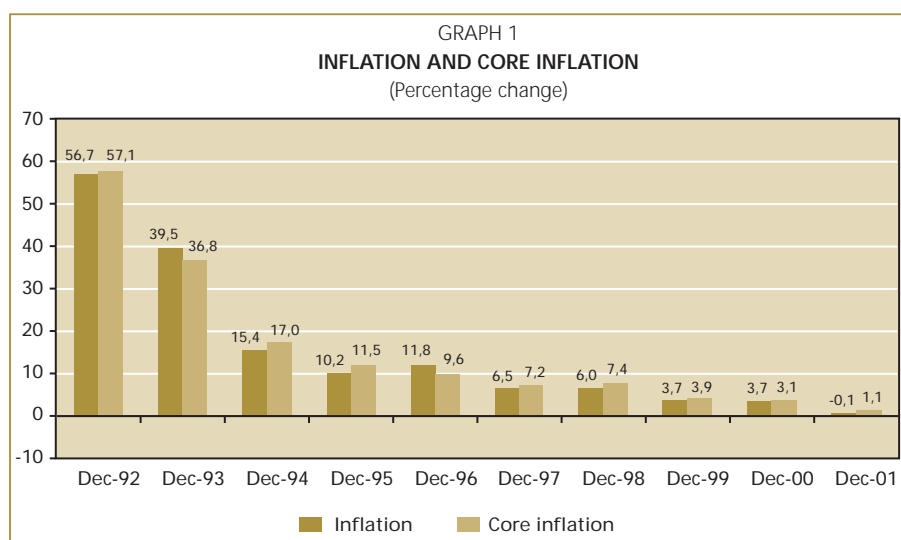


I. INFLATION AND EXCHANGE RATE

The rate of **inflation**, measured as the percentage change of the Consumer Price Index (CPI) of Metropolitan Lima was -0,13 percent in 2001, the first decline in the CPI since 1939. This evolution reflects the decrease in the price of fuels (-13,1 percent), public services (-2,7 percent) and those foods affected by supply factors (-1,2 percent). By excluding the items whose

prices are affected by changes in international quotations such as fuels and electricity fees or affected by supply factors such as some agriculture products, the measure of a general trend of prices is obtained. The resulting indicator named core inflation, decreased from 3,1 percent in 2000 to 1,1 percent in 2001, a marked decrease.



Those components that do not explain the general trend of prices -which amount to 32 percent of the CPI basket- recorded a 2,8 percent decrease, compared with a 5,2 percent increase in 2000. These price fluctuations are explained by changes in the prices of fuel, public services and some foodstuffs.

- **Fuels:** Fuel prices declined 13,1 percent, reflecting the evolution of

the international quotations of crude oil and derivatives (the quotation of oil diminished 32 percent in 2001) in a context of lower world economic activity. It should be noted that although there is a direct relationship between domestic and international fuel prices, this relationship is not proportional since the excise tax on domestic sales is specific; that is to say, a fixed amount per gallon.



CENTRAL RESERVE BANK OF PERU

TABLE 1
ANNUAL INFLATION RATES
(Percentage change)

	Weight base year 1994	1999	2000	2001
I. CORE INFLATION	68,3	3,94	3,11	1,06
Goods	41,8	2,57	2,47	0,66
Non-processed foods	1,8	0,72	-1,42	-1,13
Processed foods	16,7	-0,27	0,96	-0,69
Beverages	2,3	-8,72	6,04	0,52
Textiles	5,5	6,88	3,06	2,02
Footwear	2,0	6,22	1,30	1,71
Electrical appliances	1,0	7,20	1,83	-0,19
Other goods	12,4	8,19	4,77	2,39
Services	26,6	6,02	4,04	1,65
Restaurants	12,0	5,88	3,68	1,29
Education	5,1	6,60	5,60	3,97
Other personal services	3,5	2,33	2,82	1,08
Rent	2,3	8,45	3,43	-0,37
Health	1,3	6,85	4,68	3,02
Other services	2,4	5,43	6,22	3,50
II. NON-CORE INFLATION	31,7	3,27	5,18	-2,82
Foodstuffs	14,8	-6,95	-0,43	-1,16
Fuel	3,9	25,88	30,33	-13,14
Transportation	8,4	13,34	5,02	-0,02
Public services	4,6	12,69	5,13	-2,73
III. INFLATION	100,0	3,73	3,73	-0,13

- **Public services:** In the reduction of the average fee of public services, the determinant was the decrease in electricity charges (-6 percent) which reflected the creation of the Social Electricity Compensation Fund ("Fondo de Compensación Social Eléctrica" - FOSE) in November as well as the reduction in generation and distribution costs estimated by Osinerg. This entity considered criteria such as the interconnection expansion, lower fuel prices and more efficient systems of control, among others.
- **Foods:** The prices of food recorded high volatility over the period 1995-

2001 and decreased 1,2 percent in average. The most important items were citrous fruits (-19 percent), fresh vegetables (-22 percent), sugar (-6 percent), potatoes (-6 percent), eggs (-8 percent) and horticulture products (-6 percent).

The decrease in the price of sugar obeys to the increase of domestic production (6 percent), whereas favourable climatic conditions and a consequent good supply explained the price reduction in fresh vegetables, citrous fruits and potatoes.

Core inflation

In 2001, **core inflation** recorded a declining trend. As a result, the monthly average core inflation passed from 0,13 percent in the first semester to 0,05 percent in the second semester of 2001. The annual increase in the prices of goods amounted to 0,7 percent, lower than that in services (1,7 percent).

