

### 1. Evolution of the inflation rate

Inflation for the year, as measured in the changes in the consumer price index for Metropolitan Lima, reached 1,52 percent and was within the range of the monetary policy target set by the Board of the Central Bank. Core inflation, which excludes products with highly volatile prices and is a measure of the overall trend of prices in the economy, was 1,69 percent (1,06 percent in 2001).

The core component of the inflation rate is basically accounted for by increases in foodstuff and beverages where prices rose by 2,1 percent in 2002, compared with a 0,6 percent fall in 2001. The increase is mainly a consequence of higher bread prices. If this good were excluded from the underlying inflation, the resulting annual change in this indicator would be 1,1 percent in 2001 and 1,0 percent in 2002.

TABLE 10  
**INFLATION IN 2002**  
(In percent)

	Inflation		Core inflation	
	Monthly	12 months	Monthly	12 months
January	-0,52	-0,83	0,03	0,85
February	-0,04	-1,11	-0,01	0,82
March	0,54	-1,08	0,04	0,78
April	0,73	0,05	0,11	0,77
May	0,14	0,17	0,01	0,53
June	-0,23	0,00	0,12	0,61
July	0,03	-0,14	0,14	0,84
August	0,10	0,26	0,10	0,93
September	0,47	0,68	0,70	1,55
October	0,72	1,36	0,64	2,11
November	-0,40	1,46	-0,09	1,88
December	-0,03	1,52	-0,13	1,69

Source: INEI, BCR.



Prices of foodstuff and beverages included in the core inflation increased by 2,1 percent, in particular bread (14 percent) and edible oils (7 percent), stemming from higher international quotations for wheat (30 percent) and soybean oil (15 percent) resulting from drought in the main exporting countries (Australia and the United States) in 2002.

Goods classified as non-core that account for 32 percent of the consumer's basket increased 1,2 percent in 2002 (2,8 percent

down in 2001) due to larger changes in prices of fuels and public services rates:

- **Fuels (15,6 percent increase):** This figure reflected the evolution of international quotations for crude oil and its by-products. Quotations for West Texas Intermediate (WTI) oil increased 52 percent in 2002. This evolution is linked to the initial recovery of the world economy but mainly to tensions in the Middle East and strikes in Venezuela and Nigeria. Also influencing the

TABLE 11  
**CUMULATIVE ANNUAL INFLATION 2000 – 2002**  
 (Annual percent change)

	Weighting	2000	2001	2002
<b>I. CORE INFLATION</b>	<b><u>68,3</u></b>	<b><u>3,1</u></b>	<b><u>1,1</u></b>	<b><u>1,7</u></b>
<b>Goods</b>	<b>41,8</b>	<b>2,5</b>	<b>0,7</b>	<b>1,8</b>
Foodstuff and beverages	20,7	1,3	-0,6	2,1
Textiles and footwear	7,6	2,6	1,9	1,1
Electric domestic appliances	1,0	1,8	-0,2	3,4
Other manufactured products	12,5	4,8	2,4	1,5
<b>Services</b>	<b>26,6</b>	<b>4,0</b>	<b>1,6</b>	<b>1,6</b>
Restaurants	12,0	3,7	1,3	1,3
Education	5,1	5,6	4,0	2,7
Health	1,3	4,7	3,0	3,3
Rent	2,3	3,4	-0,4	1,0
Other services	5,9	4,3	2,1	1,0
<b>II. NON-CORE INFLATION</b>	<b><u>31,7</u></b>	<b><u>5,2</u></b>	<b><u>-2,8</u></b>	<b><u>1,2</u></b>
Foodstuffs	14,8	-0,4	-1,2	-2,3
Fuels	3,9	30,3	-13,1	15,6
Transportation	8,4	5,0	0,0	0,1
Public services	4,6	5,1	-2,7	2,0
<b>III. INFLATION</b>	<b><u>100,0</u></b>	<b><u>3,73</u></b>	<b><u>-0,13</u></b>	<b><u>1,52</u></b>

Source: INEI, BCR.

domestic price of fuel were the increases in the excise tax (ISC, in Spanish) which on average rose from S/. 1,79 per gallon in December 2001 to S/. 2,20 per gallon at the end of 2002 for all fuels included in Consumer Price Index. The impact of increased international oil to final consumers was partially absorbed by smaller price adjustments at the level of local refineries (Petroperu and RELAPASA), and by slimmer profit margins among dealers.

