

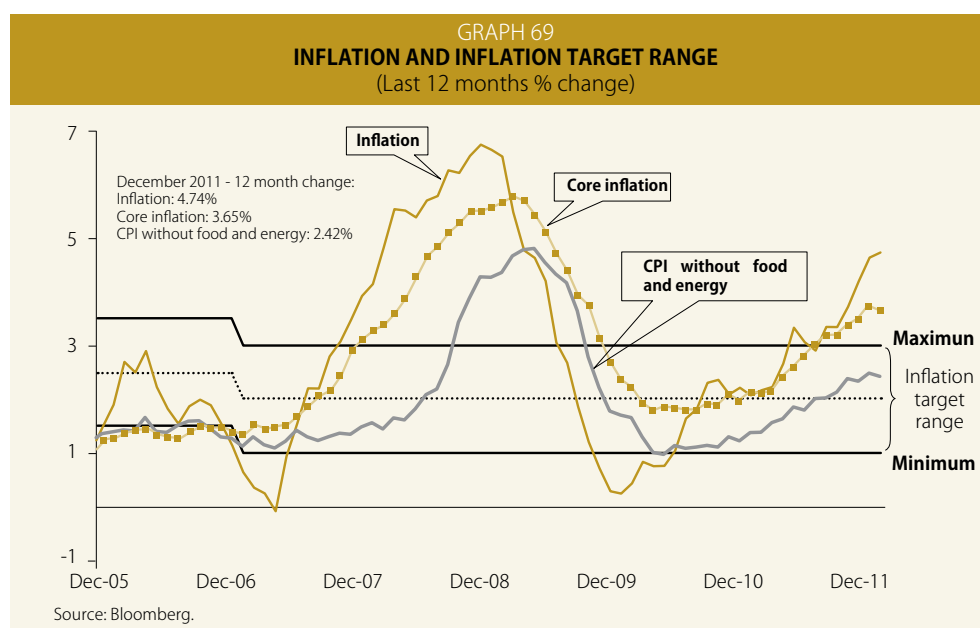
IV.

Inflation

In 2011 the consumer price index (CPI) of Metropolitan Lima recorded a growth rate of 4.74 percent after having shown a rate of 2.08 percent in 2010. This higher rate of inflation is explained by both external and domestic shocks.

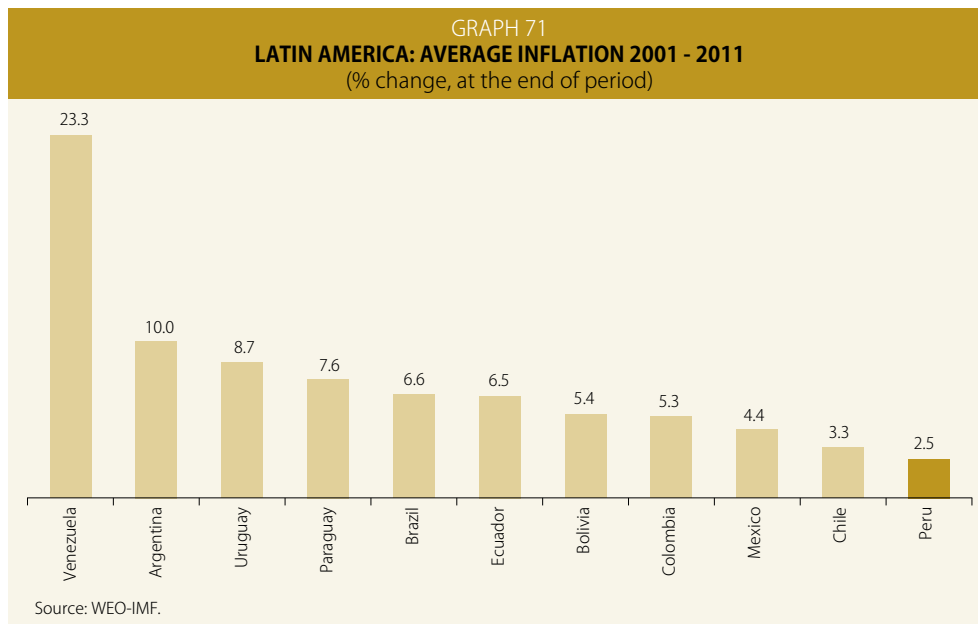
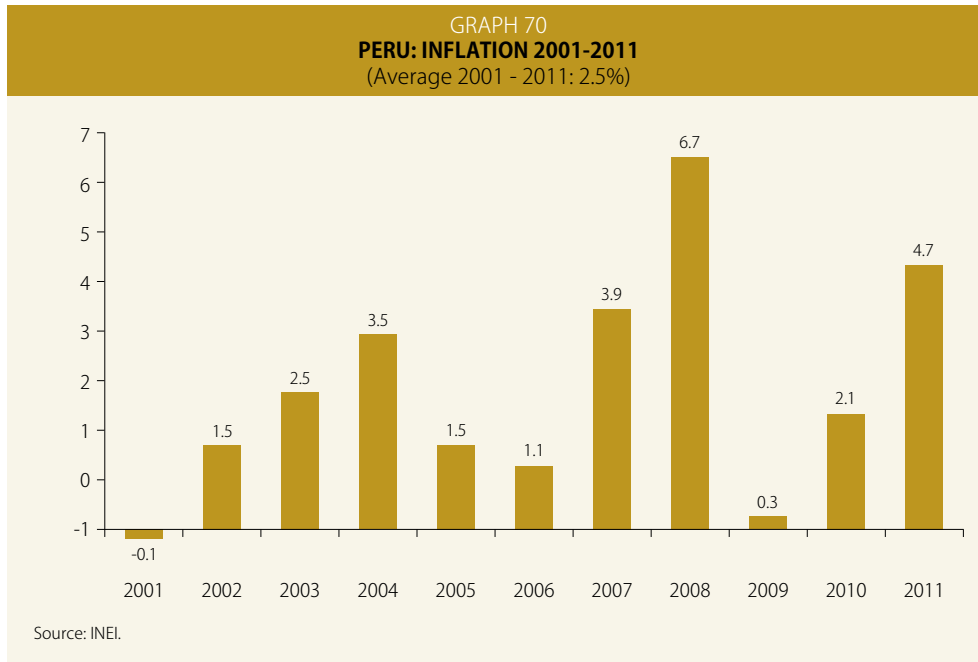
The rise in the international prices of commodities in 2010 affected the evolution of the domestic prices of food and fuels, especially in the first half of the year. Climate anomalies added onto these shocks, affecting the supply of some perishable food products, in August and November mainly, which led food prices to rise 8.0 percent. This rise accounts for 3.0 percentage points of the inflation rate recorded in the year.

