INFLATION REPORT

June 2019

Recent trends and macroeconomic forecasts 2019-2020

CENTRAL RESERVE BANK OF PERU

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Recent Trends and
Macroeconomic Forecasts 2019 - 2020

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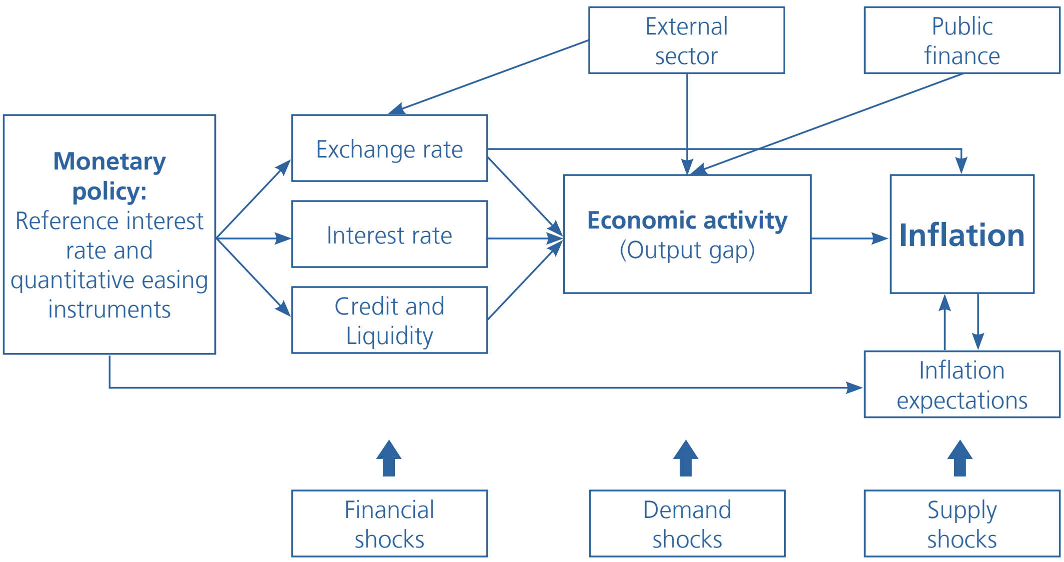

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BOXES

This ***Inflation Report*** was prepared using data on the balance of payments and the gross domestic product as of the first quarter of 2019; data on monetary accounts and the operations of the non-financial public sector as of May 2019, and data on inflation, financial markets, and the exchange rate as of June 2019.

Foreword

- According to the Constitution of Peru, the Central Reserve Bank of Peru (BCRP) is a public autonomous entity whose role is to preserve monetary stability. The BCRP is responsible for regulating the money supply and credit in the financial system, for managing the country's international reserves, and for reporting on the nation's finances.

- In order to consolidate this goal, the Bank's monetary policy is based on an inflation targeting scheme, with an inflation target between 1.0 and 3.0 percent. The Central Bank's inflation target is aimed at anchoring inflation expectations at a similar level to the inflation rate observed in developed economies and reflects the BCRP's permanent commitment with monetary stability.

- Each month, and according to a previously announced schedule, the Board of BCRP sets a benchmark rate for the interbank lending market. Since this interest rate, which is the monetary operational target, affects the rate of inflation through several channels with time lags, this rate is set on the basis of inflation forecasts and forecasts of inflation determinants.

- Inflation may transitorily deviate from the target range due to shocks that may temporarily affect the supply of goods and services, such as fluctuations in the prices of imported products or domestic climate factors. It should also be pointed out that the effectiveness of monetary policy is also assessed in terms of the success in returning and maintaining inflation expectations within the target range.

  Additionally, the Central Bank implements preventive actions to preserve macro-financial stability and monetary policy transmission mechanisms. Through reserve requirements and interventions in the foreign exchange market, the Central Bank reduces excessive volatility in the exchange rate and prevents excessive variations in the volume and composition of credit in the financial system.

- This Report includes macroeconomic forecasts that support the monetary policy decisions of BCRP as well as an analysis of the risk factors that can modify such forecasts.

- This Inflation Report was approved by the Board of Directors of BCRP on June 27, 2019.

- The following Inflation Report will be published on Friday, September 27, 2019.

Summary

i. The pace of **global GDP growth** is expected to slow down from 3.6 percent in 2018 to 3.3 percent in 2019 (3.4 percent was estimated in the March Inflation Report) and to 3.4 percent in 2020 (3.5 percent estimated in the previous Report) as a result of the uncertainty caused by commercial tensions. However, this slower pace of global economic activity will be accompanied by more favorable external financial conditions associated with more expansionary monetary positions in the central banks of the advanced economies.

ii. The **terms of trade** of exports have been deteriorating due to uncertainty about global activity and investment. As a result, after showing a rate of -0.2 percent in 2018, they are projected to register -2.8 percent in 2019 (vs. 1.3 percent projected in the March Report) and -0.7 percent in 2020 (vs. 0.4 percent in the previous Report). Moreover, an average annual copper price of US$ 2.76 per pound is projected in this report (vs. US$ 2.86 in the previous report and vs. US$ 2.97 projected as the average price of the previous year).

iii. The projected **deficit in the current account of the balance of payments** has been revised up (from 1.3 to 1.6 percent of GDP in 2019 and from 1.3 to 1.9 percent in 2020) due to the lower prices of exports compared to those projected in March. Because of this reason, the trade balance surplus has also been revised from US$ 8.03 billion in the March Report to US$ 6.27 billion. On the other hand, countering these trends in the trade of goods, the financial account flows show favorable trends, so capital inflows are expected to be higher than those projected in March. At the aggregate level of the balance of payments, the increase in net international reserves has been revised up from US$ 4.34 billion in March to US$ 6.04 billion in this report.

iv. In the first quarter of 2019, Peru's **GDP** showed a slowdown due to the lower output registered in the primary sectors of fishing and mining compared to the first quarter of 2018, which added onto lower growth in the non-primary sectors (3.3 percent). A partial reversal of the fall observed in the first quarter in the primary sectors is expected for the rest of the year, so an annual GDP growth rate of 3.4 percent is projected for 2019 (a lower rate than that projected in the

March Report) and a rate of 4.0 percent is projected for 2020 (the same rate as that estimated in the March Report).

v. The lower dynamism of GDP is associated with the lower growth of exports and **domestic demand**, particularly in terms of private sector investment spending, which has been revised down from 6.5 percent (projected in March) to 3.8 percent in this report. This lower growth projection reflects the lower pace of growth observed so far this year in a context of lower terms of trade and lower business confidence.

vi. The **fiscal deficit** foreseen for this year has been revised down from 2.3 percent of GDP in the March Report to 2.1 percent of GDP due to the higher current revenues estimated –up from 19.3 to 19.6 percent of GDP–, mainly as a result of the payment of tax obligations resulting from resolutions favorable to Sunat. The deficit projected for 2020 remains at 2.1 percent of GDP, in line with the deficit rule set out in the Fiscal Responsibility and Transparency Framework.

vii. The Board of BCRP has maintained the **benchmark interest rate** at 2.75 percent since March 2018 –in line with the expansionary monetary policy stance (a real rate of 0.3 percent in the year)–, in a context in which inflation and inflation expectations show levels within the target range and the output gap is expected to close in the forecast horizon, although in a more gradual way than the one anticipated in the March Inflation Report.

viii. In line with the expansionary monetary stance, **credit to the private sector** grew 7.9 percent year-on-year in May, as reflected in all the credit segments, especially in the segment of personal loans. In the forecast horizon, credit to the private sector as a percentage of GDP would increase from 42 percent in 2018 to 44 percent in 2020. The latter projection considers flexible monetary conditions and the recovery of the demand's rate of growth.

ix. Remaining within the inflation target range, year-on-year **inflation** rose from 2.0 percent in February to 2.3 percent in June 2019, while inflation expectations –which remain within the target range since March 2017– were between 2.4 and 2.5 percent in June and are expected to decrease gradually as inflation converges to the center of the target range.

x. The balance of **inflation risk factors** considered in this Report –domestic demand shocks, external demand shocks, and international financial shocks– translates into a bias on the downside in the inflation forecast. This bias considers a greater relative risk of a possible lower inflation resulting from a lower pace of growth in the demand.

SUMMARY OF INFLATION REPORT FORECAST						
	2017	2018	2019[1/]		2020[1/]	
			IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
Real % change						
1. Gross Domestic Product	2.5	4.0	4.0	3.4	4.0	4.0
2. Domestic demand	1.4	4.3	3.9	3.3	4.1	4.0
a. Private consumption	2.6	3.8	3.8	3.5	3.9	3.7
b. Public consumption	0.5	2.0	2.5	2.0	2.2	2.5
c. Fixed private investment	0.2	4.4	6.5	3.8	6.0	5.5
d. Public investment	-1.8	6.8	1.0	1.0	5.0	5.0
3. Exports (good and services)	7.6	2.5	4.6	2.6	5.7	5.4
4. Imports (good and services)	4.0	3.4	4.4	2.1	6.2	5.5
5. Economic growth in main trading partners	3.7	3.7	3.4	3.3	3.4	3.4
Memo:						
Output gap [2/] (%)	-0.9	-0.5	-0.6 ; 0.2	-1.0 ; -0.3	-0.5 ; 0.5	-0.7 ; 0.2
% change						
6. Inflation	1.4	2.2	2.0	2.1	2.0	2.0
7. Expected inflation [3/]	-	-	2.4	2.5	2.5	2.5
8. Expected depreciation [3/]	-	-	-1.6	-1.2	0.9	0.8
9. Terms of trade [4/]	7.5	-0.2	1.3	-2.8	0.4	-0.7
a. Export prices	13.4	6.3	-0.5	-4.0	2.6	0.7
b. Import prices	5.4	6.5	-1.8	-1.3	2.1	1.5
Nominal % change						
10. Currency in circulation	6.7	7.9	8.1	6.0	8.5	6.0
11. Credit to the private sector [5/]	6.7	8.7	9.0	8.1	9.0	9.0
% GDP						
12. Gross fixed investment	21.9	22.5	22.7	22.3	23.1	22.7
13. Current account of the balance of payments	-1.2	-1.6	-1.3	-1.6	-1.3	-1.9
14. Trade balance	3.1	3.2	3.4	2.6	3.4	2.5
15. Long-term external financing of the private sector [6/]	1.8	2.0	3.1	2.7	2.2	2.1
16. Current revenue of the general government	18.1	19.3	19.3	19.6	19.4	19.5
17. Non-financial expenditure of the general government	20.0	20.2	20.2	20.2	20.0	20.0
18. Overall balance of the non-financial public sector	-3.0	-2.3	-2.3	-2.1	-2.1	-2.1
19. Balance of total public debt	24.9	25.7	26.3	26.5	26.4	26.9
20. Balance of net public debt	9.5	11.3	13.2	13.1	14.3	14.5

IR: Inflation Report.
1/ Forecast.
2/ Differential between GDP and potential GDP (as a percentage of potential GDP).
3/ Survey on expectations to the analysts and financial entities.
4/ Average.
5/ Includes loans made by banks' branches abroad.
6/ Includes net direct investment, portfolio investment and private sector's long term disbursement.

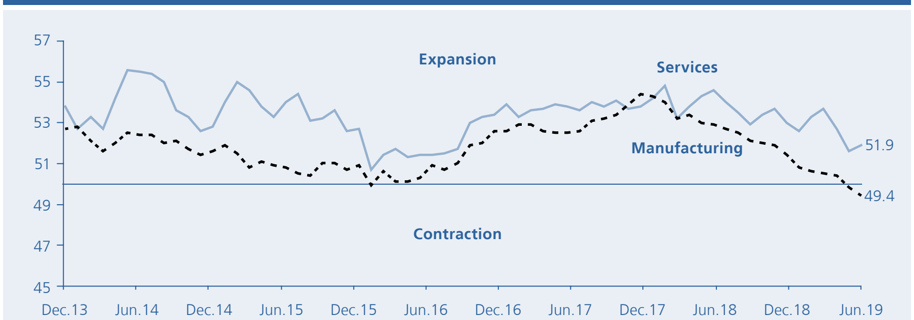
I. External Sector

Global Economy

1. The outlook for global economic growth has deteriorated since March (when our last Inflation Report was published). The global indicators of manufacturing and services of April and May have intensified their downward trend in a context of less dynamism of global trade and less confidence due to the escalation of trade tensions.

   In the case of manufacturing, the indicator has maintained its downward trend, showing levels in the contraction area (below 50) for two consecutive months. In addition, several of the major developed economies, i.e. the Eurozone, the United Kingdom, and Japan, register growth rates located in the contraction area.

Graph 1
PMI GLOBAL MANUFACTURING AND SERVICES



Source: JP Morgan.

The economic slowdown is observed in both the developed economies and the emerging economies, with lower growth in the Eurozone being associated mainly with trade tensions, including the negotiations related to the Brexit. Within the emerging market economies, Latin America shows the most marked deceleration due to the results obtained in the first quarter and the deterioration of external conditions.

Table 1
GLOBAL ACTIVITY INDEX

I. Services	Mar.18	Jun.18	Sep.18	Dec.18	Mar.19	Jun.19
Global	**53.2**	**54.6**	**52.9**	**53.0**	**53.7**	**51.9**
USA Markit	54.0	56.5	53.5	54.4	55.3	50.7
China Caixin	52.3	53.9	53.1	53.9	54.4	52.0
Eurozone	54.9	55.2	54.7	51.2	53.3	53.4
United Kingdom	51.7	55.1	53.9	51.2	48.9	50.2
Japan	50.9	51.4	50.2	51.0	52.0	51.9
II. Manufacturing	**Mar.18**	**Jun.18**	**Sep.18**	**Dec.18**	**Mar.19**	**Jun.19**
Global	**53.2**	**52.9**	**52.1**	**51.4**	**50.5**	**49.4**
USA Markit	55.6	55.4	55.6	53.8	52.4	50.6
China Caixin	51.0	51.0	50.0	49.7	50.8	49.4
Eurozone	56.6	54.9	53.2	51.4	47.5	47.6
United Kingdom	54.8	54.0	53.7	54.3	55.1	48.0
Japan	53.1	53.0	52.5	52.6	49.2	49.3

Source: JP Morgan.

The slowdown of global growth is accompanied by low inflation in most developed economies, which has increased expectations of a more expansionary monetary policy in comparison with what was foreseen in the last Inflation Report. The Fed projections in June and futures contracts take at least one rate cut for granted this year, while the European Central Bank (ECB) has postponed the rate hike that was initially planned for the June-August period of this year and expressed the possibility of additional measures. Other developed economies, such as Japan and the United Kingdom, maintain expansionary policies.

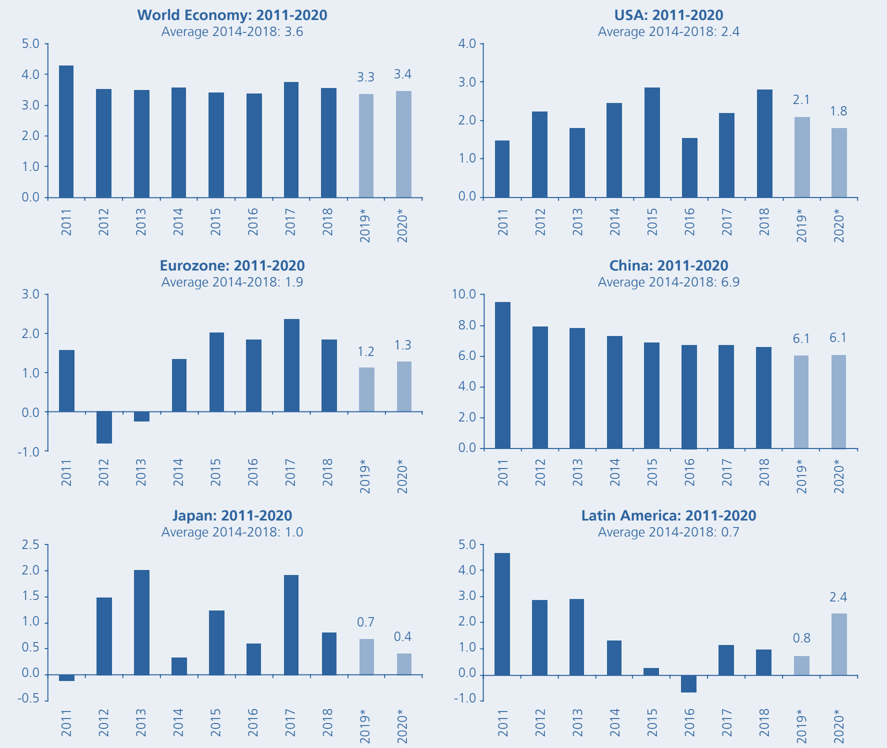
2. In line with this, the projections of world growth have been revised down from 3.4 to 3.3 percent in 2019 and from 3.5 to 3.4 percent in 2020.

Table 2
GLOBAL GDP GROWTH
(Annual % change)

	PPP %[1/]	Trading Peru %[1/]	2018	2019*		2020*	
				IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
Developed economies	**40.8**	**42.9**	**2.2**	**1.8**	**1.7**	**1.7**	**1.6**
Of which:							
1. USA	15.2	20.2	2.9	2.1	2.1	1.9	1.8
2. Eurozone	11.4	12.8	1.9	1.3	1.2	1.5	1.3
Germany	3.2	2.7	1.5	1.2	0.8	1.5	1.3
France	2.2	0.8	1.5	1.3	1.2	1.5	1.3
Italy	1.8	1.8	0.9	0.3	0.1	0.8	0.7
Spain	1.4	4.0	2.5	2.2	2.2	1.9	1.9
3. Japan	4.1	4.0	0.8	0.9	0.7	0.4	0.4
4. United Kingdom	2.2	1.3	1.4	1.3	1.2	1.5	1.4
5. Canada	1.4	2.6	1.8	1.8	1.6	1.8	1.8
Developing economies	**59.2**	**57.1**	**4.6**	**4.6**	**4.5**	**4.8**	**4.8**
Of which:							
1. Emerging and developing Asia	33.3	34.9	6.4	6.3	6.2	6.4	6.3
China	18.7	27.9	6.6	6.2	6.1	6.2	6.1
India	7.8	3.8	7.1	7.5	7.3	7.6	7.6
2. Commonwealth of Independent States	4.4	0.5	2.8	2.1	2.0	2.1	2.0
Russia	3.1	0.5	2.3	1.5	1.3	1.5	1.3
3. Latin America and the Caribbean	7.7	21.6	1.0	1.3	0.8	2.4	2.4
Brazil	2.5	5.4	1.1	2.1	1.0	2.6	2.3
Chile	0.4	3.3	4.0	3.4	2.9	3.4	3.2
Colombia	0.6	2.9	2.7	3.0	3.0	3.2	3.2
Mexico	1.9	3.0	2.0	1.6	1.2	1.7	1.7
Argentina	0.7	1.5	-2.5	-1.2	-1.4	1.9	2.0
Peru	0.3	-	4.0	4.0	3.4	4.0	4.0
World Economy	**100.0**	**100.0**	**3.6**	**3.4**	**3.3**	**3.5**	**3.4**
Memo:							
Peru's trading partners[1/]	65.9		3.7	3.4	3.3	3.4	3.3

* Forecast.
1/ Weights corresponds to 2018. Basket of Peru's 20 main trading partners.
Source: IMF and Consensus Forecast.

Graph 2
GDP GROWTH
(Real % change)



* Forecast.
Source: IMF and Consensus Forecast.

3. The **developed economies** would grow 1.7 percent in 2019 and 1.6 percent in 2020, slightly less than projected in the March Inflation Report. The **United States** economy grew at an annualized seasonally adjusted rate of 3.1 percent in the first quarter of 2019, showing a faster pace of growth than expected and a higher rate than the one registered in the previous quarter. This acceleration reflects the growth of investment, exports, and inventories, which contributed 2.4 percentage points to growth, whereas private consumption, on the other hand, showed some deceleration in the quarter.

Table 3
GDP
(Annual % change)

	Q1		
	2017	**2018**	**2019**
USA	1.9	2.6	3.2
Eurozone	2.1	2.5	1.2
Japan	1.5	1.3	0.9
United Kingdom	1.8	1.2	1.8
China	6.8	6.8	6.4

4. The indicators recorded in the second quarter suggest a slowdown in economic activity in the United States in comparison with the first quarter, reflecting mainly the impact of commercial tensions on investment and exports. In addition, in May the manufacturing PMI registered its lowest level since September 2009, while purchase orders of durable goods dropped due to the lower rate of growth of transport equipment. Furthermore, investment associated with construction has been showing negative rates since 2018.

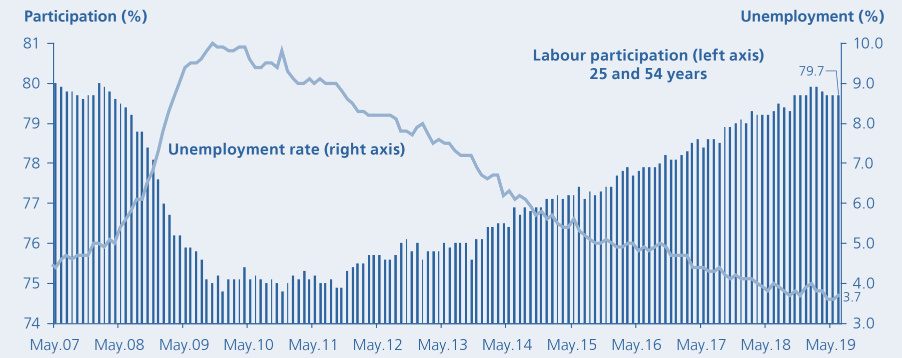
Table 4
USA: GDP
(Annualized seasonally adjusted % change)

	2017	2018					2019
		Q1	Q2	Q3	Q4	Year	Q1
Personal consumption	2.5	0.5	3.8	3.5	2.5	2.6	1.3
Gross private investment	4.8	9.6	-0.5	15.2	3.7	5.9	4.3
Non-residential investment	5.3	11.5	8.7	2.5	5.4	6.9	2.3
Residential investment	3.3	-3.4	-1.3	-3.6	-4.7	-0.3	-3.5
Change on inventories*	0.0	0.3	-1.2	2.4	0.1	0.1	0.6
Exports	3.0	3.6	9.3	-4.9	1.8	4.0	4.8
Imports	4.6	3.0	-0.6	9.3	2.0	4.5	-2.5
Government expenditure	-0.1	1.5	2.5	2.6	-0.4	1.5	2.5
GDP	**2.2**	**2.2**	**4.2**	**3.4**	**2.2**	**2.9**	**3.1**

* Contribution to growth.
Source: Bureau of Economic Analysis (BEA).

As regards consumption, some recent indicators (such as retail sales) suggest that, despite the trend observed in the first quarter, this component would show the greatest contribution to growth in the remainder of the year. On the other hand, unemployment in the United States remains at minimum levels and reached a rate of 3.7 percent in June. Despite the low unemployment rate, wages grew 3.1 percent in May, less than in December 2018.

Graph 3
USA: LABOUR PARTICIPATION AND UNEMPLOYMENT RATE



Source: Bureau of Labour Statistics (BLS).

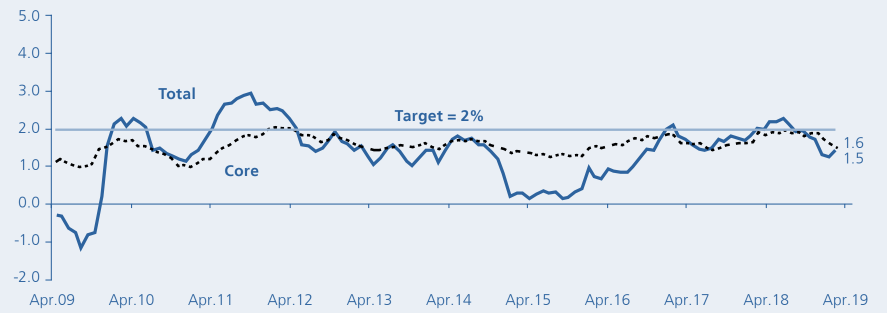
Graph 4
USA: AVERAGE WAGE PER HOUR
(Twelve-month % change)

Source: Bureau of Labour Statistics (BLS).

5. In this context, growth in the US economy is expected to go from a rate of 2.9 percent in 2018 to 2.1 percent in 2019, this growth rate still being higher than its medium-term growth rate. On the other hand, lower growth is estimated for 2020 (1.8 percent), in line with a lower fiscal stimulus after the tax reduction implemented in 2018.

   As for inflation, lower dynamism in wages and energy prices explain the low price pressures observed. In May, inflation showed a rate of 1.5 percent, below the Fed target, while core inflation, which excludes energy and food prices, stood at 1.6 percent.

Graph 5
USA: PCE PRICE INDEX
(Twelve-month % change)



Source: Bureau of Economic Analysis.

6. In view of this scenario of slowdown and low inflationary pressures, expectations of a reduction in interest rates during 2019 have increased significantly since the last Inflation Report. The recent statements of Fed officials and the latest policy statement issued by the Fed at its June meeting confirm the possibility that such a reduction would be made if commercial tensions affect economic activity. The Fed is now considering a reduction in the interest rate for next year, although this

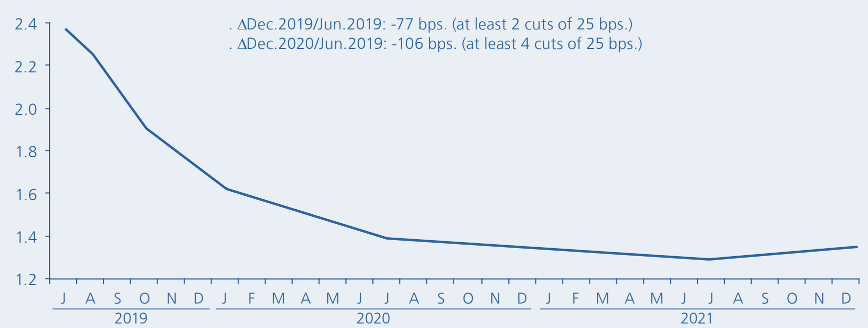
differs from what is expected by the market. According to the market of interest rate futures, at least 2 rate cuts of 25 bps would be made this year and 4 cuts of 25 bps each are expected by the end of 2020.

Table 5
FED: FORECASTS*

	2019		2020		2021		Long-term	
	Mar.19	Jun.19	Mar.19	Jun.19	Mar.19	Jun.19	Mar.19	Jun.19
GDP growth	2.1	2.1	1.9	2.0	1.8	1.8	1.9	1.9
Unemployment rate	3.7	3.6	3.8	3.7	3.9	3.8	4.3	4.2
PCE price index	1.8	1.5	2.0	1.9	2.0	2.0	2.0	2.0
Core Inflation (Core PCE)	2.0	1.8	2.0	1.9	2.0	2.0	-	-
Memo: Core PCE excluding food and energy.								
Interest rate (%)	2.4	2.4	2.6	2.1	2.6	2.4	2.8	2.5

* Adds data from 17 individual projections of the FOMC Board members at the end of period.

Graph 6
FUTURE MARKET-FED POLICY RATE (%)
(Expectation about the movement of Fed policy rate)*



* As of 24th June 2019.

7. In the **Eurozone**, seasonally adjusted GDP grew at a higher rate in the first quarter (0.4 percent quarterly) than in the previous period. Consumption decelerated its downward trend due to households' higher purchasing power following the wage increases and expansionary tax measures adopted in some economies (e.g. after the protests of 'yellow vests' in France and after paying social contributions was made easier in Germany). On the other hand, investment rebounded, reflecting the growth of the construction sector and some boost in investment in machinery and equipment.

   Despite this, more frequent indicators, such as industrial production, and the manufacturing PMI and confidence indices, would indicate that the economy would resume the trend of lower growth that had been observed since the second half of 2018. Because of this, and reflecting the lower rate of expansion of Germany, France and Italy, the growth projection for this region in 2019 (1.2 percent) and 2020 (1.3 percent) has been revised slightly to the downside.

Moreover, inflation in the region has shown a downward trend in the first months of the year, mainly due to the lower prices of energy and some services. In this context, the ECB decided to maintain its monetary policy stance and postponed the decision of raising the interest rate for next year. There are also signs of a more expansionary position in the context of uncertainty resulting from commercial tensions and political noise.

8. The growth projection for 2019 in the **emerging economies** has also been revised down from 4.6 to 4.5 percent, but remains at 4.8 percent for 2020.

   In this context, several central banks in the emerging economies (like in the developed countries) have paused in the adjustment of their monetary policy rates and, in some cases, have lowered them in this context of higher-than-expected slowdown amid a reduction of inflationary pressures.

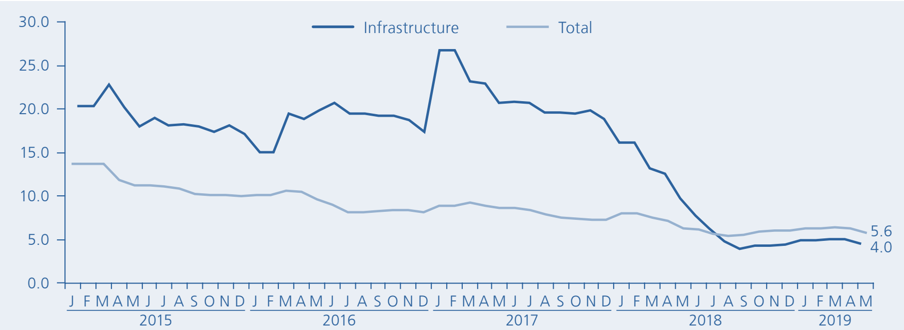
Table 6
MONETARY POLICY INTEREST RATE AND ANNUAL INFLATION
(In %)

	Monetary policy interest rate					Annual inflation (%)
	Levels in % (end-of-period)			Change (bps.)		
	Dec.18 (1)	Mar.19 (2)	Jun.19 (3)	(3)-(2)	(3)-(1)	
India	6.50	6.25	5.75	-50	-75	3.05
Iceland	4.50	4.50	3.75	-75	-75	3.30
Ukraine	18.00	18.00	17.50	-50	-50	9.60
Philippines	4.75	4.75	4.50	-25	-25	3.20
New Zealand	1.75	1.75	1.50	-25	-25	1.50
Australia	1.50	1.50	1.25	-25	-25	1.30
Chile	2.75	3.00	2.50	-50	-25	2.30
Russia	7.75	7.75	7.50	-25	-25	5.10
Malaysia	3.25	3.25	3.00	-25	-25	0.20
Brazil	6.50	6.50	6.50	0	0	4.66
China	4.35	4.35	4.35	0	0	2.70
Colombia	4.25	4.25	4.25	0	0	3.31
USA	2.50	2.50	2.50	0	0	1.80
Eurozone	0.00	0.00	0.00	0	0	1.20
Hungary	0.90	0.90	0.90	0	0	3.90
Indonesia	6.00	6.00	6.00	0	0	3.28
Japan	-0.10	-0.10	-0.10	0	0	0.70
Mexico	8.25	8.25	8.25	0	0	4.28
Peru	2.75	2.75	2.75	0	0	2.29
Poland	1.50	1.50	1.50	0	0	2.60
United Kingdom	0.75	0.75	0.75	0	0	2.00
Serbia	3.00	3.00	3.00	0	0	2.20
Switzerland	-0.75	-0.75	-0.75	0	0	0.60
Thailand	1.75	1.75	1.75	0	0	0.87
Taiwan	1.38	1.38	1.38	0	0	0.94
Turkey	24.00	24.00	24.00	0	0	15.72
Canada	1.75	1.75	1.75	0	0	2.40
South Korea	1.75	1.75	1.75	0	0	0.70
Israel	0.25	0.25	0.25	0	0	1.50
Romania	2.50	2.50	2.50	0	0	4.10
South Africa	6.75	6.75	6.75	0	0	4.50
Sweden	-0.25	-0.25	-0.25	0	0	2.16
Czech Republic	1.75	1.75	2.00	25	25	2.90
Norway	0.75	1.00	1.25	25	50	2.50
Pakistan	10.00	10.75	12.25	150	225	8.89

Memo: In case of inflation, number belongs to last data.

