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Peru: Staff Report for the 2010 Article IV Consultation

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on March 12, 2010 with the officials of Peru on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 14, 2010. 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 supplement to the staff report.

- A Public Information Notice (PIN).

- A statement by the Executive Director for Peru

The document(s) listed below will be separately released.

Selected Issues Paper

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

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INTERNATIONAL MONETARY FUND

PERU

March 26, 2010

Peru: Staff Report for the 2010 Article IV Consultation

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

Approved by Rodrigo Valdés and Dominique Desruelle

Crisis resilience followed by strong growth. Peru's resilience to the global crisis owes to its sound economic fundamentals and past prudent policies, which allowed building fiscal and international reserve buffers and implementing a timely countercyclical policy response. Peru's growth is expected to rebound strongly, with upside risks from renewed capital inflows and domestic demand dynamics. Downside tail risks could arise from a relapse in global growth and return in global risk aversion.

Focus of the consultation. Discussions focused on: (i) how to graduate the withdrawal of the accommodative policy stance in a timely manner to limit the risk of inflationary pressures later in the year; (ii) policy challenges of large and sustained capital inflows; and (iii) reforms to sustain high growth over the medium term and to solidify further Peru's policy framework.

Key policy issues. Staff viewed the policy response to the global crisis as timely and effective and supported the authorities' policy plans amid a strong rebound in growth. With upside risks to the outlook, the withdrawal of policy stimulus would need to be graduated early on, with the consolidation of the fiscal stance preceding the tightening of the policy rate to limit incentives for carry trade. To deal with a surge in capital inflows, the sequencing of the policy response should be complemented by macro-prudential measures to prevent credit and asset booms and exchange rate flexibility to avoid one-side bets. Peru's bright prospects over the medium term hinge importantly on the authorities' ambitious reform agenda to boost competitiveness and innovation, develop the domestic capital market, and further solidify the policy framework.

Exchange Rate Regime. The exchange regime is classified as floating (Informational Annex). Peru has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Mission. A staff team comprising M. Kaufman (head), M. Garcia-Escribano, L. Medina and M. Vera Martin (all WHD), I. Rial (FAD), and P. Imam (MCM) conducted the discussions in Lima during March 1−12. L. Breuer (Senior Resident Representative) assisted the mission and O. Hendrick (OAD) participated in the meetings. R. Valdés (WHD) joined the concluding meetings.

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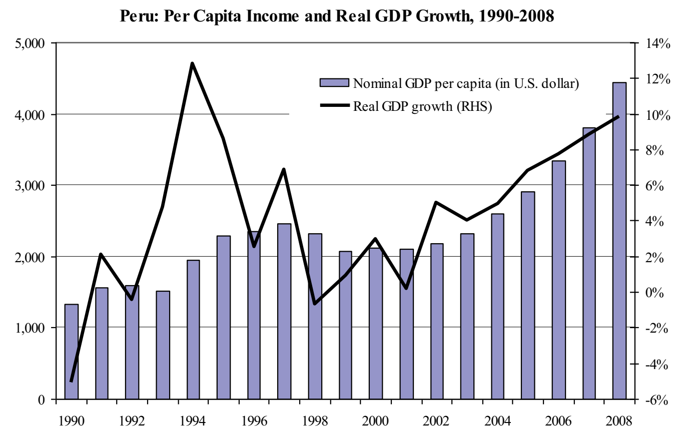
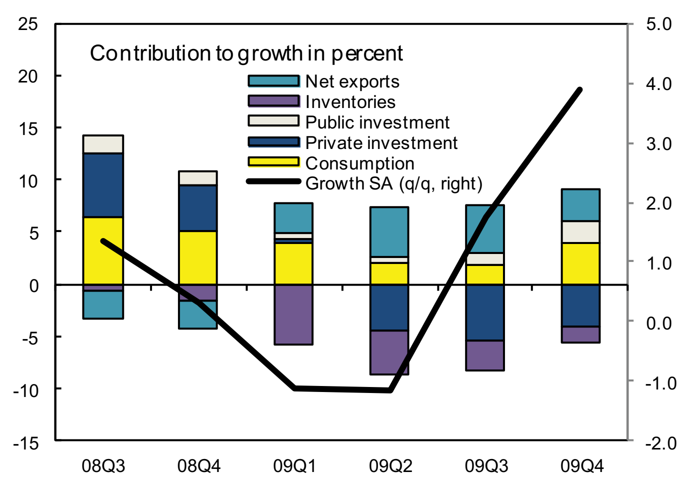
I. Background: Peru's Resilience to the Crisis

1. Peru's economic performance over the last decade has been outstanding by domestic and international standards. Strong economic fundamentals, including a sound institutional policy framework, and a solid track-record of prudent macroeconomic policies helped reduce vulnerabilities, achieve record-high economic growth, and advance significantly with poverty reduction. Economic activity experienced a 10-year expansion, the longest on record, with a cumulative growth of about 50 percent. In turn, real per-capita income grew 40 percent over this period. This resulted in strong employment creation and a significant reduction in poverty to 36 percent in 2008 from 55 percent in 2000. Reflecting on these achievements, Peru was granted investment grade by Fitch and Standard & Poor's in 2008 and by Moody's in late 2009. Peru's bright medium-term prospects remain unimpaired, linked to an ambitious reform agenda and the expected preservation of macroeconomic stability. The economic resilience during the recent global financial crisis has consolidated Peru's standing among emerging markets and is expected to become a major recipient of foreign investment.



2. As a result of the global crisis, activity in Peru decelerated sharply in 2009 but began to rebound in the second half of the year. Following exceptionally high growth in 2008 (9.8 percent) and emerging signs of overheating, growth declined substantially in 2009, with a few months in negative territory, but remained positive at about 1 percent for the whole year (Appendix 1). The downturn was primarily linked to the collapse in global trade and uncertainty about global growth, temporarily amplified by a large inventory correction in Peru. Net FDI flows stopped in the last quarter of 2008 but rebounded in 2009. The external current account shifted from a deficit to a small surplus as the decline in exports—primarily as a result of lower terms of trade in the first half of the year—was more than compensated by the slowdown in import growth. In contrast with previous economic cycles—where both investment and



consumption dragged down on growth—private investment (including inventories) fell by 30 percent in real terms but consumption proved more resilient thanks to sustained employment. Inflation, which peaked at 6.7 percent in December 2008, fell to near zero in the second half of 2009, partly because of the decline in food and fuel prices. Core inflation declined more sluggishly, to near 2 percent (the mid-point of the target range) by end–2009. Real activity gained traction in the second half of 2009, supported by the acceleration in the execution of the fiscal stimulus; the lagged impact of the monetary easing; the completion of the inventory destocking cycle; and better terms of trade and global recovery prospects. In the last quarter of 2009, the economy grew by over 15 percent (qoq, saar annualized).

3. Peru's strong policy framework and proactive response were key to limit the impact of the crisis and to the ensuing economic rebound. Thanks to the strong buffers built in recent years, Peru was able to implement a significant monetary and fiscal policy response, which helped avoid a credit crunch, support economic activity and sustain employment. As a result, the economy endured limited slack in resource utilization.

- **The direct financial impact of the global crisis was contained.** During the period of heightened global risk aversion and deleveraging, the central bank injected substantial liquidity in the system, both in Soles and U.S. dollars, to prevent a liquidity squeeze and credit crunch. Credit growth decelerated significantly but remained positive in 2009. The central bank also intervened significantly in the foreign exchange market to limit currency volatility associated with the unwinding of carry trade operations and domestic portfolio re-allocation, including some deposit re-dollarization (Appendix 2).

- **The policy interest rate was lowered significantly to support economic activity.** Once currency pressures abated, the central bank acted proactively to reduce the policy rate by 525 bps since early 2009 to a historic-low of 1¼ percent. Lending rates to the private sector also declined in line with the policy rate.

- **A substantial fiscal stimulus plan has been implemented.** The fiscal stimulus, largely financed with fiscal savings, aimed to sustain domestic demand and boost business confidence. It entailed a positive fiscal impulse of about 2½ percent of GDP in 2009, with an increase in real general government primary spending of 14 percent. The fiscal plan also included contingency measures including guarantees to support corporates, exporters and smaller financial institutions, which in the end were not needed.

4. Peru's banking sector proved resilient to the global crisis, with solid financial indicators. The banking system was well-positioned to weather the global financial crisis, with a regulatory and supervisory framework that had been strengthened substantially in past years, including through the introduction of dynamic provisioning in 2008 (Appendix 3). Short-term foreign financing was limited, thanks in part to prudential reserve requirements. Banks remained well-capitalized, liquid, and profitable during 2009. The impact of the economic slowdown on portfolio quality was limited, as non-performing loans increased modestly to 2.8 percent in January 2010 from 2.2 percent in 2008. Stress testing performed by the Superintendence of

Banks and Insurance (SBS) showed that banks remain well prepared to absorb future potential losses.

5. Peru's external financial account also proved resilient, with a recent resurgence of capital inflows and some appreciation pressures. A quick recovery of net FDI flows (which diminished slightly to a still-high 3 percent of GDP) and strong public sector flows compensated for portfolio outflows, partly driven by domestic pension funds. The public sector took advantage of improving global market conditions during 2009 and issued debt (US$2 billion) for pre-financing operations and full repayment of Paris Club debt. The Sol recovered its pre-Lehman level against the U.S. dollar by November 2009, and has appreciated by 5 percent in nominal and real effective terms since then. Recent appreciation pressures have been associated with portfolio re-allocation of domestic agents, including pension funds, and some foreign portfolio inflows. These pressures have been intermittent since late last year, with temporary respites during episodes of heightened global volatility linked to sovereign risk developments in other regions. As of March 24, the central bank has bought US$2.3 billion so far this year to moderate volatility.

II. Outlook: Strong Growth with Upside Risks

6. The economy is expected to grow strongly this year, with limited slack in resource utilization thanks to the successful policy response. With the recovery already taking place, a sustained improvement in global conditions and the remaining policy stimulus, staff projects growth at 6¼ percent this year and 6 percent in 2011. The stimulus plan has a residual impulse in 2010, with real government spending projected to grow at 7 percent, and monetary conditions remaining accommodative. Peru's recovery appears less dependent on policy support than in other advanced and emerging market economies, as it did not open a significant output gap and the balance sheets of the corporate, household, and financial sectors remain unimpaired. Inflation is expected to converge to the middle of the target range in the second half of the year, with upside risks from food and fuel price developments. Renewed appreciation pressures could materialize, linked to the re-emergence of capital inflows.

7. Overall, the balance of risks to growth in Peru appears tilted to the upside. Prospects of renewed capital inflows to strong emerging markets and domestic demand dynamics, including the cyclical rebuilding of inventories and an acceleration of private investment projects put on hold last year, could intensify growth momentum this year and next. The combination of a relapse in global growth and a return of global risk aversion is the principal tail risk that could encumber the growth outlook. Moreover, a strong El Niño weather effect this year could generate negative economic disruptions, while the upcoming electoral cycle—municipal and regional elections set for October 2010 and presidential elections for April 2011—could potentially dampen private investment temporarily.

8. The medium-term economic outlook is bright, with prospects for sizable capital inflows. Peru's potential growth is expected to remain elevated at about 5¾ percent over the medium term, somewhat lower than the rate prevailing before the global crisis due in part to the envisaged reduction in trend global growth.[1] The current account deficit is projected to fluctuate between 2 and 3 percent of GDP as global conditions normalize. Overall, the fiscal deficit is expected to decline gradually to a balanced budget, while public debt ratios will continue to decline to about 20 percent of GDP. Underpinned by continued prudent macroeconomic policies, Peru's strong economic outlook hinges on the authorities' ambitious reform agenda. Peru's solid fundamentals and bright economic prospects could stimulate large and sustained capital inflows that could test the absorption capacity of the economy and pose significant policy challenges. Such scenario would likely result in stronger private investment and a widening of the current account over the medium term.

III. Policy Discussions: Challenges From Upside Risk and to Preserve Medium-Term Growth

9. Discussions centered on:

- *The appropriate policy response to the strong recovery*. With increasing evidence of a self-sustained rebound, policies need to be graduated early on toward a neutral stance as Peru avoided opening a significant output gap.

- *Challenges associated with easy external financing conditions and renewed capital inflows.* Discussions focused on the sequencing of policy normalization and complementary tools to prevent credit and asset booms.

- *Reforms to sustain high growth over the medium term*. These include continuing with Peru's global integration; improving competitiveness and innovation; and developing domestic capital markets. Attention would also be needed on education, labor markets, economic/judicial institutions, and civil service reform.

- *Reforms to strengthen the institutional framework.* These include reviewing the current fiscal framework to reduce pro-cyclicality and further strengthening the prudential framework, guided by the emerging lessons from the global financial crisis.

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[1] See the selected issues paper "Potential Growth and Output Gap in Peru" for a detailed analysis on this topic.

Policy Challenges of Strong Growth and Easy External Financing Conditions

Graduating the macroeconomic policy stance

10. Evidence of a self-sustained private-led recovery will need to be assessed against the potential buildup of domestic demand pressures. The normal lags in the transmission of fiscal and monetary policies calls for careful monitoring of the pace of the recovery, given Peru's success in avoiding a significant slack in resource utilization. The authorities expected growth in the first semester to be driven by the remaining fiscal stimulus, accommodative monetary conditions and inventory restocking, with private sector-led growth taking over in the second semester. They indicated that the global outlook remained subdued, with risks to the strength of the recovery in Peru.

11. Graduating the withdrawal of policy stimulus in a timely manner would be crucial to avoid the risk of a buildup in inflationary pressures later in the year. The authorities agreed that a sustained recovery would reduce the need for policy support and entail the need to move the policy stance toward a more neutral position. Sustaining the policy stimulus on top of a private-sector led recovery would heighten the risk of inflationary pressures in the second part of the year. The authorities expressed that they were aware of the challenges and ready to take action as needed.

12. With global financial conditions conducive to renewed capital inflows, the sequencing of policy withdrawal would need to be complemented by a combination of prudential tools. The authorities noted that, to limit incentives for carry trade inflows, it will be beneficial to start consolidating the fiscal stance in advance of increasing policy interest rates. Moreover, they noted that, in such circumstances, normalizing accommodative monetary conditions may rely on a combination of quantitative measures, including reserve requirements, and the policy interest rate, which will help re-build liquidity buffers in the financial sector. The authorities noted that reserve requirements proved an effective tool in Peru's dollarized economy during the period of abundant global liquidity and capital inflows to build prudential buffers in the financial system, and during the global financial crisis to inject liquidity and avoid a credit squeeze. The authorities agreed that the sequencing of the fiscal and monetary policy withdrawal may need to be accompanied by the implementation of macro prudential measures to prevent credit and asset booms. Staff noted that it would be important to exercise heightened vigilance for potential one-side bets, for which greater exchange rate flexibility could reduce incentives.

13. Peru has room to provide additional policy stimulus to limit the fallout of a relapse in global growth. The authorities noted that the infrastructure and maintenance projects implemented in 2009 proved effective to help sustain economic activity and employment. They noted that the current low policy interest rate would require to recourse to non-traditional or quantitative measures, including acting along the sovereign yield curve. If global risk aversion returns and financial conditions worsen, the central bank would have room to inject liquidity in soles and U.S. dollars into the system.

14. The authorities agreed that the real effective exchange rate was broadly in line with fundamentals. The authorities noted that the overarching objective of the intervention policy has been to mitigate the volatility of the exchange rate and its potential balance-sheet effects in the context of a still highly dollarized economy, with no pre-determined target on the level of the currency. The latest CGER estimates suggested that the Sol is within the range of its equilibrium value, with some indicators suggesting a slight overvaluation and others a slight undervaluation, all within a 5−10 percent range (Appendix 4). The authorities concurred with this assessment. Staff agreed that a precise assessment was difficult to undertake at this juncture given, inter alia, the uncertainties about the impact on global trend growth and commodity prices, and the resolution of global imbalances and potential exchange rate adjustments of advance and major emerging economies.

15. Bringing the fiscal stance to a neutral position would help regain fiscal cushions and manage prospective large and sustained capital inflows to Peru. The authorities agreed that fiscal spending would need to be managed carefully to gradually lower the fiscal deficit, and return in 2011 to the 1 percent of GDP deficit limit established by the Fiscal Responsibility and Transparency Law. This will also help preserve fiscal cushions which proved very important to be able to respond to the global crisis, and prepare for the risk of a relapse in global growth. They also concurred that the mounting liabilities of the Oil Price Stabilization Fund (FEPC) would need to be addressed in the short run to avoid the buildup of large debt obligations. The authorities' projection of an overall deficit of 1.6 and 1.0 percent of GDP for 2010 and 2011 would help reduce the structural deficit that resulted from the fiscal stimulus plan, with additional efforts needed in later years. Staff noted that, as the urgency to undertake infrastructure projects wanes, it would be important to continue safeguarding the quality of public investment projects. Staff also encouraged the authorities to review some of the more unconventional measures taken during the response to the global crisis.

Peru: Fiscal Performance 2007-10 1/
(Percent of GDP)

	2007	2008	2009	2010p
Revenues	20.8	21.0	18.6	19.3
Expenditures	16.0	17.3	19.5	19.6
of which				
Current	12.9	13.2	13.8	13.7
Capital	3.1	4.1	5.7	5.9
NFPS Overall Balance	3.3	2.0	-2.0	-1.5
Fiscal Impulse	-1.2	1.1	2.4	0.1

1/ General Government.

Financial Sector Resilience with Further Strengthening of the Prudential Framework

The global financial crisis highlighted the strength of the prudential framework, and the authorities remain strongly committed to enhancing it further, by applying the lessons from the global crisis. Regulatory norms on capital, liquidity and dynamic provisioning are ahead international standards. Nevertheless, the authorities indicated that they are proactively taking steps to incorporate the lessons from the global financial crisis, including broadening further the regulatory perimeter to bring cooperative banks and Banco de la Nacion (publicly owned bank) fully under the umbrella of the SBS. They have also established additional capital requirements linked to the assessment (stress testing) and risk of borrowers' FX credit risk, which will become effective in July 2010, to further promote that banks internalize such risk. The authorities are also analyzing ways to increase cross-border collaboration with other supervisors, including improved information sharing. They noted that important steps have been taken to improve macro-prudential supervision, with meetings at the highest level being regularly conducted. The authorities are considering various initiatives being discussed at the international level, including capital requirements for systemic risk; strengthening the crisis resolution framework; and improving liquidity provisioning under systemic stress.[2]

16. Further de-dollarization will allow higher exchange rate flexibility. The authorities indicated that, over the coming years, Peru's improved fundamentals will continue fostering de-dollarization and allow further exchange rate flexibility. They noted that, with a substantial reduction in financial dollarization over the last decade, the Sol has shown greater currency volatility in recent years. Staff concurred that this de-dollarization trend has been the result of macroeconomic stability, a solid prudential framework, and a developing capital market in Soles.[3] Peru's successful management of the worst global financial crisis since the great depression has boosted confidence in the local currency and lending in Soles. The authorities noted that their reform agenda to develop mortgages in local currency and other necessary financial instruments should further contribute to de-dollarization. Staff indicated that a gradual increase in currency volatility will also foster the development of FX hedging instruments and markets to manage currency risk in the corporate and financial sectors, and further support the de-dollarization process. In this context, the exchange rate would be able to play a larger role as a shock absorber.

Reforms to Maintain High Growth and Enhance the Policy Framework

Medium-term Policies to Sustain High Growth

17. Peru's bright economic prospects would benefit from the implementation of the authorities' ambitious reform agenda to preserve high growth over the medium term. Staff concurs that growth will need to be increasingly driven by higher productivity growth over the medium term, with the current drivers of growth centered on capital accumulation and employment of under-utilized resources (labor, land and natural resources). Key pillars of the authorities' strategy include: (i) global integration through free trade agreements with the United States, Europe and Asia (where substantial progress has been made); (ii) enhancing competitiveness by improving the business environment (lowering, inter alia, the cost of setting up and conducting business and fostering innovation); and (iii) developing domestic capital

[2] A selected issue paper "Progress in Strengthening Peru's Prudential Framework" takes stock of financial sector reforms since 2005 FSAP Update, in preparation for the upcoming FSAP Update in the fall of 2010.

[3] A selected issue paper "Drivers of De-Dollarization" analyzes the factors behind the de-dollarization of credit and deposits since the implementation of the inflation targeting framework.

markets (Appendix 5). Staff welcomed the authorities' efforts to lay out plans in key reform areas over the next years. Areas that would require early attention include: education, labor markets, economic/judicial institutions, and civil service reform.

18. **The authorities have an ambitious agenda to develop the domestic capital markets**. A deeper capital market would be important to effectively channel resources in the economy. The actual and potential demand for domestic assets has increased substantially in recent years, but the supply of assets has been limited. While structural factors—economic size and selective nature of issuers—are part of the challenges to overcome over the medium term, regulations and taxation issues could be reviewed to ensure that they remain conducive to fostering the expansion of assets available. The authorities noted that steps are being taken to develop the mortgage market in Soles through the creation of a covered bond instrument, and to foster the development of key financial instruments such as the repo and interest rate swap markets that would facilitate lending in Soles. Moreover, the authorities intend to strengthen the function of the Security and Exchange Commission (CONASEV) which would help ease access to the domestic capital markets. In this context, the authorities noted that an agreement to integrate the Chilean, Colombian and Peruvian stock markets by 2011 could be expected to increase investible assets for AFPs of all countries and increase market liquidity.

