



PERU

March 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; 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 2021 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 March 19, 2021 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 March 19, 2021, following discussions that ended on January 21, 2021, 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 March 2, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Peru.

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International Monetary Fund
Washington, D.C.



IMF Executive Board Concludes 2021 Article IV Consultation with Peru

FOR IMMEDIATE RELEASE

Washington, DC – March 22, 2021: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Peru on March 19, 2021.

Peru entered the COVID-19 pandemic with a sustained track record of implementing very strong policies amid very strong economic fundamentals and institutional policy frameworks. Prudent fiscal management, supported by fiscal rules, has helped contain government debt within the 30-percent-of-GDP ceiling until 2019, at the lowest level in the region. Under the inflation targeting framework, inflation has been low and stable and financial dollarization has declined while strong supervisory and macroprudential policies have contributed to preserving financial stability. Supported by rising commodity prices and strong macroeconomic policies, growth averaged 5.2 percent in the last 15 years, poverty was halved, and external vulnerabilities reduced.

The COVID-19 shock led to very strict containment measures and hit economic activity hard, with a sharp decline in GDP in the second quarter, one of the deepest in the world. The recession was accompanied by large falls in employment and participation, particularly among women, and increasing informality and poverty. A coordinated fiscal, monetary, and financial sector policy response helped stabilize financial markets, contain insolvencies, and support the recovery in the second half of 2020, when the containment measures were eased. As a result, the output contraction narrowed to -11.1 percent in 2020, with core inflation within the target range.

The ongoing second wave of the pandemic is likely to dampen the economic recovery, but the economy is expected to rebound in 2021, assuming the health emergency is brought under control by end-March. Under this scenario, restrictions could be gradually eased in the second quarter, and activity could regain momentum led by domestic demand and historically favorable terms of trade. Under these assumptions, GDP growth would reach 8.5 percent in 2021. The outlook is highly uncertain and downside risks prevail, but policy buffers are ample.

Executive Board Assessment²

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.

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>.

Executive Directors noted that Peru entered the COVID-19 pandemic with very strong economic fundamentals and policy frameworks. The pandemic, however, inflicted a heavy human and economic toll. Directors commended the authorities for their decisive response in mitigating the impact of the crisis. Noting the significant risks ahead, they encouraged the authorities to continue efforts to limit the scarring effects, promote a robust recovery, and implement structural reforms to achieve a more broad-based, inclusive growth.

Directors advised the authorities to avoid premature withdrawal of fiscal support to help contain the pandemic, mitigate its impact on poverty, and support recovery. Once the crisis abates, priority should be given to addressing fiscal risks and rising spending pressures. In this context, Directors underscored the need to anchor fiscal policy to a credible medium-term framework. They emphasized that revenue mobilization will be key to preserving fiscal sustainability and welcomed the authorities' request for Fund Technical Advice to identify measures to increase fiscal revenues. Going forward, they noted that any recalibration of the fiscal rules should preserve debt sustainability, strengthen credibility, and be clearly communicated.

Directors agreed that monetary policy should remain accommodative while macroprudential policies should encourage banks to focus on clients' viability. In addition, they considered that greater exchange rate flexibility would have benefits, especially as financial dollarization continues to decline. Directors noted that the banking system remains resilient. They commended the progress in implementing the 2018 Financial Sector Assessment Program recommendations and encouraged the authorities to move ahead with the remaining recommendations, especially to accelerate legislative and regulatory reforms to further strengthen financial sector supervision.

Directors emphasized that the reform agenda should focus on structural fragilities exposed by the pandemic and on promoting stronger and inclusive growth. Priority could be given to (i) boosting productivity by improving education, enhancing infrastructure, facilitating labor reallocation, and improving the business climate; (ii) enhancing social protection while reducing incentives to informality from the tax-benefit system, including through investment in health care and pension reform; and (iii) strengthening governance with additional transparency in the public sector and robust anti-corruption and AML/CFT frameworks.

Peru: Selected Economic Indicators

			Prel.	Projections		
	2018	2019	2020	2021	2022	2023
Social Indicators						
Poverty rate (total) 1/	22.3	21.7	27.5

Unemployment rate for Metropolitan Lima (period average)	6.7	6.6	13.6
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(Annual percentage change; unless otherwise indicated)

Production and prices

Real GDP	4.0	2.2	-11.1	8.5	5.2	4.8
Real domestic demand	4.2	2.4	-9.8	9.4	5.4	4.8
Consumer Prices (end of period)	2.2	1.9	2.0	2.0	2.0	2.0

External sector

Exports	8.0	-2.8	-11.1	27.5	3.7	3.7
Imports	8.1	-1.9	-15.6	19.9	5.0	4.8
External current account balance (% of GDP)	-1.7	-1.5	0.5	-0.4	-0.7	-1.0
Gross reserves						
In billions of U.S. dollars	60.3	68.4	74.9	75.1	75.1	75.0
Percent of short-term external debt	363.5	432.6	496.4	518.7	505.4	494.2

Money and credit 2/ 3/

Broad money	9.6	8.8	27.5	13.0	9.6	7.8
Net credit to the private sector	10.3	6.4	14.5	4.0	4.0	6.2

(In percent of GDP; unless otherwise indicated)

Public sector

NFPS Revenue	24.5	24.8	22.1	22.4	23.1	23.1
NFPS Primary Expenditure	25.5	25.0	29.3	25.6	24.7	24.0
NFPS Primary Balance	-1.0	-0.2	-7.2	-3.3	-1.6	-0.9
NFPS Overall Balance	-2.3	-1.6	-8.8	-5.0	-3.4	-2.8

Debt

Total external debt	34.6	34.7	43.1	39.0	36.6	34.2
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NFPS Gross debt (including Rep. Certificates)	26.2	27.1	35.4	35.4	36.2	36.7
External	8.9	8.5	15.0	14.1	13.9	13.4
Domestic	17.3	18.6	20.3	21.3	22.3	23.2
Savings and investment						
Gross domestic investment	21.7	21.5	18.8	21.1	22.0	22.3
National savings	20.0	19.9	19.3	20.7	21.3	21.3
Memorandum items						
Nominal GDP (S/. billions)	740	770	712	815	872	929
GDP per capita (in US\$)	7,000	6,958	6,084	6,678	7,051	7,389

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 2021 ARTICLE IV CONSULTATION

March 2, 2021

KEY ISSUES

Context. Peru entered the pandemic with a sustained track record of implementing very strong policies amid very strong economic fundamentals and institutional policy frameworks, but was hit hard by the pandemic, which took a heavy toll in terms of human lives and economic output. Tensions between executive and legislative powers continue to affect institutional cohesion, but new general elections will be held in April-June 2021. The IMF Executive Board approved a two-year FCL arrangement in the amount of US\$11 billion (600 percent of quota) on May 28, 2020.

Outlook and risks. Assuming the second wave of COVID-19 infections is brought under control by end-Q1, activity is expected to recover steadily in 2021. Driven by domestic demand and favorable terms of trade, real GDP growth is projected to reach 8.5 percent in 2021, returning output to its pre-pandemic level in 2022. The crisis is likely to leave significant scars in the medium term. The outlook is highly uncertain, and is subject to significant downside risks, notably concerning the evolution of the pandemic.

Policy advice. In the short term, the available fiscal policy space should be used to address the pandemic, including by providing further support to households, limit its impact on poverty, and safeguard against downside risks to growth. At the same time, fiscal risks and rising spending pressures underscore the need for a credible medium-term plan to return to the fiscal targets. With inflationary pressures remaining muted, monetary conditions should remain accommodative even as extraordinary measures are withdrawn. Structural reforms should target the weaknesses exposed by the pandemic, focusing on policies that enhance productivity and strengthen the social safety net. Reforms to strengthen governance should continue.

Approved By
K. Srinivasan (WHD)
and R. Duttagupta
(SPR)

Discussions were held virtually during January 18-29, 2021. The mission comprised Leo Bonato (head), Luisa Charry, Etibar Jafarov (all WHD), and Gohar Minasyan (SPR). Krishna Srinivasan (WHD) joined the concluding meetings. Armando Morales (OED) participated in the discussions. Staff met with Minister of Economy and Finance Mendoza, Governor Velarde, other senior central government officials, and representatives of the private sector and civil society. Carlo Pizzinelli (WHD), and Ronald Cueva and Hernan Winkler (World Bank) contributed to the report. Danjing Sheng and Patricia Delgado (WHD) provided research and administrative assistance.

CONTENTS

CONTEXT	4
RECENT DEVELOPMENTS	4
OUTLOOK AND RISKS	10
POLICY DISCUSSIONS	11
A. Balancing Short-Term Fiscal Support and Medium-Term Plans to Return to the Fiscal Targets	11
B. Maintaining Monetary Accommodation and Preserving Financial Stability	14
C. Structural Reforms for Stronger, Resilient, and Inclusive Growth	17
D. Authorities' Views	19
STAFF APPRAISAL	21
FIGURES	
1. Containment Measures and Economic Recovery	23
2. Real Sector Developments	24
3. Fiscal Sector Developments	25
4. Balance Sheet Indicators	26
5. Corporate Sector Financial Performance in Peru and Peer Countries	27
6. External Sector Developments	28
7: External Debt Sustainability: Bound Tests	29
TABLES	
1. Selected Economic Indicators	30
2. Nonfinancial Public Sector Main Fiscal Aggregates	31
3. Statement of Operations of the General Government	32

4. Financial Soundness Indicators _____	33
5. Balance of Payments _____	34
6. Monetary Survey _____	35
7. External Debt Sustainability Framework, 2014–24 _____	36

ANNEXES

I. Implementation of Past Fund Advice _____	37
II. Peru’s Health Preparedness _____	39
III. Labor Market Developments and Social Support Programs _____	41
IV. 2021 Poverty Projections under Different Scenarios _____	46
V. Withdrawal from Pension Funds _____	51
VI. External Sector Assessment _____	54
VII. Risk Assessment Matrix _____	58
VIII. Public Debt Sustainability Analysis _____	61
IX. Foreign Exchange Intervention—Controlling Exchange Rate Volatility to Preserve Financial Stability _____	69
X. Implementation of 2018 FSAP Recommendations _____	71

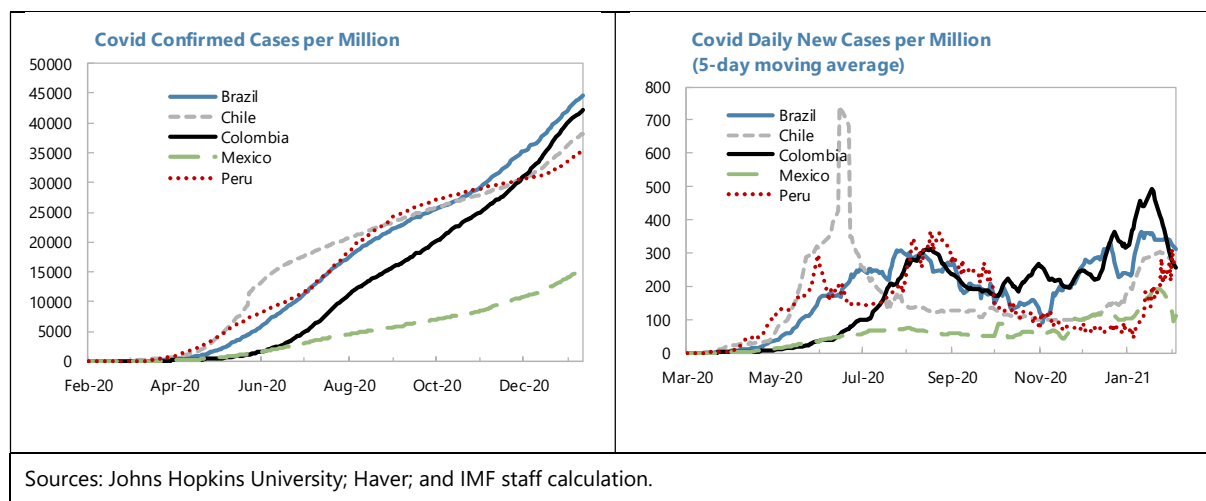
CONTEXT

1. **Peru entered the COVID-19 pandemic with a sustained track record of implementing very strong policies amid very strong economic fundamentals and institutional policy frameworks.** Prudent fiscal management, supported by fiscal rules, has helped contain government debt within the 30-percent-of-GDP ceiling until 2019, at the lowest level in the region. Under the inflation targeting framework, inflation has been low and stable and financial dollarization has declined while strong supervisory and macroprudential policies have contributed to preserving financial stability. Supported by rising commodity prices and strong macroeconomic policies, growth averaged 5.2 percent in the last 15 years, poverty was halved, and external vulnerabilities reduced. Policies have been broadly in line with past Fund advice (Annex I).
2. **The pandemic hit Peru hard.** On the heels of a combination of adverse shocks that slowed the growth momentum in recent years, the pandemic presented an unprecedented challenge, taking a heavy toll on lives and livelihoods and causing one of the deepest recessions. Based on Peru's very strong policies and institutional frameworks and track record of sound economic performance and policy implementation, and to strengthen its policy buffers and boost confidence, the IMF Executive Board approved a two-year FCL arrangement in the amount of US\$11 billion (600 percent of quota) on May 28, 2020. The authorities expect to treat the arrangement as precautionary.
3. **Political uncertainty heightened in 2020 and is likely to continue until new elections in 2021.** A new Congress was elected in January 2020, but tensions with the executive power continued to affect institutional cohesion. Instability culminated in November 2020 when the former president was impeached based on corruption allegations. His immediate successor resigned following deadly protests within days after his confirmation, following which Francisco Sagasti was installed as the interim president. Presidential and parliamentary elections will be held in April-June 2021.

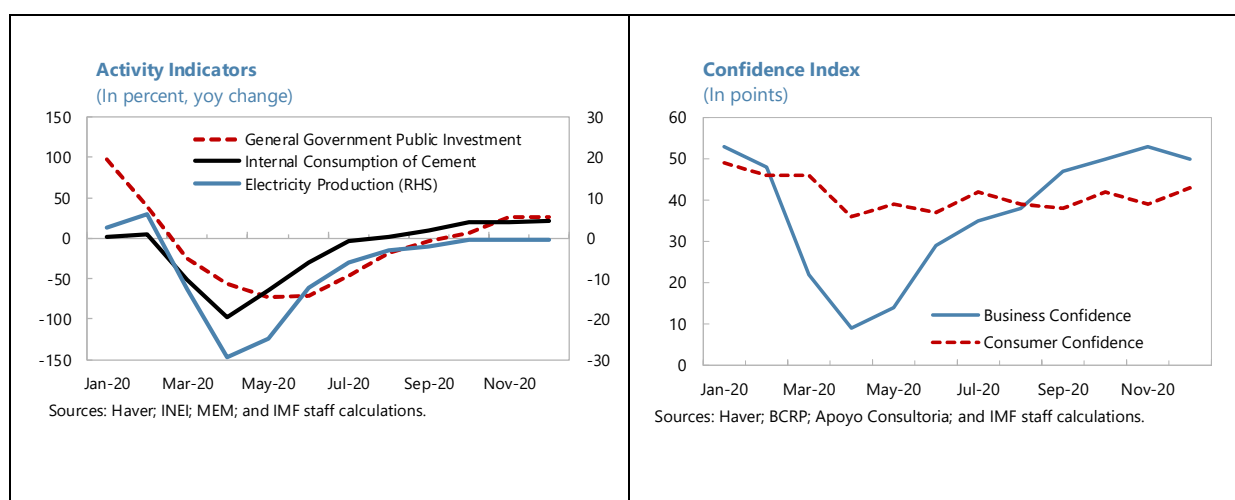
RECENT DEVELOPMENTS

4. **Despite very aggressive containment measures, the pandemic claimed many human lives in 2020 and is intensifying again in 2021.** Low capacity in the health system (Annex II) forced the authorities to enforce one of the world's earliest and strictest lockdowns. Owing to a significant share of contact-intensive sectors and limited teleworking capacity because of low digitalization, the containment measures crippled the economy but could not halt soaring infection rates, with the latter reflecting inadequate test-and-trace abilities. The spread of the infection and capacity constraints in the health system caused a surge in fatalities, with Peru recording one of the highest per-capita death rates globally. From August to December, the number of new cases subsided, but a second wave of the pandemic started in January 2021, with new infections climbing rapidly. The health system's capacity is being stretched again, and the authorities have taken targeted measures to contain infections.¹

¹ These measures include lockdowns and curfews in 32 provinces in the 17 most-affected regions (originally, the coverage was 10 most-affected regions) for the month of February.



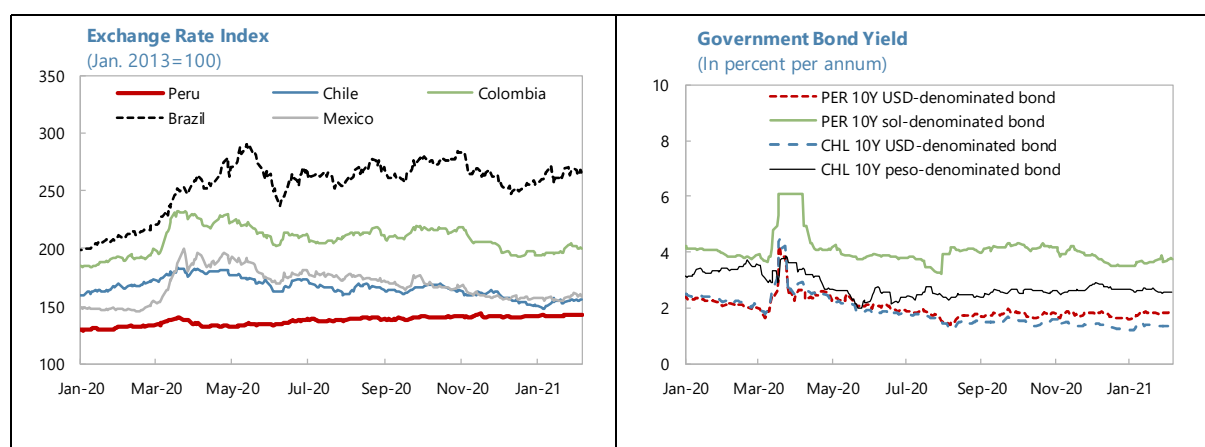
5. The pandemic's economic impact was severe in the first half of 2020, but economic activity rebounded afterwards. Real GDP fell by 3.7 percent and 30 percent (y-o-y) respectively in Q1 and Q2, owing largely to the stringent containment measures (Figure 1). Some sectors—including mining, construction, and services—almost came to a halt, affecting primary exports, consumption, and investment. Following an easing of restrictions in June-July, economic activity recovered rapidly, supported by a strong policy response. As a result, real GDP contracted by 11.1 percent in 2020 (Figure 2). Reportedly, industries representing 28 percent of GDP (including agriculture, chemical and food industries, telecommunications, and construction) have already reached their pre-COVID levels of production while another group representing 34 percent of GDP (including fishing, electricity, and manufacturing) is very close. Despite a spike in food prices in January, core inflation has remained muted.



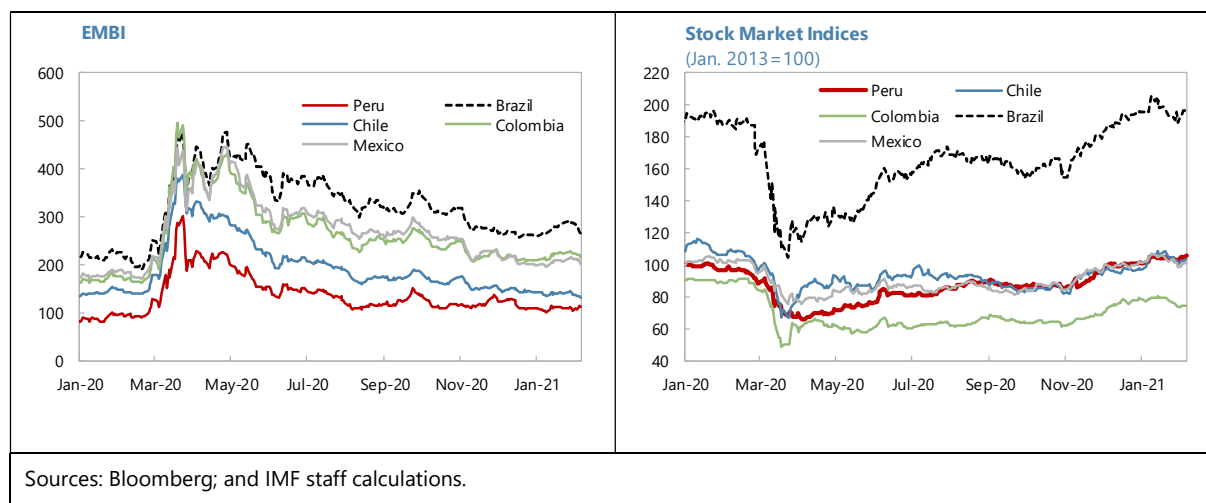
6. The recession was accompanied by large falls in employment and participation, particularly among women, and increasing informality and poverty. In the second quarter,

employment contracted by a whopping 35.5 percent (y-o-y), the largest in the region, but the contraction narrowed to 17.1 percent in the third quarter. Large reduction of wages were also experienced in the informal sector. The share of informal workers increased to 73.7 percent in 2020Q3 from 71.6 percent one year before (Annex III). Social support programs provided much needed assistance but could not fully offset income losses for vulnerable households, and poverty increased to an estimated 27.5 percent in 2020, up from 21.7 percent in 2019 (Annex IV).

7. The swift monetary policy response helped stabilize financial markets. After reducing the benchmark interest rate by 2 percentage points to a historic low of 0.25 percent at the onset of the crisis—the lowest level in the region—the central bank provided ample liquidity mainly by implementing guaranteed-credit repo operations with banks under the *Reactiva Perú* program, lowering reserve requirements, and extending the amount and maturity of repo operations. The *Banco Central de Reserva del Perú* (BCRP) also made available foreign currency liquidity to the market during periods of stress. Together with the approval of the FCL, these measures helped reassure markets, limiting the increase in risk spreads and the depreciation of the exchange rate. Peru could issue sovereign bonds at low yields in April (US\$3 billion) and November (US\$4 billion), including US\$1 billion in century bonds, immediately after the November political crisis). Macroprudential policies were also eased by reducing the countercyclical capital buffer for financial institutions and allowing them to adjust the terms of loans to households and enterprises without changing loan classification.²



² Regarding CFM/MPM measures, the weekly threshold for operations with foreign exchange derivatives above which financial institutions are required to have additional reserve requirement was raised from US\$500 to US\$575 million in December 2019 and then further to US\$675 million in March 2020. The threshold above which the additional reserve requirement applies for financial institutions' short position in foreign exchange derivatives was increased from 100 percent of equity (or 100 percent of the average short position or US\$800 million, whichever was higher) to 115 percent of equity (or 115 percent of the average short position or US\$1 billion, whichever was higher) in December 2019, and then to 135 percent of the equity (or 135 percent of the average short position or US\$1.17 billion, whichever is higher) in March 2020. Given receding capital inflows, these relaxations are in line with the Fund's institutional view on capital flows.



8. The large and broad-based fiscal policy response was essential in containing the pandemic's impact but was initially hampered by poor implementation. Including non-fiscal measures in the amount of 7.6 percent of GDP, the total package exceeded 26½ percent of GDP. Nonetheless, only about 69 percent of above-the-line fiscal measures (7.4 percent of GDP) was implemented by year-end, reflecting restrictions on construction activity that delayed public

Reactiva Peru Credits by the Size of Borrowers

	Credits (Million of Soles)	Share of total (Percent)	Number of enterprises (Units)	Share of total (Percent)	Employment (Thousands)	Share of total (Percent)
Less than 10 employees	23,857	41.1	483,245	96.2	1,089	39.1
11 to 50 employees	14,938	25.7	14,428	2.9	292	10.5
51 to 100 employees	5,495	9.5	2,060	0.4	147	5.3
101 to 500 employees	9,901	17.0	2,071	0.4	407	14.6
More than 500 employees	3,903	6.7	480	0.1	848	30.5
Total	58,094	100.0	502,284	100.0	2,782	100.0

Source: BCRP, Inflation Report, December 2020

investment and early difficulties in the delivery of direct cash transfers to households.³ The package included direct support to the health system, households, and businesses and a sizable credit-guarantee program to support lending to businesses (*Reactiva Perú*). The latter, which ended in 2020, successfully provided a lifeline to many businesses, including small ones, which constituted about 99 percent of the beneficiaries. The support of household incomes was not sufficient to prevent an increase in poverty and its implementation was delayed by administrative problems—including outdated surveys,⁴ low financial inclusion, and limited assistance to migrants and

³ By late 2020, public investment recovered significantly while the difficulties in delivery assistance to households had been largely addressed.

⁴ The Encuesta Nacional de Hogares (ENAH) and the Sistema de Focalización de Hogares (SISFOH), which determine poverty thresholds and social program targets, use the outdated 2007 and 2005 censuses, respectively.

refugees.⁵ This was partly compensated by opening access to settlement payment and private pension funds, which, however, did not provide relief to most vulnerable workers (Annex III) and had adverse implications for the pension system's integrity (Annex V). Reflecting these measures and the cyclical drop in revenues, the fiscal deficit widened from 1.6 percent of GDP in 2019 to 8.8 percent in 2020 while public debt increased from 27.1 to 35.4 percent of GDP (Tables 2–3, Figure 3).

Summary of Policy Measures – 2020		
(In percent of GDP)		
Measures	Announced	Implemented
Total	26.6	19.2
Fiscal Measures	19.0	14.0
Above the line	7.4	5.1
Revenue	2.3	1.0
<i>Of which</i> : Deferred revenue	1.7	...
Spending	5.1	4.2
Health	0.9	0.8
Non-health	4.2	3.3
Households ¹	2.8	2.4
Firms ²	0.2	0.2
Public works ³	1.1	0.6
Other ⁴	0.2	0.1
Below the line	11.6	8.8
<i>Of which</i> : Credit guarantees ⁵	9.6	8.2
Other⁶	7.6	5.2
<i>Of which</i> : Congress-mandated	5.6	3.9

Sources: Country authorities, IMF staff.

¹ Includes cash transfers, subsidies, and in-kind transfers.

² Wage subsidies.

³ Arranca Perú.

⁴ Purchases from SMEs, support to agriculture, and other measures.

⁵ Reactiva Perú and Fondo de Apoyo Empresarial MYPE.

⁶ CTS and private pension funds withdrawals.

9. To address the second wave of the pandemic, the government announced a new set of measures in late January 2021. The measures, which amount to about 1.1 percent of GDP, include: (i) direct support to the health system, including for the purchase of vaccine; (ii) universal direct cash transfers to households (a third round of the *Bono Universal*) in the most affected regions; (iii) tax deferrals for households and businesses in the same regions; and (iv) a new guaranteed-lending program for SMEs. Moreover, the implementation of already budgeted projects in the health sector, including the construction of 23 hospitals and 11 health centers, is being accelerated.

10. The financial system remains stable, but vulnerabilities have increased in some segments. At end-2019, the banking system had adequate capital (Tier-1 capital ratio of 11.6 percent) and liquidity (liquid assets at 21 percent of total assets), and low non-performing assets (3.4 percent), which were adequately provisioned (149 percent of NPLs; Table 4, Figure 4). Bank profitability has declined recently (ROE falling to 4.6 percent in November 2020 from 18.1 percent a

⁵ Over the past three years, nearly one million Venezuelan refugees have settled in Peru.

year ago, and ROA falling to 0.5 percent from 2.3 percent) reflecting lower interest rates and low demand for credit—with mostly government-guaranteed lending rising—, slight increases in NPLs (to 4 percent in November 2020, partly reflecting loan restructuring), and additional voluntary provisions by banks. Top-down stress tests point to a resilient financial system and limited solvency problems even under adverse scenarios. Nevertheless, default rates are expected to rise significantly in the cooperative and microfinance sectors, which represent about 7 percent of system assets.

Financial Soundness Indicators Heatmap												
Peru	2017Q4	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	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	M	M
Change in credit / GDP ratio (pp, annual)	-0.9	0.0	0.5	0.8	1.3	1.2	1.2	1.2	0.7	2.4	9.2	9.2
Growth of credit / GDP (% annual)	-4.5	-2.6	0.0	1.4	2.4	3.7	3.5	3.6	3.5	1.9	6.8	6.8
Credit-to-GDP gap (st. dev)	-0.9	-0.7	-0.2	0.4	1.3	1.2	1.4	1.6	1.6	2.2	3.7	3.7
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	91.1	90.2	89.1	88.0	88.6	91.0	90.5	91.7	90.5	92.0	94.5	94.5
FX liabilities % (of total liabilities)	41.1	40.2	40.5	39.3	38.9	38.3	38.8	39.9	37.4	38.3	34.3	34.3
FX loans % (of total loans)	29.3	29.0	29.4	28.5	28.3	28.0	27.6	27.4	26.4	27.0	24.6	24.6
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 (%)	12.1	11.6	12.0	12.6	12.5	12.0	12.3	12.4	12.9	12.6	11.0	11.0
Profitability	L	L	L	L	L	L	L	L	L	L	L	L
ROA	2.1	2.0	2.1	2.2	2.2	2.2	2.2	2.3	2.2	2.1	1.5	1.5
ROE	17.7	17.5	17.6	18.0	17.8	17.6	17.8	18.2	17.9	16.7	12.6	12.6
Asset quality	M	L	L	L	L	L	L	L	L	L	L	L
NPL ratio	4.7	3.4	3.4	3.4	3.3	3.4	3.4	3.5	3.4	3.5	3.5	3.5
NPL ratio change (% annual)	9.4	-26.6	-27.7	-28.2	-30.3	0.4	1.4	1.7	2.9	4.0	0.9	0.9

Note: L=Low vulnerability; M=medium vulnerability; and H=high vulnerability. The increase in the credit cycle vulnerability in Q2 2020 is related to the increase in credit growth, which was driven by less risky government-guaranteed lending, while GDP, the denominator of the relevant variables, declined sharply.

Source: IMF staff estimates.

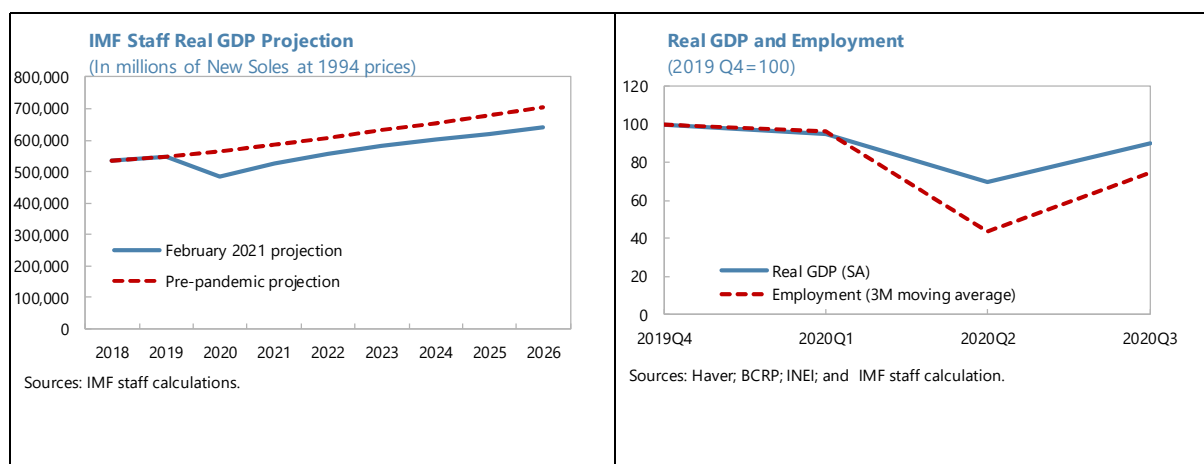
11. While weakening in 2020, Peru's corporate sector performance has remained robust, considering global and regional trends. Corporate profitability had already fallen before the pandemic and declined further in 2020, but it remains robust considering regional trends. At the same time, corporate leverage increased sharply in 2020, after declining slightly in 2017-2019, yet it is not very high by regional standards. The cash ratio and interest coverage are the highest in the region, and the share of debt at risk is not very high (Figure 5).

12. Following an initial collapse in foreign trade, the external position has strengthened. In January-September 2020, the current account balance improved, reflecting plummeting imports, lower repatriation of profits from mining, and a one-off income tax payment from a foreign sale of shares of a large domestic corporation. As a result, the current account registered an estimated surplus of 0.5 percent of GDP in 2020, compared with a deficit of 1.5 percent in 2019. FDI inflows fell sharply, which was compensated by substantial public sector foreign borrowing. At end-2020, international reserves stood at US\$74.9 billion, up from US\$68.4 billion at end-2019. Based on preliminary estimates, the external position is moderately stronger than the level predicted by fundamentals and desirable policies. However, uncertainty around this estimate is very large (Table 5, Figures 6 and 7, Annex VI).

OUTLOOK AND RISKS

13. Assuming the second wave of infections is brought under control by end-March, the economy is expected to rebound in 2021. After some delays, the authorities have finalized contracts to purchase COVID-19 vaccines and have started to deploy them.⁶ The baseline scenario assumes the recently introduced restrictions are gradually eased in Q2 while macroeconomic policies remain supportive. Under these assumptions, economic activity would slow in Q1, reflecting tighter restrictions and reduced mobility, but would regain momentum in the remainder of the year, led by domestic demand and historically high commodity prices and favorable terms of trade. Accordingly, staff projects real GDP to grow by 8.5 percent in 2021. The large negative output gap in 2021-22 would dampen inflation pressures, with inflation projected to stay within the target range of 2 +/-1 percent in the projection horizon. Following an estimated small surplus in 2020, the current account is expected to gradually converge to a deficit of 1.6 percent of GDP in the medium term, with international reserves remaining at comfortably high levels.

