.9	-2.1	-1.7	-1.0
5. Fiscal Impulse (=Change from -4)	0.2	1.9	1.2	1.2	-0.4	-0.7

The graph below shows that fiscal policy between 2008 and 2010 was expansionary. A counter cyclical policy can be applied in a context in which the level of activity is below the level of potential growth, as was the case of Peru in 2009 and until the first semester of 2010. A negative fiscal impulse is expected for 2011, reflecting mainly the end of the Economic Stimulus Plan implemented since 2009 and the aim of recovering fiscal space to be able to apply counter cyclical policies again should this be required due to the international context.

It is worth pointing out that the measurement of the fiscal impulse is reasonably robust to changes in the length of the moving average used in the calculation. If moving averages of 5, 10 or 20 years are used, the estimated fiscal impulse does not vary substantially, as the following graph shows.

FISCAL IMPULSE
(% potential GDP)



BOX 4
FISCAL RULES FOR LOCAL GOVERNMENTS

Important legislation has been approved and implemented since 2002 to transfer powers to sub-national governments[8]. A certain degree of fiscal de-centralization generates gains in terms of efficiency when decision-making about the provision of public goods depends more closely on citizens' decisions.

However, the process of de-centralization involves risks both in terms of the sustainability of public finances and in terms of an appropriate allocation of resources. The risks in the first case are associated with factors such as a weak control over the accumulation of a sub-national debt; the absence of an adequate institutional structure to develop, monitor, and implement the fiscal de-centralization policy, and a high dependence of sub- national governments on transfers from the national government. As regards resource allocation, factors such as the limited management capacity in terms of the supply of public services and recently transferred responsibilities, as well as the existence of significant regional differences may generate imbalances between regions and an inadequate use of fiscal resources.

Thus, for example, between 2006 and 2009 inter-governmental transfers (mining, gas and oil canon, over royalties, and royalties) increased as a result of the better prices of traditional exports, which allowed some municipalities and regions to accumulate deposits. These major changes in the level of transfers and the difficulty of regulating the pace for the use of these resources from the national Government add another dimension to the problem of designing a fiscal rule to ensure a counter cyclical management of public finances.

In this sense, the effect of fiscal rules for sub national levels is particularly important. Having this type of rules will prevent that fiscal adjustments depend only on the national government and will contribute to make the evolution of expenditure in regional and local governments more predictable.

Sub-national rules

Law 27245, Fiscal Accountability and Transparency Act (FATA), and Legislative Decree 955, Fiscal De-centralization Act (FDA), establish the fiscal rules applicable to sub-national governments. These rules consist mainly of limits to the ratios of stock and debt service to net current revenues and also establish that sub-national governments are required to maintain the moving average of the primary result of three years in a positive value.

8 According to the Cuenta General de la República 2008, sub-national governments comprise 26 regional governments and over 1,842 local governments.

FISCAL RULES TO BE FOLLOWED BY REGIONAL (RG) AND LOCAL (LG) GOVERNMENTS

	RULE	GENERAL [1/]	IN FORCE IN 2009-2010
LAW Nº 27245, FISCAL RESPONSABILITY AND TRANSPARENCY LAW (LFRT)			
R1.	Balance of total debt / Net current income	$\leq 100\%$	$\leq 120\%$
R2.	Service of total debt / Net current income	$\leq 25\%$. in RG $\leq 30\%$ in LG	$\leq 30\%$ in RG $\leq 35\%$ in LG
R3.	Primary result (average of the last 3 years)	≥ 0	> 0
LEGISLATIVE DECREE Nº 955, FISCAL DESCENTRALIZATION (FD)			
R4.	Short term debt (STD) < than net current revenues	$\text{STD} \leq \frac{\text{IC}}{12}$	$\text{DCP} \leq 25\%\text{IC}$ Region $\text{DCP} \leq 30\%\text{IC}$ Local gov.
R5.	Balance of total debt without guarantee / Net current income	$\leq 45\%$	Suspended
R6.	Service of total debt without guarantee / Net current income	$\leq 25\%$	Suspended
R7.	Limit to non financial expenditure (NFE) or consumption expenditure (CE)	$\frac{\text{NFE}_t - \text{NFE}_{t-1}}{\text{NFE}_{t-1}} \leq 3\%$ real	$\frac{\text{CE}_t - \text{CE}_{t-1}}{\text{CE}_{t-1}} \leq 4\%$ real
R8.	Rule for last year in office	Prohibits current expenditure involving payment commitments for the next administration [2/]	Prohibits current expenditure involving payment commitments for the next administration [2/]
R9.	Exception rule for expenditure associated with natural disasters	Does not apply Rule R7	Does not apply Rule R7

1/. Suspended by U.D. 028-2009 (February 24, 2009) and U.D. 108-2009 (November 9, 2009).
2/. Except pensions.

In the frame of the Economic Stimulus Plan (ESP), the fiscal rules for 2009-2010 in terms of the ratios of debt balance and debt service to current revenues were eased, the rules regarding the debt balance and debt service without the guarantee of the national government were suspended, and the rule establishing limits for expenditure was modified in the sense that it now included expenditure in consumption (salaries and wages, goods and services, and pensions) instead of non financial expenditure.

Compliance

The information published in the General Account (Cuenta General de la República) shows that, on average, 95% of **local governments** have complied with the limits for the debt balance and debt service in 2006-2009.

However, a temporary decline is observed in the degree of compliance in the case of the short term debt, where compliance declined from 55 percent in 2006 to 38 percent in 2008, recovering thereafter to 68 percent of municipalities in 2009. This is probably associated with the facilities for short term loans that local governments can have using the future incomes from some resources as guarantees.

As regards the rule on the primary result, local governments' compliance with this rule showed a downward trend that declined from 67 percent in 2006 to 26 percent of municipalities in 2009. Moreover, the degree of compliance with the rule on expenditure limit declined from 35 percent in 2007 to an average of 25 percent in 2008 and 2009.

LOCAL GOVERNMENTS' COMPLIANCE WITH FISCAL RULES
(Percentage of local governments)

RULE	2006			2007			2008			2009 (*)		
	Comply	Fail to comply	N/A	Comply	Fail to comply	N/A	Comply	Fail to comply	N/A	Comply	Fail to comply	N/A
R1. Balance of total debt / Net current income <= 100% (For 2009 <= 120%)	92	3	5	94	2	4	98	2	0	94	5	1
R2. Service of total debt / Net current income < 30% (For 2009 < 35%)	93	2	5	96	0	4	100	0	0	98	1	1
R3. Primary result (average of the last 3 years) > 0 (For 2009 <= 120%)	67	19	14	66	22	12	52	40	8	26	69	5
R4. Short term debt <= 1/12 of the net current income (For 2009 < 35% of Net current income)	55	40	5	53	43	4	38	60	1	68	31	1
R5. Balance of total debt without guarantee / Net current income <= 45%. (For 2009 suspended)	79	16	5	86	10	4	87	13	0	suspended		
R6. Service of total debt without guarantee / Net current income <= 25%. (For 2009 suspended)	69	26	5	96	0	4	99	0	1	suspended		
R7. Change of non financial expenditure (GNF) <= 3% real. (For 2009 < 4% real of consumption expenditure)	12	79	9	35	57	8	25	71	4	26	73	1

Note: Ratios published in *Cuenta General de la República*. The rules for 2009 were modified and suspended.
(*) Preliminary data, *Proyecto de Ley Cuenta General de la República 2009.*
Source: MEF - Dirección Nacional de Contabilidad Pública: *Cuenta General de la República*, 2006-2008.

It should be pointed out that the FATA establishes that regional and local governments' non compliance with fiscal rules generates the interruption of transfers from the Regional Compensation Fund (FONCOR) to the Inter-Governmental Fund for Decentralization (FIDE) or to the Municipal Compensation Fund (FONCOMUN). The FATA also establishes that when the budget execution of regional governments compromises the fulfillment of the Multi-Annual Macroeconomic Framework and the macro-fiscal rules established in the FATA, the government will adopt fiscal measures aimed at stabilizing the public finances of these entities through emergency decrees. However, despite high levels of non compliance, no local government has been sanctioned in accordance with this law.

This situation has been favored by the continued suspension –since 2005 to date– of the transparency regulations for sub national governments established in the Fiscal Decentralization Law, according to which these entities are required to submit fiscal management reports to the MEF . The latter is responsible for assessing the financial position of sub national governments and, if necessary, will adopt the corrective measures required so that each of the regional and local governments meet the requirements of the Fiscal Decentralization Law in a maximum term of two years.

Because sub national governments manage an increasing amount of public resources, it is necessary to ensure that fiscal behavior is consistent with maintaining the sustainability of public finances.

V. Monetary Policy

70. After initiating the withdrawal of monetary stimulus in May 2010, the Central Bank continued raising preventively the monetary policy reference rate in a context of high growth of public and private expenditure. The monetary reference rate was raised by 150 bps between May and September, with increases of 25 bps in June and July and 50 bps in August and September.

71. This preventive withdrawal of monetary stimulus has taken place after macroeconomic conditions, which favored an expansionary monetary policy and led and the Central Bank to reduce the reference interest rate to a minimum historical level of 1.25 percent, have changed substantially. Economic activity, which slowed down due to the global crisis in 2009, has been showing a high pace of growth. In June the rate of growth in the last twelve months reached 11.9 percent, as a result of which a growth rate of 10.1 percent was recorded in Q2 and the rate accumulated so far this year is 8.2 percent. Several current and advanced indicators of economic activity show a similar evolution: in July and August the production of electricity grew 12.9 and 9.2 percent; local dispatches of cement increased 12.8 and 15 percent; imports of capital goods grew 29 and 54 percent, and imports of industrial inputs grew 35 and 56 percent, which anticipates that the high pace of growth observed will continue in the next months. Moreover, because several indicators of the output gap show that the gap would be closing more rapidly, a more neutral monetary policy position is required to ensure that inflation remains within the tolerance range in the forecast horizon.

