

# III.

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## External sector

*The expansion of world economic activity, improvements in our terms of trade, tariff preferences granted by the United States, and an increase in remittances from Peruvians living abroad are the principal factors explaining the favorable current account position. The deficit thus fell from US\$ 935 million in 2003 to US\$ 10 million in 2004. This scenario, added to positive public and private capital flows, enabled the country to accumulated US\$ 2,437 million of net international reserve in 2004.*

### 1. International context

2004 was a particularly favorable year for the Peruvian economy's external accounts. Increased world economic activity, which translated into higher exports and an improvement in our terms of trade, was a determining factor in achieving a trade surplus for the third consecutive year. There was also a historically high level of current remittances from abroad. These were the main causes of the current account deficit falling almost to zero.

The terms of trade recorded their highest increase for 10 years (9.0 percent). Economic growth among our principal trading partners was 4.7 percent; the United States and China produced noteworthy figures (4.4 and 9.5 percent respectively) and, together, these two countries accounted for 34 percent of Peru's foreign trade. Exports to the United States - our main

trading partner - grew by 51 percent, due not only to economic growth, but also to temporary benefits granted under the Andean Trade Promotion and Drug Eradication Act (ATPDEA)<sup>1/</sup>. There was an important increase in sales of textiles and agricultural & livestock products, the main sectors that benefit from this agreement.

Meanwhile, China overtook the United Kingdom as Peru's second largest export market. China has been growing at an average of 10 percent a year for the last 20 years. Its influence on our economy derives not only directly, from greater demand for mining and fishing products, but also indirectly through induced increases in the prices of Peru's exports in international markets generated by increased demand from this nation of 1.3 billion inhabitants. Thus the international price of copper rose 61 percent during 2004, that of zinc 27 percent and that of lead 72 percent.

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1/ ATPDEA benefits consist of temporary preferential tariffs (until December 2006) granted by the United States enabling a list of Peruvian products to enter the North American market without paying customs duties. Textiles were included in this list of products in August 2002.



## BOX 1

**FREE TRADE AGREEMENT NEGOTIATIONS WITH THE UNITED STATES**

Peru, together with Colombia and Ecuador, is negotiating a free trade agreement (TLC) with the United States. This agreement seeks to consolidate preferential access to the North American market currently enjoyed through the ATPDEA, which expires in December 2006. In return, Peru will permit tariff-free access to imports from the United States.

Nevertheless, the agreement with the United States encompasses more than the elimination of customs duties. It also implies negotiation of collateral matters to the opening of markets (such as access to markets, customs procedures, technical obstacles to trade, agriculture, health and hygiene or phytosanitary measures and services) and more general aspects (investment, intellectual property, government procurement, competition policy, mechanisms for the defense of trade, labor matters, and the environment).

**Individual negotiations**

- |   |   |
|---|---|
| 1. Access to markets for industrial goods | 8. Intellectual property                |
| 2. Customs procedures                     | 9. Government procurement               |
| 3. Technical obstacles to trade           | 10. Competition policy                  |
| 4. Agriculture                            | 11. Mechanisms for the defense of trade |
| 5. Hygiene or phytosanitary measures      | 12. Labor matters                       |
| 6. Services                               | 13. The Environment                     |
| 7. Investment                             |   |

These matters have been discussed at six successive rounds of talks up to December 2004. Different degrees of progress have been made with each subject, depending on the existence or not of sensitive matters. These include tax relief on used goods, treatment of certain farm products and the price band system, as well as the matter of intellectual property and patents.

Similar agreements have already been reached by other countries (Chile, Morocco, Singapore, Mexico, Australia and Israel) and by economic blocks such as Central America (the CAFTA), North America (NAFTA) and South Africa (SACU). Therefore a TLC with the United States would give Peru the same access as those countries and, in addition, the country would be better placed to face Chinese competition in other sectors, particularly textiles, which could in future be affected by the elimination of the quota system.

The prices of gold and silver, used by institutional investors as assets of last resort, increased by 13 and 36 percent respectively, because of the continued weakness of the United States dollar and the geopolitical situation in the Middle East.

The United States dollar continued to weaken throughout 2004: it depreciated 7.7 percent against the euro and 5.8 percent against the yen, associated with fiscal and trade imbalances in the United States economy.

Nevertheless, higher world growth caused oil prices to rise, which had a negative impact on oil importing countries because of inflationary repercussions. The price of a barrel of WTI rose an average of 33 percent in 2004, closing the year

at US\$ 43 a barrel. This was also a response to increasing demand from Asian countries (particularly China and India) and North America, uncertainty caused by the geopolitical situation, and limited ability on the part of the Organization of Petroleum Exporting Countries (OPEC) to increase supply.

Finally, there was a progressive rise in United States Federal Reserve reference interest rates.

**2. Current account balance**

The **current account** showed a small deficit of US\$ 10 million in 2004. This can be attributed on the one hand to the significant trade surplus obtained during the year of US\$ 2,793 million (resulting from increased exports) and, on the other hand, to the

