



Financial Observatory

April 22, 2009

Foreign currency credit flow turned out to be negative in March

- In March, the monthly foreign currency credit flow in was negative by US\$270 million. This contrasts the positive flows recorded for the same month in previous years. The result mainly appears to reflect the slump in loans for foreign trade in a climate of less global trade exchange. Also, domestic currency credit rose by S/.835 million in March, a greater flow than those recorded the previous two months. For the rest of the year, we expect the credit downturn to continue due to flatter economic activity.
- Corporate and commercial loans interest rates in domestic currency continued to fall, due to the Central Bank's (BCR) policy interest rate cut. Over the coming months we expect that a greater easing of the monetary policy stance will result in interest rate cuts, with a greater downward effect on those loans with shorter terms and granted to lower-risk customers.
- The BCR has set up a new monetary policy instrument, which consists of repurchase agreements loans awarded by Financial System Firms (FSF). This will allow liquidity to be injected into smaller FSFs, in a situation in which the monetary policy rate will continue to fall dramatically over the coming months.

Foreign currency credit squeeze in line with global trade downturn

In March, the **foreign currency credit flow** was US\$-270 million. By component, the greatest dollar credit squeeze over recent months was mainly recorded in the trade sector, especially credits for foreign trade transactions (which represent around 18% of the stock of commercial credit in dollars). This performance of loans for foreign trade is taking place in a context of global trade downturn. On the other hand, the credit flow for leasing transactions, closely tied in with private investment, continued on the downward trend that had been experienced since the end of last year.

The **balance of domestic currency credit** continued to rise in March (positive flow of S/.835 million). Personal loans (which includes consumption and mortgage loans) recorded the highest flows, which should provide some support for private consumption and real estate demand. The sharp growth recorded in local currency vehicle loans, which used to be paid out in foreign currency, is worthy of mention and is related to the climate of uncertainty regarding the exchange rate's performance in the future.

On the aggregate level, **overall credit** showed a negative flow of S/.18 million in March, a result that had not been witnessed since August 2006.

Hugo Perea

hperea@grupobbva.com.pe

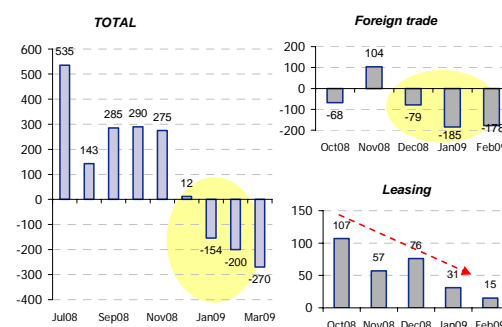
Francisco Grippa

fgrippa@grupobbva.com.pe

Rosario Sánchez

rdpsanchez@grupobbva.com.pe

Table 1: Dollar credit flow (US\$ million)



Source: SBS

Prepared by: BBVA Banco Continental ERD

In light of these results, the foreign currency credit balance accrued a fall of US\$624 million during the first quarter, and domestic currency recorded growth of S/. 2.063 billion in the same period. This credit performance YTD is mainly related to the aggregate demand slowdown than to a seasonal effect. By production sector, the reduction in credit flows is more noticeable in the case of construction, manufacturing, and trade, closely related to exports and the downturn in private investment.

In addition, in y-o-y terms, lending growth 36% in March, which mainly reflects the sharp growth rate in 2008, especially in October of that year. In the credit performance analysis, the y-o-y growth rate data is not very informative at the moment because it does not properly include the squeeze in the foreign currency balance, for example.

For the coming months, credit is expected to carry on mirroring the curb in economic growth, especially the downturn in foreign demand, private investment and private consumption expenditure. The following will act as prop-ups: (i) a forecast policy interest rate cut, which due to its size will not only affect short-term interest rates and low-risk customers, but also other rates in the system; and (ii) the positive externalities that the fiscal stimulus (Economic Stimulus Package) will generate for private spending.