As for the indicators of the inflationary trend, core inflation rose from 2.1 percent in December 2010 to 3.6 percent in December 2011, while inflation excluding food and energy rose from 1.4 to 2.4 percent in this period.





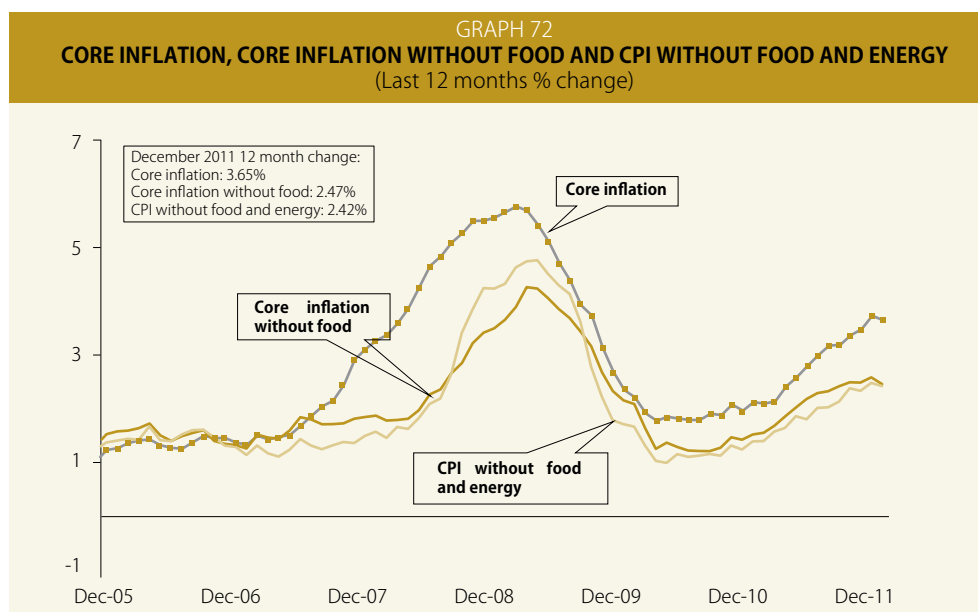
In 2001-2011, the rate of average annual inflation in Peru was 2.5 percent, one of the lowest rates in the Latin American region in this period.



Core Inflation

Core inflation, indicator of inflation's trend, rose from 2.1 percent in December 2010 to 3.6 percent in December 2011. This higher rise in inflation is mainly explained by the increase observed in food prices, since they rose from

3.2 percent in December 2010 to 5.8 percent in December 2011, while the prices of non-food items rose from 1.5 to 2.5 percent. A similar evolution was observed in the prices of goods and services.



As regards services, the prices of labor-intensive services showed a slowdown since 2008, whereas the prices of education (tuition and fees) recorded an annual average growth of 3.7 percent in the last decade.

