March 2001
IMF Country Report No. 01/48

Peru: 2000 Article IV Consultation and Request for Stand-By Arrangement—Staff Report; Staff Statement; Public Information Notice; and Statement by the Authorities of Peru

As required under Article IV of its Articles of Agreement, the International Monetary Fund conducts periodic consultations with its member countries. It also reviews the use of its resources. In the context of a combined discussion of the 2000 Article IV consultation with Peru and request for a Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the combined 2000 Article IV consultation and request for a Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **February 6, 2001,** 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 February 26, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a staff statement of **March 12, 2001,** updating information on recent economic developments;

- the Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its March 12, 2001, discussion** of the staff report on issues related to the Article IV consultation; and

- a statement by the authorities of Peru.

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

Letter of Intent sent to the IMF by the authorities of Peru
Selected Issues paper combined with Statistical Appendix

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623 7430 • Telefax: (202) 623 7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PERU

Staff Report for the 2000 Article IV Consultation and Request for a Stand-By Arrangement

Prepared by Western Hemisphere and
Policy Development and Review Departments

(In consultation with the Fiscal Affairs, Legal,
Monetary and Exchange Affairs, Statistics, and Treasurer's Departments)

Approved by Miguel E. Bonangelino and Liam P. Ebrill

February 26, 2001

Contents

Page

Figures

Appendices

EXECUTIVE SUMMARY

Recent developments

After several years of strong performance, the Peruvian economy weakened in 1998–99 under the influence of various external shocks. In 2000, a nascent recovery in the first half of the year was cut short as private investment fell in view of increasing political uncertainty, and government expenditure was restrained to offset overspending prior to the elections. Output grew by 3.6 percent in 2000, and employment declined. Inflation remained low.

The fiscal deficit in 2000 was 3 percent of GDP, above the 2 percent of GDP limit in the country's fiscal responsibility law and the indicative target in the program supported by a Fund extended arrangement. The overrun reflected a shortfall in revenue resulting from the slowdown in activity and a weakening of tax administration and tax policy. The external current account deficit fell to 3 percent of GDP, but net capital inflows were lower than programmed, which resulted in a small decline in international reserves compared with a moderate accumulation in the program. However, reserves remained at a comfortable level. The quality of bank loan portfolios deteriorated in the first seven months of the year, but has stabilized subsequently, and the authorities continued to strengthen the banking system.

Policy discussions

The overriding strategy behind the authorities' program for 2001, for which they are seeking Fund support through a stand-by arrangement, is to ensure macroeconomic stability in the transition to the government that will take office in July.

The program for 2001 envisages a recovery in economic activity following the change in government. Real GDP is expected to grow at 2.5 percent, inflation would remain low, the external current account deficit would decline further, and international reserves would increase moderately. The fiscal deficit would be reduced to 1.5 percent of GDP (the limit in the fiscal responsibility law) based on spending restraint, but priority social programs would be protected. To address an anticipated decline in government revenue beyond 2001, the authorities will prepare a comprehensive tax reform proposal for the next government. The exchange rate and interest rates will continue to be market-determined.

The authorities continue to monitor developments in the banking system closely, and are implementing some of the recommendations of a recent FSAP mission. They confirmed their intention to minimize the fiscal cost of bank restructuring by encouraging market-based solutions, including through mergers and capitalization of banks by the private sector. They also expressed their commitment to resist pressure for using public resources for the promotion of lending to specific regions or economic sectors.

The structural reform agenda includes improving the targeting of social programs (supported by the World Bank); enhancing financial administration and the transparency of government operations (supported by the Inter-American Development Bank); a program of privatization and operating concessions; the sale of agricultural land, and rural land titling and registration; and the maintenance of domestic fuel prices at international levels.

I. Introduction

1. Discussions for the 2000 Article IV consultation and on an economic program that could be supported by a Fund arrangement were held in Lima during October 17-November 1 and December 13–22, 2000.[1] In a letter to the Managing Director dated February 6, 2001, the authorities describe the policies they intend to follow during 2001 and request a one-year Stand-By Arrangement in an amount equivalent to SDR 128 million, equal to 20 percent of quota on an annual basis (Attachment I).[2] The authorities intend to treat the arrangement as precautionary. For the safeguard review with the Treasurer's Department, the central bank selected an audit firm in January 2001, and the audit process should be completed by March. Peru has accepted the obligations of Article VIII, Sections 2, 3, and 4 (Appendix I).

2. At the conclusion of the last Article IV consultation on June 24, 1999, Directors noted that the Peruvian economy continued to be vulnerable to external shocks, and urged the authorities to press ahead with planned measures to consolidate gains in policy credibility and further strengthen the economy. Directors welcomed the emphasis being placed on higher-quality fiscal expenditure, as well as on further improvements in tax administration.

3. The 2000 Article IV consultation was delayed owing to political developments in Peru. After assuming office for a third consecutive term in July 2000, President Fujimori was removed from office by congress in November, and replaced by an interim constitutional President, Mr. Valentín Paniagua. Presidential and congressional elections are scheduled for April 8, 2001, with the change in government in late-July. The interim administration decided to cancel Peru's extended arrangement and seek Fund support through a Stand-By Arrangement.[3]

4. Peru has subscribed to the Special Data Dissemination Standard, and its metadata is posted in the Fund's external web page. In June 2000, Peru's official statistical office (INEI)

---

[1] The Peruvian representatives included the Ministers of Finance, Labor, Industry and Trade, Mining and Energy, and Transport and Communications; the President of the Central Reserve Bank of Peru; senior public officials; and representatives of the private sector. The staff team consisted of Messrs. Lizondo (Head), Chua (WHD), Cordoba (FAD), and Melhado (WHD), Ms. Richter Hume (PDR), and Mr. Wolfe (WHD). Mr. Hendrick, Advisor to the Executive Director, participated in the policy discussions.

[2] As in previous arrangements, the letter of intent was issued in the country to elicit public comments before being submitted to the Fund.

[3] The three-year extended arrangement, which the authorities treated as precautionary, was approved on June 24, 1999 for the equivalent of SDR 383 million (60 percent of quota), and the first review was completed on March 29, 2000 (EBS/00/47).

published the long-overdue revision of the country's national accounts.[4] The timeliness and quality of economic statistics have been broadly adequate for effective surveillance and for formulating and monitoring the financial program. However, congress has recently started investigating allegations that during the last decade certain government spending carried out under secret norms was associated with corruption. The staff is following this issue closely to assess whether it has implications for the recording of past fiscal statistics. The authorities are working to improve the reporting of fiscal data (with the help of the Inter-American Development Bank (IDB)); it would be important that this effort include the provision of information on the accounts and operational procedures of the military and police pension funds. The authorities are also working to enhance the quality of labor market data (with the aid of the International Labor Organization).[5]

II. Background and Recent Developments

5. **During 1991–97, Peru made major progress in eliminating large disequilibria that beset the economy at the beginning of the decade**. The list of achievements included the elimination of the fiscal deficit, a liberalization of the exchange rate, interest rates, and the trade and payments system, and a reduction in labor market rigidities. Hyperinflation and falling output gave way to a sustained reduction in inflation and real GDP growth that averaged 5.3 percent during the period. Structural reforms shifted control over productive activities from the public to the private sector, strengthened the financial system, and opened up the pension system to private administration. Also, the country virtually completed the process of normalizing relations with external creditors and restructuring external debt.

6. **In 1998–99, the Peruvian economy weakened under the influence of external shocks that included the *El Niño* weather disturbance, a sharp drop in commodity export prices, and a liquidity squeeze stemming from turbulence in international financial markets** (Table 1 and Figure 1). Output declined in 1998 and recovered only slightly in 1999, as domestic demand fell. Employment also fell over this period (Figure 2). The external current account deficit increased in 1998, mainly reflecting the drop in export prices, but narrowed significantly in 1999 owing to the weakness in domestic demand. Weak demand also contributed to reducing inflation. Bank credit growth slowed sharply, initially as a result of a reduction in foreign credit lines after the Russian crisis in August 1998, but subsequently owing to banks' concern about the debt servicing capacity of their clients. As capital inflows declined, the currency depreciated significantly in real effective terms and international reserves fell, although by the end of 1999 they were still at a comfortable level. The structural reform effort weakened in this period, particularly in the area of privatization.

---

[4] Appendix II discusses the main changes resulting from this revision, including a downward adjustment of about 10 percent in nominal GDP over the 1990s. The numbers in this staff report, including ratios to GDP, are based on the revised national accounts.

[5] Chapter 1 of the selected issues paper, which analyzes developments in the labor market over the 1990s, also discusses the shortcomings in labor market statistics.

7. **The fiscal situation deteriorated sharply over 1998–99, as the combined public sector position moved from balance in 1997 to a deficit of 3 percent of GDP in 1999** (Tables 2 and 3). Government revenue fell under the combined effect of weak economic activity, the lowering of certain tax rates (most of them decided before the economic slowdown worsened tax collections), the narrowing of the tax base through the granting of tax benefits,[6] and a weakening of incentives for compliance due to the introduction of tax rescheduling schemes. Government expenditure rose significantly in 1999, mainly reflecting a large wage and pension hike that year (after two years of not having adjusted them).

8. **The program for 2000 envisaged real GDP growth of 4 percent, inflation of about 4 percent, a moderate accumulation of international reserves, and a slight rise in the external current account deficit to just under 4.5 percent of GDP.** The program targeted a reduction of the combined public sector deficit to 2.1 percent of GDP (1.9 percent of GDP using the data available prior to the revision of the national accounts), consistent with the limit in the country's Fiscal Responsibility Law (in its first year of application). Bank credit to the private sector was expected to pick up owing to a strengthening of the financial position of firms that was to result from the introduction of a fast-track facility for corporate debt restructuring, and from government-supported programs to provide liquidity to banks and to help them lengthen the maturity of their loans to clients. The authorities were to continue implementing a flexible exchange rate policy and maintaining an open trade regime. The reform agenda included a step-up in the pace of privatization and awarding of concessions, measures to promote private sector activity in the agriculture and forestry sectors, and reforms in the financial sector, social sectors, and public financial management.

9. **In the event, output grew by 3.6 percent for 2000 as a whole, but slowed sharply in the second half of the year as a result of a weakening of domestic demand**; private investment fell owing to the uncertain political situation and government expenditure was tightened (beginning in August) to offset overspending prior to the elections. Employment continued to decline, and by December 2000 it was 2.6 percent lower than a year earlier. Inflation was kept in check, ending 2000 at 3.7 percent despite a large increase in fuel prices.

10. **Strong demand for Peru's traditional exports, together with weak domestic demand, reduced the external current account deficit to an estimated 3 percent of GDP**, despite a slight deterioration in the country's terms of trade (Table 4 and Figures 3 and 4). Merchandise exports (in U.S. dollar terms) grew 15 percent, based on a volume growth of 10 percent (mainly fishmeal) and a recovery in major commodity prices (mainly minerals).[7]

---

[6] These include tax exemptions for firms in the Amazon region, a special tax regime for rice producers, and the partial exoneration from the value-added tax on home sales.

[7] Chapter 2 of the selected issues paper analyzes of the performance of Peruvian exports over the last 40 years.

Merchandise imports grew 10 percent, partly reflecting a large increase in the price of oil-products imports.

11. **The combined public sector deficit, estimated at 3 percent of GDP, overshot the program target by about 1 percent of GDP, reflecting a shortfall in general government tax revenue**. This shortfall resulted from slower than projected output growth, and the effect of certain tax policy and tax administration measures introduced in the year. The latter included: (i) lower tax compliance owing to a reduction in penalties for delinquent taxpayers, an easing of conditions to access existing tax rescheduling programs, and the introduction of a generous tax amnesty in August, [8] (ii) a weakening of tax administration efforts in the electoral period; and to a lesser extent (iii) a broadening of the scope of special tax incentive regimes.[9] General government noninterest expenditure ended the year at around program levels, following a tightening of spending (as indicated above), which offset an expenditure overrun of about 0.5 percent of GDP in the run-up to the elections in the second quarter of the year.[10]

12. **In 2000, bank credit failed to pick up despite official efforts to facilitate lending** (Table 6 and Figure 5). In addition to previous initiatives aimed at supporting the banking system and encouraging lending (described in Appendix III), in August the central bank lowered by 3 percentage points (to 34 percent) the average reserve requirement on U.S. dollar deposits, and by 1 percentage point (to 6 percent) the reserve requirement on Sol deposits.[11] In addition, the government introduced two new schemes (for the agricultural and for other sectors) to facilitate the restructuring of corporate debts to banks; so far the impact of these programs has been limited and the scheme for the nonagricultural sector is being

---

[8] These measures aimed at assisting the many cash-constrained firms that were not meeting their obligations to other enterprises and financial institutions. The authorities viewed the fiscal cost of these measures as nil, because these firms would be unlikely to pay their tax liabilities in the absence of some relief. The staff considered that these measures reduced the incentives for tax compliance for all taxpayers, and thus had a significant fiscal cost.

[9] Mainly tax benefits to the agriculture and agro business sector. In September 2000, the government closed several tax loopholes and eliminated certain tax incentives and exemptions, including accelerated depreciation in leasing contracts and tax rebates on imports of several agricultural inputs, but these steps were subsequently reversed.

[10] The midyear fiscal performance criterion under the extended arrangement was not met (Table 5). All other June performance criteria were observed. No performance criteria were set beyond June 2000 because the political turmoil in the country during the second half of the year prevented the completion of the second program review (which would have set such criteria).

[11] The Peruvian financial system is highly dollarized, with about 80 percent of total deposits and credit denominated in U.S. dollars.

revised.[12] Bank credit to the private sector (measured in U.S. dollars) declined by about 2 percent in 2000. Banks remained concerned about the creditworthiness of their clients and thus concentrated their lending on preferential clients, paid down lines of credit from abroad, and accumulated remunerated dollar deposits in excess of reserve requirements at the central bank. Despite relatively stable interest rates in U.S. dollars in the interbank market, preferential lending interest rates in U.S. dollars declined somewhat during the year (to 10.7 percent on 90-day loans by December), in reflection of the intensified competition for the limited pool of creditworthy borrowers; rates in Soles fell both on preferential loans (to 18.2 percent by December) and in the interbank market (Figure 6).

13. **The quality of bank loan portfolios deteriorated in the first seven months of 2000, but has stabilized subsequently** (Figure 7). The share of nonperforming loans rose from 9.3 percent at end-1999 to 11.6 percent by end-July 2000 and has remained at about that level through end-2000. Meanwhile, bank provisioning was around 80 percent of nonperforming loans throughout 2000, roughly unchanged from its end-1999 level.

14. **In 2000 the authorities continued in their efforts to strengthen the banking system.** Three insolvent banks were closed and one small bank was acquired by a larger one; by year's end there were 16 banks, with the five largest ones accounting for 80 percent of total banking system deposits. In addition, a state-owned commercial bank (that the government had bought in 1998 to avoid its collapse and potential systemic problems) is in the process of being acquired by the fourth largest bank. This takeover (which is expected to be completed in April 2001) would be facilitated by the government's additional capitalization of the state-owned bank and the owners' capitalization of the private bank. The upper limit for the potential fiscal cost of official measures adopted since late 1998 to support the banking system is 3.9 percent of GDP; the actual cost will most likely be lower, as the above estimate assumes that available programs are used in full (resources still not tapped amount to 1.6 percent of GDP) and that the assets received by the public sector have zero recovery value.

15. **The FSAP mission that visited Lima in late 2000 and early 2001 concluded that the authorities' current strategy for the banking system was broadly appropriate, but that the financial system in Peru will continue to face pressures.**[13] The FSAP mission found that the substantial investment of financial institutions from industrial countries in Peruvian banks has provided an important anchor for confidence in the stability of the system, and concluded that systemic risk in the banking system is limited. This

---

[12] The fast-track facility for corporate debt restructuring (which also was expected to help spur bank lending) has been hampered by conflicts with existing judicial procedures. An ongoing revision of all the schemes for corporate debt restructuring is addressing these problems.

[13] The mission also noted that certain actions to aid the banking system in the past were not transparent and may have allowed for a delay in provisioning.

notwithstanding, the quality of bank loans is not expected to turn around quickly and earnings are likely to remain flat, which may lead banks to pressure the authorities to weaken provisioning requirements. In this circumstance, the FSAP mission recommended that: (i) the Superintendency of Banks (SBS) continue with its plan for dealing with weak banks; (ii) the SBS, the Ministry of Finance (MEF), and the Central Bank (BCRP) continue their recently organized weekly meetings to monitor banking system developments and coordinate needed action; (iii) the SBS staff be given full legal protection in the performance of their duty and that the SBS budget be fully independent from ministerial oversight in order to strengthen the regulatory institution; and (iv) the SBS employ additional "triggers" (mainly related to liquidity indicators) and "formal time limits for bank responses" when enforcing corrective action toward banks.

16. **Net capital inflows in 2000 were significantly lower than programmed, leading to a small loss of net international reserves (compared with a moderate accumulation envisaged in the program).** Most of the shortfall in capital inflows resulted from lower than anticipated private inflows, as the uncertain political situation weighed heavily on foreign investors (Tables 4 and 7). Moreover, the slowdown in privatization is likely to have postponed foreign direct investment. Net public sector capital inflows were somewhat lower than originally projected owing to an unanticipated advance repayment by the state second-tier development bank. Accordingly, from an initial stock of US$8.2 billion, in 2000 net international reserves fell by about US$200 million, rather than increase by US$300 million as programmed. As of November 2000, the sol had appreciated by 9.8 percent in real effective terms from a year earlier, but was still depreciated by 5.6 percent with respect to its peak in January 1998.

17. **At end-2000 Peru had a comfortable level of international reserves, but a relatively high external debt burden, and a somewhat increased market perception of country risk** (Table 8). Despite the decline in international reserves during the year, at end-2000 gross reserves were equivalent to 143 percent of short-term external debt (on a residual-maturity basis), and to 10 months of imports of goods and services projected for 2001. External debt indicators improved, but by end-year total external debt was still equivalent to 50.5 percent of GDP, and debt service amounted to 50 percent of exports of goods and services. Spreads on Peruvian Brady bonds (PDI) rose from 443 basis points at end-1999 to a peak of 840 basis points in late October 2000, and then declined to 687 basis points at year-end, mainly reflecting the political uncertainty in the country but also the general rise in spreads throughout the region.[14] In late 2000, Standard and Poor's downgraded Peru's long-term foreign-currency sovereign credit risk to BB- (from BB);

[14] Due to an outstanding attachment order on Peruvian official assets obtained by a rogue creditor, Peru missed a scheduled interest payment on its Brady bonds in September, but the situation was resolved before the grace period expired and thus no default occurred (Appendix IV).

Moody's kept its rating at Ba3, but lowered its outlook from stable to negative. Both ratings are noninvestment grade.

18. **The authorities made progress with structural reforms in 2000.** All structural benchmarks under the program through June 2000 were observed, except for the auction of the transport and distribution phase of the Camisea project and the awarding of the first forestry management concession (the former was subsequently awarded, but the latter has been rescheduled for 2001). In addition, in 2000 the authorities started the process of granting management concessions for the Lima airport (which was awarded in February 2001) and for regional seaports (expected to be awarded later this year). Assets sales in 2000 amounted to US$418 million (0.8 percent of GDP), only two-thirds of the level programmed for the year, as the government did not divest shares in previously privatized firms as envisaged. Reform in the areas of public finances, the financial sector, and poverty alleviation, supported by the World Bank and the IDB were implemented mostly as envisaged; however, the poverty alleviation program was scaled back to focus only on healthcare reform, owing to a lack of counterpart resources.

III. Policy Discussions

19. The overriding strategy behind the authorities' economic program for 2001 is to ensure macroeconomic stability in the transition to the government that will take office in July; this would lay the basis for the next administration to move forward with an economic program to promote sustained growth of output and employment, and a declining external debt burden. The authorities believe that Fund support for their program will underscore their commitment to sound policies, thereby enhancing market confidence and also catalyzing financing for the public sector, including adjustment lending by the multilateral institutions. The short period until the change in government, as well as the lack of a majority in congress, is constraining the authorities' ability to pursue a bold agenda of structural reforms.

