V.

Money and credit

Following the reversal of the shocks that transitorily pushed inflation upwards during 2004, the pace of price growth slowed down in 2005 to settle, for the most part of the year, in the lower limit of the target range. In this scenario, the Central Bank kept its monetary policy stance unaltered. By the close of the year, the BCRP increased its reference interest rate by 25 basis points (from 3.0 to 3.25 percent) in a context of upward pressures on the exchange rate, given electoral uncertainty and the greater dynamism of economic activity.

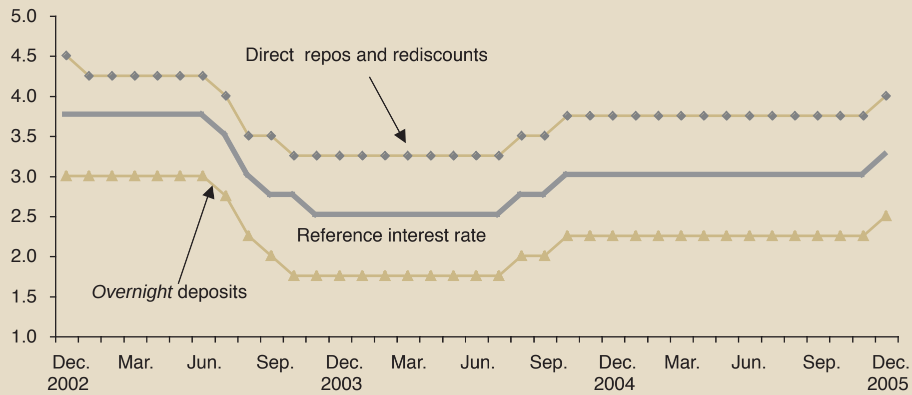
1. Monetary policy measures

Peru posted an inflation rate of 1.5 percent in 2005, a year characterized by the reversal of the transitory supply shocks that had raised inflation to 3.5 percent in 2004. Moreover, the compensatory fiscal measures adopted to offset the impact of the rises in the international prices of fuels and the appreciation of the nuevo sol during the first eight months of the year also contributed to the lower inflation rate observed this year.

In this context, the Central Bank maintained its reference rate at 3.0 percent until November. However, by the end of the year, and taking into account that the indications of a faster pace of growth and the volatility of the exchange rate could affect inflation, the BCRP decided to raise its reference interest rate by 25 basis points from 3.0 to 3.25 percent.

It is worth pointing out that one of the monetary channels used to influence the

GRAPH 18
REFERENCE INTEREST RATE
(Percentage)



economy's aggregate expenditure is associated with the possibility of affecting the interbank interest rate and, via this rate, the rest of interest rates in the Peruvian economy. Thus, the withdrawal of monetary stimulus is consistent with a gradual increase in the cost of credit, and does not represent a threat to the sustained growth the Peruvian economy has been exhibiting over the past years.

Furthermore, in a context of rises in the international interest rates and in order to continue discouraging financial dollarization, the Central Bank established a fixed rate of remuneration for additional reserve requirements in foreign currency, thus disconnecting it from the 3-month Libor for loans in dollars. Since June 2005, the remuneration on reserve requirements in foreign currency was set at 2.25 percent.

In the first nine months of 2005, amid appreciatory pressures of the nuevo sol, the BCRP intervened in the exchange market purchasing foreign currency, which implied an additional injection of nuevos soles to the market. In order to withdraw this excess of domestic currency, the Central Bank increased its placements of Certificates of Deposit (CDBCRP), which rose from S/. 8.3 billion in December 2004 to S/. 9.7 billion in September 2005.

In the fourth quarter, and amidst greater volatility in the exchange market, the BCRP sold foreign currency and placed other exchange-indexed securities called Readjustable Certificates of Deposit (CDR). These exchange operations were partially offset by the maturing of CDBCRP (totaling S/. 7.7 billion by the end of the year) and by temporary purchases of securities issued by the BCRP and Public Treasury.

BOX 5

CONTINUOUS EVALUATION OF THE INFLATION TARGET

Since 2002, the monetary policy of the BCRP has been based on an Explicit Inflation Targeting (EIT) framework, with an inflation target of 2.5 percent, plus or minus one percentage point.

Until 2005, the target established by the Central Bank referred to the percentage change of the CPI in December with respect to the same month the previous year. In other words, this was a "punctual" evaluation of the inflation target (carried out at one specific moment in time). This criterion has been used in countries where there is a convergence towards low levels of inflation, and where the adoption of the EIT framework has served to orient inflation expectations. In these cases, this punctual evaluation at the end of the year is a way of corroborating whether the convergence process tends towards the long-term value.

In the Peruvian case, the deflation process culminated when the EIT regime was adopted and between 2002 and 2005, inflation has been stable in its long-term value. Therefore, as announced in a Monetary Program press release in December 2005, the Central Bank will start evaluating the inflation target in a continuous fashion from 2006-on. In this way, Peru will form part of the group of countries with low and steady levels of inflation that evaluate the inflation target in a continuous manner.

This new evaluation method is consistent with a farsighted implementation of monetary policy aimed at accomplishing goals in the medium term, and not only concerned with specific objectives to be achieved in a particular moment in the calendar year.

IT CHARACTERISTICS IN SELECTED COUNTRIES

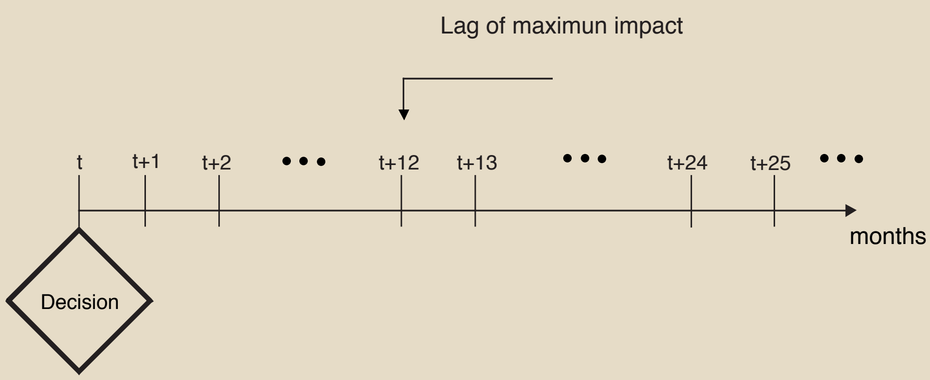
Country	Adoption of IT	Target value (2006)[1/]	Mid value of long-term target	Target horizont[2/]
Australia	April 1993	2.5%	2.5%	Medium-term
Brazil	June 1999	4.5%	Not specified	Annual
Canada	February 1991	2.0%	2.0%	Medium-term
Chile	September 1999	3.0%	3.0%	Medium-term
Colombia	September 1999	4.5%	3.0%	Annual
Philippines	January 2002	4.5%	4.5% (2007)	Annual/Biennial
Mexico	January 2001	3.0%	3.0%	Medium-term
New Zealand	March 1990	2.0%	2.0%	Medium-term
Peru	January 2002	2.5%	2.5%	Medium-term
United Kingdom	October 1992	2.0%	2.0%	Medium-term

1/ If the target is defined as an spread, the value is the middle of spread.
2/ If the horizont of target is annual, the evolution of the target is punctual.

Source: Roger Scott and Mark Stone (2005) "On target? The International Experience with Achieving Inflation Target" IMF Working paper 01 /153; World Economic Outlook (September 2005), and web pages of Central Banks.

The medium term horizon is compatible with the presence of monetary lags, that is, of periods of time between the adoption of monetary decisions and their maximum impact on inflation. However, a monetary lag may be both ample and uncertain. The following diagram of a monetary lag illustrates that the maximum impact of a monetary policy decision on inflation is estimated to occur a year after the decision was made.

ILUSTRATION OF PROCESS OF DECISION AND TRANSMISSION OF THE MONETARY POLICY



Hence, and taking into consideration these monetary lags, each monetary policy measure adopted by the Central Bank is implemented in such a way so as to ensure that the expected result will be consistent with the inflation target.