14. The crisis is likely to leave significant scars. In the medium term, output levels are projected to be about 9 percent lower than in the pre-pandemic baseline. Contact-intensive activities such as accommodation and restaurants, which halved in 2020, are expected to recover fully only in the medium-to-long term. Moreover, long-lasting effects on growth are likely to arise from firm closures, the permanent loss of dislocated workers, and reduced human capital accumulation due to school closures. Staff estimates that potential growth has declined from 3½ to 3¼ percent. Growth is projected to converge gradually toward potential, with the negative output gap closing in 2024.



15. The outlook is highly uncertain, and risks remain to the downside. The pandemic's second wave could be more acute and protracted, or another wave could follow in the winter season. Reflecting low capacity in the health system and delays in vaccination plans, this would require broader and stricter containment measures, which would hurt economic activity and

⁶ Peru has finalized agreements with Pfizer (20 million doses), Sinopharm (38 million doses), AstraZeneca (14 million doses), and the COVAX facility (13.2 million doses) to cover its 31.5 million population by-end 2021. Vaccinations started in February and 24.5 million people are expected to have received the vaccine by end-July..

dampen domestic demand. Further political uncertainty and social unrest would have depressing effects on investment in the short-term. A decline in political support for key institutions and policies could have significant medium-term implications. Main external risks include a global reversal in trade integration, a sudden change in foreign investors' sentiment, and the intensification of natural disasters in the medium term due to climate change. Stronger global growth from unexpected shifts in the pandemic and a significant increase in public investment execution are upside risks (Annex VII).

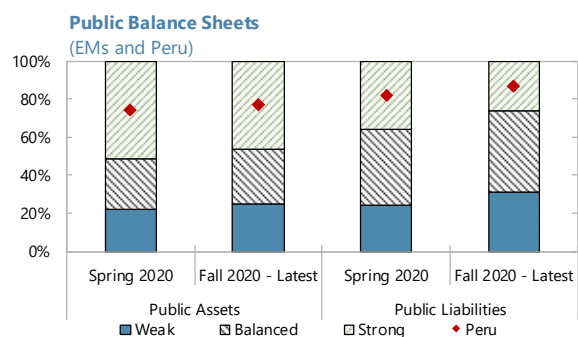
16. Despite the challenges, policy buffers are ample. Notwithstanding its recent increase, public debt remains low. Sizable international reserves (about 34 percent of GDP), access to the two-year FCL arrangement and other funding sources, and a robust financial sector mitigate macroeconomic risks stemming from the pandemic and support the country's capacity to cope with additional adverse shocks.

POLICY DISCUSSIONS

Heightened health risks require continued policy support. Using the space available, fiscal policy should address the new health emergency and sustain household incomes to reduce poverty, limit scarring, and ensure against downside risks to growth. In the absence of inflationary pressures, monetary conditions should remain accommodative. Structural reforms should address the needs exposed by the pandemic, focusing on policies to enhance productivity, improve governance, and strengthen the social safety net.

A. Balancing Short-Term Fiscal Support and Medium-Term Plans to Return to the Fiscal Targets

17. The fiscal position remains strong, notwithstanding the large policy support deployed in 2020. The fiscal deficit is expected to fall from 8.8 percent of GDP in 2020 to 5 percent of GDP in 2021 as transitory relief measures are gradually phased out. Public debt would peak at about 37.5 percent of GDP in 2025 before declining steadily toward the 30-percent-of-GDP target, beyond the forecast horizon. Gross debt and debt burden indicators are well below the corresponding benchmarks for emerging economies and are expected to remain sustainable under standard shocks (Annex VIII). Despite a large share of debt held by non-residents, market access is ample, as evidenced by the century-bond issuance last November. The authorities' goal of broadening the investor base and raising the domestic currency share of public debt should help mitigate investor concentration risks.



18. More policy support is warranted in the short term. Peru has some fiscal space under the current fiscal rules and substantial fiscal space in a scenario unconstrained by the fiscal rules. Despite the anticipated recovery in 2021, the output gap is expected to remain large while employment and labor participation are lagging. In staff's view, a more gradual withdrawal of the fiscal stimulus is needed to address the pandemic, limit its impact on poverty, and ensure against downside risks to growth. Accordingly, staff sees merit in considering a fourth round of the *Bono Universal* in the amount of about 2½ percent of GDP. In the alternative scenario with this additional stimulus, the output gap would close more rapidly, poverty would return to pre-Covid levels in 2021 (Annex IV), inflationary pressures would be contained, and public finances would remain healthy, with public debt peaking at slightly above 39 percent of GDP. Furthermore, there would remain fiscal space to use fiscal policy for countercyclical purposes in case downside risks to growth materialize.

Baseline and Alternative Scenarios								
(In percent of GDP unless otherwise specified)								
	2019	Prelim. 2020	Projections					
			2021	2022	2023	2024	2025	2026
Baseline scenario								
GDP growth rate (percent)	2.2	-11.1	8.5	5.2	4.8	3.4	3.3	3.3
Output gap (% of potential GDP)	-1.7	-7.2	-3.0	-1.4	-0.1	0.0	0.0	0.0
Primary NFPS spending	25.0	29.3	25.6	24.7	24.0	23.7	23.6	23.3
NFPS fiscal balance	-1.6	-8.8	-5.0	-3.4	-2.8	-2.4	-2.1	-1.8
NFPS debt	27.1	35.4	35.4	36.2	36.7	37.2	37.5	37.4
Poverty rate (percent)	21.7	27.5	27.2	...	...	...	...	...
Alternative scenario 1/								
GDP growth rate	2.2	-11.1	10.4	3.6	4.8	3.4	3.3	3.3
Output gap (% of potential GDP)	-1.7	-7.2	-1.4	-1.2	0.0	0.0	0.0	0.0
Primary NFPS spending	25.0	29.3	27.7	24.7	24.0	23.7	23.5	23.3
NFPS fiscal balance	-1.6	-8.8	-7.1	-3.4	-2.8	-2.4	-2.1	-1.8
NFPS debt	27.1	35.4	37.0	38.3	38.6	39.1	39.3	39.2
Poverty rate (percent)	21.7	27.5	20.8	...	...	...	...	...
Difference between output (alternative/baseline; in percent)	...	...	1.7	0.3	0.3	0.3	0.3	0.3

Sources: Peruvian authorities; and IMF staff estimates.
1/ Based on the assumption of additional fiscal spending of 2.5 percent of GDP in 2021 as advised by the IMF staff.

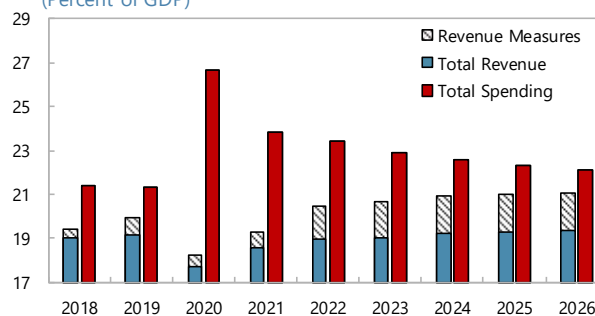
19. The authorities' current plans to return to the fiscal targets need to be revisited. After the suspension of the fiscal rules in 2020-21, the authorities' 2020 Medium-Term Macroeconomic Framework (MTMF) envisions meeting the 1-percent-of-GDP fiscal deficit target in 2026. The planned consolidation would be supported by a gradual unwinding of transitory measures, with current spending falling by 1.9 percent of GDP and tax revenues increasing by 1.7 percent of GDP. These plans seem now ambitious considering the extreme uncertainty around the macroeconomic

outlook and the need to accommodate the higher spending needs highlighted by the revival of the pandemic. In staff's views, the available fiscal space would allow for a more gradual return to the pre-pandemic fiscal targets than currently envisioned.

20. Moreover, spending needs in key sectors will have to be accommodated in the medium term.

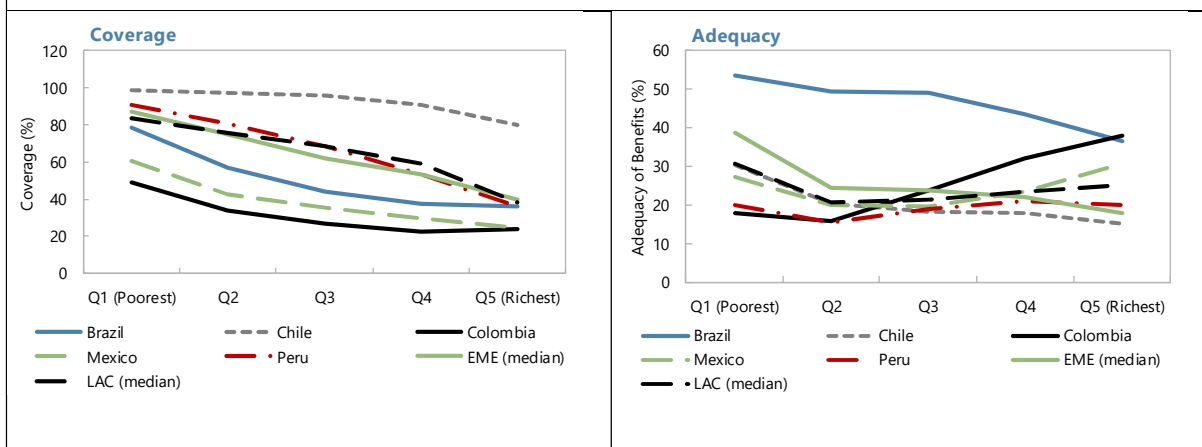
The public healthcare system suffers from serious capacity bottlenecks (Annex II). The social safety net (SSN), while having a good coverage—in line with the regional median and above the EME median, particularly for low-income families—looks worse than comparators as to adequacy for all income groups. The need to address these weaknesses has been emphasized by the pandemic. To reduce scarring, training programs and income support could be provided to displaced workers as they transition to new jobs. The depletion of personal accounts in private pension funds has heightened the challenges of low coverage and low adequacy in the pension system—with replacement rates projected to decline further in the medium term—and the urgency of reform.⁷ Investment in infrastructure is also a priority to boost productivity, increase resilience to climate change, and enhance digitalization. Some costs will arise from the contingent liabilities related with the guaranteed-lending program.

MTMF Revenue and Spending
(Percent of GDP)



Sources: MEF; and IMF staff calculation.

Social Protection and Labor: Coverage and Adequacy
(In percent, by income quintile, most recent available year)



Source: IMF FAD Social Protection & Labor - Assessment Tool (SPL-AT).

Note: Coverage measures the percentage of the quintile that receives a SSN benefit. Adequacy of benefits measures the total transfer amount received by all beneficiaries in the quintile as a percent of the pre-transfer total income/expenditure of beneficiaries (in that quintile). Calculations are based on pre-COVID-19 information. EME = emerging market economies; LAC = Latin America and the Caribbean.

⁷ See Annex V and Freudenberg, C. and F. Toscani (2019) "Informality and the Challenge of Pension Adequacy: Outlook and Reform Options for Peru", IMF WP/19/149.

21. Revenue mobilization will be key to preserving fiscal sustainability while accommodating additional spending. Increased use of electronic invoicing, the maturation of tax measures introduced in 2017-2018 (including changes to the excise schedules), the implementation of the OECD/G20 Inclusive Framework on BEPS,⁸ the expiration of tax benefits of some large mining projects, and other efforts at revenue administration (including streamlining of tax auditing processes) would yield additional tax revenues of about 1 percentage point of GDP. Staff's baseline incorporates the expected yields from the identified measures that, while ambitious, are achievable. To help identify measures that address the remaining 0.7-percent-of-GDP revenue gap, the authorities have asked for Fund TA.

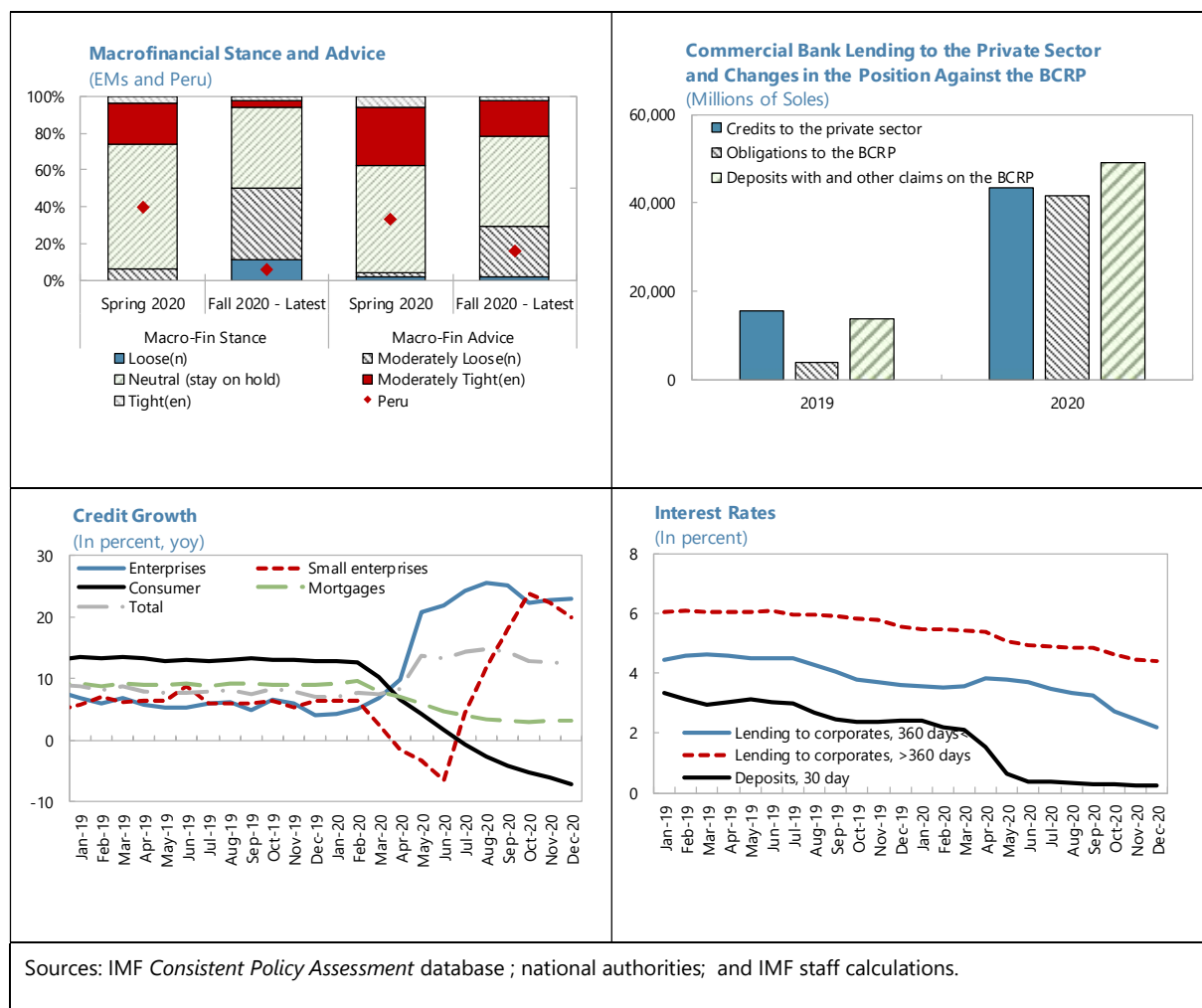
22. Continuing to anchor policy to a credible medium-term plan will help the authorities navigate through uncertainty. Peru's very strong fiscal framework has served it well to anchor fiscal policy. Guiding the adoption of the 2022 budget with a new MTMF underpinned by conservative growth projections and adequate measures will help maintain confidence in a situation of extreme uncertainty. Moreover, the new MTMF should also identify contingent policy measures in case downside risks materialize.

B. Maintaining Monetary Accommodation and Preserving Financial Stability

23. Monetary accommodation has been essential in preventing disruptions in the financial system. The extraordinary easing of monetary conditions by the BCRP, combined with the relaxation of macroprudential policies and the government-guaranteed lending programs, have succeeded in stimulating credit growth at low interest rates (Table 6), and averting widespread bankruptcies and business closures. Credit to businesses in domestic currency increased by 21.6 percent (y-o-y) in October—one of the highest rates in the region—but, excluding loans under *Reactiva Perú*, fell by 3.9 percent. Still, a significant part of the injected liquidity returned to the central bank as commercial bank deposits and other claims on the BCRP, reflecting low demand for investment.

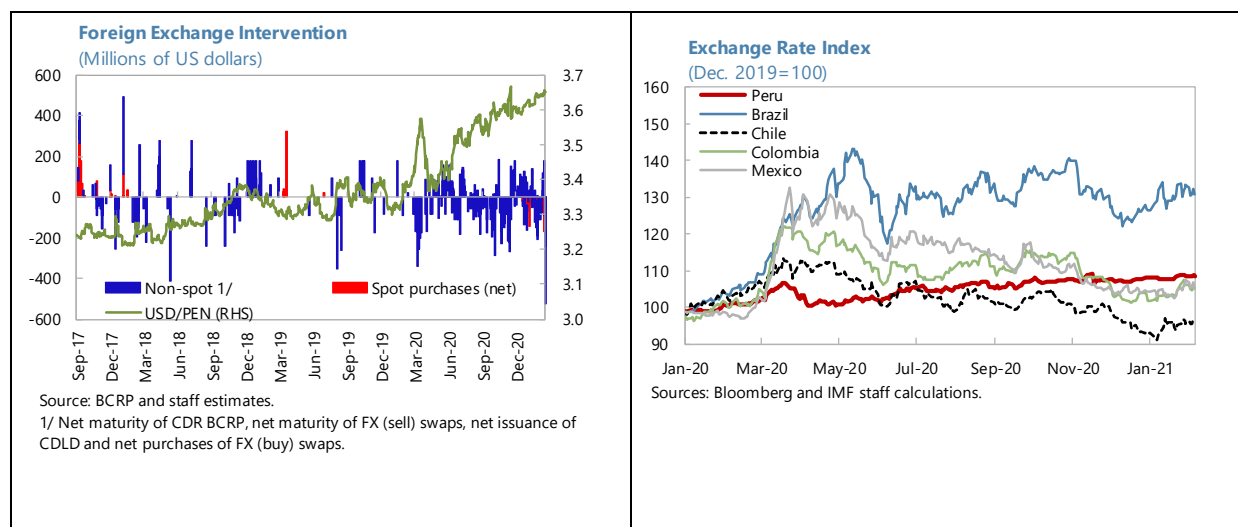
24. Easy monetary conditions should continue as extraordinary measures are being withdrawn. With a substantial negative output gap until 2022, inflationary pressures are expected to remain subdued. Continued monetary accommodation would facilitate a gradual return to normality as the impact of the extraordinary measures taken in 2020 dissipates. In its February forward-guidance, the BCRP has highlighted appropriately that easy monetary conditions are likely to persist for an extended period. In addition, the BCRP has created new security repos conditional on the expansion of long-term lending, which can enhance the transmission of monetary policy and allow further easing of monetary conditions if necessary. As extraordinary measures are withdrawn — *Reactiva Perú* expired in 2020— another guaranteed-lending program could be considered, particularly if downside risks to growth materialize.

⁸ Actions 4 (limitation on interest rate deductions), 8-10 (transfer pricing), and 13 (exchange of information).



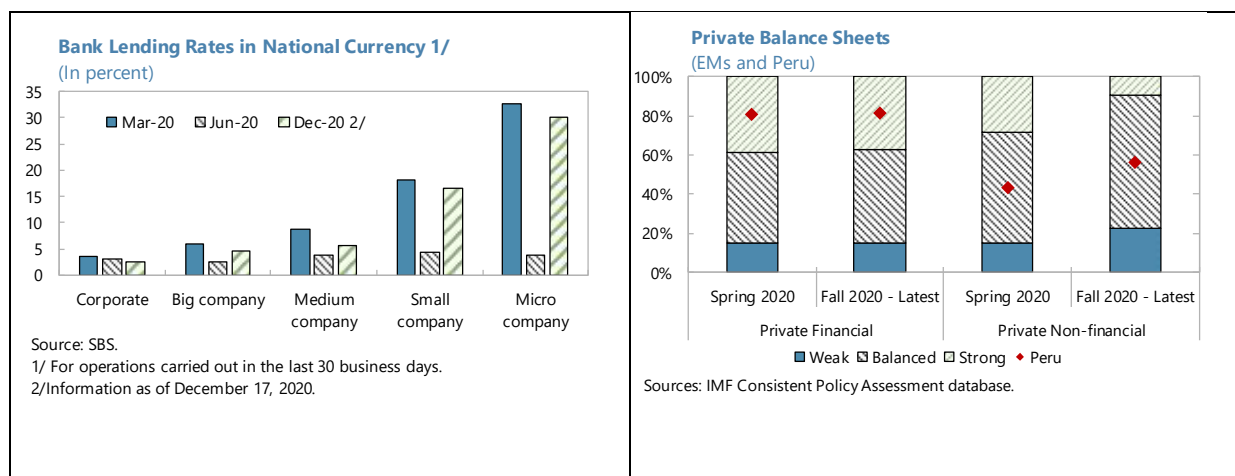
25. In the medium term, greater exchange rate flexibility would have several benefits.

With reserve levels adequate for precautionary purposes, the BCRP has intervened on both sides of the market since the beginning of the pandemic, without preventing the exchange rate from depreciating (Annex IX). In fact, the exchange rate has depreciated more than in some regional comparators, but volatility has been much less pronounced, in line with the BCRP's objective to prevent the build-up of self-fulfilling expectations in a context characterized by persistent but declining financial dollarization. As uncertainty subsides and currency mismatches decline further, additional exchange rate flexibility would help foster the development of hedging instruments, strengthen the transmission of monetary policy, and further reduce dollarization by inducing agents to internalize exchange rate risk. Higher risk weights for FX loans (a 2018 FSAP recommendation) would also help reduce dollarization.



26. Further enhancing communications could help manage the challenges of a multi-instrument framework. Peru has historically used such a framework to achieve its policy objectives, with exchange rate policy focused on managing risks associated with liability dollarization, and macroprudential policies on mitigating financial stability risks (IMF Country Report No. 20/4). While the BCRP has solid communication and transparency practices, the use of multiple instruments presents specific communication challenges. The BCRP could go further than reporting factual FX interventions, to explain, for example in its quarterly inflation reports, the rationale of past interventions by linking them to the structural characteristics of the economy and the policy trade-offs. This could help guide expectations beyond the immediate horizon, thereby facilitating a gradual transition to more exchange rate flexibility as dollarization declines. Staff and the authorities have agreed on continuing to work on better understanding the challenges and trade-offs of a multi-instrument framework.

27. As conditions allow, macroprudential policies may start shifting focus by encouraging banks to put more emphasis on the viability of clients. Interest rates on business loans — particularly to SMEs and micro-sized firms— have started to increase with the end of government-guaranteed lending programs while parts of the corporate sector remain fragile, especially in badly-hit sectors like tourism and services. At the onset of the pandemic, the *Superintendencia de Bancos, Seguros y AFPs* (SBS) reduced the countercyclical capital buffer for financial institutions and allowed them to adjust the terms of loans (allowing temporary grace periods, extensions and other loan modifications) without changing loan classification. As of November 2020, 28 percent of total loans had been modified, with the highest shares in consumer lending and lending to SMEs. Considering the credit cycle and financial vulnerabilities, macroprudential policies could start encouraging banks to focus on borrowers' viability and directing resources to viable but illiquid firms. For unviable ones, efficient bankruptcy frameworks will be needed. In this regard, the authorities should aim to reduce lengthy administrative proceedings and encourage out-of-court restructurings.

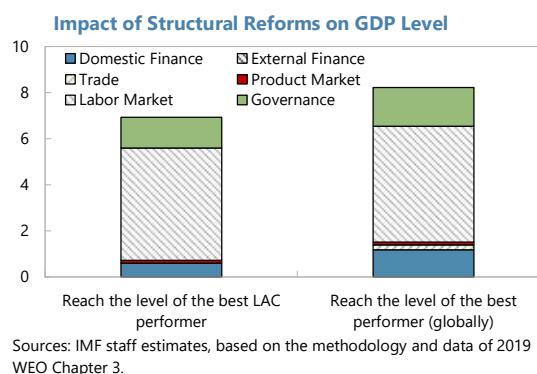


28. Closing key regulatory and supervisory gaps would boost financial resilience. The authorities have taken significant steps to strengthen financial sector oversight, in line with the recommendations of the 2018 FSAP. Reforms that have been fully or partially implemented include expanding financial co-operatives' oversight by SBS, monitoring of banks' off-balance-sheet exposures, introducing new risk-monitoring tools, implementing risk-based supervision for all insurers, strengthening crisis preparedness and management, and enhancing the emergency liquidity assistance framework. Several measures are being prepared, in line with the FSAP recommendations, including higher capital surcharges for systemically important banks, enhanced supervision of financial groups, and requirements for recovery and resolution planning for domestic systemically important banks and financial groups (Annex X).

C. Structural Reforms for Stronger, Resilient, and Inclusive Growth

29. Reforms remain essential to remove structural bottlenecks and boost sustainable growth. Sound policies and frameworks have

underpinned a very strong macroeconomic performance in the last 15 years. The continuation of this performance requires removing several structural hurdles, for which the payoff is expected to be quite large. Staff estimate that GDP could increase by up to 8 percent six years after the implementation of reforms in the areas of governance, labor market, and domestic finance.⁹



⁹ Estimated based on the methodology and data of 2019 WEO Chapter 3, "Reigniting Growth in Low-Income and Emerging Market Economies: What Role Can Structural Reforms Play?"

30. The authorities continue to make progress on strengthening governance and anti-corruption. The institutional reforms approved with the 2019 referendum have been implemented.¹⁰ In 2020, key achievements under the Anti-Corruption Plan (2018–21) have been the creation of the Offices of Institutional Integrity in more than 200 public sector entities, the launch of a whistleblower complaint platform, and the development of an integrity index by the Integrity Secretariat to focus on areas with higher corruption risks. The Comptroller's Office monitors emergency-related spending, identifies abuses, and publishes regularly its reports.¹¹ Efforts to ensure the accuracy of beneficial ownership information of companies collected by SUNAT is ongoing. Several AML/CFT regulations have been issued to guide customer due diligence requirements for politically exposed persons. Asset declaration requirements cover high-level public officials and are made publicly available.

31. Staff has completed the safeguards procedures for Peru's FCL arrangement. KPMG Peru issued an unmodified (clean) audit opinion on the BCRP's financial statements for 2019. The annual financial statements are audited in accordance with international standards, include comprehensive disclosures and are published on a timely basis. Staff reviewed the 2019 audit results and held discussions with the BCRP and KPMG Peru. No significant issues emerged from the conduct of these procedures.

32. The pandemic has exposed important structural fragilities that should become priorities in the reform agenda. Low capacity in health care, while contributing to high mortality, required stringent containment measures with strong adverse effects on growth. Poverty, low financial inclusion, high informality, and political instability hampered the authorities' efforts to provide relief to households and contain the contagion. Low digitalization, combined with a large share of contact-intensive industries, limited teleworking, aggravating the economic impact of the lockdown. Against this background, a multi-pronged strategy to address these fragilities should focus on:

a. **boosting productivity**, including by improving education, enhancing infrastructure, facilitating labor reallocation, and improving the business climate, in line with the National Plan for Competitiveness and Productivity launched in 2019. The new agriculture promotion law, while gradually removing fiscal incentives to create a level-playing field, should preserve the flexibility in labor contracts that has been a key ingredient in the success of the agro-export sector (IMF, Country Report No. 20/3, Annex I).

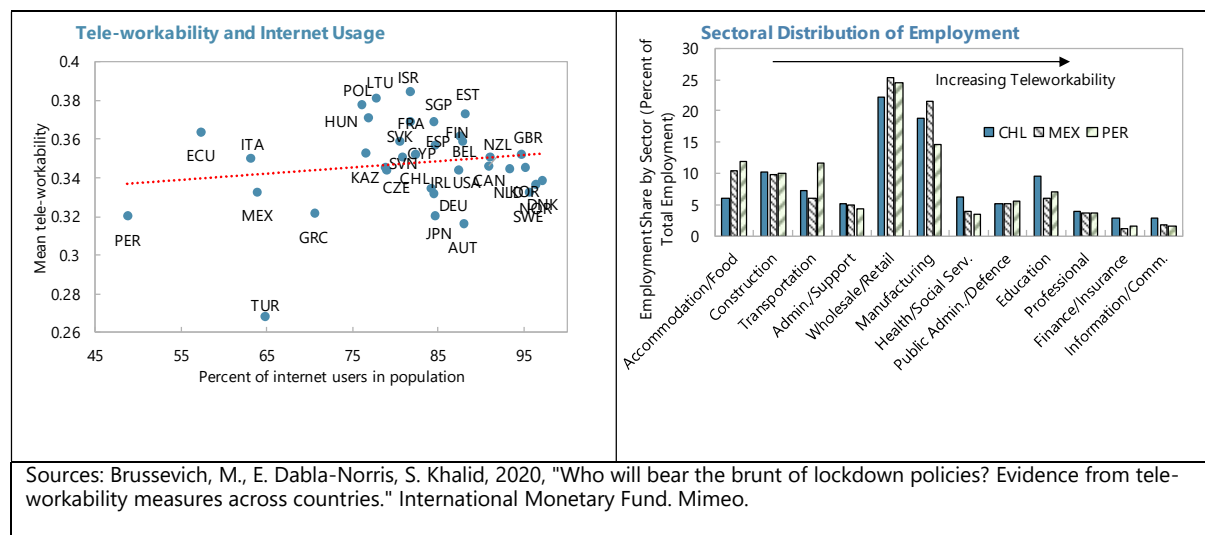
b. **enhancing social protection while reducing incentives to informality** from the tax-benefit system. Investment in health care and a more adequate SSN, including pensions, are key but the recently announced move to universal health care should be accompanied by measures that

¹⁰ For example, the National Board of Justice (an independent organ to appoint judges and prosecutors) is now operational.

¹¹ Almost 1,500 investigations were opened between March and August 2020 for irregularities amounting to 0.6 percent of GDP. Most cases were related to the direct distribution of food and medical equipment in municipalities.

reduce its adverse impact on incentives.¹² Efforts to deepen financial development and inclusion should be intensified.

c. **further strengthening governance.** Additional transparency in the public sector, including at the local level, and robust anti-corruption and AML/CFT enforcement would improve the business climate. In this context, priorities could focus on enhancing the effectiveness of anti-corruption institutions—including by providing adequate resources and training to the newly created Offices of Institutional Integrity—, strengthening the planning and implementation of public investment, and moving toward digital methods for tax and business-related procedures.



D. Authorities' Views

33. The authorities were more optimistic on the growth outlook. The authorities expected double-digit growth in 2021. They agreed that voluntary social distancing and tighter mobility restrictions would take a toll on economic activity in Q1 but underscored the limited economic impact of the targeted restrictions, with more activities allowed to operate compared with the first lockdown period. Moreover, they noted underlying strong fundamentals, including exceptionally favorable terms of trade, continued policy support, contained damage to the production capacity, and recovering public and private investment, which should set the stage for a strong recovery in the remainder of the year. While conceding that potential growth may have declined, they did not see strong evidence of that happening yet.

34. The authorities agreed with the thrust of staff's fiscal policy advice. They noted that the strong policy measures taken in 2020 helped contain the depth of the economic recession, with *Reactiva Perú* alone preventing the loss of 2.8 million jobs. Moreover, the package announced in response to the second wave of the pandemic seeks to address the medical emergency, alleviate the loss of income of vulnerable households, and protect SMEs by providing bridge financing. In line

¹² Nauerz, J. and J. Torres, "Unintended Effects from the Expansion of the Contributory System SIS in Peru", IMF WP (to be published) show that larger access to free health care may reduce informal workers' incentives to move to the formal sector.

with staff's recommendations, this package includes a third round of the *Bono Universal*, although specifically targeted to the areas hardest hit by the pandemic. The authorities noted that other measures are being considered, the nature of which will be contingent on developments on the health front. They noted the temporary nature of these measures and their limited impact on debt, reflecting the authorities' effort to use budget reallocations and public assets for their financing. A new transition path to the fiscal targets will be announced in August in the new MTMF. The authorities agreed that the MTMF should identify measures to close the ensuing revenue gaps, but noted that these measures, as well as a possible recalibration of the fiscal rules, will have to be considered by the upcoming administration.

35. There was broad agreement on the monetary policy advice, but the authorities disagreed with staff recommendations for additional transparency on foreign exchange intervention. The authorities appreciated the concurrence of staff on the importance of the aggressive monetary policy response to the pandemic and on the appropriate monetary stance. On exchange rate policy, they noted that the exchange rate evolves in line with fundamentals and broadly follows the same trend as in peer countries, although it is less volatile. However, in exceptional cases such as the current pandemic, the exchange rate has depreciated more than in other countries in the region. The authorities remarked that foreign exchange intervention is aimed at reducing excessive exchange rate volatility in the context of persistent —although declining— financial dollarization and ensuring proper market functioning. In normal times, foreign exchange intervention declined. However, they also noted that, depending on the magnitude of exogenous shocks, more frequent foreign exchange intervention may be needed. The authorities also emphasized that, consistent with discretionary foreign exchange intervention, information on these operations is published ex-post the same day. Thus, exchange rate policy is viewed as sufficiently transparent as, unlike in many other EMEs, the central bank announces when it is starting to run forex operations in the market in real time and publishes same-day information on foreign exchange intervention and explains the rationale for intervention in its official publications, such as the Inflation Report.

36. The authorities underscored the significant steps taken to strengthen financial sector oversight. They highlighted the significant reforms implemented so far and several additional measures that are being prepared to enhance oversight of the financial system and contain risks. They noted that some FSAP recommendations had been delayed by the need to build political support for amending the Banking Law. They agreed that the financial sector remains stable, and that growing risks in the microfinance sector do not have systemic implications.

37. The authorities concurred on the importance of reorienting the structural reform agenda to address the needs exposed by the pandemic. They agreed on the need to strengthen the public provision of health, education, and social protection, and on the urgency of a comprehensive and well-designed pension reform. They were confident that the new agrarian law approved by Congress would continue to underpin the success of the agro-export industry. They concurred on the importance of investing in infrastructure and highlighted their recent efforts to enhance digitalization. They confirmed their commitment to strengthening governance and fighting corruption.