20. **The program for 2001, for which Fund support through a precautionary Stand-By Arrangement is being requested**, is based on real GDP growth of 2.5 percent, which is predicated on a recovery in the second half of the year, to be driven by a pick-up in private demand as uncertainty subsides following the change in government. Inflation is targeted to decline slightly, to 3 percent by year-end, and net international reserves to increase modestly. The external current account deficit would fall to 2.4 percent of GDP, in part reflecting an expected improvement in the country's terms of trade.

21. **Consistent with the objectives of the program, and essential for limiting fiscal pressures on the next administration, the combined public sector deficit in 2001 would be reduced to 1.5 percent of GDP, the limit in the Fiscal Responsibility Law.** The authorities and the mission considered that respecting the legal limit for the fiscal deficit also would strengthen public confidence in the authorities' goal of securing macroeconomic stability in the runup to the change of government in July.

A. Fiscal Policies

22. **Discussions focused on the mix of expenditure and revenue policies to achieve the necessary fiscal adjustment in 2001.** It was agreed that it was important to halt the steady erosion of revenue that had taken place since 1997, but it was also recognized that in the context of the slowdown in economic activity the scope for increasing general government revenue above the current level of 17.4 percent of GDP was limited. Thus, the fiscal program seeks to keep general government revenue (as a ratio to GDP) at its 2000 level, with the fiscal adjustment coming from a reduction in expenditure.[15] Given the expenditure compression, the authorities and the staff agreed that any additional measures that may be needed to meet the fiscal targets should come from the revenue side, as further cuts in expenditure could jeopardize important social programs.

23. **The reduction in expenditure would fall mostly on nonproductive spending.** About one-third of the adjustment would result form a freeze in wages and pensions (following a general increase of 16 percent in 1999 and no increase in 2000). In addition, the authorities would cut other spending across all ministries, but especially in defense and national security and in the ministry of the presidency (which was expanded under the former administration and maintains several transfer programs which the authorities consider to be inefficient and poorly-targeted).[16]

24. **The authorities emphasized their intention to improve the efficiency and targeting of social programs** with the support of a structural adjustment loan from the World Bank. They will allocate budget resources to specific programs according to priorities set out in the multiannual plan that was published last October, and will develop monitoring systems for the major programs. The authorities' strategy in this area has been developed on the basis of discussions with program recipients and administrators and the academic community. Improved targeting will be aided by using the 2000 revision to the national poverty map as the single geographic targeting tool.[17]

25. **The mission expressed concern that priority social programs in primary education and health could be jeopardized as overall social spending would decline from 6.8 percent of GDP in 2000 to 6.1 percent of GDP in 2001, but the authorities confirmed their commitment to protect expenditure in these areas** (Table 9). They noted that outlays in 2001 for preprimary and primary education, health services of the Ministry of Health (which provides healthcare to the poor), and sanitation services will remain at their

---

[15] The adjustment will be spread about evenly over the year, with the deficit in the first quarter falling by 1.3 percent of GDP with respect to the same quarter in 2000.

[16] The congress has ratified the expenditure plan for 2001.

[17] Up to now, various poverty maps have been employed and each agency has utilized its own targeting criteria.

level in 2000 of 2.8 percent of GDP. They also noted that planned reductions in education spending would mainly reflect lower spending on tertiary and technical education, and that in the area of healthcare, savings from reduced outlays to build hospitals (of which there is sufficient capacity) will create room for expansion in two priority programs—the maternal-infant health insurance program and the decentralized health posts program. The mission urged the authorities to move quickly with the World Bank in this area, so as to ensure a proper monitor of priority social programs and an adequate allocation of resources for these programs.

26. **In order to maintain revenue constant as a share of GDP**, in late 2000 and early 2001, the authorities extended for one more year the payroll tax (IES), adjusted excise taxes (and adopted an automatic adjustment mechanism to maintain the real value of all specific excises), and introduced steps to tighten conditions on the current tax amnesty (canceling the extended financing period for those taxpayers that fail to pay the agreed installments). Late last year the authorities also sent to congress a proposal for a **tax reform** that was intended to be revenue-neutral. The proposal was to reduce the corporate income tax rate and the top marginal rate for the personal income tax (from 30 to 20 percent) while eliminating certain sectoral and regional tax exemptions on the income tax and other taxes, effective 2001.[18] Instead, the reform approved by congress reduces tax rates starting in 2002, but does not include the elimination of most of the tax exemptions that would have made the reform revenue-neutral.[19] To begin to address the implication of these measures for revenue in 2002, the authorities agreed with the staff to prepare a comprehensive tax reform proposal (which would generate the necessary resources for 2002 and over the medium term) that would be presented to the newly elected authorities by midyear.[20] The tax reform agenda of the next government is expected to be an integral component of the midyear program review.

27. **The authorities have set out steps to improve the efficiency and transparency of fiscal operations**. The tax collection agency (SUNAT) will step up its efforts to reduce tax evasion by: (i) introducing a new information system for the auditing of VAT and income tax returns; (ii) establishing an excise-tax auditing force; (iii) streamlining audit and collection procedures; (iv) facilitating taxpayer access to electronic filing and payment technology; and

---

[18] The mission had recommended reducing the income tax rates only to 25 percent until the impact on revenue could be better gauged. The elimination of tax exemptions was also aimed at reducing distortions, and was consistent with recommendations from a FAD technical assistance mission that visited Lima in June 2000 (Appendix V).

[19] For 2001, there will be an income tax credit of up to 10 percentage points on reinvested earnings that would be applied at the time of the final 2001 tax payment, which takes place in April 2002. Thus, revenues in 2002 will be adversely affected by both the reduction in the tax rate for that year, and the tax credit corresponding to reinvested earning in 2001.

[20] To this effect, the authorities have solicited follow-up technical assistance from FAD.

(v) implementing a new system of cross-checking information on professional activities. The authorities noted that SUNAT would have their full support in implementing these initiatives. With the assistance of the IDB, the government will expand the financial administration and control system (SIAF) to all executing units in the budget (including the ministries of defense and interior). Also, it will introduce payroll and inventory control systems, require periodic reporting of public enterprises, and develop a tax and financial administration module for municipalities. In addition, to improve transparency the ministry of finance (MEF) will publish in the first quarter of every year a report on the performance of the economy in the previous year and prospects for compliance with the multiannual macroeconomic plan (published annually in accordance with the Law on Fiscal Responsibility). In 2001, the MEF will begin publishing a monthly fiscal bulletin that will contain detailed information on the revenue and spending performance of budgetary units (including data on revenue foregone from tax exemptions and tax incentives).

28. **In the current political environment, pressures persist for further tax exemptions and official intervention in markets that threaten the achievement of the fiscal target for 2001 and the objective of delivering a sound economy to the next administration.** To resist these pressures, in recent days the government obtained legislation that gives the executive branch the authority (for 60 working days) to eliminate some of the existing tax exemptions and to stop several proposals to grant new ones. The staff urged the authorities also to resist other initiatives now before congress (such as suspending temporarily firms' ability to lay off workers, forcing banks to refinance consumer loans, and modifying—in a way that would weaken—the current two-tier pension system)[21] which would severely compromise the immediate and longer-term performance of the economy. The authorities agreed with this assessment and affirmed their commitment to oppose any such legislation. The staff also expressed concern about a recent government measure aimed at stimulating domestic demand. By this measure, employees would have free access (for the first ten months of this year) to the monthly contributions that employers have so far been required to deposit into individual accounts that can be accessed in case of unemployment. Staff pointed out that this measure would weaken the unemployment protection system and would put pressure on the next administration to renew the policy in order to avoid a reduction in workers' take-home pay.

B. Monetary and Financial Sector Policies

29. **Monetary policy in 2001 will be guided by the inflation objective of the program,** and the central bank (BCRP) will continue to manage liquidity mainly through open market operations. The monetary program for 2001 assumes that base money, the intermediate target, will increase broadly in line with nominal GDP, while credit to the private sector is expected to remain flat (in real terms) as banks continue to remain cautious in their lending operations. Interest rates and the exchange rate will continue to be market-determined. The

---

[21] For an overview of the pension system, see Chapter 3 in the selected issues paper.

mission agreed with the authorities' stance on monetary policy, and welcomed the central bank's intention to improve the transparency of monetary policy through the publication of a monthly report on monetary policy objectives and operations. The BCRP is exploring the possibility of introducing a formal inflation-targeting framework for conducting monetary policy and has sought MAE's help in organizing a seminar in Lima in mid-March that would look into whether such a framework is appropriate for Peru (in light of the high degree of dollarization of the economy).[22]

30. Guided by the preliminary findings of the FSAP mission, **staff held discussions on the situation of the banking system with the supervisory agency (SBS), the MEF, and the BCRP and agreed with the authorities' assessment that systemic risk appeared to be limited at present. This notwithstanding, the mission urged the authorities to continue strengthening the banking system.** In particular, it stressed the need to monitor closely the banks to ensure good management and adequate capitalization. The authorities were confident that the current early warning system for monitoring financial institutions (based on several liquidity and solvency indicators) was sufficient to keep track of all banks in the system. **The authorities also confirmed their intention to minimize the fiscal cost of bank restructuring by encouraging market-based solutions, including through mergers and capitalization of banks by the private sector.**

31. **The authorities have acted on some of the FSAP mission recommendations.** The SBS, MEF, and BCRP now hold weekly meetings to coordinate actions on the banking system, and legal protection for SBS staff is being sought from congress (as part of draft law to combat money laundering). In addition, the SBS will introduce rules to limit maturity mismatches, require liquidity contingency planning for financial institutions, and enhance consolidated supervision. On the other hand, the authorities preferred not to pursue measures for strengthening supervision that would require modifying the current banking law as opening this law for discussion in congress could lead (in the present political circumstances) to unanticipated and undesirable changes to the law. The mission concurred with this view.

32. **Political pressures have mounted in recent months for the creation of state-supported specialized banking institutions (such as an agricultural bank) and for an increase in government support for the restructuring of bank debt.** The staff urged the authorities to resist these pressures and rely on market-based solutions for problems in these areas. The mission pointed out that bank lending has been constrained by the lack of creditworthy clients rather than by insufficient liquidity or banks' inability to properly assess credit risks in particular sectors, and hence, specialized state financial institutions would not address the problem and only serve to drain already scarce public resources from more productive activities. The authorities affirmed their commitment to avoid the use of public resources for the establishment or maintenance of specialized banking institutions and for the

[22] Chapter 4 of the selected issues paper discusses monetary policy in Peru, and considers some benefits that could be obtained by introducing a formal inflation-targeting framework.

promotion of lending to specific regions or economic sectors. Also, they indicated that no public resources (additional to those already committed under current programs) would be used to promote the restructuring of enterprise debts with financial institutions.

C. External Sector Policies

33. **The authorities intend to maintain a flexible exchange rate policy**, undertaking intervention mainly to avoid undue short-term exchange rate volatility and in amounts consistent with the program's international reserves target. The authorities and the staff agreed that the flexible exchange rate system has served Peru well in helping the economy adjust to external shocks and maintain an adequate level of international competitiveness.

34. The external current account deficit is projected to narrow in 2001 to 2.4 percent of GDP on the basis of strong export growth (7 percent in volume terms), slower import growth (about 3.5 percent in volume terms), and some improvement in the country's terms of trade. Net capital private inflows are expected to decline, owing mainly to continued political uncertainty, although total net inflows would be somewhat higher than last year reflecting higher net disbursements to the public sector. The projected current account, together with the expected rise in net capital inflows, is consistent with the targeted increase of US$215 million in net international reserves. (Net international reserves as defined for monitoring purposes, with the financial system's foreign currency deposits in the central bank as a reserve liability, would increase by US$95 million.)

35. In the area of **trade policy**, the government maintains its commitment to an open trade regime and to not introduce trade barriers in a manner that is inconsistent with Peru's obligations as a member of the WTO.[23] The mission and the authorities agreed that the prospect for a significant reduction in the dispersion and average rate of trade tariffs was limited in the current political and fiscal circumstances, but that pressures to increase protection on industrial and agricultural products must be resisted. The mission did see room to eliminate the systems of fixed-rate and variable-rate import surcharges, which had been recommended by the staff for several years. The authorities, however, considered that, at best, the fixed-rate surcharge on meat products could be reduced from 10 to 5 percent (which was done in January), and the system of variable-rate surcharges could be reformed by

[23] Peru's low level of trade restrictiveness is reflected in its current rating of 2 on the 1–10 scale of trade restrictiveness developed by the Fund (EBS/97/163), owing to its moderate level of tariff protection (weighted average of around 13 percent) and the absence of nontariff barriers of major significance. However, the basic tariff rates of 0, 12, and 20 percent, and fixed-rate import surcharges of 5 percent (on certain agricultural products) and 10 percent (at the time of the mission, on certain meat products), implied tariff rates between 0 and 30 percent. Furthermore, Peru maintains a system of variable-rate import surcharges (based on reference prices linked to historical world prices) on certain agricultural products that on occasions has resulted in very high rates of protection.

establishing an automatic biannual adjustment to the set of reference prices that forms the base for the surcharge calculation (thus, eliminating discretionary adjustments that in the past have led to the maintenance of high protection levels). A decree to implement such an automatic adjustment would be issued in February.

36. **The authorities reaffirmed that they would not seek a restructuring of the public external debt**, either with the Paris Club or any other creditor, as had been reported on occasions by the press. The program for 2001 envisages that the fiscal deficit and the public sector amortization payments would be financed with privatization proceeds and foreign borrowing. In the event of shortfalls in those flows, however, the authorities would be prepared to seek domestic financing to meet its scheduled debt obligations.

D. Medium-Term Outlook and Capacity to Repay the Fund

37. **The authorities' medium-term scenario, discussed with the mission, point to a favorable outlook for the economy**, with high output growth, low inflation, and a declining external debt burden (Table 10). This scenario is conditional on sound macroeconomic policies, including the gradual elimination of the fiscal deficit, and the implementation of further structural reforms that would enhance productivity and provide the necessary incentives for the envisaged increase in investment. The mission was in basic agreement with the overall projection, including the path for the fiscal balance, but (as noted above) stressed that prompt action would be needed from the new government to prevent a drop in government revenue that otherwise would take place starting in 2002. More generally, the mission thought that the downward trend in revenue of the last few years should be reversed to avoid a decline in expenditure that could compromise the government's ability to provide necessary social services.

38. **The projections suggest limited external vulnerability over the medium term.** The external current account deficit would widen slightly as growth picks up, but it would remain under 3 percent of GDP through the end of the projection period (2010). Net capital inflows are projected to exceed 3 percent of GDP, mainly on the strength of private capital inflows as investment prospects improve. This would allow for an appropriate accumulation of international reserves; gross international reserve coverage would decline gradually, but would still remain at comfortable levels at the end of the projection period (6.2 months of imports of goods and services, and 51 percent of broad money). External debt indicators would improve significantly, with total external debt falling from 50 percent of GDP in 2001 to 30 percent of GDP in 2010, and external debt service falling over the same period from 42 percent to 24 percent of exports of goods and services.

39. A sensitivity analysis shows that if the prices of fishmeal, copper, and gold, Peru's most important commodities, were 10 percent lower than in the baseline scenario, the external current account deficit would be larger on average by about 0.3 percent of GDP, 0.4 percent of GDP, and 0.3 percent of GDP, respectively. Also, if international interest rates were 1 percentage point higher than expected during the projection period, the current account deficit would be higher by 0.3 percent of GDP on average. Compared with the

baseline scenario, in either of these simulations the external debt/GDP ratio would be higher by at most 3 percentage points at the end of the projection period, and debt service as a percentage of exports of goods and services by at most 1 percentage point (on average over the period).

40. Notwithstanding the envisaged decline in the ratio of public debt-to-GDP, the mission stressed the need to develop a strategy of public debt management to reduce the costs of debt service and better manage risks over the medium-term through diversification of debt instruments (currently almost all public-sector debt is external, U.S. dollar-denominated, and contracted with multilateral organizations, bilateral creditors, or in the form of Brady bonds). The mission also noted that the systematic issuance of Treasury bills and bonds would improve the government's cash and debt management, and would provide short-term and long-term benchmarks that would facilitate the development of a domestic capital market.

41. **Peru should not have difficulties in discharging its obligations to the Fund, assuming a continuation of sound economic policies** (Table 11). As noted earlier, the Peruvian authorities intend to treat the stand-by arrangement as precautionary. However, if Peru should decide to purchase all available resources under the proposed arrangement, its obligations to the Fund would peak in 2002 at SDR 157.9 million, or 0.3 percent of GDP. Fund credit outstanding to Peru would fall from 67.1 percent of quota in December 2000 to 47.3 percent of quota in 2002 and to 2.5 percent of quota in 2006.

E. Structural Reforms

42. Regarding the **structural reform agenda**, the mission and the authorities were of the view that in the current political circumstances the ability of the administration to implement structural reforms would be limited. Nevertheless, in addition to the structural adjustment programs with the IDB and World Bank noted earlier, which aim at improving the targeting of social programs and the transparency of government operations, the structural reform program envisages: (i) the privatization of a power plant, the sale of remaining shares of previously privatized firms, and the granting of operating concessions in seaports, forestry management, mining prospects, road construction, and electricity transmission, with an expected yield of US$550 million (1 percent of GDP);[24] (ii) the sale of agricultural land and an increased pace of rural land titling and registration; and (iii) the maintenance of domestic fuel prices charged by the state-owned petroleum company at parity with their international benchmark equivalents.[25]

---

[24] Details on the state assets that are to be sold to meet the privatization target are presented in the Appendix to the Technical Memorandum of Understanding.

[25] For program monitoring purposes, the weighted average (across fuels) of domestic prices should not diverge from the weighted average of the benchmark equivalents by more than 4 percent in any month.

F. Program Monitoring

43. The **performance criteria** for the first two quarters of 2001 are presented in the letter of intent (Attachment I, Table 1), with indicative targets set for the remaining two quarters. These performance criteria and targets comprise ceilings on the public sector borrowing requirement, the expansion in net domestic assets of the central bank, the contracting or guaranteeing of external public debt, and the buildup of external payment arrears, and a floor on the accumulation of net international reserves of the central bank. This floor would be adjusted upward to the extent that privatization proceeds or net foreign borrowing of the nonfinancial public sector exceed program projections. In the event of shortfalls in these inflows, the target would be adjusted downward, but with a limit. The program will have one review that is expected to be completed by September 30, 2001, at which time the performance criteria for the remainder of 2001 will be established (Table 12).

IV. Staff Appraisal

44. **Peru's economic performance in 2000 was influenced by the lingering effects of previous adverse external shocks and by political uncertainty**. In this environment, a pickup in activity in the first half of 2000 was followed by a sharp slowdown, and employment continued to be weak. The fiscal deficit exceeded the program's target and the limit in Peru's Fiscal Responsibility Law, owing to a shortfall in revenue that reflected the weakness in economic activity, as well as lower taxpayer compliance resulting from a deterioration of tax administration, the lowering of penalties, the introduction of a tax amnesty, and the broadening of special tax incentive regimes. With weakening domestic demand, the external current account deficit fell, and inflation continued to decline.

45. **The interim government's main economic objective is to secure macroeconomic stability in the transition to a new government, while making progress on structural reforms**. The authorities are seeking Fund support for this program through a Stand-By Arrangement to emphasize their commitment to sound policies, and thereby enhance market confidence and catalyze financing for the public sector, including adjustment lending by multilateral institutions.

46. **The authorities' fiscal program, which aims at reducing the overall deficit to the limit established by the Fiscal Responsibility Law in 2001, is crucial for achieving the government's goal of macroeconomic stability and limiting fiscal pressures on the next administration**. The program for this year keeps government revenue constant as a share of GDP while reducing expenditure by about 1.5 percent of GDP. While the authorities have taken measures to achieve their revenue objective in 2001, in the current political environment they are likely to face pressures to expand tax breaks for particular sectors of the economy and to ease penalties on tax arrears. These pressures must be resisted, not only to meet the program's fiscal objective, but also to avoid a further distortion in resource allocation and an additional erosion in incentives for tax compliance. In addition, the authorities should proceed forcefully with their plans to strengthen tax administration.

