

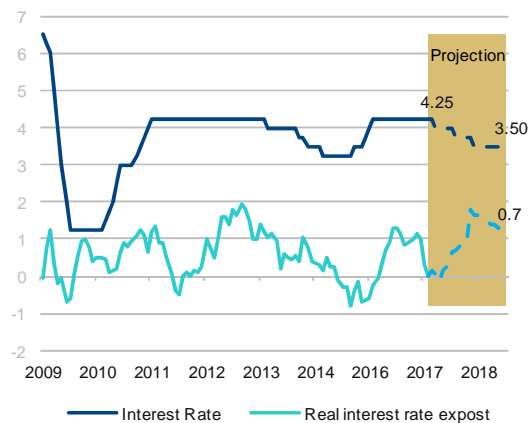
8. Monetary policy: Central bank reveals a more dovish stance

As expected, at its meeting early in April the Central Reserve Bank held its reference rate at 4.25%. The most noteworthy event at the same, however, came in a statement issued after the meeting. In it, the Central Reserve Bank indicated that it is waiting for the recent supply impact that affected inflation to cut its monetary policy rate in the short term.

Indeed, in the YoY inflation figure in March stood at 4%, a percentage point above the target rate, provisionally speeding up owing to food supply shortages (see Section 7 for greater detail). The macroeconomic environment facing the Central Bank is also characterised by the weakness of the economy, which has worsened throughout the first quarter, particularly in March, owing to weather problems. We should also add here the significant drop in business confidence, which fell from 55 points in February to 44 points in March (in the pessimistic bracket). Finally, given that the fiscal incentive tied to restoration and reconstruction work on the infrastructure damaged by *El Niño Costero* is going to be delayed, the counter-cyclical policies are currently falling on the Central Bank.

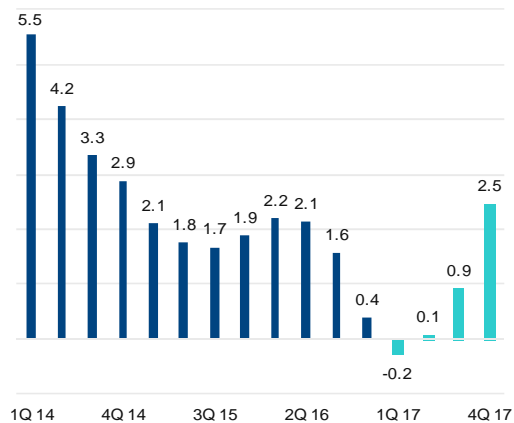
The weakness of the economy, the drop in business confidence and the delay in implementing the fiscal drive suggest that the Central Bank needs to cut back on its rate to enable it to support private sector expenditure. However, the speeding up of the inflation rate – albeit for provisional supply shortages, but which is contaminating inflationary expectations – is complicating the the monetary authority's decision. We believe that the key to when we might see a cutback on the reference rate lies in identifying the moment in which the YoY inflation figure will begin to fall. According to our inflation predictions for the coming months, it is likely that this will speed up in April but will later begin to fall back in May. Consequently, bearing in mind (i) the dovish trend disclosed by the Central Reserve Bank (rendering monetary policy flexible in the short term, conditioning it on a reversion of the supply impact that has provisionally increased inflation) and (ii) our inflation forecasts, we believe that we are likely to see a cut of 0.25% in the reference rate in June (see Figure 8.1). Given the greater cyclical weakness shown by the economy (see Figure 8.2), we also expect a further 0.25% reduction in the second half of the year.

Figure 8.1 Reference interest rate (%)



Source: Central Reserve Bank of Peru and BBVA Research.

Figure 8.2 Internal demand (accumulated over the last four quarters, excluding inventories, YoY % variation)



Source: Central Reserve Bank of Peru and BBVA Research.

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