INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/45

PERU

2012 ARTICLE IV CONSULTATION

February, 2013

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2012 Article IV consultation with Peru, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 18, 2012, with the officials of Peru on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 30, 2013. 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.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its February 13, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Peru.

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

Selected Issues Paper

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

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International Monetary Fund
Washington, D.C.

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PERU

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

January 30, 2013

KEY ISSUES

Context. Sound macroeconomic management and strong economic performance continued in 2012, and the economy is now running close to its potential. Economic activity was driven by investment, as the weak external environment took a toll on exports and deteriorated the external current account. Against the background of an exchange rate broadly in line with fundamentals, the authorities' policies have been geared toward managing a surge in capital inflows by intervening in the foreign exchange market and sterilizing the liquidity created, while at the same time rebuilding fiscal buffers. For 2013, real GDP growth is expected to remain around potential and inflation to continue to fall as supply shocks unwind.

Risks. The outlook remains favorable but risks remain. On the downside, the economy is most vulnerable in the short term to a growth shock in China that permeates through lower commodity prices. A prolonged period of low growth in the U.S. economy could also hamper Peru's economy over the medium term. On the upside, risks to growth and inflation could result from ample global liquidity and capital inflows in the context of low growth in advanced economies. Over the medium term, the economic outlook hinges on bolstering resilience to shocks and realizing productivity growth.

Near-term policy mix. The overall policy stance is broadly appropriate as the economy is growing close to potential, inflation is expected to converge to the middle of the target band, and capital inflows are expected to ease. The fiscal policy focus on achieving fiscal surpluses and attending to immediate social needs while continuing to build fiscal buffers is adequate. Monetary policy should remain flexible and react to changes in domestic and global conditions. The authorities are committed to maintaining policies flexible, to address downside risks from the global economy as well as upside risks associated with large capital inflows.

Medium-term challenges. To support more socially inclusive growth, Peru will need to implement structural reforms to cement high sustainable growth. This will require improvements in productivity and competitiveness by boosting human capital and maintaining labor market flexibility. It will be important to remove infrastructure bottlenecks, improve further the business climate, and develop the local capital markets. Strengthening the fiscal framework would require adopting a fiscal anchor that treats adequately Peru's non-renewable wealth and reduces pro-cyclicality.

Approved By
Adrienne Cheasty and Masato Miyazaki

Discussions took place in Lima during December 5–18, 2012. The team comprised: Alejandro Santos (Head), Mercedes Vera Martin and Yu Ching Wong (all WHD). Kevin Ross, the Resident Representative in Lima, assisted the mission. Oscar Hendrick (OED) participated in the meetings. Saul Lizondo (WHD) joined the mission for the concluding meetings with Economy and Finance Minister Castilla, and Central Bank Governor Velarde.

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ANNEXES

LIST OF ACRONYMS

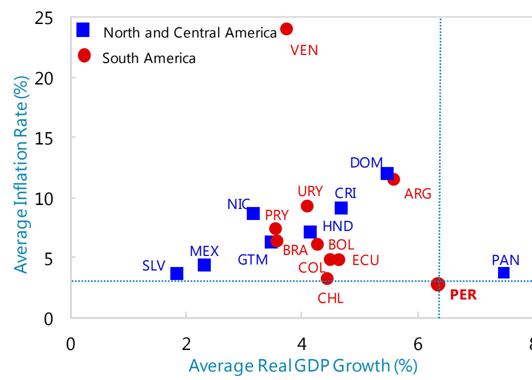
AFP	Pension Fund Administrators
AML	Anti-Money Laundering
BCRP	Central Reserve Bank of Peru
CAPM	Capital Asset Pricing Model
CDS	Credit Default Swaps
CFT	Combating the Funding on Terrorism
CGER	Consultative Group on Exchange Rate Issues
COFIDE	La Corporación Financiera de Desarrollo
CRPAOS	Certificados de Reconocimiento de Pago Annual de Obras
EM	Emerging Markets
EMBI	Emerging Market Bond Indices
eop	end of period
FSAP	Financial Sector Assessment Program
FX	Foreign Exchange
GDP	Gross Domestic Product
LA6	Brazil, Chile, Colombia, Mexico, Peru, and Uruguay
LAC	Latin American Countries
MEF	Ministry of Economy and Finance
MLT	Medium-Low Term
NFPS	Non-Financial Public Sector
NIR	Net International Reserves
NPL	Non-Performing Loans
REER	Real Effective Exchange Rate
SBS	Superintendency of Banks, Insurance, and Pensions
SMV	Superintendency of Securities Market
SOEs	State-owned Enterprises
SUNAT	National Superintendency of Tax Administration
yoy	year-on-year

CONTEXT

Following a decade of record-high growth, economic performance continued to be remarkably good in 2012. The economy decelerated somewhat and is running near potential despite weak external demand. Inflation slowed and is now within the target band. The current account deteriorated as export prices fell. Capital inflows surged, prompting sizable interventions by the central bank. Monetary conditions were tightened using higher reserve requirements and placements of central bank securities. The fiscal position strengthened, assisting the central bank in the sterilization of the capital inflows.

1. Peru's macroeconomic performance over the past decade has been exceptional. After a period of prudent macroeconomic policies, ambitious structural reforms, positive terms of trade and large direct foreign investment, Peru emerged as one of the fastest growing and most stable economies in the region. Over the period 2002–12, the Peruvian economy almost doubled in size, real GDP grew at an average annual rate of 6⅓ percent (the highest 10-year average growth in Peru's history), and the annual inflation rate fell to 2¾ percent on average (the lowest in Latin America). During the same period the public debt to GDP ratio fell by more than half to less than 20 percent of GDP.

Latin America: Real GDP Growth and Inflation
(2002-12)



2. The Peruvian economy weathered the global financial crisis of 2008–09 relatively well. The economy was only temporarily affected by the global crisis due to a well-designed contra-cyclical policy response that prevented a credit crunch, supported economic activity and sustained employment. In particular, the central bank (BCRP) dropped its policy rate by 525 basis points to 1¼ percent in 2009, and the Ministry of Finance and Economy (MEF) engineered a fiscal impulse of about 1¼ percent of GDP. The rapid policy response managed to contain the deceleration in real GDP growth to 1 percent in 2009, and the economy responded to the expansionary policies growing by 8¾ percent in 2010. As the policy stimulus was phased out during the second half of 2010 and 2011—with BCRP raising the policy rate gradually to 4¼ percent, and MEF implementing a fiscal withdrawal of 1¾ percent of GDP—economic growth moderated to 7 percent in 2011.

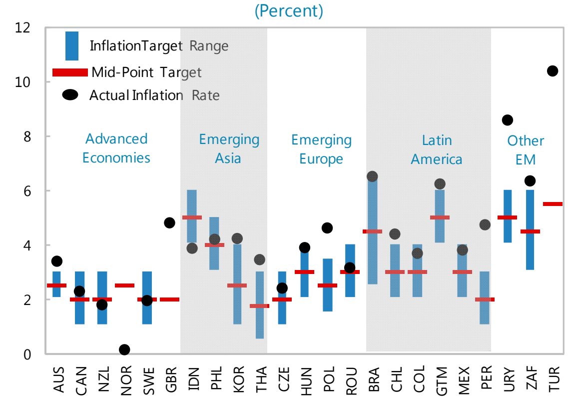
3. Economic growth gradually slowed toward potential in 2012. Real GDP growth is estimated to have moderated further to 6⅓ percent in 2012, with the output gap closing by end-2012. Activity has been driven by investment, as the weak external environment is taking a toll on exports.

- ***Strong domestic demand.*** This was driven by an acceleration of public investment, which expanded by 29¼ percent in real terms (yoy) in the first three quarters of 2012 (compensating for an unexpected fall of a similar magnitude in 2011), while private investment grew by 14½ percent in real terms (yoy) (particularly in construction). Private consumption supported the economic expansion by growing about 6 percent in real terms in the same period. Altogether, domestic demand expanded by 7½ percent in real terms (yoy) during the first three quarters of 2012, surpassing real GDP growth of 6⅓ percent (yoy).

- ***Weak external demand***. Net exports have remained a drag on economic growth as export growth decelerated to 5¼ percent in real terms (yoy) in the first three quarters of 2012 (from around 9 percent the year before) due to lower external demand and weak export prices, while import growth remained strong, at around 11 percent in real terms (yoy) in the same period.

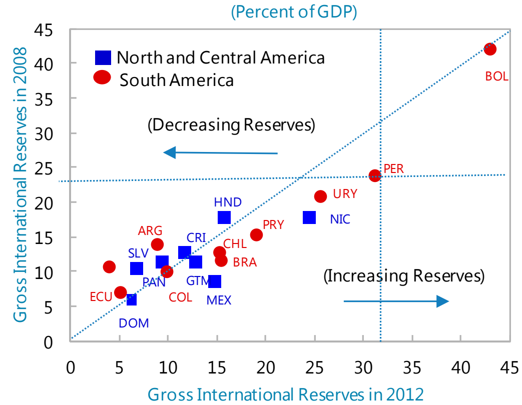
4. Inflation is converging to the mid-point of the target band. Headline inflation reached 4¾ percent by end-2011 due to supply shocks associated with higher food and fuel prices, and continued above the upper limit of the inflation target band (1–3 percent) during the first ten months of 2012 (like other emerging economies). However, inflation declined to 2¾ percent (yoy) by end-2012, as the adverse supply shocks unwound. Core inflation (excluding food and fuel items) has been well within the inflation target band during 2011–12 and remains subdued, at slightly below 2 percent. Inflation expectations remain well-anchored at 2½ percent for 2013 on account of the strong inflation targeting framework.

InflationTargets vs Outcomes in 2011
(Percent)



5. Monetary policy has been geared to deal with a surge in capital inflows. While the BCRP has kept the policy rate unchanged at 4¼ percent since May 2011, monetary conditions tightened in 2012 through the use of reserve requirements and placements of central bank's securities to sterilize large foreign exchange purchases. Abundant global liquidity and a favorable outlook for Peru—as signaled by recent sovereign credit ratings upgrades by Moody's—resulted in net capital inflows of over US$16 billion in the first 3 quarters of 2012 (about 8 percent of annual GDP), of which about ½ is in the form of foreign direct investment (FDI). Non-resident holdings of domestically-issued debt continue to increase, reaching over ½ of the total (about 3½ percent of GDP). The large capital inflow has lead BCRP to a policy of foreign exchange intervention *cum* sterilization.

Latin America: International Reserves
(Percent of GDP)

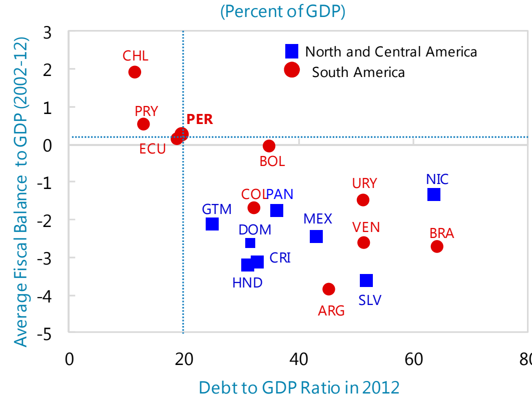


- ***Intervention***. The BCRP intervened in the foreign exchange (FX) market with a net purchase of some US$13 billion in 2012 to avoid a sharp appreciation of the currency in the context of a dollarized economy (about ⅓ of deposits and less than ½ of credits in the banking system are in U.S. dollars). Gross international reserves, reaching US$64 billion (32 percent of GDP), are adequate by any reserve adequacy metric and are among the highest in emerging market economies. Despite the large intervention, the nuevo sol appreciated by 3¾ percent (yoy) *vis-à-vis* the U.S. dollar and by almost 9 percent (yoy) in real effective terms during January-November 2012.

- ***Sterilization***. The BCRP controlled the liquidity generated from its intervention by placing its own securities with domestic financial institutions, and relying more heavily on higher reserve requirements in nuevos soles to supplement its sterilization efforts (with a hike of 225 basis points on reserve requirements during 2012 and an increase of 25 basis points in early 2013). These monetary operations sterilized about 70 percent of the liquidity generated by the intervention. Fiscal sterilization—via public sector deposits at the BCRP—also played an important role in the first part of the year thanks to a larger-than-budgeted fiscal surplus. FX intervention was accompanied by increasing sterilization costs, which staff estimates at about ¼ percent of GDP in 2012.

6. The fiscal stance was tighter than envisaged in the 2012 budget. The non-financial public sector (NFPS) overall surplus is estimated to have reached over 2 percent of GDP in 2012, (higher than the 1 percent surplus included in the 2012 budget), due to higher–than–forecast revenues and lower budget implementation despite efforts to accelerate public sector investment. Staff estimates the fiscal impulse to have been negative by about ½ percent of GDP in 2012 while there was a small positive output gap. Total financial public assets are estimated at 15 percent of GDP at end-2012, of which 4 percent of GDP are at the fiscal stabilization fund. Public debt is below 20 percent of GDP and is one of the lowest in the region.

Latin America: Fiscal Balance and Public Debt
(Percent of GDP)



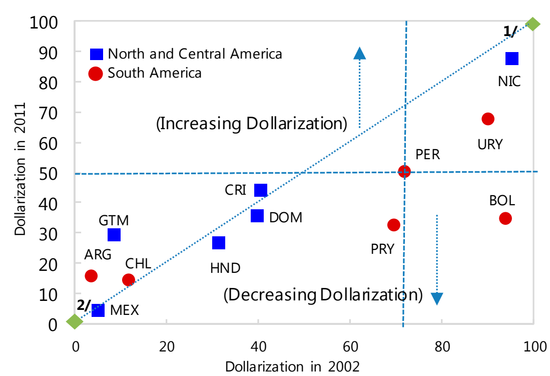
- ***Modified rule***. In April 2012, the authorities modified the current expenditure limit under the fiscal rule, mainly by excluding infrastructure maintenance from the expenditure cap (to align it with public investment), as well as current expenditures associated with some social programs and equipment for military and police forces due to higher social and security needs. In addition, the authorities introduced a temporary target on the structural fiscal balance (which controls for commodity prices) requiring an annual adjustment of at least 0.2 percent of GDP to maintain a fiscal path consistent with reaching zero structural balance over the medium term. However, the structural balance objective was achieved ahead of schedule by end-2012 due to the stronger-than-expected fiscal outcome, and the proposed fiscal adjustment is no longer binding for 2013 as the fiscal accounts have already reached a small structural surplus.[1] Moreover, the 2013 budget approved in December 2012 eliminated the temporary target on the structural fiscal balance introduced in April 2012 and proposed a non-deficit overall fiscal target for 2013. In the absence of new initiatives, the rule in place before April 2012 will be reinstated in 2014 (although a new system is expected to be in place by the time the 2014 budget is discussed in Congress).

