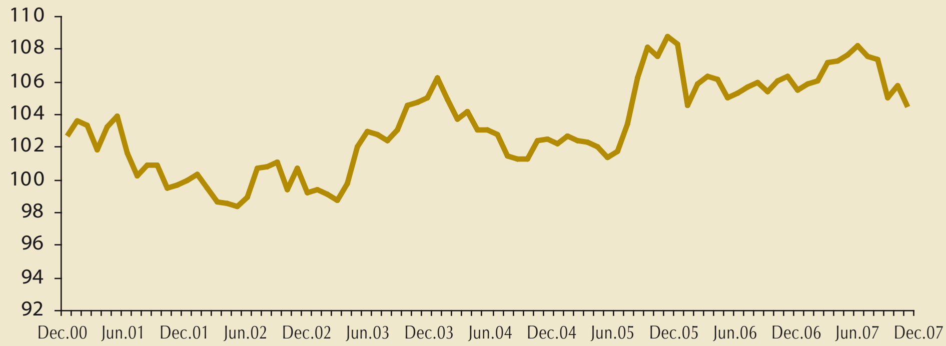
III. Exchange Rate

The real exchange rate appreciated 1.7 percent during 2007 mainly as a result of the weakening of the dollar against the currencies of our main trading partners. This appreciation was in part offset by a lower domestic inflation compared to inflation levels in the rest of the world. The Nuevo Sol appreciated 7.0 percent in nominal terms in a context marked by a series of reductions in the Federal Reserve's reference interest rate.

The Nuevo Sol strengthened in a context of better macroeconomic fundamentals in the Peruvian economy, a favorable evolution of both the current account and the financial account (which showed surpluses of 1.4 and 7.6 percent of GDP respectively), and portfolio movements towards the local currency (the dollarization ratio of liquidity in the banking system decreased from 51 to 46 percent). Among other factors, all of this was associated with the weakening of the dollar in the international financial system due to fears of a recession in the US economy and to the consecutive cuts implemented by the US Federal Reserve in its interest rate. Thus, the nominal exchange rate fell from S/. 3.21 per dollar in December 2006 to S/. 2.98 in December 2007.

GRAPH 12
MULTILATERAL REAL EXCHANGE RATE INDEX
(December 2001 = 100)



Source: BCRP.

The BCRP intervenes in the exchange market in order to reduce excessive volatility in exchange. The Central Bank has been purchasing dollars to prevent the domestic currency from strengthening too abruptly in a context in which the composition of private sector portfolios is shifting toward a higher participation of assets in domestic currency and an inflow of external speculative capitals is being observed. These purchases of dollars allow increasing the BCRP's international reserves, thus strengthening the country's external position to face adverse situations in the event of a reversal of the current favorable international context. It is worth mentioning that a part of these purchases of dollars are aimed at meeting the public sector's demand for foreign currency to fulfill its obligations in said currency.

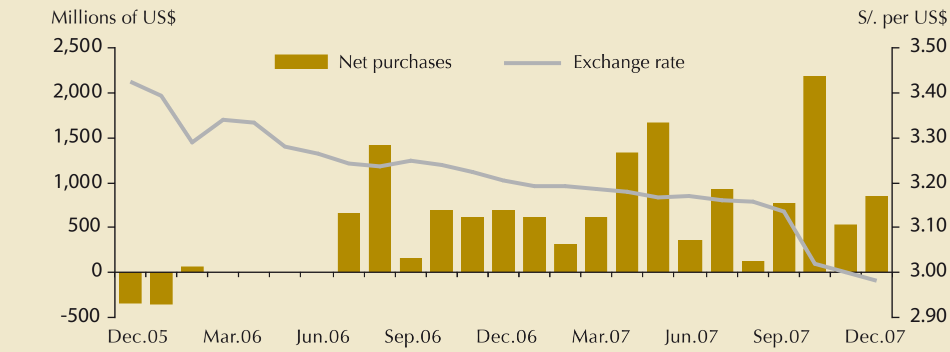
In this context of high volatility of exchange, the BCRP intervened in the exchange market purchasing foreign currency for a total of US$ 10,306 million during 2007, and sold US$ 3,275 million to the Public Treasury. Most of these operations were carried out in April (US$ 1,330 million), May (US$ 1,671 million), and October (US$ 2,181 million) when higher appreciatory pressures were observed.

TABLE 23
BILATERAL EXCHANGE RATE S/. per M.U.
(Percentage change)

	Weighted 1/	Nominal Chg. Dec. 07/ Dec. 06	Real Chg. Dec. 07/ Dec. 06
United States	29.23	-7.0	-7.0
Eurozone	12.31	2.4	1.2
Japan	3.98	-3.1	-6.5
Brazil	5.52	11.8	12.1
United Kingdom	1.31	-4.6	-6.4
Chile	6.66	-1.6	1.7
China	11.37	-1.3	2.2
Colombia	4.20	4.6	5.9
Mexico	2.93	-6.9	-6.9
Argentina	2.61	-10.5	-6.5
Corea	2.16	-7.7	-8.0
Taiwan	1.89	-6.7	-7.5
Venezuela	3.10	-7.0	9.6
Canada	4.77	7.0	5.8
Ecuador	4.61	-7.0	-8.1
Suiza	3.37	-1.4	-3.5
Basket	**100.00**	**-1.7**	**-2.5**

1/ Weighted according to the trade volume 2005.
Source: IMF, Reuters, Bloomberg and SBS.

GRAPH 13
BCRP NET PURCHASES OF DOLLARS AND EXCHANGE RATE



Source: BCRP.

Country risk

After dropping to minimum levels in the first half of the year, the spreads on emerging countries' bonds increased due to fears of an international credit crisis.

Spreads showed a strong downward trend in the first half of the year. This favorable evolution of spreads was influenced by the improvement of economic fundamentals in most economies (increase in international reserves, reducing and readjusting of debt profile, among others), reflected in turn by the better ratings assigned by the main risk rating agencies to emerging countries.

Thus, during 2007, *Standard & Poor's* increased the risk rating of Chile, Mexico, Brazil, and Colombia. Likewise, *Moody's* improved Brazil's rating and *Fitch* improved the rating of Mexico and Brazil. However, after reaching minimum levels between end May and the first half of June, the downward evolution of spreads reversed, affected by the higher turbulence observed in international markets as a result of the subprime mortgage crisis in the United States. The EMBI+ and Credit default Swap spreads increased due to higher risk aversion.

TABLE 24
SPREADS OF EMERGING MARKETS[1/]
(In bps)

	2003	2004	2005	2006	2007	Variation 2007- 2006
EMBI+	**418**	**356**	**245**	**169**	**239**	**70**
Latin America	521	420	283	186	268	82
Brazil	463	382	311	192	221	29
Colombia	431	332	238	161	195	34
Mexico	199	166	126	98	149	51
Argentina	5,632	4,703	504	216	410	194
Peru	312	220	206	118	178	60
CDS (Credit Default Swap) 5 years						
Brazil	404	305	225	100	103	4
Colombia	441	341	167	114	130	16
Mexico	122	80	63	41	69	29
Argentina	n.a.	n.a.	367	203	462	259
Peru	292	204	221	91	116	25

1/ Data at the end of period.
Source: Bloomberg and Reuters.