INTERNATIONAL MONETARY FUND

IMF Country Report No. 14/21

PERU

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

January 24, 2014

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 2013 Article IV Consultation with Peru, the following documents have been released and are included in this package:

- The **Staff Report** for the 2013 Article IV Consultation, prepared by a staff team of the IMF for the Executive Board's consideration on January 24, 2014, following discussions that ended on November 20, 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 January 8, 2014.

- An **Informational Annex** prepared by the IMF.

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 24, 2014 consideration of the staff report that concluded the Article IV Consultation with Peru.

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

Selected Issues Paper

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

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PERU

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

January 8, 2014

KEY ISSUES

Context: The overall state of the economy remains strong despite lower metal prices and market turbulence in mid-2013. The economy is still operating somewhat near potential and continues to be one of the most dynamic in the region. However, the pace of growth slowed in 2013 as a result of external shocks and lower domestic confidence. Headline inflation increased due to a combination of supply shocks and exchange rate "pass-through" effects. The current account deficit has widened recently due to a fall in exports. Against this background, fiscal policy provided a positive impulse, while the Central Reserve Bank of Peru (BCRP) eased monetary policy to support activity and allowed greater exchange rate flexibility to protect the economy from external shocks.

Perspective: The outlook is positive with balanced risks. On the upside, a faster implementation of structural reforms and elimination of investment bottlenecks can greatly increase growth potential. On the downside, unexpected effects of the withdrawal of monetary stimulus in the U.S. could affect Peru through higher cost of investment.

Near-term policy mix: The current policy mix is broadly adequate. With the economy close to full-employment and inflationary expectations in check, a relatively neutral policy stance should be maintained. Monetary policy should remain flexible as long-term interest rates in the U.S. start to gradually rise. Fiscal stance should remain broadly neutral, while the exchange rate should continue to show flexibility, strengthening its role as a shock absorber. If the external environment deteriorates further, the authorities have significant buffers that can be used to support demand to limit the negative effect of an external shock on domestic demand. Additional macro-prudential measures could also be employed, including those contributing to the de-dollarization of the economy.

Medium-term challenges: Over the medium term, the economy will need to adjust to a lower growth rate in China (one of Peru's principal trading partners) by fostering productivity improvements and sustaining investment growth. It will be key to persevere with the structural reform agenda to enhance potential growth prospects. Deepening of the reforms is needed to bolster competitiveness through increases in labor market flexibility, upgrades in human capital, the elimination of infrastructure gaps, and fostering financial deepening.

Approved By
Vivek Arora and Saul Lizondo

Discussions took place in Lima during November 5–20, 2013. The team comprised: Alejandro Santos (Head), Fei Han, Melesse Tashu, and Svetlana Vtyurina (all WHD). Kevin Ross (Resident Representative) assisted the mission. Oscar Hendrick (OED) also participated in the discussions. Alejandro Werner (WHD) joined the mission for the concluding meeting with Economy and Finance Minister Castilla, and Central Bank Governor Velarde.

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List of Acronyms

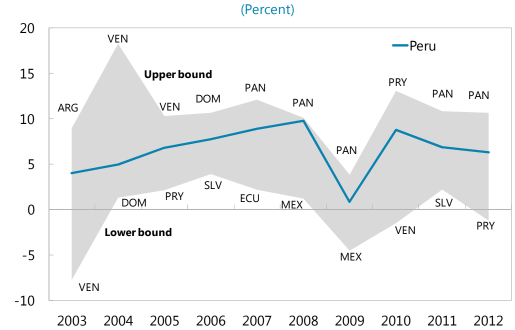
AFP	Pension Fund Administrators
BCRP	Central Reserve Bank of Peru
CA	Current Account
CAR	Capital Adequacy Ratio
CDS	Credit Default Swap
CGER	Consultative Group on Exchange Rate Issues
EBA	External Balance Assessment
EIS	Environmental Impact Studies
eop	end of period
ERER	Equilibrium Real Exchange Rate
ES	External Sustainability
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
FX	Foreign Exchange
GDP	Gross Domestic Product
IIP	International Investment Position
LA6	Brazil, Chile, Colombia, Mexico, Peru, and Uruguay
LAC	Latin America and the Caribbean
LCR	Liquidity Coverage Ratio
LR	Liquidity Ratio
MB	Macro Balance
MEF	Ministry of Economy and Finance
MLT	Medium and Long Term
NEER	Nominal Effective Exchange Rate
NFPS	Non-Financial Public Sector
NIR	Net International Reserves
NPL	Non-Performing Loans
PPP	Public-Private Partnership
REER	Real Effective Exchange Rate
RER	Real Exchange Rate
ROE	Return on Assets
RR	Reserve Requirement
SBS	Superintendency of Banks, Insurance, and Pensions
SUNAT	National Superintendency of Tax Administration
TFP	Total Factor Productivity
TOT	Terms of Trade
USFR	United States Federal Reserve
VAR	Vector Autoregressive
VAT	Value-Added Tax
VIX	Chicago Board Options Exchange Market Volatility Index
yoy	year-on-year

CONTEXT

The economy continues to be one of the most dynamic in the region and is still operating somewhat near potential. However, economic growth decelerated and the current account deficit widened in 2013 to a large extent as a result of deteriorated external conditions. Concerns about the unwinding of unconventional monetary policy in the U.S. and weaker metal prices contributed to a deterioration of confidence, a weaker domestic demand, and increased uncertainty.

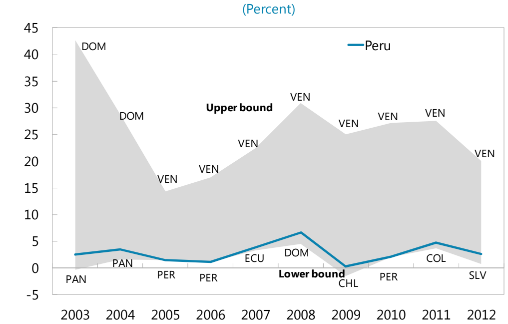
1. Peru has been one of the best macroeconomic performers in Latin America over the past decade. Peru continued to be a leader in high growth and low inflation in the region, which was achieved through a prudent macroeconomic policy implementation, a far-reaching structural reform agenda and taking advantage of the benign external environment.[1] Not least due to these factors, the economy came out virtually unscathed from the 2008–09 global financial crisis, with growth rebounding to 8¾ percent in 2010 and then being sustained at high levels in 2011–12. Accommodative monetary and fiscal policies played an instrumental role in supporting the recovery, and were smoothly unwound as growth accelerated and the negative output gap was closed.

Latin America: Real GDP Growth
(Percent)



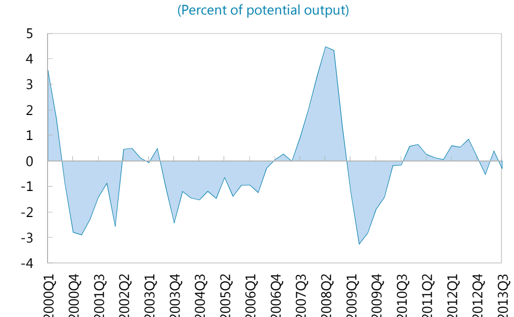
Source: WEO.

Latin America: Inflation
(Percent)



Source: WEO.

Peru: Output Gap
(Percent of potential output)



Sources: BCRP; and Fund staff estimates.

2. However, the growth momentum slowed in 2013 mostly due to adverse external conditions and a decline in domestic confidence. Following an expansion of 6⅓ percent in 2012, economic growth slowed to about 5 percent in the first three quarters of 2013 (yoy) due to a moderation in private investment and a decline in exports. Net exports had a negative impact on growth in Peru as well as in the majority of the other LA6 countries.[2] After the fall in metal prices, uncertainty increased; and domestic confidence levels dropped, reflecting also some concerns about the

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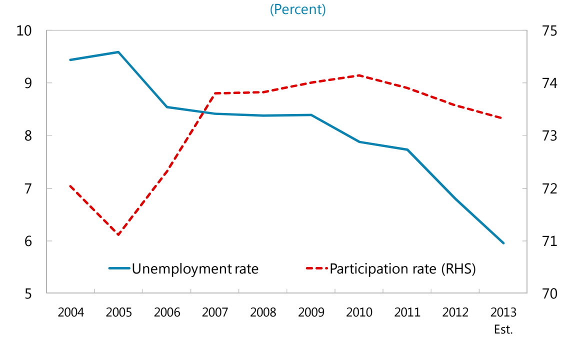
[1] The average growth rate of the Peruvian economy was 6.2 percent in the period 2002-13, the second highest growth rate in Latin America, whereas the average inflation rate was 2.8 percent in the same period, the lowest in Latin America.

[2] The LA6 countries 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.

direction of domestic policies. The turbulence in capital markets generated by the U.S. Federal Reserve's (USFR) announcement of a possible "tapering" of asset purchases added to the existing uncertainty (Annex I). On the supply side, the moderation of growth in 2013 reflected a slowdown in the mining, fishing and construction sectors. With domestic confidence indicators slowly improving starting in the third quarter of 2013, the recovery will likely be gradual. Despite the economic deceleration, the economy continues to operate somewhat near potential (although there is a very small negative output gap), and real GDP growth is expected to grow at around 5 percent in 2013, underpinned by a recovery of exports and investment in the last quarter of the year as well as improvements in confidence as temporary supply shocks are being reversed (i.e., increasing fishing quotas and fixing production problems in a large mine).

3. **The unemployment rate fell to historical lows.** The unemployment rate declined from 9½ in 2004 to 6¾ percent in 2012 as labor participation rose (from 71 to 74 percent) and the growth of working-age population remained stable. The overall unemployment rate declined further to 5⅓ percent in November 2013 as employment remained buoyant. The long-term decline in the unemployment rate can be partly explained by the high growth in the economy and the absorption by the formal sector of underemployed workers from the informal sector. While real wages have increased, they have moved in tandem with productivity, and there are no signs of overheating in the labor market.

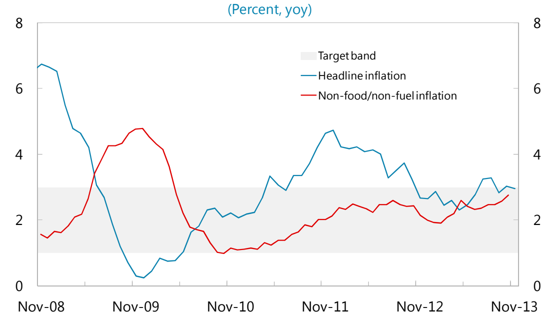
Peru: Unemployment
(Percent)



Source: INEI.

4. **Inflation picked up in 2013 mostly due to supply shocks and the pass-through effect of the exchange rate.** Inflation was outside the BCRP target band (1–3 percent) during the first half of 2012 but declined to 2¾ percent (yoy) by year-end as supply shocks unwound. Inflation increased again to slightly over 3 percent (yoy) in some months in the second half of 2013 (outside the target band) due to increases in food and fuel prices, and some "pass-through" from the exchange rate depreciation.[3] Non-food/non-fuel inflation has remained within the target band but has increased in the last several months. However, inflation is expected to remain close to the upper limit of the target band of 3 percent by end-2013, and move gradually toward the middle range of the band

Peru: Inflation
(Percent, yoy)



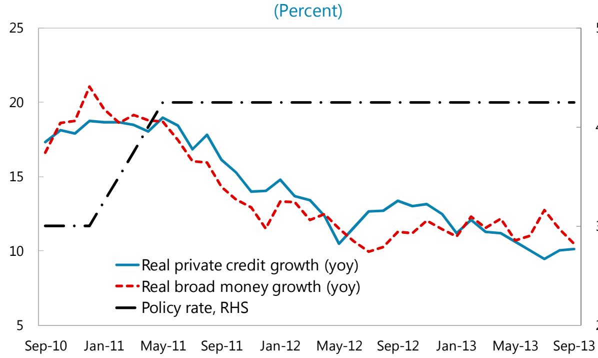
Source: BCRP, and Fund staff calculations.

[3] The "pass-through" coefficient is relatively low in Peru. A VAR analysis with commodity prices, output gap, exchange rate, and inflation as endogenous variables shows that a one percent depreciation of the nuevo sol against the U.S. dollar is likely to raise inflation by about 0.1 percentage points over a year (cumulative impact). Thus far, the exchange rate has depreciated by 8½ percent in 2013, which could generate an inflationary pass-through effect of about ⅞ of a percent over a year.

in 2014 in line with the stabilization of oil prices. Inflation expectations remain well-anchored over the medium term.

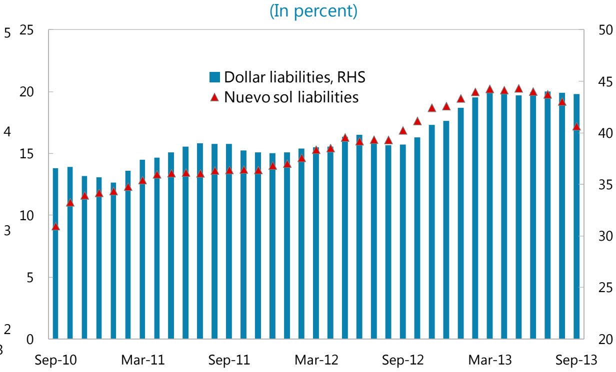
5. Monetary policy was relaxed and macro-prudential measures were unwound recently on evidence of a continued slowdown in economic activity. After keeping the policy rate at 4¼ percent for 2½ years, the BCRP cut the rate by ¼ of a point to 4 percent in November 2013, citing slower domestic and global growth, and declining inflationary expectations. The cut was intended to be preventive and to facilitate the recovery of the economy. Over the last few years, the BCRP raised reserve requirements (RR) several times to mitigate the impact of the surge in capital flows on credit expansion and the potential adverse effect on asset quality in the financial system. Consequently, real private credit growth slowed from about 20 percent in early 2011 to about 11 percent in mid-2013. During the first half of 2013, the BCRP established a ceiling on average reserve requirements on domestic liabilities and announced higher reserve requirements on foreign currency liabilities if dollar credit expanded above established limits.[4] More recently, however, the BCRP began unwinding macro-prudential measures to ease liquidity flows following the USFR's announcement in May 2013 of potential "tapering" of its unconventional monetary policy.[5]

Peru: Monetary Aggregates
(Percent)



Source: BCRP.

Peru: Reserve Requirements
(In percent)



Sources: BCRP.

6. Exchange rate policy has been more flexible over the past year, although the BCRP has intervened to limit excessive volatility in the foreign exchange (FX) market. In response to large capital inflows in 2012, the nuevo sol appreciated by 8½ percent in real effective terms, while the BCRP accumulated about US$15 billion FX reserves leading to a build-up of net international reserves (NIR) to US$64 billion (about 32 percent of GDP). Most of last year's FX purchase

[4] The measure was intended to moderate the growth of dollar loans, in particular, mortgage and vehicle loans, the central bank increased the RR on dollar liabilities by 75 and 150 bps if the balance of dollar mortgage loans and car loans expanded by either: (i) more than 10 and 20 percent respectively with respect to February 2013; or (ii) 20 and 25 percent of the regulatory capital at end-2012 respectively, whichever amount is higher; while at the same time establishing a ceiling for RR on liabilities in nuevos soles.

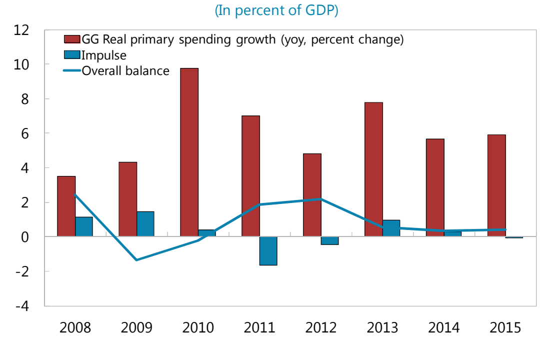
[5] In particular, the BCRP took the following measures: (i) reduced marginal RR on nuevo sol deposits from 30 percent in July to 15 percent in December 2013; (ii) reduced marginal RR on dollar deposits from 55 percent in July to 50 percent in August; and (iii) reduced average RR on local currency liabilities from 20 percent in June to 15 percent in December, and established a 45 percent ceiling on foreign currency liabilities in August 2013.

interventions were sterilized through issuance of the BCRP securities, Treasury deposits, and raising reserve requirements. Staff estimated that the cost of such sterilization was about ½ percent of GDP. The BCRP continued with FX purchases through mid-April of 2013 to avoid undue volatility, but since then sold FX to limit the volatility resulting from financial market turmoil associated with the USFR announcement in May 2013. In these circumstances, the nuevo sol depreciated about 8½ percent, year-to-date, in real terms in the first ten months of 2013. The exchange rate remains in line with fundamentals (Annex II). For 2013, the BCRP is expected to accumulate around US$3 billion in FX reserves, increasing NIR to US$67 billion; most of the intervention is expected to be sterilized through Treasury deposits, reducing the need for other (more costly) forms of sterilization.

7. Fiscal policy became more supportive of the economy in 2013 given the challenging external environment. The fiscal position strengthened considerably in 2012. The non-financial public sector (NFPS) overall surplus increased to 2¼ percent of GDP in 2012 (more than double the budgeted amount), mainly due to stronger-than-expected revenues and slower implementation of public investment plans despite efforts to accelerate it. In 2013, the fiscal surplus is estimated to have fallen to ½ percent of GDP due to: (i) budgeted allowances to increase primary spending to achieve social inclusion goals and higher wages following the civil service reform; (ii) efforts to increase capital spending; and (iii) falling mining-related revenues as metal prices weakened. Public debt is sustainable and at below 20 percent of GDP (expected for 2013) remains one of the lowest in the region (see debt sustainability analysis, Tables 10–11). Total financial assets of the NFPS are expected to reach over 15 percent of GDP by end-2013 (of which about 4 percent of GDP belongs in the fiscal stabilization fund).

Peru: Fiscal Indicators

(In percent of GDP)



Sources: MEF; and Fund staff estimates.

- ***Diminishing surplus.*** The authorities presented their revised multi-year macroeconomic framework in August 2013, lowering the expected surplus in 2013 from the budgeted 1 percent of GDP to around ⅓ percent reflecting mainly higher expenditures due to ongoing public sector reforms and projected full execution of investment spending and to a lesser extent lower tax revenues from natural resources. Staff expects a marginally higher surplus on account of a slightly lower execution rate of capital expenditures.

- ***Fiscal impulse.*** Staff estimates a NFPS structural fiscal surplus (i.e., correcting for the business cycle and high metal prices) above ½ percent of GDP in 2013, resulting in a fiscal impulse of about 1 percent of GDP. In the absence of this fiscal easing in 2013, the economic slowdown would have been more pronounced.

- ***Acceleration of investment.*** The government announced two initiatives between May and June 2013 to enhance public investment performance and improve the overall investment climate (Box 1). In particular, a special team was appointed within the Ministry of Economy and Finance

(MEF) to identify and reduce bottlenecks and speed up investment projects. Over 50 projects accounting for around 10 percent of GDP have been identified and are under close monitoring to ensure completion. A committee responsible for launching public private partnerships (PPP) was also appointed; and a new PPP law will broaden the scope and modalities under which these partnerships could be established.

- ***Support for sub-national governments.*** In September 2013, support measures were approved for local and regional governments to prevent interruptions in the ongoing projects affected by the reduction in income from lower mining taxation earmarked to the regions. The assistance is to be delivered in the form of transfers within the current budgeted expenditure envelope; and by offering a credit line. The latter mechanism is available to all local governments that are able to repay debt with future resource income.

8. **New legislation strengthening the fiscal framework was recently approved.** The law was approved by Congress in October 2013 and will be applied to the 2015 budget. The previous framework (in place since 1999) served Peru well in reducing the public debt to GDP ratio but did not prevent fiscal policy from being pro-cyclical, nor steer efficiently the management of nonrenewable resources in the context of capacity constraints, nor provide for a balancing of savings of these revenues against significant social needs and infrastructure gaps. The new framework: (i) aims at introducing a counter-cyclical component to budget formulation; (ii) strengthens accountability by introducing a fiscal council; and (iii) delineates better the relationship and fiscal practices between the national and sub-national levels. The design of the new fiscal framework followed the recommendations of the commission of experts appointed in 2012 (Box 2), and involved the participation of the BCRP, technical assistance from the Fund, and independent experts to provide more transparency and commitment to the process.

9. **The external position has deteriorated mostly due to weak export performance and higher interest rates abroad.** During the first nine months of 2013, the terms of trade deteriorated by 3½ percent (yoy) and export volumes fell 3¾ percent (yoy) while import volume growth remained strong at about 6¾ percent (yoy), leading to a current account deficit of 5½ percent of GDP. However, thus far, the current account deficit has been easily financed by private capital inflows amounting to some 8 percent of GDP (mainly FDI). While demand for external financing fell following the USFR announcements in May 2013, international bond issuance by Peruvian firms already had reached historic highs at about US$6½ billion (3 percent of GDP) in the first half of 2013, compared to US$3½ billion during 2012. Non-residents have also maintained their holding of sovereign bonds at around 57 percent of the total. At the same time, there were large net short-

Peru: Balance of Payments
(In percent of GDP)

	2010	2011	2012	Proj. 2013	Proj. 2014
Current Account	**-2.5**	**-1.9**	**-3.4**	**-4.9**	**-4.8**
Exports	23.1	25.9	23.1	20.5	20.6
Imports	-18.7	-20.7	-20.7	-20.7	-20.6
Other	-6.8	-7.1	-5.9	-4.7	-4.8
Financial Account	**9.7**	**4.4**	**10.9**	**6.3**	**5.3**
Public sector (net)	1.5	0.4	0.7	-0.3	-0.5
Private sector (net)	8.2	4.0	10.2	6.6	5.8
Foreign direct investment	5.3	4.6	6.2	5.7	4.2
Other private (net) 1/	2.9	-0.5	4.0	0.9	1.7
Overall Balance	**7.3**	**2.5**	**7.4**	**1.4**	**0.5**

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

term capital outflows of about 3½ percent of GDP registered in the second and third quarters as Peruvian banks used their liquidity position to reduce short-term external liabilities (Annex I).

10. Despite the deterioration of the external position, the risks to the stability of the external sector remained contained. Both the External Balance Approach (EBA) and the traditional Consultative Group on Exchange Rate (CGER) methodologies indicate that the real effective exchange rate is broadly in line with fundamentals, although some methodologies indicate a slight overvaluation (Annex II). The level and composition of Peru's international investment position (IIP) has improved over the last decade as the negative IIP halved since the early 2000s and the composition of foreign liabilities shifted significantly into non-debt items. Also, net international reserves remain comfortable with respect to various metrics. Peru does not maintain exchange restrictions or multiple currency practices subject to Fund jurisdiction (under Article VIII, Section 2 (a) or 3), and their macro-prudential measures aim at enhancing financial stability, and do not constitute capital flow management measures as the Peru has an open capital account.

11. The financial sector remains solid and healthy. Banks remain in a better financial position than their non-bank counterparts.

- ***Banks.*** They account for almost 90 percent of the assets of the financial system. With capital to risk-weighted asset ratios (CAR) of 14 percent, non-performing loan ratios (NPL) of 2 percent, and return-on-equity (ROE) of 21½ percent as of September 2013, the banking system remains well-capitalized, sound, and profitable. But with high dollarization of over 45 percent, the banking system remains vulnerable to exchange rate fluctuations. To moderate risks, the BCRP and the superintendency of banks (SBS) actively employed macro-prudential policies. To limit the expansion of loans in U.S. dollars and encourage their substitution by credits in nuevos soles, BCRP increased the RR on dollar liabilities during the first four months of 2013.

- ***Non-banks.*** They represent over 10 percent of the assets of the financial system. While non-banks' exposure to FX risk is limited due to their low level of dollarization of about 10 percent, their financial health has worsened recently, reflecting softer economic conditions (and despite continued strengthening of lending standards) as their portfolios are highly concentrated in consumer and small- and micro-enterprise loans.[6] NPLs and profitability and provisioning indicators have all been deteriorating lately. Nonetheless, they remained well-capitalized with CARs ranging from 13½ for *Cajas Rurales* to about 18 for *Empresas Financieras*.

[6] Main non-bank deposit-taking financial institutions include *Empresas Financieras*, *Cajas Municipales de Ahorro y Credito*, and *Cajas Rurales de Ahorro y Credito*, with financial assets of about S/. 29 billion (about 11 percent of total financial assets of deposit-taking institutions or about 5 percent of GDP) as of mid-2013.

Peru: Financial Soundness Indicators
(In percent, end of period)

	NPL to Deposit Ratio			Provisioning to NPL			Return on Equity			Capital Asset Ratio		
	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
Total	**1.8**	**2.2**	**2.6**	**225**	**202**	**176**	**23.5**	**21.5**	**20.2**	**13.7**	**14.4**	**14.0**
Banks	1.5	1.8	2.1	251	224	193	24.5	22.4	21.4	13.4	14.1	13.7
Empresas Financiera	3.5	4.5	5.1	190	171	154	20.0	21.6	15.9	15.3	17.4	17.9
Cajas Municipales	4.9	5.2	6.7	155	145	129	17.8	14.6	12.1	16.4	15.8	15.3
Cajas Rurales	4.3	5.3	6.9	150	112	102	8.1	7.1	2.4	14.4	14.2	13.6

Source: SBS. NPL stands for non-performing loans.

12. **Peru's sovereign credit rating was recently upgraded by two credit rating agencies.** Peru has had an investment grade rating since 2008/09. Standard & Poor's (S&P) raised the country's long-term sovereign foreign currency rating to BBB+ (from BBB), and long-term sovereign local currency rating to A- (from BBB+) in August 2013, whereas Fitch did the same in October 2013 (the best rating in Latin America after Chile). Both credit rating agencies said the outlook for the rating was now stable. The reasons for an upgrade included continued robust growth, establishment of a fiscal stabilization fund and buildup of international reserves, as well as improved fundamentals. In the meantime, Moody's maintained the Baa2 rating (with a positive outlook).

13. **The next electoral cycle is approaching against the background of social tensions**. Regional and municipal elections are set for October 2014, and presidential and legislative elections are scheduled for April 2016. In the meantime, social conflicts have increased over the years, with about 150 disputes earlier in the year involving extractive industries on the grounds of environmental destruction and inadequate compensation to local communities. While many large private mining projects are implemented as scheduled, the US$5 billion *Minas Conga* copper and gold project in northern Peru, has been stalled due to social discontent, and is expected to be reconsidered by the company in 2015.

14. **Previous Article IV consultations.** There has been broad agreement between the authorities and staff on policy issues in previous Article IV consultations. More recently, the authorities increased exchange rate flexibility when confronted with external shocks, and approved a new fiscal framework (to become effective in 2015), which eliminates pro-cyclicality and is based on the structural fiscal position. These two policy actions were in line with staff recommendations in recent Article IV consultations. Moreover, the authorities have embraced transparency in the discussions by publishing the concluding statement immediately at the end of the mission so that all stake holders are aware of the discussions, including staff's views and policy recommendations.

OUTLOOK AND RISKS

Fundamentals continue to be strong and buffers are ample to withstand adverse external conditions. Risks are balanced, with upside risks being very conducive to growth, while downside risks are expected to be manageable.

15. The region is cooling off. Growth has been revised downwards for many countries in the region and for some quite steeply, on the back of a less supportive external environment and supply-side constraints. Overall, regional output growth is projected to hover around 2½ percent in 2013, (with most economies now operating broadly at potential), and at about 3 percent in 2014.

16. The outlook for Peru remains favorable in the near term despite challenging external conditions. Based on World Economic Outlook projections, China (one of Peru's main trading partners) is projected to experience an economic deceleration in 2013 (to 7½ percent) and over the medium-term (to 7 percent). In the United States, the USFR has already announced the unwinding of its monthly purchases of securities starting in January 2014, which will lead to higher long-term interest rates in 2014.[7] All this will result in a lower external demand and terms of trade deterioration of 3¼ and 1 percent in 2013 and 2014, respectively. Against this background, staff projects GDP to be somewhat near potential in 2013, with growth slowing to about 5 percent reflecting lower external demand and a slowdown in domestic demand. Real GDP growth should rebound to 5½ percent in 2014 on the back of a rebound in exports as large mining projects are coming on stream (Annex III). The authorities remain more confident and placed growth slightly above 5 in 2013 and 6 percent in 2014. Inflation will gradually fall to 2.3 percent in 2013 and 2 percent in 2014 (the middle of the inflation band) as supply shocks unwind and the pass-through effects of the recent exchange rate depreciation are absorbed. The external current account deficit will decline in the fourth quarter 2013 on the back of a recovery in mining and fishing exports, but will remain at about 5 percent of GDP in 2014.

17. Short-term external and domestic risks are well balanced. The main external tail risk is significant but should be contained given large FX reserves, ample fiscal space, and a strong policy track record.

- ***Domestic upside risks.*** Staff's baseline projections were made under conservative assumptions, thus the pace of the domestic economic recovery could be stronger than envisaged due to a variety of factors, including: (i) the greater speed of operating at full capacity of large mining projects coming on stream; (ii) the ability to implement faster large infrastructure projects in the pipeline; (iii) the effectiveness of the investor facilitator office in handling a larger volume of cases; and (iv) the faster adoption of the authorities' reform agenda. Also, it is possible that with relatively softer economic conditions, the recent macroeconomic stimulus could have a faster effect on the economy.

[7] The USFR announced on December 18, 2013 that it will begin reducing its purchase of assets by US$10 billion a month to US$75 billion a month starting in January 2014.

- ***External downside risks.*** The main external risk comes from problems in unwinding the unconventional monetary policy in the U.S. News of a possible gradual USFR "tapering" of its bond purchasing program in May 2013 destabilized many emerging economies. In Peru, capital flows slowed as the corporate sector curtailed bond issuances in international capital markets and long-term sovereign bond yields increased (Annex I). However, there was no noticeable market reaction to the USFR's announcement in December 2013 of the first round of tapering mostly because this has already been priced in. While the risks to Peru have also been contained in part due to the availability of ample buffers, a disorderly and rapid withdrawal of the USFR's monetary stimulus could disrupt global financial flows and lead to sudden stops and reversal of some (non-FDI) capital flows to Peru. This could put pressure on the financial system and further decelerate growth.

South America: Selected Macro-Economic Indicators 1/

	2010	2011	2012	Proj. 2013	Proj. 2014
			(Percent)		
Real GDP growth	6.6	4.4	2.4	2.5	3.0
Peru	8.8	6.9	6.3	4.9	5.5
Inflation, end-of-period	11.9	6.2	6.2	5.4	4.3
Peru	2.1	4.7	2.6	3.0	2.3
			(Percent of GDP)		
Output gap	0.1	1.1	0.6	0.1	0.1
Peru	-0.2	0.5	0.5	-0.2	-0.1
Domestic Investment	22.1	22.8	21.6	22.1	22.2
Peru	25.2	25.9	26.9	27.7	28.4
Current account balance[2]	-1.2	-1.6	-1.9	-2.5	-2.4
Peru	-2.5	-1.9	-3.6	-4.9	-4.8
Primary fiscal balance	1.4	1.8	1.6	1.2	1.3
Peru	1.0	3.0	3.3	1.6	1.4
Gross public debt	29.5	29.2	30.4	30.2	30.4
Peru	24.4	22.3	20.5	19.5	17.9

1/ Sub-regional aggregates calculated as PPP-GDP weighted averages averages unless otherwise indicated. Includes Argentina, Brazil, Chile, Colombia, Mexico, Uruguay.