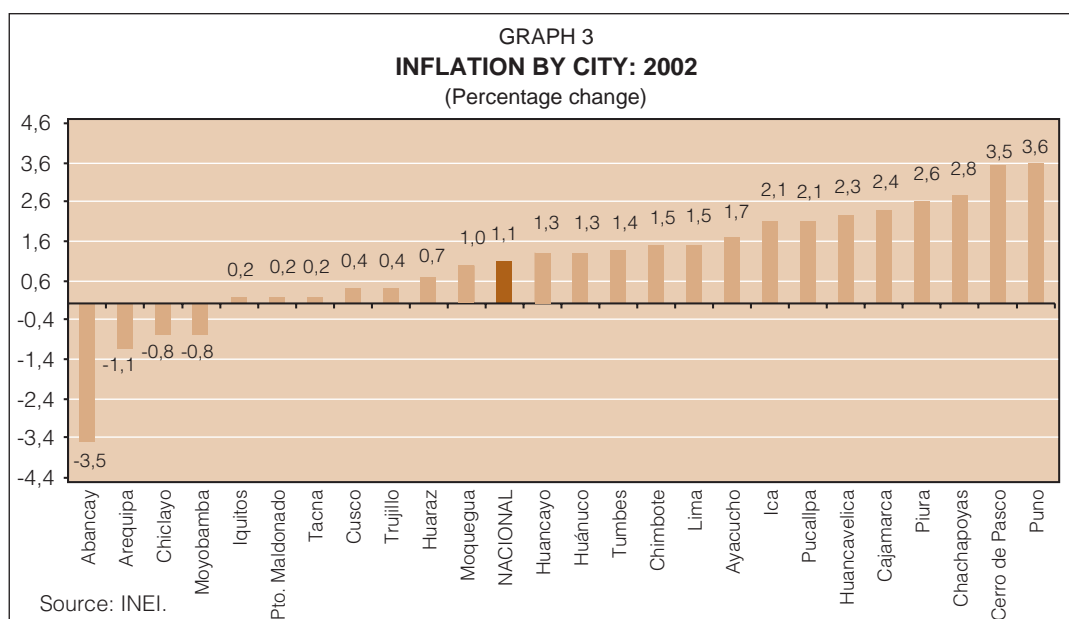
The contribution of fuel price changes to annual inflation reached 0,6 percentage points of 1,5 percent inflation rate.

- **Public services (2,0 percent):** Higher electricity and water rates (7,9 and 2,3 percent, respectively) went hand in hand with an 8,3 percent drop in telephone tariffs. Higher electricity rates were accounted for mainly by increased variable costs resulting from the higher price of fuels. Water rates were adjusted in April, authorized by the

Superintendencia Nacional de Servicios de Saneamiento (SUNASS), the water utilities regulator to cover operating costs at SEDAPAL- the Lima Water utility- and to fund the investment plans outlined in the utility's Master Plan. Telephone rates fell after the productivity factor in place since September 2001 was enforced.

- **Foodstuffs (-2,3 percent):** Prices of poultry (-8 percent), potatoes (-11 percent), sugar (-4 percent) and citrus fruits (-11 percent) fell as a consequence of a supply increase. In the case of poultry, sales of baby chicken, which are proxy to the evolution of chicken meat supplies, grew 8 percent. The potato crop rose 23 percent after a larger crop area and increased productivity resulting from weather factors. Sugar output grew 15 percent, thanks to larger investments, while limes increased the citrus fruits crop (up 26 percent).

A national aggregate index of consumer prices based on price indices for 25 cities





prepared by the National Statistics Institute (INEI) since January 2003 shows a 1,1 percent increase in cumulative prices since 2002. This index discriminates among 11 cities, which account for 22 percent of National Urban expenditure and which behaved below the national average. Another 14 cities, which account for 78 percent of national expenditure, showed average inflation above the average.