Despite trade tensions with the US, **China**'s GDP grew 6.4 percent in the first quarter of 2019 –the same rate as in the previous quarter–, which would reflect the impact of the stimulus measures implemented in the second half of 2018. Since April, however, both the indicators of economic activity and foreign trade show a marked deceleration. Investment maintains a low rate of expansion, associated with a relative stagnation of infrastructure spending. In this context, both the central bank and the government have announced measures aimed at preventing a sudden slowdown in the economy.

Graph 7
CHINA: INVESTMENT IN FIXED ASSETS
(Interannual % change)



Source: National Bureau of Statistics of China.

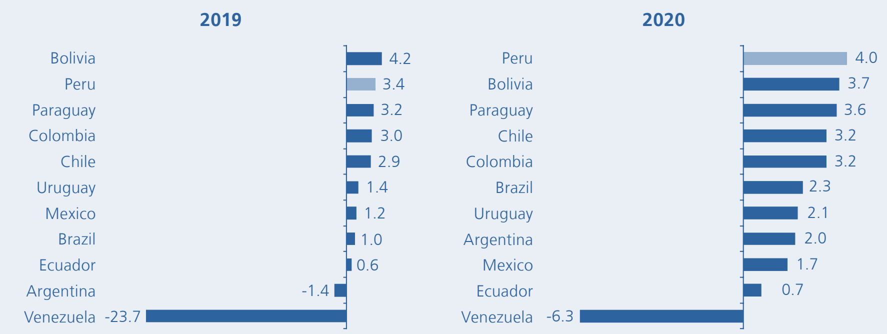
9. The central bank of China announced the reduction of reserve requirements for medium and small banks as from May, which means that the rate of reserve requirements for banks with assets below an amount equivalent to US$ 1.5 billion will decrease from 10-11.5 percent to 8 percent. In June, the Ministry of Finance announced that it will allow local governments to use part of the proceeds from the sale of special bonds as part of the capital for qualified infrastructure projects. In this context, the projected growth of China's GDP is revised down from 6.2 to 6.1 percent for both 2019 and 2020.

10. Likewise, the growth projection for **Latin America** in 2019 has been revised down from 1.3 to 0.8 percent, the lowest rate forecast since 2016. It is estimated that most economies would grow below their potential growth rates during 2019 and that they would recover during 2020.

    In the first quarter of 2019, the GDP of most countries in the region grew less than expected and recent indicators confirm a slowdown. External factors affecting the region have included the fall in the prices of basic metals and oil as well as uncertainty as a result of commercial tensions.

    As for internal factors, a slowdown has been observed in some primary sectors together with less a slower pace of growth in Chile's domestic demand. In Mexico, it is estimated that the economy will grow in 2019 at its lowest rate in six years, affected by additional external factors (the pending ratification of the agreement with the US and Canada) and internal factors (undetermined policy and situation of the state company PEMEX). In Brazil, consumers and investors' confidence has dropped due to uncertainty regarding the progress of the pension reform, and Argentina's output would register a new fall in 2019 after the restrictive monetary policy position adopted and the political noise caused by the general elections.

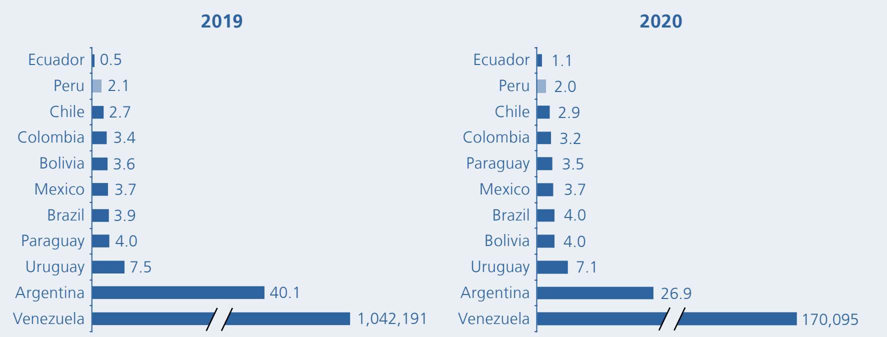
Graph 8
GDP GROWTH
(% change)



Source: Latin American Consensus Forecast (June 2019) and BCRP (Peru).

11. Inflation, on the other hand, has shown a downward trend in most countries and has been within the target range in the countries with inflation targeting. In this context of low inflationary pressures and below-potential growth, most economies in the region are expected to postpone monetary policy adjustments.

Graph 9
INFLATION
(% change, dec./dec.)



Source: Latin American Consensus Forecast (June 2019) and BCRP (Peru).

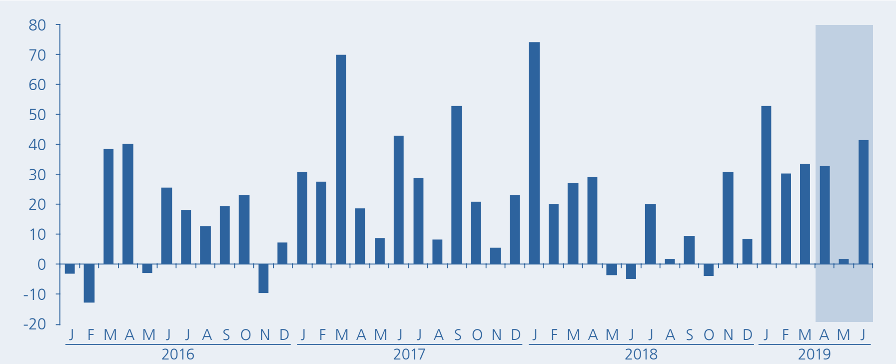
International Financial Markets

12. In the months of April and June, financial markets were influenced by the high volatility generated by the trade negotiations between the United States and China, but at the end of June both sides agreed to continue negotiations at the G-20 summit. Markets were also influenced by concerns about the global economic slowdown and geopolitical tensions. In this context, both commodity prices and yields decreased.

    The impact of these factors was offset by expectations that the developed economies would maintain expansionary monetary policies, which contributed to the appreciation of emerging currencies against the dollar.

    Non-residents' capital inflows to the emerging economies continued during the second quarter of the year, but showed a slower pace in May because of greater risk aversion and the correction of commodity prices. In June, the easing of monetary policy positions in the main economies and the negotiations resulting from the G20 meeting accounted for the high capital inflow observed.

Graph 10
FIXED AND VARIABLE INCOME FLOW FROM NON-RESIDENTS TO EMERGING MARKETS
(2016 - 2019, in billion US$)



Source: The Institute of International Finance (IIF).

13. In **fixed-income markets**, the 10-year US bond yield fell, influenced by uncertainty about the global trade policy and expectations of a rate cut in the Fed interest rate. As a result, the yield spread of the 10-year and 3-month bonds showed a negative level since May 23, which means that the yield curve has been inverted for about 5 weeks.

    In the Eurozone, the yields decreased due to the signs indicating an economic slowdown, the noise resulting from the Italian budget, and the ECB comments in favor of easing monetary policy. In the emerging economies, most yields fell after several variable-income portfolios were restructured into fixed-income portfolios in a context of deceleration of economic indicators.

Graph 11
YIELD ON THE 10-YEAR US TREASURY BOND
(In %, 2016-2019)

Source: Reuters.

Table 7
YIELDS ON 10-YEAR SOVEREIGN BONDS

	Dec.18	Mar.19	Jul.19	Accumulated change 2019 (bps.)	Change Jul.2019/ Mar.2019 (bps.)
USA	2.69	2.41	2.01	-68	-40
Germany	0.24	-0.07	-0.35	-59	-28
France	0.71	0.32	-0.04	-74	-35
Italy	2.74	2.49	1.98	-76	-50
Spain	1.41	1.09	0.37	-104	-72
Greece	4.35	3.73	2.29	-205	-144
United Kingdom	1.28	1.00	0.80	-48	-20
Japan	-0.01	-0.09	-0.15	-15	-6
Brazil	9.24	8.97	7.33	-191	-164
Colombia	6.75	6.62	6.14	-61	-48
Chile	4.24	3.97	3.11	-112	-86
Mexico	8.64	8.01	7.50	-114	-52
Peru	5.35	4.89	4.68	-67	-21
South Africa	9.28	9.04	8.74	-54	-31
India	7.37	7.35	6.88	-49	-47
Turkey	15.80	17.18	15.73	-7	-145
Russia	5.05	4.52	3.93	-112	-59
China	3.31	3.07	3.23	-8	16
South Korea	1.96	1.83	1.61	-34	-22
Indonesia	7.98	7.60	7.35	-63	-26
Thailand	2.48	2.44	2.10	-38	-34
Malaysia	4.08	3.76	3.64	-44	-12
Philippines	7.01	5.60	5.08	-193	-52

As of 1st July 2019.
Source: Reuters.

It should be pointed out that, in some cases, the downward trend observed in yields in the developed economies has been offset by the expansionary fiscal policies and the high levels of public debt maintained.

Table 8 FISCAL DEFICIT AND PUBLIC DEBT						
	Fiscal deficit (% GDP)			Public debt (% GDP)		
	2018	2019	2020	2018	2019	2020
USA	-4.3	-4.6	-4.4	106	107	108
Eurozone	-0.6	-1.0	-0.9	85	84	82
Japan	-3.2	-2.8	-2.1	237	238	237
United Kingdom	-1.4	-1.3	-1.2	87	86	84
China	-4.8	-6.1	-5.5	50	55	60
Latin Anerica	-4.7	-4.6	-4.1	68	68	68

Source: IMF.

14. In the **variable-income markets**, yields continued to rise in developed countries after the strong increase observed during the first quarter of 2019. These results were associated with the better corporate results published between April and May (corresponding to the first quarter of 2019), expectations of monetary easing measures by the main central banks, stimulus measures in China, the agreement reached between the US and Mexico, and the reopening of trade negotiations between the United States and China during the G20 summit.

Table 9 STOCK MARKETS						
		Dec.18	Mar.19	Jul.19	Accumulated change 2019 (%)	Change Jul.2019/ Mar.2019 (bps.)
VIX*	S&P 500	25.42	13.71	14.13	-11.3	0.4
USA	Dow Jones	23,327	25,929	26,672	14.3	2.9
Germany	DAX	10,559	11,526	12,521	18.6	8.6
France	CAC 40	4,731	5,351	5,568	17.7	4.1
Italy	FTSE MIB	18,324	21,286	21,346	16.5	0.3
Spain	IBEX 35	8,540	9,240	9,284	8.7	0.5
Greece	ASE	613	721	876	42.8	21.4
United Kingdom	FTSE 100	6,728	7,279	7,498	11.4	3.0
Japan	Nikkei 225	20,015	21,206	21,730	8.6	2.5
Brazil	Bovespa	87,887	95,415	101,562	15.6	6.4
Colombia	IGBC	11,144	13,060	12,606	13.1	-3.5
Chile	IGP	25,950	26,644	25,805	-0.6	-3.1
Mexico	IPC	41,640	43,281	43,379	4.2	0.2
Argentina	Merval	30,293	33,466	41,602	37.3	24.3
Peru	General Index	19,350	21,098	20,728	7.1	-1.8
South Africa	JSE	52,737	56,463	58,767	11.4	4.1
India	CNX Nifty	10,863	11,624	11,866	9.2	2.1
Turkey	XU100	91,270	93,784	99,736	9.3	6.3
Russia	Interfax	1,066	1,198	1,402	31.5	17.0
China	Shangai C.	2,494	3,091	3,045	22.1	-1.5
South Korea	Seul Composite	2,041	2,141	2,130	4.3	-0.5
Indonesia	JCI	6,194	6,469	6,380	3.0	-1.4
Thailand	SET	1,564	1,639	1,741	11.3	6.2
Malaysia	KLSE	1,691	1,644	1,684	-0.4	2.4
Philippines	Psei	7,466	7,921	8,044	7.7	1.6

* Data and variation in basis points.
As of 1st July 2019.
Source: Reuters.

The stock exchange markets of the emerging countries showed diverse movements in a context marked by a slight increase in risk aversion, the lower prices of several commodities, and a slowdown in local economic activity.

15. Moreover, most of the **emerging market currencies** strengthened against the dollar after the June Fed meeting and the resumption of negotiations between the US and China at the G20 summit.

    In this context, the appreciation of the Russian ruble, the Thai baht, the Argentine peso, the South African rand, the Philippine peso, and the Brazilian real stands out. The appreciation of the Russian ruble was driven by robust labor data and lower tensions with the United States, while the appreciation of the Thai baht was associated with the culmination of the elections process, and the Argentine peso strengthened against the dollar as a result of the improvements achieved in terms of inflation. On the other hand, the appreciation of the rand was favored by the recovery of activity and by the announcement of government measures to help the state firm Eskom; the strengthening of the Philippine peso was driven by S&P's increase in the sovereign rating as well as by the improvement of the country's external accounts and measures to ease the foreign exchange market, and the appreciation of the Brazilian real was associated with the greater cooperation observed among local powers to develop the economic agenda.

Table 10
EXCHANGE RATES

		Dec.18	Mar.19	Jul.19	Accumulated change 2019* (%)	Change Jul.2019/ Mar.2019 (bps.)*
Dollar Index**	US Dollar Index	96.17	97.28	96.44	0.3	-0.9
Eurozone	Euro	1.144	1.122	1.134	-0.8	1.1
United Kingdom	Pound sterling	1.281	1.303	1.266	-1.1	-2.8
Japan	Yen	109.93	110.84	108.28	-1.5	-2.3
Brazil	Real	3.880	3.924	3.814	-1.7	-2.8
Colombia	Peso	3,245	3,186	3,210	-1.1	0.7
Chile	Peso	693	680	675	-2.6	-0.8
Mexico	Peso	19.65	19.42	19.06	-3.0	-1.9
Argentina	Peso	37.65	43.28	41.95	11.4	-3.1
Peru	Sol	3.372	3.318	3.286	-2.6	-1.0
South Africa	Rand	14.38	14.48	14.05	-2.3	-3.0
India	Ruppe	69.77	69.18	68.90	-1.2	-0.4
Turkey	Lira	5.29	5.54	5.63	6.4	1.6
Russia	Ruble	69.68	65.67	62.85	-9.8	-4.3
China	Yuan (onshore)	6.876	6.711	6.841	-0.5	1.9
South Korea	Won	1,114	1,136	1,161	4.2	2.2
Indonesia	Rupee	14,550	14,160	14,150	-2.7	-0.1
Thailand	Bath	32.33	31.72	30.62	-5.3	-3.5
Malaysia	Ringgit	4.130	4.080	4.135	0.1	1.3
Philippines	Peso	52.49	52.67	51.08	-2.7	-3.0

* An increase (fall) in the index implies an appreciation (depreciation) of the US dollar, except in the euro and pound.
** An increase (fall) in the index implies an appreciation (depreciation) of the US dollar against currency basket (euro, yen, pound, canadian dollar, Sweeden krone and Switzerland franc).
As of 1st July 2019.
Source: Reuters.

16. **Commodity prices** have been showing a downward trend, in line with the escalation of trade tensions and lower global growth prospects.

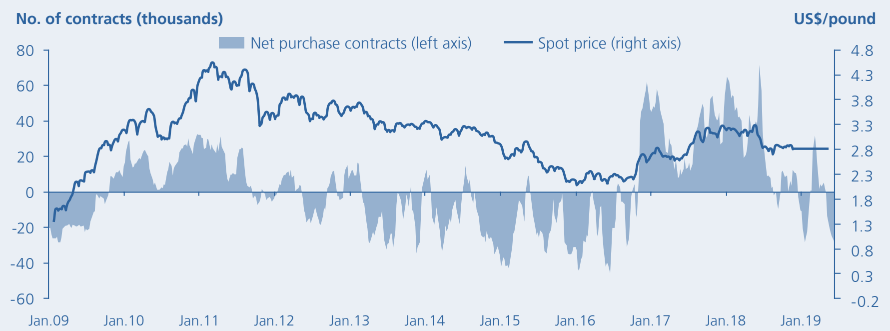
a. ***Copper***

In June, the price of copper showed a monthly average of US$ 2.66 a pound, a price level 9 percent lower than that registered in March 2019 after having increased by 6 percent in the first quarter of the year. As a result, the price of copper accumulates a fall of 3 percent compared to December 2018.

The price of copper fell, affected by the deterioration of global growth prospects. It is worth mentioning that in May the global manufacturing PMI –an indicator that has a high correlation with the demand for industrial metals– not only registered a level in the contraction zone, but also its lowest level since October 2012.

This pessimistic outlook led investors to reduce their non-commercial copper positions as a result of which non-commercial contracts went from a net purchase position in March to a net sale position since early May.

Graph 12
COPPER: NON-COMMERCIAL CONTRACTS



Note: The Copper Speculative Net Positions of the Commodities Futures Trading Commission are reported weekly and reflect the difference between the total volume of the long position (or purchase) and short position (or sale) in the market and opened by non-commercial operators (speculative). This report only includes the future markets in the USA (Chicago and New York Stock Exchanges).

Moreover, on the side of fundamentals, it should be said that a global deficit is expected in the copper market, although this deficit would be lower than in 2018.

The world supply provided by copper mines is growing at low rates due to production cuts in Indonesia and Zambia and due to unforeseen production cuts in Chile and Peru. In addition, the production of refined copper has slowed down due to maintenance in some smelters in China and Europe, as well as due to lower production in Chile and Zambia due to operational issues in their refineries.

Table 11
SUPPLY AND DEMAND FOR REFINED COPPER
(Thousand metric tonnes)

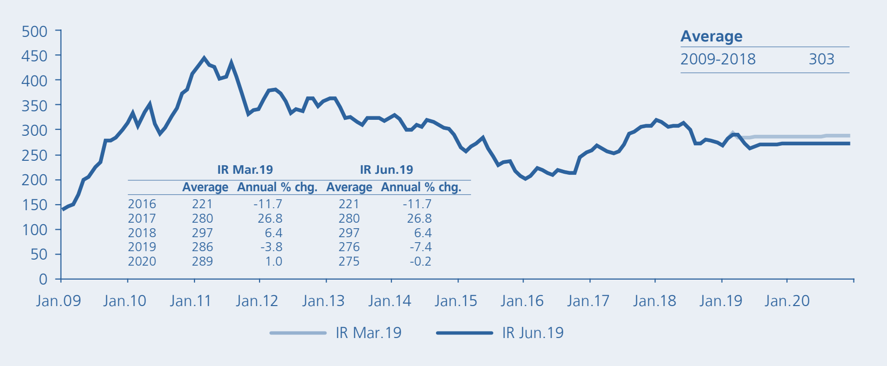
	2016	2017	2018[2/]	2019[2/]	2020[2/]
World Mine Production	20,386	20,096	20,614	20,641	21,029
Global Refined Production (Primary + Secondary)	23,362	23,553	24,111	24,780	25,080
World Refined Usage	23,512	23,732	24,510	24,969	25,330
Refined Balance[1/]	-151	-179	-399	-189	-250

1/ Balance is calculated using the total production of refined products minus refined usage.
2/ Estimated to november 2018.
Source: ICSG.

On the other hand, the outlook for demand has slowed due to the increased trade tensions between China and the United States. Notwithstanding, the expectation of new stricter regulations for the use of recycled copper and expectations of greater investment in China's infrastructure, particularly in electricity grids, would support China's demand for refined copper.

In line with these developments, the average price of copper estimated for 2019 and 2020 has been revised down. The risk factors of this projection are associated with a greater than expected slowdown in the world economy and with mine stoppages. Uncertainty about regulatory changes in China's imports of recycled copper is also an important factor.

Graph 13
COPPER: JANUARY 2009-DECEMBER 2020
(US$ cents/pd.)



b. ***Zinc***

The international price of zinc dropped 9 percent between March and June 2019 to an average monthly level of US$ 1.18 the pound in June. With this, the price of zinc accumulated a reduction of 1 percent compared to December 2018.

The price of zinc fell due to the lower demand outlook. Additionally, investment funds have reduced their positions influenced by expectations of a higher mine production and new refining capacity in China, which had decreased due to the adaptation to the new environmental regulations enacted by the Chinese government.

Despite this, the global market of refined zinc is expected to continue showing a deficit –for the fourth consecutive year– in 2019, which is reflected in the low and decreasing inventory levels (that show their lowest levels since 2009). The supply of refined products is still restricted in China due to the environmental measures imposed on the smelters by the government, although some smelters would have already made the corrections required by the new government regulations.

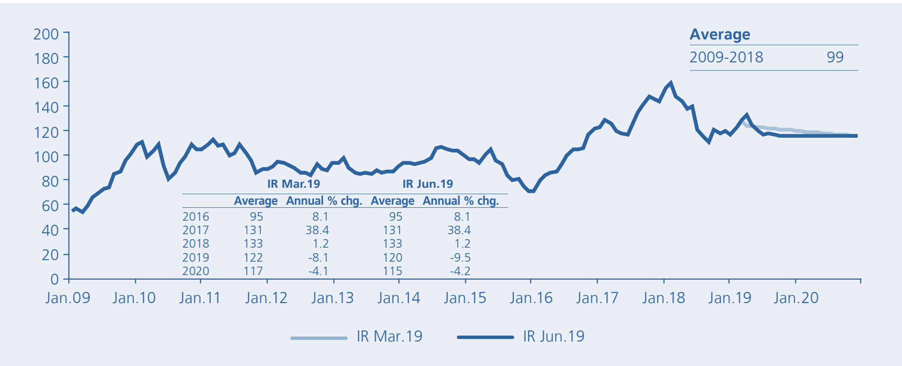
Table 12
SUPPLY AND DEMAND FOR REFINED ZINC
(Thousand metric tonnes)

	2014	2015	2016	2017	2018	2019
World Mine Production	13.42	13.63	12.60	12.53	12.69	13.48
Global Refined Production (Primary + Secondary)	13.40	13.81	13.58	13.22	13.17	13.65
World Refined Usage	13.68	13.64	13.71	13.68	13.68	13.77
Refined Balance (in thousands)	-277	169	-128	-461	-513	-121

Source: ILZSG, Forecast Report May 2019.

In line with these developments and with the new data, the projected price of zinc is revised down with respect to the projections of the previous Inflation Report. The uncertainty factors are associated with the speed with which the Chinese foundries will adapt to the new environmental standards and increase the offer of refined zinc. An important sector for the demand of zinc is the automotive industry, which is particularly sensitive to a possible escalation of commercial tensions.

Graph 14
ZINC: JANUARY 2009-DECEMBER 2020
(US$ cents/pd.)

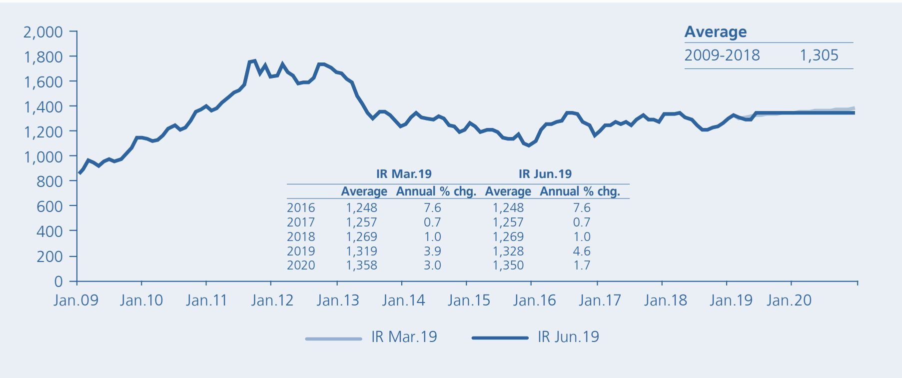


c. ***Gold***

In June, the price of gold registered an average value of US$ 1,359 the troy ounce, which represents an increase of 4 percent compared to March 2019 and an increase of 9 percent compared to December 2018.

The price of gold has increased in recent months due to investors' greater demand for safe assets in response to greater global uncertainty, this conduct being reinforced by increased expectations that the FED will cut its interest rate. These factors offset the weak demand for jewelry that is affected by higher prices. In addition to this, the estimated growth of supply would be indicating that the physical gold market will continue to show a surplus in 2019, even though the correlation between the physical market and the price is weak in the case of gold due to the exceptionally high level of inventories.

Graph 15
GOLD: JANUARY 2009-DECEMBER 2020
(US$/tr. ounce)



	IR Mar.19		IR Jun.19	
	Average	Annual % chg.	Average	Annual % chg.
2016	1,248	7.6	1,248	7.6
2017	1,257	0.7	1,257	0.7
2018	1,269	1.0	1,269	1.0
2019	1,319	3.9	1,328	4.6
2020	1,358	3.0	1,350	1.7

d. ***Crude Oil***

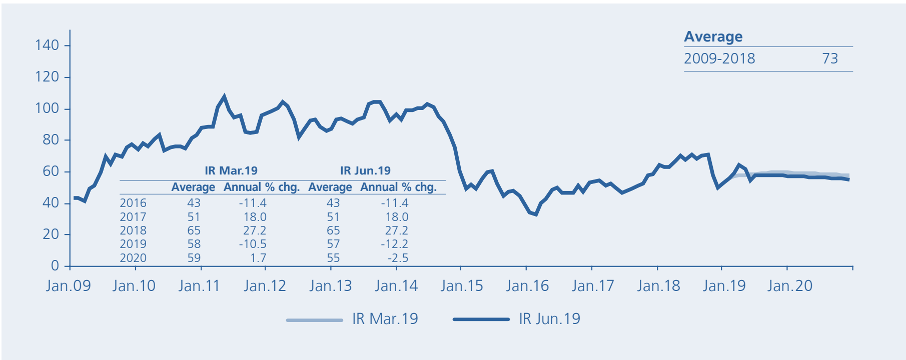
In June 2019, the average price of **WTI oil** increased 13 percent compared to December 2018, reaching an average monthly price of US$ 55 a barrel. Despite this, the price of oil fell 6 percent compared to March 2019.

The price of oil has decreased in the last two months, affected by the deterioration of the outlook for the growth of global demand, concerns of lower demand having been supported by Asian countries' lower imports of crude since May. On the fundamentals side, the price of oil has been strongly influenced by the continued growth of the US oil production.

Nonetheless, the global market remains relatively balanced due to the production cuts of the OPEC member countries and other oil producing countries, as well as due to the lower production of Iran and Venezuela.

The projected price of oil in the forecast horizon has been revised down compared to the previous Inflation Report. Although the price of oil has deteriorated in recent months due to greater fears about global growth, it is quite likely that the OPEC will prolong its production cuts until the end of the year to try to maintain current prices.

Graph 16
WTI OIL: JANUARY 2009-DECEMBER 2020
(US$/bl.)



e. ***Imported Food***

The price of **maize** increased 24 percent in the last three months, reaching an average monthly price of US$ 166 per MT in June. As a result, the international price of maize has accumulated an increase of 21 percent compared to December 2018.

Furthermore, the price of maize has increased significantly in the last two months due to the deterioration of the outlook for the US supply, the United States being the world's largest producer of this crop. The USDA has estimated that corn production in the United States will be the lowest observed since the 2012/13 season due to a historical delay in the planting period because of excessively humid weather conditions. The impact of the climate not only affects the yields of the sown grain, but also increases the probability that the entire area destined for cultivation will not be sown. This adverse supply shock counterbalances fears of lower demand associated with the escalation of trade tensions between China and the United States.

In line with these developments, the average price projected for 2019 has been revised up. The risks that could affect this projection are associated with the magnitude of the negative impact of climate on US maize production.

Graph 17
MAIZE: JANUARY 2009-DECEMBER 2020
(US$/ton)

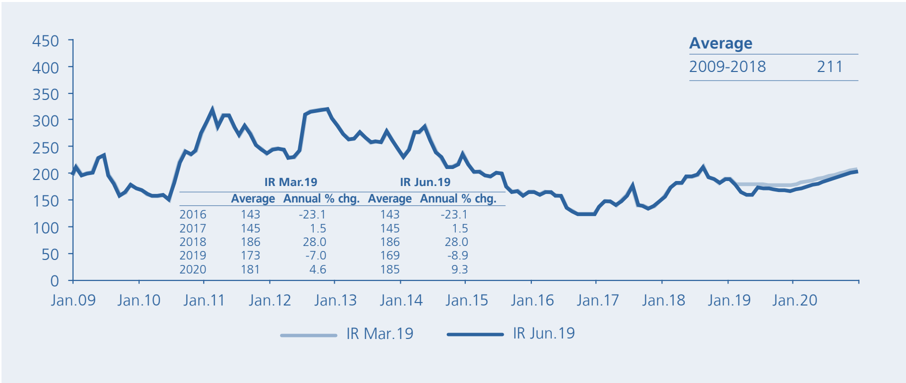
Since our last Inflation Report –published in March 2019–, the price of **wheat** has increased 6 percent, recording a monthly average of US$ 175 per MT in June. With this, the price of wheat has accumulated a reduction of 7 percent compared to December 2018.

The increase in the price of wheat was observed mainly in the month of June, both due to the lower availability of maize that can generate an increase in the demand for fodder wheat[1], as well as due to the negative impact of adverse weather conditions on winter wheat crops in the United States. However, this price increase was offset by the outlook for the 2019/2020 crop year, when global production is expected to reach a maximum level. Because of this, final inventories are expected to increase again after the reduction observed in the 2018/2019 crop year.

It is estimated that the price of wheat will show lower levels in 2019 than those foreseen in the previous Inflation Report due to the favorable next wheat crops estimated in the main producing countries. In spite of this, there are high risks that the projection could be affected by the impact that a lower production of corn in the United States could have on the demand for fodder wheat and by uncertainty about the impact of climate on the production of Australia and the Black Sea countries.

1 Used as animal feed.

Graph 18
WHEAT: JANUARY 2009-DECEMBER 2020
(US$/ton)



	IR Mar.19		IR Jun.19	
	Average	Annual % chg.	Average	Annual % chg.
2016	143	-23.1	143	-23.1
2017	145	1.5	145	1.5
2018	186	28.0	186	28.0
2019	173	-7.0	169	-8.9
2020	181	4.6	185	9.3

Average	
2009-2018	211

As of June, the average monthly price of soybean oil was US$ 623 per ton, 1 percent lower than in March 2019. Thus, the price of soybean oil has accumulated an increase of 0.4 percent so far in 2019.

The price of soybean oil declined, affected by fears of lower demand and concerns that the fall in the price of crude would discourage the demand for biodiesel. In addition, the international price of palm oil –the substitute for soybean oil– decreased last month. Despite this, soybean prices continue to be supported by global demand.

Graph 19
SOYBEAN OIL: JANUARY 2009-DECEMBER 2020
(US$/ton)

	IR Mar.19		IR Jun.19	
	Average	Annual % chg.	Average	Annual % chg.
2016	696	4.4	696	4.4
2017	707	1.5	707	1.5
2018	637	-9.9	637	-9.9
2019	662	4.0	617	-3.1
2020	682	3.0	620	0.5

Average	
2008-2017	887

Taking into account these recent developments and the prospects of a lower demand for soybean oil in the 2019/20 crop year, soybean prices are estimated to show levels below those estimated in the previous Inflation Report.

Box 1
IMPACT OF TRADE TENSIONS ON INVESTMENT AND TRADE

Trade tensions between the US and China and negotiations to define the United Kingdom's exit from the European Union (*Brexit*), among other factors of uncertainty, have reduced investor confidence. The global indices of business confidence prepared by the OECD show a sustained decline in this indicator since the second quarter of this year, this decline being greater than that observed in consumer confidence. At the country level, investor confidence shows minimum low levels not observed in Germany since 2014, unseen in the UK since 2016, and unseen in Japan since 2017.

CONFIDENCE INDEX: OECD

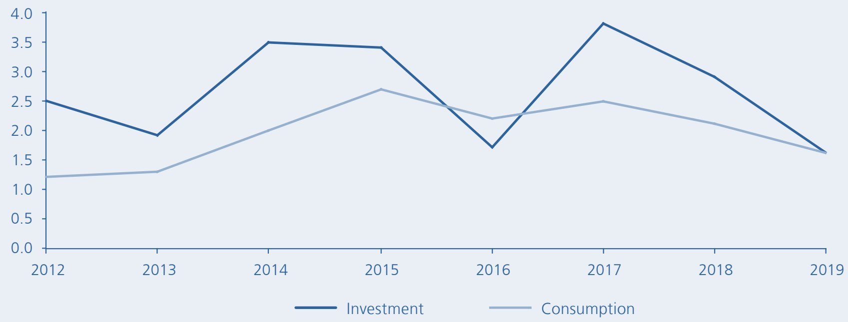
Source: OECD.

