March 2007
IMF Country Report No. 07/114

Peru: Fourth and Fifth Reviews Under the Stand-By Arrangement and Request for Waiver of Applicability—2006 Staff Report; Staff Supplement; and Press Release on the Executive Discussion Consideration

In the context of the fourth and fiifth reviews under the Stand-By Arrangement and requests for a waiver of applicability, the following documents have been released and are included in this package:

- the staff report for the Fourth and Fifth Reviews Under the Stand-By Arrangement and Request for Waiver of Applicability prepared by a staff team of the IMF, following discussions that ended on June 15, 2006, 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 July 11, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a staff supplement of July 21, 2006, updating information on recent economic developments; and

- a Press Release summarizing the views of the Executive Board consideration of the staff report that completed the reviews and request.

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

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PERU

Fourth and Fifth Reviews Under the Stand-By Arrangement and Request for Waiver of Applicability

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

Approved by José Fajgenbaum and Adrienne Cheasty

July 11, 2006

- ***Discussions.*** Discussions for the fourth and fifth reviews under the Stand-By Arrangement (SBA) were held in Lima during June 6–15, 2006. The staff team met with President Toledo, President-elect García, President of the Council of Ministers Kuczynski; Economy and Finance Minister Zavala; Energy and Mines Minister Sanchez; Acting Central Bank President Dancourt; other senior officials; and representatives of civil society.
- ***New government.*** The new government is scheduled to take office at end-July. President-elect García told the mission that his government plans to seek a new precautionary arrangement from the Fund after the expiration of the current one, to help consolidate the consensus for sound macroeconomic policy and press ahead with growth-enhancing reforms. Discussions for a new SBA could be initiated after the Annual Meetings, jointly with the 2006 Article IV consultation.
- ***Program.*** The present SBA, in the amount of SDR 287.279 million (21 percent of quota on an annual basis) and covering the period through August 16, 2006, was approved on June 9, 2004. The third review was completed on January 9, 2006. The authorities are treating the arrangement as precautionary and, with the completion of the fourth and fifth reviews, the full SDR 287.279 million would become available for purchase. The fourth and fifth reviews are being merged to ensure that all the reviews have been completed before the program expires, on August 16, 2006.
- ***Review.*** The review focused on the implementation of macroeconomic policies and reforms under the program. The economy continues to perform well and performance under the program has remained broadly on track. All quantitative performance criteria for end-June are expected to have been met and progress was made in the structural reform area, even though it fell somewhat short of program objectives. Peru has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement (Appendix II). Peru's statistics are adequate for policy formulation and program monitoring, but some shortcomings remain (Appendix V).
- ***Staff team.*** The staff team comprised G. Terrier (Head), A. López-Mejía, E. Jenkner (all WHD), K. Alexandraki (PDR), M. García-Escribano (FAD), and G. Gasha (MFD). N. Batini (Resident Representative) assisted the mission. A. Singh and J. Fajgenbaum (both WHD) joined the mission for policy discussions. Mr. Silva Ruete, Alternate Executive Director, participated in the discussions.

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EXECUTIVE SUMMARY

- ***Peru's economic program has contributed to consolidating macroeconomic stability and achieving strong economic growth.*** The overall deficit of the combined public sector was reduced from 1.7 percent of GDP in 2003 to 0.3 percent in 2005. The structural agenda advanced, notably in the areas of de-dollarization and the reform of the *Cédula Viva* pension regime, and vulnerabilities were reduced. However, there is a need to address still-widespread poverty. The incoming authorities, scheduled to take office at end-July, have expressed interest in a new precautionary arrangement to help solidify the consensus for sound policies and reforms.

- ***The Peruvian economy continues to perform well.*** Real GDP grew by 6½ percent in 2005 and by almost 7 percent in the first quarter of 2006 (year-on-year). Inflation remains well within the central bank target band and the external position is strong. Peru's financial markets have only been marginally affected by recent developments in emerging markets. Following some volatility associated to political uncertainty in early 2006, in recent weeks sovereign spreads have remained broadly stable and the currency has appreciated somewhat.

- ***In the first half of 2006, performance under the program was strong.*** The combined public sector is estimated to have registered an overall surplus of about 2 percent of annual GDP—almost three times the level envisaged under the program. For the year as a whole, the overall deficit is likely to be considerably lower than envisaged. All end-June quantitative performance criteria are expected to have been met.

- ***While further progress has been made with respect to structural reforms, efforts need to be stepped up in some areas.*** In particular, delays were registered in implementing the plan to encourage mortgage lending in domestic currency under the *MiVivienda* program and preparing the action plan to introduce a permanent framework for PPPs.

- ***A main challenge in the period ahead will be to reconcile an increase in social spending with prudent fiscal policies.*** Broadening the tax base and implementing fiscal reforms will be key to make room for social and infrastructure spending. It will also be important to use part of the additional revenue to reduce the public debt-to-GDP ratio further.

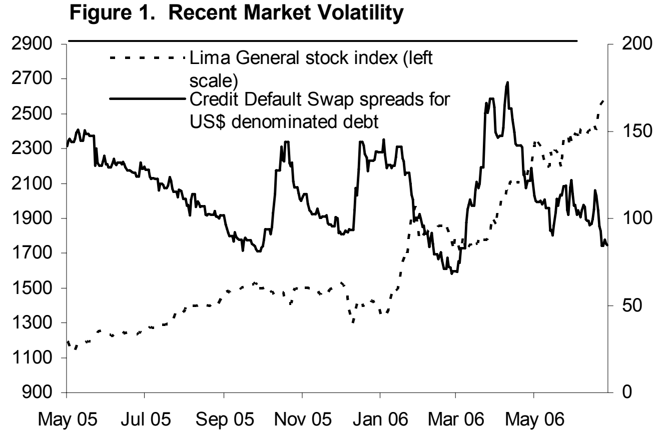
- ***The medium term outlook is favorable.*** Assuming sound macroeconomic policies, continued progress with structural reforms, and a positive external environment, economic growth is forecast at 4¾ percent a year in 2007–08. Peru has built important buffers against risks, including a comfortable level of official reserves, a significantly lower public debt ratio, and a well-capitalized banking system.

I. Background

1. ***Peru's ongoing economic program has helped preserve consensus for prudent policies throughout the election period.*** In a challenging social and political environment, the implementation of the program, supported by a Stand-By Arrangement covering the period through August 16, 2006, has contributed to achieving strong economic growth and consolidating macroeconomic stability. In particular, the overall deficit of the combined public sector was reduced from 1.7 percent of GDP in 2003 to 0.3 percent in 2005. Important structural reforms were also implemented under the program, including with respect to de-dollarization, Public-Private Partnerships (PPPs), and the reform of the *Cédula Viva* pension regime (Box 1). However, there is a need to address still widespread poverty—affecting half of the Peruvian population.

II. Recent Developments

Figure 1. Recent Market Volatility



2. ***Peru has been relatively immune to the turmoil in international markets***. Earlier this year, heightened political uncertainty associated with the elections led to downward pressure on the currency and some instability in the stock market, which has since abated. During January-April 2006, the central bank sold some US$0.4 billion in foreign exchange to ease pressures on the *Nuevo Sol* and issued exchange rate-linked CDs in a similar amount.[1] In response to liquidity shortages associated to hoarding of foreign currency and large tax payments, the central bank also provided needed liquidity to banks through its repo window while expanding the set of instruments that can be used as collateral.[2] In addition, the central bank has gradually raised its policy rate by a total of 150 basis points since December 2005 (to 4.5 percent). In recent weeks, in the context of adverse developments in the international markets, the Peruvian currency appreciated slightly against the U.S. dollar and Peruvian spreads rose marginally (they remain among the lowest in the region, at 170 basis points at end-June). Largely driven by mining stocks, the local equity market index has risen by about 70 percent so far this year,

[1] Exchange rate-linked CDs are bills indexed to the exchange rate and denominated in local currency. The central bank has been issuing such instruments since 2002.

[2] In an effort to enhance the market for *Nuevo Sol* paper, the Superintendency of Banks recently allowed private pension funds to place CDs at maturities of over 30 days with the banking sector. Also, in order to recycle large amounts of liquidity held by the central government after receiving tax payments, *Banco de la Nación* was authorized to extend lines of short-term credit to commercial banks.

Box 1. Peru: Main Achievements under the 2004–06 Program

- ***Objectives.*** The main objectives of the program, supported by the current Stand-By arrangement covering the period 2004-06, were to consolidate macroeconomic stability, reduce vulnerabilities associated with high indebtedness and dollarization, and adopt structural reforms to foster an environment conducive to private investment and job creation.

- ***Macroeconomic stability.*** Over the period 2004–06, real GDP growth is estimated to average almost 6 percent and headline inflation 2½ percent. The deficit of the combined public sector was reduced from 1.7 percent of GDP in 2003 to 0.3 percent of GDP in 2005 and is conservatively projected at about 0.4 percent of GDP in 2006. Economic growth has been more broad-based than in the past, but poverty remains high, affecting about half of the population.

- ***Resilience to shocks.*** Strong policies have made Peru more resilient to shocks. The exchange rate has become somewhat more flexible, the banking system strengthened further, and the public debt-to-GDP ratio has fallen from 47 percent in 2003 to 38 percent in 2005. A sizeable build-up of foreign exchange reserves and active liability management operations have reduced rollover and exchange rate risks. This has helped the economy withstand well the volatility associated with the elections and recent turbulence in world markets.

- ***De-dollarization.*** The authorities' efforts in the area of de-dollarization, including new regulations requiring banks to better identify and manage the risks associated with loans in foreign currency, have helped economic agents better internalize risks. In addition, since the recent implementation of the reform of the *MiVivienda* government program, all mortgage loans financed with *MiVivienda's* own funds have been denominated in domestic currency. The share of dollar deposits in total bank deposits fell from 62 percent at end–2003 to 55 percent at end-2005 while the share of dollar credit in total bank credit fell from 77 percent to 67 percent.

- ***Fiscal policy***. Over-performance with respect to the deficit ceiling has helped enhance the credibility of fiscal rules. The 2004 reform of the costly preferential public pension regime (*Cédula Viva*) removed the link of pensions with public sector wages, thus paving the way for a reform of the public sector wage structure. A general law of public indebtedness was approved in July 2005, providing a transparent framework for the management of the public debt and setting limits to commitments contracted in the context of PPP operations. The transparency of liabilities associated with these operations has improved with their publication in the Multiyear Macroeconomic Framework.

- ***Sustainable growth.*** A Free Trade Agreement was signed with the United States in March 2006 and approved by the Peruvian congress in June, and the simple average tariff rate at the MFN level was reduced from 10.4 percent in 2003 to 10.1 percent in 2005. Progress was made in addressing infrastructure bottlenecks, with the awarding of concessions under the PPP program. However, a permanent framework for PPP operations still has not been introduced and the *Inter-Oceanica* road project, which entails large fiscal costs over the medium term, was allowed to bypass SNIP's viability assessment. Also, the special payroll tax was eliminated—a key step toward reducing non-wage labor costs—collateral registries were centralized to facilitate access to credit for small and medium enterprises, and the first commercial court became operational in Lima in April 2005.

on top of a 25 percent surge registered in 2005. Nevertheless, the price-earning ratios on the Lima stock market are, on average, significantly below those in other regional markets.

3. ***Economic activity remains strong.*** Real GDP grew by 6½ percent in 2005, or over two percentage points faster than envisaged in the program, with particularly strong growth registered in the construction, manufacturing, and mining sectors. This economic momentum was largely driven by a strong performance in investment and exports. Private consumption also picked up in 2005, reflecting well-grounded consumer confidence, higher disposable income associated with favorable terms of trade, and growing employment. Economic activity has remained strong in the first quarter of 2006, with year-on-year real GDP growth of almost 7 percent.

Figure 2. Exchange Rate and Net Intervention in the Foreign Exchange Market

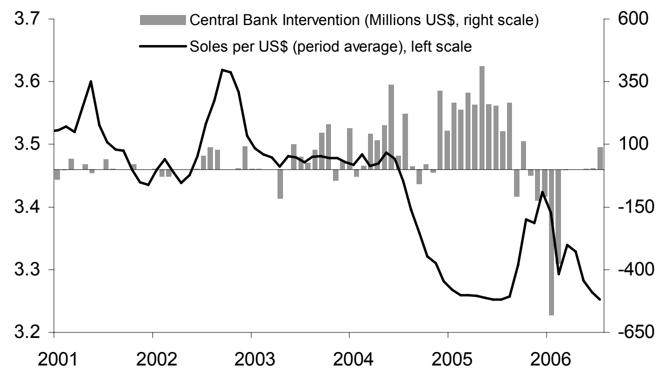


Figure 3. Contributions to Real GDP Growth

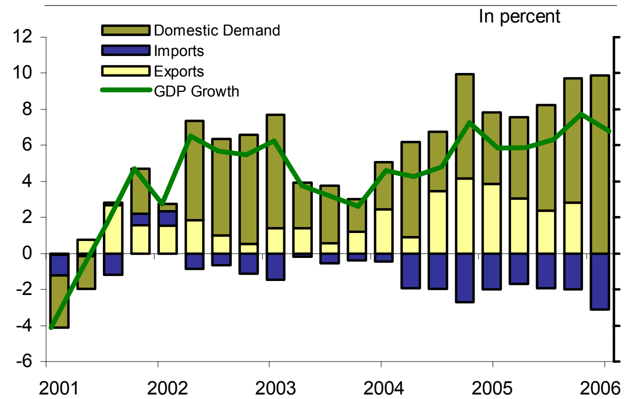
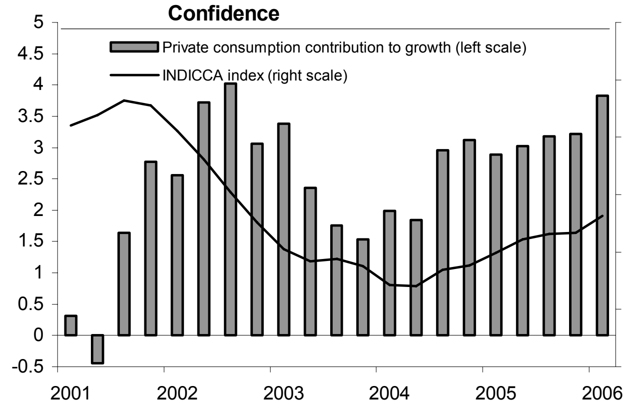


Figure 4. Private Consumption and Consumer Confidence



4. ***Inflation is well within the central bank target band.*** Twelve-month inflation rose from 1.5 percent in December 2005 to 2.9 percent in April, but has since abated, reaching 1.8 percent in June 2006, well within the 1.5-3.5 inflation target band; inflation expectations are well anchored near the middle of the band. The rise in inflation reflects in part the impact of bottlenecks in the agricultural sector on food prices and the pass-through of world oil price increases. There may have been also some pressures from the demand side, due to a pick-up in bank credit to the private sector.

5. ***Driven by export growth, the external current account balance registered a surplus in 2005.*** Record export growth (37 percent) was led by mineral products and a strong

increase (23 percent) in non-traditional exports. Imports also grew markedly (23 percent), particularly those of capital and intermediate goods. A favorable external environment and high commodity prices have helped maintain a strong export momentum in 2006, with 12-month growth estimated at 29 percent in May. Preliminary information indicates that net official international reserves amounted to US$14.4 billion at end-June; excluding bank foreign currency deposits with the central bank, net international reserves amounted to US$9.7 billion, covering about 200 percent short-term external debt on a residual maturity basis and over 8 months of merchandise imports.

Figure 5. Bank Credit to the Private Sector

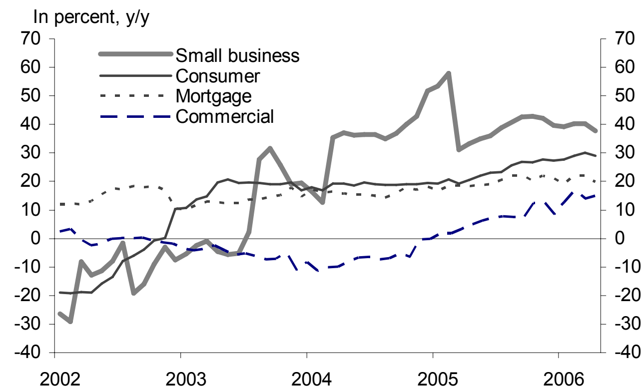


Figure 6. Current Account

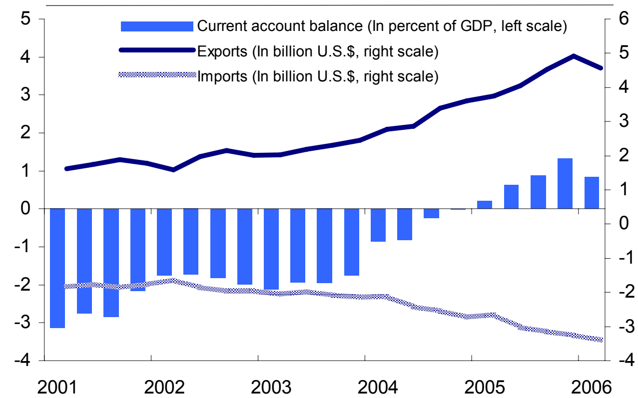
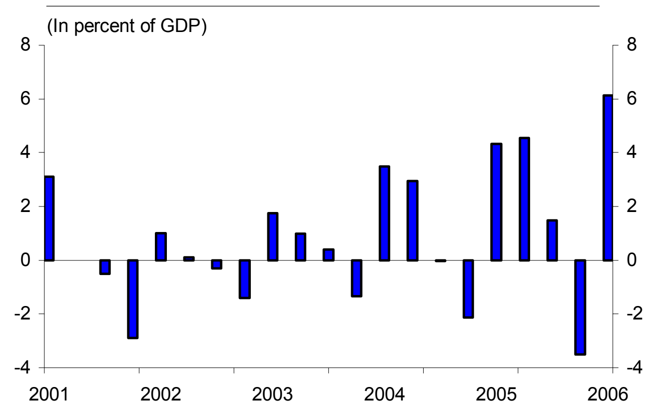


Figure 7. Combined Public Sector Primary Balance



6. ***Fiscal developments in 2005 and early 2006 have been significantly stronger than envisaged under the program.*** At the equivalent of 0.3 percent of GDP, the 2005 overall deficit of the combined public sector was well below the program ceiling of 1 percent of GDP. Boosted by high commodity prices and cyclical factors, tax collections grew steadily, the performance of public enterprises was strong, and interest payments were lower than envisaged under the program. Primary government spending rose by 8.5 percent in real terms, giving rise to a slightly expansionary fiscal policy (Box 2); however, excluding one-off current payments, expenditure growth was somewhat lower, at 6 percent in real terms. During the first quarter of 2006, the fiscal position continued to be stronger than envisaged in the program, reflecting in part higher-than-programmed corporate income and value-added tax collections. On a preliminary basis, the combined public sector is estimated to have registered a surplus of about 2 percent of annual GDP during January-June 2006, or almost three times the level envisaged under the program.

