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Peru: 2011 Article IV Consultation—Staff Report; Supplement; and Public Information Notice

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Peru, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 28, 2011, with the officials of Peru on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 18, 2011. 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 Public Information Notice (PIN).

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

Selected Issues Paper

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INTERNATIONAL MONETARY FUND

PERU

November 18, 2011

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

KEY POINTS

Context. The economy recovered rapidly in 2010 from the effects of the global recession. Policies were tightened given the closing output gap and higher inflation, with use of macro-prudential instruments to confront capital inflows and credit growth. A new government, led by President Humala, took office in July 2011, promising more social inclusion and continued macroeconomic stability, and creating some uncertainty in the private sector.

Prospects. Activity is expected to decelerate in 2011–12 to slightly below trend (estimated at 6 percent) while inflation declines towards the target and the external current account deficit remains contained. Short-term risks are markedly to the downside given global uncertainty. Once international turbulence subsides, strong growth prospects and abundant international liquidity could increase capital inflows.

Near-term policy challenges. Fiscal policy focus on undertaking the capital expenditures budgeted for 2011 (unexpectedly low in the first half of the year) is appropriate. The small fiscal expansion planned for 2012 seems warranted. Monetary policy can be kept on hold until there is more clarity with respect to the global economy. Peru has significant space and buffers to confront worsening external conditions, but policies should consider that alternative scenarios are also highly uncertain in scope and duration.

Medium-term policy challenges. Macroeconomic stability, growth potential, and social inclusion could be strengthened by adopting an ambitious reform agenda, including: (i) revenue mobilization to cover higher social spending; (ii) strengthening the fiscal framework; (iii) advancing with prudential regulations; and (iv) enhancing competitiveness, and further developing domestic capital markets.

Approved By
Rodrigo Valdés and Dominique Desruelle

Discussions took place in Lima during October 17–28, 2011. The team comprised A. Santos (head), M. Vera Martin, Y. Wong (all WHD), I Rial (FAD), T. Wezel (MCM) and K. Ross (Resident Representative). O. Hendrick (OED) participated in the meetings. R. Valdés (WHD) joined the mission for the concluding meetings with Prime Minister Lerner, Economy and Finance Minister Castilla, and Central Bank Governor Velarde.

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LIST OF ACRONYMS

AFP	Pension Fund Administrators
AML	Anti-Money Laundering
AREAER	Annual Report on Exchange Arrangements and Exchange Restrictions
BCRP	Central Reserve Bank of Peru
CAR	Capital Adequacy Ratio
CDLD	Certificate of Deposit Payable in U.S. Dollars
CFT	Combating the Funding on Terrorism
CGER	Consultative Group on Exchange Rate Issues
CONASEV	National Supervisory Commission of Enterprises and Securities
eop	end of period
FRTL	Fiscal Responsibility and Transparency Law
FSAP	Financial Sector Assessment Program
FSD	Deposit Insurance Fund
FX	Foreign Exchange
GDP	Gross Domestic Product
GEM	Special Mining Levy
IEM	Special Mining Tax
INS	Information Notice System
LA6	Brazil, Chile, Colombia, Mexico, Peru, and Uruguay
LCR	Liquidity Core Ratio
MEF	Ministry of Economy and Finance
NAIRU	Non-Accelerating Inflation Rate of Unemployment
NEER	Nominal Effective Exchange Rate
NFPS	Non-Financial Public Sector
NIR	Net International Reserves
NPL	Non-Performing Loans
NSFR	Net Stable Funding Ratio
REER	Real Effective Exchange Rate
SBS	Superintendency of Banks, Insurance, and Pensions
SMV	Superintendency of Securities Market
SUNAT	National Superintendency of Tax Administration
VAT	Value-Added Tax
WB	World Bank
yoy	year-on-year

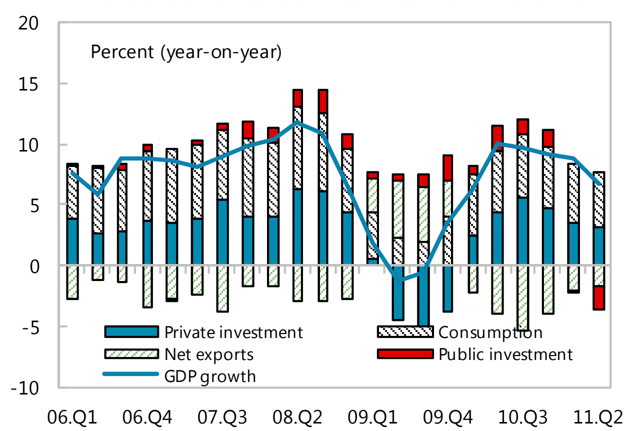
CONTEXT AND RECENT DEVELOPMENTS

1. **Peru had a stellar macroeconomic performance over the past decade**. Following a period of low growth in 1998–2001 related to a financial crisis and global turmoil in the aftermath of the Asian crisis, Peru began a period of ambitious structural reforms and prudent macroeconomic management, which—together with positive terms of trade and sizable direct foreign investment—helped them build buffers, strengthen fundamentals, and boost growth potential. As a result, per-capita income almost tripled in the decade 2001–11 to US$5,700. During the same period, public debt as a percent of GDP fell by more than one-half to about 20 percent, while real GDP growth accelerated to 5¾ percent on average per annum (the highest 10-year growth period observed in Peru's history) and the annual inflation rate fell to 2¼ percent on average (the lowest in Latin America).

2. **With strong fundamentals and a skillful macroeconomic response, the economy emerged practically unscathed from the 2008–09 global crisis.** The authorities managed to implement significant monetary and fiscal policy stimuli, which avoided a credit crunch, supported economic activity, and sustained employment. The central bank (BCRP) dropped its policy rate by 525 basis points to 1¼ percent in 2009 (one-fifth of the rate at the beginning of the year), and the Ministry of Economy and Finance (MEF) implemented a stimulus package that generated a fiscal impulse of over 1½ percent of GDP in 2009. However, real GDP growth decelerated to 1 percent in 2009 (the lowest in a decade).

3. **After a rapid economic recovery, the economy is expected to decelerate on the heels of tighter policies and the political process.** Following the policy response of 2009, real GDP expanded rapidly and grew 8¾ percent in 2010, one of the highest in the region, driven by private domestic demand. The recovery has closed a small output gap, propped by significant macroeconomic policy stimuli, a quick turnaround of terms of trade and favorable external financial conditions, with renewed capital inflows. Credit growth recovered rapidly helped by unimpaired private sector balance sheets. The external current account deficit was moderated by positive terms of trade. The economy grew at 7½ percent in the first eight months of 2011, on strong private consumption and investment and despite a sharp decline in public investment and construction. More recently, lingering political uncertainties and concerns about the global outlook are expected to slow down private demand by year-end.

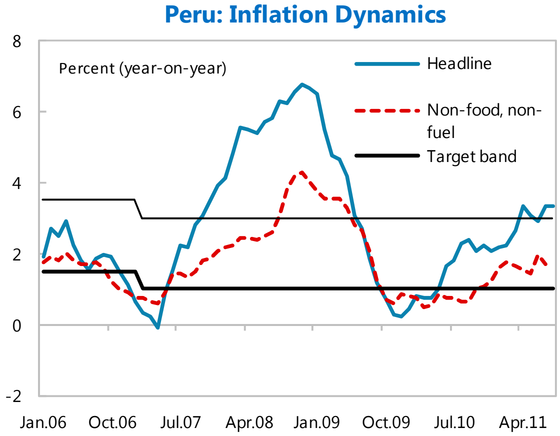
Peru: Contribution to Real GDP Growth



Source: BCRP

4. **Supply shocks and strong economic activity led to higher inflation.** Inflation fell to its lowest level in a decade to ¼ of a percent in 2009, but rebounded to 2 percent by end-2010 as demand picked up. It further increased to 4¼ percent in October 2011 (3½ percent for core inflation), above the target band of 1–3 percent, due mostly to supply shocks and some demand pressures. Non-fuel non-food inflation (at 2⅓ percent in October 2011 (yoy) has remained within the target band. As supply shocks are absorbed and the output gap hovers around zero, inflation is expected to return to the target. Inflation expectations for 2012 remain well-anchored on account of the strong inflation targeting framework and the expectation of weaker economic activity**.**

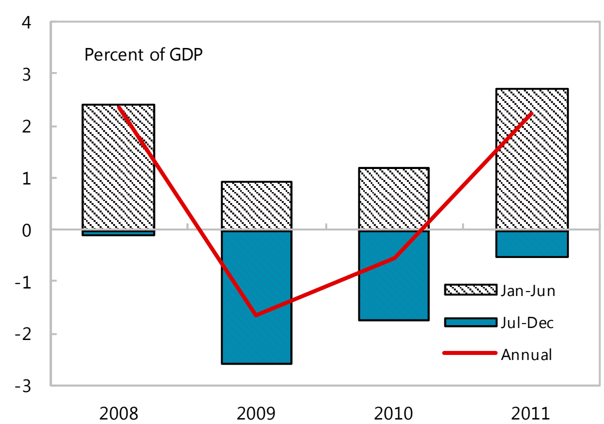
Peru: Inflation Dynamics



Source: BCRP

5. **Macroeconomic policies have focused on limiting overheating risks, with fiscal reverting in 2011 previous stimulus**. With above trend growth in 2010, the overall deficit fell from 1½ percent of GDP in 2009 to ½ percent in 2010, although real spending grew above potential.[1] Following early overheating signs, the government began in 2011 exiting the stimulus, with the political process exacerbating expenditure restriction. The fiscal position switched to an annualized fiscal surplus of about 5½ percent of GDP in the first half of 2011 (2½ percent in the first half of 2010) as revenues remained buoyant despite tax cuts and expenditures were restrained due to low implementation of investment projects at the sub-national level (related to the political cycle).[2] This help increase the Fiscal Stabilization Fund to 3⅓ percent of GDP. Under-execution of public investment projects persisted in the third quarter of 2011, prompting the authorities to adopt measures (of over ½ percent of GDP) to foster capital execution (still within the 2011 budget limits).

Peru: Nonfinance Public Sector Overall Balance



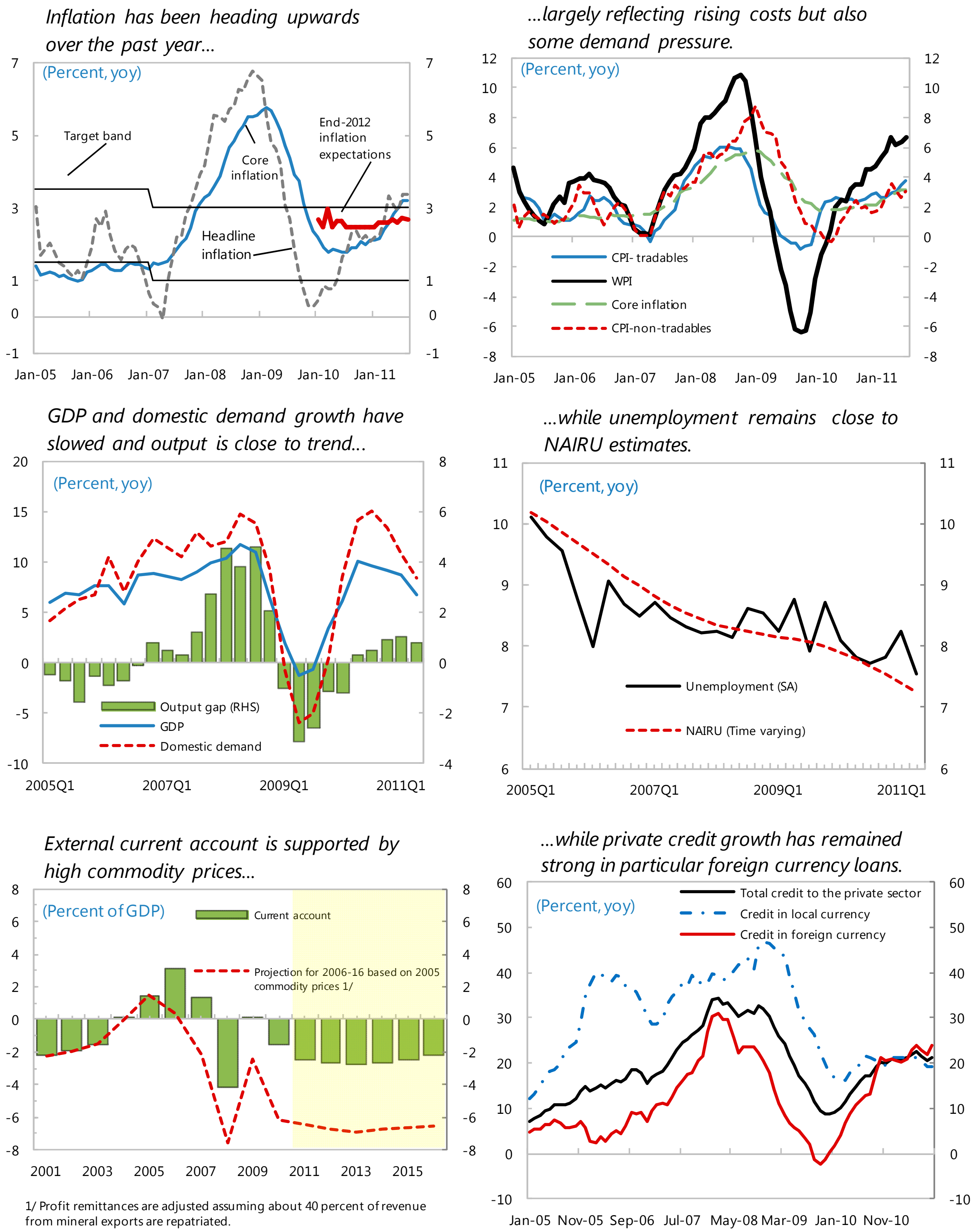
Sources: MEF and Fund staff's estimates

[1] Despite a reduction in the fiscal deficit in 2010, staff estimates a fiscal impulse of ¾ percent of GDP due to better terms of trade and expenditure recordings of almost ½ percent of GDP in late 2009 which stimulated demand in 2010.

(continued)

[2] Tax collections have improved by an average of 1 percent of GDP a year in 2010-11 helped by strong economic activity, positive terms of trade, and more recently a revised framework for mining taxation. However, several measures in 2011 eroded the tax base, including a reduction in the VAT rate (by 1 percentage point), the financial transaction tax and import duties.

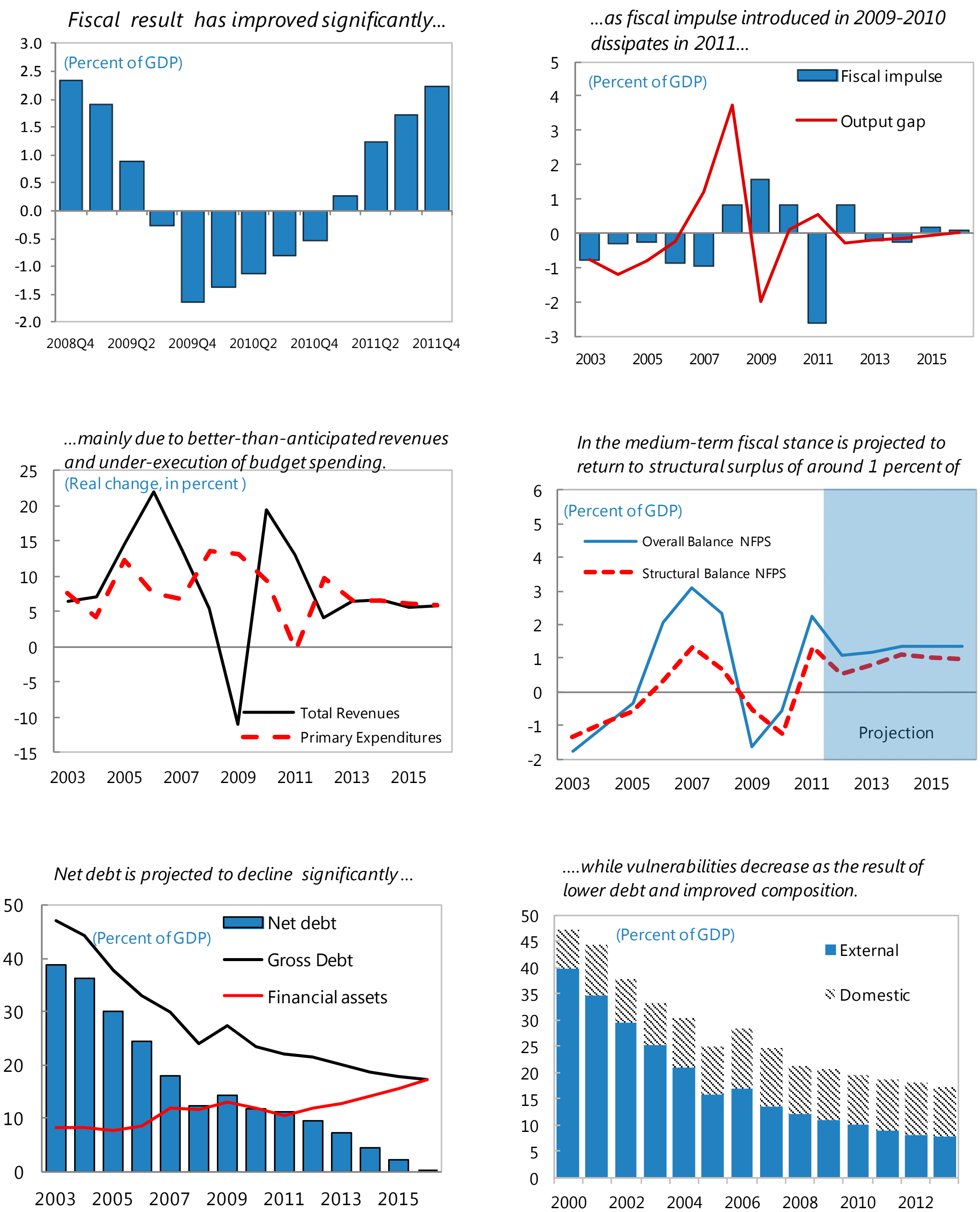
Figure 1. Peru: Overheating Indicators



1/ Profit remittances are adjusted assuming about 40 percent of revenue from mineral exports are repatriated.

Sources: BCRP; and Fund staff estimates.

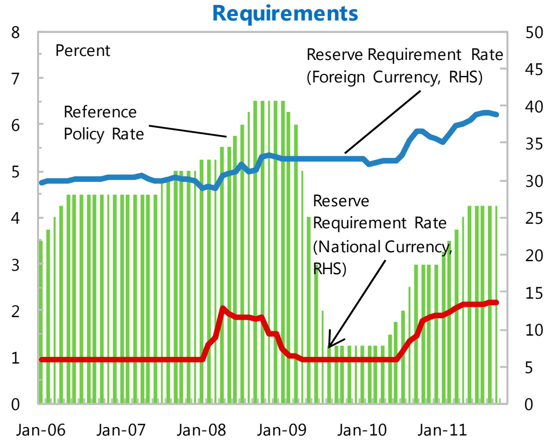
Figure 2. Peru: Exit from Fiscal Stimulus



Sources: MEF and Fund staff's estimates.

6. **Monetary policy has also been tightened and is in a wait-and-see state.** Following an aggressive easing of monetary policy during 2009, a tightening cycle began in mid-2010 as demand recovered, with the policy rate increasing a total of 300 basis points to 4¼ percent by May 2011, close to the neutral stance. Since then, the central bank has remained on hold in light of the uncertain global economic outlook. Credit growth has stayed at about 20 percent in 2010–11, with foreign currency credit surpassing growth in domestic currency. To enhance liquidity management, the monetary tightening was complemented with active hikes in reserve requirements.[3]

Peru: Policy Interest Rate and Reserve Requirements



Source: BCRP

7. **The financial sector remains sound, profitable and well-capitalized, assisted by the use of modern prudential instruments.** Financial soundness indicators did not deteriorate significantly during the 2008–09 crisis and continue improving—largely due to limited cross-border linkages, good supervision, and healthy balance sheets. The non-performing loan ratio remains low (1½ percent by mid-2011) and well–provisioned. With the strong economic rebound, dynamic provisioning was activated in September 2010; and higher capital requirements were implemented in July 2010 to account for credit risks in foreign currency, the economic cycle and concentration risks (Box 1). Recent stress tests show that the system as a whole is able to withstand severe shocks, although under some difficult scenarios a few small banks might need capital injections. Financial dollarization remains high; with credit in foreign currency at about 45 percent and increasing due to low interest rates on foreign currency loans and appreciation expectations of the *Nuevo Sol*.