72. In dollarized economies like the Peruvian economy, the reversal of monetary stimulus requires also a parallel adjustment of monetary and credit conditions in domestic currency and foreign currency to avoid generating a greater process of dollarization of credit and also a lower effectiveness of monetary adjustment through this process. Therefore, the rise of the reference rate has been coupled by a series of measures associated with reserve requirements in both domestic and foreign currency which are inducing active rates to rise. Thus, the following measures were adopted between June and September:

- Minimum legal reserve requirements were raised from 6.0 to 8.5 percent, with a waiver of either S/.50 million or 6.0 percent of liabilities subject to reserve requirements, the lower of the two options.
- Banks' minimum reserve requirements in the current account were raised from 1.0 to 3.0 percent.
- The rate of marginal reserve requirements in domestic currency was raised to 15 percent.

- The rate of marginal reserve requirements in foreign currency was raised from 30 to 50 percent.
- The rate of average reserve requirements in foreign currency was raised by 0.3 percentage points relative to the implicit rate of reserve requirements in the period July 1 – July 31, 2010.
- The rate of reserve requirements for deposits in non resident financial entities was raised from 35 to 120 percent.
- The rate of reserve requirements for short term liabilities was raised from 35 to 75 percent.

73. The Central Bank permanently assesses inflation forecasts and inflation determinants in order to adjust its monetary policy position on a timely basis so as to ensure that inflation falls within the tolerance range in the forecast horizon. In this sense, the future evolution of the reference rate will depend on the evolution of the main determinants of inflation.

Graph 71
BCRP INTEREST REFERENCE RATE
(%)

RECENT INTEREST RATE MEASURES:
July – September 2010

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

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

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

July: The Board of the Central Reserve Bank of Peru approved to raise the monetary policy reference rate from 1.75 percent to 2.0 percent.

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

Future adjustments in the reference interest rate will depend on new information on the evolution of macroeconomic indicators and their impact on inflation determinants. Uncertainty persists in international financial markets and so does uncertainty about the impact that this might have on global economic recovery.

August: The Board of the Central Reserve Bank of Peru approved to raise the monetary policy reference rate from 2.0 percent to 2.5 percent.

This measure is mainly preventive in a context of strong dynamism of domestic demand, a situation that requires continuing with the withdrawal of monetary stimulus in order to maintain inflation within the target range.

September: The Board of the Central Reserve Bank of Peru approved to raise the monetary policy reference rate from 2.5 percent to 3.0 percent.

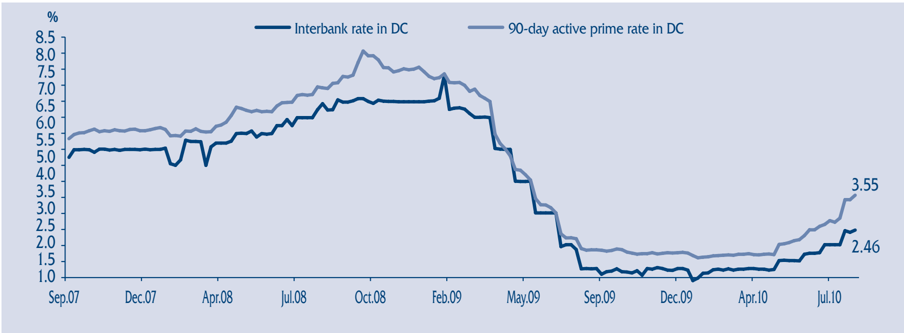
This measure is mainly preventive in a context of strong dynamism of domestic demand, a situation in which withdrawing monetary stimulus is advisable in order to maintain inflation within the target range. However, future adjustments in the reference rate will depend on new information on the evolution of inflation and its determinants.

74. The short term interest rates of the Central Bank instruments continued rising in the quarter, following the reference rate rises initiated in May of this year with the purpose of withdrawing monetary stimulus. The parallel rise in the short term yield curve and the shortening of the maturities of the Certificates issued by the Central Bank observed in the last quarter would be indicating that expectations about rising rates in the very short term remain and that there is uncertainty about the rates that will be established in longer terms.

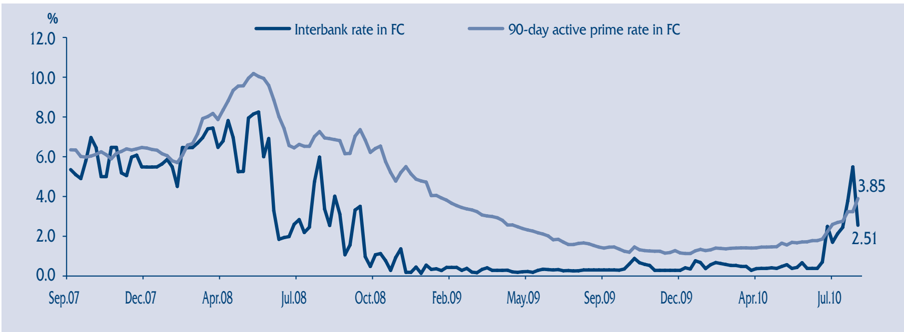
75. The size of the rises in the reference rate (150 bps between June and September) and the changes carried out in terms of reserve requirements have been modifying credit conditions in the economy. Data as of August show that interest rates on corporate loans in nuevos soles rose from 2.08 in May to 3.55 percent in August –showing a higher increase than the reference rate– and that interest rates on corporate loans in dollars rose from 1.65 to 3.85 percent in the same period. The

higher increase in the case of the latter is associated with the lower availability of liquidity in foreign currency as a result of the reserve requirement measures and the Central Bank's intervention in the foreign exchange market, which are aimed at reducing the negative effects of excessive volatility in the exchange rate.

Graph 72
INTERBANK AND CORPORATE PRIME INTEREST RATES IN DOMESTIC CURRENCY



Graph 73
INTERBANK AND CORPORATE PRIME INTEREST RATES IN FOREIGN CURRENCY



76. By type of credit, interest rates on both commercial and consumer loans in domestic currency increased: the former rose from 7.2 percent in May to 8.5 percent in August and the latter rose from 40.7 to 42.1 percent. On the other hand, the rates on credits to micro businesses declined from 32.7 to 30.5 percent and the rates on mortgage loans remained constant.

In the case of interest rates on credit in foreign currency, the rates on commercial loans rose from 6 to 7 percent between May and August, the rates on consumer and mortgage loans practically remained constant, and the rates on loans for micro businesses declined from 22.6 to 16.3 percent.

Table 22
INTEREST RATES BY TYPE OF CREDIT IN DOMESTIC AND FOREIGN CURRENCY 1/ 2/
(%)

	Domestic Currency				Foreign Currency			
	Commercial	Microbusiness	Consumption	Mortgages	Commercial	Microbusiness	Consumption	Mortgages
Dec.08	11.0	35.3	37.8	11.4	9.3	23.9	20.8	10.8
Mar.09	10.8	32.1	42.2	11.5	8.6	23.1	22.4	10.7
Jun.09	8.5	34.3	43.0	10.4	7.9	23.3	21.5	10.3
Sep.09	7.4	33.2	41.7	10.0	7.4	22.7	22.0	9.7
Dec.09	6.1	32.7	45.1	9.8	6.7	22.4	21.2	9.1
Jan.10	6.1	32.7	44.8	9.8	6.3	22.4	22.3	9.1
Feb.10	6.5	32.6	41.5	9.7	6.4	22.5	22.3	9.1
Mar.10	6.4	32.3	40.7	9.7	6.4	21.8	22.0	9.2
Apr.10	6.8	32.5	39.8	9.7	5.9	22.2	21.6	9.1
May.10	7.2	32.7	40.7	9.6	6.0	22.6	21.4	8.9
Jun.10	7.3	32.5	41.0	9.6	6.2	22.3	20.1	8.8
Jul.10	7.7	31.9	41.8	9.7	6.2	18.4	20.4	8.7
Aug.10	8.5	30.5	42.1	9.7	7.0	16.3	21.5	8.6

1/ Annual active interest rates on the operations carried out in the last 30 working days.
2/ Since July 1st, 2010, firms' reports to the SBS include more segmented information about the average interest rates on corporate loans, credits to large, medium-size, small and micro businesses, acording to the definitions established in SBS Resolution 11356-2008 and complementary regulations. Theses rate segments are published when the SBS acummulates 30 days data.
Source: SBS.

As regards passive interest rates, the rates on 30-day deposits increased from 1.6 to 2.2 percent between June and August. Moreover, the rates on 30-day deposits in foreign currency increased from 0.6 to 2.3 percent.

Table 23
INTEREST RATES IN NUEVOS SOLES AND DOLLARS
(%)

	Nuevos Soles		Dollars		Difference (bps) (Jun.-Aug.)	
	Jun.10	Aug.10	Jun.10	Aug.10	Nuevos Soles	Dollars
1. Deposits up to 30 days	1.6	2.2	0.6	2.3	57	168
2. Rate on 31 to 180-day term deposits	1.8	2.3	1.0	1.1	46	18
3. Rate on 181 to 360-day term deposits	2.5	2.9	1.7	1.7	39	-1
4. Corporate prime rate	2.3	3.4	1.6	3.5	114	185
5. TAMN / TAMEX	19.1	18.1	8.0	8.3	-104	31

Monetary operations

77. The operations of the BCRP were aimed at ensuring adequate liquidity levels to maintain a smooth flow of operations in the money market, in a context of BCRP

purchases of foreign currency aimed at reducing the negative effects of the volatility of the exchange rate. The interventions in the foreign exchange market were completely sterilized by placements of CDBCRP and higher reserve requirements.

Between July and August, the BCRP purchased dollars for a total of US$ 3,642 million. These purchases were sterilized with the net placement of CDBCRP (S/.7,681 million) and higher reserve requirements in domestic currency (S/.659 million), which reflects the increase of the minimum legal reserve requirements in domestic currency from 6 to 8.5 percent and the increase in the rate of marginal reserve requirements to 15 percent in this period.

