

INTRODUCTION

During 2016, Peru's gross domestic product (GDP) grew 3.9 percent, driven by increased activity in the primary sectors, particularly by mining, which grew 21.2 percent. On the other hand, non-primary sectors recorded the lower rates observed in the past seven years. Sectors such as construction and non-primary manufacturing were affected, for the third consecutive year, by the fall of private investment and by the reduction of public spending. In this context, domestic demand grew 0.9 percent after having grown 2.9 percent in 2015.

A more favorable international environment was observed in 2016. The terms of trade registered a significantly lower decline (0.7 percent) than in previous years and even showed an upward trend towards the end of the year in response to expectations of increased spending on infrastructure in the United States. Moreover, contrasting with the net capital outflow observed in 2015, capital flows to the emerging countries –both to fixed-income and to variable-income markets– were positive during most of 2016.

The current account deficit declined from 4.8 percent of GDP in 2015 to 2.7 percent in 2016, reflecting the surplus recorded in the trade balance after two consecutive years with deficits. The flow of private long-term capital –which includes net foreign direct investment, the portfolio of foreign investment in the country, and long-term disbursements– decreased to 4.6 percent of GDP (two percentage points of GDP less than in 2015), influenced mostly by lower capital requirements to finance projects in the mining sector.

The operations of the non-financial public sector recorded a deficit of 2.6 percent of GDP in 2016 (0.5 percentage points higher than the deficit in 2015). The effect of the slowdown of domestic demand on tax revenue and the significant increase in tax rebates were the main factors that accounted for the increase in the deficit during the year. Notwithstanding the higher deficit, the level of the public debt (23.8 percent of GDP) remains at sustainable levels and is one of the lower deficits in the region.

During the year, inflation showed a downward trend, falling from 4.4 percent in December 2015 to 3.2 percent in December 2016. In August, inflation dropped to levels within the target range for the second straight month, but increased in the months thereafter to levels above the target range as a result of a water deficit that led food prices to rise significantly. Together with the rise of electricity rates approved in December, this affected inflation's convergence towards the target range.

Banco Central de Reserva del Peru (BCRP) moderated its expansionary monetary policy stance in order to maintain inflation expectations within the target range. Thus, in February BCRP raised its benchmark interest rate from 3.75 percent in January to 4.25 percent, maintaining this level thereafter during the rest of the year.



After growing at a rate of 8.0 percent in December 2015, credit to the private sector grew 5.6 percent in December 2016, this decline being associated with the lower growth of credit in soles (down from 28.0 to 7.2 percent) in a context of slowdown of domestic demand. In contrast with 2015 when it dropped 20.7 percent, credit in dollars grew 2.1 percent. In December 2016, BCRP reduced the rate of reserve requirements in domestic currency from 6.5 to 6.0 percent, the rate of marginal reserve requirements in dollars from 70 to 48 percent, and the cap on mean reserve requirements in dollars from 65 to 48 percent in order to offset the effects of expected increases in international interest rates on domestic credit conditions. The pace of growth of total liquidity also slowed down. Deposits in soles grew 9.8 percent, while deposits in dollars fell by 1.9 percent in this period.

In 2016, Peru's domestic currency appreciated 1.7 percent (from S/ 3.41 to S/ 3.36 per dollar), this appreciation of the sol resulting from the recovery of the prices of commodities, the inflow of capital to the region, and the positive evolution of the Peruvian economy in comparison with other economies in a context of lower uncertainty about global growth (and especially about growth in China), as well as some normalization of financial markets after having been affected by the results of the referendum in the United Kingdom (*Brexit*).

The intervention of BCRP in the foreign exchange market continued being oriented to reducing the volatility of the exchange rate. After two years of interventions with sales in dollars, BCRP net purchases of foreign currency amounted to US\$ 786 million. As a result, Peru's international reserves registered a balance of US\$ 61.69 billion at the end of the year (equivalent to 32 percent of GDP).