In line with this, recent investment estimates have been revised down, which mostly explains the lower growth forecast for 2019 since this slowdown would be observed in both the developed economies and the emerging economies.

In the developed economies, investment will slow down for the second consecutive year. A slower pace of investment is foreseen in the US (in its June statement, the Fed said that a deceleration of investment is observed along with strong consumption) and in Japan (in line with the sharp drop observed in machinery purchase orders in recent months), while in the Eurozone the production of capital goods fell again in April after having grown in the first quarter of 2019, resuming the trend registered in the second half of 2018.

In the **emerging economies**, the highest deceleration in investment would be observed in the economies that have been most affected by the international context and which would even show a contraction in their investment levels. Moreover, it is worth mentioning that the recent drop in commodity prices could intensify this trend as a result of lower investment in the primary sectors.

CONSUMPTION AND INVESTMENT GROWTH: OECD COUNTRIES
(% Change)



Source: OECD.

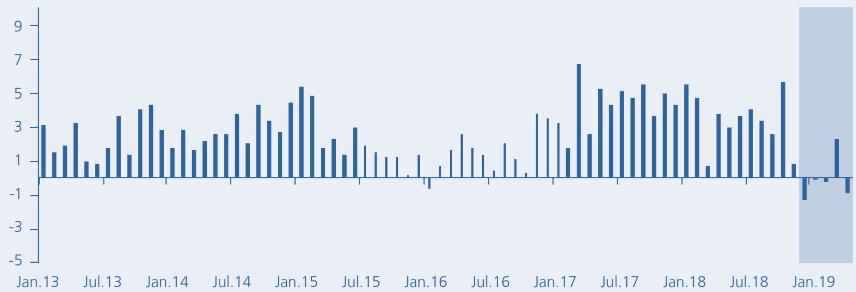
At the country level, this slowdown has been recorded in 29 of the 44 countries reported by the OECD, both in the developed economies and the emerging economies. Furthermore, the number of countries that could show an investment contraction (nine) is higher than those that would show a contraction in consumption (two).

CONSUMPTION AND INVESTMENT: OECD COUNTRIES
(% Change)

	Investment			Consumption		
Countries	**2017**	**2018**	**2019**	**2017**	**2018**	**2019**
Developed economies						
Of which:						
Germany	3.6	2.7	2.7	2.3	1.3	1.6
Canada	3.0	0.8	-2.8	3.1	1.9	0.6
Korea	8.6	-2.1	-2.4	4.7	1.7	1.7
Spain	4.8	5.3	3.8	2.9	2.9	2.2
USA	4.0	4.8	3.2	2.5	2.9	2.5
France	4.7	2.9	2.0	2.0	1.4	1.4
Italy	4.5	3.2	-0.2	1.8	1.0	0.2
Japan	3.0	1.1	2.0	1.4	0.6	0.9
United Kingdom	3.5	0.2	1.0	1.9	1.2	1.7
Emerging economies						
Of which:						
Argentina	12.2	-5.8	-16.3	4.9	-3.1	-5.3
Brazil	-2.6	4.1	0.7	0.3	1.9	1.4
Chile	-2.7	4.6	5.0	1.9	3.9	3.5
Colombia	1.9	1.1	5.3	2.3	3.4	3.7
India	9.3	10.5	7.7	8.8	8.8	8.2
Mexico	-1.6	0.6	-1.8	2.0	1.7	0.4
South Africa	1.0	-1.4	0.0	n.d.	n.d.	n.d.
Turkey	7.8	-1.7	-6.8	6.4	0.7	-5.2
OECD AVERAGE	**3.8**	**2.9**	**1.6**	**2.5**	**2.1**	**1.6**

These prospects of a slowdown in investment and, to a lesser extent, in consumption[2], have an impact on global trade, because exports, together with investment, are the components of expenditure that normally show the highest volatility[3]. Therefore, it should be pointed out that, coinciding with the escalation of trade tensions, trade volume indicators (with data available as of April) show negative growth rates.

WORLD EXPORTS: VOLUME
(Last 12-month % change)



Source: World Trade Monitor.

Moreover, the WTO's latest World Trade Outlook Indicator (WTOI) shows that world trade grew below its growth trend in the second quarter of 2019 and recorded 96.3 –level below the base value of the index of 100–, which reflects a trade expansion below the trend. The sub indicators that have deteriorated the most compared to the previous quarter are international air freight (IATA), car production and sales, and agricultural commodities.

INTERNATIONAL TRADE INDICATORS

	May.18	Aug.18	Nov.18	Feb.19	May.19	Var.% May.19/May.18
World trade outlook indicator	101.8	100.3	98.6	96.3	96.3	-5.4
Good trade volume	102.7	102.0	101.5	101.9	100.2	-2.4
Export orders	98.1	97.2	96.6	95.3	96.6	-1.5
International freight air (IATA)	102.5	100.9	100.0	96.8	92.3	-10.0
Movement of containers in port	105.8	102.2	101.2	100.3	101.0	-4.5
Automobiles production and sales	97.9	98.1	96.9	92.5	92.2	-5.8
Electronic components	104.2	102.2	93.9	88.7	96.7	-7.2
Agricultural commodities	95.9	100.1	97.2	94.3	92.4	-3.6

Source: WTO.

2 Consumption is a spending component that, together with public spending, tends to show lower volatility than investment. Although this variable is also affected by global uncertainty, favorable conditions in the labor market and favorable credit conditions offset the impact.

3 For data on the US, see The Volatility of GDP components, The Fred's Blog (Federal Reserve Bank of St. Louis, August 6, 2015).

II. Balance of Payments

Current Account

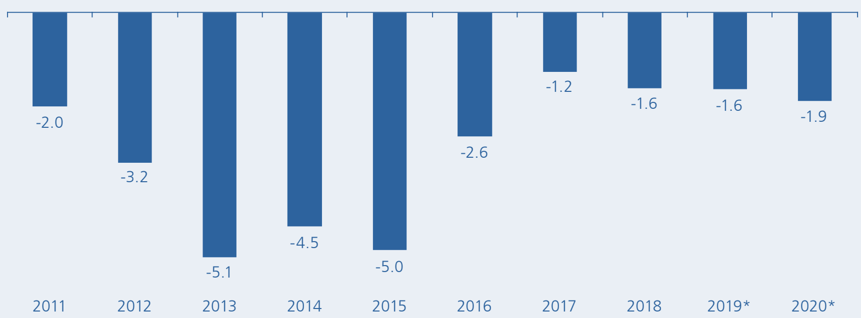
17. In the first quarter of 2019, the current account deficit of the balance of payments increased to US$ 1.66 billion (3.1 percent of GDP), a deficit US$ 352 million higher than the one registered in the same period of 2018 (2.5 percent of GDP). This result reflected mainly the lower surplus of the trade balance (US$ 701 million) resulting from lower export prices and lower mining production.

    In the forecast horizon, a lower trade surplus and a greater current account deficit than those foreseen in the Report of March are anticipated as a result of lower terms of trade (mainly due to export prices) and the expected lower dynamism of global activity. Nonetheless, the trade surplus and the current account deficit would remain at sustainable levels and below the average levels of the last 10 years (2.8 percent of GDP). Moreover, lower (mining) exports prices are expected this year and next year, which will reflect in a reduction of the terms of trade of 2.8 percent in 2019 and 0.7 percent in 2020, contrasting with the profit foreseen in the previous Report.

    Additionally, in a context of lower international interest rates, greater capital inflows to both the private sector and the public sector are expected, with long-term capital inflows exceeding the greater current account financing requirement.

    In this scenario, the projected current account deficits for 2019 and 2020 have been revised to 1.6 and 1.9 percent of GDP, respectively, in line with the lower terms of trade foreseen.

Graph 20
CURRENT ACCOUNT: 2011-2020
(% GDP)



* Forecast.

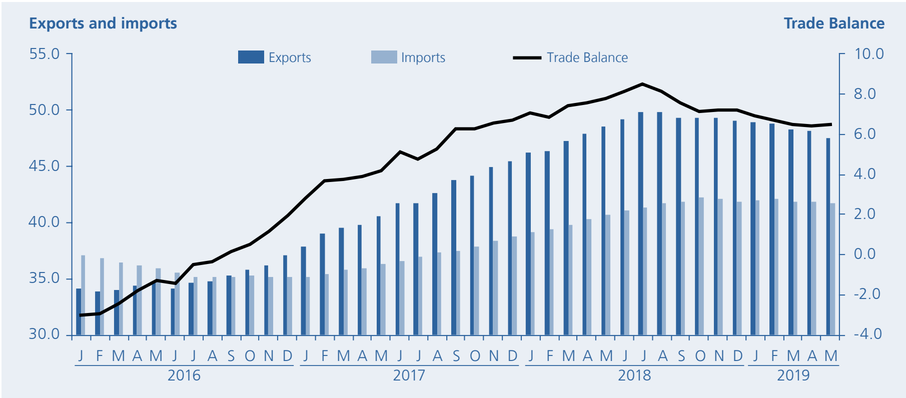
Table 13
BALANCE OF PAYMENTS
(Million US$)

	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
I. CURRENT ACCOUNT BALANCE	**-3,594**	**-1,664**	**-2,997**	**-3,782**	**-3,308**	**-4,608**
% GDP	*-1.6*	*-3.1*	*-1.3*	*-1.6*	*-1.3*	*-1.9*
1. Trade Balance	7,197	1,212	8,025	6,271	8,525	6,284
a. Exports	49,066	11,158	51,026	48,195	55,391	51,224
i) Traditional	35,638	7,883	36,431	34,023	39,175	35,611
ii) Non traditional	13,240	3,232	14,424	14,001	16,037	15,457
b. Imports	-41,870	-9,947	-43,000	-41,924	-46,866	-44,940
2. Services	-2,532	-602	-2,697	-2,514	-2,854	-2,885
3. Investment income	-11,814	-3,240	-11,988	-11,303	-12,811	-11,883
4. Current transfers	3,556	966	3,662	3,763	3,832	3,876
Of which: Remittances	3,225	800	3,364	3,382	3,532	3,551
II. FINANCIAL ACCOUNT	**94**	**4,634**	**7,333**	**9,818**	**6,389**	**6,292**
1. Private Sector	-2,028	887	2,229	3,235	4,118	3,213
a. Long-term	917	1,055	3,525	4,109	4,227	3,427
b. Short-term[1/]	-2,946	-168	-1,296	-873	-109	-214
2. Public sector[2/]	2,122	3,747	5,104	6,582	2,270	3,080
III. CHANGE ON NIRs	**-3,500**	**2,970**	**4,335**	**6,035**	**3,081**	**1,684**

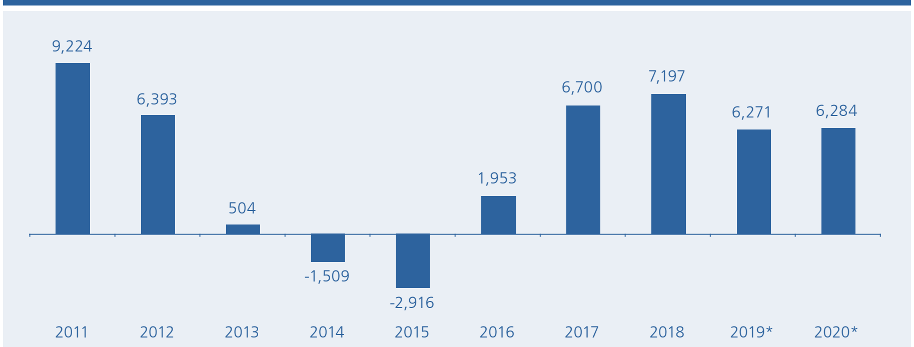
1/ Includes net errors and omissions, and NIR's effect valuation.
2/ Includes portfolio investment in sovereign bonds by non-residents.
* Forecast.
IR: Inflation Report.

18. In the first quarter of the year, the **trade balance** showed a surplus of US$ 1.21 billion, a surplus US$ 701 million lower than the balance obtained in the same period of 2018. As of May 2019, the cumulative twelve month-balance was US$ 5.87 billion, which reflects the downward trend observed since July 2018. Therefore, reflecting mainly the reduction in the value of the exports, the projection for the trade balance this year is revised down from US$ 8.03 billion to US$ 6.27 billion. Likewise, the projection for 2020 has also been revised down.

Graph 21
TRADE BALANCE, EXPORTS, AND IMPORTS
(Accumulated last 12 months - Billion US$)



Graph 22
TRADE BALANCE: 2011-2020
(Million US$)



* Forecast.

19. **Exports** totaled US$ 11.16 billion in the first quarter of the year, which represents a decrease of 6.6 percent compared to the previous year, mainly as a result of the lower prices of copper and zinc exports. Moreover, the value of our exports is expected to decline this year due to the impact of lower export prices, particularly in the case of copper, zinc, and hydrocarbons. Notwithstanding, the lower growth of the volume of traditional exports associated with the downward adjustment in mining, fishing, and hydrocarbon production, would be offset by higher exports of non-traditional goods. In 2020, the volume of traditional exports is expected to resume a positive growth trend due to several factors, including the normalization of copper production at mine Las Bambas, the normalization of operations at Shougang's expansion unit, the full operation of the Southern' Toquepala expansion unit, the onset of operations at the expansion of Chinalco's Toromocho mine, and a greater dynamism of non-traditional exports.

On the other hand, **imports** have shown little dynamism in the first quarter of 2019 in a context marked by a weak growth of domestic demand. A partial recovery is expected for the remainder of this year, whereas in 2020 imports are projected to show a full recovery, in line with the expected evolution of investment and local activity.

Table 14
TRADE BALANCE
(% change)

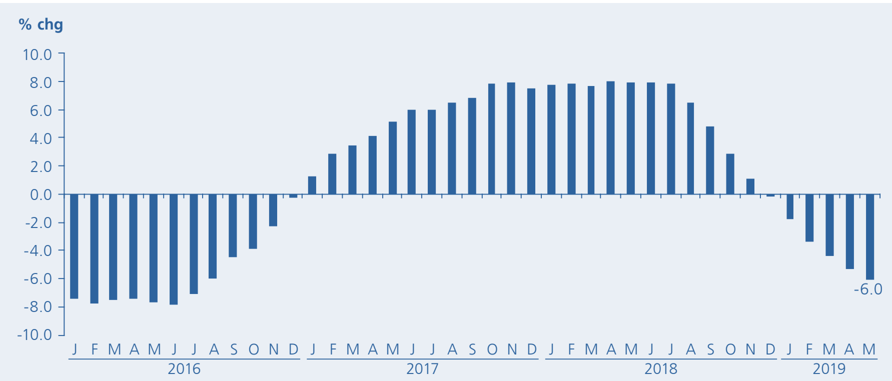
	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
1. Value:						
Exports	8.0	-6.6	4.3	-1.8	8.6	6.3
Traditional products	6.2	-10.1	2.5	-4.5	7.5	4.7
Non-traditional products	12.9	2.9	9.2	5.7	11.2	10.4
Imports	8.1	-0.9	2.6	0.1	9.0	7.2
2. Volume:						
Exports	1.6	1.4	4.8	2.4	5.8	5.5
Traditional products	-1.5	-1.7	3.5	0.6	5.0	4.8
Non-traditional products	11.0	9.3	8.2	6.9	7.9	7.2
Imports	1.6	-0.8	4.5	1.4	6.7	5.6
3. Price:						
Exports	6.3	-7.9	-0.5	-4.0	2.6	0.7
Traditional products	7.8	-8.6	-1.0	-5.1	2.4	-0.1
Non-traditional products	1.8	-5.9	0.9	-1.1	3.0	3.0
Imports	6.5	-0.1	-1.8	-1.3	2.1	1.5

* Forecast.
IR: Inflation Report.

Terms of Trade

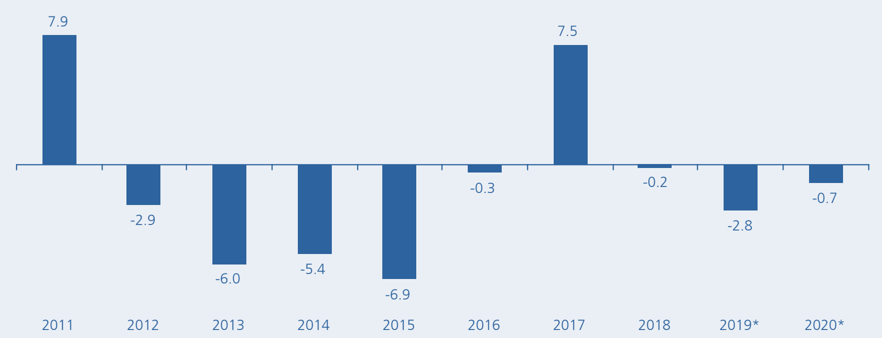
20. Since mid-2018, trade tensions between the United States and China have been affecting the prices of the main commodities, including our export metals. In the last twelve months (as of May 2019), the **terms of trade** have fallen 6.0 percent.

Graph 23
TERMS OF TRADE
(Accumulated 12 month % change)



21. In 2019, the terms of trade would show a reduction of 2.8 percent. The (annual average) prices of exports would fall by 4.0 percent, while the prices of imports would fall 1.3 percent. In 2020, the terms of trade would decrease 0.7 percent.

Graph 24
TERMS OF TRADE: 2011-2020
(Annual average % change)



* Forecast.
Source: BCRP.

Table 15
TERMS OF TRADE: 2018-2020

	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
Terms of Trade						
Annual average % chg.	**-0.2**	**-8.4**	**1.3**	**-2.8**	**0.4**	**-0.7**
Price of exports						
Annual average % chg.	**6.3**	**-8.5**	**-0.5**	**-4.0**	**2.6**	**0.7**
Copper (US$ cents per pound)	297	282	286	276	289	275
Zinc (US$ cents per pound)	133	123	122	120	117	115
Lead (US$ cents per pound)	102	92	94	86	95	84
Gold (US$ per troy ounce)	1,269	1,304	1,319	1,328	1,358	1,350
Price of Imports						
Annual average % chg.	**6.5**	**-0.1**	**-1.8**	**-1.3**	**2.1**	**1.5**
Oil (US$ per barrel)	65	55	58	57	59	55
Wheat (US$ per ton)	186	177	173	169	181	185
Maize (US$ per ton)	132	137	146	153	154	169
Soybean oil (US$ per ton)	637	636	662	617	682	620
Soybean grain (US$ per ton)	379	341	343	354	350	373

* Forecast.
IR: Inflation Report.
Source: BCRP.

External Financing

22. **Private long-term capital** is expected to continue to be the main source of financing the balance of payments in the forecast horizon. **Foreign direct investment** will

continue to be the main source of financing due to profit reinvestment, although the latter will be lower than foreseen in the March report, in line with the downward revision of investment and the lower terms of trade projected. The main investment projects expected to be implemented in the forecast horizon are mining projects, which would amount to nearly US$ 10 billion in 2019-2020. Megaprojects expected to continue being implemented include the mega projects of Quellaveco, Mina Justa, and the expansion of Toromocho, and other smaller scale projects, such as Quecher Main and Relaves B2 San Rafael.

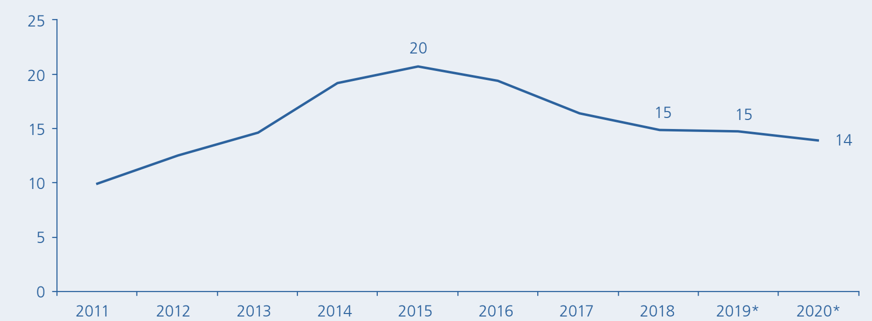
Table 16
FINANCIAL ACCOUNT OF THE PRIVATE SECTOR
(Million US$)

	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
PRIVATE SECTOR (A + B)	**-2,028**	**887**	**2,229**	**3,235**	**4,118**	**3,213**
% GDP	*-0.9*	*1.6*	*0.9*	*1.4*	*1.6*	*1.3*
A. LONG-TERM	**917**	**1,055**	**3,525**	**4,109**	**4,227**	**3,427**
1. ASSETS	**-3,558**	**-2,272**	**-4,229**	**-3,023**	**-3,774**	**-2,321**
2. LIABILITIES	**4,476**	**3,327**	**7,754**	**7,131**	**8,001**	**5,748**
Foreign direct investment in the country	6,488	2,781	7,435	6,608	8,002	5,642
Long-term loans	-1,601	733	-93	179	-584	-493
Portfolio investment	-411	-187	412	344	584	600
B. SHORT-TERM[1/]	**-2,946**	**-168**	**-1,296**	**-873**	**-109**	**-214**

1/ Includes net erros and omissions.
* Forecast.
IR: Inflation Report.

In addition to this, the greater preference for local financing has been reflected in the early amortization of loans, so that the external debt, which shows a decreasing trend during the forecast horizon, is estimated to be equivalent to 13.7 percent of GDP in 2020.

Graph 25
MEDIUM- AND LONG-TERM EXTERNAL DEBT BALANCE: 2011-2020
(% GDP)



* Forecast.

23. The **public financial account** has been revised to the upside compared to the previous projection due mainly to non-residents' greater demand for our sovereign bonds so far this year, in a context of greater capital flows to the emerging bond markets and debt management operations (DMOs) to take advantage of the context of lower international rates. The higher resources obtained from the DMOs have been earmarked for amortizations and for refinancing the 2020 public budget.

Table 17
FINANCIAL ACCOUNT OF THE PUBLIC SECTOR
(Million US$)

	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
I. Disbursements[1/]	**1,800**	**518**	**1,844**	**2,178**	**1,224**	**1,851**
II. Amortization	**-1,614**	**-219**	**-1,542**	**-1,958**	**-335**	**-335**
III. Net external assets	**-201**	**429**	**-225**	**249**	**-240**	**-240**
IV. Other transactions with Treasury bonds (IV=a-b)	**2,137**	**3,018**	**5,028**	**6,114**	**1,622**	**1,804**
a. Sovereign Bonds held by non-residentes	1,822	3,033	5,026	6,035	1,622	1,804
b. Global Bonds held by residentes	-315	15	-1	-79	0	0
V. TOTAL (V = I+II+III+IV)	**2,122**	**3,747**	**5,104**	**6,582**	**2,270**	**3,080**

1/ Includes bonds.
* Forecast.
IR: Inflation Report.

24. The soundness of the balance of payments to face negative external events is reflected in the position of Peru's international reserves relative to the balance of its short term external liabilities or comparing the total of these liabilities with the country's current account deficit. The high-levels the Peruvian economy shows in these indicators in comparison with other emerging economies was achieved thanks to the preventive accumulation of international reserves.

Table 18
NIR INDICATORS

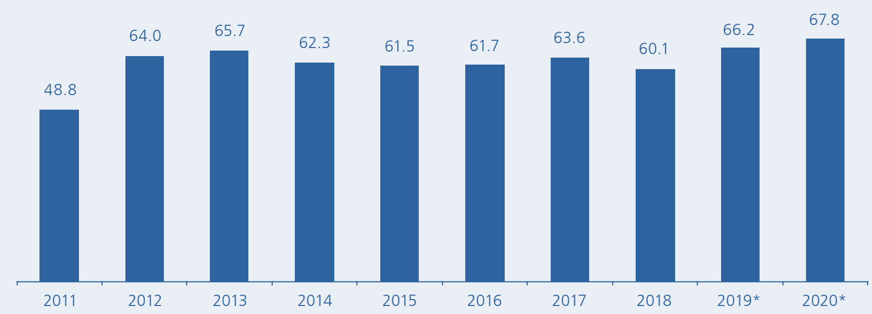
	2017	2018	2019*	2020*
NIR as a % of:				
a. GDP	29.7	26.7	28.2	27.3
b. Short-term external debt[1/]	405	410	509	516
c. Short-term external debt plus current account deficit	346	329	394	382

1/ Includes the balance of short-term debt plus one-year amortization of the private and public sector.
* Forecast.

25. As of June 28, net international reserves have increased by US$ 6.39 billion compared to the end of last year. The foreign exchange position of BCRP has increased by US$ 1.83 billion, banks' deposits in foreign currency at BCRP have

increased US$ 4.04 billion, and public sector deposits have increased US$ 566 million.

Graph 26
NET INTERNATIONAL RESERVES: 2011-2020
(Billion US$)



* Forecast.

Box 2

ADMINISTRATIVE SIMPLIFICATION OF FOREIGN TRADE PROCEDURES

One of the reforms needed to increase Peru's potential GDP is related to the implementation of better regulatory practices to reduce the transaction costs generated by public entities, such as, for example, Dirección General de Medicamentos, Insumos y Drogas (DIGEMID) –General Directorate of Drugs, Supplies and Drugs–, Dirección General de Saneamiento Ambiental (DIGESA) –General Directorate of Environmental Sanitation–, and Servicio Nacional de Sanidad Agrícola (SENASA) –or National Service for Agricultural Health. SENASA, the national authority in agricultural health matters, is in charge of the inspection, verification, and certification of plant and animal health conditions, and is also responsible for issuing the permits required to enter agricultural and forestry products into the country, as well as for managing the opening of markets through sanitary protocols.

These agencies play a fundamental role in the international trade of manufactured, agricultural, and forestry products, because the restrictions that today affect the trade of goods are not currently associated with tariffs (since much of today's trade is carried out based on free trade agreements), but rather with other tariff factors (e.g., protocols, technical standards, countervailing duties, among other factors). Therefore, these agencies contribute to generate an environment favorable to investment and to develop competitiveness among exporting companies.

RESTRICTED GOODS PROCEDURES
IN THE SINGLE WINDOW FACILITY FOR FOREIGN TRADE

	2017		2018[1/]	
Type of procedure	**Number**	**%**	**Number**	**%**
National Health Service and Food Quality (SENASA)	167,890	55.6	136,421	55.6
Of which:				
Export and re-export phytosanitary certificate	102,085	33.8	85,116	34.7
Inspection of pesticides for import	23,154	7.7	17,757	7.2
Import phytosanitary licence	18,135	6.0	10,348	4.2
Inspection for import of animals	6,605	2.2	5,710	2.3
Health licence for animals import	5,537	1.8	3,904	1.6
General office of environmental health (DIGESA)	40,425	13.4	32,213	13.1
National fisherie health agency (SANIPES)	32,115	10.6	28,175	11.5
General office of medicines, medical supplies ands drugs (DIGEMID)	30,874	10.2	24,143	9.8
Peruvian Ministry of Transportation and Communications (MTC)	21,728	7.2	16,463	6.7
Ministry of Production (PRODUCE)	3,314	1.1	2,708	1.1
National Superintendence of Control of Security Services and Weapons Ammunition and explosives for civil use (SUCAMEC)	2,971	1.0	3,000	1.2
Ministry of Foreign Trade and Tourism (MINCETUR)	1,030	0.3	922	0.4
Peruvian Institute of Nuclear Energy (IPEN)	743	0.2	578	0.2
National forestry and wildlife service (SERFOR)	642	0.2	559	0.2
Total	**301,732**	**100.0**	**245,182**	**100.0**

1/ As of September 2018.
Source: Single Window Facility for Foreign Trade (VUCE).

In general, the improvements implemented by SENASA –such as the automatic issuance of resolution documents to reply to applications or requests, and the introduction of the digital signature, for example– have contributed to reduce the average time that the procedures initiated through the *Ventanilla* Única *de Comercio Exterior* (VUCE) –or Single Window of Foreign Trade– of the Ministry of Foreign Trade and Tourism (MINCETUR) usually take. Thus, in the case of phytosanitary certificates for export products, the average response time in 2018 was 1.9 business days, a much lower period of time than the deadline established in the Single Text of Administrative Procedures (TUPA) and the average response time in 2015 (12.1 days).

TIMES OF ATTENTION OF PROCEDURES IN THE VUCE

Agency	**SENASA**	
TUPA	Export phytosanitary certificate SNS022 2/	
TUPA period	7 days	
Attention days	**Average (business days)**	**Number of procedures**
2015	12.1	67,023
2016	4.3	86,226
2017	2.3	90,347
2018 1/	1.9	79,500

1/ As of september 2018.
2/ Corresponds to the format of VUCE-SENASA to obtain the phytosanitary certificate for export of plants and vegetables.
Source: Single Window Facility for Foreign Trade (VUCE).

Because of the growing dynamism of agro-export activity and exports of fresh produce, SENASA has become the entity that deals with the greatest number of requests through the VUCE. Between January and September 2018, for example, the ratio of procedure requests handled by SENASA was 55.6 percent.

Notwithstanding the improvements made, there are still a number of aspects that could limit SENASA's efficiency and effectiveness to further contribute to introduce Peruvian products into the international markets with which Peru has signed free trade agreements, including the lack of: (a) inter-institutional coordination with other State entities to fill in the possible legal gaps in the definition of normative competences; (b) use of risk assessment and management systems; (c) coordination with the private sector; (d) transparency and accountability; (e) budget, capability, and operational independence, and (f) update and prioritization of phytosanitary protocols for products.

The World Bank (2016)[4] has proposed a series of improvements that health agencies should implement in order to reduce the logistics costs of companies engaged in the trade of goods of plant origin. One of the actions recommended is to improve the coordination between SUNAT and SENASA on the subject of sanitary inspections of imports or exports of containers of agricultural products.

4 Banco Mundial (2016). Análisis de los costos marítimos y portuarios en Perú: Reporte final. Cooperación técnica del Banco Mundial con el Ministerio de Comercio Exterior y Turismo.

In addition, it is necessary to develop international phytosanitary protocols that will allow our agro-export products to complete the requirements needed to enter other markets, some of which are still pending, as is the case of quinoa to Colombia and Mexico, or the case of Hass avocado to South Korea, Australia, and Malaysia. All the procedure improvements handled via the single window will effectively translate into a higher growth of our exports. Moreover, SENASA's accompaniment and contribution to the take-off of the country's agro-export sector should be replicated in other sectors, such as forestry, for instance.

Moreover, it is worth mentioning that the Presidency of the Council of Ministers should publish the list of the procedures that exceeded the validation of the regulatory quality of the other health agencies that participate in the VUCE, such as the Ministry of Health's agencies DIGESA and DIGEMID, or the Ministry of Production's Organismo Nacional de Sanidad Pesquera (SANIPES). Together with SENASA, these agencies accounted for 90 percent of the procedures managed by the VUCE between January and September 2018. Finally, these health agencies should monitor that our products meet not only the quality standard requirements established by international markets, but also the quality standards of the products oriented to the domestic market.

III. Economic Activity

Sector GDP

26. Lower GDP growth in January - April 2019 (1.7 percent) is explained by a 3.3 percent contraction in the output of primary industries, while the output of non-primary industries has grown 3.1 percent. Factors accounting for the decline in the former included (i) a lower fishing output due to lower anchovy catch, (ii) lower output in the metal mining sector due to a lower extraction of gold, iron, zinc, and silver, and (iii) lower output in primary manufacturing due to a lower production of fishmeal and lower refining of non-ferrous metals.

Table 19
PRIMARY AND NON-PRIMARY GDP: JANUARY-APRIL
(Real % change)

	2015	2016	2017	2018	2019
GDP	**2.5**	**4.1**	**1.8**	**4.4**	**1.7**
Primary GDP	4.1	7.3	4.3	4.4	-3.3
Non-Primary GDP	2.1	3.3	1.1	4.4	3.1

A growth rate of 3.4 percent is projected for 2019 since the effect of the output fall in the primary sectors would revert in the second half of the year due to the normalization of fishing activity anticipated in the second anchovy fishing season and due to greater mining production because the expansion units of Toquepala and Shougang would reach commercial operation levels. On the other hand, non-primary industries would show a faster pace of growth especially in construction, due to a recovery in public investment, and in non-primary manufacturing, commerce, and services, due to a recovery in consumption and private investment. In 2020 the economy would grow 4.0 percent, driven mainly by a recovery in the primary sectors.

