INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/137

PERU

May 2022

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PERU

In the context of the Staff Report for the 2022 Article IV Consultation, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its April 29, 2022 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on April 29, 2022, following discussions that ended on March 1, 2022, 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 April 13, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Peru.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR22/138

IMF Executive Board Concludes 2022 Article IV Consultation with Peru

FOR IMMEDIATE RELEASE

Washington, DC – May 2, 2022: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Peru on April 29, 2022.

Economic activity in Peru rebounded strongly in 2021 from its deepest downturn in decades. The strong policy response in 2020 help mitigate the impact of the pandemic and created the conditions for a rapid recovery. Progress in the vaccination campaign allowed a gradual lifting of Covid-19 mobility restrictions. Real GDP rose 13.3 percent in 2021, supported by robust external demand, favorable terms of trade, and pent-up domestic demand. Real GDP surpassed its pre-pandemic level but remains below its pre-pandemic trend. Labor force participation and total employment haven't fully recovered. Poverty increased significantly in 2020 and is still above pre-pandemic levels despite some improvement in 2021. Volatility in financial markets has increased amid heightened political uncertainty.

Uncertainty around the outlook is high and the balance of risks is tilted to the downside. Growth is expected to slow to 3 percent in 2022 as external conditions tighten and the policy stimulus is withdrawn. External risks from ongoing geopolitical tensions, a sharp tightening of global financial conditions, extended global supply chain disruptions, and an abrupt growth slowdown in China, Peru's main trade partner could weigh on growth. Domestically, new Covid outbreaks could prompt the reintroduction of containment measures, while political uncertainty and social unrest could weigh on private investment. Inflationary pressures could be more persistent, requiring faster tightening of monetary policy. More rapid progress on containing the pandemic, both globally and domestically, and reduced political uncertainty could result in positive surprises.

Peru's very strong policy frameworks and macroeconomic buffers, further complemented by an FCL arrangement expiring on May 27, will help shield the economy from downside risks. Strong external and fiscal accounts, adequate reserve coverage, access to international capital markets, low public debt, and a resilient financial sector provide Peru with ample buffers to face adverse shocks.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the Peruvian authorities for a decisive macroeconomic policy response, sustained by very strong policy frameworks and buffers, that helped mitigate the impact of the Covid-19 pandemic and

[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.

support a strong economic recovery. Directors noted, however, that the macroeconomic outlook remains uncertain, and external and domestic risks are still elevated. Against this background, they concurred that the policy mix should strike a balance between responding to rising inflation and managing downside risks to growth, as the impact of the pandemic on employment and poverty continues to be reversed. Directors also underscored the importance of maintaining and further strengthening policy institutional frameworks.

Directors agreed that fiscal policy should remain broadly neutral in the short term but a gradual consolidation, encompassing revenue mobilization and expenditure rationalization, including pension reforms, will be necessary to address emerging spending needs while preserving fiscal sustainability. They welcomed the authorities' steps to clarify policy intentions by aligning the fiscal rules and the medium-term budgeting framework, as well as their commitment to strengthen the Fiscal Council with technical assistance from the Fund.

Directors agreed that further tightening of monetary policy is warranted to bring inflation and inflation expectations back to the target range and help adjust to tighter global financial conditions. While foreign exchange intervention is warranted to contain excess volatility, Directors underscored that reducing its frequency would facilitate market development and de-dollarization.

Directors supported the gradual unwinding of pandemic-era prudential policies in a context of limited financial system vulnerabilities. They concurred that closing remaining regulatory and supervisory gaps and further enhancing systemic risk assessment will be important to strengthen financial resilience. Directors noted that exploring the introduction of a central-bank digital currency will require a thorough assessment of risks and costs.

Directors agreed that a renewed structural reform agenda in the context of the OECD accession process will be critical to mitigate scarring from the pandemic and support a green and inclusive recovery. They stressed the importance of addressing informality in the labor market, especially among women. More effective public services and greater transparency, including through civil service reform and anti-corruption measures, as well as a stable and predictable legal and regulatory environment, will be key to these efforts. Steps will also be needed to reduce risks from climate change, ease the transition to a low-emission economy, and contribute to global mitigation efforts.

Peru: Selected Economic Indicators

				Projections		
	2019	2020	2021	2022	2023	2024
Social Indicators						
Poverty rate (total) 1/	20.2	30.1	22.1	...	...	...
Unemployment rate (in percent; average)	6.6	13.9	10.9	...	...	...
	(Annual percentage change; unless otherwise indicated)					
Production and prices						
Real GDP	2.2	-11.0	13.3	3.0	3.0	3.0
Output gap (percent of potential GDP)	-1.6	-7.3	-0.4	-0.3	0.0	0.0
Consumer prices (end of period)	1.9	2.0	6.4	4.0	3.0	2.3
External sector						
Exports	-2.2	-10.6	47.1	16.1	3.4	2.8
Imports	-1.8	-15.6	39.3	17.9	4.7	4.8
External current account balance (% of GDP)	-1.0	0.8	-2.8	-1.5	-1.4	-1.5
Gross reserves						
In billions of U.S. dollars	68.4	74.9	78.5	78.2	77.9	78.9
Percent of short-term external debt 5/	428	487	586	561	537	565
Money and credit 2/ 3/						
Broad money	8.8	29.0	2.6	8.4	6.6	6.6
Net credit to the private sector	6.4	14.0	6.3	8.7	7.8	5.6
	(In percent of GDP; unless otherwise indicated)					

Public sector						
NFPS revenue	24.8	22.0	25.6	24.4	24.3	24.3
NFPS primary expenditure	25.0	29.2	26.6	25.5	25.1	24.5
NFPS primary balance	-0.2	-7.3	-1.0	-1.0	-0.8	-0.2
NFPS overall balance	-1.6	-8.9	-2.6	-2.6	-2.1	-1.5
Debt						
Total external debt 4/	34.7	43.3	46.1	43.5	40.0	37.8
NFPS gross debt 5/	27.1	35.1	35.9	34.4	34.7	34.4
External	8.5	14.9	19.6	20.2	19.4	18.5
Domestic	18.6	20.2	16.3	14.2	15.3	15.9
Savings and investment						
Gross domestic investment	21.0	19.3	21.3	25.1	24.7	24.5
National savings	20.0	20.0	18.6	23.6	23.3	23.0
Memorandum items						
Nominal GDP (S/. billions)	771	717	872	958	1,018	1,070
GDP per capita (in US$)	6,963	6,127	6,643	7,034	7,475	7,748

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/ Includes local currency debt held by non-residents.

5/ Includes repayment certificates and government guaranteed debt.

INTERNATIONAL MONETARY FUND

PERU

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

April 13, 2022

KEY ISSUES

Context. After being hit very hard by the pandemic in 2020, both in terms of health and economic outcomes, Peru experienced an equally strong economic rebound in 2021. A new administration was inaugurated in July 2021 with a program focused on reducing inequality and improving social conditions, but limited support from Congress and lack of cohesion heightened political uncertainty. While real GDP surpassed its pre-pandemic level by 2021, labor force participation and total employment have not fully recovered yet. Poverty increased significantly in 2020 and, despite some improvement in 2021, remains higher than in 2019. On May 27, 2021, the IMF Executive Board completed the mid-term review of Peru's continued qualification under the Flexible Credit Line (FCL) arrangement.

Outlook and Risks. Growth is expected to moderate to 3 percent in 2022 as external conditions tighten and the policy stimulus is withdrawn, and the outlook is very uncertain, with the balance of risks tilted to the downside. Significant external risks, including from the pandemic, the fallout from the war in Ukraine, and the tightening of global financial conditions, are compounded by political uncertainty and rising inflation domestically. Peru's very strong policy frameworks and proven track record, along with large macroeconomic buffers complemented by the FCL arrangement expiring on May 27, should help shield the economy from downside risks.

Policy recommendations. A neutral fiscal stance is appropriate in the short term, but a gradual fiscal consolidation will be required in the medium term to preserve fiscal sustainability. A new medium-term fiscal framework reflecting the required fiscal consolidation and new legally binding rules, consistent with that framework, will support confidence. A medium-term strategy encompassing revenue mobilization and expenditure rationalization will be needed to address spending needs. Further monetary policy tightening is warranted to bring inflation and inflation expectations back to the target range while the tradeoffs of large foreign currency intervention should be considered. A renewed push for structural reforms—including governance and anti-corruption measures—is necessary to mitigate the long-term effects of the pandemic and support a green and inclusive recovery.

Approved By
Patricia Alonso-Gamo (WHD) and Stephan Danninger (SPR)

Discussions were held virtually during February 16 - March 1, 2022. The mission team comprised Leo Bonato (head), Luisa Charry and Etibar Jafarov (WHD), Vassili Bazinas (MCM), and Oana Luca (SPR). Oscar Hendrick (OED) participated in the discussions. Alejandro Santos and Patricia Alonso-Gamo (WHD) joined some of the meetings. The mission met with Minister of Economy and Finance Oscar Graham, central bank Governor Julio Velarde, other senior government officials, and private sector and civil society representatives. Allan Dizioli (RES), Danjing Shen (WHD), Bledi Celiku, Juan José Miranda Montero, Julie Rozenberg, and Christoph Ungerer (The World Bank) provided valuable inputs to the report. Samuel Patino and Nicolás Landeta (WHD) provided administrative assistance.

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ANNEXES

CONTEXT

1. **Strong macroeconomic policies and institutional policy frameworks have helped Peru navigate significant economic shocks in recent years.** Peru attained considerable results in terms of growth and poverty reduction until 2015, sustained by high commodity prices and prudent macroeconomic management. Sound fiscal policies, supported by fiscal rules, have contributed to maintaining low public debt and ample fiscal space. Inflation has been low and stable under the inflation targeting framework while strong supervision and appropriate macroprudential policies have helped preserve financial stability. In the last few years, however, Peru has been buffeted by adverse shocks and political instability, which negatively affected its macroeconomic performance. In 2020, the devastating impact of the Covid pandemic, aggravated by structural weaknesses, led to the deepest economic recession in decades and a considerable increase in poverty. Deploying their considerable policy buffers, the authorities were able to mitigate the impact of the pandemic, maintain market access, and support a strong recovery in 2021. Policies have been broadly in line with Past Fund advice (Annex I).

2. **Political uncertainty has risen.** President Castillo was inaugurated in July 2021, following a contested election, with a program focused on reducing inequality and improving social conditions. His administration lacks a majority in Congress and has been beset by controversy, with multiple cabinet reshuffles and impeachment attempts by Congress. Nonetheless, prospects of rewriting the 1993 constitution —which underpins the high-quality macroeconomic policy framework— have receded. Moreover, the appointment of moderate technocrats as Ministers of the Economy and the confirmation of the central bank Governor have helped reassure financial markets.

3. **On May 27, 2021, the IMF Executive Board completed the mid-term review of Peru's qualification under the FCL arrangement.** The Executive Board reaffirmed that Peru's very strong macroeconomic policies and institutional policy frameworks, sound economic fundamentals, and track record continue to warrant access to FCL resources. The two-year arrangement was approved on May 28, 2020 for an amount of SDR 8.007 billion (about US$11 billion or 600 percent of quota). The authorities continue to expect to treat the arrangement as precautionary.

RECENT DEVELOPMENTS

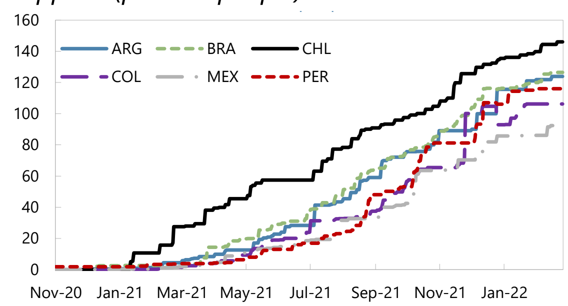
4. **Activity rebounded strongly in 2021 following the pandemic-induced steep downturn in 2020.** Progress in the vaccination campaign allowed a gradual lifting of Covid-19 mobility restrictions.[1] Robust external demand, favorable terms of trade, pent-up domestic

[1] As of March 5, 2022, 24.4 million people (about 2/3 of the target population) were vaccinated with a least two doses of the vaccine, and about 10.3 million people had received a third dose. Peru has secured an additional 55 million doses for booster shots. The vaccination of young children started in January 2022, ahead of an expected gradual return to in-person schooling in late March.

demand, and a surge in residential construction contributed to lifting real GDP by 13.3 percent in 2021, surpassing its pre-pandemic levels in 21Q3. The negative output gap is estimated to have narrowed to ½ percent, but real GDP remains 6¼ percent below its pre-pandemic trend. After rising almost ten points to 30.1 percent in 2020, the poverty rate declined to 22.1 in 2021Q3.

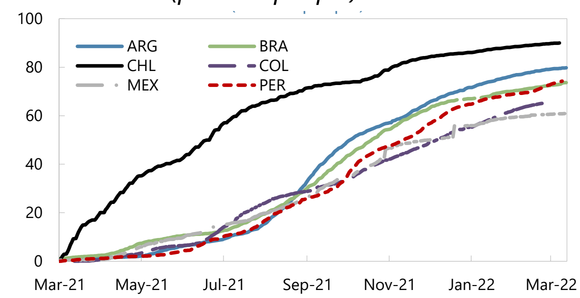
LA6: Covid-19 Vaccinations

Supplied (per 100 people)



Sources: Airfinity; and IMF staff calculations.

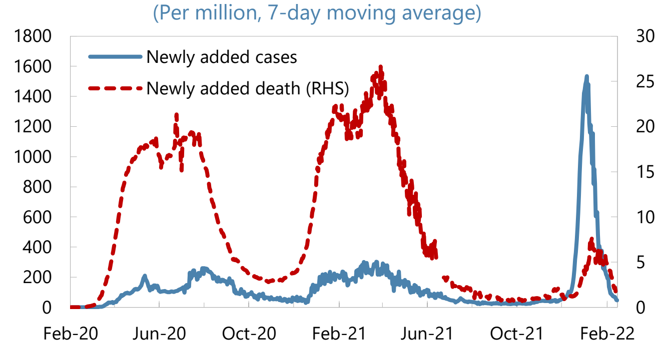
Administered (per 100 people)



Sources: Our World in Data (OWID); and IMF staff caluclations.

5. Economic activity slowed down in early 2022, partly reflecting the Omicron surge. High-frequency indicators already pointed to a slowdown in late 2021 which the Omicron surge in 2022 has likely aggravated (Figure 1). Although the surge was relatively short-lived and had a limited impact on mortality, capacity and mobility restrictions were reintroduced as Covid-19 cases rose, and teleworking arrangements were extended until end-2022.

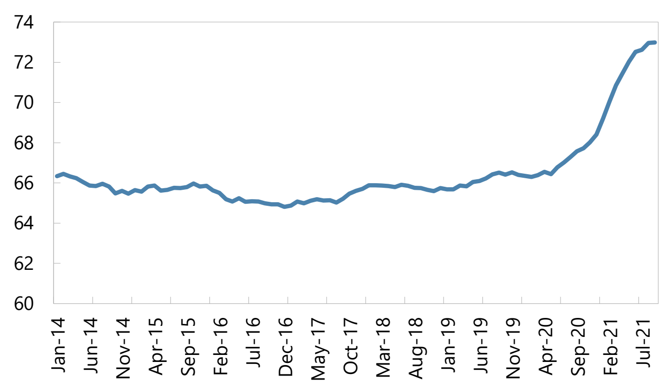
Covid Daily New Cases and Deaths
(Per million, 7-day moving average)



Sources: Johns Hopkins University, IMF staff calcluations.

6. The labor market has not fully recovered.

Share of Informal Labor



Source: Haver; and IMF staff calculations.

The pandemic led to significant increases in unemployment, informality, and poverty. Labor force participation rate and total employment remain below pre-pandemic levels.

Although formal employment in the Lima Metropolitan area fully regained its pre-pandemic levels, the number of "adequately employed" is one-fifth lower, and the number of underemployed is higher by 47 percent. At 77 percent, the share of informal jobs nationwide remains very high.

7. **Higher inflation prompted a decisive monetary policy response.** Driven by energy and food prices and currency depreciation, annual headline inflation rose to 6.8 percent in March 2022, the highest level since inflation targeting was adopted in 2002. Both core inflation and inflation expectations have moved above the central bank's 2+/- 1 percent target range (Figure 1), prompting the central bank (BCRP) to raise its policy rate by 425 bps to 4.5 percent in nine consecutive steps. While the policy stance remains accommodative, the BCRP has signaled that it will continue adjusting the policy rate until inflation and inflation expectations revert to the target range.

8. **The fiscal accounts strengthened considerably**. The Non-Financial Public Sector (NFPS) deficit fell from 8.9 to 2.6 percent of GDP (Table 1, Figure 2), on the back of higher metal prices and soaring tax revenues, the collection of tax arrears (0.7 percent of GDP), and a significant winding down of the 2020 pandemic-related stimulus. The decline in current spending was partly offset by a slight increase in public investment. Public debt rose from 35.1 to 35.9 percent of GDP, and successful debt management allowed the sovereign to pre-finance a portion of the 2022 budget. Additional fiscal resources allowed a small replenishment (US$4 million) to the Fiscal Stabilization Fund, which had been depleted in 2020. The sovereign credit rating remains investment grade[2] despite a downgrade reflecting the weakening fiscal position in 2020 and policy uncertainty following the presidential elections.

Text Table 1. Peru: Discretionary Stimulus Measures
(Percent of GDP)

	2020	2021
Cash transfers	2.4	0.7
Health spending	0.8	0.7
Support to firms	8.4	0.3
Of which : Loan guarantees	8.2	0.3
Other	2.2	0.4
Total	14.0	2.1

Sources: Country authorities; and IMF staff calculations.

9. **The financial sector remains solid as emergency measures are gradually unwound.** The banking system entered the pandemic from a position of relative strength. At end-2019, capital buffers were adequate, asset quality was relatively high, and profitability was stable. Extensive government support in the form of government-guaranteed loans, flexible adjustment to loan terms without reclassification, relaxation of the liquidity coverage ratio (LCR), and a reduction of the countercyclical capital buffer to zero provided ample liquidity. Following the gradual withdrawal of policy support, credit growth has declined in 2021 while profitability has continued to recover (Table 5). Top-down stress tests conducted by staff for the 2018 FSAP and more recently by the authorities suggest that the financial system is resilient even under severely adverse scenarios. The gradual reintroduction of the LCR and expiring liquidity and solvency programs have not led to the emergence of new risks. Rescheduled loans have decreased from 35.8 percent in June 2020 to 11.7 percent in December 2021 and remain confined to small businesses. Banks are required to provision high-risk rescheduled loans at 100 percent, and the anticipated rise in nonperforming loans (4 percent in December 2021) is limited. Weaker entities in the cooperative and microfinance sectors will continue to have access to asset strengthening measures.

[2] Fitch (BBB/Stable), Moody's (Baa1/Stable), S&P (BBB/Stable).

Financial Soundness Indicators Heatmap

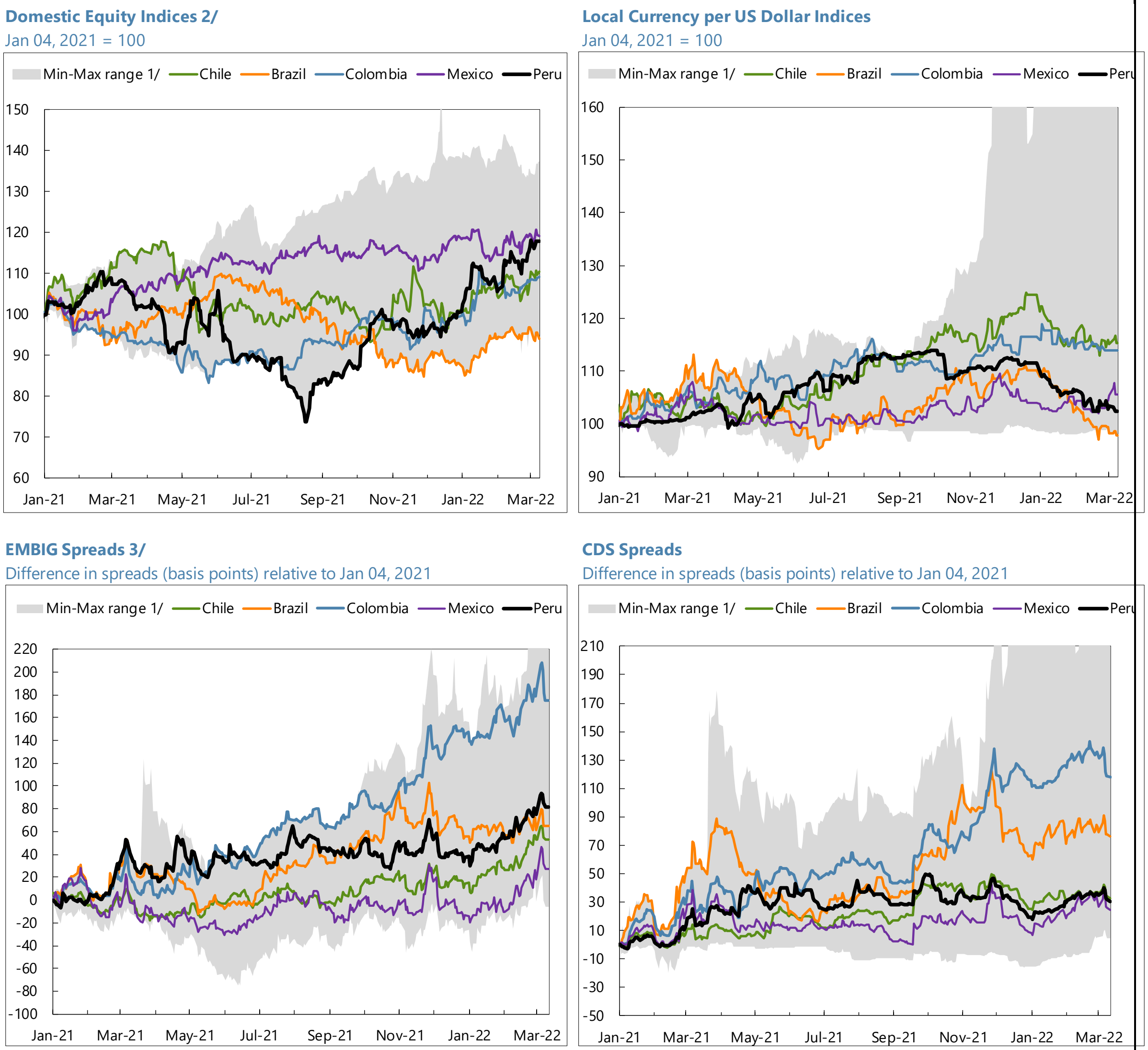
Peru	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3	Latest
Overall Financial Sector Rating	M	M	M	M	H	H	H	H	M	M	M
Credit cycle	L	L	L	L	H	H	H	H	L	L	L
Change in credit / GDP ratio (pp, annual)	1.2	1.2	0.7	2.2	9.2	10.1	9.4	6.7	-2.6	-5.2	-5.9
Growth of credit / GDP (%, annual)	3.5	3.5	3.3	1.8	6.0	25.3	27.6	25.5	17.6	-5.8	-11.1
Credit-to-GDP gap (st. dev)	1.4	1.5	1.6	2.1	3.7	2.6	1.5	0.3	-0.9	-1.6	-2.0
Balance Sheet Soundness	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
Deposit-to-loan ratio	90.5	91.7	90.5	92.0	94.5	95.3	98.2	99.8	93.5	94.6	94.6
FX liabilities % (of total liabilities)	38.9	40.1	37.6	38.5	34.5	33.2	33.4	34.8	36.0	37.2	37.2
FX loans % (of total loans)	27.6	27.4	26.4	27.0	24.6	22.6	22.7	22.9	24.1	23.8	23.8
Balance Sheet Buffers	L	L	L	L	L	L	M	L	L	L	L
Leverage	L	L	L	L	L	L	L	L	L	L	L
Leverage ratio (%)	12.3	12.4	12.9	12.6	11.0	10.6	10.5	10.2	10.3	10.3	10.3
Profitability	L	L	L	L	L	L	L	L	L	L	L
ROA	2.9	3.1	3.0	2.3	1.2	0.8	0.4	0.8	1.1	1.4	1.4
ROE	17.9	18.6	18.0	13.2	7.5	5.2	3.1	5.9	7.8	10.1	10.1
Asset quality	L	L	M	M	L	L	H	M	M	M	M
NPL ratio	3.4	3.5	3.4	3.5	3.5	3.6	4.1	4.1	3.9	4.0	4.0
NPL ratio change (%, annual)	1.4	3.8	5.3	6.0	0.9	4.2	22.6	18.0	12.5	9.7	9.7

Note: L = Low vulnerability; M = Medium vulnerability; and H = High vulnerability. The increase in the credit cycle vulnerability in 2020 Q2 is related to the increase in credit driven by government-guaranteed lending coinciding with a sharp decline in GDP at the onset of the Covid-19 pandemic.

Source: IMF staff estimates.

10. Financial market volatility increased in connection with political uncertainty but subsided in late 2021. After facing selling pressure during most of 2021, asset prices and the currency were supported by political developments —a motion to impeach President Castillo was rejected by Congress in early December— and higher risk appetite in the latter part of 2021 and early into 2022. Equity prices fully recovered previous losses and sovereign and corporate spreads remained stable compared with other countries in the region. The increased demand for foreign currency caused the sol to depreciate by 11 percent in 2021 despite large sales of foreign exchange by the BCRP —US$17.5 billion, equivalent to 7.7 percent of GDP— but the currency has appreciated by some 7 percent since December. Low demand for foreign exchange swap instruments from market participants in the face of rising interest rates led the BCRP to create a new swap instrument at a fixed rate, while maintaining risk neutral to the BCRP. Since the onset of the war in Ukraine, higher metal prices have supported asset prices, although volatility and local yields on public debt have increased somewhat.

Financial Market Indicators



Sources: Haver Analytics and Bloomberg LLP.
1/ Selected sample of emerging market countries including Brazil, Chile, Colombia, Mexico, Peru, Uruguay, Czech Republic, Croatia, Hungary, Poland, Turkey, India, Indonesia, Malaysia, Philippines, Thailand and Vietnam.
2/ National benchmark share price indices.
3/ Mexico's EMBIG includes Sovereign and Quasi.

11. **Peru's external position in 2021 was broadly in line with the level implied by fundamentals and desirable policies**. Reserve coverage remains adequate even after considering the dependence on commodity prices and the existence of substantial domestic foreign-currency liabilities (Annex II). International reserves increased US$3.6 billion to US$78.5 billion at end-2021 (35 percent of GDP). Historically-high short-term capital outflows (7.4 percent of GDP) were more than offset by public sector borrowing, foreign direct investment (notably in the form of retained earnings), the repatriation of foreign assets by pension funds to meet extraordinary withdrawals, and the 2021 SDR allocation (Table 4, Figure 3).[3] Despite a considerable trade surplus generated by high export prices and robust external demand, large

[3] The SDR allocation has been used to supplement reserves, and no alternative uses are planned.

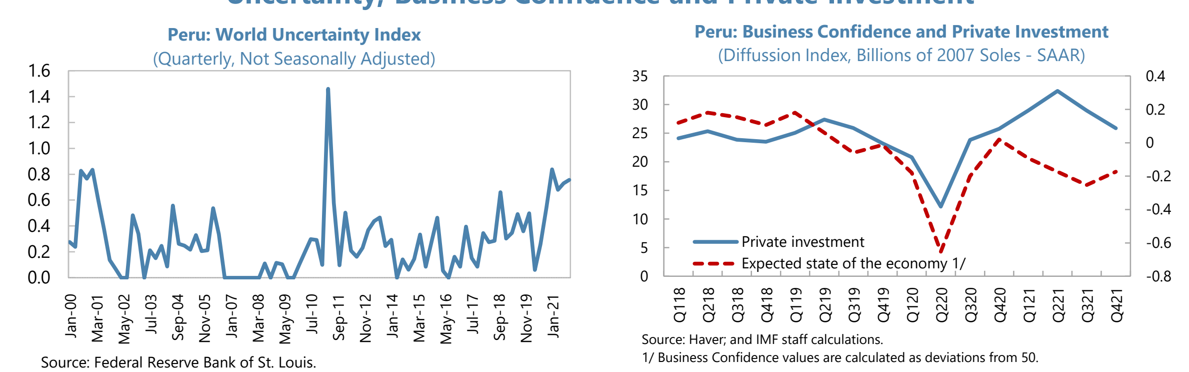
profit repatriations and weak tourism receipts led to a current account deficit of 2.8 percent of GDP. External debt rose to 46.1 percent of GDP.

OUTLOOK AND RISKS

12. Growth is expected to slow down in 2022 as external conditions tighten and the policy stimulus is withdrawn. Real GDP growth would decelerate to 3 percent reflecting slower global growth, tighter global financial conditions, the withdrawal of the policy impulse, and subdued private investment. Owing to limited trade links, the war in Ukraine will have a limited direct impact on Peru, which could even benefit from an increase in copper prices while remaining exposed to higher prices of imported energy, food, and fertilizers, a decline in global trade, and tighter financial conditions. Despite the small negative output gap, higher import prices will add one percentage point to inflation in 2022 —which will return to the target range only in 2023 (Annex III)—, possibly requiring additional monetary tightening. Over the medium-term, real GDP growth would stabilize at 3 percent reflecting scarring from the pandemic (Annex IV). Higher copper prices, lower profit repatriations, and a recovery in tourism would narrow the current account deficit.

13. Uncertainty around the outlook is high and the balance of risks is tilted to the downside, but Peru's policy buffers remain ample. In the short-term, the main external risks arise from the evolution of the pandemic, the fallout from the war in Ukraine, a sharp tightening of global financial conditions, extended global supply chain disruptions, and an abrupt growth slowdown in China, Peru's main trading partner (Annex V). Domestically, new Covid outbreaks could prompt the reintroduction of containment measures, adversely affecting activity. Political uncertainty and social unrest could weigh on private investment, undermine market confidence, and increase Peru's risk premium. Inflationary pressures could be more persistent, requiring faster tightening of monetary policy. More rapid progress on containing the pandemic, both globally and domestically, a rapid conclusion of the war in Ukraine, and reduced political uncertainty stand out as the main sources of upside risk. Very strong policy frameworks, adequate reserve coverage, access to international capital markets, low public debt, and a resilient financial sector provide Peru with ample buffers to face adverse shocks. These buffers are complemented by the FCL arrangement due to expire on May 27.

Uncertainty, Business Confidence and Private Investment



POLICY DISCUSSIONS

A neutral fiscal stance in the short term is appropriate considering the negative output gap and downside risks to growth. Realigning the fiscal framework in line with a gradual consolidation will help buttress confidence in the medium term. Addressing emerging spending needs will require a strategy encompassing revenue mobilization and expenditure rationalization. Monetary policy needs to respond rapidly to inflationary pressures and the tightening of global financial conditions. A new wave of structural reforms is needed to mitigate the long-term negative effects of the pandemic and boost growth prospects.

