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Peru: Third Review and Inflation Consultation Under the Stand-By Arrangement and Request for Waiver of Applicability of Performance Criteria—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Peru

In the context of the third review and inflation consultation under the stand-by arrangement and request for waiver of applicability of performance criteria, the following documents have been released and are included in this package:

- The staff report for the Third Review and Inflation Consultation Under the Stand-By Arrangement and Request for Waiver of Applicability of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on June 12, 2008, 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 June 30, 2008. 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 June 30, 2008 updating information on recent developments.

- A Press Release summarizing the views of the Executive Board as expressed during its July 23, 2008 discussion of the staff report that completed the review.

- A statement by the Executive Director for Peru.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Peru*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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PERU

Third Review and Inflation Consultation Under the Stand-By Arrangement and Request for Waiver of Applicability of Performance Criteria

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

Approved by José Fajgenbaum and G. Russell Kincaid

June 30, 2008

Executive Summary

Stand-By Arrangement (SBA). A 25-month SBA for SDR 172.37 million (27 percent of quota) was approved on January 26, 2007. The SBA is treated as precautionary. The Executive Board approved the second review of the SBA on December 19, 2007.

2008 Program

- ***Economic Performance.*** Peru's remarkable performance is being sustained, with broad-based real GDP growth and fiscal surpluses at record-high levels, and declining vulnerabilities. Inflation has risen to 5½ percent in recent months, largely owing to increasing imported food prices.
- ***Performance under the Program.*** All performance criteria for end-December 2007 and end-March 2008 were observed, but inflation in March exceeded the upper limit of the program's consultation band around the official inflation target range. The authorities discontinued the provision of guarantees for foreign currency loans by *MiVivienda* and submitted a draft legal framework for Public-Private Partnerships (both end-December benchmarks) in early January. The end-March structural benchmark was observed and progress has been made on end-June benchmarks.
- ***Outlook and Risks.*** The outlook for 2008 remains favorable, with the economy continuing its strong momentum, as downside global risks are buffered by improvements in fundamentals and prudent policies. However, weaker global conditions have increased downside risks for 2009.
- ***Key Policy Issues.*** The authorities are committed to:
  - ***Preserving macroeconomic stability,*** by tightening fiscal and monetary policies to contain inflation pressures.
  - ***Enhancing the economy's resilience to shocks,*** by gradually increasing the role of the exchange rate as a shock-absorber, increasing budget flexibility, minimizing fiscal risks and raising the depth and strength of the financial system and capital markets.
  - ***Entrenching long-term growth and securing further poverty reduction,*** by improving the provision of infrastructure and social services, building on the significant progress on poverty alleviation, enhancing the business environment and raising competitiveness.

Mission. A staff team comprising M. Cerisola (head), M. Gonzalez, C. Paiva (all WHD), Messrs. D. Leigh (FAD), P. Breuer (PDR), G. Gasha (MCM) visited Lima from April 28-May 13. Mr. L. Breuer (resident representative) and Mr. Silva Ruete (OED) also participated in the meetings with BCRP President Velarde and Finance Minister Carranza.

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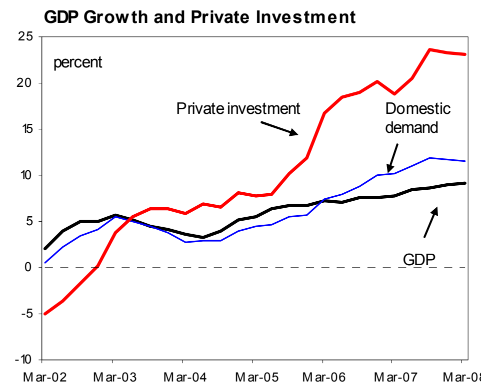
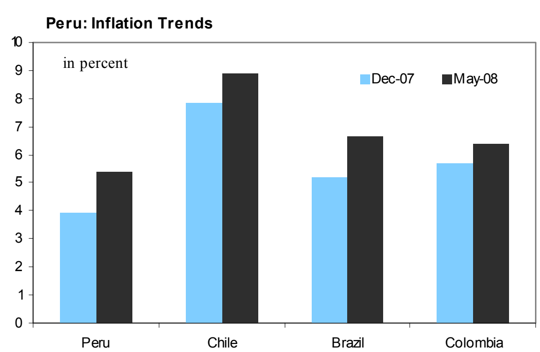
I. Performance under the Program

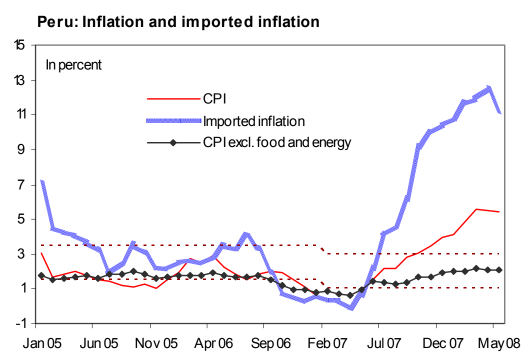
1. **Peru's remarkable economic performance is being sustained.** This owes much to the authorities' sound policies and persistently favorable external conditions. However, some policy challenges have emerged in the face of inflation pressures and strong capital inflows.

- ***Economic growth at a 13-year-high.*** Real GDP grew 9 percent in 2007, on the back of buoyant domestic demand and strong export growth, including in nontraditional sectors. (Figure 1). Economic activity remained strong into 2008, with real GDP growth at 9.2 percent in the first quarter.[1]



- ***Inflation close to 10-year highs, but still among the lowest in the region.*** Persistently high imported food inflation and weather-related shocks brought 12-month inflation to around 5½ percent since March, above the 1-3 percent target range.[2] Core inflation and expectations have risen to about 4 percent; however, inflation excluding food has hovered around 2 percent.[3] The central bank raised its reference rate by 125 basis point in four steps since mid-





[1] Official figures suggest that GDP grew by 13.3 percent in April. Nonetheless, some 3 percentage points of this increase are explained by the statistical effect of Easter in April 2007, which reduced the number of working days in that year.

[2] Peru's weight of food on CPI is based on a 1999 survey, and stands at about 48 percent—almost twice the average level in the region.

[3] The official measure of core inflation excludes product-level items based on their volatility during a specific benchmark period, as well as regulated prices for energy and transportation.

2007, to 5¾ percent, and increased reserve requirements (text table). In addition, the authorities reduced fuel excises and food import tariffs in March and June.[4]

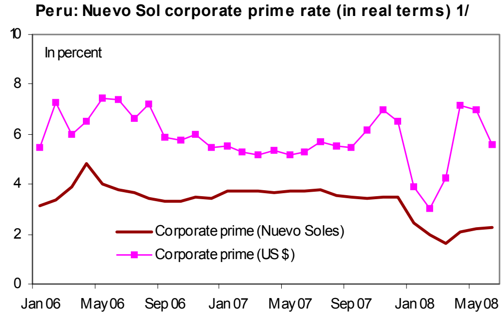
Peru: Recent Monetary Policy Measures

Measure	Effective	Impact
Restrictions to transactions with BCRP's Certificates of Deposit (CDs):		
CDs transfer of ownership subject to registration requirements; those involving nonresidents subject to 3-day confirmantion and 10 basis point commission.	Effective February, 2008	Primary market for CDs reduced and secondary market has almost disappeared.
Sales of CDs by resident financial institutions to natural persons or other financial institutions now subject to a commission of 4 percent.	Effective April 11, 2008	Penalizes BCRP CD holders for trading in secondary markets
New CD-NR (restricted circulation CD) limited to financial institutions that participate in the local financial system	Effective February, 2008	Interbank interest rates returned gradually toward the reference rate
Eased CD-NR restricted circulation for primary dealers	Effective May, 2008	
Increase in Reserve Requirements (RR):		Equivalent to an increase of 160 bps in the reference rate
> Minimum nonremunerated RR (both currencies): 6 to 8½ percent	Effective in 3 steps 1/	
> Marginal RR for FX deposits from 30 to 45 percent	Effective in 2 steps 2/	
> Marginal RR for NS deposits: from 15 to 25 percent	Effective in 3 steps 1/	
> Marginal RR for NS deposits by non-resident financial institutions: from 15 to 120 percent	Effective in 3 steps 1/	Discourage short-term capital inflows
> Banks' daily minimum current account balance at BCRP from 1 to 2 percent	Effective February, 2008	
> Long-term FX deposits are not subject to RR if they are below 200 percent of the sum of capital plus reserves of the financial institution	Effective May, 2008	Limit the reserve burden
Other measures:		
Short-term foreign currency borrowing subject to RR	Since January 1, 2008	Tighten liquidity in dollars.
Overnight window closed and CD auctions suspended for almost two weeks, and replaced with discretionary auctions of time deposits.	Overnight window closed on January 17, but later reopened and new CDs were issued	Sharp decline in interbank interest rates in Nuevo Soles

Source: Peruvian authorities.
1/ February, April and May, 2008
2/ February and May, 2008

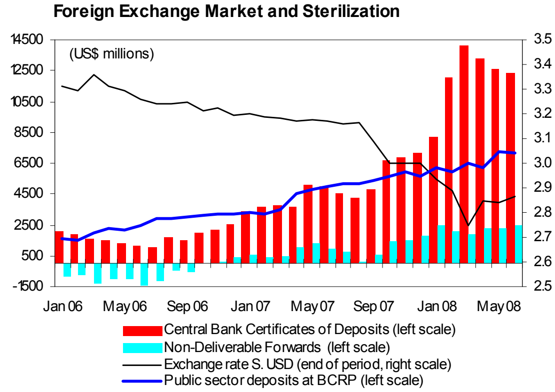
- ***Strong appreciation pressures.*** Between early 2007 and mid-April 2008, the *Nuevo Sol* appreciated 15½ percent against the U.S. dollar, and the central bank purchased some US$15 billion in the foreign exchange market—with about half of such

Peru: Nuevo Sol corporate prime rate (in real terms) 1/



1/ Based on 12-month inflation expectations of the private sector

Foreign Exchange Market and Sterilization



[4] Fuel prices follow a price band system embedded in the Fuel Price Stabilization Fund (FEPC). In June, the authorities increased wholesale fuel prices by 11 percent, and cut fuel excises to limit the impact on retail prices to 4 percent. The weighted average of fuel prices is 32 percent below import parity levels.

purchases taking place in the first four months of 2008, after a surge in short-term inflows. Since mid-April, the central bank has not intervened in the foreign exchange market, and following the measures implemented in May, the *Nuevo Sol* depreciated by about 8 percent against the U.S. dollar, as nonresident investors closed their positions in local instruments. The measures also triggered an increase in prime corporate interest rates in both local and foreign currency. Appreciation pressures raised concerns about competitiveness among some exporters.

- ***The highest fiscal surplus in 11 years.*** The consolidated public sector posted a surplus of 3.2 percent of GDP in 2007—well-above the 0.5 percent of GDP deficit target under the program (Figure 2). Public investment accelerated considerably toward year-end, owing to the reforms to the *National Public Investment System* (SNIP) implemented in 2007. The authorities raised their 2008 operational and program fiscal target to an overall surplus of 2 percent of GDP—well above the approved balanced budget—to help contain inflation pressures.

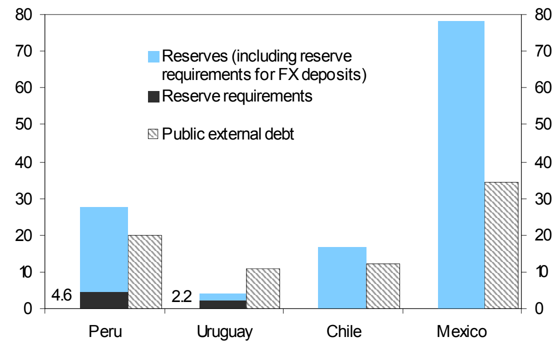
Fiscal Outcome 2007

	Prog. CR/07/241	Proj. CR/08/28	Prel.
Total revenue of general government[1]	19.8	20.6	20.5
Total primary expenditure of general government[1]	17.9	16.7	15.7
Current expenditure	13.2	13.4	12.7
Capital expenditure	4.7	3.3	3.0
Public enterprises primary balance	0.0	0.1	0.1
Interest payments	1.8	1.8	1.8
Central bank operating balance	0.1	0.2	0.2
Overall balance of CPS	0.0	2.3	3.2
Overall balance (including CRPAOs)	-0.3	1.3	2.2

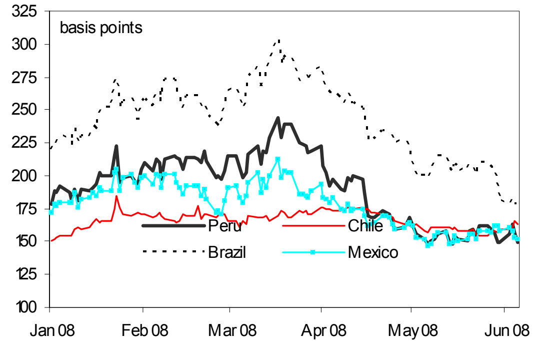
Source: Peruvian authorities and Fund staff estimates.
[1] Net of transfers to non-financial public sector (NFPS)

- ***Declining vulnerabilities and investment grade status.*** Official reserves reached some 230 percent of foreign-currency deposits in April. Prudent fiscal policy and active debt management operations have reduced public debt to the median for low investment grade countries, while raising the share of domestic-currency debt to about 34¾ percent by end-2007 (Figure 3). On April 2, Fitch upgraded Peru to investment grade status.

Official Reserves and External Debt (US$ billion, end 2007)

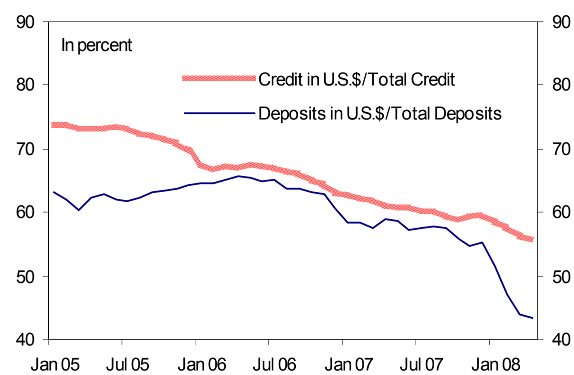


EMBIG spread



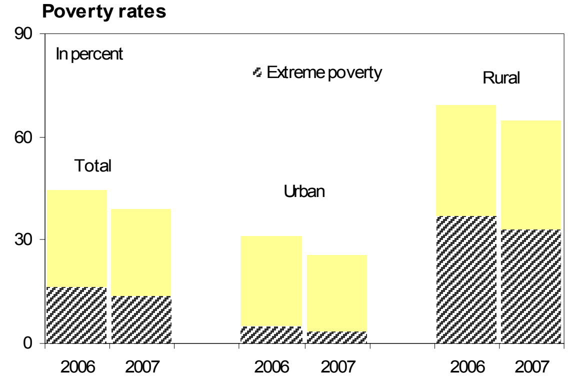
- ***Rapidly declining dollarization and strong credit growth.*** The appreciation of the *Nuevo Sol*, along with rapid growth in consumer and mortgage lending in *Nuevos Soles*, have contributed to a rapid dedollarization. Total credit growth to the private sector stood at around 30 percent by end-2007, but decelerated to about 14 percent by mid-April, following central bank's measures and stricter provisions on credit card loans established by the Superintendency of Banks (SBS) (Figure 4).

Share of Credit and Deposits in Foreign Currency



- ***Significant decline in poverty rates.*** Recent official statistics—prepared with World Bank's assistance—show that poverty declined from 44½ percent in 2006 to 39⅓ percent in 2007. The improvements were broad-based, but particularly strong in urban areas where poverty fell by 5½ percentage points. Extreme poverty also declined by 2.4 percentage points, to 13.7 percent.

Poverty rates



- ***Strong performance under the SBA.*** All quantitative performance criteria and structural benchmarks for end-December 2007 and end-March 2008 were observed. Inflation exceeded the upper bound in the program's inflation consultation mechanism with the Executive Board (see attached letter from the authorities). Data to assess quantitative performance criteria as of end-June will not be available before the Executive Board meeting, but they are expected to be observed; hence a waiver of applicability is being requested. Data on inflation to end-June will be available before the Executive Board meeting; should inflation as of end-June exceed the upper consultation band with the Executive Board, a corresponding inflation consultation would also be completed. Finally, the authorities have made significant progress toward completing the structural reform agenda envisaged for end-June 2008 ahead of schedule (Table 3).

II. Macroeconomic Framework and Outlook

2. **Peru's economic outlook is positive, although downside risks have risen for 2009.** Real GDP growth is projected to slow from about 9.2 percent in the first quarter of 2008 to 7¼ percent by the fourth quarter of 2008, as the impact of the recent monetary tightening, the global slowdown, and a deterioration in the terms of trade takes hold. Inflation is projected at 4.3 percent by end-2008, and would move back into the 1-3 percent target range by mid-2009, as imported food inflation and demand pressures wane.[5] While the strong momentum and overall confidence in the economy brings some upside risks to growth and inflation in 2008, the uncertainty about the depth and length of the global slowdown heightens downside risks for 2009.

Macroeconomic Framework 2007–09

		Prog. CR/08/28	Staff Projection	
	2007	2008	2008	2009
(Annual percentage change)				
Real GDP growth	9.0	6.5	8.2	6.5
Real domestic demand growth	11.5	...	11.0	7.1
Of which:				
Private investment	23.2	...	19.2	12.3
Government consumption	4.8	...	1.5	4.5
Inflation (end-year)	3.9	2.5	4.3	2.8
(In percent of GDP)				
External current account balance	1.4	-0.5	-0.6	-0.7
Public sector balance (excluding CRPAOs)	3.2	0.0	3.0	1.6
Public sector balance (including CRPAOs)	2.2	-0.7	2.4	1.2
Total public debt (including CRPAOs)	30.4	26.2	22.0	19.0
Gross official reserve coverage of:				
Short-term debt (residual maturity)	374	489	582	504

Source: Fund staff estimates and Peruvian authorities.

III. Policy Discussions

3. **Discussions focused on the response to policy challenges and risks to the outlook, and on how best to take advantage of favorable conditions to advance reforms to**:

[5] The June consensus forecast envisages growth of 7.6 percent and 6½ percent in 2008 and 2009, respectively, while inflation was projected at 4.3 percent as of end-December 2008, and at 3.4 percent by end-2009.

- ***Preserve macroeconomic stability.*** A well-balanced mix between fiscal and monetary policies to help bring inflation gradually toward the official target.

- ***Enhance the economy's resilience to shocks.*** Having achieved investment grade status, the need to advance reforms to further consolidate the inflation targeting framework and strengthen the role of the exchange rate as a shock absorber; increase budgetary flexibility and minimize fiscal risks; and enhance the depth and strength of the financial system and capital markets.

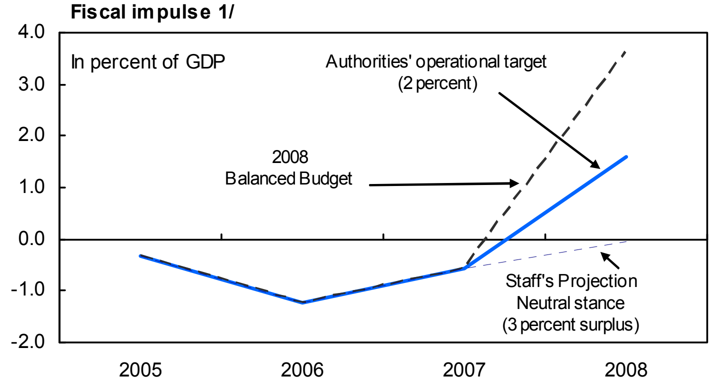
- ***Boost sustainable and equitable growth.*** Public investment in infrastructure, along with reforms to enhance the business environment, would improve competitiveness and reduce poverty.

A. Preserving Macroeconomic Stability

4. **The authorities were firmly committed to adjusting policies as needed to preserve macroeconomic stability.** A coordinated policy response aimed at carefully balancing risks to price stability against the need to preserve financial stability, including by maintaining an orderly dedollarization process, and mitigating sharp swings to external competitiveness, given global risks. The authorities committed to:

- ***A fiscal surplus target of 2 percent of GDP and saving revenue overperformance.*** The authorities decided to formalize their new operational fiscal target under the program to signal their commitment to macroeconomic stability. They also intend to limit general government spending growth to less than 4 percent in real terms, by reining in current spending, while ensuring that public investment increases as budgeted, to continue addressing infrastructure and social needs. With the favorable outlook and to support monetary policy, it was agreed that revenue overperformance would be saved, which could result in an overall consolidated surplus of up to 3 percent of GDP in 2008 and thus lock-in a neutral fiscal stance.

Fiscal impulse 1/



1/ Fiscal impulse defined as a deterioration in the NFPS structural balance-to-GDP ratio.

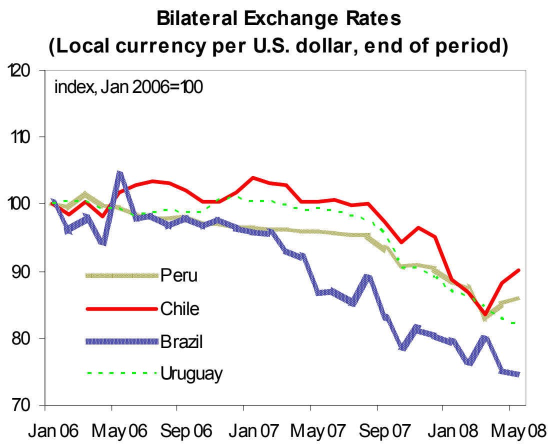
- ***Adjust monetary policy, using all instruments at their disposal, to ensure price and financial stability.*** The authorities were confident that with the recent measures, inflation would return gradually toward the target range by mid-2009. They noted that increasing reserve requirements had been the most effective way to tighten monetary conditions without exacerbating short-term capital inflows, as these had been increasingly complicating the conduct of monetary policy and posing risks to an orderly dedollarization process. Going forward, they noted that the full impact of the measures had yet to be fully reflected by market interest rates, given the step increases in reserve requirements and lifts in the reference interest rate, and stressed that they would continue to monitor inflation pressures and expectations closely, and respond promptly as needed. The authorities felt better placed to relying on the reference interest rate as their key policy instrument, as long as pressures from short-term capital inflows remained contained. However, if such inflows were to resume and lead to sharp appreciation pressures, they stressed that they may need to raise reserve requirements further. They were also confident that planned changes by the SBS to provisioning requirements on consumer loans would assist in their efforts to moderate credit and domestic demand growth.

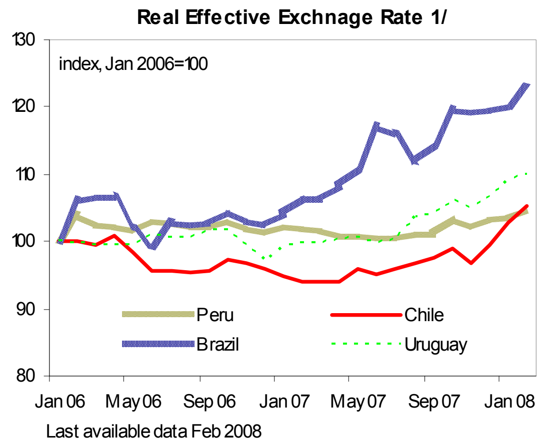
5. **The authorities and the staff agreed that there were upside risks to the inflation outlook.** The strong pace of domestic demand, along with the considerable uncertainty about the future path of international fuel prices as well as its eventual pass thru to domestic fuel prices (that were still below import parity levels), could bring inflation above the current forecast of 4.3 percent for 2008.[6] Staff noted that further interest rate adjustment and greater exchange rate flexibility, along with a neutral fiscal stance, could help contain inflation pressures and keep inflation close to the inner consultation band under the program of 4 percent. In this context, the authorities are the staff agreed that policies should nevertheless remain geared to mitigating second round effects from external shocks.

B. Enhancing the Economy's Resilience to Shocks

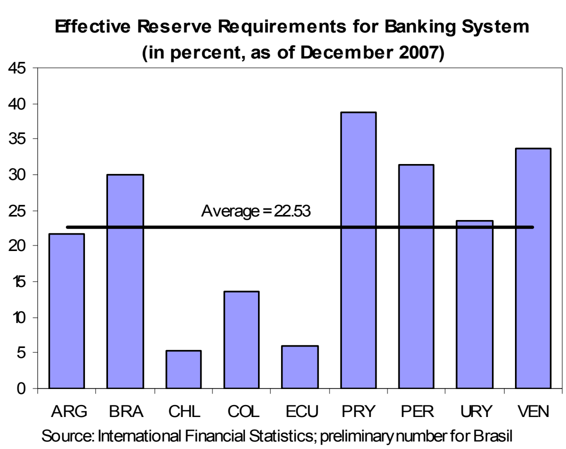
6. **With increased monetary independence, the authorities saw more scope for the exchange rate to be driven by fundamentals.** The authorities explained that intervention in the foreign exchange market continued to be geared toward protecting the economy from an expected reversal of the terms of trade and the impact of a potential global recession. Looking forward, intervention would continue to limit excessive exchange rate volatility and preserve an orderly dedollarization process. They reiterated their concern that in the context of a dollarized economy, swings in the exchange rate tended to be magnified and could thus prove destabilizing, especially when driven by short-term speculative motives. Staff agreed with the risks posed by short-term inflows, noting that the improved resilience of the banking system to exchange rate shocks and Peru's currency appreciation relative to its improved fundamentals in recent years, provided some scope for greater exchange rate flexibility and to reduce one-way bets on the currency.

