CENTRAL RESERVE BANK OF PERU

Summary
Inflation Report

June 2016

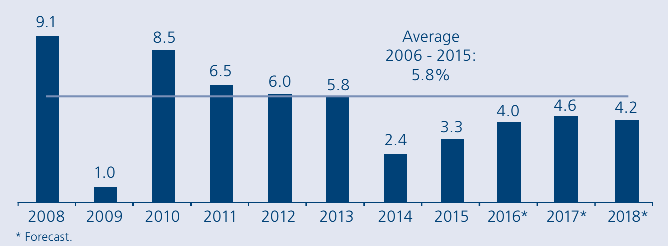
This ***Inflation Report*** was prepared using data on the Balance of Payments at Q1-2016, Monetary Accounts and Gross Domestic Product at April 2016, while data on the operations of the Non-Financial Public Sector, Inflation, Financial Markets, and the Exchange Rate at May 2016.

WORLD GDP GROWTH
(Annual % change)

	PPP % 2015	Trading Peru % 2015	2014	2015	2016 IR Mar.16	2016 IR Jun.16	2017 IR Mar.16	2017 IR Jun.16	2018 IR Jun.16
Advanced economies	**42.4**	**47.4**	**1.8**	**1.9**	**1.9**	**1.8**	**2.0**	**1.9**	**1.9**
Of which									
1. United States of America	15.8	17.5	2.4	2.4	2.2	2.0	2.3	2.0	2.2
2. Eurozone	11.9	11.0	0.9	1.6	1.5	1.6	1.7	1.7	1.6
Germany	3.4	2.8	1.6	1.5	1.5	1.7	1.5	1.6	1.5
France	2.3	0.9	0.2	1.1	1.2	1.4	1.6	1.6	1.6
Italy	1.9	1.7	-0.3	0.8	1.1	1.1	1.2	1.2	1.1
Spain	1.4	2.5	1.4	3.2	2.7	2.8	2.1	2.2	2.0
3. Japan	4.3	3.0	0.0	0.5	0.9	0.5	0.6	0.6	0.6
4. United Kingdom	2.4	1.1	2.9	2.2	2.1	1.9	2.2	2.1	2.2
5. Canada	1.4	4.4	2.5	1.2	1.6	1.7	2.2	2.3	2.2
Emerging market and developing economies	**57.6**	**52.6**	**4.6**	**4.0**	**4.3**	**4.1**	**4.7**	**4.6**	**4.8**
Of which									
1. Developing Asia	30.6	26.9	6.8	6.6	6.4	6.4	6.3	6.3	6.3
China	17.1	22.2	7.3	6.9	6.5	6.5	6.2	6.2	6.0
India	7.0	2.2	7.2	7.6	7.4	7.4	7.6	7.6	7.6
2. Commonwealth of Independent States	4.6	0.7	1.1	-2.8	0.0	-0.3	2.0	1.5	1.9
Russia	3.3	0.5	0.7	-3.7	-1.1	-0.8	1.2	1.2	1.4
3. Latin America and the Caribbean	8.3	23.2	1.3	0.0	-0.4	-0.6	1.8	1.9	2.4
Brazil	2.8	4.1	0.1	-3.8	-3.5	-3.8	0.0	0.2	1.2
Chile	0.4	3.2	1.8	2.1	2.2	1.8	2.7	2.5	2.7
Colombia	0.6	3.0	4.4	3.1	2.4	2.4	3.2	3.0	3.7
Mexico	2.0	3.4	2.3	2.5	2.6	2.6	2.9	2.7	2.8
Peru	0.3	-	2.4	3.3	4.0	4.0	4.6	4.6	4.2
World Economy	**100.0**	**100.0**	**3.4**	**3.1**	**3.3**	**3.1**	**3.6**	**3.5**	**3.6**
Memo:									
Peru's trading partners 2015 1/	65.7		3.6	3.1	2.9	2.8	3.2	3.1	3.3
BRICs 2/	30.2		5.8	4.9	5.0	5.0	5.4	5.4	5.5

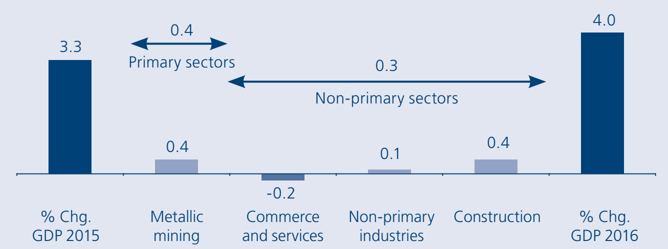
1/ Basket of Peru's 20 main trading partners.
2/ Brazil, Russia, India, and China.
IR: Inflation Report.
Source: Bloomberg, IMF, and Consensus Forecast.

