Monetary Program for 2001

January 2001

Summary

- In compliance with the constitutional mandate to preserve monetary stability, the Board of Directors of the Central Reserve Bank of Peru, as in previous years, has approved the Monetary Program for 2001.

- The objective of monetary policy this year is to attain an inflation rate within a 2.5-3.5 percent target range. In 2000, inflation was successfully brought to a rate within the announced 3.5-4.0 percent target range (3.7 percent).

- The average annual monetary base growth rate consistent with the inflation objective is 3.0-5.0 percent. This target is based on the forecasted demand for money, which is consistent with a moderate GDP growth (2.5 percent) and decreasing inflation expectations.

- The management of monetary policy instruments will continue stressing control of banks' liquidity in a floating exchange rate regime with market-determined interest rates. Central Bank interventions in the foreign exchange market will be exceptional.

- Macroeconomic conditions forecasted in the Monetary Program for 2001 reflect a moderate economic recovery after the null growth registered in the last quarter of 2000. Economic growth in 2001 would rely on export growth, while domestic demand would increase only 1.9 percent due to lower investment growth. Lower domestic demand growth would contribute to reducing the current account deficit from 3.0 percent of GDP in 2000 to 2.4 percent in 2001. Additionally, limited financing has led to a prudent fiscal stance, which would result in a lower public sector deficit, from 3.0 percent of GDP in 2000 to 1.5 percent of GDP in 2001.

- The pace of economic activity in 2001 will be associated with a moderate 5 percent increase in credit to the private sector, after a 1 percent decrease in 2000. A stronger recovery would depend on the definition of re-financing schemes promoted by the government and on structural reforms geared to stimulate private investment.

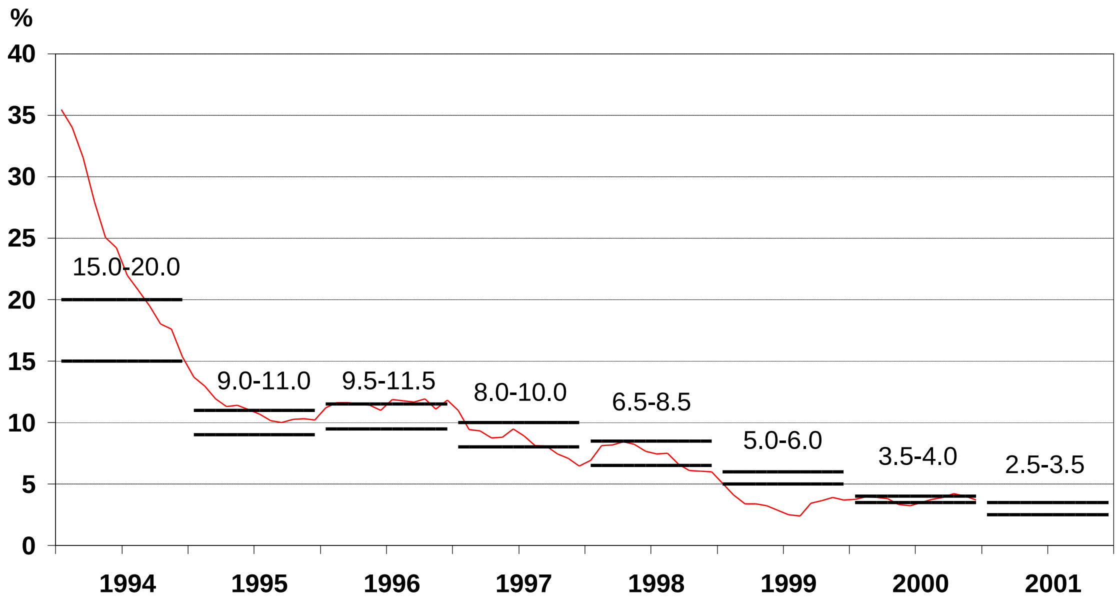
MONETARY PROGRAM FOR 2001

The mission of the Central Reserve Bank of Peru is to defend the purchasing power of the currency by consistently reducing inflation. To attain this goal, the Bank controls strictly the issuance of coins and notes according to an Annual Monetary Program. This document provides information on the Monetary Program for 2001, approved by the Central Bank Board of Directors.

Objective of Monetary Policy

In compliance with the constitutional mandate to preserve monetary stability, the Monetary Program for 2001 sets the objective of attaining an end-of-year inflation rate —measured by the percent variation of the Consumer Price Index— between 2.5 and 3.5 percent. The Central Bank will thus continue its strategy of gradually reducing the inflation rate to international levels in order to favor sustained growth.