A. Maintaining Confidence in the Fiscal Framework

14. A neutral fiscal stance is appropriate in the short term. The 2022 budget is prudent and, in line with past IMF advice, envisions increased spending in health, education, and social protection to address identified gaps. Under the baseline scenario, the overall deficit would remain unchanged at 2.6 percent of GDP in 2022. A broadly neutral fiscal stance in the short-term is appropriate, considering the negative output gap, significant risks to the growth outlook, and the tightening of monetary policy. Nevertheless, contingency plans should be prepared to contain policy slippages, which could arise from the integration of temporary workers into the permanent workforce, the review of the collective bargaining framework (Annex VI), and state-owned enterprises (SOEs). Upside surprises to the growth outlook should be used to rebuild fiscal buffers. As the need for crisis support subsides, the government should phase-out emergency procedures to appropriate budget resources for Covid-19 relief.

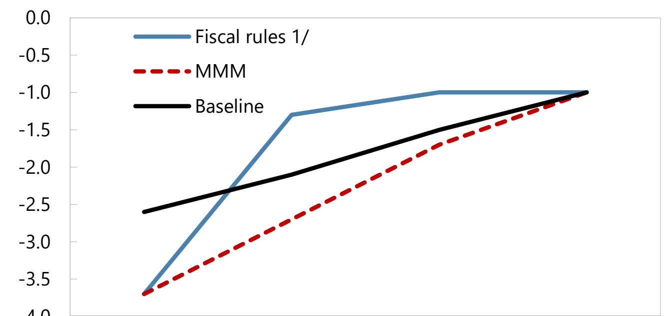
15. Public debt is sustainable. Peru has some fiscal space, and the public debt sustainability analysis (Annex VII) shows that Peru's public debt is expected to remain sustainable under the baseline. Public debt would stabilize below 35 percent of GDP in 2023 and then decline, while gross financing needs would average about 3.4 percent of GDP over the medium-term. Negative growth shocks present the major risk to the debt outlook. The main debt profile risks arise from an elevated share of public debt held by non-residents, and large rollover needs in 2024, which the authorities intend to address by conducting debt-reprofiling operations in the coming months.

16. The fiscal targets penciled in the medium-term framework for the 2023-2025 period are not aligned with the legally binding rules. The fiscal framework has served Peru well, contributing to maintaining fiscal sustainability and enhancing the credibility of the authorities' fiscal strategy (Annex VIII). Before the pandemic, the authorities were in the process of consolidating the fiscal accounts towards the long-term anchors of a fiscal deficit of 1 percent of GDP and a debt ratio of 30 percent of GDP, with a consolidation path defined in a set of intermediate and legally binding fiscal rules for the 2020-2025 period. The fiscal rules for 2020-2021 were suspended amidst the pandemic, new rules were set for 2022, and new fiscal targets were incorporated in the medium-term budgeting framework (MMM) for the 2023-2025 period which are not consistent with the pre-pandemic legally binding rules. This inconsistency has created confusion over the medium-term fiscal strategy and needs to be resolved promptly with a clearly communicated and consistent fiscal path.

17. A gradual fiscal consolidation will be necessary. Based on current spending plans, a fiscal consolidation of about 0.6 percent of GDP per year in 2023-2025 is needed to stabilize the debt ratio and reach the 1 percent of GDP deficit target (Table 1). This gradual adjustment would have a limited impact on growth. The revised consolidation path, along with realistic GDP growth projections, should underpin a revised MMM to be presented in August. The authorities have indicated that they intend to introduce legislation setting a new fiscal consolidation path along these lines. Changes to introduce more flexibility in the fiscal rules, which might be justified in view of the conservative targets, could be considered once political uncertainty has moderated.

NFPS – Overall Balance

(Percent of GDP)



	2022	2023	2024	2025
Fiscal rules 1/	-3.7	-1.3	-1.0	-1.0
MMM	-3.7	-2.7	-1.7	-1.0
Baseline	-2.6	-2.1	-1.5	-1.0

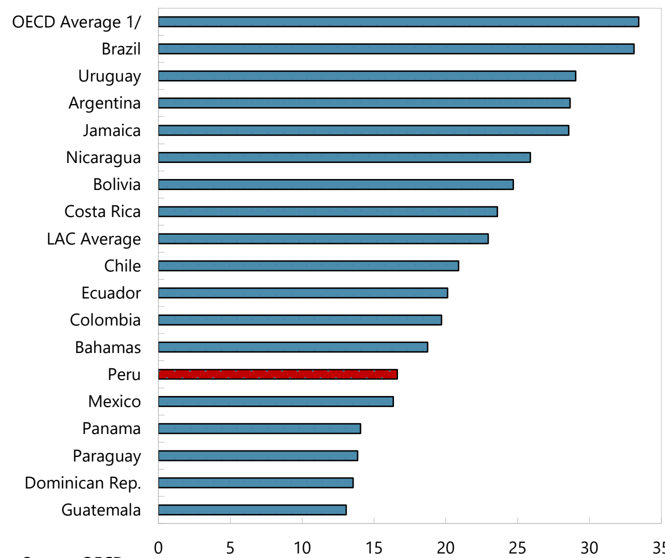
Source: Country authorities; and IMF staff calculations.
1/ 2022 target set in 2021, 2023 target set in 2019, 2024-2025 targets set in 2016.

18. Enhancing the effectiveness of the Fiscal Council will help support confidence in the fiscal framework. Since its inception in 2013, the Fiscal Council has played a constructive role in supporting Peru's fiscal framework. The institution's non-binding opinions on the fiscal strategy, compliance with the fiscal rules, the evaluation of budgetary forecasts and emerging fiscal risks are public, timely, and objective. While the Council's design is generally aligned with best practices, measures could be taken to enhance its operational independence from the Ministry of Finance and Economy (MOF), including by safeguarding the Council's role in providing a slate of candidates for nomination to the committee, and ensuring that the council's budgetary and staffing needs are adequate. To enhance transparency and accountability, the MOF could consider replying in public to the council's opinions, particularly when there are disagreements.

19. Revenue mobilization and expenditure rationalization will be key to accommodating rising spending needs. At about 15 percent of GDP, Peru's tax intake is relatively low compared to regional peers. The previous cabinet under President Castillo could not build enough support for a comprehensive tax reform that would yield about 1½ percent of GDP Addressing key needs in education, health, and social policies —including pensions— where Peru presents significant gaps, will require continued efforts to enhance tax collection as well as tax policy adjustments.

20. A medium-term spending strategy would help articulate priorities while containing expenditure pressures and mitigating fiscal risks. Evidence suggests that there is still room for improvement in the identification of potential beneficiaries of social benefits. For example, the last round of universal cash transfers (*Bono Yanapay*) relied on a different (and enlarged) registry than the previous two rounds, and benefited some 13.5 million people, well beyond the 10 million people estimated to be vulnerable/poor. Improving targeting will require a medium-term plan to develop the right infrastructure —such as reliable identification systems and appropriate channels to deliver transfers— drawing on the experience accumulated during the pandemic and coordinating with development partners. Civil service reform is required to improve effectiveness in delivering public services and reduce fiscal risks arising from legal gaps on public employment. Improved governance at SOEs will also be necessary to contain fiscal risks.

Tax to GDP Ratio for 2019
(Total tax revenue as % of GDP)



Source: OECD.
1/ Chile, Colombia, Costa Rica, and Mexico are part of the OECD group.

21. Pension reform remains a critical priority to reduce old-age poverty risks. The withdrawals from private pension funds in 2020-21 have heightened the pension system's low coverage and adequacy challenges. Additional withdrawals would only compound the problem. Any solution is likely to have fiscal implications while requiring a broader contribution base and higher contribution rates.[4]

22. Transparency, accountability, and control of Covid-related spending improved.[5] In line with best practice, the 2020 Fiscal Responsibility Report included a detailed assessment of the impact of the pandemic on fiscal accounts. Information on public procurement contracts is published online and the outcome of selected ex-post audits is also published. The capacity of the Office of the Comptroller General was enhanced with the gradual incorporation of the Offices of Institutional Control and access to new public sector databases. As of February 14, 2022, the

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

[5] The International Budget Partnership, "Managing Covid Funds. The Accountability Gap", 2021 identifies Peru as an example of good practices in (i) accountability, with updated information on the implementation of specific programs published on the government's open data portal; (ii) citizen monitoring and oversight, with a mechanism to monitor virtually the implementation of Covid-19 response policies in education; and (iii) transparency, with a dedicated website providing details on various programs for households and businesses, specifying who is entitled and why, support types and amounts and planned number of beneficiaries.

same office had completed 15,551 controls at all levels of government on Covid-related spending equivalent to 16.3 percent of GDP. Most controls were simultaneous, with corrective actions recommended in 47 percent of cases. Damages identified by ex-post controls were equivalent to 9.6 percent of audited spending. The authorities are strongly encouraged to integrate beneficial ownership requirements and publication in the public procurement framework.

B. Reining in Inflationary Pressures and Normalizing Financial Policies

23. Further tightening of monetary policy is warranted in the short term. Credibility in central bank policy remains high (Annex III), but the rapid rise in inflation and inflation expectations above the 2+/-1 percent band requires a sufficiently strong response to maintain the nominal anchor. This is particularly important when considering the additional inflationary pressures associated with the war in Ukraine and the expected tightening of global financial conditions. With the real neutral interest rate estimated at 1.5 percent, the current policy stance remains slightly expansionary. A short-term contractionary bias will provide policy space to drop back to a neutral position once inflation expectations return to the target range.

24. The authorities should carefully consider the tradeoffs of frequent foreign exchange intervention. Faced with historically large capital outflows in 2021, the BCRP intervened to an unprecedented extent in the foreign currency market while still allowing the sol to depreciate significantly. Intervention was largely justified in view of the relatively high rate of dollarization—foreign currency deposits reached 30.5 percent in 2021 from 28.1 percent in 2020—and significant volatility in market conditions. While many economic agents have access to natural hedges such as dollar invoicing, the majority who do not could benefit from a more developed foreign exchange market where hedging opportunities are more readily available. This would require fewer and more targeted interventions, for instance by making them conditional on market risk (Annex IX).

25. In the absence of systemic risks to the financial system, prudential policies should continue to unwind while protecting bank portfolios. Prudential measures used during the pandemic have successfully supported the financial system, and the authorities have proceeded to unwind policies gradually—including relaxations in the LCR and liquidity programs—while providing continued support to weaker entities, particularly in the cooperative and microfinance sectors. A relaxation of the minimum capital ratio in April 2021 from 10 percent to 8 percent has sustained bank profitability, though bank capitalization remains high (15 percent of risk-weighted assets in December 2021). The authorities should continue to monitor bank portfolios and lending standards closely and address nonperforming loans as they emerge. Once the recovery is well underway, the reactivation of the counter-cyclical capital buffer, which is tied to the GDP growth rate, should be considered.

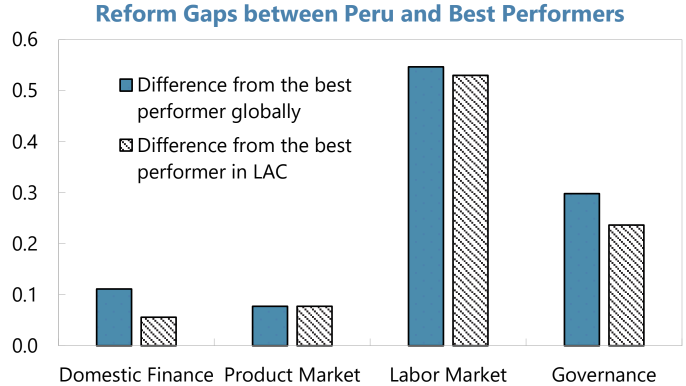
26. Closing regulatory and supervisory gaps while continuing progress on systemic risk assessment will enhance financial resilience. The authorities have taken significant steps to strengthen financial sector oversight by expanding financial co-operatives' oversight by the banking supervisor, monitoring banks' off-balance-sheet exposures, introducing new risk-monitoring tools, implementing risk-based supervision for all insurers, strengthening crisis preparedness and management, introducing a deposit insurance scheme, and enhancing the emergency liquidity assistance framework. Other important steps to be taken include 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, following the recommendations of the 2018 FSAP (Annex X).

27. The authorities are exploring ways to improve the digital payments infrastructure, potentially through the introduction of a Central Bank Digital Currency (CBDC). The IMF has provided technical assistance on the early stages of the process. While a CDBC presents an opportunity for increased financial inclusion, its adoption should be contingent on several preconditions and a robust assessment of risks. Any solution should follow an iterative approach in assessing risks and demonstrating a low-cost proof of concept before a decision on implementation is made.

C. A Well-Articulated Strategy to Boost Growth and Resilience

28. The structural reform agenda should be revamped to reduce scarring from the pandemic and boost medium-term growth. The focus should remain on addressing the fragilities exposed by the pandemic. The increase in informality, which has hit women particularly hard,[6] has undermined the authorities' effort to mitigate the impact of the pandemic on poverty and inequality.[7] The authorities are addressing gaps in health, education, and social protection, but steps are needed to improve the effectiveness of all public services, improve governance, and enhance transparency. Continued progress in the capacity to execute public investment will be essential to reduce the large infrastructure gap, including for digital infrastructure. At the same time, a stable and predictable legal and regulatory environment would nurture confidence and allow private investment to thrive.

Reform Gaps between Peru and Best Performers



Source: IMF staff estimates, based on the data set used for WEO 2019, Chapter III.

29. The recent increase in labor informality deserves close attention. Informality is a complex phenomenon linked, among other things, to high costs of formal employment,

[6] IMF Country Report No. 21/63, Annex III.

[7] IMF Country Report No. 21/63, Annex IV.

including rigid labor and business regulations, high market entry costs, limited access to financing, and weak enforcement capacity of the government.[8] It hinders the growth of firms and is associated with low productivity. Policies recently announced, like the second agrarian reform and a package of labor market reforms, including the recently introduced restrictions on outsourcing, do not address rigidities and high compliance costs, and could worsen the business climate, increase informality, and negatively affect private investment.

30. Progress on the anti-corruption agenda continued, but challenges remain.[9] Implementation of the 107 measures included in the 2018-21 Anticorruption Plan reached 70 percent at end-2020. The authorities took new measures in 2021 and 2022 to: (i) enhance integrity, transparency, and accountability in the civil service; (ii) support corruption preventive capacity in 19 ministries and 142 public entities; and (iii) strengthen the Regional Anticorruption Commissions and the integrity function in regional governments. In 2021, the responsibility for collecting, verifying, and sanctioning public officials with respect to their statement of interests to the Office of the Comptroller General. The authorities have been gradually introducing an obligation for juridical persons to present a declaration of final beneficiaries.[10] The supervisor strengthened regulations on customer due diligence on politically exposed persons by financial institutions, including by introducing a mandatory declaration of knowledge of the client. Legislation creating new authorities to reform and strengthen the judiciary were also approved by Congress. Implementing the new 2022 Integrity Strategy will help identify and manage risks of corruption in the public sector. More efforts are also needed in providing sufficient resources and training to Integrity Offices, finalizing legislation on whistleblowing, and ensuring accurate beneficial ownership information of juridical persons.

31. Peru's quest for improved government effectiveness will necessarily run through a comprehensive civil service reform. The efficient delivery of public services, and the public policy formulation and implementation processes depend critically on the availability of a professional civil service. However, Peru's civil service is fragmented and lacks professionalization. Successive attempts at reform have failed as the necessary political consensus has been hard to attain (Annex VI).

32. More efforts on climate-change policies are essential to increase resilience, contribute to global mitigation efforts, and ensure a smooth transition to a low-emission economy. Peru ranks amongst the top 25 percent most vulnerable countries due to the impacts of extreme weather events. Implementation of the National Adaptation Plan is therefore critical

[8] See Delechat, C. and L. Medina (eds.) *The Global Informal Workforce: Priorities for Inclusive Growth,* IMF, 2021, and Ohnsorge, F. and S. Yu (eds.), *The Long Shadow of Informality: Challenges and Policies,* The World Bank, Washington, 2021.

[9] In 2021, Peru continues to progress on recommendations from the evaluation of the Follow-up Mechanism of the Inter-American Convention against Corruption (OAS–MESICIC), the UN Convention against Corruption (UNCAC-ONU), and the second phase of evaluation of the OECD Anti-Bribery Convention.

[10] The obligation, introduced in 2019 for large taxpayers (12,188 entities), has been extended to almost 74,000 entities in 2022, accounting for 9 percent of companies and 90 percent of reported income. Compliance in 2021 was 95.3 percent.

to strengthening resilience. Although Peru is not a large carbon emitter, its energy matrix is intensive in natural gas (42 percent as primary source and 11 percent for natural gas liquids) and land use and deforestation account for most of the country's emissions. While the updated Nationally Determined Contributions (NDCs) are ambitious, they still fall short of the net-zero target but the recently approved legislation setting a 2030 target of 20 percent for the energy produced from unconventional renewable sources (excluding hydropower) is a welcome step in this regard.[11] The prospective phasing out of hydrocarbons, of which Peru is a producer, requires preparations to facilitate the transition.

Box 1. Climate Change in Peru[1/]

Climate change risks and already high impacts from natural hazards expose Peru to severe economic and welfare losses and threaten Peru's development path. Peru is already suffering from earthquakes, landslides, droughts, and floods. Together they cause welfare losses equivalent to 5.2 percent of GDP every year.[2/] The 2017 El Niño event left US$6–9 billion in monetary losses, affected 1.7 million inhabitants, generated 370,000 new poor, and damaged or destroyed crops, roads, bridges, homes, schools, and health posts (IPCC 2022 Report). Climate change threatens most severely the infrastructure and housing sectors, agriculture and fisheries, the health of the population, and the tourism sector. Main channels of climate change impacts on the economy are due to heat and agricultural output losses.

Peru has incorporated climate change as part of its development agenda since the early 1990s and has been increasing the ambition of its NDCs (both mitigation and adaptation) over time. Peru was the first Latin American country to ratify the Paris Agreement, in July 2016. Its NDCs include an absolute ceiling on greenhouse gases (GHG) emissions at 209 MtCO2eq in 2030 (unconditional goal) or 179 MtCO2eq2 (conditional goal). The government has announced Peru's commitment to reach carbon neutrality by 2050 and the declaration of a national climate emergency, but to achieve this ambitious target the country will need to enforce the existing regulations and strengthen institutional capacity and coordination.[3/] Peru's NDC also presents climate change adaptation measures that were included in the National Adaptation Plan released in June 2021.[4/] The prioritized sectors for adaptation include agriculture, water, forests, fisheries and aquaculture, and health, and two new areas were identified: tourism and transport.

Peru needs to take comprehensive policy action to enable structural transformation to a greener and more resilient economy. Fulfilling investment needs for adaptation and mitigation should go in parallel with increased efficiency, transparency, and accountability of public spending, alongside putting in place economy-wide incentives to encourage the private sector to take action Designing a comprehensive fiscal response to climate change will be important to align incentives and promote a just transition. A comprehensive fiscal package would include a carbon tax that can help raise fiscal revenues, redirect economic activity toward a lower emitting path, while possibly decreasing poverty.[5/] It would also include eliminating some environmental and energy subsidies and incentives which qualify as environmentally harmful subsidies (EHS). A better management of the fiscal and debt impacts of natural hazards and fiscal instruments to reduce deforestation would help.

The World Bank forthcoming Country Climate and Development Report (CCDR) will explore opportunities and trade-offs in aligning Peru's development path with its recent commitments on climate change. It will investigate how addressing the country's impediments to development jointly with climate change adaptation can maximize welfare outcomes; how Peru can limit exposure to and take advantage of a world transitioning to net zero GHG emissions by 2050; and how the country can prioritize decarbonization actions to maximize economic benefits and avoid costly lock-ins.

1/ Prepared by Bledi Celiku, Juan José Miranda Montero, Julie Rozenberg, and Christoph Ungerer (The World Bank).
2/ Well-being derived from household consumption.
3/ The need to support the implementation of international commitments prompted the adoption of the National Strategy on Climate Change, followed by the Framework Law on Climate Change in 2018. The Law defined the principles and approaches of the national climate policy and established a structure of institutional arrangements for its enforcement.
4/ Ministerial Resolution N° 096-2021-MINAM approved on June 9, 2021.5/ / If 50 percent of the revenues were used, targeting the lowest 6 deciles, the first 4 deciles would have positive net effects in consumption (compared to before the tax).

[11] Quirós-Tortós et al., (2021) "Costos y beneficios de la Carbon Neutralidad en Perú. Una evaluacion robusta", BID, 895, estimates that reaching net-zero emissions in Peru would have a net economic benefit of US$140 billion by 2050.

D. Authorities' Views

33. The authorities were slightly more optimistic on the growth outlook. They expected slightly higher GDP growth in 2022 and 2023 owing to stronger global demand, both in the short and medium-term, and the upcoming elimination of pandemic-related capacity restrictions, which will support activity in high-contact industries and services. With the reopening of schools in March, parents (particularly women) will be relieved from home childcare duties and able to return to the market to match increased labor demand. The authorities noted that the strong recovery already taking place in formal employment —particularly in agriculture, mining, electricity, and construction—will sustain household income and spending. They recognized that the war in Ukraine and its ramifications warrant a revision to the inflation outlook.

34. The authorities' agreed with the thrust of staff's fiscal policy advice. They noted that the materialization of external risks, if contained, would not lead to a change in the short-term fiscal position. A new medium-term macroeconomic framework was being prepared to recalibrate the path of fiscal consolidation in line with the fiscal rules to preserve fiscal sustainability. They recognized the need to increase tax revenues and indicated they would continue building consensus for a much-needed tax reform, which however was not an immediate priority. The authorities noted staff recommendations to enhance the functioning of the Fiscal Council, but preferred a comprehensive review to identify possible measures, and requested IMF support in conducting the assessment.

35. The authorities are aware of risks to inflation and are prepared to act. They viewed capital outflows from emerging markets and financial markets volatility associated with a faster withdrawal of the monetary stimulus in advanced economies, uncertainty about global economic growth, and the escalation of the war in Ukraine as the main risks to the outlook. They considered, however, that they are in a good position to respond to these risks if they materialize. A tighter policy stance, the credibility of the central bank, and appropriate communication would help contain the impact of higher energy prices on inflation expectations. Macroeconomic buffers, including an adequate level of international reserves, would partly shield Peru from global financial market turbulence. In case of significant movements in the foreign exchange and sovereign bond markets, the central bank stands ready to intervene.

36. With the OECD accession process underway, the authorities are focusing on a broad range of structural reforms. The revamped National Plan for Competitiveness and Productivity should provide the framework to identify priorities. More spending with appropriate quality controls should strengthen the public provision of health, education, and social protection. They saw the new law setting clear qualification criteria for public employees as helping in this regard and underscored the significant progress in the implementation of the Anti-Corruption Plan 2018-2021 and the effectiveness of monitoring Covid-related spending. They stressed that the recent decree to restrict outsourcing to noncore activities was aimed at protecting the rights of employees and, while this could lead to some increase in costs to enterprises, the impact would be limited.

STAFF APPRAISAL

37. **After a strong economy recovery in 2021, Peru faces significant challenges.** Partly reflecting a strong policy response and a successful vaccination campaign, output has recovered its pre-pandemic level, but labor force participation and total employment are still lagging, informality has increased, and poverty remains higher than in 2019 while scarring from the pandemic has likely reduced potential growth. As external conditions tighten and the policy stimulus continues to be withdrawn, growth is expected to decline in 2022. Uncertainty is high, with several risks, both external and domestic, clouding the outlook.

38. **Peru's large policy buffers and very strong policy frameworks continue to help protect the economy from external and domestic risks**. Economic fundamentals are strong. The external position is broadly consistent with the level implied by fundamentals and desirable policies and international reserves are high by standard metrics. The fiscal deficit fell considerably after the pandemic, fiscal buffers are being replenished, public debt is low and sustainable, and the sovereign credit rating remains investment grade. Monetary policy has reacted to higher inflation and central bank credibility is high. The financial system is resilient. The FCL arrangement expiring on May 27, which reflects Peru's very strong policy frameworks and track record of prudent policies attained across multiple electoral cycles and governments, can be used as additional protection.

39. **Maintaining confidence in the fiscal framework is key**. A neutral fiscal stance in the short term is appropriate, but the misalignment between fiscal rules and the medium-term fiscal framework needs to be resolved rapidly. Realigning the fiscal framework will help clarify policy intentions and preserve confidence in a context of increased volatility. A gradual fiscal consolidation of about 0.6 percent of GDP per year during 2023-2025, needed to get to the fiscal targets, is realistic and would have a limited impact on growth. Changes to the fiscal rules should be postponed until political uncertainty has subsided. Measures to augment the Fiscal Council's operational independence and enhance transparency and accountability in the dialogue with the government will support confidence in the framework.

40. **A medium-term strategy to mobilize revenue and rationalize spending is necessary to accommodate spending needs while preserving fiscal sustainability.** The authorities have made significant progress in reducing the tax compliance gap, which however remains large. Further efforts, complemented by necessary tax policy adjustments, are needed to address emerging spending needs. Enhanced targeting of social benefits, a comprehensive civil service reform, and improved governance at SOEs will help strengthen government effectiveness and contain fiscal risks. A medium-term spending strategy will help articulate priorities and identify areas for savings. These priorities should include a pension reform, which has become more urgent after large withdrawals from private pension funds have compromised the integrity of the system. More withdrawals, as currently being proposed in Congress, will only exacerbate existing problems.

41. Moving to a tighter monetary stance is warranted. Although the recent pickup in inflation has been driven mostly by supply factors, core inflation and inflation expectations have moved outside the 2+/-1 percent target range. Despite the increase in the policy rate, the policy stance remains slightly expansionary, and adopting a slightly contractionary stance will be necessary to guide core inflation and inflation expectations back to the target range. Bringing inflation and inflation expectations within the target range would help create more favorable conditions for economic growth. A tighter policy stance will also help insure against risks of a disorderly adjustment of global financial conditions.

42. While foreign exchange rate intervention is appropriate under disorderly market conditions and currency mismatches, the tradeoff with market development should be explicitly considered. Persistent dollarization in the private sector may warrant intervention by the central bank to avoid excessive volatility. However, a more developed foreign exchange market would increase efficiency by giving economic agents wider access to hedging instruments. Fewer and more targeted interventions would both promote market development and help address negative balance sheet effects. As dollarization declines, the need for frequent foreign exchange intervention will subside, allowing the exchange rate to play a larger role as a shock absorber.

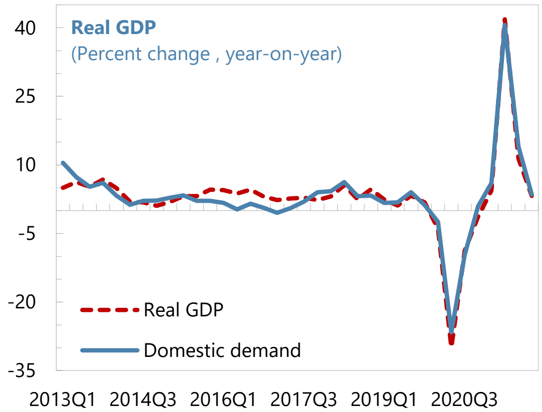
43. The gradual unwinding of pandemic-era prudential policies should continue. There are no identifiable systemic risks to the financial system. Broad policy support during the pandemic was effective in maintaining the flow of credit while voluntary provisioning by banks and targeted follow-up programs have minimized the impact of an uptick in nonperforming loans. The normalization of prudential measures should continue. Closing remaining regulatory and supervisory gaps and continuing progress on systemic risk assessment will enhance financial resilience. The introduction of a CBDC should follow an iterative approach in assessing risks and demonstrating a low-cost proof of concept before a decision on implementation is made.

44. The OECD accession process is an opportunity to define a well-articulated structural reform agenda that addresses the weaknesses emerged during the pandemic. Building support for measures that boost productivity and reduce informality while protecting workers is key. Promoting social and financial inclusion will require not only additional resources, but significant changes to improve the effectiveness of public services and enhance transparency, including by strengthening anti-corruption enforcement and institutions. Strengthening the capacity to execute public investment is also necessary to reduce the large infrastructure gap. To promote private investment, a stable and predictable legal and regulatory environment is paramount. Further impetus to climate-change policies is necessary to reduce risks, contribute to global mitigation efforts, and ease the transition to a low-emission economy.

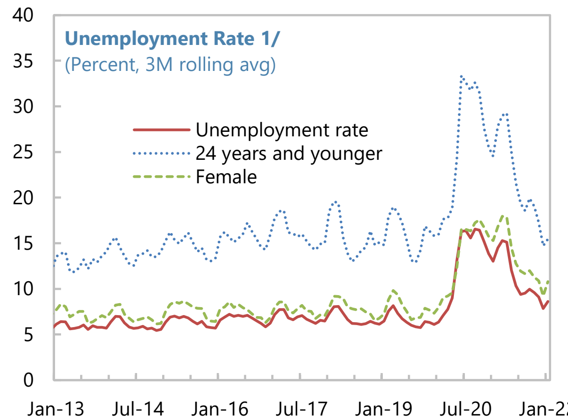
45. Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Peru: Real Sector Developments

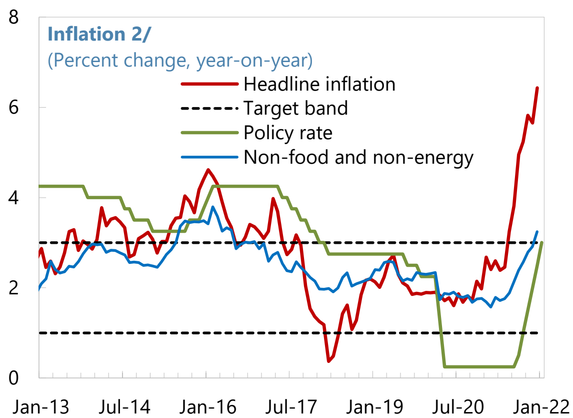
Economic activity recovered strongly in 2021…



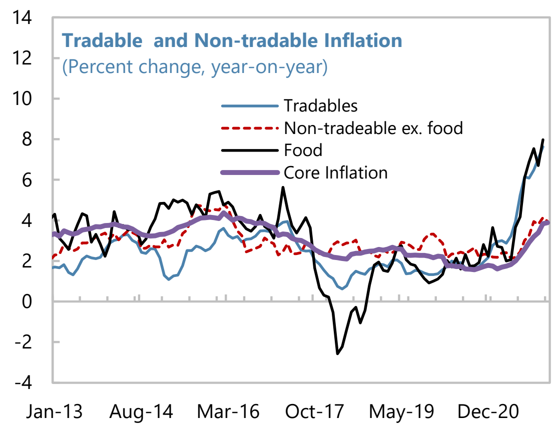
… but the labor market is lagging.