19. **Peru's progress in poverty reduction has been preserved during the global financial crisis, and there is a strong commitment to continue implementing the poverty alleviation strategy.** Poverty declined significantly from 44½ percent in 2006 to 36 percent in 2008, thanks to strong economic growth and efforts to prioritize social spending. Despite the sharp deceleration in growth in 2009, the gains in poverty alleviation were preserved as the fiscal stimulus plan helped sustain employment and protected social spending. The authorities' efforts to improve the quality of social spending have included the strengthening of the *Inter-ministerial Committee for Social Assistance* (CIAS); the consolidation and focusing of social programs; increased coverage and resources for some social programs (in particular for the conditional cash-transfer program, *Juntos*); and improvements in the provision of public health and education. Staff welcomed the authorities' strong commitment to continue fighting poverty. The authorities stressed that they will continue implementing their poverty alleviation strategy *Crecer*, focusing on further addressing targeting challenges, including through the creation of a single registry of beneficiaries, and improving the quality of social programs through performance indicators.

Solidifying the Policy Framework

20. **While the Fiscal Responsibility and Transparency Law (FRTL) has been instrumental for fiscal consolidation, the authorities showed interest in exploring ways to reduce cyclicality.** Staff underscored that the current FRTL framework has been essential to Peru's successful fiscal consolidation. However, controlling spending has been challenging and caps frequently proved to be difficult to enforce, particularly at the sub-national level. The use of structural balance indicators could facilitate and focus budget discussions on sustainable medium-term expenditure plans, anchor prudent fiscal policies over a longer horizon, and reduce the potential pro-cyclicality of other fiscal targets. The authorities concurred that a structural

balance approach can be demanding in terms of the economic and institutional prerequisites and require lengthy preparatory steps. The design of the FRTL (with deficit and expenditure growth limits) has an embedded flexibility to adapt to evolving objectives. Staff suggested that adjusting the current parameters—mainly through changes in expenditure caps—could shift the focus of fiscal policy closer to a structural balance approach, reducing its potential pro-cyclical bias and retaining debt limit objectives, which still remain important to the authorities.[4]

21. Strengthening the Oil Price Stabilization Fund (FEPC) can improve its effectiveness and reduce fiscal risks. At current prices, the potential liability of the FEPC would amount to ½ percent of GDP in 2010.[5] The authorities are considering moving to a rule-based adjustment of the price bands to ensure that the FEPC is self-financed, and to an automatic settlement of liabilities. A gradual but frequent adjustment of the reference price can help minimize disruptive effects on other prices and avoid the buildup of large price differentials and debt obligations. This could be facilitated by placing the oversight of the FEPC under a technical regulatory agency. Staff suggested that the changes in the FEPC framework could be accompanied by a mechanism to minimize the effects on the more vulnerable segments of the population.

22. Several initiatives on the fiscal front would improve the quality and efficiency of public spending. Staff commended the authorities' strong resolve to improve the quality and efficiency of public spending, including introducing performance indicators for some budgetary items and fostering capacity building at the sub-national level. Staff also welcomed the authorities' efforts to assess the potential medium–term implications of contingent fiscal liabilities, including those derived from the public-private partnerships (PPP) and remaining public sector pension schemes. The authorities indicated that they are well aware of the importance of maintaining appropriate risk sharing between the public and private sector in PPP initiatives. Staff supported the authorities' continued efforts to strengthen the financial management information system (SIAF), as well as the efforts to broaden the tax base and protect the integrity of tax administration.

23. Peru is likely to experience a persistent shift in investor preference, with large and sustained capital inflows beyond the current juncture of easy external financial conditions. Inflows, especially FDI, would support the authorities' strategy to upgrade economic productivity and boost potential growth. However, large capital inflows can pose significant macroeconomic

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[4] The selected issues paper "Performance of Alternative Fiscal Frameworks: An Application to Peru" explores the topic in detail.

[5] The mechanism involves a price band for the wholesale domestic price and an international reference price. When the international price is above the band, the FEPC compensates wholesale distributors that keep prices within the band. Similarly, distributors must compensate the FEPC when the reference price drops below the lower band limit. For more details on the determination of the price band, please see IMF Country Report No. 09/40 (2009).

and policy challenges. Staff emphasized the challenges associated with the composition of inflows, the widening of the current account and appreciation of the currency, potential credit booms and asset bubbles, and the risk of reversal and economic volatility. The authorities concurred that it is important to prepare in advance for those challenges. The lessons of the international experience point to some key elements, including a fiscal policy that creates space for private investment, the role of exchange rate flexibility, and macro-prudential instruments to avoid credit and assets price booms.[6]

IV. Staff Appraisal

Macroeconomic Policy

24. Given Peru's upside risks to growth and limited output gap, a key policy challenge will be to graduate the withdrawal of policy stimulus early on to mitigate the risks of a buildup in inflationary pressures later in the year. The normal lags in the transmission of fiscal and monetary policies call for careful monitoring of the pace of the recovery. Evidence of a self-sustained private-led recovery will need to be assessed against the potential buildup of domestic demand pressures, given Peru's success in avoiding a significant slack in resource utilization. Graduating the withdrawal of policy support in a timely manner would be crucial to avoid building inflationary pressures later this year.

25. Global financial conditions conducive to a renewed surge in capital inflows would call for sequencing the withdrawal of policy stimulus and using a combination of tools. Staff supports the authorities' view that, to limit incentives for carry trade inflows, it will be beneficial to start consolidating the fiscal stance in advance of increasing policy interest rates. Moreover, staff concurs that, in such circumstances, normalizing accommodative monetary conditions may rely first on reserve requirements before increasing the policy interest rate. The sequencing of the fiscal and monetary policy response may need to be implemented in coordination with macro prudential measures to prevent credit and asset booms, which Peru appears well prepared for, and by heightened vigilance for potential one-side bets, for which greater exchange rate flexibility could reduce incentives.

26. Should a relapse of global conditions materialize, Peru has space to provide additional policy stimulus to limit the fallout. As with the fiscal stimulus implemented in 2009, infrastructure and maintenance projects can prove effective to help sustain domestic demand and

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[6] A selected issues paper "What to Expect when you are Expecting…Large Capital Inflows?" provides lessons with episodes of large capital inflows in emerging markets.

employment. However, the limited scope for reducing further the policy interest rate would call for other monetary measures. The central bank would also have room to inject liquidity in the system if global risk aversion returns and financial conditions worsen.

27. Over the coming years, Peru's improved fundamentals will foster further de-dollarization and allow the exchange rate to play a larger role as shock absorber. Peru has shown greater currency volatility in recent years, which coincides with a substantial reduction in financial dollarization over the last decade. Moreover, the successful management of the worst global financial crisis since the great depression has boosted confidence in the local currency and lending in Soles. The authorities' reform agenda to develop mortgages in local currency and other necessary financial instruments should further contribute to de-dollarization. A gradual increase in currency volatility will foster the development of FX hedging instruments and markets to manage currency risk in the corporate and financial sectors, and further support the de-dollarization process. In this context, the exchange rate would be able to play a larger role as a shock absorber, including to large and persistent capital inflows.

28. Gradually returning to a neutral fiscal stance would help regain fiscal cushions and manage prospective large and sustained capital inflows to Peru. Fiscal spending plans should be administrated carefully to achieve a declining path for the fiscal deficit and return in 2011 to the limit of 1 percent of GDP established by the Fiscal Responsibility and Transparency Law. In addition, the mounting liabilities of the FEPC should be addressed in the short run to avoid the buildup of large debt obligations. A timely consolidation of the fiscal stance would allow regaining fiscal space in case of a relapse in global conditions. Peru's success in reducing public debt and building financial cushions was essential to have the fiscal space and credibility to launch a substantial stimulus plan, with no offsetting effect on interest rates. In addition, fiscal consolidation, by creating space for the private sector, can be a valuable tool to address the macroeconomic challenges of large and sustained capital inflows, a likely scenario for Peru. These inflows, particularly FDI, would support the authorities' reform agenda to sustain high growth over the medium term, but may also promote excessive domestic demand growth and risk taking.

Medium–Term and Structural Issues

29. Peru's bright economic prospects would benefit from the implementation of the authorities' ambitious reform agenda to preserve high growth over the medium term. Underpinned by continued prudence in macroeconomic policies, staff concurs that growth will need to be increasingly driven by higher productivity growth over the medium term, for which the authorities' reform strategy is critical. Moreover, the authorities' efforts to lay out plans in key structural reform areas are essential to facilitate the reform process over the next years. Areas that would require early attention include: education, labor markets, economic/judicial institutions, and civil service reform.

30. The development of Peru's capital market is a key area to effectively channel domestic and external resources to sustain capital formation. Staff supports the authorities' initiatives to develop the mortgage market in Soles and to foster the development of key financial instruments that would facilitate long-term lending. Moreover, the authorities' intention to strengthen the function of the Security and Exchange Commission (CONASEV) could help ease access to the domestic capital markets. Limited market size and regulatory incentives of pension funds may contribute to market volatility and inefficient price discovery.

31. The authorities' commitment to further solidifying Peru's strong prudential framework, incorporating the lessons from the global financial crisis, is essential to address an evolving international financial architecture environment. Peru's regulatory and supervisory framework includes features that have been ahead of the international practice. The challenge going forward would be to reassess the prudential framework against a moving international standard and how to incorporate those aspects most relevant for Peru. In particular, the strengthening of agency coordination for macro-prudential supervision is an important step, and formalizing the institutional mechanism could further enhance its effectiveness. Other areas to consider include assessing the scope for incorporating systemic risk into the prudential framework, reviewing the crisis resolution framework, and fully extending the prudential perimeter to cooperatives and public financial institutions.

32. Building on the success of Peru's Fiscal Responsibility and Transparency Law (FRTL) in reducing public debt, the focus of the current framework could shift toward mitigating potential pro-cyclical effects. Adjusting the current parameters of the FRTL could shift the focus of fiscal policy closer to a structural balance approach, reducing its potential pro-cyclical bias and retaining debt limit objectives. Staff supports the authorities' intentions to report as part of the fiscal balance and debt measures the government certificates of future payments issued as part of the partial completion of PPP investment projects (CRPAOs). Staff also welcomes the authorities' initiatives to improve capacity building at the sub-national level as a way to enhance the effectiveness and quality of public spending.

33. Strengthening the FEPC can improve its effectiveness and reduce significant fiscal risks. Staff welcomes the authorities' intention to move to a rule-based adjustment of the price bands to ensure that the FEPC is self-financed. In addition, gradual but frequent adjustments of the reference price can help minimize disruptive effects on other prices and avoid the buildup of large price differentials and debt obligations. This could be facilitated by placing the oversight of the FEPC under a technical regulatory agency. The changes in the FEPC framework could also be accompanied by a mechanism to minimize the effects on the more vulnerable segments of the population.

34. It is expected that the next Article IV Consultation will take place on the standard 12-month cycle.

Table 1. Peru: Selected Economic Indicators

	2005	2006	2007	2008	2009	Projections 2010	2011
Social Indicators							
Life expectancy at birth (years)	70.7	72.8	73.1	73.3	...	...	...
Infant mortality (per thousand live births)	22.8	18.9	17.2	17.0	...	...	...
Adult literacy rate	87.9	88.7	89.6	…	...	...	...
Poverty rate (Total) 1/	48.7	44.5	39.3	36.2	...	...	...
Unemployment rate	9.6	8.5	8.4	8.4	8.6	...	...
(Annual percentage change; unless otherwise indicated)							
Production and prices							
Real GDP	6.8	7.7	8.9	9.8	0.9	6.3	6.0
Real domestic demand	5.8	10.3	11.9	12.1	-2.9	7.4	7.0
Of which: Private sector	5.9	9.0	11.4	12.6	-2.1	4.9	6.2
Consumer Prices (end of period)	1.2	1.1	3.9	6.7	0.2	2.0	2.0
Consumer Prices (period average)	1.6	2.0	1.8	5.8	2.9	1.5	1.8
External sector							
Exports	35.6	37.2	17.0	13.1	-14.7	19.7	10.0
Imports	23.2	22.9	32.0	45.1	-26.1	21.4	13.4
Terms of trade (deterioration -)	5.9	28.3	3.4	-13.7	-0.8	3.7	1.1
Real effective exchange rate (depreciation -) 2/	-0.5	-1.3	-0.6	4.9	2.4	...	...
Money and credit 3/ 4/							
Liabilities to the private sector	18.4	8.8	22.7	24.2	6.2	14.7	14.0
Net credit to the private sector	16.3	6.2	30.8	31.5	1.7	14.4	14.1
(In percent of GDP; unless otherwise indicated)							
Public sector							
General government current revenue	18.0	19.9	20.7	20.9	18.5	19.2	19.0
General government noninterest expenditure	16.8	16.3	16.0	17.3	19.5	19.6	18.9
Combined public sector primary balance	1.6	4.1	5.1	3.7	-0.7	-0.2	0.3
Interest due	1.9	1.9	1.8	1.6	1.3	1.3	1.3
Combined public sector overall balance	-0.3	2.2	3.3	2.2	-2.0	-1.5	-1.0
Combined public sector overall balance (including CRPAOs)	-0.3	2.1	2.2	1.5	-2.4	-1.6	-1.0
External Sector							
External current account balance	1.4	3.1	1.3	-3.7	0.2	-0.7	-1.8
Gross reserves							
In millions of U.S. dollars	14,120	17,329	27,743	31,250	33,190	35,690	37,190
Percent of short-term external debt 5/	314.2	174.9	405.3	421.1	397.5	473.7	481.4
Percent of foreign currency deposits at banks	131.0	148.2	208.7	175.0	190.3	180.6	182.3
Debt							
Total external debt	36.1	30.8	32.4	28.9	32.3	28.6	29.6
Combined public sector debt (including CRPAOs)	37.7	33.2	30.9	25.7	27.4	26.7	25.6
External 6/	28.1	23.9	19.9	16.7	17.4	15.8	15.1
Domestic	9.7	9.2	11.0	9.0	10.0	10.9	10.6
Savings and investment							
Gross domestic investment	17.9	20.0	23.0	26.7	20.6	23.3	24.9
Public sector 7/	2.9	2.8	3.1	4.2	5.3	6.0	6.0
Private sector	15.0	17.2	19.9	22.5	15.3	17.3	18.8
National savings	19.3	23.1	24.2	23.0	20.8	22.6	23.1
Public sector 8/	2.6	5.1	6.0	6.1	3.4	4.2	4.7
Private sector	16.8	18.0	18.3	16.9	17.4	18.4	18.4
External savings	-1.4	-3.1	-1.3	3.7	-0.2	0.7	1.8
Memorandum items							
Nominal GDP (S/. billions)	261.7	302.3	335.2	372.6	381.7	415.5	449.3
GDP per capita (in US$)	2,917	3,340	3,797	4,446	4,356	4,950	5,147

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; ECLAC 2002-03; National Statistical Institute (INEI); and Fund staff estimates/projections.
1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.
2/ Based on Information Notice System.
3/ Corresponds to the banking system.
4/ Foreign currency stocks are valued at end-of-period exchange rates.
5/ Short-term debt is defined on a residual maturity basis, and includes amortization of medium- and long-term debt.
6/ Includes debt by the Central Reserve Bank of Peru.
7/ Includes CRPAOs.
8/ Excludes privatization receipts.

Table 2. Peru: Fiscal Operations of the Combined Public Sector

(In percent of GDP; unless otherwise indicated)

						Projections	
	2005	2006	2007	2008	2009	2010	2011
Central government primary balance	**1.1**	**3.2**	**3.4**	**3.6**	**-0.6**	**0.6**	**1.2**
Revenue	15.8	17.6	18.3	18.3	16.0	16.3	16.8
Current	15.6	17.4	18.2	18.2	15.9	16.2	16.7
Of which : Tax revenue	13.6	15.1	15.7	15.6	13.8	14.5	14.7
Capital	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Noninterest expenditure	14.7	14.3	14.9	14.8	16.6	15.7	15.6
Current	12.8	12.3	12.7	12.4	12.7	11.9	11.7
Capital	1.9	2.0	2.2	2.4	3.9	3.8	3.9
Rest of the general government primary balance	**0.3**	**0.4**	**1.4**	**0.1**	**-0.3**	**-0.9**	**-0.9**
General government primary balance	**1.4**	**3.7**	**4.8**	**3.7**	**-0.9**	**-0.3**	**0.2**
Revenue	18.1	20.0	20.8	21.0	18.6	19.3	19.1
Current	18.0	19.9	20.7	20.9	18.5	19.2	19.0
Of which: Taxes	13.9	15.3	15.9	16.0	14.1	14.8	15.0
Capital	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Noninterest expenditure	16.7	16.3	16.0	17.3	19.5	19.6	18.9
Current	14.2	13.5	12.9	13.2	13.8	13.7	13.0
Capital	2.5	2.8	3.1	4.1	5.7	5.9	5.9
Public enterprise primary balance	**0.2**	**0.3**	**0.1**	**0.0**	**0.3**	**0.2**	**0.1**
Nonfinancial public sector primary balance	**1.6**	**4.0**	**4.9**	**3.7**	**-0.7**	**-0.2**	**0.3**
Central bank operating balance	**0.0**	**0.2**	**0.2**	**0.1**	**0.0**	**0.0**	**0.0**
Combined public sector primary balance	**1.6**	**4.1**	**5.1**	**3.7**	**-0.7**	**-0.2**	**0.3**
Interest payments	1.9	1.9	1.8	1.6	1.3	1.3	1.3
External	1.6	1.4	1.3	0.9	0.8	0.8	0.8
Domestic	0.4	0.4	0.5	0.7	0.5	0.6	0.6
Combined public sector overall balance	**-0.3**	**2.2**	**3.3**	**2.2**	**-2.0**	**-1.5**	**-1.0**
Financing	**0.3**	**-2.2**	**-3.3**	**-2.2**	**2.0**	**1.5**	**1.0**
External	-1.3	-0.5	-0.9	-1.1	2.0	-0.3	0.5
Domestic	1.6	-1.9	-2.4	-1.1	0.0	1.7	0.5
Memorandum items							
Combined public sector overall balance (incl. CRPAOs)	-0.3	2.1	2.2	1.5	-2.4	-1.6	-1.0
Public sector debt (incl. CRPAOs)	37.7	33.2	30.9	25.7	27.4	26.7	25.6
External public sector debt	28.0	23.9	19.9	16.7	17.4	15.8	15.1
Domestic public sector debt	9.7	9.2	11.0	9.0	10.0	10.9	10.6
Foreign currency-demoninated debt	29.5	25.0	21.3	16.2	16.8	15.1	14.5
Nominal GDP (S/. millions)	261,653	302,255	335,171	372,627	381,670	415,476	449,307

Source: Peruvian authorities and staff estimates.