- ***Tax administration measures***: After receiving special transitory powers from Congress in June 2012, the government enacted a number of measures which focused on strengthening compliance and enforcement. The measures included: (i) stiffer penalties for customs and tax law infractions; (ii) changes to the tax code to reduce over-reliance on tax tribunals; (iii) deduction limits on research and development and other expenditures; (iv) modifications to transfer pricing laws; and (v) changes in administrative procedures of customs, value added tax, and other tax laws with a view toward providing more discretion to the tax revenue agency (SUNAT). These measures should yield significant revenues in the medium-term as they take effect.

7. A commission was appointed to revamp the macro–fiscal framework. The current fiscal framework embedded in the fiscal responsibility and transparency law of 1999, which had a real current expenditure growth limit of 4 percent and a cap on the deficit of 1 percent of GDP, has served Peru well. It has resulted in significant debt reduction and public sector savings that proved useful when implementing the fiscal stimulus during the 2008–09 global financial crisis. However, the framework does not prevent fiscal policy from being pro–cyclical and does not steer sufficiently the management of nonrenewable resources. To improve the framework, a commission was appointed in July 2012, consisting of domestic and international fiscal experts, and is expected to provide recommendations in early 2013. Although there is no deadline for the commission to finalize its report, the government is likely to adopt a strengthened fiscal framework in the formulation of the 2014 budget (Box 1).

8. The financial sector remains solid but credit dollarization has picked up. The banking system continues to be sound, profitable, and well-capitalized. Financial soundness indicators did not deteriorate significantly during the 2008–09 crisis and continue improving—largely due to limited cross-border linkages, good supervision, and healthy balance sheets. The proactive use of macro-prudential measures (including dynamic provisioning, countercyclical capital requirements, and capital requirements to manage foreign

Latin America: Dollarization
(Percent of dollar deposits on total deposits)



1/ Countires with full dollarization include Ecuador, El Salvador, and Panama.
2/ Countires with no dollarization include Brazil, Colombia, and Venezuela.

[1] This follows the authorities' methodology for the calculation of the structural fiscal balance, with adjustment for the economic cycle and commodity prices. The latter considers a historical moving average of 15 years as the equilibrium commodity price.

exchange credit risks) aimed to strengthen financial stability. The non-performing loans (NPL) ratio remains low (at 1¾ percent as of August 2012) and well–provisioned. Overall, private credit growth has fallen to around 16½ percent (yoy) for the first ten months of 2012, with significant growth in the consumer and mortgage segments—both also reporting a pickup in U.S. dollar lending. Outstanding foreign currency credit stands at 43 percent of total credit and could potentially exacerbate the impact of external shocks via foreign exchange effects on balance sheets. In order to deter external financing, the authorities extended in May 2012 the 60 percent reserve requirements on foreign liabilities to those with maturity up to 3 years (from 2 years) and imposed a 20 percent reserve requirement on foreign liabilities with maturity higher than 3 years.[2] While housing prices have increased lately, it seems driven by strong demand from creditworthy households and shortages of housing in several metropolitan areas (Box 2).

9. Despite a widening current account deficit, external stability risks remain contained. The current account deficit widened from 2 percent in 2011 to about 3½ percent of GDP in 2012 mostly due to deteriorated terms of trade, weak volume growth in mineral exports and strong growth in import volume. The authorities also noted that the current account deficit could be overestimated by about ½ percent of GDP due to under-recording of gold exports, as illegal gold production is no longer intermediated through legal traders. However, the current account deficit continues to be more than covered by high FDI, projected at 5 percent of GDP in 2012. Short-term capital inflows rebounded in the second quarter, with a cumulative inflow of 1¾ percent of GDP in the first three quarters of 2012.

10. Structural reforms continued to be implemented. These reform initiatives include the tax administration measures and efforts to revamp the fiscal framework mentioned above, as well as approval of new labor regulations for the armed forces and gradual wage increases for civil servants estimated at about ¼ per cent of GDP per year during the next five years starting in 2013. The reform of the private pension system adopted in July 2012 aims at increasing competition through raising the number of total workers included in the private funds from the current 30 to 40 percent of the workforce (requiring workers earning 1.5 times the monthly minimum wage to contribute 10 percent of their income to a pension fund) and lowering the fees for pension contributors. Private pension funds are administrated by four major private companies (AFPs) and total about US$34 billion (18 percent of GDP), with investments abroad accounting for 27 percent of total assets against an operating limit of 32 percent (and a legal maximum of 50 percent). In addition, the authorities presented a number of proposals to Congress for capital market reform aimed at improving good governance regulations, encouraging issuance of debt, simplifying procedures and reducing costs, and establishing special programs for qualified investors; and a plan to expedite the execution of public-private partnerships investment projects.

[2] The BCRP also reduced reserve requirements on trade credit from 60 percent to 25 percent in light of uncertain global conditions.

11. Social tensions remain a key concern. While significant progress has been made in the last decade in reducing poverty and improving standards of living, some social indicators are below those in other countries with the same level of income. The government has promoted socially inclusive growth policies consistent with macroeconomic stability. However, persistent social conflicts and slow progress in social inclusion remain a concern. There are some 250 active social conflicts, with the majority related to protests about extractive industry projects in rural areas, on the grounds of environmental destruction and inadequate compensation to local communities. While the majority of mining and gas projects have progressed without problems, protestors have been disruptive in several cases. At the same time, teachers and doctors have gone on strike to protest low salaries.

OUTLOOK AND RISKS

The near-term outlook remains favorable despite the adverse external environment, but subject to risks. In particular, negative terms of trade shocks could reduce exports, investment and growth; while ample global liquidity and capital inflows could lead to overheating.

12. The near-term outlook remains favorable, with real GDP growth projected at potential. In staff's baseline scenario, similar to that of the authorities, the output gap closes at end-2012 and growth stabilizes at around potential (6–6½ percent) supported by domestic demand and elevated commodity prices. Inflation is expected to remain subdued and converging to the mid-point of the target band (1–3 percent). Capital inflows are expected to ease as: (i) the foreigners' portfolio shift towards Peruvian assets is accommodated; (ii) the supply of additional investment instruments is limited; and (iii) the appetite for Peruvian risk moderates.

Peru: Macroeconomic Framework

	2009	2010	2011	Est. 2012	Proj. 2013
(Annual percent change)					
Real GDP	0.9	8.8	6.9	6.3	6.3
Inflation (eop) 1/	0.2	2.1	4.7	2.8	2.0
Policy rate (eop) (%)	1¼	3	4¼	4¼	…
Real exchange rate 2/	3.4	2.4	-1.0	8.8	…
(In percent of GDP)					
Output gap 3/	-2.2	-0.2	0.2	0.0	-0.1
External current account	-0.5	-2.5	-1.9	-3.5	-3.5
Fiscal balance 4/	-1.3	-0.3	1.9	2.1	1.5
Public debt 4/	28.4	24.6	22.2	19.3	17.2

Sources: Peruvian authorities; and Fund staff estimates.
1/ Inflation target 1-3 percent; 2/ Effective, avg, (-) = real depreciation.
3/ Percent of potential GDP; 4/ Nonfinancial public sector (including CRPAOs).

13. However, the global outlook poses significant risks to the economy in both directions. As revealed during the global financial crisis of 2008–09, Peru is vulnerable to a collapse in global trade and uncertainty about global growth, but it is now better positioned to deal with financial shocks.

- ***Downside risks from the global economy could have a significant impact on Peru primarily through terms of trade shocks.*** Global growth stagnation due to continued uncertainty in the euro zone will especially hurt Peru's exports, while its financial exposure to the euro zone is limited.[3] However, the combination of a sharp relapse in global growth and a return of global risk aversion is the principal tail risk that could encumber the growth outlook. In particular, a significant fall in metal prices—triggered by a larger-than-envisaged slowdown in China, Peru's largest trading partner—would have a significant negative effect on exports, investment and growth prospects.

- ***Upside risks could result from ample global liquidity and capital inflows in a context of anemic growth in advanced economies*.** Peru's combination of long-standing macroeconomic stability and prudent policy management with positive growth prospects could further stimulate large and sustained capital inflows that could test the absorption capacity of the economy and pose significant policy challenges. Strong capital inflows could result in buoyant domestic demand dynamics, heightened overheating risks and potential credit and asset price booms.

14. Notwithstanding the favorable medium-term outlook, important challenges remain. As Peru continues to benefit from steady terms of trade and as investments in natural resources mature, staff projects the economy to grow at around potential (6 percent) and inflation in the mid-point of the target band (2 percent) over the medium term. The current account deficit is projected to moderate (towards 3 percent of GDP) as global conditions normalize. Overall, primary fiscal surpluses are expected to be anchored at around 2 percent of GDP, while public debt ratios will continue to decline to below 15 percent of GDP. Going forward, the economic outlook hinges on bolstering resilience to shocks and fostering productivity growth. In addition to continued prudent macroeconomic policies, it will be important to identify key infrastructure projects to close the infrastructure gap, promote a dynamic (but stable) financial system, and ensure a more socially inclusive growth strategy.

[3] One of the links to the euro zone is through the Spanish bank BBVA, which co-owns one of the largest banks in Peru (BBVA Continental) with a domestic investor; the bank is well-capitalized, liquid, and boasts a large domestic deposit base. The ownership structure and the regulations of the Superintendency of Banks, make it very difficult for this bank to provide credit to the parent bank in Europe.

CHALLENGES AND POLICY DISCUSSIONS

With the economy close to potential but external risks looming large, discussions focused on: (i) the appropriate near-term policy mix; (ii) dealing with additional global spillovers; and (iii) policies to reinforce high growth prospects over the medium term. Under the baseline scenario, the overall policy stance is broadly appropriate as it envisages inflation converging to the middle of the target band and continues to facilitate the buildup of fiscal buffers. Policy discussions emphasized the need for policy flexibility going forward given the uncertain global environment.

A. Near–Term Policy Mix

15. The 2013 budget aims at maintaining a small fiscal surplus, which is broadly consistent with staff's previous recommendations. The approved 2013 budget targets a fiscal surplus of 1.1 percent of GDP, in line with the multi-year macroeconomic framework published in mid-2012. The authorities noted that the 2013 budget includes a number of measures to strengthen tax compliance. Staff estimates that the fiscal surplus for 2013 could be about ½ percent of GDP higher due to elevated metal prices and normal levels of expenditure execution. The budget accommodates an increase in primary spending of about 10 percent in real terms to gradually achieve the goals set by the government on social inclusion and the civil service reform (including wage increases for some civil servants—teachers and doctors—whose salaries have been frozen for several years). Staff estimates that the authorities will reach a structural fiscal surplus of about 1 percent of GDP in 2013, which is in line with previous staff recommendations. This will translate into a structural expansion of about ½ percent of GDP in 2013, which is mildly pro-cyclical—largely due to the higher-than-budgeted surplus in 2012. Prudent implementation of the 2013 budget is expected, which will help to continue rebuilding policy buffers.

Peru: Fiscal Accounts [1/]
(In percent of GDP)

	2009	2010	2011	Est. 2012	Proj. 2013
Revenues	**24.0**	**25.1**	**26.2**	**26.3**	**26.2**
Taxes	14.1	15.2	15.9	16.2	16.4
Non-taxes	9.9	9.9	10.3	10.2	9.8
Primary expenditures	**24.0**	**24.2**	**23.2**	**23.2**	**23.8**
Current primary	17.9	17.7	17.9	17.4	17.8
Capital	6.1	6.5	5.3	5.8	5.9
Primary balance	**0.0**	**0.9**	**3.0**	**3.1**	**2.5**
Interest payments	1.3	1.2	1.2	1.0	1.0
Overall balance	**-1.3**	**-0.3**	**1.9**	**2.1**	**1.5**

Sources: Peruvian authorities; and Fund staff estimates.
1/ Nonfinancial public sector.

16. The central bank remains vigilant to react to risks associated with strong domestic demand dynamics, large capital inflows and rapid credit growth. The BCRP has kept the policy rate unchanged as core inflation was within the target, the economy stayed close to potential and the external environment remained uncertain (Box 3). In parallel, hikes in average reserve requirements have resulted in tighter liquidity conditions to dampen strong credit growth. In view of the expected fall in inflation in 2013, the central bank decision to keep policy rates on hold is adequate as inflation expectations remain well–anchored. While the central bank acknowledged that there was scope for further hikes in average reserve requirements, they underscored the risks of domestic financial disintermediation in the context of easy access to external financing. The proactive use of reserve requirements, in coordination with other prudential measures, should help in containing risks associated with excess liquidity and strong private credit dynamics. Under staff's baseline scenario, capital inflows are expected to moderate significantly in 2013, alleviating appreciation pressure on the nuevo sol. Fiscal and monetary policy should be used to mitigate inflationary and demand pressures. If these inflows prove higher than expected, a policy of intervention/sterilization would be appropriate to avoid excessive exchange rate movements.

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

	2009	2010	2011	Est. 2012	Proj. 2013
Base money	**5.5**	**45.3**	**16.8**	**31.9**	**16.2**
Net domestic assets [1/]	**15.4**	**-74.4**	**-6.2**	**-46.6**	**-12.6**
Public sector (net)	-3.4	-19.8	-33.9	-32.4	-9.5
Banking system (net) [2/]	-11.4	-50.6	23.2	-22.5	-12.1
MLT foreign liabilities [3/]	25.8	-11.8	-8.5	-7.8	6.4
Other (net)	4.4	7.8	13.0	16.1	2.7
Net international reserves	**-9.8**	**119.6**	**23.0**	**78.5**	**28.8**

Sources: Central Reserve Bank of Peru; and Fund staff estimates.
1/ Includes medium- and long-term foreign liabilities
2/ Includes securities issued; 3/ Includes other foreign currency liabilities

17. With the exchange rate level remaining broadly in line with fundamentals, discussions focused on the merits of higher exchange rate flexibility over shorter time horizons going forward. Staff welcomes the authorities' efforts to increase exchange rate flexibility. The authorities are concerned about excessive exchange rate volatility in the context of a still highly dollarized economy, but do not target a pre-determined level of the exchange rate. The authorities emphasized that the exchange rate was broadly in line with fundamentals (see Annex I for a detailed analysis).[4] The challenge going forward is to allow for higher exchange rate volatility over short term horizons to reduce incentives for one-way bets on exchange rate movement and to accommodate changes in the exchange rate in line with fundamentals over longer term horizons. The authorities explained that their new FX intervention approach aims at higher intra- and inter-day foreign exchange flexibility. In late 2012, the BCRP consistently intervened by buying reduced amounts of FX, in contrast with the previous mechanism in which the central bank would intervene by the end of the session either buying or selling FX for seemingly unlimited amounts. Staff welcomes this new approach as it should help enhance the shock absorber role of the exchange rate, and help the private sector internalize exchange rate risks and reduce sterilization costs.