Table 20
GDP BY PRODUCTION SECTOR
(Real % change)

	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
Primary GDP	**3.3**	**-1.3**	**3.0**	**1.3**	**3.4**	**3.6**
Agriculture and livestock	7.8	4.9	4.5	4.5	4.0	4.0
Fishing	39.7	-20.5	-4.5	-14.6	2.0	9.0
Metallic mining	-1.5	-2.2	3.3	2.1	4.3	4.0
Hydrocarbons	0.0	9.5	3.0	2.6	-0.5	0.3
Based on raw materials	13.2	-13.0	0.5	-5.9	1.2	2.1
Non-Primary GDP	**4.2**	**3.3**	**4.2**	**4.0**	**4.2**	**4.1**
Non-primary industries	3.7	3.1	4.0	3.2	3.8	3.8
Electricity and water	4.4	6.0	4.5	4.3	4.5	4.0
Construction	5.4	1.8	6.5	5.4	7.5	6.9
Commerce	2.6	2.4	3.4	3.2	3.5	3.5
Services	4.4	3.7	4.2	4.1	4.0	4.0
GDP	**4.0**	**2.3**	**4.0**	**3.4**	**4.0**	**4.0**

* Forecast.
IR: Inflation Report.

a) The **agriculture sector** grew 4.9 percent in the first quarter of the year due to increased activity both in the agriculture subsector (5.2 percent) and in the livestock subsector (4.6 percent). A higher production of blueberries, grapes, asparagus, and cocoa as a result of larger harvested areas account for this increased output in the former subsector, together with the higher production of sugar cane obtained as a result of fewer technical stops in Casagrande and Pucalá sugar mills. This pace of growth continued in the month of April.

Agriculture is expected to grow 4.5 percent in 2019 –with which the sector would continue its sustained growth path for fourteen years– and to moderate its pace of growth slightly in 2020 (4.0 percent). The dynamism of agro-exports (blueberries, avocados, grapes, and cocoa) will continue in 2019 and 2020 with new plantations that will start production mainly on the coast of the country. The growth of production for the domestic market would be driven by increased cultivation areas for crops such as bananas, cassavas, and tangerines in 2019, and by the recovery of rice production in 2020 after the completion of works in Piura's reservoir of Poechos. On the other hand, agro-industrial production would continue contributing to the good performance of the sector until 2020 thanks to the better cotton yield achieved as a result of the More Cotton Project.

b) In the first quarter of 2019, output in the **fishing sector** dropped 20.5 percent due mainly to the sector's performance in the months of January and March. The low growth rate in January is explained by the effect of the atypical fish catch registered in January 2018, when the fishing season reopened after being suspended in November and December 2017. On the other hand, the low growth rate in March is explained by the absence of anchovy catch in the first fishing season of the Southern Zone, which is characterized by irregular catches every year.

Moreover, the low output registered in April was associated not only with the late start of the first fishing season (April 26 vs. the first week of April in the previous year), but also with the lower quota of 2.1 million metric tons established (the quota was 36 percent lower than in the previous season).

The sector's output is expected to show a contraction of 14.6 percent in 2019, mainly due to the lower quota assigned in the first fishing season, whereas in 2020 it is projected to register a growth rate of 9.0 percent, in line with the normal weather conditions foreseen in this year.

c) **Metal mining** fell 2.2 percent during the first quarter of 2019 and contracted by 1.7 percent in April. This result is explained by i) a lower gold production in Barrick and Buenaventura; ii) lower zinc grades in Antamina; iii) a lower production of molybdenum in Toromocho and Antamina due to atypical results, and iv) Shougang's lower production of iron due to the low grade of minedral ores. In addition, the lower production of silver in Buenaventura, Antamina, Volcan, and Nexa, and the partial stoppage of Las Bambas production in April contributed to this result as well.

The metal mining sector is expected to grow 2.1 percent in 2019, a result that will reflect a recovery in the rest of the year due to the increased production of Antamina, Las Bambas, and the expansion of Toquepala and Marcona. The higher growth rate projected for 2020 is explained by the onset of operations at the Toromocho expansion unit in the second half of the year.

The production of **hydrocarbons** grew 9.5 percent in the first quarter of 2019 due to a higher production of natural gas and natural gas liquids than in 2018, since production last year was affected by a break in the pipeline of Transportadora de Gas del Peru. On the other hand, oil production fell due to the sabotage of the Nor-Peruvian pipeline between January and March. In 2019, the subsector is expected to grow 2.6 percent, this deceleration of production compared to the previous months would be explained by the normalization of the previously mentioned impacts. A growth rate of 0.3 percent is estimated for 2020.

d) The **primary manufacturing** subsector contracted 13.0 percent in the first quarter and 34.0 percent in April due to the lower refining of non-ferrous metals as a result of maintenance in Southern's plant and the lower processing of fishmeal and fish oil due to lower anchovy catch.

Primary manufacturing would show a fall of 5.9 percent in 2019 due to the lower production of fishmeal associated with the lower fishing quota established for the first fishing season in the North-Central Zone, as well as due to the lower output projected in refining of non-ferrous metals, in line with the contraction registered in the first quarter.

In 2020, primary manufacturing is expected to grow 2.1 percent due to the recovery of both fishing production and the refining of non-ferrous metals. This would be offset by Petroperú's lower refining of crude oil given that the company has announced that it will stop production at the current Talara refinery in 2020 to interconnect it with the new production units that are part of the new refinery project.

e) **Non-primary manufacturing** output grew 3.1 percent in the first quarter of 2019 due to a higher production of investment-linked goods (metal structures for various private projects) and inputs (plastics and explosives for mining activity). However, in April it fell 3.3 percent, due in part to the effect of the fewer days worked because of Holy Week and due to a lower demand for capital goods (transportation material) and consumer goods (furniture, footwear, and paper and cardboard items). Because these factors are foreseen to revert in the remainder of the year, non-primary manufacturing is projected to grow 3.2 in 2019 and 3.8 percent in 2020, mainly as a result of a higher production of investment-oriented and mass consumption goods, in line with the growth of domestic demand, both in terms of consumption and of private and public investment.

f) Growth in the **construction sector** slowed to 1.8 percent in the first quarter of 2019 due to the low growth of public investment. In 2019 and 2020, the sector is expected to grow 5.4 percent and 6.9 percent, respectively, driven by a recovery in public investment and by the growth of private investment.

Expenditure-side GDP

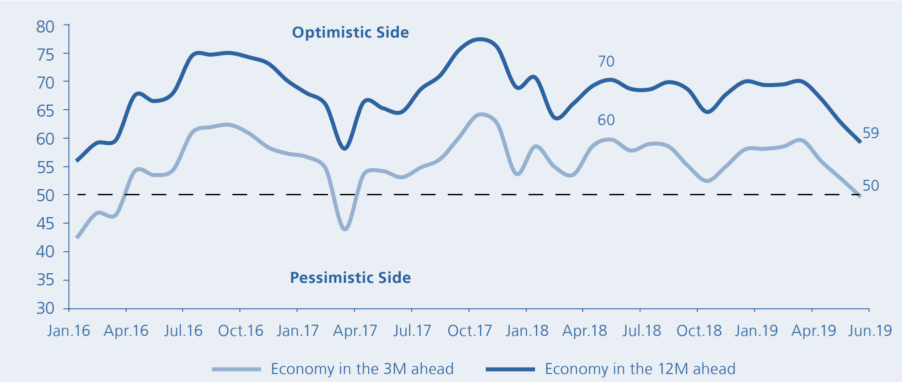
27. In the first quarter of 2019, the output showed a growth rate of 2.3 percent, mainly due to the slowdown of domestic demand and the lower pace of growth of traditional exports.

The growth rate of domestic demand fell from 4.3 percent in the first quarter of 2018 to 1.7 percent in the same period of 2019 due to the impact of lower public spending and the decline of non-mining private investment. Moreover, in the first quarter of the year, exports grew 1.6 percent –less than in the same period of 2018 (3.9 percent)– due to lower shipments of mining products, e.g. zinc, gold, and copper, as well as lower exports of crude oil and oil derivatives.

Recent indicators of consumption and investment spending, such as producer and consumer confidence indices, confirm the recent slowdown in economic activity:

a) In June, business confidence, measured via expectations about 3-months ahead and one-year ahead economic conditions, fell to 50 and 59 points, respectively, after reaching average values of 59 and 70 points in the first quarter.

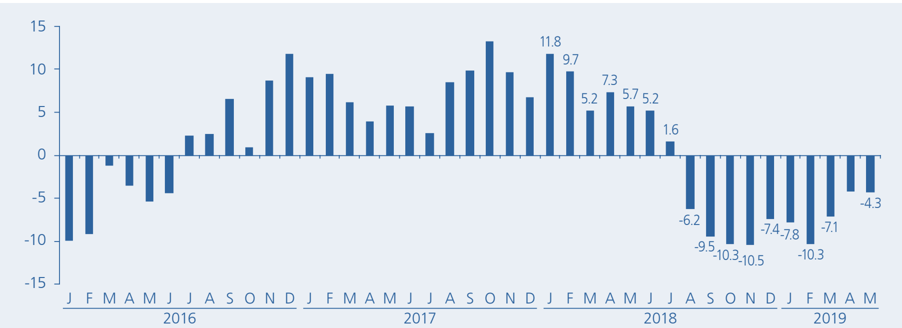
Graph 27
EXPECTATIONS ABOUT THE ECONOMY IN 3 AND 12 MONTHS AHEAD



Source: BCRP.

b) The terms of trade fell 4.3 percent in May 2019 and accumulated a 4.3 percent drop since US-China trade tensions started (May 2018). The fall recorded in May is explained by the lower export prices reported in that month.

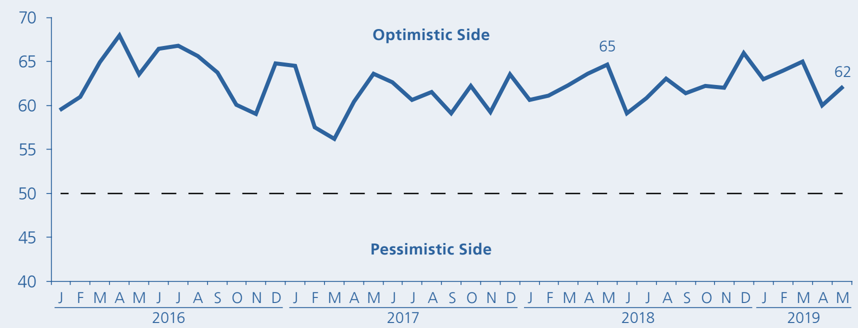
Graph 28
TERMS OF TRADE
(12 month % change)



Source: BCRP.

c) As for consumption indicators, consumer confidence –measured as households' expectations about the economy– reached a 10 month-minimum low in April, recovering slightly thereafter in May (62 points).

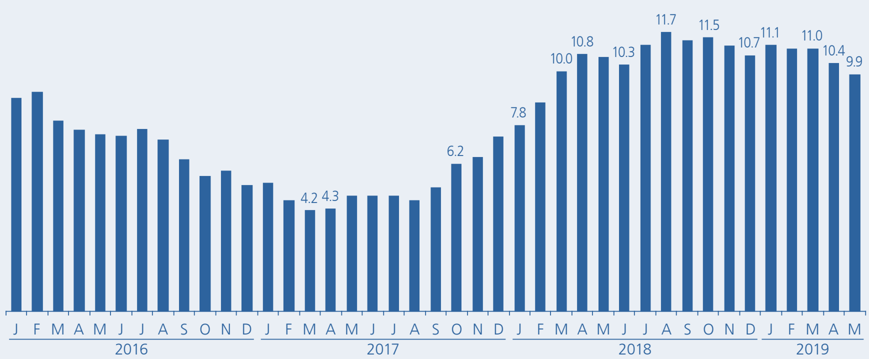
Graph 29
EXPECTATION ABOUT ECONOMIC SITUATION OF THE HOUSEHOLD IN 12 MONTHS
(INDICCA, Lima Metropolitana)



Source: Apoyo.

d) Consumer loans continued to show high growth rates (9.9 percent in May).

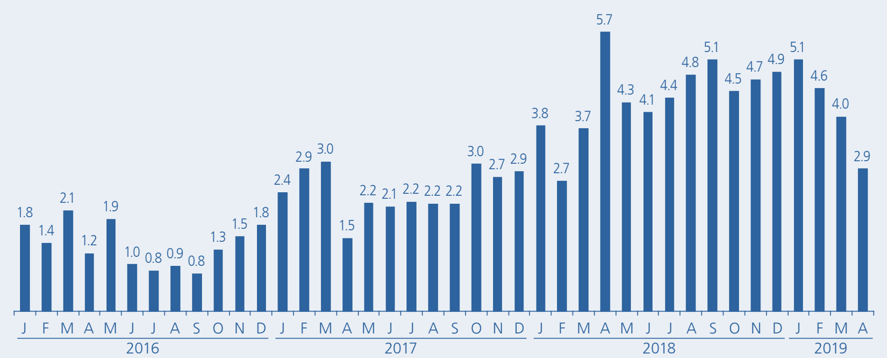
Graph 30
REAL CONSUMER LOANS
(12 month % change)



Source: BCRP.

e) The labor market moderated its pace of growth in April due mainly to jobs in the agriculture sector. Formal jobs in the private sector increased by 2.9 percent, below the average rate recorded in the first quarter (4.6 percent).

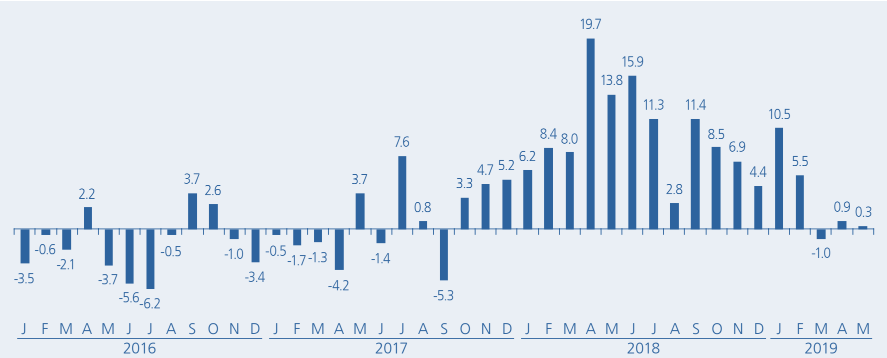
Graph 31
PRIVATE FORMAL JOBS
(12 month % change)



Source: Sunat-Electronic payroll.

f) This lower dynamism of domestic demand components was reflected in revenues from the VAT, which reduced their growth rate to 0.3 percent in May from rates of up to 10 percent in the first months of the year.

Graph 32
VALUE ADDED TAX
(12 month real % change)

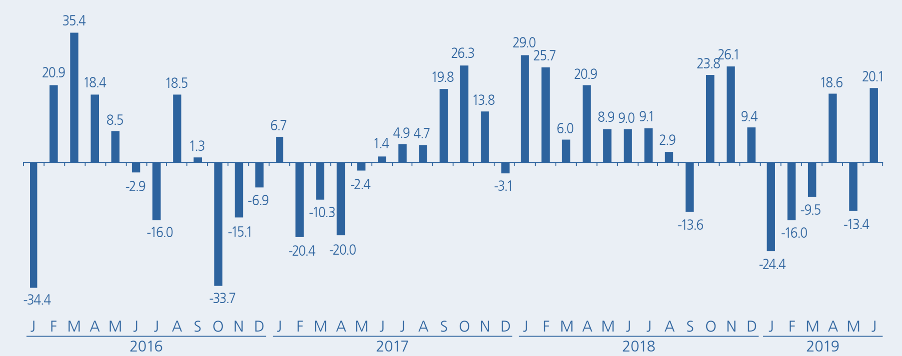


Source: SUNAT.

g) After dropping 13.4 percent in May, the investment of the general government recovered and registered 20.1 percent in

June 2019, mainly as a result of higher spending by the national government.

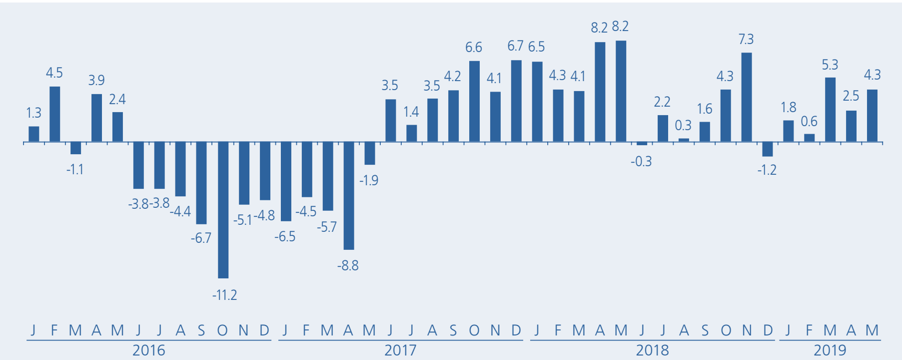
Graph 33
GENERAL GOVERNMENT INVESTMENT
(12 month real % change)



Source: MEF.

h) In May, the domestic consumption of cement increased by 4.3 percent, showing a higher rate than the average growth rate observed in the first quarter of the year (2.6 percent).

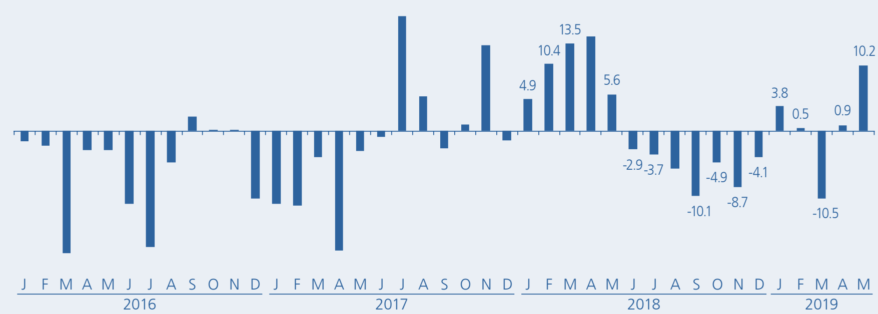
Graph 34
DOMESTIC CEMENT CONSUMPTION
(12 month % change)



Source: INEI.

i) The volume of imports of capital goods (excluding construction materials) increased 0.9 percent in April and 10.2 percent in May.

Graph 35
VOLUME OF IMPORTS OF CAPITAL GOODS
(12 month % change)



Source: SUNAT.

28. The evolution of foreseen indicators of activity was reflected in a change in private sector expectations on GDP growth. On average, agents estimate a growth rate of 3.3 percent this year and a growth rate of 3.7 percent for 2020.

Table 21
MACROECONOMIC EXPECTATIONS SURVEY: GDP GROWTH
(% change)

	IR Dec.18	IR Mar.19	IR Jun.19*
Financial entities			
2019	3.9	3.9	3.3
2020	4.0	4.0	3.6
Economic analysts			
2019	3.9	3.9	3.2
2020	4.0	4.0	3.7
Non-financial firms			
2019	3.8	3.9	3.5
2020	4.0	4.0	3.8

* Survey conducted on June 30.
Source: BCRP.

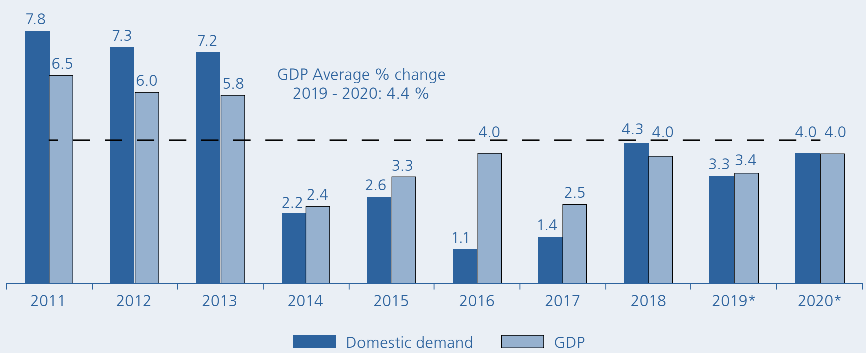
29. The growth rate of domestic demand in 2019 has been revised from 3.9 to 3.3 percent, the growth rate of private consumption being revised down from 3.8 to 3.5 percent and the growth rate of private investment, from 6.5 to 3.8 percent. On the other hand, the growth rate of public consumption has been revised down from 2.5 to 2.0 percent, while the growth rate estimated for public investment remains at 1.0 percent.

Table 22
DOMESTIC DEMAND AND GDP
(Real % change)

	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
Domestic demand	**4.3**	**1.7**	**3.9**	**3.3**	**4.1**	**4.0**
Private consumption	3.8	3.4	3.8	3.5	3.9	3.7
Public consumption	2.0	-2.5	2.5	2.0	2.2	2.5
Private investment	4.4	2.9	6.5	3.8	6.0	5.5
Public investment	6.8	-10.9	1.0	1.0	5.0	5.0
Change on inventories (contribution)	0.3	-0.5	-0.2	0.0	0.0	0.0
Exports	**2.5**	**1.6**	**4.6**	**2.6**	**5.7**	**5.4**
Imports	**3.4**	**-0.5**	**4.4**	**2.1**	**6.2**	**5.5**
Gross Domestic Product	**4.0**	**2.3**	**4.0**	**3.4**	**4.0**	**4.0**

* Forecast.
IR: Inflation Report.

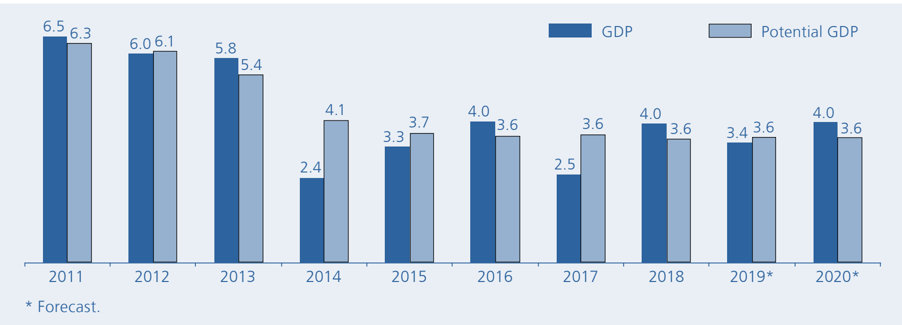
Graph 36
DOMESTIC DEMAND AND GDP: 2011-2020
(Real % change)



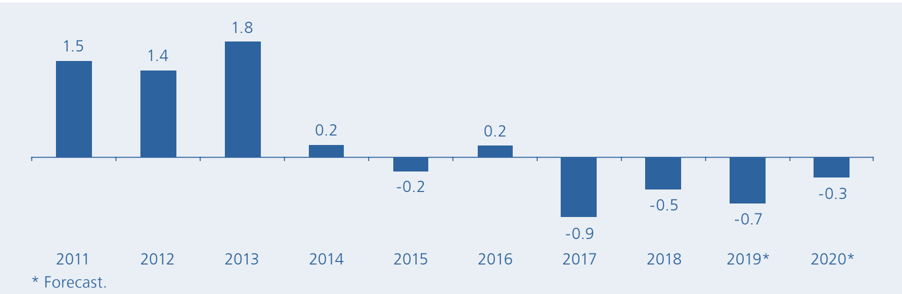
* Forecast.

30. Moreover, based on recent data, the estimation of trend economic growth has been revised from 3.7 to 3.6 percent. Considering the GDP growth projection, the output gap (percentage difference between the level of GDP and its potential) would decrease gradually over the forecast horizon. It is projected that the growth of the potential output would remain at 3.6 percent in 2019 and 2020.

Graph 37
GDP AND POTENTIAL GDP
(% change)

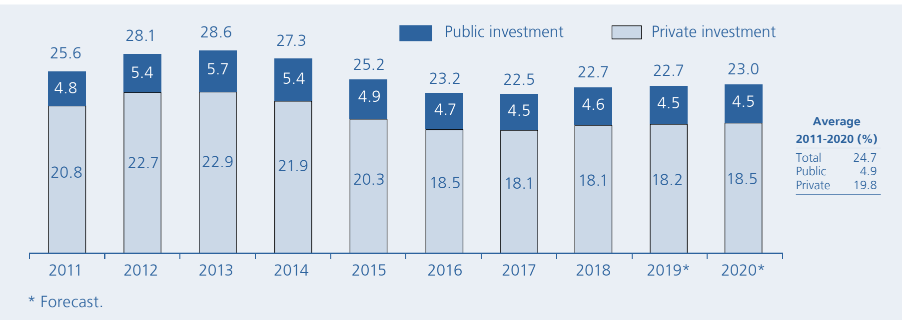


Graph 38
OUTPUT GAP
(% Potential GDP)



31. Thus, with the projection considered in this inflation report, the ratio of gross fixed investment as a percentage of real GDP, will reach 22.7 percent of GDP in 2019 –a similar ratio to that recorded in 2018– and will then increase to 23.0 percent in 2020, driven by the recovery of public and private investment relative to the levels observed in the previous year.

Graph 39
GROSS FIXED INVESTMENT: PRIVATE AND PUBLIC SECTORS 2011-2020
(% of real GDP)



32. In 2019, due to the lower growth rate of public investment and accompanied by lower private savings, gross domestic investment in GDP terms would decrease slightly, as a result of which financing requirements will remain similar to those observed in 2018 (1.6 percentage points of GDP). In 2020, the level of projected investment will require an additional increase in external financing of 0.3 percentage points of GDP.

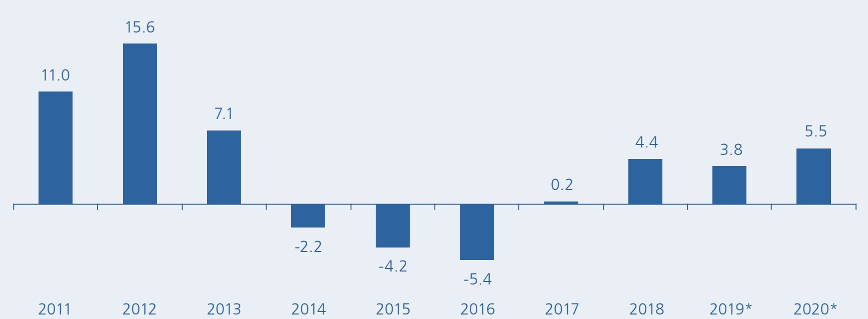
Table 23
SAVING-INVESTMENT GAP
(% of nominal GDP)

	2018	2019*	2020*
1. Domestic Gross Investment 1/	21.5	21.4	21.7
2. Domestic Saving	19.9	19.8	19.8
External Gap (=2-1)	-1.6	-1.6	-1.9
1.1. Private Domestic Gross Investment 1/	16.6	16.7	17.0
1.2. Private Saving	17.3	17.1	17.2
Private Gap (=1.2-1.1)	0.7	0.5	0.2
2.1. Public Investment	4.8	4.7	4.7
2.2. Public Saving	2.5	2.6	2.6
Public Gap (=2.2-2.1)	-2.3	-2.1	-2.1

* Forecast.
1/ Includes change on inventories.
Source: BCRP.

33. The projected growth rate of private investment in 2019 is revised down from 6.5 to 3.8 percent due to lower business confidence and to the deterioration of the terms of trade observed since the trade tensions between the U.S. and China started. On the other hand, in 2020 the international scenario would stabilize and business confidence would recover, as a result of which the investment growth rate would rise to 5.5 percent.

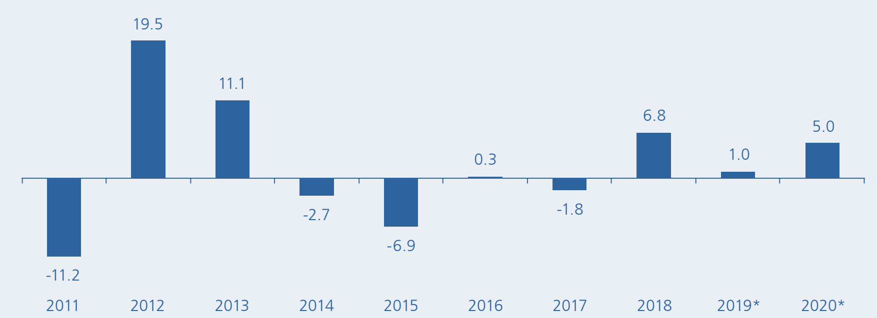
Graph 40
PRIVATE INVESTMENT: 2011-2020
(Real annual % change)



* Forecast.

34. The projection of public investment growth for this year remains at 1.0 percent. The growth of investment expenditure associated with the cost incurred in the Talara refinery project and with the reconstruction projects in the North of the country will be offset by the expected effect of lower spending at the level of sub-national governments and by the completion the construction projects for the Pan American Games by mid-year. In 2020, public investment is expected to recover with a growth rate of 5.0 percent.

Graph 41
PUBLIC INVESTMENT: 2011-2020
(Real % change)



* Forecast.

35. The 148 **main private investment projects announced** to be carried out in 2019-2020 amount approximately to US$ 19.5 billion, with mining and infrastructure being the main sectors attracting private investment.

Table 24
PRIVATE INVESTMENT PROJECTS ANNOUNCED: 2019-2020
(Billion US$)

	Total investment		Number of projects	
	IR Mar.19	**IR Jun.19**	**IR Mar.19**	**IR Jun.19**
Mining	9.7	9.7	33	33
Hydrocarbons	1.4	1.3	16	16
Energy	1.0	1.0	10	10
Industry	0.4	0.4	8	8
Infraestructure	3.9	3.8	23	23
Other sectors	3.3	3.4	57	58
Total	**19.6**	**19.5**	**147**	**148**

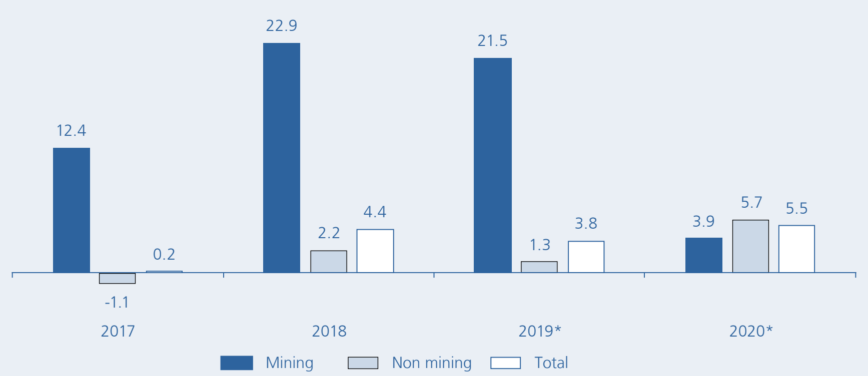
Source: Media and information of companies.

36. **Mining investment** is foreseen to continue growing in the forecast horizon, with projects such as Quellaveco (US$ 5.3 billion), Mina Justa (US$ 1.6 billion),

and the expansion of Toromocho (US$ 1.3 billion) and, to a lesser extent, other projects currently under construction, such as Quecher Main (US$ 0.3 billion) and Relaves B2 San Rafael (US$ 0.2 billion) contributing to this growth. It is worth mentioning that the latter two projet will start their production stage this year.

According to the Ministry of Energy and Mining, mining investment in January-April 2019 totaled US$ 1.6 billion, which represents a growth rate of 31.1 percent in year-on-year terms.

Graph 42
PRIVATE INVESTMENT
(Real % change)



* Forecast.

37. In the **sector of infrastructure**, progress continues to be observed in the implementation of works on Lima Metro's Line 2 project. According to OSITRAN, as of May, the project shows an implementation rate of 25.4 percent and is expected to reach a rate of 32 percent at year-end, in line with the new timetable signed in December 2018 with the last addendum (N° 2) stating that the project is to be completed in 2024. On the other hand, the Ministry of Transport and Communications will culminate the delivery of land by 2020 and the expansion of International Airport Jorge Chávez should begin earthworks in the fourth quarter of 2019 as part of the project execution timetable.

    Investment in other sectors worth pointing out include investments in the sectors of retail, real estate, and services. Important investments are expected in the retail subsector with the completion and development of new shopping center projects, the most representative investors being Grupo Ripley, Intercorp, and Grupo Falabella. In addition, new housing and office buildings projects as well as hotels and education centers are being developed in the subsectors of real estate and services.