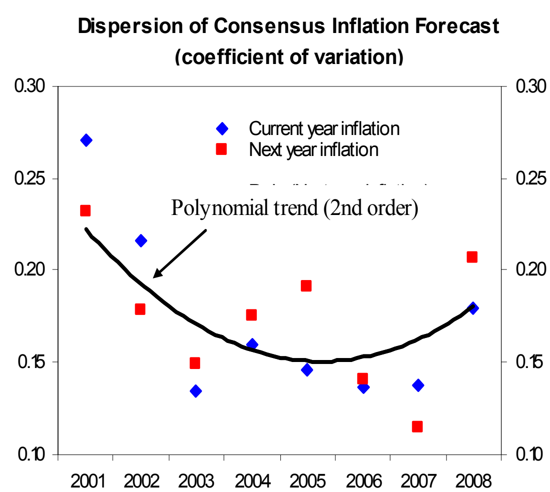
[6] The first-round impact of a 10 percent increase in retail fuel prices on the consumer price index would be 0.4 percent.





7. **The authorities viewed the recent measures as protecting the inflation targeting framework.** Market perceptions continue to attach high credibility to the authorities' commitment to the inflation target, notwithstanding the increased dispersion of inflation expectations. In this regard, the authorities noted that the draft constitutional amendment to delink the appointments of board members and the President of the central bank from the political cycle has been placed in Congress' agenda, and they intended to redouble efforts for its prompt approval. They also stressed that complementing the monetary policy tightening with higher reserve requirements would be more effective in adressing ongoing policy challenges, while helping to better anchor expectations and to reinforce the credibility of the inflation targeting framework. Recognizing that the effectiveness of higher reserve requirements could weaken over time, the central bank saw scope to dismantle them once inflation returned to the target range and global conditions—particularly growth prospects and interest rates—became more supportive. Staff noted that it would be important to consider how to eventually dismantle the high level of reserve requirements, to simplify and bring more certainty to the framework supporting inflation targeting.





8. **The authorities have continued to advance with reforms to strengthen the fiscal framework, but with some emerging risks**. In particular:

- ***Tax exemptions.*** The authorities were working to keep the momentum on implementing the new regime for limiting tax exemptions, with new methodological guidelines for assessing tax exemptions to be issued by end-June (structural benchmark). However, the gradual replacement of two key tax exemptions—on domestic VAT, and fuel VAT and excises—with direct budgetary transfers was postponed from 2009 to 2013 for two out of six regions previously benefiting from such exemptions.

- ***Tax administration.*** Proposals to separate customs from tax administration have been brought forward, reflecting the need to expedite customs procedures in the face of new trade agreements. The authorities and staff agreed that customs procedures could be simplified under the current institutional framework, which has been successful in maximizing informational synergies and enhancing tax compliance. Recent amendments by Congress have introduced an extension to 12 months on the use of the VAT credit that could complicate tax administration and reduce compliance.

- ***Fiscal rules.*** In late May, Congress approved legislation exempting the Ministry of Health from current expenditure limits for 2008. While this could undermine the existing framework under the *Fiscal Responsibility and Transparency Law* (FRTL), the authorities intended to accommodate these changes within their revised expenditure plans. At the same time, however, an amendment to the FRTL that introduces sanctions for noncompliance with targets has been approved in first instance by Congress, and the authorities intend to redouble efforts to obtain final approval in the coming months.

- ***Initiatives involving the private sector.*** The recent approval of the framework law for Public-Private Partnerships (in line with FAD recommendations) and the *Build and Transfer Program (B&T)* would facilitate private sector collaboration, including with subnational governments (SNGs). In response to staff concerns on B&T, the authorities explained that these projects will be fully reflected in the fiscal accounts and would not entail significant expenditure risks nor to the tax administration.

- ***Higher international oil prices.*** Given fiscal pressures generated by the rising gaps between international and domestic fuel prices, the authorities removed high octane gasoline from the FEPC in late May. Nonetheless, the accrued cost of implicit fuel subsidies was projected to reach about 1 percent of GDP in 2008.[7] Therefore, broader

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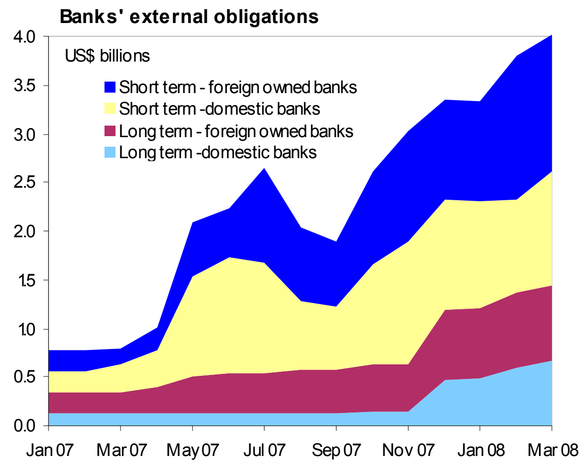
[7] The authorities expect to pay about 0.3 percent of GDP of this cost in 2008, of which about half is already included in current expenditure projections. The cost of lower fuel excises is estimated at 0.4 percent of GDP.

reforms to the FEPC were being contemplated, including new import parity reference prices that better reflect import costs and more timely payments of liabilities to importers and refineries.



9. **The authorities have proceeded with reforms to enhance the resilience of the financial system and deepen capital markets.**

- ***Market and global risks.*** Liquidity ratios are well above regulatory levels, and quarterly stress tests required by the SBS confirm banks' resilience to liquidity shocks. The authorities amended the General Banking Law (GBL) to introduce capital requirements for financial risks, including foreign-currency-induced credit risk, in line with Pillar II of Basel II, and will submit to Congress a draft amendment for the GBL to increase the minimum capital for microfinance institutions (structural benchmarks, end-June).[8] Discussions with the SBS and market participants corroborated the assessment that the vulnerability of foreign-owned banks to global shocks is well-contained, as they rely mostly on local deposits for funding and represent a small share of parents' assets. The Peruvian banking system is not directly exposed to U.S. securitized instruments.

- ***Credit risks.*** Provisioning requirements for unused credit card lines would be extended to other types of consumer credit. Credit growth of *Banco de la Nación* (BN) has been contained during the first three months of 2008—following a 68 percent rise in 2007.

- ***Supervisory framework.*** The draft law to fully bring all public financial institutions under the supervisory umbrella of the SBS remains stalled in Congress, but a new organic law for the public bank *Agrobanco* has been approved, which broadens Agrobanco's scope for first-tier operations. The authorities intend to eliminate the 49 percent limit to private sector shareholding.

- ***Capital markets.*** The SBS and the Securities Exchange Commission (CONASEV) signed a Memorandum of Understanding in January 2008, to enhance supervisory coordination and regulatory consistency. An inter-institutional committee has been

[8] Minimum capital requirements will be increased from $200,000 to $1 million for new *cajas rurales* and $1.6 million for new cajas municipales. Existing microfinance institutions will be given 2 years to comply with new requirements.

established to implement the memorandum. In May, the authorities amended the Law of Pension Funds to increase the limit for private pension funds' investments abroad from 20 to 30 percent.

Capital Markets Reform: Key Measures

Measure	Status
Promote access to capital markets	
(i) Complete regulations for facilitating the offering and demand in capital markets, including a guideline for public primary offers, minimum requirements for "titulizadoras", investment limits for investment funds, and simplified administrative regime for qualified investment funds.	In progress. CONASEV have issued several regulations on titulizadoras, investment funds. Amendments to the Law of Capital Markets for facilitating and streamlining the offering will be introduced by June 2008.
(ii) Streamlining of administrative procedures: "Law of Positive Administrative Silence"	Done. CONASEV issued new guidelines.
Boost debt, derivatives and asset-backed instruments markets	
(i) Complete regulations for classification, valuation, and provisioning of these instruments.	Mostly done. Tax treatment to be clarified by end-June 2008. Regulation on investment guidelines for derivatives to be approved by June 2008. Regulation on ABS proposed by SBS, and to be aproved by September 2008.
(ii) Complete regulation for e-trading (trading and settlement).	In progress. CONASEV working on the regulations.
(iii) Extend the use, harmonize and publish price vectors.	In progress. SBS already publishing, and coordinating with CONASEV "unique" vectors.
(iv) Amend the investment regime of insurance companies.	Done. To be approved by June 2008. 1/
(v) Develop repo market with government papers.	Done. To be approved by June 2008. 1/
(vi) Regulate the participation of MiVivienda as SPV.	CONASEV and MiVivienda working on regulations.
Enhance the Pension Fund System	
(i) Increase the limit of investments abroad.	Done. Increase of 30 percent to be approved by June 2008.1/
(ii) Improve the regulation on minimum return guarantee.	In progress. SBS to finalized work by September 2008.
(iii) Streamline the AFPs investment guidelines.	In progress. SBS to finalized work by September 2008.

Source: SBS, CONASEV, MEF.

C. Reforms to Reduce Poverty and Enhance Growth

10. **The authorities remain focused on enhancing the poverty alleviation strategy.** The Interministerial Committee for Social Affairs (CIAS) has prepared a *Multi-Annual Social Framework* to enhance the assessment and articulation of social assistance programs and spending. While *Crecer* and *Juntos* are now implemented in most poorest rural districts, the authorities recognized the need to alleviate further still high rural poverty. With IDB support, they undertook to evaluate *Juntos* and are exploring options to stimulate "productive chains" in rural areas, to help generate employment and opportunities, including for 3 million youth with limited access to education and jobs. To address the adverse impact of increased inflation on vulnerable urban groups, the authorities implemented a temporary pilot program to distribute food baskets to 100 thousand households and were considering a targeted cash-transfer program to 200 thousand households for a period of up to 6 months.

11. **Poverty alleviation efforts are being complemented by increased investment in critical areas.** Changes to the SNIP have already resulted in a significant rise in the number of projects approved. The *Fund for Regional and Local Investment* started operating in February, allowing SNGs in the poorest regions to bid for resources to finance investment projects, with the first-round results expected by end-May. The outsourcing of studies required for the formulation and approval of investment projects under the SNIP is expected to be approved soon, and will provide regions with a "certified market" for evaluators.

Projects under the framework of voluntary contributions by mining companies are being implemented.

12. **Several initiatives are being pursued to enhance the business environment.** These include a one-stop window for exporters and the implementation of the recently enacted *Positive Administrative Silence* law. The efficiency of Peru's ports is being enhanced by allowing private sector investment and expanding critical infrastructure. Discussions continue on how to simplify the labor regime for small- and medium-sized firms, to reduce informality and provide access to health and pension benefits.

Peru: Competitiveness Indicators

Country/Region	Export Procedures			Import Procedures			World Rank: Time to Export	Efficiency in Ports 1/
	Number of Documents	Number of Days	Cost (US$ per container)	Number of Documents	Number of Days	Cost (US$ per container)		
Peru	**7**	**24**	**590**	**8**	**31**	**670**	**99**	**2.8**
Argentina	9	16	1,325	7	20	1,825	42	4.3
Mexico	5	17	1,302	5	23	2,411	46	3.3
Brazil	8	18	1,090	7	22	1,240	54	3.2
Chile	6	21	645	7	21	685	79	4.1
Uruguay	10	24	925	10	23	1,180	99	4.3
Colombia	6	24	1,440	8	20	1,440	99	2.5
LAC Region	7	22	1,108	7.6	25.8	1,228	...	...
Asia-Pacific Region	7	25	885	7.5	25.8	1,015	...	...
OECD	5	10	905	5	10.4	986	...	...

Source: Peruvian authorities, Doing Business 2008, CAF, ECLAC.
1/ Index (7=highest efficiency).

13. **The authorities are pressing ahead to implement all legislation and regulations required to support the Peru-US FTA by November.** They recently signed agreements with Canada and Singapore, and negotiations continue with China, the EU, and Mexico. Recent reductions have brought the average effective tariff from 3.2 percent at end-2007 to 1.9 percent as of end-March.

IV. Staff Appraisal

14. **Peru's impressive economic performance continues unabated.** The strong performance and prospects owe much to the authorities' sound policies and progress in addressing structural vulnerabilities, which have helped achieve investment grade status despite heightened global uncertainty.

15. **Dealing with policy challenges would require a continued delicate balancing act, with price stability at the forefront.** Inflation remains one of the lowest in the region and pressures have been largely imported, although various measures of core inflation have accelerated, expectations have risen, and fuel prices lag international prices. While the coordinated policy response has been prudent, the risks to the inflation outlook may require further policy adjustments to avoid that inflation expectations deviate further from the target, as well as to help ensure a steady convergence of inflation to the official target.

16. **Staff welcomes the authorities' commitment to preserving macroeconomic stability.** The authorities' decision to tighten monetary policy, raise the fiscal target and to continue saving revenue overperformance is appropriate. While the recent tightening of monetary policy has yet to be fully reflected in market interest rates, it is also encouraging that the authorities stand ready to tighten policies further if needed. In this regard, staff sees scope for continued tight current public expenditure management, greater exchange rate flexibility and interest rate adjustment to support disinflation.

17. **With high credibility, efforts need to remain geared to solidifying the inflation targeting framework.** Staff welcomes the authorities' intention to phase out the recent increases in reserve requirements as soon as conditions permit, because their effectiveness is likely to diminish over time. Concerns about the risks to an orderly dedollarization and financial stability posed by short-term capital inflows remain valid, and phasing out reserve requirements will also help simplify and bring more certainty to the framework supporting inflation targeting. Discussions with market participants confirm the high credibility of the central bank's commitment to the inflation target, and staff encourages the authorities to solidify it by pressing ahead with the reform to strengthen central bank independence.

18. **Reforms to strengthen the fiscal framework are welcome and efforts need to remain focused on minimizing fiscal risks.** Staff welcomes the new framework for Public-Private Partnerships, the new methodological guidelines for assessing tax exemptions, and the authorities' intention to reform the Fuel Price Stabilization Fund, which should aim to more expeditiously reflect international prices and the cost of subsidies in the budget. The current institutional framework supporting tax and customs administration has worked well and needs to be preserved. Priority needs to be given to amending the Fiscal Responsibility and Transparency law, to introduce sanctions for noncompliance with targets and to ensure that expenditure limits remain effectively enforced at all government levels, particularly by avoiding further exemptions on these limits to specific government entities. It is also important that potential risks associated with the *Build and Transfer* program remain effectively contained.

19. **The authorities are implementing other reforms to enhance the economy's resilience to shocks.** The amendment to the General Banking Law to align capital requirements for financial risks with Pilar II of Basel II and proposal to raise the minimum capital for microfinance institutions are important, as well as efforts to improve coordination between CONASEV and the SBS. Finally, the authorities should press with the reform to align the regulatory framework for public banks with that of private banks, and ensure that the scope of public banks' first-tier operations remains limited. The increase in the foreign investment limits for private pension funds is a key step forward for greater diversification of investments and to reduce systemic risks.

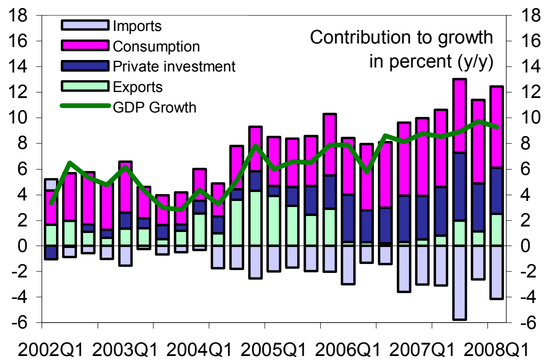
20. **The poverty alleviation strategy has begun to pay off.** The significant decline in poverty rates during 2007 is encouraging. Preserving a consolidated strategy, including by

supporting the role of the *Interministerial Committee for Social Affairs* in coordinating efforts, is essential to sustaining progress. The changes to the National System of Public Investment have already had a significant impact on public investment in the regions, which along with the recent launching of operations of the *Fund for Regional and Local Investment*, bode well for alleviating social and infrastructure needs.

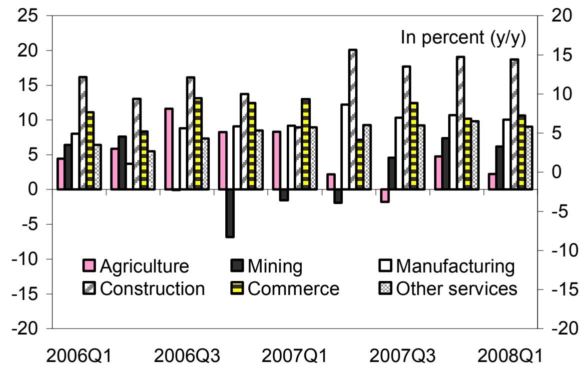
21. **Staff recommends completion of the third review and inflation consultation under the SBA,** in light of the program's good performance and the authorities' commitment to the program, as well as the authorities' request for a waiver of applicability of end-June performance criteria.

Figure 1. Peru: Real Sector Developments

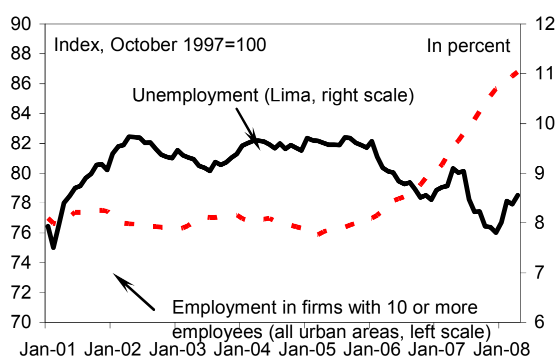
Investment and consumption remain strong...



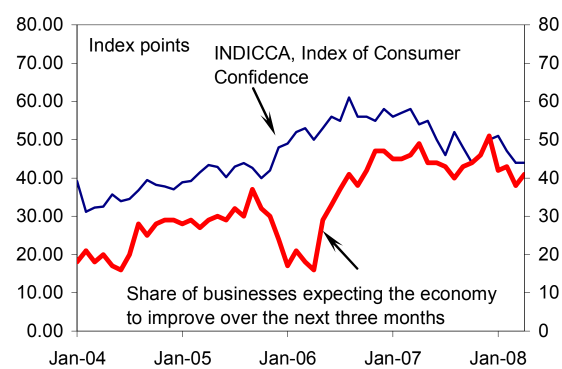
...and economic growth broad-based...



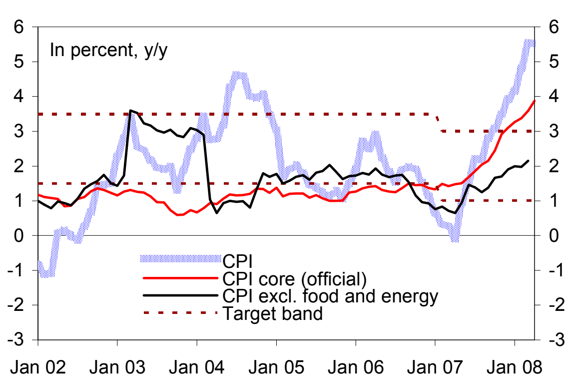
...with formal employment expanding...



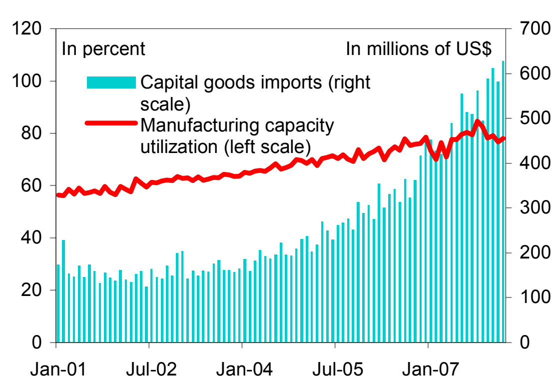
...but business and consumer confidence indicators softening somewhat.



Inflation has surpassed the upper limit of the target range mainly due to imported inflation and weathershocks...



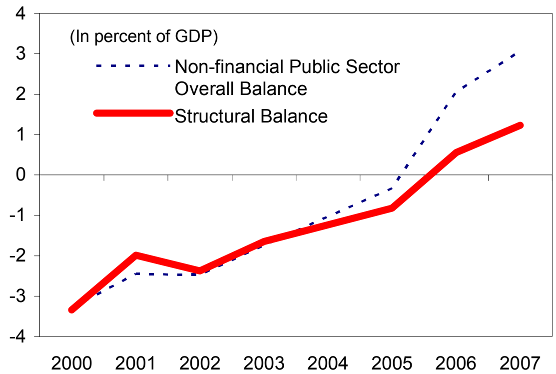
...as high capital investment contains a steady but gradual rise in capacity utilization.



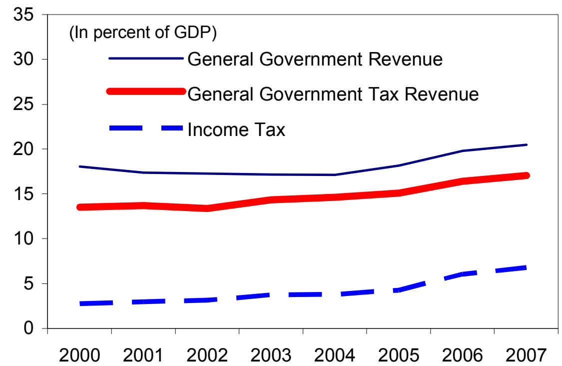
Sources: Banco Central de Reserva del Peru and IMF staff estimates.

Figure 2. Peru: Fiscal Sector Developments

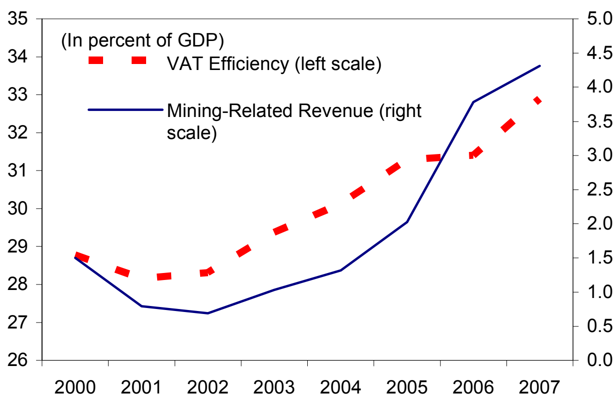
There has been a sharp improvement in the fiscal balance...



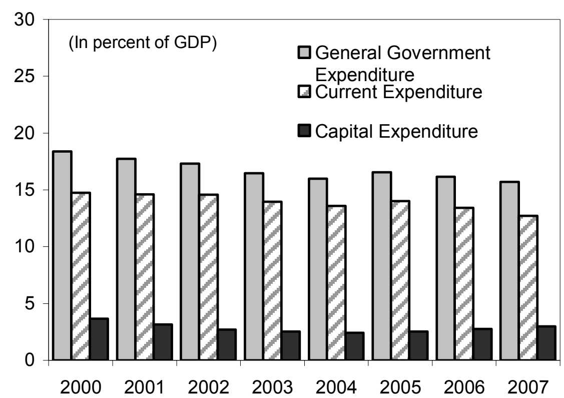
...supported by increased revenue collection.



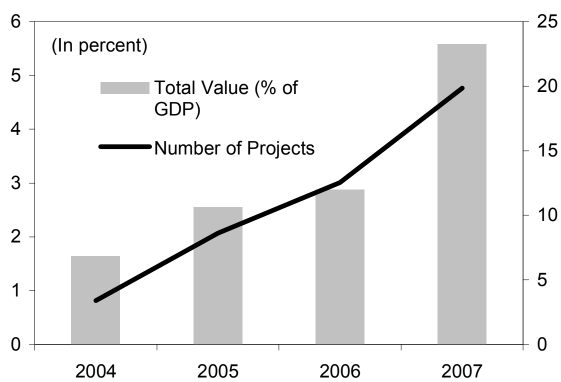
The improvement reflects better tax administration and higher commodity prices.



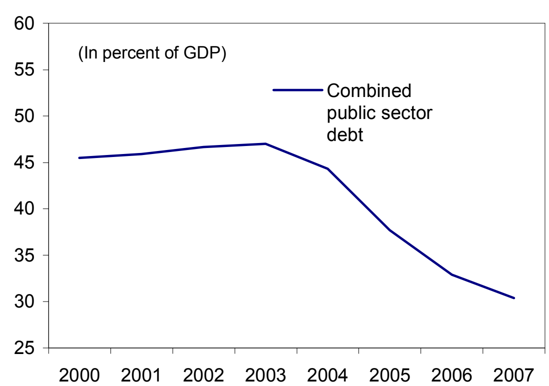
While the share of current expenditure to GDP has declined, the share of capital spending has increased in recent years...



... partly reflecting the increase in public investment projects authorized by the National System of Public Investment.



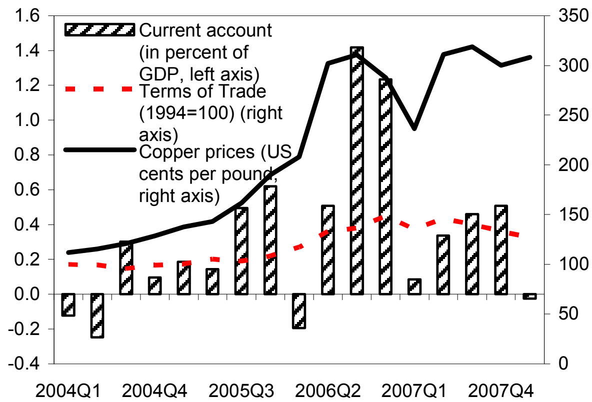
The strong fiscal performance has allowed public debt to decline markedly.



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

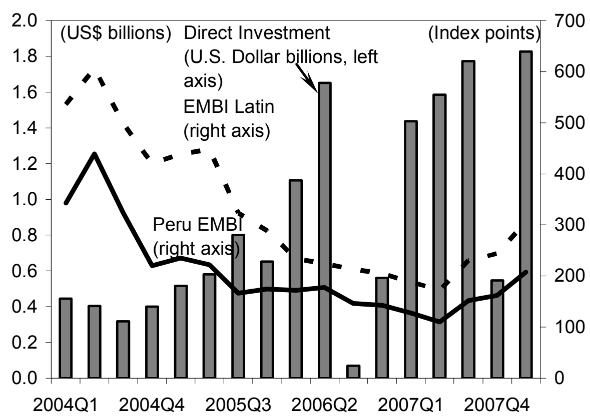
Figure 3. Peru: External Sector Developments

The strong balance of payments has been boosted by improved terms of trade...