2/ Aggregates weighted by nominal GDP at market exchange rates.

18. Medium-term challenges remain demanding given the uncertain global outlook. Staff revised Peru's potential growth slightly down in the context of a lower global growth outlook, particularly lower growth in China. The lower growth potential stresses the importance of accelerating structural reforms to gain productivity and enhance the capacity of the economy to grow. Staff projects the economy growing at potential of about 5¾ percent and inflation at 2 percent over the medium term. While the current account will continue to be elevated in the short term, it is expected to diminish over the medium term on the back of projected increases in mining exports and stabilization of global growth. Overall, primary fiscal surpluses are expected to be anchored above 1 percent of GDP, while gross public debt will remain sustainable and declining to well below 20 percent of GDP, with net debt turning negative.

POLICY DISCUSSIONS

With economic growth decelerating on the back of uncertain external conditions, the discussions focused on: (i) near-term risk assessment and the appropriate policy mix, (ii) triggers for implementing countercyclical policies and the use of buffers, and (iii) addressing challenges in the structural area to preserve a strong growth momentum over the medium term. It was agreed that the current policy mix was broadly appropriate and that policy buffers could be used in a measured manner if additional turbulence in markets emerges. Going forward, policies should be geared towards accommodating a possible reduction of potential growth.

A. Near-Term Risk and Policy Stance

19. Staff estimates that the economy continues operating somewhat near potential while inflation remains under control. The main macroeconomic objectives of achieving near full-employment with low inflation have been achieved in Peru in the period after the global financial crisis of 2008–09 thanks to skillful macroeconomic management. The output gap is estimated to have moved from slightly above potential (by 0.5 percent) in 2012 to slightly below potential (-0.2 percent) in 2013 as growth decelerated in 2013. This has been achieved while inflation has been contained within the BCRP band (1–3 percent) and inflation expectations remain well anchored.

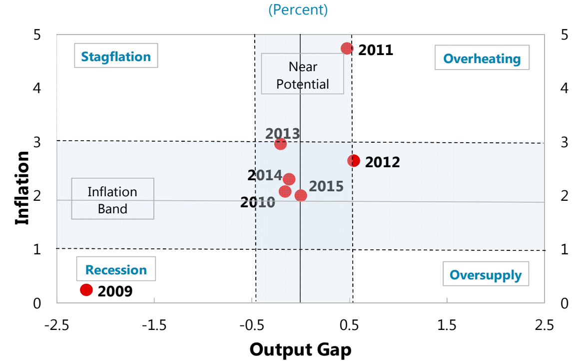
Peru: Fiscal Accounts (NFPS)
(In percent of GDP)

				Proj.	
	2010	2011	2012	2013	2014
Revenues	**25.2**	**26.1**	**26.7**	**26.4**	**26.2**
Taxes	15.2	15.9	16.4	16.0	16.0
Non-taxes	10.0	10.2	10.3	10.4	10.2
Primary expenditures	**24.2**	**23.1**	**23.5**	**24.8**	**24.9**
Current primary	17.7	17.8	17.7	18.5	18.4
Capital	6.5	5.3	5.7	6.3	6.5
Primary balance	**1.0**	**3.0**	**3.3**	**1.6**	**1.4**
Interest payments	1.2	1.1	1.1	1.0	1.0
Overall balance	**-0.2**	**1.9**	**2.2**	**0.5**	**0.3**

Sources: MEF; and Fund staff estimates.

20. The 2014 budget envisages a zero overall fiscal balance, but staff believes there is an upside risk. The 2014 budget was approved by Congress in December 2013. When applying historic rates of budget execution, the overall balance should yield a small surplus of about ⅓ percent of GDP for 2014. This reduction in the fiscal surplus (compared to an overall surplus of about ½ percent of GDP in 2013), when adjusted for the economic cycle and fluctuations in commodity prices, reduces the structural fiscal surplus to 0.4 percent of GDP in 2014 (from 0.7 percent in 2013). This entails a relatively small fiscal impulse of about ⅓ percent of GDP in 2014, which is mildly counter-cyclical (given a very small negative output gap) and broadly appropriate given the current economic conditions. While the authorities recognized that it is possible to achieve a small fiscal surplus in 2014, especially if previous budget execution rates

Peru: Inflation and Output Gap
(Percent)



materialize, they stressed that their objective is to improve budget execution and to fully implement the 2014 budget. If the 2014 budget were to be fully implemented, the fiscal impulse in 2014 would amount to about ⅔ percent of GDP, which could pose a small overheating risk (as the fiscal multiplier is likely to be low given that the economy is somewhat near potential).

21. Over the medium term, staff continued to support small fiscal structural surpluses. These could be in the order of ½ percent of GDP a year (measured under the staff's methodology) to address contingent liabilities and natural disasters risks (i.e., earthquakes, "El Niño" related droughts, tsunamis, etc.) which are high in Peru, and also to maintain the relative size of the fiscal buffers as the economy grows.[8] The new fiscal framework constitutes an important step in reducing pro-cyclicality of the budget process and in achieving an appropriate savings target from the intergenerational and fiscal risks point of view. Staff recommended the structural target taking into account the desired level of financial balances and public investment path. Staff also emphasized that further scaling up of public investment over the medium term, should be in line with enhancements in public financial management capacity, also at the sub-national level, in order to ensure high rates of return for investment projects. The authorities understand the staff's concerns but they favor a structural deficit of 1 percent of GDP (the highest deficit allowed under the new fiscal framework, measured under a methodology that is still to be decided).[9] The fiscal implications of this policy are difficult to evaluate because the authorities are still in the process of designing the methodology to calculate the structural fiscal balance that will be applied under the new fiscal law. Staff cautioned the authorities against implementing an unduly expansionary policy in 2015.

22. The recent reduction in the policy rate was undertaken against the background of a decelerating economy and weak business and consumer confidence. In staff's view, the reduction in the policy rate in November 2013 was adequate given that non-food/non-fuel inflation was within the target (albeit on an upward trend partly due to pass-through effects), inflationary expectations remained well-anchored, confidence was still recovering, and the economy had weakened faster than anticipated. The BCRP will need to continue to be vigilant and implement policies flexibly in 2014. Additional monetary policy easing should be avoided unless there is evidence of a renewed economic slowdown since an undue monetary easing may compromise

[8] The structural fiscal balance corrects for the business cycle (which affects non-mining revenues) and deviations of metal prices from a long-term "shadow" price (which affects mining-related revenues). The key parameters needed for the calculation of the structural fiscal balance are: (i) the output gap; and (ii) the "shadow" price of metals (to be used in calculating structural mining-related revenues). Staff's methodology uses a Hodrick-Prescott filter to measure the output gap, and an 8-year moving average of metal prices (centered on 5-years backward and 3-years forward, based on WEO projections) as the "shadow" price of metals.

[9] A commission has been appointed to propose the methodology used in the calculation of the structural fiscal balance under the new fiscal framework. The commission is expected to announce their conclusions by February 2014. Without knowing the methodology used by the authorities to measure the fiscal balance, it is difficult to assess the policy of a structural fiscal deficit of 1 percent of GDP, as it could entail a positive or negative fiscal impulse. For instance, if a heavily backward-looking price for metals is used to gauge the relevant structural price, it would entail a relatively low "shadow" price of metals and relatively low structural revenues, which could yield a structural deficit higher than 1 percent of GDP. In such a case, the authorities' objective (a structural deficit of 1 percent of GDP) would require a fiscal tightening. Needless to say, if the commission were to follow a methodology similar to the one used by staff, it would entail—if fully executed—a fiscal impulse of over 1 percent of GDP in 2015.

inflation objectives (especially as inflation is already near the top of the inflation band) and induce capital outflows. Once the economy recovers, consideration should be given to unwinding the recent policy rate reduction to prevent a buildup of inflationary pressures, especially since interest rates abroad are likely to rise, creating additional incentives for capital outflows. An additional issue for the BCRP to continue closely monitoring is the real estate market to ensure its proper functioning and to prevent the development of bubbles (Box 3).

23. The authorities have indicated that they would consider additional monetary easing if the economy remained weak and inflation expectations low, but remained committed to their inflation target. The authorities were of the view that monetary conditions could be eased through lower reserve requirements to foster private credit growth or a further lowering of the policy rate if the economy remained weak. The authorities argued that if long-term interest rates in the U.S. were to increase, that would not necessarily lead to a change in monetary policy in Peru as the exchange rate is flexible and would adjust. The authorities felt that higher long-term rates in the U.S. would lead to a re-pricing of long-term Peruvian bonds but that short-term rates in nuevos soles would likely continue to be anchored to the policy rate. The authorities also stressed that they remain committed to the inflation target band (1–3 percent) and that they have been successful in implementing the inflation targeting framework. The BCRP stressed that if they see any risks of inflation going above or below the target band, they would act immediately to contain pressures. Staff acknowledged the effectiveness of the BCRP in keeping inflation under control and within the announced band for most of the period since the implementation of the inflation targeting regime in 2002.

24. Maintaining exchange rate flexibility has been instrumental in cushioning the economy against external shocks. As the current account deficit deteriorated and private capital inflows declined, the BCRP has become a net seller of foreign exchange while allowing the currency to depreciate. In these circumstances, staff welcomed the higher exchange rate flexibility and encouraged the authorities to continue strengthening the role of the exchange rate as a shock absorber. Going forward, the exchange rate should continue to be driven by fundamentals, while limited foreign exchange intervention could be necessary to limit volatility and contain excessive risks to the balance sheets in a still highly dollarized economy (Box 4). Such intervention will need to continue to be sterilized to prevent large swings in credit expansion and undue movements in the interbank rate. Increasing exchange rate flexibility will create further incentives for the deepening of the forwards (and other derivatives) market as the private sector internalizes exchange rate risks, which in turn could support further de-dollarization of the economy.

25. The authorities remain committed to maintaining a flexible exchange rate regime. The authorities agreed with the staff's assessment that the exchange rate is in line with fundamentals, and stressed that they will continue intervening to ensure an orderly functioning of the FX market. The authorities remain concerned about excessive volatility of the exchange rate in the context of a relatively dollarized economy but adhere to a flexible exchange rate policy and do not target any pre-determined level of the exchange rate.

26. Macro-prudential policies should remain well targeted to reduce vulnerabilities. In addition to the recent macro-prudential measures to deter the growth of dollar loans, there is a need for measures to discourage un-hedged foreign exchange exposures. The high positive spread between reserve requirements on dollar deposits and those on local currency deposits needs at least to be maintained, if not increased, to discourage dollarization. This would put downward pressure on dollar deposit rates and an upward pressure on dollar loan rates. In the event of reversals of capital inflows, the authorities would unwind previous tightening of reserve requirements (while maintaining the spread between dollar and local currency RR) to provide an adequate level of credit to the economy. Regulatory standards need to continue to be strengthened in line with Basel III recommendations while ensuring the provision of an adequate level of private credit to the economy (Annex V). While the overall financial system remains healthy and strong, the recent deterioration of financial soundness indicators for some non-bank deposit-taking institutions warrants closer monitoring and supervision.

B. Spillovers and Triggers for Utilizing Buffers

27. Inward and outward spillover risks are limited.

- ***Inward spillovers are more relevant***. They could manifest via capital flows through financial ties to the U.S. and Canada, and to a lesser extent to Spain and Chile. Foreign banks (mainly from Spain, Canada, and the U.S.) play a big role in the financial system, but are locally funded. Inward spillovers could also take place via trade channels through commercial ties with China and the U.S.

- ***Outward spillovers are quite limited***. They relate to regional trade with Chile, Colombia, and Mexico (where the integration is increasing under the "Pacific Alliance") as well as other countries in the region (Argentina, Bolivia, Brazil, and Ecuador).

28. The authorities and staff agreed that while vulnerabilities have increased, current buffers are sufficient to address a variety of possible shocks. Preserving policy flexibility by continuing with a good track record of appropriate policy responses to adverse circumstances remains instrumental in addressing future challenges. Large buffers have been accumulated, taking advantage of positive terms of trade and income windfalls, but also as a result of adequate policy actions (Box 5). Staff discussed with the authorities the external vulnerabilities and subsequent policy responses. There was broad agreement that there were two important external risks to the Peruvian economy: (i) the uncertainty related to the withdrawal of monetary stimulus in the U.S. in the short-term; and (ii) the deterioration in growth prospects in China over the medium-term.

- ***Protracted economic and financial volatility in the short term.*** Unexpected effects in the withdrawal of monetary stimulus in the U.S. could disrupt global financial flows and lead to sudden stops and reversal of non-FDI capital flows to Peru. As done in previous occasions, this would require the BCRP to deploy resolute actions to maintain confidence and ensure an orderly functioning of markets. As in the case of the Lehman crisis, exchange rate flexibility and the use

Peru: Risk Assessment Matrix[1]					
	Shock	Direction	Relative Likelihood	Impact	Policy Response[2]
Short-term	**Protracted economic and financial volatility**, including capital flow reversal, especially for emerging markets (triggered by prospective exit from unconventional monetary policy, lower than anticipated potential growth).	↓	High	High	Use the exchange rate as a shock absorber and international reserves to avoid overshooting. Ease monetary and macro-prudential policies to avoid a credit squeeze. A temporary fiscal impulse could be considered if a credit crunch affects economic activity.[3]
	Financial stress in Euro area re-emerges (triggered by stalled or incomplete delivery of national and euro area policy commitments).	↓	Medium	High	Use the exchange rate as a shock absorber and international reserves to avoid overshooting. Ease monetary and macro-prudential policies, temporary fiscal stimulus.[3]
Medium-term	**Sharp slowdown in China** (build up of excess capacity eventually resulting in large financial losses).	↓	Medium	Low	Allow for higher exchange rate flexibility and use liquidity buffers, repo operations and dollar swap auctions together with an easing of monetary conditions to ensure the stability of the domestic financial sector and avoid a credit squeeze. A temporary fiscal stimulus could be considered if credit affects economic activity.[3]
	Sustained decline in commodity prices (triggered by deceleration of global demand and coming-on-stream of many global excess capacity new projects while global demand remains weak).	↓	Low	High	Use exchange rate as a shock absorber, ease fiscal policy temporarily, and undertake structural measures to improve productivity and investment climate to reduce investment costs. A temporary fiscal expansion could ease the adjustment to lower income.[3]
	Reversal in private sector investment (in non-renewable resources, due to continuing weak commodity prices, Peru-specific).	↓	Low	High	The exchange rate could initially absorb some of the shock. Ease fiscal policy temporarily to smooth impact on aggregate demand and income.[3]

[1] The Risk Assessment Matrix shows events that could materially alter the baseline path. The relative likelihood of risks listed in the staff's subjective assessments of the risks surrounding the baseline. The G-RAM reflects staff views on the source of risk and overall level of concern as of the time of discussions with the authorities in November 2013.

[2] Policy response recommended by staff.

[3] Starting in 2015, fiscal response guided by the escape clauses stipulated in the new fiscal law.

of reserves and liquidity buffers, as well as conducting repo operations and dollar swap auctions would help ensure liquidity in the financial system. Peru is exposed to non-FDI capital flow reversals as non-residents hold a large portion of the public debt (although the amounts are small compared to the reserve buffers). In the event of a sudden capital outflow that put downward pressure on domestic credit and growth, a temporary fiscal stimulus might be appropriate within the limits of the new fiscal framework. As monetary conditions are expected to tighten in the U.S. in the next several months with the "tapering" of asset purchases by the USFR, staff was of the view that this might put upward pressure on domestic interest rates in Peru. In these conditions, staff felt that further monetary policy easing may not be appropriate as it could fuel further capital outflows. The BCRP considered instead that they will continue to manage an independent monetary policy, establishing the policy rate with the aim of achieving domestic objectives, while continuing using macro-prudential measures to manage financial risks, with a floating exchange rate.

- ***Deterioration in growth prospects in China over the medium-term*** could be produced from a re-balancing of demand in China towards consumption, leading to a global stagnation, a reduction in external demand, a sharp deterioration in terms of trade (due to a decline in commodity prices), and a slowdown of the Peruvian economy with deflationary risks. In this case, the exchange rate should work as a shock absorber, although there are risks given the dollarization of the financial system. Monetary and macro-prudential policies could be relaxed to ease the adjustment cost, ensure proper credit flows, and to support economic activity. If there is a more pronounced slowdown in Peru's growth, a temporary fiscal impulse could be used (possibly under the escape clauses stipulated in the new fiscal law) to smooth the path to a lower growth trajectory.

C. Preserving Strong Growth Momentum

29. A solid growth record and efforts to maintain a favorable investment climate have placed Peru in a strong position in cross country comparisons. According to the World Economic Forum's "Global Competitiveness Report" for 2013, Peru retained its 61st position (out of 148 countries; and 3rd in Latin America). Macroeconomic policies and market efficiency are the main strengths, while weak public institutions, weak governance, education, and infrastructure are cited as the main liabilities. According to the World Bank's "Doing Business Report" for 2013, Peru remains in 43rd place (out of 189 countries); however, the report mentions contract enforcement and insolvency resolution as areas that remain weak. The processes for opening up a business and obtaining building permits continue to be relatively inefficient, while a lack of urban planning deters investments in manufacturing despite still competitive land prices.

30. Important structural reforms are being implemented with the aim of improving competitiveness and productivity. Staff stressed the need to prioritize and sequence structural reforms. While the authorities agreed with the principle of sequencing, they felt that given the need to strengthen potential growth in the near term, a multi-pronged approach was necessary, focusing on infrastructure and education. As a result, they are trying to implement many reforms at the same time.

- ***A far-reaching civil service reform bill***. This reform, which standardizes workplace regulations and salary scales, increases training for staff, and institutes performance evaluations. The reform has been approved by Congress, despite some opposition from state workers, and it is expected to enter into effect shortly.

- ***A reform of the private pension system***. The reform aims at generating greater public access and lower fees passed last year, but some aspects of the reform have been delayed. In particular, the compulsory membership of independent workers (whose contributions were previously optional, unlike salaried workers), was criticized by some civil society groups, and its implementation was delayed by Congress in September 2013 for one year. In the meantime, the SBS is implementing regulations which will facilitate their access to the system along with revising investment guidelines for private pension funds.

- ***Capital market regulation***. Specific regulations aiming at reducing the cost of issuing new securities has been approved, with legislation pending on strengthened corporate governance and financial reporting requirements. Moreover, an initiative to align the taxation of capital instruments across the Integrated Latin American Market (MILA) and the Pacific Alliance countries is also in progress.

- ***Improvements in labor market competitiveness***. This process is being pursued, inter alia, through an ongoing reform of Certification and Normalization of Labor Competition enacted in 2012. The goal of the reform is to reduce the high costs of employment not only through improving the system of compensation, but most importantly through raising labor productivity.[10] The latter includes better training opportunities through education credits and scholarships, enhancement in the quality of training centers, and increasing the share of foreign workers in the labor force in the specialized career streams. Over the period of five years, the authorities expect these efforts to improve productivity by 20–30 percent.

- ***Measures to boost productivity***. A number of other initiatives to strengthen production and facilitate commerce are being adopted, including the introduction of credit insurance for exports for small and medium-size enterprises and establishment of the fund for science, innovation and technology. Reforms are also targeted at improving the national system of quality, and spurring the development of the logistical services in the transportation sector.

31. Significant headway has been made in reducing poverty, child malnutrition and broadening existing social projects while advancing new ones. As part of the national strategy

[10] Non-salary labor costs to the employer are amongst the highest in the region. Depending on the type of the enterprise, these additional costs of employment (which include transfers to the individual employee unemployment protection accounts and up to three month salary bonuses) could range from 14 to 70 percent of the expenses on salaries.

for inclusive growth, social agenda was pursued through broadening the existing projects (*Juntos, Cuna Mas,* and *Qali Warma*) and advancing new initiatives to increase transparency, such as designing a registry of beneficiaries. The number of beneficiaries of the conditional cash transfer program increased from around 1 million in 2011 to over 1½ million by mid-2013 while its budget grew almost 30 percent last year. The budgets of the other social programs to combat poverty have also increased, which helped reduce child malnutrition to around 18 percent in 2012 from 28½ percent in 2007, and reduced poverty to 25¾ percent in 2012 from 55½ percent in 2005. There still remain some challenges, especially in improving the system for targeting extreme poverty.

32. Going forward, structural policies will need to continue to be implemented swiftly to strengthen growth prospects over the medium term. Lower metal prices may slow mining-related capital inflows leading to lower capital accumulation and potential growth, and should be compensated with additional reforms to support potential growth prospects. Levels of investment and capital accumulation in Peru have been relatively high by regional standards with a ratio of investment to GDP at over 25 percent. Labor has been rapidly absorbed by the economy and the unemployment rate is at record lows. Against this background, further increases in productivity will be the main driver in preserving the strong growth momentum and achieving convergence to the higher level of income of other economies in the region, such as Chile and Brazil (Box 6).

33. With tax revenue under pressure from the fall in revenue from metals, achieving ambitious tax targets would require more resolute efforts. The institutional framework and the comprehensive overhaul of the organization of the tax collection agency (SUNAT) were approved last year, and good progress was made in doubling capacity, coverage and control process, which is evident by the good performance of income and sales taxes. Work is ongoing in improving the system of risk controls, especially in customs, better diagnosing the system's bottlenecks and improving information systems. Despite this progress, additional efforts are needed to continue improving tax collections, reduce the high level of informality and tax evasion, and decrease exemptions which amount to about 2 percent of GDP. The provision in the new fiscal law to publish data on exemptions and contingent liabilities along with the budget documentation will increase transparency and accountability.

34. The authorities need to continue enhancing financial supervision and macro-prudential measures to prevent the buildup of systemic financial risks. The dominance of large and complex financial conglomerates in the Peruvian financial system could be a source of systemic vulnerabilities and has contributed to the high interest rate spreads relative to regional and income peers. In this regard, further enhancement of the macro-prudential policy framework through the oversight of corporate and household balance sheets, and strengthening the legal or regulatory framework for financial stability would be needed to further reduce systemic risk. Increasing competition and easing access to alternative sources of funding through capital market reforms would facilitate effective allocation of savings in the economy and help to reduce interest rate spreads. In this regard, recent measures to reduce transaction costs in the stock market are welcome and likely to have a positive impact in the development of capital markets,[11] but further market inefficiencies will remain and additional measures to strengthen the capital market through creating a private offering regime for sophisticated investors with minimal requirements, streamlining the debt offering regime, and strengthening the equity offering regime in line with the recent technical assistance recommendations will help ease access to non-bank finance. The creation of the MILA with the integration of the Chilean, Colombian, and Peruvian stock markets is also expected to increase market liquidity and the spectrum of investible assets.

35. All in all, perseverance in structural reform implementation would be essential to preserve growth momentum and fulfill social goals. While the recent reforms should result in higher productivity and friendlier investment climate, more resolute efforts will be needed to ensure greater labor market flexibility, upgrade human capital, and define a comprehensive public investment strategy. Reducing the economy's informality, achieving ambitious tax revenue targets (which aim to raise funds for social needs), and strengthening the judicial system will also go a long way in bolstering growth prospects and ensuring all-inclusive gains in the living standards.

STAFF APPRAISAL

36. The overall state of the economy remains strong despite lower metals prices and recent market turbulence. Peru continues to be one of the most dynamic economies in the region, and one with the largest buffers thanks to past strong policy implementation. With an economy growing somewhat near potential, macroeconomic policies should remain relatively neutral, unless additional turbulence in markets emerges or other downside risks materialize. Preserving policy flexibility by continuing with a good track record of appropriate policy responses to adverse circumstances remains instrumental to addressing future challenges. Risks are balanced. While external risks are tilted to the downside, domestic risks are on the upside. Significant terms of trade gains could be reversed if growth deteriorates in main trading partners, reducing income, investment, and growth. Sudden stops and reversal of some (non-FDI) capital flows to Peru (due to tightening of global financial conditions) could put pressure on the financial system and further decelerate growth. While these risks are significant they should be contained given a strong policy track-record, ample fiscal space, and large foreign exchange reserves. Aggressive implementation of structural reforms and infrastructure projects should help offset these risks. On the domestic side, large mining and infrastructure projects could be implemented at a faster pace thereby increasing growth.

[11] The authorities recently announced that the commissions on the Lima Stock Exchange will be reduced by 53 percent, effective November 2013, as part of the effort to reduce the transaction cost and attract more small and medium-sized companies to the bourse.

37. The fiscal objectives in the 2014 budget are broadly appropriate to maintain macroeconomic stability. Staff estimates that instead of a planned balance, the outcome will most likely be a small surplus (given past rates of expenditure implementation), which is counter-cyclical (given an emerging negative output gap) and broadly appropriate given the soft economic conditions at present. Staff welcomes the approval of the new fiscal responsibility law and the new fiscal framework. Over the medium term, staff recommended to aim for small structural surpluses (of around ½ percent of GDP a year) to address contingent liabilities and natural disasters risks, which are high in Peru. When integrating the new fiscal framework into the budget process, it would be important to take into account the aforementioned fiscal risks, as well as the need to close the infrastructure and social gaps over time. A strong political commitment as well as the steady implementation of a fiscal rule is equally important.

38. With inflation expectation in check, a neutral monetary policy in the near term would be appropriate, but continued flexibility needs to be exercised as global interest rates rise. The recent uptick in headline inflation was caused by temporary supply factors, while inflation expectations remain well-anchored. Staff stressed the need for the BCRP to focus on maintaining core inflation in check. The BCRP will also need to exercise caution in managing monetary policy in the context of a likely increase in long-term global interest rates.

39. Greater exchange rate flexibility observed over the past year is welcome as the exchange rate continued to be used as a shock absorber. The exchange rate ought to continue to be driven by fundamentals over the medium and long term, while limited foreign exchange intervention could be necessary to reduce volatility and to contain excessive risks to the balance sheets in a still highly dollarized economy. Given external risks, intervention is more likely to be on the sale side. Such intervention will need to be properly sterilized to prevent a credit crunch and unnecessary upward pressure in the interbank rate. Increasing exchange rate flexibility will create further incentives for the deepening of the forwards (and other derivatives) market as the private sector internalizes exchange rate risks, which in turn could stimulate the de-dollarization of the economy.

40. Macro-prudential policies should continue to be well targeted to reduce vulnerabilities. In addition to recent macro-prudential measures to deter the growth of dollar mortgage and car loans, there is a need for measures to discourage un-hedged foreign exchange exposures of households and corporations. The high spread between reserve requirements on dollar deposits and that on local currency deposits needs to be maintained to discourage dollarization. While the overall financial system remains healthy and strong, the recent deterioration of financial soundness indicators for some non-bank deposit-taking institutions warrants closer monitoring and supervision.

41. While vulnerabilities have increased, current buffers are sufficient to address possible short-term shocks. Increased risk aversion due to the "tapering" of asset purchases by the U.S. Federal Reserve could lead to a reversal of capital inflows, necessitating the central bank to deploy resolute actions to maintain confidence and ensure orderly functioning of markets as was done during the global financial crisis in 2008–09. Slower global growth could lead to lower external demand and deterioration in terms of trade, the exchange rate should work as a shock absorber, although there are risks given the dollarization of the financial system. Monetary and macro-prudential policies should be relaxed to support economic activity. If the economic slowdown is too pronounced, consideration could be given to use a measured and temporary fiscal impulse.

42. Resolute efforts are necessary to achieve ambitious tax targets. Staff welcomes the good progress made in doubling capacity, coverage, and control process, which is evident by the good performance of income and sales taxes. To bring Peru's tax collections at par with other emerging market economies, decisive steps will continue to be necessary in persevering with reform efforts and in reducing a high level of informality, tax evasion, and exemptions.

43. Recent efforts to increase the country's growth potential and ensure inclusive growth are welcomed. Progress has been made in enhancing competitiveness by reducing barriers to investment and increasing effectiveness of the public and private sectors, further developing the local capital markets, and reforming of the private pension system to generate greater public access and savings. Social agenda was pursued through broadening the existing projects and advancing new social programs to ensure inclusive growth. Further progress is warranted to boost productivity through increasing labor market flexibility, reducing non-salary costs, upgrading human capital, removing infrastructure bottlenecks, and strengthening institutions. Prioritization of structural reforms, including through designing a holistic nationwide infrastructure strategy, will be key to preserving strong growth momentum.

44. It is proposed that the next Article IV Consultation with Peru take place on the standard 12-month cycle.

Box 1. Peru: Initiatives to Speed Up Investment

Two investment incentive packages were launched in 2013 and directed at easing procedures to carry out investments. The objective is to facilitate public and private investment, especially in energy, mining and infrastructure, and cutting red tape. The main measures can be grouped into three categories: (i) administrative enhancements; (ii) tax related incentives; and (iii) new legislation.

Administrative Enhancements

- ***Creation of a monitoring team for investment projects.*** The team will aim at removing bureaucratic obstacles to the most important infrastructure, mining, and energy projects.
- ***Measures to facilitate the investment process.*** Adoption of measures to strengthen the capacity of *Indecopi* (the institute that promotes competition) to penalize public entities and officials who generate bureaucratic obstacles, while at the same time providing incentives for speeding up projects as a part of the program to modernize municipalities.
- ***Actions to promote the development of small and medium-sized companies.*** The measures promote the use of negotiable bills, which gives greater liquidity to SMEs and makes payments from the government more predictable.

Tax Related Incentives

- ***Administrative directives to boost competitiveness.*** These measures greatly reduce the time required by companies to take advantage of the early return of the VAT, and allow tax credits for research spending and personnel training (for a three-year period, extendable thereafter).
- ***Tax liability reductions for investments in public goods.*** The regime that reduces tax liabilities in return for companies investing in public goods in certain areas was extended to public investment in general. Previously, it could only be used for infrastructure works and in regions that applied levies, surcharges and royalties. In addition, maintenance works and pre-investment studies are now also included in the system. All projects will be approved *a priori* in the national investment plan (SNIP).

New Legislation

- ***Certification of non-existence of archeological objects.*** This law reduces to 20 days the government response to requests for certification of non-archeological items, which allows construction. If the government fails to respond within that period, the request is automatically approved. In the past it took around a year and a half for this certification to be issued.
- ***Expropriations.*** A new provision separates the expropriation of an asset from the reparation payment. It speeds up the acquisition of land for executing projects declared of public interest. This procedure is expected to take a few months and it used to take between two and three years, requiring the approval of ten different entities. The projects that have benefited from this law include the *Interoceánica Sur* highway and the *Chinchero* airport.
- ***One-stop-shop for environmental impact studies (EIS).*** The law establishes that the terms of reference for the EIS must be ready in less than a month. This procedure used to take between one and two years.
- ***Stock market.*** This law reduces the requirements and costs for accessing finance through the capital market for medium-sized and small companies.

Box 2. Peru: New Macro Fiscal Framework

The macro-fiscal framework embedded in the fiscal responsibility law of 1999 was very effective in strengthening public finances and reducing public debt. However, while the dependence of the economy on natural resources grew, the framework lacked provisions for counter-cyclical fiscal policy, did not shield the budget from resource revenue volatility, and did not lead to higher public savings in the period of record commodity prices. When measured by the correlation between the change in the cyclical component of government expenditures and the output gap, Peru displays a high level of pro-cyclicality compared to other emerging economies. Fiscal policy management has also been complicated by changes in the rules regarding coverage of expenditures; frequent use of supplementary credits; the unpredictable use of outstanding balances by sub-national governments; and the multiplicity of rules and their hard-to-grasp nature (which is a problem particularly at the sub-national level).