- The prices of unprocessed food fell 1,1 percent, whereas those of processed goods –which amount to 24 percent of the CPI basket- decreased 0,7 percent.
- The prices of beverages –alcoholic and non-alcoholic- grew 0,5 percent. The prices of sodas increased 9 percent in the year, whereas the prices of beers decreased 5,5 percent.
- The prices of textiles and footwear rose 2 percent in each case, whereas

the prices of electrical appliances declined 0,2 percent, reflecting the appreciation of the exchange rate.

- The price of other industrial products increased 2,4 percent in 2001 (0,3 percent on a monthly average basis in the first semester and 0,1 percent in the second). The most dynamic items were cleaning and personal care articles (2 percent), medicines (5 percent) and school texts and other teaching material (4 percent).
- On the other hand, service prices increased 1,7 percent in 2001, mainly due to the increase in education and health services (4 and 3 percent, respectively) and, to a lower extent, to restaurants and other personal services (1 percent in both cases).

Exchange rate

During 2001 the nominal exchange rate decreased 2,4 percent, quoting S/. 3,44 per US dollar by year-end.

The nominal exchange rate remained relatively stable, around S/. 3,52 per dollar, during the first quarter of the year, except for short periods of uncertainty mainly related to regional events. Factors behind the appreciation of the sol included a lower demand of dollars from companies and banks in a context of slow growth in economic activity and low expectations of exchange rate depreciation.

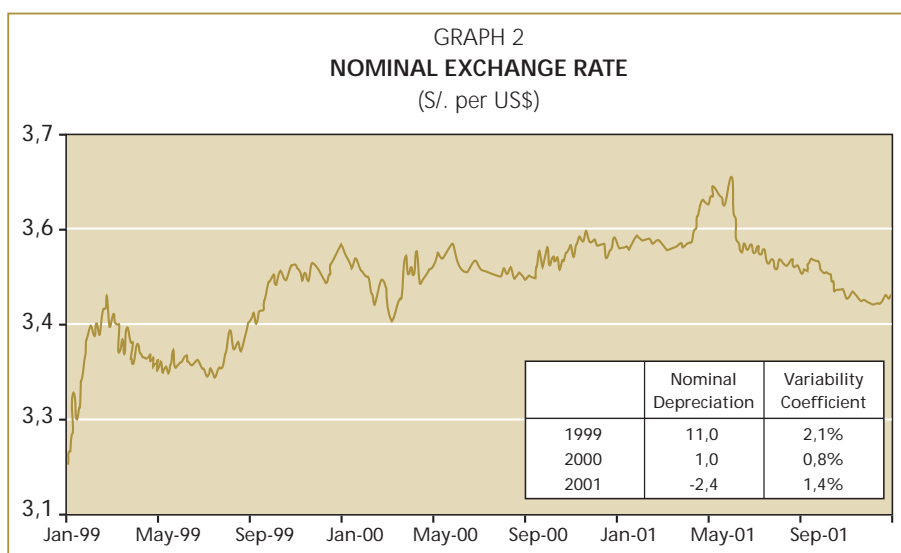


CENTRAL RESERVE BANK OF PERU

The stability of the exchange rate was reversed in April. Uncertainty due to the electoral process increased the demand for foreign currency and devaluation reached 3,0 percent between April and June 1st, showing high volatility over the period. On June 1st, on the eve of elections, the exchange rate reached its maximum level for the year, S/. 3,63 per dollar. During this period forward sales operations increased; by May the net balance of these increased US\$ 145 million compared to December 2000.

In this context, in April and May the Central Bank sold foreign currency five times, for a total amount of US\$ 58,5 million.

This upward trend was reversed in the following months and the dollar reached its lowest level on December 6th (S/. 3,43). The sharp reduction in the expected rate of devaluation was the main factor behind the appreciation of the sol (the implicit devaluation of 3-month forward operations declined from 11 percent in May to 4 percent in September). This change of expectations implied a faster drop in the return of dollars leading to a portfolio change from dollars to soles. This change constituted a temporary event that justified the intervention of the Central Bank in the exchange market. From October to December 2001 the Central Bank bought US\$ 203 million.



The appreciation of the nuevo sol and the appreciation of the dollar against other currencies (including those from Peru's main trade partners) explained the fall of the real exchange rate index

in 4,3 percent during this year. Among the currencies, the yen depreciated 13,5 percent, the euro 0,5 percent, the Chilean peso 16,4 percent and the real 20,3 percent.

TABLE 2
NOMINAL AND REAL DEVALUATION
 (Accumulated percentage change)

	1999	2000	2001
Nominal Depreciation	11,0	1,0	-2,4
External Inflation			
a. Bilateral ^{1/}	2,7	3,4	1,6
b. Multilateral	-2,9	-2,5	-2,1
Domestic Inflation	3,7	3,7	-0,1
a. Tradable goods	3,9	4,7	-1,0
b. Non tradable goods	3,6	3,1	0,5
Real Depreciation			
a. Purchasing power parity			
- Bilateral ^{1/}	10,1	0,5	-0,8
- Multilateral ^{2/}	4,0	-5,1	-4,3
b. Tradable / non tradable ^{3/}	0,3	1,6	-1,5

1/ Compared with the United States of America, which represented 27,5 percent of the foreign trade of Peru in 2001.
 2/ Measured considering nominal depreciation and the difference between external inflation and domestic inflation.
 3/ Change of relative prices between tradable and non tradable goods.