The higher demand for currency in this period (S/. 1,345 million) reflected both the growth of economic activity and the higher seasonal demand of July, as a result of which currency in circulation recorded a last 12-month growth rate of 23.6 percent in August. In the same period, the public sector purchased FC for a total of US$ 50 million from the Central Bank and accumulated deposits at the BCRP for a total of S/.518 million. The latter reflects mainly the placement of sovereign bonds for a total of S/. 800 million.

Table 24
MONETARY OPERATIONS
(Millions of nuevos soles)

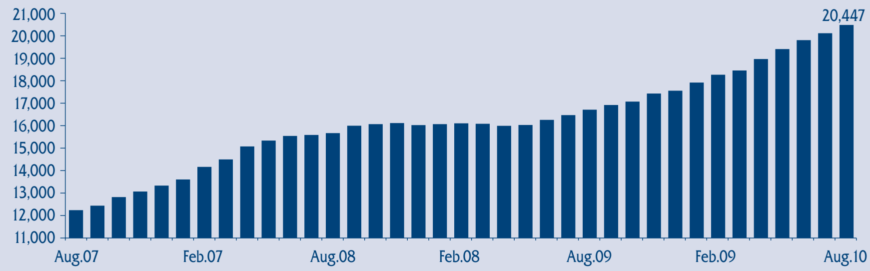
	FLOWS					BALANCE		
	2009	2010				31.Dec.09	30.Jun.10	31.Aug.10
		1Q	2Q	Jul-Aug	Jan-Aug			
I. FOREIGN EXCHANGE OPERATIONS	**-562**	**6,626**	**2,407**	**10,014**	**19,047**			
(Millions of US$)	-48	2,329	851	3,565	6,745			
1. Over the counter operations	108	2,340	841	3,642	6,822			
2. Public Sector	-261	0	0	-50	-50			
3. Other operations 1/	105	-11	10	-27	-28			
II. Monetary operations	**1,023**	**-8,143**	**-1,598**	**-8,224**	**-17,965**	**-36,323**	**-46,065**	**-54,288**
1. Sterilization operations	6,436	-8,143	-1,612	-8,210	-17,965	-36,323	-46,079	-54,288
a. CDBCRP 2/	4,509	-7,632	4,182	-7,681	-11,131	-14,121	-17,570	-25,252
b. Public sector deposits in DC	2,561	-1,217	-5,600	-518	-7,335	-21,006	-27,823	-28,341
c. Other operations 3/	-635	706	-195	-10	500	-1,196	-685	-695
2. Injection operations (Repos)	-5,412	0	14	-14	0	0	14	0
III. Reserve requirements in DC	**668**	**490**	**-228**	**-659**	**-398**	**-4,307**	**-4,045**	**-4,705**
IV. OTHER OPERATIONS 4/	**776**	**644**	**164**	**213**	**1,021**			
V. CURRENCY*	**1,905**	**-383**	**744**	**1,345**	**1,705**	**19,241**	**19,602**	**20,946**
(12-month change)						11.0%	21.2%	23.6%

1/ Includes repos in FC and over-the-counter operations.
2/ Includes CDBCRP NR and CDR BCRP.
3/ Includes overnight deposits and Deposit Insurance Funds.
4/ Includes BCRP operational expenses, interest for deposits in the BCRP (overnight, term, and special deposits), net interest for placements of CDBCRP and transfers of profits to the public sector.
* Preliminary data.

Monetary aggregates

78. In August, currency in circulation recorded a monthly growth rate of 1.8 percent and an annual growth rate of 22.5 percent, which reflects the dynamism of economic agents' transactions associated with the growth of economic activity.

Graph 74
SEASONALLY ADJUSTED AVERAGE CURRENCY
(Millions of nuevos soles)

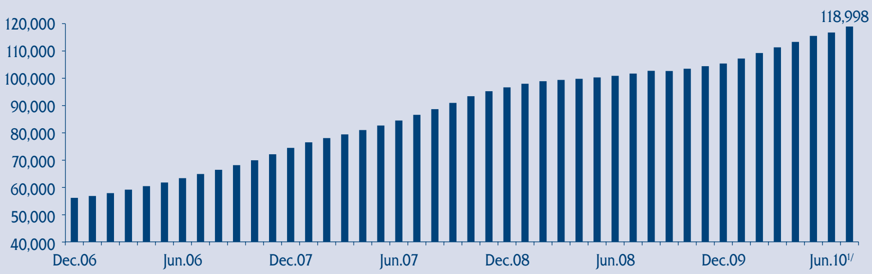


CURRENCY	Dec.07	Dec.08	Mar.09	Jun.09	Sep.09	Dec.09	Mar.10	Apr.10	May.10	Jun.10	Jul.10	Aug.10*
Original series (Millions of soles)	13,971	16,705	15,987	15,926	16,656	18,342	18,383	18,728	19,093	19,394	20,266	20,594
12-month % change	28.0	19.6	9.9	4.3	5.8	9.8	15.0	18.2	20.8	21.8	22.1	22.5
Seasonally adjusted (Millions of soles)	13,324	16,006	16,065	16,238	16,897	17,531	18,428	18,935	19,377	19,773	20,080	20,447
Seasonally adjusted monthly % change	2.0	-0.6	-0.1	1.4	1.2	0.7	1.0	2.8	2.3	2.0	1.6	1.8

* Preliminary.

79. Credit to the private sector showed a high dynamism, in line with increased economic activity. In July, credit to the private sector grew 1.9 percent, recording the second highest monthly growth rate observed so far this year (2.3 percent in May). In deseasonalized terms, credit to the private sector grew 1.9 percent in July, showing a higher rate than the average rate registered in the previous months (1.7 percent between January and June).

Graph 75
SEASONALLY ADJUSTED TOTAL CREDIT
(Millions of nuevos soles)



CREDIT	Dec.07	Dec.08	Sep.09	Dec.09	Jan.10	Feb.10	Mar.10	Apr.10	May.10	Jun.10	Jul.10
Original series (Millions of soles)	75,326	97,818	102,078	106,812	107,386	108,870	110,800	112,756	115,310	116,937	119,176
12-month % change	33.1	29.9	13.1	9.2	9.3	10.4	12.0	13.8	15.0	16.0	16.9
Seasonally adjusted	74,499	96,688	102,692	105,435	107,265	109,284	111,366	113,360	115,563	116,807	118,998
Seasonally adjusted monthly % change	3.2	1.5	-0.1	0.9	1.7	1.9	1.9	1.8	1.9	1.1	1.9

1/ Constant exchange rate.

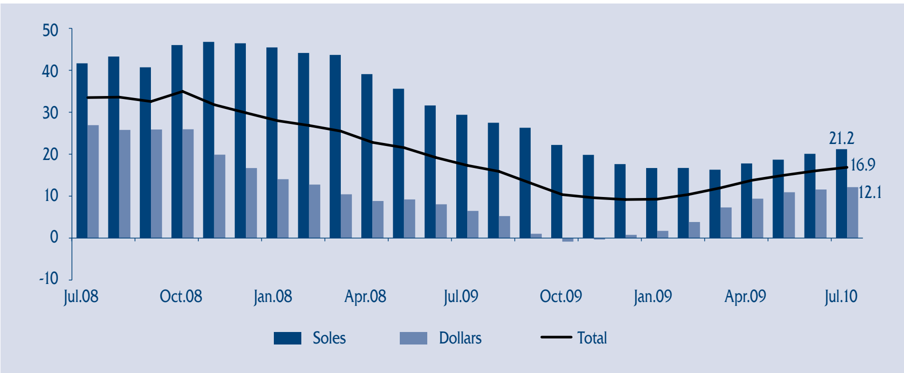
By type of financial entity, in July credit to the private sector increased 2.1 percent in commercial banks, 1.3 percent in micro finance institutions, and 0.8 percent in state banks.

Table 25
TOTAL CREDIT TO THE PRIVATE SECTOR BY FINANCIAL INSTITUTION

	Balance in millions of nuevos soles			Growth rates (%)			
	Jul.09	Jun.10	Jul.10	Jun.10/ Jun.09	Jul.10/ Jul.09	Jun.10/ May.10	Jul.10/ Jun.10
Banks	86,832	97,806	99,827	14.1	15.0	1.6	2.1
State Bank	1,919	2,596	2,618	31.0	36.4	1.7	0.8
Microfinance Institutions	12,560	15,798	16,005	27.0	27.4	0.4	1.3
of which:							
Municipal banks	6,398	7,506	7,607	19.2	18.9	1.6	1.3
TOTAL	**101,974**	**116,937**	**119,176**	**16.0**	**16.9**	**1.4**	**1.9**

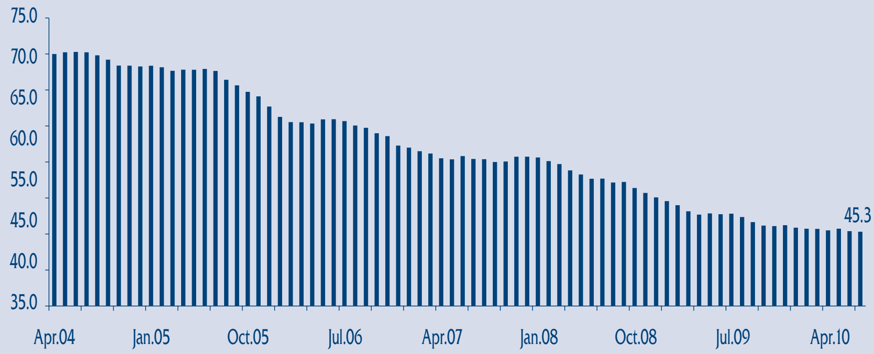
80. By type of currency, credit to the private sector in nuevos soles grew 2.0 percent in July, accumulating a growth of 21.2 percent in the last 12 months, while credit to the private sector in dollars grew 1.9 percent (12.1 percent in the last 12 months).

Graph 76
CREDIT TO THE PRIVATE SECTOR
(Annualized growth rate- %)



81. The evolution of aggregate credit in domestic and foreign currency has reflected in a reduction of the ratio of dollarization of credit to the private sector, which recorded a rate of 45.3 percent in July 2010.