2. Interest rates

The adoption of the Explicit Inflation Targeting framework has reinforced the monetary channel of interest rates as the volatility of the interbank interest rate was reduced. The interbank interest rate is used as reference for the rest of interest rates in nuevos soles. The volatility of the interbank interest rate decreased on average from 7 basis points in 2004 to 6 basis points in 2005, although it even ranged between 3 and 5 basis points in some months of the year.

Active and passive interest rates in domestic currency showed a different behavior during 2005. While interest rates on 30-day deposits in nuevos soles and on 90-day corporate prime loans recorded rises during the last months of the year, the rest of active rates showed a downward trend throughout 2005. This evolution reflected a lower risk premium given the growth of economic activity, the greater competition in the market, and the lower level of non-performing loans. Likewise, a decrease in the differential between interest rates in nuevos soles and in dollars was observed throughout the year due to the impact generated in the local market by the FED's consecutive raises of interest rates, while the reference interest rate in nuevos soles remained unvaried for the most part of the year.

As previously mentioned, **interest rates in local currency** –particularly for operations with longer maturities– showed a downward tendency in 2005. Thus, between December 2004 and December 2005, the average active interest rate with a structure of constant placements fell from 18.2 to 17.0 percent; the interest rate on overdrafts fell from 57.9 to 31.7 percent; and the interest rate on loans and commercial discounts to up to 30 days fell from 7.1 to 6.7 percent.

Conversely, interest rates with shorter maturities, such as the corporate prime and interest rates on passive operations, showed an upward trend due to banks' increased pressures on demand for nuevos soles in order to improve their foreign exchange position, as well as to the faster pace of demand for loans.

On the other hand, **interest rates in foreign currency** showed an upward trend, in line

TABLE 36
INTEREST RATES IN DOMESTIC CURRENCY 1/
(Percentage)

		2003	2004	2005
1	Interbank	2.5	3.0	3.3
2	Term deposits between 31 to 180 days	3.0	3.2	3.6
3	Term deposits between 181 to 360 days	4.2	4.4	4.6
4	Prime lending	3.3	3.8	4.4
5	Average lending rate up to 360 days	14.0	14.7	13.9
6	Fix-weighted average lending rate	19.0	18.2	17.0
7	CDBCRP (Balance)	3.9	4.5	4.7

1/ Corresponds to the average rate of the last month of the year.
Source: SBS and BCRP.

TABLE 37
INTEREST RATES IN FOREIGN CURRENCY 1/
(Percentage)

		2003	2004	2005
1	Interbank	1.1	2.2	4.2
2	Term deposits between 31 to 180 days	1.2	1.7	2.9
3	Term deposits between 181 to 360 days	1.6	1.8	2.9
4	Prime lending	1.7	2.6	5.5
5	Average lending rate up to 360 days	7.2	7.7	9.4
6	Fix-weighted average lending rate	9.4	9.4	10.3
7	3-month Libor	1.2	2.5	4.5
8	Reserve requirement remuneration	1.0	2.3	2.3

1/ Corresponds to the average rate of the last month of the year.
Source: SBS and BCRP.

with the rises of international interest rates. Thus, for example, the corporate prime rate in dollars rose from 2.6 percent in December 2004 to 5.5 percent in December 2005, while the one on deposits to up to 360 days rose from 1.8 to 2.9 percent and from 1.7 to 2.9 percent for deposits between 31 and 180 days.

As a result of this, the differential between interest rates in domestic and in foreign currency dropped throughout the year, decreasing from 1.2 percent in December 2004 to –1.1 percent at the close of 2005 in the case of the corporate prime rate.

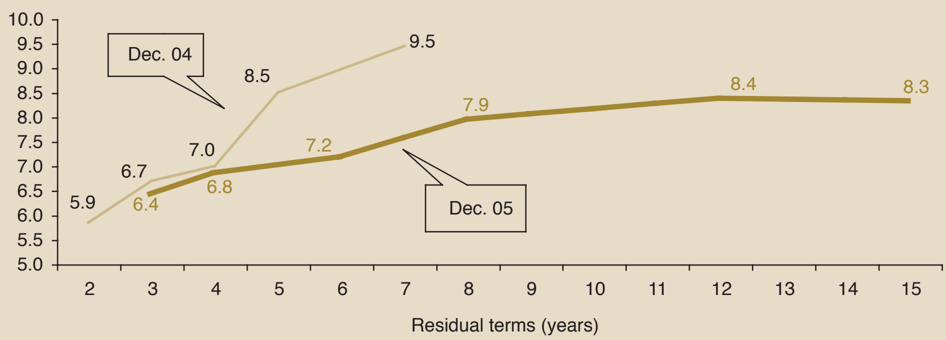
By type of credit, the interest rate on soles-denominated loans to micro-businesses decreased from 48.1 to 44.2 percent, while those denominated in foreign currency did so from 28.4 to 27.0 percent. Consumer and mortgage loans recorded a similar pattern, reflecting an improved perception of banks vis-à-vis the credit risks these market segments involve.

Commercial credits showed a reduction of interest rates in domestic currency (from 9.3 to 8.2 percent) and an increase in those rates in foreign currency (from 7.9 to 9.2 percent).

In the **bond market**, interest rates in nuevos soles in the secondary market of CDBCRPs and Peruvian sovereign bonds showed a mixed behavior, falling during the first 8 months of the year and then rising to finally settle at lower levels than by the end of 2004. Thus, for example, a bond maturing in 2011 that was transacted at 9.6 percent in December 2004 would be negotiated at 6.4 percent in September 2005 and at 7.1 percent in December this year.

The increase produced in terms of interest rates in the fourth quarter paralleled that of country risk indicators, also reflecting higher expectations of depreciation of the nuevo sol that arose in connection to the greater political uncertainty generated by the electoral process of April 2006.

GRAPH 19
PUBLIC TREASURY SOVEREIGN BONDS IN THE SECONDARY MARKET 1/
(Percentage)



1/ Yields of sovereign bonds recorded in the secondary market as of closest data to the end of period.
Source: BCRP.

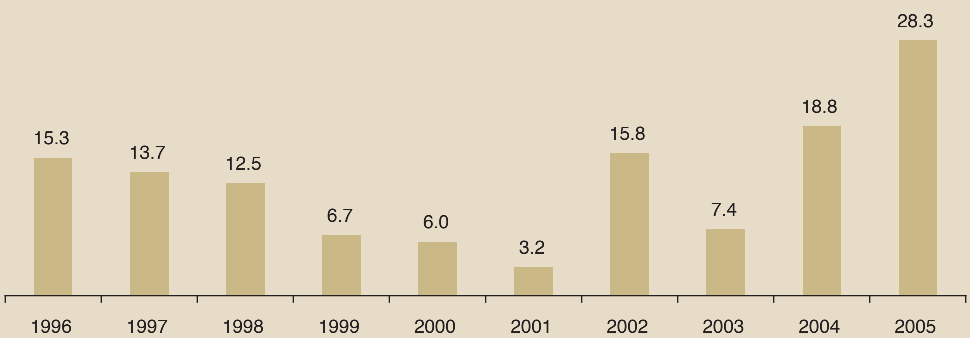
3. Monetary aggregates

The Central Bank uses the reference interest rate as a guide for the interbank market. Furthermore, the evolution of monetary aggregates reflects people's preferences in terms of the demand for money. As a result of the greater dynamism observed in the economy during 2005, the annual expansion rates of currency and the monetary base came close to 28 percent.

a. Monetary aggregates in the banking system

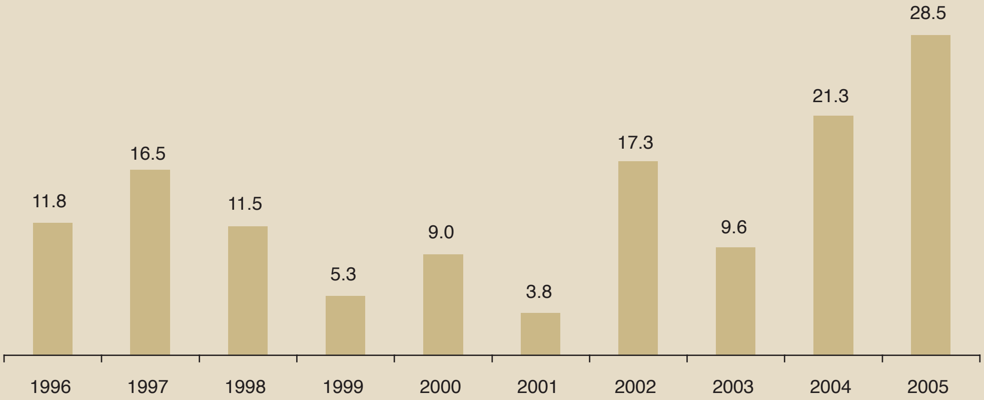
The broadest monetary aggregates in the banking system exhibited a mixed behavior in terms of growth. The expansion of banks' total liquidity increased from 8.2 to 18.4 percent between the end of 2004 and of 2005, while the expansion of liquidity in domestic currency –accounting for 45 percent of total liquidity– decreased from 28.1 to 19.5 percent.