Box 2. Peru: Has Fiscal Policy Been Procyclical in Recent Years?

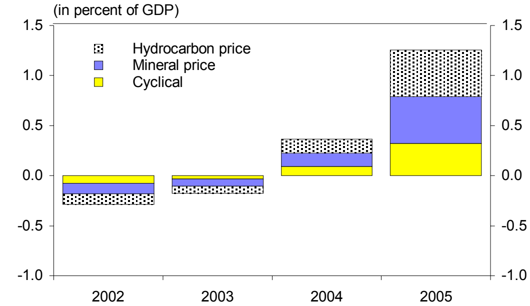
Significant fiscal consolidation was achieved in recent years. The overall deficit of the nonfinancial public sector fell from 2.5 percent of GDP in 2002 to 0.3 percent of GDP in 2005. This reflected a sharp improvement in the primary balance and somewhat lower interest payments. The public debt-to-GDP ratio was reduced from 47 percent in 2002 to 38 percent in 2005.

Peru: Nonfinancial Public Sector Finances
(in percent of GDP)

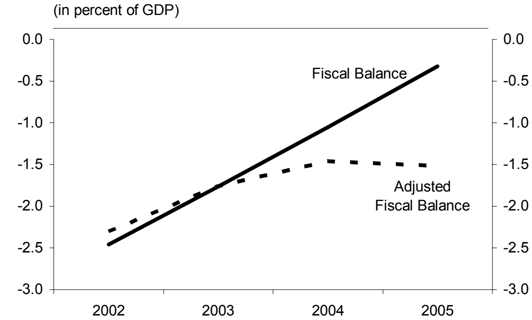
	2002	2003	2004	2005
Overall balance	-2.5	-1.7	-1.0	-0.3
Primary balance	-0.2	0.4	1.0	1.6
of which, general government	0.0	0.5	0.9	1.4
Revenues	16.8	17.4	17.4	18.2
Expenditures	17.2	17.1	16.7	17.0
of which, public enterprises	-0.1	0.0	0.1	0.2
Interest payments	2.1	2.2	2.0	1.9
Public debt	46.6	47.0	44.4	37.7

A favorable macroeconomic environment explains most of the improvement in the primary balance. Booming mineral and hydrocarbon prices have led to exceptionally high revenues, contributing an additional 0.2 percent of GDP a year since 2003, on average. An output gap put some downward pressure on the fiscal balance until 2004. The cyclical upturn is estimated to have contributed about 0.3 percent of GDP to the primary balance in 2005 through stronger tax collections, while higher hydrocarbon and mineral prices contributed close to 0.9 percent of GDP.

Peru: Contribution of the Cycle and Commodity
prices to the Primary Balance
(in percent of GDP)



Peru: Adjusted Fiscal Balance
(in percent of GDP)



These estimates, however, need to be treated with caution. The cyclical adjustment would ideally need to account for structural improvements in revenue administration and differentiate between one-off and permanent spending increases. Also, the revenue impact of higher hydrocarbon prices could partially be offset by lower profits and tax collections from other sectors, such as manufacturing and transport.

Taking the above caveats into account, it would appear that after several years of contractionary fiscal policy, the fiscal stance became slightly procyclical in 2005. The *structural balance*, which adjusts for cyclical factors and commodity price movements, shows some deterioration in 2005, suggesting a slightly expansionary fiscal policy.[1] Ongoing efforts at the Finance Ministry to enhance a structural fiscal rule indicator are designed to help promote more transparency, together with greater fiscal discipline over the cycle.

[1/] The structural fiscal balance is calculated by adjusting general government revenues for the cycle using the authorities' estimates of potential output and taking into account the deviation of mineral and hydrocarbon prices from their long-term (average over the period 1984–2000) level.

7. ***Performance under the program has remained strong in 2006.*** All the end-June 2006 quantitative performance criteria under the program are expected to have been met. Given that information with respect to these criteria will not become available by the time the Board is expected to consider the reviews, it is recommended that a waiver of applicability be granted.[3] If information on some of these quantitative performance criteria becomes available before Board consideration of the reviews, a staff supplement to this report will be issued. In the structural reform area, progress has continued to be made in 2006, but fell somewhat short of program objectives in some areas:

- ***Fiscal reforms.*** In January 2006, the central government budget formulation system and the Integrated Financial Management System (SIAF) were unified (end-June 2005 benchmark) and, with technical assistance from the Fund, action plans have been completed for implementing a Treasury Single Account and updating the budget classification system to international standards (end–June 2006 benchmark). However, ongoing work on an action plan for introducing a permanent framework for PPPs (end–March 2006 benchmark) has not been completed, in part because the technical complexities of the issues involved led to differences of views within the government on the approach to take.

- ***De-dollarization.*** Regulations associated with dollar lending to unhedged borrowers have been implemented (end–June 2006 benchmark) and a plan to encourage mortgage lending in domestic currency under the *MiVivienda* government program was prepared at end–2005 (end-December 2005 benchmark). However, subsequent changes were made to this plan and its implementation only started in May 2006. As a result, the end-June benchmark under which at least 50 percent of the mortgage loans financed by the *MiVivienda* program would be denominated in *Nuevos Soles* during the first semester of 2006 was not observed. Nevertheless, the regulations now in place should help ensure that this objective will be achieved in the second half of this year.

- ***Financial Sector.*** A centralized collateral registry that began operating in late May will help ensure increased access to credit while improving its overall quality (end-June benchmark). In April, the Superintendency of Banks published and disseminated the new pricing methodology and reference prices for nontraded financial assets (end-July 2005 benchmark), a measure designed to increase market transparency and efficiency.

[3] The end-March quantitative performance criterion on net international reserves was missed, largely reflecting higher than envisaged central bank sales of foreign currency during the first quarter of 2006 in a context of political uncertainty.

III. POLICY DISCUSSIONS

A. Discussions with the Incoming Authorities

8. ***Discussions took place in the context of strong economic growth.*** The elected authorities recognized that the state of the economy, including all the main financial indicators, was good. They considered that the main challenge ahead would be to entrench macroeconomic stability further while stepping up the fight against poverty. This is expected to require fiscal reforms to make space for social spending. In turn, these reforms would entail expanding the tax base, shelving proposals to establish free economic zones currently being considered by congress, and implementing policies aimed at reducing labor market informality. The elected authorities have indicated that they would not seek to modify the taxation regime of mining companies and would respect existing contracts.

9. ***Faced with a fragmented congress, the new administration will need to forge strategic alliances***. The new president, Mr. Alan García, was elected on June 4, 2006 with 52.6 percent of the vote, against 47.6 percent to his challenger, Mr. Humala. The election results unveiled a deeply divided country. Support for Mr. García was strong in the coastal region and in Lima, while the poor and economically-isolated Southern and Andean regions voted predominantly for Mr. Humala. A challenge for the new administration, scheduled to take office on July 28, 2006, will be to secure a stable working majority in the highly fragmented new congress.

10. ***The incoming authorities have indicated their interest to request a new arrangement from the Fund after the current one expires in August***. In their view, a new precautionary arrangement would help support the continued implementation of prudent policies in the early stages of the new administration and reinforce market confidence. Staff concurred that a new arrangement, based on sound macroeconomic policies and strong structural reforms, could be critical to ensure entrenching prudent policies. Staff also reaffirmed its commitment to provide technical assistance, including in areas in which further progress is needed to strengthen public institutions.

B. Program Reviews

Outlook and Risks

11. ***The Peruvian economy is expected to continue performing well in 2006.*** Against the backdrop of a still supportive global context and the continued implementation of prudent macroeconomic policies, real GDP is projected to grow by 5½ percent in 2006 while inflation would settle toward the middle of the inflation target range. Based on the strong revenue performance so far, the overall deficit of the combined public sector is projected at 0.4 percent of GDP in 2006—significantly below its programmed level. The external current account surplus would narrow somewhat, to around 0.7 percent of GDP, reflecting higher imports and repatriation of dividends by foreign companies. In recent years, Peru's exports

have benefited from the Andean Trade Preferences and Eradication Act (ATPDEA), which is due to expire at end–2006. Despite the recent approval by the Peruvian congress of the Free Trade Agreement (FTA) with the United States, U.S. congressional approval is still needed to make permanent Peru's preferential market access to the U.S. market, thus helping maintain the competitiveness of Peruvian non-traditional exports in that market (Box 3). At the same time, it will be important to continue pursuing unilateral trade liberalization at a multilateral level to avoid trade diversion effects.

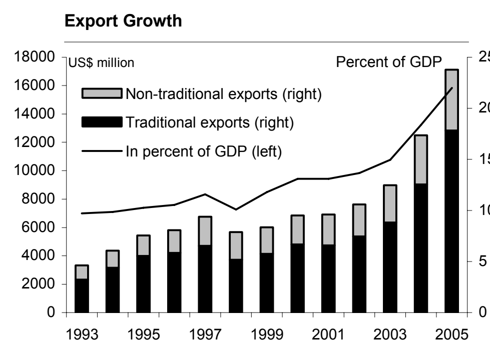
Table 1. Macroeconomic Framework

	2004	Prel. 2005	2006 Prog.	2006 Est.
Real GDP growth (in percent)	5.2	6.4	5.0	5.5
Inflation (in percent, end of period)	3.5	1.5	2.5	2.5
External current account	0.0	1.3	0.4	0.7
Public sector overall balance	-1.1	-0.3	-1.0	-0.4
Public sector debt	44.4	37.7	37.2	34.0

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

Box 3. Peru: Export Performance—Determinants and Challenges

Peruvian exports have recorded strong growth since 1998. Peru's exports rose from 10 percent of GDP in 1998 to 22 percent in 2005. Both traditional exports (e.g. copper, gold, lead, and zinc) and non-traditional exports (e.g. agro-industrial goods and textiles) grew strongly—by 19 percent and 12 percent a year, respectively, over that period.



The commodity price boom and strong global demand account for a substantial part of the Peruvian export growth, while trade preferences have also played a role. About half of the growth of traditional exports is explained by the increase in commodity prices. Volume growth has been driven by global demand, with exports to the United States and China growing fourfold over the past decade. The key drivers of non-traditional export growth have been improvements in productivity, product diversification, better access to credit, and preferential access to the U.S. market under the ATPDEA.

Peruvian exports remain vulnerable to shocks in global demand and prices. Enhanced competitiveness will be key to addressing this challenge, including through improvements in road and port infrastructure, a reduction in regulatory and legal uncertainties to investors, a cut in entry costs for new business, and strengthening the conditions for effective technology transfer. This will also help ensure that the benefits of the export-orientation of the economy are broad-based. The agricultural sector, which employs about one third of the workforce, is a case in point: measures to relax supply constraints faced by the majority of farmers will help shift production to higher value-added goods and boost production in the still small agro-industrial sector.

Figure 8. EMBI

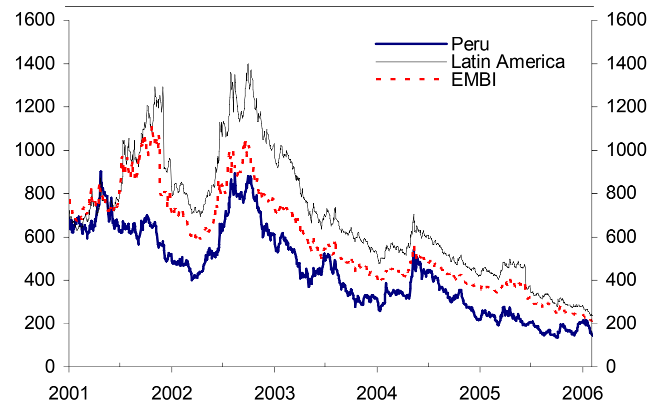
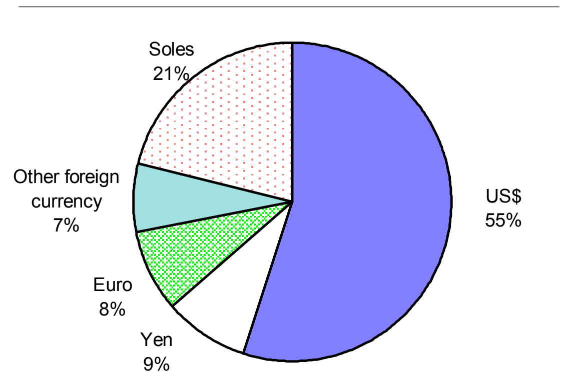


Figure 9. Total Public Debt by Currency
March, 2006



12. ***Downside risks to the external outlook stem mainly from a possible downturn in commodity prices, a reduced risk appetite for emerging markets, and the still high foreign currency-denominated debt.*** A sharp drop in Peru's terms of trade would adversely affect the fiscal accounts and could have a negative effect on the stock market. Also, a reduced risk appetite for emerging markets could lead to depreciation pressures on the *Nuevo Sol* and an increase in sovereign spreads. Despite a significant decline in the debt-to-GDP ratio in recent years, debt dynamics remain sensitive to exchange rate changes due to the large share (79 percent) of foreign-currency denominated public debt. Against these risks, Peru has built important buffers, including a comfortable level of reserves and a well-capitalized banking system.

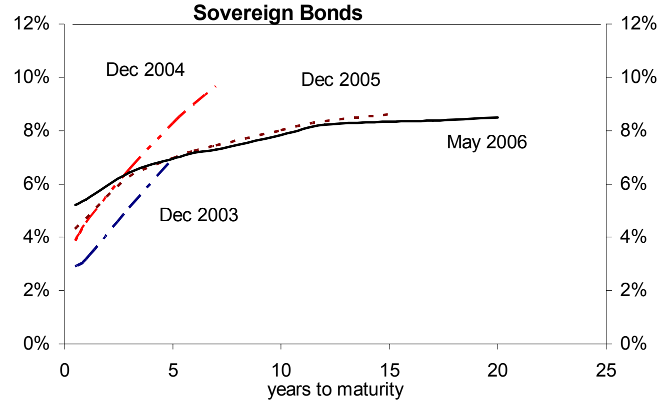
13. ***The medium-term outlook is favorable, but the social situation remains a challenge.*** Real GDP is projected to grow by about 4½ percent a year over the medium-term, inflation is expected to remain low, and the incoming government intends to help anchor sound economic policymaking. However, social pressures are likely to mount in the period ahead. With regional and municipal elections scheduled for November 2006, the incoming authorities will face the challenge of reconciling sound fiscal policies with effectively addressing social demands, particularly in the poor and economically-isolated regions.

Fiscal Policy

14. ***In 2006, the overall deficit is conservatively projected at about ½ percent of GDP, well below its programmed level.*** As noted, performance during the first half of 2006 was stronger than contemplated under the program. Reflecting the buoyancy in corporate tax collections, central government tax revenue for 2006 as a whole is projected to be above program projections by the equivalent of ½ percent of GDP. Taking into account recent increases in budgetary allocations, the primary spending of the general government would

rise by 3.5 percent in real terms.[4] This increase would be below that registered in 2005, but still above the 3 percent limit in the Fiscal Transparency and Responsibility Law (FRTL). Most of the government's gross financing requirements for 2006 (US$1.8 billion) have been secured, with less than US$0.2 billion still to be raised in the domestic market in coming months.[5] In recent weeks, the authorities also issued a 20-year bond in domestic currency for the first time and conducted a US$0.7 billion debt exchange to regroup the debt structure around a few, liquid, benchmark bonds; an additional exchange for US$0.5 billion is expected to be completed soon. The authorities' debt management strategy implemented in recent years, aimed at further reducing foreign currency exposure and rollover risks through increased government placements in local currency at lengthened maturities, has helped reinforce medium-term sustainability.[6]

Figure 10. Yield Curves of Local Currency Sovereign Bonds



15. ***There was agreement that public expenditure growth in 2006 needs to be contained.*** The authorities were well aware of the risks for the medium-term fiscal position of increasing expenditures on a permanent basis in boom years, and the mission recommended using part of the additional revenue in 2006 to reduce public debt. This would not only lower the risks associated with a global cyclical downturn, but would also help attain investment rating grade. The authorities planned to enhance fiscal discipline further over the cycle, including through ongoing efforts to develop a structural fiscal indicator, on the basis of that recently published in the Multiyear Macroeconomic Framework. The authorities also noted that the draft law strengthening the procedures for compliance with the FRTL was still under debate in congress. In the interest of avoiding procyclical fiscal policy, the incoming authorities will need to limit expenditure growth in the second semester of 2006.

16. ***In 2005 and early 2006, several steps were taken to help mitigate the impact of higher world oil prices on the economy.*** The excise tax rate on petroleum products was lowered on several occasions, with the estimated full-year effect of the last cut, in early 2006, equivalent to 0.1 percent of GDP. In 2004, the authorities also created a temporary fund

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[4] Two supplementary budgets authorizing additional spending equivalent to 0.4 percent of GDP were approved in recent months. About 40 percent of the additional spending reflected salary increases.

[5] So far this year, new issues in the domestic market have amounted to US$0.2 billion.

[6] Foreign currency denominated debt declined from 85 percent of total public debt in 2003 to 79 percent in March 2006.

aimed at avoiding excessive volatility in domestic petroleum prices, the resources of which have been increased on several occasions.[7] Staff recommended avoiding further reductions in excise tax rates and increases in the resources allocated to the stabilization fund. The authorities were in agreement that domestic fuel prices should continue to reflect international developments, and noted their intention to refrain from increasing further the resources of the stabilization fund or adopting new excise rate cuts on petroleum products to avoid creating a distorted relative price structure.

17. ***In 2007 and in subsequent years, one of the main challenges will be to reconcile an increase in social spending with the deficit limit of the FRTL.*** The 2007 budget, which will be presented to congress at end-August, is expected to be consistent with the overall deficit limit of 1 percent of GDP established in the FRTL. Tax collections are expected to drop by 0.4 percent of GDP in 2007, largely due to the phasing out of the financial transaction tax and the reduction in custom duties stemming from new trade agreements.[8] Achieving the deficit target will require efforts to prioritize spending, taking into account the compensations to the agricultural sector associated with the FTA with the United States and expected new initiatives in the social area, including in the fight against poverty and improving the delivery of basic services (e.g. health and education). In this context, it will be important to rationalize existing social programs to improve their targeting, assess the scope for gradually broadening the poverty reduction program *Juntos,* and ensure that the implementation of any new programs is accompanied by baseline indicators to allow close monitoring and evaluation. There may be also additional costs associated with the reforms of public sector employment and the pension regime of the police and military, if they are to be pushed forward by the incoming administration. Fiscal decentralization should continue to be undertaken in a gradual and fiscally neutral manner. All the external financing needs of the public sector for 2007 are expected to be covered through multilateral and bilateral sources; a small placement of bonds in the domestic market (US$0.6 billion) is also projected.