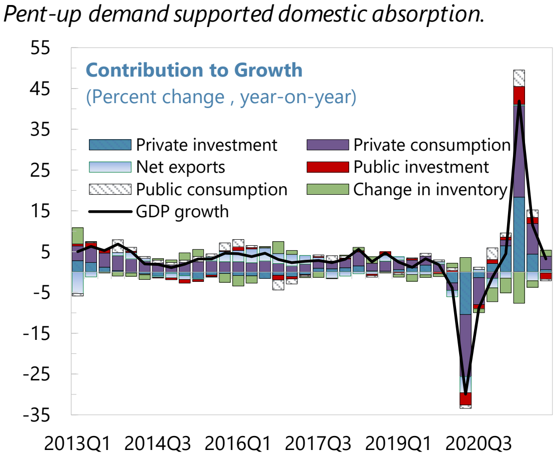
Headline inflation moved well above the target range…



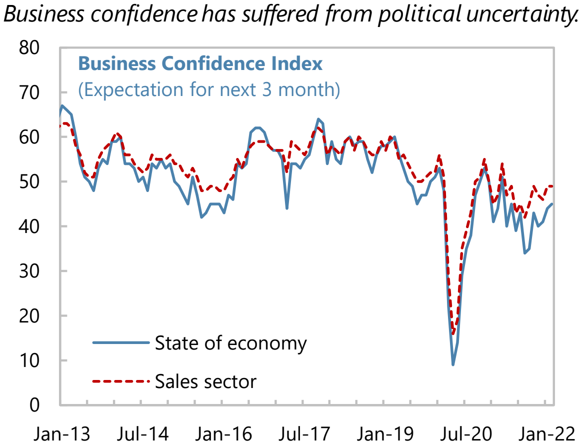
…on broad-based price increases.



Pent-up demand supported domestic absorption.



Business confidence has suffered from political uncertainty.

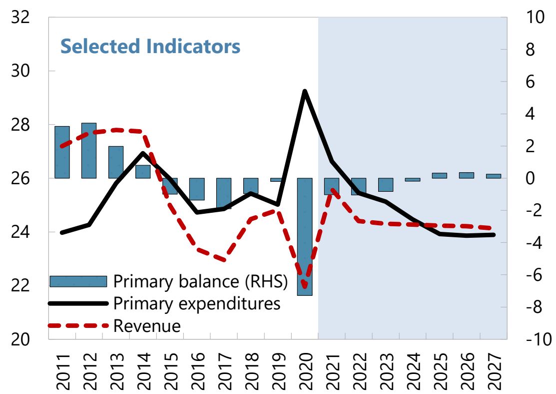


Sources: National authorities; and IMF staff calculations.
1/ Unemployment rates correspond to Metropolitan Lima.
2/ Inflation values correspond to Metropolitan Lima.

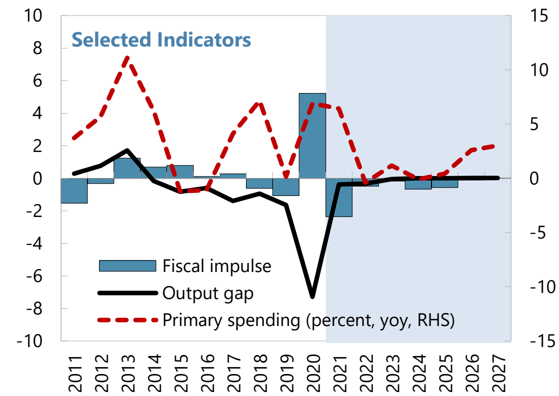
Figure 2. Peru: Fiscal Sector Developments

(Percent of GDP)

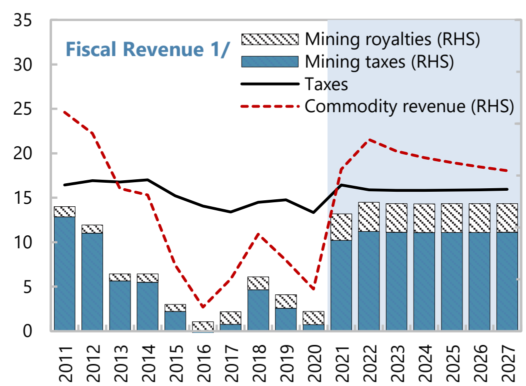
The fiscal accounts strengthened on a cyclical upswing…



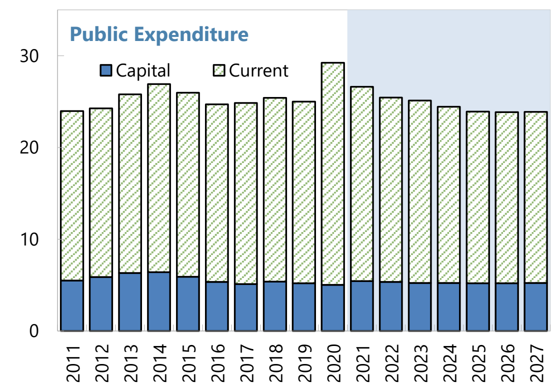
… a partial unwind of the pandemic-related support…



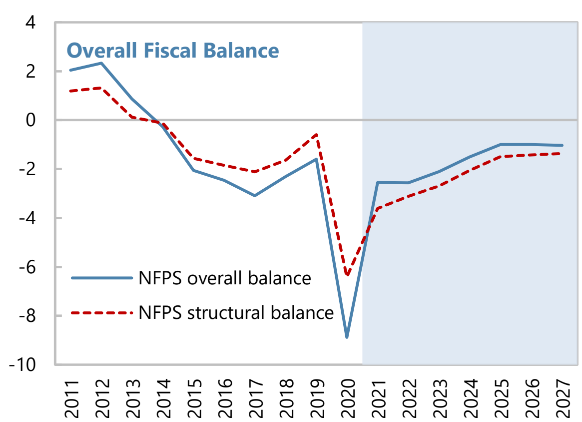
… and supportive metal prices.



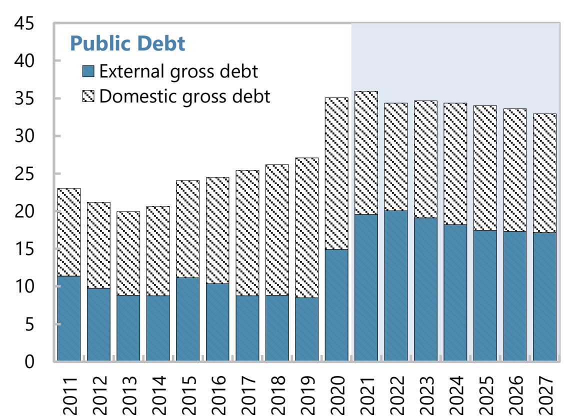
A gradual fiscal consolidation…



will guide the fiscal deficit back to the 1% of GDP target…



… and stabilize the debt ratio

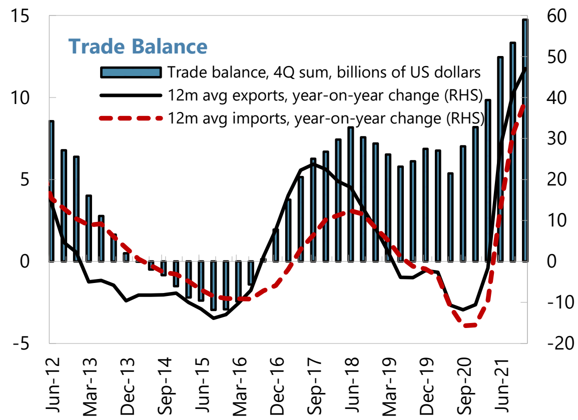


Sources: National authorities; and IMF staff estimates.

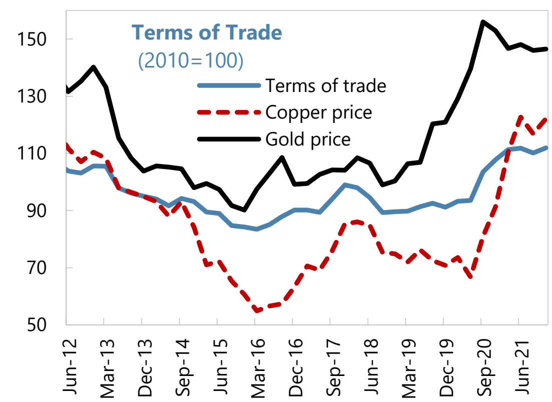
1/ Net of restitutions.

Figure 3. Peru: External Sector Developments

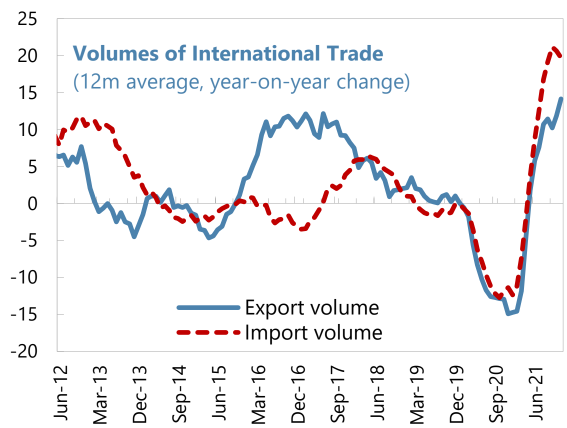
The trade balance rose to record-high levels…



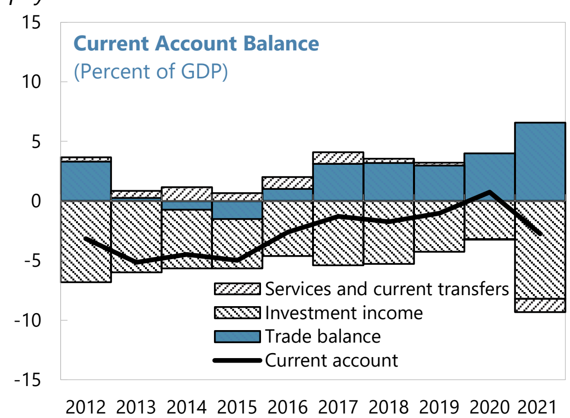
…on a large terms-of-trade gain…



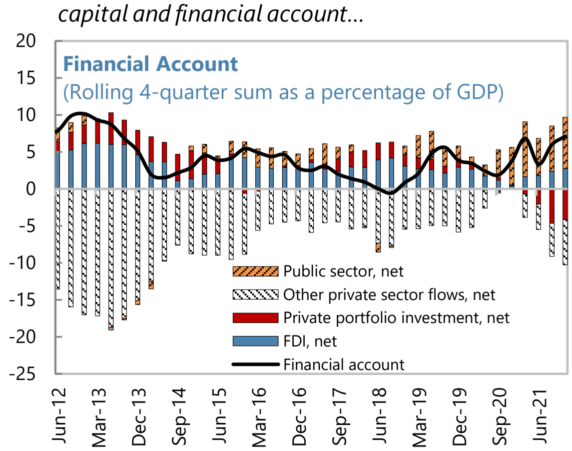
… and recovering external demand…



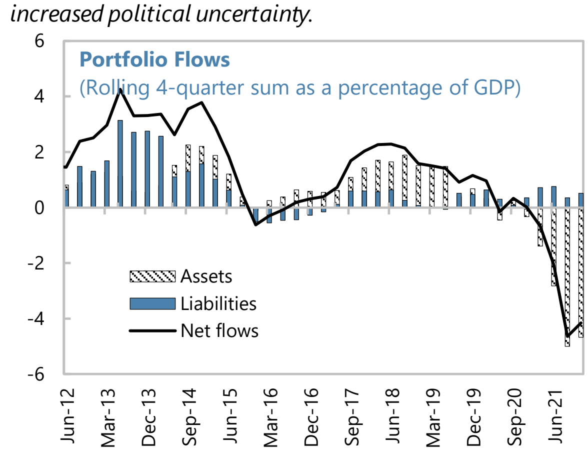
…but the current account weakened on increased factor payments and weak tourism



Public borrowing helped cushion pressure on the capital and financial account…



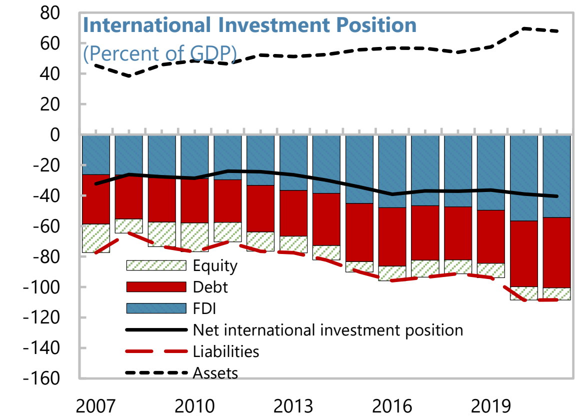
Private capital outflows rose sharply in the context of increased political uncertainty.



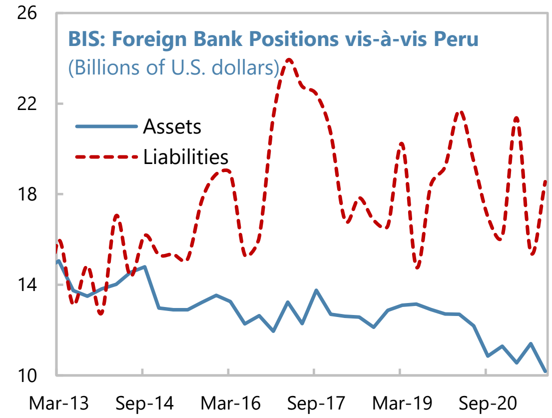
Sources: National authorities; and IMF staff estimates.

Figure 4. Peru: Balance Sheet Indicators

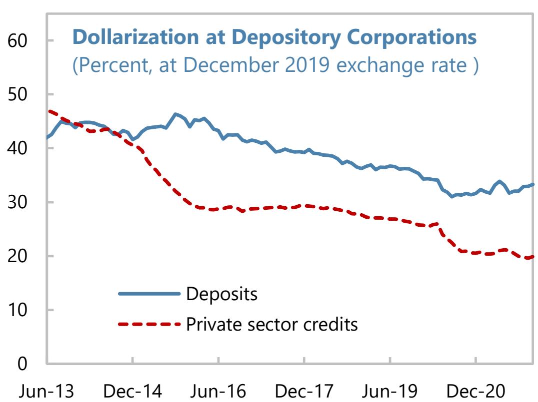
The IIP has held broadly stable



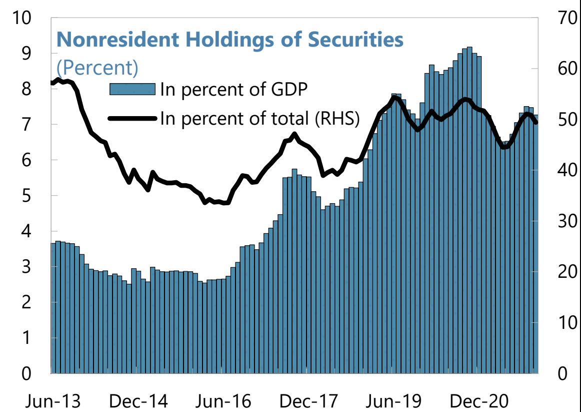
Assets with foreign banks stabilized in 2021



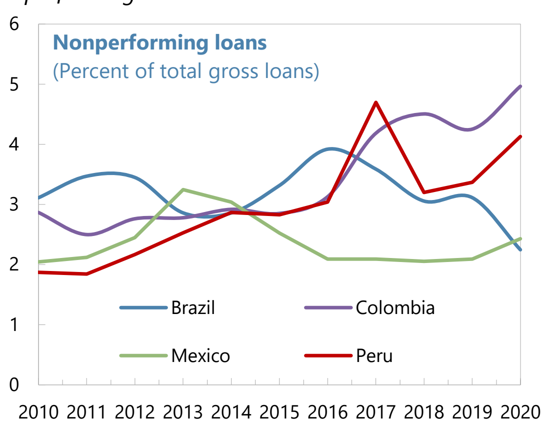
Deposit dollarization increased slightly



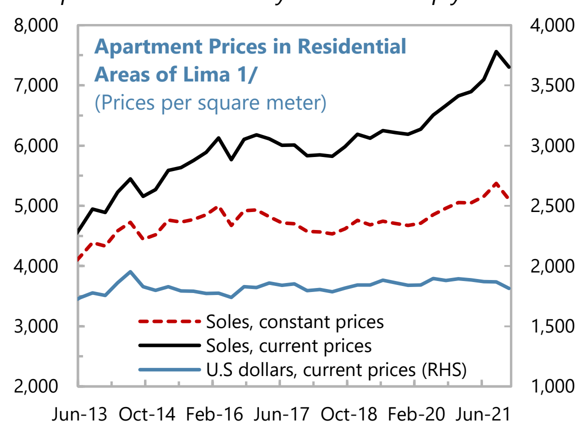
Non-residents pulled back from local sovereign debt



Non-performing loans rose in 2020



House prices in local currency increased sharply



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.

Table 1. Peru: Selected Economic Indicators

	2018	2019	2020	2021	Proj. 2022	2023	2024	2025	2026	2027
Social Indicators										
Poverty rate (total) 1/	20.5	20.2	30.1	22.1	...	...	...	...	...	...
Unemployment rate for Metropolitan Lima (period average)	6.7	6.6	13.9	10.9	...	...	...	...	...	...
(Annual percentage change; unless otherwise indicated)										
Production and prices										
Real GDP	4.0	2.2	-11.0	13.3	3.0	3.0	3.0	3.0	3.0	3.0
Output gap (percent of potential GDP)	-0.9	-1.6	-7.3	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0
Consumer prices (end of period)	2.2	1.9	2.0	6.4	4.0	3.0	2.3	2.0	2.0	2.0
Money and credit 2/ 3/										
Broad money	9.6	8.8	29.0	2.6	8.4	6.6	6.6	6.4	5.4	5.5
Net credit to the private sector	10.3	6.4	14.0	6.3	8.7	7.8	5.6	5.7	5.5	5.4
Credit-to-private-sector/GDP ratio (%)	42.0	43.0	52.6	46.0	45.5	46.2	46.4	46.8	47.0	47.2
External sector										
Exports	8.0	-2.2	-10.6	47.1	16.1	3.4	2.8	3.1	3.3	3.7
Imports	8.1	-1.8	-15.6	39.3	17.9	4.7	4.8	5.1	4.9	5.0
External current account balance (percent of GDP)	-1.7	-1.0	0.8	-2.8	-1.5	-1.4	-1.5	-1.5	-1.4	-1.4
Gross reserves In billions of U.S. dollars	60.3	68.4	74.9	78.5	78.2	77.9	78.9	80.4	82.2	84.6
Percent of short-term external debt 4/	369	428	487	586	561	537	565	516	527	563
Percent of foreign currency deposits at banks	213	224	222	229	223	225	233	243	260	282
(In percent of GDP; unless otherwise indicated)										
Public sector										
NFPS revenue	24.5	24.8	22.0	25.6	24.4	24.3	24.3	24.2	24.2	24.1
NFPS primary expenditure	25.4	25.0	29.2	26.6	25.5	25.1	24.5	23.9	23.9	23.9
NFPS primary balance	-1.0	-0.2	-7.3	-1.0	-1.0	-0.8	-0.2	0.3	0.3	0.2
NFPS overall balance	-2.3	-1.6	-8.9	-2.6	-2.6	-2.1	-1.5	-1.0	-1.0	-1.0
NFPS structural balance	-1.6	-0.6	-6.4	-3.6	-3.1	-2.7	-2.1	-1.5	-1.4	-1.4
NFPS structural primary balance 5/	-0.3	0.8	-4.8	-2.1	-1.6	-1.4	-0.7	-0.2	-0.1	-0.1
Debt										
Total external debt 6/	34.7	34.7	43.3	46.1	43.5	40.0	37.8	35.6	34.2	33.0
Gross non-financial public sector debt 7/	26.2	27.1	35.1	35.9	34.4	34.7	34.4	34.0	33.6	32.9
External	8.8	8.5	14.9	19.6	20.2	19.4	18.5	17.9	17.9	17.7
Domestic	17.3	18.6	20.2	16.3	14.2	15.3	15.9	16.1	15.8	15.3
Savings and investment										
Gross domestic investment	21.6	21.0	19.3	21.3	25.1	24.7	24.5	24.4	24.2	24.1
Public sector (incl. repayment certificates)	4.8	4.6	4.3	4.6	4.7	4.6	4.6	4.6	4.6	4.6
Private sector	17.6	18.1	16.8	20.6	20.4	20.1	20.0	19.8	19.7	19.5
National savings	19.9	20.0	20.0	18.6	23.6	23.3	23.0	22.9	22.9	22.7
Public sector	2.9	3.4	-4.0	2.7	2.7	3.1	3.7	4.2	4.2	4.2
Private sector	17.0	16.6	24.0	15.9	20.8	20.2	19.3	18.7	18.7	18.6
Memorandum items										
Nominal GDP (S/. billion)	741	771	717	872	958	1,018	1,070	1,123	1,178	1,237
GDP per capita (in US$)	7,007	6,963	6,127	6,643	7,034	7,475	7,748	8,012	8,296	8,594

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. The figure for 2021 is from Q3.
2/ Corresponds to depository corporations.
3/ Foreign currency stocks are valued at end-of-period exchange rates.
4/ Short-term debt is defined on a residual maturity basis and includes amortization of medium and long-term debt.
5/ Adjusted by the economic cycle and commodity prices, and for non-structural commodity revenue. The latter uses as equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to the IMF's World Economic Outlook.
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

	2018	2019	2020	2021	Proj. 2022	2023	2024	2025	2026	2027
	(In millions of soles; unless otherwise indicated)									
Revenues	**181,293**	**191,202**	**157,539**	**223,147**	**233,800**	**247,317**	**259,850**	**272,104**	**285,221**	**298,435**
Taxes	107,358	113,754	95,595	143,233	152,354	161,125	169,416	178,030	187,216	197,232
Other	73,935	77,448	61,944	79,915	81,447	86,191	90,434	94,075	98,004	101,203
Primary expenditures 1/	**188,407**	**192,741**	**209,793**	**232,156**	**243,846**	**255,651**	**261,828**	**268,561**	**281,113**	**295,429**
Current	148,512	152,588	173,593	184,713	192,512	202,161	205,710	209,909	219,520	230,728
Capital	39,895	40,154	36,201	47,443	51,333	53,490	56,117	58,652	61,592	64,702
Primary balance	**-7,114**	**-1,539**	**-52,254**	**-9,009**	**-10,045**	**-8,334**	**-1,978**	**3,543**	**4,108**	**3,006**
Interest	10,012	10,720	11,496	13,228	14,523	13,040	14,078	14,755	15,868	15,821
Overall balance	**-17,126**	**-12,259**	**-63,750**	**-22,237**	**-24,569**	**-21,374**	**-16,056**	**-11,212**	**-11,760**	**-12,816**
External financing	-557	4,510	31,922	52,484	19,737	767	615	-481	6,143	8,757
Domestic financing	17,683	7,749	31,828	-30,247	4,832	20,607	15,441	11,693	5,617	4,058
Public Gross Debt 2/	**193,967**	**208,759**	**251,698**	**313,317**	**329,204**	**352,828**	**367,837**	**382,172**	**396,151**	**407,413**
External	65,505	65,340	106,994	170,780	193,235	197,252	197,670	201,162	210,324	218,328
Domestic	125,184	140,651	142,214	140,031	133,763	153,670	168,561	179,704	184,821	188,378
Repayment Certificates	3,278	2,768	2,490	2,506	2,206	1,906	1,606	1,306	1,006	707
Public Assets 3/	**89,704**	**92,494**	**69,994**	**104,556**	**93,156**	**92,156**	**91,306**	**90,456**	**89,656**	**88,856**
	(In percent of GDP; unless otherwise indicated)									
Revenues	**24.5**	**24.8**	**22.0**	**25.6**	**24.4**	**24.3**	**24.3**	**24.2**	**24.2**	**24.1**
Taxes	14.5	14.8	13.3	16.4	15.9	15.8	15.8	15.9	15.9	16.0
Other	10.0	10.1	8.6	9.2	8.5	8.5	8.4	8.4	8.3	8.2
Primary expenditures 1/	**25.4**	**25.0**	**29.2**	**26.6**	**25.5**	**25.1**	**24.5**	**23.9**	**23.9**	**23.9**
Current	20.0	19.8	24.2	21.2	20.1	19.9	19.2	18.7	18.6	18.7
Capital	5.4	5.2	5.0	5.4	5.4	5.3	5.2	5.2	5.2	5.2
Primary balance	**-1.0**	**-0.2**	**-7.3**	**-1.0**	**-1.0**	**-0.8**	**-0.2**	**0.3**	**0.3**	**0.2**
Interest	1.4	1.4	1.6	1.5	1.5	1.3	1.3	1.3	1.3	1.3
Overall balance	**-2.3**	**-1.6**	**-8.9**	**-2.6**	**-2.6**	**-2.1**	**-1.5**	**-1.0**	**-1.0**	**-1.0**
External financing	-0.1	0.6	4.4	6.0	2.1	0.1	0.1	0.0	0.5	0.7
Domestic financing	2.4	1.0	4.4	-3.5	0.5	2.0	1.4	1.0	0.5	0.3
Public Gross Debt 2/	**26.2**	**27.1**	**35.1**	**35.9**	**34.4**	**34.7**	**34.4**	**34.0**	**33.6**	**32.9**
External	8.8	8.5	14.9	19.6	20.2	19.4	18.5	17.9	17.9	17.7
Domestic	16.9	18.3	19.8	16.1	14.0	15.1	15.7	16.0	15.7	15.2
Repayment Certificates	0.4	0.4	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Public Assets 3/	**12.1**	**12.0**	**9.8**	**12.0**	**9.7**	**9.1**	**8.5**	**8.1**	**7.6**	**7.2**
Public Net Debt	**14.1**	**15.1**	**25.3**	**23.9**	**24.6**	**25.6**	**25.8**	**26.0**	**26.0**	**25.8**
Memorandum items										
Commodity related revenues 4/	1.9	1.4	0.8	3.1	3.7	3.5	3.3	3.3	3.2	3.1
Output gap (percent of potential GDP)	-0.9	-1.6	-7.3	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0
NFPS non-commodity structural balance	-3.9	-2.4	-7.4	-5.6	-6.2	-5.6	-4.8	-4.3	-4.2	-4.1
NFPS non-commodity primary structural balance	-2.5	-1.0	-5.8	-4.0	-4.6	-4.3	-3.5	-2.9	-2.8	-2.9
NFPS structural balance 5/	-1.6	-0.6	-6.4	-3.6	-3.1	-2.7	-2.1	-1.5	-1.4	-1.4
NFPS structural primary balance 5/	-0.3	0.8	-4.8	-2.1	-1.6	-1.4	-0.7	-0.2	-0.1	-0.1
Fiscal impulse (+ = expansionary) 6/	-0.6	-1.1	5.2	-2.4	-0.5	-0.2	-0.7	-0.6	-0.1	0.0

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 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 equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to the IMF's World Economic Outlook.

6/ Percentage points of potential GDP.

Table 3. Peru: Statement of Operations of the General Government 1/

(In percent of GDP, unless otherwise indicated)

	2018	2019	2020	2021	Proj. 2022	2023	2024	2025	2026	2027
Revenue	**19.4**	**19.9**	**17.9**	**21.1**	**20.5**	**20.5**	**20.5**	**20.6**	**20.6**	**20.7**
Taxes	14.5	14.8	13.3	16.4	15.9	15.8	15.8	15.9	15.9	16.0
Social Contributions	2.2	2.2	2.2	2.1	2.0	2.0	2.0	2.0	2.1	2.1
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Other revenue	2.6	2.8	2.3	2.5	2.6	2.6	2.6	2.6	2.7	2.7
Expense 2/	**16.5**	**16.7**	**21.7**	**18.6**	**17.9**	**17.6**	**17.0**	**16.5**	**16.3**	**16.2**
Compensation of employees	6.2	6.4	7.3	6.3	6.1	6.1	6.0	6.0	6.0	6.0
Use of goods and services	5.7	5.8	6.5	6.4	6.0	5.8	5.7	5.6	5.6	5.7
Interest	1.2	1.3	1.5	1.4	1.4	1.2	1.1	1.0	0.9	0.7
Social benefits	1.9	1.8	1.9	1.7	1.6	1.5	1.5	1.5	1.4	1.4
Other 3/	1.5	1.5	4.5	2.9	2.9	3.0	2.7	2.4	2.3	2.4
Net acquisition of nonfinancial assets	**4.9**	**4.5**	**4.5**	**5.0**	**5.0**	**4.9**	**4.9**	**4.9**	**4.9**	**4.9**
Acquistion of nonfinancial assets	4.9	4.5	4.5	5.0	5.0	4.9	4.9	4.9	4.9	4.9
Gross Operating Balance	2.9	3.2	-3.9	2.4	2.6	2.9	3.5	4.1	4.3	4.5
Net lending (+) borrowing (-) 4/	**-2.0**	**-1.4**	**-8.3**	**-2.6**	**-2.4**	**-2.0**	**-1.4**	**-0.8**	**-0.6**	**-0.3**
Net acquistion of financial assets 5/	**-0.4**	**0.6**	**-0.4**	**3.7**	**-0.3**	**-1.9**	**-1.2**	**-0.7**	**0.0**	**0.4**
By instrument										
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/	-0.4	0.6	-0.4	3.7	-0.3	-1.9	-1.2	-0.7	0.0	0.4
By residency										
Domestic	-0.4	0.6	-0.4	3.7	-0.3	-1.9	-1.2	-0.7	0.0	0.4
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/	**1.6**	**1.9**	**7.9**	**6.2**	**2.2**	**0.2**	**0.1**	**0.0**	**0.6**	**0.8**
By instrument										
Debt securities	2.3	1.2	3.1	0.5	0.1	0.1	0.1	0.1	0.1	0.1
Loans	-0.7	0.8	4.8	5.8	2.1	0.1	0.1	0.0	0.5	0.7
By residency										
Domestic	2.3	1.2	3.1	0.5	0.1	0.1	0.1	0.1	0.1	0.1
External	-0.7	0.8	4.8	5.8	2.1	0.1	0.1	0.0	0.5	0.7
Memorandum items										
Central Government Net lending (+) borrowing (-)	-2.2	-2.5	-8.9	-3.8	-2.9	-2.4	-1.7	-0.9	-0.6	-0.2
Regional Governments Net lending (+) borrowing (-)	0.4	0.5	-0.1	0.7	0.6	0.6	0.7	0.7	0.7	0.8
Local Governments Net lending (+) borrowing (-)	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
General Government Primary Balance	-0.8	-0.1	-6.8	-1.2	-1.1	-0.9	-0.3	0.2	0.3	0.4
General Government Overall Balance	-2.0	-1.4	-8.3	-2.6	-2.4	-2.0	-1.4	-0.8	-0.6	-0.3
Gen. Gov. primary spending (real percentage change)	4.9	1.0	13.0	5.2	1.0	1.5	-0.2	0.6	2.6	3.0
Of which: Current spending	3.9	3.1	19.6	-0.4	0.0	1.8	-0.8	0.1	2.4	3.1
Capital spending	8.2	-5.7	-9.3	30.4	4.4	0.7	1.8	2.2	2.9	3.0
General Government non-financial expenditures	20.2	20.0	24.7	22.3	21.6	21.4	20.8	20.4	20.3	20.3

Sources: National authorities and IMF staff estimates.