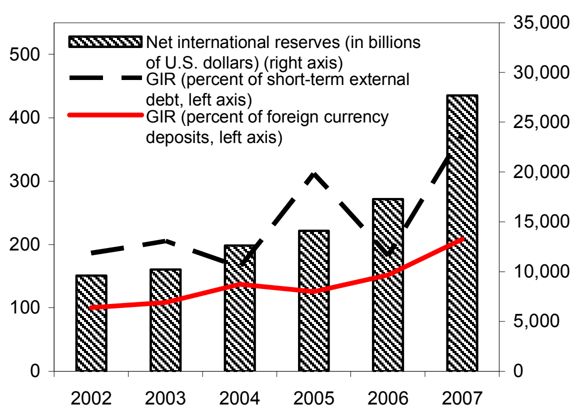


...rising non-traditional exports...

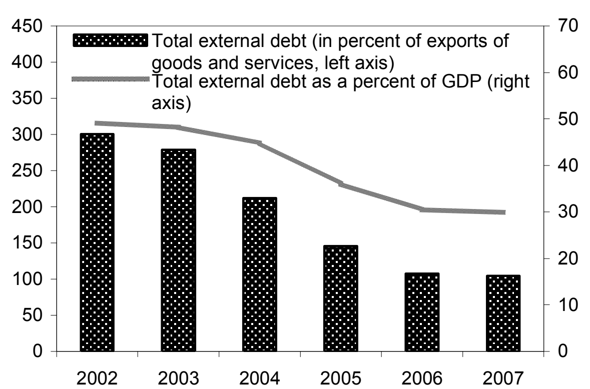
...and strong foreign direct investment, as the impact of global market turmoil was limited.



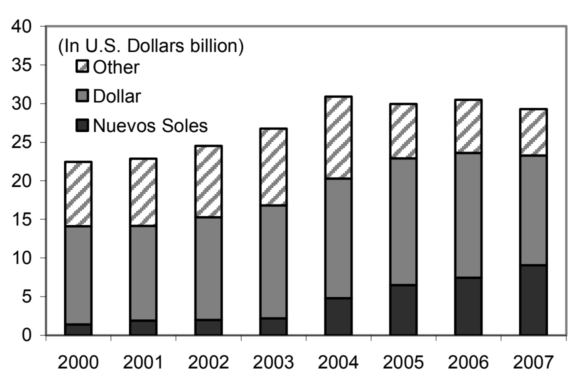
This has helped to build reserves...



...while external debt has declined markedly...



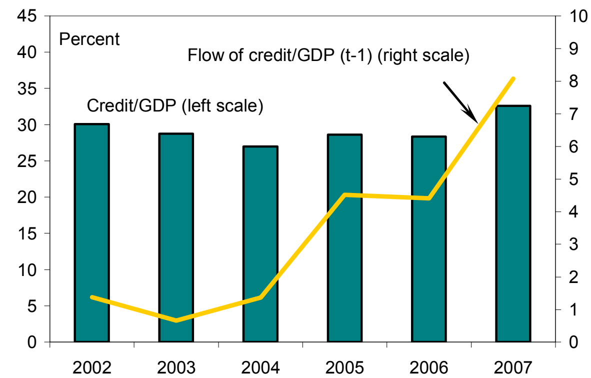
...and the domestic currency share in public debt is rising.



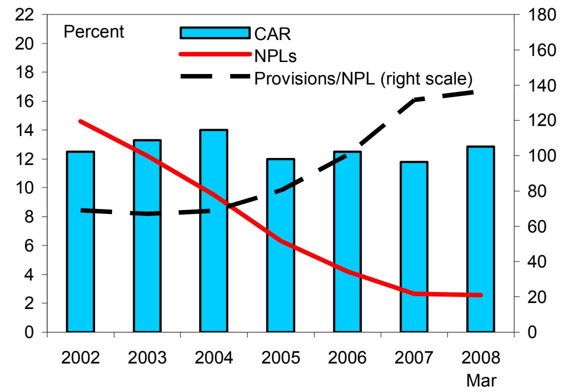
Sources: Banco Central de Reserva del Peru, Ministry of Finance, JP Morgan and IMF staff estimates.

Figure 4. Peru: Banking and Financial System 1/

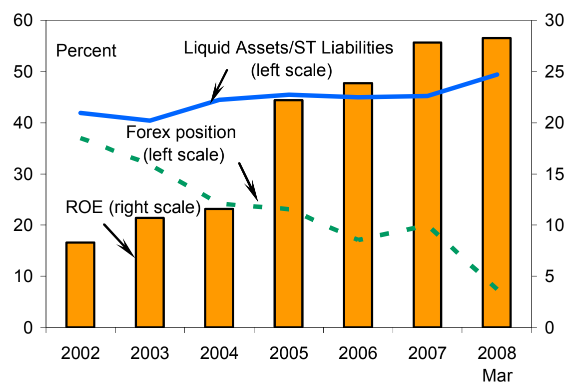
Credit continues to grow steadily, increasing financial depth...



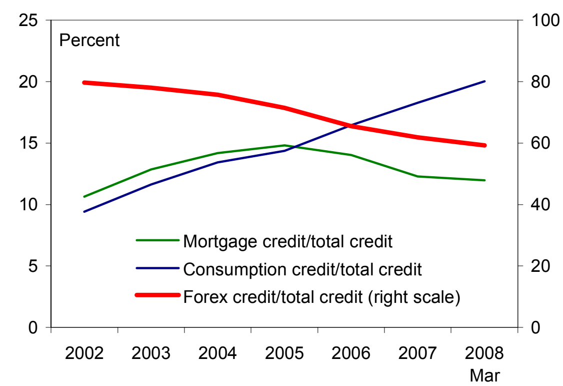
The banking system is enjoying strong capitalization ratios, declining non-performing loans, and adequate privisioning...



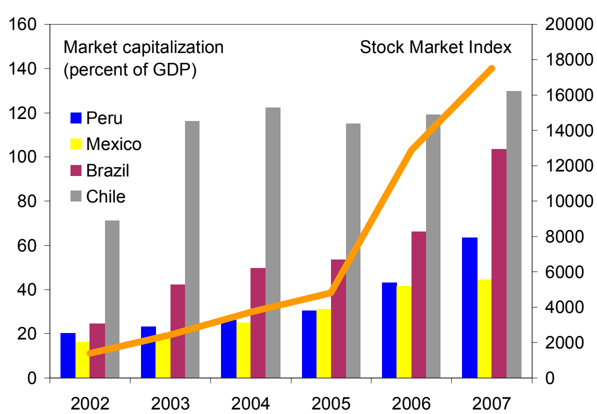
...increasing profitability, and comfortable levels of liquidity and foreign exchange positions.



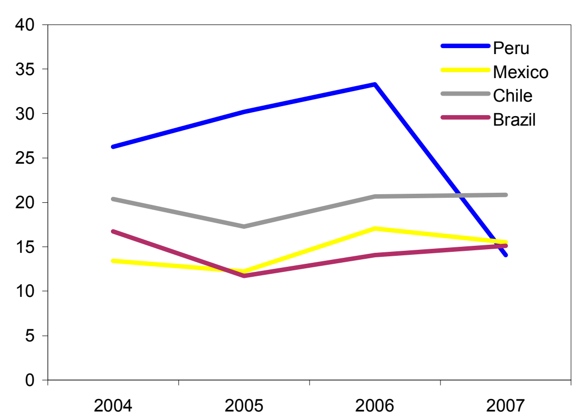
However, dollarization remains high and consumer credit is growing at a fast pace.



Equity prices and market capitalization continue their upward trend...



...but price/earning ratios have declined.



Sources: Bloomberg, SBS, World Federation of Exchange Rates and Fund staff estimates.
1/ Banking sector data corresponds to December 2007.

Table 1. Peru: Selected Economic Indicators

	2004	2005	2006	2007 Prog. CR/07/241	2007 Proj. CR/08/28	2007 Prel.	2008 Prog. CR/08/28	2008 Proj.	2009 Proj.
Social Indicators									
Life expectancy at birth (years)	...	70.7	...	...	...	...	...	...	...
Infant mortality (per thousand live births)	...	22.8	...	...	...	...	...	...	...
Adult literacy rate	87.8	87.9	...	...	...	...	...	...	...
Poverty rate (Total) 1/	48.6	48.7	44.5	...	...	39.3	...	...	...
Unemployment rate	9.4	9.6	8.6	...	...	8.4	...	...	...
(Annual percentage change; unless otherwise indicated)									
Production and prices									
Real GDP	5.1	6.7	7.6	7.0	7.5	9.0	6.5	8.2	6.5
Real domestic demand	4.0	5.7	10.1	9.2	10.9	11.5	8.0	11.0	7.1
Of which: Private sector	4.4	5.9	8.8	7.8	10.0	11.3	6.5	11.2	7.3
Consumer Prices (end of period)	3.5	1.2	1.1	2.0	3.4	3.9	2.5	4.3	2.8
Consumer Prices (period average)	3.7	1.6	2.0	1.1	1.7	1.8	3.0	4.8	3.0
External sector									
Exports	40.9	35.6	37.0	9.4	17.6	17.5	7.9	18.5	3.5
Imports	19.5	23.2	23.0	20.2	28.9	31.8	21.1	35.0	11.7
Terms of trade (deterioration -)	9.2	5.9	28.3	-0.6	3.9	6.7	-4.8	-1.8	-5.8
Real effective exchange rate (depreciation -) 2/	-1.6	-0.5	-1.3	...	...	-0.6	...	...	...
Money and credit 3/ 4/									
Liabilities to the private sector	8.3	18.4	8.8	14.5	18.2	22.7	12.9	14.9	12.4
Net credit to the private sector	-0.3	16.3	6.2	12.5	18.4	30.8	14.5	13.4	10.3
(In percent of GDP; unless otherwise indicated)									
Public sector									
General government current revenue	17.0	18.0	19.7	19.6	20.5	20.4	19.9	20.3	19.2
General government noninterest expenditure	16.2	16.7	16.1	17.8	16.8	15.7	18.2	16.0	16.2
Combined public sector primary balance	1.0	1.6	4.1	1.9	4.1	5.0	1.6	4.5	2.9
Interest due	2.0	1.9	1.9	1.8	1.8	1.8	1.6	1.5	1.3
Combined public sector overall balance	-1.1	-0.3	2.2	0.0	2.3	3.2	0.0	3.0	1.6
Combined public sector overall balance (including CRPAOs)	-1.1	-0.3	2.1	-0.3	1.3	2.2	-0.7	2.4	1.2
External Sector									
External current account balance	0.0	1.4	3.0	0.9	1.3	1.4	-0.5	-0.6	-0.7
Gross reserves									
In millions of U.S. dollars	12,649	14,120	17,329	21,329	25,429	27,743	28,679	37,243	41,243
Percent of short-term external debt 5/	163.9	311.4	182.4	336.9	500.1	373.9	489.1	582.4	503.9
Percent of foreign currency deposits at banks	137.3	125.9	151.7	167.0	204.9	208.5	207.7	264.4	258.2
Debt									
Total external debt	44.8	36.1	30.5	28.1	29.0	29.9	25.8	25.1	22.4
Combined public sector debt (including CRPAOs)	44.3	37.7	32.8	30.0	29.2	30.4	26.2	22.0	19.0
Domestic	9.2	9.7	9.1	8.7	10.8	10.8	8.7	7.3	6.5
External 6/	35.1	28.0	23.7	21.3	18.4	19.6	17.6	14.7	12.6
Savings and investment									
Gross domestic investment	18.1	17.9	20.0	22.5	22.1	23.0	23.9	25.8	27.7
Public sector 7/	2.8	2.9	2.8	4.8	4.2	3.1	5.7	4.1	4.9
Private sector	15.1	15.5	16.3	18.0	18.2	18.4	19.1	20.8	22.1
Inventories changes	0.2	-0.4	0.9	-0.3	-0.4	1.5	-0.8	0.9	0.7
National savings	18.1	19.4	23.0	23.4	23.3	24.8	23.4	25.2	27.0
Public sector 8/	1.7	2.6	5.1	4.6	5.8	6.5	5.3	7.2	6.4
Private sector	16.4	16.8	17.9	18.7	17.6	18.3	18.2	18.0	20.5
External savings	0.0	-1.4	-3.0	-0.9	-1.3	-1.4	0.5	0.6	0.7
Memorandum items									
Nominal GDP (S/. billions)	238.0	261.9	305.2	329.2	335.0	341.2	359.3	382.9	414.3
GDP per capita (in US$)	2,602	2,920	3,372	3,672	3,818	3,889	4,346	4,868	5,505

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

1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.

2/ Based on Information Notice System.

3/ Corresponds to the banking system.

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

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

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

7/ Includes CRPAOs.

8/ Excludes privatization receipts.

Table 2. Peru: Quantitative Performance Criteria and Inflation Consultation Mechanism for 2007-2008

	2007				2008
	Mar. 31	Jun. 30	Sept. 30	Dec. 31	Mar. 31
(Cumulative amounts from December 31, millions of Nuevos Soles)					
Borrowing requirement of the combined public sector					
Unadjusted limits 1/ 2/ 3/ 4/	-1,396	-4,190	-2,761	2,418	-2,036
Adjusted limits	-1,646	-4,690	-3511	1,418	-2,486
Actual	-4,194	-11,749	-14,181	-13,176	-3,050
Margin	2,548	7,059	10,670	14,594	564
(Cumulative amounts from December 31, millions of U.S. dollars)					
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions					
Unadjusted targets 5/ 6/	-260	44	336	350	-645
Adjusted targets	-635	-478	-8	-1,691	-1,458
Actual	948	4,126	4,761	8742	6,042
Margin	1,583	4,604	4,769	10,433	7500
Outstanding short-term external debt of the nonfinancial public sector					
Limits	50	50	50	50	50
Actual	0	0	0	0	0
Margin	50	50	50	50	50
Contracting or guaranteeing of nonconcessional public debt with maturity of at least one year					
Unadjusted limits 7/ 8/ 9/	751	1,237	1,608	2,636	1,568
Adjusted limits	3,146	3,632	5,506	6,935	1,568
Actual	2,741	3,028	4,627	5,630	254
Margin	405	604	879	1,305	1,314
***Of which:* external debt of 1-5 year maturity**					
Limits	100	100	100	100	100
Actual	0	0	1	1	0
Margin	100	100	99	99	100
External payments arrears of the public sector (on a continuous basis)					
Limits	0	0	0	0	0
Actual	0	0	0	0	0
NPV of future government payments associated with PPP operations (on a continuous basis)					
Unadjusted Limits 10/	1,500	1,500	1,500	1,500	1,860
Actual	58	58	58	680	0
Margin	1,442	1,442	1,442	820	1,860
(Consultation bands for the 12-month rate of inflation, in percent) 11/					
Outer band (upper limit)	5.5	5.5	5.5	5.5	5.0
Inner band (upper limit)	4.5	4.5	4.5	4.5	4.0
Central point	2.5	2.5	2.5	2.5	2.0
Inner band (lower limit)	0.5	0.5	0.5	0.5	0.0
Outer band (lower limit)	-0.5	-0.5	-0.5	-0.5	-0.5
Actual	0.3	1.6	2.8	3.9	5.6

Sources: Staff estimations.

1/ PIPP proceeds are included below the line.

2/ In 2007, the limit on the borrowing requirement of the combined public sector will be adjusted downwards by the amount central government revenues net of mandatory transfers exceed program estimates of S/. 10,489 million at end-March, up to a ceiling of S/. 250 million; S/. 23,359 million at end-June, up to a ceiling of S/. 500 million; S/. 32, 807 million at end-September, up to a ceiling of S/. 750 million; and S/. 44,821 million at end-December, up to a total ceiling of S/. 1,000 million. In 2008, the limit on the borrowing requirement of the combined public sector will be adjusted downwards by the amount central government revenues net of mandatory transfers exceed program estimates of S/. 12,767 million at end-March, up to a ceiling of S/. 450 million; S/. 26,493 million at end-June, up to a ceiling of S/. 900 million. No adjustors will be applied to the end-September 2008 nor to the end-December 2008 data when assessing the performance of the PSBR.

3/ The limit on the borrowing requirement of the combined public sector will be adjusted for the operating balance of the BCRP.

4/ The limit on the borrowing requirement of the combined public sector will be adjusted upward by up to US$100 million for capital spending by Petroperu, over the $30 million already included in the program.

5/ The target for net international reserves will be adjusted upward by the amount by which net foreign borrowing of the nonfinancial public sector exceeds '-US$15 million at end-March, -US$138 million at end-June, -US$274 million at end-September, and -US$148 million at end-December 2007. It will be adjusted downward for shortfalls from programmed net foreign borrowing. The amounts in excess will be deposited at the BCRP.

6/ The target for net international reserves will be adjusted downward for withdrawals for portfolio management purposes of deposits held at the Central Reserve Bank by the Consolidated Pension Reserve Fund (FCR) and any other funds managed by the ONP. This downward adjustment will not exceed US$300 million at any time in 2007.

7/ The limit will be adjusted upward by any amount of debt issued, and used in, debt-exchange operations, or for prefinancing of government operations.

8/ The current debt limits do not include contracting of non-guaranteed debt by Petroperu and will be adjusted upward by up to US$300 million for debt contracted by Petroper during 2007.

9/ The limit on contracting and guaranteeing of nonconcessional public debt will be adjusted upwards for guarantees contracted or extended by the government in relation to concessions, up to a ceiling of US$430 million for the year as a whole.

10/ Discount rates to calculate the NPV of the future stream of payments will be the currency-specific commercial interest reference rates (CIRRs) published by the OECD and specified in the TMU.

11/ 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 2007-08

Measure	Implementation	Status
Ensure that most of new mortgage loans extended by banks with the guarantee of *MiVivienda* are denominated in Nuevos Soles.	December 31, 2007	Observed with a slight delay. Two guarantees were issued in early 2008, on small loans granted by participating banks in late December 2007.
Submit to congress a legal framework for PPP operations.	December 31, 2007	Observed with a slight delay. The authorities submitted to Congress the draft legal framework for PPPs on January 10, 2008.
Clarify the tax treatment of securitized transactions.	December 31, 2007	Not observed. The benchmark was reset to end-June 2008 at the time of the second review.
Full implementation of the Treasury Single Account (TSA) for the central government.	December 31, 2007	Not observed. The benchmark was redefined and reset to end-September 2008 at the time of the second review.
2008 Budget prepared according to the modernized budget classification system and incorporated into the charts of accounts.	December 31, 2007	Not observed. The benchmark was redefined and reset to end-September 2008 at the time of the second review.
Issue new regulations regarding new risk categories and provisions to address foreign currency risk.	December 31, 2007	Not observed. The benchmark was redefined and reset to end-June 2008 at the time of the second review.
Submit to Congress an amendment to the SNIP Law to allow for the outsourcing of the studies required for the formulation an approval of investment projects.	March 31, 2008	Observed.
Clarify the tax treatment of securitization transactions in line with para. 11, bullet 4 of the LOI of December 5, 2007.	June 30, 2008	In progress. [Draft legislation is under preparation.]
Issue methodological guidelines for ministries and public entities to assess tax exemptions in line with the new regime for tax exemptions.	June 30, 2008	In progress. Draft methodological guidelines are already being reviewed by the authorities.
Submit to Congress amendment to the General Banking Law to allow the SBS the introduction of capital requirements for exchange-related risk in line with Basel II.	June 30, 2008	Observed.
Submit to Congress amendment to the General Banking Law to raise the minimum capital requirement for microfinance institutions.	June 30, 2008	In progress. A draft law has already been prepared.
Submit to Congress amendment to the Law of Pension Funds that would significantly raise the limit for foreign investment by private pension funds.	June 30, 2008	Observed.
2009 Budget to be prepared according to modernized budget classification system and incorporated into the chart of accounts.	September 30, 2008	In progress.
Implement the TSA, as described in para. 7 of the Letter of Intent of December 5, 2007.	September 30, 2008	In progress.
Submit to Congress amendments to the Decentralization Law to reconcile subnational government spending with that for the central government as presented in the FRTL.	September 30, 2008	
Expand the number of Technical Assistance Regional Offices from 16 to 28.	December 31, 2008	Observed.

Table 4. Peru: Fiscal Operations of the Combined Public Sector
(In percent of GDP; unless otherwise indicated)

	2004	2005	2006	Prog. CR/07/241 2007	Proj. CR/08/28 2007	Prel. 2007	Prog. CR/08/28 2008	Revised Prog. 2008	Proj. 2008	Proj. 2009
Central government primary balance	**0.6**	**1.1**	**3.2**	**1.3**	**2.8**	**3.4**	**1.8**	**2.8**	**3.4**	**2.6**
Revenue	14.9	15.8	17.4	17.3	18.1	18.0	17.6	17.0	17.6	17.0
Current	14.9	15.6	17.3	17.3	18.0	17.9	17.5	17.0	17.5	16.9
Of which: Tax revenue	13.1	13.6	14.9	15.2	15.6	15.4	15.6	14.7	15.3	14.8
Of which: Financial transaction tax	0.3	0.3	0.3	0.3	0.3	0.4	0.3	0.4	0.4	0.3
Capital	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Noninterest expenditure	14.4	14.7	14.2	15.9	15.4	14.6	15.8	14.2	14.2	14.3
Current 1/	12.5	12.8	12.2	13.0	13.2	12.5	12.4	11.7	11.7	11.3
Wages and salaries	4.4	4.4	4.1	…	…	3.8	3.9	3.7	3.7	3.5
Goods and services	3.5	3.4	3.3	…	…	3.2	3.3	3.2	3.2	3.1
Transfers	4.7	5.0	4.8	…	…	5.5	5.1	4.9	4.9	4.6
Capital	1.8	1.9	2.0	3.0	2.1	2.2	3.4	2.6	2.6	3.0
General government primary balance	**0.9**	**1.4**	**3.6**	**1.9**	**3.9**	**4.7**	**1.7**	**3.6**	**4.4**	**3.0**
Revenue	17.1	18.1	19.8	19.8	20.6	20.4	20.0	19.6	20.4	19.2
Current	17.0	18.0	19.7	19.6	20.5	20.4	19.9	19.5	20.3	19.2
Capital	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Noninterest expenditure	16.2	16.7	16.1	17.9	16.7	15.7	18.2	16.0	16.0	16.2
Current	13.8	14.2	13.4	…	13.4	12.7	13.3	12.2	12.2	11.8
Capital	2.4	2.5	2.7	…	3.3	3.0	4.9	3.8	3.8	4.5
Public enterprise primary balance	0.1	0.2	0.3	0.0	0.1	0.1	-0.1	-0.1	0.1	0.0
Nonfinancial public sector primary balance	1.0	1.6	3.9	1.8	3.9	4.8	0.0	3.5	4.5	3.0
Central bank operating balance	0.0	0.0	0.2	0.1	0.2	0.2	0.0	0.0	0.0	0.0
Combined public sector primary balance	1.0	1.6	4.1	1.9	4.1	5.0	1.6	3.5	4.5	2.9
Interest payments	2.0	1.9	1.9	1.8	1.8	1.8	1.6	1.5	1.5	1.3
External	1.7	1.6	1.4	1.4	1.3	1.3	1.0	0.9	0.9	0.8
Domestic	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.6	0.6	0.6
Combined public sector overall balance	**-1.1**	**-0.3**	**2.2**	**0.0**	**2.3**	**3.2**	**0.0**	**2.0**	**3.0**	**1.6**
Financing	1.1	0.3	-2.2	0.0	-2.3	-3.2	0.0	-2.0	-3.0	-1.6
External	1.5	-1.3	-0.4	0.0	-2.0	-0.9	0.0	-1.0	-1.0	0.5
Disbursements 2/	3.5	3.4	0.8	3.2	3.1	4.2	1.2	1.6	1.6	1.1
Amortization 3/	-1.9	-4.6	-1.3	-3.3	-5.2	-5.2	-1.2	-2.6	-2.6	-0.6
Other 4/	-0.1	-0.1	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Domestic	-0.6	1.6	-1.9	-0.1	-0.5	-2.5	0.0	-1.0	-2.0	-2.1
Bond placements 5/	1.1	2.6	1.8	1.6	2.9	2.8	0.7	0.7	0.7	0.3
Amortization 6/	-1.0	-1.0	-1.5	-1.2	-1.1	-1.1	-0.4	-0.4	-0.4	-0.2
Net deposits	-0.7	0.0	-2.1	-0.5	-2.2	-4.2	-0.3	-1.4	-2.3	-2.3
Privatization	0.2	0.1	0.1	0.0	0.1	0.1	0.1	0.0	0.0	0.0
Memorandum items										
Combined public sector overall balance (incl. CRPAOs)	**-1.1**	**-0.3**	**2.1**	**-0.3**	**1.3**	**2.2**	**-0.7**	**1.4**	**2.4**	**1.2**
Public sector debt (incl. CRPAOs)	44.3	37.7	32.8	30.0	29.4	30.4	26.2	23.0	22.0	19.0
Nominal GDP (S/. billions)	238,015	261,907	305,211	329,200	329,200	341,226	359,265	382,867	382,867	414,278

Source: Peruvian authorities and staff estimates.

1/ Figures since 2007 reflect the acceleration of transfers associated with income tax payments from the extractive industries to sub-national governments.
2/ In 2004, includes placement of US800 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. In 2007 (the projection column), includes the swap of 2.3 billion to extend the average maturity of public debt.
3/ In 2005, includes the prepayment of US1.55 billion to the Paris Club. In 2007 includes the swap of 2.3 billion to extend the average maturity of public debt.
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 US323 and US462 million Soles-denominated bonds to finance the Paris Club prepayment. In 2006, includes the placement of US$ 85 million Sol-denominated bonds to finance the Japeco prepayment.
6/ Includes in 2005 the amortization of US390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.

