March 2007
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Peru: First Review Under the Stand-By Arrangement and Requests for Modification of Performance Criterion and Waiver for Nonobservance of Performance Criterion—2004 Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Peru

In the context of the first review under the Stand-By Arrangement and requests for modification of a performance criterion and waiver for nonobservance of a performance criterion, the following documents have been released and are included in this package:

- the staff report for the First Review Under the Stand-By Arrangement and Requests for Waiver of Performance Criterion and Waiver for Nonobservance of Performance Criterion, prepared by a staff team of the IMF, following discussions that ended on September 29, 2004, 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 November 5, 2004. 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 Press Release summarizing the views of the Executive Directors as discussed during its November 19, 2004 discussion of the staff report that completed the review and requests; and

- a statement by the Executive Director for Peru

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

Letter of Intent sent to the IMF by the authorities of Peru*

*Also included in Staff Report

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

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PERU

First Review Under the Stand-By Arrangement and Requests for Modification of Performance Criterion and Waiver for Nonobservance of Performance Criterion

Prepared by the Western Hemisphere Department
(In collaboration with other departments)

Approved by José Fajgenbaum and Juha Kähkönen

November 5, 2004

Discussions. Discussions on the first review under the Stand-By Arrangement were held in Lima during September 20–29, 2004. The staff team met with Economy and Finance Minister Kuczynski, Central Bank President Silva Ruete, Minister of Energy and Mines Quijandría, Minister of Labor Neves, other senior officials, and private sector representatives. The staff team comprised G. Terrier (Head), A. López-Mejía, M. Perez dos Santos (all WHD), M. García-Escribano (FAD), and M. Shannon (PDR). J. Guzmán (Senior Resident Representative) assisted the mission. Mr. Pereyra, Advisor to the Executive Director, participated in the policy discussions.

Program. A 26-month Stand-By Arrangement in the amount of SDR 287.279 million (21 percent of quota on an annual basis) was approved by the Executive Board on June 9, 2004. With completion of this review, a total of SDR 126.06 million will be available for drawing. The authorities are treating the arrangement as precautionary.

Review. The review focused on the implementation of the 2004 program. The Peruvian economy continues to perform well, with real GDP projected to grow by 4⅓ percent in 2004 and inflation remaining relatively low, despite recent increases due in part to higher oil prices. In contrast, efforts need to be stepped up in the area of structural reform.

Letter to the Managing Director. In his letter dated November --, 2004, Minister Kuczynski describes progress made under the program and specifies the policy actions that are to be undertaken in the area of structural reform (Attachment I). Minister Kuczynski also requests a waiver for nonobservance of the end-September structural performance criterion on the establishment of a commercial court in Lima, resetting this criterion for end-December, and modifying from end-December 2004 to end-April 2005 the date of implementation of the structural performance criterion on the awarding in concession of the construction and maintenance of two major roads.

Relations with the Fund. Peru's outstanding Fund credit is SDR 66.9 million (10.5 percent of quota). The last Article IV consultation was concluded on February 23, 2004. Peru has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. Peru's economic statistics are adequate for surveillance and policy formulation.

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EXECUTIVE SUMMARY

Background

- ***The current Stand-By Arrangement was approved by the Executive Board on June 9, 2004.*** The authorities are treating this arrangement as precautionary. Directors considered the program to be appropriate to reinforce confidence, boost economic growth and employment, further reduce vulnerabilities associated with high dollarization and public debt, and strengthen the basis for defining Peru's exit from Fund-supported programs.
- ***The economy has continued to perform well in 2004.*** Real GDP is projected to grow by 4⅓ percent, inflation remains relatively low, achievement of the 2004 fiscal targets is within reach, and gross official reserves are well above program targets.
- ***Progress has been made in the structural area, but it falls short of the program objectives.*** The authorities' main focus has been on the awarding in concession transportation infrastructure to the private sector and the reform of the public pension regime. The establishment of a commercial court (end-September structural performance criterion) has been delayed and the concession of two major roads (end-December structural performance criterion) is now expected to be met in April 2005. Several other structural measures are lagging.
- ***The domestic political situation remains difficult.*** Popular support for the current administration remains low, and the government lacks a stable voting majority in congress. Most congressional commissions are under the opposition's control.

Policy discussions and staff appraisal

- ***Preserving macroeconomic stability continues to be at the core of the authorities' policies.*** The draft 2005 budget aims at further fiscal consolidation and the central bank remains committed to keeping inflation low.
- ***The authorities have reaffirmed their commitment to progress in areas where structural reform has fallen short of the program objectives***. A new timetable has been identified for the establishment of a commercial court and the awarding of infrastructure transportation in concession to the private sector. Specific measures are also being taken to accelerate progress in other structural areas, including public pension reform and decentralization. In view of these commitments, staff supports the authorities' request for a waiver of the end-September criterion, resetting this criterion for end-December, and modifying the end-December criterion to end-April 2005.
- ***The medium-term outlook remains favorable.*** Assuming sound macro policies and progress on structural reforms, growth is projected at 4½ percent a year in 2004-06. A possible free trade arrangement with the United States and a second large natural gas project are positive factors in the medium-term outlook.
- ***The political situation continues to be the main risk to the program.*** So far, however, the government has been able to preserve a consensus for prudent policies and reform.

I. Introduction

1. ***Although the domestic political and social situation remains challenging, the program continues to benefit from political support.*** With high poverty and underemployment rates, social tensions remain high, which could undermine the authorities' commitment to the program in the run-up to the presidential and congressional elections scheduled for early 2006. So far, however, the government has been able to preserve a consensus for prudent policies and reform.

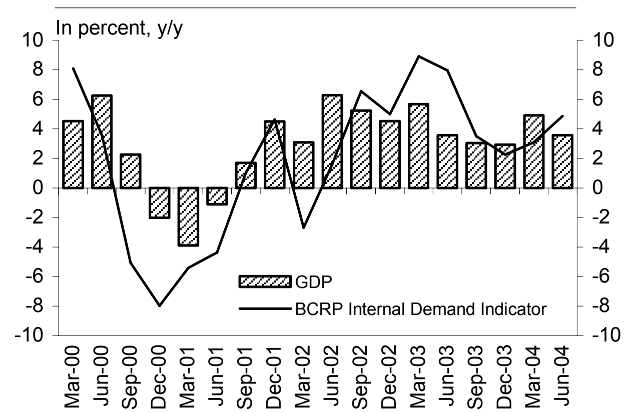
2. ***A 26-month Stand-By Arrangement in the amount of SDR 287.279 million (21 percent of quota on an annual basis) was approved on June 9, 2004.*** The authorities are treating this arrangement as precautionary. Directors considered that the pursuit of prudent macroeconomic policies together with key structural reforms would help boost economic growth and employment, further reduce the vulnerabilities associated with high dollarization and public debt, and strengthen the basis for Peru's exit from Fund-supported programs.

3. ***In the attached letter to the Managing Director, the Minister of Economy and Finance specifies actions intended to strengthen momentum in the structural reform area.*** The Minister also requests a waiver for nonobservance of the end-September structural performance criterion on the establishment of a commercial court, a resetting of this criterion for end-December, and modifying the timing for implementation of the end-December structural performance criterion on the granting of concessions for the construction and maintenance of two major roads.

II. Recent developments

4. ***The economy has continued to perform well.*** Despite a decline in agriculture output due to a severe drought, real GDP grew by 4⅓ percent during the first eight months of 2004. This economic momentum mainly reflects strong export growth and a recovery in private investment in the manufacturing and construction sectors. Partly as a result of improvements in urban employment, the unemployment rate has shown a declining trend in 2004, reaching about 8 percent in July, its lowest level in several years.

Figure 1. Economic activity



5. ***Inflation has picked up in recent months, while pressures on the Nuevo Sol to appreciate have persisted.*** At end-October, the 12–month increase in the CPI was 4 percent, above the upper limit of the authorities' year-end inflation target band (1.5–3.5 percent). This development partly reflects rising fuel prices and the impact of adverse weather on food prices (Box 1). In an effort to help ensure compliance with the year-end inflation target, the central bank raised its policy interest rate by 25 basis points on two occasions in recent months (August and October), to 3 percent at present. Partly reflecting an improvement in the

external current account and capital inflows, Peru's currency appreciated by 4 percent against the U.S. dollar during January-October 2004. The central bank has continued to intervene in the foreign exchange market, with net foreign exchange purchases of US$1.7 billion during that period. By end-October, net official international reserves amounted to US$12.2 billion,[1] up from US$10.2 billion at end-2003, covering more than 200 percent of short-term external debt. All quantitative performance criteria for end-September 2004 under the program were observed (Table 2).

6. ***Peru's external current account has strengthened further in 2004.*** Driven by a 30 percent increase in U.S. dollar terms in exports, the current account deficit narrowed to 1.3 percent of GDP during the first half of 2004, ½ percentage points below its level in the same period of 2003.[2] Export growth is being led by price and volume increases of mineral products, a revival of fishing exports, and a strong growth in non-traditional sectors—partly spurred by temporary preferential access to the U.S. markets. In the second half of 2004, completion of the first phase of the Camisea gas project, directed at the domestic

Figure 2. Exchange Rate

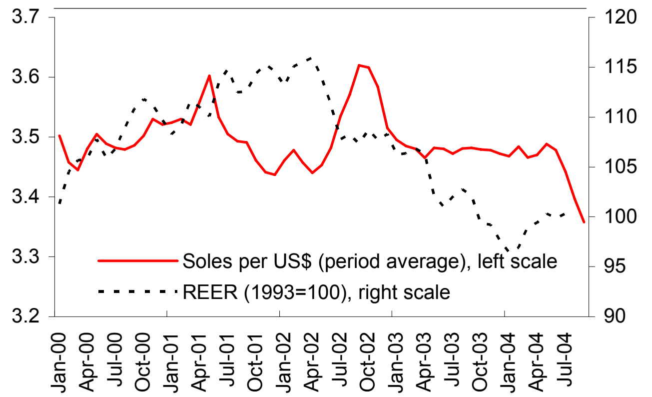


Figure 3. Exchange Rate and Central Bank Intervention, 2000 - 2004

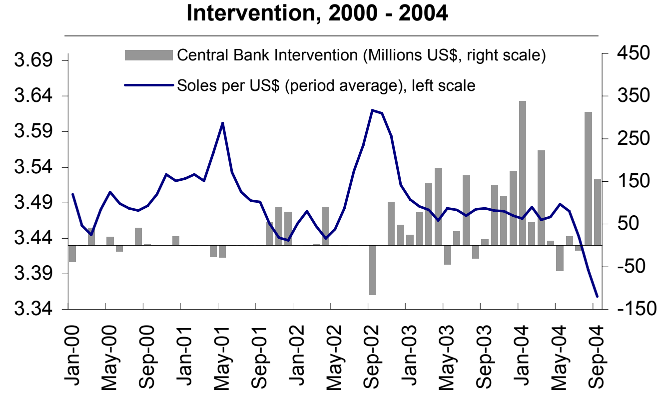
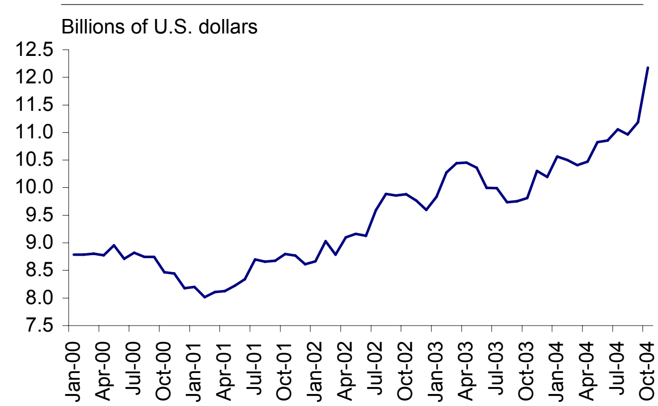


Figure 4. Net International Reserves



[1] International reserves rose significantly in October, reflecting a US$800 million bond placement by the government in the Euromarket, partially covering its financing needs for 2005.

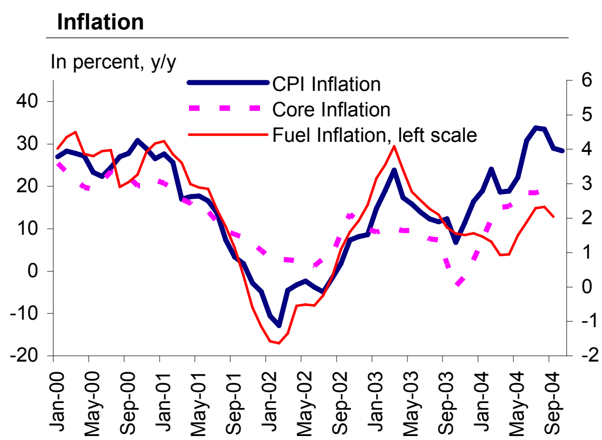
[2] Remittances also grew strongly, to 1.7 percent of GDP.

market, is expected to reduce Peru's demand for energy imports and help mitigate the impact of higher oil prices on the balance of payments.[3]

BOX 1. PERU: INFLATION DEVELOPMENTS

Twelve-month inflation peaked at 4.5 percent in August. Inflation has since declined to 4 percent in October, and is projected to return to the upper end of the inflation target range by end-2004.

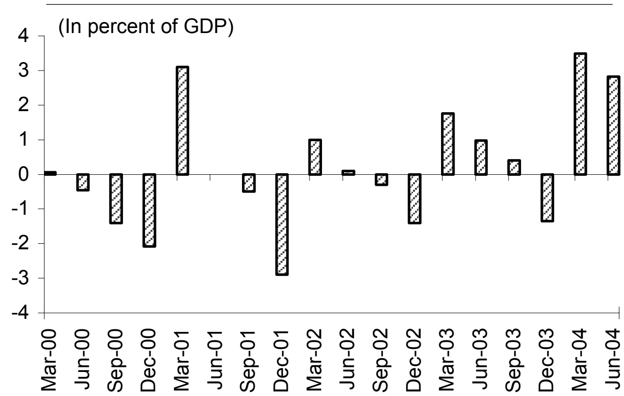
The increase in inflation in 2004 largely reflects a rise in food and petroleum products. Some domestic food prices rose because of a drought and others because of increases in world prices. Cumulative inflation during the first ten months of 2004 was 3.2 percent, with increases in food prices and oil derivatives contributing 1.8 percentage points and 0.7 percentage points, respectively.



Core inflation remains close to the mid-range of the inflation target band, but is increasing. This increase partly reflects hikes in food prices that are included in the definition of core inflation.

7. ***Reflecting higher-than-projected revenue and delays in spending execution, fiscal policy during the first half of 2004 was substantially tighter than envisaged.*** During January-June, the combined public sector registered a surplus equivalent to ½ percent of yearly GDP, compared with a slight deficit in the program. This development was mainly due to higher income tax and VAT collections and lower-than-programmed expenditure in the central and subnational governments. Heavy rains led to a postponement in central government spending, while spending by sub-national governments was delayed due to low implementation capacity for the social and infrastructure programs transferred to them by the central government. During the second semester, capital spending has been picking up, as some of these programs are now being administered by the central

Figure 5. Combined Public Sector Primary Balance



[3] In comparison with the original program, net energy imports in the second semester of 2004 are projected to be some US$260 million (0.4 percent of annual GDP) higher, due to a projected 50 percent increase in the average price of petroleum products and lower fuel export volumes.

government, while efforts have been made to strengthen capacity building in sub-national governments.

8. ***Banking and financial indicators have continued to improve.*** At end-September, the 12-month increase in broad money was 10⅔ percent and that of base money 20 percent, reflecting in part an increase in preference for the domestic currency. Over the past 12 months, credit to the private sector only rose slightly (1½ percent in September). Credit for housing, consumption, and small- and medium-scale enterprises rose, but commercial bank lending fell further, reflecting a shift in corporate borrowing from banks to the domestic bond market. Banks' nonperforming loan ratios have continued to decline, to about 5½ percent of their portfolio in September. Meanwhile, banks' risk-based capital-to-assets ratios have continued to strengthen and modest improvements have taken place in the de-dollarization of bank activities. Partly reflecting higher commodity prices, the Lima stock exchange index rose by 28 percent during January-September 2004, on top of the 75 percent surge registered in 2003. Peru's sovereign credit rating was upgraded in June by Standard and Poor's (to BB) and Fitch, and Peru's sovereign spread remains among the lowest in the region—at about 320 basis points at end-October.

Figure 6. Commercial Bank Credit to the Private Sector

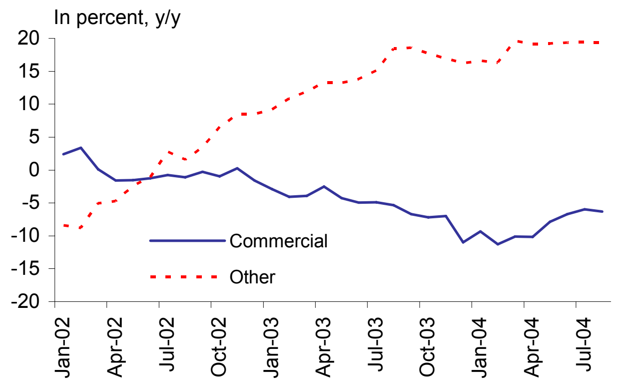
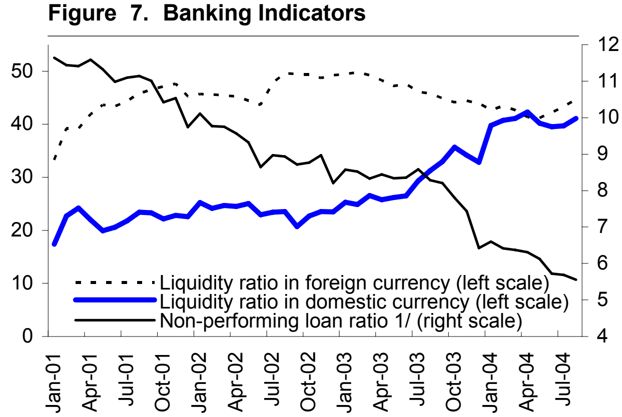
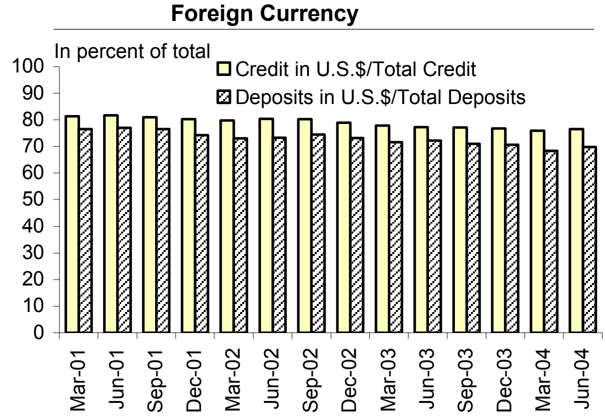


Figure 7. Banking Indicators



1/ Non-Performing Loans/Gross Credit.

Figure 8. Share of Credit and Deposits in Foreign Currency



9. ***Progress has been made in the structural reform area, but it falls short of the program objectives.*** The authorities concentrated their efforts on the awarding of concessions to the private sector (including, recently, the *Las Bambas* mining project) and the reform of the *Cédula Viva* public pension regime. However, the end-September structural performance criterion on the creation of a commercial court was missed because of administrative bottlenecks and a strike in the

judiciary; the court is now expected to be established by end-December 2004 (Table 3). Also, two structural benchmarks (on collateral registries and the pension reform of the military and police) were missed. The end-September benchmark on the elimination of the special wage tax was met with a slight delay and, in October, congress approved the elimination of this tax by December 1, 2004. The structural benchmark on a census of government employees and pensioners was completed as scheduled in September and progress has been made in computerizing the payroll and improving procurement procedures. On fiscal decentralization, legislation was enacted on the certification of the administrative capacity of subnational governments to take on devolved spending responsibilities.

10. ***The political and social situation remains difficult.*** The government continues to lack a majority in congress and a moderate member of the opposition was elected President of Congress in July. His election initially helped build consensus for the program, but the congressional agenda has been moving slowly, partly reflecting the opposition's control of important congressional commissions. Although the authorities have been able to preserve a consensus for prudent policies and reform, growing infighting within the government coalition has also contributed to a slowdown in the pace of implementation of the government's economic agenda. In the social area, manifestations of discontent have persisted in several sectors, including the civil service, and pressure on the government to increase spending is expected to build further in the period up to the elections.