8. **Commodity prices and capital inflows have supported a strong balance of payments.** As other emerging market economies, Peru received ample private capital inflows in 2010. The current account switched to a deficit of 1½ percent of GDP in 2010 despite a strengthening in the terms of trade as import growth and profit remittances rebounded and private investment expanded. The financial account registered some of the largest private capital inflows in recorded history; about 9 percent of GDP (including errors and omissions). Consequently, the overall balance reached a surplus of about 7½ percent of GDP in 2010. The current account deficit is expected to widen to 2½ percent of GDP in 2011 due to higher profit remittances of foreign mining firms and a weakening in private savings. Capital inflows

[3] The BCRP raised gradually marginal reserve requirements for domestic currency deposits in the second half of 2010 to 25 percent for residents (from zero) and to 120 percent for nonresident financial entities (from 35 percent). For foreign currency deposits, the marginal reserve requirements increased to 55 percent (from 30 percent). During 2011, the BCRP resorted to increases in the average reserve requirements (with a cumulative hike of 100 basis points).

Box 1. Peru: Macro-prudential Measures on Banks

Peru has been very proactive in the use of macro-prudential instruments complementing macro policies. In addition to using different reserve requirements (see Appendix 2 from IMF Country Report No. 10/98), the authorities are well-advanced in implementing recommendations in the spirit of Basel III regarding capital and liquidity requirements.

In July 2010, the SBS implemented additional capital requirements for financial institutions. The additional capital buffer has the following components:

- **A *countercyclical capital requirement***, which is activated or deactivated according to the dynamic provisioning activation rule, based on GDP growth. The requirement takes into account default probabilities during a recession period and expected losses by type of loan.

- **A *capital requirement for concentration risks*** associated with individual exposures and sectoral and regional exposures. The first one applies to financial institutions where their major 20 debtors represent 5 percent of their portfolio.

Peru: Maximum Capital Requirements for Concentration Risks

Individual	Group	
4%	20%	
	Sectoral Exposure	Regional Exposure
	16%	4%

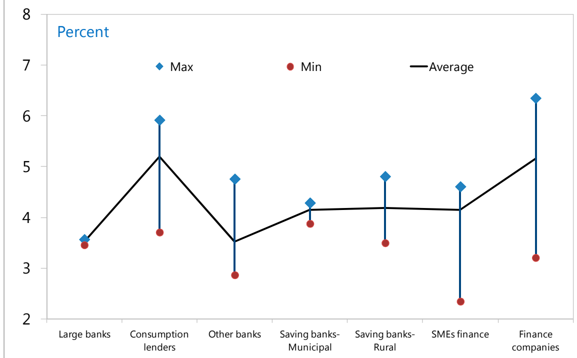
Source: SBS

A capital requirement for market concentration, that applies to financial institutions with assets-to-GDP ratio higher than 3 percent. The capital add-on increases with a lower credit rating for the institution. The regulation allows the SBS to request additional capital for market risk that could result from interconnectedness or substitutability of the financial institution.

- ***Capital requirement for interest rate risks*** associated with the banking book and proprietary portfolio. The first one applies to banks dedicated to consumption lending (¼ percent on average) and finance companies (0.3 percent). The latter considers the use of specific provisions in relation to assets in the last five years.

According to the SBS calculations, the additional capital buffer ranges from 2.4 to 6.4 percent (see chart). The SBS envisages a phased implementation, starting with 40 percent of the capital buffer by July 2012 and then gradual increments of 15 pp annually until July 2016.

Peru: Effective Additional Capital Requirements



Source: SBS.

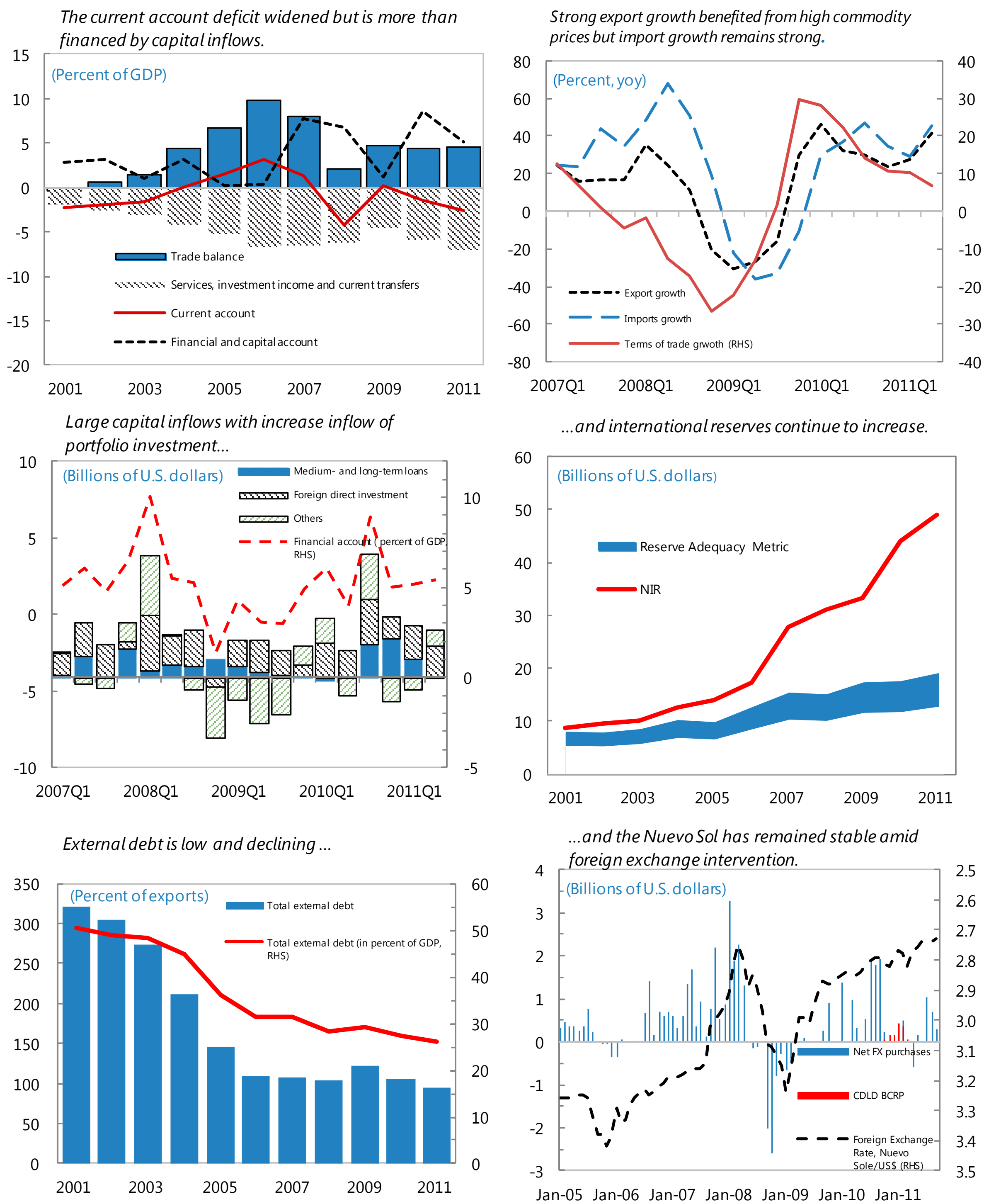
In the context of a highly dollarized economy, prudential measures to manage FX risks were issued or modified. In July 2010, Peru implemented an additional capital requirement on the FX exposure (of 2½ percent of their foreign exchange credit exposure) to help financial institutions internalize FX credit risks from lending to un-hedged borrowers. In January 2011, the SBS imposed limits on the net derivative position to financial institutions of either 40 percent of assets or S/.400 million, whichever is the highest. The limits were tightened to 30 percent or S/.350 million in October 2011. In 2011, banks' long net FX position has also been reduced to 60 percent of net equity (from 75 percent).

The SBS is working on a proposal for strengthen liquidity requirements aligned with Basel III:

- ***Current minimum liquidity ratios in national and foreign currency*** (8 and 20 percent respectively) will increase to 10 and 25 percent when there is liability concentration (debt from 20 major depositor accounts for at least 25 percent of total liabilities). Financial institutions need also to report both liquidity ratios adjusted for borrowed funding (interbank, overnight, reserve requirements and public funds from *Banco de la Nación*); and for foreign exchange forward position.

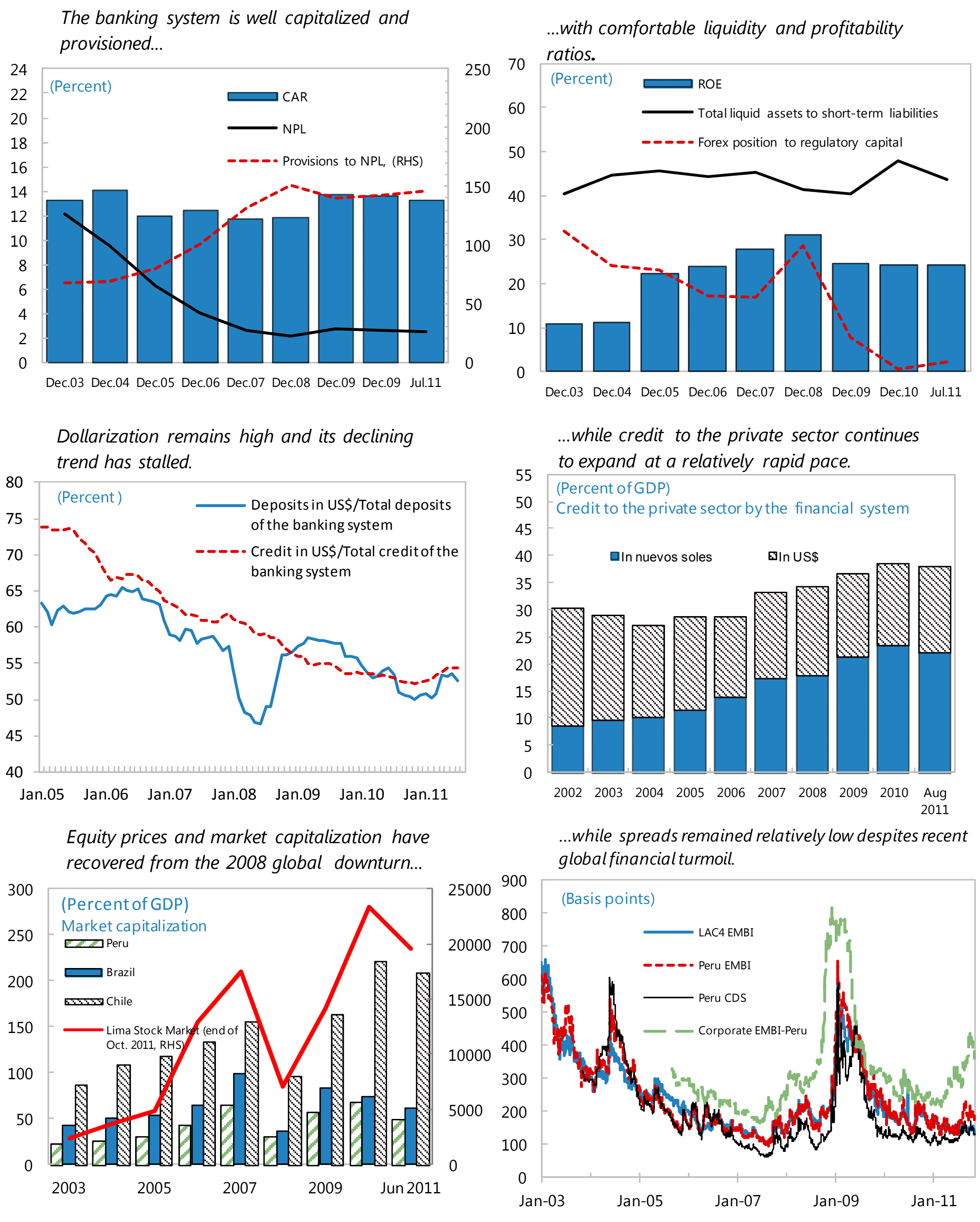
- ***A Liquidity core ratio (LCR) and a net stable funding*** **ratio *(NSFR)***. The LCR, with a minimum of 100 percent for domestic and foreign currencies, is to be phased in—with 80 percent for 2013, 90 percent for 2014, and 100 percent from 2015 onwards. Most institutions already fulfill the requirement; except for finance companies and some municipal saving banks. The SBS does not impose a minimum NSFR, but request institutions to have an internal limit. Regulation is expected to be approved by end-2011.

Figure 3. Peru: Sustainable External Sector



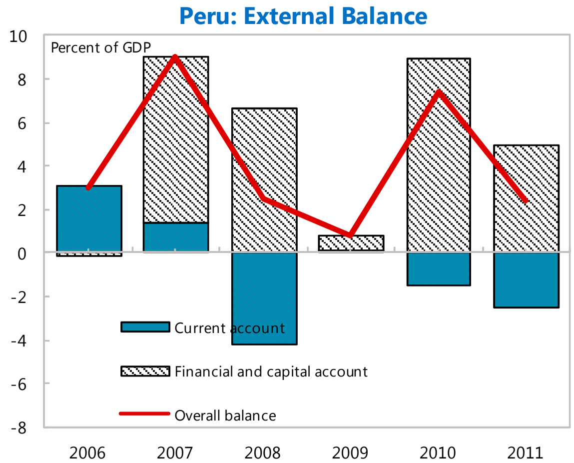
Sources: BCRP; MEF; and Fund staff estimates.

Figure 4. Peru: Solid Banking and Financial System



Sources: Bloomberg, SBS, World Federation of Exchange Rates and Fund staff estimates.

moderated with the global uncertainty and macro prudential measures, reducing the pace of reserve accumulation.



Sources: BCRP and Fund staff's estimates.

9. **Foreign exchange intervention has prevented large currency fluctuations.** The *Nuevo Sol* has remained the most stable currency among the LA6 countries.[4] The real effective exchange rate (REER) appreciated by about 1 percent since the issuance of the last Article IV consultation report (March 2010). In line with assessments in previous such reports, the Fund's latest report on exchange arrangements (AREAER) classifies Peru as currently having a *de facto* floating exchange rate regime.

10. **The Humala administration has stated a strong commitment to maintain macroeconomic stability while attending pressing social needs**. The new administration won the election in June 2011 with a clear mandate to attend social demands. Despite rapid growth, the presidential campaign exposed the growing social tensions in the country; especially when it comes to the use and control of Peru's rich natural resources. Congress approved swiftly one of the main electoral promises, a revised framework for mining taxation in September 2011 (Box 2). The authorities have also started expanding—from a narrow base and at a low pace—some well targeted and successful social programs. By fulfilling some campaign promises, President Humala's approval rating peaked at 65 percent in September 2011. However, governing may prove challenging, as the authorities' coalition only holds a two-seat majority in Congress.

11. **The authorities have developed clear targets to achieve more socially inclusive growth.** Strong economic performance in the past decade, along with more prioritized spending on social assistance programs have helped to reduce poverty and improve access to basic health, education and sanitation services. However, chronic malnutrition among indigenous children and the lack of access to social services (particularly for women and the elderly in the rural areas) remain stubbornly high. In response, the government has developed an ambitious set of performance benchmarks on social indicators, including reducing the poverty ratio from 31 percent in 2010 to 20 percent in 2016 (Box 3). A new Ministry of Social Development and Inclusion would focus on better coordinating the delivery of social programs.

[4] LA6 refers to the six Latin American countries that have adopted a formal inflation targeting framework and have relatively more developed domestic capital markets. The list includes: Brazil, Chile, Colombia, Mexico, Peru and Uruguay.

Box 2. Peru: Recent Developments in Mineral Taxation

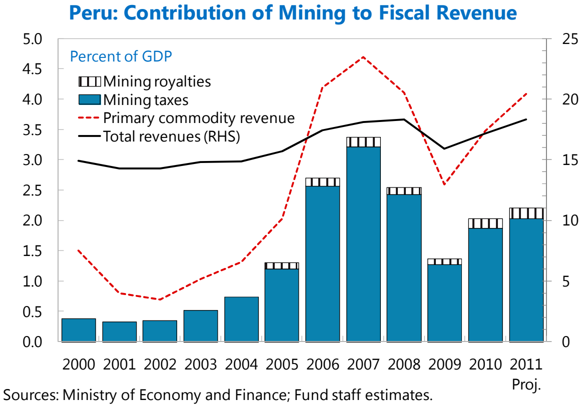
Reforms in mineral taxation were a priority in the new administration program. Peru's mining sector (mineral and hydrocarbon) represents 11 percent of GDP; 70 percent of total export (of which mineral accounted for 61 percent); and 20 percent of total fiscal revenues (3.5 percent of GDP) in 2010. Fiscal revenue from mining (i.e., copper, gold, lead, zinc, iron and tin) exceeded that from crude oil in around 2004, accounting for slightly more than 60 percent of the total revenue from mining.

The mining taxation reform, approved in September, 2011, would increase progressiveness and public revenues, while preserving competitiveness of the sector. Peru's mineral taxation regime comprised mainly of corporate income tax and royalties based on sales value (1–3 percent) introduced under the 2004 Mining Royalties Law. The new reforms include: (i) new royalties based on operating profits of 1 to 12 percent to replace the sales–based royalties, for companies with no stability contracts with the government; (ii) a new special mining tax (IEM)—as revenue for the central government—levied on a sliding scale between 2 to 8.4 percent of operating margins applicable to companies with no tax stability contracts; and (iii) a special (voluntary) levy (GEM) of 4 to 13 percent of profits on the extraction of mineral resources targeting companies holding stability contracts.

Changes have been constrained by stability contracts and the regional distribution of mineral revenue. The new special voluntary levy aims to increase the contribution from companies with stability contract agreements and replaces the voluntary contribution paid in the past. Tax stability contracts were offered to mining companies to ensure a stable legal, tax and administrative framework to attract multinational mining companies in the mid 1990s. Companies that signed stability contracts pay an additional 2 percent in income tax as an extra charge. Under the voluntary contribution scheme—introduced for regional development in 2006, the amount transferred could be up to 3.75 percent of profits after tax (2.75 percent for the local fund and 1 percent to the regional government fund). During 2007–10, resources transfer from these companies amounted to S/.2 billion.

The new regime increases the expected government revenue. The new measures are expected to raise additional US$1 billion annually (about 0.5 percent of GDP, at current commodity prices) which will help fund infrastructure and social gaps. If commodity prices increase further, revenues would increase proportionally more than in the past.

Peru: Contribution of Mining to Fiscal Revenue



Sources: Ministry of Economy and Finance; Fund staff estimates.

Summary of Mineral Taxation in Selected Countries

	Corporate income tax	Royalties	Import duties	Withholding taxes: Interest	Withholding taxes: Dividend	Other charges
Peru	30% (32% for companies with stability contract)	Most minerals: 1-12% based on operating profits for companies with no stability contract.	Range from 4% to 12% fo rmining equipment. Allows a deferment of payment of duties on imported capital items on new projects.	30% non-treaty rate	4.1%	8% workers profit share based on net income before tax. Special mining tax (IEM) 2-8.4 % of operating profits (for companies with no stability contracts) Special (voluntary) levy (GEM) 4-13 % of operating profits (for companies with stability contract).
Chile	35% on distributed profts (20% on undistributed profits)	5% -14% based on operating margin.	10% (deductible)	4% if loan granted by foreign bank, 35% otherwise	-	Worker profit shaing of 35% of pre-tax income or 25% premium on employee base salary up to a maximum of 4.75 of minimum salaries.
Australia (Western Australia)	30%	7.5% of bulk materials; 5% for concentrate material; and 2.5% for metals. Royalities are charged on gross sales value less transport costs.	-	10% or as specified by tax treaty	0% (30% if out of previously untaxed income)	-
Canada (British Columbia)	A combined federal and provincial tax of 26.5%	Minimum tax is 2% ad valorem (deducible against profit royalty); 13% profit royalty.	Most minerals are exempted	25% is withheld on payments made to non-residents (the rate could be reduced by tax treaties).		-

Sources: Philip Daniel, Michael Keen and Charles McPherson (2010), *The Taxation of Petroleum and Minerals: Principles, Problems and Practice (London and New York:* IMF and Routledge); IMF's Fiscal Analysis of Resource Industries (FARI) database; and the Peruvian authorities.

OUTLOOK AND RISKS

12. **Activity is expected to decelerate on the heels of tighter policies and a weaker external outlook.** GDP growth is expected to reach 6¾ percent in 2011, driven by private consumption and inventory building, closing the output gap by year-end. Inflation is projected at 3¾ percent in 2011 (eop). Going forward, lingering uncertainties and concerns about the global outlook are expected to slow down investment and consumption growth. Real GDP growth is projected at 5¼ percent in 2012, mostly due to lower external demand, while inflation would decline to 2½ percent. The external current account deficit remains relatively stable at around 2½ percent of GDP next year as the strong terms of trade continue. Over the medium term, staff projects economic growth at around potential (6 percent), a stable current account deficit (around 2½ percent of GDP), and headline inflation at the target.

