INFLATION REPORT

March 2009

Recent trends and macroeconomic forecasts 2009-2010

CENTRAL RESERVE BANK OF PERU

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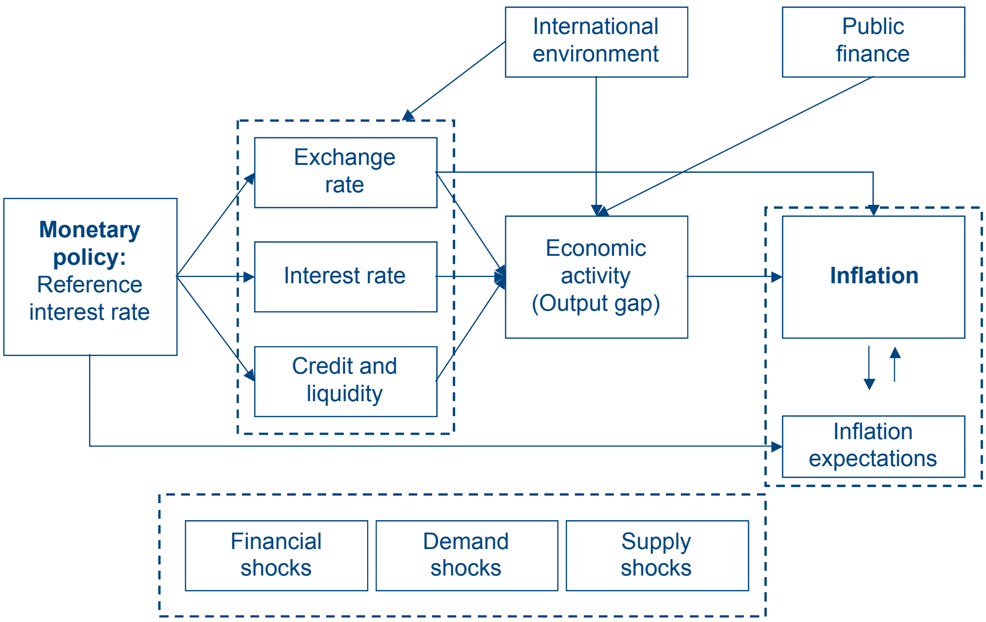

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INFLATION REPORT
Recent trends and macroeconomic forecast 2009-2010

Edition and Press Area
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CENTRAL RESERVE BANK OF PERU

CONTENTS

BOXES

This ***Inflation Report*** was drawn up using data on gross domestic product, balance of payments, and operations of the non-financial public sector as of December 2008, and data on inflation, exchange, financial markets, and monetary accounts as of February 2009.

Foreword

- According to the Peruvian Constitution, the Central Reserve Bank of Peru (BCRP) is a public autonomous entity whose role is to preserve monetary stability.

- Monetary stability is one of the basic conditions required to achieve high and sustained economic growth as it favors the appropriate environment for saving, investment, and every economic activity in general.

- In order to consolidate this goal, the Bank's monetary policy is based on an inflation targeting scheme, with an inflation target of 2.0 percent, plus or minus one percentage point (between 1.0 percent and 3.0 percent). The Central Bank's target is aimed at anchoring inflation expectations at the level of inflation in developed countries and reflects the BCRP's permanent commitment with monetary stability, independently of temporary shifts caused by factors beyond the control of monetary policy.

- Compliance with the inflation target is continuously evaluated; that is, the Central Bank considers the accumulated rate of inflation in each month and not only at year's end. In the event of any deviation of inflation from the target, the Central Bank implements the necessary measures to return inflation to the target considering monetary policy lags.

- Each month, and according to a previously announced schedule, the Board of the BCRP approves a reference rate for the interbank lending market. This interest rate affects the entire array of domestic economic variables and inflation through several channels in different timeframes and, therefore, this rate has to be determined on the basis of macroeconomic forecasts and simulations.

- The forecasts based on which monetary policy decisions are made are disseminated to generate the public's understanding of the consistency of the decisions adopted and to ensure that economic agents' expectations take these forecasts into account. The Central Bank also disseminates the studies analyzing the risk factors that may cause deviations in the forecasts of the economic variables considered.

- This Inflation Report analyzes the evolution of the main economic developments observed in 2008. The forecast scenario analyzed herein is consistent with monetary lags during the 2009-2010 macroeconomic horizon.

- As from this year, the Central Bank will publish its Inflation Report on a quarterly basis. Thus, the Inflation Report will be published in the months of March, June, September, and December.

Summary

i. The macroeconomic projections discussed in this Report have been influenced by the effects of the international financial crisis on the Peruvian economy. The forecasts on the evolution of the global economy indicate that economic activity would decelerate from a growth rate of 3.2 percent in 2008 to a nearly nil growth in 2009, with production dropping in the main industrialized countries.

ii. Considering the deterioration of conditions in the global economy, the forecast on the growth of gross domestic product (GDP) has been revised downwards from 6.5 to 5.0 percent for 2009 and from 7.0 to 6.0 percent for 2010. Thus, the Peruvian economy would go from the expansionary economic cycle observed in previous years to a neutral one in the 2009-2010 period. The economic recovery that would take place during this year and that would continue during next year is based on the following assumptions: (a) the implementation of the Economic Stimulus Plan announced by the government; (b) the convergence of firms' inventories to the desired levels; (c) appropriate levels of liquidity in soles and dollars in the financial system, and (d) the stabilization of the global economy.

iii. Inflation iniated a downward trend in December, declining from 6.7 percent to 5.5 percent in February, in a context of lower prices of fuels and food products with a high component of imported inputs. In line with this evolution, economic agents' expectations regarding inflation have begun to decline, although they still remain above the target. Conditions of domestic agricultural supply have not normalized yet, as a result of which some food items have continued showing significant rises in this period.

iv. The Central Bank has been loosening its monetary policy stance by reducing reserve requirements, as well as by reducing the reference interest rate since February. The latter has been reduced on two occasions, from 6.5 percent to 6.0 percent. The Bank's monetary policy communiqués have emphasized that the BCRP will continue to loosen its monetary stance as long as inflation and inflation expectations continue to show a downward trend.

v. Inflation is expected to continue converging towards the target in the rest of 2009 based on the following forecasts: a) the pace of growth of domestic demand would decelerate with a neutral economic cycle; b) lower levels of inflation would pass through to the domestic prices of inputs and end goods; c) inflation expectations should gradually return towards the target range; d) conditions of domestic agricultural supply should improve.

vi. To face increased upward volatility in exchange rate, the Central Bank intervened in the foreign exchange market selling dollars to reduce the volatility of exchange

and increase liquidity in foreign currency to restrain balance sheet risks. Since September, the BCRP sold foreign currency for a total of US $ 6.8 billion and placed Indexed Certificates of Deposits (BCRPCDR) for a total of US$ 3.9 billion. This policy response has been possible due to the preventive accumulation of international reserves carried out during the years of the boom of commodity prices. Under the current circumstances, this level of reserves allows the Peruvian economy to have a high capacity of response to face this type of adverse macroeconomic contingencies. Thus, at the close of February 2009, Peru's international reserves, which amount to US$ 29,412 million, are equivalent to 3.8 times the maturities of its short-term external liabilities.

vii. The fiscal surpluses of 1.1 and 0.9 percent estimated in our September Inflation Report for 2009 and 2010, respectively, have been revised to a deficit of 1 percent for each of these years. This forecast considers the lower revenues to be obtained due to the decline of the prices of commodities, as well as increased spending due to the Economic Stimulus Plan announced by the government. Saving accumulated during the period of economic expansion will allow the implementation of a counter cyclical policy through a fiscal impulse estimated at around 0.8 percent of GDP.

viii. The deficit in the current account of the balance of payments of 2008 showed a similar level to the one foreseen in our Inflation Report of September. This deficit has been revised upwards from 3.0 to 3.3 percent for both 2009 and 2010. This new forecast considers a less favorable international scenario that would affect both the volumes of exports and terms of trade. Lower global growth would also have an impact on the levels of remittances from Peruvians living abroad. This lower inflow of resources to the Peruvian economy would be in part compensated by the lower profits of foreign firms, which would remit less abroad in a scenario of lower international prices of minerals, as well as by a lower volume and lower prices of imports. The deceleration of domestic demand and the reduction of firms' inventories would account for the lower demand for imports.

Although a lower flow of direct foreign investment and lower long term external disbursements are expected for the following years –given the announced deferral of some investment projects–, the current account would continue to be financed by these long term private capitals.

ix. The main risks that could cause inflation to deviate from the forecast central scenario include the following:

- **Increased deterioration of the global economy**. The baseline scenario considers a deterioration of the global economy in 2009, as well as a scenario with an increased decline of terms of trade. Moreover, the probability of a more prolonged global recession than the one considered in the baseline scenario is considered to be higher. The risk of a greater global recession would entail lower economic growth and a lower rate of inflation than the one considered in the baseline scenario.

A more flexible monetary stance than the one considered in the baseline scenario would be adopted in this risk scenario.

- **Lower inflationary pressures due to lower domestic spending**. The baseline forecast scenario considers that the economy would grow 5 percent this year. On the domestic side, however, if delays were to occur in the execution of planned public expenditure or private investment were to decline further due to increased economic uncertainty, the rate of growth would be lower than the one forecast in this Report.

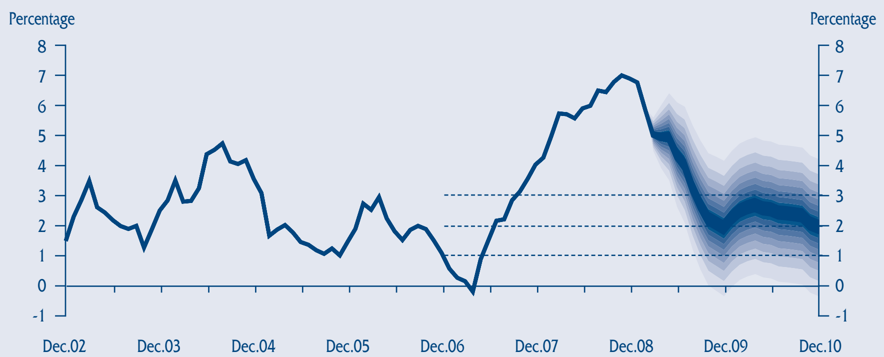
  In this situation, monetary policy would be more flexible and would operate in a more counter cyclical manner.

- **Constraints in the supply of electricity**. The supply of electricity is close to its potential capacity limit. Therefore, the risk that adverse climatic events may aggravate the fragile balance between the supply and the demand of electric energy has been considered, given that this could generate higher increases in electricity rates or the use of more costly alternative energy sources.

  This factor would not alter the monetary policy position as long as the inflationary impact does not affect inflation expectations.

x. In a context of high uncertainty about the evolution of the global economy, weighing the above mentioned risks against the baseline scenario shows a neutral balance for the inflation forecast.

INFLATION FORECAST
(12-month percentage change)

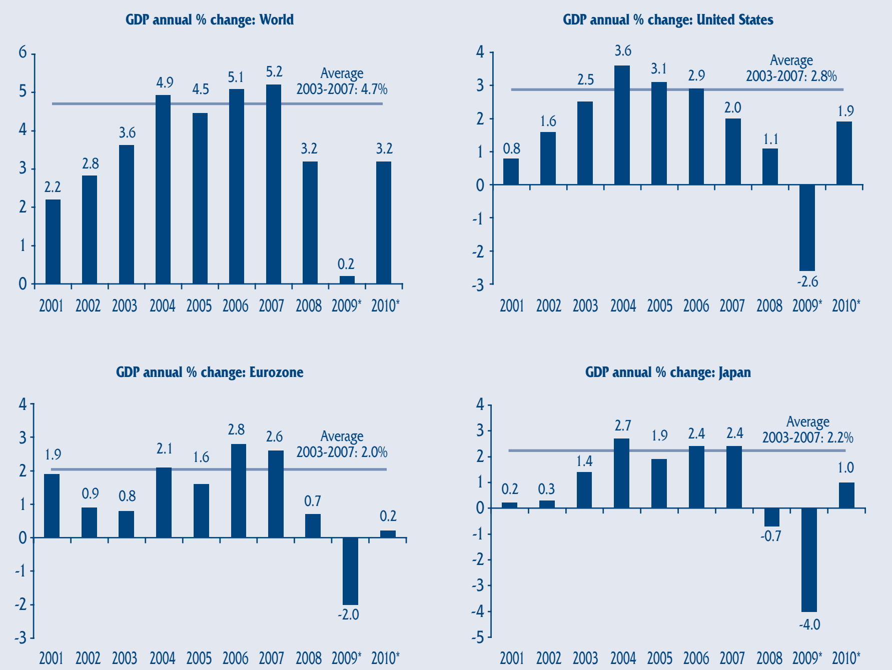


Note:
The graph shows the inflation prediction bands along the forecast horizon. The darkest band around the central forecast represents a 10 percent probability of occurrence while all the other bands represent a 90 percent probability of occurrence.

I. International environment

1. The deepening of the international financial crisis has been expressed in a global credit crunch, which has caused a higher decline in global economic activity, especially in developed countries. In 2009 GDP is expected to drop in USA (-2.6 percent), the countries of the Eurozone (-2.0 percent), and Japan (-4.0 percent).

Graph 1
WORLD ECONOMIC GROWTH

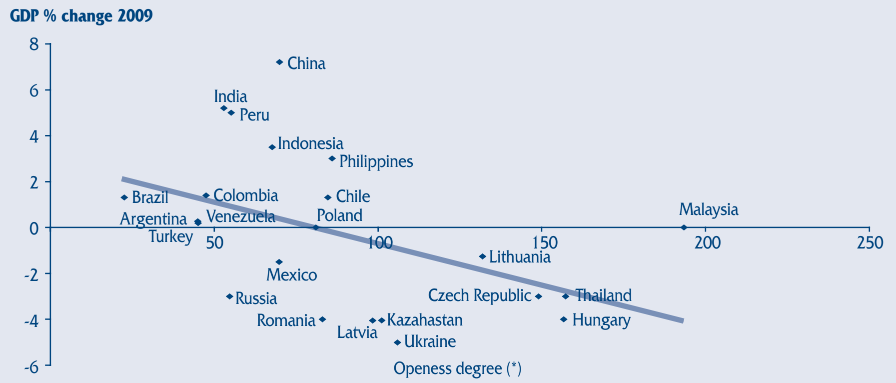


* Forecast.
Source: IMF, Consensus Forecast and investment banks.

2. The decline of international economic activity has also affected developing economies, particularly those whose growth is associated with exports of manufactured goods, which are being considerably affected by the reduction of international trade.

The degree of a country's share in international trade is measured through the index of openness to international trade, which is measured as the foreign trade (exports plus imports) to GDP ratio. Graph 2 shows the inverse relationship between the degree of openness and projected growth in several economies in the context of the current international recession.

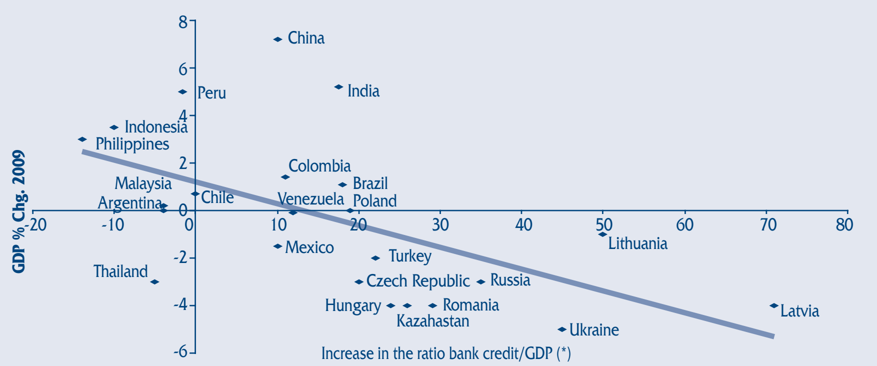
Graph 2
FORECAST GDP GROWTH FOR 2009 AND OPENESS DEGREE
(Developing countries)



(*) Exports + imports + services relative to GDP.
Source: Moody's, Consensus, UBS, JP Morgan, Deutsche Bank and BCRP.

3. A second way in which the financial crisis is affecting developing countries is through the lower access to external financing. The economies with higher deficits in the current account of the balance of payments show the highest declines in terms of economic activity, which reflects the effects of lower external financing. This factor is enhanced in the cases of countries where external financing contributed to a high expansion of domestic credit.

Graph 3
GDP AND DOMESTIC CREDIT
(Developing countries)



(*) 2008 relative to the average in 2000-2003.
Source: Consensus, UBS, JP Morgan, Deutsche Bank and BCRP.

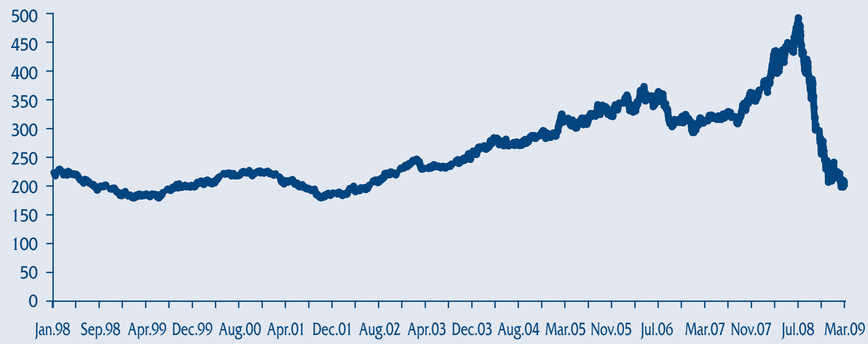
4. The drop of global growth has significantly deteriorated international trade. An indicator of the lower global trade observed is the Baltic Dry index, which fell 89 percent between September and December 2008, stabilizing thereafter in the first

months of 2009. The prices of primary products (commodities) were also severely affected, and showed a reduction of 41 percent in the same period, as reflected in Reuters' CRB index.

Graph 4
BALTIC INDEX

Source: Bloomberg.

Graph 5
REUTERS COMMODITY INDEX(CRB)



Source: Bloomberg.

The deterioration of developing countries' external accounts in a context of increased investments in hedge assets, particularly US Treasury bonds, has led investors to perceive greater risks in terms of the emerging debt. Although the reaction has been less abrupt than the one observed during the Russian crisis (1998-1999), the emerging debt spread increased 402 basis points between September and December 2008. These higher risk prime exert pressure on the possibilities of obtaining financing in the economies with higher fiscal deficits.

Graph 6
EMERGING MARKETS BOND INDEX - GLOBAL (EMBIG)

Source: Bloomberg.

As stated above, the trend of global portfolios of reducing their risk exposure has strengthened investments in dollars, especially in US Treasury bonds. This trend has been reflected in the depreciation of currencies against the dollar. Thus, between September and December 2008, the average index of the dollar's nominal exchange rate has increased 6 percent. Particularly, the dollar has strengthened 5 percent against the euro and 25 percent against the pound.

Graph 7
FED NOMINAL DOLLAR INDEX

Source: Bloomberg.

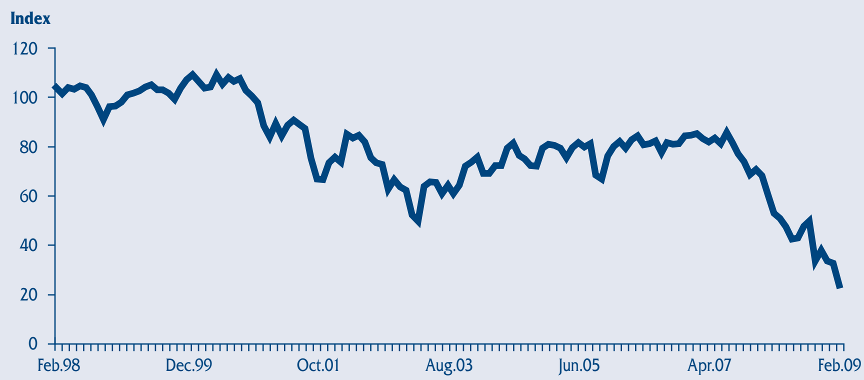
5. The last quarterly statistical data on GDP in the United States show variations of 0.7 and -0.8 percent in the third and fourth quarters of 2008 compared with the same periods in 2007. GDP is expected to fall 2.6 percent in 2009 –a drop not observed since 1982–. Economic activity would recover only in 2010, although showing a lower rate than that of the potential output, which would imply a high rate of unemployment.

TABLE 1
WORLD ECONOMIC GROWTH FORECAST *

	Weight	2008	2009		2010	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
Developed countries						
1. United States	21.3	1.1	0.1	-2.6	2.1	1.9
2. Eurozone	16.1	0.7	0.2	-2.0	0.9	0.2
3. Japan	6.6	-0.7	0.5	-4.0	1.5	1.0
4. United Kingdom	3.3	0.7	-0.2	-2.5	1.7	0.6
5. Canada	2.0	0.5	1.2	-1.0	2.4	1.9
6. Other developed countries	7.0	1.9	2.5	-2.4	3.2	2.2
Developing countries						
1. Africa	3.0	5.2	6.0	3.4	5.4	4.9
2. Central and Eastern Europe	4.0	3.2	3.4	-0.4	3.8	2.5
3. Community of Independent Countries	4.5	5.5	6.1	0.9	6.3	3.8
Russia	3.2	5.6	5.5	1.1	6.9	3.5
4. Developing Asia	20.1	7.5	8.1	5.5	7.8	6.7
China	10.8	9.1	9.0	7.3	9.0	8.3
5. Middle East	3.8	6.1	5.9	3.9	5.3	4.7
6. Latin America and the Caribbean	8.3	4.1	2.9	0.1	3.9	2.5
World Economy	**100.0**	**3.2**	**3.5**	**0.2**	**4.2**	**3.2**
Memo:						
Peru's trading partners		**2.9**	**2.2**	**-0.4**	**3.4**	**2.6**
BRICs		**7.4**	**7.3**	**4.8**	**7.6**	**6.2**

IR: Inflation Report.
Source: IMF. Consensus Forecast and investment banks.
* Weighted PPP 2007.

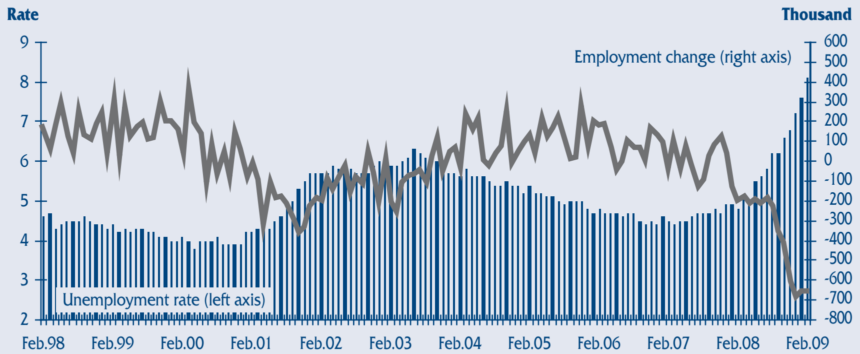
Graph 8
US: CONSUMER CONFIDENCE
(Base January 1998=100)



Source: Bloomberg.

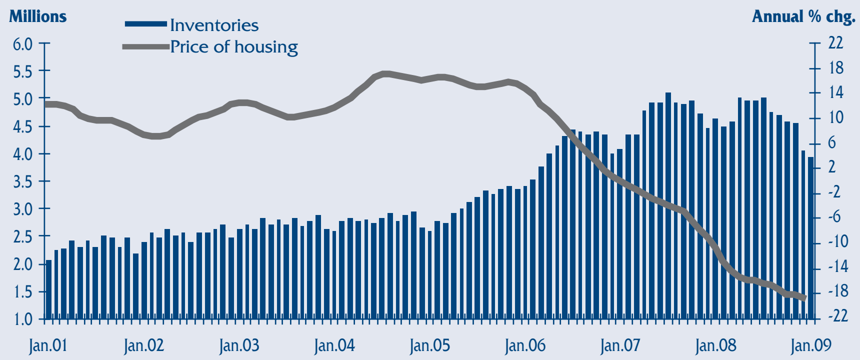
Private sector consumption –main component of GDP– would remain depressed due to the deterioration of consumer confidence, higher unemployment, and the credit crunch associated with the worsening of banks' equity. The weakness of the real estate market, expressed in declining prices and house auctions, continues affecting consumers and financial entities.

Graph 9
US: MONTHLY RATES OF EMPLOYMENT (CHG. EXPRESSED IN THOUSANDS) AND UNEMPLOYMENT (%)



Source: Bloomberg.

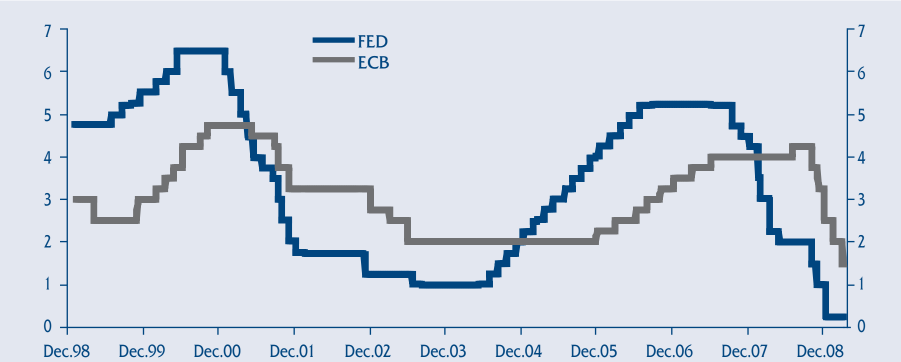
Graph 10
US: HOUSE PRICES AND INVENTORIES



Source: Bloomberg.

6. The seriousness of the economic situation in the United States has led the government to adopt unprecedented monetary and fiscal measures. The Federal Reserve (FED) continued lowering the benchmark reference rates to their historical low, reaching a range of between zero and 0.25 percent. Central banks in other industrialized countries have followed a similar path, including the European Central Bank (ECB), which has set its interest rate at 1.5 percent, and the Bank of England (BoE), with a rate of 0.5 percent.

Graph 11
FED AND ECB INTEREST RATES

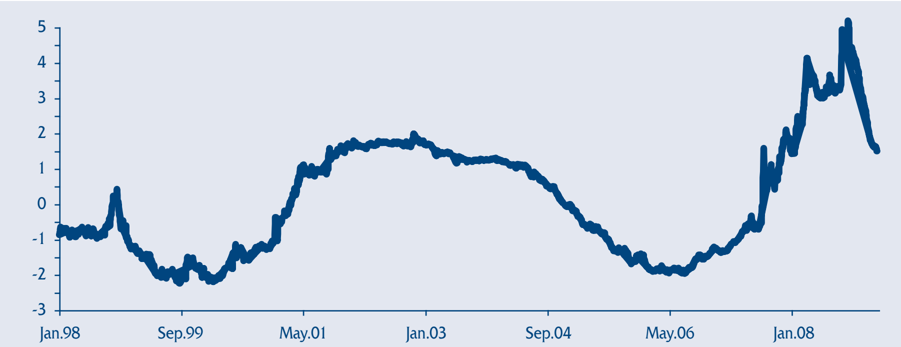


Source: Bloomberg.

In addition to cutting interest rates, the FED adopted other measures to improve the provision of liquidity in dollars in the local and international financial systems. At the local level, measures included enhancing the range of the collaterals accepted in injection operations and increasing the amounts and maturities for auctions; the creation of new instruments, such as the forwards for credit auctions, and options for credit facilities of Treasury securities. At the international level, the FED enhanced its swap operations in dollars with other central banks and included new participants in these operations, including the central banks of some emerging countries among them.

7. Some indicators show a relative stability in financial variables in the first two months of 2009, particularly in those indicating an improvement in short term liquidity conditions. Thus, the spread between the 3-month interbank Libor rate and the 3-month US Treasury bonds has returned to the levels recorded prior to September, which would seem to confirm the reduction of risk spread for intradaily operations. Likewise, the prices of raw materials would have already reached their minimum lows.

Graph 12
TED SPREAD: SPREAD BETWEEN THE LIBOR RATE AND THE YIELD ON THE 3-MONTH US TREASURY BOND



Source: Bloomberg.

8. However, credit conditions have not improved significantly. Credit spreads have remained high, reflecting the uncertainty that persists in the main markets.

   In this sense, the FED has implemented a series of measures in parallel to restore the credit market and reduce credit risks. First, guarantees were granted to bank debt issues and interbank operations, and the margin of the insurance fund for bank deposits was enhanced.

   Then, the FED was able to reactivate the market of commercial papers, the corporate sector's main source of financing, through new credit facilities. At present, the FED has generated other new credit facilities with the aim of restoring the market of mortgage loans, as well as the market of other derivative assets.

9. In the context of the financial rescue plan, the new administration in office in the United States has announced additional measures to the ones implemented by the previous administration. First, it has established the Financial Administration Fund, the entity responsible for managing the resources of the Troubled Asset Relief Program (TARP) –established under the former administration–, which will provide resources to financial institutions. Previously, with TARP funds (US$ 700 billion), the main way of providing banks with resources was through the issue of preference shares. Under the new entity, fund provision will be carried out basically through debt.