A new macro-fiscal framework was approved by Congress in 2013. The Peruvian authorities appointed a technical committee of experts in 2012 to assist them in revamping the fiscal framework**.** Based on its recommendations, the *Bill to Strengthen Fiscal Responsibility and Transparency* was submitted to Congress in September and approved in October 2013. The revised framework: (i) incorporates medium-term fiscal objectives to be followed by every administration; (ii) introduces a concept of counter cyclicality into the budget planning process by focusing on the structural balance; (iii) outlines a stronger regulatory structure though a more comprehensive spending rule, the creation of an independent body to contribute to the technical analysis of fiscal and macro policy, and corrective actions in cases of breaches in the fiscal rule; and (iv) defines the scope of public expenditure coverage for national government and sub-national governments, and simplifies and strengthens their macro-fiscal frameworks when it comes to monitoring, provision of support and corrective actions. Some detailed provisions of the new framework include:

- ***Structural fiscal objective***. After general elections, the new administrations within 90 days of taking office has to present a declaration of the macro-fiscal policy for the period of the presidential mandate, with a numerical structural fiscal objective for the presidential period which cannot be a deficit higher than 1 percent of GDP.
- ***Budgetary implications***. The limit of non-financial public spending has to be aligned to the structural fiscal objective as well as the assumptions on revenues consistent with the business cycle and commodity prices. The limit can be altered if spending in the previous year was less than budgeted. In that case, the amount of subsequent year's spending can be adjusted upwards by no more than 0.2 percent of GDP.
- ***Countercyclical policy***. If there is a positive or negative output gap of at least 2 percent of potential GDP, the spending limit should be adjusted through transitory counter-cyclical measures which together cannot exceed 0.5 percent of GDP.
- ***Fiscal revenues***. If measures are adopted to generate a permanent increase in fiscal revenues of at least 0.3 percent of GDP, the spending limit can be adjusted by the same amount.
- ***Regional and local governments***. The level of debt cannot be more than 100 percent of the average total current revenues of the last four years, and the annual growth of non-financial expenditure cannot be more than the moving average growth of annual revenues over the past four years. The governments can only borrow under the state guarantee and only for capital projects.
- ***Corrective measures.*** In case of upward deviations from the spending limit, corrective measures are to be taken within two years if over-spending is below 0.5 percent of GDP and immediately if it is above this threshold, with an exception of those years when there is a negative output gap of more than 2 percent of potential GDP.

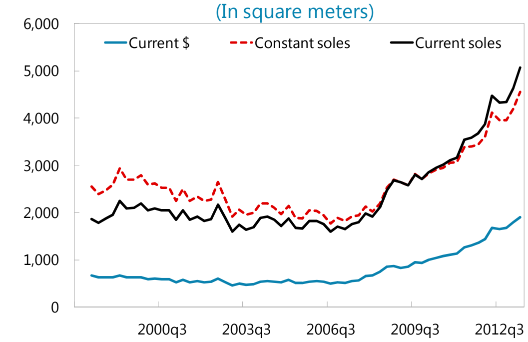
Box 3. Peru: Are Real Estate Prices Misaligned?

Real estate prices have risen substantially over the past few years. Since mid-2007, the price per square meter of high-end real estate in Lima has increased by 245 percent in U.S. dollar terms. Prices in mid-market real estate have evolved in a similar fashion. The BCRP has pointed toward robust growth in income, employment, mortgage credit, and lower real interest as key drivers.[1]

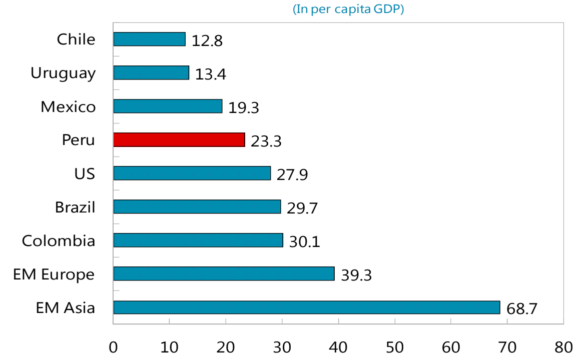
However, deviation of prices from fundamentals has apparently been minimal.[2] Estimating a co-integrated VAR (with real housing prices, real interest rate, real per capita GDP, and population) Cubeddu, et. al. (2012) found the Peruvian housing market to be near fair values. BBVA (2012) independently also noted that prices per square meter in Lima were only slightly above their equilibrium values based upon real incomes, home supply, and construction costs.

Traditional house price metrics also appear be remain solid. Despite the increase in price per square meter, the *accessibility index* (home price/per capita income) compares well to other markets and has remained stable over the last few years. Moreover, the *ratio of house prices to annual rental income* has increased slightly to 15½ in 2013 from around 13½ in 2010.[3] While Peru's ratio is the second highest in the region behind Brazil (18), it is low in comparison to North American and emerging markets in Europe and Asia which range from 22 to 28. Although the *sales price to construction cost ratio* has jumped, the *sales price to land price ratio* has declined, reflecting the increasing price of limited buildable land areas in and around Lima.

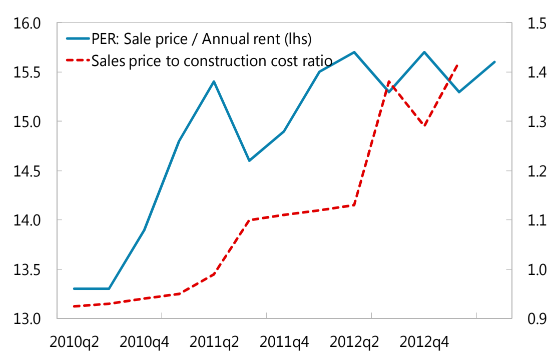
Peru: Prices of Apartments in Lima
(In square meters)



Peru: Comparative House Prices, 2012
(In per capita GDP)



Peru: Sales Price to Rents and to Costs



Recent prudential actions should slow mortgage credit and house price growth. Targeted prudential measures—capital charges on higher loan-to-value mortgages, dollar mortgages, and second homes along with higher dollar reserve requirements—have been implemented in 2013.

[1] Mismatches in particular market segments together with limited land supply and infrastructure shortages have also put upward pressure on prices. For example, more than 50 percent of effective demand is for housing priced below US$40,000 while only 4 percent of supply goes towards this market according to the methodology of the BBVA report (see next footnote).

[2] See Cubeddu, Tovar, and Tsounta, "Latin America: Vulnerabilities Under Construction" (2012), IMF Working Paper No. 12/193; and also BBVA's "Peru Real Estate Outlook" (2012).

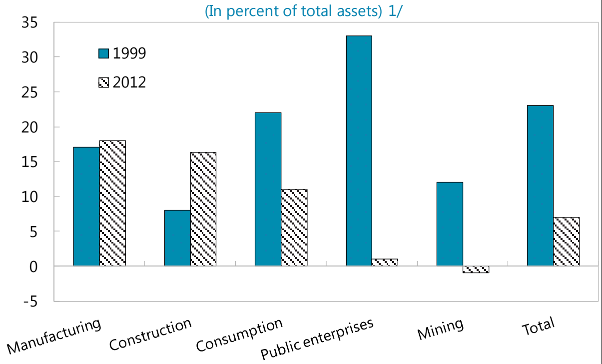
[3] Thus, current sale prices equal on average 15½ years of rental income. According to the Global Property Guide, a normal price ratio should fluctuate between 12.5 and 25.

Box 4. Peru: Currency Mismatches in the Corporate Sector

Currency mismatch of the corporate sector in Peru declined significantly over the last decade. As part of last decade's economy-wide de-dollarization process, the average foreign exchange imbalances of non-financial firms in Peru narrowed substantially to about 5 percent of total assets in 2012, from 25 percent in 1999 (excluding derivatives). Nevertheless, the decline in the economy wide average hides sectoral differences. In particular, manufacturing, construction and large scale retail (consumption) retain large FX imbalances of between 7 and 17 percent of total assets.

FX Imbalances of Non-Financial Firms

(In percent of total assets) 1/



1/ Dollar liabilities-dollar assets.

Private sector securitized debt denominated in U.S. dollars has increased, but remains manageable. Low U.S. dollar interest rates have increased Peruvian firms' appetite for issuing U.S. dollar debt. Since end-2010, U.S. dollar denominated debt securities placed abroad increased 2½ times, with a surge of Peruvian firms issuing U.S. dollar senior debt notes in the amount of some US$6 billion thus far in 2013. Overall, Peruvian-issued international debt securities now stand at about US$15 billion or 6⅔ percent of GDP. The immediate-term debt service commitments are, however, relatively small (about US$1 billion a year) and unlikely to create balance of payments difficulties.

International Debt Securities 1/

(In percent of GDP)

	Financial		Non-Financial		Total	
	2010	2013	2010	2013	2010	2013
Argentina	0.9	0.6	1.4	1.0	2.3	1.5
Brasil	1.9	2.4	1.1	1.6	3.1	4.0
Chile	2.5	3.7	6.2	7.3	8.7	11.1
Colombia	0.4	1.6	1.2	1.9	1.6	3.5
Mexico	0.9	1.2	3.7	6.1	4.6	7.3
Peru	**3.0**	**4.1**	**0.8**	**2.5**	**3.8**	**6.6**
Venezuela	0.3	0.3	4.2	6.4	4.5	6.7

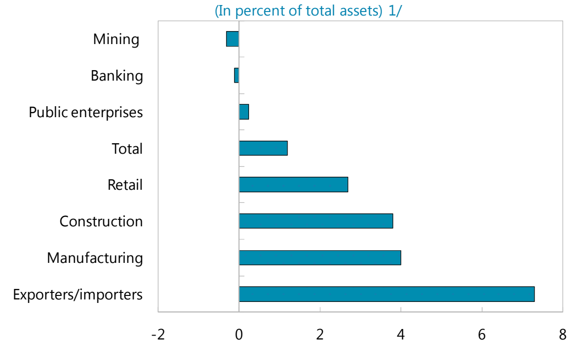
Source: BIS statistics.

1/ As of March 2013

The asset-liability currency mismatch makes Peruvian firms vulnerable to exchange rate volatility. Market analysts estimate that the depreciation of the nuevo sol by about 10 percent (equivalent to the rate of depreciation year-to-date as of September) would cause a 1 percent loss of Peruvian firms' assets, on average.[1] As expected, there were large differences among sectors, with trade experiencing losses of over 7 percent of total assets; manufacturing, construction, and large scale retail (consumption) sector losses between 2 and 4 percent. The banking and mining sectors would actually experience small gains. While the banking sector appears to have virtually no loss of its own (partly due to strict prudential regulations that prevent large currency mismatches), the large losses in other sectors (or individual firms) could be pointing to potential risks to banks.

Estimated Losses

(In percent of total assets) 1/



1/ Based on a 10 depreciation of the PEN/US$ exchange rate.

Strengthening macro-prudential policies through the oversight of corporate and household balance sheets could help contain currency mismatch risks. While macro-prudential policies that are directly targeted at risks emanating from the financial sector are welcome, systematic oversight of corporate and household balance sheets could help contain risks originating from the non-financial sectors.

[1] The calculations do not include off balance sheet items such as forward contracts, which may be providing FX cover to these imbalances.

Box 5. Peru: Income Windfall and Savings[1]

Commodity exporting countries across the world benefitted significantly from the recent boom in commodity prices. Latin America and the Caribbean (LAC), and Peru in particular, are no exception. In this context, and on the back of improvements in their macroeconomic fundamentals, several LAC countries experienced positive and large terms-of-trade shocks during the 2000s. In this regard, Adler and Magud (2013) document that although quite prominent, these shocks to the terms-of-trade were not larger than the events of the 1970s—though more persistent and more broad-based across countries. However, the income windfall associated with these shocks (defined as the difference between actual real income and the real income measured at pre-boom terms of trade) was much larger than in the 1970s.

In the case of Peru, the recent terms-of-trade boom started in 2003; and it is still ongoing. Over that period, the accumulated increase in the terms of trade was close to 62 percent. The accumulated income windfall associated with this shock is estimated at close to 8½ percent of GDP a year on average.

Emerging Latin America: Terms of Trade Booms, Income Windfall, and Saving Rates 1/

								Saving rates					
				Terms-of-Trade		Income Windfall		Boom (Upswing)					
		Length (years)		Shock 4/		(price effect) 5/		*Average 8/*			*Marginal (percent of IW) 9/*		
Countries	First Year	Up-swing 2/	Cycle 3/	Cum. (%)	Annual Avg. (%)	Cum.	Avg	Total	Domestic	Foreign	Total	Domestic	Foreign
Argentina 6/	2003	9	10	85.1	9.5	89.7	10.0	24.3	21.9	2.4	105.9	96.4	9.5
Bolivia	2003	10	10	131.1	13.1	190.1	19.0	21.7	15.9	5.8	74.6	15.1	59.5
Brazil	2006	6	7	37.2	6.2	17.1	2.9	18.0	19.1	-1.0	29.8	114.3	-84.5
Chile	2003	9	10	90.2	10.0	184.7	20.5	23.4	22.2	1.2	27.1	14.0	13.2
Colombia	2004	9	9	68.7	7.6	47.7	5.3	19.9	22.3	-2.3	91.5	116.3	-24.8
Ecuador	2002	10	11	74.9	7.5	116.8	11.7	22.4	22.2	0.2	42.8	58.6	-15.8
Paraguay	2002	3	3	89.2	29.7	55.6	18.5	17.9	16.2	1.7	36.9	13.8	23.1
Paraguay	2008	5	5	38.8	7.8	95.3	19.1	13.6	14.9	-1.3	-10.2	5.8	-16.0
Peru	2003	10	10	61.9	6.2	84.6	8.5	21.2	22.0	-0.8	74.6	57.8	16.8
Venezuela, Republica Bolivariana (	2003	10	10	233.3	23.3	303.9	30.4	33.6	24.1	9.4	47.5	24.6	23.0

Source: authors' estimations.
1/ For episodes with at least 15 percent cumulative and 3 percent annual average terms-of-trade shock (from start to peak).
2/ From start to peak.
3/ Start to end, with end identified as year when at least 1/3 of the shock is reverted (or 2012 if the latter is not met).
4/ Of goods and services, for upswing period (start to peak).
5/ In percent of income under the counterfactual (i.e., real income at pre-boom terms-of-trade).
6/ Results for Argentina are based officially reported data. The IMF has, however, issued a declaration of censure and called on Argentina to adopt remedial measures to address the quality of the official GDP and CPI-GBA data.
7/ Average of 3 years previous to the terms-of-trade boom (in percent of GDP).
8/ Aggregate average rates (percent of GDP).
9/ Aggregate marginal rates, in percent of income windfall (computed on the basis of average saving and investment rates of 3 years prior to the terms-of-trade boom).

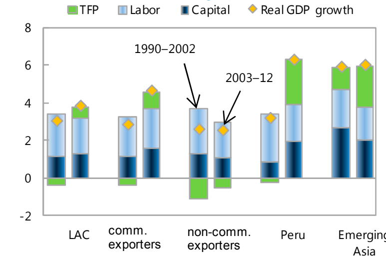
Against the background of very large income windfalls, it is worth analyzing how much of the windfall has been saved. While average saving rates appear high, marginal saving rates (i.e., how much of the windfall was saved) are actually low—and lower than in the 1970s, denoting a smaller saving effort than in past episodes. For Latin America, the median marginal saving rate has been 45 percent, slightly more than half of what was saved in the 1970s (i.e., 80 percent). In the case of Peru, the marginal saving rate, however, has been above the median, at 75 percent of the income windfall. Furthermore, most of this saving has been geared at increasing the stock of domestic capital, instead of improving the net foreign asset position—as in most of LAC. The latter, however, warrants some caution. Historical evidence shows that real income after the terms-of-trade boom ends is higher in countries that prioritized a stronger net asset position over using the extra income of the boom to expand the stock of domestic capital too fast.

[1] Prepared by Nicolas E. Magud, based on "Four Decades of Terms-of-Trade Booms: Saving-Investment Patterns and a New Metric of Income Windfall," IMF Working Paper 13/103 (Washington, D.C.).

Box 6. Why is Peru Growing Faster Than Other Countries in the Region?[1]

Latin America has enjoyed robust GDP growth in the past decade, with Peru being one of the best performers. However, there have been regional disparities. Commodity exporters (i.e., mostly South America) have grown, on average, 4¾ percent a year since 2003, (compared to about 3 percent the previous decade). These countries benefited from an unprecedented improvement in terms of trade and favorable external financial conditions. In contrast, non-commodity exporters have grown only about 2½ percent a year since 2003. Peru exhibited the strongest performance among the first group, with growth reaching an annual average of 6½ percent during 2003–12 (almost twice the average of the prior decade), similar to emerging Asian economies.

Figure 1. Contribution to Real GDP Growth
(Annual average, percent)[1]

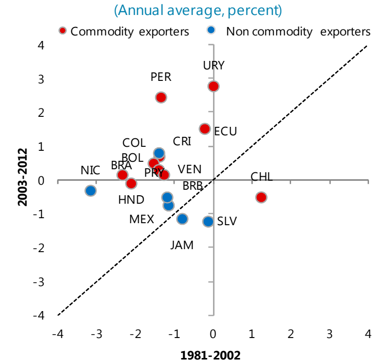


Source: Sosa, Tsounta, and Kim (2013).
[1] Simple average of countries within each group. Commodity exporters: Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, and Venezuela.
Non commodity exporters: Barbados, Costa Rica, El Salvador, Honduras, Jamaica, Mexico, and Nicaragua. Emerging Asia: China, Indonesia, Malaysia, Philippines, and Thailand.

Labor and capital accumulation were the main drivers of growth in the region. An output-decomposition exercise finds that factor accumulation accounted, on average, for 80 percent of the output growth among commodity exporters (Figure 1). Employment gains explain the high labor contribution to growth. The high contribution of capital, in turn, partly reflects favorable external financial conditions and high investment (including FDI) in the primary sector associated with the commodity price boom.

Productivity growth in the region mostly turned positive after exhibiting declines in previous decades. This partly reflects the expansionary phase of the cycle in these economies in 2003–12, as well as some structural factors such as the movement of economic activity away from the less efficient informal sector (Figure 2). However, in most countries, TFP growth continues to be tepid considering cyclical issues and comparing with emerging Asia.

Figure 2. TFP Growth
(Annual average, percent)

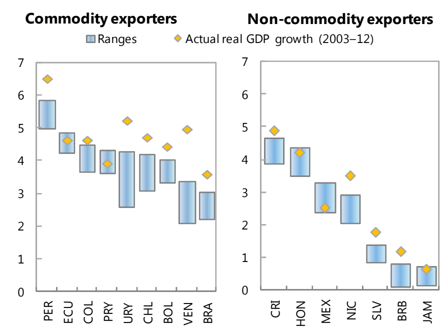


Sources: Barro-Lee (2010); IMF, *World Economic Outlook*; Penn World Table 7.1; and Fund staff calculations.

In Peru, improvements in TFP played a key role in driving the growth momentum like in emerging Asian economies. TFP accounted for almost 2½ percentage points of output growth on average during 2003–12. Furthermore, higher TFP growth—along with increases in the capital stock—explains most of the pickup in growth compared with the previous decades. After exhibiting declines in the 80s and 90s, TFP growth turned positive in Peru, reaching annual average rates of almost 2½ percent—one of the highest in the region. The marked decline in labor informality has played an important role in explaining this behavior.

Growth will be more challenging going forward. The recent deceleration has raised concerns about growth prospects in Peru and the region. Is the slowdown a temporary or structural phenomenon? Estimates of potential growth rates for 2013–17 are generally lower than those observed in recent years (Figure 3). As the low global interest rates that facilitated large capital flows to the region start to rise and commodity prices stabilize, growth of physical capital is likely to moderate. Moreover, the contribution of labor will be limited by some constraints associated with tight labor markets and, in some cases, demographic issues. In Peru, growth is projected to slow down in the next years (reflecting both cyclical and structural issues), yet potential growth will remain among the highest in LAC at quite robust rates.

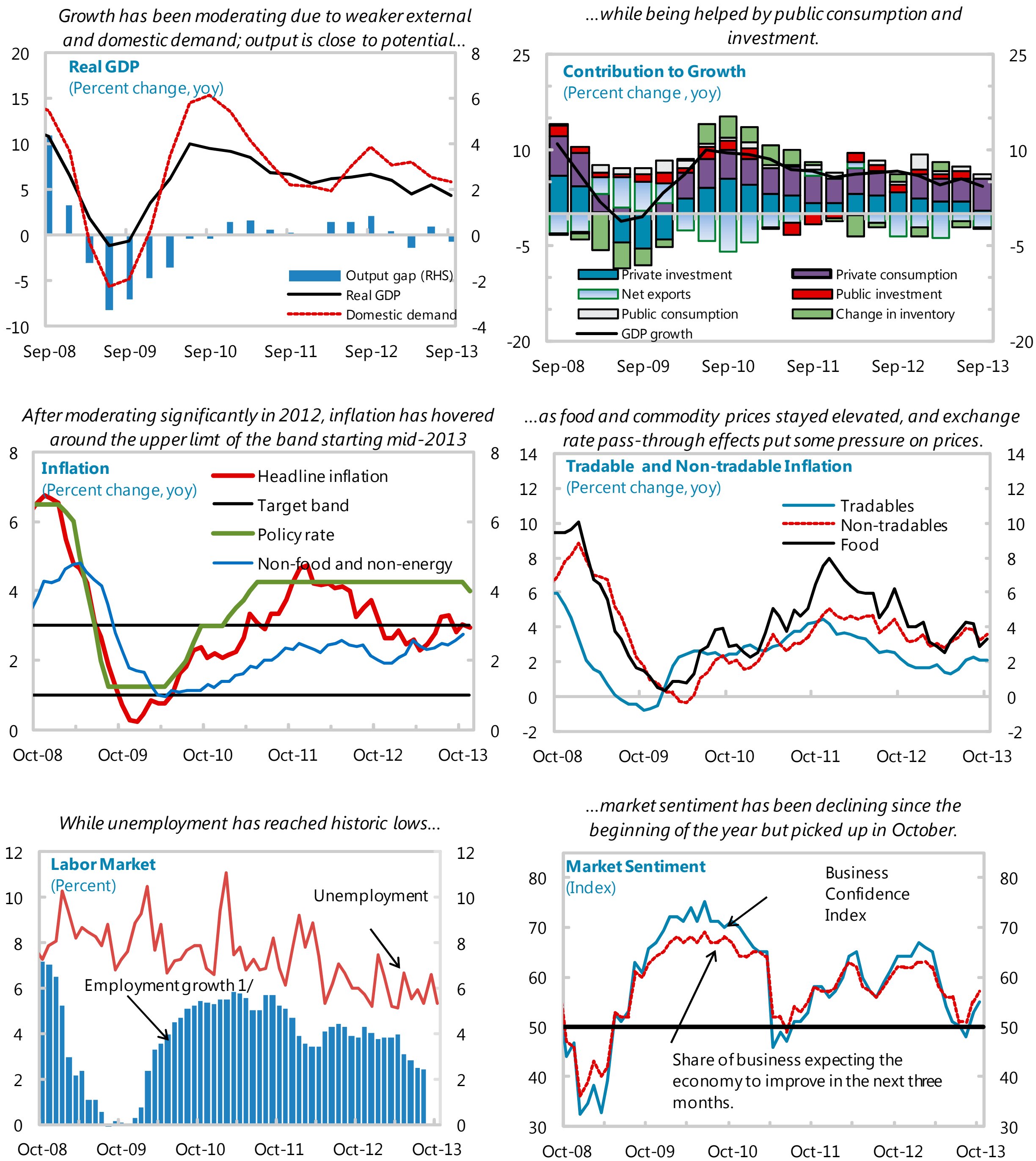
Figure 3. Potential Output Growth Ranges, 2013-17
(Annual average, percent)



Source: Sosa, Tsounta, and Kim (2013).

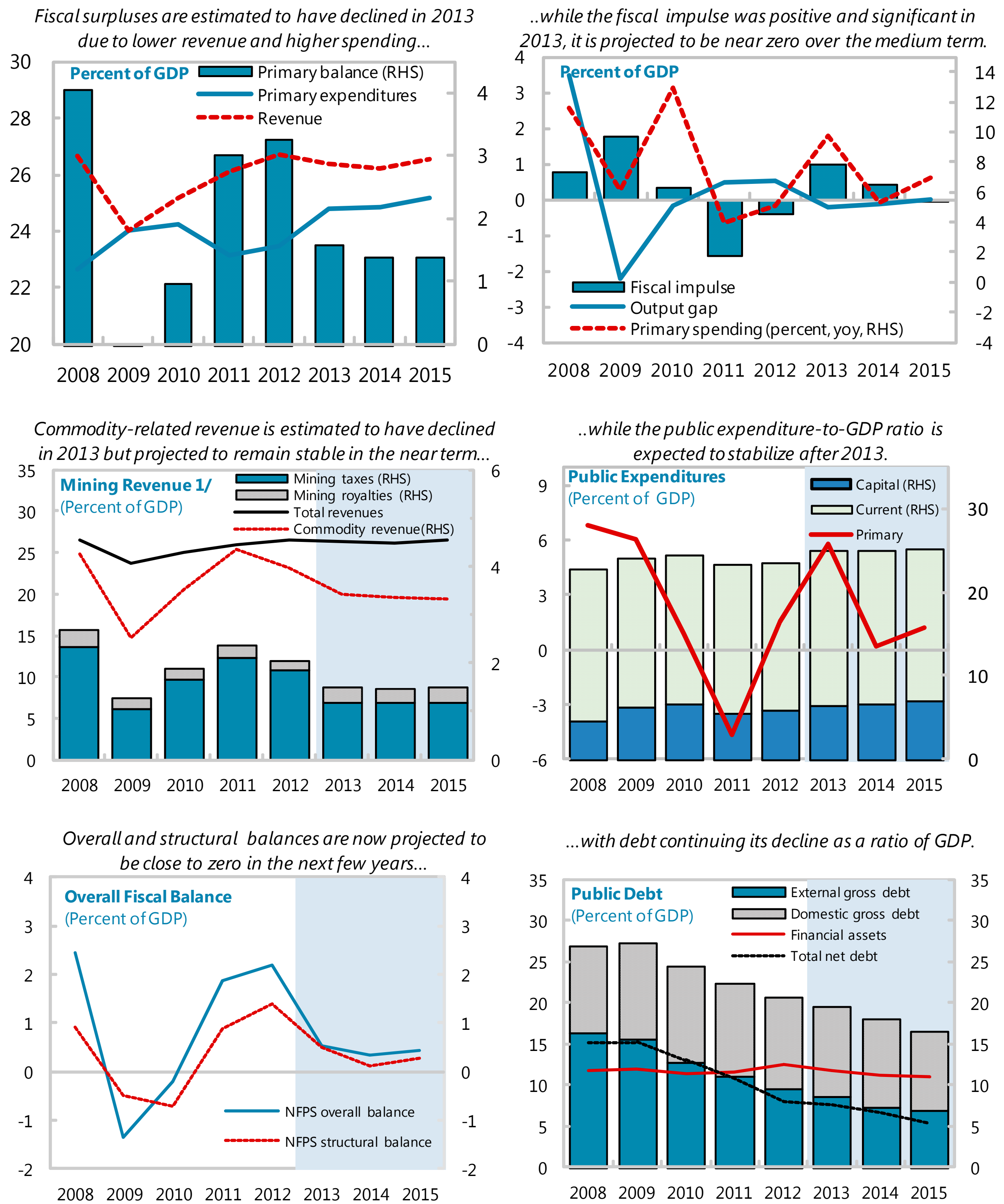
[1] Prepared by S. Sosa, based on Sosa et.al. (2013), "Is the Growth Momentum in Latin America Sustainable?" IMF Working Paper No. 13/109.

Figure 1. Peru: Real Sector Developments



Sources: BCRP; INEI; and Fund staff calculations.
1/ In firms with 10 or more employees, all urban areas.

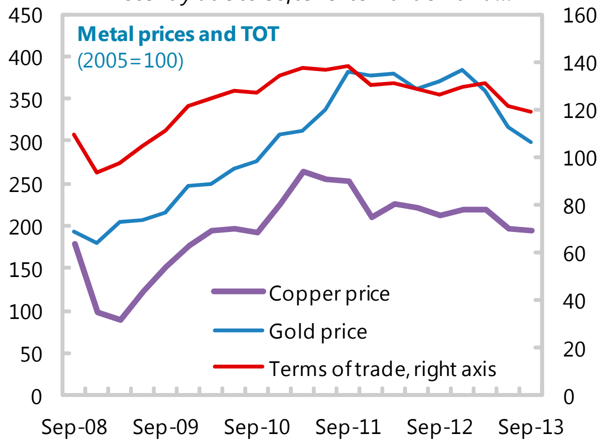
Figure 2. Peru: Fiscal Sector Developments



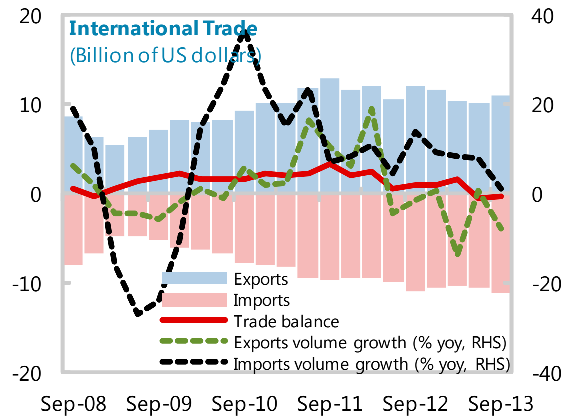
Sources: Ministry of Economy and Finance; and Fund staff estimates.
1/ Net of restitutions.

Figure 3. Peru: External Sector Developments

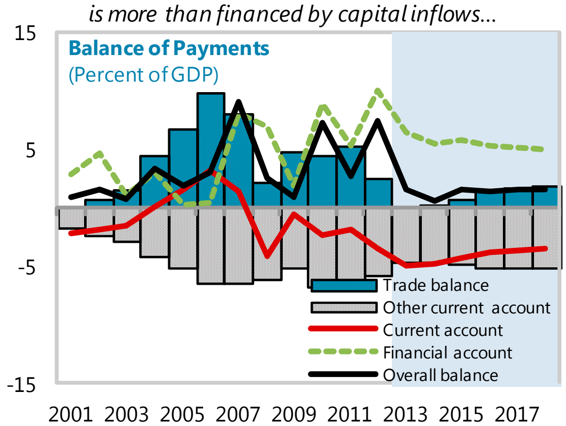
Metal prices and the terms of trade have deteriorated recently due to softer external demand...



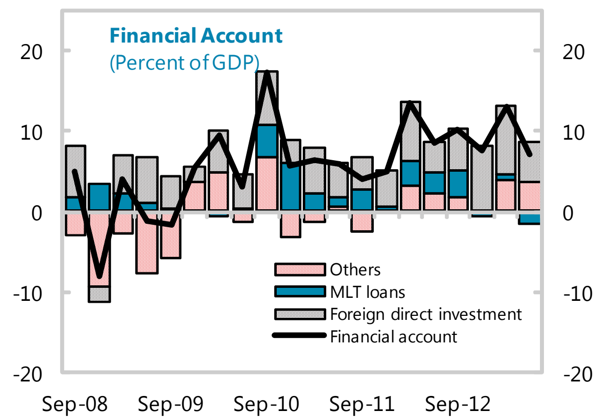
... and exports have declined while imports remain robust.