STAFF APPRAISAL

38. After being hit hard by the pandemic, Peru faces an uncertain economic outlook. Low capacity in the health care system required stringent containment measures in the first half of 2020, leading to a sharp fall in economic activity and employment while fatalities mounted. Activity rebounded rapidly in the second half of 2020, helped by a very strong policy response and rising commodity prices, but the second wave of infections that started in early 2021 is jeopardizing the recovery. Assuming infections are brought under control by end-Q1, strong fundamentals should allow a robust recovery in the rest of the year, and growth could rise to 8.5 percent in 2021 from a contraction of 11.1 percent in 2020. However, downside risks—including that of a more acute and prolonged second wave—remain.

39. Large policy buffers and continued implementation of very strong policies will help mitigate risks. Large buffers allowed the authorities to adopt sizable monetary, fiscal, and financial policy packages to fight the adverse effects of pandemic and prevent even worse economic outcomes. As a result, the public deficit increased sharply, but debt remains sustainable even under further shocks, and more fiscal space is available. With the policy rate close to the zero-lower bound, monetary policy is experimenting with the use of forward guidance and unconventional policies. The current account balance has improved significantly, and reserves are above standard reserve adequacy metrics. Very strong economic fundamentals and institutional policy frameworks continue to provide the basis for a sustained track record of very strong policies, including across multiple electoral cycles and governments.

40. The second wave of the pandemic and large downside risks surrounding the outlook argue against a premature withdrawal of the fiscal stimulus. The government is already responding to the second wave with additional measures, but more is needed to compensate for the pandemic's impact on most vulnerable groups. Moreover, the government should prepare contingency measures in the event potential downside risks to growth materialized, including by further accelerating the execution of special projects in the health sector. Similar vehicles could be considered for public investments in water, sanitation, and housing.

41. Anchoring fiscal policy to a credible medium-term framework remains essential. Converging back to the fiscal targets will take time in a situation characterized by extreme uncertainty and rising spending needs. The new MTMF, which will guide the adoption of the 2022 budget, should be underpinned by conservative growth projections and adequate revenue measures to address identified revenue gaps. It should also identify contingent measures based on the analysis of risks. Any recalibration of the fiscal rules, which might be considered when uncertainty has dissipated, should preserve debt sustainability, strengthen credibility, and be clearly communicated.

42. Easy monetary conditions should continue while macroprudential policies should encourage banks to focus on clients' viability if conditions allow. With a substantially negative output gap until 2022 and well-anchored inflation expectations, monetary policy stimulus should not be withdrawn. As dollarization declines, the central bank could allow greater exchange rate

flexibility to absorb external shocks and promote financial development. Foreign exchange intervention has been two-way, and the external position is moderately stronger than the level predicted by fundamentals and desirable policies. Loan restructuring in 2020 helped contain bankruptcies. As the economy recovers, considering the credit cycle and financial vulnerabilities, macroprudential policies could initiate a gradual return to normal conditions, encouraging banks to focus on borrowers' viability and direct resources to viable but illiquid firms. Unviable enterprises should be resolved promptly.

43. Heightened financial stability risks highlight the importance of completing the legislative and regulatory reform agenda. The authorities have taken significant measures to maintain financial stability and strengthen financial sector oversight. Nonetheless, other steps are needed to implement requirements for recovery and resolution planning for domestic systemically important banks and financial groups, reinforce the legal protection of supervisors, and bring some regulations in line with Basel III, including those regarding risk weights for foreign currency loans and capital surcharges for systemic banks.

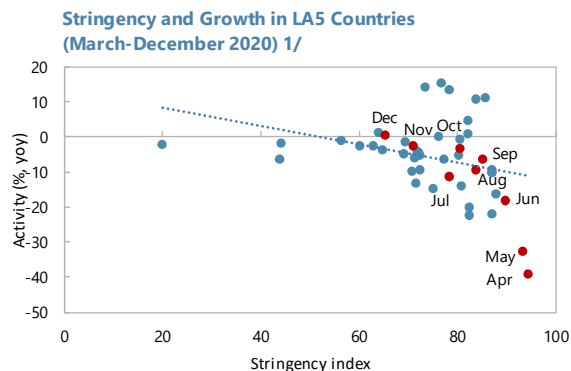
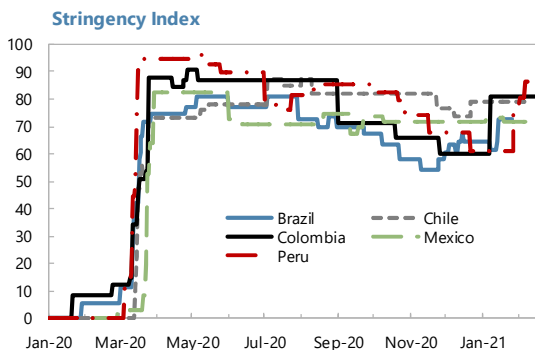
44. Priorities in the reform agenda should be informed by the important structural fragilities exposed by the pandemic. A multi-pronged strategy to address these fragilities should focus on (i) boosting productivity by improving education, enhancing infrastructure, facilitating labor reallocation, and improving the business climate; (ii) enhancing social protection while reducing incentives to informality from the tax-benefit system, including through investment in health care and pension reform; and (iii) strengthening governance with additional transparency in the public sector and robust anti-corruption and AML/CFT enforcement.

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

Figure 1. Peru: Containment Measures and Economic Recovery

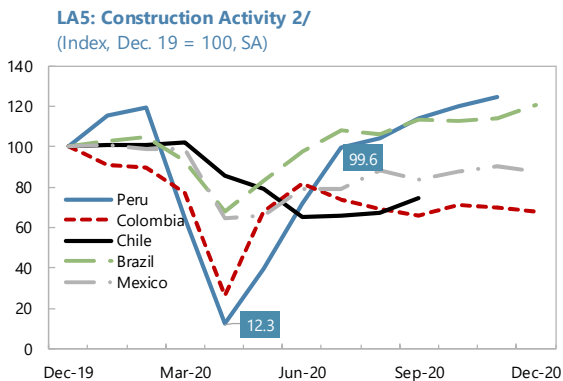
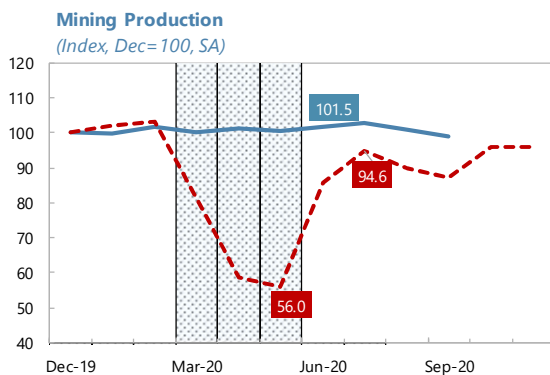
Strict containment measures were eased in June-July.

More than in other countries in the region, a large part of the economy was closed.



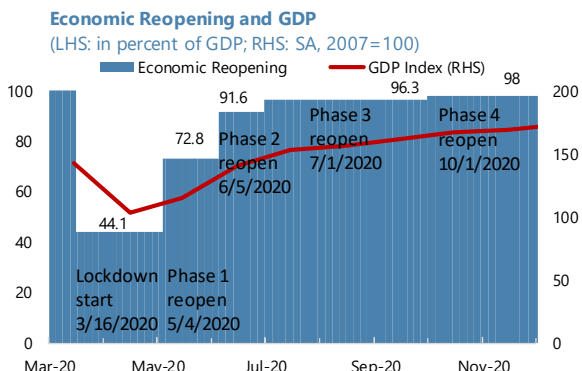
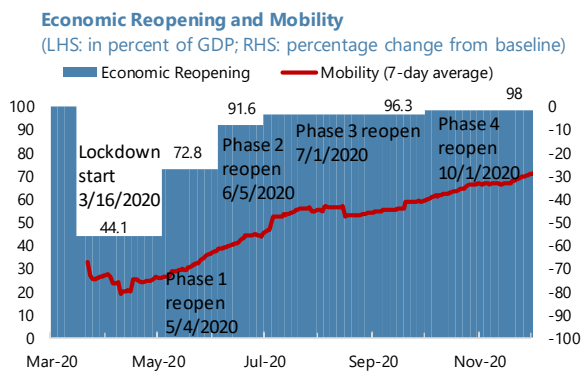
Unlike in Chile, Peru's mining sector was subject to the lockdown.

The restrictive measures crippled economic activity.



Mobility recovered as the restrictive measures were eased...

...and so did economic activity.



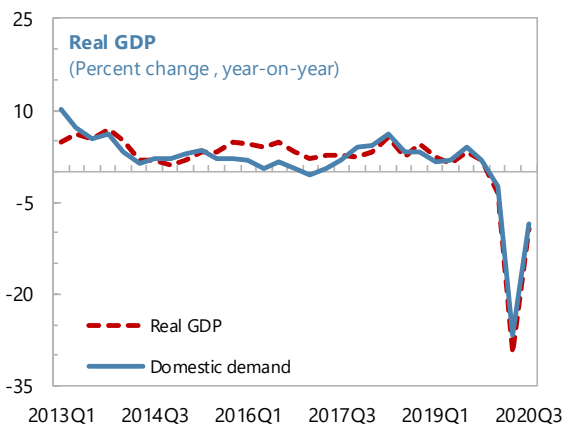
Sources: Oxford University, Haver; MEF, Diario Oficio El Peruano; Banco Central de Reserva del Perú (BCRP); and IMF staff estimates.

1/ LA5 countries include Brazil, Chile, Colombia, Mexico, and Peru (in red).

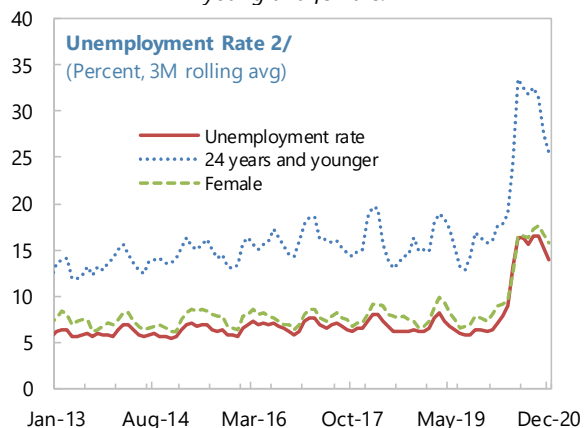
2/ Chile and Peru: Monthly GDP, Brazil and Mexico: IP - Construction, Colombia: Economic Activity Index

Figure 2. Peru: Real Sector Developments

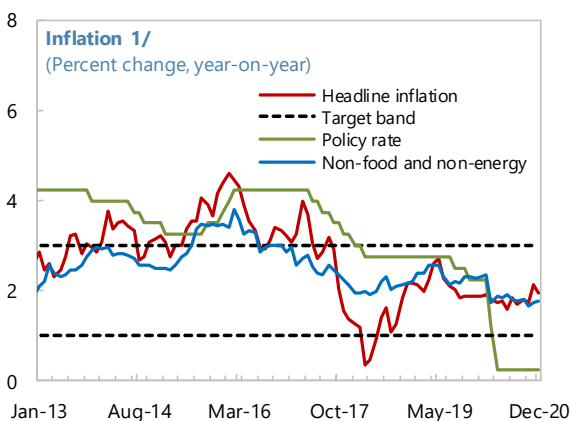
Growth was recovering in the second half of 2020.



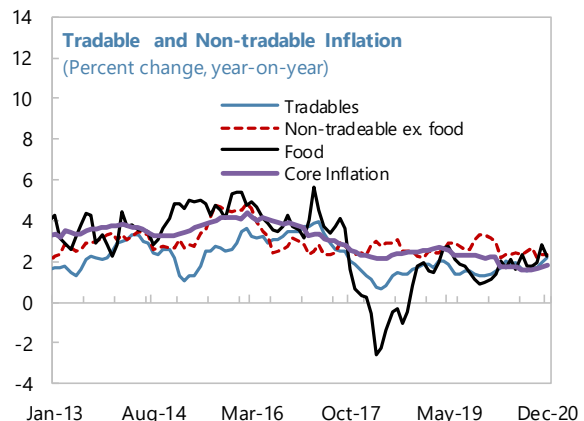
Unemployment increased sharply, particularly among young and female.



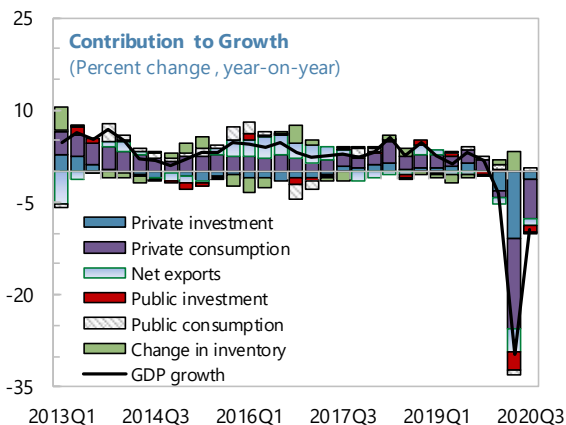
The central bank cut the policy rate to a historically low level...



...while core inflation is low.



The recovery is driven by consumption and investment.



Confidence indicators improved in the second half of 2020.



Sources: National authorities; and IMF staff calculations.

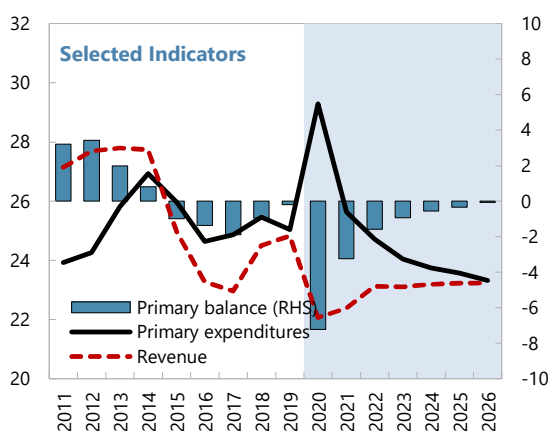
1/ Unemployment rates correspond to Metropolitan Lima.

2/ Inflation values correspond to Metropolitan Lima.

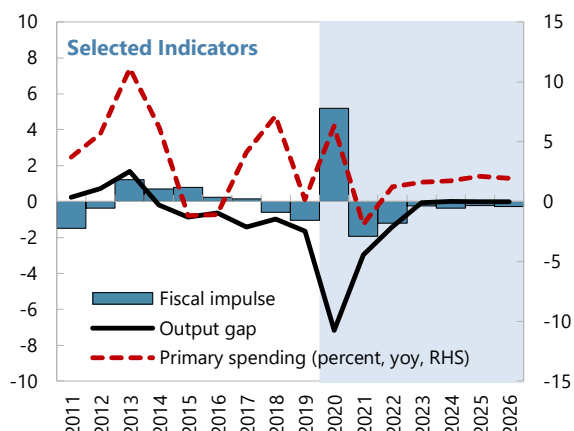
Figure 3. Peru: Fiscal Sector Developments

(Percent of GDP)

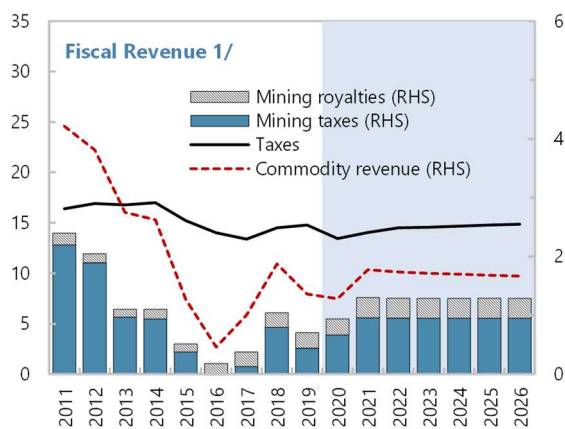
After widening sharply in 2020, the primary balance is expected to gradually improve.



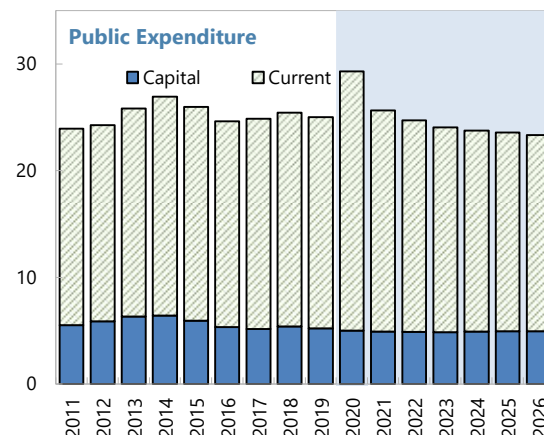
Improving growth prospects would allow for a partial withdrawal of the fiscal impulse in 2021.



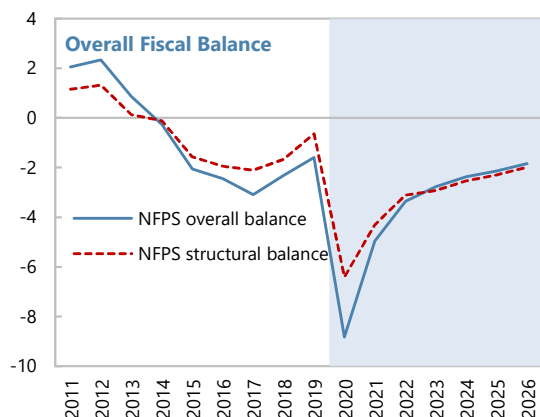
Tax revenues are expected to recover gradually...



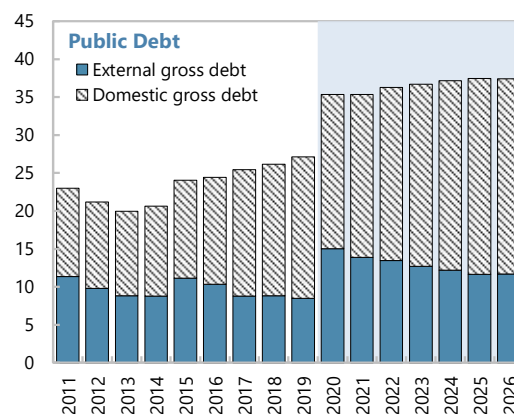
... while the increase in expenditures in 2020 is expected to reverse over the medium term.



In the baseline scenario, both the fiscal deficit ...



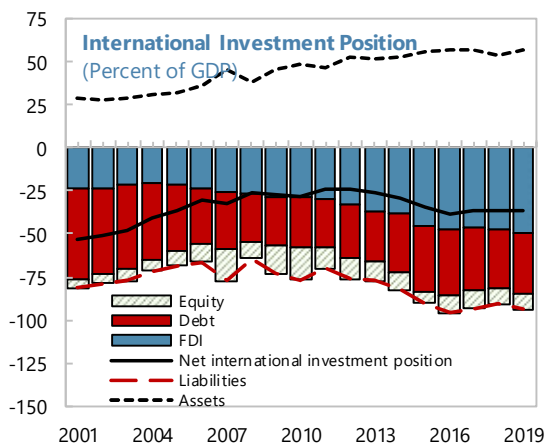
... and the debt ratio would return to their respective targets of 1 percent and 30 percent of GDP beyond the forecast horizon.



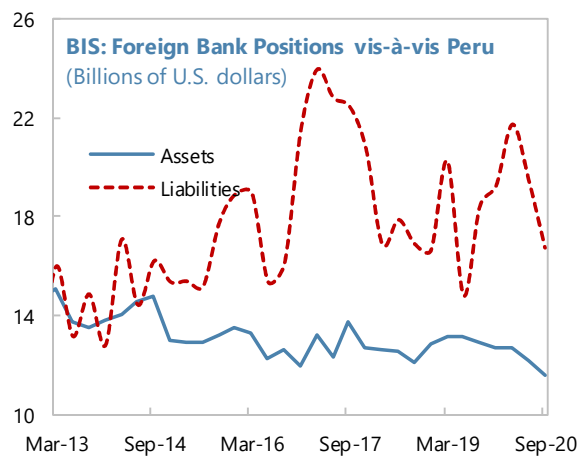
Sources: National authorities; and IMF staff estimates.
1/ Net of restitutions.

Figure 4. Peru: Balance Sheet Indicators

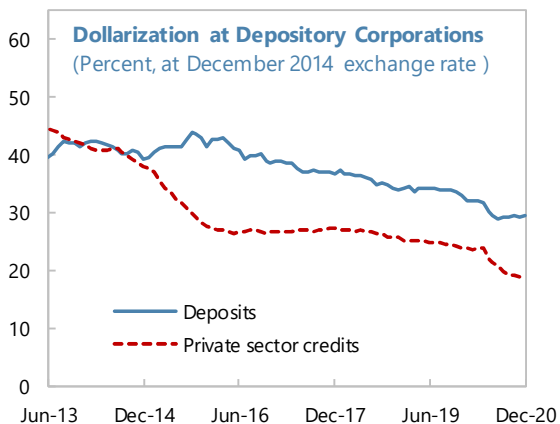
Peru's net international investment position remained stable in 2019....



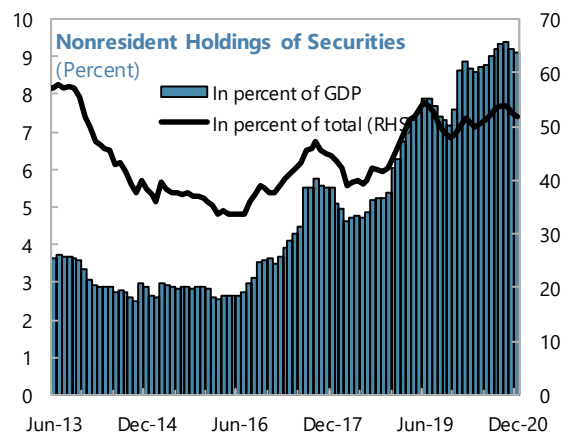
...but fluctuation in liabilities to foreign banks increased in 2020.



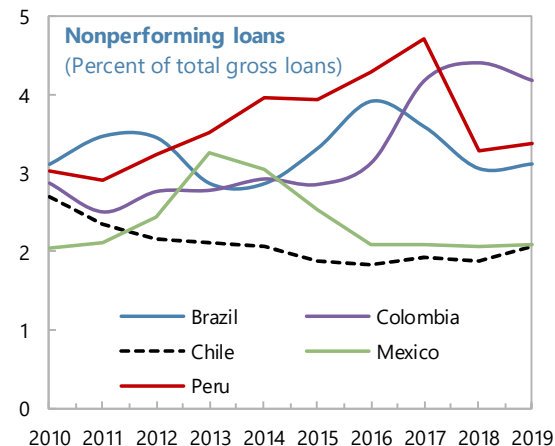
Financial dollarization has continued to decline....



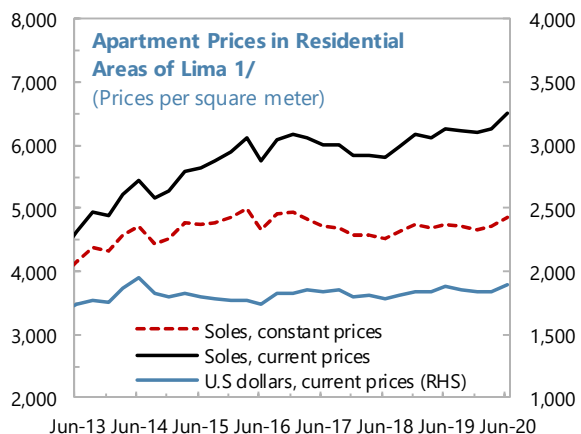
...and the increase in nonresident holdings of government securities continued to increase.



Nonperforming loans have remained broadly stable...



...while apartment prices increased slightly in mid-2020.



Sources: National authorities; Association of Banks; Bank for International Settlements; and IMF staff estimates.
 1/ Twelve Lima districts include Barranco, La Molina, Miraflores, San Borja, San Isidro, Surco, Jesús María, Lince, Magdalena, Pueblo Libre, San Miguel, and Surquillo.

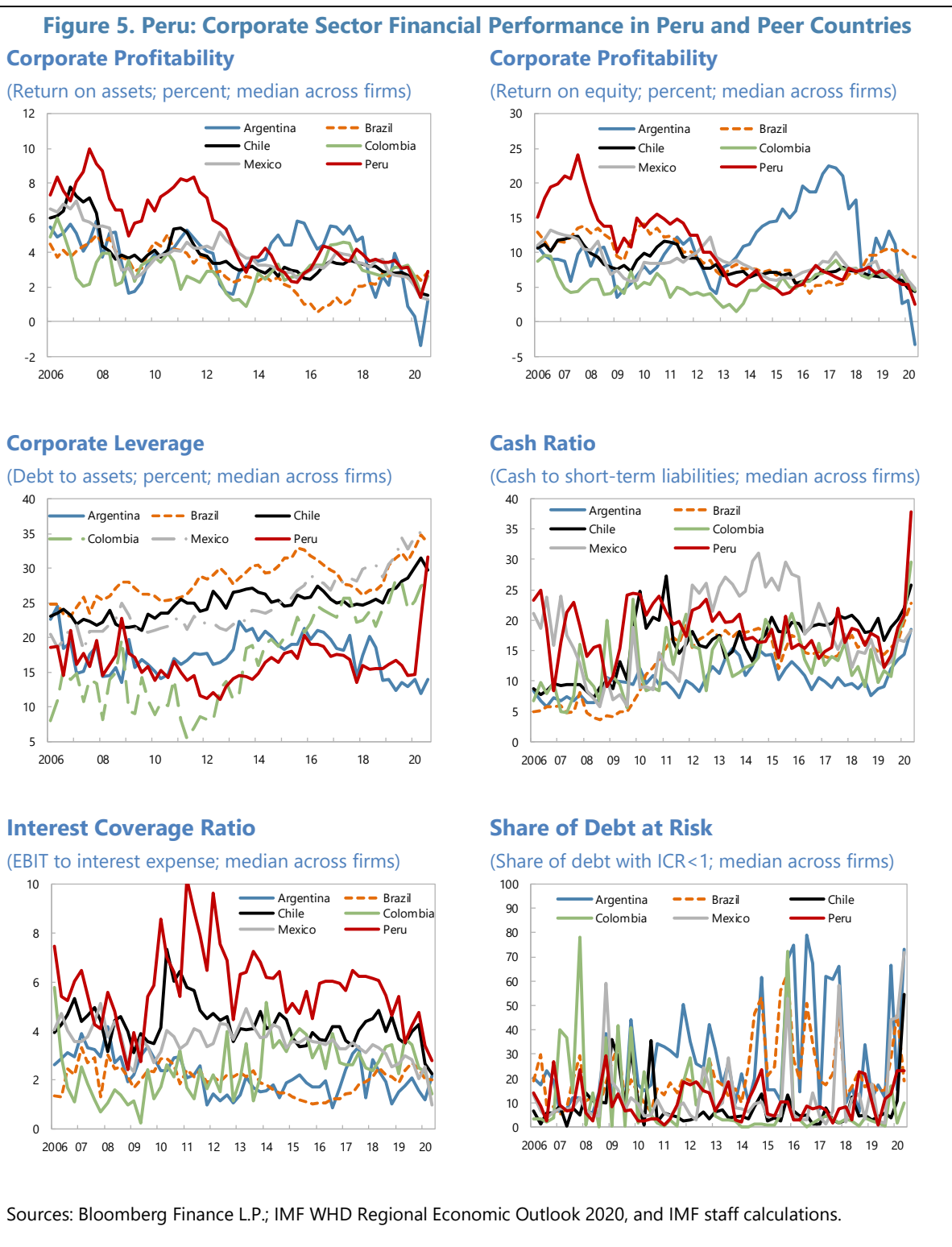
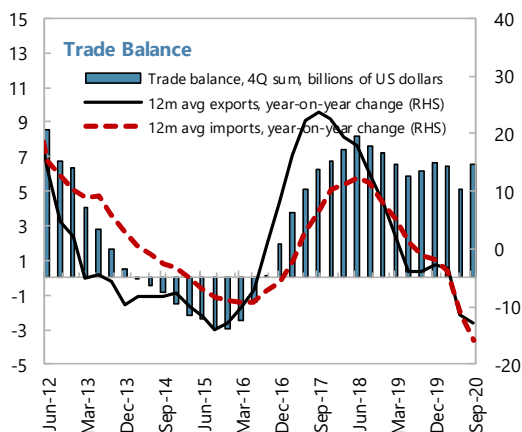
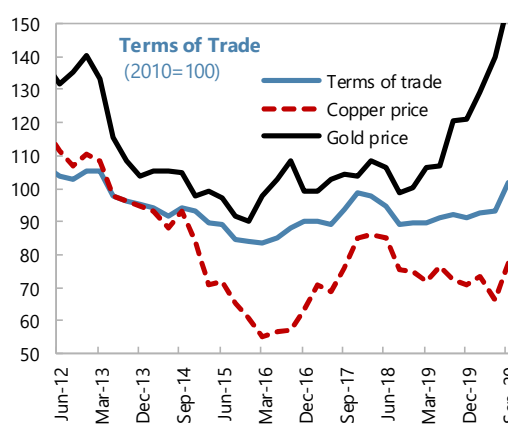


Figure 6. Peru: External Sector Developments

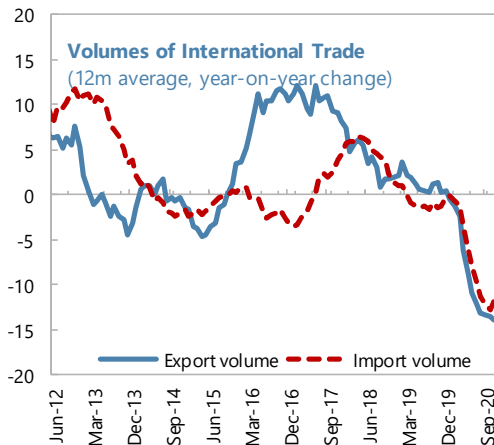
The trade surplus narrowed...



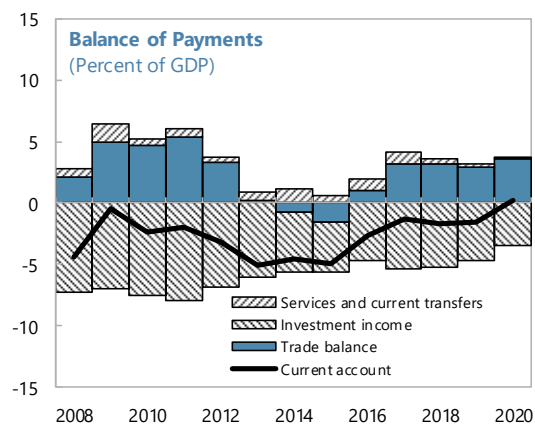
... despite some improvements in terms of trade ...



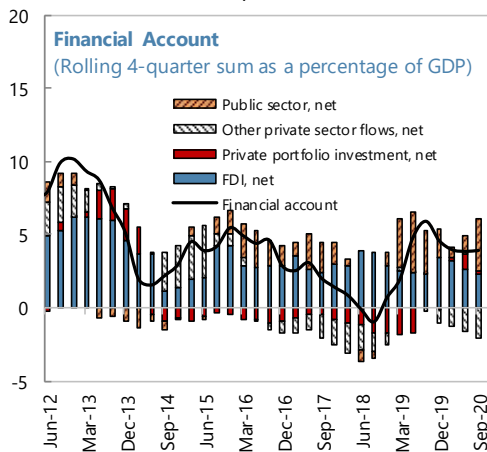
...as both exports and imports declined significantly.



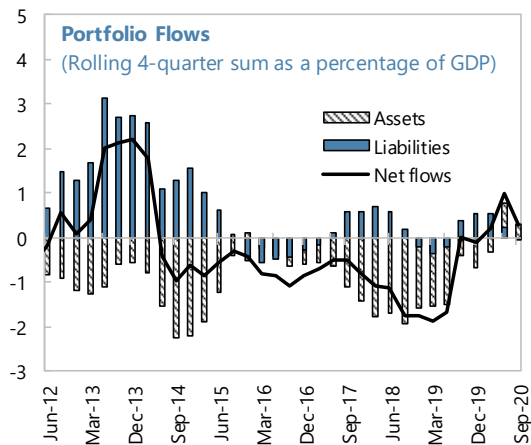
Nevertheless, the current account deficit narrowed in 2020.



The financial account was driven by large public sector inflows.