Graph 77
DOLLARIZATION OF CREDIT TO THE PRIVATE SECTOR
(%)



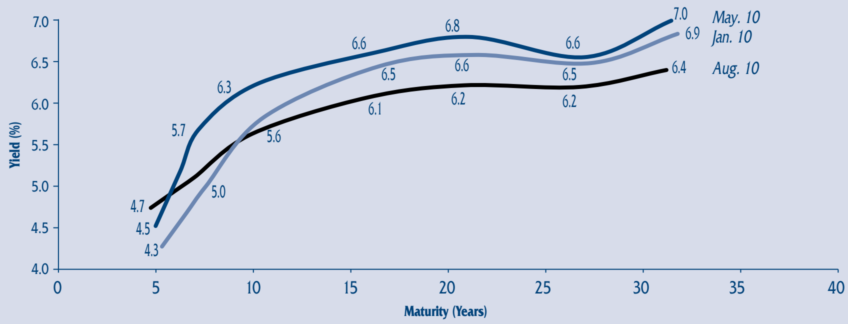
By type of financial entities, commercial banks showed a faster pace of dedollarization: this ratio declined from 51.7 to 51.3 percent between April and July 2010.

Table 26
DOLLARIZATION OF CREDIT TO THE PRIVATE SECTOR

	Dec.07	Dec.08	Jun.09	Sep.09	Dec.09	Mar.10	Apr.10	May.10	Jun.10	Jul.10
By type of institution										
Banks	61.9	56.7	54.4	52.3	52.4	51.9	51.7	51.9	51.4	51.3
State banks	1.5	1.8	1.7	1.6	1.5	1.3	1.3	1.3	1.2	1.2
Microfinance institutions	26.6	20.4	15.3	14.4	13.7	13.5	13.5	14.9	14.7	14.6
TOTAL	**56.6**	**52.2**	**48.8**	**46.6**	**46.2**	**45.7**	**45.5**	**45.7**	**45.4**	**45.3**

82. In the capital market, a significant decline of the interest rates on sovereign bonds was observed in the medium and long term tranches of the yield curve since June due to the drop of country risk as a result of the better outlook for the fundamentals of the Peruvian economy and the increased demand for these instruments, which also included a higher demand from non resident investors. On the other hand, the rates in the short tranche of the yield curve (less than 7 years) have continued showing the upward trend observed since May in connection with the BCRP withdrawal of monetary stimulus, which has resulted in a sovereign yield curve with a lower slope.

Graph 78
SECONDARY MARKET OF SOVEREIGN BONDS 1/



1/ Average yield at end-period.

The amounts of sovereign bonds negotiated in the secondary market increased significantly since July due to the higher holdings of these instruments by non resident investors. This conduct differs from the one recorded by BCRP short term instruments which, in contrast with what happened at end 2007 and early in 2008, registered a lower demand from non resident investors given that the commission for transfers of CDBCRP was raised to 4 percent.

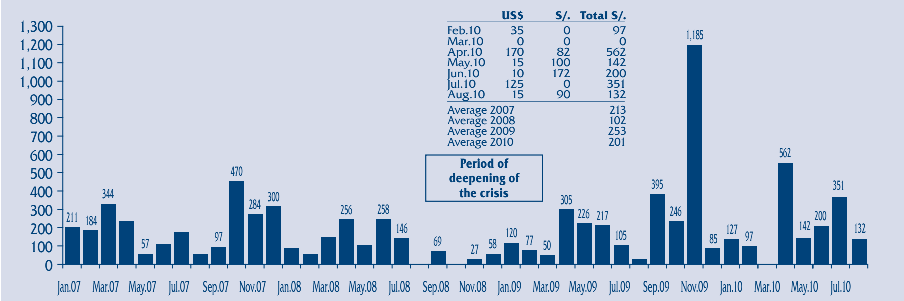
Table 27
HOLDINGS OF NON-RESIDENT INVESTORS
(Millions of nuevos soles)

	PTB	CD BCRP
Mar.07	3,440	0
Jun.07	4,008	1,094
Sep.07	4,611	839
Dec.07	5,041	2,668
Mar.08	6,937	7,542
Jun.08	7,483	5,903
Sep.08	6,323	4,770
Dec.08	5,189	2,198
Mar.09	4,586	525
Jun.09	4,184	206
Sep.09	4,222	217
Dec.09	4,053	245
Mar.10	3,594	225
Jun.10	4,643	178
Jul.10	5,653	254
Aug.10	6,650	139

83. Between January and August 2010, private issuances of non financial firms have remained on average at a higher level than the ones recorded in the same period in

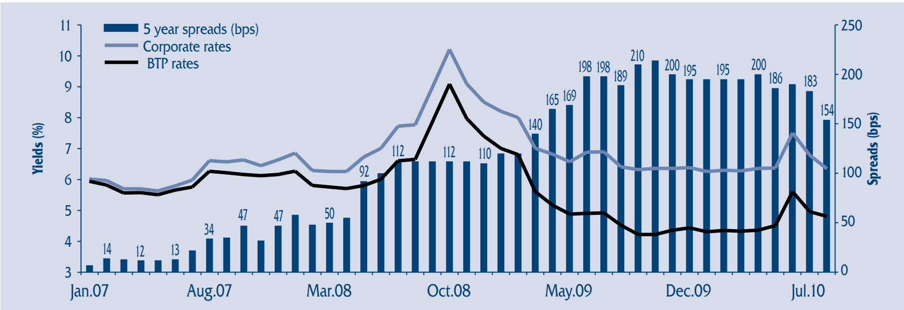
2009, complementing the financing offered by the bank system and oriented mainly to utility and energy projects. The interest rates paid by corporate issuances show an upward trend –following the evolution of the shorter tranche of the yield curve– considering that these issuances hardly exceed 10-year maturities. Moreover, the risk spread of corporate issuances has shown a downward trend during 2010.

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



* Bonds issued in FC are valued at the exchange rate value at the end of the month. Securitization bonds.

Graph 80
SOVEREIGN BONDS AND CORPORATE AAA BONDS YIELDS AND SPREADS: 5 Years



Exchange rate

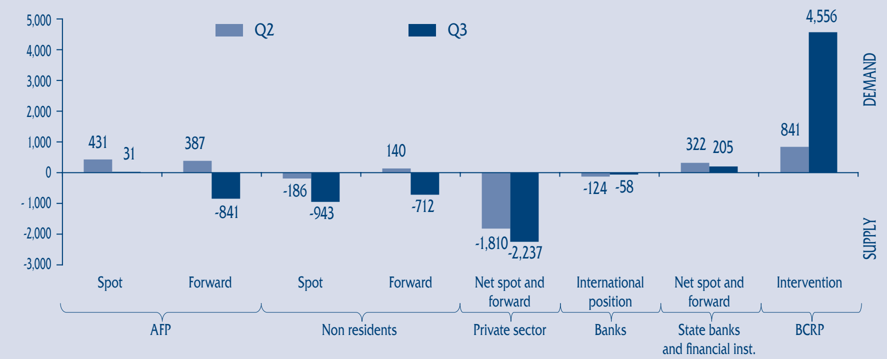
84. Between June and mid-September 2010, the average nominal exchange rate appreciated 1.6 percent reflecting the evolution of emerging markets (where the dollar remains weak), the strong inflow of capitals to the economy, and non resident and institutional investors' portfolio movements.

A downward pressure on the exchange rate was observed in Q3-2010[9] given that non resident investors generated a net supply in the foreign exchange market –

9 At September 15, 2010.

spot and forward– of US$ 1,655 million while banks reduced their foreign exchange position generating an additional supply of US$ 58 million. On the other hand, the private pension funds (AFPs) offered US$ 841 million in the forward market during the same period and the rest of private investors offered US$ 2,237 million in the spot and forward market. In this scenario, with the aim of reducing extreme volatilities in the exchange rate, the BCRP bought foreign currency for a total of US$ 4,556 million.

Graph 81
FLOWS IN THE FOREIGN EXCHANGE MARKET
(Millions of US$)



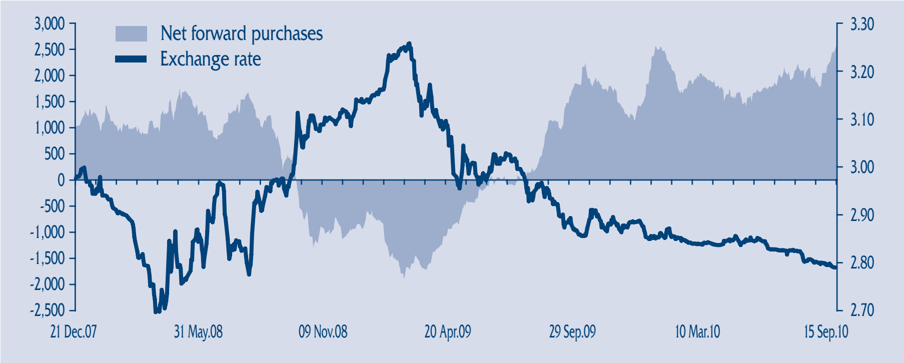
*At September 15, 2010.

It should be pointed out that the supply of dollars by non residents was associated with the capital inflow observed since June which was mainly oriented to the acquisition of sovereign bonds. The spread between domestic rates (associated with the adjustment of the policy stance) and international rates, on the one hand, and the sound fundamentals of the Peruvian economy, on the other hand, would have attracted non resident investors who increased their holdings of domestic securities (treasury bonds and BCRP certificates of deposit).

85. Between June and September 2010 the balance of net forward purchases increased strongly, from US$ 1,946 million to US$ 2,585 million. This increase, which was coupled by downward pressures on the exchange rate, was mainly due to non residents' increased purchases of repos (US$ 1,459 million) net of maturities (US$ 747 million).

The balance of net forward purchases considers forward purchase and sale agreements with delivery as well as non delivery transactions, the latter of which has the higher share in the overall balance of forward contracts. Between June and August of 2010, non delivery forward contracts, especially from AFPs and non resident investors, have shown a significant increase.

