VI. Money and Credit

Preventive measures adopted in 2007 included raising the monetary policy rate on two occasions, in a context characterized by a strong growth of domestic demand, high uncertainty in international financial markets, and higher than expected rises in the prices of fuels and foodstuffs. The Central Bank also sought to reinforce monetary stability and promote greater dedollarization in the Peruvian economy adopting a stricter inflation target. Thus, the Board of the BCRP approved to reduce the inflation target –measured as the increase of last 12-month CPI prices– from 2.5 to 2.0 percent, plus or minus one percentage point, as of January.

In order to reinforce the Central Bank's commitment of preserving monetary stability, the Board of the BCRP approved to reduce the inflation target from 2.5 to 2.0 percent, plus or minus one percentage point, as of January. Therefore, monetary policy actions were aimed at leading last 12-month inflation to converge to a rate of 2 percent, but considered the possibility that inflation might transitorily fall outside the target range in the short-term due to events such as variations in the prices of imported goods or in the prices of products subject to abrupt changes in local supply.

This lower inflation target is expected to contribute to dedollarize the economy and to further develop the capital market as the value of the domestic currency will be strengthened in the long-term.

1. Monetary policy actions

Monetary policy decisions adopted during the year were mainly of a preventive nature in a context characterized by a strong growth of domestic demand, high uncertainty in international financial markets, and higher than expected rises in the prices of food and fuels.

Special attention was given in the first months of the year to the evolution of the balance between higher domestic expenditure and the growth of productivity in a context in which no inflationary pressures were observed and in which the reversal in the price rises of foodstuffs seen in the first four months of 2006 had contributed to lead annual inflation below the lower band of the inflation target. Thus, the BCRP decided to maintain the reference rate at 4.5 percent until July.

However, in May this macroeconomic scenario began to change when some of the risks considered in the Inflation Report of January materialized with higher than expected rises in the international prices of fuels and food. In this new context, an upward trend was observed in last 12-month inflation due mainly to higher imported inflation. Moreover, in a context of strong dynamism of economic activity and a robust growth of domestic demand, core inflation –trend indicator of the growth of prices– also began to accelerate, increasing from 1.5 to 1.7 percent between May and June after having remained stable at an average level of 1.4 percent during the previous twelve months.

Given this higher risk scenario and considering monetary policy lags, in July the Board decided to raise the reference rate from 4.5 to 4.75 percent as a preventive measure aimed at maintaining inflation expectations within the target range. The Central Bank continued to withdraw monetary stimulus in September due to concerns that the higher international prices of fuels and some food inputs might translate into higher inflationary expectations. Thus, the Board raised the monetary policy rate to 5.0 percent in a context in which banks and non-financial entities corrected their inflation expectations for 2007 and 2008 slightly upwards.

During the last quarter of 2007, a pause was made in terms of modifying the monetary stimulus to assess the impact of the turbulence seen in international markets due to the US subprime mortgage crisis and to observe the economy's reaction to the monetary actions implemented in July and September.

However, the economic developments observed in the last months of 2007 showed that the scenario of higher growth of domestic demand and higher prices of food and fuel considered in the risk balance of the Inflation Report of September 2007 had materialized. Thus, at end 2007 inflation posted 3.9 percent, while core inflation showed a rate of 3.1 percent –slightly above the upper band of the target range, although core inflation excluding foodstuffs was 2.4 percent in the same period. This deviation of inflation above the target range was mainly due to imported inflation, which had in part translated into expectations and some components of core inflation.

2. Interest rates

In general the interest rates in soles in the Peruvian bank system remained stable during the first half of 2007, increasing thereafter in the second half of the year, influenced by the preventive adjustments made in the BCRP's reference rate in July and September (the reference rate was raised by 25 basis points on each occasion). This conduct was more evident in the case of short-term active and passive rates and lower-risk rates, which depend more directly on monetary policy decisions. On the other hand, long-term active rates showed a downward trend due to positive economic performance and firms' better financial standing, as well as to increased competition among financial entities.

The average interest rate on 31 to 180 day-term deposits increased from 4.8 percent in December 2006 to 5.3 percent in October 2007 (51 basis points) during the first ten months of the year, similarly to the reference interest rate, stabilizing around this level at

BOX 5

NEW INFLATION TARGET: 2.0 PERCENT

The Peruvian Political Constitution of 1993 establishes that the mission of the BCRP is to preserve monetary stability and that the Central Bank is independent, as established in its Organic Law. The Constitution also establishes that the Central Bank must inform the public about the actions and procedures adopted by the bank to fulfill its constitutional mandate.

Between 1990 and 2001, monetary policy was based on the expansion of the monetary base. However, the correlation between inflation and the growth of the monetary base faded away with the reduction of inflation, making it more difficult to communicate monetary policy decisions. Therefore, an Inflation Targeting scheme was adopted since 2002.

Under this scheme, the Central Bank's monetary actions are oriented to meeting an annual inflation target. The inflation target until 2006 was 2.5 percent, plus or minus one percentage point.

In order to reinforce its commitment of preserving monetary stability, in 2007 the Board of the BCRP reduced the inflation target from 2.5 to 2.0 percent, plus or minus one percentage point.

This decision was based on the following reasons:

1. A lower rate of inflation contributes to the dedollarization of transactions and saving, as well as to the development of a capital market given that domestic currency is strengthened.

2. The monetary policy rates of our main trading partners are set at 2.0 percent or lower. Therefore, the value of the Nuevo Sol against other currencies will not depreciate in the long run to compensate higher inflation in the country.

3. The institutional robustness of the BCRP is currently similar to that of central banks in industrialized countries, most of which have inflation targets around 2 percent. In this sense, Arnone et. al (2006) says that the degree of economic independence of the BCRP is higher than the ones observed in emerging and developing countries and similar to the ones observed in industrialized countries.