13 **Downside risks from the global economy and political uncertainties dominate in the short term.** While external risks are more prominent, domestic concerns are also important:

- ***External risks***. Unsettled conditions in Europe and the United States have had a limited impact on the economy so far. However, subpar global growth in the next couple of years could materialize, with severe adverse consequences, probably for a longer period than the 2008–09 global financial crisis. Peru could feel the pinch through lower terms of trade and adverse financial conditions as global risk aversion surges. The risk of contagion from the European crisis through the presence of Spanish banks appears limited despite a large presence in the system (about ¼ of the assets of the banking system), not only because they have a strong liquidity position and balance sheet and a heavy reliance on deposit funding, but also because of its specific ownership structure for the largest bank (with 50 percent being local investors), and strict prudential regulations. Still, over the medium term, conditions conducive to high global liquidity bode well for further capital inflows, with risks of fuelling a boom.

- ***Domestic risks***. The private sector has reacted positively to the appointment of cabinet members and the handling of the revised framework for mining taxation. However, uncertainties on the overall direction of economic policy have not fully disappeared. It might take some time to enhance credibility and change perceptions. There are also lingering concerns about a new labor market law in Congress that could raise labor costs, reduce labor flexibility and lessen competitiveness. In addition, the revised framework for mining taxation includes a "consultation clause" (with local communities) that has not been codified and some fear it could create conflict with mining companies, discouraging investment.

Box 3. Peru: Progress on Social Issues

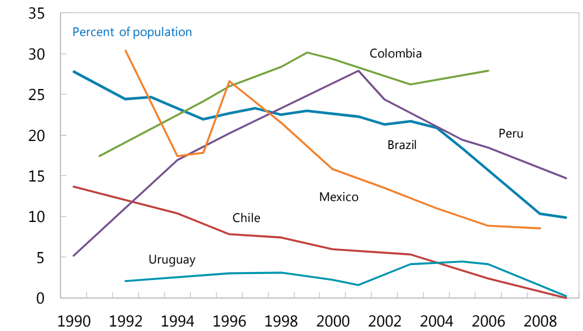
Growth and macro-stability have contributed to reducing poverty and income inequality in the past 10 years. Peru's economic performance has been one of the strongest among the LA6 countries in the region, with growth in PPP based real GDP per capita averaged 6 percent in 2000–09. Poverty, as measured by the international benchmark of the share of population living with less than $2 per day, was reduced by half during 2001–09. Income inequality has also reduced steadily with the Gini coefficient declining to 46 percent in 2010. However, inequalities in Peru are still prevalent particularly with respects to gender and ethnicity.

An uneven performance can be observed in other key social indicators. While the Human Development Index for Peru was 0.725 and was ranked 80 out of a total 187 countries in 2011; a similar rating in percentile was achieved in 2000. However, infant mortality rate was actually reduced by about half to 15 per thousand live births between 2000 and 2010.

Despite some achievements, large regional disparities persist. According to the national definition, 23 percent of Peruvians in rural areas were still living in extreme poverty and 54 percent living in poverty in 2010 and rural poverty remains very high particularly in the highlands. Urban poverty was lower at 19 percent.

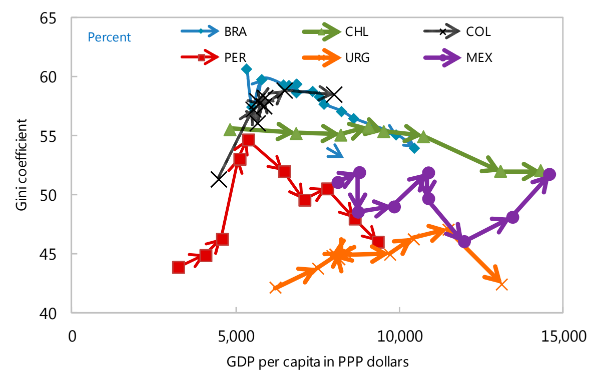
Raising more resources to increase social expenditure and further enhancing the efficiency of social spending through better targeted social programs are necessary to achieve more social inclusive growth. In this context, the authorities are prioritizing its social programs to place greater focus on the 800 poorest districts through the household targeting system. In addition, increasing the efficiency of public investments would reduce the regional gaps in physical and human capitals and bring about greater redistribution over the medium term.

LA6: Poverty Rate 1/



Source: World Bank, World Development Report
1/ Poverty headcount ratio at $2 a day (PPP).

LA 6: Gini Coefficient



Sources: World Bank, World Development Indicators; IMF WEO database.

Peru: Social Indicators-Outcome and Goals
(In percent)

	2010	Goal 2016
Poverty		
Poverty rate	31	20
Extreme poverty	10	5
Rural poverty	54	27
Health		
Chronic infant malnutrition	18	5
Neonatal mortality (per thousand)	9	5
Education		
Coverage of intital education	70	95
Rural elementary education 1/	8	40
Social services 2/		
Rural electrification	60	85
Rural water supply	39	57
Rural sanitation	11	45

Sources: Macroconsult; and Fund staff estimates.
1/ Completion.
2/ Coverge of homes.

CHALLENGES AND POLICY DISCUSSIONS

Discussions focused on managing effectively the challenging external conditions, including the scope, timing and sequencing of policies as well as possible enhancements of the macroeconomic framework. Achieving more social inclusive growth would need additional revenue mobilization to cover supplementary well-targeted social programs. As mentioned in previous Article IV consultation reports, high growth will require enhancing competitiveness and innovation, improving the business climate, investing in human capital and infrastructure, and further developing domestic capital markets while properly regulating the financial system.

A. Near-Term Macroeconomic Management

14. **Policies in the short-run are consistent with cementing macroeconomic stability and promoting growth**. The main policy challenge is to ensure a timely and flexible implementation of policies to confront changing domestic economic conditions in an external environment of heightened uncertainty.

Peru: Macroeconomic Framework

	2008	2009	2010	Proj. 2011	Proj. 2012
(Annual percent change)					
Real GDP	9.8	0.9	8.8	6.7	5.2
Inflation (eop)	6.7	0.2	2.1	3.9	2.5
Money supply	24.9	5.9	23.8	15.4	12.4
Real exchange rate 1/	4.4	3.5	2.4	...	...
(In percent of GDP)					
Domestic investment	26.9	20.7	25.0	24.6	24.6
External current account	-4.2	0.2	-1.5	-2.5	-2.6
Fiscal balance 2/	2.3	-1.6	-0.5	2.2	1.1
Public sector debt 2/	24.9	28.4	24.6	21.3	20.7

Sources: Peruvian authorities; and Fund staff estimates.
1/ Average, (-) = real depreciation; 2/ Nonfinancial public sector.

15. **Graduating the pace of withdrawal of fiscal stimulus has proved challenging**. Persistent under-execution of capital spending largely due to the change of administration has generated a tighter than expected fiscal position.

- ***Policy for 2011***. The authorities adopted measures to foster budget capital execution in the second half of 2011. Staff welcomed those efforts and estimated that the fiscal position would switch to a surplus of 2¼ percent of GDP in 2011 (compared with a fiscal deficit of 1 percent included in the 2011 budget), with an estimated withdrawal of stimulus of about 2½ percent of GDP. The tighter-than-envisaged policy stance was useful in reducing overheating concerns and rebuilding fiscal buffers.

Peru: Fiscal Accounts
(In percent of GDP)

	2008	2009	2010	Proj. 2011	Proj. 2012
Revenues	**26.6**	**24.0**	**25.0**	**26.3**	**25.9**
Taxes	16.0	14.1	15.2	16.0	15.7
Non-taxes	10.6	9.9	9.8	10.3	10.2
Primary expenditures	**22.7**	**24.3**	**24.4**	**22.9**	**23.7**
Current	18.2	18.1	17.9	17.7	17.5
Capital	4.6	6.1	6.5	5.2	6.2
Primary balance	**3.9**	**-0.3**	**0.6**	**3.4**	**2.2**
Interest payments	1.6	1.3	1.2	1.2	1.2
Overall balance	**2.3**	**-1.6**	**-0.5**	**2.2**	**1.1**

Sources: Peruvian authorities; and Fund staff estimates.

- ***Policies for 2012***. The authorities submitted to Congress a budget that partly reversed the tight expenditure levels expected for 2011 and aimed at reducing the surplus to about 1 percent of GDP. Staff supported the overall expenditure proposals in the 2012 budget (especially the higher social spending). Policies would entail a fiscal impulse of ¾ percent of GDP in 2012, which would be adequate as it came at a moment of expected softer activity.

- ***Communication***. Staff suggested that the changes and rationale of fiscal policy in the second half of 2011 and those proposed in the 2012 budget need to be clearly communicated to prevent misunderstanding of the overall fiscal stance.

- ***Tail risks***. In the event of a relapse in global growth, the authorities noted that there was room to provide additional policy stimulus to limit the fallout. Staff and authorities concurred that the uncertain nature and duration of the external shock makes advisable a careful and gradual implementation of the policy response to avoid a premature use of buffers.

- ***Medium-term***. The authorities aim at achieving structural fiscal balance over the medium term, while staff favors maintaining moderate structural surpluses of around 1 percent of GDP to strengthen fiscal buffers. Structural surpluses would put Peru in a stronger position to deal with future shocks. This is particularly important given current volatile international environment, the reliance on non-renewable natural resources, sizable contingent government liabilities,[5] and the vulnerability to natural disasters and global warming.

16. **Monetary policy should remain nimble and react to changes in the outlook.** Given the expected moderation in inflationary pressures (as oil price increases moderate) and firmly-anchored inflation expectations, staff concurred with the authorities that the central bank could pause and continue assessing domestic and external conditions before deciding the course of monetary policy in the short term. If prospects of lower growth and inflation materialize, e.g., given global developments, the central bank has space to loosen policy rates and reserve requirements. In the event of strongly deteriorated global conditions, staff recommended the use of active monetary policy (within the logic of inflation targeting) and automatic stabilizers in the budget as a first line of defense (which worked well in the past), ahead of any meaningful discretionary fiscal stimulus; the authorities did not disagree with the use of active monetary and fiscal policies under these conditions. Staff also supported the authorities' intentions to use foreign exchange intervention if disruptions materialize in the foreign exchange market due to a worsening in external conditions, including the pullout of external credit lines in case of an extreme event. In the unlikely scenario of experiencing growth faster than potential and further inflationary pressures, staff would favor a tightening of the policy stance.

[5] The Pre-Electoral report issued in January 2011 estimates public contingent liabilities for around 8 percent of GDP.

Peru: Central Bank Accounts
(In percent of currency the previous period)

	2008	2009	2010	Proj. 2011	Proj. 2012
Currency	**16.7**	**11.0**	**25.5**	**23.3**	**21.1**
Net domestic assets	**-81.6**	**21.3**	**-124.3**	**-47.0**	**1.7**
Public sector (net)	-44.7	-4.4	-24.2	8.6	6.8
Banking system (net)	37.5	-24.2	-4.8	-22.0	-17.5
Other (net)	-74.3	49.9	-95.3	-33.5	12.4
Net international reserves	**98.3**	**-10.3**	**149.8**	**70.2**	**19.4**

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

17. **The external position is expected to remain solid**. The current account deficit is expected to remain at the same level of 2½ percent of GDP, while capital inflows are expected to ease, generating a moderate reserve accumulation. In the event of another global recession, the effect would feed through mainly the trade channel as a sharp decline in the commodity prices would lower Peru's mineral exports. The impact on financial channel is likely to be less significant as banks and the private sector are not dependent on short-term foreign financing.

Peru: Balance of Payments
(In percent of GDP)

	2008	2009	2010	Proj. 2011	Proj. 2012
Current Account	-4.2	0.2	-1.5	-2.5	-2.6
Exports	24.5	21.2	23.1	25.1	25.3
Imports	-22.4	-16.6	-18.7	-20.6	-21.0
Other	-6.2	-4.5	-5.9	-7.0	-6.9
Financial Account	6.6	0.6	8.9	4.9	3.7
Public sector (net)	-1.1	0.8	-0.6	0.0	-0.3
Private sector (net)	7.8	-0.2	9.5	4.9	4.0
Foreign direct investment	4.9	4.1	4.6	4.3	4.5
Other private (net) 1/	2.9	-4.3	4.8	0.6	-0.5
Overall Balance	2.5	0.8	7.4	2.4	1.1

Sources: Peruvian authorities; and Fund staff estimates.
1/ Includes errors and omissions.

18. **With the exchange rate in line with fundamentals, staff and authorities discussed the merits of varying degree of exchange rate flexibility**. Staff exchange rate assessment (CGER) suggests that on average, Peru's exchange rate is in line with its fundamentals (Box 4). The authorities agreed with that assessment, and reiterated that they are prepared to accommodate changes in the exchange rate dictated by changes in fundamentals. They noted that the objective of their foreign exchange intervention policy has been to mitigate excessive exchange rate volatility and its potential destabilizing effects on balance sheets of banks and households in the context of a dollarized economy. Staff agreed with that representation but believed that additional exchange rate flexibility, gradually introduced, could be useful for the private sector to strengthen their ability to assess foreign exchange risk and foster de-dollarization. For instance, the market for mortgages denominated in U.S. dollars seems to be expanding rapidly on the premise that dollar financing is cheaper than local currency financing. The authorities considered that the current degree of flexibility has worked fine, being able to confront the global uncertainties and variable capital flows and terms of trade.

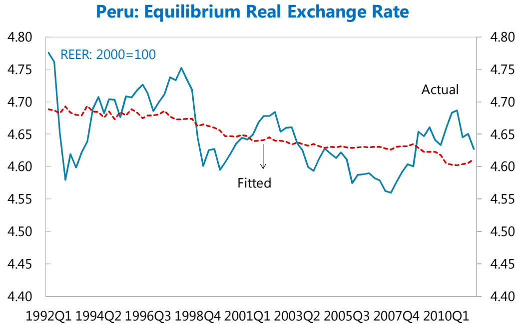
Box 4. Peru: Exchange Rate Assessment

The *Nuevo Sol* has remained the most stable currency among the LA6 countries amid strong capital inflows. Peru's real effective exchange rate (REER) appreciated in the first half of 2010; and weakened during the subsequent period up to April 2011 in part due to currency interventions. Overall, the Nuevo Sol strengthened by 4 percent in real effective terms from end-2009 to September 2011.

Staff's estimates suggest that the *Nuevo Sol* is in line with fundamentals. Panel data CGER estimates showed that, on average, the real exchange rate is not misaligned. The macroeconomic balance approach indicates an overvaluation of 10 percent; while the external stability and the equilibrium exchange rate approaches indicate that the exchange rate is undervalued (by 1 and 16 percent respectively) Finally, an alternative estimate of the equilibrium real exchange rate, following a behavioral approach that is Peru-specific, suggests a slight overvaluation of 1 percent.

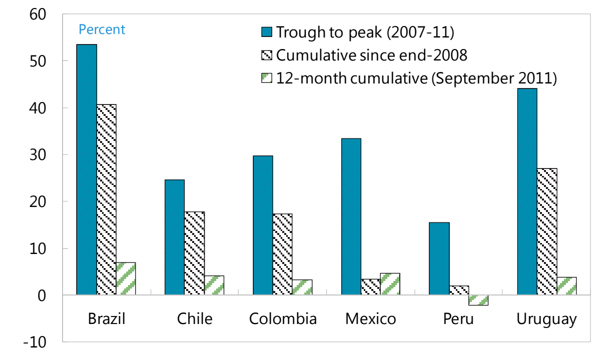
The underlying current account deficit is estimated at around 1 percent of GDP in 2012. The adjustments to the projected current account (2½ percent of GDP in 2012) take into account several factors, including the effects of closing the domestic and trading partners' output gaps over the medium term, mineral and hydrocarbon prices falling to their respective long-term levels, and lower commodity prices translating into lower profit remittances (Table). Similarly, the underlying current account deficit is estimated at a lower 1½ percent of GDP in 2016. This contrasts with the current account norm of -¾ percent of GDP according to the macroeconomic balance (MB) approach; while the net foreign assets (NFA) stabilizing CA is estimated at -2½ percent of GDP.

Peru: Equilibrium Real Exchange Rate



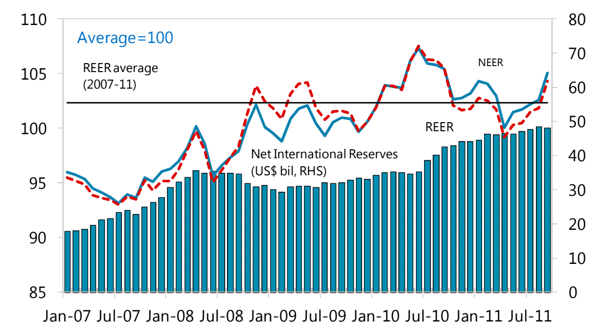
Source: Fund staff's estimates

LA6: Real Effective Exchange Rates



Sources: INS database and Fund staff calculations.

Peru: Exchange Rates and Net International Reserves



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

Peru: Estimating the Underlying Current Account Balance for 2012

	(bil. of US$)	(in percent of GDP)
Projection 2012	**-4.7**	**-2.6**
Adjustments		
Closing Peru's output which is slightly below potential would increase imports	-0.2	-0.1
Increasing foreign demand to potential would increase Peruvian exports	3.3	1.8
Exports will be lower if mineral prices fall to their long-term level	-1.0	-0.6
Lower mineral prices would also lower profit remittances	0.4	0.2
Net oil imports will be lower if prices fall to their long term level	0.2	0.1
Underlying current account	**-2.1**	**-1.1**

Source: Fund staff estimates.

B. Medium-Term Institutional Strengthening

19. **Staff welcomed the authorities' plan to strengthen tax administration to cover spending needs over the medium term.** Tax collections are low compared with other emerging markets in terms of revenue mobilization (at 15 percent of GDP) and tax effort (i.e., the ratio of actual revenues to potential). The government set the goal of raising tax revenues to 18 percent of GDP by 2016. The authorities successfully moved with the revised framework for mining taxation, with due consideration to competitiveness. However, staff projected fiscal pressure to stabilize around 16 percent of GDP. Thus, achieving the government's objective would entail sustained efficiency gains of ½ percent each year, which may prove challenging despite welcome plans to strengthen the tax collection agency (SUNAT) to reduce tax evasion. In particular, SUNAT requires: (i) investing in new technologies and equipment; (ii) enhancing administrative and financial independence from the Ministry of Finance; (iii) hiring efficient public servants; and (iv) adopting an integrated institutional strategy for the medium and long runs. If administrative efforts to enhance tax collections encounter limitations, tax policy measures could be considered in due course (i.e., reversing the 1 percentage point reduction in the VAT rate and scaling back preferential treatments).[6] [7]

[6] In addition, consideration could be given to strengthen the framework for subsidies to target the poorest segments of the population, including the GLP subsidy. Against this background, the authorities recently eliminated the subsidy on gasoline.

[7] Tax evasion was one of the major sources of proceeds of crime identified in the Fund staff assessment of Peru's Anti-Money Laundering/

(continued)

20. **Strengthening the fiscal framework would solidify macroeconomic stability**. Building on the success of Peru's Fiscal Responsibility and Transparency Law (FRTL) in reducing public debt, staff suggested that the focus of the fiscal framework could shift to prevent procyclicality of fiscal policy—e.g., by including taxes within the fiscal rule or other fiscal norm—to increasing predictability, and to build buffers by saving most of the extraordinary revenues coming from the extraction of natural resources. Accordingly, staff welcomed the authorities plan to incorporate a structural approach as an additional instrument of guidance for fiscal policy. Staff supported the authorities' plan of keeping the current FRTL and redefining its main parameters with limits on (current and capital) expenditures and escape clauses. Staff and the authorities agreed that further work is needed to precisely underpin an agreed methodology for structural calculations, in addition to medium term targets. A structural approach would help saving abnormal revenues reducing "Dutch Disease" risks in case commodity prices increase further by saving windfall revenue gains.

21. **The prudential framework is in line with new international proposals, and banks are well positioned to implement them.** Once global turmoil subsides, abundant international liquidity could raise capital inflows and risk fuelling a credit boom. The authorities took steps to incorporate the FSAP recommendations (Box 5), including:

Combating the Funding on Terrorism (AML/CFT) risks conducted at the request of the SBS.

Box 5. Peru: Financial Sector Assessment Update[1]

Peru's financial sector is comparatively small, with uneven levels of development across subsectors, and characterized by large, complex, and systemically important financial institutions. The largest segments are banks and pension funds with assets mounting to 40 percent and 20 percent of GDP respectively.

Financial institutions are highly profitable and well capitalized, and banks are likely to withstand severe shocks. Key risks for banks are consumer credit and deposit concentration, as well as maturity mismatches. Bank regulation and supervision are of high quality, although there is room to strengthen supervision by better balancing qualitative judgment and rules-based standards, and by making on-site supervision more intrusive, particularly for the larger banks.