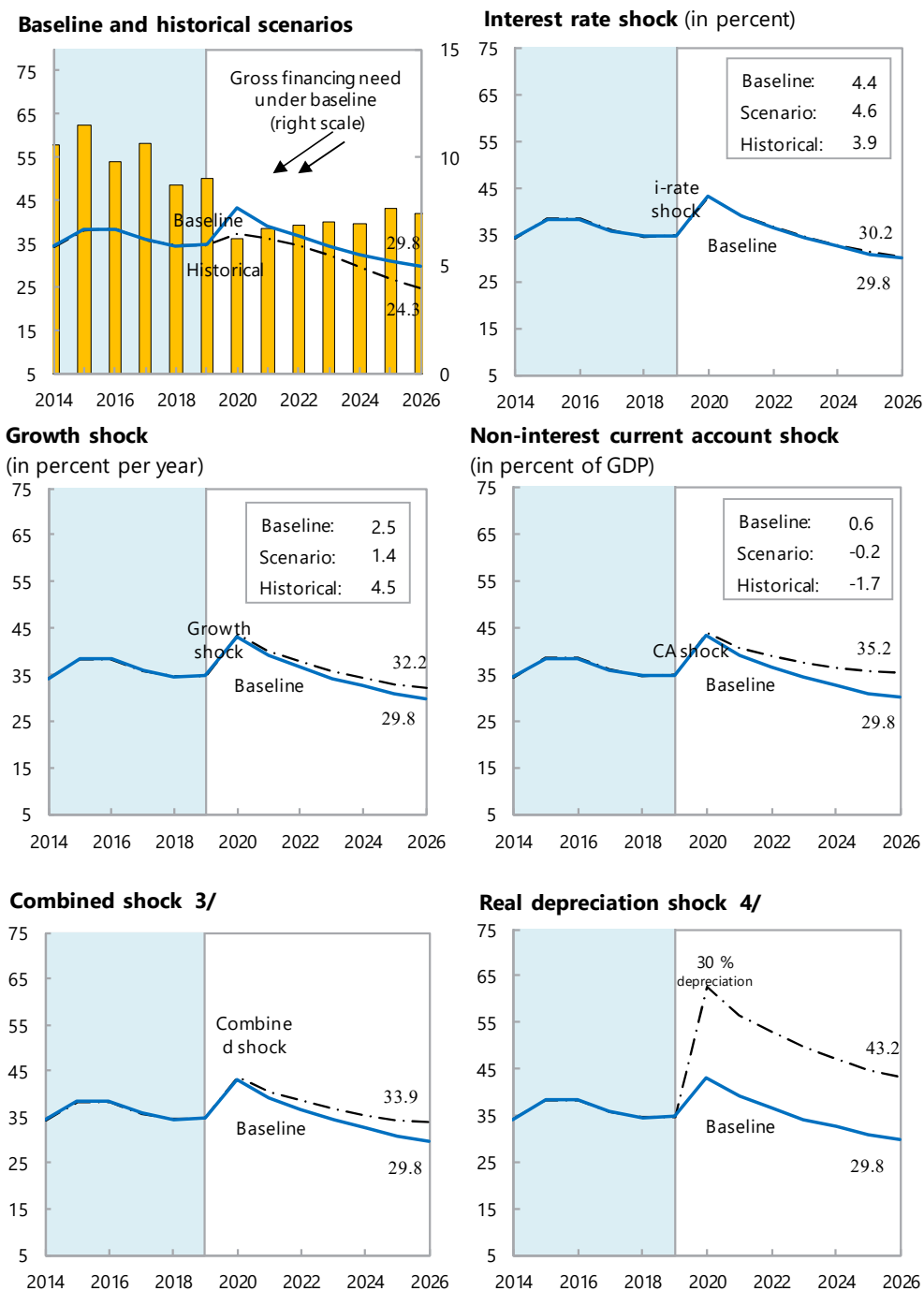


Portfolio flows have been broadly stable



Sources: National authorities; and IMF staff estimates.

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



Sources: International Monetary Fund, Country desk data, and 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 2020.

Table 1. Peru: Selected Economic Indicators

	2017	2018	2019	Prelim. 2020	2021	2022	Proj. 2023 2024		2025	2026
Social Indicators										
Life expectancy at birth (years)	76.4	76.6	...	...	...	...	...	...	...	...
Infant mortality (per thousand live births)	12.9	12.7	...	...	...	...	...	...	...	...
Adult literacy rate (%)	94.2	94.4	...	...	...	...	...	...	...	...
Poverty rate (total) 1/	24.2	22.3	21.7	27.5	...	...	...	...	...	...
Unemployment rate for Metropolitan Lima (period average)	6.9	6.7	6.6	13.6	...	...	...	...	...	...
	(Annual percentage change; unless otherwise indicated)									
Production and prices										
Real GDP	2.1	4.0	2.2	-11.1	8.5	5.2	4.8	3.4	3.3	3.3
Output gap (percent of potential GDP)	-1.4	-1.0	-1.7	-7.2	-3.0	-1.4	-0.1	0.0	0.0	0.0
Consumer prices (end of period)	1.4	2.2	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0
External sector										
Exports	22.5	8.0	-2.8	-11.1	27.5	3.7	3.7	3.9	4.1	4.5
Imports	10.2	8.1	-1.9	-15.6	19.9	5.0	4.8	5.0	4.8	4.5
Terms of trade (deterioration -)	7.5	-0.4	-1.7	8.2	9.9	-0.4	-0.9	-1.8	-1.7	-1.0
Real effective exchange rate (depreciation -)	2.6	-1.7	2.3	...	...	...	...	...	...	...
Money and credit 2/ 3/										
Broad money	8.8	9.6	8.8	27.5	13.0	9.6	7.8	7.7	6.2	5.7
Net credit to the private sector	5.1	10.3	6.4	14.5	4.0	4.0	6.2	5.5	5.4	5.3
Credit-to-private-sector/GDP ratio (%)	40.4	42.1	43.0	53.3	48.4	47.0	46.9	47.1	47.3	47.5
	(In percent of GDP; unless otherwise indicated)									
Public sector										
NFPS revenue	23.0	24.5	24.8	22.1	22.4	23.1	23.1	23.2	23.2	23.2
NFPS primary expenditure	24.9	25.5	25.0	29.3	25.6	24.7	24.0	23.7	23.6	23.3
NFPS primary balance	-1.9	-1.0	-0.2	-7.2	-3.3	-1.6	-0.9	-0.6	-0.3	-0.1
NFPS overall balance	-3.1	-2.3	-1.6	-8.8	-5.0	-3.4	-2.8	-2.4	-2.1	-1.8
NFPS structural balance	-2.1	-1.7	-0.6	-6.4	-4.3	-3.1	-2.9	-2.5	-2.3	-2.0
NFPS structural primary balance 4/	-0.9	-0.3	0.7	-4.8	-2.6	-1.3	-1.1	-0.7	-0.5	-0.2
External sector										
External current account balance	-1.3	-1.7	-1.5	0.5	-0.4	-0.7	-1.0	-1.4	-1.8	-1.8
Gross reserves										
In billions of U.S. dollars	63.7	60.3	68.4	74.9	75.1	75.1	75.0	74.2	71.8	71.0
Percent of short-term external debt 5/	306	364	433	496	519	505	494	506	445	439
Percent of foreign currency deposits at banks	225	213	224	224	206	204	207	209	211	222
Debt										
Total external debt 6/	35.7	34.6	34.7	43.1	39.0	36.6	34.2	32.5	30.9	29.8
Gross non-financial public sector debt 7/	25.4	26.2	27.1	35.4	35.4	36.2	36.7	37.2	37.5	37.4
External	8.8	8.9	8.5	15.0	14.1	13.9	13.4	12.9	12.7	12.9
Domestic	16.7	17.3	18.6	20.3	21.3	22.3	23.2	24.3	24.8	24.5
Savings and investment										
Gross domestic investment	20.6	21.7	21.5	18.8	21.1	22.0	22.3	22.5	22.7	22.9
Public sector (incl. repayment certificates)	4.6	4.8	4.6	4.2	4.1	4.1	4.1	4.2	4.2	4.3
Private sector (incl. inventories)	16.0	16.9	16.8	14.6	16.9	17.9	18.2	18.4	18.5	18.7
Private sector	17.3	17.7	18.0	16.7	16.9	17.9	18.2	18.4	18.5	18.7
National savings	19.3	20.0	19.9	19.3	20.7	21.3	21.3	21.2	20.9	21.1
Public sector	1.8	2.9	3.4	-3.9	-0.1	1.4	2.0	2.5	2.8	3.1
Private sector	17.5	17.1	16.5	23.2	20.9	19.9	19.3	18.7	18.2	18.0
Memorandum items										
Nominal GDP (\$/ billion)	698	740	770	712	815	872	929	976	1,024	1,075
GDP per capita (in US\$)	6,726	7,000	6,958	6,084	6,678	7,051	7,389	7,644	7,901	8,180

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 and government guaranteed debt.

Table 2. Peru: Nonfinancial Public Sector Main Fiscal Aggregates

			Prelim.		Projections					
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
(In millions of soles; unless otherwise indicated)										
Revenues	160,273	181,293	191,202	157,201	182,326	201,713	214,661	226,291	237,695	249,919
Taxes	93,475	107,358	113,754	95,829	114,428	126,592	135,315	143,118	151,259	159,914
Other	66,799	73,935	77,448	61,372	67,898	75,121	79,346	83,173	86,436	90,005
Primary expenditures 1/	173,546	188,407	192,741	208,626	208,829	215,571	223,330	231,687	241,229	250,757
Current	137,665	148,512	152,588	172,975	168,982	173,183	178,381	183,823	190,490	197,424
Capital	35,881	39,895	40,154	35,651	39,847	42,387	44,948	47,864	50,739	53,333
Primary balance	-13,272	-7,114	-1,539	-51,425	-26,503	-13,858	-8,669	-5,396	-3,534	-838
Interest	8,336	10,012	10,720	11,502	13,927	15,507	17,099	17,748	18,375	18,988
Overall balance	-21,609	-17,126	-12,259	-62,927	-40,430	-29,364	-25,768	-23,144	-21,909	-19,827
External financing	-10,415	-557	4,510	33,429	6,265	4,146	864	691	370	6,374
Domestic financing	32,023	17,683	7,749	29,498	34,165	25,218	24,904	22,453	21,538	13,452
Public Gross Debt 2/	177,461	193,721	208,623	251,893	288,065	316,129	340,597	362,591	383,350	402,077
External	61,163	65,505	65,340	106,994	114,732	121,313	124,687	125,745	129,777	139,041
Domestic	112,749	124,938	140,515	142,409	171,143	192,926	214,320	235,556	252,583	262,345
Repayment Certificates	3,549	3,278	2,768	2,490	2,190	1,890	1,590	1,290	990	690
Public Assets 3/	92,709	89,704	92,494	69,994	66,036	65,036	64,036	63,186	62,336	61,536
(In percent of GDP; unless otherwise indicated)										
Revenues	23.0	24.5	24.8	22.1	22.4	23.1	23.1	23.2	23.2	23.2
Taxes	13.4	14.5	14.8	13.5	14.0	14.5	14.6	14.7	14.8	14.9
Other	9.6	10.0	10.1	8.6	8.3	8.6	8.5	8.5	8.4	8.4
Primary expenditures 1/	24.9	25.5	25.0	29.3	25.6	24.7	24.0	23.7	23.6	23.3
Current	19.7	20.1	19.8	24.3	20.7	19.9	19.2	18.8	18.6	18.4
Capital	5.1	5.4	5.2	5.0	4.9	4.9	4.8	4.9	5.0	5.0
Primary balance	-1.9	-1.0	-0.2	-7.2	-3.3	-1.6	-0.9	-0.6	-0.3	-0.1
Interest	1.2	1.4	1.4	1.6	1.7	1.8	1.8	1.8	1.8	1.8
Overall balance	-3.1	-2.3	-1.6	-8.8	-5.0	-3.4	-2.8	-2.4	-2.1	-1.8
External financing	-1.5	-0.1	0.6	4.7	0.8	0.5	0.1	0.1	0.0	0.6
Domestic financing	4.6	2.4	1.0	4.1	4.2	2.9	2.7	2.3	2.1	1.3
Public Gross Debt 2/	25.4	26.2	27.1	35.4	35.4	36.2	36.7	37.2	37.5	37.4
External	8.8	8.9	8.5	15.0	14.1	13.9	13.4	12.9	12.7	12.9
Domestic	16.2	16.9	18.2	20.0	21.0	22.1	23.1	24.1	24.7	24.4
Repayment Certificates	0.5	0.4	0.4	0.3	0.3	0.2	0.2	0.1	0.1	0.1
Public Assets 3/	13.3	12.1	12.0	9.8	8.1	7.5	6.9	6.5	6.1	5.7
Public Net Debt	12.1	14.1	15.1	25.5	27.3	28.8	29.8	30.7	31.4	31.7
Memorandum items										
Commodity related revenues 4/	1.0	1.9	1.4	1.3	1.8	1.7	1.7	1.7	1.7	1.7
Output gap (percent of potential GDP)	-1.4	-1.0	-1.7	-7.2	-3.0	-1.4	-0.1	0.0	0.0	0.0
NFPS non-commodity structural balance	-3.7	-3.9	-2.4	-7.9	-5.9	-4.7	-4.5	-4.1	-3.8	-3.5
NFPS non-commodity primary structural balance	-2.5	-2.5	-1.0	-6.3	-4.2	-2.9	-2.6	-2.3	-2.0	-1.7
NFPS structural balance 5/	-2.1	-1.7	-0.6	-6.4	-4.3	-3.1	-2.9	-2.5	-2.3	-2.0
NFPS structural primary balance 5/	-0.9	-0.3	0.7	-4.8	-2.6	-1.3	-1.1	-0.7	-0.5	-0.2
Fiscal impulse (+ = expansionary) 6/	0.2	-0.6	-1.0	5.2	-1.9	-1.2	-0.2	-0.4	-0.2	-0.3

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 CRPAOs and FEPC.

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 moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to IMF World Economic

6/ Percentage points of potential GDP.

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

	2017	2018	2019	Prelim.	Projections					
				2020	2021	2022	2023	2024	2025	2026
Revenue	18.3	19.4	19.9	18.0	18.3	18.9	18.9	19.1	19.2	19.3
Taxes	13.4	14.5	14.8	13.5	14.0	14.5	14.6	14.7	14.8	14.9
Social Contributions	2.1	2.2	2.2	2.2	2.1	2.0	2.0	2.1	2.1	2.1
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	2.7	2.7	2.8	2.3	2.2	2.2	2.2	2.3	2.3	2.3
Expense 2/	16.5	16.5	16.8	21.9	18.7	17.5	16.9	16.6	16.3	16.1
Compensation of employees	6.1	6.2	6.4	7.4	6.8	6.5	6.2	6.1	5.9	5.7
Use of goods and services	6.0	5.7	5.8	6.6	6.8	6.4	6.2	6.0	5.9	5.8
Interest	1.1	1.2	1.3	1.5	1.6	1.5	1.5	1.4	1.2	1.1
Social benefits	1.7	1.9	1.8	1.9	1.8	1.7	1.7	1.6	1.6	1.6
Other 3/	1.6	1.5	1.5	4.6	1.7	1.3	1.4	1.5	1.7	1.8
Net acquisition of nonfinancial assets	4.7	4.9	4.5	4.5	4.5	4.5	4.5	4.5	4.6	4.6
Acquisitions of nonfinancial assets	4.7	4.9	4.5	4.5	4.5	4.5	4.5	4.5	4.6	4.6
Gross Operating Balance	1.8	2.9	3.2	-3.9	-0.3	1.3	2.0	2.5	2.9	3.3
Net lending (+) borrowing (-) 4/	-2.9	-2.0	-1.4	-8.4	-4.8	-3.1	-2.5	-2.0	-1.7	-1.4
Net acquisition of financial assets 5/	-1.3	-0.4	0.6	-0.7	-3.5	-2.6	-2.3	-1.9	-1.6	-0.7
<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
Currency and deposits 6/	-1.3	-0.4	0.6	-0.7	-3.5	-2.6	-2.3	-1.9	-1.6	-0.7
<i>By residency</i>										
Domestic	-1.3	-0.4	0.6	-0.7	-3.5	-2.6	-2.3	-1.9	-1.6	-0.7
External	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/	1.7	1.7	1.9	7.7	1.3	0.6	0.2	0.2	0.1	0.7
<i>By instrument</i>										
Debt securities	3.7	2.3	1.2	3.2	0.5	0.1	0.1	0.1	0.1	0.1
Loans	-2.1	-0.7	0.8	4.5	0.8	0.5	0.1	0.1	0.0	0.6
<i>By residency</i>										
Domestic	3.7	2.3	1.2	3.2	0.5	0.1	0.1	0.1	0.1	0.1
External	-2.1	-0.7	0.8	4.5	0.8	0.5	0.1	0.1	0.0	0.6
Memorandum items										
Central Government Net lending (+) borrowing (-)	-3.2	-2.2	-2.5	-9.0	-4.7	-3.3	-2.7	-2.2	-1.7	-1.3
Regional Governments Net lending (+) borrowing (-)	0.1	0.4	0.5	-0.1	0.1	0.3	0.4	0.5	0.5	0.6
Local Governments Net lending (+) borrowing (-)	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1
General Government Primary Balance	-1.8	-0.8	-0.1	-6.8	-3.1	-1.6	-1.0	-0.6	-0.5	-0.2
General Government Overall Balance	-2.9	-2.0	-1.4	-8.4	-4.8	-3.1	-2.5	-2.0	-1.7	-1.4
Gen. Gov. primary spending (real percentage change)	4.1	4.9	1.0	12.8	-3.1	-0.1	1.8	1.9	2.7	2.5
<i>Of which:</i> Current spending	3.9	3.9	3.1	19.5	-6.3	-1.6	1.0	1.3	2.3	2.1
Capital spending	4.8	8.2	-5.7	-10.2	11.3	5.9	4.4	3.9	3.9	3.9
General Government non-financial expenditures	20.1	20.2	20.0	24.9	21.5	20.5	19.9	19.7	19.7	19.6

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 corresponding cash payments.

3/ Includes other transfers.

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: Financial Soundness Indicators 1/
(In percent; unless otherwise indicated)

	2014	2015	2016	2017	2018	2019
	(as of December)					
Capital Adequacy						
Capital to risk-weighted assets 2/	14.2	14.3	15.1	15.2	14.8	14.7
Regulatory Tier I capital to risk-weighted assets 3/	10.4	10.3	11.0	11.4	11.3	11.6
Nonperforming loans net of provisions to capital 4/	0.2	-0.3	-0.4	-0.6	-0.6	-0.5
Leverage 5/	8.3	7.9	8.7	9.4	9.8	10.2
Asset Quality						
Nonperforming loans to total gross loans 4/	2.9	2.9	3.1	3.3	3.3	3.4
In domestic currency	3.4	2.9	3.2	3.6	3.7	3.8
In foreign currency	2.1	2.9	2.8	2.6	2.4	2.3
Nonperforming, refinanced and restructured loans to total gross loans 4/ 6/	4.0	4.0	4.4	4.8	4.9	4.9
In domestic currency	3.4	2.9	3.2	3.6	3.7	3.8
In foreign currency	2.1	2.9	2.8	2.6	2.4	2.3
Refinanced and restructured loans to total gross loans	1.1	1.1	1.3	1.5	1.6	1.5
Provisions to nonperforming loans 4/	157.7	161.8	157.1	151.1	150.7	149.1
Provisions to nonperforming, restructured, and refinanced loans 4/ 6/	114.4	116.5	111.1	105.0	101.6	103.3
Sectoral distribution of loans to total loans						
Consumer loans	18.1	18.3	18.9	19.2	19.8	21.4
Mortgage loans	15.5	15.2	15.1	15.4	15.3	15.6
Large corporations	17.2	21.4	22.2	22.6	23.3	22.2
Small corporations	17.0	15.8	14.8	14.3	14.3	14.3
Medium size firms	18.3	16.9	16.4	15.4	14.8	13.7
Small firms	10.1	9.0	9.1	9.4	9.1	9.3
Microenterprises	3.8	3.4	3.6	3.7	3.5	3.5
Earnings and Profitability						
Return on equity (ROE)	18.2	21.1	19.2	17.7	17.9	17.9
Return on assets (ROA)	1.9	2.1	2.0	2.1	2.2	2.2
Financial revenues to total revenues	85.0	85.1	85.3	84.2	83.4	83.7
Annualized financial revenues to revenue-generating assets	10.6	10.5	10.1	10.2	10.3	10.4
Liquidity						
Total liquid assets to total short-term liabilities (monthly average basis)	39.4	37.7	35.4	38.5	34.6	36.4
In domestic currency	25.3	26.2	26.7	33.0	27.2	27.5
In foreign currency	55.2	47.5	44.9	45.7	45.3	50.3
Deposit-to-loan	90.5	92.0	88.4	92.1	89.4	90.9
Foreign Currency Position and Dollarization						
Share of foreign currency deposits in total deposits	43.4	49.5	44.1	39.3	35.9	35.2
Share of foreign currency loans in total credit	38.4	30.1	28.8	29.4	28.5	26.5
Operational efficiency						
Financing to related parties to capital 7/	9.4	12.3	9.1	9.6	12.3	9.7
Nonfinancial expenditure to total revenues 8/	33.0	30.9	30.8	30.7	30.7	29.9
Annualized Nonfinancial expenditure to total revenue-generating assets 8/	4.1	3.8	3.7	3.7	3.8	3.7
Memorandum items						
General Stock market index, IGBVL	14,794	9,849	15,567	19,974	19,350	20,526
EMBI+ PERU spread, basis points	181	243	170	112	137	92

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 5. Peru: Balance of Payments
(In billions of U.S. dollars; unless otherwise noted)

	2017	2018	2019	Prelim. 2020	Projections					
					2021	2022	2023	2024	2025	2026
Current account	-2.8	-3.8	-3.6	1.0	-0.8	-1.7	-2.6	-3.7	-5.0	-5.4
Merchandise trade	6.7	7.2	6.6	7.7	12.5	12.5	12.5	12.5	12.6	13.2
Exports	45.4	49.1	47.7	42.4	54.1	56.1	58.2	60.5	62.9	65.7
Traditional	33.6	35.6	33.8	29.4	40.3	41.8	43.3	44.8	46.4	48.5
Mining	27.6	28.9	28.1	25.8	35.7	37.1	38.5	39.8	41.3	43.1
Nontraditional and others	11.9	13.4	13.9	13.0	13.7	14.2	14.9	15.7	16.5	17.3
Imports	-38.7	-41.9	-41.1	-34.7	-41.6	-43.6	-45.7	-48.0	-50.3	-52.5
Services, income, and current transfers (net)	-9.5	-11.0	-10.2	-6.8	-13.4	-14.2	-15.1	-16.2	-17.7	-18.6
Services	-1.5	-2.8	-3.2	-4.1	-4.5	-4.5	-4.8	-5.0	-5.4	-5.7
Investment income	-11.5	-11.8	-10.7	-6.7	-12.2	-13.1	-13.7	-14.6	-15.8	-16.5
Current transfers	3.6	3.6	3.7	4.0	3.3	3.4	3.5	3.5	3.5	3.6
Capital and financial account balance	3.0	1.5	10.6	9.5	1.0	1.7	2.6	2.9	2.6	4.6
Public sector	3.3	2.1	4.4	9.8	1.5	1.1	0.3	0.3	0.2	1.8
Medium-term loans 1/	-1.5	0.2	-0.3	9.0	1.7	1.1	0.2	0.2	0.1	1.7
Other public sector flows 2/	4.1	2.1	4.5	1.1	-0.2	0.0	0.1	0.1	0.1	0.1
Short-term flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	-0.3	-0.6	6.1	-0.3	-0.5	0.5	2.2	2.6	2.4	2.8
Foreign direct investment (net) 3/	6.4	6.5	8.0	2.7	7.2	7.6	7.9	7.9	7.9	8.3
Medium- and long-term loans	-3.7	-1.6	-2.2	-3.4	-2.4	-2.2	-2.0	-1.9	-1.8	-1.8
Portfolio investment	-1.8	-3.9	-0.3	1.3	-2.5	-2.8	-3.0	-3.3	-3.5	-3.8
Short-term flows 4/	-1.2	-1.5	0.6	-0.8	-2.8	-2.1	-0.7	-0.2	-0.2	0.0
Errors and omissions	1.4	-1.3	-0.1	-4.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.6	-3.6	6.9	5.6	0.2	0.0	0.0	-0.8	-2.4	-0.8
Financing	-1.6	3.6	-6.9	-5.6	-0.2	0.0	0.0	0.8	2.4	0.8
NIR flow (increase -)	-1.6	3.6	-6.9	-5.6	-0.2	0.0	0.0	0.8	2.4	0.8
Change in NIR (increase -)	-1.9	3.5	-8.2	-6.4	-0.2	0.0	0.0	0.8	2.4	0.8
Valuation change	0.3	0.1	1.3	0.8	0.0	0.0	0.0	0.0	0.0	0.0
					(In percent of GDP)					
Current account balance	-1.3	-1.7	-1.5	0.5	-0.4	-0.7	-1.0	-1.4	-1.8	-1.8
Trade balance	3.1	3.2	2.9	3.8	5.5	5.2	4.9	4.7	4.5	4.5
Exports	21.2	21.8	20.7	20.8	23.9	23.3	22.8	22.7	22.6	22.6
Traditional	15.7	15.8	14.6	14.4	17.9	17.4	17.0	16.8	16.7	16.7
Mining	12.9	12.8	12.2	12.6	15.8	15.4	15.1	14.9	14.8	14.8
Nontraditional and others	5.5	6.0	6.0	6.4	6.1	5.9	5.8	5.9	5.9	5.9
Imports	-18.1	-18.6	-17.8	-17.0	-18.4	-18.1	-17.9	-18.0	-18.1	-18.1
Services, income, and current transfers (net)	-4.4	-4.9	-4.4	-3.3	-5.9	-5.9	-5.9	-6.1	-6.4	-6.4
Investment income	-5.4	-5.2	-4.7	-3.3	-5.4	-5.4	-5.4	-5.5	-5.7	-5.7
Capital and financial account balance	1.4	0.7	4.6	4.7	0.4	0.7	1.0	1.1	1.0	1.6
Foreign direct investment (net)	3.0	2.9	3.5	1.3	3.2	3.2	3.1	3.0	2.9	2.9
Overall balance	0.8	-1.6	3.0	2.7	0.1	0.0	0.0	-0.3	-0.9	-0.3
Memorandum items					(Annual percentage change)					
Export value	22.5	8.0	-2.8	-11.1	27.5	3.7	3.7	3.9	4.1	4.5
Volume growth	8.0	1.6	0.6	-13.4	10.0	4.8	4.2	4.0	4.0	4.0
Price growth	13.4	6.3	-3.4	2.7	15.9	-1.0	-0.5	-0.1	0.1	0.5
Import value	10.2	8.1	-1.9	-15.6	19.9	5.0	4.8	5.0	4.8	4.5
Volume growth	4.5	1.4	-0.2	-11.1	13.8	5.6	4.3	3.2	3.0	2.9
Price growth	5.5	6.7	-1.7	-5.1	5.4	-0.6	0.4	1.7	1.8	1.5
Terms of trade	7.5	-0.4	-1.7	8.2	9.9	-0.4	-0.9	-1.8	-1.7	-1.0
Gross international reserves (in billions of US\$)	63.7	60.3	68.4	74.9	75.1	75.1	75.0	74.2	71.8	71.0
Average exchange rate (S/. per US\$)	3.26	3.29	3.34	3.50	3.61	3.62	3.64	3.66	3.68	3.70

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 nuevos soles; unless otherwise noted)

	2017	2018	2019	Prelim.	Projections					
				2020	2021	2022	2023	2024	2025	2026
I. Central Reserve Bank										
Net foreign assets	150	159	170	223	213	211	267	260	251	240
(In billions of U.S. dollars)	81	73	85	88	91	92	77	77	75	77
Net international reserves 2/	206	203	226	270	271	273	274	273	265	263
(In billions of U.S. dollars)	64	60	68	75	75	75	75	74	72	71
Long-term net external assets	0	0	0	0	0	0	0	0	0	0
Foreign currency liabilities	-56	-43	-57	-48	-57	-62	-8	-12	-14	-24
Net domestic assets	-93	-98	-105	-137	-120	-112	-164	-154	-141	-128
Net credit to nonfinancial public sector	-65	-61	-64	-49	-45	-42	-42	-42	-42	-42
Credit to the financial sector 3/	15	7	5	41	46	51	-9	-3	4	10
Securities issued	-32	-26	-28	-89	-89	-90	-88	-84	-78	-71
Other assets (net)	-11	-18	-18	-40	-31	-31	-25	-25	-25	-25
Monetary base	57	61	65	86	93	99	103	107	109	112
Currency	46	50	52	70	82	92	53	58	63	68
Reserve	11	12	12	16	11	7	49	49	46	44
II. Depository Corporations 4/										
Net foreign assets	178	172	194	248	250	256	247	246	238	236
Net domestic assets	106	138	143	183	237	277	328	374	420	459
Net credit to the public sector	-63	-57	-62	-37	-3	23	48	70	92	105
Credit to the private sector	282	311	331	379	394	410	436	460	484	510
Other assets (net)	-114	-116	-126	-160	-155	-155	-156	-156	-156	-156
Broad money	283	310	338	431	486	533	575	619	658	695
Domestic currency	191	215	237	310	355	400	442	489	533	577
Foreign currency	92	96	101	121	132	134	133	130	125	119
III. Financial System 5/										
Net foreign assets	263	262	298	365	365	363	367	366	359	358
Net domestic assets	209	236	256	342	406	459	511	563	614	658
Net credit to the public sector	-24	-15	-15	11	45	70	95	117	139	152
Credit to the private sector	340	368	393	457	488	515	543	572	601	633
Other assets (net)	-108	-116	-122	-126	-126	-126	-126	-127	-127	-127
Liabilities to the private sector	472	498	554	707	771	822	879	929	972	1,016
Domestic currency	361	383	428	549	610	663	722	777	828	880
Foreign currency	111	116	127	158	161	159	157	152	144	135
Monetary base	7.2	7.3	5.2	33.2	8.6	5.6	4.0	4.0	2.7	2.3
Broad money	8.8	9.6	8.8	27.5	13.0	9.6	7.8	7.7	6.2	5.7
Domestic currency	12.5	12.2	10.2	30.8	14.5	12.6	10.7	10.5	8.9	8.3
Foreign currency	1.7	4.1	5.6	19.8	8.9	1.5	-0.8	-1.6	-3.9	-5.4
Liabilities to the private sector	11.2	5.7	11.3	27.5	9.1	6.6	6.9	5.7	4.7	4.5
Domestic currency	13.9	6.1	11.8	28.3	11.2	8.6	8.9	7.7	6.5	6.3
Foreign currency	3.4	4.2	9.6	24.7	1.7	-1.1	-1.4	-3.1	-5.0	-6.1
Depository corporations credit to the private sector	5.1	10.3	6.4	14.5	4.0	4.0	6.2	5.5	5.4	5.3
Domestic currency	5.3	11.6	9.8	20.3	4.5	4.3	7.1	6.2	6.1	6.0
Foreign currency	4.6	7.1	-2.2	-2.4	2.2	2.8	2.9	2.9	2.7	2.7

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, 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 banks and credit unions.

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

Table 7. Peru: External Debt Sustainability Framework, 2017–26
(In percent of GDP, unless otherwise indicated)

	Actual			Projections							Debt-stabilizing non-interest current account 6/ -1.3
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	
Baseline: External debt	35.7	34.6	34.7	43.1	39.0	36.6	34.2	32.5	30.9	29.8	
Change in external debt	-2.5	-1.2	0.2	8.4	-4.1	-2.5	-2.3	-1.7	-1.6	-1.0	
Identified external debt-creating flows (4+8+9)	-4.3	-1.2	-2.6	2.0	-5.0	-3.2	-2.6	-1.5	-0.8	-0.7	
Current account deficit, excluding interest payments	-0.1	0.2	0.2	-1.7	-1.2	-0.9	-0.5	-0.1	0.2	0.3	
Deficit in balance of goods and services	-2.4	-2.0	-1.5	-1.8	-3.6	-3.3	-3.0	-2.8	-2.6	-2.6	
Exports	24.6	24.9	23.9	22.5	26.5	26.1	25.7	25.8	25.8	25.9	
Imports	22.2	23.0	22.4	20.7	22.9	22.8	22.7	23.0	23.2	23.3	
Net non-debt creating capital inflows (negative)	-2.1	-1.1	-3.4	-1.9	-2.1	-2.0	-1.9	-1.8	-1.6	-1.6	
Automatic debt dynamics 1/	-2.0	-0.3	0.5	5.6	-1.7	-0.3	-0.1	0.4	0.6	0.6	
Contribution from nominal interest rate	1.4	1.5	1.4	1.2	1.6	1.6	1.5	1.5	1.6	1.6	
Contribution from real GDP growth	-0.7	-1.3	-0.8	4.4	-3.3	-1.9	-1.6	-1.1	-1.0	-1.0	
Contribution from price and exchange rate changes 2/	-2.7	-0.4	-0.1	...	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	1.7	0.0	2.8	6.5	0.9	0.8	0.2	-0.3	-0.8	-0.4	
External debt-to-exports ratio (in percent)	145.2	138.5	145.1	191.9	147.2	140.2	133.0	126.2	119.7	115.4	
Gross external financing need (in billions of US dollars) 4/	22.8	19.5	20.9	12.7	15.2	16.6	17.8	18.4	21.2	21.6	
in percent of GDP	10.7	8.7	9.0	6.2	6.7	6.9	7.0	6.9	7.6	7.4	
Scenario with key variables at their historical averages 5/				37.2	36.0	34.4	32.2	29.7	26.8	24.3	-4.1
Key Macroeconomic Assumptions Underlying Baseline											
Real GDP growth (in percent)	2.1	4.0	2.2	-11.1	8.5	5.2	4.8	3.4	3.3	3.3	
GDP deflator in US dollars (change in percent)	7.5	1.2	0.3	-0.6	2.2	1.4	1.0	1.1	1.1	1.3	
Nominal external interest rate (in percent)	4.0	4.3	4.0	3.2	4.1	4.3	4.4	4.6	5.1	5.4	
Growth of exports (US dollar terms, in percent)	21.3	6.6	-1.7	-17.1	30.8	5.0	4.4	4.5	4.5	4.9	
Growth of imports (US dollar terms, in percent)	9.3	8.8	0.1	-18.6	23.1	5.9	5.6	5.5	5.4	5.2	
Current account balance, excluding interest payments	0.1	-0.2	-0.2	1.7	1.2	0.9	0.5	0.1	-0.2	-0.3	
Net non-debt creating capital inflows	2.1	1.1	3.4	1.9	2.1	2.0	1.9	1.8	1.6	1.6	

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.