Structural Fiscal Reforms

18. ***Broadening the tax base and deepening tax administration efforts are key to ensuring adequate resources for social and infrastructure purposes.*** Although improvements in tax administration have helped reduce VAT evasion in recent years and the effectiveness of audits and collection of arrears has been enhanced, further efforts should be made to strengthen tax administration. In particular, it is important to improve the computer systems of the tax agency SUNAT while strengthening its management oversight through the development of indicators (e.g. targets for reducing VAT tax evasion over the medium-term).

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[7] The total resources directed to this fund have been equivalent to US$88 million. Of this amount, US$54 million were paid to importers and producers of petroleum products in 2005. All remaining claims on the fund, which could amount up to US$34 million, will be computed against the 2007 budget.

[8] This projection assumes that the temporary tax on assets will be transformed into a permanent minimum corporate income tax.

The mission suggested that SUNAT prepare medium-term estimates of tax collections, taking into consideration improvements in tax administration, the expected evolution of mineral prices, and the gradual phasing out of fiscal stability clauses in concession contracts. Staff also stressed the importance of increasing the number of tax courts and removing regional and sectoral tax exemptions.

19. ***Political uncertainty has resulted in delays in the implementation of the Private-Public Partnership (PPP) program.*** Although the authorities' 2006 PPP program envisages new investments commitments of US$2⅓ billion, only a small part materialized during the first half of the year, reflecting delays associated with political uncertainty before the elections and with the introduction of a permanent PPP framework. However, a modern terminal in Peru's largest port (Callao) was awarded in concession in mid-June—a key step toward facilitating international trade. The authorities were confident that the 2006 investment commitment objective would be attained by year-end. Most of the remaining new projects are expected to be in the area of transportation infrastructure, including several roads connecting the coast with the highland, and regional airports. Staff encouraged the authorities to rapidly finalize the design of a comprehensive PPP framework, encompassing all major aspects of these operations and establishing clear responsibilities on their general oversight.

20. ***The government has continued to resist strong pressure to weaken the institutional framework in the assessment of investment projects.*** The authorities recently vetoed a draft law that would have freed *Petroperu* from the viability assessment of the National System of Public Investment (SNIP) and several other public regulations. They agreed with the mission's recommendation that the SNIP should be further strengthened to ensure a swift process in the assessment of projects, the effective weeding out of socially unviable projects, and a broadening of its role in the setting of investment priorities. In addition, it was agreed that all major projects, including those undertaken via concessions and PPPs, should continue meeting SNIP's viability requirements. To avoid bottlenecks and ensure prompt allocation of available funds, the authorities considered that it was critical to increase the technical skills of spending units and those of local governments in project preparation and execution.[9] With respect to public enterprises, staff recommended that they be allowed to operate on commercial grounds and that regulatory agencies avoid introducing distortions in the setting of their prices.

21. ***Further enhancing resource management in the public sector will also be key to generating additional room for social and infrastructure spending.*** Implementation of the action plans for introducing a Treasury Single Account and a new budget classification consistent with international standards will help increase the clarity of the budget process,

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[9] The increase in mining and petroleum revenues at the sub-national level leads to an accumulation of cash balances because of the limited capacity of these government units to prepare and execute investment projects following the criteria required by the SNIP.

strengthen information and controls on spending, and increase the transparency of financial relationships among public institutions. Regarding the Financial Integrated Management System (SIAF), the mission advised the authorities to await rolling it out to the local level until its ongoing independent assessment has been completed. The mission also recommended that the system be enabled to perform automatic accounting.

Monetary Policy

22. ***Monetary policy continues to be managed prudently.*** The gradual increase in the central bank's policy rate, to 4.5 percent, has resulted in a modest tightening in monetary conditions, as reflected in the monetary conditions index (Figure 12).[10] The central bank noted that the rise in its policy rate had been partly designed to stem incipient inflationary pressure associated in part with the depreciation of the currency in the early part of the year. While the current inflation outlook appears benign, staff encouraged the authorities to monitor closely potential upward pressures on prices arising from the strong economic activity or changes in the global environment, and to stand ready to tighten monetary policy if necessary. The authorities indicated their intention to ensure that inflation expectations remained well anchored, and noted that the pace of reduction in the monetary stimulus would largely depend on the strength of pressures arising from the domestic demand, in the context of strong economic activity. Although the central bank policy rate remains below the U.S. federal funds rate, the mission agreed with the authorities that the speed at which the

Figure 11. Inflation and Core Inflation

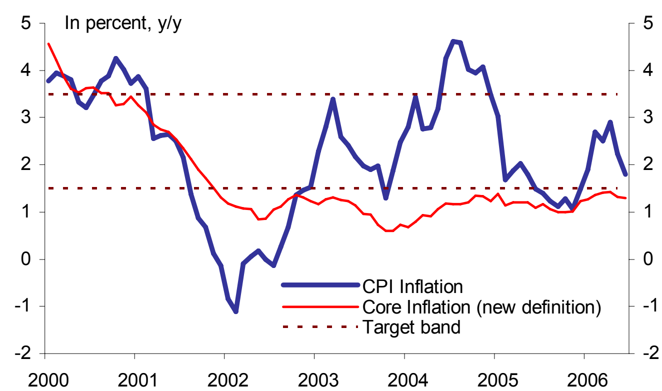
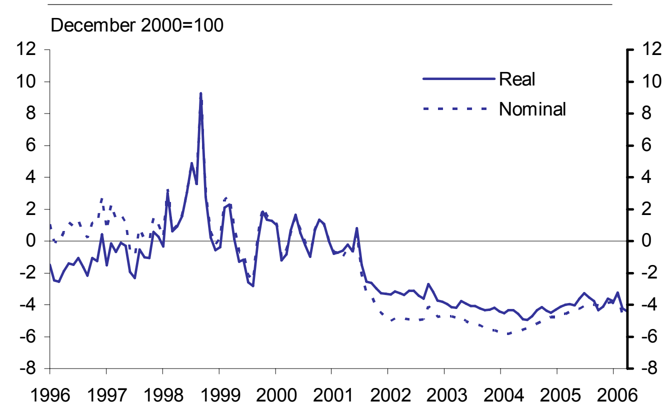


Figure 12. Monetary Conditions Index 1/



1/ An increase in the monetary conditions index indicates a tightening of monetary conditions.

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[10] A new definition of core inflation, introduced in April 2006, excludes several food items, petroleum products, and public transport services.

differential should be closed depended upon other developments in the economy, including the strength of incipient appreciation pressures on the *Nuevo Sol*.[11]

Figure 13. Fed Policy Rate and BCRP Policy Rate

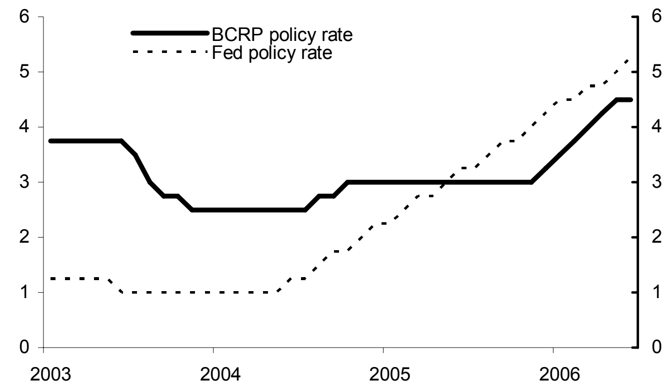
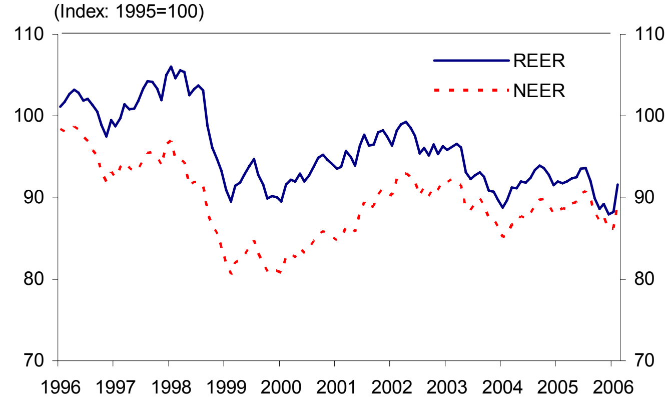


Figure 14. Nominal and Real Effective Exchange Rates
(Index: 1995=100)



23. ***The central bank has let the exchange rate move more freely.*** Following heavy intervention in early 2006, aimed at easing downward pressure on the currency associated with political uncertainty, the *Nuevo Sol* has been allowed to appreciate against the U.S. dollar in recent weeks, reaching its strongest level since 1999. In this context, staff reaffirmed its advice that the exchange rate should be allowed to move freely, with central bank intervention in the foreign exchange market aimed primarily at avoiding excess exchange rate volatility. This would help make the economy more resilient to shocks, avoid the risks associated with providing the conditions for one-way bets, and prevent undermining the inflation targeting objective. The central bank agreed in principle but noted that, in a highly dollarized banking system, there is a need to avoid large fluctuations of the exchange rate because they could have adverse effects on the quality of banks' portfolios and financial stability. Staff also encouraged the central bank to limit the issuance of exchange rate-linked CDs in order to avoid the foreign exchange risks associated with this type of instruments.

24. ***The authorities plan to continue promoting efficiency in financial intermediation.*** The central bank had kept the rate of remuneration of the legal reserves on dollar-denominated deposits at 2¼ percent since June 2005, and raised it to 2½ percent in July. Taking into account the rise in U.S. interest rates over the past two years, staff recommended raising the rate of remuneration of bank legal reserves, to help avoid creating distortions in the economy. The central bank indicated that it would continue to keep this issue under review, recognizing that there was a need to assess the trade-off between efforts to promote de-dollarization through the maintenance of a low rate and its possible adverse effects on

[11] Earlier this year, however, closing this differential would have helped avoid a weakening of the *Nuevo Sol*, thus reducing the inflationary pressures from the pass-through of the depreciation.

financial intermediation. The authorities were also following developments in retail lending closely, with a view to ensuring that the rapid growth in consumer lending would not lead to over-borrowing by households; to that effect, they have asked individual banks to explain the factors behind the rise in their retail lending operations. Further development of the domestic capital market is key to promoting greater efficiency in financial intermediation. In this context, staff indicated the Fund's readiness to provide technical assistance in the development of new financial instruments that would be viable under the domestic regulatory framework and appealing to the domestic investor base.

Financial sector issues

25. ***The authorities have continued to take steps to further strengthen the financial system.*** They have completed a road map for implementation of the Basel II framework, tightened regulations governing restructured loans, and improved consolidated and cross-boarder supervision. Progress has been made in developing a composite bank rating and classification system, which is expected to become the cornerstone of supervisory decisions on enforcement. Staff encouraged the authorities to continue pressing for a strengthening in banks' capital reserve requirements on a consolidated basis, while ensuring that provisioning requirements on offshore loans for which comprehensive information is not available are similar to those applied to onshore loans. Regarding micro finance institutions, there is a need to develop strategies to improve their supervision, corporate governance practices, and increase their capital requirements. Staff welcomed the enactment of legislation giving legal protection to supervisors in late May, but noted that it fell short of providing effective protection because of inadequacies in the law.

Figure 15. Banking Indicators

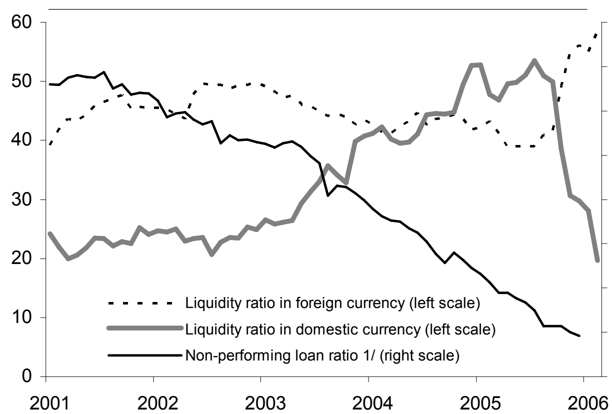
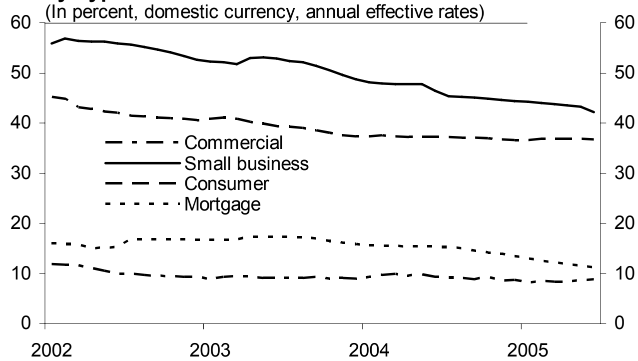


Figure 16. Average Lending Rates of Commercial Banks by Type of Credit
(In percent, domestic currency, annual effective rates)



26. ***Although financial dollarization continues to be a key source of vulnerability, economic agents are becoming increasingly aware of its risks.*** In recent years, the share of credit in local currency has risen, partly reflecting higher demand in response to lower

lending rates stemming from increased competition, particularly in the micro-finance segment. On the deposit side, however, the process of de-dollarization has been slightly reversed recently, in the face of political uncertainty. Staff welcomed progress made in implementing new regulations to measure and manage the risks associated with foreign-currency lending. While the first steps to encourage mortgage lending in domestic currency under the *MiVivienda* government program were only taken recently, the new operating scheme ensures that all mortgage loans financed with *MiVivienda's* own funds will be denominated in domestic currency.[12] Although large banks will no longer have access to the *MiVivienda* funds, they are beginning to extend mortgages in local currency under their traditional schemes. Staff stressed the need to continue supervising closely foreign-currency induced credit risks in the mortgage market.

Figure 17. Share of Credit and Deposits in Foreign Currency

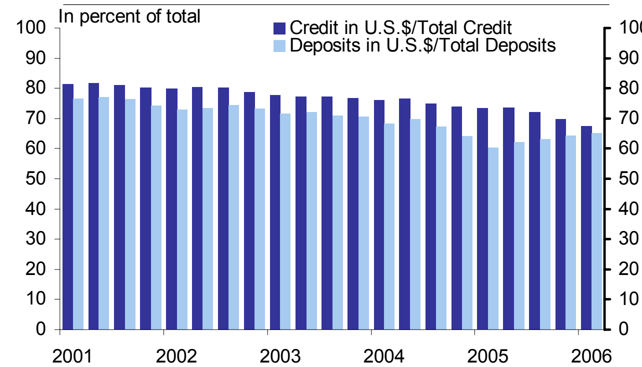


Figure 18. MiVivienda Mortgage Lending in US$

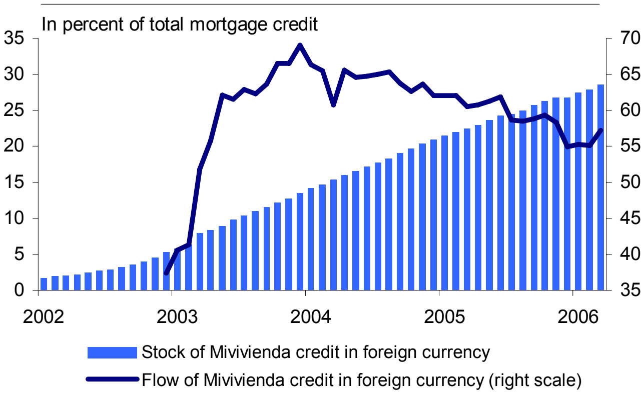
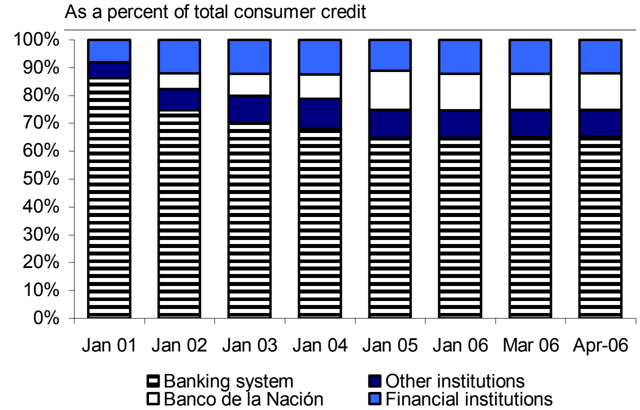


Figure 19. Consumer Credit by Institution
As a percent of total consumer credit



27. ***Staff underscored the need to limit government participation in the financial system.*** *Banco de la Nación* lending activity is expected to expand rapidly in the period ahead, as the bank has now been allowed to extend credit to small-and-medium-sized enterprises. The mission reaffirmed the importance for *Banco de la Nación* to comply with the governmental guideline to limit the growth in its consumer lending operations to 25 percent in 2006, and the need for such lending to be based on sound commercial criteria. Staff also reiterated that any expansion in lending operations by the public bank should not lead to unfair competition

[12] The funds that *MiVivienda* has available for lending have declined significantly. Accordingly, *MiVivienda* is now planning to raise additional funds through the issuance of bonds.

with the private banking sector, particularly given the presence of relatively successful micro-finance institutions. The mission urged the authorities to enhance the supervision of *Banco de la Nación* and monitor closely banks with large funding from the second–tier public financial institution (COFIDE) to ensure prudent lending policies, especially when these banks enter new loan markets for which they lack proper risk management skills.

IV. Staff Appraisal

28. ***The Peruvian economy has continued to perform strongly.*** The sustained implementation of sound macroeconomic policies, in the context of a very favorable external environment, has led to strong economic growth, low inflation, and a further improvement in the external position. All quantitative performance criteria for end-March were met, except for the performance criterion on net international reserves in a context of political uncertainty. All the end-June quantitative performance criteria are likely to have been met and, given that information with respect to these criteria will not become available by the time the Board is expected to consider the reviews, it is recommended that a waiver of applicability be granted. Progress has also been made in the structural reform area, including with respect to improving the business environment, enhancing public financial management, and implementing the bank regulatory framework to mitigate foreign currency induced risks.