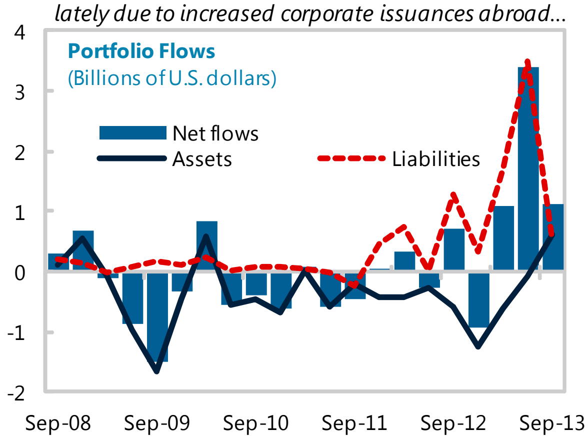
The current account deficit has widened recently, but is more than financed by capital inflows...



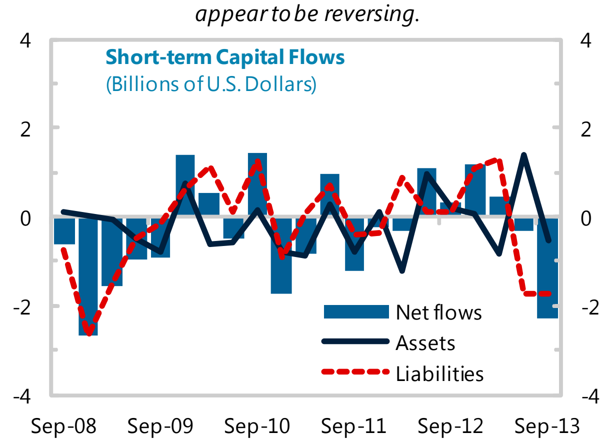
...with buoyant FDI accounting for much of the capital inflows.



Portfolio inflows are smaller but have increased lately due to increased corporate issuances abroad...

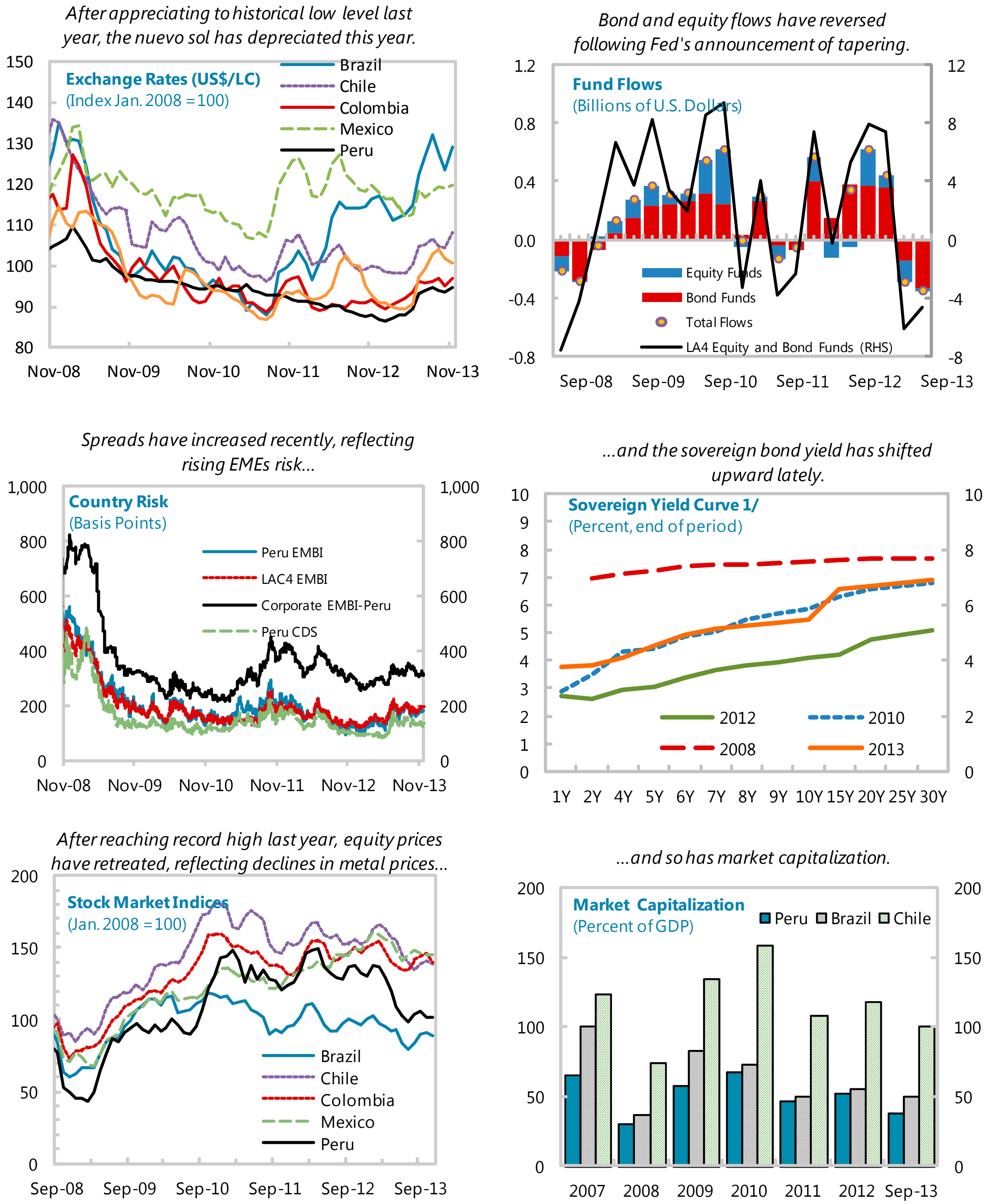


... while short-term capital inflows appear to be reversing.



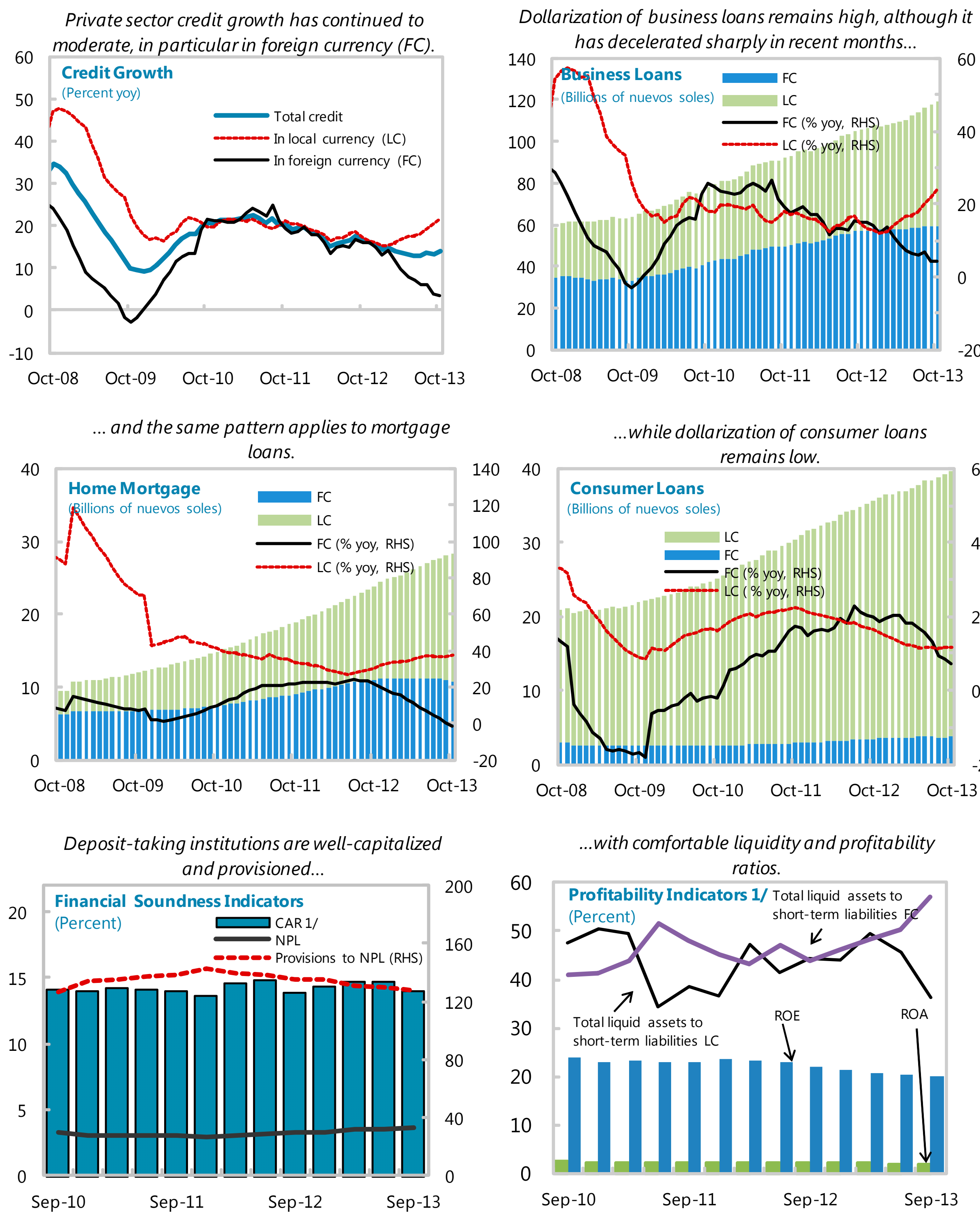
Sources: BCRP; and Fund staff estimates.

Figure 4. Peru: FX and Capital Market Developments



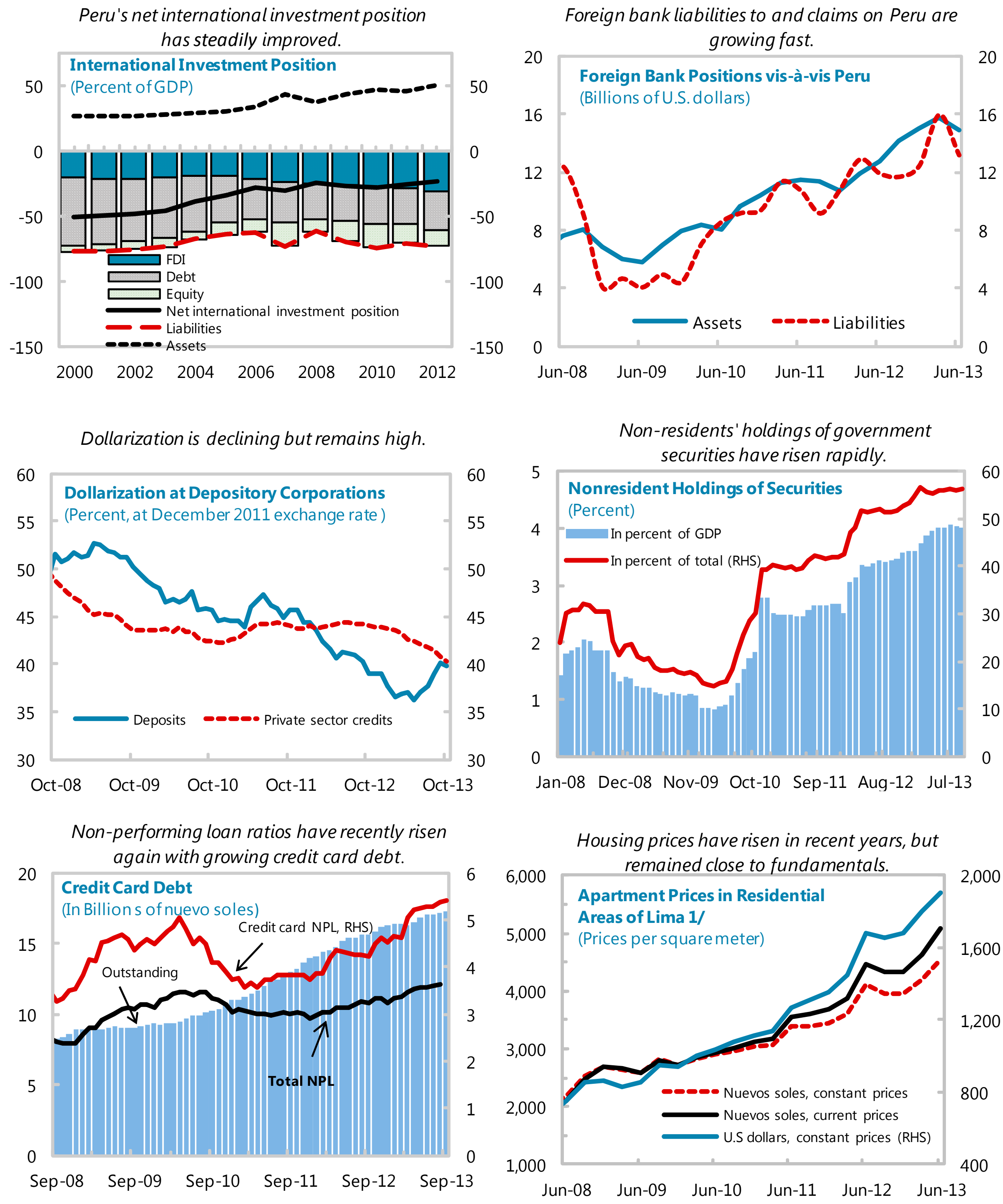
Sources: Bloomberg; Haver Analytics; BCRP; and Fund staff estimates.
1/ As of end-November for 2013.

Figure 5. Peru: Financial Sector



Sources: BCRP; Superintendency of Banks and Insurance; and Fund staff estimates.
1/ Data corresponds to depository corporations.

Figure 6. Peru: Balance Sheet Vulnerabilities



Sources: BCRP; Association of Banks; BIS; and Fund staff estimates.
1/ La Molina, Miraflores, San Borja, San Isidro, and Surco.

Table 1. Peru: Selected Economic Indicators

	2009	2010	2011	2012	Projections 2013	2014	2015
Social Indicators							
Life expectancy at birth (years)	73.5	73.8	74.0	74.2	...	...	...
Infant mortality (per thousand live births)	20.0	17.0	16.0	17.0	...	...	...
Adult literacy rate	92.4	92.6	92.9	...	...	...	...
Poverty rate (total) 1/	33.5	30.8	27.8	25.8	...	...	...
Unemployment rate	8.4	7.9	7.7	6.8	6.0	6.0	6.0
	(Annual percentage change; unless otherwise indicated)						
Production and prices							
Real GDP	0.9	8.8	6.9	6.3	4.9	5.5	5.8
Real domestic demand	-2.8	13.1	7.1	7.3	6.0	5.6	5.9
Consumer Prices (end of period)	0.2	2.1	4.7	2.6	3.0	2.3	2.0
Consumer Prices (period average)	2.9	1.5	3.4	3.7	2.8	2.5	2.1
External sector							
Exports	-13.1	31.9	30.1	-0.7	-7.7	6.9	8.7
Imports	-26.1	37.1	28.3	11.2	4.0	5.9	5.5
Terms of trade (deterioration -)	-2.8	17.9	5.4	-5.0	-3.6	-0.9	0.7
Real effective exchange rate (depreciation -)	3.4	2.4	-1.0	8.5	...	...	...
Money and credit 1/ 2/							
Broad money	6.8	21.7	15.1	12.1	15.6	13.9	13.5
Net credit to the private sector	5.0	16.7	21.6	13.3	16.5	14.4	14.5
	(In percent of GDP; unless otherwise indicated)						
Public sector							
NFPS Revenue	24.0	25.2	26.1	26.7	26.4	26.2	26.5
NFPS Primary Expenditure	24.0	24.2	23.1	23.5	24.8	24.9	25.2
NFPS Primary Balance	0.0	1.0	3.0	3.3	1.6	1.4	1.4
NFPS Overall Balance	-1.3	-0.2	1.9	2.2	0.5	0.3	0.4
External Sector							
External current account balance	-0.6	-2.5	-1.9	-3.4	-4.9	-4.8	-4.3
Gross reserves							
In millions of U.S. dollars	33,175	44,150	48,859	64,049	67,150	68,441	71,941
Percent of short-term external debt 3/	424	342	589	539	625	721	854
Percent of foreign currency deposits at banks	204	241	228	301	284	258	246
Debt							
Total external debt	29.3	27.4	25.5	27.0	24.3	22.9	22.1
NFPS Gross debt (including CRPAOs)	27.1	24.4	22.3	20.5	19.5	17.9	16.4
External	15.4	12.7	11.0	9.5	8.9	7.4	7.1
Domestic	11.7	11.7	11.2	11.0	10.6	10.5	9.3
Savings and investment							
Gross domestic investment	20.7	25.2	25.3	26.8	27.7	28.3	28.5
Public sector 4/	5.2	5.9	4.5	5.2	5.9	6.3	6.8
Private sector	17.7	19.2	19.6	21.4	21.9	22.1	22.1
National savings	20.1	22.7	23.4	23.3	22.7	23.5	24.2
Public sector 5/	4.5	6.1	7.2	7.8	6.7	6.7	7.2
Private sector	15.7	16.7	16.3	15.5	16.0	16.8	17.0
Memorandum items							
Nominal GDP (S/. billions)	382.3	434.5	486.2	526.2	561.4	605.4	653.7
GDP per capita (in US$)	4,362	5,205	5,901	6,529	6,670	7,005	7,450

Sources: Central Reserve Bank of Peru (BCRP); Ministry of Economy and Finance (MEF); National Statistical Institute (INEI); UNDP Human Development Indicators; and Fund staff estimates/projections.
1/ Corresponds to depository corporations.
2/ Foreign currency stocks are valued at end-of-period exchange rates.
3/ Short-term debt is defined on a residual maturity basis, and includes amortization of medium- and long-term debt.
4/ Includes CRPAOs.
5/ Excludes privatization receipts.

Table 2. Peru: Nonfinancial Public Sector Main Fiscal Aggregates

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Projections					
	(In millions of nuevos soles, unless otherwise indicated)									
Revenues	**91,757**	**109,512**	**127,980**	**140,524**	**148,161**	**158,830**	**173,478**	**188,425**	**205,069**	**220,689**
Taxes	53,842	65,951	78,081	86,147	89,773	96,969	106,484	116,079	126,175	136,222
Other	37,915	43,561	49,899	54,377	58,388	61,862	66,994	72,345	78,894	84,467
Primary expenditures 1/	**91,862**	**105,338**	**113,247**	**123,422**	**139,326**	**150,496**	**164,422**	**179,162**	**194,944**	**210,336**
Current	68,628	77,121	87,056	93,222	103,850	111,223	119,803	128,985	140,155	151,065
Capital	23,234	28,216	26,191	30,200	35,476	39,273	44,619	50,177	54,789	59,271
Primary balance	**-105**	**4,174**	**14,734**	**17,102**	**8,835**	**8,334**	**9,056**	**9,263**	**10,125**	**10,353**
Interest	5,035	5,099	5,608	5,577	5,779	6,326	6,293	6,441	7,239	7,063
Overall balance	**-5,140**	**-925**	**9,126**	**11,525**	**3,056**	**2,009**	**2,763**	**2,822**	**2,886**	**3,289**
External financing	4,575	3,262	2,247	44	-4,114	-4,309	1,541	-63	2,383	1,231
Domestic financing	565	-2,337	-11,373	-11,569	1,058	2,301	-4,305	-2,759	-5,269	-4,520
Public Gross Debt 2/	**103,723**	**105,932**	**109,070**	**107,885**	**109,427**	**108,284**	**107,276**	**106,208**	**105,076**	**104,152**
External	58,935	55,299	54,049	49,900	49,895	44,681	46,220	46,156	48,540	49,771
Domestic	40,387	46,167	50,341	53,925	55,560	59,864	57,579	56,833	53,418	51,364
CRPAO	4,400	4,465	4,328	3,897	3,972	3,738	3,477	3,218	3,118	3,018
Public Assets	**45,382**	**49,269**	**62,031**	**76,999**	**86,688**	...	...	...	...	...
	(In percent of GDP, unless otherwise indicated)									
Nonfinancial Public Sector										
Revenues	**24.0**	**25.2**	**26.1**	**26.7**	**26.4**	**26.2**	**26.5**	**26.7**	**27.0**	**26.9**
Taxes	14.1	15.2	15.9	16.4	16.0	16.0	16.3	16.5	16.6	16.6
Other	9.9	10.0	10.2	10.3	10.4	10.2	10.2	10.3	10.4	10.3
Primary expenditures 1/	**24.0**	**24.2**	**23.1**	**23.5**	**24.8**	**24.9**	**25.2**	**25.4**	**25.7**	**25.7**
Current	18.0	17.7	17.8	17.7	18.5	18.4	18.3	18.3	18.4	18.4
Capital	6.1	6.5	5.3	5.7	6.3	6.5	6.8	7.1	7.2	7.2
Primary balance	**0.0**	**1.0**	**3.0**	**3.3**	**1.6**	**1.4**	**1.4**	**1.3**	**1.3**	**1.3**
Interest	1.3	1.2	1.1	1.1	1.0	1.0	1.0	0.9	1.0	0.9
Overall balance	**-1.3**	**-0.2**	**1.9**	**2.2**	**0.5**	**0.3**	**0.4**	**0.4**	**0.4**	**0.4**
External financing	1.2	0.8	0.5	0.0	-0.7	-0.7	0.2	0.0	0.3	0.2
Domestic financing	0.1	-0.5	-2.3	-2.2	0.2	0.4	-0.7	-0.4	-0.7	-0.6
Public Gross Debt 2/	**27.1**	**24.4**	**22.3**	**20.5**	**19.5**	**17.9**	**16.4**	**15.1**	**13.8**	**12.7**
External	15.4	12.7	11.0	9.5	8.9	7.4	7.1	6.5	6.4	6.1
Domestic	10.6	10.6	10.3	10.2	9.9	9.9	8.8	8.1	7.0	6.3
CRPAO	1.2	1.0	0.9	0.7	0.7	0.6	0.5	0.5	0.4	0.4
Public Assets	**11.9**	**11.3**	**12.7**	**14.6**	**15.4**	...	...	...	...	...
Of which: Treasury Deposits and Fiscal Stabilization Fund	4.2	5.1	6.1	7.9	7.9	...	...	...	...	...
Public Net Debt	**15.3**	**13.0**	**9.6**	**5.9**	**4.1**	...	...	...	...	...
Memorandum items										
Commodity related revenues (in percent of GDP) 3/	2.2	3.2	4.1	3.7	3.2	3.1	3.1	3.1	3.1	3.1
Output gap	-2.2	-0.2	0.5	0.5	-0.2	-0.1	0.0	0.0	0.0	0.0
SPNF structural balance 4/	-0.4	-0.7	1.0	1.6	0.7	0.4	0.5	0.5	0.4	0.4
SPNF structural primary balance 4/	1.0	0.5	2.2	2.6	1.7	1.4	1.5	1.4	1.4	1.5
Fiscal impulse (+ = expansionary)	1.5	0.4	-1.7	-0.5	1.0	0.3	0.0	0.1	0.0	-0.1

Sources: MEF; BCRP; and Fund staff estimates.

1/ Official data excludes expense accrued during the period by Certificados de Reconocimiento de Pago Annual de Obras (CRPAOs, associated to PPP projects) and the fund for hidrocarbon price compensation (FEPC), but includes corresponding cash payments.

2/ Official data excludes stock of debt accumulated and not paid during the period in CRPAOs and FEPC. Cash payments are recorded as amortizations.

3/ Net of tax restitutions.

4/ Adjusted by the economic cycle and commodity prices. The latter uses as equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to WEO.

Table 3. Peru: Statement of Operations of the General Government 1/

(In percent of GDP, unless otherwise indicated)

					Projections					
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	**19.0**	**20.2**	**21.1**	**21.7**	**21.3**	**21.0**	**21.2**	**21.6**	**22.0**	**22.1**
Taxes	14.1	15.2	15.9	16.4	16.0	16.0	16.3	16.5	16.6	16.6
Social Contributions	1.9	1.8	1.9	2.0	2.0	2.2	2.3	2.5	2.7	2.8
Grants	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	3.0	3.3	3.2	3.3	3.3	2.8	2.6	2.6	2.7	2.7
Of which: Interest income	0.2	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Expense 2/	**15.4**	**14.9**	**14.4**	**14.6**	**14.9**	**14.9**	**14.9**	**15.1**	**15.3**	**15.2**
Compensation of employees	5.1	4.8	4.7	4.8	5.1	5.3	5.3	5.5	5.4	5.6
Use of goods and services	5.0	5.1	4.9	5.4	6.1	6.0	5.8	5.7	5.5	5.5
Consumption of fixed capital 2/	...	...	...	...	...	...	...	...	...	...
Interest	1.3	1.1	1.1	1.0	1.0	1.0	0.9	0.8	0.9	0.8
Subsidies	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
Social benefits	2.3	2.1	2.0	1.9	1.9	1.8	1.9	2.0	2.0	1.9
Other expenses 3/	1.8	1.7	1.7	1.5	0.7	0.9	1.0	1.1	1.5	1.4
Net acquisition of nonfinancial assets	**5.1**	**5.4**	**4.7**	**5.0**	**6.0**	**5.9**	**6.2**	**6.5**	**6.6**	**6.7**
Acquistions of nonfinancial assets	5.1	5.5	4.7	5.0	6.0	5.9	6.2	6.5	6.6	6.7
Disposals of nonfinancial assets	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Consumption of fixed capital 2/	....	....	....	....	....	....	....	....	....	....
Gross Operating Balance	3.6	5.3	6.7	7.1	6.5	6.0	6.3	6.5	6.7	6.9
Net Operating Balance 4/	....	....	....	....	....	....	....	....	....	....
Net lending (+) borrowing (-) 5/	**-1.5**	**-0.1**	**2.0**	**2.1**	**0.5**	**0.1**	**0.2**	**0.0**	**0.1**	**0.2**
Net acquistion of financial assets 6/	**-0.2**	**0.4**	**1.5**	**2.0**	**0.1**	**0.3**	**0.7**	**0.2**	**0.6**	0.6
By instrument										
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits 7/	-0.2	0.4	1.5	2.0	0.1	0.3	0.7	0.2	0.6	0.6
Debt securities	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
Equity and shares	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
Derivatives	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	-0.2	0.4	1.5	2.0	0.1	0.3	0.7	0.2	0.6	0.6
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities 8/	**1.3**	**0.4**	**-0.5**	**-0.1**	**-0.4**	**0.2**	**0.5**	**0.2**	**0.5**	**0.4**
By instrument										
SDRs	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
Debt securities	0.2	-0.2	-0.9	-0.4	0.4	0.9	0.3	0.2	0.2	0.3
Loans	1.2	0.6	0.4	0.3	-0.7	-0.7	0.2	0.0	0.3	0.2
Equity and shares	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
Derivatives	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	0.2	-0.2	-0.9	-0.4	0.4	0.9	0.3	0.2	0.2	0.3
External	1.2	0.6	0.4	0.3	-0.7	-0.7	0.2	0.0	0.3	0.2
Memorandum items										
Central Government Net lending (+) borrowing (-)	-1.5	0.3	4.3	4.8	3.7	4.0	3.7	3.4	3.3	3.5
Regional Governments Net lending (+) borrowing (-)	-0.2	-0.2	-3.4	-3.5	-3.7	-3.6	-3.5	-3.4	-3.3	-3.2
Local Governments Net lending (+) borrowing (-)	-0.4	-0.4	-1.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
General Government Primary Balance	-0.2	1.1	3.0	3.1	1.5	1.1	1.0	0.8	1.0	1.0
General Government Overall Balance	-1.5	-0.1	1.9	2.1	0.5	0.1	0.2	0.0	0.1	0.2
Gen. Gov. primary spending (var. real)	11.9	12.8	1.8	7.6	11.3	5.4	7.1	9.0	6.8	6.0
Of which: Current spending	4.3	9.7	7.0	4.8	6.4	6.1	5.8	8.0	6.3	5.7
Capital spending	35.5	20.1	-9.6	14.8	24.7	3.7	10.1	11.5	7.9	6.7
General Government nonfinancial expenditures	19.2	19.2	18.0	18.5	19.9	19.9	20.2	20.8	21.0	21.1

Sources: MEF; BCRP; and Fund staff estimates.

1/ Fiscal data is not fully compiled on an accrual basis.

2/ Official data excludes expense accrued during the period by Certificados de Reconocimiento de Pago Annual de Obras (CRPAOs, associated to PPP projects) and Fund for hidrocarbon price compensation (FEPC), but includes corresponding cash payments.

3/ Includes transfers to Fund for hidrocarbon price compensation (FEPC).

4/ Net operating balance is calculated as the gross operating balance minus consumption of fixed capital.

5/ Net lending (+)/ borrowing (-) is equal to gross operating balance minus net acquistions of nonfinancial assets.

6/ (+) corresponds to increase in financial assets; (-) to a decrease in financial assets.

7/ Includes Fiscal Stabilization Fund.

8/ (+) corresponds to increase in liabilities (disbursement and/or issuance); (-) to decrease in liabilities (amortizations).

Table 4. Peru: General Government Stock Positions

(In percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Projections 1/					
Stock positions:										
Net worth	....	....	....	....	....	....	....	....	....	....
Nonfinancial assets	....	....	....	....	....	....	....	....	....	....
Net financial worth	**-11.7**	**-9.9**	**-6.8**	**-4.2**	**-3.5**	**-3.1**	**-2.7**	**-2.6**	**-2.3**	**-1.9**
Financial assets	**11.9**	**11.3**	**11.5**	**12.7**	**12.0**	**11.5**	**11.3**	**10.7**	**10.5**	**10.4**
By instrument										
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits 2/	11.4	10.9	11.2	12.4	11.8	11.2	11.0	10.4	10.3	10.2
Debt securities	0.5	0.4	0.3	0.3	0.3	0.3	0.2	0.2	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
Equity and shares	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
Derivatives	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	11.4	10.9	11.2	12.4	11.8	11.2	11.0	10.4	10.3	10.2
External	0.5	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2
By currency 3/										
Domestic	12.0	11.0	11.3	12.6	11.3	11.1	10.9	10.3	10.2	10.1
Foreign	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3
Liabilities 4/	**23.6**	**21.2**	**18.3**	**16.9**	**15.5**	**14.6**	**14.0**	**13.2**	**12.8**	**12.3**
By instrument										
SDRs	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
Debt securities	15.1	14.8	12.2	11.0	10.6	10.8	10.2	9.7	9.2	8.8
Loans	8.5	6.4	6.1	6.0	4.9	3.8	3.8	3.5	3.5	3.4
Equity and shares	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
Derivatives	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	8.3	8.6	6.8	5.9	5.9	6.4	6.1	5.9	5.7	5.6
External	15.3	12.6	11.6	11.1	9.6	8.2	7.8	7.3	7.1	6.7
By currency 3/										
Domestic	10.5	10.2	10.1	10.1	9.2	9.5	8.5	7.7	6.7	6.0
Foreign	13.1	11.0	8.3	6.9	6.3	5.1	5.5	5.5	6.1	6.3
Memorandum items										
General Government Gross Debt (at face value)	23.6	21.2	18.3	16.9	15.5	14.6	14.0	13.2	12.8	12.3
General Government Net Debt (at face value)	11.7	9.9	6.8	4.2	3.5	3.1	2.7	2.6	2.3	1.9
Fiscal Stabilization Fund and other public saving:	1.4	1.4	3.2	3.6	3.6	3.7	3.7	3.6	3.6	3.6
Debt of FEPC 5/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt of CRPAOs 5/	1.2	1.0	0.9	0.7	0.7	0.6	0.5	0.5	0.4	0.4
Debt of SOEs guaranteed by government 6/	0.8	1.0	0.7	0.6	0.7	0.6	0.5	0.5	0.5	0.4

Sources: MEF; BCRP; and Fund staff estimates.

