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March 2023

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PERU

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 Article IV consultation with Peru, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 22, 2023, consideration of the staff report that concluded the Article IV consultation with Peru.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 22, 2023, following discussions that ended on February 8, 2023, with the officials of Peru on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 8, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Peru.

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PRESS RELEASE

PR23/91

IMF Executive Board Concludes 2023 Article IV Consultation with Peru

FOR IMMEDIATE RELEASE

Washington, DC – **March 24, 2023:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Peru on March 22, 2023.

Against the background of a strong economic performance over the last quarter of a century, Peru has been hit by multiple shocks in the last several years. Adequate policies and very strong macroeconomic policy frameworks have made the economy resilient. Following a steep decline in 2020 at the outset of the pandemic and a rapid recovery in 2021, growth slowed significantly in 2022 as the policy stimulus was withdrawn and external and financial conditions deteriorated, while road blockades and strikes at major mining sites adversely affected copper production and exports. Inflation has declined recently but remains well above the target range. The unemployment rate and poverty continue falling but are still above the pre-COVID-19 pandemic levels. While volatility in financial markets has recently increased in line with global trends, the Peruvian banking system remains well-capitalized, and its profitability continues to recover from the impact of the pandemic. Recent developments suggest that the government needs to work across the political spectrum to restore confidence, preserve stability, accelerate structural reforms to boost economic activity, and tackle inequality, poverty, and weaknesses in the education, health, and pension systems.

The outlook is very uncertain, and downside risks prevail. Growth is expected to slow to 2.4 percent in 2023 as external conditions tighten and political uncertainty remains high. Inflation is expected to decline to the target range at end-2023-early-2024. The main external risks to this outlook include an intensification of spillovers from Russia's war in Ukraine, an abrupt global slowdown with an associated commodity price volatility, and a possible de-anchoring of inflation expectations forcing a further tightening in the global financial conditions. Key domestic risks include an intensification of political uncertainty, social unrest over political developments, and natural disasters, which could hinder economic activity and risk the planned medium-term fiscal consolidation. New COVID-19 outbreaks may also significantly affect economic activity. Upside risks include a "soft landing" in key trade partner countries and an acceleration of structural reforms at home, which could increase Peru's medium-term growth potential.

Peru's very strong policy frameworks and macroeconomic buffers, further complemented by an FCL arrangement, will help shield the economy from downside risks. Public debt remains

[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.

the lowest in the region. Sizable international reserves (about 30 percent of GDP), access to international capital markets, and a robust financial sector mitigate macroeconomic risks and support the country's capacity to cope with additional adverse shocks. These buffers are complemented by a two-year Flexible Credit Line (FCL) arrangement for about US$ 5½ billion, approved by the IMF Executive Board in May 2022.

Executive Board Assessment[2]

Executive Directors noted that Peru's very strong economic fundamentals and policy frameworks, and sustained track record of implementing very strong macroeconomic policies have helped the country absorb large adverse shocks in recent years. The current FCL arrangement with the Fund has helped bolster these strong buffers. However, the pandemic's adverse effects on employment and poverty persist in an environment of slow growth and still-high inflation. Against the backdrop of increased downside risks, Directors urged the authorities to continue implementing prudent policies while working to create greater social cohesion and consensus for accelerating structural reforms to achieve more broad-based and inclusive growth.

Directors commended the authorities for their decisive response to high inflation and advised continuing to implement monetary policy in a flexible and well-communicated manner. Directors supported the authorities' resolve to stand ready to take further measures, if needed, to bring inflation to the target range. In addition, they considered that a deeper and more developed forward foreign exchange market, combined with further reductions in financial dollarization, would limit the need for frequent interventions, allowing the exchange rate to play a larger role as a shock absorber.

Directors noted that the banking system remains resilient. They urged the authorities to maintain a tightening bias in financial sector policies to create space for renewed support, if needed, in a deteriorating financial environment. Directors welcomed the significant steps taken by the authorities to strengthen financial sector oversight, and also stressed the importance of closing regulatory and supervisory gaps, including related to AML/CFT.

Directors agreed that the fiscal policy stance is appropriate, with a temporary, targeted, and small fiscal impulse supporting a weaker economy in the short term while avoiding adding to inflationary pressures. They underscored the need to identify specific measures, particularly in the areas of tax administration and expenditure rationalization, to support the announced fiscal consolidation in 2025-26 aimed at preserving fiscal sustainability while creating space for priority social and infrastructure spending. Directors agreed with the need to prioritize pension reform. They welcomed the recent reforms to enhance the effectiveness of the Fiscal Council and called for additional enhancements, including to strengthen its operational independence.

Directors encouraged the authorities to use the OECD accession process to promote social consensus around a well-articulated structural reform agenda to deal with the scarring effects of the pandemic and support green and inclusive growth. Priority should be given to boosting productivity, enhancing human capital and reducing informality, further improving governance, and reducing climate risks.

[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.

Peru: Selected Economic Indicators

	2019	2020	2021	2022	Projections 2023	2024	2025	2026	2027	2028
Social Indicators										
Poverty rate (total) 1/	20.2	30.1	25.9	...	...	...	...	...	...	
Unemployment rate (in percent; average)	6.6	13.0	10.7	7.8	...	...	...	...	...	
	(Annual percentage change; unless otherwise indicated)									
Production and prices										
Real GDP	2.2	-11.0	13.6	2.7	2.4	3.0	3.0	3.0	3.0	3.0
Output gap (percent of potential GDP)	-1.6	-7.2	-0.3	-0.3	-0.4	0.0	0.0	0.0	0.0	0.0
Consumer prices (end of period)	1.9	2.0	6.4	8.5	3.0	2.3	2.0	2.0	2.0	2.0
Consumer prices (period average)	2.1	1.8	4.0	7.9	5.7	2.4	2.2	2.0	2.0	2.0
External sector										
Exports	-2.2	-10.6	47.2	4.3	3.2	2.0	3.1	2.9	3.1	3.3
Imports	-1.8	-15.6	38.9	16.7	0.9	4.2	3.6	3.5	3.8	3.7
External current account balance (% of GDP)	-0.7	1.2	-2.3	-4.5	-2.1	-2.3	-2.1	-1.8	-1.6	-1.5
Gross reserves In billions of U.S. dollars	68.4	74.9	78.5	72.2	71.9	73.3	74.8	76.6	79.0	80.7
Percent of short-term external debt 5/	429	482	594	524	513	519	472	483	589	574
Percent of foreign currency deposits at banks	224	222	229	207	210	219	228	242	260	282
Money and credit 2/ 3/										
Broad money	8.8	29.2	2.7	-0.3	7.0	6.0	6.7	5.6	6.0	5.0
Net credit to the private sector	6.4	14.0	6.5	3.6	6.1	5.4	5.4	5.7	5.5	6.6
Credit-to-private-sector/GDP ratio (%)	42.7	52.5	45.9	43.9	42.9	42.9	42.9	43.2	43.4	44.1
	(In percent of GDP; unless otherwise indicated)									
Public sector										
NFPS revenue	24.7	21.9	25.6	25.7	25.3	25.2	25.1	24.9	24.7	24.7
NFPS primary expenditure	24.9	29.2	26.6	25.8	25.7	25.6	24.9	24.3	24.3	24.3
NFPS primary balance	-0.2	-7.3	-1.0	-0.1	-0.4	-0.4	0.1	0.6	0.5	0.4
NFPS overall balance	-1.6	-8.9	-2.5	-1.6	-2.0	-2.0	-1.5	-1.0	-1.0	-1.0
NFPS structural balance	-0.6	-6.4	-3.7	-1.8	-2.2	-2.3	-1.8	-1.3	-1.2	-1.1
NFPS structural primary balance 5/	0.7	-4.8	-2.2	-0.3	-0.6	-0.7	-0.2	0.3	0.3	0.3
Debt										
Total external debt 6/	34.8	44.2	45.1	42.5	38.8	37.6	35.6	34.2	32.9	32.3
NFPS gross debt 7/	26.9	35.0	36.4	33.4	33.0	33.3	33.2	32.8	32.3	31.9
External	8.4	14.9	19.5	17.4	17.0	16.6	15.5	14.9	14.1	13.8
Domestic	18.5	20.1	16.9	16.0	16.0	16.6	17.7	17.9	18.2	18.1
Savings and investment										
Gross domestic investment	21.8	19.7	22.0	23.7	25.2	25.2	25.0	24.8	24.7	24.6
Public sector (incl. repayment certificates)	4.6	4.3	4.7	5.5	5.6	5.6	5.6	5.6	5.7	5.7
Private sector (incl. inventories)	17.2	15.4	17.3	18.2	19.6	19.6	19.4	19.2	19.1	19.0
Private sector	18.0	16.8	20.5	20.7	19.6	19.6	19.4	19.2	19.1	18.9
National savings	21.1	20.9	19.8	19.3	23.0	22.9	22.9	23.0	23.2	23.1
Public sector	3.3	-3.9	2.8	4.7	4.4	4.4	5.0	5.5	5.4	5.5
Private sector	17.8	24.8	16.9	14.5	18.7	18.5	17.9	17.6	17.7	17.7
Memorandum items										
Nominal GDP (S/. billions)	775	719	877	950	1,031	1,087	1,144	1,202	1,263	1,326
GDP per capita (in US$)	7,006	6,145	6,679	7,094	7,773	8,018	8,320	8,633	8,952	9,285

Sources: National authorities; UNDP Human Development Indicators; and IMF staff estimates/projections.
1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.
2/ Corresponds to depository corporations.
3/ Foreign currency stocks are valued at end-of-period exchange rates.
4/ Adjusted by the economic cycle and commodity prices, and for non-structural commodity revenue. The latter uses as equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to IMF World Economic Outlook.
5/ Short-term debt is defined on a residual maturity basis and includes amortization of medium and long-term debt.
6/ Includes local currency debt held by non-residents.
7/ Includes repayment certificates and government guaranteed debt.

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STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

March 8, 2023

KEY ISSUES

Context. Against the background of a strong economic performance over the last quarter of a century, Peru has been hit by multiple shocks in the last several years. Adequate policies and very strong policy frameworks have made the economy resilient. Following a steep decline in 2020 at the outset of the pandemic and a rapid recovery in 2021, growth slowed significantly in 2022 as the policy stimulus was withdrawn and external and financial conditions deteriorated. Recent political developments suggest that the new government needs to work across the political spectrum to create broader political consensus, reduce uncertainty, ease social tensions, and boost growth.

Outlook and Risks. Growth is expected to slow to 2.4 percent in 2023 and converge to its potential of 3 percent over the medium term. Inflation is expected to decline gradually into the target range (1-3 percent) by end-2023-early 2024. Risks to the outlook are tilted to the downside, with key risks including escalation of Russia's war in Ukraine, an abrupt global slowdown and commodity price volatility, monetary policy miscalibration by major central banks with a possible de-anchoring of inflation expectations and systemic financial instability, an intensification of political uncertainties at home, social unrest over political developments, and natural disasters. Peru's large policy buffers, very strong macroeconomic policy frameworks, adequate policies, ample access to international capital markets, and access to an FCL arrangement continue to help protect the economy from external and domestic risks.

Policy Advice. Continuing with the agile implementation of the central bank's data-driven monetary policy remains appropriate. The monetary policy rate is already in the contractionary territory, and the BCRP is prepared to take further measures, if needed, to bring inflation to the target range. A small fiscal impulse is appropriate in the short term, while the planned fiscal consolidation needs to be implemented to stabilize the debt-to-GDP ratio and preserve fiscal sustainability over the medium term. Measures to support the announced fiscal consolidation in 2025-26 include improving tax administration and increasing the efficiency of public spending. Financial sector policies should continue to maintain a tightening bias to cement financial stability in a deteriorating financial environment. The OECD accession process should be used to define a well-articulated structural reform agenda to deal with the scarring effects of the COVID-19 pandemic and support green and inclusive growth.

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

Discussions were held in Lima during January 24-February 8, 2023. The mission team comprised Alejandro Santos (head), Luisa Charry and Etibar Jafarov (all WHD), Vassili Bazinas (MCM), Brooks Evans (FAD), and Oana Luca (SPR). Oscar Hendrick (OED) participated in the discussions. The mission met with Central Bank Governor Julio Velarde, Minister of Economy and Finance Alex Contreras, Superintendent of Banks, Insurance and Pensions Socorro Heysen, other senior government officials, and private sector and civil society representatives. Daria Kolpakova (WHD), Anthony Liu and Diego Mesa (FAD), and Kadir Tanyeri (ITD) provided valuable inputs to the report. Nicolás Landeta and Mariana Bravo Coello (all WHD) provided administrative assistance. Claudia Checa and Enrique Sanchez (CSF vendors) provided interpretation services.

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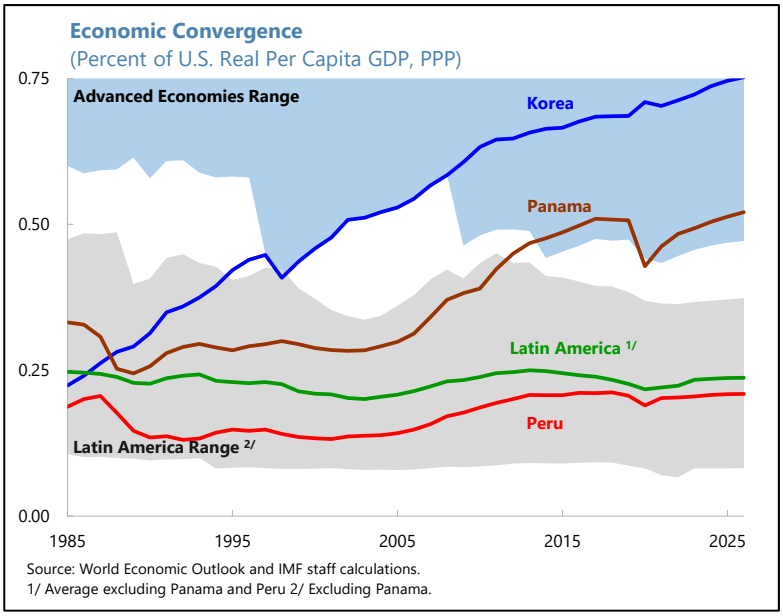
Acronyms

AML/CFT	Anti-Money Laundering and Countering the Financing of Terrorism
ARA	Assessing Reserve Adequacy
BAU	Business As Usual
BCRP	Banco Central De Reserva del Peru
BIS	Bank for International Settlements
CAB	Current Account Balance
CDLD	Central Bank Certificates of Deposit
CEPR	Centre for Economic Policy Research
CGR	Comptroller General of the Republic
CIP	Covered Interest Parity
CPAT	Climate Policy Assessment Tool
DMC	Disorderly Market Conditions
DSGE	Dynamic Stochastic General Equilibrium Model
EBA	External Balance Assessment
EDGAR	Emissions Database for Global Atmospheric Research
EMBI	Emerging Markets Bond Index
EMDE	Emerging Market and Development Economies
FAO	Food and Agriculture Organization
FCL	Flexible Credit Line
FDI	Foreign Direct Investment
FONAVI	Fondo Nacional de Vivienda
FSAP	Financial Sector Assessment Program
FSR	Financial Stability Report
FX	Foreign Exchange
FXI	Foreign Exchange Intervention
G20	Group of Twenty
GFN	Gross Financing Needs
IADB	Inter-American Development Bank
IIP	International Investment Position
IPCC	Intergovernmental Panel on Climate Change
IPF	Integrated Policy Framework
LULUCF	Land Use, Land Use Change and Forestry
MEF	Ministry of Economy and Finance
NGFS	Network for Greening the Financial System
NIIP	Net International Investment Position
OECD	Organization for Economic Co-operation and Development
SBS	Banking Regulator
SDR	Special Drawing Rights
SOE	State Owned Enterprise
UN	United Nations
UNFCCC	United Nations Framework Convention on Climate Change
USD	US Dollar
VAT	Value Added Tax
WEO	World Economic Outlook

CONTEXT

1. Peru's macroeconomic performance in the last quarter of a century has been one of the strongest in Latin America. Peru launched a strong stabilization program in the 1990s, implementing ambitious structural reforms and adopting prudent policies and strong macroeconomic policy frameworks, including an inflation targeting framework and fiscal rules, which significantly strengthened its economic fundamentals.[1] Coinciding with the commodity supercycle, these reforms allowed to lower the public debt burden in half, absorb large foreign direct investment, reduce poverty by two thirds, and build large macroeconomic buffers. As a result, Peru emerged as one of the region's fastest growing and most stable and resilient economies despite political instabilities. The economy grew at an annual rate of almost 5 percent over the last two decades prior to the COVID-19 pandemic, multiplying its size by about 2½ times, gradually making progress toward converging to the standards of living of advanced economies (see Annex I for more details). Under its credible inflation targeting framework, inflation averaged 2½ percent over the same period, the lowest level in South America. However, economic growth moderated after the end of the commodity supercycle and the emergence of several large natural disasters.



2. Peru was hit hard by the COVID-19 pandemic, but its economy rebounded strongly from the pandemic-induced deep contraction. Peru recorded one of the highest pandemic-related mortality rates globally, despite introducing one of the earliest and strictest lockdowns that had a devastating impact on economic activity in 2020. Nevertheless, the strong policy response mitigated the economic impact of the pandemic and created the conditions for a rapid recovery. Supported by robust external demand, large gains in export prices, and easing of the pandemic-related restrictions, the economy rebounded rapidly, with real GDP growing by 13.6 percent in 2021, the highest growth rate among peer countries.

3. Russia's war on Ukraine has affected Peru mainly through imported inflation and the global economic slowdown. The direct impact of the Russia-Ukraine conflict on Peru has been limited since Peru's trade transactions with Russia and Ukraine are small shares of its total trade.

[1] Peru's stabilization efforts were supported by almost uninterrupted Fund-supported programs during 1991-2009. See Renzo Rossini and Alejandro Santos (2015); Peru's Recent Economic History: From Stagnation, Disarray and Mismanagement to Growth, Stability and Quality Policies in Peru: Staying the Course of Economic Success, IMF

Nevertheless, the war is affecting Peru indirectly through a combination of higher energy prices, global supply bottlenecks, high inflation, tighter financial conditions, and a slowdown in key trade partner countries. Furthermore, demand for Peru's exports is adversely affected by the ongoing slowdown in China, Peru's largest trade partner.

4. Recent political developments point to the urgent need to seek some political stability, ease elevated social tensions, and boost growth. Former Vice-President Dina Boluarte became President of Peru in December 2022 after Congress impeached former President Castillo, following his failed *coup d'état* and attempt to dissolve Congress (to stave off a third impeachment vote). Violent protests ensued after President Boluarte was sworn in (the seventh president since 2016 and the first female president in Peru's history), in line with the Constitutional order, which point to the importance of working across the political spectrum to: (i) restore confidence; (ii) ease elevated social tensions (that led to the killings of around 60 people); (iii) tackle inequality, poverty, and weaknesses in the education and health systems that contributed to the discontent, and (iv) accelerate structural reforms to boost economic activity.[2] Early elections were initially considered to take place in April 2024, but after further social unrest, the government proposed to advance elections to October 2023. However, Congress has failed to approve the needed Constitutional amendments, and they are not scheduled to discuss this issue until later in the year, which is perpetuating uncertainty.

5. Very strong fundamentals and institutional policy frameworks remain firmly in place, while macroeconomic policies continue to be prudent. Very strong fiscal policies have allowed to maintain the public debt-to-GDP ratio at the lowest level in the region, and Peru was among the first in the region to reintroduce fiscal targets after the suspension of the fiscal rule during 2020-21. While inflation has recently risen well above the target range (in line with global trends), the central bank (BCRP) has responded with a decisive policy tightening, including an increase in the policy rate after the political turmoil, and Peru's inflation and inflationary expectations are among the lowest in the region. Strong supervision and appropriate macroprudential policies have helped preserve financial stability. The strong policy frameworks and able macroeconomic policymakers have helped reassure financial markets, including during the recent political turmoil. Specifically, financial markets' response to the recent political developments has been muted, with stock prices increasing and the exchange rate weakening slightly, while the EMBI spread has been broadly stable. Macroeconomic and prudential policies have been broadly in line with past Fund advice (see Annex II for more details). Going forward, the ability to form consensus around pressing structural reforms will become an increasingly important ingredient of Peru's strong policy framework.

6. The FCL arrangement augments buffers and provides substantial insurance against extreme adverse scenarios. The FCL was approved by the IMF Board in May 2022 on the basis of its very strong fundamentals and institutional policy frameworks, sustained track record of

[2] The administration of former President Castillo was beset by controversy and multiple cabinet reshuffles, with Mr. Castillo facing numerous criminal investigations. Pessimism among private sector representatives was widespread, with reports of political instability eroding government effectiveness and uncertainty about possible regulatory changes stifling private investment. Peru's sovereign ratings remain investment grade, but Fitch and S&P downgraded the outlook on Peru's sovereign rating (BBB) to negative, citing the risks posed by weaker governance on economic activity. Similarly, Moody's has recently reduced the outlook to negative on its sovereign rating for Peru (Baa1).

implementing very strong policies, and the authorities' commitment to maintaining very strong policies in the future. The access of SDR 4 billion (300 percent of quota) under the two-year successor FCL arrangement represents a reduction from the SDR 8 billion (600 percent of quota) under the previous arrangement, which was possible mainly due to higher reserves. The authorities expect to treat the arrangement as precautionary and to exit it over time, conditional on external risk developments. The FCL's mid-term review is scheduled to take place in May 2023.[3]

RECENT DEVELOPMENTS

7. Growth slowed in line with global trends. Following the strong economic rebound of 2021 (when the economy grew 13½ percent), real GDP growth fell to 3½ percent (y/y) in the first half of 2022 and then to an estimated 1¾ percent (y/y) in the second half of the year, with the annual growth rate in 2022 estimated at 2.7 percent. Activity was supported by robust private consumption, which in turn was driven by a strong recovery in employment, progress in the vaccination program and lifting of the pandemic-related restrictions, and several rounds of private pension withdrawals.[4] The lower growth in 2022 was due to the withdrawal of the policy stimulus, an erosion of the large terms-of-trade gains, a slowing of external demand, a tightening of financial conditions, and the negative effect of road blockades and strikes at major mining sites on copper production and exports.

8. The unemployment rate continues falling as the economy recovers. After peaking in 2020, the unemployment rate fell to around 11 percent in 2021, and it is estimated to have fallen to 7¾ percent in 2022 (still above the pre-pandemic level of around 6½ percent). While labor market and poverty indicators are improving, the impact of the pandemic on the labor market and livelihoods has been substantial**.** As the adverse effects of the pandemic dissipated, formal employment continued to increase, surpassing the pre-pandemic levels (in early 2022). The share of informal labor declined slightly in 2022 but remains at very high levels. The poverty rate peaked at 30 percent in 2020 and then declined to 26 percent in 2021 but remains well above the pre-pandemic levels of around 20 percent. Similarly, extreme poverty declined from 5 percent in 2020 to 4 percent but remains well above the pre-pandemic levels of around 3 percent.

9. Inflation has started to gradually decline but is still well above the target range. Since mid-2021, inflation has risen well above the target band of 1-3 percent, driven by imported inflation and global supply shocks, including high energy and food prices (in line with global and regional trends). Headline inflation peaked at 8¾ percent (y/y) in June 2022, the highest level in the last two

[3] Staff has completed the safeguards procedures for Peru's FCL arrangement. KPMG Peru, the BCRP external auditor, issued an unmodified (clean) audit opinion on the BCRP's financial statements for 2021. The annual financial statements are audited in accordance with international auditing standards, include comprehensive disclosures, and are published on a timely basis. Staff reviewed the 2021 audit results and held discussions with the BCRP and KPMG Peru. No significant safeguards issues emerged from the conduct of these procedures.

[4] As of end-December 2022, about 85 percent of the population was fully vaccinated. The fifth wave of the COVID-19 pandemic started in late November 2022, but related death cases have been relatively low.

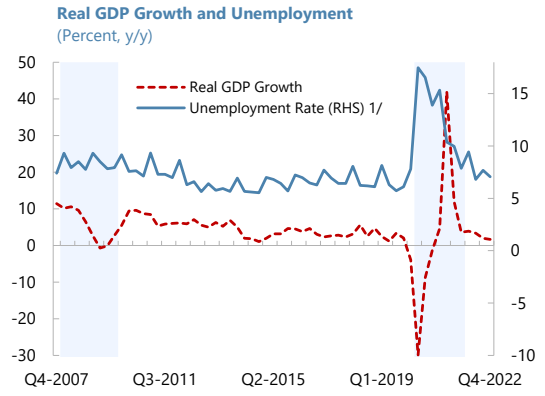
decades, gradually declining to 8½ percent (y/y) in December 2022. While headline inflation increased again to 8¾ percent in January 2023 due mainly to supply shocks related to social unrest and road blockades, the annualized rate over shorter time horizons (i.e., 3 or 6 months) has been declining since mid-2022 (see text table). Similarly, while core inflation reached 5¾ percent (y/y) in January 2023, it only reached between 3 and 4 percent when annualized over shorter time horizons (i.e., 3 to 6 months). Wholesale price inflation fell from 13¾ percent in May 2022 to 8½ percent in January 2023.

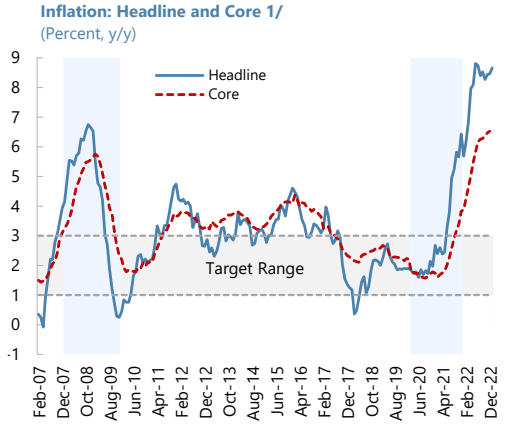
Inflation Indicators
(Annualized rates, percent)

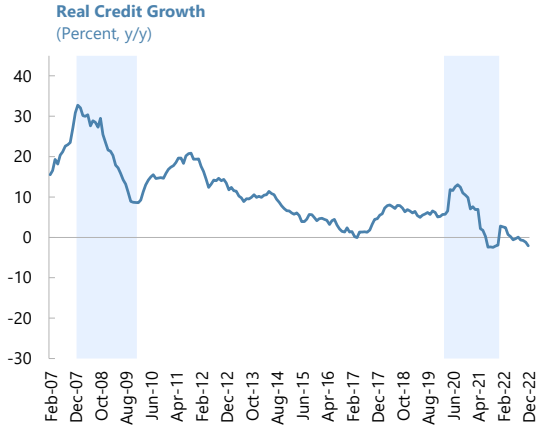
	Headline			Core		
	3-mo.	6-mo.	12-mo.	3-mo.	6-mo.	12-mo.
Jun 2021	2.8	4.4	3.3	1.9	2.3	1.9
Dec 2021	7.1	8.5	6.4	4.9	4.2	3.2
Jun 2022	10.6	9.1	8.8	7.9	5.7	5.0
Dec 2022	6.8	7.8	8.5	5.2	5.4	5.6
Jan 2023	6.3	6.3	8.7	3.3	4.0	5.8

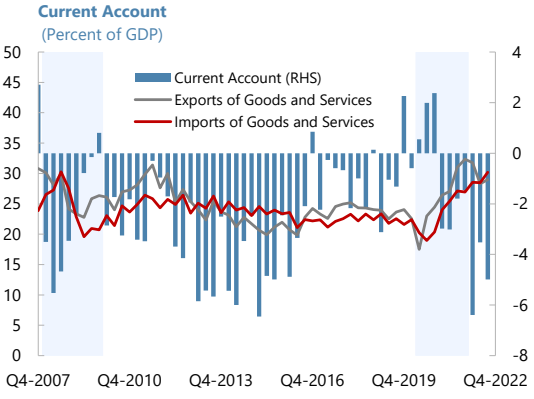
Source: BCRP.

Business Cycle: Unprecedented Shocks









Sources: Haver Analytics, National authorities; and IMF staff calculations.
Note: Shaded areas refer to the 2008 financial crisis and the COVID-19 pandemic shock.
1/ Data covers the Metropolitan Lima area.

10. Monetary policy has been normalized in one of the longest tightening cycles. Against the background of inflation well above the target range and high inflationary expectations, the central bank proactively responded in a timely manner by increasing its key policy rate by 750 basis points (bps) in 18 consecutive steps, to 7¾ percent in January 2023. The authorities paused tightening the monetary policy stance in February 2023 to assess the effects of the tightening so far. There are signs of weaker inflationary expectations (12-month forward), which have declined from 5½ percent in June 2022 to 4½ percent in January 2023.

11. The fiscal position remains strong. The Non-Financial Public Sector (NFPS) deficit fell significantly to 1.6 percent of GDP in 2022 (from 2½ percent of GDP in 2021), well below the limit of 3¾ percent of GDP set by the fiscal rule. Supported by the recovery in contact-intensive sectors, windfall revenues from mining and sizable one-off tax payments (about ½ percent of GDP), tax revenues rose over 13 percent (y/y), more than offsetting a 5 percent (y/y) increase in public spending. Public debt fell to 33½ percent of GDP in 2022 (from 36½ percent of GDP in 2021), and public assets amounted to some 12¾ percent of GDP.

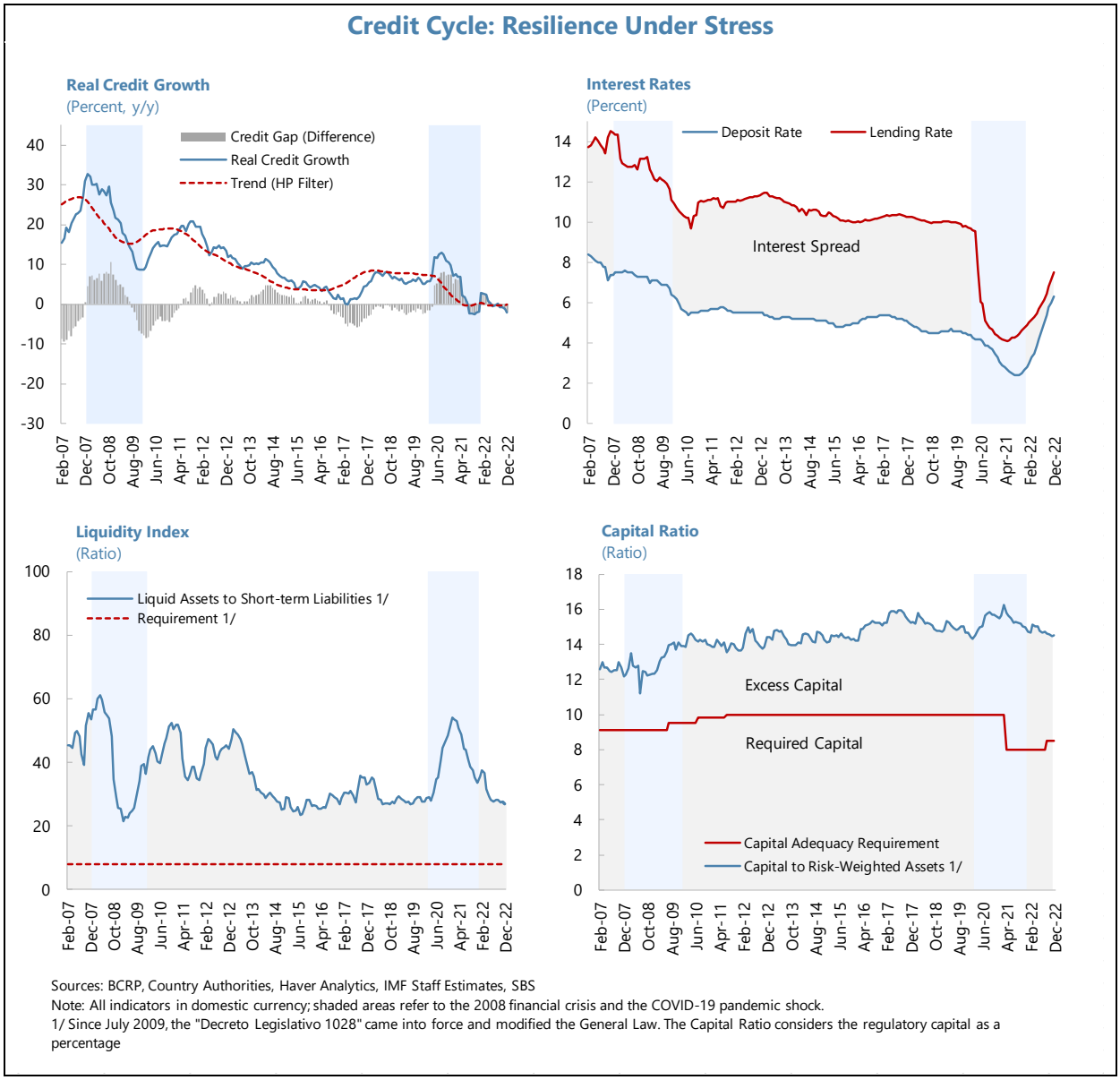
12. The financial sector remains resilient despite tightening financial conditions and the withdrawal of support measures. The banking system entered the pandemic from a position of relative strength, and performance has returned to near pre-pandemic levels after a prolonged period of lower profitability; the return on equity (ROE) and return on assets (ROA) stood at 16¼ and 2 percent as of December 2022, compared to 17¾ and 2⅓ percent in February 2020. Following the gradual withdrawal of borrower-based support measures that included extensive government-guaranteed loans and flexible loan adjustment terms, credit growth has decelerated rapidly (growing by 3½ percent (y/y) in December 2022) and turned negative in real terms as increases in consumer, small and micro enterprises, and mortgage credit, were offset by a contraction in wholesale credit. At the same time, nonperforming loans (NPLs) have stabilized at around 4 percent but remain highest for SMEs (7 percent). Top-down stress tests conducted by staff for the 2018 FSAP, and more recently by the authorities, suggest that the banking system is resilient even under severely adverse scenarios. The authorities have reinstated the liquidity coverage ratio (LCR) and are gradually phasing in the minimum capital ratio back to 10 percent in ½ percent increments every semester.

13. Financial market volatility has increased in line with global trends. Asset prices lost value in the first half of 2022, driven by falling metals prices, the global financial environment and, to a lesser extent, by political uncertainty, before regaining lost ground in the second half of 2022. The exchange rate has appreciated slightly, with swings reflecting monetary policy tightening in Peru, liftoff in advanced economies, and global metal price trends. Exchange rate volatility remained among the lowest in the region, with fewer and smaller foreign exchange interventions relative to 2021. The cost of government funding has increased in line with policy rate hikes and an increase in risk premia that reflect a global rebalancing of risks as well as heightened political uncertainty. Peru's sovereign spreads remain among the lowest in the region.

14. After suffering heavily during the pandemic, the corporate sector is showing signs of strength. Despite some bankruptcies, corporate profitability now exceeds the pre-pandemic levels and is one of the highest in the region. Corporate leverage is the lowest in the region: it increased significantly in 2020 but then it declined. The cash ratio is well above the pre-pandemic levels, while

Peru's interest coverage is the highest in the region and exceeds the pre-pandemic levels. The share of debt at risk has fallen to pre-pandemic levels and is not high by regional standards.

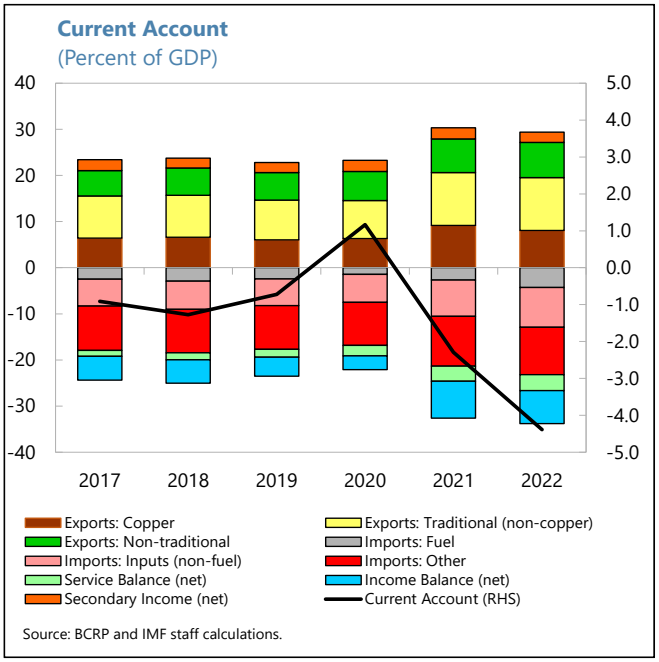
15. Peru's 2022 external position is assessed to be moderately weaker than the level implied by medium-term fundamentals and desirable policies.[5] The current account deficit is



Sources: BCRP, Country Authorities, Haver Analytics, IMF Staff Estimates, SBS
Note: All indicators in domestic currency; shaded areas refer to the 2008 financial crisis and the COVID-19 pandemic shock.
1/ Since July 2009, the "Decreto Legislativo 1028" came into force and modified the General Law. The Capital Ratio considers the regulatory capital as a percentage

[5] The evaluation of the external sector was made based on preliminary estimates for 2022 (current account data is available only for the first 3 quarters of 2022). The difference between the estimated cyclically adjusted current account balance for 2022 (-3.0 percent of GDP) and the current account norm from the multilateral model (-1.9 percent of GDP) yields a current account gap of -1.1 percent of GDP, which is marginally outside the range that would warrant an assessment of the external position to be "broadly in line with fundamentals" (i.e., +/- 1 percent of GDP). This deviation is very small, especially given elevated model uncertainty against the backdrop of multiple shocks affecting the Peruvian economy in 2022. The macroeconomic policy mix was strong and supported the external position in 2022, notably the rapid fiscal consolidation efforts and the fast pace of monetary tightening.

estimated to have widened to about 4.5 percent of GDP in 2022, double the level a year earlier, reflecting a deterioration in the terms of trade, higher demand for non-durable goods (as the economy reopened after a long period of confinement), higher freight payment rates, and large profits by foreign companies. Peru's terms of trade declined by some 10 percent in 2022, with higher import prices—especially the prices of refined oil products, industrial inputs, and food (increasing 14 percent) and almost flat export prices mainly on account of a downward correction of copper prices (declining 5 percent on average over the year). Nevertheless, the currency has remained broadly stable, and international reserves remain at a comfortable level (US$72.2 billion or around 240 percent of the ARA metric in late December compared to 78.5 billion at end-2021 or some 270 percent of the ARA metric). External debt at end-2022 was at 43percent of GDP (see Annex III for an assessment of the external sector).



OUTLOOK AND RISKS

16. Economic activity is expected to remain weak in the near term. The negative outlook is due to tighter global financial conditions, sluggish external demand, heightened political uncertainty, and road blockades. Fertilizer shortages are likely to adversely affect the agriculture sector output, while the new *Quellaveco* copper mine operations, a small fiscal impulse, and higher copper prices will support growth. The real GDP growth rate is projected at 2.4 percent in 2023 before it converges to its potential of 3 percent in subsequent years. The output gap is forecasted to be closed in 2024 after a small negative output gap of ½ percent (of potential GDP) in 2023. The current account deficit is projected at close to 2.1 percent in 2023 and to gradually decline to 1.5 percent in 2028, with external financing and debt rollover risks remaining low (see Annex IV on a DSGE model for macro analysis for more detail on economic linkages).

Macroeconomic Framework
(Percent of GDP unless otherwise indicated)

	Est.	Projection		
	2022	2023	2024	Average 2025-28
GDP growth (%Δ)	2.7	2.4	3.0	3.0
Inflation (%Δ)	8.5	3.0	2.3	2.0
Credit growth (%Δ)	3.6	6.1	5.4	5.8
Fiscal balance	-1.6	2.0	-2.0	-1.1
Public debt (NFPS)	33.4	33.0	33.3	32.6
Current account	-4.5	-2.1	-2.3	-1.8

Source: Fund staff calculations.

17. Inflation is expected to moderate. Broad-based inflationary pressures are expected to persist in the near term, given still high U.S. dollar inflation as well as high energy and food prices, lingering supply disruptions, and rising nominal wages. Higher global inflation and domestic political

turmoil may further add to these pressures. However, the proactive policy tightening already in place and weakening global and domestic demand are expected to bring inflation within the target range in late 2023-early 2024. On balance, risks to this inflation outlook are to the upside.

18. Uncertainty around the outlook is high, with the balance of risks tilted to the downside. The main external risks include escalation of Russia's war in Ukraine, an abrupt global slowdown and commodity price volatility, monetary policy miscalibration with a possible de-anchoring of inflation expectations and systemic financial instability. Key domestic risks include an intensification of political uncertainties, social unrest over political developments, and natural disasters which could hinder economic activity and risk the planned fiscal consolidation. Upside risks include a "soft landing" in key trade partner countries, and an acceleration of structural reforms at home, which could increase Peru's medium-term growth potential (see Annex V for a comprehensive list of risks and policy responses).

19. Peru has ample policy buffers to face adverse shocks. Notwithstanding its increase during the pandemic, public debt remains the lowest in the region. Sizable international reserves (about 30 percent of GDP), access to international capital markets, and a robust financial sector mitigate macroeconomic risks and support the country's capacity to cope with additional adverse shocks. These buffers are complemented by the FCL arrangement. Under downside risk scenarios, policy tradeoffs between supporting output and reducing inflation would become more acute. The appropriate mix of policies will depend on the nature of the shocks and initial conditions (see the Risk Assessment Matrix in Annex III for details on shocks and proper policy responses). An integrated policy framework (IPF) approach with the coordinated use of monetary, fiscal, and exchange rate policies may help alleviate policy tradeoffs (see Annex VI on a survey of previous work on the issue and application of the IPF which highlights the role of foreign exchange intervention under different conditions to alleviate policy tradeoffs.

