annual report 2001

BANCO CENTRAL DE RESERVA DEL PERÚ

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INTRODUCTION

In 2001, real gross domestic product (GDP) grew 0,2 percent, maintaining the conditions of low activity recorded since 1998. In the last 4 years the average rate of GDP growth has been 0,9 percent, which implies a 0,8 percent decline in per capita terms. This outcome reflects the contractive effects of restricted capital inflows in 1998 and the political uncertainty that ended with the electoral process of 2001. In the second semester the economy recovered (the GDP grew 2,1 percent during this period versus a 1,6 percent contraction in the first semester). In July, Antamina mining company started to operate, with a 0,6 percentage point impact on economic growth. Fiscal and monetary policy during the second semester were both expansive in order to counteract the recession.

The weak domestic demand, reflecting low economic level, dropped 0,7 percent. In particular, fixed gross investment declined 8,3 percent, both in the public and the private sector. It should be emphasized that whereas, in the first semester public investment fell 30,3 percent, in the second semester it only decreased 6,3 percent (due to a rise of 4,9 percent in the fourth quarter). On the other hand, private sector gross investment has decreased 25 percent since 1998; as a consequence, investment fell from 19,6 percent of GDP in 1997 to 15,1 percent in 2001.

The weak domestic demand and the tightened monetary stance in the first half of the year produced a marked slowdown in the rate of inflation, which fell to -0,1 percent in 2001, the first decline in the Consumer Price Index (CPI) since 1939. This reduction was also explained by the 13,1 percent fall in oil prices, in line with international markets. As a result, the annual rate of inflation fell below the target announced in the Central Bank's Monetary Program (2,5 to 3,5 percent). The core inflation was 1,1 percent in 2001 versus 3,1 percent in 2000, reflecting the weakness of demand for goods and services.

The current account of the balance of payments also reflected the weakness of domestic demand. The current deficit decreased from US$ 1,6 billion in 2000 to US$ 1,1 billion in 2001 (from 2,9 to 2,0 percent in terms of GDP). The latter was also a consequence of lower imports (US$ 153 million) and lower foreign investment profits (US$ 133 million). The private sector financial account recorded positive flows of US$ 1,2 billion, whereas public sector financial accounts amounted to US$ 394 million. As a result, the net international reserves of the Central Reserve Bank increased US$ 433 million, after 3 years of consecutive falls.

The external accounts show that the country maintains a strong position in terms of solvency and vulnerability indicators. Thus, the outstanding long-term external debt of both public and private sector decreased from 53 percent of GDP in 2000 to 51 percent in 2001; further, amortization and interest service of the external debt as a percentage of exports of goods and services declined from 50 percent in 2000 to 39 percent in 2001. Concerning vulnerability indicators, it should be noted that the percentage of the current account deficit funded with long-term external capitals increased from 47 percent in 2000 to 81 percent in 2001, whereas net international reserves amount to 1,5 times the flow of total external debt payments due in 1 year.

Public finances in 2001 went through two distinct periods. In the first semester the fiscal stance was restrictive in a context of economic uncertainty and the need to secure budget financing for 2001. In the second half of the year, the fiscal stance was eased in order to help economic upsurge. In August the government enacted the reduction in the Extraordinary Solidarity Tax from 5 to 2 percent, whereas in September, it granted a wage increase to civil servants. The fiscal cost of these measures amounted to 0,2 percent of GDP. The public sector deficit reached 2,5 percent of GDP which, despite being lower than the deficit recorded in 2000 (3,2 percent), exceeded the annual target announced in the Stand By program backed by the International Monetary Fund (1,5 percent of GDP). The required financing of this deficit was covered mainly by the difference between disbursements and amortizations (US$ 498 million), privatization receipts (US$ 328 million) and the issuance of sovereign bonds in domestic currency (equivalent to US$ 344 million).

In 2001, monetary policy targeted a range of 2,5 to 3,5 percent for annual inflation. In order to attain this goal, the Bank announced an annual growth of 3 to 5 percent for the monetary base. Likewise, the Board of the Central Bank started to announce at the beginning of each month an operative target for commercial banks' disposable liquidity and the Central Bank operations' interest rates, in order to transmit to economic agents, dealers and the general public, the stance of monetary policy.

The electoral process had an important effect upon financial variables, particularly during the second quarter. This forced the Central Bank to keep a cautious position on the level of disposable liquidity to financial institutions. As a consequence, the interbank interest rate increased from 11 percent in the first quarter to 14 percent in the second quarter. In the second semester monetary stance relaxed given the strong slowdown in the rate of inflation (below its target). The expansion of banking liquidity was followed by an important reduction in the interbank interest rate, from 7 percent in the third quarter to 4 percent in the fourth quarter.

Lower economic uncertainty resulted in the decrease of inflation expectations and of depreciation, encouraging savings in domestic currency. As a consequence, the rate of dollarization of the banking system diminished from 70 percent in 2000 to 66 percent in 2001. The higher availability of soles-denominated instruments resulted in a 3 percent increase in the credit of the banking system in domestic currency during 2001. In contrast, credit in foreign currency fell 4 percent reflecting the higher risks perceived by banking institutions. The evolution of the credit to the private sector in 2001 was also featured by the decrease in lending interest rates, reflecting higher liquidity, lower international interest rates and the reduction in country-risk indicators in particular during the second semester. Thus, corporate prime interest rates decreased from 15 percent in December 2000 to 5 percent in December 2001 in domestic currency and from 8 to 3 percent in foreign currency.