Table 3. Peru: Fiscal Operations of the Combined Public Sector

(In millions of Nuevos Soles; unless otherwise indicated)

	2005	2006	2007	2008	2009	Projections 2010	Projections 2011
Central government primary balance	**2,904**	**9,816**	**11,536**	**13,372**	**-2,314**	**2,466**	**5,216**
Revenue	41,372	53,076	61,498	68,354	60,939	67,758	75,317
Current	40,988	52,715	61,113	67,963	60,584	67,375	74,905
Of which : Tax revenue	35,619	45,552	52,569	58,258	52,612	60,238	65,892
Capital	384	361	385	391	355	383	413
Noninterest expenditure	38,468	43,260	49,962	54,982	63,253	65,292	70,102
Current	33,577	37,252	42,613	46,111	48,434	49,569	52,663
Capital	4,891	6,008	7,349	8,871	14,819	15,723	17,439
Rest of the general government primary balance	**748**	**1,282**	**4,655**	**6,656**	**5,868**	**4,909**	**4,820**
General government primary balance	**3,651**	**11,099**	**16,190**	**13,745**	**-3,526**	**-1,328**	**948**
Revenue	47,446	60,303	69,842	78,244	70,982	80,032	85,909
Current	47,062	60,056	69,456	77,853	70,627	79,651	85,496
Of which: Taxes	36,341	46,285	53,359	59,571	53,851	61,569	67,327
Capital	384	247	386	391	355	381	413
Noninterest expenditure	43,845	49,204	53,651	64,499	74,508	81,360	84,961
Current	37,183	40,833	43,407	49,344	52,609	56,936	58,435
Capital	6,662	8,372	10,244	15,155	21,899	24,424	26,526
Public enterprise primary balance	**558**	**858**	**285**	**-61**	**965**	**694**	**460**
Nonfinancial public sector primary balance	**4,210**	**11,957**	**16,475**	**13,684**	**-2,561**	**-634**	**1,409**
Central bank operating balance	**23**	**474**	**632**	**249**	**0**	**0**	**0**
Combined public sector primary balance	**4,233**	**12,431**	**17,107**	**13,932**	**-2,561**	**-634**	**1,409**
Interest payments	5,097	5,692	6,030	5,835	4,992	5,531	5,961
External	4,174	4,337	4,440	3,309	3,062	3,216	3,398
Domestic	924	1,355	1,590	2,526	1,930	2,315	2,563
Combined public sector overall balance	**-865**	**6,738**	**11,077**	**8,097**	**-7,553**	**-6,165**	**-4,552**
Financing	**865**	**-6,738**	**-11,077**	**-8,097**	**7,553**	**6,165**	**4,552**
External	-3,514	-1,371	-3,079	-4,028	7,483	-1,067	2,377
Domestic	4,194	-5,671	-7,998	-4,069	70	7,231	2,175
Memorandum items							
Combined public sector overall balance (incl. CRPAOs)	-865	6,330	7,483	5,557	-9,250	-6,719	-4,552
Public sector debt (incl.CRPAOs)	98,739	100,245	103,610	95,706	104,508	111,092	115,149
External public sector debt	73,410	72,354	66,758	62,333	66,441	65,793	67,675
Domestic public sector debt	25,329	27,892	36,852	33,373	38,067	45,299	47,474
Foreign currency-demoninated debt	77,367	99,837	99,626	60,536	64,051	62,745	65,172
Nominal GDP (S/. millions)	261,653	302,255	335,171	372,627	381,670	415,476	449,307

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

Table 4. Peru: Balance of Payments

(In millions of U.S. dollars)

				Projections					
	2007	2008	2009	2010	2011	2012	2013	2014	2015
Current account	**1,363**	**-4,722**	**248**	**-1,014**	**-2,734**	**-4,483**	**-4,494**	**-4,105**	**-3,988**
Merchandise trade	8,287	3,090	5,875	6,673	6,473	4,745	3,727	2,320	723
Exports	27,882	31,529	26,886	32,171	35,389	36,823	38,215	39,440	40,755
Traditional	21,464	23,796	20,572	25,454	28,135	29,167	30,162	30,975	31,789
Nontraditional and others	6,418	7,733	6,314	6,717	7,254	7,656	8,053	8,466	8,966
Imports	-19,595	-28,439	-21,011	-25,499	-28,916	-32,078	-34,488	-37,121	-40,032
Services, income, and current transfers (net)	-6,924	-7,813	-5,627	-7,687	-9,208	-9,228	-8,221	-6,425	-4,712
Services	-1,191	-1,961	-1,112	-1,740	-1,677	-1,630	-1,601	-1,590	-1,621
Investment income	-8,358	-8,775	-7,371	-8,795	-10,631	-10,834	-9,962	-8,285	-6,686
Current transfers	2,626	2,923	2,856	2,848	3,100	3,236	3,342	3,450	3,595
Financial and capital account	**8,400**	**8,672**	**1,399**	**3,510**	**4,231**	**4,983**	**4,994**	**4,405**	**4,288**
Public sector	-2,473	-1,403	923	-360	788	-244	740	-245	58
Disbursements 1/	3,384	1,580	3,592	1,097	2,209	1,542	2,161	1,815	1,815
Amortization 1/	-5,691	-3,048	-1,861	-1,408	-1,371	-1,761	-1,396	-2,035	-1,757
Other medium- and long-term	0	0	0	0	0	0	0	0	0
Public sector flows 2/	-166	65	-808	-50	-50	-25	-25	-25	0
Capital transfers (net)	0	0	0	0	0	0	0	0	0
Privatization	46	0	0	0	0	0	0	0	0
Private sector	10,827	10,076	476	3,871	3,444	5,227	4,254	4,650	4,230
Foreign direct investment (FDI) excluding privatization	5,380	6,188	4,364	4,582	4,720	4,956	5,203	5,464	5,682
Other private capital	5,447	3,888	-3,888	-711	-1,276	272	-950	-813	-1,452
Medium- and long-term loans	2,856	2,639	946	1,271	2,150	1,225	825	325	325
Portfolio investment	527	682	-3,655	-2,855	-2,576	-2,919	-3,071	-2,980	-2,886
Short-term flows 3/	2,064	567	-1,179	873	-850	1,965	1,296	1,842	1,109
Net Errors and Omissions	175	-838	-250	0	0	0	0	0	0
Balance	**9,938**	**3,112**	**1,397**	**2,496**	**1,497**	**500**	**500**	**300**	**300**
Financing	**-9,588**	**-3,112**	**450**	**-2,496**	**-1,497**	**-500**	**-500**	**-300**	**-300**
NIR flow (increase -)	-9,654	-3,169	-1,045	-2,500	-1,500	-500	-500	-300	-300
Change in NIR (increase -)	-10,414	-3,507	-1,940	-2,500	-1,500	-500	-500	-300	-300
Valuation change	-760	-338	-896	0	0	0	0	0	0
Exceptional financing	67	57	36	4	3	0	0	0	0
Debt relief 4/	67	57	36	4	3	0	0	0	0
Change in arrears	0	0	0	0	0	0	0	0	0
Rescheduling	0	0	0	0	0	0	0	0	0
	0	0	0	0	0	0	0	0	0
Memorandum items									
Current account balance (in percent of GDP)	**1.3**	**-3.7**	**0.2**	**-0.7**	**-1.8**	**-2.8**	**-2.6**	**-2.2**	**-2.0**
Capital and financial account balance (in percent of	7.8	6.8	1.1	2.4	2.7	3.1	2.9	2.4	2.2
Export value (US$), percent change	17.0	13.1	-14.7	19.7	10.0	4.1	3.8	3.2	3.3
Volume growth	2.9	8.2	-3.1	5.6	6.0	5.6	6.0	6.3	7.1
Price growth	13.7	4.5	-12.0	13.3	3.8	-1.5	-2.0	-2.7	-3.0
Import value (US$), percent change	32.0	45.1	-26.1	21.4	13.4	10.9	7.5	7.6	7.8
Volume growth	20.1	19.9	-18.2	11.2	10.5	9.4	6.1	6.1	6.2
Price growth	9.9	21.1	-9.7	9.1	2.7	1.4	1.4	1.4	1.6
GDP (in billions of US$)	107.1	127.4	126.8	146.3	154.5	161.7	172.6	184.1	195.7

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and Fund staff estimates/projections.
1/ Includes debt swap operations.
2/ Includes portfolio flows of the pension reserve fund and subscription payments into international funds.
3/ Includes COFIDE and Banco de la Nación.
4/ Debt relief under existing operations.

Table 5. Peru: Public Sector Social Expenditure

	2005	2006	2007	2008	2/ 2009	3/ 2010
	(In millions of Nuevos Soles)					
Total social expenditure and pensions	**25,708**	**27,626**	**30,105**	**33,517**	**36,667**	**37,856**
Universal coverage (Education and Health) 1/	10,892	11,888	13,113	15,302	16,235	15,725
Education	7,682	8,227	8,970	10,041	10,272	9,830
Health	3,210	3,661	4,143	5,260	5,963	5,896
Targeted programs (Extreme Poverty)	3,453	3,876	4,648	5,592	6,307	7,562
Non-Targeted Social Programs	11,363	11,862	12,343	12,624	14,125	14,569
ESSALUD	3,626	4,000	4,261	4,628	5,124	5,556
Pensions	7,737	7,862	8,082	7,997	9,001	9,014
Housing Development Program (FONAVI)	1	0	0	0	0	0
	(In percent of general government expenditure)					
Total social expenditure and pensions	**52.0**	**50.3**	**50.6**	**47.7**	**46.2**	**43.6**
Universal coverage (Education and Health) 1/	22.0	21.6	22.0	21.8	20.4	18.1
Education	15.5	15.0	15.1	14.3	12.9	11.3
Health	6.5	6.7	7.0	7.5	7.5	6.8
Targeted programs (Extreme Poverty)	7.0	7.1	7.8	8.0	7.9	8.7
Non-Targeted Social Programs	23.0	21.6	20.7	18.0	17.8	16.8
ESSALUD	7.3	7.3	7.2	6.6	6.5	6.4
Pensions	15.6	14.3	13.6	11.4	11.3	10.4
Housing Development Program (FONAVI)	0.0	0.0	0.0	0.0	0.0	0.0
	(In percent of GDP)					
Total social expenditure and pensions	**9.8**	**9.1**	**9.0**	**9.0**	**9.6**	**9.1**
Universal coverage (Education and Health) 1/	4.2	3.9	3.9	4.1	4.3	3.8
Education	2.9	2.7	2.7	2.7	2.7	2.4
Health	1.2	1.2	1.2	1.4	1.6	1.4
Targeted programs (Extreme Poverty)	1.3	1.3	1.4	1.5	1.7	1.8
Non-Targeted Social Programs	4.3	3.9	3.7	3.4	3.7	3.5
ESSALUD	1.4	1.3	1.3	1.2	1.3	1.3
Pensions	3.0	2.6	2.4	2.1	2.4	2.2
Housing Development Program (FONAVI)	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items						
General government expenditure (S/. million)	49,452	54,911	59,538	70,235	79,411	86,767
Nominal GDP (in millions of Soles)	261,653	302,255	335,171	372,627	381,670	415,476

Source: Ministry of Economy and Finance.
1/ Net of spending on education and health already included in the extreme poverty programs.
2/ Executed social expenditures. Preliminary.
3/ Preliminary.

Table 6. Peru: Monetary Survey 1/

	2005	2006	2007	2008	2009	Projections 2010	2011
	I. Central Reserve Bank (In millions of New Soles)						
Net international reserves 2/	**48,353**	**55,279**	**83,016**	**96,496**	**95,365**	**101,771**	**106,597**
(In millions of U.S. dollars)	14,097	17,275	27,689	31,196	33,136	35,636	36,636
Net domestic assets	**-38,237**	**-43,483**	**-68,159**	**-79,160**	**-76,124**	**-80,356**	**-82,713**
Net credit to nonfinancial public sector	-13,770	-19,925	-28,933	-35,491	-35,750	-33,107	-31,034
Rest of banking system	-21,585	-22,158	-39,175	-39,270	-39,719	-50,436	-55,762
Other	-2,881	-1,400	-52	-4,399	-655	3,187	4,083
Currency	**10,116**	**11,796**	**14,857**	**17,336**	**19,241**	**21,416**	**23,883**
	II. Banking System (In millions of Nuevos Soles)						
Net foreign assets	**47,582**	**56,057**	**78,993**	**96,433**	**95,406**	**101,367**	**106,003**
Net domestic assets	**20,017**	**17,505**	**11,234**	**15,651**	**23,659**	**35,207**	**49,684**
Net credit to nonfinancial public sector	-14,254	-20,601	-34,822	-42,758	-39,873	-36,873	-34,373
Net credit to private sector	50,799	53,948	70,574	92,774	94,342	107,926	123,168
Other	-16,528	-15,842	-24,518	-34,365	-30,810	-35,846	-39,111
Net credit to COFIDE	-850	-850	-850	-850	-850	-850	-850
Other	-15,678	-14,992	-23,668	-33,515	-29,960	-34,996	-38,261
Liabilities to the private sector	**67,599**	**73,562**	**90,227**	**112,085**	**119,065**	**136,573**	**155,688**
	(12-month percentage change)						
Base money	25.7	18.3	28.2	25.5	5.5	16.7	15.5
Broad money	18.4	8.8	22.7	24.2	6.2	14.7	14.0
Domestic currency	19.5	18.0	34.5	23.1	11.2	20.9	19.8
Foreign currency	17.5	1.2	11.2	25.6	0.6	6.9	5.7
Net credit to private sector	16.3	6.2	30.8	31.5	1.7	14.4	14.1
Domestic currency	34.8	29.0	43.1	46.9	11.8	23.7	22.7
Foreign currency	9.8	-3.7	23.7	21.1	-6.6	5.4	4.3
	III. Financial System (In millions of Nuevos Soles)						
Net foreign assets	**47,504**	**56,032**	**78,610**	**96,362**	**95,384**	**100,153**	**107,164**
Net domestic assets	**54,322**	**67,296**	**79,528**	**67,584**	**100,331**	**128,424**	**158,058**
Net credit to the public sector	-8,908	-10,746	-17,777	-26,894	-22,445	-21,600	-20,868
Net credit to private sector	74,945	86,575	111,218	126,759	139,747	159,466	181,697
Other	-11,715	-8,533	-13,913	-32,281	-16,971	-9,442	-2,771
Liabilities to the private sector	**101,825**	**123,329**	**158,138**	**163,946**	**195,715**	**228,577**	**265,221**
	(12-month percentage change)						
Liabilities to the private sector	22.9	21.1	28.2	3.7	19.4	16.8	16.0
Domestic currency	29.1	30.4	35.5	-0.5	27.2	20.9	19.8
Foreign currency	14.4	6.7	14.4	13.0	3.9	6.9	5.7
Net credit to private sector	16.6	15.5	28.5	14.0	10.2	14.1	13.9
Domestic currency	26.0	38.2	40.1	13.1	23.7	21.5	20.6
Foreign currency	11.1	0.4	17.8	14.9	-4.3	3.8	3.1

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

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

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

Table 7. Peru: Financial Soundness Indicators 1/

(In percent; unless otherwise indicated)

	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Jan-10
Capital Adequacy							
Equity capital to risk-weighted assets	14.0	12.0	12.5	11.7	11.9	13.5	13.5
Regulatory Tier I capital to risk-weighted assets 2/	13.1	11.2	10.6	8.8	7.7	10.5	10.5
Nonperforming loans net of provisions to capital	-17.3	-21.7	-18.0	-17.3	-15.3	-14.6	-14.3
Asset Quality							
Nonperforming loans to total gross loans 3/	3.7	2.1	1.6	1.3	1.3	1.6	1.7
In domestic currency	3.0	2.1	1.9	1.6	1.7	2.0	2.1
In foreign currency	3.9	2.2	1.5	1.1	1.0	1.2	1.2
Nonperforming loans to total gross loans 4/	9.5	6.3	4.1	2.7	2.2	2.7	2.8
In domestic currency	6.1	4.2	3.2	2.5	2.5	3.2	3.3
In foreign currency	10.6	7.1	4.6	2.8	1.9	2.3	2.4
Refinanced and restructured loans to total gross loans 5/	5.8	4.1	2.4	1.4	0.9	1.1	1.2
Provisions to nonperforming loans 3/	176.5	235.3	251.4	278.4	258.7	242.2	232.1
Provisions to nonperforming, restructured, and refinanced loans 4/	68.7	80.3	100.3	131.6	151.0	139.3	136.7
Sectoral distribution of loans to total loans							
Consumer loans	13.4	14.4	16.5	18.3	17.9	17.8	17.8
Mortgage loans	14.2	14.8	14.0	12.3	12.6	13.6	13.8
Commercial loans	68.1	65.8	64.2	63.9	63.4	62.5	62.3
Small business loans	4.3	5.0	5.3	5.5	6.0	6.1	6.1
Earnings and Profitability							
ROA	1.2	2.2	2.2	2.5	2.6	2.3	2.2
ROE	11.6	22.2	23.9	27.9	31.1	24.5	23.8
Gross financial spread to financial revenues	71.9	70.5	67.6	66.6	66.3	73.8	73.4
Financial revenues to total revenues	69.1	76.3	76.6	79.6	81.3	81.0	80.3
Annualized financial revenues to revenue-generating assets	9.0	10.3	10.6	11.6	11.7	10.7	10.5
Liquidity							
Total liquid assets to total short-term liabilities	44.5	45.5	44.2	45.3	41.4	40.4	41.5
In domestic currency	20.7	19.9	43.1	57.3	26.3	38.8	44.7
In foreign currency	44.3	49.2	45.0	37.0	53.0	41.7	38.9
Foreign Currency Position and Dollarization							
Global position in foreign currency to regulatory capital 6/	24.2	23.1	17.1	16.8	28.6	7.7	9.8
Share of foreign currency deposits in total deposits	67.1	67.2	62.7	59.3	58.0	55.8	52.6
Share of foreign currency loans in total credit	75.7	71.5	65.5	61.8	57.5	52.4	52.3
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	9,596	10,913	11,855	14,857	18,312	19,600	17,821
Commercial banks' short-term foreign assets (in millions of U.S. dollars)	547	796	878	822	1,641	1,373	1,187
Commercial banks' short-term foreign liabilities (in millions of U.S. dollars)	733	1,085	754	2,238	1,692	1,419	2,218
Operational efficiency							
Financing to related parties to capital 7/	14.3	17.9	15.5	14.4	13.9	14.5	15.1
Nonfinancial expenditure to total revenues 8/	35.9	33.3	31.3	30.1	28.7	29.6	28.7
Nonfinancial expenditure to total revenue-generating assets 8/	4.7	4.6	3.4	4.5	4.3	4.1	4.1
Memorandum items							
Number of Banks	16	14	13	15	18	17	17
Private commercial	14	12	11	13	16	15	15
Of which: Foreign-owned 9/	9	9	7	9	12	11	11
State-owned	2	2	2	2	2	2	2
Banks' credit card loans to total loans	6.4	6.9	8.1	9.2	9.6	9.2	9.2
Bank loans' 12 month increase (in real terms)	-1.9	19.0	14.0	27.7	28.9	0.3	0.3
Stock market index (U.S. dollars)	1132	1400	4032	5849	2243	4900	5054
Foreign currency debt rating (Moody's)	Ba3	Ba3	Ba3	Ba2	Ba1	Baa3	Baa3
EMBI+ PERU spread, basis points	236	186	131	175	509	165	214

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 was approximated by share capital plus reserves until June 2009. Since July 2009, Banking Law components establishes that the Tier I capital have to be defined, and Risk-weighted assets include overall risks (credit, market and operational). In year 2002, the Tier I considers a reduction on Banco Santander Central Hispano capital due to the valorization before its merger 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 bussineses 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/ Includes restructured loans, refinanced loans, and arrears.
5/ Refinanced loans refer to those loans subjected 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."
6/ Global position in foreign currency includes the foreign currency position in the balance sheet and the net position in financial derivatives.
7/ Financing to related parties corresponds to those loans to individuals and firms owning more than 4 percent of the bank.
8/ Nonfinancial expenditures do not consider provisions nor depreciations.
9/ Bank is classified as foreign-owned if share of foreign capital is more than 50 percent or if the bank is controlled by a foreign bank.

Table 8. Peru: Medium-Term Macroeconomic Framework

	2007	2008	2009	Projections 2010	2011	2012	2013	2014	2015
			(Annual percentage change)						
GDP at constant prices	8.9	9.8	0.9	6.3	6.0	5.7	5.7	5.7	5.8
Consumer prices (end of period)	3.9	6.7	0.2	2.0	2.0	2.0	2.0	2.0	2.0
GDP deflator	1.8	1.2	1.6	2.4	2.1	1.5	1.1	1.0	0.9
Merchandise trade									
Exports, f.o.b.	17.0	13.1	-14.7	19.7	10.0	4.1	3.8	3.2	3.3
Imports, f.o.b.	32.0	45.1	-26.1	21.4	13.4	10.9	7.5	7.6	7.8
Terms of trade (deterioration -)	3.4	-13.7	-0.8	3.7	1.1	-2.8	-3.4	-4.3	-5.0
			(In percent of GDP; unless otherwise indicated)						
External current account balance	1.3	-3.7	0.2	-0.7	-1.8	-2.8	-2.6	-2.2	-2.0
External current account, excluding interest obligations	3.3	-1.9	1.7	0.8	0.1	-1.0	-1.0	-0.7	-0.7
Total external debt service	8.3	4.7	2.9	3.3	3.6	3.6	3.1	3.3	2.9
Medium- and long-term	8.0	4.4	2.8	3.1	3.3	3.4	2.9	3.0	2.6
Nonfinancial public sector	6.6	3.3	1.8	1.8	1.7	1.8	1.4	1.7	1.3
Private sector	1.4	1.1	1.0	1.4	1.6	1.5	1.4	1.4	1.3
Short-term 1/	0.3	0.3	0.1	0.2	0.3	0.3	0.3	0.3	0.2
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.3	0.3	0.1	0.2	0.3	0.3	0.3	0.3	0.2
External debt service 2/	8.3	4.8	2.9	3.3	3.6	3.6	3.1	3.3	2.9
Interest	2.0	1.8	1.5	1.5	1.8	1.8	1.6	1.5	1.4
Amortization (medium-and long-term)	6.3	3.0	1.4	1.8	1.8	1.9	1.5	1.7	1.5
Combined public sector primary balance 3/	5.1	3.7	-0.7	-0.2	0.3	0.7	1.1	1.1	1.0
General government revenue	20.8	21.0	18.6	19.3	19.1	19.5	19.8	19.6	19.5
General govt. non-interest expenditure 3/	16.0	17.3	19.5	19.6	18.9	18.8	18.6	18.5	18.5
Combined public sector interest due	1.8	1.6	1.3	1.3	1.3	1.2	1.2	1.1	1.0
Combined public sector overall balance 3/	2.2	1.5	-2.4	-1.6	-1.0	-0.5	0.0	0.0	0.0
Public sector debt 3/	30.9	25.7	27.4	26.7	25.6	24.3	22.7	21.1	19.7
Gross domestic investment	23.0	26.7	20.6	23.3	24.9	25.9	26.3	26.6	26.9
Public sector 3/	3.1	4.2	5.3	6.0	6.0	6.0	6.1	6.2	6.2
Private sector	19.9	22.5	15.3	17.3	18.8	19.9	20.2	20.5	20.6
Private sector (excluding inventories)	18.2	21.5	17.7	18.2	19.0	19.5	19.8	20.1	20.3
Inventories changes	1.7	1.0	-2.4	-0.9	-0.1	0.3	0.4	0.4	0.3
National savings	24.2	23.0	20.8	22.6	23.1	23.1	23.7	24.4	24.8
Public sector 4/	6.0	6.1	3.4	4.2	4.7	5.3	5.9	6.0	6.0
Private sector	18.3	16.9	17.4	18.4	18.4	17.8	17.8	18.4	18.8
External savings	-1.3	3.7	-0.2	0.7	1.8	2.8	2.6	2.2	2.0
Memorandum items									
Nominal GDP (billions of Nuevos Soles)	335.2	372.6	381.7	415.5	449.3	482.1	515.5	550.3	587.0
Gross international reserves (billions of U.S. dollars)	27,743	31,250	33,190	35,690	37,190	37,690	38,190	38,490	38,790
Gross international reserves to broad money	92.2	86.2	80.2	74.6	69.5	63.6	56.8	50.5	45.0
External debt service (percent of exports of GNFS)	28.6	17.3	12.2	13.5	14.1	14.3	12.6	13.6	12.2
Short-term external debt service (percent of exports of GNFS)	1.0	1.0	0.5	0.7	1.0	1.0	1.1	1.0	1.0
Public external debt service (percent of exports of GNFS)	22.8	12.0	7.3	7.2	6.8	7.2	5.8	6.9	5.7

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and Fund staff estimates/projections.
1/ Includes interest payments only.
2/ Includes the financial public sector.
3/ Includes CRPAOs.
4/ Excludes privatization receipts.