Graph 82
NET FORWARD PURCHASES AND EXCHANGE RATE
(In millions of US$ and US$ / S/. exchange rate)

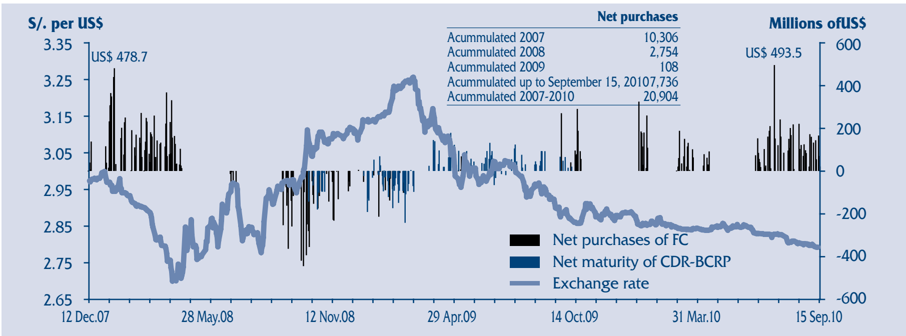


In August, the increase observed in banks' short term financing to cover their forward operations led to a substantial increase of short term liabilities abroad in that month (US$ 1,766 million relative to May) and reached a balance of US$ 4,548 million.

Graph 83
SHORT TERM FOREIGN LIABILITIES
(Millions of US$)

86. Since June 18, the BCRP resumed purchases of foreign currency in the foreign exchange market, having bought US$ 5,082 million as of September 15. It should be pointed out that the BCRP interventions in the foreign exchange market have been aimed at reducing excessive volatility in the exchange rate, in a context of a strong inflow of capitals and the depreciation of the dollar associated with an expected lower pace of recovery in the US economy. At August, the BCRP purchases of FC amount to a total of US$ 7,736 million.

Graph 84
EXCHANGE RATE, NET PURCHASES OF FC AND NET MATURITIES OF CDR-BCRP
(Exchange rate S/. per US$ and maturities in millions of US$)



To facilitate monetary management, the purchases of foreign currency have been complemented with rises in reserve requirements on short term liabilities abroad and deposit taskings from foreign banks.

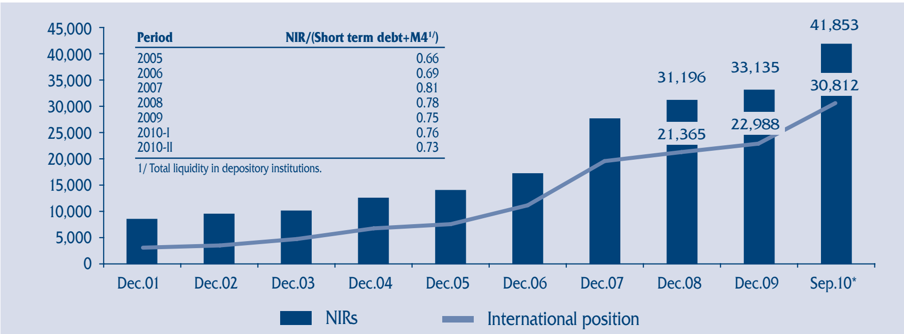
87. Expectations about the exchange rate in 2010-2012 declined between June and August, which reflected in the evolution of the dollar in foreign exchange markets. Economic analysts estimate that the dollar will close at levels below S/. 2.80 per dollar in 2010-2012, while financial entities project an exchange rate of 2.80 per dollar.

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

	May.10	Jun.10	Jul.10	Aug.10
FINANCIAL ENTITIES				
2010	2.80	2.80	2.80	2.78
2011	2.80	2.81	2.80	2.80
2012	2.80	2.83	2.80	2.80
ECONOMIC ANALYSTS				
2010	2.80	2.80	2.80	2.77
2011	2.80	2.82	2.80	2.75
2012	2.80	2.80	2.80	2.74
NON-FINANCIAL FIRMS				
2010	2.85	2.85	2.82	2.80
2011	2.90	2.90	2.90	2.88
2012	3.00	2.95	2.95	2.90
AVERAGE				
2010	2.82	2.82	2.81	2.78
2011	2.83	2.84	2.83	2.81
2012	2.87	2.86	2.85	2.81

88. Net international reserves (NIRs) have been preventively increased mainly as a result of higher purchases of FC (up by US$ 7,736 million at September 15). In this way, the balance of NIRs has increased from US$ 33,135 to US$ 41,853 million between end December 2009 and September 15, 2010.

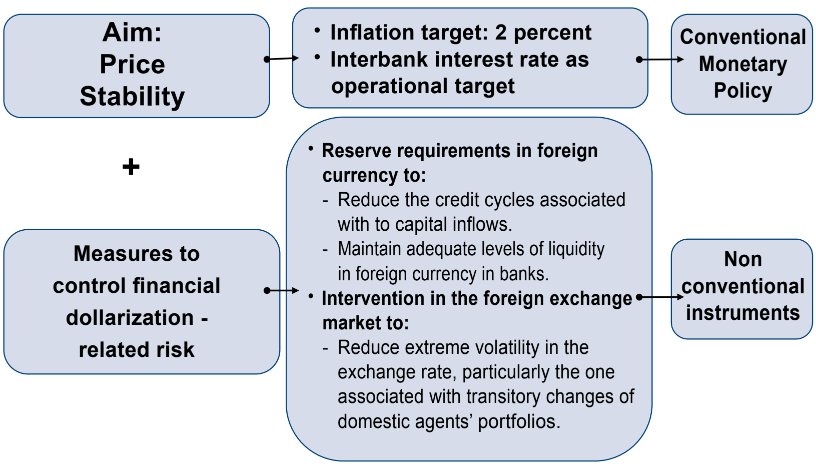
Graph 85
INTERNATIONAL RESERVES
(Millions of US$)



* At September 15, 2010.

BOX 5
MONETARY POLICY IN A DOLLARIZED ECONOMY

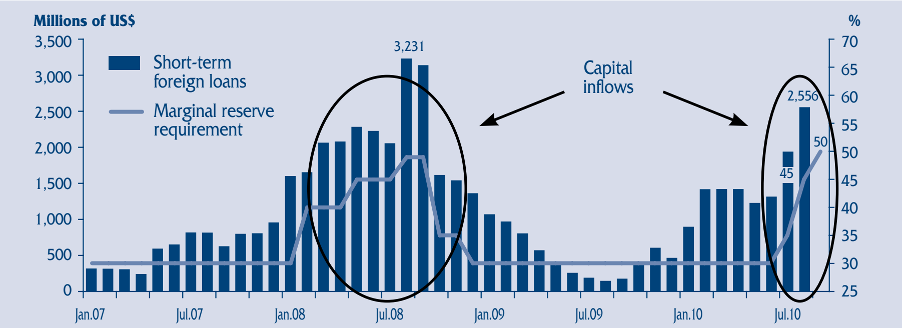
The mission of the Central Reserve Bank of Peru (BCRP) is to preserve monetary stability. A fundamental factor for this is the Central Bank's commitment to price stability, which is essential to stimulate saving, attract and promote productive investments, and promote, in this way, sustained economic growth.



The Peruvian economy is still characterized by a high degree of partial dollarization and by developing financial and capital markets. The main implication of financial dollarization on monetary policy is the currency mismatch of the assets and liabilities of firms and households that generate their revenue in local currency, but are leveraged in foreign currency. Because of this, the Central Bank's monetary policy takes into account the risks associated with financial dollarization.

Thus, to complement its operational monetary policy target –the reference interest rate–, the Central Bank can use non-conventional instruments like reserve requirements. The recent increases in reserve requirements have been adopted for two purposes: first, to affect monetary and credit conditions in foreign currency so that the withdrawal of monetary stimulus occurs in both currencies and, thus, make monetary policy more effective; and second, to maintain a smooth growth of credit and liquidity in a context of increased short-term capital inflows, which are attracted by better prospects of growth in the Peruvian economy and expectations of a significant appreciation of the nuevo sol.

SHORT TERM FOREIGN LOANS AFFECTED BY RESERVE REQUIREMENTS [1/] AND MARGINAL RESERVE REQUIREMENTS IN FOREIGN CURRENCY
(Millions of US$ and %)



1/ At August 2010.

Moreover, higher reserve requirements play a macro prudential role because banks are required to hold a higher proportion of their obligations at the Central Bank. They also increase the availability of liquid assets in foreign currency, which strengthens the capacity of banks to deal with scenarios of abrupt capital outflows, and reduce incentives for banks to increase credit rapidly.

Another fundamental aspect of monetary policy in a context of dollarization is to prevent the emergence of systemic risks associated with currency mismatches and a high volatility of the exchange rate. The Central Bank interventions in the foreign exchange market have been aimed at preventing volatility in the exchange rate, especially as a result of short-term capital inflows. High capital flows can generate a rapid and unsustainable appreciation of the domestic currency, which might induce agents to borrow in dollars with the expectation of making capital gains with this appreciation. This increased indebtedness in dollars exposes agents to heavy losses when the exchange rate trend reverts towards depreciation, which happens when capital inflows reverse.

In conclusion, changes in reserve requirements allow us to moderate the expansion of credit by increasing interest rates and by generating a lower availability of loanable funds in both currencies. Moreover, the rise in the lending rate in dollars induced by higher reserve requirements in this currency would also imply a higher cost for the forward operations that assume that there will be a significant appreciation of the nuevo sol, discouraging in this way capital inflows.

BOX 6
BCRP INTERVENTION IN THE FOREIGN EXCHANGE MARKET AND STERILIZATION MECHANISMS

The monetary policy of the Central Reserve Bank of Peru (BCRP) is implemented through an inflation targeting scheme, defined by an inflation target of 2.0 percent and a tolerance range of ±1 percent. The operational target of monetary policy is the reference interest rate for the interbank market. In this sense, the daily operations of the BCRP are aimed at maintaining the interbank interest rate around the reference interest rate, which is consistent with the inflation target.