Peru: Balance of Payments
(In percent of GDP)

	2009	2010	2011	Est. 2012	Proj. 2013
Current Account	**-0.5**	**-2.5**	**-1.9**	**-3.5**	**-3.5**
Exports	21.1	23.1	26.1	22.7	22.6
Imports	-16.5	-18.7	-20.9	-20.5	-20.2
Other	-5.1	-6.8	-7.1	-5.7	-5.8
Financial Account	**1.3**	**9.7**	**4.4**	**10.9**	**5.7**
Public sector (net)	-0.2	1.6	0.5	1.0	0.9
Private sector (net)	1.5	8.2	4.0	9.9	4.8
Foreign direct investment	4.7	5.3	4.6	5.0	4.1
Other private (net) [1/]	-3.3	2.8	-0.6	4.8	0.6
Overall Balance	**0.8**	**7.3**	**2.5**	**7.3**	**2.2**

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

18. The proactive use of prudential measures is welcome, but further efforts may be needed to deter excessive lending. While the financial sector remains strong and resilient, the authorities have shown concern about the buildup of foreign exchange mismatches as borrowers may not sufficiently internalize foreign exchange risks in the context of appreciation pressures for the

[4] As mentioned before, the external current account for 2012 overestimates the deficit by about ½ percent of GDP because of under-recording of illegal gold exports (which were recorded before because gold was intermediated through legal traders). Once adjustment is made for this amount, the average of the three CGER (consultative group on exchange rates) and two EBA (external balance assessment) methodologies gives an overvaluation of the nuevo sol of about 5 percent, which is within the acceptable margin of error.

nuevo sol. Prudential regulation has been strengthened, including: (i) liquidity requirements in line with Basel III criteria; (ii) higher provisioning and capital requirements, especially in relation to mortgages and long-term consumption lending (to help financial institutions internalize foreign exchange credit risks); and (iii) targeted measures to discourage FX lending in automobile and other consumer loans (especially those related to revolving credit). Tighter limits in the derivative and foreign exchange positions of banks may also help reduce incentives for FX lending. However, existing regulation may prove insufficient in light of the expected appreciation of the nuevo sol and easy U.S. dollar funding conditions. In this regard, staff suggested prudential measures that could penalize more heavily FX lending at long-term maturities (i.e., lower loan to value ratios for mortgages) as well as strengthening supervision to ensure that banks adequately assess FX credit risks. The authorities have also adopted key measures in the national plan for combating money laundering (Box 4).

B. Dealing with Global Spillovers

19. Preserving policy flexibility is essential given the two-sided risks to the outlook. The authorities acknowledged the policy challenges faced by the uncertain outlook for Peru during 2013 and recognized that it may require further policy coordination between the fiscal, monetary and financial authorities to manage distinct macroeconomic challenges. In assessing global risks, the authorities noted that Peru would be most vulnerable to a shock from lingering U.S. fiscal policy uncertainty and also to a growth shock that permeates through lower commodity prices in the short term; while a prolonged lack of a medium-term plan for U.S. fiscal consolidation would hamper Peru's economy over the medium term. Although these events have low probability, the impact on the Peruvian economy could be high (Box 5).

20. Peru is well-positioned to cope with negative spillovers. Under a scenario of global financial disruption and a surge in risk aversion which leads to a reversal of capital inflows, the central bank can deploy substantial actions to maintain confidence and ensure orderly functioning of financial markets. The high tenure of sovereign domestically-issued debt held by nonresidents makes Peru vulnerable to a rapid reversal in risk sentiment. Higher exchange rate flexibility in combination with the use of reserves, liquidity buffers, repo operations and dollar swap auctions can ensure liquidity in the financial system and avoid a credit squeeze, in line with the authorities' adequate response during the 2008 Lehman crisis. Under a long-term global stagnation scenario, monetary and macro-prudential policies should be relaxed as the first line of defense to support economic activity, and ease the adjustment. If a sharp deterioration in terms of trade materializes, a fiscal stimulus—in conjunction with the above—could be effective to ease the adjustment in economic activity and employment.

21. The authorities noted that, if upside risks materialize, policy coordination may prove challenging to ensure a timely and effective response to overheating risks. In the context of large capital inflows and strong domestic demand dynamics, a multipronged and more coordinated policy response may be needed to confront demand pressures and overheating risks. Under this

Peru: Global Risk Assessment Matrix 1/

Shock	Direction	Relative Likelihood	Impact
Short-Term Risks			
Strong intensification of the euro area crisis (incomplete delivery of political commitments leading to yield reversals)	↓	**Medium**	**Low**
Lingering U.S. fiscal policy uncertainty (political gridlock leading to a compromise involving excessive austerity)	↓	**Low**	**High**
EM capital flow reversal (associated with a strong unwinding of asset price overvaluation in some countries)	↓	**Medium**	**Medium**
Further slowdown in emerging markets (including a further growth shock in China permeating through commodity prices)	↓	**Low**	**High**
Ample global liquidity (fueling strong capital inflows and results in strong domestic demand dynamics)	↑	**Medium**	**High**
Medium-Term Risks			
Protracted period of slow European growth (larger than expected deleveraging or negative surprise on potential growth)	↓	**Medium**	**Low**
Lack of medium-term plan for U.S. fiscal consolidation (gradual erosion of reserve currency status and pressure on yields)	↓	**Low**	**High**
Reversal in private sector investment (especially in non-renewable resources, Peru-specific)	↓	**Low**	**High**

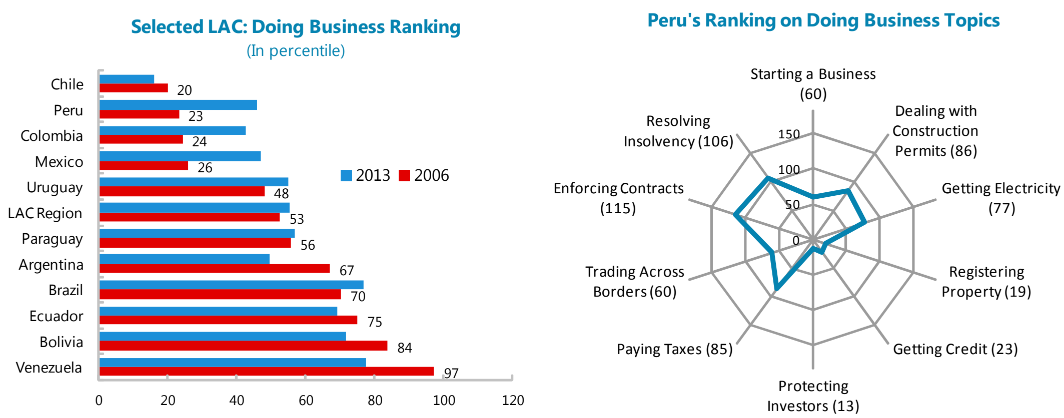
1/ The Global Risk Assessment Matrix (G-RAM) shows events that could materially alter the baseline path. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The G-RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with authorities in December 2012.

scenario, the authorities noted that tightening monetary conditions will need to rely on a combination of quantitative measures, including reserve requirements, hikes in policy rates and higher exchange rate flexibility. In parallel, tighter prudential measures would help prevent the buildup of financial underlying vulnerabilities in light of rapid credit growth. In coordination with warranted adjustment in macroeconomic policies, the authorities noted that additional targeted, transparent and temporary capital flow measures, including those to ease limits on investments abroad by the private pension funds or to deter external financing through hikes in the reserve requirement on external liabilities or in the withholding tax for nonresidents' capital gains, may be used in response to a surge in capital inflows. If upside risks materialize, fiscal policy may need to play a countercyclical role in order to avoid generating additional demand pressures and thus support monetary policy. In the event the surge in capital inflows are of a permanent nature, FX intervention would be limited to smoothing the adjustment and the exchange rate would need to play a key role and appreciate to keep the exchange rate in line with the evolving fundamentals.

C. Medium-Term Challenges to Ensure High Economic Growth

22. An ambitious reform agenda is needed to enhance potential growth and support a more socially inclusive growth strategy. Staff concurs with the authorities' view that economic growth will need to be increasingly driven by higher productivity. Staff also agrees with the authorities on the need to deepen structural reforms. Key pillars include: (i) enhancing competitiveness by boosting human capital and maintaining labor market flexibility; (ii) defining a nationwide strategy to remove infrastructure bottlenecks; (iii) improving the business climate further to foster investment and innovation (including enhancing formality and strengthening institutions); and (iv) further developing local capital markets to facilitate investment and better allocate savings. These reforms, together with more effective implementation of social programs in line with the agenda of the Ministry of Social Development and Inclusion, will enable the authorities to deliver more socially inclusive economic growth.

Peru: Doing Business Indicators, 2013 1/



Source: World Bank, Doing Business Indicators, 2006 and 2013.
1/ The 2006 and 2013 rankings are across 155 and 185 economies, respectively.

23. Since elevated commodity prices are expected to persist over the medium term, the authorities have the opportunity to put the economy on a high and sustainable growth path. The authorities agreed on the need to define a comprehensive public investment strategy that upgrades infrastructure and removes bottlenecks. This will require identifying infrastructure needs and capacity constraints at the national and sub-national levels, establishing priorities for large investment projects, and evaluating financing needs while identifying opportunities for public-private partnerships over the medium term. An investment strategy is bound to be costly and needs to be carefully integrated in the budget over time. Adopting a firm and prudent medium-term fiscal policy would help contain other short run expenditure pressures, while laying the basis for balanced economic growth and equitable spending across generations.

24. Strengthening the fiscal framework would require adopting an adequate fiscal anchor that manages Peru's non-renewable wealth appropriately. Building on the success of Peru's Fiscal Responsibility and Transparency Law in reducing public debt and ensuring fiscal responsibility, the authorities noted that a fiscal anchor should enhance the predictability of public spending growth over the medium term taking into account commodity prices and intergenerational equity in the use of nonrenewable resource wealth. Staff discussed with the authorities alternatives for the fiscal anchor, including modifications to the current rules, adoption of a structural balance, and the possibility of adopting a non-resource primary balance (NRPB) (i.e., excluding non-renewable resource taxation and interest payments) over the medium term to enhance fiscal savings.[5] However, given capacity constraints, as shown by the under-execution of public expenditure in the last two years, fiscal savings in the short term could be partially deployed as capacity expands to ensure high-quality investment. The authorities recognized the challenge of establishing a fiscal anchor that balances the need for savings arising from intergenerational equity and fiscal risks,[6] with expenditure pressures to close the infrastructure and social gaps. Over the medium term, the authorities saw merit on running a small overall fiscal surplus to address unexpected contingencies, but acknowledged strong expenditure pressures. In parallel, a comprehensive strategy to manage public savings effectively will be needed without restricting flexibility for fiscal policy formulation. Staff noted that a strong political commitment as well as the steady implementation of a fiscal rule is equally important. Once the new fiscal rule is adopted, the practice of adopting supplementary budgets would undermine the rule and should be discontinued when possible. Moreover, a communications strategy should be developed to gain public support for fiscal savings in Peru under the current elevated commodity price cycle. Over the medium term, the authorities agreed that increases in current expenditure should be moderated to avoid challenges to macroeconomic management. Staff looks forward to the report of the fiscal commission which is expected to address these issues.

25. The authorities' efforts to strengthen tax administration are welcomed, but medium-term tax targets are ambitious. The authorities noted that Peru's tax collections are low compared with other emerging markets in terms of revenue mobilization and tax effort (i.e., the ratio of actual revenues to potential) while investment and public social spending is lower than in other emerging economies with similar per-capita income. In line with Fund technical assistance recommendations, the authorities have undertaken legal changes in closing tax loopholes, approved the law strengthening the institutional framework of the SUNAT and the comprehensive overhaul of the organization of SUNAT. Also, the authorities' efforts to raise tax compliance are likely to bear significant results given the high level of informality. In this regard, the government's goal of raising tax revenues to 18 percent of GDP by 2016 will allow the country to achieve similar tax-collection ratios as in other emerging economies and will enable an expansion of social programs. Staff encouraged the authorities to take the necessary measures to ensure that the ambitious tax objective is achieved.

[5] The primary fiscal balance consistent with debt sustainability is -½ percent of GDP (see Annex II on debt sustainability analysis). A strong fiscal position consistent with debt sustainability and full savings of the non-renewable resource revenue (currently 4 percent of GDP) would yield a NRPB of -½ percent of GDP. The NRPB over the medium term is projected to be -2¼ percent of GDP, which is consistent with saving about 60 percent of the non-renewable resource revenue.

[6] Significant fiscal risks are associated with contingent liabilities and natural disasters, since Peru is vulnerable to earthquakes and climate change (as well as the "El Niño"/"La Niña" effects).

26. Further enhancing financial supervision and prudential measures may be needed to limit the buildup of systemic risks. The authorities recognized that large capital inflows to Peru risk fuelling future credit and asset price booms. The presence of financial conglomerates, coupled with continued strong credit growth, could increase systemic vulnerabilities as financial deepening may result in new credit risks. In this regard, the proactive use of prudential measures and efforts to improve corporate governance and supervision of conglomerates are welcome. Corporate governance for municipal savings banks should be strengthened, for instance by allowing private investors to have a seat on bank boards to facilitate private sector participation and enhance private investment. Going forward, staff noted that consideration could be given to strengthening the financial resolution framework for systemic stress conditions and revisiting the initiative to include cooperatives under SBS supervision. Further institutional coordination in managing systemic risks and designing macro-prudential policy could facilitate prompt policy response. Also, staff recommends monitoring household and corporate sector balance sheets, including FX mismatches, in a systematic way to better assess macro-financial risks.

