CENTRAL RESERVE BANK OF PERU

INFLATION REPORT: EVOLUTION AND PERSPECTIVES

January 2004

EXECUTIVE SUMMARY

- This inflation Report analyzes the monetary policy of 2003 as well as the macroeconomic forecasts for 2004. The inflation rate of 2003 reached the target of 2,5 per cent, which was higher than projections made in the Inflation Report in August, where it was forecast that rates would reach the lower range of the target (1,5 per cent). This difference was due mainly to a rise in food prices in the fourth quarter resulting from lower crop yields caused by poor weather during planting season. The effect on the food supply was felt into January, causing the price of certain foods to rise and leading to 0,54 per cent increase in inflation for the month and an accumulated inflation of 2,8 per cent over the last 12 months.

- In view of the recent and expected evolution of inflation, the Central Reserve Bank of Peru reduced benchmark interest rates on four occasions. This led to three reductions of 25 basis points in the interbank rate (July, September and November), and a reduction of 50 basis points (August) and resulted in an overall drop in interbank rates from 3,8 per cent in December 2002 to 2,5 per cent in December 2003. The current monetary policy stance is consistent with an expected inflation rate close to its 2004 target level (2,5 percent), which constitutes an upward revision with respect to the forecast made in the August Inflation Report (2 per cent). The inflation rate is expected to rise temporarily in the first quarter reflecting the price increase of certain foods, including oils and bread (foods heading), which may be affected by a rise in the international price of soybean and wheat.

- This report forecasts that high prices for traditional Peruvian exports and low international interest rates will continue to favor the Peruvian economy. These projections are based on the continued recovery of the global economy.

- The forecast for domestic demand remained constant at 3,6 percent in 2003, while the projection for 2004 has been lowered slightly from 3,8 per cent to 3,7. Furthermore, the projection in GDP growth stated in the Inflation Report of August 2003 was reduced slightly from 4,0 per cent to 3,9 per cent. Nevertheless, the 2004 projected GDP growth remains at 4,0 per cent, based on the strength of exports.

INTRODUCTION

1. The Central Reserve Bank of Peru (CRBP) has managed monetary policy since 2002 through an Explicit Inflation Targeting regime with an annual inflation target of 2,5 per cent, with a tolerance margin of one percentage up or down. Using this target as a guide, the Board of the CRBP adopts a monetary policy stance to neutralize inflationary or deflationary pressures. To measure the inflation target, the CRBP uses the Consumer Price Index (CPI) of Metropolitan Lima, calculated by the National Institute of Statistics and Information (INEI). The CRBP also calculates a referential measurement of core inflation that excludes goods and services subject to temporary supply shocks and that are non-relevant for the identification of the inflation tendency.

2. Since monetary policy has a delayed effect on inflation, the Central Bank's Board of Directors takes decisions considering forecasts of the future evolution of prices. These forecasts are expressed in the Inflation Reports, which the CRBP publishes to share relevant information with economic agents. This first report of 2004 contains a description of the 2003 monetary policy as well as macroeconomic forecasts for 2004.

3. Monetary policy decisions are adopted and disseminated by the Central Bank's Board of Directors on the first Thursday of every month. These decisions are announced as reference interest rates for active (rediscounts and direct *repos*) and passive (overnight deposits) monetary operations with banks. The interest rates fixed by the CRBP serve as a guideline for interbank interest rates and the monetary operations that the CRBP executes daily are intended to keep the interbank rate in the center of a referential corridor.

I. MACROECONOMIC EVOLUTION IN 2003

I.1 Interest Rates and Monetary Aggregates

Interbank Interest Rate

4. The CRBP maintained a stable monetary policy with an interbank rate of 3,8 per cent during the first semester of the year in a context of accelerated inflation in the first quarter caused by higher international fuel prices.

   The CRBP adjusted its monetary policy in the second semester on four occasions and reduced the referential interest rate, causing drops of 25 basis points in the interbank rate in July, September and November, and a drop of 50 basis points in August (2,5 per cent rate since November).

   This flexible monetary policy was adopted with the foresight that the inflation rate for 2003 and 2004 would be at the lower end of the target and that domestic demand would grow less than the August Inflation Report's forecast.

5. The referential interest rates of the Central Bank for its passive (overnight deposits) and active banking operations (rediscounts and direct repos) serve as a guideline for the interbank market's interest rate in Soles. The monetary operations that have been carried out daily in order to inject or extract liquidity have kept the level of the interbank loan market interest rate, between September and December of 2003, near the center of this referential corridor. The average standard deviation in the interbank interest rate in 2003 was 0,1 per cent, in line with the decrease registered in the past few years.

Chart 1
Level and Volatility of Interbank Interest Rates
(in percentage points)

Year	Avg. Level	Standard deviation
1998	19,0	6,6
1999	14,9	4,8
2000	12,7	2,5
2001	8,6	0,9
2002	3,2	0,5
2003	3,4	0,1

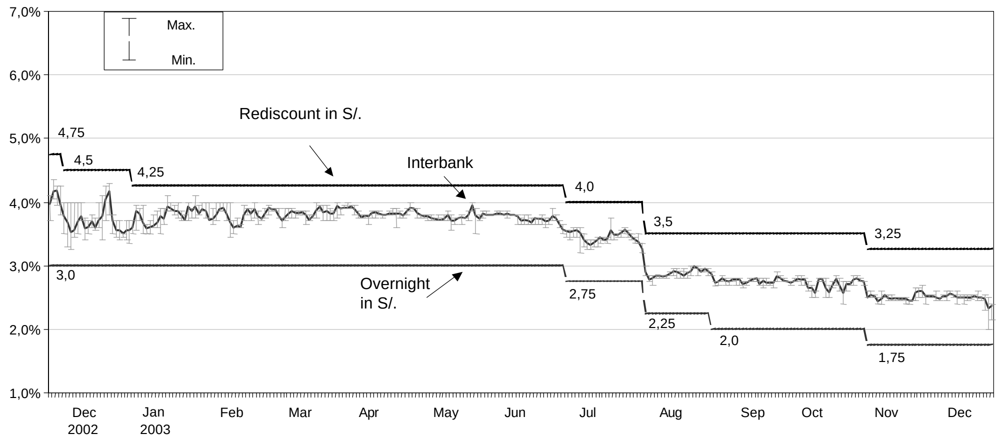
Chart 2

INTERBANK INTEREST RATES IN SOLES: 2003

	Jan.	Feb.	Mar.	Apr.	May.	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
Average	3,75	3,80	3,82	3,84	3,78	3,74	3,47	3,01	2,77	2,71	2,55	2,51
Standard deviation	0,1	0,1	0,1	0,0	0,1	0,0	0,1	0,2	0,1	0,1	0,1	0,0
Variability coefficient (%)	3,6	2,6	1,6	1,3	1,8	1,3	2,5	8,2	2,2	2,9	4,3	2,0

Graph 1

Interest Rates in Domestic Currency
(December 2002 - December 2003)



6. As in previous months, reduction in the interbank interest rate led to a decrease of other market interest rates in Soles (deposits, credits and securities). For example, the corporate prime rate for 90-day loans fell from 3,7 per cent in August to 3,3 per cent in December.

Graph 2

Monthly average interest rate in Domestic Currency
(December 2002 - December 2003)

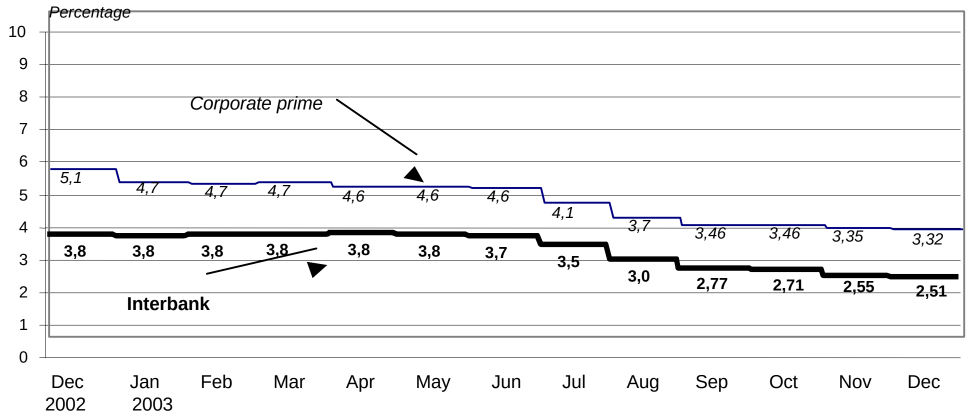


Chart 3

INTEREST RATES FOR OPERATIONS IN SOLES
(In percentages)

	2001				2002				2003			
	mar	jun	sep	dec	mar	jun	sep	dec	mar	jun	sep	dec
1. Interbank	10,3	16,0	5,9	3,1	2,5	2,6	5,4	3,8	3,8	3,7	2,8	2,5
2.Savings deposits	6,8	6,6	5,2	3,0	1,8	1,7	1,7	1,7	1,7	1,5	1,3	1,3
3.Prime lending rate	12,4	13,2	9,4	5,0	3,9	3,7	6,8	5,1	4,7	4,6	3,5	3,3
4.Average lending rate up to 360 days	21,3	21,2	19,4	17,2	15,5	14,1	14,0	14,8	14,3	14,0	14,3	14,0
5.CD												
On the balance	12,6	12,4	10,8	7,5	5,4	4,8	4,1	4,7	4,7	4,8	4,3	3,9
Monthly average of deposit length (in months) 1/	6	7	6	6	6	6	-	8	12	7	15	11

1/ Excludes one-week CD deposits

Box 1

Impact of the interbank interest rate on the rest of the interest rates in Soles

The Central Bank affects the behavior of the interbank interest rate through its monetary operations. The market of loans between banks (interbank) is formed among banks that supply, and those that demand, funds in soles for very short terms. Banks might either supply or demand in the interbank market, depending on their individual level of liquidity. The Central Bank regulates the aggregate level of liquidity in the banking system in order to modify the level of the interbank interest rate.

The interbank rate is a reference for the other interest rates in Soles, and generally has a greater effect on those rates with lower risk and shorter installments. The more the interbank rate affects the interest rate in soles, the greater the possibility of using this method as a tool of monetary policy.

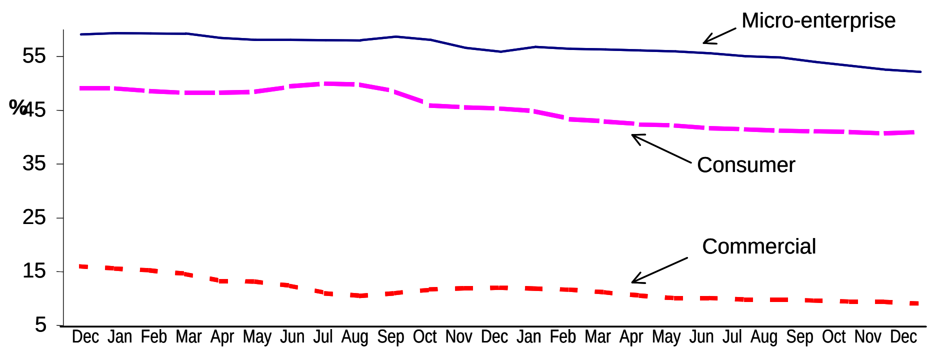
To estimate these effects, the Central Bank analyzed information gathered from 1995 to 2003 that was divided into two time-periods in order to see if this method of transmission of the monetary policy had been strengthened by the recent reduction of interbank interest rate volatility. The results show that the effect caused by a one per cent change in the interbank interest rate on the interest rates of loans and deposits of less than one year is significantly greater in the second time-period. Thus, for example, the impact of a one-percentage point change in the interbank interest rate upon the rate for credits of up to 360 days is 0,46 percentage points over the course of five months.

	IMPACTS (in percentage points)		AVERAGE DURATION OF IMPACT (in months)	
	Apr.95-Jan.01	Feb.01-Mar.03	Apr.95-Jan.01	Feb.01-Mar.03
Interes Rates				
Credits				
To 360 days	0,11	0,46	4,6	4,6
More than 360 days	0,61	0,61	9,1	9,1
Deposits				
Savings	0,04	0,25	0,3	1,5
Term to 30 days	0,18	0,61	0,0	0,6
Term from 31-179 days	0,06	0,44	0,2	2,3
Term from 180-360 days	0,21	0,21	3,0	3,0
Term more than 360 days	0,13	0,13	6,0	6,0

7. The active interest rate charged by the banking system to the micro finance sector on credits made in domestic currency fell from September to December, following the downward trend established in the past few years. This trend was particularly noticeable in the interest rates on small-business loans and to a lesser extent in the interest rates applied to consumer and commercial loans. The interest rate for small-business loans fell from 54,8 per cent in August to 52,2 per cent in December, the consumer credit rate dropped from 41,1 per cent in August to 40,9 per cent in December, and the rate for commercial loans decreased from 9,6 per cent in August to 8,9 per cent in December.

Graph 3

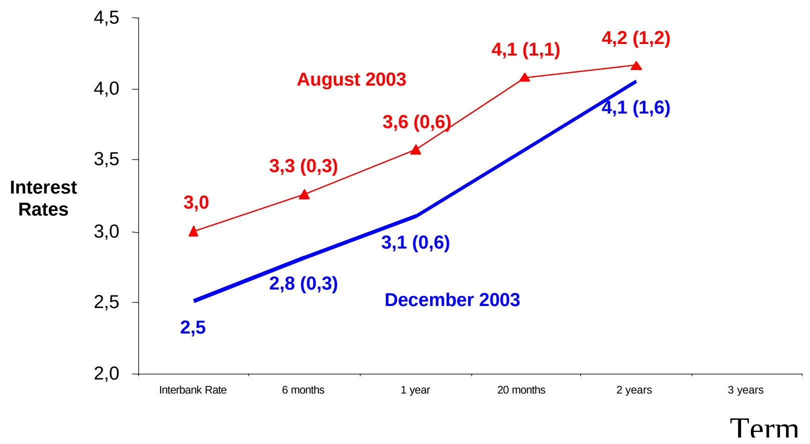
INTEREST RATE IN DOMESTIC CURRENCY FOR SMALL BUSINESS, CONSUMER AND COMMERCIAL CREDITS



8. Between August and December of 2003, the yield curve of the Central Bank Certificates of Deposit (CDBCRP) moved downwards reflecting lower benchmark interest rates. Thus, the interest rate on a one-year term fell 0,5 per cent, while the drop in the two-year term was less than 0,1 per cent. Nevertheless, the curve rose for terms longer than one year, reflecting market expectation of higher interest rates in line with a possible increase in international rates.

Graph 4

RETURNS FROM CDBCRP BY TERM 1/



1/ Numbers between parentheses indicate spreads with respect to the interbank rate.

9. The CDBCRP balance, rose from S/. 1 635 million in December 2002 to S/. 4 097 million at the close of 2003, to sterilize exchange operations of the Central Bank. The BCRP has carried out fungible placements in order to promote a greater liquidity of these titles and have lengthened the terms of the CDBCRP in order to diversify their maturity. As a result, the balance of certificates for terms of one year of more was S/. 380 million in December 2002, but this amount increased to S/. 3095 million at the close of 2003. In this period, the average interest rate paid on the balance of these certificates fell from 4,7 per cent to 3,9 per cent.

Chart 4
CDBCRP Balance per Term
(Millions of nuevos soles)

	Dec. 2002	Dec. 2003
1 and 3 month	130	32
5 and 6 month	565	790
7 and 8 month	560	180
1 year and 18 month	380	2 280
2 and 3 year	0	815
Total	**1 635**	**4 097**
Average Interest Rate of CDBCRP Balance	4,7%	3,9%

10. In 2003, within the Sovereign Bond Placement (BTP for its initials in Spanish) Program under the Market Makers Program initiated the same year, bond placement reached S/. 1 712 million. The balance of sovereign bonds in soles at the end of the year was S/. 2 660 million (S/. 1 933 million to December 2002). This program has permitted an increase in liquidity of public securities and provided the private sector with an effective benchmark for the emission of long-term debt instruments.

Within the Treasury Bills Emissions Program (LTP in Spanish) S/. 1 220 million worth of 18 to 182 day bills were placed and the balance of Treasury bills at year-end 2003 was S/. 200 million.

11. The lengthening of the CDBCRP investment terms to 3 years (from September of 2003) and the investment of nominal sovereign bonds in installments of up to 5 years, provided the private sector with a benchmark to use when issuing securities at a fixed nominal interest rates in domestic currency. Telefónica placed 5-year nominal bonds (S/. 63 million) in August, Edelnor placed 4-year bonds (S/. 40 million) in September, Luz del Sur emitted 2-year (S/. 35 million) and 3-year bonds (S/. 35 million) in December, and Edegel emitted 3-year bonds(S/. 50 million), also in December.

Chart 5

EVOLUTION OF REFERENTIAL RATES FOR INSTRUMENTS OF UP TO 5 YEARS

	PRIMARY MARKET							
	CORPORATE BONDS							
	2 years				3 years		4 years	5 years
	Backus	Edegel	Luz del Sur	Telefónica	Edegel	Luz del Sur	Edelnor	Telefónica
2003								
Jan.	-	-	-	-	-	-	-	-
Feb	-	-	-	-	-	-	-	-
Mar	6,48	-	-	6,61	-	-	-	-
Apr	-	-	-	6,28	-	-	-	-
May	-	-	-	-	-	-	-	-
Jun	-	6,09	-	5,25	-	-	-	-
Jul	-	-	-	-	-	-	-	-
Aug	-	-	-	-	-	-	-	8,10
Sep	-	-	-	-	4,17	-	4,52	-
Oct	-	-	-	-	4,93	-	-	-
Nov	-	-	-	-	-	4,87	-	-
Dec	-	-	4,05	-	4,81	4,77	-	-

12. Fixed-income securities denominated in soles emitted by companies and by the financial sector have taken a larger share of the overall fixed-income market. In 2003, the total balance of Sol-denominated instruments reached 34 per cent of the total, up from 28 per cent in 2001 and 30 per cent in 2002.

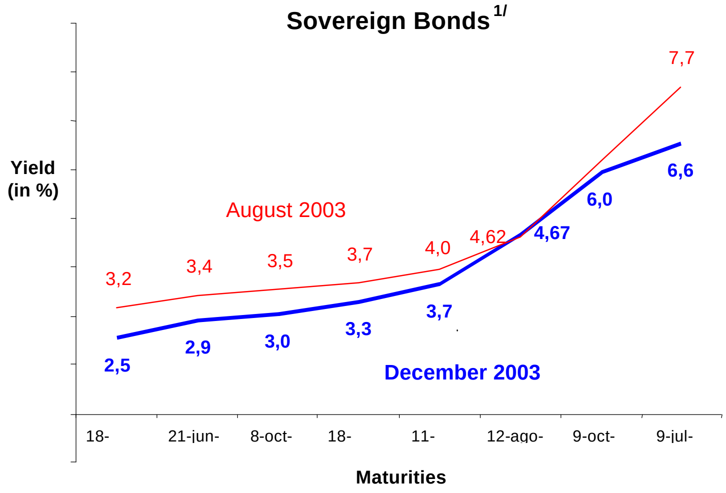
    Participation of indexed bonds (VAC) as a portion of the total bonds emitted in domestic currency has dropped notably in the past years. In 2003, the balance of VAC bonds represented 53 per cent of total titles of fixed income in domestic currency, down from 96 per cent in 1998.