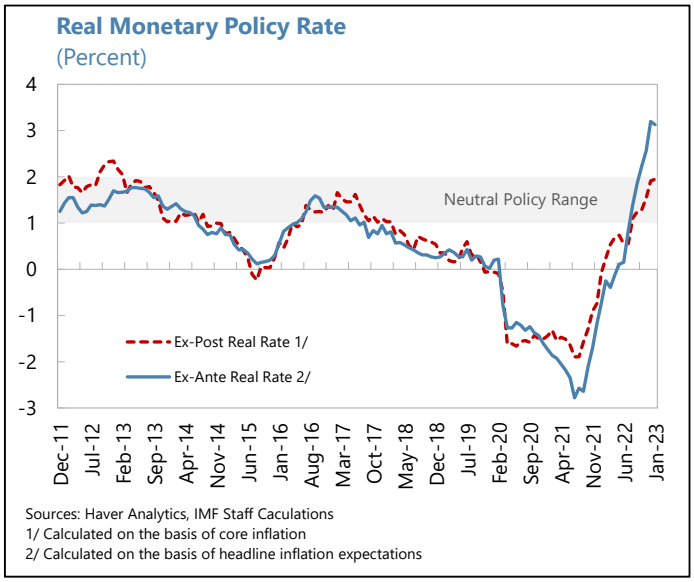
POLICY DISCUSSIONS

The most immediate challenge is to fight high inflation, which requires continuing with the data-driven monetary policy currently implemented. A temporary, targeted, and small fiscal impulse in the short term is appropriate, trying to balance a weak economy and recent supply shocks, while the planned gradual consolidation beyond 2024 is needed to cement sustainability. The authorities should ensure that the fiscal and financial sector policies are mutually supportive and consistent with monetary policy. Structural reforms should address the scarring effects of the pandemic and help eliminate impediments to inclusive and sustainable growth.

A. Challenging Monetary Policy to Tackle Inflation

20. The BCRP's data-driven monetary tightening remains appropriate. Following the BCRP's timely and sustained tightening in response to rising inflation (with a 25 bp increase in July 2021, followed by twelve consecutive rate hikes of 50 bps through August 2022, attenuated with five additional 25 bps hikes through January 2023), the authorities' decision to pause and re-assess

recent developments is appropriate since the ex-ante real policy rate has entered contractionary territory (currently at over 3 percent, compared with an estimated neutral level of about 1½ percent) and credit to the private sector is contracting in real terms. At the same time, inflationary expectations have declined, and longer-term expectations remain relatively well-anchored. While pausing, the BCRP has indicated that it would take further measures, if needed, to bring inflation to the target range. A premature and permanent ending of the tightening should be avoided, especially if inflationary pressures persist, to prevent potentially high costs of a loss of credibility of the BCRP.



21. Effective communication could help in keeping expectations anchored while limiting the output costs of disinflation. Following practices in other central banks, the BCRP could consider publishing more information on its policy intentions and the possible path underlying its macroeconomic forecasts. Such transparency, if clearly presented as working projections and not a policy commitment, could provide valuable information on how the central bank expects to adjust policy as economic conditions change. The BCRP could also consider publishing minutes of its policy meetings ahead of subsequent meetings.

22. Fiscal measures to address the impact of higher inflation were both broad-based and targeted. Following social unrest in early-March 2022, the government introduced several time-bound measures to contain the impact of higher food and fuel prices amounting to about ⅓ percent of GDP, including (i) fuel and LNG subsidies and suspending excise taxes on fuels; (ii) VAT exemptions on certain basic goods; (iii) temporary increases in the benefit level of certain social programs; and (iv) cash transfers to small farmers and fertilizer subsidies. Many of the measures expired by end-2022.

23. Foreign exchange interventions have continued to limit exchange rate volatility within a floating exchange regime. Intervention in response to disorderly market conditions that arise in an environment of shallow markets and high dollarization (deposit dollarization stood around 35 percent in 2022) in Peru is appropriate (see Annex VI). The BCRP continues to intervene frequently to address foreign exchange (FX) mismatches by targeting volatility in the exchange rate, although FX interventions are also correlated with movements in premia. While foreign exchange interventions fell dramatically in 2022, efforts should be made to use FX intervention more sparingly. Strong and persistent monetary tightening and lower capital outflows have required fewer and much smaller interventions relative to 2021. The Fund's Integrated Policy Framework (IPF) (see Annex VI) provides support for interventions in response to large shocks and the presence of frictions (e.g., shallow FX

markets or large FX mismatches) which would otherwise undermine the central bank's price and financial stability objectives. While many economic agents in Peru have access to natural hedges such as dollar invoicing, the majority who still need access to hedging could benefit from a more developed forward foreign exchange market. The development of a deeper market with fewer and more targeted interventions—for instance, conditioning these on market—would also foster the development of hedging instruments by the private sector.[6]

B. Re-Anchoring Fiscal Policy and Enhancing the Fiscal Framework

24. The authorities modified the fiscal rule and embraced a gradual fiscal adjustment path. Congress approved the modification to the fiscal rule for 2023-25 proposed by the authorities in May 2022, whereby the expected gradual fiscal adjustment (as reflected in the estimates of the 2022 Article IV Consultation) was delayed by one year, starting in 2024 and achieving the original NFPS deficit objective of 1 percent of GDP by 2026 (instead of 2025). The debt limit was set at 38 percent of GDP with the aim of returning to the original debt ceiling of 30 percent of GDP by 2030. The modification is appropriate as it would: (i) prevent an undue adjustment in 2023; (ii) adopt an appropriate gradual path of adjustment over the medium term; and (iii) signal the authorities' commitment to achieving the fiscal target of a deficit of 1 percent of GDP.

25. A slightly expansionary fiscal stance is appropriate in the short term. The 2023 budget envisions an NFPS fiscal deficit of about 2.4 percent of GDP, within the limits of a modified fiscal rule. Staff estimates that the NFPS deficit could reach 2 percent of GDP due to difficulties in implementing capital spending plans in the presence of new local government authorities, which implies a small fiscal impulse of about 0.4 percent. The bulk of the small fiscal impulse is due to weak revenues as the sizable one-off tax payments in 2022 are not expected to be repeated in 2023 (see Box 1). In staff's view, the temporary, targeted, and small fiscal impulse is appropriate considering that the authorities need to balance support for a weak economy after the pandemic, recent supply shocks, and the social costs of political unrest. While Peru has some fiscal space, it is largely limited by the modified fiscal rule; any additional fiscal support should remain targeted and be temporary to avoid adding to aggregate demand and inflationary pressure. As some of the supply shocks behind the pick-up in inflation could be long-lasting, attempts to limit price increases through subsidies or tax cuts could carry high fiscal costs. Upside surprises to the growth outlook should be used to build further fiscal buffers.

Fiscal Deficit [1/]
(Percent of GDP)

	(1)	(2)	(3)	(4)	(5)
		2022		2023	
	Old Rule	Art IV Proj.	New Rule	Art IV Proj.	(3-2) Δ
2022	3.7	2.6	…	1.6	…
2023	1.3	2.1	2.4	2.0	0.3
2024	1.0	1.5	2.0	2.0	0.5
2025	1.0	1.0	1.5	1.5	0.5
2026	1.0	1.0	1.0	1.0	0.0

Source: MEF and Fund staff calculations.
1/ The 2022 Art IV was completed before the fiscal rule was modified.

[6] See Annex VI on the IPF as well as Annex IX in the 2022 Article IV Consultation Staff Report on foreign exchange intervention.

Box 1. Fiscal Support Measures to Mitigate the Impact of Social Unrest

Implementation of fiscal policy will be challenging. Regional and municipal elections took place in 2022. Historically, budget execution is quite low after a regional election as the new regional governments are not familiar with the intricacies of following all the budgetary procedures. As a result, spending falls short of the authorized budget. The problem is particularly important since regional governments are responsible for about ⅔ of the capital spending. Similarly, tax collections are likely to fall in 2023 as large one-off tax payments in 2022 are not expected to be repeated.

Maintaining public spending is important, given recent social tensions. Against that background, the government launched a fiscal support program in January 2023 (*Con Punche Perú*) to help contain the impact of disruptive (and sometimes violent) protests, which have included road and airport blockades that negatively affected economic activity in the later part of 2022 and early in 2023. The program (about 0.6 percent of GDP) includes measures to support vulnerable households and firms in the most affected sectors, such as agriculture and tourism (e.g., blockades are impacting the flow of food, while Machu Picchu is temporarily closed), as well as the subnational governments of the most impacted regions, notably those in the southern part of the country. The program is expected to partially offset the negative economic impact of the increased social unrest on economic activity in 2023 and to facilitate budget execution in general.

Fiscal Policy
(Percent of GDP)

		2023				
		Budget [1/]	Passive Proj. [2/]		Staff Proj. [3/]	
	2022	(1)	(2)	(3)=(1+2)	(4)	(5)=(3+4)
	Actual	Balance	Δ	Balance	Δ	Balance
Revenues	25.7	25.0	0.3	25.3	0.0	25.3
Expenditures	27.3	27.4	-0.7	26.7	0.6	27.3
Current	21.0	20.9	-0.3	20.6	0.3	20.9
Capital	6.3	6.5	-0.4	6.1	0.3	6.4
Overall Balance	**-1.6**	**-2.4**	**1.0**	**-1.4**	**-0.6**	**-2.0**

Source:MEF and IMF staff calculations.
1/ Adjusted from Medium-Term Macroeconomic Framework (MEF).
2/ Higher revenue projection based on higher copper prices (WEO). Lower expenditures based on the low budget execution of regional governments after local elections.
3/ Expenditure projection based on higher budgetary execution due to the temporary and targeted *Con Punche* program.

Support programs are being reinforced. Household support measures include an additional round of direct cash transfers to beneficiaries of Peru's well-established social and food assistance programs (*Juntos, Contigo, and Pension 65*) and accelerating the execution of a national program to widen access to natural gas. Meanwhile, firms and other sectors are set to benefit from temporary tax relief, the extension of access to pandemic-era guaranteed credit programs, and the removal of official and other bureaucratic procedures that hamper private economic activity. The lion's share of support to subnational governments will be in the form of accelerating shovel-ready and high-priority public investment projects. These programs will be supported by: (i) measures to alleviate the lower rate of public investment execution typically observed following the inauguration of new subnational governments, including stepped-up technical assistance from the central government; and (ii) the hiring of experienced project managers to increase the execution of investment projects.

26. The authorities should prepare plans to strengthen the credibility of the gradual fiscal adjustment over the medium term. There are several risks for fiscal policy going forward for which plans need to be prepared. Revenues may underperform, and potentially higher default rates from pandemic-era guaranteed loan programs may materialize if economic activity slows further than expected. Failure to stabilize the situation at Petroperu could demand additional resources from the central government, and the authorities should strengthen oversight of the company and put in place a strategy that fully restores the viability of the firm (or divests state participation).[7] In addition, the authorities should prepare a plan—possibly requiring the identification of financing—to address potentially sizable spending pressures arising from the passage of unfunded expenditure initiatives by Congress, such as those emerging from the restitution of FONAVI funds,[8] and collective bargaining in the public sector.

27. Identifying measures to support the planned fiscal consolidation would also enhance the credibility of the authorities' plans. Peru's sound fiscal position is underpinned by a very strong fiscal framework. The authorities' fiscal strategy, as presented in the Medium-Term Budgeting Framework (MTBF), envisions a gradual fiscal consolidation of about ½ percentage points of GDP per year during 2025-26. In staff's view, the fiscal plans are feasible and would have a limited impact on economic activity. The MTBF could be upgraded by identifying and quantifying the policy and administrative measures to support the convergence to the fiscal targets. In particular, there is a moderate risk of overestimation of the tax revenues, which were prepared with a growth rate assumption above the authorities' recent estimates of potential GDP growth. In staff's view, additional measures to strengthen revenue mobilization and/or expenditure rationalization would be necessary to achieve the fiscal targets beyond 2024.

28. Notwithstanding important gains, further efforts are needed to continue improving tax administration and streamline tax expenditures. Despite significant efforts by the tax authority to enhance administration and compliance in 2022—including the introduction of a digital tax registry and notices of tax due, and the leveraging of big data tools and exchange of information treaties—further measures to improve tax collections could be necessary, especially as the marginal yields from the introduction of electronic invoicing, and other measures adopted in 2018 are likely to be decreasing. At about 16 percent of GDP, Peru's tax intake remains relatively low, and the tax system has been assessed as complex, exhibiting numerous sectoral tax benefits and special regimes. The authorities have signaled their preference for avoiding tax policy adjustments in the near term. Against that background, the authorities should explore the scope for rolling back tax expenditures (estimated at about 2 percent of GDP), following a comprehensive review of their fairness and effectiveness.[9] Among response measures, a reduction in sectoral tax breaks may be warranted.

[7] Petroperu (a large SOE) required successive support by the central government (of US$2.3 billion or almost 1 percent of GDP) after losing access to its credit lines following delays in the presentation of audited financial statements. The company's management team has been replaced, and an action plan to restore the viability of the firm and improve its governance is under preparation.

[8] FONAVI was a housing construction fund that was dissolved in the 1990s to pay off public debt.

[9] Including tax credits, allowances, deferrals, returns, exemptions, and rate reliefs.

29. More transparency on the procurement of public spending would strengthen its effectiveness. Independent evaluations of public spending have revealed weaknesses. Inefficiencies in public spending have been estimated at 2-2½ percent of GDP, of which 90 percent appears to be explained by weaknesses in procurement processes.[10] Improving the transparency of public procurement systems (including beneficial ownership information) would help maximize the impact of public spending. This could be supported by improved targeting of social benefits and a civil service reform. In order to meet Peru´s large infrastructure and social spending needs, capital and social spending should be prioritized, and the capacity to execute public investment be further strengthened.[11]

30. Recent reforms to enhance the effectiveness of the Fiscal Council are welcome. Peru's Fiscal Council (FC) is generally designed in line with best practices, and recently passed legislation will strengthen the credibility of fiscal policy and institutions further. In particular, the elevation of the FC to a regulatory agency for purposes of the civil service should enhance its technical capacity. Going forward, the FC's operational independence could be improved by introducing budget safeguards to secure its financial resources and by granting autonomy in the execution of its budget. To enhance the FC's traction and accountability, the agency should hold regular hearings before congress and undergo peer reviews and ex-post assessments.

31. A redesign of the pension system is needed to address elderly poverty risks and the lack of consumption smoothing. The comprehensive reform of the pension system has become a critical priority following successive Congress-mandated rounds of large early withdrawals from private pension accounts. The withdrawals were initially intended to provide support to households in the context of the COVID-19 pandemic, but further withdrawals are no longer warranted as the health emergency has abated. Since 2020, about 50 percent of the private system's assets (a cumulative 10 percent of GDP) have been withdrawn. Following the withdrawals, about 2.3 million people have no savings in their accounts, and 1.8 million people have relatively low balances. The withdrawals have exacerbated the system's long-standing problems of very low coverage and adequacy, while the resulting sales of treasury bonds have likely had a negative impact on the demand for and interest rates of public debt. Discussions on a reform proposal by the Multiparty Commission of Congress stalled after a new Congress was inaugurated in 2021. A new Multisector Commission tasked with the preparation of an evaluation of the system, and a reform proposal is expected to present a report shortly. A budget-neutral expansion to the basic pension (possibly a universal "solidarity pension") financed by additional taxation could be a possible reform option. Any reform proposal should be within the current fiscal framework (see Annex VII on pensions).

32. Public debt is assessed to be low and sustainable. The debt sustainability analysis (Annex IV) shows that public debt is sustainable with a high probability under the baseline scenario. The

[10] Defined as spending with low economic or social returns. See IADB (2018). "Mejor gasto para mejores vidas: Cómo América Latina y el Caribe puede hacer más con menos", and World Bank (2022). "New Approaches to Closing the Fiscal Gap."

[11] According to the 2017 Public Investment Management Assessment, Peru has an efficiency gap in the management of public investment of about 37 percent, above the global (27 percent) and Latin America (26 percent) averages.

public debt ratio is expected to stabilize at about 33 percent of GDP over the medium term, while assets of the public sector may reach around 15 percent of GDP. Gross financing needs would average 3.3 percent of GDP over the forecast horizon. The impact of higher interest rates is relatively limited, as over 85 percent of public debt is contracted at fixed interest rates with an average duration of 13.2 years. About 46 percent of public debt is denominated in local currency. Roll-over risks are low, while highly liquid assets of about 8 percent of GDP point to a comfortable cash position (see Annex VIII on debt sustainability for more details).

C. Maintaining a Robust Financial System

33. The financial system has emerged from the pandemic in good health with adequate buffers to absorb the impact of tightening financial conditions, but some pockets of vulnerabilities exist. The authorities have unwound most pandemic-era prudential measures that were used to support the financial system, but this has not prevented profitability from returning to pre-pandemic levels and NPLs from stabilizing. In an environment of tightening financial conditions, however, the authorities should monitor bank portfolios and lending standards closely to react quickly should vulnerabilities emerge. Financial stability risks from foreign exchange mismatches are contained through adequate reserve requirements, and FXI from the BCRP is generally consistent with the guidelines of the IPF.[12] Rural microfinance institutions continue to have weaknesses, largely related to insufficiently diversified portfolios, and may require continued access to special lending facilities that have thus far contained risks; spillover risk is negligible, as these comprise less than ½ percent of total assets of the financial system.

34. Closing remaining regulatory and supervisory gaps and 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 for credit unions, and enhancing the emergency liquidity assistance framework. A new capital structure for banks was activated in January 2023 that includes capital conservation and systemic risk buffers, in line with Basel III. Other important steps to be taken include enhanced supervision of financial groups, requirements for resolution planning for domestic systemically important banks and financial groups, and enhancing the functioning of money markets following the recommendations of the 2018 FSAP (see Annex IX on FSAP recommendations for details). Finally, the authorities should improve the payment system infrastructure, take measures to increase access to electronic banking, and conduct a robust assessment of risks before adopting a central bank digital currency in the medium term.

[12] For an evaluation of foreign exchange mismatches, see Annex VI on the IPF.

D. A Strategy to Boost Growth and Resilience

35. Further progress on the structural reform agenda is needed to address the scarring effects of the pandemic and increase growth potential. Education policies should focus on reversing pandemic-related learning losses and improving education outcomes. Business-friendly policies, including continued infrastructure investment and reduced regulatory uncertainty, could help increase investments and productivity. Increasing the efficiency of government spending (including through the *Con Punche* program) could further enhance the growth potential. It has been estimated that the implementation of significant reforms in the areas of the labor market, governance, and domestic finance could increase GDP by up to 8 percent over time.[13] Labor market reforms could reduce the risk of wage-price spirals and thus reduce inflationary pressure. While the recent political turmoil has reduced the likelihood of deep structural reforms over the short term, the OECD accession process is an opportunity to define a well-articulated structural reform agenda.

36. Reducing informality is critical to supporting sustainable and inclusive growth while supporting vulnerable groups. Enhancing human capital through better education and training and better health services, as well as reducing frictions in the labor market will be key to reducing informality. On the other hand, some recent measures, such as restrictions on outsourcing, risk increasing informality. Adjustment to the minimum wage and other salaries should be more closely aligned with the average productivity growth of workers, and bureaucratic barriers to outsourcing should be eliminated. Other efforts to reduce informality should focus on: (i) simplifying tax and business regulations to reduce the costs of formalizing a business and (ii) introducing greater labor market flexibility.

37. Strengthening governance and the rule of law would safeguard public accountability. The authorities have taken welcome measures to enhance the transparency of COVID-19-related spending, and efforts continue to strengthen anti-corruption institutions, including on access to asset declarations, effective operation of judicial self-governance bodies, and enhanced AML/CFT implementation to detect laundering of proceeds of corruption (See Annex X on governance issues). Further improving public finance management and public procurement as well as digitalization in government service delivery can strengthen governance and efficiency while reducing the likelihood of misallocation of public funds. Broader efforts are needed to strengthen the corporate regulatory framework, especially that of state-owned enterprises.

38. Climate change risks and natural hazards expose Peru to severe economic and welfare losses. In addition to public investments in containing climate risks, the authorities could facilitate private sector contribution to the cause by creating a conducive regulatory environment and providing the right financing and insurance tools. In particular, they could improve access to export markets by smallholders in the Sierra or increase the link between them and large exporting firms on the Coast, capitalizing on the more successful experiences; strengthen land tenure security to

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

facilitate productivity-enhancing investments with long-term payoffs on growth and climate; implement power sector regulatory reforms that could facilitate private sector investments in solar and wind energy; increase requirements for the financial sector to assess and disclose climate-related risk, and harness opportunities to develop a green financing ecosystem (see Annex XI for more details).[14]

AUTHORITIES' VIEWS

39. The authorities are somewhat more optimistic on the growth outlook. The Central Bank believes real GDP growth in 2023 could be ½ percent higher than staff, while the Ministry of Finance believes growth could be as much as 1 percent higher than staff. They stressed that their projections are justified given the underlying strength of the economy, the new mine (*Quellaveco*), which could provide over ½ percent of additional growth, and the fiscal impulse of the *Con Punche* program, which could provide additional support of another ½ percent of GDP growth.

40. The authorities are confident that inflation will return to the target range by the end of the year. Inflation has continued to stabilize, and the recent uptick is due to domestic supply shocks triggered by ongoing protests and will have a temporary effect on prices.

41. The authorities agreed with the thrust of staff's fiscal policy advice. The slightly expansionary fiscal policy stance is warranted given the available fiscal space resulting from last year's overperformance of the fiscal accounts as well as the need to improve social cohesion, mitigate the impact of the recent social unrest on the vulnerable populations, and support the more affected regions. The impact on inflation will be limited given the high component of supply-side measures. The fiscal policy will resume the consolidation trend to avoid undesired effects on inflation and debt sustainability. The authorities have requested technical assistance on fiscal risks.

42. The authorities acknowledged the challenging situation of the pensions system. They agreed with staff on the need to analyze all the different options available and to work with stakeholders and civil society to generate consensus for a pension reform. To that end, the Fund will support the authorities with technical assistance in the process of improving the pensions system.

43. The authorities do not see any systemic risks to the financial system. The banking sector is well-capitalized, with stress tests showing its ability to withstand even severely adverse scenarios, including the current round of disruptive protests. The deterioration in the total loan portfolio is driven by SMEs, but NPLs have stabilized. Vulnerabilities among rural microfinance institutions are relatively small and will be met with appropriate support. A new capital framework was introduced in January 2023 that now fully aligns with Basel III requirements, while most FSAP recommendations have been implemented.

44. The authorities appreciated the preliminary discussions on the use of an integrated policy approach to analyze policy tradeoffs and adverse macroeconomic scenarios. They noted

[14] Based on the World Bank, *Peru Country Climate and Development Report* (2022).

the importance of initial conditions and country-specific characteristics in the choice of appropriate policy instruments. In Peru's case, these include vulnerabilities from dollarization, which has declined over time. They welcomed closer work with the IPF framework in the future.

45. The authorities agreed on the need to deepen the structural reform agenda. They acknowledged the need to raise productivity and reduce informality. They agreed with staff that the OECD accession process would provide a great opportunity to strengthen the reform agenda. However, it was also recognized that the current administration is a transition government with limited political capital to initiate heavy reforms.

46. The authorities view climate change as a threat to the world economy and Peru. The authorities are well aware of the need to take decisive actions to adhere to their commitments to minimize the impact of climate change. To strengthen their efforts, they have recently joined the NGFS network to study this matter more deeply and to start exploring the possibility of requesting technical assistance from the Fund in this area.

STAFF APPRAISAL

47. The outlook is highly uncertain, but Peru has ample policy buffers to face adverse shocks. Staff expect growth to remain below its potential in 2023 given moderating world growth, lower commodity prices, tighter financial conditions, political uncertainty, and road blockades at major minefields and tourism centers. Inflation is well above the target, eroding real incomes. Risks to the outlook are tilted to the downside, but Peru's large policy buffers, including a low public debt ratio and ample reserves, together with very strong policy frameworks, continue to help protect the economy from external and domestic risks. Based on preliminary data, Peru's external position in 2022 is assessed as moderately weaker than the level implied by fundamentals and desirable policies, although there is uncertainty around this assessment related to the impact of multiple shocks that affected the economy. Peru continues to show very strong fundamentals and institutional policy frameworks, sustained track record of implementing very strong policies, and the authorities remain committed to maintaining very strong policies in the future.

48. Data-driven monetary management is appropriate. Although the recent surge in inflation is mainly driven by external supply factors, core inflation and inflation expectations remain outside the target range (1-3 percent). Large and sustained rate hikes have taken the ex-ante real neutral rate into contractionary territory, while inflation and inflation expectations have stabilized. The data-driven tightening policy stance will help insure against risks of disorderly adjustment to global financial conditions. A premature ending of the tightening should be avoided to prevent potentially high costs of a loss of credibility of the BCRP. The authorities should also ensure that the fiscal and financial sector policies are mutually supportive with monetary policy, thereby increasing the latter's effectiveness.

49. Foreign exchange intervention is broadly appropriate under current volatile market conditions with existing currency mismatches and shallow markets. Tradeoffs with market development and interactions with other policies should be explicitly considered in the central bank's

decision-making process. Persistent dollarization in the private sector warrants foreign exchange intervention by the central bank to avoid excessive volatility in response to uncertainty shocks. Sterilized interventions over the past year have occurred on both sides of the foreign exchange rate and have addressed volatility brought on by pension fund withdrawals, external financial conditions, and exchange rate appreciation due to the early monetary policy tightening. Building a deeper and more developed foreign exchange market, however, requires fewer and more targeted interventions. Achieving a lower structural rate of dollarization would limit the need for frequent interventions, allowing the exchange rate to play a larger role as a shock absorber.

50. The fiscal policy stance is appropriate. A temporary, targeted, and small fiscal impulse should help support a weak economy over the short term while avoiding adding to inflationary pressure. Over the medium term, the planned fiscal consolidation will be necessary to stabilize the debt ratio and preserve fiscal sustainability. The authorities should prepare contingency plans to address policy slippages that could arise from underperforming revenues stemming from an optimistic GDP projection, and emerging fiscal risks, including from the passage of unfunded spending initiatives by Congress, and a large state-owned enterprise.

51. Further enhancing Peru's very strong fiscal policy framework will help strengthen macroeconomic resilience. Identifying the measures that support the announced fiscal consolidation will enhance the credibility of the authorities' plans. Additional efforts to improve tax administration and streamline tax expenditures, more effective control of public spending, and enhanced execution of public investment will be necessary to accommodate rising spending needs and preserve fiscal sustainability. Staff welcomes the passage of legislation to strengthen the role of the FC, which will further strengthen Peru's very strong policy framework. Additional measures, such as securing adequate resources, scheduling regular hearings before Congress, undergoing peer reviews, and ex-post assessments, would enhance the operational independence and accountability of the FC.

52. Pension reform remains a critical priority. Continued early withdrawals from private pension funds are unwarranted as the Covid-19 emergency has been brought under control. The withdrawals not only risk adding to inflationary pressures, but also exacerbate the system's weaknesses of low coverage and adequacy and could endanger fiscal sustainability over the medium term. While building the necessary social consensus to advance the reforms will be hard work, it will be key to sustaining Peru's hard-won macroeconomic gains. Accordingly, any reform proposal should be within the current fiscal framework.

53. Prudential policies should continue to maintain a tightening bias in order to create space for renewed support in a deteriorating financial environment. Withdrawal of the broad policy support provided during the pandemic has not resulted in an increase in NPLs, and the reintroduction of capital buffers has not impeded the flow of credit as voluntary provisioning was maintained at high levels. The impact of tightening financial conditions domestically and abroad, however, is likely to materialize within the financial system with a lag, and the authorities should be ready to provide new targeted and time-bound support to ensure the flow of credit if needed.

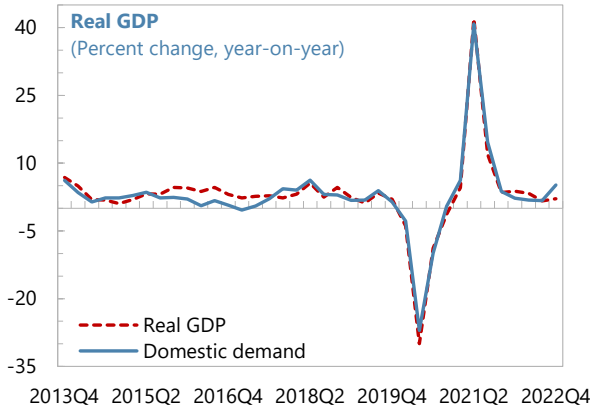
54. Closing remaining regulatory and supervisory gaps and continuing progress on systemic risk assessment will enhance financial resilience. The authorities should finalize surcharges for systemic banks and bring them in line with the Basel III framework. After the draft law granting the SBS powers to exercise full consolidated supervision is passed by Congress, supervision of financial groups should be enhanced. The new Companies Authorization Regulation, which will strengthen risk-based AML/CFT supervision, is welcome. Continued progress on the development of repo markets will provide greater depth and stability to local money markets in times of stress. Finally, the payment system infrastructure and access to electronic banking should be improved.

55. The OECD accession process is an opportunity to define a well-articulated structural reform agenda to deal with the scarring effects of the pandemic and enhance growth potential. Efforts should focus on (i) boosting productivity by reversing pandemic-related learning losses, enhancing infrastructure, reducing regulatory uncertainty, eliminating barriers to outsourcing, and improving the business climate; (ii) enhancing human capital while reducing incentives to informality; (iii) further improving governance through digitalization and enhanced transparency, stronger anti-corruption institutions, and corporate sector regulatory reforms; and (iv) reducing climate risks through both public investments and private sector contribution.

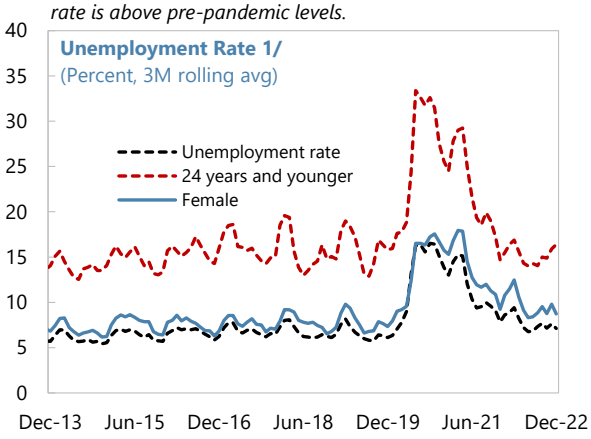
56. Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Peru: Real Sector Developments

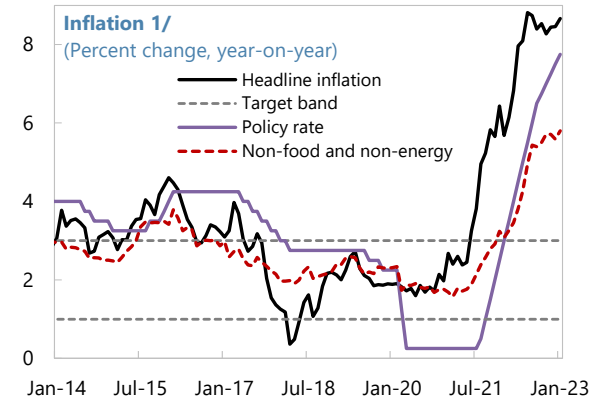
After a strong recovery in 2021, growth is slowing.



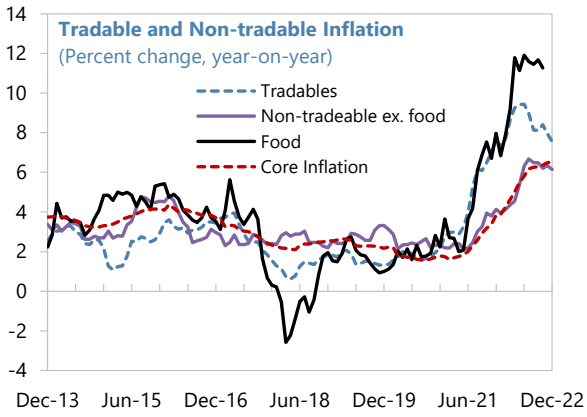
The labor market is improving, but the unemployment rate is above pre-pandemic levels.



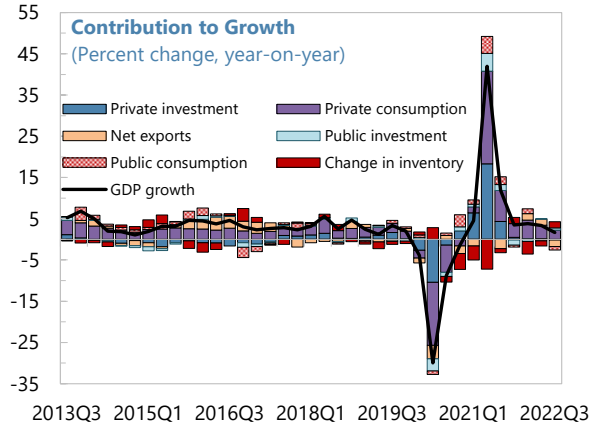
Inflation has stabilized well above the target range ...



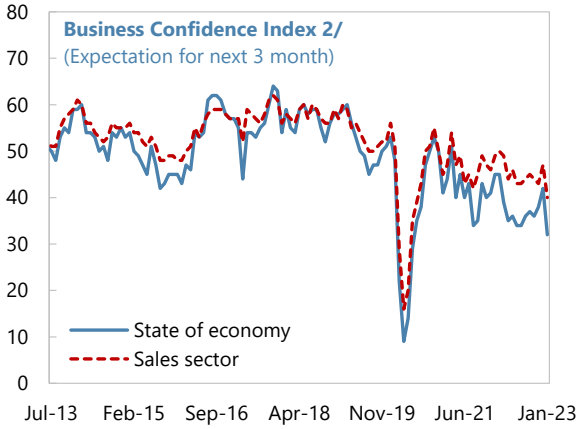
... and price increases have become broad based.



In 2022, growth is driven mainly by private consumption.



Business confidence has weakened.

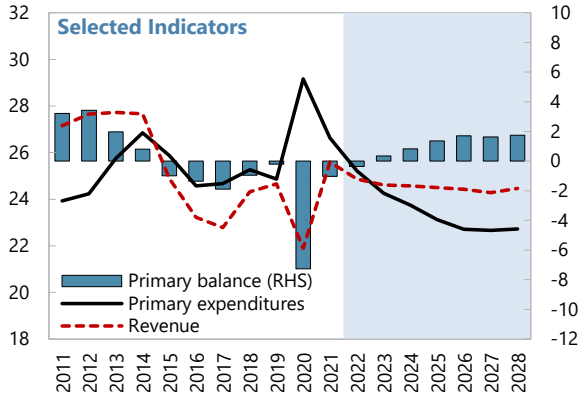


Sources: Haver Analytics; IMF staff calculations; and National authorities.
1/ Data covers the Metropolitan Lima area.
2/ Index values of 50 and greater indicate growth.

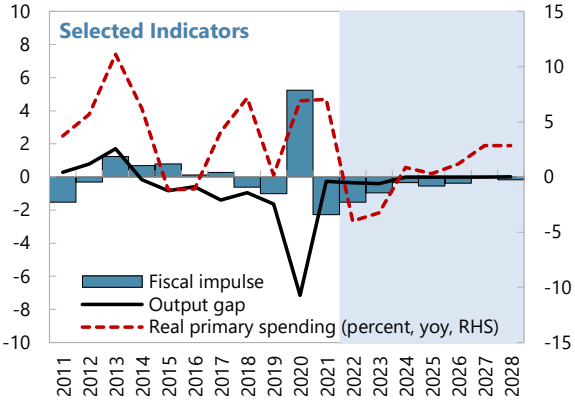
Figure 2. Peru: Fiscal Sector Developments

(Non-Financial Public Sector, Percent of GDP unless otherwise indicated)

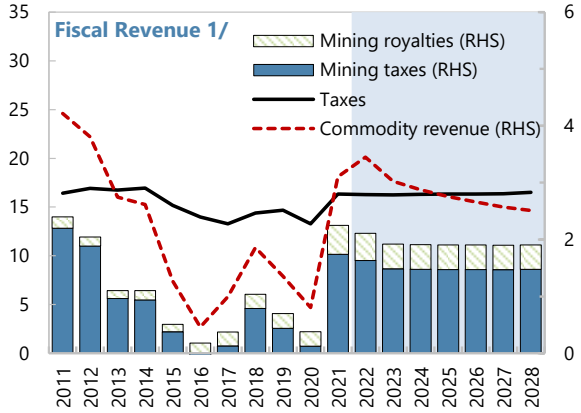
The fiscal accounts strengthened on a cyclical upswing, ...



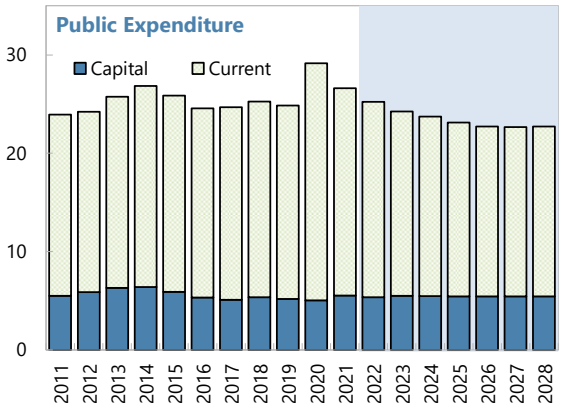
... a partial unwind of pandemic-related support, ...



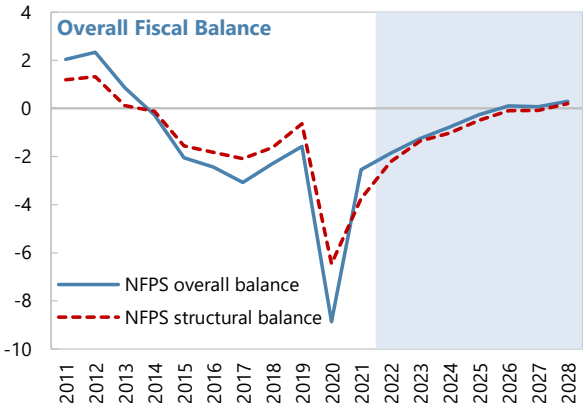
... and supportive metal prices.



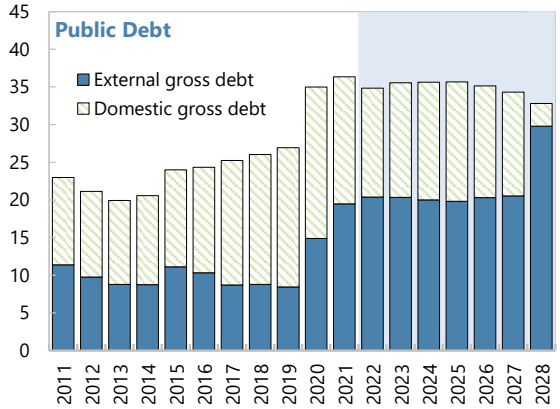
A gradual fiscal consolidation...



... will guide the fiscal deficit to the 1% of GDP target



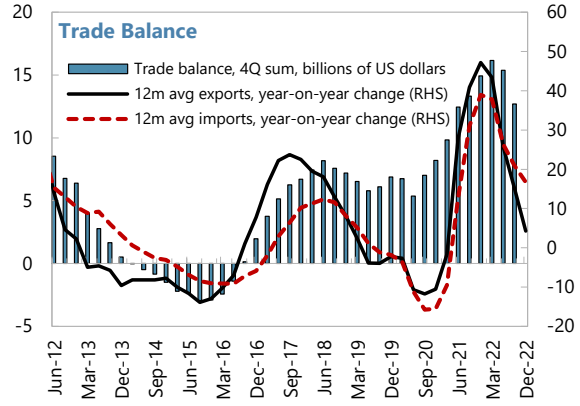
... and stabilize the debt ratio.



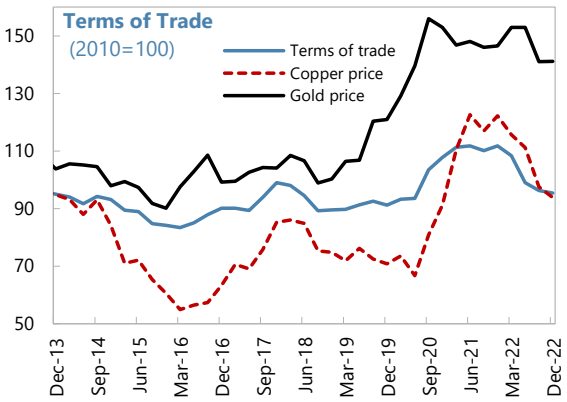
Sources: National authorities; and IMF staff estimates.
1/ Net of restitutions.

Figure 3. Peru: External Sector Developments

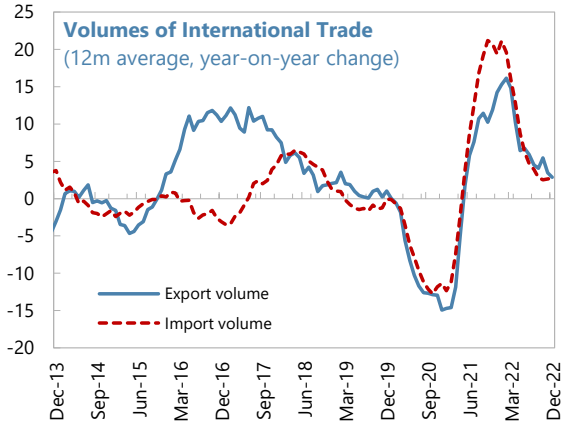
The trade balance declined from record-high levels ...



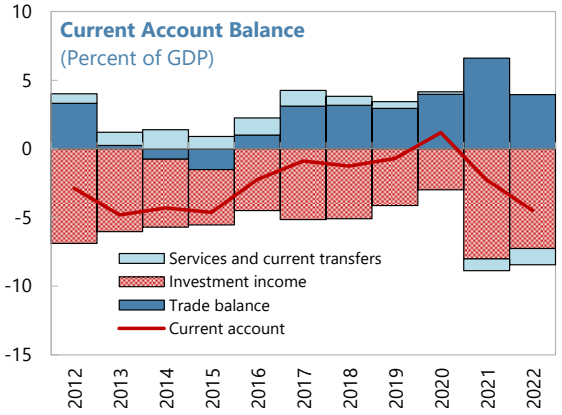
... on deteriorating terms of trade ...