GRAPH 20
MONETARY BASE
(Annual average percentage change)



Source: BCRP.

GRAPH 21
BANKING SYSTEM CURRENCY
(Annual average percentage change)



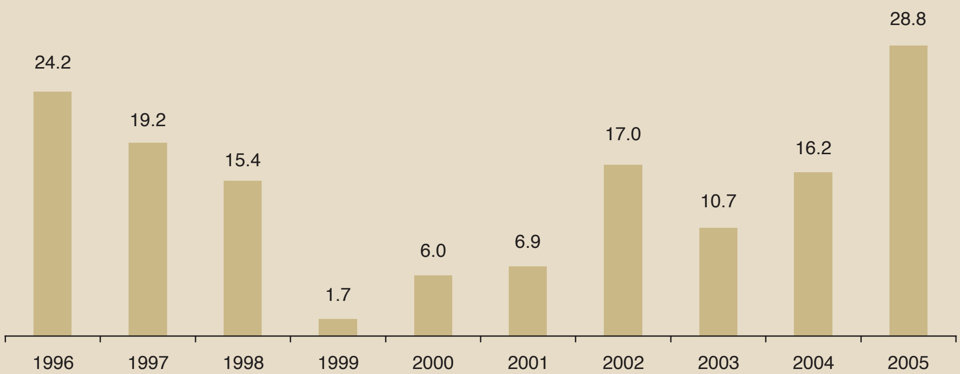
Source: BCRP.

Liquidity in foreign currency, on the other hand, grew at a faster pace than in the previous year, rising from 1.4 percent in 2004 to 12.4 percent in 2005 due to increased depreciatory expectations during the last quarter of the year.

Liquidity in domestic currency grew 28.8 percent on average, posting a level equivalent to 10.8 percent of GDP. The greater degree of monetization in the economy was associated with greater economic activity, particularly due to the expansion of domestic demand and to economic agents' increased preference for domestic currency given the credibility of the monetary policy and the strength of the nuevo sol.

Total liquidity in the banking system showed a slight increase and rose from 22.7 percent of GDP in 2004 to 23.2 percent in 2005.

GRAPH 22
BANKING SYSTEM BROAD MONEY IN NUEVOS SOLES
(Annual average percentage change)



Source: SBS and BCRP.

b. Monetary base and currency

On average, monetary base grew at a rate of 28.3 percent, associated with growth in nominal GDP of 10.0 percent, a fall of 14.6 percent in the velocity of circulation of money, and an increase of 0.4 percent in the bank multiplier.

The balance of the monetary base by December 2005 was S/. 11,724 million, showing a 25.7 percent increase with respect to the previous year, particularly as a result of variations in exchange operations. The flow of net purchases of foreign currency through the Central Bank's Front Office was US$ 2,699 million, or S/. 8,714 million, a figure

TABLE 38
AVERAGE BROAD MONEY IN NUEVOS SOLES OF THE BANKING SYSTEM
(Annual average percent change)

	GDP Deflator	GDP Growth		Local currency broad money	Velocity of money	Money supply components	
		Real	Nominal			Monetary base	Multiplier
2003	2.3	3.9	6.7	10.7	-3.6	7.4	3.1
2004	5.7	5.2	11.2	16.2	-4.4	18.8	-2.2
2005	3.5	6.4	10.0	28.8	-14.6	28.3	0.4

Source: SBS and BCRP.

TABLE 39
SOURCES OF CHANGE OF THE MONETARY BASE
(Millions of nuevos soles)

	2003	2004	2005
I. FOREIGN EXCHANGE OPERATIONS	**3,465**	**6,239**	**2,360**
(Millions of US$)	998	1,854	767
1. Over-the-counter net purchases	3,645	7,896	8,714
2. Public sector	-177	-1,663	-6,363
3. Other	-3	6	8
II. MONETARY OPERATIONS	**-2,783**	**-4,353**	**37**
1. Public sector deposits	-921	-721	-2,821
2. Operations with the financial system	-170	-.-	2,850
3. Central Bank Certificates	-2,143	-4,158	-623
4. Other	450	526	631
III. TOTAL	**682**	**1,886**	**2,397**
End-of-period percentage change	10.1	25.3	25.7
Average percentage change	7.4	18.8	28.3
Note:			
END-OF-YEAR BALANCES			
Central Bank Certificates	4,097	8,225	8,877
Operations with the financial system	-.-	-.-	2,850
Public sector deposits	1,196	1,918	4,738
Monetary base	7,441	9,327	11,724

Source: BCRP.

offset by sales of this currency to the Public Treasury for a total of US$ 1,935 million, or S/. 6,363 million, mainly for external debt repayment.

Part of this increased liquidity was absorbed by the public's greater demand for money. Excess liquidity was partially sterilized through placements of CDBCRPs and increased public sector deposits. Sterilization operations during the first quarter resulted in a total of S/. 11,261 million of certificates by March, although placements of these certificates decreased between April and August due to an increase in public sector deposits, associated with higher tax revenues and the higher profits obtained by public enterprises.

During the fourth quarter, the BCRP sought to counterbalance the depreciatory pressures on the nuevo sol by conducting net sales of foreign currency and placements of Re-adjustable Certificates of Deposit (CDR), financial instruments with a dollar-indexed yield that represent an option other than buying foreign currency for banks. Additionally, the BCRP reduced its CDBCRP placements and increased the volume and frequency of temporary purchases of securities (repos), thus generating a flow of S/. 2,850 million during the last quarter.

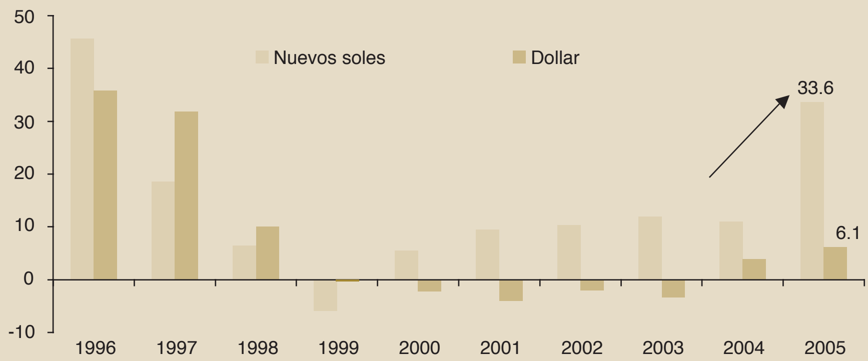
c. Financial system credits

In 2005, total credit to the public sector expanded 17.6 percent in nominal terms, boosted mainly by the growth of credit in nuevos soles, which, for the sixth consecutive year, exceeded that of credit in dollars. The former increased by 33.6 percent –the greatest increase recorded since 1997–, while the latter grew 6.1 percent. Thus, the dollarization ratio of credit to the private sector decreased from 70.7 to 66.7 percent.

The expansion of credit in nuevos soles was led by bank lending (37.1 percent), particularly to the sectors of manufacturing, commerce and transport, storage, and communications.

Lending in local currency to microfinance institutions showed a faster pace of growth and rose from 18.1 percent in 2004 to 35.9 percent in 2005. It is worth pointing out that the credit granted by Edpymes grew by 53.2 percent in 2005.