1/ Assuming zero other economic flows.

2/ Includes stocks of Fiscal Stabilization Fund.

3/ Preliminary data.

4/ Excludes debt of public enterprises guaranteed by the central government, debt of FEPC, and CRPAOs.

5/ 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 statistics in the short-term.

6/ This debt is excluded from general government liabilities since it is a liability of SOEs.

Table 5. Peru: Balance of Payments

(In billions of U.S. dollars; unless noted otherwise)

					Projections					
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Current account	**-0.7**	**-3.8**	**-3.3**	**-6.8**	**-10.2**	**-10.6**	**-10.2**	**-9.8**	**-10.0**	**-10.3**
Merchandise trade	6.0	6.7	9.3	4.8	-0.4	0.0	1.5	3.5	4.4	5.2
Exports	27.0	35.6	46.3	45.9	42.4	45.3	49.3	54.3	58.7	63.4
Traditional	20.6	27.7	35.8	34.5	30.9	32.9	35.8	39.5	42.6	45.7
Mining	16.4	21.7	27.4	26.1	23.5	24.7	27.2	30.5	32.9	35.4
Nontraditional and others	6.3	7.9	10.4	11.4	11.5	12.5	13.5	14.8	16.2	17.7
Imports	-21.0	-28.8	-37.0	-41.1	-42.8	-45.3	-47.8	-50.8	-54.3	-58.2
Services, income, and current transfers (net)	-6.7	-10.5	-12.6	-11.7	-9.8	-10.6	-11.7	-13.3	-14.4	-15.5
Services	-1.2	-2.3	-2.1	-2.3	-2.3	-2.9	-3.2	-3.5	-3.8	-4.0
Investment income	-8.4	-11.2	-13.7	-12.7	-10.9	-11.2	-12.3	-13.7	-14.8	-15.9
Current transfers	2.9	3.0	3.2	3.3	3.4	3.5	3.7	4.0	4.2	4.4
Capital and financial account balance	**2.3**	**13.6**	**9.4**	**19.8**	**13.3**	**11.8**	**13.7**	**13.3**	**14.0**	**14.8**
Public sector	-0.4	2.3	0.7	1.3	-0.6	-1.2	1.2	0.7	1.6	1.2
Medium-term loans	1.3	-1.0	0.1	0.2	-1.5	-1.6	0.6	0.0	0.9	0.4
Disbursements 1/	3.2	4.3	1.0	1.4	0.9	1.2	2.1	1.9	1.5	1.5
Amortization 1/	1.9	5.3	0.9	1.2	2.4	2.7	1.5	1.9	0.6	1.0
Other public sector flows 2/	-1.2	3.4	0.5	1.1	0.9	0.4	0.6	0.7	0.7	0.8
Net external assets	-0.3	0.0	-0.3	-0.5	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2
Other transactions of Treasury bills	-0.9	3.5	0.8	1.5	1.0	0.6	0.8	0.9	0.9	1.0
Short-term flows	-0.6	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	2.7	11.2	8.7	18.5	13.9	13.0	12.5	12.6	12.4	13.5
Foreign direct investment (net) 3/	6.0	8.2	8.1	12.3	11.9	9.2	9.2	9.8	10.5	11.3
Medium- and long-term loans	1.0	3.9	2.9	4.1	0.7	2.1	1.5	1.3	1.0	1.0
Portfolio investment	-2.8	-0.7	-1.0	-0.2	2.7	1.3	1.4	1.2	0.8	0.9
Short-term flows 4/	-1.5	-0.2	-1.3	2.2	-1.4	0.5	0.5	0.3	0.2	0.3
Errors and omissions	**-0.6**	**1.4**	**-1.4**	**1.9**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**1.0**	**11.2**	**4.7**	**14.8**	**3.1**	**1.3**	**3.5**	**3.5**	**4.0**	**4.5**
Financing	**-1.0**	**-11.2**	**-4.7**	**-14.8**	**-3.1**	**-1.3**	**-3.5**	**-3.5**	**-4.0**	**-4.5**
NIR flow (increase -)	-1.0	-11.2	-4.7	-14.8	-3.1	-1.3	-3.5	-3.5	-4.0	-4.5
Change in NIR (increase -)	-1.9	-11.0	-4.7	-15.2	-3.1	-1.3	-3.5	-3.5	-4.0	-4.5
Valuation change	0.9	-0.2	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0
					(In percent of GDP)					
Current account balance	**-0.6**	**-2.5**	**-1.9**	**-3.4**	**-4.9**	**-4.8**	**-4.3**	**-3.8**	**-3.6**	**-3.5**
Trade balance	4.7	4.4	5.2	2.4	-0.2	0.0	0.6	1.4	1.6	1.7
Exports	21.2	23.1	25.9	23.1	20.5	20.6	20.7	21.2	21.3	21.3
Traditional	16.2	18.0	20.1	17.4	15.0	14.9	15.1	15.4	15.4	15.3
Mining	12.9	14.1	15.3	13.1	11.4	11.2	11.5	11.9	11.9	11.9
Nontraditional and others	5.0	5.1	5.8	5.7	5.6	5.7	5.7	5.8	5.9	5.9
Imports	-16.5	-18.7	-20.7	-20.7	-20.7	-20.6	-20.1	-19.8	-19.7	-19.5
Services, income, and current transfers (net)	-5.3	-6.8	-7.1	-5.9	-4.7	-4.8	-4.9	-5.2	-5.2	-5.2
Investment income	-6.6	-7.3	-7.7	-6.4	-5.3	-5.1	-5.2	-5.4	-5.4	-5.3
Capital and financial account balance	**1.8**	**8.8**	**5.3**	**9.9**	**6.4**	**5.4**	**5.8**	**5.2**	**5.1**	**5.0**
Foreign direct investment (net)	4.7	5.3	4.6	6.2	5.7	4.2	3.9	3.8	3.8	3.8
Overall balance	**0.8**	**7.3**	**2.6**	**7.4**	**1.5**	**0.6**	**1.5**	**1.4**	**1.4**	**1.5**
Memorandum items					(Annual percentage change)					
Export value	-13.1	31.9	30.1	-0.7	-7.7	6.9	8.7	10.0	8.3	8.0
Volume growth	-4.1	1.9	8.5	3.7	-2.5	8.0	8.8	9.5	7.4	7.0
Price growth	-10.0	29.9	20.0	-3.3	-5.3	-1.0	0.0	0.5	0.8	0.9
Import value	-26.1	37.1	28.3	11.2	4.0	5.9	5.5	6.2	7.0	7.2
Volume growth	-20.1	24.5	12.8	9.5	5.9	6.0	6.2	6.4	6.5	6.5
Price growth	-7.4	10.1	13.8	1.7	-1.8	-0.1	-0.7	-0.1	0.5	0.7
Terms of trade	-2.8	17.9	5.4	-5.0	-3.6	-0.9	0.7	0.6	0.3	0.9
Gross international reserves (in billions of US$)	33.2	44.2	48.9	64.0	67.1	68.4	71.9	75.4	79.4	83.9

Sources: BCRP; MEF; and Fund staff estimates/projections.

1/ Includes debt swap operations.

2/ Includes public sector's net external assets and other transactions involving Treasury bonds.

3/ Excluding privatization.

4/ Includes COFIDE and Banco de la Nación.

Table 6. Peru: Monetary Survey 1/

(In billions of nuevos soles; unless noted otherwise)

	2009	2010	2011	2012	Projections 2013	2014	2015
				I. Central Reserve Bank			
Net foreign assets	**79.5**	**105.0**	**109.9**	**138.2**	**149.1**	**144.9**	**152.1**
(In billions of U.S. dollars)	38.7	50.9	57.0	73.8	81.0	84.1	88.5
Net international reserves 2/	**95.8**	**123.9**	**131.8**	**163.2**	**187.9**	**188.1**	**197.7**
(In billions of U.S. dollars)	33.1	44.1	48.8	64.0	67.1	68.4	71.9
Long-term net external assets	-0.2	0.1	0.1	0.0	0.1	0.1	0.1
Foreign currency liabilities	-16.0	-19.1	-21.9	-25.0	-38.8	-43.2	-45.6
Net domestic assets	**-56.0**	**-70.7**	**-70.0**	**-85.5**	**-93.4**	**-81.9**	**-81.0**
Net credit to nonfinancial public sector	-25.7	-30.3	-41.9	-54.9	-62.6	-63.6	-62.6
Credit to the financial sector 3/	-9.2	-10.1	-11.0	-8.9	-8.0	-8.0	-8.0
Securities issued	-14.2	-25.2	-16.4	-27.5	-24.7	-27.2	-29.9
Other assets (net)	-7.0	-5.1	-0.7	5.8	1.9	16.8	19.5
Monetary base	23.5	34.2	40.0	52.7	55.7	63.0	71.1
Currency	19.2	24.1	27.2	32.2	36.5	41.1	46.5
Reserve	4.3	10.1	12.7	20.5	19.2	21.9	24.6
				II. Depository Corporations 4/			
Net foreign assets	**86.9**	**107.9**	**111.2**	**131.9**	**156.0**	**156.8**	**166.4**
Net domestic assets	**25.5**	**28.9**	**46.2**	**44.6**	**48.0**	**75.6**	**97.4**
Net credit to the public sector	-34.7	-41.2	-53.1	-68.6	-76.4	-74.1	-78.4
Credit to the private sector	104.2	121.6	147.9	167.6	195.2	223.4	255.9
Other assets (net)	-43.9	-51.5	-48.5	-54.3	-70.8	-73.6	-80.0
Broad money	**112.4**	**136.8**	**157.5**	**176.5**	**204.0**	**232.4**	**263.9**
Domestic currency	65.3	85.4	99.5	122.2	137.9	159.4	183.6
Money	33.1	42.7	48.8	57.5	63.4	...	...
Currency	19.2	24.1	27.3	32.2	36.5	41.1	46.5
Demand deposits	13.9	18.5	21.5	25.2	26.9	...	...
Quasi-money	32.2	42.7	50.8	64.7	74.4	...	...
Foreign currency	47.1	51.5	57.9	54.2	66.2	73.0	80.3
				III. Financial System 5/			
Net foreign assets	**117.9**	**145.7**	**150.9**	**178.0**	**207.8**	**210.2**	**214.2**
Net domestic assets	**77.8**	**94.6**	**102.7**	**114.6**	**118.7**	**161.6**	**208.0**
Net credit to the public sector	-16.1	-22.4	-36.3	-51.1	-58.1	-56.3	-59.6
Credit to the private sector	137.0	164.5	187.5	213.4	237.7	269.5	308.6
Other assets (net)	-43.2	-47.5	-48.6	-47.8	-60.9	-51.6	-41.0
Liabilities to the private sector	**195.6**	**240.3**	**253.5**	**292.5**	**326.4**	**371.9**	**422.2**
Domestic currency	138.9	178.2	186.7	228.6	251.8	292.4	338.4
Foreign currency	56.7	62.1	66.8	63.9	74.6	79.4	83.8
				(12-month percentage change)			
Monetary base	5.5	45.3	16.8	31.9	5.6	13.1	12.9
Broad money	6.8	21.7	15.1	12.1	15.6	13.9	13.5
Domestic currency	14.4	30.7	16.6	22.8	12.8	15.6	15.2
Foreign currency	-2.2	9.3	12.6	-6.4	22.0	10.4	9.9
Liabilities to the private sector	19.3	22.8	5.5	15.4	11.6	13.9	13.5
Domestic currency	27.1	28.2	4.8	22.4	10.2	16.1	15.7
Foreign currency	3.7	9.6	7.6	-4.3	16.7	6.4	5.6
Depository corporations credit to the private sector	5.0	16.7	21.6	13.3	16.5	14.4	14.5
Domestic currency	17.9	21.2	20.4	16.0	21.0	16.3	16.4
Foreign currency	-7.3	11.3	23.2	9.9	10.4	11.6	11.6

Sources: 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, Corporación Andina de Fomento (CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations.

3/ Including Banco de la Nacion.

4/ Depository corporations comprise the Central Reserve Bank of Peru, Banco de la Nacion, commercial banks, Agricultural Bank (Banco Agropecuario), financial firms, municipal banks, rural banks and credit unions.

5/ Financial system comprises depository corporations and other financial corporations. Other financial companies include mutual funds, COFIDE, insurance companies, leasing companies, pension funds, the Fund Edpymes and MIVIVIENDA.

Table 7. Peru: Financial Soundness Indicators 1/

(In percent; unless otherwise indicated)

	Dec-10	Dec-11	Dec-12	Sep-13
Capital Adequacy				
Capital to risk-weighted assets 2/	14.0	13.7	14.4	14.0
Regulatory Tier I capital to risk-weighted assets 3/	11.2	10.8	10.9	10.5
Nonperforming loans net of provisions to capital	-14.4	-14.7	-12.6	-11.1
Asset Quality				
Nonperforming loans to total gross loans 4/	1.9	1.8	2.2	2.6
In domestic currency	2.5	2.5	3.0	3.5
In foreign currency	1.2	1.0	1.1	1.4
Nonperforming, refinanced and restructured loans to total gross loans	3.0	2.9	3.2	3.6
In domestic currency	3.5	3.5	4.2	3.5
In foreign currency	2.2	1.9	1.8	1.4
Refinanced and restructured loans to total gross loans	1.2	1.1	1.1	1.0
Provisions to nonperforming loans	219.1	225.2	202.0	176.3
Provisions to nonperforming, restructured, and refinanced loans	134.5	142.3	134.9	128.0
Sectoral distribution of loans to total loans 5/				
Consumer loans	18	19	19	18
Mortgage loans	13	14	15	15
Corporate	19	18	16	17
Large firms	17	15	15	16
Medium size firms	17	17	17	17
Small firms	11	12	13	12
Microenterprises	6	6	5	4
Earnings and Profitability				
Return on equity (ROE)	22.9	23.5	21.5	20.2
Return on assets (ROA)	2.3	2.3	2.2	2.0
Financial revenues to total revenues	80.9	82.0	82.7	85.8
Annualized financial revenues to revenue-generating assets	11.0	11.1	11.2	11.0
Liquidity				
Total liquid assets to total short-term liabilities (monthly average basis)	46.2	40.5	45.0	45.7
In domestic currency	50.5	36.7	44.2	36.3
In foreign currency	41.2	45.0	46.2	57.0
Foreign Currency Position and Dollarization				
Share of foreign currency deposits in total deposits	44.8	43.9	38.2	42.2
Share of foreign currency loans in total credit	47.3	45.8	44.4	42.2
Operational efficiency				
Financing to related parties to capital 6/	11.2	9.3	11.5	9.9
Nonfinancial expenditure to total revenues 7/	32.9	33.7	33.6	33.5
Annualized Nonfinancial expenditure to total revenue-generating assets 7	4.5	4.6	4.6	4.4
Memorandum items				
General Stock market index IGBVL	23,374.6	19,473.7	21,016.0	15,919.7
EMBI+ PERU spread, basis points	163	216	114	181

Sources: Superintendency of Banks and Insurance; Superintendency of Securities Market; and BCRP.

1/ These indicators correspond to depository corporations.

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

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

7/ Nonfinancial expenditures do not consider provisions nor depreciation.

Table 8. Peru: Financial and External Vulnerability Indicators

(In percent; unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Projections					
Financial indicators										
Public sector debt/GDP	27.1	24.4	22.3	20.5	19.5	17.9	16.4	15.1	13.8	12.7
Of which: in domestic currency (percent of GDP)	10.6	10.5	11.2	11.0	10.6	10.5	9.3	8.5	7.4	6.6
90-day prime lending rate, domestic currency (end of period)	1.7	3.6	5.4	5.0	4.7	...	...	...	...	...
90-day prime lending rate, foreign currency (end of period)	1.2	2.1	2.4	4.0	1.3	...	...	...	...	...
Velocity of money 1/	3.4	3.2	3.1	3.0	2.8	2.6	2.5	2.4	2.2	2.1
Net credit to the private sector/GDP 2/	27.3	28.0	30.2	31.9	34.8	36.9	39.1	41.6	44.2	46.9
External indicators										
Exports, U.S. dollars (percent change)	-13.1	31.9	30.1	-0.7	-7.7	6.9	8.7	10.0	8.3	8.0
Imports, U.S. dollars (percent change)	-26.1	37.1	28.3	11.2	4.0	5.9	5.5	6.2	7.0	7.2
Terms of trade (percent change) (deterioration -)	-2.8	17.9	5.4	-5.0	-3.6	-0.9	0.7	0.6	0.3	0.9
Real effective exchange rate, (end of period, percent change) 3/	3.4	2.4	-1.0	8.5	...	...	...	...	...	...
Current account balance (percent of GDP)	-0.6	-2.5	-1.9	-3.4	-4.9	-4.8	-4.3	-3.8	-3.6	-3.5
Capital and financial account balance (percent of GDP)	1.8	8.8	5.3	9.9	6.4	5.4	5.8	5.2	5.1	5.0
Total external debt (percent of GDP)	29.3	27.4	25.3	27.0	24.3	22.9	22.1	21.0	20.2	19.2
Medium- and long-term public debt (in percent of GDP) 4/	17.4	14.0	12.0	10.6	9.5	8.2	7.8	7.2	7.0	6.7
Medium- and long-term private debt (in percent of GDP)	8.2	9.3	9.8	12.1	11.9	12.1	11.9	11.5	11.0	10.6
Short-term public and private debt (in percent of GDP)	3.8	4.1	3.5	4.3	2.8	2.6	2.4	2.2	2.1	1.9
Total external debt (in percent of exports of goods and services)	121.6	107.4	89.2	105.1	104.0	97.8	94.0	88.0	84.3	80.5
Total debt service (in percent of exports of goods and services) 5	15.2	20.8	7.2	10.4	14.3	11.0	8.2	8.3	6.0	6.3
Gross official reserves										
In millions of U.S. dollars	33,175	44,150	48,859	64,049	67,150	68,441	71,941	75,441	79,441	83,941
In percent of short-term external debt 6/	424.3	342.0	589.4	538.6	625.0	721.4	853.6	849.9	1,029.9	1018.8
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	113.0	107.3	124.7	130.1	125.7	128.0	131.5	129.9	130.8	128.1
In percent of broad money 8/	84.9	90.9	83.7	93.7	92.2	81.0	75.0	69.3	64.3	59.8
In percent of foreign currency deposits at banks	203.6	241.1	227.7	301.2	284.2	257.7	246.4	235.4	226.1	218.1
In months of next year's imports of goods and services	11.4	12.2	12.1	15.1	14.8	14.3	14.1	13.8	13.6	...
Net international reserves (in millions of U.S. dollars)	33,135	44,105	48,816	63,991	67,093	68,384	71,884	75,384	79,384	83,884
BCRP's Foreign Exchange Position	22,988	32,422	33,300	46,063	49,164	50,456	53,956	57,456	61,456	65,956
Public sector deposits in BCRP	4,304	4,339	6,731	8,198	...	...	...	...	...	...
Banks' deposits in BCRP	5,853	7,326	8,799	10,068	...	...	...	...	...	...

Sources: BCRP; IMF Information Notice System (INS); 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; data from INS.
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.

Table 9. Peru: Medium-Term Macroeconomic Framework

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Projections					
	(Annual percentage change)									
Production										
GDP at constant prices	0.9	8.8	6.9	6.3	4.9	5.5	5.8	5.8	5.8	5.8
Consumer prices (end of period)	0.2	2.1	4.7	2.6	3.0	2.3	2.0	2.0	2.0	2.0
GDP deflator	2.2	4.5	5.5	1.1	1.7	2.2	2.0	1.9	1.9	1.9
Trade										
Merchandise trade										
Exports, f.o.b.	-13.1	31.9	30.1	-0.7	-7.7	6.9	8.7	10.0	8.3	8.0
Imports, f.o.b.	-26.1	37.1	28.3	11.2	4.0	5.9	5.5	6.2	7.0	7.2
Terms of trade (deterioration -)	-2.8	17.9	5.4	-5.0	-3.6	-0.9	0.7	0.6	0.3	0.9
	(In percent of GDP; unless otherwise indicated)									
External current account balance	-0.6	-2.5	-1.9	-3.4	-4.9	-4.8	-4.3	-3.8	-3.6	-3.5
Total external debt service 1/	3.7	5.3	2.0	2.7	3.3	2.6	1.9	2.0	1.4	1.5
Medium- and long-term	3.6	5.2	2.0	2.6	3.3	2.5	1.9	1.9	1.4	1.5
Nonfinancial public sector	2.3	4.1	1.1	1.1	1.7	1.7	1.0	1.1	0.6	0.7
Private sector	1.2	1.1	0.9	1.4	1.6	0.9	0.9	0.8	0.8	0.8
Short-term 2/	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Interest	1.3	1.0	0.9	1.0	0.9	0.8	0.8	0.8	0.7	0.7
Amortization (medium-and long-term)	2.4	4.3	1.1	1.7	2.4	1.8	1.2	1.2	0.7	0.8
Public sector										
NFPS primary balance 3/	0.0	1.0	3.0	3.3	1.6	1.4	1.4	1.3	1.3	1.3
General government revenue	19.0	20.2	21.1	21.7	21.3	21.0	21.2	21.6	22.0	22.1
General govt. non-interest expenditure 3/	24.0	24.2	23.1	23.5	24.8	24.9	25.2	25.4	25.7	25.7
NFPS interest due	1.3	1.2	1.1	1.1	1.0	1.0	1.0	0.9	1.0	0.9
NFPS overall balance 3/	-1.3	-0.2	1.9	2.2	0.5	0.3	0.4	0.4	0.4	0.4
Public sector debt 3/	27.1	24.4	22.3	20.5	19.5	17.9	16.4	15.1	13.8	12.7
Savings and investment										
Gross domestic investment	20.7	25.2	25.9	26.8	27.7	28.3	28.5	28.6	28.9	29.2
Public sector 3/	5.2	5.9	5.2	5.2	5.9	6.3	6.8	7.1	7.2	7.2
Private sector	15.5	19.3	20.7	21.6	21.8	22.0	21.7	21.6	21.7	22.0
Private sector (excluding inventories)	17.7	19.2	19.4	21.4	21.9	22.1	22.1	22.2	22.2	22.4
Inventory changes	-2.1	0.1	1.3	0.2	-0.1	-0.1	-0.4	-0.7	-0.4	-0.4
National savings	20.1	22.7	24.0	23.3	22.7	23.5	24.2	24.8	25.3	25.7
Public sector 4/	4.5	6.1	7.1	7.8	6.7	6.7	7.2	7.5	7.5	7.6
Private sector	15.7	16.7	16.9	15.5	16.0	16.8	17.0	17.3	17.7	18.1
External savings	0.6	2.5	1.9	3.4	4.9	4.8	4.3	3.8	3.6	3.5
Memorandum items										
Nominal GDP (billions of Nuevos Soles)	382.3	434.5	489.8	526.2	561.4	605.4	653.7	705.0	759.8	819.4
Gross international reserves (billions of U.S. dollars)	33.2	44.2	48.9	64.0	67.1	68.4	71.9	75.4	79.4	83.9
External debt service (percent of exports of GNFS)	15.2	20.8	7.2	10.4	14.3	11.0	8.2	8.3	6.0	6.3
Short-term external debt service (percent of exports of GNFS)	0.5	0.3	0.3	0.4	0.3	0.2	0.2	0.2	0.2	0.2
Public external debt service (percent of exports of GNFS)	9.6	16.1	3.8	4.5	7.2	7.1	4.3	4.6	2.4	2.8

Sources: BCRP; MEF; and Fund staff estimates/projections.
1/ Includes interest payments only.
2/ Includes the financial public sector.
3/ Includes CRPAOs.
4/ Excludes privatization receipts.

Table 10. Peru: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2010 [2/]	2011	2012	2013	2014	2015	2016	2017	2018
Nominal gross public debt	27.0	22.2	20.6	19.5	17.9	16.4	15.1	13.8	12.7
Public gross financing needs	2.5	-1.1	-1.3	1.0	1.2	0.8	0.8	0.3	0.2
Real GDP growth (in percent)	7.1	6.9	6.3	4.9	5.5	5.8	5.8	5.8	5.8
Inflation (GDP deflator, in percent)	3.0	3.4	3.7	2.8	2.5	2.1	2.0	2.0	2.0
Nominal GDP growth (in percent)	9.6	12.7	7.4	6.7	7.8	8.0	7.8	7.8	7.8
Effective interest rate (in percent) [4/]	5.5	5.3	5.1	5.5	6.1	6.3	6.6	6.6	6.8

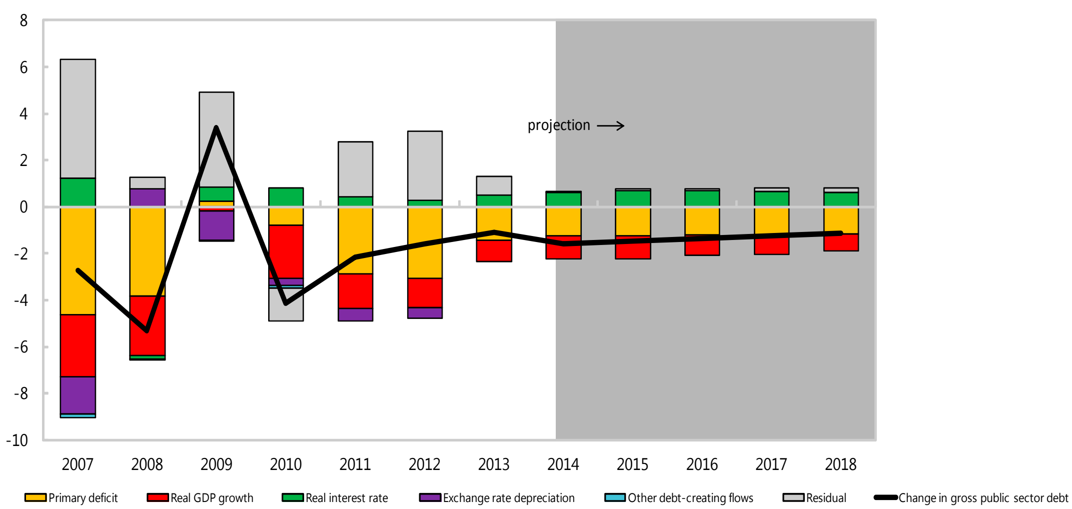
As of October 30, 2013		
Sovereign Spreads		
Spread (bp) 3/		163
CDS (bp)		1.39
Ratings	Foreign	Local
Moody's	Baa2 positive	Baa2 positive
S&Ps	BBB+ stable	A stable
Fitch	BBB+ Stable	A Stable

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2010	2011	2012	2013	2014	2015	2016	2017	2018	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.2	-2.2	-1.6	-1.1	-1.6	-1.5	-1.3	-1.2	-1.1	-7.9	
Identified debt-creating flows	-4.3	-4.5	-4.6	-1.1	-1.8	-1.6	-1.4	-1.4	-1.3	-8.6	
Primary deficit	-2.3	-2.9	-3.1	-1.4	-1.3	-1.3	-1.2	-1.2	-1.2	-7.6	-0.2
Primary (noninterest) revenue and grant	25.3	26.0	26.6	26.3	26.1	26.4	26.6	26.9	26.8	159.1	
Primary (noninterest) expenditure	23.0	23.1	23.5	24.8	24.9	25.2	25.4	25.7	25.7	151.6	
Automatic debt dynamics [5/]	-1.9	-1.6	-1.5	0.3	-0.5	-0.3	-0.2	-0.2	-0.2	-1.0	
Interest rate/growth differential [6/]	-1.3	-1.1	-1.0	-0.5	-0.4	-0.3	-0.2	-0.2	-0.2	-1.6	
Of which: real interest rate	0.6	0.4	0.3	0.5	0.6	0.7	0.7	0.6	0.6	3.7	
Of which: real GDP growth	-1.9	-1.5	-1.3	-0.9	-1.0	-1.0	-0.9	-0.8	-0.7	-5.3	
Exchange rate depreciation [7/]	-0.6	-0.5	-0.5	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	2.1	2.4	3.0	0.8	0.0	0.1	0.1	0.2	0.2	1.3	

Debt-Creating Flows

(in percent of GDP)



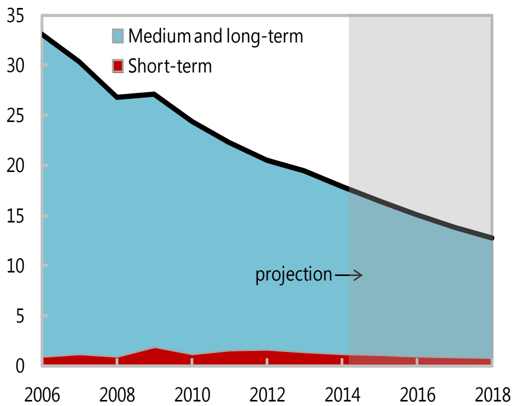
Source: National Authorities; Fund staff calculations.
1/ Public sector is defined as non-financial public sector.
2/ Based on available data.
3/ Bond Spread over U.S. Bonds.
4/ Defined as interest payments divided by debt stock at the end of previous year.
5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) 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).
6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
8/ For projections, this line includes exchange rate changes during the projection period.
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.

Table 11. Peru Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

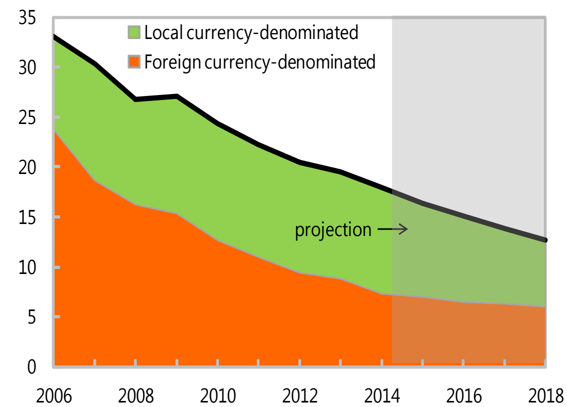
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

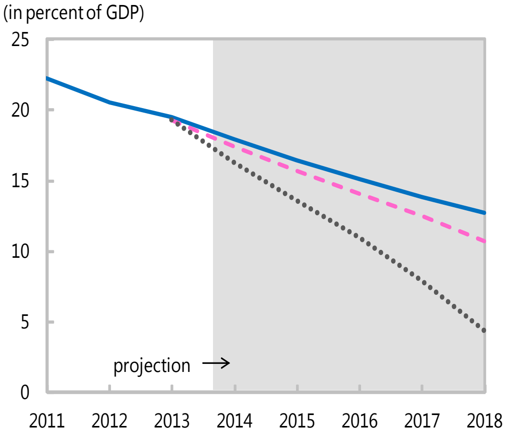


Alternative Scenarios

Baseline Historical Constant Primary Balance

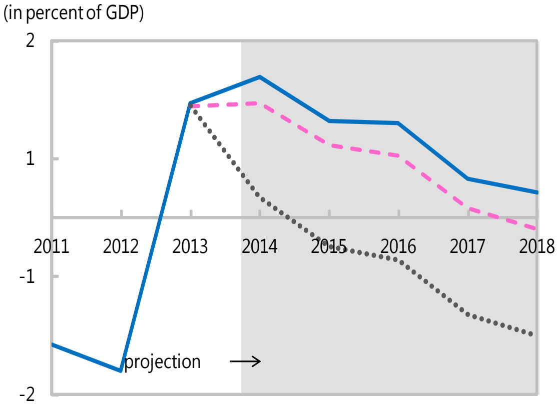
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	4.9	5.5	5.8	5.8	5.8	5.8
Inflation	2.8	2.5	2.1	2.0	2.0	2.0
Primary Balance 1/	1.4	1.3	1.3	1.2	1.2	1.2
Effective interest rate	5.5	6.1	6.3	6.6	6.6	6.8
Constant Primary Balance Scenario						
Real GDP growth	4.9	5.5	5.8	5.8	5.8	5.8
Inflation	2.8	2.5	2.1	2.0	2.0	2.0
Primary Balance 1/	1.4	1.4	1.4	1.4	1.4	1.4
Effective interest rate	5.5	6.1	6.4	6.7	6.9	7.2

Historical Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	4.9	6.5	6.5	6.5	6.5	6.5
Inflation	2.8	2.5	2.1	2.0	2.0	2.0
Primary Balance 1/	1.4	2.2	2.2	2.2	2.2	2.2
Effective interest rate	5.5	6.1	6.4	7.2	7.8	9.9

1/ Excluding interest revenue.

