



PERU

January 2020

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF STATEMENT AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PERU

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Peru, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 8, 2020 consideration of the staff report that concluded the Article IV consultation with Peru.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 8, 2020, following discussions that ended on November 18, 2019, with the officials of Peru on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 16, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Peru.

The document listed below have been or will be separately released.

Selected Issues

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IMF Executive Board Concludes 2019 Article IV Consultation with Peru

On January 8, 2020, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Peru.

Peru continues to be one of the best-performing Latin American economies. With annual real GDP growth averaging 5.4 percent over the past fifteen years, Peru has been one of the fastest-growing economies in the region, which enabled it to make significant progress in reducing poverty. A sound macroeconomic policy framework has supported growth and helped build and maintain large policy buffers.

Nonetheless, a less benign external environment and adverse domestic factors have caused growth to lose momentum in recent years, and productivity has disappointed. Trade tensions have reduced global growth and increased uncertainty, international financial markets have become more volatile, and commodity prices have only partially recovered from the 2011–15 decline. Domestically, the adverse 2017 El Niño weather event caused significant economic disruption and the findings of the Lava Jato investigation hampered large investment projects.

Against this backdrop, growth in 2019 has largely underperformed, and is projected to close at just 2.4 percent. The economy is, however, expected to gradually recover, with a strengthening of demand from Peru's trading partners, higher execution of the public investment budget, and resilient private consumption and investment all helping to raise GDP growth to 3¼ percent in 2020 and 3¾ in the following years. Inflation is expected to remain anchored within the central bank's 1–3 percent target range.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment²

Directors commended Peru for continuing to be one of the best-performing economies in Latin America, despite the recent growth deceleration. Noting the country's strong policy buffers and long track record of prudent economic policies, Directors indicated that the authorities would be in a strong position to mitigate the potential impact of any external and domestic risks to the Peruvian economy. In that context, Directors encouraged the authorities to provide short-term policy stimulus to support the recovery as well as undertake growth-enhancing structural reforms to address productivity and infrastructure gaps. They also called for measures to improve governance, and implementation of social protection policies to achieve strong and inclusive growth that would help the country converge to higher income status.

Directors commended the authorities' strong fiscal position demonstrated by low and sustainable public debt and ample fiscal buffers. However, given pro-cyclical fiscal policy and significant infrastructure gaps, Directors called for further efforts to address low capital budget execution that hamper Peru's productivity and competitiveness. In this context, Directors welcomed the recently announced relaxation of the deficit ceiling for the 2021-23 period and the intent to use the extra room for public investment. Noting that frequent modifications of the fiscal rule could undermine its credibility, Directors encouraged the authorities to consider introducing additional flexibility to the fiscal framework rather than relying on periodic modifications of the deficit ceiling. Over the medium term, Directors also encouraged enhanced domestic revenue mobilization, especially in terms of VAT compliance and tax administration, and lower current spending to create space for much needed infrastructure and social spending.

Directors welcomed the renewed monetary easing implemented in the second half of 2019 and suggested that the policy stance should continue to be data-driven while remaining vigilant against the emergence of financial sector vulnerabilities. As dollarization declines, Directors also saw room for additional exchange rate flexibility to absorb shocks and promote financial market development while stressing that foreign exchange interventions should be limited to addressing disorderly market conditions. Also, the remaining non-binding capital flow measure should be phased out.

While commending the authorities' actions to strengthen financial sector supervision, including through progress in implementing the 2018 FSAP recommendations, Directors encouraged further efforts to deepen the legislative and regulatory agenda and improve the effectiveness of the AML/CFT framework.

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Directors welcomed the authorities' efforts to improve governance and transparency under the *Anti-Corruption 2018-21 Plan* and called for continued efforts in this area, including limiting the scope for corruption, through independent audits, procurement system simplification and judicial reforms.

Directors welcomed the authorities' structural reform agenda under the *National Plan for Competitiveness and Productivity*, to boost potential growth and achieve sustainable income convergence. Priorities include reforming the legal system and product markets, addressing labor market rigidities and enhancing integration of migrant workers, which would also help address informality and promote more inclusive growth. Directors also encouraged further efforts to improve social welfare, including through pension system reforms, to ensure adequate social protection, a more equitable distribution of natural resource revenues across regions, and deepening financial development and inclusion.

Peru: Selected and Economic Indicators

		Projections			
	2018	2019	2020	2021	2022
Social Indicators					
Poverty rate (total) 1/	20.5	...	...	...	...
Unemployment rate	6.7	...	...	...	...
(Annual percentage change; unless otherwise indicated)					
Production and prices					
Real GDP	4.0	2.4	3.2	3.7	3.7
Real domestic demand	4.2	3.3	3.2	4.0	3.9
Consumer Prices (end of period)	2.2	1.9	2.0	2.0	2.0
External sector					
Exports	8.0	-5.4	3.5	4.3	4.8
Imports	8.1	-1.7	2.7	4.8	5.6
External current account balance (% of GDP)	-1.6	-1.8	-1.6	-1.4	-1.3
Gross reserves					
In billions of U.S. dollars	60.3	68.1	68.1	68.1	68.1
Percent of short-term external debt	363.5	460.9	465.7	462.2	449.7
Money and credit 2/ 3/					
Broad money	9.5	8.3	8.0	8.0	7.8
Net credit to the private sector	10.3	7.3	6.9	7.1	6.6
(In percent of GDP; unless otherwise indicated)					
Public sector					
NFPS Revenue	24.5	25.1	25.4	25.7	25.7
NFPS Primary Expenditure	25.4	25.4	25.4	25.2	25.2
NFPS Primary Balance	-0.9	-0.3	0.0	0.5	0.5
NFPS Overall Balance	-2.3	-1.7	-1.5	-1.0	-1.0
Debt					
Total external debt	34.5	35.4	34.8	33.6	32.5
NFPS Gross debt (including Rep. Certificates)	26.2	26.8	27.0	26.6	26.1
External	8.8	9.6	9.7	9.5	9.1
Domestic	17.3	17.3	17.4	17.2	17.0
Savings and investment					
Gross domestic investment	21.5	22.1	22.3	23.1	23.6
National savings	19.9	20.3	20.8	21.7	22.3
Memorandum items					
Nominal GDP (S/. billions)	741	774	816	864	916
GDP per capita (in US\$)	7,005	7,097	7,292	7,597	7,926

Sources: National authorities; UNDP Human Development Indicators; and IMF staff estimates/projections.

1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.

2/ Corresponds to depository corporations.

3/ Foreign currency stocks are valued at end-of-period exchange rates.



PERU

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

December 16, 2019

KEY ISSUES

Context. Peru's economic performance continues to be strong, but external and domestic headwinds, including the fallout from *Lava Jato* corruption investigations, have reduced growth momentum and raised concerns about long-term growth prospects. Policy responses have been appropriate, but further reforms have been delayed by a political stalemate between the executive and legislative powers. After President Vizcarra dissolved Congress in September 2019, new parliamentary elections will be held in January 2020.

Outlook and Risks. Hit by adverse temporary factors in the first part of the year, growth is expected to reach only 2.4 percent in 2019. It should strengthen to 3.2 percent in 2020, underpinned by some improvement in net exports and resilient private demand. Over the medium term, growth would converge to its potential rate of 3½ percent. Peru is exposed to several downside risks, but policy buffers are adequate to mitigate the impact of these shocks.

Policy Advice. The current slowdown in activity and heightened uncertainty justify policy stimulus. However, the fiscal stance is procyclical owing to higher-than-expected revenues and low execution of public investment. Against this background, monetary policy easing is particularly appropriate given the absence of inflationary pressures, while accelerated budget execution would mitigate the procyclical fiscal policy stance. In the medium term, additional fiscal space from tax revenues and effective expenditure control is needed to address priorities in infrastructure and social spending while a gradual transition to greater exchange rate flexibility would foster financial market development. In addition to infrastructure investment, key reforms are needed to improve governance and fight corruption, boost competitiveness, and reduce informality.

Approved By
Krishna Srinivasan
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Daria Zakharova (SPR)

Discussions took place in Lima during November 5-18, 2019. The staff team comprised Leo Bonato (head), Manuk Ghazanchyan, José Torres, and Salma Khalid, with Pedro Rodriguez (all WHD) supporting the team from headquarters. Staff met with the Minister of Economy and Finance, Maria Antonieta Alva, the Central Bank Governor, Julio Velarde, other senior central government officials, and representatives of the private sector and civil society. Armando Morales (OED) participated in the discussions. Frederik Toscani, Gonzalo Salinas, and Danjing Sheng (all WHD) contributed to sections of the report. Danjing Sheng and Patricia Delgado (WHD) provided research and administrative assistance.

CONTENTS

CONTEXT	4
RECENT DEVELOPMENTS	5
OUTLOOK AND RISKS	8
POLICY DISCUSSIONS	9
A. Making Fiscal Policy More Agile	9
B. Choosing the Right Mix—Monetary, Exchange Rate, and Macprudential Policies	12
C. Improving Financial Sector Oversight	14
D. Strengthening Governance, Fostering Competitiveness, and Reducing Informality	15
E. Authorities' Views	17
STAFF APPRAISAL	19
BOXES	
1. Economic Impact of Venezuelan Migrants	6
2. Structural Reform Priorities	16
3. Size-Dependent Labor Regulations, Informality, and Misallocation	18
FIGURES	
1. Real Sector Developments	21
2. Fiscal Sector Developments	22
3. External Sector Developments	23
4. Financial Sector Developments	24
5. FX and Capital Market Developments	25

6. Balance Sheet Indicators	26
7. External Debt Sustainability: Bound Tests	27

TABLES

1. Selected Economic Indicators	28
2. Nonfinancial Public Sector Main Fiscal Aggregates	29
3. Statement of Operations of the General Government	30
4. General Government Stock Positions	31
5. Balance of Payments	32
6. Monetary Survey	33
7. Financial Soundness Indicators	34
8. Financial and External Vulnerability Indicators	35
9. Medium-Term Macroeconomic Framework	36
10. External Debt Sustainability Framework, 2016–24	37

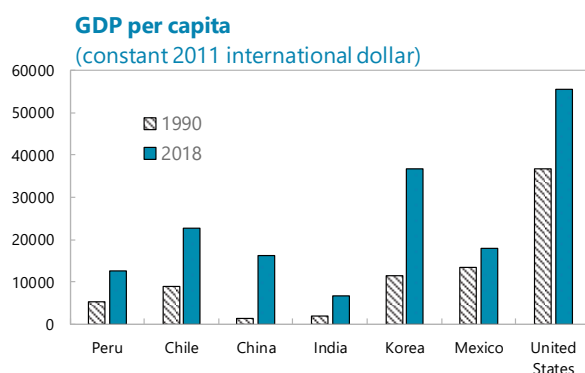
ANNEXES

I. Export Diversification: the Agro-Exporting Boom	38
II. Developing Complex Exports in Peru	40
III. Implementation of Past Fund Advice	41
IV. Risk Assessment Matrix	43
V. Public Sector Debt Sustainability Analysis	45
VI. External Sector Assessment	47
VII. Staff GDP Forecast Errors	51
VIII. Implementation of 2018 FSAP Recommendations	52

CONTEXT

1. Peru continues to be one of the best-performing economies in the region. Real GDP grew by 4 percent in 2018, well above the Latin American and Caribbean average of 1.1 percent. Inflation was only 2.2 percent, among the lowest in the region. This result is the continuation of a strong performance over the past fifteen years, when Peru grew at 5.4 percent on average, the highest among LA6 countries,¹ and made considerable progress in reducing poverty. A commodity-based economy, Peru greatly benefited from the commodity boom before the Global Financial Crisis (GFC) while attaining some economic diversification (Annex I, II); setting up a strong macroeconomic policy framework; and building and maintaining large buffers, with international reserves at approximately 26 percent of GDP, and low external and public debt respectively at 35 and 26 percent of GDP at end-2018.

2. Nonetheless, growth has lost momentum and productivity has disappointed. Peru achieved some convergence with advanced economies during the commodity boom. Nevertheless, both GDP per capita and total factor productivity (TFP) currently stand at about one fifth of those of the United States, while TFP is barely higher than in 1990. The lackluster productivity performance after the GFC—although better than in other countries in the region—has raised concerns that Peru may be stuck in a middle-income trap. In addition, the external environment has turned less benign, with trade tensions affecting global growth, more volatile international financial markets amid increasing uncertainty, and commodity prices only partially recovering from the 2011–15 decline. Domestically, the adverse 2017 El Niño weather event, the high-level corruption unearthed by the *Lava Jato* investigation, and capacity constraints to public investment hampered growth, which dropped to 3¼ percent on average in the last four years.



3. The authorities have responded to these challenges with appropriate policies, but disagreements over political reforms led to significant tension between the Government and Congress. Policies have been broadly in line with Fund advice (Annex III). Fiscal, monetary, and macroprudential policies have largely played a countercyclical role, and a broad range of reforms has been put in place to remove structural obstacles to growth, including corruption. Other

¹ LA6 countries include: Argentina, Brazil, Chile, Colombia, Mexico, and Peru.

important measures proposed by the executive, however, including political reform, met with strong opposition from Congress. In late September, after what was interpreted as a second no-confidence vote, President Vizcarra dissolved Congress and called for new legislative elections to be held on January 26, 2020. The Constitutional Court will likely rule on the constitutionality of the decision only after the elections.

RECENT DEVELOPMENTS

4. Economic activity weakened in 2019 on the back of transitory domestic factors and deteriorating external conditions.

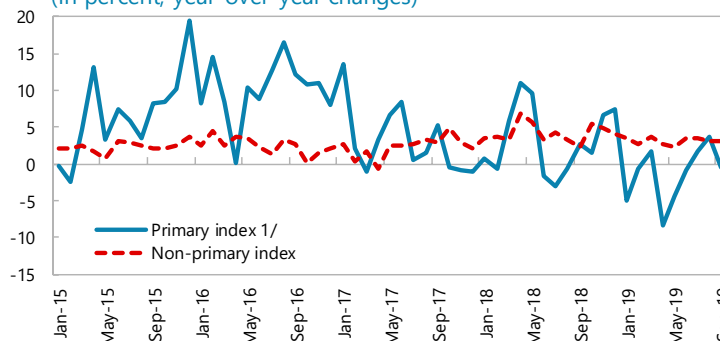
Temporary factors hampered production and exports in

traditional industries, while the deceleration in global trade further reduced demand for Peruvian exports. In particular, lower extraction and social unrest reduced the mining and fuel sector output by 0.8 percent in January-September. Fishing production dropped by 20 percent over the same period, mostly reflecting base effects from weather-related high catches in 2018Q1 and lower quotas in 2019H1. In addition,

public spending contracted, partly reflecting capacity constraints on public investment, while private investment—and, to a lesser extent, private consumption—remained robust. Overall, GDP growth slowed to 2.2 percent in 2019Q1-Q3, with clear signs of recovery in fishing and mining in Q3.

Real GDP Decomposition

(In percent, year-over-year changes)



Sources: National authorities; and IMF staff calculations.

1/ Primary includes Agriculture, fishing, mining and hydrocarbons, and manufacturing process for primary resources.

5. Inflation remained well within the 1-3 percent target range, but worsening growth prospects caused the central bank to ease policy after a nearly 18-month hiatus.

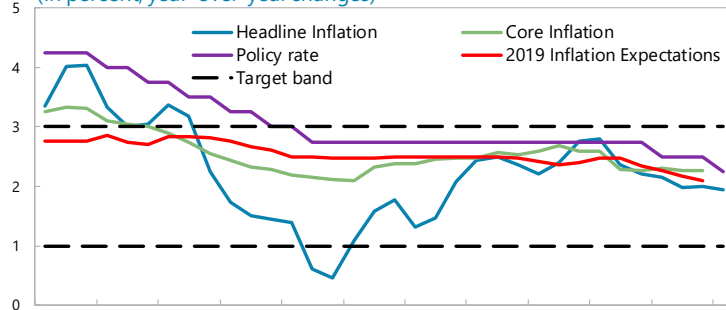
Headline inflation was 1.9 percent in

November, with core inflation slightly higher at 2.3 percent and 12-month inflation expectations at 2.2 percent in October, respectively. Citing downside risks to the inflation outlook, the Banco Central de Reserva del Perú (BCRP) cut its policy rate by ¼ percentage points in August and November to 2¼ percent, indicating that this

action did not necessarily imply further cuts. Unemployment remained stable at 6.4 percent in the Lima metropolitan region in October (3-month moving average). The sizable migration from Venezuela has been absorbed to a large extent by the informal labor market (Box 1).

Inflation and Policy Rate

(In percent, year-over-year changes)



Sources: National authorities; and IMF staff calculations.

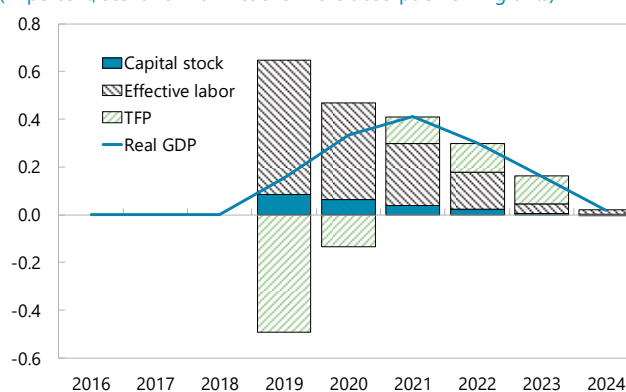
Box 1. Economic Impact of Venezuelan Migrants

Peru is the second largest recipient of Venezuelan migrants. UNHCR reports an estimated 800,000 immigrant arrivals between early 2017 and mid-June 2019, which represents 2.5 percent of the population of Peru. The 2017 population census of Peru finds that 83 percent of the migrant population is of working age and 50 percent has attained technical, graduate or post-graduate education, which exceeds the average educational attainment of the native population. At the time of the census, the employment rate among migrants was over 90 percent.

The absorption of immigrants into the workforce has created some frictions. The BCRP estimates that the competition from migrant workers has been felt particularly by young, low-skilled workers in the service and commerce sectors where wages have declined. Aggregate statistics for metropolitan Lima show no marked increase in unemployment during 2018–19, but the authorities have increased restrictions on the entry of Venezuelan immigrants into Peru effective mid-June 2019, causing a surge of inflows leading up to the deadline.¹ Displacement of local workers is likely to be a temporary phenomenon, however, as the government is taking steps to resolve skill mismatches in the migrant workforce. So far, only 3 percent of the Venezuelan skilled workforce has received accreditation for their qualifications owing to high costs, lack of information or lack of proper documentation. As part of the Productive Assimilation Plan, authorities have already halved the fee for accreditation and other constraints are likely to resolve in the medium term.

The impact of migration on growth is likely limited by these frictions. The BCRP estimates that 0.3 percentage points of the GDP growth registered in 2018 can be attributed to the private consumption of the immigrant population in Lima and Callao. Staff use a growth decomposition approach to estimate an impact of at most 0.4 percent in 2021. In the short term, the positive impact of the additional labor and of the capital stock associated with it would be tempered by the displacement of local workers and by a reduction in total factor productivity (TFP) owing to skills mismatches and high degree of employment informality.² As frictions dissipate in the medium term, the impact on TFP would turn positive, with larger growth benefits. Global experience of large immigration flows indicates that the long-term benefits of this migration episode will depend on the speed of labor market integration of entrants and the extent to which their skills are complementary with the domestic labor force³.

Growth Impact from Venezuelan Migration
(In percent, scenario with frictions in the absorption of migrants)



Sources: IMF staff estimates.

¹ Over 34,000 immigrants arrived at the border in the period June 8–15. As of June 15, Venezuelan immigrants have to present a passport at the border of entry and obtain a 'humanitarian visa' from a Peruvian consulate prior to their arrival.

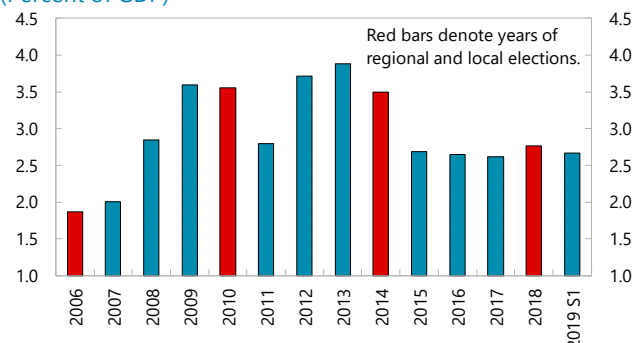
² A 2018 survey by INEI found that nearly 90 percent of Venezuelan migrant workers were working without formal contracts. The staff migration scenario assumes that: (i) the migrant labor stock grows to 0.9 million individuals in 2019 and 1.4 million by 2023; (ii) arrivals are uniformly distributed over different months; (iii) effective employment increases only by half the flow of active migrant population owing to the displacement of local workers; (iii) migrant characteristics (labor force participation, employment) are similar to the stock of migrants in the 2017 national census; (iv) capital accumulates at a higher rate than in baseline but less than the increase in employment; and (v) the impact on TFP is initially very negative and it gradually turns positive.

³ "Spillovers from China's transition and from Migration", Chapter 4, World Economic Outlook, October 2016.

6. The fiscal position improved more than anticipated, partly reflecting low execution of capital projects.

The cumulative 12-month fiscal deficit of the NFPS fell to just 1.6 percent of GDP in October, a significant decline from the 2.3 percent of GDP recorded at end-2018, driven by resilient revenues and low implementation of capital spending by the newly-elected regional and local governments. These delays materialized despite the government's efforts to address the problem, which typically happens after elections. As execution improves, the deficit should increase slightly in the last part of the year, but will fall significantly short of the projected deficit of 2.2 percent of GDP, already revised down from the budgeted 2.7 percent of GDP. The 2020 budget, targeting a fiscal deficit of 2 percent of GDP consistent with the Multiannual Macroeconomic Framework released in August, was issued by government decree in November, but will have to be ratified by the new Congress.

Gross Capital Formation of Regional and Local Governments
(Percent of GDP)



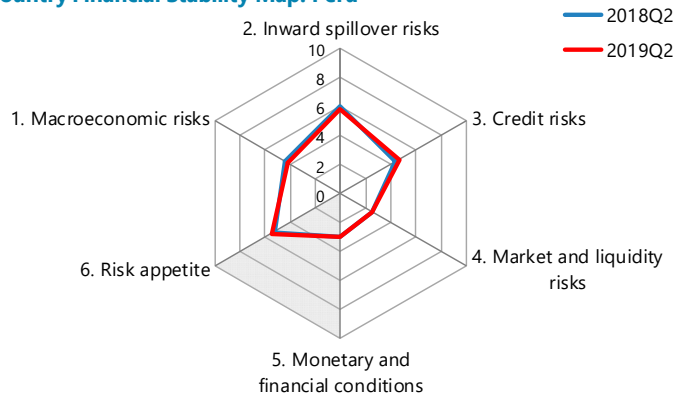
Sources: BCRP and IMF staff calculations.

7. The external current account balance deteriorated, but capital inflows led to minor exchange rate appreciation pressures. The trade balance surplus went from US\$5.3 billion in the period January–September 2018 to US\$3.7 billion in the same period of 2019. This deterioration was primarily due to declines in volumes and prices of traditional exports (e.g., fish flour, copper, and oil). Nonetheless, increased appetite for Peru's sovereign debt generated capital inflows and slight appreciation pressures. By end-September, the nominal exchange rate appreciated on average by more than 1 percent despite the central bank intervening by buying foreign exchange in the order of US\$0.2 billion.

8. Risks to financial stability declined slightly.

Financial sector credit growth to the private sector moderated slightly in the first part of the year—from 8.7 percent at end-December (2018) to 8.3 percent at end-September, likely reflecting the slowdown in activity. The financial sector remained well capitalized and profitable, but some vulnerabilities persisted in the banking sector (i.e., financial dollarization, concentration, and off-balance sheet exposures). The capital to risk-weighted assets ratio was about 14.8 percent as of August 2019, while nonperforming loans

Country Financial Stability Map: Peru



Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

Source: IMF staff calculation.

hovered around 3.1 percent of total loans and the return-on-assets at about 2.2 percent. Furthermore, the dollarization of bank deposits and loans continued to decline, reaching 35 and 27 percent respectively by end-September. The banking system, however, remains highly concentrated and financial inclusion is low (IMF Country Report No. 18/225, ¶23).

Financial Soundness Indicators Heatmap												
Peru	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2	Latest
Overall Financial Sector Rating	M	M	M	M	M	M	M	M	M	M	M	M
Credit cycle	L	L	L	L	L	L	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	-1.2	-1.8	-1.7	-1.6	-0.9	0.0	0.5	0.8	1.3	1.2	1.3	1.3
Growth of credit / GDP (% annual)	-3.3	-4.9	-4.6	-4.6	-4.5	-2.6	0.0	1.5	2.4	3.7	3.6	3.6
Credit-to-GDP gap (st. dev)	-2.6	-2.7	-2.2	-1.6	-1.0	-0.7	-0.2	0.4	1.3	1.2	1.5	1.5
Balance Sheet Soundness	M	M	M	M	M	M	M	M	M	M	M	M
Balance Sheet Structural Risk	M	M	M	M	M	M	M	M	M	M	M	M
Deposit-to-loan ratio	88.1	90.1	90.1	90.5	91.1	90.2	89.1	88.0	88.6	91.0	90.5	90.5
FX liabilities % (of total liabilities)	44.7	42.5	42.4	42.3	41.1	40.2	40.5	39.3	38.9	38.3	38.8	38.8
FX loans % (of total loans)	28.7	28.2	29.0	29.2	29.3	29.0	29.4	28.5	28.3	28.0	27.6	27.6
Balance Sheet Buffers	L	L	L	L	L	L	L	L	L	L	L	L
Leverage	L	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	11.4	11.1	11.6	11.8	12.1	11.6	12.0	12.6	12.5	12.0	12.3	12.3
Profitability	L	L	L	L	L	L	L	L	L	L	L	L
ROA	2.0	2.0	2.0	2.1	2.1	2.0	2.1	2.2	2.2	2.2	2.2	2.2
ROE	19.2	18.6	18.3	18.1	17.7	17.5	17.6	18.0	17.8	17.6	17.8	17.8
Asset quality	M	M	M	M	M	L	L	L	L	L	L	L
NPL ratio	4.3	4.6	4.7	4.7	4.7	3.4	3.4	3.4	3.3	3.4	3.4	3.4
NPL ratio change (% annual)	9.3	10.9	8.6	8.3	9.4	-26.6	-27.7	-28.2	-30.3	0.4	1.4	1.4

Note: M=medium vulnerability; L=low vulnerability
Source: IMF staff calculations.

OUTLOOK AND RISKS

9. Economic activity is expected to accelerate in the short term as temporary impediments dissipate. Public investment should continue to recover as newly-elected regional authorities overcome initial obstacles and the national government implements measures to reduce coordination issues and unblock inactive projects. Specific factors hindering mining and fishing should also recede. Nevertheless, global uncertainty and domestic political uncertainty will continue to weigh on demand, and softer commodity prices will dampen private investment. In this environment, the output gap is expected to become more negative and inflationary pressures will remain subdued. GDP growth is projected to close 2019 at 2.4 percent, with inflation well within the central bank's target range.

10. Growth is expected to strengthen gradually after 2019 before reaching its potential over the medium term. The recovery in late 2019 should carry forward into 2020 underpinned by a moderate strengthening of growth in Peru's trading partners and the dissipation of political uncertainty.² GDP growth is projected to rise to 3.2 percent in 2020 and 3.7 percent in 2021,

² More than half of Peru's exports are directed to China (32.6 percent) and the U.S (19.6 percent).

sustained by adequate credit growth. Over the medium term, growth would gradually revert to its potential of 3½ percent, which is estimated to have been reduced by delays in structural reform and infrastructure investment. The negative output gap is projected to close gradually, while inflation is expected to return to 2 percent in 2020.