Annual Inflation Target Ranges and 12-Month Inflation (1994-2001)



The accumulated inflation rate of 3.7 percent attained in 2000 —the same as in 1999— fell within the announced 3.5-4.0 percent target range, despite a 30 percent increase in fuel prices.

The inflation trend, measured by core inflation, decreased from 4.6 percent in 1999 to 3.2 percent in 2000. Additionally, the expected inflation rate —measured by the Central Bank through a survey of financial companies— diminished from 4.5 percent in January 2000 to 3.7 percent in January 2001.

The evolution of inflation was consistent with a weakening of domestic demand, associated with the effect of uncertainty on private spending perspectives. Domestic demand growth in 2000 was 2.9, compared with the forecasted 5.8 percent. GDP growth was also lower than expected (3.6 percent vs. 5.0 percent).

Target Ranges and Inflation
(Percent changes)

	Announced Target Range	Inflation	
		CPI	Core Inflation [1/]
1994	15.0 - 20.0	15.4	18.8
1995	9.0 - 11.0	10.2	11.1
1996	9.5 - 11.5	11.8	10.6
1997	8.0 - 10.0	6.5	7.4
1998	7.5 - 9.0	6.0	7.8
1999	5.0 - 6.0	3.7	4.6
2000	3.5 - 4.0	3.7	3.2
2001	2.5 - 3.5	-.-	-.-

1/ Measure of the inflation trend calculated using the less-variable components of the Consumer Price Index.

Intermediate Target

In order to attain its objective, the Central Bank's monetary policy sets a limit on monetary base growth. The Monetary Program for 2000 foresaw an average annual monetary base growth between 8.0 and 10.0 percent, which was consistent with the forecasted 5.0 percent GDP growth. Until September, the rate of growth of the intermediate target remained within the expected range. However, the economic deceleration that took place in the last quarter, as well as a higher velocity of circulation of money originated by the increase in uncertainty, resulted in a downward revision of the forecasted demand for base money, to an annual 6.0 percent.

Determinants of monetary base growth in 2000 [1/]

	Factors	Variation		Comments
		Program	Actuals	
A	Nominal GDP	9.0	7.3	Lower level of economic activity.
B	Velocity of circulation of money	-1.5	1.3	Lower demand for domestic currency due to increased uncertainty.
C	Bank multiplier	1.5	-0.1	The lower growth of the money multiplier is due to the greater preference for money in circulation, which was partially offset by a reduction in reserve requirements since September (reduction of the legal rate from 7 to 6 percent).
D	Monetary base	9.0	6.0	Actual growth was lower than the forecasted level, due to changes in the determinants of the demand for base money.

1/ $$D = \frac{\left(1+\frac{A}{100}\right)}{\left(1+\frac{B}{100}\right)\cdot\left(1+\frac{C}{100}\right)} - 1$$

As of end-2000, the monetary base was 4.0 percent lower than a year before. This was associated with a greater precautionary demand for means of payment in December 1999 due to the year 2000 problem.

The annual monetary base flow in 2000 was a negative S/. 233 million, originated mainly by the S/. 961 increase in the stock of Central Bank Certificates of Deposit, partially compensated by purchases of foreign exchange equivalent to US$ 63 million (S/. 215 million), financial and non-financial Central Bank expenditures (S/. 447 million), and withdrawals of deposits held by the public sector at the Central Bank (S/. 59 million).

The stock of Central Bank Certificates of Deposit increased from S/. 399 at end-1999 to S/. 1 360 million at end-2000. The S/. 961-million growth reflects the 1999 sterilization operations associated with the increase in the monetary base.

The 3.0-5.0 percent monetary base growth target for 2001 is based on a 2.5 percent GDP growth (a nominal variation of 6.1 percent), a 0.5 percent decrease in the velocity of circulation —associated with lower inflation expectations— and greater bank intermediation.

Determinants of monetary base growth in 2001 [1/]

	Factors	Variation	Comments
A	Nominal GDP	6.1	Moderate economic growth.
B	Velocity of circulation of money	-0.5	Deceleration associated with lower inflation expectations.
C	Bank, multiplier	2.5	The increase in the multiplier is explained by greater bank intermediation.
D	Monetary base	4.0	Considering the determinants of the demand for base money, the forecasted average growth rate for the monetary base is 4.0 percent.