Source: Fund staff calculations.

Annex I. Spillovers from the U.S. Federal Reserve Announcement of Tapering

The Shock

1. **The U.S. Federal Reserve (USFR) announcement of tapering asset purchases on May 22, 2013 rattled financial markets across emerging economies, including Peru.** In Peru, the exchange rate depreciated 5 percent and the 10-year local currency sovereign bond yield jumped over 160 basis points in the five weeks period between May 21 and June 24, 2013, the peak of volatility in financial markets. Although volatility has moderated somewhat in recent months, there have been enduring consequences to capital flows, the FX market, corporate financing, and sovereign bond yields.

The Spillovers

2. **Capital inflows slowed significantly following news of tapering, but there is no evidence of reversals.** Net capital inflows fell from 13½ percent of GDP in Q1 2013 to 4¼ percent of GDP in Q3 2013, mainly due to a drop in FDI, a slowdown in corporate bond issuance in international markets, and a reduction in short-term net external liabilities, while non-residents' holding of sovereign bonds remained steady at about 56½ percent of total (see below). The overall balance of payments was in deficit in Q2 2013 (-0.2 percent of GDP) and Q3 2013 (-0.8 percent of GDP), due to both the deterioration of the current account deficit and the reduction in capital inflows, for the first time since 2009.

3. **The impact on the FX market has been magnified by residents' additional demand for U.S. dollars.** In particular, local pension funds (AFPs) rush to reallocate their financial assets into U.S. dollars following the depreciation of the nuevo sol in May–June 2013, prompting the BCRP to intervene to reduce volatility in the FX market. In the third quarter of 2013, the central bank sold US$3⅓ billion (about 1½ percent of GDP) in the FX market, although the overall balance of payments deficit was only about US$½ billion (about ¾ a percent of GDP). A significant share of the FX sold by the BCRP was purchased by residents (i.e., AFPs), deposited in the financial system, and recycled back to the BCRP as reserves in the form of deposits by financial intermediaries (particularly commercial banks). In general, dollar deposits at commercial banks increased significantly in the third quarter of 2013 and banks appear to have used some of their increased liquidity to reduce short-term external liabilities, which fell by about 3¾ percent of GDP.

Peru: Balance of Payments, 2013
(In percent of GDP)

	Q1	Q2	Q3
Current account	*-5.2*	*-5.5*	*-5.7*
Capital account	*13.4*	*6.8*	*4.2*
FDI	8.7	4.8	4.0
Portfolio	2.1	6.3	2.3
MLT loans	0.9	-1.5	2.2
Public sector	0.8	-2.3	0.4
Short-term	0.9	-0.6	-4.6
o/w commercial banks	0.1	-1.3	-3.7
Errors and omissions	0.7	-1.6	0.6
BOP	*8.9*	*-0.2*	*-0.8*
Change in NIR 1/	*8.9*	*-0.2*	*-0.8*
FX intervention 2/	8.5	1.6	-6.7
Public sector FX transactions	-3.6	-2.8	-0.7
Public sector FX deposits	2.8	-0.1	1.0
FX deposits of financial intermediaries	0.9	0.8	5.2
Net interest gains	0.3	0.3	0.3
Other net transactions	-0.1	0.0	0.0

Source: BCRP and Fund staff estimates.
1/ Does not include valuation changes.
2/ Does not include sells of dollar-indexed securities, which are settled in local currency.

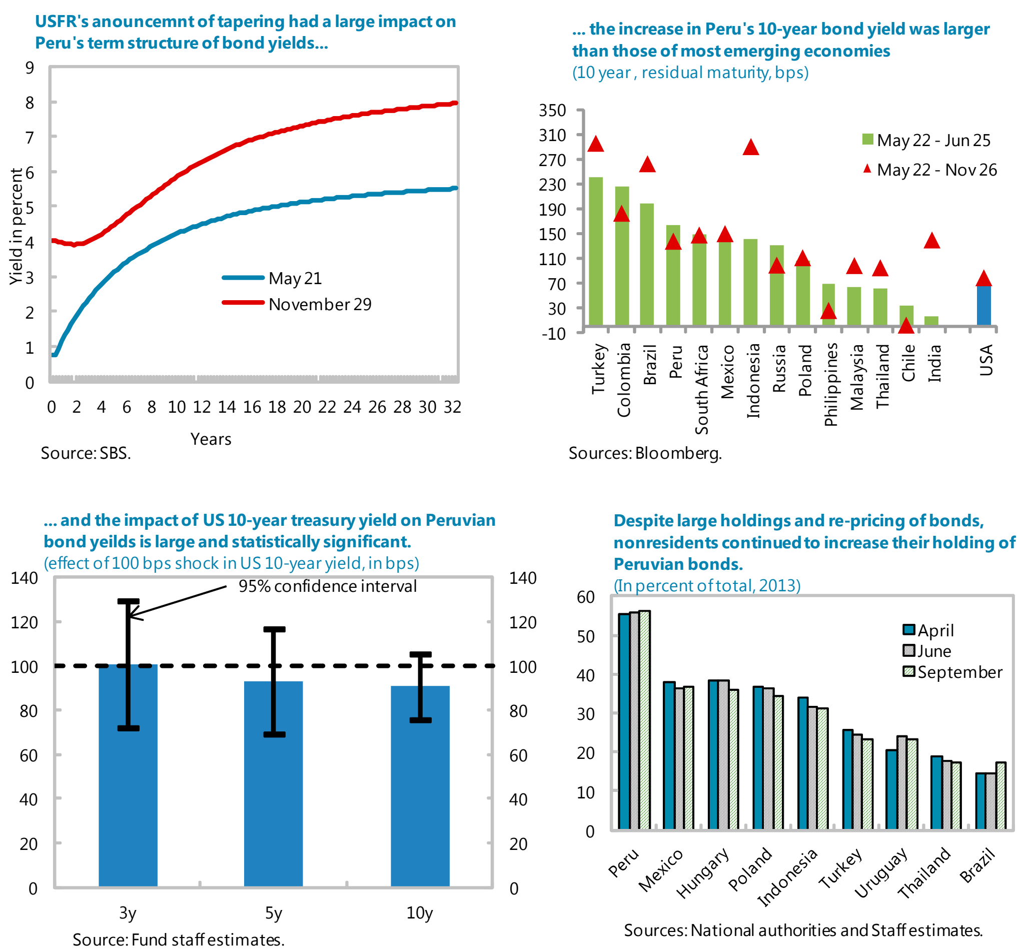
4. The composition of corporate financing changed significantly towards local sources and local currency following news of the USFR's tapering. The demand for external financing, which was high in the first half of the year diminished significantly in the third quarter of 2013. In particular, bond issuances in international capital markets came to a halt after registering a net inflow of about US$5 billion during the first half of the year, which is twice the amount registered for the whole year in 2012. Subsequently, corporate demand for local financing, in particular bank credits, increased significantly in the third quarter of 2013. It appears that firms are resorting to long-term external loans, which is the traditional source, for their foreign currency financing needs and to local markets for shorter maturities.

Peru: Net corporate debt financing, 2013
(In US$ billions)

	Q1	Q2	Q3
International	2.1	2.6	1.1
Bond issuance	1.7	3.4	0.0
Long-term loans	0.5	-0.8	1.1
Local	-0.3	-0.2	2.0
Bond issuance	0.1	-0.3	0.3
Bank credit	-0.4	0.1	1.6
National currency	0.1	0.5	1.0
Foreign currency	-0.5	-0.4	0.6

Source: BCRP and Fund staff estimates.

Peru: Impact of U.S. Fed Tapering Announcement on Local Currency Sovereign Bond Yields



5. The increase in 10-year local currency bond yields in Peru has been high compared to the changes in most emerging economies outside the region. During the five week period between May 22 and June 25, 2013 (when the U.S. 10-year treasury yield increased 78 bps), Peru's 10-year local currency bond yield jumped 162 bps. Econometric analysis also shows that the U.S. 10-year treasury yield has statistically significant impacts on Peru's local currency bond yields. After controlling for the impacts of other factors (including Peru's CDS, sovereign spread, exchange rate volatility, policy rate, and global volatility (VIX)), a 100 bps change in the U.S. 10-year treasury yield is estimated to have an impact of about 91 bps, 93 bps, and 101 bps in Peru's 10-year, 5-year, and 3-year local currency bond yields, respectively.[1] The null hypothesis that the effect of higher U.S. 10-year treasury yield to Peruvian 3-year, 5-year, and 10-year local currency bond yields is 1 to 1 cannot be rejected at the 95 percent confidence level. During all the turbulence period, non-residents not only continued to hold a large share of Peruvian bonds, but marginally increased their holdings since April of this year, despite significant re-pricing and uncertainty.

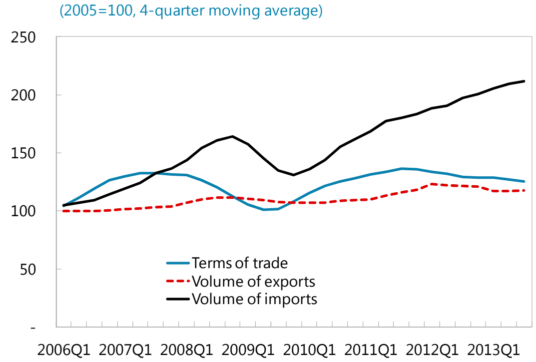
[1] A two-stage least squares regression of Peru's local currency bonds on the U.S. 10-year Treasury yield and the other factors mentioned above was used to derive the estimates in the text, using first lags as instruments to overcome a potential endogeniety problem between Peru's bond yields, CDS, sovereign spread, and exchange rate volatility.

Annex II. Assessing Balance of Payments Stability

Current Account

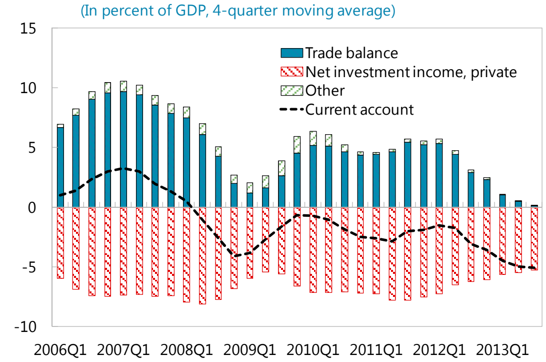
1. **Peru's current account has deteriorated since 2006 mainly reflecting the import component of FDI and despite gains in TOT.** The TOT improved by about 4½ percent a year, on average, during 2006–12, while the volume of exports grew marginally by about 3 percent a year. Nevertheless, the trade surplus continued to diminish due to surging imports, which grew 11½ percent a year, on average, during the same period, driven by robust domestic demand. On the other hand, about half of the mineral exports revenue is recorded as profit repatriation although approximately half of the repatriation is reinvested. Consequently, the current account balance deteriorated from a surplus of 3¼ percent of GDP in 2006 to a deficit of 3½ percent of GDP in 2012. The deficit worsened further to 5½ percent of GDP through September 2013 as the terms of trade deteriorated 3½ percent and exports fell 3¾ percent, while imports grew robustly at about 6¾ percent (yoy).

Peru: Exports, Imports and Terms of Trade
(2005=100, 4-quarter moving average)



Source: BCRP and Fund staff estimates.

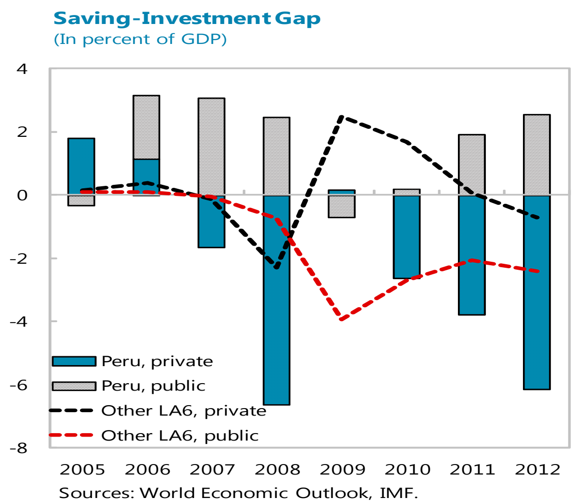
Peru: Components of Current Account
(In percent of GDP, 4-quarter moving average)

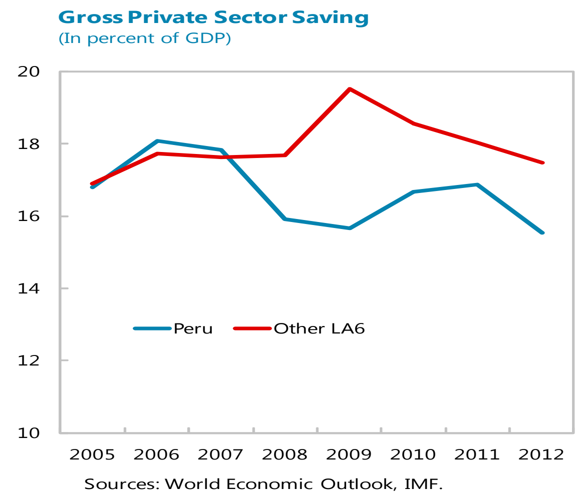


Sources: BCRP and Fund staff estimates.

2. **The deteriorating current account deficit also reflects the widening of private sector saving-investment gap.** While the public sector in Peru is a net saver, unlike that in the rest of LA6 countries, private sector saving-investment gap has widened substantially in part due to booming investment (including FDI) but also due to low and declining private sector savings. In this regard, encouraging private savings through capital market reforms and increasing pension participations could help improve the external imbalances over the medium term.

3. **The current account deficit is expected to fall to about 3½ percent of GDP over the medium term under the baseline scenario and at the current level of the real exchange rate.** Mineral exports are expected to grow significantly on account of the finalization of 4 large ongoing mining projects (i.e., Toromocho by Chinalco from China, Constancia by Hudbay from Canada, Cerro Verde by Freeport from the U.S., Las Bambas by Xtrata from Switzerland) with total investment of about US$14½ billion (7¼ percent of GDP) by 2016. In particular, according to official projections, volume of copper production and exports is expected to double in the next few years. On the other



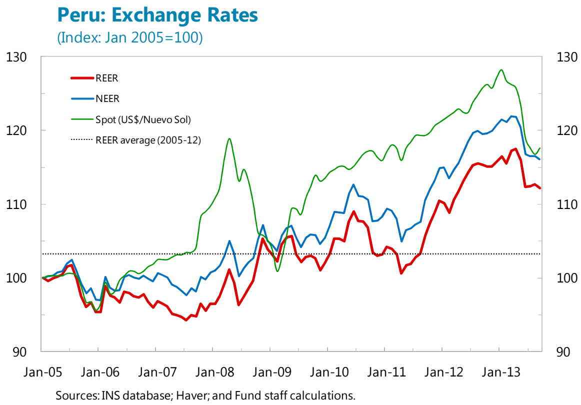


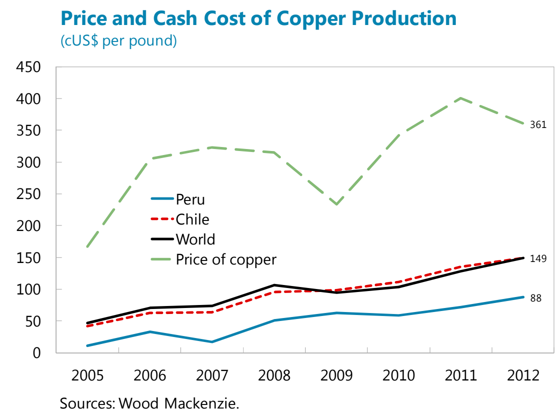
hand, import growth is expected to slow down to about 6½ percent as the growth of domestic demand cools off.

Exchange Rate and Competitiveness

4. The real exchange rate appreciated significantly over the last several years, although there has been some reversal in recent months. The real appreciation has been driven primarily by nominal appreciations as the central bank's inflation targeting policy has successfully anchored Peruvian inflation to that of major trading partners. In 2012, both the nominal and real effective exchange rates (NEER and REER) appreciated by about 8 and 8½ percent, respectively, in response to large capital inflows. Weaknesses in export prices in recent months have reversed the appreciations: the NEER and REER depreciated by about 3¾ and 3 percent, respectively, year-to-date through September 2013.

5. Meanwhile, cost-based indicators of competitiveness show that Peru is competitive in mining, its major export sector. For instance, the average cost of producing a pound of copper in 2012 was US$0.88 in Peru, compared to US$1.49 in Chile, the largest copper producer in the world. While Peru has such a natural cost advantage, the 2013–14 Global Competitiveness Report (by the World Economic Forum) shows that inefficient government bureaucracy, corruption, restrictive labor regulations, and inadequate supply of infrastructure remain key constrains to doing business in the country. Going forward, addressing these challenges will be necessary to improve the country's competitiveness further.





6. Model-based estimates show that the real exchange rate is broadly in line with fundamentals although there are variations among the different methods. The current account regression of the External Balance Approach (EBA) approach shows a current account deficit gap of about 1 percent of GDP (or about ½ percent of GDP adjusted for under-reporting of exports due to illegal gold mining) and a possible REER overvaluation of about 5½ percent (3 percent adjusted for under-reporting of exports) for 2013. But the REER has already depreciated by about 3 percent this year through September, correcting the estimated misalignments. On the other hand, the real exchange rate regression shows an overvaluation of 10 percent, but the regression has a large unexplained residual and the results need to be interpreted with caution. The traditional CGER methodologies painted a mixed picture on the medium-term real exchange rate. The equilibrium real exchange rate (ERER) method shows that the real exchange rate is broadly in line with fundamentals with a possibility of small undervaluation, whereas the macro balance (MB) and the external sustainability (ES) methods show overvaluations in the range of 8 to 13 percent (6 to 10 percent after adjusting for under-reporting of exports). Taking into account the recent depreciation of the REER, the remaining estimated gaps are smaller.

Peru: Current Account and REER Gaps

(In percent of GDP; unless stated otherwise)

	EBA Methodologies		CGER Methodologies		
	CA Regression	RER Regression	MB	ERER	ES
CA norm	-2.5	...	-1.5	...	-1.8
CA underlying 1/	-3.6	...	-3.5	...	-3.5
CA gap 2/	1.1	...	2.0	...	1.7
RER gap (in percent) 3/	***5.6***	***10.0***	***12.7***	***-3.3***	***8.3***
Adjusted: 4/					
CA underlying 1/	-3.1	...	-3.0	...	-3.0
CA gap 2/	0.6	...	1.5	...	1.2
RER gap (in percent) 3/	***3.1***	***10.0***	***10.2***	***-3.3***	***5.8***

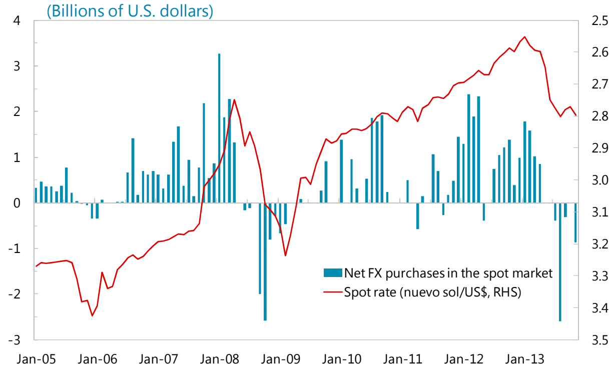
1/ Cyclically adjusted CA of 2012 for EBA; and medium-term CA for CGER.
2/CA gap is CA norm minus CA underlying.
3/ Positive value indicate overvaluation.
4/Adjusted for under-reporting in the illegal exports of gold estimated at 0.5 percent of GDP.

Capital Flows, FX Intervention, and International Reserves

7. Peru received large capital inflows during 2007–12, but faces limited risk of reversal since most of the inflows are long-term and non-debt creating. Net capital inflows averaged about 6¾ percent of GDP a year during this period, but the lion's share of these inflows were in the form of FDI (5 percent of GDP) and medium- and long-term loans (2 percent of GDP). Over two-thirds of the FDI inflows (3½ percent of GDP) were recycled mining profits (reinvestment). Net portfolio and short-term flows were very small (a net portfolio outflow of 0.5 percent of GDP was partially offset by a net short-term inflow of 0.2 percent of GDP), but the former increased very recently due to growing demand for external financing from the corporate sector to take advantage of the low global interest rates. Hence, Peru's susceptibility to external and financial instability due to capital flow reversals is likely to be very low, in particular when taking into account the central bank's ample FX reserves.

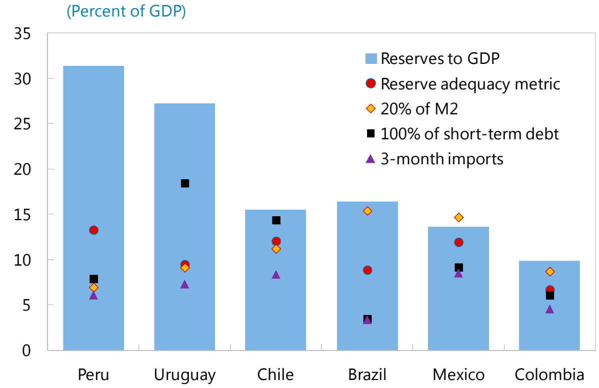
8. The authorities have employed FX intervention and macro-prudential measures to contain the pressure from capital flows. During 2010–12, a period of particularly high capital inflows pressure, the central bank deployed a number of measures including FX intervention (purchases), raising reserve requirements, and encouraging outflows, to contain the potential adverse consequences of a sharp exchange rate appreciation, which would affect balance sheets in a still highly dollarized economy. Total net FX purchases by the central bank during this period amounted to about US$26 billion (13 percent of 2012 GDP). The central bank purchased additional US$5.2 billion this year through April. In addition, the average and marginal reserve requirements on both local and foreign currency liabilities were raised several times between early 2010 and April of this year and the limit on pension fund managers' external investment was raised from 26 to 36 percent between June 2010 and April 2013 to encourage capital outflows. Consequently, the impacts of the inflows on credit growth and asset prices were contained.

Peru: Foreign Exchange Interventions
(Billions of U.S. dollars)



Source: BCRP.

LA6: NIR Coverage in 2012
(Percent of GDP)



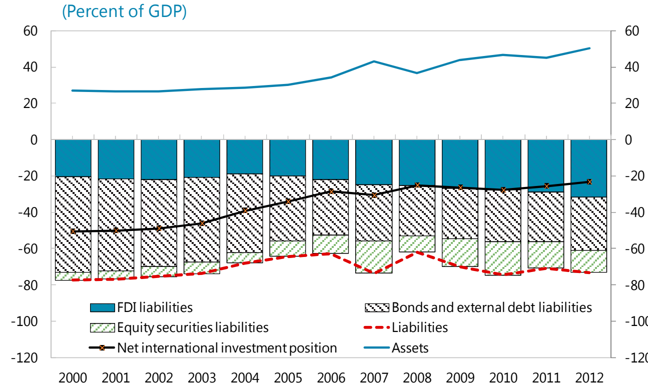
Sources: IMF Reserve Adequency Database; and Fund staff calculations.

9. Peru's net international reserves remain adequate. Net international reserves reached US$66.3 billion (32 percent of GDP) as at end-November 2013, which is adequate with respect to various metrics, including the IMF's composite adequacy measure. Peru's NIR is also the largest for the size of its economy among the LA6 countries.

Foreign Asset and Liability Position

10. Peru's international investment position (IIP) and its composition has improved over the last decade. The negative IIP more than halved since the early 2000s mostly due to accumulation of foreign assets while the composition of the foreign liabilities shifted significantly into non-debt creating items. Foreign assets almost doubled between 2000 and 2012, on the back of the central bank's accumulation of international reserves. On the other hand, while total foreign liabilities fell only by a few percentage points of GDP, the composition of non-debt creating liabilities (FDI and equity) almost doubled to 60 percent as at 2012.

Peru: International Investment Position 1/
(Percent of GDP)



Sources: BCRP and Fund staff's calculation.
1/ Liabilities are presented in negative figures.

Annex III. Natural Resource Wealth, Investment and Commodity Prices

1. **Peru is rich in various natural resources, especially minerals.** In 2011, Peru occupied a leading position in the global production of the following seven minerals: (i) copper (second after Chile); (ii) silver (second after Mexico); (iii) tin (third after China and Indonesia); (iv) zinc (third after China and Australia); (v) lead (fourth after China, Australia, and the U.S.); (vi) molybdenum (fourth after China, the U.S., and Chile); and (vii) gold (sixth after China, Australia, the U.S., Russia, and South Africa). In Latin America, Peru was first in the production of gold, lead, tin, and zinc and second in the production of cadmium, copper, mercury, molybdenum, phosphate rock, selenium, and silver. It also has large actual and potential reserves (Table 1), including of natural gas. In 2012, Peruvian mine production amounted to US$27 billion, equivalent to 4.1 percent of global mining production value, placing Peru in seventh place among the world's major mining producers.

Table 1. Peru: Mineral Reserves 1/

(Thousand metric tons unless otherwise specified)

Commodity		Reserves
Coal, all types		1,100,000
Copper		90,000
Gold	Metric tons	2,762
Iron ore		10,853
Lead		9,106
Molybdenum		450
Natural gas	Billion cubic meters	823
Natural gas liquids	Million barrels	1,550
Petroleum crude	Million barrels	3,055
Phosphate rock		820
Salt		100,000
Silver	Metric tons	120,000
Sulfur		150,000
Tin		160
Uranium		100
Zinc		25,137

1/ 2011.

Source: Ministry of Energy and Minerals.

2. **Peru's economy is relatively dependent on extraction and export of natural resources (Table 2).** In 2011, Peru's resource GDP constituted about 18 percent of nominal domestic product, comparing to about 13 percent in 2001. In real terms, however, this sector's share of GDP has actually decreased from over 15 percent to about 13 percent over the same period. After growing at an average of 5.2 percent in the first half of the 2000s, the sector's growth slowed in 2012 to the same level as a decade ago (3.5 percent). Exports of minerals reached 13 percent of GDP in 2012, growing 6 percentage points over the past decade in value terms.

Table 2. Peru: Mineral Resources

(in percent of; 2012)

Mineral value added	
Nominal GDP 1/	17.6
Real GDP 1/	12.8
Minerals fiscal revenue	
GDP	2.0
Total fiscal revenue	7.6
Total fiscal resource revenue	54.3
Exports value of minerals	15.6
Minerals exports	
GDP	13.0
Total exports value of goods	56.8
Minerals investment	
Total private investment	20.0

Sources: Peru's Statistical Agency; Ministry of Economy and Finance; Central Reserve Bank of Peru; and Fund staff calculations.

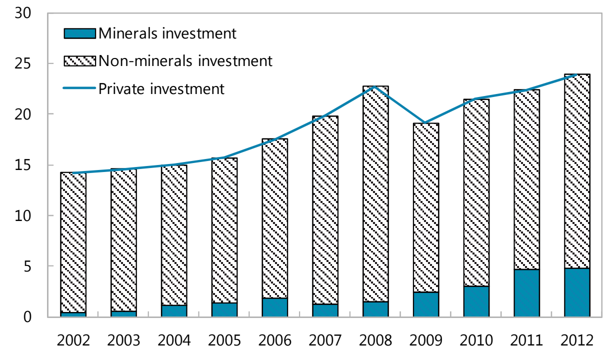
1/ 2011. Minerals and hydrocarbons.

3. **Investment in the minerals sector in Peru has been growing at an impressive rate.** Investment in the minerals sector has been growing at an annual rate of 32 percent on average during 2003–12 (in real terms). As a share of total private investment, investment in the minerals sector increased from 3 percent to over 20 percent in the last decade. The leading countries and

investors in Peru's mining sector are China, the U.S., Canada, Switzerland, Australia, Mexico, and Brazil. As of end-2012, mineral commodity investments are in copper (US$35.4 billion), gold (US$6.9 billion), iron ore (US$6.8 billion), copper-zinc (US$2.1 billion), and polymetallic minerals and silver (US$0.6 billion each). Foreign direct investment (about 70 percent of which goes to the extractive sector) has tripled over the last decade to some 6 percent of GDP in 2012. In 2012, Peru, at par with Chile, was fifth in the global destination for exploration of nonferrous metals, behind Canada, Australia, the U.S., and Mexico. Copper production could double by 2016 with coming on stream of the four large mines (Toromocho[1], Las Bambas, Constancia, and Cerro Verde) and quadruple in 2021 if the intended investment materializes without major delays (Table 3).[2]

Peru: Real Private Investment by Type

(Percent of real GDP, in real terms)



Sources: Central Reserve Bank of Peru; National Institute of Statistics and Information; Ministry of Economy and Finance; Haver Analytics; and Fund staff calculations and estimates.

Table 3. Peru: Investment in Minerals Industry

Local company	Country of Origin	Investment Company	Name of the Project	Mineral	Completion Date	US$ million
Expansion Stage						
SPCC	Mexico	Grupo Mexico	Cuajone	Cu	2013	300
SPCC	Mexico	Grupo Mexico	Fundición	Cu		
SPCC	Mexico	Grupo Mexico	Toquepala	Cu	2014	600
SPCC	Mexico	Grupo Mexico	Refinería de Ilo	Cu		
Compania Minera Miski Mayo S.R.L.	Brasil	Vale	Bayovar	Fosfats	2014	520
Minera Barrick Misquichilca S.A.	Canada	Barrick Gold Corp.	Lagunas Norte	Au	2013	400
Shougang Hierro Peru S.A.A.	China	Shougang Corporation	Marcona	Fe	2014	1,480
Sociedad Minera Cerro Verde S.A.A.	Usa	Freeport-MacMoran Copper	Cerro Verde	Cu	2016	4,400
Sociedad Minera El Brocal S.A.A.	Peru	Grupo Buenaventura	Colquijirca	Polimetals	2013	305
Minera Chinalco Perú S.A.	China	Chinalco-Aluminium Corp.of China	Toromocho	Cu	2016	1,320
Construction Stage						
Anglo American Quellaveco S.A.	Uk / Japon	Anglo American 81.9 %, Mitsubishi 18.1%	Quellaveco	Cu	2016	3,300
Invicta Mining Corp S.A.C.	Canada	Andean American Mining Corp	Invicta	Polimetals	2014	93
Minera Chinalco Perú S.A.	China	Chinalco-Aluminium Corp.of China	Toromocho	Cu	2013	3,500
Minera Yanacocha S.R.L.	Usa / Peru	Newmont 51.35%, Buenaventura 43.65%, IFC 5%	Minas Conga	Cu, Au	2017	4,800
Hudbay Minerals Inc.	Canada	HudBay Minerals Inc.	Constancia	Cu	2014	1,546
Xstrata Las Bambas S.A.	Suiza	Xstrata Copper	Las Bambas	Cu	2014	5,200
Compañía Minera Alpamarca S.A.C.	Peru	Grupo Volcan	Alpamarca-Rio Pallanga	Pb-Zn-Ag-Cu	2013	90
Minera Suyamarca S.A.C.	Peru / Usa	Grupo Hochschild 60% / IMZ -International Minerals Corp 40%	Inmaculada	Au - Ag	2014	370
Reliant Ventures S.A.C.	Canada	Silver Standard Peru S.a.	San Luis	Au - Ag		
Total Current						**28,224**
Submitted and in Exploration (24 projects)						**29,299**
TOTAL						**57,523**

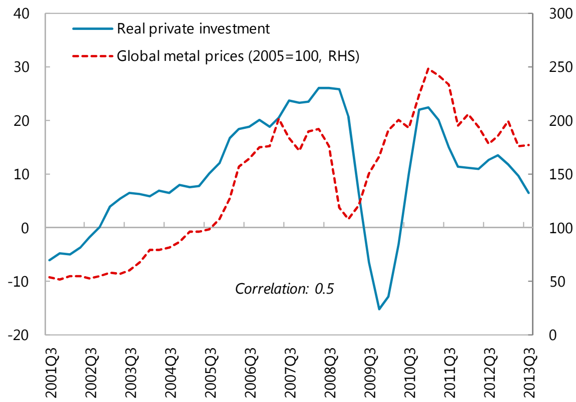
Source: Ministry of Energy and Minerals.