29. ***The authorities' commitment to meet the fiscal objectives of the program during the election period is commendable.*** Despite higher fiscal spending than originally envisaged, the program target for 2005 was met with a margin, thus helping reduce Peru's public debt-to-GDP ratio further. Moreover, an overall fiscal surplus exceeding that envisaged in the program is expected for the first half of 2006. Staff welcomes ongoing efforts to develop a structural fiscal indicator with a view toward promoting greater discipline over the cycle and, in the interest of avoiding procyclical fiscal policy, encourages the incoming authorities to limit expenditure growth in the second semester of 2006. Should revenues turn out to be higher than originally projected, the authorities should consider saving them to reduce the public debt-to-GDP ratio further.

30. ***Several measures have continued to be adopted to help mitigate the impact of higher oil prices on the economy.*** After taking similar measures in 2005, the authorities have recently further reduced the excise tax on petroleum products and increased the resources directed to the oil stabilization fund. Although the fiscal cost of these measures has been moderate, staff recommends avoiding further reductions in excise tax rates and increases in the resources allocated to the stabilization fund to avoid creating a distorted relative price structure.

31. ***The 2007 and subsequent budgets will face the challenge of reconciling an increase in social spending with prudent fiscal policies.*** Staff encourages keeping the overall deficit below 1 percent in 2007 to help reduce the debt-to-GDP ratio further to more comfortable levels. This would not only lower the risks associated with a global cyclical downturn, but

would also help attain investment rating. Staff also encourages the authorities to make every effort to raise revenues by widening the tax base and improving tax administration, including by continuing to improve the effectiveness of audits and collection of arrears, increasing the number of tax courts, and further strengthening management oversight through the development of indicators. It will also be important to keep a tight rein on expenditure growth, prioritize expenditure demands, and make room for the needed increase in social policies and the fight against poverty. Fiscal decentralization should continue to be undertaken in a gradual and fiscally neutral manner.

32. ***Sound public debt management is helping reinforce medium-term fiscal sustainability***. Staff acknowledges the skillful management of the public debt implemented in recent years and recommends continuing to seek opportunities to improve the debt profile, including by shifting its composition toward local currency and longer maturity obligations.

33. ***Further enhancing resource management in the public sector will also be key to ensuring adequate resources for social and infrastructure purposes.*** Staff encourages the authorities to press ahead with the introduction of a Treasury Single Account and a new budget classification consistent with international standards. These measures will help improve the clarity of the budget process, strengthen controls on spending, and increase the transparency of the financial relationship among public institutions. It will be important to avoid continuing to roll out the Financial Integrated Management System to municipalities until an independent assessment has been completed and the system is enabled to perform automatic accounting. Implementing the reform of the pension regime of the police and the military will be key to restoring its financial viability.

34. ***Efforts aimed at strengthening the institutional framework for PPP operations need to be stepped up.*** Staff encourages the authorities to rapidly finalize the action plan for the introduction of a permanent framework for PPP operations and to begin its implementation. Staff welcomes the recent awarding in concession of the modern terminal in Peru's largest port (Callao), a key step toward facilitating international trade. Existing efforts to strengthen the SNIP should be deepened with a view to strengthening its role in the setting of investment priorities, assessing projects promptly, and weeding out socially unviable projects. It will also be key to strengthen the technical skills of spending units and those of local governments in project preparation. It is critical that all major projects undertaken via concessions and PPPs should continue meeting SNIP's viability requirements.

35. ***Monetary policy continues to be managed prudently.*** Despite incipient inflationary pressure in the early part of the year, inflation has abated in recent months, headline inflation remains low, and inflation expectations are well anchored. Should accelerating economic activity put upward pressure on prices, the authorities will need to tighten monetary policy with a view to helping ensure that inflation expectations remain well anchored. Staff continues to advise the central bank to limit its interventions in the foreign exchange market to minimizing short-term volatility.

36. ***Further progress has been made toward strengthening the financial system and improving its efficiency.*** Staff welcomes the tightening of regulations governing restructured loans and progress in the development of a composite bank rating and classification system. The authorities should stand ready to impose provisioning requirements on offshore loans (for which comprehensive information is not available) similar to those applied to onshore loans. Care should also be taken to ensure that public financial intermediaries avoid unfair competition with the private banking sector. In the period ahead, it will also be important to enhance the supervision of *Banco de la Nación* and monitor closely banks with large funding from the second–tier public financial institution COFIDE. The recent enactment of legislation providing legal protection to supervisors is a positive step, although it falls short of providing fully effective protection.

37. ***The authorities' commitment to reducing the vulnerabilities associated with dollarization is welcome.*** The implementation of the regulation aimed at mitigating currency-induced risks is commendable. Despite delays in implementing the plan to encourage mortgage lending in domestic currency under the *MiVivienda* government program, the new scheme is designed to ensure that all new mortgage loans financed with *MiVivienda's* own funds are denominated in *Nuevos Soles.* As the bulk of mortgage lending has moved to the private sector without *MiVivienda* involvement, the authorities need to continue supervising closely foreign-currency induced credit risks.

38. ***The recent approval of the bilateral free trade agreement with the United States by the Peruvian congress is a key step toward helping to maintain Peru's competitive position in the U.S. market.*** Staff encourages the authorities to continue pursuing unilateral trade liberalization at a multilateral level to avoid trade diversion effects. Moreover, given that the Peruvian exports remain vulnerable to shocks in global demand and prices, the authorities will need to continue to enhance competitiveness, including through improvements in road and port infrastructure, a reduction in regulatory and legal uncertainties to investors, a cut in entry costs for new business, and strengthening the conditions for effective technology transfer.

39. ***The medium-term outlook is favorable.*** The successful implementation of the authorities' economic program has helped broaden the consensus on the need for continuity of prudent macroeconomic policies. The main risks to the outlook continue to stem from a possible downturn in commodity prices, high debt and dollarization, the large share of foreign-currency denominated public debt, and policy slippages associated with a challenging political and social situation. However, Peru has built important buffers, including a comfortable level of reserves and a well-capitalized banking system. The main challenge over the medium term will be to boost economic growth over a sustained period of time while reducing poverty. To this end, the incoming authorities are encouraged to entrench macroeconomic stability further, press ahead with institutional and social reforms, increase the share and effectiveness of pro-poor spending, and maintain transparent and predictable rules, particularly with a view to enhance private sector investment. With

widespread informality, they also need to build consensus on a set of reforms to promote further increases in formal employment.

40. ***In summary, Peru has performed well under the program supported by the Stand-By Arrangement, and the staff recommends completion of the fourth and fifth reviews.*** The overall stance of macroeconomic policy is appropriate and, despite delays in adopting an action plan for introducing a permanent framework for PPP operations and in implementing a new scheme for mortgage lending under the *MiVivienda* program, important structural reforms have been achieved at all stages of the program.

Table 1. Peru: Selected Economic Indicators

	2002	2003	2004	Prel. 2005	2006 Prog.	2006 Proj.	Proj. 2007
Social Indicators							
Life expectancy at birth (years)	69.8	70.0	...	...	...	...	...
Infant mortality (per thousand live births)	30.0	26.0	...	...	...	...	...
Adult literacy rate	87.3	87.7	87.8	...	...	...	...
Poverty rate (Total) 1/	53.8	52.2	51.6	50.6	...	48.0	...
Unemployment rate	9.4	9.4	9.4	9.6	...	...	...
(Annual percentage change; unless otherwise indicated)							
Production and prices							
Real GDP	5.2	3.9	5.2	6.4	5.0	5.5	5.0
Real domestic demand	4.4	3.4	4.4	5.5	5.5	7.6	5.3
Consumer Prices (end of period)	1.5	2.5	3.5	1.5	2.5	2.5	2.5
Consumer Prices (period average)	0.2	2.3	3.7	1.6	2.4	2.4	2.5
External sector							
Exports	9.8	17.8	38.8	36.7	5.8	26.6	7.3
Imports	2.8	11.2	19.0	23.0	13.5	21.3	16.0
Terms of trade (deterioration -)	3.1	1.3	9.2	6.9	-2.8	16.5	-4.9
Real effective exchange rate (depreciation -) 2/	-1.2	-6.8	1.9	-3.9	...	...	...
Money and credit 3/ 4/							
Liabilities to the private sector	4.4	1.9	11.5	15.1	7.0	13.4	9.4
Net credit to the private sector	-1.5	-3.5	3.6	11.7	5.6	11.2	8.7
(In percent of GDP; unless otherwise indicated)							
Public sector							
General government current revenue	17.0	17.4	17.5	18.3	18.3	18.6	17.8
General government noninterest expenditure	17.2	17.1	16.7	17.0	17.3	17.2	16.8
Combined public sector primary balance	0.0	0.5	1.0	1.6	1.2	1.7	1.1
Interest due	2.1	2.2	2.0	1.9	2.2	2.0	2.0
Combined public sector overall balance	-2.2	-1.7	-1.1	-0.3	-1.0	-0.4	-1.0
External Sector							
External current account balance	-1.9	-1.5	0.0	1.3	0.4	0.7	0.2
Gross reserves							
In millions of U.S. dollars 5/	9,690	10,206	12,649	14,115	13,669	15,615	16,815
Percent of short-term external debt 6/	214.2	214.4	161.2	288.5	280.2	329.3	320.9
Percent of foreign currency deposits at banks	100.6	107.3	128.3	129.4	124.9	132.1	134.0
Debt							
Total external debt	48.9	48.1	44.7	35.8	35.5	31.3	29.7
Combined public sector debt	46.6	47.0	44.4	37.7	37.2	34.0	33.0
Domestic	10.1	10.0	9.2	9.7	9.5	9.2	9.6
External 7/	36.5	37.0	35.1	28.1	27.7	24.9	23.4
Savings and investment							
Gross domestic investment	18.9	18.8	18.9	18.6	19.5	19.7	20.4
Public sector	2.8	2.8	2.8	2.9	3.2	3.3	3.3
Private sector	14.7	15.0	15.2	16.0	16.5	16.7	17.1
Inventories changes	1.4	1.0	1.0	-0.2	-0.2	-0.2	0.0
National savings	17.0	17.2	18.9	19.9	19.9	20.4	20.6
Public sector 8/	0.8	1.2	1.7	2.6	2.3	3.0	2.4
Private sector	16.2	16.0	17.2	17.3	17.6	17.4	18.2
External savings	1.9	1.5	0.0	-1.3	-0.4	-0.7	-0.2
Memorandum items:							
Nominal GDP (S/. billions)	200.6	213.9	237.8	261.6	271.3	293.4	311.1
GDP per capita (in US$)	2,194	2,330	2,599	2,917	3,081	3,210	3,386

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

1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket. 2006 refers to first quarter estimate.

2/ Based on Information Notice System.

3/ Corresponds to the banking system.

4/ Foreign currency stocks are valued at program exchange rate.

5/ Gross international reserves exceed net international reserves by the stock of Fund credit outstanding.

6/ Short-term debt includes amortization of medium- and long-term loans falling due over the following year.

7/ Includes debt by the Central Reserve Bank of Peru.

8/ Excludes privatization receipts.

Table 2. Peru: Quantitative Performance Criteria and Inflation Consultation Mechanism, 2005 and 2006

	2005	2006	
	Dec. 31	Mar. 31	Jun.30
	(Cumulative amounts from December 31, 2004, millions of New Soles)	(Cumulative amounts from December 31, 2005, millions of New Soles)	
Borrowing requirement of the combined public sector 1/			
Unadjusted limits	2,605	-596	-2,090
Adjusted limits 2/	2,605	-596	
Actual	339	-2,983	
Margin	2,266	2,387	
	(Cumulative amounts from December 31, 2004, millions of U.S. dollars)	(Cumulative amounts from December 31, 2005, millions of U.S. dollars)	
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions			
Unadjusted targets	-300	-387	-804
Adjusted targets 2/	-1,541	-655	
Actual	444	-732	
Margin	1,985	-77	
Outstanding short-term external debt of the nonfinancial public sector			
Limits	50	50	50
Actual	0	0	
Margin	50	50	
Contracting or guaranteeing of nonconcessional public debt with maturity of at least one year			
Unadjusted limits	3,100	960	1,101
Adjusted limits 2/	5,776	988	
Actual	4,343	676	
Margin	1,433	312	
***Of which:* external debt of 1-5 year maturity**			
Limits	100	100	100
Actual	0	0	
Margin	100	100	
External payments arrears of the public sector (on a continuous basis)			
Limits	0	0	0
Actual	0	0	
Margin			
	(Consultation bands for the 12-month rate of inflation, in percent) 3/		
Outer band (upper limit)	5.5	5.5	5.5
Inner band (upper limit)	4.5	4.5	4.5
Central point	2.5	2.5	2.5
Inner band (lower limit)	0.5	0.5	0.5
Outer band (lower limit)	-0.5	-0.5	-0.5
Actual	1.5	2.5	1.8

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; IMF Country Report No. 07/110; and IMF Country Report No. 06/47.

1/ PIPP proceeds are included below the line.

2/ The targets and limits were adjusted in accordance with the tables attached to the letters of intent dated May 20, 2005 (IMF Country Report No. 07/110) for 2005, and December 20, 2005 (IMF Country Report No. 06/47) for 2006.

3/ Should inflation fall outside the inner band, the authorities will discuss with the Fund staff the appropriate policy response. Should inflation fall outside the outer band, the authorities will also complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the arrangement.

Table 3. Peru: Structural Benchmarks for 2005 and 2006[1/]

Measures	Date of Implementation	Current Status
Unify the Central government budget formulation system and the Integrated Financial Management System (SIAF)	June 30, 2005	Not observed. Completed in January 2006.
The Superintendency of Banks will publish and disseminate the new pricing methodology and reference prices of nontraded financial assets.	July 30, 2005	Not observed. Completed in April 2006.
The government will develop an operational plan to ensure that at least 50 percent of the mortgage loans financed by the *MiVivienda* program during the period January–June 2006 are denominated in domestic currency.	December 31, 2005	Observed.
Prepare an action plan to introduce a permanent framework for Private-Public Partnerships, as specified in paragraph 8 of the MEFP.	March 31, 2006	Not observed.
Completion of plans for implementing a Treasury Single Account and update the budget classification system to international standards, as specified in paragraph 7 of the MEFP.	June 30, 2006	Observed
Implementation of the plan to centralize collateral registries.	June 30, 2006	Observed
Implement the plan under which at least 50 percent of the mortgage loans financed by the *MiVivienda* program during the period January–June 2006 are denominated in domestic currency.	June 30, 2006	Not observed
Fully implement the regulation measuring risks associated with foreign currency denominated loans.	June 30, 2006	Observed

1/ Structural Benchmarks for 2005 refer to those for which implementation was pending.

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

(In percent of GDP; unless otherwise indicated)

	2003	2004	Prel. 2005	2006 Prog	2006 Proj	Proj. 2007
Central government primary balance	**0.2**	**0.6**	**1.1**	**0.9**	**1.4**	**0.9**
Revenue	**14.9**	**15.0**	**15.8**	**15.8**	**16.2**	**15.7**
Current	14.7	14.9	15.7	15.7	16.1	15.6
Of which : Tax revenue	12.8	13.2	13.6	13.7	14.2	13.8
Of which: Financial transaction tax 1/	...	0.3	0.3	0.2	0.3	0.0
Capital	0.2	0.1	0.1	0.1	0.1	0.1
Noninterest expenditure	14.7	14.4	14.7	14.9	14.8	14.7
Current	12.8	12.6	12.8	12.9	12.7	12.7
Capital	1.9	1.8	1.9	2.0	2.1	2.0
Rest of the general government primary balance	**0.3**	**0.3**	**0.3**	**0.3**	**0.0**	**0.0**
Revenue	5.8	5.7	5.9	6.1	5.7	5.6
Current	5.7	5.7	5.9	6.0	5.7	5.6
Capital	0.1	0.0	0.0	0.1	0.0	0.0
Noninterest expenditure	5.5	5.4	5.6	5.8	5.7	5.6
Current	4.6	4.6	4.7	4.7	4.6	4.5
Capital	0.9	0.9	0.9	1.1	1.0	1.1
Public enterprise primary balance	**0.0**	**0.1**	**0.2**	**0.1**	**0.1**	**0.1**
Current balance	0.3	0.4	0.5	0.5	0.4	0.4
Capital balance	-0.4	-0.2	-0.3	-0.4	-0.4	-0.3
Nonfinancial public sector primary balance	**0.4**	**1.0**	**1.6**	**1.2**	**1.5**	**1.1**
Central bank operating balance	0.1	0.0	0.0	0.0	0.1	0.0
Combined public sector primary balance	**0.5**	**1.0**	**1.6**	**1.2**	**1.7**	**1.1**
Interest payments	2.2	2.0	1.9	2.2	2.0	2.0
External	1.8	1.7	1.6	1.6	1.5	1.5
Domestic	0.4	0.4	0.3	0.6	0.5	0.6
Of which: Pension recognition bonds	0.1	0.1	0.0	0.1	0.1	0.1
Combined public sector overall balance	**-1.7**	**-1.1**	**-0.3**	**-1.0**	**-0.4**	**-1.0**
Financing	1.7	1.1	0.3	1.0	0.4	1.0
External	1.4	1.5	-1.5	-0.2	-0.2	0.1
Disbursements 2/	3.4	3.6	3.3	1.2	1.2	1.3
(In millions of U.S. dollars)	2,101	2,474	2,628	999	1,065	1,250
Amortization 3/	-1.9	-1.9	-4.6	-1.4	-1.4	-1.2
(In millions of U.S. dollars)	-1,187	-1,348	-3,678	-1,149	-1,200	-1,163
Other 4/	-0.1	-0.1	-0.1	0.0	0.0	0.0
Domestic	0.2	-0.6	1.7	1.1	0.5	0.8
Bond placements 5/	0.8	1.1	2.6	0.8	0.8	0.6
(In millions of U.S. dollars)	508	759	2,090	650	700	600
Amortization 6/	-0.9	-1.0	-1.0	-0.6	-0.5	-0.5
(In millions of U.S. dollars)	-556	-719	-779	-470	-419	-501
Of which: Pension recognition bonds	-170	-215	-192	-95	-105	-95
Net deposits	0.3	-0.7	0.1	0.9	0.2	0.7
(In millions of U.S. dollars)	190	-483	50	757	197	694
Privatization	0.1	0.2	0.1	0.0	0.0	0.0
(In millions of U.S. dollars)	52	114	56	24	24	24
Memorandum items:						
Overall fiscal deficit (old definition) 7/	-1.9	-1.2	-0.5	-1.0	-0.4	-1.0
Tax on assets on public enterprises	0.0	0.0	0.0	0.0	0.0	0.0
General government current revenue 8/	17.4	17.5	18.3	18.3	18.6	17.8
General government noninterest expenditure 8/	17.1	16.7	17.0	17.3	17.2	16.8
Public sector debt-to-GDP	47.0	44.4	37.7	37.2	34.0	33.0
Nominal GDP (S/. billions)	213.9	237.8	261.6	271.3	293.4	311.1

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

1/ Assumes that the financial transaction tax expires at end-2006.
2/ In 2004, includes placement of US$800 million euro-denominated bonds, covering part of the country's financing needs for 2005. In 2005, includes placement of US$750 million bonds to finance the Paris Club prepayment.
3/ In 2005, includes the prepayment of US$1.55 billion to the Paris Club.
4/ Includes condonations, plus the net increase in short-term external credit to the NFPS and the net decrease in foreign assets of the NFPS.
5/ In 2005, includes the placement of US$323 and US$462 million Soles-denominated bonds to finance the Paris Club prepayment. In 2006, includes the placement of US$85 million Soles-denominated bonds to finance the Japeco prepayment.
6/ Includes in 2005 the amortization of US$390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.
7/ Adjusted by adding the amortization (previously booked as a current transfer) and subtracting the accrued interest payments of CPI-indexed pension recognition bonds.
8/ Net of transfers among non-financial public institutions.