The inflation targeting scheme of the BCRP differs from conventional inflation targeting in that it is complemented by non conventional monetary policy instruments aimed at adequately controlling the macroeconomic risks associated with financial dollarization. Thus, the BCRP establishes high rates of reserve requirements in foreign currency with the aim of maintaining liquidity in this currency in the financial system. It also intervenes in the foreign exchange market with the aim of reducing an excessive volatility of exchange to minimize the effects of abrupt movements of the exchange rate in the financial position of economic agents in a dollarized economy such as the Peruvian economy.

The BCRP intervention in the foreign exchange market does not compromise monetary management, since it sterilizes completely its interventions through several mechanisms. One of the mechanisms used is the placement of BCRP Certificates of Deposit. As the table below shows, in the years when the BCRP accumulated a greater amount of international reserves, as in 2007 and so far in 2010, the purchases of foreign currency were sterilized mainly through the placement of certificate of deposits. In 2007 the latter amounted to S/. 13,393 million, as a result of which the balance of certificates increased from S/. 8,065 million to S/. 21,458 million in that year. A similar evolution is observed in 2010 with placements of CDBCRP for a total of S/. 12,637 million.

The other monetary instrument used for sterilization is reserve requirements. In 2007 funds amounting to S/. 746 million were sterilized through this mechanisms, while a total of S/. 1,587 million have been sterilized so far in 2010. During this year the BCRP has raised reserve requirements in both domestic and foreign currency with the purpose of complementing consecutive rises in the reference rate. Marginal reserve requirements in domestic currency were raised from 6 percent at the beginning of the year to 15 percent in September.

MONETARY AND FISCAL STERILIZATION
(Millions of Nuevos Soles)

	2007	2008	2009	2010*
1. Net purchases of foreign currency [1/]	**32,057**	**6,811**	**-63**	**21,827**
(US$)	*10,306*	*2,754*	*108*	*7,736*
2. Fiscal sterilization	**-17,012**	**-13,288**	**1,760**	**-7,916**
Sales of foreign currency	-10,263	-6,641	-801	-141
(US$)	*-3,275*	*-2,316*	*-261*	*-50*
Deposits in domestic currency	-6,749	-6,647	2,561	-7,774
3. Monetary Sterilization	**-14,139**	**6,188**	**-236**	**-14,224**
CD BCRP	-13,393	8,241	-903	-12,637
Reserve requirements	-746	-2,053	668	-1,587
4. Currency	**3,170**	**2,478**	**1,905**	**1,172**
Balance				
CD BCRP	21,458	18,630	14,121	26,757
Deposits in domestic currency	16,924	23,568	21,006	28,781
Reserve requirements	2,922	4,975	4,307	5,894

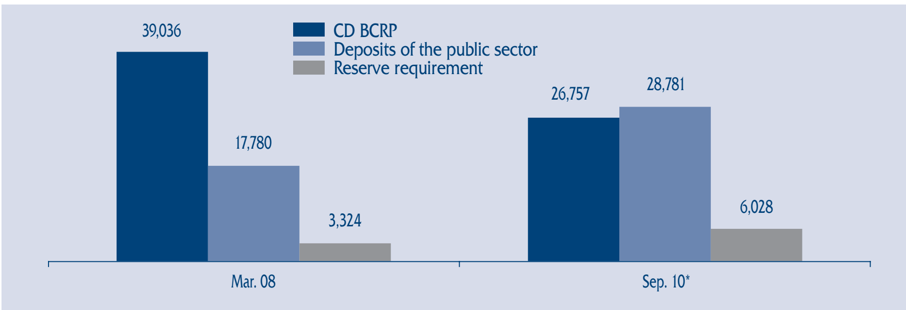
* At September 15, 2010.
1/ The amount in soles correspond to purchases and sales of foreign currency at a daily average rate on the date of the transaction.

Both the BCRP and the treasury participate in this sterilization process. Two are the main mechanisms used by the fiscal authority to do this: a) purchases of foreign currency at the BCRP, and b) accumulation of deposits in domestic currency at the Central Bank. In the first case, the treasury absorbs part of BCRP purchases of foreign currency to pay the external debt, which reduces the need for sterilization using monetary instruments. In the second case, the treasury's higher accumulation of deposits at the Central Bank directly sterilizes the nuevos soles that go into the financial system as a result of exchange interventions, reducing the need of placing CDBCRP.

In contrast with what happened in 2007, when the treasury contributed to sterilization actively using these two mechanisms, in 2010 it has not used the mechanism of purchasing foreign currency in a substantial manner. Treasury purchases of foreign currency in 2007, which amounted to US$ 3,275 million, allowed sterilizing 32 percent of net total purchases of foreign currency, while treasury deposits at the BCRP increased by S/. 6,749 million. Today, treasury purchases of foreign currency amount only to US$ 50 million and the accumulation of deposits has increased by S/. 7,774 million.

Even though the BCRP purchases of foreign currency during this year have been significant, the balances of sterilized funds are still below the historical maximum levels recorded in April of 2008. As we can see in the graph below, the balance of CDBCRP reached a maximum level of S/. 39,036 million (the balance today is S/. 26,757 million).

STERILIZATION BALANCE
(Millions of nuevos soles)



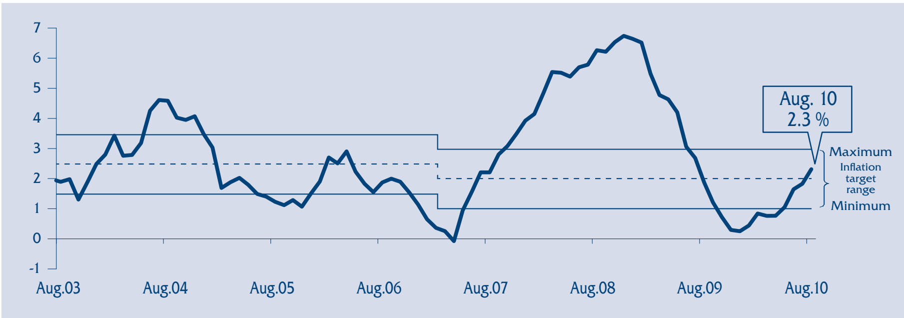
This is important because it implies that the BCRP has still a margin to continue sterilizing future purchases of foreign currency. This margin is even wider if we consider the potential purchases of foreign currency by the treasury in the next months, as well as treasury increased accumulation of deposits at the BCRP as a result of the expected more favorable evolution of fiscal revenues.

VI. Inflation

89. The evolution of inflation during the year is mainly explained by supply factors, such as the prices of some food products, coupled by some changes in the prices of fuels.

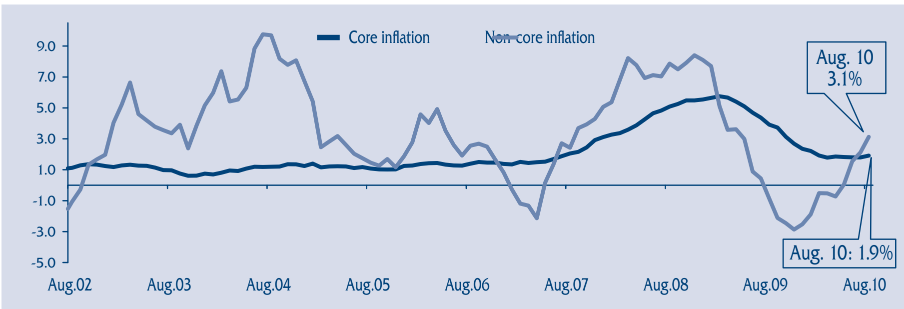
Given the increased dynamism of economic activity, which would lead the output gap to close by the next semester of the year, the BCRP began withdrawing monetary stimulus since the month of May with the purpose of raising the reference rate towards a neutral position. There are no indications of inflationary pressures on the side of demand and inflation is expected to fall within the upper band of the target towards the end of the year.

Graph 86
INFLATION AND INFLATION TARGET
(12-month % change)

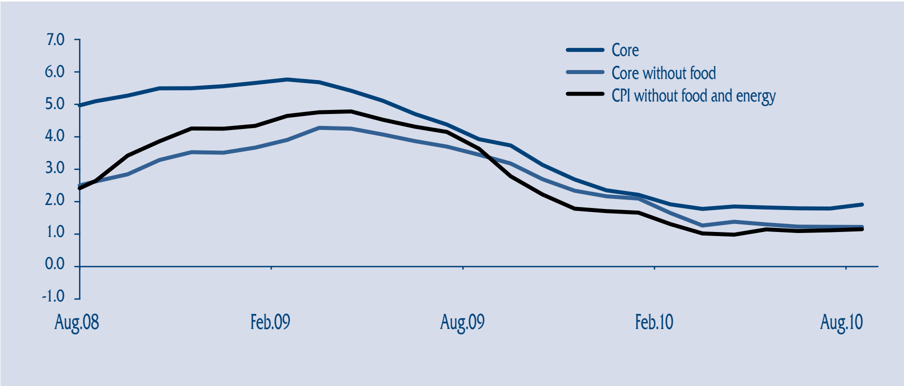


90. The rate of core inflation accumulated in the last twelve months increased from 1.8 percent in May to 1.9 percent in August of 2010. Non core inflation, which includes perishable food and fuels, increased from 0.0 percent in May to 3.1 percent in August.

Graph 87
CORE INFLATION AND NON-CORE INFLATION
(12-month % change)



Graph 88
MEASUREMENTS OF CORE INFLATION
(Last 12-month change)



91. Accumulated inflation between January and August showed a rate of 2.1 percent, mainly as a result of the rise observed in the prices of non core food (5.7 percent) and fuels (8.9 percent). Accumulated core inflation between January and August was 1.5 percent, particularly as a result of the rises observed in terms of education (3.0 percent) and meals outside the home (2.5 percent).

The rise in the prices of potato and onion is worth pointing out in terms of non core food products (27.4 and 50.5 percent, respectively). The rise in the case of the price of potato is observed mainly in the months of July and August due to the lower supply of this product from the Central Sierra and Lima.

