

## *Introduction*

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In 2012 the Peruvian economy grew 6.3 percent. This growth rate is lower than the one registered in 2011 (6.9 percent), but higher than the one forecast in the first months of the year (a growth rate of 5.7 percent was estimated in the Inflation Report of March 2012). Explained mainly by the dynamism of domestic demand which grew 7.4 percent, this higher growth was in part offset by lower net exports in a context of global economic slowdown. On the other hand, annual inflation showed a declining trend as supply shocks gradually reverted, dropping from 4.74 percent in 2011 to 2.65 percent in 2012.

During most of 2012, the world economy was affected by uncertainty regarding the situation of the Eurozone and by expectations of a lower dynamism in the emerging economies. In addition to this, the problems associated with the fiscal situation in the United States increased risk aversion, affecting consumers and investors' confidence in the developed economies. However, an improvement was observed in international financial conditions as from the fourth quarter of the year as a result of the series of measures implemented by the central banks of the Eurozone countries, the United States and Japan, as well as of indicators reflecting some degree of stabilization in China's pace of growth.



In this scenario of strong growth of domestic demand in the country, well-contained inflation expectations, and slow recovery in the world economy, the BCRP maintained its policy rate at 4.25 percent. Even though the BCRP policy rate remained unchanged, other policy measures were taken. Thus, reserve requirements were adjusted with the purpose of moderating the expansion of credit and reducing the financial system's vulnerability to potential abrupt capital outflows. Reflecting the steadiness of the monetary policy reference rate, the corporate interest rate in nuevos soles remained stable in 2012.

Affected by an international environment marked by uncertainty, the terms of trade recorded an average decrease of 5 percent after declining particularly in the first half of the year due to drop of the international prices of our main export products. The latter, together with the fact that domestic demand grew at a higher rate than GDP, accounts for the growth of the deficit in the current account of the balance of payments from 1.9 percent of GDP in 2011 to 3.6 percent in 2012. Moreover, the financial account registered a surplus of over US\$ 20 billion (10 percent of GDP), consisting mainly of long-term private capital, particularly reinvestment of companies with foreign shareholding and long-term loans directed mostly to the financial sector. A significant positive flow of foreign portfolio investment, oriented mostly to non-financial companies, was also observed in the country as a result of the bonds issued by these companies overseas.

Significant capital inflows of foreign investors with an appetite for the assets of emerging economies with good macroeconomic prospects and companies with international expansion plans were observed over the year. This explains the appreciation pressures on the new nuevo sol which, in turn, induced a process of dedollarization of deposits as well as an increased demand for credit in dollars in the domestic financial system. Moreover, the latter also contributes to explain the increase of interest rates in foreign currency. In this context, the nuevo sol appreciated 5.4 percent in 2012.

As from September, the BCRP modified its foreign exchange intervention strategy and made interventions in the foreign exchange market even in the periods of depreciation of the nuevo sol, although these interventions involved lower daily amounts. The aim of this strategy is to make the evolution of the exchange rate less predictable in order to reduce the incentives for investors' speculative positions.

In 2012, the non-financial public sector (NFPS) continued to show a countercyclical position and recorded an economic surplus of 2.2 percent of GDP (2.0 percent in 2011). The balance registered by the NFPS in the last two years is explained by the dynamism of economic activity –especially by the dynamism of domestic demand which had a positive impact on tax revenues– as well as by the moderation in the growth of non-financial expenditure.