Table 5. Peru: Financing of the Combined Public Sector

	2002	2003	2004	Prel. 2005	2006 Prog.	2006 Proj.	2007 Proj.
	(In millions of U.S. dollars)						
Combined balance	**-1,227**	**-1,037**	**-748**	**-250**	**-820**	**-336**	**-912**
Financing	**1,227**	**1,037**	**748**	**250**	**820**	**336**	**912**
Net External	1,169	843	1,078	-1,167	-141	-165	95
Disbursements	2,863	2,101	2,474	2,628	999	1,065	1,250
Bonds 1/ 2/	1,886	1,245	1,295	1,682	0	0	0
Multilaterals	807	519	863	595	499	465	650
Bilaterals and other	170	337	315	350	500	600	600
Amortization 3/ 4/	-1,837	-1,187	-1,348	-3,678	-1,149	-1,200	-1,163
Other 5/	143	-71	-48	-117	9	-30	8
Privatization	421	52	114	56	24	24	24
Net Domestic financing	-363	142	-443	1,361	937	477	793
Bonds 6/	267	508	759	2,090	650	700	600
Amortization	-193	-556	-719	-779	-470	-419	-501
Of which : Pension recognition bonds	-55	-170	-215	-192	-95	-105	-95
Net deposits	-437	190	-483	50	757	197	693
Of which: Central government	-396	299	-335	364	936	255	673
	(In percent of GDP)						
Combined balance	**-2.2**	**-1.7**	**-1.1**	**-0.3**	**-1.0**	**-0.4**	**-1.0**
Financing	**2.2**	**1.7**	**1.1**	**0.3**	**1.0**	**0.4**	**1.0**
Net External	2.0	1.4	1.5	-1.5	-0.2	-0.2	0.1
Disbursements 1/	5.0	3.4	3.6	3.3	1.2	1.2	1.3
Bonds	3.3	2.0	1.9	2.1	0.0	0.0	0.0
Multilaterals	1.4	0.8	1.2	0.7	0.6	0.5	0.7
Bilaterals and other	0.3	0.5	0.5	0.4	0.6	0.7	0.6
Amortization	-3.2	-1.9	-1.9	-4.6	-1.4	-1.4	-1.2
Other	0.3	-0.1	-0.1	-0.1	0.0	-0.0	0.0
Privatization	0.7	0.1	0.2	0.1	0.0	0.0	0.0
Net Domestic financing	-0.6	0.2	-0.6	1.7	1.1	0.5	0.8
Bonds	0.5	0.8	1.1	2.6	0.8	0.8	0.6
Amortization	-0.3	-0.9	-1.0	-1.0	-0.6	-0.5	-0.5
Of which: Pension recognition bonds	0.1	0.3	0.3	0.2	0.1	0.1	0.1
Net deposits	-0.8	0.3	-0.7	0.1	0.9	0.2	0.7
Of which: Central government	-0.7	0.5	-0.5	0.5	1.1	0.3	0.7
Memorandum item:							
Nominal GDP (S/. billions)	200.6	213.9	237.8	261.6	271.3	293.4	311.1

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

1/ In 2004, includes placement of US$800 million euro-denominated bonds, covering part of the financing needs for 2005.
2/ In 2005, includes placement of US$750 million bonds to finance the Paris Club prepayment.
3/ Includes in 2005 the amortization of US$390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.
4/ In 2005, includes the prepayment of US$1.55 billion to the Paris Club.
5/ Includes condonations, net increase in short-term external credit to the NFPS, and net decrease in foreign assets of the NFPS.
6/ In 2005, includes the placement of US$323 and US$462 million Soles-denominated bonds to finance the Paris Club prepayment. In 2006, includes the placement of US$85 million Soles-denominated bonds to finance the Japeco prepayment.

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

	2002	2003	2004	Prel. 2005	2006 Prog.	2006 Proj.	Proj. 2007
Current primary balance	**1.6**	**2.0**	**2.3**	**2.8**	**2.7**	**3.4**	**2.9**
Current revenue	14.2	14.7	14.9	15.7	15.7	16.1	15.6
Tax revenue	11.8	12.8	13.2	13.6	13.7	14.2	13.8
Income tax	3.2	3.9	4.0	4.3	4.0	5.3	5.3
Other tax revenue 1/	8.6	8.9	9.2	9.3	9.6	8.8	8.5
Of which: Financial transaction tax	...	...	0.3	0.3	0.2	0.3	0.0
Other current revenue 2/	2.4	1.9	1.7	2.1	2.0	2.0	1.9
Current noninterest expenditure	12.6	12.8	12.6	12.8	12.9	12.7	12.7
Labor services 3/	6.6	6.7	6.4	6.3	6.5	6.1	6.0
Goods and nonlabor services	3.4	3.4	3.5	3.4	3.4	3.4	3.4
Transfers and other	2.6	2.7	2.7	3.1	3.0	3.3	3.4
Capital balance	**-1.8**	**-1.7**	**-1.7**	**-1.7**	**-1.9**	**-2.0**	**-2.0**
Capital revenue	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Capital expenditure	2.0	1.9	1.8	1.9	2.0	2.1	2.0
Gross capital formation	1.7	1.6	1.6	1.7	1.8	1.9	1.9
Other	0.2	0.3	0.2	0.2	0.1	0.1	0.1
Primary balance	**-0.2**	**0.2**	**0.6**	**1.1**	**0.9**	**1.4**	**0.9**
Interest payments	2.0	2.0	1.8	1.8	2.1	1.9	1.9
External	1.7	1.7	1.6	1.6	1.6	1.5	1.4
Domestic	0.2	0.2	0.2	0.3	0.5	0.4	0.4
Overall balance	**-2.2**	**-1.7**	**-1.3**	**-0.7**	**-1.2**	**-0.5**	**-0.9**
Memorandum items:							
General government tax revenues 3/	12.0	12.9	13.4	13.9	14.0	14.4	14.0
Primary balance before transfers	2.0	2.8	3.3	4.0	3.8	4.4	4.0
Overall balance before transfers	0.0	0.9	1.4	2.2	1.8	2.5	2.2

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

1/ Assumes that the financial transaction tax expires at end-2006.

2/ Decline in 2003 reflects lower collections on the recovery of illicit funds from officials of the previous administration and special large fines paid by mining companies in 2002. Includes mining royalties since 2005.

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

Table 7. Peru: Public Sector Social Expenditure

	2000	2001	2002	2003	2004	Prel. 2005	Proj. 2006
(In millions of New Soles)							
Total social expenditure and pensions	**18,821**	**19,056**	**20,698**	**21,613**	**23,578**	**25,779**	**27,407**
Universal coverage (Education and Health) 1/	7,106	7,135	8,197	8,916	10,396	10,965	11,956
Education	5,004	5,165	5,759	6,366	7,289	7,724	8,342
Health	2,102	1,970	2,438	2,550	3,107	3,240	3,613
Targeted programs (Extreme Poverty) 2/	3,043	2,986	2,840	2,988	2,994	3,450	3,811
Non-Targeted Social Programs	8,672	8,935	9,661	9,710	10,187	11,365	11,640
ESSALUD	2,836	2,775	2,961	3,023	3,156	3,626	3,885
Pensions	5,855	6,108	6,644	6,671	7,030	7,738	7,755
Housing Development Program (FONAVI)	-19	52	56	16	1	1	0
(In percent of general government expenditure)							
Total social expenditure and pensions	**48.7**	**50.7**	**53.5**	**52.6**	**53.0**	**52.2**	**48.7**
Universal coverage (Education and Health) 1/	18.4	19.0	21.2	21.7	23.4	22.2	21.2
Education	13.0	13.7	14.9	15.5	16.4	15.6	14.8
Health	5.4	5.2	6.3	6.2	7.0	6.6	6.4
Targeted programs (Extreme Poverty) 2/	7.9	7.9	7.3	7.3	6.7	7.0	6.8
Non-Targeted Social Programs	22.4	23.8	25.0	23.6	22.9	23.0	20.7
ESSALUD	7.3	7.4	7.6	7.4	7.1	7.3	6.9
Pensions	15.2	16.2	17.2	16.2	15.8	15.7	13.8
Housing Development Program (FONAVI)	0.0	0.1	0.1	0.0	0.0	0.0	0.0
(In percent of GDP)							
Total social expenditure and pensions	**10.2**	**10.1**	**10.3**	**10.1**	**9.9**	**9.9**	**9.7**
Universal coverage (Education and Health) 1/	3.8	3.8	4.1	4.2	4.4	4.2	4.2
Education	2.7	2.7	2.9	3.0	3.1	3.0	3.0
Health	1.1	1.0	1.2	1.2	1.3	1.2	1.3
Targeted programs (Extreme Poverty) 2/	1.6	1.6	1.4	1.4	1.3	1.3	1.3
Non-Targeted Social Programs	4.7	4.7	4.8	4.5	4.3	4.3	4.1
ESSALUD	1.5	1.5	1.5	1.4	1.3	1.4	1.4
Pensions	3.2	3.2	3.3	3.1	3.0	3.0	2.7
Housing Development Program (FONAVI)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
General government expenditure (in millions of New Soles)	38,718	37,707	38,721	41,098	44,475	49,401	56,270
Defense and national security (in percent of GDP)	2.6	2.5	2.3	2.2	2.1	2.1	1.8
Justice (in percent of GDP)	0.4	0.4	0.4	0.4	0.4	0.5	0.4

Source: Ministry of Economy and Finance.

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

2/ Includes expenditures for the targeted poverty-reduction program Juntos in 2006.

Table 8. Peru: Monetary Survey

	2002	2003	2004	Prel. 2005	2006 Prog.	2006 Proj.	Proj. 2007
I. Central Reserve Bank (In millions of New Soles at program exchange rate)							
Net international reserves 1/	**32,954**	**35,361**	**42,125**	**45,639**	**44,362**	**50,612**	**54,039**
(In millions of U.S. dollars)	9,309	9,905	12,342	13,808	13,362	15,308	16,508.3
Net domestic assets	**-27,339**	**-28,991**	**-34,090**	**-35,524**	**-32,997**	**-39,203**	**-41,488**
Net credit to nonfinancial public sector	-10,147	-10,709	-12,974	-13,888	-11,014	-12,903	-12,687.1
Rest of banking system	-14,338	-14,757	-19,146	-21,384	-21,701	-24,408	-26,991.2
Other	-2,854	-3,525	-1,970	-252	-282	-1,892	-1,810.1
Currency	**5,615**	**6,370**	**8,035**	**10,115**	**11,365**	**11,409**	**12,551**
II. Banking System (In millions of New Soles at program exchange rate)							
Net foreign assets	**33,300**	**35,010**	**42,973**	**47,610**	**47,510**	**54,136**	**58,716**
Net domestic assets	**18,407**	**17,699**	**15,808**	**20,054**	**23,822**	**22,617**	**25,257**
Net credit to nonfinancial public sector	-10,532	-10,664	-13,622	-14,381	-12,608	-15,317	-15,856.0
Net credit to private sector	46,621	44,994	46,632	52,110	53,592	57,931	62,958.1
Other	-17,682	-16,631	-17,202	-17,676	-17,162	-19,998	-21,844.8
Net credit to COFIDE	-1,340	-1,018	-903	-850	-948	-857	-857.0
Other	-16,342	-15,613	-16,299	-16,826	-16,214	-19,141	-20,987.8
Liabilities to the private sector	**51,707**	**52,709**	**58,781**	**67,664**	**71,333**	**76,753**	**83,973**
(12-month percentage change)							
Base money	11.0	10.1	25.3	25.7	12.0	12.0	10.0
Broad money	4.4	1.9	11.5	15.1	7.0	13.4	9.4
Domestic currency	11.5	10.0	28.1	26.3	11.9	18.7	13.3
Foreign currency 2/	1.1	-2.3	1.7	6.8	2.6	8.8	5.7
Net credit to private sector	-1.5	-3.5	3.6	11.7	5.6	11.2	8.7
Domestic currency	7.0	5.1	11.9	34.5	15.0	27.0	20.0
Foreign currency 2/	-3.6	-5.7	1.2	4.4	2.0	4.6	3.0
III. Financial System (In millions of New Soles at program exchange rate)							
Net foreign assets	**37,354**	**44,893**	**52,416**	**56,609**	**60,746**	**60,746**	**64,998**
Net domestic assets	**28,499**	**30,212**	**31,828**	**35,207**	**38,370**	**38,370**	**41,829**
Net credit to the public sector	-9,697	-8,976	-10,442	-9,397	-8,552	-8,552	-8,552
Net credit to private sector	60,422	62,666	65,913	70,005	73,874	73,874	77,808
Other	-22,226	-23,478	-23,644	-25,401	-26,952	-26,952	-27,427
Liabilities to the private sector	**65,854**	**75,105**	**84,243**	**91,816**	**99,116**	**99,116**	**106,827**
(12-month percentage change)							
Liabilities to the private sector	9.0	14.0	12.7	9.0	8.0	8.0	7.8
Domestic currency	17.5	24.9	23.5	13.5	12.0	12.0	12.0
Foreign currency 2/	2.3	4.2	0.9	3.0	2.0	2.0	1.0
Net credit to private sector	2.1	3.7	5.2	6.2	5.5	5.5	5.3
Domestic currency	18.9	18.0	17.9	11.0	13.0	13.0	12.0
Foreign currency 2/	-3.3	-1.9	-0.9	3.5	1.0	1.0	0.8
Memorandum item:							
Program exchange rate (S/. per US$)	3.54	3.57	3.41	3.31	3.32	...	...

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

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

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

Table 9. Peru: Balance of Payments
(In millions of U.S. dollars)

	2002	2003	2004	Prel. 2005	2006 Prog.	2006 Proj.	Proj. 2007
Current account	**-1,063**	**-935**	**-11**	**1,033**	**295**	**596**	**145**
Merchandise trade	292	836	2,793	5,163	3,396	7,189	6,437
Exports	7,714	9,091	12,617	17,247	17,329	21,842	23,427
Traditional	5,369	6,356	9,028	12,839	12,430	16,679	17,588
Nontraditional and others	2,345	2,734	3,589	4,408	4,899	5,163	5,839
Imports	-7,422	-8,255	-9,824	-12,084	-13,933	-14,653	-16,990
Services, income, and current transfers (net)	-1,355	-1,771	-2,803	-4,130	-3,100	-6,593	-6,292
Services	-941	-854	-843	-912	-1,001	-931	-1,091
Investment income	-1,457	-2,144	-3,421	-5,009	-3,941	-7,655	-7,369
Current transfers	1,043	1,227	1,460	1,791	1,842	1,994	2,168
Financial and capital account	**1,881**	**1,414**	**2,337**	**495**	**-317**	**723**	**1,028**
Public sector	1,096	684	988	-1,440	-298	-283	30
Disbursements 1/	2,902	2,161	2,535	2,656	1,003	1,088	1,273
Amortization 1/	-1,843	-1,229	-1,389	-3,718	-1,186	-1,230	-1,193
Other medium- and long-term Public sector flows 2/	37	-248	-158	-378	-115	-141	-50
Capital transfers (net)	0	0	0	0	0	0	0
Privatization	186	10	31	31	10	10	10
Private sector	599	720	1,318	1,905	-30	996	988
Foreign direct investment (FDI) Excluding privatization	1,970	1,265	1,785	2,489	772	2,851	2,633
Other private capital	-1,412	-1,233	-557	-878	-801	-1,855	-1,645
Medium- and long-term loans	-146	-166	-411	-741	-84	-160	348
Portfolio investment	-472	-1,214	-376	75	-678	-955	-615
Short-term flows 3/	-794	147	231	-213	-39	-739	-1,379
Net Errors and Omissions	41	688	90	295	0	0	0
Balance	**818**	**479**	**2,326**	**1,528**	**-22**	**1,319**	**1,172**
Financing	**-818**	**-479**	**-2,326**	**-1,528**	**22**	**-1,319**	**-1,172**
NIR flow (increase -)	-832	-477	-2,353	-1,628	0	-1,376	-1,200
Change in NIR (increase -)	-985	-596	-2,437	-1,466	0	-1,500	-1,200
Valuation change	-153	-119	-84	162	0	-125	0
Exceptional financing	14	-2	27	100	22	56	28
Debt relief 4/	14	70	27	100	22	56	28
Change in arrears	0	-72	0	0	0	0	0
Rescheduling	0	0	0	0	0	0	0
Memorandum items:							
Current account balance (in percent of GDP)	**-1.9**	**-1.5**	**0.0**	**1.3**	**0.4**	**0.7**	**0.2**
Capital and financial account balance (in percent of GDP)	3.3	2.3	3.4	0.6	-0.4	0.8	1.1
Export value (US$), percent change	9.8	17.8	38.8	36.7	5.8	26.6	7.3
Volume growth	5.7	10.0	12.8	15.4	5.1	1.0	7.9
Price growth	3.9	7.1	23.0	18.4	0.7	25.4	-0.6
Import value (US$), percent change	2.8	11.2	19.0	23.0	13.5	21.3	16.0
Volume growth	1.7	5.4	7.5	11.1	9.6	12.6	10.9
Price growth	1.1	5.5	10.7	10.7	3.5	7.7	4.6
GDP (in billions of US$)	57.0	61.5	69.7	79.4	81.7	88.7	95.0
Average exchange rate (S/. per US$)	3.52	3.48	3.41	3.30	...	...	...

