INTRODUCTION

Peru's gross domestic product (GDP) grew 2.5 percent in 2017 after growing at a rate of 4.0 percent in 2016. Two negative events had a significant impact on growth in the Peruvian economy in 2017: El Niño Costero, which affected a substantial part of infrastructure in the north of the country, and the Lava Jato corruption case, which deteriorated investors' confidence and paralyzed public-private partnerships investment projects.

Domestic demand evidenced a weak economic cycle showing a growth rate of 1.6 percent, a slightly higher rate than in the previous year (1.1 percent), but lower than the GDP growth rate for four consecutive years. After the impact of the shocks that affected the economy at the beginning of the year, mining investment and public spending began to show greater dynamism in the second half of the year, favored by the impulse of higher terms of trade. Private consumption, on the other hand, recorded its lowest growth rate since 2001.

The **international environment** was favorable during 2017. Showing its largest expansion since 2011, global activity grew 3.7 percent. Unlike what happened in previous years, this recovery was explained by a synchronized growth in both the developed and the emerging economies, in a context in which there are still favorable credit conditions and low inflationary pressures. Capital inflows to emerging economies intensified in a context characterized by a gradual adjustment of monetary policy in the developed economies, investors' greater appetite for risk, and solid macroeconomic foundations in most emerging countries. The rise in commodity prices favored our export prices, which grew 13.1 percent and translated into a rise of 7.3 percent in the terms of trade.

As a result of this favorable international environment, the current account deficit declined to 1.3 percent of GDP in 2017. The flow of long-term private capital –i.e. net foreign direct investment, foreign portfolio investment in the country, and long-term loans– represented 5.6 percent of GDP and exceeded the current account financing requirements.

In 2017 the operations of the **non-financial public sector** registered a deficit of 3.1 percent of GDP (versus 2.5 percent in 2016). The lower growth of economic activity and the impact that the application of some tax measures had on tax revenue resulted in a loss of income equivalent to 0.6 percent of GDP. Moreover, from 2012 –when the surplus obtained represented 2.3 percent of GDP– until 2017, the loss of income has been equivalent to 4.8 points of the output. However, despite the greater deficit observed in 2017, the level of public debt in the Peruvian economy is still one of the lowest in the region (24.8 percent of GDP).

In 2017, **inflation** returned to the target range and showed a rate of 1.36 percent at year end –the lowest rate observed since 2009–, mainly as a result of the correction of food prices following the rapid reversal of supply shocks. On the other hand, core inflation (which excludes food and energy) was close to the midpoint of the inflation target range, which reflected the appreciation of the sol against the dollar and the context of a weak economic cycle.

Since May 2017, once the inflationary pressures had been corrected, Banco Central de Reserva del Perú (BCRP) strengthened its expansionary **monetary policy** stance with the aim of maintaining inflation within the target range of 1-3 percent. Therefore, BCRP lowered the benchmark interest rate on four occasions, reducing it from 4.25 percent (in 2016) to 3.25 percent. In addition to this, BCRP reduced the rates of reserve requirements both in soles and in dollars. The former was lowered from 6.5 to 5.0 percent, and in the case of the latter, the marginal rate was lowered from 70 to 39 percent and the cap of the mean rate was reduced from 60 to 39 percent. The aim of these actions was to ease credit conditions in domestic currency and, in the case of foreign currency, to offset the impact of a less expansionary monetary policy in the developed economies.

Credit to the private sector showed a faster pace of growth, rising from a rate of 5.6 percent in 2016 to 6.6 percent in 2017, which reflected the higher growth of credit in foreign currency (from 2.0 to 9.9 percent), in line with the appreciation of the sol against the dollar. Credit in soles continued to slow down (from 7.2 to 5.3 percent) in a context of low growth of domestic demand. On the other hand, liquidity showed higher growth (10.1 percent in 2017 versus 5.1 percent in 2016), mainly as a result of increased term deposits and demand deposits. This evolution of liquidity in the private sector was accompanied by a slight decline in the dollarization ratio, which went from 34.6 percent in 2016 to 32.3 percent in 2017.

During 2017, the sol appreciated 3.5 percent, from S/ 3.36 to S/ 3.24 per dollar, due mainly to the recovery of the prices of commodities –which favored our external accounts–, to the generalized depreciation of the dollar in international markets, and to optimism about the recovery of the world economy, which influenced a reduction in risk aversion and a greater capital inflow to the region.

BCRP intervention in the foreign exchange market continued to be oriented to reducing the volatility of the exchange rate. During 2017, net purchases of foreign currency amounted to US$ 5.25 billion, as a result of which international reserves at year end totaled US$ 63.62 billion, sum equivalent to 30 percent of GDP.