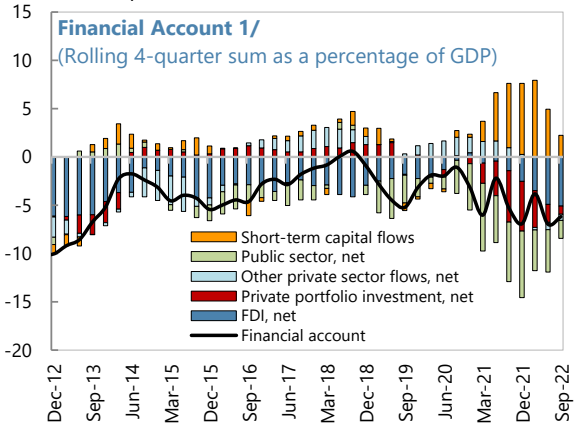
... and weakening external demand combined with lower primary production.



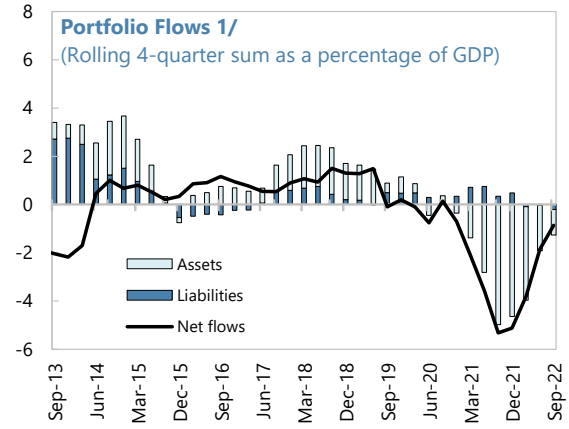
Large deficits in income payments and services further contributed to the widening current account deficit.



FDI inflows associated with reinvested profits helped cushion pressure on the financial account ...



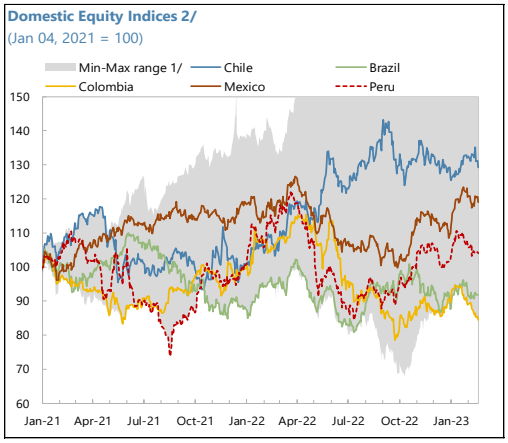
... while portfolio inflows started to stabilize after large withdrawal of pension funds from abroad.



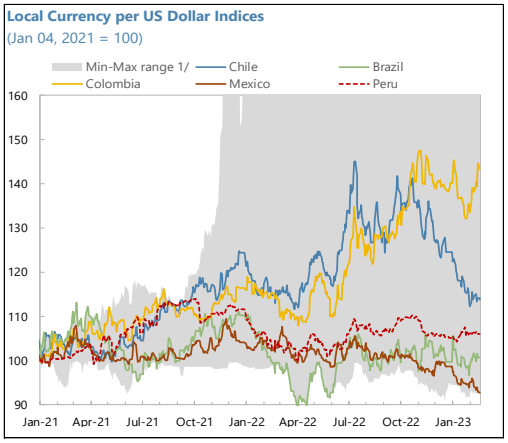
Sources: National authorities; Haver Analytics; and IMF staff estimates.
1/ Negative values indicate inflows.

Figure 4. Peru: Financial Market Indicators

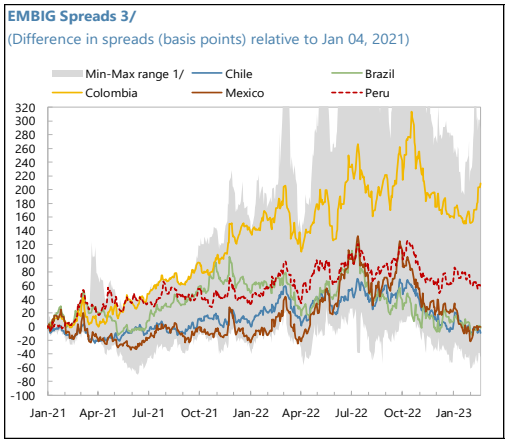
Peruvian equities have recovered after monetary tightening domestically and abroad.



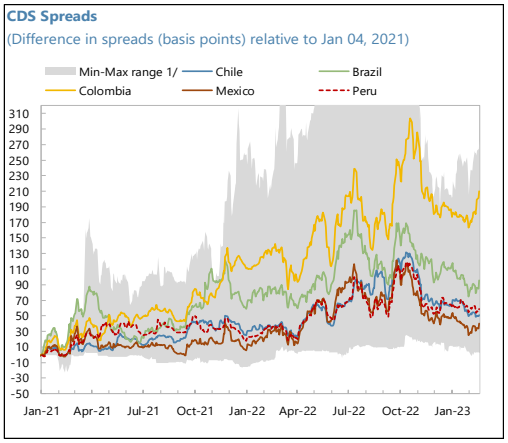
The PEN remains stable relative to the USD, with low levels of volatility compared to peers.



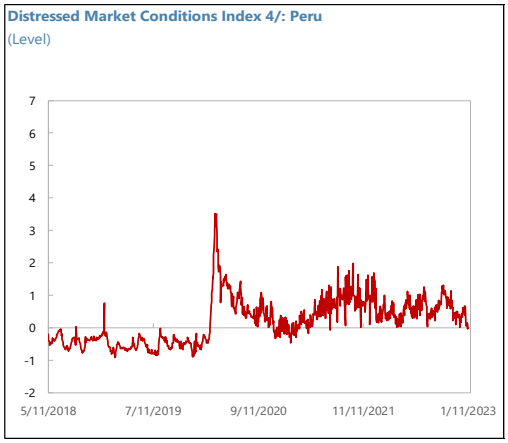
Spreads in January 2023 have widened relative to last year, reflecting cycles of political uncertainty ...



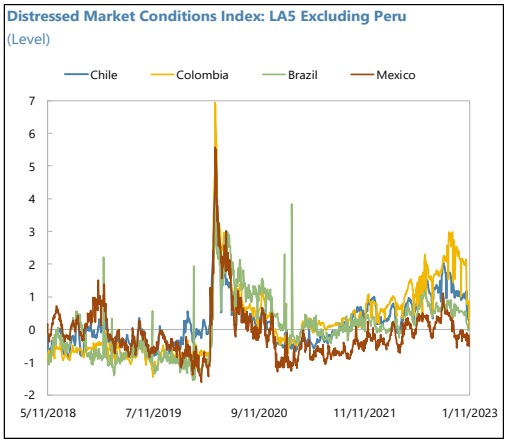
... While CDS spreads have followed the same trend.



Market conditions in Peru remain elevated and episodic ...



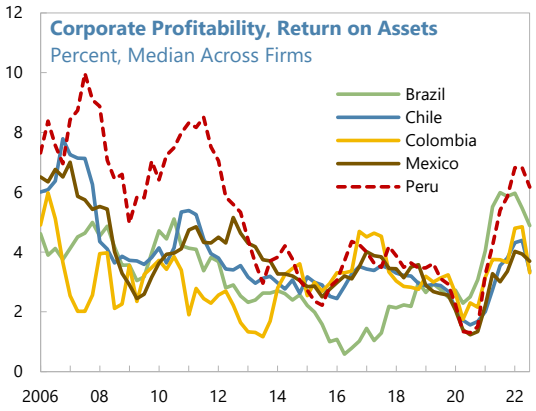
... though compare favorably with regional peers.



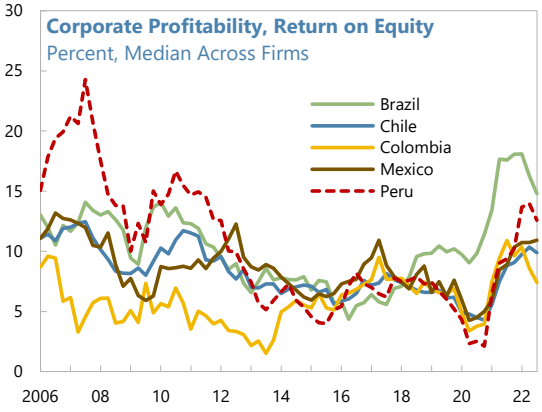
Sources: Haver Analytics and Bloomberg LLP.
1/ Selected sample of emerging market countries including Brazil, Chile, Colombia, Mexico, Peru, Uruguay, Czech Republic, Croatia, Hungary, Poland, Turkey, India, Indonesia, Malaysia, Philippines, Thailand and Vietnam.
2/ National benchmark share price indices.
3/ Mexico's EMBIG includes Sovereign and Quasi.
4/ Index is a composite of 23 indicators measuring market conditions

Figure 5. Peru: Corporate Sector Indicators

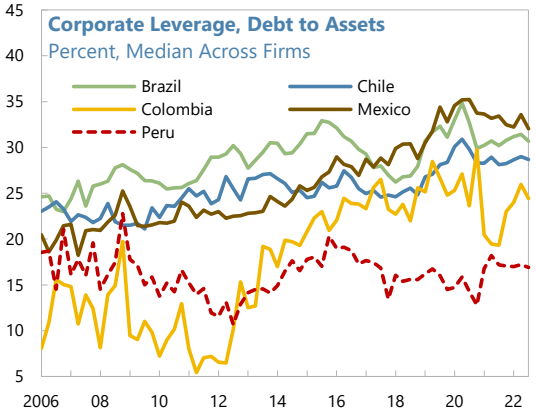
Rebound in profitability since pandemic lows tracks the performance of LA5.



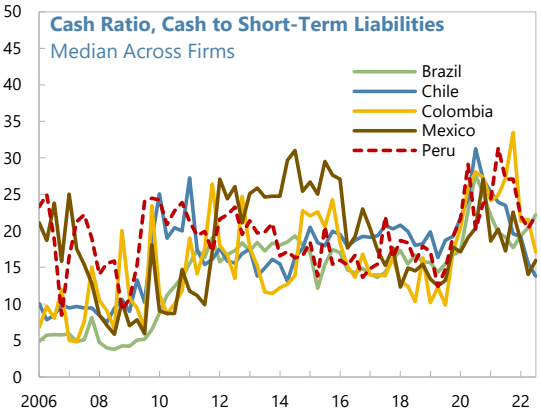
Other profitability measures exhibit a similar rebound.



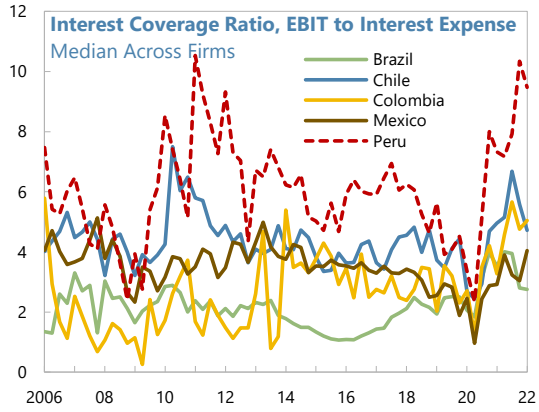
Corporate leverage remains below that of peers



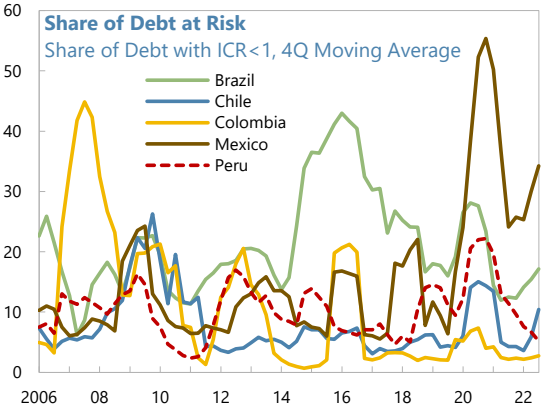
... While the cash ratio is above the pre-pandemic levels.



Peru outperforms peers on interest coverage for much of the last two decades.



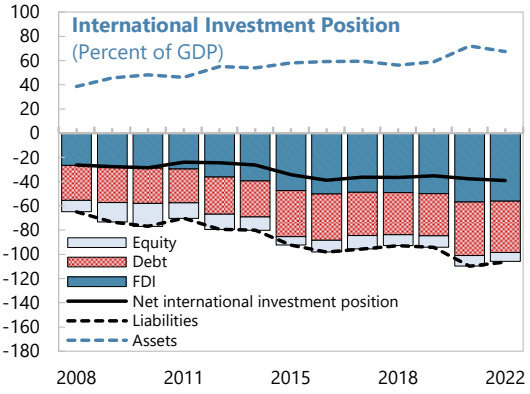
The share of debt at risk has fallen to pre-pandemic levels.



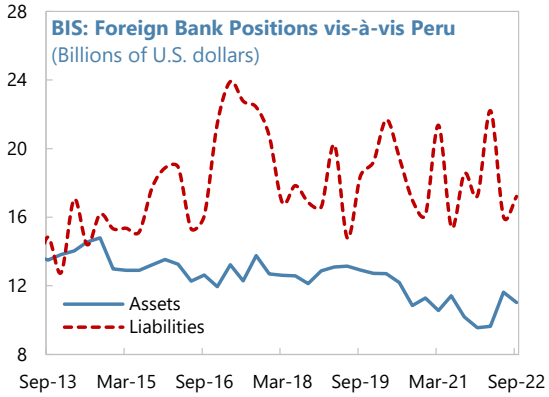
Sources: Bloomberg Finance L.P.; IMF WHD Regional Economic Outlook 2020, and IMF staff calculations.

Figure 6. Peru: Balance Sheet Indicators

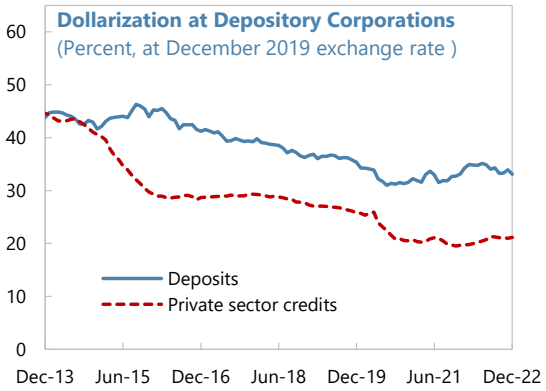
The IIP has held broadly stable.



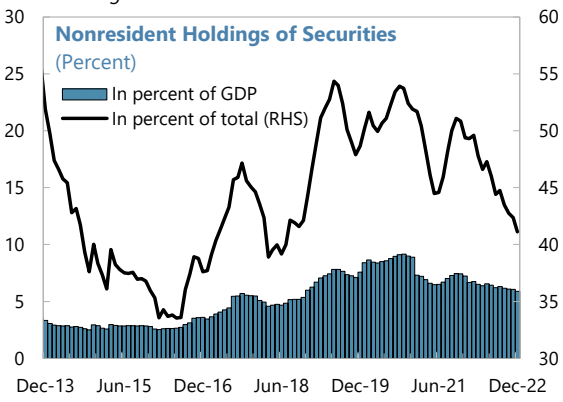
Ongoing political uncertainty may prevent the stabilization of assets with foreign banks.



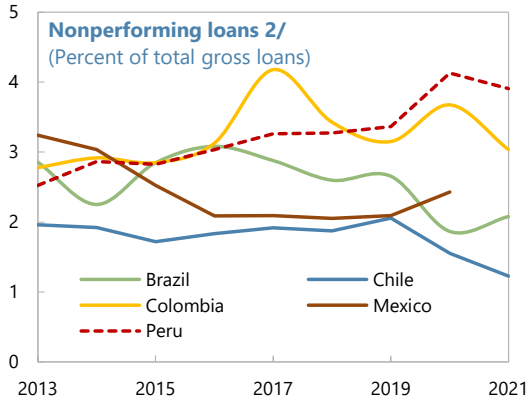
Deposit dollarization has recently increased slightly.



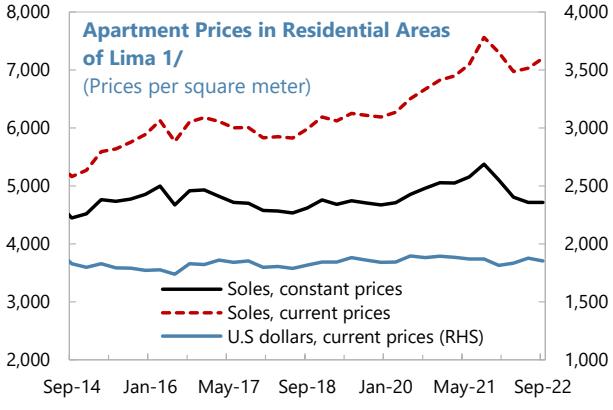
Non-residents continue to pull back from local sovereign debt.



Nonperforming loans have begun to stabilize.



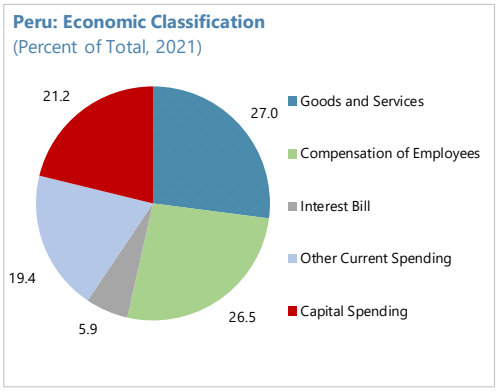
Housing prices in local currency are rising on the back of recovering mortgage demand.



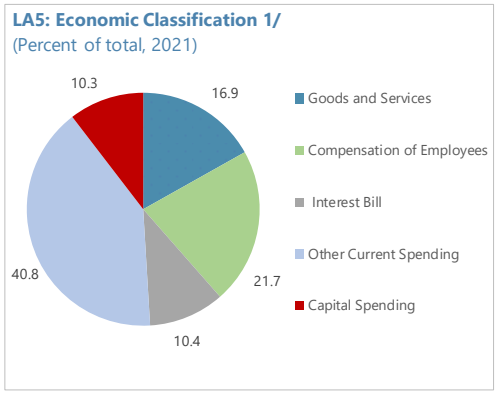
Sources: National authorities; Association of Banks; Bank for International Settlements; and IMF staff estimates.
1/ Twelve Lima districts include Barranco, La Molina, Miraflores, San Borja, San Isidro, Surco, Jesús María, Lince, Magdalena, Pueblo Libre, San Miguel and Surquillo.
2/ Data for 2021 is not available for Mexico.

Figure 7. Peru: Expenditure Assessment

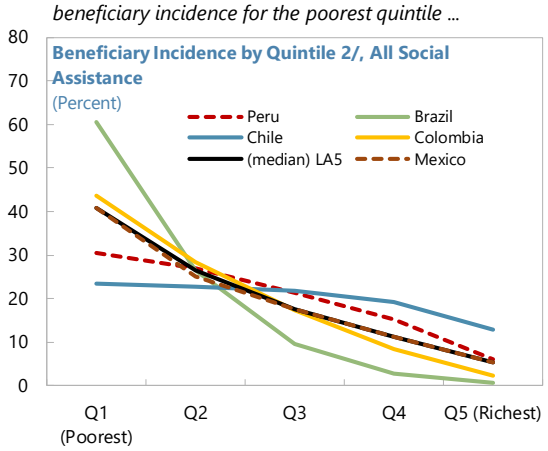
Spending in Peru is relatively balanced across sectors ...



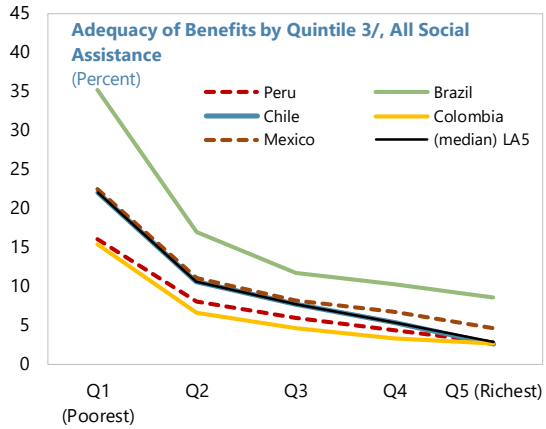
.... Peers allocate almost half that of Peru on most top spending categories, outside of compensation.



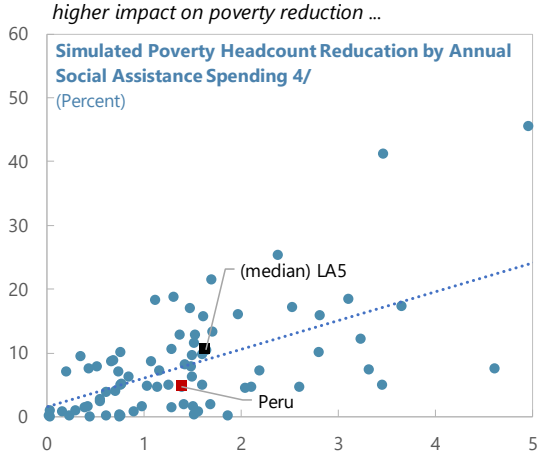
Peru falls below the LA 5 median with regard to beneficiary incidence for the poorest quintile ...



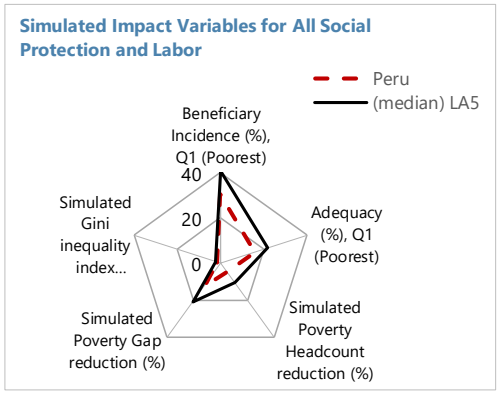
... While benefit adequacy falls on or below the median at each quintile.



There is opportunity for spending programs to have a higher impact on poverty reduction ...



... Reprioritizing spending allocation may help Peru to catch up to peers in several social outcome variables.



Source: IMF FAD Expenditure Assessment Tool (EAT), IMF Social Protection and Labor Toolkit (SPLAT), World Bank ASPIRE Database, World Economic Outlook; Note: Data is for most recent available year

1/ LA5 refers to Brazil, Colombia, Chile, Peru, Mexico

2/ Beneficiary Incidence is the percent of program beneficiaries in a quintile relative to the total number of beneficiaries in the population

3/ Adequacy of benefits is measured by the total transfer amount received by the population participating in social safety net programs as a share of their total welfare. Welfare is defined as the total income or total expenditure of beneficiary households.

4/ Annual Social Assistance Spending in percent of GDP

Table 1. Peru: Selected Economic Indicators

	2019	2020	2021	Est. 2022	Proj. 2023	2024	2025	2026	2027	2028
Social Indicators										
Poverty rate (total) 1/	20.2	30.1	25.9	...	...	...	...	...	...	
Unemployment rate for Metropolitan Lima (average)	6.6	13.0	10.7	7.8	...	...	...	...	...	
			(Annual percentage change; unless otherwise indicated)							
Production and Prices										
Real GDP	2.2	-11.0	13.6	2.7	2.4	3.0	3.0	3.0	3.0	3.0
Output gap (percent of potential GDP)	-1.6	-7.2	-0.3	-0.3	-0.4	0.0	0.0	0.0	0.0	0.0
Consumer prices (end of period)	1.9	2.0	6.4	8.5	3.0	2.3	2.0	2.0	2.0	2.0
Consumer prices (period average)	2.1	1.8	4.0	7.9	5.7	2.4	2.2	2.0	2.0	2.0
Money and Credit 2/ 3/										
Broad money	8.8	29.2	2.7	-0.3	7.0	6.0	6.7	5.6	6.0	5.0
Net credit to the private sector	6.4	14.0	6.5	3.6	6.1	5.4	5.4	5.7	5.5	6.6
Credit-to-private-sector/GDP ratio (%)	42.7	52.5	45.9	43.9	42.9	42.9	42.9	43.2	43.4	44.1
External Sector										
Exports	-2.2	-10.6	47.2	4.3	3.2	2.0	3.1	2.9	3.1	3.3
Imports	-1.8	-15.6	38.9	16.7	0.9	4.2	3.6	3.5	3.8	3.7
External current account balance (percent of GDP)	-0.7	1.2	-2.3	-4.5	-2.1	-2.3	-2.1	-1.8	-1.6	-1.5
Gross reserves In billions of U.S. dollars	68.4	74.9	78.5	72.2	71.9	73.3	74.8	76.6	79.0	80.7
Percent of short-term external debt 4/	429	482	594	524	513	519	472	483	489	574
Percent of foreign currency deposits at banks	224	222	229	207	210	219	228	242	260	282
			(In percent of GDP; unless otherwise indicated)							
Public Sector										
NFPS revenue	24.7	21.9	25.6	25.7	25.3	25.2	25.1	24.9	24.7	24.7
NFPS primary expenditure	24.9	29.2	26.6	25.8	25.7	25.6	24.9	24.3	24.3	24.3
NFPS primary balance	-0.2	-7.3	-1.0	-0.1	-0.4	-0.4	0.1	0.6	0.5	0.4
NFPS overall balance	-1.6	-8.9	-2.5	-1.6	-2.0	-2.0	-1.5	-1.0	-1.0	-1.0
NFPS structural balance	-0.6	-6.4	-3.7	-1.8	-2.2	-2.3	-1.8	-1.3	-1.2	-1.1
NFPS structural primary balance 5/	0.7	-4.8	-2.2	-0.3	-0.6	-0.7	-0.2	0.3	0.3	0.3
Debt										
Total external debt 6/	34.8	44.2	45.1	42.5	38.8	37.6	35.6	34.2	32.9	32.3
Gross non-financial public sector debt 7/	26.9	35.0	36.4	33.4	33.0	33.3	33.2	32.8	32.3	31.9
External	8.4	14.9	19.5	17.4	17.0	16.6	15.5	14.9	14.1	13.8
Domestic	18.5	20.1	16.9	16.0	16.0	16.6	17.7	17.9	18.2	18.1
Savings and Investment										
Gross domestic investment	21.8	19.7	22.0	23.7	25.2	25.2	25.0	24.8	24.7	24.6
Public sector (incl. repayment certificates)	4.6	4.3	4.7	5.5	5.6	5.6	5.6	5.6	5.7	5.7
Private sector	18.0	16.8	20.5	20.7	19.6	19.6	19.4	19.2	19.1	18.9
National savings	21.1	20.9	19.8	19.3	23.0	22.9	22.9	23.0	23.2	23.1
Public sector	3.3	-3.9	2.8	4.7	4.4	4.4	5.0	5.5	5.4	5.5
Private sector	17.8	24.8	16.9	14.5	18.7	18.5	17.9	17.6	17.7	17.7
Memorandum Items										
Nominal GDP (S/. billion)	775	719	877	950	1,031	1,087	1,144	1,202	1,263	1,326
GDP per capita (in US$)	7,006	6,145	6,679	7,094	7,773	8,018	8,320	8,633	8,952	9,285

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

	2019	2020	2021	Est. 2022	Proj. 2023	2024	2025	2026	2027	2028
	(In billions of soles; unless otherwise indicated)									
Revenues	**191.2**	**157.5**	**224.4**	**244.2**	**260.8**	**274.2**	**286.6**	**299.5**	**312.4**	**328.1**
Taxes	113.8	95.6	143.2	161.4	172.1	181.4	190.4	199.6	209.6	220.2
Other	77.4	61.9	81.1	82.8	88.7	92.8	96.2	99.9	102.7	107.9
Primary Expenditures 1/	**192.7**	**209.8**	**233.5**	**244.7**	**265.0**	**278.1**	**284.9**	**292.4**	**306.2**	**322.1**
Current	152.6	173.6	184.9	184.5	198.6	207.8	210.9	214.5	224.4	236.2
Capital	40.2	36.2	48.5	60.2	66.3	70.3	74.1	77.9	81.8	85.9
Primary Balance	**-1.5**	**-52.3**	**-9.1**	**-0.6**	**-4.2**	**-3.9**	**1.7**	**7.1**	**6.2**	**5.9**
Interest	10.7	11.5	13.2	14.7	16.5	17.5	18.5	18.8	18.6	18.8
Overall Balance	**-12.3**	**-63.8**	**-22.3**	**-15.3**	**-20.7**	**-21.4**	**-16.8**	**-11.7**	**-12.4**	**-12.8**
External financing	4.5	31.9	52.5	6.7	6.6	6.1	-0.9	5.9	5.3	14.3
Domestic financing	7.7	31.8	-30.2	8.6	14.1	15.4	17.8	5.8	7.2	-1.4
Public Gross Debt 2/	**208.8**	**251.7**	**318.7**	**317.2**	**340.1**	**361.8**	**380.4**	**394.3**	**408.1**	**422.6**
External	65.3	107.0	170.8	165.0	174.8	180.9	177.7	179.4	178.1	182.5
Domestic	140.7	142.2	145.8	150.5	163.9	179.8	201.8	214.4	229.9	240.1
Repayment Certificates	2.8	2.5	2.1	1.7	1.4	1.1	0.8	0.5	0.2	-0.1
Public Assets 3/	**92.5**	**74.5**	**107.9**	**120.9**	**119.9**	**118.9**	**117.8**	**116.6**	**115.4**	**114.1**
	(In percent of GDP; unless otherwise indicated)									
Revenues	**24.7**	**21.9**	**25.6**	**25.7**	**25.3**	**25.2**	**25.1**	**24.9**	**24.7**	**24.7**
Taxes	14.7	13.3	16.3	17.0	16.7	16.7	16.6	16.6	16.6	16.6
Other	10.0	8.6	9.3	8.7	8.6	8.5	8.4	8.3	8.1	8.1
Primary Expenditures 1/	**24.9**	**29.2**	**26.6**	**25.8**	**25.7**	**25.6**	**24.9**	**24.3**	**24.3**	**24.3**
Current	19.7	24.1	21.1	19.4	19.3	19.1	18.4	17.8	17.8	17.8
Capital	5.2	5.0	5.5	6.3	6.4	6.5	6.5	6.5	6.5	6.5
Primary Balance	**-0.2**	**-7.3**	**-1.0**	**-0.1**	**-0.4**	**-0.4**	**0.1**	**0.6**	**0.5**	**0.4**
Interest	1.4	1.6	1.5	1.5	1.6	1.6	1.6	1.6	1.5	1.4
Overall Balance	**-1.6**	**-8.9**	**-2.5**	**-1.6**	**-2.0**	**-2.0**	**-1.5**	**-1.0**	**-1.0**	**-1.0**
External financing	0.6	4.4	6.0	0.7	0.6	0.6	-0.1	0.5	0.4	1.1
Domestic financing	1.0	4.4	-3.4	0.9	1.4	1.4	1.6	0.5	0.6	-0.1
Public Gross Debt 2/	**26.9**	**35.0**	**36.4**	**33.4**	**33.0**	**33.3**	**33.2**	**32.8**	**32.3**	**31.9**
External	8.4	14.9	19.5	17.4	17.0	16.6	15.5	14.9	14.1	13.8
Domestic	18.1	19.8	16.6	15.8	15.9	16.5	17.6	17.8	18.2	18.1
Repayment Certificates	0.4	0.3	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0
Public Assets 3/	**11.9**	**10.4**	**12.3**	**12.7**	**11.6**	**10.9**	**10.3**	**9.7**	**9.1**	**8.6**
Public Net Debt	**15.0**	**24.6**	**24.0**	**20.6**	**21.4**	**22.4**	**23.0**	**23.1**	**23.2**	**23.3**
Memorandum Items										
Commodity related revenues 4/	1.4	0.8	3.1	3.2	2.7	2.7	2.6	2.5	2.4	2.4
Output gap (percent of potential GDP)	-1.6	-7.2	-0.3	-0.3	-0.4	0.0	0.0	0.0	0.0	0.0
NFPS non-commodity structural balance	-2.4	-7.4	-5.6	-4.7	-4.6	-4.6	-4.1	-3.5	-3.4	-3.3
NFPS non-commodity primary structural balance	-1.0	-5.8	-4.1	-3.2	-3.0	-3.0	-2.4	-1.9	-1.9	-1.9
NFPS structural balance 5/	-0.6	-6.4	-3.7	-1.8	-2.2	-2.3	-1.8	-1.3	-1.2	-1.1
NFPS structural primary balance 5/	0.7	-4.8	-2.2	-0.3	-0.6	-0.7	-0.2	0.3	0.3	0.3
Fiscal impulse (+ = expansionary) 6/	-1.0	5.2	-2.3	-1.9	0.4	0.1	-0.5	-0.5	0.0	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)

	2019	2020	2021	Est. 2022	Proj. 2023	2024	2025	2026	2027	2028
Revenue	**19.8**	**17.8**	**21.0**	**21.8**	**21.5**	**21.5**	**21.5**	**21.4**	**21.4**	**21.4**
Taxes	14.7	13.3	16.3	17.0	16.7	16.7	16.6	16.6	16.6	16.6
Social Contributions	2.2	2.2	2.1	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Other revenue	2.8	2.3	2.6	2.8	2.9	2.9	2.9	2.9	2.9	2.9
Expense 2/	**16.6**	**22.4**	**18.5**	**17.1**	**17.4**	**17.3**	**16.6**	**15.8**	**15.6**	**15.6**
Compensation of employees	6.3	7.3	6.2	5.9	5.8	5.8	5.8	5.8	5.8	5.8
Use of goods and services	5.7	6.3	6.1	5.9	5.6	5.4	5.3	5.2	5.2	5.2
Interest	1.3	2.2	1.4	1.4	1.5	1.4	1.3	1.1	1.0	0.9
Social benefits	1.8	1.9	1.8	1.7	1.7	1.7	1.6	1.6	1.6	1.6
Other 3/	1.6	4.7	3.0	2.2	2.8	2.9	2.6	2.0	2.0	2.0
Net Acquisition of Nonfinancial Assets	**4.5**	**4.5**	**5.0**	**6.0**	**6.1**	**6.1**	**6.1**	**6.1**	**6.1**	**6.1**
Acquistion of nonfinancial assets	4.5	4.5	5.0	6.0	6.1	6.1	6.1	6.1	6.1	6.1
Gross Operating Balance	3.1	-4.5	2.5	4.7	4.1	4.3	4.9	5.6	5.8	5.8
Net Lending (+) Borrowing (-) 4/	**-1.4**	**-9.0**	**-2.5**	**-1.3**	**-2.0**	**-1.9**	**-1.3**	**-0.5**	**-0.3**	**-0.3**
Net Acquistion of Financial Assets 5/	**0.6**	**-1.1**	**3.7**	**-2.0**	**-1.3**	**-1.2**	**-1.3**	**0.0**	**0.2**	0.8
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/	0.6	-1.1	3.7	-2.0	-1.3	-1.2	-1.3	0.0	0.2	0.8
By residency										
Domestic	0.6	-1.1	3.7	-2.0	-1.3	-1.2	-1.3	0.0	0.2	0.8
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/	**1.9**	**7.9**	**6.2**	**-0.7**	**0.7**	**0.6**	**0.0**	**0.6**	**0.5**	1.1
By instrument										
Debt securities	1.2	3.1	0.5	-1.4	0.1	0.1	0.1	0.1	0.1	0.1
Loans	0.7	4.8	5.8	0.7	0.6	0.6	-0.1	0.5	0.4	1.1
By residency										
Domestic	1.2	3.1	0.5	-1.4	0.1	0.1	0.1	0.1	0.1	0.1
External	0.7	4.8	5.8	0.7	0.6	0.6	-0.1	0.5	0.4	1.1
Memorandum Items										
Central Government Net lending (+) borrowing (-)	-2.4	-9.6	-3.8	-3.2	-3.0	-2.9	-2.2	-1.4	-1.0	-0.9
Regional Governments Net lending (+) borrowing (-)	0.5	-0.1	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.9
Local Governments Net lending (+) borrowing (-)	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
General Government Primary Balance	-0.1	-6.8	-1.2	0.1	-0.5	-0.4	0.0	0.6	0.7	0.6
General Government Overall Balance	-1.4	-9.0	-2.5	-1.3	-2.0	-1.9	-1.3	-0.5	-0.3	-0.3
Gen. Gov. primary spending (real percentage change)	1.0	13.0	5.3	-1.7	4.1	2.8	0.4	0.2	2.6	3.1
Of which: Current spending	3.1	19.6	-0.4	-8.1	3.9	2.7	-0.6	-1.0	2.5	3.2
Capital spending	-5.7	-9.3	31.2	20.2	4.7	3.0	3.1	3.1	2.9	2.9
General Government non-financial expenditures	19.9	24.7	22.2	21.7	22.0	22.0	21.4	20.8	20.8	20.8

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: Monetary Survey 1/

(In billions of soles, unless otherwise indicated)

	2019	2020	2021	Est. 2022	Proj. 2023	2024	2025	2026	2027	2028
					Central Bank					
Net Foreign Assets	**170**	**223**	**236**	**211**	**148**	**145**	**148**	**153**	**140**	**138**
(In billions of U.S. dollars)	85	88	92	85	100	104	106	109	117	
Net international reserves 2/	226	270	312	282	278	285	291	299	309	317
(In billions of U.S. dollars)	68	75	78	72	72	73	74	76	79	80
Long-term net external assets	0	0	-10	-10	-10	-10	-10	-10	-10	-10
Foreign currency liabilities	-57	-48	-65	-61	-120	-130	-133	-137	-159	-169
Net Domestic Assets	**-105**	**-137**	**-139**	**-119**	**-62**	**-58**	**-58**	**-60**	**-45**	**-42**
Net credit to nonfinancial public sector	-64	-49	-71	-71	-71	-71	-71	-71	-71	-71
Credit to the financial sector 3/	5	41	30	13	-37	-30	-24	-17	-11	-4
Securities issued	-28	-89	-42	-25	-14	-8	-4	-2	-1	0
Other assets (net)	-18	-40	-56	-36	60	51	41	30	37	34
Monetary Base	**65**	**86**	**97**	**92**	**85**	**87**	**90**	**92**	**95**	**96**
Currency	52	72	83	79	42	45	49	53	57	62
Reserve	12	14	14	14	43	42	41	39	37	35
					Depository Corporations 4/					
Net Foreign Assets	**194**	**248**	**274**	**237**	**243**	**250**	**258**	**266**	**277**	**285**
Net Domestic Assets	**143**	**189**	**174**	**210**	**242**	**263**	**290**	**312**	**336**	**359**
Net credit to the public sector	-62	-40	-74	-58	-59	-62	-60	-66	-72	-86
Credit to the private sector	331	378	403	417	450	474	500	528	557	594
Other assets (net)	-126	-150	-155	-149	-149	-149	-149	-149	-149	-149
Broad Money	**338**	**436**	**448**	**447**	**484**	**513**	**548**	**579**	**613**	**644**
Domestic currency	237	314	312	314	350	381	418	453	492	530
Foreign currency	101	122	136	133	135	132	130	126	121	114
					Financial System 5/					
Net Foreign Assets	**298**	**366**	**359**	**316**	**318**	**326**	**334**	**343**	**354**	**362**
Net Domestic Assets	**256**	**289**	**265**	**273**	**337**	**361**	**390**	**413**	**436**	**456**
Net credit to the public sector	-15	1	-43	-50	-51	-54	-52	-59	-64	-78
Credit to the private sector	393	442	469	484	548	576	603	632	661	696
Other assets (net)	-122	-155	-160	-160	-161	-161	-161	-161	-161	-161
Liabilities to the Private Sector	**554**	**654**	**624**	**604**	**655**	**687**	**723**	**755**	**790**	**818**
Domestic currency	428	501	462	441	538	575	616	654	696	734
Foreign currency	127	153	162	163	117	112	107	101	93	85
Monetary base	5.2	33.2	13.1	-5.0	-7.7	2.4	3.2	2.2	2.7	1.9
Broad money	8.8	29.2	2.7	-0.3	8.5	6.0	6.7	5.6	6.0	5.0
Domestic currency	10.2	32.7	-0.7	0.5	11.5	8.9	9.6	8.4	8.7	7.6
Foreign currency	5.6	21.1	11.4	-2.3	1.2	-1.7	-1.5	-3.3	-3.7	-5.6
Liabilities to the private sector	11.3	18.1	-4.6	-3.2	8.4	5.0	5.2	4.4	4.6	3.6
Domestic currency	11.8	17.1	-7.7	-4.6	22.0	6.9	7.1	6.2	6.4	5.4
Foreign currency	9.6	21.3	5.7	0.7	-28.5	-3.9	-4.4	-6.2	-7.2	-9.5
Depository corp credit to the private sector	6.4	14.0	6.5	3.6	7.9	5.4	5.4	5.7	5.5	6.6
Domestic currency	9.8	19.7	5.6	2.5	9.8	6.2	6.2	6.6	6.4	7.6
Foreign currency	-2.2	-2.5	10.0	7.3	1.7	2.6	2.3	2.3	2.3	2.2

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 5. Peru: Financial Soundness Indicators 1/

(In percent, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
					(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	14.5
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	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	0.3
Leverage 5/	8.3	7.9	8.7	9.4	9.8	10.2	8.8	9.0	9.9
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	4.2
In domestic currency	3.4	2.9	3.2	3.6	3.7	3.8	4.4	4.1	4.4
In foreign currency	2.1	2.9	2.8	2.6	2.4	2.3	3.5	3.5	3.4
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	6.1
In domestic currency	3.4	2.9	3.2	3.6	3.7	3.8	4.4	4.1	4.4
In foreign currency	2.1	2.9	2.8	2.6	2.4	2.3	3.5	3.5	3.4
Refinanced and restructured loans to total gross loans	1.1	1.1	1.3	1.5	1.6	1.5	1.9	2.0	1.9
Provisions to nonperforming loans 4/	157.7	161.8	157.1	151.1	150.7	149.1	178.5	159.9	149.3
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	102.8
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	20.5
Mortgage loans	15.5	15.2	15.1	15.4	15.3	15.6	14.4	14.7	15.3
Large corporations	17.2	21.4	22.2	22.6	23.3	22.2	18.7	21.2	20.4
Small corporations	17.0	15.8	14.8	14.3	14.3	14.3	16.0	15.5	14.7
Medium size firms	18.3	16.9	16.4	15.4	14.8	13.7	18.8	18.0	15.0
Small firms	10.1	9.0	9.1	9.4	9.1	9.3	10.6	10.1	10.8
Microenterprises	3.8	3.4	3.6	3.7	3.5	3.5	3.9	3.4	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	16.5
Return on assets (ROA)	1.9	2.1	2.0	2.1	2.2	2.2	0.4	1.3	1.9
Financial revenues to total revenues	85.0	85.1	85.3	84.2	83.4	83.7	84.6	81.5	83.3
Annualized financial revenues to revenue-generating assets	10.6	10.5	10.1	10.2	10.3	10.4	7.8	6.9	9.1
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	36.1
In domestic currency	25.3	26.2	26.7	33.0	27.2	27.5	50.6	33.6	27.0
In foreign currency	55.2	47.5	44.9	45.7	45.3	50.3	49.8	51.4	48.0
Deposit-to-loan	90.5	92.0	88.4	92.1	89.4	90.9	99.3	92.6	89.5
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	36.9
Share of foreign currency loans in total credit	38.4	30.1	28.8	29.4	28.5	26.5	22.7	23.3	24.2
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	8.4
Nonfinancial expenditure to total revenues 8/	33.0	30.9	30.8	30.7	30.7	29.9	31.8	35.3	30.8
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	3.4
Memorandum Items									
General Stock market index, IGBVL	14,794	9,849	15,567	19,974	19,350	20,526	20,822	21,112	21,330
EMBI+ PERU spread, basis points	181	243	170	112	137	92	117	144	146

Source: National authorities.

