

II. Inflation

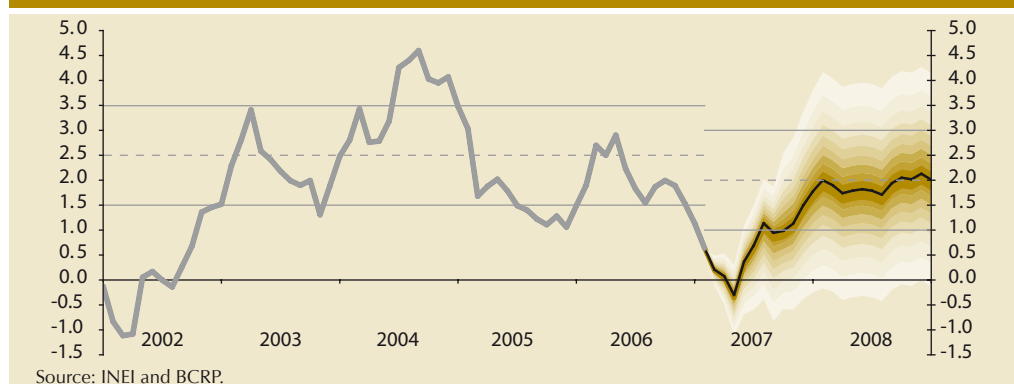
Inflation in 2007 (3.9 percent) was higher than in 2006 (1.1 percent). This higher rate of inflation was due to the effect of the prices of imported inputs (wheat, soybean oil, and petroleum) on the prices of foodstuffs, as reflected in the evolution of imported inflation which recorded 10.5 percent in 2007 (versus 0.3 percent in 2006). Core inflation –trend indicator– increased from 1.4 to 3.1 percent between 2006 and 2007. Excluding foodstuffs and beverages, inflation was 2.0 percent in 2007.

The rise in the price of food is an international phenomenon associated with both supply factors –such as lower cultivated areas and droughts in the main producing countries– and demand factors –such as increased consumption in Asian countries–.

Moreover, the costs of inputs used in the production of fuels, plastics, fertilizers, and foodstuffs have also increased, translating mainly into higher prices in a context of high growth of domestic demand.

The evolution of inflation in 2007 was mainly influenced by the higher international prices of fuels and food, which reached magnitudes unseen since the seventies that have led inflation to accelerate worldwide. In this context, the higher prices of imported goods have had a direct impact on the food component of the consumer basket and an indirect impact on firms' production costs and inputs. The impact of these rises was evidenced in the second half of the year when inflation began to accelerate and especially since October when the variation accumulated in the last 12 months increased above the 3 percent tolerance range, reaching a rate of 3.93 percent in December. The latter was associated with the spread of the rise in the international prices of food inputs –i.e. wheat, maize, and soybean– into the prices of foodstuffs that have an important effect on the consumer basket (bread, noodles, and oils).

GRAPH 8
INFLATION FORECAST
(Last 12 months percentage change)



It is worth pointing out that the probability that inflation could converge from the lower band of the target range (1 percent) to around 4 percent in 2007 was already mentioned in our Inflation Report of January.

The items with the highest positive weighted contribution to inflation included bread, meals outside the home, and fuels, while the items with the lowest negative weighted contribution to inflation included sugar, fresh legumes, and telephone rates.

TABLE 18
WEIGHTED CONTRIBUTION TO INFLATION 2007
(Percentage points)

Items	Weight	% Chg.	Positive contribution	Items	Weight	% Chg.	Negative contribution
Bread	3.7	19.2	0.84	Sugar	1.4	-9.2	-0.14
Meals outside the home	10.2	4.1	0.41	Fresh vegetables	0.4	-13.1	-0.07
Fuel	3.9	6.4	0.36	Telephone	1.3	-7.2	-0.07
Evaporated milk	2.2	11.3	0.24	Potatoes	1.5	-4.0	-0.07
Eggs	0.7	33.1	0.23	Onion	0.4	-14.4	-0.07
TOTAL			2.08				-0.42

Source: INEI and BCRP.