TABLE 60
INFLATION
(% change)

	Weight	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average % change 2001-2011
CPI	100.0	-0.13	1.52	2.48	3.48	1.49	1.14	3.93	6.65	0.25	2.08	4.74	2.49
Education (fees and tuition)	8.8	3.97	2.70	3.02	4.63	2.44	3.62	3.57	3.93	4.58	3.51	4.33	3.66
Other personal services	3.33	1.08	0.28	0.25	0.24	0.24	2.72	1.71	2.74	1.65	1.12	1.29	1.21
Housekeepers	2.06	0.05	0.30	0.30	1.09	0.00	3.64	0.09	0.03	0.00	0.98	0.20	0.60
Services of personal care	0.57	1.95	0.60	-0.50	-1.40	0.30	3.03	2.75	4.78	3.39	1.01	3.15	1.72
Repairs of vehicles	0.20	0.50	-1.70	2.03	0.90	0.99	1.57	-0.29	7.13	2.17	0.00	0.86	1.27
Cleaning services	0.19	0.06	1.80	0.10	1.18	-1.16	1.08	2.82	1.72	-0.22	1.22	2.11	0.97
Miscellaneous repairs	0.09	0.58	-0.50	1.21	0.20	-0.20	0.60	5.92	3.58	1.74	3.73	4.60	1.93
Manufacture of diverse clothes	0.05	4.54	-0.30	-0.40	0.20	2.21	0.69	4.59	5.26	2.93	1.97	6.72	2.56
Radio and television repairs	0.03	0.00	0.40	1.59	0.78	0.39	0.68	4.91	2.51	2.97	0.00	0.37	1.32
Repair of furniture	0.02	0.00	1.60	0.00	0.00	-1.38	-2.59	4.92	0.03	1.02	0.00	0.00	0.31

Source: INEI.

Non-Core Inflation

Non-core inflation, indicator that reflects inflation short-term variations that are beyond the control of monetary policy, recorded a fast pace of growth since early 2010, rising from an annual rate of 2.0 percent in December 2010 to 6.8 percent in December 2011. This increase in non-core inflation was mainly driven by the rise in the prices of



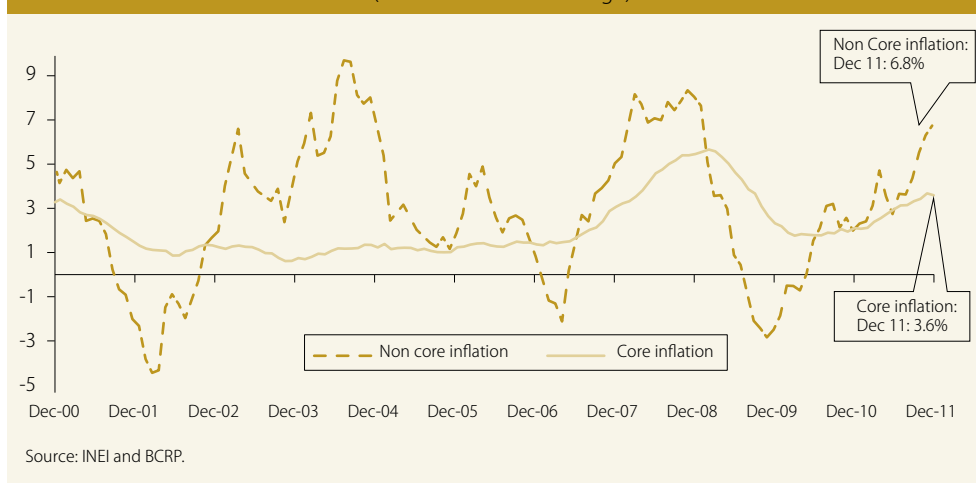
foodstuffs such as chicken meat, bread, and edible oil –up from 1.2 to 11.5 percent– as a result of the higher prices of imported inputs.

Another factor that contributed to this increase was the rise in the prices of fuels (7.5 percent), fares (3.5 percent), and electricity (4.3 percent).

TABLE 61
INFLATION
(Annual % change)

	Weight 2009=100	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average 2001-2011
I. Core inflation	65.2	1.30	1.23	0.73	1.23	1.23	1.37	3.11	5.56	2.35	2.12	3.65	2.16
1. Food	23.0	0.45	0.70	0.19	2.29	0.80	1.42	4.90	8.35	2.58	3.20	5.76	2.76
2. Non food	42.2	2.14	1.59	1.07	0.50	1.63	1.28	1.89	3.51	2.16	1.53	2.47	1.79
a. Goods	21.7	2.16	1.46	0.65	-0.38	0.87	0.64	1.72	3.29	2.32	1.07	2.37	1.46
b. Services	20.5	2.12	1.81	1.76	1.72	2.47	2.28	2.03	3.91	1.96	2.01	2.57	2.24
II. Non core	34.8	-2.36	1.96	5.16	6.75	1.87	0.83	5.07	8.11	-2.54	2.00	6.79	3.00
1. Food	14.8	-0.99	0.28	3.73	5.82	1.62	2.06	7.25	10.97	-1.41	1.18	11.50	3.73
2. Non food	20.0	-4.27	4.22	7.00	7.90	2.17	-0.67	2.37	4.39	-4.10	2.60	3.37	2.20
a. Fuels	2.8	-13.14	15.60	8.94	17.77	6.89	-1.50	6.45	-0.04	-12.66	12.21	7.54	3.89
b. Transportation	8.9	-0.02	0.11	10.99	3.49	1.29	1.12	0.82	5.86	0.37	1.94	3.61	2.64
c. Public Services	8.4	-2.73	1.96	-1.98	6.19	-1.72	-3.22	0.24	7.48	-2.31	0.01	1.50	0.44
III. Total	100.0	-0.13	1.52	2.48	3.48	1.49	1.14	3.93	6.65	0.25	2.08	4.74	2.49
Memo:													
Food	37.8	-0.21	0.50	1.89	4.00	1.13	1.76	6.02	9.70	0.57	2.41	7.97	3.20
CPI without food	62.2	-0.09	2.44	3.04	3.03	1.75	0.61	2.02	3.86	-0.07	1.87	2.76	1.92
CPI without food and energy	56.4	1.65	1.06	2.86	1.09	1.36	1.28	1.49	4.25	1.71	1.38	2.42	1.86