1/ These indicators correspond to depository corporations.

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

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

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

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

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

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

8/ Nonfinancial expenditures do not consider provisions nor depreciation.

Table 6. Peru: Balance of Payments

(In billions of U.S. dollars, unless otherwise indicated)

	2019	2020	2021	Est. 2022	Proj. 2023	2024	2025	2026	2027	2028
Current Account	**-1.6**	**2.4**	**-5.1**	**-10.9**	**-5.7**	**-6.3**	**-6.2**	**-5.6**	**-5.1**	**-5.1**
Merchandise trade	6.9	8.2	14.9	9.6	11.2	10.2	10.2	10.2	10.1	10.1
Exports	48.0	42.9	63.2	65.8	68.0	69.3	71.5	73.6	75.9	78.4
Traditional	34.0	30.0	46.6	47.3	48.7	49.2	50.4	51.6	52.9	54.4
Mining	28.3	26.1	39.7	37.7	41.0	41.4	42.5	43.6	44.8	46.2
Nontraditional and others	14.0	12.9	16.6	18.5	19.3	20.2	21.1	22.0	23.0	24.0
Imports	-41.1	-34.7	-48.2	-56.3	-56.8	-59.1	-61.3	-63.4	-65.8	-68.3
Services, income, and current transfers (net)	-8.5	-5.8	-20.0	-20.5	-16.9	-16.5	-16.4	-15.8	-15.2	-15.2
Services	-3.9	-4.6	-7.3	-8.4	-6.7	-6.4	-6.0	-5.4	-5.2	-5.1
Investment income	-9.6	-6.1	-18.1	-17.6	-15.6	-15.4	-16.0	-16.2	-16.0	-16.4
Current transfers	5.0	5.0	5.4	5.5	5.4	5.4	5.6	5.8	6.0	6.3
Capital and Financial Account Balance	**8.9**	**7.7**	**16.0**	**7.2**	**5.4**	**7.7**	**7.7**	**7.4**	**7.5**	**6.8**
Public sector	4.4	9.8	15.6	1.7	1.8	1.7	-0.1	1.6	1.4	3.6
Medium-term loans 1/	-0.3	9.0	15.3	1.7	1.7	1.6	-0.2	1.5	1.3	3.6
Other public sector flows 2/	4.5	1.1	0.3	0.0	0.1	0.1	0.1	0.1	0.1	0.0
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	4.5	-2.1	0.4	5.5	3.6	6.0	7.8	5.8	6.1	3.2
Foreign direct investment (net) 3/	6.8	0.9	6.1	11.9	7.6	8.4	8.7	9.4	9.8	10.3
Medium- and long-term loans	-2.3	-3.4	-0.9	0.2	-1.5	-1.6	-1.5	-1.5	-1.5	-1.5
Portfolio investment	-0.5	1.4	11.6	1.1	-1.2	-2.0	-1.6	-1.6	-1.6	-1.6
Short-term flows 4/	0.5	-1.0	-16.5	-7.7	-1.3	1.2	2.3	-0.4	-0.6	-4.0
Errors and Omissions	**1.2**	**-3.5**	**-5.9**	**-1.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall Balance	**6.9**	**5.3**	**6.2**	**-5.3**	**-0.3**	**1.4**	**1.5**	**1.8**	**2.4**	**1.7**
Financing	**-6.9**	**-5.3**	**-6.2**	**5.3**	**0.3**	**-1.4**	**-1.5**	**-1.8**	**-2.4**	**-1.7**
NIR flow (increase -)	-6.9	-5.3	-4.4	5.3	0.3	-1.4	-1.5	-1.8	-2.4	-1.7
Change in NIR (increase -)	-8.2	-6.4	-3.8	6.6	0.3	-1.4	-1.5	-1.8	-2.4	-1.7
Valuation change	1.3	1.1	-0.6	-1.3	0.0	0.0	0.0	0.0	0.0	0.0
				(In percent of GDP)						
Current Account Balance	**-0.7**	**1.2**	**-2.3**	**-4.5**	**-2.1**	**-2.3**	**-2.1**	**-1.8**	**-1.6**	**-1.5**
Capital and Financial Account Balance	**3.8**	**3.8**	**7.1**	**3.0**	**2.0**	**2.8**	**2.6**	**2.4**	**2.3**	**2.0**
Foreign direct investment (net)	2.9	0.4	2.7	4.9	2.8	3.0	3.0	3.0	3.1	3.1
Overall Balance	**3.0**	**2.6**	**2.8**	**-2.2**	**-0.1**	**0.5**	**0.5**	**0.6**	**0.7**	**0.5**
Memorandum Items				(Annual percentage change)						
Export value	-2.2	-10.6	47.2	4.3	3.2	2.0	3.1	2.9	3.1	3.3
Volume growth	1.2	-13.7	12.9	2.4	2.1	1.4	2.9	2.8	2.8	2.7
Price growth	-3.4	3.7	30.3	1.8	1.1	0.6	0.2	0.1	0.3	0.6
Import value	-1.8	-15.6	38.9	16.7	0.9	4.2	3.6	3.5	3.8	3.7
Volume growth	-0.2	-11.1	19.2	2.7	0.2	2.6	2.7	2.6	2.8	2.5
Price growth	-1.7	-5.0	16.6	13.7	0.7	1.5	0.8	0.8	1.0	1.2
Terms of trade	-1.8	9.1	11.8	-10.4	0.4	-0.9	-0.7	-0.7	-0.7	-0.6
Gross international reserves (in billions of US$)	68.4	74.9	78.5	72.2	71.9	73.3	74.8	76.6	79.0	80.7
Average exchange rate (S/. per US$)	3.34	3.50	3.88	3.92						

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 7. Peru: Financial and External Vulnerability Indicators

(In percent, unless otherwise indicated)

				Est.	Proj.					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Financial Indicators										
Public sector debt/GDP	26.9	35.0	36.4	33.4	33.0	33.3	33.2	32.8	32.3	31.9
Of which: in domestic currency (percent of GDP)	18.5	20.1	16.9	16.0	16.0	16.6	17.7	17.9	18.2	18.1
90-day prime lending rate, domestic currency (end of period)	3.3	0.6	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
90-day prime lending rate, foreign currency (end of period)	2.7	1.1	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Velocity of money 1/	2.3	1.6	2.0	2.1	2.2	2.1	2.1	2.1	2.1	2.1
Net credit to the private sector/GDP 2/	42.7	52.5	45.9	43.9	42.9	42.9	42.9	43.2	43.4	44.1
External Indicators										
Exports, U.S. dollars (percent change)	-2.2	-10.6	47.2	4.3	3.2	2.0	3.1	2.9	3.1	3.3
Imports, U.S. dollars (percent change)	-1.8	-15.6	38.9	16.7	0.9	4.2	3.6	3.5	3.8	3.7
Terms of trade (percent change) (deterioration -) 3/	-1.8	9.1	11.8	-10.4	0.4	-0.9	-0.7	-0.7	-0.7	-0.6
Current account balance (percent of GDP)	-0.7	1.2	-2.3	-4.5	-2.1	-2.3	-2.1	-1.8	-1.6	-1.5
Capital and financial account balance (percent of GDP)	3.8	3.8	7.1	3.0	2.0	2.8	2.6	2.4	2.3	2.0
Total external debt (percent of GDP)	34.8	44.2	45.1	42.5	38.8	37.6	35.6	34.2	32.9	32.3
Medium- and long-term public debt (in percent of GDP) 4/	16.9	24.2	26.8	27.0	24.7	23.7	22.5	22.1	21.5	21.6
Medium- and long-term private debt (in percent of GDP)	14.5	15.2	14.1	12.6	10.8	9.8	8.9	8.1	7.4	6.8
Short-term public and private debt (in percent of GDP)	3.4	4.7	4.2	3.9	3.6	3.4	3.3	3.1	3.0	2.8
Total external debt (in percent of exports of goods and services) 4/	147.7	199.2	154.1	146.2	142.8	140.1	133.9	130.4	126.8	126.2
Total debt service (in percent of exports of goods and services) 5/	37.2	35.9	24.6	24.9	25.6	25.2	26.6	25.6	25.1	21.6
Gross official reserves										
In millions of U.S. dollars	68,370	74,909	78,539	72,246	71,926	73,326	74,826	76,626	79,026	80,726
In percent of short-term external debt 6/	429	482	594	524	513	519	472	483	489	574
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	129	152	137	105	121	122	122	127	134	145
In percent of broad money 8/	67	62	71	62	58	56	54	53	51	50
In percent of foreign currency deposits at banks	224	222	229	207	210	219	228	242	260	282
In months of next year's imports of goods and services	19.5	15.4	13.6	12.7	12.1	12.0	11.8	12.1	12.1	11.9
Net international reserves (in millions of U.S. dollars)	68,316	74,707	78,495	71,883	71,563	72,963	74,463	76,263	78,663	80,363
Central Bank's Foreign Exchange Position	42,619	58,258	57,345	52,040	51,720	53,120	54,620	56,420	58,820	60,520

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

	2019	2020	2021	Est. 2022	Proj. 2023	2024	2025	2026	2027	2028
	(Annual percentage change)									
Production										
GDP at constant prices	2.2	-11.0	13.6	2.7	2.4	3.0	3.0	3.0	3.0	3.0
Domestic demand at constant prices	2.2	-9.9	14.7	2.8	1.9	3.3	3.0	3.0	3.0	3.0
Consumption	3.1	-7.2	11.5	2.1	-0.9	3.4	3.0	3.1	3.1	3.1
Investment	3.3	-16.2	35.0	1.8	1.3	2.9	2.7	2.6	2.6	2.6
Of which: Private	4.5	-16.5	37.4	-1.2	0.0	2.8	2.5	2.5	2.5	2.5
Of which: Public	-1.5	-15.1	24.9	15.5	6.3	3.5	3.6	3.0	3.0	3.0
Net exports (contribution to GDP growth)	0.1	-1.3	-1.0	-0.1	0.5	-0.3	0.0	0.0	0.0	0.0
Exports	1.1	-19.6	13.7	2.4	2.1	1.4	2.9	2.8	2.8	2.7
Imports	1.0	-15.8	18.6	2.7	0.2	2.6	2.7	2.6	2.8	2.5
Consumer prices (end of period)	1.9	2.0	6.4	8.5	3.0	2.3	2.0	2.0	2.0	2.0
GDP deflator	1.7	4.3	7.3	5.6	5.9	2.4	2.2	2.0	2.0	1.9
Trade										
Merchandise trade										
Exports, f.o.b.	-2.2	-10.6	47.2	4.3	3.2	2.0	3.1	2.9	3.1	3.3
Imports, f.o.b.	-1.8	-15.6	38.9	16.7	0.9	4.2	3.6	3.5	3.8	3.7
Terms of trade (deterioration -)	-1.8	9.1	11.8	-10.4	0.4	-0.9	-0.7	-0.7	-0.7	-0.6
	(In percent of GDP; unless otherwise indicated)									
External Current Account Balance	-0.7	1.2	-2.3	-4.5	-2.1	-2.3	-2.1	-1.8	-1.6	-1.5
Total External Debt Service 1/	8.8	8.0	7.2	7.2	7.0	6.8	7.1	6.7	6.5	5.5
Medium- and long-term	4.6	4.0	2.8	3.1	3.1	3.1	3.6	3.5	3.4	2.6
Nonfinancial public sector	1.5	1.0	0.8	1.4	1.5	1.5	2.1	1.9	2.0	1.3
Private sector	3.2	3.0	2.0	1.8	1.6	1.6	1.6	1.5	1.4	1.3
Short-term 2/	0.1	0.1	0.1	0.2	0.3	0.2	0.2	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	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Interest	1.3	1.3	1.2	1.6	1.7	1.7	1.7	1.6	1.5	1.3
Amortization (medium-and long-term)	3.5	2.8	1.7	1.8	1.7	1.6	2.2	2.1	2.1	1.3
Public Sector										
NFPS primary balance 3/	-0.2	-7.3	-1.0	-0.1	-0.4	-0.4	0.1	0.6	0.5	0.4
NFPS interest due	1.4	1.6	1.5	1.5	1.6	1.6	1.6	1.6	1.5	1.4
NFPS overall balance 3/	-1.6	-8.9	-2.5	-1.6	-2.0	-2.0	-1.5	-1.0	-1.0	-1.0
Public sector debt 3/	26.9	35.0	36.4	33.4	33.0	33.3	33.2	32.8	32.3	31.9
Savings and Investment										
Gross domestic investment	21.8	19.7	22.0	23.7	25.2	25.2	25.0	24.8	24.7	24.6
Public sector 3/	4.6	4.3	4.7	5.5	5.6	5.6	5.6	5.6	5.7	5.7
Private sector	17.2	15.4	17.3	18.2	19.6	19.6	19.4	19.2	19.1	18.9
Private sector (excluding inventories)	18.0	16.8	20.5	20.7	19.6	19.6	19.4	19.2	19.1	18.9
Inventory changes	-0.7	-1.4	-3.2	-2.5	0.0	0.0	0.0	0.0	0.0	0.0
National savings	21.1	20.9	19.8	19.3	23.0	22.9	22.9	23.0	23.2	23.1
Public sector 4/	3.3	-3.9	2.8	4.7	4.4	4.4	5.0	5.5	5.4	5.5
Private sector	17.8	24.8	16.9	14.5	18.7	18.5	17.9	17.6	17.7	17.7
External savings	0.7	-1.2	2.3	4.5	2.1	2.3	2.1	1.8	1.6	1.5
Memorandum Items										
Nominal GDP (billions of nuevos soles)	775.3	719.5	876.7	950.4	1030.7	1087.0	1,144.0	1,202.2	1,262.5	1,325.7
Gross international reserves (billions of U.S. dollars)	68.4	74.9	78.5	72.2	71.9	73.3	74.8	76.6	79.0	80.7
External debt service (percent of exports of GNFS)	37.2	35.9	24.6	24.9	25.6	25.2	26.6	25.6	25.1	21.6
Short-term external debt service (percent of exports of GNFS)	0.5	0.5	0.3	0.6	1.0	0.9	0.7	0.6	0.5	0.5
Public external debt service (percent of exports of GNFS)	6.2	4.5	2.9	4.7	5.6	5.7	7.8	7.4	7.7	5.0

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. Episodes of Economic Convergence and Divergence

1. Background. Peru is an emerging market economy with a level of income below the average for Latin America. WEO estimates per capita GDP in Peru (adjusted for purchasing power parity, PPP), at some $13,000 in 2022 (measured in international dollars of 2017) or about 15 percent lower than the average for Latin America. This estimate of per capita GDP is over 80 percent higher than its unadjusted (non-PPP) nominal level of US$7,100, reflecting a relatively undervalued real exchange rate in absolute purchasing power parity terms.[1] However, per capita GDP adjusted for PPP is a more accurate measure of economic progress and it is often used for comparisons with other countries. Usually, the U.S. is used as a benchmark, and the per capita GDP of a country (in PPP terms) is expressed as a ratio of that of the U.S. The resulting ratio is interpreted as a measure of convergence; the closer (farther) the ratio is to 1, the closer (farther) the economy is to achieving advanced economy status. Peru is far from that status as its convergence ratio reached only 0.20 in 2022, but it is some 50 percent higher than the convergence level three decades earlier. Peru's convergence ratio is similar to that of Brazil and Paraguay, but much lower than those of more advanced Latin American economies like Panama, Chile, and Uruguay.

2. Peru's experience. There has been a pronounced V shape process of (non) convergence in Peru over the last half a century:

- ***A distant episode of divergence*** (1975-90)**.** Peru experienced an episode of sharp decline in the 15 years prior to 1990. Following the oil shocks of the 1970s and the emergence of inflation in the U.S., which led to significant hikes in interest rates in the U.S. in the early 1980s, Peru had one of the less adequate policy responses in the region to the (oil and interest rate) shocks, with expansive monetary and fiscal policies, as well as the introduction of price controls, exchange restrictions, and multiple currency practices that limited payments of external debt in the mid-1980s, leading to a default on its public debt and a balance of payments crisis, on top of domestic terrorism and public health problems. Against this background, the convergence ratio fell in half from 0.28 in 1975 to 0.13 in 1990.

- ***A recent episode of convergence*** (1991-2022)**.** Peru experienced an episode of high growth since the early 1990s and up to before the pandemic. Real GDP is estimated to have grown at over 4½ percent in that period. It coincided with almost two decades of uninterrupted IMF-supported programs (1991-2009) as well as the introduction of solid macroeconomic frameworks like fiscal rules (1999) and inflation targeting (2002). Public debt fell by about ½ (as a ratio of GDP), and public bonds achieved a credit rating of investment grade. The poverty rate fell by

[1] The WEO database revised its estimates of per capita GDP on a PPP basis in 2020 following the release of the International Comparison Program's (ICP) 2017 survey for new PPP benchmarks (maintained and published by the World Bank under the auspices of the United Nations Statistical Commission (UNSC) and other international, regional and national organizations, including the Fund). The ICP's PPPs indicate how many units of a country's local currency are needed to buy a comparable basket of goods and services valued in the currency of the numeraire country, the United States. The ICP released PPP estimates for the benchmark year (2017) as well as revised historical PPP estimates through 2011–16. Extrapolations through 2018–27 and prior to 2011 are done by WEO using relative inflation rates based on GDP deflators. See Box 1.1 of the WEO for October 2020, IMF.

about ⅔, while income distribution became less unequal. It is in this context that Peru experienced a relatively rapid process of economic convergence, with the convergence ratio increasing from 0.13 in 1990 to 0.20 in 2022.

Latin America: Convergence [1/]

(Ratios of Real Per Capita GDP compared to that of the U.S.)

		Convergence Ratios			Δ Convergence		
		(A)	(B)	(C)	(D)=(B-A)	(E)=(C-B)	(F)=(C-A)
		1975	1990	2025 [2/]	1990 -1975	2025 -1990	2025 -1975
1	Panama	0.38	0.26	0.51	-0.12	0.26	0.13
2	Uruguay	0.36	0.28	0.38	-0.07	0.10	0.02
3	Chile	0.22	0.24	0.37	0.01	0.14	0.15
4	Dominican Republic	0.19	0.15	0.35	-0.04	0.20	0.16
5	Argentina	0.67	0.35	0.35	-0.32	0.00	-0.32
6	Costa Rica [3/]	0.32	0.24	0.34	-0.08	0.10	0.02
7	Mexico	0.43	0.37	0.30	-0.07	-0.07	-0.14
8	Colombia	0.22	0.21	0.25	-0.02	0.05	0.03
9	Brazil	0.32	0.27	0.24	-0.05	-0.03	-0.08
10	Peru	0.28	0.13	0.21	-0.15	0.07	-0.08
11	Paraguay	0.20	0.21	0.20	0.01	-0.01	0.00
12	Ecuador	0.25	0.20	0.17	-0.05	-0.03	-0.08
13	El Salvador	0.23	0.13	0.14	-0.09	0.01	-0.08
14	Bolivia	0.21	0.12	0.13	-0.10	0.02	-0.08
15	Guatemala	0.20	0.14	0.13	-0.06	-0.01	-0.06
16	Venezuela	0.75	0.41	0.09	-0.34	-0.31	-0.65
17	Honduras	0.12	0.10	0.09	-0.02	-0.01	-0.03
	Latin America	**0.32**	**0.22**	**0.25**	**-0.09**	**0.03**	**-0.06**

Source: WEO

1/ Excludes Nicaragua because of data constraints. Convergence in 2025 estimated at 0.10.

2/ WEO projection for 2025 (based on the October 2022 issue).

3/ Assumes convergence for 1975 similar to that of 1980.

Convergence	(i.e., Δ convergence greater than +0.05)
Stagnation	(i.e., Δ convergence between +0.05 and -0.05)
Divergence	(i.e., Δ convergence less than -0.05)

- **Overall, a case of a mild long-term divergence.** In the end, the convergence ratio fell from 0.28 in 1975 to 0.20 in 2022 producing a mild divergence in the last half a century. The recent episode of convergence was not enough to offset the distant period of divergence. This relatively poor performance over such a long period of time highlights the importance of adopting ambitious structural reforms to improve potential growth prospects and accelerate convergence in the future.

3. Latin American experience. There are no advanced economies in Latin America, only emerging and low-income economies. Over the last half a century, only four countries have led the region with the highest level of convergence:

- ***Venezuela*** (1975-93). For 19 years, Venezuela was the country with the highest level of income and convergence in Latin America, partly helped by the high oil prices of the 1970's, reaching its highest convergence level of 0.75 in 1976. At that time, Venezuela had a level of convergence similar to that of advanced economies like Canada, Finland and France, only to fall dramatically in the following two decades to be among the poorest countries in the region. Venezuela is probably the most extreme case of divergence in modern history.

- ***Argentina*** (1994-2001 and 2005-11). For 14 years, Argentina led the region in terms of income and convergence, reaching its highest convergence level of 0.67 in 1975. It was a level similar to that observed by advanced economies like Italy, Japan and Spain, only to fall in half in the next half a century.

- ***Mexico*** (2002-04). For three years, Mexico had the highest convergence in Latin America (at a time Argentina was going through one of its worst crises), but its highest convergence was achieved back in 1981 at 0.50 (partly helped by high oil prices in the 1970s), right before the debt crisis that began in Mexico and spread to the rest of Latin America in the 1980s (usually called the lost decade).

- ***Panama*** (2012-22). For the last 11 years, Panama has led the region with the highest income and convergence, reaching its highest point before the COVID-19 pandemic at 0.51 driven by a very high investment rate and facilitated by the expansion of the Panama Canal.

4. Patterns in Latin America. It is important to note that the V shape path of (non) convergence observed in Peru was also observed in many countries in Latin America, which highlights the severity of the oil and interest rate shocks experienced in the 1970s and 1980s and the lasting effects of such shocks, especially if they are accompanied by an inadequate policy response (even oil-producing countries like Ecuador, Mexico and Venezuela experienced severe macroeconomic problems). However, there were variations to the V shape convergence path of Peru:

- ***Divergence***. The majority of the Latin American countries (about ½ or 9 out of 17) observed divergence over the last half a century, including Argentina, Bolivia, Brazil, Ecuador, El Salvador, Guatemala, Mexico, Peru, and Venezuela.

- ***Stagnation***. About ⅓ of the Latin American countries (or 5 out of 17) experienced a form of stagnation when it comes to convergence in the same period, including Colombia, Costa Rica, Honduras, Paraguay, and Uruguay.

- ***Convergence***. Only about ⅙ of the Latin American countries (or 3 out of 17) achieved some meaningful convergence over the last 50 years, including: Chile, Dominican Republic, and Panama, with the Dominican Republic accomplishing the fastest convergence in the region in the last half a century.

5. Peru's growth outlook. Potential growth estimates have been reduced by ½ from around 6 percent in the period 2002-13 to 3 percent in the next several years. However, there is scope for higher potential growth over the medium term if current political and social uncertainties are resolved and the authorities embrace an ambitious structural reform agenda. With higher investment, the contribution to growth could be 1 percentage point higher and with more reforms, the total factor productivity (TFP) could be up to 2 percentage points higher, which would increase potential growth to 5 or 6 percent. For this reason, it will be important to undertake structural reforms that increase productivity in the economy, including by: (i) advancing the quality of education to improve the effectiveness of the labor force; (ii) improving the business environment to attract higher levels of investment; (iii) facilitating the absorption of foreign talent to increase the human capital; (iv) fostering innovation to adopt better technologies; and (v) reducing institutional vulnerabilities to enhance the overall functioning of the economy. With higher potential growth, Peru could rapidly narrow the wide convergence gap with advanced economies.

Growth Accounting [1/]
(In percent)

	1981-1990	1991-2001	2002-2013	2014-2019	2020-2022	Proj. 2023-30
Labor [2/]	3.0	3.3	1.8	1.4	1.2	1.4
Capital	-1.1	-0.8	0.4	1.0	0.6	0.8
TFP	-2.6	1.2	3.9	0.6	0.0	0.8
GDP	**-0.7**	**3.7**	**6.1**	**3.0**	**1.8**	**3.0**

Source: IMF Staff calculations.
1/ See "Potential Output Estimates in the Aftermath of the Pandemic", Appendix IV of the 2022 Article IV Consultation.
2/ Includes human capital.

Annex II. Implementation of Past Fund Advice

Recommendations	Authorities' Response
Fiscal Policy	
Stance. 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.	**Implemented.** The fiscal impulse was negative in 2022, on account of higher tax revenues and the gradual unwinding of Covid-19 related stimulus. The fiscal rules were reintroduced in 2022, envisioning a backloaded and gradual fiscal consolidation of about 0.5 percent of GDP per year during 2025-2026.
Council. 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 fiscal framework.	**Implemented**. Law 31681enhances the operational independence of the Fiscal Council by elevating the FC to a regulatory agency for the purposes of the civil service.
Taxes. Tax policy adjustments, enhanced targeting of social benefits, a comprehensive civil service reform, and improved governance at SOEs will help address rising spending needs, strengthen government effectiveness, and contain fiscal risks.	**Partially implemented**. Tax policy adjustments have been ruled out by the current administration. Recommendations from the Multisectoral Commission to Strengthen the Civil Service are under implementation. A plan to improve governance at Petroperu is pending.
Pensions. Pension reform is urgent following large withdrawals from private pension funds. More withdrawals will exacerbate existing problems.	**In progress**. A new commission for the evaluation of the pension system was tasked with presenting a pension reform proposal by January 2023. The deadline has been extended until May 2023.
Monetary and Exchange Rate Policy	
Tightening. Further tightening of monetary policy is warranted in the short term. Inflation and inflation expectations are above the 2+/-1 percent bend, requiring a sufficiently strong response to maintain the nominal anchor.	**Implemented**. Tightening of monetary policy into contractionary territory has shown signs of taming inflation and inflation expectations.

Recommendations	Authorities' Response
FXI. Consider the tradeoffs of frequent foreign exchange intervention. Fewer and more targeted interventions can address risks while permitted the foreign exchange market to develop.	**Partially implemented**. Fewer and smaller interventions have been undertaken over the past year, but tradeoffs in a multi-instrument framework are not yet explicitly considered. The authorities continue to intervene in the foreign exchange markets to minimize volatility, maintaining a discretionary approach but providing ample information on foreign currency intervention.
Financial Policies	
Macroprudential. In the absence of systemic risks to the financial system, prudential policies should continue to unwind while protecting bank portfolios.	**Implemented**. All pandemic-era prudential policies have been unwound.
Regulation. Close key regulatory and supervisory gaps in line with the recommendations of the 2018 FSAP.	**In progress**. See Annex IX.
Structural Policies	
Productivity. Boost productivity by improving education, enhancing infrastructure, facilitating labor reallocation, and improving the business climate.	**Partially implemented.** Spending on education has been significantly increased under the 2021 and 2022 NFPS budgets. In-person schooling has resumed. Some of the announced policies, such as a second agrarian reform law and recent restriction off outsourcing, may have worsened the business climate.
Informality. Reduce informality.	**Partially implemented.** Informality has been reduced from levels observed in 2020, but remains at very high levels.
Governance. Improve the effectiveness of public services and enhance transparency, including by strengthening anti-corruption enforcement and institutions.	**In progress.** Efforts to strengthen anti-corruption institutions continue, and the National Board of Justice, which appoints judges and prosecutors, is fully operational, but civil service reform is pending.
Infrastructure. Strengthen the capacity to execute public investment to reduce the large infrastructure gap.	**Partially implemented.** Public investments have been increased significantly after the first quarter of 2022 until the local elections in October. It is not clear, however, if this trend can be sustained in light of changes in local governments.

Annex III. External Sector Assessment

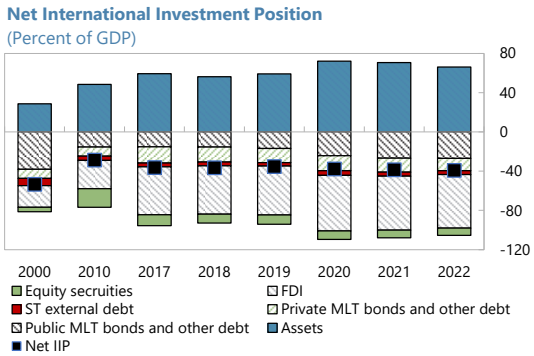
Overall Assessment: *Peru's external position in 2022 was moderately weaker than the level implied by medium-term fundamentals and desirable policies. Notwithstanding the lingering effects of the pandemic, the impact of declining terms of trade, and political uncertainty, reserve coverage remains adequate even after considering the dependence on commodity prices and the existence of substantial domestic FX liabilities. These estimates are preliminary and subject to uncertainty related to the impact of multiple shocks that affected the economy in 2022.*

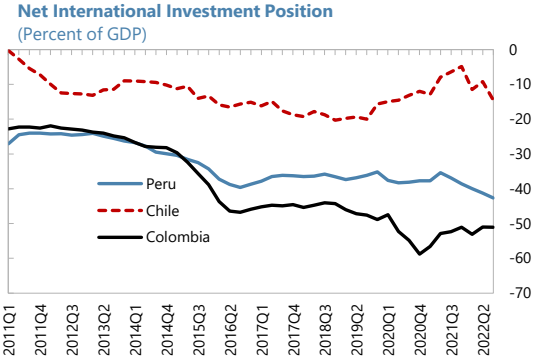
Potential Policy Responses: *The authorities responded appropriately to the Covid-19 outbreak with effective and well-coordinated fiscal, monetary, and financial support, which resulted in a rapid recovery from the pandemic. In response to inflationary pressures in 2022, the BCRP pro-actively began monetary tightening, and fiscal policy consolidation advanced to return to the fiscal rule, creating a strong macroeconomic policy mix that supported the external position in 2022. An acceleration of structural reforms, including growth-enhancing public and private investment and measures to reduce informality, could increase Peru's competitiveness and support a balanced external position in the medium term.*

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 2022, the ratio of the net IIP-to-GDP declined slightly to -40 percent of GDP. Peru's external assets (about 65 percent of GDP) include sizeable holdings of foreign assets by the central bank (30 percent of GDP) and the financial system (about 10 percent of GDP). The assets are offset by large FDI liabilities (56 percent of GDP), moderate external indebtedness (public and private external debt of about 43 percent of GDP), and equity securities (7.3 percent of GDP). The net IIP is projected to stay at about -40 percent of GDP over the medium term.

Assessment. Gross external financing needs rose to an estimated 10 percent of GDP in 2022. The external stability (ES) approach suggests a need for an external adjustment once the recovery is fully underway. The estimated medium-term non-interest current account balance (CAB) required to stabilize the NIIP at its end-2021 level is -2.7 percent of GDP, which is below the medium-term projections in the baseline.





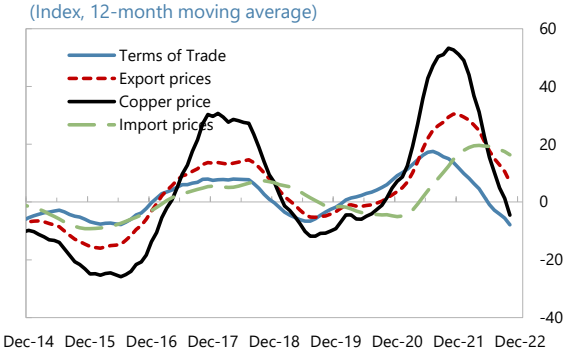
Sources: Haver, BCRP and IMF staff estimates.

2022 (% GDP)	NIIP: -40	Gross Assets: 65	Reserve Assets: 30	Gross Liab.: 106	Debt Liab.: 42.5

Current Account

Background. Despite a robust trade surplus, the current account deficit worsened by 2.2 pp of GDP to an estimated 4.5 percent of GDP in 2022. The trade balance declined by 2.7 pp of GDP from a historically high level of 6.6 percent of GDP in 2021, reflecting a large deterioration in the terms of trade (about 10 percent). Exports of goods increased by about 2.5 percent, reflecting a roughly equal deceleration in both prices) and volumes. Imports of goods grew by about 17 percent, reflecting a recovery in volumes due to higher domestic demand (about 2.5 percent) and increases in prices (about 13.5 percent). Investment income outflows declined by 1.3 pp of GDP but remained high at 6.8 percent of GDP, as foreign companies registered large profits. The services trade deficit worsened by 0.2 pp of GDP as freight costs increased and tourism-related revenues remained at low levels. Over the medium term, the current account deficit is expected to stabilize at about 1.5 percent of GDP.

Terms of Trade
(Index, 12-month moving average)



Assessment. The EBA CA model estimates a current account norm of -1.9 percent of GDP. After accounting for the temporary impact of the pandemic on travel and transportation (1.9 percent of GDP) and for the output and terms of trade gap, and further adjusting for the impact of social unrest on net mining exports and the unprecedented increases in the import price of fertilizers (a combined 0.5 percent of GDP), staff estimates the 2022 cyclically adjusted current account balance to be -3 percent of GDP. Thus, the overall CA gap is about -1.1 percent of GDP, pointing to an external position in 2022 moderately weaker than the level implied by fundamentals and desirable policy settings. These estimates are preliminary and subject to uncertainty regarding the impact of the Covid

Current Account and REER Gaps, 2022
(Percent of GDP, unless stated otherwise)

	CA regression	REER (index)	REER (level)
CA Actual	**-4.5**	..	..
Cyclical contributions (from model) (-)	0.8	..	..
COVID-19 adjustor (+) 1/	1.9	..	..
Adjustor for impact of protests on mining (+) 2/	0.3	..	..
Adjustor for impact of fertilizers (+) 3/	0.2	..	..
Cyclically adjusted CA	**-3.0**	..	..
CA norm (from model) 4/	**-1.9**	..	..
CA gap 5/	**-1.1**	..	..
o/w Policy gaps	0.4	..	..
Elasticity	-0.2	..	..
REER gap (in percent) 6/	***5.0***	***5.3***	***20.9***

Source: IMF staff estimates.

1/ Additional cyclical adjustment of 1.9 percent of GDP to account for the temporary impact of the pandemic on travel (+0.4 percent of GDP) and transport (+1.5 percent of GDP).

2/ Additional adjustment of 0.26 percent of GDP to reflect net exports loss at the Las Bambas and Southern mines due to protests and blockades.

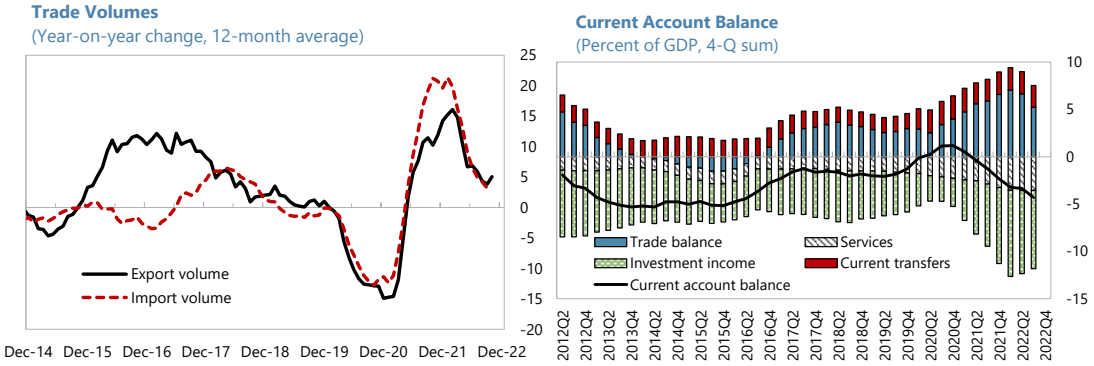
3/ Additional adjustment of 0.18 percent of GDP to account for the temporary impact of higher import prices of fertlizers.

4/ Cyclically adjusted

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

6/ Positive value indicates overvaluation.

pandemic and social unrest on economic activity. Excluding the policy gap of 0.4 percent of GDP, the current account gap would be -1 percent of GDP. The positive policy gap 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 0.7 percent of GDP) and a larger credit gap (the contribution of the relative credit gap to the overall CA gap being estimated at -0.5 percent of GDP). Given the positive contribution of domestic policies, staff is of the view that the assessment reflects high uncertainty and foreign influences on Peru's current account and exchange rate.

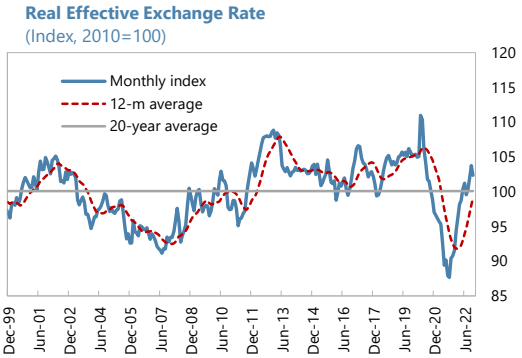


Sources: BCRP; IMF INS database; and IMF staff calculations.

Real Exchange Rate

Background. The real exchange rate (REER) appreciated in 2022. The average REER in 2022 was about 8 percent stronger than in 2021 and converged back to its 20-year average. The nominal exchange rate against the US dollar depreciated by about 1.2 percent to 3.8 S/USD (the average rate during the year).

Assessment. The EBA REER approaches estimate an overvaluation of 5.3 percent (index method) and an overvaluation of 20.9 percent (level method) in 2022. The REER gap derived from the IMF staff's CA gap assessment, with an estimated elasticity of 0.22, implies a REER overvaluation of 5.0 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 2022 to be in the range of 3.2 and 6.8 percent, with a midpoint of 5.0 percent. The estimated REER overvaluation of 5.0 percent is small, especially given elevated model uncertainty against the backdrop of multiple shocks affecting the Peruvian economy in 2022.



Capital and Financial Accounts: Flows and Policy Measures

Background. Net inflows into the capital and financial account are estimated to have declined in 2022 to 3 percent of GDP after record highs of 7.1 percent of GDP observed a year before. Inflows were dominated by a sharp increase in FDI (about US$12 billion), reflecting increases in reinvested earnings associated with high metal prices and liquidation of portfolio investments abroad by the

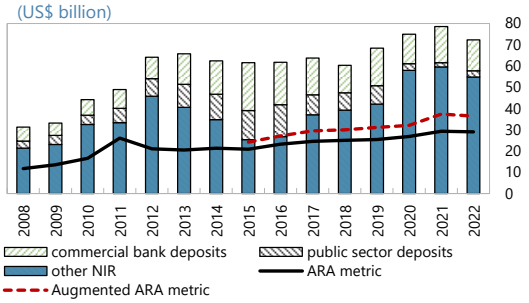
pension funds. These inflows were offset by sales of sovereign bonds by non-residents and public sector debt amortization, as well as purchases of short-term net foreign assets.

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

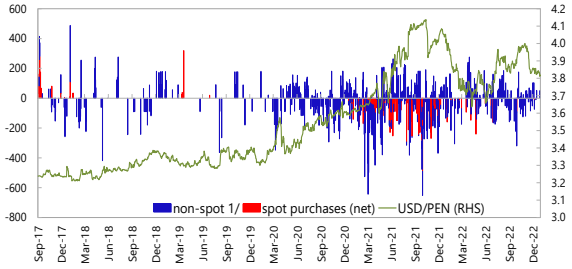
Background. The BCRP has been active in the foreign exchange market to smooth the exchange rate volatility caused by recent shocks without targeting a specific rate. While the central bank stepped in to smooth the volatility at the outset of the Covid-19 pandemic and during later episodes of significant market pressure, the intervention was limited in 2020. In 2021, the BCRP increased its interventions to contain volatility in the context of heightened political uncertainty, selling US$18.3 billion (8.1 percent of GDP), including US$11.6 billion on the spot market (5.1 percent of GDP). In 2022, interventions were limited, with the central bank selling US$1 billion on the spot market (0.4 percent of GDP). Interventions on the non-spot market were done mainly through FX swap transactions. Peru's gross reserves declined by about US$6.3 billion in 2022.

Components of GIR and ARA Metric
(US$ billion)



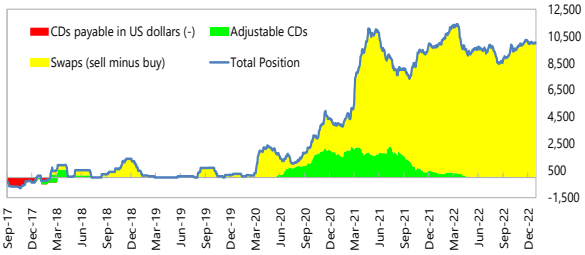
Source: BCRP and IMF staff estimates.

Exchange Rate and Foreign Exchange Intervention
(Millions of US dollars)



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

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



Source: BCRP and Fund 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$72.2 billion (30 percent of GDP) at the end of 2022, or 240 percent of the ARA metric, well above the 100–150 percent adequacy range. Reserves also exceed an augmented ARA metric that incorporates the volatility of copper and gold prices and Peru's heavy reliance on commodity exports.