**TABLE 23**  
**DIRECTION OF TRADE 1/**  
(In percent of total)

	Exports 2/			Imports 3/			X + M		
	2002	2003	2004	2002	2003	2004	2002	2003	2004
USA	26.0	26.8	29.1	19.9	19.1	19.9	23.0	23.2	25.1
China	7.8	7.5	9.9	6.5	8.0	7.9	7.2	7.7	9.0
United Kingdom	11.8	13.0	9.2	1.0	1.0	0.8	6.5	7.3	5.5
Chile	3.3	4.6	5.1	6.2	5.2	5.1	4.7	4.9	5.1
Brazil	2.5	2.6	2.8	6.2	6.3	6.6	4.3	4.4	4.5
Colombia	2.1	2.1	2.1	5.9	5.8	7.6	3.9	3.9	4.5
Japan	4.9	4.3	4.4	5.2	4.4	3.6	5.0	4.3	4.0
Ecuador	1.8	1.7	1.7	5.7	7.7	6.6	3.7	4.6	3.8
Venezuela	1.5	1.2	1.6	3.1	3.6	6.6	2.3	2.4	3.8
Germany	3.3	2.8	3.1	3.0	2.8	2.7	3.1	2.8	2.9
Spain	3.2	3.4	3.4	2.1	2.0	2.1	2.6	2.7	2.9
Argentina	0.2	0.2	0.3	7.4	5.8	5.0	3.7	2.9	2.4
Mexico	1.7	1.2	1.8	3.9	3.6	3.0	2.8	2.3	2.4
Others	29.9	28.4	25.6	23.9	24.7	22.5	27.0	26.7	24.2
<b>TOTAL</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

X: Exports M: Imports

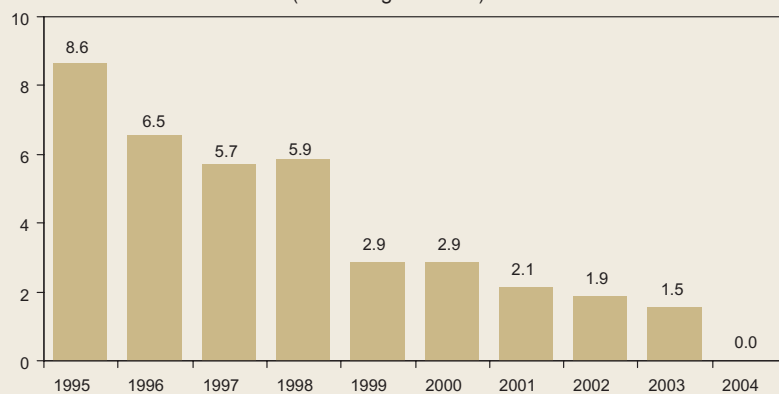
1/ Imports are grouped by origin country.

2/ Exports exclude products classified as other exports and the repair of foreign ships and aircrafts.

3/ Imports exclude defensive material, products classified as other imports and the repair of Peruvian ships and aircrafts abroad.

Source: SUNAT.

**GRAPH 13**  
**CURRENT ACCOUNT DEFICIT**  
(Percentage of GDP)



Source: BCRP.



considerable increase in current transfers, which amounted to US\$ 1,461 million. Thus the positive contribution of the trade surplus and current transfers offset a deficit in services and factor income.

The **trade balance** of US\$ 2,793 million was US\$ 1,957 million higher than that achieved in 2003,

because the US\$ 3,526 million (39 percent) increase in exports was higher than the US\$ 1,569 million (19 percent) increase in imports.

The growth in exports arises from both higher tonnages and better export prices. The average export price rose 21 percent, while export volumes