Table 9. Peru: Financial and External Vulnerability Indicators

(In percent; unless otherwise indicated)

	2005	2006	2007	2008	2009
Financial indicators					
Public sector debt/GDP	37.7	33.2	30.9	25.7	27.4
Of which: in domestic currency (percent of GDP)	8.2	8.1	9.6	9.4	10.6
90-day prime lending rate, domestic currency (end of period)	4.4	5.2	5.6	7.5	1.7
90-day prime lending rate, foreign currency (end of period)	5.5	6.1	6.4	5.2	1.2
Velocity of money 1/	3.9	4.1	3.7	3.3	3.2
Net credit to the private sector/GDP 2/	28.6	28.6	33.2	34.0	36.6
External indicators					
Exports, U.S. dollars (percent change)	35.6	37.2	17.0	13.1	-14.7
Imports, U.S. dollars (percent change)	23.2	22.9	32.0	45.1	-26.1
Terms of trade (percent change) (deterioration -)	5.9	28.3	3.4	-13.7	-0.8
Real effective exchange rate, (end of period, percent change) 3/	-0.5	-1.3	-0.6	4.9	2.4
Current account balance (percent of GDP)	1.4	3.1	1.3	0.2	-0.7
Capital and financial account balance (percent of GDP)	1.1	1.0	7.8	1.1	2.4
Total external debt (percent of GDP)	36.1	30.8	32.4	28.9	32.3
Medium- and long-term public debt (in percent of GDP) 4/	28.0	23.9	19.9	16.4	20.2
Medium- and long-term private debt (in percent of GDP)	4.0	3.6	6.3	7.4	8.2
Short-term public and private debt (in percent of GDP)	4.0	3.3	6.1	5.0	3.9
Total external debt (in percent of exports of goods and services) 4/	145.8	107.6	111.8	104.6	133.9
Total debt service (in percent of exports of goods and services) 5/	35.6	13.7	28.6	17.3	12.2
Gross official reserves					
In millions of U.S. dollars	14,120	17,329	27,743	31,250	33,190
In percent of short-term external debt 6/	314.2	174.9	405.3	421.1	397.5
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	92.5	80.2	137.8	124.0	128.7
In percent of broad money 8/	71.6	75.3	92.2	86.2	80.2
In percent of foreign currency deposits at banks	131.0	148.2	208.7	175.0	190.3
In months of next year's imports of goods and services	9.3	8.7	9.8	14.5	12.8
Net international reserves (in millions of U.S. dollars)	14,097	17,275	27,689	31,196	33,136
Net foreign exchange position (in millions of U.S. dollars) 10/	8,562	11,315	20,970	24,139	25,183

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. Source: Information Notice System, IMF.

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, including debt swaps.

7/ Current Account deficit adjusted for 0.75*net FDI inflows; if adjusted CA balance>0, set to 0.

8/ At end-period exchange rate.

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

10/ Includes public sector foreign currency deposits in central bank (e.g. pension reserve funds) as reserve liability.

Peru: Staff Report for the 2010 Article IV Consultation

Appendices

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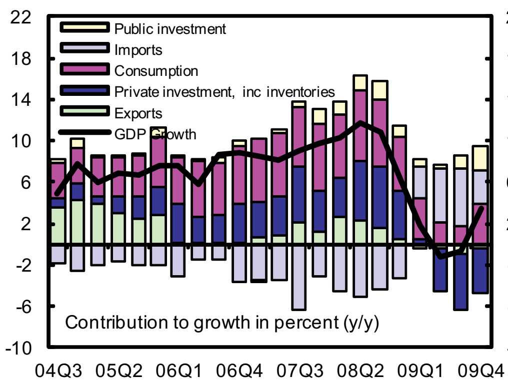
Appendices

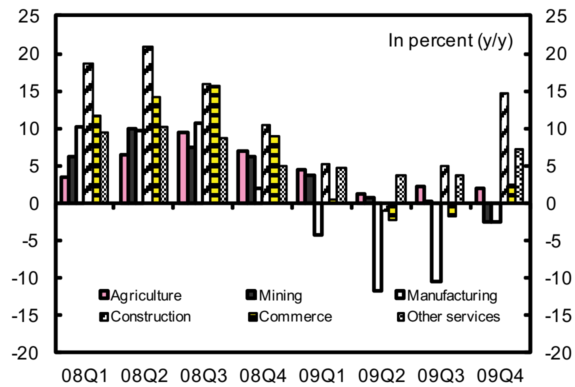
Appendix 1: Recent Economic Developments

Figure 1. Peru: Real Sector Developments

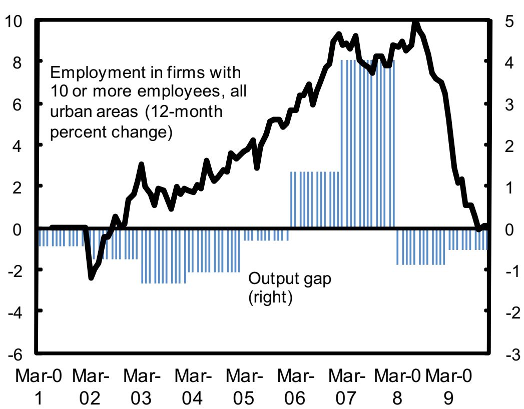
Following a rapid growth deceleration of activity in the first half of 2009, growth recovered strongly in the second half...



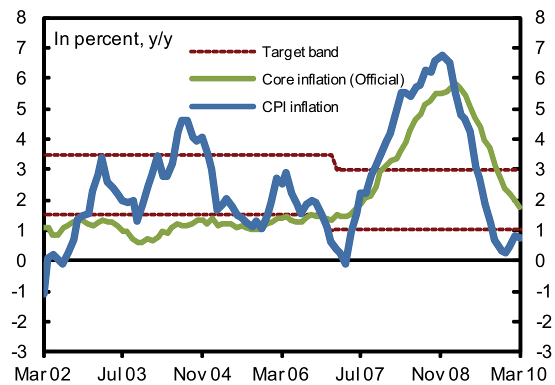
...with construction and government spending leading the recovery.



Employment remained resilient as Peru avoided opening a significant output gap.

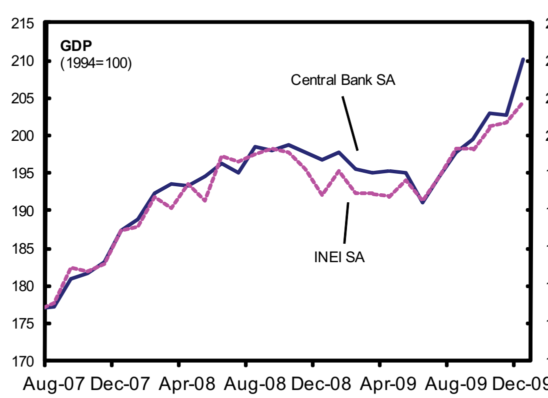


Inflation pressures have abated in part due to food and fuel prices.



Business and consumer confidence indicators have recovered to pre-crisis levels...

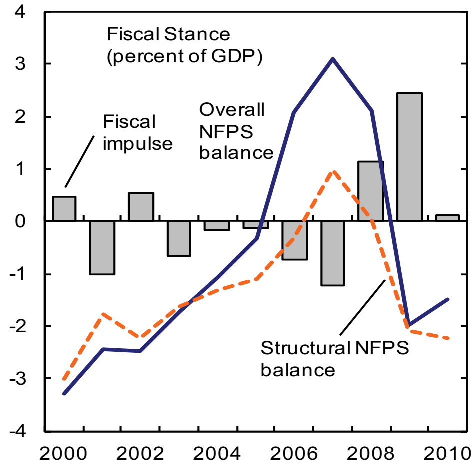
...with strong rebound momentum in growth.



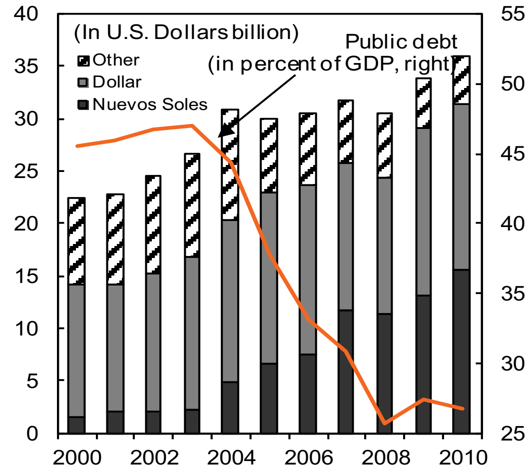
Sources: Banco Central de Reserva del Peru and IMF staff estimates.

Figure 2. Peru: Fiscal Sector Developments

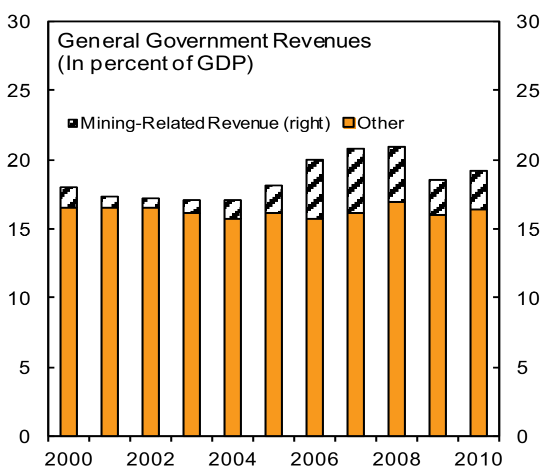
A significant fiscal stimulus was implemented...



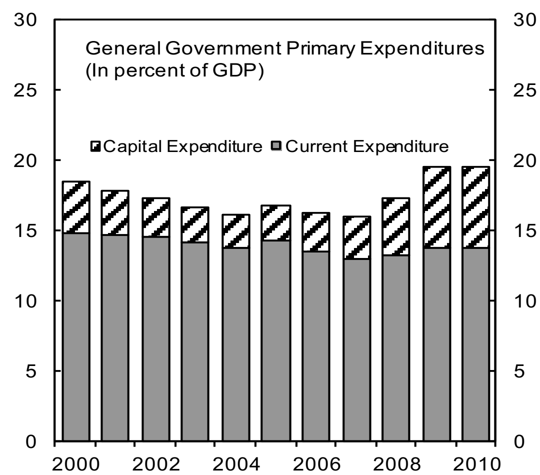
..thanks to past strong fiscal performance, reduced debt and accumulated fiscal reserves.



Revenues were affected by the negative terms of trade shock and the economic slowdown.



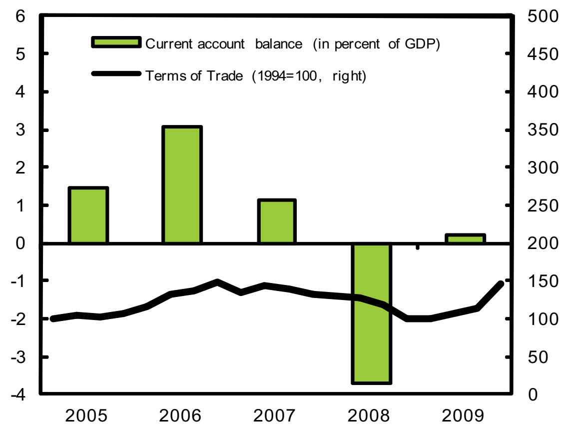
The fiscal stimulus centered on infrastructure investment.



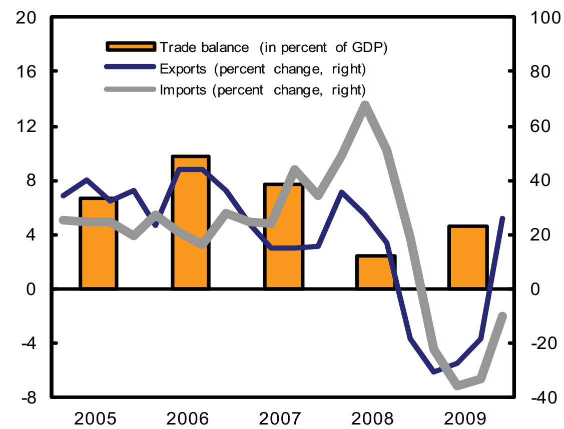
Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance and IMF staff Estimates

Figure 3. Peru: External Sector Developments

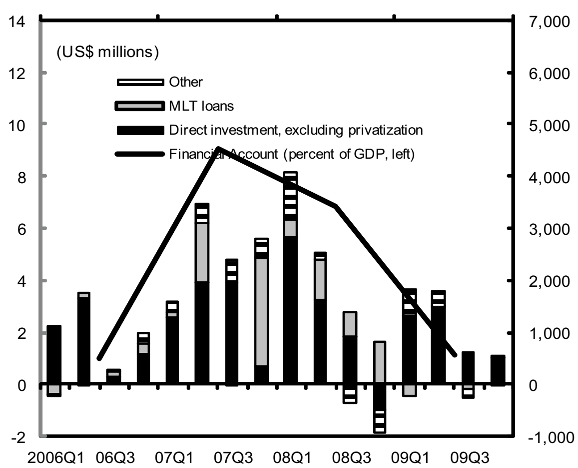
The current account improved due to a large decline in imports and profit remittances, and the recent recovery in terms of trade.



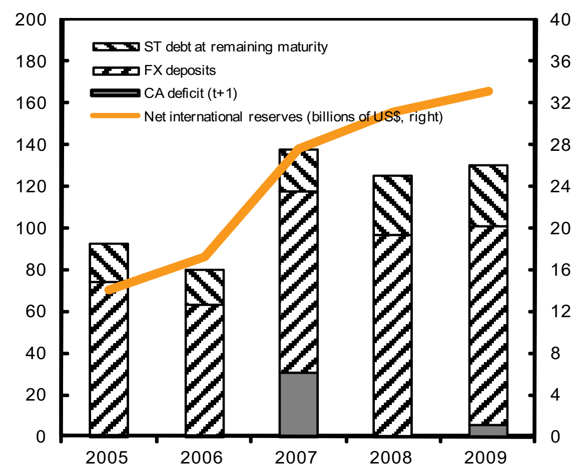
The trade balance remained relatively stable amid a collapse in both exports and imports.



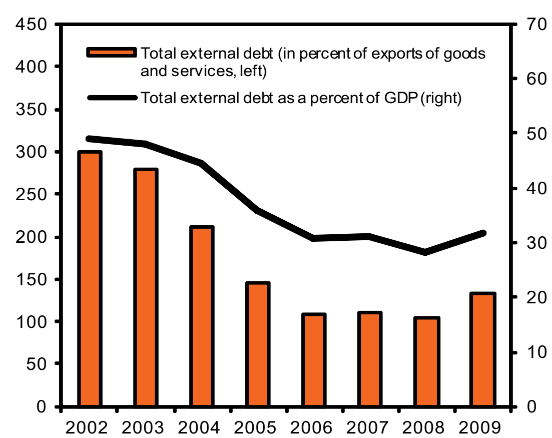
The capital account remained resilient despite a reversal in FDI and portfolio flows at end-2008.



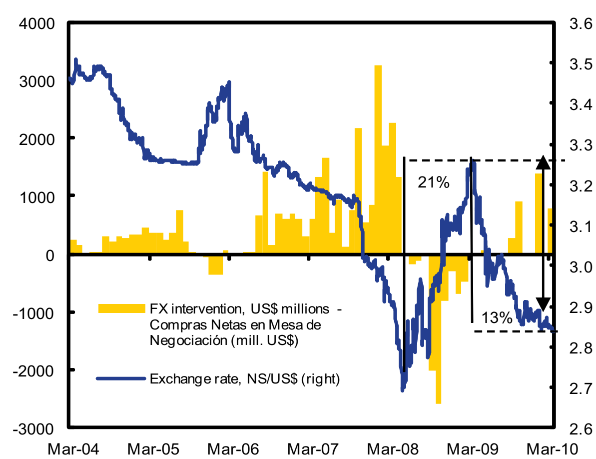
Reserves continue to be adequate.



External debt remains low...



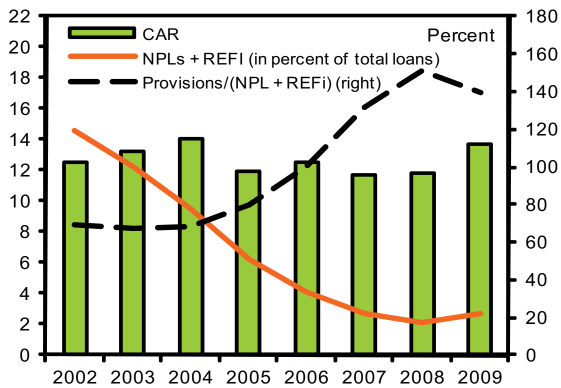
...and the Sol has returned near its pre-crisis level.



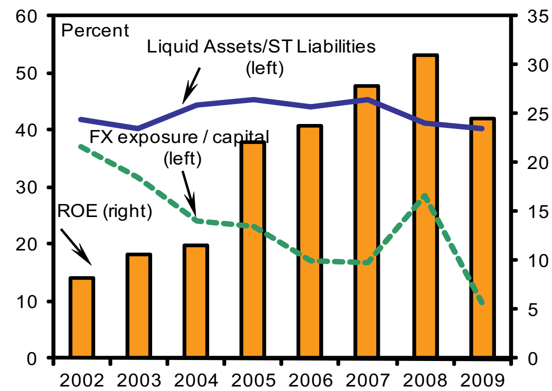
Sources: Banco Central de Reserva del Peru, Ministry of Finance, JP Morgan and IMF staff estimates.

Figure 4. Peru: Banking and Financial System 1/

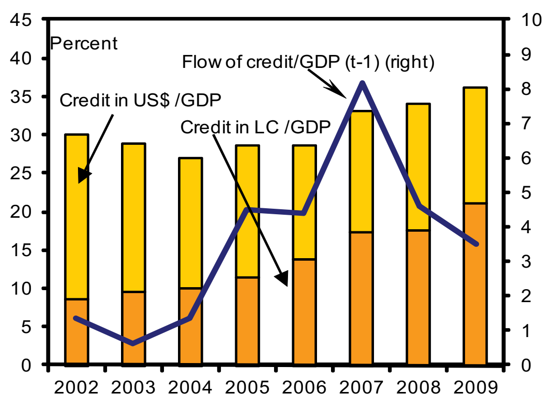
Financial soundness indicators remain solid...



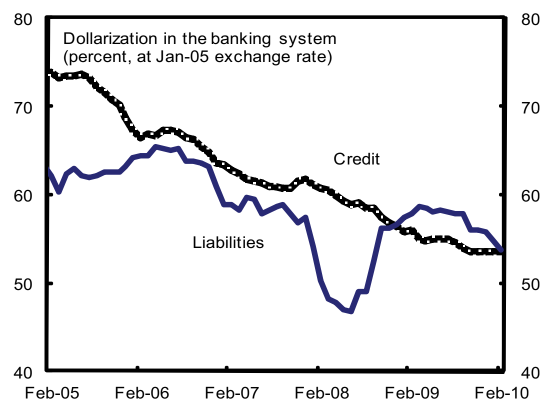
...with comfortable liquidity and profitability ratios.



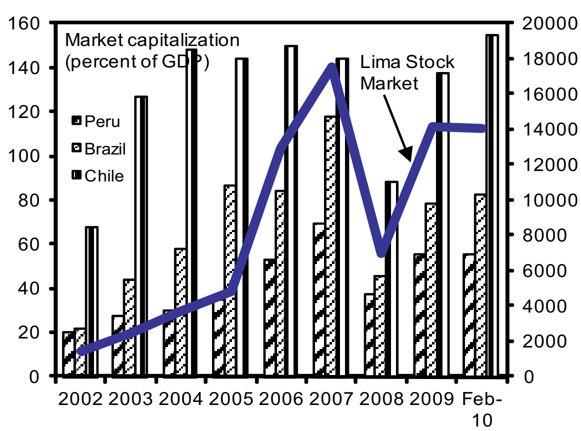
Credit has decelerated but continues to expand, particularly in Soles.