Annex IV. Monetary Policy Analysis and Forecasts Based on a DSGE Model

Model Description

1. We analyze monetary policy challenges in Peru and make forecasts using the below semi-structural model, which builds on the standard linear version of the quarterly projection models (QPMs), or "gap models," widely used by inflation-targeting central banks. This family of models nests a new-Keynesian-type model with rigidities and rational expectations, allowing the monetary policy to have real effects in the short-to-medium term. The linear version of such models greatly simplifies the analysis and processes. The below model builds on the work done by Berg and others (2006a, 2006b).

2. The model comprises domestic and foreign economy blocks, but the latter is exogenous to the model. There are four main equations describing the domestic economy: aggregate demand, aggregate supply (the Phillips curve), uncovered interest rate parity (UIP), and a monetary policy rule. Expectations are formed based on a combination of lagged effects and model-predicted future outcomes (rational expectations).

A. Aggregate Demand

3. The aggregate demand equation models the output gap ($\hat{y}_t$) as a function of its own lag, monetary conditions index (mci_t), and foreign output gap ($\hat{y}_t^*$). The monetary conditions index, in turn, is a weighted average of the "real interest rate" gap (*r-r**), credit premium (*cr_prem*), and the real exchange rate gap ($z_t - z_t^*$).

$$\hat{y}_t = b_1\hat{y}_{t-1} - b_2 mci_t + b_3\hat{y}_t^* + \varepsilon_t^y$$

$$mci_t = b_4(\hat{r}_t + cr\_prem_t) + (1 - b_4)(-\hat{z}_t)$$

where ε_t^y represents aggregate demand shocks. Note that unmodeled influences such as fiscal policy can be attributed to the aggregate demand shock. The second equation means that a change in the monetary policy stance can be achieved via changes to the interest rate, exchange rate movements, and the premium.

B. Aggregate Supply

4. The aggregate supply equation is represented by the Phillips curve, expressing the quarterly annualized inflation rate (π_t) as a function of the previous period inflation rate (π_{t-1}), expected inflation in the next quarter (π_{t+1}), and real marginal costs (*rmc*). The *rmc* is a function of the domestic and foreign factors: the output gap (y_t); the real exchange rate gap (z_t), and international

oil and food prices. Inflation is determined as the weighted average of core inflation, food inflation, and energy inflation.

$$\pi_t^{core} = a_1\pi_{t-1}^{core} + (1-a_1)E_t\pi_{t+1} + a_2 rmc_t + \varepsilon_t,$$

$$rmc_t = a_3\hat{y}_t + (1-a_3)\hat{z}_t^{core}$$

$$\pi_t^{food} = a_{21}\pi_{t-1}^{food} + (1-a_{21})E_t\pi_{t+1}^{food} + a_{22}rmc_t^{food} + \varepsilon_t^{food}$$

$$rmc_t^{food} = a_{23}\hat{z}_t^{food} + (1-a_{23})\hat{y}_t$$

$$\pi_t^{energy} = a_{31}\pi_{t-1}^{energy} + (1-a_{31})E_t\pi_{t+1} + a_{32}rmc_t^{energy} + \varepsilon_t^{energy}$$

$$rmc_t^{energy} = rwoi\hat{l}_t + \hat{z}_t^{energy}$$

where ε_t is a cost-push or aggregate supply shock.

C. Uncovered Interest Rate Parity (UIP)

5. The arbitrage condition between real returns on domestic and foreign interest rates gives rise to the UIP condition in equation:

$$s_t = (1-e_1)E_t s_{t+1} + e_1(s_{t-1} + 2/4(\pi_t^T - \bar{\pi}_t^* + \Delta\bar{z}_t)) + (i_t^* - i_t + prem_t)/4 + \varepsilon_t^S,$$

6. Where s_t denotes the RER, $s_{t+1}$is expected RER, s_{t-1} is the lag of the RER, π^Tdenotes the inflation target, $\bar{\pi}_t^*$ denotes the steady-state foreign inflation, i_t represents real domestic and foreign (US) interest rates, *prem* is the sovereign risk premium, and $\varepsilon_t^S$is a shock that captures unexpected deviations from the UIP. RER expectations are formed as a weighted average between model-consistent expectations and past values but are also affected by the inflation expectations bias. Note that the equation implies a pure float when e_1 is equal to 1.

7. All foreign variables (output gap, inflation, and interest rate), as well as other exogenous variables (real food and energy prices), are modeled as AR (1) processes, with the steady-state values reflecting the corresponding sample averages, unless respective WEO GAS assumptions are used as projections. For the sake of simplicity, the US economy represents the foreign economy. Thus, the foreign interest rate is approximated by the Federal funds rate.

D. Policy Reaction Function for a Freely Floating Exchange Rate

8. Under an inflation targeting framework, the short-term interest rate responds to (i) deviations of the 3-quarter-ahead year-on-year inflation forecast from its target and (ii) the output gap. To avoid excessive volatility in the policy rate or to achieve "interest-rate smoothing," the last-period policy stance is also included:

$$i_t = g_1 i_{t-1} + \left(1-g_1\right)\left(i_t^n + g_2(E_t\pi_{t+3} - \pi_{t+3}^T) + g_3\widehat{y}_t\right) + \varepsilon_t\,,$$

where i_t is the domestic short-term nominal interest rate and ε_t is a policy shock. The monetary authority is forward-looking and uses model-consistent inflation expectations, $E_t\pi_{t+3}$. The policy-neutral rate, i_t^n, is the value of the policy rate that is consistent with economic equilibrium and is equal to the sum of the trend real interest rate and the model-consistent inflation expectations: $i_t^n = \bar{r}_t + E_t\pi_{t+1}$.

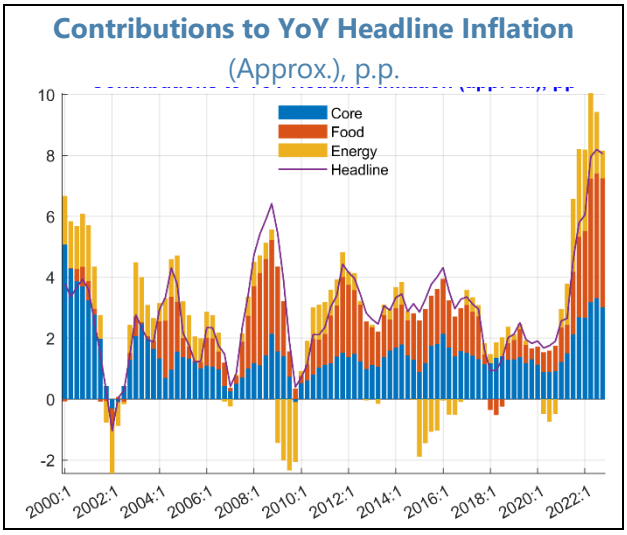
9. In the baseline calibration, the parameters are chosen based on attempts to match observed data, views about cyclical developments, and taking into consideration coefficients in similar studies (such as Abradu-Otoo and others (2022); Aguirre and others (2022); Berg and others (2006b); Chansriniyom and others, (2020); Epstein and others, (2022).[1] In the end, the parameters are set in the table above.

Model Calibration

Aggregate Demand		Phillips Curve		Uncovered Interest Parity		Taylor Rule	
Parameter	Value	Parameter	Value	Parameter	Value	Parameter	Value
b_1	0.75	a_1	0.50	e_1	0.80	g_1	0.75
b_2	0.25	a_2	0.25	...	...	g_2	1.00
b_3	0.20	a_3	0.65	...	...	g_3	0.50
b_4	0.70	...	...	...	...	...	...

Ability of the Model to Interpret Historical Inflation Data

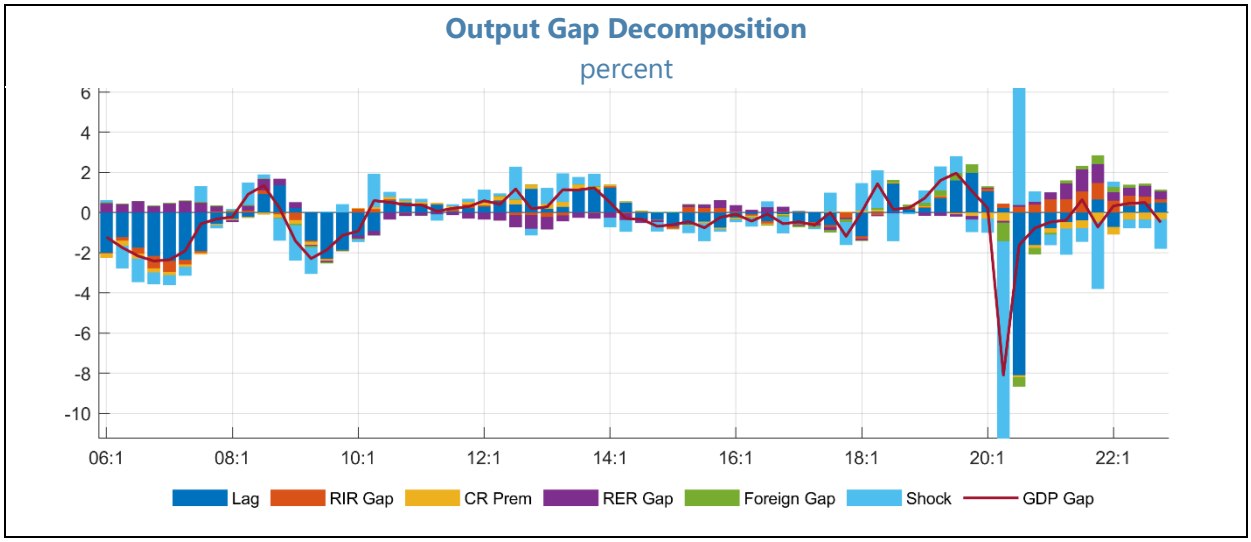
10. Before forecasting, we look at the historical developments of the three components of inflation. As can be seen from the text figure, the recent surge in inflation has been due mostly to very high food and energy prices, but core inflation also picked up starting in late 2021. Regarding monetary conditions, they became highly expansionary during the COVID-19 pandemic but have become neutral in recent months due mainly to the narrowing of the interest rate gap.



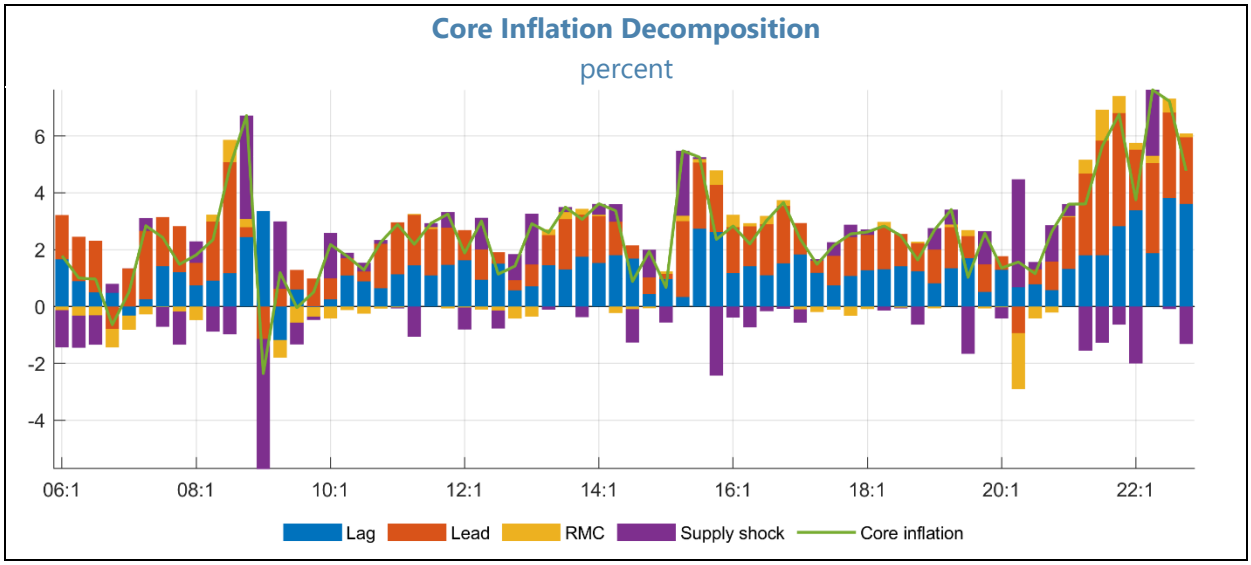
11. Then, we check the ability of the model to interpret the historical inflation patterns using the Kalman filter technique. The text figure displays the decomposition of the output gap. It shows that the output gap became negative during the global financial crisis, then moved around zero until the COVID-2019 pandemic, and turned negative again during the pandemic. After the start of the pandemic, both lower interest rates and the depreciation of the currency have been stimulating the output until recent months, while higher premium has adversely affected output. The foreign output

[1] The model specification only indirectly takes into account the high levels of dollarization in Peru by considering in model calibration the coefficients in the analyses for countries with broadly similar levels of dollarization (e.g., Indonesia and Ghana).

gap adversely affected Peru's output gap in 2020, but this has partly reversed since then. There are also other unmodeled factors represented as adverse shocks, including the large fiscal package adopted in 2020, which shows up as a positive shock in mid-2020.



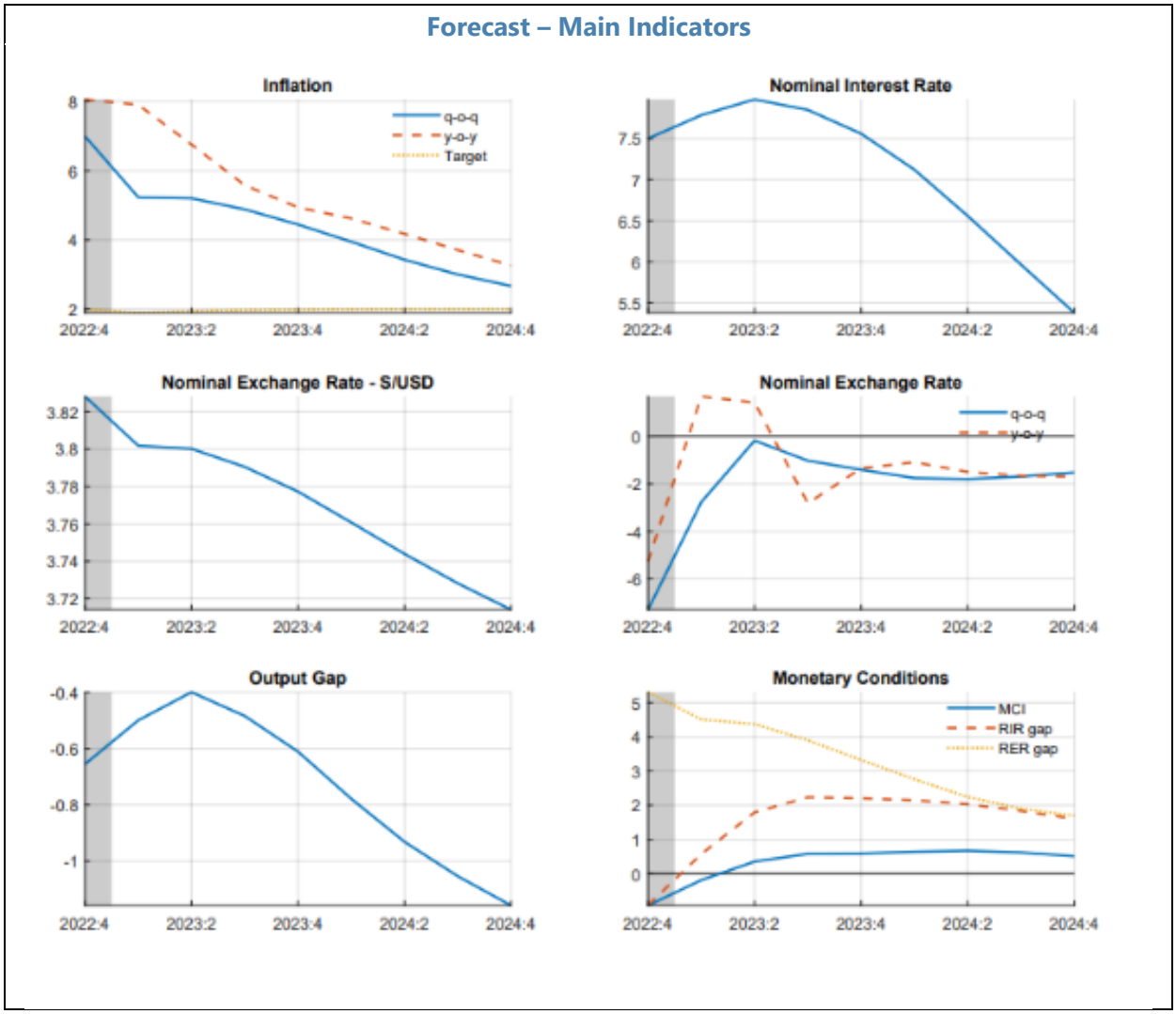
12. The next text figures display the Phillips curve decomposition of core inflation. It shows an important contribution of the forward-looking component (rational expectations), inflation expectations, in explaining past inflation, which suggests the monetary policy has been credible. However, the importance of the backward-looking component, past inflation, has recently increased. This means there is no room for complacency, and the authorities should continue tightening the monetary policy stance until this trend (increased role of past inflation) reverses. Supply shocks and a declining relative price trend (not shown here) explain a significant share of core inflation since the beginning of the COVID-19 pandemic.



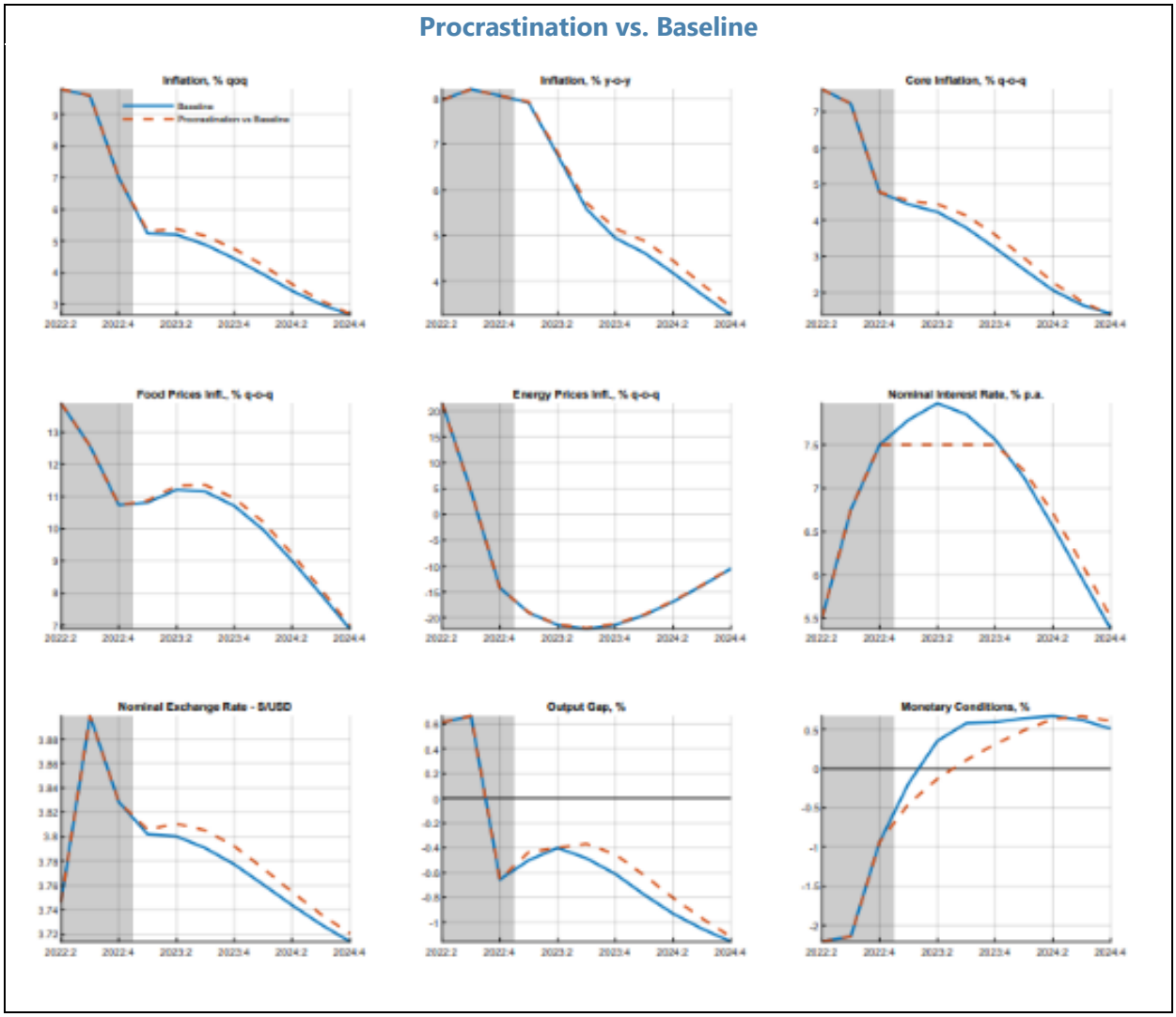
Forecasts

13. To illustrate the impact of the expected declines in food and energy inflation as well as possible central bank policy stance on headline inflation, we run several scenarios. The results suggest that the BCRP's data-driven monetary policy is appropriate.

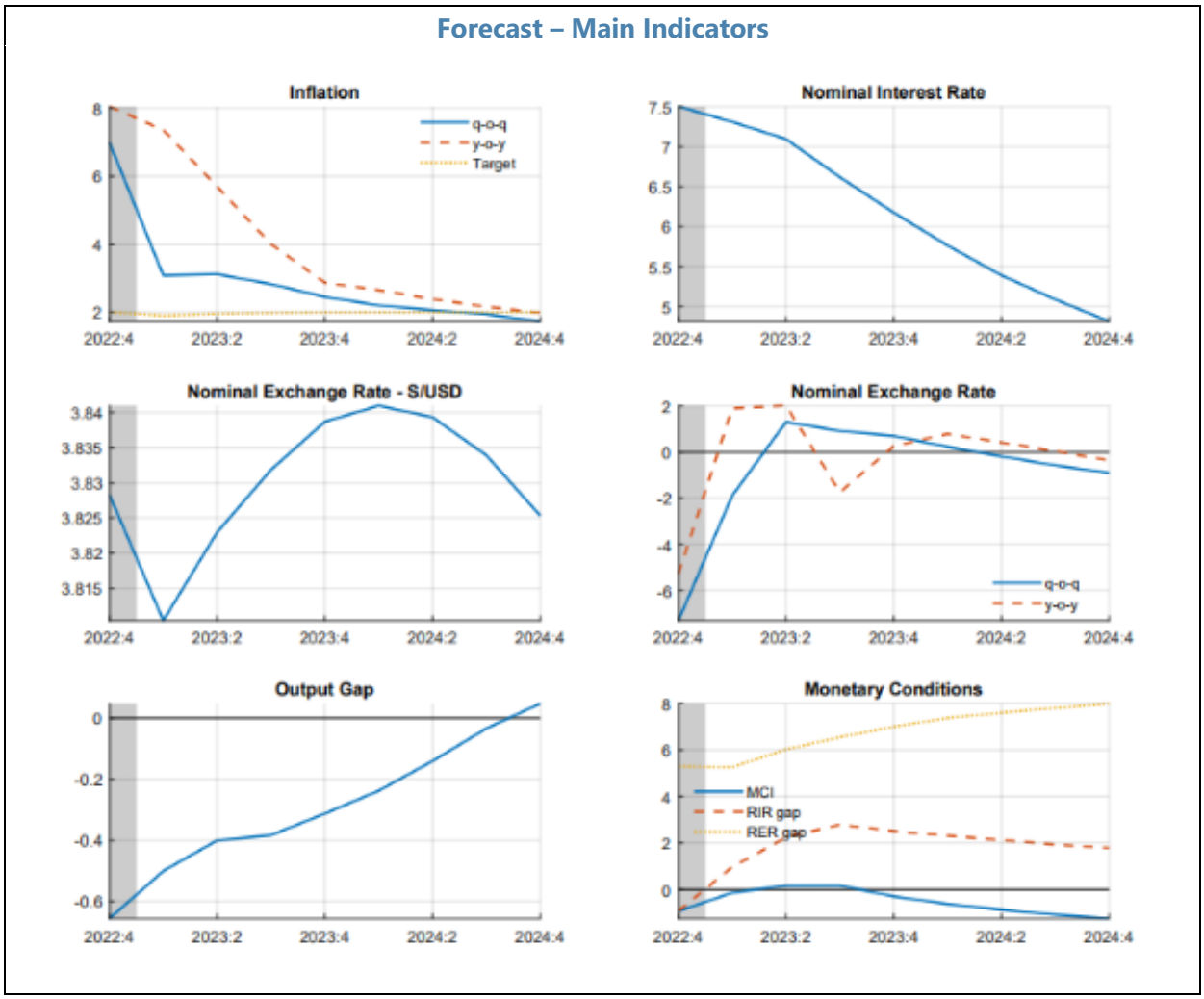
14. Scenario 1. Under this scenario, we make a forecast without considering expected declines in global food and energy prices in 2023-24. Under these conditions, headline inflation is expected to decline to about 5 percent in Q4, 2023, and to slightly above 3 percent in Q4, 2024 (still above the target range). Accordingly, the policy rate will increase to slightly above 8 percent by mid-2023 to reduce inflationary pressure. The exchange rate of the Sol appreciates as the interest rate differential against the foreign interest rates increases (under the UIP equation). Since the monetary conditions tighten, the growth rate falls, causing the negative output gap to widen. The policy rate starts to fall in the second half of 2023 as inflation declines toward the target range. Note that if we set g2 at levels below 1 (implying a less hawkish central bank), the inflation rate would be even higher.



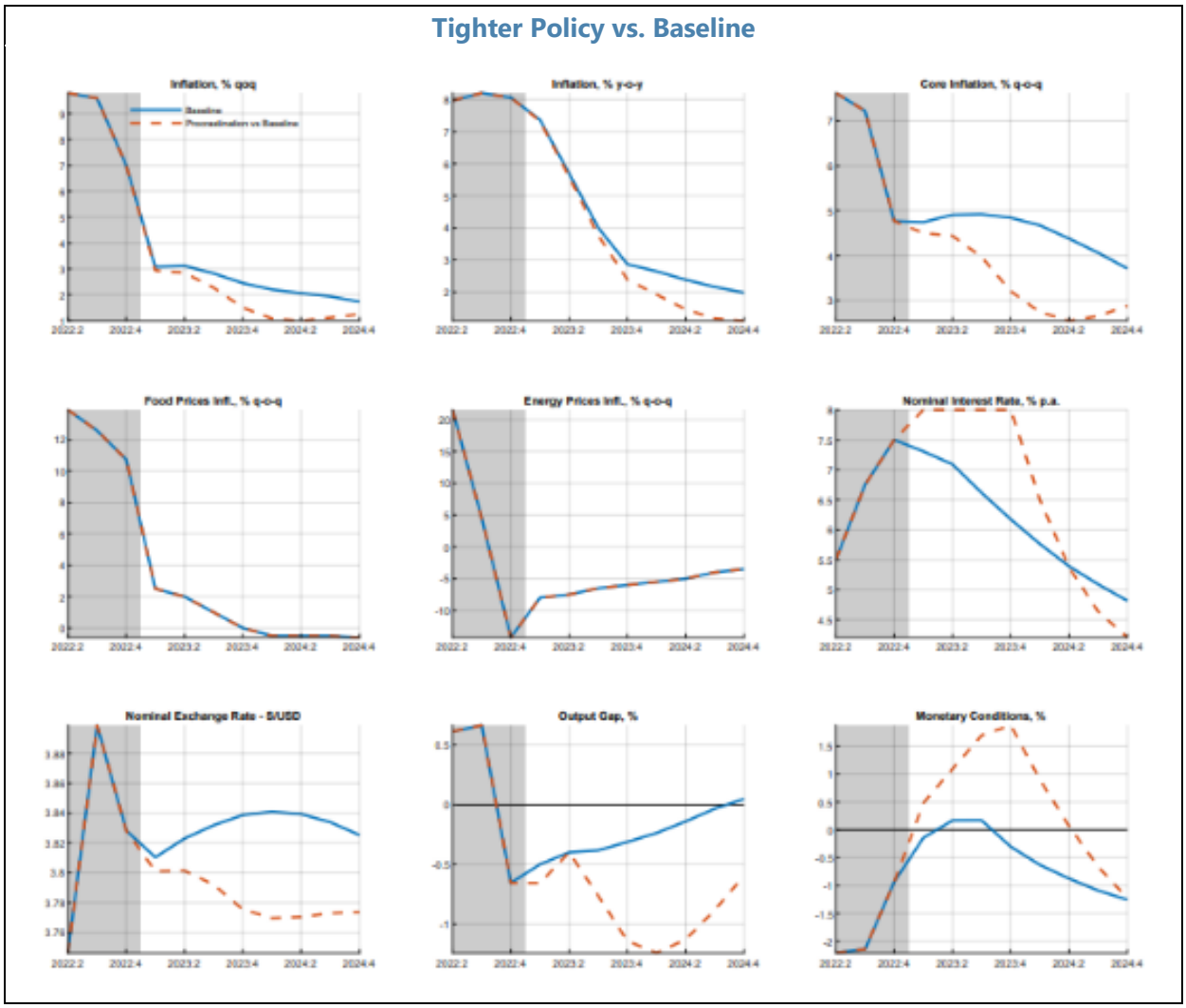
15. Scenario 2. Here, in addition to ignoring the expected declines in global food and energy inflation, we assume that the central bank does not respond to strong inflationary pressure and even slightly reduces its policy rate slightly and keeps it unchanged during 2023. This implies an expansionary policy, which leads to a depreciation of the currency and stronger growth (compared to the baseline), leading to higher inflation.



16. Scenario 3. Under this scenario, we take into account the expected declines in global food and energy prices in 2023-24. In this case, inflation falls within the target range by the end of 2023 and the center of the target range in late 2024. The interest rate is reduced throughout the forecast period as inflation/inflation expectations firmly decline. This leads to a slight depreciation of the currency. The declines in the interest rate and the depreciation of the currency, in turn, lead to stronger growth, with the (negative) output gap closing at the end of 2024.



17. **Scenario 4.** Under this scenario, in addition to taking into account the expected deceleration in global food and oil prices, we assume a stronger policy response to the current inflationary pressure than under the baseline. Specifically, we assume that the central bank increases its current policy rate to 8 percent and keeps it unchanged during 2023, even though inflation keeps falling in the year, with the real interest rate increasing to more than 6 percent by the end of 2023. This means a tighter policy stance, which leads to lower inflation and a stronger exchange rate. Accordingly, growth is weaker, with the negative output gap widening until early 2024.



Conclusion

18. The decomposition of inflation suggests that the monetary policy has been credible, but there is no room for complacency. In particular, the role of the forward-looking component in explaining inflation dynamics is significant, pointing to the credibility of the monetary policy target. However, the role of the backward-looking component has recently increased, which suggests that the monetary policy stance should be kept tight until this trend reverses. The decomposition of the output gap suggests that the easy monetary policy and exchange rate depreciation supported growth in 2020-22.

19. The model-based forecasts suggest that the BCRP's data-driven monetary policy is appropriate. In particular, the recent tightening of the monetary policy and the expected global food and energy prices disinflation can reduce headline inflation to the target range. Overly easy or tight policies, on the other hand, can lead to higher inflation or a larger negative output gap, respectively.

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Annex V. Risk Assessment Matrix

Risks	Likelihood	Time Horizon	Impact	Policy Response
Global Risks				
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation. **EMDEs:** A new bout of global financial tightening, possibly combined with volatile commodity prices, leads to spiking risk premia, debt distress, widening of external imbalances, fiscal pressures, and sudden stops.	Medium	Short term	**High.** Peru would be affected by a reduction of global trade and rising import prices. Lower exports and falling terms of trade would dent growth and exert downward pressure on the exchange rate.	**Use existing policy space** to soften the impact on growth and protect the most vulnerable. Allow the exchange rate to play its role as shock absorber. Exchange rate interventions could be used to prevent excessive volatility.
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations (e.g., reflecting China reopening) causes recurrent commodity price volatility, external and fiscal pressures, and social and economic instability.	Medium	Short term	**Medium.** Peru would be affected by volatile export and import prices. Food and energy prices account for over 40 percent of the consumption basket in Peru.	**Allow the exchange rate to play its role** as a shock absorber. If inflationary pressures build up, extend the tightening cycle within the inflation-targeting framework. Provide targeted fiscal support the most vulnerable.
Intensification of regional conflict(s). Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, refugee flows, FDI and financial flows, and payment systems.	High	Short term	**Medium.** Peru has been affected by the war in Ukraine mainly through the commodity price channel, with a negative impact on Peru's terms of trade.	**If inflationary pressures build up, extend the tightening cycle** within the inflation-targeting framework. Allow the exchange rate to play its role as a shock absorber. Provide targeted fiscal support to the most vulnerable.
Monetary policy miscalibration. Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	Medium	Short term	**Medium.** A tightening in financial conditions abroad could lead to large capital outflows from Peru. The risk is mitigated by large policy buffers, including access to an FCL. The financial sector can absorb major shocks.	**Extend the monetary tightening cycle** and continue communicating a strong commitment to the inflation target. Allow the exchange rate to play its role as shock absorber. Exchange rate interventions could be used to prevent excessive volatility. Use fiscal buffers to provide targeted fiscal support to the most vulnerable.

Risks	Likelihood	Time Horizon	Impact	Policy Response
Systemic financial instability. Sharp swings in real interest rates, risk premia, and assets repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing markets dislocations and adverse cross-border spillovers.	**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.	**Extend the monetary tightening cycle** and continue communicating a strong commitment to the inflation target. Allow the exchange rate to play its role as shock absorber. Exchange rate interventions could be used to prevent excessive volatility. Use fiscal buffers to provide targeted fiscal support to the most vulnerable.
Domestic Risks				
Social unrest. Persistent inflation, slowing economic growth, and declining incomes amplify risks of social unrest. Political polarization and instability weaken policymaking and confidence.	**High**	**Short/ Medium term**	**High.** Political uncertainty and social conflict could 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	**Strengthen governance** and enhance anti-corruption enforcement efforts. Accelerate structural reforms aimed at increasing potential GDP.
Natural disasters related to climate change. More frequent natural disasters deal severe damage to infrastructure (especially in smaller vulnerable economies) and amplify supply chain disruptions and inflationary pressures, causing water and food shortages and reducing medium-term growth.	**Medium**	**Medium term**	**High.** Peru is highly vulnerable to natural disasters related to 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. The Integrated Policy Framework and Underlying Frictions

Peru has followed an inflation-targeting regime since 2002, adapted to account for risks associated with financial dollarization, with a managed floating exchange rate. Despite political uncertainty and global economic headwinds, the BCRP has successfully contained exchange rate volatility through foreign exchange interventions (FXI). The recently adopted IMF Integrated Policy Framework (IPF) allows for a structured, frictions-based approach to the use of FXIs, complementary to the general recommendation to counter disorderly market conditions. FXIs could be justified in response to large shocks that present significant risks to the central bank's price and stability objectives when frictions, including shallow markets and FX mismatches, exist. This annex provides a discussion of underlying frictions in Peru, thus placing the central bank's FXI in the context of the IPF. A risk-based intervention range for Peru is also discussed.

The Integrated Policy Framework

1. Under the IMF's Integrated Surveillance Decision (ISD), FXIs are justified in response to disorderly market conditions (DMCs). These conditions "may be characterized inter alia by disruptive short-term movements in the exchange rate" of a country's domestic currency. The recently adopted Integrated Policy Framework (IPF), which modernizes the IMF's thinking about policy responses to shocks, takes a more nuanced approach to DMCs and provides the foundations for deeper, frictions-based advice on FXI. The IPF draws on insights from modeling, empirical analysis, and a review of country cases. The IPF incorporates frictions associated with cross-border capital flows and explores the joint use of policy levers—that is, the role of the monetary, exchange rate, macroprudential and capital flow management policies and their interactions with each other and other policies. Under the IPF, there is a role for FXI when sharp exchange rate movements impede the central bank's ability to deliver price stability (either because inflation expectations may be at risk of de-anchoring, or because borrowing rates spike unrelatedly to domestic policy changes) or generate broader financial stability risks (because of large FX exposures).

2. The IPF framework provides general principles and specific use cases tied to key IPF frictions. The general principles are that FXI should: (i) be undertaken only in the presence of well-identified frictions; (ii) be used only if shocks are large enough to pose significant risks to central bank price and financial stability objectives; (iii) not substitute for a warranted adjustment of macroeconomic (fiscal and monetary) policies; (iv) be integrated within the overall policy response which includes other IPF policies; (v) be accompanied by strong central bank governance and communication; (vi) consider intertemporal trade-offs in spending and accumulating reserves; and (vii) consider multilateral effects. The framework identifies three specific use cases under which FXI may be appropriate: (i) to address premia from arbitrage frictions in shallow FX markets; (ii) to counter financial stability risks from FX mismatches; and (iii) to preserve price stability when exchange rate changes risk de-anchoring inflation expectations.

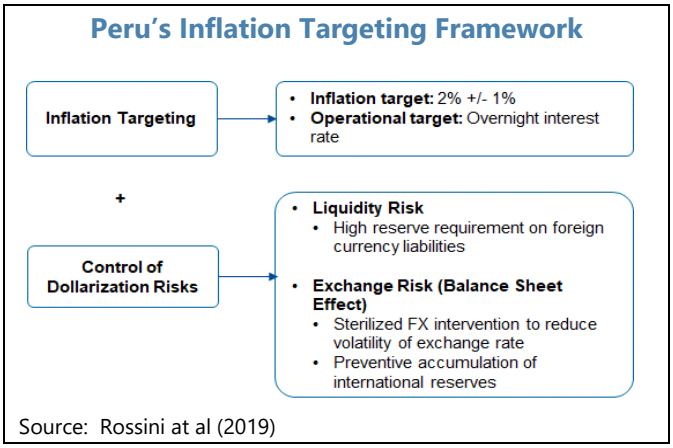
Peru's Multi-Policy Framework

3. Peru uses a multi-policy framework which has been effective in responding to shocks, maintaining inflation low and stable, and keeping the financial system sound. Fiscal policy is anchored in a fiscal rule, while monetary policy follows an inflation targeting regime adapted to respond to two key vulnerabilities associated with financial dollarization. First, in dollarized economies capital outflow episodes can trigger foreign currency liquidity shortages for banks and put pressure on international reserves if central bank liquidity support is needed. Second, currency mismatches in the balance sheets of non-tradable firms and households can amplify the impact of a currency depreciation on credit risk and induce a financial crisis. Because of these two vulnerabilities, Peru's framework includes sterilized FXIs to reduce the volatility of the exchange rate, preventive accumulation of international reserves and high reserve requirements on foreign currency liabilities to mitigate liquidity risk (see text chart). Most macroprudential instruments are managed by the Superintendence of Banks, but reserve requirements are managed by the central bank.

4. There is less reliance on FXI as a policy instrument. Over time, declining dollarization, new macroprudential tools, and the changing nature of shocks have facilitated a transition towards a more intense use of monetary policy and away from FXI (see text chart).

- ***During the boom period 2002-07***, the BCRP responded to large capital inflows and favorable terms of trade by increasing the policy rate and reserve requirements, along with FXI to smooth appreciation pressures. Fiscal policy was countercyclical, while macroprudential rules (dynamic provisioning and countercyclical buffers) were activated to dampen the financial cycle.

- ***During the bust period 2008-11***, as terms of trade worsened and capital inflows stalled, fiscal policy provided a positive fiscal impulse, the macroprudential rules for dynamic provisioning and countercyclical buffers were deactivated, and FXIs were used to smooth the depreciation of the currency. The policy rate was initially reduced but hiked again when inflation breached the upper bound of the target range. FX reserve requirements were increased to reduce dollarization, and other de-dollarization tools (thresholds for foreign currency lending combined with currency repos) were also introduced.



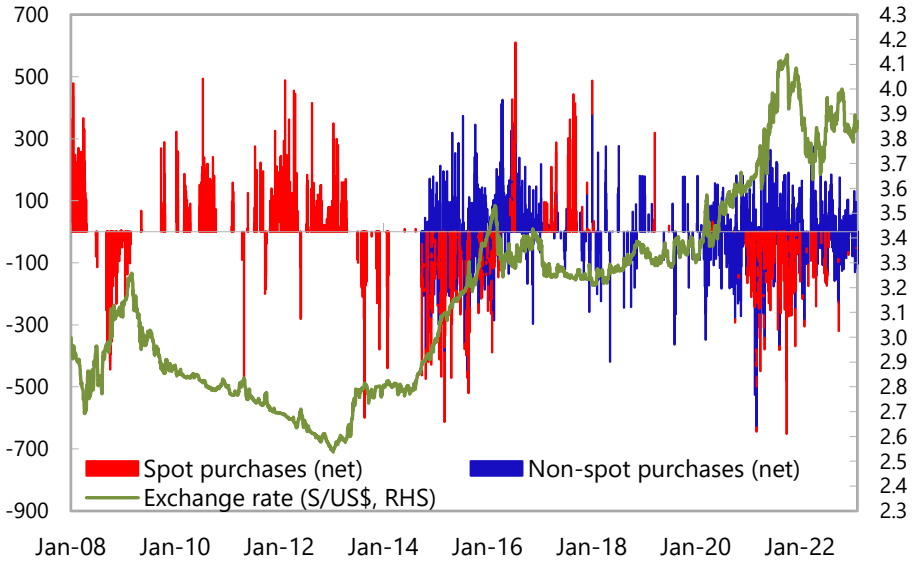
Source: Rossini at al (2019)

- ***During the period 2012-2019***, in the face of declining terms of trade and volatile capital flows, macroprudential polices were more aggressively deployed, and more flexibility was allowed in the exchange rate. [1]

[1] For a more detailed discussion, see Ghazanchyan at all, 2020.

- ***During the global COVID-19 pandemic 2020-2022***, fiscal policy provided a significant impulse at the onset of the pandemic, and the policy rate was reduced to a historic low. FX liquidity was made available to the market during periods of stress and macroprudential policies were eased by reducing the countercyclical capital buffer for financial institutions. The weekly threshold for operations with FX derivatives above which financial institutions were required to have additional reserves was raised. As activity rebounded strongly in 2021 and terms of trade reversed, but large short-term capital outflows were triggered by political uncertainty, FXIs were used to smooth exchange rate volatility and accumulate reserves. In 2022, the policy rate was raised to respond to inflationary pressures driven by energy and food import prices and currency depreciation.