GRAPH 73
CORE AND NON CORE INFLATION
(Last 12 months % change)

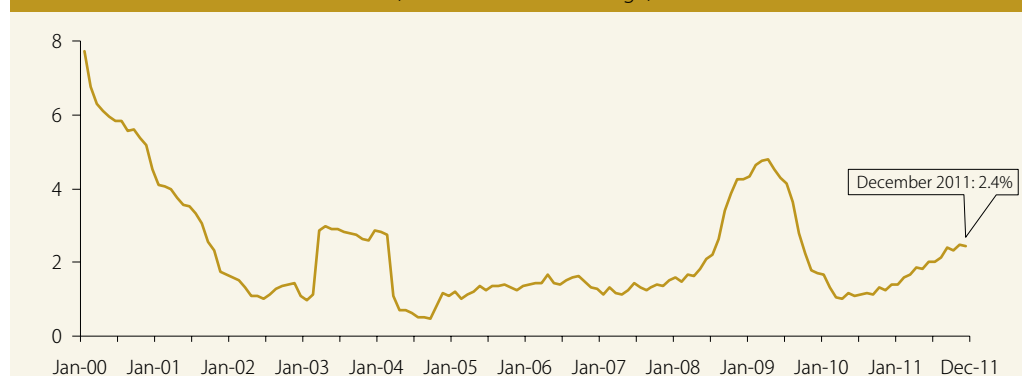


The items which contributed the most to the growth of inflation included meals outside the home, chicken meat, education, urban fares, and gasoline, while the items that contributed the most to reduce inflation were telephone rates and home rents.

TABLE 62
INFLATION

	Weight 2009=100	% Change 2011	Weighted contribution
I. CORE INFLATION	65.2	3.6	2.38
Goods	32.9	3.2	1.04
Food and beverages	11.3	4.7	0.53
Textiles and footwear	5.5	4.7	0.26
Domestic appliances	1.3	-1.1	-0.01
Other industrial products	14.9	1.8	0.26
Services	32.2	4.1	1.34
Meals outside home	11.7	6.8	0.82
Education	9.1	4.2	0.39
Health	1.1	1.9	0.02
Rent	2.4	-0.7	-0.02
Other services	7.9	1.7	0.13
II. NON-CORE INFLATION	34.8	6.8	2.36
Food	14.8	11.5	1.68
Chicken meat	3.0	16.5	0.43
Bread	1.9	7.5	0.14
Rice	1.9	10.8	0.19
Potato	0.9	2.4	0.02
Sugar	0.5	1.9	0.01
Noodles	0.5	5.3	0.03
Oils	0.5	22.2	0.11
Other foodstuff	5.6	13.1	0.74
Fuels	2.8	7.5	0.23
Oil and lubricants	1.3	14.3	0.22
Gas	1.4	1.0	0.01
Transportation	8.9	3.6	0.32
Urban Fares	8.5	3.5	0.30
National Transportation	0.3	5.2	0.02
Public services	8.4	1.5	0.12
Electricity	2.9	4.3	0.12
Telephone	2.9	-3.3	-0.09
Water consumption	1.6	5.8	0.10
III. CPI	100.0	4.7	4.74
Memo:			
Food	37.8	8.0	3.03
CPI without food	62.2	2.8	1.71
CPI without food and energy	56.4	2.4	1.36

Source: INEI and BCRP.

GRAPH 74
CPI WITHOUT FOOD AND ENERGY
(Last 12 months % change)

Source: INEI and BCRP.



In 2011, the CPI excluding food and energy registered 2.4 percent, a rate within the inflation target range. The item which contributed the most to the rise of this indicator was education costs (tuition and fees), which increased 4.3 percent.

Effect of International Prices

As mentioned above, the higher prices of commodities reflected in the higher domestic prices of fuels and food products.

In 2011 crude oil showed a higher price (US\$ 95 per barrel) than in the previous two years (US\$ 62 in 2009 and US\$ 79 in 2010). In 2010-2011, the price of gasoline registered an accumulated rise of 33.1 percent and the price of diesel a rise of 48 percent, influencing a rise of 3.5 percent in urban fares.