1/ $$D = \frac{\left(1 + \frac{A}{100}\right)}{\left(1 + \frac{B}{100}\right) \cdot \left(1 + \frac{C}{100}\right)} - 1$$

Operating Target

Daily monetary management involves setting a limit on the average balance of banks' deposits held at the Central Bank, which is measured by the level of their current accounts (a daily S/. 120 million in 2000).

Based on the estimation of banks' deposits in domestic currency, the average balance of the banks' current account held at the Central Bank in 2001 is forecasted at a range between S/. 130 million and S/. 145 million. The average balance of the banks' current account held at the Central Bank guides the daily monetary policy actions in a way consistent with the intermediate target (the increase in the monetary base). However, this target can be revised due to variations in the determinants of the demand for liquidity or an adjustment in the monetary policy stance. In the latter case, the decision is aimed at attaining the inflation target set for the year.

Monetary Policy Transmission Mechanisms

The decision to adopt the inflation-reduction strategy of controlling the monetary base has proved successful in bringing inflation close to industrial-country levels. Low inflation provides the stability required by investment and the welfare of the population. However, it should be stressed that economic growth is also the result of factors such as productivity growth and general macroeconomic stability.

Monetary policy actions affect inflation mainly through economic agents' expectations and aggregate demand, even though the latter can also be influenced by factors such as fiscal policy and future-income expectations.

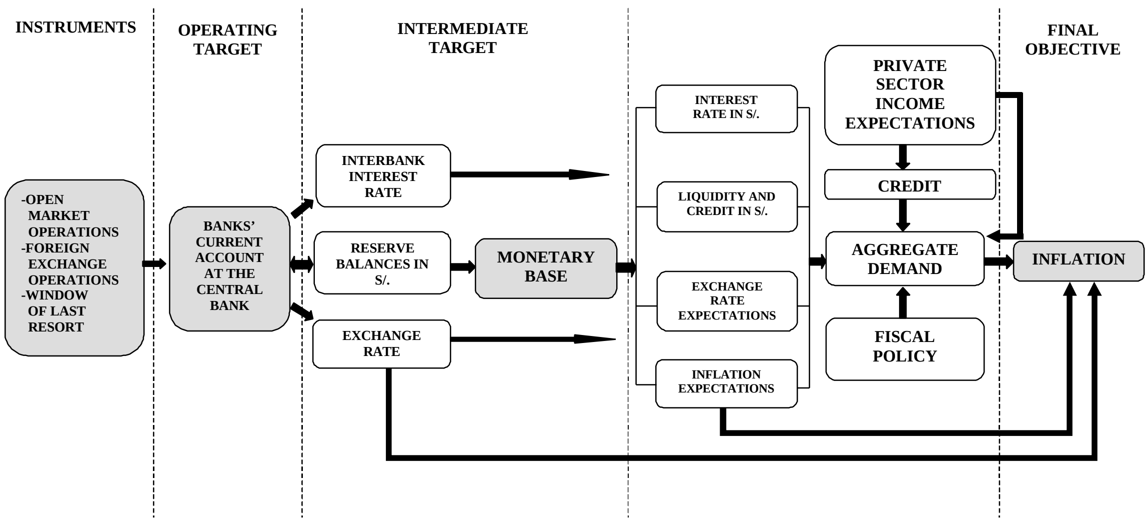
The effect of monetary control is not immediate, taking between 9 and 12 months to be transmitted completely. Thus, the evaluation of monetary policy decisions must take this lag into consideration.

TRANSMISSION MECHANISMS OF MONETARY POLICY

Monetary instruments are used to affect the banking system's disposable liquidity by controlling the current account held by banks at the Central Bank (operating target). The availability of these funds has an influence on the interbank interest rate and the exchange rate.

Control of the banks' current account (operating target) allows the Central Bank to attain the desired monetary base level (intermediate target). In turn, the monetary base, the interbank interest rate and the exchange rate affect inflation expectations and interest rates in domestic currency, especially prime interest rates. Concerning monetary aggregates, control of the monetary base affects the money supply and credit in domestic currency. These variables have an influence on economic agents' spending decisions, thus affecting aggregate demand. In particular, spending on goods included in the public's consumption basket has an effect on inflation.

Other factors that affect inflation through aggregate demand are public sector spending and private sector income expectations. The latter influences aggregate demand directly, as well as indirectly through credit supplied by banks.



Credit to the Private Sector

Banking system credit to the private sector decreased 1 percent in 2000. The fall is mainly associated with the banking system's cautious credit policy. In 2001, banking system credit to the private sector is expected to show a 5 percent increase.