Under the inflation targeting scheme, the BCRP announces the inflation target to the public in order to maintain economic agents' inflation expectations anchored around this target. The BCRP also seeks that actions are implemented on a timely basis in order to counter inflationary or deflationary pressures that could lead inflation away from the target, given monetary policy lags.

Therefore, the tolerance range of plus or minus one percentage point of the target provides flexibility to monetary policy and prevents reactions associated with temporary price fluctuations.

the end of the year. On the other hand, the average rate on 181 to 360 day-term deposits remained unchanged around 5.7 percent, showing only a reduction of 28 basis points between May and September when the rate was 5.5 percent. As regards active rates in soles, the 3-month corporate prime rate –for low risk clients– increased from 5.2 to 5.6 percent between end 2006 and end 2007, while the active rate with a constant structure –which includes credits with different risk levels– fell from 17.1 to 16.3 percent in the same period.

TABLE 44
INTEREST RATES IN DOMESTIC CURRENCY
(Percentage)

	2005	2006	2007
1. Interbank	3.3	4.5	5.0
2. Term deposits (31 to 180 days)	3.6	4.8	5.3
3. Term deposits (181 to 360 days)	4.6	5.7	5.6
4. Prime lending	4.4	5.2	5.6
5. Average lending rate (up to 360 days)	13.9	13.8	13.2
6. Fix-weighted average lending rate	17.0	17.1	16.3
7. 3-month Libor	4.7	5.1	5.5

Source: SBS and BCRP.

In case of the conduct of interest rates in dollars, this evolution was reflected mainly for investors' increased perception of country risk due to the uncertainty generated by the crisis of the US subprime mortgage market. Thus, short-term interest rates in dollars increased by up to 40 basis points between end 2006 and end 2007. However, like rates in soles, long-term rates in dollars continued to decline due to clients' lower perception of credit risk.

TABLE 45
INTEREST RATES IN FOREIGN CURRENCY
(Percentage)

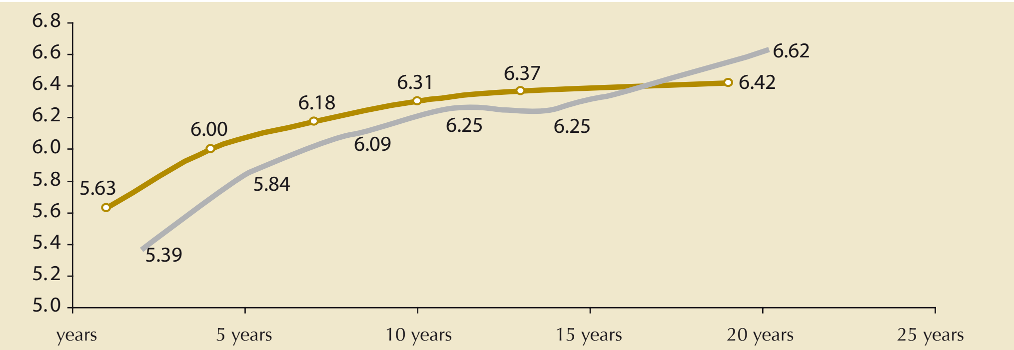
	2005	2006	2007
1. Interbank	4.2	5.4	5.9
2. Term deposits (31 to 180 days)	2.9	3.4	3.8
3. Term deposits (181 to 360 days)	2.9	3.6	3.9
4. Prime lending	5.5	6.1	6.4
5. Average lending rate (up to 360 days)	9.4	10.1	9.7
6. Fix-weighted average lending rate	10.3	10.6	10.0
7. 3-month Libor	4.5	5.4	5.0

Source: SBS and BCRP.

By rate modalities, a downward trend was observed in the cost of credit for the corporate sector and for microenterprises due to improvements in borrowers' payment capacity. The average rate for commercial loans in soles fell from 9.5 percent at end 2006 to 9.0 percent at end 2007, while the rate for credit to microenterprises fell from 39.1 to 35.6 percent in the same period. Likewise, average interest rates in dollars for productive activity showed a downward trend: the interest rate for loans to microenterprises declined from 24.7 percent to 23.8 percent between end 2006 and end 2007, while the rate for commercial loans fell from 9.9 to 9.2 percent in the same period.

The yield curve on sovereign bonds in the fixed income market increased in the case of bonds with maturities of over 15 years, reflecting the shift seen in the Central Bank's monetary policy, as well as increased country risk perception in mid-2007 given expectations of a slowdown in the US economy due to the subprime mortgage crisis in that country. The strength of the Nuevo Sol against the dollar was not enough to revert this trend. The rates with shorter maturity terms increased the most: the rate on the 1-year bond (maturing in 2008) increased 24 points (to 5.63 percent), while the rate on the 10-year bond (maturing in 2017) increased 6 points (to 6.31 percent). On the other hand, the rate on the 20-year bond (maturing in 2027) fell 20 percentage points to 6.42 percent.

GRAPH 25
YIELD CURVE OF SOVEREIGN BONDS[1/]
(In billions of US$)



Source: BCRP.

Short-term interest rates –represented by BCRP Certificates of Deposit– increased influenced by the BCRP adjustment of its monetary stance: this rate increased 72 basis points in one year (from 5.13 percent at end 2006 to 5.85 percent at end 2007), showing a higher increase than the one observed in the BCRP reference rate (50 points), which reflected investors' perception of higher country risk.

