

## Peru

The economic performance of Peru was characterized by buoyant domestic demand and a deterioration in external conditions. This included inflationary pressure, a fall in the terms of trade, strong capital movements that pushed up exchange-rate volatility and —towards the end of the year— a worsening of financing conditions and considerable uncertainty surrounding the future of global markets. Be that as it may, GDP growth once more accelerated to over 9%, spearheaded by investment and private consumption. Inflation, which had already exceeded the target range by the end of the previous year, rose throughout the year and is expected to stand above 6% in December.

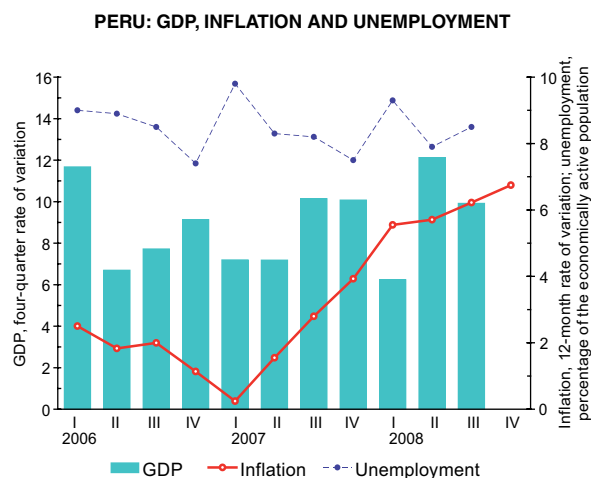
Buoyant imports and the worsening terms of trade resulted in a current account deficit equivalent to close to 4% of GDP. However, high foreign investment led to another expansion of net international reserves. The difficult global situation and higher interest rates point to a smaller expansion of economic activity of about 5% in 2009. Inflation is expected to decline gradually and approach the target range by late 2009.

In the first half of the year, the main challenges of economic policy were the rise in inflation and currency appreciation. In the second half, the authorities endeavoured to contain the impact of the international financial crisis on the Peruvian economy.

To ensure that price rises in mainly imported products such as fuel and food were prevented from generating expectations of across-the-board increases in consumer prices, the benchmark interest rate was raised several times from 5.0% at the beginning of the year to 6.5% in September. As interest rates were lowered in the United States at the same time, this attracted short-term capital inflows that brought down the exchange rate. To offset this trend and halt the credit expansion, on several occasions the authorities increased the legal reserve requirement (from 6% to 9%) and the marginal reserve requirement (to 25% for local currency and 49% for foreign currency), while the fee for transactions by non-residents was raised as well. Also in the first half of the year the central bank acquired US\$ 8.7 billion, bringing its reserves to US\$ 35.5 billion.

This successfully put an end to short-term capital inflows and to the appreciation of the new sol. However, in a context of high economic growth and the swelling ranks of debtors, those measures failed to stop the financial system's credit to the private sector from expanding rapidly (28.5% in mid-October).

Using fiscal policy to curb inflation, the authorities raised the target for the surplus of the non-financial public sector (NFPS) to 2.7% of GDP. High economic growth contributed to a new real increase in fiscal receipts (8%



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

up to October), although this was less dramatic than in previous years. Total receipts from the general sales tax expanded by 20% in this period, while real receipts from income tax edged up only slightly (mainly on account of lower prices for exports of natural resources). As a result, the central government's income as a proportion of GDP is expected to fall moderately for the year as a whole.

Efforts to step up public investment continued. Up to October, central government capital expenditure grew by 32% in real terms, while current expenditure as a proportion of GDP fell owing mainly to lower interest payments. This development boosted the resources of the fiscal stabilization fund, which will in turn facilitate the implementation of counter-cyclical policies in case the external crisis has a higher-than-expected impact on the Peruvian economy.

The deepening of the United States financial crisis and the contagion of other markets were reflected from September in a sharp downturn of stock-market indicators, more expensive external credit (higher country risk rating) and an increased preference for liquidity in dollars, which increased their proportion of total liquidity in the financial system from 29.6% in August to 36.2% in October. In a bid to increase the financial sector's liquidity, the authorities adopted a number of measures: by November they had sold off US\$ 5.685 billion of previously accumulated reserves; long-term credit from abroad was exempted from the reserve requirement; and the marginal reserve requirement was eliminated for local currency and reduced to 35% for foreign currency.