Table 5. Peru: Fiscal Operations of the Combined Public Sector
(In millions of Nuevos Soles; unless otherwise indicated)

				Prog. CR/07/241	Proj. CR/08/28	Prel.	Prog. CR/08/28	Revised Prog.	Proj.	
	2004	2005	2006		2007		2008	2008	2008	2009
Central government primary balance	**1,405**	**2,904**	**9,816**	**4,424**	**9,272**	**11,536**	**6,460**	**10,749**	**12,980**	**10,963**
Revenue	35,570	41,372	53,076	56,923	60,701	61,498	63,259	65,278	67,510	70,284
Current	35,381	40,988	52,715	56,923	60,330	61,113	62,870	64,900	67,131	69,900
Of which: Tax revenue	31,267	35,619	45,552	50,107	52,216	52,569	55,908	56,375	58,606	61,429
Of which: Financial transaction tax	650	706	843	922	1,021	1,486	968	1,604	1,667	1,406
Capital	189	384	361	306	371	385	389	379	379	384
Noninterest expenditure	34,165	38,468	43,260	52,499	51,430	49,962	56,800	54,530	54,530	59,320
Current	29,870	33,577	37,252	42,686	44,358	42,613	44,462	44,738	44,738	46,784
Wages and salaries	10,509	11,593	12,553	…	…	13,020	14,106	13,986	13,986	14,685
Goods and services	8,219	8,960	10,192	…	…	10,994	12,000	12,140	12,140	12,869
Transfers	11,142	13,024	14,506	…	…	18,599	18,356	18,612	18,612	19,230
Capital	4,295	4,891	6,008	9,813	7,071	7,349	12,337	9,791	9,791	12,536
General government primary balance	2,080	3,651	11,099	6,130	12,900	16,190	6,266	13,761	16,881	12,413
Revenue	40,742	47,518	60,303	65,037	68,905	69,748	71,817.1	74,871	77,992	79,715
Current	40,553	47,134	60,056	64,652	68,526	69,468	71,536.6	74,602	77,723	79,438
Capital	189	384	247	385	378	280	280.5	269	269	278
Noninterest expenditure	38,647	43,850	49,204	58,906	56,005	53,557	65,551.1	61,111	61,111	67,303
Current 1/	32,913	37,183	40,833	…	44,877	43,420	47,928	46,743	46,743	48,793
Capital	5,733	6,668	8,372	…	11,128	10,138	17,622.9	14,367	14,367	18,509
Public enterprise primary balance	320	558	858	-137	279	285	-483	-397	299	-186
Nonfinancial public sector primary balance	2,400	4,210	11,957	5,993	13,178	16,475	5,783.3	13,243	17,181	12,227
Central bank operating balance	-89	23	474	196	576	632	0	11	11	-144
Combined public sector primary balance	2,311	4,233	12,431	6,189	13,754	17,107	5,783	13,375	17,192	12,083
Interest payments	4,865	5,097	5,692	6,088	5,973	6,030	5,883	5,706	5,706	5,503
External	3,951	4,174	4,337	4,506	4,273	4,440	3,757	3,502	3,502	3,166
Domestic	914	924	1,355	1,582	1,700	1,590	2,126	2,204	2,204	2,336
Combined public sector overall balance	**-2,554**	**-865**	**6,738**	**101**	**7,782**	**11,077**	**-100**	**7,669**	**11,486**	**6,580**
Financing	2,554	865	-6,738	-101	-7,782	-11,077	100	-7,669	-11,486	-6,580
External	3,678	-3,514	-1,371	-30	-6,653	-3,089	-104	-3,776	-3,776	2,221
Disbursements 2/	8,443	8,989	2,448	10,521	10,498	14,339	4,147	5,997	5,997	4,642
Amortization 3/	-4,602	-12,118	-3,906	-10,835	-17,430	-17,707	-4,366	-9,888	-9,888	-2,537
Other 4/	-162	-385	87	284	279	279	115	115	115	115
Domestic	-1,514	4,194	-5,671	-199	-1,577	-8,438	23	-3,930	-7,746	-8,829
Bond placements 5/	2,592	6,822	5,453	5,352	9,683	9,604	2,610	2,856	2,856	1,300
Amortization 6/	-2,455	-2,672	-4,642	-3,800	-3,795	-3,662	-1,578	-1,605	-1,605	-728
Net deposits	-1,650	43	-6,482	-1,751	-7,465	-14,381	-1,010	-5,181	-8,997	-9,401
Privatization	389	185	304	128	448	450	180	37	37	28
Memorandum items										
Combined public sector overall balance (incl. CRPAOs)	**-2,554**	**-865**	**6,330**	**-1,116**	**4,494**	**7,483**	**-2,691**	**5,281**	**9,097**	**5,139**
Public sector debt (incl.CRPAOs)	105,483	98,739	100,245	98,672	98,368	103,610	94,254	87,883	84,055	78,888
Nominal GDP (S/. billions)	238,015	261,907	305,211	329,200	334,993	341,226	359,265	382,867	382,867	414,278

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

1/ Figures since 2007 reflect the acceleration of transfers associated with income tax payments from the extractive industries to sub-national governments.
2/ In 2004, includes placement of US800 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. In 2007 (the projection column), includes the swap of 2.3 billion to extend the average maturity of public debt.
3/ In 2005, includes the prepayment of US1.55 billion to the Paris Club. In 2007 includes the swap of 2.3 billion to extend the average maturity of public debt.
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 US323 and US462 million Soles-denominated bonds to finance the Paris Club prepayment. In 2006, includes the placement of US$ 85 million Sol-denominated bonds to finance the Japeco prepayment.
6/ Includes in 2005 the amortization of US390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.

Table 6. Peru: Public Sector Social Expenditure

	2004	2005	2006	2007 Proj.	2007 Prel.	2008 Proj. 3/
	(In millions of Nuevos Soles)					
Total social expenditure and pensions	**23,528**	**25,708**	**27,711**	**31,905**	**31,905**	**33,041**
Universal coverage (Education and Health) 1/	10,263	10,892	12,285	14,685	14,685	14,123
Education	7,251	7,682	8,244	9,648	9,648	9,409
Health	3,011	3,210	4,041	5,037	5,037	4,714
Targeted programs (Extreme Poverty)	3,078	3,453	3,565	5,027	5,027	6,024
Non-Targeted Social Programs	10,187	11,363	11,861	12,193	12,193	12,894
(In percent of general government expenditure)						
Total social expenditure and pensions	**60.9**	**58.6**	**56.3**	**51.4**	**59.6**	**54.1**
Universal coverage (Education and Health) 1/	26.6	24.8	25.0	23.7	27.4	23.1
Education	18.8	17.5	16.8	15.6	18.0	15.4
Health	7.8	7.3	8.2	8.1	9.4	7.7
Targeted programs (Extreme Poverty) 2/	8.0	7.9	7.2	8.1	9.4	9.9
Non-Targeted Social Programs	26.4	25.9	24.1	19.7	22.8	21.1
	(In percent of GDP)					
Total social expenditure and pensions	**9.9**	**9.8**	**9.1**	**9.5**	**9.4**	**8.6**
Universal coverage (Education and Health) 1/	4.3	4.2	4.0	4.4	4.3	3.7
Education	3.0	2.9	2.7	2.9	2.8	2.5
Health	1.3	1.2	1.3	1.5	1.5	1.2
Targeted programs (Extreme Poverty)	1.3	1.3	1.2	1.5	1.5	1.6
Non-Targeted Social Programs	4.3	4.3	3.9	3.6	3.6	3.4
Memorandum items						
Total social expenditure and pensions (annual percentage change, deflated by CPI)	5.3	7.5	5.7	13.4	13.1	-1.1
General government expenditure (in millions of Nuevos Soles)	38,647	43,850	49,204	62,026	53,557	61,111

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.
3/ As per the 2008 approved budget.

Table 7. Peru: Monetary Survey 1/

				Prog. CR/07/241	Proj. CR/08/28	Prel.	Prog. CR/08/28	Proj.	
	2004	2005	2006	2007			2008	2008	2009
				I. Central Reserve Bank (In millions of New Soles)					
Net international reserves 2/	**41,430**	**48,353**	**55,279**	**68,079**	**74,856**	**83,017**	**81,581**	**96,691**	**107,091**
(In millions of U.S. dollars)	12,631	14,097	17,275	21,275	25,375	27,689	28,625	37,189	41,189
Net domestic assets	**-33,394**	**-38,237**	**-43,483**	**-54,368**	**-59,613**	**-68,032**	**-64,323**	**-77,686**	**-85,148**
Net credit to nonfinancial public sector	-12,930	-13,770	-19,925	-23,205	-29,114	-28,932	-29,614	-34,821	-44,260
Rest of banking system	-19,191	-21,585	-22,158	-27,275	-32,917	-39,174	-36,011	-54,243	-56,481
Other	-1,273	-2,881	-1,400	-3,888	2,417	75	1,302	11,378	15,593
Currency	**8,036**	**10,116**	**11,796**	**13,711**	**15,243**	**14,985**	**17,258**	**19,005**	**21,943**
				II. Banking System (In millions of Nuevos Soles)					
Net foreign assets	**40,903**	**47,582**	**56,057**	**67,898**	**71,557**	**78,993**	**76,257**	**91,701**	**103,141**
Net domestic assets	**16,191**	**20,017**	**17,505**	**16,285**	**15,420**	**11,235**	**21,971**	**11,947**	**13,407**
Net credit to nonfinancial public sector	-12,970	-14,254	-20,601	-26,274	-33,943	-34,818	-34,943	-41,422	-50,456
Net credit to private sector	43,683	50,799	53,948	60,655	63,850	70,575	73,109	80,019	88,287
Other	-14,522	-16,528	-15,842	-18,097	-14,487	-24,522	-16,195	-26,650	-24,424
Net credit to COFIDE	-1,087	-850	-850	-850	-850	-850	-850	-850	-850
Other	-13,435	-15,678	-14,992	-17,247	-13,637	-23,672	-15,345	-25,800	-23,574
Liabilities to the private sector	**57,094**	**67,599**	**73,562**	**84,182**	**86,977**	**90,228**	**98,227**	**103,648**	**116,548**
				(12-month percentage change)					
Base money	25.3	25.7	18.3	15.4	26.0	28.2	14.0	29.0	14.7
Broad money	8.3	18.4	8.8	14.5	18.2	22.7	12.9	14.9	12.4
Domestic currency	28.1	19.5	18.0	21.4	33.3	34.5	20.8	30.2	14.5
Foreign currency	-3.9	17.5	1.2	7.8	3.7	11.2	3.2	-3.0	9.2
Net credit to private sector	-0.3	16.3	6.2	12.5	18.4	30.8	14.5	13.4	10.3
Domestic currency	11.9	34.8	29.0	28.6	34.8	43.1	29.8	31.2	14.5
Foreign currency	-4.0	9.8	-3.7	3.2	8.8	23.7	3.5	1.5	6.7
				III. Financial System (In millions of Nuevos Soles)					
Net foreign assets	**40,771**	**47,504**	**56,032**	**64,346**	**72,842**	**78,610**	**76,484**	**88,043**	**95,086**
Net domestic assets	**42,060**	**54,322**	**67,296**	**80,871**	**72,822**	**79,528**	**90,595**	**101,672**	**119,680**
Net credit to the public sector	-10,121	-8,908	-10,746	-12,882	-16,118	-17,777	-16,280	-19,463	-21,585
Net credit to private sector	64,271	74,945	86,575	98,674	101,714	111,218	116,568	128,428	141,864
Other	-12,090	-11,715	-8,533	-4,920	-12,774	-13,913	-9,694	-7,293	-599
Liabilities to the private sector	**82,831**	**101,825**	**123,329**	**145,218**	**145,664**	**158,138**	**167,079**	**189,715**	**214,766**
				(12-month percentage change)					
Liabilities to the private sector	12.5	22.9	21.1	17.8	18.1	28.2	14.7	20.0	13.2
Domestic currency	23.5	29.1	30.4	24.0	25.0	35.5	20.0	30.2	14.5
Foreign currency	0.1	14.4	6.7	6.0	5.0	14.4	2.7	-3.0	9.2
Net credit to private sector	4.7	16.6	15.5	14.1	17.5	28.5	14.6	15.5	10.5
Domestic currency	17.9	26.0	38.2	25.0	30.0	40.1	25.0	28.3	13.2
Foreign currency	-1.7	11.1	0.4	4.0	6.0	17.8	2.9	1.5	6.7
Memorandum item									
End-of-period exchange rate (S/. per US$	3.28	3.43	3.20	...	...	3.00	...	...	...

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

1/ Stocks in foreign currency are valued at the end-of-period exchange rate.
2/ Excludes subscriptions to the IMF and the Latin American Reserve Fund (FLAR), Pesos Andinos, credit lines to other central banks, as well as Corporacion Andina de Fomento (CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations.

Table 8. Peru: Financial Soundness Indicators 1/
(In percent; unless otherwise indicated)

	Dec-04	Dec-05	Dec-06	Mar-07	Dec-07	Mar-08
Capital Adequacy						
Equity capital to risk-weighted assets	14.0	12.0	12.5	12.5	11.7	12.9
Regulatory Tier I capital to risk-weighted assets 2/	13.1	11.2	10.6	10.7	8.8	9.8
Nonperforming loans net of provisions to capital	-17.3	-21.7	-18.0	-17.2	-17.3	-14.8
Asset Quality						
Nonperforming loans to total gross loans 3/	3.7	2.1	1.6	1.6	1.3	1.4
In domestic currency	3.0	2.1	1.9	1.9	1.6	1.8
In foreign currency	3.9	2.2	1.5	1.5	1.1	1.1
Nonperforming loans to total gross loans 4/	9.5	6.3	4.1	3.9	2.7	2.6
In domestic currency	6.1	4.2	3.2	3.1	2.5	2.6
In foreign currency	10.6	7.1	4.6	4.3	2.8	2.5
Refinanced and restructured loans to total gross loans 5/	5.8	4.1	2.4	2.2	1.4	1.2
Provisions to nonperforming loans 3/	176.5	235.3	251.4	246.5	278.4	257.7
Provisions to nonperforming, restructured, and refinanced loans 4/	68.7	80.3	100.3	104.3	131.6	136.7
Sectoral distribution of loans to total loans						
Consumer loans	13.4	14.4	16.5	17.0	18.3	20.3
Mortgage loans	14.2	14.8	14.0	14.0	12.3	12.0
Commercial loans	68.1	65.8	64.2	63.6	63.9	61.9
Small business loans	4.3	5.0	5.3	5.4	5.5	5.8
Earnings and Profitability						
ROA	1.2	2.2	2.2	2.4	2.5	2.5
ROE	11.6	22.2	23.9	25.8	27.9	28.2
Gross financial spread to financial revenues	71.9	70.5	67.6	69.2	66.6	60.0
Financial revenues to total revenues	69.1	76.3	76.6	80.2	79.6	81.8
Annualized financial revenues to revenue-generating assets	9.0	10.3	10.6	11.0	11.6	12.1
Liquidity						
Total liquid assets to total short-term liabilities	44.5	45.5	44.2	44.9	45.3	49.4
In domestic currency	20.2	20.6	43.1	48.1	57.3	62.8
In foreign currency	44.3	49.2	45.0	42.6	37.0	36.4
Foreign Currency Position and Dollarization						
Global position in foreign currency to regulatory capital 6/	24.2	23.1	17.1	30.2	16.8	7.4
Share of foreign currency deposits in total deposits	67.1	67.2	62.7	60.7	59.3	48.4
Share of foreign currency loans in total credit	75.7	71.5	65.5	64.7	61.8	59.2
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	9,596	10,913	11,855	11,993	14,857	14,117
Commercial banks' short-term foreign assets (in millions of U.S. dollars)	547	796	878	758	822	981
Commercial banks' short-term foreign liabilities (in millions of U.S. dollars)	733	1,085	754	712	2,238	2,606
Operational efficiency						
Financing to related parties to capital 7/	14.3	17.9	15.5	16.6	14.4	14.4
Nonfinancial expenditure to total revenues 8/	35.9	33.3	31.3	29.8	30.1	26.4
Nonfinancial expenditure to total revenue-generating assets 8/	4.7	4.6	3.4	4.6	4.5	4.6
Memorandum items						
Number of Banks	16	14	13	13	15	17
Private commercial	14	12	11	11	13	15
Of which: Foreign-owned	9	9	7	7	9	11
State-owned	2	2	2	5	2.0	2.0
Banks' credit card loans to total loans	6.4	6.9	8.1	8.2	9.2	10.6
Bank loans' 12 month increase (in real terms)	-1.9	19.0	14.0	17.2	27.7	21.5
Stock market index (U.S. dollars)	1132	1400	4032	5390	5849	6334
Foreign currency debt rating (Moody's)	Ba3	Ba3	Ba3	Ba3	Ba2	Ba2
Spread of Peruvian Brady bonds, basis points	220	257	118	129	178	223

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 merger with Banco de Crédito.
3/ Nonperforming loans are overdue loans after 15 days since the due date for commercial loans, after 30 days for small 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 9. Peru: Balance of Payments

(In millions of U.S. dollars)

				Prog. CR/07/241	Proj. CR/08/28	Prel.	Prog. CR/08/28	Proj.	
	2004	2005	2006		2007		2008	2008	2009
Current account	**19**	**1,149**	**2,757**	**877**	**1,378**	**1,516**	**-618**	**-821**	**-1,181**
Merchandise trade	3,004	5,286	8,934	8,066	8,833	8,357	7,005	6,670	4,744
Exports	12,809	17,368	23,800	25,974	27,990	27,956	30,203	33,124	34,290
Traditional	9,199	12,950	18,374	19,766	21,569	21,494	22,839	24,966	24,656
Nontraditional and others	3,611	4,418	5,426	6,208	6,422	6,463	7,364	8,159	9,634
Imports	-9,805	-12,082	-14,866	-17,908	-19,157	-19,599	-23,198	-26,454	-29,546
Services, income, and current transfers (net)	-2,985	-4,137	-6,177	-7,189	-7,455	-6,841	-23,198	-7,491	-5,924
Services	-732	-834	-781	-1,296	-1,268	-928	-23,198	-1,538	-2,160
Investment income	-3,686	-5,074	-7,581	-8,522	-8,739	-8,408	-23,198	-8,534	-6,441
Current transfers	1,433	1,772	2,185	2,630	2,552	2,495	-23,198	2,581	2,676
Financial and capital account	**2,155**	**141**	**847**	**2,969**	**6,583**	**8,623**	**3,829**	**10,282**	**5,154**
Public sector	988	-1,440	-599	135	-1,251	-1,275	763	-1,512	704
Disbursements 1/	2,535	2,656	747	3,689	4,280	4,588	2,463	2,173	1,786
Amortization 1/	-1,389	-3,718	-1,222	-3,460	-5,406	-5,694	-1,603	-3,588	-981
Other medium- and long-term Public sector flows 2/	-158	-378	-125	-94	-125	-169	-97	-97	-101
Capital transfers (net)	0	0	0	0	0	0	0	0	0
Privatization	31	31	79	0	0	0	0	0	39
Private sector	1,288	1,788	491	2,834	7,520	9,326	3,067	11,794	4,411
Foreign direct investment (FDI) excluding privatization	1,568	2,548	3,388	2,893	6,175	5,343	4,771	6,791	6,205
Other private capital	-432	-997	-2,020	-59	1,659	4,556	-1,704	5,003	-1,794
Medium- and long-term loans	-285	-840	148	262	1,373	3,151	61	1,932	27
Portfolio investment	-377	79	-1,540	-1,717	-1,656	261	-2,975	1,640	296
Short-term flows 3/	231	-237	-628	1,395	1,942	1,143	1,210	1,431	-2,117
Net Errors and Omissions	151	238	-877	21	-314	-572	0	0	0
Balance	**2,326**	**1,528**	**2,726**	**3,846**	**7,647**	**9,567**	**3,211**	**9,461**	**3,973**
Financing	**-2,326**	**-1,528**	**-2,726**	**-3,846**	**-7,647**	**-9,567**	**-3,211**	**-9,461**	**-3,973**
NIR flow (increase -)	-2,353	-1,628	-2,753	-3,925	-7,733	-9,654	-3,250	-9,500	-4,000
Change in NIR (increase -)	-2,437	-1,466	-3,178	-4,000	-8,100	-10,414	-3,250	-9,500	-4,000
Valuation change	-84	162	-425	-75	-367	-760	0	0	0
Exceptional financing	27	100	27	79	86	86	39	39	27
Debt relief 4/	27	100	27	79	86	86	39	39	27
Change in arrears	0	0	0	0	0	0	0	0	0
Rescheduling	0	0	0	0	0	0	0	0	0
Memorandum items									
Current account balance (in percent of GDP)	**0.0**	**1.4**	**3.0**	**0.9**	**1.3**	**1.4**	**-0.5**	**-0.6**	**-0.7**
Capital and financial account balance (in perce	3.1	0.2	0.9	2.9	6.1	7.9	3.1	7.4	3.2
Export value (US$), percent change	40.9	35.6	37.0	9.4	17.6	17.5	7.9	18.5	3.5
Volume growth	13.9	15.0	-0.1	5.9	4.3	6.8	8.7	11.5	7.8
Price growth	23.7	17.9	37.2	3.3	12.7	10.0	-0.8	6.2	-4.0
Import value (US$), percent change	19.5	23.2	23.0	20.2	28.9	31.8	21.1	35.0	11.7
Volume growth	7.9	10.8	15.0	15.7	18.8	27.9	16.1	24.7	9.6
Price growth	10.7	11.3	7.0	3.9	8.5	3.1	4.3	8.2	1.9
GDP (in billions of US$)	69.7	79.5	93.0	103.1	107.2	109.2	123.9	138.8	159.3

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

1/ Includes debt swap operations.
2/ Includes portfolio flows of the pension reserve fund and subscription payments into international funds.
3/ Includes COFIDE and Banco de la Nación.
4/ Debt relief under existing operations.