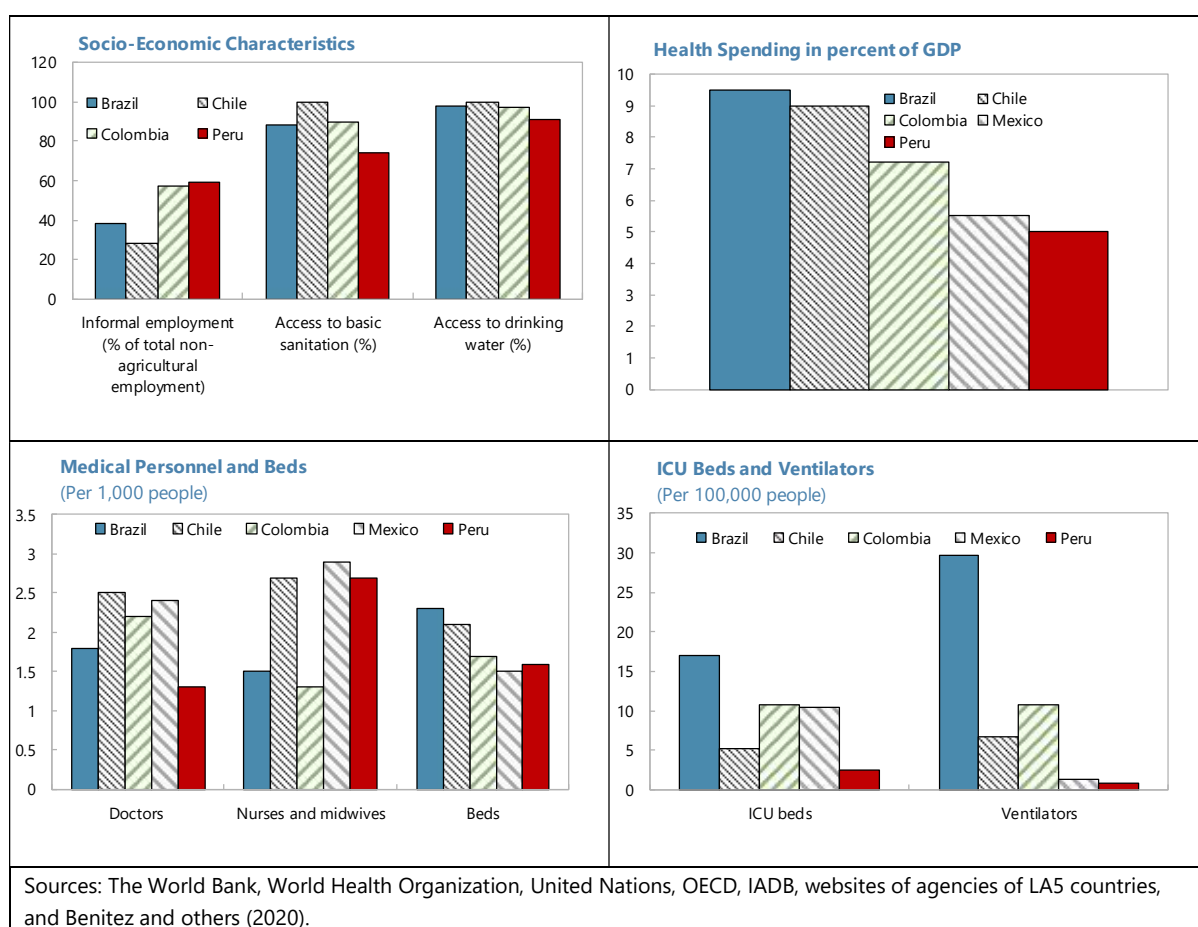
Annex I. Implementation of Past Fund Advice

Recommendations	Authorities' Response
Fiscal policies	
Ease fiscal policy in the short term through accelerating budget execution and improve investment execution capacity, including through strengthening project design, better integrating projects with budget preparation, improving information systems for project execution, promoting concurrent control procedures, and enhancing the implementation capacity of local and regional governments.	In progress. Public investments increased in early 2020 just before the COVID-19 pandemic hit but declined sharply in H1 2020 due to strict COVID-19-related containment measures. The implementation accelerated again in the second half of the year, but bottlenecks in implementing public investments remain.
Introduce greater flexibility in the fiscal policy framework in the medium term to make it counter cyclical.	In progress. While responding to large shocks, the authorities have suspended the fiscal rules in 2020-21.
Raise revenue mobilization capacity in the medium term.	In progress. The 2021 budget plan and MTMF include several revenue measures.
Monetary and exchange rate policies	
Follow data-dependent policy. Ease policy further if downside risks materialize while remaining vigilant against the emergence of financial sector vulnerabilities	Implemented. The BCRP has taken a number of measures to ease monetary conditions in the aftermath of very large shocks and support financial stability.
Introduce greater exchange rate flexibility to absorb external shocks and promote financial development	In progress. The authorities continue to implement an inflation-targeting framework without targeting any particular level of the exchange rate. While the BCRP increased its interventions to stabilize the exchange rate during the COVID-19 and political shocks, the Sol was allowed to depreciate more than in some peer countries.
Limit FX interventions to cases of disorderly market conditions.	Partially implemented. Spot market interventions were limited in 2020, and intervention using other instruments has been two-way.
Financial policies	
Reinforce the legal protection of supervisors	Not implemented.
Mandate the SBS to exercise consolidated supervision	Not implemented. However, the authorities believe that the existing regulations allow the SBS to exercise consolidated supervision.
Enhance the effectiveness of the AML/CFT framework	In progress. A new Companies Authorization Regulation has been prepared that contains clauses on the shareholders' moral suitability, final beneficiaries, directors, managers, and main officials of companies. Similarly, amendments to the Corporate Governance and Comprehensive Risk Management Regulations (GIR) include clauses on evaluating moral

Recommendations	Authorities' Response
	suitability. Both regulations will be published shortly. Also, modifications to the Financial System's Law to increase the limits on fines have been prepared.
Implement Basel III recommendations as outlined in the 2018 FSAP including increasing capital surcharges for systemic banks and countercyclical provisioning for smaller banks would help to strengthen financial sector resilience.	In progress. New methodologies were developed for countercyclical provisions and capital surcharges for systemic banks. A methodology for determining buffers for concentration and interest rate risk is being prepared. A new provisioning scheme more sensitive to risk has been developed, with a new quantitative impact study planned to be conducted in 2021.
Structural policies	
Increase labor market flexibility and reduce economic informality.	In progress. These are priority objectives of the National Competitiveness Plan.
Accelerate reforms to improve governance and fight corruption, boost competitiveness, and reduce informality.	The National Board of Justice, which appoint judges and prosecutors, is now fully operational. Other key reforms include openings of Offices of Institutional Integrity in more than 200 public sector entities, the launch of a platform to collect whistleblower allegations, and the development of an integrity index to help focus on areas where corruption risks are higher.
Improve social protection, 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	In progress. Despite early difficulties in their delivery, cash transfers to households have helped absorb the COVID-19 shock. On the other hand, allowing pension withdrawals did not provide relief to most informal workers and had adverse implications on the pension system's integrity. Financial deepening and inclusion are priority objective of the National Competitiveness Plan.
Foster economic diversification, including through an extension of the agriculture promotion law and further improvements in business climate	In progress. Improving the business climate is a priority objective of the National Competitiveness Plan. The new agriculture promotion law requires a gradual removal of fiscal incentives to create a level-playing field.

Annex II. Peru's Health Preparedness¹

1. Peru appears to lag its peer countries in terms of infrastructure and the number of qualified medical personnel. Peru had invested a smaller part of its GDP on public health than its peers for many years, and a large proportion of this comes out of pocket or from other private sources. Peru has fewer doctors than in peer countries, and most of them work in richer urban areas. Peru also had fewer ICU beds and ventilators than in peer countries before the pandemic hit, with reports suggesting that Peru had just 100 ICU beds available for COVID-19 patients when the pandemic struck. Furthermore, Peru underperforms its peers in terms of access to basic sanitation and drinking water, which facilitate the spread of the virus, undermining its containment efforts.



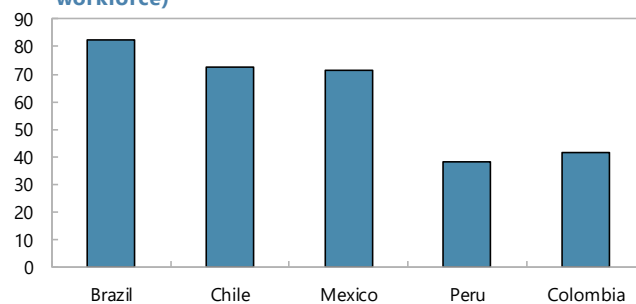
¹ This annex is prepared based on OECD Reviews of Health Systems: Peru (2017), OECD Health at a Glance 2015 and 2019, Global Health Security Index by the EIU, "Responses to COVID-19 in five Latin American countries" by Benitez, Velasco, Sequeira, Henriquez, Menezes, Paolucci, various media reports as well as data by the World Bank, World Health Organization, United Nations, OECD, IADB, and websites of agencies of LA5 countries.

2. Before the pandemic hit, sizable groups of people had limited access to health services. The distribution of infrastructure varied by region, with hospital services overwhelmingly (97 percent) concentrated in urban areas, where populations tend to be richer. Indigenous people, especially women, had been reported as experiencing difficulties in accessing health services (OECD, 2015). This problem was exacerbated by high informality, with about 17 percent of the population not having health insurance. Survey data on accessibility suggest that the health system did not meet the demand, and long waiting times were reported (OECD, 2017).

3. With five main healthcare insurers each owning and operating its own clinics and hospitals, the highly fragmented health care system was slow to react to the pandemic. Following the “decentralization reform,” supervision and management of health services and financial resources were transferred to regional and local governments. However, there were signs that the dual fragmentation of the system—vertically by subsystem and horizontally to regions—was causing problems for the quality of care. The persistence of high infectious disease burden and diminishing vaccination coverages indicated that regional authorities were not fully prepared to provide good-quality services. Low user satisfaction and readiness to seek care outside of their insurance-covered providers and pay for care out of pocket suggest that there were problems with quality within the subsystems (OECD, 2017).

4. There were also problems in early detection and reporting capacity. Global Health Security Index, which is a project of the Nuclear Threat Initiative and the Johns Hopkins Center for Health Security and was developed with The Economist Intelligence Unit, suggests that Peru underperformed its peers in terms of early detection and reporting capacity. Moreover, in the early days of the pandemic, Peru predominantly used rapid antibody tests, which cannot detect early COVID-19 infections, making it hard to identify and isolate the sick quickly. Reportedly, this produced a sizable number of false positives and negatives.

**Early Detection and Reporting
(Including laboratory system and epidemiology workforce)**

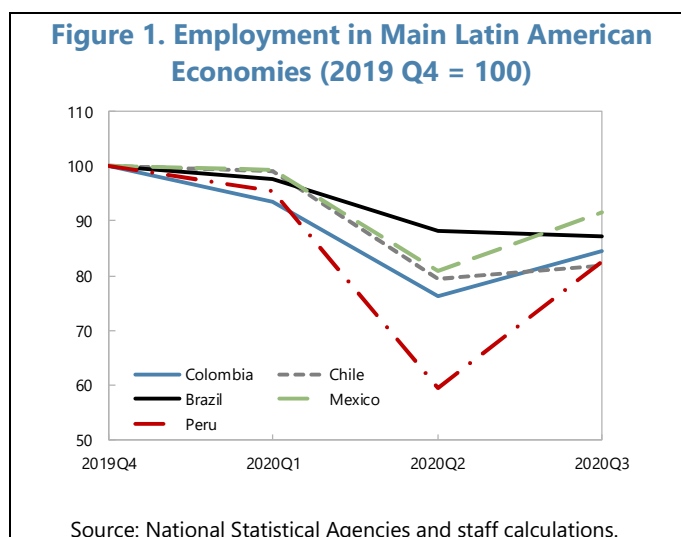


Sources: Global health security index; and IMF staff calculation.

Annex III. Labor Market Developments and Social Support Programs in Peru during the COVID-19 Pandemic¹

1. Peru suffered the largest contraction in employment in the second quarter of 2020 among the main economies of Latin America (LA5). As the COVID-19 pandemic began to

spread in March and the Peruvian government established a national lockdown, employment fell slightly in the last month of Q1 and subsequently declined by 41 percent in Q2 relative to 2019Q4. In comparison, employment in the other LA5 economies contracted between 11 and 24 percent in the same period. While the stronger rebound in Q3 brought Peru in line with the other LA5 economies, employment remained some 20 percent below the pre-pandemic level, suggesting a potentially long path towards a full recovery.



2. Compared to other LA5 economies, the employment contraction in Peru was more evenly distributed across the labor force. Historically, certain groups of workers, such as

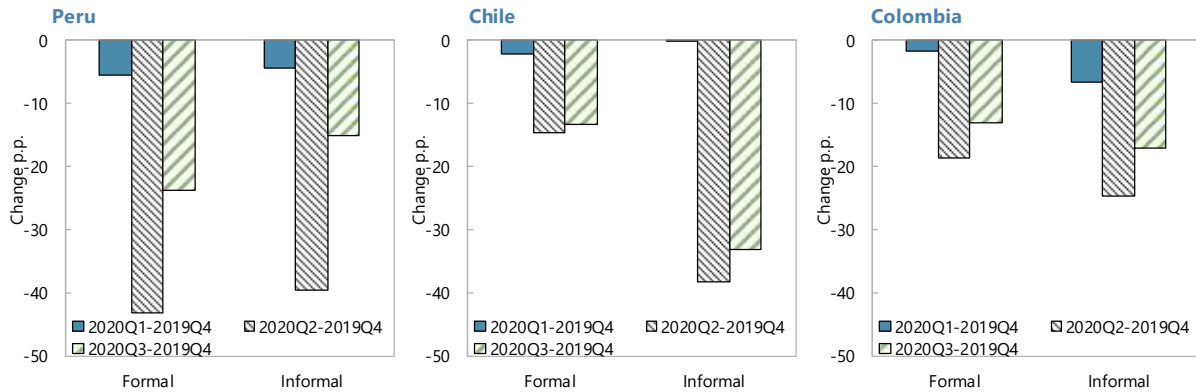
females, younger and older workers, and those in the informal sector experience larger fluctuations in employment over the business cycle. During the pandemic, the high contact intensity of certain occupations and the low ability to telework have exacerbated these differences across groups (see WHD October 2020 REO). As shown in Figure 2, unlike in Chile and Colombia, the employment decline in Q2 for Peru was more homogeneous with respect to formality of work arrangements and age. Only with respect to gender the larger contraction for females in Peru is consistent with developments in the other two countries.² Informal employment experienced a smaller fall than formal employment in Q2 and a faster recovery in Q3. As a result, the informality share of employment rose from 71.6 percent in 2019Q3 to 73.7 percent in 2020Q3.

¹ Prepared by Carlo Pizzinelli (WHD).

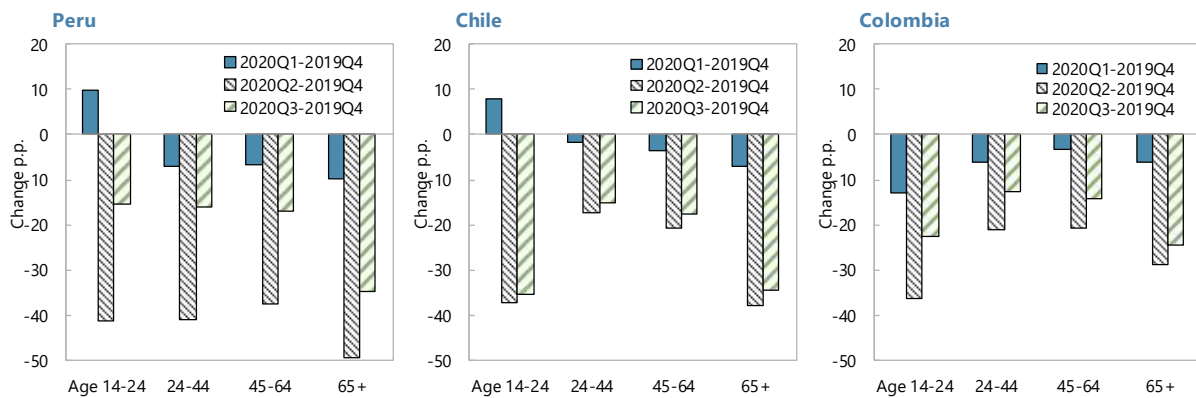
² For the detailed analysis of Peru, Chile, and Colombia we use micro-data at the worker level from national statistical agencies from 2019Q3 to 2020Q3. Namely, the Encuesta Nacional de Hogares (ENAH) for Peru, the Encuesta Nacional de Empleo (ENE) for Chile, and the Gran Encuesta Integrada de Hogares (GEIH) for Colombia.

Figure 2. Job Losses by Worker Characteristic: Peru, Colombia, and Chile
(Employment loss since 2019Q4, percent)

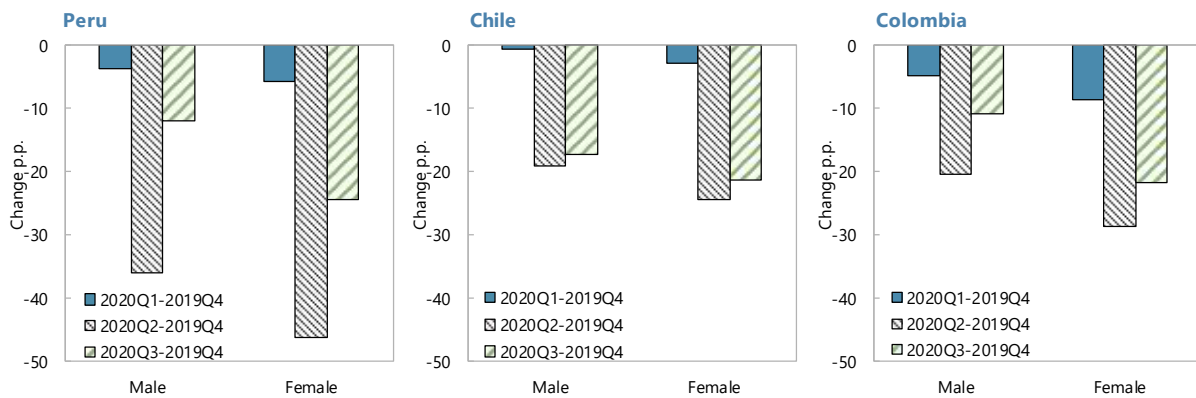
By formality of work arrangements



By age



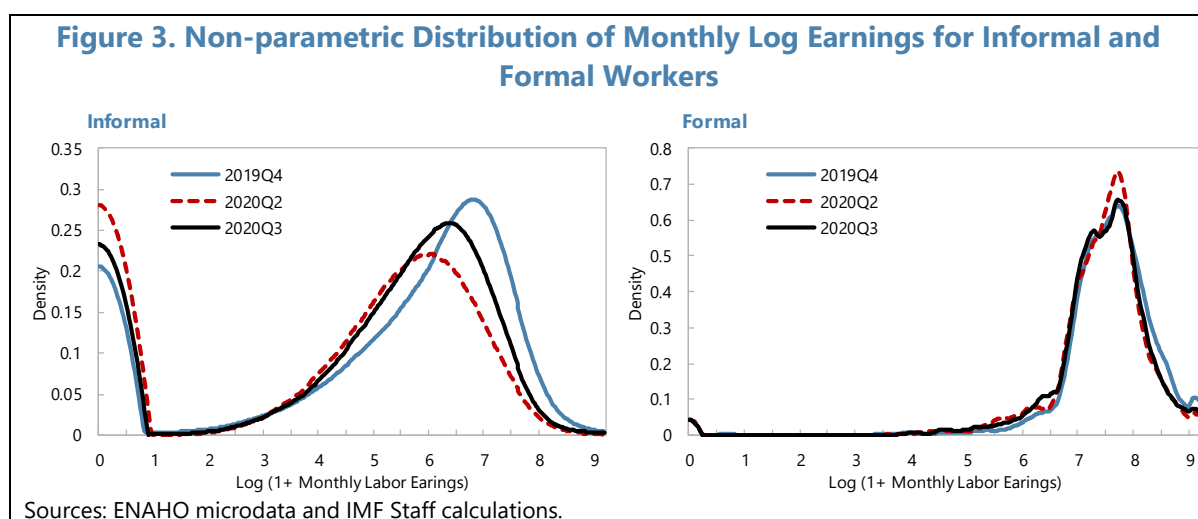
By gender



Sources: National Statistical Agencies and staff calculations.

3. Particularly in the informal sector, employment losses were accompanied by wage reductions. Many informal workers who did not lose their jobs reported falls in their monthly earnings. Figure 3 reports the non-parametric distribution of log monthly labor earnings for

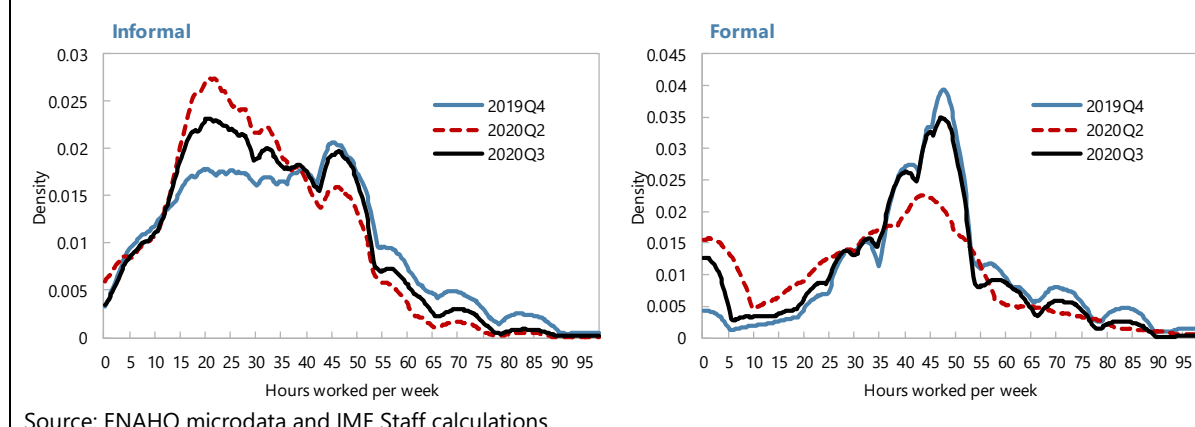
informal and formal workers over time.³ As shown in the left panel, before the pandemic about 20 percent of informal workers reported receiving no income for their labor in the reference month. That share rose to almost 30 percent in 2020Q2. Furthermore, among those workers who received salaries or business profits, income falls were frequent, as indicated by the shift in the distribution to the left. By Q3, the situation had partly reverted to pre-pandemic conditions, with both a fall in the fraction of unpaid workers and a shift to the right of the rest of the distribution. Conversely, income losses were not common among formal workers who retained employment (right panel). Not only is unpaid labor extremely rare among formal workers but also the rest of the distribution did not show marked shifts during the pandemic.



4. The higher incidence of income shocks among informal workers is likely driven by a tighter link between hours worked and earnings. Figure 4 reports the non-parametric distribution of weekly hours worked before and during the pandemic for informal and formal workers. In normal times, the distribution of weekly hours worked is more diffused for informal than for formal workers, as the latter are more likely to work conventional schedules such as 35, 40, or 50 hours. During the pandemic, most informal workers worked fewer hours than usual, with the peak in the distribution falling from more than 40 hours to about 20. Meanwhile, the formal sector saw a small rise in the share of those working no hours but the peak in the distribution remained broadly unchanged between 40 and 50 hours. Taken together, Figures 3 and 4 suggest that informal work is characterized by a tighter link between hours worked and income. On the other hand, formal workers may benefit from greater protection of their incomes when their hours are reduced.

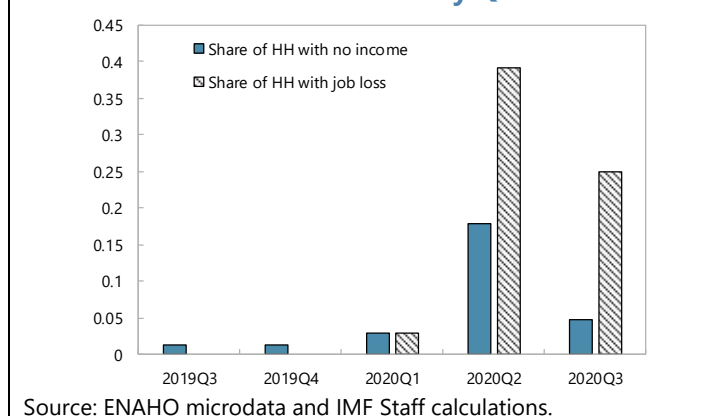
³ The distribution is computed by adding 1 to monetary and non-monetary earnings from all jobs before taking the log. This transformation allows to include in the distribution those workers who were employed without pay.

Figure 4. Non-parametric Distribution of Weekly Hours Worked for Informal and Formal Workers

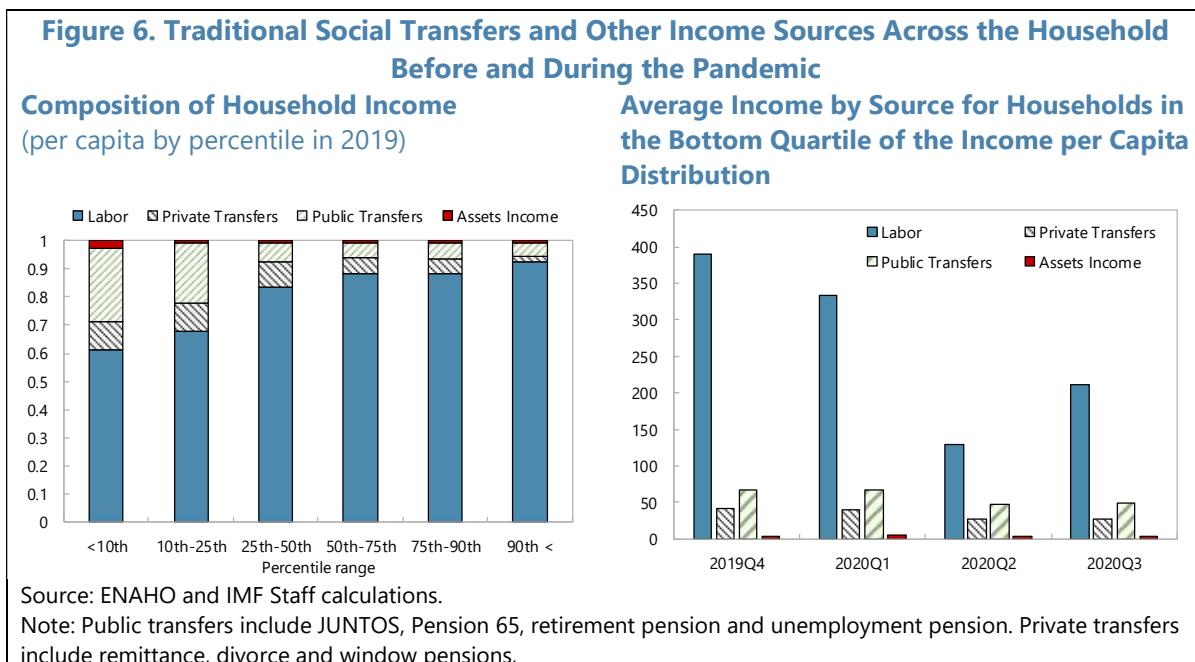


5. Employment losses for individual workers left many households without any income during the pandemic (Figure 5). In Q2 almost 40 percent of households reported that at least one of their members had lost their job since the national lockdown and had not yet returned to work. In the same period, 18 percent of households reported receiving no income from any source—including public and private transfers— compared to a pre-pandemic average of 2 percent. By Q3, the shares of households with job losses and without any income had fallen to 25 and 5 percent, respectively. The fact that the latter fell by a greater extent may indicate that either new income sources, including public transfers, have offset job losses or that the presence of multiple workers within a household may have served as a partial “insurance” mechanism.

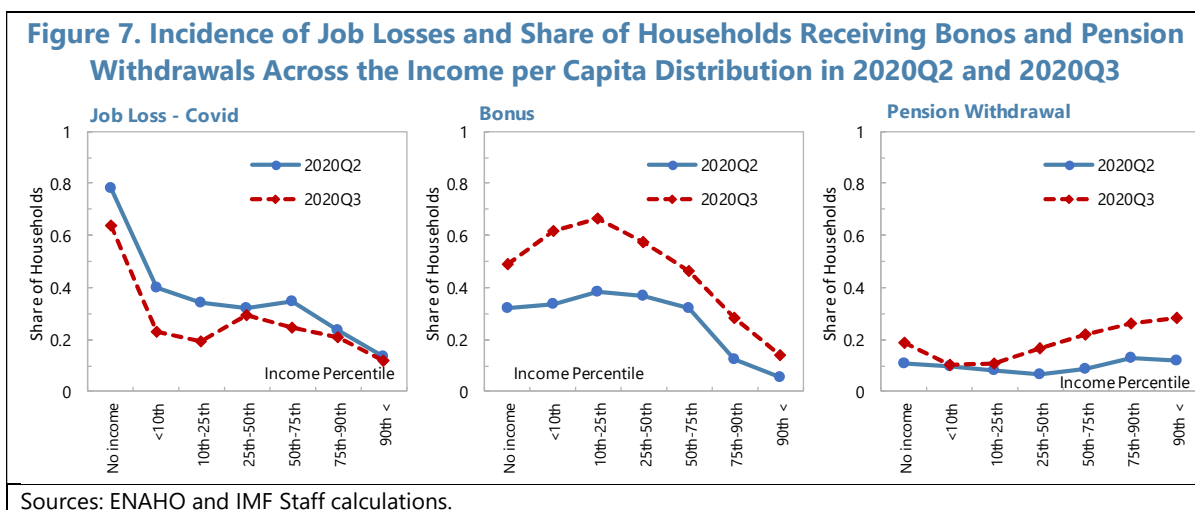
Figure 5. Share of Households with no Income and with at Least One Worker Losing their Job since the National Lockdown by Quarter



6. Pre-existing social safety net programs, although well targeted, were not designed to address the short-lived shock brought about by the pandemic. Peru features a diverse set of social safety net programs, including *JUNTOS* and *Pensión 65*. Before the pandemic, these public transfer schemes constituted a larger fraction of total income per capita for low-income households (Figure 6, left panel), indicating that they are generally progressive in nature and constitute an important means of sustenance for the most vulnerable in society. However, during the pandemic, even as labor earnings fell sharply for low-income households, there was no offsetting rise in transfers from the traditional social safety net (Figure 6, right panel).

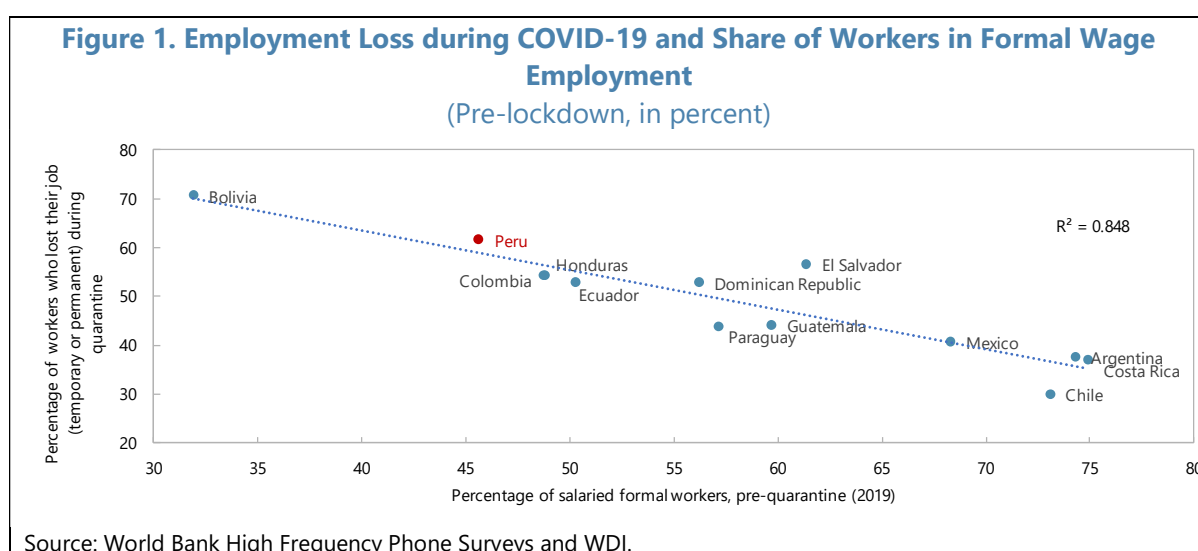


7. After initial delays, newly created social support programs were effective in reaching the most adversely affected households. The government enacted a wide range of measures to support struggling households, especially those in the informal sector. Among these, cash transfers programs, such as *“Bono Yo me quedo en casa”* and *“Bono universal”* were particularly successful in reaching low-income households and those affected by job losses (Figure 7). Another support measure allowed households to make temporary withdrawals from their private pension funds. However, fewer households took advantage of this initiative which mostly reached those in the upper end of the income distribution. As participation in individual pension schemes is connected to the formal labor sector, the regressive nature of the pension withdrawal initiative is likely connected to the lower incidence of formal work arrangements among low-income households.



Annex IV. 2021 Poverty Projections under Different Scenarios¹

1. Peru has been one of the countries hardest-hit by the COVID-19 crisis in terms of job and income losses. The effect of the lockdown measures implemented in Peru had large and negative impacts on households, especially those who depended on informal jobs in non-essential sectors. The fact that informal workers were more likely to lose their jobs and that Peru has one of the highest levels of labor informality in the region contribute to explain the severity of the economic impacts (Figure 1). At the same time, women were affected disproportionately when compared to men. This is partially explained by gender biases in family care responsibilities, but also because female-dominated sectors tend to be more intensive in face-to-face interactions and, thereby, hit harder by the social-distancing measures. Job-loss was less prevalent in rural areas, but labor incomes fell more than in their urban counterparts.²



2. Cash transfers to households in 2020 mitigated the impact of the crisis on poverty to a significant degree. Preliminary estimates indicate that moderate poverty (at US\$5.5/day) in 2020 increased by about 6 percentage points, although it would have grown by 10 percentage points if the emergency cash transfers to households (*"bonos"*) had not been implemented. Results from a simulation model show that the impact of the crisis on poverty incidence has been

¹ Prepared by Ronald Cueva (Extended Term Consultant) and Hernan Winkler (Senior Economist), Poverty and Equity Global Practice, World Bank.