**TABLE 24**  
**BALANCE OF PAYMENTS**

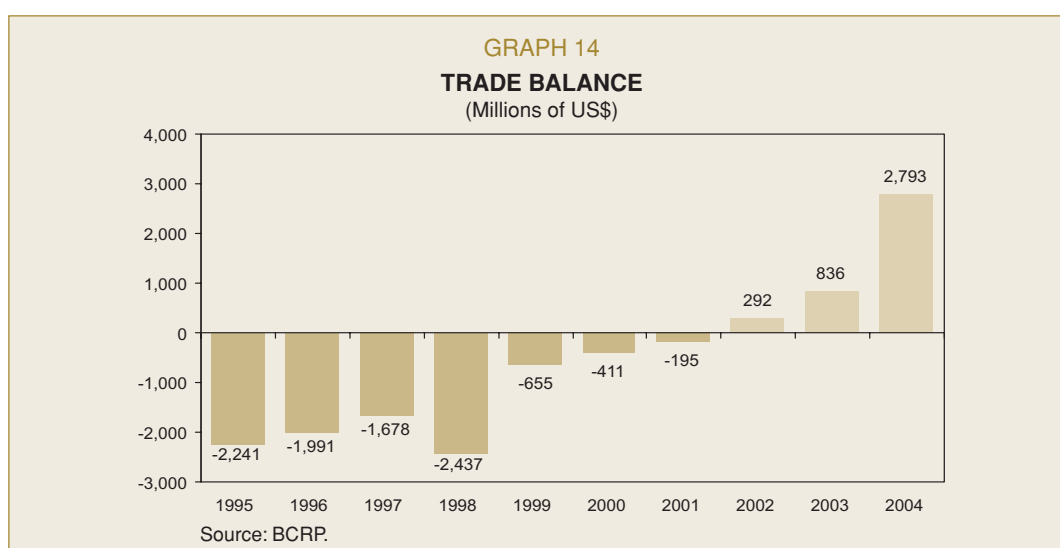
	Millions of US\$			Percentage of GDP		
	2002	2003	2004	2002	2003	2004
<b>I. CURRENT ACCOUNT BALANCE</b>	<b>- 1,063</b>	<b>- 935</b>	<b>- 10</b>	<b>- 1.9</b>	<b>- 1.5</b>	<b>0.0</b>
1. Trade balance	292	836	2,793	0.5	1.4	4.1
a. Exports	7,714	9,091	12,617	13.6	15.0	18.4
b. Imports	-7,422	-8,255	-9,824	-13.1	-13.6	-14.3
2. Services	- 941	- 854	- 843	-1.7	-1.4	-1.2
a. Exports	1,530	1,695	1,914	2.7	2.8	2.8
b. Imports	-2,471	-2,549	-2,756	-4.4	-4.2	-4.0
3. Investment income	-1,457	-2,144	-3,421	-2.6	-3.5	-5.0
a. Private sector	- 746	-1,275	-2,451	-1.3	-2.1	-3.6
b. Public sector	- 711	- 869	- 970	-1.3	-1.4	-1.4
4. Current transfers	1,043	1,227	1,461	1.8	2.0	2.1
of which: Workers' remittances	705	860	1,123	1.2	1.4	1.6
<b>II. FINANCIAL ACCOUNT</b>	<b>1,800</b>	<b>672</b>	<b>2,244</b>	<b>3.2</b>	<b>1.1</b>	<b>3.3</b>
1. Private sector	1,538	- 105	1,027	2.7	-0.2	1.5
a. Direct investment without privatization	1,970	1,265	1,785	3.5	2.1	2.6
b. Long-term loans	- 146	- 166	- 408	-0.3	-0.3	-0.6
c. Bonds	- 153	- 36	- 4	-0.3	-0.1	-0.0
d. Stock market and ADR's	- 9	1	- 47	0.0	0.0	-0.1
e. Other external assets	- 310	-1,179	- 330	-0.5	-1.9	-0.5
f. Privatization	186	10	31	0.3	0.0	-0.0
2. Public sector	1,056	630	988	1.9	1.0	1.4
a. Disbursements	2,902	2,161	2,535	5.1	3.6	3.7
b. Amortization	-1,843	-1,228	-1,389	-3.3	-2.0	-2.0
c. Other external assets	- 3	- 303	- 159	0.0	-0.5	-0.2
3. Short-term capital	- 794	147	230	-1.4	0.2	0.3
<b>III. EXCEPTIONAL FINANCING</b>	<b>14</b>	<b>64</b>	<b>26</b>	<b>0.0</b>	<b>0.1</b>	<b>0.0</b>
<b>IV. BCRP NET INTERNATIONAL RESERVES FLOW (1-2)</b>	<b>- 833</b>	<b>- 477</b>	<b>-2,352</b>	<b>-1.5</b>	<b>-0.8</b>	<b>-3.4</b>
(Increase with negative sign)						
1. Change in Central Bank reserves	- 985	- 596	-2,437	-1.7	-1.0	-3.5
2. Valuation changes and monetization of gold	- 152	- 119	- 85	-0.3	-0.2	-0.1
<b>V. NET ERRORS AND OMISSIONS</b>	<b>83</b>	<b>676</b>	<b>92</b>	<b>0.1</b>	<b>1.1</b>	<b>0.1</b>

Source: BCRP, MEF, Superintendency of Banking and Insurance (SBS), SUNAT, Ministry of Foreign Affairs, Cofide, ONP, FCR, Zofratatna, Banco de la Nación, Cavalí ICLV S.A., Proinversión, BIS and companies.

were 15 percent higher. The price increase is explained mainly by higher average metal prices: gold (13 percent), copper (62 percent) and zinc (25 percent). On the other hand import prices (which increased 11 percent) reflected higher prices for oil and petroleum derivatives (25 percent), sugar (9 percent) and wheat (12 percent), while import volumes increased 7 percent. Higher prices for our

exports and imports meant an increase of 9 percent in the terms of trade.

**Traditional exports** increased by 42 percent, driven by favorable prices which rose, on average, by 27.7 percent. This price effect represented additional income of US\$ 2,227 million and is calculated as the difference between the value



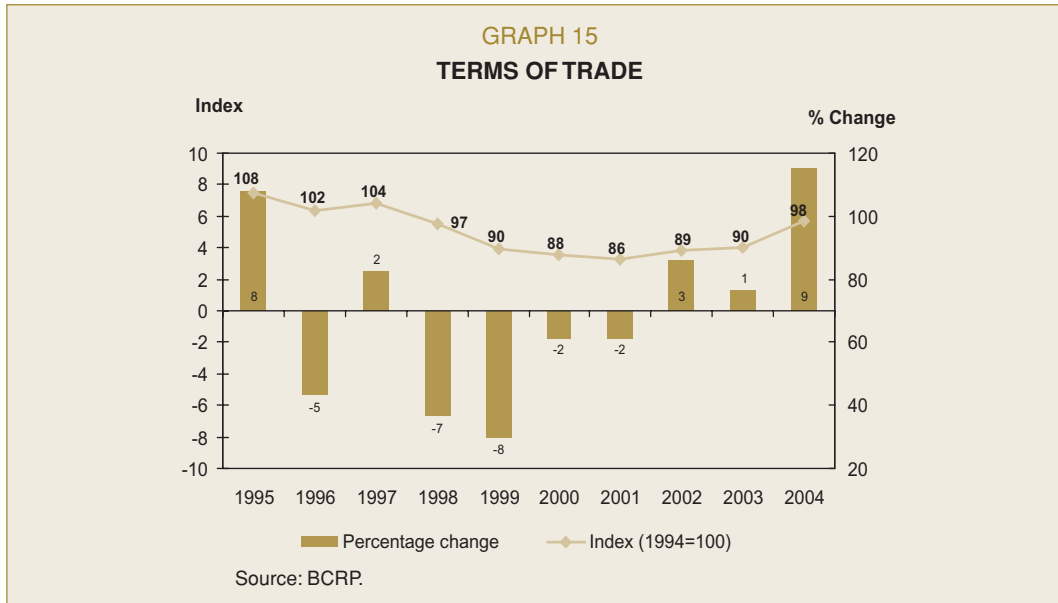
## BOX 2

### TERMS OF TRADE

The calculation of the terms of trade index takes into account a weighted average of the prices of Peru's main traditional exports, a basket of prices of our main trading partners for the remaining traditional products and all non-traditional exports. The same applies to imports; the price index is calculated as the weighted average of the prices of the principal foodstuffs and fuels, and a basket of prices for the remaining imports. It should be pointed out that remaining traditional products consist mainly of molybdenum, a product that has increased its share of total exports in recent years. From 1 percent of mining exports in 2001 it accounted for 6 percent in 2004. Given the increase in price, especially in 2004, from now on this product will be given its own price in the calculation and will no longer be included in the basket of prices mentioned.