III. Report on the Discussions

A. Outlook

11. ***The Peruvian economy is expected to continue to perform well in 2004 and 2005, although there are some risks.*** Assuming that the rate of growth of the world economy remains strong, real GDP growth would average 4½ percent during 2004–05. Given Peru's relatively large reliance on mineral exports, a slowdown in the world economy would adversely affect its export and growth performance. Downside risks also derive from the removal of world textile and clothing quotas in January 2005 (Box 2). A deterioration in

Macroeconomic Framework

		Prel.	2004		Proj.	
	2002	2003	Prog.	Proj.	2005	2006
Real GDP growth (in percent)	4.9	3.8	4.0	4.3	4.5	4.5
Private sector investment (in percent of GDP)	15.9	15.9	15.4	16.2	16.5	16.8
Consumer prices (end of period)	1.5	2.5	2.5	3.5	2.5	2.5
External current account balance (in percent of GDP)	-2.0	-1.8	-0.7	-0.8	-0.8	-0.8
Combined public sector overall balance (in percent of GDP)	-2.2	-1.7	-1.4	-1.4	-1.0	-1.0
Combined public sector primary fiscal balance (in percent of GDP)	0.0	0.5	0.8	0.8	1.2	1.3
NIR accumulation (in millions of US$) 1/	985	596	100	1,741	-500	100
Gross official reserve coverage of:						
US dollar deposits in the banking system	99.1	105.2	107.3	115.8	106.8	105.6
Short-term external debt	217.2	221.2	225.5	246.0	227.2	214.4
Public sector debt (in percent of GDP)	47.1	47.7	44.6	44.7	41.7	39.9

1/ The reduction in reserves in 2005 reflects a drawndown next year of prefinancing secured in 2004 (US$800 million).

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

investor sentiment could also materialize if current political uncertainties and election-related expenditure pressures were to lead to a relaxation of the fiscal stance. Against these risks, Peru has built important buffers. Its level of official reserves is comfortable, the banking system well capitalized, and the debt sustainability analysis indicates that public and external debt dynamics are relatively robust to possible shocks (Appendix I).

12. ***Macroeconomic stability remains at the core of the authorities' policies.*** Achievement of the 2004 program targets, including in the fiscal area, is within reach, and the draft 2005 budget aims at further fiscal consolidation. Despite a recent increase in the12–month rate of inflation, the central bank is committed to bringing it back to the mid-point of its target band in 2005. Progress in the structural reform area has been slower than envisaged, but policy actions are being taken to speed up the reform process (Attachment I). The authorities noted that adhering closely to their medium-term program during the forthcoming electoral period would go a long way toward reducing perceptions about Peru's vulnerabilities and would help pave the way for exiting from Fund-supported programs.

BOX 2. PERU: IMPLICATIONS OF THE REMOVAL OF QUOTA ON TEXTILES AND CLOTHING EXPORTS

Textiles exports account for close to 10 percent of Peru's total exports, with approximately 75 percent of these exports going to the United States. Since 2002, Peru's textile exports have benefited from the Andean Trade Preference and Drug Eradication Act (ATPDEA) which gives Andean countries tariff-free and high-quota access to the U. S. market. Peru's textile exports are estimated to be growing by almost 30 percent in 2004, providing an important source of job creation.

The removal of quotas in 2005 under the WTO Agreement on Textiles and Clothing (ATC) is expected to adversely affect Peru's textile and clothing exports. Under the agreement, textile quotas are to be eliminated in January 2005, allowing greater entry by low-cost producers, particularly China. In recent years, Peruvian textile exporters have increasingly focused on higher-end niches, with a view to helping insulate themselves from increased competition. However, Peru's higher production costs (estimated to be 50 percent higher than China's), present an important challenge.

A free trade agreement (FTA) with the United States would help mitigate the impact of the expiration of the ATC. An FTA would make permanent Peru's current duty free access to the United States markets under the ATPDEA. While this would not address the effect of the quota removal, it would, along with the existing duty drawback system, maintain the price differential with Chinese imports in the U.S. market to about 20 percent.

Broader efforts to improve Peru's competitiveness will be important. Structural reforms directed at reducing transportation costs and lowering labor market rigidities, for example, would help reduce cost differentials with low cost producers.

B. Fiscal Policy

13. ***The overall deficit of the combined public sector is projected to decline to 1.4 percent of GDP in 2004, as programmed.*** Central government revenue is expected to be somewhat higher than in the program, non-interest expenditure broadly the same, and interest payments slightly lower. These improvements would be fully offset by a small operational loss of the central bank due to the sterilization of its intervention in the foreign exchange market, and by a lower primary balance of public enterprises, reflecting higher electricity production costs associated with the drought. While the projected pick up in capital spending during the second semester will provide a boost to economic activity, it is not expected to undermine achieving the 2005 fiscal targets.

14. ***Central government tax revenue is projected to rise from 13 percent of GDP in 2003 to 13.4 percent in 2004, slightly above program projections***. Significant gains are being achieved in 2004 in corporate income tax collections, due to high mineral prices. Improvements in tax administration,[4] associated in part with an extension in the coverage of the VAT withholding schemes, also explain the good revenue performance. In June, congress approved the introduction of a royalty on the sales of mining companies.[5] Staff supported the government's resolve to work closely with congress toward changing the base for the royalty from gross sales to profits (or a proxy of profits), to minimize its adverse effect on investment. In an effort to mitigate the impact of higher world oil prices on the economy, in mid–2004 the authorities lowered the specific excise tax rates on petroleum products—diesel particularly.[6] More recently, they also created a small temporary fund aimed at avoiding excessive volatility in domestic petroleum prices.[7] The authorities gave the mission assurances that, if oil prices were to remain at the high levels registered in early October, they would promptly adjust domestic prices and would not, under any circumstances, increase the amount in the fund.

15. ***Central government expenditure is broadly in line with the program.*** Mostly because of higher-than-expected increases in teachers' salaries, current expenditure is projected to be slightly above program projections, offset by lower capital outlays. The mission noted that targeted spending on extreme poverty had remained broadly constant as a share of GDP in recent years, at the relatively low level of 1½ percent of GDP. The authorities concurred, but stressed the critical importance of first completing ongoing efforts supported by the World Bank, aimed at reducing large leakages in existing programs through

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[4] See IMF Country Report No. 04/226, Box 4, page 13, for a full description of the measures.

[5] The rate of the royalty is set at 1–3 percent, with annual proceeds estimated at US$35–40 million in 2005 (about 0.06 percent of GDP).

[6] The full-year effect of the cuts in petroleum product tax rates is estimated at 0.1 percent of GDP. The authorities have indicated that they may reverse the cuts in case of a decline in world oil prices.

[7] Under this mechanism, claims accumulated by petroleum companies against the fund when import parity prices move above a band ceiling are guaranteed by the government up to a total amount of US$17 million, computed against the 2006 budget.

their consolidation and improvements in managerial efficiencies. They also noted that, in real terms, military spending had remained broadly stable in recent years, and that they planned to create a US$40 million Defense Fund, financed in part with gas royalties. The mission expressed reservations about the creation of such a fund, stressing that scarce resources would be taken away from other social and infrastructure programs, and that budget rigidities associated with earmarking of resources should be avoided.

16. ***As envisaged under the program, the draft 2005 budget aims at reducing the deficit of the combined public sector to 1 percent of GDP, but achieving this objective will be a challenge.*** The draft budget includes the elimination of the special payroll tax (IES), a reduction in the Financial Transactions Tax rate, and an further extension of the temporary increase in the VAT rate to 19 percent introduced in 2003. As a percent of GDP, revenue is projected to rise slightly, reflecting stronger VAT and income tax collections and higher royalties on gas and mining. On the expenditure side, the draft budget only includes in the wage bill the full-year impact of the wage increases granted in 2004. The authorities noted that new increases would only be considered in a supplement budget later in the year if savings expected from improvements in procurement processes and the elimination of payroll irregularities had materialized by mid-year. Given that wage pressure is expected to remain strong, the mission strongly encouraged the authorities to prepare well-quantified contingency measures to ensure meeting the 2005 deficit target. These measures will be discussed during the next mission.

17. ***To further improve the framework for prudent fiscal management, the government plans to amend the Fiscal Responsibility and Transparency Law (FRTL).*** A draft law is being prepared, with a view to establishing sanctions for noncompliance with the law's fiscal deficit target. Supporting regulations will be issued to address the implementation of the quarterly reports of fiscal performance required under the FRTL. The authorities also plan to issue a law on public indebtedness that will ensure a transparent reporting of public contingent liabilities and of the quasi-fiscal operations of trusts.

18. ***The authorities reaffirmed their commitment to reinforce medium-term sustainability through a sound public debt management strategy.*** Eighty percent of the public sector's 2005 gross financing needs are expected to be met through official financing and external bond placements, and the remainder through borrowing in the domestic market. In October, the authorities successfully placed a US$800 million 10–year Eurobond, covering about 70 percent of Peru's external market financing needs for 2005.[8] The authorities intend to continue including collective action clauses in foreign sovereign debt placements. They also are seeking to increase the local currency composition of new debt issuance through medium and long-term placements in the domestic market, and to re-profile their existing debt through swaps and other market operations—recently conducting transactions to reduce the dollar composition of domestic public debt. In addition, to smooth out debt servicing requirements falling due over the next several years, discussions have been

[8] Balance of payments projections show a US$500 million decline in official reserves in 2005, reflecting a drawdown of prefinancing secured in 2004.

initiated with Paris Club creditors on possible prepayments, financed through longer-term operations—and a formal proposal may be presented to the Paris Club before year-end.

C. Monetary, Exchange Rate, and Financial Policies

19. ***Monetary policy continues to be managed prudently within the inflation-targeting framework.*** There is a risk that inflation could be slightly above the upper limit of the central bank's band by end–2004, but the authorities are confident that the recent tightening in monetary policy will help inflation converge to the target band by then. The central bank has also indicated its readiness to further tighten monetary policy, if needed, to ensure the return of inflation to the mid-point of the target band in 2005.

20. ***In the discussions, the staff stressed the importance of flexibility and transparency in exchange rate policy.*** Noting that large central bank intervention in the foreign exchange market had contained the appreciation of the sol against the U.S. dollar during the first semester, the staff welcomed the somewhat higher flexibility observed in recent months. The staff also encouraged the authorities to pursue a clear communication strategy regarding exchange rate management, and to limit central bank intervention in the foreign exchange market to smoothing out excessive volatility in the rate. The authorities noted that their intervention in the foreign exchange market was aimed in part at offsetting a shift away from the U.S. dollar in the composition of the asset portfolio of banks and other economic agents. The mission indicated that sterilized intervention could become costly, and that higher exchange rate flexibility would help discourage one-way bets for capital inflows while enabling economic agents to better adjust to shocks. In the present context, a reduction in central bank intervention would likely lead to an appreciation of the currency and a less pressing need to raise interest rates.

21. ***The staff also argued in favor of further raising the limits on private pension fund investments abroad.***[9] Such a policy would help diversify the risks of pension funds and reduce appreciation pressures. The central bank was not in favor of such an increase, on the grounds that priority should be given to supporting the development of the domestic capital market, including by ensuring that the resources of pension funds were available for long-term financing for the private sector.

22. ***The authorities remain committed to reducing financial dollarization and strengthening bank supervision.*** The central bank expects dollarization to gradually decline as a result of sound economic policies and strong bank supervision. A monitoring system to measure risks associated with foreign currency denominated loans is expected to be operational by year-end (end-December benchmark). The staff supported the authorities' intention to introduce differentiated generic loan provision requirements, with a view to creating disincentives for banks to lend in foreign currency to economic agents who do not earn income in foreign currency. As part of efforts to promote the development of lending to small and medium-sized firms, the authorities intend to announce a plan to centralize collateral registries by end-December (end-June benchmark). A follow-up FSAP is scheduled

[9] These limits were raised from 9 percent of total assets to 10.5 percent in May 2004.

to take place in early 2005 to assess compliance with the Basle core principles for effective bank supervision and prepare technical notes on selected financial sector issues, including the securities market, the public debt market, and pensions. The follow-up FSAP will also assess progress in the area of anti-money laundering and combating the financing of terrorism.

23. ***Sectoral support programs of public banks will need to be managed prudently.*** During the first eight months of 2004, credit extended under Banco de la Nación's consumer-lending program to civil servants rose significantly more rapidly than envisaged under the program (credit expanded by the equivalent of US$120 million, compared to a yearly increase of US$65 million in the program). The authorities are taking steps to limit credit growth under this program during the remainder of 2004 and in 2005. They have also indicated that the Agricultural Bank will continue to limit its lending operations to channeling credit lines from abroad to agricultural producers and its quasi-fiscal operations with small-scale farmers will continue to be recorded in the budget.

D. Structural Reforms

24. ***Peru's structural reform effort aims at fostering private investment and improving resource management in the public sector.*** To help enhance the competitiveness of the Peruvian economy, the authorities are focusing their efforts on improving infrastructure and the business climate.

25. ***Progress is being made toward boosting private investment through the awarding in concession of transportation infrastructure to the private sector.*** In early October, the government called for bids to award the construction and maintenance of seven regional airports in concession to the private sector. In the area of road infrastructure, some delays have been registered, in part due to the complex technical issues involved in the design of Public-Private Partnerships. Completion of the end-December performance criterion on awarding two major roads in concession has been delayed to April 2005, in part to allow for the completion of an environmental impact assessment necessary to secure a loan guarantee from the IDB. The authorities generally concurred with the recommendations of a recent IMF-World Bank-IDB mission that focused on options for fiscally responsible public investment, issues related to Public-Private Partnerships, and the treatment of commercially-run enterprises (Box 3).

26. ***The establishment of the first specialized commercial court in Lima (end-September structural performance criterion) has been delayed by a few months.*** Administrative bottlenecks and a strike in the judiciary have delayed the opening of the court, and the authorities now expect it to begin operations in December. Several important steps have already been taken: the Supreme Court has issued the required resolution for establishing the court; budgetary resources have been assigned; building facilities have been selected; and the selection of judges and administrative personnel is under way. Implementation of this reform and parallel improvements in non-judicial dispute resolution mechanisms, including enhancing arbitrator and mediator accreditation and training, is being supported by the IDB.

BOX 3. PERU: PRELIMINARY FINDINGS OF THE PUBLIC INVESTMENT AND FISCAL POLICY MISSION

Public investment

Output growth has been robust in recent years despite a sharp fall in the public investment-to-GDP ratio and infrastructure bottlenecks. Public investment fell to about 3 percent of GDP in 2003 from an average of 5 percent of GDP in the mid–1990s. This decline is overstated because it reflects in part a narrower coverage of the public sector, due to privatization of large state-owned telecommunications and electricity companies during the 1990s. However, it also reflects a reduction in the overall fiscal deficit, in the context of policies that have weakened public sector savings. Infrastructure bottlenecks persist, hindering faster output and employment growth.

Institutional and procedural improvements have increased the productivity of public investment, but institutional weaknesses still constrain the contribution that such investment could make to sustainable output growth. Since the National Public Investment System (SNIP) was established at the Ministry of Economy and Finance in 2001, the authorities' ability to weed out unviable public investment projects has improved significantly. Important weaknesses persist, however, including: (i) difficulties in setting maintenance and investment priorities in the annual budget process, leading to inadequate maintenance and unduly long project execution rates; (ii) weak project preparation and appraisal and implementation units in government ministries and in subnational governments; and (iii) inadequate transparency in the approval of unviable and politically-motivated projects.

Public enterprises

No public enterprise currently meets the criteria for recommending their exclusion from the fiscal accounts. The authorities may consider granting certain public enterprises in concession.

Public-private partnerships (PPPs)

Efficient use of PPPs should help relieve infrastructure bottlenecks. The authorities should enter into PPPs only in areas where the benefits of doing so—in terms of increased future revenue streams or lower service costs—clearly outweigh their budgetary costs or the costs associated with government contingent liabilities. Transparency in reporting the costs and liabilities associated with PPPs is required in budget and other documents. The legal and regulatory frameworks covering PPPs should be strengthened to help ensure adequate enforcement of PPP contracts.

South American Infrastructure Authority (ASI)

The mission reviewed a preliminary proposal to establish a regional authority (ASI) with the aim of undertaking public works financed by external borrowing. Proponents of an ASI consider that its key objective would be to permit the construction of public infrastructure beyond the limits imposed by national budget ceilings and to protect investment from the interruptions that often affect projects undertaken by governments. The mission noted that, as currently envisaged, the operations of an ASI could: (i) generate contingent liabilities and risks not sufficiently well assigned among its member governments; and (ii) undermine fiscal transparency and the integrity of budgets in the member countries. In addition, the mission indicated that it was unrealistic to assume that ASI could benefit from cross-default privileges from multilateral institutions and have the ability to perform its functions given its very limited staff resources.

27. ***The authorities are taking steps to improve resource management in the public sector, with a view to generating additional savings for social and infrastructure spending.*** In recent months, the authorities' efforts have focused on the reform of the *Cédula Viva* preferential public pension regime. A draft law has been introduced in congress, but progress has been slow (Box 4). Progress is under way toward designing a plan to reform the pension regime of the police and the military to make it financially viable (end-September benchmark); this plan is now expected to be announced by end-December. The authorities

BOX 4. REFORM OF THE *Cédula Viva* PUBLIC PENSION REGIME

Main Characteristics

The Cédula Viva (CV) is a preferential, pay-as-you-go, highly subsidized public pension regime. In 2003, outlays under the *CV* regime amounted to 2.4 percent of GDP— twice as much as the general public pension regime, which has 35 percent more pensioners. Pension liabilities, resulting from the indexation of CV pensions with the wages of active workers, are high; in NPV terms, the authorities estimated the fiscal cost at US$24 billion (40 percent of GDP) at end-2003.

The high budgetary cost of CV is primarily due to its generous benefits to pensioners and survivors. Current CV pensioners are eligible for pensions of up to about US$9,000 a month, compared with a maximum of about US$350 for those in the general pension regime, even though until 2003 the pension contribution rate in the CV regime was only half that of the general pension regime (6 percent of salaries compared with 13 percent).

The Reform

Reforming the CV regime requires a constitutional amendment. The amendment must be approved by two-thirds of congress in two consecutive legislatures. Congress approved the constitutional amendment a first time on May 26, 2004, and the second vote is scheduled to take place before year-end. The government has already submitted to congress a draft law to reform the system.

The reform of the CV is expected to limit expenditure outlays, through a combination of improved administration and reduced benefits. The authorities estimate the fiscal savings at ½ percent of GDP a year over 2005-09—with only minimal savings in 2005-06. Under their estimates, the reform would reduce *CV* pension liabilities by 24 percent in NPV terms. The main elements of the reform include:

- ***Eliminating the automatic link of pensions with public sector wages.*** Savings from the elimination of the indexation of CV pensions and wages are estimated at about 0.4 percent of GDP a year. Eliminating the link would also pave the way for a comprehensive reform of the public sector wage structure.
- ***Closing the CV system to new entrants.***
- ***Limiting benefits.*** The reform would impose a ceiling on pension payments, adjust pensions on an annual basis based on inflation and cash availability, and limit survivors' benefits.

The reform of the CV would bring more equity among retirees and allow the unification of all public sector pensions in a single public entity. The draft law submitted to congress envisages that pensions above a monthly ceiling of US$1,035 a month (3½ percent of the beneficiaries) would be reduced gradually while pensions below US$200 a month would be immediately raised by US$30.

are also working with congress toward the early passage of legislation needed to implement the framework law on public sector human resource management, and have reaffirmed their intention of implementing gradually a comprehensive reform of the public wage structure once the *Cédula Viva* reform has been completed. In addition, they are developing a Management Control and Evaluation System to improve the quality of public expenditures and intend to build an initial database of program management indicators and include these indicators in the 2006 budget.

28. ***The mission reaffirmed the need for broadening the tax base through the elimination of sectoral and regional tax exemptions.*** Draft laws were introduced in congress in 2003, with little or no progress in recent months. The authorities told the mission that they remain committed to pressing congress for an early approval of these reforms.

29. ***Progress has been mixed in the area of fiscal decentralization, but the government continues to proceed in a cautious and fiscally-sound manner.*** The authorities are working toward ensuring prompt issuance of regulations necessary to implement the law certifying the administrative capacity of regional governments (end-December benchmark). Theseregulations are key to eliminating the problems in the execution of capital spending by subnational governments and the imperfections in the interim certification process.[10] However, given a lack of consensus on passing the law clarifying shared functional responsibilities among different levels of government (end-December benchmark), the authorities plan to instead clarify these responsibilities through the implementation of annual devolution plans and budgets, and sectoral legislation, along with safeguards to avoid reversals in this process. To monitor government finances and strengthen the tax bases of municipalities, the Integrated Financial Management System (SIAF) is being extended to local governments with World Bank support.[11] The authorities are also planning to put in place SIAF payroll and debt modules, and building capacity in public investment planning and public assets management at the subnational level.