13. The interest rates of Public Treasury sovereign bonds in the secondary market have been decreasing, with a rise being observed for installments shorter than 3 years, and a flattening of the curve for longer terms. Thus, the interest rate of the June 2005 Sovereign Bond fell 0,3 percentage points between August and December of 2003, while the rate of the August 2006 Bond remained stable for a similar period. For its part, the rate of the July 2008 Sovereign Bond dropped 1,1 percentage points between August and December, after the initial effect of the higher interest rate that is obtained when a bond is emitted for the first time at a longer term (5 years).

CENTRAL RESERVE BANK OF PERU

Graph 5

Interest Rates for Public Treasury Sovereign Bonds [1/]



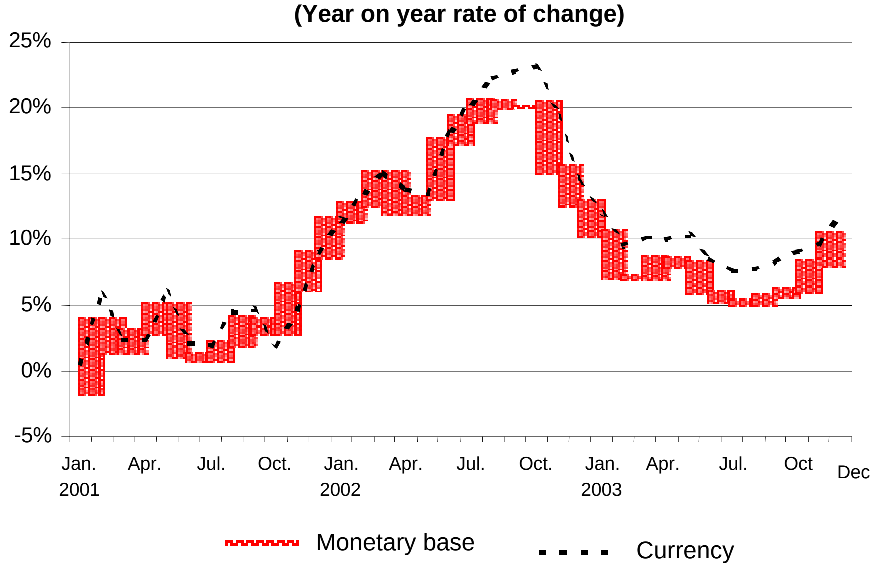
1 / Final registered rates in primary and/or secondary markets.

Monetary Aggregates

14. Annual growth rates of the currency and monetary base began to rise again in August 2003, following the trend registered at the end of 2001 and the first semester of 2002. Currency growth rates diminished significantly between October 2002 and July 2003, due in part to a rise of interest rates in the second semester and to a statistical effect of greater balances from the previous year. The currency growth has again accelerated as a result of the reduction of rates in the second semester of 2003. Therefore, the annual variation rate of this variable grew from 8 percent in August 2003, to 12 per cent in December the same year. The average monetary base balance registered an annual growth rate of 5 percent in August 2003, and later increased to 10 per cent in December of the same year.

Graph 6

CURRENCY AND MONETARY BASE GROWTH: JANUARY 2001 - DECEMBER 2003 (Year on year rate of change)



15. From July to December 2003, financial system credit to the private sector in Soles grew 4,8 per cent, while credit in Dollars fell 0,4 per cent. Over the course of the year, credit in Soles increased 11,7 per cent while credit in Dollars dropped 3,6 per cent.

16. The expansion of credit in Soles from July to December (S/. 679 million) was due mainly to increased interest from institutional investors (S/. 401 million) and entities specialized in micro finance (S/. 355 million). This counteracted the slump of Sol-denominated credit to the banking sector (S/. 145 million). Over the course of the year, the microfinance sector contributed the most to the expansion of credit in Soles within the private sector of the financial system (S/. 759 million of a total growth of S/. 1 552 million).

Graph 7

PRIVATE SECTOR CREDITS FROM THE FINANCIAL SYSTEM

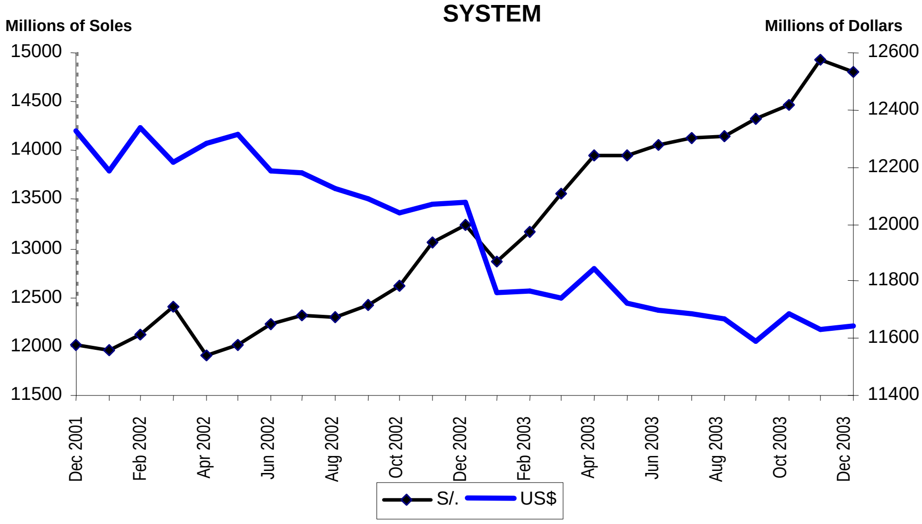


Chart 6

FINANCIAL SYSTEM CREDITS TO THE PRIVATE SECTOR IN DOMESTIC CURRENCY

	Balances in millions of new soles			Growth rates	
	Dec.02	Jul.03	Dec.03	Dec.03/ Dec.02	Dec.03/ Jul.03
Commercial banks 1/	7 660	7 927	7 782	1,6	-1,8
Banco de la Nación	434	463	512	17,9	10,5
Microfinance Institutions	**3 107**	**3 511**	**3 866**	**24,4**	**10,1**
Banks (Banco de Trabajo and MiBanco)	774	894	970	25,3	8,5
Municipal S&L´s	848	952	1 057	24,6	11,1
Rural S&L´s	135	155	177	31,0	14,1
Cooperatives	381	423	444	16,8	5,1
Edpymes	130	151	177	35,8	16,9
Financial enterprises	840	937	1 042	24,1	11,2
Institutional investors 2/	**1 653**	**1 790**	**2 191**	**32,6**	**22,4**
AFP's	1 102	1 220	1 449	31,5	18,7
Insurance companies	493	498	579	17,4	16,3
Mutual funds	58	72	163	182,5	127,5
Leasing & other companies	**393**	**430**	**450**	**14,3**	**4,5**
Total Financial System	**13 248**	**14 121**	**14 800**	**11,7**	**4,8**

1/ Excludes Banco de Trabajo and MiBanco.

2/ Mainly private sector securities.

The slump in foreign currency credits to the private sector from July to December (US$ 45 million) was mainly from banks (US$ 119 million). This decrease offset the increase of credit issued by micro finance enterprises (US$ 56 million) and by institutional investors (US$ 48 million). Over the course of the year, the reduction in credit from banks (US$ 586 million) was the main cause behind the fall of foreign currency credits to the private sector (US$ 434 million).

Chart 7

FINANCIAL SYSTEM CREDIT TO THE PRIVATE SECTOR IN FOREIGN CURRENCY

	Balances in millions US$			Growth Rates	
	Dec.02	Jul.03	Dec.03	Dec.03/ Dec.02	Dec.03/ Jul.03
Commercia banks 1/	10 015	9 548	9 429	-5,9	-1,2
Banco de la Nación	36	23	22	-38,0	-0,4
Microfinance Institutions	**367**	**405**	**461**	**25,8**	**14,0**
Banks (MiBanco y Banco de Trabajo)	34	37	49	44,1	32,4
Municipal S&Ls	111	147	178	60,2	21,5
Rural S&Ls	44	44	47	8,0	7,9
Cooperatives	101	106	112	11,4	5,7
Edpymes	31	36	40	27,6	11,4
Financial enterprises	45	35	34	-24,2	-1,7
Institutional investors 2/	**800**	**1 042**	**1 090**	**36,2**	**4,6**
AFPs	445	537	517	16,2	-3,8
Insurance companies	37	45	59	58,7	31,8
Mutual funds	318	460	514	61,4	11,8
Leasing and other companies	**858**	**671**	**640**	**-25,4**	**-4,6**
Total Financial System	**12 077**	**11 688**	**11 643**	**-3,6**	**-0,4**

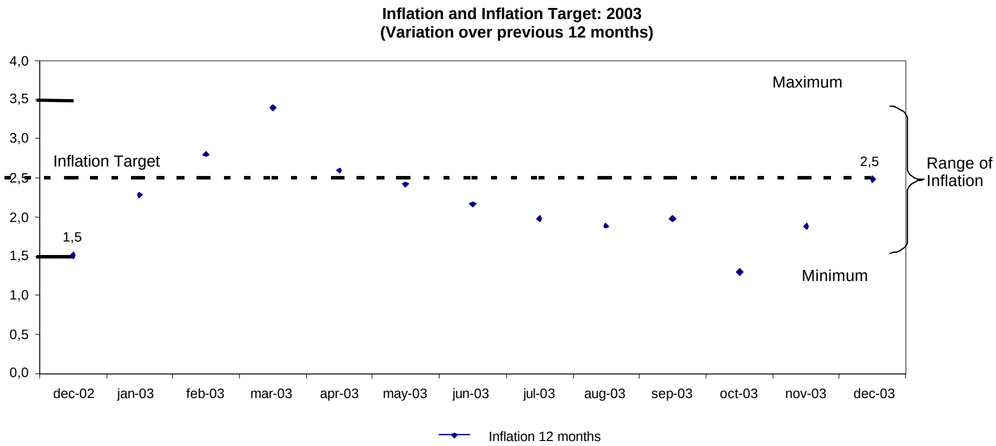
1/ Excluding Banco de Trabajo and MiBanco

2/ Mainly private sector securities.

I.2 Inflation

Inflation in 2003, measured by accumulated change in the Consumer Price Index of Metropolitan Lima, was within its target range at 2,48 per cent.

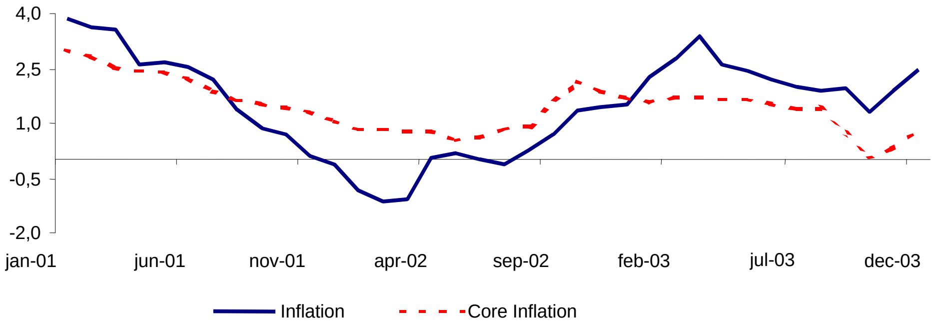
Graph 8



Core inflation, which excludes volatile goods and services such as perishable foods, fuels, utilities and transport fares, rose 0,77 per cent (1,69 per cent in 2002). Non-core inflation, which includes goods and services that are subject to supply shocks or whose prices are regulated, increased 6,21 per cent (1,16 per cent in 2002).

Graph 9

INFLATION AND CORE INFLATION
(Percentage variation 12 months)



17. Inflation in 2003 was caused mainly by supply-side factors, particularly those affected by international prices and by local agricultural production. Normally, this type of price increase or decrease does not spread to the rest of the consumer basket and eventually reverts, so it is not cause for a change in monetary policy.

Graph 8

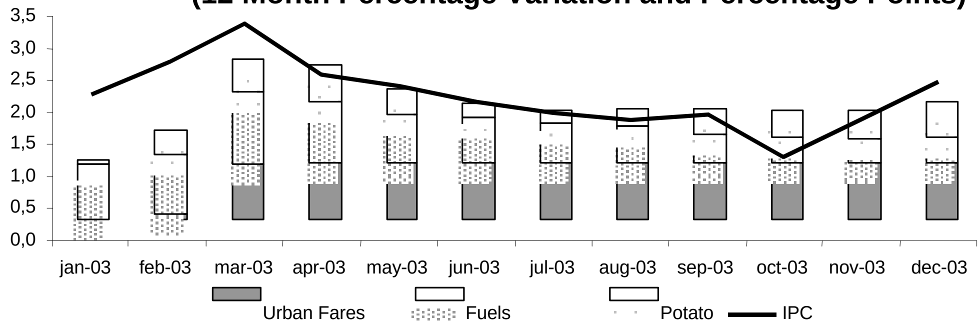
WEIGHTED CONTRIBUTION TO INFLATION: 2003
(Percentage Points)

Items	Weight	Var. %	Positive Contribution	Items	Weight	Var. %	Negative Contribution
Urban transportation fares	8,0	11,1	0,88	Electricity 1/	2,3	-4,6	-0,11
Potatoes	1,5	42,9	0,58	Eggs 1/	0,7	-8,6	-0,07
Kerosene 1/	1,2	13,0	0,18	Soft Drinks2/	1,0	-6,0	-0,06
Gasoline 1/	1,5	9,7	0,16	Beer 2/	1,1	-5,1	-0,06
Education 2/	5,1	3,0	0,16	Personal care goods 2/	4,5	-1,3	-0,06
Total			**1,96**				**-0,36**

1/ Component of non-core inflation.
2/ Component of core inflation.

Chart 10

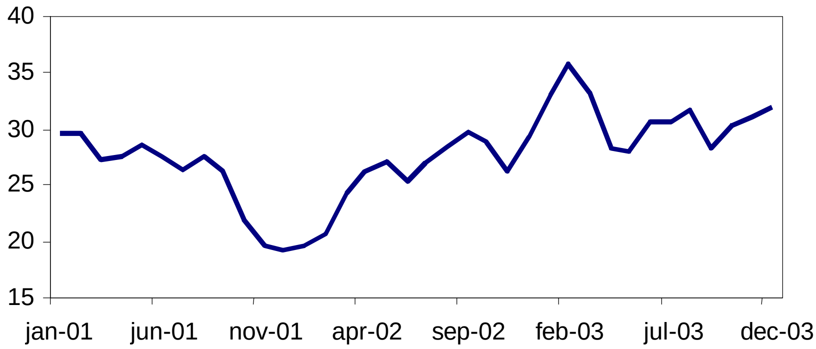
CONTRIBUTION TO INFLATION
BY MAIN PRODUCTS
(12 Month Percentage Variation and Percentage Points)



a. The international market price of petroleum WTI grew – mainly as a result of the Iraq conflict - from US$ 26,3 to US$ 35,8 per barrel between November 2002 and February 2003 (36 per cent). This led to a 10,2 per cent increase in fuel prices in the domestic market between December 2002 and March 2003.

Graph 11

WTI OIL INTERNATIONAL QUOTATION
(US$ per barrel)



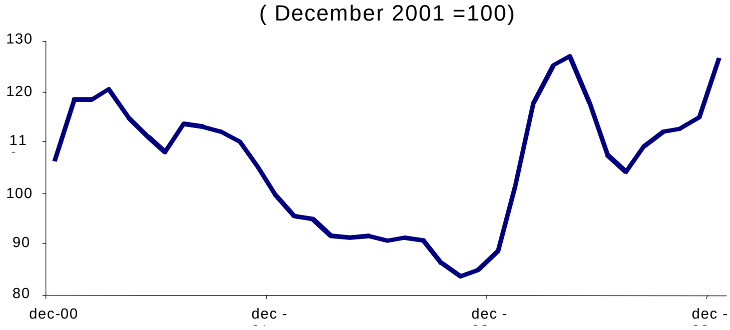
The international market price of petroleum fell 21 per cent in May 2003, then rose to US$ 32,6 per barrel towards the end of the year. The price rise was motivated in part by a strengthening world economy and by a reduction of production quotas set by the Organization of Petroleum Exporting Countries (OPEC) and was driven also by signs of a strengthening global economy

b. Urban transportation fares rose 11,1 per cent between January and March 2003, after remaining steady since September 2002. The combined effect on total inflation in 2003 by the increase in fuel prices (gasoline, kerosene and domestic gas) and of urban transportation fares is 1,28 percentage points.

c. Potato prices rose 43 per cent, after falling 17 per cent between 2001 and 2002, a drop that caused potato producers to plant less. Additionally, bad weather during planting season resulted in lower yields. The rise in potato prices added 0,58 percentage points to overall inflation in 2003.

Graph 12

POTATO PRICE
(December 2001 =100)



Core and non-core inflation

18. From January to October 2003, **core** inflation registered an average monthly increase of 0,02 percent. In November and December it rose 0,52 per cent, due mainly to price increases for processed food. The annual increase totaled 0,77 per cent.

Chart 9

INFLATION
(Percentage change)

	Weighting	2001	2002	2003
I. CORE INFLATION	**68,3**	**1,06**	**1,69**	**0,77**
Goods	**41,8**	**0,66**	**1,76**	**0,29**
Food and beverages	20,7	-0,59	2,07	-0,08
Textiles and footwear	7,6	1,94	1,06	0,91
Electrical appliances	1,0	-0,19	3,42	-1,91
Other industrial products	12,5	2,39	1,54	0,70
Services	**26,6**	**1,65**	**1,57**	**1,53**
Restaurants	12,0	1,29	1,28	1,25
Education	5,1	3,97	2,70	3,02
Health	1,3	3,02	3,31	2,19
Rents	2,3	-0,37	1,00	0,99
Other services	5,9	2,14	1,02	0,85
II. NON-CORE INFLATION	**31,7**	**-2,82**	**1,16**	**6,21**
Food	14,8	-1,16	-2,35	5,24
Fuel	3,9	-13,14	15,60	8,94
Transportation	8,4	-0,02	0,11	10,99
Utilities	4,6	-2,73	1,96	-1,98
III. INFLATION	**100,0**	**-0,13**	**1,52**	**2,48**

Inside the group “Food and Beverages”, the price of processed foods rose 0,54 per cent in 2003, while the price of beverages and beer decreased 5,18 per cent, due to strong competition in the sector.

The price of processed foods grew mainly between October and December, particularly the price of rice (8,2 percent), cooking oil (5,3 percent), beef (1,4 percent), milk and noodles (0,5 percent each) and bread (0,2 percent). In annual terms, the price of rice and oil rose 4,3 per cent and 5,9 per cent respectively, while the price of bread fell 1,1 per cent.

