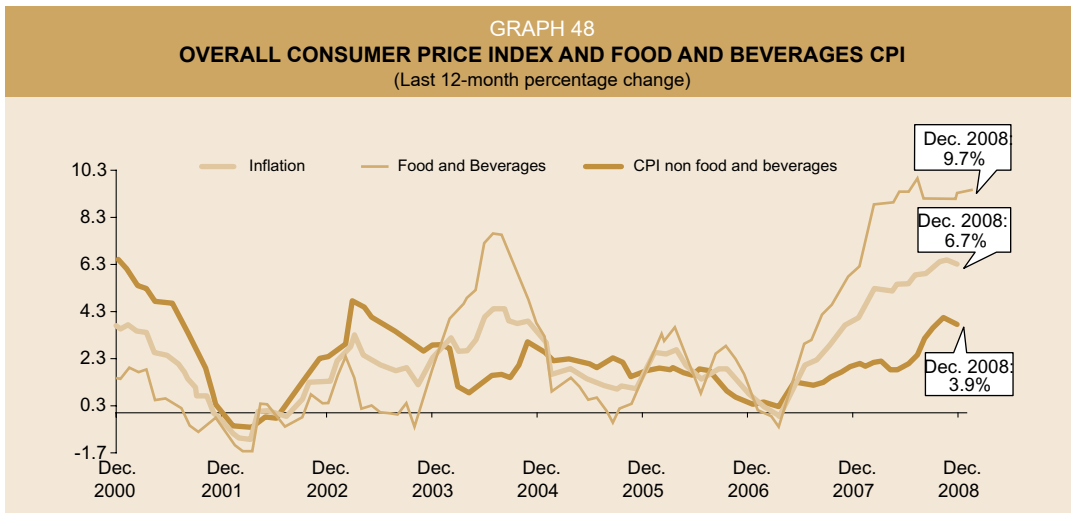
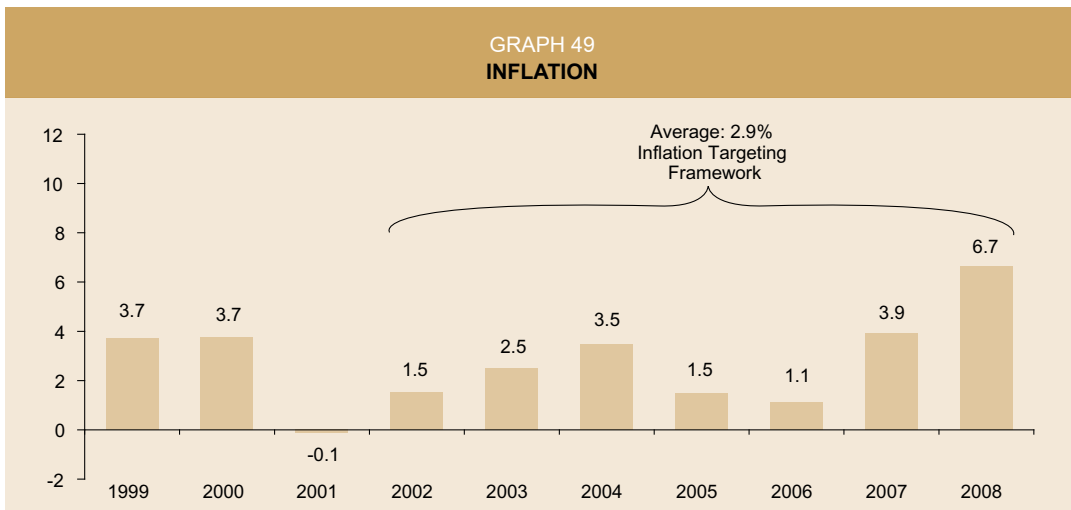


## IV. Inflation

Measured by the Consumer Price Index (CPI), inflation showed a rate of 6.65 percent in 2008. This rate was mainly due to the higher international prices of food in the first months of the year, as well as to the higher domestic prices of farming products as a result of climatic factors and the higher prices of fertilizers. In this sense, food prices increased 9.7 percent in 2008, while the prices of components other than food increased 3.9 percent.



The average inflation rate since inflation targeting was adopted in 2002 has been 2.9 percent, with average core inflation showing a rate of 2.1 percent.



This means that the drastic increase observed in the prices of food and beverages –from 6.0 percent in 2007 to 9.7 percent in 2008– resulted from domestic and external supply shocks. Moreover, the price rise of public utilities (8.7 percent), electricity (6.3 percent), and transport (5.9 percent) should also be pointed out in terms of other CPI components.