11. Risks are tilted to the downside, but there are ample policy buffers to mitigate the impact of adverse shocks. Global uncertainty has increased, and Peru is exposed to shocks to global growth and financial conditions (Annex IV). External risk-off events could determine a sudden tightening of financial conditions and trigger contagion effects. The associated exchange rate movements could be magnified by balance sheet effects owing to the partial degree of dollarization still present in Peru's financial system. Domestically, prolonged uncertainty from the political impasse and ongoing corruption investigations could stifle private investment and growth. Nonetheless, low public debt and significant financial assets, a large stock of international reserves, and a solid financial sector would mitigate the impact of adverse shocks.

POLICY DISCUSSIONS

The current slowdown in activity and heightened uncertainty justify policy stimulus. However, the fiscal stance is procyclical, and should be corrected by accelerating budget execution. Going forward, compliance with the fiscal rules will require a modest consolidation effort as cyclical conditions improve. Given the negative output gap and the absence of inflationary pressures, accommodative monetary policy is appropriate, and the policy stance should continue to be data-driven. In the medium term, additional fiscal space from tax revenues and effective expenditure control is needed to address priorities in infrastructure and social spending while a gradual transition to greater exchange rate flexibility would facilitate financial market development. In addition to infrastructure investment, key reforms are needed to improve governance, boost competitiveness, and reduce informality.

A. Making Fiscal Policy More Agile

12. The long-term fiscal position is strong, and the government is on track to comply with fiscal rules, but the policy stance is procyclical. Public debt is low and sustainable owing to favorable debt dynamics. In addition, Peru holds ample fiscal buffers in the form of bank deposits (including a stabilization fund of 2½ percent of GDP). Notwithstanding the vulnerability associated with the large share of foreign-currency denominated debt (33.8 percent), Peru has some fiscal space under its current fiscal rule (and would have substantial fiscal space in a scenario unconstrained by fiscal rules) (Annex V). Following an adverse El Niño weather pattern in 2017 that brought considerable human and economic losses, the government invoked an escape clause from the fiscal deficit ceiling of 1 percent of GDP allowing it to exceed that ceiling until 2021.³ Peru has been overperforming in meeting its fiscal targets owing to higher-than-expected revenues and low

³ In addition to the headline fiscal deficit ceiling, Peru's fiscal rules include a debt ceiling of 30 percent of GDP and a dual expenditure growth ceiling (on non-interest expenditures and on current expenditures). The escape clause can be invoked in case of disasters, significant external shocks, or when exogenous shocks affect economic activity in a way that requires a modification of the fiscal balance (see IMF Country Report No. 17/166, Annex I).

execution of public investment, resulting in a procyclical fiscal stance in 2019. Difficulties in raising the execution of public investment to the government targets are projected to cause the deficit to reach 1½ percent of GDP in 2020, below the 2 percent deficit envisaged in the budget.

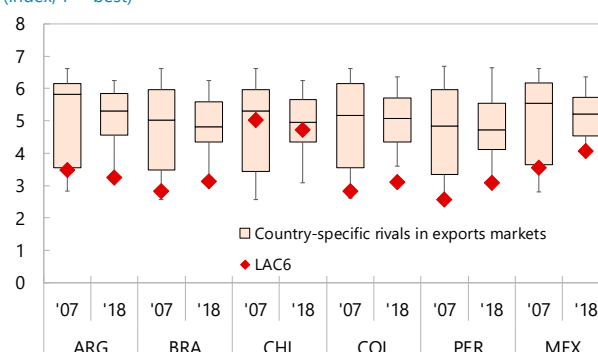
13. With more uncertain economic prospects, policy easing is desirable in the short term.

The government should at least make sure that the 2020 budget is fully executed. This requires unblocking inactive projects while removing financing and capacity constraints to local and regional governments; addressing structural constraints hampering large infrastructure projects, increasing budgeted resources for local and regional governments; anticipating their deliver, and providing the necessary technical assistance on administrative systems. As growth strengthens, a moderate consolidation effort will be required to attain the deficit target of 1 percent of GDP in 2021.

14. The authorities are planning a much-needed expansion of public investment.

Enhancing the quality of infrastructure is a key component of the government's strategy to improve competitiveness. In fact, Peru's infrastructure compares unfavorably with that of competitors, and investment is particularly needed in transportation, sanitation, health, telecommunications, and water. The National Plan of Infrastructure for Competitiveness estimates an infrastructure gap of 15 percent of GDP with comparable countries and 47 percent of GDP with OECD countries. To partially close these gaps, the plan identifies 52 priority projects to be executed in the next decade amounting to 13 percent of GDP, including both PPPs and government-financed projects.⁴ Projections in the 2020–23 Multi-Annual Macroeconomic Framework indicate that improvements in revenue administration and the performance of public enterprises, and reduced current spending would be necessary to accommodate this effort.

LAC6 and Trade Competitors: Quality of Infrastructure, 2007–2018
(Index, 7 = best)

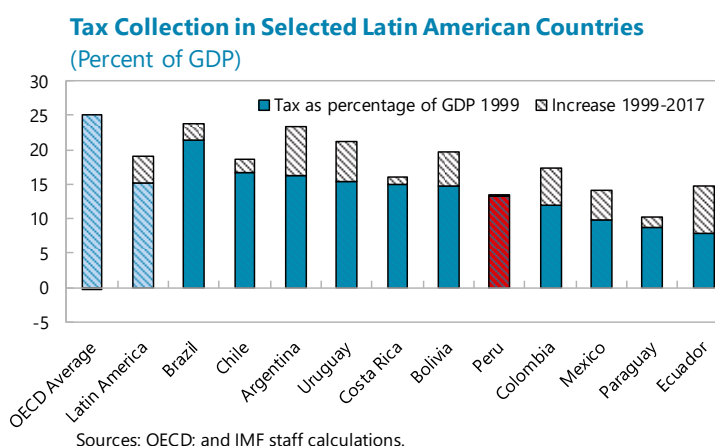


Sources: IMF Staff estimates with WEF and UNCOMTRADE data.
Note: Red diamonds represent the value for the corresponding LAC6 country.
The box and whiskers correspond to the country-specific rivals.

⁴ The Plan includes a combination of projects that have already been initiated (e.g., Line II of the Lima Metro, Chancay Port, expansion of the Lima airport, and Majes Siguas II irrigation project) and new projects (e.g., Lima Beltway). For the old projects, implementation was modest in 2018–19, but is expected to pick up in 2020–23. For other projects, the investment outlook is naturally more uncertain, but some energy-related projects (electricity and gas) are expected to see significant investment in 2020–23.

15. Pressing needs for infrastructure and other priority spending highlight the importance of raising revenue mobilization capacity in the medium term.

The increase in excises adopted in mid-2018 and electronic invoicing have supported tax revenues, and further increases in mining revenues are expected as new production comes on stream. Nonetheless, Peru has fallen behind in the last 20 years in the effort to mobilize revenues and the tax revenue ratio remains comparatively low.⁵ Going forward, efforts should continue to focus on revenue administration measures, particularly on reducing the VAT's compliance gap, which increased during 2015–17 and remains above 30 percent despite some improvement in 2018. In this regard, the authorities should try to develop an integrated control strategy for income taxes and VAT, including of withholdings, and continue their efforts to develop information systems that can fully exploit e-invoicing data.



16. Expenditure control should focus on protecting capital spending and other priority areas. The Medium-Term Budget framework includes provisions to: (i) enforce multiannual budget allocations, which should act as an effective ceiling on expenditures; and (ii) limit the incorporation of unbudgeted expenses throughout the budget year. Full implementation would ensure an effective control and, together with additional revenue efforts, create room for spending in priority areas, including poverty reduction and education. Regarding the implementation of capital spending, swift efforts are needed to strengthen project design, better integrate projects with budget preparation, improve information systems for project execution, promote concurrent control procedures, and enhance the implementation capacity of local and regional governments.

17. In the medium term, the authorities could consider introducing more flexibility in the fiscal framework. The current procyclical stance reflects limited capacity in investment execution, but the 1-percent headline deficit target would reduce the space needed to address considerable infrastructure gaps. Although frequent revisions may weaken the integrity of the rules-based system, the available fiscal space and the strong fiscal framework would limit the risks associated with, say, a modest increase in the deficit ceiling. While fiscal buffers would be eroded modestly, the fiscal position would remain strong and existing expenditure rules would constrain current spending even under a higher deficit ceiling, ensuring that the additional space under the rule is used mostly for investment. This would help mitigate reputational risks. Another option would be to replace the headline deficit ceiling with a structural deficit ceiling, along the lines of the framework that was in place during 2014–16.

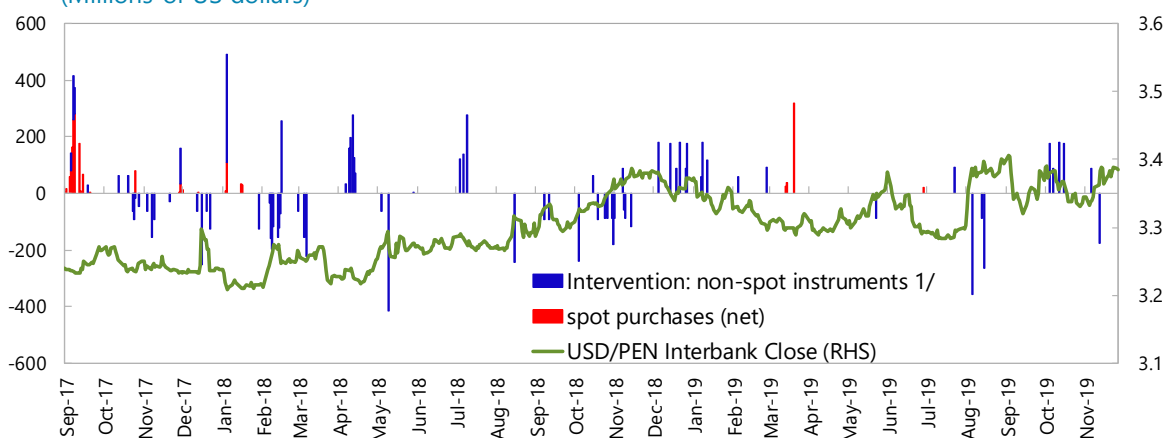
⁵ See S. Khalid, Selected Issues (www.imf.org).

B. Choosing the Right Mix—Monetary, Exchange Rate, and Macprudential Policies

18. In the absence of inflationary pressures, the recent monetary policy easing is appropriate considering weakening growth, increased risks, and contractionary fiscal policy. After being unchanged since March 2018, the policy rate was reduced by 25 basis points in August and November to 2¼.⁶ With the real interest rate now close to zero, the monetary stance is expansionary. Nonetheless, with muted inflationary pressures, the authorities should be prepared to ease policy further if downside risks materialize while remaining vigilant against the emergence of financial sector vulnerabilities. The recent forward guidance from the central bank—indicating that the last policy rate cut did not necessarily imply that further cuts would follow—is useful to clarify that policy remains data-dependent.

19. While monetary and macroprudential policies have been used parsimoniously, foreign exchange intervention (FXI) has been frequent, albeit limited in size and broadly symmetric. Reserve requirements remained unchanged since June 2018 when marginal requirements on FX liabilities were reduced one percentage point to 35 percent. Other macroprudential instruments, such as countercyclical capital buffers and dynamic provisioning, were switched off in 2014 after credit growth moderated. One capital flow management measure and macroprudential measure (CFM/MPM)—reserve requirements on FX derivative transactions—was relaxed in early 2019, while other CFM/MPMs and a CFM have not been adjusted since 2015.⁷ FXI has been used more actively

Foreign Exchange Intervention
(Millions of US dollars)



Source: BCRP and IMF staff estimations.

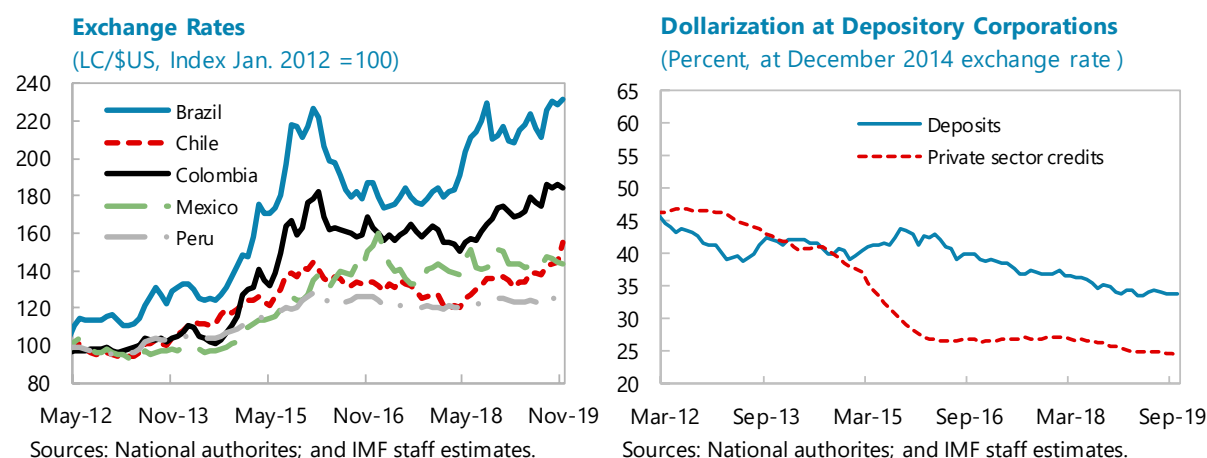
1/ Non-spot instruments include net maturity of CDR BCRP, net maturity of FX (sell) swaps, net issuance of CDLD and net purchases of FX (buy) swaps. An increase is equivalent to a purchase of foreign exchange.

⁶ The March 2018 change was, in turn, the culmination of an easing cycle that had started in May 2017 in response to adverse shocks like the El Niño weather pattern and the *Lava Jato* investigation.

⁷ Peru has one CFM—a tax on non-resident income gains from short-term financial derivatives—and four measures that were assessed as CFM/MPMs: (i) reserve requirement on short-term external liabilities; (ii) limit on net FX derivative position; (iii) reserve requirement related to short position in FX derivatives; and (iv) reserve requirements

and has largely been two-way and contained. In the second half of 2018, the BRCP intervened to smooth exchange rate volatility against a backdrop of declining terms of trade and depreciation pressures. In the first part of 2019, when improved sentiment led to capital inflows and appreciation pressures, the central bank stood on the opposite side of the market. More recently, the central bank returned to selling FX, when renewed concerns with trade tensions led to another wave of global financial volatility in early August. The external sector assessment concludes that in 2018 the external position was broadly in line with fundamentals and desirable policies (Annex VI). Preliminary results suggest that this assessment would be confirmed for 2019.

20. As dollarization declines, the BRCP should allow greater exchange rate flexibility to absorb external shocks and promote financial market development. Activism in the use of FXI has contributed to making the sol the most stable currency in the LAC region, reflecting the authorities' concerns for liability dollarization and its possible impact on financial stability. The latter has fallen substantially from the peaks experienced in the early 1990s and early 2000s, when dollarization of both deposits and credit had reached around 80 percent. With loan dollarization now well below 30 percent, there would be limited risks in allowing greater exchange rate volatility and limiting FXI to cases of disorderly market conditions. This would further reduce dollarization by



inducing agents to internalize exchange rate risk, foster the development of hedging instruments, and strengthen the interest channel of monetary policy. FXI would remain a key line of defense against disorderly market conditions. Higher risk weights for FX loans would also help reduce dollarization.

21. Going forward, the multi-instrument framework could be enhanced by evaluating costs and trade-offs of different tools. Peru has historically used a multi-instrument policy framework to achieve its policy objectives, with monetary policy focused on inflation, exchange rate policy on managing risks associated with liability dollarization, and macroprudential policies on

on FX derivative transactions. The relaxation of the latter in 2019 is in line with Fund's Institutional View on capital flows. The remaining CFM should be phased out, while CFM/MPMs should be continuously reviewed and the authorities should consider alternative measures that directly address the systemic financial risks without limiting capital flows.

mitigating financial stability risks.⁸ While definite conclusions cannot be drawn lacking a counterfactual, the combination of these policies and instruments has been associated with strong macroeconomic performance in the last fifteen years.⁹ The framework could be further strengthened by fully considering the interaction of policy instruments under different shocks and by assessing explicit and implicit costs and benefits of their use, including, for example, the adverse effects of FXI on the development of hedging markets and on financial dollarization or the output costs associated with a slower adjustment of the real exchange rate. This would allow to improve the combination of instruments and better assess the overall policy stance.

C. Improving Financial Sector Oversight

22. The authorities have taken important steps to strengthen financial sector oversight.

More specifically,

- The new law on credit cooperatives became effective in January 2019 and the Superintendence of Banks, Insurance, and Pension Managers (SBS) initiated the registering process for those institutions. Over 400 cooperatives were registered and the SBS is in the process of determining their respective regulatory requirements—which vary according to size. The SBS will also work with the cooperatives towards establishing a deposit insurance scheme.
- The SBS has made progress in implementing a broad set of FSAP recommendations, including in the areas of: systemic risks and macroprudential policies (e.g., enhancing the monitoring of banks' off-balance sheet exposures and strengthening the stress tests models), institutional arrangements for the SBS (internal governance and control framework), bank and insurance supervision (consolidated and risk-based supervision), crisis management (crisis preparedness and management arrangements), and financial integrity (financial sector law).

23. Completing the legislative and regulatory reform agenda requires additional efforts.

Further steps are needed to advance three legislative agendas to: (i) strengthen the legal protection of all supervisors and former SBS staff; (ii) grant the SBS powers to exercise consolidated supervision; and (iii) enhance the effectiveness of the AML/CFT framework, including ensuring the dissuasiveness and proportionality of sanctions. Efforts to improve risk-based supervision to ensure AML/CFT compliance by financial institutions should also continue. It will also be important to bring some regulations in line with Basel III, including those regarding capital surcharges for systemic banks and risk weights for foreign currency loans, which would help reduce dollarization further.

⁸ The evolution of this framework is described in M. Ghazanchyan, M., Selected Issues (www.imf.org).

⁹ Comparing Peru with Chile, which follows a conventional inflation-targeting approach, Rodriguez, P., Selected Issues Paper (www.imf.org) finds that outcomes in terms of output and inflation volatility have been similar, and Peru's deviations from orthodoxy have been temporary and limited in size.

D. Strengthening Governance, Fostering Competitiveness, and Reducing Informality

24. Continuing legal reform is critical. Based on the expected growth payoff and the popular support for it, legal and product market reforms remain key (Box 2). Indeed, the authorities have advanced in their efforts to improve public sector transparency and governance. In the wake of the *Lava Jato* investigation, the government has put fighting corruption at the top of its agenda. In this regard, President Vizcarra submitted four political and judicial reforms aimed at improving governance to national referendum—of which three were approved.¹⁰ Moreover, an Anti-Corruption Plan (2018-21) is currently being implemented to strengthen anti-corruption institutions and improve transparency and public access to information. Other key reforms included the creation of *invierte.pe* and the reform to *Proinversion* to strengthen institutional mechanisms for public investment and PPPs and ensuring the functioning of the payment chain for contractors that had provided goods and/or services to companies subsequently involved in corruption investigations.

25. Additional reforms are necessary to mitigate vulnerabilities in the governance framework and limit the scope for corruption.¹¹ In this regard, a stronger Integrity Secretariat—a new entity within the Presidency of the Council of Ministers—could play a key role in promoting coordination and implementation of the reforms. A robust system of income and asset declaration for high-level public officials would help prevent and detect illegal enrichment and laundering of corruption proceeds, and identify conflicts of interests. The agreement signed with the Finance Controller to enhance investigations is welcome, but more steps are needed to strengthen due diligence of politically exposed persons (PEPs), further enhancing investigations of PEPs, and increasing sanctions for non-compliance. Ensuring accurate and up-to-date information in the beneficial ownership registry will also contribute to increasing transparency of companies. Other reforms include making the procurement system simpler, more transparent, and competitive, as well as reforming the National Control System to better manage risks and increase accountability. Introducing independent internal auditors in some entities and strengthening external audits would be important steps in this area.

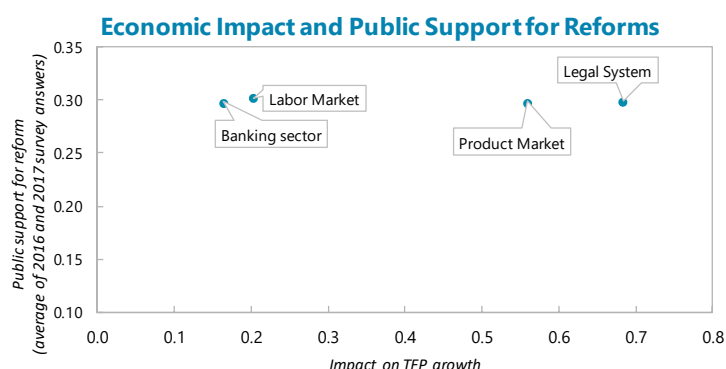
¹⁰ The referendum was held on December 9, 2018 and the three proposals approved were: (i) reforming the National Council of the Magistrature, which was the entity in charge of appointing, ratifying, and removing judges and prosecutors; (ii) reforming the financing of political parties; and (iii) prohibiting the immediate re-election of parliamentarians. A proposal to transform Congress back into a bicameral institution was rejected, with the president withdrawing his support for this proposal after Congress modified the government's original proposal.

¹¹ See IMF Country Report No. 18/225 (Box 2).

Box 2. Structural Reform Priorities

Weak productivity growth has been a long-standing concern and will need to be tackled for Peru to converge to high-income status. Well-established obstacles to productivity growth discussed in previous staff reports include education, infrastructure, institutions, and labor market reform.

Legal system and product market reforms are priorities. Given the many potential areas of structural reforms, and the possible political difficulties associated with implementing them, prioritizing is key. To provide a high-level assessment of reform priorities, we followed the approach in Biljanovska and Sandri (2018), which combines estimates of the TFP impact of reforms with information on the public support for them.¹ With little variation in the public support, the analysis identifies as priorities reforms of the legal system and of product markets to enhance competition, where reform gaps are most evident. Given the progress already made on trade openness, reforms in this area are unlikely to yield a large productivity payoff, and labor market reforms would be more beneficial. Within the legal system, survey data indicate that impartiality of courts is a major concern.²

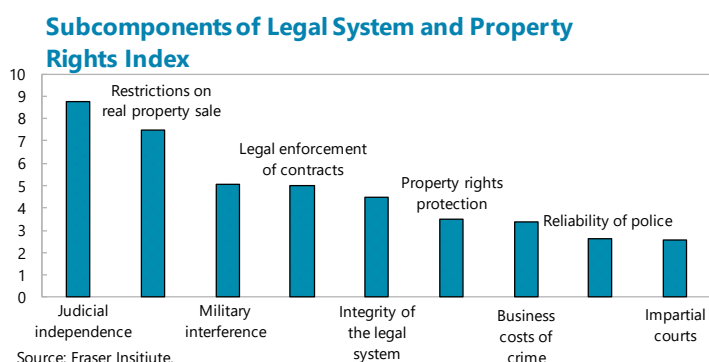


Source: IMF Staff calculations.

Note: See Biljanovska and Sandri (2018) for details on the methodology and data.

Indeed, the authorities' new competitiveness plan recognizes judicial reform as one of the priority areas.

The plan lays out the importance of strong institutions for competitiveness, given that successful market competition requires clear rules applicable to all agents. Concrete steps to improve the legal system and with it the enforceability and reliability of contracts and property rights include increasing efficiency and transparency via the use of technology as well as institutional changes to the structure of the judicial system to reduce the scope for corruption.



Source: Fraser Institute.

¹ For details on the sources for the measures of different reforms see Biljanovska and Sandri, "Structural Reform Priorities for Brazil", IMF Working Paper No. 18/224. The analysis only considers individual reforms, thus potentially overlooking interaction effects of reform packages. Given the complexity of the link between structural reforms and TFP gains, the analysis in this box should be taken as indicative. Other measures, such as closing infrastructure gaps, which are not considered here, also remain key priorities.

² The legal system indicator is a composite indicator compiled by the Fraser Institute. The individual components come mainly from a survey of perceptions conducted by the World Economic Forum and published in the World Competitiveness Report. This is the only source on perceptions regarding aspects of the legal system and is appropriate for the purpose of measuring public support for reforms.

26. Escaping the middle-income trap requires boosting productivity and enhancing competitiveness. The government adopted a National Policy for Competitiveness and Productivity in late 2018—which established nine priority objectives along with measurable indicators to monitor progress and implementation—and concrete measures have been identified in the National Plan issued in late July.¹² To achieve tangible progress in the next few years, the government should consider further narrowing its focus. The authorities are collaborating with the World Bank on a subnational Doing Business assessment to identify competitiveness needs across regions. Reforms are also needed to ensure the agro-export success story continues (Annex I, II) and to promote diversification to other sectors, including tourism. Reducing informality is a complex task that requires a comprehensive package of reforms balancing lower costs of formality (regulations) with higher benefits (public services). Attenuating differences in labor regulations across firms of different size would be an important component of this package (Box 3), especially if accompanied by policies that increase labor mobility. In view of capacity constraints, identifying key priorities will be crucial to the success of the broad reform agenda. While most reforms would be growth-friendly or neutral in the short term, changes to labor regulations should wait until cyclical conditions have improved.

27. Growth-enhancing policies should be accompanied by further efforts to improve social protection. Peru has made significant progress in reducing poverty since the turn of the century. Nonetheless, action is needed to address critical needs, including by reforming the pension system to ensure adequate social protection, providing a more equitable distribution of natural resource revenues across regions (IMF Country Report No. 18/225), providing technical support to regional governments for timely execution of their mining canons, and deepening financial development and inclusion, which the authorities have identified as a priority in the National Competitiveness Plan.

E. Authorities' Views

28. The authorities broadly agreed on the deterioration of the growth outlook. They were more optimistic on short-term prospects as they expected a stronger rebound in public investment and more resilient consumption in 2020. They concurred, however, that weak growth outcomes will result in a more gradual reduction of the output gap and that delays in reforms and public investment have reduced potential growth to about 3½ percent.

29. The authorities recognized that delays in public investment have limited the ability of fiscal policy to support growth and emphasized their commitment to improving budget execution. New measures to reallocate resources towards ongoing projects, reactivate those that are stagnant, and increase the use of government-to-government agreements in reconstruction are expected to yield results in 2020. Improvements in tax administration from electronic invoicing and

¹² Priorities include: (i) improving the economic and social infrastructure; (ii) enhancing human capital; (iii) creating capacity to innovate and adopt new technologies; (iv) improving mechanisms for domestic and external financing; (v) creating a more dynamic and competitive labor market; (vi) improving the business climate; (vii) facilitating international trade; (viii) strengthening domestic institutions; and (ix) ensuring environmental sustainability.

Box 3. Size-Dependent Labor Regulations, Informality, and Misallocation

Informality remains a significant barrier to growth in Peru. Informal employment comprises nearly 70 percent of total employment in Peru, well above the already high Latin American average of 54 percent. High levels of informality reduce productivity and narrow the tax base. In addition, they harm the formal economy. The World Bank Enterprise Survey (2017) shows that 75 percent of manufacturing firms face competition from unregistered firms and business practices of informal competitors are cited as the single largest obstacle in the business environment by 39.1 percent of Peruvian companies, as opposed to 31.3 percent in the LAC region and 28.2 percent globally.