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

1/ In 2002, includes the Brady Bond swap. For details of the swap, see IMF Country Report No. 03/72, Box 3.

2/ Includes portfolio flows of the pension reserve fund and subscription payments into international funds.

3/ Includes COFIDE and Banco de la Nación. Outflows in 2002 reflect a further reduction in the financial system's short-term debt.

4/ Debt relief under existing operations.

Table 10. Peru: External Financing Requirements and Sources

(In millions of U.S. dollars)

				Prel.	2006		Proj.
	2002	2003	2004	2005	Prog.	Proj.	2007
Gross financing requirements	**7,768**	**6,008**	**7,125**	**8,440**	**4,598**	**5,921**	**5,797**
External current account deficit (excluding official transfers)	**1,063**	**935**	**11**	**-1,033**	**-295**	**-596**	**-145**
Debt amortization	5,873	4,524	4,761	7,845	4,893	5,142	4,741
Medium- and long-term debt	2,664	1,954	2,247	5,094	2,006	2,096	1,695
Public sector	1,843	1,229	1,389	3,718	1,186	1,230	1,193
Multilateral 1/	399	486	571	628	650	646	703
Bilateral	496	686	742	2,159	401	407	373
Bonds and notes	940	44	67	90	90	90	113
Other	8	13	9	842	45	87	4
Private sector	821	725	858	1,376	820	866	502
Short-term debt 2/	3,209	2,570	2,514	2,751	2,887	3,046	3,046
Rescheduling and repayment of arrears	0	72	0	0	0	0	0
Accumulation of NIR (flow)	832	477	2,353	1,628	0	1,376	1,200
Change in gross reserves	852	513	2,440	1,470	-6	1,496	1,200
Payments of short-term liabilities incl. IMF	133	84	-3	-4	6	5	0
Other	-153	-119	-84	162	0	-125	0
Available financing	**7,768**	**6,008**	**7,125**	**8,440**	**4,598**	**5,921**	**5,797**
Foreign direct investment (net)	2,156	1,275	1,816	2,519	782	2,861	2,643
Privatization	186	10	31	31	10	10	10
FDI	1,970	1,265	1,785	2,489	772	2,851	2,633
Portfolio (net)	-472	-1,214	-376	75	-678	-955	-615
Short-term assets (flow)	-163	870	102	-209	-39	-443	-1,379
Of which: Errors and omissions	41	688	90	295	0	0	0
Debt financing from private creditors	5,179	4,346	4,474	5,359	3,623	3,455	3,896
Medium- and long-term financing	2,560	1,811	1,742	2,316	735	705	850
To public sector	1,886	1,252	1,295	1,682	0	0	0
To private sector	675	559	447	635	735	705	850
Short-term financing	2,619	2,535	2,732	3,042	2,887	2,749	3,046
				68	46	46	46
Official creditors 3/	1,016	909	1,240	974	1,003	1,088	1,273
Multilateral 1/	807	699	1,049	762	811	756	940
Of which: Balance of payments financing	625	527	863	581	499	450	600
Bilateral	209	210	191	212	193	332	333
To public sector	209	210	191	212	193	332	333
To private sector	0	0	0	0	0	0	0
Other medium- and long-term public sector flows	51	-178	-131	-278	-93	-85	-22

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

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

Table 11. Peru: Medium-Term Macroeconomic Framework

				Staff Projection					
	2003	2004	2005	2006	2007	2008	2009	2010	2011
	(Annual percentage change)								
GDP at constant prices	3.9	5.2	6.4	5.5	5.0	4.5	4.5	4.5	4.5
Consumer prices (end of period)	2.5	3.5	1.5	2.5	2.5	2.5	2.5	2.5	2.5
GDP deflator	2.6	5.6	3.4	6.3	1.0	1.0	1.2	1.5	2.0
Merchandise trade									
Exports, f.o.b.	17.8	38.8	36.7	26.6	7.3	0.2	3.3	3.4	5.6
Imports, f.o.b.	11.2	19.0	23.0	21.3	16.0	8.9	7.0	6.2	6.0
Terms of trade (deterioration -)	1.3	9.2	6.9	16.5	-4.9	-6.8	-4.0	-3.2	-0.2
	(In percent of GDP; unless otherwise indicated)								
External current account balance	-1.5	0.0	1.3	0.7	0.2	0.3	0.3	0.4	0.4
External current account, excluding interest obligations	2.0	4.9	7.6	9.3	7.9	5.8	4.9	4.2	4.0
Total external debt service	5.4	5.3	8.5	4.5	3.8	4.1	3.5	3.6	3.5
Medium- and long-term	5.3	5.1	8.3	4.2	3.6	3.9	3.3	3.3	3.2
Nonfinancial public sector	3.8	3.7	6.2	2.9	2.7	3.1	2.4	2.5	2.4
Private sector	1.5	1.5	2.0	1.3	0.9	0.8	0.8	0.8	0.8
Short-term 1/	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
External debt service 2/	5.4	5.3	8.5	4.5	3.8	4.1	3.5	3.6	3.5
Interest	2.2	2.1	2.1	2.1	2.0	1.9	1.9	1.8	1.7
Amortization (medium-and long-term)	3.2	3.2	6.4	2.4	1.8	2.2	1.6	1.8	1.8
Combined public sector primary balance	0.5	1.0	1.6	1.7	1.1	1.0	0.9	0.8	0.7
General government current revenue 3/	17.4	17.5	18.3	18.6	17.8	17.8	17.8	17.9	17.9
General govt. non-interest expenditure	17.1	16.7	17.0	17.2	16.8	16.9	17.0	17.0	17.1
Combined public sector interest due	2.2	2.0	1.9	2.0	2.0	2.0	1.9	1.8	1.7
Combined public sector overall balance	-1.7	-1.1	-0.3	-0.4	-1.0	-1.0	-1.0	-1.0	-1.0
Public sector debt	47.0	44.4	37.7	34.0	33.0	32.3	31.5	30.6	29.6
Gross domestic investment	18.8	18.9	18.6	19.7	20.4	20.8	21.1	21.4	21.6
Public sector	2.8	2.8	2.9	3.3	3.3	3.3	3.4	3.5	3.6
Private sector	15.0	15.2	16.0	16.7	17.1	17.5	17.7	17.9	18.0
Inventories changes	1.0	1.0	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0
National savings	17.2	18.9	19.9	20.4	20.6	21.1	21.4	21.8	22.0
Public sector 4/	1.2	1.7	2.6	3.0	2.4	2.4	2.5	2.6	2.7
Private sector	16.0	17.2	17.3	17.4	18.2	18.7	18.9	19.2	19.3
External savings	1.5	0.0	-1.3	-0.7	-0.2	-0.3	-0.3	-0.4	-0.4
Memorandum items:									
Nominal GDP (billions of New Soles)	213.9	237.8	261.6	293.4	311.1	328.4	347.2	368.3	392.6
Gross international reserves (billions of U.S. dollars)	10,206	12,649	14,115	15,615	16,815	17,015	17,235	17,455	17,455
Gross international reserves to broad money	67.4	73.4	68.7	67.3	65.9	63.7	61.8	59.9	57.2
External debt service (percent of exports of GNFS)	31.0	25.4	34.8	16.4	13.8	15.9	13.9	14.5	14.3
Short-term external debt service (percent of exports of GNFS)	0.8	0.7	0.8	0.9	0.8	0.9	0.9	1.0	1.0
Public external debt service (percent of exports of GNFS)	21.5	17.6	25.5	10.5	9.9	11.8	9.7	10.2	10.0

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

1/ Includes interest payments only.
2/ Includes the financial public sector
3/ Assumes that the financial transactions tax expires at end-2006.
4/ Excludes privatization receipts.

Table 12. Peru: Financial Soundness Indicators 1/
(In percent; unless otherwise indicated)

	Dec-01	Dec-02	Dec-03	Dec-04	Dec-05	Mar-06
Capital Adequacy						
Equity capital to risk-weighted assets	12.8	12.5	13.3	14.0	12.0	12.8
Regulatory Tier I capital to risk-weighted assets 2/	12.4	12.4	12.1	13.1	11.2	11.6
Nonperforming loans net of provisions to capital	-11.1	-17.2	-15.2	-17.3	-21.7	-20.6
Asset Quality						
Nonperforming loans to total gross loans 3/	9.0	7.6	5.8	3.7	2.14	2.10
In domestic currency	5.2	5.2	4.0	3.0	2.1	2.0
In foreign currency	9.9	8.2	6.3	3.9	2.2	2.1
Nonperforming loans to total gross loans 4/	17.0	14.6	12.2	9.5	6.3	6.0
In domestic currency	9.9	8.8	6.6	6.2	4.2	3.8
In foreign currency	19.0	16.4	14.1	10.8	7.1	7.0
Refinanced and restructured loans to total gross loans 5/	8.0	7.0	6.4	5.8	4.1	3.9
Provisions to nonperforming loans	118.9	133.2	141.1	176.5	235.3	240.8
Sectoral distribution of loans to total loans						
Consumer loans	8.6	9.4	11.6	13.4	14.4	14.8
Mortgage loans	9.6	10.7	12.9	14.2	14.8	14.8
Commercial loans	79.2	77.6	72.6	68.1	65.8	65.3
Small business loans	2.5	2.3	2.9	4.3	5.0	5.1
Earnings and Profitability						
ROA	0.4	0.8	1.1	1.2	2.2	2.3
ROE	4.5	8.4	10.8	11.3	22.2	23.7
Gross financial spread to financial revenues	51.9	66.1	71.2	71.9	70.5	57.2
Financial revenues to total revenues	78.8	72.7	70.6	69.1	76.3	75.4
Annualized financial revenues to revenue-generating assets	11.6	9.9	9.2	9.0	10.3	10.4
Liquidity						
Total liquid assets to total short-term liabilities	39.2	41.9	40.4	44.5	45.5	45.7
In domestic currency	22.6	23.5	32.9	44.8	38.6	28.1
In foreign currency	46.0	49.3	43.9	44.3	49.2	55.0
Foreign Currency Position and Dollarization						
Global position in foreign currency to regulatory capital 6/	37.6	37.0	31.8	24.2	23.1	31.3
Share of foreign currency deposits in total deposits	71.9	71.6	69.7	67.1	66.7	66.1
Share of foreign currency loans in total credit	80.5	79.7	77.9	75.7	69.6	68.7
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	9,357	9,658	9,210	9,596	10,913	11,376
Commercial banks' short-term foreign assets (in millions of U.S. dollars)	748	779	601	547	796	954
Commercial banks' short-term foreign liabilities (in millions of U.S. dollars)	1,161	763	702	733	1,085	789
Operational efficiency						
Financing to related parties to capital 7/	...	20.1	18.7	14.3	17.9	17.1
Nonfinancial expenditure to total revenues 8/	32.1	36.2	37.7	35.9	33.3	31.6
Nonfinancial expenditure to total revenue-generating assets 8/	4.7	4.9	4.9	4.7	4.6	4.4
Memorandum items:						
Number of Banks	16	16	16	16	14	14
Private commercial	15	14	14	14	12	12
Of which: Foreign-owned	10	9	9	9	9	9
State-owned	1	2	2	2	2	2
Banks' credit card loans to total loans	2.4	3.3	4.6	6.4	6.9	7.1
Bank loans' 12 month increase (in real terms)	-3.3	1.0	-8.3	-1.9	19.0	19.7
Stock market index (U.S. dollars)	342.1	396.0	700.6	1,131.6	1,400.1	1,763.6
Foreign currency debt rating (Moody's)	Ba3	Ba3	Ba3	Ba3	Ba3	Ba3
Spread of Peruvian Brady bonds, basis points	521	610	312	220	257	226

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

1/ These indicators correspond to private commercial banks.

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

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

4/ Includes restructured loans, refinanced loans, and arrears.

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

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

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

8/ Nonfinancial expenditures do not consider provisions nor depreciations.

Table 13. Peru: Financial and External Vulnerability Indicators

(In percent; unless otherwise indicated)

	2002	2003	2004	Prel. 2005	2006 Prog.	2006 Proj.	Proj. 2007
Financial indicators							
Public sector debt/GDP	46.6	47.0	44.4	37.7	37.2	34.0	33.0
Of which: in domestic currency (percent of GDP)	6.9	7.1	6.9	8.2	7.8	7.5	7.6
90-day prime lending rate, domestic currency (end of period)	5.1	3.3	3.8	4.4	...	...	...
90-day prime lending rate, foreign currency (end of period)	2.4	1.7	2.6	5.5	...	...	...
Velocity of money 1/	3.9	4.1	4.0	3.9	3.8	3.8	3.7
Net credit to the private sector/GDP 2/	30.1	29.3	27.7	26.8	25.5	25.2	25.0
External indicators							
Exports, U.S. dollars (percent change)	9.8	17.8	38.8	36.7	5.8	26.6	7.3
Imports, U.S. dollars (percent change)	2.8	11.2	19.0	23.0	13.5	21.3	16.0
Terms of trade (percent change) (deterioration -)	3.1	1.3	9.2	6.9	-2.8	16.5	-4.9
Real effective exchange rate, (end of period, percent change) 3/	-1.2	-6.8	1.9	-3.9	...	...	...
Current account balance (percent of GDP)	-1.9	-1.5	0.0	1.3	0.4	0.7	0.2
Capital and financial account balance (percent of GDP)	3.3	2.3	3.4	0.6	-0.4	0.8	1.1
Total external debt (percent of GDP)	48.9	48.1	44.7	35.8	35.5	31.3	29.7
Medium- and long-term public debt (in percent of GDP) 4/	36.4	37.0	35.1	28.1	27.9	24.9	23.4
Medium- and long-term private debt (in percent of GDP)	7.9	7.0	5.6	3.9	4.1	2.9	3.1
Short-term public and private debt (in percent of GDP)	4.5	4.1	4.0	3.9	3.5	3.5	3.2
Total external debt (in percent of exports of goods and services) 4/	301.5	274.3	214.1	146.5	147.3	114.2	108.0
Total debt service (in percent of exports of goods and services) 5/	45.1	31.0	25.4	34.8	19.7	16.4	13.8
Gross official reserves, in							
millions of U.S. dollars	9,690	10,206	12,649	14,115	13,669	15,615	16,815
percent of short-term external debt 6/	214.2	214.4	161.2	288.5	280.2	329.3	320.9
percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	68.3	71.6	71.4	88.0	86.4	94.3	94.5
percent of broad money 8/	65.9	67.2	70.6	71.5	63.6	66.7	65.9
percent of foreign currency deposits at banks	100.6	107.3	128.3	129.4	124.9	132.1	134.0
months of next year's imports of goods and services	10.8	9.7	10.0	9.8	7.9	9.0	9.0
Net international reserves (in millions of U.S. dollars)	9,598	10,194	12,631	14,097	13,651	15,597	16,797
Net international reserves (program definition; in millions of U.S. dollars) 9/	5,830	6,906	9,304	9,748	9,577	10,375	11,318
Net foreign exchange position (in millions of U.S. dollars) 10/	3,341	4,583	6,936	7,380	7,209	8,007	8,950

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

1/ Defined as the inverse of the ratio of end-period broad money to annual GDP.
2/ Corresponds to the financial system.
3/ End of period. 2005 data up to August. Based on Information Notice System.
4/ Includes Central Reserve Bank of Peru debt.
5/ Includes debt service to the Fund. For 2002, excludes US$923 million of Brady bonds that were amortized in a debt exchange operation.
6/ Short-term debt includes amortization of medium- and long-term loans falling due over the following year.
7/ Current Account deficit adjusted for 0.75*net FDI inflows; if adjusted CA balance>0, set to 0.
8/ At end-period exchange rate.
9/ Includes financial system's foreign currency deposits in central bank as reserve liability.
10/ Includes public sector foreign currency deposits in central bank (e.g. pension reserve funds) as reserve liability.

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

Amount of Purchase	Availability Date	Conditions Include
1. SDR 80.00 million 2/	June 9, 2004	Board approval of SBA.
2. SDR 23.031 million	August 31, 2004	Observance of end-June 2004 performance criteria.
3. SDR 23.031 million	October 31, 2004	Completion of the First Review and observance of end-September 2004 performance criteria.
4. SDR 23.031 million	February 28, 2005	Completion of the second review and observance of end-December 2004 performance criteria.
5. SDR 27.6372 million	August 31, 2005	Observance of end-June 2005 performance criteria.
6. SDR 27.6372 million	November 15, 2005	Completion of the third review and observance of end-September 2005 performance criteria.
7. SDR 27.6372 million	February 28, 2006	Completion of the fourth review and observance of end-December 2005 performance criteria.
8. SDR 27.6372 million	May 15, 2006	Observance of end-March 2006 performance criteria.
9. SDR 27.6372 million	July 26, 2006	Completion of the fifth review and observance of end-June 2006 performance criteria.

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

Table 15. Peru: Capacity to Repay the Fund as of June 15th, 2006 1/

(In millions of SDRs; unless otherwise indicated)

	2006	2007	2008	2009	2010	2011	Total
Obligations from existing drawings							
Principal (repurchases)	13.4	13.4	0.0	0.0	0.0	0.0	26.8
Charges and interest 2/							
GRA charges	0.5	0.2	0.0	0.0	0.0	0.0	0.7
SDR charges	1.7	3.3	3.3	3.3	3.3	3.3	18.3
Credit outstanding	13.4	0.0	0.0	0.0	0.0	0.0	...
(percent of quota)	2.1	0.0	0.0	0.0	0.0	0.0	...
Obligations from prospective drawings							
Principal (repurchases)	0.0	0.0	0.0	35.9	143.7	107.7	287.3
Charges and interest 3/							
GRA charges	3.6	14.3	14.3	14.3	9.8	2.7	58.9
Service charges	1.4	0.0	0.0	0.0	0.0	0.0	1.4
Credit outstanding	287.3	287.3	287.3	251.4	107.7	0.0	...
(percent of quota)	45.0	45.0	45.0	39.4	16.9	0.0	...
Cumulative (existing and prospective)							
Principal (repurchases)	13.4	13.4	0.0	35.9	143.7	107.7	314.1
Charges and interest 3/							
GRA charges	4.2	14.5	14.3	14.3	9.8	2.7	59.7
SDR and Service charges	3.1	3.3	3.3	3.3	3.3	3.3	19.8
Credit outstanding	300.6	287.3	287.3	251.4	107.7	0.0	...
percent of quota	47.1	45.0	45.0	39.4	16.9	0.0	...
percent of GDP	0.5	0.4	0.4	0.3	0.1	0.0	...
percent of exports of goods and services	1.8	1.6	1.6	1.4	0.6	0.0	...
percent of public sector debt service	12.6	11.5	10.1	9.9	3.9	0.0	...
percent of external public debt	2.0	1.9	1.9	1.7	0.7	0.0	...
percent of external public debt service	17.0	16.2	13.7	14.3	5.5	0.0	...
percent of gross foreign reserves	2.8	2.5	2.4	2.1	0.9	0.0	...
Memorandum items:							
Purchases	287.3	0.0	0.0	0.0	0.0	0.0	287.3

Sources: Fund staff estimates/projections.