47. **Reducing government expenditure as envisaged in the program will present a major challenge for the authorities**. While part of the adjustment will come from the wage bill, other expenditure will need to be compressed significantly. The staff supports the government's intention to concentrate expenditure cuts in the areas of defense and internal security, to shield priority social programs—including those on health and primary education—and to improve government transfer programs, as this would protect the most vulnerable sectors of the society. In this regard, the staff welcomes the authorities' intention to work with the World Bank to properly monitor priority social programs and ensure the allocation of adequate resources for these programs. The staff urges the authorities to be prepared to take additional revenue measures that may be needed to keep the fiscal program on track. As a longer-term consideration, the initiative to improve the transparency of the public finances is welcomed. Also, the authorities should undertake efforts to determine whether certain government expenditure was misrecorded in the official statistics over the last decade.

48. **The tax reform approved in late 2000 would have adverse consequences for government revenue after 2001**, and thus additional measures will be necessary to ensure that revenues are sustained in 2002 and beyond. The authorities' intention to prepare a comprehensive tax reform proposal for the next government is welcomed, and the new administration will need to address this issue early on. The reform should pursue the simplification of the tax system along the lines recommended by the recent FAD technical assistance mission, including by eliminating all regional and sectoral exemptions (to complement the approved reduction in income tax rates), strengthening of incentives for tax compliance, eliminating import surcharges, and reducing import tariffs while moving towards a uniform tariff rate.

49. **The monetary policy stance for 2001 is appropriate**. The staff welcomes the increase in the transparency of monetary policy that is now being afforded by the central bank's monthly report, and supports the authorities' intention (with technical assistance from the Fund) to examine the adoption of a formal inflation-targeting framework.

50. **The current official strategy for banks is generally well focused, and the staff urges the authorities to continue strengthening the banking system**. Over the last two years there has been a significant yet orderly consolidation of the banking system. As some banks are likely to remain under pressure as their portfolios may continue to deteriorate, additional provisioning would need to come from further capitalization. In this regard, the supervisory agency (SBS) should remain vigilant in ensuring that all banks have adequate capital bases and should resist pressures to ease existing regulations. The SBS is advancing on several fronts, including strengthening consolidated supervision of financial entities' operations, limiting maturity mismatches, and requiring liquidity contingency planning for financial institutions. Also, the authorities have submitted to congress a money laundering law that includes giving legal protection to the staff of the SBS in carrying out their oversight duties, a measure long advocated by the staff and supported by the FSAP mission. The authorities' intention to refrain from committing public resources to support specialized regional or sectoral financial institutions is appropriate. Also, the various official programs to

help the restructuring of debts to banks should be sufficient to deal with current difficulties, and thus the decision to limit government support to the funds committed to date is correct.

51. **The authorities must continue resisting current initiatives that could damage the prospects of the economy**. These include proposals in congress for forcing banks to refinance consumer loans, for some modifications to the two-tier pension system that could severely weaken the private pension program, and for the temporary prohibition of layoff by private firms, which would reduce efficiency and prompt the firing of workers in advance of a congressional decision on the issue. Moreover, the staff encourages the authorities to overturn, before the new government takes office in July, the recent decree that granted workers access to current contributions made to their unemployment protection funds until October of this year.

52. **The staff views the authorities' plan for divestiture of state assets as appropriate, particularly regarding the granting of private sector operating concessions, and reiterates the need to move forward in this area.** It is also important that other structural reforms be pursued, including maintaining the state oil company's petroleum prices at internationally competitive levels—to avoid distortions in the domestic oil market and strengthen the fiscal position—and advancing in the titling and registration of agricultural land to promote private sector activity in this sector.

53. **The staff supports the authorities' intention of continuing with the flexible exchange rate system and an open trade and payments regime**. The floating rate system with only limited intervention has served Peru well in helping the economy adjust to external shocks.

54. **Owing to the transitory nature of the current administration, progress on a general reform of the trade system is not feasible**. In this context, the reduction of the import surcharge on selected meat products, which brought it in line with the surcharge on other agricultural products, and the decision to eliminate discretion in setting reference prices for variable import surcharges (which had allowed for prolonged protection for certain agricultural products) was appropriate.

55. The **medium-term prospects for the economy** look favorable, assuming a continued implementation of sound macroeconomic policies, including the gradual elimination of the fiscal deficit, and the adoption of structural reforms that would enhance productivity and provide incentives for investment. Peru currently has a comfortable level of international reserves, but a relatively high external debt and debt service. Under appropriate policies, the country should be able to maintain a prudent reserve coverage and reduce its external debt burden.

56. In sum, the staff is of the view that the authorities' program is consistent with the objective of securing macroeconomic stability in the transition to the next government; the successful implementation of this program would also lay the basis for sustained growth of output and employment over the medium term. There are risks to the program, mainly

reflecting the relatively weak governing position of the current administration, resulting from the lack of a legislative majority, that could lead to policy initiatives from congress that jeopardizes the fiscal target and weakens the structure of economy. The authorities recognize these risks and believe that with the support of the Fund and their current broad popular backing they will be able to prevent unsound policies and take appropriate corrective action in a timely manner. The staff, therefore, supports Peru's request for a one-year Stand-By Arrangement from the Fund.

Table 1. Peru: Selected Economic Indicators

	1997	1998	1999	2000 Prog.	2000 Prel.	2001 Prev. Prog. EBS/00/47	2001 Prog. SBA
	(Annual percentage change)						
Production, prices, and trade							
Real GDP	6.7	-0.4	1.4	4.0	3.6	6.0	2.5
Real domestic demand	6.7	-0.9	-2.6	4.7	2.9	6.7	1.9
Of which: private consumption	4.2	-1.0	-0.2	3.6	4.3	5.3	3.4
Consumer prices							
End of period	6.5	6.0	3.7	4.0	3.7	3.0	3.0
Period average	8.5	7.3	3.5	3.9	3.8	3.5	3.3
Exports (U.S. dollars)	15.8	-15.7	6.2	15.8	14.8	8.9	8.9
Imports (U.S. dollars)	8.5	-3.9	-18.2	12.7	9.6	13.2	3.4
Terms of trade	5.6	-13.8	-6.6	5.3	-0.6	0.1	2.0
Real effective exchange rate							
(depreciation -) 1/	7.4	-11.1	-2.5	...	9.8	...	...
Money and credit							
Broad money 2/	15.0	0.2	4.3	7.7	2.2	10.6	4.2
Credit to the private sector 2/	27.4	7.8	-2.3	6.9	-1.9	10.0	3.0
	(In percent of GDP)						
Public sector							
Combined public sector primary balance	1.9	1.3	-0.8	0.2	-0.7	1.0	0.8
Interest due	1.9	1.9	2.2	2.2	2.3	2.2	2.4
Combined public sector overall balance	0.0	-0.6	-3.0	-2.1	-3.0	-1.2	-1.5
Balance of payments							
Current account	-5.2	-6.4	-3.5	-4.3	-3.0	-5.1	-2.4
Capital and financial account	8.4	4.0	2.0	4.7	2.7	5.5	2.8
Net international reserves (increase -)	-2.9	1.8	1.5	-0.5	0.3	-0.5	-0.4
Savings and investment							
Gross domestic investment	24.6	24.2	22.0	24.8	20.6	26.3	20.0
Public sector	4.4	4.5	4.8	4.4	3.8	4.3	3.4
Private sector	20.2	19.7	17.2	20.4	16.8	22.0	16.6
National savings	19.4	17.8	18.5	20.5	17.6	21.2	17.6
Public sector 3/	5.2	4.0	1.9	2.3	0.9	3.2	1.9
Private sector	14.2	13.8	16.6	18.2	16.7	18.0	15.7
External savings	5.2	6.4	3.5	4.3	3.0	5.1	2.4
Memorandum item:							
Nominal GDP (S/. billions)	157.1	167.0	175.9	189.1	188.7	203.4	200.2

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ Based on Information Notice System.
2/ Flows in foreign currency are valued at program exchange rate.
3/ Excludes privatization receipts.

Table 2. Peru: Operations of the Combined Public Sector 1/

(In percent of GDP)

				2000		2001	
	1997	1998	1999	Prog.	Prel.	Prev. Prog. EBS/00/47	Prog. SBA
Central government primary balance	**0.9**	**0.9**	**-1.0**	**-0.2**	**-0.4**	**0.5**	**0.7**
Revenue	15.7	15.8	14.8	15.0	14.8	15.1	14.6
Current	15.6	15.4	14.4	14.7	14.5	14.9	14.4
Capital	0.2	0.3	0.4	0.2	0.4	0.2	0.2
Noninterest expenditure	14.8	14.9	15.7	15.2	15.2	14.5	13.9
Current	11.3	11.6	12.4	12.0	12.5	11.8	11.5
Capital	3.5	3.2	3.4	3.2	2.7	2.7	2.4
Rest of the general government primary balance	**0.3**	**0.5**	**0.1**	**0.2**	**0.3**	**0.4**	**0.4**
Revenue	5.6	5.9	5.4	5.4	5.5	5.3	5.4
Current	5.4	5.8	5.3	5.2	5.4	5.2	5.3
Capital	0.2	0.1	0.0	0.2	0.1	0.1	0.1
Noninterest expenditure	5.3	5.4	5.3	5.2	5.2	4.9	5.0
Current	4.2	4.4	4.3	4.1	4.3	4.2	4.2
Capital	1.1	1.0	0.9	1.0	1.0	0.7	0.9
Public enterprise primary balance	**0.6**	**-0.1**	**0.0**	**0.1**	**-0.5**	**-0.0**	**-0.2**
Current balance	1.2	0.7	1.0	0.6	0.3	0.5	0.3
Capital balance	-0.5	-0.8	-0.9	-0.6	-0.7	-0.5	-0.5
Nonfinancial public sector primary balance	**1.8**	**1.2**	**-0.9**	**0.1**	**-0.7**	**0.9**	**0.8**
Central bank operating balance	**0.1**	**0.1**	**0.1**	**0.1**	**0.0**	**0.1**	**0.0**
Combined public sector primary balance	**1.9**	**1.3**	**-0.8**	**0.2**	**-0.7**	**1.0**	**0.8**
Interest payments	**1.9**	**1.9**	**2.2**	**2.2**	**2.3**	**2.2**	**2.4**
Combined public sector overall balance	**0.0**	**-0.6**	**-3.0**	**-2.1**	**-3.0**	**-1.2**	**-1.5**
Statistical discrepancy	-0.1	-0.1	0.0	-0.0	0.0	0.1	0.0
Financing	-0.1	0.5	3.0	2.1	3.0	1.2	1.6
External	-0.6	0.4	-0.0	1.1	1.2	0.5	1.3
Domestic	-0.4	-0.3	2.3	-0.3	1.1	-1.0	-0.7
Privatization	0.9	0.4	0.7	1.2	0.8	1.8	1.0
Memorandum items:							
General government current revenue	18.1	18.5	17.4	17.7	17.4	17.9	17.4
General government current revenue net of transfers 2/	18.1	18.5	17.4	17.7	16.8	17.9	16.9
Of which: tax revenue	16.2	15.8	14.2	14.8	13.7	14.8	13.8
General government noninterest expenditure	17.1	17.5	18.7	17.9	17.9	17.4	16.5
Military expenditure	1.8	1.8	1.9	1.7	2.0	1.6	1.6
Fiscal impulse	0.3	-0.6	1.9	-1.2	-0.3	-1.1	-1.7
Real growth rate of G.G. Revenue	5.3	1.3	-4.2	5.3	-0.0	5.1	2.8
Real growth rate of G. G. Noninterest Expenditure	3.8	1.1	9.0	-1.0	-0.8	0.7	-5.4
Public assistance to the banking system 3/	...	0.5	1.9	...	1.9	...	...

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Comprises the operations of the nonfinancial public sector and the operating balance of the central bank.

2/ Excludes current transfers from public enterprises and the tax on assets of public enterprises established in 2000.

3/ Amounts are gross program disbursements less repayments, plus the two debt restructuring programs in 2000 which have not yet been disbursed (see Appendix III).

Table 3. Peru: Operations of the Central Government

(In percent of GDP)

	1997	1998	1999	2000 Prog.	2000 Prel.	2001 Prev. Prog. EBS/00/47	2001 Prog. SBA
Current primary balance	**4.2**	**3.8**	**2.0**	**2.7**	**1.9**	**3.1**	**2.9**
Current revenue	15.6	15.4	14.4	14.7	14.5	14.9	14.4
Tax revenue 1/	14.6	14.2	12.7	13.2	12.2	13.1	12.3
Direct taxes	4.5	4.3	3.4	3.4	3.3	3.3	3.2
Indirect taxes	10.1	9.9	9.2	9.8	9.0	9.8	9.2
Other current revenue	0.9	1.2	1.7	1.5	2.2	1.8	2.1
Current noninterest expenditure	11.3	11.6	12.4	12.0	12.5	11.8	11.5
Labor services 2/	5.9	6.1	6.7	6.6	6.6	6.4	6.1
Goods and nonlabor services	2.4	2.7	3.0	2.9	3.2	2.9	2.8
Transfers and other	3.1	2.9	2.7	2.6	2.8	2.5	2.6
Capital balance	**-3.3**	**-2.9**	**-3.0**	**-3.0**	**-2.3**	**-2.5**	**-2.2**
Capital revenue	0.2	0.3	0.4	0.2	0.4	0.2	0.2
Capital expenditure	3.5	3.2	3.4	3.2	2.7	2.7	2.4
Gross capital formation	2.2	2.3	2.7	2.3	2.1	2.1	1.8
Other	1.3	0.9	0.7	0.9	0.6	0.6	0.6
Primary balance	**0.9**	**0.9**	**-1.0**	**-0.2**	**-0.4**	**0.5**	**0.7**
Interest payments	**1.8**	**1.8**	**2.1**	**2.2**	**2.3**	**2.2**	**2.3**
External	1.7	1.7	2.0	2.0	2.0	2.0	2.0
Domestic	0.1	0.1	0.1	0.2	0.3	0.2	0.3
Overall balance	**-0.9**	**-1.0**	**-3.1**	**-2.4**	**-2.7**	**-1.7**	**-1.6**
Statistical discrepancy	**-0.1**	**-0.1**	**0.0**	**0.0**	**0.0**	**-0.0**	**0.0**
Financing	**0.8**	**0.9**	**3.1**	**2.4**	**2.7**	**1.7**	**1.6**
Memorandum items:							
Primary balance before transfers	3.2	2.9	0.6	1.7	0.9	2.4	2.1
Overall balance before transfers	1.4	1.1	-1.5	-0.5	-1.4	-0.1	-0.2

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Net of tax on assets of public enterprises and of central government payroll tax (IES) payments.
2/ Includes wages, salaries, and employer contributions to social security.

Table 4. Peru: Balance of Payments

	1997	1998	1999	2000 Prog.	2000 Prel.	2001 Prev. Prog. EBS/00/47	2001 Prog. SBA
(In millions of U.S. dollars)							
Current account	**-3,057**	**-3,638**	**-1,817**	**-2,264**	**-1,631**	**-2,863**	**-1,352**
Merchandise trade	-1,721	-2,465	-614	-486	-356	-861	21
Exports	6,832	5,758	6,114	7,083	7,016	7,706	7,642
Traditional	4,705	3,712	4,143	4,909	4,815	5,345	5,161
Nontraditional	2,127	2,046	1,971	2,174	2,201	2,361	2,481
Imports	-8,553	-8,222	-6,729	-7,570	-7,372	-8,567	-7,621
Services, income, and current transfers (net)	-1,336	-1,173	-1,203	-1,778	-1,275	-2,002	-1,373
Services	-764	-595	-600	-631	-613	-668	-542
Investment income	-1,473	-1,489	-1,547	-1,817	-1,640	-2,041	-1,817
Current transfers	901	911	944	670	978	707	986
Financial and capital account	**4,962**	**2,267**	**1,025**	**2,514**	**1,450**	**3,142**	**1,554**
Public sector	-55	-56	393	652	279	421	644
Disbursements	985	790	1,237	1,461	1,528	1,360	1,621
Amortization	-837	-859	-961	-809	-1,116	-939	-925
Other medium- and long-term public sector flows 1/	-203	13	117	0	-133	0	-52
Privatization	145	60	219	410	229	400	507
Foreign direct investment (FDI) excluding privatization	1,553	1,820	1,751	1,473	448	2,212	741
Other private capital	3,320	443	-1,338	-21	494	109	-338
Medium- and long-term loans	448	423	388	266	741	155	256
Portfolio investment	317	-345	-317	-54	-281	-16	-238
Short-term flows to the financial system 2/	2,683	-98	-1,424	-200	-211	-150	-250
Other short term flows (incl. errors and omissions)	-128	463	15	-33	245	120	-106
Financing	**-1,905**	**1,371**	**792**	**-250**	**181**	**-279**	**-202**
Change in central bank reserves (increase-)	-1,733	1,006	774	-300	189	-292	-215
Exceptional financing	-172	365	18	50	-8	13	13
(In percent of GDP unless otherwise specified)							
Memorandum items:							
Current account balance	-5.2	-6.4	-3.5	-4.3	-3.0	-5.0	-2.4
FDI and private MLT capital (percent of CA deficit)	65.5	61.7	117.7	76.8	72.9	82.7	73.7
Export value (US$), percent change	15.8	-15.7	6.2	15.8	14.8	8.9	8.9
Volume growth	13.2	3.1	13.9	7.4	10.1	6.3	6.8
Price growth	2.3	-18.2	-6.7	7.8	4.2	2.4	2.0
Import value (US$), percent change	8.3	-3.9	-18.2	12.7	9.6	13.2	3.4
Volume growth	11.9	1.3	-18.1	10.7	4.3	10.7	3.4
Price growth	-3.2	-5.1	-0.1	1.8	5.0	2.2	0.0
Public sector external arrears (end-period, US$ mn) 3/	187	166	155	102	104	102	104
GDP (millions of U.S. dollars)	58,954	57,080	51,963	53,056	54,062	56,813	55,965

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ Includes medium- and long-term flows of the financial public sector, as well as subscription payments into international funds.

2/ Includes COFIDE and Banco de la Nacion.

3/ Most of the external arrears are owed to unguaranteed suppliers, some of which are in discussions with the government, while the rest have not been located.

Table 5. Peru: Quantitative Performance Criteria, January-June 2000

	March 31	June 30
(Cumulative amounts from December 31, 1999; in millions of soles)		
Borrowing requirement of the combined public sector		
Unadjusted limits	1,060	1,820
Adjusted limits 1/	937	1,820
Actual	863	2,215
Margin	74	-395
(Cumulative change from December 31, 1999; in millions of soles)		
Net domestic assets of the central reserve bank		
Unadjusted limits	-368	-245
Adjusted limits 1/	-304	205
Actual	-1,130	-435
Margin	826	640
(Cumulative change from December 31, 1999; in millions of U.S. dollars)		
Net international reserves of the central reserve bank		
Unadjusted targets	-45	-71
Adjusted targets 1/	-63	-196
Actual	131	-72
Margin	194	124
Short-term net external debt of the public sector		
Limits	50	50
Actual	0	0
Margin	50	50
External payments arrears of the public sector (on a continuous basis) 2/		
Limits	0	0
Actual	0	0
Margin	0	0
(Cumulative amounts from December 31, 1999; in millions of U.S. dollars)		
Contracting or guaranteeing of nonconcessional external public debt with maturity of at least one year		
Total		
Limits	715	985
Actual	207	262
Margin	508	723
Of which: 1- to 12-year maturity		
Limits	75	225
Actual	0	55
Margin	75	170

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and EBS/00/47.

1/ The targets and limits have been adjusted in accordance with the table attached to the letter of intent dated March 13, 2000, which is appended to the staff report EBS/00/47.

2/ Excluding arrears associated with nonrescheduled debt to foreign creditors outstanding as of end-1999.