27. The deepening of domestic capital markets would facilitate channeling resources effectively in the economy. The actual and potential demand for domestic assets has increased substantially in recent years, but the supply of assets has been limited. The creation of the Integrated Latin American Market (MILA) with the integration of the Chilean, Colombian and Peruvian stock markets is expected to increase market liquidity and the spectrum of investible assets.[7] While structural factors—economic size and selective nature of issuers—are part of the challenges to overcome, the authorities are taking steps in reviewing regulations and taxation to foster the expansion of assets available including by easing access to capital-market financing. In this context, and following up on the 2010 FSAP recommendations, the authorities have started to explore elements to ease access to capital markets (through review of the public offering regime, market transactions costs and an analysis of indirect mechanisms for SME access to capital markets). In addition, the authorities aim at strengthening their supervisory approach via the implementation of risk-based supervision. Pre-approval of the asset class for pension funds investment portfolio, rather than the SBS's approval by instrument, would also facilitate channeling savings more effectively.

STAFF APPRAISAL

28. Peru's impressive economic performance attests to its strong fundamentals and sound policy management. The strength of the economic growth after the global financial crisis has been underpinned by strong fundamentals, sound balance sheets and policy frameworks and skillful policy management. With the economy close to potential, the policy challenges ahead involve maintaining an appropriate policy mix, and weighing policy responses to both downside and upside scenarios. The near-term outlook remains favorable, but subject to risks. In particular, negative terms of trade shocks could reduce exports, investment and growth; while ample global liquidity and capital inflows

[7] It is expected that MILA will incorporate Exchange Traded Fund (ETFs), American Depositary Receipts (ADRs) and fund participations listed in Chile, Colombia and Peru during 2013.

could lead to overheating. The policy stance and mix have been broadly appropriate so far and have enabled Peru to cope with capital inflows amid lax monetary conditions in advanced economies.

29. The fiscal policy stance imbedded in the 2013 budget remains broadly adequate. The approved 2013 budget aims at a fiscal surplus of about 1 percent of GDP. Staff estimates that the fiscal surplus in 2013 could be about ½ percent of GDP higher due to elevated metal prices and normal expenditure execution. Despite a budgeted increase in primary spending of about 10 percent in real terms for 2013, an overall fiscal surplus is expected to continue. The structural expansion of about ½ percent of GDP is mildly pro-cyclical and in part due to the higher-than-budgeted surplus in 2012. Over the medium term, further increases in current expenditure should be moderated to avoid challenges to macroeconomic management.

30. The monetary authority should remain vigilant and react flexibly to changing domestic and global conditions. Under the baseline scenario, policy rates should continue to be neutral if core inflation remains subdued and expectations well-anchored. There continues to be room for the proactive use of reserve requirements to manage liquidity and credit dynamics, while being vigilant to the risks of domestic financial disintermediation. Under the baseline scenario, monetary policy should be used to mitigate demand and inflationary pressures.

31. The anticipated higher exchange rate flexibility is welcomed as it will strengthen the role of the exchange rate as a shock absorber. Staff welcomes the steps by the central bank to increase exchange rate flexibility and introduce higher intra– and inter–day volatility in the foreign exchange market. With the exchange rate level broadly in line with fundamentals, the authorities will allow higher exchange rate flexibility while at the same time accommodating changes due to fundamentals. Going forward, the higher exchange rate flexibility will play a key role in buffering external shocks and assist the private sector to better internalize foreign exchange risks and reduce sterilization costs.

32. The proactive use of macro-prudential measures should continue to limit the buildup of financial vulnerabilities in the context of large capital inflows and strong credit growth. While the financial sector remains strong and resilient, large capital inflows risk fuelling credit and asset price booms in the future. The increase in FX lending in mortgages and long-term consumption credit may reflect borrowers' not sufficiently internalizing foreign exchange risks. Existing regulation may prove insufficient in light of the expected appreciation of the nuevo sol and easy U.S. dollar funding conditions. Further institutional coordination in managing systemic risks and designing macro-prudential policy would facilitate a prompt policy response. Therefore, prudential measures that penalize more heavily FX lending at long-term maturities as well as strengthening supervision to ensure that banks adequately assess FX credit risks would be welcome.

33. Preserving policy flexibility is essential given the two-sided risks to the outlook. The authorities have the policy buffers to deal with negative spillovers. In the event of a reversal of capital inflows, the central bank can use a combination of exchange rate flexibility and reserve buffers. Relaxing reserve requirements would help to ensure orderly functioning of credit markets. If weak global conditions continue, monetary and macro-prudential policies could be eased to support economic activity. If a sharp deterioration in terms of trade materializes, a fiscal stimulus could ease the adjustment in economic activity and employment. Further policy coordination will be needed if upside risks materialize to prevent overheating. Monetary policy would need to be tightened. In parallel, tighter prudential measures would be required to prevent the buildup of financial vulnerabilities in light of rapid credit growth. In coordination with warranted adjustment in macroeconomic policies (including on the exchange rate), additional targeted, transparent and temporary capital flow measures could be used in response to a large surge in capital inflows to address excessive exchange rate movements. Fiscal policy may need to play a more supportive countercyclical role to avoid generating additional demand pressures.

34. Strengthening the fiscal framework will require an adequate anchor. Given the significant reduction in public debt in the last decade, any new fiscal framework should cement the prudent management of non-renewable resources, taking into account commodity prices and intergenerational equity, and avoiding pro-cyclicality in the fiscal stance. A fiscal anchor will require balancing the need for savings for future generations and to cushion fiscal risks with the need to close infrastructure and social gaps over time. Staff looks forward to the report of the fiscal commission which is expected to address these issues.

35. Tax targets are ambitious but necessary to finance the social agenda. Staff welcomes the authorities' actions to revamp the SUNAT and improve tax compliance. In this regard, the government's goal of raising tax revenues to 18 percent of GDP by 2016 would bring Peru's tax ratio in line with those of other emerging economies and help finance the expansion of social programs and public investment over the medium term. Staff encouraged the authorities to take the necessary measures to ensure that the ambitious tax objective is achieved.

36. To improve growth prospects, Peru should tackle long-standing structural bottlenecks to enhance productivity. Economic growth will need to be driven by higher productivity. Key pillars for the structural reform agenda include enhancing competitiveness; defining a nationwide strategy to remove infrastructure bottlenecks; improving the business climate further to foster investment; and developing local capital markets further to facilitate investment and better allocate savings. The elevated commodity prices expected to persist over the medium term provide the opportunity to put Peru on a sustainable high long-term growth path.

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

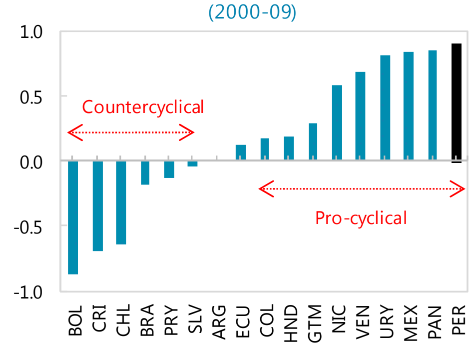
Box 1. Peru: Revamping the Macro Fiscal Framework

The Peruvian authorities have announced their intention to improve the macro-fiscal framework. The system of fiscal rules introduced in 1999 has served Peru well, facilitating the strengthening of public finances and reducing public debt. However, with the weight of mining revenue growing and pressures to spend mounting in a context of high commodity prices and contained social demands, there is a case for refining the framework with a view to ensuring the efficient use of commodity revenues and enhancing public savings while maintaining macroeconomic stability. For that purpose, the authorities have established a technical commission with local and international experts to come up with proposals that would tie up the previous analyses with a focus on feasibility. The recommendations of the fiscal commission are expected to be incorporated in the formulation of the 2014 budget.

The current framework embedded in the fiscal responsibility law has been very effective in strengthening public finances and reducing public debt. The framework contains the following elements: (i) a multi-annual macroeconomic framework which sets three-year macroeconomic projections of revenue, expenditure, public investment and public debt; (ii) numerical fiscal rules which could be classified into three main categories: balanced budget, expenditure and debt rules applied to three different levels of government; and (iii) a fiscal stabilization fund (FEF) which is endowed with any fiscal surpluses generated by the Treasury, 10 percent of privatization proceeds and 10 percent of concessional fees, with a cap of 4 percent of GDP, which is about to be reached.

However, the implementation of the macro-fiscal framework has not been conducive to counter-cyclical fiscal policy. When measured by the correlation between the change in the cyclical component of government expenditures and the output gap, Peru displays a high level of pro-cyclicality compared to other emerging economies.[1] Fiscal policy management has been complicated by changes in the rules regarding coverage of expenditures (from general to central government); exclusion of investment; frequent use of supplementary credits; and the unpredictable use of outstanding balances by sub-national governments. Furthermore, the rapid increase of transfers to sub-national governments associated with the natural resource revenues and a lack of absorption capacity have resulted in added volatility in expenditure patterns, particularly for those regions and municipalities that are mineral producers. Furthermore, the multiplicity of rules and their hard-to-grasp nature is a problem particularly at the sub-national level, where no less than eight rules exist.

Latin America: Procyclicality of Public Expenditure 1/
(2000-09)



Source: Frankel et al (2011).
1/ Pairwise correlation between the cyclical components of public expenditure and real GDP.

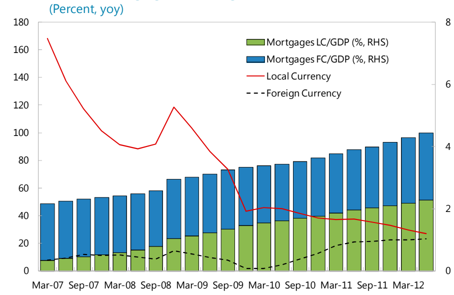
In order to enhance public financial management in Peru, a commodity exporter, a comprehensive approach needs to identify expenditure needs, savings objectives, and absorption capacity limits. Reliance on natural resource revenues has increased over time. Overall, the share of mining in total revenues has increased from 2½ percent in 2000 to 14 percent in 2011 (or about 2.6 percent of GDP). This has the potential to raise fiscal vulnerabilities since these revenues are much more volatile than other sources and have a temporary component; while any new increases in current spending are likely to become permanent. At current commodity prices, Peru may not have fully taken advantage of the commodity boom to increase public savings. Additional savings may also be warranted in the context of limited absorption capacity in the short term, especially for investment spending, and necessary in view of the potentially large contingent liabilities (i.e., earthquakes, climate change such as "*El Niño*"/"*La Niña*" effects). Those savings would need to be balanced with the need to increase social and infrastructure spending in the shorter term to reduce poverty and enhance potential economic growth. Defining a nationwide public investment/social strategy with clear priorities and objectives would help identify medium-term spending needs and bottlenecks to overcome. In this context, a multi-annual budgeting design will also help enhance the management of public finances.

1/ Frankel, J. 2011, "A Solution to Fiscal Procyclicality: The Structural Budget Institutions Pioneered by Chile", NBER Working Paper No. 16945 (Cambridge, Massachusetts, National Bureau of Economic Research).

Box 2. Peru: Housing Market Developments

In line with developments in the region, Peru's housing market has been performing strongly in the past years.[1] The average price of homes sold in the Lima Metropolitan Area rose 20 percent in 2011, to S/. 262,000 (about US$100,000), according to the real estate consulting firm Tinsa, although this may partly reflect a change in the composition of home sales. Residential home sales went up by 50 percent in 2011. The districts with most projects are the high-end *Santiago de Surco*, followed by *Miraflores* and *San Isidro*. Other districts with high demand are those associated with low socioeconomic status districts (i.e., *San Juan de Lurigancho* and *Los Olivos*). In 2012 and beyond, the housing market is likely to continue to be strong, with the help of lower mortgage rates, improved public investment and Peru's economic strength.

Peru: Mortgage Lending Growth
(Percent, yoy)



Sources: BCRP; and Fund staff calculations.

Favorable external conditions, economic growth and stronger fundamentals have boosted housing finance, supported by rising living standards. Mortgage lending has almost doubled from 2.6 percent of GDP in 2007 to 4.4 percent of GDP as of June 2012. Most of the increase has been in local currency mortgages, which account now for about half of outstanding mortgages (and represented less than one-fifth in 2007). Rising mortgage lending has gone in hand with the expansion of the construction sector, which has been the most dynamic sector in the economy.

Given the sustained growth in the housing sector, the supervisory authorities issued targeted prudential measures in November 2012. These are designed to deter high indebtedness, FX exposure, and speculative property investment. The SBS demands higher capital requirements by tabulating higher risk weights for mortgage lending depending on prudential loan-to-value (LTV) ratios that would vary according to the currency and the interest rate features of the mortgage. The LTV ratio also depends on whether the property is a first residency or not. The risk weight for mortgages below the LTV ratios reported in Table 1 is 50 percent; while Table 2 reports risk weights for mortgages above the prudential LTV ratios, which vary according to residual maturity.

Table 1. Peru: Prudential Loan-to-Value Ratios
(In percent)

Mortgage Type	Loan-to-Value Ratio	
	Domestic currency	Foreign currency
First residency (fixed rate)	90	80
First residency (variable or mixed rat	80	70
Other mortgages	70	65

Source: SBS

Table 2. Peru: Risk Weights for Mortgages
(In percent)

	Residual Maturity		
	Below 20 years	Between 20 and 30	Above 30 years
Below prudential level, registered guarantee 1/	50	75	100
Above prudential level, registered guarantee 1/ Below prudential level, nonregistered guarantee 1/	100	150	200
Above prudential level, nonregistered guarantee 1/	150	200	250

Source: SBS. 1/ Refers to the loan-to-value ratio in Table 1.

Better data would facilitate stronger oversight of developments in the housing sector. Housing prices in Peru have being collected regularly for Lima by the central bank. However, additional measures are needed to close information gaps such as developing more timely and comprehensive information on house prices (with national coverage, distinguishing between new and existing homes, commercial and residential real estate) and construction activity (housing stocks and flows, employment in the sector, and price of construction inputs including land prices).