Figure 1. Peru: Exchange Rate and Foreign Exchange Intervention
(Millions of US dollars)



Sources: Bloomberg; BCRP; and IMF staff calculations.
Note: Non-spot instruments include net maturity of CDR BCRP, net maturity of FX (sell) swaps, net issuance of CDLD and net purchases of FX (buy) swaps. An increase is equivalent to a purchase of foreign exchange.

5. Nevertheless, FXIs have remained a complementary tool to preserve macro-financial stability. While originally FXIs were performed mostly through transactions in the spot market, over time, the BCRP has made use of a central bank security indexed to the exchange rate (CDR, since 2002) and currency swaps (since 2014). The latter form the bulk of the interventions nowadays, with the important advantage that they do not affect liquidity in local currency, being settled at the end of the contract on a net basis, and thus no requiring sterilization by the central bank (Rossini at al., 2019). Intervention frequency has increased since the onset of the pandemic, particularly in 2021 as a result of large capital outflows and political uncertainty.

Characteristics of the Peruvian Economy and Underlying Frictions

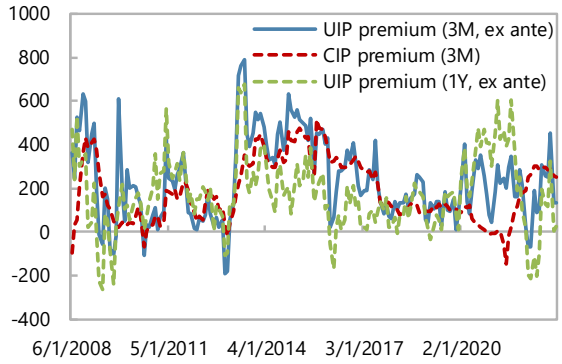
6. Peru's foreign exchange market has continued to develop over the past decade, yet several indicators suggest that market shallowness may require the use of FXIs (Figure 2). The presence of uncovered interest parity (UIP) premia, both ex-ante and ex-post, exist at both short (3 months) and long (1 year) horizons, widening during periods of capital outflows; the latter are shown at a high frequency by using bond and equity fund flows. At the same time, a persistent covered interest parity (CIP) premium over short horizons closely tracks the UIP premium, suggesting hedging inefficiencies that are correlated with volatile capital flows; however, the CIP premium disappears over longer horizons. Overall, premia have been more volatile since the COVID-19 pandemic, reflecting both the increased volatility in capital flows, as well as the persistent increase in political uncertainty. The high share of foreign investors in the local currency sovereign bond market—holding 41 percent of outstanding bonds—presents a further risk, as these investors' flows are especially sensitive to exchange rate movements (Figure 3). FXIs display high negative correlation with UIP premia (around 48 percent), indicating that spikes (troughs) in premia correlate with FX sales (purchases). While there is a need to curtail premia and the central bank has been active in reducing volatility, intervention has likely crowded out FX operations in the private sector, indicated by the stagnant FX turnover.

7. The Peruvian economy remains highly dollarized, further supporting the case for the use of FXIs (Figures 3 and 4). Over the past two decades, Peru has managed to bring dollarization down significantly; currently, deposit and credit dollarization stand at 23 and 37 percent from over 50 percent a decade ago. High rates of dollarization create financial stability risks associated with unhedged foreign currency borrowing. In Peru, total FX credit to FX deposits stands at 17 percent and 142 percent for households and corporates. While this indicates possible financial stability risks to households borrowing in foreign currency, it is also worth examining corporates more closely. Large corporates and SMEs have the highest rates of dollarization but also the greatest access to FX hedges; very small enterprises and consumers have relatively low rates of dollarization but low access to FX hedges. More specifically, high rates of dollarization in mining (98 percent), agriculture and fishing (72 percent), and manufacturing (60 percent) are partially offset through foreign currency invoicing and access to hedging instruments such as FX swaps; once accounting for these, the exposure to foreign currency risk declines significantly for these sectors. Other sectors with a lower overall share in FX debt have a higher exposure to FX risks, in particular electricity and water and services. Sectors with greater exposure to exchange rate risk also have high leverage ratios and low coverage ratios, further indicators of looming financial stability vulnerabilities that can be exacerbated through currency mismatches. FXI to mitigate volatility and smooth large movements in the exchange rate may help exposed corporates adjust their mismatches without engaging in a vicious macro-financial spiral.

Figure 2. Peru: Market Depth Indicators

Interest parity premia

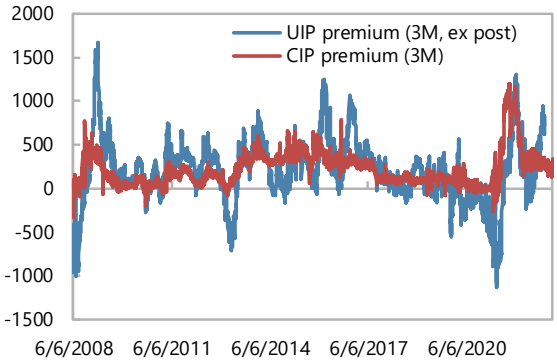
(Bps)



Sources: Consensus Forecast, Refinitiv, IMF staff calculations

Interest parity premia, 3 months

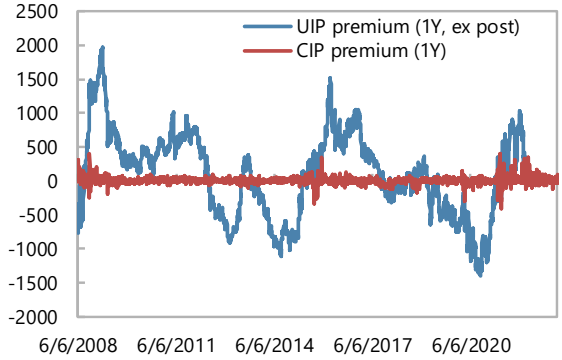
(Bps)



Sources: Refinitiv, IMF staff calculations

Interest parity premia, 1 year

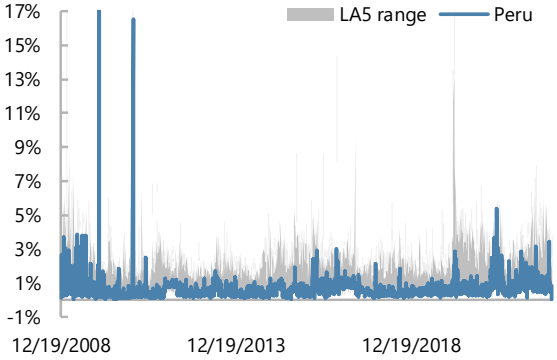
(Bps)



Sources: Refinitiv, IMF staff calculations

Quoted bid-ask spread

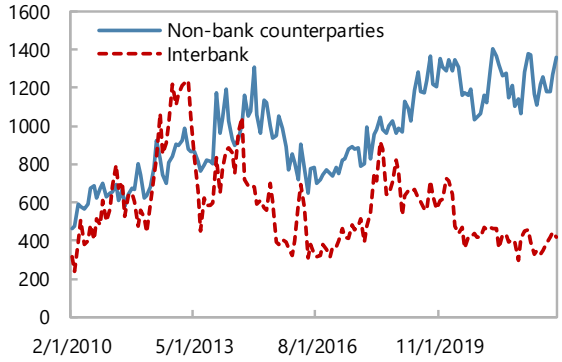
(Percent)



Sources: Bloomberg, IMF staff calculations

FX turnover

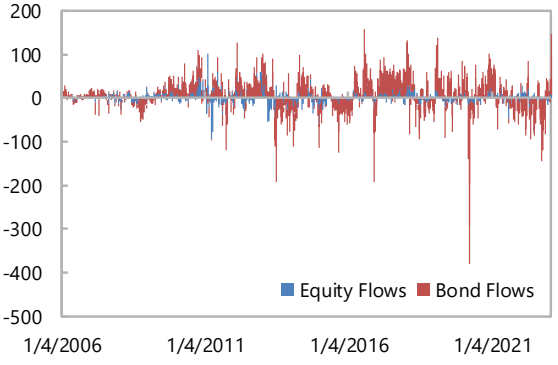
(USD mn)



Sources: BCRP

Weekly fund flows

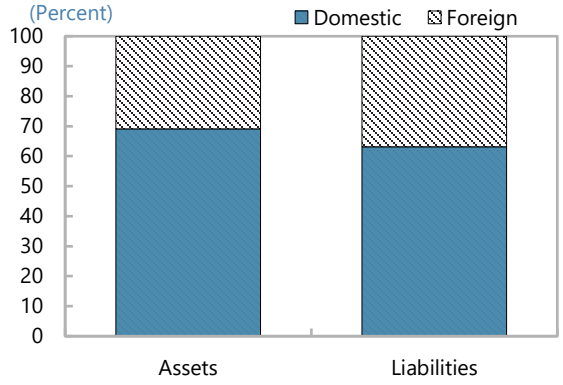
(USD mn)



Sources: EPRF

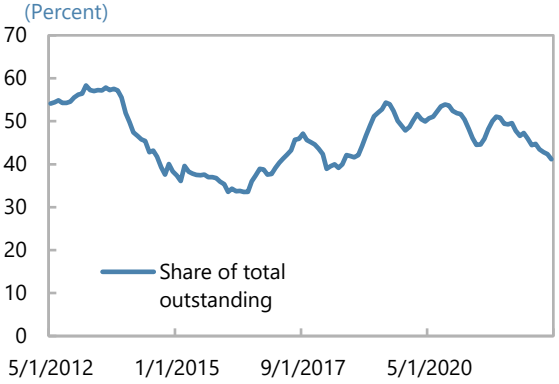
Figure 3. Peru: Currency Mismatch Indicators

Bank exposures by currency, December 2022



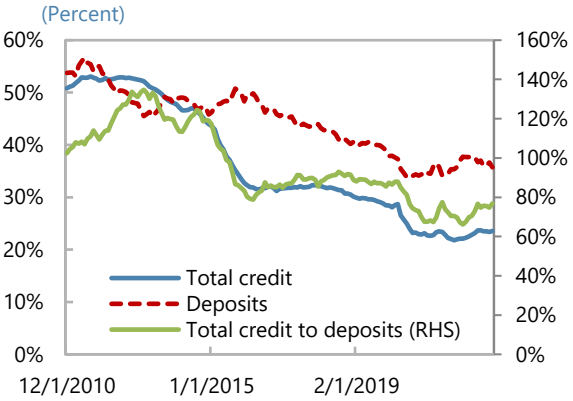
Sources: SBS

Sovereign bonds held by non-residents



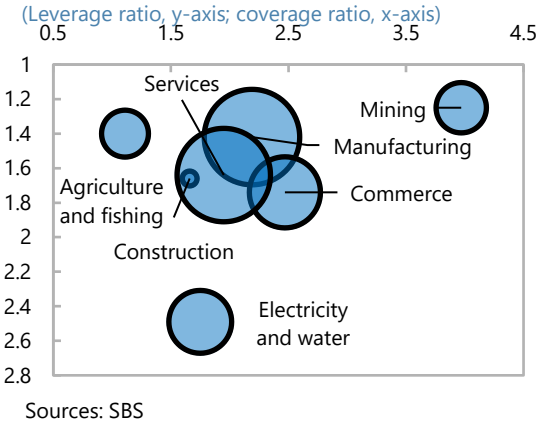
Sources: BCRP

Dollarization rates



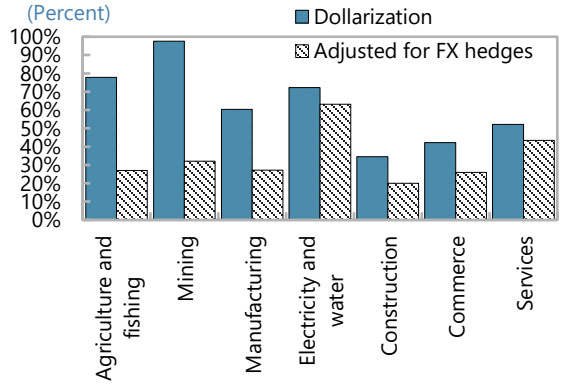
Sources: BCRP

Sectoral debt



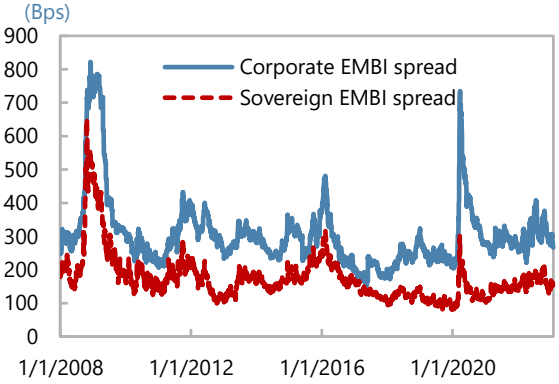
Sources: SBS

Debt dollarization by sector



Sources: SBS

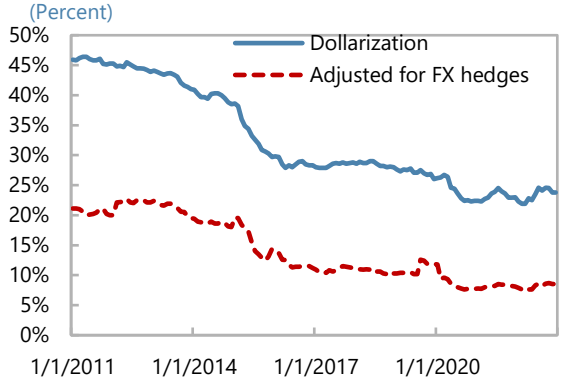
EMBI spreads



Sources: J.P. Morgan

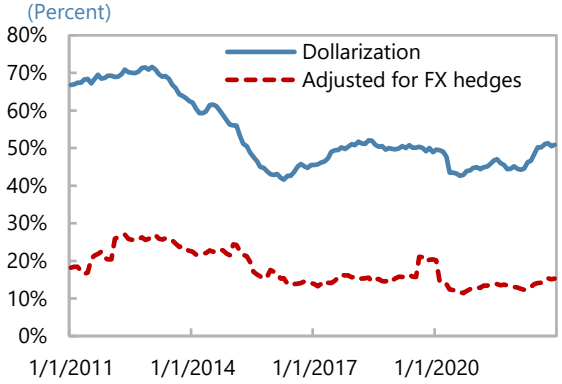
Figure 4. Peru: Credit Exposure to Currency Risk

Total credit
(Percent)



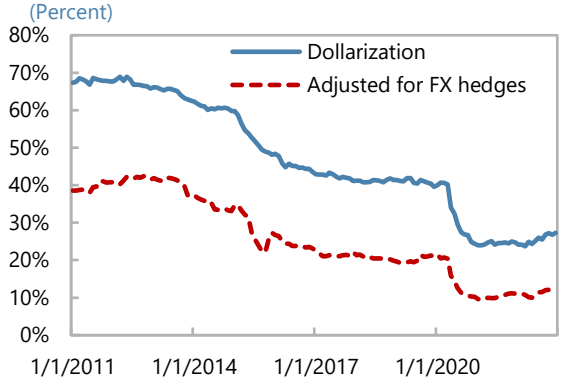
Sources: SBS

Credit to large corporates
(Percent)



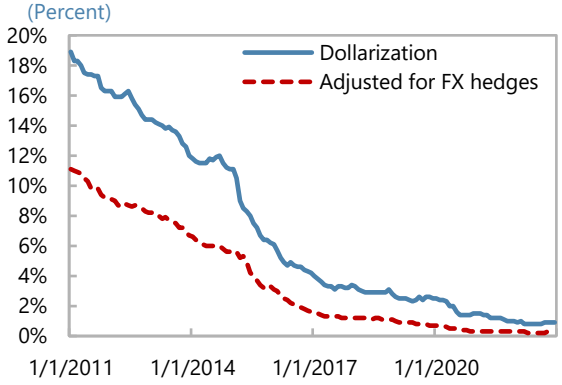
Sources: SBS

Credit to SMEs
(Percent)



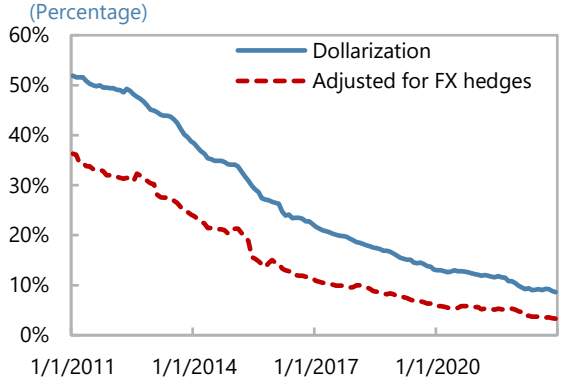
Sources: SBS

Credit to very small enterprises
(Percent)



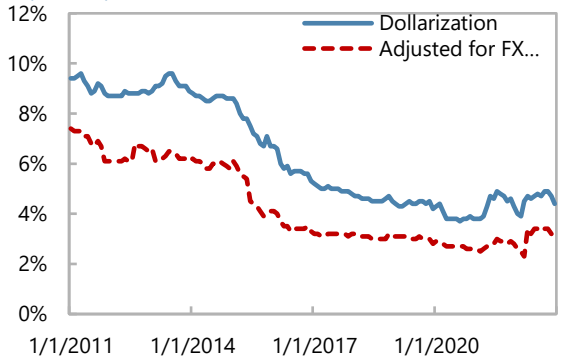
Sources: SBS

Mortgage credit
(Percentage)



Sources: SBS

Consumer credit
(Percent)



Sources: SBS

8. Inflation expectations in Peru are well-anchored and FXI has not been used to address the BCRP's price stability mandate. The BCRP has implemented a successful inflation-targeting regime over the past two decades. Exchange-rate pass-through is limited, as is co-movement of the exchange rate with inflation and inflation expectations.

A Rules-Based Case for FXIs

9. Targeted FXIs can address issues with market depth and currency mismatch while permitting the development of the private foreign exchange market. There exist clear indications that FXIs may be justified in Peru, but this does not mean that intervention is always warranted. Indeed, the IPF calls for intervention in response to large, temporary, destabilizing shocks that are not a result of other domestic policies. One option for determining an intervention region—that is, a region of appreciation or depreciation in the exchange rate that may warrant but does not require intervention—is to consider risk-based interventions, as defined in Lafarguette and Veyrune (2021). A risk-based framework can address issues of excess volatility and simultaneously circumvent issues with excessive interventions.

10. Targeted interventions based on a value-at-risk approach to the exchange rate can minimize the number of interventions required to curtail volatility (Figure 5). By modeling the conditional volatility of FX returns along with market fundamentals to capture premia, mismatch, and commodity prices, we can construct an asymmetric, time-varying distribution for FX returns by parametrizing a skew t-distribution.[2] With this in hand, we can set an intervention region depending on the risk tolerance of the central bank. For example, a central bank that wants to tightly control FX volatility would choose a value-at-risk with a higher probability value, whereas a central bank preferring more flexible control of FX volatility would choose a value-at-risk with a lower probability value. In the example provided in Figure 5, the 5 percent level is chosen. With information as of January 31, 2023, the intervention region is set an appreciation beyond 78 bps and a depreciation beyond 64 bps in the exchange rate. If we were to apply this tolerance over the entire sample, the number of FXIs would be much more limited than has been the historical experience in Peru. Of course, it is possible to use such a framework as a guide to transition from a more interventionist regime to a more flexible regime, thereby allowing the private markets to develop more gradually over time.

Conclusions

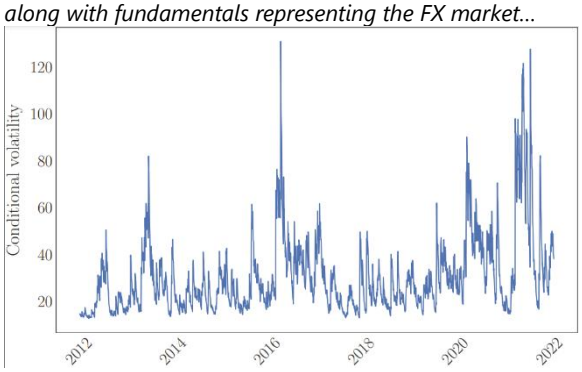
11. The IPF framework offers insights to address shocks interacting with underlying frictions that generate disorderly market conditions. Given the extent of shallow FX markets in Peru, FXIs and macroprudential policies may be used to smooth large changes in hedging and financing premia when capital flow shocks generate sharp destabilizing changes in premia with implications for macroeconomic and financial stability. In this case, FXIs should aim to ensure that markets function appropriately, primarily targeting the premia rather than the exchange rate per se. In case of an episode of large depreciation increasing financial stability risks from FX mismatches,

[2] For details, see Lafarguette and Veyrune (2021).

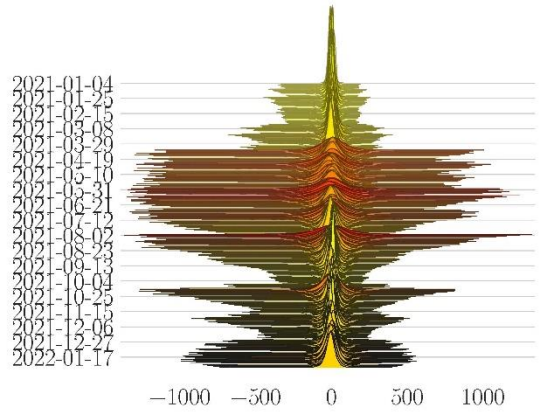
FXIs can help prevent the adverse macro-financial amplification, irrespective of whether the initial shock is real or financial. If FX mismatches continue to decline, such financial stability risks should also be mitigated, reducing the need for FXIs for this motive, while the case for smoothing large destabilizing changes in premia arising from market shallowness would continue to exist. Future work could explore, making use also of the IPF conceptual and analytical models, of policy tradeoffs and interactions. At the same time, a risk-based approach to interventions would allow for more flexibility and a gradual deepening of FX markets over time.

Figure 5. Peru: A Risk-Based Intervention Model for Peru

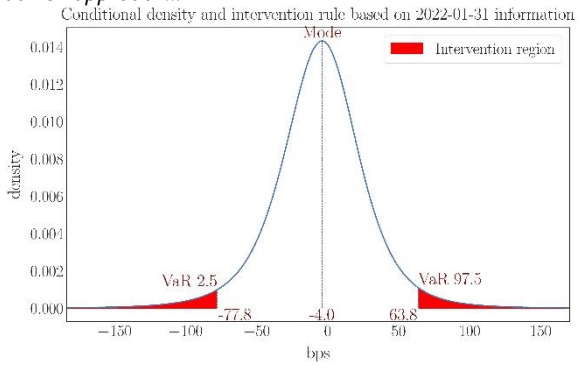
The conditional volatility of FX returns can be modeled along with fundamentals representing the FX market…



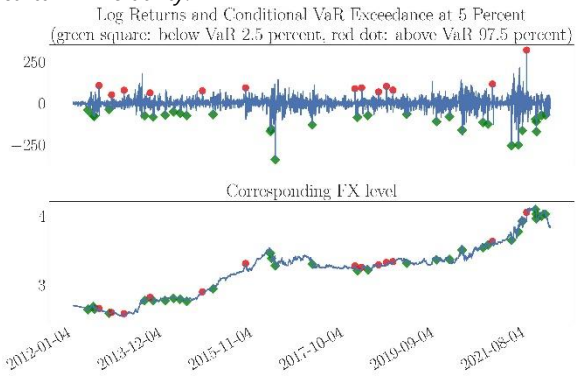
…and then used to construct asymmetric, time-varying estimates of the FX return distribution.



An intervention region can be chosen based on the value-at-risk approach…



…thereby limiting the number of requisite interventions to curtail FX volatility.



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Annex VII. General Policy Considerations for the Pension System

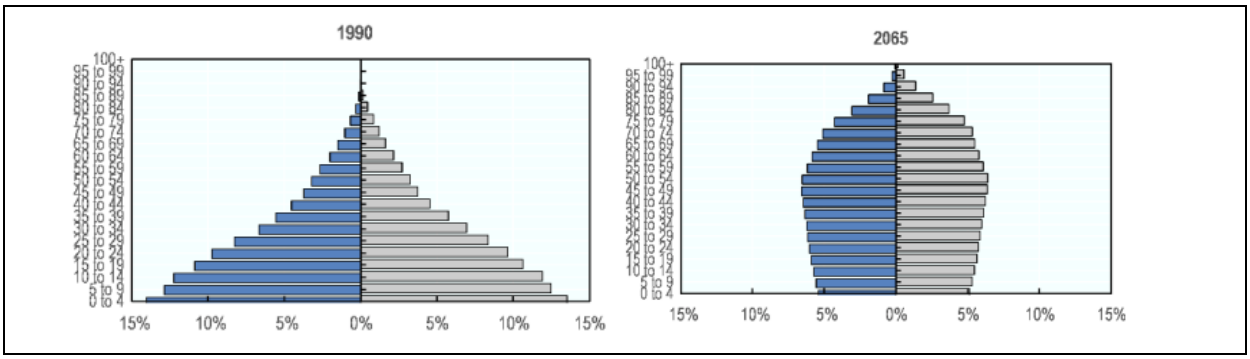
The Peruvian pension system does not fulfill the main objectives of pensions, namely, to protect the elderly against old age poverty and provide regular income upon retirement. Early withdrawals from the private system since the pandemic, amounting to close to half of reserves or 10 percent of GDP, may pose risks such as the viability of the private scheme, higher financing costs for the government, lower national savings, and slower development of capital markets. A lack of a systemic pension assessment and reform has kept the public and private systems in competition, while the social pension could be improved by broader coverage and higher adequacy. In the short-term, non-critical early withdrawals should be stopped and lump-sum payments replaced with regular pension payments. In the medium term, the social pension likely will need to be expanded in a fiscally neutral manner, as part of an overhaul of the country's pension system.

Overview

1. The Peruvian pensions system is composed of three main components. These include: (i) a publicly funded defined benefit (DB) scheme, *Sistema Nacional de Pensiones (SNP);* (ii) a privately funded defined contribution (DC) scheme, *Sistema Privado de Pensiones (SPP);* and (iii) a non-contributory pension, *Pensión 65*. The SNP is administered by the *Oficina de Normalization Previsional (ONP).* The SNP contribution rate is 13 percent and the minimum vesting period is 20 years, though in recent years the vesting period had been shortened to 15 and 10 years, which results in a lower pension payment. The private system, SPP, was created in 1992 to expand the pension system and not solely rely on the pay-as-you-go (PAYG) SNP. Contributions are roughly equal to the SNP at 10 percent, a commission to *administradoras de fondos de pensiones* (AFPs), plus a disability and survivor premium. The 1992 Decree Law 25897 established the funded pension scheme to ensure the fiscal sustainability of the pay-as-you-go national pension. The law also created a non-contributory social pension, *Pensión 65*. *Pensión 65* is a poverty-tested social pension. There are also voluntary schemes and more than 15 special schemes.

Issues

2. Old-age pensions should play an important role in income smoothing and mitigating old-age poverty, though in this regard, pensions are relatively ineffective in Peru. The country faces demographic challenges, which will place increasing strain on the sustainably of the public pay-as-you-go system. High labor market informality results in low pension contribution frequencies (and therefore low contribution densities). Despite the importance of pensions, Peru's pension system does not cover the majority of the population with approximately 25 percent of the labor force making a pension contribution and most elderly not receiving a pension. Further, lumpsum withdrawals are allowed, which negate the regular old age income benefits payments that pensions are supposed to provide. Further, high informality with most Peruvians not contributing, and if they do so, only on an infrequent basis, results in low payouts.



3. Peru has unique pension design issues—such as lumpsum payouts—and more recently early withdraws—that undermine the system. Early lump-sum withdrawals – of around 95 percent of individual account assets - since the pandemic have greatly weakened the system. While early in the pandemic, with the slowdown in economic activity, may have made such withdrawals more warranted, they have since continued, with the private pension scheme assets declining from 22 percent of GDP in 2020 to around 12 percent in 2022. This places many elderly at risk once they deplete their savings. Further, in a recent meeting of the finance minister with foreign investors in February 2023, investors stated that early pension withdrawals and the related decrease in liquidity – and the political situation – are primary concerns.[19] The former represents a financing risk for the government with potentially a smaller share of domestic and foreign purchasers of Peruvian debt and equities, which may in turn increase borrowing costs, slow growth, and hinder capital market development.

Policy Advice

4. Ensure the current systems survives as best as possible, and then enact a comprehensive reform.

- ***A moratorium should be placed on early withdrawals in the short term.*** Such withdrawals should be limited to a terminal illness and potentially a small amount for housing, while excluding unemployment and other non-cataphatic events. There should be caps for the entire pension system – public and private – such as permitting 80-100 percent withdrawal for terminal illness and 10-20 percent one-off cumulative withdrawals for housing. Voluntary schemes can allow for more flexibility.

- ***Expand the social pension—possibly universally—in a budget neutral and savings compatible manner over the medium term***. The level of the social pension could be set at the poverty line or very slightly above, which could induce the majority of the population to contribute to existing pension schemes and national savings. The scheme should be budget

[19] https://www.bloomberg.com/news/articles/2023-02-08/peru-finance-chief-sees-investors-tense-about-pensions-election#xj4y7vzkg

neutral – e.g., via taxation on housing or via custom tariffs on luxury and/or items with negative externalities (e.g., diesel, tobacco).

- ***Ensure the entire pension system's long-term viability by addressing the shortcomings of both the publicly funded system and the private system.*** This requires a significant reform of both the public pay-as-you-go component to make it more fiscally sustainable and equitable and the privately funded DC scheme able to fulfill basic pension functions.

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Annex VIII. Sovereign Risk and Debt Sustainability Analysis

Peru's overall risk of sovereign stress is low and public debt is sustainable with a high probability. This assessment is not surprising given that Peru is the country with the lowest level of public debt (as a percent of GDP) in the region and possesses a significant amount of assets.

1. The public debt ratio and other indicators have stabilized as the recovery from the COVID-19 pandemic has advanced. Public debt is expected to stabilize over the medium term and fall toward the long-run debt target reflecting the planned fiscal consolidation envisioned in the fiscal rules. The shares of foreign and domestic-currency denominated debt, marketable debt, and the residual maturity profile of public debt are expected to remain broadly stable over the forecast horizon.

2. The statistical coverage of Peru's public debt statistics is that of the Non-Financial Public Sector, beyond the minimum required (general government). The sovereign's investor base is well diversified, and the law of the debt is equally distributed between local and foreign. The lion's share of public debt is marketable, with over ten years of residual maturity.

3. The realism analysis of the baseline scenario does not point to major concerns. The forecast track record for the main debt drivers does not reveal any systematic bias, and the projected fiscal consolidation is well within norms. The real GDP growth forecast in the baseline is consistent with reasonable estimates of the fiscal multiplier.

4. Medium-term liquidity risks are low, as signaled by the GFN Financeability Module and supported by low gross financing needs, and the strength of the macroeconomic policy frameworks and institutions, while the Fanchart module points to moderate levels of risk. In turn, long-term risks are low. Stress tests suggest that debt would remain manageable under risk scenarios of sharp falls in commodity prices and large borrowing needs arising from natural disasters. Risks from large amortization profiles are assessed as low. Aging-related public spending on health and pensions are expected to be accommodated within the fiscal rules.

Figure 1. Peru: Public Debt Sustainability Analysis—Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Low	The overall risk of sovereign stres is low, reflecting low levels of vulnerability in the medium and long term horizons.
Near term 1/	…	…	The risk of sovereing stress is low over the near term, owing to low levels of debt, a strong fiscal position, and solid buffers.
Medium term	Low	Low	Medium-term risks are assessed as low on the basis of the strength of macroeconomic policy frameworks and institutions, and low gross financing needs.
Fanchart	Moderate	…	
GFN	Low	…	
Stress test	…	…	
Long term	…	Low	Risks from large amortization profiles in the long term are low. Aging-related public spending on health and pensions are expected to be accommodated within the fiscal rules.
Sustainability assessment 2/	…	Sustainable with high probability	The projected debt path is expected to stabilize and GFNs will remain at manageable levels, conditional on the implementation of the planned fiscal adjustment measures envisioned in the fiscal rules. Debt is assessed as sustainable with high probability.
Debt stabilization in the baseline			Yes

DSA summary assessment

Commentary: Peru's overall risk of sovereign stress is low and public debt is sustainable with a high probability. The public debt ratio and other indicators have stabilized as the recovery from the COVID-19 pandemic has advanced. The public debt ratio is expected to stabilize over the medium term as the authorities proceed with a planned fiscal consolidation. Medium-term liquidity risks are low, as signaled by GFN Financeability Module and supported by the strength of the macroeconomic policy frameworks and institutions. Long term risks are low.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure 2. Peru: Public Debt Sustainability Analysis—Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

					Subsectors captured in the baseline	Inclusion	
CPS	NFPS	GG: expected	CG	1	Budgetary central government	Yes	
				2	Extra budgetary funds (EBFs)	Yes	Not applicable
				3	Social security funds (SSFs)	Yes	
				4	State governments	Yes	
				5	Local governments	Yes	
				6	Public nonfinancial corporations	Yes	
				7	Central bank	No	
				8	Other public financial corporations	No	

	Currency & deposits	Loans	Debt securities	Oth. acct. payable 2/	IPSGSs 3/
3. Instrument coverage:					

	Basis of recording		Valuation of debt stock		
4. Accounting principles:	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

	Consolidated	Non-consolidated
5. Debt consolidation across sectors:		

Color code: chosen coverage | Missing from recommended coverage | Not applicable

Reporting on intra-government debt holdings

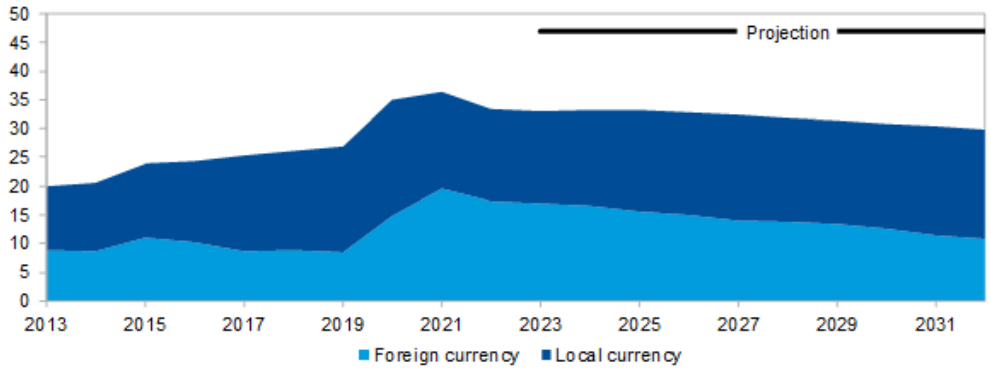
				Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS	NFPS	GG: expected	CG	1	Budget. central govt								
				2	Extra-budget. funds	2,681							2,681
				3	Social security funds	406							406
				4	State govt.	1,267							1,267
				5	Local govt.								
				6	Nonfin pub. corp.	1,509							1,509
				7	Central bank	7,442							7,442
				8	Oth. pub. fin. corp	7,142							7,142
					Total	20,447	0	0	0	0	0	0	0	20,447

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: Millions of PEN. Only includes debt securities and loans from the BCG to subnational governments and the rest of the public sector.

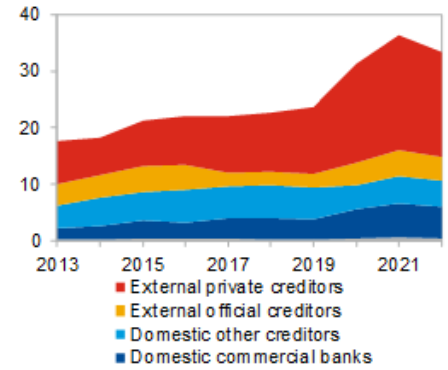
Figure 3. Peru: Public Debt Sustainability Analysis—Public Debt Structure Indicators

Debt by currency (percent of GDP)



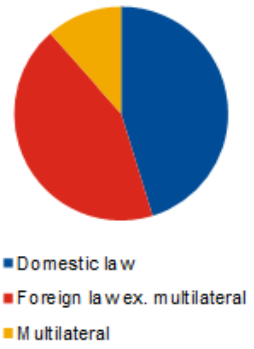
Note: The perimeter shown is nonfinancial public sector.

Public debt by holder (percent of GDP)



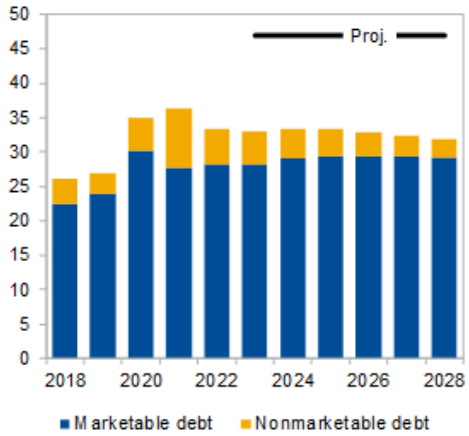
Note: The perimeter shown is nonfinancial public sector.

Public debt by governing law, 2022 (percent)



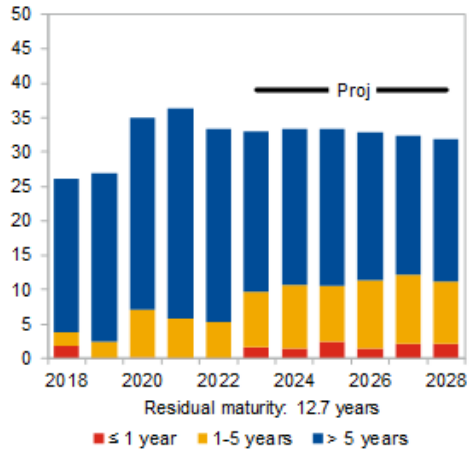
Note: The perimeter shown is nonfinancial public sector.

Debt by instruments (percent of GDP)



Note: The perimeter shown is nonfinancial public sector.

Public debt by maturity (percent of GDP)



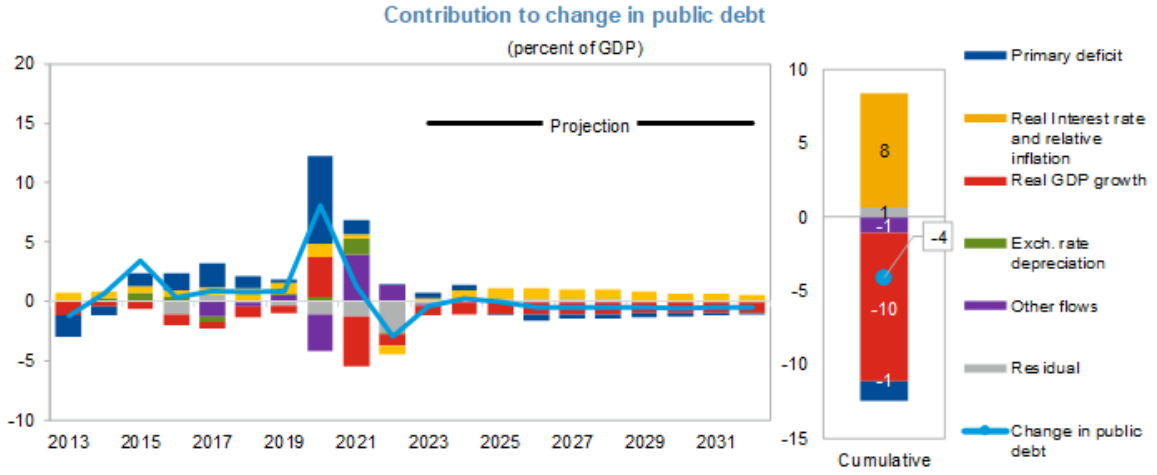
Note: The perimeter shown is nonfinancial public sector.

Commentary: The share of domestic and foreign-currency denominated public debt is expected to remain broadly stable over the forecast horizon. The lion's share of public debt is expected to remain marketable, and with a residual maturity longer than 10 years. The investor base is well diversified, and the lawof the debt is equally distributed between local and foreign.

Figure 4. Peru: Public Debt Sustainability Analysis—Baseline Scenario

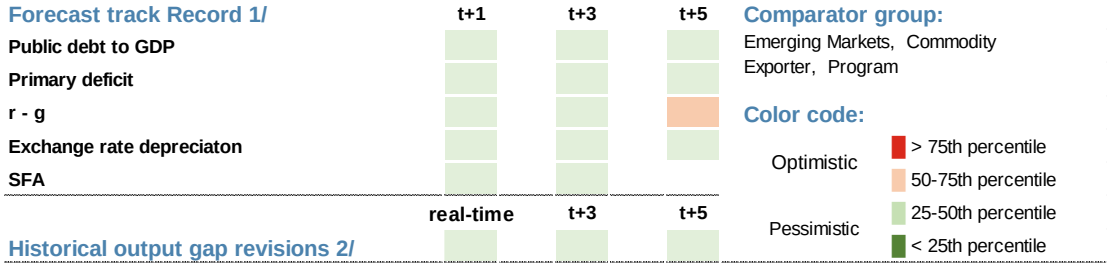
Percent of GDP, unless otherwise indicated

	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	33.4	33.0	33.3	33.2	32.8	32.3	31.9	31.4	30.8	30.4	29.9
Change in public debt	-3.0	-0.4	0.3	0.0	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Contribution of identified flows	-0.3	-0.1	0.2	-0.2	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6	-0.5
Primary deficit	0.1	0.5	0.4	-0.1	-0.5	-0.4	-0.4	-0.3	-0.2	-0.2	-0.1
Noninterest revenues	25.6	25.2	25.2	25.0	24.9	24.7	24.7	24.7	24.8	24.8	24.8
Noninterest expenditures	25.8	25.7	25.6	24.9	24.3	24.3	24.3	24.4	24.5	24.6	24.7
Automatic debt dynamics	-1.8	-0.5	-0.1	0.0	0.0	-0.1	-0.1	-0.2	-0.3	-0.3	-0.3
Real interest rate and relative inflation	-0.8	0.3	0.8	0.9	0.9	0.8	0.8	0.7	0.7	0.6	0.6
Real interest rate	-1.1	-0.2	0.9	0.9	0.9	0.8	0.8	0.7	0.7	0.6	0.6
Relative inflation	0.3	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-1.0	-0.8	-1.0	-1.0	-1.0	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9
Real exchange rate	-0.1	...	...	...	...	...	...	...	...	...	...
Other identified flows	1.4	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	1.4	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Contribution of residual	-2.6	-0.2	0.1	0.2	0.2	0.2	0.2	0.1	0.0	0.1	0.0
Gross financing needs	2.3	2.8	3.5	3.1	4.0	3.3	4.2	4.4	3.7	5.3	5.0
of which: debt service	2.3	2.4	3.2	3.3	4.6	3.8	4.6	4.7	4.0	5.5	5.2
Local currency	1.2	1.1	1.8	1.2	2.5	1.5	2.8	2.9	1.7	2.9	3.0
Foreign currency	1.0	1.3	1.3	2.0	2.1	2.3	1.8	1.8	2.3	2.6	2.1
Memo:											
Real GDP growth (percent)	2.7	2.4	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Inflation (GDP deflator; percent)	7.9	5.7	2.4	2.2	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	8.4	8.5	5.5	5.2	5.1	5.0	5.0	5.0	5.0	5.1	5.1
Effective interest rate (percent)	4.6	5.2	5.1	5.1	4.9	4.7	4.6	4.3	4.2	4.1	3.9



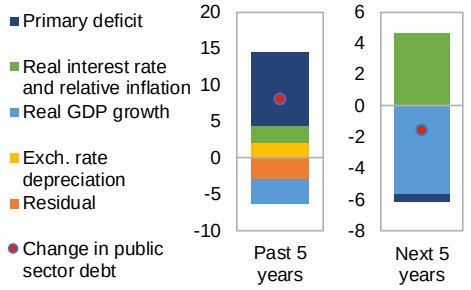
Commentary: Public debt is expected to stabilize over the medium term and fall toward the long-run debt target reflecting the planned fiscal consolidation envisioned in the fiscal rules.