GRAPH 23
CREDIT TO THE PRIVATE SECTOR IN DOMESTIC AND FOREIGN CURRENCY
(Annual end of period rates of growth)



Source: SBS and BCRP.

TABLE 40
FINANCIAL SYSTEM'S CREDIT TO THE PRIVATE SECTOR IN DOMESTIC CURRENCY

	Millions of nuevos soles			Growth rates	
	Dec. 03	Dec. 04	Dec. 05	Dec. 04/ Dec. 03	Dec. 05/ Dec. 04
Commercial banks 1/	8,221	8,464	11,606	3.0	37.1
Banco de la Nacion	511	1,051	1,277	105.9	21.5
Microfinance institutions	**3,666**	**4,329**	**5,882**	**18.1**	**35.9**
Banks (micro finance credits)	730	1,120	1,545	53.4	37.9
Local government S&Ls	1,083	1,376	1,848	27.1	34.3
Rural S&Ls	181	253	348	40.0	37.5
Saving and credit cooperatives	459	511	634	11.2	24.1
EDPYMES	172	229	351	33.6	53.2
Financial companies	1,042	840	1,156	-19.4	37.7
Institutional investors 2/	**2,180**	**2,307**	**2,900**	**5.8**	**25.7**
Pension funds	1,449	1,337	1,821	-7.7	36.2
Insurance companies	568	812	751	42.9	-7.5
Mutual funds	163	158	328	-2.9	107.1
Leasing companies and others	**247**	**306**	**323**	**23.9**	**5.6**
Total financial system	**14,824**	**16,457**	**21,988**	**11.0**	**33.6**

1/ Excludes microfinance credits.
2/ Mainly securities issued by the private sector
Source: SBS and BCRP.

TABLE 41
FINANCIAL SYSTEM'S CREDIT TO THE PRIVATE SECTOR IN FOREIGN CURRENCY

	Millions of US$			Percentage change	
	Dec. 03	Dec. 04	Dec. 05	Dec. 04/ Dec. 03	Dec. 05/ Dec. 04
Commercial banks 1/	9,409	9,465	9,875	0.6	4.3
Banco de la Nacion	22	22	22	-1.2	-1.0
Microfinance institutions	511	665	804	30.3	20.9
Banks (micro finance credits)	**87**	**126**	**177**	**45.8**	**40.1**
Local government S&Ls	186	250	292	34.6	16.9
Rural S&Ls	48	55	56	16.1	0.7
Saving and credit cooperatives	116	154	188	31.9	22.5
EDPYMES	40	49	55	20.6	12.4
Financial companies	34	32	37	-6.6	16.0
Institutional investors 2/	**1,091**	**1,333**	**1,497**	**22.2**	**12.3**
Pension funds	517	729	733	41.1	0.5
Insurance companies	60	89	151	49.8	68.8
Mutual funds	514	515	613	0.1	19.2
Leasing companies and other	**637**	**639**	**669**	**0.2**	**4.7**
Total financial system	**11,670**	**12,125**	**12,867**	**3.9**	**6.1**

1/ Excludes microfinance credits.
2/ Mainly securities issued by the private sector.
Source: SBS and BCRP.

Lending by institutional investors increased by S/. 593 million due to higher transactions in the bond market, which grew from 5.8 to 25.7 percent.

The growth of credit in nuevos soles showed acceleration in the fourth quarter due to a reduction in the differential between interest rates in nuevos soles and in dollars, and to higher expectations of depreciation of the domestic currency.

The US$ 742 million increase in credit **in foreign currency** is mainly explained by banks' greater lending (US$ 410 million), particularly for mortgage purposes. In the segment of microfinance institutions, the annual growth rate slowed down from 30.3 percent in 2004 to 20.9 percent in 2005, although bank loans in this segment grew 40.1 percent.

Meanwhile, credit in the case of institutional investors declined from 22.2 to 12.3 percent between 2004 and 2005. It should be recalled that the increase recorded in 2004 in this sector was mainly connected to Transportadora de Gas del Peru's issue of bonds, which were basically purchased by local institutional investors.

d. Banks

Banks in 2005 continued to show improved financial indicators, particularly in terms of a lower equity exposure to credit and exchange risks –as both loans and deposits became more *solarized* or domestic currency-denominated–, despite the greater exchange volatility observed by the end of the year. In addition to this, 2005 saw an important recovery of commercial credit in nuevos soles.

The above-mentioned improvement in terms of exposure to credit risks was reflected in the reduction of the portfolio of non-performing loans from 3.8 percent in 2004 to 2.2 percent en 2005, as well as in the greater hedging against non-performing loans which increased from 68.2 percent in 2004 to 79.5 percent in 2005.

Banks' profits in 2005 doubled with respect to the previous year to S/. 1,483 million, thus allowing return over equity (ROE) to reach 22.1 percent. This growth is explained by an increase in financial margins, as well as in incomes for non-financial services –especially fees for debit and credit cards– which reflected the expansion of placements in other more profitable segments, such as consumer and microfinance loans in

TABLE 42
COMMERCIAL BANKS INDICATORS
(Percentage)

	2003	2004	2005
Non-performing loans[1/] / Gross assets	6.0	3.8	2.2
Provissions / Non-performing, Restructured, Refinanced loans [2/]	67.1	68.2	79.5
Return of equity	10.6	11.5	22.1

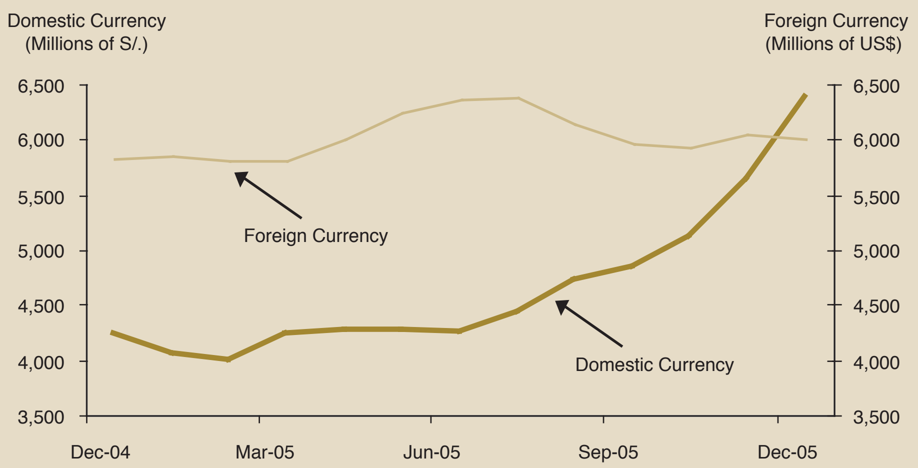
1/ Non-performing loans include those late in payment and those in judicial actions.
2/ Non-performing loans plus refinanced and strutured credits.
Source: Balance of verification of banks and SBS.

domestic currency, and the investment of excess liquidity in CDBCRPs. An additional factor contributing to banks' increased profitability was the reduction of the operational expenditure-over-assets, despite the fact that some banks increased both their staff and number of offices as a result of expansion of operations with the retail sector.

This year also saw a marked *solarization* of commercial loans, which grew by S/. 2,143 million, while loans in dollars increased by US$ 311 million. This evolution is explained mainly by the reduction of financial costs in domestic currency.

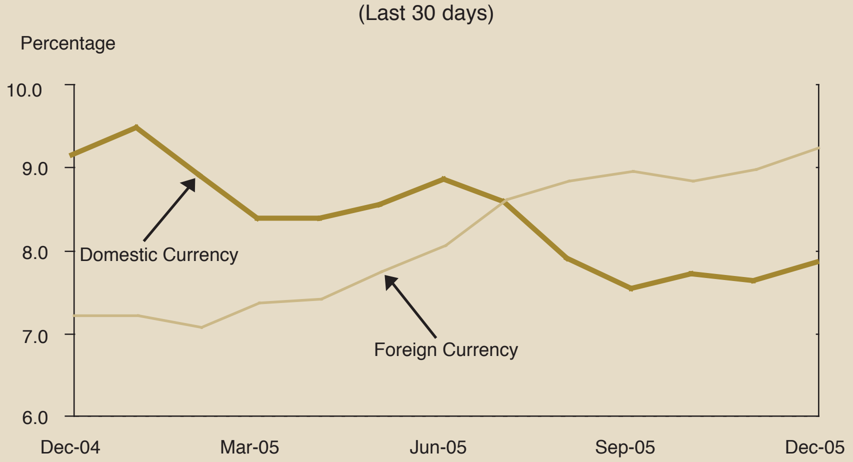
During the year, Standard Chartered Bank and the Bank of Boston closed operations in the country due to a new global strategy adopted at the headquarters of both banks. In Peru, these two banks focused on the corporate segment and had a limited

GRAPH 24
COMMERCIAL CREDITS



Source: SBS and BCRP.