Imported inflation

The 10.5 percent rate of imported inflation was mainly explained by the higher prices of food (18.8 percent) and fuels (6.4 percent).

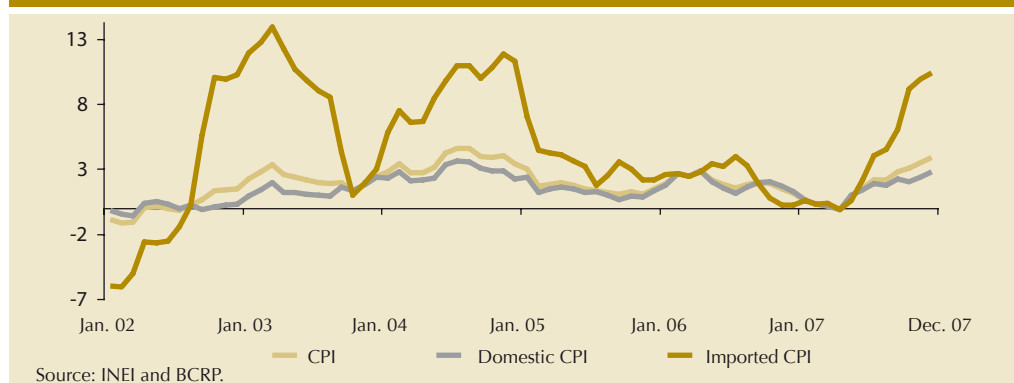
TABLE 19
DOMESTIC AND IMPORTED INFLATION
(Accumulated percentage change)

	Weighted	2002	2003	2004	2005	2006	2007
I. IMPORTED CPI	12.1	10.3	3.0	11.3	2.2	0.3	10.5
Food	5.4	10.0	-0.1	10.9	-1.5	2.1	18.8
Bread	3.7	13.6	-1.1	12.9	-0.3	3.4	19.2
Pasta	1.0	-1.2	-1.0	8.4	-2.2	-1.4	12.6
Petroleum	0.8	7.1	5.9	4.1	-6.8	-1.0	24.4
Fuel	3.9	15.6	8.9	17.8	6.9	-1.5	6.4
Domestic appliances	1.0	3.4	-1.9	-2.8	-1.2	-1.3	-1.5
Other	1.8	3.4	1.4	3.2	2.3	0.6	0.5
II. DOMESTIC CPI	87.9	0.3	2.4	2.3	1.4	1.3	2.8
III. CPI	100.0	1.5	2.5	3.5	1.5	1.1	3.9
Exchange rate		2.3	-1.2	-5.5	4.4	-6.4	-7.0

Source: INEI and BCRP.



GRAPH 9
INFLATION, DOMESTIC AND IMPORTED INFLATION
 (Last 12 month percentage change)



Bread and pasta: The prices of these products increased 19.2 percent and 12.6 percent respectively, reflecting the higher price of wheat flour (the wholesale price increased 43 percent), which is the main input used to elaborate them. In turn, this rise was due to the higher international price of wheat, partially offset by the elimination of the tariff and overcharge on wheat in July.

Oil: The accumulated increase in the price of oil as of December was 24 percent. This product was affected by the higher international price of soybean oil (63 percent) –the main input used to elaborate vegetable oils–.