Macroeconomic Environment

The macroeconomic scenario for 2001 foresees rates of growth of 2.5 percent and 1.9 percent for GDP and domestic demand, respectively; a current account deficit equivalent to 2.4 percent of GDP; and a fiscal policy that ensures a 1.5 percent public sector deficit consistent with the Fiscal Responsibility and Transparency Law.

Global Supply and Demand

GDP growth in 2001 is estimated at 2.5 percent, lower than in 2000.

GROSS DOMESTIC PRODUCT
(Percent variations)

		1999	2000 1/	2001 2/
I.	**AGRICULTURE**	**12.0**	**6.0**	**4.5**
II.	**FISHING**	**28.9**	**8.6**	**4.4**
III.	**MINING AND FUELS**	**11.8**	**3.4**	**8.1**
IV.	**MANUFACTURING**	**0.3**	**6.9**	**0.9**
	1. Processsing of primary goods	15.6	9.3	3.7
	2. Non-primary industries	-3.4	6.2	0.0
V.	**CONSTRUCTION**	**-10.8**	**-3.8**	**0.8**
VI.	**COMMERCE**	**-1.6**	**5.0**	**2.5**
VII.	**OTHER SERVICES**	**1.2**	**2.7**	**2.1**
VIII.	**GDP**	**1.4**	**3.6**	**2.5**
	GDP primary sectors	***13.0***	***5.9***	***5.4***
	GDP non-primary sectors	***-0.9***	***3.1***	***1.8***

1/ Estimated
2/ Projected

Lower growth is explained by the deceleration of domestic demand from 2.9 percent in 2000 to 1.9 percent in 2001. It should be noted that the primary and non-primary sectors would grow 5.4 and 1.8 percent, respectively.

GLOBAL SUPPLY AND DEMAND
(Real percent variations)

	1999	2000 [1/]	2001 [2/]
I. GLOBAL DEMAND (1 + 2)	**-1.6**	**3.8**	**2.7**
1. Domestic demand	-2.6	2.9	1.9
a. Private consumption	-0.2	4.3	3.4
b. Public consumption	3.6	4.7	-4.9
c. Gross domestic investment	-11.8	-2.4	-0.4
- Private	-16.3	-1.1	2.7
- Public	7.2	-17.2	-8.6
2. Exports of goods and services	5.4	9.5	7.8
II. GLOBAL SUPPLY (3 + 4)	**-1.6**	**3.8**	**2.7**
3. Gross Domestic Product	1.4	3.6	2.5
4. Imports of goods and services	-17.1	4.9	4.0

[1/] Estimated
[2/] Projected

On the demand side, GDP growth would rely on export dynamism (7.8 percent growth). Domestic demand would grow 1.9 percent as a result of the 3.4 percent and 2.7 percent increases in private consumption and investment, respectively, partially offset by a fall in public consumption and investment (4.9 percent and 8.6 percent, respectively). Projections foresee that, in the first months of 2001, private investment would remain at the level registered in the second half of 2000, due to the uncertainty-driven postponement of investment projects.

Balance of Payments

The current account deficit forecasted for 2001 is 2.4 percent of GDP, lower than the 3.0 percent deficit estimated for 2000. The flow of Net International Reserves (NIR) projected for 2001 is equivalent to US$ 215 million.

At end-2001, NIR would amount to US$ 8 395 million, which would ensure an adequate level of international liquidity. NIR would be equivalent to 1.5 times the short-term external debt plus medium- and long-term amortizations falling due within a year.

The reduction in the current account deficit is mainly related with the trade balance, which is expected to register a US$ 21 million surplus in 2001, US$ 377 million higher than in 2000. This result would be associated with export growth, which is estimated at 8.9 percent, compared with the 3.4 percent increase in imports, and with the US$ 70 million increase in the service balance. Additionally, the income deficit would register a US$ 179 million increase, mainly due to public sector interest payments and profits and dividends remitted abroad.