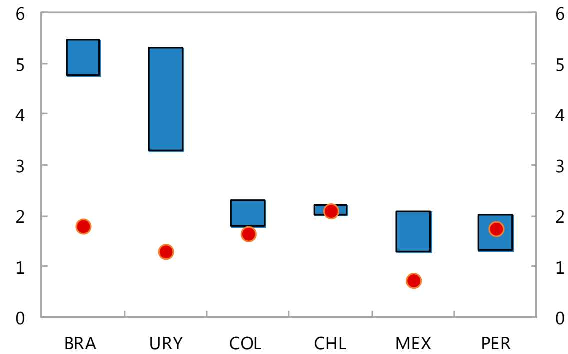
1/ For an overview of developments in mortgage credit and the housing sector in Latin America, see Cubeddu, L., C. Tovar and E. Tsounta (2012) "*Latin America: Vulnerabilities under Construction*?" IMF WP/12/193, Washington D.C.

Box 3. Peru: Neutral Interest Rate[1]

Policymakers in inflation targeting regimes typically compare the current policy interest rate to a benchmark or *neutral* rate—consistent with stable inflation and a closed output gap—to assess the stance of monetary policy. If the current rate is below the neutral rate, monetary policy is accommodative and the economy expands; if it is above the neutral real rate, policy is restrictive and the economy shrinks. The neutral real interest rate (NRIR) is not an observable variable, so there is no unique way to estimate it; and it can change over time.

LA6: Neutral Real Interest Rate in 2012

(In percent; results from different methodologies)



Several static and dynamic techniques were employed to assess the neutral policy rate. These are commonly used methodologies in the literature to estimate real neutral policy interest rate ranges for a set of several Latin American countries starting in the early 2000s, including Peru (see Table for results of each methodology).

Peru's neutral real interest rate is estimated to be in the 1¼–2 percent range, implying that the current monetary stance is appropriately neutral. Based on these estimates (which includes an inflation rate of 2 percent), it appears that Peru has been effective in: (i) containing domestic demand fluctuations and inflationary pressures through counter-cyclical monetary policy; and (ii) lowering its NRIR amid improved economic fundamentals. In addition, Peru has also successfully used macro-prudential policies to affect the monetary stance through proactive use of reserve requirements to manage credit dynamics and liquidity in the financial system.

LA6: The Neutral Interest Rate

(Results of different methodologies as of May 2012, in percent)

	Uncovered Interest Parity	Consumption-based CAPM	HP Filter	Implicit Common Stochastic Trend	Dynamic Taylor Rule	Expected-Inflation Augmented Taylor Rule	General Equilibrium Model	**Average**
Brazil	4.5	4.5	4.8	5.4	5.7	5.5	5.5	**5.1**
Chile	1.3	2.9	2.0	2.1	2.3	2.2	1.2	**2.0**
Colombia	2.5	4.4	1.9	1.8	1.6	1.7	2.1	**2.3**
Mexico	2.0	4.2	1.7	1.3	1.3	1.3	2.9	**2.1**
Peru	**2.3**	**5.0**	**1.3**	**1.5**	**1.8**	**1.0**	**1.3**	**2.0**
Uruguay	3.6	3.3	1.3	2.1	5.3	-	7.2	**3.8**

Source: Magud and Tsounta (2012).

1/ The results here presented are based on Magud, N. and E. Tsounta (2012), "*To Cut or not to Cut: That is the (Central Bank's) Question. In Search of Neutral Interest Rates in Latin America*," IMF WP/12/243, Washington, D.C.

Box 4. Update on Anti-Money Laundering Efforts[1]

The authorities have improved the national system for combating money laundering and the financing of terrorism (AML/CFT). The Peruvian authorities, with the assistance of Fund staff, identified at an early stage the need to develop a national strategy in this area, based on an in-depth analysis of the specific money laundering and terrorist financing risks that Peru faces. The culmination of these efforts was the adoption of the "National Plan for Combating Money Laundering and the Financing of Terrorism" in July 2011.[2]

The analysis identified several structural vulnerabilities, including high levels of informality, the prevalence of corruption, and weaknesses in inter-agency coordination. These structural vulnerabilities made it easier for criminals to conduct money laundering transactions with a low risk of being punished. In addition, the report specified a number of functional vulnerabilities related to detection and financial intelligence, and weaknesses in the criminal justice system that could be addressed through: (i) legal enhancements to the powers of AML/CFT supervisors in the banking, securities, and other sectors; (ii) training for inspectors, prosecutors, and investigators; and (iii) more formal mechanisms for consultation between the many institutions involved in the AML/CFT effort. The National Plan, itself the result of strong inter-agency collaboration led by Peru's Financial Intelligence Unit (FIU), set eleven general strategic objectives aimed at remedying these functional vulnerabilities.

Progress has been achieved in implementing many actions included in the plan. Changes in the legal and regulatory framework increased the sanctions for money laundering, hardened penalties on activities related to the financing of terrorism, empowered the FIU to freeze terrorist assets, and strengthened regulation and supervision in key sectors such as money exchanges, public notaries, customs brokers and casinos. The securities sector regulator was elevated to a Superintendency level and is strengthening its AML/CFT regulatory and supervisory framework (with further assistance from the Fund). Interagency coordination had been significantly improved through the institutionalization of the collaborative structures that the Peruvian agencies created.

The authorities are working on an update to the strategy that will reflect the progress to date and identify new specific actions. All in all, progress has been satisfactory; over one third of the actions have been completed, and most of the rest are underway, including legislation currently in Congress granting the FIU access to information protected by banking and tax secrecy.

1/ Prepared by Paul Ashin and Mariano Federici.

2/ The analysis was included in an annex on the illicit drug sector and its macroeconomic significance in Peru, that was later published as a Fund working paper. See Pedroni, P. and C. Verdugo Yepes, "The Relationship Between Illicit Coca Production and Formal Economic Activity in Peru," IMF WP/11/182.

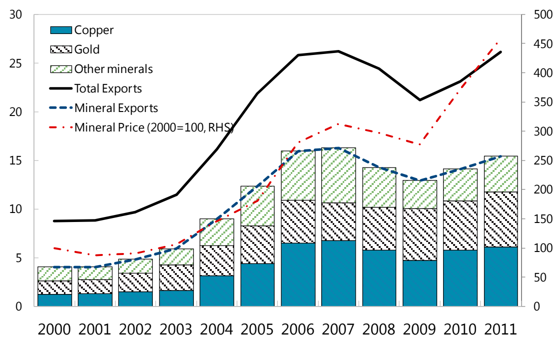
Box 5. Peru: International Linkages and Spillovers

Peru's linkages to the global market have intensified in the past decade through growth in trade and capital flows. Potential inward spillovers to the domestic economy are therefore closely associated to its increasing dependence on commodity exports, demand from China, and increasing exposure to international capital flows.

Trade Linkages

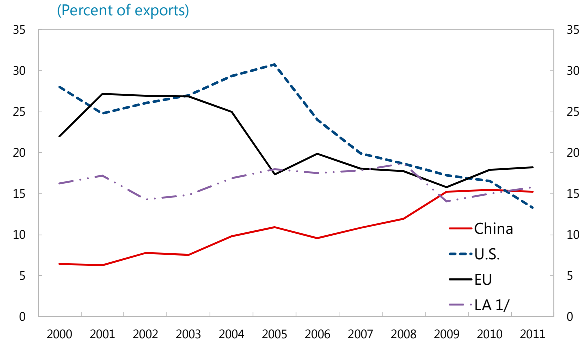
There has been significant increase in trade openness but rising concentration in commodity exports that are sensitive to global price developments and to demand from China. Trade accounted for 47 percent of GDP in 2011—a great leap from just 26 percent of GDP in 2000—led by the rapid increase in mineral exports since the mid 2000s, which now account for 60 percent of total exports. While Peru exports six key metals, the export structure has become more concentrated, with copper and gold accounting for 80 percent of mineral exports or 12 percent of GDP in 2011. Similar to other LA commodity exporters, the share of exports to China has risen rapidly over the past decade to 15 percent of total, replacing the U.S. as the largest single export country for Peru in 2011.

Peru: Main Exports
(Percent of GDP)



Sources: BCRP; and Fund staff calculations.

Peru: Main Export Markets
(Percent of exports)



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

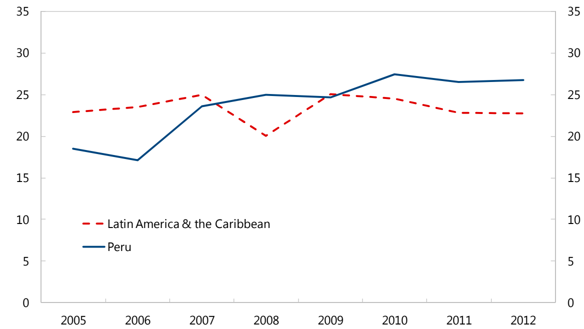
Capital Flows

The bulk of the capital inflows to Peru remained in FDI which is less prone to capital reversal. Net FDI amounted to 4.9 percent of GDP during 2007–11, with reinvestment FDI accounting for close to 2/3 of these flows, a testimony of the attractiveness of Peru as an investment destination. However, FDI in Peru is concentrated in resource-intensive sectors, and by investing firms from a small number of countries. Based on the *2009 Coordinated Direct Investment Survey*, the mining sector received close to 30 percent of the total FDI inflows as of end-2009 (most of which from the United States and Canada), followed by 24 percent in services (mostly from Spain, Chile and the United States) and 17 percent in the hydrocarbon sectors.

Box 5. Peru: International Linkages and Spillovers (concluded)

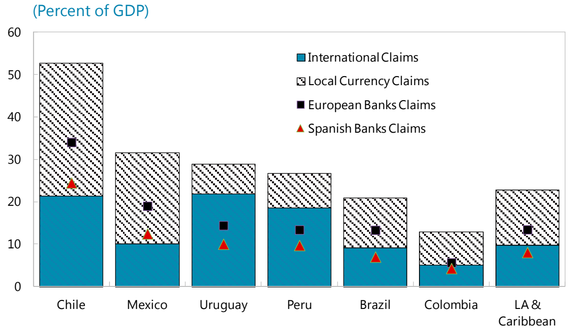
Foreign bank claims on Peru have increased with concentration on the non-bank private sector. Foreign bank claims on Peru by BIS reporting banks have increased to 27 percent of GDP, above the regional average, from 19 percent of GDP over 2005–12. Close to 70 percent of these claims are in foreign currency. Peru's exposures to European banks are broadly comparable with other LA6 economies, with claims of Spanish banks equivalent to about 10 percent of GDP. Spanish banks' claim on Peru continued to increase in 2012 compared to slight reductions for most other LA6 economies. While the banking sector in Peru has relatively small exposure to international bank claims, 60 percent of international claims are concentrated in the non-bank private sector (11 percent of GDP), which is higher than most other LA6 economies.

Latin America: Foreign Bank Claims, 2005-June 2012
(Percent of GDP)



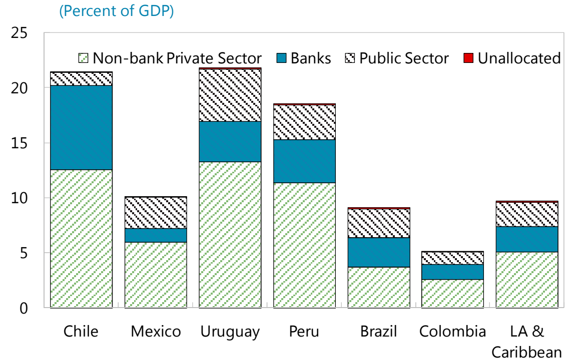
Sources: Bank for International Settlement; and Fund Staff calculations.

LA6: Foreign Bank Claims, June 2012
(Percent of GDP)



Sources: Bank for International Settlements; WEO database; and Fund staff calculations.
1/ Based on inmediate borrower basis as reported by the consolidated banking statistics, International claims include consolidated cross-border claims in all curriences and local claims in non-local currencies.

LA6: International Claims by Sector, June 2012
(Percent of GDP)

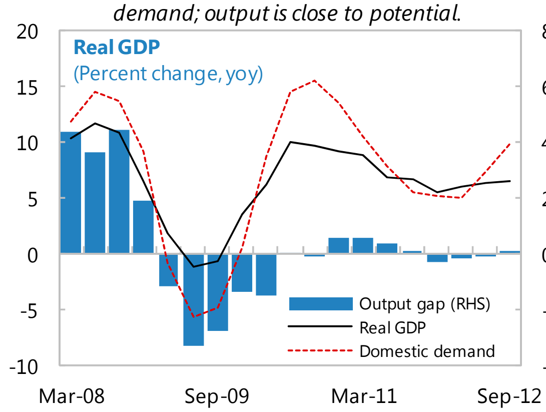


Sources: Bank for International Settlements; WEO database; and Fund staff calculations.

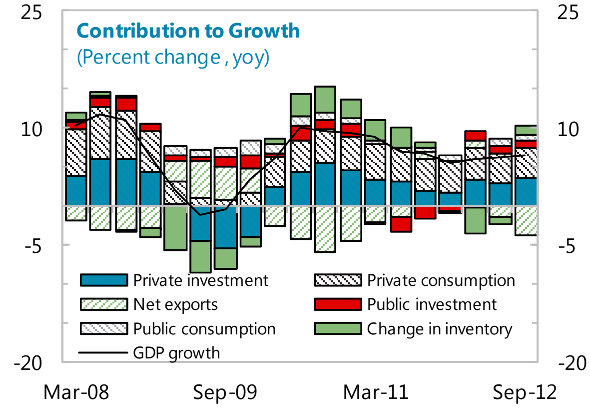
Foreign bank subsidiaries are however funded locally, limiting the impact from parent banks. Overall, the share of external financing in all banks' financing is estimated at around 12 percent (as of September 2012). Foreign banks represent 43 percent of the total assets of the banking system (18 percent of GDP) as of September 2012. BBVA-Continental (9 percent of GDP), and Scotia Bank (6 percent of GDP), the second and third largest by assets, rely on domestic deposits (70 percent of total liabilities) as the funding source. They are financially sound and, profitable, and funding pressure at the parent banks is likely to have limited impact on these subsidiaries. In addition, for foreign bank subsidiary, as in the case of BBVA-Continental, transfer of financial resources to the parent bank would need the approval of SBS and the agreement from the majority-owned local partner.