[1] Started operations in December 2013.

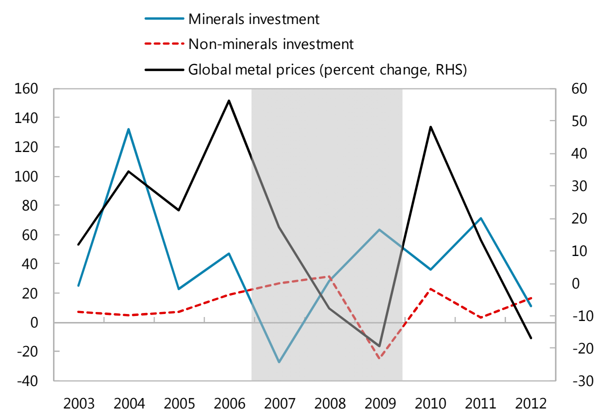
[2] Average industry time for the mine to reach full capacity since the turn key stage is 6-9 months. Las Bambas, which is owned by Xstrata of Switzerland, is in the midst of a sale of the mine as required by the China's competition law since the company operates in China as well.

4. The strong growth in the minerals investment reflected a number of factors. Largely it was due to favorable global metal prices, low cash costs of extraction especially copper, as well as the country's macroeconomic stability, judicial framework in the minerals sector, good investment climate, and evolving engagement of the operating companies with the local community. In particular, global metal prices grew at 16 percent annually on average during 2003–12. Empirical analyses show that investment in the minerals sector is significantly and positively affected by global metal prices.[3]

Peru: Real Private Investment
(Percent change, 4-quarter moving average SAAR)

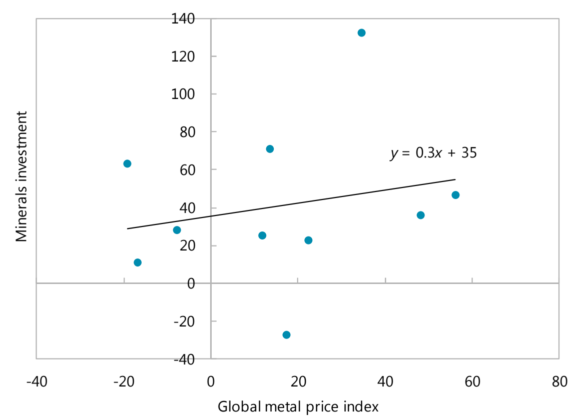


Peru: Real Private Investment by Type 1/
(Percent change)

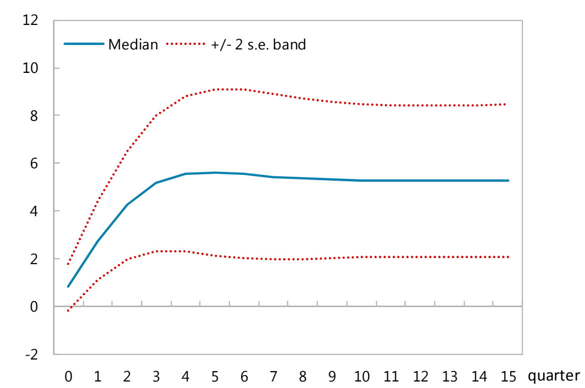


1/ The shadow area indicates the period of the global financial crisis.

Peru: Minerals Investment and Global Metal Prices
(Annual percent change)



Cumulative Impulse Response of Private Investment to One-S.D. Shock of Global Metal Prices
(Percent)



Sources: Central Reserve Bank of Peru; National Institute of Statistics and Information; Ministry of Economy and Finance; Haver Analytics; International Financial Statistics; and Fund staff calculations and estimates.

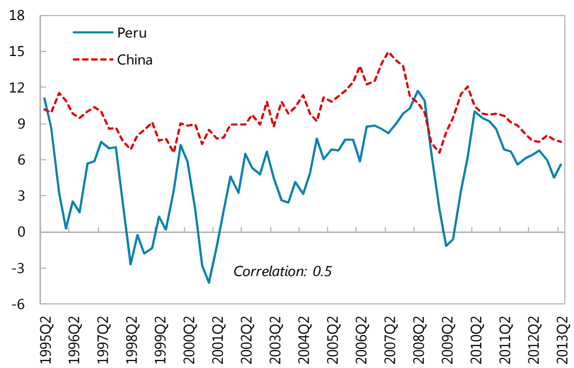
[3] Annual data was used due to data limitations on investment in minerals on a high frequency basis.

5. Total private investment has been growing strongly over the last decade as well. Due to the rapid growth of investment in the minerals sector, total private investment grew at an annual rate of 13 percent on average during 2003–12, higher than the 10-percent annual growth rate of investment in the non-minerals sectors. VAR models using global metal prices, exchange rate, and private investment (on a quarterly basis, in real terms) suggest that a one-standard-deviation shock to the global metal prices (about 8 percent in a quarter) is likely to raise total private investment by about 5 percent in the following year after the shock.

Annex IV. China's Spillovers to Peru

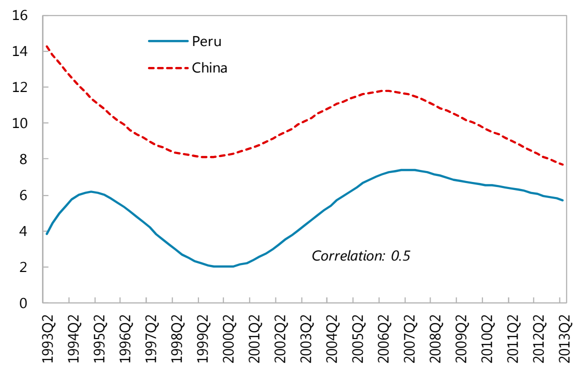
1. The growth rates of Peru and China have been highly correlated with each other. The correlation of quarterly GDP growth rates of Peru and China is 0.5. The estimated potential GDP growth rates of the two countries seem to have synchronized somewhat since the mid-1990s, and their correlation also stands at 0.5.

Real GDP of Peru and China
(Annual percent change)



Sources: BCRP; Haver Analytics; and Fund staff calculations.

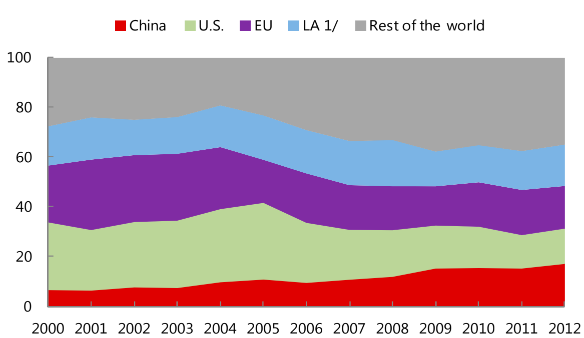
Real Potential GDP of Peru and China 1/
(Annual percent change)



Sources: BCRP; Haver Analytics; and Fund staff estimates.
1/ Real potential GDP is estimated by the HP filter.

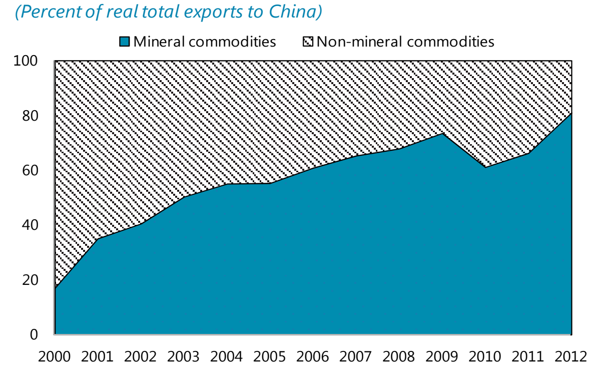
2. China has become one of the largest export partner of Peru. Peru sells 17 percent of its total exports to China (about 4 percent of GDP in 2012), and about 81 percent of its metals exports. Cross-country comparison shows that over a third of Peru's copper exports, 64 percent of gold exports, and 22 percent of other mineral commodities went to China during 2008–12 in real terms.[1] However, China's mineral imports from Peru, including copper and gold, are still at a relatively small share in its total mineral imports from the world.

Peru: Exports by Destination
(Percent of total exports)



Sources: UN Commodity Trade Statistics; and Fund staff calculations.
1/ Comprising LA6 economies, Argentina, Bolivia, Ecuador, Paraguay, and Venezuela.

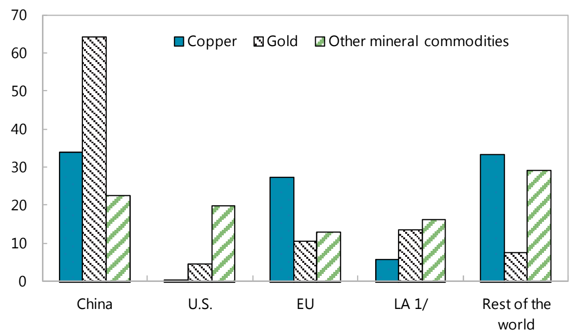
Peru's Real Exports To China: Mineral v.s. Non-Mineral
(Percent of real total exports to China)



Sources: UN Commodity Trade Statistics; IFS; and Fund staff calculations.

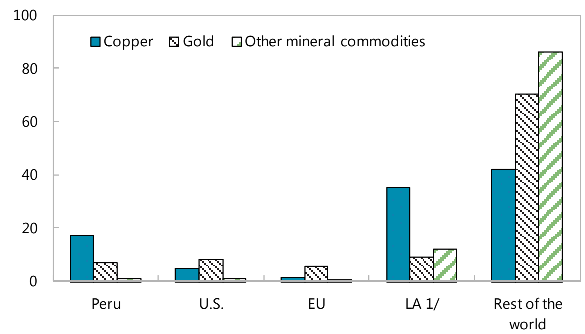
[1] Based on UN Commodity Trade Statistics. Peruvian statistics show lower levels of exports of metals to China, and higher levels to the E.U.

Peru's Real Mineral Exports by Destination
(Percent of corresponding exports to the world during 2008-12)



Sources: UN Commodity Trade Statistics; IFS; and Fund staff calculations.
1/ Comprising LA6 economies, Argentina, Bolivia, Ecuador, Paraguay, and Venezuela.

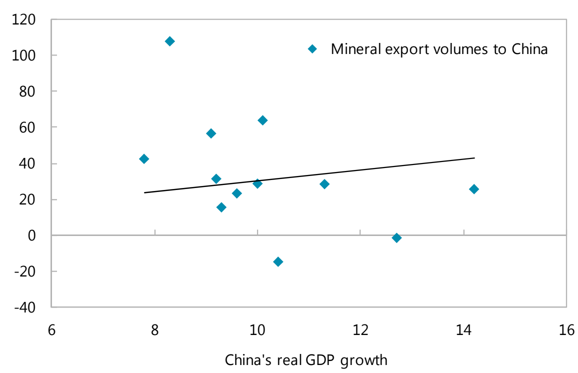
China's Real Mineral Imports by Origin
(Percent of corresponding imports from the world during 2008-12)



Sources: UN Commodity Trade Statistics; IFS; and Fund staff calculations.
1/ Comprising LA6 economies (excluding Peru), Argentina, Bolivia, Ecuador, Paraguay, and Venezuela.

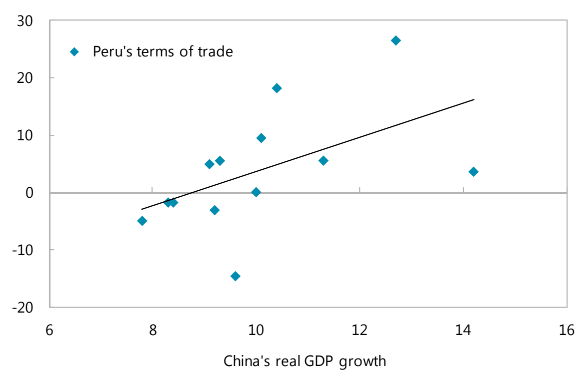
3. The main channel that China's growth spills over to Peru is through its impact on global commodity prices, and hence Peru's terms of trade (price effect). Peru's terms of trade (TOT) (not mineral export volumes) seem to co-move with China's growth, suggesting that the spillovers of China's growth to Peru's growth are likely to take place mainly through the price effect instead of quantity effect.[2]

Peru: Mineral Export Volumes to China and China's Growth
(Annual percent change)



Sources: Central Reserve Bank of Peru; Haver Analytics; and Fund staff calculations.

Peru: Terms of Trade and China's Growth
(Annual percent change)

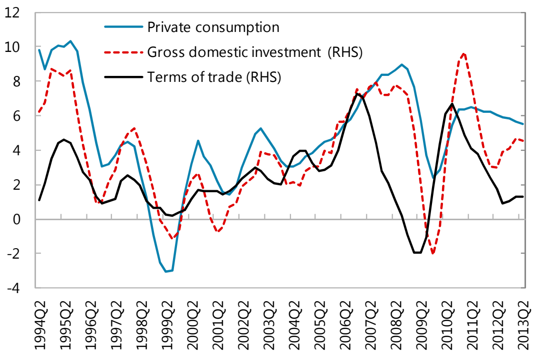


Sources: Central Reserve Bank of Peru; Haver Analytics; and Fund staff calculations.

4. Deterioration in Peru's TOT might lead to lower growth of investment and consumption. The correlation between Peru's TOT and investment growth is 0.4, and the correlation between TOT and private consumption growth is 0.3. Empirical analyses suggest that Peru's TOT Granger-causes and has statistically significant effects on the growth of investment and private consumption with one-quarter lag. These effects seem to operate mainly through the TOT's impact on domestic income and imported capital and consumer goods.

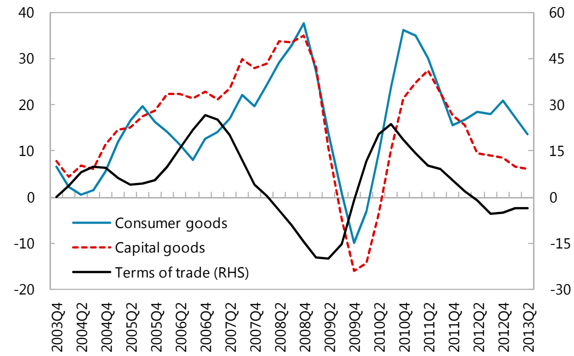
[2] Notice that the spillovers through China's FDI and portfolio flows to Peru are relatively small, as most literature found, such as Jenkins, Peters, Moreira (2007).

Peru: Terms of Trade and Consumption, Investment
(Annual percent change, one-year moving average)



Sources: BCRP; Haver Analytics; and Fund staff calculations.

Peru: Terms of Trade and Imported Consumer, Capital Goods
(Annual percent change, one-year moving average)

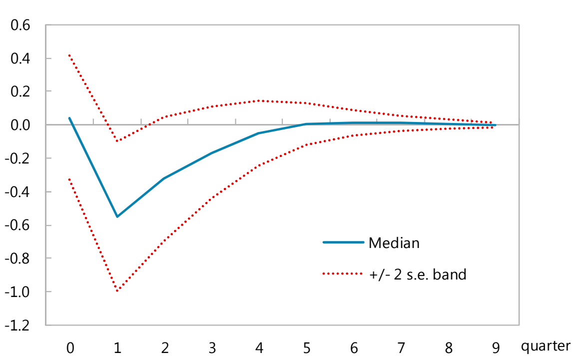


Sources: BCRP; Haver Analytics; and Fund staff calculations.

5. One percentage-point decline in China's real GDP growth in one year is likely to reduce Peru's real GDP growth by about 0.4 percentage points over the year, mainly through its impact on Peru's TOT. A structural VAR model, including China's real GDP growth, and Peru's TOT, exchange rate *vis-a-vis* the U.S. dollar, export volumes, and Peru's real GDP growth as endogenous variables, was used to assess the extent to which China's growth spills over to Peru, and identify the main spillover channel. The impulse responses from the model suggest that a one-percentage-point decline in China's real GDP growth in one year is likely to result in a (statistically) significant deterioration in Peru's TOT, a significant depreciation of the nuevo sol, and a significant decline of 0.4 percentage points in Peru's real GDP growth over the year.

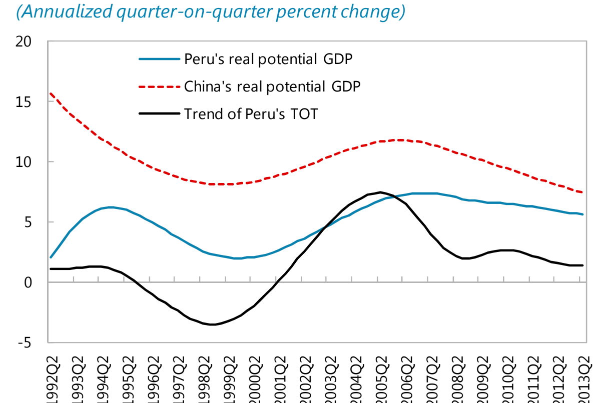
6. In the medium term, a permanent slowdown of one percentage point in China's growth would reduce Peru's potential growth by about 0.2–0.4 percentage points, mainly through its permanent impact on Peru's TOT. Potential growth of Peru and China as well as the trend of TOT seem to co-move with one another. The Vector Error Correction Models (VECM) suggest that a one-percentage-point drop in China's potential growth over a year seems to deteriorate Peru's TOT permanently, and leads to a decline between 0.2 and 0.4 percentage points in Peru's potential growth over the year. Thus, if China's growth permanently slows down to 7.5 percent from about 10.5 percent in the last decade, then this would likely bring down Peru's medium-term growth between 5.3 and 5.9 percent.

Impulse Response of Peru's Real GDP Growth to a One-Percentage-Point Decline of China's Real GDP Growth
(Annualized quarter-on-quarter percent change)



Sources: BCRP; Haver Analytics; IFS; and Fund staff estimates.

Real Potential GDP of Peru and China, and Trend of TOT
(Annualized quarter-on-quarter percent change)



Sources: BCRP; Haver Analytics; and Fund staff estimates.

Annex V. Prudential Measures and Credit Development

Overview

1. The proactive use of prudential measures has helped Peru to prevent the buildup of financial sector vulnerabilities during the global financial crisis and the recent episode of surges in capital flows. Private sector credit continued to grow at a robust rate even at the height of the global financial crisis (at about 10 percent at end-2009). Early signs of excessive credit growth during the recent episode of high capital inflows were addressed with prudential measures. In addition to the standard capital, provisioning, and liquidity requirements, the Peruvian authorities have employed macroprudential measures to contain the buildup of risks associated with currency and maturity mismatches, interconnectedness and business cycles. The authorities also continue to implement FSAP recommendations. At the same time, the Peruvian banks have easily surpassed both national and Basel III prudential requirements.

Prudential measures and performance of financial institutions

2. Peru's regulatory requirements have met most, but not all, of Basel III recommendations on capital. The minimum regulatory capital to risk weighted asset ratio (CAR) required by Peru's Superintendence for Banks, Insurance Companies, and Pension Funds (SBS) is 10 percent, which is above Basel III requirement of 8 percent. SBS's minimum required ratios for common equity and Tier 1 capital are also higher than Basel III requirements for the current year and next year (in the case of common equity), but may become lower starting from next year (2015 in the case of common equity) unless SBS increases its requirements. Moreover, SBS's regulatory framework requires additional capital buffers for risks associated with the business cycle, credit concentration (sectoral, individual, and geographic), systemic, interest rate, and foreign currency. On November 2012, the SBS amended the regulations on capital requirements for credit risk, defining capital requirements according to the type of credit (mortgage loans, revolving and non-revolving consumer loans) and according to the currency in which credit is granted, establishing higher requirements for credits in foreign currency.

Peru: Capital Adequacy and Leverage Ratios 1/
(In percent)

	Common equity capital	Tier 1 capital	Regulatory capital	Leverage Ratio
Legal requirements				
Basel II– minimum	2.0	4.0	8.0	...
Basel III– minimum 2/	4.5	6.0	8.0	3.0
Basel III– minimum plus 2.5% buffer	7.0	8.5	10.5	...
Peru– minimum 3/	4.3	5.0	10.0	...
Actual (Sep 2013)				
Banks	8.3	10.1	13.7	5.7
Financial companies	14.0	14.0	17.9	12.1
Cajas municipales	13.3	13.4	15.3	12.2
Cajas rurales	11.9	11.9	13.6	9.2
Financial system	8.9	10.5	14.0	6.3

Source: BIS and SBS.

1/ Capital adequacy ratios are defined as ratios of risk weighted asset and leverage ratio is defined as Tier 1 capital/Total (on– and off– balance sheet) exposure.

2/ The schedule for Basel III implementation is as follows: (i) Minimum common equity: 3.5% in 2013, 4.0% in 2014 and 4.5% in 2015; (ii) Capital conservation buffer: 0.625% in 2016, 1.25% in 2017, 1.875% in 2018, and 2.5% in 2019; and (iii) Minimum Tier 1 capital: 4.5% in 2013, 5.5% in 2014, and 6.0% in 2015.

3/Current requirements. Common equity and Tier 1 capital requirements are implicit. Tier 2 capital cannot be greater than Tier 1 capital and hybrids are considered into Tier 1 capital up to 17.65% of common equity.

3. Peru's financial institutions have already surpassed both national and Basel III regulatory capital requirements ahead of time. Common equity capital ratios at deposit taking institutions as of September 2013 range from 8.3 percent for banks to 14 percent for financial companies, compared to Basel III minimum (plus conservation buffer) requirement of 7 percent for 2019. Tier 1 capital ratios range from 10 percent for banks to 14 percent for financial companies, well above Basel III minimum (plus conservation buffer) requirements of 8.5 percent for 2019. Similarly, total CAR range from 13.6 percent for rural micro-finance institutions to 17.9 for financial companies, compared to Basel III minimum (plus conservation buffer) requirements of 10.5 for 2019. Finally, the average leverage ratio range from 5.7 percent for banks to 12.2 for *Cajas municipales* (municipal microfinance institutions), well above the 3 percent minimum requirement recommended by Basel III.

4. Peru is implementing Basel III liquidity ratio requirement, in addition to its own existing requirements. Minimum liquidity ratio (LR) requirements, defined and calculated on a daily basis as the ratios of liquid assets to short-term liabilities separately for local and foreign currencies, have already been implemented since the late 1990s with the aim of containing risks associated with both maturity and currency mismatches. More specifically, the minimum required liquidity ratios (LRs) for local currency and foreign currency have been 8 percent and 20 percent, respectively. Recently, the SBS issued a new regulation for additional liquidity requirements, including the liquidity coverage ratio (LCR), which is in line with Basel III recommendations. Although SBS's definition of the LCR is slightly different from that of Basel III, its definition 'high quality assets' is more restrictive compared to Basel III requirements since it entirely excludes corporate bond holdings.[1] The LCR requirement is 100 percent, consistent with Basel III recommendations.

Peru: Liquidity Ratios
(In percent)

	Liquidity coverage ratio	Liquidity ratio: Local currency	Liquidity ratio: Foreign currency
Minimum requirements			
Basel III 1/	100	...	...
Peru's SBS 2/	100	8	20
Actual (Sep 2013)			
Banks	167	36	57
Financial companies	83	30	62
Cajas municipales	170	42	64
Cajas rurales	184	51	87
Financial system	163	36	57

Source: BIS and SBS.
1/ The schedule for implementation is as follows: 60% in 2015, 70% in 2016, 80% in 2017, 90% in 2018, and 100% in 2019.
2/ The schedule for implementation is as follows: 80% in 2014, 90% in 2015 and 100% in 2016.

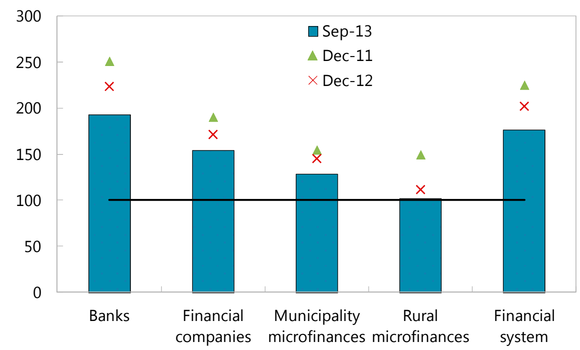
5. Liquidity ratios at financial intermediaries in Peru are large and have easily surpassed both national and international standards. LRs in local currency range from 30 percent at financial companies to 51 percent at rural micro-finance institutions, compared to the minimum requirement of 8 percent. Similarly, LRs in foreign currency range from 57 percent at banks to 87 at rural micro-

[1] Basel III requires LCR, defined as the ratio of the stock of high quality liquid assets to the difference between the next 30 days outflows and the minimum of the next 30 days inflows and 75 percent of next 30 days outflows, to be at least a 100 percent. SBS also requires LCR to be at least a 100 percent, but it defines LCR as the ratio of the sum of the stock of high quality assets and the minimum of the next 30 days inflows and 75 percent of next 30 days outflows to the next 30 days outflows.

finance institutions, well above the 20 percent minimum regulatory requirement. Although the new liquidity requirements are not effective yet, average estimated LCR for the financial system as a whole based on the Peruvian definition was 163 percent as of September 2013, surpassing SBS's 100 percent minimum requirement ahead of the implementation period (2014–16).[2] Only financial companies have LCR less than a 100 percent, but at 83 percent their LCR is still higher than the 80 percent requirement by the SBS for 2014.

6. On top of the standard provisioning requirements for non-performing loans, Peru has introduced dynamic provisioning requirements to contain risks associated with the business cycle. The dynamic provisioning regime, being implemented since November 2008, requires financial institutions to accumulate additional provisioning during the expansion stages of the economic cycle, which can be used to finance potential loan losses during economic downturns.[3] The requirements vary according to credit types: 0.4 percent for corporate loans, 0.3 percent for loans to medium size firms, 0.5 percent for loans to small and micro enterprises, 0.4 percent for mortgages, and 1 to 1½ percent for consumer loans. Provisioning by Peruvian financial intermediaries is well in excess of 100 percent of non-performing loans with the exception of rural microfinance institutions.

Peru - Provisioning to non-performing loans
(In percent)



Sources: SBS

7. Regulations aim to reduce FX risks through limits on FX derivative positions and additional capital and provisioning requirements for foreign currency exposures. The SBS limits banks' FX derivative positions to minimize the exposure of their equity to FX risks. Current limits on banks' FX positions are: 50 percent of regulatory capital for global FX long positions, 10 percent of regulatory capital for global FX short positions, and 20 percent of regulatory capital or S/. 300 million, whichever is higher, for the absolute value of net positions in financial products derived from foreign currency. An additional capital requirement for FX exposures has been in place since July 2010 (2.5 percent of firms' exposure to FX credit risk which will reach 8 percent by the end of 2015) to ensure that financial institutions internalize FX risks associated with loans to clients without coverage. Furthermore, SBS requires financial entities, that in its opinion do not adequately assess credit risk associated with exchange rate mismatches, to provision up to 1 percent of their direct loans in foreign currency.

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[2] The excess liquidity buffer is in part due to high reserve requirements by the central bank, which is included in the definition of liquid assets for LRs and partially (the reserves above the minimum requirement) in the definition of high quality assets for LCRs.

[3] The dynamic provisioning regime is activated when GDP growth surpasses certain thresholds relative to the potential output growth.

8. The authorities continue implementing the FSAP recommendations on the oversight of banking institutions. For instance, new regulations are being introduced to address recommendations on developing benchmarks to evaluate the effectiveness of management and tightening regulations on related party intra-group transactions. A draft Law is being coordinated with the association of credit unions to bring credit unions under SBS's supervision and in the deposit guarantee fund.

9. In addition to regulatory measures, the central bank (BCRP) uses reserve requirements (RR) as a macro-prudential policy instrument. The BCRP imposes RRs on both local and foreign currencies deposits and short-term external liabilities to contain the buildup of vulnerabilities associated with capital flows in a partially dollarized economy. For instances, RRs were raised several times during the recent episode of surges in capital inflows and are now being unwound to ease liquidity constraints resulted from the ongoing volatility in emerging financial markets. RRs are also used as countercyclical measures to fluctuations in liquidity flows in the financial system and as means to encourage de-dollarization of credits by maintaining a high positive spread between RRs on foreign currency liabilities and those on local currency. The current spread between local currency and foreign currency marginal RRs is 35 percentage points. The marginal RR ratios are 15 percent (with a 15 percent limit on average RR ratio) on local currency liabilities; 50 percent (with a 45 percent limit on the average RR ratio) on foreign currency domestic liabilities; and 50 percent on short-term external liabilities.

Peru: Progress on implementation of the 2010 FSAP recommendations on banking oversight

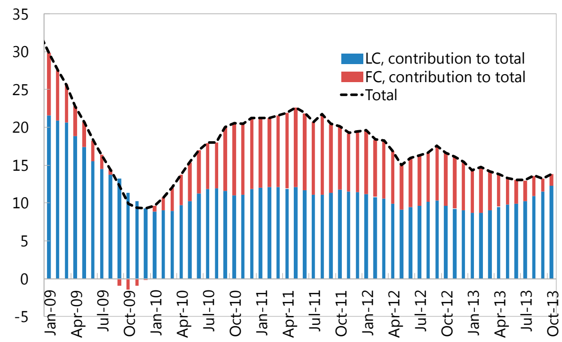
Recommendations	Progress
Include credit cooperatives under SBS's supervision and in the FSD.	Draft law being coordinated with the association of credit unions.
Increase the number and caliber of SBS' on-site inspection staff.	On-site and off-site inspections have been integrated to generate synergies. New staff has been hired and special attention is given to training.
Develop benchmarks to evaluate the effectiveness of management.	Definitions of criteria and principles are in the project Risk Matrix of Risks PE 2013-2015.
Tighten regulations on related party intra-group transactions.	New regulations and definitions of Ultimate Beneficiary Owners in the process PE 2013. Definition of groups and related parties to be updated.
Strengthen consolidated supervision and regulate holdings.	Not implemented yet; requires change in law.