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

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

3/ Includes other transfers.

4/ Net lending (+)/ borrowing (-) is equal to gross operating balance minus net acquistions 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: Balance of Payments
(In billions of U.S. dollars, unless otherwise indicated)

	2018	2019	2020	2021	Proj. 2022	2023	2024	2025	2026	2027
Current account	**-3.9**	**-2.4**	**1.5**	**-6.2**	**-3.7**	**-3.7**	**-4.1**	**-4.3**	**-4.0**	**-4.2**
Merchandise trade	7.2	6.9	8.2	14.8	16.2	16.0	15.3	14.5	13.9	13.5
Exports	49.1	48.0	42.9	63.1	73.3	75.7	77.8	80.3	82.9	86.0
Traditional	35.6	34.0	30.0	46.5	55.0	56.3	57.4	58.9	60.6	62.7
Mining	28.9	28.3	26.1	39.6	45.8	47.7	49.3	50.9	52.6	54.7
Nontraditional and others	13.4	14.0	12.9	16.6	18.3	19.5	20.4	21.4	22.3	23.3
Imports	-41.9	-41.1	-34.7	-48.4	-57.0	-59.7	-62.6	-65.8	-69.0	-72.5
Services, income, and current transfers (net)	-11.1	-9.3	-6.6	-20.9	-19.9	-19.7	-19.4	-18.7	-17.9	-17.7
Services	-2.8	-3.2	-4.2	-6.6	-7.1	-6.9	-6.8	-6.7	-6.6	-6.5
Investment income	-11.9	-9.8	-6.5	-18.4	-17.1	-17.1	-16.9	-16.5	-15.9	-15.9
Current transfers	3.6	3.7	4.1	4.1	4.3	4.4	4.4	4.5	4.6	4.7
Capital and financial account balance	**2.0**	**8.9**	**7.7**	**16.0**	**3.3**	**3.4**	**5.1**	**5.8**	**5.8**	**6.6**
Public sector	2.1	4.4	9.8	15.6	5.0	0.3	0.3	0.0	1.6	2.3
Medium-term loans 1/	0.2	-0.3	9.0	15.3	5.0	0.2	0.2	-0.1	1.5	2.2
Other public sector flows 2/	2.1	4.5	1.1	0.3	0.0	0.1	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	-0.2	4.5	-2.1	0.4	-1.6	3.1	4.9	5.8	4.2	4.3
Foreign direct investment (net) 3/	6.9	6.8	0.9	6.1	5.3	6.3	6.5	7.5	7.6	7.8
Medium- and long-term loans	-1.9	-2.3	-3.4	-0.9	-2.5	-2.3	-2.2	-2.0	-1.9	-1.8
Portfolio investment	-3.2	-0.5	1.4	11.6	2.2	1.2	-0.3	-1.8	-1.8	-1.8
Short-term flows 4/	-1.9	0.5	-1.0	-16.5	-6.6	-2.1	0.8	2.2	0.3	0.1
Errors and omissions	**-1.7**	**0.4**	**-4.0**	**-5.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**-3.6**	**6.9**	**5.6**	**5.6**	**-0.4**	**-0.3**	**1.0**	**1.5**	**1.8**	**2.4**
Financing	**3.6**	**-6.9**	**-5.6**	**-5.6**	**0.4**	**0.3**	**-1.0**	**-1.5**	**-1.8**	**-2.4**
NIR flow (increase -)	3.6	-6.9	-5.6	-3.8	0.4	0.3	-1.0	-1.5	-1.8	-2.4
Change in NIR (increase -)	3.5	-8.2	-6.4	-3.8	0.4	0.3	-1.0	-1.5	-1.8	-2.4
Valuation change	0.1	1.3	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
					(In percent of GDP)					
Current account balance	**-1.7**	**-1.0**	**0.8**	**-2.8**	**-1.5**	**-1.4**	**-1.5**	**-1.5**	**-1.4**	**-1.4**
Trade balance	3.2	3.0	4.0	6.6	6.8	6.2	5.6	5.1	4.7	4.4
Exports	21.8	20.8	20.9	28.1	30.5	29.4	28.8	28.5	28.1	27.9
Traditional	15.8	14.7	14.6	20.7	22.9	21.8	21.3	20.9	20.5	20.3
Mining	12.8	12.3	12.7	17.6	19.1	18.5	18.2	18.0	17.8	17.7
Nontraditional and others	6.0	6.0	6.3	7.4	7.6	7.5	7.6	7.6	7.6	7.5
Imports	-18.6	-17.8	-16.9	-21.5	-23.7	-23.2	-23.2	-23.3	-23.4	-23.5
Services, income, and current transfers (net)	-4.9	-4.0	-3.2	-9.3	-8.3	-7.6	-7.2	-6.6	-6.1	-5.7
Investment income	-5.3	-4.3	-3.2	-8.2	-7.1	-6.6	-6.3	-5.9	-5.4	-5.1
Capital and financial account balance	**0.9**	**3.9**	**3.8**	**7.1**	**1.4**	**1.3**	**1.9**	**2.0**	**2.0**	**2.1**
Foreign direct investment (net)	3.1	2.9	0.4	2.7	2.2	2.4	2.4	2.7	2.6	2.5
Overall balance	**-1.6**	**3.0**	**2.7**	**2.5**	**-0.1**	**-0.1**	**0.4**	**0.5**	**0.6**	**0.8**
Memorandum items					(Annual percentage change)					
Export value	8.0	-2.2	-10.6	47.1	16.1	3.4	2.8	3.1	3.3	3.7
Volume growth	1.6	1.2	-13.7	12.9	4.4	3.9	3.7	3.8	3.6	3.5
Price growth	6.3	-3.4	3.7	30.3	11.2	-0.5	-0.9	-0.6	-0.3	0.2
Import value	8.1	-1.8	-15.6	39.3	17.9	4.7	4.8	5.1	4.9	5.0
Volume growth	1.4	-0.2	-11.1	19.5	3.9	4.7	4.6	4.6	4.5	4.3
Price growth	6.7	-1.7	-5.0	16.6	13.5	0.0	0.1	0.5	0.4	0.7
Terms of trade	-0.4	-1.8	9.1	11.8	-2.0	-0.5	-1.0	-1.1	-0.7	-0.5
Gross international reserves (in billions of US$)	60.3	68.4	74.9	78.5	78.2	77.9	78.9	80.4	82.2	84.6
Average exchange rate (S/. per US$)	3.29	3.34	3.50	3.88	3.99	3.94	3.96	3.98	3.99	4.01

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 privatizations.

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

Table 5. Peru: Monetary Survey 1/

(In billions of soles, unless otherwise indicated)

	2018	2019	2020	2021	Proj.					
					2022	2023	2024	2025	2026	2027
					Central Bank					
Net foreign assets	**159**	**170**	**223**	**241**	**173**	**214**	**216**	**220**	**224**	**209**
(In billions of U.S. dollars)	73	85	88	93	107	96	98	100	103	112
Net international reserves 2/	203	226	270	322	308	308	313	320	329	339
(In billions of U.S. dollars)	60	68	75	78	78	78	79	80	82	85
Long-term net external assets	0	0	0	-11	-10	-10	-10	-10	-10	-11
Foreign currency liabilities	-43	-57	-48	-70	-124	-84	-87	-89	-94	-119
Net domestic assets	**-98**	**-105**	**-137**	**-146**	**-85**	**-122**	**-122**	**-124**	**-126**	**-109**
Net credit to nonfinancial public sector	-61	-64	-49	-75	-72	-72	-72	-72	-72	-72
Credit to the financial sector 3/	7	5	41	30	35	-15	-8	-2	5	11
Securities issued	-26	-28	-89	-43	-43	-42	-40	-37	-34	-30
Other assets (net)	-18	-18	-40	-59	-5	6	-2	-13	-25	-19
Monetary base	**61**	**65**	**86**	**95**	**89**	**91**	**94**	**97**	**99**	**101**
Currency	50	52	72	82	88	48	52	56	61	66
Reserve	12	12	14	13	1	43	42	40	38	35
					Depository Corporations 4/					
Net foreign assets	**172**	**194**	**253**	**274**	**281**	**273**	**280**	**288**	**298**	**311**
Net domestic assets	**138**	**143**	**183**	**172**	**203**	**243**	**270**	**297**	**319**	**340**
Net credit to the public sector	-57	-62	-35	-74	-79	-74	-73	-74	-81	-90
Credit to the private sector	311	331	378	401	436	470	497	525	554	584
Other assets (net)	-116	-126	-160	-155	-154	-154	-154	-154	-154	-154
Broad money	**310**	**338**	**436**	**447**	**484**	**516**	**550**	**586**	**617**	**651**
Domestic currency	215	237	313	311	346	380	416	454	491	531
Foreign currency	96	101	122	136	138	137	135	132	126	120
					Financial System 5/					
Net foreign assets	**262**	**298**	**366**	**359**	**354**	**358**	**366**	**374**	**384**	**397**
Net domestic assets	**236**	**256**	**289**	**264**	**303**	**335**	**360**	**387**	**409**	**428**
Net credit to the public sector	-15	-15	1	-44	-49	-44	-43	-44	-51	-59
Credit to the private sector	368	393	442	467	512	539	563	591	620	648
Other assets (net)	-116	-122	-155	-160	-160	-160	-160	-160	-161	-161
Liabilities to the private sector	**498**	**554**	**654**	**623**	**656**	**694**	**726**	**761**	**793**	**825**
Domestic currency	383	428	501	461	529	570	607	648	687	728
Foreign currency	116	127	153	162	127	124	119	113	106	98
Monetary base	7.3	5.2	33.2	10.4	-6.7	2.9	3.0	2.9	2.1	2.2
Broad money	9.6	8.8	29.0	2.6	8.4	6.6	6.6	6.4	5.4	5.5
Domestic currency	12.2	10.2	32.3	-0.9	11.5	9.6	9.5	9.2	8.1	8.1
Foreign currency	4.1	5.6	21.2	11.4	1.3	-0.9	-1.4	-2.3	-4.0	-4.8
Liabilities to the private sector	5.7	11.3	18.1	-4.8	5.4	5.7	4.6	4.8	4.2	4.1
Domestic currency	6.1	11.8	17.1	-8.0	14.9	7.7	6.5	6.7	6.1	5.9
Foreign currency	4.2	9.6	21.3	5.7	-21.8	-2.5	-4.2	-4.8	-6.3	-7.6
Depository corporations credit to the private sector	10.3	6.4	14.0	6.3	8.7	7.8	5.6	5.7	5.5	5.4
Domestic currency	11.6	9.8	19.7	5.0	11.5	9.7	6.4	6.4	6.2	6.0
Foreign currency	7.1	-2.2	-2.4	10.7	-0.9	0.9	2.6	2.3	2.3	2.3

Sources: National Authorities; and IMF staff estimates.

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

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

3/ Including the National Bank.

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

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

Table 6. Peru: Financial Soundness Indicators 1/
(In percent, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021
			(as of December)					
Capital Adequacy								
Capital to risk-weighted assets 2/	14.2	14.3	15.1	15.2	14.8	14.7	15.6	15.0
Regulatory Tier I capital to risk-weighted assets 3/	10.4	10.3	11.0	11.4	11.3	11.6	11.8	11.0
Nonperforming loans net of provisions to capital 4/	0.2	-0.3	-0.4	-0.6	-0.6	-0.5	-3.6	-1.4
Leverage 5/	8.3	7.9	8.7	9.4	9.8	10.2	8.8	9.0
Asset Quality								
Nonperforming loans to total gross loans 4/	2.9	2.9	3.1	3.3	3.3	3.4	4.2	3.9
In domestic currency	3.4	2.9	3.2	3.6	3.7	3.8	4.4	4.1
In foreign currency	2.1	2.9	2.8	2.6	2.4	2.3	3.5	3.5
Nonperforming, refinanced and restructured loans to total gross loans 4/ 6/	4.0	4.0	4.4	4.8	4.9	4.9	6.0	6.0
In domestic currency	3.4	2.9	3.2	3.6	3.7	3.8	4.4	4.1
In foreign currency	2.1	2.9	2.8	2.6	2.4	2.3	3.5	3.5
Refinanced and restructured loans to total gross loans	1.1	1.1	1.3	1.5	1.6	1.5	1.9	2.0
Provisions to nonperforming loans 4/	157.7	161.8	157.1	151.1	150.7	149.1	178.5	159.9
Provisions to nonperforming, restructured, and refinanced loans 4/ 6/	114.4	116.5	111.1	105.0	101.6	103.3	123.6	105.8
Sectoral distribution of loans to total loans								
Consumer loans	18.1	18.3	18.9	19.2	19.8	21.4	17.7	17.2
Mortgage loans	15.5	15.2	15.1	15.4	15.3	15.6	14.4	14.7
Large corporations	17.2	21.4	22.2	22.6	23.3	22.2	18.7	21.2
Small corporations	17.0	15.8	14.8	14.3	14.3	14.3	16.0	15.5
Medium size firms	18.3	16.9	16.4	15.4	14.8	13.7	18.8	18.0
Small firms	10.1	9.0	9.1	9.4	9.1	9.3	10.6	10.1
Microenterprises	3.8	3.4	3.6	3.7	3.5	3.5	3.9	3.4
Earnings and Profitability								
Return on equity (ROE)	18.2	21.1	19.2	17.7	17.9	17.9	3.1	12.1
Return on assets (ROA)	1.9	2.1	2.0	2.1	2.2	2.2	0.4	1.3
Financial revenues to total revenues	85.0	85.1	85.3	84.2	83.4	83.7	84.6	81.5
Annualized financial revenues to revenue-generating assets	10.6	10.5	10.1	10.2	10.3	10.4	7.8	6.9
Liquidity								
Total liquid assets to total short-term liabilities (monthly average basis)	39.4	37.7	35.4	38.5	34.6	36.4	50.3	41.5
In domestic currency	25.3	26.2	26.7	33.0	27.2	27.5	50.6	33.6
In foreign currency	55.2	47.5	44.9	45.7	45.3	50.3	49.8	51.4
Deposit-to-loan	90.5	92.0	88.4	92.1	89.4	90.9	99.3	92.6
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	34.6	39.5
Share of foreign currency loans in total credit	38.4	30.1	28.8	29.4	28.5	26.5	22.7	23.3
Operational efficiency								
Financing to related parties to capital 7/	9.4	12.3	9.1	9.6	12.3	9.7	9.7	8.9
Nonfinancial expenditure to total revenues 8/	33.0	30.9	30.8	30.7	30.7	29.9	31.8	35.3
Annualized Nonfinancial expenditure to total revenue-generating assets 8/	4.1	3.8	3.7	3.7	3.8	3.7	2.9	3.0
Memorandum items								
General Stock market index, IGBVL	14,794	9,849	15,567	19,974	19,350	20,526	20,822	21,112
EMBI+ PERU spread, basis points	181	243	170	112	137	92	117	144

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

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 7. Peru: Financial and External Vulnerability Indicators
(In percent, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Proj.					
Financial indicators										
Public sector debt/GDP	26.2	27.1	35.1	35.9	34.4	34.7	34.4	34.0	33.6	32.9
Of which: in domestic currency (percent of GDP)	17.3	18.6	20.2	16.3	14.2	15.3	15.9	16.1	15.8	15.3
90-day prime lending rate, domestic currency (end of period)	4.3	3.3	0.6	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
90-day prime lending rate, foreign currency (end of period)	3.4	2.7	1.1	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Velocity of money 1/	2.4	2.3	1.6	2.0	2.0	2.0	1.9	1.9	1.9	1.9
Net credit to the private sector/GDP 2/	42.0	43.0	52.6	46.0	45.5	46.2	46.4	46.8	47.0	47.2
External indicators										
Exports, U.S. dollars (percent change)	8.0	-2.2	-10.6	47.1	16.1	3.4	2.8	3.1	3.3	3.7
Imports, U.S. dollars (percent change)	8.1	-1.8	-15.6	39.3	17.9	4.7	4.8	5.1	4.9	5.0
Terms of trade (percent change) (deterioration -) 3/	-0.4	-1.8	9.1	11.8	-2.0	-0.5	-1.0	-1.1	-0.7	-0.5
Current account balance (percent of GDP)	-1.7	-1.0	0.8	-2.8	-1.5	-1.4	-1.5	-1.5	-1.4	-1.4
Capital and financial account balance (percent of GDP)	0.9	3.9	3.8	7.1	1.4	1.3	1.9	2.0	2.0	2.1
Total external debt (percent of GDP)	34.7	34.7	43.3	46.1	43.5	40.0	37.8	35.6	34.2	33.0
Medium- and long-term public debt (in percent of GDP) 4/	15.5	17.0	23.7	26.9	27.2	25.4	24.4	23.3	22.8	22.5
Medium- and long-term private debt (in percent of GDP)	15.0	14.3	14.9	13.7	12.3	10.8	9.8	8.9	8.1	7.4
Short-term public and private debt (in percent of GDP)	4.2	3.4	4.7	4.3	4.0	3.8	3.6	3.4	3.3	3.1
Total external debt (in percent of exports of goods and services) 4/	141.0	146.7	194.6	157.0	135.8	128.6	122.8	116.8	112.8	109.6
Total debt service (in percent of exports of goods and services) 5/	33.6	37.7	35.6	24.1	23.3	22.7	21.6	23.1	22.4	21.2
Gross official reserves										
In millions of U.S. dollars	60,288	68,370	74,909	78,539	78,189	77,869	78,869	80,369	82,169	84,569
In percent of short-term external debt 6/	369	428	487	586	561	537	565	516	527	563
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	112	127	152	134	138	135	139	137	144	154
In percent of broad money 8/	66	67	62	71	64	60	57	55	53	52
In percent of foreign currency deposits at banks	213	224	222	229	223	225	233	243	260	282
In months of next year's imports of goods and services	14.2	19.7	15.5	13.9	13.2	12.5	12.1	11.7	12.0	11.8
Net international reserves (in millions of U.S. dollars)	60,121	68,316	74,707	78,495	78,145	77,825	78,825	80,325	82,125	84,525
Central Bank's Foreign Exchange Position	39,548	42,619	58,258	57,345	56,995	56,675	57,675	59,175	60,975	63,375

Sources: National authorities; IMF's Information Notice System (INS); and IMF staff estimates/projections.
1/ Defined as of the ratio of annual GDP to end-period broad money.
2/ Corresponds to depository corporations.
3/ End of period; data from INS.
4/ Includes Central Bank's debt.
5/ Includes debt service to the Fund.
6/ Short-term debt includes amortization of medium- and long-term loans falling due over the following year, including debt swaps.
7/ Current Account deficit adjusted for 0.75*net FDI inflows; if adjusted CA balance>0, set to 0.
8/ At end-period exchange rates.

Table 8. Peru: Medium-Term Macroeconomic Framework

	2018	2019	2020	2021	Proj. 2022	2023	2024	2025	2026	2027
	(Annual percentage change)									
Production										
GDP at constant prices	4.0	2.2	-11.0	13.3	3.0	3.0	3.0	3.0	3.0	3.0
Domestic demand at constant prices	4.2	2.2	-9.5	14.4	2.8	3.2	3.2	3.2	3.2	3.2
Consumption	3.3	3.1	-7.3	11.6	-1.3	3.5	3.4	3.4	3.4	3.4
Investment	4.4	3.3	-16.3	34.9	0.2	2.4	2.6	2.6	2.6	2.6
Of which: Private	4.1	4.5	-16.5	37.6	0.0	2.4	2.5	2.5	2.5	2.5
Of which: Public	5.5	-1.5	-15.5	23.7	1.3	2.2	3.2	2.8	3.0	3.0
Net exports (contribution to GDP growth)	-0.1	0.0	-1.8	-1.0	0.1	-0.2	-0.2	-0.2	-0.2	-0.2
Exports	2.4	1.1	-20.5	14.0	4.4	3.9	3.7	3.8	3.6	3.5
Imports	3.2	1.2	-15.6	18.8	3.9	4.7	4.6	4.6	4.5	4.3
Consumer prices (end of period)	2.2	1.9	2.0	6.4	4.0	3.0	2.3	2.0	2.0	2.0
GDP deflator	2.0	1.8	4.6	7.3	6.7	3.1	2.1	1.8	1.9	1.9
Trade										
Merchandise trade										
Exports, f.o.b.	8.0	-2.2	-10.6	47.1	16.1	3.4	2.8	3.1	3.3	3.7
Imports, f.o.b.	8.1	-1.8	-15.6	39.3	17.9	4.7	4.8	5.1	4.9	5.0
Terms of trade (deterioration -)	-0.4	-1.8	9.1	11.8	-2.0	-0.5	-1.0	-1.1	-0.7	-0.5
	percent of GDP; unless otherwise indicat									
External current account balance	-1.7	-1.0	0.8	-2.8	-1.5	-1.4	-1.5	-1.5	-1.4	-1.4
Total external debt service 1/	8.3	8.9	7.9	7.1	7.5	7.1	6.6	7.1	6.8	6.4
Medium- and long-term	4.4	4.7	4.0	2.8	3.4	3.2	2.9	3.5	3.4	3.1
Nonfinancial public sector	1.3	1.5	1.0	0.8	1.5	1.5	1.4	2.1	2.0	1.9
Private sector	3.1	3.3	3.0	2.0	1.8	1.6	1.5	1.4	1.3	1.2
Short-term 2/	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Interest	1.5	1.4	1.2	1.2	1.7	1.4	1.5	1.5	1.5	1.5
Amortization (medium-and long-term)	3.1	3.5	2.8	1.7	1.8	1.9	1.6	2.1	2.0	1.7
Public sector										
NFPS primary balance 3/	-1.0	-0.2	-7.3	-1.0	-1.0	-0.8	-0.2	0.3	0.3	0.2
NFPS interest due	1.4	1.4	1.6	1.5	1.5	1.3	1.3	1.3	1.3	1.3
NFPS overall balance 3/	-2.3	-1.6	-8.9	-2.6	-2.6	-2.1	-1.5	-1.0	-1.0	-1.0
Public sector debt 3/	26.2	27.1	35.1	35.9	34.4	34.7	34.4	34.0	33.6	32.9
Savings and investment										
Gross domestic investment	21.6	21.0	19.3	21.3	25.1	24.7	24.5	24.4	24.2	24.1
Public sector 3/	4.8	4.6	4.3	4.6	4.7	4.6	4.6	4.6	4.6	4.6
Private sector	16.9	16.4	15.0	16.7	20.4	20.1	20.0	19.8	19.7	19.5
Private sector (excluding inventories)	17.6	18.1	16.8	20.6	20.4	20.1	20.0	19.8	19.7	19.5
Inventory changes	-0.7	-1.6	-1.8	-3.9	0.0	0.0	0.0	0.0	0.0	0.0
National savings	19.9	20.0	20.0	18.6	23.6	23.3	23.0	22.9	22.9	22.7
Public sector 4/	2.9	3.4	-4.0	2.7	2.7	3.1	3.7	4.2	4.2	4.2
Private sector	17.0	16.6	24.0	15.9	20.8	20.2	19.3	18.7	18.7	18.6
External savings	1.7	1.0	-0.8	2.8	1.5	1.4	1.5	1.5	1.4	1.4
Memorandum items										
Nominal GDP (billions of nuevos soles)	740.8	770.5	717.4	872.0	958.0	1017.5	1070.5	1,122.9	1,178.1	1,236.5
Gross international reserves (billions of U.S. dollars)	60.3	68.4	74.9	78.5	78.2	77.9	78.9	80.4	82.2	84.6
External debt service (percent of exports of GNFS)	33.6	37.7	35.6	24.1	23.3	22.7	21.6	23.1	22.4	21.2
Short-term external debt service (percent of exports of GNFS)	0.5	0.5	0.3	0.2	0.3	0.5	0.5	0.5	0.4	0.4
Public external debt service (percent of exports of GNFS)	5.1	6.2	4.4	2.8	4.8	4.9	4.5	6.8	6.7	6.3

Sources: National authorities and IMF staff estimates.
1/ Includes interest payments only.
2/ Includes the financial public sector.
3/ Includes Repayment Certificates (CRPAOs).
4/ Excludes privatization receipts.

Annex I. Implementation of Past Fund Advice

Recommendations	Authorities' Response
Fiscal Policy	
Continue to use the available fiscal space to help contain the pandemic, mitigate its impact on poverty, and safeguard against downside risks to growth.	**Implemented**. Discretionary spending measures of about 2 percent of GDP were deployed in 2021 to contain the impact of the pandemic.
Anchor fiscal policy to a credible medium-term framework. Any recalibration of the fiscal rules should preserve debt sustainability, strengthen credibility, and be clearly communicated.	**Partially implemented**. Fiscal targets for the fiscal deficit and public debt were introduced in 2021 for 2022. The 2023-2025 MTBF is not aligned with the fiscal rules.
Raise revenue mobilization capacity in the medium-term.	**Partially implemented**. Congress approved measures to reduce tax evasion in 2021 but rejected a comprehensive reform proposal, which included an increase in income and mining sector tax rates.
Monetary and Exchange Rate Policy	
Monetary policy should remain accommodative even as extraordinary measures are withdrawn. Another guaranteed-lending program could be considered if downside risks to growth materialize.	**Implemented**. The authorities have maintained accommodative conditions until inflationary pressures have emerged. Downside risks to growth, instead, have not materialized.
Additional exchange rate flexibility would help foster the development of hedging instruments, strengthen the transmission of monetary policy, and reduce dollarization by inducing agents to internalize exchange rate risk.	**Partially implemented**. The authorities continue to intervene to stabilize the exchange rate during volatile periods without altering the exchange rate trend.
Further enhancing communications could help manage the challenges of a multi-instrument framework. The BCRP could go further than reporting factual FX interventions and explain the rationale of past interventions by linking them to the structural characteristics of the economy and the policy tradeoffs.	**Partially implemented**. The authorities continue to intervene in foreign exchange markets to minimize volatility maintaining a discretionary approach but provide ample information on foreign currency intervention.
Financial Policies	
As conditions allow, macroprudential policies may start shifting focus by encouraging banks to put more emphasis on the viability of clients.	**In progress**. The authorities are in a transitory period where supportive measures implemented during the COVID-19 pandemic are gradually being removed or reversed.

Close key regulatory and supervisory gaps in line with the recommendations of the 2018 FSAP.	**In progress.** See Annex X.
Structural Policies	
Boost productivity by improving education, enhancing infrastructure, facilitating labor reallocation, and improving the business climate.	**Partially implemented.** Spending on education will significantly increase under the 2021 NFPS budget, but in-person schooling is yet to resume. Some of the announced policies, such as a second agrarian reform law and a package of labor market measures could worsen the business climate.
Enhance social protection while reducing incentives to informality from the tax-benefit system, including through investment in health care and pension reform.	**Partially implemented.** Social protection is an important pillar of the government program, and the authorities have introduced subsidies to increase formal employment. Spending on health will significantly increase under the 2021 NFPS budget. Progress on pension reform is delayed.
Strengthen governance with additional transparency in the public sector and robust anti-corruption and AML/CFT frameworks.	**In progress.** New legislation on the qualifications in the civil service has been approved recently

Annex II. External Sector Assessment

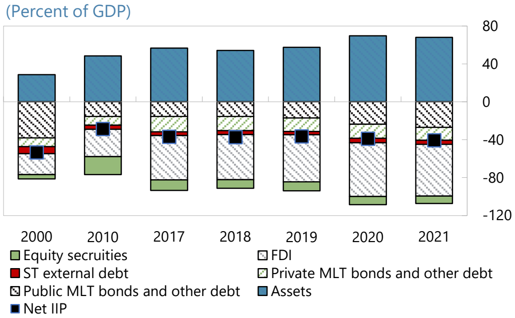
Overall Assessment: *The external position in 2021 was broadly in line with the level implied by medium-term fundamentals and desirable policies, although this assessment is subject to high uncertainties related to the impact of the COVID-19 pandemic. Notwithstanding the adverse effects of the pandemic and significant capital outflows reflecting increased political uncertainty, reserve coverage remains adequate even after considering the dependence on commodity prices and the existence of substantial domestic FX liabilities.*

Foreign Assets and Liabilities: Position and Trajectory

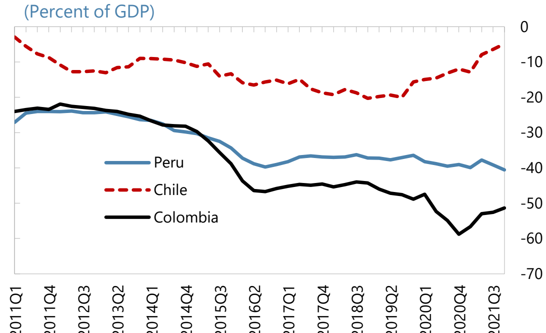
Background. Peru's IIP is characterized by large foreign reserves, moderate external debt, and large FDI liabilities. After improving from a low of -54 percent of GDP in the late 90s to -24 percent of GDP in 2011, Peru's net IIP has been on a declining trend, driven by the accumulation of FDI liabilities. In 2021, the ratio of the net IIP-to-GDP declined by 1.6 percentage points to -40.6 percent of GDP, but this was mainly due to the recovery in output, the denominator of the ratio. Peru's external assets (about 68 percent of GDP) include sizeable holdings of foreign assets by the central bank (35 percent of GDP) and the financial system (about 13 percent of GDP). The assets are offset by large FDI liabilities (55 percent of GDP), moderate external indebtedness (public and private external debt of about 45 percent of GDP), and equity securities (7.9 percent of GDP). The net IIP is projected to decline at about 36 percent of GDP over the medium term.

Assessment. Gross external financing needs rose to an estimated 8.7 percent of GDP in 2021. The external stability (ES) approach suggests a need for an external adjustment once the recovery is fully underway. The estimated medium-term current account balance (CAB) required to stabilize the NIIP at its end-2020 level is -1.9 percent of GDP which is below the medium-term CAB projections in the baseline.