Figure 1. Peru: Real Sector Developments

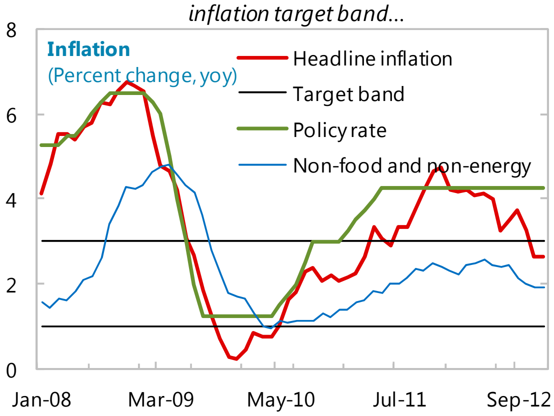
Growth has moderated due to weaker external demand; output is close to potential.



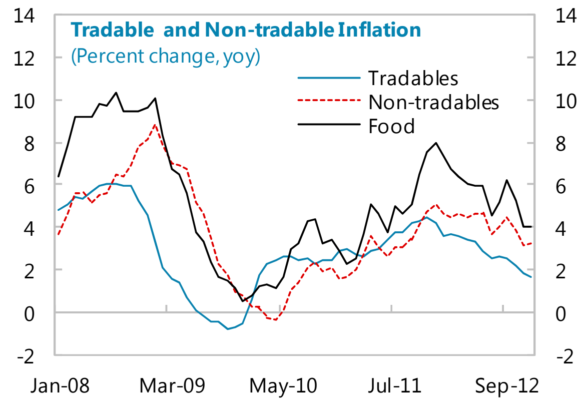
Growth has been driven by private consumption and investment.



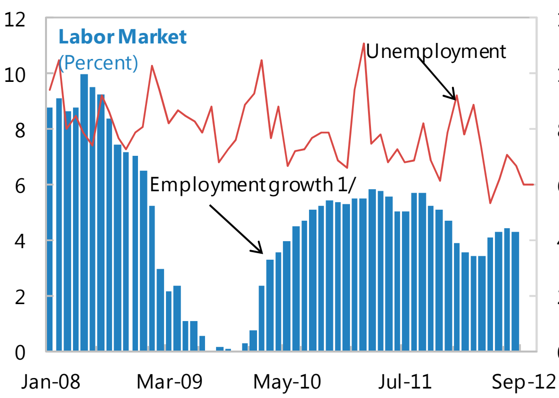
Inflation is moderating after exceeding the upper inflation target band...



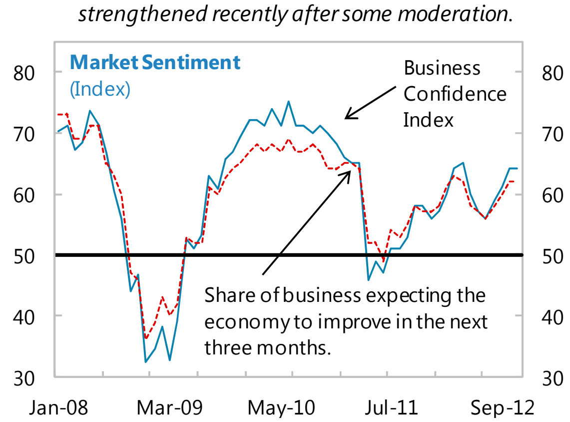
...reflecting movements in food prices.



Unemployment shows a declining trend...

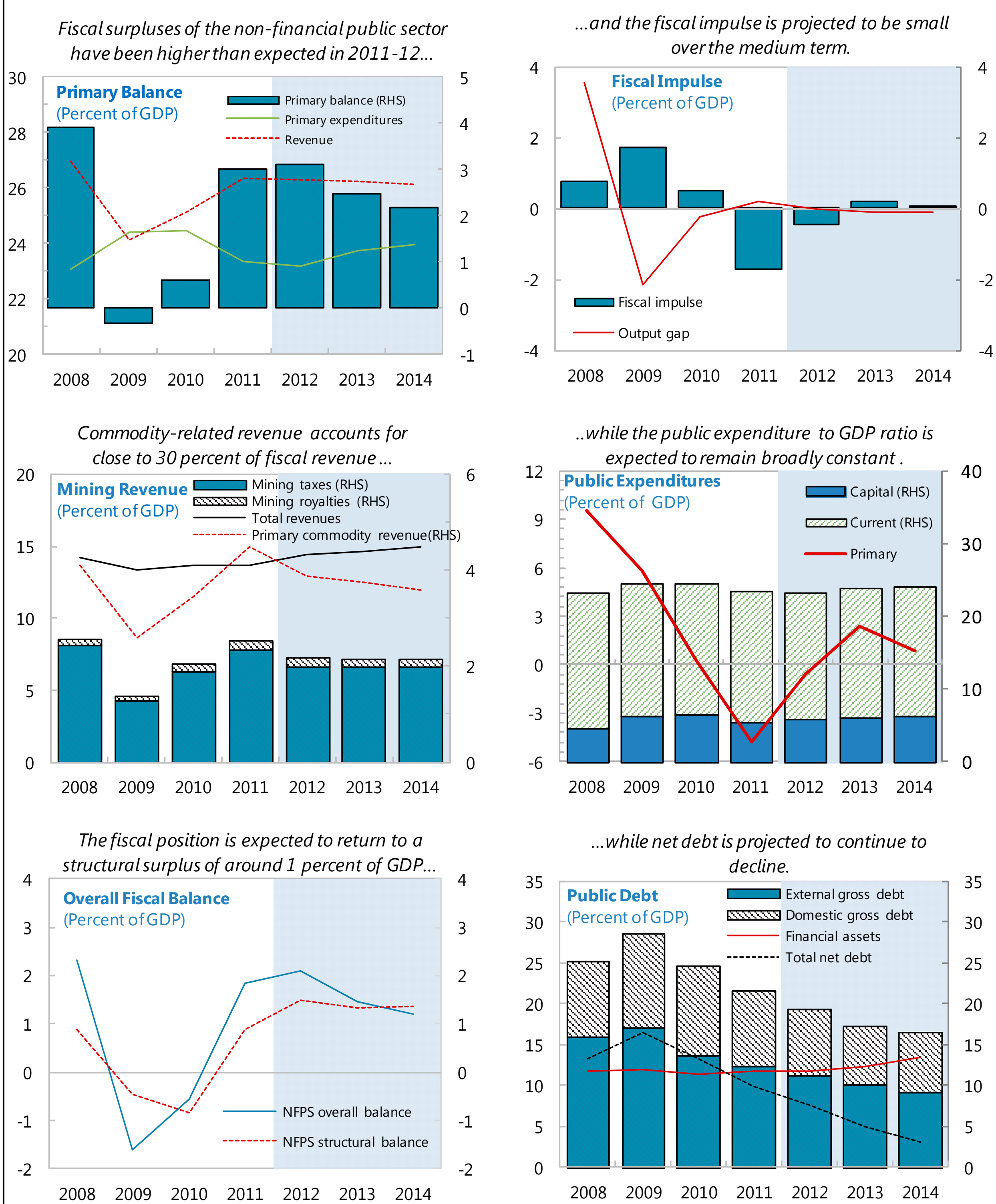


...and business confidence appears to have strengthened recently after some moderation.



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

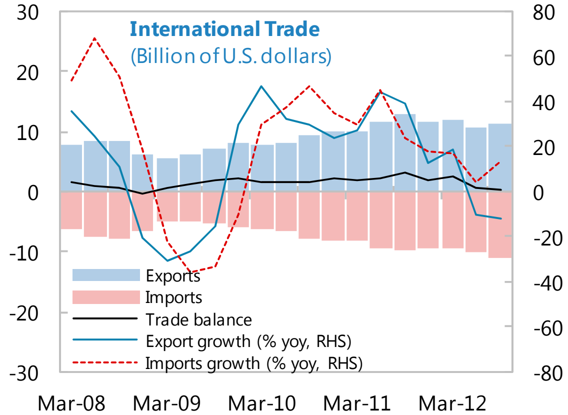
Figure 2. Peru: Fiscal Sector Developments



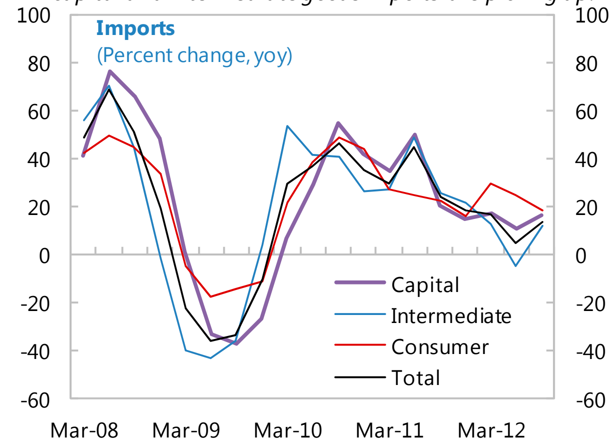
Sources: Ministry of Economy and Finance; and Fund staff estimates.

Figure 3. Peru: External Sector Developments

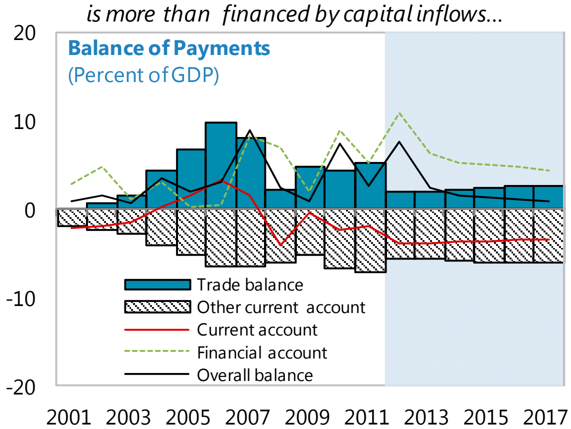
Exports declined due to lower metal prices and volumes while import growth remains positive.



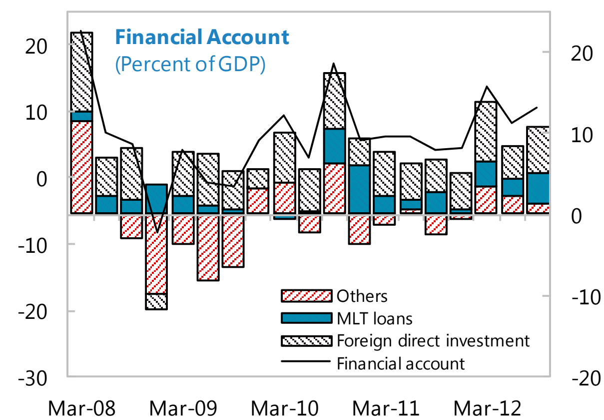
High growth in consumer goods is moderating while capital and intermediate goods imports are picking up.



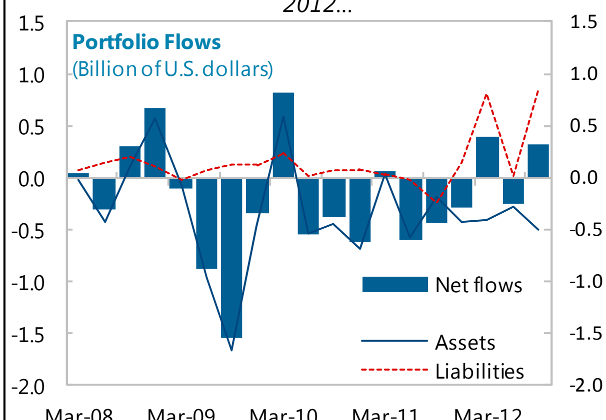
The current account deficit has widened in 2012, but is more than financed by capital inflows...



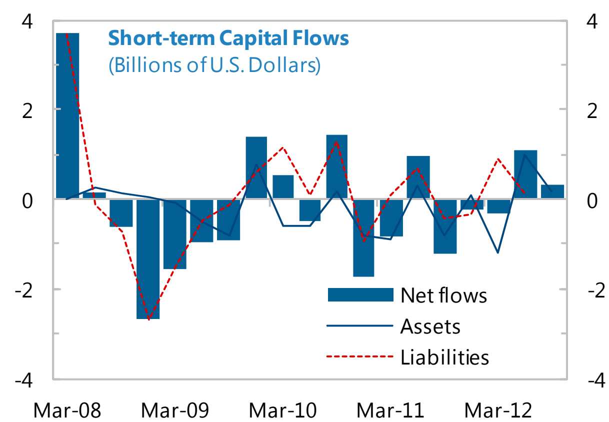
...with buoyant FDI accounting for much of the capital inflows.



Portfolio inflows have increased since early 2012...