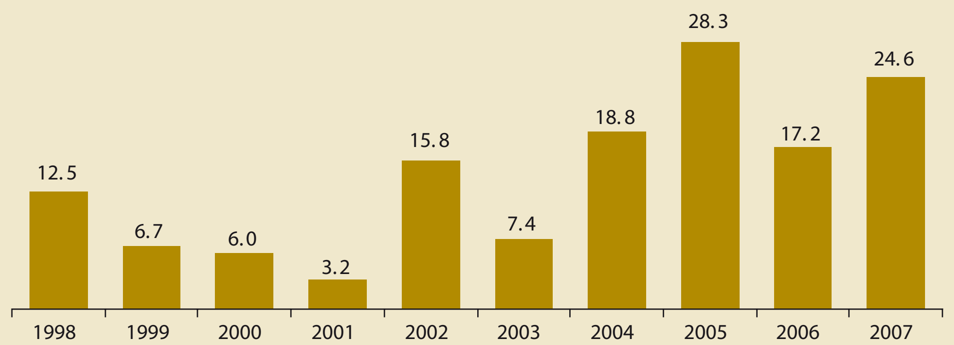
3. Monetary aggregates

Monetary aggregates showed a high growth in 2007 due to factors such as the expansion of economic activity, the process of dedollarization, and "bankarization". In order to maintain inflation expectations anchored around the target, the BCRP raised its reference interest rate in both July and September, which slightly affected the growth of lower aggregates. However, aggregates in general showed higher growth rates than in previous years, particularly in the case of aggregates in soles as a result of dedollarization and “bankarization”.

Monetary base and currency

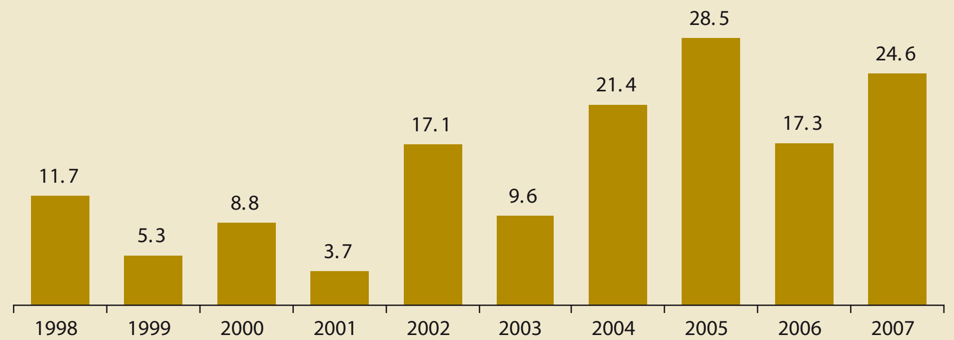
The average balances of the primary base and currency increased 24.6 percent in 2007, showing a higher growth rate than in 2006 (17.2 percent and 17.3 percent respectively), in line with the higher demand for Nuevos Soles due to the expansion of economic activity and to dedollarization.

GRAPH 26
MONETARY BASE
(Annual percentage change, period average)



Source: BCRP.

GRAPH 27
CURRENCY
(Annual percentage change, period average)



Source: BCRP.

On average terms, the 24.6 percent growth of the monetary base –as well as the 31.5 percent growth of liquidity in soles in the private sector– was consistent with an

11.8 percent average growth in nominal GDP, a 15.0 percent drop in the circulation velocity of money, and a 5.6 percent increase in the bank multiplier. The increase in the average multiplier in 2007 was mainly associated with a reduction of the preference for currency (the latter decreased from 32.4 percent to 29.6 percent between 2006 and 2007).

The primary base during 2007 was S/. 3,916 million. Its growth was mainly explained by the BCRP exchange operations (S/. 21,914 million or US$ 7,070 million), which included purchases of foreign currency (S/. 32,057 million or US$ 10,306 million), in part compensated by net sales of dollars to the public sector (S/. 10,263 million or US$ 3,275

TABLE 46
AVERAGE BROAD MONEY IN NUEVOS SOLES OF THE PRIVATE SECTOR
(Average percentage change of year)

	GDP Deflator	GDP Growth		Local Currency Broad money	Velocity of money	Money supply components	
		Real	Nominal			Monetary Base	Multiplier
2005	3.1	6.7	10.0	34.6	-18.2	28.3	4.9
2006	8.3	7.6	16.5	17.9	-1.2	17.2	0.6
2007	4.8	9.0	11.8	31.5	-15.0	24.6	5.6

Source: BCRP.

TABLE 47
OPERATIONS OF CENTRAL RESERVE BANK OF PERU
(In millions of nuevos soles)

	2003	2004	2005	2006	2007
I. NET INTERNATIONAL POSITION	**4,315**	**6,917**	**2,518**	**11,696**	**26,464**
(Millions of US$)	1,242	2,056	811	3,636	8,536
1. Foreign exchange operations	998	1,854	767	2,861	7,070
A. Over the counter	1,050	2,340	2,699	3,944	10,306
B. Public sector	-51	-487	-1,935	-1,084	-3,275
C. Other operations	-1	2	3	1	39
2. Other operations	244	202	44	775	1,466
II. NET DOMESTIC ASSETS	**-3,560**	**-5,252**	**-438**	**-10,016**	**-23,275**
1. Public sector deposits	-921	-721	-2,821	-5,434	-6,751
2. Reverse Repos	-170	0	2,850	-2,850	0
3. BCRP Certificates of Deposit	-2,462	-4,158	578	-389	-13,393
4. BCRP Indexed Certificates of Deposit (CDR)	319	0	-1,202	1,202	0
5. Overnight deposits	65	-52	-8	-188	227
6. Reserve requirements in domestic currency	7	-148	4	63	-157
7. Other assets	-398	-173	160	-2,420	-3,201
III. CURRENCY	**755**	**1,665**	**2,080**	**1,680**	**3,189**
Memo: Balance at the end of period					
- BCRP Certificates of Deposit	4,097	8,255	7,676	8,066	21,458
- Public sector deposits	1,196	1,918	4,738	10,172	16,924