Figure 5. Peru: Public Debt Sustainability Analysis—Realism of Baseline Assumptions

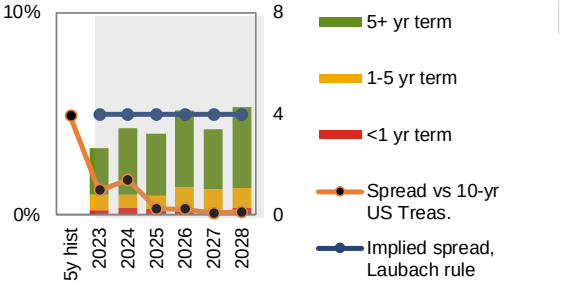


Public Debt Creating Flows

(Percent of GDP)

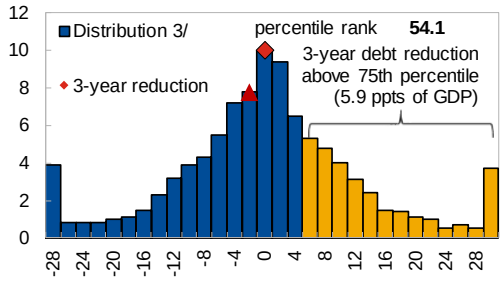


Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))

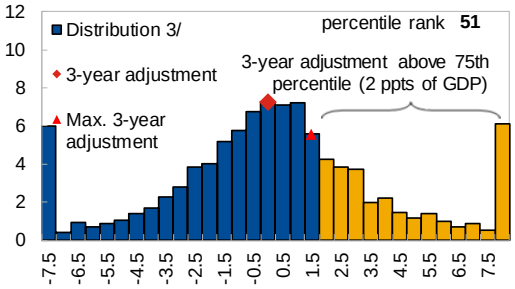


3-Year Debt Reduction

(Percent of GDP)

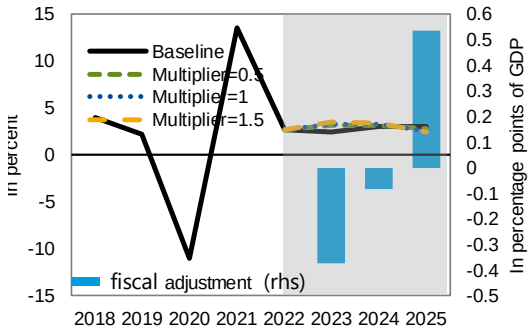


3-Year Adjustment in Cyclically-Adjusted Primary Balance (percent of GDP)



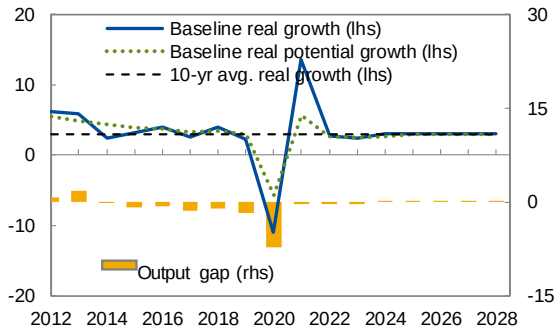
Fiscal Adjustment and Possible Growth Paths

(lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS))



Real GDP Growth

(in percent)



Commentary: The realism analysis does not point to major concerns. The forecast track record for the main drivers does not reveal any systematic bias, and the projected fiscal consolidation is well within norms. The real GDP growth forecast in the baseline is consistent with reasonable estimates of the fiscal multiplier, and converges to potential GDP growth over the forecast horizon.

1/ Projections made in the October and April WEO vintage.

2/ Data covers annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

3/ Starting point reflects the team's assessment of the initial overvaluation from EBA (or EBA-Lite).

Figure 6. Peru: Public Debt Sustainability Analysis—Medium-term Risk Analysis

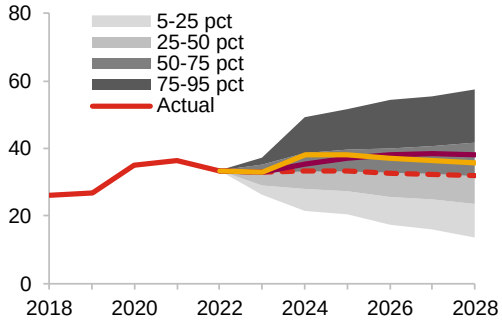
Debt fanchart and GFN financeability indexes

(percent of GDP unless otherwise indicated)

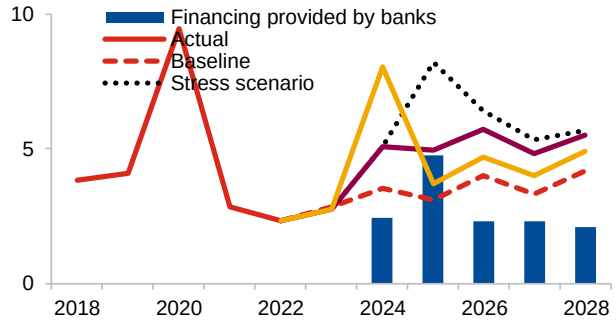
Module	Indicator	Value	Risk index	Risk signal	Adv. Econ., Non-Com. Exp, Program (0 25 50 75 100)
Debt fanchart module	Fanchart width	43.8	0.6	…	
	Probability of debt not stabilizing (pct)	21.9	0.2	…	
	Terminal debt level x institutions index	19.7	0.4	…	
	Debt fanchart index	**…**	**1.2**	**Moderate**	
GFN finance-ability module	Average GFN in baseline	3.5	1.2	…	
	Bank claims on government (pct bank assets)	7.3	2.4	…	
	Chg. in claims on govt. in stress (pct bank assets)	2.7	0.9	…	
	GFN financeability index	**…**	**4.5**	**Low**	

Legend: Interquartile range; Peru

Final fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

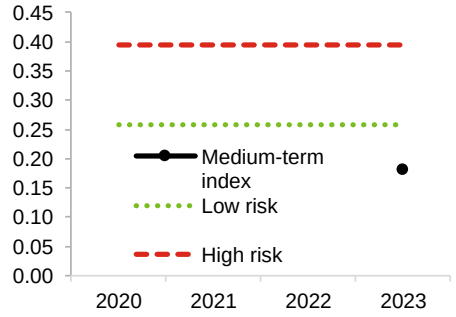


Triggered stress tests (stress tests not activated in gray)

Banking crisis; Commodity prices; Exchange rate; Contingent liab.; Natural disaster

Medium-term index

(index number)



Medium-term risk analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.3
GFN finaceability index	7.6	17.9	0.5	0.1
Medium-term index (MTI)	0.3	0.4	…	0.2, Low

Prob. of missed crisis, 2023-2028 (if stress not predicted): 9.1 pct.

Prob. of false alarm, 2023-2028 (if stress predicted): 58.0 pct.

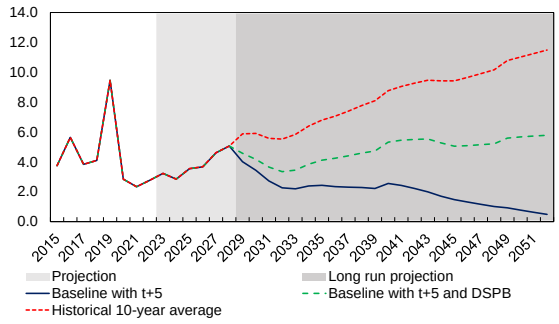
Commentary: Of the two medium-term tools, the Debt Fanchart Module is pointing to a moderate level of risk, while the GFN Financeability Module suggests a low risk level, supported by low gross financing needs.

Figure 7. Peru: Public Debt Sustainability Analysis—Long-term Risk Analysis

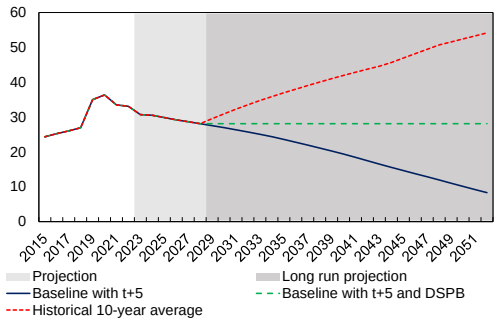
Large Amortization

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

GFN-to-GDP ratio



Total public debt-to-GDP ratio



Annex IX. Implementation of FSAP Recommendations

1. The financial system has improved and gained strength with time. The 2018 FSAP for Peru found that the financial system had developed and become more resilient since the 2011 FSAP. Peru's main vulnerabilities were assessed to be external, particularly related to growth in trading partners due to reliance on commodity exports, as well as to exchange rate depreciation due to significant dollarization. At that time, shocks in the form of uncertainty and spillovers from the ongoing *Lava Jato* investigation were judged as significant domestic headwinds. The mission's stress-test analysis showed that although highly concentrated, the banking system proved resilient to adverse shocks due to the strong capital buffers and profitability. The interconnectedness analysis found that the joint probability of distress across all banks had fallen since the peak of the global financial crisis; however, shocks affecting credit exposures, which are strongly correlated among large banks, could become systemic events due to the highly concentrated nature of the banking system.

2. The FSAP found that the Peruvian authorities could improve financial stability by acting across a number of dimensions. The macroprudential framework could be improved by bringing capital surcharges in line with Basel III requirements, enhancing monitoring of off-balance-sheet exposures, increasing foreign currency lending risk weights, and introducing new risk-monitoring tools. Oversight of banks could be strengthened by granting the Superintendency of Banks (SBS) powers to exercise consolidate supervision, enhancing financial group supervision, implementing recovery and resolution requirements for domestic systemically important banks (D-SIBs), finalizing the review of the capital requirement framework, implementing risk-based supervision for insurers, and creating a deposit-insurance system for cooperatives. The FSAP also recommended measures to strengthen crisis preparedness and cooperation between relevant agencies. Finally, measures that would deepen money markets and improve the private pension system were also proposed.

3. The authorities have made significant progress on the recommendations from the 2018 FSAP. Notably, countercyclical provisions and capital surcharges have been fully aligned with the Basel III framework since January 2023, while a new methodology has also been established for determining additional capital buffers. The SBS has enhanced its monitoring of off-balance-sheet exposures, while also implementing various additional tools for monitoring systemic risks. The deposit insurance system for cooperatives was implemented from March 2022. Further progress has been made on other recommendations, including an 8 percent capital surcharge to exposures subject to exchange rate risk, amending the SBS' authority to exercise consolidated supervision, requirements for recovery plans for domestic systemically important banks (D-SIBs), risk-based supervision for insurance companies, strengthening crisis preparedness, and efforts to strengthen money markets. Notable areas of non-compliance with recommendations include the lack of reforms to improve the private pension system, as well as reforms the strengthen the legal protection of SBS staff.

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)	**Implemented.** New regulations were issued for countercyclical provisions and capital surcharges in line with Basel III framework. In addition, a new methodology was established by the SBS for determining buffers for concentration (single debtor, economic sector and geographic area). A new provisioning scheme more sensitive to risk has been developed, requiring higher countercyclical provisions for SME portfolio. In March 2022, the General Law was changed in order to align the composition of regulatory capital to Basel III. All the related regulation were issued in December 2022 and is active as of January 2023. Systemic risk buffers will be completely phased in 2023 and conservation buffers in 2026.
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.
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.

Recommendations	Status
Implement requirements for recovery and resolution planning for D-SIBs, as well as for financial groups. (SBS) (MT)	**In progress**. The SBS has officially requested the systemic banks to prepare and submit their recovery plan, approved by the Board of Directors, no later than June 30, 2023.
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. In December 2021, a modification to the regulation of the regulatory capital requirement for systemic risk was issued, in order to include elements of interconnection, substitutability, and complexity in addition to size. Another regulatory change that took place in December 2021 was the reduction of the trigger that activates the cyclical provisioning and countercyclical capital requirement rule. Also, the new regulation changed the countercyclical provisioning rates to be more sensitive to heterogeneous risk in the credit portfolio. Finally, a regulation establishing a methodology to calculate the leverage ratio and report it periodically to the SBS was also issued in December 2021.
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	
Design a deposit-insurance system after passage of law to bring financial cooperatives under supervisory umbrella of SBS. (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, when collection began.

Recommendations	Status
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.
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)	**Partially implemented.** In January 2021, a new Company Authorization Regulation was issued containing stricter clauses on moral suitability of shareholders, ultimate beneficial owners, directors, managers, and principal officers of companies. The modification to the Corporate Governance and Comprehensive Risk Management Regulations was also issued, including clauses on the evaluation of moral suitability. Additionally, work has been done on the modification of the General Law of the Financial System to increase the limits of 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.

Recommendations	Status
	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.** In July 2022, a Multisectoral Commission was created with the functions of preparing the Technical Reports evaluating the Peruvian pension system and the regulatory proposal for the creation of the new pension system.
Time Frame: IT (Immediate) = less than 1 year; ST (short-term) = 1- 3 years; MT (medium-term) = 3-5 years.	

Annex X. Progress on Governance Issues

1. The Fund supports efforts to address weaknesses in governance.[1] The IMF has sought to address macro-critical governance issues in member countries by adopting a policy for economic governance in 1997, elaborating a Guidance Note (The Role of the IMF in Governance Issues) and adopting the Framework for Enhanced Engagement on Governance in 2018. This includes an assessment of governance weaknesses in the following state functions; (i) governance of fiscal issues; (ii) financial sector oversight; (iii) central bank governance and operations; (iv) market regulation; (v) rule of law; and (vi) anti-money laundering and combatting the financing of terrorism. The assessment also examines the severity of corruption.

2. The authorities have made considerable progress in implementing their governance agenda. While progress has been made in several governance areas, some weaknesses remain. Additional efforts are needed to maintain the reform momentum. The table below provides an assessment of the governance agenda implementation. Staff supports continued efforts by the authorities to close remaining governance gaps and to ensure that hard-won gains are preserved.

3. Efforts were made to strengthen governance and fighting corruption. A new Anti-Corruption Plan (based on a broad consultative process) is being implemented. New legislation has been passed to strengthen fiscal governance. The National Board of Justice (an independent organ to appoint judges and prosecutors) is operational. The Offices of Institutional Integrity have been opened in more than 200 public sector entities. A whistleblower complaint platform has been launched, and an integrity index by the Integrity Secretariat has been created to focus on areas with higher corruption risks. The Comptroller's Office monitors emergency-related spending, identifies abuses, and regularly publishes its reports.

4. There has been progress on fiscal governance along several lines. Business procedures are being streamlined, economic and regulatory impact analysis is being implemented, a unified civil servant human resource system is under consideration, and a reduction in redundant workers and related savings is underway. The integrity of expenditures has been enhanced via stricter controls and more secure payment orders, public procurement is being strengthened, while other fiscal governance measures are in the process of being implemented.

[1] The IMF guidance note on governance can be found here: https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/04/20/pp030918-review-of-1997-guidance-note-on-governance.

Governance Agenda Key Recommendations	
Recommendations	**Status**
Fiscal Governance	
A. Legal Framework	
Administrative simplification and better-quality regulations. These measures include: (i) cutting back on excessive regulations and exemptions; (ii) systematically evaluating the economic impact of new laws; (iii) consulting relevant interested stakeholders, such as subnational governments and the private sector; and (iv) shortening transition periods for implementation of new laws.	**Partially implemented.** The Secretariat of Public Management (SGP) and the Multisectoral Commission for Regulatory Quality have standardized 100 administrative procedures, helping to reduce the number of excessive regulations. A decree mandating Regulatory Impact Analysis was introduced in 2022, and all regulations include compliance mechanisms and indicators (including on timing) to corroborate their implementation and impact. As of 2022, 100 percent of executive branch entities with regulatory functions approve their work program early and make it available to the public for input and/or reviews.
Implementation of public financial management (PFM) reform initiatives without lengthy transition periods. This could include setting end dates for different steps and monitor execution.	**Partially implemented.** Legislative Decree No. 1436 (2018) establishes the Financial Management System Committee (SAFI) in charge of leading governance of the Public Sector Financial Administration. The Investment, Human Resources, and Procurement System elements were added to the PFM system. Directives have been introduced and approved in the following areas: (i) strengthening of authorizations for accrued expenses; (ii) programming and budgeting of the Multiyear Budget; (iii) directives for budget execution; (iv) strengthening of procedures for acts involving the acquisition and final disposal of fixed assets; (v) guidelines for wage bill management and multiyear programming of the wage bill; (vi) recording information in the information system for the Centralized Registry of Public Sector Payrolls and Human Resource Data; (vii) disbursements within the National Debt System; (viii) management of public entity assets; (ix) presentation of the financial information of public enterprises, the Central Bank of Peru, the military and police pension fund, and other funds; (x) procedures to close out the financial statements of public entities; and (xi) approval of the milestones required to implement the SIAF-RP (the system that integrates all of the financial management systems). Further actions will be included in the action plan to address the OECD Recommendations for the Public Sector's Financial Management Systems.

Recommendations	Status
The Ministry of Economy and Finance (MEF) to adopt an example of best practices for the legal framework. It could establish the following: (i) a consolidated legal framework that unifies a law's amendments into a single text; (ii) it should systematically develop economic impact assessments of new bills, including analyses of the administrative burden; (iii) in terms of PFM regulation, the consultation process, including with SNGs, could be done more systematically to ensure that all stakeholders are heard; and (iv) it should secure backing to speed up the implementation of certain PFM reforms. This could be achieved by better aligning reform initiatives with the overall strategy to enhance integrity and combat corruption.	**Partially implemented.** On (i) a number of Directives were introduced. On (ii) the MEF will set up a department under the Directorate General of Public Budgeting in 2023 tasked with carrying out economic impact assessments of regulatory measures. On (iii) there are legislative pre-publication processes for the public in general, so that they can give suggestions and make comments on the draft proposals. For example: the draft General Law of the Public Supply Chain was pre-published in October 2020 (Ministerial Decision 285-2020-EF/54). The regulation was not approved. In December 2022, the draft bill of the new State Procurement Law (Ministerial Decision No. 318-2022-EF/54) was pre-published and is currently undergoing review by the entities. On (iv) an action plan will be prepared to improve PMF systems as part of the OECD accession process.
B. Modernization of the Civil Service System	
Fully implement SERVIR proposals to improve transparency when hiring human resources. Develop human resource-related capacities at the central government and among subnational governments (SNG). It will be important to incorporate a system for rotating staff in positions at high risk for corruption.	**Partially implemented.** A "Directive on Hiring and Dismissing" staff at government entities has been drafted, seeking to standardize and align the procedures for hiring and dismissing civil servants at all public entities nationwide. The Directive is expected to be approved by April 2023. On the rotation of staff in positions at high risk for corruption, provisions were established in Law No. 31657 for staff transfers from the system of Service Administration Contracts (CAS) to the Civil Service.
Unify a staff registry and payroll to do away with "ghost employees." Improvements to the registry could begin in the central government and at national institutions, while SNGs start gradually introducing them to achieve the goals set in Decree Law 1442. Improvements need to be made to internal controls and selection processes at the same time.	**Partially implemented.** The draft bill No. 03078/2022-CR, which creates the Integrated Electronic System for Human Resource Management (to be run by SERVIR with updated information on civil servants), is under consideration by Congress. The pilot for the implementation of the Payroll Validation Module in the Computer Software for the Centralized Registry of Public Sector Payrolls and Human Resources Data (AIRHSP) for the complete, progressive validation of public sector payrolls is ongoing. The module is integrated into larger information systems used to process the payroll, thus promoting transparency and reducing ghost payrolls. In 2019, measures were implemented to identify staffing resources not included in the Centralized

Recommendations	Status
	Registry of Public Sector Payrolls and Human Resources Data, forcing a nationwide reconciliation of payrolls. Associated unidentified spending fell 93 percent between 2020 and 2022.
C. Digitalization	
Initiatives to increase digitization and automation should continue in various other areas of the government. These cover the payroll system, public investment, and public procurement, and should promote integration of information systems throughout the public sector. It is also important to reduce or eliminate manual actions and cash payments in key treasury processes.	**Partially implemented.** The Digitization of the registry for staff covered under Service Administration Contracts at the AIRHSP (Human Resources and Budgeting process) was completed in 2022. The implementation of centralized authorization of the certificate, commitment, accrual, and operating phases, using the electronic ID and dynamic code was completed for the national government and is ongoing for the local governments. The SIAF-SP module for the payment of customs tax electronically by executing units was implemented in June 2021. The digitization of offers from the selection processes in the Electronic State Procurement Platform (SEACE) was completed in 2019. The supplier inquiries and comments are submitted through the Electronic State Procurement Platform (SEACE). The implementation of the Digital Work Notebook and the "Works Valuation Management" module, leading to more predictability among processes, remote accessibility, shorter times, among other things, and the "Electronic Quoting System" to carry out market research on framework agreement catalogues were introduced in 2020.
The Integrated Financial Management System (SIAF) needs to be updated, giving priority to measures that improve the integrity of processes and tracking expenditures. This effort entails automating information shared with other systems and updating the technology platform, based on the authorities' reform plans (Decree Law 1436). Specifically, the following measures should be adopted: (i) integrate budget and accounting information across all stages of the SIAF to generate prompt, reliable information about transactions; (ii) renew the SIAF's technology platform to strengthen its security, adopting web-based technologies that enable information updates to be centrally managed; and (iii) reinforce other systems (SEACE - Electronic System for Government Procurement), SIGA (Integrated System for Administrative Management),	**Partially implemented.** The payment processes have been made more secure, with the ability for more tracking through the mandatory use of token-like codes associated with electronic ID, to identify the employees in charge of payment operations (fully implemented in February 2022). Updating of the SIAF-SP's technological platform is ongoing. The project entails the following modules: (i) certification and filing (accounts for 80 percent of transactions); (ii) accounting and debt (20 percent of transactions); and (iii) back-office. The pilot of the certification module is deployed across 46 executing units, with full deployment expected by October 2023. Accounting and debt (accounts for 20% of transactions). Roll-out of the accounting and debt module is set for March 2023, while progressive deployment of the back-office module is set to start in February 2023.

Recommendations	Status
investment project bank, other records) and their interoperability with the SIAF.	Further improvements are anticipated under new procurement and investment bank systems.
D. Enhancing Institutions	
Determine the sources of corruption risk in public hiring and establish an alert system, such as red warnings indicating risk hotspots. Frequently evaluate the results of public procurement processes, using indicators. Create the right environment for expanding the pool of potential suppliers and ensuring fair competition.	**Partially implemented.** Inclusion on multilateral organizations' lists of persons and companies ineligible to be hired is now an impediment to doing business with the government. The Supervisory Agency for Public Procurement (OSCE) has been strengthened to carry out oversight in all phases of the procurement process. *Peru Compras* has been strengthened to standardize government requirements, and the possibility of using trusts for project advances has been incorporated, in order to have better tracking of advances given (Legislative Decree 1444). The National Institute for the Defense of Competition and the Protection of Intellectual Property (INDECOPI) issued "Guidelines to Combat Bidding Fraud in Public Procurement" in 2018. The Public Procurement Surveillance Program was implemented in 2021. In 2018, a Risk Management directive was issued for planning the execution of works (OSCE). Documents on "Diagnosis and Strategy for Public Procurement Risk Management" and "Recommendations for Public Procurement Risk Mitigation" were drafted in 2020 and 2021. Available at: https://cdn.www.gob.pe/uploads/document/file/1038474/Diagn%C3%B3stico_y_Estrategia_para_la_Gestion_de_Riesgos_en_Contrataci%C3%B3n_P%C3%BAblica.pdf?v=1595541496 Measures to broaden the set of suppliers include: i) Executive Decree No. 168-2020-EF that established provisions for ministries to prioritize the approval of requirements, driven by *Peru Compras*. and ii) A "Samaritan Alert" created in framework agreements and implemented in 2022, which is activated whenever only one brand of the good included in the agreement catalogue has been selected. A draft bill to reform public procurement regulations with a focus on integrity has been tabled before Congress. The bill addresses OECD recommendations, using open data, citizen participation, accountability, risk management, and specific internal control mechanisms for public procurement, while recognizing the private sector as a strategic ally for accomplishing public goals, fostering competition and innovation.

Recommendations	Status
	Available at: https://www.gob.pe/institucion/mef/normas-legales/3815521-318-2022-ef-54
Start with a pilot project in the new logistics system, with a few sectors, such as healthcare (medication, equipment, etc.). Clearly define responsibilities and coordination among the MEF (governing body), the State Procurement Oversight Body (OSCE), and *Peru Compras* (execution).	**Partially implemented.** Legislative Decree No. 1439 develops the National Procurement System (SNA), which delimits the competencies of those in the SNA (Directorate of Public Procurement - DGA, OSCE and *Peru Compras*). In 2018, the DGA issued regulation with a vision for the supply chain and has carried out training and technical assistance. As of 2022, the DGA has issued 6 directives, and completed 56 webinars, 173 virtual trainings, and 40 in-person trainings. A draft public procurement bill further clarifies the scope of the competencies of the DGA, OSCE and *Peru Compras*. Available at: https://www.gob.pe/institucion/mef/normas-legales/3815521-318-2022-ef-54
Invest more in electronic procurement systems and develop them to improve transparency. Publish all public bidding and prices, improve the current electronic system, SEACE, with more information and facilitating access. Make it easier for civil society to participate as additional oversight. To increase public awareness of conflicts of interest, publish simple examples or guidelines that help them understand the implications of situations that tend to emerge in the bidding process.	**Partially implemented.** All bidders' offers are required to be submitted through SEACE since 2019. The "Digital Work Notebook and the "Works Valuation Management" modules, leading to more predictability among processes, remote accessibility, shorter times, among other things have been implemented (2020). In 2020, the Public Procurement Center implemented an "Electronic Quoting System" to carry out market research on framework agreement catalogues. In 2021, the OSCE implemented the Public Procurement Surveillance Program (6 citizen surveillance operations each in 2021 and 2022).
Improve the arbitration and litigation process by increasing transparency, strengthening entities' ability to report cases, and making the sanctions system more effective.	**Partially implemented.** Regulations were issued in 2018 and 2020 promoting the use of the Dispute Resolution Board, as a mechanism for preventing disputes from ending up in arbitration (DS 344-2018-EF and DS 250-2020-EF). The draft public procurement bill i) expands the OSCE's supervisory powers, including oversight of arbitration institutions (meeting minimum transparency requirements); ii) delimits the jurisdiction for seeking injunctive relief, based on the entity's domicile; and iii) broadens the scope of the Dispute Resolution Boards (to all purposes and amounts). Available at: https://www.gob.pe/institucion/mef/normas-legales/3815521-318-2022-ef-54

Recommendations	Status
E. Control System Reform	
Effective internal controls need to be systematically implemented across all levels of government. This is a medium-term process but one that should commence as soon as possible. More specifically, the following is essential: (i) create a culture of risk management and internal control. The Presidency of the Council of Ministers (PCM), as the highest body of the Executive branch, and the MEF, which is responsible for the sustainability of public finances, have an important role to play in promoting control and monitoring progress; (ii) Improve the risk-assessment capacity of both the central government and SNGs. Start with high-priority sectors that can be used as a model; (iii) strengthen the MEF's regional offices to help implement internal control systems at SNGs; (iv) as internal controls are strengthened, based on a clear risk assessment-oriented strategy, it will be important to set up an independent internal audit unit at each entity. This unit will assess and advise the entity's management about how to improve the organization and processes, independently from the external auditor.	**Partially implemented.** Supreme Decree 103-2022-PCM approved the PNMGP (national policy on modernization of public administration) for 2023, which empowers the SGP to approve the policy's administrative services, including the service of "timely technical assistance in risk management for public entities of the 3 levels of government," pending regulation of risk management as a means for modernization. Resolution No. 006-2022-PCM/SGP of the Secretariat of Public Management, approving the strategy called "implementation of pilot modernization actions in Peru." A pilot project in the Regional Government of Lambayeque is slated to be implemented in 2023. The PCM through the SGP, verifies compliance with Resolution No. 392-2020-CG of the Office of the Comptroller. Directive No. 020-2020-CG/NORM (Directive on the Institutional Control Bodies), defines the functions of the institutional control bodies (OCIs) in public sector entities.

Annex XI. A Primer on Climate Mitigation Policy in Peru[1]

This Annex offers a preliminary analysis of mitigation policies to bring Peru in line with its Nationally Determined Contribution (NDC) by 2030 and net-zero pledge for 2050. Emissions from Land Use, Land Use Change and Forestry (LULUCF), the largest source of emissions in the country, must be addressed if Peru is to meet its NDC commitment by the end of the decade. The analysis also models two carbon tax options for energy-related emissions, using the Climate Policy Assessment Tool (CPAT) developed jointly by IMF and World Bank staff. The main conclusion is that the greater the reduction in emissions from deforestation and land-use, the lower the carbon tax required to achieve climate goals.

1. While Peru is committed to climate action, including developing a sound legal and institutional framework, climate policy needs to be strengthened to meet its climate objectives. As part of its national and international climate commitments, Peru published in 2015 both the National Strategy on Climate Change and the Forest and Wildlife Law.[2] Moreover, in 2018 Peru became the first Latin-American country to enact a Framework Law on Climate Change[3] in line with the Paris Agreement. In 2020, the government established a High-Level Commission on Climate Change, a cabinet body responsible for proposing climate measures, and presented an updated NDC to the United Nations Framework Convention on Climate Change (UNFCCC). The revised NDC includes an absolute unconditional (conditional) target of 208.8 (179) million tons of CO2 equivalent (MtCO2eq) by 2030, equivalent to a 30 and 40 percent reduction from the business-as-usual baseline. Finally, Peru published its National Adaptation Plan in 2021[4] and declared a national climate emergency in 2022. Among other initiatives, this Plan aims to increase the share of variable renewable energy in the power matrix from less than 5 percent to 20 percent in 2030.[5]

2. To meet its NDC goal, Peru needs to implement policies to reduce emissions from LULUCF and energy, which combined represent more than 70 percent of total emissions. Deforestation is a significant and pressing challenge, especially in a country where 57 percent of its territory is forestland and 95 percent of this is Amazon rainforest.[6] To meet its NDC goals, Peru must implement policies to swiftly reverse recent increases in the rate of deforestation. Additional policies are required in energy sectors, which make up 20 percent of emissions.

3. The Annex is structured as follows: section A provides a brief global perspective on emission reduction pledges and challenges; section B reviews LULUCF and agriculture issues in Peru; section C analyses emissions in energy-related sectors; and section D provides a quantitative evaluation of carbon taxes for energy-related sectors using the CPAT methodology.

[1] Prepared by Diego Mesa Puyo and Antung Anthony Liu (both from FAD's Climate Policy Division)

[2] See Ministerio del Ambiente de Peru (2015) and Ley Forestal y de Fauna Silvestre (2015).

[3] See Decreto Supremo (2022).

[4] See Ministerio del Ambiente de Peru (2021).

[5] See Ministerio del Ambiente de Peru (2022).

[6] See Ministerio del Ambiente de Peru (2016).

A. A Global Perspective

4. Containing global warming to below 2°C has become a more urgent and pressing challenge. Global carbon dioxide (CO_2) and other greenhouse gas (GHG) emissions must be cut by 25 to 50 percent respectively below 2019 levels by 2030, followed by a rapid transition to zero net emissions, or negative net emissions to maintain the 1.5°C target alive—the central goal of the 2015 Paris Agreement—. The baseline projections under existing climate policies imply that global CO_2 emissions excluding LULUCF will rise from 30 billion tons in 2020 to over 35 billion by 2030, while containing global warming to 1.5 – 2.0°C above pre-industrial levels requires CO_2 emissions to be limited to about 15 to 25 billion tons in 2030.[7]

5. Countries have continued to update their climate goals, as Peru did in 2020, but additional implementation efforts are needed at the global level. At an aggregate level, updated commitments remain insufficient and more ambitious near-term targets and policy action are needed to limit global warming. According to the UN, current national climate plans – for all 193 Parties to the Paris Agreement taken together – would lead to a sizable increase of almost 14 percent in global GHG by 2030, compared to 2010 levels. Moreover, while many countries have stated their 2030 emission goals in terms of percentage reductions or absolute emissions targets by 2030, few have provided details on how to achieve those objectives.

6. Against this background, IMF analysis suggests that measures equivalent to a global carbon price at $75 per ton by 2030 are needed to limit global warming below 2°C.[8] This is especially true for large emitters. For example, G20 countries should adopt measures equivalent to a carbon price of over $75 per ton by 2030, on top of existing policies, to cut emissions at least 30 percent below business as usual (BAU) levels.

B. Land Use, Land-Use Change and Forestry Emissions in Peru

7. Peru faces particular mitigation challenges, as a significant share of emissions are from LULUCF and agriculture which require multiple sectoral policies to be addressed. For most of the world, more than 50 percent of GHG emissions are from energy-related activities. Carbon pricing has been broadly accepted to be the most effective mitigation instrument for this type of emissions from both an economic and environmental perspective. In Peru, however, deforestation and land-use are responsible for more than half of the emissions, followed by energy-related activities and agriculture. As a result, if deforestation is not contained is unlikely that the country will meet its NDC (see figure 1a).

[7] The February 2023 release of the IMF Climate Change Dashboard estimates that GHG emissions in 2021 are on par with global emissions in 2019. As a result, Atmospheric CO2 concentrations have continued to rise. Moreover, current global pledges to reduce GHG emissions outlined under the Paris Agreement are insufficient to limit global warming to 1.5°C. For more information see https://climatedata.imf.org/.

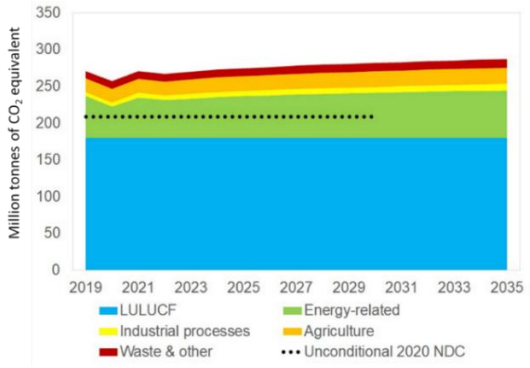
[8] See *Black and others (2021).*

8. According to Peru's latest National Registry of Greenhouse Gases report, emissions from LULUCF in 2016 were 109 million tons of CO2eq or about 53 percent of total emissions.[9] However, emissions from LULUCF are likely to have increased over the past 6 years, as high annual deforestation rates continued to be recorded. The majority of LULUCF emissions results from conversion of forests to grassland and farmland for agriculture, cattle and in some in some instances illegal crops and illegal mining. A 2016 report from the Ministry of Environment stated that agricultural and livestock use were responsible for more than three quarters of annual deforestation between 2011 and 2016. This was followed by mining operations and settlement expansion, including development of roads, infrastructure and migration (see figure 1b).

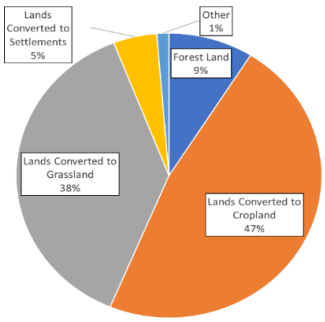
9. Over the past two decades, Peru has lost about 2.6 million hectares of forest cover (see figure 1c) or about 3.6 percent of the total. 2020 marked the highest annual rate of deforestation on record at 203,272 hectares (Figure 1d), above the annual average of 150,000 hectares since 2012. Some analysts attribute severe obstacles to the attainment of a more sustainably managed forest sector, including a lack of planning, institutional and governance weakness at the national and subnational level, inadequate property and rights allocation, and absence of appropriate and modern financial and sectoral instruments (De La Torre 2021).

Figure 1. Peru: Projected Emissions under a Business-as-Usual Scenario and Deforestation

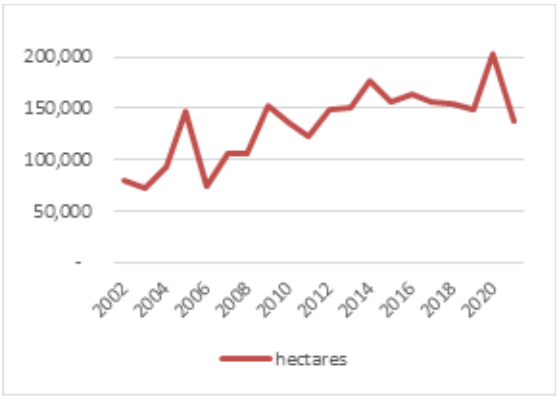
1a. Projected Emissions under BAU



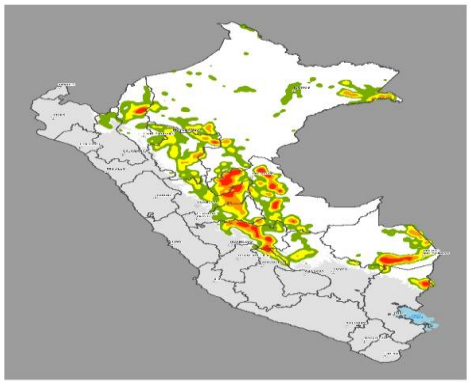
1b. Sources of Deforestation



1c. Annual Forest Cover Loss 2002-2021



1d. Main Deforested Regions



Source: IMF staff using CPAT and Ministerio del Ambiente

[9] See Ministerio del Ambiente and Ministerio de Desarrollo Agrario y Riego (2020)

10. Ideally, forestry and land use policies would promote, nationwide, the main channels for increasing carbon storage. These include: (i) reducing deforestation; (ii) afforestation; and (iii) enhancing forest management (e.g., planting larger trees, fertilizing, tree thinning, increasing rotation lengths). To the extent deforestation could be reversed and forest coverage expanded in Peru, other environmental co-benefits would be generated including reduced risks of water loss, floods, soil erosion, and river siltation.

11. There are several sectoral policies that could be implemented to stop deforestation in the near and medium term. The World Bank and the IADB have proposed multiple sectoral interventions to reverse deforestation from the current rates to about 15,000 hectares by 2050. These include assignment of forest rights and concessions, investments in conservation, reforestation, and afforestation, and the introduction of agroforestry systems. [10] The World Bank suggests that these measures, along with nature-based tourism and silvopastoral systems, could reduce deforestation while providing new jobs and sources of economic activity.[11] If these interventions are followed, the forestry sector could become a net carbon sink. These policies could be complemented with governance and anti-corruption measures to stop illegal activities in the Amazon basin. Monitoring and transparency will be critical to Peru's deforestation efforts.

12. Peru could also explore a national feebate program as a cost-effective mechanism that incentivizes forest carbon storage. The policy would charge landowners—most importantly those at the agricultural/forestry boundary—a fee given by:

[CO2 rental price] × [carbon storage on their land in a baseline period — stored carbon in the current period]

For landowners who cut down trees, carbon storage in the current period will be less than storage in the base period, resulting in fee payments. For landowners who allow the forest to regenerate or who even replant trees, carbon storage in the current period will be greater than that in the baseline period, resulting in negative fees (subsidies). Subsidies would be paid to landowners out of the pool of fee payments. Unlike policies like afforestation subsidies, a feebate rewards all three channels for enhancing carbon storage – reduced deforestation, afforestation, and enhanced forest management. Periods can be defined as averages over multiple years, since harvesting makes carbon storage lumpy from year to year.

13. Feebates can be designed—through appropriate scaling of the baseline over time[12]—to be revenue-neutral. Unlike afforestation subsidies, feebates can be designed to not incur new spending. Feebates are comparatively simple to administer as landowners are presumably already required to register for business tax collection. Feebates will be popular among responsible landowners who anticipate receiving rebates; they may offer political support for the program.

[10] See IADB 2021

[11] See World Bank Group 2022

[12] See Parry (2020) for details.

Feebates have not previously been used in the forestry sector, but environmental services payments programs have been used in Costa Rica.[13]

14. Feebates have become more practical to implement with advances in monitoring technologies. Forest carbon inventories can be estimated through a combination of satellite monitoring, aerial photography, and on-the-ground tree sampling. Satellite pictures are used to measure forest coverage and reveal visible land use changes such as clear-cutting of intact forest. Low-level aerial photography along forest boundaries, using technologies like Light Detection and Ranging (LIDAR), can estimate wood volume (implicitly accounting for selective harvesting and changes in forest management) more cheaply than on-the-ground sampling. However, on-the-ground sampling is still needed in some dense forests.[14]

Agriculture

15. According to Peru's latest National Registry of GHG report, emissions from agriculture in 2016 were 25.9 million tons of CO_2eq or 12.6 percent of total emissions. The main emission source in the sector is enteric fermentation, which accounts for 44 percent of the total, followed by direct N_2O emissions from managed soils, representing almost 30 percent of sector emissions. The remainder of the emissions come from indirect N2O from managed soils (10 percent), biomass burning (7 percent), rice cultivation (4 percent), manure management (2,4 percent), urea application (1 percent), and indirect N2O emissions from manure management (0.8 percent).