Main FSSA Recommendations

- **Oversight.** For banks, recommendations focus on (i) the need to strengthen consolidated supervision and regulate holdings; (ii) increase the number and caliber of SBS' on-site inspection staff; (iii) develop benchmark to evaluate the effectiveness of management; and (iv) tighten regulations on related party and intra-group transactions. The credit cooperatives should be supervised by the SBS and they should be members of the deposit insurance fund (FSD). For pension funds, staff recommended to eliminate requirement for the SBS to pre-authorize issuers and instruments in which AFPs can invest after introducing a risk-based supervision framework; update the mortality tables for annuities; and increase investment limit in foreign assets to 50 percent.
- **Safety nets.** Despite being well designed, a resolution regime for systemic situations is needed, and the deposit insurance fund (FSD) could be increased by raising fees and/or reducing coverage.
- **Macroprudential framework.** Better institutional coordination of macroprudential policy across agencies would help improve the monitoring of systemic risk, policy formulation and response.
- **Securities regulation.** Provide CONASEV with strong independence, including authority over its own budget and administrative matters, and legal protection against suits similar to SBS staff.
- **Capital market development.** Main recommendations focus on introducing a comprehensive program to support the development of local venture industry and private equity firms; complete the yield curve; and review regulatory requirements for issuers.
- **Payments system.** Financial infrastructure is modern and efficient, but the explicit allowance for unwinding of payment and securities transfer instructions could be abolished to guarantee finality. Consider more geographically distant production and back-up processing for systemically important payment systems.

Progress so far

- **Oversight.** Various projects, including a draft law, are under discussion in order to bring holdings of conglomerates into the regulatory perimeter and to assess the contribution of affiliates to overall group risk. In this context, the SBS is evaluating the effectiveness of its management as well as the resource need for increasing the number and caliber of SBS on-site inspection staff. With regard to consolidated supervision, the SBS is working on incorporating the risk stemming from operating within a conglomerate into its risk assessment matrix. An attempt to bring credit cooperatives under the supervision of the SBS has not progressed so far, but the SBS hopes to re-launch this project. The SBS is working toward removing the pre-authorization of instruments on which pension funds could invest, shifting toward ex-post monitoring and supervision.
- **Safety nets.** A mechanism for liquidity assistance to smaller institutions via a trust fund has been introduced to facilitate central bank's liquidity injection for institutions under stress. The SBS is also working on draft legislation that would facilitate crisis management in systemic situations.
- **Securities Regulator**. The new *Superintendencia de Mercado de Valores (SMV)*–replacing CONASEV–has operational and budgetary independence, and provides legal protection to its staff. The SMV is working on fostering the issuance of venture capital and by medium-size firms and to reduce the legal cost of debtors' first issuance.
- **Pension funds**. In July 2011, the legal limit on investments abroad for pension funds was increased to 50 percent (from 30 percent). The operational limit, set by the central bank, stands currently at 30 percent.

[1] A joint IMF-WB mission visited Lima in the fall of 2010 to update the financial sector assessment conducted in 2005.

- ***New capital requirements***. These take into account credit risk stemming from foreign exchange mismatches, the economic cycle and concentration risks. Some of the large banks are already compliant with the capital add-ons. Staff welcomed steps taken to implement liquidity requirements in line with Basel III. The authorities noted that they would likely implement regulation in line with Basel III ahead of the international schedule, starting in July 2012.

- ***Stock market regulator***. Staff commended the authorities for establishing the Stock Market Superintendence, providing operational and budgetary independence to the previous CONASEV.

- ***Balance sheets***. In addition, the authorities are working on steps to gather information about corporate sector balance sheet beyond listed companies. Staff noted that this would be a good opportunity to request information on foreign exchange mismatches.

- ***Conglomerates***. Staff welcomed efforts to enhance supervision of conglomerates, via higher risk assessment

- ***Pension funds***. The superintendence of banks (SBS) is working on an initiative that eliminates the requirement to pre-authorize issues and instruments for pension fund investments.

- ***Systemic banks***. Consideration could be given to enacting a special resolution regime for systemic situations. The authorities considered the current framework (based on consultations and emergency decrees) to be mostly adequate and saw difficulties in defining all contingencies ex-ante.

- ***Other***. Consideration could also be given to retaking the initiative to include cooperatives under the SBS supervision; increasing the number and caliber of the SBS' staff allocated to inspections and achieving a better balance between qualitative and quantitative elements in risk-based supervision.

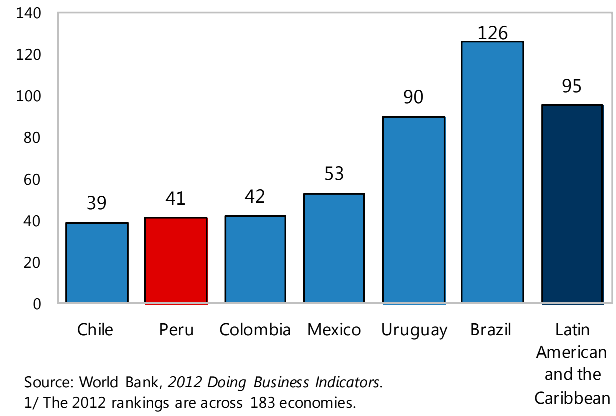
22. **Further coordination in the conduct of macro-prudential policy would assist in managing systemic** risks more effectively. The mission commended the authorities for being active in the implementation of macro-prudential instruments, but noted that the institutional coordination among government agencies could be strengthened as it is currently done on a voluntary basis. A more formal institutional setup would enhance analysis, mandates, accountability, and coordination across institutions. Staff noted that it would also facilitate monitoring systemic risks more effectively, and design macro-prudential instruments in a more coordinated manner. As a first step, enhancing information sharing will facilitate a better understanding of systemic macro-financial linkages.

23. **Given the importance of maintaining high growth, efforts should be made to cement the business climate.** While Peru compares relatively well with other counties in the region, staff encouraged the authorities to take additional measures to enhance competitiveness. According to the World Bank's "doing business indicators", Peru's relative strength lies in protecting investors ease of getting credit, and registering property. However, it still lags behind in

subcategory rankings such as enforcing contracts, resolving insolvency, dealing with construction permits, ease of paying taxes, and getting electricity.

24. **Additional reforms are needed in support of small and medium enterprises to enhance competitiveness and growth prospects.** While the economy benefited greatly from the growth of mining and related sectors due to the commodity price boom, the economy still comprises largely of small and medium enterprises and informal employment. Over the past decades, there has been limited progress in providing support to businesses in improving management, innovation and quality standard. In this context, the authorities initiated structural reforms to facilitate technical assistance to small and medium enterprises with a view to reduce costs and enhance their productivity by creating a certified network of providers to support firms to deal with technology and business innovation issues.

LAC 6: Doing Business Ranking 1/



Source: World Bank, *2012 Doing Business Indicators*.
1/ The 2012 rankings are across 183 economies.

C. Poverty Alleviation and Social Inclusion

25. **Sustaining poverty alleviation and achieving more social inclusive growth would require improvements in targeted social programs**. Despite advances in reducing poverty (thanks to strong economic performance and rising employment opportunities), large regional disparities persist. The authorities prioritized social programs to place greater focus on the 800 poorest districts through the household targeting system. Other key measures include expanding successful social programs, such as Juntos, the cash transfer program to additional districts, and increasing the coverage of targeted programs for elderly in extreme poverty through Pension 65. In addition, increasing the efficiency of public expenditures in education and infrastructure would reduce the regional gaps in physical and human capitals and bring about greater redistribution over the medium term. The authorities are well aware of the risks posed by increasing regional disparities, in part due to differences in resource endowment. The revised framework for mining taxation aims at addressing this problem.

26. **Additional social spending will need to be carefully calibrated.** While Peru lags behind other countries with comparable income level in health and education expenditures, any increases in social spending will require skillful implementation to ensure the fiscal position is not compromised. Staff supported the authorities' effort to expand social programs within the expenditure envelop available in the 2012 budget, as well as efforts to increase social spending over the medium term as revenues are strengthened.

STAFF APPRAISAL

27. **The policy mix seems broadly adequate to maintain macro stability and foster growth.** The main challenge is to ensure a timely and flexible implementation of policies to confront changing domestic economic conditions in an external environment of heightened uncertainty.

28. **The 2012 budget proposal seems appropriate.** Efforts to reinvigorate public spending in the second half of 2011 are welcome as the fiscal stance was becoming somewhat tight. Still, there will be a higher-than-expected surplus for 2011. The proposed 2012 budget, which aims at a surplus of 1 percent of GDP and entails a structural expansion of ¾ percent of GDP, is broadly adequate as activity is expected to be softer. Additional short-term social spending can be accommodated within the expenditure limits established by the 2012 budget.

29. **Given the uncertain external environment, monetary policy can remain on hold.** In view of the expected fall in inflationary pressures (as the impact of higher oil and food prices is absorbed) and the previous tightening in monetary policy, Staff supports the central bank decision to keep policy rates unchanged, at least until a clearer picture on the global outlook emerges. The authorities should continue monitoring private credit developments and ensuring risks remain contained.

30. **Against a background of heightened risks to the global outlook, policies should remain flexible.** Peru's solid fundamentals and scope for policy response are likely to mitigate the effects of a weak world economy. As a first line of defense, and consistent with the functioning of an inflation targeting regime, monetary policy could be eased as inflation prospects decline and the output gap widens, while fiscal policy activates automatic stabilizers. Against the background of potential global financial volatility, some foreign exchange support would be warranted. Reserve requirements may be loosen if liquidity conditions become stressed or if domestic credit decelerates too rapidly.

31. **Should tail risks in global conditions materialize, additional policy stimulus could be deployed to limit the fallout.** The buildup of buffers in the last few years suggests there is space to implement a sizable policy response. Yet, the uncertainty about the nature and duration of the external shock makes advisable a gradual use of these buffers. The central bank has the capacity to inject considerable liquidity and cut rates more aggressively if external financial conditions deteriorate (although potential pressures in the foreign exchange market could become a constraint). As with the fiscal stimulus implemented in 2009, infrastructure and maintenance projects can prove effective to help sustain domestic demand and employment. Under this scenario, the policy response would only help mitigate the shock, with economic activity likely being below potential in the short term. Therefore, it will be important to design and communicate clearly the authorities' strategy and objectives, and ensure continuity in the policy framework.

32. **Giving more weight to structural measures to anchor fiscal policy would help cementing macroeconomic stability.** This

approach helps reducing procyclicality risks, enhances predictability, and accumulates fiscal buffers. Staff sees merits of targeting moderate structural overall balances of 1 percent of GDP in the medium-term to cope with the volatile global environment, contingent liabilities, and Peru's vulnerability to natural disasters. In the short-term, current FRTL parameters could be calibrated to maintain a relatively stable structural result, with limits to expenditure growth, unless a discretionary fiscal reaction is called for.

33. **Tax mobilization efforts will be key to the sustainability of the social agenda.** Staff welcomes the authorities' plans to strengthen tax administration to increase the tax ratio to 18 percent of GDP by 2016 to provide additional resources to cover increasing social programs and public investments in the medium-term. The approval of the revised mining taxation framework, with due consideration for competitiveness in the sector, is a welcome first step. Staff also welcomes the authorities' efforts to reduce tax evasion, but warns that in the event these efforts did not yield the expected results, tax measures could be considered.

34. **Going forward, Peru's improved fundamentals will foster further de-dollarization, allowing the exchange rate to play a larger role as shock absorber.** Staff believes that some additional exchange rate flexibility, gradually implemented, is important for the private sector to strengthen its ability to assess foreign exchange risk, and may contribute to de-dollarize. Financial dollarization remains high and has actually increased in some segments given low international interest rates and appreciation expectations. A gradual increase in exchange rate flexibility would foster the development of hedging instruments and private sector awareness about managing currency risk, thereby allowing the exchange rate to play a larger role as a shock absorber.

35. **The financial sector is strong, and the prudential framework is ahead in the implementation of proposed international standards.** Peru's financial sector remains sound, profitable and well-capitalized. Most prudential regulations aligned with Basel III will be applied ahead of the internationally-agreed schedule, with banks well positioned to implement them. Monitoring corporate balance sheets, including foreign exchange and derivative positions, will be critical to assess vulnerabilities. Formalizing an institutional setup for macro-prudential policies would facilitate monitoring systemic risks more effectively, and enhance analysis and coordination across institutions.

36. **Peru's bright economic prospects will benefit from an ambitious reform agenda to maintain high potential growth.** Staff concurs with the view that growth will need to be increasingly driven by higher productivity over the medium term. Key pillars to ensure high growth include: (i) enhancing competitiveness by boosting human capital and infrastructure and maintaining labor market flexibility; (ii) improving the business climate to foster investment and innovation (including enhancing formality); and (iii) further developing the local capital markets to facilitate investment and better allocate savings.

37. **Staff proposes that Peru remains on the 12-month consultation cycle.**

Table 1. Peru: Selected Economic Indicators

	2006	2007	2008	2009	2010	Projections 2011	2012
Social Indicators							
Life expectancy at birth (years)	72.8	73.0	73.2	73.5	73.7	...	...
Infant mortality (per thousand live births)	23.8	22.2	20.7	19.4	...	...	...
Adult literacy rate	88.7	89.6	89.6	89.6	89.6	...	...
Poverty rate (total) 1/	44.5	39.3	36.2	34.8	31.1	...	...
Unemployment rate	8.5	8.4	8.4	8.4	7.9	7.5	7.5
(Annual percentage change; unless otherwise indicated)							
Production and prices							
Real GDP	7.7	8.9	9.8	0.9	8.8	6.7	5.2
Real domestic demand	10.3	11.8	12.3	-2.8	12.8	8.1	5.5
Of which: Private sector	10.3	12.2	12.4	-5.7	12.2	9.6	4.0
Consumer Prices (end of period)	1.1	3.9	6.7	0.2	2.1	3.9	2.5
Consumer Prices (period average)	2.0	1.8	5.8	2.9	1.5	3.2	2.8
External sector							
Exports	37.2	17.9	10.4	-13.1	31.9	19.6	7.0
Imports	22.9	32.0	45.2	-26.1	37.1	21.2	8.1
Terms of trade (deterioration -)	26.6	3.6	-14.5	-3.1	18.2	5.8	0.0
Real effective exchange rate (depreciation -) 2/	-1.8	-1.7	4.4	3.5	2.4	...	...
Money and credit 3/ 4/							
Broad money	9.0	22.2	24.9	5.9	23.8	15.4	12.4
Net credit to the private sector	6.4	30.2	32.4	1.3	14.6	20.5	14.4
(In percent of GDP; unless otherwise indicated)							
Public sector							
NFPS Revenue	25.4	25.8	26.6	24.0	25.0	26.3	25.9
NFPS Primary Expenditure	21.2	21.0	22.7	24.3	24.4	22.9	23.7
NFPS Primary Balance	4.2	4.8	3.9	-0.3	0.6	3.4	2.2
NFPS Overall Balance	2.3	3.1	2.3	-1.6	-0.5	2.2	1.1
General Government Primary Balance	3.7	4.9	3.7	-0.9	0.8	3.3	2.3
General Government Overall Balance	1.9	3.2	2.2	-2.1	-0.3	2.2	1.2
External Sector							
External current account balance	3.1	1.4	-4.2	0.2	-1.5	-2.5	-2.6
Gross reserves							
In millions of U.S. dollars	17,329	27,720	31,233	33,175	44,150	48,243	50,243
Percent of short-term external debt 5/	339.6	206.2	317.9	435.4	342.5	496.8	465.1
Percent of foreign currency deposits at banks	151.4	209.7	173.8	190.3	217.3	226.6	230.5
Debt							
Total external debt	31.4	31.3	28.4	29.3	27.4	26.1	25.4
NFPS Gross debt (including CRPAOs)	33.1	30.4	24.9	28.4	24.6	21.3	20.7
External 6/	23.8	18.8	15.1	16.2	12.9	11.7	10.6
Domestic	9.3	11.7	9.8	12.2	11.6	9.7	10.1
Savings and investment							
Gross domestic investment	20.0	22.8	26.9	20.7	25.0	24.6	24.6
Public sector 7/	3.1	3.4	4.3	5.2	5.9	5.1	6.1
Private sector	16.4	18.2	21.5	17.7	19.2	18.7	18.2
Inventories changes	0.6	1.3	1.0	-2.1	-0.1	0.8	0.3
National savings	23.2	24.2	22.7	20.9	23.5	22.1	22.0
Public sector 8/	5.1	6.4	6.8	4.2	5.7	7.3	7.2
Private sector	18.0	17.8	15.9	16.6	17.8	14.8	14.8
External savings	-3.1	-1.4	4.2	-0.2	1.5	2.5	2.6
Memorandum items							
Nominal GDP (S/. billions)	302.3	335.5	371.1	382.3	434.6	485.3	524.1
GDP per capita (in US$)	3,339	3,800	4,425	4,361	5,205	5,669	5,951

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; ECLAC 2002-03; National Statistical Institute (INEI); UNDP Human Development Indicators; 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: Main Fiscal Aggregates

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
						Projections 1/					
	(In millions of Nuevos Soles, unless otherwise indicated)										
Nonfinancial Public Sector											
Revenues	**76,640**	**86,455**	**99,305**	**91,581**	**108,606**	**127,635**	**135,866**	**145,657**	**157,577**	**169,503**	**182,859**
Taxes	46,285	53,435	59,672	53,842	65,951	77,603	82,287	89,658	97,720	105,270	113,672
Other	30,355	33,020	39,632	37,739	42,656	50,032	53,579	55,999	59,857	64,233	69,187
Primary expenditures 2/	**63,970**	**70,224**	**84,788**	**92,751**	**105,902**	**111,147**	**124,071**	**132,547**	**142,773**	**154,108**	**166,382**
Current	55,330	58,889	67,709	69,364	77,643	86,014	91,685	98,900	106,834	115,185	124,296
Capital	8,640	11,334	17,078	23,386	28,260	25,134	32,386	33,647	35,939	38,923	42,086
Primary balance	**12,671**	**16,231**	**14,517**	**-1,170**	**2,704**	**16,487**	**11,795**	**13,110**	**14,805**	**15,395**	**16,477**
Interest	5,660	6,008	5,884	5,011	5,057	5,686	6,183	6,458	6,647	6,606	6,874
Overall balance	**7,010**	**10,223**	**8,633**	**-6,181**	**-2,353**	**10,801**	**5,612**	**6,652**	**8,158**	**8,789**	**9,603**
External financing	-1,790	-6,398	-3,472	4,069	3,686	425	-1,046	-1,223	-1,547	-1,322	-1,656
Domestic financing	-5,220	-3,825	-5,161	2,112	-1,333	-11,227	-4,566	-5,429	-6,611	-7,467	-7,947
Public Gross Debt 3/	**99,822**	**99,718**	**89,675**	**104,352**	**102,288**	**98,873**	**104,229**	**106,906**	**110,406**	**114,623**	**119,470**
External	71,948	62,834	56,286	62,051	56,250	56,689	55,642	54,419	52,872	51,550	49,894
Domestic	27,875	36,885	33,389	42,300	46,038	42,185	48,586	52,487	57,534	63,073	69,576
Public Gross Debt (including CRPAO)	**100,061**	**101,903**	**92,944**	**108,753**	**106,754**	**103,554**	**108,725**	**111,198**	**114,472**	**118,438**	**123,007**
Of which: CRPAO	238.6	2,185	3,269	4,401	4,466	4,681	4,496	4,292	4,066	3,816	3,538
Foreign-currency denominated debt	**75,564**	**71,324**	**58,789**	**65,083**	**59,097**	**59,349**	**58,111**	**56,739**	**55,024**	**53,297**	**55,353**
	(In percent of GDP, unless otherwise indicated)										
Nonfinancial Public Sector											
Revenues	**25.4**	**25.8**	**26.6**	**24.0**	**25.0**	**26.3**	**25.9**	**25.7**	**25.8**	**25.7**	**25.7**
Taxes 5/	15.3	16.0	16.0	14.1	15.2	16.0	15.7	15.8	16.0	16.0	16.0
Other	10.0	9.9	10.6	9.9	9.8	10.3	10.2	9.9	9.8	9.7	9.7
Primary expenditures 2/	**21.2**	**21.0**	**22.7**	**24.3**	**24.4**	**22.9**	**23.7**	**23.4**	**23.3**	**23.4**	**23.4**
Current	18.3	17.6	18.2	18.1	17.9	17.7	17.5	17.4	17.5	17.5	17.5
Capital	2.9	3.4	4.6	6.1	6.5	5.2	6.2	5.9	5.9	5.9	5.9
Primary balance	**4.2**	**4.8**	**3.9**	**-0.3**	**0.6**	**3.4**	**2.2**	**2.3**	**2.4**	**2.3**	**2.3**
Interest	1.9	1.8	1.6	1.3	1.2	1.2	1.2	1.1	1.1	1.0	1.0
Overall balance	**2.3**	**3.1**	**2.3**	**-1.6**	**-0.5**	**2.2**	**1.1**	**1.2**	**1.3**	**1.3**	**1.3**
External financing	-0.6	-1.9	-0.9	1.1	0.8	0.1	-0.2	-0.2	-0.3	-0.2	-0.2
Domestic financing	-1.7	-1.1	-1.4	0.6	-0.3	-2.3	-0.9	-1.0	-1.1	-1.1	-1.1
Public Gross Debt 3/	**33.0**	**29.8**	**24.0**	**27.3**	**23.5**	**20.4**	**19.9**	**18.9**	**18.1**	**17.4**	**16.8**
External	23.8	18.8	15.1	16.2	12.9	11.7	10.6	9.6	8.6	7.8	7.0
Domestic	9.2	11.0	9.0	11.1	10.6	8.7	9.3	9.3	9.4	9.6	9.8
Public Gross Debt (including CRPAO)	**33.1**	**30.4**	**24.9**	**28.4**	**24.6**	**21.3**	**20.7**	**19.6**	**18.7**	**18.0**	**17.3**
Of which: CRPAO	0.1	0.7	0.9	1.2	1.0	1.0	0.9	0.8	0.7	0.6	0.5
Foreign-currency denominated debt	**25.0**	**21.3**	**15.8**	**17.0**	**13.6**	**12.2**	**11.1**	**10.0**	**9.0**	**8.1**	**7.8**
Memorandum items											
Gen. Gov. primary spending (var. real)	7.1	7.3	13.7	12.8	10.9	-1.1	9.7	6.5	6.5	6.0	6.0
Of which: Current spending	3.7	7.4	6.2	6.0	7.2	4.7	3.5	6.0	6.0	6.0	6.0
Capital spending	24.9	7.0	46.0	34.1	20.1	-13.9	26.1	7.6	7.7	6.2	6.0
Output gap	-0.2	1.2	3.7	-2.0	0.1	0.6	-0.3	-0.2	-0.1	-0.1	0.0
SPNF structural balance 4/	0.3	1.3	0.7	-0.5	-1.2	1.3	0.5	0.8	1.1	1.0	1.0
SPNF structural primary balance 4/	2.2	3.1	2.2	0.8	-0.1	2.5	1.7	1.9	2.2	2.0	1.9
Fiscal impulse (+ = expansionary)	-0.9	-1.0	0.8	1.6	0.8	-2.6	0.8	-0.2	-0.3	0.2	0.1