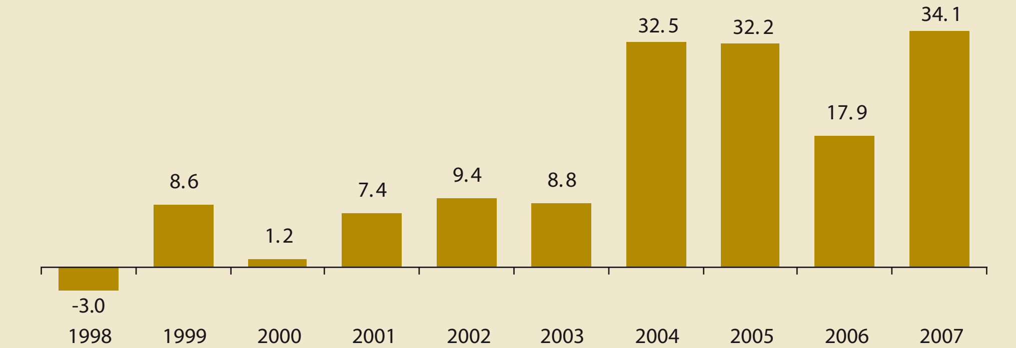
Source: BCRP.

million). Conversely, the monetary base shrank due to net placements of BCRP Certificates of Deposit (S/. 13,393 million) and to public sector's higher deposits at the BCRP (S/. 6,751 million).

Liquidity in Depositary Corporations

The growth of liquidity in domestic currency increased from 17.9 percent in 2006 to 34.1 percent in 2007.

GRAPH 28
LIQUIDITY IN NUEVOS SOLES IN DEPOSITARY CORPORATIONS
(Annual percentage change, period average)



Source: BCRP.

However, in contrast with 2006, the growth of liquidity in soles was mainly driven by term deposits, which grew 51.8 percent (10.4 percent in 2006) reflecting the public's higher preference for assets used to store value.

TABLE 48
LIQUIDITY AND SAVINGS IN DOMESTIC CURRENCY IN DEPOSITARY CORPORATIONS

	Balance in millions of nuevos soles			Growth rate	
	2005	**2006**	**2007**	**2006**	**2007**
Currency	10,036	11,687	14,857	16.5	27.1
Demand deposits	5,453	7,231	9,895	32.6	36.8
Savings deposits	5,767	6,658	8,547	15.5	28.4
Term Deposits	6,630	7,318	11,111	10.4	51.8
Securities and others	581	678	594	16.8	-12.4
TOTAL	**28,467**	**33,573**	**45,005**	**17.9**	**34.1**

Source: BCRP.

Liquidity in dollars grew 18.3 percent (12.7 percent in 2006), also due to the higher growth of deposits with longer maturity terms. Deposits with maturity terms in dollars explain 58 percent of variation of annual growth of liquidity in such currency.

TABLE 49
LIQUIDITY AND SAVINGS IN FOREIGN CURRENCY IN DEPOSITARY CORPORATIONS

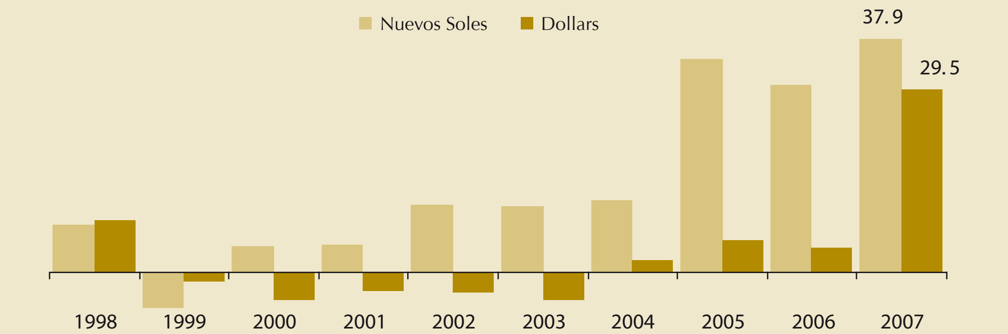
	Balance in millions of Dollars			Growth rate	
	2005	2006	2007	2006	2007
Demand deposits	2,235	2,668	3,368	19.4	26.2
Savings deposits	2,331	2,654	2,837	13.9	6.9
Term Deposits	5,102	5,607	6,777	9.9	20.9
Securities and others	137	120	86	-12.1	-28.2
TOTAL	**9,805**	**11,049**	**13,068**	**12.7**	**18.3**

Source: BCRP.

Credit to the private sector

Total credit to the private sector grew at a rate of 28.0 percent, the highest growth rate observed since 1997. Credit to the private sector in soles grew 37.9 percent (30.2 percent in 2006), while credit to the private sector in dollars grew 29.5 percent, (3.9 percent in 2006). The dollarization ratio of credit to the private sector decreased from 60 to 57 percent.

GRAPH 29
CREDIT TO THE PRIVATE SECTOR IN DOMESTIC AND FOREIGN CURRENCY
(Annual percentage change, period average)



Source: BCRP.

The expansion of credit in Nuevos Soles was mainly associated with loans from banks (42.6 percent, with an annual flow of S/. 7,526 million) and from the Banco de la Nación (68.2 percent, with an annual flow of S/. 907 million). Credit in the segment of micro financial entities grew 13.9 percent (annual flow of S/. 701 million), showing a lower growth than in 2006 (44.5 percent). The most dynamic entities in this segment were rural deposit banks (44.8 percent).

Credit to the private sector in foreign currency grew 29.5 percent (with an annual flow of US$ 3,310 million), with banks' higher lending accounting for most of this growth (annual flow of US$ 3,287 million).

