

Peru

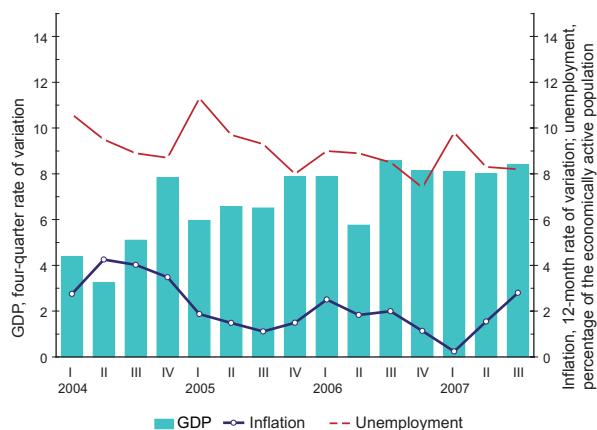
With economic expansion at 8.2%, the Peruvian economy enjoyed its fourth consecutive year of growth in excess of 5%. Domestic demand rose by more than 10%, and a further improvement in the terms of trade contributed to a fiscal surplus of 2%. Inflation picked up somewhat in the second semester, influenced by supply factors, and exceeded the ceiling of the inflation target range set by the Central Reserve Bank of Peru. The lessened buoyancy of the world economy is expected to lead to a worsening of the terms of trade in 2008, but domestic demand should remain strong, so there should be only a small decline in the growth rate, to about 6.5%.

In early 2007 a new standby drawing rights agreement was signed with the International Monetary Fund. To facilitate a significant increase in public investment, investments and transfers were excluded from the ceiling of 3% per year established under the Fiscal Responsibility and Transparency Act. Administrative measures were also taken to expedite public works. Furthermore, reconstruction work has to be undertaken following the August earthquake, which mostly affected the department of Ica. Although constraints relating to the efficient use of available funds persist, general government gross capital formation is estimated to have risen slightly in GDP terms. Since general government non-financial current expenditure fell in GDP terms, total general government spending is estimated to have dipped from 18.1% to 17.7% of GDP.

Revenue swelled considerably thanks to buoyant economic growth and the high prices of natural resources, which boosted income tax receipts. For the year as a whole, general government current revenue is expected to climb from 19.7% to 20.5% of GDP. As a result, the overall balance of the non-financial public sector, which had been forecast to be a 0.8% deficit, is now expected to post a larger surplus than in 2006. In 2008, the authorities are facing the challenge of improving

the inclusion of growing sectors of the population in the benefits of economic and social growth. Forecasts call for a smaller primary surplus and a slight overall deficit for the non-financial public sector, as a result of higher spending (especially capital spending), and zero growth in government revenue in GDP terms.

PERU: GDP, INFLATION AND UNEMPLOYMENT



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Given the favourable circumstances in 2007, the government stuck to its strategy of reducing the vulnerability associated with the public debt. In February, it bought back Brady bonds and global bonds due in 2012, replacing them with new bonds due in 2016, 2033 and 2037. In October it prepaid some US\$ 1.794 billion to Paris Club creditors, financing most of that amount by issuing bonds denominated in national currency. It is estimated that the public debt will fall from 32.7% to 28.4% of GDP.

The authorities retained the inflation target system, set in a range whose central value was reduced from 2.5% to 2% with a range of one percentage point on either side. The consumer price index (CPI) rose gradually in the course of the year and in October it exceeded the ceiling of the inflation target range. Although the increase was due more to supply factors (fuels, foodstuffs) than to demand pressure, the authorities, as a precaution, raised the benchmark interest rate in July and September, by 25 basis points each time, after having held it at 4.5% for 13 months.

Lending rates in national currency (fixed structure of rates) continued to decline gradually, from an average of 17.1% in 2006 to 16.4% (January to October 2007), but short-term rates rose from the third quarter onwards, in line with monetary policy. Credit to the private sector remained an engine of growth, with two-figure increases year-on-year throughout 2007 (18.5% year-on-year as of October).