Table 10. Peru: External Financing Requirements and Sources

(In millions of U.S. dollars)

				Prog. CR/07/241	Proj. CR/08/28	Prel.	Prog. CR/08/28	Proj.	
	2004	2005	2006	2007			2008	2008	2009
Gross financing requirements	**7,247**	**8,434**	**4,965**	**9,855**	**15,173**	**17,415**	**10,111**	**19,569**	**12,744**
External current account deficit (excluding official transfers)	**-19**	**-1,149**	**-2,757**	**-877**	**-1,378**	**-1,516**	**618**	**821**	**1,181**
Debt amortization	4,914	7,956	4,969	6,807	8,819	9,278	6,243	9,248	7,563
Medium- and long-term debt	2,400	5,205	1,783	3,901	5,929	6,313	2,195	4,456	1,604
Public sector	1,389	3,718	1,222	3,460	5,406	5,694	2,195	3,588	981
Multilateral 1/	571	628	647	705	712	974	2,195	1,859	564
Bilateral	742	2,159	394	411	2,177	2,203	2,195	320	269
Bonds and notes	66	90	90	2,340	2,513	2,513	2,195	1,338	0
Other	10	842	92	4	4	4	67	71	148
Private sector	1,011	1,486	561	441	523	619	593	868	623
Short-term debt 2/	2,514	2,751	3,186	2,906	2,890	2,964	4,047	4,792	5,960
Rescheduling and repayment of arrears	0	0	0	0	0	0	0	0	0
Accumulation of NIR (flow)	2,353	1,628	2,753	3,925	7,733	9,654	3,250	9,500	4,000
Change in gross reserves	2,443	1,471	3,177	4,000	8,100	10,414	3,250	9,500	4,000
Payments of short-term liabilities incl. IMF	-6	-5	1	0	0	0	0	0	0
Other	-84	162	-425	-75	-367	-760	0	0	0
Available financing	**7,247**	**8,434**	**4,965**	**9,855**	**15,173**	**17,415**	**10,111**	**19,569**	**12,744**
Foreign direct investment (net)	1,599	2,579	3,467	2,893	6,175	5,343	4,771	6,791	6,244
Privatization	31	31	79	0	0	0	0	0	39
FDI	1,568	2,548	3,388	2,893	6,175	5,343	4,771	6,791	6,205
Portfolio (net)	-377	79	-1,540	-1,717	-1,656	261	-2,975	1,640	296
Short-term assets (flow)	163	-434	-1,276	21	470	-1,256	1,209	262	-2,117
Of which: Errors and omissions	151	238	-877	0	-314	-572	0	0	0
Debt financing from private creditors	4,753	5,513	3,790	6,256	9,277	12,002	5,978	9,625	7,164
Medium- and long-term financing	2,021	2,328	834	3,393	5,230	7,210	1,930	3,666	1,204
To public sector 3/	1,295	1,682	125	2,690	3,333	3,440	1,277	866	554
To private sector	726	647	709	703	1,896	3,771	654	2,800	650
Short-term financing	2,732	3,185	2,956	2,863	4,047	4,792	4,047	5,960	5,960
Official creditors 4/	1,240	974	623	999	946	1,148	1,186	1,308	1,231
Multilateral 1/	1,049	762	499	725	780	1,005	938	1,018	822
Of which: Balance of payments financing	863	581	315	404	604	854	541	691	462
Bilateral	191	212	123	274	167	143	248	290	409
To public sector	191	212	123	274	167	143	248	290	409
To private sector	0	0	0	0	0	0	0	0	0
Other medium- and long-term public sector flows 5/	-131	-278	-98	-15	-39	-83	-58	-58	-74
IMF	0	0	0	0	0	0	0	0	0
Accumulation of arrears (exceptional)	0	0	0	0	0	0	0	0	0

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

1/ Excluding IMF.
2/ Original maturity of less than one year. Equals stock at the end of the previous period.
3/ Based on projections of no placements in external markets over the program period. Projections exclude possible external issuance for debt prepayments.
4/ Includes both loans and grants. Breakdown not available as of 2008.
5/ 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

		Prel.	Proj.					
	2006	2007	2008	2009	2010	2011	2012	2013
	(Annual percentage change)							
GDP at constant prices	7.6	9.0	8.2	6.5	5.5	5.5	5.5	5.5
Consumer prices (end of period)	1.1	3.9	4.3	2.8	1.8	2.0	2.0	2.0
GDP deflator	8.1	2.6	3.7	1.6	0.3	1.0	1.0	1.6
Merchandise trade								
Exports, f.o.b.	37.0	17.5	18.5	3.5	2.5	7.4	5.1	4.6
Imports, f.o.b.	23.0	31.8	35.0	11.7	7.9	8.0	6.8	6.4
Terms of trade (deterioration -)	28.3	6.7	-1.8	-5.8	-7.2	-3.7	0.0	-1.3
(In percent of GDP; unless otherwise indicated)								
External current account balance	3.0	1.4	-0.6	-0.7	-0.7	-0.9	-1.1	-1.3
External current account, excluding interest obligations	5.0	3.3	0.8	0.5	0.7	0.4	0.0	-0.3
Total external debt service	3.9	7.7	4.6	2.3	2.7	2.6	3.1	2.2
Medium- and long-term	3.7	7.5	4.5	2.1	2.5	2.4	3.0	2.1
Nonfinancial public sector	2.7	6.5	3.4	1.3	1.8	1.7	2.3	1.4
Private sector	0.9	1.0	1.1	0.8	0.8	0.7	0.7	0.6
Short-term 1/	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1
External debt service 2/	3.9	7.7	4.7	2.3	2.7	2.6	3.1	2.2
Interest	2.0	1.9	1.4	1.3	1.4	1.3	1.1	1.0
Amortization (medium-and long-term)	1.9	5.8	3.2	1.0	1.3	1.3	2.0	1.2
Combined public sector primary balance 3/	3.9	4.0	3.9	2.6	1.9	2.0	1.9	1.9
General government revenue	19.8	20.4	20.4	19.2	20.3	20.5	20.7	20.9
General govt. non-interest expenditure 3/	16.1	15.7	16.0	16.2	18.3	18.5	18.7	18.9
Combined public sector interest due	1.9	1.8	1.5	1.3	1.3	1.3	1.2	1.1
Combined public sector overall balance 3/	2.1	2.2	2.4	1.2	0.6	0.7	0.8	0.8
Public sector debt 3/	32.8	30.4	22.0	19.0	17.4	15.6	13.9	12.1
Gross domestic investment	20.0	23.0	25.8	27.7	28.4	28.2	28.4	28.7
Public sector 3/	2.8	3.1	4.1	4.9	5.0	5.0	5.1	4.6
Private sector	16.3	18.4	20.8	22.1	23.2	23.5	23.7	24.2
Inventories changes	0.9	1.5	0.9	0.7	0.2	-0.3	-0.3	0.0
National savings	23.0	24.8	25.2	27.0	27.7	27.3	27.3	27.4
Public sector 4/	5.1	6.5	7.2	6.4	6.6	6.6	6.7	6.7
Private sector	17.9	18.3	18.0	20.5	21.2	20.8	20.7	20.7
External savings	-3.0	-1.4	0.6	0.7	0.7	0.9	1.1	1.3
Memorandum items								
Nominal GDP (billions of Nuevos Soles)	305.2	341.2	382.9	414.3	438.4	467.1	497.7	533.5
Gross international reserves (billions of U.S. dollars)	17,329	27,743	37,243	41,243	45,043	48,643	52,043	55,243
Gross international reserves to broad money	75.3	92.8	99.1	98.7	100.0	102.7	105.9	109.4
External debt service (percent of exports of GNFS)	13.8	26.9	17.5	9.4	11.6	11.0	13.6	9.8
Short-term external debt service (percent of exports of GNFS)	0.8	0.9	0.6	0.7	0.7	0.6	0.6	0.6
Public external debt service (percent of exports of GNFS)	9.6	22.6	12.8	5.3	7.6	7.2	10.0	6.4

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

1/ Includes interest payments only.
2/ Includes the financial public sector.
3/ Includes CRPAOs.
4/ Excludes privatization receipts.

Table 12. Peru: Financial and External Vulnerability Indicators

(In percent; unless otherwise indicated)

				Prog. CR/07/241	Proj. CR/08/28	Prel.	Prog. CR/08/28	Proj.	
	2004	2005	2006	2007			2008	2008	2009
Financial indicators									
Public sector debt/GDP	44.3	37.7	32.8	30.0	29.2	30.4	26.2	22.0	19.0
Of which: in domestic currency (percent of GDP)	6.9	8.2	8.0	7.4	8.0	7.4	7.5	8.0	7.5
90-day prime lending rate, domestic currency (end of period)	3.8	4.4	5.2	...	...	5.6	...	...	...
90-day prime lending rate, foreign currency (end of period)	2.6	5.5	6.1	...	...	6.4	...	...	...
Velocity of money 1/	4.2	3.9	4.1	3.9	3.7	3.8	3.6	3.7	3.6
Net credit to the private sector/GDP 2/	27.0	28.6	28.4	30.0	31.2	32.6	31.9	33.5	34.2
External indicators									
Exports, U.S. dollars (percent change)	40.9	35.6	37.0	9.4	17.6	17.5	7.9	18.5	3.5
Imports, U.S. dollars (percent change)	19.5	23.2	23.0	20.2	28.9	31.8	21.1	35.0	11.7
Terms of trade (percent change) (deterioration -)	9.2	5.9	28.3	-0.6	3.9	6.7	-4.8	-1.8	-5.8
Real effective exchange rate, (end of period, percent change) 3/	-1.6	-0.5	-1.3	...	...	-0.6	...	...	...
Current account balance (percent of GDP)	0.0	1.4	3.0	0.9	1.3	1.4	-0.5	-0.6	-0.7
Capital and financial account balance (percent of GDP)	3.1	0.2	0.9	2.9	6.1	7.9	3.1	7.4	3.2
Total external debt (percent of GDP)	44.8	36.1	30.5	28.1	29.0	29.9	25.8	25.1	22.4
Medium- and long-term public debt (in percent of GDP) 4/	35.1	28.0	23.8	21.6	19.5	19.6	17.6	14.8	13.3
Medium- and long-term private debt (in percent of GDP)	5.7	4.0	3.6	3.7	5.7	5.9	4.9	6.1	5.3
Short-term public and private debt (in percent of GDP)	4.0	4.0	3.2	2.8	3.8	4.4	3.3	4.3	3.8
Total external debt (in percent of exports of goods and services) 4/	212.2	145.8	107.4	101.6	100.7	104.3	96.2	94.5	93.2
Total debt service (in percent of exports of goods and services) 5/	26.1	35.0	13.8	20.6	25.9	26.9	12.8	17.5	9.4
Gross official reserves									
In millions of U.S. dollars	12,649	14,120	17,329	21,329	25,429	27,743	28,679	37,243	41,243
In percent of short-term external debt 6/	163.9	311.4	182.4	336.9	500.1	373.9	489.1	582.4	503.9
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	74.7	89.6	82.8	118.9	145.4	133.9	145.8	181.8	170.7
In percent of broad money 8/	72.7	71.6	75.3	81.1	86.2	92.8	83.2	99.1	98.7
In percent of foreign currency deposits at banks	137.3	125.9	151.7	167.0	204.9	208.5	207.7	264.4	258.2
In months of next year's imports of goods and services	10.0	9.3	8.7	8.5	11.0	10.5	11.3	12.5	12.9
Net international reserves (in millions of U.S. dollars)	12,631	14,097	17,275	21,275	25,375	27,689	28,625	37,189	41,189
Net international reserves (program definition; in millions of U.S. dollars) 9/	9,304	9,748	13,963	13,331	21,119	23,292	...	31,283	...
Net foreign exchange position (in millions of U.S. dollars) 10/	6,936	8,564	11,317	15,086	19,186	20,970	22,436	30,470	34,470

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

1/ Defined as the inverse of the ratio of end-period broad money to annual GDP.

2/ Corresponds to the financial system.

3/ End of period. Source: Information Notice System, IMF.

4/ Includes Central Reserve Bank of Peru debt.

5/ Includes debt service to the Fund. For 2002, excludes US$923 million of Brady bonds that were amortized in a debt exchange operation.

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

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

8/ At end-period exchange rate.

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

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

Table 13. Peru: Proposed Schedule of Purchases Under the Stand-By Arrangement, 2008–09 1/

Amount of Purchase	Availability Date	Conditions Include
1. SDR 159.6 million 2/	January 26, 2007	Board approval of SBA.
2. SDR 1.596 million	June 27, 2007	Completion of the First Review and observance of end-March 2007 performance criteria.
3. SDR 1.596 million	August 15, 2007	Observance of end-June 2007 performance criteria.
4. SDR 1.596 million	December 19, 2007	Completion of the Second Review and observance of end-September 2007 performance criteria.
5. SDR 1.596 million	February 15, 2008	Observance of end-December 2007 performance criteria.
6. SDR 1.596 million	July 7, 2008	Completion of the Third Review and observance of end-June 2008 performance criteria.
7. SDR 1.596 million	August 15, 2008	Observance of end-June 2008 performance criteria.
8. SDR 1.596 million	November 15, 2008	Completion of the Fourth Review and observance end-September 2008 performance criteria.
9. SDR 1.596 million	February 15, 2009	Observance of end-December 2008 performance criteria.

1/ Total access under the Stand-By Arrangement is SDR 172.368 million (27 percent of quota).

2/ This amount is required to exhaust the first credit tranche which is not subject to phasing.

Table 14. Peru: Capacity to Repay the Fund as of May 31, 2008 1/
(In millions of SDRs; unless otherwise indicated)

	Jun-Dec 2008	2009	2010	2011	2012	2013	2014	Total
Obligations from existing drawings								
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest								
GRA charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
SDR charges	1.3	2.5	2.5	2.5	2.5	2.5	2.5	16.3
Credit outstanding	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
(percent of quota)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
Obligations from prospective drawings								
Principal (repurchases)	0.0	0.0	60.5	83.2	25.5	3.0	0.2	172.4
Charges and interest 2/								
GRA charges	6.8	7.0	6.4	3.3	0.5	0.1	0.0	24.0
Service charge	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit outstanding	170.8	172.4	111.9	28.7	3.2	0.2	0.0	...
(percent of quota)	26.8	27.0	17.5	4.5	0.5	0.0	0.0	...
Cumulative (existing and prospective)								
Principal (repurchases)	0.0	0.0	60.5	83.2	25.5	3.0	0.2	172.4
Charges and interest 2/								
GRA charges	6.8	7.0	6.4	3.3	0.5	0.1	0.0	24.0
SDR and Service charges	1.3	2.5	2.5	2.5	2.5	2.5	2.5	16.4
Credit outstanding	20.2	172.4	20.6	20.3	3.2	0.2	0.0	...
Percent of quota	3.2	27.0	3.2	3.2	0.5	0.0	0.0	...
Percent of GDP	0.0	0.2	0.0	0.0	0.0	0.0	0.0	...
Percent of exports of goods and services	0.1	0.7	0.1	0.1	0.0	0.0	0.0	...
Percent of public sector debt service	0.5	7.8	0.9	0.8	0.1	0.0	0.0	...
Percent of external public debt	0.1	1.2	0.2	0.1	0.0	0.0	0.0	...
Percent of external public debt service	0.6	11.5	1.1	1.0	0.1	0.0	0.0	...
Percent of gross foreign reserves	0.1	0.6	0.1	0.1	0.0	0.0	0.0	...
Memorandum item								
Purchases	170.8	1.6	0.0	0.0	0.0	0.0	0.0	172.4

Sources: Fund staff estimates/projections.

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

ANNEX 1. PERU—LETTER OF INTENT

Lima, Peru
June 23, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

1. The Peruvian economy has continued to perform remarkably well. In 2007, real GDP grew by 9 percent—a 13-year-high—formal employment rose by 8 percent, and the poverty rate declined to 39 percent. The nonfinancial public sector posted a surplus of 3.1 percent of GDP, and our prudent fiscal policy and debt management strategy have helped bring public debt down to 29.1 percent of GDP. The Central Reserve Bank of Peru continued to strengthen its net international reserves, which reached $27.7 billion, with the sovereign shifting to a net creditor position. Such strong economic performance has helped Peru achieve investment grade status—a testimony to the prudent policies and reform efforts over the past several years. Notwithstanding the heightened risks in the global economy, we remain confident that the Peruvian economy will continue to perform solidly in the coming years.

2. In line with global developments, inflation rose to 5½ percent in March, driven by the significant increase in international food prices, to subsequently ease to 5.39 percent in May. The Central Reserve Bank of Peru has tightened monetary conditions markedly, raising interest rates by 125 basis points and reserve requirements, to avoid that imported inflation propagates through expectations to the rest of prices in the economy, which have risen by 2 percent over the past twelve months, once food items are excluded. Based on this and the reversal of some of these external shocks, we expect inflation to return gradually to within the official target range of 1-3 percent by mid-2009. All other quantitative performance criteria of the program for end-December 2007 and end-March 2008 were observed.

3. To guard against the impact of a potential decline in the terms of trade and a possible global recession, the Central Reserve Bank of Peru has accumulated $6.4 billion of international reserves during the first quarter of 2008, well-above the program target.

4. To support macroeconomic stability, the fiscal target for the nonfinancial public sector has been raised to a surplus of 2 percent of GDP (from balance envisaged in the 2008 Budget), and incorporated into the Fund-supported program. While ensuring that social and infrastructure needs are met, the government will continue with its prudent fiscal strategy.

5. Further strengthening the poverty alleviation strategy remains a top priority for the government. The CIAS has continued to expand significantly the coverage of the social strategy *Crecer* and the cash-conditional program *Juntos*, both focused in rural areas. To continue strengthening the coverage and effectiveness of our social programs, the CIAS will begin undertaking an assessment review of *Juntos*, with technical collaboration from the Interamerican Development Bank.

6. Considerable progress has also been made in advancing the structural reform agenda. A Public-Private Partnership framework law was issued to improve the allocation of risk between private and public participants in PPP projects. *MiVivienda* no longer issues guarantees for foreign currency denominated mortgage loans. The reform of the National System of Public Investment (SNIP) to allow for the outsourcing of studies required for the formulation and approval of investment projects has been submitted to Congress (an end-March structural benchmark) and is expected to be approved soon. Specific measures related to capital market reforms are being implemented, such as the increase in the limit for foreign investment abroad by pension funds and the amendment to the General Banking Law, which allows the Superintendency of Banks (SBS) the introduction of Basel II capital requirements for market risks, both end-June 2008 structural benchmarks.

7. The Government believes that the policies set forth in this letter, as well as in our previous letters of January 3, 2007, June 12, 2007, and December 5, 2007, are adequate to achieve the objectives of the program, but stands ready to take any further measures that may become appropriate or needed for this purpose. In light of this, we hereby request the completion of the Third Review under the Stand-By Arrangement. We will maintain a close and proactive dialogue with the Fund, in accordance with Fund policies on such matters.

Sincerely yours,

/s/	/s/
Luis Carranza	Julio Velarde
Minister of Economy and Finance	President Central Reserve Bank of Peru

Table 1. Peru: Quantitative Performance Criteria and Inflation Consultation Mechanism for 2008

	Mar. 31	Jun. 30	Sept. 30	Dec. 31
(Cumulative amounts from December 31, 2007, millions of New Soles)				
Borrowing requirement of the combined public sector				
Unadjusted limits 1/ 2/ 3/ 4/	-2,036	-5,555	-6,302	-7,350
(Cumulative amounts from December 31, 2007, millions of U.S. dollars)				
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions				
Unadjusted targets 5/ 6/	-645	-404	-437	0
Outstanding short-term external debt of the nonfinancial public sector				
Limits	50	50	50	50
Contracting or guaranteeing of nonconcessional public debt with maturity of at least one year				
Unadjusted limits 7/ 8/ 9/	1,568	1,673	2,354	2,680
Of which: **external debt of 1-5 year maturity**				
Limits	100	100	100	100
External payments arrears of the public sector (on a continuous basis)				
Limits	0	0	0	0
NPV of future government payments associated with PPP operations (on a continuous basis)				
Unadjusted Limits 10/	1,860	1,860	1,860	1,860
(Consultation bands for the 12-month rate of inflation, in percent) 11/				
Outer band (upper limit)	5.0	5.0	5.0	5.0
Inner band (upper limit)	4.0	4.0	4.0	4.0
Central point	2.0	2.0	2.0	2.0
Inner band (lower limit)	0.0	0.0	0.0	0.0
Outer band (lower limit)	-0.5	-0.5	-0.5	-0.5

Sources: Staff estimations.

1/ PIPP proceeds are included below the line.

2/ The limit on the borrowing requirement of the combined public sector will be adjusted for the operating balance of the BCRP.

3/ The limit on the borrowing requirement of the combined public sector will be adjusted upward by up to US$100 million for capital spending by Petroperu, over the $30 million already included in the program.

4/ In 2008, the limit on the borrowing requirement of the combined public sector will be adjusted downwards by the amount of central government revenues net of mandatory transfers exceed program estimates of S/. 12,767 million at end-March, up to a ceiling of S/. 450 million; S/. 26,493 million at end-June, up to a ceiling of S/. 900 million. No adjustors will be applied to the end-September 2008 nor to the end-December 2008 targets.

5/ The target for net international reserves will be adjusted upward by the amount by which net foreign borrowing of the nonfinancial public sector exceeds '-US$600 million at end-March, -US$394 million at end-June, -US$497 million at end-September, and -US$41 million at end-December 2008. It will be adjusted downward for shortfalls from programmed net foreign borrowing. The amounts in excess will be deposited at the BCRP.

6/ The target for net international reserves will be adjusted downward for withdrawals for portfolio management purposes of deposits held at the Central Reserve Bank by the Consolidated Pension Reserve Fund (FCR) and any other funds managed by the ONP. This downward adjustment will not exceed US$300 million at any time in 2008.

7/ The limit will be adjusted upward by any amount of debt issued, and used in, debt-exchange operations, or for prefinancing of government operations.

8/ The current debt limits do not include contracting of non-guaranteed debt by Petroperu and will be adjusted upward by up to US$300 million for debt contracted by Petroperu during 2008.

9/ The limit on contracting and guaranteeing of nonconcessional public debt will be adjusted upwards for guarantees contracted or extended by the government in relation to concessions, up to a ceiling of US$293 million for the year as a whole.

10/ Discount rates to calculate the NPV of the future stream of payments will be the currency-specific commercial interest reference rates (CIRRs) published by the OECD and specified in the TMU.

11/ 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.

ANNEX 2. PERU: TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

1. This technical memorandum sets out the understandings between the Peruvian authorities and the Fund relating to the monitoring of the program for 2008. It defines the concepts used to assess compliance with quantitative performance criteria specified in the letter of the Government of Peru dated June 23, 2008. It also sets the frequency of the data to be provided to the Fund for monitoring the program. For purposes of the program for 2008, operations in foreign currency will be converted into *Nuevos Soles* at the average program exchange rate of S/. 2.90 per U.S. dollar.

I. DEFINITIONS OF CONCEPTS

2. The nonfinancial public sector (**NFPS)** includes the central government, the autonomous agencies, the local and regional governments, and the nonfinancial public enterprises.

3. **The borrowing requirement of the combined public sector (PSBR)** will be measured as: (a) net domestic financing of the NFPS; plus (b) net external financing of the NFPS; plus (c) proceeds from the Private Investment Promotion Program (PIPP); and less (d) the operating balance of the Central Reserve Bank of Peru (BCRP). The PSBR will be adjusted to exclude the impact of data revisions that do not represent a change of its flows during 2008. The components of the PSBR (see Table 1), will be defined and measured as follows:

(a) **The net domestic financing of the NFPS** is defined as the *sum* of: (i) the increase in net claims of the domestic **financial system**[1] on the NFPS, excluding Peruvian Brady bonds and other government bonds initially sold abroad; (ii) the net increase in the amount of public sector bonds[2] held outside the domestic financial system and the NFPS, excluding Peruvian Brady bonds and other bonds initially sold abroad; and (iii) the increase in the floating debt of the NFPS due to expenditure operations and tax refund arrears; *less* (iv) the accumulation of stocks, bonds, or other domestic financial assets by the NFPS and (v) the amortization of pension related bonds. In the case of enterprises that are divested after December 31, 2007, the net credit of the financial system to these enterprises will be recorded, for the remainder of the program period, as unchanged from their level at the time of the PIPP.

(b) **The net external financing of the NFPS** comprises (i) disbursements of loans; plus (ii) receipts from the issuance of government bonds abroad; minus (iii) cash payments of

[1] The financial system comprises the banking system, the Corporación Financiera de Desarrollo (COFIDE), *MiVivienda* and all other nonbank financial intermediaries. The banking system includes the BCRP, the commercial banks, *Banco de la Nación* (BN), and *AgroBanco*.

[2] Excluding the new issuances of pension-related bonds.

principal (current maturities of both loans and bonds); minus (iv) cash payments of arrears (principal and interest); plus/minus (v) the net increase/decrease in short-term external debt; minus (vi) debt buy-backs or other prepayments of debt (at market value) not included in the following item (including repayments of short-term external debt assumed by the government at the time of the divestiture of public enterprises, net of the proceeds from the sale of inventories of such enterprises); minus (vii) debt-equity swaps used in the PIPP accounted at the market value of these papers as defined by *ProInversion*; minus/plus (viii) the net increase/decrease in foreign assets of the nonfinancial public sector (including those held abroad by the *Fondo Consolidado de Reservas* (FCR), and any other fund managed by the *Oficina de Normalización Previsional* (ONP)) (see Table 2).

(c) **PIPP proceeds** are defined as (i) the cash payments received by the Treasury from the sale of state-owned assets (including proceeds transferred to the FCR, and any other specialized funds) valued at the program exchange rate, plus (ii) debt equity swaps used in the PIPP, accounted at market values as defined by *ProInversion*. PIPP proceeds also include up-front payments received by the Treasury for the granting of concessions for public services but exclude the annual payments under the concession program, which are part of nontax revenue.

(d) **The operating balance of the BCRP** includes: (i) cash interest earnings of the BCRP minus cash interest payments by the BCRP, in both domestic and foreign currency; (ii) the administrative expenses of the BCRP; and (iii) any realized cash losses or gains from activities in currencies, financial instruments, and derivatives.

4. **The quarterly limits on the borrowing requirement of the combined public sector (PSBR)** will be reduced by the amount to which revenues of the central government net of mandatory transfers exceed program estimates of S/.12,767 million at end-March, up to a ceiling of S/. 450 million; and S/. 26,493 million at end-June, up to a ceiling of S/. 900 million. No revenue adjustor will be applied to the quarterly limits on the PSBR when assessing the end-September and end-December performance criteria. Mandatory transfers are earmarked central government expenditures that are linked to revenue. These comprise the *canon and sobrecanon*, *fondo de Camisea, regalía minera, renta de aduanas,* and the *Impuesto de Promoción Municipal (IPM).*

5. **The consultation bands for inflation** are based on the 12-month rate of change in consumer prices as measured by the *Indice de Precios al Consumidor (IPC)* at the level of Metropolitan Lima by the *Instituto Nacional de Estadística e Informática* (INEI). Should inflation fall outside an inner band of 2 percentage points around the central point of 2 percent, the authorities will discuss with the Fund staff on an appropriate policy response. Should inflation fall outside an outer band of 3 percentage points above and 2.5 percentage points below the central point of 2 percent, the authorities will discuss with Fund staff an appropriate policy response, and complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the program.

6. **The net consumer lending of the *Banco de la Nación*** will be defined as disbursements of all consumer loans, including these under the "*Multired Program*" (established in November 2001), including *Multired Maestro*, *Multired Policia* and *Multired Pensionistas ONP*, and "*Prestamos a 60 Quotas*" (established in September 2004) less cash amortizations under the loan programs. Interest payments on these loans are excluded from the definition of net lending.

7. **The net international reserves of the BCRP, excluding foreign-currency deposits of financial institutions,** are defined for the purpose of the program as: (a) the foreign assets of the BCRP (excluding subscriptions to the IMF and the Latin American Reserve Fund (FLAR), *Pesos Andinos*, credit lines to other central banks, *Corporación Andina de Fomento* (CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations); less (b) reserve liabilities, defined as the sum of: (i) the BCRP's external liabilities with an original maturity of less than one year, and (ii) its liabilities to the IMF, to the Inter-American Development Bank (IADB) and to the FLAR; less (c) deposits in foreign currency by the banking system, other financial intermediaries and the private sector, net of repos of Treasury bonds with the financial system.

8. **BCRP's silver holdings** will be included as net domestic assets and excluded from the net international reserves.

9. **BCRP's gold holdings** will be accounted at US$646.89 per troy ounce (the average book value as of June 30, 2007), SDRs at US$1.514 per SDR. Foreign currency assets and liabilities of the BCRP in other currencies than US$ will be valued at the exchange rate of June 30, 2007. Net international reserves will be adjusted to exclude any valuation gains or losses resulting from net sales or deliveries of gold by the BCRP. The end-June 2007 level of net international reserves is shown in Table 3.

10. The flows of the **short-term external debt of the NFPS** are defined as the net change in the NFPS's outstanding external indebtedness with a maturity of less than one year (including instruments with put options that would be triggered within one year of the contracting date), measured, in part, on the basis of the operations of a selected sample of public enterprises comprising *Petroperú* and *Electroperú*. These limits exclude normal import financing but include forward commodity sales. In the case of companies sold to the private sector under the PIPP, the short-term debt of these entities will be recorded, for the remainder of the program period, as unchanged from their level at the time of the PIPP. The end-June 2007 stock of short-term external debt of the NFPS is shown in Table 4.