Molybdenum is a metal with properties similar to those of chromium. Approximately two thirds of molybdenum consumption is used in steel alloys due to its strength and resistant to high temperatures and pressures. Such alloys are used mainly in construction, aircraft parts and forgings for the automotive industry. Molybdenum is also used as a catalyst in the petroleum industry to eliminate sulfur. Molybdenum wire is used in the production of electronic components and as electrodes in glass kilns. Molybdenum sulfide is employed as a lubricant for high temperature applications.

Almost two thirds of world supply is obtained as a by-product of copper mining. For this reason its importance as one of Peru's exports goes hand in hand with the country's increased copper exports. Thus the significant increase in the volume of molybdenum exported in 2004 (28 percent) was associated with the increase in copper exports (20 percent). Furthermore, its price has increased 235 percent over the last year, influenced principally by an expansion of the world's market for steel, especially for infrastructure projects in China.



effectively exported and a hypothetical value derived from export volumes in 2004 at the previous year's average price. In addition it should be mentioned that export volumes also increased by 10.8 percent on average, particularly those of fishmeal and copper.

Sales of **copper** were almost double those of 2003, due both to increased volumes (19 percent) and a 62 percent increase in the average export price. The export sales of this metal amounted to US\$ 2,446 million, US\$ 1,186 million (94 percent) higher than in the previous year. It is worth pointing out that Peru is the world's third largest producer of copper and the second largest in the region.

Similarly, there was an increase in exports of gold (13 percent), refined silver (36 percent), lead (93 percent), zinc (9 percent), and tin (66 percent). Peru is the sixth largest gold producer, third largest zinc producer and second largest silver producer in the world.

Exports of **molybdenum** reached US\$ 407 million, an increase of 330 percent making this metal, previously included under "other mining products" the fourth most important mineral export after

**TABLE 25**  
**PRICE EFFECT**  
**OVER TRADITIONAL**  
**EXPORTS**  
(Millions of US\$)

Product	Hypothetical value 1/	Actual price 2004	Price effect 2/
<b>MINERAL PRODUCTS</b>	<b>4,893</b>	<b>6,941</b>	<b>2,048</b>
Copper	1,472	2,446	974
Molybdenum	122	407	285
Gold	2,115	2,383	268
Lead	216	389	173
Tin	218	351	133
Zinc	458	577	119
Silver (refined)	190	260	70
Iron	102	128	26
<b>PETROLEUM AND DERIVATIVES</b>	<b>563</b>	<b>646</b>	<b>83</b>
<b>AGRICULTURAL PRODUCTS</b>	<b>248</b>	<b>311</b>	<b>63</b>
Coffee	230	290	60
Sugar	13	15	2
Cotton	5	6	1
<b>FISHING</b>	<b>1,071</b>	<b>1,104</b>	<b>33</b>
Fishoil	123	149	26
Fishmeal	948	955	7
<b>TOTAL</b>	<b>6,775</b>	<b>9,002</b>	<b>2,227</b>

1/ 2004 export volumes at 2003 average prices.  
2/ Difference between the actual and hypothetical values.  
Source: BCRP.

copper, gold and zinc. The United States is the largest producer, followed by Chile and China, with Peru in fourth place.

Foreign sales of **petroleum and derivatives** amounted to US\$ 646 million, an increase of US\$ 25 million or 4 percent, associated with higher

average export prices (16 percent), while fishmeal exports totaled US\$ 954 million, a 29 percent increase compared to 2003, reflecting both higher Peruvian anchovy landings and better international prices. As far as **agricultural exports** were concerned, sales of coffee increased by US\$ 109 million or 60 percent during the year as international prices rose.