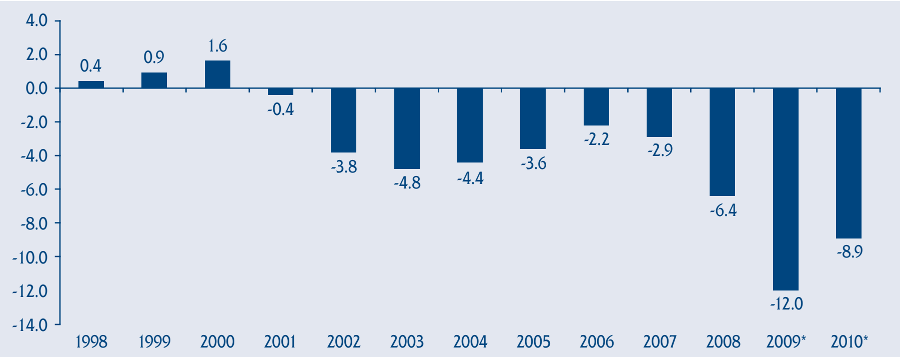
   Recently, in the presentation of the National Budget to Congress, the new administration announced an additional fund for the financial sector (amounting to up to US$ 750 billion, considering the US$ 250 billion initial fund for this year's budget), which has not been approved yet. The main regulating entities (the FED and the Treasury) have already given signals that it is quite likely that the financial sector will require greater resources than the ones provided by the TARP.

   In the second place, the establishment of a Private-Public Investment Fund for illiquid assets (of up to US$ 1 billón) was also announced, although this measure has not been detailed yet. Finally, the new administration announced the Homeowner Affordability and Stability Plan, which has been designed to help families avoid mortgage foreclosure and prevent higher pressures on home prices. This measure involves US$ 275 billion that will be used to refinance mortgages (through the GSEs) and to modify mortgage contracts to reduce debt services (interests and principal).

10. Additionally, the US fiscal policy has adopted a marked counter cyclical position, with emphasis in increasing public expenditure. The US$ 787 billion fiscal stimulus package includes higher spending in infrastructure and social welfare packages (over 65 percent of the total), as well as tax cuts.

11. The official projections on the cost of all the measures, including both the fiscal and financial measures, considering the scenario of economic recession this year would indicate an increase of the fiscal deficit of 6 percent of GDP in 2008 and of between 12 and 14 percent in 2009, as a result of which the balance of the public debt would represent over 80 percent of GDP. The weight of the public debt financial burden is offset by the low interest rate of US Treasuries, resulting in turn from the global flow of resources to investing in these securities due to risk aversion.

Graph 13
UNITED STATES: FISCAL OVERALL BALANCE
(Percentage of GDP)



* Source: IMF.

12. Similar measures in fiscal and monetary terms have been adopted in other economies, particularly in developed countries where economic activity will be also seriously affected. **European** countries face similar credit constraints, a correction of their real estate markets (United Kingdom, Spain, and Ireland) and a drop of their external demand (especially in Germany). With this unfavorable outlook, most economies have adopted fiscal packages that range –in most cases– between 1 and 2 percent of their respective GDP (the highest being that of Germany, which is equivalent to 2.6 percent of its GDP).

Japan recorded for the third consecutive quarter a contraction of growth (3.3 percent, the highest drop observed since 1974) in the fourth quarter of 2008, as a result of which economic activity would have contracted 0.7 percent in 2008. The strong decline of economic activity in Q4 is explained by the unfavorable evolution of net exports and investment (except for residential investment). A contraction of 4 percent is estimated for 2009.

As regards emerging economies, the four largest –known as BRICs (Brasil, Russia, India, and China)– showed an important deceleration. In the case of China, outstanding measures include the fiscal stimulus package –estimated at US$ 586 billion and equivalent to 14 percent of GDP– and the monetary measures implemented by the Central Bank, which are aimed at dynamizing domestic demand and at compensating lower external demand. Despite these measures, a deceleration is expected in the rate of GDP growth for 2009 and 2010.

13. The IMF considers that the optimal fiscal package to face the current crisis has to be timely (immediate implementation), broad (given the magnitude of the crisis), long-lasting (since the crisis will extend for several other quarters), diversified (given the uncertain effectiveness of the measures), collectively implemented (since the contribution of several countries is required), and sustainable (so as to not generate subsequent problems). Moreover, greater emphasis should be given to public expenditure measures since they directly increase consumers' and firms purchasing power in the economy.

BOX 1
USA: MEASURES TO FACE THE FINANCIAL CRISIS

Measures to ensure the solvency of financial institutions and reverse deleveraging:

1. New capital injections into financial entities:

a) Establishment of the "Financial Stability Trust", entity that would operate through a new modality of Treasury loans with funds from the Troubled Asset Relief Program (TARP). This measure is aimed at promoting that banks seek private financing sources. Already implemented Treasury investments in banks will be transferred to this new entity.

b) Implementation of "comprehensive stress tests" to identify the vulnerabilities of bank assets and provide banks with the necessary funds. This test would be mandatory for banks with assets of over US$ 100 billion (19 banks affected).

2. Withdrawal of toxic assets from banks' balances:

a) Establish a Private-Public Investment Fund for illiquid assets of up to US$ 1 trillion with the support of the FED, the Federal Deposit Insurance Corporation (FDIC), and the private sector using both private and public funds. The program would start with US$ 500 billion and would be expanded as required.

b) The private sector (co-investor) will determine the prices of illiquid assets.

c) The FDIC will guarantee the value of toxic assets to limit investors' losses.

Measures to restore the credit and credit derivatives market:

1. **Mortgage-backed Securities (MBS).** The FED would buy mortgages and derivatives for up to US$ 600 billion.

2. **Credit derivatives market:** The FED credit facility will be expanded to finance new issues of backed securities, increasing credit assets from US$ 200 billion (amount established in November) to US$ 1 trillion (in February). The purpose of this facility is to restore the security market, which is vital for consumer and business loans. This facility would finance the purchases of AAA securities associated with consumer and business loans, car loans, credit cards, student loans, Commercial Mortgage-Backed Securities mortgages, private Residential Mortgage-Backed Security mortgages, and in some cases, with leasing of equipments. This facility should start operating on March 25.

3. The Small Business Administration will be provided with new powers to grant loans to small businesses.

Measures to prevent mortgage foreclosures: Home Owner Affordability and Stability Plan:

1. Program that would potentially benefit up to 9 million homeowner as it will allow the refinancing of traditional mortgages –created by the Government Sponsored Enterprises (GSEs)– and the modification of non-traditional mortgage contracts (i.e. subprime) established by other financial entities.

2. The purpose of the program is to reduce payments of mortgage service (for troubled homeowners) and to prevent a drastic adjustment in real estate prices that could represent a stronger deepening of the financial crisis.

3. The program resources would include US$ 75 billion (to modify contracts) and US$ 200 billion for the re-capitalization of GSEs.

II. Economic activity

14. GDP maintained a high pace of growth during 2008 mainly due to the dynamism of domestic demand, particularly the evolution of private and public investment. Thus, while domestic demand grew 12.3 percent, private investment grew 25.6 percent and public investment grew 41.9 percent.

    A situation in which the growth of domestic demand would be higher than the dynamism of exports as determinating factor of the growth of GDP would still be observed in 2009. However, the pace of growth would be lower than that of last year basically due to a lower increase of private investment (8 percent) and private consumption (5.5 percent), although this would be slightly compensated by a high dynamism of public investment (51.1 percent).

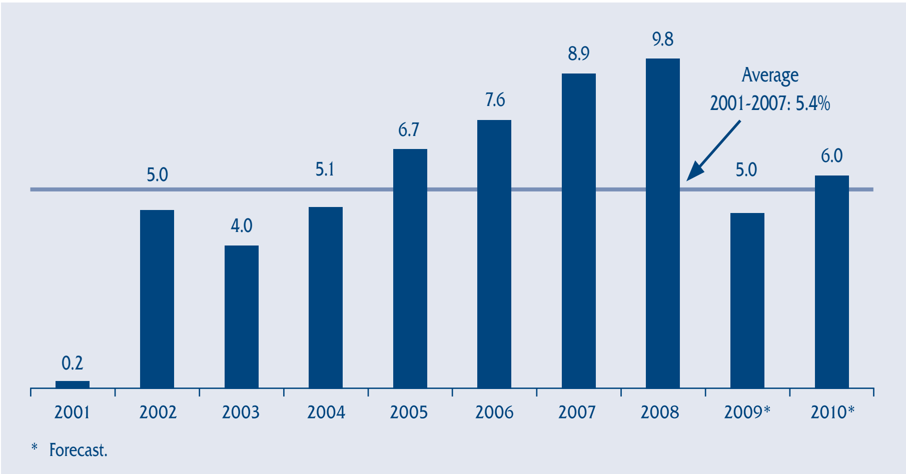
    Private investment would be mainly affected by the mining component, given the current scenario of lower prices for raw materials. Public investment, on the other hand, would be significantly boosted by a fiscal policy oriented to stimulating productive activity.

TABLE 2
DOMESTIC DEMAND AND GDP
(Real percentage change)

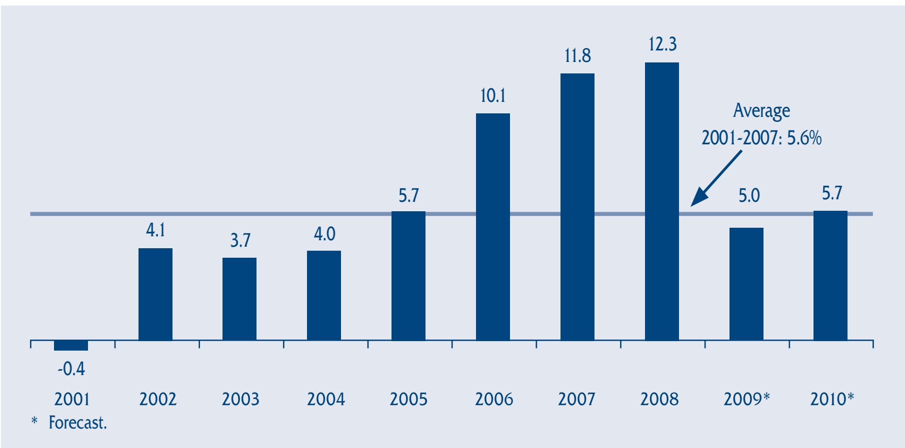
	2007	2008	2009*		2010*	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
1. Domestic demand	**11.8**	**12.3**	**7.1**	**5.0**	**7.1**	**5.7**
a. Private consumption	8.3	8.8	6.3	5.5	5.2	5.2
b. Public consumption	4.5	4.0	3.0	2.6	3.8	4.5
c. Private investment	23.4	25.6	12.5	8.0	10.3	8.0
d. Public investment	18.4	41.9	26.3	51.1	20.0	13.2
2. Exports	**6.2**	**8.2**	**6.2**	**1.9**	**10.0**	**6.6**
3. Imports	**21.3**	**19.9**	**9.0**	**2.1**	**9.8**	**5.1**
4. GDP	**8.9**	**9.8**	**6.5**	**5.0**	**7.0**	**6.0**

IR: Inflation report.
* Forecast.

Graph 14
GDP GROWTH RATE
(Annual percentage change)



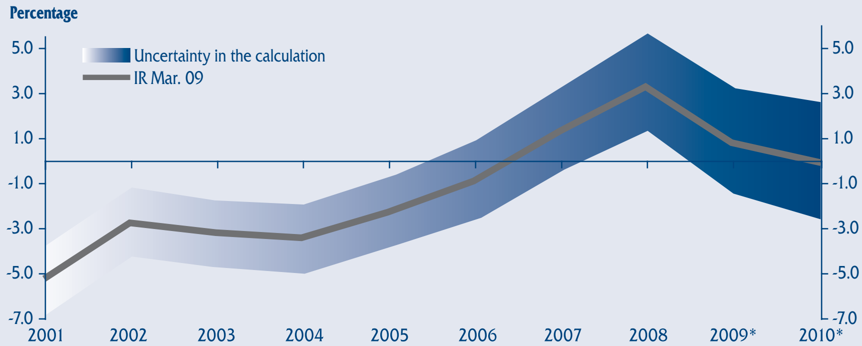
Graph 15
DOMESTIC DEMAND GROWTH RATE
(Annual percentage change)



15. The average pace of growth of GDP in 2009 and 2010 would remain below the growth of the potential output, which is estimated to grow in the range of 6-7 percent.

The difference between the GDP and the potential GDP is called the output gap and is an indicator of the economic cycle and of demand inflationary or deflationary pressures. The economy is projected to go from the expansionary cycle observed in recent years to a neutral economic cycle.

Graph 16
OUTPUT GAP
(Percentage of the potential GDP)



* Forecast.

Note: GDP gap estimated with information as of February 2009. The shadowed area represents existing uncertainty in the calculation and forecast of the output gap plus/minus one standard deviation.

16. After recording a growth of 8.8 percent in 2008, private consumption would continue growing although at a lower rate. Thus, private consumption is expected to grow 5.5 percent in 2009 and 5.2 percent in 2010. The factors determining the dynamism of private consumption would include the growth of national disposable income, the increase of employment nationawide, and access to credit.

    In contrast with the concept of GDP, the national disposable income also considers the effect of international prices and remittances from Peruvians residing abroad. In addition, it deducts the profits generated by foreign investments, which provides a more accurate indicator on the economic transactions generating incomes for the country. After growing 8.3 percent in 2008, the national disposable income would show a lower rate of growth this year (5.8 percent) due to lower terms of trade and to a lower pace of growth of remittances from Peruvians living abroad.

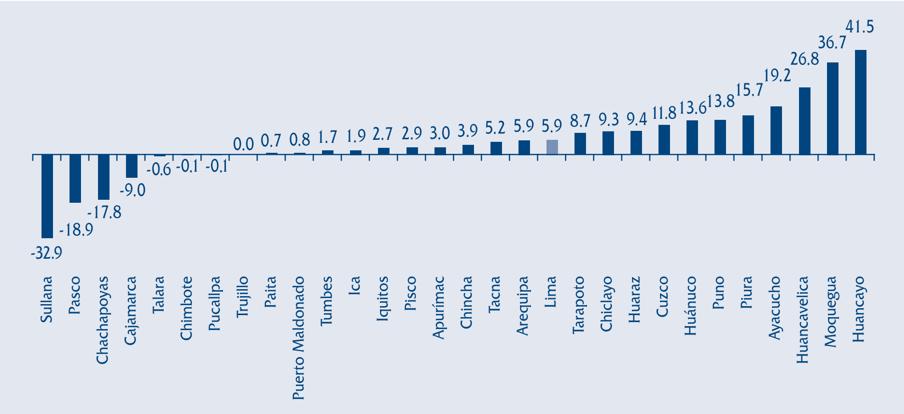
TABLE 3
NATIONAL DISPOSABLE INCOME
(Real percentage change)

	2007	2008	2009*		2010*	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
1. GDP	8.9	9.8	6.5	5.0	7.0	6.0
2. Gross national product	9.3	12.1	10.1	9.1	7.5	5.3
3. Gross national income	9.9	8.5	7.8	5.9	7.2	5.7
4. National disposable income[1/]	**9.8**	**8.3**	**7.6**	**5.8**	**7.1**	**5.6**

IR: Inflation report.
* Forecast.
1/ Includes factor income, net gains and losses due to changes in terms of trade, and net transfers to non-residents.

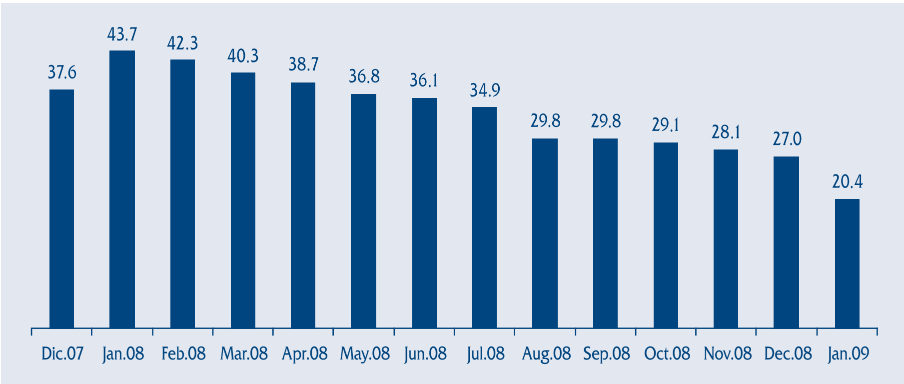
Employment in urban areas continues to grow at a higher rate than the rate of growth of the labor force. In January it grew 5.9 percent on average, showing 2-digit growth rates in eight cities.

Graph 17
GROWTH OF EMPLOYMENT BY CITIES (PERCENTAGE CHANGE)
January 2009 / January 2008



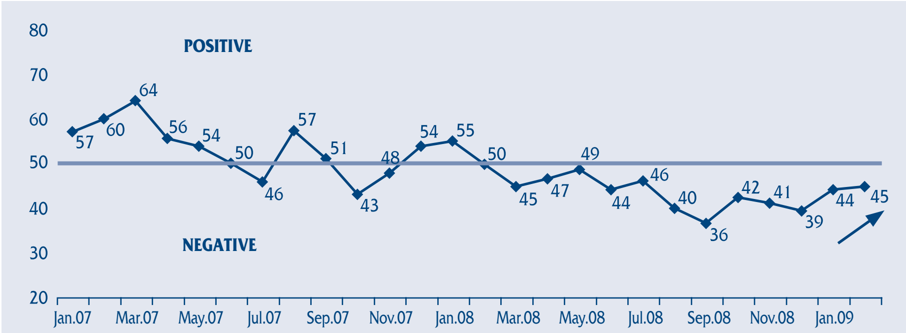
Credit for consumption grew 27.0 percent in 2008 and maintains a 20.4 percent growth rate at January 2009 compared with the same month last year.

Graph 18
CONSUMER CREDIT
(Annual percentage change)



The consumer confidence index, which has fallen in the pessimistic area (below 50 points) as from March 2008, confirms the evolution of consumer credit. However, consumer confidence has started to reverse this negative trend as from January this year, recording 45 points in February.

Graph 19
CONSUMER CONFIDENCE INDEX
Family Economic Situation

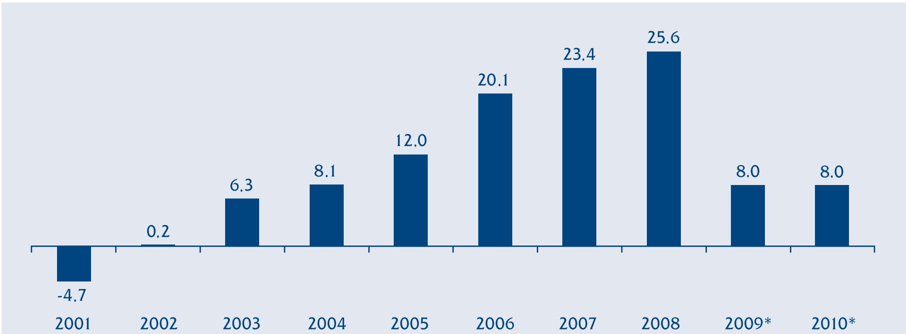


Source: Ipsos APOYO Opinión y Mercado.

17. During 2008, **private sector investment** showed an important dynamism, reaching a growth rate of 25.6 percent. An accumulation of capital was observed mainly in the sectors associated with mining and hydrocarbon exports, as well as in the items oriented to production for the local market.

    The negative impact of the international crisis on export sectors would reduce the drive of private investment and therefore, it is projected to grow 8 percent in 2009 and 2010.

Graph 20
GROWTH OF PRIVATE INVESTMENT
(Real percentage change)



* Forecast.

18. Despite the deterioration of the international context, investment projects are still being implemented. For example, in the mining sector, Shougang Hierro Perú will expand its production capacity by 10 million tons per year with an investment of US$ 1 billion which is expected to be operating at end 2010. Vale confirmed that it will invest US$ 279 million in Bayovar phosphate project during 2009, which includes the construction of a concentrating plant with an annual production capacity of 3.9 million tons that should start operations in 2010.

Dubai Ports World Callao will invest US$ 250 million in the construction of the South Pier this year, as a result of which it will have the capacity to mobilize 450 thousand 20-feet containers since July 2010. Red de Energía del Perú will continue with the construction of the Machu Picchu-Cotaruse and Chilca-Zapallal transmission lines with an investment of US$ 200 million in 2009. In the commerce sector, Malls Perú will build two commercial centers –one in Lima and another one in Piura– with a total investment of US$ 120 million. These projects should be completed by end 2009.

TABLE 4
MAIN INVESTMENT PROJECTS [1/]
(Millions of US$)

Sector	2008	2009	2010	Total
Mining and Hydrocarbons	1,411	2,898	4,493	8,802
Electricity	457	819	641	1,917
Transport and Telecommunications	811	1,714	1,925	4,450
Industry	1,570	817	1,361	3,748
Other Sectors	1,243	668	388	2,299
Total	**5,492**	**6,916**	**8,808**	**21,216**

1/ Flows of the main investment projects confirmed during the period.
Source: Daily reports and specialized media.

19. The business confidence index has fallen in the pessimistic area (below 50 points) since October 2008, recording its lowest level in December 2008 with 32 points. However, business confidence has started to reverse this negative trend recording 38 points in February. Moreover, private sector macroeconomic projections consider similar rates of growth of GDP to the ones estimated herein for 2009 and 2010: 5 percent and 5.5-6.0 percent, respectively.

Graph 21
BUSINESS CONFIDENCE INDEX
Economic situation

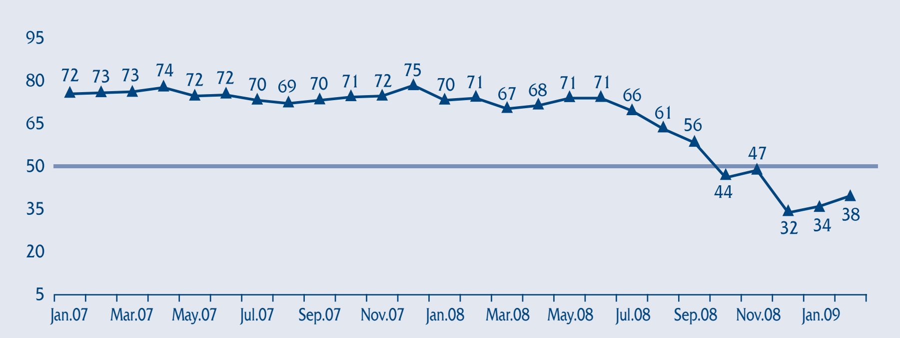
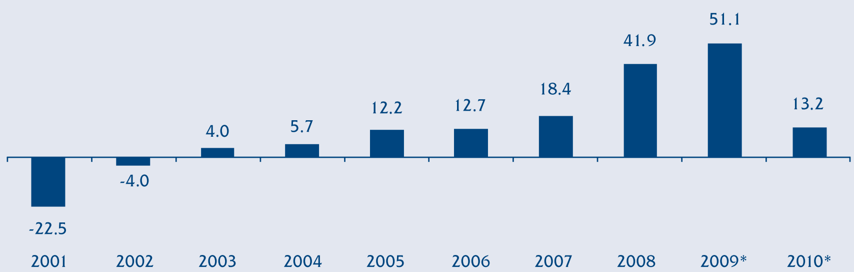


TABLE 5
SURVEY ON MACROECONOMIC EXPECTATIONS: GDP GROWTH
(Percentage)

	Survey carried out to:		
	IR May.08	**IR Sep.08**	**IR Mar.09**
FINANCIAL INSTITUTIONS			
2009	7.0	7.0	5.0
2010	6.5	6.5	5.5
ECONOMIC ANALYSTS			
2009	6.6	7.0	5.0
2010	6.5	7.0	5.5
NON-FINANCIAL BUSINESSES			
2009	7.0	7.2	5.0
2010	7.0	7.0	6.0

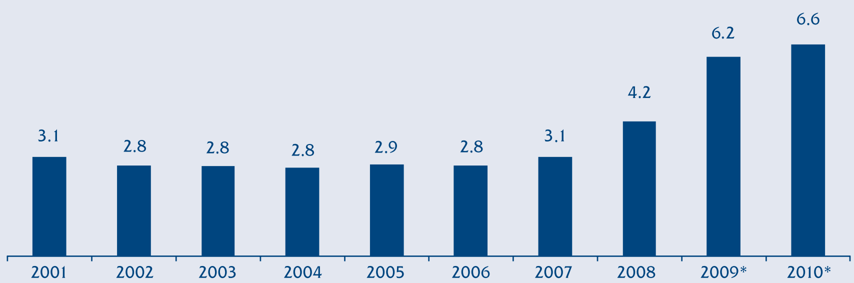
20. During 2008 **public investment** grew 42 percent, driven mainly by sub-national governments' expenditure. Public investment would grow 51 percent in 2009 and 13 percent in 2010. The flow of public investment in 2009 would be explained by local governments (41 percent), the national government (33 percent), regional governments (18 percent), and public enterprises (8 percent).

Graph 22
GROWTH OF PUBLIC INVESTMENT
(Real percentage change)



* Forecast.

Graph 23
PUBLIC INVESTMENT
(Percentage of GDP)



* Forecast.

TABLE 6 MAIN PRIORITY PROJECTS IN TERMS OF THE FISCAL STIMULUS PLAN
Public-Private Partnership
Paita Seaport.
San Martín Seaport (Pisco).
Salaverry seaport.
IIRSA central highway.
Regional Airport Group 2°.
Majes-Siguas special project.
Transport
Maintenance and improvement of the Tingo Maria - Aguaytía - Pucallpa highway.
Maintenance and improvement of the Ayacucho - Abancay highway.
Education
Maintenance, remodeling and equipment of 20 emblematic 100-year old schools in Lima.
Support job-oriented professional training in Peru: consolidation and expansion of Aprolab II.
Water Management Services
National rural program of water and sanitation - Pronasar.
Improve and expand water supply and sewage in the city of Tumbes.
Health
New National Child Health Care Institute, category III-2, Lima-Peru.
Strengthen the capacity of health services of the Regional Hospital of Ica, Ica-Diresa.
Energy
Expand the electric grid in Loreto (10 projects).
Expand the electric grid in San Martin (7 projects).

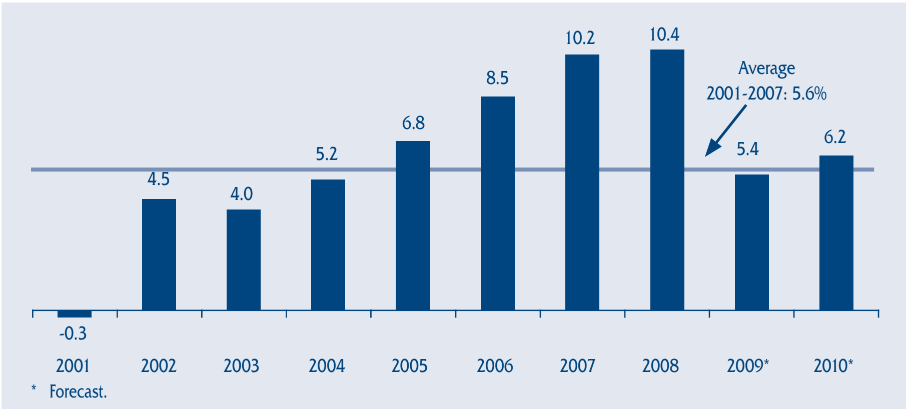
Production Sector

21. The growth of GDP during 2008 reflected a generalized dynamism in all the economic sectors, particularly in construction due to increased activity in home construction and road infrastructure projects, to the modernization of infrastructure given in concession, and to the implementation of projects, mainly in the mining sector. Growth in the commerce sector was also noteworthy given the greater insertion of the population to new retail sale formats. On the other hand, the dynamism of the mining sector is worth highlighting in the primary sectors.

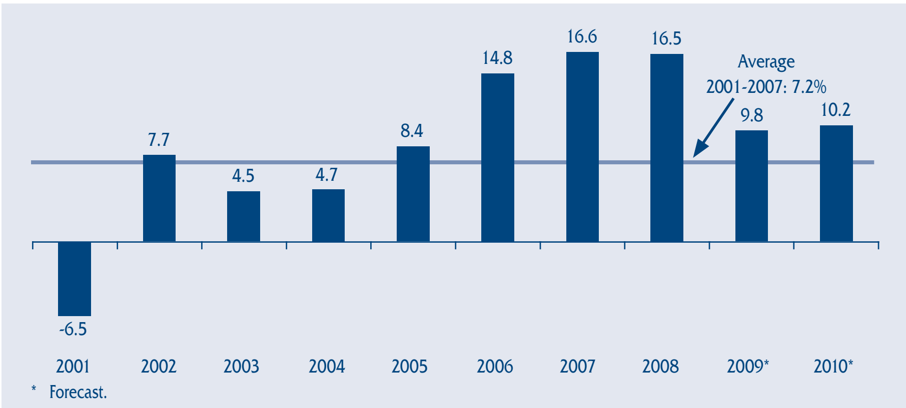
22. The growth of non-primary manufacturing (8.7 percent) reflected the greater production of construction materials, of massive consumption goods, and of those demanded by mining and energy projects. Activities associated with agroexports

also generated an additional impulse on the production of wood, plastic, and glass containers and packaging materials.

Graph 24
GROWTH OF NON-PRIMARY SECTORS
(Real percentage change)



Graph 25
GROWTH OF THE CONSTRUCTION SECTOR
(Real percentage change)



23. A slow down is forecast in the non-primary sectors in 2009 due to an international context affected by the financial crisis and the lower prices of mining commodities. This would affect not only the export sector, but also the segments oriented to the domestic market because the lower disposable national income would decelerate consumption and generate a lower return on investment. Nevertheless, the economy should resume its dynamism since 2010 in line with the recovery of our main trading partners.