Net International Investment Position
(Percent of GDP)



Net International Investment Position
(Percent of GDP)



Sources: Haver, BCRP and IMF staff estimates.

2021 (% GDP)	NIIP: -40.6	Gross Assets: 67.9	Debt Assets: 34.9	Gross Liab.: 108.5	Debt Liab.: 45

Current Account

Background. While Peru's trade surpluses increased to historically high levels in 2021, its CAB turned into a deficit. The trade balance increased by 2.6 pp of GDP to a historically high level of 6.6 percent of

GDP, reflecting large gains in the terms of trade (about 12 percent) and robust external demand. Exports of goods increased by about 47 percent, reflecting higher prices (about 30 percent) and volume growth (about 13 percent). Imports of goods grew by about 40 percent, reflecting a sharp recovery in volumes (about 17 percent) and increases in prices (about 20 percent). Nevertheless, following a rare surplus of 0.8 percent of GDP in 2020, the CAB turned into a deficit of 2.8 percent of GDP in 2021, due mainly to an increase in investment income outflows of about 5 pp of GDP to 8.2 percent of GDP, and a fall in the services trade balance of 0.9 pp of GDP as tourism-related revenues remained at very low levels. Over the medium term, the current account deficit is expected to stabilize at about 1.4 percent of GDP.

Assessment. The EBA CA model estimates a current account norm of -2.0 percent of GDP. After accounting for the temporary impact of the pandemic on travel, transportation, and other factors (1.3 percent of GDP) and for the output and terms of trade gap, staff estimates the 2021 cyclically adjusted current account to be -2.1 percent of GDP. Thus, the overall CA gap is about -0.1 percent of GDP, pointing to an external position in 2021 broadly in line with the level implied by fundamentals and desirable policy settings. Out of the CA gap of -0.1 percent of GDP, policy gaps account for 0.5 percent of GDP. This is mainly explained by stronger fiscal balances compared to the rest of the world, the contribution of the relative fiscal policy gap to the overall CA gap being estimated at 1.1 percent of GDP. It needs to be emphasized that, given the unprecedented nature of the 2020-21 period, uncertainty around these estimates is very high.

Current Account and REER Gaps, 2021

(Percent of GDP, unless stated otherwise)

	CA regression	REER (index)	REER (level)
CA Actual	**-2.8**	..	..
Cyclical contributions (from model) (-)	0.6	..	..
COVID-19 adjustor (+) 1/	1.3	..	..
Cyclically adjusted CA	**-2.1**	..	..
CA norm (from model) 2/	**-2.0**	..	..
CA gap 3/	**-0.1**	..	..
o/w Policy gaps	0.5	..	..
Elasticity	-0.2	..	..
REER gap (in percent) 4/	***0.5***	***-1.2***	***14.5***

Source: IMF staff estimates.

1/ Additional cyclical adjustment of 1.3 perceny of GDP to account for the temporary impact of the pandemic on travel (+0.4 percent of GDP), transport (+0.8 percent of GDP), and consumption shift and medical goods (0.0 percent of GDP).

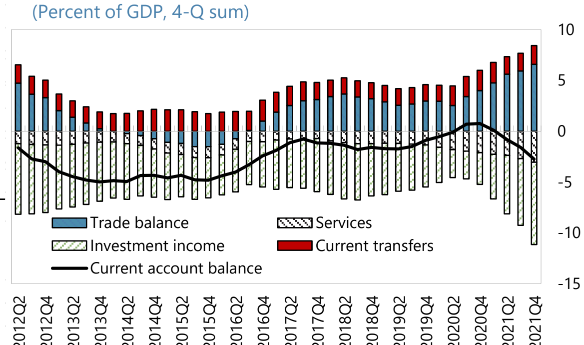
2/ Cyclically adjusted

3/ The CA gap is the cyclically adjusted CA minus the CA norm.

4/ Positive value indicates overvaluation.

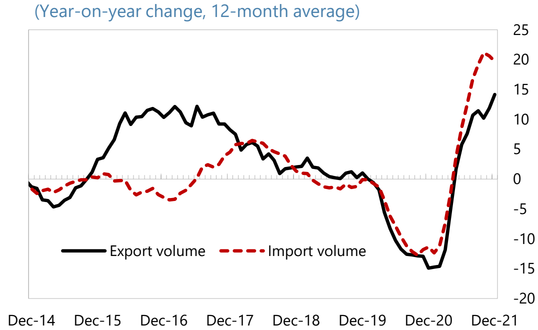
Current Account Balance

(Percent of GDP, 4-Q sum)



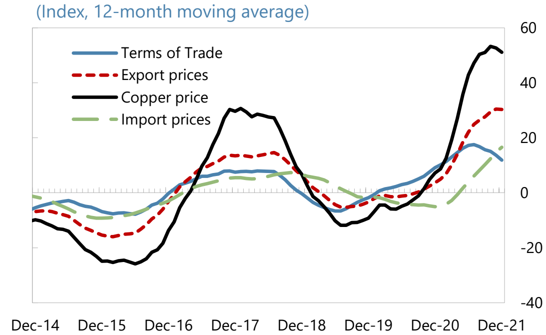
Trade Volumes

(Year-on-year change, 12-month average)



Terms of Trade

(Index, 12-month moving average)



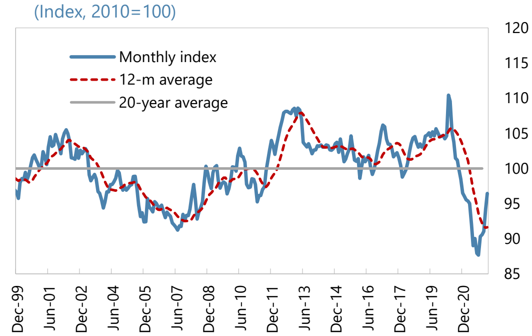
Sources: BCRP; IMF INS database; and IMF staff calculations.

Real Exchange Rate

Background. The real exchange rate (REER) depreciated in 2021. The average REER in 2021 was about 10 percent weaker than in 2020 and remained well below its 20-year average. The nominal exchange rate against the US dollar depreciated by about 11 percent reflecting the historically high levels of short-term outflows.

Assessment. The EBA REER approaches estimate an undervaluation of 1.2 percent (index method) and overvaluation of 14.5 percent (level method) in 2021. The REER gap derived from the IMF staff's CA gap assessment, with an estimated elasticity of -0.2, implies a REER overvaluation of 0.5 percent. In line with the assessment implied by the current account model—while considering all estimates and the uncertainties around them — staff assesses the REER gap in 2021 to range between -1.2 and 14.5, though with a wide range of uncertainty given the substantial differences in results across the REER and CA approaches.

Real Effective Exchange Rate
(Index, 2010=100)



Capital and Financial Accounts: Flows and Policy Measures

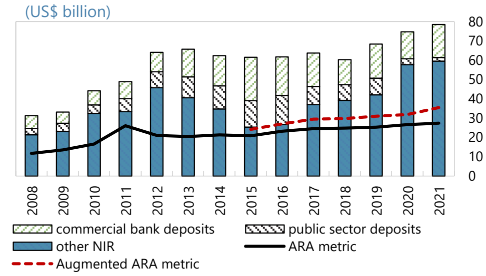
Background. Net inflows into the capital and financial account rose in 2021 despite sharp increases in short-term capital outflows in the context of increased political uncertainty. Inflows were dominated by public sector borrowing, a sharp increase in FDI, and the repatriation of foreign assets by pension and mutual funds. Foreign borrowing by the public sector was substantial and included bond issuances on international markets of about US$5 billion in March and US$5.1 billion in November. FDI increased by about US$8.5 billion, reflecting increases in retained earnings due to higher commodity prices and the acceleration of investment as Covid-related restrictions were eased. There was also a contribution from the new SDR allocation of US$1.8 billion, which the authorities intend to keep as reserves. Short-term capital outflows increased to a historically high level of about US$17 billion or 7.4 percent of GDP due to political uncertainty.

Assessment. Strong economic fundamentals and diversification of creditors have underpinned capital inflows, including around periods of stress. Peru's attractiveness as an investment destination should allow investments to pick up in the medium term.

FX Intervention and Reserves Level

Background. The BCRP has been active in the foreign exchange market to smooth the exchange rate volatility caused by recent shocks, without targeting a specific rate. While the central bank stepped in to smooth the volatility at the outset of the Covid-19 pandemic, and during later episodes of significant market pressure, the intervention was limited in 2020. In 2021, the BCRP increased its interventions to contain volatility in the context of the

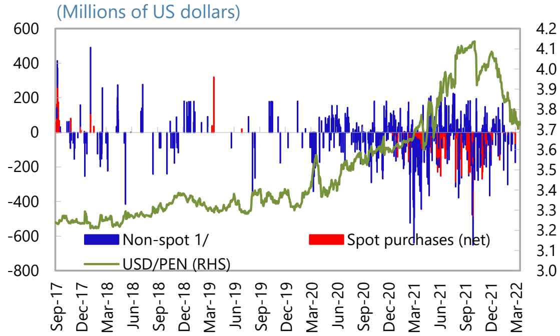
Components of GIR and ARA Metric
(US$ billion)



Source: BCRP and IMF staff estimates.

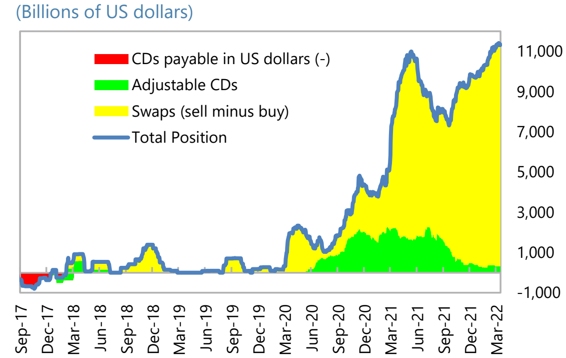
heightened political uncertainty, selling US$17.5 billion (7.7 percent of GDP), including US$11.6 billion on the spot market (5.1 percent of GDP). Interventions on the non-spot market were done mainly through FX swap transactions. Peru's gross reserves increased by about US$3.6 billion in 2021 including due to realized valuation gains and the 2021 IMF General SDR Allocation of roughly US$1.8 billion.

Foreign Exchange Intervention
(Millions of US dollars)



Source: BCRP and IMF staff estimates.
1/ Net maturity of CDR BCRP, net maturity of FX (sell) swaps, net issuance of CDLD and net purchases of FX (buy) swaps.

Net position of non-spot intervention 1/
(Billions of US dollars)



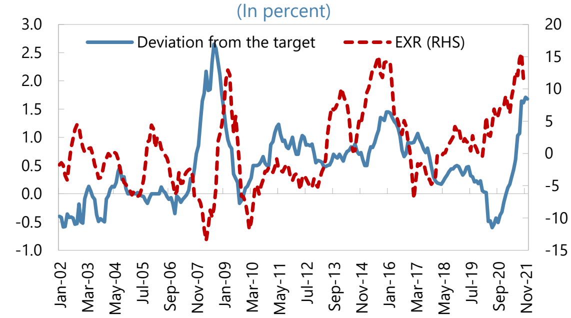
Source: BCRP and IMF staff estimations.
1/ An increase is equivalent to a sale of foreign exchange.

Assessment. The flexible exchange rate has long served as the primary mechanism of adjustment to external shocks. Peru's international reserve coverage exceeds adequacy metrics. Gross international reserves were US$78.5 billion (34.4 percent of GDP) at end-2021, or 287 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 exceed the augmented metric even after subtracting large FX liabilities to the banking sector (reserve requirements and deposits from de-dollarization swaps).

Annex III. Inflation Expectations and Inflation Forecast

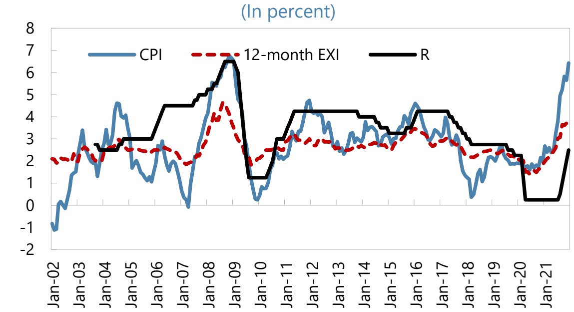
1. After Peru adopted its inflation targeting framework in 2002, inflation expectations have remained mostly within the target range, deviating from the target range only during the global financial crisis, 2015-2016, and after July 2021**.** As can be seen from the right-side chart, the BCRP has been actively responding to these deviations, changing its policy rate in response to economic developments, in line with the inflation targeting framework.

Exchange Rate Change and Inflation Expectations
(In percent)



Sources: Haver, and IMF staff estimates.

Inflation and Interest Rate
(In percent)



Sources: Haver, and IMF staff estimates.

2. Given the high correlation between inflation and inflation expectations (0.81), we analyze inflation and the formation of inflation expectations in two separate exercises. We first run a vector autoregression (VAR) analysis of inflation dynamics and then another VAR analysis of 12-month inflation expectation (survey-based data), using quarterly data for 2004-2019. The high correlation between inflation and inflation expectations suggests that expectations are mostly backward-looking. The robust correlation between the policy rate in real terms and inflation/inflation expectations (-0.59/-0.45), seems to imply that the policy rate is an effective tool in controlling inflation in Peru.

3. The following variables are included in the first VAR: the output gap, core inflation, and the nominal policy rate. The order of the variables is based on theoretical considerations (e.g., that the authorities change the policy rate to control inflation and output gap), correlation analysis, and Granger-causality tests. The latter analysis suggests causality from the policy rate and the output gap to core inflation and from the output gap and inflation to the policy rate, while causality to the output gap is limited. We choose the lag length of the VAR at two, considering Schwarz and Hannan-Quinn information criteria and final prediction error.

Granger Causality Tests

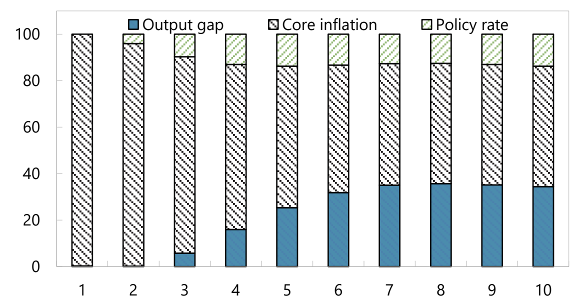
Dependent variable	Output gap	Core inflation	R
Output gap		rejected	rejected
Core inflation	yes		yes
R	yes	yes	

Sources: Haver; and IMF staff estimates.

1/ **, *, and w show the rejection of the null hypothesis of no causality at 1 percent, 5 percent, and at 10-20 percent level.

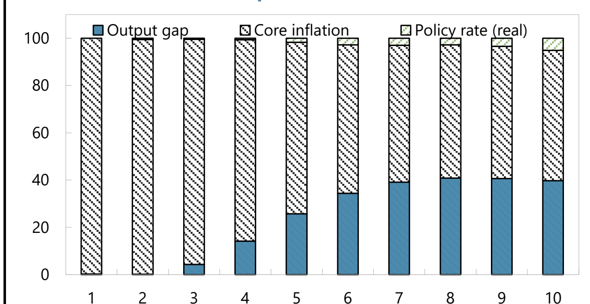
4. The results (left-side chart) suggest that the impact of the policy rate on inflation materializes mostly within four to five quarters, and the effect of the output gap takes more time to materialize (six to seven quarters). In this context, the increases in the policy rate from 0.25 percent in July 2020 to 4.5 percent in April 2022, in nine steps, will have most of their effects by mid-2023. Assuming that current pressures on global food and energy prices dissipate over time, both inflation and core inflation are likely to return to the target range at end-2023, in the absence of new adverse shocks. Repeating this exercise using the real policy rate yields similar results, but the policy rate's effect seems somewhat smaller. The latter finding is related to the fact that changes in the policy rate become diluted with inflation inertia under this model.

Variance Decomposition of Core Inflation 1/



Sources: Haver; and IMF staff estimates.
1/ Based on estimations using the nominal policy rate.

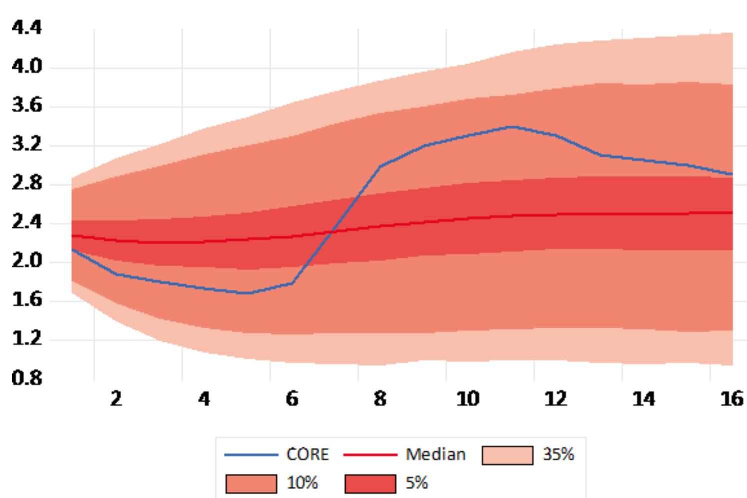
Variance Decomposition of Core Inflation 1/



Sources: Haver; and IMF staff estimates.
1/ Based on estimations using the policy rate in real terms.

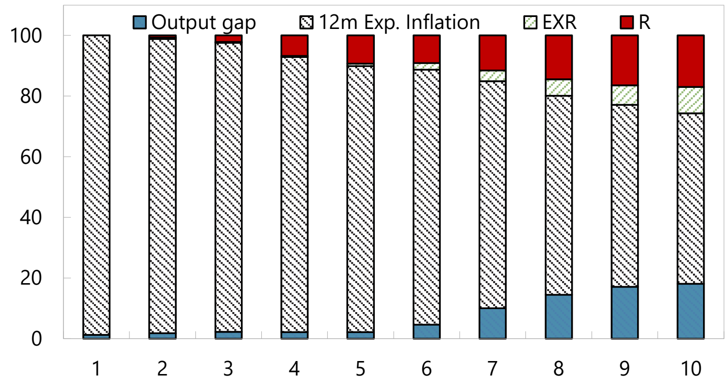
5. Then, we repeat the exercise using a Bayesian VAR methodology, which supports the above findings but suggests slightly more inertia in inflation expectations than under the standard VAR model. This analysis suggests that there is a relatively high probability that core inflation will fall to about 3 percent by end-2023.

Core Inflation Forecast



6. Inflation expectations are analyzed in the second VAR. It includes the following variables: the output gap, 12-month inflation expectations (survey-based data), and the policy rate. We choose the lag length of the VAR at six, considering LR tests and final prediction error (Akaike information criterion suggests eight lags while Schwarz information criterion suggests two lags). The results suggest more inertia in inflation expectations than in inflation itself, but this may reflect the monetary policy's historical credibility and anchored inflation expectations rather than the authorities' limited ability to affect inflation expectations. All the above analyses suggest that the monetary policy effectively controls inflation and that the authorities have been actively using it to keep inflation within the target range.

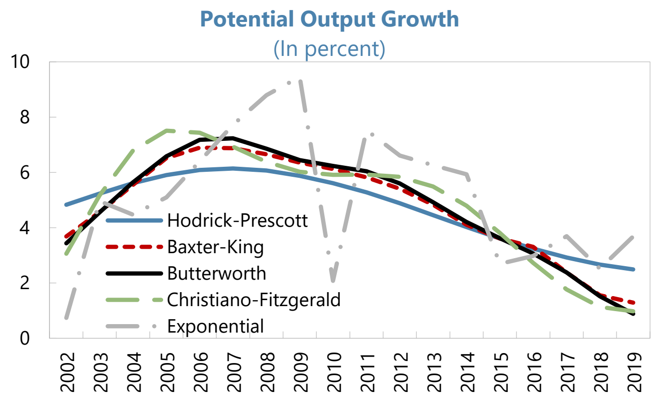
Variance Decomposition of Expected Inflation



Sources: Haver, and IMF staff estimates

Annex IV. Potential Output Estimates in the Aftermath of the Pandemic

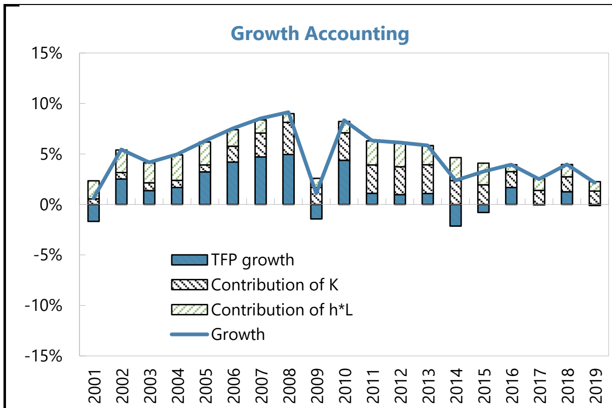
1. **Evidence suggests that Peru's potential output growth was declining before the Covid-19 pandemic from high levels during the commodity supercycle**. Peru recorded high real GDP growth (averaging 6.1 percent) and gradually declining unemployment in 2002-13, but growth declined (averaging 3 percent) and unemployment increased slightly in 2015-19. Inflationary pressures have been moderate since adopting an inflation targeting framework in 2002, except for 2008-2009, during the global financial crisis, and 2015- 2016, when the exchange rate depreciated sharply. These developments suggest that the output gap was not large until 2020, meaning potential output growth too was high during the commodity supercycle and declined before the COVID-19 pandemic. Estimates of potential output using statistical filters such as Hodrick-Prescott, Baxter-King, Butterworth, Christiano-Fitzgerald, and exponential filters support this conclusion.

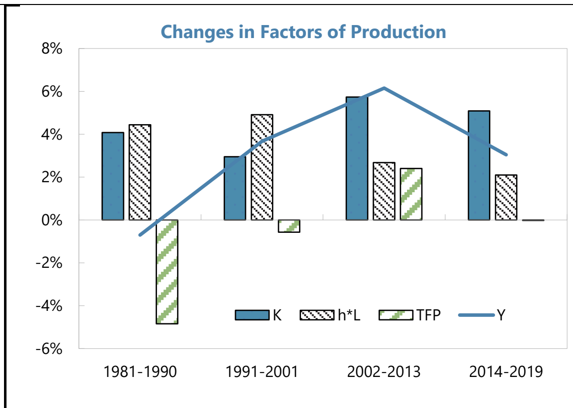


Sources: Peruvian authorities, and IMF staff estimates.

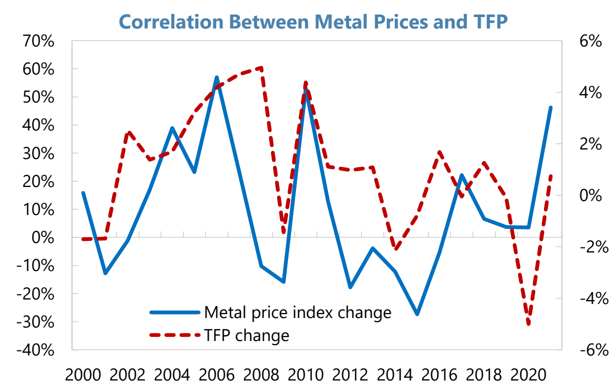
Cobb-Douglas Production Function

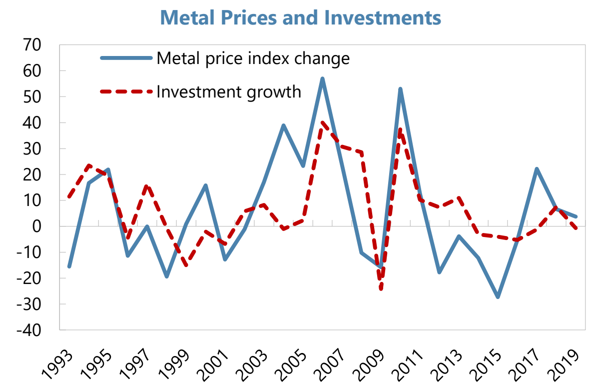
2. **Growth decomposition analysis using a Cobb-Douglas production function suggests that increases in capital stock and total factor productivity (TFP) accounted for most real GDP growth in the 2002-13 high-growth period** (left-side chart). TFP increased by 2.4 percent per annum on average and capital stock by 5.7 percent during this period. In 2014-19, however, growth declined as TFP was broadly flat and increases in capital stock decelerated, with investment declining on average by 1.2 percent per annum (right-side chart).





3. The significant TFP increase observed during the 2002-13 period likely reflects significant reforms to stimulate private sector activity[1] and enhance the macroeconomic policy framework as well as favorable external conditions like high commodity prices. Indeed, TFP and international prices for minerals, which account for more than 60 percent of Peru's total goods exports, are strongly correlated (left-side chart). The relationship between TFP and commodity prices is not clear-cut. For example, some analysts argue that changes in terms of trade have no first-order effects on productivity (Kehoe and Ruhl, 2008), and some other analysts suggest that sustained increases in exports can even reduce growth through the so-called Dutch disease.[2] In Peru, it is possible that higher commodity prices stimulated growth mainly through higher investments (right-side chart).



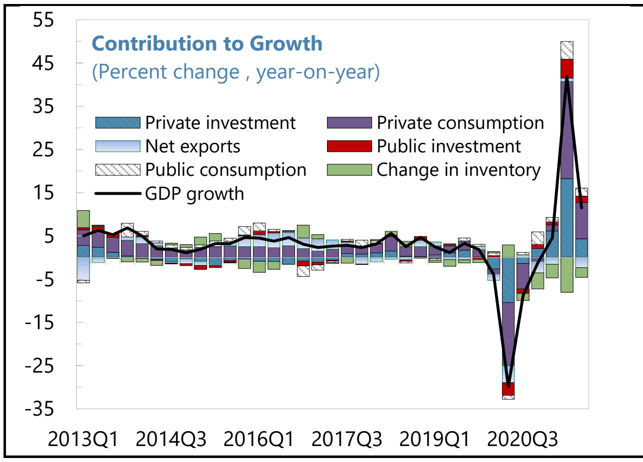


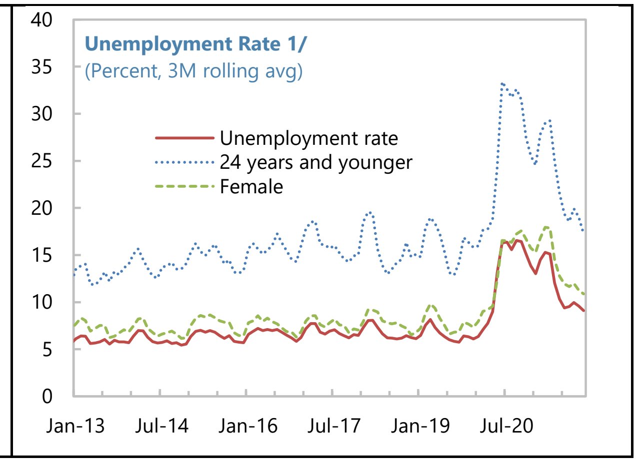
Impact of the COVID-19 Pandemic

4. The COVID-19 pandemic has taken a heavy toll on lives and livelihoods, with a devastating impact on economic activity in 2020. Production in many sectors came to a standstill in mid-2020 as the authorities introduced the strictest mobility restrictions in the region to contain the contagion. Restrictions were eased towards the end of the year, and the authorities introduced a large financial package to help people and businesses. Nonetheless, real GDP declined by 11 percent in 2020. Unemployment in the Lima metropolitan region increased sharply, closing the year at 11.8 percent, while productivity per employee temporarily increased. Poverty increased by about twelve percentage points to 32.6 percent. However, the economy recovered strongly in 2021, with robust external demand, favorable terms of trade, and pent-up domestic demand pushing real GDP to exceed its pre-pandemic levels already in the third quarter, and annual output increasing by 13.3 percent. The formal employment level recovered to the pre-COVID levels, but total employment remains slightly below the pre-pandemic levels. Following global trends, inflation increased sharply to 6.4 percent at the end of the year, the highest level since the global financial crisis in 2008-09.

[1] See Ortiz and Winkelried (2022).

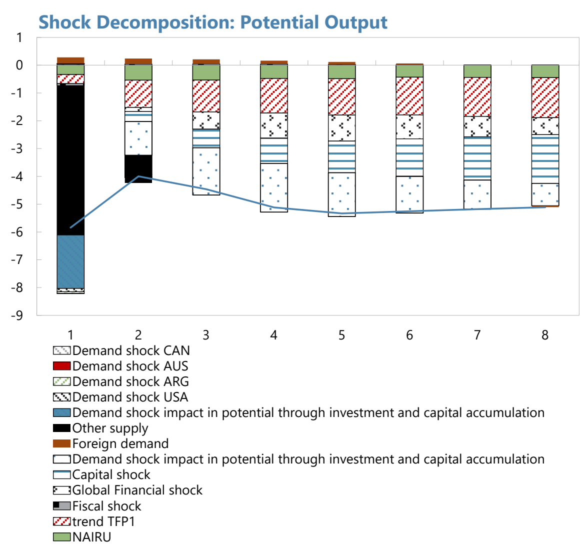
[2] See Fardmanesh (1991) and Bandara (1991).



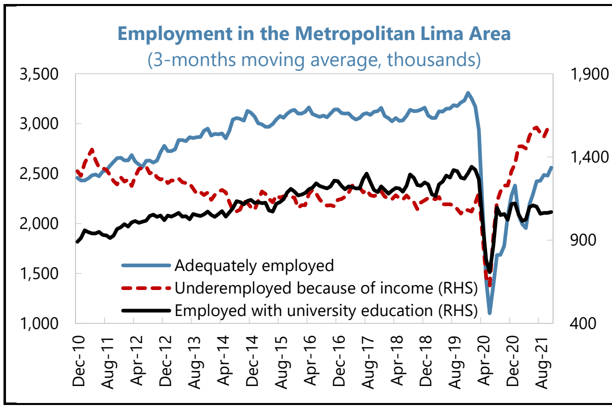


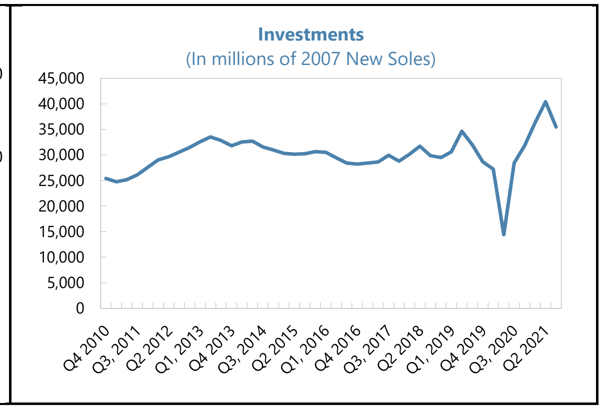
5. Globally, the discussion on the scarring effects of the COVID-19 pandemic on economic activity has focused on the size of the impact rather than its existence. The effects are expected to take place through a slower accumulation of physical capital stock (due to foregone investments during the pandemic), a contraction in labor force participation, lower human capital due to reduced education/training, and overall inefficiency owing to the reallocation of capital and labor. In the short-to-medium-term, there is also a reduced ability to fully employ capital stock in high-contact industries (tourism, restaurants, cinemas, etc.). At the same time, rapid developments in IT solutions and growth in some new segments such as online shopping and deliveries are likely to boost productivity in many sectors.