TABLE 50
CREDIT TO THE PRIVATE SECTOR IN DOMESTIC CURRENCY

	Balance in millions of nuevos soles			Growth rate		Flows	
	2005	2006	2007	2006	2007	2006	2007
Commercial banks	13,105	17,669	25,195	34.8	42.6	4,564	7,526
Banco de la Nación	1,277	1,330	2,237	4.1	68.2	53	907
Development Banking System	202	130	158	-35.8	21.6	-72	28
Microfinance institutions	3,985	5,058	5,759	26.9	13.9	1,072	701
Local government S&Ls	1,848	2,400	3,193	29.9	33.0	552	793
Rural S&Ls	348	462	669	33.0	44.8	115	207
Saving and credit cooperatives	634	758	952	19.6	25.6	124	194
Financial companies	1,156	1,437	945	24.3	-34.3	281	-493
Total Financial System	**18,570**	**24,186**	**33,349**	**30.2**	**37.9**	**5,617**	**9,163**

Source: BCRP.

TABLE 51
CREDIT TO THE PRIVATE SECTOR IN FOREIGN CURRENCY

	Balance in millions of Dollars			Growth rate		Flows	
	2005	2006	2007	2006	2007	2006	2007
Commercial banks	10,041	10,370	13,657	3.3	31.7	329	3,287
Banco de la Nación	22	14	12	-37.4	-15.3	-8	-2
Development Banking System	160	159	161	-0.7	1.1	-1	2
Microfinance institutions	573	673	696	17.4	3.5	100	23
Local government S&Ls	292	349	370	19.4	6.2	57	21
Rural S&Ls	56	55	48	-1.5	-12.5	-1	-7
Saving and credit cooperatives	188	224	250	19.0	11.6	36	26
Financial companies	37	46	28	22.5	-38.1	8	-17
Total Financial System	**10,796**	**11,216**	**14,525**	**3.9**	**29.5**	**420**	**3,310**

Source: BCRP.

4. Banks

In 2007 banks continued to show improved financial indicators, particularly in terms of lower exposure to credit risks, and the "solarization" of credit and deposits. This lower exposure to credit risks was reflected in the reduction of non-performing loans (which decreased from 1.6 percent in 2006 to 1.3 percent in 2007) and in the higher provision coverage for non-performing loans, which increased from 100.3 percent in 2006 to 124.4 percent in 2007.

Despite lower margins for active and passive operations, return on equity (ROE) increased from 23.9 percent in 2006 to 27.9 percent in 2007 due to improvements in banks' efficiency and to the investment of surplus liquidity in BCRP Certificates of Deposit.

TABLE 52
COMMERCIAL BANKS INDICATORS
(Percentage)

	2005	2006	2007
Non-performing loans / Gross assets 1/	2.1	1.6	1.3
Provisions / Non-performing, Restructured 2/	80.3	100.3	124.4
Return on equity ratio	22.2	23.9	27.9

1/ Including overdue loans.
2/ Non-performing loans plus refinanced and restructured credits.
Source: SBS.

Placements in both soles and dollars grew at a higher rate than in 2006. The former grew 46.9 percent, mainly due to the dynamism of mortgage loans (105.1 percent), although this segment is still small in terms of volume.

Consumer loans in soles, which grew significantly, showed a growth rate of 56.1 percent (flow of S/. 3,406 million), higher than in 2006. This growth is in part due to the inclusion of the former CMR, whose credits were mainly consumer loans in soles. On the other hand, placements in dollars grew 33.7 percent, driven mainly by commercial loans (39.6 percent).

It is worth mentioning that two new banks incorporated this year: the former Financiera CMR, which became Banco Falabella in June, and Banco Santander in October.

TABLE 53
COMMERCIAL BANKS DIRECT CREDITS

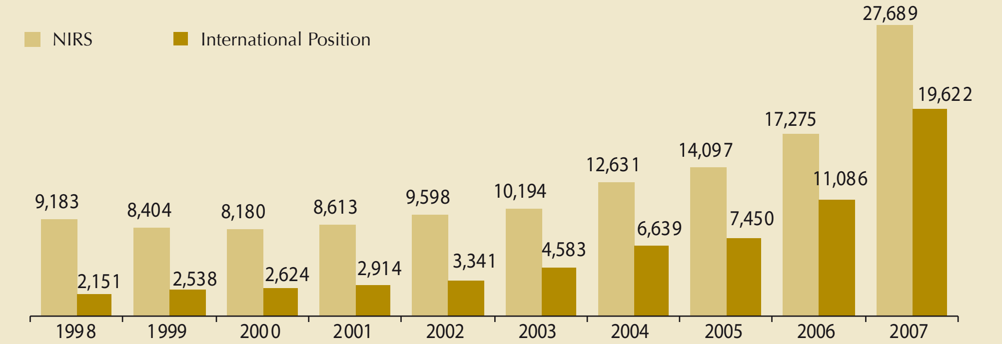
	DOMESTIC CURRENCY (Millions of nuevos soles)						
	End-of-period balances			Flows		Percentage change	
	2005	2006	2007	2006	2007	2006	2007
Commercial	6,372	8,557	11,602	2,185	3,045	34.3	35.6
Microbusiness	1,548	1,959	2,828	411	869	26.6	44.3
Consumer	4,269	6,075	9,480	1,806	3,406	42.3	56.1
Mortgage	275	793	1,627	518	834	188.6	105.1
TOTAL	**12,464**	**17,384**	**25,538**	**4,920**	**8,153**	**39.5**	**46.9**
	FOREIGN CURRENCY (Millions of US$)						
	End-of-period balances			**Flows**		**Percentage change**	
	2005	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**
Commercial	6,525	7,425	10,369	900	2,943	13.8	39.6
Microbusiness	182	223	291	41	69	22.3	30.7
Consumer	586	690	908	105	217	17.9	31.5
Mortgage	1,807	1,960	2,196	153	236	8.5	12.1
TOTAL	**9,100**	**10,298**	**13,764**	**1,199**	**3,466**	**13.2**	**33.7**

Source: SBS.