TABLE 7
GROSS DOMESTIC PRODUCT BY ECONOMIC SECTORS
(Real percentage change)

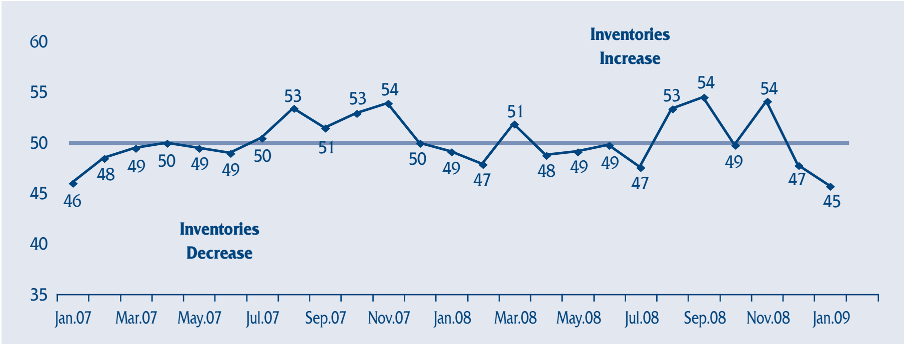
	2007	2008	2009*		2010*	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
Agriculture and livestock	**3.3**	**6.7**	**3.7**	**2.7**	**3.8**	**5.2**
Agriculture	2.0	6.6	3.6	1.0	3.9	5.0
Livestock	5.3	6.9	3.3	4.6	3.6	5.5
Fishing	**6.9**	**6.2**	**5.1**	**-4.1**	**5.0**	**3.1**
Mining and hydrocarbons	**2.7**	**7.6**	**5.3**	**3.7**	**9.6**	**5.2**
Metallic mining	1.7	7.3	5.1	1.6	3.7	3.7
Hydrocarbons	6.5	10.3	8.2	22.7	67.7	16.0
Manufacture	**10.8**	**8.5**	**7.1**	**4.6**	**7.0**	**5.7**
Raw materials	0.7	7.6	5.0	4.3	4.7	6.3
Non-primary industries	13.0	8.7	7.5	4.6	7.5	5.5
Electricity and water	**8.5**	**7.7**	**6.0**	**4.6**	**6.4**	**5.6**
Construction	**16.6**	**16.5**	**12.5**	**9.8**	**10.6**	**10.2**
Commerce	**9.7**	**12.8**	**6.8**	**4.5**	**6.8**	**6.3**
Other services	**8.9**	**9.5**	**6.1**	**5.3**	**6.9**	**5.9**
GDP	**8.9**	**9.8**	**6.5**	**5.0**	**7.0**	**6.0**
Primary	**2.7**	**7.2**	**4.5**	**3.2**	**6.0**	**5.3**
Non-Primary	**10.2**	**10.4**	**7.0**	**5.4**	**7.3**	**6.2**

IR: Inflation report.
* Forecast.

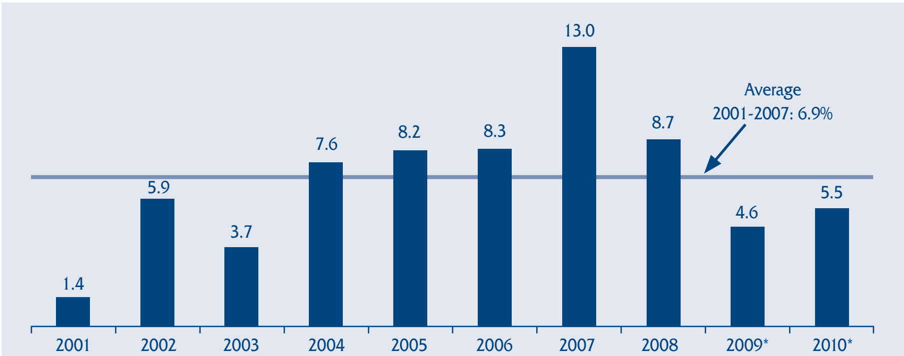
24. Non-primary manufacturing grew 2.2 percent in Q4 of 2008, in contrast with the average growth of 11.1 percent exhibited in the first three quarters of the year. This fast deceleration would be reflecting a process of stock disaccumulation in some firms, which would have been high levels of inventories during the previous months given the positive expectations of a strong growth of domestic demand. Thus, for example, a temporary suspension of activities was observed in the iron and steel industry with the purpose of normalizing the level of inventories.

The index of inventories of end goods in the manufacturing sector has been falling in the area of disaccumulation of stocks (below 50 points) since November. In January 2009, this index recorded its lowest level since January 2007.

Graph 26
FINISHED GOODS INVENTORY INDEX
Manufacturing Sector



Graph 27
GROWTH OF NON-PRIMARY MANUFACTURING
(Real percentage change)



* Forecast.

25. The agriculture and livestock sector is expected to grow 2.7 percent in 2009, reaching again historical records in crops such as potato and rice. Likewise, crops such as yucca and banana, which were affected during 2008 due to abundant rainfall, would recover. However, lower growth would be observed in the production oriented to the external market and agroindustry, as well as a decline in the productive cycle of coffee, mango, and olives. On the other hand, the livestock sub-sector would grow 4.6 percent due to the higher production of poultry associated with increased domestic demand.

    A growth of 5.0 percent is forecast in the agricultural sector in 2010 due to the recovery of the productive cycles of coffee, mango and olives; to higher dynamism in the sugar sector given continuous investments; to a higher volume of production of asparagus, whose prices would recover, as well as to higher volumes of hard maize in order to meet the demand of poultry production. Production for the domestic market would grow at a rate of 2.4 percent showing an increase in the production of the main products (i.e. potato, rice, banana, and yucca), which account for over 40 percent of the production oriented to this market. Normal climatic conditions are expected given that no "Niño" or "Niña" events are foreseen.

26. The projection of the evolution of the fishing sector does not consider significant climatic alterations. Moreover, given that fishing quotas for anchovy are established by the Ministry of Production, the sector's result in 2009 would be mainly associated with a lower catch of giant squid –record volumes of this species were caught in 2008– to produce frozen products. However, a recovery is also expected in the presence of yellow mackerel.

    The sector's recovery in 2010 would be associated with a higher catch of fish to produce conserves and frozen products, considering the consolidation of new investments in fish processing.

27. In mining, investments would include the expansion of Yanacocha's plant and the onset of operations in its new Gold Mill in 2009. Improvements in Antamina and the initiation of copper production at Cerro Corona are also considered. Another factor that would significantly affect the results obtained in the sector of hydrocarbons is Pluspetrol's production of oil in Lot 56 during all the year.

    Projects foreseen for 2010 include the onset of operation at Buenaventura's gold project La Zanja and the stabilization of Yanacocha's production at 2 million ounces, as well as the recovery Antamina's full production capacity. A higher production of liquid hydrocarbons by Pluspetrol and BPZ are also considered in addition to a higher production of gas at Camisea's Lot 88, which would reach its maximum operation capacity in 2010.

BOX 2
ELECTRICITY GENERATION:
RISKS IN THE SHORT TERM AND PENDING AGENDA IN THE LONG TERM

The convergence of three factors last year account for the important reduction –to practically zero– observed in the electricity reserve margin in September: i) the growth of maximum demand[1] for electricity, which recorded an increase of 10.1 percent in the first half of the year; ii) the seasonal reduction of hydro electrical production of energy due to more severe lower levels of river flow than in previous years, and iii) constraints in the capacity of transporting natural gas. As a result of this, historically high marginal costs and interruptions in the supply of electricity were observed in the year.

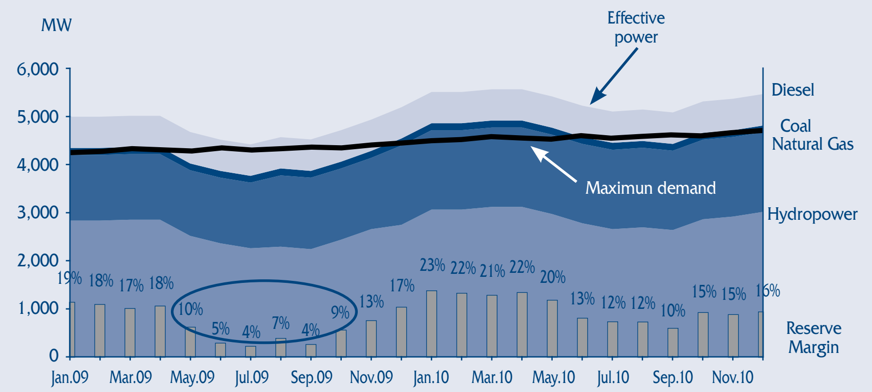
The expected slowdown of economic growth due to the impact of the international crisis reduces the risk of electricity rationing (programmed cuts in energy supply). However, the risk of failure-

1 Defined as the maximum daily demand recorded in a month.

related cuts (partial interruption of supply resulting from failures in generating units) remains. This risk would increase should hydrological conditions similar to the ones observed in 2008 were to be experienced.

For example, if this should be the case and if maximum demand should increase by around 5 percent, the reserve margin would reduce to an average of 5 percent between June and September. Under these circumstances, if a 200 MW generation plant would fail in these months, there would be a high probability that the electrical service would be interrupted in peak hours.

FORECAST 2009-2010: MAXIMUN DEMAND OF ELECTRICITY
Scenario: Moderate growth and significantly low river flows



Note: The scenario of moderate growth considers an average growth of maximum demand of 5.2% in 2009 and 6.8% in 2010. The significantly low levels of river flow considered implied applying a correction factor to supply hydroelectric power during the dry season on the basis of the evolution of the coverage of the monthly peak demand for water in comparison with the month recording the higher levels in 2008. The effective onset of operations of thermal plants is also considered in line with the expansion of the natural gas pipeline.

This risk of failure would be lower since October this year due to the programmed enhancement of the gas pipe capacity –from 293 to 450 MMcf per day–, which would allow the onset of operations of two natural gas plants, Kallpa TG2 and Chilca I-TG3, as a result of which the supply of energy would increase by 385 MW this year. Moreover, the hydro electric plant of Platanal, with a capacity of 220 MW, would start operating in November 2009.

Considering that a period of not less than two years is required until the additional power plants start operating and that there is no margin to expand the capacity of the gas pipeline until 2010, the policy measures applicable in the short term can only include emergency measures oriented to relieving the seasonal reduction of the reserve margin.

The main short term measures being implemented include the following: a) establishment of the supply of natural gas for domestic consumption, which prioritizes the provision of gas to dual and efficient thermal power plants (operating with natural gas and liquid fuel, and with a combined cycle, respectively); b) using the 75 MW thermal power plants rent by Electroperú; c) negotiating with Perú LNG in order to allocate for domestic consumption 150 MMcfd of the gas pipeline capacity to be exported; and d) energy efficient policies, such as the massive replacement of incandescent lamps with saving light bulbs, which should generate a maximum energy saving of 100 MW.

In the medium term, there is an additional constraint in the production of natural gas. The current maximum production capacity of Camisea's Malvinas processing plant is 1,160 MMcfd, an infrastructure capacity that would be insufficient to meet overall demand for natural gas (domestic consumption and exports) in 2011. Therefore, the production capacity of this plant should be expanded, and the exploration and onset of operations in new natural gas wells should be promoted.

In the long term, the expansion of electricity supply should be encouraged, maintaining an appropriate balance between hydro electrical and thermal generation. In this sense, the measures oriented to ensuring an unlimited supply of electricity should be based on the complementary implementation of three policy axes:

1) Promote the gradual formation of market prices reflecting investment needs in terms of generation;
2) Intensify the promotion of investment in hydro electricity projects, and
3) Implement complementary measures to ensure electric transmission (continuing actively with the network concession process) and access to energy resources (expand the production and transport capacity of natural gas), among other measures.

III. Balance of payments

28. The current account recorded a deficit of 3.3 percent of GDP in 2008, reflecting the high growth of domestic demand and the decline of terms of trade in foreign trade. The latter factor became more relevant since September when, due to the deepening of the international financial crisis, terms of trade deteriorated drastically, declining 25 percent in the last quarter of the year, as a result of which the trade balance showed negative results in that period. The deficit in the current account in 2008 was more than compensated by private long-term capital flows associated with direct foreign investment and loans, whose amount was equivalent to 5.6 percent of GDP.

    A deficit in the current account equivalent to 3.3 percent of GDP is projected for 2009 and 2010 considering the lower dynamism shown by the global economic activity. The latter would reflect in a lower external demand and in lower commodity prices (of both exported and imported products) than the average ones observed last year, which would also imply lower outflows of profits of foreign mining and oil companies. Moreover, a lower increase in the volume of imports (particularly inputs) is also projected due to the cuts of stocks. The flow of long term private capitals in these years is expected to range between 4.5 and 5.0 percent of GDP, exceeding the requirement of the current account.

29. Until 2007, the period of global economic expansion allowed improving the result of the current account of the balance of payments via higher prices for our exports and via an increased global demand for our products. Part of the resources resulting from this higher price of exports translated into the higher profits generated by resident foreign firms and also in higher imports, especially of imports of capital goods which have had a positive impact on the potential output. The pro-cyclical conduct of these two factors explains why the current account did not show the same result as the trade balance during this period.

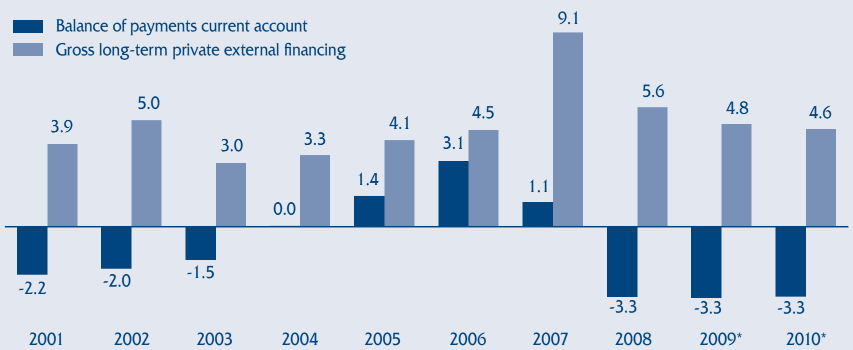
    In a context of deceleration of global economic activity, which is causing a decline in the volumes and prices of our export products, the lower profits generated and the lower value of imports (both in terms of volume and price) would partially compensate the lower income for exports and remittances from abroad. Therefore, the deficit of the current account projected for 2009 would be of 3.3 percent of GDP, higher than the 3.0 percent deficit estimated in our Inflation Report of September 2008.

TABLE 8
BALANCE OF PAYMENTS
(Millions of US$)

	2007	2008	2009*		2010*	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
I. CURRENT ACCOUNT BALANCE	**1,220**	**-4,180**	**-4,143**	**-4,061**	**-4,572**	**-4,332**
As percentage of GDP	1.1	-3.3	-3.0	-3.3	-3.0	-3.3
1. Trade balance	8,287	3,090	27	-1,368	-441	-397
a. Exports	27,882	31,529	29,712	23,576	32,930	26,696
b. Imports	-19,595	-28,439	-29,685	-24,945	-33,371	-27,094
2. Services	-1,187	-1,929	-1,472	-1,722	-1,591	-1,857
3. Investment income	-8,374	-8,144	-5,511	-3,656	-5,560	-4,873
4. Current transfers	2,494	2,803	2,814	2,686	3,020	2,795
Remittances	2,131	2,437	2,400	2,334	2,596	2,430
II. FINANCIAL ACCOUNT	**9,195**	**7,686**	**4,343**	**1,061**	**4,772**	**3,832**
Of which:						
1. Private sector	9,148	7,657	5,579	4,536	5,671	4,405
2. Public sector	-2,473	-1,404	-662	257	-656	-254
3. Short-term capital	2,630	1,118	-394	-2,827	-48	-448
III. BALANCE OF PAYMENTS (=I+II)	**10,414**	**3,507**	**200**	**-3,000**	**200**	**-500**
Memo:						
Gross long-term external private financing						
Millions of US$	9,779	7,130	7,382	5,852	7,796	6,079
Percentage of GDP	9.1%	5.6%	5.4%	4.8%	5.1%	4.6%

IR: Inflation Report.
* Forecast.

Graph 28
CURRENT ACCOUNT
(Percentage of GDP)



* Forecast.

In 2008 the 3.3 percent deficit in the current account was lower than the flow of long term private capitals, which were equivalent to 5.6 percent of the product. During 2001-2008, long term gross external financing, which includes both direct foreign investment and long term loan disbursements, was not lower than the equivalent of 3 percent of GDP, thus exceeding the requirements of the current account.

30. A deficit in the current account of the balance of payments reflects an excess of domestic investment relative to the saving generated by a country's private and public sectors. This gap is covered with external resources, that is, with external saving. Since the deficit in the current account has remained at 3.3 percent of GDP in 2009 and 2010, it is estimated that domestic saving will cover investment flows in the country, which would be consistent with a more moderate evolution of consumption expenditure.

TABLE 9
SAVING - INVESTMENT GAP
(Percentage of GDP)

	2007	2008	2009 *		2010 *	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
Gross domestic investment = total savings	22.9	26.6	28.7	27.4	30.1	27.7
1. Domestic saving	24.0	23.3	25.7	24.0	27.1	24.4
a. Private sector	17.8	17.0	19.8	18.8	20.7	18.8
b. Public sector	6.2	6.3	5.9	5.2	6.4	5.6
2. External saving	-1.1	3.3	3.0	3.3	3.0	3.3

IR: Inflation report.
* Forecast.

Trade Balance

31. The trade balance in 2008 showed a lower surplus than the one estimated in our Inflation Report of September due to the impact that the rapid deterioration of the global economy had on the volume and prices of our exports. In 2008, the surplus in the trade balance amounted to around US$ 3.1 billion.

In 2009, the main developed economies would continue showing negative growth rates and commodity prices would continue to be lower. Therefore, the projected result in the trade balance has been revised from a slight surplus of US$ 27 million to a deficit of US$ 1,368 million. The trade deficit is expected to decline in 2010 due to the recovery of global demand, which would imply a higher volume of non traditional exports, and to the onset of operations at Camisea's liquefied natural gas project, whose production will be oriented to the external market.

Graph 29
TRADE BALANCE
(Millions of US$)

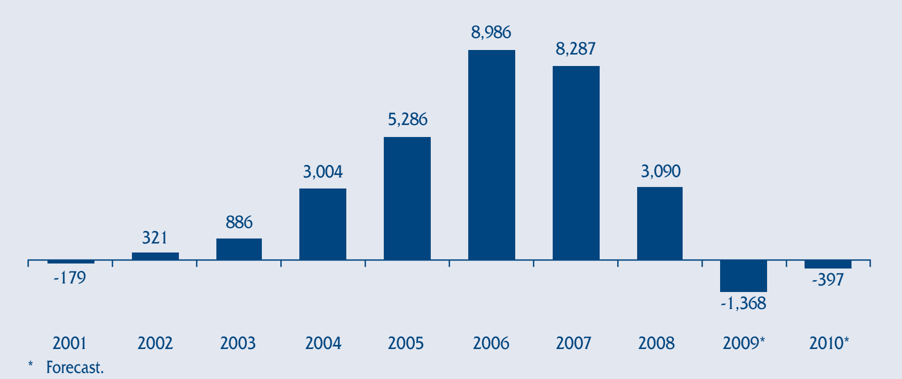


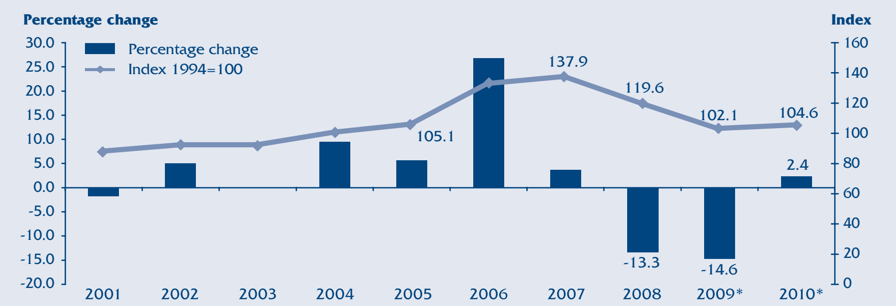
TABLE 10
TRADE BALANCE
(Millions of US$)

	2007	2008	2009*		2010*	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
EXPORTS	**27,882**	**31,529**	**29,712**	**23,576**	**32,930**	**26,696**
Of which:						
Traditional products	21,464	23,796	21,179	16,742	23,194	19,451
Non-traditional products	6,303	7,543	8,328	6,663	9,517	7,065
IMPORTS	**19,595**	**28,439**	**29,685**	**24,945**	**33,371**	**27,094**
Of which:						
Consumer goods	3,192	4,527	4,753	4,499	5,203	4,984
Raw materials	10,435	14,553	14,318	10,915	15,776	11,879
Capital goods	5,861	9,239	10,500	9,423	12,276	10,114
TRADE BALANCE	**8,287**	**3,090**	**27**	**-1,368**	**-441**	**-397**
Note: % Change						
Exports	17.0	13.1	-8.7	-25.2	10.8	13.2
Imports	32.0	45.1	2.8	-12.3	12.4	8.6
Export volumes	2.5	8.1	7.4	1.9	8.6	6.8
Import volumes	19.3	19.6	8.2	2.5	10.2	5.2
Export prices	14.4	5.1	-12.8	-26.6	0.3	6.1
Import prices	10.4	21.2	-4.9	-14.1	2.0	3.6

IR: Inflation report.
* Forecast.

32. Terms of trade would decline 14.6 percent on average in 2009. The forecasts consider that prices would have already reached their minimum levels and that some products would start showing a recovery in the second half of the year given that some of these products would be affected by supply constraints due to market prices at the time. Terms of trade in 2010 should increase by 2.4 percent, in line with the recovery expected in global economic activity. It should be pointed out that the level of terms of trade projected for 2009 is similar to the one recorded in 2005.

Graph 30
TERMS OF TRADE



* Forecast.

Between December 2008 and February 2009, terms of trade increased 7.6 percent driven by the higher prices of metals, particularly silver (30.4 percent), gold (15.2 percent), lead (14.3 percent), and copper (7.9 percent), as well as by the higher prices of other traditional products, such as fishmeal (7.2 percent) and coffee (9.8 percent).

TABLE 11
TERMS OF TRADE
(Annual average data)

	2007	2008	2009*		2010*	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
Terms of trade (annual % change)	**3.6**	**-13.3**	**-8.3**	**-14.6**	**-1.6**	**2.4**
Export prices (annual % change)	**14.0**	**5.1**	**-12.8**	**-26.6**	**0.3**	**6.1**
Of which:						
Copper (US$ per pound)	3.23	3.15	2.48	1.52	2.48	1.60
Gold (US$ per troy ounce)	697	872	820	881	820	890
Import prices (annual % change)	**10.0**	**21.2**	**-4.9**	**-14.1**	**2.0**	**3.6**
Of which:						
Petroleum (US$ per barrel)	72	100	75	49	75	59
Wheat (US$ per MT)	231	293	202	225	202	245
Maize (US$ per MT)	138	192	139	154	139	172
Soybean oil (US$ per MT)	768	1 092	779	731	779	777

IR: Inflation report.
* Forecast.

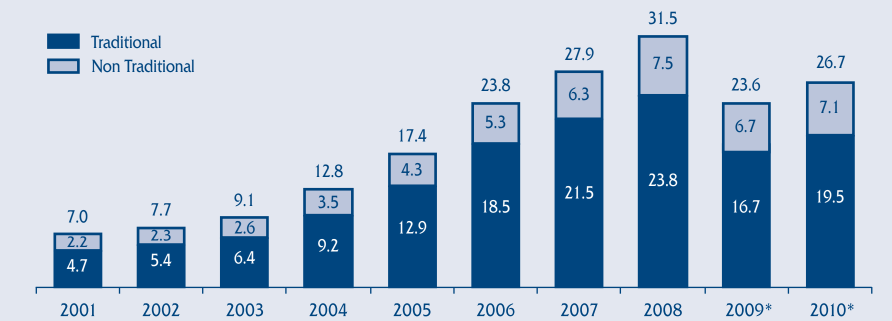
Exports

33. In **2008**, traditional exports increased 11 percent and non-traditional exports increased 20 percent. The volume of the former grew 7 percent, while the volume of the latter grew 13 percent.

    In **2009** traditional exports would decline by US$ 7 billion due to the drop of the prices of metals, mainly copper and zinc. On the other hand, non-traditional exports –mainly textiles– would fall due to lower external demand from the United States, the European Union and Japan, a situation observed since the last months of 2008.

    Exports would show a recovery in **2010** due to the onset of operations at Camisea II, which would increase traditional exports of hydrocarbons. Non-traditional exports would recover in line with the estimated evolution of global growth and as a result of the trade agreements signed with other countries.

Graph 31
EXPORTS OF GOODS
(Billions of US$)



Note: Total exports include other exports.
* Forecast.

34. The demand for our raw materials is being affected by global recession. In this context, the prices of copper and zinc have fallen sustainedly –since Q2 in the case of the former and since 2007 in the case of the latter. On the other hand, gold maintains its appeal as a hedge asset in a context of high risk aversion due to the international crisis.

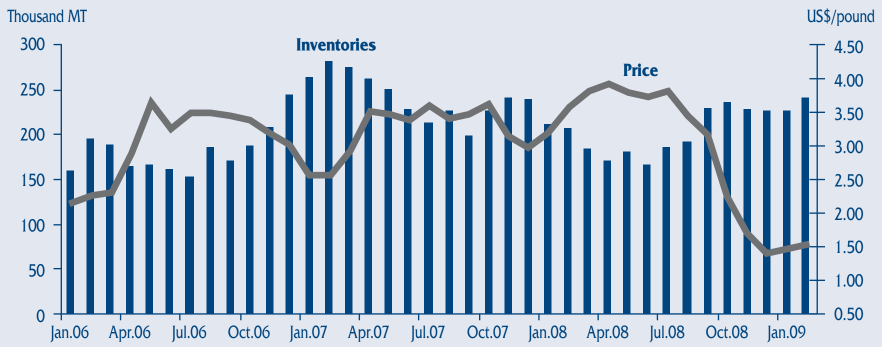
35. During 2008, the price of **copper** dropped 2.3 percent on average terms. After reaching an historical high of US$ 4.07 the pound on July 3, the price declined rapidly and reached a minimum low of US$ 1.25 per pound on December 25 –a price level not observed since October 2004. This decline of prices observed since the second half of the year was associated with the outlook of a lower global demand (contraction in the automobile and construction sectors in the United

States, Europe, and Japan) and with the increase of inventories to similar levels as the ones recorde in 2004[2] in the main metal exchange markets.

Since the beginning of 2009 the downward trend observed in the price of copper reversed: the price of this metal rose from US$ 1.38 the pound in December 2008 to US$ 1.50 in February 2009[3]. This price has fluctuated around this level during the last weeks. This recovery was associated with China's increased demand for concentrates and refined copper (given the low prices of copper and to replenish its inventories), as well as with supply problems after BHP Billiton, the world's largest mining company, announced that it would shut down one of its main mines in Australia.

The price of copper should remain around US$ 1.50 per pound, in line with some supply constraints, such as the lower utilization of metal waste to produce refined copper, the closing of not profitable small and medium-size operations, and the postponement of the extraction of mineral with a lower content due to lower prices. In 2010, the price of copper would reach levels of over US$ 1.60 per pound as global economic activity starts recovering.

Graph 32
COPPER PRICE AND INVENTORIES



Source: Bloomberg. London Metal Exchange. COMEX and Shangai Metal Exchange.

36. During 2008, the price of **zinc** dropped 42 percent on average. The price of this metal has been declining constantly since April 2008, falling from a maximum level of US$ 1.28 the pound on March 6 to a minimum low of US$ 0.47 the pound on December 12, a level unobserved since November 2004.

In addition to fears of a global slowdown, this drop in the price of zinc in 2008 reflects the broad balance between the supply and the demand for this basic metal.

2 The report of the International Copper Study Group indicates a global surplus of refined copper (seasonally adjusted) of 308 thousand tons in the first 10 months of 2008 in comparison with the 265 thousand ton surplus recorded in the same period of 2007.

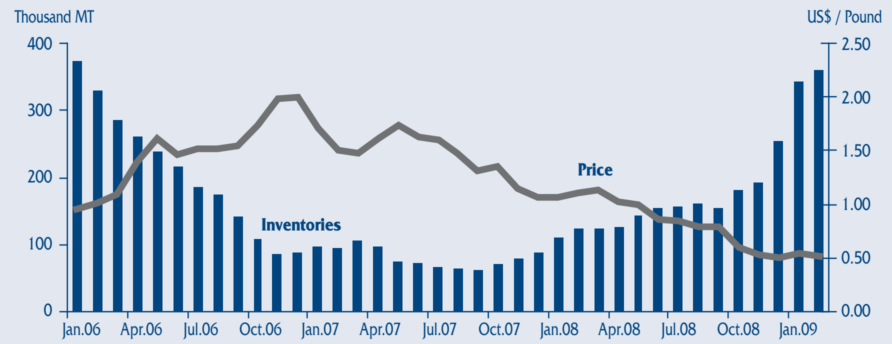
3 Average price at February 20.

The increase seen in the level of inventories was associated with a higher global supply of zinc in 2008. The production of zinc concentrates increased 5.6 percent due to increased extraction of mineral in Peru and China, while the higher production of refined copper (up 2.9 percent) resulted from higher production in China.

In 2009, this downward trend in the average price of zinc has been reversing. Thus, the price of this metal increased 4 percent, from US$ 0.49 per pound in December 2008 to US$ 0.51 per pound in February 2009 (as of February 20), and has been fluctuating around this level thereafter. This reversal in the downward trend of zinc would be associated with expectations of a lower supply due to the closing and production cuts in mining operations, such as Boliden AB in Sweden (zinc producing company), which would temporarily close some units in Ireland. Moreover, China is expected to buy higher amounts of zinc to replace its metal inventories after the New Year holiday.