GDP: 2008 - 2018
(Real % change)



* Forecast.

GDP GROWTH: 2016 VS 2015
(% Chg. and % contributions)



The global economy is projected to grow this year at the same rate as in 2015 (3.1 percent). This downward revision of our previous forecast (3.3 percent, Inflation Report of March) is explained by the evolution of growth in both the developed countries and in the emerging market economies. The lower growth estimated in the United States and the deterioration of growth prospects in Japan and the United Kingdom standing out in the case of the former and the revision of Brazil's GDP growth rate on the downside standing out in the case of the latter. Global growth in 2017 and 2018 would show a gradual recovery, with growth rates of 3.5 and 3.6 percent respectively being estimated for these years.

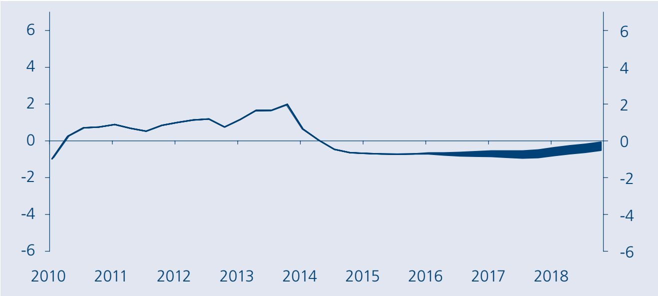
In line with this outlook for global growth, the terms of trade are expected to decline (for the fifth consecutive year) to 2.6 percent in 2016, a more moderate rate than in previous years. More stable terms of trade are expected thereafter.

Peru's GDP grew 3.9 percent in the first four months of 2016, driven mainly by the primary sectors which grew 7 percent. Thus, the GDP growth rate forecast for 2016 in this report remains at 4.0 percent. The forecast considers a higher growth of government spending, offset by a decline of private investment which is explained mostly by the execution of spending in the first quarter.

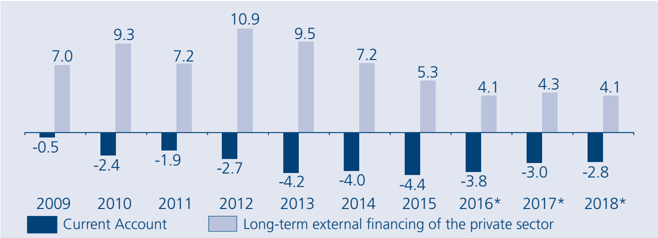
In 2017 and 2018 GDP would show growth rates of 4.6 percent and 4.2 percent, respectively, growth being driven mainly by the primary sectors. A faster pace of growth is foreseen by 2018 in the non-primary sectors, which would be driven by a higher growth rate in construction (due to the implementation of infrastructure projects) and by the recovery of non-primary manufacturing (due to increased external demand and to higher private investment).

The projected evolution of the output gap is determined by the evolution of external conditions, the monetary policy stance and other financial conditions, the fiscal impulse and economic agents' confidence in the course of the

OUTPUT GAP: 2010 - 2018
(% potential GDP)

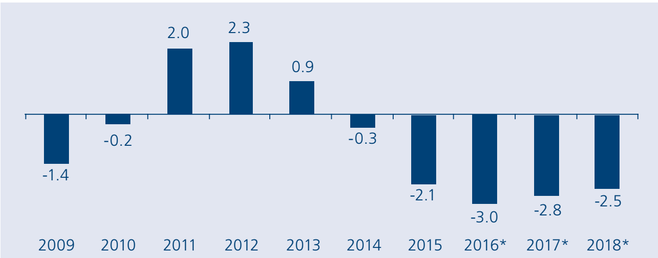


CURRENT ACCOUNT AND LONG-TERM EXTERNAL FINANCING OF THE PRIVATE SECTOR: 2009-2018 1/
(% GDP)



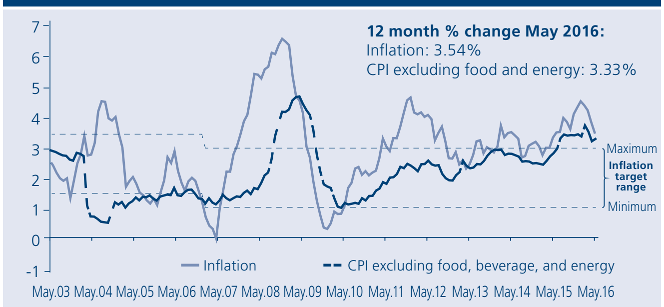
1/ Includes net foreign investments, portfolio investment, and private sector's long-term disbursement.
* Forecast.

ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2009-2018
(% GDP)

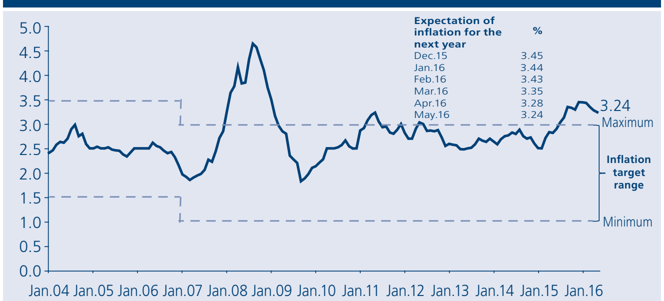


* Forecast.

INFLATION AND INFLATION TARGETING
(Last 12-month % change)



EXPECTATIONS OF INFLATION FOR THE NEXT YEAR*
(% points)



* Corresponds to the average of the expectations of the financial system and economic analysts.

economy. Thus, the forecast of economic growth for the 2016-2018 horizon is consistent with the gradual recovery of the output gap and with a potential GDP level close to 4.0 percent.

The deficit in the current account of the balance of payments would start declining this year from 4.4 percent of GDP in 2015 to 3.8 percent in 2016, decreasing thereafter to around 3 percent in the next two years as a result of increased volumes of exports. Exports would be driven in all of this period by the greater dynamism of exports of minerals as well as by a greater contribution of exports of non-traditional goods by the end of the period, in line with increased access to external markets and with the expansion of the agricultural frontier. This reduction of the external deficit would take place in a context in which long-term capital flows would continue financing the balance of payments, in line with the implementation of investment projects in infrastructure, hydrocarbons and energy.

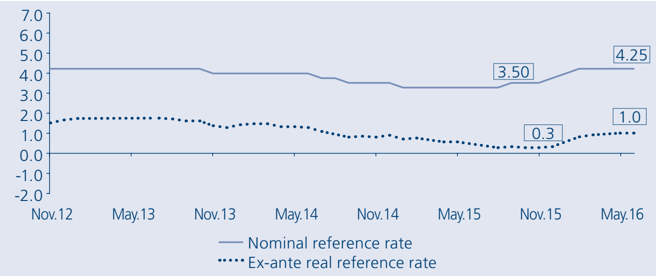
The fiscal deficit in the first quarter registered an annual rate of 2.9 percent of GDP, a higher rate than the 2.1 percent rate recorded in 2015. The increase in the deficit reflects basically the decline in tax revenues during this period (down 0.5 percentage points) and the increase of 0.2 percentage points of GDP in current expenditure.

The fiscal deficit projected in this report for 2016 and 2017 is higher than that estimated in the Inflation Report of March, in line with the execution registered at May and the level of investment spending considered in the Multiannual Macroeconomic Framework for 2017-2019. The projection considers a recovery in sub-national governments' spending after two years of contraction as well as the continuation of the modernization works of the Refinery of Talara. A gradual reduction of the deficit over the next 3 years to 2.5 percent in 2018 is considered in the forecast scenario.

Inflation accumulated in the last twelve months fell from 4.5 percent in February to 3.5 percent in May 2016 as a result of the reversal of the domestic supply shocks associated with El Niño. Moreover, the decline in the rate of inflation would also be associated with the reduction of inflation expectations and with the appreciation of the domestic currency since February.

As pointed out in our last Inflation Report, the upside risks to the inflation forecast have been reversing, with the inflationary effect of the depreciation of the

NOMINAL AND REAL* REFERENCE INTEREST RATE
(%)



* Ex-ante: With expectation of inflation.

PEN having moderated and with inflation expectations declining gradually. In addition to this, the supply shocks that temporarily affected inflation continue to reverse.

In this context, the Board of the Central Bank maintained the monetary policy interest rate at 4.25 percent since March and reiterated to oversee the inflation forecasts and inflation determinants to evaluate the convenience of making additional adjustments in the monetary policy rate, leading to inflation to return to be within the target range.

Balance of Risks

The balance of risks remains neutral in the inflation forecast, which means that the probability of the occurrence of factors that affect inflation on the upside is equal to the probability of the occurrence of factors that imply a lower price increase. There are no signals indicating an upward or a downward bias of the inflation forecast. Among the events that could divert the rate of inflation from the baseline scenario, the following stand out:

Lower global growth

The baseline scenario considers a slower recovery in the world economy in 2016-2018 than the one estimated in our Inflation Report of March, due mainly to lower growth in the United States, Japan, and in some emerging economies. However, if such recovery were to take even longer, the resulting lower external impulse would translate into a lower output gap and into lower domestic inflation.

