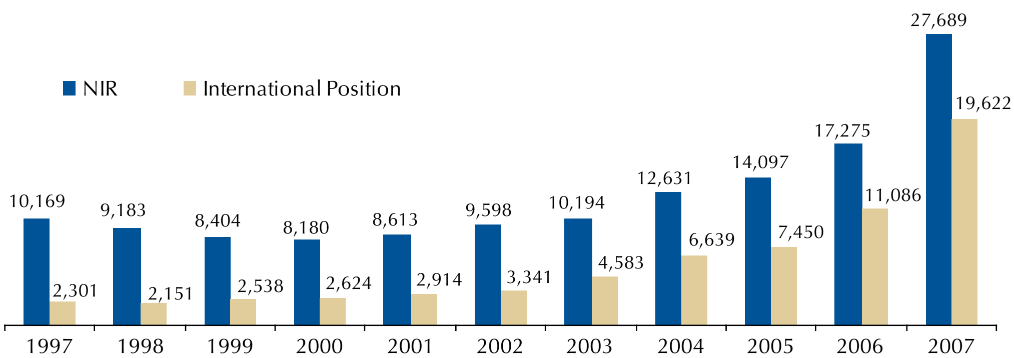
Management of International Reserves

In 2007 Net International Reserves (NIR) and the International Position of the BCRP reached record levels. In this way, NIR increased US$ 10,414 million, while the International position increased US$ 8,536 million.

GRAPH 19
NET INTERNATIONAL RESERVES AND INTERNATIONAL POSITION
(Millions of US$)



Gross International Reserves (GIR)[1] at end 2007 reached US$ 27,720 million, a sum US$ 10,391 million higher than at end 2006.

This increase in the international reserves has improved the country's liquidity indicators. At the end of 2007, NIRs were equivalent to 17 months of imports, 4.2 times the short-term foreign liabilities, and 4.8 times the balance of broad money.

HIGH LEVEL OF INTERNATIONAL RESERVES STRENGTHENED THE INTERNATIONAL LIQUIDITY POSITION

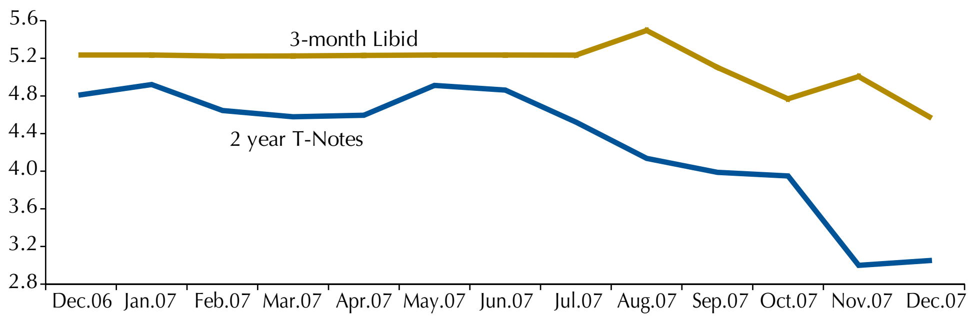
NIRs in US$ 27.7 billion	- 4.2 times the 1-year debt (short-term liabilities + amortizations). - 4.8 times the broad money. - 17 months of imports.

The US Federal Reserve (Fed) maintained the rate of federal funds at a constant 5.25 percent during the first eight months of the year. This policy stance varied in the last four months of the year given the crisis of the subprime mortgage market and some indications of economic slowdown. Therefore, the Fed decided to lower its reference rate on three

[1] Gross international reserves are obtained by deducting the value of silver from total liquidity.

consecutive occasions (the reference rate was reduced by 50, 25, and 25 basis points in the Fed's meetings of September 18, October 31, and December 11 respectively), as a result of which the reference rate was 4.25 percent at the close of the year. This was also reflected in the Libor rate and in the yield of the US Treasury bonds.

GRAPH 20
3-MONTH LIBID AND 2 YEAR US T-NOTES
Annual yield (%)



Source: Bloomberg.

An important increase in the volatility of the prices of fixed-income titles and investors' increased risk aversion was seen in the second half of 2007 due to the crisis of the subprime mortgage market in the United States, which began to affect important financial institutions, as well as liquidity and credit in international markets.

In this scenario, the investment portfolio was managed so as to replicate more closely the Reference Portfolio. A rather conservative position was assumed given increased market risks, but maintaining some strategic deviations that would allow obtaining a greater return in the short-term.

It is worth highlighting that the priority principles based on which international reserves are invested are to preserve the capital and to guarantee reserve liquidity. Once these conditions have been met, the highest possible yield is sought. In general, international assets are managed in consonance with the characteristics of the sources of said resources in terms of amount, currency, maturity, and volatility. In this way, the Bank minimizes the market risks that could affect the value and availability of the assets it is responsible for managing.

Composition of international reserve assets

At end 2007, 61 percent of gross reserves or international assets were invested in high-quality credit liquid securities and 35 percent were invested in first-class banks abroad. The security portfolio was formed by debt bonds issued by the US Treasury and US Agencies, supranational organizations, and other governmental agencies with a long-tem credit rating of AA- or higher.

Liquid international reserve assets[2] at end 2007 amounted to US$ 26,871 million. The income[3] generated by these assets was US$ 987 million, higher than in 2006.

As regards the portfolio's currency structure, investments in securities denominated in currencies other than the US dollar decreased, while the share of investments in US dollars increased. Investments maturing in terms of three months or less declined, while those maturing in 12 or more months increased. Moreover, 64 percent of the portfolio is kept in entities with a long-tem credit rating of **AAA**, and the rest is kept in entities rated **AA-** or higher. The average duration of the investment portfolio in 2007 was 1.32 years (higher than in 2006).

TABLE 9
GROSS INTERNATIONAL RESERVES
(Millions of US$)

Heading	2006		2007	
	Amount	%	Amount	%
Deposits abroad	6,850	39.5	9,568	34.5
Securities	9,387	54.2	16,834	60.7
Gold	706	4.1	928	3.3
Others 1/	386	2.2	390	1.4
TOTAL	**17,329**	**100.0**	**27,720**	**100.0**

1/ Includes contributions to the FLAR and balances from international agreements.
Source: BCRP.

In 2007 the return on BCRP international reserves was higher than the financial cost of the exchange interventions carried out to reduce the volatility of exchange. The return on BCRP international investments in 2007 was 8.6 percent, mainly due to the increase seen in the price of the securities in the investment portfolio at the end of the year and the appreciation of the euro against the US dollar.

2 GIR minus capital subscription to the FLAR, balance of international agreements (ALADI), and gold holdings stored at the BCRP.
3 Includes accrued interests, accounting gains for the sale of securities, and amortization of premium or discount for holding of securities. Does not include exchange gains in the year.

TABLE 10
COMPOSITION OF LIQUID INTERNATIONAL ASSETS
(Percentage structure)

		2006	2007
1.	**By currency and gold**	**100.0**	**100.0**
	US$	80.1	85.6
	Other currencies	17.8	12.7
	Gold	2.1	1.7
2.	**By maturity**	**100.0**	**100.0**
	0-3 months	50.2	43.0
	3-12 months	13.2	12.3
	> 1 year	36.6	44.7
3.	**By long-term qualification**	**100.0**	**100.0**
	AAA	54.3	63.8
	AA+/AA/AA-	42.5	36.2
	A+	3.2	0.0

Source: BCRP.