FOODS COMPOSING UNDERLYING INFLATION

Product	Weight	Annual percentage change	Factor
Bread	3,7	-1,1	This reduction is explained mainly by the corrective drop in prices between November 2002 and March 2003 (6 per cent), which followed an 18 per cent rise between September and October 2002. In August 2003, the international market price of wheat rose 15 per cent, which led to an increase of 0,36 per cent in the price of bread between September and October.
Rice	2,3	4,3	This price rise is mainly due to reduced planting as a result of water shortages and crop replacement. The total rice harvest fell 6 percent in the August-November 2003 period, with respect to the previous agricultural campaign.
Oils	0,8	5,9	The increase is due to the evolution of the international price of soy oil in 2003, which passed from US$ 467 per M.T. in January to US$ 445 per M.T. in August and US$ 642 per M.T. in December. This evolution is explained by the reduction of stocks in North America, due to a lower level of harvest and to an increased demand by the People's Republic of China.
Noodles	1,0	-1,0	The price of noodles fell at an average rate of 0,2 percent between January and August, but increased 1,0 percent between September and December. The effect of rising international prices for wheat and wheat flour on consumer prices is minimal, due to the strong competition in this sector.

In 2003, **non-core inflation** accumulated an annual variation of 6,2 per cent, due to higher transportation fares, as well as higher food and fuel prices, which account for 2,9, 2,4 and 1,3 percentage points of the annual non-core inflation rate, respectively. Prices of utilities fell, contributing with –0,3 percentage points to non-core inflation.

Unstable weather caused planting delays of crops, such as potatoes, and low prices further inhibited planting. Additionally, the supply of poultry fell towards the end of the year.

As mentioned earlier, the Central Bank does not take transitory price changes into account when setting monetary policy. Inflation control is motivated by readings of permanent and generalized price movements.

CENTRAL RESERVE BANK OF PERU

NON-CORE FOOD COMPONENT IN INFLATION

Product	Measurement	Annual percentage change	Factor
Potato	1,5	42,9	The price of the potatoes was quite volatile during the year; between January and April it grew 43 per cent, then fell 18 per cent between May and July and grew 21 per cent between August and December. This volatility is explained by increases or reductions in planted areas during the agricultural campaign. In August-October 2002, planting decreased 15 per cent; between June and July 2003 it decreased 14 per cent, with respect to the same period of the previous year; while in November 2002 and May 2003, planted areas grew 11 per cent. Several factors affected the farmers' decision to plant: low prices at the close of the last agricultural season and uncertainty about the weather. The rise in prices was also affected by poor crop performance associated with the lack of rain.
Poultry	4,0	2,1	The annual figure was affected by lower stocks and related to a 2 per cent drop in chick hatchings compared to 2002. The initial 6 per cent fall in prices between January and August was overshadowed by the 9 per cent increase between September and December, which was a consequence of lower investment in chicks (an average of 26 million units between January and August, and 25,2 million units between September and December).

Fuel prices rose 8,9 per cent in 2003. Contributing factors were a 13 per cent rise in kerosene prices, a 9,7 per cent price rise in gasoline, and a 4,2 per cent rise in domestic gas prices. After an initial rise between January and April, when fuel prices rose 11,1 per cent, prices fell 5,6 per cent between May and July, only to rise again 3,9 percent between August and December of 2003, in line with the evolution of international petroleum prices.

Chart 10

FUEL PRICES

(Monthly percentage change)

	2002	2003												
	Jan-Dec.	Jan.	Feb.	Mar.	Apr.	May.	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.-Dec.
Fuels	15,6	2,7	2,4	4,9	0,8	-3,2	-1,4	-1,1	0,3	2,8	0,2	0,1	0,5	8,9
Gasoline	15,7	1,0	3,3	8,7	1,5	-5,3	-1,7	-2,4	0,2	5,4	-0,5	-0,2	0,2	9,7
Gas	11,3	6,9	1,8	1,0	-0,8	-3,2	-2,0	-0,3	0,6	0,1	0,1	0,2	0,1	4,2
Kerosene	20,4	0,3	1,8	4,5	1,6	-0,4	-0,5	-0,4	0,2	2,4	1,2	0,4	1,2	13,0
WTI quotation in US$	52,4	11,9	8,6	-6,9	-15,3	-0,3	9,2	0,1	2,7	-10,4	7,1	2,7	3,0	8,9

Urban transportation fares grew 11,1 per cent between January and April of 2003 and then remained stable. It should be noted that the impact of a price increase from fuels to transportation fares is reduce, due to the excess of supply of public transportation units.

Prices of utility services fell 2 per cent, which reflects the fall of 4,6 per cent in electricity rates. Telephone and potable water rates increased marginally by 0,3 per cent and 0,9 percent, respectively. Electricity rates decreased due mainly to the readjustment of the generation rates during the May to October 2003 period and the November 2003 to April 2004 period, and because of the review made in June and July 2003 after the forecast of the potential supply and demand of energy were modified.

Potable water prices were not modified because Sunass did not authorize the 6 per cent increase requested by SEDAPAL; the registered variation in the price of water reflects the full transfer of the one-percentage point growth of the value added tax (IGV by its initials in Spanish) to the consumer. In a similar way, telephone rates grew as a result of the one percentage point readjustment of the IGV, which was partially compensated by the quarterly application of the productivity factor.

Chart 11
PUBLIC SERVICE FARES
(Monthly percentage variation)

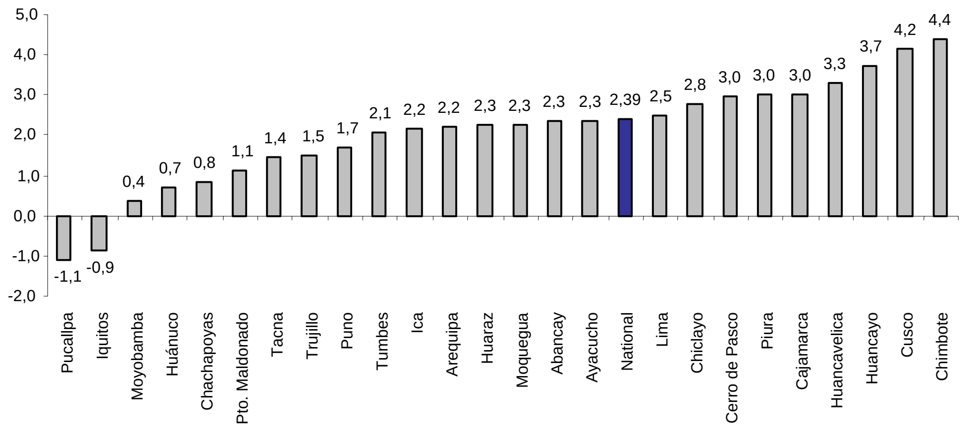
	2002	2003												
	Jan-Dec.	Jan.	Feb.	Mar.	Apr.	May.	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan-Dec.
Public services	2,0	-0,8	0,0	0,1	0,0	-0,3	-0,2	-0,5	0,7	0,0	0,0	-1,1	0,0	-2,0
Electricity	7,9	-1,5	0,1	0,6	0,1	-0,6	-0,7	-1,0	0,5	0,0	0,1	-2,3	0,0	-4,6
Telephone	-8,3	0,0	0,0	-0,9	0,0	0,0	0,4	0,0	0,9	-0,1	0,0	0,0	0,0	0,3
Water	2,3	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,9	0,0	0,0	0,0	0,0	0,9

National Inflation

19. Since January 2003, the National Institute of Statistics (INEI by its initials in Spanish) has presented an aggregate national consumer price index based on price indices of 25 cities. National inflation during 2003 was 2,4 per cent: 16 cities registered an inflation rate below average and 9 cities above average.

Graph 13

INFLATION BY CITY: 2003
(Percentage Variation)

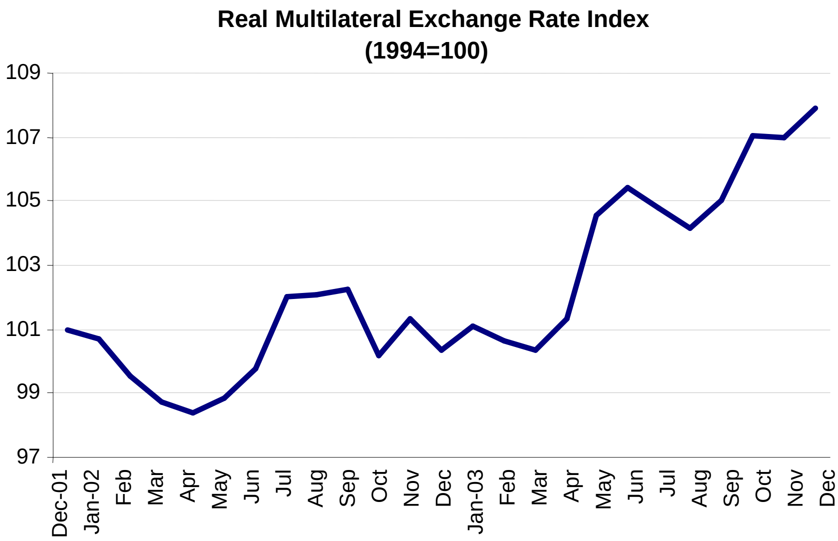


I.3 Exchange Rate

20. The exchange rate reached S/. 3,472 per Dollar in December 2003, implying nominal appreciation of 1,2 per cent since December 2002. With the exception of May, the exchange rate appreciated in the first half of the year, then remained relatively stable in the second half of the year (with the exception of December[1]), displaying market prices between S/. 3,47 and S/. 3,48 per Dollar.

Over the same period, the real exchange rate rose 7,5 per cent following a change in the nominal exchange rate (-1,2 per cent), domestic inflation (2,5 per cent) and the change in the foreign price index (11,5 per cent).

Graph 14



The variation of the Foreign Price Index stems from the appreciation of the currencies of our main trade partners with respect to the US Dollar. Over the course of the year, the Dollar depreciated 12 per cent against the Yen and 17 per cent against the Euro. In the region, the Dollar depreciated against the Brazilian Real (19 per cent), the Argentine Peso (14 per cent) and against the Chilean Peso (14 per cent).

[1] In December, due to seasonal reasons, the Sol was quoted at S/. 3,463 per dollar during the last 15 days of the month, a rate similar to that reached back in April, when the exchange rate reached its lowest point of the year.

Chart 12
NUEVO SOL NOMINAL AND REAL DEPRECIATION WITH RESPECT TO OUR MAIN TRADE PARTNERS

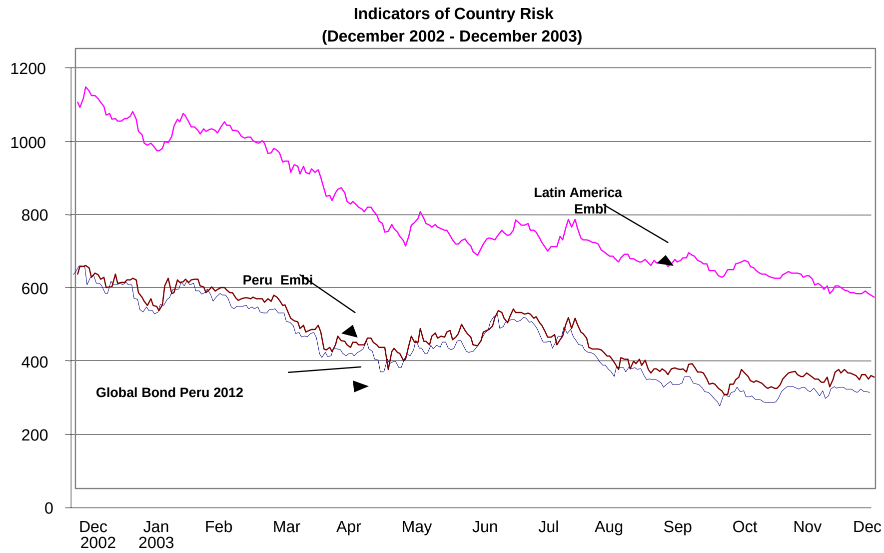
(Growth rates as of December 2003)

	Weights*	Nominal		Real	
		From 1998	From 2002	From 1998	From 2002
USA	25,1	28	-1	23	-2
Euro zone	20,1	43	19	35	18
Japan	10,3	53	12	26	9
Brazil	6,4	-51	23	-37	31
United Kingdom	5,8	35	9	30	10
Chile	4,8	-7	15	-6	14
China	4,3	28	-1	5	-1
Colombia	4,0	-41	-1	-9	3
Mexico	3,4	-8	-10	29	-9
Argentina	3,4	-57	15	-49	16
korea	3,3	59	0	61	1
Taiwan	2,5	21	1	22	-2
Venezuela	2,5	-60	-18	12	1
Canada	2,4	39	17	34	17
Bolivia	1,8	-12	-5	-12	-5
Basket		13	7	15	8

* Weighting according to 1994 trade structure. Since the Euro came into effect in 1999, Figures were calculated based on the currency of each country (Mark, French Franc, Belgian Franc, Italian Lira, Dutch Florin and the Peseta).

21. A positive outlook for Brazil - basically due to pension system reforms that could lead to a substantial decrease in their fiscal deficit and the reduced inflation expectations that applied downward pressure on interest rates - have favored economies in the region. These changes encouraged capital inflows and greater demand for emerging-economy debt securities. In addition to creating downward pressures on regional currencies, such capital inflows may have led to reduced spreads. Peru's EMBI+ spread reached a low of under 300 bps in the final quarter of the year. In the same period, Fitch improved Peru's rating from "negative" to "stable", Standard & Poor´s maintained the country rating at "BB-", and the government placed a 30-year term global bond for US$ 500 million.

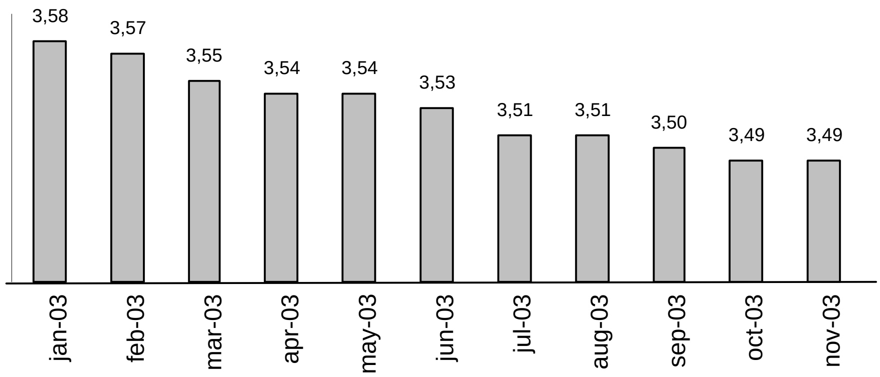
Graph 15



22. Month-end surveys carried out by the CRBP among financial agents reflected lower depreciation expectations during 2003. Likewise, the implicit depreciation rate of three-month forward transactions fell from 3,2 per cent to 1,8 per cent from the end of December 2002 to the end of December 2003.

Graph 16

Evolution of Expectations of the Exchange Rate in the Financial System for December 2003

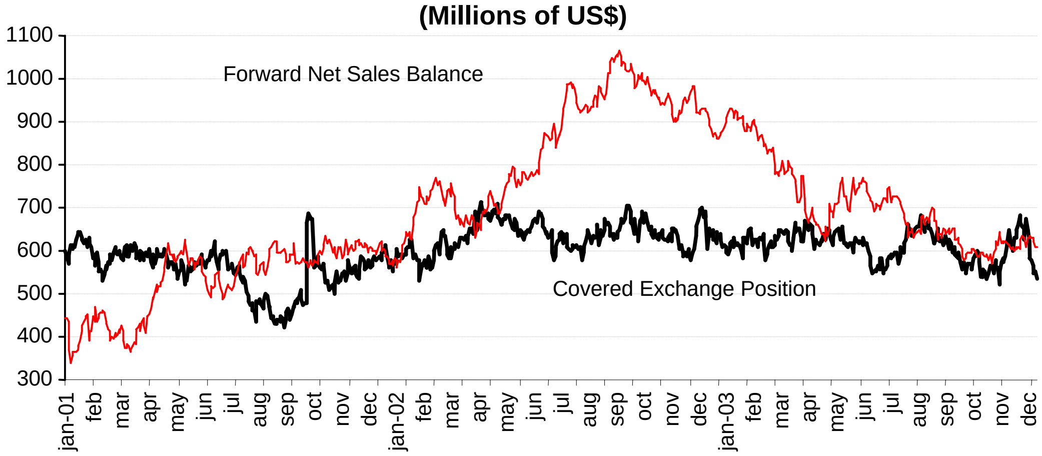


23. Lower depreciation expectations are explained by the positive evolution of the external accounts, a stable regional environment and by the weakening of the Dollar against other strong currencies. Lower depreciation expectations may have influenced the reduced movement of forward operations, especially in sales operations (a lesser flow of new operation and term renewals[2]). Between the end of December 2002 and 2003, the net balance of forward transactions dropped from US$ 905 to US$ 607 million, reflecting lower public demand for exchange coverage.

The foreign **exchange position** of banks over the same period fell US$ 106 million, dropping from US$ 643 to US$ 536 million.

Graph 17

Covered Exchange Position and Forward Net Balance (Millions of US$)

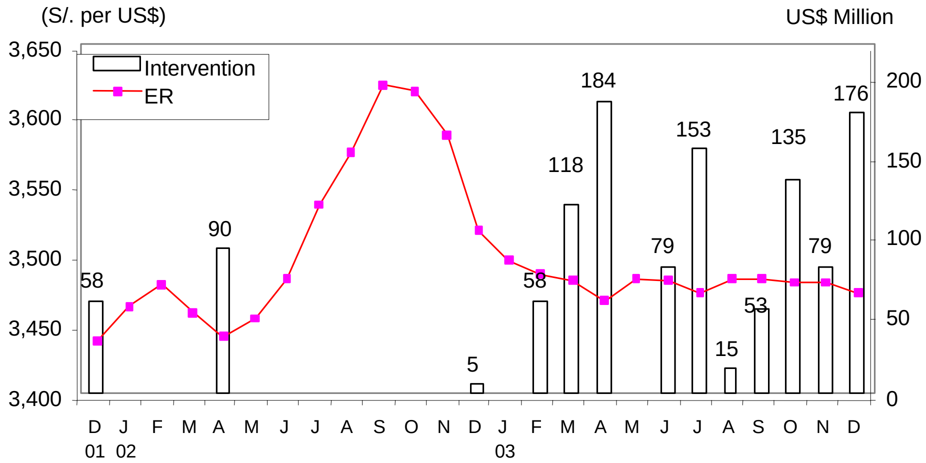


[2] The forward purchase balance registered a slight reduction from US$ 9 million, and the forward sales balance reduced US$ 307 million.