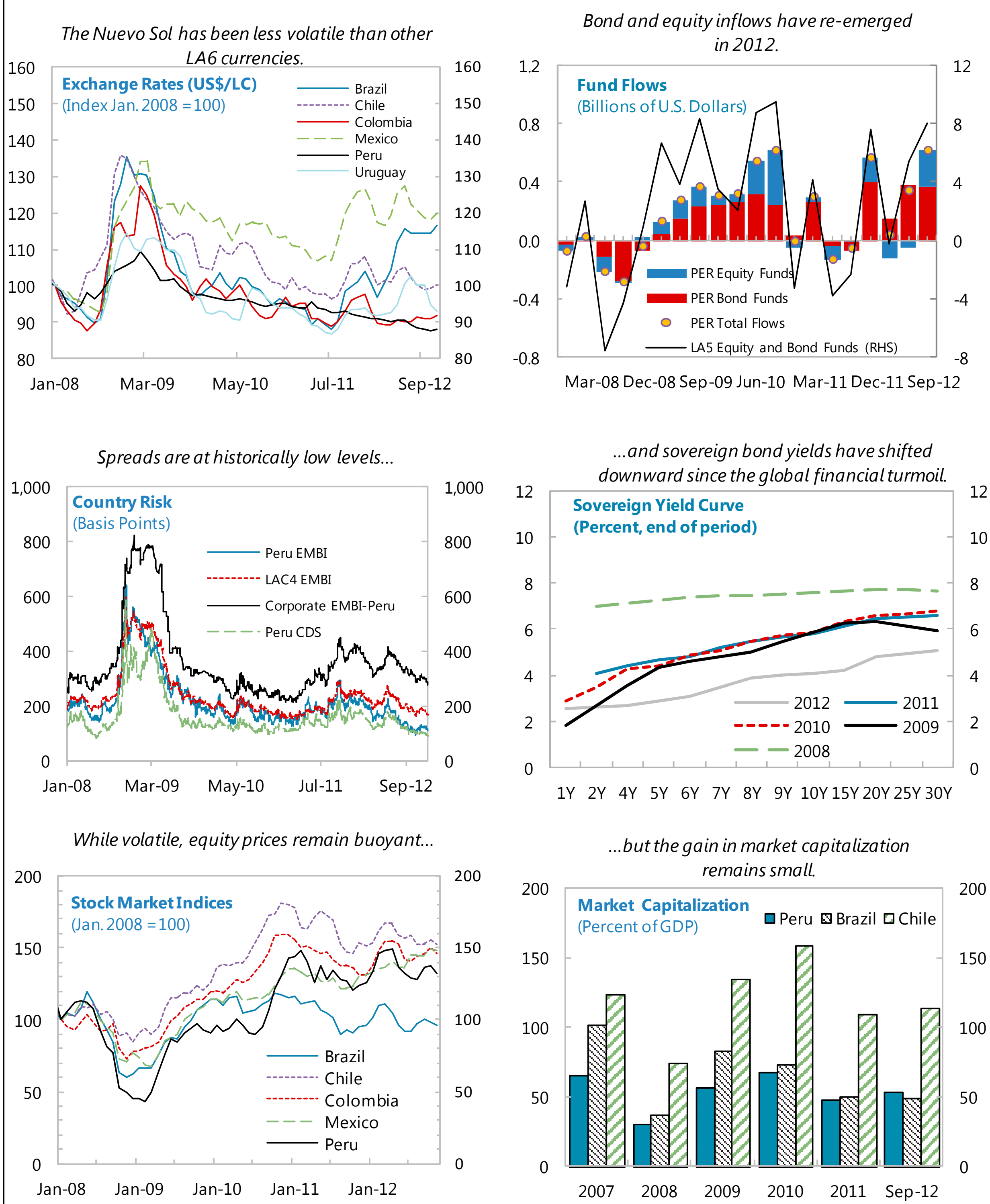


... as have short-term capital inflows .



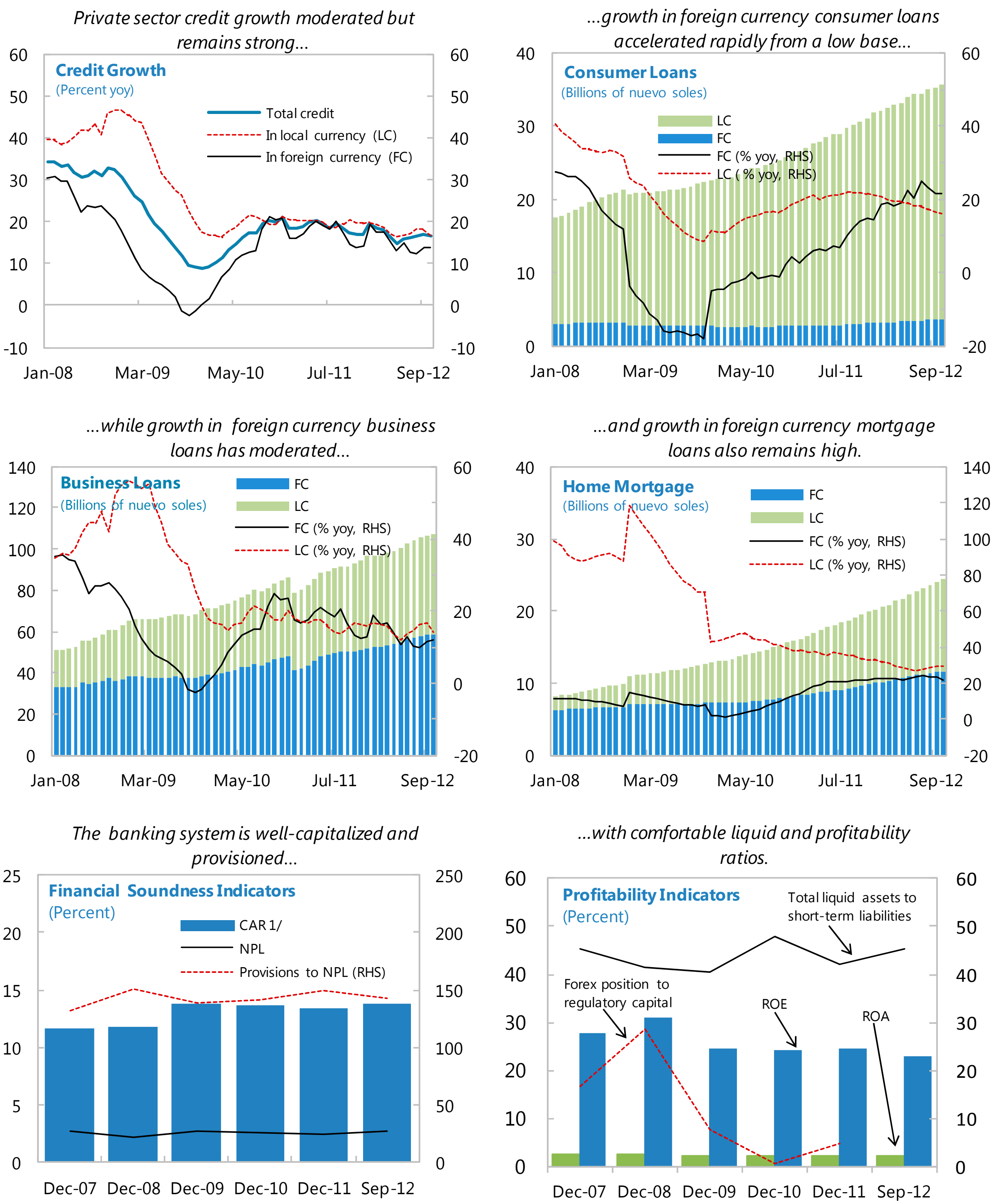
Sources: BCRP; and Fund staff estimates.

Figure 4. Peru: Financial Market Developments



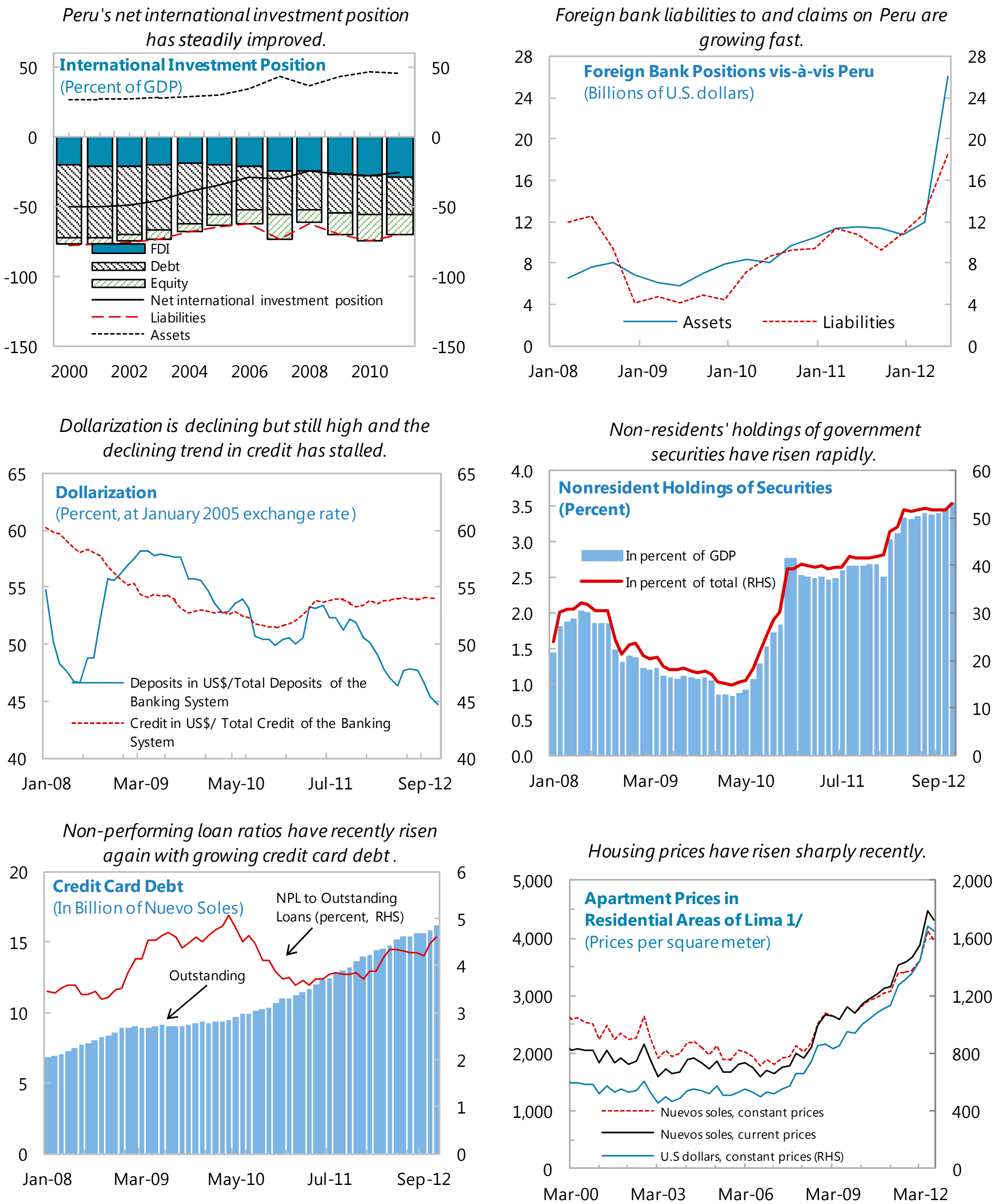
Sources: Bloomberg; Haver Analytics; BCRP; and Fund staff estimates.

Figure 5. Peru: Banking System



Sources: BCRP; Superintendency of Banks and Insurance; and Fund staff estimates.
1/ As of September 2012.

Figure 6. Peru: Balance Sheet Vulnerabilities



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

Table 1. Peru: Selected Economic Indicators

					Est.	Projections	
	2008	2009	2010	2011	2012	2013	2014
Social Indicators							
Life expectancy at birth (years)	73.2	73.5	73.8	74.0	...	...	...
Infant mortality (per thousand live births)	17.3	16.2	15.1	14.1	...	...	...
Adult literacy rate	89.6	89.6	89.6	...	...	...	...
Poverty rate (total) 1/	37.3	33.5	30.8	27.8	...	...	...
Unemployment rate	8.4	8.4	7.9	7.7	6.8	6.8	6.8
	(Annual percentage change; unless otherwise indicated)						
Production and prices							
Real GDP	9.8	0.9	8.8	6.9	6.3	6.3	6.3
Real domestic demand	12.3	-2.8	13.1	7.2	8.3	6.6	6.4
Consumer Prices (end of period)	6.7	0.2	2.1	4.7	2.8	2.0	2.0
Consumer Prices (period average)	5.8	2.9	1.5	3.4	3.7	2.3	2.0
External sector							
Exports	10.4	-13.1	31.9	30.1	-1.1	8.9	10.1
Imports	45.2	-26.1	37.1	28.3	11.9	8.0	9.0
Terms of trade (deterioration -)	-14.5	-3.1	18.2	5.5	-2.9	1.6	0.0
Real effective exchange rate (depreciation -) 2/	4.4	3.4	2.4	-1.0	...	...	...
Money and credit 3/ 4/							
Broad money	25.6	6.8	21.7	14.7	10.8	12.7	12.7
Net credit to the private sector	33.9	5.0	16.7	21.8	12.9	15.6	14.9
	(In percent of GDP; unless otherwise indicated)						
Public sector							
NFPS Revenue	27.0	24.0	25.1	26.2	26.3	26.2	26.1
NFPS Primary Expenditure	23.0	24.0	24.2	23.2	23.2	23.8	24.0
NFPS Primary Balance	4.0	0.0	0.9	3.0	3.1	2.5	2.2
NFPS Overall Balance	2.4	-1.3	-0.2	1.9	2.1	1.5	1.2
General Government Primary Balance	3.7	-0.9	0.8	2.9	3.0	2.6	2.4
General Government Overall Balance	2.2	-2.1	-0.3	1.8	2.0	1.7	1.6
External Sector							
External current account balance	-4.2	-0.5	-2.5	-1.9	-3.5	-3.5	-3.4
Gross reserves							
In millions of U.S. dollars	31,233	33,175	44,150	48,859	63,651	68,751	72,251
Percent of short-term external debt 5/	318.3	428.4	342.3	589.3	661.2	646.6	595.9
Percent of foreign currency deposits at banks	203.6	203.6	241.1	227.7	298.5	298.1	280.0
Debt							
Total external debt	28.3	29.2	27.5	25.6	25.6	26.2	25.3
NFPS Gross debt (including CRPAOs)	25.0	28.4	24.6	22.2	19.3	17.2	16.4
External 6/	15.2	16.2	12.9	11.2	9.5	8.7	7.9
Domestic	9.9	12.2	11.6	11.0	9.7	8.6	8.5
Savings and investment							
Gross domestic investment	26.9	20.7	25.3	26.2	26.8	26.6	26.6
Public sector 7/	4.3	5.2	5.9	5.2	5.7	5.8	6.0
Private sector	21.5	17.7	19.2	19.6	20.7	20.7	20.8
Inventory changes	1.0	-2.1	0.2	1.4	0.4	0.1	-0.2
National savings	22.7	20.2	22.8	24.3	23.3	23.2	23.3
Public sector 8/	6.8	4.6	5.9	7.1	7.8	7.3	7.2
Private sector	15.9	15.5	16.9	17.2	15.5	15.9	16.0
External current account deficit	4.2	0.5	2.5	1.9	3.5	3.5	3.4
Memorandum items							
Nominal GDP (S/. billions)	371.1	382.3	434.7	486.5	529.7	577.0	624.2
GDP per capita (in US$)	4,427	4,362	5,207	5,904	6,614	7,132	7,794