11. **The contracting or guaranteeing of nonconcessional public debt with a maturity of at least one year** refers to all domestic and external obligations of the NFPS contracted or guaranteed by the government, COFIDE, the BCRP, the BN, and any other public financial entity, except for loans classified as reserve liabilities of the BCRP. The program limits on nonconcessional debt will exclude: (i) any new loans extended in the context of a debt

rescheduling or debt reduction operation; (ii) any loans on concessional terms; and (iii) certificates (CDBCRPs and CDBCRP-NRs) issued by the BCRP for conducting monetary policy. The program limits will be adjusted upward by up to US$300 million for debt contracted by *Petroperu* during 2008 that is not guaranteed by the central government.

12. **For the purpose of the performance criterion on the contracting or guaranteeing of public debt,** external public debt applies also to commitments contracted or guaranteed for which value has not been received. In this regard, the term "debt" has the meaning set forth in point No.9 of the Guidelines on Performance Criteria with respect to Foreign Debt adopted on August 24, 2000 (Board Decision No. 12274-(00/85)). Thus, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time: these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property; (iv) PAO Entitlement Recognition Certificates (CRPAOs) used to facilitate the financing of Public-Private Partnership (PPP) projects by concessionaires.[3] For the purpose of the performance criterion, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt. Foreign currency public debt to be contracted or guaranteed will be converted based on the program exchange rate, with cross rates for non-dollar foreign currencies set based upon the rate on the day of the transaction, published by REUTERS.

[3] Under Peruvian law, the CRPAOs are not treated as sovereign debt.

13. For program purposes, **a debt is concessional** if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., grant element) is equal to nominal value minus NPV divided by nominal value. The NPV of debt at the time of its disbursement is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the OECD. For debt with a maturity of at least 15 years, the ten-year average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. For the purposes of the program through end-December 2008, the CIRRs published by the OECD in August 2007 will be used (Table 5).

14. **The concessionality of loans in currency baskets** will be assessed on the basis of U.S. dollar interest rate tables. For loans with interest rates based on the internal policy of the creditors, the relevant interest rate to define concessionality will be the interest rate for each creditor at the time of the commitment. Loans or portions of loans extended in the context of a debt rescheduling or a debt reduction operation will be excluded from the ceiling.

15. **The NPV of the future government payments associated with PPP operations** will include all payments, firm and contingent, committed by the government in relation to new PPP projects signed during the program period. Specifically, such payments will include, *inter alia*, annual payments for the coverage of the investment made by the concessionaire (*Pagos Anuales por Obra*, or PAOs); annual payments for the maintenance and operation of the project (*Pagos Anuales por Mantenimiento y Operación* or PAMOs); and the minimum annual revenues guaranteed to a concessionaire by the government (*Ingresos Minimos Anuales Garantizados*, or IMAGs). For those projects where the government's payment commitments have yet to be defined in terms of PAOs and PAMOs, the target also includes the estimated aggregate annual payments for the project (*Pagos Anuales por Servicio*, or PAS). The discount factor used in the calculation of the NPV of the payments will be the 10-year commercial interest reference rate (CIRR). For purposes of the program through end-December 2008, the CIRRs published by the OECD in August 2007 will be used (Table 5).

16. **The external payments arrears of the public sector** include arrears to multilateral financial institutions, to Paris Club creditors, and to other foreign creditors with whom debt restructuring agreements have been concluded. They exclude arrears outstanding at end-2007 that were not covered under restructuring agreements. The public sector will be defined to include the NFPS, COFIDE, the BCRP, the BN, and any other state development bank.

17. **Definitions used in Table 1 of the letter of intent dated [June x, 2008] for the calculation of adjusters, limits and targets for net international reserves:**

a. **Net foreign borrowing** (Table 2) is defined as the sum of disbursements of loans (I.2.b.i); plus receipts from the issuance of government bonds abroad (I.2.b.ii); minus cash payments of principal (I.2.b.iii); minus cash payments of arrears (principal and interest) (I..b.iv); plus/minus the net increase/decrease in short-term external debt (I.2.b.v).

b. **The withdrawals for portfolio management purposes** of deposits held at the BCRP by the FCR and any other fund managed by the ONP, mentioned in footnote 6 of Table 1 attached to the letter of intent dated June 23, 2008 refer to placements of funds that are in accord with an investment plan approved by the Board of the FCR, excluding deposits in public financial institutions and government securities.

II. Periodic Reporting

18. Periodic reporting includes:

(a) The latest *Nota Semanal* published by the BCRP;
(b) Report of BCRP daily operations;
(c) Daily exchange rate statistics.
(d) Monthly Report of:

(i) **Performance criteria**
Data on the program's quarterly quantitative performance criteria.

(ii) **Financial sector**
(a) Disaggregation of the net domestic assets of the BCRP and BN with details of the other net accounts.
(b) Evolution of gross disbursements and cash amortizations of consumer loans under the *"Multired Program"* of *Banco de la Nación*.

(iii) **Fiscal sector**
(a) PSBR as defined in Table 1.
(b) List of domestic and external debt instruments contracted or guaranteed by the public sector, including data on the amount, lender, grace period, maturity, and interest rate (refinancing credits should be labeled as such), collateral guarantees, any instrument enhancements (such as but not limited to put or call options) that affect the price or maturity of the debt instrument.
(c) Summary of disbursements and interest and amortization due and paid (identifying the payments of arrears) of loans included in the records of the General Directorate of Public Credit by creditor and debtor, indicating foreign origin (distinguishing between financial and nonfinancial public sector debt) and domestic origin (Table 6).
(d) Cash operations of the treasury (which includes floating debt, with a memorandum item on tax refund arrears).

(e) Data on PIPP revenue, which will include gross receipts, costs of the PIPP, use of debt-for-equity swaps, commissions received by *ProInversion* and the resulting cash receipts received by the Treasury and the FCR. In addition, the report will include debts assumed by the government in connection with the PIPP.

(f) Stocks of the central government PIPP accounts in the BCRP and the BN.

(iv) **External sector**

(a) Summary of imports by products (volume and prices); and

(b) Summary of exports by products (volume and price).

(d) **Quarterly data on the breakdown of public sector debt,** distinguishing between external and domestic total public sector debt by currency composition and instruments, according to the debt definition of the *Marco Macroeconomico Multianual* (MMM), and including CRPAOs.

(f) **Other**

(a) Summary of legislative changes pertaining to economic matters.

(b) BCRP circulars.

(c) BCRP inflation report.

Table 1 Peru: Public Sector Borrowing Requirement 2007-08
(In million of Nuevos Soles)

	Stock as of Dec. 31 2006 1/	Stock as of Dec.31 2007 1/	Flow Jan-Dec	Stock as of Dec. 31 2007 2/	Stock as of Mar.31 2008 2/	Flow Jan-Mar
a. Net domestic financing of the nonfinancial public sector	**21**	**-6 019**	**-6 040**	**-4 427**	**-3 466**	**961**
i. Net claims of the financial system (1+2+3)	-10 843	-18 764	-7 921	-17 366	-17 451	- 84
1. Net credit of the banking system on the NFPS, COFIDE and MiVivie	-21 587	-35 745	-14 158	-34 117	-32 907	1 210
Credits	5 281	5 321	40	5 314	4 609	- 705
Liabilities	26 868	41 066	14 198	39 431	37 516	-1 915
2. Net credit of COFIDE and MiVivienda on the banking system	3 145	3 660	515	3 433	3 626	193
Credits	3 293	3 906	613	3 679	3 945	266
Liabilities	148	246	98	246	319	72
3. Net credit of nonbanking financial institutions on the NFPS	7 599	13 322	5 723	13 318	11 831	-1 487
Credits	8 194	13 909	5 715	13 893	12 422	-1 471
Liabilities	595	588	- 8	575	592	17
ii. Stock of NFPS bonds in circulation	10 766	11 725	958	11 725	14 389	2 664
(excluding bonds held by NFPS and of the financial system)						
1. Total	21 945	31 296	9 351	31 230	31 640	410
2. Less: holdings of the financial system (including COFIDE and MiVivi	10 816	19 031	8 215	18 976	16 634	-2 342
3. Less: holdings of nonfinancial public sector entities	363	540	178	529	618	88
iii. Floating debt	3 695	4 813	1 118	4 813	3 124	-1 689
iv. Less: Accumulation of stocks, bonds, or other domestic financial assets by the NFPS	2 517	2 606	89	2 412	2 342	- 71
v. Less: Issuance of pension recognition bonds in program period	1 080	1 187	107	1 187	1 187	0
b. Net external financing			**-6 966**			**-4 119**
(Millions of US dollars)			-$ 2,150			-$ 1,420
c. Privatization			**462**			**22**
(Millions of US dollars)			$ 143			$ 8
d. Operating balance of the BCRP			**632**			**-86**
PSBR (a+b+c-d)			**-13 176**			**-3 050**

1/ Foreign currency valued at US$ 1 = S/. 3,24
2/ Foreign currency valued at US$ 1 = S/. 2,90

Table 2 Peru: Public External Debt 1/
Net External Financing N.F.P.S. 2007-08
(In millions of dollars)

	2007								2008			
	Jan - Mar		Jan - Jun		Jan - Sep		Jan - Dec		Jan-Mar	Jan-Jun	Jan-Sep	Jan-Dec
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Prel.	Prog.	Prog.	Prog.	Prog.
i. Loan Disbursements	294	50	440	105	592	367	1,000	1,043	145	291	436	1140
-Projects	144	50	290	105	442	167	600	243	145	291	436	600
-Non Projects	150	0	150	0	150	200	400	800	0	0	0	540
ii. Bonds	0	2,290	0	2,290	0	2,290	0	2,290	0	290	290	290
iii. Cash payments on amortization	309	-2,747	578	-3,014	866	-3,289	1,148	-5,597	-745	-975	-1224	-1470
- Loans	252	-256	521	-523	753	-776	1,035	-1,029	-223	-453	-679	-926
- Bonds	56	-56	56	-56	113	-78	113	-78	-522	-522	-544	-544
- Prepayments		-2,435		-2,435		-2,435		-4,490				
iv. Cash payments to settle arrears	0	0	0	0	0	0	0	0	0	0	0	0
v. Change in short term debt (increase+)	0	23	0	-35	0	31	0	80	0	0	0	0
A. NET FOREIGN BORROWING (i+ii-iii-iv+v)	**-14**	**-385**	**-138**	**-654**	**-274**	**-601**	**-148**	**-2,184**	**-600**	**-394**	**-497**	**-41**
vi. Debt equity swaps	0	0	0	0	0	0	0	0	0	0	0	0
vii. Change in foreign assets held by the NFP	3	7	6	12	8	25	11	16	7	10	17	20
viii. Investment project under the PIPP 2/	**0**	**0**	0	2	0	46	0	51	0	0		
B. NET EXTERNAL FINANCING (A-vi-vii+viii)	**-17**	**-391**	**-143**	**-664**	**-282**	**580**	**-159**	**-2,150**	**-607**	**-404**	**-514**	**-61**

1/ Excludes balance of payments support loans to the Central Reserve Bank of Peru.
2/ Includes disbursements for the project "Yuncan" since April 2004.
Source: Central Reserve Bank of Peru

Table 3: Peru. Net International Reserves of the Central Reserve Bank of Peru excluding foreign currency deposits of financial institutions 1/
(In millions of US dollars)

		Stock as of:	
	30-Jun-07	**31-Dec-07**	**31-Mar-08**
a. **Assets**	**21,186**	**27,165**	**32,959**
Deposits abroad	8,060	9,568	11,115
Securities	12,378	16,834	21,085
Gold 2/	721	721	721
Holdings of SDR 3/	12	13	11
Reciprocal credit agreement	6	19	16
Cash	10	10	10
Others	0	0	0
b. **Liabilities**	**27**	**31**	**31**
Reciprocal credit agreement	0	4	3
Liabilities with international organizations	**26**	**28**	**28**
IMF 3/	0	1	1
IADB	26	27	28
FLAR	0	0	0
c. **Foreign currency deposits of financial institutions at the Central Bank**	**3,547**	**4,655**	**4,111**
Banking enterprises	3,395	4,396	3,669
Banco de la Nación	58	174	315
COFIDE	24	20	80
Financial enterprises	70	65	46
d. **Treasury bond repos**	**0**	**0**	**0**
e. **Swaps**	**0**	**0**	**0**
f. **Valuation US$/other currencies**	**0**	**249**	**547**
g. **Net international Reserves - Program definition (a-b-c+d-e-f)**	**17,612**	**22,229**	**28,270**
Memorandum items:			
1. Subscription to the IMF and FLAR	348	348	348
2. Pesos andinos	20	0	0
3. CAF bonds	0	0	0
4. Valuation change by BCRP's gold holdings	0	207	299
5. Valuation change by BCRP's SDR holdings	0	1	2
6. Net international reserves, official definition (g+c-d+e+f+1+2+3+4+5)	21,528	27,689	33,576

Source: Central Reserve Bank of Peru.

1/ As defined in the Technical Memorandum of Understanding
2/ Gold valued at US$ 646,88755
3/ Valued at US$ 1,51434 per SDR.

Table 4. Peru: Short term external debt owed by the Non-Financial Public Sector
(In millions of US$)

	Export Financing	Working Capital	Import Financing	Total
	As of end-June 2007			
Total	**0**	**0**	**99**	**99**
Petroperu	0	0	99	99
Electroperu	0	0	0	0
General government	0	0	0	0
	As of end-December 2007			
Total	**0**	**0**	**277**	**277**
Petroperu	0	0	277	277
Electroperu	0	0	0	0
General government	0	0	0	0
	As of end-March 2008			
Total	**0**	**0**	**379**	**379**
Petroperu	0	0	379	379
Electroperu	0	0	0	0
General government	0	0	0	0

Source: Central Reserve Bank of Peru and state companies.

Table 5. Peru: Commercial Interest Reference Rates (CIRRs)

Note: the latest six-month CIRRs averages are to be used for loans whose maturiry is less than 15 years. For all others use 10-year averages.

	Average CIRRs		Previous rates for loans with maturity =>15 years contracted in								
	Six-month	Ten-year	before 1999	1999	2000	2001	2002	2003	2004	2005	2006
	2/07-8/07	1/97-12/06 1/	1/86-12/95	1/89-12/98	1/90-12/99	1/91-12/00	1/92 - 12/01	1/93 - 12/02	1/94 - 12/03	1/95 - 12/04	1/96 - 12/05 1/
Australian Dollar	7.10%	6.61%	12.15%	10.15%	9.28%	8.55%	7.98%	7.68%	7.48%	7.24%	6.85%
Austrian Schiling 2/	n.a.	5.34%	8.35%	7.73%	7.65%	7.43%	6.72%	6.34%	6.03%	5.76%	5.45%
Belgian Franc 2/	n.a.	5.48%	9.25%	8.60%	8.45%	8.13%	7.21%	6.80%	6.44%	6.07%	5.68%
Canadian Dollar > 8.5 years	5.19%	5.95%	9.83%	8.90%	6.07%	6.78%	7.41%	7.34%	7.05%	6.69%	6.25%
Danish Krone	5.21%	5.41%	10.37%	8.88%	8.33%	7.80%	7.29%	6.81%	6.37%	6.09%	5.65%
Finnish Markkaa 2/	n.a.	5.36%	10.64%	9.32%	9.15%	8.72%	7.56%	6.92%	6.43%	6.02%	5.55%
French Franc 2/	n.a.	5.36%	9.62%	8.42%	8.19%	7.82%	6.95%	6.50%	6.16%	5.89%	5.51%
German Mark 2/	n.a.	5.34%	7.91%	7.62%	7.54%	7.27%	6.58%	6.23%	5.96%	5.73%	5.45%
Irish Punt 2/	n.a.	5.47%	10.37%	7.59%	8.36%	8.44%	7.44%	6.97%	6.50%	6.16%	5.70%
Italian Lira 2/	n.a.	5.43%	11.50%	10.38%	10.06%	9.71%	8.30%	7.61%	6.94%	6.47%	5.81%
Japanese Yen	2.46%	2.03%	5.53%	4.65%	4.30%	3.75%	3.17%	2.77%	2.45%	2.24%	2.08%
Korean Won	6.03%	8.32%	n.a.	n.a.	n.a.	11.57%	10.74%	10.19%	9.55%	9.04%	8.59%
Netherlands Guilder >8.5 year	n.a.	5.53%	8.08%	5.24%	5.81%	6.52%	6.95%	6.75%	6.43%	6.11%	5.74%
New Zealand dollar	7.70%	7.25%	12.17%	9.62%	8.90%	8.33%	7.97%	7.94%	7.80%	7.68%	7.46%
Norwegian Krone	5.80%	6.14%	11.27%	8.93%	8.36%	7.94%	7.60%	7.28%	7.04%	6.74%	6.36%
Spanish Peseta 2/	n.a.	5.47%	12.99%	11.35%	10.89%	10.31%	8.65%	7.92%	7.20%	6.65%	5.91%
Swedish Krona	5.06%	5.57%	11.67%	10.10%	9.42%	8.61%	8.04%	7.52%	7.08%	6.67%	5.98%
Swiss Franc	3.75%	3.83%	6.68%	3.78%	5.97%	5.67%	5.26%	4.85%	4.55%	4.31%	4.01%
U.K. Pound	6.19%	6.25%	10.37%	9.53%	8.99%	8.38%	7.85%	7.41%	7.16%	6.91%	6.53%
U.S. Dollar > 8.5 years	5.72%	5.93%	8.62%	7.93%	7.59%	7.35%	7.06%	6.85%	6.63%	6.36%	6.09%
Euro (ECU for ten-year avg)	5.17%	5.19%	8.56%	7.99%	7.82%	7.13%	6.79%	6.40%	6.07%	5.80%	5.39%
Memorandum:											
SDR 3/	5.22%	5.11%	8.22%	7.51%	7.21%	6.85%	6.49%	6.17%	5.90%	5.64%	5.33%

1/ Estimates based on actual CIRRs for 1/97 to 12/06.
2/ For the current 10-year averages, rates for Euro are used from 1/99.
3/ The 10-year SDR denominated CIRR rate was constructed based on the weighted average of the five 10-year CIRR averages for the underlying currencies. For details for six-month and ten-year SDR CIRR averages, please refer to "current CIRR_SDR" sheet in this workbook.

Previous six-month rates

Loans with maturity <15 years, contracted between:

		2/15/99 and **8/14/99**	8/15/99 and **2/14/00**	2/15/00 and **8/14/00**	8/15/00 anc **2/14/01**	2/15/01 an **8/14/01**	8/15/01 and **2/14/02**	2/15/02 and **8/14/02**	8/15/02 and **2/14/03**	2/15/03 and **8/14/03**	8/15/03 and **2/14/04**	2/15/04 and **8/14/04**	8/15/04 and **2/14/05**	2/15/05 and **8/14/05**	8/15/05 and **2/14/2006**	2/15/06 and **8/14/2006**	8/15/06 and **2/14/2007**	2/15/07 and **8/14/2007**
based on rates:	2/15 thru 8/14/98	8/15/98- 2/14/99	2/15 thru 8/14/99	8/15/99- 2/14/00	2/15 thru 8/14/00	8/15/00- 2/14/01	2/15 thru 8/14/01	8/15/01- 2/14/02	2/15 thru 8/14/03	8/15/02- 2/14/03	2/15/03- 8/14/03	8/15/03- 2/14/04	2/15/04 - 8/14/04	08/15/04- 2/14/05	2/15/05- 8/14/05	8/15/05- 2/14/2006	02/15/06- 8/14/2006	08/15/06- 2/14/2007
Australian Dollar	6.42%	6.01%	6.34%	7.20%	7.47%	6.99%	6.27%	6.18%	6.83%	6.23%	5.83%	6.45%	6.6%	6.34%	6.36%	6.24%	6.51%	6.83%
Austrian Schiling	5.59%	4.99%	n.a	n.a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Belgian Franc	5.99%	5.24%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Canadian Dollar > 8.5 years	6.27%	6.12%	6.20%	6.88%	7.26%	6.80%	6.24%	6.17%	6.21%	5.69%	5.50%	5.24%	5.0%	5.23%	4.85%	4.79%	5.22%	5.08%
Danish Krone	5.77%	5.44%	4.72%	5.71%	6.46%	6.55%	6.01%	5.66%	6.15%	5.48%	4.85%	5.02%	5.0%	4.75%	4.13%	3.99%	4.71%	4.76%
Finnish Markkaa	5.52%	5.04%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
French Franc	5.71%	5.03%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
German Mark	5.57%	4.86%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Irish Punt	5.69%	4.93%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Italian Lira	5.31%	5.22%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Japanese Yen	2.32%	2.28%	2.13%	2.05%	1.98%	2.02%	1.58%	1.55%	1.95%	1.64%	1.45%	1.92%	2.0%	2.08%	1.87%	2.05%	2.49%	2.49%
Korean Won	n.a.	n.a.	n.a.	10.51%	10.18%	8.85%	7.91%	7.42%	7.95%	7.00%	6.11%	5.94%	5.9%	4.80%	5.10%	5.94%	6.10%	5.82%
Netherlands Guilder >8.5 year	6.12%	5.43%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
New Zealand dollar	8.17%	6.76%	6.64%	7.74%	8.08%	7.57%	7.16%	7.10%	7.51%	7.00%	6.45%	6.36%	6.9%	7.10%	7.02%	6.87%	6.87%	7.19%
Norwegian Krone	6.11%	6.58%	5.97%	6.82%	7.51%	7.98%	7.96%	7.46%	7.75%	7.34%	5.97%	5.27%	4.7%	4.45%	4.21%	4.35%	4.81%	5.09%
Spanish Peseta	5.68%	4.98%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Swedish Krona	6.04%	5.38%	4.78%	6.19%	6.46%	6.03%	5.63%	5.89%	6.42%	5.85%	5.22%	5.31%	5.4%	5.15%	4.33%	4.01%	4.50%	4.70%
Swiss Franc	4.07%	3.91%	3.81%	4.50%	5.24%	5.17%	4.17%	3.89%	4.05%	3.06%	2.88%	3.39%	3.4%	3.30%	2.85%	2.84%	3.40%	3.43%
U.K. Pound	7.15%	6.53%	5.79%	6.97%	7.03%	6.59%	6.11%	5.96%	6.17%	5.60%	5.22%	5.69%	5.9%	5.82%	5.54%	5.26%	5.34%	5.68%
U.S. Dollar > 8.5 years	6.63%	5.92%	6.37%	7.18%	7.54%	6.86%	6.09%	5.67%	5.86%	4.75%	4.38%	4.75%	4.9%	4.89%	5.04%	5.27%	5.78%	5.73%
ECU/Euro	5.36%	4.72%	4.72%	5.82%	6.27%	6.15%	5.73%	5.53%	5.91%	5.27%	4.73%	4.85%	4.8%	4.61%	4.17%	4.05%	4.62%	4.76%
SDR	5.59%	5.01%	5.02%	5.80%	6.07%	5.88%	5.31%	5.04%	5.32%	4.53%	4.13%	4.46%	5.64%	4.49%	4.37%	4.50%	4.97%	5.04%

Table 6. Peru: Stock of Domestic Debt of the NFPS

	Legal Norm	Gross placements		Stock (estimated)
		Currency	Amount	(Millions of Nuevos Soles)
	Af of end-June 2007			
Banking Credits				**116**
Credits from BN				**13**
Credit to central government		US$ / S/. / Y		0
Credit to local governments		US$ / S/.		13
Net public treasury overdraft		S/.		0
Other Banks		S/.		102
Bonds				**16,509**
Bonos TP - Financial system strengthening	D.U. 041-99	US$	175	167
Bonos TP - Temporal suscription of stocks	D.U. 034-99	US$	52	165
Bonos TP - Debt exchange bonds	D.S. 002-2007-EF	S/.	2,645	2,645
Bonos TP - RFA and FOPE programs	D.S. 059-2000-EF / D.U. 050-2002	US$	109	381
Bonos TP - Sovereign bonds 1/		S/.	13,812	13,042
Bonos Municipalidad de Lima		S/.	250	109
Total				**16,624**
Of which:				
Pension Reform Bonds (Bonos de Reconocimiento)	D.S. 096-95-EF	S/.		8,896
Floating debt		S/.		1,565
	As of end-December 2007			
Banking Credits				**156**
Credits from BN				57
Credit to central government		US$ / S/. / Y		12
Credit to local governments		US$ / S/.		45
Net public treasury overdraft		S/.		0
Other Banks		S/.		99
Bonds				**22,178**
Bonos TP - Financial system strengthening	D.U. 041-99	US$	175.3315854	106
Bonos TP - Temporal suscription of stocks	D.U. 034-99	US$	52.06	0
Bonos TP - Temporal portfolio exchange	D.S. 114-98-EF	US$	136.3	0
Bonos TP - Debt exchange bonds	D.S. 068-99-EF	US$	259	0
Bonos TP - Debt exchange bonds	D.S. 002-2007-EF	S/.	2644.571931	2,645
Bonos TP - RFA and FOPE programs	D.S. 059-2000-EF / D.U. 050-2002	US$	109.456	363
Bonos TP - Financial system consolidation	D.U. 108-2000 / D.U. 099-2001	US$	392	0
Bonos TP - Sovereign bonds 1/		S/.	13812	18,929
Bonos TP - Caja de Pensiones Militar Policial Bonds	D.U. 030-2001	US$	34	0
Bonos Municipalidad de Lima		S/.	250	135
Total				**22,334**
Of which:				
Pension Reform Bonds (Bonos de Reconocimiento)	D.S. 096-95-EF	S/.		8,945
Floating debt		S/.		4,041
	Af of end-March 2008			
Banking Credits				**151**
Credits from BN				**52**
Credit to central government		US$ / S/. / Y		8
Credit to local governments		US$ / S/.		44
Net public treasury overdraft		S/.		0
Other Banks		S/.		99
Bonds				**22,246**
Capitalización BCRP	D.S.066-94-EF	S/.	614	**0**
Serie A			239	0
Serie B			375	0
Bonos TP - Financial system strengthening	D.U. 041-99	US$	175	98
Bonos TP - Temporal suscription of stocks	D.U. 034-99	US$	52	0
Bonos TP - Temporal portfolio exchange	D.S. 114-98-EF	US$	136	0
Bonos TP - Debt exchange bonds	D.S. 068-99-EF	US$	259	0
Bonos TP - Debt exchange bonds	D.S. 002-2007-EF	S/.	2,645	2,415
Bonos TP - RFA and FOPE programs	D.S. 059-2000-EF / D.U. 050-2002	US$	109	334
Bonos TP - Financial system consolidation	D.U. 108-2000 / D.U. 099-2001	US$	392	0
Bonos TP - Sovereign bonds 1/		S/.	16,692	19,238
Bonos TP - Caja de Pensiones Militar Policial Bonds	D.U. 030-2001	US$	34	0
Bonos Municipalidad de Lima		S/.	250	162
Total				**22,397**
Of which:				
Pension Reform Bonds (Bonos de Reconocimiento)	D.S. 096-95-EF	S/.		9076
Floating debt		S/.		2351

1/ Include public debt operations to exchange Bonds Financial system consolidation for Sovereign Bonds (S/. 851 millions in May and S/. 393 millions in September of 20(the Bonds to prepay external public debt with Paris Club (S/. 2 619 millions in July and August of 2005) and Japeco (S/. 811 millions in November of 2005), the Bonds to p external public debt with Japeco (S/. 278 millions in May of 2006), and the Bonds to prepay external public debt with Japeco (S/. 280 millions in February of 2007) and Pa Club (S/. 4 750 millions in July of 2007).