24. In 2003, the CRBP bought US$ 1 050 million in the foreign exchange market, an amount superior to the interventions carried out over the last 6 years. Considering that net sales in Dollars were made to the Public Treasury, net purchases totaled US$ 998 million. The purchase of Dollars in 2003 has: strengthened the position of international reserves; accommodated portfolio movements within a context of de-dollarization; and has reduced the deflationary pressure that was felt between the second and third quarter of the year. In this way, a policy of a floating exchange is maintained using intervention, which eliminates significant fluctuations in the exchange rate without trying to defend predetermined levels of exchange parity.

Graph 18

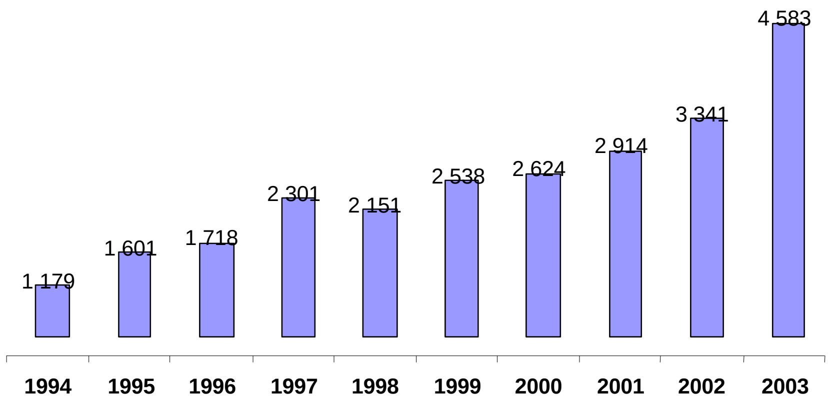
Exchange Rate and CRBP Intervention Dec 2001 – Dec 2003



25. These exchange interventions, together with other operations (principally net interest earnings) permitted that the CRBP's international position increase by US$ 1 242 million. As a result, international reserves increased despite fewer deposits from the public sector (US$ 139 million) and from financial system enterprises (US$ 488 million), which reduced their excess liquidity in Dollars. The balance of Net International Reserves (NIR) grew US$ 596 million, reaching a balance of US$ 10 194 million, a level that had not been registered since prior to the Russian crisis in 1997.

Graph 19

International Position of the CRBP
(Millions of US$)



Graph 20

Net International Reserves
(Millions of US$)

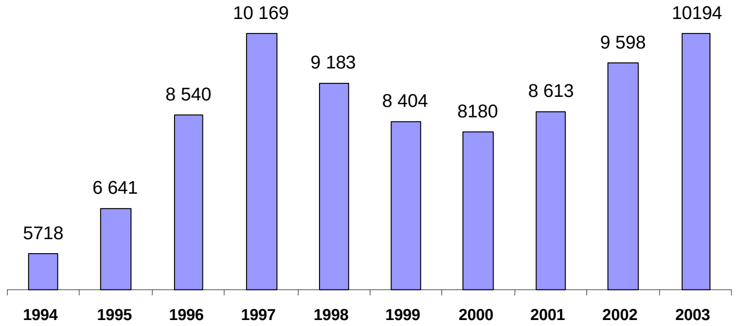


Chart 13
FLOW OF NET INTERNATIONAL RESERVES (NIR)
(Millions of US$)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
I. Net exchange operations	593	345	60	543	- 330	253	63	135	128	998
II. Financial system deposits	629	355	958	141	- 649	- 99	- 12	245	185	- 488
III. Public sector deposits	1 640	110	824	926	- 121	-1 034	- 269	- 158	364	- 139
IV. Others	114	113	57	19	114	100	- 6	211	308	225
VI. TOTAL	2 976	923	1 899	1 629	- 986	- 780	- 224	433	985	596

I.4 Domestic Demand and GDP

26. Monetary and fiscal policies have favored an environment of growth that has permitted the economy to expand for 30 consecutive months, achieving the highest rates in the region.

27. During 2003, **domestic demand** grew 3,6 per cent whereas the GDP grew 3,9 per cent due to the additional impulse of exports, which grew 5,0 per cent in real terms. This was the second consecutive year of growth for the domestic demand since it grew 4,1 per cent in 2002. Nevertheless, unlike 2002, when this increase was driven by a growth in private consumption (4,5 per cent in 2002 against a rate of 3,3 per cent in 2003), growth in 2003 was encouraged by growth in private investment (5,1 per cent against a growth of 0,2 per cent in 2002).

    Private investment grew more than 6 per cent to September, propelled by the Camisea project. Likewise, the construction sector grew 4,6 per cent during the first semester and 2,3 per cent in the second semester.

Chart 14
GROSS DOMESTIC PRODUCT
(Real percentage variations with respect to the same period of the prior year)

	2002	2003				
		I	II	III	IV*	Year*
I. TOTAL DEMAND (1 + 2)	**4,5**	**6,2**	**3,3**	**3,5**	**2,4**	**3,8**
1. Domestic Demand	4,1	6,0	2,6	3,9	2,1	3,6
a. Private consumption	4,5	4,5	3,0	2,9	2,8	3,3
b. Public consumption	1,6	6,1	1,9	2,5	7,3	4,5
c. Private fixed investment	0,2	6,9	4,9	6,6	2,3	5,1
d. Public investment	-5,0	8,0	-3,3	-3,8	16,7	5,0
2. Exports	6,8	7,1	7,6	1,8	4,0	5,0
II. TOTAL SUPPLY (3 + 4)	**4,5**	**6,2**	**3,3**	**3,5**	**2,4**	**3,8**
3. Gross Domestic Product	**4,9**	**6,0**	**3,6**	**3,5**	**2,5**	**3,9**
4. Imports	2,4	7,2	1,3	3,6	2,0	3,5

* Forecast

28. Private consumption grew 3,3 per cent in 2003, continuing with the recovery began in the year 2000 when it grew 3,5 per cent after falling 0,4 per cent in 1999. This increase of private consumption is related to the increase in family income, which according to the Survey of Socio-economic Levels of Greater Lima conducted by the company APOYO Opinión y Mercado S.A., registered a growth of 3,6 per cent during 2003.

As the next chart shows, this growth was not equal across all socio-economic levels. Greatest growth was felt in sectors C, B and A.

Chart 15
Monthly Family Income in Greater Lima 1/
(In US$)

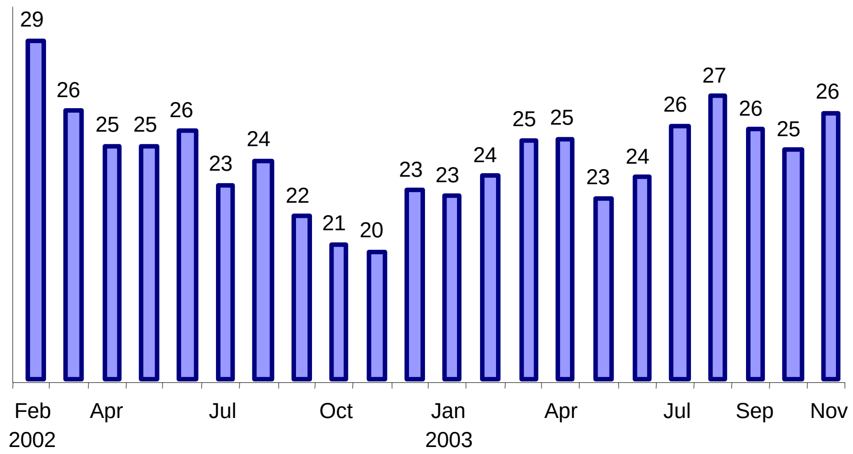
	Socio-economic Levels					Total
	A	B	C	D	E	Greater Lima
			Average Income			
2001	3,018	871	347	180	126	401
2002	3,254	816	322	192	143	419
2003	3,498	890	353	203	146	434
			Percentage Variation			
2002	7,8	-6,3	-7,2	6,7	13,5	4,5
2003	7,5	9,1	9,6	5,7	2,1	3,6

1/ Metropolitan Lima and peripheral districts
Source: Socio-economic Level of Greater Lima 2001, 2002 y 2003
APOYO Opinión y Mercado S.A.

Growth in consumer credits from financial enterprises helped propel the increase of private consumption. These credits grew 24,0 per cent in a context of lower interest rates in domestic currency, which led to a decrease in the lending rate and commercial discounts from 9,6 per cent in 2002 to 7,5 percent in 2003. This development was accompanied by a decrease in the level of non-performing loans (5,8 per cent of total credits), which reached their second lowest level since 1995 when levels fell to 4,8 per cent.

Graph 21

CONSUMER CREDITS FROM FINANCIAL ENTERPRISES
(Percentage variations with respect to the same month of the prior year)



Exports grew 5 per cent and registered increases in both the traditional and non-traditional sectors. Traditional exports grew 5,9 per cent in real terms, largely explained by increased gold (18,8 per cent), silver (5,1 per cent) and zinc exports (2,5 per cent), which compensated for the decrease of copper and lead exports. Meanwhile, non-traditional exports rose 15,0 per cent, reaching the highest levels in textile (US$ 818 million) and agricultural goods (US$ 619 million), principally asparagus, which signified that Peru might have replaced China as the largest exporter of asparagus in the world.

29. On the **sectoral** side, non-primary industries contributed to GDP growth (3,9 per cent) while primary industries participated at a lower rate (2,5 per cent). Among non-primary industries, the most dynamic were electricity and water and other services, with rates of 4,6 per cent and 4,2 per cent respectively, while non-primary manufacturing and construction grew 3,4 per cent and 3,2 per cent respectively. In non-primary manufacturing, the largest growth took place in the sectors geared toward the external market, particularly textiles, and the construction-related sector, including non-metallic minerals, iron and steel and metallic structures. Food and beverages and other mass-consumption goods also experienced rates of moderate growth in the domestic market.

Chart 16
GROSS DOMESTIC PRODUCT
(Annual rates of growth)

	2002	2003				
		I	II	III	IV *	Year*
Agriculture and Livestock	**5,7**	**2,3**	**4,1**	**2,9**	**-0,7**	**2,4**
Fishing	**5,7**	**-15,0**	**-16,0**	**-12,3**	**-11,4**	**-13,9**
Mining and fuel	**11,6**	**4,5**	**10,8**	**7,5**	**3,5**	**6,5**
Metalic Mining	12,3	5,6	12,0	9,0	4,1	7,6
Natural gas and oil	0,6	-6,2	-1,2	-7,3	-3,1	-4,5
Manufacturing	**4,2**	**6,0**	**0,8**	**1,7**	**0,0**	**2,0**
Based on raw materials	-0,5	-2,2	-2,6	-1,2	-5,4	-2,9
Non-primary industries	5,6	8,0	1,8	2,4	1,5	3,4
Construction	**7,9**	**3,4**	**4,6**	**2,0**	**3,0**	**3,2**
Commerce	**4,6**	**7,7**	**2,8**	**3,0**	**0,4**	**3,4**
Services	**3,8**	**5,8**	**3,9**	**3,3**	**4,2**	**4,2**
Electricity and water	5,1	4,8	4,0	4,8	4,6	4,6
Other services	3,8	5,8	3,9	3,2	4,2	4,2
GROSS AGGREGATED VALUE (GAV)	**5,0**	**5,4**	**3,6**	**3,1**	**2,3**	**3,6**
Taxes on products and import duties	3,9	11,9	4,3	7,3	3,8	6,6
TOTAL GDP	**4,9**	**6,0**	**3,6**	**3,5**	**2,5**	**3,9**
Primary GAV	**6,5**	**1,9**	**4,2**	**3,6**	**-0,3**	**2,5**
Non-primary GAV	**4,5**	**6,4**	**3,3**	**3,0**	**3,0**	**3,9**

* Projection

30. The **national disposable income** would have grown 4,1 per cent in 2003, a rate slightly superior to that which the GDP growth, but due to an improvement in the terms of trade, this difference increased during the second semester. Higher profits by foreign-owned companies explain the greatest difference in investment income, and as such the lower growth rate of the Gross National Product compared with the growth of the GDP. This behavior is offset by improvements in the terms of trade and by the increase of current transfers - consisting of remittance from Peruvians abroad and donations that are included in national disposable income.

Chart 17
National Disposable Income
(Real Annual Variation)

	2002	2003				
		I	II	III	IV *	Year*
I. Gross domestic product (GDP)	4,9	6,0	3,6	3,5	2,5	3,9
II. Gross national product (GNP) 1/	4,2	4,8	3,2	3,1	2,2	3,3
III. Gross national income (GNI) 2/	4,3	5,5	2,7	4,0	3,9	4,0
IV. National Disposable Income (NDI) 3/	4,3	5,6	2,8	4,5	3,8	4,1

1/ Excludes from the GDP the net investment income paid to non-resident producers
2/ The GDP and GNP are isolated from changes in terms of trade in exterior commerce
3/ Adds to the GNI the received net transfers from non-residents
* Projection

Box 2

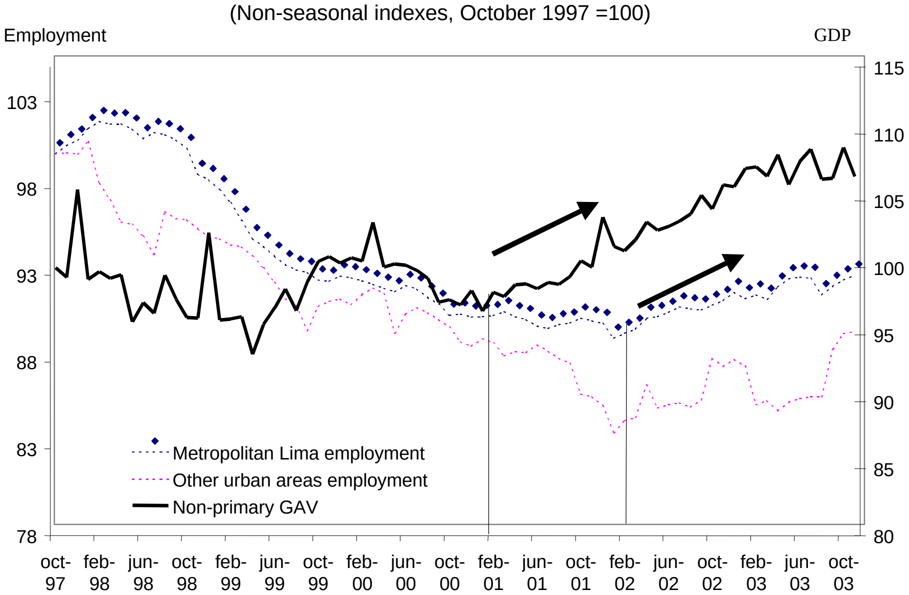
Economic Activity and Employment

Growth in domestic production is related to an increase in employment.

This relationship was estimated using the employment indicator from the Index of Urban Employment in businesses of 10 or more workers subject to private sector labor laws. This index is calculated by the Ministry of Labor, using a survey of 4 749 businesses in Metropolitan Lima and in 20 of the principle cities of the country. This survey also includes all registered businesses with more than 50 workers, which are considered in the census.

Activity is measured using the Non-primary Gross Added Value (GAV) resulting in a formal employment-product elasticity of 0,5, which is consistent with previous estimates[3]. This means that for each percentage point of growth in production, employment grows at approximately 0,5 percentage points.

NON-PRIMARY GAV AND EMPLOYMENT IN BUSINESSES OF 10 OR MORE WORKERS
(Non-seasonal indexes, October 1997 =100)



Source: ENVME, MTPE.

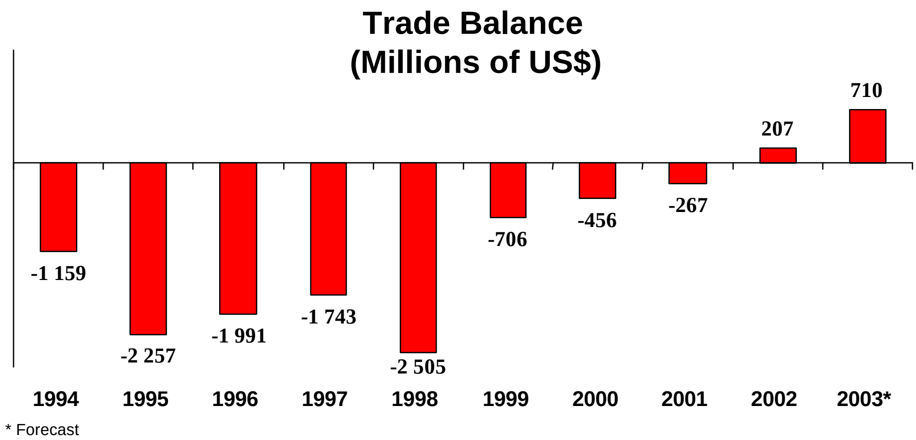
Tests of statistic causality showed that growth in employment lags behind growth in production (95 per cent of statistical significance).This statistical evidence is consistent with the observed. Periods of non- seasonal non-primary GAV growth are followed by subsequent rises in urban employment (Metropolitan Lima and Other Urban areas). The non-seasonal, non-primary GAV rose from June of 2001, while non-seasonal employment in businesses of 10 or more workers stayed constant or began to grow in January 2002, approximately six months later.

[3] Ministry of Labor and Employment Promotion (1998), "Hacia una interpretación del problema del empleo en el Perú", (Towards an interpretation of the problem of employment in Peru) Boletín de Economía Laboral N° 8.

I.5 External accounts

31. At US$ 710 million, the trade surplus in 2003 surpassed the 2002 surplus in US$ 503 million. Such improved figures are explained by a 17 per cent increase in exports and an 11 per cent rise in imports.