5. Net international reserves (NIRs)

Peru's liquidity international position continued to improve in 2007, as reflected in the country's higher NIRs and the better international position of the BCRP, which amounted to US$ 27,689 and US$ 19,622 million respectively at the end of 2007.

GRAPH 30
BCRP NET INTERNATIONAL RESERVES AND INTERNATIONAL POSITION
(Millions of US$)

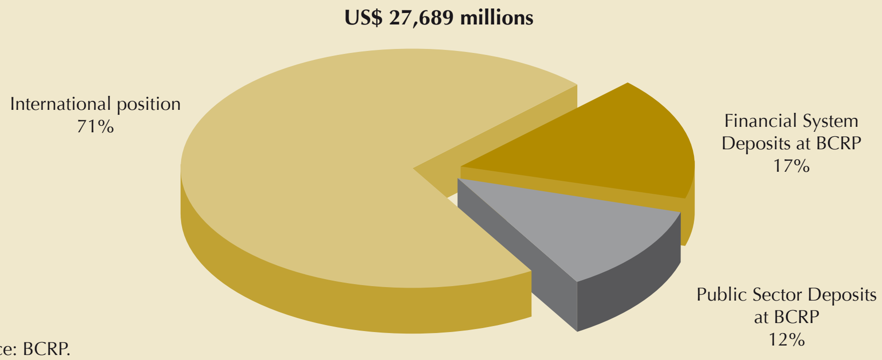


Source: BCRP.

The annual increase in NIRs (US$ 10,414 million) is basically explained by net purchases of foreign currency (US$ 10,306 million during 2007), as well as by banks' higher deposits (US$ 1,154 million), net investment yield (US$ 773 million), and public sector's higher deposits (US$ 630 million).

This was offset by net sales of dollars to the public sector, which amounted to US$ 3,275 million in the year.

GRAPH 31
NIR COMPOSITION AT END DECEMBER 2007



Source: BCRP.

The BCRP's international position increased by US$ 8,536 million to US$ 19,622 million in December due to the high volume of net purchases during the year. With this result, the BCRP's foreign exchange position in terms of NIRs increased from 64 percent at end 2006 to 71 percent at end 2007. Other components contributing to the evolution of NIRs (as of December) included banks' reserve requirements and deposits in dollars at the BCRP (17 percent), as well as public sector's deposits (12 percent).

6. Financial saving and capital market

Financial saving includes all the liabilities of the financial system with the private sector, excluding money (banknotes and coins held by the public and demand deposits). In 2007 financial saving grew 33.4 percent compared to 2006, increasing from 30.3 percent to 36.1 percent in GDP terms. This growth was mainly driven by saving in soles, which increased from 17.0 to 22.8 percent in GDP terms. In contrast with 2006, this growth of financial saving in soles was not only associated with the growth of private pension funds, but also with the growth of term deposits and mutual funds, which reflects the public's higher acceptance of the Nuevo Sol as medium to store value.

TABLE 54
FINANCIAL SAVINGS
(Average balance, in percentage of GDP)

	Domestic Currency	Foreign Currency	Total
1998	6.3	15.9	22.2
1999	7.1	17.7	24.8
2000	7.9	17.5	25.5
2001	9.1	17.5	26.6
2002	10.6	16.8	27.4
2003	12.1	16.3	28.4
2004	13.4	14.7	28.0
2005	15.4	13.6	29.0
2006	17.0	13.2	30.3
2007	22.8	13.3	36.1

Source: BCRP.

Primary bond market

At end 2007 the balance of fixed-income instruments issued by companies in the private sector had increased 12 percent compared to 2006 (17 percent considering a constant exchange rate). Excluding financial entities, the number of issuers increased from 51 to 55.

By type of issuer, the balance of instruments issued by non-financial private firms (mainly corporate bonds) increased 11 percent, showing an annual flow of S/. 1,111million. By currencies, the share of instruments denominated in soles relative to total instruments increased from 27 percent at end 2006 to 37 percent at end 2007, which implied that the share of bonds in dollars decreased from 64 percent to 55 percent. Moreover, the maturity terms of bond issues in soles were also longer. Thus, while 26 percent of bond issues in soles matured in 5 years or more in 2006, this percentage increased to 45 percent in 2007. The firms with the largest bond issues in soles included Telefónica del Perú (S/.650 million), Gloria (S/. 240 million), Banco Continental BBVA (S/.185 million) and Banco de Crédito del Perú (S/.180 million), while the firms with the largest issues in dollars were Banco Continental BBVA (US$ 114 million), Relapasa (US$ 78 million) and Red de Energía del Perú (US$ 60 million).

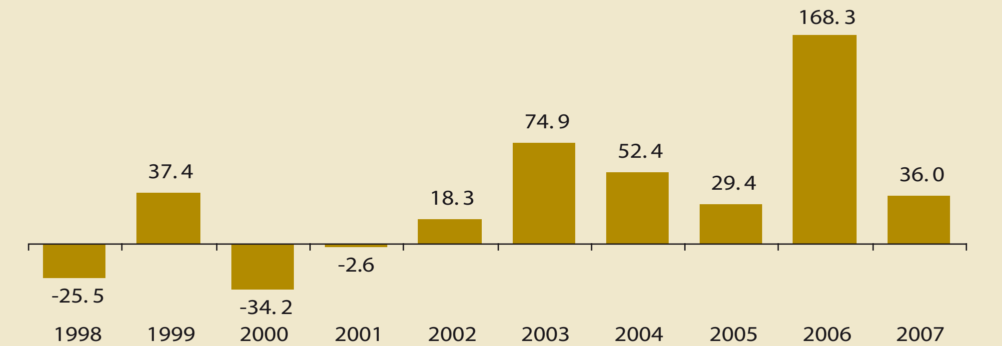
Stock exchange

The Lima Stock Exchange (LSE) recorded six years of consecutive gains showing a yield of 36.0 percent in its General Index (IGBVL) in 2007. Furthermore, the Blue Chip Index (ISBVL) –which records the 15 most representative stocks– showed an annual yield of 31.0 percent. It is worth pointing out that the LSE was the second most profitable Latin American stock exchange after the Sao Paulo Stock Exchange (43.6 percent).