The price of zinc during 2009 is expected to remain above US$ 0.50 per pound, but without returning to the levels it recorded before the crisis (US$ 1.00 per pound), recovering thereafter by 2010 as global demand recovers as well.

Graph 33
ZINC PRICE AND INVENTORIES



Source: Bloomberg. London Metal Exchange.

37. During 2008, the price of **gold** increased 25.1 percent on average. The price increased and remained around US$ 900/troy ounce during the first seven months of the year. This trend reversed thereafter in a context of increased volatility, especially in the last months of 2008. Thus, after reaching an historical record price of US$ 1,011 per troy ounce on March 17, the price dropped to a minimum low of US$ 712 per troy ounce on October 24, the lowest level observed since September 2007.

Since December 2008, the price of gold started increasing rapidly, climbing from US$ 762 per troy ounce in November 2008 to US$ 925 in February 2009 as demand for gold as a hedge asset increased in an unstable context that included increased risk aversion, forecasts of a lower production of mineral in South Africa during 2009, and prospects of a weakening of the dollar against the euro, all of which increased interest in this metal as a hedge asset. According to the World Gold Council, global demand for this metal increased 29 percent in 2008, its most dynamic component being demand for investment, which grew 102 percent.

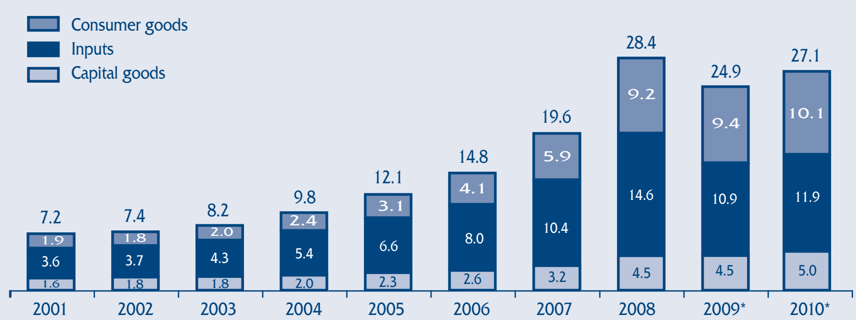
The outlook for 2009 and 2010 points to average prices around US$ 900 per troy ounce. As the global economy recovers and uncertainty about the duration and scope of the world recession clears up, the demand for gold should stabilize. Upward pressures would come from supply constraints in South Africa (one of the main producers of gold).

Imports

38. In **2008** imports grew 45 percent. The higher imports of capital goods (58 percent) and inputs (39 percent), especially for industry, were noteworthy. Higher volumes of imports were also observed, particulary in the case of capital goods and consumer goods. This high growth of imports was driven by the growth of GDP, which showed the highest growth rate in the last 14 years.

A drop in the value of imports is expected in **2009** due to the lower dynamism of economic activity –especially investment– and to the lower level of imports of fuels associated with the drop of the price of oil. Particularly, the deferral of investment decisions would result in lower imports of capital goods. Thus, imports would decline from US$ 28.4 billion in 2008 to US$ 24.9 billion in 2009. This lower imports offset the effect of the decline of exports on the trade balance and on the current account. In line with a higher growth of the economy, in **2010** import would recover reaching a total of US$ 27.1 billion.

Graph 34
IMPORTS OF GOODS
(Billions of US$)



Note: Total imports includes other imports.
* Forecast.

Financial Account

39. In **2008** the long term financial account of the private sector amounted to US$ 7,657 million, of which US$ 4,079 million was foreign direct investment (FDI) and US$ 2,401 million was the net flow of long term loans. The rest reflected mainly the reduction of Pension Funds' and mutual funds assets abroad.

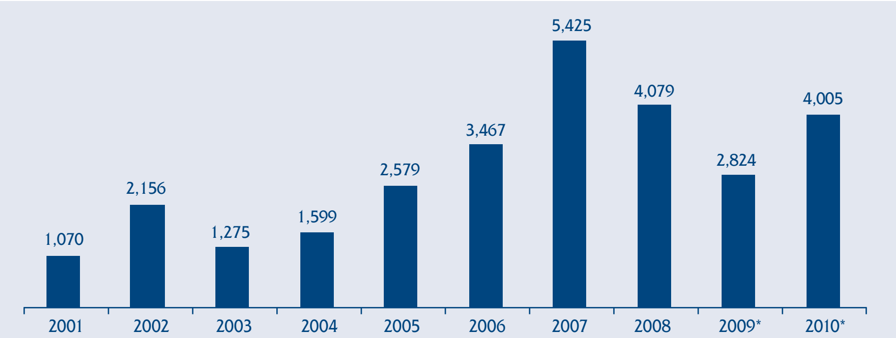
Several operations carried out during the last quarter of the year led the flow of direct investment to show a negative result of US$ 1,113 million. These operations were associated with firms' decisions to distribute dividends corresponding to previous periods and to firms' financial operations with their head offices, all of which have been considered as negative direct investment in this item due to methodological reasons.

The baseline forecast scenario for **2009** and **2010** considers a portfolio of foreign investment projects of approximately US$ 5 billion each year, which would be financed through reinvestment, contributions of the head offices (both components of FDI), and disbursements of long term foreign loans.

These figures consider a reduction in the portfolio of foreign investment projects included in the Inflation Report of September 2008 as a result of the international financial crisis and its impact on commodity prices, on external financing conditions, and on the slowdown of domestic demand, as well as a result of the possibility to re-negotiate better contract terms in some cases given the decline of the prices of materials and inputs.

40. The flow of short-term capitals, which amounted to US$ 1,118 million, showed a similar conduct, reflecting mainly the evolution observed in the first half of the year. An external negative net financing of US$ 2,213 million –of which US$ 856 million was the reduction of non-residents' holdings of BCRP Certificates of Deposits– was observed in Q4.

Graph 35
FLOW OF FOREIGN DIRECT INVESTMENT
(Millions of US$)



* Forecast.

TABLE 12
PRIVATE FINANCIAL ACCOUNT AND SHORT-TERM CAPITALS
(Millions of US$)

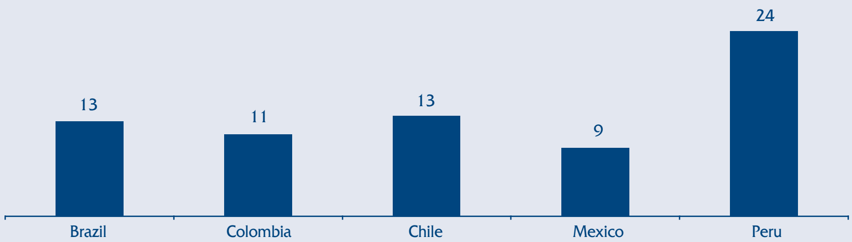
	2007	2008	2009*		2010*	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
DIRECT INVESTMENT AND LONG-TERM LOANS	**8,749**	**6,480**	**6,666**	**5,136**	**6,997**	**5,280**
A. Direct investment	5,425	4,079	6,011	2,824	6,225	4,005
B. Long-term loans	3,324	2,401	655	2,312	772	1,275
PORTFOLIO INVESTMENT	**398**	**1,177**	**-1,087**	**-600**	**-1,325**	**-875**
A. Bonds and capital participation	205	85	0	0	0	0
B. Other external assets and liabilities	194	1,092	-1,087	-600	-1,325	-875
SHORT-TERM CAPITAL	**2,630**	**1,118**	**-394**	**-2,816**	**-48**	**-448**
A. Banks	2,538	-1,591	-394	-2,186	-48	-448
B. Others	91	2,709	0	-630	0	0
Memo:						
Gross External Financing	9,779	7,130	7,382	5,852	7,796	6,079

IR: Inflation report.
* Forecast.
1/ Including AFPs, Mutual Funds, Insurance companies and other entities. The positive (negative) sign indicates capital inflows (outflows), that is, sales (purchases) of foreign assets by foreign investors.
2/ The positive (negative) sign indicates capital inflows (outflows), that is. sales (purchases) of domestic assets by non-residents.

41. The possibility of contagion in an international financial crisis depends essentially on an economy's degree of vulnerability. An economy is more exposed to the risk of an abrupt cut of external financing when it shows high deficits, when it has high financing requirements, when it has low international reserves, and when it is strongly dependent on short-term capitals. This weakness is magnified when the country has undergone a credit boom. Therefore, an economy is less vulnerable when it has been able to accumulate an appropriate amount of international reserves and has maintained prudent financial policies.

At end December 2008, net international reserves (NIRs) amounted to US$ 31 billion, a sum equivalent to 24 percent of GDP. This level of NIRs, which is higher than those of other reference countries in the region, is an important indicator of our economy's protection against probable foreign capital constraints.

Graph 36
INTERNATIONAL RESERVES
(Percentage of GDP)



Source: For Perú. BCRP forecasts. For other countries, information based on Moody's, November 2008.

BOX 3
THE PERUVIAN ECONOMY IN CONTEXTS OF NEGATIVE EXTERNAL SHOCKS

Like the rest of emerging countries, Peru has been facing an extremely negative international environment since September 2008 due to the deepening of the international crisis. The last external crisis faced by the Peruvian economy was the one derived from the Russian crisis in the last two weeks of August 1998. Characterized by a severe constraint of liquidity, this crisis deepened the effects of the Asian crisis and of El Niño episode, leading to an economic recession in 1998-1999.

When the current situation of the Peruvian economy is compared with the situation observed before the Russian crisis, we can see that the economy's fundamentals have improved substantially. Peru's international reserves at end 2008 were equivalent to 4.0 times short term external liabilities, in contrast with 1998 when this indicator was equivalent to 1.2 times said liabilities. If deposits in dollars are also included, current net international reserves (NIRs) are equivalent to 1.4 times these liabilities (versus 0.6 times in 1998). In addition to this, today the Central Bank can use new instruments to inject liquidity in foreign currency into the financial system, such as: repos in foreign currency and indexed certificates of deposits (CDR), which contribute to the effectiveness of monetary management, in contrast with 1998 when these instruments did not exist.

MACROECONOMIC INDICATORS

	1997	1998					1999	2007	2008				
		1Q	2Q	3Q	4Q	Year			1Q	2Q	3Q	4Q	Year
BP Current Account / GDP (%)	-5.7	-7.3	-6.8	-5.3	-3.9	-5.9	-2.7	1.1	-2.8	-4.5	-3.1	-2.5	-3.3
NIRs / STEL (times)	1.3	1.3	1.2	1.2	1.2	1.2	1.3	3.1	3.0	3.1	3.3	4.0	4.0
NIR / (STEL+LQFC) (times)	0.6	0.6	0.6	0.6	0.5	0.5	0.5	1.3	1.5	1.5	1.4	1.4	1.4
Public Debt / GDP (%)	37.9	40.6	41.8	42.9	44.1	44.1	47.1	29.6	27.5	25.2	23.8	24.0	24.0
Dollarization of credit (%)	76.9	74.8	75.4	77.1	78.9	78.9	81.6	56.1	53.2	53.0	52.7	51.6	51.6

STEL: Short-Term External Liabilities.
LQFC: Banks' liquidity in foreign currency of the banking system.

The country's fiscal position to face the current crisis is much better than the one observed during the last crisis. This is due to the surpluses recorded in the fiscal accounts in the last three years, which allow for a greater margin to implement counter cyclical policies. The economic result of the Non-Financial Public Sector is considerably higher today (-0.9 percent in 1998 versus 2.1 percent in 2008). Moreover, the public sector's solvency and lower vulnerability is expressed in lower levels of public debt (24.0 percent in 2008 versus 44.1 percent in 1998), as well as in its levels of dollarization. Furthermore, assets in the Non-Financial Public Sector amount to nearly 11.6 percent of GDP.

Another essential factor in the current context of a negative external environment is the robustness of the financial system, which reduces the probabilities that the process of credit intermediation might be interrupted. The current international financial crisis finds the Peruvian financial system with much higher indicators of liquidity, solvency and profitability than the ones it showed during the first months of the Russian crisis. Liquid assets held by banks in the form of certificates of deposit (CD, CD-NR and CDR) and Treasury bonds (BTP) have increased from 0.9 percent of total liquidity in 1998 to nearly 26 percent in 2008, representing approximately 21 percent of overall placements in 2008. Today, the financial system's high levels of liquid assets reduce the probability that events like the one observed in September 1998 might occur again since this allows a rapid injection of liquidity to the system. The high levels of bank reserve requirements in foreign currency (average reserve requirements at end 2008 was 33.8 percent) complement the system's appropriate levels of liquid assets in soles.

Banks' capacity of generating resources has contributed to strengthen their equity and to maintain appropriate levels of capital provisions. The level of overdue loan repayments (1.3 percent, nearly a fifth part of the level recorded in 1997) is one of the lowest in the region.

On the other hand, economic agents are increasingly less vulnerable to exchange variations (due to the balance sheet effect) because of the reduction recorded in the ratio of financial dollarization over the past few years as a result of higher confidence in the domestic currency. The level of dollarization of credit has declined from levels of close to 80 percent to 52 percent today, which allows for increased exchange flotation to respond the external crisis through this adjustment mechanism.

These positive fundamentals are based on the market expectations of growth and macroeconomic stability in the Peruvian economy in 2009, which identify it as one of the economies with the highest growth in the region.

REFERENCES:

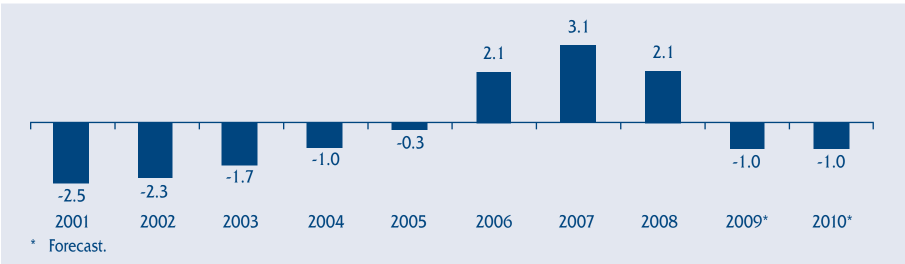
- Castillo, Paul and Pereda, Javier: "Lecciones de la crisis rusa para enfrentar la crisis financiera global actual" in: Revista Moneda 139, BCRP, 2009.
- Castillo, Paul and Barco, Daniel: "Enfrentando salidas inesperadas de capital: Lecciones de política de la experiencia peruana de los años 90's". Documento de Trabajo No 2, BCRP, January 2008.

IV. Public finances

Overall Balance

42. In **2008** the Non-Financial Public Sector (NFPS) recorded surplus equivalent to 2.1 percent of GDP, a result 1 percentage point lower than the one recorded in the previous year. This lower result was mainly due to the strong growth of public investment, which increased 42 percent in real terms. This increase resulted mainly from strong investment from local governments, which recorded an actual increase of 99 percent.

Graph 37
OVERALL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(Percentage of GDP)



43. Sustainable fiscal deficits of 1.0 percent of the product are estimated for **2009** and **2010**. These results are lower than the ones estimated in our September Report (fiscal surpluses of 1.1 and 0.9 percent, respectively).

TABLE 14
NON-FINANCIAL PUBLIC SECTOR
(Percentage of GDP)

	2007	2008	2009*		2010*	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
1. General government current revenue [1/]	**20.7**	**20.8**	**19.4**	**19.4**	**19.2**	**19.1**
Real percentage change	*13.6*	*5.8*	*-3.1*	*-5.6*	*5.5*	*5.2*
2. General government non-financial expenditure	**16.0**	**17.2**	**17.0**	**19.1**	**17.1**	**18.9**
Real percentage change	*6.8*	*13.5*	*5.1*	*12.5*	*7.6*	*5.2*
Of which:						
a. Current	13.0	13.2	12.4	13.1	12.0	12.6
Real percentage change	*4.7*	*7.1*	*-0.5*	*1.1*	*3.4*	*2.5*
b. Gross capital formation	2.8	3.9	4.4	5.8	5.0	6.1
Real percentage change	*17.6*	*44.8*	*24.6*	*51.7*	*19.5*	*11.8*
3. Others	**0.2**	**0.1**	**0.1**	**0.1**	**0.1**	**0.0**
4. Primary balance (1-2+3)	**4.9**	**3.7**	**2.6**	**0.4**	**2.2**	**0.3**
5. Interests	**1.8**	**1.6**	**1.5**	**1.4**	**1.3**	**1.3**
6. Overall Balance	**3.1**	**2.1**	**1.1**	**-1.0**	**0.9**	**-1.0**
Central government current revenues [2/]	**18.1**	**18.2**	**16.7**	**16.7**	**16.5**	**16.4**
Central government non-financial expenditure	**14.7**	**14.7**	**14.1**	**16.0**	**13.9**	**15.9**

IR: Inflation report.
* Forecast.
1/ The General government includes the Central government, local governments, regulatory and supervisor institutions, EsSalud, welfare societies, registries, ONP and retirement funds.
2/ The Central government includes the ministries, public institutions, national universities and regional governments.

The decrease on the fiscal result is a result from the implementation of the Economic Stimulus Plan, which involves higher public expenditure to prevent and relieve the impact of the international crisis on the real sector of the economy.

44. The government has announced an Economic Stimulus Plan to be implemented through a public expenditure of S/. 7,697 million[4], of which S/. 5,227 million will be for infrastructure works; S/. 915 million to support the economic sectors affected by the crisis, including S/. 360 million for the temporary extension of the drawback and S/. 300 million as business guarantee funds; as well as S/. 715 million for social welfare programs. It is estimated that these measures would imply a higher public spending of around S/. 3,200 million (0.8 percent of GDP) in terms of the 2009 Budget.

TABLE 14
ECONOMIC STIMULUS PLAN 1/

Concept	Law	Mill. Soles
1. Aid to Affected Sectors		**915**
- Purchase uniforms and school furniture from Mypes	UD 015-2009	150
- Workforce Retraining Program	UD 021-2009	100
- Business Guarantee Fund (FOGEM)	UD 024-2009	300
- Temporary increase of Drawback	SD 018-2009-EF	360
- Strengthening the Mypes	UD 019-2009	5
2. Infrastructure Works		**5,227**
- Investment projects	UD 010-2009	2,148 2/
- Infrastructure investment Fund - COFIDE	UD 018-2009	325
- IIRSA Sur	UD 025-2009	773
- Costa Verde Project	SD 019-2009-EF	16
- Investment continuance	SD 017-2009-EF	1,285
- Road maintenance	SD 034-2009-EF	300
- Regional trusts	UD 028-2009	260 3/
- Basic infrastructure for local governments	SD 033-2009-EF	100
- Santiago de Chuco-Shorey highway	Law 29321	20
3. Social Protection		**715**
- Maintenance of educational institutions	UD 011-2009	120 4/
- Maintenance and equipment of health facilities	UD 016-2009	165
- Maintenance of irrigation infrastructure	UD 016-2009	153
- Basic infrastructure for local governments	UD 016-2009	100
- Social investment - Equality Fund	Law 29322	105
- Supplementary Food Program	SD 022-2009-EF	64
- FORSUR	SD 027-2009-EF	8
4. Other expenses		**840**
- Supplementary credit to finance the FEPC	UD 009-2009	500
- School Bonus	SD 026-2009-EF	300
- Include resources from the Ministry of Education into the 2009 Budget	SD 023-2009-EF	36
- Transfer Health responsibilities to the Regional Government of Callao	SD 035-2009-EF	4
Total Stimulus Plan		**7,697**
(Percentage of GDP)		***2.0%***

1/ Refers to the first 9 packages of the Economic Stimulus Plan. Considers only measures associated with fiscal revenues and expenses. Excludes bonds issues for S/. 1,405 million.
2/ Preliminary estimate of MEF.
3/ Refers to the estimate for 2009. The total for ten years is S/. 2,600 millions.
4/ S/. 270 millions are included in the UD 010-2009.

4 Figures at February 20, 2009.

45. The risk of a permanent deterioration of the treasury accounts is low given the temporary nature of most of the measures included in the Stimulus Plan. In the case of expenditure-related measures, the increase of public investment is temporary by definition, while tax reductions have been determined for specified periods. In this way, a permanent deterioration in the fiscal result can be prevented, if an adjustment be required in terms of the availability of financing resources.

As regards the effectiveness of the fiscal package, a recent review of the estimate of the short term multiplier of government expenditure suggests that this higher spending –0.8 percent of GDP in terms of the Budget– would translate into around 1.0 percentage point of increased economic activity[5].

46. The fiscal result projected for 2009 (deficit of 1.0 percent) differs from the one estimated by the Ministry of Economy and Finance (deficit of 0.7 percent) given that a conservative scenario has been considered in the projection of fiscal revenue, although the same assumptions have been used in terms of fiscal expenditure.

Primary Structural Result

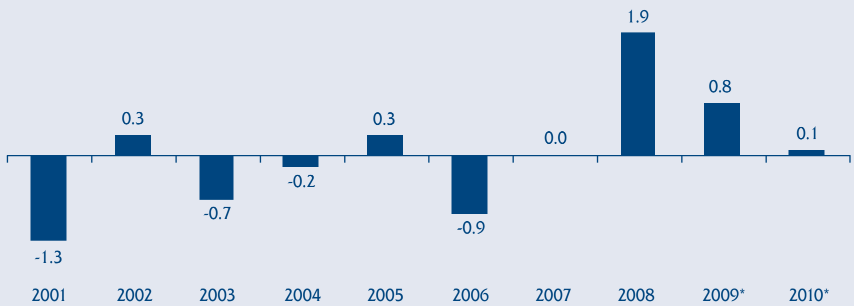
47. The primary structural result –indicator that shows the evolution of fiscal policy decisions because it isolates the effects of the economic cycle and of the prices of main mineral exports from the primary conventional result– was 0.4 percent of GDP in 2008. Primary deficits of 0.4 and 0.5 percent of GDP are expected for 2009 and 2010, respectively. These results would be consistent with the counter cyclical fiscal policy that would be implemented in these years. The fiscal impulse, which shows the net expansionary effect of fiscal policy on domestic demand, would be of 0.8 percent of GDP in 2009 and slightly positive in 2010.

Graph 38
PRIMARY STRUCTURAL BALANCE OF THE NON FINANCIAL PUBLIC SECTOR
(Percentage del GDP)

* Forecast.

5 Ferreyros, G. (2009) "Estimación del Multiplicador del Gasto Público". BCRP.

Graph 39
FISCAL IMPULSE
(Percentage of GDP)



* Forecast.

48. The increase of the fiscal deficit in 2009 and 2010 does not affect the sustainability of fiscal accounts because the level of the public debt is kept under control. The table below shows the fiscal deficit required to stabilize the debt to GDP ratio at the value observed at end 2008 (around 24 percent of GDP) for different scenarios of growth in the economy. Even in the case that growth should remain around an annual rate of 5 percent, the public sector could have a deficit of 1.6 percent of GDP without generating un upward trend in the balance of the public debt.

TABLE 15
SUSTAINABLE FISCAL DEFICIT 1/
(Percentage of GDP)

	Real growth rate		
	3%	**5%**	**7%**
Deficit	1.1%	1.6%	2.0%

1/ Deficit is consistent with a constant debt to GDP ratio.

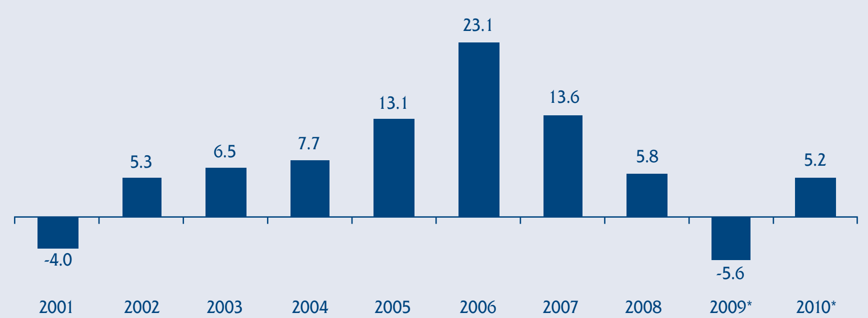
Evolution of Fiscal Revenues

49. In **2008** the current revenues of the general government reached a level of 20.8 percent of GDP –the highest historical level recorded since 1980–, which represented an increase of 5.8 percent in real terms compared with the previous year.

    This favorable evolution of fiscal revenues started showing a moderation in the last quarter of the year. The rate of growth recorded in the first quarters was associated with the high international prices of exports and oil, as well as with the strong economic dynamism observed in that period. However, a slight decrease (1.5 percent in real terms) was seen in the last quarter mainly due to lower payments collected on account of third category income tax as a result of the drop of the international prices of the main metals.

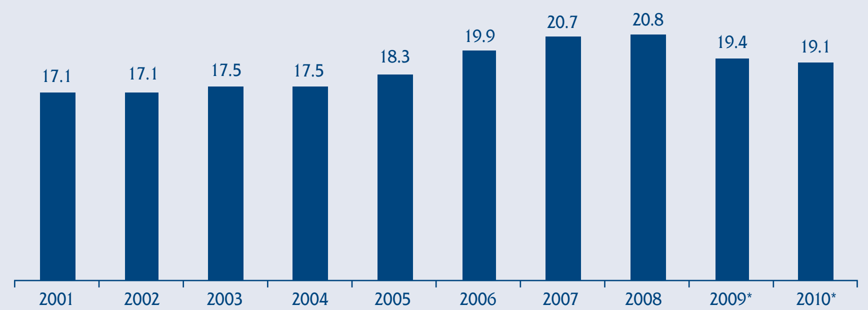
The current revenues of the general government are projected to decline to 19.4 percent of GDP in **2009**, which represents a reduction of 5.6 percent in real terms. This decline is higher than the one considered in our previous Inflation Report (3.1 percent) given that current forecasts are less favorable in terms of the impact that the global crisis would have on exports, imports, and economic growth. The main reduction would be seen in revenues from income tax, which would decline from 6.5 percent in 2008 to 5.2 percent in 2009. Revenues from value added tax –our main tax, which has been growing sustainably in recent years– would be slightly higher than 8.5 percent of GDP in the next years.

Graph 40
GENERAL GOVERNMENT CURRENT REVENUE
(Real Percentage change)



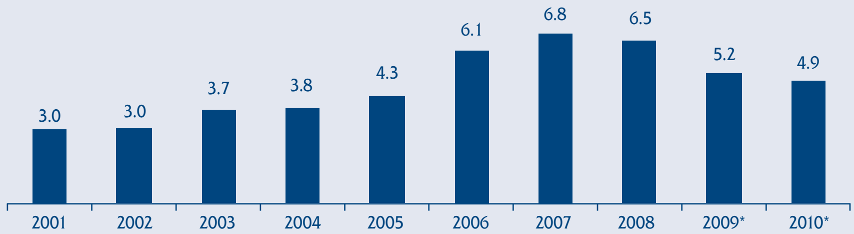
* Forecast.

Graph 41
GENERAL GOVERNMENT CURRENT REVENUE
(Percentage of GDP)



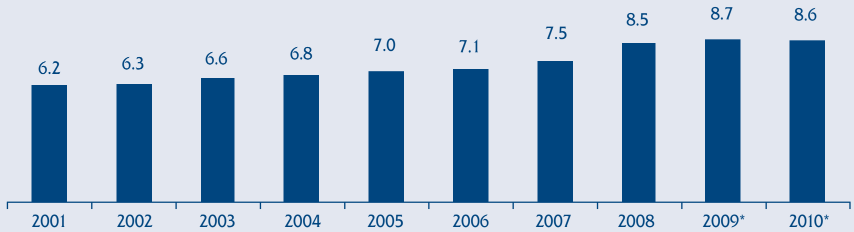
* Forecast.

Graph 42
INCOME TAX
(Percentage of GDP)



* Forecast.

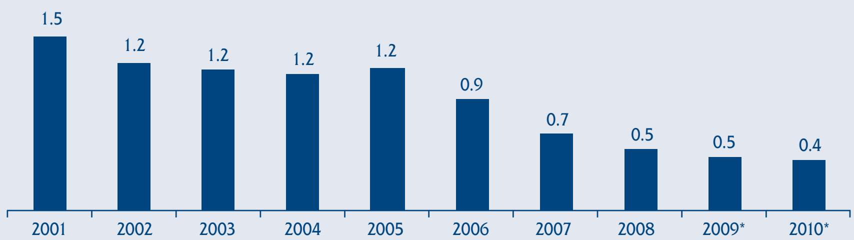
Graph 43
VALUE ADDED TAX
(Percentage of GDP)



* Forecast.

50. Revenues from import duties would continue showing a downward trend and would represent only 0.4 percent of GDP by 2010. This evolution would result from the successive reductions of tariffs implemented recently in the frame of the trade policy, as well as in the frame of the trade agreements established. This trade policy would allow to continue promoting higher productivity and competitiveness in the economy in the next years. Moreover, the contraction of imports in the following periods will also contribute to reduce revenues from this tax.

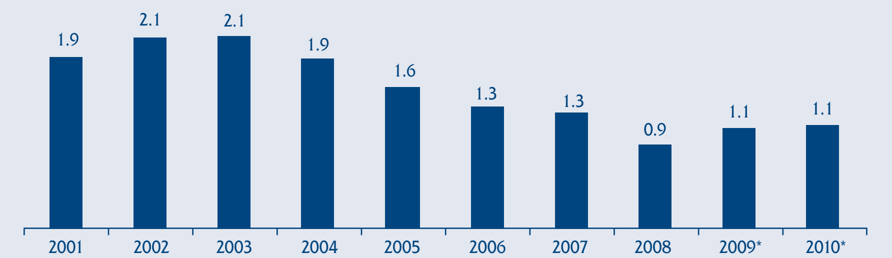
Graph 44
REVENUE FROM IMPORT DUTIES
(Percentage of GDP)



* Forecast.