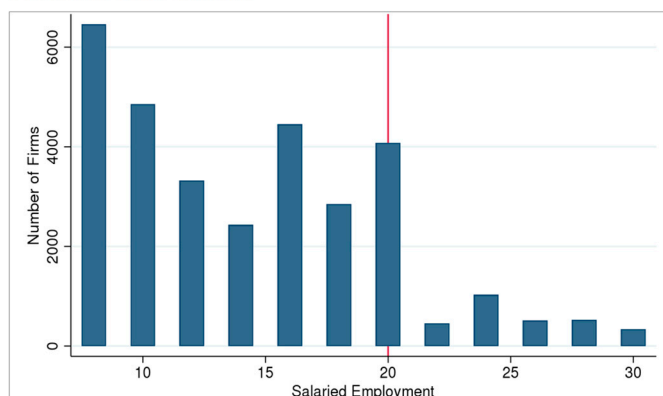
Policies may have conflicting effects on informality.

While Peru offers micro and small enterprises several incentives to lower the cost of formalization, including simplified tax regimes, other regulations may create incentives for greater informality. When firms exceed 20 salaried employees, they face new obligations, including sharing profits with their salaried workers, permitting the creation of a firm-specific union, and setting up a health and safety committee. While these obligations reflect key safeguards for workers, they involve additional costs, which, if significant, may prevent firms from growing or hiring more formal employees beyond the threshold at which the policy becomes binding.

Size-dependent labor regulations appear to constrain the size of the formal workforce in Peru.

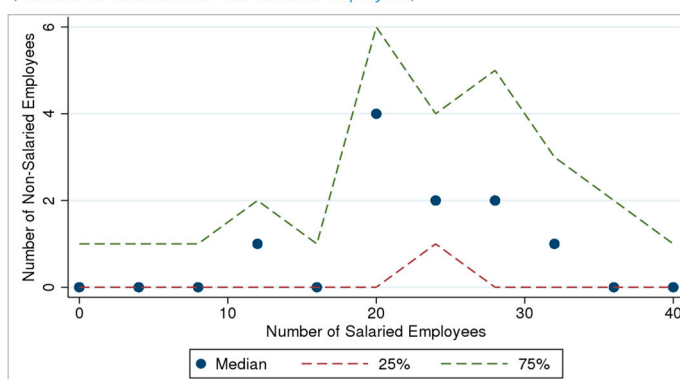
A recent IMF study¹ finds that the distribution of firms by size is discontinuous at the 20-employee threshold at which additional labor regulations bind, with a sharp reduction in the number of firms that have more than 20 salaried employees. In addition, the number of non-salaried employees increases dramatically in the firms with at least 20 salaried employees. Overall, the study finds these regulations to create incentives for firms to remain small and hire informally, lowering demand for formal labor and the associated wages. Improving the design of these labor regulations will therefore have important consequences for formalization, wages, and overall productivity.

Firm Size Distribution



Sources: ENE and IMF Staff calculations.

Employment Composition in Firms (Number of Salaried and Non-Salaried Employees)



Sources: ENE and IMF Staff calculations.

¹ Dabla-Norris, M. E., Jaramillo, L., Lima, F., & Sollaci, A. (2018). *Size Dependent Policies, Informality and Misallocation*. International Monetary Fund.

new measures to combat base erosion and profit shifting, and additional tax revenues from new mines should create space for public investment while complying with the fiscal rule.

30. There was agreement on the monetary policy stance. The authorities noted that monetary policy remains data-dependent and further policy easing may be needed if downside risks to the inflation outlook materialized. On exchange rate policy, they underscored that the use of FXI has declined significantly over time and remains limited to episodes of disorderly market conditions, when large capital flows may cause financial instability or exchange rate misalignments. On dollarization, the authorities considered that, after the progress made in the last decade, remaining dollarization largely reflects widespread dollar invoicing of intermediate goods and services, which would be irresponsive to additional exchange rate volatility.

31. The authorities agreed on the financial sector reform agenda but noted that some changes will take time to be completed. Reinforcing the legal protection of supervisors and mandating the SBS to exercise consolidated supervision will require changing the Banking Law, which is not a priority in the current political context. Other measures are being considered and their impact evaluated, including increasing risk weights for foreign currency loans.

32. The authorities concurred on the need to improve resource allocation and boost productivity. They noted their current focus on improving governance and addressing the infrastructure gap, and on proposals being elaborated on youth unemployment and pension reform. The authorities conceded that a broad set of reforms are necessary to obtain sizeable reductions in informality, spanning from tax and benefit reform to quality of education. They highlighted their efforts to increase the ability of the migrant population to effectively contribute to the labor market.

STAFF APPRAISAL

33. Peru continues to be one of the best-performing Latin American economies, but economic activity has lost momentum. A less benign external environment and adverse domestic factors have weakened considerably the pace of economic activity. Trade tensions have reduced global growth and increased uncertainty, international financial markets have become more volatile, and commodity prices have only partially recovered from the 2011–15 decline. Domestically, the adverse 2017 El Niño weather event caused significant economic disruptions and the findings of the *Lava Jato* investigation have hampered large investment projects. The disappointing growth performance has been accompanied by poor productivity outcomes.

34. After weakening significantly in 2019, growth is expected to strengthen gradually. Driven by a recovery in net exports and resilient private demand, GDP growth should gain strength in 2020 and more so in the following years. The outlook, however, is clouded by significant risks. As a small open economy, Peru is exposed to possible swings in global growth and in financial conditions. Domestically, prolonged uncertainty from the political situation and ongoing corruption investigations could stifle investment and growth. Nonetheless, low public debt partly backed by financial assets, a large stock of international reserves, and a robust financial sector would help mitigate the impact of adverse shocks.

35. Additional fiscal support would be desirable in the short term. Monetary and macroprudential policies are providing adequate stimulus, with the policy rate near zero in real terms, reserve requirements low by historical standards, and macroprudential instruments switched off since 2014. FXI has been two-way and contained, and the external position has remained broadly in line with fundamentals and desirable policies. Fiscal policy, however, has been procyclical, partly owing to budget under-execution. The government should focus on using the fiscal space available under the fiscal rule, with special emphasis on improving the implementation of public investment projects. In the medium term, the authorities could consider introducing more flexibility in the fiscal framework while increasing revenue mobilization.

36. Further strengthening the financial sector would increase resilience. As dollarization declines, the central bank could allow greater exchange rate flexibility to absorb external shocks and promote financial development. Additional efforts are needed to complete the legislative and regulatory reform agenda building on the considerable progress already made. Steps are needed to reinforce the legal protection of supervisors; mandate the SBS to exercise consolidated supervision; and enhance the effectiveness of the AML/CFT framework. It will also be important to bring some regulations in line with Basel III, including those regarding risk weights for foreign currency loans, which would help reduce dollarization further.

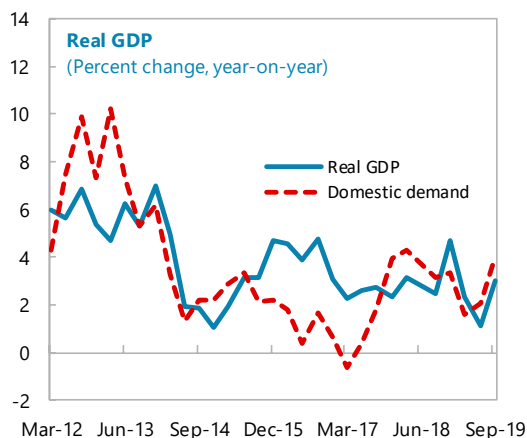
37. A stronger focus on key priorities would facilitate progress on the authorities' broad structural reform agenda. The National Competitiveness Plan released in June covers a large spectrum of reforms which might require a focused approach with clear timelines. Significant progress has already been made in enhancing public sector transparency and governance, but more efforts are necessary. Addressing infrastructure gaps is key to boosting productivity, for which significant improvements in public investment management are needed. Strengthening anti-corruption enforcement should contribute to improving growth and investment climate. In addition, it will be important to foster economic diversification, for which an extension of the agriculture promotion law and further improvements in business climate appear crucial.

38. Improving social protection is necessary to make growth more inclusive and sustainable. Peru has made significant progress in reducing poverty since the turn of the century. Nonetheless, action is needed to address critical needs, including by reforming the pension system to ensure its sustainability and enhance its coverage, providing a more equitable distribution of natural resource revenues across regions, and deepening financial development and inclusion, which the authorities have identified as priorities in the National Competitiveness Plan. These actions should be accompanied by reforms that reduce labor market rigidities and other costs that prevent workers and firms shifting from the informal to the formal sector.

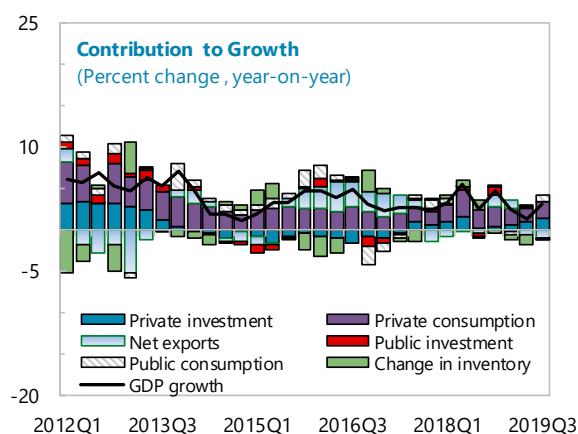
39. Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Peru: Real Sector Developments

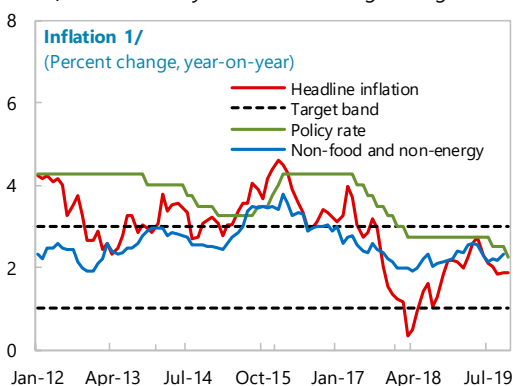
After a bounce back in 2018, growth slowed again in 2019...



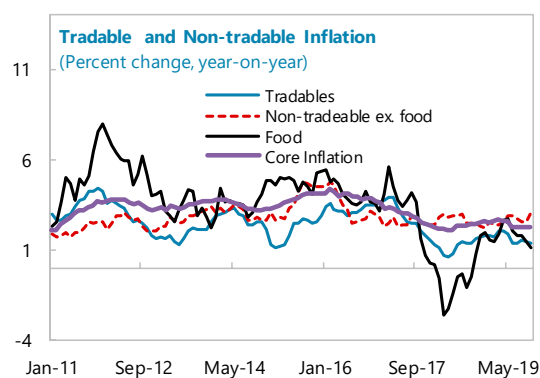
...due to weak export performance and lower than expected government expenditure.



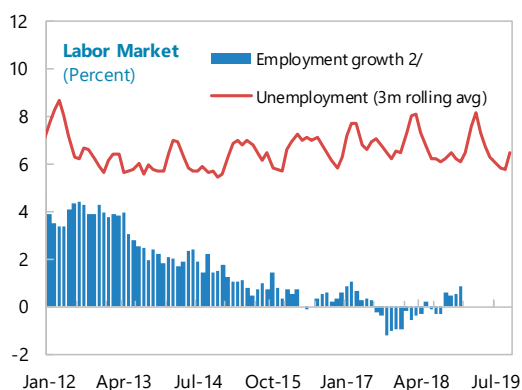
The central bank lowered the policy rate, as headline inflation has stayed within the target range...



...and so has core inflation.



Unemployment has remained stable in spite of the growth slowdown and inward migration...



...but confidence indicators have been declining recently on economic and political uncertainty...



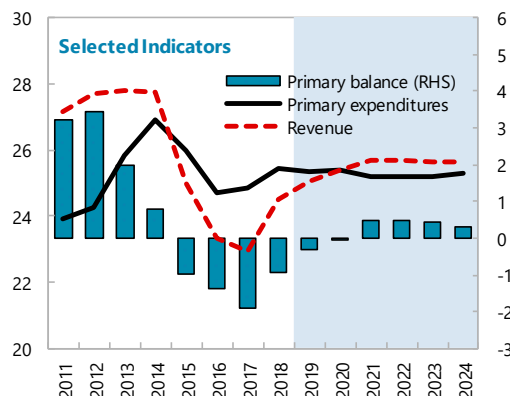
Source: National authorities; and IMF staff calculations.

1/ Inflation values correspond to Metropolitan Lima.

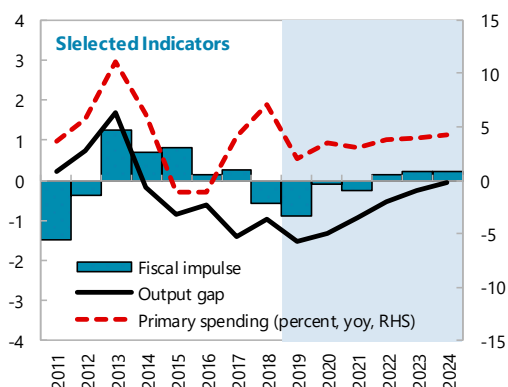
2/ In formal firms with 10 or more employees, all urban areas.

Figure 2. Peru: Fiscal Sector Developments
(Percent of GDP)

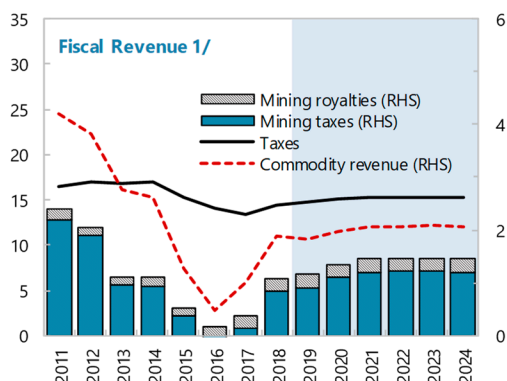
The primary balance has been increasing faster than anticipated...



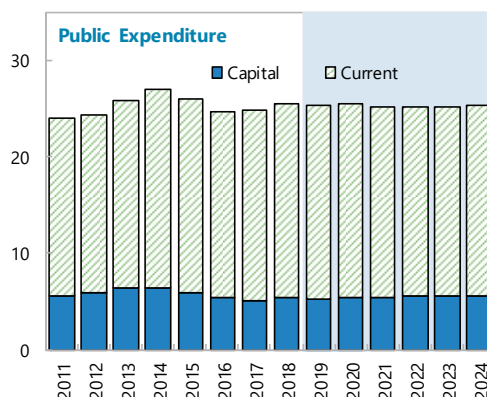
...leading to a negative fiscal impulse



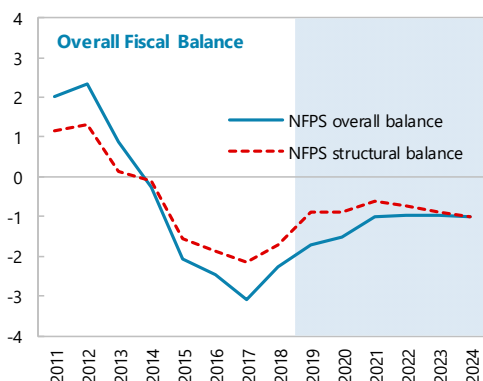
This has been the result of a continued recovery in tax revenues....



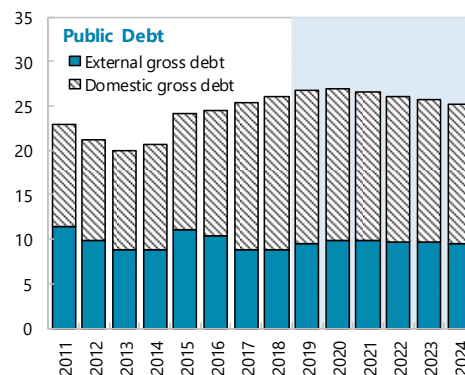
...as well as lower than expected government expenditure



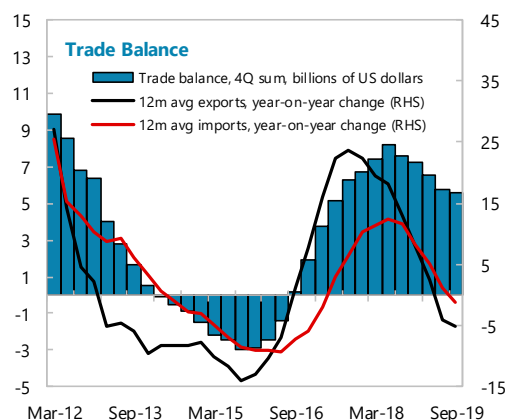
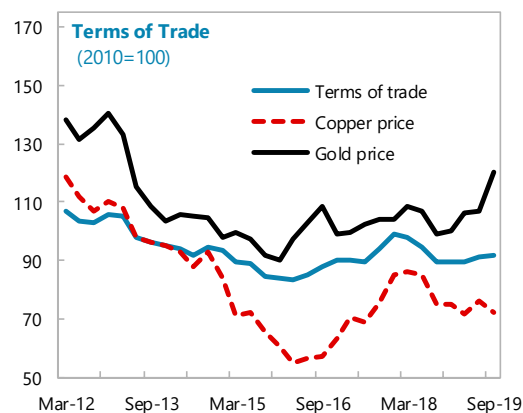
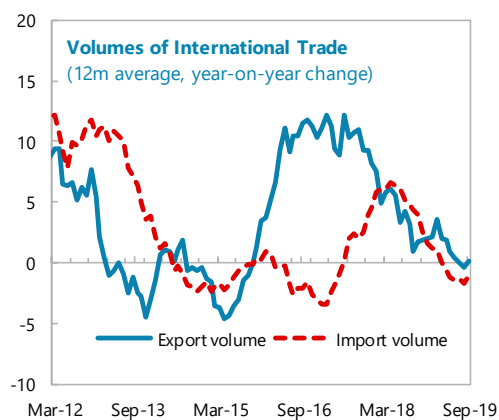
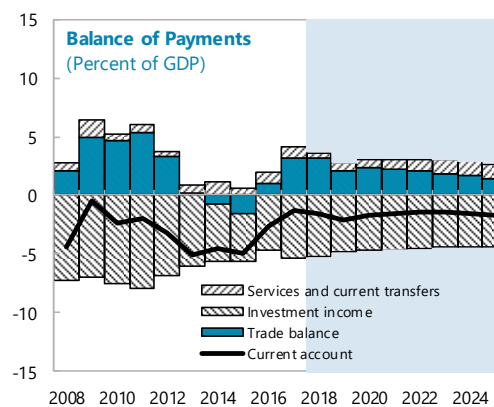
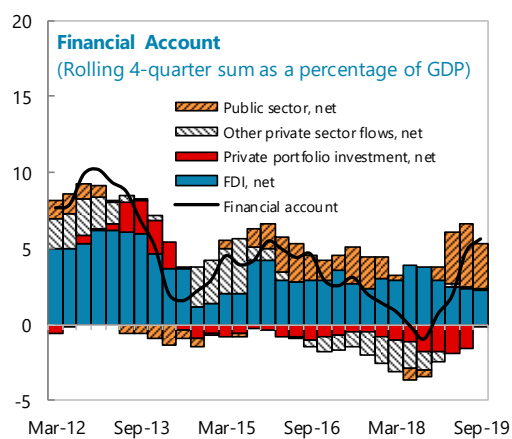
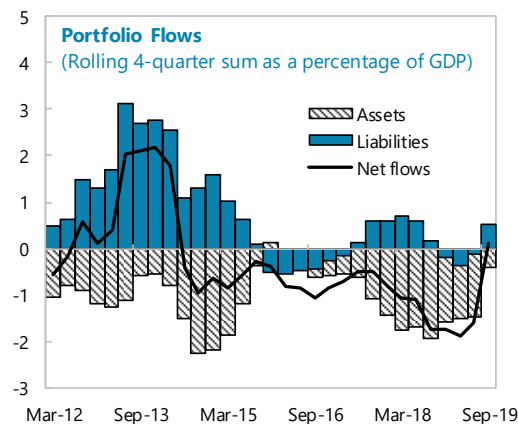
The fiscal deficit is converging to the fiscal rule ceiling...



...while public debt remains below the 30 percent of GDP ceiling.



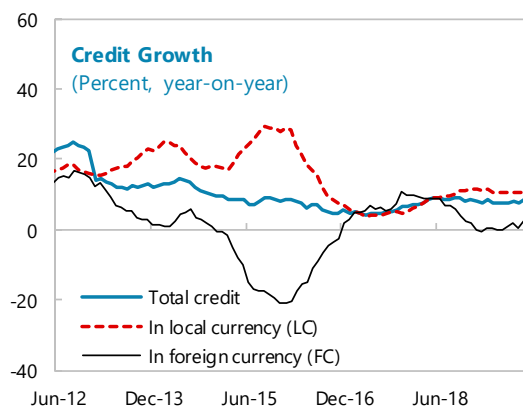
Sources: National authorities; and IMF staff estimates.
1/ Net of restitutions.

Figure 3. Peru: External Sector Developments*The trade surplus has been shrinking on account of ...**...lower terms of trade....**...as well as stagnating export volumes.**As a result, the current account deficit is expected to widen in 2019.**FDI has remained robust...**...but private portfolio financing has turned into net outflows.*

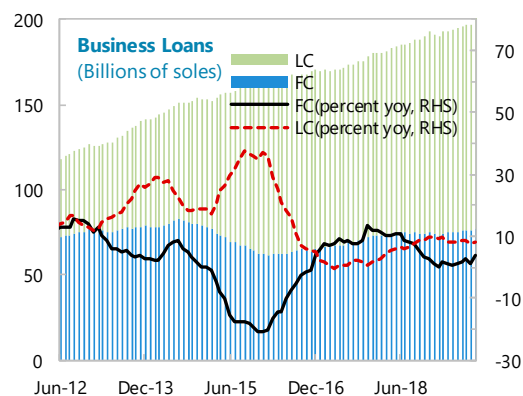
Sources: National authorities; and IMF staff estimates.

Figure 4. Peru: Financial Sector Developments

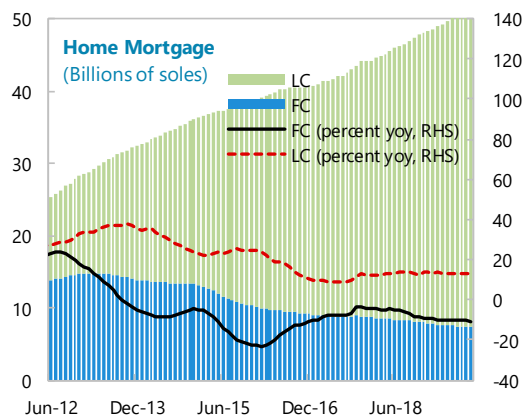
Credit growth has moderated, with the expansion almost exclusively in local currency credit.



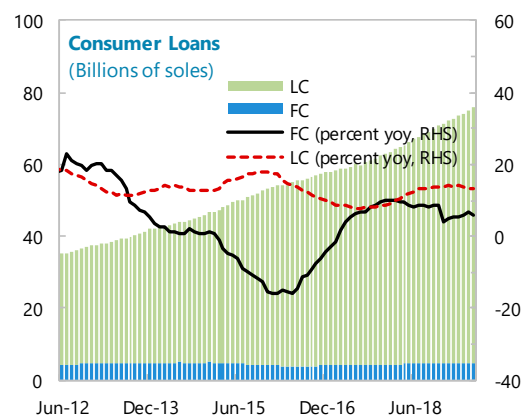
That has been the case across business loans...



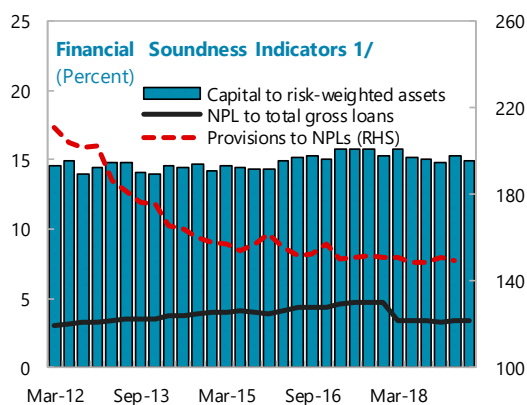
...mortgage lending



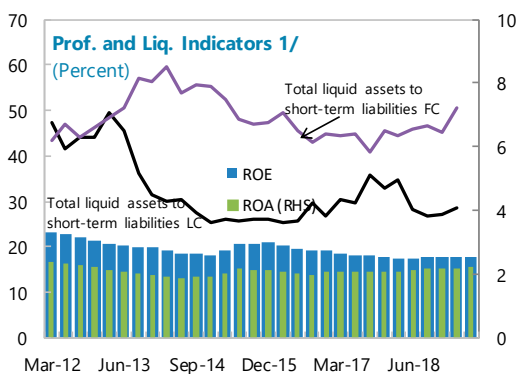
...and consumer lending.



Depository corporations remain well capitalized and with low NPL ratios...



...while profitability and liquidity indicators remain high.

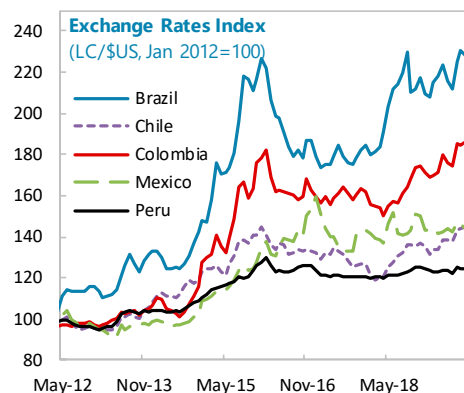


Sources: National authorities; and IMF staff estimates.

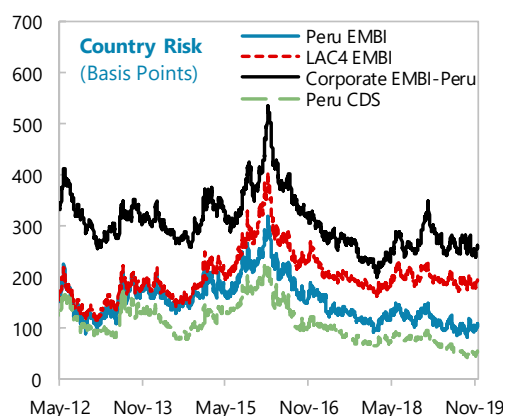
1/ Data corresponds to depository corporations. Last data available is for March 2019.

Figure 5. Peru: FX and Capital Market Developments

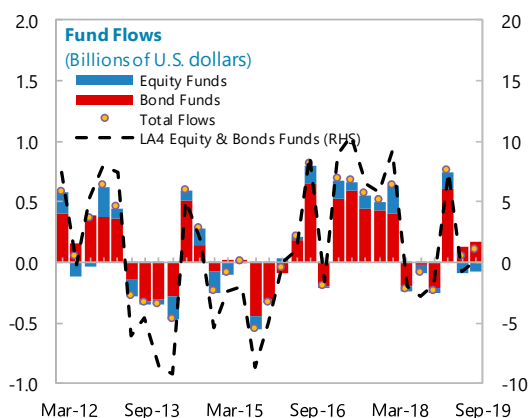
In line with historical patterns, the sol has been more stable than other Latin American currencies....