Sources: MOF, BCRP, and Fund's estimates.
1/ Fund's estimates.
2/ Official data excludes expense accrued during the period by CRPAOs and FEPC, but includes corresponding cash payments.
3/ Corresponds to the nonfinancial public sector. Official data excludes stock of debt accumulated and not paid during the period in CRPAOs and FEPC. Cash payments are recorded as amortizations.
4/ Adjusted by the economic cycle and commodity prices.
5/ Definicion of tax pressure used by the authorities.

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

(In percent of GDP, unless otherwise indicated)

						Projections					
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Revenue	**20.1**	**20.9**	**21.0**	**18.7**	**20.0**	**20.9**	**20.7**	**20.9**	**21.0**	**21.0**	**21.0**
Taxes	15.3	15.9	16.0	14.1	15.2	16.0	15.7	15.8	16.0	16.0	16.0
Social Contributions	1.5	1.6	1.7	1.7	1.7	1.7	1.5	1.5	1.5	1.5	1.5
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other revenue	3.2	3.4	3.3	2.8	3.0	3.2	3.5	3.5	3.5	3.5	3.5
Of which: Interest income	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Expense 1/	**15.6**	**15.0**	**15.0**	**15.7**	**14.8**	**13.9**	**13.7**	**13.7**	**13.7**	**13.6**	**13.6**
Compensation of employees	5.6	5.3	5.1	5.5	5.1	4.7	4.8	4.7	4.7	4.6	4.7
Use of goods and services	4.5	4.4	4.3	5.0	5.1	5.1	5.3	5.3	5.4	5.2	5.3
Comsumption of fixed capital 2/	....	....	...	...	...	...	...	...	...	...	...
Interest	1.9	1.8	1.5	1.3	1.1	1.1	1.1	1.1	1.0	0.9	0.9
Subsidies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	2.9	2.6	2.3	2.4	2.2	2.0	2.0	2.0	2.1	2.3	2.1
Other expenses 8/	0.8	1.0	1.7	1.5	1.3	1.0	0.6	0.6	0.5	0.5	0.6
Net acquisition of nonfinancial assets	**2.5**	**2.7**	**3.8**	**5.2**	**5.4**	**4.8**	**5.8**	**5.9**	**6.0**	**6.0**	**6.0**
Acquistions of nonfinancial assets	2.6	2.9	3.9	5.2	5.5	4.8	5.8	5.9	6.0	6.0	6.0
Disposals of nonfinancial assets	0.1	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Comsumption of fixed capital 2/	....	....	....	....	....	....	....	....	....	....	....
Gross Operating Balance	4.4	5.9	6.0	3.1	5.1	7.0	7.0	7.2	7.4	7.4	7.4
Net Operating Balance 3/	....	....	....	....	....	....	....	....	....	....	....
Net lending (+) borrowing (-) 4/	**1.9**	**3.2**	**2.2**	**-2.1**	**-0.3**	**2.2**	**1.2**	**1.3**	**1.4**	**1.4**	**1.4**
Net acquistion of financial assets 5/	**1.9**	**3.3**	**1.3**	**-0.7**	**0.8**	**0.5**	**2.0**	**1.8**	**2.3**	**2.5**	**2.7**
By instrument											
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits 7/	1.9	3.3	1.3	-0.7	0.8	0.5	2.0	1.8	2.3	2.5	2.7
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	....	....	....	....	....	....	....	....	....	....	....
By residency											
Domestic	1.9	3.3	1.3	-0.7	0.8	0.5	2.0	1.8	2.3	2.5	2.7
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities 6/	**0.0**	**0.1**	**-0.9**	**1.4**	**1.1**	**-1.6**	**0.8**	**0.5**	**0.9**	**1.1**	**1.3**
By instrument											
SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	0.5	1.9	-0.9	1.9	2.0	-1.7	1.0	0.8	1.2	1.3	1.5
Loans	-0.5	-1.8	0.0	-0.5	-0.9	0.0	-0.2	-0.2	-0.3	-0.2	-0.3
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	....	....	....	....	....	....	....	....	....	....	....
By residency											
Domestic	0.6	2.1	0.1	0.2	1.6	-1.7	1.0	0.8	1.2	1.3	1.5
External	-0.6	-2.0	-1.0	1.2	-0.6	0.0	-0.2	-0.2	-0.3	-0.2	-0.3
Memorandum items											
Central Government Net lending (+) borrowing (-)	1.8	2.0	2.0	-1.5	0.3	0.9	1.0	1.5	1.7	1.8	1.8
Regional Governments Net lending (+) borrowing (-)	0.0	0.2	0.2	-0.2	-0.2	0.3	0.1	-0.1	0.1	0.2	0.3
Local Governments Net lending (+) borrowing (-)	0.1	1.1	0.0	-0.4	-0.4	-1.0	-0.2	-0.2	-0.2	-0.2	-0.2
Commodity related revenue	4.2	4.7	4.1	2.6	3.5	4.1	4.1	4.0	4.0	4.1	4.2
General Government Primary Balance	3.7	4.9	3.7	-0.9	0.8	3.3	2.3	2.3	2.4	2.3	2.3
General Government nonfinancial expenditures	16.1	15.9	17.2	19.4	19.3	17.6	18.4	18.5	18.6	18.7	18.7

Sources: MOF, BCRP, and Fund's estimates.
*/ Fiscal data is not fully compiled on an accrual basis.
1/ Official data excludes expense accrued during the period by CRPAOs and FEPC, but includes corresponding cash payments.
2/ Not compiled by the authorities.
3/ Net operating balance is calculated as the gross operating balance minus consumption of fixed capital
4/ Net lending (+)/ borrowing (-) is equal to gross operating balance minus net acquistions of nonfinancial assets.
5/ (+) corresponds to increase in financial assets; (-) to a decrease in financial assets.
6/ (+) corresponds to increase in libialities (disbursement and/or issuance); (-) to decrease in liabilities (amortizations) .
7/ Includes FEF.
8/ Includes transfers to FEPC.
9/ (+ increase expense; - decrease expense)

Table 4. Peru: General Government Stock Positions
(In percent of GDP, unless otherwise indicated)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
						Projections 1/					
Stock positions:											
Net worth	....	....	....	....	....	....	....	....	....	....	....
Nonfinancial assets	....	....	....	....	....	....	....	....	....	....	....
Net financial worth	**-22.8**	**-16.0**	**-12.4**	**-11.7**	**-9.9**	**-6.7**	**-5.0**	**-3.3**	**-1.7**	**-0.2**	**1.3**
Financial assets	**8.0**	**10.8**	**11.7**	**11.9**	**11.3**	**10.7**	**11.9**	**12.8**	**14.2**	**15.7**	**17.2**
By instrument											
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits 2/	7.4	10.3	11.2	11.4	10.9	10.3	11.6	12.6	13.9	15.4	16.9
Debt securities	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.2	0.2
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts recivable	....	....	....	....	....	....	....	....	....	....	....
By residency											
Domestic	7.4	10.3	11.2	11.4	10.9	10.3	11.6	12.6	13.9	15.4	16.9
External	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.2	0.2
By currency 6/											
Domestic	7.6	10.9	10.6	12.0	11.0	10.2	11.5	12.4	13.8	15.2	16.6
Foreign	0.6	0.5	0.4	0.4	0.4	0.3	0.4	0.4	0.4	0.5	0.5
Liabilities 3/	**30.8**	**26.8**	**24.1**	**23.6**	**21.2**	**17.4**	**16.9**	**16.2**	**15.9**	**15.8**	**15.9**
By instrument	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	15.9	16.5	14.1	15.1	14.8	11.6	11.7	11.6	12.0	12.4	13.0
Loans	14.9	10.3	10.0	8.5	6.4	5.8	5.1	4.5	3.9	3.4	2.9
Equity and shares	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	....	....	....	....	....	....	....	....	....	....	....
By residency											
Domestic	8	8.9	8.1	8.3	8.6	6.1	6.7	6.9	7.6	8.4	9.2
External	23.2	17.9	16.0	15.3	12.6	11.3	10.2	9.2	8.3	7.5	6.7
By currency 6/											
Domestic	7.7	10.5	8.5	10.4	10.0	9.6	9.6	8.8	9.0	9.2	9.4
Foreign	23.0	16.3	15.6	13.2	11.2	7.7	7.3	7.3	6.9	6.6	6.5
Memorandum items											
General Government Gross Debt (at face value)	30.8	26.8	24.1	23.6	21.2	17.4	16.9	16.2	15.9	15.8	15.9
General Government Net Debt (at face value)	22.8	16.0	12.4	11.7	9.9	6.7	5.0	3.3	1.7	0.2	-1.3
Stock of FEF	0.4	0.5	1.4	1.4	1.4	3.3	5.2	5.8	6.5	7.2	7.9
Debt of FEPC 4/	0.0	0.3	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt of CRPAOs 4/	0.1	0.7	0.9	1.2	1.0	1.0	0.9	0.8	0.7	0.6	0.5
Debt of SOEs guaranteed by government 5/	0.5	0.5	0.7	0.8	1.0	0.8	0.7	0.7	0.6	0.6	0.5

Sources: MOF, BCRP, and Fund's estimates.
1/ Assuming zero other economic flows.
2/ Includes stocks of FEF
3/ Excludes debt of public enterprises guaranteed by the central government, debt of FEPC, and CRPAOs.
4/ On an accrual basis this debt should be included as liabilities (i.e., general government gross debt). The authorities are in the process of refining fiscal estimates and plan to adjust fiscal estatistics in the short-term.
5/ This debt is excluded from general government liabilities since it is a liability of SOEs.
6/ Preliminary data.

Table 5. Peru: Public Sector Social Expenditure

	2006	2007	2008	2009	2010	Proj. 2011	Proj. 2012
(In millions of Nuevos Soles)							
Total social expenditure and pensions	**30,928**	**33,814**	**37,099**	**43,341**	**46,367**	**46,590**	**50,310**
Universal coverage (Education and Health) 1/	**11,800**	**12,852**	**14,955**	**18,220**	**18,979**	**18,514**	**20,667**
Education	8,063	8,688	9,606	11,010	11,292	10,681	11,475
Health	3,737	4,164	5,350	7,210	7,687	7,832	9,192
Targeted programs (Extreme Poverty)	**3,856**	**4,844**	**5,875**	**6,861**	**7,300**	**9,062**	**9,940**
Non-Targeted Social Programs	**13,394**	**13,710**	**13,868**	**14,888**	**16,215**	**15,857**	**16,683**
ESSALUD	4,000	4,261	4,628	5,124	5,609	5,993	6,359
Pensions	9,394	9,448	9,241	9,764	10,605	9,864	10,324
Housing Development Program (FONAVI)	0	0	0	0	0	0	0
Other Social Expenditure 2/	**1,878**	**2,408**	**2,400**	**3,372**	**3,873**	**3,157**	**3,020**
(In percent of general government expenditure)							
Total social expenditure and pensions	**57.0**	**56.4**	**53.2**	**54.7**	**52.3**	**51.7**	**49.2**
Universal coverage (Education and Health) 1/	21.8	21.5	21.5	23.0	21.4	20.5	20.2
Education	14.9	14.5	13.8	13.9	12.7	11.9	11.2
Health	6.9	7.0	7.7	9.1	8.7	8.7	9.0
Targeted programs (Extreme Poverty)	7.1	8.1	8.4	8.7	8.2	10.1	9.7
Non-Targeted Social Programs	24.7	22.9	19.9	18.8	18.3	17.6	16.3
ESSALUD	7.4	7.1	6.6	6.5	6.3	6.7	6.2
Pensions	17.3	15.8	13.3	12.3	12.0	10.9	10.1
Housing Development Program (FONAVI)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Social Expenditure	3.5	4.0	3.4	4.3	4.4	3.5	3.0
(In percent of GDP)							
Total social expenditure and pensions	**10.2**	**10.1**	**10.0**	**11.3**	**10.7**	**9.6**	**9.6**
Universal coverage (Education and Health) 1/	3.9	3.8	4.0	4.8	4.4	3.8	3.9
Education	2.7	2.6	2.6	2.9	2.6	2.2	2.2
Health	1.2	1.2	1.4	1.9	1.8	1.6	1.8
Targeted programs (Extreme Poverty)	1.3	1.4	1.6	1.8	1.7	1.9	1.9
Non-Targeted Social Programs	4.4	4.1	3.7	3.9	3.7	3.3	3.2
ESSALUD	1.3	1.3	1.2	1.3	1.3	1.2	1.2
Pensions	3.1	2.8	2.5	2.6	2.4	2.0	2.0
Housing Development Program (FONAVI)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Social Expenditure	0.6	0.7	0.6	0.9	0.9	0.7	0.6
Memorandum items:							
(In millions of Nuevos Soles)							
General government expenditure	54,226	59,908	69,719	79,195	88,654	90,121	102,182
Nominal GDP	302,255	335,528	371,073	382,320	434,612	485,263	524,139

Source: Ministry of Economy and Finance.

1/ Net of spending on education and health already included in the extreme poverty programs. Includes social expenditure of the 3 levels of government: national, regional and local.

2/ Includes basically other social expenditure of the local and regional government.

Table 6. Peru: Balance of Payments

(In millions of U.S. dollars)

						Projections					
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Current account	**2,872**	**1,460**	**-5,318**	**211**	**-2,315**	**-4,269**	**-4,729**	**-5,442**	**-5,523**	**-5,574**	**-5,288**
Merchandise trade	8,986	8,503	2,569	5,951	6,749	7,605	7,746	8,648	11,115	14,234	17,139
Exports	23,830	28,094	31,019	26,962	35,565	42,522	45,491	49,294	54,530	60,434	66,375
Traditional	18,461	21,666	23,266	20,622	27,669	33,132	35,824	39,279	44,256	49,818	55,454
Nontraditional and others	5,369	6,428	7,753	6,339	7,896	9,390	9,667	10,015	10,274	10,616	10,921
Imports	-14,844	-19,591	-28,449	-21,011	-28,815	-34,918	-37,744	-40,646	-43,415	-46,200	-49,236
Services, income, and current transfers (net)	-6,114	-7,043	-7,887	-5,740	-9,064	-11,874	-12,476	-14,090	-16,638	-19,808	-22,427
Services	-737	-1,192	-2,056	-1,144	-2,037	-2,500	-2,869	-3,056	-3,208	-3,367	-3,532
Investment income	-7,562	-8,359	-8,774	-7,484	-10,053	-12,552	-13,053	-14,601	-17,799	-21,149	-23,977
Current transfers	2,185	2,508	2,943	2,887	3,026	3,178	3,447	3,567	4,370	4,707	5,081
Capital and financial account balance	**348**	**8,400**	**8,674**	**1,499**	**13,149**	**8,818**	**6,699**	**7,412**	**7,523**	**7,574**	**7,288**
Public sector	-660	-2,428	-1,404	1,032	-856	30	-560	-620	-733	-655	-771
Disbursements 1/	609	3,384	1,166	3,229	4,427	1,187	851	974	1,000	1,050	1,100
Amortization 1/	-1,223	-5,691	-2,635	-1,879	-5,268	-1,107	-1,386	-1,569	-1,708	-1,680	-1,846
Other public sector flows 2/	-125	-166	65	-317	-15	-50	-25	-25	-25	-25	-25
Private sector	1,008	10,827	10,077	467	14,005	8,788	7,259	8,032	8,256	8,230	8,059
Foreign direct investment (net) 3/	3,388	5,380	6,188	5,178	7,113	7,341	8,075	8,882	9,771	10,748	11,554
Other private capital	-2,380	5,448	3,889	-4,711	6,892	1,447	-816	-851	-1,515	-2,518	-3,494
Medium- and long-term loans	204	2,856	2,640	1,151	3,752	1,250	1,425	1,025	1,025	1,025	1,025
Portfolio investment	-1,504	528	682	-3,649	2,458	-1,523	-1,940	-2,395	-2,296	-2,247	-2,597
Short-term flows 4/	-1,079	2,064	568	-2,214	681	1,720	-301	519	-243	-1,296	-1,922
Errors and omissions	-495	-175	-244	-702	566	-469	0	0	0	0	0
Overall balance	**2,726**	**9,685**	**3,112**	**1,008**	**11,401**	**4,080**	**1,970**	**1,970**	**2,000**	**2,000**	**2,000**
Financing	**-2,726**	**-9,588**	**-3,112**	**-1,007**	**-11,173**	**-4,080**	**-1,970**	**-1,970**	**-2,000**	**-2,000**	**-2,000**
NIR flow (increase -)	-2,753	-9,654	-3,169	-1,043	-11,192	-4,093	-2,000	-2,000	-2,000	-2,000	-2,000
Change in NIR (increase -)	-3,178	-10,414	-3,507	-1,939	-10,970	-4,747	-2,000	-2,000	-2,000	-2,000	-2,000
Valuation change	-425	-760	-338	-896	222	-654	0	0	0	0	0
Exceptional financing	27	67	57	36	19	14	30	30	0	0	0
				(In pecent of GDP)							
Current account balance	**3.1**	**1.4**	**-4.2**	**0.2**	**-1.5**	**-2.5**	**-2.6**	**-2.8**	**-2.6**	**-2.5**	**-2.2**
Trade balance	9.7	7.9	2.0	4.7	4.4	4.5	4.3	4.5	5.3	6.3	7.0
Exports	25.8	26.2	24.5	21.2	23.1	25.1	25.3	25.4	25.9	26.7	27.2
Traditional	20.0	20.2	18.3	16.2	18.0	19.6	19.9	20.2	21.1	22.0	22.7
Nontraditional and others	5.8	6.0	6.1	5.0	5.1	5.5	5.4	5.2	4.9	4.7	4.5
Imports	-16.1	-18.3	-22.4	-16.6	-18.7	-20.6	-21.0	-20.9	-20.7	-20.4	-20.2
Investment income	-8.2	-7.8	-6.9	-5.9	-6.5	-7.4	-7.2	-7.5	-8.5	-9.3	-9.8
Capital and financial account balance	**0.4**	**7.8**	**6.8**	**1.2**	**8.5**	**5.2**	**3.7**	**3.8**	**3.6**	**3.3**	**3.0**
Foreign direct investment (net)	3.7	5.0	4.9	4.1	4.6	4.3	4.5	4.6	4.6	4.7	4.7
Overall balance	**3.0**	**9.0**	**2.5**	**0.8**	**7.4**	**2.4**	**1.1**	**1.0**	**1.0**	**0.9**	**0.8**
				(Annual percentage change)							
Export value	37.2	17.9	10.4	-13.1	31.9	19.6	7.0	8.4	10.6	10.8	9.8
Volume growth	1.5	6.3	8.9	-2.8	3.6	2.8	5.3	8.9	11.7	11.9	10.4
Price growth	35.2	10.9	1.4	-10.5	27.3	16.3	1.6	-0.5	-1.0	-0.9	-0.5
Import value	22.9	32.0	45.2	-26.1	37.1	21.2	8.1	7.7	6.8	6.4	6.6
Volume growth	14.3	19.3	20.0	-20.3	24.6	10.5	7.7	7.2	6.6	6.0	6.0
Price growth	7.5	10.6	21.0	-7.4	10.1	9.7	0.4	0.4	0.2	0.4	0.5
Terms of trade	26.6	3.6	-14.5	-3.1	18.2	5.8	0.0	-1.3	-1.5	-1.6	-1.2
Memorandum items											
GDP (in billions of US$)	92.3	107.2	126.8	126.9	153.8	169.3	180.1	194.2	210.2	226.3	244.2

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/ Excluding privatization.
4/ Includes COFIDE and Banco de la Nación.