30. ***Staff welcomed the elimination of the payroll tax, but noted that consensus still needed to be built to achieve a deeper labor reform.*** In particular, consensus has not yet been reached on a set of reforms that would aim at promoting formal employment, including through proposals to lower regulatory charges in formal regular employment contracts (which exceed 50 percent of wages). Some of these proposals envisage extending the flexible labor regulations on micro-enterprises introduced in late 2003 to medium-size firms (thus far, some 1,200 micro-enterprises have asked to be placed under this new regime). In September, the authorities reinstated the unemployment protection system for workers that was in place until 2001.[12] In view of the continuing high levels of underemployment and informality, the

[10] In addition, the Congress enacted a law introducing incentives for the consolidation of regions in mid-2004. The law aims to allow regions to benefit from economies of scale in the joint delivery of public services and provision of infrastructure.

[11] By year end, the SIAF is expected to cover about 800 of the 1829 municipalities.

[12] Under this system, firms deposited one-half of a salary every six months in an earmarked account. Workers could withdraw up to 50 percent of accumulated contributions at any point in time—and the balance only upon leaving their job for voluntary reasons or when laid off.

authorities concurred with the mission on the importance of refraining from any new increases in the minimum wage (it was last increased by 12 percent in September 2003).

31. ***Peru is continuing to strengthen its integration in the global economy within multilateral and bilateral fora, but domestic protection has increased.*** The authorities aim at completing the discussions on a Free Trade Agreement (FTA) with the United States by early 2005 and are party to an economic cooperation agreement signed between the Andean Community and Mercosur in October. The authorities are also making progress in discussions with Thailand and are exploring possible negotiations with others, including Chile and the European Union. The mission noted that, while Peru's external tariff rates have been reduced in recent years, dispersion has increased, and import surcharges of up to 60 percent remain in place for some agricultural products, including rice, milk products, and sugar; in March, the authorities also imposed phyto-sanitary restrictions on rice imports. Late last year, temporary restrictions were imposed under safeguard provisions on imports of over 100 Chinese textile products; these temporary safeguards were renewed in October 2004, with a reduction in the number of textile items from 100 to 20, and expanded to all countries. The mission stressed the need for cautious and temporary application of such measures, noting their negative impact on low-income Peruvian consumers, the concerns expressed by exporters about possible retaliatory action by foreign countries, and the encouragement given to broader protectionist pressures.

E. Other Issues

32. ***Safeguards assessment***. The safeguards assessment of the central bank was completed on October 26, 2004. The assessment confirmed that adequate mechanisms are in place that safeguard the use of Fund resources and minimize the possibility of misreporting. The authorities are working toward implementing the main recommendation of the report, which encourages the central bank and the Comptroller General's Office to promptly reach satisfactory understandings clarifying the responsibilities of the two institutions in the areas of internal and external audits.

33. ***Statistical issues.*** Peru's statistics are adequate for policy formulation, surveillance, and program monitoring. Progress is being made in line with the Data ROSC, addressing some shortcomings, mainly in national accounts and price statistics (Appendix V).

34. ***Peru is participating in the G-8 Anti-corruption and Transparency Initiative.*** During the June G-8 Summit, Peru announced its intention to cooperate with G-8 partners in promoting transparency in public management and in combating corruption. The G-8 have pledged support to Peru, including in developing regional and local government resource management capabilities, with a special emphasis on extractive industries; further developing and expanding the State Procurement and Contracting Electronic System; and assisting in strengthening connectivity for state institutions. The authorities are working on a technical action plan to reinforce existing initiatives in these areas, which they expect to finalize by year-end. The authorities have also held discussions with the World Bank and the Department for International Development (DFID) regarding the Extractive Industry Transparency Initiative, expressing their support to world efforts to reinforce transparency in these sectors.

IV. Program Modalities and Risks

35. ***The specific quantitative targets for 2005 will be discussed during the mission scheduled for early next year and brought to the Board for consideration in the context of the second review.*** The next mission will discuss quarterly quantitative performance criteria, the inflation consultation mechanism, and structural criteria and benchmarks through end-2005. Staff has discussed with the authorities the broad lines of their structural reform program for 2005. Key steps would include: (i) the granting in concession the construction, operation and maintenance several roads, regional airports and, possibly, a port terminal; (ii) continuing to clarify gradually the functional responsibilities among levels of governments, extending further the SIAF coverage at the sub-national level, and strengthening the capacity of key sub-national governments to deliver devolved responsibilities, while ensuring the satisfactory functioning of the accreditation system; (iii) putting in place a SIAF budget module at the national level to improve fiscal budgeting and transparency; (iv) strengthening prudential regulations for dollarized credit risks; and (v) enhancing the regulation of private pensions funds to help reduce their administration costs and fees.

36. ***There is minimal risk of a failure to repay the Fund.*** Even if Peru were to draw the full amount available under the program, Fund credit outstanding would peak in 2006 at 47.1 percent of quota, representing 0.6 percent of GDP and 3.8 percent of gross foreign reserves.

37. ***Political uncertainty remains the key risk to program implementation.*** Despite a difficult political environment, the authorities have so far been able to maintain forward momentum in implementing their economic program, albeit with some delays in key aspects of the structural agenda. As the presidential election draws closer, however, meeting the ambitious fiscal objectives for 2005 and strengthening structural reform efforts will be challenging. There are also potential downside risks arising from the external environment due to Peru's sensitivity to commodity price developments and the uncertain effects from the removal of world textile and clothing quotas early next year. Still, ongoing investment in energy sectors is reducing the sensitivity of Peru's external position to oil price changes. Moreover, a comfortable level of international reserves and a well capitalized banking system help mitigate vulnerabilities associated with high financial dollarization and the relatively high level of public debt.

V. Staff Appraisal

38. ***The Peruvian economy has continued to perform well during 2004.*** Despite a difficult political situation, the steadfast implementation of sound macroeconomic policies has led to strong growth, moderately low inflation, and a further strengthening of the external position. However, progress on structural reforms has fallen short of the program objectives. The end-September structural performance criterion on establishing the first commercial court was not met, a delay is expected in meeting the end-December structural performance criterion on the concession for two major roads, and several other structural measures are lagging. The authorities' commitment to rekindle the reform effort is welcome.

39. ***Appropriately, fiscal consolidation continues to be at the core of the authorities' macroeconomic strategy***. Although challenging, the 2005 budget aims at reducing the deficit to 1 percent of GDP, which is consistent with a reduction in Peru's still high public debt-to-GDP ratio without undermining growth. Staff supports the steps being taken in the area of tax policy, including a reduction in the rate of the tax on financial transactions and the elimination of the special payroll tax.

40. ***In the months ahead, wage pressures are expected to remain strong, and vigilance will be needed to meet the 2005 fiscal target.*** The staff stresses the importance of preparing contingency measures and urges the authorities to refrain from granting any new wage increases until the savings from improvements in procurement and the elimination of payroll irregularities have materialized. In addition, continued high oil prices could adversely affect the fiscal accounts, and the quasi-fiscal losses of the central bank would rise if domestic interest rates move up. It will also be important to minimize government guarantee claims on the fuel stabilization fund, while ensuring that domestic petroleum prices fully reflect international developments. The staff recommends that the authorities avoid earmarking revenues, including for the creation of a Defense Fund, and continue working with congress toward improving the design of the mining royalty.

41. ***The authorities' efforts to improve the framework for prudent fiscal management and decentralization are commendable.*** The introduction of sanctions should help further institutionalize the Fiscal Responsibility and Transparency Law. In the area of decentralization, the authorities consider that a careful approach is crucial for fiscal sustainability. The staff welcomes progress made on the implementation of the law on the certification of subnational governments' administrative capacity. The staff also stresses the importance of effective procedures to clarify shared functional responsibilities among different levels of government, noting the shift in the authorities' strategy to rely on congressional approval of annual devolution plans and budgets, along with safeguards to avoid reversals in this process.

42. ***Staff concurs with the authorities on the importance of improving infrastructure in a fiscally-sound manner, consistent with debt sustainability.*** To bolster public savings and make room for additional investment, the authorities need to take actions to broaden the tax base—including stepping up efforts to eliminate tax exemptions—and improve expenditure allocation. At the same time, care should be given to provide adequate maintenance of existing infrastructure and ensure that only those projects with high economic and social returns are implemented. When pursuing Public-Private Partnerships, staff urges the authorities to ensure appropriate risk transfer and transparency and to strengthen the legal and regulatory framework.

43. ***Reducing the currency and rollover risk of public debt is a key element of the debt management strategy***. Staff supports the authorities' efforts to gradually shift the composition of new public debt toward local-currency instruments and seek opportunities to reprofile existing debt.

44. ***There is a need to allow the exchange rate to move more freely.*** The staff stressed the importance of flexibility and a clear communication strategy regarding exchange rate management under the inflation targeting regime, with intervention limited to minimizing

short-run volatility in the exchange rate. This would help avoid the risks associated with providing one-way bets for capital inflows and contain the losses of the central bank. Meanwhile, to help diversify the risks of the private pension funds and reduce appreciation pressures on the currency, staff recommends that the authorities consider raising the limit on private pension funds' investments abroad.

45. ***The authorities have continued strengthening and modernizing the regulation and supervision of financial intermediaries.*** Staff welcomes the authorities' intentions to raise generic loan provisioning requirements according to risks. The staff regrets the significant increase in *Banco de la Nación's* consumer-lending program during 2005 and welcomes the authorities' commitment to limit its expansion in the period ahead.

46. ***The authorities' efforts to further integrate Peru in the global economy are commendable.*** The staff encourages the authorities to continue pursuing multilateral trade discussions and free-trade agreements. Staff cautions against protectionist measures, including in the form of temporary restrictions on textile products.

47. ***Adherence to the structural reforms envisaged in the program is key to boosting sustained growth and employment over the medium-term.*** The authorities' focus has rightly been on promoting concessions, aimed at fostering private sector investment, and reforming the *Cédula Viva* public pension regime. The staff welcomes the authorities' commitment to address the delays in some areas of structural reform, and looks forward to the establishment of a commercial court to help enhance the conditions for private sector activity. Staff also welcomes the elimination of the special payroll tax by year-end and urges the authorities to move with determination to further reduce labor costs.

48. ***The baseline medium-term outlook is favorable.*** Successful implementation of the program is reinforcing confidence in continuity of prudent macroeconomic policies and should help set the basis for Peru's exit strategy from Fund-supported programs. Risks to the program continue to include adverse terms-of-trade shocks and policy slippages associated with possible political instability. So far, however, the government has been able to preserve a consensus for prudent policies and reform. Moreover, Peru has built important buffers, including a comfortable level of international reserves and a well-capitalized banking system.

49. ***In summary, Peru has performed well under the program supported by the Stand-By Arrangement, and staff recommends completion of the first review.*** The staff supports the authorities' request for a waiver for the nonobservance of the end-September 2004 structural performance criterion on the establishment of a commercial court in Lima and resetting of this criterion for end-December since the delay is expected to be temporary. In addition, the staff supports the authorities' request for a modification in the timing of implementation of the end-December structural performance criterion on the granting of concessions for the construction and maintenance of two major roads. Solid progress is being made by the authorities in this area and the structural performance criterion is expected to be observed with a few months' delay, in April 2005.

Table 1. Peru: Selected Economic Indicators

	2001	2002	Prel. 2003	2004 Prog.	2004 Proj.	Proj. 2005	Proj. 2006
(Annual percentage change; unless otherwise indicated)							
Production, prices, and trade							
Real GDP	0.2	4.9	3.8	4.0	4.3	4.5	4.5
Real domestic demand	-0.6	4.0	3.3	3.5	4.6	4.4	4.5
Consumer Prices (end of period)	-0.1	1.5	2.5	2.5	3.5	2.5	2.5
Consumer Prices (period average)	2.0	0.2	2.3	3.2	3.7	2.4	2.5
External Sector							
Exports (U.S. dollars)	1.0	9.9	16.4	22.9	29.4	3.9	2.2
Imports (U.S. dollars)	-2.0	2.7	11.3	8.0	17.7	4.1	4.0
Terms of trade (deterioration -)	-1.8	2.8	1.4	9.1	6.5	-5.0	-0.8
Real effective exchange rate (depreciation -) 1/	4.4	-5.5	-10.7	...	...	...	...
Money and credit 2/ 3/							
Liabilities to the private sector	7.8	9.0	14.0	3.9	4.8	8.0	8.0
Net credit to the private sector	-2.0	2.1	3.7	3.1	3.5	6.1	6.1
(In percent of GDP, unless otherwise indicated)							
Public sector							
General government current revenue	17.2	17.2	17.7	17.4	17.8	17.9	17.8
Of which : Central government tax revenue	12.2	11.9	13.0	13.3	13.4	13.5	13.4
General government noninterest expenditure	17.8	17.3	17.3	16.7	17.1	16.8	16.7
Of which : capital expenditure	3.3	2.8	2.8	2.7	2.7	2.7	2.9
Combined public sector primary balance	0.0	0.0	0.5	0.8	0.8	1.2	1.3
Interest due	2.2	2.2	2.2	2.2	2.1	2.2	2.3
Combined public sector overall balance	-2.3	-2.2	-1.7	-1.4	-1.4	-1.0	-1.0
External Sector							
External current account balance	-2.2	-2.0	-1.8	-0.7	-0.8	-0.8	-0.8
Capital and financial account	3.0	3.4	2.4	0.8	3.3	0.1	0.9
Gross reserves							
in millions of U.S. dollars 4/	8,838	9,690	10,206	10,306	11,947	11,447	11,547
percent of short-term external debt 5/	149.9	217.2	221.1	225.5	246.0	227.2	214.4
percent of foreign currency deposits at banks	92.5	100.6	107.3	107.3	127.0	117.8	117.3
Debt							
Total external debt	50.7	49.3	49.1	45.9	46.2	43.5	41.4
Combined public sector debt	46.6	47.1	47.7	44.6	44.7	41.7	39.9
Domestic	10.8	10.3	10.1	9.3	9.1	8.3	8.3
External 6/	35.8	36.9	37.6	35.4	35.6	33.4	31.5
Savings and investment							
Gross domestic investment	18.8	18.8	18.8	18.2	19.0	19.3	19.8
Public sector	3.1	2.8	2.9	2.9	2.8	2.8	2.9
Private sector	15.7	15.9	15.9	15.4	16.2	16.5	16.8
National savings	16.6	16.8	17.0	17.5	18.2	18.5	18.9
Public sector 7/	1.1	0.8	1.3	1.4	1.5	1.9	2.0
Private sector	15.5	16.0	15.8	16.1	16.7	16.6	16.9
External savings	2.2	2.0	1.8	0.7	0.8	0.8	0.8
Memorandum item:							
Nominal GDP (S/. billions)	188.3	198.7	210.7	231.6	231.8	246.9	265.1

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

1/ End of period. Based on Information Notice System.
2/ Corresponds to the financial system.
3/ Foreign currency stocks are valued at program exchange rate.
4/ Gross international reserves exceed net international reserves, basically by the stock of Fund credit outstanding.
5/ Short-term debt includes amortization of medium- and long-term loans falling due over the following year.
6/ Includes Central Reserve Bank of Peru debt.
7/ Excludes privatization receipts.

Table 2. Peru: Quantitative Performance Criteria and Structural Benchmarks, 2004

	June 30	Sept. 30	Dec. 30
(Cumulative amounts from December 31, 2003, millions of new soles)			
Borrowing requirement of the combined public sector 1/			
Unadjusted limits	200	1,590	3,300
Adjusted limits 2/	223	1,646	
Actual	-1,100	-180	
Margin	1,323	1,826	
(Cumulative amounts from December 31, 2003, in millions of U.S. dollars)			
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions			
Unadjusted targets	286	-44	-157
Adjusted targets 2/	8	-507	
Actual	529	741	
Margin	522	1,248	
Outstanding short-term external debt of the nonfinancial public sector			
Limits	50	50	50
Actual	0	0	
Margin	50	50	
Contracting or guaranteeing of nonconcesional public debt with maturity of at least one year			
Unadjusted limits	2,050	2,675	3,200
Adjusted limits 2/	2,050	2,675	
Actual	1,495	1,807	
Margin	555	868	
***Of which:* external debt of 1-5 year maturity**			
Limits	100	100	100
Actual	0	0	
Margin	100	100	
External payments arrears of the public sector (on a continuous basis) 3/			
Limits	0	0	0
Actual	0	0	
Margin	0	0	
(Consultation bands for the 12-month rate of inflation, in percent) 4/			
Outer band (upper limit)	5.5	5.5	5.5
Inner band (upper limit)	4.5	4.5	4.5
Central point	2.5	2.5	2.5
Inner band (lower limit)	0.5	0.5	0.5
Outer band (lower limit)	-0.5	-0.5	-0.5
Actual	4.26	4.03	

Structural Performance Criterion and Benchmarks Through September 2004

	Target date	Current status
Performance criterion		
Begin operations of a commercial court in Lima.	End-September	Not observed.
Benchmarks		
1. Announce a plan to centralize the information on collateral registries.	End-June	Not observed.
2. Submit to Congress legislation to eliminate by end-December the special wage tax (IES).	End-September	Observed in early October.
3. Complete a census of government employees and pensioners.	End-September	Done
4. Develop a satisfactory action plan for reforming the pension regimes for the police and the military.	End-September	Not observed.

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and IMF Country Report No. 04/226.

1/ PIPP proceeds are included bellow the line.
2/ The targets and limits were adjusted in accordance with the table attached to the letter of intent dated May 25, 2004 (IMF Country Report No. 04/226).
3/ Excluding arrears associated with nonrescheduled debt to foreign creditors outstanding as of end-2003.
4/ Should inflation fall outside the inner band, the authorities will discuss with the Fund staff the appropriate policy response. Should inflation fall outside the outer band, the authorities will also complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the arrangement.