TABLE 26  
EXPORTS

	Millions of US\$			Percentage change	
	2002	2003	2004	2003	2004
<b>I. TRADITIONAL PRODUCTS</b>	<b>5,369</b>	<b>6,356</b>	<b>9,028</b>	<b>18.4</b>	<b>42.0</b>
<b>FISHING</b>	<b>892</b>	<b>821</b>	<b>1,104</b>	<b>- 8.0</b>	<b>34.4</b>
Fishmeal	823	742	954	- 9.8	28.6
Fish oil	69	79	149	14.3	88.7
<b>AGRICULTURAL PRODUCTS</b>	<b>216</b>	<b>224</b>	<b>325</b>	<b>3.6</b>	<b>45.1</b>
Coffee	188	181	290	- 3.7	60.1
Sugar	16	19	15	17.9	- 24.0
Cotton	2	6	6	144.8	10.1
Other agricultural products 1/	10	18	14	89.7	- 20.6
<b>MINERAL PRODUCTS</b>	<b>3,809</b>	<b>4,690</b>	<b>6,953</b>	<b>23.1</b>	<b>48.3</b>
Copper 2/	1,187	1,261	2,446	6.2	94.0
Gold	1,501	2,102	2,383	40.0	13.4
Zinc	429	529	577	23.3	9.1
Molybdenum	64	95	407	47.0	330.0
Lead 2/	211	201	389	- 4.5	93.2
Tin	155	211	351	35.9	66.2
Silver (refined)	174	191	260	10.0	36.2
Iron	83	94	128	13.4	36.5
Other mineral products 3/	5	7	12	35.9	74.5
<b>PETROLEUM AND DERIVATIVES</b>	<b>451</b>	<b>621</b>	<b>646</b>	<b>37.7</b>	<b>4.0</b>
<b>II. NON-TRADITIONAL PRODUCTS</b>	<b>2,256</b>	<b>2,620</b>	<b>3,476</b>	<b>16.1</b>	<b>32.6</b>
Agriculture and livestock	550	624	799	13.4	28.1
Fishing	164	205	277	25.1	35.3
Textile	677	823	1,092	21.7	32.7
Timbers and papers, and its manufactures	177	172	214	- 2.7	24.3
Chemical	256	316	415	23.6	31.2
Non-metallic minerals	68	74	94	8.1	27.9
Basic metal industries and jewelry	222	262	391	17.8	49.4
Fabricated metal products and machinery	110	99	135	- 9.3	35.8
Otros 4/	33	45	58	36.5	28.9
<b>III. OTHER PRODUCTS 5/</b>	<b>89</b>	<b>114</b>	<b>113</b>	<b>27.9</b>	<b>- 0.8</b>
<b>IV. TOTAL EXPORTS</b>	<b>7,714</b>	<b>9,091</b>	<b>12,617</b>	<b>17.8</b>	<b>38.8</b>

1/ Including coca leaves and derivatives, molasses, wools and furs.

2/ Including silver contents.

3/ Including bismuth and tungsten, mainly.

4/ Including furs, leathers and handicrafts, mainly.

5/ Fuel and food sold to foreign ships and aircrafts and repairs on capital goods.

Source: BCRP, SUNAT and companies.



Exports of **non-traditional products** amounted to US\$ 3,476 million, a figure 33 percent higher than that of 2003, reflecting higher sales of textiles, agricultural & livestock products, iron and steel and jewelry, chemicals and fish products.

Under the heading **textiles** clothing exports increased significantly to account for 87 percent of total growth (from US\$ 233 to US\$ 269 million) due to the benefits arising from the ATPDEA. Total textile exports were valued at US\$ 1 092 million, an increase of 33 percent compared to 2003. Exports of non-traditional **agricultural & livestock products** amounted to US\$ 799 million, an increase

of US\$ 175 million (28 percent), mainly in fresh asparagus, paprika, and evaporated milk (the latter product going mainly to Central America). Regarding **chemical products**, there was an increase in sales of cosmetics and polymers to the United States, Ecuador, Colombia and Bolivia; while in the **metal products and jewelry**, exports of copper, zinc and jewelry benefited from higher international prices. Exports of non-traditional **fish** products improved as sales of frozen shellfish and frozen fish increased, particularly hake.

The dynamism of the export market was also shown by higher sales of **timber and paper**, which

TABLE 27  
IMPORTS

	Millions of US\$			Percentage change	
	2002	2003	2004	2003	2004
<b>I. CONSUMER GOODS</b>	<b>1,754</b>	<b>1,848</b>	<b>1,973</b>	<b>5.3</b>	<b>6.8</b>
Non-durable	1,032	1,035	1,136	0.3	9.7
Durable	722	812	837	12.5	3.1
<b>II. RAW MATERIALS AND INTERMEDIATE GOODS</b>	<b>3,740</b>	<b>4,341</b>	<b>5,356</b>	<b>16.0</b>	<b>23.4</b>
Fuels	975	1,376	1,754	41.1	27.4
For agriculture	249	278	348	11.7	25.3
For industry	2,516	2,686	3,254	6.8	21.1
<b>III. CAPITAL GOODS</b>	<b>1,842</b>	<b>1,984</b>	<b>2,365</b>	<b>7.7</b>	<b>19.2</b>
Building materials	272	199	191	- 26.7	- 4.1
For agriculture	20	17	29	- 16.6	69.4
For industry	1,227	1,425	1,655	16.1	16.2
Transportation equipment	323	344	490	6.3	42.7
<b>IV. OTHER GOODS 1/</b>	<b>85</b>	<b>82</b>	<b>130</b>	<b>- 3.0</b>	<b>57.7</b>
<b>V. TOTAL IMPORTS</b>	<b>7,422</b>	<b>8,255</b>	<b>9,824</b>	<b>11.2</b>	<b>19.0</b>
Note:					
<b>Foodstuff 2/</b>	<b>546</b>	<b>560</b>	<b>722</b>	<b>2.7</b>	<b>28.8</b>
Wheat	171	185	220	8.2	18.5
Corn and/or sorghum	92	99	119	7.1	20.6
Rice	9	4	26	- 49.0	494.0
Sugar 3/	30	3	45	- 91.2	1,587.0
Dairy products	31	23	36	- 25.9	54.2
Soybean	195	224	255	14.8	13.9
Meat	17	22	21	27.9	- 3.7

1/ Include donated goods, fuel and food bought by Peruvian ships and aircrafts and repairs of capital goods, as well as other goods not included in this classifier.

2/ Exclude food donations.

3/ Includes non-refined sugar cane, classified as raw materials.

Source: BCRP, SUNAT, Zofratracna, Banco de la Nación and companies.



increased by US\$ 42 million (24 percent); **chemical products**, which increased by US\$ 99 million (31 percent); **metal products and jewelry** which increased by US\$ 130 million (49 percent); non-metallic minerals, up US\$ 21 million (28 percent) and **light engineering** products, up US\$ 36 million (36 percent).