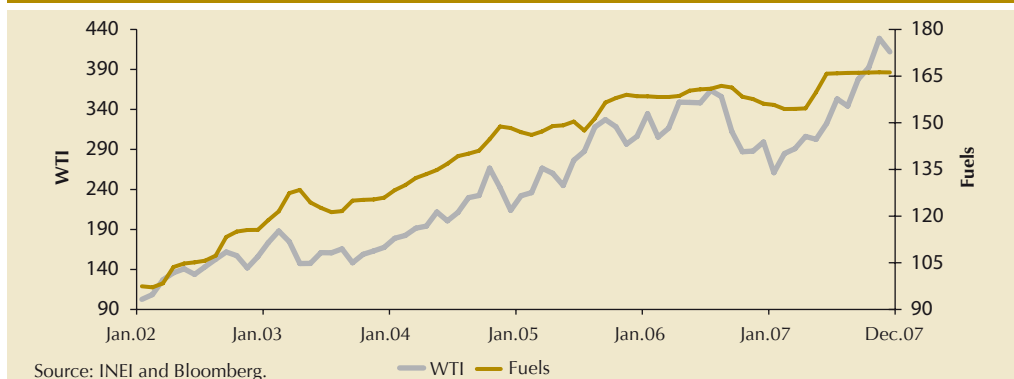
Fuels: The domestic price of fuels increased 6.4 percent on average in 2007. In the international market, the price of West Texas Intermediate oil (WTI oil) rose from US\$ 62 in December 2006 to US\$ 92 in December 2007. However, the impact of this rise on domestic prices was buffered through the Oil Price Stabilization Fund, which was increased by S/. 770 million in 2007.

TABLE 20
FUEL PRICES
 (Annual percentage change)

	2002	2003	2004	2005	2006	2007
FUELS	15.6	8.9	17.8	6.9	-1.5	6.4
Gasoline	15.7	9.7	17.7	9.2	-6.2	10.7
Gas	11.3	4.2	15.3	-10.9	0.3	1.3
Kerosene	20.4	13.0	20.3	21.0	2.2	5.8
WTI Price of oil (end of period)						
US Dollars	29.4	32.1	43.3	59.4	61.9	91.7
Nuevos soles	103.5	111.3	142.0	203.3	198.6	273.4

Source: INEI and Bloomberg.

GRAPH 10
PRICE OF WTI: OIL AND FUEL
(Index December 2001 = 100)



Core inflation in 2007 (3.1 percent) was higher than in 2006 (1.4 percent) because the rise in the price of commodities also affected the price of core foodstuffs, such as milk, beef, meals outside the home, among other prices.

TABLE 21
INFLATION
(Accumulated percentage change)

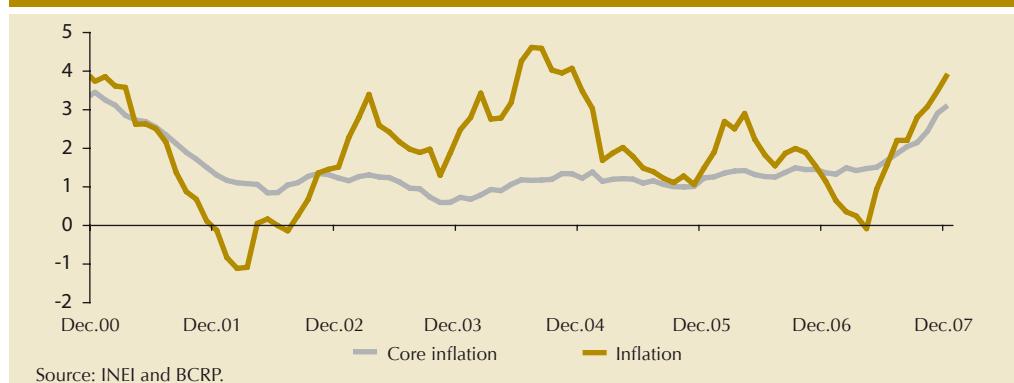
	Weighted	2002	2003	2004	2005	2006	2007	Annual average 2002-2007
I. Core	60.6	1.23	0.73	1.23	1.23	1.37	3.11	1.48
1. Food	10.7	0.02	0.14	3.24	0.98	0.98	6.24	1.91
2. Non-Food	49.9	1.49	0.85	0.80	1.28	1.45	2.44	1.39
a. Goods	23.3	1.39	0.08	-0.29	0.71	0.97	1.92	0.80
b. Services	26.6	1.57	1.53	1.75	1.77	1.85	2.88	1.89
II. Non-Core	39.4	1.96	5.16	6.75	1.87	0.83	5.07	3.58
1. Food	22.5	0.28	3.73	5.82	1.62	2.06	7.25	3.43
2. Non-Food	16.9	4.22	7.00	7.90	2.17	-0.67	2.37	3.79
a. Fuel	3.9	15.60	8.94	17.77	6.89	-1.50	6.45	8.84
b. Transport	8.4	0.11	10.99	3.49	1.29	1.12	0.82	2.90
c. Public services	4.6	1.96	-1.98	6.19	-1.72	-3.22	0.24	0.20
III. Total	100.0	1.52	2.48	3.48	1.49	1.14	3.93	2.33