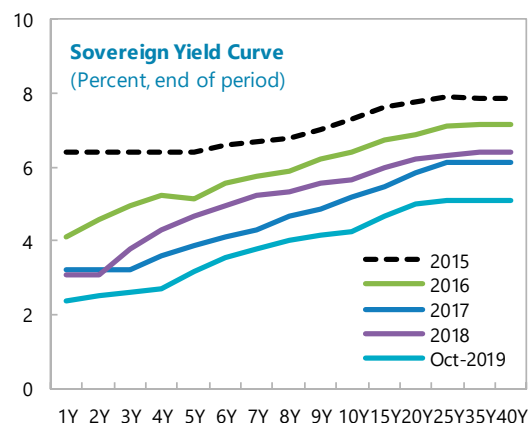
...and country risk spreads have remained low.



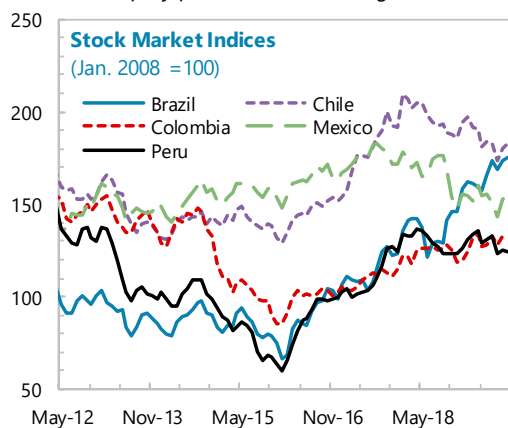
Bond and equity flows have been irregular...



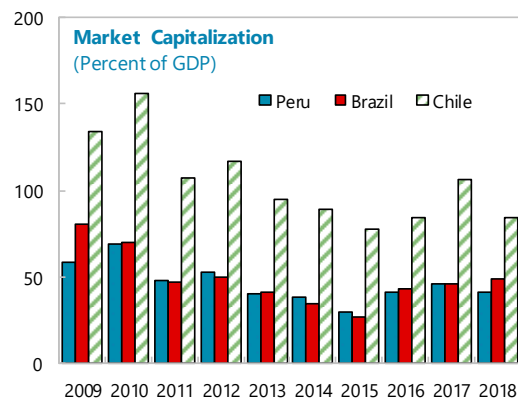
...but the sovereign yield curve has shifted down so far in 2019.



Equity prices have been stagnant...



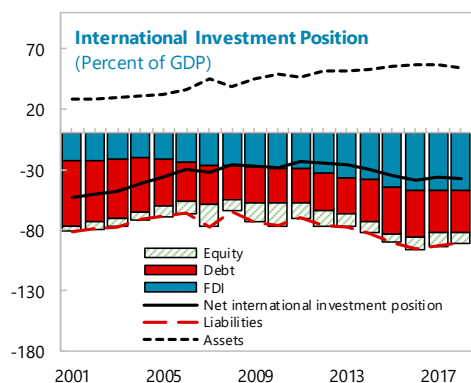
...while market capitalization declined again.



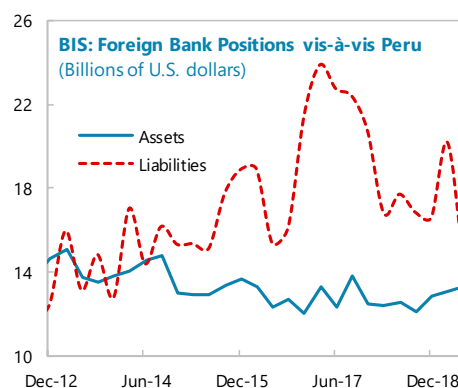
Sources: Bloomberg; Haver Analytics; National authorities; and IMF staff estimates.

Figure 6. Peru: Balance Sheet Indicators

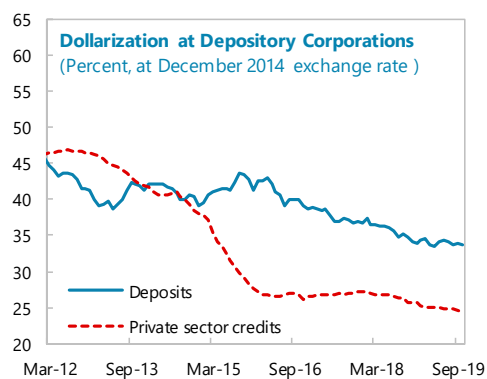
Peru's net international investment position remained stable in 2018....



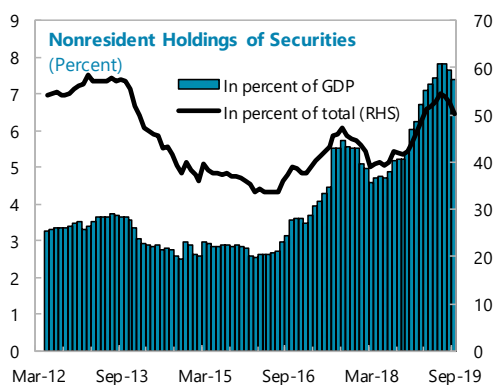
...in spite of fluctuations in liabilities to foreign banks.



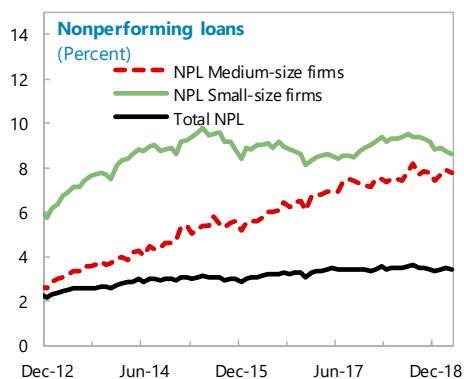
Financial dollarization has continued to decline....



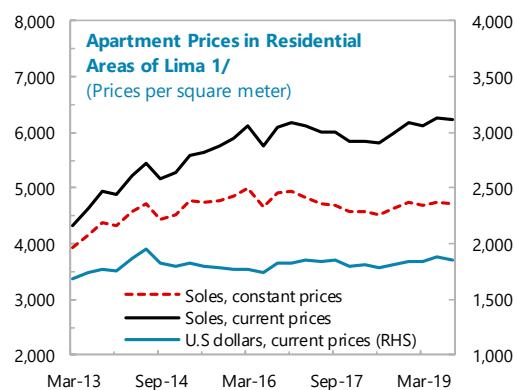
...and the increase in nonresident holdings of government securities continued to increase in the first quarter of 2019.



Nonperforming loans have remained stable...

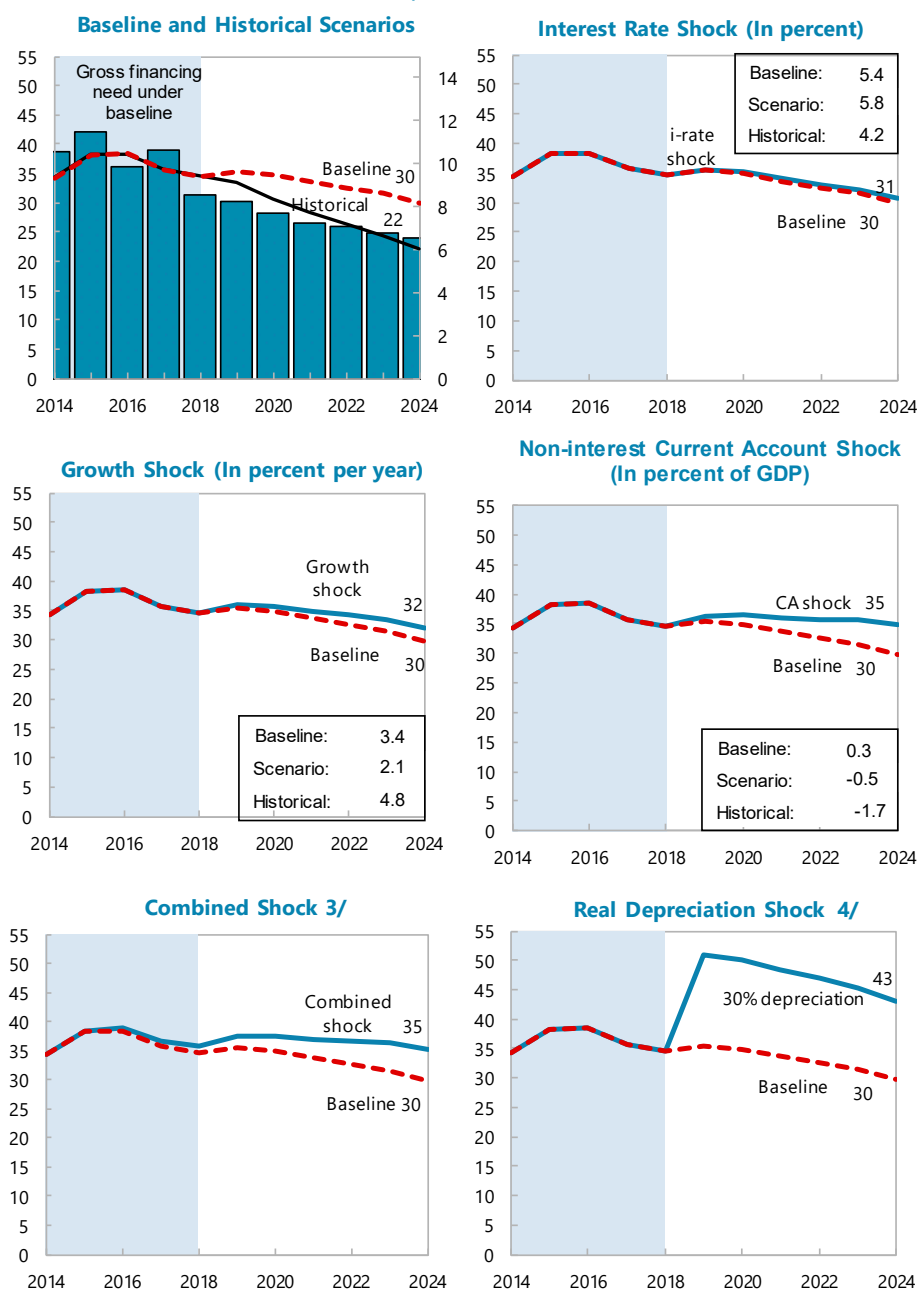


...while apartment prices increased in 2018 after some weakness in previous years.



Sources: National authorities; Association of Banks; Bank for International Settlements; and IMF staff estimates.
1/ La Molina, Miraflores, San Borja, San Isidro, and Surco.

Figure 7. Peru: External Debt Sustainability: Bound Tests 1/ 2/
(In percent of GDP)



Source: Fund staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2019.

Table 1. Peru: Selected Economic Indicators

	2014	2015	2016	2017	Prel. 2018	2019	2020	Proj. 2021	2022	2023	2024
Social Indicators											
Life expectancy at birth (years)	75.6	75.9	76.1	76.4	76.6	...	...	...	...	...	...
Infant mortality (per thousand live births)	13.5	13.2	13.0	12.9	12.7	...	...	...	...	...	...
Adult literacy rate	93.7	94.0	94.1	94.2	94.4	...	...	...	...	...	...
Poverty rate (total) 1/	22.7	21.8	20.7	21.7	20.5	...	...	...	...	...	...
Unemployment rate	6.0	6.5	6.7	6.9	6.7	...	...	...	...	...	...
(Annual percentage change; unless otherwise indicated)											
Production and prices											
Real GDP	2.4	3.3	4.1	2.5	4.0	2.4	3.2	3.7	3.7	3.7	3.7
Real domestic demand	2.2	2.6	1.1	1.4	4.2	3.3	3.2	4.0	3.9	3.8	3.8
Real domestic demand (contribution to GDP)	2.3	2.7	1.1	1.4	4.1	3.2	3.1	4.0	3.8	3.8	3.7
Consumption (contribution to GDP)	3.1	3.7	2.4	1.8	2.6	2.0	2.1	2.2	2.3	2.4	2.5
Investment (contribution to GDP)	-0.9	-1.0	-1.3	-0.4	1.5	1.1	1.0	1.8	1.5	1.3	1.2
Net Exports (contribution to GDP)	0.1	0.6	2.9	1.1	0.0	-0.7	0.1	-0.2	-0.1	-0.1	0.0
Output gap (percent of potential GDP)	-0.2	-0.9	-0.6	-1.4	-0.9	-1.5	-1.3	-0.9	-0.5	-0.3	-0.1
Consumer prices (end of period)	3.2	4.4	3.2	1.4	2.2	1.9	2.0	2.0	2.0	2.0	2.0
Consumer prices (period average)	3.2	3.5	3.6	2.8	1.3	2.1	1.9	2.0	2.0	2.0	2.0
External sector											
Exports	-7.8	-12.9	7.8	22.5	8.0	-5.4	3.5	4.3	4.8	5.0	5.1
Imports	-3.1	-9.0	-5.9	10.2	8.1	-1.7	2.7	4.8	5.6	6.1	5.8
Terms of trade (deterioration -)	-5.4	-6.9	-0.3	7.5	-0.2	-1.2	0.8	0.8	-0.1	-0.6	-0.4
Real effective exchange rate (depreciation -)	-2.1	-0.4	-1.7	2.6	-1.7	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Money and credit 2/ 3/											
Broad money	9.5	11.5	4.4	8.8	9.5	8.3	8.0	8.0	7.8	7.7	7.7
Net credit to the private sector	13.2	13.9	5.1	5.1	10.3	7.3	6.9	7.1	6.6	6.7	6.8
(In percent of GDP; unless otherwise indicated)											
Public sector											
NFPS revenue	27.7	25.0	23.3	22.9	24.5	25.1	25.4	25.7	25.7	25.7	25.6
NFPS primary expenditure	26.9	26.0	24.7	24.8	25.4	25.4	25.4	25.2	25.2	25.2	25.3
NFPS primary balance	0.8	-1.0	-1.4	-1.9	-0.9	-0.3	0.0	0.5	0.5	0.4	0.3
NFPS overall balance	-0.3	-2.1	-2.5	-3.1	-2.3	-1.7	-1.5	-1.0	-1.0	-1.0	-1.0
NFPS structural balance	-0.8	-1.6	-1.8	-2.1	-1.7	-0.9	-0.9	-0.6	-0.7	-0.9	-1.0
NFPS structural primary balance 4/	0.3	-0.5	-0.7	-0.9	-0.4	0.5	0.6	0.9	0.7	0.5	0.3
External sector											
External current account balance	-4.5	-5.0	-2.6	-1.2	-1.6	-1.8	-1.6	-1.4	-1.3	-1.3	-1.4
Gross reserves											
In billions of U.S. dollars	62.4	61.5	61.7	63.7	60.3	68.1	68.1	68.1	68.1	68.1	68.1
Percent of short-term external debt 5/	522	472	424	306	364	461	466	462	450	446	442
Percent of foreign currency deposits at banks	258	225	230	225	213	239	240	242	245	250	257
Debt											
Total external debt 6/	34.2	38.2	38.4	35.7	34.5	35.4	34.8	33.6	32.5	31.5	29.8
Gross non-financial public sector debt 7/	20.6	24.1	24.5	25.4	26.2	26.8	27.0	26.6	26.1	25.7	25.3
External	8.8	11.2	10.4	8.8	8.8	9.6	9.7	9.5	9.1	8.8	8.3
Domestic	11.9	12.9	14.1	16.7	17.3	17.3	17.4	17.2	17.0	16.9	17.0
Savings and investment											
Gross domestic investment	24.7	23.7	21.9	20.5	21.5	22.1	22.3	23.1	23.6	23.9	24.0
Public sector (incl. repayment certificates)	5.6	5.1	4.9	4.6	4.8	4.7	4.8	4.9	5.0	5.0	5.0
Private sector (incl. inventories)	19.1	18.6	17.0	15.9	16.6	17.4	17.5	18.2	18.7	18.9	19.0
Private sector	20.4	19.6	18.2	17.3	17.6	17.6	17.5	18.2	18.7	18.9	19.0
National savings	20.2	18.7	19.3	19.3	19.9	20.3	20.8	21.7	22.3	22.5	22.7
Public sector	6.0	3.8	2.7	1.8	2.9	3.4	3.7	4.3	4.4	4.5	4.5
Private sector	14.2	14.9	16.6	17.4	17.0	16.9	17.1	17.4	17.9	18.1	18.2
Memorandum items											
Nominal GDP (\$/ billions)	574	609	656	698	741	774	816	864	916	970	1,027
GDP per capita (in US\$)	6,565	6,141	6,173	6,730	7,005	7,097	7,292	7,597	7,926	8,279	8,661

Sources: National authorities; UNDP Human Development Indicators; and IMF staff estimates/projections.

1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.

2/ Corresponds to depository corporations.

3/ Foreign currency stocks are valued at end-of-period exchange rates.

4/ Adjusted by the economic cycle and commodity prices, and for non-structural commodity revenue. The latter uses as equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to IMF World Economic Outlook.

5/ Short-term debt is defined on a residual maturity basis and includes amortization of medium and long-term debt.

6/ Includes local currency debt held by non-residents and excludes global bonds held by residents.

7/ Includes repayment certificates.

Table 2. Peru: Nonfinancial Public Sector Main Fiscal Aggregates

	2014	2015	2016	2017	Prel. 2018	Projections					
						2019	2020	2021	2022	2023	2024
(In millions of soles; unless otherwise indicated)											
Revenues	159,293	152,210	153,192	160,273	181,482	193,948	207,136	221,947	235,264	248,788	263,183
Taxes	97,649	92,788	92,221	93,475	107,358	114,093	122,627	131,927	140,274	148,560	156,986
Other	61,644	59,422	60,972	66,799	74,124	79,854	84,509	90,020	94,990	100,228	106,197
Primary expenditures 1/	154,648	158,245	162,152	173,546	188,395	196,403	207,300	217,785	230,726	244,521	259,877
Current	117,808	122,140	127,047	137,665	148,559	155,648	163,532	170,686	180,285	190,549	202,127
Capital	36,840	36,105	35,105	35,881	39,836	40,755	43,768	47,099	50,441	53,972	57,750
Primary balance	4,644	-6,034	-8,960	-13,272	-6,913	-2,455	-163	4,163	4,538	4,267	3,306
Interest	6,206	6,507	7,178	8,336	10,010	10,824	12,406	13,013	13,425	13,808	13,545
Overall balance	-1,562	-12,541	-16,138	-21,609	-16,923	-13,279	-12,569	-8,850	-8,887	-9,541	-10,239
External financing	-843	9,733	4,320	-10,415	-1,067	7,941	5,626	3,926	4,027	4,127	3,929
Domestic financing	2,405	2,808	11,817	32,023	17,990	5,338	6,943	4,925	4,860	5,414	6,310
Public Gross Debt 2/	118,558	146,652	160,653	177,461	193,721	207,584	220,624	230,044	239,297	249,212	259,555
External	50,388	67,956	68,057	61,163	65,505	74,031	79,024	81,686	83,654	84,988	85,078
Domestic	64,004	74,236	88,552	112,749	124,938	130,575	138,922	145,980	153,566	162,446	173,000
Repayment Certificates	4,166	4,460	4,044	3,549	3,278	2,978	2,678	2,378	2,078	1,778	1,478
Public Assets 3/	90,618	99,497	100,795	92,709	89,881	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
(In percent of GDP; unless otherwise indicated)											
Revenues	27.7	25.0	23.3	22.9	24.5	25.1	25.4	25.7	25.7	25.7	25.6
Taxes	17.0	15.2	14.1	13.4	14.5	14.7	15.0	15.3	15.3	15.3	15.3
Other	10.7	9.8	9.3	9.6	10.0	10.3	10.4	10.4	10.4	10.3	10.3
Primary expenditures 1/	26.9	26.0	24.7	24.8	25.4	25.4	25.4	25.2	25.2	25.2	25.3
Current	20.5	20.0	19.4	19.7	20.1	20.1	20.0	19.7	19.7	19.6	19.7
Capital	6.4	5.9	5.3	5.1	5.4	5.3	5.4	5.4	5.5	5.6	5.6
Primary balance	0.8	-1.0	-1.4	-1.9	-0.9	-0.3	0.0	0.5	0.5	0.4	0.3
Interest	1.1	1.1	1.1	1.2	1.4	1.4	1.5	1.5	1.5	1.4	1.3
Overall balance	-0.3	-2.1	-2.5	-3.1	-2.3	-1.7	-1.5	-1.0	-1.0	-1.0	-1.0
External financing	-0.1	1.6	0.7	-1.5	-0.1	1.0	0.7	0.5	0.4	0.4	0.4
Domestic financing	0.4	0.5	1.8	4.6	2.4	0.7	0.9	0.6	0.5	0.6	0.6
Public Gross Debt 2/	20.6	24.1	24.5	25.4	26.2	26.8	27.0	26.6	26.1	25.7	25.3
External	8.8	11.2	10.4	8.8	8.8	9.6	9.7	9.5	9.1	8.8	8.3
Domestic	11.1	12.2	13.5	16.1	16.9	16.9	17.0	16.9	16.8	16.7	16.8
Repayment Certificates	0.7	0.7	0.6	0.5	0.4	0.4	0.3	0.3	0.2	0.2	0.1
Public Assets 3/	15.8	16.3	15.4	13.3	12.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public Net Debt	4.9	7.7	9.1	12.1	14.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Memorandum items											
Commodity related revenues 4/	2.6	1.3	0.5	1.0	1.9	1.8	2.0	2.0	2.1	2.1	2.1
Output gap (percent of potential GDP)	-0.2	-0.9	-0.6	-1.4	-0.9	-1.5	-1.3	-0.9	-0.5	-0.3	-0.1
NFPS non-commodity structural balance	-3.3	-2.8	-2.7	-3.7	-3.9	-3.1	-3.1	-2.8	-2.9	0.0	0.0
NFPS non-commodity primary structural balance	-2.2	-1.7	-1.6	-2.5	-2.5	-1.7	-1.6	-1.3	-1.4	1.4	1.3
NFPS structural balance 5/	-0.8	-1.6	-1.8	-2.1	-1.7	-0.9	-0.9	-0.6	-0.7	-0.9	-1.0
NFPS structural primary balance 5/	0.3	-0.5	-0.7	-0.9	-0.4	0.5	0.6	0.9	0.7	0.5	0.3
Fiscal impulse (+ = expansionary) 6/	0.7	0.8	0.2	0.3	-0.6	-0.9	-0.1	-0.3	0.1	0.2	0.2

Sources: National Authorities; and IMF staff estimates.

1/ Official data excludes expense accrued during the period by Repayment Certificates (CRPAOs) and Petroleum Price Stabilization Fund (FEPC), but includes corresponding cash payments.

2/ Official data excludes stock of debt accumulated and not paid during the period by Repayment Certificates (CRPAOs) and Petroleum Price Stabilization

3/ Obligations of depository corporations with the public sector.

4/ Net of tax restitutions. In 2014, excludes one-off revenue from the sale of a mine Las Bambas.

5/ Adjusted by the economic cycle and commodity prices, and for non-structural commodity revenue. The latter uses as equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to IMF World Economic Outlook.

6/ Percentage points of potential GDP.

Table 3. Peru: Statement of Operations of the General Government 1/
(In percent of GDP; unless otherwise indicated)

	2014	2015	2016	2017	Prel. 2018	2019	2020	2021	2022	2023	2024
						Projections					
Revenue	22.4	20.3	18.8	18.3	19.4	19.9	20.2	20.5	20.5	20.5	20.5
Taxes	17.0	15.2	14.1	13.4	14.5	14.7	15.0	15.3	15.3	15.3	15.3
Social Contributions	2.2	2.0	2.2	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	3.1	2.9	2.5	2.7	2.7	3.0	2.9	3.0	3.0	3.0	3.0
Expense 2/	16.6	17.0	16.4	16.5	16.5	16.7	16.8	16.5	16.5	16.5	16.4
Compensation of employees	6.0	6.0	6.0	6.1	6.2	6.2	6.2	6.1	6.1	6.0	6.0
Use of goods and services	6.1	6.7	6.2	6.0	5.7	5.7	5.7	5.6	5.5	5.5	5.5
Interest	1.1	1.0	1.1	1.1	1.2	1.3	1.4	1.4	1.4	1.4	1.3
Social benefits	2.1	1.9	1.7	1.7	1.9	2.0	1.9	1.9	1.8	1.7	1.7
Other expenses 3/	1.5	1.4	1.5	1.6	1.5	1.5	1.5	1.6	1.7	1.8	2.0
Net acquisition of nonfinancial assets	6.0	5.4	4.7	4.7	4.9	4.7	4.8	4.9	5.0	5.0	5.1
Acquisitions of nonfinancial assets	6.0	5.4	4.7	4.7	4.9	4.7	4.8	4.9	5.0	5.0	5.1
Gross Operating Balance	5.8	3.3	2.4	1.8	2.9	3.3	3.4	3.9	4.1	4.1	4.1
Net lending (+) borrowing (-) 4/	-0.2	-2.1	-2.3	-2.9	-2.0	-1.4	-1.4	-1.0	-0.9	-0.9	-0.9
Net acquisition of financial assets 5/	1.0	-1.3	0.9	-1.3	-0.4	-0.3	-0.5	-0.5	-0.5	-0.5	-0.6
<i>By instrument</i>											
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits 6/	1.0	-1.3	0.9	-1.3	-0.4	-0.3	-0.5	-0.5	-0.5	-0.5	-0.6
<i>By residency</i>											
Domestic	1.0	-1.3	0.9	-1.3	-0.4	-0.3	-0.5	-0.5	-0.5	-0.5	-0.6
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities 7/	1.2	0.8	3.1	1.6	1.6	1.2	0.9	0.5	0.4	0.4	0.4
<i>By instrument</i>											
Debt securities	1.3	0.8	3.0	3.7	2.3	0.2	0.2	0.0	0.0	0.0	0.0
Loans	-0.1	-0.1	0.2	-2.1	-0.7	1.0	0.7	0.5	0.4	0.4	0.4
<i>By residency</i>											
Domestic	1.3	0.8	3.0	3.7	2.3	0.2	0.2	0.0	0.0	0.0	0.0
External	-0.1	-0.1	0.2	-2.1	-0.7	1.0	0.7	0.5	0.4	0.4	0.4
Memorandum items											
Central Government Net lending (+) borrowing (-)	-0.9	-2.8	-2.2	-3.2	-2.2	-1.9	-2.0	-1.7	-1.5	-1.5	-1.4
Regional Governments Net lending (+) borrowing (-)	0.6	0.7	0.1	0.1	0.4	0.5	0.6	0.7	0.8	0.9	0.9
Local Governments Net lending (+) borrowing (-)	0.2	0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1
General Government Primary Balance	0.8	-1.1	-1.2	-1.8	-0.7	-0.1	0.1	0.5	0.5	0.5	0.3
General Government Overall Balance	-0.2	-2.1	-2.3	-2.9	-2.0	-1.4	-1.4	-1.0	-0.9	-0.9	-0.9
Gen. Gov. primary spending (real percentage change)	7.3	1.5	-2.7	4.1	4.9	1.8	3.8	3.2	4.0	4.1	4.4
<i>Of which:</i> Current spending	10.6	4.6	0.1	3.9	3.9	2.8	3.4	2.4	3.7	3.8	4.3
Capital spending	-0.4	-6.6	-10.8	4.8	8.2	-1.2	5.3	5.8	5.0	4.9	4.9
General Government non-financial expenditures	21.6	21.4	20.0	20.1	20.2	20.1	20.2	20.0	20.0	20.1	20.2

Sources: National authorities and IMF staff estimates.

1/ Fiscal data is not fully compiled on an accrual basis.

2/ Official data excludes expense accrued during the period by Repayment Certificates (CRPAOs) and Petroleum Price Stabilization Fund (FEPC), but includes corresponding cash payments.