Table 6. Peru: Monetary Survey

	1997	1998	1999	2000 Prog.	2000 Prel.	2001 Prev.Prog. EBS/00/47	2001 Prog. SBA
I. Central Reserve Bank (Change in percent of currency in circulation at the beginning of period) 1/							
Net international reserves	**144.1**	**-75.2**	**-68.6**	**24.4**	**-14.7**	**21.8**	**16.9**
(In millions of U.S. dollars)	1,732	-1,006	-775	300	-189	292	215
Net domestic assets	**-126.2**	**78.4**	**85.9**	**-22.3**	**13.0**	**-11.3**	**-7.8**
Net credit to nonfinancial public sector	-24.3	64.0	81.1	7.7	14.9	-1.1	-3.2
Rest of banking system	-47.8	67.9	9.1	-24.2	-14.3	-23.3	-3.4
Other	-54.1	-53.4	-4.4	-5.8	12.3	13.1	-1.2
Currency	**17.9**	**3.2**	**17.2**	**2.1**	**-1.7**	**10.5**	**9.1**
II. Banking System (Change in percent of liabilities to private sector at the beginning of period) 1/							
Net foreign assets	**-1.8**	**-6.9**	**4.2**	**3.5**	**0.0**	**2.0**	**3.5**
Net domestic assets	**16.7**	**7.1**	**0.1**	**4.1**	**2.2**	**8.6**	**0.7**
Net credit to nonfinancial public sector	-0.9	-0.1	9.5	-1.0	3.3	-0.4	-2.1
Credit to private sector	25.9	8.2	-2.6	7.5	-2.0	10.8	3.1
Other	-8.3	-1.0	-6.8	-2.3	0.9	-1.8	-0.2
Net credit to COFIDE	-2.4	0.0	-1.3	-0.1	1.6	0.0	0.0
Other	-5.8	-1.0	-5.5	-2.2	-0.8	-1.8	-0.2
Liabilities to the private sector	**15.0**	**0.2**	**4.3**	**7.7**	**2.2**	**10.6**	**4.2**
(12-month percentage change) 1/							
Base money	19.2	5.5	17.0	0.0	-4.0	8.0	6.0
Broad money	15.0	0.2	4.3	7.7	2.2	10.6	4.2
Domestic currency	25.6	-2.1	11.5	11.1	0.8	14.0	9.0
Foreign currency	9.9	1.4	1.7	6.5	3.2	9.0	2.1
Credit to private sector	27.4	7.8	-2.3	6.9	-1.9	10.0	3.0
Domestic currency	16.1	6.6	-5.3	12.5	1.5	14.1	5.8
Foreign currency	31.4	8.1	-1.6	5.7	-2.6	9.1	2.3
Memorandum item:							
Program exchange rate (S/. per US$)	2.70	2.87	3.45	3.60	3.60	...	...

Source: Central Reserve Bank of Peru.

1/ Flows in foreign curency are valued at program exchange rate.

Table 7. Peru: External Financing Requirements and Sources

(In millions of U.S. dollars)

	1998	1999	Estimate 2000	Official Projections 2001	2002
Gross financing requirements	**11,235**	**9,675**	**8,550**	**7,313**	**7,602**
External current account deficit (excl. official transfers)	3,638	1,817	1,631	1,352	1,445
Debt amortization	8,594	8,624	7,050	5,746	5,468
Medium- and long-term debt	2,203	2,445	2,508	2,066	2,144
Public sector	859	961	1,116	925	950
Multilateral 1/	254	272	544	354	407
Bonds and notes	16	319	109	70	56
Other	589	370	463	501	487
Private sector	1,344	1,484	1,392	1,141	1,194
Short-term debt 2/	6,391	6,179	4,542	3,680	3,324
Repayment of arrears	9	8	58	0	0
Accumulation of NIR	-1,006	-774	-189	215	690
Change in gross reserves	-1,198	-894	-305	31	498
Payments of short-term liabilities of the Central Bank	192	120	116	184	192
Of which: IMF repurchases and repayments	192	120	116	184	192
Available financing	**10,311**	**9,384**	**8,034**	**7,300**	**7,602**
Foreign direct investment (net)	1,880	1,970	677	1,248	2,128
Privatization	60	219	229	507	1,000
FDI	1,820	1,751	448	741	1,128
Portfolio (net)	-345	-317	-281	-238	-214
Short-term assets (flow)	27	-37	430	0	0
Debt financing from private creditors	8,026	6,438	5,843	4,721	4,587
Medium- and long-term financing	1,847	1,896	2,163	1,397	1,584
To public sector	80	24	30	0	53
Of which: balance of payments financing 3/	0	0	0	0	0
To private sector	1,767	1,872	2,133	1,397	1,531
Short-term financing	6,179	4,542	3,680	3,324	3,003
Of which: balance of payments financing 3/	0	0	0	0	0
Official creditors 4/	710	1,213	1,498	1,621	1,137
Multilateral 1/	603	960	828	1,326	771
Of which: balance of payments financing 3/	100	414	472	975	450
Bilateral	107	253	670	295	366
To public sector	107	253	670	295	366
Of which: balance of payments financing 3/	0	0	298	0	0
To private sector	0	0	0	0	0
Bonds and other	13	117	-133	-52	-36
IMF	0	0	0	0	0
Accumulation of arrears (exceptional)	0	0	0	0	0
Financing gap	**924**	**291**	**516**	**13**	**0**
Other flows 5/	923	291	516	13	0
Errors and omissions	549	265	466	0	0
Debt relief	374	26	50	13	0
Memorandum item:					
Total balance of payments financing 3/	100	414	770	975	450

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ Excluding the IMF.

2/ Original maturity of less than one year. Equals stock at the end of the previous period. Excludes BCRP short-term debt (US$40 million at end-2000.)

3/ Includes those transactions that are undertaken for the purpose of financing a balance of payments deficit or an increase in reserves.

4/ Includes both loans and grants.

5/ Includes all other net financial flows (incl. exceptional financing), and errors and omissions.

Table 8. Peru: Financial and External Vulnerability Indicators

(In percent; unless otherwise indicated)

				2000		2001	
	1997	1998	1999	Prog.	Prel.	Prev. Prog. EBS/00/47	Prog. SBA
Financial indicators							
Public sector debt/GDP	33.3	36.1	40.8	40.4	37.8	39.7	38.4
90-day prime lending rate, domestic currency 1/	19.1	27.0	21.6	...	17.0	...	...
90-day prime lending rate, foreign currency 1/	13.2	17.5	10.9	...	10.3	...	...
Velocity of money 2/	4.3	4.4	3.9	4.1	4.0	3.6	4.1
Credit to the private sector/GDP	24.5	26.0	28.0	29.0	26.4	29.7	25.4
Share of foreign currency deposits in total deposits	72.0	74.7	77.1	77.2	78.2	76.8	76.9
Share of foreign currency loans in total credit	77.2	78.5	82.0	81.4	82.0	81.2	81.5
Nonperforming loans/total loans 3/	5.8	6.5	9.4	...	11.2	...	...
Loan-loss provisions/nonperforming loans 3/	79.4	81.1	79.4	...	77.8	...	...
Risk-based capital-assets ratio	10.2	11.2	11.9	...	12.6	...	...
Commercial banks' short-term foreign assets (in millions of U.S. dollars)	578	613	981	996	649	1,146	649
Commercial banks' short-term liabilities (in millions of U.S. dollars)	2,984	2,879	1,835	1,637	1,217	1,786	967
External indicators							
Exports, U.S. dollars (percent change)	15.8	-15.7	6.2	15.8	14.8	8.9	8.9
Imports, U.S. dollars (percent change)	8.3	-3.9	-18.2	12.7	9.6	13.2	3.4
Terms of trade (percent change)	5.6	-13.8	-6.6	5.3	-0.6	0.1	2.0
Real effective exchange rate, (end-period, percent change)	7.4	-11.1	-2.5	...	9.8	...	...
Current account balance (percent of GDP)	-5.2	-6.4	-3.5	-4.3	-3.0	-5.0	-2.4
Capital and financial account balance (percent of GDP)	8.4	4.0	2.0	4.7	2.7	5.5	2.8
Total external debt (percent of GDP)	48.6	51.6	53.8	55.1	50.5	51.9	49.6
Medium- and long-term public debt (percent of GDP) 4/	33.3	35.6	38.7	38.9	36.1	36.8	35.9
Medium- and long-term private debt (percent of GDP)	4.3	5.1	6.4	7.3	7.5	7.0	7.7
Short-term public and private debt (percent of GDP)	11.0	10.9	8.8	8.9	6.9	8.1	6.0
Total external debt (percent of exports of goods and services) 4/	342.2	392.8	366.2	328.1	316.1	305.3	294.1
Total debt service (percent of exports of goods and services) 5/	44.5	53.1	54.7	48.0	50.1	37.4	41.6
Gross official reserves (in millions of U.S. dollars) 1/	10,824	9,666	8,673	8,830	8,259	8,945	8,330
Gross official reserves, percent of short-term external debt 6/	124.8	115.1	122.8	131.0	142.7	163.1	151.2
Gross official reserves, percent of broad money 7/	78.2	73.4	65.7	62.6	62.4	58.0	59.5
Gross official reserves (in months of imports of goods and services)	12.3	13.1	10.8	9.7	9.9	8.7	9.3
Net international reserves (in millions of U.S. dollars) 1/	9,968	8,962	8,187	8,487	7,876	8,779	8,091
Net international reserves (program definition; in millions of U.S. dollars) 8/	6,255	5,880	5,195	5,203	4,891	5,370	4,989
Financial market indicators							
Stock market index (U.S. dollars)	657.3	422.3	523.4	...	342.8	...	...
Foreign currency debt rating (Moody's)	B2	Ba3	Ba3	...	Ba3	...	...
Spread of Peruvian Brady bonds, basis points 9/	421	655	443	...	687	...	...

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ At end of period.

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

3/ Annual average. For 2000, January-November only and includes adjustment for bond-swap programs.

4/ Includes Central Reserve Bank of Peru 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.

7/ At end-period exchange rate.

8/ Includes financial system's foreign currency deposits in central bank as reserve liability.

9/ Over 20-year U.S. Treasury bond yield.

Table 9. Peru: Functional Classification of Central Government Expenditure

	1997	1998	1999	2000 Budget	2000 Prel.	2001 Budget
	(In percent of GDP)					
Total	**18.8**	**17.3**	**19.0**	**18.0**	**18.3**	**17.2**
Planning and Administration	5.6	4.0	4.7	4.6	4.5	5.0
Debt service	4.8	3.0	3.4	3.4	3.8	3.9
Administration	0.8	0.9	1.2	1.2	0.7	1.0
Pensions and social assistance	3.6	3.5	4.1	4.0	4.1	3.7
Pensions	2.6	2.7	3.0	2.9	3.2	3.1
Other social assistance	1.0	0.8	1.0	1.1	0.9	0.7
Education	2.7	2.7	3.0	2.7	2.9	2.6
Preprimary	0.2	0.2	0.3	0.2	0.2	0.2
Primary	1.0	1.0	1.1	1.0	1.0	1.0
Secondary	0.7	0.7	0.7	0.7	0.7	0.7
Tertiary	0.5	0.5	0.6	0.5	0.5	0.4
Other	0.3	0.3	0.3	0.3	0.4	0.2
Defense and national security	2.9	2.9	2.8	2.5	2.9	2.3
Health and water	1.4	1.5	1.5	1.6	1.6	1.5
Water and sewage	0.2	0.2	0.2	0.2	0.1	0.2
Healthcare services	1.3	1.3	1.4	1.4	1.4	1.4
Transportation	1.1	0.9	1.0	0.8	0.6	0.6
Agriculture	0.6	0.7	0.7	0.6	0.7	0.5
Justice	0.4	0.4	0.4	0.4	0.4	0.3
Energy and natural resources	0.2	0.2	0.2	0.2	0.1	0.1
Foreign relations	0.1	0.2	0.2	0.2	0.2	0.2
Legislative	0.1	0.1	0.1	0.1	0.1	0.1
Housing and urban development	0.0	0.1	0.1	0.1	0.1	0.1
Industry, commerce, and services	0.1	0.1	0.1	0.1	0.1	0.1
Fishing	0.1	0.0	0.1	0.0	0.1	0.1
Communications	0.0	0.0	0.0	0.0	0.0	0.0
Employment	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:						
Total social expenditure	6.9	6.5	7.0	7.0	6.8	6.1
Budgetary social expenditure 1/	5.1	5.0	5.5	5.5	5.3	4.7
ESSALUD 2/	1.1	1.2	1.4	1.4	1.5	1.3
Fonavi 3/	0.8	0.3	0.1	0.1	0.0	0.0

Source: Ministry of Economy and Finance.

1/ Includes education, health and sanitation and other social assistance.

2/ Total expenditure by Essalud, the public health insurance administration.

3/ Net operations of the national housing fund (Fonavi), loan disbursements and amortizations received.

Table 10. Peru: Medium-Term Outlook

	Prel.	Projections									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	I. Balance of Payments and Other External Indicators										
	(In billions of U.S. dollars)										
Current account	**-1.63**	**-1.35**	**-1.44**	**-1.60**	**-1.77**	**-1.90**	**-2.10**	**-2.48**	**-2.77**	**-3.01**	**-3.26**
Merchandise trade	-0.36	0.02	0.53	0.63	0.82	1.12	1.13	1.01	0.94	1.00	1.01
Exports	7.02	7.64	8.75	9.66	10.67	11.96	13.14	14.43	15.88	17.53	19.41
Imports	-7.37	-7.62	-8.22	-9.04	-9.86	-10.84	-12.01	-13.42	-14.94	-16.53	-18.40
Services	-0.61	-0.54	-0.65	-0.70	-0.78	-0.83	-0.87	-0.93	-0.93	-0.89	-0.85
Investment income	-1.64	-1.82	-2.32	-2.57	-2.89	-3.33	-3.56	-3.81	-4.08	-4.48	-4.83
Current transfers	0.98	0.99	1.01	1.05	1.09	1.13	1.19	1.24	1.30	1.36	1.42
Capital and financial account	**1.45**	**1.55**	**2.13**	**2.20**	**1.98**	**2.28**	**2.54**	**3.01**	**3.30**	**3.56**	**3.79**
Public sector	0.28	0.64	0.20	-0.02	-0.04	-0.04	-0.03	-0.01	0.00	0.00	0.00
Disbursements 1/	1.53	1.62	1.19	1.13	1.20	1.41	1.55	1.67	1.71	1.80	1.74
Amortization due	-1.12	-0.93	-0.95	-1.11	-1.20	-1.41	-1.55	-1.67	-1.71	-1.80	-1.74
Other medium- and long-term public flows 2/	-0.13	-0.05	-0.04	-0.04	-0.04	-0.04	-0.03	-0.01	0.00	0.00	0.00
Private sector	1.17	0.91	1.93	2.22	2.01	2.32	2.57	3.01	3.31	3.57	3.79
Privatization receipts from direct investment	0.23	0.51	1.00	1.00	0.10	0.07	0.07	0.07	0.07	0.05	0.04
Direct investment, excluding privatization	0.45	0.74	1.13	1.32	1.39	1.59	1.79	2.33	2.61	2.80	3.09
Other 3/	0.49	-0.34	-0.20	-0.09	0.53	0.66	0.71	0.62	0.63	0.72	0.66
Overall balance	**-0.18**	**0.20**	**0.69**	**0.60**	**0.21**	**0.38**	**0.44**	**0.53**	**0.53**	**0.55**	**0.53**
Change in central bank reserves	0.19	-0.22	-0.69	-0.60	-0.21	-0.38	-0.44	-0.53	-0.53	-0.55	-0.53
Exceptional financing 4/	-0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	(In percent of exports of goods and services)										
Total external debt service	50.1	41.6	38.5	35.8	33.2	31.3	30.2	29.0	27.5	26.1	23.9
Public external debt service	26.0	22.6	21.4	21.1	20.2	19.7	19.1	18.5	17.3	16.2	14.5
	(In months of next year's imports of goods and services)										
Gross reserves	9.9	9.3	9.4	9.1	8.5	8.0	7.5	7.1	6.8	6.4	6.2
	(In percent of broad money)										
Gross reserves	62.4	59.5	60.9	61.1	58.7	57.3	56.0	55.1	53.9	52.5	50.9
	(In percent of GDP)										
Current account deficit	-3.0	-2.4	-2.4	-2.5	-2.6	-2.6	-2.6	-2.8	-2.9	-2.9	-2.9
Merchandise exports	13.0	13.7	14.8	15.2	15.5	16.0	16.3	16.5	16.8	17.1	17.5
Merchandise imports	13.6	13.6	13.9	14.2	14.3	14.5	14.9	15.3	15.8	16.1	16.6
Total external debt	50.5	49.6	46.8	43.7	40.9	38.6	36.5	34.6	32.8	31.2	29.6
Total medium- and long-term public external debt 5/	36.1	35.9	34.1	31.6	29.2	27.0	24.9	23.0	21.2	19.6	18.1

Table 10. Peru: Medium-Term Outlook

	Prel.	Projections									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
					II. Output and Prices						
					(Annual percentage change)						
Real GDP	3.6	2.5	5.0	5.5	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Real domestic demand	2.9	1.9	4.5	5.6	5.9	5.8	6.2	6.3	6.3	6.1	6.1
Of which:											
Private consumption	4.3	3.4	4.5	5.2	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Private investment	-2.4	-0.4	5.8	9.0	9.0	8.5	9.0	9.1	8.9	7.9	8.1
Consumer prices (end of period)	3.7	3.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
					(In percent of GDP)						
					III. Savings and Investment						
Gross domestic investment	**20.6**	**20.0**	**20.1**	**20.7**	**21.3**	**21.8**	**22.4**	**23.1**	**23.6**	**24.0**	**24.5**
Public sector	3.8	3.4	3.2	3.0	2.9	2.8	2.8	2.9	2.8	2.8	2.8
Private sector	16.8	16.6	16.9	17.7	18.4	19.0	19.6	20.2	20.8	21.2	21.7
National savings	**17.6**	**17.6**	**17.7**	**18.2**	**18.8**	**19.3**	**19.8**	**20.2**	**20.7**	**21.1**	**21.6**
Public sector 6/	0.9	1.9	2.2	2.5	2.7	2.9	2.9	2.9	2.9	2.9	3.0
Private sector	16.7	15.7	15.5	15.7	16.1	16.4	16.9	17.3	17.8	18.2	18.6
External savings	**3.0**	**2.4**	**2.4**	**2.5**	**2.6**	**2.6**	**2.6**	**2.8**	**2.9**	**2.9**	**2.9**
					IV. Combined Public Sector						
Combined public sector primary balance	**-0.7**	**0.8**	**1.4**	**1.8**	**2.0**	**2.1**	**2.0**	**2.0**	**1.9**	**1.8**	**1.7**
Interest due	2.3	2.4	2.4	2.3	2.2	2.0	1.9	1.9	1.8	1.7	1.6
Combined public sector overall balance	**-3.0**	**-1.5**	**-1.0**	**-0.5**	**-0.2**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Net external financing	1.2	1.3	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic financing 7/	1.1	-0.7	-1.0	-1.1	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Privatization receipts	0.8	1.0	1.7	1.6	0.2	0.1	0.1	0.1	0.1	0.1	0.1

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ Includes bonds.

2/ Includes medium- and long-term flows of the financial public sector, as well as subscription payments into international funds.

3/ Includes errors and omissions.

4/ Includes debt relief from Paris Club creditors, and debt forgiveness.

5/ Includes Central Reserve Bank of Peru debt.

6/ Excludes privatization receipts.

7/ Includes statistical discrepancy.