Monetary policy easing is starting to affect domestic currency lending rates

In February and March, the Central Bank cut its policy rate by 25 basis points each month, whereas in April the cut was more aggressive, i.e. 100 bp.

This BCR's monetary policy easing has led to cuts in **local currency corporate and trade rates**. In the future, these rates will continue to record a downtrend because the BCR has hinted that it will carry on easing the monetary policy, in a climate of a greater-than-expected economy slowing and less inflationary pressure and expected inflation.

Meanwhile, upturns in both **domestic and foreign currency consumption loan** interest rates were recorded. This could be a sign of the greater risks related to this sector, in light of the curb in employment growth and consequently in households income.

As for **corporate foreign currency rates**, these continued to fall, into line with foreign interest rates (especially the Federal Reserve's policy rate).

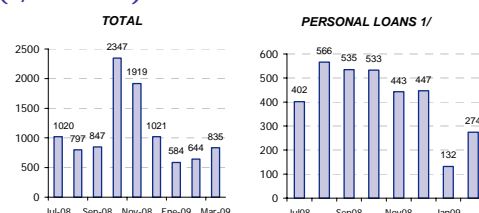
Liquidity: the BCR has set up a new monetary policy instrument, repurchase agreements loans awarded by Financial System Firms (FSF)

As the Central Reserve Bank Board Chairman had announced earlier, a new liquidity injection instrument has been set up: purchasing with repurchase agreements for loans awarded by Financial System represented by bearer certificates. These transactions can be in the form of auctions and direct purchases, and banks, financial corporates, municipal savings and credit banks, and popular municipal credit banks can participate in them.

The loans that financial system companies submit for these transactions must fulfill the following requirements:

- Be represented by promissory notes or bills, or other bearer certificates that the BCR allows.
- 100% normal ranking for main debtors.
- The securities backing them must remain valid for the duration of the repo operation and comply with specific terms and conditions.
- They must not be subject to charges or levies.
- They must have an outstanding balance (individually) of equal to or more than S/.20 thousand and a due date that is later than the end of the repo operation. When the BCR sees fit, it will allow the portfolio to be included in foreign currency and will set the minimum amount for the outstanding balance.
- They must not be for companies linked to the FSF or its main duties.

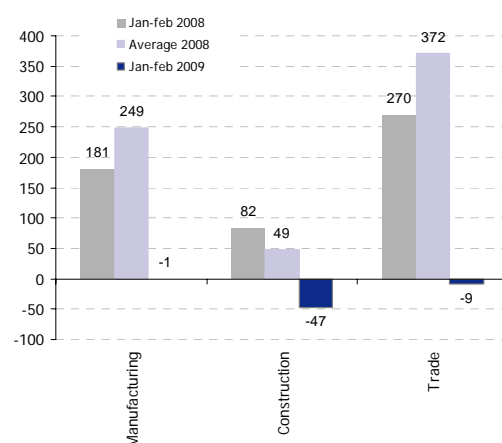
Table 2: Local currency credit flow (S/. million)



1/Includes consumption and mortgage loans.

Source: SBS
Prepared by: BBVA Banco Continental ERD

Table 3: Credit flows by sector (S/. million)



Source: Asbanc
Prepared by: BBVA Banco Continental ERD

Table 4: Interest rates by loan type* (%)

	Domestic currency					Ch. % Feb-april
	21 April 09	Mar-09	Feb-09	Dec08	Dec07	
Corporate 90 d.	6.5	6.9	7.2	7.5	5.6	-0.7
Commercial	10.3	10.8	11.2	11.0	8.8	-0.9
Small business	32.1	32.1	33.7	35.3	34.3	-1.7
Consumer	43.1	42.2	41.6	37.8	34.7	1.6
Mortgage	11.4	11.5	11.8	11.4	9.3	-0.4
	Foreign currency					
	21 April 09	Mar-09	Feb-09	Dec08	Dec07	
Corporate 90 d.	2.9	3.2	3.3	5.2	6.0	-0.4
Commercial	8.5	8.6	9.0	9.3	9.0	-0.5
Small business	22.9	23.1	23.6	23.9	20.3	-0.7
Consumer	22.5	22.4	22.4	20.8	15.8	0.1
Mortgage	10.8	10.7	10.6	10.8	9.6	0.1

*Average of transactions undertaken over the last 30 working days.