Table 25
MAIN ANNOUNCEMENTS OF PRIVATE INVESTMENT PROJECTS: 2019-2020

SECTOR	INVESTOR	PROJECTS
MINING	Angloamerican	Quellaveco
	Grupo Breca	Justa Mine
	Aluminium Corp. of China (Chinalco)	Expansion of Toromocho Mine
	Yanacocha Mining	Quecher Main
	Bear Creek Mining Corp	Corani
	Minsur	Relaves B2 San Rafael
HYDROCARBONS	Consorcio Promigas Surtigas	Massive use of gas
	Karoon Gas	Exploration Lote Z-38
	Pluspetrol Perú Corp.	Expansion of transportation capacity
ENERGY	Interconexión Eléctrica	Mantaro-Nueva Yanango-Carapongo Connection
	Hydro Global Investment	San Gabán III
INDUSTRY	Arca Continental	Improvements in infrastructure and equipment
	Corporación Aceros Arequipa	Expansion of Pisco Plant
	Cementos Inka	Milling Pisco Plant
INFRASTRUCTURE	Grupo Volcan	Chancay Port Terminal Stage I
	New Consortium Metro de Lima	Line 2 of the Metro network of Lima and Callao
	Lima Airport Partners	Expansion of International Airport (Jorge Chavez)
	Romero Group	Salaverry Port Terminal
	APM Terminals	Modernization of the North Pier
	Paracas Consortium	San Martin Port Terminal in Pisco
OTHER SECTORS	Entel	Development of services 4G
	Grupo Ripley	Expansion of new shopping centers
	Edifica	Real Estate investments
	Armas Domo	Real Estate investments
	Interbank Group	Expansion of new shopping centers
	Breca Group	Expansion of new shopping centers
	InterContinental	Hotels Group

Source: Information on companies, newspaper and specialized media.

38. Moreover, Proinversión reports an investment portfolio of US$ 8.3 billion for 2019-2020, with projects to be awarded under concession contracts in 2019 being estimated to amount to US$ 2.1 billion. It is also worth pointing out that Mexican Peruvian firms Consortium Fypasa Construcciones S.A. de C.V and Operadora de Ecosistemas S.A.de C.V were awarded in April the concession contract for the implementation of the Treatment system of waste water in the Lake Titicaca basin. The project is due to start in 2020 and to conclude in 2022 and 2023.

Table 26
MAIN PROJECTS TO BE IMPLEMENTED THROUGH CONCESSION ARRANGEMENTS IN 2018-2020
(Million US$)

		Estimated investment
A.	**Awarded 2018**	**3,289**
	Michiquillay Mining Project	2,500
	Upgrading of Salaverry Multipurpose Port Terminal	229
	Broadband for Comprehensive Connectivity and Social Development for Ancash, Arequipa, La Libertad, Huánuco, Pasco and San Martin regions	560
B.	**Awarded 2019**	**180**
	Treatment system for wastewater from the basin of Lake Titicaca	180
C.	**To be called**	**8,319**
	Peripheral Ring Road	2,049
	Headworks and Conduction for the Drinking Water Supply in Lima	720
	Water consolidation system in the Chancay-Lambayeque Valley	619
	New San Juan de Marcona Port Terminal	540
	Water consolidation system in the Ica-Pisco Valley and areas irrigation in Huaytará Province and Castrovirreyna in Huancavelica	520
	Longitudinal of the Sierra road project, Section 4	464
	Wide-Scale Use of Natural Gas in Central and South Region	400
	Algarrobo Mining Project	350
	Two hospitals of high complexity	254
	Hipolito Unanue Hospital	250
	Huancayo - Huancavelica Railway	227
	La Niña - Piura 500 kV Connection, Substations, Lines, and Associated Expansions; Pariñas - Nueva Tumbes 220 kV Connection, Substations, and Associated Expansions; and Tingo María - Aguaytía 220 kV Connection, Substations, Lines, and Associated Expansion	209
	Cayetano Heredia Hospital	186
	INA Essalud Lima	170
	Specialized health services in Piura district and resizing of health services at Sullana level III Support hospital	160
	Transmission Line 500 kV Substation Piura Nueva - Frontera	144
	Huaycan Hospital	120
	New Military Hospital	116
	International Terminal for Containers - Chimbote	110
	Others	712

Source: Proinversión.

Box 3
SEASONAL ADJUSTMENT OF ECONOMIC INDICATORS

In order to analyze the trend of an economic variable, such as the GDP or the consumer price index (CPI), its level is usually compared with the level it registered in the same period of the previous year. This variation is usually called the 12-month percentage variation. Thus, the growth rate of 0.02 percent of GDP in April results from comparing the level of economic activity of April 2019 with the level of activity in the same month of 2018. Similarly, an annual inflation rate of 2.3 per in June results from comparing the CPI of June 2019 against the one recorded in June 2018.

However, an annual comparison of an economic variable could not reflect a recent trend shift or structural change. Therefore, a methodology is needed to compare variables with a recent period, for example, on a monthly or quarterly basis. The purpose of seasonally adjusting an economic series is to exclude any recurring event of such variable, such as holidays, Easter, Christmas, the rainy season, the agricultural calendar, and fishing seasons, among other events. For example, a seasonal adjustment isolates the effects of Easter holidays on production, since there are fewer working days in March or April depending on the year. In this way, variables can be compared in consecutive months regardless of the number of work days that each month has.

The seasonal adjustment methodology prevents the monthly or quarterly series from being contaminated by effects that are often repeated in certain periods of the year, as a result of which we obtain a series in which one can compare a variable with its more recent values. The growth rate obtained by comparing a given quarter against the previous quarter in seasonally adjusted terms is called the seasonally adjusted annual rate (SAAR).

SEASONALLY ADJUSTED GDP

	GDP Million soles of 2007	**Annual % chg.**	**Seasonally adjusted GDP** Million soles of 2007	**Annualized Quarterly % Change**
2018-I	124,513		132,027	
2018-IV	141,201		136,012	
2019-I	127,354	2.3	135,320	-2.0

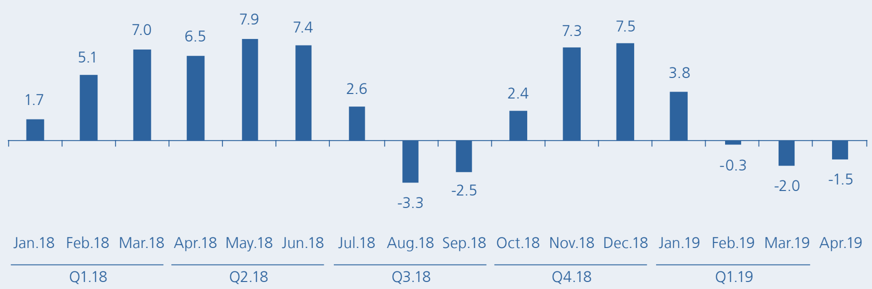
The economic series of the Central Reserve Bank of Peru (BCRP) are seasonally adjusted using the Tramo-Seats[5] method, which allows to incorporate the national holidays and project the seasonal adjustment factors for the next two years. When new information is added, the latest data is more greatly revised, so a date is set as a reference point to prevent greater volatility in the results. For example, the factors used to seasonally adjust the monthly series of GDP until March were the ones that had been obtained using information as of December

5 TRAMO: Time series Regression with ARIMA noise, Missing values and Outliers. SEATS: Signal Extraction in ARIMA Time Series).

2018. Therefore, to seasonally adjust the January, February and March 2019 observations, the factors forecast by the Tramo-Seats method were used.

Updating the factors to March 2019 (versus the factors as of December 2018), we observe a lower fall in total GDP in February and March 2019, and GDP in April would still remain negative. As from the publication of the GDP for the second quarter, the seasonally adjusted series of the quarterly GDP will be the same as the one corresponding to the monthly series.

SEASONALLY ADJUSTED GDP
(Annualized % change of the mobile quarter - with factors of March 2019)

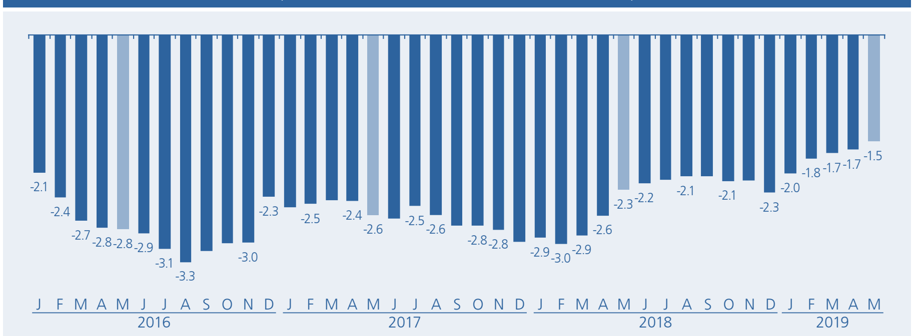


IV. Public Finances

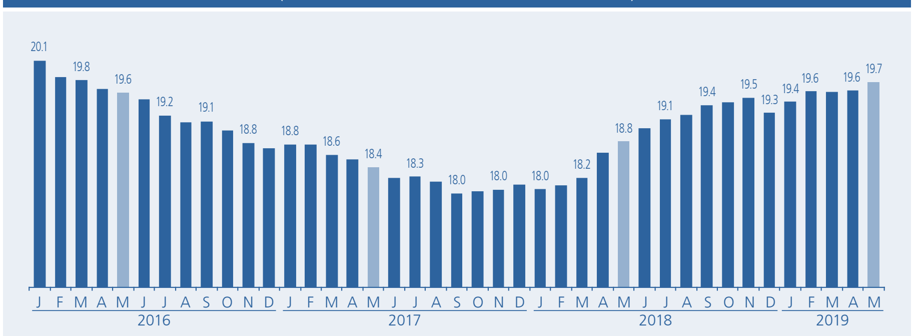
Evolution of Fiscal Accounts

39. In May 2019, the **fiscal deficit** accumulated in the last twelve months, which decreased by 0.8 percentage points from the deficit recorded in 2018, was equal to 1.5 percent of GDP. This deficit reduction resulted from both the increase in the current revenues of the general government (from 19.3 to 19.7 percent of GDP) and from the reduction in the non-financial expenditure of the general government (0.2 percentage points).

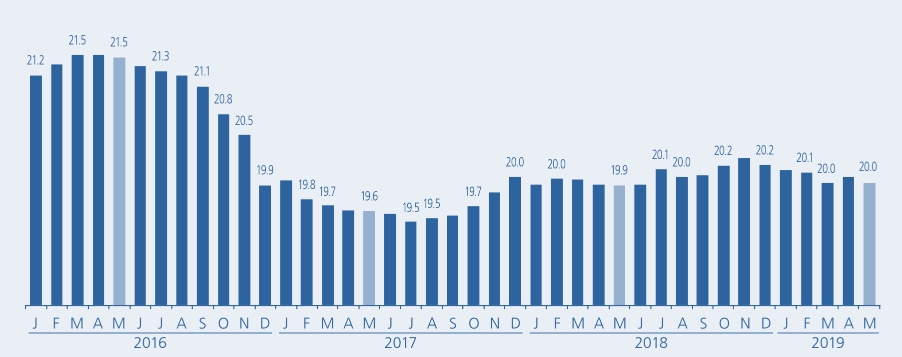
Graph 43
ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2016-2019
(Accumulated last 12 months - % GDP)



Graph 44
CURRENT REVENUES OF THE GENERAL GOVERNMENT: 2016-2019
(Accumulated last 12 months - % GDP)



Graph 45
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT: 2016-2019
(Accumulated last 12 months - % GDP)



40. In January-May 2019, the economic balance of the non-financial public sector increased by S/ 5.41 billion compared to the same period of the previous year due to higher current revenues (8.0 percent) and to a slight reduction in non-financial expenditure. The former results from higher tax and non-tax revenues, with the increase in revenues from the excise tax standing out (31.7 percent) due to the higher rates in force since May 2018. On the other hand, the reduction in non-financial expenditure is explained by the decrease in capital expenditure (9.6 percent), offset by higher current expenditure (2.3 percent).

Table 27
ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR
(Million S/)

	Jan.-May		
	2018	2019	% chg
1. General government current revenues	**63,184**	**68,236**	**8.0**
a. Income tax	21,438	22,529	5.1
b. Value Added Tax	24,747	26,172	5.8
c. Excise tax	2,527	3,327	31.7
d. Others	14,472	16,208	12.0
2. General government non-financial expenditure	**-52,137**	**-52,101**	**-0.1**
a. Current expenditure	-41,749	-42,716	2.3
b. Capital expenditure	-10,387	-9,385	-9.6
3. Others	**-452**	**245**	
4. Primary balance (=1+2+3)	**10,595**	**16,379**	
5. Interests	**4,645**	**5,018**	**8.0**
6. Overall Balance (=4+5)	**5,950**	**11,361**	

41. In January-May 2019, expenditure associated with the **Reconstruction with Changes** Program amounted to S/ 1.20 billion, which represented an execution of

18 percent of the annual budget framework. As for expenditure on projects, S/ 764 million was accrued, which represented an implementation rate of 15 percent, the projects carried out by local governments (S/ 478 million) standing out.

On the other hand, in January-May 2019 spending on the main sports infrastructure projects for the **PanAmerican Games** amounted to S/ 346 million, a figure S/ 150 million higher than that recorded in the same period of 2018, which means that 40 percent of the Modified Institutional Budget (PIM) has been spent as of May this year. By projects, it is worth highlighting the expenditure made in improvements of the National Sports Village (VIDENA) and the Pan American Village.

Forecasts

42. The fiscal deficit projected for this year has been revised from 2.3 percent of GDP in the March Report to 2.1 percent of GDP in this report given. This downward revision is explained by the the higher current revenues projected (up from 19.3 to 19.6 percent of GDP) mainly as a result of control actions and resolutions in favor of SUNAT.

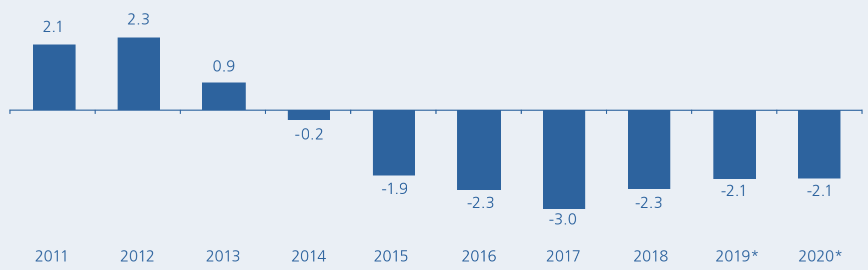
In 2020, the deficit is projected to remain at 2.1 percent of GDP, in line with the deficit rule established for this year in the Marco de la Responsabilidad y Transparencia Fiscal.

Table 28
NON-FINANCIAL PUBLIC SECTOR
(% GDP)

	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
1. General government current revenues	**19.3**	**21.7**	**19.3**	**19.6**	**19.4**	**19.5**
Real % change	*11.2%*	*7.0%*	*4.0%*	*4.6%*	*5.1%*	*3.3%*
2. General government non-financial expenditure	**20.2**	**16.2**	**20.2**	**20.2**	**20.0**	**20.0**
Real % change	*5.3%*	*-4.4%*	*3.2%*	*2.9%*	*3.2%*	*3.0%*
Of which:						
Current expenditure	*15.3*	*13.7*	*15.6*	*15.5*	*15.4*	*15.4*
Real % change	*4.5%*	*-1.9%*	*4.8%*	*4.6%*	*2.9%*	*2.7%*
Gross capital formation	*4.3*	*2.2*	*4.1*	*4.1*	*4.1*	*4.1*
Real % change	*10.6%*	*-13.9%*	*-2.4%*	*-1.0%*	*4.9%*	*3.9%*
3. Others	**0.0**	**0.4**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
4. Primary balance (1-2+3)	**-0.9**	**6.0**	**-1.0**	**-0.7**	**-0.7**	**-0.6**
5. Interests	**1.4**	**2.4**	**1.4**	**1.4**	**1.4**	**1.5**
6. Overall Balance	**-2.3**	**3.6**	**-2.3**	**-2.1**	**-2.1**	**-2.1**
Gross Debt Flow	*2.3*	*-1.2*	*2.2*	*2.0*	*1.6*	*1.9*
Flow of public deposits	*0.0*	*-1.3*	*0.3*	*0.4*	*0.4*	*0.2*
Others	*0.0*	*-1.2*	*-0.1*	*-0.3*	*0.2*	*0.0*

* Forecast.
IR: Inflation Report.

Graph 46
ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2011-2020
(% GDP)



* Forecast.

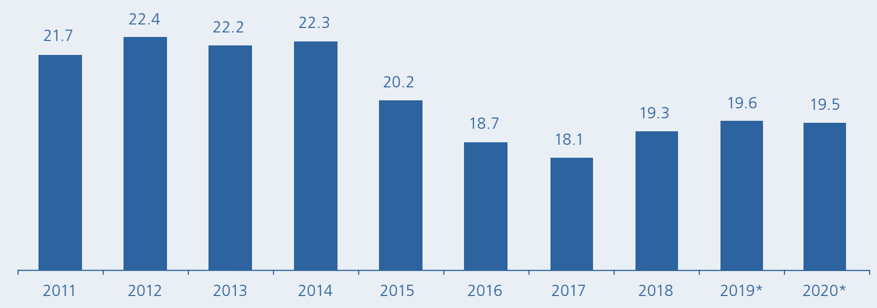
43. It is estimated that the growth rate of **current revenues** would increase from 4.0 to 4.6 percent of GDP in real terms. This projection has been revised due to the tax payments recorded after the control actions carried out and the resolutions favorable to SUNAT. In addition, a greater real growth of non-tax revenues was also observed, which reflected higher transfers from Banco de la Nación and Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE). On the other hand, tax revenues would grow at a lower rate than in the previous Report (4.3 percent versus 5.1 percent) due to the impact of the fall in commodity prices and to the economic slowdown observed in the first half of the year. In 2020, although current revenues are estimated to reach 19.5 percent of GDP, the growth rate would slow down from 5.1 to 3.3 percent due to the lower tax revenues expected as a result of the prices of commodities.

Table 29
CURRENT REVENUES OF THE GENERAL GOVERNMENT
(% GDP)

	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
TAX REVENUES	**14.5**	**16.3**	**14.6**	**14.7**	**14.8**	**14.7**
Income tax[1/]	5.6	6.9	5.5	5.6	5.6	5.5
Value Added Tax	8.2	9.0	8.3	8.3	8.4	8.3
Excise tax	0.9	1.1	1.0	1.1	1.0	1.1
Import duties	0.2	0.2	0.2	0.2	0.2	0.2
Other tax revenues	1.8	1.4	1.8	1.8	1.7	1.8
Tax returns	-2.2	-2.4	-2.2	-2.2	-2.1	-2.2
NON-TAX REVENUES	**4.8**	**5.5**	**4.7**	**4.9**	**4.6**	**4.8**
Contributions to social security	2.2	2.2	2.2	2.2	2.2	2.2
Own resources and transfers	1.5	1.5	1.5	1.7	1.5	1.6
Royalties	0.7	0.7	0.6	0.6	0.6	0.5
Rest	0.3	1.1	0.4	0.4	0.3	0.4
TOTAL	**19.3**	**21.7**	**19.3**	**19.6**	**19.4**	**19.5**

1/ Includes revenues by repatriation of capital.
* Forecast.
IR: Inflation Report.

Graph 47
CURRENT REVENUES OF THE GENERAL GOVERNMENT: 2011-2020
(% GDP)



* Forecast.

44. The projection of non-financial expenditure in 2019 remains at 20.2 percent of GDP, but with a lower level of public investment and a higher level of current expenditure. In 2020, non-financial expenditure is expected to decrease due to lower current expenditure.

Table 30
GROSS CAPITAL FORMATION: LOCAL AND REGIONAL GOVERNMENTS
(Nominal % change)

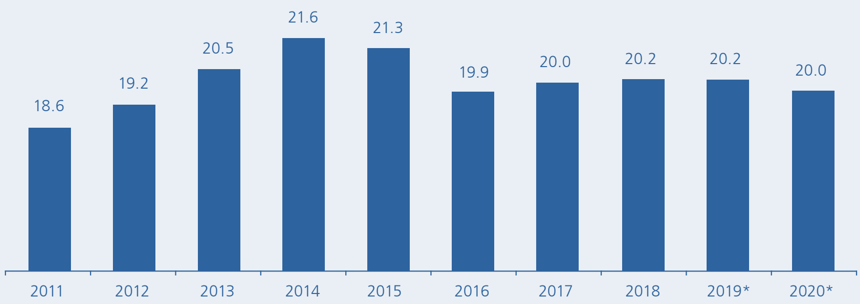
	January-May		
	2011	**2015**	**2019**
Regional Governments	-14.7	-34.8	-9.7
Local Governments	-47.8	-40.8	-0.2
Sub-national Governments	**-37.3**	**-38.6**	**-3.3**

Table 31
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT
(% GDP)

	2018	2019*			2020*	
		Q1	**IR Mar.19**	**IR Jun.19**	**IR Mar.19**	**IR Jun.19**
CURRENT EXPENDITURE	**15.3**	**15.6**	**15.6**	**15.5**	**15.4**	**15.4**
National Government	10.3	10.6	10.5	10.5	10.3	10.4
Regional Governments	3.4	3.4	3.3	3.4	3.3	3.3
Local Governments	1.6	1.7	1.7	1.6	1.8	1.7
CAPITAL EXPENDITURE	**4.9**	**4.7**	**4.6**	**4.6**	**4.6**	**4.7**
Gross capital formation	**4.3**	**4.2**	**4.1**	**4.1**	**4.1**	**4.1**
National Government	1.5	1.8	1.7	1.5	1.7	1.5
Regional Governments	0.9	0.8	0.8	0.8	0.8	0.8
Local Governments	1.9	1.6	1.6	1.8	1.7	1.9
Others	**0.6**	**0.6**	**0.6**	**0.5**	**0.5**	**0.5**
TOTAL	**20.2**	**20.4**	**20.2**	**20.2**	**20.0**	**20.0**
National Government	12.3	12.9	12.8	12.5	12.5	12.4
Regional Governments	4.2	4.1	4.1	4.2	4.0	4.1
Local Governments	3.6	3.3	3.3	3.5	3.4	3.6

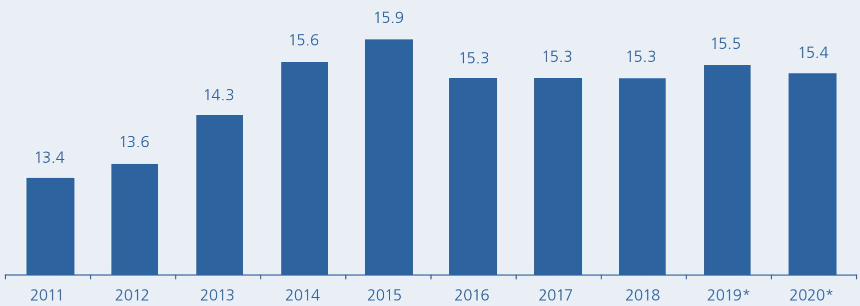
* Forecast.
IR: Inflation Report.

Graph 48
NON-FINANCIAL EXPENDITURE OF THE GENERAL GOVERNMENT: 2011-2020
(% GDP)



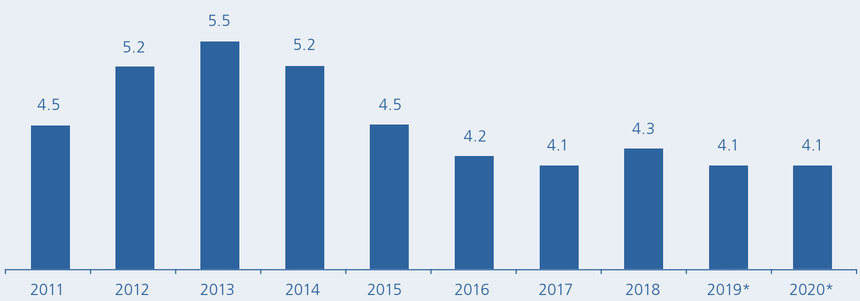
* Forecast.

Graph 49
CURRENT EXPENDITURE OF THE GENERAL GOVERNMENT: 2011-2020
(% GDP)



* Forecast.

Graph 50
GROSS CAPITAL FORMATION OF THE GENERAL GOVERNMENT: 2011-2020
(% GDP)



* Forecast.

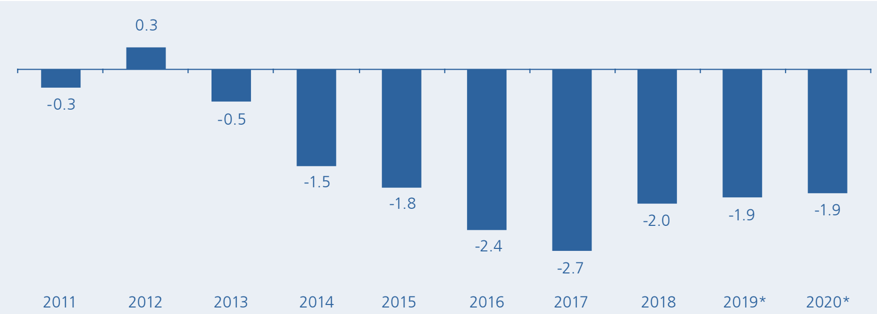
Table 32
PUBLIC INVESTMENT
(Million S/)

Main Projects	2018	2019*	2020*
Reconstruction with Changes1/	876	3,500	4,500
PanAmerican Games2/	920	870	-.-
Lima Metro's Line 2	370	400	1,300
Talara Refinery	1,900	2,240	2,120

1/ Only includes investment expenses.
2/ Only considers the investment expenditure of the national government in 8 main sport infraestructure projects.
* Forecast.

45. The **structural primary balance** seeks to identify the effects of fiscal policy decisions beyond the effects of factors that are not within government control, such as the effects of export prices and their impact on revenues from the income tax or the stage of the business cycle and its effect on tax revenue. In addition, the **weighted fiscal impulse** considers the multiplier effects of changes in the structural components of fiscal revenues, current expenditures, and capital expenditures to obtain a measurement that takes into account the relative difference of the impacts of changes in these three variables on production. Thus, a contractionary position is projected for 2019 due to public investment's low growth, while a neutral weighted fiscal impulse is estimated for 2020 as long as the fiscal deficit remains constant (2.1 percent of GDP).

Graph 51
STRUCTUTRAL ECONOMIC BALANCE OF THE NON-FINANCIAL PUBLIC SECTOR: 2011-2020
(% Potential GDP)



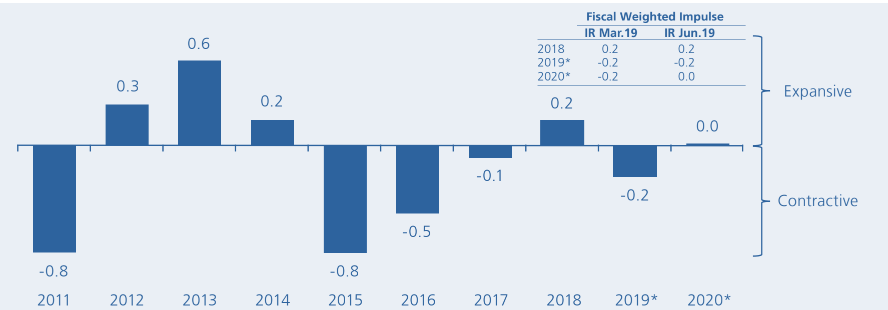
* Forecast.

Table 33
STRUCTURAL BALANCE AND FISCAL IMPULSE
(% Potential GDP)

	2017	2018	2019*	2020*
I. Conventional fiscal balance				
1. Current revenues	17.9	19.1	19.5	19.5
2. Non-financial expenditures	-19.8	-20.0	-20.1	-20.0
i. Current	-15.1	-15.2	-15.4	-15.3
ii. Capital	-4.7	-4.9	-4.6	-4.6
3. Others	0.1	0.0	-0.1	-0.1
4. Conventional primary balance	-1.8	-0.9	-0.7	-0.6
II. Structural primary balance				
1. Current revenues	18.2	19.4	19.6	19.7
2. Non-financial expenditures	-19.7	-19.9	-19.9	-19.9
i. Current	-15.0	-15.1	-15.3	-15.2
ii. Capital	-4.7	-4.9	-4.6	-4.6
3. Others	0.1	0.0	-0.1	-0.1
4. Primary Structural Result	-1.4	-0.6	-0.4	-0.3
III. Fiscal impulse[1/]	**0.1**	**-0.7**	**-0.4**	**0.1**
5. Net effect of multipliers[2/]	-0.2	0.9	0.2	-0.1
IV. Weighted fiscal impulse (IV = III + 5)	**-0.1**	**0.2**	**-0.2**	**0.0**

1/ In 2017, 2018, and 2019 includes the impact of temporary revenues as the repatriation of assets, payment of taxes, fines, and other concepts, excluding structural revenues.
2 / Multipliers: (i) if the Output gap is negative: Revenues -0.25, current expenditure 0.93, capital expenditure 1.42.
(ii) if the Output gap is positive: Revenues 0, current expenditure 0.28, capital 0.73.
* Forecast.

Graph 52
FISCAL WEIGHTED IMPULSE[1/]
(% Potential GDP)

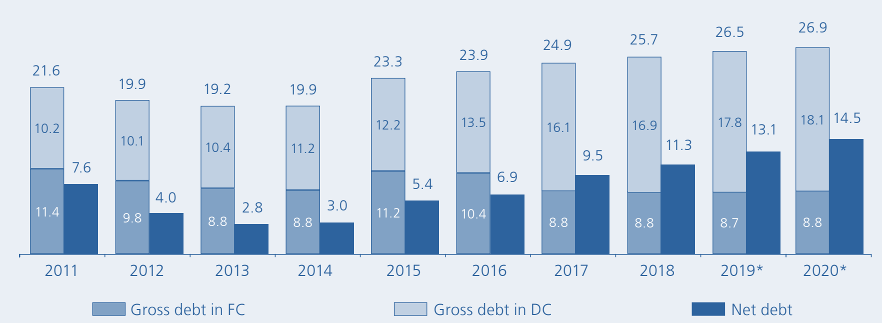


1/ The fiscal weighted impulse takes account the multiplier model of changes in the incomes, current expenditures and public investment.
* Forecast.

46. The net public debt would be equivalent to 14.5 percent of GDP by the end of the forecast horizon, while at the end of 2019 it is expected to amount to 13.1 percent of GDP. In gross terms, the debt in the next two years would amount to

26.5 percent of GDP in 2019 and to 26.9 percent of GDP in 2020. The higher ratio of debt in domestic currency observed in recent years is worth pointing out in terms of the debt composition.

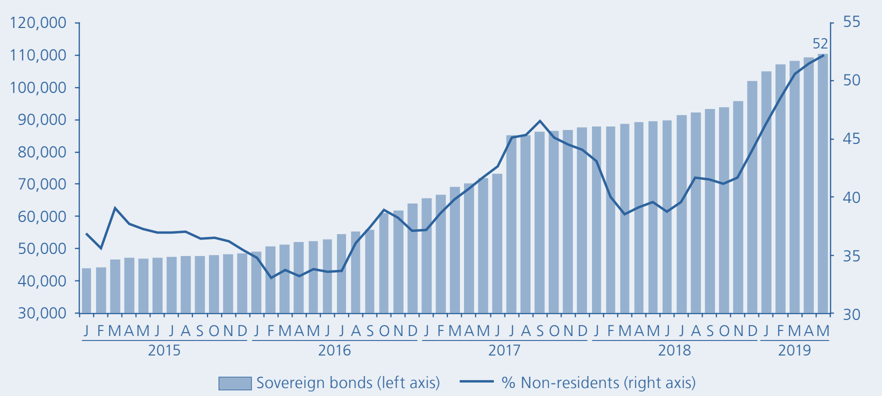
Graph 53
NON-FINANCIAL PUBLIC SECTOR DEBT: 2011-2020
(% GDP)



* Forecast.

47. The balance of **sovereign bonds** as of May 2019 was S/ 110.36 billion, S/ 2.08 billion higher than the balance recorded at the end of the first quarter of 2019. On the demand side, the share of non-resident investors was 52 percent of the balance of bonds, non-residents' holdings having increased from S/ 54.86 billion in March 2019 to S/ 57.68 billion in May.