Table 11. Peru: Projected Payments to the Fund as of January 31, 2001 1/

(In millions of SDRs)

	Over-due	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Beyond	Total
Obligations from existing drawings													
Principal (repurchases)	0	120.5	133.9	80.3	26.8	26.8	26.8	13.4	0.0	0.0	0.0	0.0	428.3
Charges and interest 2/													
On Fund credit	0	20.7	13.5	6.8	4.3	2.9	1.5	0.2	0.0	0.0	0.0	0.0	49.9
On use of SDRs	0	4.1	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	44.1
Total obligations	0	145.2	151.4	91.1	35.1	33.7	32.3	17.6	4.0	4.0	4.0	4.0	522.4
(percent of quota)	0	22.8	23.7	14.3	5.5	5.3	5.0	2.8	0.6	0.6	0.6	0.6	81.8
Obligations from prospective drawings													
Principal (repurchases)	0	0.0	0.0	0.0	21.0	61.0	43.0	3.0	0.0	0.0	0.0	0.0	128.0
Charges and interest 2/													
On Fund credit	0	2.5	6.5	6.8	6.6	4.7	1.5	0.1	0.0	0.0	0.0	0.0	28.6
On use of SDRs	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations	0	2.5	6.5	6.8	27.6	65.7	44.5	3.1	0.0	0.0	0.0	0.0	156.6
(percent of quota)	0	0.4	1.0	1.1	4.3	10.3	7.0	0.5	0.0	0.0	0.0	0.0	24.5
Cumulative (existing and prospective)													
Principal (repurchases)	0	120.5	133.9	80.3	47.8	87.8	69.8	16.4	0.0	0.0	0.0	0.0	556.3
Charges and Interest 2/													
On Fund credit	0	23.2	20.0	13.6	11.0	7.6	3.0	0.3	0.0	0.0	0.0	0.0	78.5
On use of SDRs	0	4.1	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	44.1
Total obligations	0	147.7	157.9	97.9	62.7	99.3	76.7	20.7	4.0	4.0	4.0	4.0	679.0
(percent of quota)	0	23.1	24.7	15.3	9.8	15.6	12.0	3.2	0.6	0.6	0.6	0.6	106.4
(percent of GDP)	0	0.3	0.3	0.2	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0	1.4
(percent of exports of goods and services)	0	2.0	1.9	1.1	0.6	0.9	0.6	0.2	0.0	0.0	0.0	0.0	7.5
Memorandum items:													
Purchases		102.4	25.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	128.0
Fund credit outstanding													
(end period)		410.2	301.9	221.6	173.8	86.0	16.2	0.0	0.0	0.0	0.0	0.0	...
(percent of quota)		64.3	47.3	34.7	27.2	13.5	2.5	0.0	0.0	0.0	0.0	0.0	...
(percent of GDP)		1.0	0.7	0.5	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	...

Sources: Treasurer's Department; and Fund staff estimates and projections.

1/ Assuming all scheduled purchases are made.

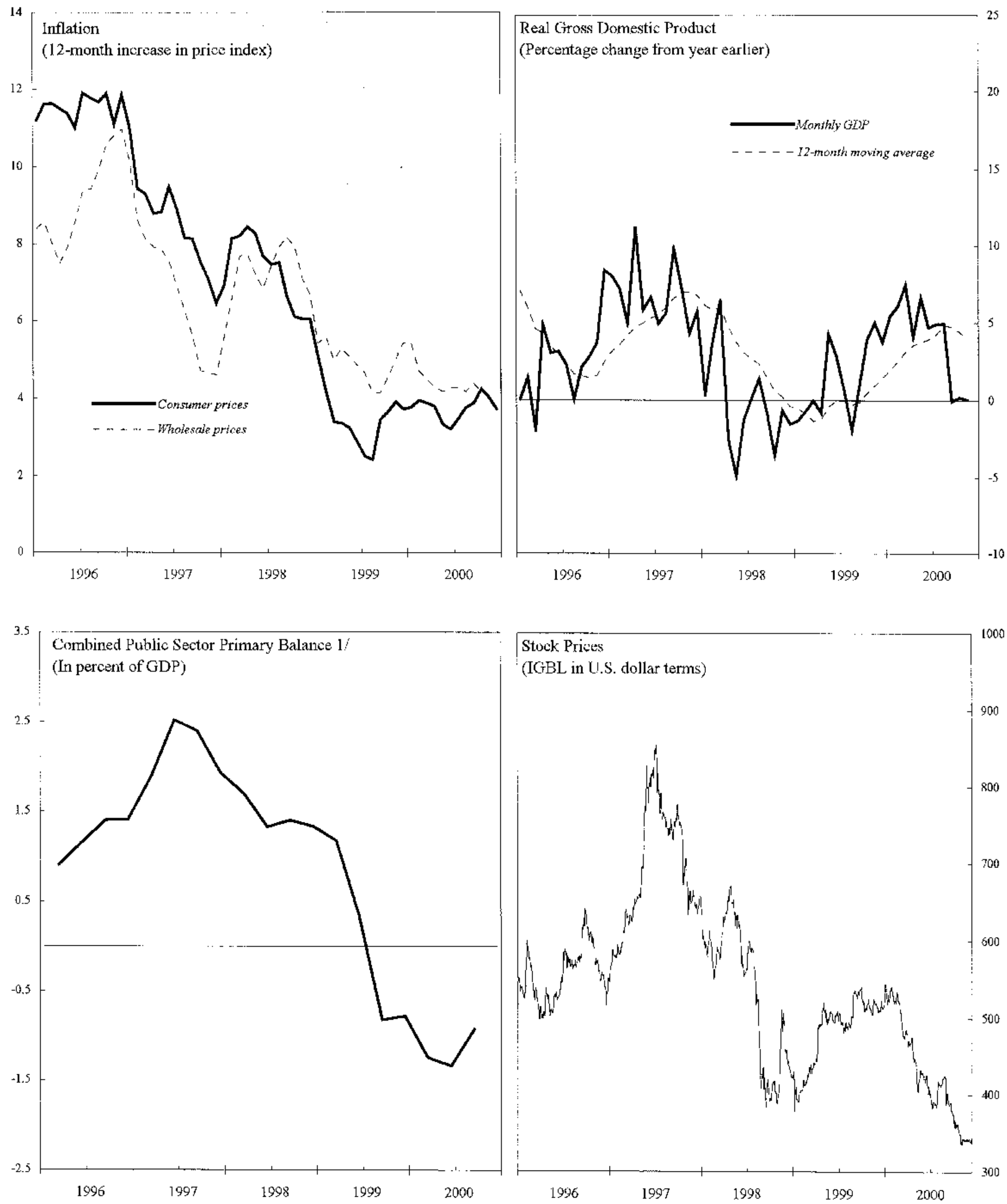
2/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates for SAF, PRGF, and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.

Table 12. Peru: Proposed Schedule of Purchases
Under the Stand-By Arrangement, 2001–02 [1/]

Amount of Purchase	Availability Date	Conditions Include
SDR 32 million	March 12, 2001 (Board date)	Board approval of SBA.
SDR 24 million	May 15, 2001	Observance of end-March 2001 performance criteria.
SDR 24 million	August 15, 2001	Completion of mid-term review and observance of end-June 2001 performance criteria.
SDR 24 million	November 15, 2001	Observance of end-September 2001 performance criteria.
SDR 24 million	February 15, 2002	Observance of end-December 2001 performance criteria.

1/ Total access under the Stand-By Arrangement is SDR 128 million (20 percent of quota).

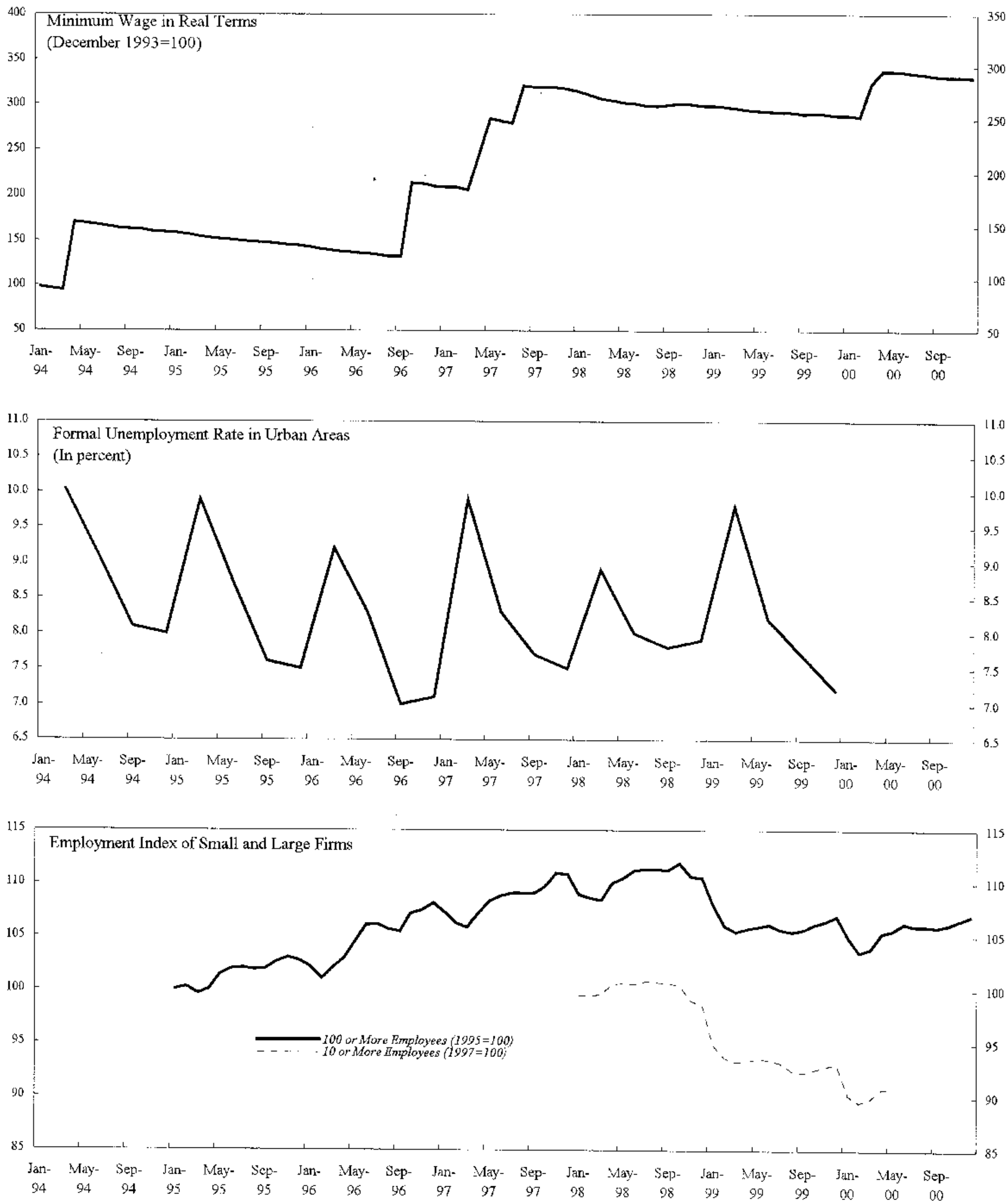
Figure 1. Peru:
Selected Economic Indicators, 1996-2000



Source: Central Reserve Bank of Peru.

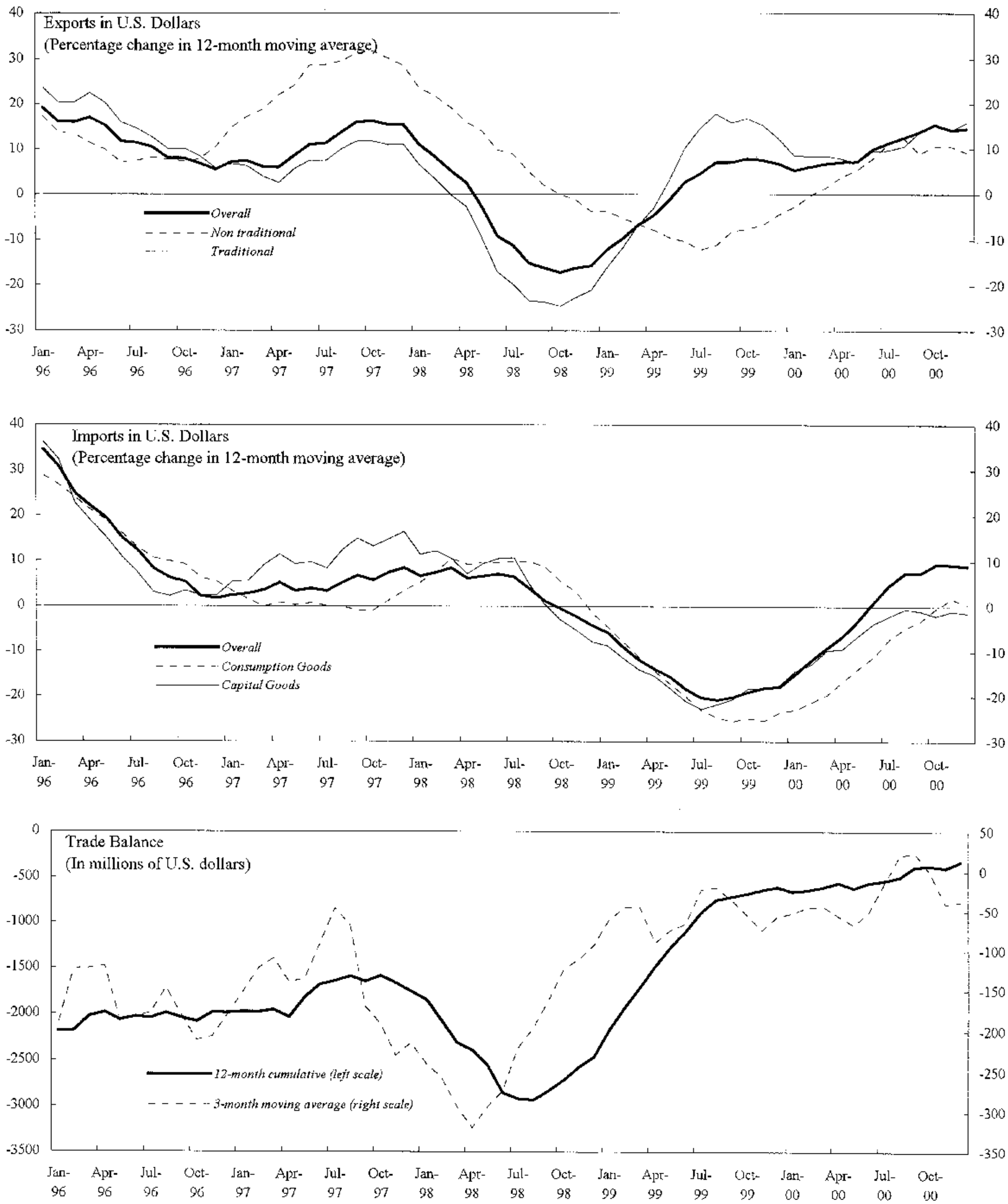
1/ 12-month cumulative.

Figure 2. Peru:
Labor Market Indicators, 1994-2000



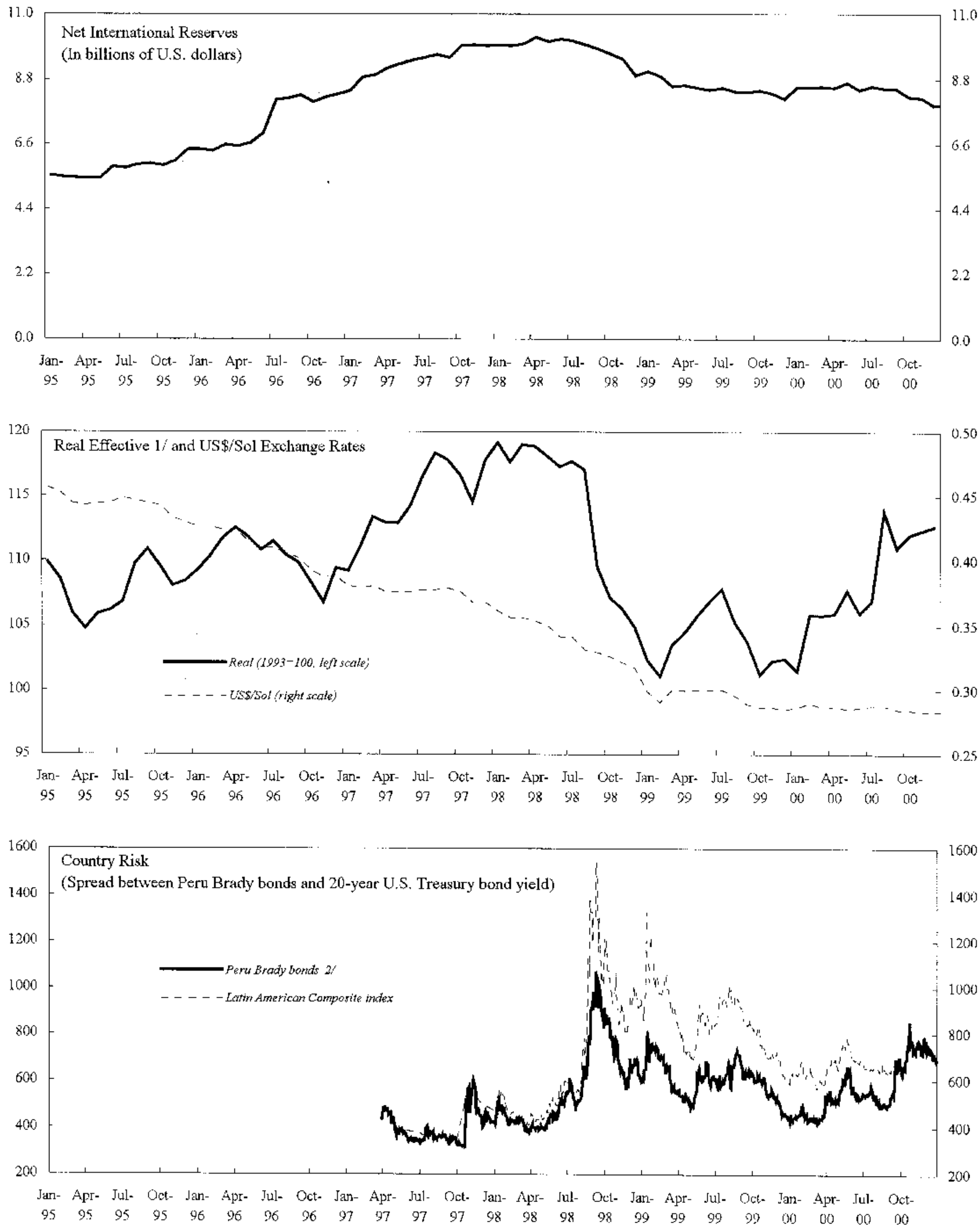
Sources: Ministry of Labor; Central Reserve Bank of Peru; and Fund staff estimates.

Figure 3. Peru:
Trade Indicators, 1996-2000



Source: Central Reserve Bank of Peru.