The rise in the price of onion, on the other hand, was observed in the first semester of the year due to the decline of cultivated areas and due to lower yields resulting from alterations in climatic conditions in Arequipa. This situation has partially reversed in the months of July and August.

The rise in the prices of fuels reflects the evolution of the prices of WTI oil and the adjustments in the target price band of the Fuel Price Stabilization Fund. WTI oil registered an average price of US$ 77.6 per barrel in August, higher by 9.12 percent than the price observed in August 2009 (US$ 71.1 per barrel).

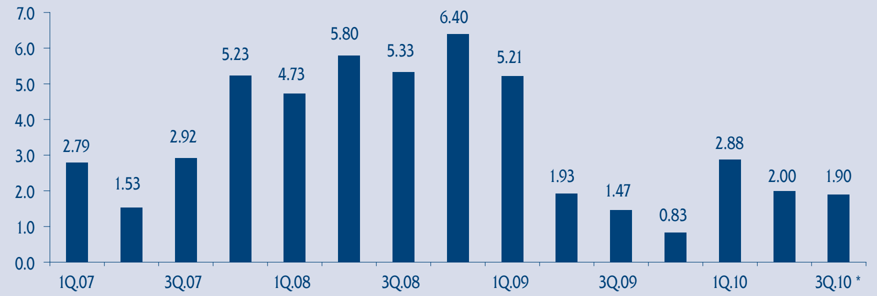
Table 29
INFLATION
(% change)

	Weight 2009=100	2006	2007	2008	2009	2010 Jan.-Aug.	2010 12 months
I. INFLATION	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.06**	**2.31**
II. CORE INFLATION	**65.2**	**1.37**	**3.11**	**5.56**	**2.35**	**1.53**	**1.91**
Goods	32.9	0.97	3.30	5.32	2.17	1.20	1.66
Services	32.2	1.85	2.88	5.86	2.56	1.87	2.14
III. NON-CORE INFLATION	**34.8**	**0.83**	**5.07**	**8.11**	**-2.54**	**3.07**	**3.13**
Food	14.8	2.06	7.25	10.97	-1.41	5.73	5.17
Fuel	2.8	-1.50	6.45	-0.04	-12.66	8.87	11.75
Transportation	8.9	1.12	0.82	5.86	0.19	-0.21	1.11
Public services	8.4	-3.22	0.24	7.48	-4.56	-0.13	-2.03
Note:							
CPI without food and beverages, and energy	56.4	1.28	1.49	4.25	1.71	0.75	1.15

Table 30
INFLATION
(% change and contributions)

	Peso		Jan.-Aug. 2009		Jan.-Aug. 2010	
	Dec. 01 = 100	2009=100	% Chg	Contribution	% Chg	Contribution
I. INFLATION	**100.0**	**100.0**	**0.01**	**0.01**	**2.06**	**2.06**
II. CORE INFLATION	**60.6**	**65.2**	**1.97**	**1.12**	**1.53**	**1.00**
Goods	34.0	32.9	1.71	0.53	1.20	0.39
Services	26.6	32.2	2.28	0.59	1.87	0.60
III. NON-CORE INFLATION	**39.4**	**34.8**	**-2.59**	**-1.12**	**3.07**	**1.06**
Food	22.5	14.8	-0.89	-0.22	5.73	0.84
Fuel	3.9	2.8	-14.91	-0.80	8.87	0.25
Transportation	8.4	8.9	-0.94	-0.08	-0.21	-0.02
Utilities	4.6	8.4	-0.43	-0.02	-0.13	-0.01

Graph 89
CORE INFLATION
(Annualized quarterly change)



* July - August.

92. The items that contributed most to the rise of inflation between January and August were meals outside the home, education (fees and tuition), potato, gasoline, and onion. On the other hand, the items that contributed most to reduce inflation were telephone rates, citrus fruits, domestic transport, cleaning items, and recreational and cultural devices.

Table 31
WEIGHTED CONTRIBUTION TO INFLATION: JANUARY - AUGUST 2010
(% points)

Positive	Weight	% Chg.	Contribution	Negative	Weight	% Chg.	Contribution
Meals outside the home	11.7	2.5	0.29	Telephone rates	2.9	-2.3	-0.07
Education (fees and tuition)	8.8	3.0	0.27	Citrus fruits	0.5	-10.3	-0.06
Potato	0.9	27.4	0.22	Domestic transportation	0.3	-11.7	-0.05
Gasoline and oil	1.3	12.8	0.17	Cleaning items	0.9	-2.9	-0.03
Onion	0.4	50.5	0.13	Recreation and cultural items	0.9	-2.1	-0.02
Eggs	0.6	24.3	0.12	Electricity rates	2.9	-0.7	-0.02
Spices and seasonings	0.5	18.9	0.11	Edible oils	0.5	-3.6	-0.02
Gas	1.4	5.7	0.08	Canned milk	1.6	-1.0	-0.02
Water supply	1.6	4.5	0.07	Rent	2.4	-0.6	-0.01
Sodas	1.3	5.6	0.07	Avocado	0.1	-9.4	-0.01
Total			**1.53**	**Total**			**-0.31**

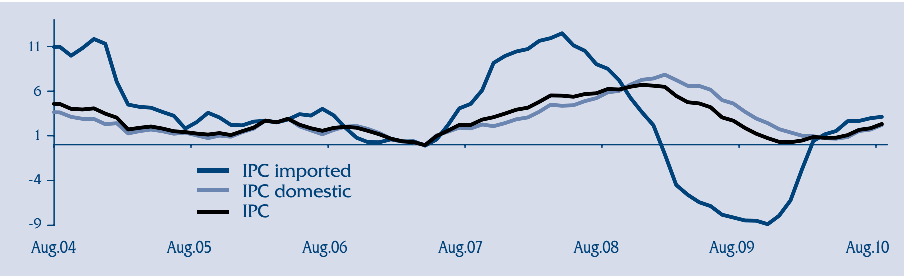
Imported inflation

93. Imported inflation recorded an accumulated growth rate of 2.5 percent between January and August, reflecting the evolution of fuel components (8.9 percent).

Table 32
DOMESTIC AND IMPORTED INFLATION
(Accumulated % change)

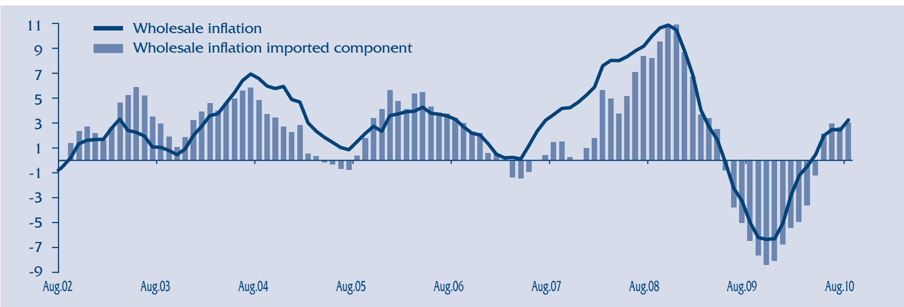
	Weight 2009=100	2006	2007	2008	2009	2010 Jan.-Aug.	2010 12 months
I. IMPORTED CPI	**10.8**	**0.27**	**10.46**	**2.20**	**-6.25**	**2.45**	**3.13**
Food	3.0	2.08	18.83	4.75	-3.07	-0.30	-0.67
Fuels	2.8	-1.50	6.45	-0.04	-12.66	8.87	11.75
Electric appliances	1.3	-1.29	-1.50	-0.06	-2.39	0.06	-0.34
Others	3.7	0.64	0.47	0.46	-0.34	0.53	-0.29
II. DOMESTIC CPI	**89.2**	**1.28**	**2.84**	**7.44**	**1.35**	**2.02**	**2.19**
III. CPI	**100.0**	**1.14**	**3.93**	**6.65**	**0.25**	**2.06**	**2.31**
Exchange rate		**-6.40**	**-7.00**	**4.47**	**-7.59**	**-2.63**	**-5.04**

Graph 90
DOMESTIC AND IMPORTED INFLATION
(12-month % change)



The wholesale price index increased 2.7 percent between January and August, reflecting the evolution of its domestic and imported components (up 2.7 percent and 2.5 percent, respectively). In the last 12 months, wholesale prices increased 3.2 percent, with the domestic component recording an increase of 3.3 percent and the imported component an increase of 3.0 percent

Graph 91
WHOLESALE PRICE INDEX
(12-month % change)



Expectations about inflation

94. Economic agents expect higher rates of inflation in 2010 than the ones discussed in our June Report. On the other hand, in general, inflation in 2011 and 2012 is expected to fall within the target range (between 2.0 and 3.0 percent).

Table 33
SURVEY ON MACROECONOMIC EXPECTATIONS: INFLATION (%)

	May 2010	August 2010
FINANCIAL ENTITIES		
2010	2.5	2.7
2011	2.5	2.5
2012	2.5	2.5
ECONOMIC ANALYSTS		
2010	2.5	2.9
2011	2.5	2.4
2012	2.5	2.0
NON-FINANCIAL FIRMS		
2010	2.2	2.5
2011	2.5	2.5
2012	2.5	2.5

As regards the average prices of inputs and sale prices in the next 3-4 months, the index of expected average prices of inputs has declined from 66 in our June Report to 60 in this Report because the percentage of firms expecting a reduction in the prices of inputs has declined. The index of expected average sale prices has also declined from 66 to 61 since our previous Report.

Graph 92
INDEX OF EXPECTED AVERAGE PRICES OF INPUTS IN THE NEXT 3-4 MONTHS
Manufacturing sector

Source: BCRP Survey on Macroeconomic Expectations, August 2010.

Graph 93
EXPECTED AVERAGE SALE PRICES IN THE NEXT 3-4 MONTHS
Manufacturing sector

Source: BCRP Survey on Macroeconomic Expectations, August 2010.