TRADE BALANCE
(Millions of U.S. dollars)

	1999	2000 1/	2001 2/	Percent variation 2000 1/	Percent variation 2001 2/
1. EXPORTS	**6 112,7**	**7 016,2**	**7 642,8**	**14,8**	**8,9**
Traditional goods	4 141,8	4 815,3	5 162,1	16,3	7,2
Mining	3 008,0	3 192,8	3 419,9	6,1	7,1
Oil and derivatives	251,3	405,8	305,3	61,5	- 24,8
Agrícultural	281,9	240,3	302,7	- 14,8	25,9
Fishing	600,5	976,4	1 134,2	62,6	16,2
Non-traditional goods	1 874,2	2 042,1	2 299,4	9,0	12,6
Other	96,7	158,8	181,3	64,2	14,2
2. IMPORTS	**6 728,9**	**7 371,6**	**7 621,3**	**9,6**	**3,4**
Consumption goods	1 438,3	1 451,6	1 523,1	0,9	4,9
Intermediate goods	3 015,4	3 702,9	3 771,1	22,8	1,8
Capital goods	2 139,5	2 091,3	2 226,6	- 2,3	6,5
Other	135,6	125,8	100,6	- 7,2	- 20,1
3. TRADE BALANCE	**- 616,2**	**- 355,4**	**21,5**		

1/ Estimated
2/ Projected

These forecasts assume a lower world growth. Our main commercial partners would grow 3 percent in 2001, compared with 4 percent in 2000, mainly due to the slowdown of the U.S. economy (from 5 percent in 2000 to 2.5-3.0 percent in 2001). Europe would expand by a similar rate, and Japan would experience a modest growth rate. On the contrary, certain Latin American economies would show rates of growth above average.

TRADITIONAL EXPORTS
(Millions of U.S. dollars)

	1999	2000 1/	2001 2/	Percent variation 2000 1/	Percent variation 2001 2/
FISHING	**600,5**	**976,4**	**1 134,2**	**62,6**	**16,2**
Fishmeal	532,5	889,6	1 013,9	67,1	14,0
Volume (thousands of t.)	1 474,4	2 374,0	2 446,6	61,0	3,1
Priceo (US$/t.)	361,2	374,7	414,4	3,8	10,6
Fish oil	68,1	86,9	120,3	27,6	38,5
Volume (thousands of t.)	258,7	495,0	488,0	91,4	- 1,4
Price (US$/t.)	263,1	175,5	246,4	- 33,3	40,5
AGRICULTURAL	**281,9**	**240,3**	**302,7**	**- 14,8**	**25,9**
Cotton	1,6	5,0	5,1	214,0	2,9
Volume (thousands of t.)	0,9	2,7	2,7	206,8	1,0
Price (US$/t.)	1 823,3	1 865,8	1 900,7	2,3	1,9
Sugar	9,4	7,1	17,8	- 24,5	151,1
Volume (thousands of t.)	21,3	20,9	43,2	- 1,9	106,9
Price (US$/t.)	442,5	340,4	413,0	- 23,1	21,3
Coffee	267,7	224,3	275,6	- 16,2	22,9
Volume (thousands of t.)	145,7	138,1	146,7	- 5,2	6,2
Price (US$/t.)	1 837,5	1 624,4	1 879,2	- 11,6	15,7
Rest of agricultural goods	3,2	3,9	4,1	23,0	3,0
MINING	**3 008,0**	**3 192,8**	**3 419,9**	**6,1**	**7,1**
Copper	776,3	900,8	1 013,4	16,0	12,5
Volume (thousands of t.)	521,1	512,3	548,0	- 1,7	7,0
Price (US$/t.)	1 489,9	1 758,3	1 849,3	18,0	5,2
Tin	132,8	174,5	188,0	31,4	7,7
Volume (thousands of t.)	28,0	36,3	37,9	29,7	4,5
Price (US$/t.)	4 749,0	4 810,5	4 960,4	1,3	3,1
Iron	66,7	72,1	85,2	8,1	18,2
Volume (millions of t.)	3,8	3,9	4,3	2,1	9,5
Precio (US$/t.)	17,4	18,4	19,9	5,9	7,9
Gold	1 192,5	1 174,7	1 231,9	- 1,5	4,9
Volume (thousands of tr.oz.)	4 228,1	4 151,1	4 333,0	- 1,8	4,4
Price (US$/tr.oz.)	282,0	283,0	284,3	0,3	0,5
Refined silver	169,3	181,5	184,6	7,2	1,7
Volume (millions of tr.oz.)	32,4	35,8	35,8	10,4	0,1
Price (US$/tr.oz.)	5,2	5,1	5,2	- 2,9	1,6
Lead	177,1	176,6	182,1	- 0,3	3,1
Volume (thousands of t.)	222,1	243,5	261,1	9,6	7,2
Price (US$/t.)	797,2	725,5	697,4	- 9,0	- 3,9
Zinc	462,4	476,1	494,7	3,0	3,9
Volume (thousands of t.)	669,2	745,5	774,4	11,4	3,9
Price (US$/t.)	691,0	638,6	638,9	- 7,6	0,1
Rest of mining products	30,8	36,4	40,0	18,4	9,8
OIL	**251,3**	**405,8**	**305,3**	**61,5**	**- 24,8**
Volume (millions of barrels)	17,5	16,4	14,0	- 6,3	- 14,5
Price (US$/barrel)	14,4	24,8	21,8	72,4	- 12,0
TRADITIONAL EXPORTS	**4 141,8**	**4 815,3**	**5 162,1**	**16,3**	**7,2**