Figure 4. Peru: External Indicators, 1995-2000

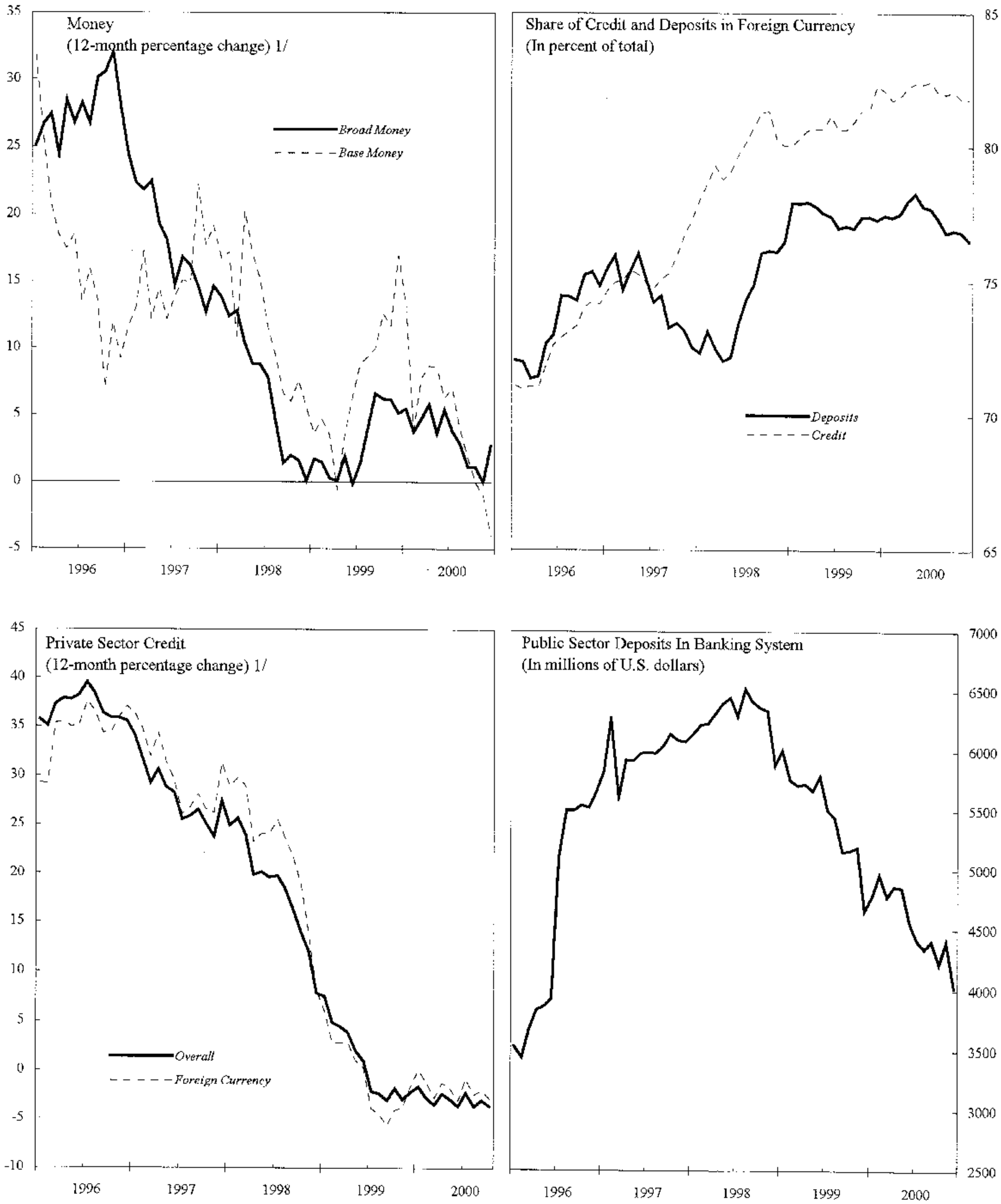


Sources: Central Reserve Bank of Peru; J.P. Morgan; and Fund staff estimates.

1/ Trade weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices. An increase (decrease) indicates appreciation (depreciation).

2/ Peruvian Brady bonds were first issued on March 31, 1997.

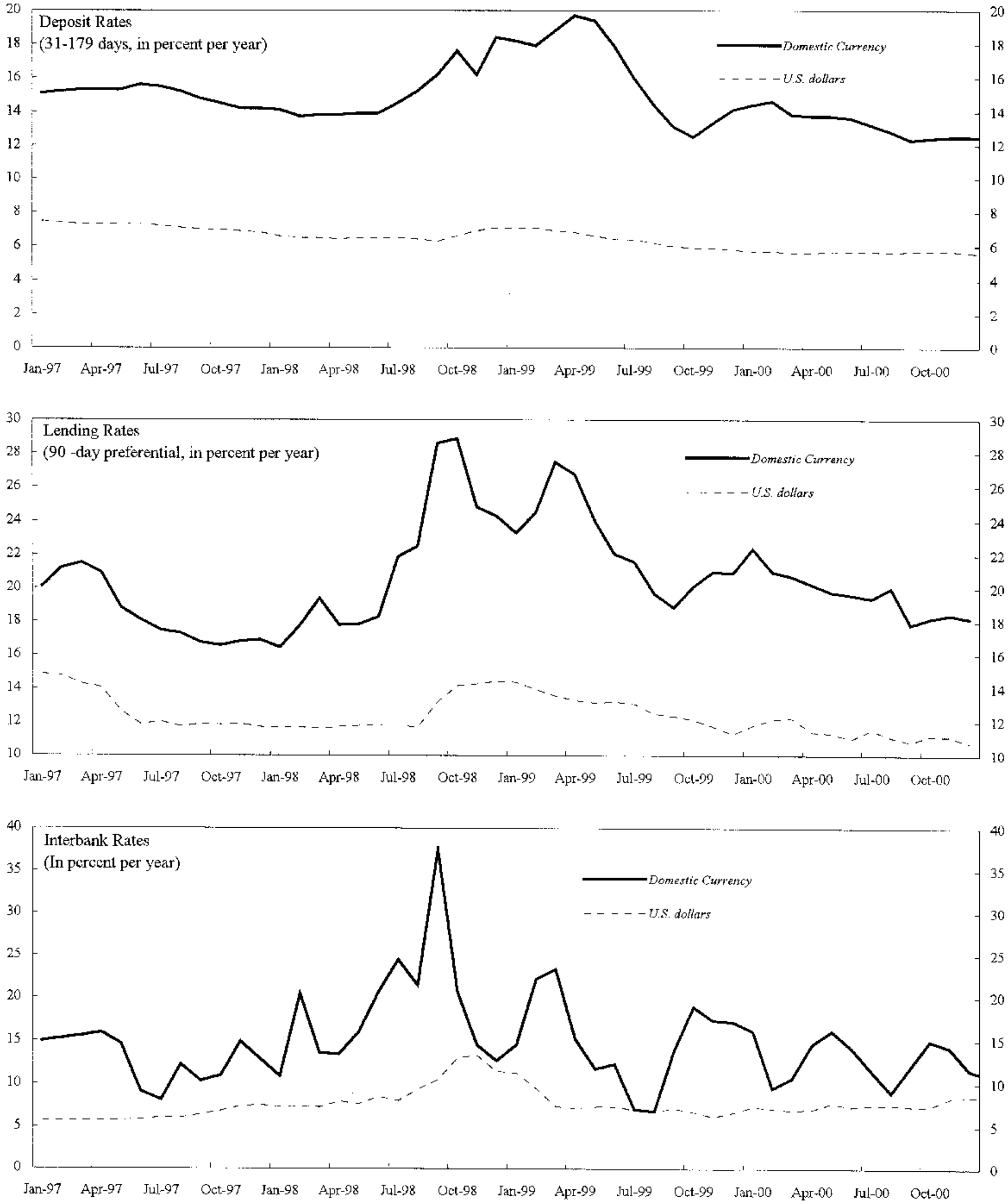
Figure 5. Peru:
Monetary Indicators, 1996-2000



Sources: Central Reserve Bank of Peru; and Fund staff estimates.

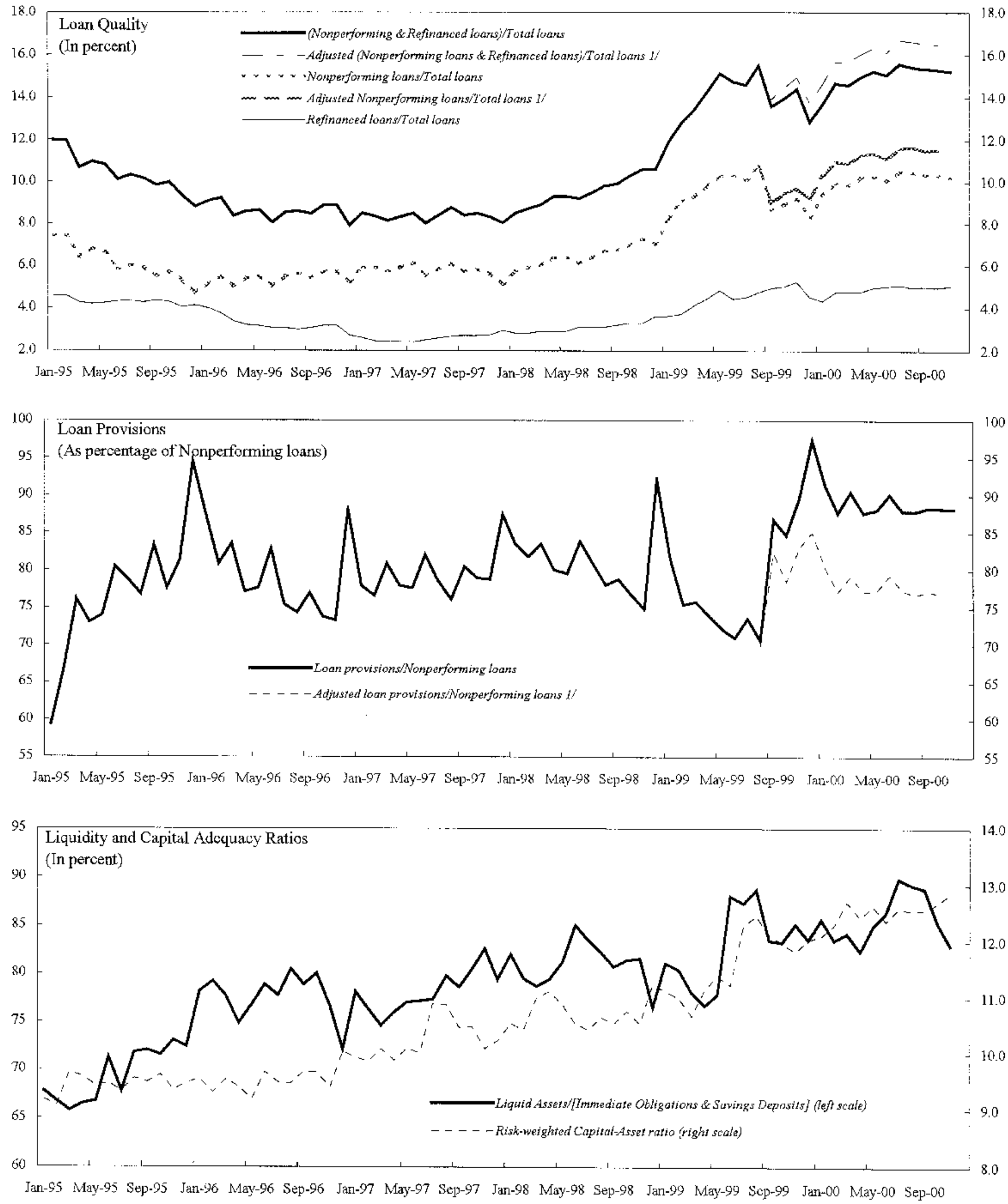
1/ U.S. dollar stocks are valued at program exchange rates.

Figure 6. Peru:
Interest Rates, 1997-2000



Source: Central Reserve Bank of Peru.

Figure 7. Peru:
Banking Indicators, 1995-2000



Source: Superintendency of Banks and Insurance.

1/ Adjusted for the bond for loan swap programs from August 1999.

Peru: Fund Relations
(As of January 31, 2001)

I. **Membership Status:** Joined 12/31/1945; accepted Article VIII status on February 15, 1961.

II. **General Resources Account**

	SDR Million	Percent Quota
Quota	638.4	100.0
Fund holdings of currency	1,066.7	167.1

III. **SDR Department**

	SDR Million	Percent Allocation
Net cumulative allocation	91.3	100.0
Holdings	1.2	1.3

IV. **Outstanding Purchases and Loans**

	SDR Million	Percent Quota
Extended arrangements	428.3	67.1

V. **Financial Arrangements**

Type of Arrangement	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	6/24/99	5/31/02	383.0	0.0
EFF	7/01/96	3/31/99	300.2	160.5
EFF	3/18/93	3/17/96	1,018.1	642.7
Stand-By	4/26/84	4/24/85	250.0	30.0

VI. **Projected Obligations to Fund** (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	1/31/01	2001	2002	2003	2004	2005
Principal	0	120.5	133.9	80.3	26.8	26.8
Charges/interest	0	24.7	17.5	10.8	8.3	6.9
Total	0	145.2	151.4	91.1	35.1	33.7

VII. **Exchange Arrangements**

Peru maintains a unified, floating exchange rate. On January 31, 2001, the average of official buying and selling rates was 3.53 new soles per U.S. dollar. The central government maintains external payments arrears. Peru maintains a clearing arrangement with Malaysia.

VIII. **Last Article IV Consultation**

The 1999 Article IV consultation was concluded on June 24, 1999 (EBS/99/93).

IX. Technical Assistance

Department	Date	Purpose
FAD	1997	Long-term assistance for the Financial Management Information System (SIAF).
	March 1997	Tax administration.
	September 1997	Public expenditure management and development of the SIAF.
	November 1999	Fiscal rules.
	June 2000	Tax policy and administration.
MAE	March 1997 and August 1997	Unification of the domestic and foreign operation desks at the central bank and reform of the payment system.
	May 1997	Reorganization of the Superintendency of Banks and Insurance.
	April 1998	Modernization of the payments system.
	January 2000	Forward foreign exchange markets.
	September, October, November 2000, January 2001	Financial sector assessment.
STA	June 1997, September 1997, January 1998, and October 1999	National account statistics, new base year for the national account series.
	December 1997	Measurement of worker remittances in the balance of payments.
TRE	March 1999	Central bank accounting.

X. Resident Representative

Vacant since August 2000.

Peru: National Accounts Revision

In June 2000, the Peruvian authorities published the long-delayed revision of the national accounts, for which the Statistics Department provided technical assistance. The revision entailed the change in the base year from 1979 to 1994. The previous national accounts were considerably distorted as a result of the lack of adjustment to the weights assigned to each sector over the period, notwithstanding major structural changes in production since 1979 (a year when the terms of trade were significantly above the long-run trend).

The **main changes** resulting from the revision are:

1. **The average annual rate of real GDP growth in the 1990s fell from 4.5 percent to 4.1 percent.** Real growth was revised downward for all years other than 1992 and 1995, with the largest downward revision occurring in 1998–99 (when growth was revised downward from 0.3 and 3.8 percent to -0.4 and 1.4 percent, respectively).

2. **Annual nominal GDP in the 1990s was revised downward by about 10 percent,** on average. In 1999, the new nominal GDP was 10.2 percent lower than the pre-revision number, with a concurrent fall in per capita GDP from US$2,229 to US$2,065.

3. The structure of GDP has changed significantly. The share in total GDP of the services sectors rose from 46.6 percent (in the 1979 base) to 59.6 percent (in the 1994 base), while the share of the primary sector fell from 24.7 percent to 13.5 percent. The share of manufacturing and construction fell slightly. These changes reflect the greater dynamism of the services sector in 1979–94 and the artificially high level of mining and petroleum product activity in 1979 in reflection of the above-mentioned unusual level of Peru's terms of trade in that year.

4. On the expenditure side, the new GDP series shows a greater share of private consumption (rising from 61 to 72 percent) and a lower share for exports (falling from 27.7 to 12.8 percent) and imports (declining from 19.1 to 16.2 percent). The reduction in exports' share to GDP mainly reflects lower commodity prices of important export items such as fishmeal and silver. The decrease in imports' share reflects the lower prices of main import items.

Peru: Recent Programs to Support Banks

In late 1998 and 1999, the fiscal authorities implemented several measures to help banks improve their liquidity and strengthen their financial and capital structures. Additional measures were adopted in 2000, including those that fostered bank mergers and provided lines of credit for the Deposit Insurance Fund. These measures, described below, involved gross fiscal contributions of about 4.8 percent of GDP (with a recovery of resources equivalent to 0.5 percent of GDP as of end-2000).

Liquidity assistance

In November 1998, the government authorized Banco de la Nación, the state fiscal agent, to place its deposits in banks requiring liquidity support. This program expired in June 2000. Also, in late 1998, rules for the placement of **public sector deposits** were changed to benefit weak banks. A total of 0.5 percent of GDP has been placed as deposits in those banks which have subsequently failed. **The potential fiscal cost is 0.5 percent of GDP.**

A **bond-for-loan liquidity swap** program in December 1998 permitted banks to exchange temporarily their performing loans for interest-bearing, negotiable treasury bonds in U.S. dollars. Participating banks were required to increase their capital, limit lending to related parties, capitalize profits, and continue provisioning for these loans. **The gross bond issue was 0.2 percent of GDP.**

Bank balance sheet restructuring, mergers, and others

A second **bond-for-loan restructuring swap** program adopted in June 1999 permitted banks to exchange temporarily their past-due loans for noninterest bearing, nonnegotiable treasury bonds in U.S. dollars, and to defer the related loan-loss provisions over five years. Participating banks were required to increase their capital, strengthen management and internal controls, and capitalize their profits. Mergers were encouraged. By end-1999, when the program expired, **the gross bond issue had reached 0.5 percent of GDP**, but the potential fiscal cost of this program is zero (because if banks fail, or do not comply with the conditions of the program, the bonds revert automatically to the treasury).

COFIDE, a state-owned second-tier bank, provided **medium- and long-term credits to banks** (at market rates) in dollars and in soles through three programs to help banks finance a lengthening of the maturity structure of enterprise loans. The ongoing **programs had provided (net) support for 0.5 percent of GDP** as of end-2000.

The government acquired shares in a problem large bank under a **temporary equity consolidation program** in June 1999 and provided a **portfolio guarantee** to help this bank merge with a foreign bank. **The share purchase and portfolio guarantee amounted to 0.4 percent of GDP.**

In late 1998, the government purchased shares and acquired control of a medium-sized problem bank (Latino). In 1999, additional support came through a purchase of the bank's nonperforming loans. In late 2000 the government authorized the issuance of Treasury bonds to capitalize, and facilitate the merger of Latino, which still had a negative net worth, with another medium-sized bank under a new financial system consolidation program. **The total fiscal cost in the Latino intervention is likely to reach 0.8 percent of GDP.**

In August 2000, the government authorized the issuance of up to **1 percent of GDP** in bonds to finance two programs (*FOPE* and *RFA*) to facilitate the restructuring of bank loans to the corporate and agricultural sectors respectively. So far no disbursements have been made under these programs. The FOPE is being revised. Under the RFA, a participating bank would write-off a portion of the loan and the debtor would amortize another portion. The remaining amount of the original loan would be refinanced with resources from the banks and from the government bond issue.

Also, in late 2000, the government extended a line of credit to the Deposit Insurance Fund (repayable over 10 years) financed by the issuance of **Treasury bonds in an amount of 0.4 percent of GDP**.

Peru: Public Assistance to the Banking System, 1998-2000 1/

(Annual Flows)

	1998	1999	2000
	(In millions of U.S. dollars)		
Bond programs	**136**	**460**	**362**
Liquidity swap	136	...	-24
Portfolio restructuring	...	285	-14
Banco Latino (portfolio purchase)	...	175	...
Deposit insurance fund 2/	...	...	200
Banco Latino (merger with Interbank) 3/	...	...	200
Cofide	**89**	**252**	**-79**
Financing restructuring lines	...	160	-58
MT working capital (in U.S. dollars)	89	48	-44
MT working capital (in soles)	...	43	23
Government Guarantee	**0**	**180**	**0**
Wiese (portfolio value)	...	180	...
Public sector deposits	**0**	**62**	**245**
Deposits in failed banks 4/	...	62	245
Equity participation	**60**	**50**	**0**
Banco Latino (equity acquisition)	60	...	...
Banco Wiese (equity acquisition)	...	50	...
Debt restructuring programs 5/	**0**	**0**	**500**
FOPE	...	...	400
RFA	...	...	100
Total	**285**	**1,004**	**1,028**
in percent of GDP	0.5	1.9	1.9
Memorandum item:			
GDP (millions of U.S. dollars)	57,080	51,963	54,062

Sources: Superintendency of Banks, Central Reserve Bank of Peru, Ministry of Economy and Finance, and Fund staff estimates.

1/ Amounts are gross program disbursements minus repayments.
2/ So far US$50 million has been disbursed.
3/ Program was announced in 2000 but the merger had not taken place as of end-January, 2001.
4/ Staff estimates for Republica, Banex , Serbanco, Nuevo Mundo, and NBK.
5/ Programs announced in 2000 but no disbursements have been reported yet.

Peru: Elliott Case

On September 7, 2000, the government of Peru missed Brady bond coupon payments amounting to US$80 million, as the government could not circumvent an attachment order on its assets stemming from an outstanding legal problem with Elliott Associates ("Elliott"), a "rogue" creditor. Elliott, an investment firm specializing in distressed or bankrupt assets, had purchased Peruvian official debt with a market value of US$11 million (face value of roughly US$22 million) in 1995. They did not take part in Peru's commercial debt (Brady) restructuring, which was completed in 1997, suing instead for full payment of the face value of the debt (plus interest and legal fees).