By economic sector, the most profitable shares were those oriented to the domestic market, such as industrial and agroindustrial stocks (69.4 percent and 87.9 percent respectively).

The LSE showed a differentiated conduct in the year. The General Index accumulated a yield of 81.8 percent between January and July, mainly due to the growth of the domestic market, but since July the LSE was affected by the crisis of the US subprime market and the subsequent fall of global stock markets. In November the General Index at the LSE recorded its strongest monthly fall (15.9 percent) since the Russian crisis of 1998, reverting most of the gains obtained in the previous months.

GRAPH 32
LIMA STOCK EXCHANGE
(Annual Profitability)



Source: Lima Stock Exchange.

The amount of transactions during 2007 (S/. 38.9 billion) increased 88.4 percent compared to 2006. The most dynamic segment was the segment of variable income papers, whose volume of transactions grew 96.5 percent compared to 2006, while the segment of fixed income papers grew 35.0 percent. The value of market capitalization increased 68 percent compared to end 2006, reaching an average level equivalent to 95 percent of GDP (63 percent in 2006).

It is worth mentioning that the LSE established a new index in June. This index, called the National Capitalization Index (INCA), tracks the performance of the 20 most liquid securities listed at the LSE, but weighing it against the market capitalization of the free-float of these securities[5].

TABLE 55
STOCK EXCHANGE

				Percentage change	
	2005	**2006**	**2007**	**2006**	**2007**
INDICES (end of period)					
(December 1991 = 100)					
General Stock Index	4,802	12,884	17,525	168.3	36.0
Blue Chip Index	7,681	22,159	29,035	188.5	31.0
Index Peru-15	8,440	24,959	34,039	195.7	36.4
TRADING VOLUME[1/]	**12,023**	**20,625**	**38,854**	**71.5**	**88.4**
(Millions of nuevos soles)					
Equities	8,754	17,916	35,197	104.7	96.5
Fixed-income instruments	3,268	2,708	3,657	-17.1	35.0
LSE MARKET CAPITALIZATION					
(Millions of nuevos soles)	**124,062**	**192,364**	**324,118**	**55.1**	**68.5**
(Millions of US$)	36,170	60,114	108,039	66.2	79.7
(Percentage of GDP)	47.4	63.0	95.0		

1/ Only cash operations
Source: Lima Stock Exchange.

The value of variable and fixed income securities listed at CAVALI increased from US$ 31,115 million at end 2006 to US$ 56,941 million at end 2007 (83 percent). Moreover, the value of shareholdings at market prices grew 101 percent compared to 2006, reaching a value of US$ 43,818 million.

This increase at nominal value was 25 percent (US$ 7,257 million). The participation of non-resident investors (valued at market prices) increased from 43 percent to 48 percent.

[5] Free-float is usually defined as all shares held by investors owning 1 percent or less of all shares of a security.

TABLE 56
VALUE OF HOLDINGS IN CAVALI: EQUITIES AND FIXED INCOME

	Balance in millions of US$			Participation %	
	2005	2006	2007	2006	2007
NOMINAL VALUE	**5,052**	**5,825**	**7,257**	**100**	**100**
Residents	3,340	3,595	3,890	62	54
Non-residents	1,712	2,230	3,367	38	46
MARKET VALUE	**14,265**	**21,805**	**43,818**	**100**	**100**
Residents	7,517	12,491	22,972	57	52
Non-residents	6,748	9,314	20,846	43	48

Source: CAVALI.

Private pension system

The value of private pension funds as of December 2007 amounted to S/. 60,406 million (32.6 percent higher than at end 2006) and increased from 14.9 percent in 2006 to 17.7 percent in 2007 in GDP terms. Furthermore, the number of affiliates increased by 5.6 percent to 4.1 million.

TABLE 57
PRIVATE PENSION SYSTEM

	2005	2006	2007
Number of affiliates			
In thousands	3,637	3,882	4,101
Percentage change, end-of-period	7.1	6.7	5.6
Fund Value			
In millions of nuevos soles	32,223	45,547	60,406
Percentage change, end-of-period	25.6	41.4	32.6
As percentage of GDP	12.3	14.9	17.7
Year on Year Yields (in percentages)			
Nominal	20.2	28.3	25.0
Real	18.4	26.8	20.2

Source: SBS.

The real return of pension funds was 20.2 percent (26.8 percent in 2006), the highest return recorded since the system started operating in 1993, due mainly to the lower return of investments in shares.

Given the strong yield observed at the stock exchange, especially in the first half of the year, the participation of pension funds type 3 (higher risk) increased from 5.0 percent to 23.1 percent, while the participation of pension funds type 2 (medium risk) fell from 89.1 percent to 71.9 percent.

TABLE 58
PRIVATE PENSION SYSTEM

	2005	2006	2007
Fund type (S/. Millions)	**32,223**	**45,547**	**60,406**
Type - 1	2,270	2,667	3,044
Type - 2	29,740	40,599	43,427
Type - 3	213	2,281	13,935
Percentage participation	**100.0**	**100.0**	**100.0**
Type - 1	7.0	5.8	5.0
Type - 2	92.3	89.1	71.9
Type - 3	0.7	5.0	23.1

Source: SBS.

