ANNUAL REPORT 2003

CENTRAL RESERVE BANK OF PERU

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Board of Directors

Javier Silva Ruete
Chairman

Carlos Castro Rodríguez
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Kurt Burneo Farfán
Director

Oscar Dancourt Masías
Director

Gonzalo García Núñez
Director

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Director

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Director

CENTRAL RESERVE BANK OF PERU

Senior Officers as of December 31, 2003

Renzo Rossini Miñán
General Manager (i)

Marylin Choy Chong
Central Manager for Technical Affairs

Juan Ramírez Andueza
Manager for Credits and Financial Regulation

- Luis Martínez Green — *Deputy Manager for Credits and Services*
- Mario Mesía Lizaraso — *Deputy Manager for Financial Regulation and Evaluation*

Carlos Ballón Avalos
Manager for International Operations

- Jorge Patrón Worm — *Deputy Manager for Foreign International Investments*
- Teresa San Bartolomé Gelicich — *Deputy Manager for International Agreements*

Pacífico Huamán Soto
Manager for Treasury

- Augusto Otero Castro — *Deputy Manager for Custody*
- José Arturo Pastor Porras — *Deputy Manager for Analysis and Programming for Bills and Coins*
- Saúl Paredes Zúñiga — *Deputy Manager for the National Mint*

Javier Olivera Vega
Administration Manager (i)

- Roberto Eslava Robles — *Deputy Manager for Personnel*
- Raúl Arce Baca — *Deputy Manager for Administrative Services*

Manuel Monteagudo Valdez
Legal Affairs

- Jorge Bravo Benites — *Deputy Manager for Legal Office*
- Helena Uzátegui Tellería — *Deputy Manager for Technical Affairs*

Renzo Rossini Miñán
Manager for Economic Studies

- Adrián Armas Rivas — *Deputy Manager for the Monetary Sector*
- Gladys Choy Chong — *Deputy Manager for the External Sector*
- Jorge Estrella Viladegut — *Deputy Manager for the Public Sector*
- Susana Ishisaka Frukawa — *Deputy Manager for Research and Global Analysis*
- Teresa Lamas Pérez — *Deputy Manager for the Real Sector*

Emilio Pallete Celi
Manager for Accounting and Supervision

- Carmen Aguilar Mondoñedo — *Deputy Manager for Accounting*
- Luis Valdivia Acevedo — *Deputy Manager for Supervision*

Percy Damiani Arboleda
Systems Manager

- Ricardo Chávez Caballero — *Deputy Manager for System Development*
- Rolando Pacheco Campusano — *Deputy Manager for Operations and Users Support*
- Juan Carlos Pacheco Pacheco — *Deputy Manager for Technical Services*

Oscar Solís de la Rosa
Internal Auditor

- Alberto Aquino Velaochaga — *Supervisor I*
- Romano Batagelj Cobolli — *Supervisor I, Systems Auditor*

José Rocca Espinoza
Institutional Relations Office

Dehera Bruce Mitrani
General Secretary

Branch Heads

Arequipa
Javier Curo García

Cusco
Raúl Castro Alegría

Huancayo
Alejandro Rozas Alosilla Velasco

Iquitos
José Monzón García

Piura
Carlos Alatrista Gironzini

Puno
Flavio Miraval Bedoya

Trujillo
Jaime Esquivel Rodríguez

Introduction

Year 2003 saw the improvement of main macroeconomic indicators, namely the fulfillment of the inflation target, economic growth, increase of international liquidity, diminishing current account and fiscal deficits, the health of the financial system and more dynamic capital markets.

Gross domestic product grew by 4.1 percent, one of the highest regional records, induced by sound monetary and fiscal policies, in a context of world economic recovery. It should be noted that up to December 2003, the Peruvian economy grew for 30 months in a row.