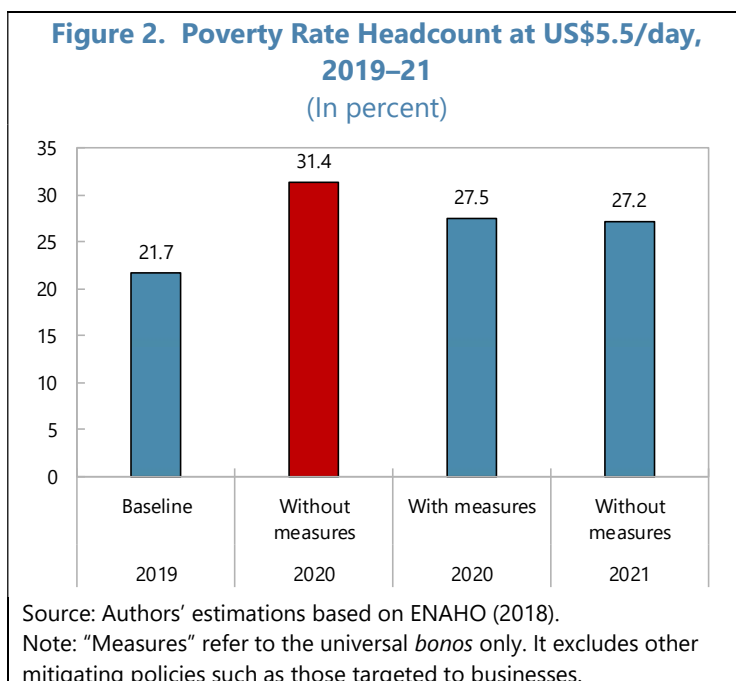
² Cueva, R. Del Carpio, X. and Winkler, H. (forthcoming), *The Labor Market Impacts of COVID-19 in Peru: Insights from a Longitudinal Household Survey*.

dramatic, leading to an unprecedented increase in poverty rates (Figure 2). However, the roll-out of cash transfers to poor and vulnerable households helped to offset such increase substantially.³

3. Without universal cash transfers across all regions in 2021, poverty is expected to remain 4.8 percentage points above pre-crisis levels. While economic growth in 2021 is expected to rebound strongly, the poverty rate is projected to decline only marginally and still remain close to the levels of the 2012 rate headcount (Figure 2).⁴ This limited

progress in poverty reduction in 2021 can be explained by the large scale and progressivity of the *bonos* disbursed in 2020. Although the Government of Peru has already implemented a *bono* of S/.600 (US\$167) for the 10 regions in lockdown⁵, its impact would only decrease poverty levels by 0.7 percentage points compared to a scenario with no measures (Figure 3). The absence of further income support for all regions in 2021 would result in many households falling again in poverty despite strong economic rebound.

4. When evaluating alternative policies, the implementation of a *bono* with similar targeting to the one rolled-out in 2020 is expected to have the largest poverty- and inequality-mitigating impacts in 2021. As seen in Figure 3, of the four policies simulated, another round of universal *bonos* would reduce poverty dramatically, even below pre-crisis levels.⁶ The most generous *bono*, equivalent to about 2.3 percent of GDP (and S/.,2,760 or US\$767 per household), would have the largest impact, reducing poverty by almost 6.4 percentage points with respect to the baseline scenario without emergency cash transfers and increasing monthly income for the bottom decile by almost 35 percent compared to the baseline (Figure 6). Likewise, the same *bono* would also reduce inequality, measured using the Gini coefficient, by 3 points and below pre-crisis levels.⁷ In contrast, the new *bono* announced by the government for the 10 regions in lockdown is expected to have only a mild impact on poverty, reducing it by less



³ Table 1 shows the details of the targeting mechanism of *Bono Universal*.

⁴ In 2012, the poverty headcount at US\$5.5/day (2011 PPP) was 26.9 percent.

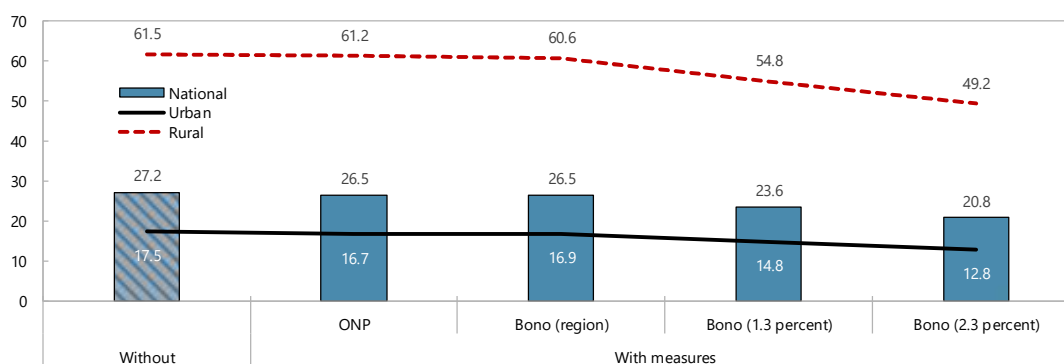
⁵ Between February 1 to February 15.

⁶ Table 1 reports the full list of mitigation policies simulated.

⁷ In 2019, the Gini Index was 42.82.

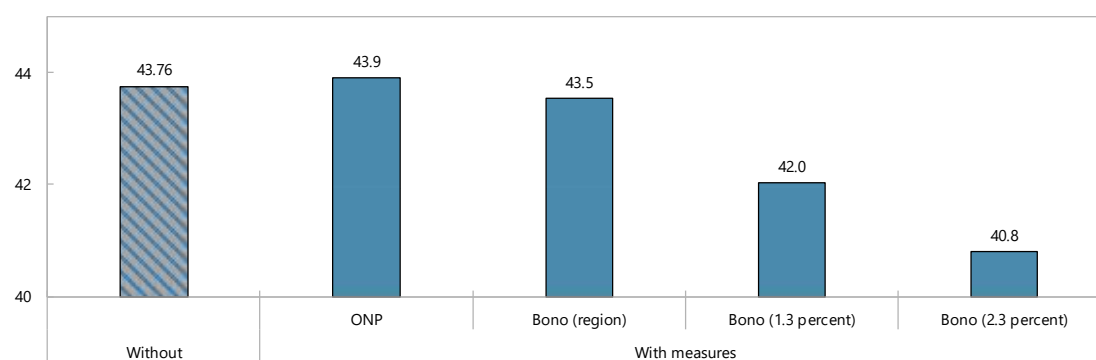
than 1 percentage point. This is because some of the regions targeted—such as Lima—have incomes substantially higher than excluded ones. Finally, the disbursement of *bonos* to those affiliated to the ONP system and the (now-denied) measure to allow early withdrawals from ONP would have only minimal poverty-reducing impacts, by about a percentage point or less.⁸ The fiscal cost of such measure (at least 1.3 percent of GDP⁹) would have been similar to one of the universal *bonos* considered (“*Bono* (1.3 percent)”). However, the latter could reduce poverty by more than 3.6 percentage points in 2021. Figure 5 shows the coverage rates of the different programs by income quintiles.

Figure 3. 2021 Poverty Rates including Four Scenarios of Mitigation Measures
(US\$5.5/day, in percent)



Source: Author's calculation based on ENAHO (2018).

Figure 4. 2021 Gini Index including Four Scenarios of Mitigation Measures
(in percent)



Source: Author's calculation based on ENAHO (2018).

⁸ As seen in Figure 5, ONP contributors and pensioners are mostly distributed in the upper quintiles. As such, poverty impacts from this measure would be minimal. On February 4, 2021 the Constitutional Court of Peru (*Tribunal Constitucional*) declared the Congress-proposed law of ONP withdrawals to be unconstitutional.

⁹ According to the Fiscal Council (*Consejo Fiscal*), the fiscal cost of such measure would have been equivalent to 2.3 percent of GDP.

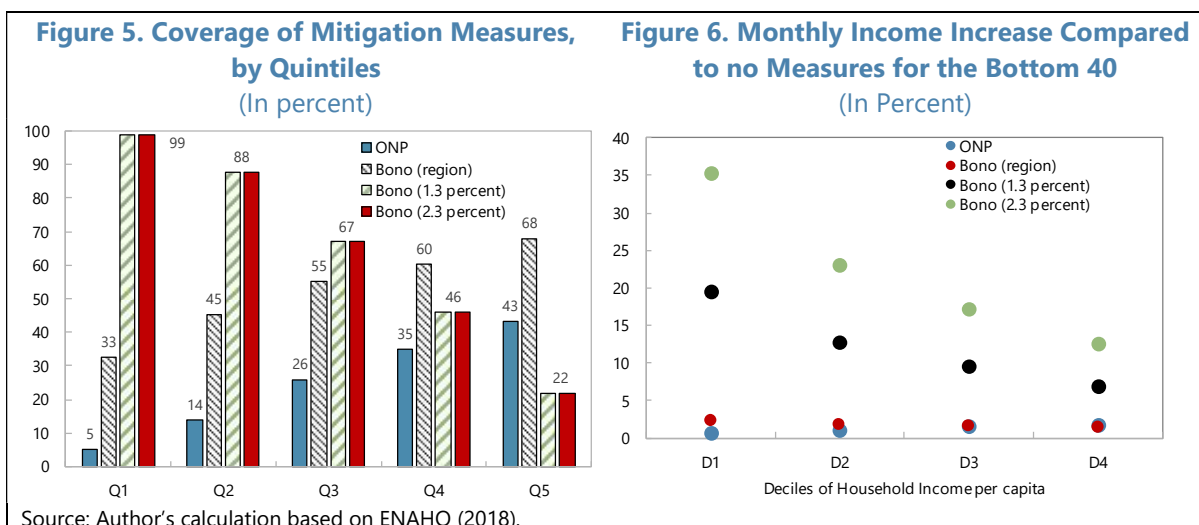


Table 1. Criteria and Amounts of the Simulated Mitigation Measures

Program	Criteria	Amount
Bono ONP¹	<p>ONP will provide a one-time cash transfer equivalent to 1 <i>Remuneración Mínima Vital</i> (RMV) ~ S/.930 for all ONP pensioners.</p> <p>Pensioner Criteria: -To be a pensioner, a worker must have contributed to the public pension system for at least 20 years and be 65 years or older. Early retirement requires 30 years of contribution.</p> <p>Model Criteria: -Affiliated to the public pension system. -Receiving a pension from ONP. -50 years or older (in order to consider early retirement workers).</p>	S/.930 (~US\$260)
Withdrawal ONP²	<p>One-time refund of up to 1 <i>unidad impositiva tributaria</i> (UIT) ~ S/.4300 for all active and inactive contributors.</p> <p>Contributors Criteria: -Workers (dependent or independent) who are not affiliated to the private pension system (AFP). -Contribute 13 percent of their monthly labor income to the public fund.</p>	Maximum of S/.4300 (~US\$1,200)

Table 1. Criteria and Amounts of the Simulated Mitigation Measures (concluded)		
Program	Criteria	Amount
	<p>Model Criteria:</p> <p>We can observe the minimum amount of money in a worker's fund using the time in current employment and last contribution to ONP. If the amount surpasses S/.4300, we assign a withdrawal of S/.4300.</p> <p>For affiliated people whose last contribution to ONP was prior to the start date of their current job or are unemployed, we simulate a scenario with a top withdrawal of S/.4300.</p>	
Bono Universal	<p>Simulation of a one-time cash transfer to households who:</p> <ul style="list-style-type: none"> -Are recipients of the <i>Juntos</i> and <i>Pensión 65</i>.³ -HH in poverty conditions in urban or rural areas. -HH with members who are no formal waged workers⁴ in the public or private sectors, and who earn below S/.3000 each (837 USD).⁵ 	<p>Amounts of S/.1530 and S/.2760 (US\$425 and US\$767) to match 1.3 percent and 2.3 percent of GDP.</p>
Bono of S/.600 for regions in Lockdown	<p>Same criteria as for <i>Bono Universal</i>.</p> <p>Only for households in Ancash, Apurímac, Callao, Huancavelica, Huánuco, Ica, Junín and Lima.</p>	<p>S/.600 (US\$167 USD).</p>
<p>¹ Based on Law N° 31082 (https://busquedas.elperuano.pe/download/url/ley-que-establece-un-regimen-especial-facultativo-de-devoluc-ley-n-31083-1909102-4). Total withdrawals from inactive workers who do not comply requirements to be pensioners (at least 20 years of contribution to the system) are not simulated.</p> <p>² Ídem.³ Even though the Government also includes HH with members of the <i>Contigo</i> program, it was not included in the simulation as question for this social program are not included in ENAHO.</p> <p>⁴ <i>Trabajadores en planilla</i>.</p> <p>⁵ <i>Bono Independiente</i> originally included HH with members who earned less than S/.1200, then <i>Bono Familiar Universal</i> included HH whose members earned less than S/.3000.</p>		

Annex V. Withdrawals from Pension Funds

To alleviate the hardship caused by COVID-19, three rounds of extraordinary withdrawals from private pension funds accounts have been approved along with a one-off payment from the public pension fund (ONP). While the private pension funds appear to have absorbed the immediate shock and the overall financial market reaction has been muted, adverse medium-term implications are expected. The withdrawals have likely helped support household consumption in an environment of arguably inadequate budget support.

1. About five million members of private pension funds made withdrawals of an estimated S/.24.3 billion in the first two rounds.¹ Withdrawals of up to S/.2,000 by members who had not contributed for six consecutive months from private pension fund accounts were authorized under emergency decrees by the government in the context of the health emergency early in April.² Congress-led legislation later in May allowed access of up to 25 percent of the savings accounts, subject to a maximum of S/.12,900 (about US\$3,600). Overall, about 2.8 million people made withdrawals under the April measures amounting to about S/.5.2 billion (for an average withdrawal of S/.1,761). In turn, some 3.7 million people made withdrawals under the May authorization amounting to about S/.19.2 billion over the entire withdrawal window of April through July (for an average withdrawal of S/.5,147).

2. A law authorizing a third round of withdrawals was approved by Congress in November. The law allowed those who had not contributed to the system in the past twelve months and others with health conditions to withdraw up to S/.17,200 from their pension accounts. The expected withdrawal is S/.11.8 billion, which some 2 million potential beneficiaries. The first tranche of withdrawals started in December and will continue into 2021. About S/.7.8 billion has already been withdrawn. In early December, Congress passed a law authorizing exceptional payments by the public pension fund (ONP) of up to S/.4,300. The law also authorizes additional one-off payments to current retirees and allows those over 65 years of age that have not met the requisites for a pension to withdraw the full amount of their contribution. The law was struck down by the Constitutional Tribunal, which ruled against its constitutionality in February.

3. So far, pension funds appear to have managed the shock well, helped by liquidity support from the Central Bank. Four private pension fund companies (APFs) operate in Peru. In March, assets under management stood at about US\$46 billion. APFs were able to respond to the extraordinary demand for cash during the first round of withdrawals by using monthly contributions, repos provided by the central bank (about S/.4.9 billion), liquidating some positions abroad (about US\$410 million), using their deposits, and selling some domestic assets.

4. The first two rounds of withdrawals did not cause major disruptions in financial markets either (Figure). Financial markets went through turbulence before the first measure was

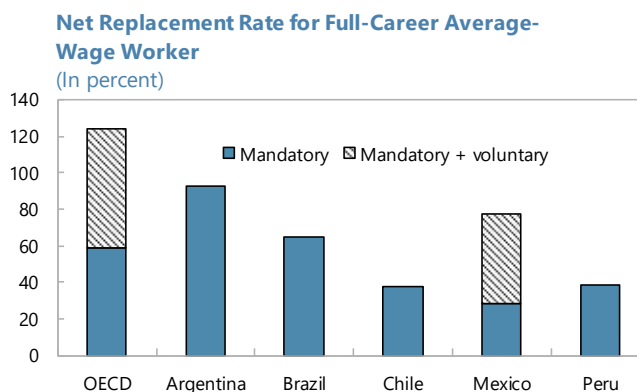
¹ Preliminary estimate based on the variation of the system's assets under management.

² The benefit was later extended to furloughed workers.

adopted, but that seems to be mainly related to the onset of the COVID-19 pandemic. Asset prices moved down in April (the exchange rate slightly depreciated, bond yields slightly increased, and stock prices declined), but the losses were quickly reversed in the following months. The financial system took in stride the following measures as well. Within the domestic financial sector, the outflow of savings from the private pension funds has boosted bank deposits and liquidity. Overall, the weakening of pension funds vis-a-vis banks is not desirable in terms of competition within the financial sector and long-term financing availability.

5. While pension withdrawals may have helped support consumption, they have likely benefitted mostly the relatively well-off households. Subsidies to households in response to the crisis were relatively small. Most families benefitted from two rounds of cash transfers of S/.760, with delays in implementation and the second round rolled out only in August. These compare with an average pension withdrawal of S/.3,683 in the first two rounds alone. The additional provision of cash may have provided some relief but its effect on consumption may have not been very strong. Pension withdrawals benefitted mostly workers in the formal sector, who have higher income and lower propensity to consume.³ Anecdotal evidence points to some households using the liquidity to pay down existing debt or increasing their liquid assets. Most workers in the informal sector, who are a large majority (70 percent) with lower incomes and hit harder by the crisis, do not have pension savings to access.

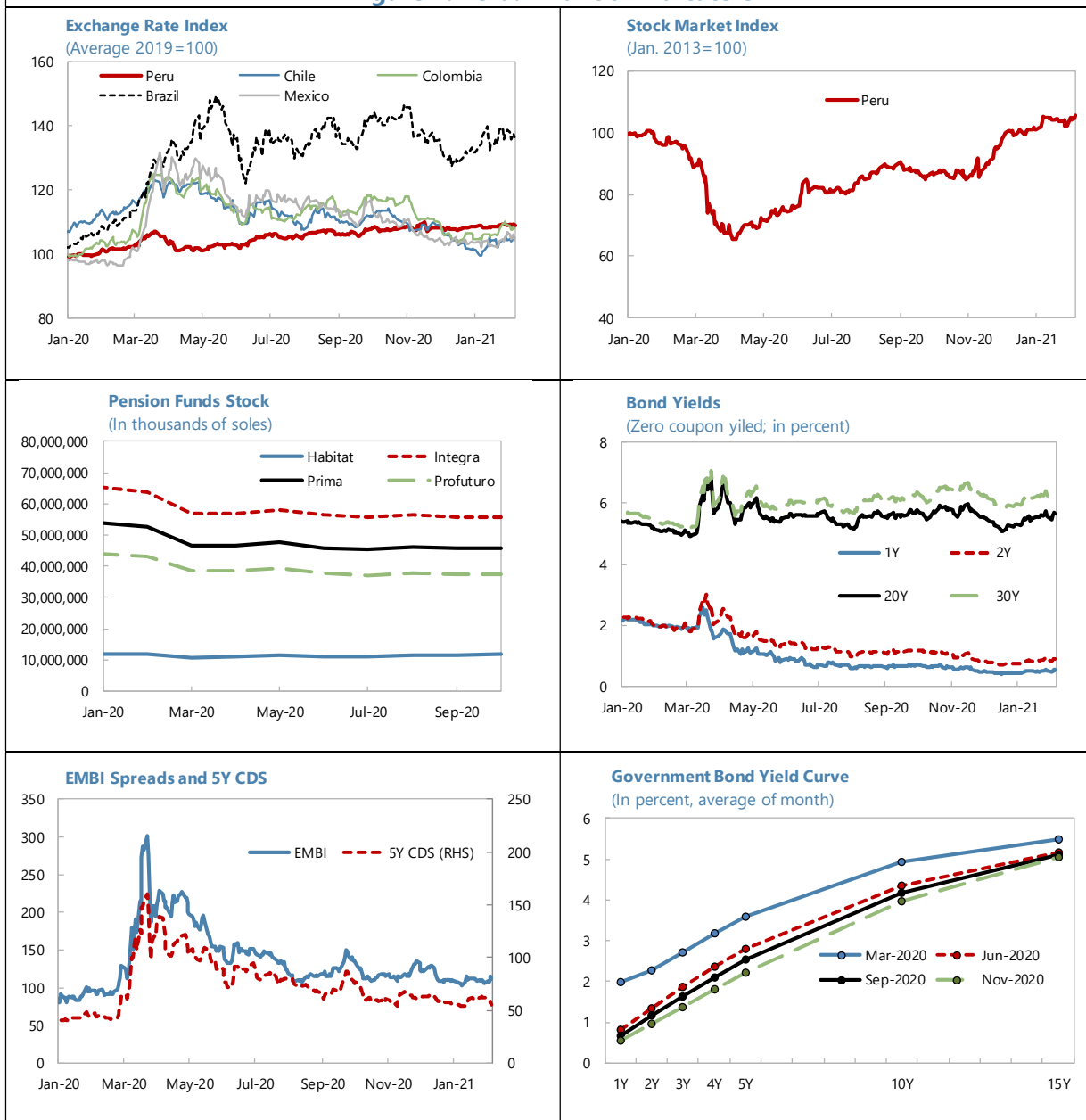
6. The weakening financial position of pension systems poses challenges for the viability of the private social insurance model and may create implicit liabilities for the state. Pensions are already relatively low, with an average monthly pension of below S/.440, and only one percent of APF members receive above S/.775 compared with average wage of S/.2,283. This reflects both low coverage and low replacement rates (40 percent average). The ad-hoc withdrawal authorizations would further worsen the replacement rates, which had already been projected to decline to 12-34 percent in the next 30 years (Freudenberg and Toscani, 2019).



Sources: OECD, Pensions at Glance, 2019; Freudenberg and Toscani, 2019.

³ See also Annex IV, which provides estimates on the impact of pension withdrawals on poverty and inequality.

Figure 1. Peru: Financial Indicators



Sources: Bloomberg; Haver; national authorities; and IMF staff calculations.

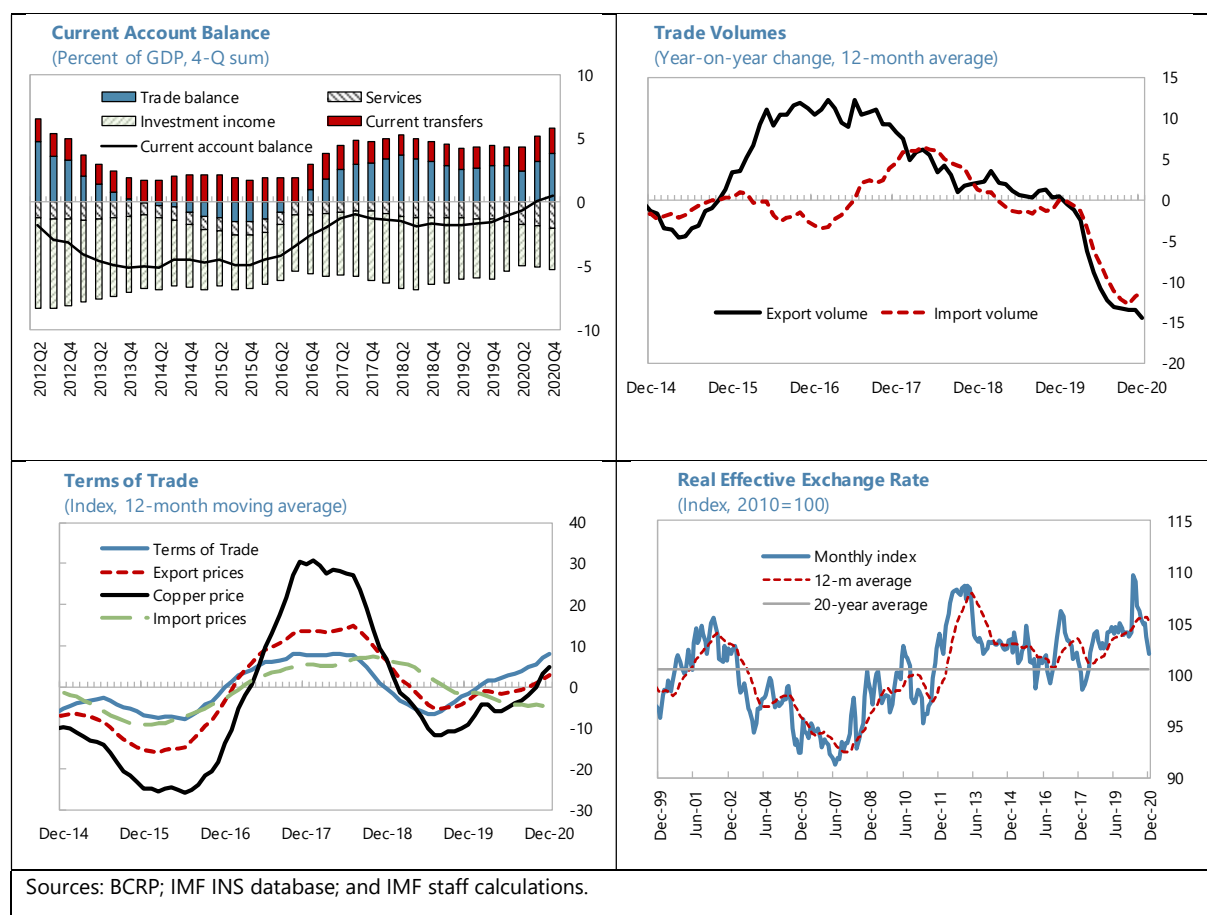
Annex VI. External Sector Assessment

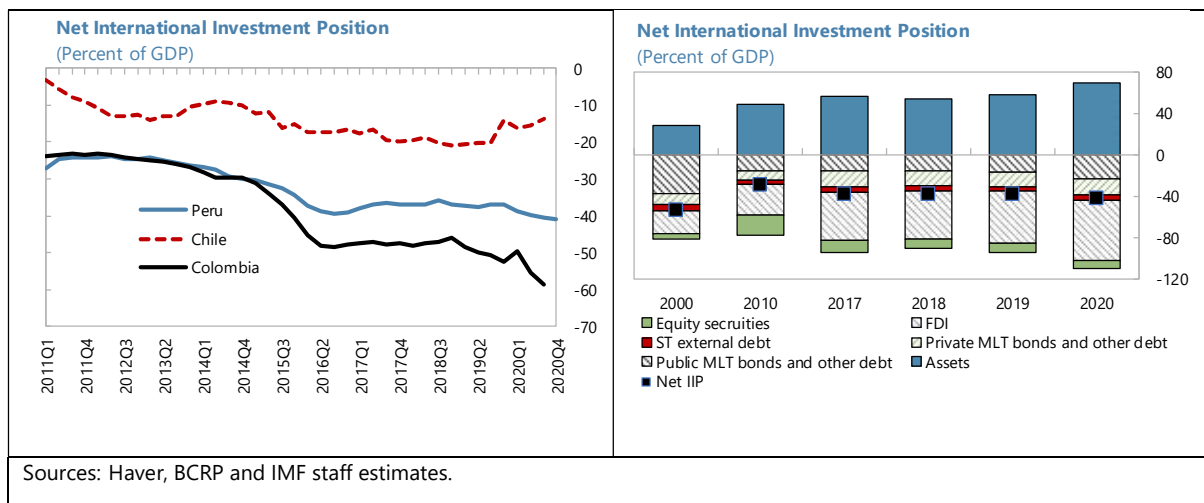
Based on preliminary estimates, Peru's external position in 2020 is assessed as moderately stronger than implied by fundamentals and desirable policies, nevertheless, uncertainty around the estimates is very high. Reserve coverage remains adequate, including after accounting for dependence on commodity prices and significant domestic FX liabilities.

Background

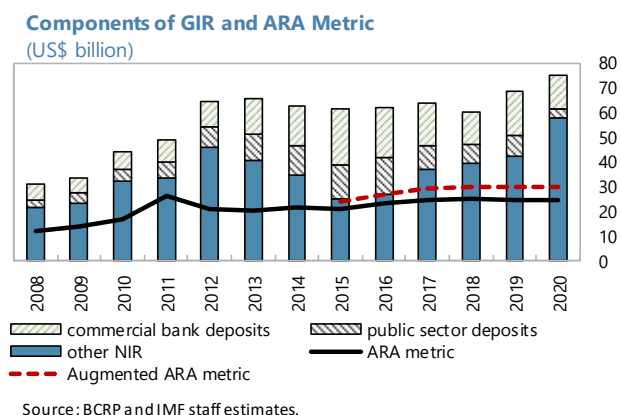
- 1. The current account balance narrowed sharply in 2020 as the COVID-19 shock took effect.** The current account deficit was 1.5 percent of GDP in 2019 (as compared to 1.7 percent in 2018). Dramatic shift in the first nine months of 2020 included a collapse of trade volumes, commodity price volatility, and unprecedented low levels of profit repatriation, on balance leading to a near zero deficit. The contraction of exports owed to a combination of supply and demand factors, notably the restriction of most economic activities, including mining, especially in Q2, and the fall of most of Peru's export prices, including copper, partially compensated by favorable prices for gold. Tourism related services registered unprecedented low levels. The decline of imports was sharpest for intermediate goods in part due to lower fuel prices.
- 2. Both commodity exports and imports recovered strongly in Q4 with the partial reopening of the economy and favorable terms of trade.** According to preliminary data the current account registered a surplus of 0.5 percent of GDP for the year of 2020, helped also by temporarily higher current transfers due to income tax proceeds from the sale of shares of Luz del Sur electric power distribution company to China Three Gorges Corporation. As recovery takes effect, imports are expected to rebound strongly in part driven by projected larger public spending in 2021-21 and gradual recovery of private demand. Exports are also expected to rebound, helped by favorable prices, albeit at a slower pace. Over the medium term, the current account deficit is expected to stabilize at about 1.8 percent of GDP.
- 3. The REER has increased somewhat in 2019 and 2020.** The average REER in 2019 was 2.3 percent stronger than in 2018 and in 2020 it strengthened by another 1.6 percent y-o-y, mostly driven by nominal depreciation while relative prices stayed broadly stable. The 12-month average REER as of end- 2020 was about 5 percent higher than the 20-year average.
- 4. The capital and financial account in 2020 was dominated by public sector borrowing as private sector flows diminished sharply.** The impact of the COVID-19 chock was felt most dramatically on FDI inflows, which declined by 67 percent in year-on-year. At the same time, external borrowing by the private sector including MLT loans, portfolio investment and ST borrowing stayed at broadly similar levels to last year. The foreign borrowing by the public sector was substantial and included large bond issuances of US\$3 billion in April and US\$4 billion in November.

5. Peru's IIP is characterized by large foreign reserves, moderate external debt and large FDI liabilities. After improving from a minimum of -54 percent of GDP in the late 90s to -24 percent of GDP in 2011, Peru's IIP has been on a declining trend, driven by the accumulation of FDI liabilities. As of end-2019 Peru's external assets were (57.1 percent of GDP) including sizeable holdings of foreign assets by the central bank (29.6 percent of GDP). The assets are offset by large FDI liabilities (50 percent of GDP), moderate external indebtedness (public and private external debt of 35 percent of GDP) and other liabilities (9.5 percent of GDP). In 2020 the large increase in central bank assets was offset by large fiscal borrowing and other flows, leaving the IIP balance in dollar terms largely unchanged. These developments are expected to be short-lived and the IIP is projected to stay broadly stable in percent of GDP in the medium term.

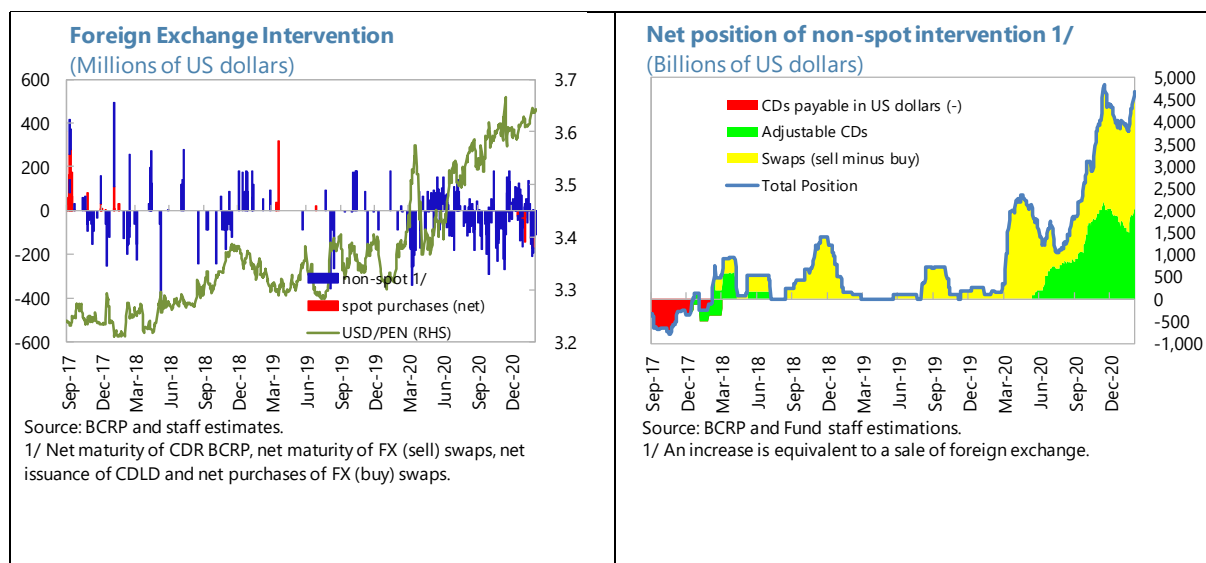




6. Peru’s international reserve coverage exceeds adequacy metrics. Gross international reserves were US\$74.9 billion (estimated 37.4 percent of GDP) at end-2020, or 307 percent of the ARA metric, well above the 100–150 percent adequacy range. Reserves also exceed an augmented ARA metric that incorporates the volatility of copper and gold prices and Peru’s heavy reliance on commodity exports. Reserves also exceed the augmented metric even after subtracting large FX liabilities to the banking sector (reserve requirements and deposits from de-dollarization swaps).



7. The BCRP has been active in the foreign exchange market to smooth the volatility caused by recent shocks, but as before, it does not target a specific level of the exchange rate. While the central bank stepped in to smooth the volatility at the outset of the COVID-19 and during later episodes of significant market pressure, the intervention was limited, and the sol continued to depreciate along with other regional currencies. More recently, interventions were aimed at calming the markets in the context of the heightened political uncertainty surrounding the impeachment of the president followed by the resignation of his newly sworn-in successor after public protests. Overall, in 2020 the BCRP has sold US\$4billion (about 2 percent of GDP) in the non-spot market, including swaps and adjustable CDs. Interventions in the spot market were limited, with net of close to zero.