3/ Includes transfers to the Petroleum Price Stabilization Fund (FEPC).

4/ Net lending (+)/ borrowing (-) is equal to gross operating balance minus net acquisitions of nonfinancial assets.

5/ (+) corresponds to increase in financial assets; (-) to a decrease in financial assets.

6/ Includes Fiscal Stabilization Fund (FEF).

7/ (+) corresponds to increase in liabilities (disbursement and/or issuance); (-) to decrease in liabilities (amortizations).

Table 4. Peru: General Government Stock Positions
(In percent of GDP; unless otherwise indicated)

	2014	2015	2016	2017	Prel. 2018	2019	2020	2021	2022	2023	2024
	Projections 1/										
Stock positions:											
Net worth	....	....	....	....	....	....	....	....	....	....	....
Nonfinancial assets	....	....	....	....	....	....	....	....	....	....	....
Net financial worth	-2.7	-5.3	-7.0	-8.7	-10.2	-11.2	-12.0	-12.3	-12.6	-12.8	-13.0
Financial assets	15.0	15.5	14.6	12.5	11.4	10.6	9.6	8.6	7.6	6.7	5.8
<i>By instrument</i>											
Currency and deposits 2/	14.7	15.2	14.3	12.2	11.2	10.4	9.4	8.4	7.5	6.5	5.6
Debt securities	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
<i>By currency 3/</i>											
Domestic	7.9	6.8	6.3	7.7	7.1	6.7	6.2	5.5	4.9	4.3	3.7
Foreign	6.4	7.7	8.4	4.8	4.0	3.8	3.5	3.1	2.7	2.4	2.1
Liabilities 4/	17.7	20.8	21.5	21.2	21.6	21.9	21.7	20.9	20.2	19.5	18.8
<i>By instrument</i>											
Debt securities	12.2	12.4	14.5	17.3	18.6	18.0	17.3	16.3	15.4	14.5	13.7
Loans	5.5	8.4	7.1	3.9	3.0	3.9	4.4	4.6	4.8	4.9	5.0
<i>By residency</i>											
Domestic	8.5	9.2	10.9	13.3	14.8	14.3	13.9	13.1	12.3	11.7	11.0
External	9.2	11.6	10.7	8.0	6.8	7.5	7.8	7.8	7.8	7.8	7.8
<i>By currency 3/</i>											
Domestic	24.2	29.3	36.6	43.2	48.7	48.1	47.2	44.9	42.6	40.4	38.3
Foreign	26.0	36.9	36.0	25.9	22.3	25.2	26.7	26.9	27.1	27.1	27.0
Memorandum items											
Fiscal Stabilization Fund and other public savings	4.5	4.1	4.2	3.0	2.6	2.2	1.9	1.8	1.7	1.6	1.6

Sources: National authorities and IMF staff estimates.

1/ Assuming zero other economic flows.

2/ Includes stocks of Fiscal Stabilization Fund (FEF).

3/ Preliminary data.

4/ Excludes debt of public enterprises guaranteed by the central government, debt of Petroleum Price Stabilization Fund (FEPC), and Repayment Certificates (CRPAOs).

Table 5. Peru: Balance of Payments
(In billions of U.S. dollars; un less otherwise indicated)

	2014	2015	2016	2017	Prel. 2018	2019	2020	Projections 2021	2022	2023	2024
Current account	-9.1	-9.5	-5.1	-2.7	-3.6	-4.2	-3.7	-3.5	-3.6	-3.7	-4.0
Merchandise trade	-1.5	-2.9	2.0	6.7	7.2	5.2	5.8	5.8	5.7	5.5	5.4
Exports	39.5	34.4	37.1	45.4	49.1	46.4	48.0	50.1	52.5	55.1	57.9
Traditional	27.7	23.4	26.2	33.6	35.6	32.7	34.0	35.3	36.8	38.3	39.9
Mining	20.5	19.0	21.8	27.6	28.9	27.0	28.2	29.3	30.5	31.7	32.9
Nontraditional and others	11.8	11.0	10.9	11.9	13.4	13.7	14.0	14.8	15.6	16.7	18.0
Imports	-41.0	-37.3	-35.1	-38.7	-41.9	-41.2	-42.3	-44.3	-46.7	-49.6	-52.5
Services, income, and current transfers (net)	-7.6	-6.6	-7.0	-9.4	-10.8	-9.4	-9.5	-9.3	-9.3	-9.2	-9.4
Services	-2.0	-2.1	-2.0	-1.4	-2.5	-2.5	-2.5	-2.4	-2.4	-2.3	-2.3
Investment income	-9.9	-7.9	-9.0	-11.5	-11.8	-10.6	-11.1	-11.4	-11.7	-12.1	-12.8
Current transfers	4.4	3.3	4.0	3.6	3.6	3.7	4.1	4.5	4.8	5.2	5.6
Capital and financial account balance	5.9	10.4	5.5	3.0	1.5	11.1	3.7	3.5	3.6	3.7	4.0
Public sector	-0.1	3.1	2.6	3.3	2.1	5.5	1.9	1.3	1.4	1.4	1.3
Medium-term loans 1/	1.3	4.0	0.2	-1.5	0.2	2.4	1.7	1.1	1.2	1.2	1.1
Other public sector flows 2/	-0.7	-0.4	2.7	4.1	2.1	3.1	0.2	0.2	0.2	0.2	0.2
Short-term flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	6.0	7.3	2.9	-0.3	-0.6	5.7	1.9	2.2	2.2	2.4	2.7
Foreign direct investment (net) 3/	2.8	8.1	5.6	6.4	6.5	5.9	5.2	6.3	6.9	7.3	7.7
Medium- and long-term loans	5.7	1.5	-1.7	-3.7	-1.6	-0.9	-1.0	-0.8	-0.6	-0.4	-0.2
Portfolio investment	-1.3	-0.8	-1.7	-1.8	-3.9	-1.1	-2.5	-2.5	-2.5	-2.5	-2.5
Short-term flows 4/	-1.3	-1.5	0.7	-1.2	-1.5	1.8	0.2	-0.8	-1.6	-2.0	-2.3
Errors and omissions	1.0	-0.8	-0.3	1.3	-1.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.2	0.1	0.2	1.6	-3.6	6.9	0.0	0.0	0.0	0.0	0.0
Financing	2.2	-0.1	-0.2	-1.6	3.6	-6.9	0.0	0.0	0.0	0.0	0.0
NIR flow (increase -)	2.2	-0.1	-0.2	-1.6	3.6	-6.9	0.0	0.0	0.0	0.0	0.0
Change in NIR (increase -)	3.4	0.8	-0.2	-1.9	3.5	-7.7	0.0	0.0	0.0	0.0	0.0
Valuation change	-1.2	-0.9	0.0	0.3	0.1	0.8	0.0	0.0	0.0	0.0	0.0
(In percent of GDP)											
Current account balance	-4.5	-5.0	-2.6	-1.2	-1.6	-1.8	-1.6	-1.4	-1.3	-1.3	-1.4
Trade balance	-0.7	-1.5	1.0	3.1	3.2	2.3	2.4	2.3	2.2	2.0	1.8
Exports	19.5	18.0	19.1	21.2	21.8	20.1	20.1	19.9	19.8	19.7	19.6
Traditional	13.7	12.2	13.5	15.7	15.8	14.2	14.2	14.0	13.9	13.7	13.5
Mining	10.2	9.9	11.2	12.9	12.8	11.7	11.8	11.6	11.5	11.3	11.1
Nontraditional and others	5.9	5.7	5.6	5.5	6.0	5.9	5.8	5.9	5.9	6.0	6.1
Imports	-20.3	-19.5	-18.1	-18.1	-18.6	-17.8	-17.7	-17.6	-17.6	-17.7	-17.8
Services, income, and current transfers (net)	-3.7	-3.5	-3.6	-4.4	-4.8	-4.1	-4.0	-3.7	-3.5	-3.3	-3.2
Investment income	-4.9	-4.1	-4.6	-5.4	-5.2	-4.6	-4.6	-4.5	-4.4	-4.3	-4.3
Capital and financial account balance	2.9	5.4	2.8	1.4	0.7	4.8	1.6	1.4	1.3	1.3	1.4
Foreign direct investment (net)	1.4	4.2	2.9	3.0	2.9	2.5	2.2	2.5	2.6	2.6	2.6
Overall balance	-1.1	0.0	0.1	0.8	-1.6	3.0	0.0	0.0	0.0	0.0	0.0
(Annual percentage change)											
Memorandum items											
Export value	-7.8	-12.9	7.8	22.5	8.0	-5.4	3.5	4.3	4.8	5.0	5.1
Volume growth	-1.0	3.0	11.4	8.0	1.6	-3.2	3.0	3.8	3.9	3.8	3.8
Price growth	-6.8	-15.5	-3.3	13.4	6.3	-2.3	0.4	0.4	0.9	1.1	1.3
Import value	-3.1	-9.0	-5.9	10.2	8.1	-1.7	2.7	4.8	5.6	6.1	5.8
Volume growth	-1.6	0.2	-3.0	4.5	1.6	-0.6	3.1	5.2	4.5	4.3	4.1
Price growth	-1.5	-9.2	-3.0	5.5	6.5	-1.1	-0.4	-0.4	1.0	1.7	1.7
Terms of trade	-5.4	-6.9	-0.3	7.5	-0.2	-1.2	0.8	0.8	-0.1	-0.6	-0.4
Gross international reserves (in billions of US\$)	62.4	61.5	61.7	63.7	60.3	68.1	68.1	68.1	68.1	68.1	68.1
Average exchange rate (S/. per US\$)	2.84	3.19	3.38	3.26	3.29	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: National authorities and IMF staff estimates and projections.

1/ Includes financial public sector.

2/ Includes public sector's net external assets and other transactions involving Treasury bonds.

3/ Excluding privatization.

4/ Includes Financial Corporation for Development (COFIDE) and the National Bank.

Table 6. Peru: Monetary Survey 1/
(In billions of soles; unless otherwise indicated)

	2014	2015	2016	2017	Prel. 2018	2019	2020	Projections			
								2021	2022	2023	2024
I. Central Reserve Bank											
Net foreign assets	140	133	142	150	159	183	185	187	188	191	193
(In billions of U.S. dollars)	78	84	81	81	73	80	80	80	80	79	79
Net international reserves 2/	186	210	207	206	203	228	229	231	232	233	233
(In billions of U.S. dollars)	62	61	62	64	60	67	67	67	67	67	67
Long-term net external assets	0	0	0	0	0	0	0	0	0	0	0
Foreign currency liabilities	-46	-77	-66	-56	-43	-45	-45	-44	-44	-43	-41
Net domestic assets	-86	-82	-88	-93	-98	-118	-113	-108	-101	-94	-86
Net credit to nonfinancial public sector	-67	-71	-76	-65	-67	-71	-66	-61	-56	-51	-46
Credit to the financial sector 3/	2	23	22	15	13	13	13	13	13	13	13
Securities issued	-14	-20	-21	-32	-26	-29	-32	-35	-39	-42	-47
Other assets (net)	-6	-13	-13	-11	-18	-32	-29	-25	-20	-14	-6
Monetary base	54	51	53	57	61	65	71	79	87	97	107
Currency	39	41	43	46	50	53	58	63	69	75	82
Reserve	15	11	10	11	12	11	13	16	18	21	24
II. Depository Corporations 4/											
Net foreign assets	152	172	176	178	172	202	204	205	206	207	207
Net domestic assets	72	77	85	106	138	133	159	186	216	248	283
Net credit to the public sector	-73	-78	-78	-63	-57	-52	-45	-40	-35	-30	-24
Credit to the private sector	224	255	269	282	311	334	357	382	408	435	465
Other assets (net)	-79	-100	-106	-114	-116	-149	-153	-156	-156	-157	-159
Broad money	224	249	260	283	310	336	363	392	422	455	490
Domestic currency	152	156	170	191	215	239	266	294	326	360	398
Foreign currency	72	93	90	92	95	97	97	97	96	95	92
III. Financial System 5/											
Net foreign assets	211	237	246	263	261	289	291	293	295	296	296
Net domestic assets	143	157	178	209	236	250	291	336	384	435	491
Net credit to the public sector	-50	-52	-45	-24	-14	-8	-2	3	8	14	20
Credit to the private sector	271	303	323	340	367	381	402	432	463	497	534
Other assets (net)	-77	-94	-100	-108	-118	-122	-109	-99	-88	-76	-63
Liabilities to the private sector	355	394	424	472	498	540	583	629	678	731	787
Domestic currency	273	288	317	361	383	423	465	512	562	616	675
Foreign currency	82	106	107	111	116	117	118	118	117	115	112
(12-month percentage change)											
Monetary base	3.7	-4.8	4.1	7.2	7.3	5.3	10.2	10.7	10.7	10.7	10.7
Broad money	9.5	11.5	4.4	8.8	9.5	8.3	8.0	8.0	7.8	7.7	7.7
Domestic currency	10.6	3.0	9.0	12.5	12.1	11.4	11.0	10.9	10.7	10.5	10.4
Foreign currency	7.3	29.3	-3.3	1.7	4.1	1.3	0.5	-0.1	-0.9	-1.7	-2.7
Liabilities to the private sector	10.2	10.9	7.7	11.2	5.7	8.3	8.0	8.0	7.8	7.7	7.7
Domestic currency	11.1	5.5	9.9	13.9	6.1	10.4	10.1	10.0	9.8	9.7	9.6
Foreign currency	7.4	29.2	1.6	3.4	4.2	1.3	0.5	-0.1	-0.8	-1.7	-2.6
Depository corporations credit to the private sector	13.2	13.9	5.1	5.1	10.3	7.3	6.9	7.1	6.6	6.7	6.8
Domestic currency	17.7	28.0	7.2	5.3	11.6	9.6	9.0	9.0	8.5	8.5	8.5
Foreign currency	6.5	-9.2	0.4	4.6	7.1	1.4	1.1	1.2	0.6	0.6	0.3

Sources: National Authorities; and IMF staff estimates.

1/ Stocks in foreign currency are valued at the end-of-period exchange rate.

2/ Excludes subscriptions to the IMF and the Latin American Reserve Fund, Pesos Andinos, credit lines to other central banks, Andean Development Corporation bonds, and foreign assets temporarily held by the Central Bank as part of swap operations.

3/ Including the National Bank.

4/ Depository corporations comprise the Central Bank, the National Bank, commercial banks, the Agricultural Bank, financial firms, municipal banks, rural banks and credit unions.

5/ Financial system comprises depository corporations and other financial corporations. Other financial companies include mutual funds, COFIDE, insurance companies, leasing companies, pension funds, the Financing Agency for Small and Medium-sized Enterprises and the Fund for Financing Housing.

Table 7. Peru: Financial Soundness Indicators 1/
(In percent; unless otherwise indicated)

	2014	2015	2016	2017	2018
	(as of December)				
Capital Adequacy					
Capital to risk-weighted assets 2/	14.2	14.3	15.1	15.2	15.3
Regulatory Tier I capital to risk-weighted assets 3/	10.4	10.3	11.0	11.4	11.5
Nonperforming loans net of provisions to capital 4/	0.2	-0.3	-0.4	-0.6	-0.5
Leverage 5/	8.3	7.9	8.7	9.4	9.4
Asset Quality					
Nonperforming loans to total gross loans 4/	2.9	2.9	3.1	3.3	3.4
In domestic currency	3.4	2.9	3.2	3.6	3.7
In foreign currency	2.1	2.9	2.8	2.6	2.6
Nonperforming, refinanced and restructured loans to total gross loans 4/ 6/	4.0	4.0	4.4	4.8	4.9
In domestic currency	3.4	2.9	3.2	3.6	3.7
In foreign currency	2.1	2.9	2.8	2.6	2.6
Refinanced and restructured loans to total gross loans	1.1	1.1	1.3	1.5	1.5
Provisions to nonperforming loans 4/	157.7	161.8	157.1	151.1	150.8
Provisions to nonperforming, restructured, and refinanced loans 4/ 6/	114.4	116.5	111.1	105.0	104.9
Sectoral distribution of loans to total loans					
Consumer loans	18.1	18.3	18.9	19.2	19.3
Mortgage loans	15.5	15.2	15.1	15.4	15.5
Large corporations	17.2	21.4	22.2	22.6	22.8
Small corporations	17.0	15.8	14.8	14.3	14.2
Medium size firms	18.3	16.9	16.4	15.4	15.1
Small firms	10.1	9.0	9.1	9.4	9.4
Microenterprises	3.8	3.4	3.6	3.7	3.6
Earnings and Profitability					
Return on equity (ROE)	18.2	21.1	19.2	17.7	17.8
Return on assets (ROA)	1.9	2.1	2.0	2.1	2.1
Financial revenues to total revenues	85.0	85.1	85.3	84.2	85.6
Annualized financial revenues to revenue-generating assets	10.6	10.5	10.1	10.2	10.2
Liquidity					
Total liquid assets to total short-term liabilities (monthly average basis)	39.4	37.7	35.4	38.5	39.4
In domestic currency	25.3	26.2	26.7	33.0	33.6
In foreign currency	55.2	47.5	44.9	45.7	47.1
Deposit-to-loan	90.5	92.0	88.4	92.1	94.2
Foreign Currency Position and Dollarization					
Share of foreign currency deposits in total deposits	43.4	49.5	44.1	39.3	39.3
Share of foreign currency loans in total credit	38.4	30.1	28.8	29.4	29.2
Operational efficiency					
Financing to related parties to capital 7/	9.4	12.3	9.1	9.6	10.4
Nonfinancial expenditure to total revenues 8/	33.0	30.9	30.8	30.7	27.5
Annualized Nonfinancial expenditure to total revenue-generating assets 8/	4.1	3.8	3.7	3.7	3.7
Memorandum items					
General Stock market index, IGBVL	14,794	9,849	15,567	19,974	21,069
EMBI+ PERU spread, basis points	181	243	170	112	99

Source: National authorities.

1/ These indicators correspond to depository corporations.

2/ Since July 2009, the regulatory capital requirement applied to all risks: credit, market and operational risk.

3/ Since July 2009, Banking Law component establishes that the Tier I capital have to be defined, and Risk-weighted assets include overall risks (credit, market and operational).

4/ Nonperforming loans are overdue loans after 15 days since the due date for commercial loans, and after 30 days for small businesses loans. In the case of mortgage, consumer and leasing loans, they are considered overdue after 30 days since the due date only for the non paid portion and after 90 days for all the credit. The overdue loans include credits under judicial resolution. Figures are net of specific and general provisions.

5/Tier I regulatory capital / Total Exposure (on-balance sheet exposures, derivative exposures and off-balance exposures converted into credit exposure equivalents using credit conversion factors).

6/ Includes restructured loans, refinanced loans, and arrears. Refinanced loans refer to those loans subjected to either term and/or principal modifications with respect to the initial debt contract. Restructured loans refer to those loans whose payments have been restructured according to the "Ley General del Sistema Concursal."

7/ Financing to related parties corresponds to those loans to individuals and firms owning more than 4 percent of the bank.

8/ Nonfinancial expenditures do not consider provisions nor depreciation.

Table 8. Peru: Financial and External Vulnerability Indicators
(In percent; unless otherwise indicated)

	2014	2015	2016	2017	Prel. 2018	2019	2020	Projections 2021	2022	2023	2024
Financial indicators											
Public sector debt/GDP	20.6	24.1	24.5	25.4	26.2	26.8	27.0	26.6	26.1	25.7	25.3
Of which: in domestic currency (percent of GDP)	11.9	12.9	14.1	16.7	17.3	17.3	17.4	17.2	17.0	16.9	17.0
90-day prime lending rate, domestic currency (end of period)	4.7	4.9	5.2	3.6	4.3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
90-day prime lending rate, foreign currency (end of period)	0.7	1.1	1.2	2.2	3.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Velocity of money 1/	2.6	2.4	2.5	2.5	2.4	2.3	2.2	2.2	2.2	2.1	2.1
Net credit to the private sector/GDP 2/	39.1	41.9	40.9	40.4	42.1	43.2	43.8	44.3	44.5	44.9	45.3
External indicators											
Exports, U.S. dollars (percent change)	-7.8	-12.9	7.8	22.5	8.0	-5.4	3.5	4.3	4.8	5.0	5.1
Imports, U.S. dollars (percent change)	-3.1	-9.0	-5.9	10.2	8.1	-1.7	2.7	4.8	5.6	6.1	5.8
Terms of trade (percent change) (deterioration -) 3/	-5.4	-6.9	-0.3	7.5	-0.2	-1.2	0.8	0.8	-0.1	-0.6	-0.4
Current account balance (percent of GDP)	-4.5	-5.0	-2.6	-1.2	-1.6	-1.8	-1.6	-1.4	-1.3	-1.3	-1.4
Capital and financial account balance (percent of GDP)	2.9	5.4	2.8	1.4	0.7	4.8	1.6	1.4	1.3	1.3	1.4
Total external debt (percent of GDP)	34.2	38.2	38.4	35.7	34.5	35.4	34.8	33.6	32.5	31.5	29.8
Medium- and long-term public debt (in percent of GDP) 4/	11.8	14.0	15.2	15.4	15.5	16.2	16.3	15.9	15.5	15.2	14.4
Medium- and long-term private debt (in percent of GDP)	19.1	20.5	19.2	16.4	14.9	15.2	14.6	14.0	13.5	13.0	12.3
Short-term public and private debt (in percent of GDP)	3.3	3.8	4.0	4.0	4.2	4.1	3.9	3.7	3.5	3.3	3.2
Total external debt (in percent of exports of goods and services) 4/	152.2	179.5	171.7	144.8	137.8	150.3	147.2	142.2	137.2	132.3	124.9
Total debt service (in percent of exports of goods and services) 5/	31.9	36.8	38.6	43.7	33.6	35.0	33.6	32.3	31.4	29.8	28.4
Gross official reserves											
In millions of U.S. dollars	62,353	61,537	61,746	63,731	60,288	68,062	68,062	68,062	68,062	68,062	68,062
In percent of short-term external debt 6/	522	472	424	306	364	461	466	462	450	446	442
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	132	110	122	113	113	131	134	133	132	132	132
In percent of broad money 8/	83	84	80	73	66	69	64	60	56	52	48
In percent of foreign currency deposits at banks	258	225	230	225	213	239	240	242	245	250	257
In months of next year's imports of goods and services	16.4	17.0	15.6	14.8	14.0	15.3	14.5	13.7	12.9	11.7	n.a.
Net international reserves (in millions of U.S. dollars)	62,308	61,485	61,686	63,621	60,121	67,067	67,067	67,067	67,067	67,067	67,067
Central Bank's Foreign Exchange Position	35,368	25,858	27,116	37,493	39,548	46,494	46,494	46,494	46,494	46,494	46,494

Sources: National authorities; IMF's Information Notice System (INS); and IMF staff estimates/projections.

1/ Defined as of the ratio of annual GDP to end-period broad money.

2/ Corresponds to depository corporations.

3/ End of period; data from INS.

4/ Includes Central Bank's debt.

5/ Includes debt service to the Fund.

6/ Short-term debt includes amortization of medium- and long-term loans falling due over the following year, including debt swaps.

7/ Current Account deficit adjusted for 0.75*net FDI inflows; if adjusted CA balance>0, set to 0.

8/ At end-period exchange rate.

Table 9. Peru: Medium-Term Macroeconomic Framework

	2014	2015	2016	2017	Prel. 2018	Projections					
						2019	2020	2021	2022	2023	2024
(Annual percentage change)											
Production											
GDP at constant prices	2.4	3.3	4.1	2.5	4.0	2.4	3.2	3.7	3.7	3.7	3.7
Domestic demand at constant prices	2.2	2.6	1.1	1.4	4.2	3.3	3.2	4.0	3.9	3.8	3.8
Consumption	4.2	4.9	3.2	2.3	3.4	2.7	2.8	2.9	3.0	3.3	3.3
Investment	-2.3	-4.7	-4.3	-0.2	4.7	1.7	3.5	7.9	6.6	5.4	5.0
Of which: Private	-2.2	-4.2	-5.4	0.2	4.2	2.1	2.9	8.3	7.0	5.6	5.0
Of which: Public	-2.7	-6.9	0.3	-1.8	6.8	0.0	6.0	6.2	4.8	4.9	4.9
Net exports (contribution to GDP growth)	0.1	0.6	2.9	1.1	0.0	-0.7	0.1	-0.2	-0.1	-0.1	0.0
Exports	-0.8	4.7	9.1	7.6	2.7	-3.2	3.0	3.8	3.9	3.8	3.8
Imports	-1.3	2.2	-2.3	3.9	3.2	-0.6	3.1	5.2	4.5	4.3	4.1
Consumer prices (end of period)	3.2	4.4	3.2	1.4	2.2	1.9	2.0	2.0	2.0	2.0	2.0
GDP deflator	2.7	2.7	3.5	3.9	2.0	2.0	2.1	2.1	2.1	2.1	2.1
Trade											
Merchandise trade											
Exports, f.o.b.	-7.8	-12.9	7.8	22.5	8.0	-5.4	3.5	4.3	4.8	5.0	5.1
Imports, f.o.b.	-3.1	-9.0	-5.9	10.2	8.1	-1.7	2.7	4.8	5.6	6.1	5.8
Terms of trade (deterioration -)	-5.4	-6.9	-0.3	7.5	-0.2	-1.2	0.8	0.8	-0.1	-0.6	-0.4
(In percent of GDP, unless otherwise indicated)											
External current account balance	-4.5	-5.0	-2.6	-1.2	-1.6	-1.8	-1.6	-1.4	-1.3	-1.3	-1.4
Total external debt service 1/	7.2	7.8	8.6	10.8	8.4	8.2	8.0	7.6	7.4	7.1	6.8
Medium- and long-term	3.7	4.3	4.8	7.1	4.5	4.1	3.9	3.8	3.8	3.7	3.5
Nonfinancial public sector	1.3	1.1	1.5	2.6	1.3	1.3	1.1	1.1	1.2	1.1	1.1
Private sector	2.4	3.1	3.3	4.4	3.3	2.8	2.9	2.7	2.6	2.5	2.4
Short-term 2/	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Interest	1.1	1.3	1.4	1.4	1.5	1.9	1.8	1.8	1.7	1.6	1.6
Amortization (medium-and long-term)	2.6	3.0	3.5	5.8	3.2	2.3	2.2	2.1	2.2	2.1	2.1
Public sector											
NFPS primary balance 3/	0.8	-1.0	-1.4	-1.9	-0.9	-0.3	0.0	0.5	0.5	0.4	0.3
NFPS interest due	1.1	1.1	1.1	1.2	1.4	1.4	1.5	1.5	1.5	1.4	1.3
NFPS overall balance 3/	-0.3	-2.1	-2.5	-3.1	-2.3	-1.7	-1.5	-1.0	-1.0	-1.0	-1.0
Public sector debt 3/	20.6	24.1	24.5	25.4	26.2	26.8	27.0	26.6	26.1	25.7	25.3
Savings and investment											
Gross domestic investment	24.7	23.7	21.9	20.5	21.5	22.1	22.3	23.1	23.6	23.9	24.0
Public sector 3/	5.6	5.1	4.9	4.6	4.8	4.7	4.8	4.9	5.0	5.0	5.0
Private sector	19.1	18.6	17.0	15.9	16.6	17.4	17.5	18.2	18.7	18.9	19.0
Private sector (excluding inventories)	20.4	19.6	18.2	17.3	17.6	17.6	17.5	18.2	18.7	18.9	19.0
Inventory changes	-1.3	-1.0	-1.1	-1.4	-1.0	-0.2	0.0	0.0	0.0	0.0	0.0
National savings	20.2	18.7	19.3	19.3	19.9	20.3	20.8	21.7	22.3	22.5	22.7
Public sector 4/	6.0	3.8	2.7	1.8	2.9	3.4	3.7	4.3	4.4	4.5	4.5
Private sector	14.2	14.9	16.6	17.4	17.0	16.9	17.1	17.4	17.9	18.1	18.2
External savings	4.5	5.0	2.6	1.2	1.6	1.8	1.6	1.4	1.3	1.3	1.4
Memorandum items											
Nominal GDP (billions of nuevos soles)	574.3	609.4	656.2	698.4	740.6	774.0	816.0	864.4	915.7	969.9	1027.0
Gross international reserves (billions of U.S. dollars)	62.4	61.5	61.7	63.7	60.3	68.1	68.1	68.1	68.1	68.1	68.1
External debt service (percent of exports of GNFS)	31.9	36.8	38.6	43.7	33.6	35.0	33.6	32.3	31.4	29.8	28.4
Short-term external debt service (percent of exports of GNFS)	0.2	0.3	0.4	0.4	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Public external debt service (percent of exports of GNFS)	5.9	5.4	6.9	10.7	5.0	5.5	4.6	4.6	5.0	4.8	4.6
Sources: National authorities and IMF staff estimates.											
1/ Includes interest payments only.											
2/ Includes the financial public sector.											
3/ Includes Repayment Certificates (CRPAOs).											
4/ Excludes privatization receipts.											