Table 3. Structural Performance Criteria and Benchmarks for end-2004 and 2005

Measures	Date of implementation
I. Performance Criteria	
1. Begin operations of a commercial court in Lima.	December 31, 2004
2. Grant concessions or enter into Public Private Partnerships for the construction and maintenance of at least two major roads.	April 30, 2005
II. Benchmarks	
1. Introduce in congress a constitutional amendment and, once approved, introduce in Congress draft laws to allow a comprehensive reform of the *Cédula Viva*, as described in paragraph 11 of the May 25, 2004 MEFP.	December 31, 2004
2. Implementation of a satisfactory law providing objective criteria for certifying that regional governments have the administrative capacity to take on devolved expenditure (*Ley del Sistema Nacional de Acreditación*).	December 31, 2004
3. Implementation of a satisfactory law clarifying shared functional responsibilities among the national, regional, and local governments.	December 31, 2004
4. Put in full operation a system within the SBS to measure currency risks.	December 31, 2004

Table 4. Peru: Fiscal Operations of the Combined Public Sector

(In percent of GDP; unless otherwise indicated)

			Prel.	Program 2004			Projection 2004			Proj.	
	2001	2002	2003	H1	H2	year	H1	H2	year	2005 1/	2006
Central government primary balance	**-0.7**	**-0.2**	**0.2**	**0.9**	**-0.3**	**0.6**	**1.2**	**-0.6**	**0.6**	**1.0**	**1.0**
Revenue	14.4	14.4	15.0	7.3	7.7	15.0	7.5	7.7	15.1	15.5	15.4
Current	14.2	14.3	14.8	7.3	7.6	15.0	7.4	7.6	15.0	15.4	15.3
Of which : tax revenue 2/	12.2	11.9	13.0	6.6	6.7	13.3	6.7	6.7	13.4	13.5	13.4
Of wich: financial transaction tax	...	...	...	0.1	0.2	0.3	0.1	0.2	0.3	0.3	0.2
Capital	0.2	0.2	0.2	0.0	0.1	0.1	0.0	0.1	0.1	0.1	0.1
Noninterest expenditure	15.1	14.6	14.8	6.4	8.0	14.5	6.3	8.2	14.5	14.5	14.3
Current	12.7	12.6	12.8	5.7	6.8	12.6	5.7	7.0	12.7	12.6	12.3
Capital	2.4	2.0	1.9	0.7	1.2	1.9	0.5	1.3	1.8	1.9	2.0
Rest of the general government primary balance	**0.3**	**0.2**	**0.3**	**0.1**	**0.1**	**0.2**	**0.2**	**-0.1**	**0.2**	**0.2**	**0.2**
Revenue	5.7	5.7	5.9	2.5	3.0	5.5	2.7	3.1	5.8	5.8	5.7
Current	5.5	5.7	5.8	2.5	3.0	5.5	2.7	3.1	5.8	5.7	5.7
Capital	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Noninterest expenditure	5.4	5.5	5.6	2.5	2.9	5.4	2.4	3.2	5.6	5.6	5.6
Current	4.5	4.8	4.7	2.1	2.5	4.6	2.0	2.7	4.7	4.7	4.7
Capital	0.9	0.8	0.9	0.4	0.4	0.8	0.4	0.4	0.8	0.9	0.9
Public enterprise primary balance	**0.2**	**-0.1**	**0.0**	**0.1**	**0.0**	**0.1**	**0.1**	**-0.1**	**0.0**	**0.1**	**0.1**
Current balance	0.6	0.2	0.3	0.2	0.2	0.4	0.2	0.1	0.3	0.4	0.4
Capital balance	-0.4	-0.3	-0.4	-0.2	-0.2	-0.3	-0.1	-0.2	-0.3	-0.3	-0.3
Nonfinancial public sector primary balance	**-0.2**	**-0.2**	**0.4**	**1.0**	**-0.2**	**0.8**	**1.6**	**-0.7**	**0.8**	**1.2**	**1.3**
Central bank operating balance	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0
Combined public sector primary balance	**0.0**	**0.0**	**0.5**	**1.0**	**-0.2**	**0.8**	**1.6**	**-0.8**	**0.8**	**1.2**	**1.3**
Interest payments	2.2	2.2	2.2	1.1	1.1	2.2	1.1	1.1	2.1	2.2	2.3
External	2.0	1.8	1.8	0.9	0.9	1.8	0.8	0.9	1.7	1.8	1.8
Domestic	0.3	0.4	0.4	0.2	0.1	0.4	0.3	0.2	0.4	0.4	0.4
Of which: pension recognition bonds	0.0	0.1	0.1	...	...	0.1	...	...	0.1	0.1	0.1
Combined public sector overall balance	**-2.3**	**-2.2**	**-1.7**	**-0.1**	**-1.3**	**-1.4**	**0.4**	**-1.8**	**-1.4**	**-1.0**	**-1.0**
Financing	2.3	2.2	1.7	0.1	1.3	1.4	-0.4	1.8	1.4	1.0	1.0
External	0.9	2.1	1.6	0.7	0.2	1.0	0.4	1.7	2.1	0.2	0.3
Disbursements 3/ 4/	2.5	5.1	3.5	1.7	1.3	3.0	1.4	2.7	4.0	2.1	2.2
(In millions of U.S. dollars)	1319.0	2863.0	2100.0	1121.0	840.0	1961.0	906.0	1783.0	2689.0	1484.0	1700.0
Amortization	-1.4	-3.2	-2.0	-1.0	-1.0	-2.0	-0.9	-1.1	-2.0	-2.0	-1.9
(In millions of U.S. dollars)	-768.0	-1837.0	-1187.0	-642.0	-693.0	-1335.0	-626.0	-729.0	-1355.0	-1410.0	-1493.0
Rescheduling/arrears (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Condonation	-0.1	0.3	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0
Domestic	0.8	-0.6	0.0	-0.8	1.0	0.2	-1.0	0.1	-0.9	0.7	0.6
Bond placements	0.6	0.5	0.8	0.5	0.3	0.8	0.4	0.3	0.7	0.8	0.8
(In millions of U.S. dollars)	348.0	267.0	508.2	357.3	187.5	552.4	268.4	233.3	501.6	600.0	650.0
Amortization 5/	-0.4	-0.3	-0.9	-0.6	-0.3	-0.9	-0.6	-0.3	-1.0	-1.3	-0.6
(In millions of U.S. dollars)	-197.4	-193.2	-556.5	-398.0	-180.7	-586.6	-409.5	-234.5	-643.9	-913.0	-431.0
Of which: pension recognition bonds	-52.2	-55.2	-172.0	...	...	-235.0	...	...	-233.0	-183.0	-85.0
Net deposits	0.5	-0.8	0.1	-0.7	1.0	0.3	-0.8	0.1	-0.7	1.2	0.3
(In millions of U.S. dollars)	254.9	-439.8	44.0	-454.3	639.7	192.9	-524.1	46.0	-469.9	832.5	269.1
Privatization	0.6	0.8	0.1	0.1	0.1	0.2	0.1	0.1	0.2	0.1	0.0
(In millions of U.S. dollars)	327.0	421.0	52.0	68.0	43.0	111.0	75.0	68.0	143.0	95.0	24.0
Memorandum items:											
Overall fiscal deficit (old definition) 6/	-2.4	-2.2	-1.9	...	...	-1.6	...	...	-1.6	-1.2	-1.0
General government current revenue 7/	17.2	17.2	17.7	8.5	8.9	17.4	8.8	9.0	17.8	17.9	17.8
General government noninterest expenditure 7/	17.8	17.3	17.3	7.5	9.2	16.7	7.4	9.7	17.1	16.8	16.7
Public sector debt-to-GDP 4/	46.6	47.1	47.7	...	...	44.6	...	...	44.7	41.7	39.9
Nominal GDP (S/. billions)	188.3	198.7	210.7	231.6	231.6	231.6	231.8	231.8	231.8	246.9	265.1

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

1/ Consistent with 2005 budget

2/ Net of tax on assets of central government IES payment and of public enterprises (0.2 percent of GDP in 2002 and 0 in 2003 as the tax on assests of public enterprises has been phased out).

3/ Includes the Brady bond swap of US$923 million carried out in early 2002.

4/ Includes placement of US$800 million euro-denominated bonds, covering part of the country's financing needs for 2005.

5/ Includes in 2005 the amortization of US$ 390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.

6/ Adjusted by adding the amortization (previously booked as a current transfer) and subtracting the accrued interest payments of CPI-indexed pension recogniton bonds.

7/ Net of transfers among non-financial public institutions.

Table 5. Peru: Financing of the Combined Public Sector

	2001	2002	Prel. 2003	2004 Prog.	2004 Proj.	Proj. 2005 1/	Proj. 2006
	(In millions of U.S. dollars)						
Combined balance	**-1,212**	**-1,230**	**-1,027**	**-927**	**-925**	**-727**	**-746**
Financing	**1,212**	**1,230**	**1,027**	**927**	**925**	**727**	**746**
Net External	479	1,169	977	657	1,392	113	234
Disbursements 2/	1,319	2,863	2,100	1,961	2,689	1,484	1,700
Bonds 3/	0	1,886	1,245	500	1,300	400	700
Multilaterals	1,105	807	519	1,012	961	584	500
Bilaterals and other	214	170	336	449	428	500	500
Amortization 2/	-768	-1,837	-1,187	-1,335	-1,355	-1,410	-1,493
Condonation	-72	143	64	31	58	39	27
Privatization	327	421	52	111	143	95	24
Net Domestic financing	406	-360	-2	159	-610	519	488
Bonds	348	267	508	552	502	600	650
Amortization	-197	-193	-556	-587	-644	-913	-431
Of which : pension recognition bonds	-52	-55	-172	-235	-233	-183	-85
Net deposits	255	-433	46	193	-468	832	269
Of which: Central government	228	-393	154	221	-540	883	333
	(In percent of GDP)						
Combined balance	**-2.3**	**-2.2**	**-1.7**	**-1.4**	**-1.4**	**-1.0**	**-1.0**
Financing	**2.3**	**2.2**	**1.7**	**1.4**	**1.4**	**1.0**	**1.0**
Net External	0.9	2.1	1.6	1.0	2.1	0.2	0.3
Disbursements 2/	2.5	5.1	3.5	3.0	4.0	2.1	2.2
Bonds	0.0	3.3	2.1	0.8	1.9	0.6	0.9
Multilaterals	2.1	1.4	0.9	1.5	1.4	0.8	0.6
Bilaterals and other	0.4	0.3	0.6	0.7	0.6	0.7	0.6
Amortization 2/	-1.4	-3.3	-2.0	-2.0	-2.0	-2.0	-1.9
Condonation	-0.1	0.3	0.1	0.0	0.1	0.1	0.0
Privatization	0.6	0.7	0.1	0.2	0.2	0.1	0.0
Net Domestic financing	0.8	-0.6	-0.0	0.2	-0.9	0.7	0.6
Bonds	0.6	0.5	0.8	0.8	0.7	0.8	0.8
Amortization 4/	-0.4	-0.3	-0.9	-0.9	-1.0	-1.3	-0.6
Of which: pension recognition bonds	0.1	0.1	0.3	0.4	0.3	0.3	0.1
Net deposits	0.5	-0.8	0.1	0.3	-0.7	1.2	0.3
Of which: Central government	0.4	-0.7	0.3	0.3	-0.8	1.2	0.4
Memorandum item:							
Nominal GDP (S/. billions)	188.3	198.7	210.7	231.6	231.8	246.9	265.1

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

1/ Consistent with 2005 budget
2/ Includes the Brady bond swap of US$923 million carried out in early 2002.
3/ Includes placement of US$800 million euro-denominated bonds, covering part of the country's financing needs for 2005.
4/ Includes in 2005 the amortization of US$ 390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.

Table 6. Peru: Fiscal Operations of the Central Government
(In percent of GDP)

	2001	2002	Prel. 2003	2004 Prog.	2004 Proj.	Proj. 2005 1/	Proj. 2006
Current primary balance	**1.5**	**1.6**	**2.0**	**2.4**	**2.4**	**2.7**	**2.9**
Current revenue	14.2	14.3	14.8	15.0	15.0	15.4	15.3
Tax revenue 2/	12.2	11.9	13.0	13.3	13.4	13.5	13.4
Direct taxes	3.4	3.2	4.0	3.9	4.0	4.1	4.0
Indirect taxes	8.8	8.7	9.0	9.4	9.3	9.5	9.4
Of which: financial transaction tax	...	...	...	0.3	0.3	0.3	0.2
Other current revenue 3/	2.0	2.4	1.8	1.6	1.7	1.8	1.8
Current noninterest expenditure	12.7	12.6	12.8	12.6	12.7	12.6	12.3
Labor services 4/	6.7	6.7	6.8	6.5	6.5	6.5	6.2
Goods and nonlabor services	3.8	3.4	3.5	3.4	3.4	3.4	3.4
Transfers and other	2.2	2.5	2.6	2.7	2.7	2.8	2.8
Capital balance	**-2.2**	**-1.9**	**-1.7**	**-1.8**	**-1.7**	**-1.7**	**-1.9**
Capital revenue	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Capital expenditure	2.4	2.0	1.9	1.9	1.8	1.9	2.0
Gross capital formation	2.1	1.8	1.7	1.7	1.6	1.7	1.8
Other	0.3	0.2	0.3	0.2	0.2	0.2	0.2
Primary balance	**-0.7**	**-0.2**	**0.2**	**0.6**	**0.6**	**1.0**	**1.0**
Interest payments	2.2	2.0	2.0	2.0	1.9	2.0	2.1
External	1.9	1.8	1.8	1.8	1.7	1.8	1.8
Domestic	0.2	0.2	0.2	0.2	0.2	0.2	0.3
Overall balance	**-2.8**	**-2.2**	**-1.8**	**-1.5**	**-1.3**	**-1.1**	**-1.1**
Memorandum items:							
General Government Tax Revenues 2/	12.5	12.2	13.1	13.6	13.6	13.8	13.7
Primary balance before transfers	1.2	1.9	2.8	3.1	3.2	3.7	3.8
Overall balance before transfers	-1.0	-0.1	0.8	1.1	1.3	1.7	1.7
Tax compliance rate 5/	83	87	...	...	...	...	...
Nominal GDP (S/. billions)	188.3	198.7	210.7	231.6	231.8	246.9	265.1

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

1/ Consistent with 2005 budget

2/ Net of tax on assets of public enterprises and of central government IES payment.

3/ The decline in 2003 reflects lower collections on the recovery of illicit funds from officials of the previous administration and special large fines paid by mining companies in 2002.

4/ Includes wages, salaries, and employer contributions to social security.

5/ Measured as the ratio between paid tax obligations and total tax obligations. Obligations covered as VAT and income tax for large taxpayers only.

Table 7. Peru: Public Sector Social Expenditure

					Prel.	Proj.	
	1999	2000	2001	2002	2003	2004	2005 1/
				(In millions of soles)			
Total social expenditure and pensions	**17,780**	**18,821**	**19,056**	**20,480**	**21,876**	**23,860**	**24,972**
Universal coverage (Education and Health) 2/	6,840	7,106	7,135	7,987	8,919	10,391	11,001
Education	4,737	5,004	5,165	5,737	6,366	7,122	7,619
Health	2,103	2,102	1,970	2,250	2,552	3,269	3,382
Targeted programs (Extreme Poverty)	3,257	3,043	2,986	2,840	3,207	3,192	3,440
Non-Targeted Social Programs	7,683	8,672	8,935	9,653	9,751	10,276	10,532
ESSALUD	2,489	2,836	2,775	2,961	3,038	3,201	3,259
Pensions	5,104	5,855	6,108	6,644	6,671	7,052	7,249
Housing Development Program (FONAVI)	90	-19	52	48	42	23	24
				(In percent of general government expenditure)			
Total social expenditure and pensions	**48.3**	**48.7**	**50.7**	**53.0**	**53.2**	**53.5**	**53.0**
Universal coverage (Education and Health) 2/	18.6	18.4	19.0	20.7	21.7	23.3	23.3
Education	12.9	13.0	13.7	14.9	15.5	16.0	16.2
Health	5.7	5.4	5.2	5.8	6.2	7.3	7.2
Targeted programs (Extreme Poverty)	8.8	7.9	7.9	7.4	7.8	7.2	7.3
Non-Targeted Social Programs	20.9	22.4	23.8	25.0	23.7	23.1	22.4
ESSALUD	6.8	7.3	7.4	7.7	7.4	7.2	6.9
Pensions	13.9	15.2	16.2	17.2	16.2	15.8	15.4
Housing Development Program (FONAVI)	0.2	0.0	0.1	0.1	0.1	0.1	0.1
				(In percent of GDP)			
Total social expenditure and pensions	**10.2**	**10.1**	**10.1**	**10.3**	**10.4**	**10.3**	**10.1**
Universal coverage (Education and Health) 2/	3.9	3.8	3.8	4.0	4.2	4.5	4.5
Education	2.7	2.7	2.7	2.9	3.0	3.1	3.1
Health	1.2	1.1	1.0	1.1	1.2	1.4	1.4
Targeted programs (Extreme Poverty)	1.9	1.6	1.6	1.4	1.5	1.4	1.4
Non-Targeted Social Programs	4.4	4.6	4.7	4.9	4.6	4.4	4.3
ESSALUD	1.4	1.5	1.5	1.5	1.4	1.4	1.3
Pensions	2.9	3.1	3.2	3.3	3.2	3.0	2.9
Housing Development Program (FONAVI)	0.1	0.0	0.0	0.0	0.0	0.0	0.0
				(In millions of soles)			
Memorandum items:							
General government expenditure	36,821	38,636	37,613	38,622	41,111	44,570	47,118
Nominal GDP	174,719	186,756	188,314	198,654	210,746	231,813	246,948
Defense and national security	2.8	2.9	2.5	2.2	2.2	2.2	2.0
Justice	0.4	0.4	0.4	0.4	0.4	0.4	0.4

Source: Ministry of Economy and Finance.

1/ Consistent with 2005 budget.

2/ Net of spending on education and health already included in the extreme poverty programs.

Table 8. Peru: Monetary Survey

	2001	2002	Prel. 2003	2004 Prog.	2004 Proj.	Proj. 2005	Proj. 2006
I. Central Reserve Bank (In millions of Nuevos Soles at program exchange reate)							
Net international reserves 1/	**29,800**	**32,954**	**35,361**	**34,968**	**40,062**	**38,123**	**38,635**
(In millions of U.S. dollars)	8,324	9,309	9,905	10,005	11,646	11,147	11,247
Net domestic assets	**-24,855**	**-27,339**	**-28,991**	**-28,120**	**-32,912**	**-30,373**	**-30,319**
Net credit to nonfinancial public sector	-8,758	-10,147	-10,709	-9,865	-12,055	-8,220	-8,281
Rest of banking system	-13,695	-14,338	-14,757	-15,495	-18,230	-19,872	-20,145
Other	-2,402	-2,854	-3,525	-2,760	-2,628	-2,280	-1,893
Currency	**4,945**	**5,615**	**6,370**	**6,848**	**7,150**	**7,750**	**8,316**
II. Banking System (In millions of Nuevos Soles at program exchange reate)							
Net foreign assets	**28,503**	**33,300**	**35,010**	**35,709**	**39,612**	**39,441**	**39,784**
Net domestic assets	**21,004**	**18,407**	**17,699**	**19,924**	**16,422**	**19,909**	**22,816**
Net credit to nonfinancial public sector	-9,351	-10,532	-10,664	-9,997	-14,214	-10,593	-9,260
Net credit to private sector	47,343	46,621	44,994	46,831	46,552	48,006	49,833
Other	-16,988	-17,682	-16,631	-16,910	-15,915	-17,503	-17,757
Net credit to COFIDE	-1,732	-1,340	-1,018	-1,018	-1,018	-1,018	-1,018
Other	-15,256	-16,342	-15,613	-15,892	-14,897	-16,485	-16,739
Liabilities to the private sector	**49,507**	**51,707**	**52,709**	**55,633**	**56,034**	**59,350**	**62,600**
(12-month percentage change)							
Base money	7.9	11.0	10.1	8.0	12.0	8.0	8.0
Broad money	4.9	4.4	1.9	4.1	6.3	5.9	5.5
Domestic currency	13.7	11.5	10.0	12.0	20.7	10.3	10.3
Foreign currency 2/	1.1	1.1	-2.3	-0.5	-2.2	2.7	1.7
Net credit to private sector	-2.6	-1.5	-3.5	4.3	3.5	3.1	3.8
Domestic currency	2.9	7.0	5.1	22.9	9.6	10.0	12.1
Foreign currency 2/	-3.8	-3.6	-5.7	-1.1	1.7	1.0	1.0
III. Financial System (In millions of Nuevos Soles at program exchange rate)							
Net foreign assets	**30,931**	**37,354**	**44,893**	**45,592**	**45,994**	**48,844**	**52,414**
Net domestic assets	**29,503**	**28,499**	**30,212**	**32,438**	**32,724**	**36,171**	**39,419**
Net credit to the public sector	-8,581	-9,697	-8,976	-8,309	-8,382	-7,209	-6,560
Net credit to private sector	59,191	60,422	62,666	64,635	64,872	68,829	72,996
Other	-21,106	-22,226	-23,478	-23,888	-23,766	-25,450	-27,017
Liabilities to the private sector	**60,435**	**65,854**	**75,105**	**78,029**	**78,717**	**85,015**	**91,833**
(12-month percentage change)							
Liabilities to the private sector	7.8	9.0	14.0	3.9	4.8	8.0	8.0
Domestic currency	18.0	17.5	24.9	11.7	12.7	12.2	12.0
Foreign currency 2/	1.0	2.3	4.2	-4.6	-3.8	2.7	2.5
Net credit to private sector	-2.0	2.1	3.7	3.1	3.5	6.1	6.1
Domestic currency	5.6	18.9	18.0	18.3	18.8	14.8	13.6
Foreign currency 2/	-4.2	-3.3	-1.9	-4.1	-3.7	1.0	1.0
Memorandum item:							
Program exchange rate (S/. per US$)	3.58	3.54	3.57	...	...	...	...

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

1/ Excludes subscriptions to the IMF and the Latin American Reserve Fund (FLAR), Pesos Andinos, credit lines to other central banks, Corporación Andina de Fomento (CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations.

2/ Flows in foreign currency are valued at the program exchange rate.

