Introduction

In 2009 the Peruvian economy had to face a series of challenges derived from the international financial crisis that generated the deepest global recession observed since the postwar era. At end 2009 the global economy recorded a drop in the level of global economic activity for the first time in sixty years, having reached its lowest level in Q1 when global production contracted by around 7 percent in deseasonalized terms in the last 12 months.

In this scenario, the unprecedentedly strong monetary and fiscal policy measures applied in developed countries generated their first results towards the second semester of 2009, when the global economy already started showing signs of recovery and the cycle of inventory adjustment was coming to an end.

In Peru, monetary policy efforts were aimed at offsetting the negative impact of the international financial crisis on the economy through monetary and credit easing, generating monetary and credit conditions consistent with inflation being under control.

To do so, the Central Bank implemented a policy of interest rate cuts, as a result of which the reference rate was lowered to minimum historical levels: from 6.5 percent in January to 1.25 percent in August. Prior to this, the BCRP had implemented non-conventional monetary measures aimed at providing the market with liquidity and prevent a contraction of credit that could significantly weaken monetary policy transmission mechanisms.

The series of monetary easing measures applied, which represented an injection of liquidity equivalent to 9.6 percent of GDP, contributed not only to maintain the flow of credit during the year, but also allowed credit to grow over the year and even in Q4-2008, during the peak of the deterioration of international credit conditions. The fiscal policy was also expansionary in order to counterbalance the effects of the slowdown of private domestic demand and external demand.

Economic activity in the country grew 0.9 percent in 2009, while it dropped 0.6 percent on average in the global economy and 3.2 percent in developed countries. In contrast with what happened in industrialized countries, employment in Peru continued growing, thus allowing private consumption to continue growing too, even though both employment and private consumption recorded lower growth rates than in 2008. In addition to inventories, the component of domestic demand that was most heavily affected during the year was private investment, which declined 15.1 percent.

The monetary policy actions adopted in 2009 translated into lower interest rates, especially shorter-term and lower risk rates, in both the financial system and the capital market, in line with the reductions of the reference rate. Similarly, the interest rates on credit to micro-businesses and mortgage loans continued declining, responding with some lag to monetary stimulus.

Monetary easing was also reflected in the evolution of monetary aggregates: liquidity in domestic currency grew 15.0 percent, credit to the private sector grew 9.2 percent, and the ratios of dollarization of liquidity and credit declined from 46 to 42 percent and from 52 to 46 percent, respectively.

As regards the implementation of fiscal policy, non financial expenditure increased by a real 13 percent as a result of the Economic Stimulus Plan launched in early 2009, with capital expenditure recording an increase of 41 percent. This, together with the reduction of tax revenues due both to lower terms of trade and to the deceleration of economic activity, generated a fiscal deficit equivalent to 1.9 percent of GDP. This result contrasted with the consecutive fiscal surpluses recorded in the earlier three years.

The rate of inflation declined from 6.65 percent in 2008 to 0.25 percent at end 2009. This evolution reflected mainly the reversal of the supply shocks that caused the prices of food and fuels to increase in 2008, as a result of which non-core inflation declined from 8.11 percent in 2008 to -2.54 percent in 2009.

Because the level of economic activity was lower than the potential level, no demand pressures were observed and inflation expectations returned to the target range. In contrast with the deficit of 3.7 percent of GDP recorded in 2008 due to lower imports in a context of moderate growth and de-stocking, the current account of the balance of payments showed a surplus of 0.2 percent of GDP in 2009.

In order to reduce the volatility of the exchange rate caused by movements of economic agents' portfolio positions amid uncertainty and higher risk aversion in international financial markets, the Central Bank intervened in the foreign exchange market purchasing or selling foreign currency. The purpose of these interventions was to offset the risks of equity losses for individuals and firms in an economy that still maintains a high level of financial dollarization.

During the first quarter, when strong depreciatory pressures still persisted, the Central Bank sold foreign currency in the foreign exchange market for a total of US$ 1,149 million and placed Indexed Certificates of Deposit for a total of US$ 1,727 million. Towards the end of March, the prices of commodities started to increase due to the reactivation of China and to expansionary monetary policies. This generated a reversal of depreciatory trends, which led the region's currencies to recover the levels they had prior to the crisis. Between March and December, the Central Bank purchased foreign currency for a total of US$ 1,256 million and amortized Indexed Certificates of Deposit for a total of US$ 3,148 million.

In this way, the Central Bank's policy of intervention in the foreign exchange markets not

only prevented the economy from being affected by abrupt temporary changes in the foreign exchange rate which could have affected economic agents' decisions, but also allowed the Central Bank to accumulate US$ 1,939 million in reserves. As a result of this, net international reserves at end 2009 amounted to US$ 33,135 million, a sum equivalent to nearly five time total short-term liabilities and 26 percent of GDP.