Inflation forecasts

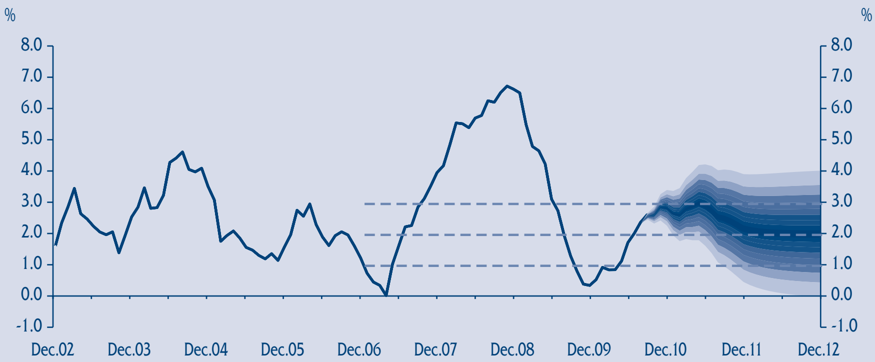
95. The data on inflation observed since our June Report have been in line with the forecasts contained in that report. Inflation imitated a stage of convergence towards the target range, recording a rate of 2.31 percent in August. The revision and update of data about the main factors that would affect the rate of inflation during the next years have generated some minor changes in the central forecast scenario compared with the one considered in our last Report.

    Inflation would remain within the target range in the next two years, but would fall closer to the upper band of the target range due to the transitory effect of rises in the prices of some food products resulting from some supply shocks. This forecast considers that the output gap will close in 2010, that inflation expectations remain within the target range, and that part of the transitory shocks that affected inflation during the first semester of 2010 will reverse.

    The baseline forecast scenario also considers a gradual withdrawal of the monetary stimulus adopted in response to the recent financial crisis, which is consistent with the evolution of the output gap which indicates a lower need of a significant monetary stimulus. In this scenario, the forecast on GDP growth is raised from 0.9 in 2009 to an annual growth rate of around 8.0 percent in 2010.

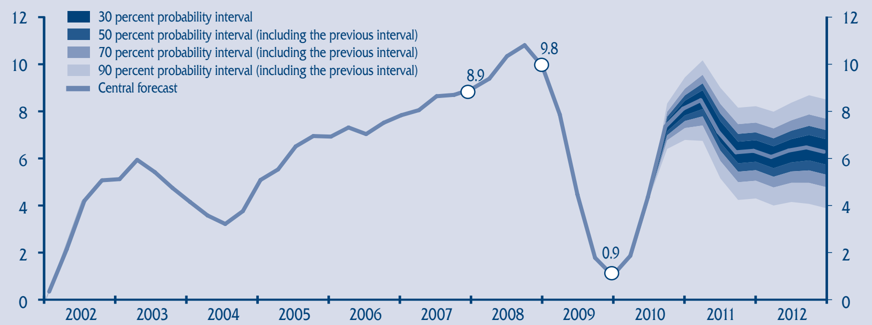
96. In 2011 and 2012 GDP would grow around 6.0 percent, showing a rate close to that of potential growth, which would contribute to allow inflation to fall within the target range during these years.

Graph 94
INFLATION FORECAST
(12-month % change)



Note: The graph shows the inflation forecast bands over the forecast horizon. The darkest band around the central forecast has a 10 percent probability of occurrence, while all the bands together have a 90 percent probability of occurrence.

Graph 95
FORECAST GDP GROWTH: 2010 - 2012
(Annual % change of GDP in each quarter)



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

Table 34
APPENDIX

	2008	2009	2010 1/ IR Jun.10	2010 1/ IR Sep.10	2011 1/ IR Jun.10	2011 1/ IR Sep.10	2012 1/ IR Jun.10	2012 1/ IR Sep.10
Real % change								
1. GDP	9.8	0.9	6.6	8.0	6.0	6.0	6.0	6.0
2. Domestic demand	12.1	-2.9	8.8	11.4	6.8	6.9	6.0	6.0
a. Private consumption	8.7	2.4	3.9	5.2	4.5	4.5	4.6	4.6
b. Public consumption	2.1	16.5	7.8	9.9	3.7	4.4	3.2	3.6
c. Private fixed investment	25.8	-15.1	12.5	16.7	9.0	11.1	11.0	11.8
d. Public investment	42.8	25.5	23.9	31.6	7.3	6.3	6.5	3.4
3. Exports (goods and services)	8.8	-2.5	3.0	1.4	5.7	5.2	7.9	8.4
4. Imports (goods and services)	19.8	-18.4	14.5	19.4	10.1	10.1	8.0	8.0
5. Main trade partners' economic growth	2.6	-1.1	3.6	3.7	3.5	3.3	3.5	3.2
Memo:								
Output gap 2/ (%)	4.3	-1.6	-1.0 ; 0.0	-0.5 ; +0.5	-0.5 ; +0.5	-0.0 ; +1.0	-0.5 ; +0.5	-0.5 ; +0.5
% change								
6. Forecast inflation	6.7	0.2	2.0-2.5	2.5-3.0	1.5-2.5	1.5-2.5	1.5-2.5	1.5-2.5
7. Average price of crude oil	37.8	-38.1	22.2	23.6	1.4	-1.6	1.3	0.0
8. Nominal exchange rate 3/	4.5	-7.6	-2.1	-3.3	0.6	1.0	1.2	0.1
9. Real multilateral exchange rate 3/	-4.8	0.9	-2.2	-3.0	0.2	1.6	1.1	0.9
10. Terms of trade	-13.8	-5.5	12.6	13.8	-3.3	-3.6	-1.3	-1.6
a. Export price index	4.9	-12.5	20.7	24.4	-1.5	-0.4	0.6	0.6
b. Import price index	21.7	-7.4	7.2	9.4	1.9	3.3	2.0	2.2
Var.% nominal								
11. Currency in circulation	16.7	11.0	22.0	25.0	19.0	19.0	18.5	18.5
12. Credit to the private sector 4/	29.9	9.2	17.0	19.0	16.0	14.0	16.5	14.0
% of GDP								
13. Domestic investment rate	26.7	20.6	23.6	24.9	25.6	26.8	26.8	27.8
14. Current account of the balance of payments	-3.7	0.2	-1.0	-1.7	-2.1	-3.0	-2.3	-3.0
15. Trade balance	2.4	4.6	4.5	3.3	3.2	1.7	2.8	1.2
16. Gross external financing to the private sector 5/	7.5	4.8	5.1	6.0	4.6	5.4	5.3	5.7
17. Current revenue of the general government	20.9	18.6	19.5	19.7	19.7	20.0	19.9	20.1
18. Non-financial expenditure of the general government	17.3	19.6	19.8	19.9	19.4	19.8	19.0	19.3
19. Overall balance of the non-financial public sector	2.1	-1.9	-1.6	-1.5	-1.0	-1.0	-0.4	-0.4
20. Total public debt	24.0	26.6	23.4	22.7	22.9	21.5	21.2	20.0

RI: Inflation Report.
1/ Forecast.
2/ Differential between GDP and potential GDP (percentage).
3/ Expeded nominal exchange rate.
4/ Credit from depository' institutions measured at a constant rate.
5/ Includes foreign direct investment or and private sector's long term disbursements.

VII. Balance of Risks

97. The inflation forecast considers a neutral balance of risks, that is, that there is the same probability that the rate of inflation will be above or below the baseline forecast.

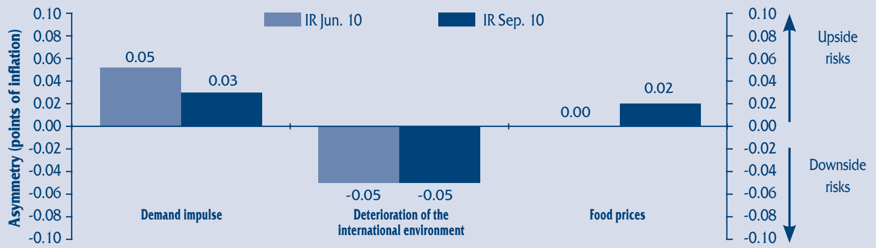
98. The main risks that could deviate the rate of inflation from the baseline scenario in the forecast horizon are:

- **Deterioration of the international environment.** The baseline scenario considers that global economic activity would recover and that terms of trade would remain at high although declining levels during the forecast horizon (2010 - 2012). In this scenario, there would be a lower global demand for commodities, lower prices for a great deal of our primary exports, unfavorable credit conditions, and a subsequent slowdown in the domestic economy. If this risk materialized, monetary policy would maintain the monetary stimulus for a longer period of time. The Central Bank maintains a high availability of international reserves and has different liquidity injection mechanisms to face this contingency.

- **Increased dynamism in the domestic economy**. The baseline forecast scenario considers a sustained growth trend in terms of domestic demand, without inflationary pressures. However, if private and public spending increased significantly above the levels considered in the baseline scenario, monetary stimulus would be reduced more rapidly.

- **Increase in food prices.** The recent evolution in the price of food commodities such as wheat, maize, soy bean, and sugar shows that the probability of higher prices in the future has increased. In addition, there is uncertainty about climatic factors that could affect the domestic supply of food. These shocks would have a transitory effect on inflation. In this scenario, the Central Bank would withdraw monetary stimulus more rapidly only if the potential increase of inflation due to supply factors affects inflation expectations.

Graph 96
INFLATION FORECAST: BALANCE OF RISKS
(2 year-ahead inflation deviations in % points)



Memo: This graph shows changes in risk perception compared with the prior Inflation Report (June 2010). The size and sign of bars show the asymmetry of each risk factor in the distribution of the inflation forecast. Adding all the effects results in a neutral balance of risks.

CONCLUSION

99. Inflation is expected to remain within the target range in the forecast horizon. This forecast is based on evidence showing that the output gap would close this year due to the higher growth of economic activity and that inflation would remain close to zero in the forecast horizon. The forecast also considers inflation expectations that remain anchored to the target range, a gradual reversal of monetary stimulus and a moderation of fiscal stimulus, and the reversal of the supply shocks that affected the prices of imported products in the first half of 2010.