GRAPH 25
COMMERCIAL CREDITS INTEREST RATE
(Last 30 days)



Source: SBS and BCRP.

participation in the market, representing 3.1 percent of total loans in the system. The client portfolio of the Bank of Boston was transferred to the Banco de Credito.

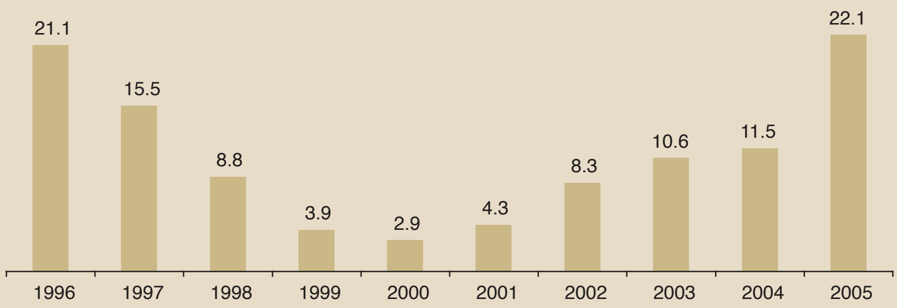
A development worth mentioning in terms of banks is the implementation of agreements with non-financial entities in order that they may act as correspondent banking for money withdrawal or payment of services in places where banks have no agencies. This will contribute not only to develop a payment system, but also to increase the use of banks in the economy.

TABLE 43
COMMERCIAL BANKS' DIRECT CREDITS

	DOMESTIC CURRENCY Millions of nuevos soles						
	End-of-period balances			Flows		Percentage change	
	2003	2004	2005	2004	2005	2004	2005
Commercial	4,353	4,229	6,372	-124	2,143	-2.9	50.7
Small business	730	1,120	1,548	390	428	53.4	38.2
Consumer	2,575	3,217	4,269	642	1,052	24.9	32.7
Mortgage	201	211	275	10	64	5.0	30.2
TOTAL	**7,859**	**8,777**	**12,464**	**918**	**3,687**	**11.7**	**42.0**
	FOREIGN CURRENCY Millions of US$						
	End-of-period balances			Flows		Percentage change	
	2003	2004	2005	2004	2005	2004	2005
Commercial	6,214	6,214	6,525	0	311	0.0	5.0
Small business	87	128	182	41	55	46.9	42.9
Consumer	453	499	586	46	86	10.2	17.3
Mortgage	1,264	1,498	1,807	235	308	18.6	20.6
TOTAL	**8,017**	**8,339**	**9,100**	**322**	**760**	**4.0**	**9.1**

Source: Balance of verification of banks and SBS.

GRAPH 26
BANKS' PROFITS 1/
(Percentage)



1/ Return on Equity (ROE), registered at December.
Source: SBS.

e. Payment system

The total value of payments carried out through interbank payment systems in the country –including both the Real Time Gross Settlement for high-value payments, administered by the Central Bank, and the system for low-value payments, administered by the Camara de Compensacion Electronica S.A. (CCE. S.A.)– increased by 2.5 percent with respect to 2004. This was the result of a 6.8 percent increase in sol-denominated payments, as dollar-denominated payments decreased by 0.7 percent. In this way, interbank payments in domestic currency rose from 59.7 percent in 2004 to 62.2 percent in 2005.

TABLE 44
INTERBANK PAYMENT SYSTEM

	Millions of nuevos soles				
	2004	Structure (%)	2005	Structure (%)	% change 05/04
I. RTGS System	**547,532**	**84.2**	**556,792**	**83.5**	**1.7**
1.- Domestic Currency	323,178	49.7	342,516	51.4	6.0
2.- Foreign Currency	224,354	34.5	214,276	32.1	-4.5
(In millions of US$)	65,793		64,824		-1.5
II. Electronic Clearing House System	**102,790**	**15.8**	**109,919**	**16.5**	**6.9**
a.- Checks	101,565	15.6	106,202	15.9	4.6
1.- Domestic Currency	64,460	9.9	69,539	10.4	7.9
2.- Foreign Currency	37,105	5.7	36,663	5.5	-1.2
(In millions of US$)	10,887		11,109		2.0
b.- Transfers of Credit	1,225	0.2	3,717	0.6	203.4
1.- Domestic Currency	699	0.1	2,549	0.4	264.7
2.- Foreign Currency	526	0.1	1,168	0.2	122.1
(In millions of US$)	156		354		126.9
III. TOTAL (I+II)	**650,322**	**100.0**	**666,711**	**100.0**	**2.5**
1.- Domestic Currency	388,337	59.7	414,604	62.2	6.8
2.- Foreign Currency	261,985	40.3	252,107	37.8	-3.8
(In millions of US$)	76,836		76,287		-0.7

	Thousands of units				
	2004	Structure (%)	2005	Structure (%)	% change 05/04
I. RTGS System	**312**	**3.7**	**331**	**3.8**	**6.1**
1.- Domestic Currency	179	2.1	195	2.2	8.9
2.- Foreign Currency	133	1.6	136	1.6	2.3
II. Electronic Clearing House System	**8,051**	**96.3**	**8,406**	**96.2**	**4.4**
a.- Checks	7,870	94.1	7,918	90.6	0.6
1.- Domestic Currency	4,832	57.8	4,975	56.9	3.0
2.- Foreign Currency	3,038	36.3	2,943	33.7	-3.1
b.- Transfers of Credit	181	2.2	488	5.6	169.6
1.- Domestic Currency	133	1.6	406	4.6	205.3
2.- Foreign Currency	48	0.6	82	0.9	70.8
III. TOTAL (I+II)	**8,363**	**100.0**	**8,737**	**100.0**	**4.5**
1.- Domestic Currency	5,144	61.5	5,576	63.8	8.4
2.- Foreign Currency	3,219	38.5	3,161	36.2	-1.8

Source: BCRP.

The RTGS –the system where high-value individual operations of banks and companies are processed– grew 1.7 percent, whereas the system CCE S.A. –for the processing of massive and low-value individual operations, but significant in aggregate terms– showed greater dynamism and grew 6.9 percent. It is worth highlighting the growth of loan transfers via CCE S.A., particularly of those to pay suppliers of good and services for the State, even though they are still not representative. The RTGS system still prevails as the main interbank payment system with 83.5 percent of the value of transactions, although its volume of transactions is relatively low (only 3.8 percent) in comparison with the CCE S.A. system.

It should be pointed out that the rotation of payments in GDP terms fell from 2.7 times in 2004 to 2.6 times in 2005, evidencing that economic activity grew at a greater level than payments.

As part of the modernization process initiated in 2000 with the introduction of the RTGS and CCE S.A. systems, a system was also implemented for securities: the Sistema de Liquidación Multibancaria de Valores –Multibank Bond Settlement System–, legally recognized by the Institución de Compensación y Liquidación de Valores CAVALI ICLV S.A. (CAVALI). This system started operating in November 2005, following a coordination process between the Central Bank and CONASEV (Comisión Nacional Supervisora de Empresas y Valores).

f. Multibank bond settlement system

This new system that perfects and replaces the previous one is based on multiple banking entities acting as representatives of Settlement Banks. As a result, settlement risk is adequately controlled as direct participants no longer depend for their liquidity needs on a single bank, as they used to, but instead may resort for this purpose to six of the largest bank companies in the country, and thus the system's capacity to attend to temporary liquidity requirements has increased considerably.