Imports increased 19 percent compared to 2003, reflecting both greater economic activity and higher prices for fuels and foodstuffs. Imports of raw materials and capital goods for industry also increased (21 and 16 percent, respectively).

Imports of fuels, lubricants and related products rose 27 percent during the year, because of higher average import prices (23 percent); while foodstuff purchases rose by US\$ 161 million (29 percent), consisting mainly of rice and sugar to offset lower domestic production, as well as

soybean, wheat, and maize. It should be pointed out that higher fuel and foodstuff prices meant expenditure that was US\$ 398 million higher than in the previous year.

The deficit in the **balance of services** fell by US\$ 11 million as the result of an improvement in the **travel** category. This was associated with a 15 percent rise in visitors, the incoming tourism sector reporting income of US\$ 1,078 million, which represents an increase of US\$ 138 million compared to the previous year. The deficit in **insurance and reinsurance** also fell by US\$ 50 million, associated with smaller foreign premium payments as customers preferred to obtain reinsurance from local companies; foreign reinsurers were charging more to cover losses incurred in previous years and a 7 percent fall in revenue abroad resulting from losses. The deficit in **transport services** increased by US\$ 103

TABLE 28  
SERVICES

	Millions of US\$			Percentage change	
	2002	2003	2004	2003	2004
<b>I. TRANSPORTATION</b>	<b>- 618</b>	<b>- 612</b>	<b>- 715</b>	<b>1.0</b>	<b>- 16.8</b>
1. Credit	266	309	381	16.4	23.0
2. Debit	- 884	- 922	-1,096	- 4.2	- 18.9
<b>II. TRAVEL</b>	<b>234</b>	<b>342</b>	<b>458</b>	<b>46.2</b>	<b>33.9</b>
1. Credit	814	940	1,078	15.6	14.7
2. Debit	- 580	- 598	- 620	- 3.2	- 3.7
<b>III. COMMUNICATIONS</b>	<b>22</b>	<b>19</b>	<b>16</b>	<b>- 12.5</b>	<b>- 15.9</b>
1. Credit	82	79	79	- 3.6	0.0
2. Debit	- 60	- 60	- 63	0.4	- 5.0
<b>IV. INSURANCE AND REINSURANCE</b>	<b>- 149</b>	<b>- 175</b>	<b>- 125</b>	<b>- 17.0</b>	<b>28.7</b>
1. Credit	94	88	82	- 6.1	- 7.5
2. Debit	- 243	- 263	- 206	- 8.1	21.5
<b>V. OTHER 1/</b>	<b>- 429</b>	<b>- 428</b>	<b>- 477</b>	<b>0.2</b>	<b>- 11.3</b>
1. Credit	274	278	294	1.3	5.7
2. Debit	- 703	- 706	- 770	- 0.4	- 9.1
<b>VI. SERVICES</b>	<b>- 941</b>	<b>- 854</b>	<b>- 843</b>	<b>9.3</b>	<b>1.4</b>
1. Credit	1,530	1,695	1,914	10.8	12.9
2. Debit	-2,471	-2,549	-2,756	- 3.2	- 8.1

1/ Comprises government services, financial and computing services, royalties, equipment rentals and companies services among others.

Source: BCRP, SUNAT, Ministry of Foreign Affairs and companies.



million because of increased import freight payments generated by higher foreign purchases and higher fuel prices. The deficit in other services was US\$ 48 million compared to 2003 because of higher payments for business, professional and technical services made by direct foreign investors, principally oil and mining companies.

In the **factor income** account, the deficit increased from US\$ 2,144 to US\$ 3,421 million, due principally to higher profits accruing to the private sector (especially mining companies), which more than doubled from US\$ 1,112 million to US\$ 2,304 million and, to a lesser extent, the start of a cycle of international interest rate rises.

The total interest payable on Peru's foreign debt rose to US\$ 1,173 million, equivalent to 1.7 percent of GDP and US\$ 74 million higher than the figure for 2003, most of which consisted of interest on bonds.

Finally, **current transfers** totaled US\$ 1,461 million during 2004, consisting mostly of remittances from Peruvians living abroad (particularly in the United States, Japan, Spain and Argentina) within a context of higher world growth, while Argentina, where a substantial number of Peruvian citizens live, managed to overcome its economic crisis. Remittances during this period were estimated at US\$ 1,123 million (31 percent higher than in the previous year), equivalent to 1.6 percent of GDP or 9 percent of exports.

### 3. Financial account

A positive balance of payments financial account in 2004 (US\$ 2,244 million) was a reflection of higher cash flows in private sector and public sector accounts and lower asset acquisitions abroad.

The **private sector financial account** amounted to US\$ 1,027 million. Direct investment amounted

to US\$ 1,785 million, most of which (US\$ 1,667 million) consisted of profits generated and retained by companies with foreign shareholders (principally in the mining sector). It should be mentioned that retained profits are used as working capital or to finance investments, and companies may capitalize them or distribute them at a later date. Furthermore, the balance of US\$ 118 million consisted basically of a net flow of new investment, including US\$ 423 million in the hydrocarbons sector, principally Camisea, offset by capital withdrawals by a large telecommunications company (US 220 million).

The net flow of long-term loans was negative (-US\$ 408 million), as a result of fewer loans received and higher repayments in advance by the mining sector, while net investment in foreign assets fell from US\$ 1,179 million to US\$ 330 million, basically because the financial system invested less in assets abroad.