Table 10. Peru: External Debt Sustainability Framework, 2016–24
(In percent of GDP; unless otherwise indicated)

	2016	2017	Prel. 2018	2019	2020	Projections 2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	38.4	35.7	34.5	35.4	34.8	33.6	32.5	31.5	29.8	-1.8
Change in external debt	0.1	-2.6	-1.2	0.9	-0.6	-1.2	-1.1	-1.0	-1.7	
Identified external debt-creating flows (4+8+9)	-0.9	-1.8	-0.9	-1.1	-0.7	-1.3	-1.5	-1.5	-1.5	
Current account deficit, excluding interest payments	1.2	-0.2	0.1	-0.1	-0.3	-0.4	-0.4	-0.3	-0.2	
Deficit in balance of goods and services	0.0	-2.5	-2.1	-1.2	-1.4	-1.3	-1.3	-1.1	-1.1	
Exports	22.3	24.7	25.0	23.5	23.6	23.6	23.7	23.8	23.9	
Imports	22.4	22.2	23.0	22.4	22.3	22.3	22.4	22.7	22.8	
Net non-debt creating capital inflows (negative)	-2.0	-2.1	-1.1	-2.0	-1.1	-1.5	-1.6	-1.7	-1.8	
Net foreign direct investment, equity	2.9	3.0	2.9	2.5	2.2	2.5	2.6	2.6	2.6	
Net portfolio investment, equity	-0.9	-0.8	-1.8	-0.5	-1.1	-1.0	-1.0	-0.9	-0.9	
Automatic debt dynamics 1/	-0.1	0.5	0.1	1.0	0.8	0.6	0.5	0.5	0.5	
Denominator: $1+g+r+gr$	1.0	1.1	1.1	1.0	1.0	1.1	1.1	1.1	1.1	
Contribution from nominal interest rate	1.4	1.4	1.5	1.9	1.8	1.8	1.7	1.6	1.6	
Contribution from real GDP growth	-1.5	-0.9	-1.4	-0.8	-1.1	-1.2	-1.2	-1.1	-1.1	
Contribution from price and exchange rate changes 2/	...	...	...	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	1.1	-0.9	-0.3	1.9	0.1	0.1	0.4	0.5	-0.2	
External debt-to-exports ratio (in percent)	171.7	144.8	137.8	150.3	147.2	142.2	137.2	132.3	124.9	
Gross external financing need (in billions of U.S. dollars) 4/	19.1	22.7	19.3	19.0	18.3	18.3	18.7	19.0	19.4	
In percent of GDP	9.8	10.6	8.6	8.2	7.7	7.2	7.0	6.8	6.6	
Scenario with key variables at their historical averages 5/		35.7	34.5	33.3	30.6	28.3	26.2	24.4	22.0	-4.3
Key Macroeconomic Assumptions Underlying Baseline										
Real GDP growth (in percent)	4.1	2.5	4.0	2.4	3.2	3.7	3.7	3.7	3.7	
GDP deflator in U.S. dollars (change in percent)	-2.3	7.5	1.1	-0.1	0.6	1.4	1.6	1.7	1.8	
Nominal external interest rate (in percent)	3.7	4.0	4.3	5.5	5.4	5.4	5.4	5.3	5.3	
Growth of exports and services (U.S. dollar terms, in percent)	6.6	21.6	6.8	-3.8	4.2	5.2	5.6	5.8	6.0	
Growth of imports and services (U.S. dollar terms, in percent)	-4.9	9.4	8.9	-0.4	3.4	5.4	6.0	6.5	6.2	
Current account balance, excluding interest payments	-1.2	0.2	-0.1	0.1	0.3	0.4	0.4	0.3	0.2	
Net non-debt creating capital inflows	2.0	2.1	1.1	2.0	1.1	1.5	1.6	1.7	1.8	

Source: National authorities and Fund staff calculations.

1/ Derived as $[r - g - r(1+g) + ea(1+r)]/(1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)]/(1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

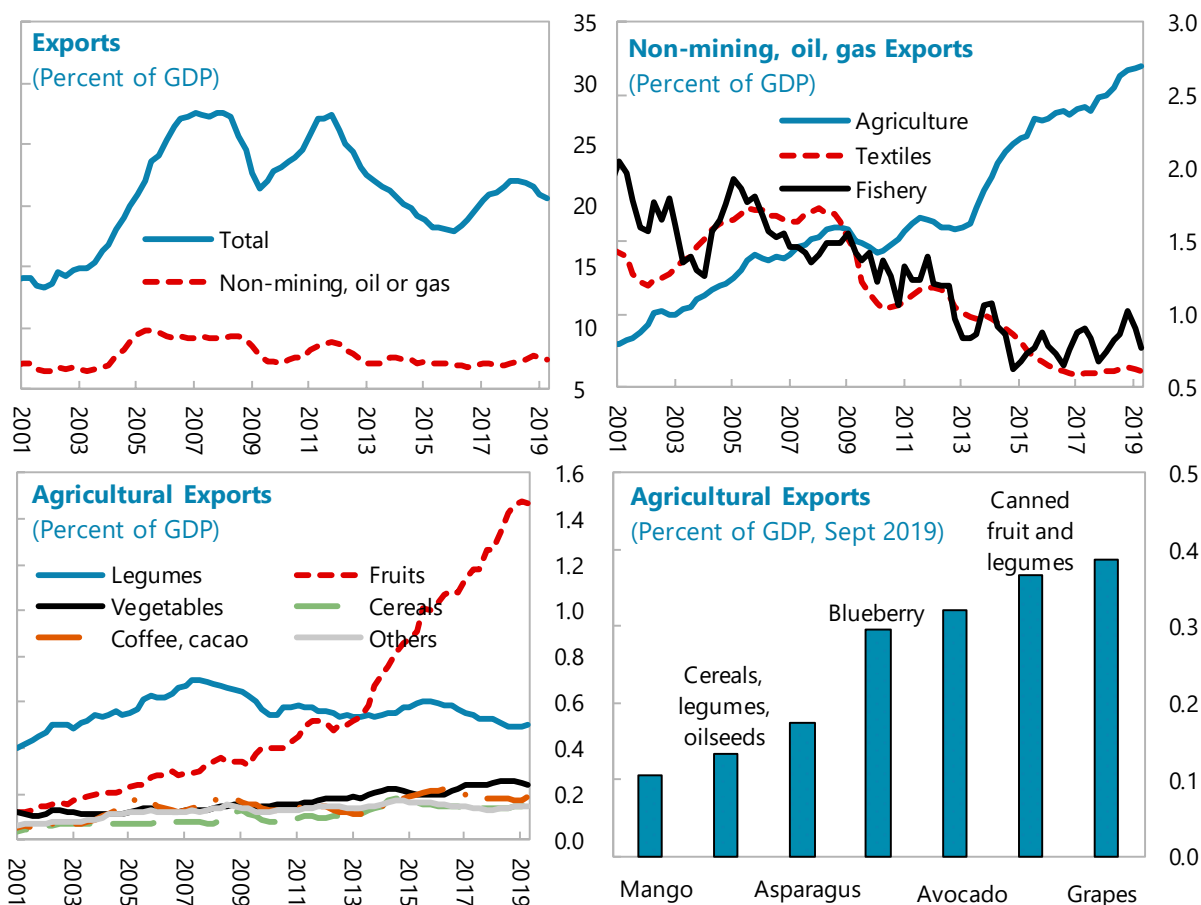
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex I. Export Diversification: The Agro-Exporting Boom

1. Over the past two decades Peru has experienced an agro-exporting boom. Peru is a commodity producer with mining, oil and gas exports still accounting for about 2/3 of total exports and 22 percent of GDP. However, agricultural exports have expanded dramatically, reaching an estimated US\$6 billion or 2.7 percent of GDP in 2019 from 0.4 percent in 2001. Seasonal exports to the northern hemisphere of high-value fresh fruits and vegetables (mostly grapes, avocados, blueberries, and asparagus) total US\$2.5 billion or 1.2 percent of GDP. Exports of other products (including citrus, bananas, cacao, and pomegranates) are also rising rapidly.



Source: BCRP.

2. This boom has contributed to poverty reduction. Traditional agriculture is labor intensive and characterized by low productivity, employing 4.5 million workers (25 percent of the labor force) mostly in non-salaried or informal jobs. Conversely, the agro-exporting sector provides 0.8 million formal agricultural jobs, up from 0.46 million in 2004, and supports indirectly another 0.7 million jobs, with high productivity and incomes. The development of this sector has been particularly beneficial for the coastal areas where it is located. While poverty has fallen dramatically in rural areas (from 80 percent in 2004 to 36 percent in 2018) reflecting nationwide progress, poverty in coastal areas has fallen even more (from 67 percent in 2004 to 19 percent in 2018).

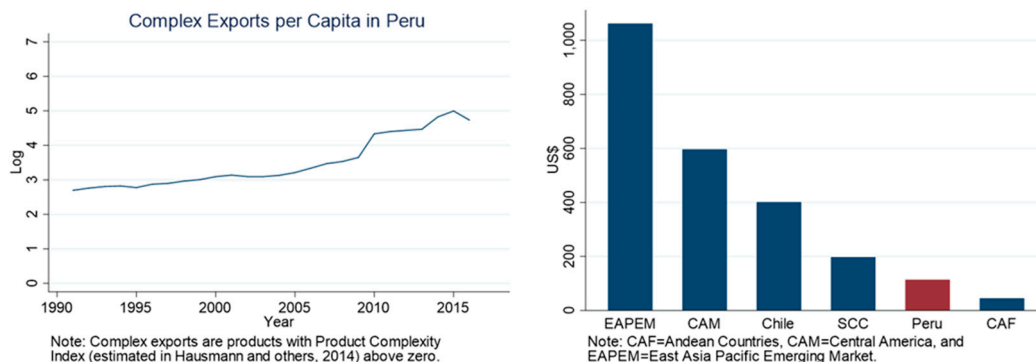
3. The agro-exporting boom was the result of comparative advantages and good policies. Peru has obvious comparative advantages for large scale agriculture, such as year-round good weather and abundant cheap land near the coast. However, the boom would not have been possible without the construction of irrigation districts (which converted desertic areas near the coast into farmland), the existence of several free trade agreements, and the diligent work of the phytosanitary authority (SENASA), which contributed to opening new markets. Moreover, the agriculture promotion law (Law 27360), promulgated in December 2000, provided fiscal benefits and more flexible labor regulation for the sector.¹

4. Further expansion of non-traditional exports would require addressing structural constraints. The agriculture promotion law expires in 2021 and large investments have stalled owing to disagreements between government and congress on whether it should be extended. SENASA will need to continue opening new markets to reduce the seasonality of demand. New investments in irrigation, roads, and ports are needed to extend farmland and reduce transportation and logistics costs. Owing to the elevated vertical integration of the sector, large enterprises dominate and accessing export markets remains extremely difficult for small-scale producers. Difficult access to affordable long-term financing and adequate land titles may prevent new expansion areas, such as forestry and aquaculture, where comparative advantages are also high.

¹ The agriculture promotion law includes a corporate income tax of 15 percent (instead of 30), social security contributions for health of 4 percent (instead of 9,) and allows for an accelerated 20 percent depreciation of investments. It introduces temporary contracts for planting and harvesting, where workers are paid a daily rate (inclusive of the extra salaries and payroll insurance for regular workers), with 15 days of vacation (instead of 30, inclusive of holidays), severance pay of ½ the monthly pay for unjustified dismissal (instead of 1½).

Annex II. Developing Complex Exports in Peru

1. **With an export basket highly concentrated on exports of raw materials, Peru has sought to develop exports with higher value added and labor content.** There has been significant progress on this front in recent decades as inferred from the sustained growth of Peru's complex exports, especially following several Free Trade Agreements in the late 2000s.¹ But while its level of complex exports per capita is above the average among Andean countries, it remains considerably below other regions, especially those that participate intensely in Global Value Chains (GVCs).

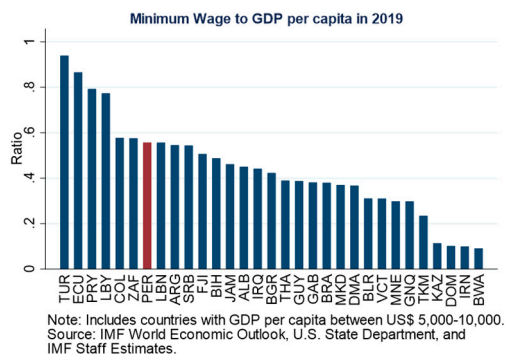


2. As predicted by standard trade models, Peru's significant distance from large international markets likely explains part of this lag. Peru is also behind in other factors associated with exports diversification and complexity.² Its infrastructure ranks below comparator regions, denoting mainly weaknesses in road, railroad, ports, and phone infrastructure. Its high minimum wage relative to its GDP per capita, in the top quintile among countries with similar income per capita (and much higher than in advanced economies), is also a major constraint on export competitiveness.³ Recently, the authorities issued legislation to encourage private investment to develop Special Economic Zones. These zones are more likely to attract investments if they provide quality infrastructure and moderate unit labor costs.

Determinants of Exports Diversification and Complexity in Peru and Selected Countries/Regions (2015-17)

	Proximity	Governance	Education	Infrastructure	Tariffs
Other Andean	8.4	-0.7	0.7	3.5	9.0
Central America	11.1	-0.3	0.6	4.0	3.8
Chile	6.7	0.9	0.8	4.8	1.0
East Asian Emerging Market:	10.7	-0.2	0.7	4.4	6.5
Peru	7.7	-0.1	0.7	3.8	1.4
Southern Cone	7.1	0.1	0.7	3.8	11.1

Notes: Proximity is an index calculated for each country as the sum of GDPs of other countries in the world divided by their distance to that country (Salinas, forthcoming). Governance is the overall Worldwide Governance Indicator (D. Kaufmann (Natural Resource Governance Institute and Brookings Institution) and A. Kraay (World Bank). Education is the Education Subindex of the Human Development Index (United Nations). Infrastructure is the 12th Pillar of the Global Competitiveness Index (World Economic Forum). Tariffs is the simple average tariff from the World Integrated Trade Solution (World Bank).



¹ Complex exports are defined here as products in the upper half of the Product Complexity Index, a measure of the knowledge intensity of a product estimated in Hausmann and others (2014).

² These factors have been identified in Hausmann and others, 2005; Ding and Hadzi-Vaskov, 2017; Giri and others, 2019; and Salinas (www.imf.org).

³ Low-skill employment in formal export firms can be particularly constrained by a minimum wage not aligned with labor productivity. Note that, for Peru, GDP per capita is a better proxy of labor productivity than the average formal wage as the labor force is mainly informal.

Annex III. Implementation of Past Fund Advice

Recommendations	Authorities' Response
Fiscal Policies	
Expand public investment given significant reconstruction needs. Given the key role of subnational governments in public investment, continue efforts to build their capacity.	In progress. The authorities are undertaking significant efforts to increase public investment, including through: regulations to simplify the execution of reconstruction projects, technical assistance to subnational governments, and bringing forward in the budget cycle the investment allocations to subnational governments.
Focus on revenue mobilization through strengthening tax policy and administration.	In progress. Measures to improve revenue administration and reduce tax avoidance, with the latter in line with the recommendations of the BEPS plan of the OECD. Reduction of tax exemptions for some geographic regions.
Continue combining medium-term fiscal consolidation with structural reforms.	In progress. Revenue mobilization and expenditure restrained measures have been implemented, while the structural reform agenda is being advanced through the National Competitiveness Plan.
Consider reforms to strengthen Peru's institutions and governance.	In progress. President Vizcarra proposed a set of political and judicial reforms to national referendum.
Reform the pension system to enhance social protection.	Not implemented.
Revisit the distribution of natural resource revenues to enhance horizontal equities between regions.	Not implemented.
Monetary and Exchange Rate Policies	
Reduce financial dollarization further.	In progress. Financial dollarization has continued to decline in 2019.
Limit FX interventions to cases of disorderly market conditions.	Partially implemented. The authorities continue to implement flexible exchange rate regime and over the past two years intervention has been two-way.

Financial Policies (see Annex VI)	
Structural Policies	
Increase labor market flexibility and reduce economic informality.	In progress. Priority objectives of the recently released National Competitiveness Plan.
Improve business climate.	In progress. Priority objective of the recently released National Competitiveness Plan.
Strengthen implementation of anticorruption and AML/CFT measures.	In progress. Regarding AML/CFT, the SBS is working on modifications to the Financial Sector Law with the aim at increasing fines. Regarding anticorruption, the government proposed a series of political and judicial reforms via a national referendum. Three of the four proposals were approved.

Annex IV. Risk Assessment Matrix¹

	Likelihood	Time horizon	Impact	Policy Advice ²
Country-Specific Risks				
Extended period of uncertainty stemming from external conditions, political conflict and possible early elections, spillovers from the ongoing Odebrecht corruption investigation.	High	ST, MT	M (↓) Uncertainty could stifle investment and economic recovery. This can be accompanied by a tightening of domestic financial conditions and the price of risk.	Use policy space (e.g., fiscal and/or monetary if inflation remains anchored) as a countercyclical measure if necessary. Persevere with structural reforms, especially those aimed at increasing investment potential and improving framework for PPPs. Strengthen anticorruption institutions and seek synergies between anticorruption and AML tools.
External Risks				
Rising protectionism and retreat from multilateralism. In the near term, escalating and unpredictable trade actions and a WTO dispute settlement system under threat imperil the global trade system and international cooperation. Additional barriers, including investment and trade restrictions in technology sectors, and the threat of new actions reduce growth both directly, and through adverse confidence effects and financial market volatility. In the medium term, geopolitical competition, protracted tensions, and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on investment, growth, and stability.	High	ST, MT	H (↓) Given its high exposure to international trade, Peru would be strongly affected. In the short term, exports and commodity prices would fall, the current account deficit would widen, and activity would decelerate. In the medium term, potential growth would decline.	Exchange rate flexibility as first line of defense. Use policy space (e.g., fiscal and/or monetary if inflation remains anchored) as a countercyclical measure if necessary. Accelerate structural reforms.
¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. ² Recommended by staff.				

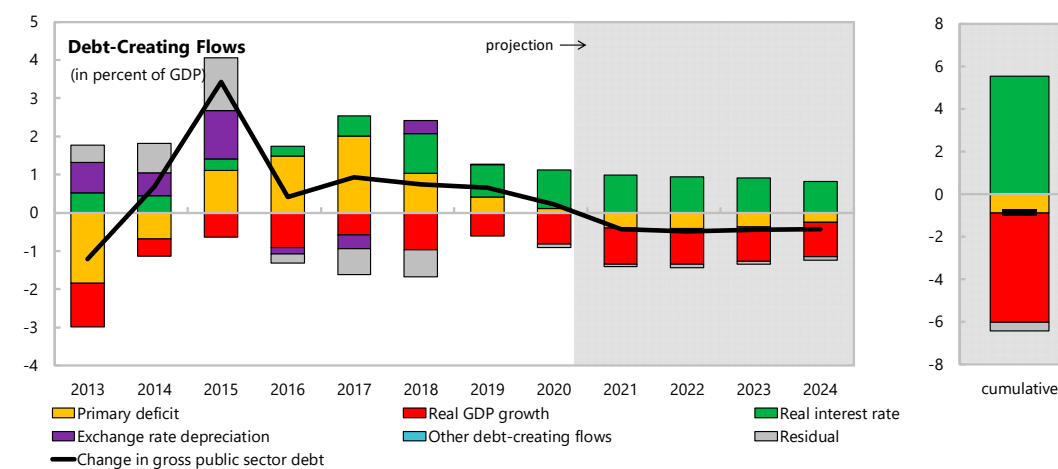
	Likelihood	Time horizon	Impact	Policy Advice ²
Country-Specific Risks				
Sharp rise in risk premia. An abrupt deterioration in market sentiment could trigger risk-off. Higher risk premia cause higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; disruptive corrections to stretched asset valuations; and capital account pressures—all depressing growth.	High	ST	H (↓) Capital outflows and depreciation pressures could trigger balance sheet effects in fx leveraged corporates. Sharp increases in interest rates would strain leveraged corporates, households; worsen bank balance sheets and profitability by raising funding costs and reducing loan portfolio quality; expose liquidity mismatches; and bring on disruptive corrections in stretched asset valuations. The rise in global risk aversion may also create contagion effects.	Tighten monetary and macroprudential policies while using exchange rate intervention to smooth excessive volatility. Use fiscal buffers if necessary. Monitoring the systemic risks stemming from tightening of financial conditions.
Further build-up of financial vulnerabilities. Although the turn in the monetary policy cycle toward easing provides a reprieve for risky assets, it encourages risk taking through underpricing of risk and reduces financial resilience to shocks and risk-off events.	High	MT	M (↓) Risk taking would increase vulnerabilities, which could be partially contained by the strong macroprudential framework.	Continue de-dollarization policies and macroprudential tools to stem FX risk. Exchange rate flexibility, while intervening to smooth excessive volatility, developing a market in hedging instruments so agents can internalize risks in the absence of the central bank intervention.
Weaker than expected global growth. Idiosyncratic factors in the U.S., Europe, China, and stressed emerging markets feed off each other to result in a synchronized and prolonged growth slowdown.	High/ Medium	ST, MT	H/M (↓) Weaker global demand would reduce commodity prices, worsen the current account deficit and weaken growth, especially through lower exports. Higher funding needs of the government would lead to higher domestic yields. This would be accompanied by lower corporate profits and weaker household income, which, together with higher unemployment, would lead to higher NPLs and credit losses for banks.	Exchange rate flexibility as first line of defense and use of liquidity buffers. Use policy space (e.g., fiscal and/or monetary if inflation remains anchored) as a countercyclical measure if necessary). Accelerate structural reforms.

Annex V. Public Sector Debt Sustainability Analysis

Figure 1. Peru: Debt, Economic and Market Indicators^{1/}

Debt, Economic and Market Indicators ^{1/}										As of November 19, 2019		
	Actual			Projections								
	2008-2016 ^{2/}	2017	2018	2019	2020	2021	2022	2023	2024			
Nominal gross public debt	23.9	25.4	26.2	26.8	27.0	26.6	26.1	25.7	25.3	Sovereign Spreads EMBIG (bp) 3/ 5Y CDS (bp)		
Of which: guarantees	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Public gross financing needs	1.6	5.7	3.8	2.1	2.2	1.7	1.8	2.6	3.4			
Real GDP growth (in percent)	5.2	2.5	4.0	2.4	3.2	3.7	3.7	3.7	3.7	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	3.4	2.8	1.3	2.1	1.9	2.0	2.0	2.0	2.0	Moody's	A3	A3
Nominal GDP growth (in percent)	8.4	6.4	6.0	4.5	5.4	5.9	5.9	5.9	5.9	S&Ps	BBB+	A-
Effective interest rate (in percent) ^{4/}	5.3	5.2	5.6	5.6	6.0	5.9	5.8	5.8	5.4	Fitch	BBB+	A-

Contribution to Changes in Public Debt											
	Actual			Projections							
	2008-2016 ^{2/}	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance ^{9/}
Change in gross public sector debt	-0.8	0.9	0.7	0.7	0.2	-0.4	-0.5	-0.4	-0.4	-0.9	
Identified debt-creating flows	-2.0	1.6	1.5	0.7	0.3	-0.4	-0.4	-0.4	-0.3	-0.5	
Primary deficit	-1.2	2.0	1.0	0.4	0.1	-0.4	-0.4	-0.4	-0.2	-0.9	
Primary (noninterest) revenue and gran	26.2	22.8	24.4	25.0	25.3	25.6	25.6	25.6	25.6	152.6	
Primary (noninterest) expenditure	25.0	24.8	25.4	25.4	25.4	25.2	25.2	25.2	25.3	151.7	
Automatic debt dynamics ^{5/}	-0.8	-0.4	0.4	0.2	0.2	0.0	0.0	0.0	-0.1	0.4	
Interest rate/growth differential ^{6/}	-0.8	0.0	0.1	0.2	0.2	0.0	0.0	0.0	-0.1	0.4	
Of which: real interest rate	0.4	0.5	1.0	0.9	1.0	1.0	0.9	0.9	0.8	5.5	
Of which: real GDP growth	-1.2	-0.6	-1.0	-0.6	-0.8	-1.0	-0.9	-0.9	-0.9	-5.1	
Exchange rate depreciation ^{7/}	0.1	-0.4	0.4	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
General government net privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroa	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{8/}	1.2	-0.7	-0.7	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	



Source: IMF staff.

1/ Public sector is defined as non-financial public sector and includes public guarantees, defined as .

2/ Based on available data.