16. Agricultural GHGs can be reduced through several channels, involving multiple sectoral policies. Again, the World Bank[15] and the IADB have outlined a suite of policies that have the potential to significantly reduce emission from this sector. These include incorporating agroforestry systems, changing irrigation practices and substituting fertilizers, allowing for higher crop yields. Other policies include implementing silvopastoral systems and rotating feed in the Amazon, increasing carbon sequestration and the weight of cattle by up to 20 percent, reducing methane emissions per kilogram of meat produced.

C. Emissions in Energy-Related Sectors

17. Energy and industry-related CO_2 emissions accounted for 19 percent of Peru's 257 MtCO_2 GHG emissions in 2020 (see figure 2a). Transportation accounted for 7 percent of Peru's GHGs, followed by power generation with 6 percent. Industrial process emissions, consisting of CO_2 released during processes like cement production, fluorinated gases from air conditioners, aerosols,

[13] See, for example, www.fonafifo.go.cr/en. Costa Rica's scheme involves payments to develop and maintain forests (but does not apply fees for reductions in forest coverage).

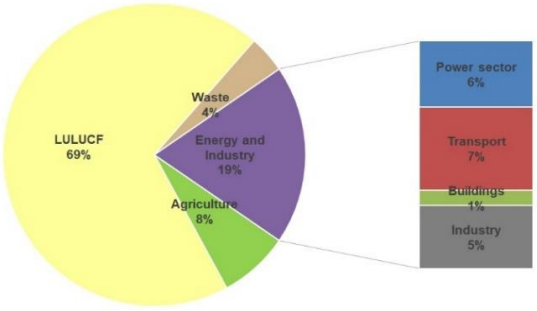
[14] Measuring above ground carbon only (usually about three quarters of the total) could also keep costs down. Along with 46 other developing countries, capacity is being developed to measure forest carbon inventories in Peru under the REDD+ program (see www.forestcarbonpartnership.org).

[15] See World Bank Group 2022 and IADB 2021

and refrigerants, accounted for 5 percent, while agriculture and waste accounted for 8 and 4 percent of GHG emissions respectively.

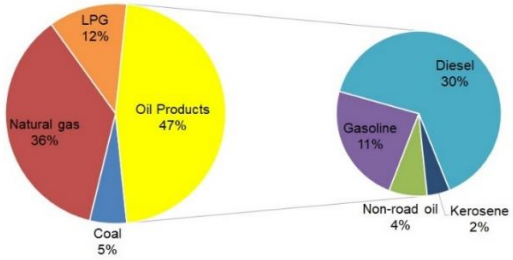
Figure 2. Peru: Emissions Sources

2a. Emissions by Source in Peru, 2020



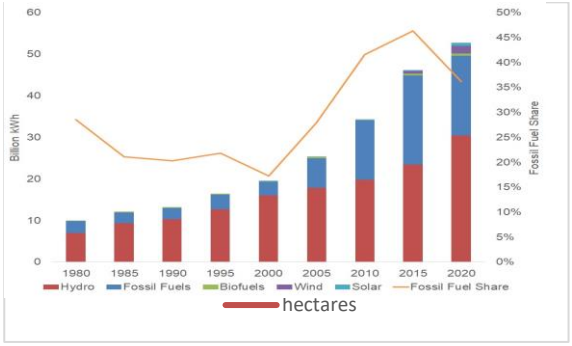
Source: IMF/EDGAR/FAO/UNFCCC

2b. Carbon Emissions by Fuel Type, 2020



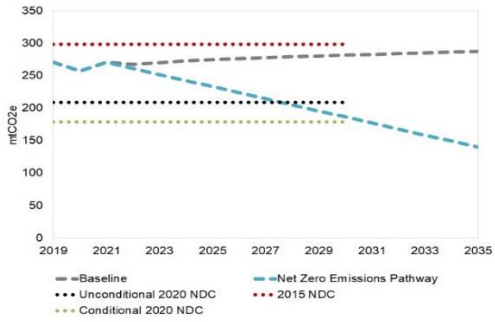
Source: IMF/EDGAR/FAO/UNFCCC

2c. Electricity Generation by Source, 1980 – 2020



Source: IMF/EDGAR/FAO/UNFCCC

2d. GHG Emissions vs. Paris Pledge (NDCs) and Net Zero Emissions Pathway



Source: IMF staff using CPAT

18. For energy-related products, the contributors to carbon emissions are primarily oil products and natural gas. Combustion of oil products, natural gas, and liquified natural gas (LNG) accounted for 47, 36, and 12 percent of energy-related CO_2 emissions.

19. In the power sector, fossil fuels accounted for 36 percent of electricity generation in 2020, a decrease from 42 percent in 2010. Generation shares for gas, coal, and oil were 34, 1, and 1 percent respectively (see Figure 2c). Although Peru has a large and growing amounts of hydro power, accounting for 58 percent of electricity output, its rapidly growing electricity demand has outstripped the growth of this source. Fossil fuel's share of electricity production increased in the past decade above the 29 percent observed in 1980.

20. As a contribution to the Paris Agreement, Peru has pledged to reduce GHG emissions to 208.8 MtCO2eq by 2030 in its updated NDC. This is a significant increase in ambition compared to its first NDC submission in 2015, which pledged a reduction of emissions to 298.3 MtCO2eq. According to IMF staff projections, graphed in figure 2d, the 2015 NDC target would be reached in

the baseline without any emissions cuts, while the updated NDC target will require a 24 percent reduction in GHG emissions in 2030, relative to the baseline.

D. Quantitative Evaluation of Emissions Mitigation Options

21. In most countries, carbon pricing would be centerpiece of a country's mitigation strategy to address energy- and combustion-related emissions. Carbon pricing has several key attractions as it promotes the full range of opportunities for reducing energy use and shifting to cleaner energy sources across all covered sectors. Moreover, carbon taxes can mobilize a valuable source of revenue, while generating domestic environmental co-benefits (such as reductions in local air pollution deaths). In summary, pricing carbon achieves the largest amounts of emissions cuts while causing the least harm to the economy.

22. However, in Peru, cuts in land-use change emissions are necessary to meet Peru's NDC goal. Peru's land-use change emissions are so large that it is almost impossible for the economy to meet its emissions cuts goals without significant reductions in land-use change emissions.

23. The following three scenarios would bring Peru in line with its NDCs and climate goals for 2030. While the "Just Land-Use" scenario can meet emissions targets if stringent cuts in land-use change emissions are achieved, other scenarios that have smaller cuts in land-use change emissions require filling the gap with a carbon price.

- ***Just Land-Use***: Cut land-use change emissions by 41 percent by 2030. No other changes are necessary to meet Peru's 2030 carbon emissions target.
- ***Proportionate***: All emissions (including land-use change emissions) are cut about 25 percent from BAU scenarios. This requires an economy-wide carbon tax starting at $25 per ton of CO_2 in 2023 and rising to $155 per ton of CO_2 by 2030.[16]
- ***Hybrid***: Land-use change emissions are cut by 35 percent by 2030 from BAU scenarios. A less-stringent carbon tax makes up the remainder of emissions cuts. The required carbon tax starts at $20 per ton of CO_2 in 2023 and rises to only $50 per ton of CO_2 by 2030.

24. The report analyzes each of the carbon pricing scenarios in terms of their impact on emissions, revenues and GDP, their distributional impacts, as well as in terms of comparing efficiency costs with domestic environmental co-benefits. The analysis was conducted using Climate Policy Assessment Tool (CPAT), a spreadsheet model developed jointly by the IMF and the World Bank, which is routinely used for cross-country and individual country assessments of mitigation policies. Covering over 200 countries, CPAT provides estimates of future fuel use and

[16] A carbon price of $155 per ton of CO2 is a relatively high price globally. For comparison, a permit to emit one ton of carbon traded at a price of about $90 per ton at the end of 2022 on the European Union's Emissions Trading System.

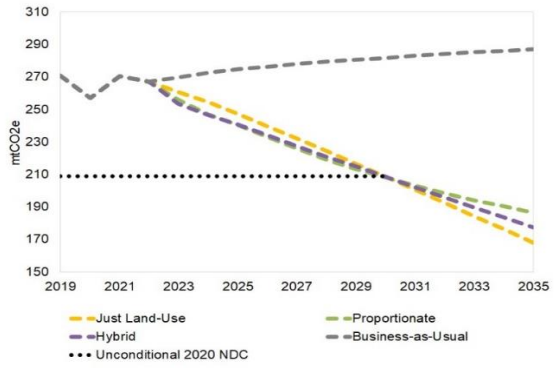
emissions by major energy sector as well as the emissions impacts of a diverse range of pricing and non-pricing mitigation approaches.

Emissions Analysis

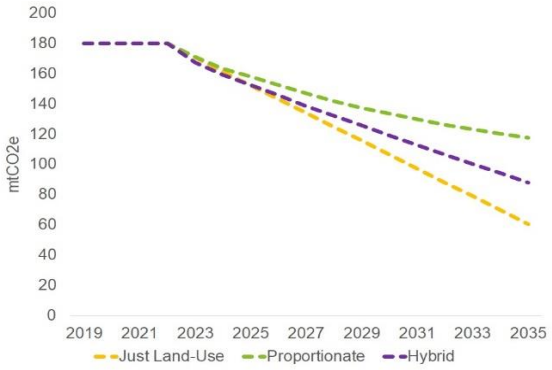
25. Each of the three scenarios brings Peru's emissions in line with its NDC target by 2030 (Figure 3a). The manner in which scenario achieves this emissions cut is different. Figure 3b presents the changes to land-use change emissions effects in each scenario. Larger cuts to land-use change emissions are required in the "Just Land-Use" scenario than in the "Proportionate" and "Hybrid" scenarios.

Figure 3. Peru: Emissions Results from Scenarios Analysis

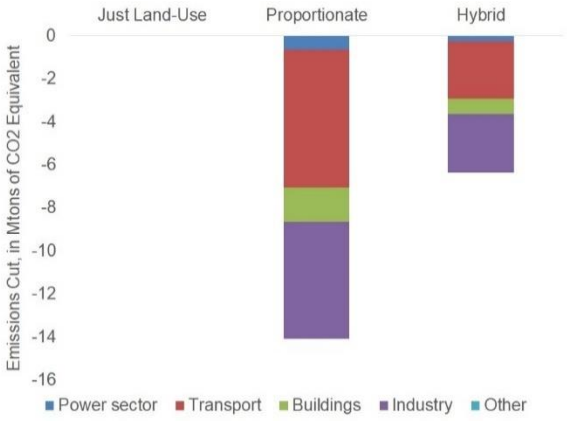
3a. The Impact on Total GHG Emissions by Scenario



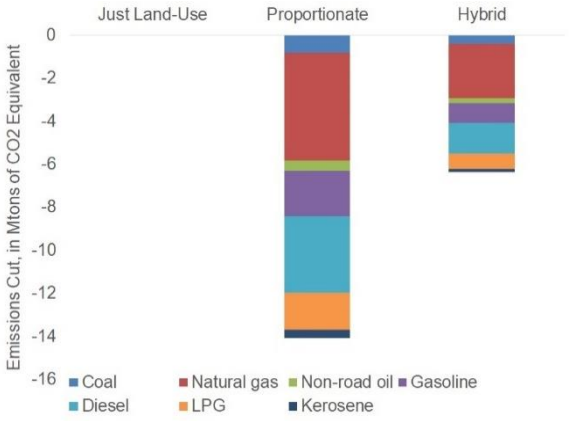
3b. The Impact on Land-Use Change Emissions by Scenario



3c. CO2 Emissions Reductions from the Baseline, by Sector



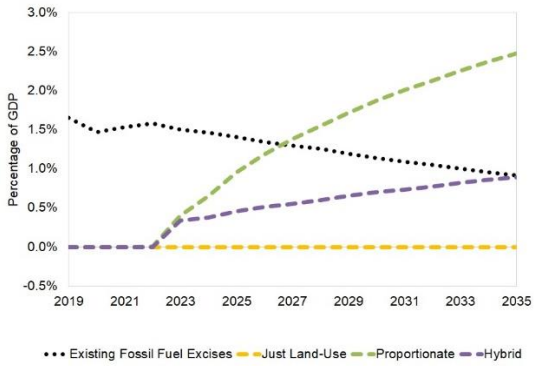
3d. CO2 Emissions Reductions from the Baseline, by Fuel Type



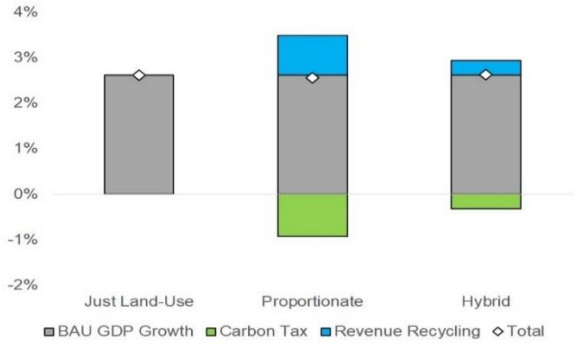
Source: IMF staff using CPAT

Figure 4. Peru: Fiscal Results from Scenarios Analysis

4a. New Government Revenues



4b. Impact on GDP Growth in 2030



Source: IMF staff using CPAT

26. Higher carbon pricing would have a negative on GDP growth, but this could be entirely offset with revenue recycling. The potential negative impact on GDP growth in 2030 is 0.9 and 0.3 percentage points in the proportionate and hybrid scenarios, respectively. However, if we examine a policy where 50 percent of revenues collected from the carbon tax are recycled effectively through productive public investment, the negative impact would be completely offset (see Figure 4b).

Prices analysis

27. Carbon pricing is likely to put upward pressure on energy prices, with the highest impact on coal, followed by oil and road fuels. Weighted average coal prices would increase by 158 and 51 percent in the proportionate and hybrid scenarios compared to the reform just focused on land-use change. Natural gas prices would increase by 44 and 14 percent. Since natural gas is the largest fossil fuel source for the electricity sector, rises in prices of electricity are relatively restrained at 23 and 5 percent.

28. Prices for fuels in the transportation sector would increase significantly. Diesel prices are expected to increase 48 and 16 percent compared to the reform just focused on land-use change. Gasoline prices are expected to increase 82 and 27 percent.

Table 1. Peru: Energy Prices by Scenario

Fuel	Unit	2022 Price	2030 Price		
			Just Land-Use	Proportionate	Hybrid
Gasoline	$/L	0.71	0.50	0.92	0.64
Diesel	$/L	1.26	0.98	1.45	1.13
LPG	$/L	0.78	0.62	0.94	0.72
Kerosene	$/L	0.81	0.59	1.04	0.74
Oil	$/bbl	87.62	56.59	129.35	80.06
Coal	$/GJ	13.33	9.25	23.89	13.97
Natural gas	$/GJ	22.66	19.79	28.47	22.59
Electricity	$/kWh	0.11	0.10	0.12	0.10

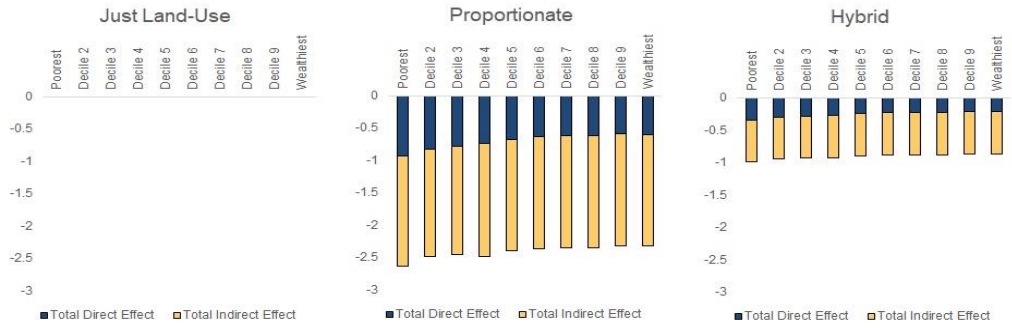
Source: IMF Staff Using CPAT

Distributional Impact and Co-Benefits

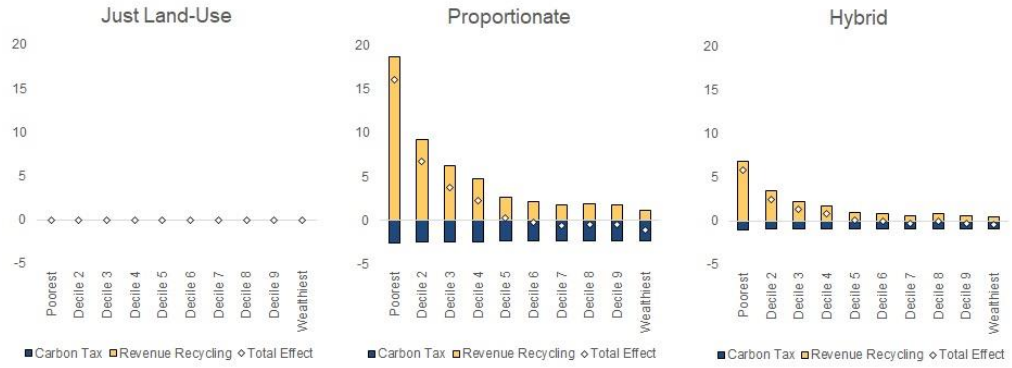
29. Civil society and some interest groups may oppose carbon pricing because of the burden of higher energy prices on households. Therefore, evaluating the household incidence from carbon pricing is important and measures should be taken to counteract these burdens.[17]

Figure 5. Peru: Welfare Results from Scenarios Analysis

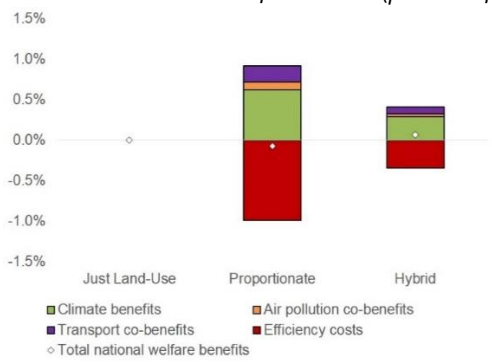
5a. Relative Mean Consumption Effect before Revenue Recycling



5b. Relative Mean Consumption Effect after Revenue Recycling



5c. Economic Costs and Domestic Environmental Co-benefits in 2030 (percent of GDP)



Source: IMF staff using CPAT
Note: Graph Unit is percent of Baseline Consumption in 2030.

[17] The analysis is based on a two-step approach to assess the distributional impacts of the reforms. Firstly, using input-output tables to calculate the effect of carbon pricing on different categories of consumer goods; and secondly, mapping price increases to data on budget shares for different goods by household income group using household expenditure surveys.

30. The results of the distributional analysis show that the impact of pricing carbon is regressive for both the Proportionate and Hybrid scenarios if revenue is wasted. The results from Figure 5a suggest that carbon pricing imposes a burden on an average household of 1-2.5 percent of consumption, driven largely by direct increases in the price of fossil fuels.

31. Revenue recycling would offset the negative impact of carbon pricing on households, while targeted recycling could even make the reforms pro-poor. In our scenario analysis, we apply 50 percent of revenues for a targeted, unconditional cash transfer aimed at the bottom four consumption deciles, making the reform both pro-poor and equity enhancing. In the Proportionate scenario, the bottom four deciles are better off from the reform with net benefits amounting to about 2-16 percent of consumption. The next five deciles are approximately no better or worse off, while the richest households are worse off on net but by only 1.2 percent of consumption.

32. Carbon pricing imposes a relatively small economic cost in Peru equivalent to about 0.3-1.0 percent of GDP in 2030 and they are offset by domestic environmental co-benefits. Economic costs reflect pure mitigation costs,[18] primarily the annualized costs of using cleaner but more expensive technologies instead of fossil-based technologies (net of any savings in lifetime energy costs). The carbon pricing does not impose a net cost on Peru, before even counting the climate benefits. About 30 percent of the domestic environmental co-benefits reflect fewer local air pollution deaths while 70 percent are projected to come from reductions in traffic congestion and accident externalities.[19] Adding the global climate benefits increases environmental benefits from 0.4 to 0.9 percent of GDP, almost exactly equal to the economic efficiency cost.The table below summarizes the main results across different scenarios, which might be helpful to weigh different trade-offs in the decision-making process.

[18] Estimation of economic costs is made under specific assumptions on emissions projections and responsiveness of emissions to carbon pricing (reflecting marginal abatement cost curves). See Black and others (2022) on methodology for estimating the economic costs.

[19] See Vernon and others (2021) on methodologies for quantifying the broad range of environmental impacts of fossil fuel use on a country-by-country basis.

Table 2. Peru: Summary Table			
	Just Land-Use	**Proportionate**	**Hybrid**
CO2 emissions reduction in 2030, % from BAU	26%	26%	26%
Land-Use Emissions Reduction by 2030, % from BAU	41%	26%	34%
Carbon tax required, $ per MtCO2	$0	$25 in 2023 rising to $155 by 2030	$20 in 2023 rising to $50 by 2030
Cumulative CO2 emissions reductions in 2024-2030, MtCO2	321	357	350
Additional fiscal revenues raised in 2030, % of GDP	0.00	1.88	0.70
Cumulative additional fiscal revenues raised in 2024-2030, bn USD	0.0	28.3	11.6
Impact on GDP growth in 2030, percentage points deviation from the BAU growth	0.0%	0.0%	0.0%
Electricity price increase in 2030, percent from the BAU price	0%	23%	5%
Diesel price increase in 2030, percent from the current price	0%	48%	16%
Relative mean consumption effect on the poorest after revenue recycling, % of BAU consumption	0.0%	16.0%	5.9%
Pure abatement costs, % of GDP	0.0%	-1.0%	-0.3%
Domestic co-benefits (transport, air pollution, climate), % of GDP	0.0%	0.9%	0.4%

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INTERNATIONAL MONETARY FUND

PERU

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

March 8, 2023

Prepared By

The Western Hemisphere Department (In consultation with other departments)

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FUND RELATIONS

(As of January 31, 2023)

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	949.12	71.12
Reserve Tranche Position	385.43	28.88

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	1888.95	100.00
Holdings	1775.06	93.97

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
FCL	May 27, 2022	May 26, 2024	4,003.50	0.00
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:

	2023	2024	2025	2026	2027
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	3.60	3.71	3.70	3.71	3.71
Total	3.60	3.71	3.70	3.71	3.71

Exchange Arrangement

Peru has a floating exchange rate arrangement. On January 31, 2023 the average of interbank buying and selling rates was 3.846 soles per U.S. dollar. Peru accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 15, 1961. Peru maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, 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 2022 Article IV consultation was concluded on April 29, 2022 (IMF Country Report No. 22/137).

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
2022	Debt Management – Debt Servicing Payment Process	2/15/2022
MCM		
2021	CBDC Feasibility	08/27/2021
2022	Back Office Processes	02/15/2022
2022	CBDC Design Phase 1/3	08/01/2022
2022	CBDC Design Phase 2/3	12/20/2022
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
2021	Sectoral Accounts	06/21/2021

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

World Bank Group:

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

Inter-American Development Bank:

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

STATISTICAL ISSUES

(As of January 31, 2022)

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 disseminated these new series unofficially to key users in July 2021 for feedback purposes (see the link) https://www.inei.gob.pe/media/MenuRecursivo/publicaciones_digitales/Est/Lib1808/libro_ingles.pdf.

Price Statistics. The official measure of inflation for Peru is the CPI for Metropolitan Lima and CPI National, 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 improve new weights of some items of CPI. INEI compiles and publishes a WPI for Peru. Likewise, it prepares and publishes a Producer Price Index (IPP) by economic sectors since January 2016, with base year 2015=100 and the weights corresponding to the value added by economic sectors in the year 2007.

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. Peru has participated in 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 Dec 2017). Balance of payments and international investment position (IIP) statistics are reported on quarterly basis following the B*alance of Payments and International Investment Position Manual,* 6th edition (BPM6), starting with Q1 20182 data.

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 February 1, 2023)

	Date of Latest Observation	Date Received	Frequency of data[5]	Frequency of Reporting[5]	Frequency of Publication[5]	Memo Items:	
						Data Quality – Methodological Soundness[6]	Data Quality Accuracy and Reliability[7]
Exchange Rates	2023M1	01/31/23	M	M	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	01/31/23	02/02/23	M	M	M		
Reserve/Base Money	01/31/23	02/07/23	M	M	M	O, LO, LO, LO	O, O, O, O, O
Broad Money	12/31/23	01/27/23	M	M	M		
Central Bank Balance Sheet	01/31/23	02/07/23	M	M	M		
Consolidated Balance Sheet of the Banking System	12/31/22	01/27/23	M	M	M		
Interest Rates[2]	01/31/23	02/07/23	M	M	M		
Consumer Price Index	January 2023	01/31/23	M	M	M	O, LO, LO, LO	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing- Central Government	December 2022	01/27/23	M	M	M	O, LO, O, O	O, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing – General Government	Q4/2022	01/27/23	Q	Q	Q	O, LO, O, O	O, O, O, LO, O
Stocks of Central Government and Central Government Guaranteed Debt[3]	Q4/2022	02/18/23	Q	Q	Q		
International Investment Position[4]	Q3/2022	[12/18/22]	Q	Q	Q		
External Current Account Balance	Q3/2022	[12/21/22]	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	Q4/2022	02/07/23	Q	Q	Q		
GDP/GNP	Q4/2022	02/`16/23	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	Q3/2022	[12/18/22]	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.

Statement by Mr. Herrera and Mr. Hendrick on Peru
March 22, 2023

Key Points

- The Peruvian economy grew 2.7 percent in 2022 and is expected to grow at a similar rate in 2023, one of the highest in the LAC region, thanks to strong fundamentals, and despite the impact of multiple external and domestic shocks.
- Following a global trend, inflation in Peru increased in 2022, but less than in its LAC peers. Inflation peaked in June 2022 and is forecast to follow a downward trend since March 2023. The authorities are confident that Peru will continue to have one of lowest inflation rates in the region, as it has been so far this century.
- The fiscal position remains strong. By end-2022, the fiscal deficit declined further to 1.6 percent of GDP; and public debt fell to 34 percent of GDP, one of the lowest in emerging markets. Despite consolidation efforts, and supported by a strong recovery in revenues, spending in critical social sectors like health, education, and social protection has been prioritized.
- Peru's external position continues to be one of the strongest among emerging market economies. International reserves amount to 30 percent of GDP. This buffer, together with access to a precautionary FCL arrangement, provides additional insurance against tail risks.
- The financial sector remains solid, well capitalized, and with excellent financial soundness indicators, despite the full unwinding of COVID-related emergency measures. Recent stress testing continues to suggest that the financial system is resilient even under severely adverse scenarios.
- The Peruvian authorities continue to work on their structural reform agenda under the OECD accession process, to boost economic growth and address social needs. At the same time, recent political tensions underscore the need to muster social consensus across a range of issues to consolidate the hard-won gains of macroeconomic stability, inclusive growth, and poverty reduction.

INTRODUCTION

1. **The Peruvian authorities would like to express their gratitude to Mr. Santos and his team for constructive policy dialogue during the Article IV Consultation.** The staff report (SM/23/61) provides a well-balanced analysis of recent economic developments and policy discussions. The authorities are in broad agreement with the staff's assessment and policy recommendations. We appreciate the consultation's focus on the authorities' strategy to deal with the materialization of downside risks, such as the economic slowdown in trading partners (China, the U.S., and the euro area), tighter-than-anticipated global financial conditions, high inflation, and increased uncertainty, associated with the Russia-Ukraine war. Additionally, Peru has been hit by flooding and heavy rainfall caused by cyclone Yaku, which affected agricultural activities and damaged infrastructure in the coastal region. Moreover, road blockades during the first 45 days of 2023 hampered Peru's mining, tourism, and agribusiness industries, while also stoking inflation. However, Peru can build on its strong fundamentals to recover high potential growth once social and political stability is restored.

2. **Peru continues to maintain a strong economic performance and substantial policy buffers despite successive external and domestic shocks.** As stated in the first paragraph of the staff report, Peru's macroeconomic performance in the last quarter of a century has been one of the strongest in Latin America. This has been possible by maintaining very strong economic policies and institutional policy frameworks, despite political uncertainty episodes in recent years. The economy grew at an annual rate of almost 5 percent over the last two decades prior to the pandemic; and, under the inflation-targeting framework conducted by the Central Reserve Bank of Peru (BCRP), inflation averaged 2½ percent over the same period (the lowest in South America). After a strong rebound from the pandemic-induced contraction in 2021 (13.6 percent, the highest among peer countries), economic activity is normalizing but growth remains below potential (3 percent). Fiscal buffers are being replenished, international reserves are near 30 percent of GDP, and the FCL arrangement continues to provide insurance against tail risks.

RECENT DEVELOPMENTS

3. **The Peruvian economy grew 2.7 percent in 2022 on the back of strong domestic demand, reflecting a recovery in employment and the lifting of pandemic-related restrictions.** The national unemployment rate fell to 4.3 percent in 2022, while formal employment surpassed pre-pandemic levels in early 2022. While growth could have been higher, the slowdown reflected global trends, deteriorating terms of trade, lower external demand, tightening financial conditions, and road blockades affecting mining activities (especially copper production and exports). Real GDP growth was -1.1 percent (yoy) in January 2023, reflecting the impact of road blockades. However, the authorities believe the conditions are in place to expect a similar rate of growth as in 2022. Even considering the staff's more conservative forecast, a recent IMF Blog suggests that Peru' s economic growth in 2023 may be one of the highest in the LAC region, as it has been so far this century.

Western Hemisphere: Real GDP growth
(year-over-year percent change)

		EST.	PROJECTIONS	
	2021	2022	2023	2024
North America	5.7	2.2	1.4	1.1
Canada	5.0	3.5	1.5	1.5
Mexico	4.7	3.1	1.7	1.6
United States	5.9	2.0	1.4	1.0
Puerto Rico	2.7	4.8	0.4	-1.6
South America	7.4	3.9	1.5	1.9
Argentina	10.4	4.6	2.0	2.0
Bolivia	6.1	3.4	2.9	2.8
Brazil	5.0	3.1	1.2	1.5
Chile	11.7	2.7	-1.5	1.9
Colombia	10.7	8.1	1.1	2.1
Ecuador	4.2	2.7	3.0	2.8
Paraguay	4.2	0.2	4.3	3.5
Peru	13.6	2.6	2.5	3.2
Uruguay	4.4	5.3	3.6	2.7
Venezuela	0.5	6.0	6.5	n.a.
Latin America and the Caribbean	7.0	3.9	1.8	2.1
LAC excluding Venezuela	7.1	3.9	1.7	2.1
LAC excluding Argentina and Venezuela	6.7	3.8	1.7	2.1
LA5	6.4	3.6	1.3	1.7

Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Projections are based on information available up to mid-Jan 2023. Regional aggregates are purchasing-power-parity GDP-weighted averages. CAPDR = Central America, Panama, and the Dominican Republic; LAC = Latin America and the Caribbean. IMF

Western Hemisphere: Inflation, end of period
(year-over-year percent change)

		EST.	PROJECTIONS	
	2021	2022	2023	2024
North America	7.2	6.9	2.8	2.2
Canada	4.7	6.7	3.3	2.1
Mexico	7.4	8.5	4.8	3.5
United States	7.4	6.7	2.5	2.1
Puerto Rico	4.2	4.8	2.3	2.5
South America	14.1	18.3	12.7	8.9
Argentina	50.9	95.9	60.0	44.0
Bolivia	0.9	3.8	3.5	3.5
Brazil	10.1	5.8	5.7	3.5
Chile	7.1	12.5	5.0	3.0
Colombia	5.6	12.7	7.3	3.2
Ecuador	1.9	3.7	2.3	1.3
Paraguay	6.8	8.2	4.2	4.0
Peru	6.4	8.0	3.0	2.3
Uruguay	8.0	8.9	7.2	5.8
Venezuela	686.4	220.0	150.0	n.a.
Latin America and the Caribbean	11.6	14.8	9.9	7.0
LAC excluding Venezuela	11.6	14.8	9.9	7.0
LAC excluding Argentina and Venezuela	7.8	7.9	5.2	3.4
LA5	8.3	8.0	5.4	3.4

Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Projections are based on information available up to mid-Jan 2023. Regional aggregates are purchasing-power-parity GDP-weighted geometric averages. Venezuela is excluded from all inflation aggregates. CAPDR = Central America, Panama, and the Dominican Republic; LAC = Latin America and the Caribbean. IMF

4. **Headline and core inflation have risen in line with global trends, but inflation is expected to return within the target band in 2023.** In the context of global inflationary pressures, headline inflation was 8½ percent at end-2022, driven by imported inflation and global supply shocks (including high energy and food prices). In February 2023, headline inflation declined slightly to 8.65 percent respect to January 2023 (8.75 percent). Factors such as moderating global food and energy costs, a reversal of agricultural supply shocks, and lower inflation expectations, are expected to drive inflation back to the BCRP's 1-3 percent target band by end-2023. Inflation in Peru will likely continue to be one of the lowest and less volatile among LAC and emerging countries, supported by solid BCRP credibility and strong fundamentals.

5. **The BCRP responded in a decisive and timely manner to curb inflation expectations and bring headline inflation back within the target band.** Following the first 25-bp policy rate hike in July 2021, the BCRP has raised it by 725 bps in 17 consecutive steps, to 7¾ percent in January 2023. The monetary authority then decided to pause its hitherto longest tightening cycle to assess the effects of the policy stance and the impact of the recent social unrest on the output gap. At the same time, the BCRP has signaled the markets that its policy stance is data-dependent and may be adjusted if warranted by market conditions. BCRP estimations show that currently the level of economic activity is close to potential.

6. **The fiscal position remains strong, and the public debt-to-GDP ratio is one of the lowest among LAC and emerging economies.** The non-financial public sector (NFPS) deficit continues on a rapidly declining trend (1.6 percent of GDP in 2022), well below the limit of 3.7 percent of GDP set by the fiscal rule, down from 8.9 percent of GDP in 2020 (due to the exceptionally large stimulus implemented to counter the impact of the COVID-19 pandemic).

The lower fiscal deficit in 2022 was driven by a strong 12.7 percent (nominal) increase in tax revenues (real terms 4.5 percent), offsetting a moderate (nominal) 6 percent expenditure increase (real term -1.7 percent, mainly in capital spending). Public debt fell to 34 percent of GDP in 2022, one of the lowest among emerging markets, while public assets stood at 12¾ percent of GDP. The sovereign credit rating remains at investment grade, and sovereign spreads remain among the lowest in the region. Going forward, fiscal consolidation will continue, and the deficit is expected to converge to the medium-term target of 1.0 percent of GDP by 2026.

7. **Peru's external position continues to be strong and FX coverage remains adequate under all Fund metrics.** International reserves remained at a comfortable level of US$72.2 billion as of end-December 2022, one of the highest FX coverages under different criteria (30 percent of GDP, 524 percent of short-term debt at remaining maturity, 207 percent of FX bank deposits, and 250 percent of the Fund ARA metric). Capital inflows are dominated by FDI and other private sources. Regarding the temporary increase in the current account deficit to 4.3 percent of GDP in 2022, it is worth mentioning that, in line with staff's BOP forecasts, the deficit is expected to decline to 2.1 percent in 2023, close to the current account norm estimated from the multilateral EBA model. As highlighted by staff, this year's estimations are subject to considerable model uncertainty, given the multiple shocks on the Peruvian economy in 2022. Moreover, with the update of commodities prices, the current account is expected to be even lower.

8. **The financial sector remains strong and resilient despite tightening financial conditions and the withdrawal of support measures.** It is worth underscoring that the financial system entered the pandemic from a position of strength and remained stable during 2020-2021, as shown by the previous financial soundness indicators heatmap. Profitability was positive but small; and performance has returned to near pre-pandemic levels, with ROE at 16½ percent and ROA at 2.0 percent as of December 2022. NPLs have stabilized around 4 percent, with a remarkably high provision coverage ratio. As expected, credit growth has decelerated rapidly, following the withdrawal of support measures, which included extensive government-guaranteed loans and flexible loan adjustment terms. An updated top-down stress test recently conducted by the authorities continues to confirm the 2018 FSAP findings that the financial system is resilient even under severely adverse scenarios. Yet, the supervisory and regulatory authority will continue to monitor market conditions and take measures as needed.

OUTLOOK AND RISKS

9. **The authorities are more optimistic than staff on the 2023 growth outlook and are confident that the envisaged structural reforms will enhance medium-term potential output.** The new Quellaveco mine, owned by UK's Anglo America and Japan's Mitsubishi, may provide additional growth over ½ percent. This factor will partially offset the output loss due to recent protests. In addition, in line with staff's policy advice, the authorities are implementing a short-term fiscal impulse ("Con Punche Peru" program), which may provide an additional ½ percent growth.

10. **Despite the persistence of global uncertainty and the balance of risks tilted to the downside, we agree with staff that Peru has ample policy buffers to face adverse shocks.** As discussed above, economic fundamentals are very strong, international reserves are high by all standard metrics, the fiscal deficit continues to decline, fiscal consolidation is firmly in place, public debt is low, the sovereign rating remains at investment grade, there is ample access to international markets and low spreads, and the domestic financial sector is strong. These buffers are complemented by the FCL arrangement, thereby shielding the economy from the materialization of tail risks. There is a consensus among market participants that the BCRP's solid reputation and credibility will contribute to driving inflation back within the target band by end-2023 or early 2024. Nevertheless, the authorities stand ready to take additional actions as warranted from evolving and unpredictable global market conditions.

LOOKING FORWARD – RESUMING INCLUSIVE ECONOMIC GROWTH AND POVERTY REDUCTION

11. **The authorities agreed with staff that a small short-term fiscal impulse is appropriate, while maintaining the planned fiscal consolidation beyond 2024.** This is particularly important, not only to provide some stimulus in response to the recent sequence of supply shocks, but also to mitigate the implications of political unrest and higher inflation on vulnerable population segments. As explained in Box 1 of the staff report, the "Con Punche Peru" program aims to inject 0.6 percent of GDP into the economy by providing support to vulnerable households and firms in agriculture and tourism, among the most affected sectors. The program also includes support to subnational governments to help them execute their capital expenditure programs. There are encouraging initial results of these initiatives at the local and regional level.

12. **The authorities remain committed to the fiscal rule and fiscal consolidation in the medium term.** The original NFPS deficit target of 1 percent by 2025 was delayed by only one year, while the limit of the public debt-to-GDP ratio was temporarily set at 38 percent, with a view to returning to the original debt ceiling of 30 percent of GDP by 2032. The fiscal strategy is based on the authorities' Medium-Term Budgeting Framework, which attempts to strike a balance between fiscal consolidation and economic growth. In addition, the Fiscal Council plays a key role in providing an independent view to the Ministry of Finance on fiscal policies. Recent legislation has further enhanced the strength and credibility of the Fiscal Council. The authorities are aware of the importance of redesigning the pension system. Along these lines, they are assessing options and promoting a consensus among stakeholders and civil society.

13. **Maintaining stable and low inflation is also key to support growth and secure poverty reduction.** After the transitory COVID-related shocks in 2020-21 and the recent global supply shocks, the monetary authority is focused on reducing headline inflation back within the 1–3 percent target band. Inflation in Peru has been one of the lowest and less volatile in LAC (2.7 percent on average in 2001-2021). Maintaining single-digit inflation during more than two decades has been instrumental in creating a good business climate, favoring higher real

household incomes, and promoting substantial poverty reduction. The BCRP's successful inflation-targeting performance ensures a decisive data-driven policy response.

14. **Financial resilience and the absence of systemic risks are also instrumental in supporting economic growth and financial stability.** Despite the strength of Peru's financial system, tested in several recent crises, the authorities continue to further enhance the financial regulatory and supervisory framework. In January 2023, a new capital framework was introduced, fully aligned with Basel III requirements; and most FSAP recommendations have been implemented, including expanding financial cooperative oversight by the banking supervisor, monitoring banks' balance sheet exposures, introducing a deposit insurance scheme for credit unions, and enhancing the emergency liquidity assistance framework.

15. **The authorities remain committed to their structural reform agenda under the OECD accession process, although approval by Congress may take longer than expected.** Raising productivity and reducing informality continue to be top priorities. The authorities are cognizant that first the pandemic, and more recently political unrest, highlight the need to enhance the public provision of health, education, and social protection. To this end, the authorities are taking steps to enhance budget implementation capacities and the quality of public spending at the local and regional level. Progress has also been made on public accountability, as detailed in Annex X of the staff report.

16. **Peru was the first Latin American country to enact a Framework Law on Climate Change in 2018, in line with the Paris Agreement.** In 2020, the government established a High-Level Commission on Climate Change. Peru published its National Adaptation Plan in 2021 and declared a national climate emergency in 2022. It is important to underscore that Peru is not a large carbon emitter, as its energy matrix is intensive in natural gas and hydroelectric power. As explained in Annex XI, the main sources of emissions are land use change and forestry (LULUCF). As 57 and 95 percent of Peru's territory are forestland and Amazon rainforest, respectively, deforestation represents a considerable challenge.

FINAL REMARKS

17. **The strength of the Peruvian economy has been built over the last three decades.** After a deep recession and hyperinflation in the late 1980s, Peru transformed its economy and institutional framework through solid macroeconomic policies leading to sustained growth, low inflation, and substantial poverty reduction, thereby paving the way for a resilient economy. Fiscal discipline, openness, and a friendly investment framework were critical for building strong fiscal and international reserve buffers against a series of shocks in recent decades, and for strengthening the economy in the face of future challenges. The very strong fundamentals of the economy have helped to protect it from both external and domestic shocks, including political instability.; and Peru has emerged as one of the region's fastest growing and most stable and resilient economies. Nevertheless, the authorities are not complacent and stand vigilant to make

any necessary corrections along the road to ensure sustained and inclusive growth; and remain committed to complying with Peru's burden-sharing for a better and sustainable world.