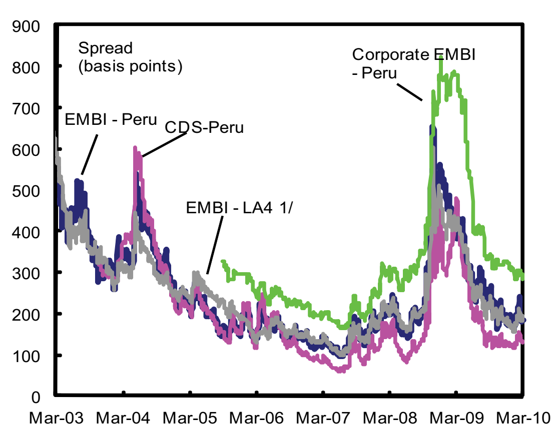
The financial system is still highly dollarized.



Equity prices and market capitalization have recovered in line with global developments...



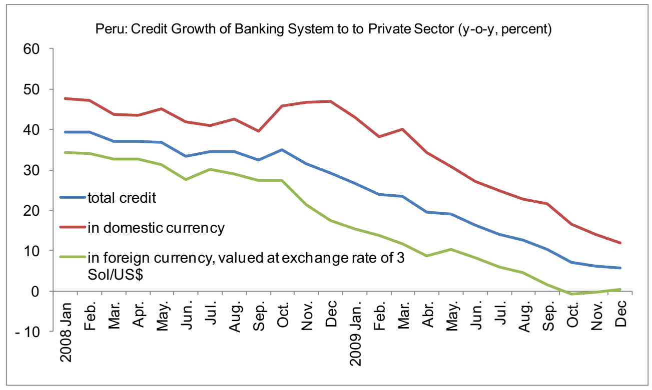
..while financial conditions have returned to pre-Lehman levels.



Sources: Bloomberg, SBS, World Federation of Exchange Rates and Fund staff estimates.
1/ Banking sector data corresponds to October 2008.

Appendix 2: Monetary Response during the Crisis

Since September 2008, Peru's proactive monetary response was instrumental to limit spillovers from the global financial crisis. The soundness of Peru's financial system and measures of the central bank providing ample liquidity in soles and dollars helped maintain orderly financial conditions during the global crisis and prevented a liquidity squeeze. Unlike in other countries, credit to the private sector continued to grow, albeit at lower rates than in the previous year. Peru's proactive monetary response was instrumental to limit spillovers from the global financial crisis.



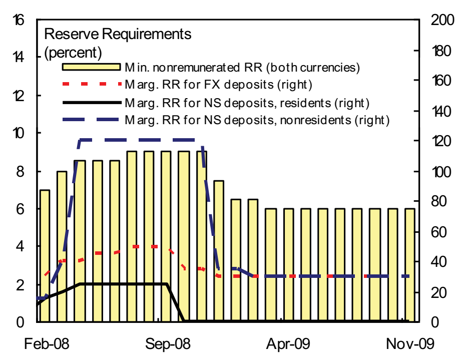
The mix of monetary tools used by the central bank to inject liquidity was modified throughout the global financial crisis to address evolving conditions. These measures were possible thanks to the high credibility of the monetary regime and prudent policies in the run up of the crisis.

Peru: Liquidity Management during the Crisis

	Flows (millions of Soles)	Implementation date
REPO	7,877	Since October 2008. Of which, S/. 1,180 millons through Swaps with a term between one week and a year.
CDBCRP 1/	8,045	Between January 2008-May 2009
CDBCRP-NR 1/	16,581	Since Septemebr 2009.
Reserve requirements	2,307	Eight measures lowering reserve requirements between September 2009-March 2009.
Total	**34,810**	

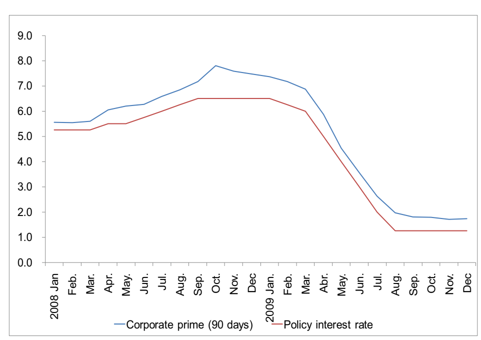
1/ Central bank's deposit certificates. NR can be acquired only by financial institutions.
Source: BCRP

- **During the first months following Lehmann's collapse, the monetary response consisted primarily of unconventional measures** such as: reduction of reserve requirements, currency swaps, repo operations, announcing the possibility of intervening along the sovereign yield curve, as well as the repurchase of central bank's certificates of deposits. Moreover, the central bank sold nearly US$7 billion (20 percent of international reserves) during September 2008−February 2009 to mitigate disruptive currency movements in a still highly dollarized financial system.



- **Since February 2009, when inflation and currency pressures started to recede, the central bank began to cut aggressively the policy interest rate to a historic-low of 1¼ percent**, and continued to rely to a lesser extent on unconventional measures.

Peru: Policy and Lending Interest Rates (percent)



- **As conditions stabilized, the central bank began to reverse some of the unconventional measures.** Since the second quarter of 2009, the central bank has reduced the stock of FX-swaps, repo operations and FX-indexed CDs. In January 2010, a reserve requirement of 35 percent on short-term (less than 2 years) foreign credit lines was reinstalled.

Table A2.1. Peru: Authorities' Measures to Manage Liquidity, 2008-09

September-December 2008	January-March 2009	April-December 2009
	Reserve Requirements	
• (Sep). Flexibilization of RR on long-term (2+ years) foreign credit lines from foreign institutions. The term of foreign credit lines had increased significantly during the months following the introduction of the RR exoneration on long-term foreign credit lines in September 2007.	• (Jan). Reduction of the minimum RR rate (both currencies) to 6.5 percent from 7.5 percent.	• (Aug). Elimination of RR on funding from foreign investment funds specialized on microfinance, with terms of at least 2 years, and up to an amount equivalent to the effective capital of the financial entity.
• (Oct). Reduction of the marginal RR in domestic currency from 25 percent to zero (thereby reducing effective reserve requirements from about 11 percent to 9 percent, which was the minimum legal requirement).	• (Jan). Reduction of the minimum balance of bank's total liabilities subject to reserve requirement that have to be kept at the BCRP by 50 bps to 1.5 percent.	
• (Oct). Reduction of the marginal RR rate on foreign currency deposits to 35 percent from 49 percent.	• (Mar). Reduction of the minimum RR rate (both currencies) to 6 percent from 6.5 percent.	
• (Oct). Elimination of RR for increases in foreign credit lines in both currencies.	• (Mar). The minimum balance requirement of bank's deposits at the BCRP was lowered by 50 bps to 1 percent.	
• (Nov). In domestic currency, elimination of the RR on 33 percent of depositstotal liabilities subject to RR or up to a maximum of S/. 100 million;, reduction of the RR rate for nonresidents deposits to 35 percent from 120 percent;, and reduction of the RR rate on foreign funding for microfinance loans to 9 percent from 120 percent.		
• (Nov). In foreign currency, introduction of a cap of 35 percent on the average RR for short term foreign debt, and reduction the RR on liabilities of the special regime to 35 percent.		
• (Dec.) Reduction of the minimum reserve requirement rate to 7.5 percent from 9 percent, and of the marginal RR rate in foreign currency for liabilities of general regime to 30 percent from 35 percent.		

Source: BCRP.

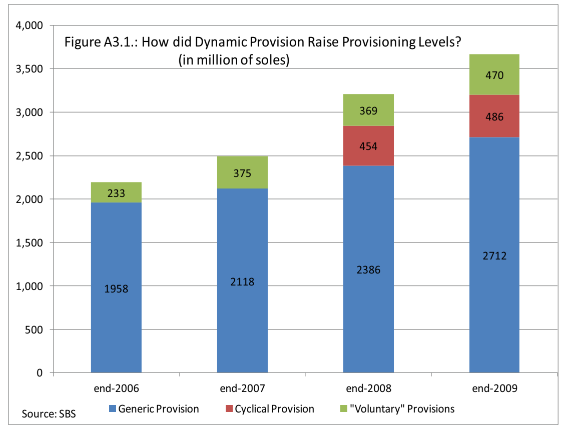
Table A2.1. Peru: Authorities' Measures to Manage Liquidity, 2008-09 (cont.)

September-December 2008	January-March 2009	April-December 2009
Foreign Exchange Intervention		
• (Sep). Sold US$2 billion. • (Oct). Sold US$2.6 billion • (Nov). Sold US$ 810 million. • (Dec). Sold US$ 289 million.	• (Jan). Sold US$ 676 million. • (Feb). Sold US$ 473 million.	• (May). Purchased US$77 million. • (Sep). Purchased US$269 million. • (Oct). Purchased US$910 million.
Swaps and Repo Operations		
• (Sep). Repo operations for S./ 73 million daily. • (Oct). Introduction of repos in foreign currency. • (Oct). Launched direct swaps as a new instrument. • (Oct). Extension of the terms of repos to 1 year and raised the number of bidding participants. • (Oct). Repos for S./1,663 million daily. • (Nov). Repos for S./1,543 million daily. • (Dec). Repos for S./1,158 million daily. • Acting along the sovereign yield curve. • (Oct). Repurchase proposal of Treasury bonds in the secondary market.	• (Jan). Repos for S./2,075 million daily. • (Feb). Repos for S./3,176 million daily. • (March). Repos for S./1,942 million daily.	• (April). Repos for S./1,278 million daily. • (May). Repos for S./490 million daily. • (July). Swap operations of soles in exchange of US$ with a term of 6 months. • (Aug). Swap operations of soles in exchange of US$ with a term of 1 year.
Repurchase of Central Bank's Certificate of Deposits and Other Measures		
• (Oct). Repurchase of CDBCRP (S./ 14.8 million) • (Oct). Issuance of exchange-rate indexed securities (US$ 950 million).		• (Apr). BCRP offers purchasing the financial institutions' credit portfolio in "titulos valores", under the agreement that these institutions would repurchase it on the agreed date. The measure was published, but repo operations with this type of collateral have not been offered.
Cuts in the Policy Interest Rate		
	• (Feb). Cut by 25bps to 6.25 percent. • (Mar). Cut by 25bps to 6 percent.	• (Apr). Cut by 100bps to 5 percent. • (May). Cut by 100bps to 4 percent. • (Jun). Cut by 100bps to 3 percent. • (Jul). Cut by 100bps to 2 percent. • (Aug). Cut by 75bps to 1.25 percent.

Source: BCRP.

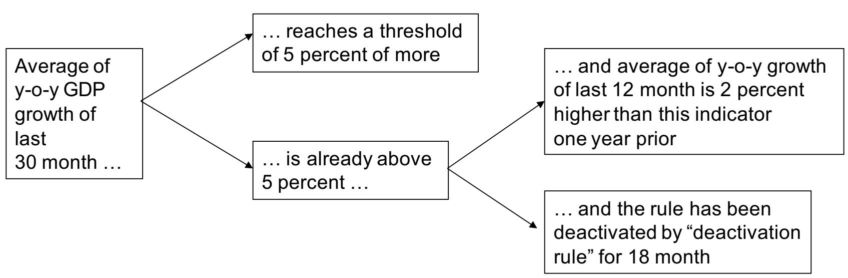
Appendix 3: Dynamic Provisioning in Peru

Peru was among the first emerging market economies to introduce dynamic provisioning (DP) at end-2008. The introduction was a reaction to several years of double-digit credit growth and a desire to dampen lending pro-cyclicality (see Figure A3.1). In contrast with static provisioning, where provisions are set in a backward looking, provisions under DP are set against loans outstanding in each period in line with an estimate of *long-run, expected losses.* Financial institutions are therefore required to recognize in good times loan impairment and losses which will materialize later in the business cycle based on past experience.

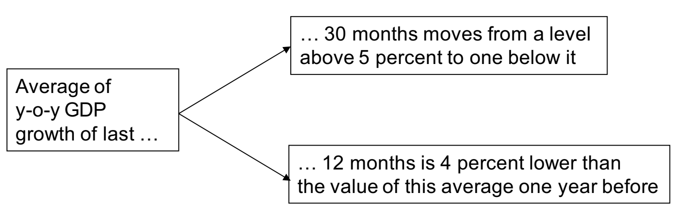


Peru's provisioning requirements are composed of a fixed component ("generic rate"), and a variable dynamic element, which reflects the state of the business cycle ("cyclical rate"). 'Generic' provisioning is defined according to eight separate loan categories that represent different credit risks. 'Cyclical' provisioning is activated and deactivated only according to certain pre-determined growth-thresholds (see graphs below). These cyclical provisions, which became effective in December 2008, were calibrated on data from the crisis of the late 1990s, and are higher for consumption credit.

Cyclical Provisioning Activation



Cyclical Provisioning De-Activation



Peru's DP has two unique features compared with Spain, Colombia and Uruguay (Table A3.1). First, it is a GDP-based rule, as opposed to being a credit-based rule. The reason for using GDP as a trigger was in part to avoid interfering with the desirable trend of financial deepening in Peru. Second, it applies equally across banks, independently of individual bank's behavior. The impact could be asymmetric across banks, with a potential higher burden on more prudent banks. While tailoring the rule to individual institutions could be better from an efficiency perspective, the current rule has the advantage of simplicity.

Table A3.1 Dynamic Provisioning: Cross-country Comparison

Country	Year of introduction	Forms of provisioning	Trigger of rule	Applicability	Form of provisioning
Peru	2008	(i) generic provision depends on credit; and (ii) procyclical rate, dependent on GDP growth.	GDP-based.	Systemic.	Procyclical provisioning is discrete, and only implemented once trigger set in place.
Spain 1/	2005	(i) the specific provision covers incurred losses individually identified in specific loans; and, (ii) the general provision, to cover incurred losses, not yet individually identified, in homogeneous loan portfolios classified as normal and calculated using statistical procedures.	Depends on individual NPLs.	Depends on individual banks portfolio.	Cumulative Funds gradually build over time.
Colombia	2007	(i) individual provisioning depends on the characteristic of the borrower; (ii) counter-cylical provisioning reflects changes in borrower's credit risk due to economic cycle; and (iii) generic provisioning of at least 1 percent of total loan portfolio.	Regulator decides, based on default probabilities, but has also some discretion. Recent revisions will make decision more rule based.	Systemic, but is moving to individual banks.	Cumulative Funds gradually build over time.
Uruguay	2001	(i) individual provisioning; and (ii) dynamic provisioning, which reflects the difference between monthly statistical losses on loans minus the realized loan loss in that month.	Depends on individual NPLs.	Depends on individual banks portfolio.	Cumulative Funds gradually build over time.

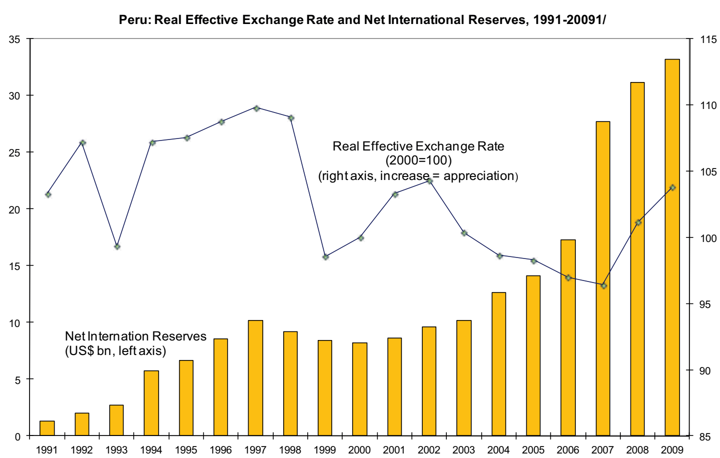
1/ Between 2000-04, the provisioning system was slightly different (there were three types of provisions instead of the current two and there were also some differences in the value of the parameters provided by the central bank's model).

Source: Various regulators.

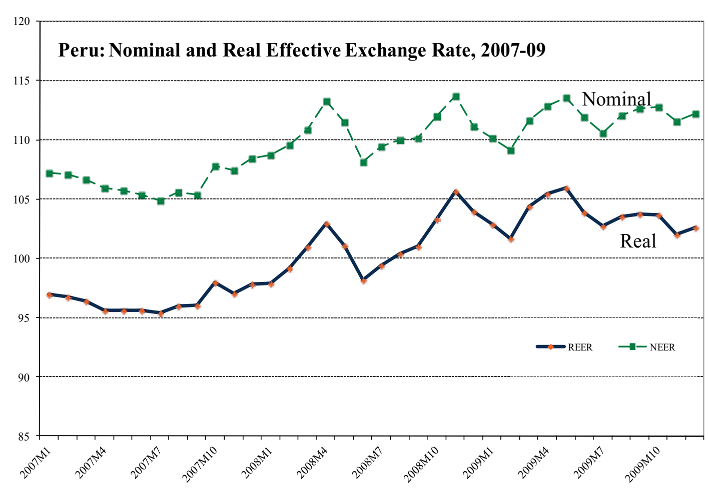
Appendix 4: Exchange Rate Developments and Assessment

Amid the global financial crisis, the Nuevo Sol has appreciated by about 5 percent in the last 2 years, thanks to stronger fundamentals and a weaker U.S. dollar. The appreciation has been very gradual, as the Sol has been the most stable currency among major countries in the region. Exchange rate volatility in Peru compares positively in light of other dollarized economies. Different exchange rate assessments suggest that the exchange rate is in line with fundamentals, with estimates ranging from an undervaluation of 7 percent to an overvaluation of 6 percent.

In real effective terms, the Nuevo Sol has recovered from its low level in recent years (Chart 1). In November, the real effective exchange rate (REER) was at around its 1991−2008 average. In contrast with the period of 2004−7 when the Nuevo Sol was at its lowest level, the Nuevo Sol has appreciated by a cumulative 5 percent during 2008−09, thanks to stronger fundamentals and a weaker U.S. dollar. The appreciation has been accompanied by accumulation of reserves of about US$4 billion (15 percent of the 2007 NIR level).



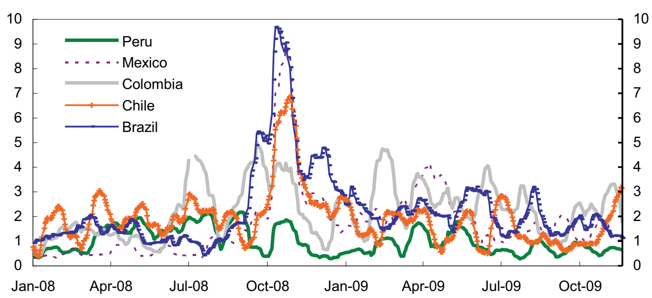
In recent months, however, the Nuevo Sol has depreciated in real terms (Chart 2). The Nuevo Sol reached its peak in May 2009, with a cumulative appreciation of 10 percent since September 2007. Since then, the currency has depreciated by about 4 percent in real effective terms, most recently because of inflation differential. In nominal terms, however, currency appreciation pressures have reemerged and the BCRP intervened and purchased US$1.4 billion in the spot market in January. There are indications of foreign portfolio inflows and domestic portfolio reallocation, with expectations of an appreciation of the Sol linked to the increase in commodity prices and a strong rebound in Peru.



Peru's *Sol* has been the most stable currency among major countries in the region. 3-month rolling volatility for the nominal exchange rate (vis-à-vis the US$) has been below 2 percent during 2008−09, well below other large economies in the region which have a freely floating exchange rate regime. Further, volatility has been declining since June 2009 and remains somehow subdued (below 1 percent). However, Peru compares well with respect to other dollarized economies in the region. The exchange rate volatility in Peru is historically about middle ground between those of Uruguay and Costa Rica.

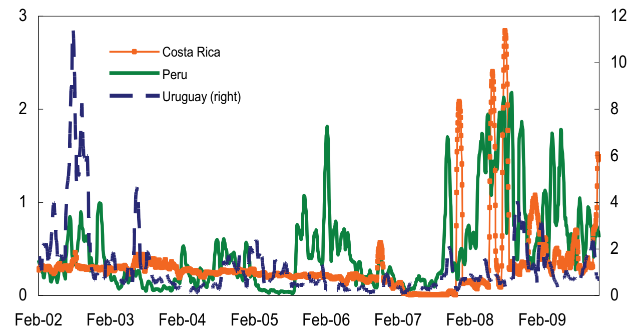
3-month Rolling Volatility for Selected Latin American Emerging Market Economies, 2008-09

(in percent)



3-month Rolling Volatility in Dollarized Economies, 2002-09

(in percent)



CGER-type calculations suggest that the exchange rate is broadly in line with fundamentals.

- **The macroeconomic balance approach** compares the difference between the underlying current account balance projected over the medium term at the current exchange rate, and an estimated equilibrium current account or "CA norm". The change in the real effective exchange rate needed to close the gap between the two measures is the degree of misalignment. The CA norm is estimated as a function of the economy's medium-term fundamentals on the basis of a cross-country panel regression. This approach shows an overvaluation of 6 percent in the real effective exchange rate.

- **The external stability approach** calculates the difference between the actual current account balance and the balance that would stabilize the net foreign asset position of the country at a benchmark level. The real exchange rate adjustment needed to bring the current account balance in line with the NFA-stabilizing level over the medium term is the degree of misalignment. This approach suggests an overvaluation of 5 percent.

- **The equilibrium real exchange rate** approach estimates the long-run relationship between the real effective exchange rate and fundamentals based on a cross country panel regression. The exchange rate adjustment needed to restore equilibrium over the medium term is calculated as the difference between the estimated equilibrium real exchange rate and its current value. This approach suggests an undervaluation of the Nuevo Sol of 7 percent as of October 2009.