51. These projections of lower tax revenues have been also affected since January 2009 by the reductions of the rates of the tax on financial transactions –ITF– (from 0.07 percent to 0.06 percent) and of the temporary tax on net assets –ITAN– (from 0.5 percent to 0.4 percent).

Graph 45
EXCISE TAX
(Percentage of GDP)



* Forecast.

Conversely, in 2009 revenues from the excise tax should increase to 1.1 percent of GDP given the increases of the excise tax on fuels implemented in October and November 2008. These tax increases reversed the reductions of tax rates implemented in the beginning of last year to reduce the impact of the higher international prices of crude on domestic prices.

52. The **non-tax revenues** of the general government, on the other hand, would decline in 2009 due to lower collection of revenues associated with the mining and hydrocarbon sector. The lower prices of crude would imply a reduction in the revenues from oil royalties, while the lower prices of minerals would imply lower revenues from mining royalties. Moreover, lower revenues would also be obtained from the remnants that mining companies transfer to regional governments after distributing profits to its workers and after transferring funds to Fondoempleo.

Current revenues would also decline in GDP terms (19.1 percent of GDP) in **2010**, although in real terms this will represent a 5.2 percent increase compared to the previous year. This slight rebound would be associated with a slow recovery of the international prices of exports, as well as with the higher dynamism expected in the economy in that year.

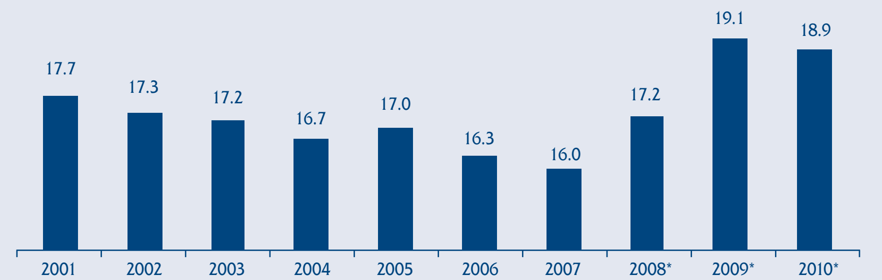
Evolution of Fiscal Espenditure

53. In **2008** the non financial expenditure of the general government increased 13.5 percent in real terms. This increase was mainly observed in gross capital formation (45 percent), which reached a maximum actual increase in the case of EsSalud (191 percent) and local governments (99 percent).

By government levels, this trend was led by local governments (99 percent in real terms), followed by regional governments (22 percent), and the national government (4 percent).

On the other hand, the current expenditure of the general government also increased (7.1 percent in real terms). In this sense, it is worth highlighting current transfers to the Fuel Price Stabilization Fund (S/. 2,150 million), which were oriented to offseting the impact of the escalade seen in the international prices of hydrocarbons on domestic prices.

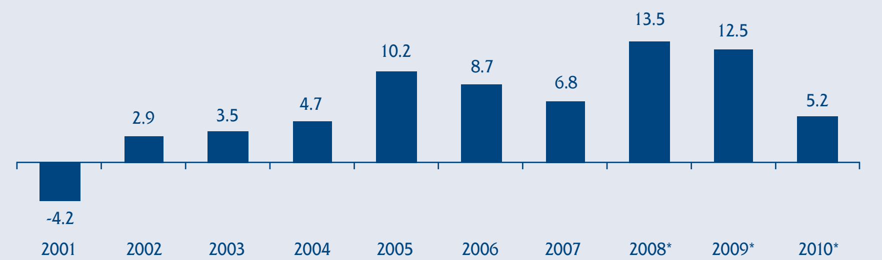
Graph 46
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(Percentage of GDP)



* Forecast.

The non-financial expenditure of the general government should grow by a real 12.5 and 5.2 percent in **2009** and **2010**, respectively. This growth would be mostly explained by the impulse of the general government investment, which would grow 51.7 and 11.8 percent in real terms in 2009 and 2010, respectively, due to the onset of several public projects in the frame of the Economic Stimulus Plan to avoid traumatic impacts of the global crisis on the economy's real sector. The highest dynamism of investment would be concentrated in the central government entities.

Graph 47
GENERAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(Real percentage change)



* Forecast.

Current expenditure, on the other hand, would grow at a much lower pace than investment (1.1 and 2.5 percent in real terms in 2009 and 2010, respectively).

Projections on the growth of current expenditure in 2009 and 2010 consider compliance with the limits set forth in the Fiscal Responsibility and Transparency Law, which establishes that that the annual increase of the central government' expenditure in consumption shall not be higher than 4 percent in real terms, including total spending in salaries, pensions, goods and services.

Moreover, Urgency Decree 016-2009 established the suspension of transfer of funds to the Fiscal Stabilization Fund (FSF) in 2009 due to the surplus of ordinary resources resulting from the execution of the 2008 budget (estimated at US$ 1,650 million). These resources will be used to finance, at least partially, basic infrastructure projects. The balance of the FSF at February 2009 is US$ 1,807 million.

Financing Requirements

54. General government deposits accumulated in the financial system as of December 2008 amount to US$ 13,618 million (10.7 percent of GDP), which allows the government to finance a counter cyclical fiscal policy during the forecast horizon. Financing requirements for 2009 and 2010 are estimated at US$ 2,459 and US$ 2,766 million, respectively.

TABLE 16
FINANCIAL REQUIREMENTS OF THE NON-FINANCIAL PUBLIC SECTOR 1/
(Millions of US$)

	2007	2008	2009*		2010*	
			IR Sep.08	IR Mar.09	IR Sep.08	IR Mar.09
I. Uses	-1,757	-839	-261	2,459	17	2,766
1. Amortization	1,506	1,971	1,190	1,203	1,358	1,381
a. External	1,172	1,449	965	949	1,110	1,108
b. Internal	334	522	225	254	248	273
Of which: Pension bonds	134	94	137	122	144	125
2. Overall balance (negative sign indicates surplus)	-3,264	-2,811	-1,450	1,256	-1,341	1,385
II. Sources	-1,757	-839	-261	2,459	17	2,766
1. External	1,036	1,100	355	936	479	1,104
2. Bonds 2/	869	473	326	881	310	462
3. Internal 3/	-3,663	-2,412	-941	642	-771	1,200
Memo:						
Balance of gross public debt						
Millions of US$	31,870	30,648	30,665	31,132	30,372	31,125
As percentage of GDP	29.6	24.0	22.2	25.6	20.0	23.5
Balance of net public debt 4/						
Millions of US$	19,061	15,815	14,690	17,071	13,151	18,072
As percentage of GDP	17.5	12.4	10.7	14.0	8.6	13.6

IR: Inflation Report.
* Forecast.
1/ The effect of exchanging treasury bonds by longer-maturity bonds, as well as the effect of placements made for the prepayment of both internal and external operations has been isolated in the case of amortization and disbursements.
2/ Includes domestic and external bonds.
3/ Positive sign indicates overdraft and negative sign indicates higher deposits.
4/ Defined as the difference between gross public debt and NFPS deposits.

51. At December 2008, the balance of the public debt was equivalent to 24.0 percent of GDP, while the balance of the net debt –which deducts liquid assets– was equivalent to only 12.4 percent of GDP, which implies a reduction of 5.1 percentage points relative to 2007. This evolution is derived from the public sector's lower financing requirements due to the fiscal surplus recorded and the resulting accumulation of deposits. A higher financing requirement is projected for the next years. This would be covered through higher external and domestic disbursements. Moreover, a reduction in government deposits –which would translate into slightly higher levels of gross and net debt in 2009 and, to a lesser extent, in 2010– is also projected.

Graph 48
PUBLIC DEBT
(Percentage of GDP)

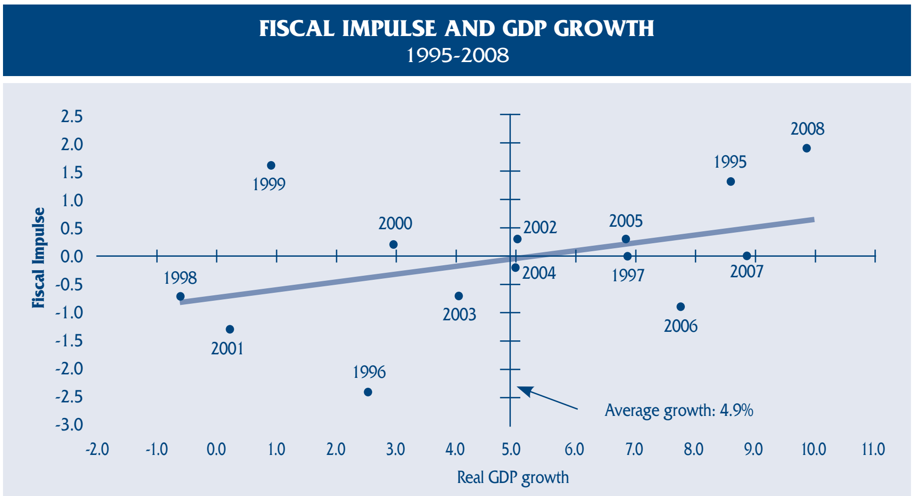
* Forecast.

BOX 4
FISCAL POLICY RESPONSES TO THE INTERNATIONAL CRISIS

An indicator called "fiscal impulse" –defined as the annual change recorded in the primary structural result of the non-financial public sector[6]– is usually used to estimate the fiscal policy position. On the other hand, the economy's position in the economic cycle is estimated through the output gap, which is the percentage deviation of GDP relative to an estimate of its potential level.

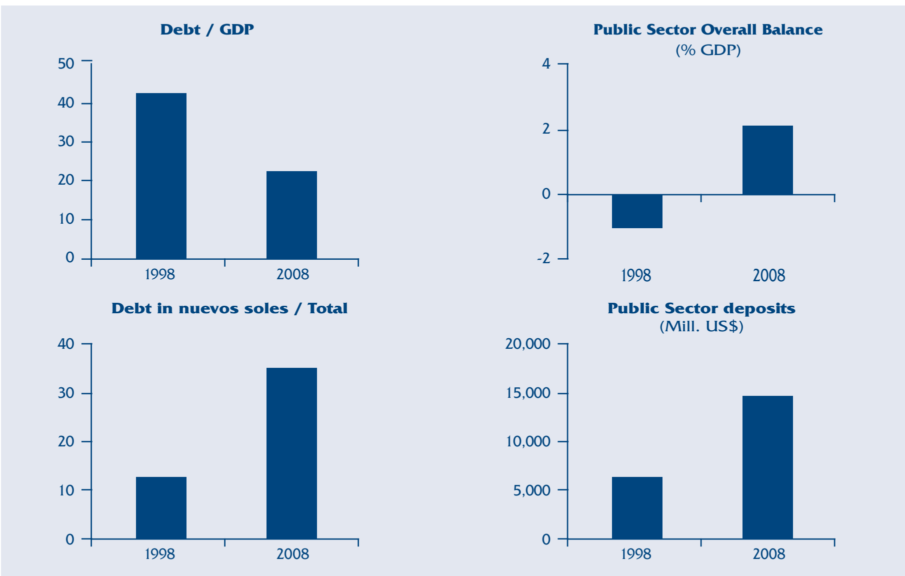
Available data for 1995-2008 and the projections contained in this Inflation Report for 2009 show that episodes of fiscal expansion have occurred when the economy was in a stage of boom in the economic cycle, while the periods of fiscal consolidation coincided with recessive periods of the cycle, bringing about a pro cyclical management of fiscal policy. The following table shows that there is a positive association between the fiscal impulse and the gap of the growth of actual GDP and its historical mean in 1995-2008 (4.9 percent).

6 The primary structural result is the primary result that would be obtained by the public sector if the product were at its potential level and if the prices of mineral and oil exports were at an average long-term level. The methodology used to elaborate this indicator is explained in Nota de Estudios del BCRP N° 51, 2008.



Several fiscal rules have been implemented since 1999 to mitigate deficit biases in fiscal management and to prevent a pro cyclical conduct in fiscal policy, which has contributed to continuously reduce the fiscal deficit observed in 2002-2008.

The graph below compares some indicators of fiscal vulnerability at the beginning of the last recessive cycle experienced by the Peruvian economy (1998-2002) and those observed at end 2008. These indicators show higher levels of fiscal soundness compared with the levels observed in the nineties, which is reflected in the significant reduction of the balance of the public debt, as well as in the higher share of the debt in domestic currency in terms of the overall debt. Moreover, the amount of treasury's deposits in the financial system is also much higher.



V. Monetary policy

56. The deepening of the international financial crisis, marked by the bankruptcy of the Lehman Brothers investment bank on September 15, 2008, increased the risk of a generalized credit crunch worlwide.

    In this context, it was necessary to prevent that these events that took place abroad might reproduce in the domestic money, credit, foreign exchange and capital markets as a credit contraction. Such an evolution would introduce a recessive and deflationary stimulus that could jeopardize macroeconomic and financial stability. Therefore, monetary policy actions in this period have been oriented to ensuring the flow of credit under conditions that will not affect inflation's convergence towards the 2 percent target (plus or minus 1 percentage point).

57. The BCRP injected liquidity to the secondary market to minimize the impact of the financial crisis on banks' availability of liquidity and on interest rates. Thus, the BCRP introduced resources into the financial system through repo operations with up to one year maturities, swaps in foreign currency, and the permanent repurchase of BCRP Certificates of Deposits (CDs).

    Considering only the maturities of the BCRP CDs and REPO operations during the period of deepening of the financial crisis, a total of S/. 30,053 million was injected between September 2008 and February 11, 2009.

    Likewise, since the financial crisis started deepening, the BCRP reduced reserve requirements in both domestic currency and foreign currency on succesive occasions, which allowed injecting liquidity in a permanent manner and stabilizing liquidity conditions in the financial system.

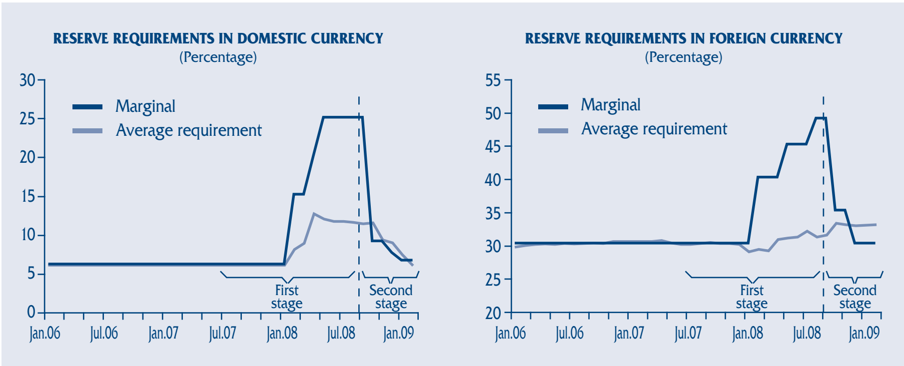
    As summarized in the table below, the BCRP reduced the rate of marginal reserve requirements in domestic currency from 25 to 6.0 percent, the rate of marginal reserve requirements in foreign currency from 49 to 30 percent, and the rate of reserve requirements for deposits of non-resident financial entities from 120 to 35 percent. Additionally, banks' external liabilities due in two-year terms or more were exempted from the reserve requirement regime.

TABLE 17
MONETARY POLICY ACTIONS

Date	Actions
September 2008	**BCRP modifies reserve requirements in domestic and foreign currency** (S/. 18 million and US$ 102 million released) - Banks' external liabilities with 2-year or longer maturities are exempted from reserve requirements.
October 2008	- Terms for REPOS are extended to up to 1 year and the number of entities participating in the auctions in increased (Pension Funds and Mutual Funds). - Direct swaps of dollars for soles allowed. - REPOS in foreign currency established. **BCRP modifies reserve requirements in domestic currency** (thus releasing S/. 967 million) - BCRP establishes a unique rate of reserve requirements (9 percent), which is the similar to the minimum legal requirements for obligations subject to the general regime. Reserve requirement for increases in foreign credit lines are also eliminated. **BCRP modifies reserve requirements in foreign currency** (releasing resources for US$ 279 million) - Marginal reserve requirements for obligations subject to the general regime reduced from 49 to 35 percent. Reserve requirement for increases in foreign credit lines are also eliminated. **BCRP modifies reserve requirements in domestic currency** (releasing resources for S/. 154 million) - Liabilities in soles of up to S/. 100 million are exempted from 33 percent reserve requirement. - Reserve requirement for non-resident deposits reduced from 120 to 35 percent. - Reserve requirement for non-resident loans to micro finance reduced from 120 to 9 percent.
November 2008	**BCRP modifies reserve requirements in foreign currency** (releasing resources for US$ 27.2 million) - Cap of 35 percent for average requirement for short-term foreign credit lines. - Reserve requirement for liabilities included in special regime reduced to 35 percent.
December 2008	**BCRP modifies reserve requirements in domestic currency** (releasing resources for S/. 650 million) - Minimum legal reserve requirement reduced from 9.0 to 7.5 percent. **BCRP modifies reserve requirements in foreign currency** - Minimum legal reserve requirement reduced from 9.0 to 7.5 percent. - Marginal requirement for external liabilities subject to the special regime reduced from 35 to 30 percent.
January 2009	**BCRP modifies reserve requirements in domestic currency** (releasing resources for S/. 300 million) - Minimum legal reserve requirement reduced from 7.5 to 6.5 percent. The minimum reserve requirements that banks should hold at their current account in the BCRP reduced from 2.0 to 1.5 percent of total obligations subject to reserve requirement.
February 2009	**Reference interest rate was reduced** - The Board of Directors of the BCRP approved to reduced the reference interest rate of monetary policy from 6.50 to 6.25 percent.
March 2009	**Reference interest rate was reduced and the reserve requirement in domestic currency** - The Board of Directors of the BCRP approved to reduced the reference interest rate of monetary policy from 6.25 to 6.00 percent. - The legal minimun reserve requirement was reduced from 6.5 to 6.0 percent. and the minimun reserve requirement that the banks should held in their current account was reduced from 1.5 to 1.0 percent. since April (frees resources for S/. 250 million).

58. As a result of these succesive reductions, reserve requirements in force reached similar levels to the ones observed at end 2007.

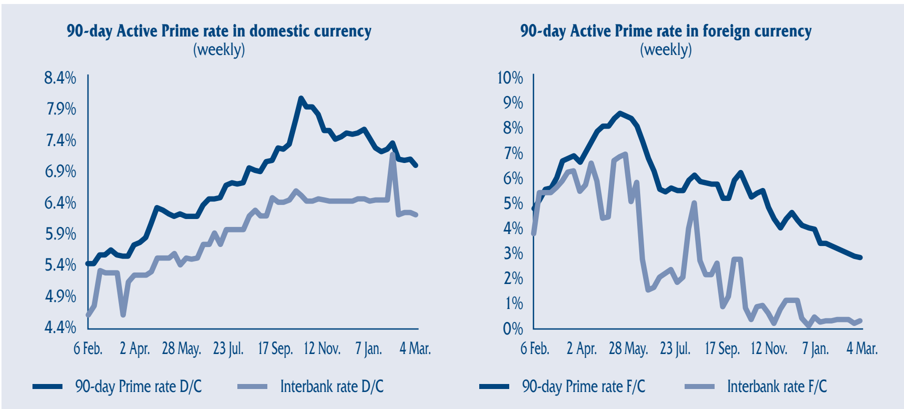
Graph 49



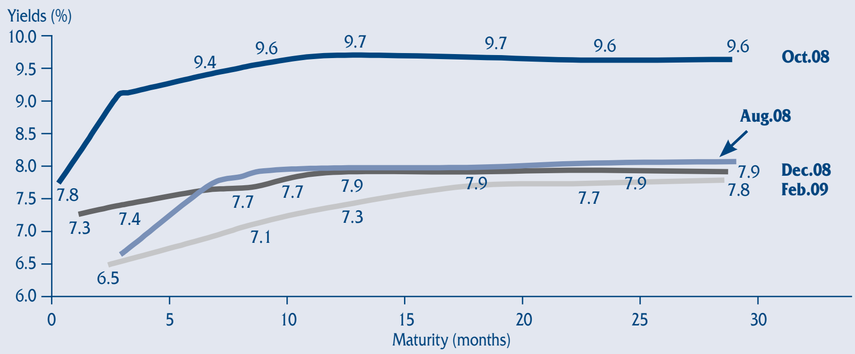
59. Because of the measures implemented by the BCRP, the interbank money market in soles has maintained its volume of transactions despite the deepening of the global financial crisis. Moreover, after the temporary reduction observed between September and October, 2008, the average volume of interbank operations has even increased.

60. As a result of the measures implemented in the last quarter, the pressures on the money market declined and interest rates resumed their normal levels. In this way, the Central Bank prevented that the pressures on the interest rates might affect economic agents' indebtedness conditions. Furthermore, upward pressures on the yield on public bonds and BCRP securities normalized and interest rates returned to the same levels observed in August 2008, before the crisis. As a result of this, private debt issues have been resumed in the capital market in 2009. Because of the timely measures adopted by the Central Bank –which implied a comprehensive activation of its operational procedures–, the rate of inflation in Peru in 2008 has been one of the lowest rates in the region. Therefore, inflation is expected to continue converging towards the 2 percent target and should do so at end 2009.

Graph 50
INTERBANK AND CORPORATE PRIME INTEREST RATES



Graph 51
PUBLIC TREASURY SOVEREIGN BOND OF SECONDARY MARKET 1/

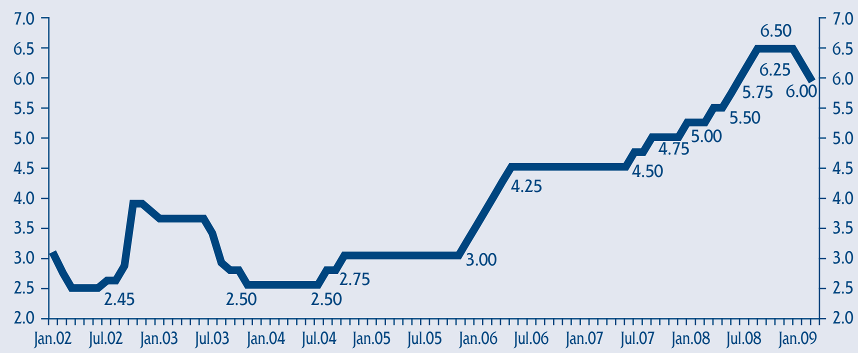


1/ Average yield auctioned in the period.

61. With greater clearness on the downward trend shown by the rate of inflation and public expectations about it, in February 2009 the Bank started implementing a sequence of reductions in the monetary policy reference interest rate. Thus, the reference rate was lowered from 6.5 to 6.25 percent in February and to 6.0 percent in March.

Previously, in order to contain the inflationary pressures that were observed particularly in 2008, the Bank had implemented a sequence of rate increases since July 2007. The reference rate was raised from 4.75 percent in that month to 6.50 percent in September 2008.

Graph 52
REFERENCE INTEREST RATE
(Percentage)



SUMMARY OF COMMUNIQUÉS ON THE MONETARY PROGRAM: October 2008 – March 2009

October: The Board of Directors of the Central Bank of Peru approved to maintain the monetary policy reference interest rate at 6.50 percent.

This decision has been made considering high uncertainty regarding the evolution of global economy and its impact on global economic activity, the international prices of our exports and imports, and international financial flows. It should be pointed out that the recent drops observed in the prices of commodities and fuels, as well as the downward trend observed in the prices of imported foodstuffs favor a gradual reduction of inflation in the country.

November: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference interest rate at 6.50 percent.

The Board will continue to oversee the development of domestic demand and of the national and international economic and financial situation, as well as the evolution of inflation and its determinants, including the impact of public utility rates. The Board also reiterates that the Central Bank will adopt any necessary measures to lead inflation to gradually converge to the target range in a context of sustained growth, including adopting a more flexible monetary stance, should this be required.

December: The Board of the Central Reserve Bank of Peru approved to maintain the monetary policy reference interest rate at 6.50 percent.

The Board also approved to reduce minimum legal reserve requirements from 9.0 to 7.5 percent, which would release approximately S/. 650 million, and to reduce marginal reserve requirements in foreign currency from 35 to 30 percent.

The Board will continue to oversee the development of domestic demand and of the national and international economic and financial situation, as well as the evolution of inflation and its determinants. The Board also reiterates that the Central Bank will adopt any necessary measures to lead inflation to gradually converge to the target range. Moreover, the Board reaffirms its commitment of using monetary instruments to supply the economy with the amount of liquidity required and states that a more flexible monetary stance will be adopted as inflation expectations start converging towards the target range.

January: The Board of the Central Reserve Bank of Peru approved to reduce minimum legal reserve requirements by 1 percentage point and to maintain the monetary policy reference interest rate at 6.50 percent.

This measure is part of the series of policies that the Central Bank has been implementing since September 2008 to provide liquidity to the economy and to face the international financial crisis in order to preserve the normal functioning of the credit market.

The Board continues to oversee the development of domestic demand and of the national and international economic and financial situation, as well as the evolution of inflation and its determinants. The Board also reiterates that the Central Bank will adopt any necessary measures to lead inflation to gradually converge to the target range and affirms its commitment to providing the economy with the required liquidity through monetary instruments. As long as inflation and inflation expectations continue converging to the target range, the Board will also adopt a more flexible monetary stance.

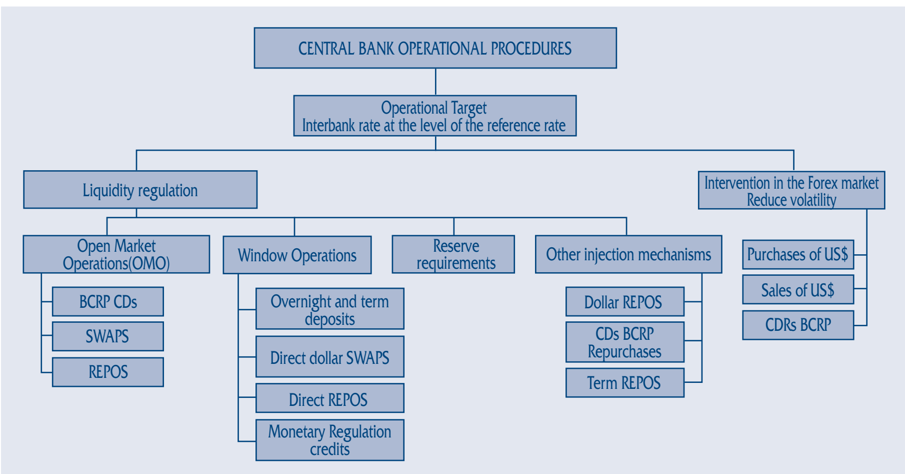
February: The Board of the Central Reserve Bank of Peru approved to reduce the monetary policy reference interest rate from 6.50 to 6.25 percent.

This decision is based on the fact that lower inflationary pressures have been observed in a context of lower global economic growth and a drop in the international prices of food and fuels.

The Board continues to oversee the evolution of inflation and its determinants, particularly in terms of the development of domestic demand and of the national and international economic and financial situation.

March: The Board of the Central Reserve Bank of Peru approved to reduce the monetary policy reference interest rate from 6.25 to 6.0 percent. With this decision, the Central Bank continues to loosen its monetary policy stance given that lower inflationary pressures and declining inflation expectations are being observed in a context of lower growth in the global economy. Should this trend persist, the Bank will continue to loosen its monetary policy stance.

Graph 53



62. The BCRP uses a variety of operational instruments to control liquidity in both soles and in dollars. Thus, the Bank can temporarily inject liquidity to the financial system through repo operations of government securities in both soles and dollars. Moreover, banks can also obtain soles from the BCRP in the short term through a temporary sale of dollars (Swap operations). To inject liquidity in a permanent manner, the BCRP can also reduce reserve requirements or purchase its own securities or government papers in the secondary market.

63. The aim of BCRP monetary operations is that the interbank lending market operates with the reference interest rate, for which the Central Bank injects or withdraws liquidity in domestic currency into the financial system. Additionally, the Central Bank intervenes in the foreign exchange market purchasing or selling dollars to prevent strong fluctuations in the exchange rate that could compromise its stability. Considering the desired level of the reference interest rate to be attained, the BCRP injects or withdraws domestic currency through its foreign exchange operations at the same time that it injects or withdraws dollars into the interbank market.

64. Since the financial crisis deepened, the BCRP monetary actions have been oriented to preserving the normal operation of the monetary and financial markets –especially the credit market–, which has implied preventing that the following effects might be generated: a) liquidity shortages (in soles or in dollars) that could negatively affect the process of financial intermediation; b) adverse effects on firms' balances and on families due to abrupt depreciations that could cause recessive pressures; c) excessive upward shifts –disconnected from the expected evolution of the reference rate– in the monetary market yield curve that could weaken the interest rate channel of monetary policy.

Therefore, an appropriate level of liquidity (in soles and in dollars) has been provided in the financial system by a series of successive reductions of reserve requirements and by enhancing the amount and type of liquidity injection operations. Moreover, the normal term of liquidity injection operations has been extended or BCRP CDs have been repurchased to facilitate the formation of interest rates with different maturities when this has been required.