Graph 22

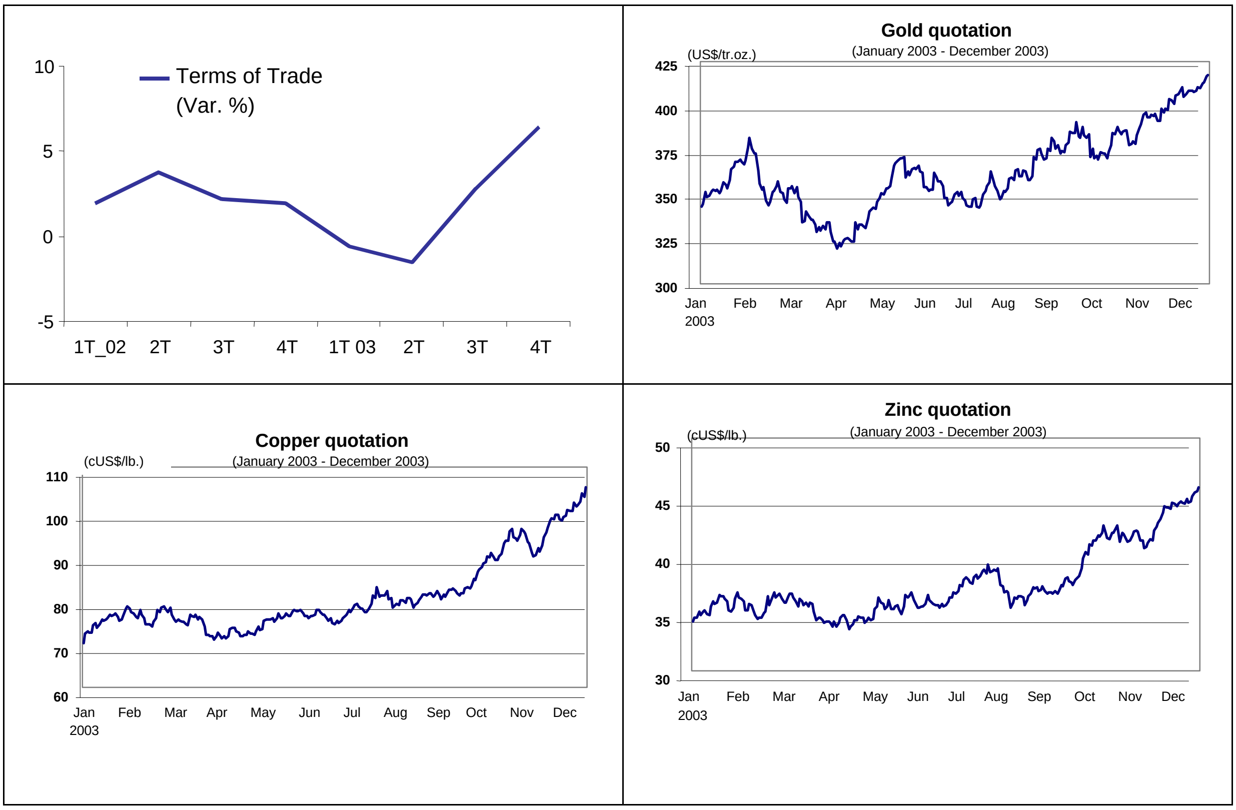


32. In the period under review, exports grew US$ 1 307 million to reach US$ 8 954 million, through an increase in both traditional exports (18 per cent) and non-traditional exports (15 per cent). Larger traditional exports are basically explained by increased gold exports, as much in terms of volume (18 per cent) as for higher international prices (17 per cent). Meanwhile, the largest growing non-traditional exports in 2003 were textiles, which increased 21 per cent (propelled by the ATPDEA agreement), as well as growth in agriculture and livestock exports at 12 per cent, chemicals at 21 per cent and fishing at 24 per cent.

33. The import of raw materials and intermediate goods, including fuel – whose price raised an average of 17 per cent – was the principal cause of an 11 per cent increase in imports in 2003. The amount of capital goods imported also rose (8 per cent), even though demand from the Camisea project fell as it nears completion, and the amount of consumer goods also rose (4 per cent).

34. The improvement in the trade balance stems from a recuperation in the terms of trade - particularly in the second semester - which reflected improvements in the global economy and growth in China and the United States. Terms of trade improved 2,5 per cent, propelled by an increase in the price of exports grew 8,1 per cent, which surpassed the rise in the price of imports (5,5 per cent). Contributing to the price growth of exports, gold prices spiked 17 per cent, copper prices climbed 16 per cent, petroleum and derivatives prices jumped 15 per cent and zinc prices increased 18 per cent. On the other hand, the increase in the prices of petroleum and derivatives (15 per cent), soybean (16 per cent) and wheat (7 per cent) account for the rise in import prices.

Graph 23



35. The **current account of the Balance of Payments** in 2003 registered a deficit of US$ 1 039 million, an amount equal to 1,7 per cent of the GDP. This is US$ 167 million less than that of the previous year and is mostly due to the improvement in the trade balance.

Chart 18
Balance of Payments
(Millions of US dollars)

	2002	2003				
		I	II	III	IV*	Year*
CURRENT ACCOUNT BALANCE	**- 1 206**	**- 514**	**- 220**	**- 195**	**- 111**	**- 1 039**
Percentage of GDP	*-2,1*	*-3,6*	*-1,4*	*-1,3*	*-0,7*	*-1,7*
1. Trade balance	207	- 22	202	230	300	710
a. Exports	7 647	2 023	2 184	2 316	2 431	8 954
b. Imports	- 7 440	- 2 045	- 1 982	- 2 086	- 2 130	- 8 244
2. Services	- 948	- 269	- 240	- 253	- 243	- 1 005
3. Investment income	- 1 509	- 494	- 463	- 519	- 462	- 1 937
4. Current transfers	1 043	271	281	347	294	1 193
II. FINANCIAL ACCOUNT	**1 987**	**1 363**	**- 267**	**- 94**	**483**	**1 486**
1. Private sector 1/	936	768	68	54	- 108	782
2. Public sector	1 051	596	- 335	- 148	591	704
III. EXCEPTIONAL FINANCING	**51**	**2**	**17**	**2**	**12**	**33**
IV. BCR INTERNATIONAL RESERVES FLOW (1 - 2)	**- 832**	**- 851**	**470**	**287**	**- 384**	**- 479**
(Increase with negative sign)						
1. Change in BCR reserves	- 985	- 845	446	241	- 438	- 596
2. Valuation changes and monetization of gold	- 153	6	- 23	- 46	- 54	- 118

1/ Includes short-term capital and errors and net omissions.
*Forecast

During 2003, capital accounts registered a positive flow of US$ 1 486 million, US$ 501 million less than the previous year. This decrease is explained by extraordinary operations in 2002, such as the sale of Backus stock to non-residents (US$ 657 million), and because in 2003 AFPs and other financial institutions purchased sovereign bonds emitted internationally by the government.

Highlights in private capital inflows in 2003 include investments in the Camisea gas project (US$ 707 million) and capital contributions made to the TIM telecommunications company (US$ 196 million) and the Banco Wiese Sudameris (US$ 100 million). Public capital inflows include the sale of sovereign bonds in the international market for a nominal value of US$ 1 250 million, at installments between 12 and 30 years, as well as the receipt of free-disposal funds from multilateral institutions for US$ 519 million.

I.6 Government expenditure and fiscal accounts

37. The non-financial public sector overall balance in 2003 was a deficit equivalent to 1,9 percent of GDP. This figure was smaller in 0,4 per cent of GDP than the deficit observed in 2002 (2,3 percent of GDP) and it was consistent with the target established in the Economic Program for 2003. The primary balance moved from a deficit of 0,3 percent of GDP to a surplus of 0,1 percent of GDP. This improvement reflected the fact that central government real revenues grew at a faster rate (8,2 percent) than real non-financial expenditures (5,2 percent).

Chart 19
Non-financial Public Sector
(Millions of nuevos soles)

	2002	2003				
		I	II	III	IV*	Year*
1. Current revenue	**28 319**	**7 403**	**7 858**	**7 840**	**8 231**	**31 331**
(% of GDP)	*14,3*	*14,9*	*14,0*	*15,0*	*15,3*	*14,8*
Var % real	*5,3*	*16,9*	*6,6*	*3,5*	*7,3*	*8,2*
2. Non-financial expenditure	**-29 030**	**-6 671**	**-7 550**	**-7 775**	**-9 239**	**-31 234**
(% of GDP)	*-14,6*	*-13,4*	*-13,4*	*-14,9*	*-17,1*	*-14,7*
Var % real	*2,7*	*7,5*	*3,1*	*-0,8*	*11,2*	*5,2*
3. Other	**197**	**- 65**	**74**	**93**	**21**	**123**
(% of GDP)	*0,1*	*-0,1*	*0,1*	*0,2*	*0,0*	*0,1*
4. Primary balance	**- 514**	**667**	**382**	**158**	**- 987**	**220**
(% of GDP)	***-0,3***	***1,3***	***0,7***	***0,3***	***-1,8***	***0,1***
5. Interests	**-4 148**	**-1 033**	**-1 045**	**-1 229**	**-1 040**	**-4 347**
(% of GDP)	***-2,1***	***-2,1***	***-1,9***	***-2,4***	***-1,9***	***-2,1***
Of which: External debt (Millions of US$)	*-$1 002*	*-$ 252*	*-$ 255*	*-$ 316*	*-$ 257*	*-$1 080*
6. Overall balance	**-4 663**	**- 365**	**- 663**	**-1 071**	**-2 027**	**-4 126**
(% of GDP)	***-2,3***	***-0,7***	***-1,2***	***-2,1***	***-3,8***	***-1,9***
Mill. US$	***-$1 319***	***-$ 105***	***-$ 191***	***-$ 308***	***-$ 583***	***-$1 187***

* Projection

38. The improvement in the central government primary balance was due mainly to the tax measures taken in the second semester of 2002 and during 2003. In the former, the most important measures were the withholding, detraction and perception mechanisms for the payment of the Value Added Tax –VAT-, and the anticipated payment of Income Tax on business profits. In the second group of measures there were a one-percentage-point increase (from 16 to 17 percent) in the VAT, in place since August 2003, and the increase in the Excise Tax applied on fuels. These sets of measures, and the persistent increase in economic activity, raised central government current revenues in about 0,5 percentage points of GDP, to reach an equivalent to 14,8 percent of GDP. Of this amount, tax revenues grew from 11,9 to 12,9 percent of GDP, an increase equivalent to S/. 3 799 million.

39. Central Government non-financial expenditures grew 5,2 percent in real terms to reach 14,7 percent of GDP, reflecting salary increases in the Education (primary, secondary and higher) and Justice sectors, and a moderate growth in capital expenditure (1,9 per cent in real terms), its first increase since 1999. Gross capital formation also grew in the rest of the public sector, in particular, in state-owned enterprises, causing public investment to grow 5,0 percent in real terms.

40. Despite the reduction of the overall fiscal deficit, higher amortization payments of both domestic and external debt caused non-financial public sector gross financial requirements to reach US$ 2 733 millions, a level US$ 340 million higher than the one observed in 2002. This demand for financial resources was covered by external disbursements for US$ 1 201 millions, which included US$ 336 million for investment projects and US$ 1 246 million in sovereign bonds. Additionally, the government issued an equivalent to US$ 508 millions in domestic bonds and received US$ 52 millions in privatization proceeds.

Chart 20
Non-financial Public Sector Financing
(Millions of US$)

	2002	2003				
		I	II	III	IV*	Year*
1. Overall balance (millions of soles)	**-4 663**	**- 365**	**- 663**	**-1 071**	**-2 027**	**-4 126**
(% of GDP)	***-2,3***	***-0,7***	***-1,2***	***-2,1***	***-3,8***	***-1,9***
Mill. US$	***-$1 319***	***-$ 105***	***-$ 191***	***-$ 308***	***-$ 583***	***-$1 187***
2. Amortization (millions of US$)	**-$1 074**	**-$ 328**	**-$ 373**	**-$ 478**	**-$ 368**	**-$1 546**
Domestic	-$ 138	-$ 73	-$ 76	-$ 204	-$ 31	-$ 385
External 1/	-$ 936	-$ 255	-$ 296	-$ 274	-$ 336	-$1 161
3. Gross financial requirements (millions of US$)	**$2 393**	**$ 432**	**$ 563**	**$ 786**	**$ 951**	**$2 733**
External financing	*$1 960*	*$ 838*	*$ 81*	*$ 231*	*$ 950*	*$2 101*
Free disposal 1/	*$1 609*	*$ 750*	*$ 0*	*$ 149*	*$ 866*	*$1 765*
- Multilaterals	*$ 625*	*$ 0*	*$ 0*	*$ 149*	*$ 370*	*$ 519*
- Bonds	*$ 984*	*$ 750*	*$ 0*	*$ 0*	*$ 495*	*$1 246*
Investment projects	*$ 351*	*$ 88*	*$ 81*	*$ 83*	*$ 84*	*$ 336*
Domestic bonds	*$ 213*	*$ 48*	*$ 175*	*$ 156*	*$ 129*	*$ 508*
Privatization	*$ 421*	*$ 6*	*$ 4*	*$ 9*	*$ 33*	*$ 52*
Others	*-$ 194*	*-$ 460*	*$ 304*	*$ 389*	*-$ 161*	*$ 72*

1/ Exclude the repurchasing operation in the first quarter of 2002 for US$ 902,05 million.
* Projection

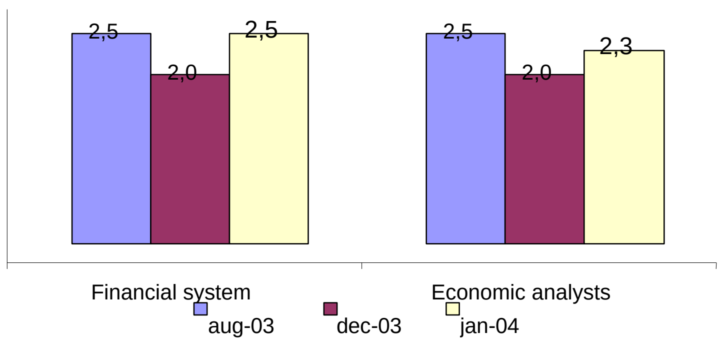
II. FORECASTS

II.1 Inflation

41. The BCR surveys financial organizations and economic analysts in order to compile a forecast of inflation for 2004. Although toward the end of the year, the surveys reported a lower-than forecast expectation of 2%, temporary seasonal shocks of offer established the overall average at 2,4%.

Graph 24

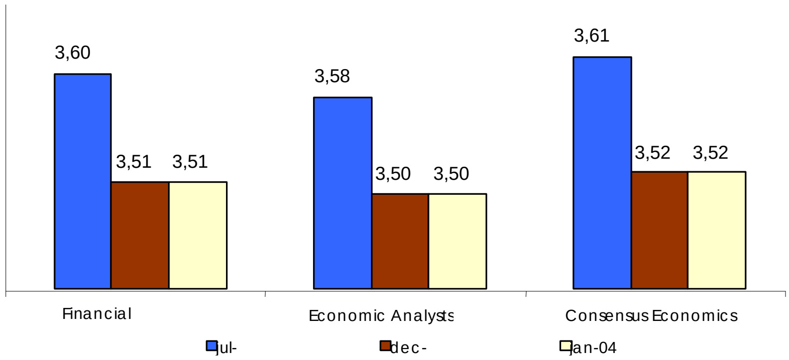
INFLATION PROSPECTS (VAR.%): 2004



Central Bank and Consensus Economics surveys forecast an exchange rate of between S/. 3,50 and S/. 3,52 per Dollar by December 2004.

Graph 25

EXCHANGE RATE: DECEMBER 2004



Based on information from Consensus Economics, the exchange rate in December 2004 should reach S/. 3,52 per Dollar, which implies a nominal depreciation of 1,6 per cent and a depreciation of 2,0 per cent in real terms. The projection forecasts that most currencies will appreciate slightly against the Dollar in 2004.

Chart 21

Nominal and Real Depreciation of the currencies of our main trade partners in relation to the Dollar

(Rates of annual variation to December of 2004)

	Depreciation % with US$	Inflation 1/	Var. % BREI 2/
Germany	-0,5	1,1	0,7
Italy	-0,5	2,3	-0,5
Holland	-0,5	3,0	-1,3
Belgium	-0,5	1,7	0,1
Spain	-0,5	1,6	0,2
France	-0,5	2,2	-0,4
Japan	-3,9	0,3	-2,1
Brazil	7,6	6,1	3,6
United Kingdom	0,7	1,1	1,8
Chile	2,4	2,4	2,2
China	-1,9	1,7	-1,4
Colombia	6,4	5,7	2,9
Mexico	1,5	3,9	-0,1
Argentina	1,4	7,6	-3,7
Korea	-6,0	3,3	-6,9
Taiwan	-3,8	0,2	-1,9
Venezuela	43,0	32,9	10,0
Canada	-1,1	2,2	-1,0
Bolivia	-1,1	3,6	-2,4
Average	1,1	3,4	-0,1

1/ The end of the year inflation data has been calculated on the basis of the inflation average from Consensus Economics.

2/ Var. % Bilateral real exchange index (=1+deprec.%)*(1+infla.%USA)/(1+infla.%domestic)

Source: Consensus Forecast, January 12 2004

42. The inflation projection is based on the premise that monetary policy stance remains unchanged during the projected period. This methodological assumption allows evaluating likely inflationary events if the monetary policy does not react to the macroeconomic scenario projected for subsequent months.

43. Macroeconomic scenario forecasts for 2004 are based on the following considerations:

- A non-core inflation rate for 2004 of 1,1 per cent. This growth reflects an expected rise in food prices (3,0 per cent), which are offset by a fall in the price of public services (-1,0 per cent), due to the expected decrease of electricity rates from the second semester once offer from Camisea enters the market. Fuel prices are also expected to drop (-0,5 per cent) due to a projected fall in the international price of petroleum.

- A 4 per cent growth in the GDP and a 3,7 per cent growth in domestic demand. Of particular importance are the growth of private investment and an increase of exports of goods and services at 6,1 per cent each, and an increase in private consumption of 3,5 per cent.

- With respect to the August Inflation Report, the non-core inflation has been revised upward from 0,9 per cent to 1,1 per cent. This change is due to the lesser-than-expected decrease of fuel prices (changed from –4,1 per cent to –0,5 per cent).

- A deficit in the public sector equal to 1,5 per cent of the GDP in 2004. This fiscal stance reflects the scenario described in the Multi-annual Macroeconomic Framework.

- A favorable external environment where we expect an increase in terms of trade (7,2 per cent) and stable international financial conditions. It is also expected that the LIBOR interest rate remains unchanged during the first semester of the year but may later present a gradual and moderate increase. This evolution is in line with growth forecast for the global economy and the expected rise of the FED interest rates.