The original legal decision handed down in October 1998 was in Peru's favor (the Southern District of New York based its finding that Elliott had purchased the Peruvian debt in violation of Section 489 of the New York Judiciary Law, known as the "champerty doctrine", which disallows the purchase of a financial claim with the intent and purpose to sue). However, the U.S. Court of Appeals overturned this decision in October 1999, on the grounds that Elliott's original intention when purchasing the debt was to seek full repayment, not to sue, and Elliott was awarded a US$58.4 million judgment. Peru's request for a rehearing of the case was rejected in May 2000, and Elliott subsequently secured an attachment order on Peruvian official assets. Assets held in government accounts in New York (with exception of central bank reserves) were put at risk of being attached. In addition, Elliott obtained sweeping restraining orders that in the end left Peru no practical alternative for avoiding default on its Brady bonds (for which the grace period for coupon payment expired on October 6) that did not involve settling the case. Specifically:

(i) Elliott obtained a restraining order in New York that prevented Chase (the fiscal agent responsible for making payments to Brady holders) from making any payments to bondholders on behalf of Peru.

(ii) They obtained a restraining order (also in New York) that prevented Peru from "alienating" any of its property in the U.S.; i.e., Peru could not make payments with any property it may have held in the U.S.

(iii) They obtained attachment orders in many jurisdictions (UK, Netherlands, Belgium, Germany, Switzerland, Canada, and Luxembourg) as a means of seizing any property of Peru that may have been located in these jurisdictions.

On September 29, 2000, Peru settled its case with Elliott by agreeing to pay the full amount set out in the original judgment. This decision cleared the way for the attachment orders on Peruvian assets to be lifted, and coupon payments were made to Brady bondholders on October 4, 2000. If Peru had missed the payment and gone into default, there was considerable risk that the full principal amount of the Brady bonds could have been accelerated by bondholders, and that cross-default provisions of other debt would have been triggered. Although investors clearly believed that Peru would not default, Brady bond spreads rose as a result of the uncertainty surrounding the mechanism and timing of the coupon payment. (Spreads rose 25 basis points to 506 basis points on the day of default, September 7, and continued to rise, reaching 615 basis points, until payment was made on October 4).

Peru: FAD Technical Assistance on Tax Policy and Tax Administration

A technical assistance mission from FAD which visited Lima in mid-2000 proposed a comprehensive reform of tax policy and tax administration. The thrust of the FAD proposal was to eliminate the numerous special tax regimes and exemptions that had been introduced over the last few years (with an estimated fiscal cost of over 2 percent of GDP). The resulting broadening of the tax base would allow for a reduction in tax rates and a net rise in total tax collections. Direct budget transfers would replace tax incentives aimed at regional and sectoral development. The mission also recommended new taxes (e.g., a levy on electricity consumption in excess of that consumed by households of moderate income), that the elimination of the special wage tax (IES) be gradual, the realignment of some excise taxes, the redesign of taxation of the mining sector and steps to strengthen tax administration.

Overall, the complexity and lack of neutrality of the tax system remain as described in the TA report. The main sector- and region-specific benefits include: accelerated depreciation and investment tax credits for certain economic activities; tax exemptions or lower tax rates for regions and sectors for the income tax, value-added tax (IGV), IES, and excises; and, special payment conditions for taxes paid on imports or import tax refunds for some sectors. The proliferation of these special regimes also impairs the work of the tax administration agency SUNAT, as they give incentive to taxpayers to appeal actions against them by SUNAT, which in some cases has led to a *de facto* extension of benefits beyond their original intention.

To foster transparency and promote discussion on tax reform, the TA report recommended that an annual estimation of tax expenditures be included in the annual budget, an initiative that the authorities intend to undertake beginning in 2001. Finally, the mission also recommended that limits on congress' ability to introduce tax exemptions be imposed in line with those used to limit spending initiatives. Currently, only the executive branch has the constitutional faculty to propose spending initiatives, and congress can either accept them or deny them; modifications proposed by congress to these spending priorities need to be approved by the MEF. The mission proposed that equivalent rules be adopted for tax legislation; at present, congress is free to introduce legislation on the tax system without the executive branch's agreement. Over the last few years, this has been the primary source of the introduction of tax exemptions and frequent changes to the tax system, which has added considerable uncertainty for economic agents.

Peru: Relations with the World Bank Group

I. Objectives

The overriding objective of the World Bank's assistance program for Peru continues to be to support the government's effort to achieve a sustained, continuous reduction in poverty. The lending program focuses on increasing human capital, developing market-integrating infrastructure, strengthening private property ownership and public institutions, and enhancing macroeconomic stability.

II. Lending

The Peru Country Assistance Strategy (CAS), discussed on July 22, 1997 by the Board, proposed a lending program of US$200 million a year on average over the period 1998–2000, significantly lower than the base case of US$425 million a year endorsed by the previous CAS. This reduced level of lending reflected at that time the government's willingness to control its overall borrowing level in the context of significantly stepped up concessionary bilateral lending. Lending in FY 1998 amounted to US$172.5 million (an *El Niño* emergency loan of US$150 million and a judiciary reform loan of US$22.5 million, which was canceled at the request of the government in FY 1999 before it became effective). In FY 1999, the Bank approved an Urban Property Rights Loan of US$38 million and a Financial Sector Adjustment Loan II (FSAL II) of US$300 million. The FSAL II, cofinanced with the Japan Bank for International Cooperation (JBIC) for a similar amount, supported second-generation reforms in the financial sector. The first tranche (US$178 million) was disbursed in June 1999 and the second tranche in September 2000. A second adjustment operation, a social reform loan (formerly poverty SAL) in an amount to be determined, is under preparation and is expected to be approved in FY 2001. In FY 2000, the Bank approved under the Adaptable Program Lending, an agricultural research and extension loan (US$9.6 million) and a health reform loan (US$80 million), and under the Learning and Innovation loan program, an indigenous and afro-Peruvian development loan (US$5 million). The agricultural research and the indigenous, afro-Peruvian development loans have been signed. The health reform loan whose amount was subsequently decreased to US$27 million at the request of the Government is expected to be signed before the end-March. One investment loan, a rural road investment program is being prepared for FY 2001.

The Bank will start the preparation of a new CAS when the new administration takes office after July.

III. Nonlending Services (NLS)

The current CAS has introduced a shift toward lower lending and increased nonlending services. Building on previous work done on poverty, a work program was initiated in FY 1998 in close collaboration with the Prime Minister's office. The first multiyear poverty dialogue took place in October 1998, the second in September and December 1999 and the third one in November 2000 through January 2001. The poverty dialogue aims at facilitating open channels of communication on poverty and promoting the development of a poverty reduction strategy. The Bank completed studies on education finance and health finance for the poor, and their recommendations helped form the basis for policy reforms of the social reform loan as well as being incorporated in the new operations on rural education and health reform. A study on private participation in infrastructure has been jointly prepared by the Bank and IFC, cofinanced by the Japanese Government. Work on an institutional and governance review and an assessment of the type and areas of corruption are under preparation to support an anticorruption program recently started by the transition government.

Policy Notes identifying the challenges for Peru in the coming years have been prepared and were discussed with the government and distributed to experts in the various areas of analysis.

IV. World Bank Technical Assistance (TA)

The Bank has secured a number of grants from Japan, Canada, and other bilateral donors to support project preparation, economic and sector work, supervision, and implementation issues. There are two Institutional Development Fund (IDF) grants under implementation, one to help the national statistical institute (INEI) to carry out household surveys and the other to strengthen the Ombudsman's office.

Statement of World Bank Loans
(As of December 31, 2000)

Loan Number	Fiscal Year Approved	Borrower	Purpose	In millions of U.S. dollars Total (net of cancellation)	Undisbursed
Seventy four (74) loans fully disbursed 1/				3,548.7	
Partially disbursed or undisbursed loans					
37010	1994	Republic of Peru	Basic health and nutrition	34.0	1.0
38110	1995	Republic of Peru	Lima water rehabilitation and management project (SEDAPAL)	150.0	29.1
38260	1995	Republic of Peru	Primary education quality project	125.7	11.1
39620	1996	Republic of Peru	Rural roads rehabilitation and maintenance	90.0	4.2
40760	1997	Republic of Peru	Irrigation rehabilitation	85.0	42.8
41300	1997	Republic of Peru	Sierra national resource management	51.0	13.2
42500	1998	Republic of Peru	*El Niño* emergency	69.0	2.0
43840	1999	Republic of Peru	Urban property rights	38.0	23.3
45190	2000	Republic of Peru	Agricultural research and extension	9.6	9.6
45360	2000	Republic of Peru	Indigenous development	5.0	5.0
45270	2000	Republic of Peru	Health reform	80.0	80.0
Total				**4,286.0**	
Of which: amount repaid				1,356.9	
Total outstanding				**2,929.1**	
Total undisbursed					**221.3**

1/ Includes the 1979 program loans (US$115 million), 1992 Financial Sector Adjustment Loan (US$400 million), 1992 Trade Policy Loan (US$300 million), and 1992 Structural Adjustment Loan (US$150 million), 1993 Privatization Adjustment Loan (US$250 million), 1997 Pension Reform Adjustment Loan (US$100 million), 1997 DDSR Loan (US$183 million), and 1999 Financial Sector Adjustment Loan (US$300 million).

Statement of IFC Investments
(As of September 30, 2000)

In millions of U.S. dollars

	Loans	Equity	Quasi-equity	Participation loans	Total
Total commitments held by IFC	147.32	18.37	23.50	223.00	412.19
Total disbursed	112.5	18.33	23.50	134.82	289.15

Source: World Bank.

Peru: Relations with the Inter-American Development Bank

A. Background

Since 1991 the Inter-American Development Bank (IDB) has played a major role in supporting the Peru's strategy of economic stabilization, structural reforms, and normalization of relations with the international financial community. Currently, the IDB is supporting the transition government in maintaining macroeconomic stability and external viability. The Bank is financing programs aimed at modernizing the public sector, reducing poverty, creating the conditions for growth in agriculture, protecting the environment, strengthening the health sector, improving the quality of secondary education, and assisting in the reform of public finances. The Bank is also lending directly to the private sector to build infrastructure projects.

B. Lending

Peru's total outstanding debt with the IDB as of the end of December 2000 amounted to US$2.6 billion and current commitments (undisbursed balance) amounted to about US$1 billion, corresponding to 24 loans currently in execution. The lending program for 2001 includes six loan operations for a total of US$555 million. The lending program for 2002-2003 will be discussed with the new government after July.

C. Recent Economic and Sector Work

A comprehensive review of major economic, social, and institutional issues is under way in order to prepare the Country Paper for Peru, the document will lay out the Bank's strategy for the next three years. IDB project teams also are performing sector work to collect background information for the definition of sector strategies, which would lead to the identification of future projects that could be supported by the IDB.

D. Nonreimbursable Technical Cooperation

During the past eight years the IDB has extended a number of grants for institutional building programs through the following institutions: SUNAT (tax administration), SUNAD (customs), FONCODES (social programs), Congress, the Ministry of Finance and Economy, the Republic's General Comptroller, the Institute for the Defense of Competition and Intellectual Property (INDECOPI), the municipal savings banks, and financial institutions that provide credit to microenterprises and indigenous enterprise associations. In addition, the Bank has provided resources of the Multilateral Investment Fund (MIF) to finance private sector projects.

Statement of IDB Loans
As of December 31, 2000

Number	Approved	Borrower	Executor/Purpose	In millions of U.S. dollars Disbursed	Undisbursed
131 loans fully disbursed 1/				**3,424.59**	
24 loans with undisbursed balances				**1,031.52**	**1,022.14**
836/OC	1994	Republic of Peru	MTC–Road rehabilitation and improvement	243.57	8.43
847/OC	1994	Republic of Peru	PRONAP–Support to basic sanitation sector	129.56	10.44
901/OC	1995	Republic of Peru	MTC–Rural infrastructure transportation plan	90.00	0.65
902/OC	1995	Republic of Peru	MEF–Public investment program	3.92	0.08
931/OC	1996	Republic of Peru	FONCODES–Support to Foncodes II	135.18	14.82
956/OC	1996	Republic of Peru	MED–Education: quality improvement	55.76	44.24
985/OC	1996	Republic of Peru	MEF–Sector investment loan	76.14	73.86
1025/OC	1997	Republic of Peru	MAG–Agricultural sanitation	12.12	33.48
1050/OC	1997	Republic of Peru	SUNAT–Tax administration III	2.05	0.65
1058/OC	1997	Republic of Peru	MEF–*El Niño* emergency	118.77	31.23
1061/OC	1997	Republic of Peru	CEPJ–Modernization of justice administration: MBJ	7.36	4.14
1128/OC	1998	Republic of Peru	COFIDE–Microenterprise credit II	27.44	2.56
1137/OC	1998	Republic of Peru	COFIDE–Multisectorial credit II	106.68	93.32
1144/OC	1998	Republic of Peru	MPMDH–Human development	7.04	21.76
1150/OC	1998	Republic of Peru	MTC–Road rehabilitation and improvement	13.84	286.16
1196/OC	1999	Republic of Peru	MEF–TC loan sector reform II	0.97	9.94
1208/OC	1999	Republic of Peru	MINSA–Health sector reform		87.00
1218/OC	1999	Republic of Peru	MEF–Customs system		1.00
1233/OC	1999	Republic of Peru	MEF-*El Niño* Reconstruction		120.00
1236/OC	2000	Republic of Peru	TC to support public finance reform	1.12	5.38
1237/OC	2000	Republic of Peru	Quality improvement in secondary education		120.00
1285A/OC	2000	Red Eléctrica del Sur, S.A.	Transmission line Redesur		18.30
1285B-1/OC	2000	Red Eléctrica del Sur, S.A.	Transmission line Redesur		13.30
1285B-2/OC	2000	Red Eléctrica del Sur , S.A.	Transmission line Redesur		21.40
Total disbursed (since 1961)				**4,455.11**	
Of which: repaid				**1,850.42**	
Total outstanding 2/				**2,604.69**	

Source: Inter-American Development Bank Report FIN-17.

1/ Excludes seven loans fully cancelled
2/ May differ from disbursement less repayments, owing to valuation changes.

Peru: Statistical Issues

Outstanding statistical issues

Real sector

The authorities published in June 2000 a revised GDP series dating back to 1991. The base year of the new series was changed from 1979 to 1994 to reflect changes in the structure of the economy during this period. Detailed revisions of the demand and supply sides of the national accounts have been completed for 1991–99. Revision for earlier years is ongoing. The main implications of the revision are described in Appendix II.

The authorities monitor labor market developments through four indicators: open unemployment, underemployment, employment, and remunerations. The quality of these indicators has improved significantly over the last two years. However, long delays in publishing the data is still a major shortcoming.

Government finance

Central government accounts are prepared on a commitment basis and adjusted to a cash basis. In 2000 the BCRP reported data on the operations of the central government, state governments, and local governments for 1999 for publication in the *Government Finance Statistics Yearbook*, but no debt data were reported.

Peru: Core Statistical Indicators
As of January 31, 2001

	Exchange Rate	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt
Date of Latest Observation	1/31/2001	1/29/2001	1/23/2001	1/23/2001	1/5/2001	1/31/2001	12/2000	11/2000	Q3/2000	Q3/2000	11/2000	9/30/2000
Date Received	1/31/2001	1/31/2001	1/26/2001	1/26/2001	1/26/2001	1/31/2001	1/5/2001	1/12/2001	11/24/2000	11/24/2000	1/12/2001	11/24/2000
Frequency of Data[1/]	D	D	W	W	W	D	M	M	Q	Q	M	Q
Frequency of Reporting[1/]	D	D	W	W	W	D	M	M	Q	Q	M	Q
Source of Update[2/]	A	A	A	A	A	A	A	A	A	A	A	A
Mode of Reporting[3]	E	E	E	M	E	E	M	M	M	M	M	M
Confidentiality[4/]	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication[1/]	D	D	W	W	W	D	M	M	Q	Q	M	Q

1/ D=Daily; W=Weekly; M=Monthly; Q=Quarterly; and A=Annual.
2/ A=Central bank; Ministry of Finance; or other official agency.
3/ E=Electronic, and M=mail
4/ C=For unrestricted use

Statement by the IMF Staff Representative on Peru
March 12, 2001

1. This statement provides an update of information that has become available since the release of the staff report (EBS/01/25, 2/26/01) and additional details regarding the status of the safeguards assessment for Peru. This information does not change the thrust of the staff appraisal.

2. The main developments were as follow:

- The latest central bank data on macroeconomic variables for 2000 confirm the preliminary data presented in the staff report. Real GDP grew by 3.6 percent, the external current account deficit was 3 percent of GDP, and the overall fiscal deficit was equivalent to 3 percent of GDP. The slowdown in economic activity that started in the second half of 2000 continued in 2001, with output falling by 1.6 percent (year-on-year) in January. Inflation through February was in line with program projections. Tax revenues were slightly above programmed levels in the first two months of the year, owing to the higher than envisaged one-time payment required under the tax amnesty program. Other tax collections were somewhat below program.

- In recent discussions with staff, the authorities noted that congress' ongoing investigation of government spending carried out under secret norms during the 1990s (noted in the staff report) focuses on irregularities related to the purchase of defense equipment, but it does not have implications for the fiscal statistics. They were of the view that while the outcome of this investigation may call into question the quality of the expenditure, it will not affect data on the level of expenditure, as all spending (including that authorized under secret norms) is fully recorded in the official statistics. Based on these discussions, the staff does not anticipate that fiscal data related to the expenditure under investigation would require revision. Staff plans to remain in contact with the authorities on this issue.

- The Ministry of Economy and Finance (MEF) has launched a website that should substantially increase the transparency of government operations. The site contains information on official three-year macroeconomic projections, strategic plans of the MEF, operations of public institutions, and budget execution, including on defense and national security.

- In recent discussions with the authorities, the staff was informed that additional external financing for 2001 has been secured from multilateral and bilateral sources. This leaves identified sources of external financing above the program projection, which under the program would increase the target on the accumulation of net international reserves.

- over -

- Consistent with the need to improve public debt management and facilitate the development of domestic capital markets, the MEF approved regulations for the placement of domestic-currency denominated Treasury bonds in the local market (for up to 0.25 percent of GDP).

- A decree was issued on February 5 that establishes a new formula for the biannual adjustments in 2001 of the minimum prices used for setting the variable-rate surcharge on certain agricultural imports. The new formula has reduced the protection to these products, but the adjustments to the minimum prices will not be automatic, as they will continue to require the approval of the Ministry of Agriculture and the MEF, a feature that had delayed adjustments in the past. The authorities indicated that Peru's legal framework does not allow for changes in minimum prices without intervention of those ministries, but stressed their commitment to avoid delays in the future.

- On March 1, 2001, revised data for 1999 on public debt was submitted for publication in the Government Finance Statistics Yearbook, thus addressing the pending matter noted in the Statistical Issues appendix of the staff report.

3. The details regarding the status of the safeguards assessment for Peru are as follows:

Under its last arrangement (EFF), Peru was subject to the transitional procedures governing safeguards assessments. These procedures require the Central Reserve Bank of Peru to publish annual financial statements that are independently audited in accordance with internationally accepted standards (the "external audit"). In November 2000, as part of the safeguards assessments process, the authorities sought staff assistance in the procurement process for the appointment of external auditors. On January 23, 2001, they informed the staff, through the Executive Director's Office, that the audit firm *Caipo y Asociados Sociedad Civil*, a member company of *KPMG International*, had officially been appointed to undertake an external audit of the Central Reserve Bank of Peru for the first time. The *KPMG* audit is expected to be completed by March 15, 2001 and publication of the financial statements will follow shortly thereafter. Pursuant to the safeguards framework and Peru's request for a new stand-by arrangement, staff is undertaking a full Stage One safeguards assessment of the Central Reserve Bank of Peru, which includes an assessment of the quality and effectiveness of the external audit to ascertain that it meets internationally accepted standards.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/26
FOR IMMEDIATE RELEASE
March 19, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Peru

On March 12, 2001, the Executive Board concluded the 2000 Article IV consultation with Peru and approved a one-year Stand-By Arrangement in an amount of SDR 128 million (see Press Release 01/9, March 12, 2001).[1]

Background

In 1998–99 the economy weakened under the influence of the *El Niño* weather disturbance, a sharp drop in commodity export prices, and a liquidity squeeze stemming from turbulence in international financial markets. Output declined in 1998 and recovered only slightly in 1999. Employment fell. The external current account deficit increased in 1998, as export prices dropped, but narrowed in 1999 when domestic demand weakened. Weak domestic demand also helped to lower inflation. Bank credit slowed sharply, initially reflecting cuts in foreign credit lines after the Russian crisis, but subsequently owing to banks' concern about the debt servicing capacity of their clients. Bank loan portfolios deteriorated. As capital inflows declined, the currency depreciated significantly in real effective terms and international reserves fell; however, international reserves still remained at a comfortable level. The fiscal situation deteriorated over this period from balance in 1997 to a deficit of 3 percent in 1999.