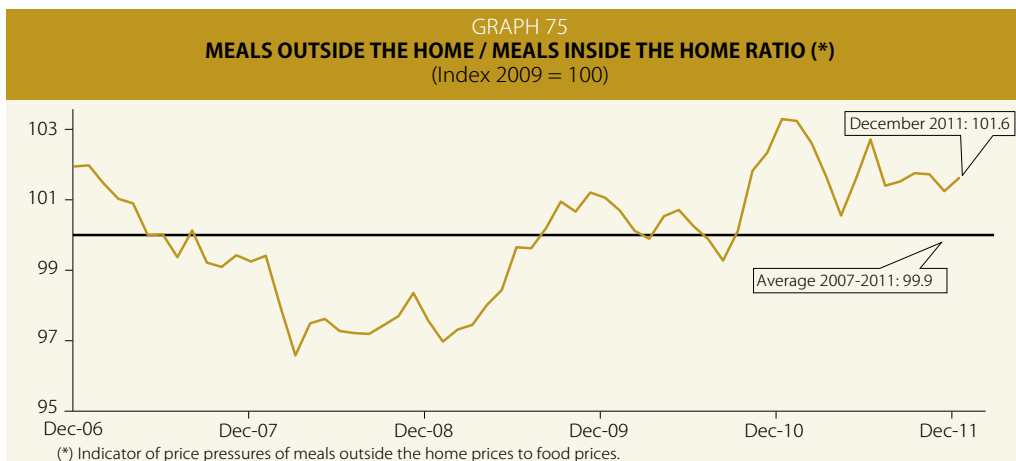
Moreover, the prices of fuels rose 7.5 percent on average, but the price of gasoline rose 14.3 percent as a result of the update of the price bands established by the Fuel Price Stabilization Fund (FPSF).

TABLE 63 FUEL PRICES (Annual % change)												
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average 2001-2011
Fuels	-13.1	15.6	8.9	17.8	6.9	-1.5	6.4	0.0	-12.7	12.2	7.5	3.9
Gasoline	-11.4	15.7	9.7	17.7	9.2	-6.2	10.7	-6.1	-15.8	16.4	14.3	4.2
Gas	-12.3	11.3	4.2	15.3	-10.9	0.3	1.3	2.7	-4.6	8.8	1.0	1.2
Price of WTI oil, end of period ^{1/}												
US Dollars	19.3	29.4	32.1	43.2	59.4	62.0	91.4	41.4	74.3	89.2	98.5	
Nuevos soles	66.4	103.5	111.6	141.9	203.5	198.8	272.4	129.1	213.8	251.2	265.6	

^{1/} West Texas Intermediate. Source: INEI and Bloomberg.

As for foodstuffs, the 16.5 percent rise observed in the price of chicken meat was influenced by a 57.3 percent increase in the international price of maize and by fluctuations in the supply of fish. Likewise, the 60.6 percent rise in the international price of wheat in 2010 affected the price of flour, which rose 14.6 percent in the last two years, as well as the price of bread, which rose 7.5 percent in 2011.

Moreover, the prices of meals outside the home rose 6.8 percent, reflecting the higher prices of food. An additional rise was associated with the adjustment of the minimum wage from S/. 600 to S/. 675 in August. According to a BCRP survey conducted in 40 restaurants, 84 percent of the participants surveyed reported salary rises.



Items Affected by Climate Anomalies

Both the cultivation and yields of some crops were affected by climate anomalies, which led to rises in the prices of some perishable farm products, such as vegetables, legumes, and fruits between August and December, which is usually the period when these prices fall. The prices of these items, which account for 4.2 percent of the consumer basket, rose 9.2 percent between August and September.

The price of papaya stands out among this group of prices, since it rose by a record level of 90 percent due to lower production. The supply of papaya dropped 33 percent compared to 2010 due to abundant rainfall in the main producing areas like Ucayali and San Martín and affected both the yield and the transportation of this product.

The production of rice was also affected by climate anomalies, which led the price of rice to increase 10.8 percent. The highest rises were recorded in March and May, when production dropped in Piura, Lambayeque, and San Martín due to scarce and irregular rainfall in the sowing period.

Other Items Which Showed High Rises

Education (tuition and fees) rose 4.3 percent after having risen 3.5 percent in 2010. Education costs contributed with 0.4 percentage points to the rise of inflation in the year due to the adjustments in the prices of education in schools, universities, and higher education institutes.

Electricity rates rose 4.3 percent due to the adjustments established by OSINERGMIN, the regulating organization, in the months of January, April, and August to update the rates of electricity generation, transmission, and distribution due to the higher costs of fuels and metals such as copper and aluminum. These rises were offset by a 2.8 percent rate reduction in February due to the update of the electricity generation price made by OSINERGMIN every three months and by a 2.9 percent rate reduction in May due to the annual adjustment in the electricity generation price as a result of tender processes.

The water rate rose 5.8 percent due to adjustments made in January, February, and June. This rise is based on the Ley General de Servicios de Saneamiento, which entitles SEDAPAL to raise water rates whenever the wholesale price index (WPI) shows accumulated variations of 3 percent or more.

TABLE 64
PUBLIC UTILITIES RATES
(Annual % change)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average 2001-2011
Public utilities	-2.7	2.0	-2.0	6.2	-1.7	-3.2	0.2	7.5	-2.3	0.0	1.5	0.4
Electricity	-6.3	7.9	-4.6	12.0	-2.5	-7.3	1.9	6.3	-4.6	1.4	4.3	0.6
Telephone	1.1	-8.3	0.3	-2.0	-7.0	-6.2	-7.2	-4.2	-1.4	-3.8	-3.3	-3.9
Water	0.0	2.3	0.9	3.0	5.2	8.5	3.2	18.9	0.0	4.5	5.8	4.6

Source: INEI.