Table 9. Peru: Balance of Payments

	2001	2002	Prel. 2003	2004 Prog.	2004 Proj.	Proj. 2005	Proj. 2006
	(In millions of U.S. dollars)						
Current account	**-1,157**	**-1,127**	**-1,062**	**-453**	**-521**	**-597**	**-643**
Merchandise trade	-194	306	731	2,103	1,907	1,964	1,831
Exports	7,026	7,723	8,986	11,009	11,625	12,084	12,353
Traditional	4,730	5,369	6,267	7,982	8,309	8,391	8,408
Nontraditional and others	2,296	2,354	2,719	3,027	3,315	3,693	3,946
Imports	-7,220	-7,417	-8,255	-8,906	-9,717	-10,120	-10,522
Services, income, and current transfers (net)	-963	-1,433	-1,793	-2,556	-2,429	-2,561	-2,474
Services	-881	-986	-931	-1,053	-988	-992	-952
Investment income	-1,124	-1,490	-2,082	-2,711	-2,887	-3,047	-3,078
Current transfers	1,042	1,043	1,220	1,208	1,446	1,478	1,556
Financial and capital account	**1,606**	**1,945**	**1,476**	**521**	**2,192**	**58**	**716**
Public sector	425	1,096	684	543	1,179	-178	143
Disbursements 1/	1,343	2,902	2,161	2,037	2,688	1,532	1,725
Amortization 1/	-886	-1,843	-1,229	-1,375	-1,391	-1,452	-1,531
Other medium- and long-term public sector flows 2/	-32	37	-248	-119	-118	-258	-51
Capital transfers (net)	0	0	0	0	0	0	0
Privatization	267	186	10	10	50	10	10
Private sector	914	663	782	-32	963	226	563
Foreign direct investment (FDI) excluding privatization	803	1,970	1,307	1,100	1,203	999	1,393
Other private capital	102	-1,412	-1,089	-912	-325	-773	-830
Medium- and long-term loans	204	-146	-22	200	-40	163	211
Portfolio investment	-291	-472	-1,214	-1,012	-544	-1,015	-650
Short-term flows 3/	189	-794	147	-100	259	79	-391
Net Errors and Omissions	9	105	564	-220	84	0	0
Financing	**-449**	**-818**	**-414**	**-68**	**-1,670**	**539**	**-73**
NIR flow (increase -)	-448	-832	-478	-100	-1,730	500	-100
Change in NIR (increase -)	-433	-985	-596	-100	-1,741	500	-100
Valuation change	15	-153	-118	0	-11	0	0
Exceptional financing	-1	14	64	32	60	39	27
Debt relief 4/	1	14	64	32	60	39	27
Rescheduling	53	0	0	0	0	0	0
Change in arrears	-56	0	0	0	0	0	0
Memorandum items:							
Current account balance	**-2.2**	**-2.0**	**-1.8**	**-0.7**	**-0.8**	**-0.8**	**-0.8**
FDI and private MLT capital (in percent of CA deficit)	87.0	161.8	121.1	287.0	223.1	194.5	249.6
Capital and financial account balance (in percent of GDP)	3.0	3.4	2.4	0.8	3.3	0.1	0.9
Export value (US$), percent change	1.0	9.9	16.4	22.9	29.4	3.9	2.2
Volume growth	6.0	5.8	8.6	9.0	11.0	7.7	7.5
Price growth	-4.7	3.9	7.1	13.0	16.6	-3.5	-4.9
Import value (US$), percent change	-2.0	2.7	11.3	8.0	17.7	4.1	4.0
Volume growth	1.1	1.6	5.5	4.3	6.2	2.6	7.3
Price growth	-3.0	1.1	5.5	3.6	10.8	1.5	-3.1
GDP (in billions of US$)	53.7	56.5	60.6	66.3	67.4	72.2	77.2
Average exchange rate (S/. per US$)	3.51	3.52	3.48	...	...	...	...

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

1/ In 2002, includes the Brady Bond swap. For details of the swap, see IMF Country Report No. 03/72, Box 3.
2/ Includes portfolio flows of the pension reserve fund and subscription payments into international funds.
3/ Includes COFIDE and Banco de la Nación. Outflows in 2002 reflect a further reduction in the financial system's short-term debt.
4/ Debt relief under existing operations.

Table 10. Peru: External Financing Requirements and Sources

(In millions of U.S. dollars)

			Prel.	2004		Proj.	
	2001	2002	2003	Prog.	Proj.	2005	2006
Gross financing requirements	**7,061**	**7,855**	**6,002**	**5,155**	**6,866**	**4,954**	**5,781**
External current account deficit (excluding official transfers)	1,157	1,127	1,062	453	521	597	643
Debt amortization	5,454	5,896	4,462	4,602	4,615	4,857	5,038
Medium- and long-term debt	1,714	2,664	1,873	2,075	2,089	2,089	2,220
Public sector	886	1,843	1,229	1,375	1,391	1,452	1,531
Multilateral 1/	335	399	486	573	572	603	654
Bilateral	456	496	686	724	741	748	744
Bonds and notes	83	940	50	68	67	93	90
Other	12	8	7	10	11	8	43
Private sector	828	821	644	700	698	637	689
Short-term debt 2/	3,740	3,232	2,589	2,527	2,526	2,768	2,818
Rescheduling and repayment of arrears	2	0	0	0	0	0	0
Accumulation of NIR (flow)	448	832	478	100	1,730	-500	100
Change in gross reserves	279	852	512	100	1,741	-502	99
Payments of short-term liabilities incl. IMF	154	133	84	0	0	2	1
Other	15	-153	-118	0	-11	0	0
Available financing	**7,061**	**7,855**	**6,002**	**5,155**	**6,866**	**4,954**	**5,781**
Foreign direct investment (net)	1,070	2,156	1,317	1,100	1,253	1,009	1,403
Privatization	267	186	10	10	50	10	10
FDI	803	1,970	1,307	1,100	1,203	999	1,393
Portfolio (net)	-291	-472	-1,214	-1,012	-544	-1,015	-650
Short-term assets (flow)	706	-47	775	-211	101	29	-542
Of which: errors and omissions	9	105	564	-220	84	0	0
Debt financing from private creditors	4,264	5,150	4,393	3,827	4,725	4,018	4,575
Medium- and long-term financing	1,032	2,561	1,867	1,400	1,957	1,200	1,757
To public sector	0	1,886	1,245	500	1,299	400	857
To private sector	1,032	675	622	900	658	800	900
Short-term financing	3,232	2,589	2,526	2,427	2,768	2,818	2,818
Official creditors 3/	1,343	1,016	915	1,538	1,388	1,132	1,019
Multilateral 1/	1,105	807	699	1,307	1,177	879	826
Of which: balance of payments financing	877	625	519	1,011	961	569	501
Bilateral	238	209	216	231	211	253	193
To public sector	238	209	216	231	211	253	193
To private sector	0	0	0	0	0	0	0
Other medium- and long-term public sector flows 4/	-31	51	-184	-87	-58	-219	-24
IMF	0	0	0	0	0	0	0
Accumulation of arrears (exceptional)	0	0	0	0	0	0	0

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

1/ Excluding IMF.
2/ Original maturity of less than one year. Equals stock at the end of the previous period.
3/ Includes both loans and grants.
4/ Includes debt relief and subscription payments to international organizations and changes in Banco de la Nación's long-term assets.

Table 11. Peru: Medium-Term Macroeconomic Framework

				Staff Projections					
	2001	2002	2003	2004	2005	2006	2007	2008	2009
	(Annual percentage change)								
GDP at constant prices	0.2	4.9	3.8	4.3	4.5	4.5	4.5	4.5	4.5
Consumer prices (end of period)	-0.1	1.5	2.5	3.5	2.5	2.5	2.5	2.5	2.5
GDP deflator	1.4	0.6	2.2	5.4	1.9	2.7	2.1	2.6	2.6
Merchandise trade									
Exports, f.o.b.	1.0	9.9	16.4	29.4	3.9	2.2	4.2	5.1	4.7
Imports, f.o.b.	-2.0	2.7	11.3	17.7	4.1	4.0	4.3	6.2	5.0
Terms of trade (deterioration -)	-1.8	2.8	1.4	6.5	-5.0	-0.8	-1.1	-1.0	-1.0
	(In percent of GDP; unless otherwise indicated)								
External current account balance	-2.2	-2.0	-1.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.7
External current account, excluding interest obligations	-0.1	0.6	1.7	3.5	3.4	3.2	3.0	2.8	2.7
Total external debt service 1/ 2/	6.4	7.4	5.4	5.3	5.3	5.2	5.5	5.7	4.9
Medium- and long-term	6.0	7.1	5.2	5.1	5.1	5.0	5.3	5.5	4.7
Nonfinacial public sector	3.7	5.1	3.8	3.8	3.8	3.8	3.8	4.2	3.4
Private sector	2.4	2.1	1.4	1.3	1.3	1.2	1.4	1.3	1.3
Short-term 3/	0.4	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Nonfinacial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.4	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2
External debt service	6.4	7.4	5.4	5.3	5.3	5.3	5.5	5.7	4.9
Interest	3.1	2.4	2.2	2.2	2.4	2.5	2.5	2.4	2.3
Amortization (medium-and long-term)	3.4	5.0	3.2	3.1	2.9	2.7	3.0	3.3	2.6
Combined public sector primary balance	0.0	0.0	0.5	0.8	1.2	1.3	1.4	1.3	1.2
General government current revenue 4/	17.2	17.2	17.7	17.8	17.9	17.8	17.5	17.4	17.4
General govt. non-interest expenditure 5/	17.8	17.3	17.3	17.1	16.8	16.7	16.5	16.5	16.6
Combined public sector interest due	2.2	2.2	2.2	2.1	2.2	2.3	2.3	2.3	2.2
Combined public sector overall balance	-2.3	-2.2	-1.7	-1.4	-1.0	-1.0	-1.0	-1.0	-1.0
Public sector debt 1/ 2/	46.6	47.1	47.7	44.7	41.7	39.9	38.3	36.6	35.1
Gross domestic investment	18.8	18.8	18.8	19.0	19.3	19.8	20.0	20.1	20.1
Public sector	3.1	2.8	2.9	2.8	2.8	2.9	2.9	3.0	3.0
Private sector	15.7	15.9	15.9	16.2	16.5	16.8	17.1	17.1	17.1
National savings	16.6	16.8	17.0	18.2	18.5	18.9	19.2	19.3	19.4
Public sector 6/	1.1	0.8	1.3	1.5	1.9	2.0	2.1	2.1	2.1
Private sector	15.5	16.0	15.8	16.7	16.6	16.9	17.1	17.2	17.3
External savings	2.2	2.0	1.8	0.8	0.8	0.8	0.8	0.8	0.7
Memorandum items:									
Nominal GDP (billions of Nuevos Soles)	188.3	198.7	210.7	231.8	246.9	265.1	282.7	303.1	324.9
Gross international reserves (billions of U.S. dollars)	8,838	9,690	10,206	11,947	11,447	11,547	11,647	11,747	11,847
Gross international reserves to broad money	62.6	65.9	67.4	73.3	66.0	63.4	60.8	58.2	55.6
External debt service (percent of exports of GNFS)	40.1	45.0	30.6	26.6	27.5	28.1	29.9	31.5	27.5
Short-term external debt service (percent of exports of GNFS) 7/	2.3	1.3	0.8	0.7	1.1	1.2	1.3	1.2	1.1
Public external debt service (percent of exports of GNFS)	22.8	30.8	21.7	19.0	19.9	20.6	20.8	23.0	19.3

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

1/ In 2002, includes the Brady Bond swap. For details of the swap, see IMF Country Report No. 03/72, Box 3.
2/ Spikes in 2008-09 reflect bullet-payment amortizations of international bond issues from 2002 and 2003.
3/ Includes interest payments only.
4/ Assumes that the financial transactions tax expires at end-2006.
5/ Real expenditure growth is limited to 3 percent a year under the nation's fiscal responsibility law.
6/ Excludes privatization receipts.
7/ Interest only.

Table 12. Peru: Financial Soundness Indicators 1/

(In percent; unless otherwise indicated)

	Dec-00	Dec-01	Dec-02	Dec-03	Jun-04
Capital Adequacy					
Equity capital to risk-weighted assets	12.8	12.8	12.5	13.3	14.1
Regulatory Tier I capital to risk-weighted assets 2/	12.7	12.4	12.4	12.1	12.9
Nonperforming loans net of provisions to capital	-4.6	-11.1	-17.2	-15.2	-14.4
Asset Quality					
Nonperforming loans to total gross loans 3/	9.7	9.0	7.6	5.8	5.1
In domestic currency	7.0	5.2	5.2	4.0	4.4
In foreign currency	10.3	9.9	8.2	6.3	5.3
Refinanced and restructured loans to total gross loans 4/	6.1	8.0	7.0	6.4	6.1
Provisions to nonperforming loans	107.4	118.9	133.2	141.1	146.9
Sectoral distribution of loans to total loans					
Consumer loans	6.7	8.6	9.4	11.6	12.2
Mortgage loans	7.8	9.6	10.7	12.9	13.3
Commercial loans	84.7	79.2	77.6	72.6	71.0
Small business loans	0.9	2.5	2.3	2.9	3.5
Earnings and Profitability					
ROA	0.3	0.4	0.8	1.1	1.1
ROE	3.0	4.5	8.4	10.9	11.3
Gross financial spread to financial revenues	47.9	51.9	66.1	71.2	73.3
Financial revenues to total revenues	80.3	78.7	73.3	70.6	68.7
Annualized financial revenues to revenue-generating assets	14.7	11.6	9.9	9.2	8.9
Liquidity					
Total liquid assets to total short-term liabilities	...	39.2	41.9	40.4	41.4
In domestic currency	19.4	22.6	23.5	32.9	39.7
In foreign currency	37.7	46.0	49.3	43.9	43.7
Foreign Currency Position and Dollarization					
Global position in foreign currency to regulatory capital 5/	35.7	37.6	37.0	31.8	34.2
Share of foreign currency deposits in total deposits	73.5	71.9	71.6	69.7	69.9
Share of foreign currency loans in total credit	81.9	80.5	79.7	77.9	78.1
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	8,729	9,357	9,658	9,210	9,409
Commercial banks' foreign assets (in millions of U.S. dollars)	824	748	779	601	508.0
Commercial banks' short-term foreign liabilities (in millions of U.S. dollars)	1,519	1,161	763	702	873.0
Operational efficiency					
Financing to related parties to capital 6/	...	...	20.1	18.7	14.9
Nonfinancial expenditure to total revenues 7/	29.8	32.1	36.2	37.7	36.7
Nonfinancial expenditure to total revenue-generating assets 7/	5.5	4.7	4.9	4.9	4.7
Memorandum items:					
Number of Banks	17	16	16	16	16
Private commercial	16	15	14	14	14
Of which: Foreign-owned	10	10	9	9	9
State-owned	1	1	2	2	2
Banks' credit card loans to total loans	0.0	2.4	3.3	4.6	5.5
Bank loans' 12 month increase (in real terms)	-11.7	-3.3	1.0	-8.3	-4.5
Stock market index (U.S. dollars)	342.8	342.1	396.0	700.6	831.4
Foreign currency debt rating (Moody's)	Ba3	Ba3	Ba3	Ba3	Ba3
Spread of Peruvian Brady bonds, basis points	687	521	610	312	439

Sources: Superintendency of Banks and Insurance of Peru; Central Bank of Peru; and Fund staff estimates/projections.

1/ These indicators correspond to private commercial banks.

2/ Tier I regulatory capital is equivalent to share capital and reserves. Risk-weighted assets include market risk exposure. In year 2002, the Tier I considers a reduction on Banco Santander Central Hispano capital due to the valorization before its merge with Banco de Crédito.

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

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

5/ Global position in foreign currency corresponds to those items in the balance sheet subject to exchange rate risk.

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

7/ Non financial expenditures do not consider provisions nor depreciations.

Table 13. Peru: Financial and External Vulnerability Indicators

(In percent; unless otherwise indicated)

	2000	2001	2002	Prel. 2003	2004 Prog.	2004 Proj.	Proj. 2005	Proj. 2006
Financial indicators								
Public sector debt/GDP	45.9	46.6	47.1	47.7	44.6	44.7	41.7	39.9
Of which: in domestic currency (percent of GDP)	4.6	4.7	5.7	5.7	7.2	7.2	6.7	6.4
90-day prime lending rate, domestic currency (end of period)	15.4	5.0	5.1	3.3	...	...	...	...
90-day prime lending rate, foreign currency (end of period)	8.2	3.1	2.4	1.7	...	...	...	...
Velocity of money 1/	3.9	3.8	3.8	4.0	4.0	4.1	4.2	4.2
Credit to the private sector/GDP 2/	32.3	31.4	30.4	29.7	27.3	26.3	26.0	25.8
External indicators								
Exports, U.S. dollars (percent change)	14.3	0.8	9.9	16.4	22.9	29.4	3.9	2.2
Imports, U.S. dollars (percent change)	9.1	-1.8	2.7	11.3	8.0	17.7	4.1	4.0
Terms of trade (percent change)	-2.1	-1.8	2.8	1.4	9.1	6.5	-5.0	-0.8
Real effective exchange rate, (end of period, percent change) 3/	7.2	4.4	-5.5	-10.7	...	...	...	...
Current account balance (percent of GDP)	-2.9	-2.2	-2.0	-1.8	-0.7	-0.8	-0.8	-0.8
Capital and financial account balance (percent of GDP)	2.7	3.0	3.4	2.4	0.8	3.3	0.1	0.9
Total external debt (percent of GDP)	52.7	50.7	49.3	49.1	45.9	46.2	43.5	41.4
Medium- and long-term public debt (in percent of GDP) 4/	36.9	35.7	36.8	37.6	35.4	35.6	33.3	31.5
Medium- and long-term private debt (in percent of GDP)	8.8	8.9	7.9	7.3	6.9	6.5	6.3	6.3
Short-term public and private debt (in percent of GDP)	7.0	6.0	5.7	4.3	3.7	3.7	3.8	3.7
Total external debt (in percent of exports of goods and services) 4/	327.1	315.1	300.4	278.8	239.9	231.3	224.8	221.6
Total debt service (in percent of exports of goods and services) 5/	44.2	40.1	45.0	30.6	28.3	26.6	27.5	28.1
Gross official reserves, in								
millions of U.S. dollars	8,562	8,838	9,690	10,206	10,306	11,947	11,447	11,547
percent of short-term external debt 6/	155.6	149.9	217.2	221.1	223.9	246.0	227.2	214.4
percent of broad money 7/	64.0	62.6	65.9	67.4	64.8	73.3	66.0	63.4
percent of foreign currency deposits at banks	91.9	92.5	100.6	107.3	107.3	127.0	117.8	117.3
months of imports of goods and services	10.7	11.0	11.7	11.3	10.6	11.4	10.6	10.2
Net international reserves (in millions of U.S. dollars)	8,180	8,613	9,598	10,194	10,294	11,935	11,435	11,535
Net international reserves (program definition; in millions of U.S. dollars) 8/	4,891	5,056	5,830	6,906	7,064	8,488	7,699	7,699
Net foreign exchange position (in millions of U.S. dollars) 9/	2,624	2,914	3,341	4,583	4,683	6,313	5,813	5,913

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

1/ Defined as the inverse of the ratio of end-period broad money to annual GDP.
2/ Corresponds to the financial system.
3/ End of period.
4/ Includes Central Reserve Bank of Peru debt.
5/ Includes debt service to the Fund. For 2002, excludes US$923 million of Brady bonds that were amortized in a debt exchange operation.
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/ Includes public sector foreign currency deposits in central bank (e.g. pension reserve funds) as reserve liability.

Table 14. Peru: Proposed Schedule of Purchases
Under the Stand-By Arrangement, 2004–06 1/

Amount of Purchase	Availability Date	Conditions Include
1. SDR 80.00 million 2/	June 9, 2004	Board approval of SBA.
2. SDR 23.031 million	August 31, 2004	Observance of end-June 2004 performance criteria.
3. SDR 23.031 million	October 31, 2004	Completion of the First Review and observance of end-September 2004 performance criteria.
4. SDR 23.031 million	February 28, 2005	Completion of the second review and observance of end-December 2004 performance criteria.
5. SDR 23.031 million	May 15, 2005	Observance of end-March 2005 performance criteria.
6. SDR 23.031 million	August 31, 2005	Completion of the third review and observance of end-June 2005 performance criteria.
7. SDR 23.031 million	November 15, 2005	Observance of end-September 2005 performance criteria.
8. SDR 23.031 million	February 28, 2006	Completion of the fourth review and observance of end-December 2005 performance criteria.
9. SDR 23.031 million	May 15, 2006	Observance of end-March 2006 performance criteria.
10. SDR 23.031 million	July 31, 2006	Completion of the fifth review and observance of end-June 2006 performance criteria.

1/ Total access under the Stand-By Arrangement is SDR 287.279 million (21 percent of quota on an annual basis).
2/ This amount is required to bring total disbursements outstanding to above 25 percent of quota.