The trend in the value of the dollar and the strength of the Peruvian external sector helped to bring about a gradual nominal appreciation of the new sol against the dollar throughout the year, a process which accelerated from September onwards. In October, real bilateral appreciation posted a year-on-year rate of 6.4%. However, owing to the appreciation of other currencies, the real effective exchange rate fell by only 0.7%. The authorities are facing the challenge of meeting the inflation target without spurring a greater real appreciation of the national currency.

The central bank intervened to restrain the real bilateral appreciation of the new sol by means of purchases totalling almost US\$ 9 billion. As a result, its net international reserves rose to US\$ 24.9 billion. To avoid a major inflationary effect, the total amount of deposit certificates was increased from about 8 billion new soles in late 2006 to almost 20 billion new soles in October 2007.

Of fundamental importance to Peruvian trade policy were the efforts to ensure approval by the United States Congress of the free trade agreement. That finally occurred in late 2007.

PERU: MAIN ECONOMIC INDICATORS

	2005	2006	2007 ^a
Annual growth rates			
Gross domestic product	6.7	7.6	8.2
Per capita gross domestic product	5.5	6.3	7.0
Consumer prices	1.5	1.1	3.5 ^b
Average real wage	-1.9	1.2	0.9 ^c
Money (M1)	29.1	18.0	26.5 ^d
Real effective exchange rate ^e	0.6	1.7	1.4 ^f
Terms of trade	7.3	26.5	7.1
Annual average percentages			
Urban unemployment rate	9.6	8.5	8.4 ^g
Central administration overall balance / GDP	-0.7	1.5	1.8
Nominal deposit rate	2.7	3.4	3.5 ^h
Nominal lending rate	17.9	17.1	16.5 ^h
Millions of dollars			
Exports of goods and services	19 657	26 251	31 057
Imports of goods and services	15 205	18 266	24 124
Current account	1 148	2 589	1 524
Capital and financial account	264	632	8 032
Overall balance	1 411	3 221	9 556

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary estimates.

^b Twelve-month variation to November 2007.

^c Year-on-year average variation, November 2006 to October 2007.

^d Twelve-month variation to September 2007.

^e A negative rate indicates an appreciation of the currency in real terms.

^f Year-on-year average variation, January to October 2007.

^g Estimate based on data from January to October.

^h Average from January to November, annualized.

The high level of economic growth (8.2%) was based on buoyant domestic demand, especially private investment, which rose by about 25% and was especially strong in mining and in activities related to the domestic market, such as construction. The marked growth of household consumption (over 7%) was mainly sustained by dynamic job creation and strong expansion of credit. Public investment rose throughout the year and eventually exceeded a 10% growth rate, while public consumption was up 3%. Exports once again grew at a moderate pace (5%), whereas imports rallied in response to soaring demand. The sectors which enjoyed the fastest growth included construction and non-primary manufacturing, which achieved two-figure rates.

Rapid economic growth encouraged the creation of formal jobs (8.2% in the first eight months of the year). Aggregate employment also rose, but the unemployment rate showed little change owing to a considerable increase in labour supply

as unemployment and underemployment levels remained high, workers' incomes stagnated. To boost low incomes, increases in the minimum wage totalling 10% were announced for October 2007 and January 2008.

Traditional exports were affected by a fall in gold production, but this was more than compensated for by the favourable trend in prices. In the first three quarters, traditional exports were up by 17% and non-traditional exports by 20%. For the year as a whole, the increase in external sales is estimated at

17% and that of imports at 33%, with a very strong performance by capital goods purchases (close to 50%), encouraged by tariff reductions. As a result, there were smaller surpluses on the trade balance and the current account. The latter fell from 2.8% to about 1.6% of GDP.

There were copious financial flows, particularly in the form of foreign direct investment. These were partly counteracted by the reduction of public sector external debt. Estimates place the financial account surplus at around US\$ 8 billion.