Assessment

8. Based on preliminary estimates, the external position in 2020 is assessed as moderately stronger than implied by fundamentals and desirable policies. The EBA current account model estimates a current account norm of -2.4 percent of GDP. After excluding the one-off tax payment of about 0.3 percent of GDP due to foreign sales of shares of a domestic corporation, the current account was cyclically adjusted considering the output and the terms of trade gaps, arriving at -1 percent of GDP. Thus, the overall CA gap is about 1.4 percent of GDP pointing to an external position in 2020 that was moderately stronger than implied by fundamentals and desirable policy settings. Out of the CA gap of 1.4 percent of GDP, policy gaps account for 1 percent of GDP. This is explained by stronger fiscal balances compared to the rest of the world, implying that a more supportive fiscal policy, as recommended by staff, would have helped reduce the policy gap. REER models point to different results than the CA model: an external position moderately weaker than fundamentals in case of the REER index model and weaker in case of the REER level model. Normally, the CA regression-based approach is more reliable for Peru and therefore the assessment places more weight on this approach. Nevertheless, it needs to be emphasized that, given the unprecedented year of 2020, uncertainty around these estimates is very high.

Current Account and REER Gaps, 2020 (Percent of GDP, unless stated otherwise)			
	CA regression	REER (index)	REER (level)
Actual CA	0.5	..	..
Actual CA, adjusted for one-off factor:	0.2		
Cyclically adjusted CA	-1.0	..	..
Cyclically adjusted CA norm	-2.4	..	..
CA gap 1/	1.4	..	..
o/w Policy gaps	1.0	..	..
Elasticity	-0.2		
REER gap (in percent) 2/	-6	5.6	12.1

Source: IMF staff estimates.
1/ CA gap is cyclically adjusted CA minus CA norm.
2/ Positive value indicates overvaluation.

Annex VII. Risk Assessment Matrix¹

	Likelihood	Time horizon	Impact	Policy Advice ²
Domestic Risks				
<p>Unexpected shift in the COVID-19 pandemic. The disease proves harder to eradicate (e.g., due to vaccines' ineffectiveness and difficulties in distribution), requiring more containment efforts and impacting economic activity directly and through persistent behavioral changes (prompting costly reallocations of resources).</p>	Medium	ST	<p>H (↓) Peru is vulnerable to a prolonged pandemic owing to low capacity in the health system and delays in vaccination plans. Repricing of risk assets and financial market volatility may lead to capital outflows and depreciation pressures. Lower external demand due to disruption of trade and global value chains would further reduce growth.</p>	<p>Countercyclical policies should be recalibrated to mitigate the impact of the larger or more prolonged shock, building on the lessons learned so far. In addition to protecting the vulnerable, policies should focus on limiting scarring and facilitating adjustment to the new normal.</p>
<p>Widespread social discontent and political instability ahead of general elections in 2021. Tensions between executive and legislative powers continue; requests of higher wages and better working conditions lead to industrial conflict; and demands for a new Constitution intensify.</p>	Medium /Low	ST, MT	<p>M/H (↓) Political uncertainty and industrial conflict could stifle investment and economic recovery in the short-term (probability: M; impact: M). A constitutional reform that undermines policy frameworks underpinning prudent policies could have significant medium-term implications (probability: L; impact: H).</p>	<p>Continue institutional reforms and strengthen anticorruption institutions. Use policy space (particularly fiscal) if necessary. Persevere with structural reforms, especially those aimed at increasing investment potential and improving framework for PPPs.</p>
<p>Faster execution of public investment. Recent changes may have improved the speed of execution as shown by the rapid growth of capital spending in the second part of 2020.</p>	Medium	ST, MT	<p>M (↑) The rapid execution of investment in the health sector would help address the needs related with the pandemic while stimulating domestic demand.</p>	<p>Countercyclical policies should be recalibrated. In the medium term, the ability to mobilize public investment rapidly would increase the effectiveness of fiscal policy.</p>

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. 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.

External Risks				
<p>Accelerating de-globalization. Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation (globally). Reshoring and less trade reduce potential growth.</p>	High	MT	<p>H (1) Given its high exposure to international trade, Peru would be strongly affected. Falling commodity prices and export volumes would lead to a decline of potential growth.</p>	<p>The exchange rate should be allowed to adjust in response to permanent real shocks. Structural reforms should be accelerated to mitigate the decline in potential.</p>
<p>Sharp rise in risk premia that exposes financial vulnerabilities. An abrupt reassessment of market fundamentals (e.g., in response to adverse COVID-19 developments or a premature withdrawal of policy support) triggers widespread risk-off events. This exposes financial vulnerabilities that have been building up in the aftermath of COVID-19, including in sectors that are no longer viable after the pandemic. Risk asset prices fall sharply, leading to significant losses in major financial institutions. Higher risk premia generate debt service and refinancing difficulties for leveraged firms and households, and a wave of bankruptcies further erode banks' capital buffers. Financing difficulties extend to vulnerable sovereigns, in the case of Emerging and Frontier Markets leading to capital outflows, depreciation pressures, and cascading debt defaults.</p>	Medium	ST	<p>M (1) Peru is vulnerable to a sudden exit of foreign investors, which hold a large share of its sovereign bonds. This risk is mitigated by its large policy buffers, including the FCL and a dollar repo line with the NY Fed, and the financial sector can absorb major shocks.</p>	<p>The central bank should use all its tools to provide liquidity both in soles and dollars as needed and maintain financial markets functioning. Exchange rate interventions could be used to prevent excessive volatility but their rationale should be clearly communicated. Avoiding a premature withdrawal of fiscal policy support, accompanied by a clear path of return to the fiscal rules in the medium term, would help maintain confidence.</p>
<p>Unexpected shift in the COVID-19 pandemic. Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity.</p>	Medium	ST	<p>H (1) Given its high exposure to international trade, Peru would strongly benefit. Rising commodity prices and export volumes would provide an impulse to growth.</p>	<p>Countercyclical policies should be recalibrated, and policy stimulus could be withdrawn sooner than expected.</p>

<p>Higher frequency and severity of natural disasters related to climate change cause severe economic damage, reduces GDP, and prompts a recalculation of risk and growth prospects.</p>	<p>Medium</p>	<p>ST, MT</p>	<p>M (↓) Peru is vulnerable to extreme weather events (El Niño) with large adverse impacts on human life, economic activity, and fiscal costs.</p>	<p>Preparedness in the immediate aftermath and building resilience in economic activities and infrastructure would reduce the medium-term impact. Countercyclical policies should be deployed as needed.</p>
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Annex VIII. Public Debt Sustainability Analysis

The public debt sustainability analysis (DSA) indicates that Peru's public debt is expected to remain sustainable given the projected recovery of the economy in the medium term, and a gradual withdrawal of the fiscal impulse deployed to attend the COVID-19 health emergency. Under the baseline scenario, the public debt-to-GDP ratio is forecast to stabilize at about 38 percent of GDP in over the medium term. Gross financing needs are expected to average about 5 percent of GDP over the forecast horizon. While historical projections have been optimistic, medium term projections are conservative. Nonetheless, a negative growth shock represents one of the major risks to the debt outlook. An elevated share of public debt held by non-residents stands out as the main debt profile risk, along with moderate external financing requirements risks.

Background

1. The last DSA for Peru assessed the country's public debt as sustainable with a high probability (see Country Report 20/181). The COVID-19 pandemic triggered a large policy response in 2020 that triggered an increase in the Non-Financial Public Sector (NFPS) deficit to 8.8 percent of GDP in 2020, from 1.6 percent of GDP in 2019. Public debt rose by about 8.3 percentage points to 35.4 percent of GDP in 2020. The fiscal deficit is expected to decline to 5.0 percent of GDP in 2021, as some of the COVID-19 transitory measures are phased out. The debt-to-GDP ratio would peak at about 38 percent of GDP in 2025 and fall slowly thereafter.

2. Peru's strong track record of credit worthiness has allowed it to maintain access to both local and international capital markets. The bulk of the government's borrowing requirement is sourced from a highly liquid domestic market, with external public debt representing around 40 percent of the total. About 90 percent of the debt is marketable and contracted at fixed rates, with a half-life of 12 years (above the median for EMs).¹ Peru's sovereign debt is rated investment grade by all major rating agencies. The credit rating sits comfortably above speculative grade (1 full grade in the case of Moody's, and two notches above in the case of S&P and Fitch). Moody's and S&P have qualified the outlook as stable. Fitch downgraded the outlook to negative on concerns over political instability stalling progress on reforms and curbing economic growth on December 2020.

Baseline Scenario

3. The baseline scenario is built on two main assumptions. First, the COVID-19 health emergency is expected to remain broadly contained until a vaccine or treatment is broadly deployed, and any health policies to address emerging outbreaks would have a limited impact on economic activity. Second, a return to the pre-COVID-19 targets of the fiscal rules would occur outside the forecast horizon (2021-26). Other main parameters of the macroeconomic framework are summarized below.

¹ Excluding the century bond issued in November 20, 2020.

- **Real GDP Growth.** Real output growth is anticipated to recover strongly in 2021-22 reflecting a post-pandemic rebound. Afterwards, real GDP growth would converge gradually to potential GDP growth. The level of real GDP would reach pre-pandemic levels by end-2022. A large negative output gap is expected to close by end-2024.
- **Consumer prices and GDP deflator.** Consumer price inflation and the GDP deflator are expected to remain anchored at about 2 percent over the forecast horizon
- **Fiscal strategy.** The baseline scenario assumes a gradual fiscal consolidation is in place. The primary deficit is anticipated to progressively narrow from 7.2 percent of GDP in 2020 to reach balance in 2026. New debt issuances are assumed to principally consist of domestic currency debt, in line with the authorities' medium-term debt management strategy of mitigating exchange rate, interest rate, and rollover risks.
- **Current Account.** The current account deficit is expected to average 1.2 percent of GDP over the medium term. The external accounts are anticipated to remain balanced, secured by continued market access to international capital markets and support from FDI.

Public DSA Assessment

4. Public-sector debt dynamics are sustainable with a high probability both under the baseline and historical scenarios (Figure 1 and Figure 2). Under the baseline scenario, the public debt-to-GDP ratio is expected to reach its peak of about 38 percent of GDP in 2025, where after it would decline gradually. The reduction in the primary deficit will be partly offset by a negative interest rate and real GDP growth differential. Under the historical scenario (where real GDP growth, the primary balance, and real interest rates are set at their historical average while other variables are the same as in the baseline) the debt ratio would peak outside the forecast horizon.

5. The baseline scenario is realistic for purposes of the DSA (Figure 3). An analysis of staff's forecast errors shows that while estimates of real GDP growth have tended to be optimistic, these have reflected unexpected shocks such as the commodity price downturn in 2014-2016 and climate-related natural disasters. Partly addressing any potential bias, staff's real GDP growth forecast is below both the consensus and the authorities' forecasts for 2021. On the other hand, the primary balance, and inflation (deflator) forecast errors have been closer to the median for all countries. Finally, the projected fiscal consolidation underpinning the debt burden trajectory looks realistic.

Stress Tests and Distribution of Risks

6. Standardized stress tests reveal that the public debt ratio is likely to remain at manageable levels over the forecast horizon (Figure 4). In all cases, the debt ratio remains below the 70 percent of GDP benchmark for EMs. The assessment is further confirmed by a probabilistic analysis of the uncertainty surrounding the baseline scenario, as indicated by the Fan Charts.

- **Real GDP growth shock.** Lower real output growth than in the baseline by one standard deviation for 2 years starting in 2021 would take the public debt level towards 55 percent of GDP and public gross financing needs of about 7 percent of GDP over the medium term.
- **Real interest rate and real exchange rate shock.** Simulations of a 200bp increase in real interest rates or a 20 percent depreciation of the exchange rate yield similar results. Any of these events would take the public sector debt level to about 44 percent of GDP in 2026. Gross financing needs would stand at about 5.1 percent of GDP through 2026.
- **Primary balance shock.** Fiscal slippage in the form of a deterioration in the primary balance of an additional cumulative 3 percent of GDP over the 2021-26 period would take the debt ratio to about 46 percent of GDP in 2026. Public gross financing needs would remain at about 6.1 percent of GDP during 2021-26.
- **Combined macro-fiscal shock.** A single scenario that combines the above-mentioned shocks would imply a debt ratio of about 60 percent of GDP by 2026. The ratio of public debt to revenue, and public gross financing needs would remain at elevated levels over the medium term.
- **COVID-19 contingent liabilities shock.** Under the baseline scenario, a fifth of the guarantees issued under *Reactiva Perú* will be called, amounting to 1.8 percent of GDP during the 2021-23 period. A doubling of the expected rate of materialization of these contingent liabilities issued under *Reactiva Perú*, along with lower real GDP growth by 0.5 percentage points, would keep the public debt ratio over 46 percent of GDP by 2025.

7. The risk assessment shows that debt profile vulnerabilities are limited. Risks arise mostly from a high share of public debt held by non-residents, as the corresponding risk indicator is close to the upper early warning threshold. Meanwhile, moderate risks arise from the share of public debt in foreign currency and external financing requirements, which could give rise to concerns over financial stability in the case of large exchange rate adjustments (Figure 5).

Conclusion

8. Peru's public-sector debt level is sustainable with a high probability. The debt sustainability analysis is broadly positive. Debt is unlikely to exceed 70 percent of GDP over the medium term, including in the event of large shocks to key macroeconomic variables. However, in the absence of fiscal consolidation an adverse shock could take the debt ratio close to the 70 percent of GDP benchmark. The main sources of risk arise from the high proportion of public debt held by non-residents and real GDP growth shocks. Moderate risks from the share of public debt in foreign currency and external financing requirements are emerging.

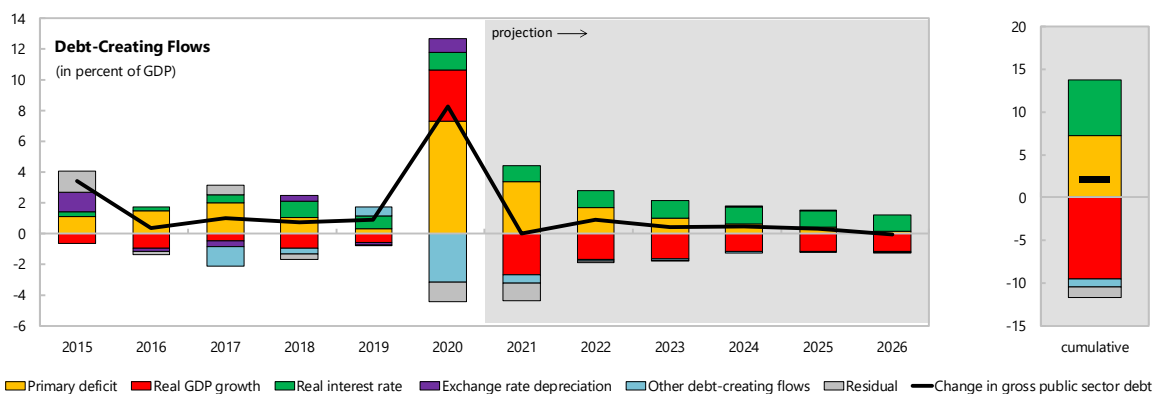
Figure 1. Peru: Public Debt, Economic and Market Indicators¹
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators^{1/}

	Actual			Projections						As of February 08, 2021	
	2010-2018 ^{2/}	2019	2020	2021	2022	2023	2024	2025	2026	Sovereign Spreads	
Nominal gross public debt	23.4	27.1	35.4	35.4	36.2	36.7	37.2	37.5	37.4	EMBIG (bp) 3/	136
Public gross financing needs	2.3	4.1	9.2	5.4	4.3	4.4	4.8	4.6	5.9	5Y CDS (bp)	55
Real GDP growth (in percent)	4.8	2.2	-11.1	8.5	5.2	4.8	3.4	3.3	3.3	Ratings	Foreign Local
Inflation (GDP deflator, in percent)	2.9	2.1	1.8	2.0	2.0	2.0	2.0	2.0	2.0	Moody's	A3 A3
Nominal GDP growth (in percent)	8.2	4.0	-7.5	14.4	7.1	6.5	5.0	4.9	5.1	S&Ps	BBB+ A-
Effective interest rate (in percent) ^{4/}	5.3	5.5	5.5	5.5	5.4	5.4	5.2	5.1	5.0	Fitch	BBB+ BBB+

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026		
Change in gross public sector debt	-0.2	0.9	8.3	0.0	0.9	0.4	0.5	0.3	-0.1	2.0	
Identified debt-creating flows	-1.2	1.0	9.5	1.2	1.0	0.4	0.5	0.3	0.0	3.3	
Primary deficit	-0.5	0.3	7.3	3.3	1.7	1.0	0.6	0.4	0.1	7.2	-0.2
Primary (noninterest) revenue and grants	25.7	24.7	22.0	22.3	23.0	23.0	23.1	23.2	23.2	137.8	
Primary (noninterest) expenditure	25.2	25.0	29.3	25.6	24.7	24.0	23.7	23.6	23.3	145.0	
Automatic debt dynamics ^{5/}	-0.4	0.1	5.4	-1.7	-0.6	-0.5	-0.1	-0.1	-0.1	-3.0	
Interest rate/growth differential ^{6/}	-0.6	0.3	4.5	-1.7	-0.6	-0.5	-0.1	-0.1	-0.1	-3.0	
Of which: real interest rate	0.5	0.8	1.2	1.1	1.1	1.1	1.1	1.1	1.0	6.5	
Of which: real GDP growth	-1.1	-0.6	3.3	-2.7	-1.7	-1.6	-1.2	-1.1	-1.2	-9.5	
Exchange rate depreciation ^{7/}	0.1	-0.2	0.9	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.3	0.6	-3.2	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-1.0	
General government net privatization proceeds (negative)	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	
Use of stabilization fund	-0.3	0.6	-3.2	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-1.0	
Residual, including asset changes ^{8/}	0.9	-0.1	-1.3	-1.2	-0.1	0.0	0.0	0.0	0.0	-1.2	



Source: IMF staff calculations.

1/ Public sector is defined as non-financial public sector.

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).

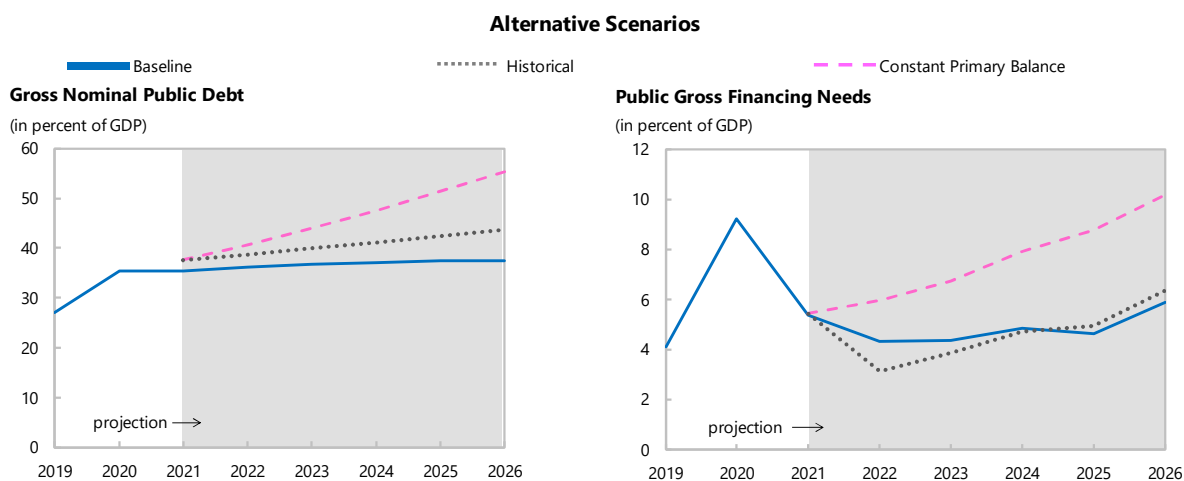
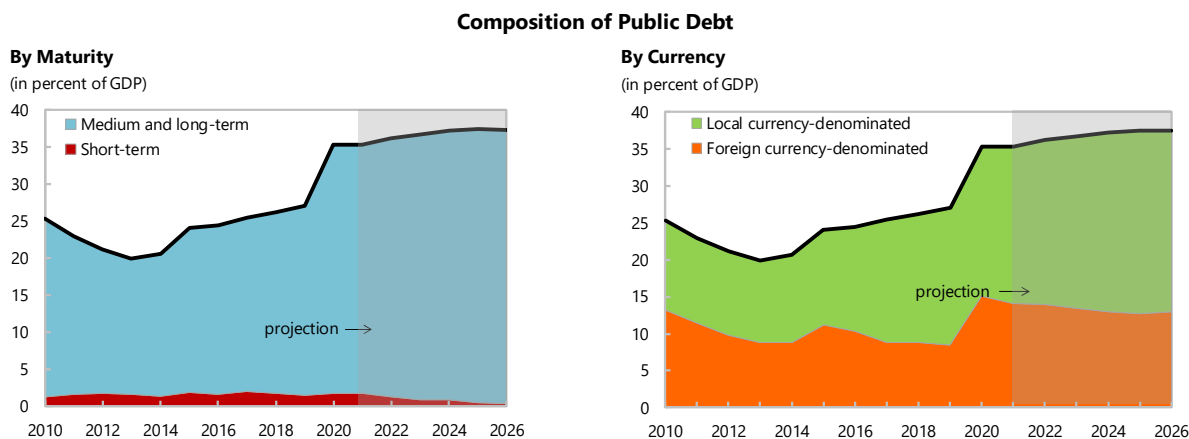
6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

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

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

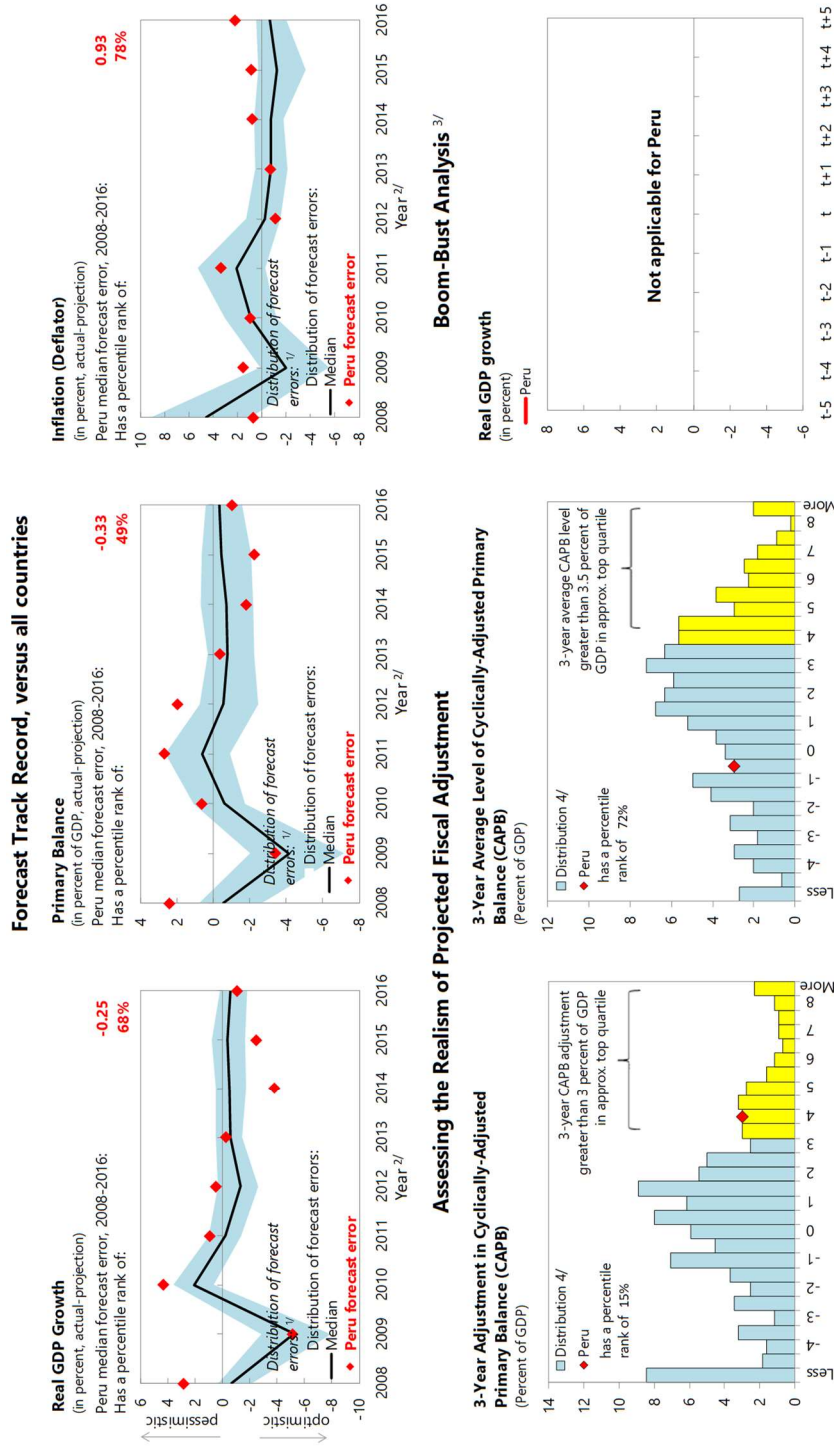


Underlying Assumptions (in percent)

	2021	2022	2023	2024	2025	2026
Baseline Scenario						
Real GDP growth	8.5	5.2	4.8	3.4	3.3	3.3
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary Balance	-3.3	-1.7	-1.0	-0.6	-0.4	-0.1
Effective interest rate	5.5	5.4	5.4	5.2	5.1	5.0
Constant Primary Balance Scenario						
Real GDP growth	8.5	5.2	4.8	3.4	3.3	3.3
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary Balance	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
Effective interest rate	5.5	5.3	5.2	5.0	4.8	4.7
Historical Scenario						
Real GDP growth	8.5	2.5	2.5	2.5	2.5	2.5
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary Balance	-3.3	-0.4	-0.4	-0.4	-0.4	-0.4
Effective interest rate	5.5	5.3	5.3	5.0	4.8	4.6

Source: IMF staff calculations.

Figure 3. Peru: Public DSA – Realism of Baseline Assumptions



Source: IMF Staff

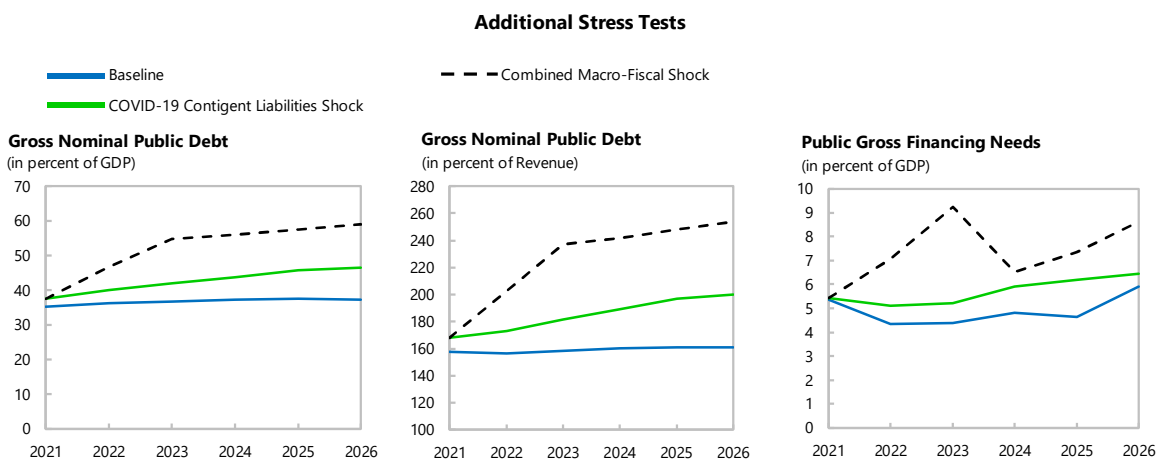
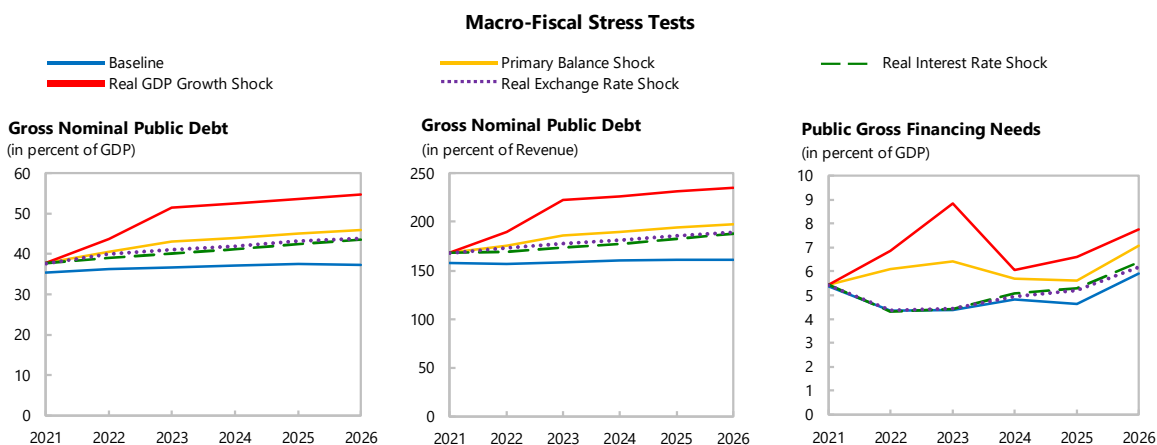
1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Peru, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. Peru: Public DSA – Stress Tests



Underlying Assumptions (in percent)

	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	8.5	5.2	4.8	3.4	3.3	3.3
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary balance	-3.3	-3.2	-2.5	-0.6	-0.4	-0.1
Effective interest rate	5.5	5.3	5.3	5.1	5.0	4.9
Real Interest Rate Shock						
Real GDP growth	8.5	5.2	4.8	3.4	3.3	3.3
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary balance	-3.3	-1.7	-1.0	-0.6	-0.4	-0.1
Effective interest rate	5.5	5.3	5.5	5.5	5.5	5.6
Combined Shock						
Real GDP growth	8.5	0.1	-0.3	3.4	3.3	3.3
Inflation	2.0	0.7	0.7	2.0	2.0	2.0
Primary balance	-3.3	-4.1	-5.0	-0.6	-0.4	-0.1
Effective interest rate	5.5	5.6	5.4	5.4	5.5	5.5
Real GDP Growth Shock						
Real GDP growth	8.5	0.1	-0.3	3.4	3.3	3.3
Inflation	2.0	0.7	0.7	2.0	2.0	2.0
Primary balance	-3.3	-4.1	-5.0	-0.6	-0.4	-0.1
Effective interest rate	5.5	5.3	5.3	5.2	5.0	4.9
Real Exchange Rate Shock						
Real GDP growth	8.5	5.2	4.8	3.4	3.3	3.3
Inflation	2.0	6.8	2.0	2.0	2.0	2.0
Primary balance	-3.3	-1.7	-1.0	-0.6	-0.4	-0.1
Effective interest rate	5.5	5.6	5.2	5.0	4.8	4.7
COVID-19 Contingent Liabilities Shock						
Real GDP growth	8.5	4.7	4.3	2.9	3.3	3.3
Inflation	2.0	2.0	2.0	2.0	2.0	2.0
Primary balance	-3.3	-1.7	-1.0	-0.6	-0.4	-0.1
Effective interest rate	5.5	5.3	5.3	5.0	4.9	4.7

Source: IMF staff.