Graph 54
BALANCE OF SOVEREIGN BONDS AND SHARE OF NON-RESIDENT INVESTORS
(Amounts in million S/ and shares in %)



Source: MEF.

48. The projection of the gross financing requirement (GFR) for 2019 has been increased in comparison to the projection considered in our March Report

because the payment of amortizations has been revised on the upside due to the debt management operation carried out in June. This operation, which implied an amortization of S/ 6.08 billion for the sovereign bond and for the global bonds (see Box 5), was financed through the issuance of a new sovereign bond for a total of S/ 5.83 billion and a new global bond (BG2030) for a total of US$ 750 million, which is reflected in the higher disbursements reported in this Inflation Report.

A reduction in financial requirements is foreseen in 2020 (S/ 20.47 billion) due to lower amortizations, with the lower payment of amortizations in 2020 reflecting the effect of the debt management operation carried out in 2019.

Table 34
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR AND ITS FUNDING
(Million S/)

	2018	2019*			2020*	
		Q1	IR Mar.19	IR Jun.19	IR Mar.19	IR Jun.19
I. USES	**28,425**	**-2,183**	**23,918**	**28,887**	**21,148**	**20,470**
1. Amortization	11,488	4,162	5,382	12,821	3,715	3,134
a. External	4,222	673	2,293	3,684	992	991
b. Domestic	7,266	9,137	3,089	9,137	2,724	2,144
Of which: Recognition bonds	*1,171*	*211*	*695*	*856*	*550*	*550*
2. Overall balance	16,938	-6,346	18,535	16,065	17,433	17,336
(Negative sign indicates surplus)						
II. SOURCES	**28,425**	**-2,183**	**23,918**	**28,887**	**21,148**	**20,470**
1. Disbursements and others	25,630	11,948	25,471	31,914	16,271	18,352
2. Change on deposits and others[1/]	2,795	-14,132	-1,554	-3,027	4,877	2,118

1/ A positive sign indicates a reduction of deposits.
* Forecast.
IR: Inflation Report.

Box 4
CHANGES IN EXCISE TAXES

The excise tax on fuels, vehicles, alcoholic beverages, sugar, and tobacco was raised in May 2018. The table below summarizes the main changes in the tax structure:

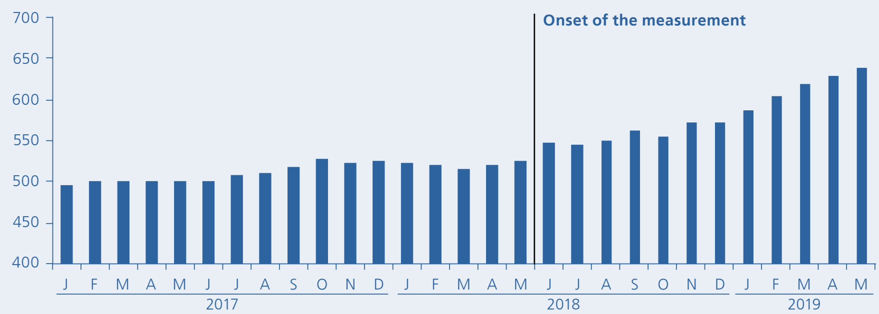
MAIN CHANGES IN THE EXCISE TAX

	Prior	Reform 2018	Reform 2019
New gasoline vehicles			
Light vehicles			
Up to 1,400cc			5%
From 1,400cc to 1,500cc	0%	10%	7,50%
From 1,500cc to more			10%
Converted to gas			0%
Motorcycles			
Up to 125cc	0%	10%	5%
More than 125cc			10%
New vehicles to Diesel			
Light vehicles	10%	20%	Without changes
Other new vehicles			
Gas and electric hybrids and Pick-Ups	10%	0%	Without changes
Used vehicles			
Hybrid and electric (includes motorcycles)	0%	10%	40%
Rest	30%	40%	
Beer (tax is per liter and PVP = is the Retail price without VAT)			
From 0° to 6°	max(S/ 1.25; 30% PVP)	max(S/ 1.25; 35% PVP)	S/ 2.25 per liter
From 6° to 12°	max(S/ 2.50; 25% PVP)	max(S/ 2.50; 25% PVP)	
Alcoholic beverages other than beer			
From 0° to 6°	max(S/ 1.25; 30% PVP)	max(S/ 1.25; 35% PVP)	max(S/ 1.25; 20% PVP)
From 6° to 12°	max(S/ 2.50; 25% PVP)	max(S/ 2.50; 25% PVP)	
From 12° to 20°	max(S/ 3.40; 25% PVP)	max(S/ 2.70; 30% PVP)	Without changes
More than 20°		max(S/ 3.40; 40% PVP)	
Non-alcoholic beverages			
Up to 0,5 g/100ml of Sugar		17%	12%
From 0,5 g/100ml to 6 g/100ml of Sugar	17%	17%	17%
More than 6 g/100ml of Sugar		25%	25%
Tobacco Products			
Cigarettes of tobacco blond/black	S/ 0.18 per unit	S/ 0.27 per unit	Without changes
Other cigarettes and substitutes	50% to the value	50% to the value	
Products of the heated tobacco	Without taxing	Without taxing	S/ 0.27 per unit
Other tobacco products*			50% to the value
Main Fuels	**Prior**	**Reform 2018**	**Reform 2019**
Diesel B5 (S-50)	S/ 1.10 per gallon	S/ 1.49 per gallon	Without changes
Gasoholes average	S/ 0.95 per gallon	S/ 1.19 per gallon	

* Of National Subheading 2403.99.00.00.

After this reform, the annualized monthly revenue from the excise tax increased 21 percent, from S/ 526 million in May 2018 to S/ 638 million in May 2019.

EXCISE TAX
(Million S/, moving average 12 months)



More recently, the government has approved decree 181-2019-EF, which modifies the excise tax on vehicles, beverages, and tobacco. The fiscal projections considered in this Report include the estimated impact of these measures, equivalent to S/ 530 million in annual terms, the most important impact being the tax on beer which will go from a mixed tax scheme to a specific tax rate.

Vehicles

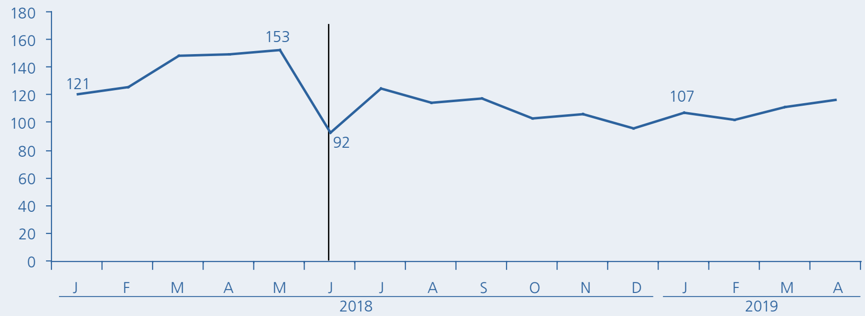
The rate applicable to **new gasoline vehicles[6] with low displacement engines** has been lowered. Thus, the vehicles with engines of less than 1,400 cubic centimeters (cc) will pay 5 percent, the ones with engines of between 1,400 and 1,500 cc will pay 7.5 percent, and the rate for vehicles with larger engines remains at 10 percent, which is the rate that applied to all new vehicles since June 2018. The decree also established that the units that use CNG or LPG and gasohol, or CNG or LPG and diesel, will not pay the excise tax. New motorcycles will also get a tax reduction according to the size of their engine.

The reduction of the excise tax for new vehicles with smaller displacement engines that use gas would support a market that was affected by the excise tax reform in May 2018, which increased the tax on new cars from 0 to 10 percent. In the case of **used vehicles**, the MEF unified the rate on these goods by 40 percent, as a result of which the tax on used hybrid cars (which use electricity and fossil fuels) rose from 10 to 40 percent.

After the tax amendment of 2018, car imports decreased: in January-April 2019, the value of vehicle imports dropped by 20 percent compared to the same period of 2018.

6 The rate for new Diesel vehicles remains at 20 percent.

VEHICLES IMPORTS
(FOB values in million US$)



Alcoholic Beverages

The decree excludes beer from the mixed system (ad valorem and specific), assigning beer a specific amount of S/ 2.25 per liter. It also reduces the ad valorem component of the tax on low alcohol content drinks from 35 to 20 percent. With this change, the tax on alcoholic beverages (other than beer) show increasing rates according to the alcohol content of these products.

The change in the excise tax on beer increases the tax on lower value varieties, which would have been paying S/ 1.25 in the mixed system –that has been eliminated– and will pay S/ 2.25 per liter. Beer varieties with higher alcohol contents, such as craft beers, may benefit from this change because they would pay S/ 2.25 per liter instead of paying S/ 2.50 or more per liter given their higher value.

It should be pointed out that, with this change, the tax on beers is in line with the Andean Community (CAN) regulations, such as Decision 600. This CAN decision considers that in the case of the excise tax on consumption, applied through ad valorem rates, the tax base (the price of the good) should not include the value added taxes nor the excise taxes themselves.

Non-alcoholic beverages

The tax on beverages was lowered from 17 to 12 percent for non-alcoholic beverages with sugar contents below 0.5g/100 ml, while the rates for products with higher sugar contents remains unchanged.

Indexing of Specific Excise Taxes

On the other hand, MEF resolution RM 234-2019-EF/15 establishes that, from January 2020, the specific amounts of the excise tax will be adjusted every year according to the CPI variation if the latter has increased by more than 1 percent. These adjustments will be carried out within the first 10 days of the month of January of each year. It is worth mentioning that the goods that are currently subject to the specific system include fuels, beers, tobacco products, and alcoholic beverages.

Box 5
THE DEBT MANAGEMENT OPERATION OF JUNE 2019

On June 13, 2019, the Ministry of Economy and Finance (MEF) announced a buy-back and exchange operation of global bonds (GB) in US dollars (maturing in 2025, 2027, 2033, and 2037) and in euros (maturing in 2026 and 2030), and of a sovereign bond (BTP) maturing in 2023.

This operation was financed through the issuance of a new GB in US dollars due in 2030 (the first issuance of this type of bonds after 3 years, when bonds in euros were placed) and of a new BTP maturing in 2034.

The MEF issued the BTP 2034 for a total of S/ 5.83 billion at a coupon rate of 5.4 percent and the GB 2030 for a total of US$ 750 million at a coupon rate of 2.84 percent. The spread between the 2030 GB and the US Treasury bond was 75 basis points, while the spread between the 2034 BTP and the equivalent US Treasury bond was 289 basis points, which was the lowest historical spread in both cases.

A strong demand for both bonds was observed: S/ 20 billion for the 2034 BTP and US$ 4 billion for the 2030 GB.

ISSUE OF PTB 2034 AND GB 2030

CHARACTERISTICS	PTB 2034	GB 2030
Auction date	13/Jun/2019	13/Jun/2019
Date of issue	20/Jun/2019	20/Jun/2019
Maturity date	12/Aug/2034	20/Jun/2030
Coupon rate	5.40%	2.84%
Amount issued	S/ 5,828 Millions	US$ 750 Millions
Price	99.89%	100.00%
Yield rate	5.40%	2.84%

Source: MEF and BVL.

The resources obtained from the issuance of the 2034 BTP (S/ 5.83 billion) allowed:

i) Exchanging S/ 4.11 billion of 2023 BTP through the issuance of S/ 4.39 billion.

ii) Exchanging US$ 88 million of GB in US dollars with the issuance of S/ 382 million.

iii) Pre-financing S/ 1.06 billion of the 2020 debt service through both national currency (S/ 140 million) and foreign currency (US$ 275 million, equivalent to S/ 916 million).

On the other hand, the issuance of GB 2030 (US$ 750 million) allowed:

i) A buy-back of GB in US dollars for a total of US$ 318 million and GB in euros for a total of € 4 million, through a bond issuance of US$ 392 million.

ii) Pre-financing US$ 358 million of the 2020 debt service.

RESULTS OF THE PUBLIC DEBT ADMINISTRATION OPERATION-JUNE 2019

	BOND CONDITIONS			EXCHANGE[2/]		REPURCHASE[3/]	
Offered Bonds	**Balance[1/]**	**Price**	**Coupon**	**Change**	**PTB 2034**	**Withdrawal**	**BG 2030**
Sovereign Bond							
PTB 2023	5,887	106.82%	5.20%	4,110	4,390	0	0
Global Bonds in US$							
GB 2025	1,793	126.93%	7.35%	36	153	110	140
GB 2027	1,250	111.10%	4.13%	16	60	172	191
GB 2033	2,188	159.64%	8.75%	10	51	27	43
GB 2037	1,165	139.17%	6.55%	25	118	9	13
Global Bonds in €							
GB 2026	1,100	113.34%	2.75%	0	0	3	3
GB 2030	1,000	124.11%	3.75%	0	0	2	2
TOTAL S/	**5,887**			**4,110**	**4,772**	**0**	
TOTAL US$	**6,396**			**88**		**318**	**392**
TOTAL €	**2,100**			**0**		**4**	

1/ As of 31st May 2019.
2/ The amounts exchanged are expressed in their currency of origin, while the amount issued of the sovereign bond (PTB 2034) is expressed in soles.
3/ The amounts withdrew are expressed in their currency of origin, while the amount issued for the global bond (BG 2030) is expressed in US dollars.

The impact of this operation has been an increase of S/ 1.72 billion in the balance of the BTPs, of which S/ 662 million are the result of the exchange operation of 2023 BTP and global bonds in US dollars and S/ 1.06 billion are the result of pre-financing the debt service. Another impact of the operation has been an increase of US$ 339 million in the balance of GBs, explained by an increase of US$ 358 million resulting from pre-financing the debt service and by an increase of US$ 69 million resulting from the buy-back of GB 2030, offset and the reduction of GB through the issuance of BTP 2034 used for the exchange (US$ 88 million).

PERU: 10-YEAR BTP YIELD

Source: MEF.

As a result of the operation, the average life of the BTP and GB has been estimated to increase from 12.6 years at the end of May to 12.9 years, which implies an improvement in the debt profile and lower risk for refinancing this debt. On the other hand, however, the depth of the short-term market of securities in domestic currency would decrease.

EFFECTS OF THE PUBLIC DEBT ADMINISTRATION OPERATION (PDAO) ON THE PTB BALANCE AT FIXED RATE[1/]
(Million S/)

DENOMINATION	Years	19/jun/2019		20/jun/2019		Balance Change	% change
		PRE-PDAO	%	POST-PDAO	%		
PTB Balance		**106,416**	**100.0**	**108,134**	**100.0**	**1,718**	**0**
PTB 2020	1	644	0.6	644	0.6	0	0.0
PTB 2023[2/]	4	5,887	5.5	1,777	1.6	-4,110	-3.9
PTB 2024	5	11,543	10.8	11,543	10.7	0	-0.2
PTB 2026A	7	116	0.1	116	0.1	0	0.0
PTB 2026	7	12,515	11.8	12,515	11.6	0	-0.2
PTB 2028	9	14,471	13.6	14,471	13.4	0	-0.2
PTB 2029E	10	13,855	13.0	13,855	12.8	0	-0.2
PTB 2031	12	14,292	13.4	14,292	13.2	0	-0.2
PTB 2032	13	13,382	12.6	13,382	12.4	0	-0.2
PTB 2034[3/]	15	0	0.0	5,828	5.4	5,828	5.4
PTB 2037	18	12,965	12.2	12,965	12.0	0	-0.2
PTB 2042	23	4,443	4.2	4,443	4.1	0	-0.1
PTB 2055	36	2,272	2.1	2,272	2.1	0	0.0

1/ As of 31 december 2018.
2/ Sovereign bond exchanged in the Public Debt Administration Operation.
3/ Sovereign bond issued in the Public Debt Administration Operation.
Source: MEF.

V. Monetary Policy and Financial Conditions

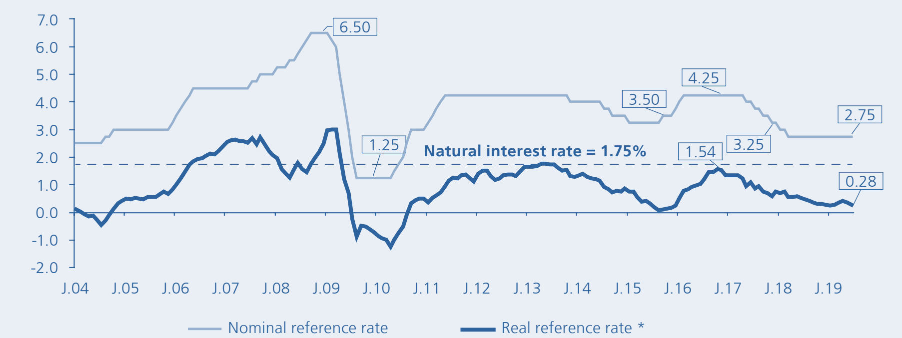
Monetary Policy Actions

49. The BCRP **monetary policy** actions continued to be aimed at maintaining an expansionary monetary stance to ensure that inflation and inflation expectations remain within the target range, in a context in which economic activity continued to be below its potential level and increased uncertainty was observed in international financial markets.

    In this context, the Board of BCRP decided to maintain the **benchmark interest rate** at 2.75 percent and reiterated in its policy statements that it "*considered appropriate to maintain an expansionary policy stance while inflation expectations remain anchored, in a context in which the level of economic activity is below its potential*". Moreover, since May the Board has also emphasized the weak performance of primary industries due to transitory factors that are expected to revert in the second half of the year.

    As a result of these monetary policy actions, the real benchmark interest rate stood around 0.3 percent in this period, below its neutral level which is estimated at 1.75 percent. This expansionary monetary policy stance is consistent with an inflation rate of around 2.0 percent and an output gap that is estimated to close in the forecast horizon, although more gradually than anticipated in the Inflation Report of March.

Graph 55
NOMINAL AND REAL* REFERENCE INTEREST RATE
(%)



* With expectation of inflation.

50. The Board's decision of maintaining an expansionary monetary policy stance was based on the following factors:

    i. Between March and June 2019, the **year-on-year inflation rate and indicators of trend inflation** were within the target range. The inflation rate rose from 2.0 percent in February to 2.3 percent in June, due mainly to specific factors such as the increase in the price of education (tuition and fees) in March.

    ii. **Inflation expectations** remain within the target range.

    iii. **Indicators of economic activity** in the non-primary industries show a weak performance as a result of transitory supply shocks, while non-primary industries maintain a moderate growth momentum due mainly to lower public investment. The slow pace of investment is expected to revert in the second half of the year.

    iv. **Global growth** risks persist and higher volatility has been observed in international financial markets over the past few weeks due to intensifying trade tensions prior to the G-20 meeting of heads of state.

Monetary Operations

51. The **monetary operations of the Central Bank** were oriented to maintaining appropriate levels of liquidity. To do so, and because of public sector's increased deposits at the Central Bank resulting from the regularization period for the payment of the income tax, the Treasury's placement of bonds, and lower government expenditure, between March and June BCRP continued injecting

liquidity via security repos and currency repos with up to 1 year maturity terms. As a result of these operations, the balance of repos increased from S/ 14.25 billion in February to S/ 20.03 billion at the end of June 2019.

Table 35
BALANCE OF BCRP MONETARY OPERATIONS

	Balance (Mill. S/)			Average interest rate (%)		
	Dec.18	Mar.19	Jun.19	Dec.18	Mar.19	Jun.19
Monetary Sterilization						
1. CDBCRP	27,061	29,226	27,265	2.70	2.75	2.74
2. Overnight deposits	1,802	1,926	2,835	1.50	1.50	1.50
Monetary Injection						
3. Currency repos	7,358	8,153	11,450	3.80	4.09	3.93
4. Security repos	5,950	6,100	8,575	3.95	3.96	3.80
5. Auctions of Treasury funds	4,000	4,700	4,100	4.22	4.25	4.31

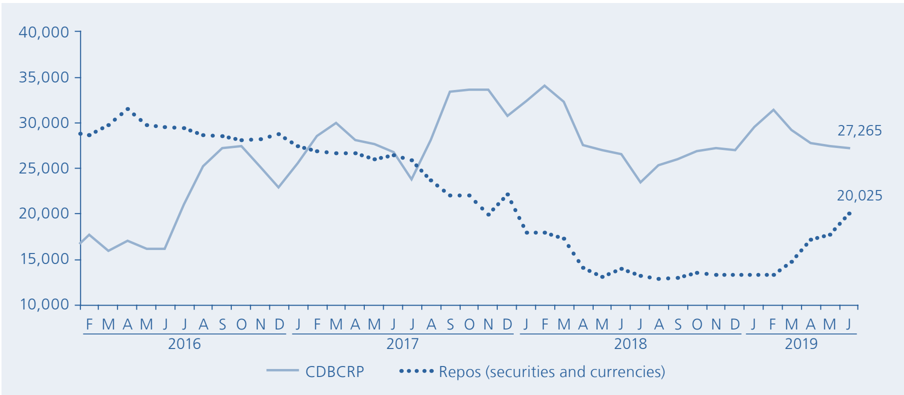
52. Thus, the ratio of repos operations in terms of the BCRP net assets increased to 8.4 percent, from 6.6 percent in March, while the ratio of BCRP sterilization instruments fell to 12.7 percent at the end of June 2019, from 13.9 percent in March. On the other hand, the ratio of public sector deposits at the central bank in terms of the BCRP net liabilities increased to 33.8 percent, from 32.4 percent in March, and remained as the most important liability of BCRP.

Table 36
SIMPLIFIED BALANCE SHEET OF THE BCRP*
(As % of Net Assets)

	Dec.18	Mar.19	Jun.19
I. Net assets	**100**	**100**	**100**
Net International Reserves	**93.8**	**93.4**	**91.6**
	(US$ 60,121 mills.)	(US$ 63,091 mills.)	(US$ 66,512 mills.)
Repos	**6.2**	**6.6**	**8.4**
II. Net liabilities	**100**	**100**	**100**
1. Total public sector deposits	**31.3**	**32.4**	**33.8**
In domestic currency	18.5	19.9	21.7
In foreign currency	12.8	12.5	12.1
2. Total financial system deposits	**25.6**	**26.4**	**28.4**
In domestic currency	5.3	4.9	4.8
In foreign currency	20.3	21.6	23.6
3. BCRP instruments	**13.4**	**13.9**	**12.7**
CD BCRP	12.6	13.0	11.5
CDLD BCRP	0.0	0.0	0.0
CDR BCRP	0.0	0.0	0.0
Term deposits	0.0	0.0	0.0
Overnight and Term deposits	0.8	0.9	1.2
4. Currency	**22.9**	**20.9**	**19.3**
5. Others*	**6.8**	**6.4**	**5.8**

* Includes assets and other accounts of balance of the BCRP.

Graph 56
REPO OPERATIONS AND PLACEMENT OF CDBCRP
(Balance in mill. S/)



Interest Rates

53. Money market **interest rates** showed a downward trend in the second quarter of 2019. Thus, while the interbank rate was at its benchmark level, the prime lending and deposit rates for terms of over 180 days decreased on average 7 and 10 basis points, respectively. Similarly, the rates on deposits with terms over 30 days decreased by an average of 17 basis points between March and June. Factors explaining the recent evolution of interest rates include banks' greater availability of liquidity as a result of the BCRP liquidity injection operations and market expectations of a more gradual reversal of monetary stimulus.

Graph 57
INTEREST RATE IN S/: 90-DAY CORPORATE PRIME AND REFERENCE RATE
(%)

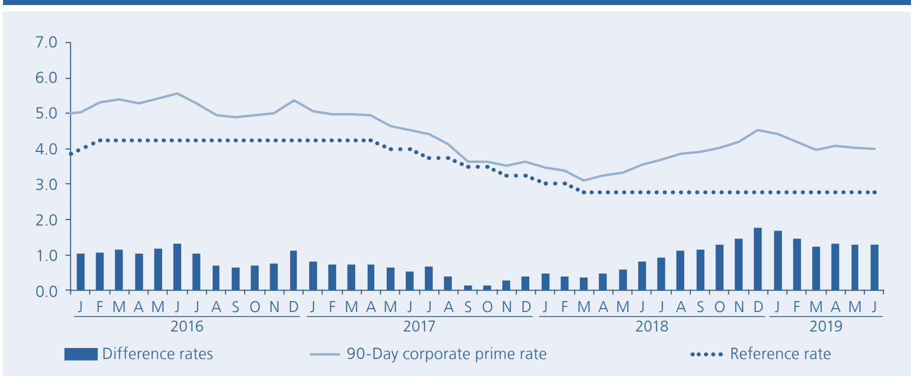


Table 37
INTEREST RATE IN DOMESTIC CURRENCY
(%)

		Mar.18	Jun.18	Sep.18	Dec.18	Mar.19	Jun.19
Passive	Deposits up to 30-day	2.7	2.9	2.7	3.1	2.6	2.9
	On 31 to 180-day term deposits	3.0	2.8	3.4	4.0	3.6	3.4
	On 181 to 360-day term deposits	3.2	3.3	3.6	4.2	4.1	3.9
Active	90-day corporate prime	3.1	3.6	3.9	4.5	4.0	4.0
	Corporates	3.8	4.3	4.3	4.9	4.7	4.5
	Large companies	6.4	6.3	6.2	6.4	6.5	6.3
	Medium-sized enterprises	9.8	9.3	10.3	9.8	10.3	9.9
	Small businesses	19.8	19.1	19.1	18.5	18.5	18.8
	Consumer	43.9	41.7	41.1	44.9	40.8	41.1
	Mortgage	7.4	7.3	7.5	7.6	7.9	7.7

Source: SBS.

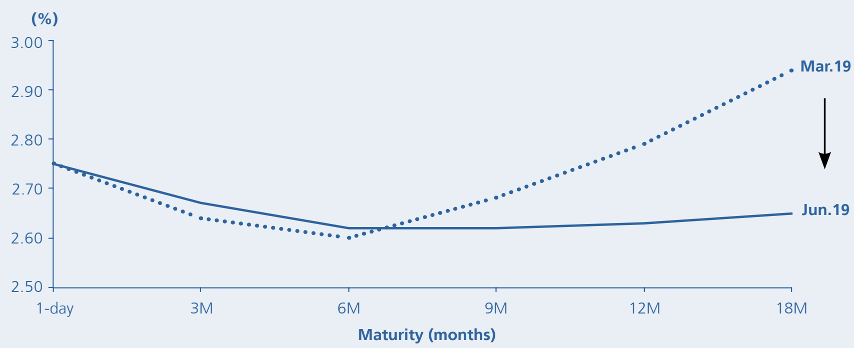
Table 38
SURVEY ON MACROECONOMIC EXPECTATIONS: REFERENCE RATE

	March 31	April 30	May 31	June 28
Financial entities				
2019	2.75	2.75	2.75	2.75
2020	3.00	3.00	3.00	2.75
Economic analysts				
2019	2.75	2.75	2.75	2.75
2020	3.00	3.25	3.00	2.75

Survey made in dates indicated on the items.
Source: BCRP.

54. The **yield curve** of **CDBCRP** for 3 to 12 month-terms decreased 9 basis points on average between March and June 2019, mainly due to banks' increased demand for high quality securities and to expectations of a more gradual withdrawal of monetary stimulus by BCRP.

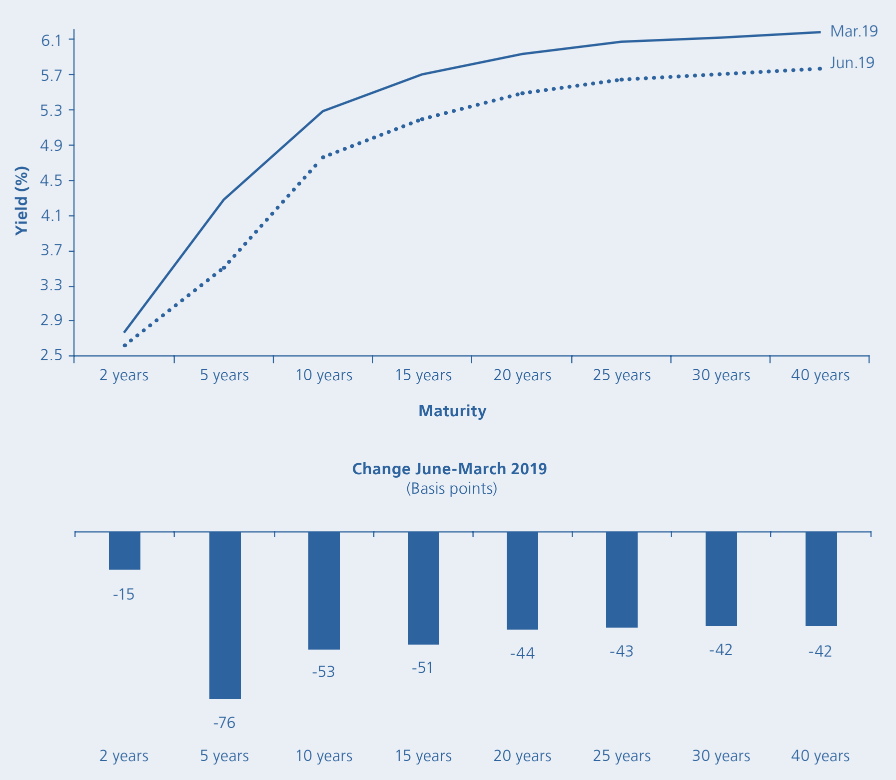
Graph 58
YIELD CURVE OF CENTRAL BANK SECURITIES[1/]



1/ Yield rate in the primary and secondary market.

55. Similarly, the interest rates on **sovereign bonds** decreased 64 basis points on average compared to the first quarter of 2019, with expectations that the Federal Reserve will reduce its monetary policy interest rate in the short-term together with the recent issuance of sovereign and global bonds in the international market favoring the performance of Peruvian bonds. It should be pointed out that non-resident investors' demand for Peruvian bonds increased by S/ 5.82 billion between March and June 2019.

Graph 59
YIELD CURVE OF PERUVIAN SOVEREIGN BONDS
(%)



Source: MEF.

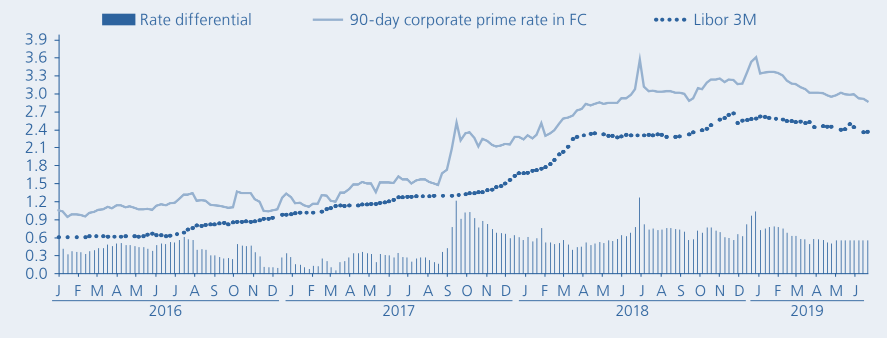
56. Interest rates in dollars declined as well, influenced by the downward trend of international interest rates. The interbank rate remained at 2.50 percent between March and June 2019, while the 90-day corporate prime rates for loans and deposits decreased by 14 and 7 basis points, respectively. Moreover, the interest rates in foreign currency in the credit market decreased on average 20 basis points.

Table 39
INTEREST RATE IN FOREIGN CURRENCY
(%)

		Mar.18	Jun.18	Sep.18	Dec.18	Mar.19	Jun.19
Passive	Deposits up to 30-day	1.2	1.3	1.4	1.9	1.9	1.7
	On 31 to 180-day term deposits	1.4	1.6	1.7	2.0	2.1	2.0
	On 181 to 360-day term deposits	1.1	1.5	1.3	1.9	2.1	1.9
Active	90-day corporate prime	2.8	3.1	3.0	3.6	3.1	2.9
	Corporates	3.0	3.4	3.7	4.0	3.7	3.6
	Large companies	5.1	5.1	5.4	5.5	5.4	5.6
	Medium-sized enterprises	6.7	7.1	7.3	6.9	7.4	6.8
	Small businesses	10.1	10.2	9.9	9.9	10.1	9.9
	Consumer	34.1	33.9	34.8	36.1	35.4	35.2
	Mortgage	5.9	5.8	6.1	6.1	6.3	5.9

Source: SBS.

