

## Monetary Policy Decisions

During the first half of 2007, the Board of Directors of the Central Bank maintained the monetary policy reference interest rate at 4.5 percent –the same rate since May 2006–, given that last 12-month inflation remained below the inflation target range (1% - 3%) during the first four months of the year, mainly as a result of the reversal in the price rises of food observed in the first months of 2006.

Since May 2007, inflation showed an upward trend, influenced mainly by rises in the international prices of food and petroleum. On the other hand, core inflation –indicator excluding the most volatile components of the consumer basket– also showed an upward tendency since mid-2007.

Therefore, the reference interest rate was raised by 25 basis points in both July and September, as a result of which this rate increased from 4.5 percent in June to 5.0 percent in December.

This gradual increase of the reference interest rate was a preventive action adopted to maintain inflation expectations anchored in a context marked by a robust growth of domestic demand (domestic demand grew 10.9 percent between January and July 2007).

In the second half of 2007 the BCRP communiqués on the monetary program emphasized that the Central Bank would continue to keep a close watch on inflation and on the factors affecting it, distinguishing between those factors with temporary effects and those with a permanent impact.

In the last quarter of the year, the Board of the BCRP decided to maintain the policy rate at 5.0 percent. This pause allowed the Central Bank to analyze the reaction of the economy and evaluate the impact of the turbulence seen in international markets as a result of the crisis of the subprime mortgage market in the United States.

**TABLE 5**  
**MONTHLY MONETARY PROGRAM: 2007**  
Interest rates (%)

	Operations in domestic currency		
	Reference Rate	Overnight Deposits	Direct repos and rediscounts
January	4.50	3.75	5.25
February	4.50	3.75	5.25
March	4.50	3.75	5.25
April	4.50	3.75	5.25
May	4.50	3.75	5.25
June	4.50	3.75	5.25
July	4.75	4.00	5.50
August	4.75	4.00	5.50
September	5.00	4.25	5.75
October	5.00	4.25	5.75
November	5.00	4.25	5.75
December	5.00	4.25	5.75



### INFLATION TARGETING IN PERU

Implemented in several countries over the past 15 years, Inflation Targeting has contributed to reinforce the credibility of central banks in controlling inflation and, hence, to maintain expectations of inflation at low levels.

This monetary policy framework has been implemented in different countries with a variety of modalities and characteristics in terms of the inflation target established (which inflation index has been used), the calculation of inflation (if inflation is estimated at the end of a period or on average terms, or continuously or not), and the horizon period used to assess if the inflation target has been met (short-, medium-, or long-term period).

Since 2002 the BCRP replaced monetary base control by an Inflation Targeting scheme and established an annual inflation target of 2.5 percent, plus or minus one percentage point (1.5% - 3.5%).

At the beginning of 2007, the Board of the BCRP approved to reduce the inflation target from 2.5 to 2.0 percent, plus or minus one percentage point (1% - 3%) as of February. Likewise, the Board decided that the evaluation of whether the inflation target had been met would be carried out on a monthly basis (last 12-month inflation) instead of at end December.

The purpose of reducing the inflation target was to continue reinforcing confidence in the domestic currency and reducing the vulnerability of the Peruvian economy associated with dollarization, as well as increasing flexibility to deal with adverse macroeconomic episodes and to mitigate the magnitude and duration of its recessive impacts.

Moreover, the 2 percent inflation target reflects the increase in the prices of the main developed economies, avoiding on this way the relative depreciation of the Nuevo Sol.

The graph below illustrates the evolution of last 12-month inflation and the range of inflation forecasts published in the various Inflation Reports. As the graph shows, executed inflation has been within the ranges projected in the Central Bank's forecasts, except in the last period because of the reasons explained above.