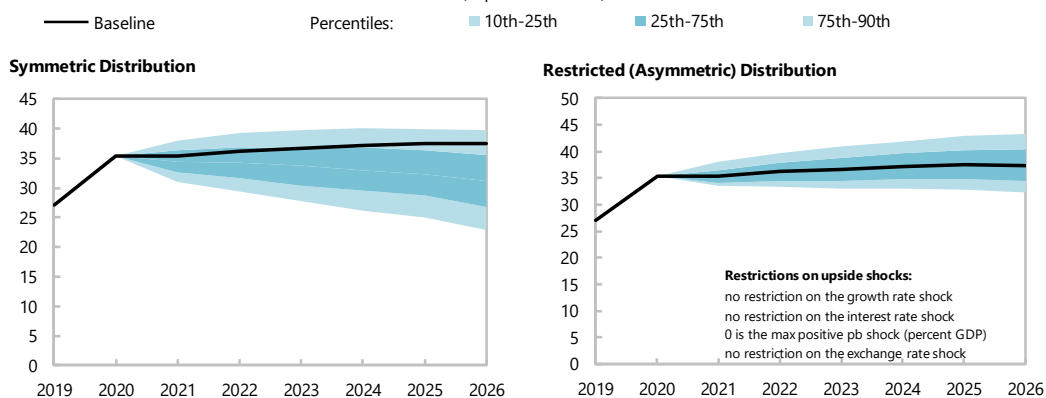
Figure 5. Peru: Public DSA - Risk Assessment

Heat Map

Debt level ^{1/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs ^{2/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile ^{3/}	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

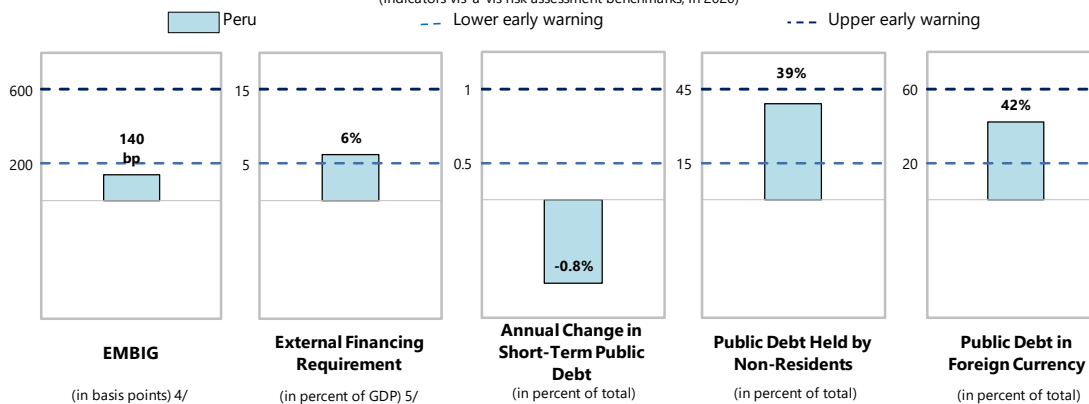
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

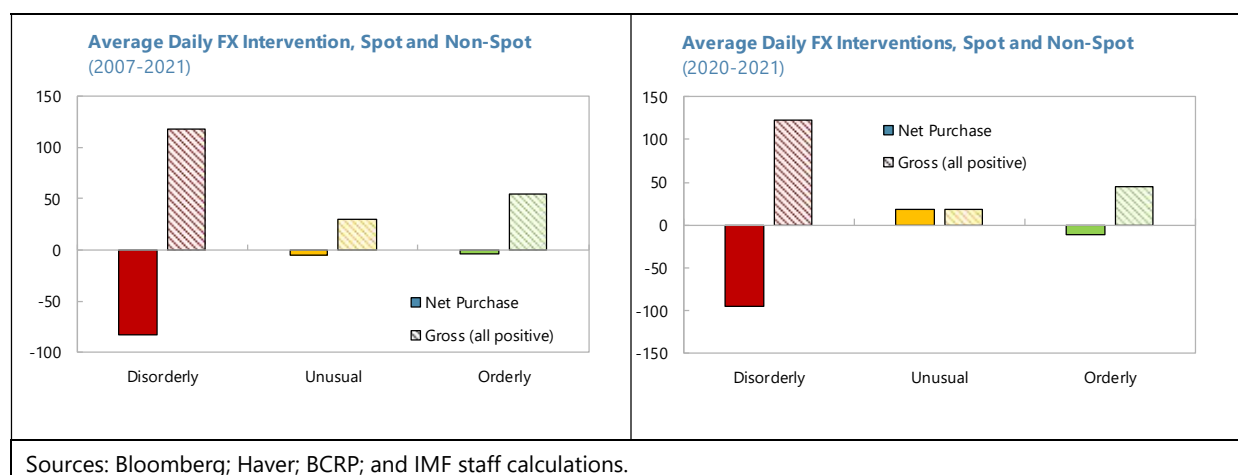
4/ EMBIG, an average over the last 3 months, 10-Nov-20 through 08-Feb-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex IX. Foreign Exchange Intervention—Controlling Exchange Rate Volatility to Preserve Financial Stability

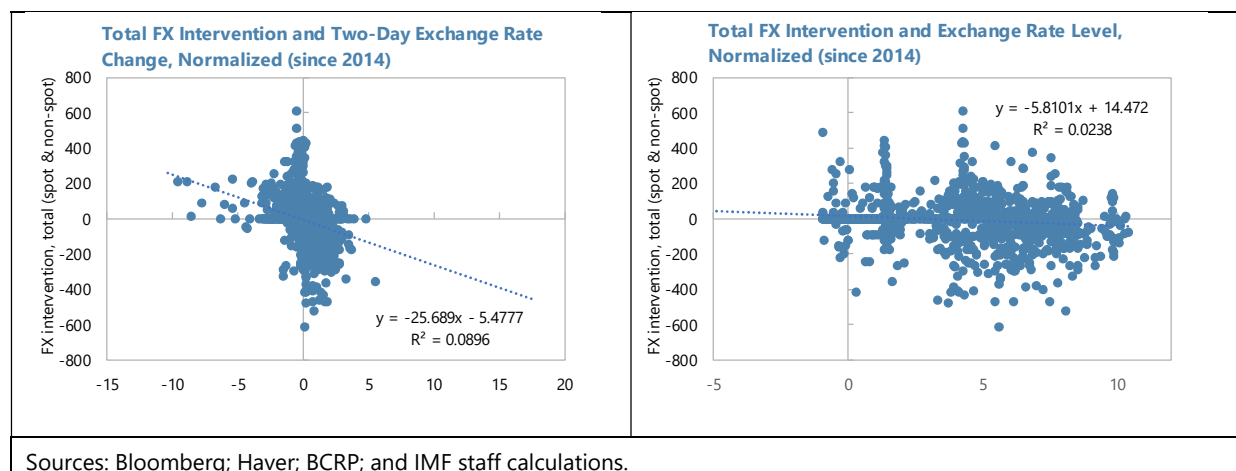
1. Since abandoning the exchange rate peg in 1990, the Central Reserve Bank of Peru has been intervening in the foreign exchange market to smooth volatility. Over the years, the macroeconomic policy frameworks evolved substantially, especially with the adoption of inflation targeting in 2002, but the strong focus on the exchange rate and financial stability has persisted. The key rationale for limiting exchange rate volatility stems from financial dollarization, which implies that due to balance sheet mismatches, large depreciations can cause financial instability, leading in turn to macro instability and these negative effects can outweigh the beneficial effects of expenditure switching. Comparisons of Peru’s macroeconomic performance in terms of inflation and output with that of other EMEs suggests that the multi-instrument framework has worked well.¹ At the same time, it is important to continuously assess policy trade-offs and costs and benefits of active discretionary FX interventions in light of the evolution of the structural characteristics of the economy as well as in the context of various external shocks.

2. A large share of FXI in Peru can be explained by standard metrics of disorderly market conditions. Average daily interventions have been much higher when market conditions were disorderly. Still, gross interventions data suggest that the BCRP tends to be active on the FX market also on days when markets are not disorderly, although less so in the most recent past (text chart). In part, this may reflect the “proactive” approach of the BCRP in that, in the face of uncertainty about the permanent or transitory nature of shocks, it opts to respond to all shocks.² Looking at specific financial market variables that characterize market conditions, it appears that FXI has been correlated with unusual changes in the exchange rate but not with unusual levels (text chart).

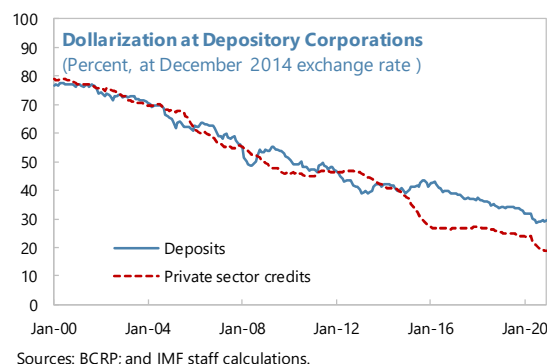


¹ Peru. Selected Issues, IMF 2020

² Armas, A. and M. Vega “Peru: Foreign Exchange Intervention under Financial Dollarization” Chapter 12 in “Foreign Exchange Intervention in Inflation Targeters in Latin America”, IMF, 2019.



3. Dollarization has come down significantly over the past decades, but progress may be slower in the future. The growing credibility of macroeconomic policies as well as targeted measures, such as higher reserve requirements for foreign currency liabilities, have led to impressive reduction of financial dollarization. Nevertheless, the history of hyperinflation has left some persistent scars, manifested for example in the widespread dominant currency pricing not just for exports but also for domestic activities, especially for productive inputs. On the institutional level, the right to have deposits in US dollars as well as in domestic currency is enshrined in Peru's constitution, unlike in many EME peers. These factors suggest that some level of entrenched dollarization may need to be tolerated over the medium term, with ensuing implications for the appropriate degree of foreign exchange interventions.



4. The transparency of Central Bank's actions has contributed to its credibility, however communication about policy goals and tradeoffs can be improved. Publishing foreign exchange intervention data at daily frequency by BCRP sets as high standard of transparency. The markets have also learned from practice that the Central Bank steps in to reduce volatility of the exchange rate and have learned to adjust their expectations and actions accordingly. While this transparency is commendable, BCRP could go further by explaining the rationale of its actions on the FX front, how they are conditioned by the structural characteristics of the economy and what the policy trade-offs are. Without compromising the discretionary approach to FXI, such communication could be done ex-post, for example by enriching the currently factual discussion of FXI in the BCRP's inflation reports.

Annex X. Implementation of 2018 FSAP Recommendations

Peru: FSAP Key Recommendations	
Recommendations	Status
Systemic Risk and Macprudential 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. New methodologies were developed for countercyclical provisions and capital surcharges for systemic banks. Currently working on the methodology for determining buffers for concentration and interest rate risk. A new provisioning scheme more sensitive to risk has been developed, with a new quantitative impact study planned to be conducted in 2021.
Enhance the monitoring of off-balance-sheet exposures of banks. (SBS) (IT)	Implemented.
Increase foreign currency lending risk weights in line with Basel III guidelines. (SBS) (ST)	In progress. An 8-percent increase in capital surcharges is currently applied to exposures subject to credit exchange rate risk. The SBS is assessing whether additional surcharges are needed.
Introduce new risk-monitoring tools, such as growth-at-risk, systemic risk analysis, and corporate sector stress testing; give enhanced mandate for macroprudential policy to BCRP and SBS; implement Memorandum of Understanding between BCRP and SBS to strengthen coordination. (BCRP/SBS) (ST/MT)	Implemented. The growth-at-risk methodology and granular risk model for corporate debtors have been incorporated in the stress test model. Heat maps for the financial system are included in the Financial Stability Report (FSR; since November 2019). Growth-at-risk monitoring was discussed in the December 2019 Inflation Report and November 2020 FSR. Coordination among the BCRP, MEF, and SBS increased during the pandemic mainly through virtual meetings. Some examples of such coordination are the implementation of the Reactiva Peru and the National Guarantee programs for Financial Intermediaries in May 2020. The authorities believe that the current arrangements are working well, and there is no need to designate a formal committee for macroprudential policy.
Financial Sector Oversight	
Banks	
Amend legal framework to grant SBS powers to exercise full consolidated supervision. (SBS) (MT)	In progress. The draft law for holding companies is in the process of being sent to Congress.
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. Draft law on supervision of holding companies covers issues related to corporate governance and comprehensive risk management issues. The authorities believe that the Consolidated Supervision Regulation already defines the company responsible for the consolidated information.

Peru: FSAP Key Recommendations (continued)	
Recommendations	Status
Implement requirements for recovery and resolution planning for D-SIBs, as well as for financial groups. (SBS) (MT)	In progress.
Strengthen legal protection of all SBS staff in line with international best practice. (MEF) (MT)	Not implemented.
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)	Partly 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. The review of the methodology for activating the cyclical rule and the additional charges for systemic risk was completed. The methodological review of the creation of buffers for individual concentration risk, geographic sector, and economic sector as well as risk propensity was also completed. The methodological review of capital charges for the interest-rate risk in the bank book is in process. Once this last element is completed, a quantitative impact study of the new additional capital scheme will be carried out.
Insurance	
Implement risk-based supervision for all insurers and brokers. (SBS) (ST)	Partly implemented. Risk-based supervision for insurance companies was applied in 2019-2020. The SBS is developing a risk-based supervision model that will be applied to brokers.
Cooperatives	
After passage of law to bring financial cooperatives under supervisory umbrella of SBS, design a deposit-insurance system. (BCRP, MEF and SBS) (MT)	Implemented. The regulation for a deposit-insurance system has been approved. The amount of the coverage and the contribution rates to the Cooperative Deposit Insurance Fund have been approved. The beginning of the collection was scheduled for April 2020, but this was postponed due to the pandemic, initially to July 2020 and then to April 2021.
Crisis Management	
Strengthen crisis preparedness and management arrangements. (MEF, BCRP, SBS, FSD) (MT)	In progress. The measures taken to maintain financial stability during the pandemic have shown that the current crisis management arrangements have worked effectively.
Enhance information-sharing between SBS and FSD. (SBS, FSD) (MT)	In progress. Work is underway to develop a proposal for 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)	Partly implemented. In practice, FSD payouts are carried out within 48 hours.

Peru: FSAP Key Recommendations (concluded)	
Recommendations	Status
Enhance the ELA framework by specifying eligibility and collateral requirements, and by providing for enhanced supervision, to ensure its effectiveness. (BCRP) (ST)	Partly implemented. The BCRP can grant loans of last resort to financial institutions that need short-term liquidity and may not have high-quality collaterals used for repo operations. Coordination between the BCRP and the supervisory authority is not required to provide CRM, but the BCRP shares information with the supervisory authority. In addition to CRM, the BCRP can offer liquidity using repos, for which eligible instruments are announced.
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. A new Companies Authorization Regulation has been prepared that contains clauses on the moral suitability of the shareholders, final beneficiaries, directors, managers, and main officials of companies. Similarly, amendments to the Corporate Governance and Comprehensive Risk Management Regulations (GIR) include clauses on the evaluation of moral suitability. Both regulations have been published. Also, work has been done to modify the General Law of the Financial System to increase the limits on fines.
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. Work is going on to improve Repurchase Agreements related to the temporary transfer of securities in order to give greater dynamism to the public debt market and allow financial institutions to improve their settlement procedures in the secondary market. Currently, regulations for these operations have been approved while a framework contract is being prepared. To facilitate securities loans, a collateral management system is being developed. The Strategy for Global Asset and Liability Management (EGIAP for its acronym in Spanish) aims to strengthen the market for public debt securities in the national currency with medium and long-term maturities. The EGIAP also aims to achieve interconnection with Euroclear. The implementation of phase 2 “Secondary Market Link” would allow all bonds to be euro-clearable and can be registered and settled in the local ICLV, improving investors’ access to this market.
Design reforms to improve the private pension system. (MEF) (ST/MT)	Not implemented. A Multiparty Commission of Congress on the subject has been created. The committee has proposed a reform, which has created confusion about policy intentions.
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

March 1, 2021

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 January 31, 2021)

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	993.12	74.42
Reserve Tranche Position	341.43	25.58

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	609.89	100.00
Holdings	511.80	83.92

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
FCL	May 28, 2020	May 27, 2022	8,007.00	0.00
Stand-By	Jan. 26, 2007	Feb. 28, 2009	172.37	0.00
Stand-By	Jun. 09, 2004	Aug. 16, 2006	287.28	0.00

Projected Payments to the Fund:

	2021	2022	2023	2024	2025
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.07	0.07	0.07	0.07	0.07
Total	0.07	0.07	0.07	0.07	0.07

Exchange Arrangements

Peru has a floating exchange rate arrangement. On January 29, 2021 the average of interbank buying and selling rates was 3.64 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 2019 Article IV consultation was concluded on January 8, 2020 (IMF Country Report No. 20/3).

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	08/12/2019
2019	Revenue Administration	11/13/2019
2019	Public Financial Management (PFM) - MTBF	12/6/2019
2020	Large Taxpayer Units	1/20/2020
2020	Customs – Risk Management	8/9/2020
2020	PFM/Treasury Management and Payments Digitalization	10/14/2020
2020	PFM/Treasury Management: Cash Flow Plans	11/24/2020
LEG		
2017	Strengthening AML/CFT Supervision of the SMV	2/7/2017
STA		

2018	Monetary and Financial Sector Statistics	10/22/2018
2019	Sectoral Accounts	7/15/2019
2020	National accounts (sectoral balance sheets, GDP statistics)	1/16/2020
2020	Follow-up National accounts (sectoral balance sheets, GDP statistics)	4/27/2020
2020	CPI Weights	10/19/2020
2020	Follow-up Sectoral Accounts	11/23/2020

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 January 29, 2021)

General. Macroeconomic statistics are broadly adequate for policy formulation, surveillance, and monitoring. Peru subscribes to the Special Data Dissemination Standard (SDDS) since August 7, 1996. 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 accounts series implementing the *2008 SNA* and using 2007 as the base year. INEI is preparing historical series of the quarterly GDP for the period 1980-2007. Peru has fully developed, with STA assistance, integrated quarterly sectoral accounts and balance sheet statistics (Q1 2014 to Q3 2020) to support domestic policymaking. INEI intends to disseminate these new series unofficially to key users by April 2021; the data will be submitted to the STA on this date and officially to the general public by end of 2021.

Price statistics. The official measure of inflation for Peru 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 represent current expenditure patterns. A national level CPI (December 2011=100) has been published separately since January 2012. INEI started the 2019/20 ENAPREF in May 2019; due to the pandemic the data collection stopped in May 2020. Currently, STA is assisting INEI to estimate the missing data of the 2019/20 ENPREF and compile new weights with this information to rebase the CPI by June 2021. INEI compiles and publishes a WPI for Peru. Ideally, the index would be redeveloped as a PPI with expanded coverage to improve volume estimates in the national accounts.

The BCRP, assisted by STA, has updated since 2018 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. There are four indicators to monitor labor market developments: open unemployment, underemployment, employment, and remunerations. While monthly unemployment, employment and income data for metropolitan area of Lima from INEI are timely, only formal employment data are available from SUNAT, BCRP, and the Ministry of Labor; monthly remuneration data for the government are timely. 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 (ENAHOG). It would be useful to develop competitiveness indicators such as productivity and unit labor cost indexes.

Government financial statistics. Following the GFSM 1986 framework, the Central Bank (BCRP) compiles monthly government finance statistics (GFS) for the general government and its subsectors and quarterly GFS for the nonfinancial public sector and its subsectors; financing information is only available at the nonfinancial public sector level. 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 2014 framework. 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. Authorities are encouraged to resume participation in both the Coordinated Direct Investment Survey (their latest inward data are for 2013 and outward for 2010) and in the Coordinated Portfolio Investment Survey (their latest data pertain to 2017).

Authorities should 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

Peru: Table of Common Indicators Required for Surveillance

(As of January 29, 2021)

	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	1/29/21	1/29/21	D	M	D		Exchange Rates
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	1/15/21	1/22/21	D	M	W		International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹
Reserve/Base Money	1/15/21	1/22/21	W	M	W		Reserve/Base Money Broad Money Central Bank Balance Sheet Consolidated Balance Sheet of the Banking System
Broad Money	12/31/20	1/22/21	W	M	W		
Central Bank Balance Sheet	12/31/20	1/22/21	W	M	W		
Consolidated Balance Sheet of the Banking System	12/31/20	1/22/21	W	M	W	O, LO, LO, LO	
Interest Rates ²	December 2020	1/22/21	D	M	D		Interest Rates ²
Consumer Price Index	December 2020	1/07/21	M	M	M	O, LO, LO, LO	Consumer Price Index
Revenue, Expenditure, Balance and Composition of Financing – Central Government	October 2020	11/21/20	M	M	M	O, LO, O, O	Revenue, Expenditure, Balance and Composition of Financing – CG
Revenue, Expenditure, Balance and Composition of Financing – General Government	Q3/2020	11/21/20	Q	Q	Q	O, LO, O, O	Revenue, Expenditure, Balance and Composition of Financing – GG
Stocks of Central Government and Central Government Guaranteed Debt ³	Q3/2020	11/25/20	Q	Q	Q		Stocks of CG Debt ³
International Investment Position ⁴	Q3/2020	11/25/20	Q	Q	Q		International Investment Position ⁴
External Current Account Balance	Q3/2020	11/21/20	Q	Q	Q	O, LO, LO, LO	External Current Account Balance
Exports and Imports of Goods and Services	Q3/2020	11/21/20	Q	Q	Q		Exports and Imports of Goods and Services

GDP/GNP	Q3/2020	11/21/20	Q	Q	Q	LO, LO, LO, LO	GDP/GNP
Gross External Debt	Q3/2020	11/21/20	Q	Q	Q		Gross External Debt

¹ Every Friday the central bank disseminates daily net international reserves, and weekly International Reserve Assets and Reserve Liabilities.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Including type of instrument, maturity and type of creditor.

⁴ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁵ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

⁶ Reflects the assessment provided in the data ROSC published in October 2003 and *based on* 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).

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.

**Statement by Mr. Chodos and Mr. Hendrick on Peru
March 19, 2021**

Key points

- Peru remains one of the best performing economies in Latin America, maintaining a sustained period of economic growth, low inflation, and poverty reduction for more than two decades.
- Economic growth averaged 4.6 percent from 1999-2019, but the pandemic hit economic activity hard, leading to a temporary recession of 11.1 percent in 2020. However, double-digit growth is expected in 2021 and pre-pandemic levels will be reached in 2022.
- Peru designed a large and comprehensive fiscal, monetary, and financial package, which was essential to contain the impact of the pandemic, save jobs, and provide a lifeline to many small and medium enterprises (SMEs).
- Inflation expectations remain well anchored, and headline inflation in 2021 and beyond is expected to fluctuate around the mid-point of the inflation-targeting range of 1-3 percent.
- The external and fiscal positions are strong, with net international reserves equivalent to 37 percent of GDP in 2020. Fiscal savings accumulated during the peak of the economic cycle, providing a substantial buffer for future shocks and countercyclical policies. The financial system remains very liquid, profitable, and well regulated. The public debt is one of the lowest among emerging markets at 35.0 percent of GDP, despite the substantial fiscal stimulus to address the negative impact of Covid-19.
- These outstanding achievements reflect the authorities' sustained commitment, over more than two decades, to sound macroeconomic policies and structural reforms; accompanied by social policies to ensure that the benefits of growth reach all segments of society. The reduction in the poverty rate from near 59 percent in 2004 to 20.2 percent in 2019 illustrates the progress in social and financial inclusion.
- The main challenges ahead are how to sustain the economic recovery in the near term, and how to boost potential growth in the medium term, given the uncertainty related to post-pandemic recovery and the evolution of commodity prices. Second and third generation structural reforms are being assessed to boost productivity, enhance the social safety net, and ensure a sustainable and equitable economic growth.

INTRODUCTION

1. **Our Peruvian authorities would like to express their gratitude to Mr. Leo Bonato and his team for the open and constructive policy dialogue and for their excellent work.** The staff report (SM/21/20) provides a fair and well-balanced description and analysis of recent economic developments and policy discussions. We appreciate the focus of the consultation on the authorities' strategy to deal with the economic impact of the pandemic and the remaining challenges to resume a path of steady and inclusive economic growth. Our authorities are in broad agreement with the staff's assessment and policy recommendations, and they consent to the publication of the report.
2. **Peru entered the pandemic with very strong fundamentals, large policy buffers, and solid institutional policy frameworks.** By end-2019, public debt was equivalent to 26.8 percent of GDP, one of the lowest levels in the region and in the world. Public finance was in good standing and the fiscal deficit was in line to converge to the fiscal rule of 1.0 percent in the medium term. Steady economic growth contributed to a low unemployment rate of 6.6¹ percent. International reserves reached US\$68.4 billion in 2019, equivalent to almost 500 percentage of short-term external debt defined on a residual maturity basis and includes amortization of medium and long-term debt. The inflation-targeting framework in place since the beginning of the century resulted in very low, single-digit inflation, reaching 1.9 percent by end-2019. The financial system remained strong and the poverty rate was further reduced to 20.2 percent. These strong initial conditions helped the Peruvian economy navigate the negative impact of the pandemic on the economy, providing support to the poorest segment of the population and SMEs.

COVID-19 IMPACT AND POLICY RESPONSE

3. **The pandemic had a dramatic effect on economic activity, employment, and human lives in 2020.** Peru was one of the first countries in the world to impose a very strict lockdown and curfews in early March 2020, with the main objective to contain the spread of Covid-19, while efforts were undertaken to enhance the capacity of the health system to respond to the pandemic. Unfortunately, as in many developing countries, due to the high share of contact-intensive sectors and limited teleworking capacity, Covid-19 took a heavy toll on lives and livelihoods. The economy fell 30 percent y/y in 2020-Q2, and despite a rebound in the second half of the year, following an easing of restrictions in June and a strong policy response, real GDP growth was -11.1 percent in 2020, a significant setback in economic activity after 20 years of continued and sustained growth of 4.6 percent on average. The unemployment rate doubled to 13.9 percent by end-2020, leading to an increase in informality and some reversal of the hard-won gains in the poverty level.

¹ INEI, Labor Market Indicators for Metropolitan Lima.

Policy Response

4. **The Peruvian authorities designed a large and comprehensive fiscal, monetary, and financial package to contain the impact of the pandemic.** The size of the policy measures, equivalent to 26.6 percent of GDP, was one of the largest in EMEs and about 19.2 percent of the package has already been implemented.
 - a. **The Central Bank of Peru (BCRP) had a rapid and timely response since the beginning of the crisis.** In April 2020 the policy rate was reduced 200 bps to a historic low of 0.25 percent, the lowest in the region. To provide additional liquidity to the system, reserve requirements were lowered, and the maturity of repo operations were extended. The monetary authority also provided foreign currency liquidity to the market during the period of stress. The approval of the Flexible Credit Line (FCL) in May 2020 also helped to reassure markets.
 - b. **In coordination with the Ministry of Finance, the BCRP created the program “Reactiva Perú”, to provide liquidity to small and medium-sized businesses.** These guaranteed-credit repo operations with banks were successful in stimulating credit growth at low interest rates and averting widespread bankruptcies and business closures. The payment chain was maintained, and businesses were able to pay their obligations and survive during the crisis. This facility, together with another program aimed at micro-enterprises, was instrumental in maintaining most of the production capacity in many industries and saved 2.8 million jobs. Out of more than half a million firms that participated in the program, 99 percent of the beneficiaries were small businesses. This fiscal credit guarantee program was equivalent to 9.6 percent of GDP.
 - c. **The large fiscal buffers accumulated in good times allowed a large and broad-based fiscal policy response.** Revenues and expenditure measures amount to 7.4 percent of GDP. Priority was given to support the poorest segment of the population with direct cash transfers to households, wage subsidies to businesses, and direct support to the health system. The authorities are in the process of updating the databases used for cash transfers and social support to improve targeting and effectiveness of the programs.
 - d. **The Financial System Regulator eased macroprudential policies.** Countercyclical capital buffers for financial institutions were reduced, allowing banks to adjust the term of loans to households and enterprises without changing the loan classification. As shown in the Financial Soundness Indicators Heatmap, the financial system remains stable. Top-down stress tests point to a resilient banking system and limited solvency problems even under adverse scenarios.

OUTLOOK

5. **A strong recovery is expected in 2021, with a gradual closing of the output gap and a sustained reduction in unemployment in the medium term.** As reported by staff, many productive sectors in the economy are very close or already reached their pre-Covid levels of production by end-2020. In fact, by the fourth quarter of 2020, Peru's economic activity was one

As of the fourth quarter of 2020, Peru's economic activity is one of the closest to pre-pandemic levels.

Seasonally-adjusted Real Gross Domestic Product
Annual % change

	2019		2020		
	Q4	Q1	Q2	Q3	Q4
Germany	0.4	-2.2	-11.3	-4.0	-3.9
France	0.8	-5.7	-18.8	-3.9	-5.0
Italy	0.1	-5.6	-18.1	-5.1	-6.6
Spain	1.7	-4.2	-21.6	-9.0	-9.1
United Kingdom	1.2	-2.2	-21.0	-8.7	-7.8
USA	2.3	0.3	-9.0	-2.8	-2.5
Argentina ^{1/}	-0.3	-4.6	-19.6	-10.1	-4.8
Brazil	1.6	-1.4	-10.9	-3.9	-1.2
Chile	-2.4	0.4	-14.0	-10.3	-0.5
Colombia	3.3	0.3	-15.9	-8.4	-3.6
Mexico ^{1/}	-0.7	-2.2	0.0	-8.6	-4.6
Peru	1.7	-4.8	-29.7	-9.0	-1.7

^{1/} Fourth quarter's annual % change is estimated using monthly series of economic activity (Argentina) and Estimador Oportuno (Mexico).
Source: Federal Reserve of St. Louis, Eurostat, Office for National Statistics of UK, central banks and statistic institutes

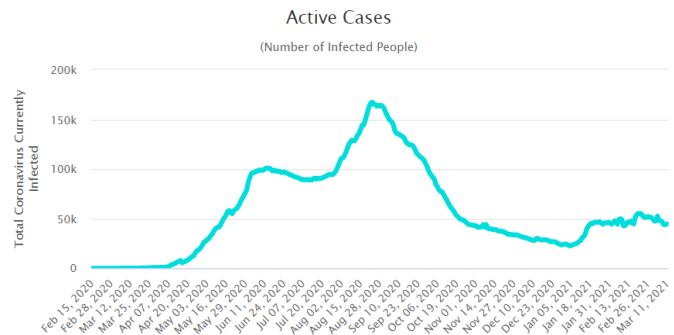
12

of the closest to pre-pandemic levels (see table). Despite a 39.5 percent y/y contraction in employment in the second quarter of 2020, the largest among the main economies of Latin America (LA5), the contraction narrowed to only 6.1 percent by November 2020.² The authorities expect double-digit growth in 2021, led by a strong

recovery in domestic demand, historical high commodity prices, and favorable terms of trade.

6. **A second small wave is affecting 2021 Q1 but it is expected to be short lived.** A new set of measures were announced in late January and in March 2021 to provide further support to the health system and households, as well as a new guaranteed-lending program for SMEs. Early economic indicators suggest that the recovery is firmly on hold. Firms and households have learned how to conduct business while complying with public health guidelines. Peru has already secured vaccines for the whole population. The vaccine rollout began in February 2021 and the vaccination process is expected to speed up with the arrival of higher

Active Cases in Peru



² INEI, Labor Market information for Metropolitan Lima.

quantities. The main engines of growth are fully working (mining, agriculture, construction, etc.) and industries in the services sector are gradually reopening.

7. **We agree with staff that policy buffers are ample, and Peru should be able to cope with additional adverse shocks if downside risks materialize.** Despite the increase in the fiscal deficit, due to cyclical loss of revenues and the large fiscal stimulus, public debt remains low, and international reserves increased to about 37 percent of GDP by end-2020, equivalent to 307 percent of the ARA metric, well above the 100-150 percent adequacy range. The financial system remains resilient and strong. Peru maintains access to international markets with low financing costs and the two-year FCL provides additional reassurance to the markets.

THE ROAD AHEAD

8. **The authorities are working hard to provide the necessary conditions for the economy to resume a strong, sustainable, and inclusive growth.** In the short term, the priority continues to be the enhancement of the health system, a need that is clearly illustrated in Annex II, with further improvements in the social safety net. Much work remains to be done to bring it to at least a level similar to that in peer countries in the region. Support to small businesses will continue, given their impact on job creation, as well as on informality and poverty reduction. For this purpose, on March 9, the government extended the program “*Reactiva Peru*”, providing an additional grace period of one year (payments were scheduled to begin in May 2021) and a period of 36 months for repayment. Public investment in key infrastructure projects will accelerate and large private projects, particularly in the mining sector, will continue, providing an additional boost to economic growth and potential output.
9. **The gradual withdrawal of the fiscal stimulus will be consistent with the authorities’ commitment to fiscal sustainability in the medium term.** The fiscal rule was suspended for 2020-2021 to finance the large policy support demanded by the pandemic. Yet, the fiscal position remains strong, and after a temporary increase in the public debt-to-GDP ratio of 37.5 percent by 2025, it will decline steadily towards the 30 percent target and will remain sustainable under different shocks, as illustrated in the DSA annex. The authorities are monitoring the economic developments and are open to providing additional assistance, as needed, both to households and small businesses. The Fund’s expertise has been requested to identify additional revenue sources.
10. **The BCRP will continue to maintain a supportive monetary policy stance until the economy is on a solid path to recovery.** Inflationary pressures are expected to be in check, given the sizable negative output gap. In its March 2021 forward-guidance, the monetary authority continues to state that easy monetary conditions are likely to persist for an extended period. The BCRP stands ready to take any additional measures as needed. The authorities continue to value exchange rate flexibility as an appropriate shock absorber for a small open economy like Peru. As explained by staff, the exchange rate evolves in line with fundamentals and broadly follows the

same trend, as in peer countries but with less volatility. The monetary authority reiterates that exchange rate policy is sufficiently transparent, including announcing in real time when it runs operation in the FX market, unlike many other EMEs; and publishes same-day information on FX intervention. Moreover, the rationale for intervention is fully explained in official publications, including the Inflation Report.

11. **Peru has made significant progress regarding the recommendations from the 2018 FSAP, as detailed in Annex X.** Despite many challenges and the current Covid-19 crisis, several reforms have been fully or partially implemented, including extending oversight by the regulator to credit unions, enhancing the emergency liquidity assistance framework, and monitoring banks' off-balance-sheet exposures. Some recommendations that require amendments of the banking law are pending, while the administration seeks to build enough political support.
12. **The authorities agree on the importance of additional structural reforms to address the needs exposed by the pandemic.** At the same time, they concur with staff's acknowledgement that sound policies and frameworks in place have underpinned a very strong macroeconomic performance in the last 15 years. The National Plan for Competitiveness and Productivity, launched in 2019, provides a framework to address medium-term issues, such as improving education, enhancing infrastructure, facilitating labor relocation, and further improving the business climate. The implementation of new structural reforms, notably the integrated review of the pension system, will need to wait until a new administration takes office on July 28, 2021.³
13. **Further progress on strengthening governance and anti-corruption was implemented in 2020.** The institutional reforms, approved with the 2019 referendum, are now operational, including the National Board of Justice, and Offices of Institutional Integrity were created in more than 200 public sector entities. The Comptroller's Office monitors emergency-related spending. Several AML/CFT regulations have been issued to guide customer due diligence requirements for politically exposed persons. Asset declarations of public officials have been made publicly available for the last 20 years.

Final Remarks

14. We would like to reiterate our appreciation to Management and staff for their permanent support and critical role as trusted advisor, particularly under the current difficult global circumstances. We take comfort and agree with staff's assessment that Peru's very strong economic fundamentals and institutional policy frameworks continue to provide the basis for a sustained track record of very strong policies, including across electoral cycles and administrations.

³ Peru's Presidential and Congress general elections are scheduled for April 11, 2021. If none of the candidates reach more than 50 percent of eligible votes, a run-off with the two candidates with the highest votes will take place on June 6, 2021.