Table 15. Peru: Capacity to Repay the Fund as of August 31, 2004 1/

(In millions of SDRs; unless otherwise indicated)

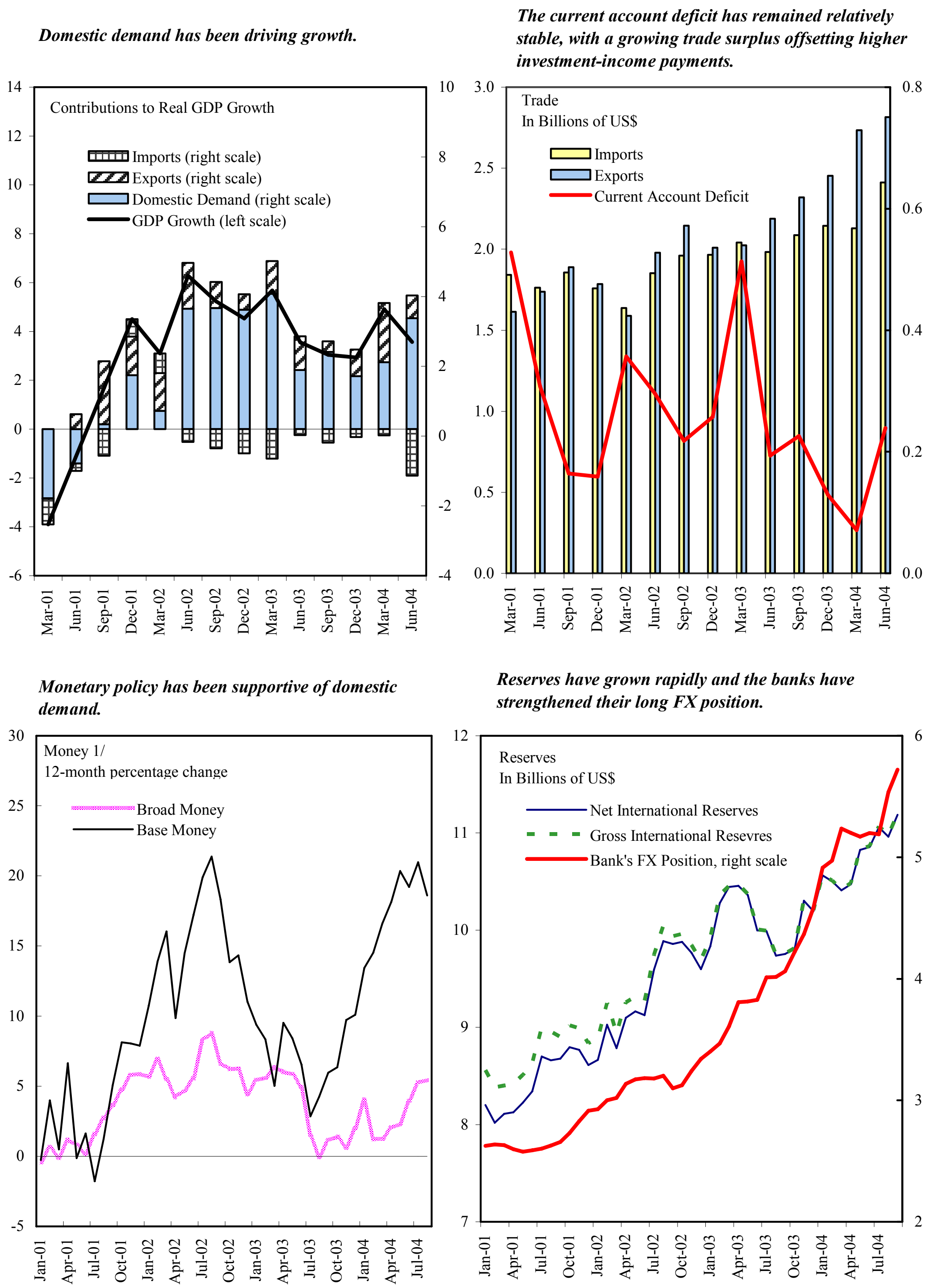
	2004	2005	2006	2007	2008	2009	2010	2011	Total
Obligations from existing drawings									
Principal (repurchases)	26.8	26.8	26.8	13.4	0.0	0.0	0.0	0.0	93.6
Charges and interest 2/									
GRA charges	2.1	1.6	0.8	0.1	0.0	0.0	0.0	0.0	4.6
SDR charges	1.5	1.7	1.7	1.7	1.7	1.7	1.7	1.7	13.5
Credit outstanding	66.9	40.1	13.4	0.0	0.0	0.0	0.0	0.0	...
(percent of quota)	10.5	6.3	2.1	0.0	0.0	0.0	0.0	0.0	...
Obligations from prospective drawings									
Principal (repurchases)	0	0	0	0	80.3	126.4	63.3	17.3	287.3
Charges and interest 2/									
GRA charges	0.6	5.3	8.1	8.9	8.1	5.1	1.8	0.3	38.1
Credit outstanding	126.1	218.2	287.3	287.3	207.0	80.6	17.3	0.0	...
(percent of quota)	19.7	34.2	45.0	45.0	32.4	12.6	2.7	0.0	...
Cumulative (existing and prospective)									
Principal (repurchases)	26.8	26.8	26.8	13.4	80.3	126.4	63.3	17.3	...
Charges and interest 2/									
GRA charges	2.7	6.9	8.9	9.0	8.1	5.1	1.8	0.3	...
SDR charges	1.5	1.7	1.7	1.7	1.7	1.7	1.7	1.7	...
Credit outstanding	192.9	258.3	300.7	287.3	207.0	80.6	17.3	0.0	...
percent of quota	30.2	40.5	47.1	45.0	32.4	12.6	2.7	0.0	...
percent of GDP	0.4	0.5	0.6	0.5	0.3	0.1	0.0	0.0	...
percent of exports of goods and services	2.1	2.7	3.1	2.8	1.9	0.7	0.1	0.0	...
percent of public sector debt service	8.3	9.6	12.0	10.5	6.3	2.7	0.6	0.0	...
percent of external public debt	1.2	1.6	1.8	1.7	1.2	0.5	0.1	0.0	...
percent of external public debt service	11.3	13.9	15.2	13.6	8.3	3.7	0.8	0.0	...
percent of gross foreign reserves	2.4	3.3	3.8	3.6	2.6	1.0	0.2	0.0	...
Memorandum items:									
Purchases	126.0	92.1	69.1	0.0	0.0	0.0	0.0	0.0	...

Sources: Fund staff estimates/projections.

1/ Assuming all scheduled purchases are made. Repurchases assumed to be made under obligations schedule.

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 PRGF and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.

Figure 1. Peru: Main Economic Indicators, 2001-2004

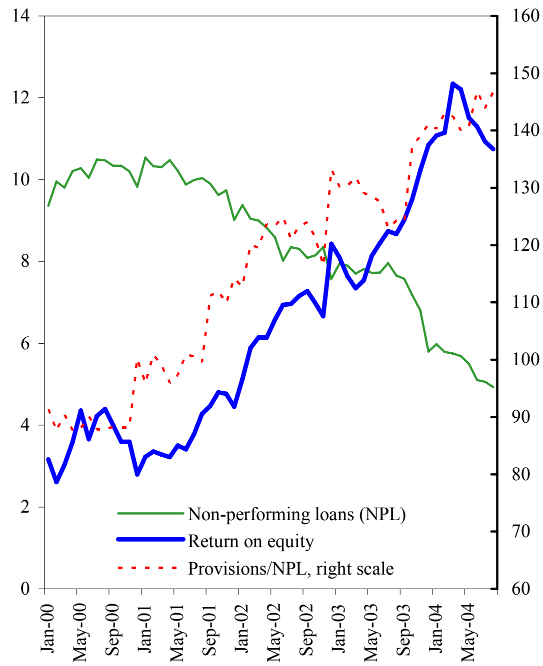


Sources: Central Reserve Bank of Peru; Superintendence of Banks; and Fund staff estimates.

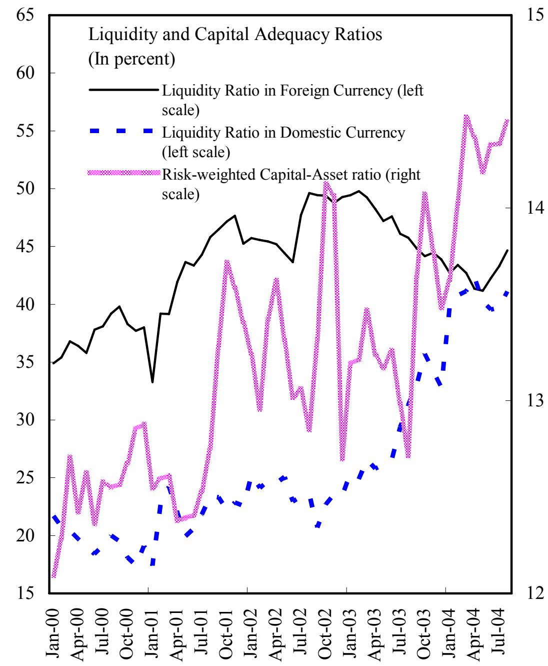
1/ U.S. dollar stocks are valued at market exchange rates.

Figure 2. Peru: Selected Financial Indicators, 2000-2004

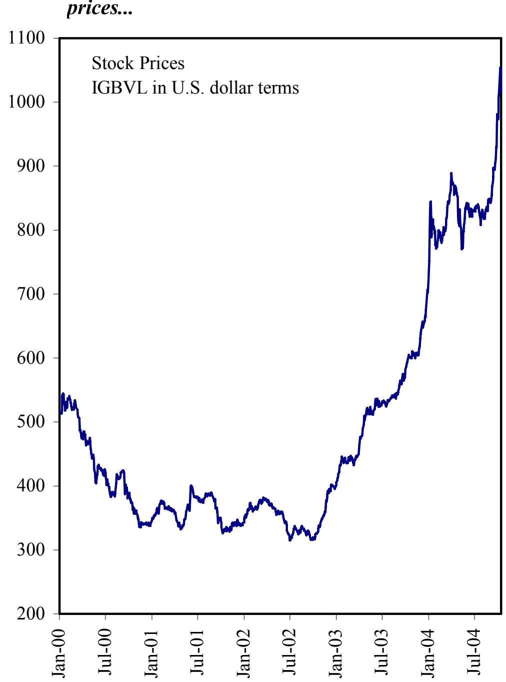
Non-performing loan ratios continue to decline, provisioning ratios remain strong, and bank profitability is improving.



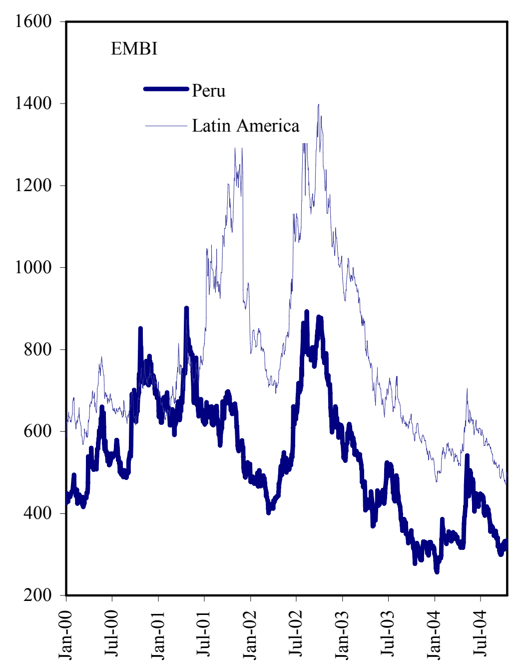
Capital adequacy and liquidity ratios remain high.



Stock prices in U.S. dollar terms have recovered strongly since 2003 reflecting higher commodity prices...



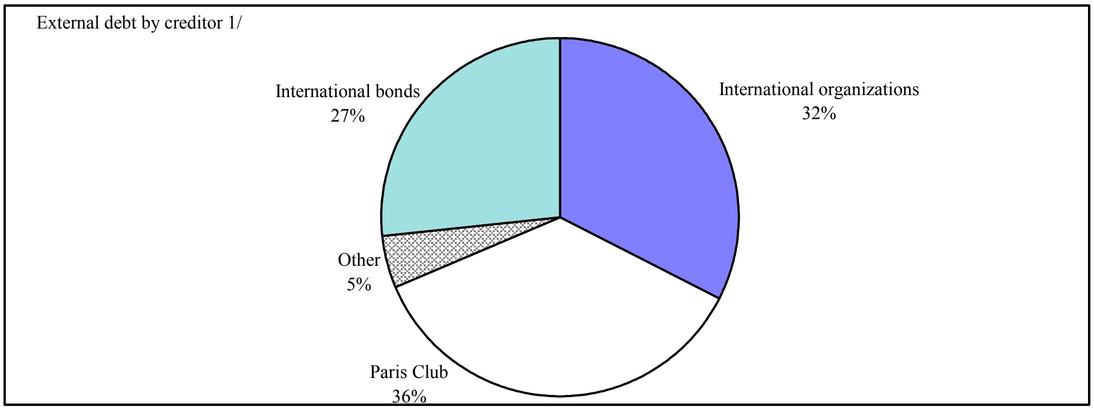
... and external spreads have been declining.



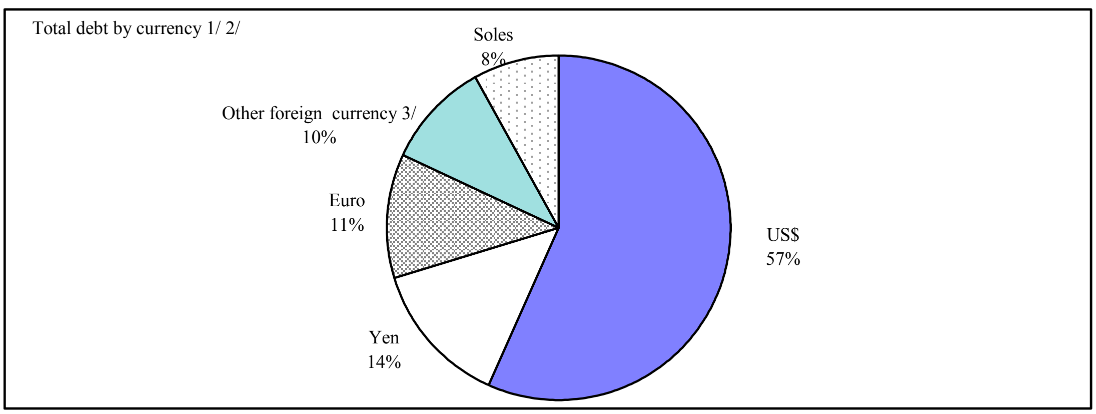
Source: Superintendency of Banks and Insurance and JP Morgan.

Figure 3. Peru: Composition of Public Debt, June 2004

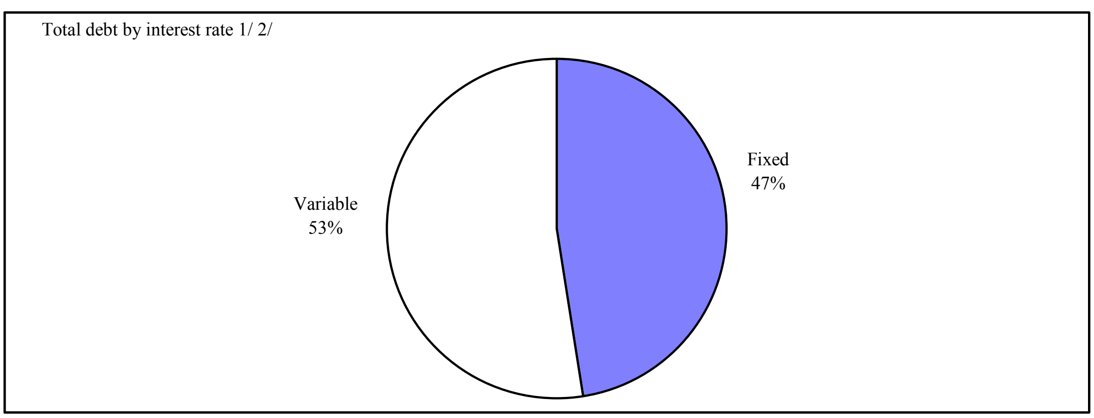
Three-fourths of the US$22.8 billion public external debt is owed to official creditors.



92 percent of the US$26.8 billion total public debt is denominated in foreign currency.



Slightly more than half of the public debt bears a variable interest rate.



Source: Ministry of Economy and Finance.

1/ Millions of U.S. dollars.
2/ Domestic debt includes floating debt.
3/ Includes loans expressed as a currency basket, comprised mostly of Euro, Yen, and U.S. dollars.

Peru—Debt Sustainability Analysis[1]

Peru's external and public sector debt ratios are robust to alternative assumptions about underlying macroeconomic variables. The debt trajectory shows a steady improvement under baseline assumptions due to good fiscal performance, low real interest rates, strong economic growth, and a recent appreciation of the exchange rate. Peru's public sector debt stock is projected to decline to about 43½ percent of GDP at end-2004, and further to about 35 percent of GDP by 2009. Standard sensitivity tests also suggest resiliency; using 10-year historical standard deviation shocks does not significantly alter the medium-term projection. Even under more severe stress tests, e.g. two-standard-deviation shocks, the debt ratios generally decline once conditions normalize.

External and public debt are sensitive to changes in growth and, given the high foreign currency composition of Peru's debt, to exchange rate changes. Nonetheless, Peru's debt dynamics are resilient to short-term real exchange rate shocks of magnitudes experienced by Peru in the recent past. A sustained 30–percent real depreciation would lead to a protracted period of higher ratios, albeit with a declining trend. Debt dynamics are only moderately vulnerable to a decline in growth and an increase in the fiscal deficit. A country specific scenario, assuming a shock to Peru's terms of trade, leading to a sustained 15 percent real depreciation and a reduction in projected output by 4 percentage points during 2005 would result in a sharp increase in external and public debt ratios, but those ratios would decline rapidly with subsequent recovery in output and the exchange rate, supported by the strong primary balance.

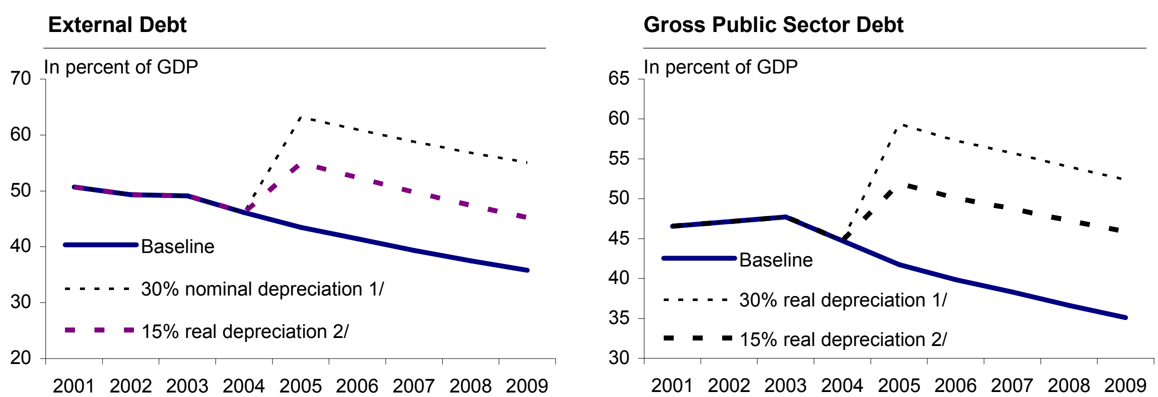


Chart Notes:
1/ Effect of a sustained 30 percent real depreciation of the Nuevo Sol.
2/ Effect of a sustained 12 percent real depreciation of the Nuevo Sol, and endogenous current account adjustment.

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[1] The DSA includes standard sensitivity tests around the baseline medium-term scenario. The methodology used is in line with that endorsed in the assessing sustainability (dated February 28, 2001 See May 28, 2002, see www.imf.org).