65. The operations conducted by the Central Bank have resulted in a recomposition of its assets and liabilities with the financial system in response to two different scenarios that affected the Peruvian economy. Between September 2008 and February 2009, a scenario of a higher preference for liquidity in dollars was faced through the sale of foreign currency in the foreign exchange market, which reduced the Bank's exchange position by US$ 6,920 million. The opposite scenario, when there was a higher preference for domestic currency which attracted strong inflows of short-term capitals and generated downward pressures on the exchange rate, was observed between January and August 2008. In this context, the BCRP carried out sterilizing operations purchasing dollars, thus increasing its foreign currency assets and its exchange position by US$ 7,125 million.

Counterbalancing the change in assets in foreign currency –and reflecting sterilization–, the balance of the BCRP shows an increase in domestic net assets in soles of S/. 21,610 million between September 2008 and February 2009. This reflects the reduction of its liabilities due to the maturity of CDs (S/. 24,626 million) and the reduction of reserve requirements in soles (S/. 1,301 million), offset by higher liabilities due to the issue of CDs for a total of S/. 10,351 million. Thus, the balance of CDs declined from S/. 34,024 million in August 2008 to S/. 9,398 million in February 2009. On the other hand, assets in soles increased by S/. 7,877 million due to injections of liquidity through repo operations.

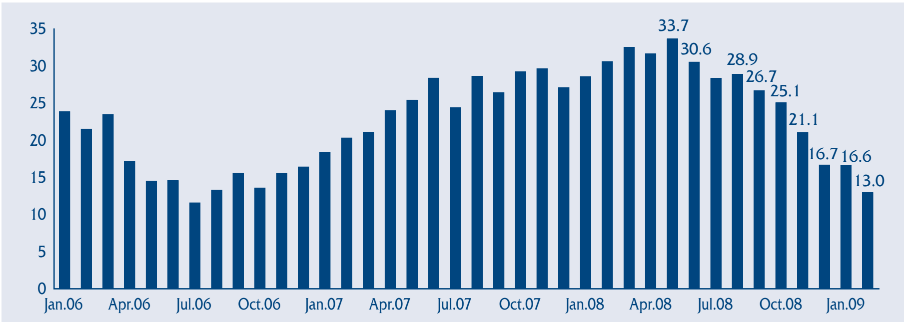
66. The variety of instruments that the BCRP can use is important because it increases the efficiency of monetary policy operational procedures given that they may be adapted to be used according to the changing conditions of the money and exchange markets. Thus, for example, in October 2008, when some banks did not have government securities and not all the banks had access to REPOS, the BCRP inyected liquidity through swaps, which contributed not only to a better distribution of liquidity in the system but also to a faster convergence of short-term interest rates.

TABLE 18
OPERATIONS OF THE BCRP
(Millions of nuevos soles)

	2007	2008	Jan - Aug 08	Sep 08 - Feb 09
I. INTERNATIONAL POSITION	**26,464**	**4,114**	**20,525**	**-21,305**
(Millions of US$)	**8,536**	**1,743**	**7,125**	**-6,920**
A. Foreign exchange operations	**7,070**	**488**	**6,480**	**-7,204**
1. FOREX trading	10,306	2,754	8,449	-6,843
2. Public sector purchases	-3,275	-2,316	-2,010	-356
3. Other	39	50	40	-4
B. Other operations	**1,466**	**1,255**	**645**	**283**
II. NET DOMESTIC ASSETS	**-23,294**	**-1,632**	**-19,278**	**21,610**
A. Monetary Operations	**-20,115**	**1,368**	**-17,979**	**20,221**
1. Sterilization operations	**-20,115**	**-4,045**	**-17,979**	**12,344**
a. Deposits of the public sector	-6,751	-6,644	-4,958	-2,188
b. CD-BCRP	-13,393	13,737	9,541	8,045
c. CDR-BCRP	0	-4,425	0	-10,351
d. CD-BCRP of Restricted Negotiation	0	-6,483	-22,107	16,581
e. Term deposits	0	0	-283	283
f. Overnight deposits	227	-3	-84	26
g. Other operations	-199	-226	-89	-52
2. Injection operations	**0**	**5,412**	**0**	**7,877**
a. REPOS	0	5,412	0	7,877
B. Reserve deposits in domestic currency	**-746**	**-2,050**	**-1,693**	**1,301**
C. Other assets	**-2,433**	**-950**	**394**	**88**
III. CURRENCY IN CIRCULATION	**3,170**	**2,482**	**1,246**	**305**
% change at end period	27.1	16.7	28.9	13.0
Memo:				
Balance				
End of period sterilized balance	**38,714**	**42,758**	**56,693**	**44,349**
Public sector deposits	16,924	23,568	21,882	24,069
CD-BCRP	21,458	7,721	11,917	3,872
CDRBCRP	0	4,425	0	10,351
CDBCRP-NR	0	6,483	22,107	5,526
REPOS	0	5,412	0	-7,877
1. CURRENCY	14,857	17,339	16,104	16,408
2. RESERVE DEPOSITS	2,922	4,971	4,615	3,314
3. MONETARY BASE (1+2)	17,779	22,311	20,718	19,722

67. Demand pressure for deposits in dollars and the declining growth rate of GDP have led to a deceleration in the growth of the balance of currency in circulation, which fell from an annual growth rate of 33.7 percent in May 2008 to a rate of 13 percent in February 2009.

Graph 54
CURRENCY
(12 month percentage change)



68. Passive interest rates in nuevos soles increased relative to the levels recorded in September, particularly those with longer terms. Thus, the rates on 180-day deposits and on up to 360-day deposits increased from 5.6 to 6.5 percent and from 5.7 to 6.5 percent, respectively.

The active 3-month corporate prime rate returned to a similar level to the one observed in September (7.2 percent) after having recorded higher levels between October and December 2008 reflecting the generalized uncertainty associated with the international financial crisis. The last reduction observed in this rate is explained by the decline of the reference rate which was lowered from 6.50 to 6.25 percent in February. With this, the spread between the interbank rate and the corporate rate in nuevos soles was around 73 basis points in February 2009.

TABLE 19
INTEREST RATES IN NUEVOS SOLES
(In percentage)

	Dec. 2007	Sep. 2008	Oct. 2008	Nov. 2008	Dec. 2008	Jan. 2009	Feb.* 2009
1. Reference interest rate	5.00	6.50	6.50	6.50	6.50	6.50	6.25
2. Deposits up to 30 days	4.8	5.8	6.3	6.4	6.5	6.5	6.6
3. Rate on 31-day to 180-day term deposits	5.3	5.6	5.8	6.2	6.4	6.5	6.5
4. Rate on 31-day to 180-day term deposits	5.6	5.7	5.9	6.1	6.3	6.4	6.5
5. Corporate prime rate	5.6	7.2	7.8	7.6	7.5	7.4	7.2
6. Average rate on loans of up to 360 days	13.2	14.4	14.8	15.3	15.2	15.5	15.6
7. Average lending rate, constant structure	16.3	16.9	16.9	17.2	17.2	17.3	17.4

* As of February 24.

69. The other interest rates on active operations increased: the rates on commercial loans increased from 10.5 to 10.9 percent in the same period, while the rates on consumer loans and on loans to microbusinesses increased from 31.8 to 32.8 percent and from 35.0 to 35.5 percent, respectively. This was mainly associated with banks' higher financing costs and with a higher perception of credit risk in the context of the international financial crisis.

TABLE 20
INTEREST RATES IN NUEVOS SOLES
(In percentage)

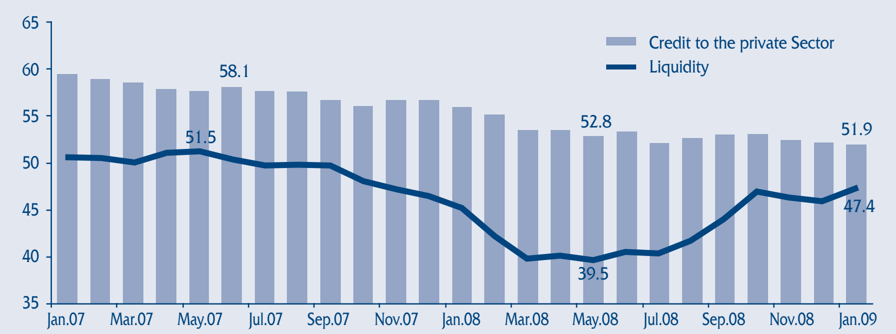
Date	Monetary reference rate	Corporate	Interbank	Commercial	Microbusiness	Consumer
Dec.06	4.50	5.23	4.51	9.46	39.05	34.79
Dec.07	5.00	5.60	4.99	8.99	35.60	33.54
Mar.08	5.25	5.59	5.21	9.20	35.44	34.10
Jun.08	5.75	6.27	5.68	9.65	35.13	32.47
Sep.08	6.50	7.18	6.43	10.45	35.02	31.80
Oct.08	6.50	7.81	6.60	10.64	34.93	31.59
Nov.08	6.50	7.59	6.55	10.85	34.91	32.17
Dec.08	6.50	7.48	6.54	10.84	34.97	32.26
Jan.09	6.50	7.36	6.57	10.77	35.05	32.68
Feb.09*	6.25	7.18	6.45	10.86	35.49	32.75

* As of February 24.

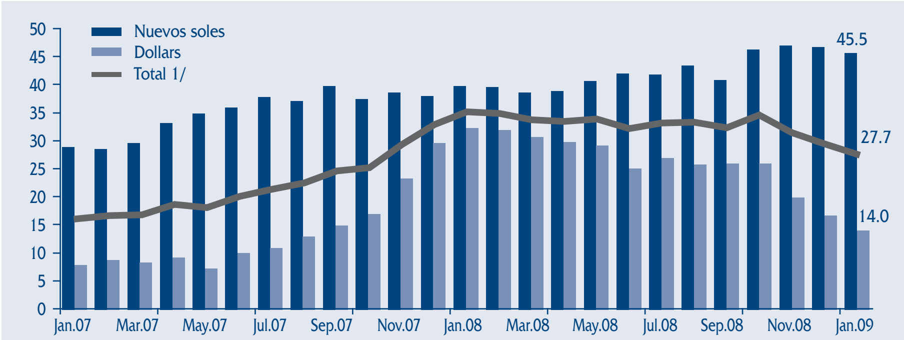
Credit to the Private Sector

70. Credit to the private sector in soles grew at an annual rate of 45.5 percent in January 2009 –showing a higher growth rate than the one recorded in September (40.7 percent)–, while credit to the private sector in dollars continued showing the downward trend observed since September and declined to 14.0 percent in January 2009. The evolution of credit in both currencies was reflected in the lower dynamism of overall credit, which showed a growth rate of 27.7 percent in January 2009.

Graph 55
DOLLARIZATION COEFFICIENT



Graph 56
CREDIT TO THE PRIVATE SECTOR
(Annual percentage change)



1/ The balances of dollars are valued at the constant exchange rate of January, 2009.

Graph 57
CREDIT TO THE PRIVATE SECTOR BY TYPE OF LOAN
(Annual percentage change)

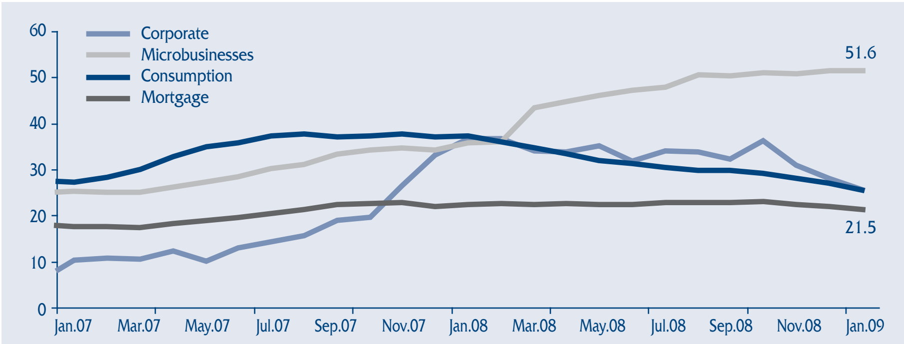


TABLE 21
BALANCE OF CREDIT TO THE PRIVATE SECTOR BY TYPE OF LOAN
(Millions of nuevos soles)

	Jan.08	Feb.08	Mar.08	Apr.08	May.08	Jun.08	Jul.08	Aug.08	Sep.08	Oct.08	Nov.08	Dec.08	Jan.09
Corporate	47,284	47,607	47,655	48,629	49,561	50,766	52,596	52,795	54,200	56,720	58,746	59,248	59,403
Microbusiness	6,710	6,889	7,442	7,672	7,914	8,172	8,432	8,742	9,025	9,406	9,837	10,086	10,173
Consumer	17,876	18,187	18,573	19,021	19,579	20,013	20,216	20,658	21,086	21,475	21,815	22,314	22,398
Mortgage	9,199	9,355	9,510	9,695	9,863	10,057	10,266	10,480	10,669	10,877	11,011	11,082	11,180

71. It is worth pointing out that the average monthly flow of overall credit between September 2008 and January 2009 was S/. 2,062 million, higher than the average growth observed between January 2008 and September 2008 (S/. 1,680 million).

TABLE 22
TOTAL CREDIT: MONTHLY BALANCES AND FLOWS
(Millions of nuevos soles)

	Jan.08	Feb.08	Mar.08	Apr.08	May.08	Jun.08	Jul.08	Aug.08	Sep.08	Oct.08	Nov.08	Dec.08	Jan.09
Balance	78,409	79,370	80,493	82,313	84,180	86,234	88,659	89,815	92,044	95,481	98,363	99,681	100,122
Monthly Flows	1,484	961	1,123	1,820	1,868	2,054	2,424	1,156	2,229	3,437	2,882	1,318	442
1-month % chg.	1.9	1.2	1.4	2.3	2.3	2.4	2.8	1.3	2.5	3.7	3.0	1.3	0.4
12-month % chg.	35.3	35.1	33.9	33.6	34.1	32.3	33.4	33.4	32.4	34.8	31.5	29.6	27.7

72. Consumption credit continues to show a deceleration: its growth rate in the last 12 months has declined from 29.8 percent in September 2008 to 20.4 percent in January 2009. Corporate loans reached a last 12-month growth rate of 28.4 percent at end January 2009, while loans to microbusinesses grew at a rate of 50.7 percent, showing a similar level than the one observed since September 2008. Mortgage loans, on the other hand, grew at an annual rate of 22.2 percent.

TABLE 23
CREDIT TO THE PRIVATE SECTOR BY TYPE OF CREDIT 1/

	Balance in millions of Nuevos Soles				Last 12-month growth rate			
	Sep.08	Nov.08	Dec.08	Jan.09	Sep.08 / Sep.07	Nov.08 / Nov.07	Dec.08 / Dec.07	Jan.09 / Jan.08
Corporate credit 2/	52,087	56,546	57,039	57,200	32.7	31.8	28.7	28.4
Microbusiness	8,856	9,657	9,899	9,988	49.8	50.1	50.8	50.7
Consumer 3/	20,871	21,595	22,102	22,196	29.8	28.1	27.0	20.4
Mortgages 3/	10,230	10,564	10,640	10,738	23.8	23.2	22.9	22.2
TOTAL	92,044	98,363	99,681	100,122	32.4	31.5	29.6	27.7

1/ Includes loans given by banks, Banco de la Nación, financial businesses, municipal banks, rural banks, and savings and credit cooperatives. Total credit is calculated based on a constant exchange rate.
2/ Includes commercial credit to non-financial businesses and investment in securities.
3/ Corrected due to the effect of re-classifying from consumer loans to mortgages in December 2008.

73. Between September 2008 and January 2009, the highest sources of expansion of credit to the private sector included the increase of financial entities' equity (S/. 3,023 million) and repo operations with the BCRP which amounted to S/. 5,239 million, of which S/. 1,389 million were repo operations maturing in more than 2-month terms. Factors negatively affecting the growth of credit included the decline of public sector deposits (by S/. 398 million), deposits of non-residents (S/. 455 million), and private sector deposits (S/. 709 million).

TABLE 24
SOURCES OF CREDIT TO THE PRIVATE SECTOR IN NUEVOS SOLES 1/
(Millions of nuevos soles)

	Flows	Balance	
	Jan.09 / Sep.08	Sep.08	Jan.09
CREDIT IN DOMESTIC CURRENCY	**6,470**	**43,122**	**49,592**
1. Private sector deposits	-709	39,256	38,547
2. Public sector deposits	-398	17,660	17,262
3. Non-residents' deposits	-455	582	127
4. Increase in equity 2/	3,023	28,653	31,676
5. REPOS	5,239	0	5,239
6. (-) BCRP Deposits and CDBCRP	2,143	30,131	27,988
7. (-) Accounting international position (banks)	-4,044	879	4,924
8. Others	1,672		

1/ Source and balance use approach. Flows with a positive sign indicate funding for banks, either because liabilities increase or assets decrease an anchor for financial institutions.
2/ Includes provisions.

On the other hand, the highest sources of growth of credit in dollars included the higher long-term external liabilities (US$ 169 million), private sector's higher deposits (US$ 981 million), public sector's higher deposits (US$ 10 million), and banks' higher exchange position (US$ 2,170 million), all of which compensated the decline of short-term external liabilities (US$ 909 million).

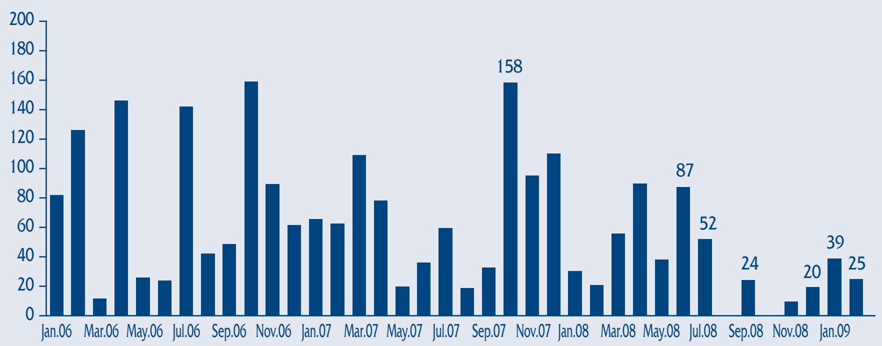
TABLE 25
SOURCES OF CREDIT TO THE PRIVATE SECTOR IN US DOLLARS 1/
(Millions of US$)

	Flows	Balance	
	Jan.09 / Sep.08	Sep.08	Jan.09
CREDIT IN FOREIGN CURRENCY	**536**	**16,307**	**16,844**
1. Short-term external liabilities	-909	2,460	1,551
2. Long-term external liabilities	169	3,564	3,734
3. Deposits of the private sector	981	14,577	15,557
4. Deposits of the public sector	10	1,054	1,064
5. Accounting international position (banks)	2,170	295	2,465
6. (-) Foreign assets	-575	2,072	2,647
7. (-) Deposits in the BCRP	427	6,956	6,529
8. Others	-1 737		

1/ Source and balance use approach. Flows with a positive sign indicate funding for banks, either because liabilities increase or assets decrease an anchor for financial institutions.

74. Placements of non-financial firms' private issues of long-term bonds have been recovering in the last months, although without reaching the levels observed in the first half of 2008. The measures implemented by the Central Bank to face the turbulence of the international credit market, which temporarily tightened local financing conditions generating a strong movement in the yield curve in October, have contributed to this recovery. As a result of this, normal conditions of business access to the capital market to finance investment projects was re-established.

Graph 58
BONDS ISSUED BY NON-FINANCIAL COMPANIES 1/
(Millions of US$)



1/ Primary Public Offer.
Source: BCRP Weekly Report. Data on February is preliminary.

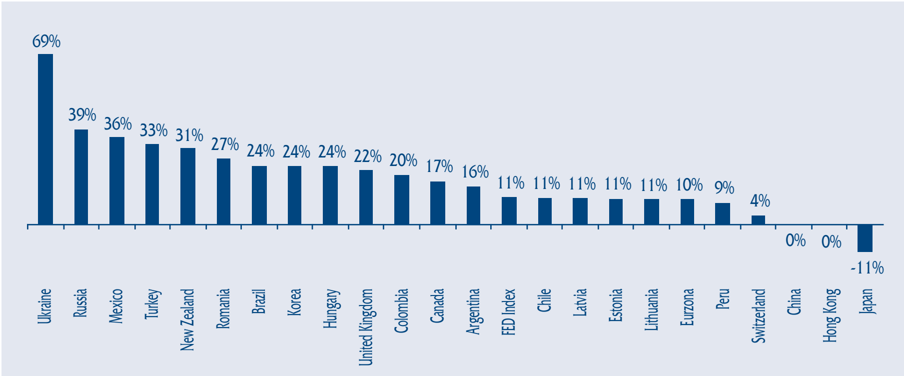
Exchange Rate

75. The appreciatory trend of the nuevo sol observed in previous years reversed in 2008 when the nuevo sol depreciated 4.5 percent against the dollar compared with 2007. This shift to a depreciatory trend was generated by changes in key variables, such as the decline of terms of trade and the deterioration of foreign trade due to the international financial crisis. Moreover, the evolution of the exchange rate in 2008 was characterized by higher volatility, explained by changes in the composition of the portfolio of financial assets held by both resident and non-residents. This year, the exchange rate continues to show an upward trend. Thus, at the close of February the nuevo sol recorded a depreciation of 3.9 percent against the dollar compared to December 2008.

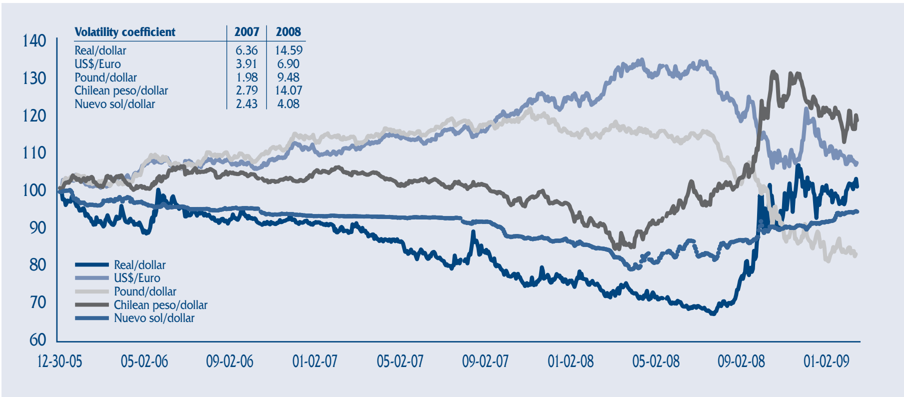
76. The international financial crisis brought about a shift in the composition of the portfolio towards safer assets in the case of both resident and non-resident investors, which led to a higher volatility in exchange in 2008 (variability ratio of 4.1 percent) than the one observed in 2007 (variability ratio of 2.4 percent). This higher volatility was not an isolated event in the Peruvian economy, but rather a

generalized phenomenon in both industrialized countries and in Latin American countries. For example, the ratio of volatility of the sterling pound against the dollar increased from 2 percent in 2007 to 9.5 percent in 2008, while the ratio of volatility of the Chilean peso against the dollar increased from 2.8 percent in 2007 to 14 percent in 2008.

Graph 59
EVOLUTION OF CURRENCIES AGAINST THE DOLLAR
(February 2009 / September 2008)



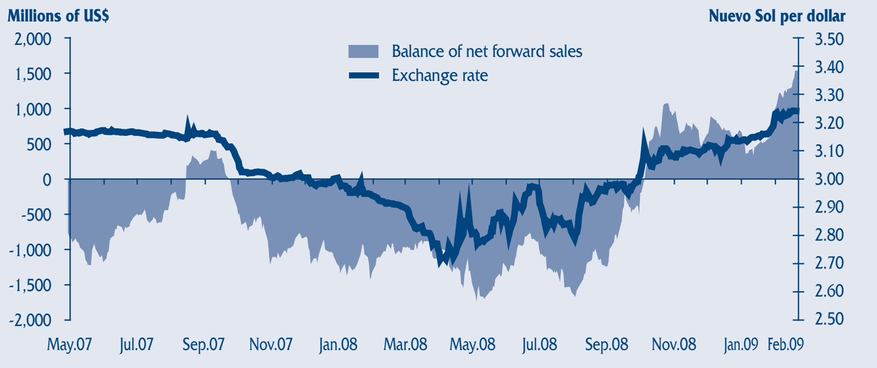
Graph 60
EXCHANGE RATE INDEX
(December 2005=100)



Volatility coefficient	2007	2008
Real/dollar	6.36	14.59
US$/Euro	3.91	6.90
Pound/dollar	1.98	9.48
Chilean peso/dollar	2.79	14.07
Nuevo sol/dollar	2.43	4.08

77. This volatility of exchange and its effect on economic agents' expectations was also reflected in the forward market. Thus, the balance of net forward purchases declined from US$ 1,203 million at end 2007 to a balance of net forward sales of US$ 693 million at end 2008, reflecting a shift from appreciatory expectations to depreciatory expectations.

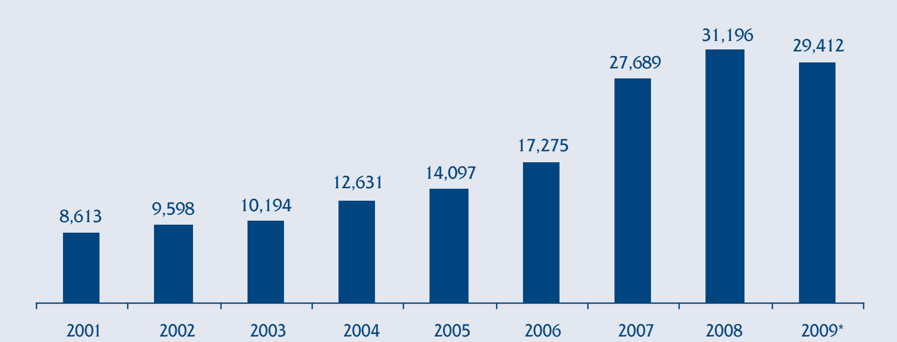
Graph 61
BALANCE OF NET FORWARD SALES AND EXCHANGE RATE
(Millions of US$ and Nuevos Soles per dollar)



78. The BCRP actions were also oriented to reducing the volatility of exchange in a context of high uncertainty in the money markets and higher risk aversion vis-à-vis emerging markets. With this aim, the BCRP sold foreign currency for a total of US$ 6,843 million since September 2008 and placed CDRs for a total of US$ 3,980 (S/. 12,636 million). These sales prevented the deterioration of dollarized balances of firms and families due to the evolution of exchange.

Despite this, during 2008 the BCRP accumulated international reserves for US$ 3,507 million, thus increasing its balance from US$ 27,689 million in December 2007 to US$ 31,196 million in December 2008. This was possible due to the preventive accumulation of international reserves carried out by the Central Bank, whereby a total of US$ 10,306 million was bought in the exchange market in 2007 and a total of US$ 8,449 million was bought until August 2008.

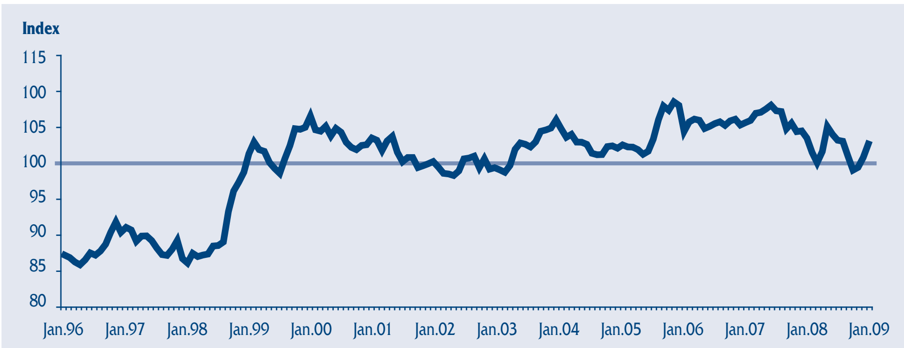
Graph 62
NET INTERNATIONAL RESERVES
(Millions of US$)



* February 2009.

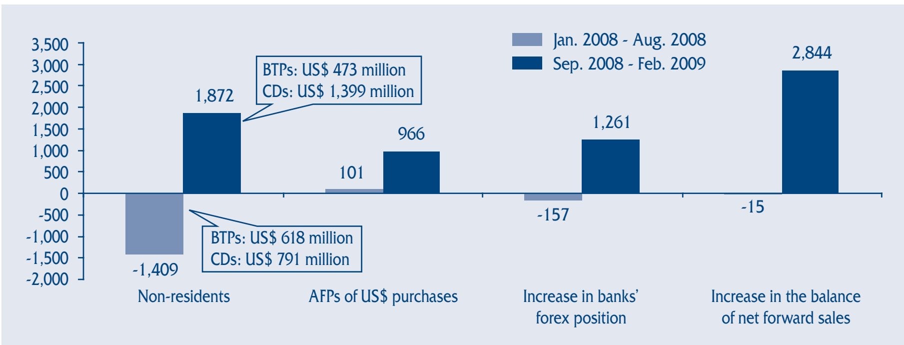
79. The real exchange rate has remained stable in the last years due to the sound fundamentals of the Peruvian economy, which included a good fiscal position, low debt levels, and a sustainable level in the current account.

Graph 63
REAL EXCHANGE RATE INDEX



80. The evolution of economic agents' portfolio was infuenced by the effects of the international financial crisis on the domestic financial system. Between January and August 2008, a period characterized by inflows of short-term capitals in a context of appreciation of exchange, economic agents reduced their positions in dollars. Particularly, non-resident economic agents purchased assets in domestic currency. Since September 2008, in a context of higher risk aversion, economic agents sought to recover their positions in foreign currency. Thus, a higher dynamism was observed in the forward market which showed increased net sales to non-residents and an increase in banks' and pension funds (AFPs) exchange position.