The **public sector financial account** recorded a positive balance of US\$ 988 million, a figure US\$ 358 million higher than in 2003. Disbursements amounted to US\$ 2,535 million, while repayments were US\$ 1,389 million. The net external assets account reflected an increase in international assets of US\$ 159 million, basically as a result of investments by the government and COFIDE, as well as foreign deposits by the Consolidated Reserve Fund (FCR).

Short-term capital showed similar behavior to 2003, with a positive flow of resources amounting to US\$ 230 million. This evolution by the current account balance and capital flows explained the increase in net international reserves of US\$ 2,437 millions.

### 4. International assets and liabilities position

The international assets and liabilities position shows that total foreign debt (public and private)

**TABLE 29**  
**INTERNATIONAL INVESTMENT POSITION**  
(End of period levels)

	Millions of US\$			Percentage of GDP		
	2002	2003	2004	2002	2003	2004
<b>I. ASSETS</b>	<b>15,714</b>	<b>18,038</b>	<b>21,214</b>	<b>27.8</b>	<b>29.7</b>	<b>30.9</b>
1. Reserve assets of the BCRP	9,690	10,206	12,649	17.1	16.8	18.4
2. Financial system (excluding BCRP)	2,990	4,404	4,834	5.3	7.2	7.0
3. Other assets	3,034	3,428	3,731	5.4	5.6	5.4
<b>II. LIABILITIES</b>	<b>43,411</b>	<b>45,461</b>	<b>47,379</b>	<b>76.8</b>	<b>74.8</b>	<b>69.0</b>
<b>1. Bonds and private and public external debt</b>	<b>27,872</b>	<b>29,587</b>	<b>31,117</b>	<b>49.3</b>	<b>48.7</b>	<b>45.3</b>
a. Medium and long-term	25,283	27,062	28,348	44.7	44.5	41.3
Private sector 1/	4,496	4,294	3,882	8.0	7.1	5.7
BCRP	73	0	0	0.1	0.0	0.0
Public sector	20,715	22,768	24,466	36.6	37.5	35.6
b. Short-term	2,589	2,525	2,769	4.6	4.2	4.0
Financial system (excluding BCRP)	817	732	834	1.4	1.2	1.2
BCRP	19	12	18	0.0	0.0	0.0
Other 2/	1,753	1,782	1,917	3.1	2.9	2.8
<b>2. Direct investment</b>	<b>12,549</b>	<b>12,876</b>	<b>13,310</b>	<b>22.2</b>	<b>21.2</b>	<b>19.4</b>
<b>3. Stock market and ADR's</b>	<b>2,990</b>	<b>2,999</b>	<b>2,952</b>	<b>5.3</b>	<b>4.9</b>	<b>4.3</b>

1/ Including bonds.

2/ Non-financial private sector short-term debt is mainly accounted.

Source: BCRP, MEF, Cavali ICLV S.A., Proinversión and BIS.

in the medium and long term, amounted to US\$ 28,348 million, equivalent to 41.3 percent of GDP. Although there was an increase in nominal debt of US\$ 1,286 million, the debt burden with respect to GDP is less than in 2003. This reduction occurred in the percentage of both public debt (from 37.5 to 35.6 percent) and private debt (from 7.1 to 5.7 percent).

Furthermore, direct foreign investment in Peru amounted to US\$ 13,310 million, equivalent to 19.4 percent of GDP while capital (US\$ 2,952 million) represented 4.3 percent of GDP. Thus total liabilities abroad amounted to US\$ 47,379 million.

Assets amounted to US\$ 21,214 million, made up mainly of Central Bank assets (US\$ 12,649 million), which rose by US\$ 2,443 million, an increase that can be explained principally by the BCRP's accumulation of US\$ 2,437 million in net international reserves. NIR at the close of the year amounted to US\$ 12,631 million.

The country's liquidity position was thus strengthened further. International reserves represent 15 months' goods imports, 2.5 times the foreign debt maturing in one year, and more than 4 times the monetary base.

The external position and various indicators of vulnerability abroad show that Peru has increased



TABLE 30  
EXTERNAL VULNERABILITY INDICATORS

	2002	2003	2004
1. Current account deficit (% of GDP)	1.9	1.5	0.0
2. Exports concentration by products (%) 1/	51	51	50
3. Net international reserves (NIR) (millions of US\$)	9,598	10,194	12,631
4. NIR / Debt due in one year (times) 2/	2.1	2.1	2.5
5. NIR (number of month of imports of goods)	16	15	15
6. Total external debt (% of GDP)	49	49	45
7. Total external debt / Current account revenues (times)	2.6	2.4	1.9
8. Public sector external debt (% of GDP)	36.6	37.5	35.6
9. Public sector external debt / Current account revenues (times)	1.9	1.8	1.5
10. Total external debt service (% current account revenues) 3/	29.2	26.8	22.6
11. Public sector external debt service (% current account revenues) 3/	18.4	18.9	15.7

1/ Share of gold, copper, fishmeal and zinc in total exports.  
2/ Short-term debt and medium and long-term debt due in one year.  
3/ Excluding debt swap transactions in 2002.  
Source: BCRP.

its ability to respond to any tightening of the international capital market or exceptional demand for foreign currency, and this has

improved perception of country risk, reflected in improved ratings being awarded by ratings agencies.