Table 7. Peru: Monetary Survey 1/

	2006	2007	2008	2009	2010	Projections 2011	Projections 2012
			I. Central Reserve Bank (In millions of New Soles)				
Net international reserves 2/	**55,383**	**82,557**	**97,167**	**95,375**	**124,215**	**141,181**	**146,961**
(In millions of U.S. dollars)	17,275	27,689	31,196	33,135	44,105	48,852	50,852
Net domestic assets	**-43,682**	**-67,686**	**-79,818**	**-76,120**	**-100,051**	**-111,396**	**-110,887**
Net credit to nonfinancial public sector	-12,052	-17,135	-23,787	-24,546	-29,203	-27,126	-25,097
Rest of banking system	-16,195	-20,304	-14,732	-18,935	-19,864	-25,179	-30,401
Other	-15,435	-30,247	-41,298	-32,639	-50,983	-59,091	-55,389
Currency	**11,701**	**14,871**	**17,350**	**19,255**	**24,164**	**29,786**	**36,075**
			II. Banking System (In millions of Nuevos Soles)				
Net foreign assets	**56,162**	**78,556**	**97,105**	**95,418**	**125,866**	**144,912**	**151,550**
Net domestic assets	**17,470**	**11,440**	**15,343**	**23,619**	**21,559**	**25,235**	**39,705**
Net credit to nonfinancial public sector	-21,059	-34,204	-42,140	-39,333	-43,544	-41,044	-39,244
Net credit to private sector	54,012	70,340	93,130	94,311	108,101	130,245	148,970
Other	-15,483	-24,696	-35,647	-31,359	-42,999	-63,966	-70,021
Net credit to COFIDE	-850	-850	-850	-850	-850	-850	-850
Other	-14,633	-23,846	-34,797	-30,509	-42,149	-63,116	-69,171
Liabilities to the private sector	**73,631**	**89,996**	**112,447**	**119,037**	**147,425**	**170,147**	**191,255**
			(12-month percentage change)				
Base money	18.3	28.2	25.5	5.5	45.3	16.9	12.8
Broad money	9.0	22.2	24.9	5.9	23.8	15.4	12.4
Domestic currency	18.0	34.5	23.1	11.1	35.3	21.1	17.7
Foreign currency	1.5	10.3	27.1	-0.1	9.3	6.5	3.0
Net credit to private sector	6.4	30.2	32.4	1.3	14.6	20.5	14.4
Domestic currency	29.0	43.1	46.9	11.8	19.0	22.8	18.8
Foreign currency	-3.4	22.8	22.6	-7.3	10.4	18.0	9.6
			III. Financial System (In millions of Nuevos Soles)				
Net foreign assets	**56,137**	**78,175**	**97,033**	**95,477**	**125,805**	**134,611**	**144,034**
Net domestic assets	**67,191**	**79,819**	**66,913**	**100,538**	**114,465**	**147,245**	**177,907**
Net credit to the public sector	-10,746	-17,920	-26,894	-22,401	-27,709	-26,913	-26,323
Net credit to private sector	86,575	111,217	126,759	139,470	167,133	196,619	222,541
Other	-8,638	-13,478	-32,952	-16,531	-24,959	-22,460	-18,311
Liabilities to the private sector	**123,329**	**157,995**	**163,946**	**196,015**	**240,270**	**281,856**	**321,941**
			(12-month percentage change)				
Liabilities to the private sector	21.1	28.1	3.8	19.6	22.6	17.3	14.2
Domestic currency	30.4	35.3	-0.4	27.4	28.1	21.1	17.7
Foreign currency	6.7	14.4	13.0	4.0	9.1	6.5	3.0
Net credit to private sector	15.5	28.5	14.0	10.0	19.8	17.6	13.2
Domestic currency	38.2	40.1	13.1	23.8	24.5	20.8	17.0
Foreign currency	0.4	17.8	14.9	-4.7	13.4	12.9	6.8

Sources: Central Reserve Bank of Peru (BCRP); 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, as well as Corporacion Andina de Fomento (CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations.

Table 8. Peru: Financial Soundness Indicators 1/

(In percent; unless otherwise indicated)

	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Jul-11
Capital Adequacy						
Capital to risk-weighted assets 2/	12.5	11.7	11.9	13.8	13.6	13.2
Regulatory Tier I capital to risk-weighted assets 3/	10.6	8.8	7.7	10.5	10.8	10.8
Nonperforming loans net of provisions to capital	-18.0	-17.3	-15.3	-14.6	-14.3	-14.0
Asset Quality						
Nonperforming loans to total gross loans 4/	1.6	1.3	1.3	1.6	1.5	1.5
In domestic currency	1.9	1.6	1.7	2.0	1.9	2.0
In foreign currency	1.5	1.1	1.0	1.2	1.1	1.1
Nonperforming, refinanced and restructured loans to total gross loans	4.1	2.7	2.2	2.7	2.6	2.5
In domestic currency	3.2	2.5	2.5	3.2	3.0	3.1
In foreign currency	4.6	2.8	1.9	2.3	2.2	2.0
Refinanced and restructured loans to total gross loans	2.4	1.4	0.9	1.1	1.1	1.0
Provisions to nonperforming loans	251.4	278.4	258.7	242.2	245.6	238.2
Provisions to nonperforming, restructured, and refinanced loans	100.3	131.6	151.0	139.3	141.9	146.0
Sectoral distribution of loans to total loans 5/						
Consumer loans	16.5	18.3	17.9	17.8	17.0	17.0
Mortgage loans	14.0	12.3	12.6	13.6	14.1	14.5
Commercial loans	64.2	63.9	63.4	62.5	...	...
Small and Micro Enterprises (MES)	5.3	5.5	6.0	6.1	...	...
Earnings and Profitability						
Return on assets (ROA)	2.2	2.5	2.6	2.3	2.4	2.3
Return on equity (ROE)	23.9	27.9	31.1	24.5	24.2	24.3
Gross financial spread to financial revenues	67.6	66.6	66.3	73.8	79.3	75.3
Financial revenues to total revenues	76.6	79.6	81.3	81.0	78.2	79.6
Annualized financial revenues to revenue-generating assets	10.6	11.6	11.7	10.7	9.6	9.3
Liquidity						
Total liquid assets to total short-term liabilities (monthly average basis)	44.2	45.3	41.4	40.4	48.0	43.6
In domestic currency	43.1	57.3	26.3	38.8	54.6	37.9
In foreign currency	45.0	37.0	53.0	41.7	41.1	49.0
Foreign Currency Position and Dollarization						
Global position in foreign currency to regulatory capital 6/	17.1	16.8	28.6	7.7	0.5	2.2
Share of foreign currency deposits in total deposits	62.7	59.3	58.0	55.8	47.8	48.7
Share of foreign currency loans in total credit	65.5	61.8	57.5	52.4	52.3	51.6
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	11,855	14,857	18,312	19,600	19,857	21,624
Commercial banks' short-term foreign assets (in millions of U.S. dollars)	878	822	1,641	1,373	1,613	1,644
Commercial banks' short-term foreign liabilities (in millions of U.S. dollars)	754	2,238	1,692	1,419	1,099	2,631
Operational efficiency						
Financing to related parties to capital 7/	15.5	14.4	13.9	14.6	12.3	9.0
Nonfinancial expenditure to total revenues 8/	31.3	30.0	28.7	29.6	31.0	32.0
Nonfinancial expenditure to total revenue-generating assets 8/	3.4	4.5	4.3	4.1	3.9	3.9
Memorandum items						
Number of Banks	13	15	18	17	17	17
Private commercial	11	13	16	15	15	15
Of which: Foreign-owned	7	9	11	11	11	11
State-owned	2	2	2	2	2	2
Banks' credit card loans to total loans	8.1	9.2	9.6	9.2	9.2	9.4
Bank loans' year-over-year change (in real terms)	14.0	27.7	28.9	0.3	16.3	15.7
General Stock market index IGBVL (U.S. dollars)	4,032	5,849	2,245	4,902	8,321	8,022
Foreign currency debt rating (Moody's)	Ba3	Ba2	Ba1	Baa3	Baa3	Baa3
EMBI+ PERU spread, basis points	118	178	509	165	165	159

Sources: Superintendency of Banks and Insurance of Peru; Superintendency of Securities Market; and Central Reserve Bank of Peru.
1/ These indicators correspond to private commercial banks.
2/ From July 2009 the regulatory capital requirement applied to all risks: credit, market and operational risk.
3/ 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).
4/ Nonperforming loans are overdue loans after 15 days since the due date for commercial loans, after 30 days for small businesses loans. In the case of mortgage, consumer and leasing loans, they are considered overdue after 30 days since the due date only for the non paid portion and after 90 days for all the credit. The overdue loans include credits under judicial resolution.
5/ Includes restructured loans, refinanced loans, and arrears. 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.

Table 9. Peru: Financial and External Vulnerability Indicators
(In percent; unless otherwise indicated)

	2006	2007	2008	2009	2010	Projections 2011	2012
Financial indicators							
Public sector debt/GDP	33.2	30.4	24.9	28.4	24.6	21.3	20.7
Of which: in domestic currency (percent of GDP)	8.1	11.1	9.2	11.4	11.0	9.1	9.7
90-day prime lending rate, domestic currency (end of period)	5.2	5.6	7.5	1.7	3.6	…	…
90-day prime lending rate, foreign currency (end of period)	6.1	6.4	5.2	1.1	2.1	…	…
Velocity of money 1/	4.1	3.7	3.3	3.2	2.9	2.9	2.7
Net credit to the private sector/GDP 2/	28.7	33.1	34.2	36.5	38.5	40.5	42.4
External indicators							
Exports, U.S. dollars (percent change)	37.2	17.9	10.4	-13.1	31.9	19.6	7.0
Imports, U.S. dollars (percent change)	22.9	32.0	45.2	-26.1	37.1	21.2	8.1
Terms of trade (percent change) (deterioration -)	26.6	3.6	-14.5	-3.1	18.2	5.8	0.0
Real effective exchange rate, (end of period, percent change) 3/	-1.8	-1.8	4.4	3.4	2.3	…	…
Current account balance (percent of GDP)	3.1	1.4	-4.2	0.2	-1.5	-2.5	-2.6
Capital and financial account balance (percent of GDP)	0.4	7.8	6.8	1.2	8.5	5.2	3.7
Total external debt (percent of GDP)	31.4	31.3	28.4	29.3	27.4	26.1	25.4
Medium- and long-term public debt (in percent of GDP) 4/	23.9	19.4	16.0	17.4	14.0	12.6	11.3
Medium- and long-term private debt (in percent of GDP)	3.9	6.1	7.3	8.2	9.3	9.2	9.4
Short-term public and private debt (in percent of GDP)	3.6	5.8	5.0	3.8	4.2	4.4	4.6
Total external debt (in percent of exports of goods and services) 4/	109.4	107.5	103.7	121.5	106.7	94.8	91.6
Total debt service (in percent of exports of goods and services) 5/	13.6	29.9	16.4	15.0	20.9	9.2	9.0
Gross official reserves							
In millions of U.S. dollars	17,329	27,720	31,233	33,175	44,150	48,243	50,243
In percent of short-term external debt 6/	339.6	206.2	317.9	435.4	342.5	496.8	465.1
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	90.5	94.7	82.7	115.5	108.0	118.3	115.8
In percent of broad money 8/	77.1	96.4	81.3	83.9	84.6	81.5	76.0
In percent of foreign currency deposits at banks	151.4	209.7	173.8	190.3	217.3	226.6	230.5
In months of next year's imports of goods and services	8.7	9.7	14.5	11.4	12.8	12.9	12.5
Net international reserves (in millions of U.S. dollars)	17,275	27,689	31,196	33,135	44,105	48,852	50,852
Net foreign exchange position (in millions of U.S. dollars) 9/	11,664	22,077	25,585	27,524	38,494	43,240	45,240

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

Table 10. Peru: Medium-Term Macroeconomic Framework

			Projections					
	2009	2010	2011	2012	2013	2014	2015	2016
(Annual percentage change)								
Production								
GDP at constant prices	0.9	8.8	6.7	5.2	6.0	6.0	6.0	6.0
Consumer prices (end of period)	0.2	2.1	3.9	2.5	2.0	2.0	2.0	2.0
GDP deflator	2.0	2.1	2.2	2.2	2.3	2.3	2.3	2.4
Trade								
Merchandise trade								
Exports, f.o.b.	-13.1	31.9	19.6	7.0	8.4	10.6	10.8	9.8
Imports, f.o.b.	-26.1	37.1	21.2	8.1	7.7	6.8	6.4	6.6
Terms of trade (deterioration -)	-3.1	18.2	5.8	0.0	-1.3	-1.5	-1.6	-1.2
(In percent of GDP; unless otherwise indicated)								
External current account balance	0.2	-1.5	-2.5	-2.6	-2.8	-2.6	-2.5	-2.2
External current account, excluding interest obligations	1.5	-0.4	-1.4	-1.5	-1.7	-1.6	-1.5	-1.3
Total external debt service	3.6	5.4	2.5	2.5	2.4	2.3	2.1	2.1
Medium- and long-term	3.5	5.3	2.4	2.4	2.3	2.2	2.0	1.9
Nonfinancial public sector	2.3	4.1	1.3	1.3	1.3	1.3	1.1	1.1
Private sector	1.2	1.1	1.2	1.1	1.0	0.9	0.9	0.8
Short-term 1/	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
External debt service 2/	3.6	5.4	2.5	2.5	2.4	2.3	2.1	2.1
Interest	1.4	1.1	1.2	1.1	1.1	1.0	0.9	0.9
Amortization (medium-and long-term)	2.2	4.2	1.4	1.4	1.3	1.3	1.2	1.2
Public sector								
Combined public sector primary balance 3/	-0.3	0.6	3.4	2.2	2.3	2.4	2.3	2.3
General government revenue	18.9	20.0	20.9	20.7	20.9	21.0	21.0	21.0
General govt. non-interest expenditure 3/	19.4	19.3	17.6	18.4	18.5	18.6	18.7	18.7
Combined public sector interest due	1.3	1.2	1.2	1.2	1.1	1.1	1.0	1.0
Combined public sector overall balance 3/	-1.9	-0.7	2.2	1.1	1.2	1.3	1.3	1.3
Public sector debt 3/	28.4	24.6	21.3	20.7	19.6	18.7	18.0	17.3
Savings and investment								
Gross domestic investment	20.7	25.0	24.6	24.6	24.7	24.6	24.7	24.6
Public sector 3/	5.2	5.9	5.1	6.1	5.8	5.8	5.8	5.8
Private sector	15.5	19.1	19.5	18.5	18.9	18.8	18.9	18.8
Private sector (excluding inventories)	17.7	19.2	18.7	18.2	18.6	19.3	19.2	19.2
Inventories changes	-2.1	-0.1	0.8	0.3	0.3	-0.5	-0.4	-0.4
National savings	20.9	23.5	22.1	22.0	22.0	22.0	22.2	22.5
Public sector 4/	4.2	5.7	7.3	7.2	7.0	7.1	7.1	7.2
Private sector	16.6	17.8	14.8	14.8	14.9	14.9	15.1	15.3
External savings	-0.2	1.5	2.5	2.6	2.8	2.6	2.4	2.1
Memorandum items:								
Nominal GDP (billions of Nuevos Soles)	382.3	434.6	485.3	524.1	566.9	611.7	660.4	713.3
Gross international reserves (billions of U.S. dollars)	33,175	44,150	48,243	50,243	52,243	54,243	56,243	58,243
Gross international reserves to broad money	83.9	84.6	81.5	76.0	69.4	63.0	57.3	52.0
External debt service (percent of exports of GNFS)	15.0	20.9	9.2	9.0	8.6	8.1	7.3	6.9
Short-term external debt service (percent of exports of GNFS)	0.5	0.3	0.3	0.3	0.3	0.3	0.4	0.3
Public external debt service (percent of exports of GNFS)	9.7	16.1	4.6	4.8	4.7	4.5	4.0	3.8

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.

ANNEX I. PERU: 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. Public sector gross debt has been declining as a share of GDP from 47.1 percent in 2003 to 24.6 percent in 2010. Currency risks have also declined significantly in recent years, with the foreign currency share in total public debt declining from 80 percent in 2000 to 57 percent in 2010. High real GDP growth and overall fiscal surpluses averaging 1.7 percent of GDP (2000–10) have contributed to debt consolidation. In the medium term, real GDP growth will average 6 percent a year in 2011–16 underpinned by domestic demand dynamics and external demand supported by high commodity prices. In this context, overall fiscal surpluses are projected to average 1.4 percent of GDP. Under the baseline scenario, Peru's public sector debt stock (including CRPAOs) would decline further from 21.3 percent of GDP at end-2011, to 17.3 percent of GDP by 2016.

External debt is projected to decline further to about 20 percent of GDP. Following a decade of a continuously improving external position, Peru's external debt has been on a downward trajectory, declining by half to 27.4 percent of GDP in 2010 from 52.7 percent of GDP in 2000. The baseline scenario projects total external debt to decline further by about 5 percentage points of GDP from 26.1 percent at end-2011 to 20.8 percent by 2016 (of which public external debt would decline from 11.7 percent of GDP to 7 percent of GDP over the same period).

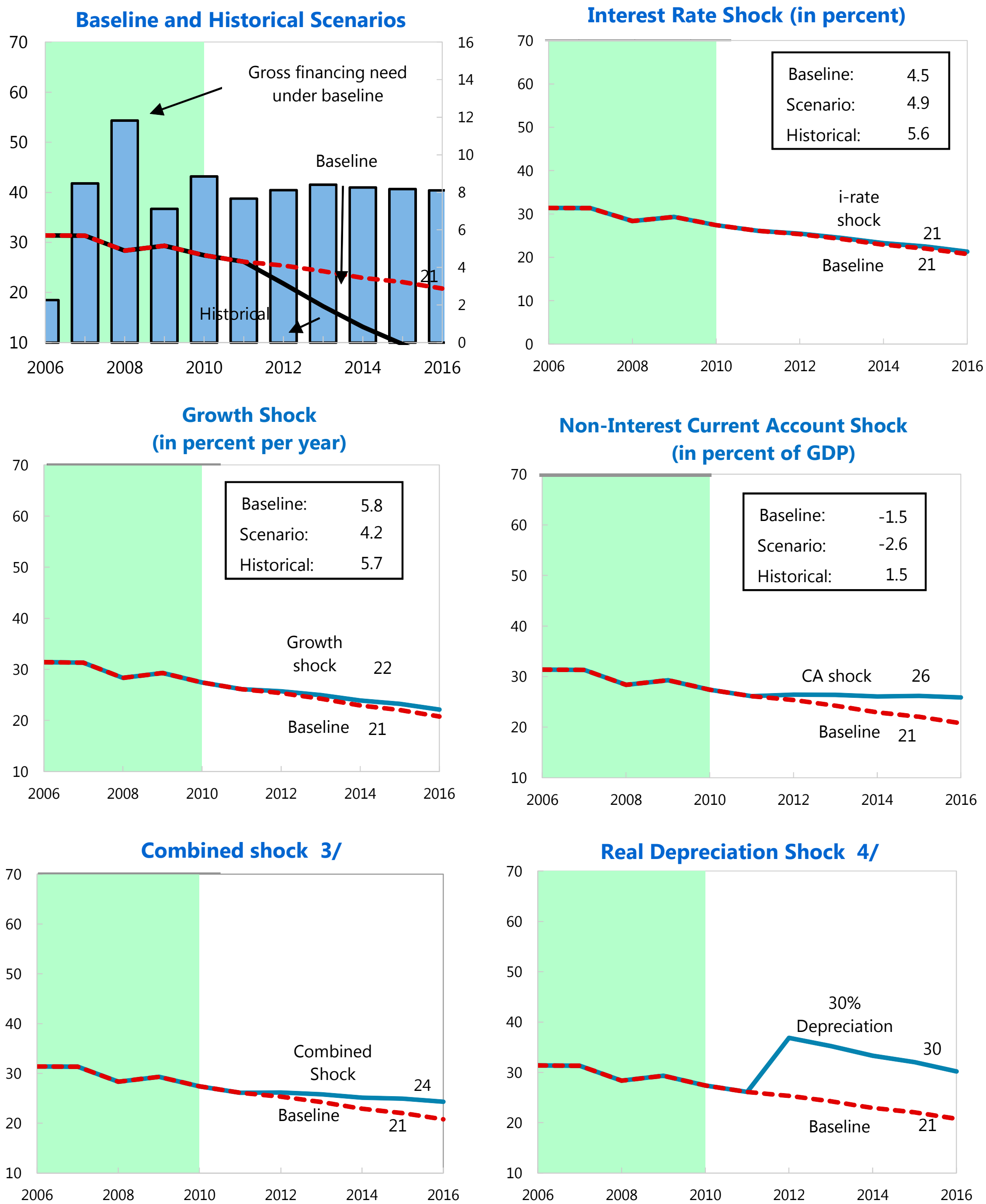
Peru's external and public sector debt ratios are robust to alternative assumptions about underlying macroeconomic variables. Sensitivity tests based on 10-year historical standard deviations for GDP growth, interest rates and noninterest current account shocks (such as in the terms of trade) show that they would have a moderate adverse impact on external and public indebtedness.