TABLE 56 INFLATION (Percentage change)								
	Weight	2002	2003	2004	2005	2006	2007	2008
<b>CPI</b>	<b>100.0</b>	<b>1.52</b>	<b>2.48</b>	<b>3.48</b>	<b>1.49</b>	<b>1.14</b>	<b>3.93</b>	<b>6.65</b>
<b>1. Food and beverages</b>	<b>47.5</b>	<b>0.50</b>	<b>1.89</b>	<b>4.00</b>	<b>1.13</b>	<b>1.76</b>	<b>6.02</b>	<b>9.70</b>
<b>2. Rest of components</b>	<b>52.5</b>	<b>2.44</b>	<b>3.04</b>	<b>3.03</b>	<b>1.75</b>	<b>0.61</b>	<b>2.02</b>	<b>3.86</b>
a. Fuels and electricity	6.2	12.81	4.23	15.93	4.01	- 3.16	5.21	1.65
Fuels	3.9	15.60	8.94	17.77	6.89	- 1.50	6.45	- 0.04
Electricity	2.2	7.90	- 4.63	11.95	- 2.52	- 7.30	1.92	6.31
b. Transport costs	8.4	0.11	10.99	3.49	1.29	1.12	0.82	5.86
c. Public utilities	2.4	- 3.62	0.81	0.46	- 0.83	1.22	- 1.44	8.68
d. Other goods and services	35.5	1.59	1.07	0.50	1.63	1.28	1.89	3.51
<b>Note</b>								
Core inflation	60.6	1.23	0.73	1.23	1.23	1.37	3.11	5.56
Core inflation excluding food and beverages	35.5	1.59	1.07	0.50	1.63	1.28	1.89	3.51

The prices contributing most heavily to the growth of inflation included the price of meals outside the home, potato, chicken meat, and urban fares, while the prices offsetting the increase in the CPI included the prices of sugar, citrus fruits, sweet potato, and telephone rates.

### Meals outside the home:

This rise (8.3 percent) is associated with the higher prices of food and beverages (9.7 percent), as well as with the growth of domestic demand.

### Potato:

The increase observed in the price of potato (50.9 percent) reflects lower sown areas in departments that supply Lima with this product (i.e. Ica and Huánuco), mainly since July. These departments were affected by a lower availability of seeds and by the higher cost of fertilizers, amid a context of increased demand due to campaigns promoting the consumption of potato.

### Chicken:

The price rise of chicken (15.6 percent) was associated with increased demand as a result of the population's higher incomes. The price of this product also increased due to the lower availability of

substitute products (especially yellow mackerel, whose supply declined 38 percent compared to 2007). This was offset by higher placements of baby chicken, which increased 9 percent compared with the previous year.

Another factor contributing to this price rise was higher production costs, due mainly to the higher price of maize in international markets: in 2008 the international price of maize increased 39 percent relative to 2007.

Two distinctive trends were observed in the international price of maize during the year: a sustained upward trend until June, when the price of maize reached a record level of US\$ 280/ton, and a declining trend that led this price to a minimum low of US\$ 106/ton on December 5. This price started falling as the global economy slowed down and in line with the downward trend observed in the price of crude, a reference for the price of ethanol, one of whose inputs is maize.

### **Beef:**

The rise of the price of beef (14.5 percent) was associated with the higher price of chicken meat, its main substitute, amid lower activity in the beef-cattle fattening industry, affected by the higher prices of imported inputs (such as soybean cake, bran, etc). Seasonal factors, such as rainfall which affected cattle butchering in the highlands in Q4-2008, added to this.

### **Rice:**

The higher price of rice was due to higher production costs as a result of the increase of fertilizer prices, as well as to the increase observed in the international prices of this cereal. The price of rice increased despite a high level of supply of this grain, since domestic production grew 14 percent relative to 2007.

### **Onion:**

The rise in the price of onion (58.4 percent) was more evident in March-May (91 percent) due to lower supply. This result is explained by a 16 percent reduction of sown areas compared with the previous farming season due to the lower prices obtained by farmers in the last half of 2007. The price of onion was also affected by the higher costs of fertilizers and labor. Between June and October, the prices of onion fell due to higher supply.

### **Urban fares:**

The rise of fares (6.1 percent) was associated with the higher prices of fuels observed until October 2008. The price of gasoline accumulated an increase of 21.7 percent between April 2007 and October 2008.