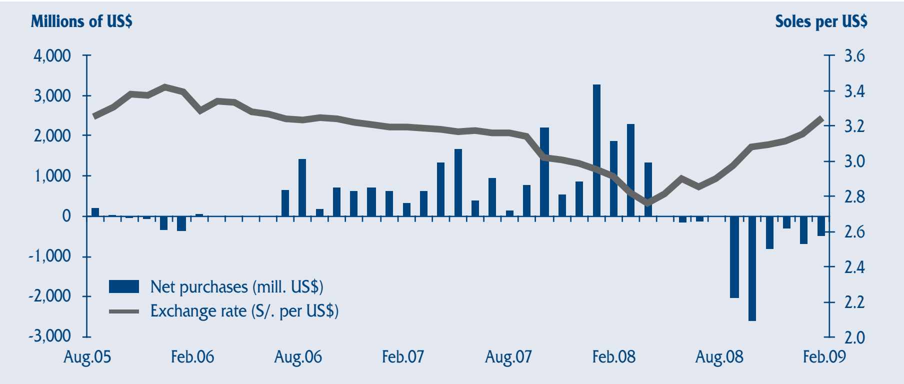
Graph 64
FOREIGN EXCHANGE MARKET: PORTFOLIO MOVEMENTS



BOX 5
BCRP INTERVENTION IN THE EXCHANGE MARKET

The Central Reserve Bank of Peru intervenes in the exchange market with the aim of reducing the volatility of exchange. In small open economies, especially in highly dollarized economies with an imperfect financial market as the Peruvian economy, abrupt fluctuations of nominal exchange can negatively affect the level of economic activity, employment, and income through the balance sheet effect, which affects economic agents with debts in dollars but who have income sources denominated in nuevos soles.

EXCHANGE RATE AND NET PURCHASES OF FOREIGN CURRENCY



Likewise, these fluctuations may cause adverse effects if the economy has a high level of price dollarization, understood as the percentage of prices in an economy that are set in dollars. Strong appreciations of the local currency may reduce the incomes of those who sell their products in dollars. This effect is usually greater in emerging economies where hedge markets are not very developed (Calvo & Reinhart, 2000).

Reducing the volatility of exchange becomes even more important when we consider that financial and exchange markets usually generate price volatilities that are not in line with macroeconomic fundamentals, but caused by speculative bubbles (Brunnermier, 2008). Therefore, many emerging countries are reluctant to total free flotation (independent) and have rather opted for a managed flotation of exchange.

Central banks also intervene in the exchange market to preventively accumulate international reserves, thus providing signals of their availability of liquidity, and to have an insurance to face potential crisis[7]. A considerable stock of international reserves also allows the economy to buffer the effects of abrupt capital outflows on aggregate expenditure, also allowing the Central Bank to act as lender of last resort in economies with high ratios of dollarization.

7 Also known as the precaution motive.

The reasons explaining the BCRP's intervention in the exchange market have been documented in the last IMF's Country Report on Peru[8]. This report offers different estimates of the determinants of the BCRP intervention in terms of smoothing movements of the exchange rate, of net international reserves (as precaution), and of control variables, such as the effects of week days or holidays. These estimates are based on data collected on a daily basis between January 2001 and September 2008.

The results indicate that intervention in the exchange market has been mostly associated with the smoothing of exchange. However, the importance of this reason has been declining in the last two years. On the contrary, precaution (the accumulation of reserves) has become more relevant as a reason for this intervention, as evidenced in the accumulation of reserves which amount to US$ 30 billion at January 2009.

Given that Peru is an emerging economy and considering the detrimental effects of a strong depreciation (appreciation) to which Peru is exposed, the BCRP's participation in the exchange market and its accumulation of reserves are key instruments used to offset any negative impact of an excessive volatility of the exchange rate.

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BOX 6
CURRENCY MISMATCH IN THE REAL SECTOR BUSINESSES

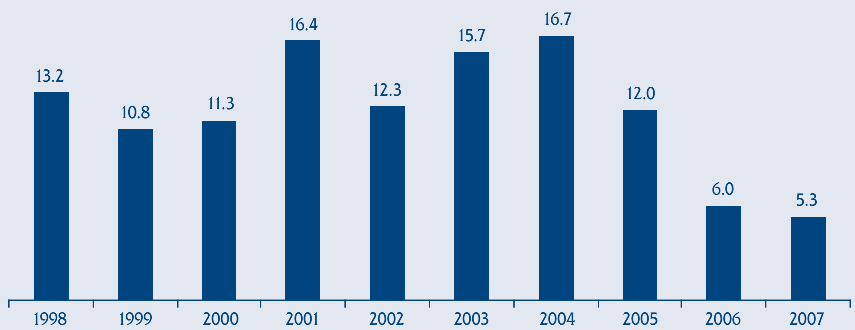
The volatility of the exchange rate generated by the international financial crisis has again brought about concern in emerging countries about the financial risks associated with currency mismatches in non-financial firms. In a context of a currency mismatch, when the exchange rate increases, a firm's debt in dollars expressed in terms of nuevos soles increases more than its assets in dollars –in terms of nuevos soles–, affecting the firm's financial situation.

Has currency mismatch decreased in Peru over the past few years? In order to answer to this question, we analyzed the information on the audited financial statements of non financial firms

8 http://www.imf.org/external/pubs/ft/scr/2009/cr0941.pdf

registered at the Comisión Nacional de Empresas and Valores (CONASEV) through a sample of 80 firms[9]. Using the net passive position in dollars (liabilities in foreign currency minus assets in foreign currency) to total assets ratio to measure the exchange rate mismatch, we can see that the average currency mismatch has declined from 13.2 percent in 1998 to 5.3 percent in 2007. This decline drops drastically since 2005.

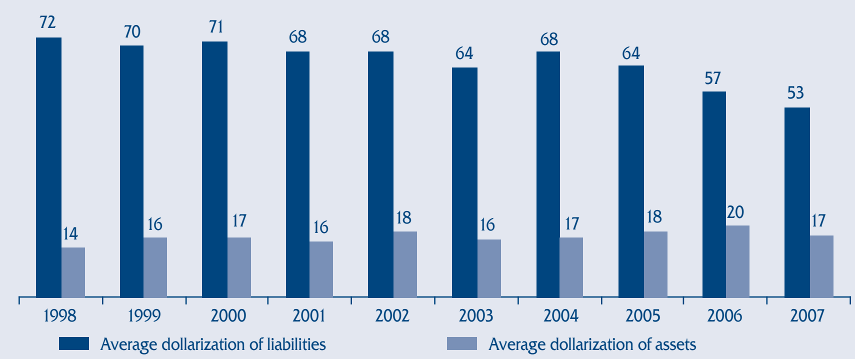
CURRENCY MISMATCH 1/



1/ (FC Liabilities – FC Assets)/Total Assets. The same firms have been considered each year.

Moreover, we analyzed the evolution of the average level of dollarization of assets and liabilities to determine the cause of this drop. As we can see in the graph below, the main reason explaining this drop is the lower dependence from financing in foreign currency (the dollarization of liabilities declined from 72 percent in 1998 to 53 percent in 2007) and, to a lesser extent, the higher natural coverage against currency mismatch achieved by generating incomes in dollars (the dollarization of assets increased from 14 percent in 1998 to 17 percent in 2007).

DOLLARIZATION OF ASSETS AND LIABILITIES1/

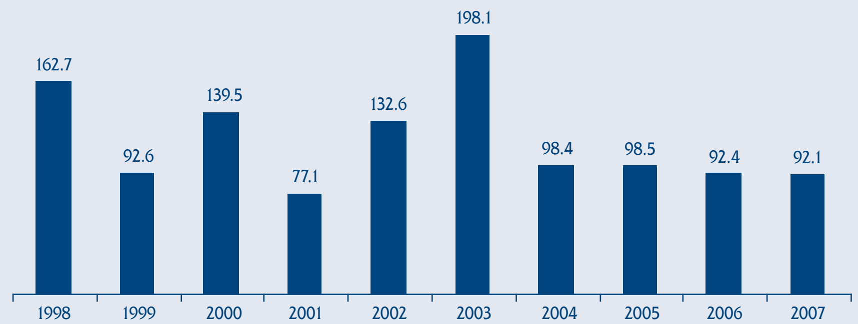


1/ Dollarization of assets = Assets in FC/Total assets. Dollarization of liabilities = Liabilities in FC/Total liabilities.

9 The total assets of the firms included in this sample represents 26 percent of the total assets of the major 1,000 firms reported by "Perú Top Publications".

Furthermore, the leverage degree has declined significantly and has remained stable at around 100 percent during the last years. Average leverage fell from 163 percent in 1998 to 92 percent in 2007. This lower leverage has had a positive effect on non-financial firms' access to credit in a context of recession, since it limits their exposure to interest rate and exchange fluctuations.

LEVERAGE RATIO 1/



1/ Total assets / equity.

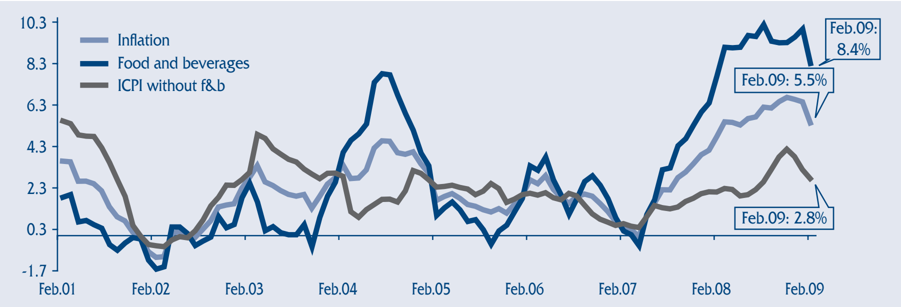
Thus, firms' balances show a reduction in Peruvian non-financial firms financial fragility vis-à-vis exchange rate shocks in the last decade due to lower currency mismatch, to the reduction of the dollarization ration of liabilities, and to the lower leverage degree. This result is important because it shows that the real sector has a higher capacity to absorb increased exchange volatility. It should be pointed out that this is not an isolated phenomenon taking place in the Peruvian economy. A recent study developed by Kamil (2008) offers statistical data on currency mismatch and dollarization of assets and liabilities for a sample of non-financial firms in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay, which show that currency mismatch has declined significantly in these economies in the last years.

VI. Inflation

81. During 2008 the inflation rate reflected the impact of supply shocks on the prices of domestic and imported foodstuffs. As a result of this, while the consumer price index (CPI) rose 6.65 percent, the prices of food increased 9.7 percent, and the prices of several components other than food recorded an increase of 3.9 percent.

A reversal in the upward trend of the prices of imported raw materials and fuels has been observed in the first months of this year, causing a favorable impact on the cost of living. Thus, the 12-month growth rates of prices at February have declined to 5.5 percent in the case of the general index and to 8.4 percent in the case of the food index.

Graph 65
OVERALL CONSUMER PRICE INDEX AND FOOD AND BEVERAGES CPI
(Last 12-month percentage change)



82. The items that contributed most heavily to accumulated inflation in the March 2008 - February 2009 period were meals outside the home, potato, poultry, urban fares, onion, and beef. Conversely, the items with a highest negative contribution to inflation were gasoline, sugar, and kerosene.

TABLE 26
WEIGHTED CONTRIBUTION TO INFLATION (MARCH 2008 - FEBRUARY 2009)
(Percentage points)

Items	Weight	% Chg.	Positive contribution	Items	Weight	% Chg.	Negative contribution
Meals outside the home	12.0	7.8	0.91	Gas and oil	1.5	-23.2	-0.49
Potato	1.5	32.7	0.54	Kerosene	1.2	-11.5	-0.25
Chicken meat	4.0	13.9	0.49	Sugar	1.4	-8.0	-0.10
Urban fares	8.0	6.0	0.48				
Meat	2.3	15.1	0.34				
Onion	0.4	81.2	0.33				
Total			**3.09**				**-0.84**

83. A change of trend in the last 12-month price variations of food and beverages and fuels and electriciy is observed at February 2009. However, un upward trend persists in the prices of the rest of goods and services in connection with the high dynamism of domestic demand, as well as with an increase in the exchange rate. Items worth pointing out in this group include grooming articles, cleaning products, garments for women and girls, acquisition of cars, and house rents.

TABLE 27
INFLATION

	Weight	2007	2008	2009			
				Jan.	Feb.	Acumm.	12-month
Inflation	**100.0**	**3.93**	**6.65**	**0.11**	**-0.07**	**0.03**	**5.49**
1. Food and beverages	47.5	6.02	9.70	0.96	0.23	1.20	8.40
2. Rest of components	52.5	2.02	3.86	-0.70	-0.39	-1.09	2.78
a. Fuels and electricity	6.2	5.21	1.65	-4.71	-4.92	-9.40	-7.87
b. Transport	8.4	0.82	5.86	-0.68	0.12	-0.56	5.97
c. Public services	2.4	-1.44	8.68	0.02	-0.13	-0.11	10.09
d. Other goods and services	35.5	1.89	3.51	0.11	0.45	0.56	3.91
Memo							
Core inflation	60.6	3.11	5.56	0.35	0.46	0.81	5.77
Core inflation excluding food	35.5	1.89	3.51	0.11	0.45	0.56	3.91

84. The evolution of the items contributing most heavily to in inflation between March 2008 and February 2009 is discussed below:

a. Meals outside the home:

The rise in this item (7.8 percent) is associated with the higher prices of food and beverages (8.4 percent), as well as with the greater dynamism of domestic demand.

b. Potato:

The rise in the price of potato (32.7 percent) reflects the rises recorded mainly since July due to the lower areas cultivated in the departments that supply potato to Lima, such as Ica and Huánuco, which were affected by a lower availability of seeds and by the higher cost of fertilizers. Another factor contributing to this was increased demand due to campaigns promoting its consumption.

c. Chicken meat:

The rise in the price of chicken meat (13.9 percent) was associated with increased demand, coupled by a lower supply of substitute products, particularly yellow mackerel (-38 percent in 2008 relative to 2007). This price rise occurred despite the high level of supply, since the placements of baby chicken have increased 9 percent compared with the previous year. The price drop recorded in the month of January is explained by a lower demand following the festivities of the end of the year. In February, the price increased 1.3 percent due to some reduction in supply (the placement of baby chicken associated with supply in February was 2 percent lower than in January).

Another factor that contributed to the price rise of chicken was the increase of production costs due mainly to the higher price of maize in the international market (39 percent more than in 2007).

Two marked trends were observed in the price of maize in the year: the first was a sustained upward trend observed until June (when maize posted a record level of US$/MT 280), and the other was a downward trend observed until December (when maize reached a minimum low of US$/MT 106 on December 5). The price of maize has started declining as the economy decelerates and in line with the downward trend seen in the price of crude.

So far in 2009, the international price of maize has fluctuated around US$/MT 140. Its downward trend has been interrupted due to production problems associated with unfavorable climatic conditions in Argentina and the United States.

d. Urban fares:

The rise of fares (6.0 percent) resulted from the higher prices of fuels recorded until October 2008.

e. Onion:

The rise in the price of onion (81.2 percent) reflects mainly the strong increases recorded between March and May (91 percent), which was offset with the price drop seen in February (5.7 percent). This was a result of the reduction of sown areas in those months (down 16 percent relative to the previous crop year) due to the low prices paid for the product in the last half of 2007 and to the higher costs of fertilizers and labor.

f. Beef:

This price rise (15.1 percent) is associated with the higher price of chicken meat, its main substitute, and with lower activity in the livestock fattening industry given the higher prices of the imported inputs required (soybean cake, wheat bran, etc.). Seasonal factors, such as a reduction in the selection of livestock in the highlands during Q4 of 2008 and the first two months of 2009, due to rainfall also contributed to this.

g. Sugar:

The price of sugar dropped 8.0 percent mainly due to a higher domestic production of sugar cane (up 13.6 percent in 2008 relative to 2007) as a result of management improvements in the sugar producing enterprises located in La Libertad and Lambayeque.

h. Fuels:

The reduction in the price of fuels (-13.7 percent) stemmed from the strong drop recorded in the international price of crude (the barrel of crude fell from US$ 133.9 in June 2008 to US$ 39.0 in February 2009).

TABLE 28
FUEL PRICES
(Annual percentage change)

	2006	2007	2008	2009			
				Jan.	Feb.	Acumm.	12-month
Fuels	**-1.5**	**6.4**	**0.0**	**-6.5**	**-7.5**	**-13.5**	**-13.7**
Gasoline	-6.2	10.7	-6.1	-8.6	-10.5	-18.2	-23.2
Gas	0.3	1.3	2.7	-3.1	-1.4	-4.4	-2.4
Kerosene	2.2	5.8	4.2	-6.8	-9.0	-15.2	-11.5
Price of WTI oil (end period)							
US Dollars	62.0	91.4	41.4	41.7	39.0		
Nuevos soles	198.8	272.4	129.1	131.6	126.4		

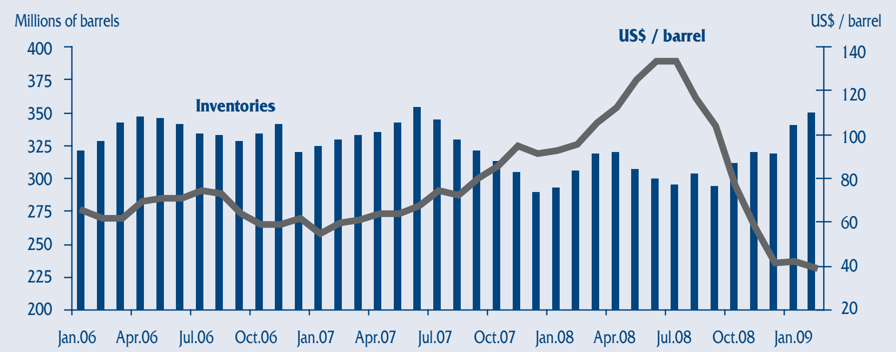
Source: INEI and Bloomberg.

The average price of crude, which rose 38 percent during 2008, showed two clear trends during the year: a rapid acceleration whereby the barrel of crude reached an historical record of US$ 145.3 in July and a fall thereafter until December reaching minimum levels of US$ 31 (these levels had not been recorded since December 2003). The drop in the price of oil in the last months has been associated with the continuous deceleration of global demand for crude –particularly in the case of the Organization for Economic Cooperation and Development (OECD)–, with the increase of inventories of crude and oil derivatives in the United States (which counterbalanced the OPEC's reduction of production quotas), and with high uncertainty regarding the evolution of financial markets (which has affected global demand from non-commercial investors).

In the first two months of 2009, the price of crude was volatile and fluctuated around US$ 40 the barrel. In January the price rose due to the OPEC's announcement that it would continue reducing its production, as well as due to geopolitical tensions in the Middle East and between Russia and Ukrania. In February, the price of crude resumed its downward trend because of the following factors: crude inventories in the United States were higher than expected, global recession deepened, and there was a negative outlook on the evolution of global demand for crude (the IEA, the OECD, and the OPEC reduced their forecasts on the global demand for crude in 2009).

Prospects in the medium term point to a slight recovery in the price of oil. The IEA estimates that global GDP weighed in terms of participation in global consumption of oil would increase 3 percent in 2010, after showing a slight contraction of 0.1 percent in 2009. Additionally, the OPEC has reduced its production quotas in February and is expected to reduce it again in its meeting of March 15.

Graph 66
CRUDE PRICES AND INVENTORIES IN USA



Source: Bloomberg, US Department of Energy.

i. Electricity:

The rise in electricity rates (8.2 percent) in 2008 resulted mainly from the higher rates established by Osinergmin in October and November with the purpose of updating the cost of generation, affected by variations in the prices of fuels and in the exchange rate. The reduction implemented in December was due to the update of the rate structure which, among other factors, included the reduction of the prices of Diesel 2 and Residual fuel. In February, Osinergmin approved a new increase (1.4 percent) based on the revision of the prices of energy and power.

j. Water:

The rate of water increased 18.9 percent in 2008 due to the rises approved by the regulating entity Sunass. The highest increase was seen in November to compensate Sedapal for the spending associated with investment plans. The rest of readjustments implemented were related to the increase observed in the Wholesale Price Index, which is one of the components of Sedapal's rate formula.

TABLE 29
PUBLIC UTILITY RATES
(Percentage change)

	2006	2007	2008	2009			
				Jan.	Feb.	Accum.	12-month
Public utilities	**-3.2**	**0.2**	**7.5**	**0.0**	**0.6**	**0.6**	**9.1**
Electricity	-7.3	1.9	6.3	-0.1	1.4	1.3	8.2
Telephone	-6.2	-7.2	-4.2	0.1	-0.3	-0.2	-1.1
Water	8.5	3.2	18.9	0.0	0.0	0.0	18.9

Source: INEI.

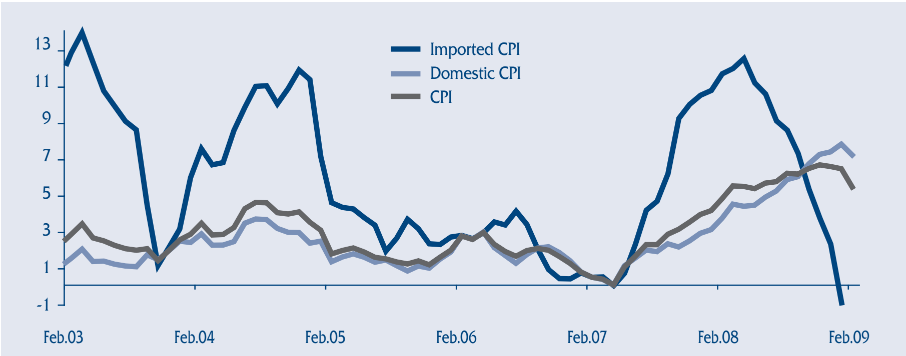
Imported inflation

85. Imported inflation at February showed an annual variation of -1.5 percent, a drop explained by the evolution of the fuel component (-6.6 percent). Because of the deceleration observed in the component of imported food, the annual rate dropped from 23.3 percent in May 2008 to 1.6 percent in February 2009 due to the effect of the deceleration of the price of commodities on the prices of bread (from 19.1 percent in May to 0.9 percent in February), noodles (from 17.4 to 2.4 percent), and edible oils (from 46.6 to -1.3 percent).

TABLE 30
DOMESTIC AND IMPORTED INFLATION
(Accumulated percentage change)

	Weight	2006	2007	2008	2009			
					Jan.	Feb.	Acumm.	12-month
I. IMPORTED CPI	**12.1**	**0.27**	**10.46**	**2.20**	**-2.69**	**-3.04**	**-5.65**	**-1.53**
Food	5.4	2.08	18.83	4.75	-0.70	-0.81	-1.51	1.63
Fuels	3.9	-1.50	6.45	-0.04	-6.49	-7.54	-13.54	-6.64
Electric appliances	1.0	-1.29	-1.50	-0.06	0.00	-0.35	-0.35	0.28
Other items	1.8	0.64	0.47	0.46	0.20	0.28	0.48	1.58
II. DOMESTIC CPI	**87.9**	**1.28**	**2.84**	**7.44**	**0.58**	**0.41**	**0.99**	**6.83**
III. CPI	**100.0**	**1.14**	**3.93**	**6.65**	**0.11**	**-0.07**	**0.03**	**5.57**
Imported CPI excluding food	6.7	-1.02	4.31	0.06	-4.44	-5.06	-9.27	-4.24
Food and beverage domestic CPI	42.1	1.72	4.14	10.53	1.23	0.40	1.63	9.24
Domestic CPI excluding food	45.8	0.89	1.64	4.53	-0.07	0.43	0.36	4.50

Graph 67
DOMESTIC AND IMPORTED INFLATION
(Last 12-month percentage change)



Wheat

The average price of wheat increased 27 percent in 2008. After climbing to a record level of US$ 477 the ton on February 27, the price dropped along the year to a minimum low of US$ 166 the ton on December 4, a level not observed since mid-2007. The downward trend observed in the price of wheat during most of the year was associated with two factors: favorable prospects for production in Argentina, Australia and the United States, and the deceleration of global demand.

In January 2009, the price of wheat increased due to the drought that affected Argentina and China, as well as due to the cold wave that affected producer areas in the United States. This price stabilized in February at levels close to US$ 200 the ton, reflecting the normalization of climatic conditions in these countries.

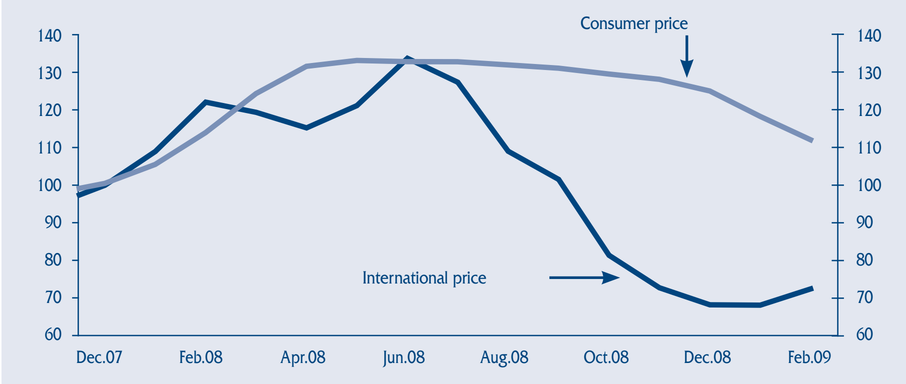
Soybean oil

The international price of raw soybean oil increased 42 percent on average in 2008. After reaching a maximum level of US$ 1,376 in June, the average price dropped rapidly reaching a level of US$ 646 the ton in December.

Because of this reduction in the price of this imported input (raw soybean oil), the costs of local producers have declined, which has directly benefited consumers.

The following graph shows the evolution of the international price of raw soybean oil expressed in soles and the sale price of bottled oil to the public. The graph shows that while the former recorded a reduction of 46 percent between June 2008 and February 2009, the price to consumers dropped 16 percent.

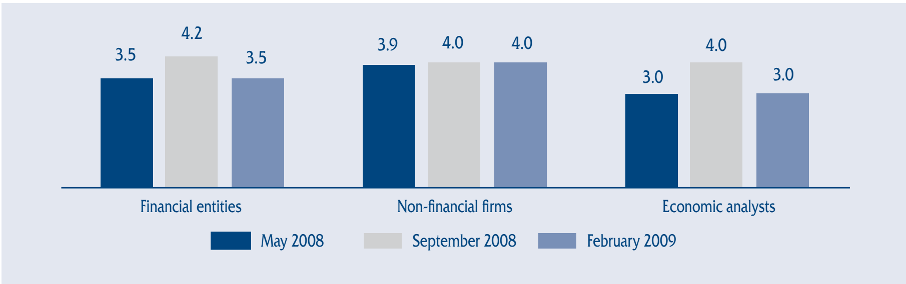
Graph 68
INTERNATIONAL PRICE OF RAW SOYBEAN OIL IN NUEVOS SOLES AND PRICE OF BOTTLED OIL
(Index december 2007=100)



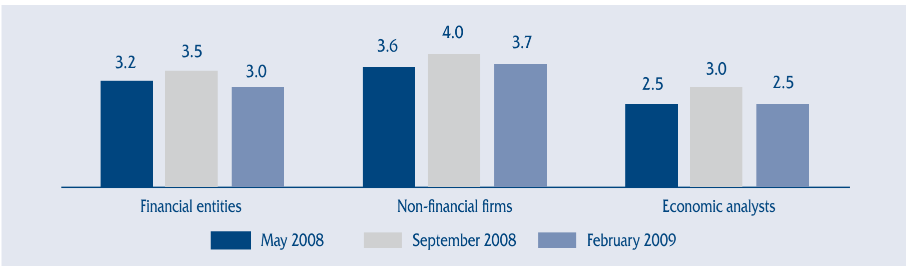
Inflation Expectations

86. Financial entities and economic analysts have revised their inflation expectations downwards in a context of deceleración of the annualized rate of inflation observed since December. The expectations of both groups fall in the range of the inflation target in 2010. Non-financial firms still expect a rate of inflation of 4 percent for this and the next year.

Graph 69
INFLATION EXPECTATIONS FOR 2009

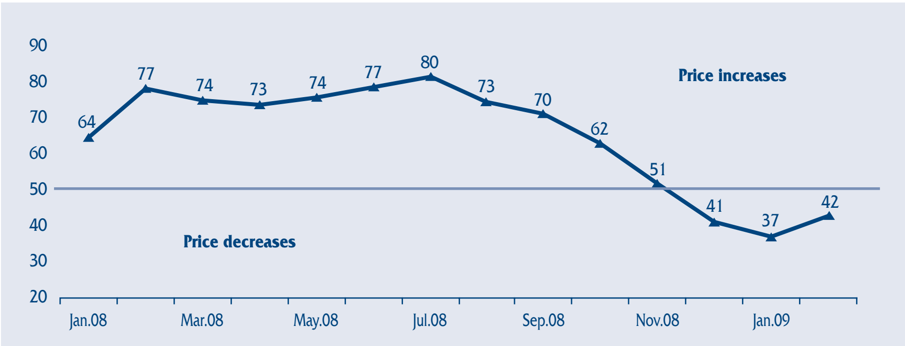


Graph 70
INFLATION EXPECTATIONS FOR 2010

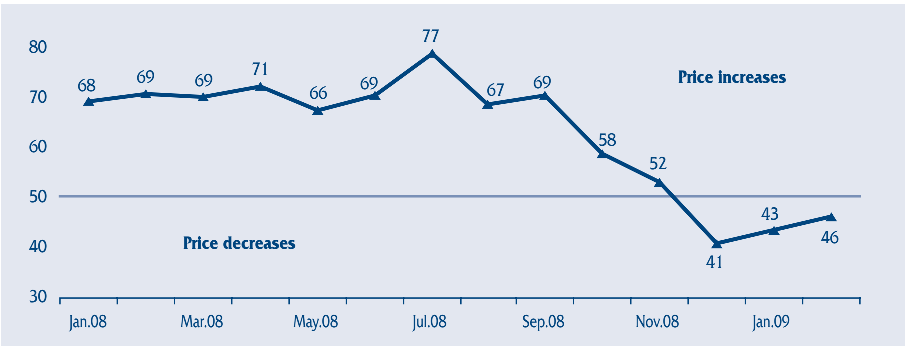


87. Compared with September, the number of surveyed firms expecting reductions in the prices of end goods increased two-fold, while those expecting the prices of their inputs to drop almost increased four-fold. Likewise, an important increase was observed in the number of firms expecting reductions in the prices of both their inputs and end goods in the next three months.