1/ Assuming all purchases are made. Repurchases assumed to be made under obligations schedule.
2/ For 2006, they show charges and interest for May - December.
3/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA. The current SDR interest rate is assumed for net use of SDRs.

Table 16. Peru: Millennium Development Goals

	1995	2001	2002	2003	2004	2015 Target
Goal 1: Eradicate extreme poverty and hunger						
Population below $1 a day (in percent of population)	...	18.1	...	...	...	9.1
Poverty gap at $1 a day (in percent of total population,)	...	9.1	...	...	...	4.6
Percent of income or consumption held by poorest 20 percent	...	2.9	...	...	...	1.5
Prevalence of child malnutrition (in percent of children under 5)	7.8	7.1	...	...	...	5.4
Pop. below min. of dietary energy consumption (in percent of total)	18.0	11.0	13.0	12.0	...	20.0
Goal 2: Achieve universal primary education						
Net primary enrollment ratio (in percent of relevant age group)	90.8	99.9	...	99.7	...	100.0
Percentage of cohort reaching grade 5 (in percent)	...	87.4	...	...	...	100.0
Youth literacy rate (in percent of ages 15-24)	95.7	96.9	96.8	...	97.0	100.0
Goal 3: Promote gender equality and empower women						
Ratio of girls to boys in primary and secondary education (in percent)	96.0	97.0	97.1	...	...	100.0
Ratio of young literate females to males (in percent of ages 15-24)	96.0	97.1	97.8	97.8	97.8	100.0
Share of women employed in the nonagricultural sector (in percent)	30.5	34.6	35.0	37.2	...	...
Proportion of seats held by women in national parliament (in percent)	10.0	...	...	18.0	18.0	...
Goal 4: Reduce child mortality						
Under 5 mortality rate (per 1,000)	60.0	42.0	39.0	34.0	29.0	53.3
Infant mortality rate (per 1,000 live births)	46.0	40.0	30.0	26.0	24.0	...
Immunization, measles (in percent of children under 12 months)	98.0	97.0	95.0	95.0	89.0	...
Goal 5: Improve maternal health						
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	410.0	...	...	...	307.5
Births attended by skilled health staff (in percent of total)	56.4	59.3	...	...	...	...
Goal 6: Combat HIV/AIDS, malaria and other diseases						
Prevalence of HIV, female (in percent of ages 15-24)	...	0.2	0.2	0.5	...	0.1
Contraceptive prevalence rate (in percent of women ages 15-49)	64.0	68.9	...	...	...	...
Number of children orphaned by HIV/AIDS	...	17000	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	196.7	196.0	202.4	187.6	...	...
Tuberculosis cases detected under DOTS	99.0	94.0	84.5	80.6	83.1	...
Goal 7: Ensure environmental sustainability						
Forest area (in percent of total land area)	...	50.9	...	...	...	...
Nationally protected areas (in percent of total land area)	2.7	2.7	6.1	6.1	...	...
GDP per unit of energy use (PPP $ per kg oil equivalent)	8.9	10.4	10.7	11.0	...	...
CO2 emissions (metric tons per capita)	1.0	1.1	...	1.0	...	...
Access to an improved water source (in percent of total population)	...	80.0	81.0	...	...	87.0
Access to improved sanitation (in percent of total population)	...	71.0	62.0	...	...	...
Access to secure tenure (in percent of total population)	...	...	...	...	...	...
Goal 8: Develop a Global Partnership for Development						
Youth unemployment rate (in percent of labor force ages 15-24)	11.4	13.2	15.2	19.2	...	...
Fixed line and mobile telephones (per 1,000 people)	50.3	136.7	152.3	175.6	222.9	...
Personal computers (per 1,000 people)	14.9	47.9	43.0	64.7	97.6	...

Sources: United Nations, Report 2006.

APPENDIX I. PERU—DEBT SUSTAINABILITY ANALYSIS[1]

Under the baseline debt sustainability scenario, Peru's debt-to-GDP ratio is projected to decline to moderate levels over the medium term. Economic growth would average 4.5 percent a year, and the overall deficit of the combined public sector would be kept at the equivalent of 1 percent of GDP, in line with the ceiling of the Fiscal Responsibility and Transparency Law. Medium-term fiscal projections assume that public sector revenue would remain broadly unchanged as a percent of GDP following the drop in collections in 2007 driven by the phasing out of the financial transaction tax and the reduction in custom duties resulting from trade agreements. Under these assumptions, Peru's public sector debt stock would decline from 38 percent of GDP at end-2005 to about 30 percent of GDP by 2011.

Given that 80 percent of total external debt is public, in the baseline scenario the projected drop in public debt largely determines the path of Peru's total external debt. Following a decline during 2005-06, as companies took advantage of favorable market conditions to pay down their external debt, private sector external debt is projected to remain broadly stable over the medium term. As a result, total external debt is projected to decline from 36 percent of GDP at end-2005 to 25 percent by 2011 (public external debt would decline from 28 percent to 19 percent over the same period).

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

In contrast, external and public debt ratios are sensitive to changes in exchange rate changes, given the high foreign currency share of Peru's debt. Specifically, under a one-off 30 percent depreciation of the exchange rate, the external debt-to-GDP ratio would shift by 16 percentage points above the baseline projections in the medium term. It should be noted that this test assumes that the exchange rate would remain at its depreciated level over the medium term—a scenario that could only occur in case of the current exchange rate being significantly overvalued. Available data, however, do not point to such an overvaluation.

A similar pattern is observed under a 10 percent of GDP shock to the contingent liabilities of the public sector. The public debt-to-GDP ratio would rise sharply in the short run and, while declining over the medium term, would remain 10 percentage points above the debt levels projected under the baseline scenario.

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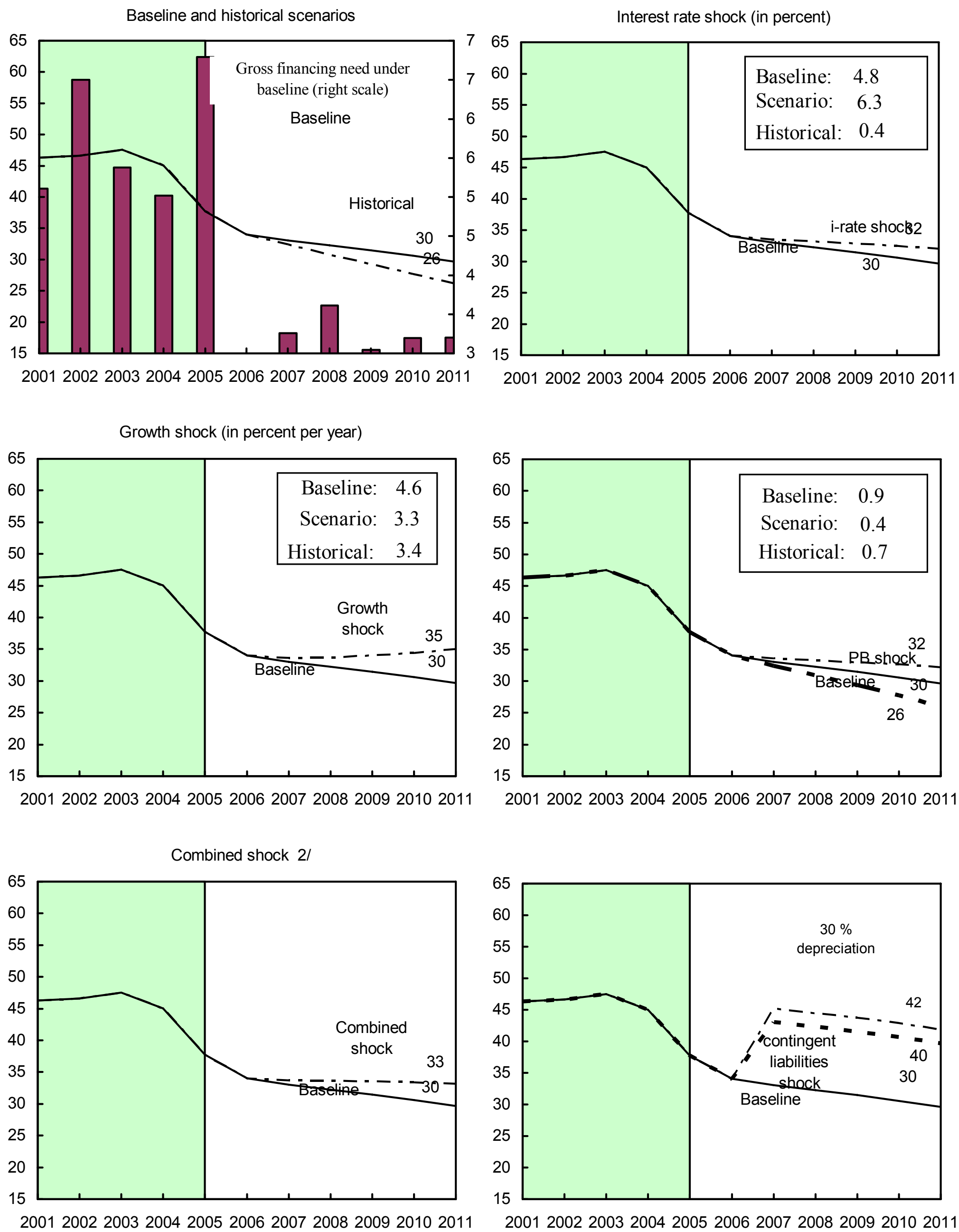
[1] The DSA includes standard sensitivity tests around the baseline medium-term scenario. The methodology used is in line with that endorsed in http://www.imf.org/external/np/pp/eng/2005/070105.htm .

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



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data.Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2006, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 1. Peru: External Debt Sustainability Framework, 2001–2011
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Debt-stabilizing non-interest current account 6/
Baseline: External debt	**50.4**	**48.9**	**48.1**	**44.7**	**35.8**	**31.3**	**29.7**	**28.0**	**26.4**	**25.4**	**24.8**	**1.5**
Change in external debt	-1.7	-1.6	-0.7	-3.5	-8.8	-4.5	-1.6	-1.7	-1.7	-1.0	-0.6	
Identified external debt-creating flows (4+8+9)	0.3	-3.5	-2.0	-7.5	-8.9	-3.9	-2.2	-1.5	-1.6	-0.9	-0.2	
Current account deficit, excluding interest payments	-0.8	-0.5	-0.7	-2.1	-3.4	-2.8	-2.2	-2.2	-2.2	-2.2	-2.1	
Deficit in balance of goods and services	1.9	1.1	0.0	-4.0	-5.4	-7.1	-5.5	-3.6	-2.7	-2.0	-1.8	
Exports	15.9	16.2	17.5	20.9	24.5	27.4	27.3	25.9	25.2	24.6	24.3	
Imports	17.7	17.3	17.6	16.8	19.1	20.4	21.8	22.3	22.5	22.6	22.5	
Net non-debt creating capital inflows (negative)	-1.5	-2.7	0.0	-1.9	-2.2	-1.5	-0.6	0.0	-0.1	0.6	1.3	
Automatic debt dynamics 1/	2.6	-0.4	-1.3	-3.6	-3.4	0.4	0.6	0.7	0.7	0.7	0.6	
Contribution from nominal interest rate	3.0	2.4	2.2	2.1	2.1	2.1	2.0	1.9	1.9	1.8	1.7	
Contribution from real GDP growth	-0.2	-2.5	-1.8	-2.2	-2.5	-1.8	-1.5	-1.3	-1.2	-1.1	-1.1	
Contribution from price and exchange rate changes 2/	-0.1	-0.3	-1.8	-3.4	-2.9	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-2.0	2.0	1.3	4.0	0.1	-0.6	0.6	-0.2	-0.1	-0.1	-0.4	
External debt-to-exports ratio (in percent)	317.9	301.5	274.3	214.1	146.5	114.2	108.8	108.3	104.4	103.1	101.8	
Gross external financing need (in billions of US dollars) 4/	6.7	7.1	5.5	4.8	6.8	4.6	4.6	5.0	4.5	4.6	4.7	
in percent of GDP	12.4	12.5	9.0	6.9	8.6	5.1	4.9	4.9	4.2	4.1	3.9	
Scenario with key variables at their historical averages 5/						**31.3**	**30.2**	**28.0**	**25.8**	**23.6**	**21.2**	**-2.5**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	0.4	5.2	3.9	5.2	6.4	5.5	5.0	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	0.2	0.6	3.8	7.7	7.1	5.9	2.0	1.1	1.0	1.3	1.7	
Nominal external interest rate (in percent)	5.7	5.0	4.9	4.9	5.4	6.6	6.9	6.9	7.1	7.3	7.2	
Growth of exports (US dollar terms, in percent)	0.8	8.1	16.7	34.7	33.7	25.4	6.5	0.2	3.0	3.1	5.1	
Growth of imports (US dollar terms, in percent)	-0.4	3.4	9.2	8.5	29.5	19.3	14.3	8.2	6.6	6.0	5.9	
Current account balance, excluding interest payments	0.8	0.5	0.7	2.1	3.4	2.8	2.2	2.2	2.2	2.2	2.1	
Net non-debt creating capital inflows	1.5	2.7	0.0	1.9	2.2	1.5	0.6	0.0	0.1	-0.6	-1.3	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

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

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

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

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

Table 2. Country: Public Sector Debt Sustainability Framework, 2000–2010
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	**46.3**	**46.6**	**47.5**	**45.0**	**37.7**	**34.0**	**33.0**	**32.2**	**31.4**	**30.6**	**29.6**	**-0.2**
o/w foreign-currency denominated	39.2	39.7	40.3	38.1	29.6	26.5	25.4	24.8	24.2	23.5	22.8	
Change in public sector debt	0.1	0.3	0.9	-2.5	-7.3	-3.7	-1.0	-0.8	-0.8	-0.9	-0.9	
Identified debt-creating flows (4+7+12)	-0.2	-1.1	-0.5	-4.4	-5.7	-3.7	-1.0	-0.8	-0.8	-0.9	-0.9	
Primary deficit	0.0	0.0	-0.4	-1.0	-1.6	-1.7	-1.1	-1.0	-0.9	-0.8	-0.7	
Revenue and grants	18.1	17.5	18.2	18.2	18.9	19.1	18.2	18.2	18.2	18.2	18.2	
Primary (noninterest) expenditure	18.1	17.5	17.8	17.2	17.3	17.5	17.2	17.2	17.3	17.4	17.5	
Automatic debt dynamics 2/	0.3	-0.4	-0.1	-3.2	-4.0	-2.0	0.1	0.2	0.1	0.0	-0.2	
Contribution from interest rate/growth differential 3/	1.3	-0.5	-0.3	-2.5	-2.8	-2.0	0.1	0.2	0.1	0.0	-0.2	
Of which contribution from real interest rate	1.5	1.8	1.4	-0.3	-0.2	-0.2	1.7	1.6	1.5	1.3	1.1	
Of which contribution from real GDP growth	-0.2	-2.3	-1.7	-2.2	-2.6	-1.9	-1.6	-1.4	-1.4	-1.3	-1.3	
Contribution from exchange rate depreciation 4/	-1.0	0.1	0.3	-0.7	-1.2	...	...	...	...	...	...	
Other identified debt-creating flows	-0.6	-0.7	-0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.6	-0.7	-0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	0.3	1.4	1.4	1.9	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	255.9	266.2	261.7	247.0	199.9	177.8	181.2	177.1	172.8	168.0	162.9	
Gross financing need 6/	5.1	6.5	5.4	5.0	6.8	3.0	3.3	3.6	3.0	3.2	3.2	
in billions of U.S. dollars	2.8	3.7	3.3	3.4	5.4	2.7	3.1	3.6	3.2	3.6	3.8	
Scenario with key variables at their historical averages 7/						**34.0**	**32.4**	**30.8**	**29.2**	**27.7**	**26.2**	**-0.7**
Scenario with no policy change (constant primary balance) in 2005-2010						**34.0**	**32.4**	**31.0**	**29.4**	**27.8**	**26.0**	**-0.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	0.4	5.2	3.9	5.2	6.4	5.5	5.0	4.5	4.5	4.5	4.5	
Average nominal interest rate on public debt (in percent) 8/	4.9	4.9	4.7	4.8	4.8	6.2	6.3	6.2	6.2	6.0	5.8	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.2	4.1	3.2	-0.4	-0.1	-0.1	5.3	5.2	5.0	4.5	3.8	
Nominal appreciation (increase in US dollar value of local currency, in percent)	2.4	-0.3	-0.6	1.9	3.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	1.7	0.8	1.4	5.3	4.9	6.3	1.0	1.0	1.2	1.5	2.0	
Primary deficit	0.0	0.0	-0.4	-1.0	-1.6	-1.7	-1.1	-1.0	-0.9	-0.8	-0.7	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Appendix II. Peru: Fund Relations
(As of May 31, 2006)

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

II. General Resources Account	**SDR Million**	**Percent Quota**
Quota	638.40	100.00
Fund holdings of currency	665.18	104.20

III. SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	91.32	100.00
Holdings	0.62	0.68

IV. Outstanding Purchases and Loans	**SDR Million**	**Percent Quota**
Extended arrangements	26.75	4.19

V. Financial Arrangements

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

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

	Overdue 12/31/03	**2006**	**2007**	**2008**	**2009**	**2010**
Principal	0	13.38	13.38	0.00	0.00	0.00
Charges/interest	0	2.17	3.46	3.28	3.27	3.27
Total	0	15.54	16.84	3.28	3.27	3.27

VII. Safeguards Assessments

The safeguards assessment of the central bank was completed on October 26, 2004. The assessment found that, with few exceptions, safeguards at the *Banco Central de Reserva del Perú* (BCRP) meet the requirements of the safeguards policy. Following the recommendations of the safeguards assessment, the involvement of the office of the comptroller general has been better specified to clearly limit it to the administrative aspects of the bank's operations.