Another advantage of this new system, which also provides greater security and efficiency to the stage of fund settlement, is that the new settling agent is the Central Bank, an institution free of intervention or liquidity related risks. The liquidity risk refers to the risk involved if the counterpart does not settle an obligation for its total amount upon the maturity of the said obligation. This does not imply that the counterpart is insolvent, as these obligations may be settled in an unspecified date in the future. This measure contributes to implement one of the basic principles established by the Bank for International Settlements (BIS) for payment systems, which provides that the asset used for settlements should be the Central Bank's money.

Another element reinforcing the security and efficiency of settlements is that these operations are now carried out through the RTGS system, as a result of which each transfer order is processed and paid immediately provided that the paying entity has enough resources to do so, thus eliminating the liquidity risk of settlement banks.

Finally, this system also reinforces compliance with BIS recommendation of eliminating risks –both the seller's risk of delivering a security and not being paid for it, and the buyer's risk of paying for a security and not receiving it– through a scheme of delivery-against-cash scheme, which will contribute to ensure that both stages (payment and delivery) of the transaction are carried out.

4. Currency management

Demand for bills and coins

The growth of the economy in 2005 promoted a greater demand for currency, which was also reinforced by better quality standards for banknotes and brought about an increased reposition of deteriorated bills.

An important increase in the demand for bills of all denominations (45.7 percent) was recorded in this context, particularly in the S/. 10.00-denominated bills.

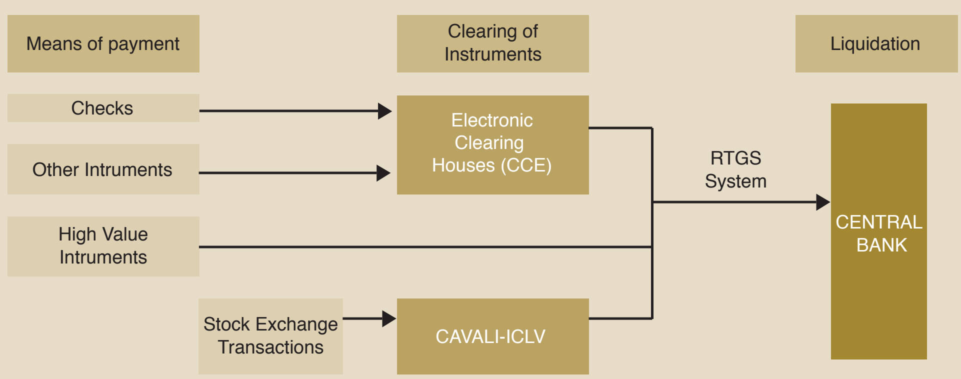
The demand for coins increased by 19.0 percent, mainly due to a requirement of low denomination coins (S/. 0.01 and S/. 0.05), especially in the second semester of the year. The most requested coin was the S/. 0.10 coin.

In order to adequately accomplish its mission of issuing bills and coins on behalf of the Peruvian State, the BCRP invited a number of firms to International Biddings for the procurement of 105 million S/. 10.00 bills and of 40 million S/. 50.00 bills, which were won by the French company Francois Charles Oberthur Fiduciaire and the German Company Bundesdruckerei International Services GmbH respectively.

Likewise, in order to guarantee an adequate supply of coins, the Central Bank hired the service of transforming 350 tons of alpacca and 40 tons of brass into laminated strips. Additionally, the BCRP bought 330.2 tons of laminated brass strips, 137.8 tons of laminated alpacca strips, and 7.2 tons of laminated aluminum strips, a significant part of which will be delivered to the Central Bank in 2006.

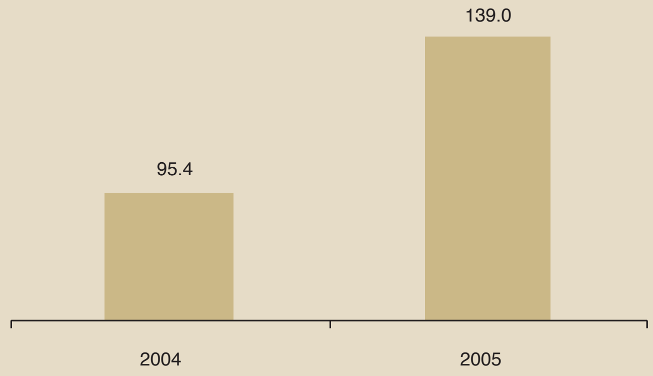
The S/. 100.00 bill, which incorporates three new security features –the holographic security thread, the iridescent band, and the optically variable ink (OVI) that shifts colors

GRAPH 27
ORGANIZATION OF THE PAYMENTS SYSTEM IN PERU



Source: BCRP.

GRAPH 28
DEMAND OF BANKNOTES
(Million of units)



Source: BCRP.

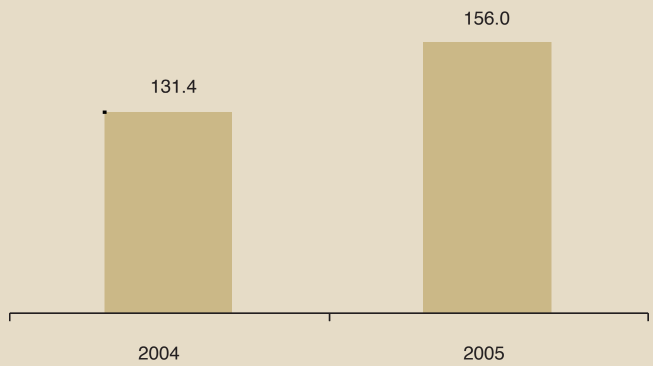
when printed– that will facilitate the public's quick identification and prevent counterfeiting was released in November. On the other hand, aluminum S/.0.01-denominated coins were placed into circulation in December.

Finally, in order to inform the public about the new security features of banknotes and coins, 446 talks were given to approximately 20 thousand people, including the staff of financial entities, commercial businesses, and the general public in different parts of the country. Furthermore, 333 thousand posters, fliers, and brochures on the security features of our coins and banknotes were distributed nationwide.

Currency destruction

In 2005, 63.3 million banknotes denominated in nuevos soles and 9 million deteriorated S/.1.00-denominated coins were destroyed in National Mint facilities.

GRAPH 29
DEMAND OF COINS
(Million of units)



Source: BCRP.

National Mint

The National Mint produced 112.3 million coins in 2005, most of which were S/. 0.10- and S/. 0.01-denominated, as showed in the table below.

TABLE 45
PRODUCTIONS OF COINS

Denomination	Amount (Millions of units)	Value (Millions of nuevos soles)
S/. 0.01	22.7	0.22
S/. 0.05	8.9	0.45
S/. 0.10	39.5	3.95
S/. 0.50	14.6	7.30
S/. 1.00	14.6	14.60
S/. 2.00	6.0	12.00
S/. 5.00	6.0	30.00
Total	**112.3**	**68.52**

Source: BCRP.

Moreover, 870 silver and 40 gold commemorative coins were also minted.

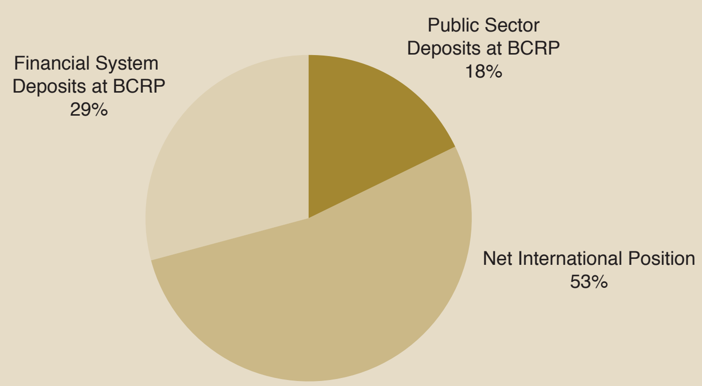
5. Net international reserves (NIRs)

The Peruvian economy continued to show a sound international position in 2005 based on the high level of Net International Reserves (NIRs) that the Central Bank maintained. As of the close of the year, NIRs amounted to US$ 14,097 million, that is to say, US$ 1,466 million more than in 2004.