Table 1. Peru. External Debt Sustainability Framework, 2001-2009
(In percent of GDP, unless otherwise indicated)

	Actual 2001	2002	2003			Projections 2004	2005	2006	2007	2008	2009	
								I. Baseline Projections				**Debt-stabilizing non-interest current account 6/**
1 **External debt**	50.7	49.3	49.1			**46.2**	**43.5**	**41.4**	**39.4**	**37.5**	**35.8**	**-0.7**
2 Change in external debt	-1.5	-1.4	-0.2			-2.9	-2.7	-2.0	-2.1	-1.8	-1.7	
3 Identified external debt-creating flows (4+8+9)	0.7	-3.6	-1.3			-5.1	-1.9	-2.9	-2.9	-2.3	-2.3	
4 Current account deficit, excluding interest payments	-0.9	-0.4	-0.5			-1.4	-1.6	-1.7	-1.8	-1.6	-1.6	
5 Deficit in balance of goods and services	1.8	1.2	0.3			-1.4	-1.3	-1.1	-1.0	-0.8	-0.7	
6 Exports	16.1	16.4	17.6			20.0	19.3	18.7	18.4	18.1	17.8	
7 Imports	17.9	17.6	17.9			18.6	18.0	17.6	17.4	17.3	17.1	
8 Net non-debt creating capital inflows (negative)	-1.4	-3.0	0.2			-0.9	0.4	-0.9	-1.3	-0.6	-0.6	
9 Automatic debt dynamics 1/	3.0	-0.1	-1.1			-2.8	-0.7	-0.3	0.1	-0.1	-0.1	
10 Contribution from nominal interest rate	3.1	2.4	2.2			2.2	2.4	2.5	2.5	2.4	2.3	
11 Contribution from real GDP growth	-0.1	-2.3	-1.7			-1.9	-2.0	-1.8	-1.8	-1.7	-1.6	
12 Contribution from price and exchange rate changes 2/	0.1	-0.2	-1.6			-3.1	-1.1	-0.9	-0.6	-0.8	-0.8	
13 Residual, incl. change in gross foreign assets (2-3)	-2.2	2.2	1.1			2.2	-0.8	0.8	0.9	0.5	0.6	
External debt-to-exports ratio (in percent)	315.1	300.4	278.8			231.3	224.8	221.6	214.0	207.1	201.1	
Gross external financing need (in billions of US dollars) 3/	6.7	7.2	5.6			5.2	5.5	5.6	5.9	6.4	5.9	
in percent of GDP	12.5	12.7	9.2			7.7	7.6	7.2	7.2	7.3	6.3	
Key Macroeconomic Assumptions				10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	0.2	4.9	3.8	4.3	4.1	4.3	4.5	4.5	4.5	4.5	4.5	4.5
Exchange rate appreciation (US dollar value of local currency, change in percent)	-1.5	-0.3	1.1	-5.3	4.8	1.1	0.6	-0.4	-0.5	-0.5	-0.5	0.0
GDP deflator in US dollars (change in percent)	-0.1	0.3	3.4	1.7	6.8	6.6	2.5	2.2	1.6	2.1	2.1	2.9
Nominal external interest rate (in percent)	5.9	5.0	4.9	5.9	0.9	4.9	5.6	6.2	6.5	6.5	6.4	6.0
Growth of exports (US dollar terms, in percent)	0.9	7.4	15.1	9.9	11.0	26.1	3.8	3.3	4.4	5.1	4.8	7.9
Growth of imports (US dollar terms, in percent)	-0.9	3.5	9.2	7.8	14.7	15.3	3.7	4.3	5.0	6.3	5.4	6.7
Current account balance, excluding interest payments	0.9	0.4	0.5	-1.3	2.0	1.4	1.6	1.7	1.8	1.6	1.6	1.6
Net non-debt creating capital inflows	1.4	3.0	-0.2	3.3	2.7	0.9	-0.4	0.9	1.3	0.6	0.6	0.7
								II. Stress Tests for External Debt Ratio				**Debt-stabilizing non-interest current account 6/**
A. Alternative Scenarios												
A1. Key variables are at their historical averages in 2005-09 4/						**46.2**	**43.2**	**41.9**	**40.7**	**39.0**	**37.4**	**-3.4**
A2. Country-specific shock in 2005, with real depreciation of 15 percentage 5/						**46.2**	**55.0**	**52.4**	**49.8**	**47.4**	**45.2**	**-0.8**
B. Bound Tests												
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006						**46.2**	**44.4**	**42.9**	**40.8**	**39.0**	**37.3**	**-0.7**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						**46.2**	**47.5**	**49.6**	**47.5**	**45.6**	**43.9**	**-0.8**
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006						**46.2**	**50.8**	**56.8**	**54.6**	**52.7**	**50.9**	**-0.9**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006						**46.2**	**50.4**	**55.3**	**53.3**	**51.4**	**49.6**	**-0.7**
B5. Combination of B1-B4 using one standard deviation shocks						**46.2**	**54.6**	**64.6**	**62.0**	**59.6**	**57.4**	**-0.9**
B6. One time 30 percent nominal depreciation in 2005						**46.2**	**63.2**	**61.0**	**58.8**	**56.8**	**55.0**	**-1.0**

1/ Derived as [r - g - ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as [-ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock. ρ increases with an appreciating domestic currency (ε > 0) and rising inflation (based on GDP deflator).
3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
5/ The implied change in other key variables under this scenario is discussed in the text.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 2. Peru. Public Sector Debt Sustainability Framework, 2001-2009
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	2001	2002	2003			2004	2005	2006	2007	2008	2009
						I. Baseline Projections					
1 **Public sector debt 1/**	46.6	47.1	47.7			**44.7**	**41.7**	**39.9**	**38.3**	**36.6**	**35.1**
o/w foreign-currency denominated	41.9	41.5	42.0			37.6	35.1	33.5	30.6	29.3	28.1
2 Change in public sector debt	0.7	0.6	0.6			-3.0	-3.0	-1.9	-1.6	-1.7	-1.5
3 Identified debt-creating flows (4+7+12)	0.3	-0.8	-0.9			-3.6	-2.1	-1.7	-1.4	-1.5	-1.4
4 Primary deficit	0.0	0.0	-0.4			-0.8	-1.2	-1.3	-1.4	-1.3	-1.2
5 Revenue and grants 11/	18.1	17.7	18.2			18.1	18.3	18.2	18.2	18.1	18.1
6 Primary (noninterest) expenditure	18.2	17.7	17.8			17.4	17.1	17.0	16.8	16.8	16.8
7 Automatic debt dynamics 2/	0.9	-0.1	-0.4			-2.6	-0.7	-0.4	0.0	-0.2	-0.1
8 Contribution from interest rate/growth differential 3/	1.9	-0.2	-0.7			-2.2	-0.5	-0.6	-0.2	-0.3	-0.3
9 Of which contribution from real interest rate	2.0	1.9	1.0			-0.3	1.4	1.2	1.5	1.3	1.3
10 Of which contribution from real GDP growth	-0.1	-2.1	-1.7			-1.9	-1.9	-1.8	-1.7	-1.6	-1.5
11 Contribution from exchange rate depreciation 4/	-1.0	0.1	0.3			-0.4	-0.2	0.2	0.2	0.1	0.1
12 Other identified debt-creating flows	-0.6	-0.7	-0.1			-0.2	-0.1	0.0	0.0	0.0	0.0
13 Privatization receipts (negative)	-0.6	-0.7	-0.1			-0.2	-0.1	0.0	0.0	0.0	0.0
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0
16 Residual, including asset changes (2-3)	0.4	1.4	1.4			0.5	-0.9	-0.2	-0.2	-0.1	-0.1
Public sector debt-to-revenue ratio 1/	256.7	267.0	262.0			246.6	227.6	218.8	210.3	202.0	194.0
Gross financing need 5/	4.8	6.2	4.5			4.4	3.6	3.6	3.3	4.2	4.0
in billions of U.S. dollars	2.6	3.5	2.7			3.0	2.6	2.7	2.7	3.6	3.7
Key Macroeconomic and Fiscal Assumptions				10-Year Historical Average	10-Year Standard Deviation						
Real GDP growth (in percent)	0.3	4.9	3.7	4.3	4.1	4.3	4.5	4.5	4.5	4.5	4.5
Average nominal interest rate on public debt (in percent) 6/	4.9	4.9	4.7	5.6	1.1	4.9	5.3	5.8	6.2	6.3	6.4
Average real interest rate (nominal rate minus change in GDP deflator, in percent) 12/	4.4	4.3	2.3	0.0	3.8	-0.5	3.4	3.2	4.2	3.7	3.8
Nominal appreciation (increase in US dollar value of local currency, in percent)	2.4	-0.3	-0.7	-4.5	5.5	1.1	0.6	-0.4	-0.5	-0.5	-0.5
Inflation rate (GDP deflator, in percent)	0.5	0.6	2.4	7.5	7.7	5.4	1.9	2.7	2.1	2.6	2.6
Growth of real primary spending (deflated by GDP deflator, in percent)	-2.8	2.0	4.7	7.2	13.5	1.6	3.2	3.4	3.8	4.5	4.6
Primary deficit	0.0	0.0	-0.4	-0.5	1.0	-0.8	-1.2	-1.3	-1.4	-1.3	-1.2
						II. Stress Tests for Public Debt Ratio					
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2005-09 7/						**44.7**	**41.1**	**38.8**	**36.6**	**34.5**	**32.5**
A2. Country-specific shock in 2005, with real depreciation of 15 percentage 8/						**44.7**	**51.9**	**50.1**	**48.7**	**47.3**	**45.9**
B. Bound Tests											
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006						**44.7**	**43.5**	**43.3**	**41.8**	**40.1**	**38.5**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						**44.7**	**47.1**	**52.4**	**54.0**	**55.4**	**56.8**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006						**44.7**	**44.3**	**45.1**	**43.5**	**41.8**	**40.3**
B4. Combination of B1-B3 using one standard deviation shocks						**44.7**	**45.4**	**47.4**	**45.8**	**44.1**	**42.5**
B5. One time 30 percent real depreciation in 2005 9/						**44.7**	**59.3**	**57.3**	**55.7**	**54.0**	**52.4**
B6. 10 percent of GDP increase in other debt-creating flows in 2005						**44.7**	**51.7**	**49.8**	**48.2**	**46.5**	**44.9**

1/ Gross debt of the public sector including debt of public enterprises and the central bank.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate;
a = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ The implied change in other key variables under this scenario is discussed in the text.
9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
10/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.
11/ Net of transfers among non-financial public institutions.
12/ Calculated for period 1995-2003 to exclude the effect of recovery from hyperinflation during early 1990s.

Peru: Fund Relations
(As of September 30, 2004)

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

II. General Resources Account	**SDR Million**	**Percent Quota**
Quota	638.40	100.00
Fund holdings of currency	705.31	110.48

III. SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	91.32	100.00
Holdings	0.03	0.03

IV. Outstanding Purchases and Loans	**SDR Million**	**Percent Quota**
Extended arrangements	66.88	10.48

V. Financial Arrangements

Type of Arrangement	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-by	6/09/04	8/16/06	287.28	0.00
Stand-By	2/01/02	2/29/04	255.00	0.00
Stand-By	3/12/01	1/31/02	128.00	0.00

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

	Overdue	**Forthcoming**				
	12/31/03	**2004**	**2005**	**2006**	**2007**	**2008**
Principal	0	0.00	26.75	26.75	13.38	0.00
Charges/interest	0	1.00	3.60	2.74	1.98	1.86
Total	0	1.00	30.35	29.49	15.35	1.86

VII. Safeguard Assessments

The safeguards assessment of the central bank was completed on October 26, 2004. The assessment found that, with few exceptions, safeguards at the Banco Central de Reserva del Peru (BCRP) meet the requirements of the safeguards policy. The assessment recommended that by end-January 2005 the BCRP and the Comptroller General's Office agree on a Memorandum of Understanding, already under discussion, which would harmonize the respective organic laws in the area of oversight of the external and internal audit mechanisms.

VIII. Exchange Arrangements

Peru maintains a unified, managed floating exchange rate. On October 15, 2004, the average of interbank buying and selling rates was 3.32 *Nuevo Sol* per U.S. dollar. The central government maintains external payments arrears to unguaranteed suppliers, some of whom are in discussions with the government, while the rest have not been located. Peru has maintained a clearing arrangement with Malaysia since 1991.

IX. Last Article IV Consultation

The 2003 Article IV consultation was concluded on February 23, 2004 (IMF Country Report No. 04/155).

X. FSAP and ROSCs

Several joint Fund-Bank missions visited Lima in the period September 2000–January 2001 to conduct an FSAP for Peru. The corresponding FSSA report (dated February 28, 2001 See www.imf.org) was discussed by the Executive Board on March 12, 2001. A follow-up FSAP mission is expected for early next year. In October 2002, an FAD mission conducted a Fiscal ROSC for Peru, while an STA mission conducted a Data ROSC for Peru in February 2003.

XI. Technical Assistance

Department	Date	Purpose
FAD	August 2004 including	Public investment and fiscal policy, issues related to PPPs.
	June 2000, September 2002, September 2003	Tax policy and administration
	November 1999	Fiscal rules
MFD	March, September 2004, February 2003,	Central bank organization
	April, December 2002	Inflation targeting
	October 2002	Foreign exchange operations
	August 2002	Accounting and organizational issues
	May 2002	Inflation targeting
	March 2002	Monetary operations and government securities market
STA	January 1998 and October 1999	National account statistics, new base year for the national account series
TRE	July 2004,	Safeguards assessment

XII. Resident Representative

Mr. Jorge Guzmán has been the Fund Senior Resident Representative in Peru since August 2003.

Peru: World Bank Relations

Bank Group strategy

The World Bank Group Country Assistance Strategy (CAS), discussed by the IBRD Board on September 17, 2002, supports the implementation of the government's poverty reduction strategy with programs addressing fiscal, national competitiveness, and social-sector needs. In November 2003, the Bank decided to move Peru to a CAS high-case lending scenario with a total envelope of around US$300–400 million a year over FY04–06. Triggers met for the high case are related to the tax ratio and satisfactory progress in implementing key reforms in public sector management, social sectors, decentralization, and competitiveness. New lending includes quick-disbursing programmatic loans and investment projects for an additional US$200 million a year.

In FY 2004, following the additional priorities outlined in the CAS, the Bank approved operations for US$357 million for Peru (See Appendix IV, IMF Country Report No. 04/155). As of September 2004 in FY 2005, the Bank has approved two technical assistance loans for US$16.4 million to support the programmatic loans that are currently under preparation.

Bank-Fund collaboration in specific areas

- *Tax Reform and Fiscal Decentralization*. Fund staff has taken the lead in assisting in the design of tax reform. Jointly with the World Bank and IDB, staff has worked on drafting laws and regulations for fiscal decentralization. The World Bank has also focused on the design and implementation of decentralization of the social sectors and pro-poor spending policies.
- *Financial Sector.* A joint FSAP was completed in May 2001. Follow up technical assistance to implement FSAP recommendations has been given by both institutions.
- *Public expenditure review (PER).* In a joint effort with the IDB, and close collaboration with the IMF, the Bank completed in June 2002 a comprehensive diagnosis of, and made policy recommendations for, Peru's public expenditure management. A social sector expenditure review, with support of the Fund, is being prepared to assess fiscal trends in the social sector under decentralization, review the quality of social spending, and fine-tune the on-going budgetary protection policy of priority social programs.
- *Fiscal reforms.* In March 2002, the Bank and the Fund supported an international seminar (organized by the Ministry of Economy and Finance) on proposals for revising the law on fiscal prudence and transparency. A joint IMF-World Bank-IaDB mission took place in September 2004 for a pilot study on Public Investment and Fiscal Policy.
- *CAS follow-up and preparation of the Programmatic Loans* (Social Reform Loans I, II, III, and IV, and Decentralization and Competitiveness Loan I and II). The World Bank and the Fund have engaged in an interactive and continuous dialogue on CAS implementation and preparation of the subsequent programmatic loans. Dialogue has concentrated on the macroeconomic background, setting of triggers, overall loan conditionality, and risks and estimation of the fiscal implications of Bank operations.

Statement of World bank Loans
(As of September 30, 2004)

Loan Number	Year approved	Borrower	Purpose	Total (Net of Cancellation)	Undisbursed
				In millions of U.S. dollars	
One hundred ten (115) loans fully disbursed				4,723.2	
Partially disbursed or undisbursed loans:					
40760	1996	Republic of Peru	Irrigation Rehabilitation	85.0	2.7
41300	1997	Republic of Peru	Sierra Natural Resources Management	51.0	2.9
43840	1998	Republic of Peru	Urban Property Rights	38.0	1.9
45190	1999	Republic of Peru	Agricultural Research and Extension	9.6	1.6
45270	1999	Republic of Peru	Health Reform Program	27.0	15.7
45360	2000	Republic of Peru	Indigenous People Development	5.0	3.9
46140	2001	Republic of Peru	Second Rural Roads Rehabilitation and Maintenance	50.0	23.6
71420	2002	Republic of Peru	Rural Water and Sanitation	50.0	48.4
71760	2003	Republic of Peru	Rural Education Project	52.5	50.5
71770	2003	Republic of Peru	Trade Facility and Productivity Improvement TA	20.0	19.8
72090	2003	Republic of Peru	Lima Transport Project	45.0	45.0
71600	2003	Republic of Peru	Lima Water Rehabilitation Additional Financing	20.0	20.0
72190	2004	Republic of Peru	Justice Services Improvement	12.0	12.0
72550	2004	Republic of Peru	Institutional Capacity for Decentralization	8.8	8.8
72540	2004	Republic of Peru	Accountability for Decentralization Soc Sector	7.8	7.8
Total disbursed:				4,723.8	
of which: amount repaid				1,902.5	
Total outstanding [1]				2,803.0	
Total undisbursed					265.4

1/ Includes exchange rate adjustments and loans sold to third parties.

Statement of IFC Investments
(As of July, 2004)
In millions of U.S. dollars

	Loans	Equity	Quasi	Participation Loans	Total
Total commitments held by IFC	277.2	27.7	30.0	51.6	386.5
Total disbursed	177.2	27.7	30.0	51.6	286.4

Source: World Bank.

Peru: Relations with the Inter-American Development Bank

Country Strategy 2002-2006

The key objectives for the 2002-2006 strategy for Peru are poverty reduction and equity promotion, within the context of high economic growth, which is needed to make these goals sustainable. Toward this end, the Bank will support the government's efforts to: (i) raise the economy's productivity and competitiveness, by removing institutional obstacles to increased productivity and investment and making structural investments in human capital; (ii) improve the efficiency of social policy while implementing measures to mitigate poverty and protect vulnerable groups; and (iii) create a modern, decentralized and efficient state.

Lending

As of October 1, 2004, the country's portfolio consists of 23 loans for a total amount of US$1,490.5 million. These resources are distributed among 21 investment loans (US$890.5 million) and two policy-based loans (US$600 million). The lending program for 2004 foresees the approval of eight investment loans for US$137.2 million (one already approved) and one policy-based loan for US$300 million and a supporting reimbursable technical cooperation for US$10 million.

In addition, the country portfolio with Peru includes 23 non-reimbursable technical cooperation grants (US$6.6 million) and six small projects (US$2.6 million). The Multilateral Investment Fund (MIF) has 32 non-reimbursable technical cooperation grants under execution (US$14.5 million).

IDB Loans Portfolio By Sector as of October 1, 2004

(In millions of US$)

	Commitments	Disbursements	Percent Disbursed
Agriculture	68.9	46.5	67.4
Education	87.0	19.7	22.6
Social investment	327.6	194.7	59.4
Public sector management	669.0	415.3	62.1
Environment	5.0	1.0	19.5
Health	28.0	7.6	27.3
Transportation	245.0	124.5	50.8
Urban development	60.0	0.3	0.5
Total	**1,490.5**	**809.5**	**54.3**

Peru—Statistical Issues

Peru is in observance of the Special Data Dissemination Standard (SDDS) and meets the specifications for coverage, periodicity, and timeliness of the data categories. The dissemination of the advance release calendars and the metadata has been posted on the Fund's Dissemination Standards Bulletin Board. A data ROSC module was completed in 2003.

I. Real Sector

In June 2000, the authorities published a revised GDP series using 1994 as the base year. However, since 1994, the statistical techniques have been largely based on extrapolations. The lack of detailed tables for supply and use hampers the reconciliation of discrepancies in the data. As a result, changes in inventories are mainly determined as a residual. Even though the quarterly accounts have benefited from some improvements in the timeliness of monthly production indices, their coverage is still very limited. The National Statistics Office (INEI) is working on a new national account series using 2001 as the base year.

The weight structure for the CPI is derived from a 1993–94 household expenditure survey. Except for weights, source data are timely and consistent with the technical requirements for producing the index. The coverage of owner-occupied housing, however, was eliminated from the Metropolitan Lima index through the exclusion of imputed rent, a deviation from international practices. Imputed rent is included in the indices of the other 24 cities in the CPI. Thus, the national index is a weighted average of indices that have different coverage. The weights for the WPI are also outdated. INEI derived the weights from the 1994 input-output table and other reports and publications of relevant ministries. The WPI statistical techniques follow generally accepted international standards.

The authorities monitor labor market developments through four indicators: open unemployment, underemployment, employment, and remunerations. The quality of these indicators has improved over the last two years. However, wage data comes with a relatively long delay; the nationwide unemployment and underemployment situation is surveyed only once a year; and labor productivity data is only published at the time of adjustments to electricity and telecommunications tariffs.

II. Fiscal Sector

For the general government, GFS data are compiled using the analytical framework of the *GFS Manual 1986*. For the consolidated central government, revenues are compiled on a cash basis, while expenditures are compiled on an accrual basis. The authorities have sent to the Fund information on the components of consolidated central government expenditures by function. The authorities have not prepared a plan to migrate to the *GFS Manual 2001.*

The authorities report annually GFS data for publication in the *Government Finance Statistics Yearbook (GFSY)* and monthly for the *International Financial Statistics (IFS)*.

The coverage of national budget accounting is narrower than the fiscal accounting carried out in the program.

III. Monetary Sector

The BCRP prepares and publishes the analytical accounts of the banking system and of the central bank broadly in line with the methodology recommended by the Fund's *Monetary and Financial Statistics Manual*. The main discrepancy is the valuation of some financial instruments at cost rather than at market prices. Until early 2003, nonbank deposit-taking institutions were not included in the depository corporations' survey. However, following the recommendations of the February 2003 data ROSC mission, the BCRP expanded the coverage of the survey to incorporate them. Monetary statistics are disseminated only in a summary form.