Calculations based on an alternative methodology for countries with large stocks of non-renewable resources confirm the CGER results. Under the stock approach (Thomas, Kim, and Aslam (2008)) the level of the non-copper current account consistent with optimal consumption smoothing is estimated. The degree of misalignment is the real exchange rate adjustment needed to bring the current account balance in line with the estimated equilibrium non-copper current account (a deficit of 2.1 percent of GDP). An analysis for Peru based on copper suggests an undervaluation of 2 percent. Uncertainties in this approach include the estimate of the stock of copper reserves, assumptions on the return on investment and the discount rate, and the exclusion of other non-renewable resources in the country.

Under the 2007 Surveillance Decision, the underlying current account balance is defined as the medium-term level of the current account stripped of temporary factors influencing the trade and income balances. The projected current account (at -1.3 percent of GDP for 2010) may differ from the underlying current account for several reasons, including:

- **Domestic output gap.** Peru's output is estimated to be below potential in 2010. If output were brought up to its potential, imports would increase, widening the current account deficit.
- **Output gap in trading partners.** Foreign demand in Peru's key trading partner is estimated to be below potential. If this gap were to close, Peru's exports would benefit, leading to an improvement in the trade and current account balances.
- **Commodity prices.** 2010 prices are estimated above their long-term level (average of 2014−15). If prices were to be adjusted to their long-term level the trade and current account balances would deteriorate. In parallel, profit remittances for foreign companies would decline in line with reduced commodity prices.
- **Hydrocarbon prices.** As a net importer of hydrocarbon products, Peru's trade balance has deteriorated due to the recent price increase. If these were reversed and prices were to fall to a smoothed average. The current account would improve.

The adjustments to the projected current account balance imply an estimated underlying current account deficit of 1.1 percent of GDP compared to a projection of a deficit of 0.7 percent of GDP in 2010. With mining products accounting for nearly two thirds of Peru's goods exports, lower longer-term commodity prices have the strongest effect on Peru's current account through reduced exports—equivalent to 1¼ percent of GDP (see table). This is only partially offset by lower profit remittances, and the effects of Peru's and trading partner's negative output gap. These temporary factors are expected to dissipate over the medium term as output gaps are closed and commodity and mineral prices approach their long-term levels. The level of the underlying current account is consistent with external sustainability.

Finally, the exchange rate assessments are subject to considerable uncertainties stemming from the model assumptions, as well the rapid changes taking place against the background of the global financial and economic turmoil. Further disruptions in currency markets, declines in commodity prices, and changes in relative inflation and output gaps can also complicate the analysis at this juncture.

Table A4.1. Peru: Estimating the Underlying Current Account Balance for 2010

Current account (billions of US$)	Current account (in percent of GDP)	Adjustment (billions of US$)	Adjustment (in percent of GDP)	Concept	Explanation
Projection 2010					
-1.0	-0.7	-0.39	-0.27	Output gap in Peru	Output is below potential. Reaching potential growth would increase imports.
		1.02	0.69	Output gap trading partner	Foreign demand is growing below potential. Assuming the gap will be closed will benefit Peruvian exports.
		-1.85	-1.27	Mineral prices	Exports will be lower as mineral prices are estimated above their long-term level.
		1.11	0.76		Lower mineral prices will translate also in lower profit remittances.
		-0.45	-0.30	Hydrocarbon prices	2010 oil prices are below their long term level. If they rise, net imports will be higher.
Underlying current account					
-1.6	-1.1				

Source: Fund staff estimates.

Appendix 5: Capital Markets in Peru

Peru's financial market has grown rapidly in recent years, and demand for Peruvian assets is expected to continue growing strongly. A decade of macroeconomic stability and economic growth has put Peru on the emerging markets map. Peru's stock market has been among the best performers in recent years, driven by the rebound in mineral prices and obtaining investment–grade status from all three major rating agencies. Rising domestic savings—in the form of increasingly capitalized pension and mutual funds as well as sound public finances—and increasing demand for Peruvian assets by foreign investors, insurance companies and other financial intermediaries, have led to increased demand for domestic equity, bonds and other financial assets, which is expected to be sustained in coming years.

Peru's supply of financial assets is limited by regional standards (Table A5.1). High equity returns, a stable macroeconomic environment and rising assets under management of AFPs have not led to the take off of the primary market. Equity issuances/Initial Public Offerings (IPO) are still rare, with many companies raising capital overseas instead. The stock market has had few new listings and remains dominated by commodity–producing companies (two-thirds). By regional comparison, the domestic fixed income market is also underdeveloped and dominated by public debt. Most fixed-income products remain illiquid, as they are bought and held by AFPs.

Table A5.1. Comparing Size of Tradable Assets Across Latin America, 2009 1/
(as a share of GDP)

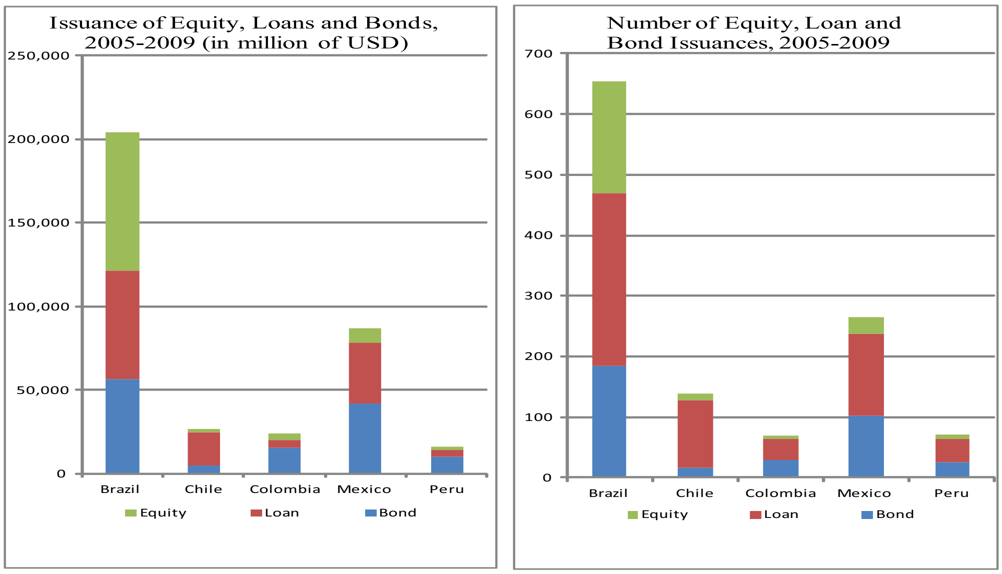
	Equity Market	Domestic Public Sector Debt
Peru	54.1	6.5
Brazil	75.4	45.0
Chile	120.3	16.8
Colombia	53.5	17.9
Mexico	28.7	33.1

Source: Haver Analytics, Bloomberg, National Authorities and Staff estimates.
(1) Reflects latest available data.
(2) Includes gross external debt (registered and nonregistered public and private).

The constraint to expanding the supply of domestic assets is partly structural, related to market size. In comparison to key emerging markets in the region, Peru has the smallest market size in dollar amounts, as well as the fewest issuances of equity, loans and bonds between 2005 and 2009 (Figure A5.1). This reflects in part the size of the economy, which limits the scope for deep domestic capital markets. Moreover, the dominance of buy and hold investors in Peru leads to a lack of liquidity, which raises the entry and exit hurdle into the stock market. The selective nature of issuers—mainly companies in the mining sector—restricts the benefit of diversification for investors. Corporate culture also plays a part in explaining why entities and controlling shareholders are reluctant to relinquish control over firms. Finally, for medium-sized corporations in Peru, banks provide capital in a more cost-efficient way than capital markets, given the minimum amount needed for the issuance to be cost-effective.

Reforms in recent years are aiming at improving market conditions. The reforms over the last decade have laid down important keystones for an efficient capital market (see Box 1). A yield curve in soles has been established, creating a reference point for the corporate sector. Regulations have been modified, and laws have been amended to reduce the costs of raising capital. Some investment restrictions on institutional investors have been lifted, creating demand for new assets.

Figure A5.1: Comparison of Equity, Loan and Bond Issuances in Latin America, 2005-09



Source: BEL

Box A5.1: Measures implemented since 2002 to deepen Capital Markets

2002: Reform of the *Bankruptcy Code* to facilitate reorganization and restructuring.

2003: Implementation of the *Market Makers Program*, which, through the regular issuance of soles-denominated sovereign bonds, establishes a domestic currency yield curve.

2005: (i) Reform of *Securities Settlement System*, in which a group of banks (instead of a single bank) acts as counterparty to market participants, thereby ensuring the provision of liquidity. (ii) Reforming the *Pension Fund system*, by creating two new types of private pension funds on top of the standard fund, allowing for more equity exposure.

2006: (i) Implementation of a *Unified Registry of Collateral*, facilitating to pledge and execute collaterals of borrowers and lenders. (ii) Establishing a new *Court* specialized in commercial and financial disputes.

2007: (i) Creation of *Mortgage Administrator* firms dedicated to the securitization of mortgages.
(ii) Amending of *Trading Rules* of certificates of deposit, account receivable and other instruments issued by small borrowers to ease trading in the Lima Stock Exchange, and further easing the eligibility criteria for stock purchases by pension funds.

2008: (i) Amendments to the *Financial System Law* to expand the range of investments available to non-bank financial institutions, and implementation of close-out netting operations. (ii) Amendment the *Capital Market Law* to facilitate and reduce the cost of debt issuance. (iii) SBS amends regulation on *Pension Funds* to facilitate trading in derivatives, shares, mutual funds and alternative investments. (iv) CONASEV implements simplified procedures for *IPOs* geared to accredited investors.

Appendix 6: Fiscal and External Debt Sustainability Analysis

Peru's public debt-to-GDP ratio is projected to decline under the baseline debt scenario to below 20 percent of GDP. Economic growth will recover after the dip in 2009, and will reach potential this year. Growth will average 6 percent a year in 2010–15 underpinned by domestic demand dynamics and the global recovery. The public sector revenue-to-GDP ratio is expected to increase by a cumulative 0.9 percentage points, reflecting the recovery in growth and mining revenues. Under these assumptions, Peru's public sector debt stock (including CRPAOs) would decline from 27.4 percent of GDP at end-2009, to 19.7 percent of GDP by 2015.

External debt is projected to remain below 30 percent of GDP. The decline in external public sector debt over the medium term (of about 5 percentage points of GDP) would be compensated by a marginal increase in private sector external debt as financing conditions improve globally. Given the recent declines in public external debt, total external debt is projected to diminish from 32 percent of GDP at end-2007 to 26 percent by 2015 (public external debt would decline from 18 percent to 11 percent over the same period).

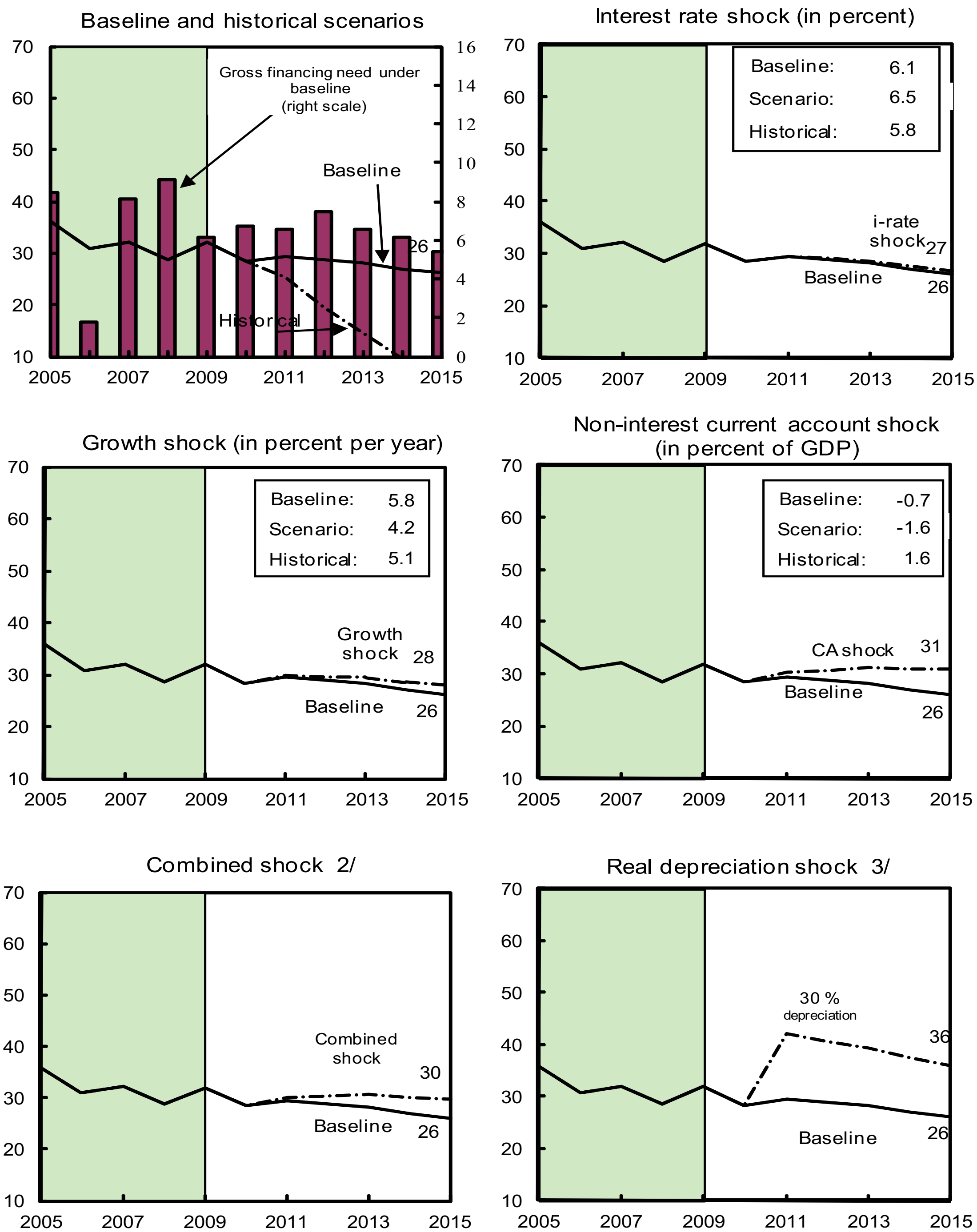
Peru's external and public sector debt ratios are robust to alternative assumptions about underlying macroeconomic variables. Sensitivity tests based on 10-year historical standard deviations for GDP growth and interest rates show that Peru's debt dynamics are only moderately vulnerable to such changes.

Despite the increasing share of public sector debt in domestic currency, external and public debt ratios remain sensitive to large and permanent exchange rate shocks. Under a one-off 30 percent real depreciation of the exchange rate, the external and public debt ratios would increase by about 10 percentage points above the baseline projections over the medium term. This test assumes that the exchange rate would remain at a depreciated level permanently, which would occur if the current level of the exchange rate was significantly overvalued. CGER estimates, however, indicate that the Sol is broadly in line with fundamentals. Noninterest current account shocks (such as in the terms of trade) would have a moderate adverse impact on external indebtedness.

A contingent liabilities shock to the public sector of 10 percent of GDP would increase public debt by a similar amount over the medium term. The public debt ratio would rise sharply in the short run and decline over the medium term. By 2015 the debt ratio would remain 9.6 percentage points above the baseline scenario.

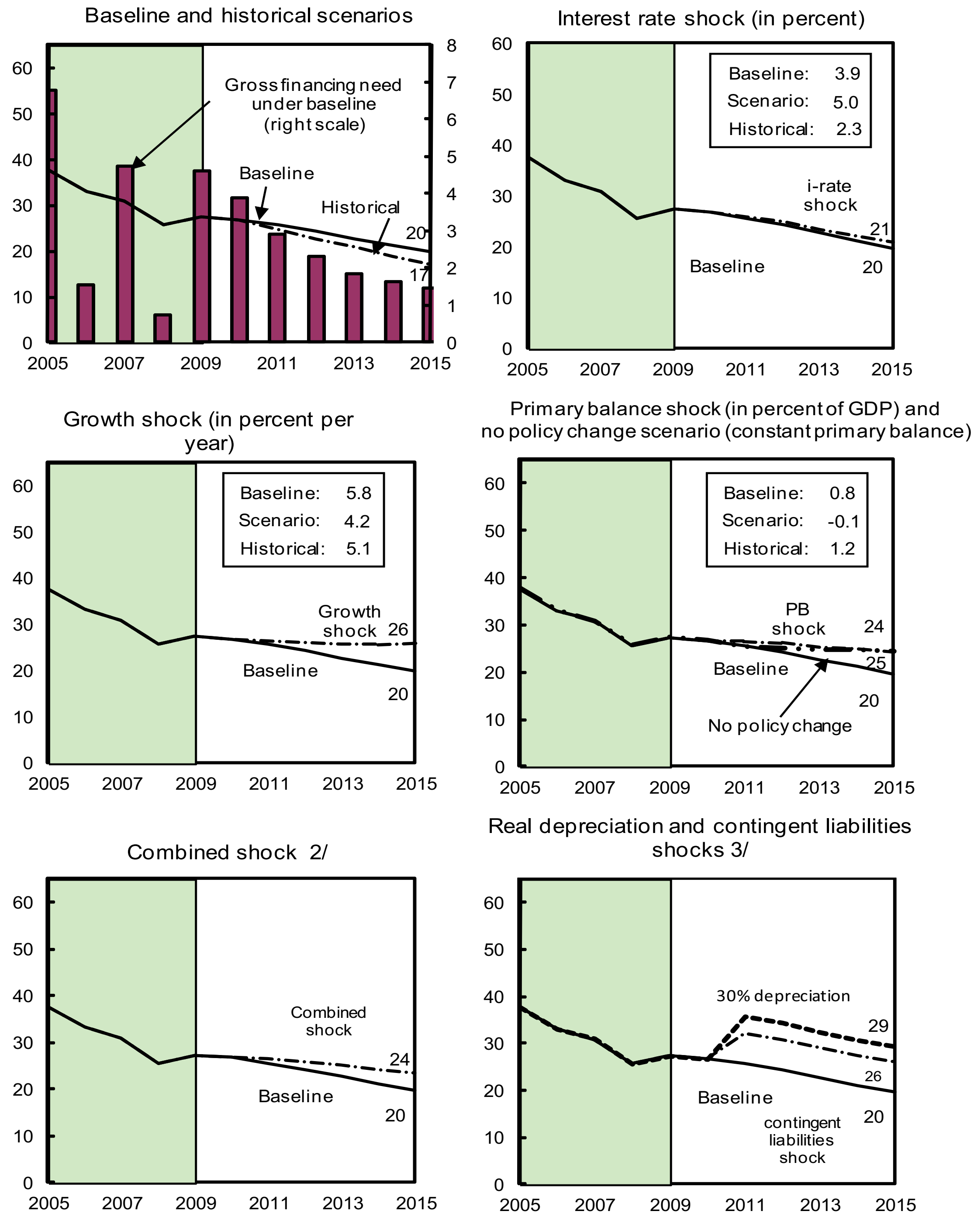
The authorities are strongly committed to continue improving the debt profile through the implementation of a proactive debt management strategy. Currency risks have declined significantly in recent years, with the foreign currency share in total public debt declining from 94 percent in 2000 to less than 60 percent in 2009. In 2010, the authorities are targeting a decline in the share of debt at fixed interest rate to 70−80 percent, as well as extending the average maturity of debt to 11−12 years.