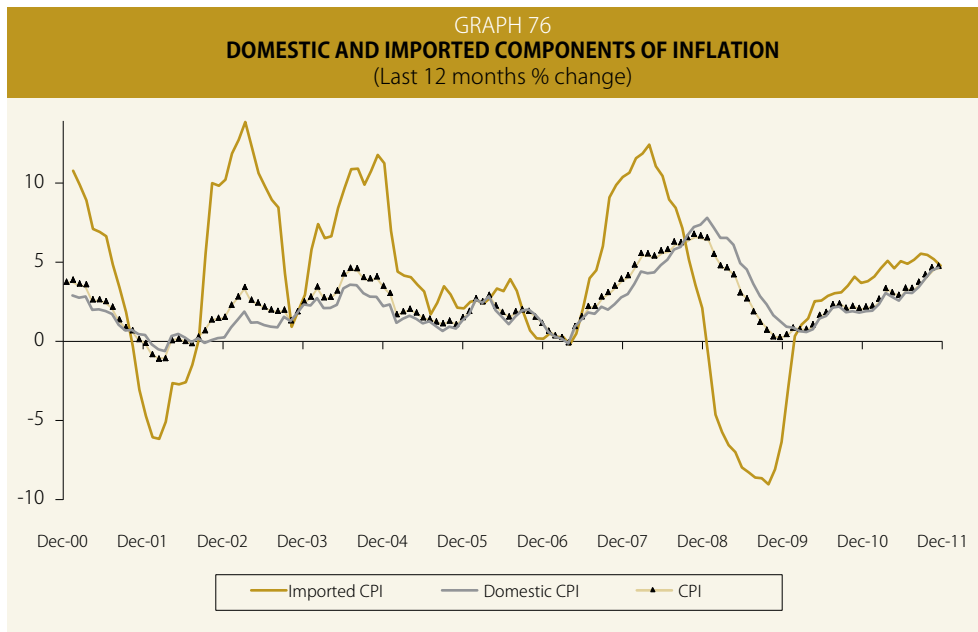
Imported Inflation

The imported component of the CPI rose 4.9 percent due to the higher prices of food (9.6 percent) and fuels (7.5 percent).

TABLE 65 DOMESTIC AND IMPORTED INFLATION (Annual % change)													
	Weight	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average 2001-2011
I. IMPORTED CPI	10.8	-4.61	10.30	3.03	11.33	2.18	0.27	10.46	2.20	-6.25	3.78	4.87	3.27
Food	3.0	-1.18	9.98	-0.10	10.90	-1.49	2.08	18.83	4.75	-3.07	0.76	9.59	4.44
Fuels	2.8	-13.14	15.60	8.94	17.77	6.89	-1.50	6.45	-0.04	-12.66	12.21	7.54	3.89
Domestic appliances	1.3	-0.19	3.42	-1.91	-2.83	-1.23	-1.29	-1.50	-0.06	-2.39	-0.58	-1.13	-0.89
Others	3.7	4.99	3.39	1.40	3.23	2.27	0.64	0.47	0.46	-0.34	1.20	0.83	1.67
II. DOMESTIC CPI	89.2	0.47	0.30	2.40	2.28	1.38	1.28	2.84	7.44	1.35	1.87	4.72	2.38
III. CPI	100.0	-0.13	1.52	2.48	3.48	1.49	1.14	3.93	6.65	0.25	2.08	4.74	2.49
Exchange rate		-2.40	2.29	-1.23	-5.48	4.36	-6.40	-7.00	4.47	-7.59	-2.15	-4.24	-2.40

Source: INEI and BCRP.

However, the nominal appreciation of the nuevo sol (4.2 percent) against the dollar contributed to reduce the prices of imported products. Thus, for example, the prices of electrical appliances fell 1.1 percent.



BOX 7

FOOD INFLATION IN 2011

Inflation in 2011 fell above the upper bank of the inflation target range (2 percent, plus or minus one percentage points), with food prices accounting for 3.0 percentage points of inflation in the year due to the impact of the higher international prices of food inputs on domestic prices, as well as due to the impact of climate anomalies that affected the supply of some perishable food products, especially between August and November.

WEIGHTED CONTRIBUTION TO INFLATION			
Item	Weight	2011	
	2009=100	% Change	Weighted contribution
INFLATION	100.0	4.7	4.74
<i>Of which:</i>			
Food	37.8	8.0	3.03
Items affected by international prices	10.0	10.6	1.02
<i>Of which:</i>			
Poultry	3.0	16.5	0.43
Bread	1.9	7.5	0.14
Noodles	0.5	5.3	0.03
Edible oils	0.5	22.2	0.11
Items affected by climatological changes	4.9	14.2	0.69
<i>Of which:</i>			
Papaya	0.2	90.2	0.13
Carrot	0.1	88.7	0.09
Citrus	0.5	8.2	0.05
Corn	0.1	38.8	0.05
Fresh vegetables	0.2	22.4	0.05
Pumpkin	0.1	40.7	0.03
Tomato	0.2	14.2	0.03
Meals outside the home	11.7	6.8	0.82
Other foodstuffs	11.1	4.4	0.50
Fuels and urban fares	11.3	4.6	0.54
<i>Of which:</i>			
Gasoline and oil	1.3	14.3	0.22
Urban fares	8.5	3.5	0.30
CPI without food and energy	56.4	2.4	1.36