This positive level of NIRs resulted mainly from the banks' higher deposits (US$ 1,251 million) and the Central Bank's net purchases of foreign currency (US$ 767 million), a figure partially offset by public sector withdrawals for a total of US$ 587 million.

The Central Bank's international position rose by US$ 812 million mainly as a result of exchange operations carried out during this year. By the end of 2005, the BCRP's international position amounted to US$ 7,451 million, representing 53 percent of total NIRs, a similar level to that of 2004.

GRAPH 30
NIR COMPOSITION AT DECEMBER 31, 2005



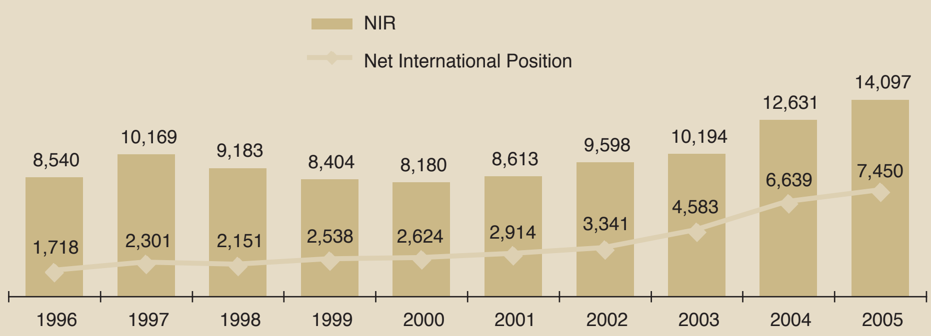
Source: BCRP.

TABLE 46
NET INTERNATIONAL RESERVES SOURCES OF CHANGE
(Millions of US$)

	2003	2004	2005
I. Foreign exchange operations	**998**	**1,854**	**767**
1. Over-the-counter net purchases	1,050	2,340	2,699
- Purchases	1,050	2,340	3,130
- Sales	-.-	-.-	431
2. Public sector	-51	-487	-1,935
3. Other	-1	2	3
II. Financial system and private sector deposits	**-488**	**23**	**1,251**
1. Commercial banks	-361	124	1,265
2. Banco de la Nacion	-137	-108	-12
3. Other	9	7	-2
III. Public sector deposits	**-139**	**359**	**-587**
IV. Other	**226**	**201**	**35**
V. TOTAL	**596**	**2,437**	**1,466**
Balances as of December 31:			
Net international reserves	10,194	12,631	14,097
Net international position	4,583	6,639	7,450
Deposits of the financial system	2,892	2,915	4,165
Deposits of the public sector at the BCRP	2,761	3,120	2,533

Source: BCRP.

GRAPH 31
NET INTERNATIONAL RESERVES AND NET INTERNATIONAL POSITION
(Millions of US$)



Source: BCRP.

Managing international reserves

In 2005, gross international reserves (GIRs) increased by US$ 1,471 million (11.6 percent) with respect to their level as of December 2004 to reach US$ 14,120 million. As of the close of the year, 61 percent of gross reserves were invested in liquid assets, while 32 percent were deposits in banks abroad.

TABLE 47
GROSS INTERNATIONAL RESERVES
(Milllons of US$)

Heading	12.31.2004		12.31.2005	
	Amount	%	Amount	%
Foreign deposits	4,305	34.0	4,485	31.8
Securities	7,488	59.2	8,687	61.5
Gold	489	3.9	576	4.1
Others 1/	368	2.9	372	2.6
TOTAL	**12,649**	**100.0**	**14,120**	**100.0**

1/ Includes contributions to the FLAR and balances from international agreements.
Source: BCRP.

As of the close of 2005, the BCRP's liquid international reserve assets –that is to say, Gross International Reserves less subscription to the FLAR, balance for international agreements (ALADI), and vault holdings, mainly gold– amounted to US$ 13,463 million. The main component of this balance were investments in dollars, although the share of the latter decreased with respect to 2004 from 88.4 to 79.1 percent, while investments in other currencies increased. In terms of the risk involved, most of these investments are grade "AAA" (60 percent of the portfolio), although those involving an intermediate level of risk "A" have increased their share from zero to up to 4.1 percent in December 2005.

TABLE 48
COMPOSITION OF INTERNATIONAL LIQUIDITY ASSETS
(Percentage structure)

	2004	2005
1. By currency and gold	**100.0**	**100.0**
US$	88.4	79.1
Other currencies	9.6	18.8
Gold	2.0	2.1
2. By maturity	**100.0**	**100.0**
0-3 month	46.4	56.8
3-12 month	26.3	13.2
1-5 years	27.3	30.0
3. By long-term qualification	**100.0**	**100.0**
AAA	59.9	60.0
AA+/AA/AA-	40.1	35.9
A+/A	-.-	4.1

Source: BCRP.

In terms of maturities, investments with less than 3-month maturities increased from 46.4 to 56.8 percent, while those with maturities of over a year increased from 27.3 to 30 percent. The average maturity was 0.8 years, and the average accounting profitability was 2.8 percent.

The exchange position by currencies was as follows: 58 percent in US dollars; 29 percent in euros; 4 percent in sterling pounds; and 1 percent in Canadian dollars. The other 8 percent remained as investments in gold.

6. Financial savings and capital market

The expansion of the financial system may also be analyzed through the growth of financial savings, which includes all financial system obligations to the private sector except for cash (banknotes and coins held by the public and demand deposits). In 2005,

TABLE 49
FINANCIAL SAVINGS
(Average of period balances, as a percentage of GDP)

	Domestic Currency	TOTAL
1996	4.4	17.5
1997	5.2	19.8
1998	6.3	22.2
1999	7.1	24.9
2000	7.9	25.6
2001	9.1	26.7
2002	10.6	27.5
2003	12.2	28.6
2004	13.4	28.1
2005	15.4	29.0

Source: BCRP.

financial savings represented 29 percent of GDP, a level 1percentage point and 11.5 percentage points higher than in 2004 and in 1996 respectively. This growth was associated mainly with higher deposits and with increased institutional savings through mutual funds, private pension funds, and life insurance systems.

The growth of financial savings was fueled by savings in nuevos soles, which grew 25 percent in real terms, and rose from 13.4 percent to 15.4 percent in GDP terms, mainly as a result of the growth produced in terms of pension funds and banking entities.

Financial savings in dollars, on the other hand, grew 3.7 percent in real terms, a result explained mainly by higher deposits in banks given electoral uncertainty.

a. Primary bond market

In 2005 the balance of bonds issued by private companies grew by 8 percent, although showing a slower pace than in 2004 –when a growth rate of 21 percent was logged– due to a greater flow of maturities resulting from the advance redemption of bonds during the first half of the year. Taking into consideration only non-financial private companies, the number of issuers increased from 38 to 43.

As in previous years, the expansion of the bond market was mainly associated with the growth of corporate issues by non-financial private companies. In 2005, the balance of securitization bonds by private companies increased considerably (55 percent) and so did short-term instruments (115 percent), both with respect to 2004. Conversely, the balance of instruments issued by financial companies remained almost unaltered, although their composition was modified: securitization bonds by financial companies increased, while leasing bonds decreased. Non-financial companies contributing most heavily to this evolution included Hunt Oil, Telefónica del Perú, Egenor, Relapasa, Transportadora del Gas del Perú, Alicorp, and Edegel, which together accounted for a total of S/. 2,118 million. This represents 43 percent of total placements in the domestic market throughout the year.

Despite the increase of interest rates in dollars, the ratio of bonds in this currency, particularly short-term bonds and instruments, remained stable throughout the year. On the other hand, sol-denominated bonds increased from 17 to 20 percent –due to substitution of inflation-indexed instruments, which fell from 17 to 14 percent– reflecting the longer maturities in soles and reduction of interest rates that allowed companies to issue debt in soles with up to 10-year maturities. Government's issues played an important role in this process as investors used them as a benchmark to value their private issues in nuevos soles.

b. Stock market

In 2005, the Lima Stock Exchange (LSE) continued to exhibit an important dynamism and recorded, for the fourth consecutive year, positive results: a growth of 29.4 percent in the General Index and of 24.7 percent in the Blue Chip Index. In terms of sectors, it is worth highlighting a 105.2 percent increase in the shares of banking and financial entities, as well as a 41.4 percent raise in investment shares.