Figure A6.1. Peru: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2011

Figure A6.2. Peru: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table A6.1. Peru: External Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	36.1	30.8	32.1	28.7	32.0	**28.4**	**29.4**	**28.8**	**28.2**	**27.0**	**26.1**	**-1.6**
Change in external debt	-8.8	-5.2	1.3	-3.4	3.4	-3.6	1.0	-0.6	-0.6	-1.3	-0.9	
Identified external debt-creating flows (4+8+9)	-11.4	-10.1	-10.8	-6.8	-0.1	-2.2	-1.2	-0.1	-0.2	-0.6	-0.9	
Current account deficit, excluding interest payments	-3.5	-5.1	-3.1	1.9	-1.7	-0.8	-0.1	1.0	1.0	0.7	0.7	
Deficit in balance of goods and services	-5.6	-8.9	-6.6	-0.9	-3.8	-3.4	-3.1	-1.9	-1.2	-0.4	0.5	
Exports	24.7	28.6	29.0	27.6	24.1	24.7	25.6	25.4	24.8	24.0	23.4	
Imports	19.1	19.7	22.3	26.7	20.3	21.3	22.5	23.5	23.5	23.6	23.9	
Net non-debt creating capital inflows (negative)	-4.4	-2.0	-5.5	-5.4	0.0	-1.2	-1.4	-1.3	-1.2	-1.3	-1.4	
Automatic debt dynamics 1/	-3.4	-3.0	-2.2	-3.3	1.6	-0.3	0.2	0.2	0.1	0.0	-0.1	
Contribution from nominal interest rate	2.1	2.0	2.0	1.8	1.5	1.5	1.8	1.8	1.6	1.5	1.4	
Contribution from real GDP growth	-2.7	-2.4	-2.4	-2.6	-0.2	-1.8	-1.6	-1.6	-1.5	-1.5	-1.5	
Contribution from price and exchange rate changes 2/	-2.8	-2.7	-1.8	-2.5	0.4	…	…	…	…	…	…	
Residual, incl. change in gross foreign assets (2-3) 3/	2.6	4.9	12.1	3.3	3.5	-1.4	2.2	-0.5	-0.4	-0.6	0.0	
External debt-to-exports ratio (in percent)	145.8	107.6	110.9	103.8	133.0	115.2	115.1	113.2	114.0	112.2	111.4	
Gross external financing need (in billions of US dollars) 4/	6.7	1.7	8.7	11.6	7.8	9.8	10.1	12.0	11.4	11.3	10.5	
in percent of GDP	8.4	1.8	8.1	9.1	6.2	6.7	6.5	7.4	6.6	6.1	5.4	
Scenario with key variables at their historical averages 5/						**28.4**	**25.3**	**19.5**	**14.6**	**9.6**	**5.2**	**-2.7**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.7	7.7	8.9	9.8	0.9	6.3	6.0	5.7	5.7	5.7	5.8	
GDP deflator in US dollars (change in percent)	6.8	8.0	6.4	8.3	-1.4	8.5	-0.4	-1.0	1.0	0.9	0.5	
Nominal external interest rate (in percent)	5.3	6.6	7.6	6.6	5.2	5.4	6.8	6.3	6.1	5.7	5.4	
Growth of exports (US dollar terms, in percent)	32.8	34.8	17.2	13.3	-13.2	18.2	9.4	4.2	4.0	3.5	3.6	
Growth of imports (US dollar terms, in percent)	21.4	20.0	31.2	42.2	-24.3	20.9	11.3	9.6	6.9	7.1	7.4	
Current account balance, excluding interest payments	3.5	5.1	3.1	-1.9	1.7	0.8	0.1	-1.0	-1.0	-0.7	-0.7	
Net non-debt creating capital inflows	4.4	2.0	5.5	5.4	0.0	1.2	1.4	1.3	1.2	1.3	1.4	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ 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 $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table A6.2. Peru: Public Sector Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	37.7	33.2	30.9	25.7	27.4	**26.7**	**25.6**	**24.3**	**22.7**	**21.1**	**19.7**	**-0.3**
o/w foreign-currency denominated	29.6	25.2	21.3	16.2	16.8	15.1	14.5	13.3	9.1	8.5	7.9	
Change in public sector debt	-6.6	-4.6	-2.3	-5.2	1.7	-0.6	-1.1	-1.3	-1.6	-1.5	-1.4	
Identified debt-creating flows (4+7+12)	-5.0	-7.4	-7.7	-3.8	0.7	-0.6	-1.0	-1.2	-1.5	-1.4	-1.3	
Primary deficit	-1.6	-4.0	-4.0	-2.9	1.1	0.3	-0.3	-0.7	-1.1	-1.1	-1.0	
Revenue and grants	18.9	20.6	20.8	21.0	18.6	19.3	19.1	19.5	19.8	19.6	19.5	
Primary (noninterest) expenditure	17.3	16.7	16.8	18.1	19.7	19.5	18.8	18.8	18.7	18.6	18.5	
Automatic debt dynamics 2/	-3.3	-3.4	-3.5	-0.9	-0.4	-0.9	-0.7	-0.5	-0.4	-0.3	-0.3	
Contribution from interest rate/growth differential 3/	-2.1	-3.2	-1.5	-1.5	0.7	-0.9	-0.7	-0.5	-0.4	-0.3	-0.3	
Of which contribution from real interest rate	0.6	-0.7	1.1	1.2	0.9	0.7	0.8	0.9	0.9	0.9	0.8	
Of which contribution from real GDP growth	-2.7	-2.5	-2.6	-2.7	-0.2	-1.6	-1.5	-1.4	-1.3	-1.2	-1.1	
Contribution from exchange rate depreciation 4/	-1.2	-0.2	-2.0	0.6	-1.2	...	...	...	...	...	...	
Other identified debt-creating flows	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-1.6	2.9	5.4	-1.4	1.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	
Public sector debt-to-revenue ratio 1/	199.2	160.7	148.5	122.3	147.2	138.8	134.0	124.4	114.5	107.7	101.4	
Gross financing need 6/	6.8	1.6	4.8	0.8	4.6	3.9	2.9	2.3	1.8	1.6	1.5	
in billions of U.S. dollars	5.4	1.4	5.1	1.0	5.9	5.7	4.5	3.8	3.2	3.0	2.9	
Scenario with key variables at their historical averages 7/						**26.7**	**24.7**	**22.7**	**20.8**	**18.9**	**17.1**	**-0.4**
Scenario with no policy change (constant primary balance) in 2010-2015						**26.7**	**25.5**	**25.2**	**24.9**	**24.7**	**24.6**	**-0.3**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.7	7.7	8.9	9.8	0.9	6.3	6.0	5.7	5.7	5.7	5.8	
Average nominal interest rate on public debt (in percent) 8/	4.8	5.8	6.0	5.6	5.2	5.3	5.4	5.2	5.1	5.1	5.1	
Average real interest rate (nominal rate minus change in GDP deflator, in p	1.8	-1.5	4.0	4.5	3.7	2.9	3.3	3.7	3.9	4.1	4.3	
Nominal appreciation (increase in US dollar value of local currency, in perc	3.6	0.6	9.2	-3.1	7.5	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	3.0	7.2	2.0	1.1	1.5	2.4	2.1	1.5	1.1	0.9	0.9	
Growth of real primary spending (deflated by GDP deflator, in percent)	8.9	3.7	9.6	18.3	10.1	5.4	1.9	5.8	4.8	5.1	5.3	
Primary deficit	-1.6	-4.0	-4.0	-2.9	1.1	0.3	-0.3	-0.7	-1.1	-1.1	-1.0	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
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; π = growth rate of GDP deflator; g = real GDP growth rate; α = 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/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

INTERNATIONAL MONETARY FUND
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International Monetary Fund
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Public Information Notice (PIN) No. 10/50
FOR IMMEDIATE RELEASE
- April 15, 2010

IMF Executive Board Concludes 2010 Article IV Consultation with Peru

On April, 14, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Peru.[7]

Background

Peru's economic performance over the last decade has been impressive by domestic and international standards. Strong economic fundamentals, a sound institutional policy framework, and a solid track-record of prudent macroeconomic policies helped reduce vulnerabilities, achieve record-high economic growth, and advance significantly with poverty reduction. Reflecting on these achievements, Peru was granted investment grade by Fitch and Standard & Poor's in 2008 and by Moody's at end-2009, consolidating its standing among major emerging market economies. Peru's medium-term prospects remain bright, linked to sustained efforts in the implementation of an ambitious structural reform agenda.

Peru's economic resilience during the global financial crisis was the result of the proactive policy response and sound fundamentals. Growth in Peru decelerated sharply in 2009, due to the global financial crisis, but remained positive at about 1 percent for the year, despite a few

[7]Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

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months in negative territory. Thanks to the strong buffers built in recent years, Peru was able to implement a significant monetary and fiscal policy response, which helped to avoid a credit crunch, support domestic demand and sustain employment. The central bank injected substantial liquidity in the financial system and lowered the policy rate to an historic low of 1.25 percent. A significant fiscal stimulus plan was introduced, which entailed a positive fiscal impulse of about 2.5 percent of GDP in 2009. Peru's financial sector proved resilient to the global financial crisis thanks to the sound prudential framework put in place in past years and its strong initial standing, and it has remained well-capitalized, liquid and profitable. Peru's external financial account showed also resilience to the global financial crisis, with a resurgence of capital inflows and appreciation pressures in recent months. To moderate currency volatility, the central bank has intervened in the foreign exchange market, purchasing US$2.5 billion so far this year.

Economic activity is expected to grow strongly in 2010, with limited slack in resource utilization thanks to the successful policy response. With the economy already gaining momentum, a sustained improvement in global conditions and the remaining stimulus, staff projects growth at 6.25 percent this year and 6 percent in 2011. Peru's recovery appears less dependent on policy support than in other advanced and emerging market economies, as it did not open a significant output gap and the balance sheets of the corporate, household, and financial sectors remain unimpaired. Moreover, the balance of risks to growth in Peru appears tilted to the upside, linked to prospects of renewed capital inflows to strong emerging markets and domestic demand dynamics, including the cyclical rebuilding of inventories and acceleration of private investment projects put on hold last year. A relapse in global growth and a return of global risk aversion are the principal tail risk that could encumber the growth outlook for Peru.

Executive Board Assessment

Executive Directors commended the Peruvian authorities for their impressive track-record of prudent macroeconomic policies which helped limit the impact of the global crisis and jump start a vigorous economic rebound. Given its strong fundamentals, the economy is expected to return to rapid growth. Peru's medium–term outlook remains bright, supported by the authorities' ambitious reform agenda.

Directors noted that the balance of risks to Peru's growth is tilted to the upside because of domestic demand dynamics and renewed capital inflows. They agreed that, with limited slack in resource utilization, these risks call for early withdrawal of policy stimulus to avoid a buildup in inflationary pressures. Directors also noted that a renewed surge in capital inflows would require close monitoring and would benefit from a strategy that focuses on fiscal consolidation and greater exchange rate flexibility. Directors observed that normalizing monetary conditions may rely on a combination of measures, including reserve requirements, along with macro–prudential measures to prevent credit and asset booms.

Directors welcomed the authorities' intention to manage spending plans carefully to achieve in 2011 the fiscal deficit limit established by the Fiscal Responsibility and Transparency Law. They supported the plans to strengthen the Oil Price Stabilization Fund (FEPC) for addressing the rising liabilities and reducing fiscal risks. Directors also welcomed the authorities' interest in exploring ways to reduce pro-cyclicality of the fiscal framework.

Directors noted the progress made with de-dollarization over the last decade and agreed that improved fundamentals would continue to advance this process and allow the exchange rate to play a larger role as shock absorber. A gradual increase in currency flexibility could foster the development of foreign exchange hedging instruments and reduce dollarization.

Directors commended the authorities' resolve to further solidify Peru's strong prudential framework, with some regulatory norms ahead of international standards. The challenge would be to reassess the framework in light of the moving international standards, and incorporate in it the elements relevant for Peru. Directors noted that it would be important to continue strengthening macro–prudential supervision. Consideration could be given to assessing the scope for incorporating systemic risk into the regulatory framework, reviewing the crisis resolution framework, and extending the prudential perimeter to cooperatives and public financial institutions.

Directors welcomed the authorities' ambitious reform agenda to preserve high growth over the medium term, underpinned by continued prudent macroeconomic policies. The authorities' plans to further develop Peru's capital market would be key to effectively channel resources to sustained capital formation over the long term. Directors encouraged the authorities to continue with their poverty reduction efforts.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Peru: Selected Economic Indicators

						Projections	
	2005	2006	2007	2008	2009	2010	2011
Social Indicators							
Life expectancy at birth (years)	70.7	72.8	73.1	73.3	...	...	...
Infant mortality (per thousand live births)	22.8	18.9	17.2	17.0	...	...	...
Adult literacy rate	87.9	88.7	89.6	…	...	...	...
Poverty rate (Total) 1/	48.7	44.5	39.3	36.2	...	...	...
Unemployment rate	9.6	8.5	8.4	8.4	8.6	...	...
(Annual percentage change; unless otherwise indicated)							
Production and prices							
Real GDP	6.8	7.7	8.9	9.8	0.9	6.3	6.0
Real domestic demand	5.8	10.3	11.9	12.1	-2.9	7.4	7.0
Of which: Private sector	5.9	9.0	11.4	12.6	-2.1	4.9	6.2
Consumer Prices (end of period)	1.2	1.1	3.9	6.7	0.2	2.0	2.0
Consumer Prices (period average)	1.6	2.0	1.8	5.8	2.9	1.5	1.8
External sector							
Exports	35.6	37.2	17.0	13.1	-14.7	19.7	10.0
Imports	23.2	22.9	32.0	45.1	-26.1	21.4	13.4
Terms of trade (deterioration -)	5.9	28.3	3.4	-13.7	-0.8	3.7	1.1
Real effective exchange rate (depreciation -) 2/	-0.5	-1.3	-0.6	4.9	2.4	...	...
Money and credit 3/ 4/							
Liabilities to the private sector	18.4	8.8	22.7	24.2	6.2	14.7	14.0
Net credit to the private sector	16.3	6.2	30.8	31.5	1.7	14.4	14.1
(In percent of GDP; unless otherwise indicated)							
Public sector							
General government current revenue	18.0	19.9	20.7	20.9	18.5	19.2	19.0
General government noninterest expenditure	16.8	16.3	16.0	17.3	19.5	19.6	18.9
Combined public sector primary balance	1.6	4.1	5.1	3.7	-0.7	-0.2	0.3
Interest due	1.9	1.9	1.8	1.6	1.3	1.3	1.3
Combined public sector overall balance	-0.3	2.2	3.3	2.2	-2.0	-1.5	-1.0
Combined public sector debt (including CRPAOs)	37.7	33.2	30.9	25.7	27.4	26.7	25.6
External Sector							
External current account balance	1.4	3.1	1.3	-3.7	0.2	-0.7	-1.8
Gross reserves							
In millions of U.S. dollars	14,12	17,32	27,74	31,25	33,19	35,69	37,19
Percent of short-term external debt 5/	314.2	174.9	405.3	421.1	397.5	473.7	481.4
Percent of foreign currency deposits at banks	131.0	148.2	208.7	175.0	190.3	180.6	182.3
Debt							
Total external debt	36.1	30.8	32.4	28.9	32.3	28.6	29.6
Combined public sector debt (including CRPAOs)	37.7	33.2	30.9	25.7	27.4	26.7	25.6
External 6/	28.1	23.9	19.9	16.7	17.4	15.8	15.1
Domestic	9.7	9.2	11.0	9.0	10.0	10.9	10.6

Savings and investment							
Gross domestic investment	17.9	20.0	23.0	26.7	20.6	23.3	24.9
Public sector 7/	2.9	2.8	3.1	4.2	5.3	6.0	6.0
Private sector	15.0	17.2	19.9	22.5	15.3	17.3	18.8
National savings	19.3	23.1	24.2	23.0	20.8	22.6	23.1
Public sector 8/	2.6	5.1	6.0	6.1	3.4	4.2	4.7
Private sector	16.8	18.0	18.3	16.9	17.4	18.4	18.4
External savings	-1.4	-3.1	-1.3	3.7	-0.2	0.7	1.8
Memorandum items							
Nominal GDP (S/. billions)	261.7	302.3	335.2	372.6	381.7	415.5	449.3
GDP per capita (in US$)	2,917	3,340	3,797	4,446	4,356	4,950	5,147

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; ECLAC 2002-03; National Statistical Institute (INEI);
and IMF staff estimates/projections.

1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.
2/ Based on Information Notice System.
3/ Corresponds to the banking system.
4/ Foreign currency stocks are valued at end-of-period exchange rates.
5/ Short-term debt is defined on a residual maturity basis, and includes amortization of medium- and long-term debt.
6/ Includes debt by the Central Reserve Bank of Peru.
7/ Includes CRPAOs.
8/ Excludes privatization receipts.

INTERNATIONAL MONETARY FUND

PERU

March 26, 2010

Peru: Staff Report for the 2010 Article IV Consultation

Informational Annex

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

Contents

Annexes

Annex I. Peru: Fund Relations

(As of February 28, 2010)

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	516.43	80.89

III. SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	609.89	100.00
Holdings	524.09	85.93

IV. Outstanding Purchases and Loans None

V. Financial Arrangements

Type of Arrangement	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	1/26/07	2/28/09	172.37	0.00
Stand-By	6/09/04	8/16/06	287.28	0.00
Stand-By	2/01/02	2/29/04	255.00	0.00

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

	2010	2011	2012	2013	2014
Principal					
Charges/interest	0.20	0.25	0.25	0.25	0.25
Total	0.20	0.25	0.25	0.25	0.25

VII. Safeguards Assessments

An off-site safeguards assessment of the central bank has been finalized and has found that safeguards at the *Banco Central de Reserva del Perú* (BCRP) meet the requirements of the safeguards policy.

VIII. Exchange Arrangements

Peru maintains a unified, floating exchange rate. The monetary authorities have in place an inflation targeting framework. The Central Bank has established an inflation target of 2.0 percent, with a tolerance margin of ±1 percent. On March 11, 2010, the average of interbank buying and selling rates was 2.84 Nuevos Soles per U.S. dollar. The exchange system is free of restrictions, except for those maintained solely for the preservation of national or international security, and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). Those restrictions are maintain pursuant to UN Security Council Resolutions 1267 (October 15, 1999) and 1373 (September 28, 2001). The central government maintains small external payment arrears to unguaranteed suppliers (US$11.7 million of principal and accrued interests as of December 31, 2009). Peru has maintained a clearing arrangement with Malaysia since 1991.

IX. Last Article IV Consultation

The 2008 Article IV consultation was concluded on January 14, 2009 (EBS/09/10, IMF Country Report No. 09/40).

X. FSAP, ROSCs, and AML/CFT

Several joint Fund-Bank missions visited Lima in the period September 2000–January 2001 to conduct an FSAP for Peru. The corresponding FSSA report (SM/01/75 dated February 28, 2001) was discussed by the Executive Board on March 12, 2001. A follow-up FSAP mission was concluded in February 2005. 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.

The Fund is actively engaged with Peru in delivering technical assistance to the Superintendency of Banks, Insurance and Pension Fund Companies (SBS) in the following areas: (i) developing and/or strengthening of existing AML/CFT supervisory policies, practices, systems and tools needed to identify, measure, monitor, and control ML/FT risks with the financial institutions under the responsibility of the SBS; (ii) providing advice and assistance to SBS officials in addressing organizational and operational issues of the newly created AML/CFT Unit, including the identification of resources, both human and technological to facilitate the implementation of the risk-based approach to AML/CFT supervision; and most recently (iii) initiating the process for conducting a national risk assessment of ML/FT risks impacting Peru. So far, Peru has received three TA missions and the TA program is expected to continue for the next 18 months.

XI. Technical Assistance

Department	Date	Purpose
FAD	June 2005, March 2006, November 2006, May 2007−present	Public Financial Management
	February and June 2009, April, June and October 2008, February, June and August 2007, February, September, and November 2006, and May 2005	Tax policy and administration, customs administration
	August 2004, September 2003, and September 2002	Public investment and fiscal policy, including issues related to PPPs
	November 1999	Fiscal rules
MFD/MCM	May and August 2009	Mortgage covered bonds
	September 2008	Supervision of Capital Markets
	March 2008	Implementation of Basel II
	October 2007	Strengthening the Capital Markets

	July 2007	Strengthening the Capital Markets
	April 2007	Strengthening the Capital Markets
	April 2006	Financial sector supervision
	April 2005	Consumer protection in the banking system
	March 2005	Central bank organization
	April, December 2002, February 2003, March and September 2004	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
LEG	February 2010, May 2009, and September 2008	AML/FT (see previous section)
STA	May and September 2009, March, September and November 2008, October 1999, and January 1998	National account statistics, new base year for the national account series; and Government Finance Statistics 2001

XII. Resident Representative

Mr. Luis Breuer has been Resident Representative in Peru since January 2008.

Annex II. Peru: World Bank Relations

Bank Group Strategy

The World Bank Group support to Peru is defined in the Country Partnership Strategy (CPS) approved by the Board on December 19, 2006. The strategy supports the government's developmental goals with emphasis on inclusive growth and poverty reduction. The agenda includes programs addressing fiscal, national competitiveness, infrastructure and social-sector needs. The country strategy underscores partnerships, flexibility and results orientation in public expenditure. The CPS projects financial assistance of up to US$3.5 billion between July 2007 and June 2011 and envisages a flexible lending program. The strategy includes development policy lending operations in the fiscal, social, and environmental sectors.

The CPS Progress Report discussed by the Board on February 17, 2009 showed progress in the areas of fiscal management, sustained economic growth, and poverty reduction. New government priorities have been included in the Bank's program in response to changing circumstances. The Bank responded rapidly to the Government's request of contingent credit lines to mitigate potential effects of the developing global crisis, with US$1.36 billion in DPL-DDOs during FY 09. In addition, two investment lending operations in transport infrastructure and water and sanitation sector, and a CAT DDO were included in the program during the preparation of the CPS Progress Report. While the Program adjusted accordingly to the Government's financial needs, the overall medium term vision of the CPS continues to be relevant for Peru.

Peru's current lending portfolio includes 19 active projects with a commitment of US$1.9 billion and an undisbursed balance of US$1.5 billion. The portfolio includes fourteen investment loans, three DPL/DDOs and two GEF grants. The areas covered by the existing portfolio are economic policy, environment, social protection, transport infrastructure, water resources, among others.

The Board has approved four new operations during FY 10, including two programmatic DPLs in the fiscal and environmental sectors for US$200 million and two investment operations in water resources management and transport infrastructure for US$160 million. In the remaining of the FY 2010, three investment operations in the areas of nutrition, justice services improvement, and agriculture irrigation are expected to be submitted to the Board for approval.

FY 2011 pipeline comprises eleven operations for a total of US$685 million. It includes three DPLs in the fiscal, environmental, and social sectors for US$275 million, one CAT DDO for US$75 million, and seven investment lending operations in the areas of agriculture, education, water and sanitation, and rural electrification for US$335 million.

In addition, the Bank has an extensive program of analytical and advisory activities for FY 10−11, including both economic and sector work and non-lending technical assistance. The economic and sector work covers areas such as public expenditure, infrastructure, gas development strategy, decentralization, labor markets, social sectors, climate change, and housing and municipal financing. Several multi-year non-lending technical assistance are currently in progress, covering areas such as governance and governability enhancement, poverty monitoring, and performance informed budgeting. In addition, non-lending technical assistance in education, nutrition, governance, disasters risk management, and natural resources management are planned for delivery in FY 10−FY 11.