Source: SBS
Prepared by: BBVA Banco Continental ERD

Setting up this instrument will allow the Central Bank to inject liquidity, especially for smaller financial corporates (in a climate of a heavily slowing economy in which the BCR has eased its monetary policy aggressively) when: (i) the BCR's balance of certificates, with which it undertakes repos (around S/.8.6 billion) is concentrated in few financial institutions, especially in larger ones and, (ii) the possibility of undertaking repos with government securities is subject to the legal limit that the Central Bank has to purchase government paper (the maximum purchase for one year is equal to 5% of the monetary base balance at the end of the previous year, which is around S/. 1.1 billion).

It is also worth mentioning that the Central Bank was already authorized to accept this type of holding assets, although under the form of rediscounts, to support temporary liquidity. Now this instrument is also part of open market operations.

Financial Indicators

The banking system's financial indicators continue to show strength, which will allow it to deal with a further downturn. In this regard, profit in the banking system in February measured against assets was 32% and liquidity levels, both domestic currency (22%) and foreign currency (59%), remained above minimum legal requirements (8% and 20%, respectively). In addition, the default rate uptrend came to a stop in March (decreasing from 1.43% in February to 1.41% in March), reflecting the preventive measures and effective risk management undertaken in the banking sector.

Appraisal

The economy is still slowing down due to less foreign demand, the inventory adjustment and a more cautious approach shown by corporates and consumers. In this climate, bank credit flows are continuing to fall (in the case of foreign currency the credit flows are negative, which was not recorded for similar periods in previous years). By financial product, this is reflected in loans for foreign trade and leasing, while by production sector lower credit flows for manufacturing, construction and trade, mainly, stand out. To offset this effect, the Central Bank has cut its policy rate and will continue to do so in the future, in order to keep up the credit demand. This will be achieved insofar as the lower policy rate spreads to other credit rates significantly and quickly. In light of the sharp lending growth recorded in previous months and the strength of the Peruvian banking system's financial indicators, we do not expect problems for the banking sector in the short term.

Table 5: Financial system company loans

HOLDING IN LOCAL CURRENCY AND BY PRODUCT*
(S/. millions)

	Bank	Municipal credit and savings institutions*	Financial institutions	
Current accounts	38,122	4,904	1,836	
Credit cards	463	0	0	Commercial credit would be about 54%
Discounts	7,408	0	357	
Factorings	1,412	0	0	
Leasing	302	0	0	Commercial credit would be about 22%
Loans	20,069	4,702	1,303	
Mortgage	3,743	62	146	
Foreign trade	877	0	0	Commercial credit would be about 4%
Others	791	139	28	

* Includes the Caja Metropolitana de Lima.

AVERAGE LOAN AMOUNT*
(S/. thousands)

	Banks	Municipal credit and savings institutions	Financial institutions
Commercial	599	93	25
Small business	10	6	5
Consumer	4	4	1
Mortgage	105	53	20

* To be able to undertake purchase transactions with a holding repurchase agreement, the amount of each loan must be equal to or more than S/.20 thousand.

Source: SBS

Prepared by: BBVA Banco Continental ERD

Table 6: Financial indicators

	Feb	Jan
Leverage (times)	8.4	8.4
Non performing loans / Total loans (%)	1.4	1.3
Provisions / non performing loans (%)	240.9	249.3
Operative expenses / Total financial margin (%)	40.5	40.4
ROE (%)	32.0	31.5
ROA (%)	2.6	2.6
Liquidity in local currency (%)	22.0	26.2
Liquidity in foreign currency (%)	58.6	55.1

Source: SBS

Prepared by: BBVA Banco Continental ERD