6. In Peru, the pandemic's scarring effects are estimated to have significantly reduced potential output. Formal employment has recovered to pre-covid levels, but the number of "adequately employed" is lower by one-fifth relative to pre-pandemic levels (left-side chart), and the number of people "underemployed because of income" has increased by 47 percent from pre-pandemic levels (left-side chart). Furthermore, the number of employed with a university education has significantly declined (right-side chart). Regarding capital accumulation, investments declined by 20.3 percent in 2020 but grew more than 30 percent in 2021, although it was due partly to an increase in residential investment, now well exceeding the pre-covid levels (right-side chart). Based on a set of impulse response functions generated by the IMF's Flexible System of Global Models (FSGM), which includes also external demand shocks and global financial conditions, we estimate that potential output was about 6 percent below the baseline projection in 2020, due mostly to the impact of the strict lockdown, and that potential output still was 4 percent below the pre-pandemic trend in 2021.



Sources: Authorities; and IMF staff calculations.





7. The pandemic's scarring effects are also likely to affect the potential growth rate. Going forward, labor productivity is likely to weaken because of skill deterioration during extended periods of unemployment or when moving to the less productive informal sector, delayed labor market entry for young workers, and reduced training as face-to-face education was largely discontinued until the spring of 2022. Importantly, productivity could decline because of resource misallocation, increased bankruptcies, and reduced investments (compared to the pre-pandemic trend).

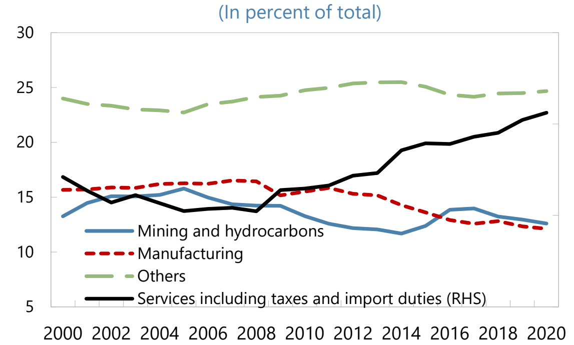
Political Uncertainty

8. Peru experienced large short-term capital outflows during and after the 2021 elections. Short-term capital outflows were about US$18 billion or 7.4 percent of GDP. While ongoing investments continued in 2021 and even accelerated to offset the adverse impact in 2020, a central bank survey suggests that private investments will be broadly flat in 2022. If continued, political uncertainty is likely to suppress investments and growth in the medium-term. We assess the combined effects of the pandemic and political uncertainty on growth at about ½ percentage point.

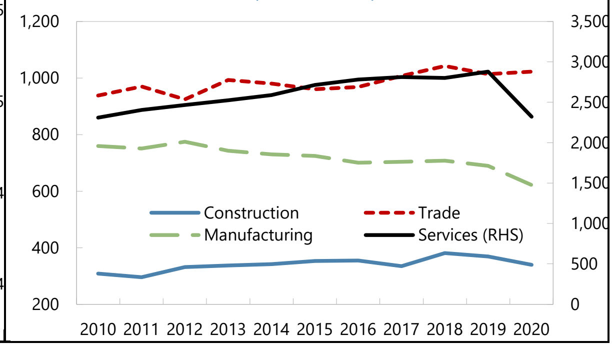
Other Considerations

9. Trends in the sectoral composition of GDP and employment signal that productivity growth may not be very strong in the medium-term. As can be seen from the chart, the share of the services sector in total GDP has been increasing steadily since 2008, with this increase accelerating in 2014-15 and continuing even in 2020. At the same time, the share of manufacturing has been declining, with this decline accelerating in 2014-17. The share of mining and hydrocarbons declined until 2014, recorded some increase in 2015-16, and continued falling in 2018-20. Employment data in the Metropolitan Lima area suggest similar trends. As can be seen from the chart, employment in the services sector recorded a sharp contraction in 2020, much more than in all the other sectors combined. These suggest a relative increase in labor productivity in the services sector in 2020, probably reflecting the growth of novel services such as online trade and delivery, but this is not likely to be sustainable. Usually, productivity in the traditional services sector grows more slowly. Together with the fact that economic activity in some service sectors will not reach pre-Covid levels for a few years, this suggests lower productivity growth in the medium-term.

GDP by Sectors
(In percent of total)

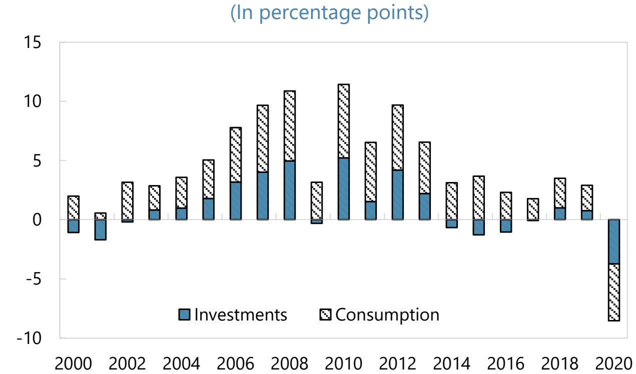


Employment by Industry in the Metropolitan Lima
(In thousands)



10. Recent trends in the composition of GDP from the expenditure side do not look favorable for medium-term growth. Investments contributed 2.6 percentage points to real GDP growth on average during the 2002-13 period, with this ratio exceeding 4-5 percentage points in some years (chart). In 2014-19, however, investments contributed minus 0.2 percentage point to growth. Also, as can be seen from the chart, consumption was very strong during 2005-2013 but contributed only 2.6 percent on average in 2014-2019. If these trends continue in the future, growth would be less than 3 percent. In this context, the expected fiscal consolidation in the medium term implies small negative impulses from fiscal policy.

Contribution to Real GDP Growth
(In percentage points)

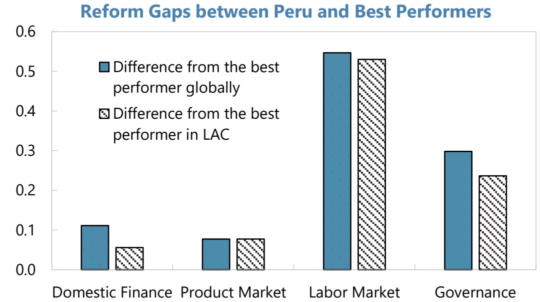


"Reform Gaps"

11. Reforms remain essential to boost sustainable growth. Sound policies and frameworks have underpinned a very strong macroeconomic performance in the last 20 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 labor market, governance, and domestic finance.[3]

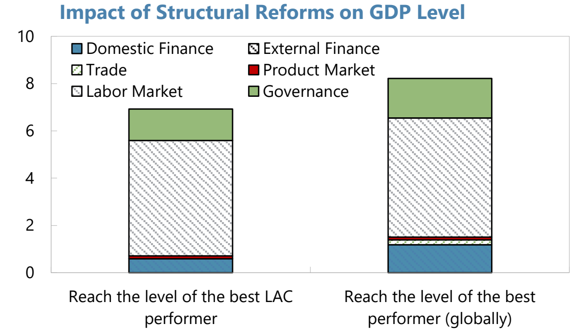
[3] Estimated based on the methodology and data of 2019 WEO Chapter3, "Reigniting Growth in Low-Income and Emerging Market Economies: What Role Can Structural Reforms Play?"

Reform Gaps between Peru and Best Performers



Source: IMF staff estimates, based on the data set used for WEO 2019, Chapter III.

Impact of Structural Reforms on GDP Level

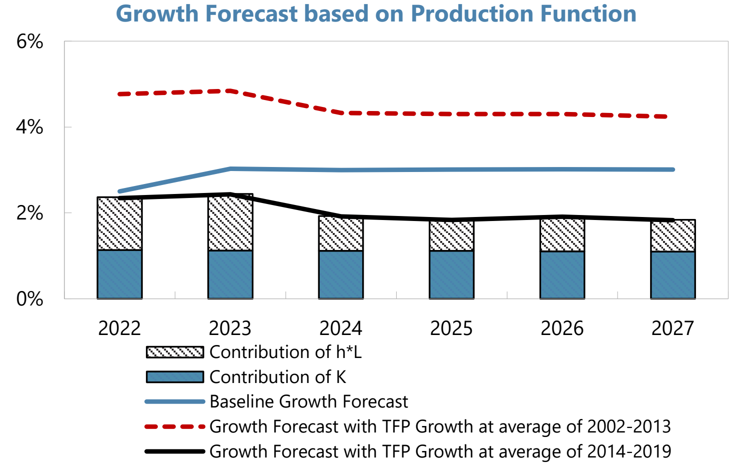


Sources: IMF staff estimates, based on the methodology and data of 2019 WEO Chapter 3.

Medium-Term Forecast

12. On the production approach, IMF staff's medium-term growth forecasts are based on the projections of labor inputs and capital stock as well as TFP assumptions.[4] In the 2022-27 period, our baseline projections assume that investments and TFP will grow faster than in 2014-2019 but less than in 2002-13 as the current high metal prices are expected to reverse slightly in the medium-term. Based on these assumptions, our medium-term baseline real potential GDP growth is 3 percent. In case TFP is flat, as was in the 20014-19 period, the growth rate could be less than 2 percent, given the same labor input and investment projections as under the baseline. If both TFP and investments grow faster under a reform scenario, the growth rate could increase to 3.5 percent. But for this to happen, political uncertainty should be reduced, and the business environment should be improved. In case of a low-probability scenario of TFP growing at the average of the 2002-13 period, the potential growth rate could exceed 4 percent.

Growth Forecast based on Production Function



[4] IMF staff project growth using both production and expenditures approaches.

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Annex V. Risk Assessment Matrix

Risks	Likelihood	Time horizon	Impact	Policy Response
Global risks				
Outbreaks of lethal and highly contagious Covid-19 variants lead to subpar/volatile growth, with increased divergence across countries. Rapidly increasing hospitalizations and deaths, due to low vaccination rates or caused by vaccine-resistant variants, force lockdowns and increased uncertainty about the course of the pandemic. Policies to cushion the economic impact are prematurely withdrawn or for many EMDEs, constrained by lack of space. In addition to declines in external demand, a reassessment of growth prospects triggers capital outflows, financial tightening, currency depreciations, and debt distress in some EMDEs, with spillovers to AEs, leading to growing divergence of economic recovery paths.	**Medium**	**Short term**	**High.** Lower external demand due to disruption of trade and global value chains would further reduce growth. Financial market volatility may lead to capital outflows and depreciation pressures. Domestically, limited health system capacity could prompt widespread lockdowns. ICU beds and oxygen availability have increased, and containment and mitigation strategies have significantly improved, but challenges remain.	Provide targeted policy support to the most affected households and firms.
De-anchoring of inflation expectations in the U.S. and/or advanced European economies. A fast recovery in demand amid a lagging supply-side response leads to a rapid de-anchoring of inflation expectations, which prompts central banks to tighten policies abruptly. The resulting sharp tightening of global financial conditions and spiking risk premia lead to currency depreciations, asset market selloffs, bankruptcies, sovereign defaults, and knock-on effects (e.g., lower commodity prices and possible contagion across EMDEs).	**Medium**	**Short term**	**Medium.** Peru is vulnerable to a sudden exit of foreign investors, which hold a large share of its sovereign bonds. The risk is mitigated by large policy buffers, including access to an FCL. The financial sector can absorb major shocks.	Accelerate the normalization of the monetary policy stance. Exchange rate interventions could be used to prevent excessive volatility.
Extended global supply chains disruptions. Persistent disruptions in the production and shipment of components caused by lockdowns and logistical bottlenecks continue until 2023. This leads to shortages of intermediate and final	**High**	**Short term**	**Medium.** Peru would be affected by a reduction of global trade and rising import prices.	Deploy fiscal buffers to soften the impact on growth. Stand ready to use

consumer goods, growth slowdowns, and price surges, compounded by the passthrough from currency depreciations in vulnerable countries.			Large policy buffers would help mitigate the impact.	monetary policy to prevent second-round effects on inflation.
Abrupt growth slowdown in China. A combination of a sharper-than-expected slowdown in the property sector amid ongoing regulatory tightening, further strong fiscal consolidation and more frequent Covid-19 outbreaks cause a sharp slowdown of economic activity, with spillovers affecting other countries through financial, trade, and commodity-price channels.	**Medium**	**Short term**	**High.** China is Peru's largest trading partner. Lower exports and falling terms of trade would dent growth and exert downward pressure on the exchange rate.	Deploy fiscal buffers to soften the impact on growth. Exchange rate interventions could be used to prevent excessive volatility.
Rising and volatile food and energy prices. Commodity prices are volatile and trend up amid pent-up demand and supply disruptions, conflicts, or a bumpy transition to renewable energy sources. This leads to bouts of price and real sector volatility, including acute energy crises in some countries.	**High**	**Short term**	**Medium.** Food and energy prices account for over 40 percent of the consumption basket in Peru. Inflation expectations have increased recently, running the risk of becoming more entrenched.	Accelerate the normalization of the monetary policy stance.
Geopolitical tensions and de-globalization. Intensified geopolitical tensions, security risks, and conflicts cause economic and political disruptions, disorderly migration, production reshoring, a decline in global trade, and lower investor confidence. Associated supply chain disruptions and commodity price shocks give rise to inflationary pressures.	**High**	**Medium term**	**Medium.** Peru would be affected by a reduction of global trade and financial market volatility. Large policy buffers would help mitigate the impact.	Deploy fiscal buffers to soften the impact on growth. Exchange rate interventions could be used to prevent excessive volatility.
Global information infrastructure failure. A disruption in global information systems (from an unintended error, natural disaster, or knock-on effects of widespread energy shortages) and/or cyber-attacks on critical institutions trigger financial instability, extreme volatility in crypto assets, or widespread disruptions in socio-economic activities and remote work arrangements.	**Medium**	**Medium term**	**Medium.** Peru would be affected by a reduction of global trade and financial market volatility. Large policy buffers would help mitigate the impact.	Deploy fiscal buffers to soften the impact on growth. Exchange rate interventions could be used to prevent excessive volatility.
Domestic risks				
Widespread social discontent and political instability. Social tensions erupt as the imposition of vaccine mandates and mobility	**High**	**Short/ Medium term**	**High.** Political uncertainty and social conflict could	Strengthen governance and enhance anti-

restrictions and/or a withdrawal of pandemic-related policy support—amid increasing prices of essentials, slower growth, and rising inequality—results in higher unemployment and heavier household debt burdens. Political instability triggers capital outflows.			stifle private investment and generate capital outflows in the short-term. A decline in political support for key institutions and policies could have significant medium-term implications.	corruption enforcement efforts. Accelerate structural reforms aimed at increasing potential GDP.
Natural disasters related to climate change. Higher frequency of natural disasters cause severe economic damage to smaller vulnerable economies and accelerate emigration. Severe events in large economies reduce global GDP and prompt a recalculation of risk and growth prospects. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility.	**Medium**	**Medium term**	**High.** Peru is highly vulnerable to natural disasters and climate change, ranking amongst the top 25 percent of most vulnerable countries due to the impacts of extreme weather events, with large adverse impacts on human life, economic activity, and fiscal costs.	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.
Note: 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.				

Annex VI. Peru's Civil Service: A Much-Needed Reform

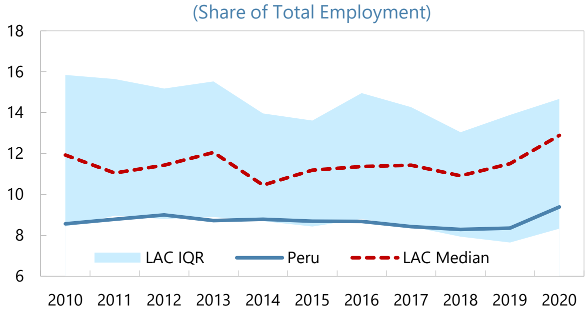
Peru's civil service faces a set of long-standing challenges arising from fragmentation, increased job instability, and lack of professionalization that have hindered government effectiveness, and have become a source of fiscal risks. A comprehensive civil service reform will be critical to improve governance, implement high-quality public policies, and strengthen the delivery of public services.

1. **Peru's civil service is relatively small.** On a comparative basis, Peru's civil service is relatively small, with public employment representing about 9 percent of total employment, and the public wage bill representing about 6.5 percent of GDP (Figure 1). About 45 percent total public employment occurs at the central government level, while regional and local governments account for about 43 and 12 percent, respectively. Since 2015, public employment and compensation (including wages, bonus, and other benefits) have increased by 30 percent and 73 percent (43 percent in real terms), respectively. Overall, there's no substantial wage premium against the private sector, although there is some heterogeneity among skill levels, with low-skilled workers reportedly earning a premium in the public sector and high-skilled workers earning a discount.

2. **The civil service is fragmented, hindering government effectiveness.** There are 20 labor regimes in the public administration, which can be classified in three major categories (Text Table). About 40 percent of public employees are classified under the general regimes, 55 percent under the specialized regimes, while the "other" category is mainly comprised of military service personnel. Each regime has its own provisions regarding compensation1 and dismissal rules, benefits, trial periods, and contract lengths, which in turn can vary within sectors and institutions. Each regime also grants differential rights and duties to public servants. According to the OECD, there are 500 public employment regulations, and over 400 different wage criteria.

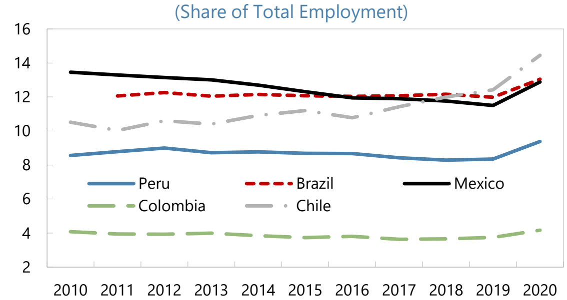
Figure 1. Peru's Civil Service – Some Stylized Facts

LAC: Public Employment
(Share of Total Employment)



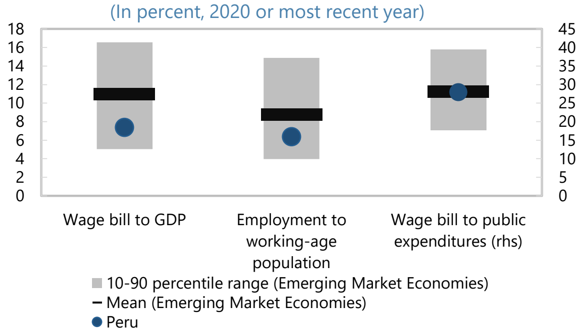
Sources: ILO; and IMF staff calculations.

LA5: Public Employment
(Share of Total Employment)



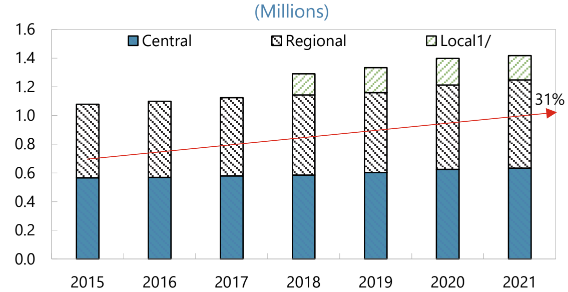
Sources: ILO; and IMF staff calculations.

Benchmarking for Wage Bill and Employment
(In percent, 2020 or most recent year)



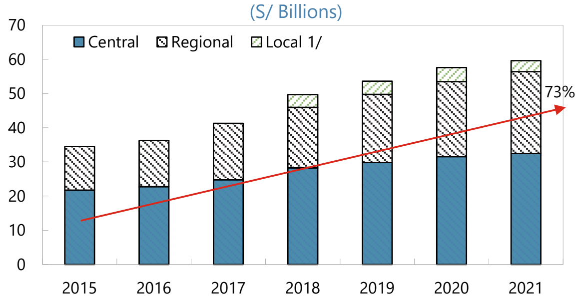
Source: Country authorities; and IMF staff calculations.

Peru: Public Employment by Levels of Government
(Millions)



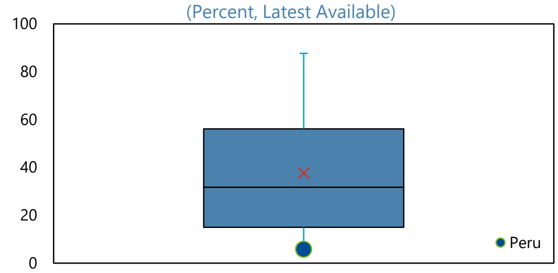
Sources: Country authorities; and IMF staff calculations.
1/ Data not available prior to 2018.

Peru: Compensation by Levels of Government
(S/ Billions)



Sources: Country authorities; and IMF staff calculations.
1/ Data not available prior to 2018.

LA: Average Public Wage Premium
(Percent, Latest Available)



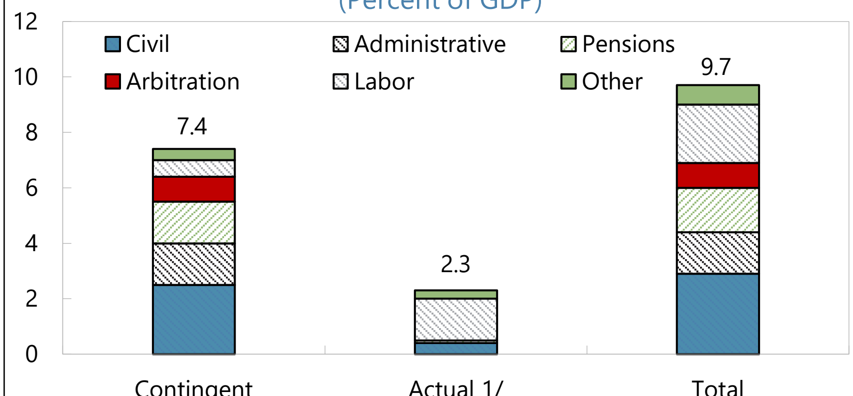
Sources: Gasparini et al (2015); and IMF staff calculations.
Note: LA includes ARG, BOL, BRA, COR, ECU, HON, MEX, PAN, PER, PAR, SAL, URU, and VEN.

Peru: Public Employment by Regime – 2021
(Percent)

Type	Regime	Share of Total
General (41.2 percent)	Public (*Carrera Administrativa, DL 276*)	9.9
	Private (*DL 728*)	7.5
	CAS (*Contrato Administrativo de Servicio*)	23.7
	Servir (*Law 30057)*	0.0
Specialized (55.4 percent)	Education: School Teachers	31.0
	Education: University Professors	1.8
	Health: Public Doctors	4.5
	Health: Other health officials	3.9
	Judiciary: Judges	0.2
	Judiciary: Prosecutors	0.5
	Foreign Service: Diplomats	0.0
	Judiciary: Penitentiary	0.3
	Armed Forces: Military and Police	13.2
	Culture	0.0
Other (3.4 percent)	General: Public managers	0.0
	General: UNDP agreements	0.0
	Health: Doctors in training	0.0
	General: *Fondo de Apoyo Gerencial*	0.3
	Health: Rural health professionals	0.5
	Armed Forces: Service Personnel	2.5

Source: Country authorities, IMF staff.

Figure 2. Peru: Outstanding Claims Against the State
(Percent of GDP)



Sources: Country authorities; and IMF staff calculations.
1/ Final ruling against the State.

3. **Variation in rules and regulations is significant among the general regimes, leading to significant distortions.** The *Carrera Administrativa* regime, introduced by the Decree Law (DL) 276, is characterized by open-ended contracts, dismissals only for cause, clear promotion criteria, and a job ladder. Access to the regime was closed in the early 1990s with entry limited to openings resulting from attrition, dismissals or resignations. Base salaries under the regime are frozen and cannot make up for more than 20 percent of remuneration, but compensation has increased through the introduction of bonuses and other allowances. On the other hand, the *private regime* (ruled by DL 728) has open-ended contracts, with no job ladder or promotion requirements,

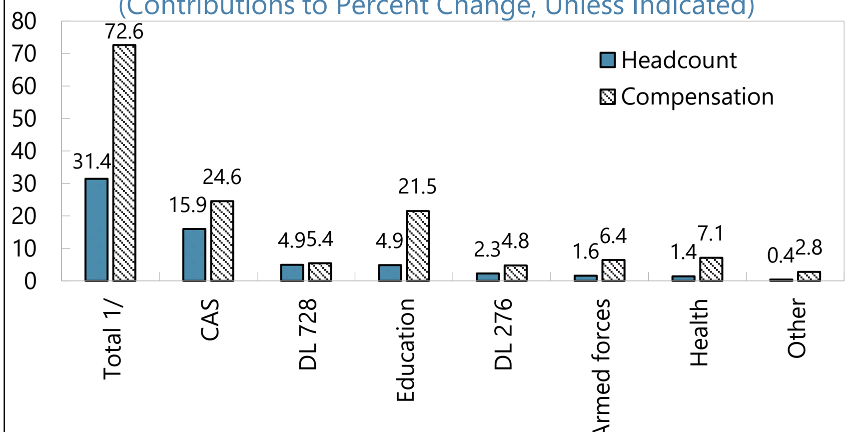
and dismissals without cause are allowed.[1] Compensation scales broadly follow the private sector. Meanwhile, the *Contrato Administrativo de Servicio* (CAS) is a temporary appointment that offers 1-year fixed-term contracts with an option to extend for an additional year. There is no promotion criteria or merit-based practices, and remuneration is negotiated on a case-by-case basis, although there are limits set within the annual budget. Benefits and other protections under the regime are limited. While there is lower within-regime dispersion in compensation compared to the other two, some reports point to a wage premium over same-skill private sector jobs. Furthermore, legislation gaps have resulted in large liabilities from litigation for the state, as labor disputes in the public sector are settled through the legal system (Figure 2).

4. **A large share of the recent increase in headcount and compensation has been in the form of temporary (CAS) contracts** (Figure 3). Over time, this has given rise to increased pressures to incorporate contractual employees into the permanent workforce. In 2021, Congress suspended the CAS regime, arguing that it was discriminatory, and mandated the transition of its employees to the DL 728 and DL 276 regimes. Although the Constitutional Tribunal deemed the legislation unconstitutional it urged the government to organize the civil service. In the interim, the administration has turned to hiring under a parallel arrangement (Emergency CAS).

5. **Gaps in the legal framework regarding collective bargaining have resulted in further disarray**. Collective bargaining in the public sector was outlawed in the early 1990s, although unionization and strikes in the public sector are allowed under the Constitution. In 2005, the Constitutional Tribunal deemed collective bargaining in the public sector to be legal. However, there are no safeguard mechanisms to ensure that collective bargaining is aligned with the also Constitutionally enshrined budget equilibrium principle. According to reports, in practice, institutions at various levels of government seem to have engaged in bilateral negotiations despite limitations set forth in the annual budget laws limiting collective bargaining, thus encouraging further fragmentation of the public administration. Likewise, in some instances, the agreements have lacked transparency and go unreported to the Ministry of Finance. In other instances, some agreed-upon benefits and/or other

Figure 3. Peru: Public Employment 2015-2021

(Contributions to Percent Change, Unless Indicated)



Sources: Country authorities; and IMF staff calculations.
1/ Percent change.

[1] The regime was introduced in the early 1990s, and was initially meant to cover newly created public institutions following the fiscal crisis and hyperinflation of the 1980's. With the passage of time, the regime has been extended to the wider public sector. A 2001 report by the Mission to Assess and Diagnose the Situation of the Civil Service reached the conclusion that the regime was inherently more expensive and not more efficient than the DL276 regime.

compensation payments are classified under spending lines difficult to identify (Martinez-Ortiz, 2020).

6. **Recent attempts to regulate collective bargaining could provide some structural improvement but could also be a source of fiscal risks**. In 2021, Congress passed a law that provides a framework for collective bargaining in the public sector (Law 31188) that was followed in early 2022 by the issuance of implementing rules and regulations by the Ministry of Finance. The rules define the parameters and available fiscal space for negotiations, setting aside S/1,000 million (about 1 percent of GDP) appropriation to attend the negotiations. However, concerns are growing that the demands could be substantially larger,[2] which in turn could result in significant fiscal slippages, particularly in a context of rising inflation.

7. **Political instability is further eroding the effectiveness of the civil service.** A large majority of senior managers in the public administration are political appointees, and political instability has led to frequent turnover at the highest levels of the public administration.[3] Along with the lack of qualification criteria for political appointees, the high turnover has resulted in several instances in the appointment of inexperienced officials who have faced steep learning curves and have had to step down quickly. This has permeated to the rest of the administration, further hindering government effectiveness. To partly address the situation, Congress introduced legislation setting minimum qualification requirements for high-level appointments in February (Law 31419). The law was vetoed by President Castillo.

8. **Successive civil service reform attempts since the 1990s have had limited success**. In 1990-92, entry limitations to the DL 276 regime and new contractual arrangements were introduced. A push to "Modernize the State" in 1995-97 was unsuccessful amid limited political support and budget constraints. Budget considerations also limited the implementation of the 2004 Public Employment Law that consolidated the civil service into a single regime. Other attempts included the creation of the National Civil Service Authority (SERVIR, for its acronym in Spanish) in 2008, and the introduction of performance evaluations in 2010.

9. **The 2013 civil service reform, designed in line with best practices, was a missed opportunity**. The Civil Service Law of 2013, designed in law with OECD's best practices, was the latest attempt at comprehensive reform. The law provided a broad framework for a merit-based career service by, among others, standardizing the terms and conditions of employment and paid time-off and other benefits, limiting the use of political appointments, mandating performance evaluations, simplifying the pay system, and guaranteeing the right to organize and bargain for working conditions, though not wages or compensation. SERVIR was tasked with overseeing and monitoring the reform. Ten years after inception it is generally accepted that the effort has floundered.[4] The process has been hindered by the introduction of cumbersome and, in some cases,

[2] Between 2.5 – 6.5 percent of GDP, according to the Ministry of Finance.