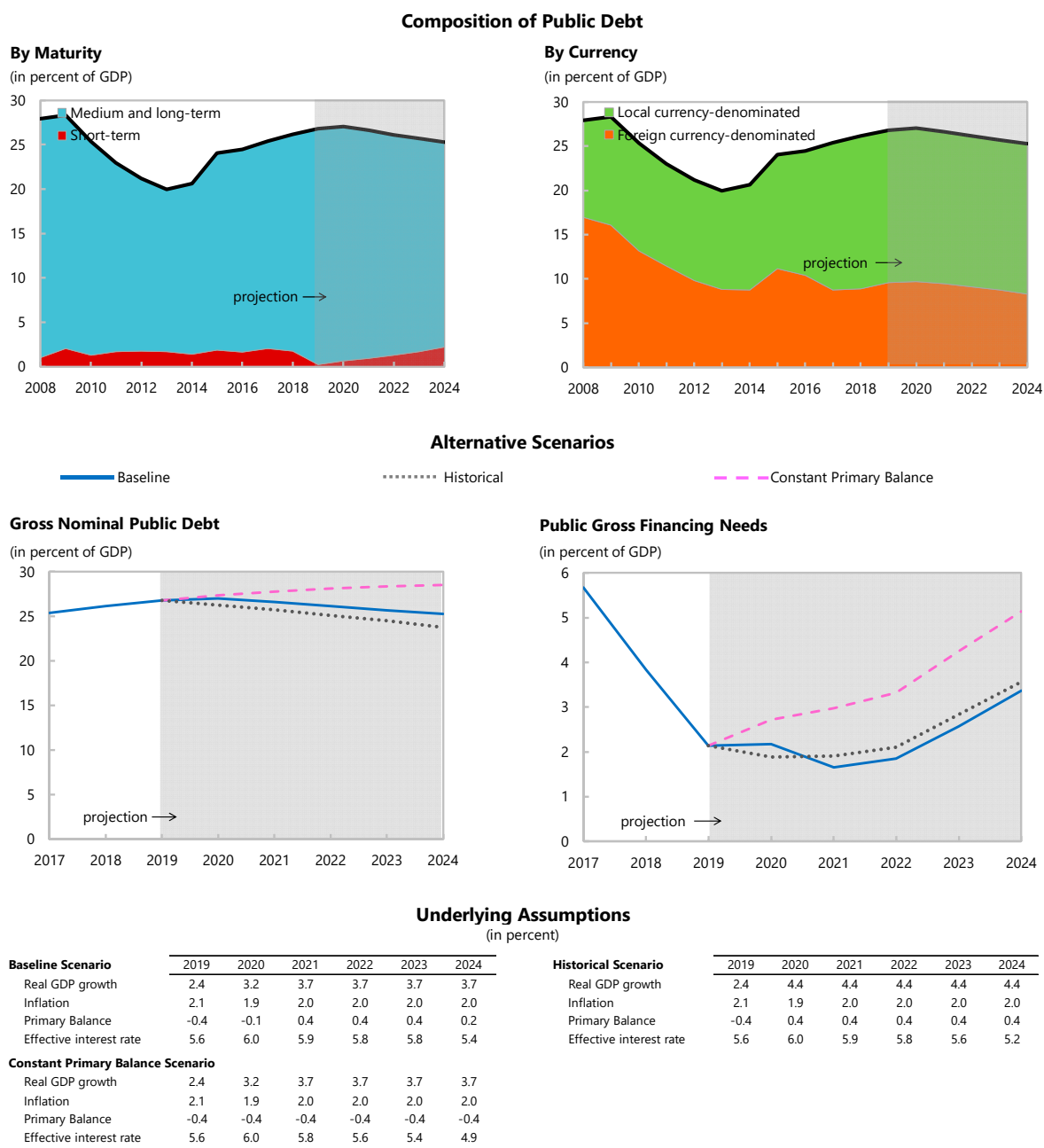
3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+g\pi)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

Figure 2. Peru: Public DSA – Composition of Public Debt and Alternative Scenarios

Source: IMF staff.

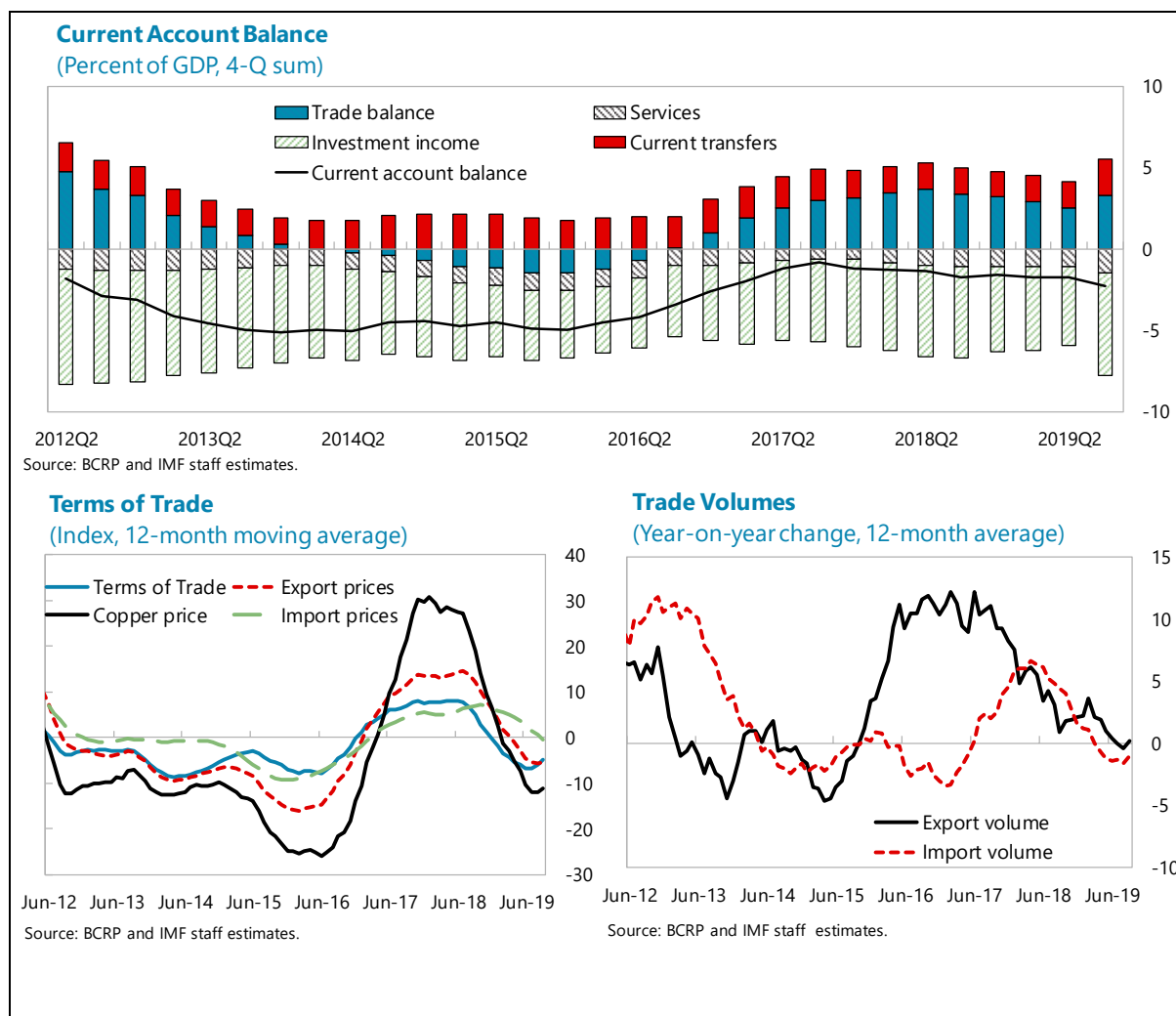
Annex VI. External Sector Assessment

Peru's external position in 2018 was broadly consistent with fundamentals and desirable policies. Reserve adequacy remains satisfactory, notwithstanding volatile commodity prices and significant domestic FX liabilities. Preliminary estimates confirm this assessment for 2019.

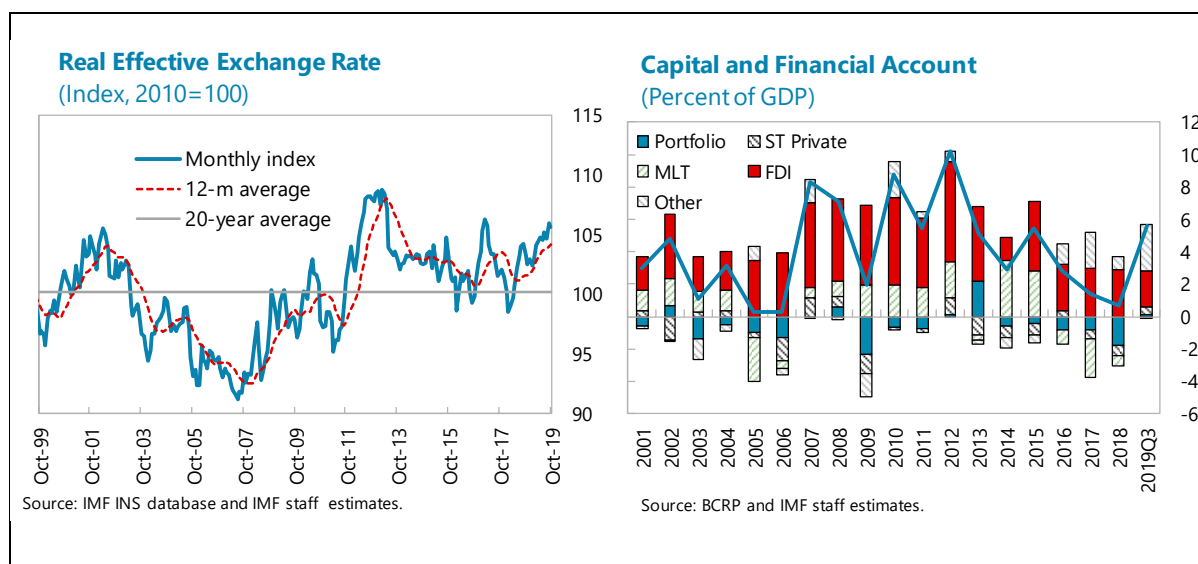
Background

1. The current account deteriorated slightly reflecting a worsening service balance.

The current account deficit increased to 1.6 percent of GDP in 2018 (from 1.2 percent in 2017) driven by a fall of 0.4 percentage points of GDP in the service balance. The trade balance remained broadly unchanged as a share of GDP. Similarly, terms of trade remained broadly unchanged as the rise in copper and other commodity prices were balanced by higher import prices. Over the medium term, the current account deficit is expected to stabilize at about 1.5 percent of GDP after some widening in 2019.

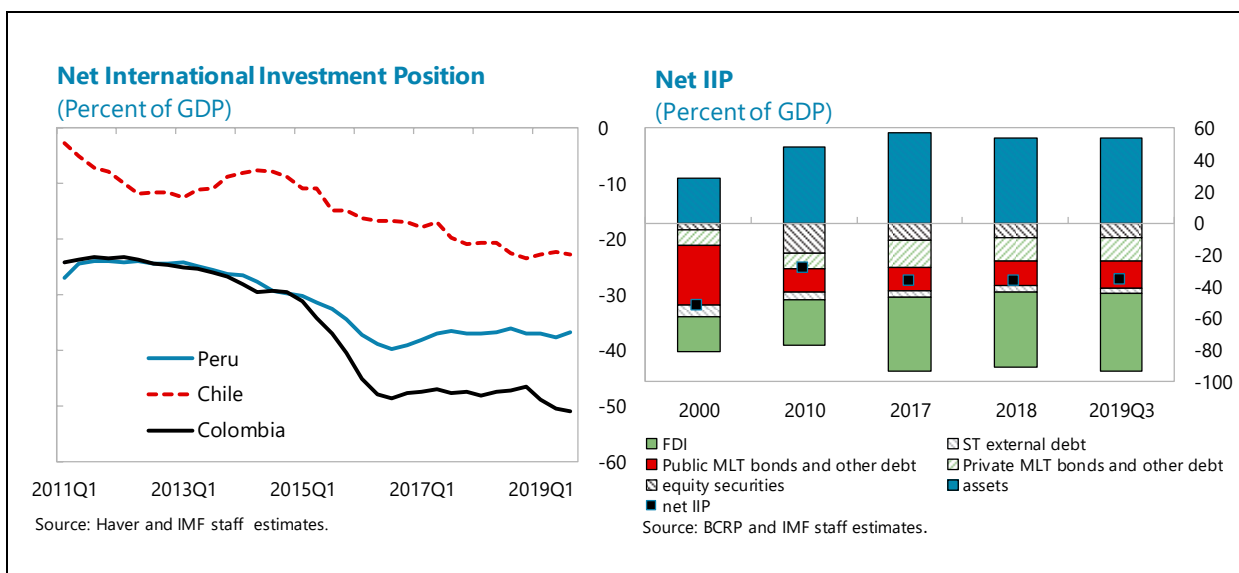


2. The REER has remained broadly constant. The average REER in 2018 was 1.7 percent weaker than in 2017 but remained marginally higher than the 20-year average. The REER strengthened somewhat in 2019 and is on average 1 percent higher than in 2017.



3. The capital and financial account deteriorated in 2018, as it did since the peak of the commodity price boom, but recovered in 2019. The current account is mostly financed with net FDI inflows, which have somewhat slowed with the moderation of commodity prices. The capital and financial account was close to zero in 2018, as the net FDI inflows were compensated by net portfolio and short-term private flows. Nonetheless, the capital and financial account turned positive in 2019 due in large part to strong private portfolio flows.

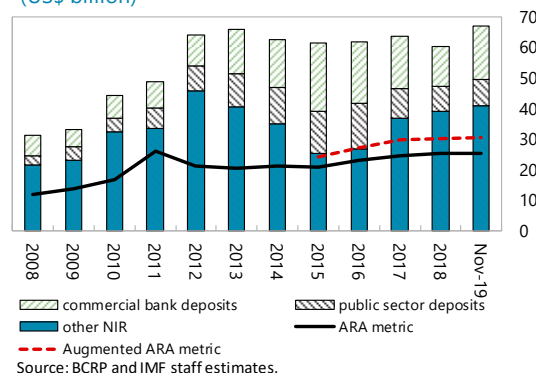
4. Peru's IIP is characterized by large foreign reserves, moderate external debt, and large FDI liabilities. Peru's IIP improved from a minimum of -54 percent of GDP in the late 90s to -24 percent of GDP in 2011. Since then, the IIP has been on a declining trend, driven by the accumulation of FDI liabilities (net FDI averaged 2.9 percent of GDP in the past 5 years). Peru's external assets (54 percent of GDP) include sizeable holdings of foreign assets by the central bank (27 percent of GDP) and the financial system (16 percent of GDP). The assets are offset by large FDI liabilities (47 percent of GDP), moderate external indebtedness (public and private external debt of 35 percent of GDP) and other liabilities (9 percent of GDP). The IIP is projected to slightly improve to about 34 percent of GDP in the medium term.



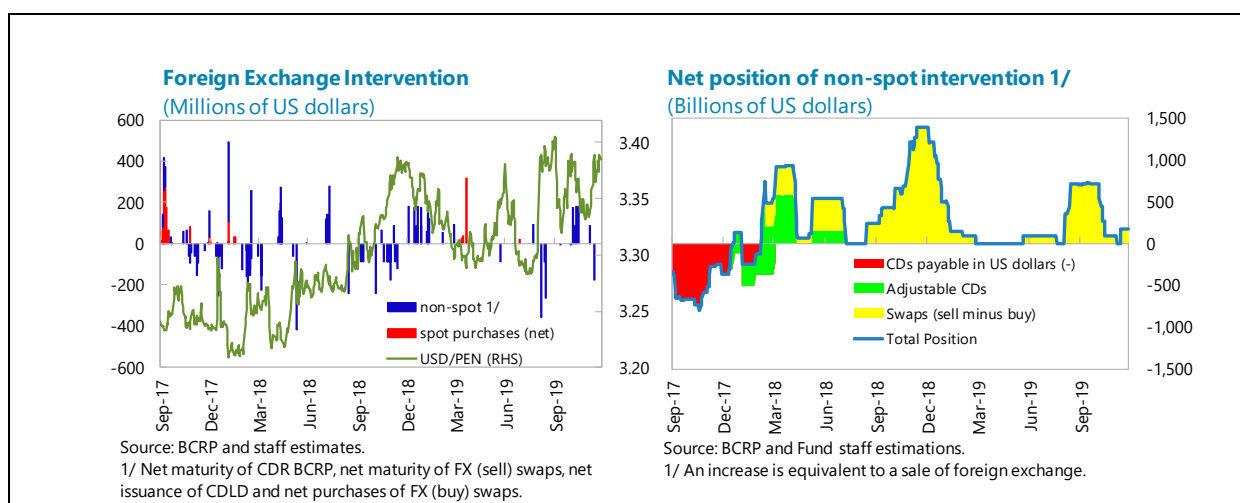
5. Peru's gross international reserve coverage exceeds adequacy metrics. Gross

international reserves were US\$60.1 billion (27 percent of GDP) at end-2018, or 240 percent of the ARA metric, well above the 100–150 percent adequacy range. Reserves also exceed an augmented ARA metric that incorporates the volatility of copper and gold prices and Peru's heavy reliance on commodity exports. Reserves are about 200 percent of the ARA metric, after subtracting large FX liabilities to the banking sector (reserve requirements and deposits from de-dollarization swaps). If public sector deposits are excluded, reserves would be about 160 percent of the ARA metric. These ratios have remained largely unchanged in 2019, when gross international reserves have increased by around 11 percent.

Components of NIR and ARA Metric (US\$ billion)



6. The BCRP is an active participant in the foreign exchange market, but it does not target a specific level of the exchange rate. In the past two years, the central bank BCRP has been on both sides of the market both in the spot market and with the use of non-spot intervention instruments such as FX swaps and adjustable CDs. In 2018, the BCRP purchased US\$0.2 billion (0.1 percent of GDP) in the spot market and was rather more active using non-spot instruments. Intervention in 2019 has remained two-sided and limited, aimed at reducing the volatility of the exchange rate.



Assessment

7. The external position for 2018 is broadly in line with fundamentals, although lack of consistency among approaches points to some uncertainty.

The EBA current account model

estimates a current account norm of -2.8 percent of GDP. The cyclically adjusted current account is estimated at around 2.1 percent of GDP (with a standard error of 1 percent of GDP), considering output and terms of trade gaps. Thus, the overall CA gap is about 0.7 percent of GDP (with the policy gap at around zero as different gaps offset each other). The positive CA gap implies that in 2018 the REER was broadly in line with the level consistent with fundamentals. On the contrary, the REER regressions point to different results: while the index-based regressions point that the REER is broadly in line with the fundamentals, the level-based regression indicates that the REER is overvalued. Given that the CA regression-based approach is more reliable, the assessment places more weight on this approach.

Current Account and REER Gaps, 2018 (Percent of GDP, unless stated otherwise)			
	CA regressio	REER (index)	REER (level)
Actual CA	-1.6	..	..
Cyclically adjusted CA	-2.1	..	..
CA norm	-2.8	..	..
CA gap 1/	0.7	..	..
o/w Policy gaps	0	..	..
Elasticity	-0.22		
REER gap (in percent) 2/	-3	-0.6	6
REER range (in percent) 3/	(-8,2)		

Source: IMF staff estimates.
1/ CA gap is cyclically adjusted CA minus CA norm.
2/ Positive value indicates overvaluation.
3/ Incorporates the uncertainty around estimates (+/-5 percent).

8. Preliminary results confirm this assessment for 2019. For 2019, the external position is expected to remain broadly in line with fundamentals, as the current account balance is expected to have a small deterioration (bringing it closer to the norm). Preliminary results suggest an overall CA gap of about 0.4 percent of GDP (with a standard error of 1 percent of GDP) and a REER gap under the current account regressions of 2 percent in 2019 (from 3 percent in 2018). The REER-based estimates are expected to show a movement towards overvaluation, with the index-based regressions suggesting an overvaluation of 4 percent and the level-based regression suggesting an overvaluation of 10 percent. However, as indicated above, our assessment puts more weight on the more reliable CA-based approach.

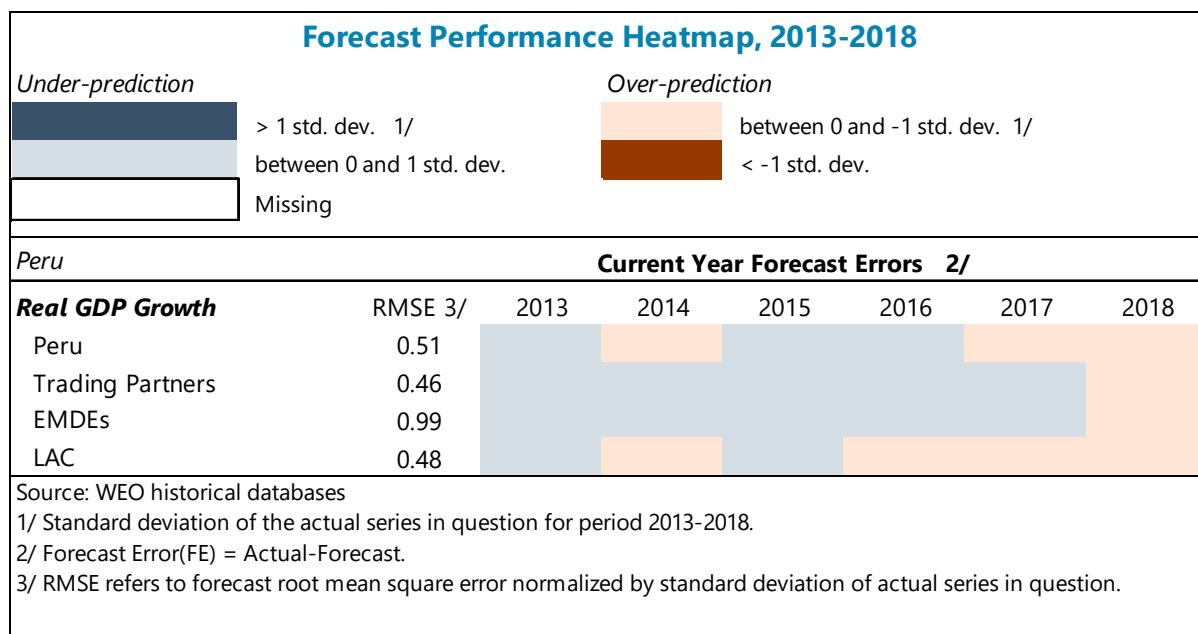
Annex VII. Staff GDP Forecast Errors

1. In recent years, forecast errors of GDP growth for Peru have been smaller than the EMDE average but slightly larger than for LAC peers. The higher forecast error relative to

other LAC countries is mainly due to large overestimations of growth in 2014 and 2017. External shocks such as lower Chinese growth and commodity prices in 2014 were compounded by temporary supply disruptions in fishing, mining, and agriculture as well as an unexpected drop in subnational investment implementation. In 2017,

domestic shocks related to the Odebrecht corruption scandal and the el Niño weather phenomenon reduced growth by one percent relative to the April WEO forecast.

Real GDP Forecast Error					
Vintages	2014	2015	2016	2017	2018
Peru Real GDP Growth (in percent)					
Outturn	2.4	3.3	4.0	2.5	4.0
Forecast April of each year	5.5	3.8	3.7	3.5	3.7
Current year error (pp)	-3.1	-0.5	0.3	-1.0	0.3
Metals (2005 = 100)					
Outturn	164.4	126.6	119.7	146.3	156.0
Forecast April of each year	173.0	136.8	108.3	147.5	165.4
Current year error (percent)	-4.96	-7.49	10.51	-0.78	-5.67
Trading partner GDP Growth (in percent)					
Outturn	3.8	3.5	3.1	3.6	3.5
Forecast April of each year	3.2	2.7	2.3	2.8	3.5
Current year error (percent)	0.6	0.7	0.8	0.8	0.0
Source: WEO; and IMF staff calculations.					



Annex VIII. Implementation of 2018 FSAP Recommendations

FSAP Key Recommendations	
Recommendations	Status
Systemic Risk and Macroprudential Policy	
Increase capital surcharges for systemic banks to levels in line with Basel III framework; increase countercyclical provisioning for smaller banks. (SBS) (ST)	In progress. Currently working on improving the methodology for countercyclical provisions and for capital surcharges for systemic banks. Currently working on methodology for determining buffers for concentration risk, and interest rate risk. Developed a new scheme of risk sensitive provisioning that differentiates between different types credit portfolios.
Enhance the monitoring of off-balance-sheet exposures of banks. (SBS) (IT)	Implemented. Information on exposures to construction companies and related projects is now required to be submitted to SBS for monitoring purposes. Work is also on-going on collecting data on exposures to non-retail clients.
Increase foreign currency lending risk weights in line with Basel III guidelines. (SBS) (ST)	In progress. An add-on capital charge equivalent to an 8 percent increase in the risk weight for foreign exchange credit risk exposures is applied. The SBS is assessing whether additional surcharges or increasing risk weights are needed.
Introduce new risk-monitoring tools, such as growth-at-risk, systemic risk analysis, and corporate sector stress testing; give specific mandate for macroprudential policy to BCRP and SBS; implement Memorandum of Understanding between BCRP and SBS to strengthen coordination. (BCRP/SBS) (ST/MT)	Partially implemented. The growth-at-risk methodology has been incorporated in the stress test model. The authorities' view is that current arrangements are working well and there is no need to designate a formal committee for macroprudential policy. In addition, the authorities view the current division of responsibilities, including where the BCRP is responsible for some macro-prudential policies and the SBS for micro-and other macro- prudential policies, in line with their constitutional mandates.
Financial Sector Oversight	
Banks	
Amend legal framework to grant SBS powers to exercise full consolidated supervision. (SBS) (MT)	In progress. SBS has developed a first draft of the needed changes in the banking law to grant the SBS full powers over holding companies. The SBS is also currently evaluating the timing of sending to Congress.

FSAP Key Recommendations	
Recommendations	Status
Enhance financial group supervisory and regulatory approach with regard to (i) group governance and risk-management requirements; (ii) consolidated capital adequacy and liquidity risk-management assessment; (iii) establishing a lead supervisor; and (iv) establishing a supervisory group rating. (SBS) (ST)	In progress. (i) Draft law on supervision of holding companies covers issues related to corporate governance; (ii) Amendments to regulation by Technical Subcommittee on Standardization (SC) related to the definition of consolidated equity are being evaluated; Contingency plans are revised to the group level for four D-SIBs.
Implement requirements for recovery and resolution planning for D-SIBs, as well as for financial groups. (SBS) (MT)	In progress. Two D-SIBs are already required to incorporate information on their recovery plans in the Capital Sufficiency Self-Assessment Report. In addition, a working group reporting to (CERF, Financial Regulations Standards Committee) is created to provide recommendations on type of recovery plans and their implementation.
Strengthen legal protection of all SBS staff in line with international best practice. (MEF) (MT)	Not implemented. It requires modification to the Banking Law.
Strengthen the SBS's internal governance and control framework by enhancing the Internal Audit Function, including the establishment of an Internal Audit Committee. (SBS) (ST/MT)	Implemented.
Finalize the review of the current methodology for the calculation of the additional capital requirements as planned; enhance the activation trigger of the countercyclical buffer, and enhance the systemic and single name risk buffers. (SBS) (ST)	In Progress. Surcharge for D-SIBs has been already addressed. The activation trigger will be reviewed in early 2020. SBS is currently working on the remaining components with the implementation planned for 2021.
Insurance	
Implement risk-based supervision for all insurers and brokers. (SBS) (ST)	In progress. In the case of insurers, risk base supervision is fully implemented. In the case of intermediaries, resolution 808-2019 is issued to improve the requirements for registering intermediaries and brokers. Resolution 809-2019 is issued to more effectively supervise by differentiating regulatory requirements by size for all brokers and intermediaries.
Cooperatives	
After passage of law to bring financial cooperatives under supervisory umbrella of SBS, design a deposit-insurance system. (BCRP, MEF and SBS) (MT)	Partially implemented. The regulation for a deposit-insurance system has been approved. Further, a complementary regulation establishing the coverage and contribution rates is planned to be published in December 2019.