Graph 60
INTEREST RATE IN US$: 90-DAY CORPORATE PRIME AND LIBOR 3-MONTHS
(%)



Foreign Exchange Market

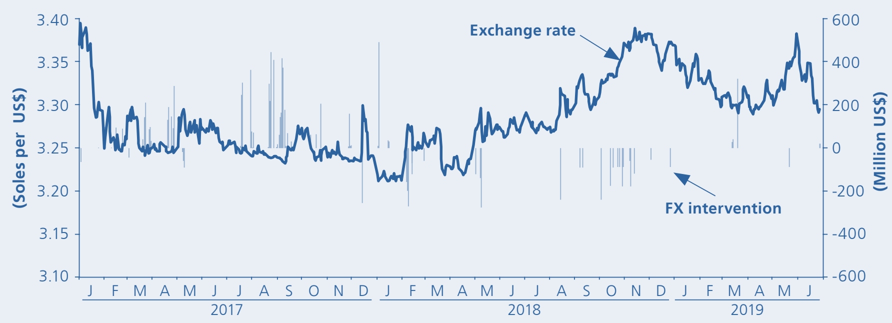
57. Between March and June 2019, the **sol** appreciated 0.7 percent against the dollar, from S/ 3.319 to S/ 3.295 per dollar, thus showing an accumulated appreciation of 2.2 percent so far this year. This recent evolution of the US-PEN exchange rate is mainly explained by expectations of a reduction in the interest rate of the Federal Reserve, in a context of moderation in the pace of economic global growth associated with the trade tensions between the United States and China. As regards the Central Bank's actions in the foreign exchange market, BCRP has intervened five times in the forex market this year. It is worth pointing out that, between March and June, BCRP purchased dollars for a total of US$ 405 million, and placed FOREX swaps-sell for a total of US$ 90 million in May in response to greater exchange rate volatility influenced by the international context previously mentioned.

Table 40
FOREIGN EXCHANGE INTERVENTION

	Trading days in the market	Number of intervention days: Spot Market	Placement of derivatives and indexed instruments	Total (*spot and/or* placement)	% of days with intervention: Spot	% of days with intervention: Instruments	SD of the Exchange Rate (Annual % change)
2017	249	55	23	63	22%	10%	4.5%
2018	245	4	27	30	2%	11%	3.4%
2019*	125	4	1	5	3%	4%	3.7%

* As of 28th June 2019.

Graph 61
EXCHANGE RATE AND FX INTERVENTION[1/]



1/ Includes Net purchases of US$ and placement of CDLD BCRP, CDR BCRP, and FX swaps.

58. As for capital flows in the local exchange market, it is worth mentioning that, between March and June 2019, the non-financial sector's net supply of dollars (US$ 1.52 billion) was offset by the financial sector's demand (US$ 1.21 billion) and by the BCRP intervention the foreign exchange market (US$ 315 million). Non-resident investors stood out as suppliers of dollars in the spot market (US$ 1.74 billion), while the administrators of private pension funds (AFPs) stood out in terms of the demand for dollars in the spot market and the derivatives market.

Table 41
FLOWS OF FX MARKET *
(Million US$)

	March-June 2019: Spot	Derivatives	Total
Financial Sector (1)	**274**	**-1,483**	**-1,209**
1. AFP	-1,276	-313	-1,589
2. Non-residents	1,743	-1,170	573
3. Financial institutions	-193	0	-193
FX intervention of BCRP (2)	**-405**	**90**	**-315**
Non-financial Sector (3)	**1,695**	**-171**	**1,524**
Net flow (1)+(2)+(3)	**1,564**	**-1,564**	**0**

* Positive (negative) means supply (demand).

Liquidity

59. Private sector deposits registered a year-on-year growth rate of 8.7 percent in May. By currencies, deposits in soles grew at a year-on-year rate of 12.8 percent, while deposits in dollars grew 2.4 percent, which reflected people's greater preference for saving in domestic currency in a context marked by the appreciation of the sol in the first months of the year.

Graph 62
DEPOSITS OF THE PRIVATE SECTOR BY CURRENCY
(Annual % change)

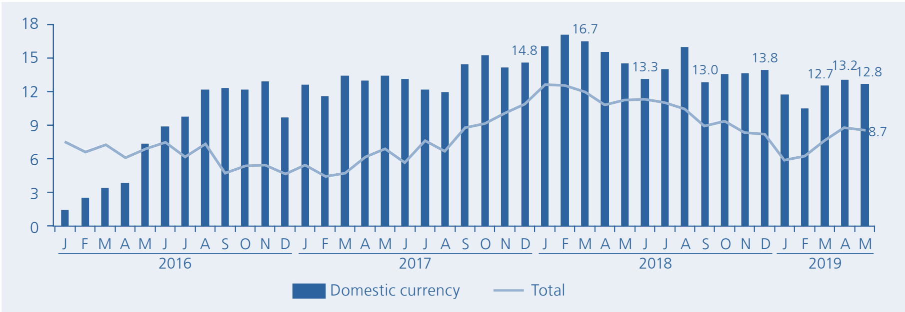


Table 42
DOLLARIZATION RATIO OF DEPOSITS[1/]
(%)

	Mar.18	Jun.18	Sep.18	Dec.18	Mar.19	May.19
Individuals	**35.0**	**34.4**	**33.7**	**32.5**	**31.7**	**32.0**
Demand deposits	48.5	50.3	47.9	46.3	45.3	46.5
Savings deposits	38.5	38.3	36.9	35.5	35.7	35.6
Term deposits	30.5	29.5	29.5	29.4	28.7	28.0
CTS	27.7	26.1	26.1	24.4	24.6	23.4
Business	**49.3**	**50.1**	**48.7**	**47.2**	**46.1**	**47.7**
Demand deposits	46.3	48.0	45.6	44.1	43.1	44.6
Savings deposits	60.9	55.5	74.6	45.4	57.6	49.2
Term deposits	57.9	57.5	56.8	63.9	57.2	58.5
TOTAL	**39.9**	**39.6**	**38.6**	**37.3**	**37.1**	**37.4**

1/ Balances are valuated at constant exchange rate on December 2018.

Table 43
MONETARY AND CREDIT ACCOUNTS OF THE DEPOSITORY CORPORATIONS (END OF PERIOD)
(Annual % change)

	Mar.18	Jun.18	Sep.18	Dec.18	Mar.19	May.19	Dec.19*	Dec.20*
Currency (End of period)	10.8	10.3	8.5	7.9	5.3	4.8	6.0	6.0
Deposits in domestic currency	16.7	13.3	13.0	14.1	12.7	12.8	11.8	14.4
Total deposits[1/]	12.2	11.5	9.0	8.3	7.7	8.7	9.0	11.4
Broad money in domestic currency	14.9	12.5	11.8	12.1	11.6	11.1	10.5	12.5
Total broad money[1/]	12.2	11.4	9.2	8.1	7.5	8.2	8.5	10.6
Credit to the private sector in domestic currency	7.4	9.3	10.1	11.6	11.7	10.5	10.0	11.2
Total credit to the private sector[1/]	**7.8**	**9.1**	**8.9**	**8.7**	**8.4**	**7.9**	**8.1**	**9.0**

1/ Balances are valuated at constant exchange rate on December 2018.
* Forecast.

Credit to the Private Sector

60. **Credit to the private sector** grew at a year-on-year rate of 7.9 percent in May. By segments, credit to businesses grew 5.9 percent, while loans to households grew 11.3 percent. In the case of personal loans, consumer loans and mortgage loans continue to show the higher growth rates (12.9 and 8.9 percent, respectively), while in the case of loans to businesses, the segments with the higher growth rates were loans to corporations and to large companies, as well as loans to small and micro businesses (6.4 percent in each case).

Table 44
TOTAL CREDIT TO THE PRIVATE SECTOR
(Annual growth rate)

	Mar.18	Jun.18	Sep.18	Dec.18	Mar.19	May.19
Businesses	**6.7**	**8.0**	**7.4**	**7.1**	**6.4**	**5.9**
Corporate and large companies	8.1	10.6	9.9	9.1	7.2	6.4
Medium-sized enterprises	1.9	2.4	2.7	3.8	3.9	4.1
Small business and Microbusinesses	8.8	8.5	6.9	5.9	7.0	6.4
Individuals	**9.7**	**10.9**	**11.4**	**11.4**	**11.7**	**11.3**
Consumer	10.4	11.9	12.8	13.1	13.5	12.9
Car loans	-0.8	-2.9	-1.8	-3.7	2.6	4.1
Credit cards	3.8	6.0	8.5	11.9	14.7	14.6
Rest	14.8	16.1	15.9	14.7	13.4	12.5
Mortgage	8.6	9.4	9.5	9.0	9.1	8.9
TOTAL	**7.8**	**9.1**	**8.9**	**8.7**	**8.4**	**7.9**

61. Credit in soles continues to grow at two-digit rates, while the pace of growth of credit in dollars has moderated due to the greater preference for local funding and due to the fact that interest rates in soles have remained below their historical average levels. Thus, credit in soles grew 10.5 percent in May, while credit in dollars grew 1.7 percent in the same month.

Graph 63
TOTAL CREDIT TO THE PRIVATE SECTOR
(Annual % change)

62. Moreover, the balance of total credit to the private sector continued to evolve in line with its long-term trend, in line with easing conditions for credit provision.

Graph 64
SEASONALLY ADJUSTED AND TREND TOTAL CREDIT TO THE PRIVATE SECTOR
(Current million S/)

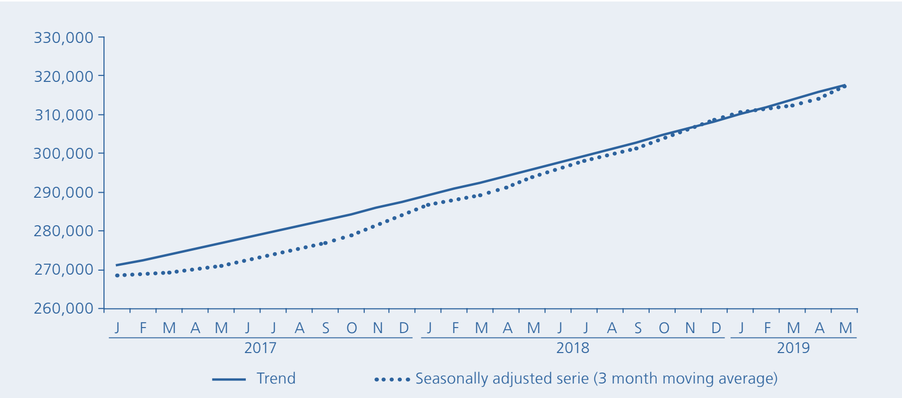


Table 45
CREDIT TO THE PRIVATE SECTOR
(Annual % change)

	Mar.18	Jun.18	Sep.18	Dec.18	Mar.19	May.19
Domestic currency	,7.4	9.3	10.1	11.6	11.7	10.5
Foreign currency	8.6	8.7	6.0	1.9	0.6	1.7
Total	**7.8**	**9.1**	**8.9**	**8.7**	**8.4**	**7.9**

63. As of May 2019, depository institutions' credit to the private sector in domestic currency increased by S/ 21.95 billion in year-on-year terms. This increase has been financed mainly by the increase observed in private sector deposits (S/ 18.57 billion).

Banks increased deposits at the Central Bank (S/ 1.56 billion in reserve funds and S/ 3.09 billion in other deposits) were offset by means of repo operations amounting to S/ 4.48 billion as well as by the maturity of BCRP securities (S/ 689 million). In addition, the BCRP auctions of Public Treasury deposits, an instrument that has steadily gained importance as a funding source since 2017, also increased by S/ 1.40 billion.

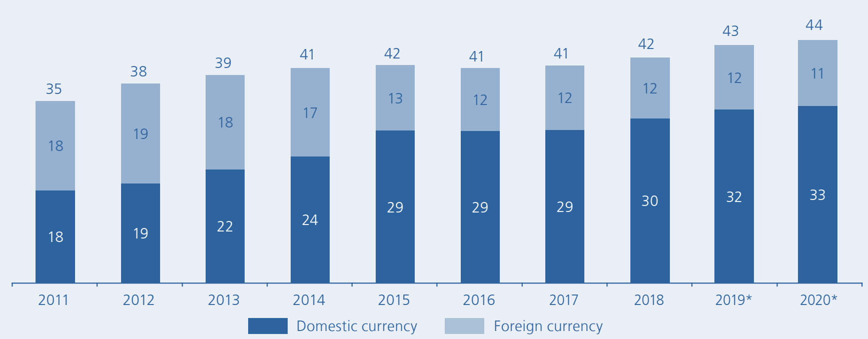
Table 46
SOURCES OF EXPANSION OF THE CREDIT IN DOMESTIC CURRENCY[1/]
(Million S/)

Domestic currency	Balance	Flows		
	May.19	2018	Acum.2019	May.19/May.18
Credit to the private sector	**230,643**	**23,382**	**6,384**	**21,952**
1.- Total liabilities	**213,181**	**17,812**	**3,098**	**18,423**
a.- Non-financial Private sector	166,155	19,105	3,643	18,488
Deposits	*163,345*	*19,386*	*3,597*	*18,567*
Other securities	*2,810*	*-281*	*46*	*-79*
b.- Non-financial Public sector[2/]	20,703	-141	-714	-231
c.- Other financial institutions[3/]	21,499	-3,133	1,001	-296
d.- Non-residents	4,824	1,980	-833	461
2.- BCRP operations	**-21,666**	**-1,265**	**5,199**	**1,923**
a.- Reserve requirements	-11,062	-491	305	-1,557
b.- Other deposits[4/]	-7,965	64	140	-3,093
c.- Securities	-24,450	4,773	189	689
d.- Repos	17,412	-8,412	4,166	4,484
Securities	*6,750*	*530*	*800*	*2,490*
Currency	*10,662*	*-8,942*	*3,366*	*1,994*
e.- Deposits auctions of the Public sector	4,400	2,800	400	1,400
3.- Public sector financing	**-25,314**	**-3,055**	**1,328**	**-608**
4.- Rest[5/]	**64,441**	**9,889**	**-3,240**	**2,214**

Credit to the private sector = (1)+(2)+(3)+(4).
1/ Balance with positive signs means liabilities, flows with positive signs means source of expansion of the credit to the private sector.
2/ Excludes auctions of the Public Treasury deposits and Banco de la Nación in charge of the BCRP.
3/ Includes liabilities with mutual funds, AFPs, COFIDE, and Mivivienda.
4/ Includes overnight, term, and special deposits.
5/ Includes capital, provisions, exchange position, equity and other liabilities with positive sign and other assets with negative signs.

64. In the forecast horizon, **credit to the private sector** is expected to grow at higher rates than the nominal GDP and therefore the ratio of credit-to-GDP would increase from 42 percent in 2018 to 44 percent in 2020. This forecast takes into account loose monetary conditions and a recovery in the pace of growth of domestic demand.

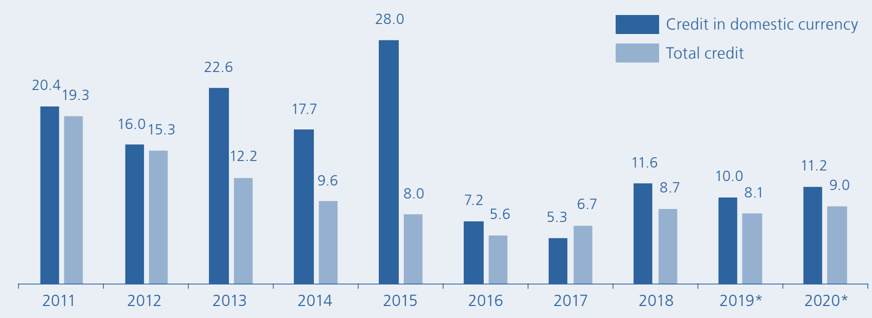
Graph 65
RATIO CREDIT/GDP
(%)



* Forecast.

Credit to the private sector in domestic currency is projected to grow 10.0 percent in 2019 and 11.2 percent in 2020 and thus total credit would grow 8.1 percent in 2019 and 9.0 percent in 2020. As a result, the credit dollarization ratio would continue to decline, reaching a level of 26 percent by the end of 2020.

Graph 66
CREDIT TO THE PRIVATE SECTOR
(% change)



* Forecast.

65. Credit expansion is projected to be financed mainly through deposits. Moreover, during 2019 the Central Bank would inject liquidity through repo operations if required by the evolution of monetary aggregates and consistently with the BCRP policy interest rate.

Table 47
SOURCES OF EXPANSION OF THE CREDIT IN DOMESTIC CURRENCY
(Million S/)

	Balance			Flows		
	2018	2019*	2020*	2018	2019*	2020*
Credit to the private sector	**224,258**	**246,598**	**274,198**	**23,382**	**22,339**	**27,600**
1. Total liabilities[1/]	210,084	228,117	258,007	17,812	18,033	29,890
2. BCRP operations	-26,865	-26,013	-26,172	-1,265	852	-159
3. Public sector financing	-26,641	-27,591	-33,011	-3,055	-950	-5,419
4. Rest	67,681	72,085	75,374	9,889	4,404	3,288

1/ Includes deposits and issued securities.
* Forecast.

66. More broadly, **total financing** to the non-financial private sector (credit from financial intermediaries, funding from the local capital market, and foreign debt) is expected to accelerate its annual growth rate from 4.7 percent in 2018 to

6.6 and 7.6 percent in 2019 and 2020, respectively. In line with expectations of lower international interest rates, the recovery of external funding is anticipated to stands out. In relative terms, credit from depository institutions, which would grow 8.1 and 9.0 percent in 2019 and 2020, respectively, would continue to be the most dynamic source of credit.

Table 48
GLOBAL FINANCING OF THE PRIVATE SECTOR[1/]

	Balance (Mill. S/)			Change (%)			
	May 19[2/]	2019*	2020*	Dec.18/Dec.17	May.19/May.18	Dec.19/Dec.18	Dec.20/Dec.19
Credit of Depository Corporations	**319,954**	**337,721**	**368,013**	**8.7**	**7.9**	**8.1**	**9.0**
Domestic currency	230,643	246,598	274,192	11.6	10.5	10.0	11.2
Foreign currency (Mill. US$)	26,502	27,040	27,840	1.9	1.7	3.5	3.0
Dollarization (%)	*27.9*	*27.0*	*25.5*				
Credit of the other financial institutions	**41,791**	**41,563**	**43,548**	**0.2**	**5.0**	**5.0**	**4.8**
Domestic currency	25,727	27,085	31,009	6.8	18.0	16.9	14.5
Foreign currency (Mill. US$)	4,767	4,296	3,721	-7.8	-10.8	-11.8	-13.4
Dollarization (%)	*38.4*	*34.8*	*28.8*				
Private external borrowing	**95,207**	**95,121**	**98,849**	**-5.2**	**-0.6**	**2.1**	**3.9**
(Mill. US$)	28,251	28,226	29,332	-5.2	-0.6	2.1	3.9
Short-term (Mill. US$)	3,845	3,845	3,845	-3.2	-11.8	-5.7	0.0
Medium- and long-term (Mill. US$)	24,407	24,381	25,487	-5.5	1.4	3.5	4.5
Soles (Mill. S/)	4,809	4,930	5,154	90.8	227.3	235.5	4.5
US dollars (Mill. US$)	22,980	22,918	23,958	-6.4	-2.8	-0.9	4.5
TOTAL	**456,953**	**474,406**	**510,410**	**4.7**	**5.7**	**6.6**	**7.6**
Domestic currency	261,179	278,613	310,354	11.4	12.6	11.9	11.4
Foreign currency (Mill. US$)	58,093	58,099	59,364	-2.8	-2.2	-0.2	2.2
Dollarization (%)	*42.8*	*41.3*	*39.2*				

1/ Balances are valuated at constant exchange rate on December 2018.
2/ Preliminary data for private external borrowing.
* Proyección.

As of May 2019, total financing to the private sector grew 5.7 percent, showing a higher rate than that registered in 2018 (4.7 percent). The largest component of this expanded financing was lending from credit makers, with a balance of S/ 319.95 billion in that month. The second largest component was the direct financing that companies obtained abroad, the balance of which was US$ 28.25 billion (S/ 95.21 billion) in that month. Moreover, these companies have substituted their debt with the local financial system for debt in the external market. Thus, in April 2019, Alicorp and Telefónica issued bonds in domestic currency –bonds for a total of S/ 1.64 billion the former and for a total of S/ 1.70 billion the latter–, while Transmataro issued bonds in dollars for a total of US$ 400 million in the external market.

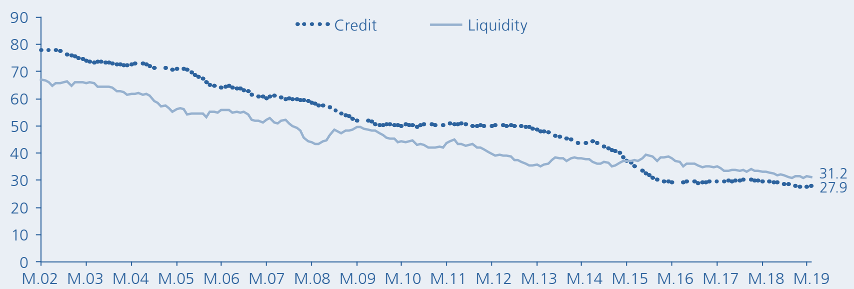
67. The ratio of dollarization of credit measured at a constant exchange rate was 27.9 percent in May, lower than in December (28.2 percent). This reduction reflects the lower dollarization ratio of credit to households, which fell from 10.5 to 9.9 percent. The ratio of dollarization also continued to show a downward trend in the segments of mortgage loans and car loans, which showed rates of 15.3 and 14.3 percent, respectively, in May.

Table 49
RATIO OF DOLLARIZATION OF THE CREDIT TO THE PRIVATE SECTOR[1/]
(%)

	Mar.18	Jun.18	Sep.18	Dec.18	Mar.19	May.19
Businesses	**40.5**	**40.5**	**40.0**	**39.1**	**38.7**	**39.4**
Corporate and large companies	54.5	54.4	53.7	52.3	51.7	52.7
Medium-sized enterprises	41.2	41.4	40.5	40.6	40.4	40.9
Small business and Microbusinesses	6.7	13.1	13.0	12.4	6.0	5.9
Individuals	**11.8**	**11.4**	**11.1**	**10.5**	**10.1**	**9.9**
Consumer	6.8	6.8	6.7	6.5	6.4	6.4
Car loans	18.1	16.4	15.1	14.2	13.6	14.3
Credit cards	7.3	7.4	7.5	7.3	7.3	7.5
Rest	6.0	6.0	5.9	5.7	5.5	5.4
Mortgage	19.1	18.3	17.5	16.6	15.8	15.3
TOTAL	**29.7**	**29.5**	**29.0**	**28.2**	**27.6**	**27.9**

1/ Balances are valuated at constant exchange rate on December 2018.

Graph 67
RATIO OF DOLLARIZATION OF CREDIT AND LIQUIDITY: 2002-2019
(%)



68. The ratio of non-performing loans was 3.52 percent in May, 0.2 percentage points higher than at the end of 2018 (3.32 percent). It is worth mentioning that the ratio of non-performing loans in credit to businesses has increased by 0.26 percentage points compared to December 2018, while the ratio of non-performing loans in personal loans has increased by 0.11 percentage points.

Table 50
NON-PERFORMING LOANS INDEX OF THE CREDIT
(%)

	Mar.18	Jun.18	Sep.18	Dec.18	Mar.19	May.19
Businesses	**3.48**	**3.54**	**3.62**	**3.42**	**3.60**	**3.68**
Corporate and large companies	0.54	0.57	0.60	0.55	0.61	0.64
Medium-sized enterprises	7.38	7.46	7.75	7.53	8.02	8.23
Micro and Small businesses	7.53	7.75	7.83	7.35	7.44	7.55
Individuals	**3.27**	**3.28**	**3.15**	**3.13**	**3.07**	**3.24**
Consumer	3.60	3.59	3.32	3.21	3.16	3.36
Credit cards	4.89	4.84	4.16	3.88	3.87	4.13
Vehicular	6.14	5.59	5.30	4.45	3.92	3.97
Rest	2.60	2.68	2.68	2.70	2.66	2.83
Mortgage	2.86	2.89	2.92	3.03	2.96	3.07
Average	**3.40**	**3.45**	**3.45**	**3.32**	**3.41**	**3.52**

Box 6
DOLLARIZATION OF BUSINESS DEPOSITS AND LOANS BY ECONOMIC SECTOR

In spite of the significant reduction observed in the ratio of dollarization, particularly in the family segment, financial dollarization still remains high in the corporate segment, both in the case of loans and deposits. With the objective of identifying the corporate segments where there is still room to continue reducing financial dollarization, this box provides information on the ratio of dollarization of corporate deposits and loans based on the Business Balance Sheet by economic sectors.

Deposits

As of April 2019, **companies' deposits** in the banking sector amount to S/ 58.9 billion (valued at the constant exchange rate of December 2018 for comparison purposes) and represent 28.7 percent of total deposits. The high ratio of demand deposits (78.1 percent) –followed by term deposits (16.9 percent)– in corporate deposits reflects the traditional way in which companies use deposits to carry out their operations. Because of their size, services and commerce are the economic sectors that maintain the largest amounts of deposits in the financial system, followed by manufacturing and mining.

DEPOSITS BY ECONOMIC SECTOR: APRIL 2019

Sector	Billion S/	Share	Structure			
		%	Demand	Saving	Term	Other1/
Agriculture	1,534	2.6	91.9	3.5	4.1	0.5
Fishing	645	1.1	81.8	1.7	16.3	0.2
Mining	6,331	10.7	67.3	1.5	30.2	1.0
Manufacturing	6,407	10.9	83.2	2.4	13.5	0.9
Energy	1,944	3.3	83.5	0.7	15.5	0.4
Construction	5,707	9.7	71.7	6.4	19.2	2.7
Commerce	10,335	17.5	86.9	4.0	8.5	0.6
Services	17,479	29.7	80.9	4.9	13.2	1.1
Tourism	1,129	1.9	71.8	7.1	20.9	0.2
Transport	4,873	8.3	80.1	3.9	15.8	0.2
Real Estate	3,305	5.6	80.1	3.8	12.6	3.5
Business activity2/	6,683	11.3	83.9	5.0	10.4	0.8
Education	602	1.0	79.6	6.5	13.8	0.1
Social services3/	886	1.5	77.6	9.4	12.8	0.3
Others4/	8,556	14.5	66.5	5.1	28.3	0.1
Total	**58,938**	**100.0**	**78.1**	**4.1**	**16.9**	**0.9**

1/ Includes repos and deposits without specifying.
2/ Includes activities of professional consulting services.
3/ Includes services of provision of food, maternal and child health, popular dining-places, and other related.
4/ Includes other services like security, recreation, amog others.

The ratio of **dollarization of deposits** of non-financial companies in banks is 53.0 percent (versus 39.5 percent in the case of family deposits). By type of deposits, time deposits have a higher dollarization ratio (56.6 percent), while demand deposits show the lowest ratio (52.2 percent). Nonetheless, all the types of deposits show dollarization ratios between 50 and 60 percent. By sectors, tradable sectors, such as fisheries, have the highest dollarization ratio of deposits (88.3 percent), followed by mining (84.8 percent). It should be pointed out that companies in these sectors carry out trade operations with non-residents (exports), which would explain their strong demand for deposits in foreign currency. The sectors of commerce and education, on the other hand, show the lowest deposit dollarization ratios.

DOLLARIZATION OF DEPOSITS BY ECONOMIC SECTOR: APRIL 2019
(%)

Sector	Dollarization	Dollarization by type of deposit			
		Demand	Saving	Term	Others[1/]
Agriculture	58.4	58.0	42.1	79.7	69.2
Fishing	88.3	89.5	71.5	84.3	94.1
Mining	84.8	79.9	97.4	95.0	99.8
Manufacturing	49.8	48.9	59.1	53.4	77.9
Energy	60.1	59.3	76.0	64.0	99.9
Construction	51.7	48.7	78.8	54.0	37.5
Commerce	48.0	48.6	46.1	43.4	40.8
Services	52.1	52.3	51.3	51.4	27.8
Tourism	48.4	41.8	42.1	73.4	69.1
Transport	56.4	59.8	50.9	40.5	31.7
Real Estate	61.3	60.0	77.7	65.1	16.1
Business activity	52.6	52.1	51.2	57.2	51.5
Education	17.5	14.8	39.9	22.5	1.0
Social services	20.3	20.3	27.4	14.9	11.4
Others	35.6	35.4	38.5	35.5	45.3
Total	**53.0**	**52.2**	**54.6**	**56.6**	**47.9**

1/ Includes repos and deposits without specifying.

Moreover, the sectors in which the ratio of dollarization of deposits has decreased the most in the last 12 months are mining (from 91.6 percent to 84.8 percent) and other sectors (from 41.1 percent to 35.6 percent), whereas, on the other hand, this ratio has increased in the energy and fishing sectors in the same period.

EVOLUTION OF DOLLARIZATION OF TOTAL DEPOSITS
(%)

Sector	Apr.18	Jun.18	Sep.18	Dec.18	Mar.19	Apr.19
Agriculture	61.2	59.7	58.4	59.0	62.6	58.4
Fishing	84.2	84.9	90.3	88.0	81.8	88.3
Mining	91.6	89.9	90.1	87.9	82.7	84.8
Manufacturing	53.3	65.2	58.5	59.9	56.3	60.1
Energy	49.7	52.9	51.9	53.6	50.5	49.8
Construction	54.2	51.2	49.6	46.8	49.3	51.7
Commerce	48.4	48.0	45.5	40.7	47.4	48.0
Services	56.4	54.1	54.0	54.3	51.2	52.1
Others	41.1	39.5	35.3	36.1	35.2	35.6
Total	**56.5**	**55.8**	**54.7**	**53.0**	**52.1**	**53.0**

Loans

The **dollarization of loans to companies** as of April 2019 is equivalent to 47.7 percent of total loans. The sectors with the highest dollarization ratio are mining (94.1 percent) and fishing (91.3 percent), while the lower levels of dollarization are observed in non-tradable sectors such as services. Notwithstanding, sectors such as real estate still show a high level of dollarization (47.5 percent). By sectors, energy is the sector that shows the highest reduction, this ratio having decreased from 83.8 percent in April 2018 to 79.5 percent in April 2019.

CREDITS AND DOLLARIZATION OF CREDITS BY ECONOMIC SECTOR: APRIL 2019

Sector	Billion S/	Share (%)	Dollarization (%)
Agriculture	7,170	5.2	65.8
Fishing	869	0.6	91.3
Mining	7,725	5.6	94.1
Manufacturing	35,281	25.5	48.1
Energy	7,027	5.1	79.5
Construction	4,472	3.2	43.9
Commerce	34,893	25.2	39.7
Services	36,359	26.3	37.1
Tourism	3,064	2.2	43.4
Transport	12,186	8.8	37.5
Real Estate	9,110	6.6	47.5
Business activity	8,418	6.1	36.8
Education	2,356	1.7	2.1
Social services	1,226	0.9	10.1
Others	4,548	3.3	29.7
Total	**138,344**	**100**	**47.7**

EVOLUTION OF DOLLARIZATION OF TOTAL CREDITS
(%)

Sector	Apr.18	Jun.18	Sep.18	Dec.18	Mar.19	Apr.19
Agriculture	64.3	65.5	65.3	66.5	66.3	65.8
Fishing	90.1	90.5	89.6	90.2	91.2	91.3
Mining	89.4	88.8	90.6	87.5	94.0	94.1
Manufacturing	48.9	48.0	47.4	45.6	47.9	48.1
Energy	83.8	83.6	81.4	81.5	81.7	79.5
Construction	37.3	38.4	38.9	41.2	40.6	43.9
Commerce	42.0	42.2	42.0	42.4	39.8	39.7
Services	39.7	40.8	40.3	39.1	36.1	37.1
Others	30.7	28.9	28.7	27.6	30.5	29.7
Total	**49.1**	**49.1**	**48.9**	**48.0**	**47.5**	**47.7**

Based on the information of companies' deposits and loans by sectors, we can identify which sectors have net debt in dollars with banks. It should be pointed out that this indicator may omit heterogeneity at the level of individual companies, but at an aggregate level this indicator reflects the flow of funds in foreign currency between non-financial companies and the financial system. Interestingly, the sectors in which there are more loans in dollars than deposits in dollars are non-tradable sectors, such as manufacturing and trade. On the other hand, the tradable sectors, such as mining, fishing, and agriculture, which have the capacity to generate income in foreign currency, have much less bank net credit in dollars. Moreover, the case of the real estate sector stands out in the sector of services since it also shows a high level of net credit in foreign currency from banks.