## 2. Exchange rate

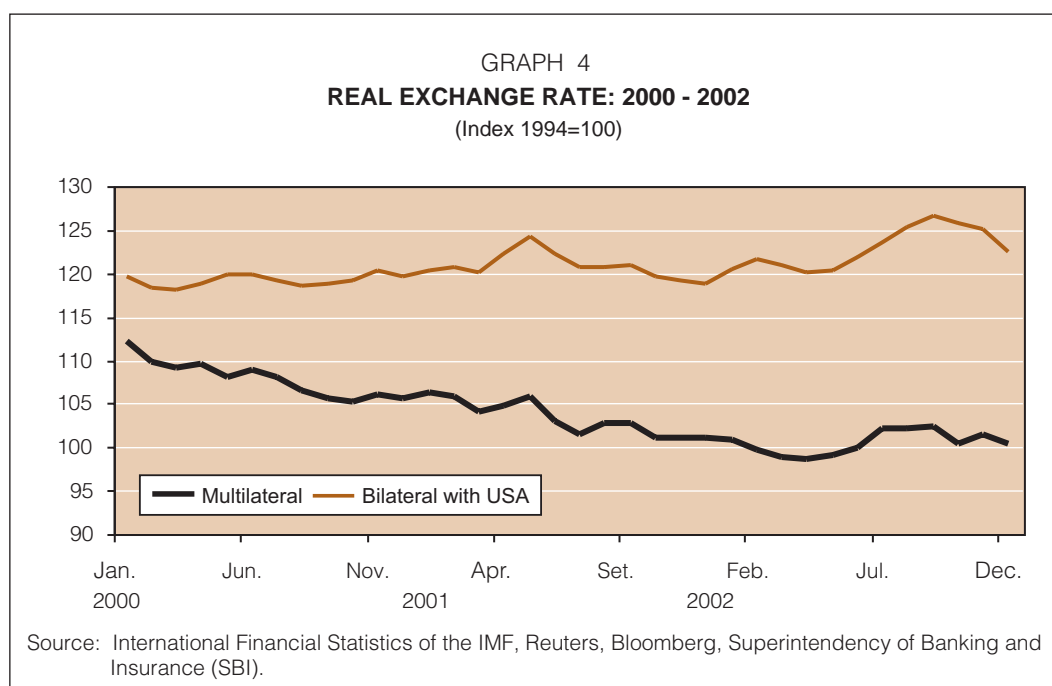
The exchange rate recorded a nominal 2,3 percent increase, to close 2002 at S/. 3,52 per US dollar. The Nuevo sol was the currency showing the smallest depreciation rate during 2002 in Latin America.

In real terms, the Nuevo sol appreciated by 0,6 percent during 2002. The 2,3 percent nominal sol- to-dollar depreciation

rate was offset by domestic inflation of 1,5 percent and a 1,3 percent lower foreign price index.

The fall in the foreign price index was influenced by currency depreciation against the dollar, in particular the depreciation of the Argentinean Peso (244 percent), the Venezuelan Bolivar (76 percent), the Brazilian Real (54 percent), the Colombian Peso (21 percent) and the Mexican Peso (11 percent). Japan's Yen and the Euro appreciated towards the end of 2002 after a negative perception related to the foreign and fiscal deficits in the United States and the uncertainty created by the potential impact of a war conflict in Iraq. Consequently, the Euro and the Yen rose in value by 12 and 4 percent in 2002, respectively.

The strength of the Nuevo sol relative to the other regional currencies may be accounted for the growing differential risk



perception of the Peruvian economy compared to their regional economies (reflected in the larger inflow of public and private capitals), weak commercial and financial links with MERCOSUR economies hit by the Argentinean crisis and large foreign currency reserves. This latter factor made the timely intervention by the Central Bank of Peru in the exchange market to contain the possible domino effect of the electoral process in Brazil.

In 2002, net international reserves grew US\$ 985 million to reach a year-end balance of US\$ 9 598 million. This growth was accounted for a favorable evolution

of export's prices and volumes and the significant increase in long and short term private capital flows. Export's price and volumes increased 3,7 and 5,0 percent, respectively; terms of trade increased 2,5 percent after falling 1,8 percent in 2001; while the overall trade balance was positive for the first time since 1990. The flow of long term loans, foreign direct investment and short term debt rose from US\$ 492 million in 2001 to US\$ 1 389 million in 2002. Larger government access to foreign market was reflected on revenues by foreign placements of global bonds worth US\$ 1 886 million.