IV. External Sector

The BCRP is responsible for the compilation and dissemination of balance of payments and international investment position statistics. The BCRP prepares quarterly data on the balance of payments and international investment position largely in line with the recommendations of the *Balance of Payments Manual, Fifth Edition (BPM5).* These data are reported to the Fund for publication in the *IFS* and the Balance of Payments Statistics Yearbook. Some departures from *BPM5* include the lack of coverage of assets held abroad and land acquisition abroad by residents; lack of separate identification of liabilities to affiliated enterprises; and the recording of some external debt transactions that are not on an accrual basis.

Regarding international reserves, the BCRP has been reporting since August 2001 weekly data in accordance with the *Operational Guidelines for Data Template on International Reserves and Foreign Currency Liquidity.* The BCRP includes the full amount of the liquidity requirements in the reserve template under official reserve assets, but does not register the contingent net drain (as specified in Section III of the Data Template). Peru started to disseminate quarterly data on external debt with a one-quarter lag in end-September 2003. External debt data are not compiled on an accrual basis, as recommended by *BPM5* and the *External Debt Statistics: Guide for Compilers and Users.*

V. Findings of the Data ROSC Mission

A ROSC data module mission visited Lima during February 12–26, 2003. Although Peru's macroeconomic statistics are largely adequate for effective surveillance, the mission identified important shortcomings mainly in national accounts and price statistics. Most of the recommendations made by the mission have been implemented. However, the areas that still need to be improved includes: (i) coordination among the agencies that compile official statistics to avoid duplication of efforts and confusion among users; (ii) establishing an updated business register that provides the basis for sample surveys; (iii) implementing a new benchmark and base year for GDP; (iv) expanding the coverage of the wholesale price index to include mining, oil and gas extraction, electricity and water, public transportation, and communication; (v) preparing sectoral breakdowns of depository corporations and financial surveys in accordance with the *MFSM* methodology; and (vi) expanding the scope of data sources for compiling financial flows of individual residents.

Peru: Core Statistical Indicators

As of October 27, 2004

	Exchange Rate	Interna-tional Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance 2/	GDP/ GNP	External Debt 3/	Debt Service 3/
Date of Latest Observation	10/26/2004	10/26/2004	10/22/2004	10/22/2004	09/30/2004	10/26/2004	09/2004	08/2004	Q2/2004	08/2004	09/2004	Q2/2004	Q2/2004
Date Received	10/27/2004	10/27/2004	10/25/2004	10/27/2004	10/25/2004	10/27/2004	10/15/2004	10/12/2004	08/16/2004	10/12/2004	10/13/2004	08/16/2004	08/16/2004
Frequency of Data 4/	D	D	W	D	W	D	M	M	Q	M	M	Q	Q
Frequency of Reporting 4/	D	D	W	D	W	D	M	M	Q	M	M	Q	Q
Source of Update 5/	B	B	B	B	B	B	O	B	B	B	O	B	B
Mode of Reporting 6/	E	E	E	F	E	E	E	E	E	E	E	E	E
Confidentiality 7/	C	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication 4/	D	D	W	D	W	D	M	M	Q	Q	M	Q	Q

1/ Data refer to net international reserves. Reserve template data are reported weekly, with a lag of 1 week.

2/ Refers to combined public sector deficit, including general government, public enterprises, and the operating balance of the central bank.

3/ Data are reported quarterly with a lag of 2 months, and cover private and public sector debt and debt-service.

4/ D=Daily; W=Weekly; M=Monthly; Q=Quarterly; and A=Annual.

5/ B=Central bank; F=Ministry of Finance; O=other official agency.

6/ E=Electronic; and F=Fax.

7/ C=For unrestricted use.

Lima, November 4, 2004

Dr. Rodrigo de Rato y Figaredo
Managing Director
International Monetary Fund
Washington, DC 20431
USA

Dear Mr. de Rato,

This letter is to inform you of performance under Peru's economic program during 2004 as well as our policy intentions and actions in the period ahead.

Adherence to our macroeconomic program is enabling Peru to continue to benefit from a strong economic performance. Led by strong private investment and exports, output and employment growth have picked up. We now expect the economy to grow by about 4⅓ percent during 2004, above program projections. Twelve-month inflation has recently picked up reflecting in part supply shocks, including fuel prices, but we anticipate that it will settle at about 3.5 percent by year-end—the upper end of the inflation target range of the Central Bank. The external current account deficit is narrowing and gross official international reserves have risen well above programmed levels. Fiscal policy is on track to meet the deficit target of 1.4 percent of GDP in 2004, and the draft 2005 budget is consistent with reducing the deficit further to 1 percent of GDP, as envisaged in the program. Congress has recently approved legislation submitted by the government in October to eliminate the special wage tax by December. All quantitative performance criteria of the program for end-September were observed.

The government is pressing forward with the programmed policy actions aimed at sustaining rapid growth while making room for higher social and poverty-reducing spending over the medium-term. We would like to update and specify progress in the following areas: the granting of privately operated concessions for public asset management; public pension reform; decentralization; fiscal transparency; the establishment of a commercial court in Lima; and public bank lending.

Preparatory work to award in concession to the private sector the construction and maintenance of two major roads has made good progress. Such a preparatory work currently involves four main roads to be completed over the next year. The concession award process is being delayed by a few months because of technical factors, including to allow for the completion of administrative work related to environmental impact assessments. We thereby request a modification of the date of implementation of the structural performance criterion on the completion of the concessioning or the entering into Public Private Partnerships for the construction and maintenance of two main roads from December 31, 2004 to April 30, 2005. The government has also called for bids to award in concession to the private sector the operation and maintenance of several airports and has completed the legal and regulatory process to allow awarding a concession for a new port terminal during 2005.

In the area of public pension reform, the constitutional amendment to allow a comprehensive reform of the *Cédula Viva* regime was approved by the first of two required legislative sessions by Congress last June. We are working with Congress to ensure that the constitutional amendment is approved before year-end and have already submitted a draft law to congress (end-December benchmark). The reform of the *Cédula Viva* will bring more equity among retirees while freeing up public resources to increase social spending over time. The census of civil servants and pensioners, which will help improve government resource management, has been completed. A draft plan for reforming the pension regimes of the police and the military has been completed by the Ministry of Economy and Finance; inter-ministerial discussions to further elaborate on this plan are now under way and are expected to be completed by end-December.

In the area of decentralization, solid progress has been made toward the implementation of a law on the certification of subnational governments' administrative capacity by year-end (end-December benchmark). The Government remains committed to a gradual and fiscally neutral decentralization process. In this context, it may not be possible to secure consensus toward implementation of a law clarifying shared responsibilities among the national, regional, and local governments by year-end (end-December benchmark). The government remains committed to the objectives of the reform and intends to continue clarifying gradually such responsibilities through congressional approval of sectoral legislation or annual devolution plans and budgets, adopting safeguards to avoid discontinuities and reversals in the process, and maintaining a close balance between the resources and responsibilities devolved. The government also plans to issue in 2005 regulations specifying procedures for the central government to penalize or intervene subnational governments that are not compliant with fiscal rules.

The Judiciary is implementing a program to strengthen property rights including the establishment of a commercial court module in Lima to adjudicate commercial disputes and speed-up contract enforcement. Although the program envisaged that the court would have been established by end-September, delays have been incurred because of administrative bottlenecks and a recent prolonged strike in the Judiciary. The Supreme Court has recently approved the creation of the commercial court, and we expect that it will begin operations by December. We therefore request a waiver of non-observance of the structural performance criterion for end-September, with a resetting of this structural performance criterion from September 30, 2004 to December 31, 2004. The preparation and announcement of a plan to centralize the information of collateral registries has been delayed, but the government is committed to do so by end-December.

Public bank lending to the private sector will continue to be closely monitored in accordance with sound banking practices. So far this year, net lending under the Banco de la Nación consumer-lending program has grown faster than anticipated. We will limit the stock of outstanding loans to S/. 1,000 million through the end of 2004 and avoid excessive growth in 2005. Progress is under way to ensure compliance by the Superintendency of Banks and Insurance with the implementation by end-December of a system to measure currency risks (end-December benchmark).

In light of the strong performance under the program and the important progress being made in growth enhancing reforms, I hereby request the completion of the First Review under the Stand-By Arrangement.

Sincerely yours,

____________/s/______________

Pedro Pablo Kuczynski
Minister of Economy and Finance

Press Release No. 04/245
FOR IMMEDIATE RELEASE
November 19, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review Under Peru's Stand-By Arrangement

The Executive Board of the International Monetary Fund today completed the first review of Peru's economic performance under a 26-month Stand-By Arrangement originally approved on June 9, 2004 (see Press Release No. 04/112). The Board also approved the modification of a structural performance criterion and a waiver for the nonobservance of a performance criterion.

The completion of the review makes available for drawing a total equivalent to SDR 126.06 million (about US$191.2 million), but the Peruvian authorities intend to continue treating the arrangement as precautionary.

Following the Executive Board discussion, Agustín Carstens, Deputy Managing Director and Acting Chair, said:

"The Peruvian economy continues to perform well. Economic activity is robust, inflation remains low, and the external position is strong. The outlook for next year and the medium term is positive, as prudent macroeconomic policies and structural reforms are expected to continue to be implemented. Peru has built important buffers to mitigate vulnerabilities, including a comfortable level of international reserves and a well-capitalized banking system. The national consensus on prudent policies and reform needs to be preserved in order to further reduce the vulnerabilities associated with Peru's public debt and financial dollarization, and thereby help set the basis for Peru's strategy for exiting from Fund-financial support.

"Preserving macroeconomic stability and promoting poverty reduction continue to be co-objectives of the authorities. The 2004 fiscal target is well within reach and the draft 2005 budget aims at further fiscal consolidation. Since wage pressures are expected to remain strong in the months ahead, it will be important to prepare contingency measures to ensure compliance with the 2005 fiscal targets.

"The central bank remains committed to keeping inflation low. Allowing the exchange rate to move more freely is important, among other things, to limit the costs of sterilized intervention and avoid the risks associated with one way bets to capital inflows.

"Several growth-enhancing reforms are under way, and the authorities are committed to addressing the delays registered in some areas of the structural reform agenda. The authorities' focus has been on awarding infrastructure transportation in concession to the private sector and reforming the preferential public pension regime. The planned establishment of a commercial court by end-2004 will help enhance the business climate. In addition, private sector investment is expected to be boosted with the awarding of two major roads in concession by end-April 2005. Other important structural areas in which progress has been made include completing a census of government employees and pensioners and taking the first step toward reducing labor costs by eliminating the special payroll tax by year-end," Mr. Carstens said.

Statement by Javier Silva-Ruete, Alternate Executive Director for Peru and Carlos Pereyra, Advisor to Executive Director
November 19, 2004

1. Adherence to the program under the Stand-By Arrangement continues to result in strong economic performance. Growth has accelerated beyond projections, inflation is expected to remain within the annual target, and progress has been made to further diminish vulnerabilities. All end-September quantitative performance criteria were met. The authorities' reform program stresses the need to enhance competitiveness and improve the business climate, with the aim of ensuring sustained and equitable growth and facing the demands arising from greater trade openness. Delays in reform implementation are due solely to unexpected or technical factors—as explained in the authorities' request to reschedule the 2004 structural performance criteria—but the authorities' commitment remains intact. The domestic political debate is considerable, but the authorities' determination to push ahead with consistent policies is proving to have a much greater impact on market confidence. The recent approval by Congress of a constitutional amendment for the elimination of the preferential public pension regime reflects their ability to muster consensus around the main features of the reform program.

Macroeconomic Developments

2. GDP growth has exceeded program projections, and is now expected to be at least 4.5 percent for the year. The pickup in economic activity continues to be led by strong private investment and exports—with estimated growth rates of 6.5 percent and 17.8 percent, respectively, in the third quarter. Greater productive capacity and a growing presence in foreign markets enhance Peru's potential for broad-based, sustainable growth, free of inflationary and balance-of-payments pressures. Investment has grown steadily since the second half of 2002 on the back of important mining and energy projects, increasing corporate profits, and lower financial costs. Global recovery and favorable terms of trade continue to boost commodity exports—mainly mining products—and textile exports are expanding at unprecedented rates—35.7 percent year-on-year in the third quarter, in dollar terms.

3. The authorities remain committed to improving fiscal performance and strengthening debt sustainability. The balanced fiscal result as of September (-0.2 percent of GDP) is explained by buoyant collection performance associated with the level of economic activity, the continuation of administrative improvements—mainly the extension of the withholding tax system to a wider range of products and to imports—and tax measures introduced since the second half of last year—including the tax reform completed in early 2004. On the expenditure side, wages in the education sector and social expenditures increased above initial projections, but were offset, among other factors, by delays in the devolution of functions to sub-national governments. Measures to secure implementation of the latter will contribute to reverting the overperformance towards the end of the year, but the fiscal target of 1.4 percent of GDP will be achieved comfortably, and the 3 percent limit for real expenditure growth established in the Fiscal Responsibility and Transparency Law (FRTL) will be respected. The authorities' medium-term

macroeconomic framework envisages a decline in the fiscal deficit as a percentage of GDP to 1 percent in 2005, 0.9 percent in 2006 and 0.7 percent in 2007, and public debt would decrease from 45 percent of GDP in 2004 to around 39 percent in 2007.

4. Peru has maintained access to international capital markets, and sovereign spreads remain among the lowest in the Latin American region. Progress in public finances and a level of international reserves well above program projections—2.5 times short-term debt—have contributed to this positive outlook. In October, Peru issued a ten-year bond for 650 million euros—Peru's first in the euro-denominated market—with the aim of diversifying and increasing demand for Peruvian paper and completing financing needs for 2005. In order to reduce rollover and currency risks, the authorities continue to expand placements in longer-term local currency instruments through the primary dealer system initiated in March 2003. Thanks to greater market confidence, they are succeeding in extending maturities and flattening the yield curve for local-currency paper. As part of their strategy to improve Peru's debt profile, the authorities' are also considering a plan to pre-pay Paris Club creditors.

5. The inflation targeting framework adopted in 2002 aims at a 2.5 percent medium-term inflation target within a ±1 percent range, in the context of a floating exchange rate regime. Supply shocks, mainly increases in world oil prices and weak agricultural crops, generated a rise in inflation. Given the temporary nature of these pressures, the monetary authorities maintained their policy stance until July. However, in August and October they increased the central bank's reference interest rates to ensure meeting the inflation target in the medium-run through the reduction of monetary stimulus. Inflation has decreased to rates close to zero in the last three months, and twelve-month inflation is expected to converge to the upper bound of the target range (3.5 percent) at end-2004. The authorities are confident to bring inflation back to the mid-point (2.5 percent) in 2005.

6. Favorable balance of payments developments—mainly high international prices and growing export volumes—in addition to improving investor sentiment towards emerging markets and decreasing dollarization of the financial system, resulted in a clear appreciatory pressure on the currency since mid-2004. In this context, central bank interventions in the foreign exchange market were limited to those needed to confront excessive exchange rate volatility, without an implicit or explicit commitment to any given exchange rate level. This year the nominal exchange rate has appreciated by 5 percent, consistent with the favorable external accounts. Forex intervention has also contributed to increasing international reserves and thus reducing the probability of financial volatility in the runup to the next electoral period. The monetary policy setting has been instrumental in maintaining a stable interbank rate and in promoting bank intermediation.

Structural Reforms

7. The concession of a major copper project was successfully completed in August, and currently the authorities are pressing forward to bridge Peru's significant infrastructure deficit. They will continue to explore innovative financial mechanisms to enhance public

investment in a way that is fully consistent with fiscal targets and debt sustainability, and that ensures economic and social spillover effects on the economy, in line with the declaration issued on November 5, 2004 at the 18th Summit Meeting of Heads of State and Government of the Rio Group. The authorities also expect that the final report of the mission on public investment and fiscal policy will include an assessment of the long-term impact of infrastructure investment on fiscal accounts and output, as well as a deeper analysis of state-owned enterprises.

8. Crucially, the authorities will continue to promote greater private sector participation in this field:

   - The authorities have called for bids to award in concession the operation and maintenance of several airports and have completed the legal and regulatory process for the concession of a new port terminal in 2005.
   - The award of concession contracts or the establishment of public-private partnerships (PPPs) for the construction of two main roads—an end-December performance criterion—has been delayed by a few months due to technical factors, including mandatory environmental impact assessments. Therefore, the authorities request moving it to April 30, 2005. Altogether, concessions or PPPs for a total of four major roads would be completed over the next year.

9. On November 11, 2004, Congress approved the constitutional amendment needed to phase out the preferential public pension regime (*Cédula Viva*)—including the establishment of a maximum pension, the closure to new entrants, and the elimination of the costly link between wage increases and pensions. Effective political coordination and an adequate communications policy paved the way for the passage of the amendment in two legislative periods, as required by law. The reform will eliminate sharp inequities among pensioners and reinforce fiscal sustainability. Additionally, a draft plan for reforming the pension regimes of the police and the military has been completed by the Ministry of Economy and Finance. Inter-ministerial discussions to further elaborate this plan are now underway and are expected to be completed by end-December.

10. Greater transparency and accountability is expected to enhance market confidence in the authorities' commitment to fiscal discipline. A census of civil servants (end-September benchmark), which will help improve government resource management, has been completed. Also, the authorities have the intention to include sanctions in the Fiscal Responsibility and Transparency Law (FRTL) for officials responsible for meeting fiscal targets. With the aim of assessing the quality of expenditure, they are planning to put in place a system of performance indicators, which in a first stage will cover the education, health and transport sectors. They are also working towards implementing quarterly reporting of fiscal performance in 2005. These efforts are part of the strategy to create room for higher social and poverty-reduction spending over the medium-term.

11. In October, Congress approved legislation to eliminate the special wage tax (IES). Even though the tax had been gradually lowered over the last years, it continued to represent a significant labor cost. The authorities intend to offset the fiscal effect of the measure

through improved VAT and income tax collections. Phasing out regional and sectoral exemptions has proved challenging, but the authorities continue to negotiate with sub-national governments and press for congressional support.

12. The authorities continue to strengthen the legal framework for decentralization. Solid progress has been made towards the implementation of the law on the certification of subnational governments' administrative capacity by year-end. Regarding the implementation of a law clarifying shared responsibilities among the national, regional, and local governments (end-December benchmark), the authorities prefer to shift to an approach intended to secure consensus. Thus, they intend to clarify gradually such responsibilities through congressional approval of sectoral legislation or annual devolution plans and budgets. Consistent with the principles of the reform, they will adopt safeguards to avoid discontinuities in the provision of public services and will keep a close balance between resource constraints and responsibilities devolved. Adequate accountability mechanisms are crucial to ensure a gradual and fiscally neutral decentralization process, and towards this end the authorities plan to include procedures in the FRL to penalize or intervene sub-national governments that do not comply with fiscal rules.

13. The strategy to improve the business climate hinges crucially on increasing the transparency and efficiency of the legal system. Along these lines, a commercial court module to defend property rights, settle commercial disputes, and speed up contract enforcement will begin operating in December. Originally fixed as an end-September performance criterion, establishment of the court was delayed by unanticipated events—including a protracted judiciary strike. The authorities therefore request a waiver of non-observance, with a resetting to end-December.

14. In the financial sector: (i) the preparation and announcement of a plan to centralize the information of collateral registries has been delayed, but the government is committed to do so by end-December; (ii) progress is underway to ensure compliance by the Superintendence of Banks and Insurance Companies with the implementation by year-end of a system to measure currency risks; and (iii) the significant resources handled by private pension funds are critical for developing the domestic capital market. After raising the limits for private pension funds' investments abroad from 7.5 to 9 percent last year and to 10.5 percent this year, for the moment the authorities have reservations about raising them again. The follow-up FSAP mission will further analyze the private pension system.

15. The authorities are engaged in actively pursuing regional and bilateral free-trade agreements (FTAs). Steps have been taken to further the FTA with Thailand, and Peru is part of the recent agreement between Mercosur and the Andean Community. The authorities have continued negotiations for an FTA with the U.S., and aim at completing discussions by early 2005. The FTA is expected to make permanent the benefits reaped under the Andean Trade Promotion and Drug Eradication Act (ATPDEA) with the U.S. Particularly, it will encourage export diversification and provide a platform for accelerating critical reforms geared to attract private investment.

16. The authorities are firmly committed to achieving the program's goals. While they agree that political economy developments should be given due consideration, in their opinion there is no clear evidence of significant risks to program implementation associated with political uncertainty. Therefore, they suggest that political risks be put in proper perspective to provide a balanced assessment.