TABLE 57  
WEIGHTED CONTRIBUTION TO INFLATION 2008

	Weight	Percentage change	Weighted contribution
<b>CPI</b>	<b>100.0</b>	<b>6.65</b>	<b>6.65</b>
<b>1. Food and beverages</b>	<b>47.5</b>	<b>9.7</b>	<b>4.67</b>
<b>Of which:</b>			
Meals outside the home	12.0	8.3	0.96
Potato	1.5	50.9	0.78
Chicken	4.0	15.6	0.55
Beef	2.3	14.5	0.32
Rice	2.3	12.8	0.30
Onion	0.4	58.4	0.22
<b>2. Other components</b>	<b>52.5</b>	<b>3.9</b>	<b>1.98</b>
<b>a. Fuels and electricity</b>	<b>6.2</b>	<b>1.7</b>	<b>0.13</b>
<b>Fuels</b>	<b>3.9</b>	<b>0.0</b>	<b>0.00</b>
Gasoline and lubricants	1.5	-6.1	-0.13
Gas	1.3	2.7	0.04
Kerosene	1.2	4.2	0.09
<b>Electricity</b>	<b>2.2</b>	<b>6.3</b>	<b>0.13</b>
<b>b. Transport</b>	<b>8.4</b>	<b>5.9</b>	<b>0.51</b>
<b>Of which:</b>			
Urban fares	8.0	6.1	0.50
<b>c. Public services</b>	<b>2.4</b>	<b>8.7</b>	<b>0.17</b>
<b>Of which:</b>			
Water consumption	1.0	18.9	0.21
<b>d. Other goods and services</b>	<b>35.5</b>	<b>3.5</b>	<b>1.18</b>

### Fuels:

On average, the domestic price of fuels showed no variation in 2008. However, two trends were observed in these prices during the year: an increase of 5.8 percent between January and October, and a drop of 5.5 percent between November and December. In the international market, the price of WTI oil increased from US\$ 91 in December 2007 to a peak of US\$ 145.29 early in July, declining thereafter to US\$ 41 in December 2008.

These two clear trends included a fast pace of growth to a historical record price of US\$ 145.3 the barrel in July, and a plunging decline until December, when this price reached a minimum low of US\$ 31/barrel –a level which had not been recorded since December 2003. The reduction observed in the price of crude during the last months was associated with the continuous decline observed in the global demand for crude, particularly from OECD countries, as well as with higher inventories of crude and derivatives in the United States (which offset the cuts of the OPEC production quotas), and with high uncertainty about the evolution of financial markets, which has affected the global demand of non-commercial investors.

TABLE 58  
**FUEL PRICES**  
 (Percentage change)

	2002	2003	2004	2005	2006	2007	2008
<b>Fuels</b>	<b>15.6</b>	<b>8.9</b>	<b>17.8</b>	<b>6.9</b>	<b>- 1.5</b>	<b>6.4</b>	<b>0.0</b>
Gasoline	15.7	9.7	17.7	9.2	- 6.2	10.7	- 6.1
Gas	11.3	4.2	15.3	- 10.9	0.3	1.3	2.7
Kerosene	20.4	13.0	20.3	21.0	2.2	5.8	4.2
WTI Price of oil (end of period)							
US Dollars	29.4	32.2	43.3	59.4	62.0	91.4	41.4
Nuevos soles	103.4	111.6	142.2	203.5	198.8	272.4	129.1

Source: INEI and Bloomberg.

### Electricity:

The increase of electricity rates (6.3 percent) reflected mainly the rises implemented by Osinergmin in October and November to update the cost of generation according to the price variations of fuels and exchange rate. In December, on the other hand, these rates declined as a result of the reduction of the prices of Diesel 2 and Residual fuels.

### Water:

The rate of water increased 18.9 percent mainly due to rises decreed by the regulating entity Sunass. The highest increase was approved in November to compensate Sedapal for the expenditure executed by this organization in terms of investment plans. The rest of price adjustments were associated with the increase of the wholesale CPI, which is one of the components of Sedapal's rate formula and which showed an accumulated variation of 8.79 percent in 2008.