When we look at the recent evolution of this indicator, as of April 2019 we find that **net credit (loans minus deposits)** in foreign currency has increased by US$ 814 million over the last year, mainly due to loans to mining companies (US$ 791 million) and agriculture companies (US$ 217 million), offset by a fall in net lending to the energy sector (US$ 488 million). The sectors of services and manufacturing have continued to increase their net loans in foreign currency from banks.

NET CREDIT IN FOREIGN CURRENCY BY SECTORS[1/]
(Million US$)

Sector	Apr.18	Jun.18	Sep.18	Dec.18	Mar.19	Apr.19	Net credit/ Deposits	Apr.19-Apr.18
Agriculture	918	1,031	1,096	1,112	1,081	1,135	2.51	217
Fishing	133	142	15	97	96	66	0.35	-67
Mining	-211	-73	127	232	638	580	0.31	791
Manufacturing	3,961	3,975	4,041	3,759	3,966	4,100	2.18	140
Energy	1,801	1,536	1,644	1,561	1,543	1,313	2.28	-488
Construction	-361	-293	-279	-311	-271	-269	-0.16	91
Commerce	2,752	2,944	3,144	3,227	2,559	2,649	0.87	-103
Services	1,152	1,388	1,272	1,165	1,183	1,331	0.26	179
Tourism	257	251	216	218	231	233	0.70	-25
Transport	552	663	607	615	530	544	0.38	-8
Real Estate	549	594	620	670	667	703	0.74	154
Business activity	-87	-68	-137	-285	-202	-115	-0.06	-28
Education	-51	-42	-21	-39	-21	-17	-0.09	34
Social services	-67	-10	-14	-14	-21	-16	-0.06	51
Others	-555	-505	-350	-420	-416	-501	-0.20	54
Total	**9,591**	**10,146**	**10,709**	**10,423**	**10,379**	**10,404**	**0.60**	**814**

1/ Credits less deposits.

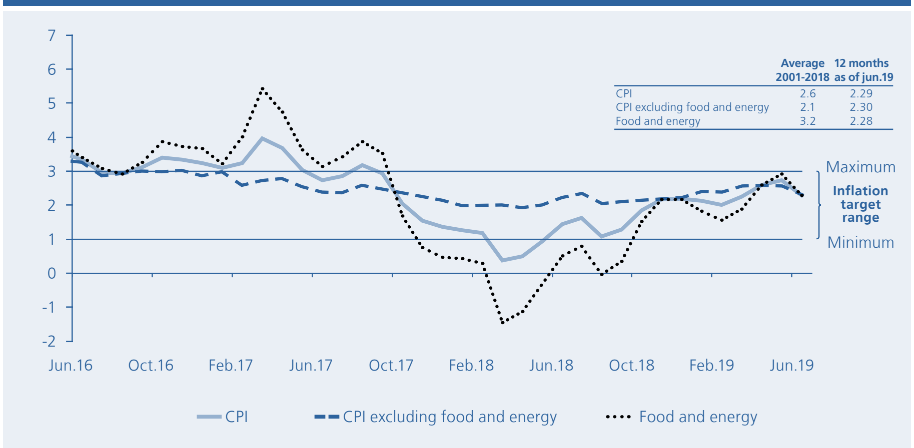
The indicators presented herein show that there is still room to continue reducing financial dollarization, particularly in some subsectors of services, such as real estate and transportation, since they maintain dollarization ratios of deposits and loans higher than 37 percent in spite of not being non-tradable sectors.

VI. Inflation and Balance of Inflation Risks

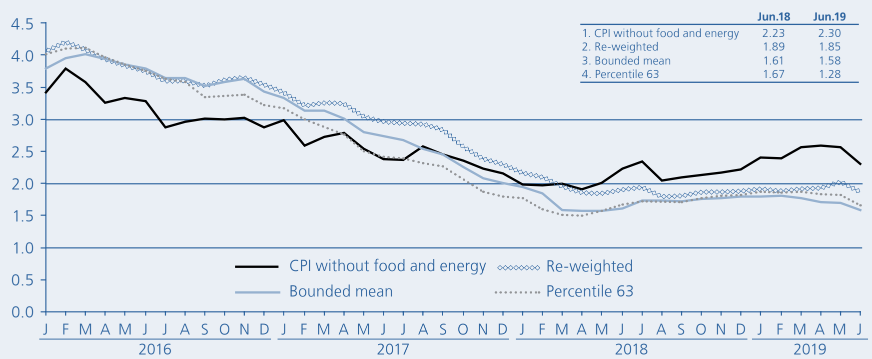
Recent Trends in Inflation and Inflation Expectations

69. The annual rate of inflation as of June was 2.29 percent, within the Central Bank target range (1 - 3 percent). On the other hand, the rate of core inflation (CPI excluding food and energy prices) registered 2.30 percent in June. All of the indicators of trend inflation show levels within the inflation target range.

Graph 68
INFLATION
(Last 12-month % change)



Graph 69
MEASUREMENTS OF THE INFLATIONARY TREND
(Last 12 months % change)



Memo:
CPI without food and energy: Excluding food, fuel and electricity.
Re-weighted: Reduces the weight of items with greater volatility, considers the original weights of each item between the standard deviation of their monthly percentage changes.
Bounded mean: Weighted average of the percentage change of prices between the 34th and 84th percentiles.
Percentile 63: Corresponds to the percentage changes of the item located in the 63th percentile.

70. In January - June 2019, the general price level increased 1.18 percent, at an average monthly rate of 0.20 percent. The CPI excluding food and energy grew 1.41 percent, while food and energy prices grew at a lower rate (0.92 percent), the prices of food and beverages showing the lowest price variation (0.65 percent) due to the reductions observed in the prices of items such as chicken, lemons, avocados, and sugar.

Table 51
INFLATION
(% change)

	Weight	2018	2019 Jan.-Jun.	2019 12 months as of June
CPI	**100.0**	**2.19**	**1.18**	**2.29**
1. CPI excluding food and energy	**56.4**	**2.21**	**1.41**	**2.30**
a. Goods	21.7	2.25	0.84	1.72
b. Services	34.8	2.19	1.76	2.66
2. Food and energy	**43.6**	**2.17**	**0.92**	**2.28**
a. Food and beverages	37.8	1.95	0.65	2.06
b. Fuel and electricity	5.7	3.67	2.70	3.76
Fuel	2.8	5.35	0.73	1.52
Electricity	2.9	2.39	4.26	5.54

71. Moreover, as regards services, education showed the highest price increase in the last twelve months, with tuition and education fees increasing 5.2 percent mainly as a result of the adjustment carried out in March at the beginning of the school year and the price increase in universities and higher institutes' tuition. With this increase, education costs registered a higher variation than the annual

average variation observed in the last eight years. Most of the rest of services, e.g. meals consumed outside the home and "other personal services", which includes personal care (hairdressing, mainly), showed lower rates than those recorded in 2010-2018. This would be reflecting the lower labor costs associated with the greater availability of foreign workers.

Table 52
INFLATION
(Annual % change)

	Weight	2018	Mar.19	Jun.19	2010-18 Annual average
CPI	**100.0**	**2.19**	**2.25**	**2.29**	**2.97**
Education	**9.1**	**4.73**	**5.35**	**5.23**	**4.55**
Health	**1.1**	**1.76**	**1.52**	**1.56**	**3.42**
Meals outside home	**11.7**	**2.19**	**1.98**	**1.89**	**4.71**
Other personal services	**3.3**	**1.29**	**1.48**	**1.38**	**1.85**
Of which:					
Domestic workers	2.1	0.66	0.88	0.88	0.78
Toiletries	0.6	2.21	2.40	2.31	3.94

72. At the disaggregated level, the items with the higher positive contribution to inflation in January-June included education (tuition and fees), electricity rates, meals outside the home, and eggs. The increase in education costs resulted mainly from tuition increases in private schools and universities at the beginning of the school year in March, while the increases in electricity rates authorized by Osinergmin were mainly associated with the reconsideration of Added Value of Power Distribution established in November 2018, as well as with the quarterly payment of the compensation mechanism to regulated users considering the contracts between energy distribution and generation companies. As for food items, the rise in the price of eggs reflected a greater demand for eggs during festivities in the provinces and the recovery of egg prices compared to 2018.

Table 53
ITEM WITH HIGHER WEIGHTED CONTRIBUTION TO INFLATION: JANUARY-JUNE 2019

Positive	**Weight**	**% Chg.**	**Contribution**	**Negative**	**Weight**	**% Chg.**	**Contribution**
Education costs (tuition and fees)	8.8	5.1	0.52	Chicken meat	3.0	-3.7	-0.10
Electricity rates	2.9	4.3	0.14	National transportation	0.3	-15.6	-0.06
Meals outside home	11.7	1.0	0.13	Avocado	0.1	-28.1	-0.05
Eggs	0.6	23.0	0.10	Lemon	0.2	-24.0	-0.05
Other fresh fruits	0.4	15.3	0.06	Papaya	0.2	-13.5	-0.03
Water consumption	1.6	3.0	0.05	Sugar	0.5	-5.8	-0.03
Show tickets	1.7	3.4	0.05	Telephone rates	2.9	-1.3	-0.02
Carrots	0.1	34.4	0.05	Onion	0.4	-3.8	-0.02
Cigarretes	0.1	13.1	0.04	Tomato	0.2	-6.9	-0.02
Other vegetables	0.4	7.3	0.04	Tangerine	0.2	-7.8	-0.02
Total			**1.18**	**Total**			**-0.40**

On the other hand, the items with the higher negative contribution to inflation were chicken meat, domestic transportation, avocados, and lemons. The price of chicken meat fell in the first two months of the year in a context of a greater supply of its main substitutes (horse mackerel and bonito), while the decline in the prices of domestic transportation reflected the reversal of interprovincial fares after carnival celebrations in some cities of the country and after Holy Week. Finally, the lower price of lemons reflected the recovery of lemon production after crops were affected by climate factors in recent years.

On the other hand, despite the 19 percent reduction in the price of WTI crude oil in the last twelve months, local fuel prices showed an increase of 1.52 percent in that period. This price divergence is mainly explained by the fact that the refinery domestic price for gasohol has not followed the same decreasing trend as the one observed in various international price indicators, such as the theoretical indicators of Osinergmin and SNMPE[7], the CIF price of imports, and the refinery price in Chile. This situation became more noticeable since September 2018.

Thus, in the case of 90 octane gasohol, which represents around 60 percent of sales in Peru, the local refinery increased its prices by 2 percent (in soles) between September 2018 and June 2019[8]. In contrast with this increase, the parity prices of Osinergmin and SNMPE showed reductions of 12 percent, the CIF price reported to SUNAT decreased by 9 percent, and the refinery price in Chile (measured in US$ per gallon) was lowered by 12 percent in that period.

Table 54
GASOHOL 90 OCTANES
(Comparison of refinery price) 1/

	OSINERGMIN Price (S/ per gallon)			SNMPE Price (S/ per gallon)			CIF Price (S/ per gallon)			Country (US$ per gallon)		
	Refinery	Parity 2/	Diff. %	Refinery	Parity	Diff. %	Refinery	CIF	Diff. %	Refinery	Chile 3/	Diff. %
Sep.2018 (a)	7.31	7.22	1%	7.31	7.97	-8%	7.31	6.53	12%	2.21	2.20	0%
Jun.2019 (b)	7.48	6.37	17%	7.48	7.05	6%	7.48	5.91	26%	2.25	1.93	17%
% change (b)/(a)	**2%**	**-12%**		**2%**	**-12%**		**2%**	**-9%**		**2%**	**-12%**	

1/ Corresponds to the refinery price. Excludes VAT, excise tax, and road tax charged in sale price.
2/ Adds S/ 0.19 per gallon as trading margin.
3/ Corresponds to gasoline 93 octanes from ENAP-Chile.
Source: ENAP-Chile, Repsol, Osinergmin, and SUNAT.

7 Sociedad Nacional de Minería, Petróleo y Energía.

8 At the end of June.

Forecasts

73. BCRP monetary policy actions are taken on the basis of inflation forecasts and projections of inflation determinants elaborated using all the macroeconomic information available at the time of decision making. Key indicators include inflation expectations, imported inflation (including the impact of the exchange rate), and demand inflationary pressures which are quantified through the concept of the output gap (the difference between the GDP observed and its potential level).

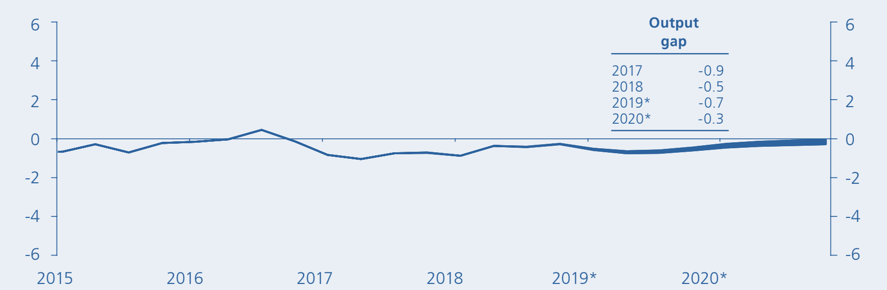
    Based on the new information available, the inflation rate is forecast to decline gradually from 2.29 percent in June to 2.1 percent in December 2019 and to 2.0 percent at end-2020, due mainly to the gradual convergence of inflation expectations towards the midpoint of the target range in a context with moderate imported inflation and a negative output gap.

Graph 70
INFLATION FORECAST: 2015-2020
(Last 12-month % change)

* Forecast.

74. The negative output gap estimated indicates the absence of demand inflationary pressures. GDP is expected to grow at a lower rate than its potential growth level in 2019, so the output gap is foreseen to close at a slower pace than estimated in the March Inflation Report. This revision takes into account the lower impact anticipated in external demand due to the lower prices of commodities and the downward revision of growth rates in our trading partners, as well as a more gradual recovery of business confidence.

Graph 71
OUTPUT GAP: 2015-2020
(% Potential GDP)



* Forecast.

75. Inflation expectations estimated on the basis of surveys applied to financial and non-financial firms and economic analysts reveal that inflation is expected to show rates between 2.4 and 2.5 percent in 2019 and to remain around the center of the target range in 2020, with a rate of 2.5 percent. Inflation expectations are foreseen to continue declining as inflation converges towards the midpoint of the target range.

Graph 72
EXPECTATIONS OF INFLATION FOR THE NEXT YEAR
(% points)

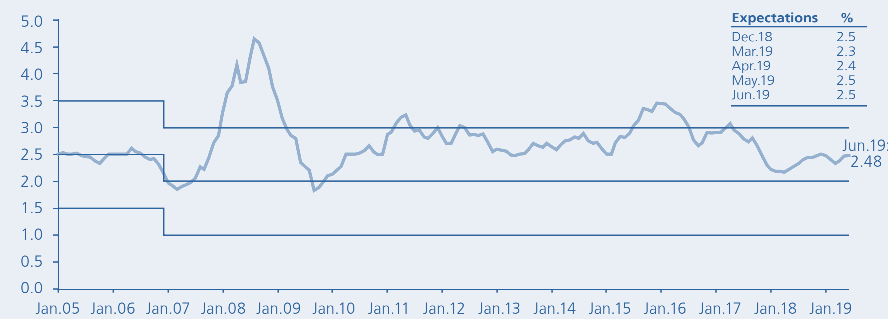


Table 55
SURVEY ON MACROECONOMIC EXPECTATIONS: INFLATION
(% change)

	IR Dec.18	IR Mar.19	IR Jun.19*
Financial entities			
2019	2.50	2.40	2.40
2020	2.50	2.50	2.50
Economic analysts			
2019	2.50	2.35	2.50
2020	2.50	2.50	2.50
Non-financial firms			
2019	2.50	2.50	2.50
2020	2.50	2.50	2.50

* Survey conducted during June 30.
IR: Inflation Report.

76. Another determinant of inflation is its imported component, which combines the effect of the international prices of goods we import –such as oil, wheat, soybean and maize, among other products– with the effect of exchange rate variations. Average import prices are projected to fall by 1.3 percent in 2019 –mainly due to the lower prices of commodities such as crude, wheat, and soybean– and that they will increase by 1.5 percent in 2020. Moreover, the surveys on expectations about the US/PEN exchange rate show that economic agents expect the exchange rate to be around S/ 3.34 per dollar at the end of 2019 and between S/ 3.35 and S/ 3.37 at the end of 2020. This forecast also takes into account the impact of the excise tax measures on inflation.

Table 56
SURVEY ON MACROECONOMIC EXPECTATIONS: EXCHANGE RATE
(S/ per US$)

	IR Dec.18	IR Mar.19	IR Jun.19*
Financial entities			
2019	3.35	3.30	3.33
2020	3.35	3.33	3.35
Economic analysts			
2019	3.41	3.33	3.33
2020	3.44	3.36	3.36
Non-financial firms			
2019	3.35	3.35	3.34
2020	3.40	3.38	3.37

* Survey conducted during June 30.
IR: Inflation Report.

Balance of Inflation Risks

77. The balance of inflationary or deflationary risks in this Report shows a downward bias accompanied by higher uncertainty, which contrasts with the neutral bias considered in the previous report. In this context, the expected impact of possible lower imported inflation due to lower economic growth exceeds the impact of higher imported inflation.

- **Domestic demand shocks**

  The growth of the output could be lower than the level foreseen in the central scenario if investment –both public and private investment– grew at lower rates than expected, which could be exacerbated by lower-than-expected levels of growth in the primary sectors. This would imply a more negative output in the forecast horizon, as a result of which inflation would tend to fall below the baseline scenario level.

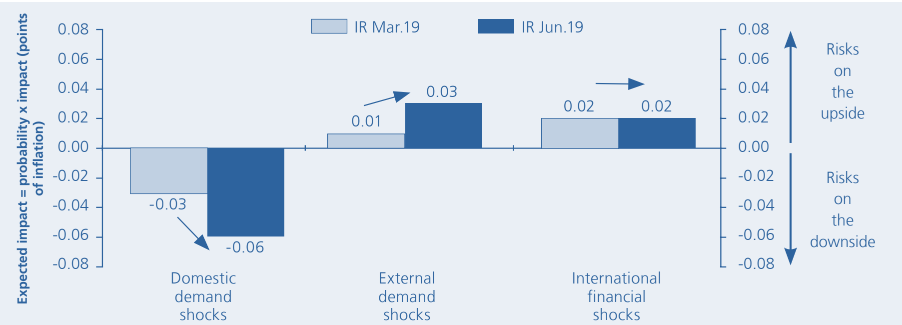
- **External demand shocks**

  It is estimated that the escalation of the trade war could imply a decline in global growth of about one percentage point compared to the growth level in the central scenario, with lower commodity prices and institutional investors' withdrawal of capital flows from the emerging economies being expected due to the perception of greater risk. Therefore, because the US dollar would appreciate in this scenario, the expected impact of this risk on inflation has been revised on the upside. In addition, the slowdown in global growth, lower terms of trade, and higher financial costs would imply a greater risk of lower economic growth. Moreover, in the short term, inflation would rise due to the effect of a higher exchange rate and would then decrease due to lower domestic demand.

- **International financial shocks**

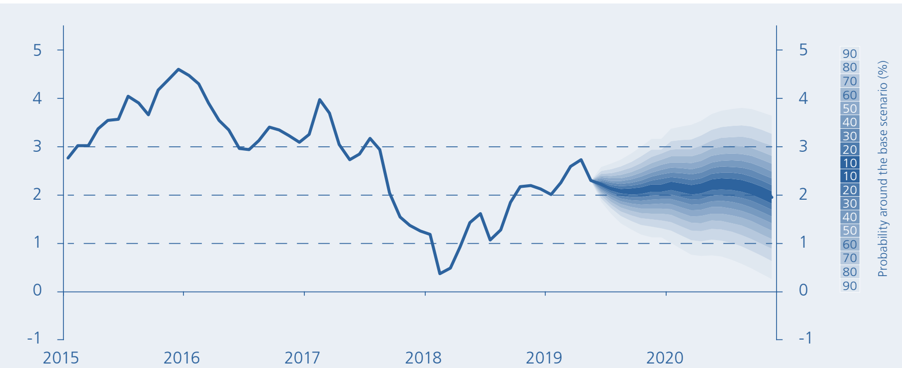
The central forecast considers that commercial tensions do not generate a scenario of strong risk aversion and sudden adjustments in financial markets. Should this risk materialize, it could translate into capital outflows in the emerging economies –due to portfolio reallocations– and strengthen the US dollar against the currencies of these economies, including the PEN, which would push inflation up due to an effect of higher imported inflation.

Graph 73
BALANCE OF RISKS AGAINST THE BASE SCENARIO



IR: Inflation Report.

Graph 74
INFLATION FORECAST: 2015-2020
(Last 12-month % change)



Memo: The graph shows the probability of occurrence of values of inflation in the future, according to the combination of the statistical analysis and the balance of risks. Each band concentrates 5% probability and the total bands cover 90% of probability. The darker bands contain the path of the base scenario.

Box 7

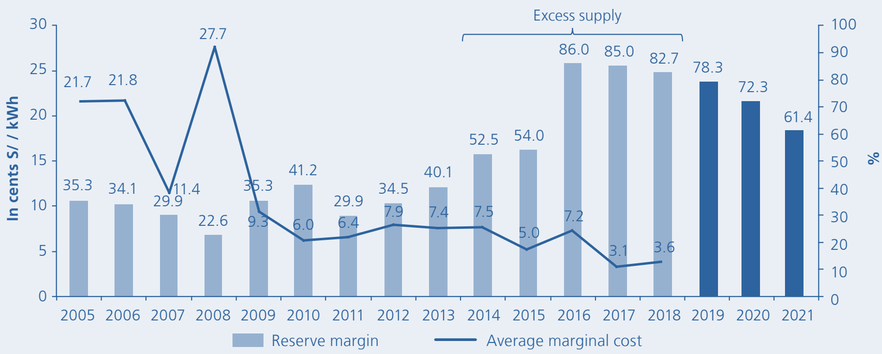
ELECTRICITY RATES IN THE UNREGULATED AND REGULATED MARKETS

One of the most important prices in an economy is the electricity rate because it affects directly the budget of families and the production costs of companies. The electricity sector comprises both a regulated market (which includes the generation, transmission, and distribution segments) and an unregulated market.

The marginal cost of the spot market is an important indicator of the price of energy for future contracts between generators and unregulated customers, and, to a lesser extent, for contracts between electricity generation and electricity distribution companies (for the latter to serve customers in the regulated market). In recent years, this marginal cost of the National Interconnected Electric System –Sistema Eléctrico Interconectado Nacional (SEIN)– has fallen from S/ 27.7 cents per kWh in 2008 to S/ 3.6 cents per kWh in 2018.
Among the various reasons that explain the decrease in the average marginal cost, the oversupply of energy generation stands out because the growth of the maximum demand for power in recent years has not accompanied the pace of growth of generation infrastructure.

The evidence shows a negative association between the reserve margin and the average marginal cost of SEIN. The reserve margin is understood as the slackness of the generation segment to meet the maximum power demand. Because the commercial start-up of a generation plant is not immediate, typically power generation projects are based, on the growth projections of maximum demand, among other variables. The high reserve margin observed since 2014 is the result of optimistic projections of a growth of demand that did not materialize. Therefore, the excess generation capacity has contributed to reduce the marginal cost.[9]

AVERAGE MARGINAL COST OF SEIN AND RESERVE MARGIN
(In cent S/ per kWh and in % of maximum demand)



Memo: Reserve margin is the ratio between the effective power (MW) less maximum demand (MW) and maximum demand (MW). 2019-2021 estimated is at the end of period.
Source: COES.
Elaboration: BCRP.

9 The sample correlation between marginal cost and reserve margin is -0.64 from 2005 to 2018, with this correlation rising to -0.73 from 2010 to 2018.

However, based on the information available today, it is projected that the reserve margin will progressively decline to 61 percent by 2021 due to a growth in demand that would offset the onset of commercial operations in new generation plants which already have definitive concession contracts.

In addition to this, the generation segment has also seen a significant onset of operations in hydroelectric generation plants and plants based on renewable energy resources (RER). Since hydroelectric generation has very low variable costs (albeit high fixed costs) and the RER generation plants have the highest priority due to the current regulations, they also push the short-term marginal cost downwards.

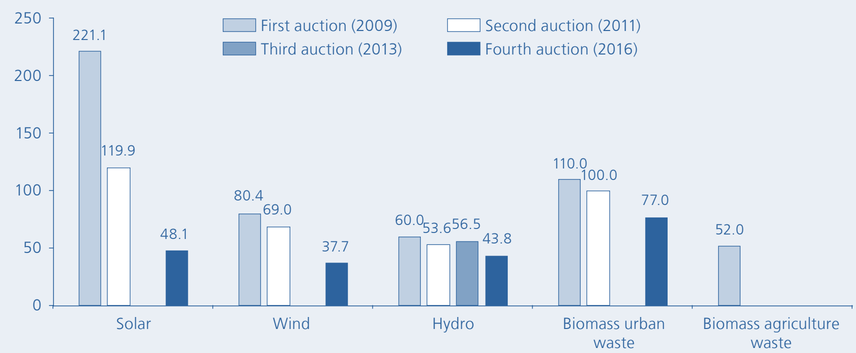
SEIN: ENERGY POWER PLANT AS OF DECEMBER 2018
(In MW, by source of energy and geographical position)

	Hydro	NG Camisea	NG (Non-Camisea)	Oil	Coal	RER	TOTAL
North	602	0	157	611	0	130	1,500
Central	3,680	3,863	176	104	0	284	8,107
South	660	0	0	1,889	140	285	2,974
TOTAL	**4,942**	**3,863**	**333**	**2,603**	**140**	**699**	**12,581**

Memo: RER includes sources of non-conventional renewable energy of thermal plants of biogas, eolic, and solar. Non-Camisea natural gas came from Aguaytia in the center (1.5 percent), Malacas (0.9 percent) and La Isla (0.2 percent) in the north. Oil: Contains central power with residual and Diesel 2.
Source: COES.
Elaboration: BCRP.

It is worth mentioning that the concessions of the RER-based generation plants, which account for 6 percent of the effective power as of December 2018, were awarded in a series of auctions between 2009 and 2016. During these auctions, the average price (in US$ per MWh) increased at the end of the last decade, reflecting the technology costs of the time, and then showed a decreasing trend, particularly due to solar and wind technologies. In the case of the former, the average price decreased 78 percent between the first and fourth auctions, while the price of the latter decreased 53 percent in the same period.

RESULTS IN AUCTION: RENEWABLE ENERGY RESOURCE
(Average price in US$/MWh)

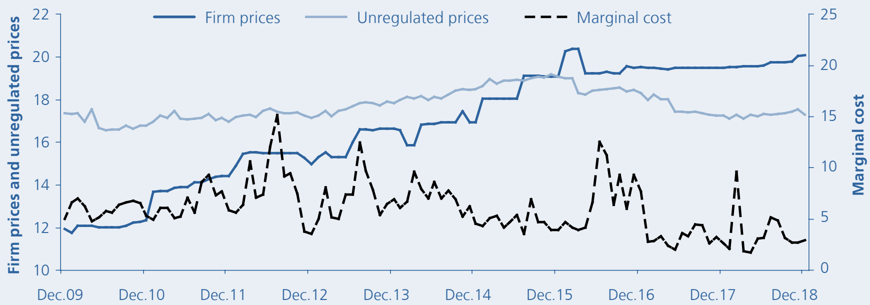


Source: OSINERGMIN.
Elaboration: BCRP.

Another factor that has contributed to reduce the marginal cost is the scheme according to which the variable costs of natural gas are declared for production priority purposes. Due to *take* or *pay* contracts for the supply of natural gas, the latter becomes a fixed cost and therefore is not considered in the variable cost. This situation could be a potential problem if it generates a use of natural gas over the socially desirable use.

The decreasing trend observed in marginal cost in recent years resulted in lower energy prices for unregulated customers, which led the customers[10] with a demand between 0.2 MW and 2.5 MW, that is, to those who had the option to leave the regulated market[11], to massively and unexpectedly migrate to the unregulated market. However, the lower marginal cost was not transferred to "firm prices"; that is, to the prices established in the long-term contracts between the generation and distribution companies for the latter to serve the regulated market.

FIRM PRICES, UNREGULATED PRICES AND MARGINAL COST
(Cent S/ KwH)



Source: OSINERGMIN and COES.
Elaboration: BCRP.

Because "firm prices" serve as inputs to determine electricity rates in the regulated market, the decrease in the marginal cost did not imply a reduction in the residential electricity rate. On the contrary, the decrease in the marginal cost led to a rise in the residential rate, since the RER generation plants receive a remuneration guaranteed by the Ministry of Energy –based on the auctions awarded– that depends in a complementary manner on the marginal

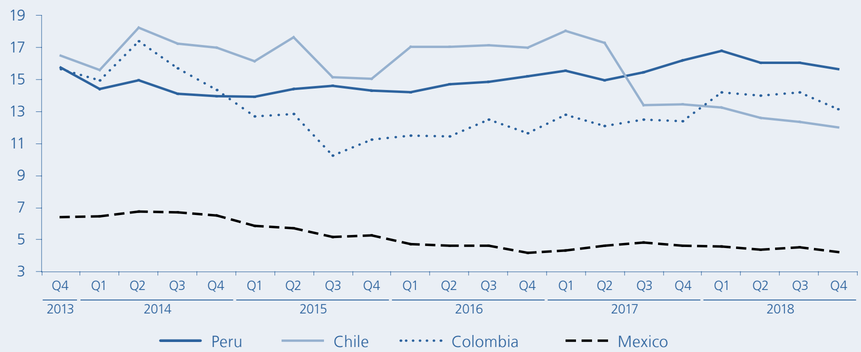
10 The evidence shows that, between 2014 and 2018, the sample correlation of marginal costs and energy prices of free customers is 0.65. This also includes the new contracts with shorter terms signed between unregulated customers and generation companies.

11 Regulated customers' migration to the unregulated market introduced a short-term risk in distribution companies' management of the demand as these companies have the legal obligation to maintain long-term contracts with the generation companies to guarantee the supply in the regulated market. In other words, the collateral effect of the migration was the overconsumption of power. Under Supreme Decree No. 022-2018-EM enacted at the end of 2018, which amended Tender Regulations for Electricity Supply, some distribution companies renegotiated their supply contracts with the generation companies to offset the problem of power overconsumption and, as a result, the contracts that would expire around 2021 were extended until 2028.

cost in the spot market and the additional RER charge (toll) in the Main Transmission System (Sistema Principal de Transmisión - SPT).

Thus, in order to maintain the guaranteed remuneration, the lower marginal cost of the short-term market led to an increase in the SPT toll, which pushed up the residential electricity rate. This is one of the reasons that explains why the electricity residential rate in Peru is the highest rate in the countries of the Pacific Alliance.

RESIDENTIAL ELECTRICITY RATE- MONTHLY CONSUMPTION OF 125 KWH
(Cent US$ / kWh)



Memo: Considers capital cities of each country.
Source: OSINERGMIN.
Elaboration: BCRP.

The recent evolution of electricity rates suggests that it is advisable to review the regulations that establish the requirement to contract 100 percent of *ship* or *pay* of natural gas to have access to the remuneration of the installed power of thermal power plants. On the other hand, the new *take* or *pay* supply contracts, which will be signed as current contracts expire, should allow for more flexible adjustments of natural gas demand. For example, new contracts may consider different volumes of *take* or *pay* for the wet and the dry seasons.[12]

12 The take or pay contract establishes a fixed sum that users must pay to the supplier for the supply of a quantity of natural gas. This payment is made even when the quantity of natural gas supplied is less than the one agreed in the contract. On the other hand, the ship or pay contract establishes a fixed payment from the user to the carrier for the firm transport of natural gas. In this case, the payment is made even when the quantity of natural gas transported is less than that agreed in the contract.