Source: Central Reserve Bank of Peru

ANNEX 3. PERU: INFLATION CONSULTATION LETTER

Mr. Dominique Strauss-Kahn
Managing Director,
International Monetary Fund

June 25, 2008

Dear Mr. Strauss-Kahn,

1. As we mention in our letter of June 23 describing Peru's economic performance under the program, inflation rose up to 5.5 percent in March, driven by the significant increase in international food prices, while subsequently declining to 5.39 percent in May. The Central Bank has implemented an important adjustment to the monetary stance in recent months, raising the reference rate by 125 basis points and increasing reserve requirements to prevent imported inflation from spreading through expectations into non-food prices, which have only risen by about 2 percent in the last twelve months. Based on this, and on the expectation that some external shocks will unwind, inflation should return gradually to the target range of 1-3 percent by mid-2009. We provide additional information regarding this particular issue.

2. As it was projected in our Inflation Report published last January, the inflation rate during the first five months of the year remained above the upper limit of the target range for monetary policy (3 percent), increasing from 3.9 percent as of end-December 2007 to 5.4 percent in May. This outcome reflected an increase of 11.2 percent in food prices, while the remainder of the goods and services rose by 1.9 percent on average, in line with the inflation target of the Central Bank (2 percent).

3. The increase in food prices has continued to be associated with rising international prices of basic inputs for products such as bread, pasta and edible oil. Furthermore, increases in international prices of these food products in the world market, while not directly linked to those of national products such as milk and rice, partially affected the domestic prices of the latter. It should be mentioned that the cumulative increase in the Consumer Price Index (CPI) between January and May 2008 stood at 2.7 percent, of which the above-mentioned products explained some 32 percent. Weather shocks at the beginning of the year also affected the domestic supply of goods and services. Heavy rains altered not only the production of onion, tomato and other vegetables, but they also affected transportation due to landslides, which implied greater prices for goods such as that of papaya. This kind of restriction in the intermal food supply explain about 40 percent of the cumulative inflation to May.

4. The higher inflation rate has been reflected in an increase of inflation expectations. Economic analysts' inflation expectations have risen from 3.0 to 4.5 percent for the present year; from 2.5 to 3.5 percent for the year 2009 and from 2.1 to 2.5 percent for the year 2010. While presenting a declining trend over the next few years, expected inflation for 2008 and

2009 stands above the upper limit of the target range set by the BCRP. The risk that the rising inflation expectations may be translated into decisions by enterprises to increase prices has not materialized significantly. In particular, according to the BCRP's survey on macroeconomic expectations, only 35 percent of enterprises are projecting to increase their prices within the next three months, a percentage only slightly higher than that observed in January (33 percent).

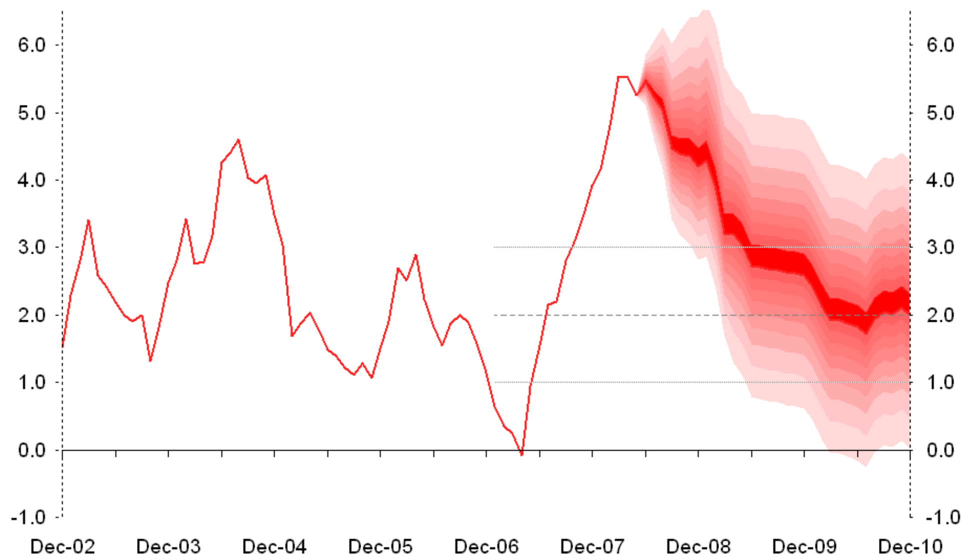
5. Data on economic activity for the first quarter of the year suggest a strong momentum for both GDP and domestic demand, which have grown at 9.3 and 10.8 percent, respectively. In our current Inflation Report, we increase our GDP growth projection from 7 to 8 percent, and that of domestic demand from 8.2 to 9.8 percent. Similarly, for the year 2009, projections have been adjusted upward from 6.3 to 6.5 percent for GDP and from 7.2 to 8.0 percent for domestic demand. The adjustment to domestic demand growth for the current year is explained by increases in private consumption growth (from 5.8 to 6.6 percent) and public investment spending (from 33.0 to 41.5 percent), while private investment continues to be projected to grow at an annaul rate of 20.4 percent. These economic dynamics, greater than originally envisaged, imply that the projected gap between GDP and its potential would reach 2 percent in 2008. For this calculation, the BCRP estimates that potential output has been expanding at a rate of 7.2 percent, led by investment and productivity growth in our country.

6. In light of the risks that inflation expectations could spread to other prices, particularly in an environment of increased spending by the private and public sectors, the Central Bank has adopted an anti-inflationary stance. With this, the central bank seeks to achieve a gradual return of inflation and expected inflation into the target range.

7. The monetary policy adjustment has included, first, the increase in the interest reference rate by 125 basis points, from 4.5 percent in June 2007 to 5.75 percent in June 2008. In addition, this decision was complemented by an increase of the reserve requirements on obligations both in domestic and foreign currency. These actions have supported a more rapid adjustment of financial conditions, given the unprecedented context of significant foreign capital inflows mostly oriented to acquiring short term capital assets denominated in domestic currency. Between December 2007 and May 2008, the preferential interest rates for credits have risen from 5.6 to 6.2 percent for operations in domestic currency, and from 6.4 to 10.1 percent for loans in foreign currency.

8. The inflation projection in the current Inflation Report extends to 2010, and it is envisaged that inflation would reach its target range by mid-2009. The projected inflation trend implies that inflation will still exceed the upper limit of the target range by end-2008, following a peak in inflation of 5.55 pecent in March 2008.

Peru: Inflation Forecast
(Annual percentage change)



Note: The figure shows the prediction bands for inflation through the forecast horizon. The darkest band around the central proyection shows a 10 percent probability of ocurrence, while together, all bands represent a 90 percent probability of ocurrence.

9. The different risks that could cause deviations from the projected inflation path are mostly on the upside. The risks being assessed are the following:

- ***Higher fuel prices.*** The baseline scenario considers that the price of oil will partially reverse its recent increase and that the Fuel Price Stabilization Fund will be maintained. A scenario of sustained increases in oil prices that cannot be compensated with fiscal measures would drive domestic fuels prices above expected levels.

  In such a scenario, monetary policy would not be altered as long as inflation expectations remain well anchored and the effect on inflation appears to be temporary.

- ***Higher food prices.*** The baseline scenario assumes that current imbalances between supply and demand in the food commodities markets would diminish throughout the forecast horizon. It also assumes that agricultural output will decelerate this year due to adverse weather conditions and rising fertilizer costs, problems that should be overcome within the next two years. However, there are risks that those high prices may be more persistent than envisaged, or that they may even rise further if world or domestic supply conditions were suddenly to worsen, or if demand from biofuels keeps rising, which would put upward pressure on domestic food prices.

In such scenario, monetary policy would not be altered as long as inflation expectations remain stable and the effect on inflation appears to be of a temporary nature.

- ***Stronger pressures from domestic demand.*** The baseline scenario considers that aggregate demand growth rates will converge towards levels more compatible with potential growth (around 7-7.5 percent). A scenario of higher-than-expected demand, boosted by either public or private expenditure, that is not accompanied by higher potential growth, would generate domestic demand pressures on inflation.

  In this scenario, monetary policy would need to be tightened to achieve sustainable growth rates and to allow the return of inflation rates to the target range.

- ***Further deceleration in the global economy.*** The international context is characterized by gradually worsening terms of trade (particularly due to rising import prices), a temporary deceleration of the economy in 2008 and a slight recovery from 2009 on for our main trading partners. If the U.S. economy were to enter a severe recession, the ensuing drastic correction in our export prices could generate capital outflows and cause a contractionary impulse on domestic demand.

  In this scenario, the Central Bank holds high levels of international reserves and could intervene to limit excessive exchange rate volatility. If necessary, the Bank could ease its monetary stance to mitigate falling demand pressures on inflation during the forecast horizon.

10. The Central Reserve Bank reiterates its commitment to act proactively to assure the convergence of inflation rates to the 2 percent target, taking due consideration of the existence of temporary factors that could cause transitory deviations of inflation from the target range.

Julio Velarde
President
Central Reserve Bank of Peru

ANNEX 4. PERU: DEBT SUSTAINABILITY ANALYSIS[1]

Peru's debt-to-GDP ratio is projected to decline considerably under the baseline debt sustainability scenario. Economic growth would average close to 6 percent a year in 2008-13 underpinned by a moderate fiscal surplus position. Public sector revenue would remain broadly stable. Under these assumptions, Peru's public sector debt stock (including CRPAOs) would decline from 30.4 percent of GDP at end-2007, to 12.1 percent of GDP by 2013.

Given that nearly two thirds 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. Private external debt rose in 2007 as banks sought long term loans abroad to expand their domestic business, but is projected to decline over the medium term as more financing becomes available domestically. Given the recent declines in public external debt, total external debt is projected to decline from 30 percent of GDP at end-2007 to 17 percent by 2013 (public external debt would decline from 15 percent to 10 percent over the same period).

Peru's external and public sector debt ratios are robust to alternative assumptions about underlying macroeconomic variables. Sensitivity tests based on 10-year historical standard deviations 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.

Despite the increasing share of domestic currency in public sector debt, external and public debt ratios remain sensitive to changes in exchange rate changes, given the high foreign currency share of Peru's debt. Specifically, under a one-off 30 percent real depreciation of the exchange rate, the external debt-to-GDP ratio would shift by about 10 percentage points above the baseline projections in the medium term. This test assumes that the exchange rate would remain at its depreciated level permanently—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. Non-interest current account shocks (such as in the terms of trade) would have a moderate adverse impact on external indebtedness.

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,

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[1] The DSA includes standard sensitivity tests around the baseline medium-term scenario. The methodology used is in line with that endorsed in the Information Note on Modifications to the Fund's Debt Sustainability Assessment Framework for Market Access Countries, dated July 5, 2005.

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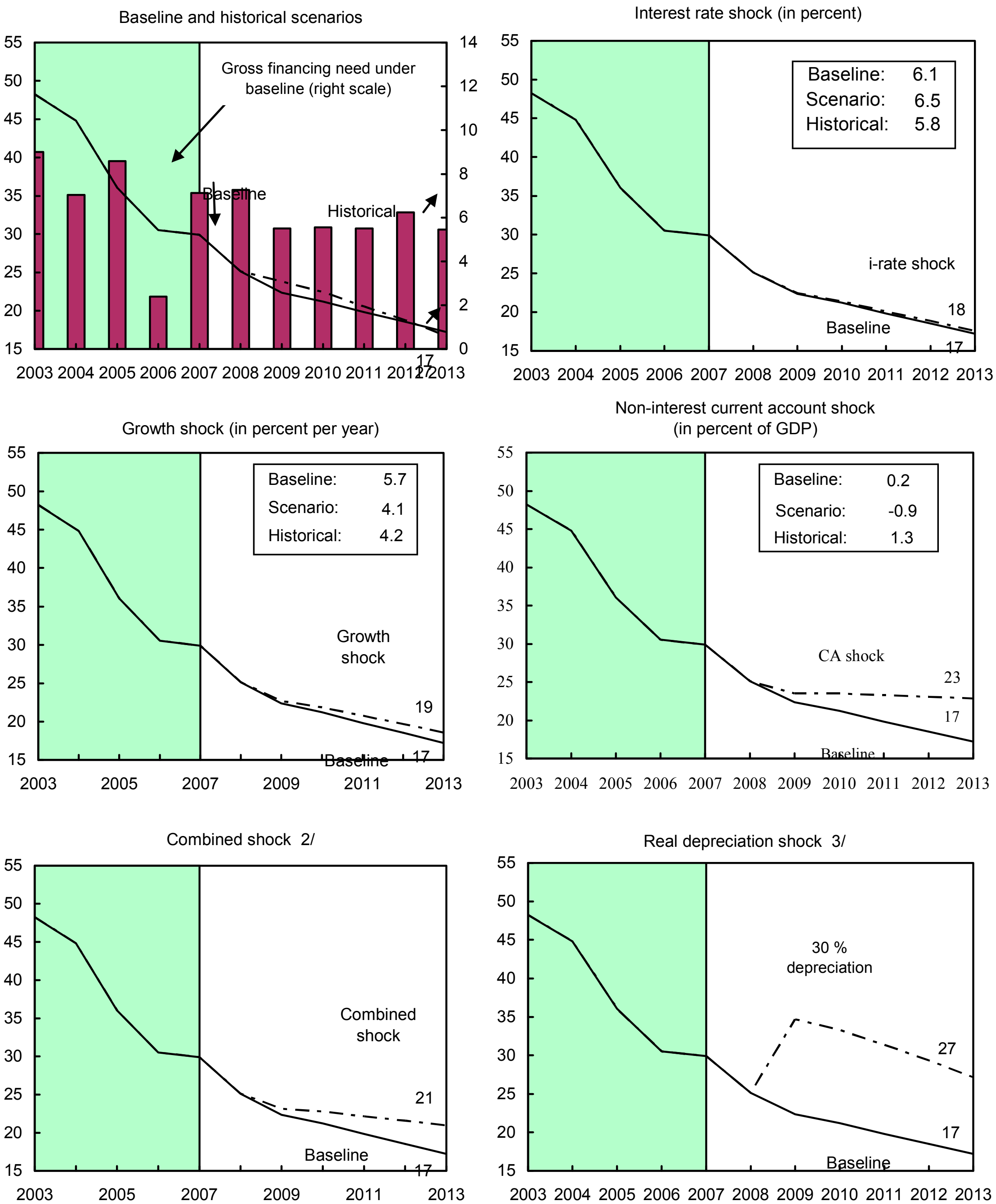
while declining over the medium term, would remain 10.4 percentage points above the debt levels projected under the baseline scenario.

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



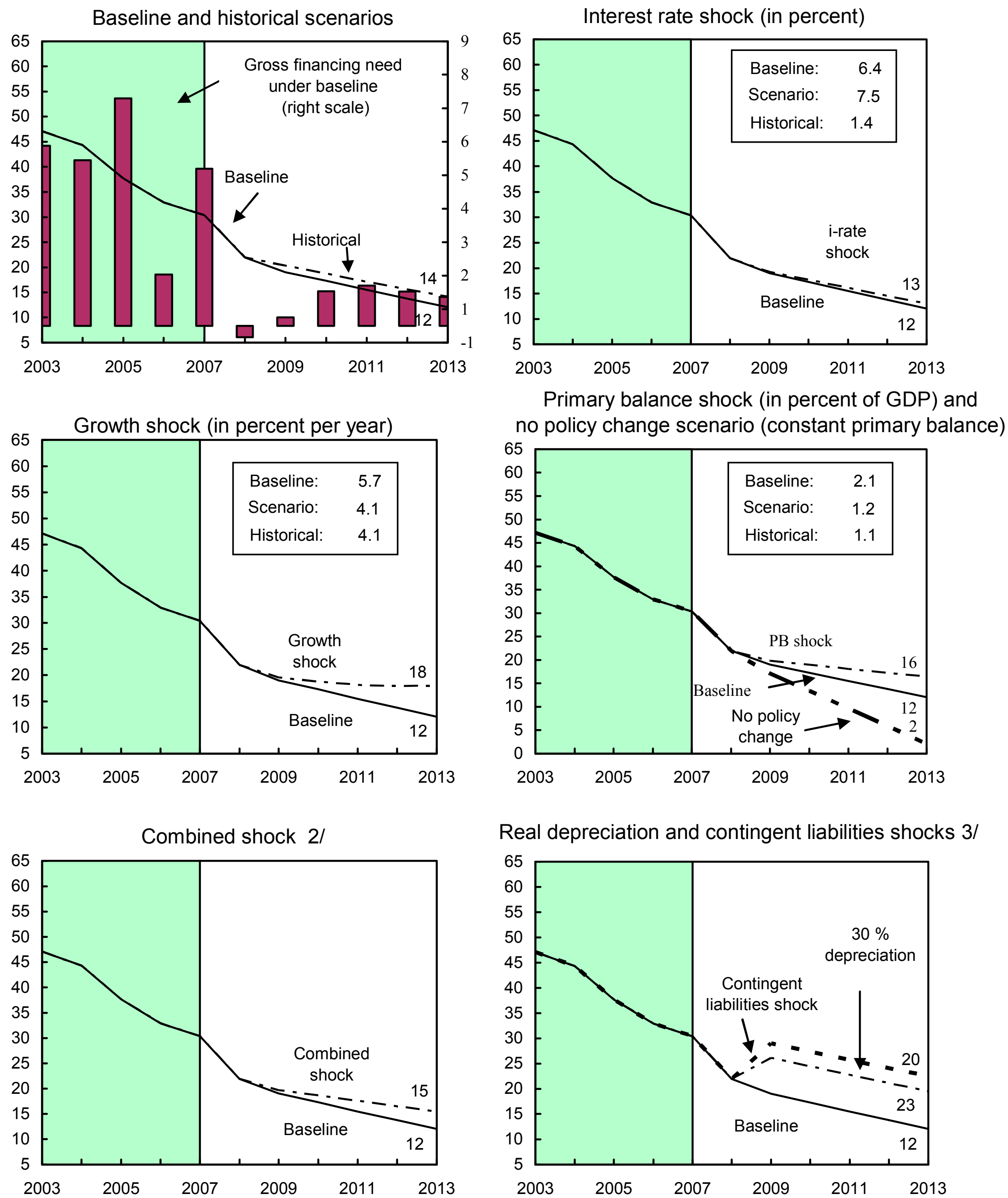
Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

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

3/ One-time real depreciation of 30 percent occurs in 2009.

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 2009, 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, 2003-2013
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	48.2	44.8	36.1	30.5	29.9	**25.1**	**22.4**	**21.2**	**19.8**	**18.5**	**17.2**	**-3.3**
Change in external debt	-0.9	-3.4	-8.8	-5.5	-0.6	-4.8	-2.8	-1.1	-1.4	-1.3	-1.3	
Identified external debt-creating flows (4+8+9)	-2.1	-7.4	-9.0	-9.7	-10.3	-7.5	-3.4	-3.4	-3.1	-3.1	-2.7	
Current account deficit, excluding interest payments	-0.7	-2.1	-3.5	-5.0	-3.3	-0.8	-0.5	-0.7	-0.4	0.0	0.3	
Deficit in balance of goods and services	-0.1	-3.1	-5.6	-8.8	-6.8	-3.7	-1.6	-0.6	-0.5	-0.1	0.3	
Exports	17.6	21.1	24.7	28.4	28.7	26.6	24.0	23.3	23.4	23.1	22.5	
Imports	17.5	18.0	19.1	19.7	21.9	22.9	22.4	22.7	22.9	23.0	22.8	
Net non-debt creating capital inflows (negative)	0.0	-1.5	-2.0	-1.5	-4.4	-6.2	-2.7	-3.0	-2.9	-3.2	-3.1	
Automatic debt dynamics 1/	-1.5	-3.7	-3.4	-3.2	-2.6	-0.5	-0.2	0.2	0.2	0.1	0.0	
Contribution from nominal interest rate	2.2	2.1	2.1	2.0	1.9	1.4	1.3	1.4	1.3	1.1	1.0	
Contribution from real GDP growth	-1.8	-2.2	-2.7	-2.3	-2.3	-1.9	-1.4	-1.2	-1.1	-1.0	-1.0	
Contribution from price and exchange rate changes 2/	-1.8	-3.6	-2.8	-2.9	-2.2	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.2	3.9	0.2	4.2	9.6	2.8	0.6	2.3	1.7	1.8	1.4	
External debt-to-exports ratio (in percent)	274.3	212.2	145.8	107.4	104.3	94.5	93.2	91.2	84.7	80.3	76.4	
Gross external financing need (in billions of US dollars) 4/	5.5	4.9	6.8	2.2	7.8	10.1	8.8	9.4	9.9	11.9	11.2	
in percent of GDP	9.0	7.0	8.6	2.4	7.1	7.3	5.5	5.6	5.5	6.2	5.5	
Scenario with key variables at their historical averages 5/						**25.1**	**23.8**	**22.4**	**20.5**	**18.8**	**16.7**	**-2.5**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.0	5.1	6.7	7.6	9.0	8.2	6.5	5.5	5.5	5.5	5.5	
GDP deflator in US dollars (change in percent)	3.9	8.2	6.8	8.8	7.7	17.5	7.8	0.3	1.0	1.0	1.6	
Nominal external interest rate (in percent)	4.9	4.9	5.3	6.5	7.4	6.1	5.7	6.5	6.3	6.0	5.8	
Growth of exports and services (US dollar terms, in percent)	16.7	36.5	33.5	34.5	18.3	17.9	3.5	2.7	7.1	5.1	4.6	
Growth of imports and services (US dollar terms, in percent)	8.7	16.8	21.0	20.3	30.5	33.1	12.1	7.5	7.7	6.7	6.4	
Current account balance, excluding interest payments	0.7	2.1	3.5	5.0	3.3	0.8	0.5	0.7	0.4	0.0	-0.3	
Net non-debt creating capital inflows	0.0	1.5	2.0	1.5	4.4	6.2	2.7	3.0	2.9	3.2	3.1	

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

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

3/ 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, 2003-2013
(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Debt-stabilizing primary balance 9/
1	**Baseline: Public sector debt 1/**	47.1	44.3	37.7	32.9	30.4	**22.0**	**19.0**	**17.3**	**15.5**	**13.8**	**12.1**	**0.2**
	o/w foreign-currency denominated	43.3	37.5	29.5	25.0	21.9	15.6	12.9	11.4	9.9	8.5	7.2	
2	Change in public sector debt	0.4	-2.8	-6.6	-4.8	-2.5	-8.4	-3.0	-1.7	-1.8	-1.7	-1.7	
3	Identified debt-creating flows (4+7+12)	-1.1	-4.7	-5.0	-7.6	-7.8	-5.7	-3.0	-1.7	-1.8	-1.7	-1.7	
4	Primary deficit	-0.4	-1.0	-1.6	-3.9	-4.0	-3.9	-2.6	-1.9	-2.0	-1.9	-1.9	
5	Revenue and grants	18.0	17.9	18.9	20.5	20.5	20.4	19.2	20.3	20.5	20.7	20.9	
6	Primary (noninterest) expenditure	17.6	17.0	17.3	16.5	16.5	16.5	16.7	18.4	18.5	18.7	18.9	
7	Automatic debt dynamics 2/	-0.7	-3.6	-3.3	-3.6	-3.7	-1.8	-0.4	0.2	0.2	0.2	0.2	
8	Contribution from interest rate/growth differential 3/	-0.9	-2.8	-2.1	-3.4	-1.7	-1.8	-0.4	0.2	0.2	0.2	0.2	
9	Of which contribution from real interest rate	0.8	-0.7	0.6	-1.0	0.9	0.4	0.9	1.2	1.1	1.0	0.9	
10	Of which contribution from real GDP growth	-1.8	-2.2	-2.7	-2.4	-2.6	-2.2	-1.3	-1.0	-0.9	-0.8	-0.7	
11	Contribution from exchange rate depreciation 4/	0.3	-0.7	-1.2	-0.2	-2.0	...	...	...	...	...	...	
12	Other identified debt-creating flows	-0.1	-0.2	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
13	Privatization receipts (negative)	-0.1	-0.2	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15	Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16	Residual, including asset changes (2-3) 5/	1.5	1.9	-1.6	2.8	5.3	-2.7	0.0	0.0	0.0	0.0	0.0	
	Public sector debt-to-revenue ratio 1/	261.7	247.0	199.2	160.7	148.6	107.6	98.9	85.3	75.7	66.6	57.8	
	Gross financing need 6/	5.4	4.9	6.8	1.5	4.7	-0.3	0.2	1.0	1.2	1.0	0.9	
	in billions of U.S. dollars	3.3	3.4	5.4	1.4	5.1	-0.5	0.4	1.7	2.2	2.0	1.8	
	Scenario with key variables at their historical averages 7/						**22.0**	**20.3**	**18.7**	**17.1**	**15.6**	**14.2**	**-0.4**
	Scenario with no policy change (constant primary balance) in 2008-2013						**22.0**	**17.1**	**13.4**	**9.6**	**5.9**	**2.1**	**0.0**
	Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
	Real GDP growth (in percent)	4.0	5.1	6.7	7.6	9.0	8.2	6.5	5.5	5.5	5.5	5.5	
	Average nominal interest rate on public debt (in percent) 8/	4.8	4.8	4.8	5.8	6.0	5.5	6.6	7.1	7.9	8.1	8.6	
	Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.0	-1.3	1.7	-2.4	3.3	1.8	4.8	6.6	6.7	6.9	7.1	
	Nominal appreciation (increase in US dollar value of local currency, in percent)	-0.6	1.9	3.6	0.6	9.2	...	...	...	...	...	...	
	Inflation rate (GDP deflator, in percent)	2.8	6.1	3.1	8.1	2.7	3.7	1.8	0.5	1.2	1.2	1.5	
	Growth of real primary spending (deflated by GDP deflator, in percent)	4.1	1.3	8.9	2.8	8.7	8.3	7.4	16.5	6.2	6.8	6.7	
	Primary deficit	-0.4	-1.0	-1.6	-3.9	-4.0	-3.9	-2.6	-1.9	-2.0	-1.9	-1.9	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

INTERNATIONAL MONETARY FUND

PERU

Third Review and Inflation Consultation Under the Stand-By Arrangement and Request for Waiver of Applicability of Performance Criteria—Informational Annex

Prepared by the Western Hemisphere Department

June 30, 2008

Contents Page

Appendixes

APPENDIX 1. PERU: FUND RELATIONS

(As of May 31, 2008)

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	638.43	100.01
III.	**SDR Department**	**SDR Million**	**Percent Allocation**
	Net cumulative allocation	91.32	100.00
	Holdings	7.52	7.68
IV.	**Outstanding Purchases and Loans**	None	

V. **Financial Arrangements**

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

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

	2008	2009	2010	2011
Principal				
Charges/interest	1.25	5.21	2.51	2.51
Total	1.25	2.51	2.51	2.51

VII. **Safeguards Assessments**

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

VIII. **Exchange Arrangements**

Peru maintains a unified, managed floating exchange rate. On November 16, 2007, the average of interbank buying and selling rates was 3.00 *Nuevos Soles* per U.S. dollar. The exchange system is free of restrictions, except for those maintained solely for the preservation of national or international security, and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). Those restrictions are maintain pursuant to UN Security Council Resolutions 1267 (October 15, 1999) and 1373 (September 28, 2001). The central government maintains external payments arrears to unguaranteed suppliers, some of whom are in discussions with the government, while the rest have not been located. Peru has maintained a clearing arrangement with Malaysia since 1991.