Output recovered in the first half of 2000, but subsequently slowed markedly as private investment weakened because of heightened political uncertainty and as government spending was tightened to offset overspending prior to the elections in the first half of the year. The weakening in domestic demand contributed to a further decline in employment and the maintenance of low inflation. Strong demand for Peru's exports in 2000, together with weak

[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. 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. This PIN summarizes the views of the Executive Board as expressed during the March 12, 2001 Executive Board discussion based on the staff report.

domestic demand, reduced the external current account deficit to an estimated 3 percent of GDP. The combined public sector deficit, at 3 percent of GDP, exceeded the limit established by Peru's Fiscal Responsibility Law.

The deterioration in bank loans continued in 2000. In response to the weakening of the banking system, the authorities took additional steps to ease liquidity further and help bring about needed consolidation of the banking system. As banks remained cautious in their lending given the weak outlook for the business sector, bank credit continued to decline in 2000.

The program for 2001 assumes real GDP to grow between 2 and 3 percent, with inflation declining to between 2.5 and 3.5 percent, a further reduction in the external current account deficit, and a moderate accumulation of net international reserves that would keep gross reserves at about nine months of imports of goods and services and 60 percent of broad money. Consistent with Peru's Fiscal Responsibility Law, the combined public sector deficit would be reduced to 1.5 percent of GDP. The growth projection is predicated on a recovery in the second half of the year, driven by a pick-up in private demand as uncertainty subsides following the change in government.

Executive Board Assessment

While noting that the pickup in output growth in the first half of 2000 was short-lived and that economic activity continued to be weak, Directors concurred with the authorities' intention to focus their efforts on securing macroeconomic stability in the transition to a new government. In this regard, Directors welcomed the authorities' objective of reducing the overall fiscal deficit to the limit established by the Fiscal Responsibility Law for 2001.

Directors agreed with the authorities that the fiscal adjustment in 2001 falls appropriately on the side of current expenditure, as the slowdown in economic activity limits the scope for increasing revenues. They welcomed the government's commitment to safeguard expenditure on social programs, and supported the authorities' intention to work with the World Bank to improve the targeting and monitoring of social programs, and to ensure the allocation of adequate resources for these programs.

Directors expressed concern about recent changes in tax policy that did not turn out to be revenue neutral. They urged the authorities to resist pressures for granting tax breaks and relaxing tax administration in the period through the change in government. Directors stressed the need for preparing a comprehensive tax reform proposal by midyear, so that the next administration will be able to move rapidly to improve tax policy and strengthen tax administration, while ensuring an appropriate level of government revenue for 2002 and beyond.

Directors advised the authorities to resist proposals to force banks to refinance consumer debt, to introduce legislation that could weaken the private pension system, and to temporarily prohibit layoffs in the private sector. Several Directors also expressed concern about the recent measures to give employees free access to their current contributions to the unemployment protection fund. Given its short-term nature and neutral fiscal effect, a few other Directors did not think that this move entailed much risk.

Directors urged the authorities to continue their current efforts to strengthen the banking system along the lines recommended by the FSAP mission. They welcomed, in particular, the intention to improve the consolidated supervision of financial entities, strengthen anti-money laundering statutes, and to refrain from committing public resources to support specialized regional or sectoral financial institutions.

Directors noted that there has been a significant consolidation of the banking system over the last two years, but considered it critical that the supervisory agency remain vigilant in ensuring that all banks have adequate capital bases and resist pressures to ease existing regulations.

Directors endorsed the authorities' monetary policy stance for 2001 and commended the recent steps taken by the central bank to improve the transparency of monetary policy. They supported the intention to examine the adoption of a formal inflation targeting framework for monetary policy in Peru, and encouraged them to carefully assess the advantages and the requirements. Directors agreed that the current flexible exchange rate policy has served the economy well, and supported the authorities' intention to continue with the present regime.

Directors considered that the proposed steps in the area of privatization and the awarding of private sector operating concessions are appropriate. They noted, however, that over the last few years progress has lagged in these areas, and urged the authorities to meet their 2001 objectives. Directors also welcomed Peru's continued commitment to trade liberalization.

Directors noted that the authorities' recent efforts to diversify debt instruments and deepen the domestic capital market and encouraged them to continue to pursue a prudent debt management strategy.

Directors noted that Peru was one of the early subscribers to the Special Data Dissemination Standard and viewed positively the publication last year of the revision of the country's national accounts. They also welcomed the authorities' intention to improve the quality of labor market data. Directors supported the authorities' plan to improve the transparency of government operations, and welcomed the recent creation of a Ministry of Economy and Finance website, which includes information on the execution of the budget, fiscal projections, and the government's policy strategy.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Peru: Selected Economic Indicators

	1997	1998	1999	Prel. 2000	Proj. 2001
(Annual percentage change, unless otherwise indicated)					
Real economy					
Real GDP	6.7	-0.4	1.4	3.6	2.0-3.0
Inflation 1/	6.5	6.0	3.7	3.7	2.5-3.5
Terms of trade	5.6	-13.8	-6.6	-0.6	2.0
Real effective exchange rate (depreciation -) 1/ 2/	7.4	-11.1	-2.5	9.8	...
Nominal exchange rate (in soles per U.S. dollar) 1/	2.72	3.13	3.48	3.52	...
Money and credit					
Base money	19.2	5.5	17.0	-4.0	6.0
Broad money 3/	15.0	0.2	4.3	2.2	4.2
Credit to private sector 3/	27.4	7.8	-2.3	-1.9	3.0
(In percent of GDP, unless otherwise indicated)					
Savings and investment					
Gross domestic investment	24.6	24.2	22.0	20.6	20.0
National savings	19.4	17.8	18.5	17.6	17.6
External savings	5.2	6.4	3.5	3.0	2.4
Balance of payments					
Current account	-5.2	-6.4	-3.5	-3.0	-2.4
Capital and financial account	8.4	4.0	2.0	2.7	2.8
Gross official reserves (in months of imports of goods and services) 1/	12.3	13.1	10.8	9.9	9.3
Gross official reserves (in percent of broad money) 1/	78.2	73.4	65.7	62.4	59.5
Public sector					
Combined public sector primary balance 4/	1.9	1.3	-0.8	-0.7	0.8
Combined public sector overall balance 4/	0.0	-0.6	-3.0	-3.0	-1.5
Public sector medium- and long-term external debt	33.3	35.6	38.7	36.1	35.9

Sources: Central Reserve Bank of Peru; and Fund staff estimates and projections.

1/ At end of period.
2/ Based on Information Notice System.
3/ Flows in foreign currency are valued at program exchange rate.
4/ Revenue excludes privatization receipts.

Statement by A. Guillermo Zoccali, Executive Director
and Oscar A. Hendrick , Advisor
for Peru
March 12, 2001

Overview

1. Despite the lingering effects of recent adverse external shocks and the uncertainty related to the political turmoil during the second semester of last year, our Peruvian authorities maintained macroeconomic stability while safeguarding the most critical components of the social safety net. The continued support of the Fund in the context of the requested one year Stand By arrangement, which is intended to be precautionary, is particularly appreciated.

2. Under the previous Extended Arrangement, the main macroeconomic objectives for 2000 were attained. GDP grew 3.6 percent while inflation ended the year at 3.7 percent, below the level envisaged in the program. Net international reserves remained at a very comfortable level, equivalent to some 10 months of imports of goods and services and 142.7 percent of short- and medium-and long- term external liabilities maturing in the following year. In addition, despite the deterioration in the terms of trade, the external current account deficit narrowed at a faster rate than envisaged in the program. This was partially explained by the weakness in domestic demand, but was also accompanied by a 10.1 percent growth in the volume of exports. FDI, excluding privatization proceeds and medium-and-long-term private flows, financed about 73 percent of the current account deficit in 2000.

3. In the fiscal front, expenditure grew faster than originally planned in the run-up to the Presidential and Congressional elections of 2000, but the authorities took strong measures beginning in August 2000 to offset overspending in the first semester. Total expenditure at end-year was kept in line with the program target. The fiscal deficit, however, was 0.9 percent of GDP higher than projected. This development was fully explained by the shortfall in revenue attributable to the slowdown in economic activity, particularly in the non-primary sectors which are the main sources of tax revenue. To enhance the efficiency of the tax system, the authorities requested technical assistance from the Fund on tax policy and tax administration. The FAD mission visited Lima in mid-2000 and the Peruvian Tax Authority (SUNAT) and the Ministry of Economic and Finance (MEF) have already acted on some of the mission's recommendations, as noted by the staff.

4. In recent years, the Peruvian banking system experienced some stress as a result of external shocks, climatic events and political turmoil. Despite this difficult environment, the system has successfully weathered the test through bank restructurings and capitalization

and consolidation of banking institutions, including mergers and bank exits. In spite of the severity of the shocks, the costs of recent programs to support banks to avert more systemic banking problems, identified in Appendix III of the main staff report, are low. This was possible, because of the inherent soundness of the financial system and the implementation of forward-looking prudential norms.

5. The FSAP mission that visited Peru in late 2000 and early 2001, concluded that the current strategy for the banking system was broadly appropriate, that systemic risk is limited and that international standards and best practices are generally being observed. The strength of the banking system stems from its robust capital base, that includes over 45 percent in foreign equity, the participation of major international banks, and a solid regulatory and supervisory framework. The restructuring strategy of the authorities has favored market-based solutions, exits of shareholders of problems banks and least-cost resolutions, particularly when public funds or the Deposit Insurance Fund were at risk. Additionally, during 2000 the authorities introduced a real time gross settlement system and a new electronic check clearinghouse, which has substantially reduced risks in the payment system. Further actions will be taken in line with the FSAP findings and recommendations.

6. The strong ownership of this program is evidenced not only by the authorities' commitment to maintain prudent monetary and fiscal policies – in the difficult climate of the run-up to the presidential and congressional election on April 8th – but also from the manifestations of support given by the main presidential candidates. As in previous years, a draft of the Letter of Intent, including the quantitative performance criteria table, was published and posted in several web sites for consultation. The Interim Constitutional Government of President Paniagua-Corazao, appointed by Congress in November 22, 2000, has reaffirmed its commitment to guaranteeing a clear, transparent and democratic electoral process, as well as to maintaining stable macro economic conditions until the new Government takes office on July 28, 2001.

Recent Economic Developments and Policy Issues

7. The staff reports for the 2000 Article IV consultation and request for Stand by Arrangements (EBS/01/25 and SM/01/70) provide a well-balanced description and analysis of recent economic developments and policy discussions, and were complemented by a useful Financial System Stability Assessment – FSSA – (SM/01/75). Our authorities are in broad agreement with the staff assessment and policy recommendations, therefore, we will focus on a few salient points that merit further clarification.

Democratic Transition to Economic Recovery

8. During its first three months in office, the interim government has demonstrated its commitment to macroeconomic stability and structural reforms. The concessions for the distribution of natural gas from the large Camisea project, and for the operation of the Lima airport have been awarded. New privatizations and concessions are planned for this year, and are expected to yield revenue in excess of US$ 500 million. The Congress passed last

month legislation rationalizing and strictly limiting public expenditure for 2001. Additionally, in early 2001 it enacted a tax package that reduces income tax rates, closes a tax loophole on foreign-source income and accelerates the payment of rescheduled tax obligations while penalizing those who fail to comply. The Executive Branch was also given special legislative powers to review the tax structure and eliminate or rationalize tax exceptions . This will be important for achieving the ambitious 50 percent reduction in the fiscal deficit - from 3.0 percent of GDP in 2000 to 1.5 percent of GDP in 2001- mandated by the Fiscal Responsibility and Transparency Law.

9. To further enhance transparency, the interim government has posted in its websites a detailed set of macroeconomic indicators, including medium term fiscal, monetary and external sector projections. Moreover, our authorities have established a hyperlink to the Integrated System of Financial Administration (SIAF), which consolidates the budget management, accounting, and treasury operations of the Government. This provides for full public disclosure of the process of authorizations and execution of government expenditure, at the level of the 559 government entities included in the budget. Any citizen is able to monitor from now on the structure and composition of national public expenditure, in real time, and with a significant level of disaggregation dating back to 1999. Such actions put Peru in the forefront of efforts to improve public sector transparency.

10. The authorities expect to reverse the weakening trend in domestic demand, reestablish investor confidence and strengthen the medium-term fiscal solvency. The requested one year Stand-By Arrangement is seen as providing a framework for macroeconomic stability in the transition to the new government and a clear signal to the markets regarding the authorities' commitment to sound policies. In the current circumstances, the program for 2001 realistically aims at real GDP growth in the range of 2 to 3 percent, well below potential, inflation declining to between 2.5 and 3.5 percent, and a further reduction in the external current account deficit to 2.4 percent of GDP. Net International reserves are projected to increase by US$ 215 million, to US$ 8.091 million.

Fiscal sector

11. Our authorities' confidence in achieving these objectives is helped by their having secured the financing of the fiscal deficit 2001, through new program and structural loans of the World Bank, the Inter American Development Bank and the Andean Financial Corporation. In addition, the Government has recently obtained new bilateral support from Spain and Germany. Higher than envisaged financing under the program will be directed to strengthening further the already comfortable international reserves position. Thus, the authorities do not envisage a need to place sovereign bonds in the international financial markets, but would be ready to do so if market conditions are favorable. In January of this year, the government published its domestic bond issuance calendar of up to S/. 500 million soles, equivalent to US$ 140 million, to broaden the domestic capital market and to develop an interest rate yield curve for domestic government paper which is not currently available. The first tranche for S/.100 million soles was placed last Thursday. This first issue of

domestic sovereign bonds was awaited by market participants and demand exceeded supply by five times.

12. The authorities are committed to maintaining the delicate balance between further fiscal consolidation and an appropriate fiscal response to the cyclical downturn, which greatly reduced the scope for increasing, in the short run, general government revenue above their current level. The degree of effort to attain the targeted fiscal deficit for 2001 is reflected in the negative impulse of the fiscal stance of 1.7 percent of GDP, for second consecutive year, as noted in table 2 of the main staff report. Expenditure retrenchment extends across all ministries, with particular emphasis on outlays in defense and national security and in the Ministry of the Presidency. While nominal wages and pensions have been frozen, critical social expenditure programs in the health and education sectors will be protected, and important actions have been taken to improve the quality of the public expenditure.

13. Against this backdrop, there are few options to stimulate domestic demand and help speed up the recovery. Our authorities' decision to allow employees to access, at their discretion, contributions to the private unemployment insurance scheme paid in by employers during the first ten months of this year, if used fully, could temporarily increase employees' disposable incomes by some US$ 30 million a month. This will stimulate private consumption and contribute to the recovery, particularly the manufacturing and services sectors which were most negatively affected by the current slowdown.

Privatization Process

14. Our authorities see significant benefits from pressing ahead with the remaining privatizations and concessions and with strengthening the conditions for domestic and foreign direct investment. The Camisea natural gas project will require investments of some US$3 billion (about 5 percent of GDP) over the next few years, while the recently awarded concession of the Lima airport entails an investment commitment of US$ 1,2 billion. The privatization schedule for 2001 agreed in the arrangement with the Fund is, in our authorities' view, a minimum. They are confident that the new government will be equally ambitious in this area.

Monetary Policy

15. Monetary policy remains geared exclusively to reducing inflation, with base money as the intermediate target. Market-based monetary instruments, ensure a fully flexible interest rate response and have contributed to monetary stability, which has been instrumental for strengthening the Peruvian economy. To further promote transparency and provide clear signals to the market, the monetary program made public, since the beginning of last year, is now available on a monthly basis together with the report on monetary policy objectives and operations. Also worth noting is that the presentation and release of Central bank macro-economic data, including international reserves, meet the standards of the Special Dissemination Standards (SDDS), which Peru subscribed to in 1996. The Central Bank is

also currently undergoing an external audit of its financial balances, in accordance with the new Fund policy in safeguard assessments.

16. Our authorities are analyzing the possibility of moving to an inflation-targeting framework. While many of the conditions are in place, the trade-offs involved are still being assessed. A seminar on this issue will be held this week in Lima with the support of the MAE. Different countries experiences will be reviewed and a decision could be taken during this year.

Banking system

17. Our authorities concur with the FSSA that: (i) systemic risk in the Peruvian financial system is limited and (ii) stress in the system is subsiding. In general, the solvency and liquidity of the banking sector have remained within comfortable levels despite: (a) lower profits and margins and (b) the recent closure of two banks that accounted for some 7 percent of the system's assets. It is important to note that even if all the non-performing loans under provisioning estimated by staff are subtracted from the existing regulatory capital, the overall leverage ratio of the banking system would remain within legal limits. Non-performing loans -- as a proportion of total loans -- have stabilized in the last few months and credit growth is gradually resuming. Moreover, the fact that international foreign banks hold around 60 percent of banks' total assets has allowed Moody's to conclude, in its report dated December 2000, that it "does not believe that the Peruvian system is inherently fragile" and to appraise as "quite positive for the short-term stability of the banking system" the announced merger between a bank that had earlier been taken over by the government and a medium sized private bank.

18. Notwithstanding this and, as anticipated to the FSAP mission, it is possible, that some small banks may still be vulnerable to further deterioration of portfolios or to adverse liquidity shocks. However, these banks account for less than 5 percent of the banking system assets. In any event, our authorities are closely monitoring these developments and have defined remedial actions that might be required. The few banks that in the stress test were over the solvency legal limit, have, however, made the necessary capital increases, are committed to doing so in the very short run under close monitoring by the SBS, or have already exited the market.

19. The frank and candid discussions between the FSAP mission and our authorities was predicated on a high degree of transparency and cooperation, including in the preparation and disclosure by the Superintendency of Banking and Insurance (SBS) of highly market-sensitive and detailed information, such as the potential loan provisioning deficiencies of the banking system and on-site bank inspection reports selected by the mission. Cooperation is critical for the success of the FSAP exercise and this aspect should be at least noted in the FSSA.

20. While the Peruvian regulatory and supervisory framework has demonstrated its effectiveness, the supervisory authorities are focusing their efforts on further upgrading the

bank supervisory oversight and addressing remaining weaknesses. Future developments in bank supervision include the full implementation of consolidated supervision of financial conglomerates in 2001, the strengthening of liquidity risk monitoring -- to include stress testing and contingency planning --, and further improvements of credit and market risk supervision. Regarding monitoring of credit risk, one of the main objectives of the Supervisory Authority is and has been to ensure proper loan classification and provisioning, through periodical on-site examinations and through several off-site techniques. There is full agreement with staff on the need for some changes in the existing banking law and these are currently under consideration. In addition, the SBS is selecting through public bidding the accounting firm responsible for external audit of its financial statements. A final report is expected to be delivered by mid-May.

Trade Policy

21. The government reaffirmed its commitment to an open and transparent trade regime. As staff indicates, Peru's low level of trade restrictiveness is reflected in its current rating of 2 on the 1-10 scale of trade restrictiveness index developed by the Fund.

A. A Final Remark

22. Our Peruvian authorities remain convinced that the economic policy framework in place will continue to serve the country well. Peru exhibits strong economic fundamentals and has established a solid track record of policy performance during the last decade predicated on an unambiguous commitment to stabilization and reform. The indications given by the front runners in the forthcoming presidential elections point to the maintenance of a market-oriented policy to achieve a sustained, non-inflationary growth, and to continued structural reforms to reduce poverty and produce the investment opportunities needed for sustainable development.