VIII. Exchange Arrangements

Peru maintains a unified, managed floating exchange rate. On May 31, 2006, the average of interbank buying and selling rates was 3.29 *Nuevo Sol* per U.S. dollar. The exchange system is free of restrictions, except for those maintained solely for the preservation of national or international security, and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). Those restrictions are maintain pursuant to UN Security Council Resolutions 1267 (October 15, 1999) and 1373 (September 28, 2001). The central government maintains external payments arrears to unguaranteed suppliers, some of whom are in discussions with the government, while the rest have not been located. Peru has maintained a clearing arrangement with Malaysia since 1991.

IX. Last Article IV Consultation

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

X. FSAP and ROSCs

Several joint Fund-Bank missions visited Lima in the period September 2000–January 2001 to conduct an FSAP for Peru. The corresponding FSSA report (dated February 28, 2001, see www.imf.org) was discussed by the Executive Board on March 12, 2001. A follow-up FSAP mission was concluded in February 2005. In October 2002, an FAD mission conducted a Fiscal ROSC for Peru, while an STA mission conducted a Data ROSC for Peru in February 2003.

XI. Technical Assistance

Department	Date	Purpose
FAD	June 2005, March 2006	Public Financial Management
	May 2005, February 2006	Tax policy and administration
	September 2003	
	September 2002	
	August 2004	Public investment and fiscal policy, including issues related to PPPs.
	November 1999	Fiscal rules
MFD	April 2006	Financial sector supervision
	April 2005	Consumer protection in the banking system
	March, 2005	Central bank organization
	March, September 2004	
	February 2003	
	April, December 2002	Inflation targeting
	October 2002	Foreign exchange operations
	August 2002	Accounting and organizational issues
	May 2002	Inflation targeting
	March 2002	Monetary operations and government securities market
STA	January 1998 and October 1999	National account statistics, new base year for the national account series

XII. Resident Representative

Ms. Nicoletta Batini has been Resident Representative in Peru since January 2006.

APPENDIX III. PERU—WORLD BANK RELATIONS

Bank Group strategy

The World Bank Group Country Assistance Strategy (CAS), discussed by the IBRD Board on September 17, 2002, will come to an end when the new administration takes over in July 2006. The present CAS provided the Bank's framework to support the implementation of the current government's poverty reduction strategy with programs addressing fiscal, national competitiveness, and social-sector needs. In November 2003, the Bank decided to move Peru to a CAS high-case lending scenario with a total envelope of around US$300–400 million a year over FY04–06. One year later, in November 2004, a CAS Progress Report to cover FY05–06 was approved by the Board. New lending included quick-disbursing programmatic loans and investment projects for an additional US$300 million a year.

In FY 2005, following the additional priorities outlined in the CAS progress report, the Bank approved eight operations (including 2 adjustment loans for US$100 million) for US$255 million, and an additional US$200 million Infrastructure Guarantee Facility. In FY05, between adjustment and investment lending, $234 million were disbursed. To date, in FY06 four operations have been approved, the Regional Transport Decentralization project for $50 million; the Decentralization and Competitiveness Development Policy Loan for $150 million; the Real Property Rights Consolidation Project for 25 million; and the Rural Electrification Project for $50 million. Peru's current portfolio amounts to 14 operations for US$468 million. By end FY06 the disbursement level should hover around US$200 million.

It is expected that the new CAS, covering the 2007–2010 period, will go to the Board during the second quarter of FY07. Herein, the Bank expects to prepare a new series of programmatic operations (approx. US$150 million per year) and will explore development policy lending possibilities in the fiscal and social sectors, including the first Development Policy Loan for the environment sector. For the transition period the Bank has committed itself to prepare a new series of programmatic operations and to have them ready for the new government.

Bank-Fund collaboration in specific areas

- *Policy Notes.* The World Bank has been preparing a series of 30 Policy Notes covering the Bank's work in different sectors over the last year. It is expected that this set of policies will be delivered to the new government before it takes office and to have the current administration take the lead in presenting them at a retreat organized expressly for this purpose. It will contain 30 plus notes based on the feedback from the Bank's country team meeting with the presidential candidates. A first draft will be shared with the current administration by the end of June 2006.

- *Tax Reform and Fiscal Decentralization*. Fund staff has taken the lead in assisting in the design of tax reform. Jointly with the World Bank and IDB, staff has worked on drafting laws and regulations for fiscal decentralization. The World Bank has also focused on the design and implementation of decentralization of the social sectors and pro-poor spending policies.

- *Financial Sector.* A joint FSAP was completed in May 2001. Follow up technical assistance to implement FSAP recommendations has been given by both institutions. A joint FSAP update was completed in June 2005.

- *Public expenditure review (PER).* In a joint effort with the IDB, and close collaboration with the IMF, the Bank completed in June 2002 a comprehensive diagnosis of, and made policy recommendations for, Peru's public expenditure management. A social sector expenditure review, with support of the Fund, is being prepared to assess fiscal trends in the social sector under decentralization, review the quality of social spending, and fine-tune the on-going budgetary protection policy of priority social programs. There is also close collaboration in the area of financial management information systems.

- *Fiscal reforms.* In March 2002, the Bank and the Fund supported an international seminar (organized by the Ministry of Economy and Finance) on proposals for revising the law on fiscal prudence and transparency. A joint IMF-World Bank-IaDB mission took place in September 2004 for a pilot study on Public Investment and Fiscal Policy.

- *CAS follow-up and preparation of the Programmatic Loans* (Social Reform Loans I, II, III, and IV, and Decentralization and Competitiveness Loan I, II, and III). The World Bank and the Fund have engaged in an interactive and continuous dialogue on CAS implementation and preparation of the subsequent programmatic loans. Dialogue has concentrated on the macroeconomic background, setting of triggers, overall loan conditionality, and risks and estimation of the fiscal implications of Bank operations.

Statement of World Bank Loans
(As of May 2006)

Loan Number	Year approved	Borrower	Purpose	In millions of U.S. dollars: Total (Net of Cancellation)	Undisbursed
Ninety-two loans fully disbursed[1]				4,976.6	
Partially disbursed or undisbursed loans:					
8037	1997	Republic of Peru	Irrigation Subsector	95.3	7.9
46140	2001	Republic of Peru	Second Rural Roads Rehabilitation and Maintenance	50.0	9.2
71760	2003	Republic of Peru	Rural Education Project	52.5	39.9
71770	2003	Republic of Peru	Trade Facility and Productivity Improvement TA	20.0	16.2
72090	2003	Republic of Peru	Lima Transport Project	45.0	43.2
71600	2003	Republic of Peru	Lima Water Rehabilitation Additional Financing	20.0	17.9
71420	2003	Republic of Peru	National Water Rural Supply	50.0	42.6
72190	2004	Republic of Peru	Justice Services Improvement	12.0	11.6
72570	2004	Republic of Peru	Vilcanota Valley Rehabilitation Program	5.0	4.8
72550	2004	Republic of Peru	Institutional Capacity for Decentralization and Management	8.8	8.1
72540	2005	Republic of Peru	Accountability for Decentralization Soc.Sector	7.8	5.7
72850	2005	Republic of Peru	Agricultural Research and Extension	25.0	23.5
78894	2006	Republic of Peru	Real Property Rights	25.0	25.0
90116	2006	Republic of Peru	Rural Electrification	50.0	50.0
78813	2005	Republic of Peru	Regional Transport Decentralization	50.0	49.9
Total disbursed:				5,135.4	
Of which : amount repaid				2,649.6	
Total outstanding 1				2,485.8	
Total indisbursed					355.5

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

Statement of IFC Investments
(As of December 2005)
In millions of U.S. dollars

	Loans	Equity	Quasi	Participation Loans	Total
Total commitments held by IFC	187.7	21.0	34.4	15.7	258.8
Total disbursed	118.8	20.4	33.4	15.7	188.3

Source: World Bank.

APPENDIX IV. PERU: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Country Strategy 2002–2006

The key objectives for the 2002–2006 strategy for Peru are poverty reduction and equity promotion, within the context of high economic growth. Toward this end, the Bank will support the government's efforts to: (i) raise the economy's productivity and competitiveness, by removing institutional obstacles to increased productivity and investment and making structural investments in human capital; (ii) improve the efficiency of social policy while implementing measures to mitigate poverty and protect vulnerable groups; and (iii) create a modern, decentralized, and efficient state. The Bank and the authorities have started the dialogue for the preparation of the new strategy for 2007–2011. The Bank is collaborating closely with the Fund in the area of financial management information systems.

Lending

As of May 30th, 2006, the country's portfolio consists of 27 loans for a total amount of US$1,434.0 million. These resources are distributed among 25 investment loans (US$834.0 million) and two policy-based loans (US$600.0 million). The lending program for 2006 relies on the approval of six investment loans for US$478.3 million.

In addition, the country portfolio with Peru includes 34 non-reimbursable technical cooperation grants (US$7.2 million) and seven small projects (US$4.5 million). The Multilateral Investment Fund (MIF) has 28 non-reimbursable technical cooperation grants under execution (US$15.7 million).

IDB Loans Portfolio By Sector as of May 30th, 2006
(In millions of US$)

	Commitments	Disbursements	Percent Disbursed
Agriculture	53.3	20.7	38.8%
Education	87.0	68.1	78.3%
Environment	5.0	3.1	62.5%
Health	28.0	25.1	89.6%
Public sector management	365.9	206.4	56.4%
Sanitation	50.8	0.0	0.0%
Science and technology	404.1	197.5	48.9%
Social investment	355.0	173.8	49.0%
Transportation	60.0	10.0	16.7%
Urban development	25.0	0.0	0.0%
Total	**1434.0**	**704.7**	**49.1%**

APPENDIX V. PERU: STATISTICAL ISSUES

Peru's macroeconomic statistics are largely adequate for effective surveillance, but there are important shortcomings, particularly in national accounts and price statistics. Peru is in observance of the Special Data Dissemination Standard (SDDS). An advance release calendar and the metadata for Peru are posted on the Fund's Dissemination Standards Bulletin Board. A data ROSC was published in 2003.

Despite progress in recent years, there is scope for improvement in the following areas: (i) coordination among the agencies that compile official statistics as to avoid duplication of efforts and confusion among users; (ii) updating the business register that provides the basis for sample surveys; (iii) implementing a new benchmark and base year for GDP; (iv) expanding the coverage of the wholesale price index to include mining, oil and gas extraction, electricity and water, public transportation, and communication; (v) preparing sectoral breakdowns of depository corporations and financial surveys in accordance with the *MFSM* methodology; and (vi) expanding data sources for compiling financial flows of individual residents.

I. Real Sector and Prices

In June 2000, the authorities published a revised GDP series using the 1994 benchmark estimates including detailed input-output tables. However, due to limited availability of 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 in the data. 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, their coverage is still very limited. The National Statistics Office (INEI) is working on a new national account series using 2001 as the base year.

The weight structure for the CPI is derived from a 1993–94 household expenditure survey. These weights were changed in January 2002 as a result of a revision of the INEI methodology to ensure that the CPI would reflect consumption changes over the last seven years. In addition, the index base was changed from 1994 to December 2001. The coverage of owner-occupied housing, however, was eliminated from the Metropolitan Lima index through the exclusion of imputed rent. Imputed rent is included in the indices of the other 24 cities in the CPI, making the national index a weighted average of indices that have different coverage. Regarding the wholesale price index (WPI), the statistical techniques follow generally accepted international standards, but the weights for the WPI are outdated. INEI derived the weights from the 1994 input-output table and other reports and publications of relevant ministries.

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

II. Fiscal Sector

The government finance statistics (GFS) for the general government are compiled using the analytical framework of the *GFS Manual 1986*. For the consolidated central government, revenues are compiled on a cash basis, while expenditures are compiled on an accrual basis. The coverage of the GFS used in the preparation of the national budget is narrower than the those prepared for program purposes. The authorities have recently prepared a plan to migrate to the *GFS Manual 2001,* but the schedule for migration has yet to be defined. The authorities report annual GFS data for publication in the *Government Finance Statistics Yearbook (GFSY)* and monthly data for the *International Financial Statistics (IFS)*.

III. Monetary Sector

The Central Reserve Bank of Peru (BCRP) prepares and publishes the analytical accounts of the banking system and of the central bank broadly in line with the methodology recommended by the Fund's *Monetary and Financial Statistics Manual*. The main discrepancy is the valuation of some financial instruments at cost rather than at market prices. Monetary statistics are disseminated only in a summary form.

IV. External Sector

The BCRP compiles and disseminates 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).* These data are also reported to the Fund for publication in the *IFS* and the *Balance of Payments Statistics Yearbook (BOPSY*). Some departures from *BPM5* include the lack of coverage of assets held abroad and land acquisition abroad by residents; lack of separate identification of liabilities to affiliated enterprises; and the recording of some external debt transactions that are not on an accrual basis.

Regarding international reserves, the BCRP has been reporting weekly data since August 2001 in accordance with the *Operational Guidelines for Data Template on International Reserves and Foreign Currency Liquidity.* The BCRP includes the full amount of the liquidity requirements in the reserve template under official reserve assets, but does not register the contingent net drain (as specified in Section III of the Data Template). In September 2003, Peru started to disseminate quarterly data on external debt with a one-quarter lag. Peru also reports quarterly external debt data with a one-quarter lag to the World Bank's Quarterly External Debt Statistics (QEDS) database, launched in November 2004. External debt data are not compiled on an accrual basis, as recommended by *BPM5* and the *External Debt Statistics: Guide for Compilers and Users.*

PERU: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE AS OF JUNE 27, 2006

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items: Data Quality – Methodological soundness[7]	Memo Items: Data Quality Accuracy and reliability[8]
Exchange Rates	4/30/06	5/15/06	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/30/2005	5/06/2005	D	W	W		
Reserve/Base Money	4/30/06	6/15/06	W	W	W	O, LO, LO, LO	O, O, O, O, O
Broad Money	4/30/06	6/15/06	W	W	W		
Central Bank Balance Sheet	4/30/06	6/15/06	W	W	W		
Consolidated Balance Sheet of the Banking System	4/30/06	6/15/06	W	W	W		
Interest Rates[2]	5/31/06	6/15/06	D	D	D		
Consumer Price Index	May 2006	June 2006	M	M	M	O, LO, LO, LO	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q4/2004	2/21/2004	Q	Q	Q	O, LO, O, O	O, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	February 2005	3/25/2005	M	M	M		
Stocks of Central Government Debt[5]	Q4 2004	2/21/2004	Q	Q	Q		
External Current Account Balance	Q4 2005	03/14/06	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	December 2005	5/19/06	M	M	M		
GDP/GNP	December 2005	2/18/2005	M	M	M	LO, LO, LO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	Q4 2005	March 2006	Q	Q	Q		

[1] Every Friday the Central Bank disseminates daily net international reserves, and weekly International Reserve Assets and Reserve Liabilities.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including type of instrument, maturity and type of creditor.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published on October 4, 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).
[8] 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.

INTERNATIONAL MONETARY FUND

PERU

Fourth and Fifth Reviews Under the Stand-By Arrangement and Request for Waiver of Applicability

Supplementary Information

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

Approved by José Fajgenbaum and Adrienne Cheasty

July 21, 2006

This supplement provides information on quantitative performance criteria that have become available since the staff report was issued on July 11, 2006. As anticipated, the end-June 2006 quantitative performance criteria on net international reserves, outstanding short-term external debt of the nonfinancial public sector, contracting or guaranteeing of nonconcessional public debt, and external payment arrears of the public sector have been met (Table 1). The authorities have indicated that end-June data on the borrowing requirement of the combined public sector are not yet available, but staff expects that the related quantitative performance criterion will be met with a margin. Accordingly, a waiver of applicability is requested for the borrowing requirement of the combined public sector.

Table 1. Peru: Quantitative Performance Criteria and Inflation Consultation Mechanism, 2005 and 2006

	2005	2006	
	Dec. 31	Mar. 31	Jun.30
(Cumulative amounts from December 31, 2004, millions of New Soles)		(Cumulative amounts from December 31, 2005, millions of New	
Borrowing requirement of the combined public sector 1/			
Unadjusted limits	2,605	-596	-2,090
Adjusted limits 2/	2,605	-596	...
Actual	339	-2,983	...
Margin	2,266	2,387	...
(Cumulative amounts from December 31, 2004, millions of U.S. dollars)		(Cumulative amounts from December 31, 2005, millions of U.S.	
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions			
Unadjusted targets	-300	-387	-804
Adjusted targets 2/	-1,541	-654	-1176
Actual	444	-732	-561
Margin	1,985	-78	615
Outstanding short-term external debt of the nonfinancial public sector			
Limits	50	50	50
Actual	0	0	0
Margin	50	50	50
Contracting or guaranteeing of nonconcessional public debt with maturity of at least one year			
Unadjusted limits	3,100	960	1,101
Adjusted limits 2/	5,776	1198	2,623
Actual	4,343	900	2,290
Margin	1,433	299	333
***Of which:* external debt of 1-5 year maturity**			
Limits	100	100	100
Actual	0	0	0
Margin	100	100	100
External payments arrears of the public sector (on a continuous basis)			
Limits	0	0	0
Actual	0	0	0
Margin			
(Consultation bands for the 12-month rate of inflation, in percent) 3/			
Outer band (upper limit)	**5.5**	**5.5**	**5.5**
Inner band (upper limit)	4.5	4.5	4.5
Central point	2.5	2.5	2.5
Inner band (lower limit)	0.5	0.5	0.5
Outer band (lower limit)	**-0.5**	**-0.5**	**-0.5**
Actual	1.5	2.5	1.8

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; IMF Country Report No. 07/110; and IMF Country Report No. 06/47.

1/ PIPP proceeds are included below the line.
2/ The targets and limits were adjusted in accordance with the tables attached to the letters of intent dated May 20, 2005 (IMF Country Report No. 07/110) for 2005, and December 20, 2005 (IMF Country Report No. 06/47) for 2006.
3/ Should inflation fall outside the inner band, the authorities will discuss with the Fund staff the appropriate policy response. Should inflation fall outside the outer band, the authorities will also complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the arrangement.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/170
FOR IMMEDIATE RELEASE
August 1, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth and Fifth Reviews under Peru's Stand-By Arrangement

The Executive Board of the International Monetary Fund completed the fourth and fifth reviews of Peru's economic performance under a 26-month Stand-By Arrangement, in an amount equivalent to SDR 287.279 million (about US$423.6 million), approved on June 9, 2004 (see Press Release No. 04/112). The completion of the final reviews makes available for purchase the full amount of the arrangement. The Peruvian authorities have been treating the arrangement as precautionary and indicated that they will not make any drawings before the arrangement expires on August 16, 2006.

In completing the reviews, the Board granted a waiver of applicability of the June 30, 2006 quantitative performance criterion on the borrowing requirement of the combined public sector, for which data were not available yet. Staff anticipates that this quantitative performance criterion will be met with a margin.