Source: SBS.

Private sector credit dynamics

10. The proactive use of prudential measures has helped build financial sector resilience against external shocks. Despite global credit crunch during the recent global financial crisis, credit growth in Peru remained relatively robust. The use of macro-prudential policy instruments has also helped to keep credit growth under control during the recent episode of surge in capital inflows. After moderating in the first half of the year due to a combination of regulatory measures and the slowdown in economic growth, growth in private credit is picking up again as the central bank has begun unwinding some macro-prudential measures.

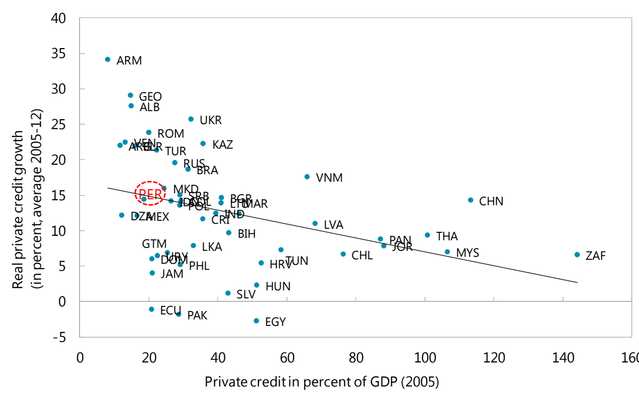
Peru- Private Credit Growth
(FX-adjusted yoy, in percent)



Sources: BCRP and Staff estimates.

11. All things considered, there is no evidednce that implementation of Basel III recommendations has a negative impact on private credit growth. While Peru has not officially stated that it was implementing Basel III, it has been implementing elements of Basel III recommendations since 2008. Meanwhile private credit growth remained strong since then and Peru's credit growth is consistent with the level of financial deepening. The fact that the central bank has been hiking reserve requirements in recent years also suggests that the concern has been more on the excessive growth side than the contrary. Going forward, it would be important to continue strengthening the coordination between the BCRP and SBS to ensure that the credit channel continues to work properly.

Private Credit in Emerging Economies



Sources: World Bank (WDI), Haver Analytics and Staff estimates.

INTERNATIONAL MONETARY FUND

PERU

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 8, 2013

Prepared By: The Western Hemisphere Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of November 30, 2013)

Membership Status: Joined 12/31/1945; accepted the obligations of Article VIII, Sections 2(a), 3, and 4 on 2/15/1961.

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	638.40	100.00
Fund holdings of currency	405.92	63.58
Reserve Tranche Position	232.50	36.42

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	609.89	100.00
Holdings	531.11	87.08

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-By	Jan 26, 2007	Feb 28, 2009	172.37	0.00
Stand-By	Jun 09, 2004	Aug 16, 2006	287.28	0.00
Stand-By	Feb 01, 2002	Feb 29, 2004	255.00	0.00

Projected Payments to Fund [1/]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2013	2014	2015	2016	2017
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.04	0.03	0.03	0.03	0.03
Total	0.04	0.03	0.03	0.03	0.03

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Arrangements

Peru maintains a unified, floating exchange rate. On December 11, 2013, the average of interbank buying and selling rates was 2.79 *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 maintained pursuant to UN Security Council Resolutions 1267 (October 15, 1999) and 1373 (September 28, 2001).

Last Article IV Consultation

The 2012 Article IV consultation was concluded on February 13, 2013 (IMF Country Report No. 13/45).

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).

Technical Assistance

A list of technical assistance provided to Peru in the last several years is provided in Annex V.

Resident Representative

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

WORLD BANK RELATIONS

(As of December 3, 2013)

A. Bank Group Strategy

The World Bank Group support to Peru is defined in the Country Partnership Strategy (CPS) approved by the Board on February 1, 2012. The CPS is closely aligned with the Government's strategic vision of strong economic growth with greater inclusion and is focused in four strategic objectives: (i) increased access and quality of social services for the poor; (ii) connecting the poor to services and markets; (iii) sustainable growth and productivity; and (iv) inclusive governance and public sector performance. The CPS also addresses cross-cutting issues such as those of governance and gender. The CPS is a result of extensive consultations with government and civil society.

The indicative lending program is at about US$250 million per annum, reflecting Government's interest in policy reform support through Development Policy Lending and in reform implementation support through an investment lending program. The strategy includes development policy lending operations in the fiscal, social, and environmental sectors mainly through deferred drawdown options.

Peru's current lending portfolio includes 17 active projects with a commitment of US$1.8 billion and an undisbursed balance of US$1.4 billion. The portfolio includes twelve investment loans, three DPL/DDOs and one GEF grant. The areas covered by the existing portfolio are economic policy, environment, social protection, transport infrastructure, water resources, among others. Examples of projects include Basic Education (US$25 million), Higher Education (US$25 million) Regional Transport (US$50 million), Lima Optimization of Water Systems (US$54.5 million), and Second Rural Electrification Project (US$50 million).

During FY 12, there were no deliverables given that there was a newly elected Government, and a review of the proposed work was carried out during that year. For FY 13, a new Social Inclusion DPL (U$45 million), a new Social Inclusion Technical Assistance Loan ($10 million) and new Higher Education (US$25 million) and Basic Education (US$25 million) projects were approved by the Board. For FY 14, the first sub national lending operation is being prepared for Cusco in the tourism sector that also includes waste management and risk disaster management components (US$35 million). Other projects in preparation include Innovation in Agriculture (US$40 million), a new GEF project for Guano Islands, and a project in Urban Transport for Cusco.

In addition, the Bank has an extensive program of analytical and advisory activities for FY 13–14, including both economic and sector work and non-lending technical assistance. The economic and sector work covers areas such as public expenditure, fiscal incidence, infrastructure, social sectors, climate change, and housing and municipal financing.

Finally, the Bank's TF portfolio (currently over US$23 million) 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 November 2013
(In millons of US$)

Project name	Approval	Lending instrument	Net commitment amount	Total undistributed balance	Total disburseme nt	Total in fiscal year
Investment						
Sierra Irrigation	07/27/2010	SIL	20.00	12.91	7.09	1.37
Water Resources Mgmt.	07/02/2009	SIL	10.00	4.50	5.50	1.25
Regional Transport Decentralization	07/12/2005	SIL	50.00	9.47	40.53	8.50
Optimization of Lima Wat & Sewerage	04/07/2011	SIL	54.50	42.01	12.49	2.25
Higher education quality improvement	12/04/2012	SIL	25.00	24.40	0.60	0.60
Basic Education	01/17/2013	SIL	25.00	25.00	0.00	0.00
Health Reform Program	02/17/2009	APL	15.00	7.60	7.40	1.11
Results Nutrition for Juntos SWAp	03/08/2011	SIL	25.00	17.72	7.28	7.28
Social Inclusion	12/13/2012	TAL	10.00	9.89	0.11	0.11
Justice Services Improv. II	11/18/2010	TAL	20.00	11.34	8.66	0.71
Sierra Rural Development Project	04/24/2007	SIL	40.00	20.00	20.00	0.00
Second Rural Electrification	04/21/2011	SIL	50.00	49.50	0.50	0.50
GEF Natural Protected Areas System	05/20/2010	SIL	8.89	2.57	6.32	0.31
Adjustment						
First Prog. Environ DPL/DDO	02/17/2009	DPL	330.00	310.00	20.00	0.00
CAT DDO	12/09/2010	DPL	100.00	100.00	0.00	0.00
2nd Prg Fiscal Mgmt & Comp. DPL/DDO	08/05/2008	DPL	700.00	480.00	220.00	0.00
2nd Results & Accnt.(REACT)DPL/DDO	04/09/2009	DPL	330.00	310.00	20.00	0.00
Total			**1813.39**	**1436.90**	**376.5**	**24.0**

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

Peru: Committed and Disbursed Outstanding Investment Porfolio

As of October 31, 2012

(In millions of US$)

		Committed						Disbursed Outstanding					
Commitment FY	**Institution**	**Loan**	**Equity**	***Quasi Equity**	**Guarantee**	**Risk Mgmt**	**Participant**	**Loan**	**Equity**	***Quasi Equity**	**Guarantee**	**Risk Mgmt**	**Participant**
2000/06	Agrokasa	1.4	-	-	-	-	-	1.4	-	-	-	-	-
2008/12	Amerika Fin.	10.0	-	-	-	-	-	10.0	-	-	-	-	-
2011	Arequipa Region	-	-	-	1.4	-	-	-	-	-	1.4	-	-
2007/08/11/13	B.Continental	133.8	-	-	-	-	23.0	133.8	-	-	-	-	23.0
2007/09/10/ 11/12	BIF	11.7	-	18.0	9.0	-	-	11.7	-	18.0	9.0	-	-
2007/08/09/10	BPZ	-	28.5	9.9	-	-	-	-	28.5	9.9	-	-	-
2010	Calidda	35.0	-	10.0	-	-	-	35.0	-	10.0	-	-	-
2004/07009	Cartones America	-	-	-	-	0.5	-	-	-	-	-	0.3	-
2011	Cheves	70.0	-	-	-	-	180.0	26.5	-	-	-	-	68.1
2010	Enfoca	-	15.0	-	-	-	-	-	11.8	-	-	-	-
2012	Financiera Crear	13.1	-	-	-	-	-	13.1	-	-	-	-	-
2011	Grupo Salud	25.0	-	-	-	-	-	-	-	-	-	-	-
2002/03	ISA Peru	7.1	-	-	-	-	-	7.1	-	-	-	-	-
2012	La Positiva Vida	-	10.0	-	-	-	-	-	10.0	-	-	-	-
2000/07	Laredo	13.2	-	-	-	1.5	-	13.2	-	-	-	1.0	-
2007	Lima JCIAirport	-	20.0	-	-	-	-	-	13.4	-	-	-	-
2010	Lima Muni	-	-	-	17.7	-	-	-	-	-	17.7	-	-
2002/06/07/08/12	MIBANCOPERU	9.6	7.0	-	-	35.1	15.6	9.6	7.0	-	-	32.2	-
2000	Milkito	-	-	-	-	-	-	-	-	-	-	-	-
2003	Norvial S.A.	10.6	-	-	-	-	-	10.6	-	-	-	-	-
2009/11	Nuestra Gente	9.6	12.4	-	-	-	-	9.6	12.4	-	-	-	-
2007/09/10/11	PHMC	-	-	-	0.1	-	-	-	-	-	0.1	-	-
2008	LNG	279.5	-	-	-	-	-	279.5	-	-	-	-	-
2009/10/11/12	Protecta	-	2.4	-	-	-	-	-	2.4	-	-	-	-
2008/12	SAV	-	-	5.0	-	-	20.0	-	-	5.0	-	-	20.0
2001/12	UPC	41.2	-	-	-	-	-	-	-	-	-	-	-
1994/95/2000	Yanacocha	-	0.3	-	-	-	-	-	0.3	-	-	-	-
Total Portfolio		679.4	98.23	49.94	28.31	2.1	248.59	566.92	88.46	49.94	28.31	1.32	136.69

*Quasi equity includes both loan and equity types

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

A. Country Strategy

Peru's current Country Strategy covers the period 2012–2016. The strategy has two pillars for the Bank's assistance to the Peruvian authorities: First, it will support their efforts to close the economic and social gaps that still persist between urban and rural areas; and, it will support productivity gains as the main basis for inclusive, and sustainable economic growth.

IDB's strategic engagement with Peru focus on nine areas: (i) social inclusion; (ii) rural development and agriculture; (iii) housing and urban development; (iv) climate change and disaster risk management; (v) water, sanitation, water resources, and solid waste; (vi) energy; (vii) transportation; (viii) public management; and (ix) competitiveness and innovation.

The implementation of the new Country Strategy is on its way. The Bank intends to work with the government on a multi-sector and multi-annual approach of articulated interventions addressing, in a coordinated fashion, various development gaps at the same time. Also, the Bank's intention is to diversify the instruments of support to the country. Innovation in instruments include service contracts with the government in priority areas ("fee for services"), larger private sector operations, and extended use of knowledge sharing and technical cooperation.

The Bank's financial engagement scenario would entail positive but small average net flows to the country between 2012 and 2016. In the base scenario, the Bank will maintain its share as a creditor in Peru's total multilateral debt. The lending framework for the strategy is consistent with the demand assumptions and the external financing strategy of the government.

B. Lending

As of November 2013, the Bank's portfolio of active, public sector operations consisted of 24 loans for a total amount of US$712.3 million, of which US$259.8 million (36.5 percent) had been disbursed. The public sector lending program for 2013 has comprised six operations for a total of US$150 million. In addition, on December 2013 the Bank expects to approve a contingency program for natural disaster for US$300 million. The public sector lending program for 2014 comprises three policy-based loans for US$75 million and seven investment loans for US$480 million which includes the financing the Lima Metro Subway for US$300 million.

Regarding private sector operations, the Structured Corporate Finance Department's (SCF) portfolio in execution consists of four operations amounting to US$185 million in infrastructure and financial services, the IIC portfolio comprises 20 operations for US$159.5 million, primarily in manufacture and financial services, and the Opportunities for the Majority (OMJ) department portfolio consists of two operations amounting US$35 million, in the housing sector and education.

As of November 2013 disbursement for SCF & OMJ total has been US$98 million.
Private sector lending for 2014 includes two SCF projects for US$102.5 million in agriculture sector and renewable energy sector, one OMJ operation for US$20 million in financial market, five MIF projects for US$9.8 million, and six IIC operations for US$50 million.

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

As of November 2013

(In millions of U.S. dollars)

Sector	Commitments	Disbursements	% Disbursed
Agriculture	50.0	24.2	48.4
Science, Technology and Competitiveness	64.3	29.0	45.1
Social Investment	76.0	13.6	17.9
Modernization of the State	96.0	13.9	14.5
Water and Sanitation	127.0	8.8	6.9
Transportation	274.0	170.3	62.1
Climate Change	25.0	0	0
Total	712.3	259.8	36.5

STATISTICAL ISSUES

A. Assessment of Data Adequacy for Surveillance

General: The economic database is generally comprehensive and of high quality, and data provision is adequate for surveillance.

Despite progress in recent years, there is scope for improvement in the following areas: (i) coordination among the agencies that compile official statistics to avoid duplication of efforts; (ii) 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.

Real sector statistics:

National accounts. 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 were aimed at 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.

Labor market statistics. The authorities monitor labor market developments using four indicators: open unemployment, underemployment, employment, and remunerations. While monthly unemployment, employment and income data for metropolitan area of Lima from INEI are timely, only urban employment indexes are available from the Ministry of Labor for other areas and with some delays; monthly remuneration data for the government are timely but the monthly remuneration data for the private sector are no longer available. The nationwide unemployment and underemployment situation is surveyed quarterly. It would be useful to expand the coverage of labor statistics to national level and develop competitiveness indicators such as productivity and unit labor cost indexes.

Price Statistics: At the present time, the official measure of inflation for Peru is the CPI for Metropolitan Lima, compiled and published by INEI. 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. 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. An STA mission on the CPI was conducted in May 2–13, 2011 to evaluate the methodology of the new national CPI index. The new national level CPI, starting with January 2012, was disseminated since from February 2012, but it is not yet used as the official CPI for policy purposes. The statistical techniques used to compile the wholesale price index (WPI) generally follow international standards but its weights that were derived from the 1994 input-output table and other reports and publications of relevant ministries, are outdated.

Government Finance Statistics: The Central Bank (BCRP) compiles government finance statistics (GFS) following the GFSM2001, 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.

Monetary and Financial Statistics:

Monetary statistics. The 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 divergences 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 assets held to maturity at cost rather than at market prices or at the lower of cost or market price for investment securities. At the request of the authorities, two missions visited the country in January 2007 and September 2008 to assist with the introduction of the standardized report forms (SRFs) for the central bank and other depository corporations (ODCs) for reporting monetary data to the IMF. The BCRP reported test data for the central bank in the SRF in July 2013 and it is expected that test data in the SRF for the ODCs will be submitted to STA by December 2013.

Financial soundness indicators. Peru started reporting twelve core and nine encouraged financial soundness indicators (FSIs) in June 2011 with quarterly frequency, beginning with data for December 2010.

External Sector Statistics: 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)*. 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. Since August 2001, the BCRP has been reporting weekly data on international reserves in accordance with the Operational Guidelines for the 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.

B. Data Standards and Quality

Peru subscribes to the Special Data Dissemination Standard (SDDS) since August 1996. A data ROSC was disseminated in 2003.

C. Reporting to Fund for publication:

The authorities report data for publication in the *Government Finance Statistics Yearbook (GFSY)* using the *GFSM 2001*. No high frequency data are reported for publication in *International Financial Statistics (IFS)*. External Sector Statistics are reported to the Fund for publication in the *IFS* and the *Balance of Payments Statistics Yearbook*.

Peru: Table of Common Indicators Required for Surveillance

(As of December 31, 2012)

	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]	Data quality accuracy and reliability[9]
Exchange Rates	12/10/13	12/10/13	D	M	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/6/13	12/6/13	D	M	W		
Reserve/Base Money	11/30/13	12/6/13	W	M	W	O, LO, LO, LO	O, O, O, O, O
Broad Money	11/15/13	12/6/13	W	M	W		
Central Bank Balance Sheet	11/30/13	12/6/13	W	M	W		
Consolidated Balance Sheet of the Banking System	11/15/13	12/6/13	W	M	W		
Interest Rates[2]	11/30/13	12/6/13	D	M	D		
Consumer Price Index	12/01/13	12/01/13	M	M	M	O, LO, LO, LO	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q3 2013	11/15/13	Q	Q	Q	O, LO, O, O	O, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Q3 2013	11/15/13	Q	Q	Q		
Stocks of Central Government Debt[5]	Q3 2013	11/15/13	Q	Q	Q		
International Investment Position[6]	Q3 2013	11/22/13	Q	Q	Q		
External Current Account Balance	Q3 2013	11/22/13	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	Q3 2013	11/22/13	M	M	M		
GDP/GNP	Q3 2013	11/15/13	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	Q3 2013	11/22/13	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] Revenue and expenditure data are available monthly; and the composition of financing are available quarterly. Financing comprises of 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.

TECHNICAL ASSISTANCE

Department	Purpose	Date
FAD	Medium-term budget framework, IFMIS, and treasury management	April, August, November 2013, September–October 2012
	Cash management	January 2013, August–September 2012
	Macro-fiscal framework and fiscal rules	August 2012
	Derivatives, concession contracts and budget information in financial statements	April 2012
	Distribution of natural resource revenue to sub-national governments	February 2012
	Defining a methodology for the structural fiscal balance	January–February 2012
	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.	January, March, May, June, July and November 2013, February, May, July, September and November 2012, October 2011, February 2011, 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
	Information technology	September 2013
MCM	Payment systems	September 2013
	Capital market regulation	April 2013
	Capital market regulation	October–November 2012
	Developing repo market	April 2010
	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 (accompanied by LEG short-term expert)	April 2005
	Central bank organization	March, 2005
	Inflation targeting	April, December 2002, February 2003, March and September 2004
	Foreign exchange operations	October 2002

Department	Purpose	Date
	Accounting and organizational issues	August 2002
	Inflation targeting	May 2002
	Monetary operations and government securities market	March 2002
LEG	Strengthening the AML/CFT supervisory framework in the securities sector (SMV)	Ongoing since April 2012
	AML/CFT national strategies and coordination	Ongoing since January 2011.
	ML/FT risk assessment	August 2009–July 2011
	Strengthening the AML/CFT financial supervisory framework in the banking sector (SBS)	June 2008–July 2010
STA	Government Finance Statistics	April 2008, April 2013
	Consumer Price Index	May 2011
	National accounts	November 2008, April–May 2009, September 2009, September 2010
	Money and Banking Statistics	September 2008

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

IMF Executive Board Concludes 2013 Article IV Consultation with Peru

On January 24, 2014, 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.[1,2]

Peru's economy continues to be a leader in high growth and low inflation in the region, which has been achieved through a prudent macroeconomic policy implementation, a far-reaching structural reform agenda and taking advantage of the benign external environment. No least due to these factors, the economy came out virtually unscathed from the 2008–09 global financial crisis, with growth rebounding to 8.8 percent in 2010 and then being sustained at high levels in 2011–12. After reaching 4.7 percent in 2011, end-period inflation fell to 2.6 percent in 2012, within the 1-3 percent target range. Stimulative monetary and fiscal policies played an instrumental role in supporting the recovery, and were smoothly unwound as growth accelerated and the negative output gap was closed.

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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.

[2] Article IV consultations are concluded without a Board meeting when the following conditions apply: (i) there are no acute or significant risks, or general policy issues requiring Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact; (iii) in the event a parallel program review is being completed, it is also being completed on a lapse-of-time basis; and (iv) the use of Fund resources is not under discussion or anticipated."

Activity has slowed this year on the heels of adverse external shocks and a decline in domestic confidence. Real GDP is expected to have grown around 5 percent in 2013, underpinned by a recovery of exports and investment in the last quarter of the year as well as improvements in confidence as temporary supply shocks are being reversed. Inflation remained within the 1-3 percent target range, reaching 2.9 percent by end-2013 due to increases in food and fuel prices and some pass-through from the exchange rate depreciation. Private credit growth slowed in real terms to 12.5 percent at end-2012 (from 14.0 percent at end-2011) due to macro-prudential measures aimed at mitigating the impacts of surges in capital flows. The financial sector remains sound, profitable and well-capitalized, supported by the authorities' pro-active use of prudential measures.

The outlook remains favorable in the near term despite challenging external conditions. The projected growth deceleration in China (one of Peru's main trading partners) and the unwinding of monthly purchases of securities by the U.S. Federal Reserve will result in a lower external demand and terms of trade deterioration. Against this background, real GDP growth is projected to be 5.5 percent in 2014, slightly below potential, while inflation is projected to decline to about 2.5 percent as expectations are well-anchored owing to the strong inflation targeting framework. The current account deficit is projected to remain elevated at 4.8 percent of GDP in 2014, but will decline gradually over the medium-term on account of expected pickup in mining exports.

Macroeconomic policies have focused on being supportive of economic activity. The fiscal surplus is estimated to have fallen to 0.5 percent in 2013, from 2.2 percent in 2012, in part due to increased capital spending to support growth. The central bank has been unwinding reserve requirement, in particular on local currency, since mid-2013 and cut the policy rate by 0.25 percent of a point to 4 percent on November 2013 citing slower domestic and global growth. The exchange rate policy has been more flexible, but the central bank has intervened to limit excessive volatility in the foreign exchange market.

Executive Board Assessment

In concluding the 2013 Article IV consultation with Peru, Executive Directors endorsed staff's appraisal, as follows:

The overall state of the economy remains strong despite lower metal prices and recent market turbulence. Peru continues to be one of the most dynamic economies in the region, and one with the largest buffers thanks to past strong policy implementation. With an economy growing somewhat near potential, macroeconomic policies should remain relatively neutral, unless additional turbulence in markets emerges or other downside risks materialize. Preserving policy flexibility by continuing with a good track record of appropriate policy responses to adverse circumstances remains instrumental to addressing future challenges. Risks are balanced. While external risks are tilted to the downside, domestic risks are on the upside. Significant terms of trade gains could be reversed if growth deteriorates in main trading partners, reducing income, investment, and growth. Sudden stops and reversal of some non-Foreign Direct Investment (FDI) capital flows to Peru (due to tightening of global financial conditions) could put pressure on the financial system and further decelerate growth. While these risks are significant they should be contained given a strong policy track-record, ample fiscal space, and large Foreign Exchange (FX) reserves. Aggressive implementation of structural reforms and infrastructure projects should help offset these risks. On the domestic side, large mining and infrastructure projects could be implemented at a faster pace thereby increasing growth.

The fiscal objectives in the 2014 budget are broadly appropriate to maintain macroeconomic stability. Staff estimates that instead of a planned balance, the outcome will most likely be a small surplus (given past rates of expenditure implementation), which is counter-cyclical (given an emerging negative output gap) and broadly appropriate given the soft economic conditions at present. Staff welcomes the approval of the new fiscal responsibility law and the new fiscal framework. Over the medium term, staff recommended to aim for small structural surpluses (of around ½ percent of GDP a year) to address contingent liabilities and natural disasters risks, which are high in Peru. When integrating the new fiscal framework into the budget process, it would be important to take into account fiscal risks associated with contingent liabilities and natural disasters, as well as the need to close the infrastructure and social gaps over time. A strong political commitment as well as the steady implementation of a fiscal rule is equally important.

With inflation expectation in check, a neutral monetary policy in the near term would be appropriate, but continued flexibility need to be exercised as global interest rates rise. The recent uptick in headline inflation was caused by temporary supply factors, while inflation expectations remain well-anchored. Staff stressed the need for the Banco Central de Reserva del Peru (BCRP) to focus on maintaining core inflation in check. The BCRP will also need to exercise caution in managing monetary policy in the context of a likely increase in long-term global interest rates.

Greater exchange rate flexibility observed over the past year is welcome as the exchange rate continued to be used as a shock absorber. The exchange rate ought to continue to be driven by fundamentals over the medium and long term, while limited foreign exchange intervention could be necessary to reduce volatility and to contain excessive risks to the balance sheets in a still highly dollarized economy. Given external risks, intervention is more likely to be on the sale side. Such intervention will need to be properly sterilized to prevent a credit crunch and unnecessary upward pressure in the interbank rate. Increasing exchange rate flexibility will create further incentives for the deepening of the forwards (and other derivatives) market as the private sector internalizes exchange rate risks, which in turn could stimulate the de-dollarization of the economy.

Macro-prudential policies should continue to be well targeted to reduce vulnerabilities. In addition to recent macro-prudential measures to deter the growth of dollar mortgage and car loans, there is a need for measures to discourage un-hedged foreign exchange exposures of households and corporates. The high spread between reserve requirements on dollar deposits and that on local currency deposits needs to be maintained to discourage dollarization. While the overall financial system remains healthy and strong, the recent deterioration of financial soundness indicators for some non-bank deposit-taking institutions warrants closer monitoring and supervision.

While vulnerabilities have increased, current buffers are sufficient to address possible short-term shocks. Increased risk aversion due to the expected "tapering" of asset purchases by the USFR could lead to a reversal of capital inflows, necessitating the central bank to deploy resolute actions to maintain confidence and ensure orderly functioning of markets as was done during the global financial crisis in 2008–09. Slower global growth could lead to lower external demand and deterioration in terms of trade, the exchange rate should work as a shock absorber, although there are risks given the dollarization of the financial system. Monetary and macro-prudential policies should be relaxed to support economic activity. If the economic slowdown is too pronounced, consideration could be given to use a measured and temporary fiscal impulse.

Resolute efforts are necessary to achieve ambitious tax targets. Staff welcomes the good progress made in doubling capacity, coverage, and control process, which is evident by the good performance of income and sales taxes. To bring Peru's tax collections at par with other emerging market economies, decisive steps will continue to be necessary in persevering with reform efforts and in reducing a high level of informality, tax evasion, and exemptions.

Recent efforts to increase the country's growth potential and ensure inclusive growth are welcomed. Progress has been made in enhancing competitiveness by reducing barriers to investment and increasing effectiveness of the public and private sectors, further developing the local capital markets, and reforming of the private pension system to generate greater public access and savings. Social agenda was pursued through broadening the existing projects and advancing new social programs to ensure inclusive growth. Further progress in warranted to boost productivity through increasing labor market flexibility, reducing non-salary costs, upgrading human capital, removing infrastructure bottlenecks, and strengthening institutions. Prioritization of structural reforms, including through designing a holistic nationwide infrastructure strategy, will be key to preserving strong growth momentum.

Peru: Selected Economic Indicators

	2009	2010	2011	2012	Projections 2013	2014	2015
Social Indicators							
Life expectancy at birth (years)	73.5	73.8	74.0	74.2	...	...	...
Infant mortality (per thousand live births)	20.0	17.0	16.0	17.0	...	...	...
Adult literacy rate	92.4	92.6	92.9	...	...	...	...
Poverty rate (total) 1/	33.5	30.8	27.8	25.8	...	...	...
Unemployment rate	8.4	7.9	7.7	6.8	6.0	6.0	6.0
	(Annual percentage change; unless otherwise indicated)						
Production and prices							
Real GDP	0.9	8.8	6.9	6.3	4.9	5.5	5.8
Real domestic demand	-2.8	13.1	7.1	7.3	6.0	5.6	5.9
Consumer Prices (end of period)	0.2	2.1	4.7	2.6	2.9	2.3	2.0
Consumer Prices (period average)	2.9	1.5	3.4	3.7	2.8	2.5	2.1
External sector							
Exports	-13.1	31.9	30.1	-0.7	-7.7	6.9	8.7
Imports	-26.1	37.1	28.3	11.2	4.0	5.9	5.5
Terms of trade (deterioration -)	-2.8	17.9	5.4	-5.0	-3.6	-0.9	0.7
Real effective exchange rate (depreciation -)	3.4	2.4	-1.0	8.5	...	...	...
Money and credit 1/ 2/							
Broad money	6.8	21.7	15.1	12.1	15.6	13.9	13.5
Net credit to the private sector	5.0	16.7	21.6	13.3	16.5	14.4	14.5
	(In percent of GDP; unless otherwise indicated)						
Public sector							
NFPS Revenue	24.0	25.2	26.1	26.7	26.4	26.2	26.5
NFPS Primary Expenditure	24.0	24.2	23.1	23.5	24.8	24.9	25.2
NFPS Primary Balance	0.0	1.0	3.0	3.3	1.6	1.4	1.4
NFPS Overall Balance	-1.3	-0.2	1.9	2.2	0.5	0.3	0.4
External Sector							
External current account balance	-0.6	-2.5	-1.9	-3.4	-4.9	-4.8	-4.3
Gross reserves							
In millions of U.S. dollars	33,175	44,150	48,859	64,049	67,150	68,441	71,941
Percent of short-term external debt 3/	424	342	589	539	625	721	854
Percent of foreign currency deposits at banks	204	241	228	301	284	258	246
Debt							
Total external debt	29.3	27.4	25.5	27.0	24.3	22.9	22.1
NFPS Gross debt (including CRPAOs)	27.1	24.4	22.3	20.5	19.5	17.9	16.4
External	15.4	12.7	11.0	9.5	8.9	7.4	7.1
Domestic	11.7	11.7	11.2	11.0	10.6	10.5	9.3
Savings and investment							
Gross domestic investment	20.7	25.2	25.3	26.8	27.7	28.3	28.5
Public sector 4/	5.2	5.9	4.5	5.2	5.9	6.3	6.8
Private sector	17.7	19.2	19.6	21.4	21.9	22.1	22.1
National savings	20.1	22.7	23.4	23.3	22.7	23.5	24.2
Public sector 5/	4.5	6.1	7.2	7.8	6.7	6.7	7.2
Private sector	15.7	16.7	16.3	15.5	16.0	16.8	17.0
Memorandum items							
Nominal GDP (S/. billions)	382.3	434.5	486.2	526.2	561.4	605.4	653.7
GDP per capita (in US$)	4,362	5,205	5,901	6,529	6,670	7,005	7,450

Sources: Central Reserve Bank of Peru (BCRP); Ministry of Economy and Finance (MEF); National Statistical Institute (INEI); UNDP Human Development Indicators; and IMF staff estimates/projections.

1/ Corresponds to depository corporations.

2/ Foreign currency stocks are valued at end-of-period exchange rates.

3/ Short-term debt is defined on a residual maturity basis, and includes amortization of medium- and long-term debt.

4/ Includes CRPAOs.

5/ Excludes privatization receipts.