FSAP Key Recommendations	
Recommendations	Status
Crisis Management	
Strengthen crisis preparedness and management arrangements. (MEF, BCRP, SBS, FSD) (MT)	In progress. Simulation programs of different potential sources of crisis (financial crisis, cyberattacks) are being prepared for 2020. Programs include strengthening the institutional and staff capacity for crisis management.
Enhance information-sharing between SBS and FSD. (SBS, FSD) (MT)	In progress. The working group to report to CERF is evaluating international practices to propose a comprehensive bank resolution framework.
Require payout of most insured deposits within seven working days and provide legal protection to FSD staff/agents. (SBS, MEF) (MT)	Not implemented. The authorities do not see the need to have binding law as the payouts in practice are done much faster.
Enhance the ELA framework by specifying eligibility and collateral requirements, and by providing for enhanced supervision, to ensure its effectiveness. (BCRP) (ST)	Not in the authorities' plans. According to the authorities, current provisions address the FSAP's concerns. BCRP uses a large variety of collaterals in its lending operations. The eligibility and requirements for their use are detailed in the corresponding circulars enacted by the BCRP (022-2015-BCRP and 052-2013-BCRP). This regulation establishes a comprehensive list of instruments to inject liquidity: i) short-term and long-term repo operations that use high quality assets as BTPs and CDBCRPs as collateral; ii) short and long-term fx-swaps, which use foreign currency as collateral; and ii) repos that use bank's loans as collateral through two instruments: a) repos with loan portfolio operations represented in securities; and b) repos with preferential participation certificates.
Financial Integrity	
Strengthen risk-based AML/CFT supervision (including sanctioning powers to enhance effectiveness) for banks and other high-risk reporting entities, focusing on preventive measures for mitigating risks of laundering of proceeds of corruption and drug trafficking. (MEF/SBS) (ST/MT)	In progress. Working on amendments to the Banking Law in order to increase penalties which may include suspending dividends, restricting asset growth and operations in certain sectors of activity.
Financial Deepening and Pension reforms	
Deepen repo markets, improve clearing and settlement infrastructure, prioritize medium- and long-term issuance around benchmark tenors. (BCRP/MEF) (ST/MT)	In progress. The repo market is expanding. By October 2019, interbank repo operations that use as collateral CDBCRP and BTPs accounted for 52 percent of the total volume of operations in the O/N money market.

FSAP Key Recommendations	
Recommendations	Status
Design reforms to improve the private pension system. (MEF) (ST/MT)	In progress. A commission is created to evaluate a comprehensive reform package under the leadership of the Ministry of Economy and Finance.
Time Frame: IT (Immediate) = less than 1 year; ST (short term) = 1- 3 years; MT (medium term) = 3-5 years.	



PERU

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 16, 2019

Prepared By

The Western Hemisphere Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS _____ 2

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS _____ 4

STATISTICAL ISSUES _____ 5

FUND RELATIONS

(As of October 31, 2019)

Membership Status: Joined 12/31/1945; accepted the obligations of Article VIII, Sections 2(a), 3, and 4 on 2/15/1961.

General Resources Account:	SDR Million	Percent of Quota
Quota	1334.50	100.00
Fund holdings of currency	1089.12	81.61
Reserve Tranche Position	245.43	18.39

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	609.89	100.00
Holdings	531.81	87.15

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jan. 26, 2007	Feb. 28, 2009	172.37	0.00
Stand-By	Jun. 09, 2004	Aug. 16, 2006	287.28	0.00
Stand-By	Feb. 01, 2002	Feb. 29, 2004	255.00	0.00

Projected Payments to the Fund:

	2019	2020	2021	2022	2023
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.17	0.64	0.64	0.64	0.64
Total	0.17	0.64	0.64	0.64	0.64

Exchange Arrangements

Peru has a de jure floating exchange rate arrangement. On October 30, 2019 the average of interbank buying and selling rates was 3.35 soles per U.S. dollar. The exchange system is free of restrictions, except for those maintained solely for the preservation of national or international security, and which have been notified to the Fund pursuant to Executive Board Decision No. 144–(52/51).

Last Article IV Consultation

The 2018 Article IV consultation was concluded on June 18, 2018 (IMF Country Report No. 18/225).

FSAP and ROSCs

Several joint Fund-Bank missions visited Lima in the period September 2000–January 2001 to conduct an FSAP for Peru. The corresponding Financial System Stability Assessment (FSSA) report was discussed by the Executive Board on March 12, 2001. A follow-up FSAP mission was concluded in February 2005. In April 2011, the Executive Board took note of the staff's analysis and recommendations in the report on Peru's FSAP Update. More recently, Fund-Bank missions visited Lima in the period July 2017–February 2018 to conduct another FSAP Update. Regarding ROSCs, In October 2002, an FAD mission conducted a Fiscal ROSC for Peru (IMF Country Report No. 04/109, 4/16/04), while an STA mission conducted a Data ROSC for Peru in February 2003 (IMF Country Report No. 03/332, 10/24/03).

Technical Assistance

FAD		
Year	Purpose	
2014	Follow-up macro-fiscal	7/30/2014
2014	Treasury Management	11/23/2014
2015	Follow-up on tax and customs administration	1/19/2015
2015	Local government revenues and BEPS in natural resource sector	12/1/2015
2015	RA-GAP	7/7/2015
2016	Budget Management	2/15/2016
2017	Fiscal Reporting and Budgeting	1/16/2017
2017	Follow-up on tax and customs administration - TADAT	3/7/2017
2017	Tax Administration	6/7/2017
2017	Public Investment Management	8/17/2017
2018	Treasury Management	2/20/2018
2018	Governance Pilot	9/23/2018
2019	Budgeting investment and PIMA	4/29/2019
2019	Tax regimes	08/12/19
2019	Revenue administration	11/13/19
LEG		
2017	Strengthening AML/CFT Supervision of the SMV	2/7/2017
STA		
	Housing Price Indexes	to be confirmed
2018	Monetary and Financial Sector Statistics	10/22/2018
2020	National accounts (sectoral balance sheets, GDP statistics)	1/27/2020

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

World Bank Group:

- Country page: <http://www.worldbank.org/en/country/peru>
- Overview of World Bank Group lending to Peru:
<http://financesapp.worldbank.org/en/countries/Peru/>
- IBRD-IDA project operations:
http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=PE

Inter-American Development Bank:

- Country page: <https://www.iadb.org/en/countries/peru/overview>
- IADB's lending portfolio: <https://www.iadb.org/en/countries/peru/projects-glance>

STATISTICAL ISSUES

(As of November 30, 2019)

General. Macroeconomic statistics are broadly adequate for policy formulation, surveillance, and monitoring. Peru subscribes to the Special Data Dissemination Standard (SDDS). A data ROSC was prepared and published in 2003.

Despite progress in recent years, there is scope for improvement in the following areas:

(i) coordination among the agencies that compile official statistics to avoid duplication of efforts; (ii) publishing a single official measure of inflation for Peru with component regional indexes; (iii) redeveloping the wholesale price index (WPI) as a producer price index (PPI); (iv) finalizing the migration to the standardized report forms for monetary data related to other financial corporations; and (v) expanding the scope of data sources for compiling financial flows of individual residents.

National accounts. In 2014, the National Statistics Office (INEI) released a new national account series implementing the 1993 SNA and using 2007 as the base year. Recently INEI has made significant progress in preparing historical series of the quarterly GDP for the period 1980-2007. Peru also continues to make progress, with STA assistance, on the compilation of quarterly sectoral accounts and balance sheet statistics to support domestic policy making. It is expected that INEI will finalize time series estimates by early 2020, at which point they will be in quarterly production of sector accounts.

Price statistics. The official measure of inflation for Peru currently is the CPI for Metropolitan Lima, compiled and published by INEI. The index is compiled using weights based on the 2008/09 Encuesta Nacional de Presupuestos Familiares (ENAPREF) and may no longer be representative of current expenditure patterns. The index would benefit from a weights and item basket update as well as implementation of the international standard classification (COICOP). A national level CPI has been published separately since February 2012. INEI compiles and publishes a WPI for Peru. Ideally the index would be redeveloped as a PPI with expanded coverage, so as to improve volume estimates in the national accounts.

The BCRP, assisted by STA, has recently updated the residential property price index for apartments in Lima implementing a hedonic property-mix adjustment methodology in line with international best practice.

Labor market statistics. The authorities monitor labor market developments using five indicators: open unemployment, underemployment, employment, employment in the formal sector, and remunerations. While monthly unemployment, employment and income data for metropolitan area of Lima from INEI are timely, only urban employment indexes are available from the Ministry of Labor for other areas and with some delays; monthly remuneration data for the government are timely but the monthly remuneration data for the private sector are no longer available. The

nationwide unemployment and underemployment situation are surveyed quarterly, and INEI is now publishing a broader regional coverage of the labor market statistics based on the Encuesta Nacional de Hogares (ENAH). The source for formal sector employment is the electronic registry of the tax agency (SUMAT), which covers both public and private entities. It would be useful to develop competitiveness indicators such as productivity and unit labor cost indexes.

Government financial statistics. The Central Bank (BCRP) compiles government finance statistics (GFS) following the GFSM2001, for the general government and its subsectors. Data for all subsectors are reported on a cash basis for revenues and on accrual basis for expenditures, and financial assets and liabilities are reported at face value. The coverage of published national budget data is narrower than the fiscal statistics prepared for the combined public sector. The authorities report data for publication in the Government Finance Statistics Yearbook (GFSY) using the GFSM 2001. No high frequency data is published in the International Financial Statistics (IFS) but is available from the weekly report of the BCRP.

Monetary and financial statistics: Monetary and financial statistics are reported on a regular monthly basis to STA using standardized report forms (SRFs) for the central bank and other depository corporations (government owned and private banks, financial companies, savings and loan associations and financial cooperatives). Data on other financial corporations (OFCs) have been recently reported and are under review. OFCs comprise insurance companies, pension funds, mutual funds, and other financial intermediaries and auxiliaries. The reported monetary statistics are broadly in line with the methodology of the *Monetary and Financial Statistics Manual (MFSM)*.

Financial sector surveillance: The BCRP report on quarterly basis all twelve core financial soundness indicators (FSIs) and nine (out of thirteen) of the encouraged set for the deposit taking sector. No FSIs are reported for other sectors and real estate markets. BCRP and SBS report data on several series and indicators to the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

External sector statistics. The BCRP compiles quarterly balance of payments and international investment position (IIP) following the fifth edition of the Balance of Payments Manual (BPM5). Timeliness in data submission to STA should improve, as these data are reported to STA for publication in IFS and BOPSY once a year rather than quarter by quarter. Authorities should migrate to the latest methodological standards and strengthen efforts to improve: data coverage (including for manufacturing services on physical inputs owned by others, compensation of employees, money market funds and insurance corporations, and households); valuation (loans and debt securities are at face value rather than at nominal and market value); instrument classification and level of detail (particularly for other investment); delineation of reserves in IIP according with international standards (as participations in the FLAR and BIS should be excluded from reserves). Further, authorities should improve consistency among external sector statistics datasets (IIP and Coordinated Portfolio Investment Survey (CPIS), and IIP and external debt).

The BCRP has been reporting since August 2001 weekly data on international reserves in accordance with the Guidelines for a Data Template on International Reserves and Foreign Currency Liquidity. Since August 2006, the BCRP is including the full amount of the liquidity requirements in the reserve template both under official reserve assets and as a contingent net drain (as specified in Section III of the Data Template). Peru disseminates quarterly data on external debt

Authorities are encouraged to resume participation in the Coordinated Direct Investment Survey (their latest inward data are for 2013 and outward for 2010) and improve timeliness for the CPIS.

Peru: Table of Common Indicators Required for Surveillance (As of November 30, 2019)							
	Date of Latest Observation	Date Received	Frequency of data ⁵	Frequency of Reporting ⁵	Frequency of Publication ⁵	Memo Items:	
						Data Quality – Methodological Soundness ⁶	Data Quality Accuracy and Reliability ⁷
Exchange Rates	11/28/19	11/29/19	D	M	D		Exchange Rates
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	11/15/19	11/22/19	D	M	W		International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹
Reserve/Base Money	11/15/19	11/22/19	W	M	W	O, LO, LO, LO	Reserve/Base Money
Broad Money	10/31/19	11/22/19	W	M	W		Broad Money
Central Bank Balance Sheet	11/15/19	11/22/19	W	M	W		Central Bank Balance Sheet
Consolidated Balance Sheet of the Banking System	10/31/19	11/22/19	W	M	W		Consolidated Balance Sheet of the Banking System
Interest Rates ²	October 2019	11/22/19	D	M	D		Interest Rates ²
Consumer Price Index	October 2019	11/08/19	M	M	M	O, LO, LO, LO	Consumer Price Index
Revenue, Expenditure, Balance and Composition of Financing – Central Government	October 2019	11/22/19	M	M	M	O, LO, O, O	Revenue, Expenditure, Balance and Composition of Financing – CG
Revenue, Expenditure, Balance and Composition of Financing – General Government	Q3/2019	11/22/19	Q	Q	Q	O, LO, O, O	Revenue, Expenditure, Balance and Composition of Financing – GG
Stocks of CG Debt ³	Q3/2019	11/25/19	Q	Q	Q		Stocks of CG Debt ³
International Investment Position ⁴	Q3/2019	11/25/19	Q	Q	Q		International Investment Position ⁴
External Current Account Balance	Q3/2019	11/22/19	Q	Q	Q	O, LO, LO, LO	External Current Account Balance

Exports and Imports of Goods and Services	Q3/2019	11/22/19	Q	Q	Q		Exports and Imports of Goods and Services
GDP/GNP	Q3/2019	11/22/19	Q	Q	Q	LO, LO, LO, LO	GDP/GNP
Gross External Debt	Q3/2019	11/22/19	Q	Q	Q		Gross External Debt
<p>¹ Every Friday the central bank disseminates daily net international reserves, and weekly International Reserve Assets and Reserve Liabilities.</p> <p>² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.</p> <p>³ Including type of instrument, maturity and type of creditor.</p> <p>⁴ Includes external gross financial asset and liability positions vis-à-vis nonresidents.</p> <p>⁵ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).</p> <p>⁶ Reflects the assessment provided in the data ROSC published in October 2003 and <i>based on</i> the findings of the mission that took place during February 12–26, 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), not observed (NO), or not available (NA).</p> <p>⁷ Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.</p>							

Statement by the Staff Representative on Peru
January 8, 2020

This statement provides information that has become available since the staff report was issued on December 19, 2019. This information does not alter the thrust of the staff appraisal.

1. **The latest data and information releases suggest that economic activity remains sluggish.** The monthly GDP data for October shows a 2.1 percent y-o-y growth, with the growth for the period January-October staying at 2.2 percent (y-o-y). While the October data recorded some recovery in the primary sectors, this positive development was offset by a weakening in the nonprimary sectors, particularly in manufacturing and construction. In its last quarterly inflation report for the year, issued on December 20th, the BCRP revised down its 2019 growth projection from 2.7 percent to 2.3 percent. This revision is in line with Staff's projections. The BCRP left its 2020 growth forecast unchanged at 3.8 percent.
2. **The government invoked the escape clause of the fiscal rule framework to relax the fiscal deficit ceilings for the period 2021-23.** As indicated in the staff report, in 2017 the government invoked the fiscal rule's escape clause after the economy was impacted by a severe El Niño weather pattern. This allowed the fiscal deficit to exceed the 1 percent ceiling for the period 2017-20, but the deficit was required to meet the ceiling again in 2021. Given the current economic slowdown, the government has invoked the escape clause one more time in order to implement a more gradual consolidation. Under the new path, the fiscal deficit ceiling will be 1.8, 1.6, and 1.3 percent of GDP in 2021, 2022, and 2023, respectively. The increase in the ceiling is primarily aimed at creating room for higher capital expenditure. The deficit ceiling for 2020 remains unchanged at 2 percent of GDP. The temporary modification of the fiscal rule has been legislated via a government decree. The latter has been submitted to Congress' Permanent Commission, which will in turn bring it to the new Congress once it is in session.
3. **On balance, staff assess this measure as appropriate, although some actions are needed to enhance its benefits and mitigate its shortcomings.** The relaxation of the deficit ceiling is in line with staff's view about the desirability of short-term fiscal easing. In addition, using the additional fiscal room for capital spending is in line with the objective of closing infrastructure gaps. Finally, Peru's sound fiscal position, with low public debt and significant fiscal assets, limits risks to the debt dynamics. Nonetheless, the actual impact of this measure will crucially depend on the government's capacity to reverse the budget under-execution, which has been a difficult task in recent years. It will also be important to the government to implement measures to maintain the credibility of the fiscal framework. As indicated in the staff report, frequent revisions may weaken the integrity of the rules-based fiscal framework. As a result, it may be important for Peru to add additional flexibility to the

fiscal framework in the medium term rather than relying on frequent uses of the escape clause.

4. **The government has also extended the agriculture promotion law until 2031, although with some modifications.** As indicated in the staff report, the law was set to expire in 2021 and the uncertainty about its future was affecting investment decisions. The government has issued a decree extending the law for an additional ten years, while also applying some of its provisions to the forestry and aquaculture sectors. The decree includes some modifications to the existing law, including an increase in the number of vacation days (from 15 to 30), an 8 percent increase in the minimum daily remuneration, as well as an increase in employers' health care contributions (which will gradually converge to the 9 percent rate applicable economy wide). The extension of the agriculture promotion law is in line with staff's policy advice and, as in the case of the modification of the fiscal rules, the decree has been submitted to Congress' Permanent Commission, which will in turn bring it to the new Congress once it is in session.

**Statement by Mr. Lopetegui , Executive Director
and Mr. Morales, Senior Advisor on Peru
January 8, 2020**

On behalf of the Peruvian authorities, we would like to thank staff for the comprehensive Article IV report and selected issues paper. The authorities consent to the publication of the reports and appreciate the open discussions in Lima and the staff's thorough analysis of recent economic developments and relevant policy issues.

Macroeconomic Background

Peru's macroeconomic performance remains strong. Economic growth reached 5.4 percent on average for the last 15 years in an environment of macroeconomic stability, free trade, and capital mobility. Moreover, Peru has made substantial inroads in mitigating key vulnerabilities by reversing dollarization, strengthening financial soundness, and reducing poverty. Peru's GDP growth is expected to decelerate to 2.2 percent in 2019, a decline largely associated with temporary and/or idiosyncratic factors, mainly in mining and fishing. Non-primary industries are expected to grow by 3.2 percent (down from 4.2 percent in 2018), mainly due to lower terms of trade and lower growth in trade partner economies (associated with international trade tensions and China's economic deceleration).

Despite deteriorating external conditions, Peru maintains strong buffers which have proved instrumental in helping to limit the risks from currency mismatches and dollarization. Gross international reserves reached USD 68 billion and net public debt remains low at 12.6 percent of GDP (26.7 percent in gross terms), with a declining share of foreign currency liabilities. These buffers and Peru's long-standing track record of consistent economic policies ensure the continuation of macroeconomic stability and facilitate an effective policy response to external shocks.

The Central Reserve Bank of Peru (BCRP) implements its monetary policy within an inflation-targeting scheme, with the short-term interest rate as the main instrument. Changes in the BCRP policy rate have evolved in line with inflation and output gap forecasts.

This has allowed the implementation of counter-cyclical monetary policy to mitigate the impact of demand shocks on inflation and economic activity.

Unconventional monetary instruments in Peru complement policy rate decisions and aim at limiting the risks from financial dollarization and the impact of the credit cycle on financial stability. In a context of financial dollarization and high volatility in capital flows, the use of reserve requirements and foreign exchange intervention (FXI) has contributed to increasing the effectiveness of the interest rate as a counter-cyclical policy tool. During the global financial crisis, the use of non-conventional instruments allowed the BCRP to maintain low policy rates and implement an effective counter-cyclical policy response. As a result, between 2001 and 2019 Peru's inflation and growth performance was considerably stable. Over the same period, credit dollarization declined by 54 percentage points (from 80 to 26 percent) and financial intermediation (measured as the credit-to-GDP ratio) increased from 23 to 42 percentage points of GDP.

Recent Developments

Lower GDP growth in 2019 reflects mainly a contraction in primary sectors during the first half of the year, especially mining and fishing, because of external and idiosyncratic factors. In addition, domestic demand slowed down to 2.5 percent annual growth in 2019 (from 4.2 percent the year before) in response to lower terms of trade and a slowdown in global activity. However, consumer and business confidence started to recover in the second half of the year. Non-commodity exports, mainly agricultural products, continued to rise, placing Peru among the world top exporters of blueberries, citrus, grapes, avocados and others, thereby contributing to job creation and poverty reduction. In the absence of shocks, we expect an important recovery both in exports and in domestic demand in 2020-2021, triggered by a normalization of production in major mines, the phasing-out of "base effects" affecting fishing growth, and the start of operations of new mining projects. We project a faster narrowing of the output gap relative to staff forecasts as confidence recovers and public investment rebounds.

Some political economy developments had an impact on overall confidence. Corruption allegations and difficulties in the interaction between the government and congress affected investor sentiment. Additionally, the assumption of duties by new local authorities caused a delay in the implementation of regional projects. Going forward, the weight of these factors on expectations and domestic demand should diminish as the underlying frictions are resolved and new congressional authorities are elected at end-January.

External Sector

The external current account deficit in 2019 remained unchanged relative to 2018. In addition, a soft global growth environment contributed to a decline in traditional exports.

However, commodity prices recovered somewhat towards the end of the year because of diminished trade tensions and the depreciation of the US dollar. As economic activity picks up, the current account deficit is expected to remain stable in 2020 and 2021, below the average for the last 8 years. Foreign direct investment continues being the main source of external financing, coupled with a significant increase in capital inflows explained by a decline in the probability of a rise in interest rates in advanced economies and a positive assessment of Peru's economic performance and prospects by foreign investors. Foreign portfolio investors allocated US\$2.1 billion to the private sector assets and US\$4.2 billion to sovereign securities in 2019, a significant increase relative to previous years.

Monetary Policy

The BCRP reduced its policy interest rate in August and again in November to 2.25 percent, thereby expanding policy stimulus in the face of a negative output gap and well-anchored inflation expectations. In 2019, inflation was 1.9 percent and the estimated output gap around -1 percent on average. The current monetary policy stimulus aims at maintaining inflation and inflation expectations around the midpoint of the inflation target range of 1-3 percent and gradually closing the negative output gap.

BCRP intervention in the foreign exchange market has continued to aim at containing excessive exchange rate volatility, although FXI frequency had decreased significantly. During 2018 and 2019, the number of days of central bank intervention declined to less than a week in both the spot and the derivative markets. At the same time, the participation of non-residents in the foreign exchange market has increased over time, consistent with their higher share in sovereign bonds holdings, which reached 47 percent towards the end of the year. In 2019, foreign investors mostly sold foreign exchange in the spot market to acquire domestic currency to purchase government securities and hedged their currency exposure in the derivatives market (which has become much more active in recent years).

Fiscal Policy

The overall fiscal deficit is expected to decline to 1.7 percent in 2019, mostly because of higher revenue. Efforts to monitor tax compliance and to strengthen oversight by the revenue authority translated into higher extraordinary revenue collection for the year. Regarding government expenditure, the share of capital spending declined because of investment underperformance by regional and local governments. As a result, the structural fiscal balance improved by 0.8 percent of potential GDP, reflecting fiscal policy stance more contractionary than originally envisaged.

The authorities aim at reversing fiscal policy pro-cyclicality by raising budget execution. At the same time, higher tax revenue should contribute to enlarge fiscal space for capital and social spending. With that purpose, the tax authority has put in place a results-

based strategy to expand the tax revenue base through different initiatives such as introducing a Digital Transformation Plan, encouraging voluntary compliance, introducing anti-elusion measures, and expanding electronic invoicing. These measures should help to reduce widespread compliance gaps, particularly VAT compliance.

The decline of public investment in 2019 resulted from a combination of idiosyncratic factors. Consistent with historical patterns, the implementation of regional projects slowed down as new local authorities took office. At the national level, recurrent implementation problems explain project execution well below original targets. To address these challenges, a monitoring system has been implemented to receive timely feedback regarding project execution, and “urgency decrees”, subject to validation by the new congress, have been enacted to introduce a simplified process to implement priority projects included in the National Infrastructure Plan for Competitiveness and to adopt measures to encourage a higher execution of public projects. These measures comprise the reallocation of fiscal resources to projects with better implementation track record, the removal of red tape hampering the continuation of public works showing substantial implementation progress, and a fast-track allocation of contingent fiscal resources to regional governments showing improved project execution.

Regarding debt management, the government has been active in issuing new obligations to improve the country’s debt service profile. In this regard, tangible results have been achieved over time in lengthening the average maturity of obligations, raising the share of local currency liabilities, and increasing the share of fixed-rate borrowing instruments. To make further progress on these fronts, the government issued local currency bonds in June and November 2019. The November issuance amounted to 10 billion soles (about USD 3 billion), with maturities of 15 and 21 years, attaining interest rates of 4.95 (record low for domestic currency securities) and 5.35 percent respectively.

For the medium term, the government has revised the trajectory of the overall fiscal deficit to smooth out the transition towards the one percent fiscal deficit rule, as economic activity is still below potential. On current trends, the prior trajectory would have brought about a significant fiscal adjustment between 2020 and 2021, implying a pro-cyclical fiscal stance. The new trajectory aims at reaching a 1 percent overall fiscal deficit by 2024.

Financial Sector

Consumer loans continue to increase, while business loans are decelerating. Overall, this has resulted in a continuous increase in financial intermediation, with a ratio of credit to GDP of 44 percent, up by 3 percent from 2014. Consumer loans have picked up in response to an environment of lower interest rates in domestic currency, contributing to de-dollarization. The deceleration in business loans reflects higher risk aversion by banks and firms, and weaker economic activity. Although nonperforming loans remain low at 3.5 percent of total,

the Superintendency of Banks, Insurance and Pension Funds (SBS) remains vigilant to anticipate any deterioration in credit risk arising from the slowdown and/or the acceleration in borrowing by households.

The banking sector remains well capitalized. The SBS is enhancing the monitoring of banks' off-balance sheet exposures and is considering additional surcharges for systemic banks. It also introduced an additional capital charge equivalent to an 8 percent increase in the risk weight for foreign exchange credit risk exposures. Regarding non-bank institutions, risk-based supervision of insurers is fully implemented. Moreover, in line with the new SBS mandate to incorporate more than one thousand financial cooperatives under its supervision, the SBS is taking stock of basic information on the financial soundness of existing institutions. Regarding pension funds, the SBS is coordinating with the Ministry of Finance and the Ministry of Labor on reform proposals to be discussed with relevant stakeholders.

Structural Reform

The authorities agree with the urgent need to raise productivity to raise growth potential over the medium term. The National Plan of Competitiveness and Productivity approved last July provides the framework and a roadmap to support appropriate government intervention in key areas around nine priority objectives, namely improving infrastructure, human capital, innovation, financial deepening, labor markets, the business environment, international trade, government institutions, and environmental sustainability. Complementarily, the National Infrastructure Plan for Competitiveness identifies 52 priority projects to narrow the infrastructure gap estimated at about USD 100 billion, with institutional arrangements for a better planning and monitoring of projects at different government levels. In addition, given slow progress to rebuild infrastructure in regions affected by the 2017 “El Niño” disaster, the entity in charge has been empowered to sign government-to-government agreements to accelerate this process.

Reducing the large share of informal employment in the labor market is a challenging task. On the one hand, the informal sector has provided employment alternatives especially to the economically disadvantaged, with national unemployment at 3.7 percent of the labor force in the third quarter of 2019. However, widespread informality makes it difficult to raise productivity in a scale sufficient to raise standards of living significantly, in a sustainable and inclusive manner. In this regard, the government gives high priority to policies to strengthen human capital, including by improving access to high quality education, job training, and matching capacity building with skill gaps. Because of the success of the agrarian promotion law in driving labor formalization in the sector, it has been extended for ten more years. The new law retains the flexibility in labor contracts, at the same time increasing the benefits to workers. In the medium term, it would be necessary to formulate policies conducive to a more efficient absorption of Venezuelan immigrants to the formal job market.

The government gives high priority to improve public sector transparency and governance. The implementation of the 2018-21 Anti-corruption Plan is helping to strengthen anti-corruption institutions. To support these efforts, the government created the Council for Judicial Reform in May 2019, to coordinate and monitor all judiciary reform initiatives. Regarding AML/CFT prevention, the number of suspicious activities reported to the Financial Intelligence Unit has more than tripled between 2013 and 2018, and is expected to have increased further in 2019, reflecting increased awareness among the population about the need to contribute to enhance integrity at all levels of society.