Chart 22

INFLATION REPORT PROJECTIONS: JANUARY 2004 vs. AUGUST 2003

	2001	2002	2003 [1/]		2004 [1/]	
			August Report 2003	January Report 2004	August Report 2003	January Report 2004
			Var. % Real			
1. Gross dom. product	0,6	4,9	4,0	3,9	4,0	4,0
2. Domestic demand	-0,1	4,1	3,6	3,6	3,8	3,7
a. Private consump..	1,8	4,5	3,6	3,3	3,6	3,5
b. Public consump.	-0,3	1,6	4,0	4,5	2,1	3,4
c. Private fixed invest.	-5,7	0,2	5,1	5,1	5,7	6,1
d. Public invest.	-22,9	-5,0	2,3	5,0	4,7	6,4
3. Exports of goods and services	6,7	6,8	4,7	5,0	6,8	6,1
4. Imports of goods and services	0,7	2,4	2,7	3,5	5,3	4,5
5. Growth of our trade partners	1,2	1,6	1,9	2,4	3,4	4,0
			Var. %			
7. Accum. inflation	-0,1	1,5	1,5	2,5	2,0	2,5
8. Accum. nominal depreciation	-2,4	2,3	-0,3	-1,2	2,5	1,2
9. Accum. real depreciation (multilateral)	-4,3	-0,6	5,6	7,5	1,8	2,0
10.Terms of Trade	-1,8	2,5	-0,4	2,5	1,6	7,2
			% of PBI			
11. Balance of payments' current account	-2,0	-2,1	-2,0	-1,7	-1,9	-1,0
12. Trade balance	-0,2	0,4	0,8	1,2	1,2	2,7
13. Gross external financing of the private sector [2/]	3,4	5,2	2,8	3,5	2,7	3,2
14. Primary balance of non-financial public sector	-0,3	-0,3	0,1	0,1	0,6	0,6
15. Overall balance of non-financial public sector	-2,5	-2,3	-2,0	-1,9	-1,5	-1,5
16. Tax revenue of Central Government [3/]	12,1	11,9	12,7	12,9	13,0	13,4
17. Outstanding public external debt	35,0	36,4	35,8	36,6	35,6	34,8
			Var. % Nominal			
18. Non-financial expenditure of Central Gov.	-2,3	2,5	6,3	7,6	4,7	5,8
19. Average monetary base	3,2	15,8	7,5	7,4	7,0	8,0
20. Banking system credit to private sector	-4,5	0,1	1,2	-4,6	6,5	4,7

[1/] Projection

[2/] Direct foreign investments and long term expenditures in private sector

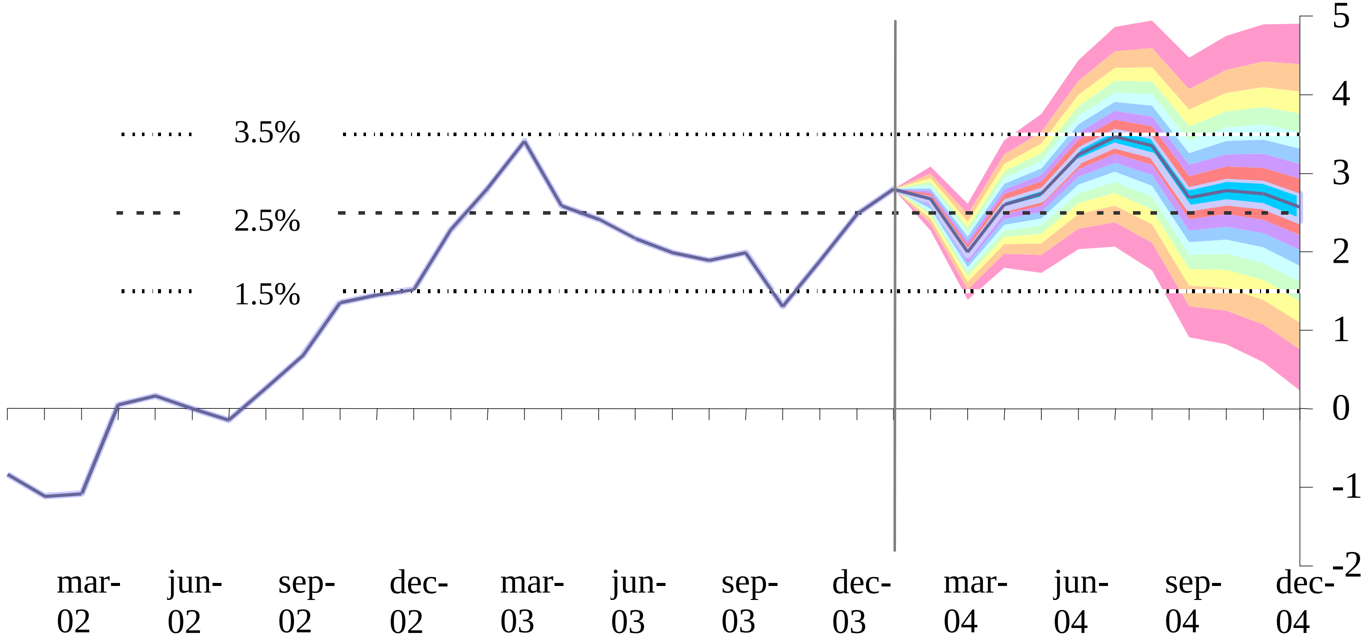
[3/] Excludes tax on state shares

44. In view of the above considerations, graph 26 shows the central inflation forecast for 2004 and illustrates that the inflation forecast is close to the target. The shadest band in the graph indicates the most probable result, assuming that the current monetary policy established by the Central Bank's Board of Directors is maintained through the end of next year.

Graph 26

INFLATION PROJECTION

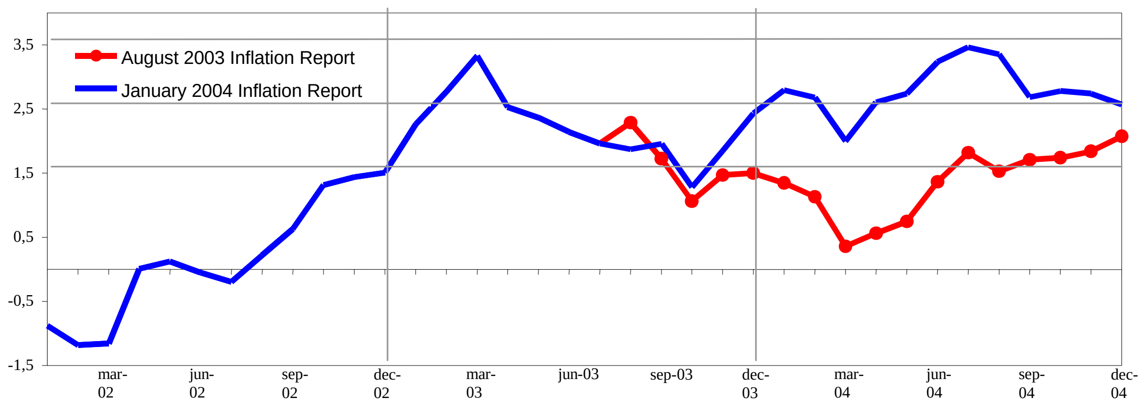
(Accumulated 12 month CPI variation)



45. The central inflation forecast for 2004 is higher than what was considered in the August Inflation Report of last year (2,0 per cent). This change is due to anticipated supply shocks of certain foods during the first quarter of the year, including an increase in the price of vegetable oil and bread (food heading) as a result of an increase in the international quotation of soybean and wheat, respectively.

Graph 27

Inflation Projection
(Accumulated 12 month CPI variation)

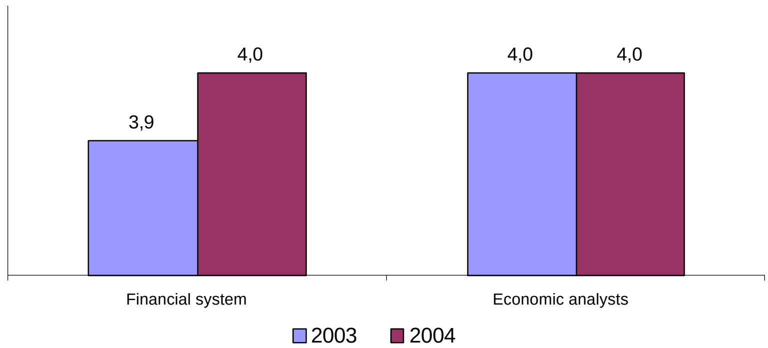


II.2 Economic activity

46. The surveys carried out by the CRBP among financial entities and economic specialists indicate that production is expected to grow between 3,9 per cent and 4,0 per cent for 2003, and 4,0 per cent for 2004.

Graph 28

EXPECTED GROWTH OF GDP



47. The GDP is expected to grow an estimated 4,0 per cent, and domestic demand at 3,7 per cent in 2004:

   a. **Private consumption** would grow 3,5 per cent and private investment would increase 6,1 per cent. It is worth mentioning that the INDICCA index published by the APOYO company - which measures the perception of consumers with respect to their future economic situation - registered an improvement in January 2004 over the previous month.

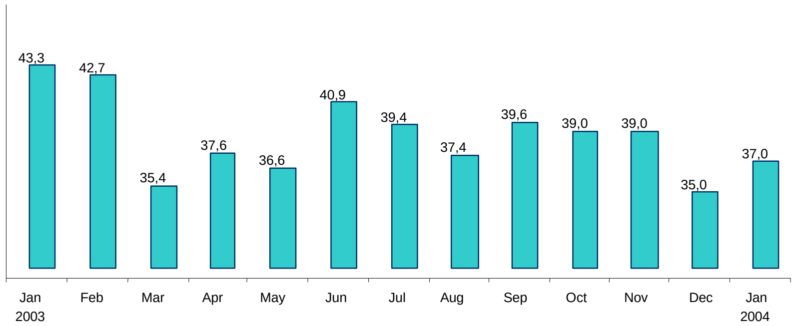
Chart 23
TOTAL SUPPLY AND DEMAND
(Real percentage variation with respect to the same period of the previous year)

		2002	2003 *	2004*
I.	**Total demand (1+2)**	**4,5**	**3,8**	**4,0**
	1. Domestic demand	4,1	3,6	3,7
	a. Private consumption	4,5	3,3	3,5
	b. Public consumption	1,6	4,5	3,4
	c. Fixed private investment	0,2	5,1	6,1
	d. Public investment	-5,0	5,0	6,4
	2. Exports	6,8	5,0	6,1
II.	**Total supply (3+4)**	**4,5**	**3,8**	**4,0**
	3. Gross Domestic Product	**4,9**	**3,9**	**4,0**
	4. Imports	2,4	3,5	4,5

* Projection

Graph 29

INDEX OF CONSUMER CONFIDENCE: INDICCA



Source: APOYO

b. Growth in private investment in 2004 will be funded by the higher profits earned by businesses in 2003 (by the third quarter, manufacturing businesses registered a 15,3 per cent growth in profit). There will also be important investment in various projects, primarily Camisea (including the investment of the consortium exporter Perú LNG) with an investment of US$ 732 million, the Alto-Chicama project (Barrick Gold Corporation) and Minas Conga (Minera Yanacocha).

Investment in construction could also increase, due to the continued growth of the MiVivienda program, especially in housing built for sector C. It is worth mentioning that there is a low rate of non-performing mortgage credits. To November, non-performance on mortgages in this program was 4.4 per cent, compared to 7 per cent for commercial credits. The mortgage market unrelated to the MiVivienda program is also expected to continue to expand. Furthermore, construction programmed for the Alto Chicama mine in the department of La Libertad in the second semester of 2004, as well as growth in public investment, will boost overall construction figures.

c. **Public investment** would grow 6,4 per cent this year compared to 5,0 per cent in 2003. Additionally, the government will turn over important concessions for the construction and rehabilitation of highways. Among the most important are the Red-Vial 6 (Lima – Ica), for an estimated investment of US$ 205 million, the Red Vial 1 (Piura-Tumbes) for US$ 104 million and the Red Vial 4 (Ancash-Trujillo), which is expected to reach US$ 100 millions. Furthermore, bids will be solicited in order to award the management of a shopping center in the Centro Cívico de Lima and the construction of the El Chaco-La Puntilla (Paracas) tourist complex.

CENTRAL RESERVE BANK OF PERU

Box 3

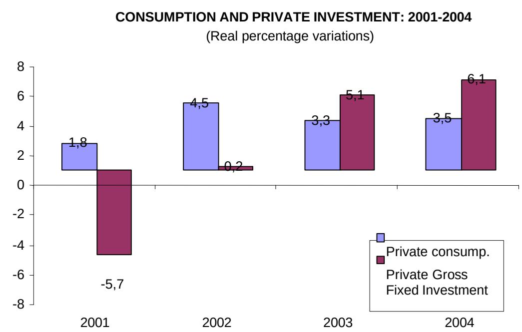
PROJECTS FOR CONCESSION			
Projects	**Amount (US$ Millions)**	**Date of Award**	Description
INFRASTRUCTURE	**1260**		
Olmos project (first phase)	112	Quarter III 2004	The first phase includes the construction of the trans-andina tunnel and the “del Limón” dam. The concession is for 20-years. Of the total amount, US$ 35million will be provided by the concessionary.
Hydroelectric Central of Yuncán	200	Quarter I 2004	The project consists of a hydroelectric central with 130 Mw of installed potential, to produce 901 Gwh of energy. The concession is for 30 years.
Multi-modal hub of the North Amazon (Integration of South American infrastructure)	124	Quarter II 2004	This is the second via of communication with Brazil, which connects the port of Paita and Yurimaguas by road. From here, Brazil is reached by river. The project contemplates the rehabilitation and maintenance of different sections between the cities mentioned and investment in the ports of Yurimaguas and Iquitos, as well as the maintenance of the overland route. Part of the total will be co-financed by the state.
Multimode Hub of the Central Amazon (Integration of South American infrastructure)	62	Quarter III 2004	This hub permits integration with Brazil. Originating in Lima and ending in Pucallpa, where Brazil can be reached by river. The project includes the rehabilitation of certain sections between Lima and Pucallpa, as well as investments in the port there and the maintenance of the entire route.
Road Network No. 4	100	Quarter II 2004	This project contemplates the construction of a road that circumvents Chimbote, the rehabilitation of the Pativilca-Conococha-Huaraz-Caraz highway, the rehabilitation and repair of the Pativilca-Casma-Trujillo section and the rehabilitation of the access to the Port of Salaverry.
Road Network No. 1	104	Quarter II 2004	This project contemplates the construction of a 37km highway connecting Piura and Sullana, a road that circumvents the city of Piura, the rehabilitation of the Paita-Sullana highway and the accesses to Talara, Puerto Pizarro and the airport in Tumbes.
Road Network No. 6	205	Quarter I 2004	This projects includes the maintenance of the Puente Pucusana-Cerro Azul section (74km); the construction of the Cerro Azul-Ica highway (149km) and the maintenance of the Cañete-Lunahuaná section (40km)
Airport	153		In the case of airports administered by CORPAC, a public-private scheme has been proposed in which the State fixes quality of service and safety standards that must be observed in each airport. Services are transferred in accordance with the DBFOT format (design, construction, finance, operate and transfer)
EPS Grau and EMFAPA Tumbes	200		The objective of this project is to involve private investment in services of potable water and piping in the departments of Piura and Tumbes.
MINING	**300**		
Bayóvar	300		This project involves the exploitation of a phosphate deposit whose reserves are equal to 262 million tons of phosphoric rock concentrate. The criteria for award will be the amount of investment devoted to the project over the course of seven years. The earnings from exploitation will be a feature of the bidding process. Also taken into account will be the construction of a rock phosphate plant in a determined time period as well as a fund for community development.

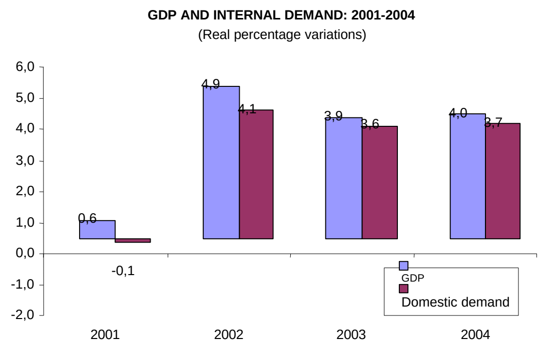
TOURISTIC	**40**		
Centro Cívico de Lima	20		The objective of this project is to hand over to a private operator the rehabilitation and conditioning of the entire Centro Cívico, with the exception of the tower, in order to build a shopping center and multi-screen cinema. The promotion of this private investment will be handled through a rental contract.
Complejo Turístico El Chaco – La Puntilla	8		This project includes the design, construction and operation of a tourist complex in the Chaco-La Puntilla zone, located on the Bay of Paracas, on state land.
Complejo Turístico Playa Hermosa	**12**		This project undertakes the development of tourist infrastructure on the shoreline established as a National Tourist Reserve Zone, which includes basically the entire coast of the Tumbes region. The promotion of private investment will take place through a concession of land for the design, construction and operation of said infrastructure. The criteria for award are the commitment of investment, the right of exploitation and the payment for award.
Total	**1600**		

Source: Proinversión

d. **Exports** of goods and services could grow 6,1 per cent in real terms, as a result of increased traditional exports, especially minerals. Export volume is expected to grow in lead (20 per cent), copper and iron (7 per cent), zinc (7 per cent) and silver (6 per cent). In addition to greater volumes of exports, the price paid for minerals is expected to rise an average of 10 per cent. Non-traditional exports are expected to increase 11 percent, led by the textile sector.

Graph 30





48. The Primary Sector is expected to grow 5,1 per cent in 2004, with the most dynamic growth in the fishing and mining sectors. The non-primary sector is projected to grow 3,7 per cent.

Chart 24
GROSS DOMESTIC PRODUCT
(Real percentage change, compared with the same period of the previous year)

	2002	2003*	2004*
Agriculture	**5,7**	**2,4**	**2,8**
Fishing	**5,7**	**-13,9**	**10,5**
Mining and fuel	**11,6**	**6,5**	**6,9**
Metalic mining	12,3	7,6	6,0
Natural gas and oil	0,6	-4,5	18,1
Manufacturing	**4,2**	**2,0**	**4,0**
Based on raw materials	-0,5	-2,9	7,5
Non-primary industries	5,6	3,4	3,1
Construction	**7,9**	**3,2**	**5,0**
Commerce	**4,6**	**3,4**	**3,7**
Services	**3,8**	**4,2**	**3,7**
Electricity and water	5,1	4,6	3,9
Other services	3,8	4,2	3,6
GROSS AGGREGATED VALUE (GAV)	**5,0**	**3,6**	**4,0**
Taxes on products and import duties	3,9	6,6	4,0
TOTAL GDP	**4,9**	**3,9**	**4,0**
Primary GAV	**6,5**	**2,5**	**5,1**
Non-primary GAV	**4,5**	**3,9**	**3,7**

* Projection

49. Among the primary sectors, increased activity in mining and fishing could be counterbalanced by reduced growth in the agriculture sector, which is expected to fall in the first quarter and experience reduced growth in the second quarter in three of its principal products (potato, rice and yellow corn), due to reduced planting and smaller harvests caused by bad weather.

Among the non-primary sectors, the construction sector could grow 5 per cent, sustained by the growth in mortgage credits and increased public and private investment.

Non-primary manufacturing would grow 3,1 per cent, due to an increase in the food, drink and tobacco heading, and the textile, leather and footwear heading. In the former, growth would be associated with a greater increase of domestic demand; while in the latter, growth will be a result of the trade preferences offered by the ATPDEA.

50. Disposable national income is expected to grow by 4,6 per cent in 2004- which is higher than GDP growth – due to favorable changes in the terms of trade.

Chart 25
NATIONAL DIPOSABLE INCOME
(Real Annual Variation)

	2002	2003*	2004*
I. Gross domestic product (GDP)	4,9	3,9	4,0
II. Gross national product (GNP) 1/	4,2	3,3	3,3
III. Gross national income (GNI) 2/	4,3	4,0	4,8
IV. National disposable income (NDI) 3/	4,3	4,1	4,6

1/ Excludes from the GDP net investment earnings paid on non-resident investment
2/ The GDP and GNP are isolated from changes to terms of trade in foreign trade.
3/ Adds net received transfers from non-residents to GNI.
* Projection

II.3 External sector

World growth

51. The global economy is expected to rebound in 2004 at a higher-than-expected rate. According to Consensus Economics, the GDP of our main trade partners could grow 4,0 per cent. Of particular importance is the recuperation of the North American economy. Asia - and in particular China - could maintain high growth rates as well. In South America, Argentina, Brazil and Chile are expected to recuperate due to foreign (global growth) and domestic factors. Of special note are the advancement in structural reform (particularly of the pension system) and the reduction of interest rates in Brazil, as well as good prospects for the commodity market in Chile.