Graph 71
AVERAGE INPUT PRICE INDEX: Next 3 - 4 months
Manufacture sector



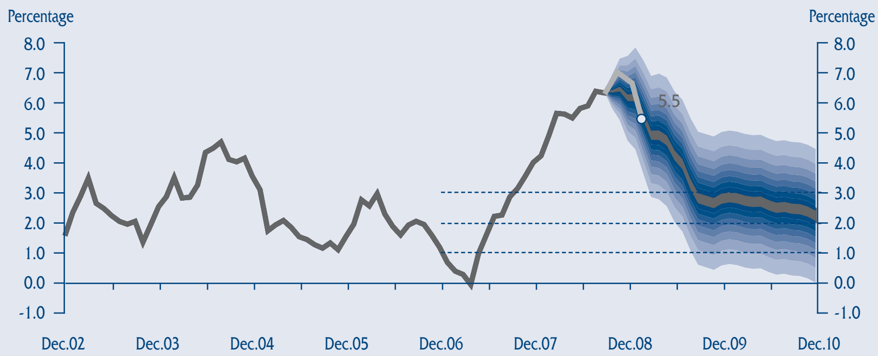
Graph 72
AVERAGE SALE PRICE INDEX: Next 3 - 4 months
Manufacture sector



Inflation Forecasts

88. A faster convergence of inflation to the 2 percent target is forecast for the 2009-2010 horizon, which implies a downward revision of the inflationary profile considered in the Inflation Report of September 2008. This forecast considers the inflation rate observed in 2008, which was higher than the one projected in the Inflation Report of September due to supply-related factors that increased electricity rates and the prices of some food products (i.e. onion, potato, etc.). This report also considers the recent decline of external inflationary pressures and the economic slowdown in the domestic sphere.

Graph 73
INFLATION FORECAST INCLUDED IN THE INFLATION REPORT OF SEPTEMBER 2008 AND OBSERVED INFLATION



Note:
The graph shows the inflation prediction bands along the forecast horizon. The darkest band around the central forecast represent a 10 percent probability of occurrence, while all the other bands represent a 90 percent probability of occurrence.

89. Starting from a higher point in the monetary policy horizon, inflation is expected to converge earlier to the 2 percent inflation target in the 2009-2010 horizon. Signals of an important decline of inflationary pressures were observed in the first months of 2009, such as, for example, the slowdown of the monthly rates of inflation, especially the marked drop of the wholesale price index observed since last November. In this way, inflation should converge to a more moderate annual rate (between 1 and 3 percent) around the third or fourth quarter of 2009.

90. The impacts of the international financial crisis have translated into a slowdown in the rates of growth of GDP during Q4 of 2008. In the first quarter of this year, GDP should grow 4.0 percent –below the pace of growth observed in the last 5 years, which was around 7.7 percent. Factors that would negatively affect growth would include the deterioration of the international environment and the related decline of terms of trade. These negative impulses are expected to be partially offset by the Economic Stimulus Plan, which is to be implemented mainly during this year.

The deterioration of the international context implies a higher global recession and, therefore, a reduction in the demand for Peruvian exports. Likewise, because of the global recession, a stronger decline is expected in terms of trade in 2009 (-14.6 percent), which should be followed by a slight recovery (2.4 percent) in 2010. Moreover, despite the moderation of the negative effects of international turbulence on liquidity in the local financial sector, credit conditions remain relatively adverse. This is reflected, for instance, in the rise of interest rates, especially for the segments of consumption and mortgages.

In summary, a progressive deceleration is expected in the output gap, measured as the deviation of GDP relative to potential GDP. Because of this, demand pressures on inflation would tend to decline in the forecast horizon at a faster pace than the one considered in our report of September 2008.

91. As regards inflation associated with external conditions, lower global growth has generated much stronger reductions in the prices of food commodities and crude than the ones considered in our previous report, which has brought about lower domestic prices for food and fuels. Although a slight upward correction is projected in these prices for 2009, their annual average levels would be lower than in 2008. In this sense, the average price of WTI oil would go from US$ 100 in 2008 to US$ 49 in 2009.

The lower imported inflation induced by the drop of commodity prices has been partially offset by the depreciation of the nuevo sol which fell around 5 percent against the dollar between its average level in last October and February this year. Although the evolution of exchange would eventually continue refleting the uncertainty associated with the international financial crisis, in the medium term its trend would be determined by its macroeconomic fundamentals, which do not suggest a depreciatory pressure.

Graph 74
WHOLESALE PRICE INDEX
(Last 12-month percentage change)

Therefore, the projection of imported inflation considers both the reduction of the prices of foreign goods and inputs and the possible evolution of exchange. On the whole, these factors are expected to contribute to the decline of overall inflation in the forecast horizon.

92. Finally, the moderation of inflation expectations should also contribute to the projected reduction of inflation. In these sense, the Surveys on Macroeconomic Expectations conducted by the BCRP show a downward trend in expected future inflation since December 2008, which reflects that inflation expectations are gradually adjusting to levels consistent with the inflation target.

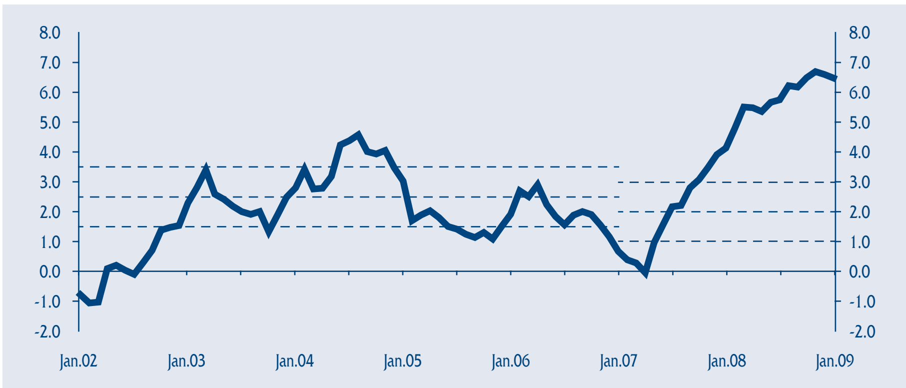
BOX 7

WHAT EXPLAINS INFLATION MOVEMENTS IN PERU?

Monetary policy decision-making requires understanding the factors that explain the evolution of inflation. Although the analysis of indicators such as the rates of variation of the items included in the price basket (i.e. foodstuffs, house rents, etc.) contributes to this, identifying the macroeconomic factors (or shocks) that lead to fluctuations in inflation implies using other quantitative tools.

One example that contributes to illustrate this problem is the inflationary leap of 2007-2008. On the one hand, strong pressures were observed during this period on the prices of food and crude, which derived in a strong increase of domestic food and energy inflation. At the same time, on the other hand, domestic demand and GDP showed high rates of growth (reaching even two digit rates), and core inflation –measure excluding the most volatile components of the basket– climbed even above the upper band of the Central Bank's inflation target (3 percent).

TOTAL INFLATION
(Last 12-month percentage change)



In this context, the debate focused on whether the rise of inflation could be mainly attributed to external price shocks (that is, to shocks derived from the international higher prices due to the substantial increase observed in the prices of commodities) or to domestic demand shocks. This case suggests that, in fact, determining the causes of inflation movements is a complex task.

In this sense, Salas (2009) offers an analysis of the evolution of inflation in Peru covering the period extending between 2002 –when the inflation targeting regime was implemented– and the second quarter of 2008. In his analysis, he considers the contribution of four macroeconomic factors on inflation movements, two factors of foreign origin: i) external inflation and ii) terms of trade, and two domestic factors: iii) aggregate supply shocks, and iv) aggregate demand shocks.

Since economic theory clearly shows that inflation is inversely affected by aggregate supply shocks (that is, a positive supply shock generates a reduction of inflation) and directly affected by aggregate demand shocks (a positive demand shock generates an increase of inflation), it is necessary to briefly examine the impact of external factors. The following diagram shows in a very simplified manner that higher domestic inflation should be expected when external prices increase. On the other hand, in the case of terms of trade, the impact on inflation is a priori uncertain.

EFFECT OF EXTERNAL PRICES AND TERMS OF TRADE SHOCKS ON INFLATION

↑ External prices	⇒	↑ Price of imported inputs ↑ Price of imported capital goods	⇒ ↑ Producer prices			⇒ ↑ Consumer prices (↑inflation)	
	⇒	↑ Price of imported consumer goods	⇒ ↑ Consumer prices (↑inflation)				
↑ Terms of trade	⇒	↑ (Exports - imports)	⇒ ↑ Demand	⇒ ↑ GDP gap	⇒ ↑ Inflation		
			⇒ ↑ Dollar supply	⇒ ↓ Exchange rate	⇒ ↓ Inflation		

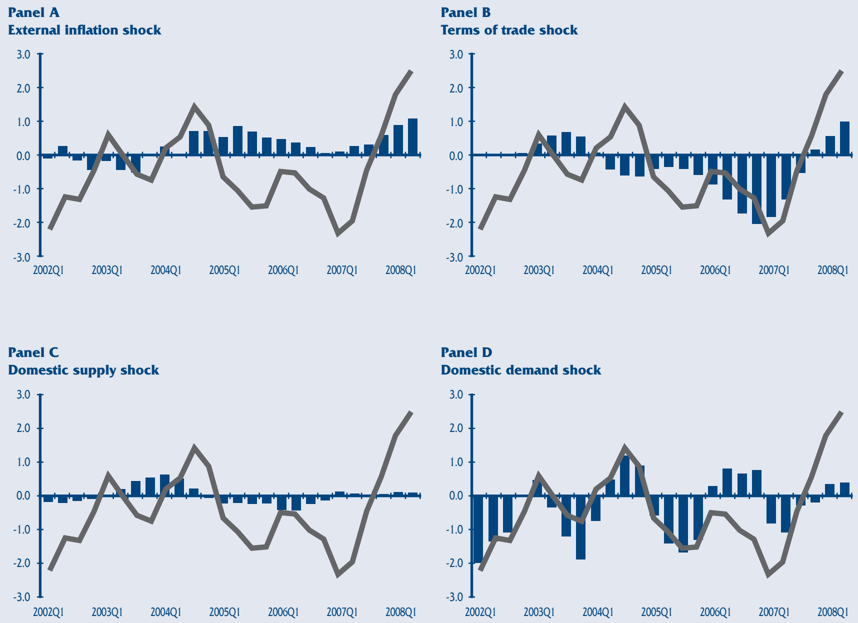
Salas' findings show that, between 2002 and 2005, domestic demand shocks would have been more important to explain the evolution of inflation. During this period, aggregate demand tended to grow at lower levels than the economy's potential capacity of growth, which was reflected in the fact that core inflation fell steadily below the BCRP inflation target.

Thereafter, between 2006 and Q2 of 2008, externals shocks associated with imported inflation and with terms of trade were more relevant. These factors account for most of inflation's deviations from the target range during this period.

The findings also suggest that the transmission of terms of trade shocks is dominated by the exchange rate to prices pass-through (or pass-through effect) in the sense that a positive (negative) shock on terms of trade generates a decrease (increase) of the exchange rate, and that this generates a decline (rise) in inflation.

These results also indicate that external inflation shocks, associated with the higher prices of commodities, have played a crucial role during the recent episode of high inflation. Although the contribution of demand shocks during this episode cannot be disregarded, it's the relevance of these shocks would have been secondary.

EVOLUTION OF ANNUAL INFLATION
(2002:1 - 2008:2)



Source: Salas (2009). The thick line represents the aggregate contribution of the macroeconomic shocks that affected inflation (measured as the mean deviation of inflation relative to average inflation). The bars represent the components explained by the following shocks: external inflation (Panel A), terms of trade (Panel B), domestic supply (Panel C) and domestic demand (Panel D).

On the other hand, a study carried out by the IMF (Canales-Kriljenko et al., 2008) analyzes the different factors that led to historical fluctuations of inflation in five Latin American countries, including Peru. The study findings show that during 2004-2008 the cost shocks derived from movements in the prices of commodities were significantly relevant. Finally, this research emphasizes the role of the appreciation of the exchange rate to buffer inflationary pressures in the sample of countries analyzed.

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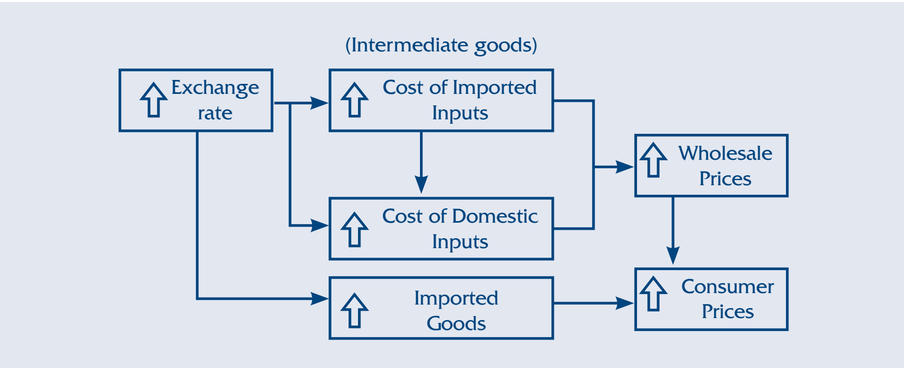
- Salas, J. "¿Qué explica las fluctuaciones de la inflación en el Perú en el periodo 2002 – 2008? Evidencia de un análisis VAR estructural", Revista Estudios Económicos No.16 (in press), Banco Central de Reserva del Perú, 2009.

BOX 8
EXCHANGE RATE TO PRICES PASS-THROUGH

The pass-through effect measures the impact of a depreciation of the exchange rate on inflation. When the exchange rate increases, producers using inputs whose prices are denominated in foreign currency, experience an increase in their costs, which can lead to an increase in the prices of end goods. Likewise, a depreciation of the exchange rate has a direct impact on inflation in the case of end goods denominated in dollars. This mechanism is illustrated in the following diagram:

EXCHANGE RATE TO PRICE PASS-THROUGH MECHANISM



The magnitude of the pass-through depends mainly on producers' capacity to transmit the higher costs to their buyers. In a context of homogeneous goods within an integrated market, the single price law translates into a complete pass-through; in other words, a one percent increase in the exchange rate will cause a similar increase in domestic prices so that relative prices remain.

However, under circumstances other than perfect competition, the pass-through may be lower than one (incomplete) due to the presence of oligopolic structures (Dornbusch, 1987), the existence of substitutes for imported goods (Burstein et al., 2002), or the fact that not all the goods in the consumer basket are tradable products (Betts and Kehoe, 2001).

LONG TERM PASS-THROUGH

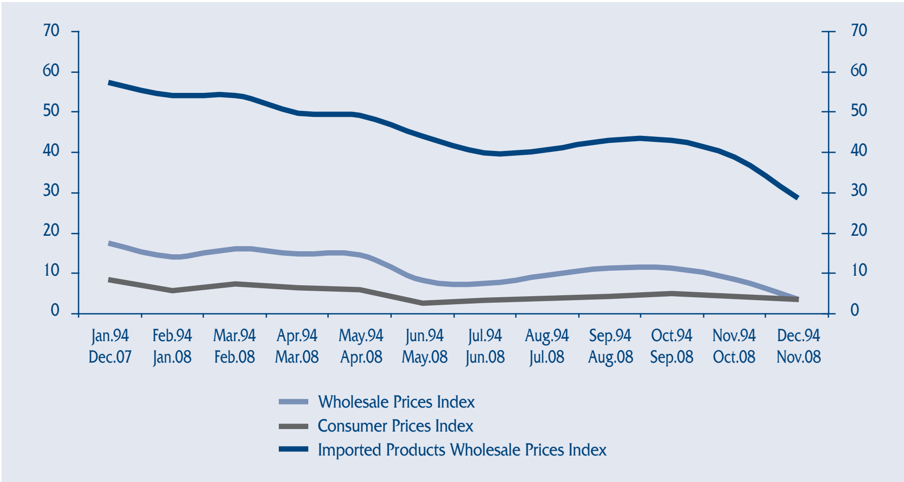
Based on the methodology proposed by Winkelried (2003), the long term pass-through[10] has been estimated for data to up to 2008. The pass-through ratio is calculated using the following equation:

$$\text{Exchange rate to prices pass-through} = \frac{\text{Price index accumulated \% chg.}}{\text{Exchange rate accumulated \% chg.}}$$

10 The long term pass-through is the value of the pass-through when it has stabilized. According to estimates, this takes place after almost three years.

Estimates calculated with a sample covering the January 1994 - November 2008 period show that the pass-through of the exchange rate to the Consumer Price Index shrank to less than 10 percent. Likewise, the pass-through to the Wholesale Price Index of imported goods has also declined considerably, from around 60 percent to 30 percent. Thus, as reflected in the estimates included in the Inflation Report of September 2008, a reduction in the pass-through effect is also observed.

ESTIMATE OF THE EXCHANGE RATE TO PRICES IN SELECTED SAMPLES PASS-THROUGH
(Percentage of one depreciation)



ASYMMETRY OF THE PASS-THROUGH

Following Winkelried (2003), the pass-through ratio is estimated considering different economic states. The estimates of the pass-through that depend on the following variables are discussed in this box:

- Size of the depreciation of the exchange rate: when there is a slight depreciation, cost increases can be absorbed by producers' profit margin. When the depreciation is strong, producers translate their higher costs to prices in a greater extent. Therefore, the pass-through effect is higher when there is a strong depreciation.

- Stage in the economic cycle: in periods of growth, when production in the economy is above the potential output, it is easier for producers to pass-through higher costs to their prices since the demand is less elastic.

The table below shows the estimates of the exchange rate to prices pass-through according to the stage of the economic cycle (recession and expansion) and according to the size of depreciation.

LONG-TERM PASS-THROUGH FROM A DEPRECIATION OF THE EXCHANGE RATE TO CONSUMER PRICES
(Percentage of depreciation)

Period of analysis	1993-2002		1994-2008	
Size of depreciation 1/	High depreciation 36	Low depreciation 24	High depreciation 13	Low depreciation 4
Phase of Economic cycle 2/	Expansion 36	Recession 22	Expansion 12	Recession 3

1/ High depreciation: Annual depreciation higher than 10 percent. Low depreciation: Annual depreciation lower than 10 percent.
2/ Expansion: Output gap higher than zero. Recession: Output gap lower than zero.

CONCLUSION

Non-linear estimates performed for the 1994-2008 period show pass-through ratios that are lower than the ones calculated for the 1993-2002 period. These results are consistent with the linear estimate discussed above. Based on both a linear and a non-linear model, the results confirm that the pass-through effect has declined in magnitude (from 13 to 4 percent) during the last 6 years when inflation targeting has been implemented. This reduction in the pass-through is associated, for example, with the process of dedollarization experienced in Peru over the past few years, with a higher stability of inflation, and with the impact of increased commercial competition resulting from the presence of foreign products. In practice, the final effect of the pass-through of the exchange rate to prices will depend on factors, such as the magnitude of the variation of the exchange rate and the economy's position in the economic cycle.

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VII. Balance of risks

93. The risks and the uncertainty considered in the forecasts have increased since our Inflation Report of September was published. Risks are more biased to the pessimistic side in terms of global growth.

94. The main risks that could cause inflation to deviate from their projection in the central scenario include the following:

- **Increased deterioration of the global economy**. The baseline scenario considers a deterioration of the global economy in 2009, as well as a scenario with an increased decline of terms of trade. Moreover, the probability of a more prolonged global recession than the one considered in the baseline scenario is considered to be higher. The risk of a greater global recession would entail lower economic growth and a lower rate of inflation than the one considered in the baseline scenario.

  A more flexible monetary stance than the one considered in the baseline scenario would be adopted in this risk scenario.

- **Lower inflationary pressures due to lower domestic spending**. The baseline forecast scenario considers that the economy would grow 5 percent this year. On the domestic side, however, if delays were to occur in the execution of planned public expenditure or private investment were to decline further due to increased economic uncertainty, the rate of growth would be lower than the one forecast in this Report.

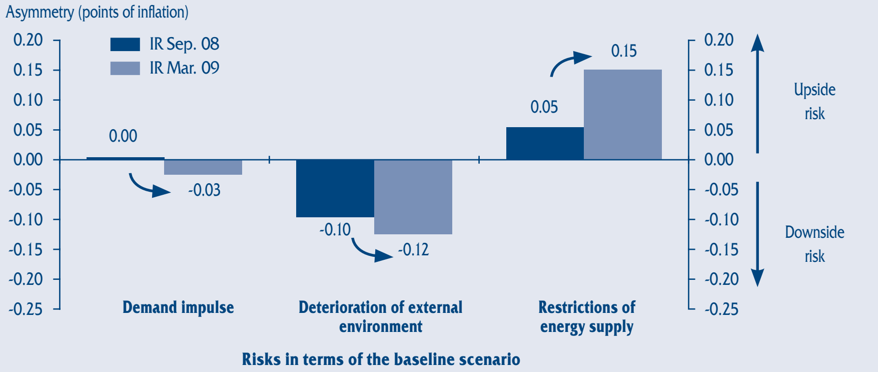
  In this situation, monetary policy would be more flexible and would operate in a more counter cyclical manner.

- **Constraints in the supply of electricity**. The supply of electricity is close to its potential capacity limit. Therefore, the risk that adverse climatic events may aggravate the fragile balance between the supply and the demand of electric energy has been considered, given that this could generate higher increases in electricity rates or the use of more costly alternative energy sources.

  This factor would not alter the monetary policy position as long as the inflationary impact does not affect inflation expectations.

95. In a context of high uncertainty about the evolution of the global economy, weighing the above mentioned risks against the baseline scenario shows a neutral balance for the inflation forecast.

Graph 75
INFLATION FORECAST: BALANCE OF RISKS 1/
(2 year-ahead inflation deviations in percentage points)

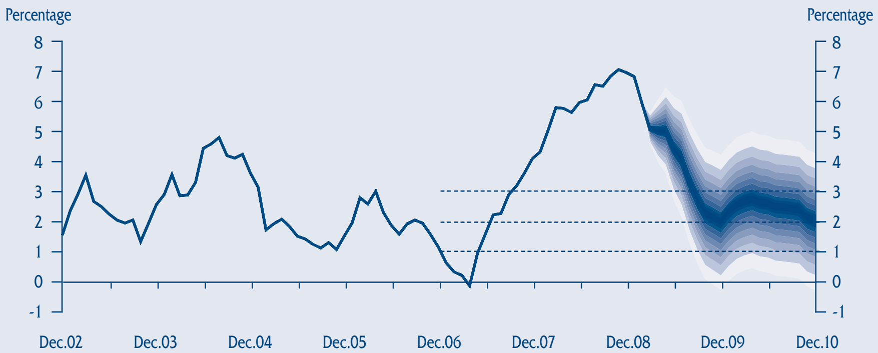


1/ This graph shows changes in risk perception compared with the September 2008 Inflation Report. The size and sign of bars show the asymmetry of each risk factor in the inflation forecast distribution. In contrast with the previous report, added total effects generated a slightly downward asymmetry in the inflation forecast.

96. This implies a projection of symmetric density for inflation throughout the forecast horizon, which means that there is the same probability that inflation will fall below or above the level considered in the baseline scenario.

Inflation would converge to the 2 percent target during the second half of 2009 and should remain around this level in 2010.

Graph 76
INFLATION FORECAST 1/
(Annual percentage change)

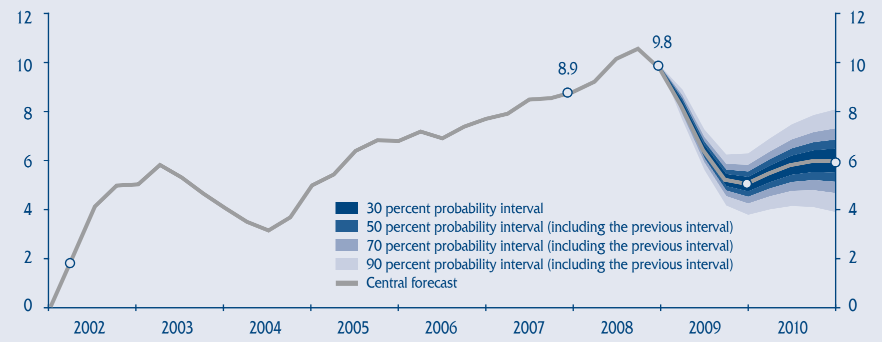


Note: The graph shows the inflation prediction bands along the forecast horizon. The darkest band around the central forecast represents a 10 percent probability of occurrence, while all the other bands represent a 90 percent probability of occurrence.

97. Moreover, the balance of risks for the projection on the growth of GDP is neutral, as considered in our Inflation Report of September. Although a context of greater

external financial fragility could occur, this considers that GDP would start increasing more rapidly given a desaccumulation of inventories.

Graph 77
GDP GROWTH DENSITY FORECAST
(Annual percentage change of GDP in each quarter)



Note: The graph shows the inflation forecast bands along the forecast horizon. The darkest band around the central forecast has a 30 percent probability of occurrence, while all the bands together have a 90 percent probability of occurrence.

CONCLUSION

98. Inflation has gradually started to converge to the 2 percent inflation target. It is expected that last 12-month inflation will fall close to the target in Q4 of 2009, fluctuating thereafter around this level. The forecasts considered herein are based on a international context of global recession and of a transitory reduction of external prices, in the frame of which domestic policy actions are aimed at preserving price stability, in line with sustainable economic growth in the medium- and long-terms.

99. The Central Bank permanently oversees the different risk factors that could affect the evolution of inflation. Weighing the above mentioned risks against the baseline scenario shows a neutral balance for the inflation forecast.

100. The Bank will continue implementing measures associated with its reference interest rate, as well as with liquidity provision instruments to ensure the normal operation of monetary and financial markets, and particularly to ensure the normal operation of the credit market in a context of monetary stability.

APPENDIX
INFLATION REPORT FORECAST

	2007	2008	2009 1/		2010 1/	
			IR Sep. 08	IR Mar. 09	IR Sep. 08	IR Mar. 09
Real % change						
1. GDP	8.9	9.8	6.5	5.0	7.0	6.0
2. Domestic demand	11.8	12.3	7.1	5.0	7.1	5.7
a. Private consumption	8.3	8.8	6.3	5.5	5.2	5.2
b. Public consumption	4.5	4.0	3.0	2.6	3.8	4.5
c. Private fixed investment	23.4	25.6	12.5	8.0	10.3	8.0
d. Public investment	18.4	41.9	26.3	51.1	20.0	13.2
3. Exports (goods and services)	6.2	8.2	6.2	1.9	10.0	6.6
4. Imports (goods and services)	21.3	19.9	9.0	2.1	9.8	5.1
5. Main trade partners' economic growth	4.7	2.9	2.2	-0.4	4.2	3.2
Note:						
Output gap 2/ (%)	1.5	3.2	1.0-1.5	0.5-1.0	0.5-1.0	0-0.5
% change						
6. Forecast inflation	3.9	6.7	2.5-3.0	1.75-2.25	2.0-2.5	1.75-2.25
7. Average price of crude	9.4	38.5	-28.1	-50.8	0.0	19.9
8. Average price of wheat	45.2	26.7	-31.6	-23.3	0.0	9.1
9. Nominal exchange rate 3/	-7.0	4.5	2.1	5.1	0.8	-0.2
10. Real Multilateral exchange rate	-1.7	-4.8	1.1	-3.7	1.4	0.3
11. Terms of trade	3.6	-13.3	-8.3	-14.6	-1.6	2.4
a. Export price index	14.4	5.1	-12.8	-26.6	0.3	6.1
b. Import price index	10.4	21.2	-4.9	-14.1	2.0	3.6
Nominal % change						
12. Currency in circulation	27.1	16.7	13.5	13.0	14.0	13.5
13. Credit to the private sector	28.0	32.7	15.4	15.0	16.2	15.0
% of GDP						
14. Current account of the balance of payments	1.1	-3.3	-3.0	-3.3	-3.0	-3.3
15. Trade balance	7.7	2.4	0.0	-1.1	-0.3	-0.3
16. Gross external financing to the private sector 4/	9.1	5.6	5.4	4.8	5.1	4.6
17. Current revenue of the general government	20.7	20.8	19.4	19.4	19.2	19.1
18. Non-financial expenditure of the general government	16.0	17.2	17.0	19.1	17.1	18.9
19. Overall balance of the non-financial public sector	3.1	2.1	1.1	-1.0	0.9	-1.0
20. Total public debt balance	29.6	24.0	22.2	25.6	20.0	23.5

IR: Inflation Report.
1/ Forecast.
2/ Differential between GDP and potential GDP (percentage).
3/ Expectations of economic agents about the exchange rate expectations according to the survey on macroeconomic expectations.
4/ Includes foreign direct investments and private sector's long term disbursements.