The underpinnings of economic growth were higher real exports of goods and services and an increased domestic demand. Exports growth (5.8 percent) was driven by higher access to international markets, to which contributed in particular the Andean Trade Promotion and Drug Eradication Act –ATPDEA- and higher exports of gold and zinc. The increase in domestic demand (3.6 percent) was explained by a higher private investment (5.3 percent), mostly related to Camisea project and improved firms' financial statements. Private consumption –the main component of aggregate expenditure- climbed 3.2 percent, reflecting the increase of national disposable income, the reduction in interest rates and increased consumer loans of financial institutions.

By sectors, non-primary activities recorded the highest growth (4.2 percent), particularly services, construction and non-primary industries, while primary activities were led by metallic mining, in particular gold (Yanacocha) and zinc (Antamina).

The current account of the balance of payments deficit dropped to 1.7 percent of GDP this year from 2.0 percent in 2002, mainly due to an increased trade surplus (from US$ 306 million in 2002 to US$ 731 million this year) and higher current transfers. Larger textile exports to the US market (under the ATPDEA) and the increase in terms of trade contributed to the exports upsurge. Thus, the trade balance showed a surplus for a second year in a row, after 11 years of deficits.

The financial account registered a positive flow of US$ 914 million, down US$ 926 million from 2002, due to the increase of pension funds' (AFPs) and other financial institutions' investments abroad –mainly in Peruvian sovereign bonds issued internationally- and the extraordinary sale of Backus shares in 2002.

In a context of a favourable external environment, i.e. lower depreciation expectations and forwards sale balance, the Central Bank purchased foreign currency in the exchange market which strengthened its international liquidity. Thus, international position rose by US$ 1,242 million, whereas net international reserves (NIR) did likewise by US$ 596 million, with an outstanding balance of US$ 10,194 million by December 2003. This amount is equivalent to 2.3 times the debt due in 1 year, 15 months of imports and nearly 5 times the monetary base, which demonstrates Peru's capability to withstand international capital shortages or speculative pressures on the Nuevo sol.

In 2003, the non-financial public sector deficit decreased to 1.8 percent of GDP, from 2.3 percent in 2002, in compliance of the Fiscal Transparency and Responsibility Law and following the trend of recent years. Central government current revenue increased from 14.4 to 14.9 percent of GDP, in response to greater Income and Value Added taxes' collection. Fiscal requirements -NFPS deficit plus external debt amortization- was financed through the issuance of Global bonds in the international markets in three instances for a total of US$ 1,250 million.

Monetary policy operations were embedded in the Explicit Targeting Inflation scheme, in force since 2002, aimed at reaching an annual rate of inflation of 2.5 percent with a +/- 1 percentage point tolerance. In 2003, the Board of the Central Bank started communicating its policy decisions by announcing lending and deposit reference interest rates instead of releasing the projected banks' current account balance.

In 2003, the rate of inflation was 2.5 percent, in line with the Central Bank's target and which was achieved through a flexible monetary policy. Two distinct phases were observed during the year: (i) a steady monetary stance from January to June, given the transitory rise in inflation during the first quarter due to higher fuel prices as a result of the war in Iraq (ii) a loose monetary policy during the second semester, in which the reference rates were reduced given that for 2003 and 2004 inflation was expected to approach the lower band of the target. Thus, the interbank interest rate dropped from 3.8 percent in December 2002 to 2.5 percent as of December 2003.

During 2003, the floating exchange rate policy was held. In real terms, the exchange rate increased 7.5 percent, in response to the 11.5 percent rise of the external price index

-which includes the appreciation of our main trade partners' currencies to the US dollar-.

Monetary aggregates in soles recorded a strong growth during the year, which together with a larger issuance of sol-denominated securities contributed to financial system dedollarization. Thus, liquidity and financial system credit to the private sector grew by 24.3 and 11.9 percent, respectively, noteworthy being the increase in credit to small businesses (25.3 percent) and institutional investors (31.9 percent).

This year saw moreover improved banking results, such as the ratio of non-performing to total loans, which reached its lowest level in 6 years (5.8 percent). Besides, there was an important increase in primary issuances of bonds (18.5 percent), in the value of investment mutual funds (24.7 percent) and of the private pension fund (38.7 percent), which recorded a real profitability of 21.2 percent, thanks to the good performance of the Stock Market.