Nonetheless, the new sol depreciated in the second half of the year, and in October the real bilateral exchange rate against the dollar was similar to the level recorded in the same month of the previous year, although the average for the year shows an appreciation. As for the real effective exchange rate, the appreciation was more significant (around 4% in October) and held steady until the end of the year.

Approval by the Congress of the United States has paved the way for the entry into force of the free trade agreement with that country in 2009, when a similar agreement with Canada will also come into effect. Negotiations with China were being concluded towards the end of the year.

Despite slower growth in the final quarter, GDP has expanded by more than 9% on the strength of domestic demand, fuelled by a strong increase in private investment (around 25%) and public investment (over 50%) and a significant rise in household consumption (about 8%). In addition, export figures were higher than in the previous year, although some loss of dynamism could be seen towards the

#### PERU: MAIN ECONOMIC INDICATORS

	2006	2007	2008 <sup>a</sup>
<b>Annual growth rates</b>			
Gross domestic product	7.6	8.9	9.4
Per capita gross domestic product	6.3	7.6	8.2
Consumer prices	1.1	3.9	6.7 <sup>b</sup>
Average real wage	1.2	-1.8	2.6 <sup>c</sup>
Money (M1)	22.4	30.7	27.3 <sup>d</sup>
Real effective exchange rate <sup>e</sup>	2.8	1.0	-3.3 <sup>f</sup>
Terms of trade	26.5	3.6	-7.0
<b>Annual average percentages</b>			
Urban unemployment rate	8.5	8.4	8.3 <sup>g</sup>
Central government overall balance / GDP	1.5	1.8	2.3
Nominal deposit rate	3.4	3.5	3.3 <sup>h</sup>
Nominal lending rate	17.1	16.5	16.7 <sup>h</sup>
<b>Millions of dollars</b>			
Exports of goods and services	26 447	31 298	35 868
Imports of goods and services	18 295	23 870	34 772
Current account	2 757	1 505	-5 635
Capital and financial account	-30	8 082	9 095
Overall balance	2 726	9 588	3 460

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

<sup>a</sup> Preliminary estimates.

<sup>b</sup> Twelve-month variation to November 2008.

<sup>c</sup> Figure for June.

<sup>d</sup> Twelve-month variation to October 2008.

<sup>e</sup> A negative rate indicates an appreciation of the currency in real terms.

<sup>f</sup> Year-on-year average variation, January to October.

<sup>g</sup> Estimate based on data from January to October.

<sup>h</sup> Average from January to November, annualized.

end of the year. Meanwhile, rising domestic demand boosted imports, which expanded by over 20% in real terms.

Higher prices for imported food and fuel contributed to a steeper rise in the consumer price index (CPI), which in November stood at 6.75% (clearly exceeding the inflation target ceiling of 3%). The fall in international prices and a moderate slackening of domestic demand are expected to help bring down inflation gradually during 2009.

High economic growth stimulated labour demand and between January and September employment in formal enterprises climbed by 8.9%, albeit with decreasing rates from the middle of the year. There was a decline in employment in microenterprises and own-account work, such that the employment rate in metropolitan Lima dropped by 0.4 percentage points in the first three quarters of the year and the unemployment rate only remained virtually unchanged thanks to a fall in labour-force participation. Despite the rise in inflation, real wages grew by 2.6% (June).

The buoyancy of merchandise imports and the widening deficit on the commercial services account contributed to the significant narrowing of the trade surplus from 6.9% of GDP in 2007 to approximately 1% in 2008; another contributing factor was the worsening of the terms of trade (down an estimated 7% for the year as

a whole), which was a turnaround of the trend observed since 2002. Given the continuing high transfers from the factor income account, the current account surplus of the last four years gave way to a deficit equivalent to approximately 4% of GDP.

The private sector received considerable capital inflows (particularly in the form of foreign direct investment),

while the public sector continued the policy of reducing its external debt, with advance payments made to the Andean Development Corporation and in Brady bonds. The net effect of rising private external debt and shrinking public external debt was a drop in total external debt from 30.3% of GDP in late 2007 to 27.8% at the end of the third quarter of 2008.