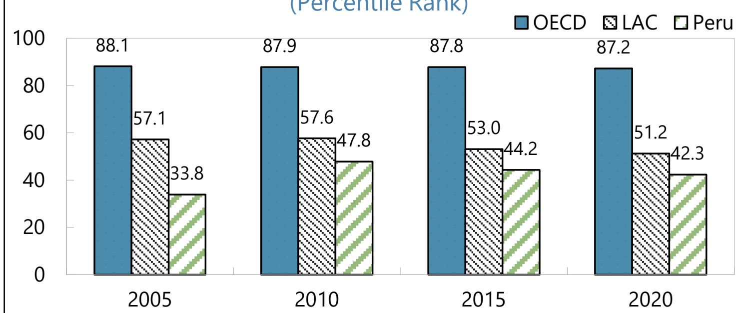
[3] Since 2016, Peru has had 5 presidents and 13 cabinets, including 4 just in the last 8 months.

[4] SERVIR's goal was to gradually transition to the new regime some 565 thousand employees during a 6-year period. As of 2021, some 700+ public employees had done so.

rigid procedures. Participation in the new regime is not compulsory, and those who opt-in must apply into a lengthy selection process that can last up to 4 years. A champion for the reform has not been clearly visible, suggesting that high-level support is lacking, and early gains have not been built upon.

10. A new push to advance the much-needed reforms is warranted. Peru's quest for improved government effectiveness will necessarily run through a comprehensive civil service reform. However, civil service reform has not been a policy priority since 2016. More recent efforts have focused on operational issues such as improving information systems by consolidating a single employee database and the introduction of a single payer IT-system. Plans to move SERVIR, which is housed at the Prime Minister's Office, to the Ministry of Labor are unlikely to support the comprehensive view that is required to advance the reforms. The veto of Law 31419 is yet another missed opportunity.

Figure 4. Peru: WGI - Government Effectiveness 1/
(Percentile Rank)



Sources: World Bank; and IMF staff calculations.
1/Reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and thecredibility of the government's commitment to such policies.

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Annex VII. Debt Sustainability Analysis

Figure 1. Peru: Public Debt Sustainability Analysis (DSA)

(In percent of GDP unless otherwise indicated)

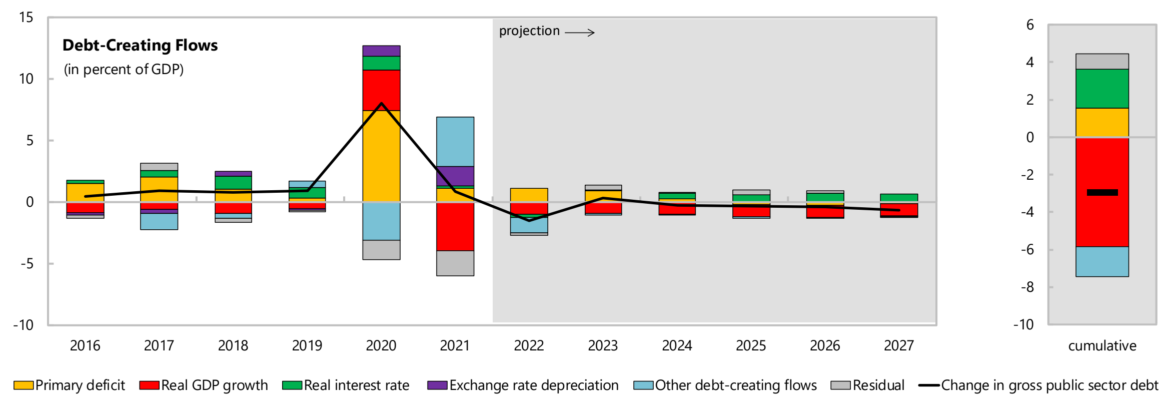
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2011-2019 [2/]	2020	2021	2022	2023	2024	2025	2026	2027
Nominal gross public debt	23.6	35.1	35.9	34.4	34.7	34.4	34.0	33.6	32.9
Public gross financing needs	2.3	9.5	2.8	3.1	3.2	3.4	3.0	4.3	3.4
Real GDP growth (in percent)	4.1	-11.0	13.3	3.0	3.0	3.0	3.0	3.0	3.0
Inflation (GDP deflator, in percent)	2.9	1.8	4.0	5.5	3.6	2.5	2.1	2.0	2.0
Nominal GDP growth (in percent)	7.0	-6.9	21.5	9.9	6.2	5.2	4.9	4.9	5.0
Effective interest rate (in percent) [4/]	5.4	5.5	5.3	4.6	4.0	4.0	4.0	4.2	4.0

As of March 28, 2022		
Sovereign Spreads		
EMBIG (bp) 3/		184
5Y CDS (bp)		80
Ratings	Foreign	Local
Moody's	Baa1	Baa1
S&Ps	BBB	BBB+
Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.2	8.0	0.8	-1.6	0.3	-0.3	-0.3	-0.4	-0.7	-3.0	
Identified debt-creating flows	-0.7	9.6	2.9	-1.4	-0.1	-0.3	-0.7	-0.7	-0.6	-3.8	
Primary deficit	-0.3	7.4	1.1	1.1	0.9	0.3	-0.2	-0.3	-0.2	1.6	-0.4
Primary (noninterest) revenue and grants	25.5	21.9	25.5	24.3	24.2	24.2	24.2	24.1	24.1	145.1	
Primary (noninterest) expenditure	25.2	29.2	26.6	25.5	25.1	24.5	23.9	23.9	23.9	146.7	
Automatic debt dynamics [5/]	-0.2	5.3	-2.2	-1.3	-0.9	-0.5	-0.4	-0.3	-0.4	-3.8	
Interest rate/growth differential [6/]	-0.4	4.5	-3.8	-1.3	-0.9	-0.5	-0.4	-0.3	-0.4	-3.8	
Of which: real interest rate	0.5	1.2	0.2	-0.3	0.1	0.5	0.6	0.7	0.6	2.1	
Of which: real GDP growth	-0.9	3.3	-4.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-5.9	
Exchange rate depreciation [7/]	0.2	0.9	1.6	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.1	-3.1	4.0	-1.2	-0.1	-0.1	-0.1	-0.1	-0.1	-1.6	
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	-0.1	-3.1	4.0	-1.2	-0.1	-0.1	-0.1	-0.1	-0.1	-1.6	
Residual, including asset changes [8/]	0.9	-1.6	-2.0	-0.2	0.4	0.0	0.4	0.2	-0.1	0.8	



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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (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).

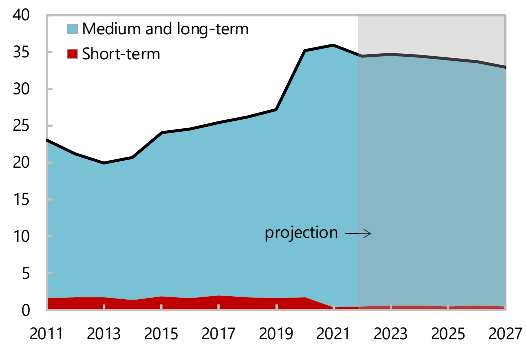
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

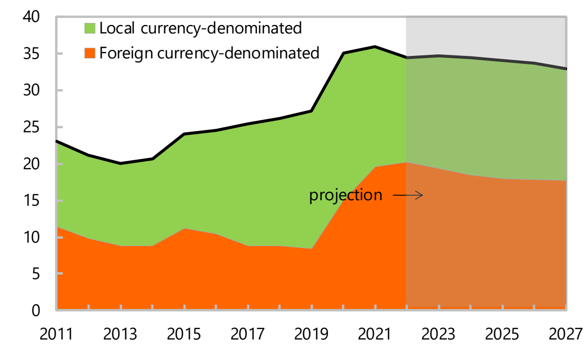
Figure 2. Peru: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



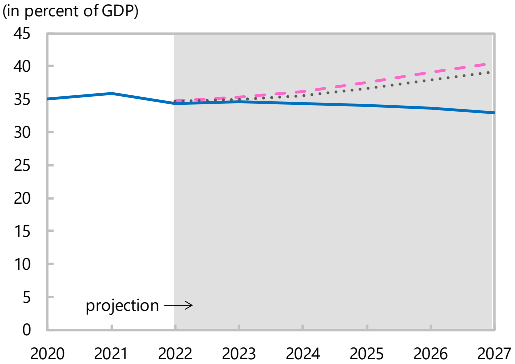
By Currency
(in percent of GDP)



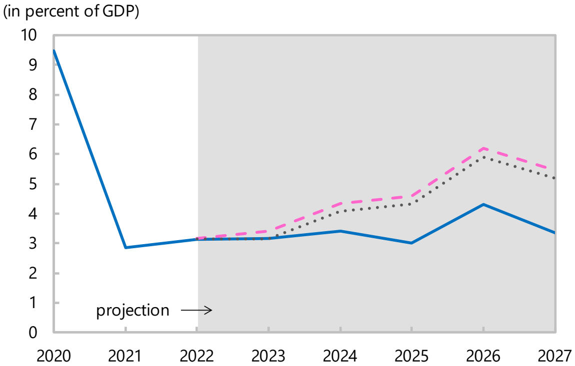
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



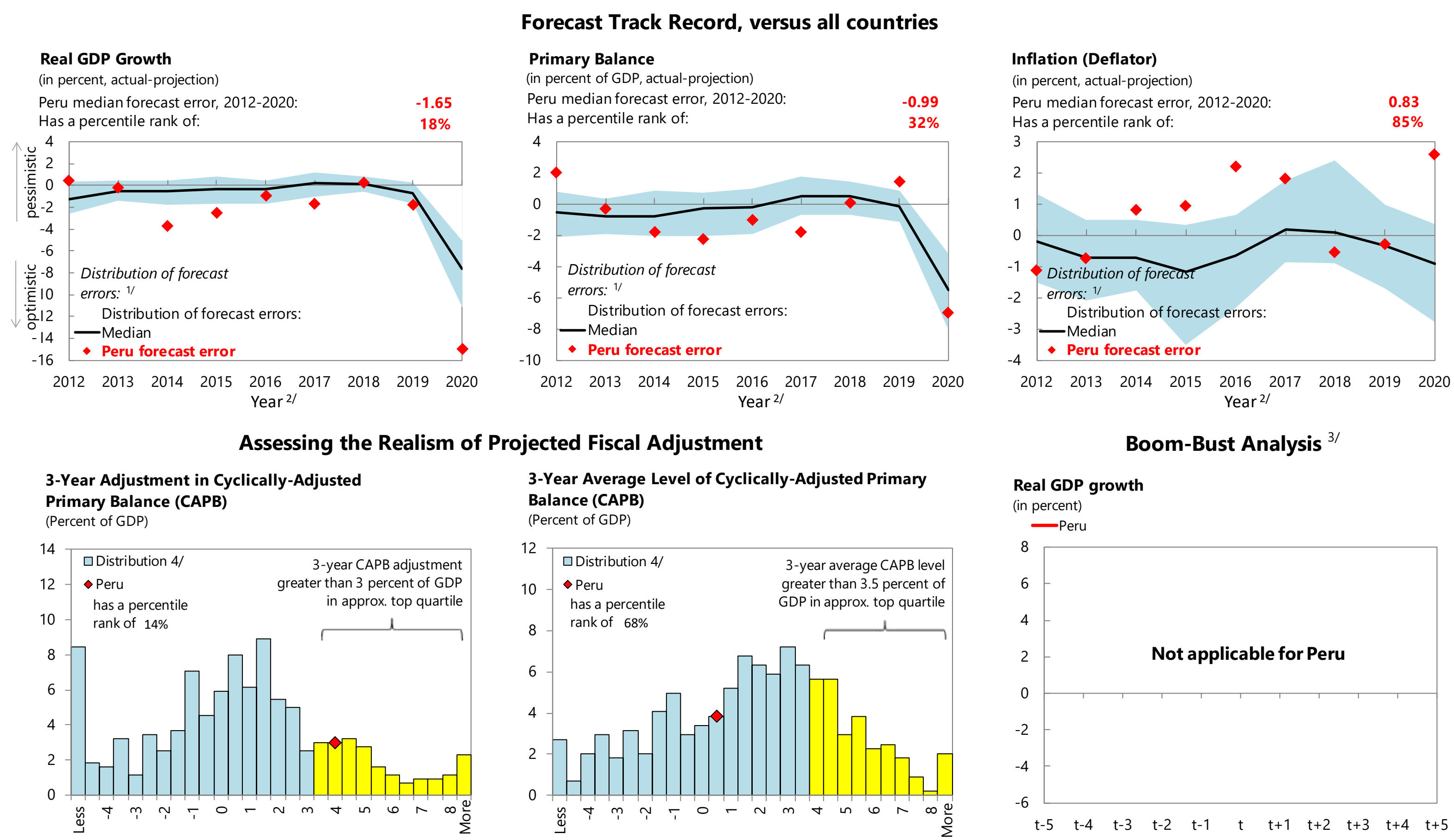
Underlying Assumptions
(in percent)

Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	3.0	3.0	3.0	3.0	3.0	3.0
Inflation	5.5	3.6	2.5	2.1	2.0	2.0
Primary Balance	-1.1	-0.9	-0.3	0.2	0.3	0.2
Effective interest rate	4.6	4.0	4.0	4.0	4.2	4.0
Constant Primary Balance Scenario						
Real GDP growth	3.0	3.0	3.0	3.0	3.0	3.0
Inflation	5.5	3.6	2.5	2.1	2.0	2.0
Primary Balance	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	4.6	4.0	4.0	4.0	4.2	4.1

Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	3.0	3.3	3.3	3.3	3.3	3.3
Inflation	5.5	3.6	2.5	2.1	2.0	2.0
Primary Balance	-1.1	-0.9	-0.9	-0.9	-0.9	-0.9
Effective interest rate	4.6	4.0	4.1	4.3	4.5	4.6
Contingent Liability Shock						
Real GDP growth	3.0	-3.0	-3.0	3.0	3.0	3.0
Inflation	5.5	2.1	1.0	2.1	2.0	2.0
Primary Balance	-1.1	-0.9	-0.3	0.2	0.3	0.2
Effective interest rate	4.6	4.5	4.0	4.0	4.2	4.0

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.

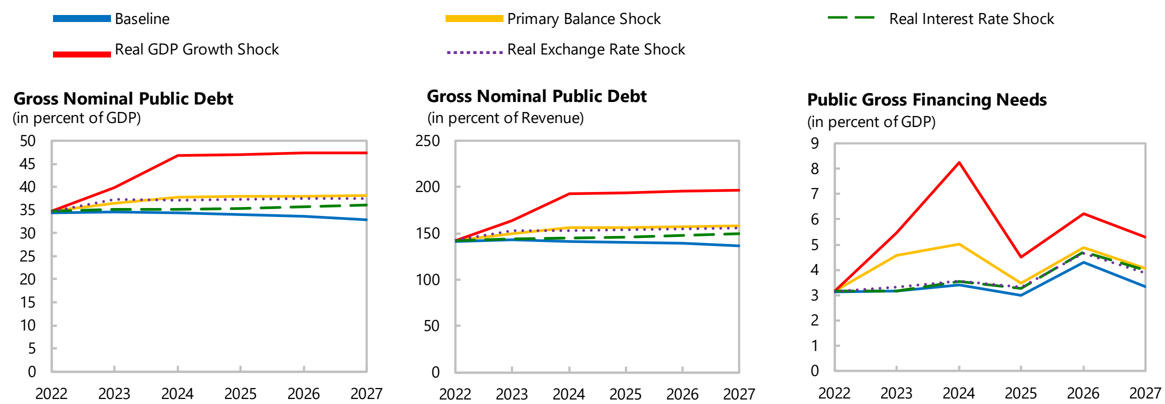
2/ Projections made in the spring WEO vintage of the preceding year.

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

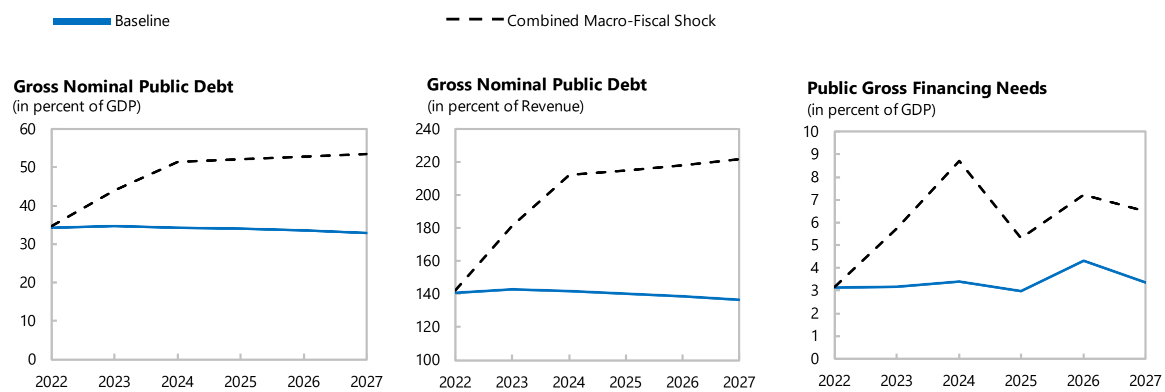
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. Peru: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2022	2023	2024	2025	2026	2027
Primary Balance Shock						
Real GDP growth	3.0	3.0	3.0	3.0	3.0	3.0
Inflation	5.5	3.6	2.5	2.1	2.0	2.0
Primary balance	-1.1	-2.3	-1.7	0.2	0.3	0.2
Effective interest rate	4.6	4.0	4.0	4.1	4.3	4.1
Real Interest Rate Shock						
Real GDP growth	3.0	3.0	3.0	3.0	3.0	3.0
Inflation	5.5	3.6	2.5	2.1	2.0	2.0
Primary balance	-1.1	-0.9	-0.3	0.2	0.3	0.2
Effective interest rate	4.6	4.0	4.3	4.6	4.9	5.1
Combined Shock						
Real GDP growth	3.0	-3.0	-3.0	3.0	3.0	3.0
Inflation	5.5	2.1	1.0	2.1	2.0	2.0
Primary balance	-1.1	-3.0	-4.3	0.2	0.3	0.2
Effective interest rate	4.6	4.2	4.2	4.8	5.1	5.3

	2022	2023	2024	2025	2026	2027
Real GDP Growth Shock						
Real GDP growth	3.0	-3.0	-3.0	3.0	3.0	3.0
Inflation	5.5	2.1	1.0	2.1	2.0	2.0
Primary balance	-1.1	-3.0	-4.3	0.2	0.3	0.2
Effective interest rate	4.6	4.0	4.1	4.3	4.4	4.3
Real Exchange Rate Shock						
Real GDP growth	3.0	3.0	3.0	3.0	3.0	3.0
Inflation	5.5	8.4	2.5	2.1	2.0	2.0
Primary balance	-1.1	-0.9	-0.3	0.2	0.3	0.2
Effective interest rate	4.6	4.2	3.8	3.9	4.0	3.9

Source: IMF staff.

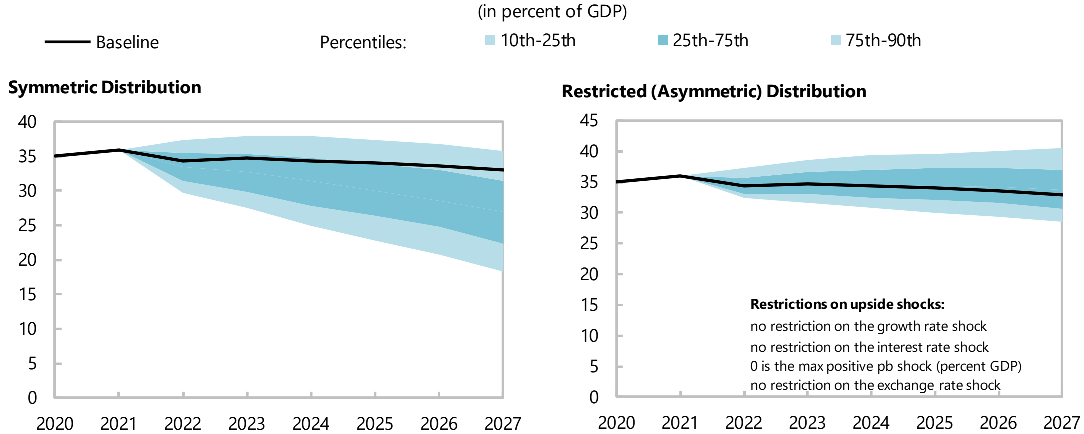
Figure 5. Peru: Public DSA – Risk Assessment

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

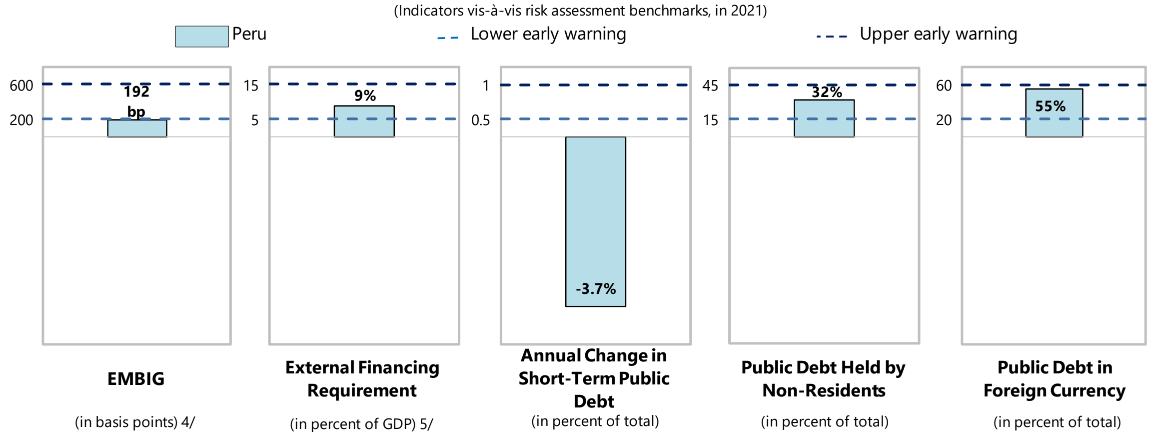
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2021)



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, 28-Dec-21 through 28-Mar-22.

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 VIII. Peru's Fiscal Framework

1. **Peru's fiscal framework was first introduced in 1999**. In its current form, the framework is comprised by five key elements: (i) a set of fiscal rules (numerical ceilings) on the overall balance, public debt, and expenditure, (ii) a medium-term budgeting (MTBF) framework that aligns the budget preparation process and the fiscal rules, (iii) escape clauses that determine the conditions under which deviations from the rules are allowed, (iv) a Fiscal Stabilization Fund, and (v) an independent Fiscal Council.

2. **Amendments and revisions to the framework have been frequent.** The ***Initial framework*** introduced fiscal rules setting a (i) ceiling on the growth of the nonfinancial expenditure of the general government (annual average inflation plus 2 percent); and (ii) a ceiling on the fiscal deficit of the nonfinancial public sector (1 percent of GDP). The ***2003 Revised Framework*** introduced rules for the regional and local governments (to take effect in 2009) and set the ceiling for the real growth of nonfinancial expenditure of the general government was relaxed from 2 to 3 percent (and later eased to 4 percent in 2008). The MTBF, in the form of the Multiannual Macroeconomic Framework (MMM), and the Fiscal Stabilization Fund (FEF) were introduced at this point. The MTBF presents the macroeconomic framework and guides the budget preparation process for the next 4 years.

3. **The introduction of a *structural balance rule in 2013* followed recommendations from the Commission to Strengthen the Macro-Fiscal Framework.** With input from the IMF, the revised framework included a guideline for the structural deficit of 1 percent of GDP (to be implemented in 2015), and the introduction of a public debt benchmark of 30 percent of GDP, with deviations from the benchmark expected to trigger corrective action. This revision also simplified the rules for the regional and local governments, and created the Fiscal Council, which was tasked with issuing non-binding opinions on: (i) modifications and compliance with the rules, (ii) the macroeconomic projections underpinning the MTBF, (iv) the expected trajectory of fiscal accounts in the short, medium, and long term, and (v) the methodology to estimate the structural accounts.

4. **The *2016 Revision (current framework)* addressed concerns over transparency and a perceived expansionary bias of the existing rules**. The structural balance rule was dropped for an overall deficit rule (set at 1 percent), while the debt benchmark was substituted for a debt ceiling of 30 percent of GDP. Temporary breaches from the debt rule (of at most 4 percent of GDP in periods of financial volatility if the other fiscal rules are met) were allowed. Ceilings on real (non-interest and current) expenditures of the general government were reintroduced, using as reference a centered moving average of yearly real GDP growth estimated with 15 years of observed data and 5 years of projected GDP growth.

5. **Suspension of the rules or use of the escape clauses have not been unusual**. The deficit rule was suspended in 2009-10 to accommodate a stimulus plan following the GFC. In 2017, the escape clause was invoked to accommodate reconstruction needs following a severe El Niño weather event. The rules were suspended in 2020-21 in the wake of the Covid-19 pandemic to accommodate a substantial crisis response package.

Annex IX. Foreign Exchange Interventions in Peru

1. **Peru adopted an inflation-targeting regime in 2002 and has continued to address dollarization risks through foreign exchange interventions (FXIs).** Regional comparisons show that the new regime has worked well, with inflation and exchange rate stability comparing favorable to regional peers.

2. **Intervention frequency has increased since the onset of the pandemic, with a shift from purchases to sales reflecting external pressures.** Over the period spanning January 2012 to January 2022, the BCRP intervened on the FX spot market approximately half of all days, with a relatively equal distribution between purchases and sales. The Covid-19 pandemic was a turning point, shifting the distribution of interventions from purchases overwhelmingly to sales, reflecting large capital outflows and political uncertainty.

Foreign Exchange Interventions

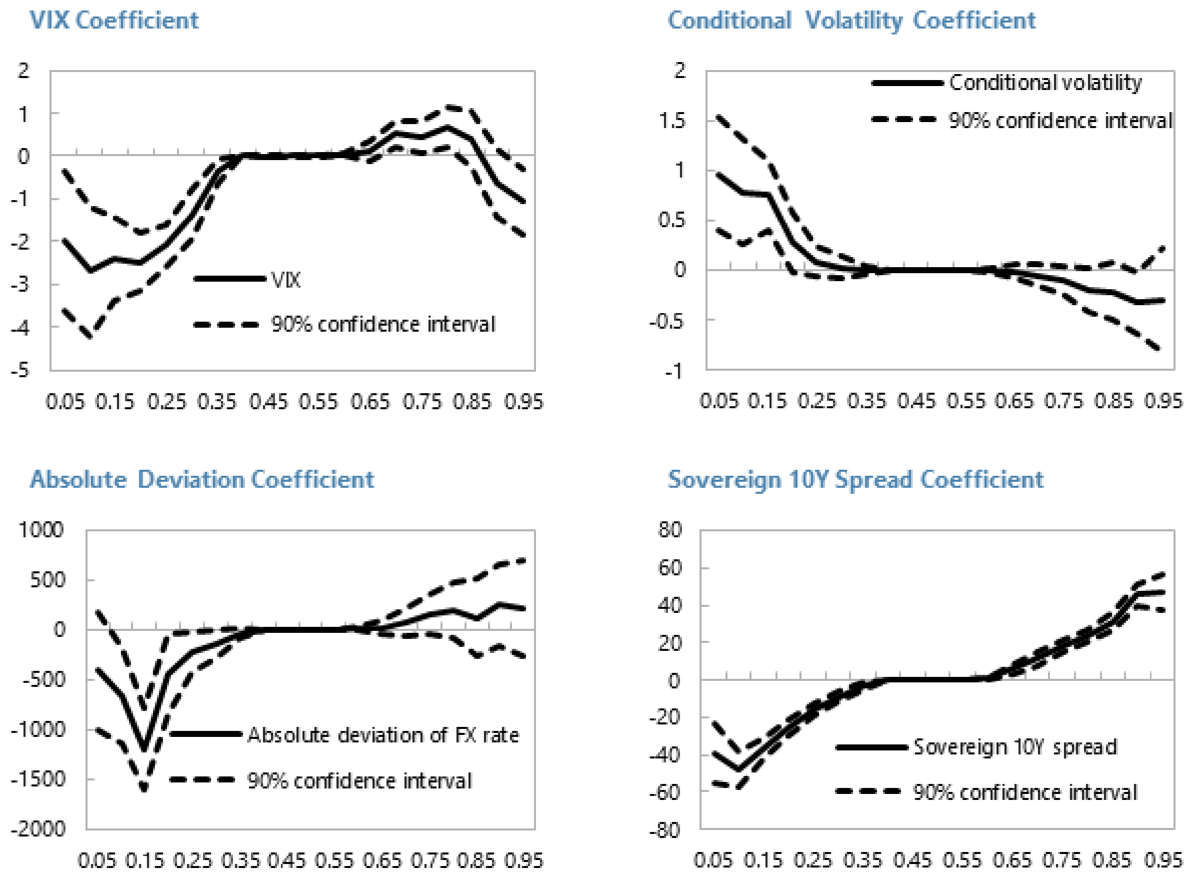
	2012/01-2020/01	2020/02-2022/01	Full sample
Observations	2109	503	2612
Total intervention days	912	377	1289
Unconditional probability of intervention	0.43	0.75	0.49
Number of days with purchases	562	131	693
Average purchase (USD million)	99.7	17.24	93.37
Median purchase (USD million)	76.36	54.63	71.36
Std. dev. of purchase (USD million)	96.21	52.74	90.55
Unconditional probability of purchase	0.27	0.26	0.27
Number of days with sales	350	246	596
Average sale (USD million)	137.54	62.22	133.28
Median sale (USD million)	101.96	91.42	99.44
Std. dev. of sale (USD million)	113.28	113.06	113.31
Unconditional probability of sale	0.17	0.49	0.23

Source: Bloomberg, IMF staff calculations.

3. **The BCRP continues to respond by smoothing the exchange rate and addressing volatility.** The BCRP does not have a public intervention rule and employs discretion, often citing that it aims to: i) smooth FX fluctuations; and ii) to respond to volatility. We test this by estimating a quantile regression model for the BCRP's de facto intervention reaction function. The quantile regression setup addresses censoring at zero by only identifying coefficients at quantiles where the dependent variable is non-zero. In this case, the dependent variable is continuous FX interventions where positive values correspond to purchases and negative interventions correspond to sales. To test the two hypotheses, we construct a variable measuring absolute deviations of the exchange rate relative to a 5-day moving average, as well as a conditional volatility estimate based on an asymmetric GARCH model. We address generated regressor issues by bootstrapping confidence intervals. Figure 1 shows that the BCRP intervenes strongly in response to both conditional volatility and absolute deviations. Additionally, among

the various controls included in the model, the BCRP appears to respond strongly to the VIX as well as to the sovereign 10-year spread relative to the US.

Figure 1. Peru: Quantile Model Estimates for Foreign Exchange Interventions



Source: IMF staff calculations.
Notes: Estimated coefficients (y-axis) by quantile (x-axis).