1/ Estimated
2/ Projected

This scenario foresees a slight improvement in the terms of trade (2 percent) associated with higher export prices, mainly for fishmeal (10.6 percent), copper (5.2 percent) and iron (7.9 percent). Lead and oil prices would fall by 3.9 percent and 12.0 percent, respectively. It should be noted that in 2000 oil prices reached their highest level in two decades.

Long-term private capitals —mainly privatization revenues and direct investment in the mining, hydrocarbons, telecommunications, energy and financial sectors— would cover 57 percent of the current account deficit.

BALANCE OF PAYMENTS

(Millions of U.S. dollars)

	1999	2000 1/	2001 2/	Percentage of GDP		
				1999	2000 1/	2001 2/
I. CURRENT ACCOUNT BALANCE	**-1 817**	**-1 625**	**-1 349**	**- 3,5**	**- 3,0**	**- 2,4**
II. FINANCIAL ACCOUNT	**1 037**	**1 402**	**1 564**	**2,0**	**2,6**	**2,8**
1. Sector privado	626	1 133	910	1,2	2,1	1,6
2. Sector público	411	269	654	0,8	0,5	1,2
III. CENTRAL BANK NIR FLOW	**- 780**	**- 223**	**215**	**- 1,5**	**- 0,4**	**0,4**

1/ Estimated

2/ Projected

Fiscal Sector

The estimated fiscal deficit in 2000 is 3.0 percent of GDP. The deficit is forecasted at 1.5 percent of GDP in 2001, in compliance with the Fiscal Responsibility and Transparency Law.

The projection assumes that central government current revenues would amount to 14.4 percent of GDP in 2001, 0.1 percent points lower than in 2000. The tax structure includes the adjustment mechanism for the excise tax on fuel, the new income tax regulations, the special payroll tax —including an exemption for bonuses— and the tax on state-owned shares, and no new tax exemptions will be introduced. Non-financial central government expenditure is expected to decrease 3.0 percent in nominal terms, to 13.9 percent of GDP.

The financing requirement of the public sector would amount to US$ 1 758 million, given that the deficit and the amortization of the domestic and foreign debt would be equal to US$ 866 million and US$ 892 million, respectively. Financing would consist mainly of disbursements equivalent to US$ 1 475 million (US$ 500 million for projects and US$ 975 million for structural reforms) and privatization revenues amounting to US$ 550 million.

FISCAL INDICATORS
(Millions of nuevos soles)

				Percentage of GDP		
	1999	**2000 1/**	**2001 2/**	**1999**	**2000 1/**	**2001 2/**
Central government current revenue	25 334	27 299	28 927	14,4	14,5	14,4
Central government current expenditure	27 697	28 756	27 875	15,7	15,2	13,9
Rest of public sector	978	7	599	0,6	0,0	0,3
Interests	3 807	4 300	4 754	2,2	2,3	2,4
Economic result	**-5 192**	**-5 750**	**-3 103**	**-3,0**	**-3,0**	**-1,5**
Financing	**5 192**	**5 750**	**3 103**	**3,0**	**3,0**	**1,5**
1. External	- 111	2 096	2 495	-0,1	1,1	1,2
2. Domestic	4 070	2 229	-1 355	2,3	1,2	-0,7
3. Privatization	1 233	1 425	1 963	0,7	0,8	1,0

1/ Estimated
2/ Projected

Communication of Monetary Policy

Since 1994, the Central Bank has announced inflation target ranges and maintained a broad disclosure policy concerning macroeconomic statistics. The Annual Monetary Program, as well as comments on the forecasts presented by the Ministry of Economy and Finance in the Multiannual Macroeconomic Framework, has been published since 2000.

Starting this year, **Annual Monetary Program** revisions will be published in May and September. Additionally, on the first Friday of each month, an **Informative Note** will provide information concerning the monthly monetary targets set by the Central Bank Board of Directors the previous day [1].

[1] In June and November, the announcement will be made on Friday 8 and Friday 9, respectively.