However, external and public debt ratios remain sensitive to large and permanent exchange rate shocks despite the increasing share of public sector debt in domestic currency. Under a one-off 30 percent real depreciation of the exchange rate, the external and public debt ratios would increase by about 9 and 5 percentage points, respectively above the baseline projections over the medium term. CGER estimates, however, indicate that the *Nuevo Sol* is not misaligned.

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 2016, the debt ratio would remain 9.2 percentage points above the baseline scenario.

Figure A1. Peru: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and Fund 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.

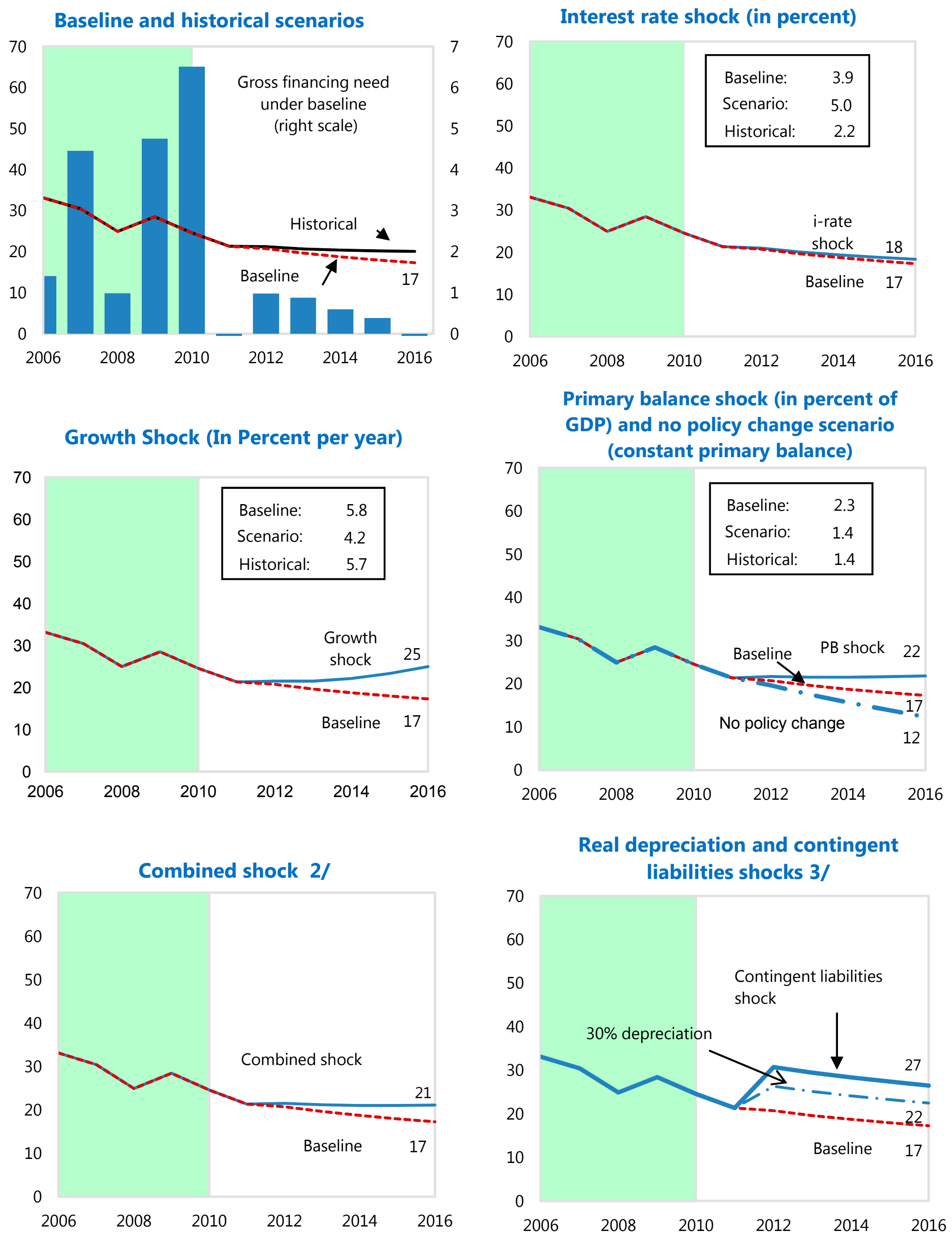
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2012.

Figure A2. Peru: Public Debt Sustainability: Bound Tests 1/

(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and Fund 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 A1. Peru: External Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	**31.4**	**31.3**	**28.4**	**29.3**	**27.4**	**26.1**	**25.4**	**24.2**	**22.9**	**22.0**	**20.8**	**-4.4**
Change in external debt	-4.7	-0.1	-3.0	1.0	-1.9	-1.3	-0.8	-1.1	-1.3	-0.9	-1.3	
Identified external debt-creating flows (4+8+9)	-10.3	-11.3	-6.1	-1.4	-9.8	-2.6	-2.0	-2.0	-2.3	-2.6	-2.7	
Current account deficit, excluding interest payments	-5.1	-3.4	2.4	-1.5	0.4	1.4	1.5	1.7	1.6	1.5	1.3	
Deficit in balance of goods and services	-8.9	-6.8	-0.4	-3.8	-3.1	-3.0	-2.7	-2.9	-3.8	-4.8	-5.7	
Exports	28.7	29.1	27.3	24.1	25.7	27.6	27.7	27.8	28.3	29.1	29.5	
Imports	19.8	22.3	26.9	20.3	22.6	24.5	25.0	24.9	24.5	24.3	23.9	
Net non-debt creating capital inflows (negative)	-2.1	-5.6	-5.4	-1.2	-6.2	-3.4	-3.4	-3.3	-3.6	-3.8	-3.7	
Net foreign direct investment, equity	3.8	5.1	4.9	4.1	4.6	4.3	4.5	4.6	4.6	4.7	4.7	
Net portfolio investment,equity	-1.6	0.5	0.5	-2.9	1.6	-0.9	-1.1	-1.2	-1.1	-1.0	-1.1	
Automatic debt dynamics 1/	-3.0	-2.4	-3.1	1.3	-4.0	-0.5	-0.1	-0.4	-0.3	-0.3	-0.3	
Denominator: 1+g+r+gr	1.2	1.2	1.2	1.0	1.2	1.1	1.1	1.1	1.1	1.1	1.1	
Contribution from nominal interest rate	2.0	2.0	1.8	1.4	1.1	1.2	1.1	1.1	1.0	0.9	0.9	
Contribution from real GDP growth	-2.4	-2.4	-2.6	-0.2	-2.1	-1.7	-1.3	-1.4	-1.3	-1.3	-1.2	
Contribution from price and exchange rate changes 2/	-2.7	-2.0	-2.2	0.2	-3.0	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	5.6	11.2	3.1	2.3	7.9	1.3	1.3	0.8	0.9	1.7	1.5	
External debt-to-exports ratio (in percent)	109.4	107.5	103.7	121.5	106.7	94.8	91.6	87.3	81.0	75.9	70.4	
Gross external financing need (in billions of US dollars) 4/	2.1	9.1	15.0	9.0	13.6	13.0	14.6	16.3	17.4	18.5	19.8	
in percent of GDP	2.3	8.5	11.8	7.1	8.8	7.7	8.1	8.4	8.3	8.2	8.1	
Scenario with key variables at their historical averages 5/						**26.1**	**21.7**	**17.3**	**13.1**	**9.7**	**6.2**	**-3.4**
Key Macroeconomic Assumptions Underlying Baseline												
Nominal GDP (US dollars)	92.3	107.2	126.8	126.9	153.8	169.3	180.1	194.2	210.2	226.3	244.2	
Real GDP growth (in percent)	7.7	8.9	9.8	0.9	8.8	6.7	5.2	6.0	6.0	6.0	6.0	
Exchange rate appreciation (US dollar value of local currency,	0.7	4.7	6.9	-2.9	6.6	-0.9	-1.3	-0.3	0.3	0.0	0.0	
GDP deflator (change in domestic currency)	7.2	1.9	0.7	2.2	4.5	4.2	2.5	2.0	1.8	1.6	1.8	
GDP deflator in US dollars (change in percent)	7.9	6.7	7.7	-0.8	11.4	3.2	1.2	1.7	2.1	1.6	1.8	
Nominal external interest rate (in percent)	6.5	7.4	6.7	4.8	4.7	4.7	4.6	4.5	4.4	4.4	4.3	
Growth of exports (US dollar terms, in percent)	34.8	18.0	11.0	-11.7	29.1	18.0	6.8	8.2	10.4	10.5	9.6	
Growth of imports (US dollar terms, in percent)	20.0	31.2	42.7	-24.5	34.9	19.3	8.2	7.5	6.8	6.4	6.0	
Current account balance, excluding interest payments	5.1	3.4	-2.4	1.5	-0.4	-1.4	-1.5	-1.7	-1.6	-1.5	-1.3	
Net non-debt creating capital inflows	2.1	5.6	5.4	1.2	6.2	3.4	3.4	3.3	3.6	3.8	3.7	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. 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 [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 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 A2. Country: Public Sector Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	**33.1**	**30.4**	**24.9**	**28.4**	**24.6**	**21.3**	**20.7**	**19.6**	**18.7**	**18.0**	**17.3**	**-0.3**
o/w foreign-currency denominated	25.2	19.3	15.8	17.0	13.6	12.2	11.1	10.0	9.0	8.1	7.8	
Change in public sector debt	-4.6	-2.7	-5.5	3.5	-3.9	-3.2	-0.6	-1.1	-0.9	-0.8	-0.7	
Identified debt-creating flows (4+7+12)	-9.1	-7.5	-4.3	0.1	-3.1	-4.8	-2.7	-2.7	-2.8	-2.7	-2.7	
Primary deficit	-4.1	-4.4	-3.6	0.6	-0.5	-3.4	-2.2	-2.3	-2.4	-2.3	-2.3	
Revenue and grants	25.5	25.8	26.6	24.0	25.0	26.3	25.9	25.7	25.8	25.7	25.7	
Primary (noninterest) expenditure	21.4	21.5	23.1	24.6	24.5	22.9	23.7	23.4	23.3	23.4	23.4	
Automatic debt dynamics 2/	-4.9	-3.1	-0.7	-0.5	-2.6	-1.4	-0.4	-0.4	-0.3	-0.4	-0.4	
Contribution from interest rate/growth differential 3/	-3.2	-1.4	-1.5	0.7	-2.3	-1.4	-0.4	-0.4	-0.3	-0.4	-0.4	
Of which contribution from real interest rate	-0.7	1.2	1.2	0.9	-0.1	0.1	0.6	0.7	0.7	0.7	0.6	
Of which contribution from real GDP growth	-2.5	-2.6	-2.7	-0.2	-2.2	-1.5	-1.0	-1.2	-1.1	-1.0	-1.0	
Contribution from exchange rate depreciation 4/	-1.7	-1.7	0.8	-1.2	-0.3	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	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/	4.4	4.8	-1.2	3.4	-0.8	1.5	2.1	1.6	1.9	1.9	2.0	
Public sector debt-to-revenue ratio 1/	129.7	117.9	93.6	118.8	98.3	81.1	80.0	76.3	72.6	69.9	67.3	
Gross financing need 6/	1.4	4.5	1.0	4.8	6.5	-0.2	1.0	0.9	0.6	0.4	-0.1	
in billions of U.S. dollars	1.3	4.8	1.3	6.0	10.0	-0.4	1.8	1.7	1.3	0.9	-0.3	
Scenario with key variables at their historical averages 7/						**21.3**	**21.2**	**20.6**	**20.4**	**20.2**	**20.0**	**-0.7**
Scenario with no policy change (constant primary balance) in 2011-2016						**21.3**	**19.6**	**17.5**	**15.7**	**14.0**	**12.3**	**-0.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	7.7	8.9	9.9	0.9	8.8	6.7	5.2	6.0	6.0	6.0	6.0	
Average nominal interest rate on public debt (in percent) 8/	5.7	6.0	5.7	5.4	4.7	5.3	6.0	5.9	6.0	5.8	5.8	
Average real interest rate (nominal rate minus change in GDP deflator, ir	-1.5	4.3	4.4	3.7	0.2	0.6	3.3	4.0	4.2	4.0	4.0	
Nominal appreciation (increase in US dollar value of local currency, in pe	6.8	7.5	-4.3	8.2	2.2	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	7.2	1.8	1.4	1.7	4.5	4.7	2.7	1.9	1.8	1.8	1.8	
Growth of real primary spending (deflated by GDP deflator, in percent)	0.2	9.2	18.1	7.4	8.3	0.0	8.5	4.8	5.8	6.0	6.0	
Primary deficit	-4.1	-4.4	-3.6	0.6	-0.5	-3.4	-2.2	-2.3	-2.4	-2.3	-2.3	

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 - p(1+g) - g + ae(1+r)]/(1+g+p+gp) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = 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 - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(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

PERU

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

November 18, 2011

Prepared By

The Western Hemisphere Department
(In consultation with other departments)

CONTENTS

ANNEX I. FUND RELATIONS

(As of September 30, 2011)

I. Membership Status

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

II. General Resources Account

	SDR Million	% Quota
Quota	638.40	100.00
Fund holdings of currency	453.83	71.09
Reserve Tranche Position	184.60	28.92

III. SDR Department

	SDR Million	% Allocation
Net cumulative allocation	609.89	100.00
Holdings	524.31	85.97

IV. Outstanding Purchases and Loans

None

V. Financial Arrangements

Type	Date of Arrangement	Expiration Date	Approved (SDR Million)	Drawn (SDR Million)
Stand-by	Jan 26, 2007	Feb 28, 2009	172.37	0.0
Stand-by	Jun 09, 2004	Aug 16, 2006	287.28	0.0
Stand-by	Feb 01, 2002	Feb 29, 2004	255.00	0.0

VI. Projected Obligations to the Fund

(SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2011	2012	2013	2014	2015
Principal	-	-	-	-	-
Charges/Interest	0.07	0.24	0.24	0.24	0.24
Total	**0.07**	**0.24**	**0.24**	**0.24**	**0.24**

VII. Exchange Arrangements

Peru maintains a unified, floating exchange rate. On September 30, 2011, the average of interbank buying and selling rates was 2.77 *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 external payments arrears to unguaranteed suppliers, some of whom are in discussions with the government, while the rest have not been located. Peru has maintained a clearing arrangement with Malaysia since 1991.

VIII. Last Article IV Consultation

The 2010 Article IV consultation was concluded on March 29, 2010 (IMF Country Report No. 10/98).

IX. FSAP and ROSCs

Several joint Fund-Bank missions visited Lima in the period September 2000–January 2001 to conduct an FSAP for Peru. The corresponding Financial System Stability Assessment (FSSA) report was discussed by the Executive Board on March 12, 2001. A follow-up FSAP mission was concluded in February 2005. More recently, the Executive Board, on April 20, 2011, took note of the staff's analysis and recommendations in the report on Peru's FSAP-Update. In October 2002, an FAD mission conducted a Fiscal ROSC for Peru (IMF Country Report No. 04/109, 4/16/04), while an STA mission conducted a Data ROSC for Peru in February 2003 (IMF Country Report No. 03/332, 10/24/03).

X. Technical Assistance

Technical assistance provided in 2000 through September 2011 is summarized in Annex V.

XI. Resident Representative

Mr. Kevin Ross has been Resident Representative in Peru since July 2011.

ANNEX II. WORLD BANK RELATIONS

(As of September 30, 2011)

A. 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 thirteen investment loans, four 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 approved ten new operations in FY 11, the last year of the current CPS, for a total commitment of US$524 million. These comprised the Third Environmental DPL (US$75 million), Fourth Fiscal Management and Competitiveness DPL (US$100 million), Third Results and Accountability in Social Sectors DPL (US$50 million), first CAT DDO (US$100 million), Irrigation in Sierra (US$20 million), Second Justice Improvement (US$20 million), Rural Water and Sanitation Program Additional Financing (US$30 million), Results in Nutrition (US$25 million), Lima Optimization of Water Systems (US$54.5 million), and Second Rural Electrification Project (US$50 million).

The next CPS for the period FY2012−16 is expected to be presented to the Board in March 2012. The team has started the consultation process with the civil society—including NGOs and religious institutions—, the private sector and the academia at the central and regional level. The formal consultation with the new government administration is expected to be held in November–December 2011.

In addition, the Bank has an extensive program of analytical and advisory activities for FY 12–14, 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.

Finally, the Bank's TF portfolio (currently over US$27 million) has been also expanding significantly. The majority of TFs complements other WB support in the current core engagement areas of this CPS by providing valuable AAA and technical assistance. They support the harmonization and alignment of funding from various development partners behind core government programs.

B. 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. Joint FSAP updates were completed in June 2005 and April 2011.

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.

Peru: IBRD Portfolio Status

As of September 5, 2011

(In millions of US$)

Project	Approval	Lending Instrument	Net Commitment Amount	Undisbribbuted Balance at FY	Total Undisbribbuted Balance	Total Disbursement	Disbursement in FY
Investment							
National Rural Water Supply	8/29/2002	SIL	80.0	42.1	40.5	39.5	1.6
Regional Transport Decentralization	7/12/2005	SIL	50.0	31.9	29.5	20.5	2.4
Real Property Rights II	3/14/2006	SIL	25.0	8.0	7.4	17.6	0.6
Sierra Rural Development Project	4/24/2007	SIL	20.0	9.7	8.5	11.5	1.2
Rural Electrification	3/7/2006	SIL	50.0	5.2	3.7	46.3	1.5
(APL2) Health Reform Program	2/17/2009	APL	15.0	13.8	13.8	1.2	0.0
Decentralized Rural Transport Project	12/19/2006	SIL	50.0	12.2	10.2	39.8	2.0
Sierra Irrigation	7/27/2010	SIL	20.0	19.0	19.0	1.0	0.0
Water Resources Mgmt.	7/2/2009	SIL	10.0	9.5	9.5	0.5	0.0
Justice Services Improv. II	11/18/2010	TAL	20.0	20.0	19.5	0.5	0.5
Optimization of Lima Wat & Sewerage	4/7/2011	SIL	54.5	54.5	54.5	0.0	0.0
Results Nutrition for Juntos SWAp	3/8/2011	SIL	25.0	25.0	25.0	0.0	0.0
Second Rural Electrification	4/21/2011	SIL	50.0	50.0	50.0	0.0	0.0
			469.5	300.9	291.1	178.4	9.8
Adjustment							
2nd Results & Accnt.(REACT)DPL/DDO	4/9/2009	DPL	330.0	310.0	310.0	20.0	0.0
First Prog. Environ DPL/DDO	2/17/2009	DPL	330.0	310.0	310.0	20.0	0.0
2nd Prg Fiscal Mgmt & Comp. DPL/DDO	8/5/2008	DPL	700.0	480.0	480.0	220.0	0.0
CAT DDO	12/9/2010	DPL	100.0	100.0	100.0	0.0	0.0
			1,460.0	1,200.0	1,200.0	260.0	0.0
Total			1,929.5	1,500.9	1,491.1	438.4	9.8

Notes: APL: Adaptable Program Loan; DPL: Development Policy Loan; SIL: Specific Investment Loan; and TAL: Technical Assistance Loan.