### BOX 3

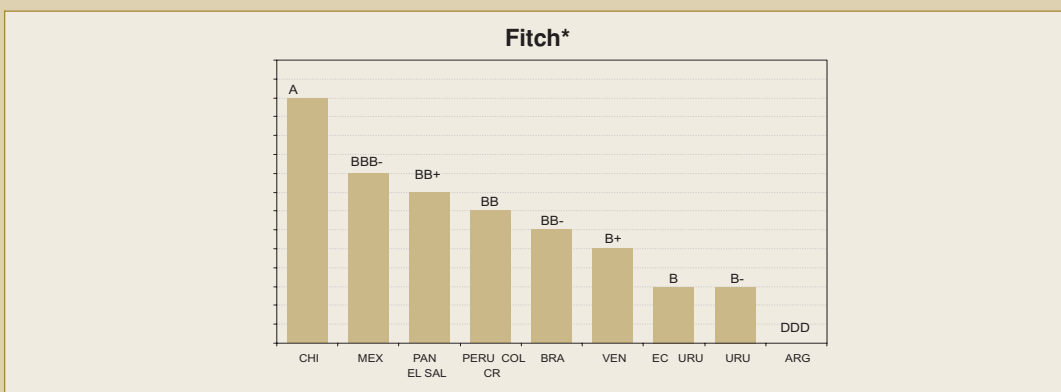
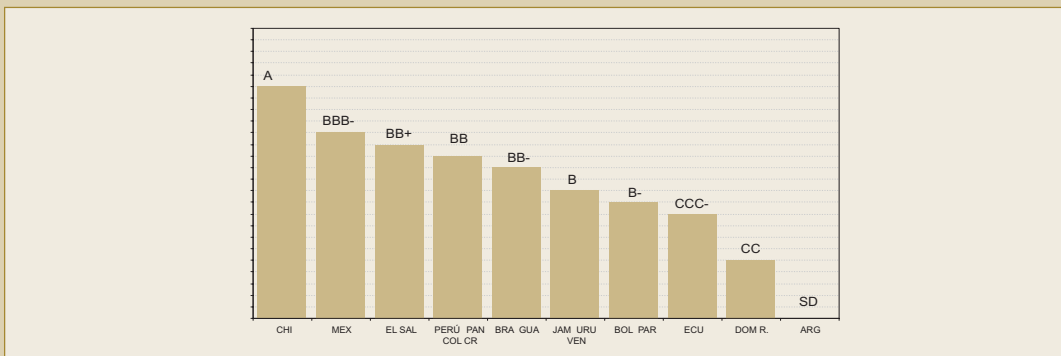
#### FITCH AND STANDARD & POOR'S RAISE PERU'S SOVEREIGN DEBT RATING

On the 8th of June 2004, rating agency Standard & Poor's (S&P) raised their rating of Peru's long-term dollar-denominated foreign debt from BB- to BB, two steps below investment grade. S&P said that the decision was based on improved economic fundamentals which are likely to continue in the medium term. Among macroeconomic achievements, the agency mentioned fiscal consolidation, which has contributed to a gradual stabilization of the country's debt burden. The agency also stated that vulnerability to external shocks had been mitigated by a number of factors, including a fall in the borrowing requirement (because of a lower fiscal deficit); strong export growth; and higher issues of domestic currency-denominated debt. The high level of international reserves has also contributed to reducing vulnerability to external economic factors, though this is still considered high. Among less optimistic elements, the agency mentioned political problems.

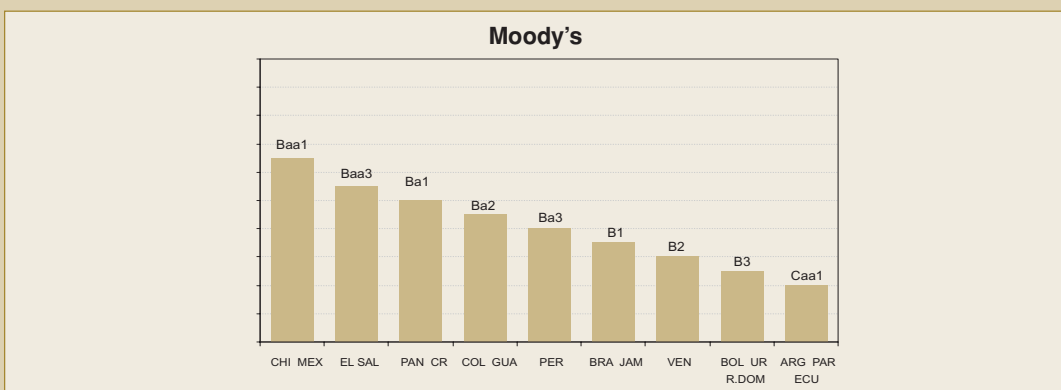
Similarly, on the 18th of November 2004 Fitch raised its rating of Peruvian long-term dollar-denominated debt from BB- to BB, also two steps below investment grade. The agency continued to describe the situation as "stable". This improvement was based on a favorable view of Peru's fiscal accounts, macroeconomic strength, export growth and progress with pension reform (closure of the so-called Cédula Viva). The agency said that pension reform measures could form the basis for further progress on public policy.

Moody's maintained its Ba3 rating for Peru's credit risk, first applied on the 20th of July 1999, throughout 2004. This category is three steps down from investment grade.

**S & P\***  
**LONG TERM SOVEREIGN DEBT RATING IN FOREIGN CURRENCY**  
 (As of December 31 of 2004)



\* From BBB+ correspond to investment grade.



\*\* From Baa1 correspond to investment grade.

**LATIN AMERICAN COUNTRIES EMBI+ INDEX**  
 (In basic points)

	Dec. 2003	Dec. 2004
Argentina	5,632	4,703
Brazil	463	382
Colombia	431	332
Ecuador	799	690
Mexico	199	166
Peru	312	220
Venezuela	593	411

1/ End of period.  
 Source: Reuters and Bloomberg.