The volume of transactions during the year amounted to S/. 12,023 million, of which S/. 8,753 million were shares (73 percent of total) and S/. 3,270 million were bonds.

In real terms, the volume of transactions increased 40.8 percent during 2005; shares augmented 62.2 percent, while bonds increased 4.0 percent. The number of operations also improved by 15 percent with respect to the previous year.

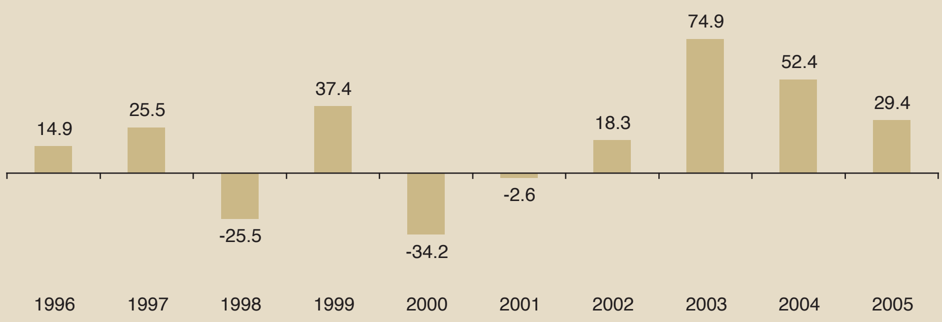
The value of market capitalization grew 87 percent, reaching a level equivalent to 34.5 percent of GDP. It is worth mentioning that the capitalization of Southern Peru increased when this company bought the shares of Minera Mexico, after which new shares were issued on behalf of America Mining Corporation, the entity controlling the shares of the Mexican company.

TABLE 50
STOCK MARKET

				Percentage change	
	2003	2004	2005	2004	2005
INDICES (end-of-period)					
(December 1991=100)					
General Stock Index	2,435.0	3,710.4	4,802.3	52.4	29.4
Blue Chip Index	3,993.9	6,159.6	7,681.1	54.2	24.7
Index Peru-15	4,172.1	6,698.7	8,440.1	60.6	26.0
Index ID1-BVL 1/	1,853.5	2,072.4	2,481.9	11.8	19.8
TRADING VOLUME	**7,836**	**8,415**	**12,023**	**7.4**	**42.9**
(Millions of nuevos soles)					
Variable Income	3,963	5,316	8,753	34.1	64.6
Fixed Income	3,873	3,099	3,270	-20.0	5.5
LSE MARKET CAPITALIZATION					
Millions of nuevos soles by December 2005	58,693	67,317	124,062	14.7	84.3
Millions of US$	16,084	20,108	36,196	25.0	80.0
(Percentage of GDP)	23.6	26.4	34.5		

1/ Index ID1-BVL is an indicator elaborated and calculated by BVL to measure the stock portfolio yield of equities that represents the average positioning of Pension funds.
Source: Lima Stock Exchange.

GRAPH 32
LIMA STOCK EXCHANGE
Annual Profitability 1996 - 2005 1/



1/ Yield at last day of year.
Source: Lima Stock Exchange.

c. Private pension system

By December 2005, the value of private pension funds had reached S/. 32,223 million –a level 25.6 percent higher than in 2004 and equivalent to 12.3 percent of GDP. Moreover, the number of affiliates had increased 7.1 percent to 3.6 million.

Real profitability of the pension funds was 18.4 percent, a level above the historic average of 8.8 percent in real terms achieved in the last 10 years. This higher profitability was associated with the better performance exhibited by shares, which had a profitability of 19.8 percent in nominal terms (against 11.8 percent in 2004), according to the LSE's Derivative Index. The system's real profitability (discounting commission charged by pension funds to their affiliates) was close to 6.2 percent by the close of the year.

TABLE 51
PRIVATE PENSION SYSTEM

	2003	2004	2005
Number of affiliates			
In thousand	3,193	3,397	3,637
Percentage change, end-of-period	6.7	6.4	7.1
Fund Value			
In millions of nuevos soles	21,844	25,651	32,223
Percentage change, end-of-period	38.7	17.4	25.6
As a percentage of GDP	10.3	10.8	12.3
Return (in percentages)			
Nominal	24.2	9.3	20.2
Real	21.2	5.6	18.4
Real net of fees 1/	4.4	4.8	6.2

1/ Annualized historic yield. Since 2004 corresponds to the SBS publication.
Source: SBS.

In terms of the portfolio's composition, the share of government securities decreased from 24.2 to 20.3 percent, while other securities issued by companies from the non-financial sector increased from 3.9 to 9.3 percent (namely investment funds and securitized assets, partly backed by foreign assets). On the whole, investments in non-financial private companies' instruments increased their participation from 52.2 percent to 55.6 percent of the fund's value. Investments abroad maintained a participation of 10.1 percent, close to the 10.5 percent maximum limit allowed by regulations.

AFP Prima, a new administrator of pension funds, initiated operations during 2005, thus increasing the number of pension fund administrators to five. It should be also pointed out that a multi-fund system, which allows affiliates to choose up to three types of funds according to their tolerance to risks, became effective since November 2005. As of December 2005, the composition of these funds was: 7 percent of type-1 funds (conservative); 92 percent of type-2 funds (moderate risk); and 1 percent of type-3 funds (risky).

d. Mutual funds

During the year, investments managed by mutual funds partially recovered from the fall they experienced in 2004 as a result of the increases produced in international interest rates. Mutual funds in the hands of the non-financial private sector increased nearly 20 percent, while the number of participants grew by 40 percent, outnumbering 115 thousand by the end of the year.

TABLE 52
MUTUAL FUNDS

	2003	2004	2005
Number of participants			
(In units)	66,655	82,568	115,413
Percentage change, end-of-period	20.8	23.9	39.8
Funds value 1/			
In millions of nuevos soles	5,752	5,347	6,431
Percentage change, end-of-period	24.7	-7.0	20.3
As a percentage of GDP	2.7	2.2	2.5
Composition			
Mixed-income funds	0.4	2.2	2.9
Fixed-income funds	99.6	97.8	96.8
In nuevos soles	12.0	10.7	15.4
In US$	87.6	87.1	81.4
Structured	-	-	0.3
Yields (In percentages)			
Mixed-income funds (nominal)	33.8	6.5	6.2
Mixed-income funds (real)	30.6	2.9	4.6
Fixed-Income funds (nominal)	1.3	-2.4	3.4
In nuevos soles	3.9	2.1	4.3
In US$ 2/	0.9	-3.0	3.2
Fixed-income funds (real)	-1.2	-5.7	1.9
In nuevos soles	1.4	-1.3	2.8
In US$	-1.5	-6.3	1.7

1/ Numbers represent the shares of mutual funds held by households and non-financial private corporations.
2/ Yields in dollars plus the effect of the nuevo sol revaluation.
Source: CONASEV and BCRP.

Fixed-income funds in nuevos soles continued to increase their share in the system, rising from 11 to 15 percent due to the higher yield of these funds (4.3 percent on average) in comparison with those in dollars, which had an average profitability of 3.2 percent. Mixed funds continued to have a minority share of 3 percent as of December 2005.

In terms of changes in the composition of the investment portfolio, it is worth mentioning the following: the financial system's deposits and instruments decreased from 45 to 40 percent; holdings of sovereign bonds decreased from 18 to 8 percent; while corporate securities and other agreed-upon operations increased from 32 to 36 percent and from 1 to 7 percent respectively.

A great deal of the fall in holdings of sovereign bonds may be explained by the participation of mutual funds in a debt-exchange operation carried out in May, whereby mutual funds sold approximately US$ 141 million.

Another element worth mentioning is that a new type of mutual funds, called structured funds, started operating since December 2005. Structured funds enable fund administrators to ensure a minimum yield provided that they are supported by a guarantee (bank deposit, warrant or insurance in the name of Conasev). In order to do so, structured funds are allowed to invest up to 15 percent of the fund's value in derived instruments issued in the country or abroad.