Chart 26

		Growth Projections of the GDP (in percentages)			
		August 2003		January	
	2002	2003	2004	2003	2004
World	**1,9**	**2,0**	**2,9**	**2,5**	**3,6**
Trade partners	**1,6**	**1,9**	**3,4**	**2,4**	**4,0**
• North America	2,4	2,3	3,7	2,9	4,4
• Eurpoe	1,2	1,2	2,1	1,2	2,3
• Asia	4,1	3,8	4,1	4,6	4,9
• Latin America	-1,1	0,6	3,8	1,0	4,3

Source: Consensus Forecasts.

Terms of trade

52. The year 2004 should see an improvement in the global economy - which is expected to lead to higher commodity prices - and the persistence of a weak dollar. The market price of copper could reach US$/lb 1,00 by the end of the year, and gold may hold its price at US$ 400 per ounce. It is estimated that the price of petroleum will reduce gradually by 7,6 per cent by the end of the period, once the greater demand resulting from lower winter temperatures in the northern hemisphere has passed. The prices of other imported products are also expected to rise. This report forecasts an improvement in terms of trade (7,2 per cent) as a result of higher export prices (9,2 per cent) that are superior to the1,9 per cent price rise of imports.

Graph 31

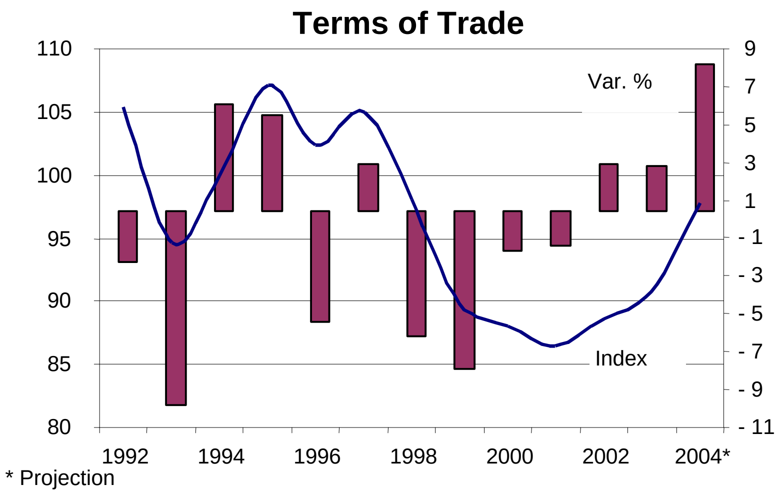
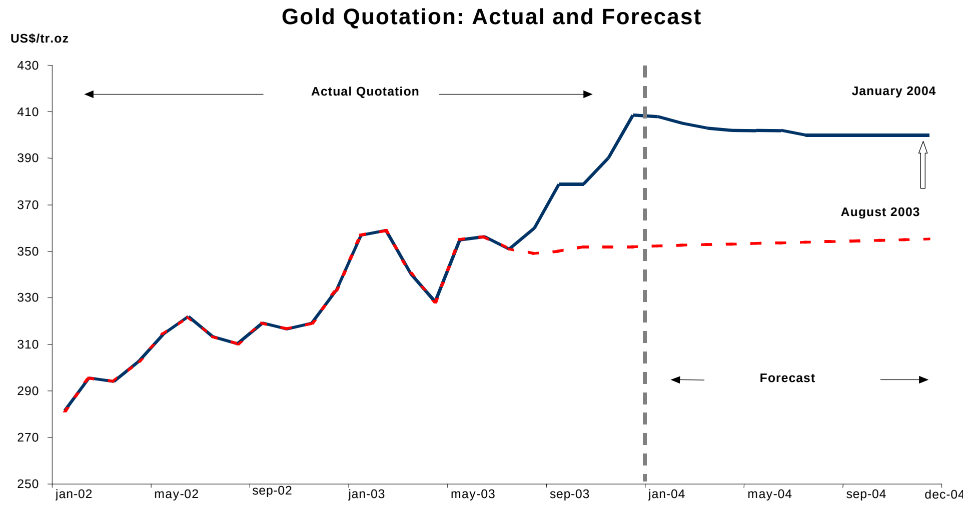


Chart 27

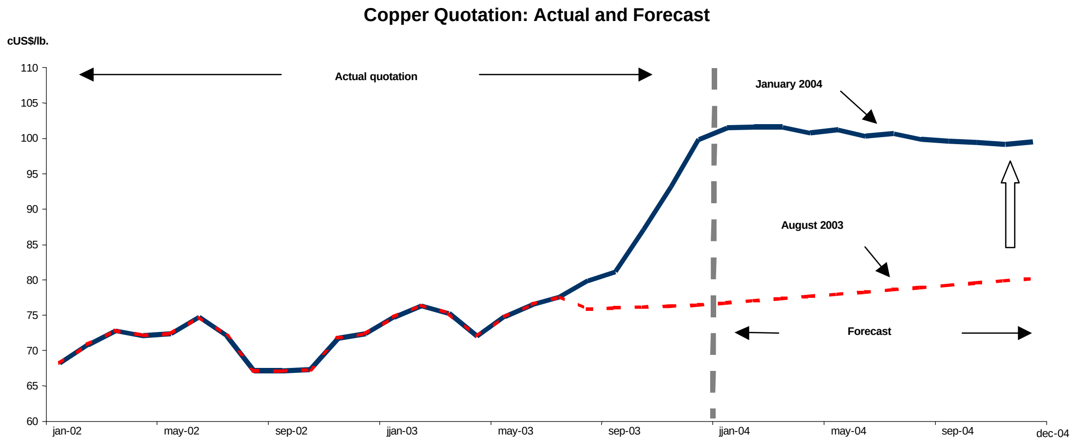
PROJECTION OF ANNUAL CHANGE IN TERMS OF TRADE

	Projections			
	August 2003		January 2004	
	2003	2004	2003	2004
TERMS OF TRADE	**-0,4**	**1,6**	**2,5**	**7,2**
Index of export prices	5,2	1,2	8,1	9,2
Index of import prices	5,7	-0,4	5,5	1,9

Graph 32

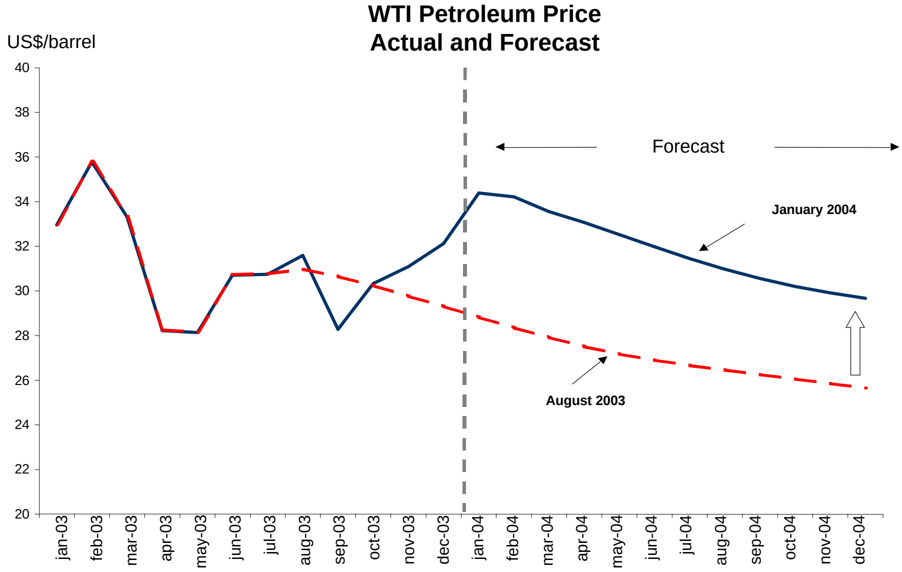


Graph 33



The price of petroleum surpassed forecasts made in August as a result of low inventory levels in the U.S., a cold winter and fear of a range of different attacks over the course of the year. As a result, the average WTI price reached in 2003 US$ 31,1 per barrel (an increase of 19,2 per cent), while the forecast made in the August report estimated the price to reach an average of US$ 30,9 per barrel (an increase of 18,4 per cent). It is expected that the average WTI price will drop from US$ 31,1 per barrel to US$ 29,7 per barrel in 2004.

Graph 34



Box 4

Terms of Trade and Activity Indicators

There are at least two transmission mechanisms through which terms of trade affect the GDP. The first mechanism highlights the impact that terms of trade have directly upon private and public investment levels. In the case of private investment, higher growth is reached through the reinvestment of profit - and in the case of public investment - through an increase in tax revenue. The second mechanism is based on the effects on consumption, whereas a temporary improvement on terms of trade generates a growth in disposable income greater than permanent income, which encourages agents to increase their consumption marginally. However, if the impact is perceived as being permanent, the increase in consumption will be more pronounced.

The association between terms of trade and the levels of activity is depicted in the following box, where the reader can appreciate that an increase in the terms of trade was accompanied by an increase in GDP in the years 1954, 1955, 1962, 1966, 1973-1974 and 1994-1995. Likewise, the reader can see that falls in terms of trade preceded a deceleration in the rhythm of growth of the GDP. It has been estimated that a 1.0 per cent increase in terms of trade will have a maximum impact of 0,2 per cent upon the GDP.

CENTRAL RESERVE BANK OF PERU

TERMS OF TRADE AND ACTIVE INDICATORS
(Real Percentage Variation)

	GDP	Terms of Trade	Domestic Demand	Private Consumption	Public Consumption	GFI Private	Public Investment
1951	9,4	7,6	12,8	9,2	2,9	34,2	5,8
1952	5,2	-13,0	5,0	1,9	11,3	8,0	123,8
1953	4,9	-14,1	4,9	4,2	2,0	11,3	-16,5
1954	6,1	3,9	3,9	7,7	18,6	-21,2	-21,7
1955	5,8	5,5	8,1	7,1	-0,1	3,9	119,1
1956	4,3	1,5	5,5	1,8	5,9	39,6	-20,9
1957	6,7	0,4	7,5	5,5	15,7	10,3	-16,8
1958	-0,7	-15,7	-2,3	0,3	-0,1	-14,3	2,8
1959	1,6	2,1	-1,7	1,0	12,0	-19,7	-33,9
1960	8,9	-2,7	7,8	4,6	17,5	9,1	-8,9
1961	8,4	-5,1	8,6	6,8	15,6	14,2	151,9
1962	9,2	4,5	10,1	10,4	5,1	19,7	-11,8
1963	5,4	5,4	7,1	9,9	5,8	-6,4	3,6
1964	6,2	2,0	6,2	6,1	12,5	-7,9	35,8
1965	6,7	2,1	8,5	7,6	6,8	16,8	29,4
1966	8,1	15,3	9,3	8,7	0,1	11,3	15,5
1967	4,4	-8,4	5,2	7,9	3,5	-6,3	-13,6
1968	0,4	-1,8	-2,2	1,0	6,4	-16,0	-11,5
1969	3,9	11,2	4,0	3,5	5,5	-0,9	19,0
1970	6,2	-2,3	6,3	6,1	5,0	9,2	20,1
1971	4,5	-11,9	5,5	3,6	6,9	11,8	15,5
1972	3,4	-7,8	2,2	3,2	6,6	1,8	8,7
1973	6,5	24,4	10,4	4,1	6,0	44,6	18,0
1974	8,8	10,3	11,7	6,8	6,0	16,3	57,0
1975	4,4	-9,5	3,4	4,1	11,1	-0,2	11,9
1976	1,2	-8,3	-1,1	1,8	4,8	-18,2	-5,7
1977	0,6	-5,5	-0,5	0,2	14,4	2,7	-26,7
1978	-3,8	-12,0	-8,2	-7,7	-12,7	-5,4	-17,2
1979	2,0	22,6	-0,2	-2,7	-8,5	8,2	14,1
1980	7,7	1,5	14,1	6,3	24,2	31,2	30,2
1981	5,5	-11,3	8,2	5,0	-1,9	18,1	24,5
1982	-0,3	-5,7	-1,3	-0,9	9,4	-7,0	3,6
1983	-9,3	6,1	-11,3	-2,5	-8,2	-38,6	-12,0
1984	3,8	-4,8	0,8	3,9	-6,6	-6,9	0,8
1985	2,1	-5,1	0,1	2,9	4,4	-11,4	-19,2
1986	12,1	-13,1	16,4	15,2	8,0	38,8	-4,6
1987	7,7	-0,1	9,2	6,9	5,7	26,8	-4,8
1988	-9,4	4,9	-9,7	-8,3	-15,8	-9,0	-32,0
1989	-13,4	-6,5	-16,7	-15,3	-19,1	-21,5	15,6
1990	-5,1	-9,2	-2,6	-2,3	-10,2	13,0	-26,7
1991	2,2	-4,5	3,5	3,4	2,0	-0,2	8,5
1992	-0,4	-2,5	0,2	-0,3	2,8	-4,0	20,0
1993	4,8	-7,3	4,8	3,4	3,1	9,1	17,4
1994	12,8	7,8	14,0	9,8	8,7	39,4	17,7
1995	8,6	4,3	11,8	9,7	8,5	27,4	3,1
1996	2,5	-4,2	1,3	3,1	4,4	-2,2	-5,7
1997	6,8	5,5	7,0	4,5	7,6	16,0	12,2
1998	-0,6	-13,5	-0,9	-0,9	2,5	-2,4	2,9
1999	0,9	-5,9	-3,1	-0,4	3,5	-15,2	6,2
2000	2,8	-0,5	2,2	3,5	3,1	-2,0	-14,9
2001	0,3	-2,7	-0,5	1,4	0,1	-4,5	-22,9
2002	4,9	1,1	4,1	4,5	1,6	0,2	-5,0

Events of product expansion above 6% and an improvement in exchange terms.
Events of product fall and deterioration in exchange terms.

Trade balance

53. After taking into account the above developments in the terms of trade and the world economy, the trade balance in 2004 is expected to record a surplus for the third consecutive year and might reach US$ 1 758 million.

Chart 28

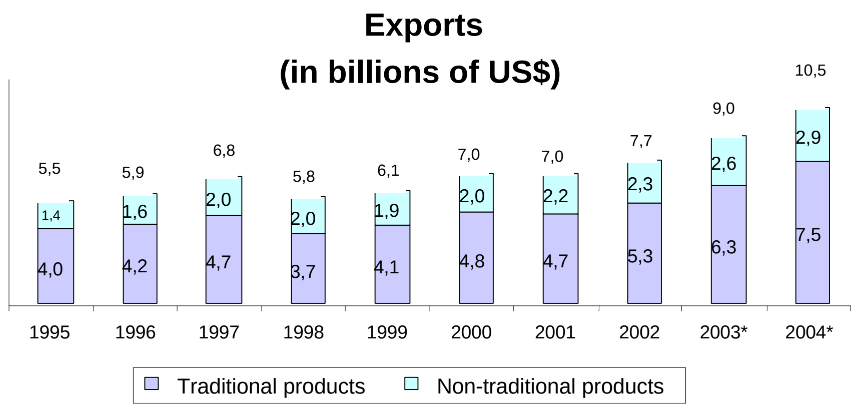
TRADE BALANCE
(Millions of US$)

	2002	2003 *	2004 *	Var. % 2003 *	Var. % 2004 *
1. EXPORTS	**7 647**	**8 954**	**10 491**	**17,1**	**17,2**
Traditional exports	5 312	6 281	7 524	18,2	19,8
Non-traditional products	2 260	2 596	2 885	14,9	11,2
Other	75	78	81	3,9	4,7
2. IMPORTS	**7 440**	**8 244**	**8 733**	**10,8**	**5,9**
Consumer goods	1 770	1 850	1 996	4,5	7,9
Raw materials and Intermediate Goods	3 747	4 337	4 425	15,7	2,0
Capital Goods	1 843	1 982	2 205	7,6	11,2
Other goods	80	75	107	-6,1	41,7
3. TRADE BALANCE	**207**	**710**	**1 758**		

* Forecast

54. Exports are projected to grow at a rate of 17 per cent, due to the greater volumes and prices of exported minerals - especially copper, gold, fish meal and zinc -and increased sale of apparel thanks to the Andean Trade Preference and Drug Eradication Act (ATPDEA). In 2004, total exports could reach a level of US$ 10 491 million, due in part to traditional exports that could reach US$ 7 524 million (20 per cent) and to the export of non-traditional goods, which are estimated at US$ 2 885 million (11 per cent). The greatest growth could be in copper sales, expected to reach US$ 418 million, driven in part by higher prices and the increased production due to the re-opening of the Tintaya sulfide plant. Gold might reach US$ 231 million, again a result of higher international market prices, and zinc might reach US$ 199 million, due to the recuperation of Volcan mining company. Finally, fish meal exports are expected to benefit from the recuperation of the marine biomass and might reach US$ 112 million.

Graph 35

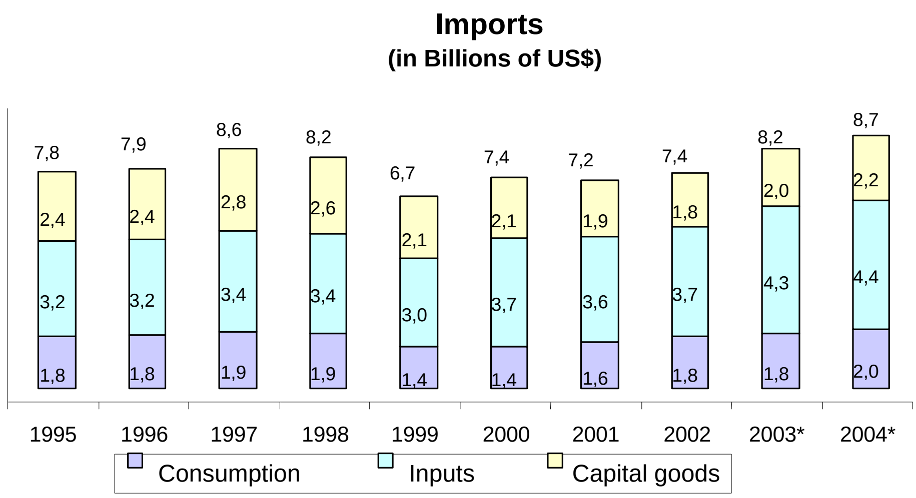


Note: Total of exports includes the heading other exports

***** Forecast

A 6 per cent growth rate is expected in imports in 2004 (4,5 per cent in real terms in imports of goods and services), compatible with the 4 per cent GDP growth and the recuperation of private investment and consumption. Foreign purchases could reach US$ 8 733 million, impelled by the imports of capital goods and raw materials for industry (11 per cent in both cases), and partially offset by reduced fuel acquisitions (18 per cent). This decrease is due to increased domestic supply as the Camisea project begins to produce in the second half of the year and by the lower prices forecast for crude oil.

