INTRODUCTION

Sound monetary and fiscal policies together with improved global conditions kept Peruvian economy growing over 30 consecutive months, reaching one of the highest rates in 2003 in the region. GDP grew by 4%, based on the expansion of private consumption, private investment and exports. Higher levels of national disposable income and consumer loans granted by financial institutions induced an increase in private consumption; whereas private investment growth was primarily associated with the ongoing natural gas Camisea project and the improvement of firms' performance.

The 4% growth in non-primary sectors, particularly services and manufacturing industries that produce end-consumer and construction-related goods reflected the increase in private consumption, investment and exports, especially non-traditional exports such as textiles.

The current account deficit of the balance of payments amounted to US$ 1.1 billion, equivalent to 1.8% of GDP as compared to 2.1% in 2002. A main factor in the lower current account deficit was the US$ 710 million surplus achieved in the trade balance, mainly reflecting larger volumes of gold, silver and zinc, textiles and agricultural products. This was the second trade surplus, after 11 years of deficits.

Peruvian solid international liquidity position as seen by the high level of Central Bank net international reserves at US$ 10.2 billion in late December, equivalent to 2.3 times yearly debt payments or to 15 months of imports, continued to function as a key buffer against external shocks.

Fiscal policy persevered in consolidating the sustainability of public finances, applying measures to raise tax revenue and to reduce the deficit to medium term acceptable levels. The 1.9% of GDP deficit was consistent with the Fiscal Responsibility and Transparency Law. This deficit and foreign debt amortization payments were partially financed by the placement of global bonds in the international market, obtaining US$ 1.25 billion.

Under the Inflation Targeting regime adopted in 2002, the Central Bank conducts a monetary policy consistent with a target of 2.5% +/- 1% (1.5%-3.5%). In 2003 annual inflation rate was 2.5%, meeting the announced target.

The Central Bank continued communicating monetary policy decisions through its rediscount and overnight deposit interest rates. During the first half of 2003, the Central Bank maintained its monetary policy stance, in a context of accelerated inflation due to higher international fuel prices associated with the Iraq conflict.

Over the second half of 2003, due to concerns that inflation rate for 2003 and 2004 may be around the lower bound of the target range, the Central Bank loosed its monetary stance and reduced policy interest rates. This reduction had a favorable effect on economic activity and favored an increase in monetary and credit aggregates, particularly in domestic currency. The interest rate went down from 3.8% in the first half of 2003 to 2.5% in the second.

Financial system broad money and financial credit to the private sector in domestic currency increased 24.7% and 11.7%, respectively, standing out microfinance entities growth. The broad money / GDP ratio rose from 31.0% to 34.1% between 2002 and 2003 while the ratio of credit to the private sector / GDP went down from 27.8% to 25.8% in the same period. In the banking system, these indicators went down from 25.5% and 23.3% in 2002 to 24.5% and 21.0% in 2003, the latter due to the dynamism of the capital market.

During 2003, the floating exchange rate was mantained, however the Central Bank intervened in the foreign exchange market to reduce significant fluctuations. Over the year, real exchange rate depreciated 7.5% mainly because of the appreciation of the currencies of our main trading partners vis-à-vis the US dollar.

Profitability indicators for the banking system improved over previous years, a tendency observed since 2001. The return on equity (ROE) coefficient improved from 8.4% in December 2002 to 10.9% in

December 2003. Further, the coefficient of non-performing loans to total went down to 5.8%, the lowest level in the last six years.

Peruvian economy is expected to grow by 4% over 2004, with an inflation rate within the rate announced by the Central Bank (2.5% +/- 1%). The trade surplus is estimated at US$ 1.8 billion reaching a balance of payments current account deficit of 1% of GDP. The fiscal deficit is expected to decline from 1.9% to 1.5% of GDP, within the estimates of the Multi Annual Macroeconomic Framework for 2004-2006.