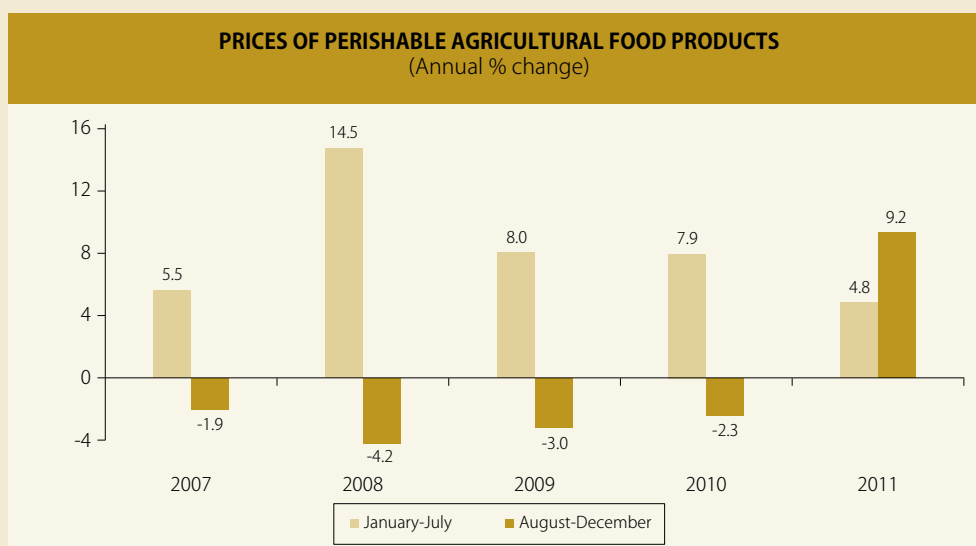
Effects of International Prices

The prices of food inputs have risen since mid-2010 as a result of the lower production caused by climate problems in the main producing countries (crops were affected by a drought in Russia and by the effects of La Niña in Argentina, Australia, and Canada). The economic growth of China and India, with the increased demand for food products this implies, added to this. The upward trend observed in these prices began to reverse in Q2 due to the effect of the slowdown of global demand and the improvement registered in the production of the main exporting countries of these products. This had an impact on the final price of foodstuffs which have a significant weight in the consumer basket –i.e. chicken, bread, noodles, and oils– and showed the highest rises in 2011.

FOOD: INTERNATIONAL PRICES OF INPUTS AND CONSUMER PRICE (Annual % change)				
	2008	2009	2010	2011
Eviscerated chicken (S/. per kg)	15.4	3.7	-13.2	17.2
Maize (US\$ per MT)	-17.8	8.1	57.3	5.7
Soybean tart (US\$ per MT)	-13.9	24.4	5.1	-16.4
Bread (Pan francés) (S/. per kg)	0.7	-1.4	0.9	5.8
Noodles (S/. per kg)	4.9	-2.4	0.3	7.0
Wheat (US\$ per MT)	-44.2	-9.8	60.6	-14.0
Bottled vegetable oil (S/. per liter)	25.2	-15.9	-1.3	18.3
Soybean oil (US\$ per MT)	-35.1	25.3	40.7	-2.9

Items Affected by Climate Anomalies

The climate anomalies observed between August and December 2011 translated into rises in the prices of some perishable farm goods (vegetables, legumes, and fruits). The prices of these items, which account for 4.2 percent of the consumer basket, rose 9.2 percent instead of declining due to seasonal factors, as expected.



Moreover, a significant reduction was observed in the production of the areas that supply foodstuffs to Lima due to the decline of sown areas.

CROPS Hectares				
By main area of origin August-July crop year				
		2009-2010	2010-2011	% change
Carrot	Lima	2,095	1,808	-13.7
	Junin	2,530	2,298	-9.2
Onion	Arequipa	9,465	8,640	-8.7
Peas	Lima	1,344	1,180	-12.2
	Huanuco	3,270	3,317	1.4
	Junin	5,961	5,857	-1.7
Tomato	Lima	1,363	1,225	-10.1

In addition, the yields of some crops were affected by La Niña, especially in the central coast areas. The cultivation of tomato registered lower yields since July, while the yield of green peas declined since August.

YIELDS IN THE VALLEYS OF LIMA MT per hectares						
	Tomato			Green pea		
	2010	2011	% Chg.	2010	2011	% Chg.
January	28.2	31.4	11.4	3.6	4.7	31.5
February	29.9	31.9	6.6	3.6	3.9	6.8
March	29.3	30.4	4.0	3.8	4.5	17.0
April	25.9	34.5	33.4	4.0	4.3	7.9
May	27.8	30.9	11.4	3.7	3.7	1.0
June	31.6	34.9	10.2	3.8	3.9	2.4
July	35.6	31.8	-10.7	4.1	4.5	10.4
August	29.6	29.2	-1.3	4.9	4.5	-6.8
September	29.5	26.9	-8.9	5.1	5.1	-1.6
October	26.3	26.0	-1.3	6.0	5.0	-16.1
November	27.8	25.6	-8.0	5.4	5.3	-1.1
December	26.2	25.0	-4.8	4.9	5.1	4.7

Source: Ministry of Agriculture.

