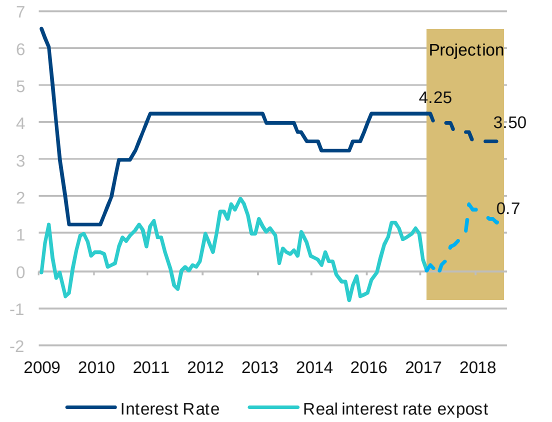
8. Monetary policy: Central bank reveals a more dovish stance

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.

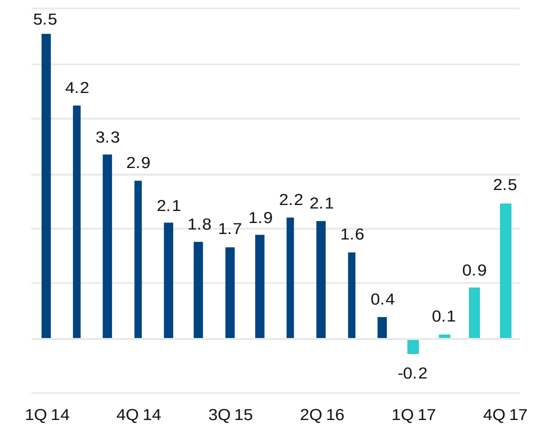
The weakness of the economy, the drop in business confidence and the delay in implementing the fiscal drive suggest that the Central Bank needs to cut back on its rate to enable it to support private sector expenditure. However, the speeding up of the inflation rate – albeit for provisional supply shortages, 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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This report has been produced by the Peru Division

Head Economist, Peru
Hugo Perea
hperea@bbva.com
+51 1 2112042

Francisco Grippa
fgrippa@bbva.com

Ismael Mendoza
ismael.mendoza@bbva.com

Yalina Crispin
yalina.crispin@bbva.com

Marlon Broncano
marlon.broncano@bbva.com

Vanessa Belapatiño
vanessa.belapatino@bbva.com

BBVA Research

Chief Economist BBVA Group
Jorge Sicilia Serrano

MACROECONOMIC ANALYSIS
Rafael Doménech
r.domenech@bbva.com

Global Economic Situations
Miguel Jiménez
mjimenezg@bbva.com

GLOBAL FINANCIAL MARKETS
Sonsoles Castillo
s.castillo@bbva.com

Long-Term Global Modelling and Analysis
J. Julián Cubero
juan.cubero@bbva.com

Innovation and Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

FINANCIAL SYSTEMS AND REGULATION
Santiago Fernández de Lis
sfernandezdelis@bbva.com

International Coordination
Olga Cerqueira
olga.gouveia@bbva.com

DIGITAL REGULATION
Álvaro Martín
alvaro.martin@bbva.com

Regulation
María Abascal
maria.abascal@bbva.com

FINANCIAL SYSTEMS
Ana Rubio
arubiog@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Spain and Portugal
Miguel Cardoso
miguel.cardoso@bbva.com

United States
Nathaniel Karp
Nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Middle East, Asia and Geopolitical
Álvaro Ortiz
alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

Asia
Le Xia
le.xia@bbva.com

South America
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

ENQUIRIES TO: BBVA Research Peru Av. República de Panamá 3055, San Isidro, Lima 27, Peru. Tel: + 51 12112042-bbvaresearch@bbva.com
www.bbvaresearch.com