4. **A risk-based model may allow for fewer and better-targeted interventions.** Consider the value-at-risk (VaR) approach proposed in Lafarguette and Veyrune (2021).[1] Rather than employing an unconditional threshold of FX returns at which to intervene, the VaR approach proposes a method to identify conditional and time-varying thresholds for intervention. Intervention thresholds can be conditioned on the prevailing risk environment through measures of market microstructure, volatility, dollar effects, commodities, and country risk. If FX returns exceed a risk-contingent threshold, the central bank can intervene to smooth out unusually large shocks—where "unusual" corresponds to a chosen probability level of the conditional density of FX returns. For instance, on January 31, 2022 at a 5 percent VaR, the central bank would have intervened if FX returns exceeded -77.8 bps or 63.8 bps. On other days, the intervention thresholds would change. Applying the framework to the entire sample under consideration for

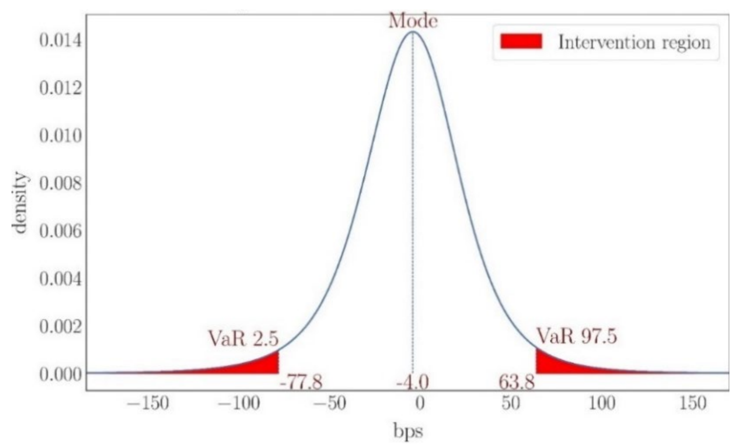
[1] Lafarguette, Roman and Romain M. Veyrune (2021), "Foreign Exchange Intervention Rules for Central banks: A Risk-Based Framework," IMF Working Papers No. 2021/032.

Peru, the 5 percent VaR threshold is exceeded on 42 occasions—requiring 29 FX purchases (green) and 13 sales (red)—considerably fewer than the 1,289 interventions undertaken by the BCRP. The result is that some movements in the exchange rate are conditionally significant and require intervention—for instance in 2016 following the commodities boom and in 2021 following the attenuation of political uncertainty—whereas other movements are conditionally insignificant and do not require intervention.

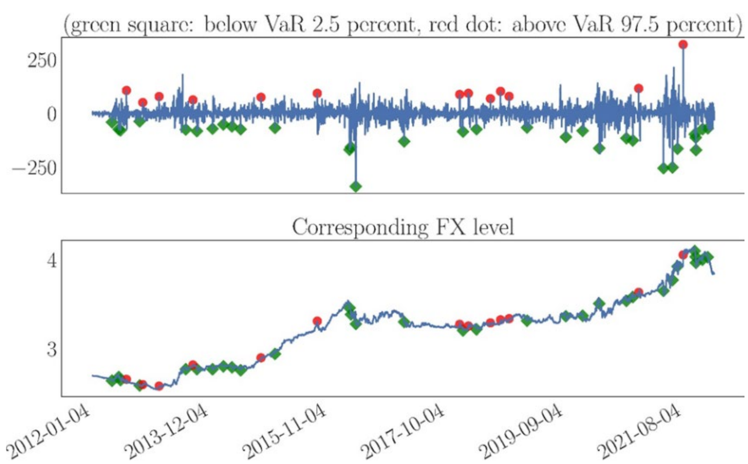
5. A transitional strategy for FXIs will help foster development of the FX market. The risk tolerance of the central bank can be reflected in the calibration of VaR thresholds. For a low risk tolerance, for instance due to a high level of dollarization, a large VaR can be chosen and gradually reduced over time. A VaR at 20 percent, for example, will require four times as many interventions over the same sample as a VaR at 5 percent. Gradually reducing the number of interventions while ensuring that risks are addressed will incentivize private market development and disincentivize excessive currency mismatch, thereby encouraging de-dollarization.

Value-at-Risk Estimates

Conditional density and intervention rule based on 2022-01-31 information.



Log returns and conditional VaR exceedance at 5 percent.



Source: IMF staff calculations.

Annex X. Implementation of 2018 FSAP Recommendations

Peru: FSAP Key Recommendations	
Recommendations	**Status**
Systemic Risk and Macroprudential Policy	
Increase capital surcharges for systemic banks to levels in line with Basel III framework; increase countercyclical provisioning for smaller banks. (SBS) (ST)	**In progress.** New methodologies were developed for countercyclical provisions and capital surcharges for systemic banks. A new methodology was established for determining buffers for concentration and interest rate risk. A new provisioning scheme more sensitive to risk has been developed. The SBS is working to modify the General Law to conform the composition of regulatory capital to the Basel III standard.
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)	**Partially implemented.** An 8-percent increase in capital surcharges is currently applied to exposures subject to credit exchange rate risk.
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. 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. A new resolution adapts the calculation of the consolidated regulatory capital for financial groups, while liquidity contingency plans at the consolidated level are being reviewed. 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**. The SBS is drafting general guidelines for recovery plans of financial institutions.
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)	**Implemented.** The functions of the Internal Control Committee were expanded to include internal risk management, information security, and compliance with SBS regulations. An Internal Risk Management Department was created to ensure the integrity of the SBS, and the Ethics Tribunal was formed.
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)	**Implemented.** The review for calculation of additional capital requirements has been completed. A recommendation was issued (December 2021) to modify the regulatory capital requirement for systemic risk to include elements of interconnectedness, substitutability, and complexity, in addition to size. Another recommendation was issued reducing the activation trigger of the cyclical rule while also modifying the countercyclical provision rates to be more sensitive to heterogenous risk in the credit portfolio. A final recommendation was issued establishing a methodology for calculating the leverage ratio and periodically reporting to the SBS.
Insurance	
Implement risk-based supervision for all insurers and brokers. (SBS) (ST)	**Partially 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, then to April 2021, and finally to March 2022.
Crisis Management	
Strengthen crisis preparedness and management arrangements. (MEF, BCRP, SBS, FSD) (MT)	**Partially implemented.** The authorities believe that 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)	**Partially implemented.** In practice, FSD payouts are usually 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)	**Partially 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, but the bill has not yet been sent to Congress. 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 Reform	
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 ongoing 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 that has not advance and 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.	

INTERNATIONAL MONETARY FUND

PERU

May 4, 2022

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	The Western Hemisphere Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of February 28, 2022)

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	966.12	72.40
Reserve Tranche Position	368.43	27.61

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	1888.95	100.00
Holdings	1782.98	94.39

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:

	2022	2023	2024	2025	2026
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.20	0.26	0.26	0.26	0.26
Total	0.20	0.26	0.26	0.26	0.26

Exchange Arrangement

Peru has a floating exchange rate arrangement. On February 28, 2022 the average of interbank buying and selling rates was 3.76 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 2021 Article IV consultation was concluded on March 19, 2021 (IMF Country Report No. 21/63).

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	PFM - MTBF	5/15/2020
2020	PFM/Budget - MTBF	7/16/2020
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
2021	Tax Administration – Risk Management	4/20/2021

2021	Tax and Customs Administration – Risk Management and Research	3/14/2021
2021	Tax and Customs Administration – Risk Management and Exchange of Information	3/13/2021
2021	Tax Policy – Mining Sector, Digital Services and Capital Gains Taxation	11/15/2021
MCM		
2021	CBDC Feasibility	8/27/2021
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 March 31, 2021)

I. Assessment of Data Adequacy for Surveillance

General. Data provision and macroeconomic statistics have some shortcomings but are broadly adequate for policy formulation, surveillance, and monitoring.

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 as a producer price index; (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 2019/2020 Encuesta Nacional de Presupuestos Familiares (ENAPREF). 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. STA assisted INEI to estimate the missing data of the 2019/20 ENPREF and compile new weights with this information to rebase the CPI. 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 (ENAHO). 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

II. Data Standards and Quality

Peru subscribes to the Special Data Dissemination Standard (SDDS) since August 7, 1996. A data ROSC was prepared and published in 2003.

Peru: Table of Common Indicators Required for Surveillance
(As of March 31, 2022)

	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]	Memo Items: Data Quality Accuracy and Reliability[7]
Exchange Rates	2022M3	04/01/22	M	M	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	02/28/22	03/08/22	M	M	M		
Reserve/Base Money	02/28/22	03/08/22	M	M	M	O, LO, LO, LO	O, O, O, O, O
Broad Money	01/31/22	03/27/22	M	M	M		
Central Bank Balance Sheet	02/28/22	03/08/22	M	M	M		
Consolidated Balance Sheet of the Banking System	01/31/22	03/27/22	M	M	M		
Interest Rates[2]	February, 2022	03/16/22	M	M	M		
Consumer Price Index	February 2022	01/26/22	M	M	M	O, LO, LO, LO	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing-Central Government	February 2022	03/24/22	M	M	M	O, LO, O, O	O, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing – General Government	Q4/2021	01/27/22	Q	Q	Q	O, LO, O, O	O, O, O, LO, O
Stocks of Central Government and Central Government Guaranteed Debt[3]	Q4/2021	02/18/22	Q	Q	Q		
International Investment Position[4]	Q4/2021	02/18/22	Q	Q	Q		
External Current Account Balance	Q4/2021	02/21/22	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	Q4/2021	02/21/22	Q	Q	Q		
GDP/GNP	Q4/2021	11/21/20	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	Q4/2021	02/18/22	Q	Q	Q		

[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.

PERU

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

April 26, 2022

Prepared By Western Hemisphere Department

The information below has become available following the issuance of the staff report. It does not alter the thrust of the staff appraisal.

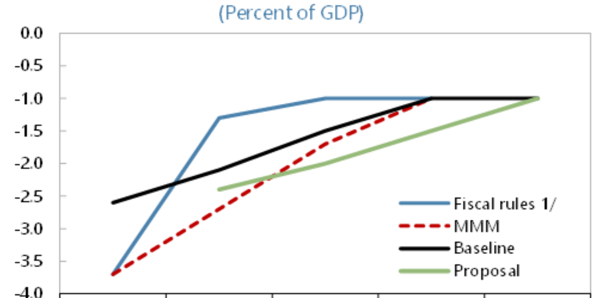
1. **Economic activity was slightly stronger-than-expected in early 2022**. Real GDP grew by 3.9 percent year-on-year in the first two months of 2022, driven by a strong recovery of accommodation and restaurants reflecting the limited impact of the Omicron surge. Formal employment continued to increase. International trade and tax revenues also grew strongly. Most restrictions related to the pandemic were removed at the end of February.

2. **The government announced several measures to contain inflation.** These measures include increasing fuel subsidies, suspending excise taxes on fuels, and eliminating the value-added tax (VAT) on certain basic goods (chicken, sugar, eggs, noodles, and bread) for three months. The government also increased the minimum wage by about 10 percent and postponed the planned diesel price increases ("reference band"). On April 12, the parliamentary Economics Commission approved a new private pension fund withdrawal of up to about US$4,800 per person to provide additional resources to households at a time of high inflation. The bill is likely to gather support for floor approval.

3. **The government proposed legislation to modify the fiscal rule for 2023-25.** The authorities reiterated their commitment to pursue a neutral fiscal stance for 2022 but out of an abundance of caution, they propose a relatively neutral stance for 2023 too, and then to begin the gradual fiscal adjustment only in 2024, reaching the objective of a fiscal deficit of 1 percent of GDP in 2026 (rather than 2025). The new fiscal deficit targets are shown in the text chart. In addition, the ceiling on the debt ratio would be set at 38 percent, with indicative guidance stating that it should converge to 30 percent of GDP within the next 10 years. The proposal should be discussed by Congress ahead of the presentation of the next medium-term budgeting framework in August. The new fiscal targets envision a more gradual than anticipated fiscaconsolidation but remain broadly in line with the path discussed with staff while reflecting the materialization of significant risks to growth. The announced fiscal

strategy would imply a neutral fiscal stance in 2023, and a gradual fiscal consolidation of about 0.5 percent of GDP per year during 2024-2026.

Peru: NFPS - Overall Balance
(Percent of GDP)



	2022	2023	2024	2025	2026
Fiscal rules 1/	-3.7	-1.3	-1.0	-1.0	
MMM	-3.7	-2.7	-1.7	-1.0	
Baseline	-2.6	-2.1	-1.5	-1.0	-1.0
Proposal		-2.4	-2.0	-1.5	-1.0

Sources: Country authorities; and IMF staff calculations.
1/ 2022 target set in 2021, 2023 target set in 2019, 2024-2025 targets set in 2016.

4. The government announced the creation of a Multisectoral Commission to Strengthen the Civil Service. The commission has been tasked with preparing a report within the next 60 days on the status of the 2013 Civil Service Reform, presenting a set of recommendations to improve its implementation, and strengthen the Civil Service Authority (SERVIR).

5. Social unrest escalated partly due to higher food and fuel prices. Protests in Lima against rising energy prices turned violent, leading the government to impose curfews. Road blockades by local population disrupted production in two major copper mines.

6. Political developments. The president sent a bill to Congress, proposing a referendum for a new constitution to be carried out along municipal elections scheduled for October 2. The process proposed in the bill does not conform to the current constitution and is unlikely to be approved by the opposition-controlled Congress. Peru did not impose any sanctions in connection with the war in Ukraine.

INTERNATIONAL MONETARY FUND

PERU

April 28, 2022

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—FURTHER SUPPLEMENTARY INFORMATION

Prepared By | Western Hemisphere Department

The information below has become available following the issuance of the staff report. It does not alter the thrust of the staff appraisal.

1. Text Table 1 of the main text of the staff report now reflects updated information on spending execution figures for 2020 and 2021 received on April 26, 2022.

Text Table 1. Peru: Covid-19 Stimulus Measures*
(Percent of GDP)

	2020	2021
Cash transfers	2.0	0.9
Health spending	0.9	1.5
Support to firms	9.0	0.5
Of which: Loan guarantees	8.1	0.2
Other	2.1	0.7
Total	14.0	3.7

* Figures for 2021 include measures authorized under Emergency and Supreme Decrees.
Sources: Country authorities; and IMF staff calculations.

Statement by Sergio Chodos, Executive Director for Peru and Oscar Hendrick, Senior Advisor to Executive Director

April 29, 2022

Key Points

- The Peruvian economy grew 13.3 percent in 2021, one of the highest rates in the LAC region, thanks to timely and effective policy actions taken by the authorities at the beginning of the COVID-19 pandemic.
- Inflation in Peru has been one of the lowest and less volatile in LAC so far this century (2.7 percentage on average 2001-2021). The temporary increase in inflation in 2021-22 is expected to return to the central bank inflation target range in 2023.
- As of March 2022, the fiscal deficit stood at 1.7 percent of GDP, one of the lowest in LAC, marking 12 consecutive months of decline.
- Despite a substantial fiscal stimulus to sustain economic activity and provide social protection during the pandemic, and the associated borrowing to finance part of the additional expenditure, public debt to GDP was 36.1 percent as of end-2021.
- Peru's external position is one of the strongest among emerging market economies. International reserves amount to 35 percent of GDP. This buffer, together with access to a precautionary FCL provides additional insurance against exogeneous financial shocks.
- The financial sector remains solid despite the gradual unwinding of emergency measures, and recent stress tests suggest that the financial system is resilient even under severely adverse scenarios.
- Looking ahead, and with the OECD accession process underway, the authorities are working on a broad range of structural reforms to boost economic growth, address social needs highlighted during the COVID-19 pandemic, and resume the successful poverty reduction process that was taking place prior to 2020.

INTRODUCTION

1. **Our Peruvian authorities would like to convey their appreciation to Mr. Bonato and his team for a frank and constructive policy dialogue during the Article IV Consultation.** In its Staff Report (SM/22/83), staff provides an in-depth analysis of the strong performance by the Peruvian economy and the challenges ahead. Our authorities are in broad agreement with the staff's assessment and policy recommendations. We appreciate the focus on the consultation on the appropriate near-term policy mix, during the transition to a post-COVID-19 world, and the staff's recommendations to face the new challenges associated with the war in Ukraine and bleak global outlook. Dealing with potential additional global spillovers, risk of a new wave of the pandemic, and domestic inflationary pressures, will also require structural reforms and policies to rebuild buffers and reinforce high growth prospects over the medium term.

2. **Peru has maintained its strong economic performance and substantial policy buffers during the last two decades.** As stated in the first paragraph of the staff report, Peru has successfully navigated significant economic shocks in recent years, thanks to strong economic policies and institutional policy frameworks. Despite recent political uncertainty, real GDP growth remained strong during the first quarter of 2022, after a substantial two-digit rebound in economic growth in 2021. Yet the shock caused by the pandemic is still affecting employment and caused a backtrack of the successful poverty reduction trend in the last decade. Nonetheless, large macroeconomic buffers, complemented by the FCL arrangement expiring on May 27, will continue to shield the economy from downside and tail risks.

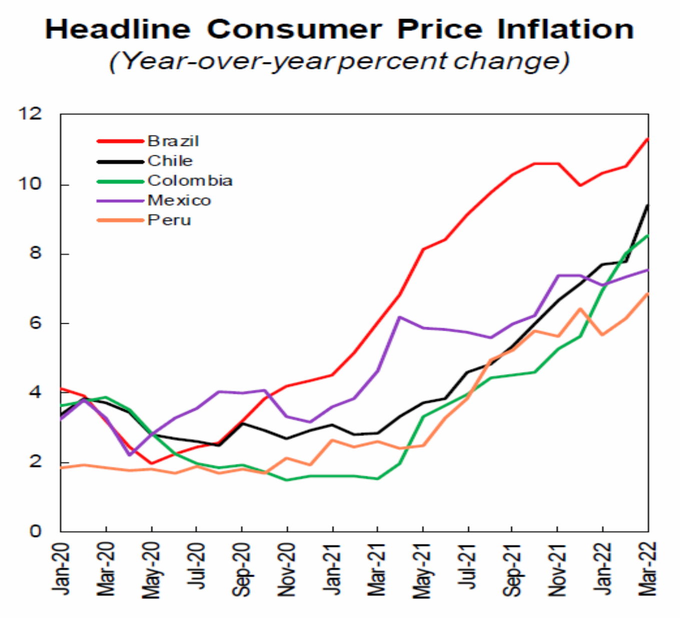
POST-COVID 19: RECOVERY AND OUTCOME OF THE POLICY RESPONSE

3. **The Peruvian economy grew 13.3 percent in 2021, one of the highest rates in the LAC region.** The relaxation of the COVID-19 related mobility restriction and a widespread vaccination rollout[1], supported by a substantial fiscal stimulus and expansionary monetary policy, allowed a strong rebound of economic activity in 2021, after the deepest economic recession in decades. Economic activity continued its recovery path in early 2022, despite the Omicron surge, which was relatively short-lived and had a very limited impact on mortality. Real GDP growth was 3.9 percent in the first two months of 2022 (yoy), and higher than the 3.2 percent of 2021 Q4.

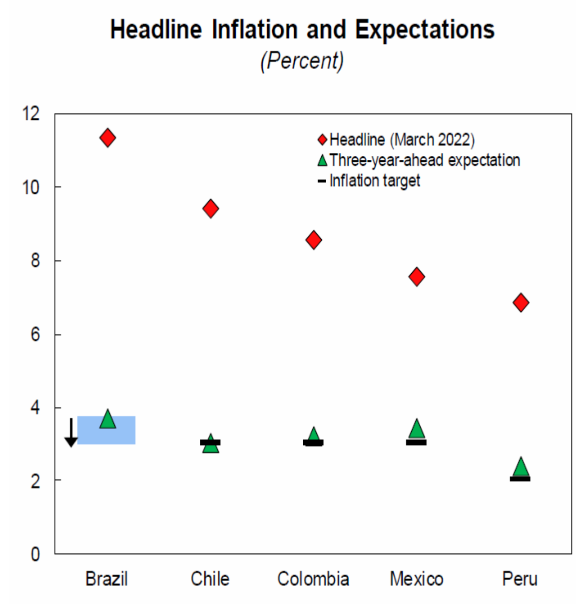
4. **Inflation in Peru has been one the lowest and less volatile in LAC so far this century, 2.7 percent on average in 2001-2021.** However, in a context of global inflationary pressures, 12-month headline inflation increased to 6.8 percent in March 2022, due to higher food and oil prices. Core inflation only rose to 3.5 percent. Twelve-month inflation expectations reached 4.4 percent, above the 1-3 percentage target range of the Central Bank. However, inflation is

[1] As of April 9, 2022, 26.3 million people were fully vaccinated, equivalent to 80 percent of the population, and 43 percent of the population received a booster shot.

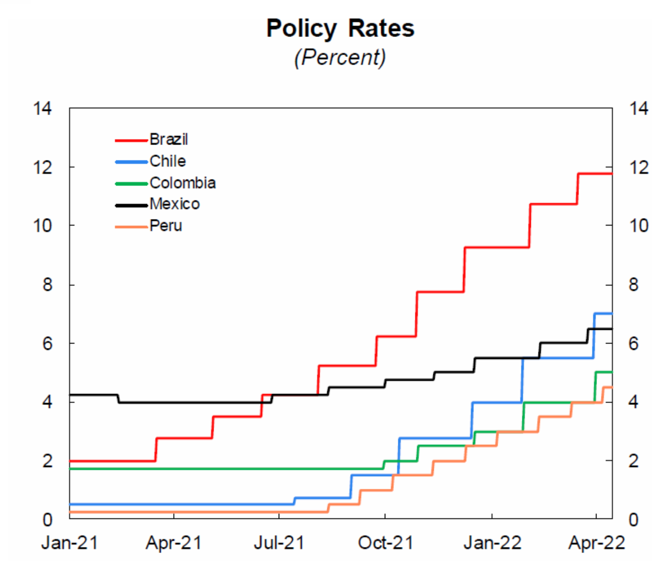
expected to return to the target range in 2023, as transitory supply-side effects revert, and economic activity remains below potential. See charts below[2].



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Peru refers to Lima.



Sources: Consensus Economics; Haver Analytics; and national authorities.
Note: Brazil inflation target is set to decline over time from 3.75 percent in 2022 to 3 percent in 2024.



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

5. **The Central Bank of Peru (BCRP) had a decisive and rapid response to curb inflation expectation and bring headline inflation back within the target range.** The monetary authority raised its policy rate by 425 bps to 4.5 percent in nine consecutive steps, but the policy stance remains accommodative. Nonetheless, the BCRP stands ready to continue adjusting the policy rate, to guide inflation and its expectations back to the target range. Policy decisions will continue to be data driven and are based on a careful monitoring of inflation expectations.

6. **The fiscal stance in 2021 and during the first months of 2022 has been stronger than originally expected.** The non-financial public sector (NFPS) deficit fell from 8.9 percent of GDP in 2020 to 2.6 percent of GDP in 2021. This outcome is mainly explained by a substantial increase in tax revenues associated with higher metal prices, and the reactivation of economic activity, after the lifting of mobility and sanitary

[2] Presentation by WHD during the Meeting with the Authorities of South America and Mexico, April 23, 2022.

restrictions. This will support economic activity in high-contact industries and services sectors, particularly tourism, which has a lot of room for further growth. As of March 2022, the fiscal deficit stood at 1.7 percent of GDP (yoy), one of the lowest in LAC, marking 12 consecutive months of decline. The favorable fiscal results of 2021 allowed to rebuild liquid financial assets for around US$4.6 billion, of which about US$ 1.4 billion will go to replenish the Fiscal Stabilization Fund, while the rest will go to the Secondary Liquidity Reserve. Despite public borrowing to finance part of the fiscal stimulus, public debt as of end-2021 reached only 36.1 percent of GDP, one of the lowest among emerging markets. The sovereign credit rating remains at investment grade. Going forward, fiscal consolidation will continue, and the deficit is expected to decrease as the economy gradually recovers from the COVID-19 shock.

7. **Peru's external position remains strong and international reserve coverage remains adequate under all Fund metrics.** For a small open and commodity exporting economy, with substantial domestic foreign currency liabilities, maintaining large external buffers is a key tool to enhance the resilience of the Peruvian economy. Despite historical short-term capital outflows in 2021, due to the political uncertainty, this was more than compensated by inflows of FDI, public borrowing and the 2021 SDR allocation. By end-2021, international reserves increased to US$ 78.5 billion (US$ 3.6 billion larger than end-2020), and equivalent to 35 percent of GDP. We concur with the staff's assessment that the external position in 2021 is broadly in line with the level implied by fundamentals and desirable policies.

8. **The financial sector remains strong and resilient as emergency measures are gradually unwound.** As shown in the Financial Soundness Indicators Heatmap, the financial system remains stable after some volatility in 2021. Sovereign and corporate spreads remain low and stable compared with other countries in the region. Equity prices fully recovered previous losses. Following a gradual withdrawal of policy support, including the reduction of countercyclical capital buffers, and the government-guaranteed loans, credit growth has naturally declined, while profitability has continued to recover. Top-down stress tests conducted recently by the authorities confirm the 2018 FSAP findings that the financial system is resilient even under severely adverse scenarios. Although the anticipated rise in non-performing loans is limited (4 percent by end 2021), the supervisory and regulatory authority will continue to monitor market conditions and take measures as needed.

OUTLOOK AND RISKS

9. **After a strong rebound in 2021, real GDP is expected to reach 3.4 percent in 2022, supported by a rebound of the primary sector and a recovery of private consumption.** The lower growth is consistent with withdrawal of the policy stimulus, expected slower global growth, tighter global financial conditions, among other factors. On the other hand, the successful vaccination of the population, the elimination of remaining sanitary restrictions due to COVID-19, the reopening of schools and universities, and more demand of other activities including in

the services and tourism sectors will provide a boost to economic activity and further increase in employment.

10. **Despite the global uncertainty and risks tilted to the downside, we agree with staff that policy buffers remain ample to protect the economy from external and domestic risks.** As discussed above, economic fundamentals are very strong, international reserves are high by standard metrics, the fiscal deficit fell substantially after the pandemic, public debt is low, the sovereign credit rating remains investment grade. The Central Bank's strong reputation and credibility will help to guide inflation back to the target range in 2023. The financial system continues to be strong and resilient. Nevertheless, the authorities remain ready to take additional actions as warranted by evolving and unpredictable global market conditions.

BUILDING BLOCKS FOR A POST COVID-19 WORLD WITH STRONGER AND INCLUSIVE ECONOMIC GROWTH

11. **The authorities agreed with staff that a neutral fiscal stance is appropriate in the short term, and that an enhancement of the medium-term strategy would be helpful to preserve fiscal sustainability.** As noted above, the fiscal stance in 2021 and so far in 2022 is already much better than anticipated. The 2022 budget is balanced and in line with past IMF advice, with increased spending in health, education, and social protection. The authorities stand ready to take additional actions if some of the contingent fiscal risks materialize. As discussed with staff, last week, the Executive branch submitted to Congress a proposal for a new law for a recalibration of the fiscal rule. The proposal establishes a ceiling of 2.4 percent of GDP in 2023, and a convergence to 1.0 percent of GDP in 2026 and beyond. Also, it is proposed that the ratio of public debt to GDP should not be greater than 38 percent, and that this ratio should gradually converge back to 30 percent of GDP in no more than 10 years. This approach is slightly more gradual than original envisaged, but this is needed considering the additional spending pressures causes for the higher inflation, and the need to reduce taxes for staple foods and additional cash transfers to assist the poorest segments of the population.

12. **Enhancing the effectiveness of the Fiscal Council is also a priority.** The Fiscal Council has been supporting Peru's fiscal framework with transparency and independence. Their opinion and views (even when they have been different from the Ministry of Finance's) have always been welcomed and openly disseminated to the markets and public in general. Yet, there could be room for further improvement. In that sense, the Minister of Finance formally requested technical assistance from the IMF Fiscal Department to further improve the framework of the Fiscal Council, following best international practices.

13. **The Central Bank's long track record of implementing a successful inflation targeting framework is the best warranty of a decisive data driven policy response.** Since August 2021, the monetary authority began to increase its policy rate, in line with the normalization of

the monetary stance, and has since introduced nine rate hikes, to 4.5 percent currently. The Central Bank will continue to take the necessary steps to bring inflation back within the target range over the forecast horizon. The real exchange rate plays an important role as a shock absorber, which is why the sol depreciated significantly in 2021, despite the large FX interventions, which were justified, as explained by staff, by the historically large capital outflows, and the still relatively high rate of dollarization, and significant volatility in market conditions.

14. **The resilience and strength of the financial system and the absence of systemic risks, allows a gradual unwinding of policies taken during the pandemic.** Yet, the authorities are mindful of providing continued support to weaker entities in the cooperative and microfinance sectors, which are important for micro and small size businesses. They are also closely monitoring bank portfolios and lending standards for any unexpected increase in non-performing loans, although the likelihood is very low. With the help of the IMF and other international agencies, the authorities are exploring ways to improve the digital payment infrastructure, potentially through the introduction of a central bank digital currency. This initiative is still in the early stages of the process.

15. **With the OECD accession process underway, the authorities are focusing on a broad range of structural reforms.** Enhancing the public provision of health, education, and social protection (needs exposed by the pandemic) is a number one priority. Many reforms, including a substantial improvement of the civil service, is key to enhance the quality of public spending, quality control, and to optimize the needed increase in the budget for these critical sectors. Significant progress has been made in the implementation of the Anti-Corruption Plan 2018-2021 and the effectiveness of monitoring COVID-related spending, nonetheless, recognizing that there is still room for further improvement.

16. **Peru was the first Latin American country to ratify the Paris Agreement in July 2016 and its fully committed to a 2030 target of 20 percent for the energy produced from unconventional renewable sources.** It is important to underscore that Peru is not a large carbon emitter. Its energy matrix is intensive in natural gas, 42 percent as primary source and 11 percent for natural gas liquids. It is land use and deforestation which account for most of the country's emissions. At the same time, Peru is one of the most vulnerable countries due to the impact of extreme weather events. As it is well explained in Box 1, earthquakes, landslides, droughts, and floods together cause large welfare losses every year. The 2017 El Niño event left around US$ 6-9 billion in monetary losses, affecting 1.7 million people. The assistance to be provided by the World Bank and other partners will be instrumental to reach the commitment to carbon neutrality by 2050.

FINAL REMARKS

17. Peru's strong economic fundamentals and more than three decades of implementing good economic policies, with sustained growth, low inflation, and a substantial reduction in poverty has paved the way for a resilient economy, with the buffers and drive to navigate through these difficult times and potential challenges ahead. The authorities do not take anything for granted and remain vigilant to make any necessary corrections along the road for a continuation of sustained inclusive growth and fulfillment of its commitment to comply with its burden sharing for a better and sustainable world.