



**Cloth (Transition)
Seventeenth Century
Southern Peru
Central Reserve Bank of Peru
Popular Peruvian Art, Exhibition Hall**

I. INFLATION AND THE EXCHANGE RATE

1. Inflation

Inflation dropped from 6.5 percent in 1997 to 6.0 percent in 1998 –the lowest rate in the past 26 years–, and fell below the target set for 1998 by the Central Reserve Bank of Peru (7.5-9.0 percent).

TABLE 1
ANNUAL INFLATION RATES
(Percentage change)

| | End of period | Average |
|------|---------------|---------|
| 1972 | 4.3 | 7.2 |
| 1973 | 13.8 | 9.5 |
| 1974 | 19.2 | 16.8 |
| 1975 | 24.0 | 23.6 |
| 1976 | 44.7 | 33.5 |
| 1977 | 32.4 | 38.0 |
| 1978 | 73.7 | 57.8 |
| 1979 | 66.7 | 67.7 |
| 1980 | 60.8 | 59.2 |
| 1981 | 72.7 | 75.4 |
| 1982 | 72.9 | 64.5 |
| 1983 | 125.1 | 111.2 |
| 1984 | 111.5 | 110.2 |
| 1985 | 158.3 | 163.4 |
| 1986 | 62.9 | 77.9 |
| 1987 | 114.5 | 85.8 |
| 1988 | 1,722.3 | 667.0 |
| 1989 | 2,775.3 | 3,398.7 |
| 1990 | 7,649.7 | 7,481.7 |
| 1991 | 139.2 | 409.5 |
| 1992 | 56.7 | 73.5 |
| 1993 | 39.5 | 48.6 |
| 1994 | 15.4 | 23.7 |
| 1995 | 10.2 | 11.1 |
| 1996 | 11.8 | 11.5 |
| 1997 | 6.5 | 8.5 |
| 1998 | 6.0 | 7.3 |

Also, core-inflation was 6.8 percent, below the target range and the 1997 rate (7.8 percent).

TABLE 2
PROJECTED, CORE AND GENERAL
INFLATION

| | Projected | Core | General |
|------|-------------|------|---------|
| 1994 | 15.0 - 20.0 | 17.5 | 15.4 |
| 1995 | 9.0 - 11.0 | 10.4 | 10.2 |
| 1996 | 9.5 - 11.5 | 9.9 | 11.8 |
| 1997 | 8.0 - 10.0 | 7.8 | 6.5 |
| 1998 | 7.5 - 9.0 | 6.8 | 6.0 |

In 1998 the prices of tradable goods grew at a higher rate (7.4 percent) than those of nontradable goods (5.1 percent). Among tradable items, the prices of food products grew 9.0 percent, reflecting the effect of bad climate conditions on rice and sugar production. It must be mentioned that fuel prices declined by 3.0 percent because of lower oil international prices.

On the other hand, the averages of non-tradable items resulted mainly from increases in the prices of house renting (12.8 percent) and education (10.6 percent).



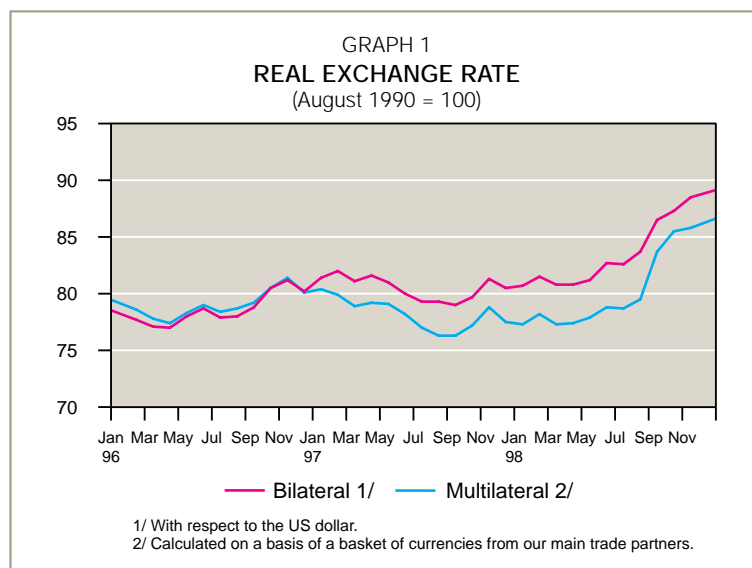
TABLE 3
INFLATION IN METROPOLITAN LIMA

| | Weight | 1996 | 1997 | 1998 |
|------------------------------|--------------|-------------|------------|------------|
| GENERAL INDEX (IPC) | 100.0 | 11.8 | 6.5 | 6.0 |
| TRADABLE PRODUCTS | 41.7 | 8.9 | 5.7 | 7.4 |
| FOOD | 19.4 | 8.4 | 4.4 | 9.0 |
| TEXTILE AND FOOTWEAR | 6.5 | 7.1 | 7.2 | 5.6 |
| ELECTRICAL APPLIANCES | 0.5 | 10.5 | 4.3 | 10.5 |
| FUEL | 3.3 | 20.2 | -3.8 | -3.0 |
| OTHERS | 12.0 | 7.8 | 9.7 | 8.4 |
| NON-TRADABLE PRODUCTS | 58.3 | 13.9 | 7.0 | 5.1 |
| FOOD | 20.7 | 13.5 | 4.9 | 2.2 |
| SERVICES | 36.3 | 14.5 | 8.2 | 6.7 |
| PUBLIC SERVICES | 4.1 | 11.9 | 4.8 | 5.9 |
| LABOR | 2.1 | 8.2 | 7.7 | 5.9 |
| HEALTH | 0.8 | 9.9 | 10.2 | 5.0 |
| TRANSPORTATION | 6.7 | 27.6 | 7.4 | 2.7 |
| EDUCATION | 3.0 | 14.7 | 13.3 | 10.6 |
| RESTAURANTS | 15.4 | 12.5 | 8.6 | 6.6 |
| RENT | 2.9 | 11.9 | 7.5 | 12.8 |
| OTHER SERVICES | 1.4 | 9.6 | 6.1 | 6.6 |
| OTHERS | 1.3 | 4.3 | 4.1 | 3.1 |

2. Exchange rate

Since 1990, Peru has a free-floating exchange rate arrangement, consistent with control of the monetary base. The Peruvian currency (*Nuevo Sol*) depreci-

ated by 12.6 percent in real terms in 1998. The nominal exchange rate rose by 15.4 percent from December 1997 to December 1998, while the domestic and external inflation rates were 6.0 and 3.4 percent, respectively.



During the first months of 1998, the exchange rate was influenced by spillovers from the Asian crisis. Since June, the depreciation rate of the domestic currency increased, as the Japanese economy faltered prompting the yen to depreciate. This development was coupled with an important depreciation of the Deutsche Mark and falling commodities prices.

Turbulence reappeared in Russia by the end of August, causing a liquidity constraint in the Peruvian financial sys-

tem by reducing short-term credits and forcing an exchange rate increase of 4.2 percent between August and September. The Central Bank responded to the shortage of dollars by selling US\$ 82.6 million in September and reducing the marginal reserve requirement in dollars. Moreover, the Central Bank opened the foreign-currency discount window and continued to support the floating exchange rate regime with limited intervention to avoid excessive volatility.