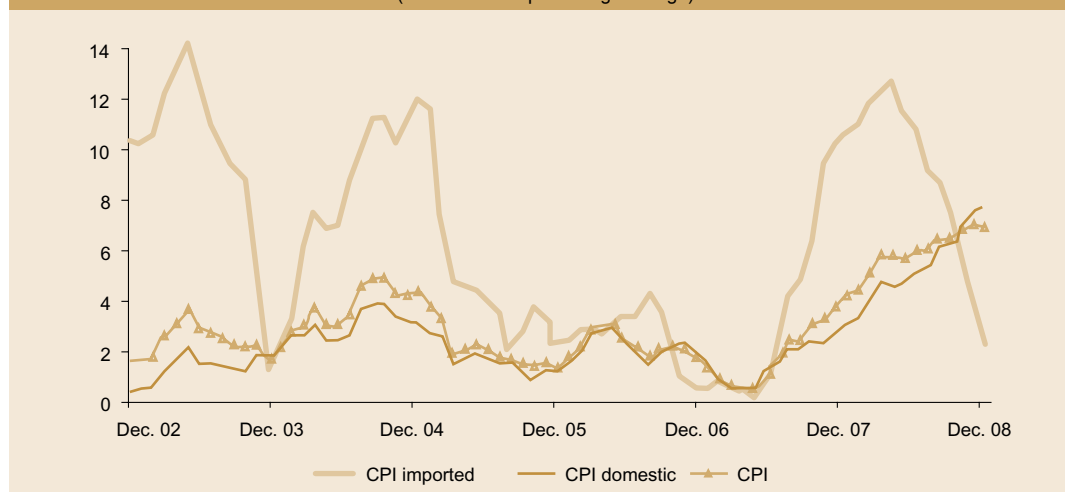
### Imported inflation:

Imported inflation recorded 2.2 percent. This rate is mainly explained by higher food prices (4.7 percent). Between January and October (4.5 percent), imported inflation showed an upward trend, declining thereafter between November and December (-2.2 percent). This evolution is associated both with the conduct of food prices (5.1 percent variation between January and October, and -0.3 percent variation between November and December) and with fuel prices (5.8 percent variation between January and October, and -5.5 percent variation between November and December).

TABLE 59  
DOMESTIC AND IMPORTED INFLATION  
(Cumulation percentage change)

	Weight	2002	2003	2004	2005	2006	2007	2008
<b>I. IMPORTED CPI</b>	<b>12.1</b>	<b>10.30</b>	<b>3.03</b>	<b>11.33</b>	<b>2.18</b>	<b>0.27</b>	<b>10.46</b>	<b>2.20</b>
Food	5.4	9.98	- 0.10	10.90	- 1.49	2.08	18.83	4.75
Fuel	3.9	15.60	8.94	17.77	6.89	- 1.50	6.45	- 0.04
Domestic appliances	1.0	3.42	- 1.91	- 2.83	- 1.23	- 1.29	- 1.50	- 0.06
Other	1.8	3.39	1.40	3.23	2.27	0.64	0.47	0.46
<b>II. DOMESTIC CPI</b>	<b>87.9</b>	<b>0.30</b>	<b>2.40</b>	<b>2.28</b>	<b>1.38</b>	<b>1.28</b>	<b>2.84</b>	<b>7.44</b>
<b>III. CPI</b>	<b>100.0</b>	<b>1.52</b>	<b>2.48</b>	<b>3.48</b>	<b>1.49</b>	<b>1.14</b>	<b>3.93</b>	<b>6.65</b>
<b>Exchange rate</b>		<b>2.29</b>	<b>- 1.23</b>	<b>- 5.48</b>	<b>4.36</b>	<b>- 6.40</b>	<b>- 7.00</b>	<b>4.47</b>
Non-food imported inflation	6.7	10.56	5.57	11.66	4.96	- 1.02	4.31	0.06
Food and beverage-related domestic inflation	42.1	- 0.73	2.18	3.04	1.52	1.72	4.14	10.53
Non-food domestic inflation	45.8	1.25	2.60	1.60	1.25	0.89	1.64	4.53

GRAPH 50  
INFLATION, DOMESTIC AND IMPORTED INFLATION  
(Last 12-month percentage change)



### Bread and pasta:

The prices of bread and pasta increased 1.6 percent and 6.5 percent, respectively. The price of wheat flour, the main input of these two foodstuffs, increased 43 percent in 2007 and 7 percent between January and April 2008, falling thereafter 13 percent between May and December 2008.

Moreover, the average price of wheat increased 27 percent in 2008. After climbing to a record of US\$ 477/ton on February 27, the price dropped over the year to a minimum low of US\$ 166/ton on December 4 –a level not observed since mid-2007. The declining trend shown by the price of wheat during most of the year was associated with two factors: favorable prospects for wheat production in Argentina, Australia, and the United States, and the slowdown of global demand.

### Edible oil

The accumulated increase of the price of edible oil at December 2008 was 20 percent. This price increased 25.9 percent between January and August and then fell 4.4 percent between September and December. This evolution was associated with the trend of the price of soybean oil –the main input used to elaborate oils–, although fluctuations in both prices showed different magnitudes. The international price of soybean oil increased 38 percent between January and June, but dropped 53 percent between July and December.