Source: INEI and BCRP.

Non-core inflation accumulated 5.1 percent, particularly due to foodstuffs (7.2 percent) and fuels (6.4 percent).



GRAPH 11
INFLATION AND CORE INFLATION
 (Last 12-month percentage change)



Other items that contributed significantly to inflation

Items with a positive contribution:

Milk: The price of milk showed an accumulated variation of 11.3 percent as of December. According to milk producers, this rise was due to higher production costs as a result of the higher prices of the inputs used to feed cattle (wheat bran, maize, and cotton paste) and the higher prices of energy and fuels.

Eggs: The rise in the price of eggs (33 percent in 2007) would have been associated with increased demand, as well as with a lower placement of laying hens (-4 percent compared to 2006). In addition to this, some small enterprises would have been affected by the higher prices of feed inputs (maize and soybean), which would have implied an increase in the relative price of eggs.

Utility rates: The rates of public utilities increased 0.2 percent in 2007. The increase of electricity (1.9 percent) and water (3.2 percent) rates was partially offset by the reduction of telephone rates (-7.2 percent). Electricity rates fell 2.8 percent between April and May due to the annual update of block rates, which considered new generation projects. These rates increased 2.3 percent between June and July due to the approval of the rural electrification law, which considers a contribution of 2/1000 of 1 tax unit from residential users, and again 1.6 percent in August due to the quarterly adjustment that is made considering the higher prices of fuels.

Items with a negative contribution:

Sugar: The price of sugar showed an accumulated change of -9.2 percent as of December. According to available information, the production of sugar cane in 2007 increased

13.8 percent compared to the same period in 2006, mainly due to higher production in Lambayeque (22 percent) and La Libertad (15 percent) as a result of management improvements in the main enterprises.

Fresh legumes: The prices of legumes fell 13 percent on average. It is worth mentioning that the price of peas, which is the product with the highest weight in this group, declined 18 percent. Pea production increased 12.4 percent in 2007.

Potato: The price of potato decreased 4 percent during 2007 due to higher supply. According to the Ministry of Agriculture, the production of potato nationwide grew 4.3 percent in 2007.

Onion: The price of onion fell 14.4 percent due to higher production (9.3 percent). In Arequipa, Lima's main supplier of potato, production grew 6.3 percent given that cultivated areas increased due to better farm prices during the sowing period.

The drop of telephone rates reflected mainly the reduction of the monthly basic rate for classic residential lines and a series of rate plans resulting from negotiations between the state and Telefónica del Perú.

TABLE 22
PUBLIC UTILITY RATES
(Percentage change)

	2002	2003	2004	2005	2006	2007
Public utilities	2.0	-2.0	6.2	-1.7	-3.2	0.2
Electricity	7.9	-4.6	12.0	-2.5	-7.3	1.9
Telephone	-8.3	0.3	-2.0	-7.0	-6.2	-7.2
Water	2.3	0.9	3.0	5.2	8.5	3.2

Source: INEI.