Introduction

In 2011, the world economy faced again several events that affected growth especially in developed countries. The debt crisis in the Eurozone, the weak recovery of employment and consumption in the United States, the earthquake in Japan, and the rise in the price of crude had also an impact on growth in emerging economies.

Uncertainty associated with the Eurozone crisis increased risk aversion and volatility in financial markets. The effects of the crisis extended also to foreign exchange markets, leading the dollar to show an appreciatory trend against the euro. Investors' demand for safer assets in debt markets, especially for lower risk securities such as US sovereign bonds, increased as well. All of these factors resulted in a slowdown in the pace of growth of global economic activity, global growth declining from 5.2 percent in 2010 to 3.7 percent in 2011.

In the domestic front, the economic slowdown was associated with the uncertainty which usually arises in a year of national elections. Thus, while private consumption continued to grow at high rates during nearly all the year, the evolution of public spending and private investment, especially in the second semester, led to a slowdown in domestic demand. As a result of this, GDP growth fell from 8.8 percent during 2010 to 6.9 percent in 2011. The latter is close to the potential GDP rate and higher than the average growth rate in the period 2002-2011 (5.8 percent).

On the other hand, the rate of inflation rose from 2.08 percent in 2010 to 4.74 percent in 2011, falling transitorily above the target range due mainly to the impact of some supply shocks. For example, the domestic prices of food and fuels rose due to the effect of the rise observed in the international prices of commodities since the last months of 2010. In addition, anomalous climatic conditions in some regions of the country during some months affected the cultivation and yields of some crops. Inflation excluding food and energy increased 2.4 percent in the year.

In a context of high uncertainty in external markets, dynamism in domestic demand, and rising prices of food and fuels in the first months of the year, the Central Reserve Bank of Peru (BCRP) continued to withdraw monetary stimulus by raising the reference interest rate and increasing the rates of reserve requirements to offset the growth of credit and liquidity in the domestic market.

The reference rate was raised from 3.0 percent in December 2010 to 4.25 percent in May 2011, while the rates of mean reserve requirements in both domestic currency and foreign currency were raised by 0.25 and 0.50 percentage points, respectively, in February and March. However, given the moderation of the growth of domestic economic activity and the lower growth foreseen in the world economy, the BCRP preventively maintained its reference rate at 4.25 percent.

In the first part of the year, interest rates –especially those with shorter maturity terms and lower risk– increased in line with the rises in the reference rate and the adjustments made in the rates of reserve requirements. However, in the second semester prime rates declined due to the pause the Central Bank made in raising the reference rate. Thus, after having risen from 3.6 percent to 5.6 percent between December 2010 and June 2011, corporate interest rates in domestic currency declined to 5.4 percent towards December.

Monetary aggregates grew in line with the dynamism of economic activity. Credit to the private sector increased 19.6 percent boosted by credit to households due to the improvement of consumer expectations and the sustained growth of employment, while the level of dollarization of this aggregate fell from 46 to 45 percent between 2010 and 2011.

In order to reduce excessive exchange rate volatility, during 2011 the BCRP bought foreign currency for a total of US$ 3.54 billion in the foreign exchange market. The supply of foreign currency came mainly from local private economic agents (US$ 9.22 billion), while the demand came from the forward market due to non-residents' need of coverage with holdings of government bonds. Through these interventions in the foreign exchange market, the BCRP accumulated international reserves for a total of US$ 4.71 billion, as a result of which international reserves at December 2011 amounted to US$ 48.81 billion (level equivalent to 28 percent of GDP).

Contrasting with the deficit of 0.3 percent recorded in 2010, a fiscal surplus of 1.9 percent of GDP was registered in 2011. This result is consistent with the growth of economic activity in the country and with the rise in the prices of our main export commodities, which had a positive impact on the current revenues of the general government. The latter, which increased by 1.0 percentage point relative to 2010, amounted to 21.0 percent of GDP. Government spending, on the other hand, grew 1.7 percent after having recorded a rate of 11.7 percent in the previous year due to lower expenditure in subnational governments.

The current account deficit in the balance of payments declined from 2.5 percent of GDP in 2010 to 1.9 percent of GDP in 2011. A higher trade surplus was observed as a result of both greater volumes of exports and better terms of trade. In an international context of lower demand, it is worth pointing out the increased diversification of markets and the higher share of Latin American *countries as destination of the country's total exports and particularly non-traditional exports. The financial account showed positive results associated with increased long-term capitals, especially in the case of mining, hydrocarbons, financial, and service companies.*