

Peru is a developing country with a Gross Domestic Product(GDP) of \$181.1 billion USD in 2006. About half of its citizens are living below the poverty line, with about twenty percent being extremely poor. However, due to government interventions and reforms, Peru has been experiencing economic growth since the early 1990's. Foreign direct investment in Peru and international reserve transactions conducted by the Banco Central de Reserva del Peru, were the two largest components, within the factors of this report, making up over 40% of GDP. If you refer to the attached graph showing major Balance of Payments components as a percentage of GDP, you'll see that the country's imports exceeded its exports until early 2001. At this time, exports soared above imports and in 2004 and 2005 the country was running a trade surplus. Peru's current account balance improved dramatically over the ten year period, going from - 8.63% of GDP in 1995 to a positive 1.45% in 2005. From 1995 to 2003, Peru had a deficit in their current account balance, but ran a surplus in 2004 and 2005 largely due to an increase in exports. Their exports went from 10.25% of GDP in 1995 to 18.36% in 2004 and 21.87% in 2005. Reversely, Peru's imports fell from 14.43% of GDP in 1995 to 13.37% in 2003 then inched back up to 15.21% in 2005. One exogenous factor that negatively affected Peru's economy in 1998 was the severe weather that ravaged the country caused by El Nino. The financial account dropped more than 6% during the year of the storms and exports hit a ten year low at 10.13% of GDP.

Over the last decade, Peru's direct foreign investment abroad has been minimal. There is substantially more direct foreign investment as an outflow for Peru. Peru's direct investment abroad has been stagnant with a marginal increase in 2005. The percentage of GDP of other

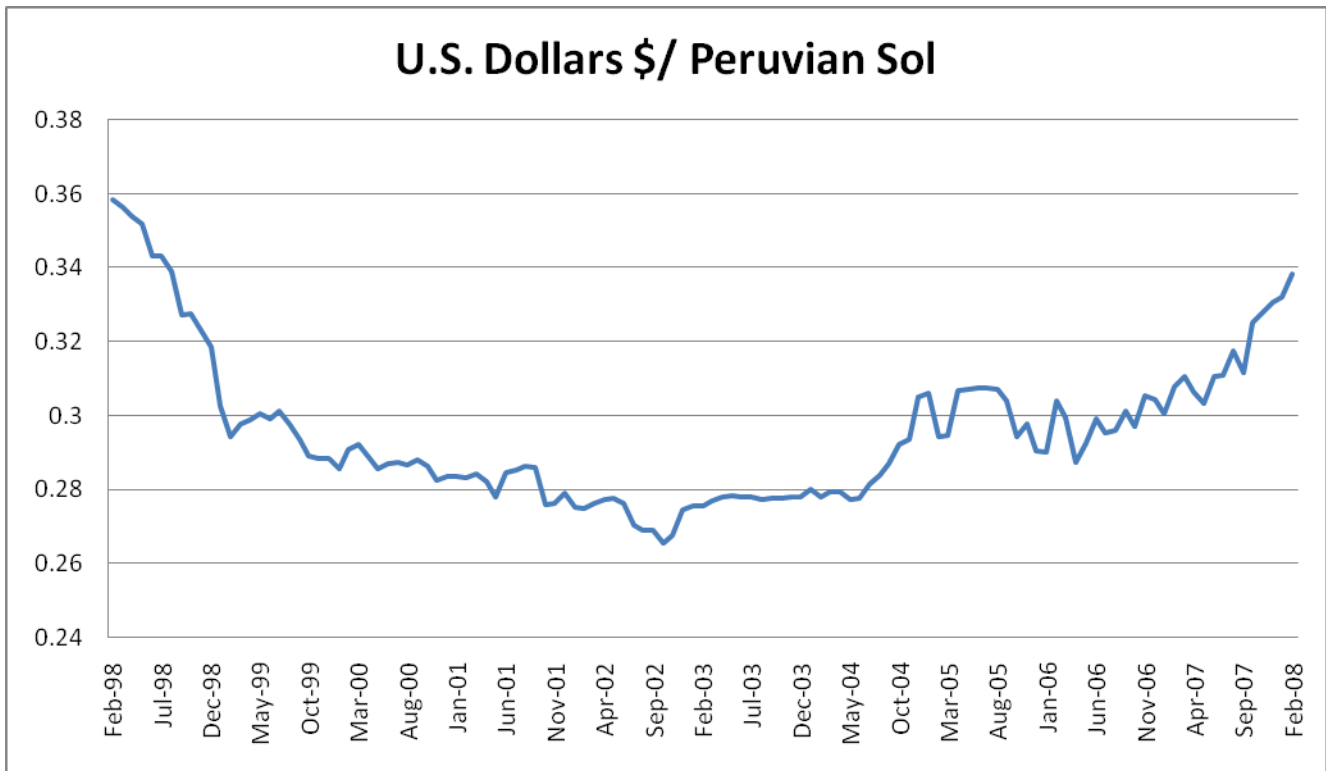
countries investing in Peru, however, has jumped 10% over an eight year period, from 21.06% in 1998 to 31.48% in 2008.

Peru's service debits have exceeded its credits over the past decade. Services aren't a major component of the country's balance of payments, as you can see the steady line just under zero percent of GDP. This is due to the deficit in the service sector for Peru. Peru's inflow of current transfers has exceeded its outflow. Over the last 10 years, its current transfer credits have steadily increased reaching \$1.7 billion in 2005, while its current transfer outflow has slimmed down to just \$6 million in the same year. Its impact on GDP is small, only accounting for about 1.5% to 2.25% from 1995 to 2005.

Peru's central bank international reserve assets represent a large portion of the percentage of GDP. Their international reserve assets have been slightly volatile between 1995 and 2005. International reserve assets were about 21% of GDP and jumped up 7% over the next couple of years, but then began dwindling from beginning of 1998 to 2000. For the next 5 years, they increased steadily back to 28% of GDP in 2005. The rapid drop in international reserve assets in 1998 may be due to emergency funding needed to repair damaged caused by the series of El Nino storms.

The direct exchange rate between the U.S. dollar and the Peruvian Sol was .338\$/sol as of February 20, 2008. The attached graph includes the monthly exchange rates for one unit of the Peruvian Sol to the amount in U.S. dollars from February 1998 to February 2008. The sol reached its lowest value against the dollar at .275\$/sol and its highest value at .359\$/sol. Since the exchange rate is quoted directly, the value of the Sol is higher when the exchange rate is .359\$/sol, because that means it takes .359\$ USD to purchase one Peruvian sol. If it costs .275\$ USD in the foreign exchange market to purchase one sol, it costs less dollars to purchase one unit

of Peruvian currency and the sol has depreciated in value. The graph shows the trend of the sol to the dollar over the past decade. When the line falls, the sol is depreciating against the dollar and a rise in the line indicates the sol appreciating in value. As you can see, the sol was at its lowest value against the dollar from about the end of 2002 until about the middle of 2004. Starting in June 2006, the sol rapidly appreciated against the dollar. This may be consistent with the housing bubble and credit crisis that has caused the Fed to lower the Federal Funds rate and cause interest rates to drop and the dollar to depreciate against other foreign currencies.



References

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