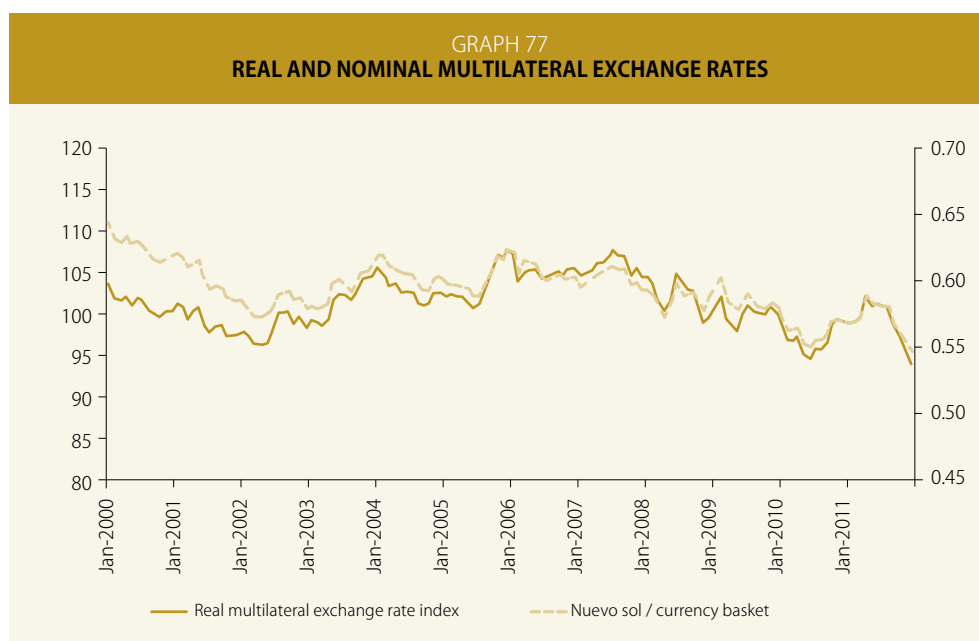


The food items in this group that showed the highest price rises were papaya (90.2 percent) and carrots (88.7 percent). The supply of papaya dropped 33 percent compared to 2010, as the cultivation and transportation of this crop was affected by heavy rains in the main producing areas (Ucayali and San Martín). According to the Dirección Regional Agraria of Ucayali, farmers reduced their production due to the price fall observed in the previous year due to excessive supply in several selva areas. In addition, some phytosanitary problems forced producers to seek more distant lands to cultivate papaya, which also raised production costs.

The production of carrots was affected by the lower number of sown areas in Lima in August-July compared to the previous crop period (down 13.7 percent). The higher costs of fertilizers also affected farmers' intentions to cultivate carrots in Lima, the main producing area of this crop in the second half of the year, while production costs in Junín were higher since this crop was affected by the pest locally known as manto rojo.

Exchange Rate

In 2011 the nuevo sol appreciated 4.2 percent against the US dollar, the latter falling from S/. 2.82 in December 2010 to S/. 2.70 in December 2011. Furthermore, the nuevo sol appreciated 4.0 percent against the currency basket of our main trading partners, from S/. 0.569 in December 2010 to S/. 0.546 in December 2011. In real terms, the nuevo sol appreciated 5.2 percent in real terms and the real multilateral exchange rate index declined from 99 in December 2010 to 94 in December 2011.



BOX 8

UPDATE OF THE WEIGHTS OF THE REAL MULTILATERAL EXCHANGE RATE

An external price index made up by the price indices of Peru's major trading partners is elaborated to calculate the real multilateral exchange rate index (RMER). The new series of the RMER includes an update of the weights. Until last year, Peru's 20 major trading partners share in trade (exports plus imports) in 2005 was used as weights. As from this Annual Report, the weights are updated using the trade structure recorded in 2010.

WEIGHTED STRUCTURE		
Countries	Weight	
	2005	2010
United States	29.2	20.7
China	11.4	18.4
Switzerland	3.4	7.2
Canada	4.8	6.9
Japan	4.0	5.5
Brazil	5.5	5.5
Chile	6.7	4.5
Germany	3.6	4.3
Ecuador	4.6	4.0
Colombia	4.2	3.7
South Korea	2.2	3.4
Spain	2.9	2.8
Mexico	2.9	2.5
Italy	2.3	2.4
Argentina	2.6	2.2
Netherland	2.4	1.6
Belgium	1.1	1.3
Taiwan	1.9	1.1
Venezuela	3.1	1.1
United Kingdom	1.3	0.9
TOTAL	100	100

The new series considers the use of the current structure of weights for the whole period and uses 2009 as the base year, in line with the base year used in the consumer price index.