The participation of investments abroad by private administrators of pension funds (AFPs) also increased from 8.5 percent to 13.2 percent given the greater flexibility given to said investments, whose limit was raised from 12 percent (limit in force until December 2006) to 15 percent (in force until December 2007). The share of Public Treasury sovereign bonds, including global bonds in soles, also increased from 17.7 percent to 20.7 percent. On the other hand, the participation of corporate securities fell from 62.9 percent to 59.4 percent, mainly due to the drop seen in securitization instruments and quotas of investment funds. Moreover, the participation of deposits declined from 5.5 percent to 2.0 percent.

TABLE 59
COMPOSITION OF THE PRIVATE PENSION SYSTEM PORTFOLIO
(Percentage)

	2005	2006	2007
a. Government securities	**20.3**	**19.1**	**21.9**
Central government	13.8	14.5	19.7
Central Bank securities	1.8	3.2	1.0
Brady bonds	4.7	1.3	1.3
b. Financial institutions	**11.4**	**9.2**	**5.4**
Deposits in domestic currency	4.4	4.9	1.7
Deposits in foreign currency	3.0	0.6	0.3
Shares[1/]	3.2	2.9	2.8
Bonds	0.8	0.8	0.6
c. Non-financial institutions	**58.3**	**62.9**	**59.4**
Common and investment shares	35.6	41.3	40.6
Corporate bonds	11.1	12.1	13.5
Securitization instruments	8.7	7.1	4.0
Domestic investment funds	2.8	2.4	1.3
d. Foreign Investmets	**10.1**	**8.5**	**13.2**
Foreign States debt securities	9.5	6.3	10.6
Foreigns Mutual funds	0.3	2.0	1.5
Foreign shares	0.3	0.2	0.6
American Depositary Shares (ADS)	0.0	0.0	0.5
e. Others[2/]	**-0.1**	**0.3**	**0.1**

1/ Includes mortgage bills and Investment Funds share.
2/ Includes commercial bills and securitization assets.
Source: SBS.

Mutual investment funds

The total equity administered by mutual investment funds in 2007 grew 57.5 percent, while the number of participants increased 64.3 percent to over 275 thousand participants at the end of the year. The total number of operating funds increased from 35 to 36.

TABLE 60
MUTUAL FUNDS[1/]

	2005	2006	2007
Number of participants			
(In units)	115,447	167,492	275,126
Percentage change, end-of-period	40.0	45.1	64.3
Funds value			
In millions of Nuevos Soles	6,848	8,248	12,989
Percentage change, end-of-period	18.0	20.4	57.5
As a percentage of GDP	2.6	2.7	3.8
Composition (percentage)			
Mixed-income funds	3.1	5.8	26.6
Fixed-income funds	96.9	94.2	73.4
In Nuevos Soles	15.5	17.7	20.9
In US$	81.3	76.5	52.4
Structured	0.3	0.2	0.1
Nominal Profitability (in percentages)			
Mixed-income funds and variable yield	6.2	19.6	5.1
Fixed-Income funds(Nuevos Soles)	4.3	4.7	4.4
Fixed-Income funds(US$)[2/]	3.2	-2.5	-1.4
Structured[2/]	-	-0.8	-2.6
Real Profitability (in percentages)			
Mixed-income funds and variable yield	4.6	18.3	1.1
Fixed-Income funds (Nuevos Soles)	2.8	3.5	0.5
Fixed-Income funds(US$)[2/]	1.7	-3.6	-5.1
Structured[2/]	-	-1.9	-6.3

1/ Figures recorded at end-December.
2/ Interest rates in US$ plus change of exchange rate in the period.
Source: CONASEV and BCRP.

By type of fund, the participation of mixed funds showed the highest growth, increasing from 5.8 to 26.6 percent, while the participation of fixed income funds declined from 94.2 percent to 73.4 percent. The increase seen in the former was associated with the high return observed at the stock exchange in the first half of the year. The share of mutual funds in soles increased from 17.7 percent to 20.9 percent, reflecting a decline in the dollarization ratio (from 81 percent at end 2006 to 69 percent at end 2007). New participants in the mutual fund system amounted to 108 thousand participants, of which 69 thousand preferred funds in soles and 39 thousand preferred funds in dollars.

Mutual fund investments were mainly oriented to local shares and BCRP securities. The share of local actions in terms of total shares increased from 0.7 percent to 11.3 percent, while the participation of CDBCRPs increased from 9.0 percent to 17.6 percent. In contrast, the participation of private bonds and short-term instruments dropped from 34.3 to 23.4 percent, while the participation of bank deposits and bonds fell from 33.5 to 23.9 percent.

TABLE 61
MUTUAL FUND INVESTMENT COMPOSITION

		2005	2006	2007
a.	**Government securities**	**15.4**	**25.3**	**29.8**
	Central government	8.4	7.1	5.0
	Global bonds and Brady bonds	3.6	9.3	7.3
	Central Bank securities	3.5	9.0	17.6
b.	**Financial institutions**	**42.3**	**33.5**	**23.9**
	Deposits in domestic currency	6.9	7.6	4.8
	Deposits in foreign currency	21.8	15.3	9.4
	Financial system Bonds	13.5	10.5	8.9
	Shares and others	0.0	0.1	0.7
c.	**Non-financial institutions**	**37.8**	**35.0**	**34.8**
	Common and investment shares	0.5	0.7	11.3
	Corporate bonds	37.3	34.3	23.4
d.	**Foreign Investmets**	**2.0**	**5.2**	**6.4**
e.	**Others** 1/	**2.5**	**1.0**	**5.2**

1/ Includes Repos operations and pact operations.
Source: CONASEV.