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. A joint FSAP update was completed in June 2005.

Public Sector Management. Bank-Fund collaboration has focused in the area of results based budgeting, the implementation of a Treasury Single Account and modernization of budget processes, institutions and information systems.

Customs Administration Modernization: A needs assessment mission was undertaken together with the IMF to develop an action plan for modernizing customs administration. The joint team presented a technical report to SUNAT.

Reform of the National Public Investment System (SNIP). The Bank has been working in close collaboration with the authorities in reducing the institutional bottlenecks of the public investment system. A joint WB-IADB mission took place in March 2007 to revise current government procurement regulations. The Bank is also providing technical assistance in the design of the framework law for Public-Private Partnerships as well as in the implementation of FONIPREL.

Statement of World Bank Loans
(As of February 1st, 2010)

Loan Number	Year Approved	Borrower	Purpose	Total (Net Cancellation)	Undisbursed
				In million of US Dollars	
Sixty seven loans have been fully repaid.					
Partially disbursed or undisbursed loans:					
72090	2003	Republic of Peru	Lima Transport Project	45.0	5.9
71420	2002	Republic of Peru	National Rural Water Supply and Sanitation	50.0	20.0
72190	2004	Republic of Peru	Justice Services Improvement	12.0	0.0
73220	2005	Republic of Peru	Regional Transport Infrastructure	50.0	42.6
73680	2006	Republic of Peru	Real Property Rights II	25.0	13.0
74430	2007	Republic of Peru	Sierra Rural Development Project	20.0	17.0
72850	2005	Republic of Peru	(APL2)Agric Research and Extension	25.0	3.9
72570	2004	Republic of Peru	Vilcanota Valley Rehab & Mgmt Project	5.0	2.7
72550	2004	Republic of Peru	Inst. Capacity for Decent. TAL	6.6	1.1
73660	2006	Republic of Peru	Rural Electrification	50.0	17.9
76430	2009	Republic of Peru	(APL2) Health Reform Program	15.0	15.0
74230	2006	Republic of Peru	Decentralized Rural Transport Project	50.0	20.2
76680	2009	Republic of Peru	2nd Results & Accnt.(REACT)DPL/DDO	330.0	310.0
76740	2009	Republic of Peru	First Prog. Environ DPL/DDO	330.0	310.0
76490	2008	Republic of Peru	2nd Prg Fiscal Mgmt & Comp. DPL/DDO	700.0	530.0
77010	2009	Republic of Peru	Water Resources Mgmt.	10.0	10.0
78320	2010	Republic of Peru	Safe and Sustainable Transport	150.0	150.0
Total disbursed:				6,147.1	
Of which: amount repaid				3,191.6	
Total Outstanding:				2,897.6	
Total Undisbursed:					1,469.3

Statement of IFC Operations in Peru
(As of December 31st, 2009)

	Total: Commitments held	Total: Disbursed
Loans	596.0	512.6
Equity	111.1	88.6
Quasi	32.1	32.1
GT/RM	0.5	0.0
Particip. Loans	139.0	139.0
Total	878.8	772.4

Annex III. Peru: Relations with the Inter-American Development Bank

Country Strategy

The Country Strategy for 2007−2011 continues the thrust of Bank assistance in areas relating to competitiveness, social development, and modernization of the State, and reflects wide-ranging discussions of policies with the Government and with Peruvian society to identify the constraints the country faces in achieving its development objectives.

The IDB supports Peru's development agenda by deepening the country's sustainable economic growth and generating greater opportunities for the majority of Peruvians, through efforts grouped into the following three strategic pillars: (i) strengthening Peru's participation in the global economy and enhancing competitiveness; (ii) promoting social development and economic inclusion; and (iii) deepening the reform of the State and improving public sector management. More recently, government demands for IDB interventions have been linked to environmental sustainability. These operations have been grouped in what may be called the "green cluster", including interventions in water and sanitation, solid waste, energy, climate change, natural disasters and agriculture.

Lending

As of January 31, 2010, the Bank's portfolio of active, public sector operations consisted of 25 loans for a total amount of US$793 million, of which US$255 million (32.1 percent) had been disbursed. The public sector lending program for 2010 comprises seven policy-based loans for US$252 million and six investment loans for US$133 million, all of them pending approval.

Regarding private sector operations, the Structured Corporate Finance Department's portfolio in execution consists of four A-loans and two B-loans amounting to US$470 million and US$415 million, respectively. There are also five credit guarantee operations for US$165 million (includes the Trade Finance Facilitation Program). These operations are focused primarily in the financial, natural gas and renewable energy sectors. By the end of January, about 65 percent of this portfolio had been disbursed. At the moment, private sector lending for 2010 includes two projects.

To assist Government efforts to de-dollarize public sector debt, the Bank successfully converted US$131 million of previously disbursed loans into local currency in 2008. The Government also requested to modify 23 loan contracts, converting their interest rates from variable LIBOR-based to fixed rates in 2009. This modification represented an opportunity to reduce volatility and debt service payments.

PERU—IDB Loan Portfolio by Sector

As of January 31st, 2010

(millions of US$)

Sector	Commitments	Disbursements	% Disbursed
Agriculture	40.0	15.0	37.5%
Environmental	0	0	0%
Science and Technology	25.0	11.2	44.8%
Urban Development	60.0	47.9	79.8%
Social Investment	52.2	29.6	56.7%
Modernization of the State	44.6	23.0	51.6%
Water and Sanitation	112.6	36.5	32.4%
Transportation	459.0	91.7	20.0%
Total	**793.4**	**254.9**	**32.1%**

Annex IV. Peru: Statistical Issues

Macroeconomic statistics are broadly adequate for policy formulation and surveillance. Peru subscribes to the Special Data Dissemination Standard (SDDS). A data ROSC was prepared and published in 2003.

Despite progress in recent years, there is scope for improvement in the following areas: (i) coordination among the agencies that compile official statistics to avoid duplication of efforts and confusion among users; (ii) implementing a new benchmark and base year for GDP; (iii) expanding the coverage of the wholesale price index to include mining, oil and gas extraction, electricity and water, public transportation, and communication; (iv) finalizing the migration to the standardized report forms for monetary data, with the introduction of report forms for the central bank, other depository corporations, and other financial corporations; and (v) expanding the scope of data sources for compiling financial flows of individual residents.

I. Real Sector and Prices

The authorities published a revised GDP series in 2000. The series used the 1994 benchmark estimates as the base year, and included input-output tables. However, due to limited availability of periodic source data, estimates after 1994 are largely based on extrapolation techniques. The lack of current detailed tables for supply and use hampers the reconciliation of discrepancies. As a result, changes in inventories are mainly determined as a residual. Although the quarterly accounts have benefited from some improvements in the timeliness of monthly production indices, coverage is still very limited. The National Statistics Office (INEI) is working on a new national account series implementing the *1993 SNA* and using 2007 as the base year. Three national accounts statistics missions visited the country in November 2008, May 2009, and September 2009. The missions are assisting the authorities in compiling the complete set of national accounts by institutional sectors, and in developing the sequence of accounts of nonfinancial corporations. More technical assistance will be needed in the coming years.

Expenditure weights of the CPI (2009=100) for the Metropolitan area of Lima were derived from the 2008−2009 household budget survey. 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. As concerns the WPI, statistical techniques used to compile the index generally follow international standards. The weights for the WPI are outdated, and were derived from the 1994 input-output table and other reports and publications of relevant ministries.

The authorities monitor labor market developments using four indicators: open unemployment, underemployment, employment, and remunerations. The quality of the indicators has improved over recent years. Monthly wage data for the Metropolitan area of Lima is timely, but for other areas come with a relatively long delay; the nationwide unemployment and underemployment situation is surveyed quarterly; and monthly employment indices for the private sector and the government are available and are relatively timely.

II. Fiscal Sector

Institutional coverage and classification of the government finance statistics (GFS) still follow 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 coverage of published national budget data is narrower than the fiscal statistics prepared for the combined public sector. The authorities have prepared a plan to migrate to the *GFS Manual 2001,* preparing a new budgetary classification and chart of accounts aligned to the *GFSM 2001* methodology. The new budget aligned to *GFSM 2001* was used for the 2009 budget processing. However, there are still problems of coordination of GFS compiling units in the Ministry of Finance and in the central bank. Although the authorities report data for publication in the *Government Finance Statistics Yearbook (GFSY)* using the *GFSM 2001*, they do not report high frequency data for publication in *International Financial Statistics (IFS)* using this methodology.

III. Monetary Sector

The central bank (BCRP) compiles and publishes the analytical accounts of the central bank, depository corporations, and financial corporations broadly in line with the methodology recommended by the *Monetary and Financial Statistics Manual*. The main discrepancies are the exclusion of the deposits of other financial corporations, state and local governments, and public nonfinancial corporations from the definition of broad money; and valuation of some financial instruments at cost rather than at market prices. At the request of the authorities, a mission visited the country in January 2007 to assist with the migration to the new standardized report forms (SRFs) for reporting monetary data to the IMF. The mission finalized the SRF for the central bank, recommending improvements in the classification and sectorization of some accounts. A follow-up mission took place in September 2008. The mission completed the work on the SRF for the central bank and developed a bridge table linking the source data reported by banks to the BCRP to the report form 2SR (other depository corporations). The mission identified shortcomings in the management of the database that generate the accounts of the other depository corporations sector at the BCRP. Although the two technical assistant missions finalized the groundwork for the migration to the SRFs, the BCRP is in the process of revising historical data for form 2SR, and will report to the Fund using the SRFs when the revision is completed.

IV. External Sector

The BCRP prepares quarterly data on the balance of payments and international investment position largely in line with the recommendations of the fifth edition of the *Balance of Payments Manual (BPM5).* Data are reported to the Fund for publication in the *IFS* and the *Balance of Payments Statistics Yearbook*. Departures from *BPM5* include the lack of coverage of assets held abroad and land acquisition abroad by residents; and not recording on an accrual basis some external debt transactions.

The BCRP has been reporting since August 2001 weekly data on international reserves in accordance with the *Operational Guidelines for Data Template on International Reserves and Foreign Currency Liquidity.* Since August 2006, the BCRP is including the full amount of the liquidity requirements in the reserve template both under official reserve assets and as a contingent net drain (as specified in Section III of the Data Template). Peru disseminates quarterly data on external debt with an eight week lag on the National Summary Data Page with a hyperlink to the Fund's website.

Peru: Table of Common Indicators Required for Surveillance

As of February 18, 2010

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality Accuracy and reliability[9]
Exchange Rates	February 2010	3/5/10	D	M	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	February 2010	3/5/10	D	M	W		
Reserve/Base Money	February 2010	3/5/10	W	M	W	O, LO, LO, LO	O, O, O, O, O
Broad Money	January 2010	2/26/10	W	M	W		
Central Bank Balance Sheet	February 2010	3/5/10	W	M	W		
Consolidated Balance Sheet of the Banking System	January 2010	2/26/10	W	M	W		
Interest Rates[2]	February 2010	3/5/10	D	M	D		
Consumer Price Index	February 2010	3/5/10	M	M	M	O, LO, LO, LO	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	January 2010	2/26/10				O, LO, O, O	O, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	January 2010	2/26/10	M	M	M		
Stocks of Central Government Debt[5]	January 2010	2/26/10	M	M	M		
International Investment Position[6]	Q4 2009	2/26/10					
External Current Account Balance	Q4 2009	2/26/10	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	January 2010	3/12/10	M	M	M		
GDP/GNP	Q4 2009	2/26/10	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	Q4 2010	2/26/10	Q	Q	Q		

[1] Every Friday the Central Bank disseminates daily net international reserves, and weekly International Reserve Assets and Reserve Liabilities.

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

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including type of instrument, maturity and type of creditor.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

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

[8] Reflects the assessment provided in the data ROSC published in October 2003 and based on the findings of the mission that took place during February 12–26, 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), not observed (NO), or not available (NA).

[9] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by Pablo Pereira, Executive Director for Peru and Oscar Hendrick, Advisor to the Executive Director
April 14, 2010

Key Points

- The resilience of the Peruvian economy has been successfully tested once again by the worst financial crisis in recent history. At end-2009, Peru was granted investment grade by Moody's, joining Fitch and Standard & Poor's, consolidating its standing among major emerging market economies.
- Overall, macro-economic indicators are very good. Growth was positive in 2009, inflation expectations are well anchored within the inflation target of 2 percent, the external position is very strong, with NIR in excess of four times the total short-term external debt on a residual maturity basis, and the financial system remains very liquid, profitable, and well regulated. The public debt is one of the lowest among emerging markets, and is set to decline below 20 percent by 2015.
- This favorable outcome reflects the strong economic fundamentals after two decades of continuity in the implementation of sound economic policies; key structural reforms, and a very proactive policy response by the Peruvian authorities to deal with the recent financial crisis.
- The economic outlook remains very favorable. The Peruvian economy is set for a strong rebound in 2010 and robust economic growth thereafter. The possibility of a higher and sustained level of capital inflows, and domestic demand pressures derived from higher-than-expected growth could pose certain challenges to fiscal and monetary policy. The authorities are taking preventive actions and they are confident in their ability to manage the challenges of their economic success.
- Nevertheless, many challenges and risks remain. Poverty is still relatively high, despite substantial progress achieved in recent years, and risks to g lobal recovery remain a factor that could undermine external demand and induce higher volatility in commodity prices.

INTRODUCTION

1. ***Our Peruvian authorities would like to express their gratitude to Management and the staff for the open and constructive policy dialogue, and for their excellent work.*** The report provides a fair and well-balanced description and analysis of recent economic developments and policy discussions. Our authorities are in broad agreement with the staff's assessment and policy recommendations. We are grateful for the comprehensive set of selected issues papers, which provide interesting insights into relevant economic topics. We appreciate the focus on the consultation on the exit

strategy from policy stimulus and the challenges to handle economic success, including possible large and sustained capital inflows. The authorities consent to the publication of the staff report.

2. ***Peru is looking for new and proactive ways to engage the Fund as a partner and as a client of the Fund's accumulated cross-country experience.*** As a partner, Peru has volunteered to be part of pilot on innovating Article IV consultations to help improve the consultation process, including a timely Board discussion of the mission findings and timely disclosure to the markets. Peru is a very active participant in the Fund's lending activities through the Financial Transaction Plan, and it has renewed its commitment to poorer countries by contributing to the Poverty Reduction and Growth Trust Fund. As a client, Peru is currently receiving technical assistance to strengthen the existing AML/CFT, and has requested a new FSAP update, scheduled for the fourth quarter of 2010 (Peru was one of the first countries to volunteer in the original FSAP pilot program back in 2000, and an FSAP update was undertaken in February 2005).

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

3. ***The Peruvian economy continued to perform well in 2009, despite the lingering effects of the worst financial crisis in recent history.*** Although growth was in the negative territory during the first half of the year, the successful implementation of contracyclical monetary and fiscal policies led to a fast recovery in the second half of the year ending in real GDP growth close to 1.0 percent. In the fourth quarter of 2009, the economy grew over 15 percent (seasonally adjusted and annualized). This was one of the shortest economic cycles in the last 30 years in Peru, both in entering into the crisis and exiting from it (a total of four quarters). Net international reserves grew to US$ 33 billion, equivalent to some 13 months of imports of goods and services, 80 percent of broad money, and 412 percent of short-term external debt on a maturity basis. In addition, despite the deterioration in the terms of trade, the external current account had a small surplus. FDI flows remained strong, more than compensating for portfolio and short-term outflows. In 2009, due to favorable market conditions, Peru issued a US$ 2 billion debt for pre-financing operations and repayment of Paris Club debt.

4. ***The authorities' decisive and proactive fiscal response to the crisis was possible thanks to the strong buffers built in recent years during the economic boom.*** A substantial fiscal stimulus—equivalent to around 2½ percent of GDP—was largely financed with fiscal savings. Government expenditure was focused on infrastructure and poverty alleviation to boost growth potential, while preserving the gains attained in poverty reduction and employment creation. The authorities were successful in increasing public investment to close to 6 percent of GDP—up from an annual average of 3 percent in the last decade, with the additional impulse from the fiscal stimulus plan. Public investment is expected to remain at this level in the medium term, contributing to a higher potential output. The public debt is expected to continue its declining trend and reach a level below 20 percent by 2015, one of the lowest in the region and among emerging markets.

5. ***The Central Bank's swift policy response was instrumental to limit spillovers from the global financial crisis.*** The central bank provided ample liquidity in soles and dollars, helping to maintain orderly financial conditions during the peak of the crisis, preventing a liquidity squeeze. It has also reduced its policy rate by 525 bps since early 2009 to a historic low level of 1¼ percent. Lending rates to the private sector also declined to historical low levels, in line with the policy rate. Inflation fell to near zero by end-2009, but core inflation declined to near 2 percent, the mid-point of the target range. As conditions have stabilized, the central bank has started to reverse some of the measures to inject liquidity.

6. ***The Free Trade Agreement with China went into effect on March 1, 2010* and similar arrangements with Korea, Japan, and other countries are underway.** The agreement with the European Union is almost complete and final legal details are being revised. These new agreements, together with the FTA signed with the United States last year, are expected to continue to encourage investment, higher export growth and diversification.

7. ***The 2010 outlook is promising.*** Early economic indicators, such as electricity consumption and construction activity, point to a strong economic rebound in 2010. The latest WEO projection has real GDP growing at 6¼ percent in 2010 but the authorities have a somewhat more conservative forecast of 5½ percent, which is more in line with market expectations. The consolidation of the investment grade by the three major rating agencies is expected to further reduce the financing cost for the public and the private sector. Inflation expectations remain well anchored, and all market surveys point to an easy compliance with the central bank target of 2 percent in 2010 and beyond. The authorities concur with the staff that the balance of risks to growth is tilted to the upside, and that a new wave of capital inflows may take place. Nonetheless, they are confident that they have the toolkit to deal with it.

THE EXIT STRATEGY AND THE MEDIUM-TERM CHALLENGES

8. ***The Peruvian authorities agree with the staff on the timing and sequencing of the withdrawal of policy stimulus.*** In particular, they are already taking the first steps towards the consolidation of the fiscal stance, prior to the tightening of the monetary policy. However, they will carefully monitor the dynamics of the private sector activity to avoid undermining economic recovery. Under the baseline scenario, the authorities intent to gradually reduce the fiscal deficit, and return to the 1.0 percent of GDP deficit limit established by the Fiscal Responsibility and Transparency Law in 2011. They agree with the importance of safeguarding the quality of public investment projects, and the need to preserve the fiscal cushions. As the staff indicates, Peru has room for additional fiscal stimulus in case of the risk of a relapse in global growth.

9. ***On monetary and exchange rate policy, the central bank stands ready to adjust the current policy stance and use its toolkit in tandem with the speed of economic recovery.*** The credibility of the central bank has contributed significantly to the resilience and stability of the Peruvian economy. Among the option at its disposal, the

reserve requirements have proved to be an effective tool in Peru's dollarized economy during the period of abundant global liquidity and capital inflows. These measures were reversed during the global financial crisis (Appendix 2 of the staff report), and could again increase in tandem with expected higher economic activity. Although, the central bank has kept its policy rate at 1¼ percent in its recent March 2010 review, it will closely monitor developments for any signs of inflationary pressures, and will take action as needed. On the exchange rate, our authorities agree with the staff's assessment that the real effective exchange rate is broadly in line with fundamentals. They underscored that the central bank is committed to a floating exchange rate and, as in the past, they noted that intervention policy has been focused on smoothing out volatility of the exchange rate, and the potential negative balance sheet effects in the context of a still highly dollarized economy.

10. ***The framework for crisis management and resolution has been strengthened, but the authorities are proactively taking steps to incorporate the lessons from the global financial crisis.*** Peru's regulatory and supervisory framework includes features such as dynamic provisioning and risk management practices that are ahead of international standards. They have established additional capital requirements like the assessment (stress testing) and risk of borrowers' foreign exchange credit risk, which will become effective in July 2010. Steps to improve macro-prudential supervision have been taken and the outcome is constantly being monitored by the Coordination Committee, comprising of senior officials from the Ministry of Finance, the central bank, and the Superintendency of Banks, Insurance and Pensions. The central bank is currently organizing a conference with local and international participants on Macro Prudential regulations scheduled to take place in July.

11. ***The authorities regard the development of domestic capital markets as a high priority.*** A liquid and well-developed domestic capital market will enhance the effectiveness in channeling resources in the economy. In particular, the development of instruments in domestic currency would be instrumental in reducing further financial dollarization, and creating room for greater exchange rate flexibility in the future. Our authorities are grateful for the Fund's assistance in developing the mortgage market in local currency through the creation of a covered bond instrument, and repo and interest swap markets to further facilitate lending in domestic currency. The authorities are also revamping the functions of the Security and Exchange Commission to promote access to the domestic capital market.

12. ***Poverty reduction is still a challenge, despite the substantial progress attained so far, and the successful efforts to protect this gain in 2009 despite the marked decline in the rate of economic growth.*** The fiscal stimulus plan helped sustain employment and protected social spending. The authorities will continue with their social programs for poverty alleviation, but they are convinced that the best answer is to maintain the momentum of economic growth, persevere with sound economic policies, and continue working on their structural reform agenda.