IX. Last Article IV Consultation

The 2006 Article IV consultation was concluded on January 26, 2007 (Country Report No. 07/54).

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 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, November 2006, May 2007-present	Public Financial Management
	May 2005, February, September, and November 2006, February 2007	Tax policy and administration
	September 2002, September 2003 and August 2004	Public investment and fiscal policy, including issues related to PPPs.
	November 1999	Fiscal rules
MFD/MCM	March 2008	Implementation of Basel II requirements
	October 2007	Strengthening the Capital Markets
	July 2007	Strengthening the Capital Markets
	April 2006	Financial sector supervision
	April 2005	Consumer protection in the banking system
	March, 2005	Central bank organization
	April, December 2002, February 2003, March and September 2004	Inflation targeting
	October 2002	Foreign exchange operations
	August 2002	Accounting and organizational issues
	May 2002	Inflation targeting
	March 2002	Monetary operations and government securities market
STA	January 1998, October 1999, and March 2008	National account statistics, new base year for the national account series; and Government Finance Statistics 2001

XII. Resident Representative

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

APPENDIX 2. PERU: WORLD BANK RELATIONS

Bank Group strategy

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

The FY08-09 pipeline comprises 11 operations for the amount of 550-700 million in commitments. A new series of programmatic operations (up to $500 million) are planned for the next three years, in the fiscal and social sectors as well as in the environment sector. Recent DPL approvals include the $200 million Fiscal and Competitiveness DPL and the $150 million Results and Accountability II (REACT II) DPL.

Bank-Fund collaboration in specific areas

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

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

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

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

Statement of World Bank Loans
(As of May 2008)

Loan Number	Year Approved	Borrower	Purpose	In millions of U.S. Dollars Total (Net of Cancellation)	Undisbursed
72090	2004	Republic of Peru	Lima Transport Project	45.0	31.3
72850	2005	Republic of Peru	Agricultural Research and Extension - APL II	25.0	14.6
74230	2007	Republic of Peru	Decentralized Rural Transport Project	50.0	49.5
73080/40760	1997	Republic of Peru	Irrigation Subsector Project	95.3	2.2
72550	2005	Republic of Peru	Institutional Capacity for Sustainable Fiscal Decentral	8.8	7.0
72190	2004	Republic of Peru	Justice Services Improvement	12.0	5.8
52856	2004	Republic of Peru	Lima Transport	7.9	4.1
71600	2003	Republic of Peru	Additional Financing Lima Water Rehabilitation and M	20.0	5.5
3811	1995	Republic of Peru	PE LIMA WATER Rehabilit & Mgt. Proj.	150.0	0.3
71420	2003	Republic of Peru	National Rural Water Supply and Sanitation Project	50.0	32.2
73680	2006	Republic of Peru	Real Property Rights II Project	25.0	21.6
73220	2006	Republic of Peru	Regional Transport Infrastructure Decentralization	50.0	47.4
73660	2006	Republic of Peru	Rural Electrification	50.0	43.3
74430	2007	Republic of Peru	Sierra Rural Development Project	20.0	20.0
71770	2003	Republic of Peru	Trade Facilitation and Productivity Improvement Tech	20.0	5.1
72570	2005	Republic of Peru	Vilcanota Valley Rehabilitation and Management Proj	5.0	3.8
71760	2003	Republic of Peru	Rural Education	52.5	23.5
72540	2005	Republic of Peru	Accountability for Decentralization in the Social Secto	7.8	3.1
74550	2007	Republic of Peru	Results and Accountability (REACT)DPL	150.0	150.0
Total disbursed:				**5,439.9**	
	Of which: amount repaid			2,782.3	
Total Outstanding:				**2,585.6**	
Total Undisbursed					**470.4**

Statement of IFC Operations in Peru
As of end May 2008 (US$ million)

	Total of Commitments held	Total of Disbursed
Loans	324.0	249.4
Equity	125.9	118.4
Quasi	54.0	54.0
Particip Loans	230.0	230.0
Total	**503.9**	**421.4**

APPENDIX 3. PERU: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Country Strategy

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

The IDB supports Peru's development agenda by deepening the country's sustainable economic growth and generating greater opportunities for the majority of Peruvians, through efforts grouped into the following three strategic pillars: (i) strengthening Peru's participation in the global economy and enhancing competitiveness; (ii) promoting social development and economic inclusion; and (iii) deepening the reform of the State and improving public sector management.

Lending

As of May 31, 2008 the Bank's portfolio of active, public sector operations consisted of 25 loans for a total amount of US$859.3 million, of which US$164.1 million (19.1%) had been disbursed. The public sector lending program for 2008 comprises seven investment loans for US$150.0 million and two programmatic loans for US$125.0 million.

The Structured Corporate Finance department's portfolio in execution consists of 5 loans for a total amount of US$550.0 million, focusing primarily in the financial and natural gas sectors. Private sector lending for 2008 currently includes one project for US$15.0 million.

To assist Government efforts to de-dollarize the public sector debt, the Bank successfully converted US$50.0 million of a previously disbursed loan into local currency, and further local currency transactions are being considered.

PERU—IDB Loan Portfolio by Sector
As of May 31st, 2008
US$ million

Sector	Commitments	Disbursements	% Disbursed
Agriculture	30.0	15.0	49.9%
Environmental	5.0	0.0	0.0%
Science and Technology	25.0	1.7	6.8%
Urban Development	60.0	32.0	53.3%
Social Investment	103.3	86.6	83.8%
Modernization of the State	126.5	13.6	10.8%
Water and Sanitation	200.5	0.1	0.1%
Transportation	308.9	15.1	4.9%
Total	**859.3**	**164.1**	**19.1%**

APPENDIX 4. PERU: STATISTICAL ISSUES

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

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

I. Real Sector and Prices

The authorities published a revised GDP series in 2000. The series used the 1994 benchmark estimates as the base year, and included input-output tables. However, due to limited availability of periodic source data, estimates after 1994 are largely based on extrapolation techniques. The lack of current detailed tables for supply and use hampers the reconciliation of discrepancies. As a result, changes in inventories are mainly determined as a residual. Although the quarterly accounts have benefited from some improvements in the timeliness of monthly production indices, coverage is still very limited. The National Statistics Office (INEI) is working on a new national account series using 2007 as the base year. A national accounts statistics mission has been tentatively scheduled for the fiscal year starting in May 2008.

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

The authorities monitor labor market developments using four indicators: open unemployment, underemployment, employment, and remunerations. The quality of the indicators has improved over recent years. However, wage data come with a relatively long delay; the nationwide unemployment and underemployment situation is surveyed only once a year; and labor productivity data are published only at the time of adjustments of 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 authorities have sent to the Fund information on the components of consolidated central government expenditures by function. The coverage of published national budget data is narrower than the fiscal statistics prepared for 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 using the *GFSM 2001* presentational framework for publication in the *Government Finance Statistics Yearbook (GFSY)* and monthly data for the *International Financial Statistics (IFS)*.

III. Monetary Sector

The central bank (BCRP) compiles and publishes the analytical accounts of the central bank, depository corporations, and financial corporations broadly in line with the methodology recommended by the *Monetary and Financial Statistics Manual*. The main discrepancies are the exclusion of the deposits of other financial corporations, state and local governments, and public nonfinancial corporations from the definition of broad money; use of cash accounting; and valuation of some financial instruments at cost rather than at market prices. At the request of the authorities, a mission visited the country in January 2007 to assist with the migration to the new standardized report forms (SRFs) for reporting monetary data to the IMF. The mission finalized the SRF for the central bank, recommending improvements in the classification and sectorization of some accounts. A follow-up mission during 2008 should complete the work on the SRF for other depository corporations and other financial corporations.

IV. External Sector

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

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

Peru: Table of Common Indicators Required for Surveillance
As of June 10, 2008

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality Accuracy and reliability[9]
Exchange Rates	Mar. 2008	4/3/08	D	M	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May 2008	6/9/08	D	M	W		
Reserve/Base Money	Feb. 2008	4/8/08	W	M	W	O, LO, LO, LO	O, O, O, O, O
Broad Money	Feb. 2008	4/8/08	W	M	W		
Central Bank Balance Sheet	Feb. 2008	4/8/08	W	M	W		
Consolidated Balance Sheet of the Banking System	Feb. 2008	4/8/08	W	M	W		
Interest Rates[2]	Mar. 2008	4/8/08	D	M	D		
Consumer Price Index	Apr. 2008	5/19/08	M	M	M	O, LO, LO, LO	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2004	9/21/2005	Q	Q	Q	O, LO, O, O	O, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing3– Central Government	Feb. 2008	4/16/08	M	M	M		
Stocks of Central Government Debt[5]			Q	Q	Q		
International investment Position[6]	Q1 2007	8/16/07					
External Current Account Balance	Q1 2007	8/16/07	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	Q1 2007	8/16/07	Q	Q	Q		
GDP/GNP	Q4 2007	3/27/08	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	June 2006	Sep. 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] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC published in October 2003 and based on the findings of the mission that took place during February 12–26, 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), not observed (NO), or not available (NA).
[9] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

PERU

Third Review and Inflation Consultation Under the Stand-By Arrangement and Request for Waiver of Applicability of Performance Criteria—Supplementary Information

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

Approved by Jose Fajgenbaum and Martin Fetherston

July 21, 2008

1. This supplement provides additional information that has become available since the circulation of the staff report. It does not alter the thrust of the staff appraisal.

2. **On July 14, Mr. Luis Valdivieso was sworn in as new Finance Minister, replacing Mr. Carranza.** Mr. Valdivieso, a former Fund-staff member, supports the letter of intent and has provided assurances to the staff of his strong commitment to the program.

3. **Macroeconomic performance remains strong.** Recent indicators point to real GDP growth at nearly 10 percent during the first five months of 2008, over the same period in 2007, with domestic demand estimated to have expanded at around 11½ percent. Exports have risen by 33 percent in the same period, while imports, particularly capital goods and intermediate goods, have risen by 53 percent. Nationwide employment rose by 10 percent (year-on-year) in May, led by commerce and services.

4. **Financial market sentiment has improved.** Since early July, the Nuevo Sol has appreciated by about 4 percent against the U.S. dollar and the central bank has not intervened. On July 14, Standard & Poor's upgraded Peru to investment grade, which bodes well for private investment and economic growth prospects over the medium term. Peru's sovereign bond spread has declined by 15 basis points since then.

5. **Inflation was 5.7 percent (y/y) in June, exceeding the upper consultation band with the Executive Board under the program.** Monthly inflation accelerated markedly in June, reaching 0.77 percent, reflecting the continued impact of higher food prices, as well as a 1.6 percent average increase in domestic fuel-related retail prices. Excluding food and fuel, consumer prices rose 2.2 percent over the past 12 months.

6. **On July 10, the central bank increased its policy interest rate by 25 basis points, to 6 percent and tightened reserve requirements.** Minimum reserve requirements will rise from 8½ percent to 9 percent effective in August and cover all obligations, notably banks' long-term borrowing (2-7 years) in foreign currency. Marginal reserve requirements for foreign currency deposits will rise from 45 percent to 49 percent. In line with their inflation consultation letter, the authorities see upside risks to inflation given the sustained strong domestic demand growth and higher fuel prices. The authorities reaffirmed their commitment to continue tightening monetary policy to bring inflation gradually toward the inflation target range by mid-2009.

7. **The authorities have enacted wide-ranging legislation as part of the Peru-U.S. Free Trade Agreement (FTA).** Since March 2008, the government has approved 96 legislative decrees, under the special powers granted by Congress. Staff will explain key reforms more fully in the next staff report. Those enacted since the staff report was issued are:

- ***Customs law.*** Adapts rules to expedite procedures and sets new rules for controls at customs. The new law preserves the current joint structure for tax and customs administration under a single agency, which is consistent with staff recommendations.

- ***Small Businesses.*** Establishes a new labor and tax regime, and broader definition for micro and small enterprises to encourage their formalization, while the government shares the costs of providing workers with gradual access to social security and health benefits. As a result, small enterprise labor costs (such as severance payments) would be reduced from 72 percent of gross salaries to 41½ percent. The authorities expect that about two million enterprises would be formalized over the next three years, thereby improving health and social security coverage significantly. The staff is of the view that this law is an important step toward reducing labor market informality.

- ***General Banking law and Supervision.*** Most important changes include: i) strengthening the bank surveillance and intervention regimes; ii) introducing minimum capital requirements for credit, market, and operational risks in line with Basel II; iii) modifying the definition and limits in minimum capitalization (raised from 9.1 percent to 10 percent), also in line with Basel II; and iv) allowing nonbank financial institutions to conduct similar operations as banks, such as syndicated loans, factoring, and external trade financing.

8. **Some of the end-June structural benchmarks were not met, although significant progress has been made towards their completion.** In particular:

- ***Guidelines for assessing tax exemptions.*** The authorities have finalized the draft guidelines and intend to issue them shortly.

- ***Submission to Congress of law to raise minimum capital requirements for microfinance institutions.*** The draft law prepared by the Superintendency of Banks is currently under legal review at the Ministry of Finance. The authorities intend to submit it to the Council of Ministers for discussion and approval within the next two weeks. Staff recognizes these efforts and expects its prompt submission to Congress, given the importance of this law in the context of the recent approved expansion of operations to nonbank financial institutions.

- ***Clarification of tax treatment of securitization transactions.*** The authorities prefer to hold this reform, as it would entail amendments to the VAT law and a suspension of income tax withholding difficult to justify with Congress at this juncture, as the authorities have been resisting introducing other tax exemptions in the recent period. Staff shares the authorities' assessment of the risks and is of the view that several reforms implemented under the program still support the deepening of domestic capital markets. While staff will continue to explore options with the authorities on how to facilitate securitization transactions, it supports the authorities' view that the risks of proceeding with this measure would outweigh the benefits.

Press Release No. 08/181
FOR IMMEDIATE RELEASE
July 24, 2008

International Monetary Fund
Washington, D.C. 20431 USA

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

The Executive Board of the International Monetary Fund (IMF) has completed the third review of Peru's economic performance under a 25-month Stand-By Arrangement in the amount equivalent to SDR 172.4 million (about US$280.7 million).

The authorities reiterated their intention to continue treating the arrangement as precautionary. The arrangement was approved on January 26, 2007 (see Press Release No. 07/15).

Following the Executive Board discussion, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

"Peru has achieved record-high economic growth, rising employment, and significant poverty reduction, despite heightened risks in the global economy. This impressive performance, underpinned by the authorities' prudent policies and structural reform efforts, has helped Peru achieve investment grade status. Sustaining these efforts will be critical to entrenching long-term growth and poverty reduction.

"The authorities remain focused on preserving macroeconomic stability. They have tightened monetary policy to contain underlying pressures and help anchor inflation expectations. Fiscal policy has also been tightened, and the authorities are committed to maintaining their prudent strategy of past years to help achieve a neutral fiscal stance.

"While rising inflation has been driven mostly by international developments, it is important to continue using all monetary policy instruments to bring inflation gradually toward its target range while ensuring an orderly dedollarization process.

"The authorities have made significant progress in enhancing the fiscal structural framework. A comprehensive law for Public-Private Partnerships provides more balanced risk-sharing between the public and private sectors, and a new Customs Law maintains customs and domestic tax administration under a single agency. Continued reforms are important to minimize fiscal risks, including by preserving a sound public investment policy; amending the Fiscal Responsibility Law to introduce sanctions for noncompliance and ensure that spending limits are observed by all government levels; and reforming the Fuel Price Stabilization Fund to better align domestic and international prices and reduce its fiscal burden.

“Peru has made great strides on poverty alleviation. The launching of the Fund for Regional and Local Investment, as well as the recent reforms to the National System of Public Investment and the continued leadership of the Interministerial Committee for Social Affairs in implementing the poverty alleviation strategy will help entrench these gains.

“The authorities continue to focus on strengthening of financial sector, and very significant steps were achieved through the recent amendment of the General Banking Law that will align minimum capital requirements and those on exchange-rate-related risks with Basel II. In the period ahead, it will be important to amend the General Banking Law to raise the minimum capital requirements of microfinancial institutions, and to align the regulatory framework for public banks with that of private banks to help maintain a level playing field in the private sector. The increase in the legal limit for foreign investment by private pension funds will help deepen domestic capital markets.

“Important steps have been taken towards the completion of a set of wide-ranging reforms oriented to boost competitiveness and enhance the business environment, and to ensure their steadfast implementation. The new legal framework for micro and small businesses is a welcome advance that will help reduce informality and provide workers with better access to social security and health benefits,” Mr. Portugal said.

Statement by Javier Silva-Ruete, Executive Director for Peru
Executive Board Meeting
July 23, 2008

1. The Peruvian Economy continues to perform well, supported by sound macroeconomic policies, despite the international financial turmoil and the rise in fuel and food prices. Growth has been strong (9 percent in 2007); poverty has decreased markedly for the second year in a row; and formal employment has risen. Nevertheless, inflation increased in line with global developments, exceeding the upper limit of the Central Bank's (BCRP) official target range (between 1-3 percent) by around 2½ percent points. The authorities are strongly committed to preventing inflation expectations from translating into other prices.

2. GDP growth reached 9 percent in 2007, a 13-year high, mainly due to sound macroeconomic policies, strong market confidence and a favorable external environment for Peruvian exports. Investment and consumption continued to expand steadily and exports, both commodities and industrial goods, continued to grow vigorously. GDP growth reached a solid 9.2 year-on-year in the first quarter of 2008 and the forecast is approximately 8 percent in 2008 and 6.5 percent in 2009. According to our authorities, private investment will continue to expand, 20 percent in 2008 and around 14 percent in 2009, laying the foundations for long-term growth.

3. As a result of the significant increase in international food prices and the weather-related shocks that affected Peru during the first quarter of the year, the annual inflation rate rose to 5.5 percent in March and 5.7 in June 2008. The authorities have rapidly responded to curtail second-round inflationary effects. The BCRP has adopted an anti-inflationary stance, raising the reference rate by 150 points since 2007, to 6 percent, and increasing the reserve requirements several times with an impact equivalent to 140 basic points in the interest rate. Furthermore, on the fiscal side, the operational fiscal target for the year has been raised. At the end of both March and June, annual non-food inflation was about 2 percent. The authorities expect inflation to gradually return to the target range of 1-3 percent by mid-2009. They are committed to taking further action, if required, to guide inflation expectations and prevent further inflationary pressures. The authorities acknowledge the existence of risks that could steer the projected inflation path off course and will continue to closely monitor the evolution of international prices and domestic demand. Nevertheless, Peruvian inflation continues to be among the lowest in the region.

4. During the first quarter of 2008, the BCRP built up an additional $6.4 billion in international reserves. Interventions in the foreign exchange market aimed at alleviating the de-stabilizing effects of strong capital inflows. At end-March, official reserves reached $27.7 billion—more that 200 percent of foreign-currency deposits. The strong reserve position will protect the economy from possible terms-of-trade reversals and a global downturn. BCRP interventions will continue to be limited to reducing exchange rate volatility.

5. Financial dollarization is receding considerably, driven by stronger confidence in the currency. This momentum has been observed particularly in the growing mortgage lending in

domestic currency. The authorities are committed to pursuing an orderly dedollarization process in order to further reduce financial vulnerabilities.

6. In 2007, the consolidated public sector posted a better-than-expected surplus of 3.2 percent of GDP. Although a fiscal balance was originally expected in 2008, the authorities have raised their operational fiscal target to a surplus of 2 percent of GDP to protect against international developments, reduce inflationary pressures, and signal a strong commitment to fight inflation. At the same time, the government attaches great importance to addressing social and infrastructure needs. In this regard, public investment has accelerated considerably in response to improvements in National System of Public Investment (SNIP) procedures.

7. The fall in public debt to 29.1 percent of GDP, as a result of prudent fiscal practices and the debt management strategy implemented by the authorities, and the increase in international reserves, have turned Peru into a net creditor.

8. The Fund for Regional and Local Investment, aimed at enhancing infrastructure in the poorer areas, was launched in February. The Fund will allow the poorest regions to bid for resources to finance investment projects. The call for projects was a success and the first results are to be announced soon.

9. In line with the authorities' efforts to strengthen financial regulation and supervision, diminish dollarization, and deepen capital markets, the following actions were taken:

- New capital requirements for financial risk, including foreign currency-induced credit risk, in line with Pillar II of the Basel II capital requirements for market risks, were introduced through an amendment to the General Banking Law (GBL).

- An amendment of the GBL was passed to strengthen microfinance institutions, and, at the same time, to improve their position to compete with the rest of the financial sector.

- The limit on foreign investment abroad by pension funds was raised.

- MiVivienda stopped issuing guarantees for loans denominated in foreign currency.

10. The authorities have also accelerated other aspects of the structural reform agenda. On the fiscal side, a framework law was passed to improve the allocation of risks between private and public sectors in Public-Private Partnerships (PPPs). In a parallel effort to increase the response of the public sector to social needs, the authorities submitted a draft law to Congress to allow the outsourcing of studies required for the design and approval of investment projects under the SNIP. The proposed law will expedite investment in critical areas, preserving its quality, and approval is expected soon. Nevertheless, the authorities have expressed their intention to delay some changes to the VAT law and the income tax treatment of some operations related, in both cases, to securitization transactions (end-June 2008 structural benchmark). These operations required enacting some tax exemptions, in the midst of a general effort by the government to reduce them.

11. In line with the obligations under the Free Trade Agreement with the U.S., the government launched a number of decrees to improve competitiveness, including the reform of ports, improvements in markets oversees, and particularly the reform of the labor market reducing the labor cost for small enterprises in an effort to formalize this sector, among others. The authorities intend to complete similar arrangements with other important trade partners.

12. The poverty rate declined from 44 percent in 2006 to 39 percent in 2007, as a result of strong growth. Even though poverty reduction was broad-based, the larger improvements took place in urban areas. In order to strengthen the poverty alleviation strategy, a Multi-Annual Social Framework was prepared by the Interministerial Committee for Social Affairs. The social program *Crecer* was expanded and, together with the conditional cash transfer program *Juntos*, has now been implemented in the poorest rural districts. Furthermore, in response to the recent increase in food prices, a temporary pilot program to distribute food among vulnerable urban groups has also been implemented. The authorities are evaluating other possible ways to mitigate the impact of the rise in food prices on the poorest segments of the population, including a targeted cash-transfer program.

13. In recognition to Peru's declining vulnerabilities and strengthened fiscal position, the rating agencies Fitch and Standard and Poor's granted investment grade to Peruvian debt. The authorities are committed to preserving macroeconomic stability and enhancing the resilience to shocks while promoting sustainable and equitable growth.

14. All end-March 2008 performance criteria were met, except the inflation target. In view of the progress under the Stand-By Arrangement, the authorities request completion of the Third Review. They stand ready to take the necessary steps to meet their commitments and pledge to maintain the usual dialogue with the Fund. They also consent to the publication of the staff report.