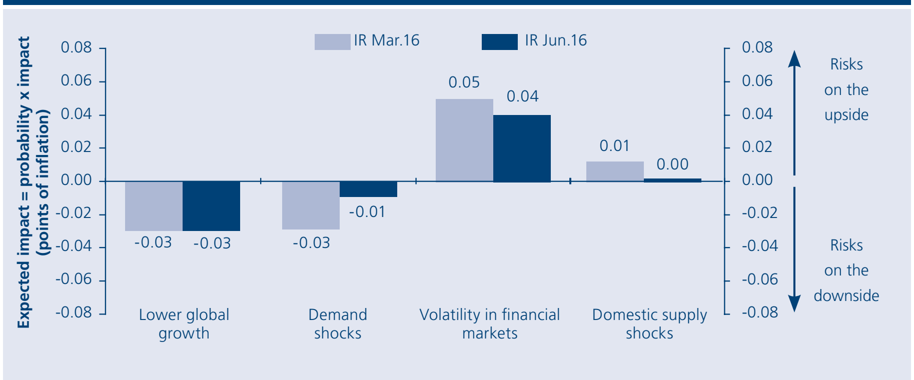
Negative domestic demand shocks

Economic recovery could take longer than expected if the implementation of investment projects were postponed, which would imply a more negative output gap and lower inflation in the forecast horizon. The probability of occurrence of such scenario has decreased in comparison with our previous report due to the recovery of public investment.

Increased volatility in international financial markets

This risk could materialize if unanticipated rises in the policy rate of the U.S. Federal Reserve brought about volatility in international financial markets. In such case, this could generate capital outflows from the emerging markets and depreciation pressures on the currencies of these countries, which could lead to higher inflation. However, this risk has become more moderate, as reflected in the change of expectations about a rise in the Fed interest rate.

BALANCE OF RISKS AGAINST THE BASE SCENARIO



SUMMARY OF INFLATION REPORT FORECAST

	2015	2016[1/]		2017[1/]		2018[1/]
		IR Mar.16	IR Jun.16	IR Mar.16	IR Jun.16	IR Jun.16
Real % change						
1. Gross Domestic Product	3.3	4.0	4.0	4.6	4.6	4.2
2. Domestic demand	2.9	2.5	2.5	3.8	3.8	3.8
a. Private consumption	3.4	3.5	3.5	3.8	3.8	4.0
b. Public consumption	9.5	4.0	4.7	3.0	1.0	0.8
c. Fixed private investment	-4.4	0.0	-1.0	4.0	4.0	4.2
d. Public investment	-7.5	7.4	10.3	5.0	7.9	6.0
3. Exports (good and services)	3.5	6.4	6.4	6.7	6.4	4.9
4. Imports (good and services)	2.2	0.7	0.3	3.5	3.5	3.5
5. Economic growth in main trading partners	3.1	2.9	2.8	3.2	3.1	3.3
Memo:						
Output gap [2/] (%)	-1.5 ; -0.5	-1.5 ; 0.0	-1.5 ; 0.0	-1.0 ; 0.0	-1.0 ; 0.0	-0.5 ; 0.0
% change						
6. Inflation	4.4	3.0 - 3.5	2.7 - 3.2	2.0 - 2.2	2.0 - 2.2	2.0 - 2.2
7. Expected inflation	-	3.5	3.5	3.2	3.0	2.8
8. Expected depreciation	-	7.3	2.9	1.8	1.9	1.7
9. Terms of trade [3/]	-6.3	-2.6	-2.6	0.1	0.9	0.0
a. Export prices	-14.9	-5.2	-4.8	2.3	2.8	0.9
b. Import prices	-9.2	-2.7	-2.3	2.2	1.9	0.9
Nominal % change						
10. Currency in circulation	3.8	4.6	5.5	5.0	6.0	6.0
11. Credit to the private sector [4/]	9.6	8.0	7.0	7.0	7.0	6.5
% GDP						
12. Gross fixed investment	24.3	23.9	24.0	24.0	24.3	24.4
13. Current account of the balance of payments	-4.4	-3.9	-3.8	-3.0	-3.0	-2.8
14. Trade balance	-1.6	-0.9	-0.8	-0.4	-0.2	0.0
15. Long-term external financing of the private sector [5/]	5.3	3.8	4.1	4.3	4.3	4.1
16. Current revenue of the general government	20.0	19.5	19.3	19.5	19.3	19.3
17. Non-financial expenditure of the general government	21.3	20.8	21.1	20.6	20.7	20.4
18. Overall balance of the non-financial public sector	-2.1	-2.6	-3.0	-2.3	-2.8	-2.5
19. Balance of total public debt	23.3	24.7	25.5	24.0	26.6	28.0
20. Balance of net public debt	6.6	8.6	10.1	10.1	13.1	15.5

1/ Forecast.
2/ Differential between GDP and potential GDP (%).
3/ Average.
4/ Includes loans made by banks' branches abroad.
5/ Includes net direct investment, portfolio investment and private sector's long term disbursement.
IR: Inflation Report.