Graph 36

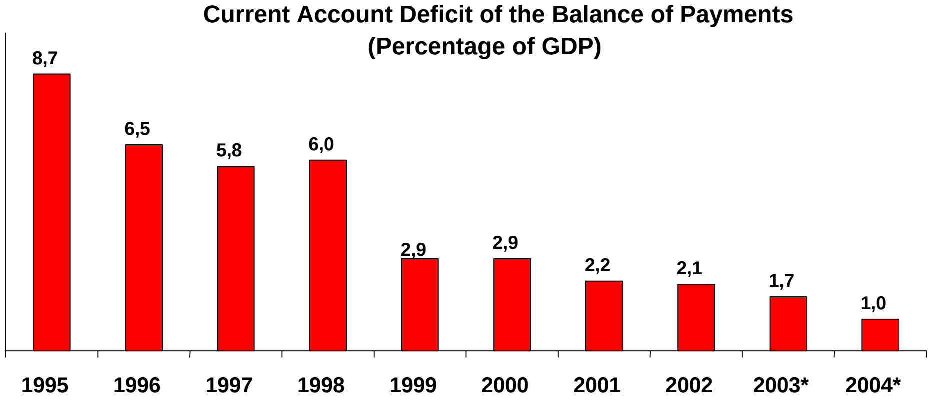


Note: Total of imports includes the heading other imports
***** Forecast

Current account of the balance of payment and capital flows

55. A US$ 623 million deficit is projected for 2004 in the current account balance of payments. This amount is equal to 1,0 per cent of the GDP. This is less than last year, due to an estimated improvement in terms of trade.

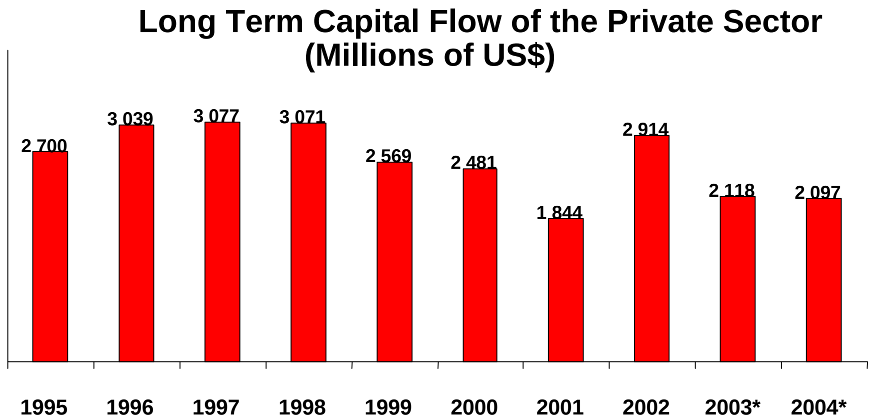
Graph 37



* Forecast

The financial account forecast shows gross private long-term expenditures of US$ 2 100 million, as well as an important flow of investment in the exterior by financial institutions (US$ 836 million). Outstanding private capital flows are the Alto Chicama project, with a US$ 100 million contribution, and the Camisea project phases II, and I, which account for a US$ 732 million contribution. Public sources could contribute a net US$ 448 million. International reserves are expected to increase US$ 300 million this year.

Graph 38



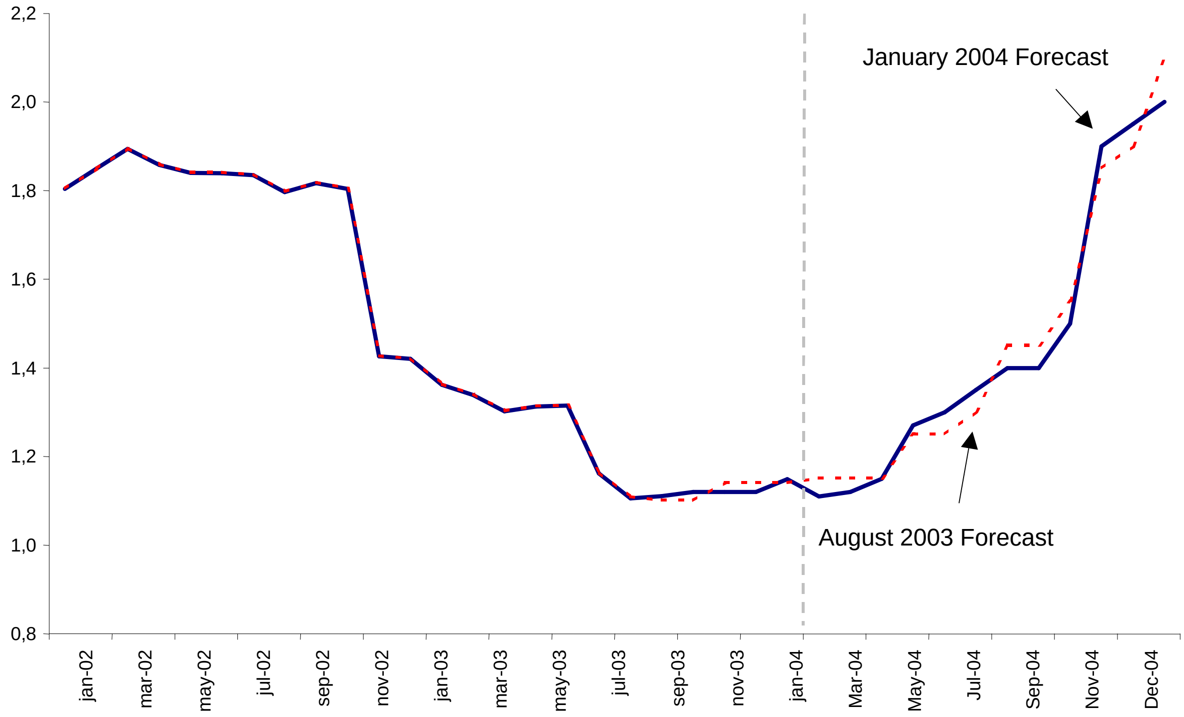
* Forecast
1/ Includes direct foreign investment plus long-term expenditures

International interest rates

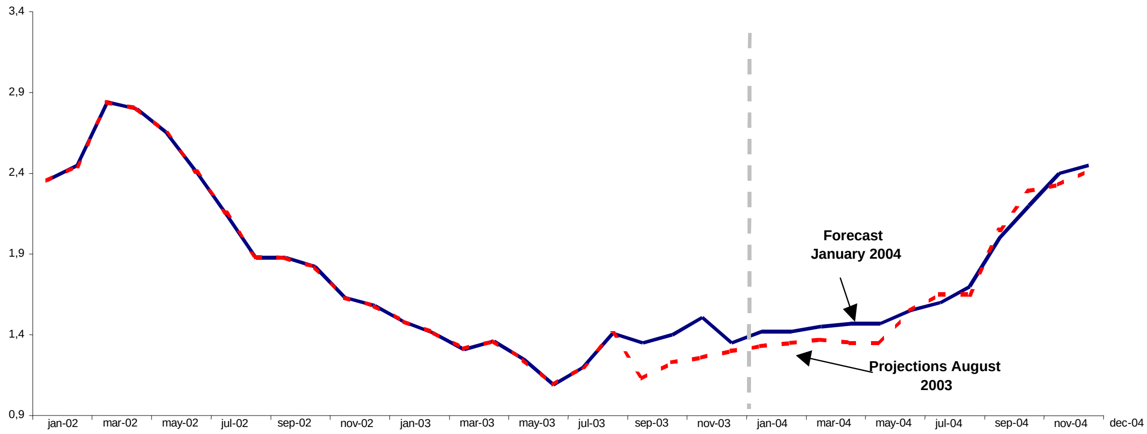
56. The LIBOR interest rate dropped from 1,38 per cent to 1,15 per cent between December 2002 and December 2003. This trend was established as the principal central banks reduced their rates (in June the FED reduced their policy rate from 1,25 to 1,0 per cent, while the Central European Bank (CEB) lowered their policy rate from 2,5 per cent to 2,0 per cent). The LIBOR is expected to begin to rise in the second semester of 2004, in line with expectations of growth in the global economy and a forecast rise in FED rates.

Graph 39

LIBOR at 1 month: Actual and Forecast



Libor for 12 months: Actual and Forecast



Box 5

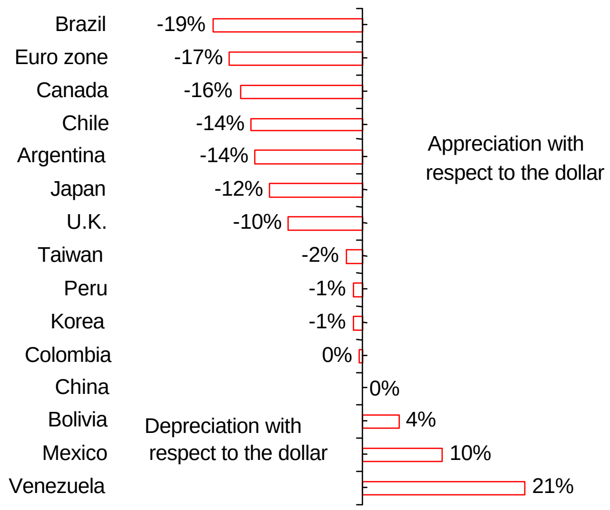
Weakening of the Dollar

The US Dollar depreciated against the strongest world currencies (Euro and Yen) as well as against the majority of other currencies in 2003. The 17 per cent depreciation against the Euro brought it to historic lows. This depreciation is likely due in part to interest rate differentials as well as the concern about financing the fiscal and current account deficits in the USA. The Dollar dropped 12 per cent against the Yen in spite of strong intervention by the Bank of Japan to reduce the impact on their export sector. Regionally, the Brazilian Real had the strongest showing against the dollar, registering a 19 per cent appreciation. Only the currencies in Venezuela, Mexico and Bolivia depreciated with respect to the Dollar. It is worth noting that the depreciatory pressure of the Dollar in international markets was partially compensated by the demand of American Treasury bonds on the part of foreign governments and institutions, in particular certain central banks in Asia.

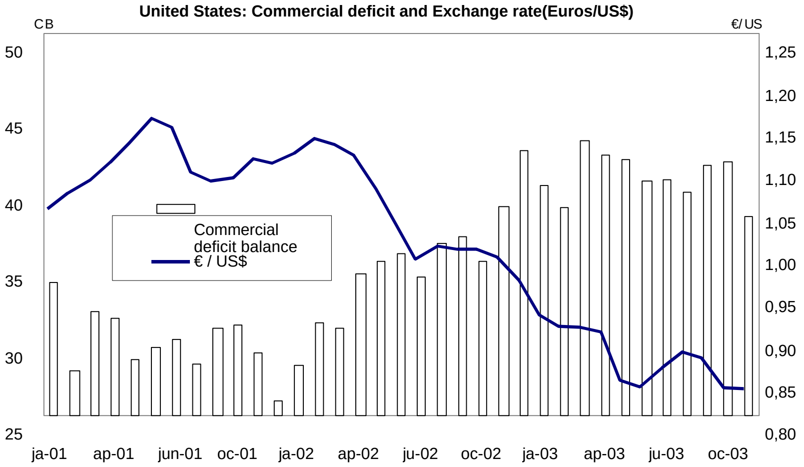
Exchange Rate: Monetary units in US$

Principle Trade Partners of Peru

Var. % Dec. 03 - Dec. 02



Source: Reuters, FMI

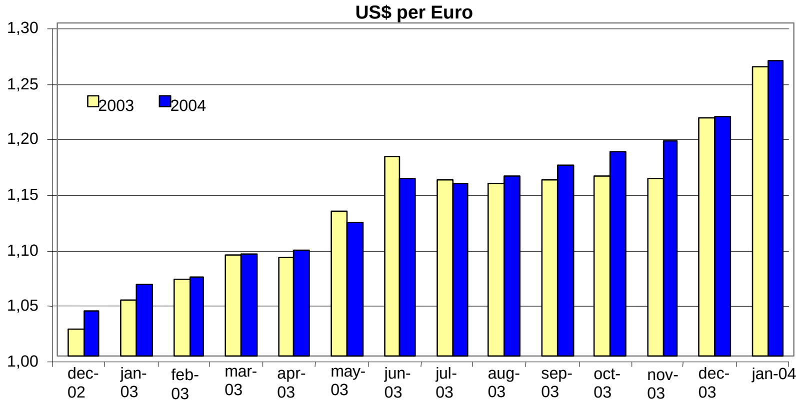


Source: FED of St. Lois

At the outset of 2004, the dollar has continued to fall against other currencies particularly the Euro - although according with futures contracts and to the Consensus Forecast, a significant depreciation is not expected for the rest of the year. Nevertheless, as long as there is uncertainty about the foreign and fiscal situation of the United States, outlook on the value of the dollar is uncertain. A possible flexibilitization of Asian exchange systems is also contributing to the uncertainty (China and Japan), as these countries might reduce their reserve deposits and to demand fewer Dollar-denominated titles, such as American Treasury bonds.

EVALUATION OF EXPECTATIONS OF THE EURO

US$ per Euro



Source: Consensus Forecast

II.4 Fiscal accounts

57. The non-financial public sector overall balance is expected to fall to 1,5 percent of GDP in 2004, according to the forecasts contained in the Multiannual Macroeconomic Framework 2004-2006. The primary balance would grow from 0,1 percent of GDP to 0,6 percent of GDP in 2004 mainly due to increasing fiscal revenues, which would grow 7,5 percent in real terms against a 3,4 real increase in non-financial expenditures.

Chart 29
NON-FINANCIAL PUBLIC SECTOR
(Millions of nuevos soles)

	2002	2003*	2004*
1. Current revenues of central government	**28 319**	**31 331**	**34 469**
(% of GDP)	*14,3*	*14,8*	*15,1*
Var. % real	*5,3*	*8,2*	*7,5*
2. Non-financial expenditure	**-29 030**	**-31 234**	**-33 057**
(% of GDP)	*-14,6*	*-14,7*	*-14,5*
Var. % real	*2,7*	*5,2*	*3,4*
3. Others	**197**	**123**	**30**
(% of GDP)	*0,1*	*0,1*	*0,0*
4. Primary balance	**- 514**	**220**	**1 443**
(% of GDP)	***-0,3***	***0,1***	***0,6***
5. Interests	**-4 148**	**-4 347**	**-4 904**
(% of GDP)	***-2,1***	***-2,1***	***-2,1***
Of which: external debt (Million de US$)	*-$1 002*	*-$1 080*	*-$1 218*
6. Overall balance	**-4 663**	**-4 126**	**-3 462**
(% of GDP)	***-2,3***	***-1,9***	***-1,5***
Mill. US$	***-$1 319***	***-$1 187***	***-$ 990***

* Forecast

58. The expected real growth in central government non-financial expenditures implies an increase of S/. 1 400 millions with respect of the amount approved in the Public Sector Budget Law for year 2004, S/. 300 millions of which correspond to a higher external indebtedness for investment projects.

59. The expected amount of central government current revenue is consistent with the primary balance target (0,6 percent of GDP) and the projected increase in real non-financial expenditures (3,4 percent). Therefore, central government current revenues would be equivalent to 15,1 percent of GDP.

60. The improvement in the overall fiscal balance would reduce non-financial public sector gross financial requirements from US$ 2 733 millions in 2003 to US$ 2 686 millions in 2004, which would be covered with new external debt by US$ 1 796 millions, including US$ 500 millions in sovereign bonds, US$ 450 millions in disbursements for investment projects and US$ 846 millions in free disposal disbursements from multilateral institutions. Likewise, the government would issue the equivalent to US$ 560 millions in domestic bonds denominated in local currency. It should be noted that US$ 500 millions of the sovereign bonds issued in the international capital market in late 2003 would be used to finance the 2004 budget.

Chart 30

FINANCING OF NON-FINANCIAL PUBLIC SECTOR
(Millions of US$)

	2002	2003*	2004*
1. Overall balance (millions of soles)	**-4 663**	**-4 126**	**-3 462**
(% of GDP)	***-2,3***	***-1,9***	***-1,5***
Mill. US$	***-$1 319***	***-$1 187***	***-$ 990***
2. Amortization (millions of US$)	**-$1 074**	**-$1 546**	**-$1 681**
Domestic	-$ 138	-$ 385	-$ 356
External	-$ 936	-$1 161	-$1 326
3. Gross financial requirements (millions of US$)	**$2 393**	**$2 733**	**$2 686**
External financing	*$1 960*	*$2 101*	*$1 796*
Free disposal of funds	*$1 609*	*$1 765*	*$1 346*
- Multilaterals	*$ 625*	*$ 519*	*$ 846*
- Bonds	*$ 984*	*$1 246*	*$ 500*
Investment projects	*$ 351*	*$ 336*	*$ 450*
Domestic bonds	*$ 213*	*$ 508*	*$ 560*
Privatization	*$ 421*	*$ 52*	*$ 20*
Others	*-$ 194*	*$ 72*	*$ 296*

* Forecast

III. BALANCE OF RISKS

61. The macroeconomic scenario described in this document is considered to be the most probable. Notwithstanding, the presence of different sources of uncertainty and risk could affect the central scenario of inflation projection in this Report. The risk factors in consideration are:

- **Appreciation of the Sol:** The fiscal and external weakness of the United States, and the improvement of our terms of trade, could further accentuate the devaluation of the dollar against other currencies, including the Nuevo Sol. Hence, a greater appreciation of the Nuevo Sol could cause the rate of inflation to fall. If faced with this, the BCR could adopt a more flexible stance in order to offset this effect and could also intervene in the exchange market to reduce the volatility of the exchange rate.

- **Less consumer confidence:** The central projection scenario contemplates a 4,0 per cent GDP growth, which presupposes that consumer confidence be maintained. If the expectations of consumers deteriorate, this might cause the inflation rate to fall, in which case the monetary policy could assume a more flexible stance.

- **Greater supply shocks:** The central scenario contemplates that the recent rise in prices is a temporary shock, including the rise in international food prices and local agricultural supply. This scenario forecasts continued high futures quotations for wheat and projects a drop in the second semester in the price of soybean oil. Rice production is also expected to fall due to reduced planting and shortages of water, which will result in higher prices.

  Nevertheless, there is a risk of increased inflation of imported food prices and of unstable weather conditions (rain) that could affect the central scenario projection.

  In this case, a temporary increase in the inflation rate is expected that should later move toward the target level, without the need for the Central Bank to modify its monetary policy. Nevertheless, if the price increases of foods should elevate the expectations of inflation during 2004 above the target and consequently affect the dynamic formation of prices in the economy , then the Central Bank stance could be tightened.

62. The scenario presented here could also benefit from the current international juncture:

    - A situation where prices of our principle export products may continue to rise, which could be accompanied by greater investment and would favor potential product growth and therefore favor long-term growth.

    Upon date of publication of this report, the risk balance considers that there is neither an upward nor a downward bias in the 2004 inflation projection.

CONCLUSIONS

63. This Report's inflation estimate falls close to the 2,5 per cent target. This projection assumes that the monetary policy stance is maintained during the projected period.

64. Although latest information indicates that the monetary policy stance need not to be modified, the Central Bank will remain watchful on most recent macroeconomic developments, that may alter the course of inflation, in order to take timely action.