Peru: Committed and Disbursed Outstanding Investment Portfolio

As of August 31, 2011

(In millions of US$)

		Committed					Disbursed Outstanding				
FY Approval	Company	Loan	Equity	**Quasi Equity	*GT/RM	Participant	Loan	Equity	**Quasi Equity	*GT/RM	Participant
1993/96	Aaqsa	-	46.8	-	-	-	-	46.7	-	-	-
2006	Agrokasa	5.5	-	-	-	-	5.5	-	-	-	-
2008/11	Amerika fin.	10.0	-	-	-	-	10.0	-	-	-	-
2007/08	B.continental	69.3	-	-	-	69.0	69.3	-	-	-	69.0
2007/11	Bif	15.0	-	18.0	-	-	15.0	-	18.0	-	-
201	Bpz	-	36.9	9.9	-	-	-	36.9	9.9	-	-
2010	Calidda	40.0	-	10.0	-	-	31.3	-	7.8	-	-
2009	Cartones america	-	-	-	0.7	-	-	-	-	0.5	-
2011	Cheves	70.0	-	-	-	180.0	-	-	-	-	-
2010	Enfoca	-	15.0	-	-	-	-	4.0	-	-	-
2011	Grupo salud	25.0	-	-	-	-	-	-	-	-	-
2002/03	Isa peru, sa	9.4	-	-	0.2	-	9.4	-	-	0.1	-
2004	Laredo	13.2	-	-	1.5	-	13.2	-	-	1.2	-
2007	Lima jciairport	-	20.0	-	-	-	-	13.4	-	-	-
2008	Maple energy	-	1.6	-	-	-	-	1.6	-	-	-
2007	Mibancoperu	-	7.0	7.0	-	-	-	6.3	7.0	-	-
2005	Miraflores	3.8	-	-	-	-	3.8	-	-	-	-
2003	Norvial s.a.	12.5	-	-	-	-	12.5	-	-	-	-
2009	Nuestra gente	9.2	12.4	-	-	-	9.2	12.4	-	-	-
2008	Peru lng	293.4	-	-	-	-	293.4	-	-	-	-
2001	Peru oeh	13.2	-	-	-	-	12.3	-	-	-	-
2011	Protecta	-	2.0	-	-	-	-	2.0	-	-	-
2008	Sav	5.3	-	5.0	-	-	5.3	-	5.0	-	-
1993	Yanacocha	-	0.3	-	-	-	-	0.3	-	-	-
Total Portfolio:		594.7	142.0	49.9	2.4	249.0	490.0	123.6	47.8	1.9	69.0

* Denotes guarantee and risk management products.

** Quasi equity includes both loan and equity types.

ANNEX III. RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

A. Country Strategy

Peru's current Country Strategy (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.

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.

The IDB and Peru are in the final phase of drafting a new country strategy covering the period from 2012–2016. Under the new country strategy, the IDB projects to be flexible adapting the financial envelope to the financial needs of the country. The new 2012–2016 Bank's country strategy with Peru, will probably agree on making sustainable growth and poverty-inequality reduction as main objectives of their strategic engagement. In the pursuit of these objectives, the Bank will align its actions with those in Peru's National Plans and the policy road map depicting the actions of the incoming administration.

B. Lending

As of September 9, 2011, the Bank's portfolio of active, public sector operations consisted of 28 loans for a total amount of US$681, 76 million, of which US$443.78 million (65 percent) had been disbursed. The public sector lending program for 2011 comprises five policy-based loans for US$125 million and five investment loans for US$196 million, and one contingent loan for natural disaster emergencies for US$100 million, seven of them pending approval.

Regarding private sector operations, the Structured Corporate Finance Department's (SCF) portfolio in execution consists of seven operations amounting to US$249 million and a guarantee mechanism for Continental Bank for US$100 million, the IIC 2011 portfolio has approved US$25.6 million primarily in manufacture and financial services, and the Opportunities for the Majority (OMJ) department portfolio consists of four operations amounting US$20 million, focused on housing improvement and microenterprise financing. In addition, OMJ has two regional operations for US$5 million, which also benefit to Peru, both in the agriculture sector.

As of September 2011, disbursement projections for SCF & OMJ total US$79 million.

As of September, private sector lending for 2011 includes three SCF projects for US$174 million, in infrastructure and financial markets, two OMJ operations for US$13 million, in education and mobile banking. MIF has five projects in pipeline for US$8.7 million and the IIC has five operations for US$31 million, focused on livestock and poultry, textiles, leather clothing, utilities and infrastructure.

Peru: IDB SG Loan Portfolio by Sector (Sovereign Guarantee)

As of September 9, 2011

(In millions of U.S. dollars)

Sector	Commitments	Disbursements	% Disbursed
Agriculture	50.0	36.2	72.5
Environmental	63.4	13.4	21.1
Science and Technology	25.0	21.7	86.6
Urban Development	60.0	55.9	93.1
Social Investment	26.2	8.7	33.0
Modernization of the State	90.6	39.3	43.3
Water and Sanitation	112.6	101.3	89.9
Transportation	249.0	166.9	67.0
Capital Markets and Financial Institutions Division	5.0	0.6	11.8
Total	681.8	443.8	65.1

ANNEX IV. 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.

A. 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. Four national accounts statistics missions visited the country in November 2008, May 2009, September 2009, and September 2010. 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. At the present time, the official measure of inflation for Peru is the CPI for Metropolitan Lima, compiled and published by INEI. However, a new law issued in 2009 requires the INEI to compile a new national level CPI that will serve as the official CPI for Peru in the future. Starting in January 2010, the Metropolitan Lima CPI has been compiled using updated weights based on the 2008/09 Encuesta Nacional de Presupuestos Familiares (ENAPREF). Since January 2011, city level indices have been compiled and disseminated for the 24 departmental capitals and another large urban area using weights from the 2008/09 ENAPREF and a methodology matching that employed for the Metropolitan Lima CPI. However, a corresponding national level CPI has not been disseminated. It is planned that the new national level CPI, which will become the official measure of inflation for Peru, will be disseminated in February 2012 starting with the January 2012 index. An STA mission on the CPI was conducted in May 2–

13, 2011 to evaluate the methodology of the new national CPI index.
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.

B. Fiscal Sector

The Central Bank compiles government finance statistics (GFS) following the GFSM2011, for the general government and its subsectors. Data for all subsectors are reported on a cash basis and financial assets and liabilities are reported at face value. The authorities have not yet sent to the Fund information on the components of expenditures by function. The coverage of published national budget data is narrower than the fiscal statistics prepared for the combined public sector. 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. The authorities report data for publication in the Government Finance Statistics Yearbook (GFSY) using the GFSM 2001. No high frequency data is reported for publication in International Financial Statistics (IFS).

C. 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 has not yet started reporting monetary data using the SRFs. No set date is foreseen for the migration to the SRFs.

In June 2011, the country started reporting data and metadata for financial soundness indicators (FSIs) with a quarterly frequency. Latest data received correspond to the second quarter of 2011.

D. 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 September 30, 2011

	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	August 2011	9/9/11	D	M	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	August 2011	9/28/11	D	M	W		
Reserve/Base Money	July 2011	9/9/11	W	M	W	O, LO, LO, LO	O, O, O, O, O
Broad Money	July 2011	9/9/11	W	M	W		
Central Bank Balance Sheet	July 2011	9/9/11	W	M	W		
Consolidated Balance Sheet of the Banking System	July 2011	9/9/11	W	M	W		
Interest Rates[2]	July 2011	9/9/11	D	M	D		
Consumer Price Index	August 2011	9/29/11	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 2010	7/12/11					
External Current Account Balance	Q4 2010	7/12/11	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	Q4 2010	7/12/11	M	M	M		
GDP/GNP	Q2 2011	9/7/11	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.

ANNEX V. TECHNICAL ASSISTANCE

Department	Purpose	Date
FAD	Fiscal regimes for copper mining: an international comparison	September 2011
	Fiscal consideration in establishing a sovereign wealth fund	March 2011
	Modernizing treasury management and improving public accounting	November-December 2010
	Public financial management	June 2005, March 2006, November 2006, May 2007–present
	Tax policy and administration, customs administration.	February and June 2009, April, June and October 2008, February, June and August 2007, February, September, and November 2006, and May 2005
	Public investment and fiscal policy, including issues related to PPPs.	August 2004, September 2003, and September 2002
	Fiscal rules	November 1999
MCM	Mortgage covered bonds	May and August 2009
	Supervision of capital markets.	September 2008
	Implementation of Basel II	March 2008
	Strengthening the capital markets	October 2007, July 2007, and April 2007
	Financial sector supervision	April 2006
	Consumer protection in the banking system	April 2005
	Central bank organization	March, 2005
	Inflation targeting	April, December 2002, February 2003, March and September 2004
	Foreign exchange operations	October 2002
	Accounting and organizational issues	August 2002
	Inflation targeting	May 2002
	Monetary operations and government securities market	March 2002
LEG	AML/CFT national strategies and coordination	January 2011–Present
	ML/FT risk assessment	August 2009–July 2011
	Strengthening the AML/CFT financial supervisory framework	June 2008–July 2010
STA	National account statistics, new base year for the national account series; and Government Finance Statistics 2001.	September 2010, May and September 2009, March, September and November 2008, October 1999, and January 1998

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 11/158
FOR IMMEDIATE RELEASE
December, 14, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with Peru

On December, 05, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Peru, and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis.[1] [2]

Background

The Peruvian economy emerged largely unscathed from the 2008–09 global crisis supported by strong fundamentals and proactive macroeconomic response. Real Gross Domestic Product (GDP) expanded rapidly at 8.75 percent in 2010, one of the highest in the region, driven by private domestic demand. The recovery was propped by significant macroeconomic policy stimuli, a quick turnaround of terms of trade and favorable external financial conditions, with renewed capital inflows. Inflation, after falling to 0.25 percent in 2009, rebounded to 2 percent by end-2010 as demand picked up, the center of the target band of 1–3 percent. A new government, led by President Ollanta Humala, took office in July 2011, promising more social inclusion and continued macroeconomic stability.

Activity is expected to decelerate on the heels of tighter policies and a weaker external demand. Real GDP growth is expected to reach 6.75 percent in 2011, driven mainly by private

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

consumption. Inflation is projected at 3.75 percent at end-2011, due mostly to supply shocks but also some demand pressures. Credit growth has stayed at about 20 percent in 2010–11.The financial sector remains sound, profitable and well-capitalized, assisted by the authorities' active use of prudential instruments.

The outlook is for continued albeit lower growth with short-term risks titled markedly to the downside given global uncertainty. Real GDP growth is projected at 5.25 percent in 2012, slightly below trend (estimated at 6 percent), mostly due to softer external demand conditions, while inflation would decline to 2.5 percent. Inflation expectations for 2012 remain well-anchored on account of the strong inflation targeting framework. The external current account deficit would remain stable at around 2.5 percent of GDP next year as the strong terms of trade continue. Once international turbulence subsides, strong growth prospects in Peru and abundant international liquidity could increase capital inflows.

On the policy front, macroeconomic policies have focused on limiting overheating risks. The government began unwinding the previous fiscal stimulus in 2011. The fiscal position switched to an annualized fiscal surplus of about 5.5 percent of GDP in the first half of 2011 as revenues remained buoyant despite tax cuts, and expenditures were restrained due to low implementation of investment projects at the sub-national level and the presidential elections. Monetary policy has been tightened as demand recovered, with the policy rate increasing a total of 300 basis points to 4.25 percent between mid-2010 and May 2011. This was complemented with active hikes in reserve requirements. Since then, the central bank has remained on hold in light of the uncertain global economic outlook.

Executive Board Assessment

In concluding the 2011 Article IV consultation with Peru, Executive Directors endorsed staff's appraisal, as follows:

The policy mix seems broadly adequate to maintain macro stability and foster growth. The main challenge is to ensure a timely and flexible implementation of policies to confront changing domestic economic conditions in an external environment of heightened uncertainty.

The 2012 budget proposal seems appropriate. Efforts to reinvigorate public spending in the second half of 2011 are welcome as the fiscal stance was becoming somewhat tight. Still, there will be a higher-than-expected surplus for 2011. The proposed 2012 budget, which aims at a surplus of 1 percent of GDP and entails a structural expansion of 0.75 percent of GDP, is broadly adequate as activity is expected to be softer. Additional short-term social spending can be accommodated within the expenditure limits established by the 2012 budget.

Given the uncertain external environment, monetary policy can remain on hold. In view of the expected fall in inflationary pressures (as the impact of higher oil and food prices is absorbed) and the previous tightening in monetary policy, staff supports the central bank decision to keep policy rates unchanged, at least until a clearer picture on the global outlook emerges. The authorities should continue monitoring private credit developments and ensuring risks remain contained.

Against a background of heightened risks to the global outlook, policies should remain flexible. Peru's solid fundamentals and scope for policy response are likely to mitigate the effects of a weak world economy. As a first line of defense, and consistent with the functioning of an inflation targeting regime, monetary policy could be eased as inflation prospects decline and the output gap widens, while fiscal policy activates automatic stabilizers. Against the background of potential global financial volatility, some foreign exchange support would be warranted. Reserve requirements may be loosen if liquidity conditions become stressed or if domestic credit decelerates too rapidly.

Should tail risks in global conditions materialize, additional policy stimulus could be deployed to limit the fallout. The buildup of buffers in the last few years suggests there is space to implement a sizable policy response. Yet, the uncertainty about the nature and duration of the external shock makes advisable a gradual use of these buffers. The central bank has the capacity to inject considerable liquidity and cut rates more aggressively if external financial conditions deteriorate (although potential pressures in the foreign exchange market could become a constraint). As with the fiscal stimulus implemented in 2009, infrastructure and maintenance projects can prove effective to help sustain domestic demand and employment. Under this scenario, the policy response would only help mitigate the shock, with economic activity likely being below potential in the short term. Therefore, it will be important to design and communicate clearly the authorities' strategy and objectives, and ensure continuity in the policy framework.

Giving more weight to structural measures to anchor fiscal policy would help cementing macroeconomic stability. This approach helps reducing procyclicality risks, enhances predictability, and accumulates fiscal buffers. Staff sees merits of targeting moderate structural overall balances of 1 percent of GDP in the medium-term to cope with the volatile global environment, contingent liabilities, and Peru's vulnerability to natural disasters. In the short-term, current Fiscal Responsibility and Transparency Law parameters could be calibrated to maintain a relatively stable structural result, with limits to expenditure growth, unless a discretionary fiscal reaction is called for.

Tax mobilization efforts will be key to the sustainability of the social agenda. Staff welcomes the authorities' plans to strengthen tax administration to increase the tax ratio to 18 percent of GDP by 2016 to provide additional resources to cover increasing social programs and public investments in the medium-term. The approval of the revised mining taxation framework, with due consideration for competitiveness in the sector, is a welcome first step. Staff also welcomes the authorities' efforts to reduce tax evasion, but warns that in the event these efforts did not yield the expected results, tax measures could be considered.

Going forward, Peru's improved fundamentals will foster further de-dollarization, allowing the exchange rate to play a larger role as shock absorber. Staff believes that some additional exchange rate flexibility, gradually implemented, is important for the private sector to strengthen its ability to assess foreign exchange risk, and may contribute to de-dollarize. Financial dollarization remains high and has actually increased in some segments given low international interest rates and appreciation expectations. A gradual increase in exchange rate flexibility would foster the development of hedging instruments and private sector awareness about managing currency risk, thereby allowing the exchange rate to play a larger role as a shock absorber.

The financial sector is strong, and the prudential framework is ahead in the implementation of proposed international standards. Peru's financial sector remains sound, profitable and well-capitalized. Most prudential regulations aligned with Basel III will be applied ahead of the internationally-agreed schedule, with banks well positioned to implement them. Monitoring corporate balance sheets, including foreign exchange and derivative positions, will be critical to assess vulnerabilities. Formalizing an institutional setup for macro-prudential policies would facilitate monitoring systemic risks more effectively, and enhance analysis and coordination across institutions.

Peru's bright economic prospects will benefit from an ambitious reform agenda to maintain high potential growth. Staff concurs with the view that growth will need to be increasingly driven by higher productivity over the medium term. Key pillars to ensure high growth include: (i) enhancing competitiveness by boosting human capital and infrastructure and maintaining labor market flexibility; (ii) improving the business climate to foster investment and innovation (including enhancing formality); and (iii) further developing the local capital markets to facilitate investment and better allocate savings.

Peru: Selected Economic Indicators

	2006	2007	2008	2009	2010	Projections 2011	2012
Social Indicators							
Life expectancy at birth (years)	72.8	73.0	73.2	73.5	73.7	...	...
Infant mortality (per thousand live births)	23.8	22.2	20.7	19.4	...	...	...
Adult literacy rate	88.7	89.6	89.6	89.6	89.6	...	...
Poverty rate (total) 1/	44.5	39.3	36.2	34.8	31.1	...	...
Unemployment rate	8.5	8.4	8.4	8.4	7.9	7.5	7.5
(Annual percentage change; unless otherwise indicated)							
Production and prices							
Real GDP	7.7	8.9	9.8	0.9	8.8	6.7	5.2
Real domestic demand	10.3	11.8	12.3	-2.8	12.8	8.1	5.5
Of which: Private sector	10.3	12.2	12.4	-5.7	12.2	9.6	4.0
Consumer Prices (end of period)	1.1	3.9	6.7	0.2	2.1	3.9	2.5
Consumer Prices (period average)	2.0	1.8	5.8	2.9	1.5	3.2	2.8
External sector							
Exports	37.2	17.9	10.4	-13.1	31.9	19.6	7.0
Imports	22.9	32.0	45.2	-26.1	37.1	21.2	8.1
Terms of trade (deterioration -)	26.6	3.6	-14.5	-3.1	18.2	5.8	0.0
Real effective exchange rate (depreciation -) 2/	-1.8	-1.7	4.4	3.5	2.4	...	...
Money and credit 3/ 4/							
Broad money	9.0	22.2	24.9	5.9	23.8	15.4	12.4
Net credit to the private sector	6.4	30.2	32.4	1.3	14.6	20.5	14.4
(In percent of GDP; unless otherwise indicated)							
Public sector							
NFPS Revenue	25.4	25.8	26.6	24.0	25.0	26.3	25.9
NFPS Primary Expenditure	21.2	21.0	22.7	24.3	24.4	22.9	23.7
NFPS Primary Balance	4.2	4.8	3.9	-0.3	0.6	3.4	2.2
NFPS Overall Balance	2.3	3.1	2.3	-1.6	-0.5	2.2	1.1
General Government Primary Balance	3.7	4.9	3.7	-0.9	0.8	3.3	2.3
General Government Overall Balance	1.9	3.2	2.2	-2.1	-0.3	2.2	1.2
External Sector							
External current account balance	3.1	1.4	-4.2	0.2	-1.5	-2.5	-2.6
Gross reserves							
In millions of U.S. dollars	17,329	27,720	31,233	33,175	44,150	48,243	50,243
Percent of short-term external debt 5/	339.6	206.2	317.9	435.4	342.5	496.8	465.1
Percent of foreign currency deposits at banks	151.4	209.7	173.8	190.3	217.3	226.6	230.5
Debt							
Total external debt	31.4	31.3	28.4	29.3	27.4	26.1	25.4
NFPS Gross debt (including CRPAOs)	33.1	30.4	24.9	28.4	24.6	21.3	20.7
External 6/	23.8	18.8	15.1	16.2	12.9	11.7	10.6
Domestic	9.3	11.7	9.8	12.2	11.6	9.7	10.1

Savings and investment							
Gross domestic investment	20.0	22.8	26.9	20.7	25.0	24.6	24.6
Public sector 7/	3.1	3.4	4.3	5.2	5.9	5.1	6.1
Private sector	16.4	18.2	21.5	17.7	19.2	18.7	18.2
Inventories changes	0.6	1.3	1.0	-2.1	-0.1	0.8	0.3
National savings	23.2	24.2	22.7	20.9	23.5	22.1	22.0
Public sector 8/	5.1	6.4	6.8	4.2	5.7	7.3	7.2
Private sector	18.0	17.8	15.9	16.6	17.8	14.8	14.8
External savings	-3.1	-1.4	4.2	-0.2	1.5	2.5	2.6
Memorandum items							
Nominal GDP (S/. billions)	302.3	335.5	371.1	382.3	434.6	485.3	524.1
GDP per capita (in US$)	3,339	3,800	4,425	4,361	5,205	5,669	5,951

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; ECLAC 2002-03; National Statistical Institute (INEI);

UNDP Human Development Indicators; 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.