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

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

Table 2. Peru: Main Fiscal Aggregates

					Est.	Projections 1/				
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(In millions of nuevos soles, unless otherwise indicated)									
Nonfinancial Public Sector										
Revenues	**100,124**	**91,655**	**109,156**	**127,609**	**139,329**	**151,354**	**163,067**	**176,255**	**192,034**	**205,868**
Taxes	59,672	53,842	65,951	77,257	85,563	94,525	102,425	112,118	123,146	132,719
Other	40,452	37,813	43,205	50,353	53,766	56,829	60,643	64,137	68,888	73,149
Primary expenditures 2/	**85,380**	**91,713**	**105,053**	**112,837**	**122,905**	**137,097**	**149,522**	**163,346**	**178,803**	**192,427**
Current	68,496	68,526	76,884	86,863	91,972	102,845	111,367	121,677	132,025	141,853
Capital	16,884	23,187	28,170	25,975	30,933	34,252	38,155	41,670	46,778	50,574
Primary balance	**14,744**	**-58**	**4,103**	**14,772**	**16,424**	**14,257**	**13,545**	**12,908**	**13,231**	**13,441**
Interest	5,850	5,012	5,057	5,696	5,416	5,858	6,034	5,863	5,863	5,864
Overall balance	**8,894**	**-5,070**	**-955**	**9,076**	**11,008**	**8,399**	**7,510**	**7,045**	**7,368**	**7,577**
External financing	-3,472	4,069	3,217	602	753	1,847	-1,007	-1,101	-1,052	-1,024
Domestic financing	-5,422	1,001	-2,262	-9,678	-11,761	-10,246	-6,503	-5,944	-6,315	-6,553
Public Gross Debt 3/	**89,642**	**104,327**	**102,263**	**103,271**	**97,549**	**95,139**	**98,166**	**102,657**	**107,814**	**112,396**
External	56,266	62,037	56,237	54,470	50,535	49,961	49,209	48,480	47,910	47,353
Domestic	33,376	42,291	46,027	48,801	47,014	45,178	48,957	54,176	59,904	65,043
Public Gross Debt (including CRPAO)	**92,910**	**108,728**	**106,729**	**107,950**	**102,061**	**99,467**	**102,294**	**106,570**	**111,495**	**115,830**
Of which: CRPAO	3,267	4,400	4,465	4,680	4,512	4,327	4,128	3,913	3,682	3,432
Foreign-currency denominated debt	**58,767**	**65,068**	**59,082**	**57,214**	**58,576**	**58,005**	**56,743**	**55,327**	**53,994**	**52,707**
	(In percent of GDP, unless otherwise indicated)									
Nonfinancial Public Sector										
Revenues	**27.0**	**24.0**	**25.1**	**26.2**	**26.3**	**26.2**	**26.1**	**26.1**	**26.4**	**26.2**
Taxes 4/	16.1	14.1	15.2	15.9	16.2	16.4	16.4	16.6	16.9	16.9
Other	10.9	9.9	9.9	10.3	10.2	9.8	9.7	9.5	9.5	9.3
Primary expenditures 2/	**23.0**	**24.0**	**24.2**	**23.2**	**23.2**	**23.8**	**24.0**	**24.2**	**24.6**	**24.5**
Current	18.5	17.9	17.7	17.9	17.4	17.8	17.8	18.0	18.1	18.0
Capital	4.6	6.1	6.5	5.3	5.8	5.9	6.1	6.2	6.4	6.4
Primary balance	**4.0**	**0.0**	**0.9**	**3.0**	**3.1**	**2.5**	**2.2**	**1.9**	**1.8**	**1.7**
Interest	1.6	1.3	1.2	1.2	1.0	1.0	1.0	0.9	0.8	0.7
Overall balance	**2.4**	**-1.3**	**-0.2**	**1.9**	**2.1**	**1.5**	**1.2**	**1.0**	**1.0**	**1.0**
External financing	-0.9	1.1	0.7	0.1	0.1	0.3	-0.2	-0.2	-0.1	-0.1
Domestic financing	-1.5	0.3	-0.5	-2.0	-2.2	-1.8	-1.0	-0.9	-0.9	-0.8
Public Gross Debt 3/	**24.2**	**27.3**	**23.5**	**21.2**	**18.4**	**16.5**	**15.7**	**15.2**	**14.8**	**14.3**
External	15.2	16.2	12.9	11.2	9.5	8.7	7.9	7.2	6.6	6.0
Domestic	9.0	11.1	10.6	10.0	8.9	7.8	7.8	8.0	8.2	8.3
Public Gross Debt (including CRPAO)	**25.0**	**28.4**	**24.6**	**22.2**	**19.3**	**17.2**	**16.4**	**15.8**	**15.3**	**14.7**
Of which: CRPAO	0.9	1.2	1.0	1.0	0.9	0.7	0.7	0.6	0.5	0.4
Foreign-currency denominated debt	**15.8**	**17.0**	**13.6**	**11.8**	**11.1**	**10.1**	**9.1**	**8.2**	**7.4**	**6.7**
Memorandum items										
Commodity related revenues (in percent of GDP)	4.1	2.6	3.5	4.5	3.9	3.7	3.6	3.5	3.5	3.4
Gen. Gov. primary spending (var. real)	11.1	10.7	12.0	1.8	6.4	9.7	7.9	7.1	7.4	5.0
Of which: Current spending	5.6	3.3	8.7	7.0	2.9	11.3	7.1	7.1	6.2	4.6
Capital spending	32.7	34.1	20.1	-9.6	15.5	6.1	10.0	7.2	10.4	6.0
Output gap	3.6	-2.1	-0.2	0.2	0.0	-0.1	0.0	-0.1	-0.2	-0.2
General Gov. structural balance	0.9	-0.6	-0.8	0.9	1.5	1.3	1.3	1.6	1.8	2.0
General Gov. structural primary balance	2.4	0.7	0.3	2.0	2.5	2.3	2.3	2.4	2.6	2.7
Fiscal impulse (+ = expansionary)	0.8	1.8	0.4	-1.7	-0.5	0.2	0.0	-0.1	-0.1	-0.1
SPNF structural balance 5/	0.5	-0.4	-0.8	0.9	1.6	1.1	1.0	1.0	1.1	0.9
SPNF structural primary balance 5/	2.1	0.9	0.4	2.0	2.6	2.1	2.0	1.9	1.9	1.8
Fiscal impulse (+ = expansionary)	1.0	1.3	0.5	-1.7	-0.6	0.5	0.2	0.1	0.0	0.0

Sources: MEF; BCRP; and Fund staff estimates.

1/ Fund staff estimates.

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

3/ Corresponds to the nonfinancial public sector. Official data excludes stock of debt accumulated and not paid during the period in CRPAOs and FEPC. Cash payments are recorded as amortizations.

4/ Definition of tax pressure used by the authorities.

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

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

(In percent of GDP, unless otherwise indicated)

					Est.	Projections				
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	**21.1**	**18.7**	**20.0**	**21.1**	**21.3**	**21.6**	**21.7**	**21.9**	**22.3**	**22.3**
Taxes	16.0	14.1	15.2	15.9	16.2	16.4	16.4	16.6	16.9	16.9
Social Contributions	1.7	1.7	1.7	2.0	2.0	2.1	2.3	2.3	2.4	2.6
Grants	0.1	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Other revenue	3.3	2.8	3.0	3.1	3.1	3.0	3.0	2.9	2.9	2.8
Of which: Interest income	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Expense 2/	**15.0**	**15.7**	**14.8**	**14.2**	**13.8**	**14.3**	**14.4**	**14.4**	**14.4**	**14.2**
Compensation of employees	5.2	5.5	5.1	4.7	4.8	5.1	5.2	5.2	5.1	4.9
Use of goods and services	4.3	5.0	5.1	5.2	5.6	5.9	5.8	5.8	5.5	5.5
Consumption of fixed capital 2/	...	...	...	...	...	...	...	...	...	...
Interest	1.5	1.3	1.1	1.1	1.0	1.0	0.9	0.8	0.8	0.7
Subsidies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social benefits	2.3	2.4	2.2	2.0	2.0	1.9	1.7	1.8	1.9	1.9
Other expenses 3/	1.7	1.5	1.3	1.1	0.3	0.5	0.8	0.8	1.2	1.2
Net acquisition of nonfinancial assets	**3.9**	**5.2**	**5.4**	**5.0**	**5.5**	**5.5**	**5.7**	**5.8**	**6.0**	**6.0**
Acquistions of nonfinancial assets	3.9	5.2	5.5	5.0	5.5	5.5	5.7	5.8	6.0	6.0
Disposals of nonfinancial assets	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Consumption of fixed capital 2/	....	....	....	....	....	....	....	....	....	....
Gross Operating Balance	6.1	3.1	5.1	6.9	7.6	7.2	7.3	7.4	7.9	8.1
Net Operating Balance 4/	....	....	....	....	....	....	....	....	....	....
Net lending (+) borrowing (-) 5/	**2.2**	**-2.1**	**-0.3**	**1.8**	**2.0**	**1.7**	**1.6**	**1.7**	**1.8**	**2.1**
Net acquistion of financial assets 6/	**1.3**	**-0.7**	**0.8**	**1.6**	**1.0**	**1.6**	**2.0**	**2.3**	**2.3**	**2.4**
By instrument										
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits 7/	1.3	-0.7	0.8	1.6	1.0	1.6	2.0	2.3	2.3	2.4
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	...	...	...	...	...	...	...	...	...	...
By residency										
Domestic	1.3	-0.7	0.8	1.6	1.0	1.6	2.0	2.3	2.3	2.4
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities 8/	**-0.9**	**1.4**	**1.1**	**-0.3**	**-0.9**	**-0.1**	**0.4**	**0.7**	**0.6**	**0.3**
By instrument										
SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	-0.9	1.9	2.0	-0.4	-0.8	0.0	0.6	0.8	0.7	0.0
Loans	0.0	-0.5	-0.9	0.1	-0.2	-0.1	-0.1	-0.1	-0.1	0.3
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	...	...	...	...	...	...	...	...	...	...
By residency										
Domestic	0.1	0.2	1.6	-0.4	-0.8	0.0	0.6	0.8	0.7	0.0
External	-1.0	1.2	-0.6	0.1	-0.2	-0.1	-0.1	-0.1	-0.1	0.3
Memorandum items										
Central Government Net lending (+) borrowing (-)	2.0	-1.5	0.3	0.6	1.4	1.2	1.1	1.1	1.3	1.3
Regional Governments Net lending (+) borrowing (-)	0.2	-0.2	-0.2	0.3	0.2	0.0	0.1	0.3	0.4	0.5
Local Governments Net lending (+) borrowing (-)	0.0	-0.4	-0.4	-1.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Commodity related revenue	4.1	2.6	3.5	4.5	3.9	3.7	3.6	3.5	3.5	3.4
General Government Primary Balance	3.7	-0.9	0.8	2.9	3.0	2.6	2.5	2.4	2.5	2.7
General Government nonfinancial expenditures	17.4	19.2	19.2	18.1	18.3	18.9	19.2	19.4	19.7	19.5
CRPAOs expenses accrued and not paid										
FEPC expenses accrued and not paid	0.5	-0.4	0.1	0.3	-0.2	0.0	0.0	0.0	0.0	0.0

Sources: MEF; BCRP; and Fund staff estimates.

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

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

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

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

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

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

7/ Includes Fiscal Stabilization Fund.

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

Table 4. Peru: General Government Stock Positions

(In percent of GDP, unless otherwise indicated)

	2006	2007	2008	2009	2010	2011	Est. 2012	Projections 1/ 2013	2014	2015	2016	2017
Stock positions:												
Net worth	....	....	....	....	....	....	....	....	....	....	....	....
Nonfinancial assets	....	....	....	....	....	....	....	....	....	....	....	....
Net financial worth	**-22.8**	**-16.0**	**-12.5**	**-11.7**	**-9.9**	**-7.0**	**-4.4**	**-2.3**	**-0.6**	**1.1**	**2.9**	**4.7**
Financial assets	**8.0**	**10.8**	**11.7**	**11.9**	**11.3**	**11.7**	**11.7**	**12.3**	**13.4**	**14.7**	**15.9**	**17.1**
By instrument												
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits 2/	7.4	10.3	11.2	11.4	10.9	11.3	11.4	12.1	13.1	14.5	15.7	16.9
Debt securities	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts recivable	...	...	...	...	...	...	...	...	...	...	...	...
By residency												
Domestic	7.4	10.3	11.2	11.4	10.9	11.3	11.4	12.1	13.1	14.5	15.7	16.9
External	0.6	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.2
By currency 3/												
Domestic	7.6	10.9	10.6	12.0	11.0	11.5	11.7	12.1	13.2	14.4	15.7	16.7
Foreign	0.6	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5
Liabilities 4/	**30.8**	**26.8**	**24.2**	**23.6**	**21.2**	**18.7**	**16.1**	**14.7**	**14.0**	**13.5**	**13.1**	**12.4**
By instrument												
SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	15.9	16.4	14.2	15.1	14.8	12.8	10.9	10.0	9.8	9.8	9.7	9.0
Loans	14.9	10.3	10.0	8.5	6.4	5.9	5.2	4.7	4.2	3.7	3.4	3.4
Equity and shares	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	...	...	...	...	...	...	...	...	...	...	...	...
By residency												
Domestic	8	8.9	8.2	8.3	8.6	7.3	5.9	5.4	5.5	5.8	6.0	5.6
External	23.2	17.9	16.0	15.3	12.6	11.4	10.3	9.3	8.5	7.7	7.0	6.8
By currency 3/												
Domestic	7.7	10.5	8.5	10.4	10.0	9.3	8.7	7.5	7.6	7.8	8.1	8.1
Foreign	23.1	16.3	15.7	13.2	11.2	9.4	7.5	7.1	6.3	5.7	5.0	4.3
Memorandum items												
General Government Gross Debt (at face value)	30.8	26.8	24.2	23.6	21.2	18.7	16.1	14.7	14.0	13.5	13.1	12.4
General Government Net Debt (at face value)	22.8	16.0	12.5	11.7	9.9	7.0	4.4	2.3	0.6	-1.1	-2.9	-4.7
Fiscal Stabilization Fund and other public savings	0.4	0.5	1.4	1.4	1.4	3.2	4.4	5.9	6.7	7.1	7.3	7.5
Debt of FEPC 5/	0.0	0.3	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt of CRPAOs 5/	0.1	0.7	0.9	1.2	1.0	1.0	0.9	0.7	0.7	0.6	0.5	0.4
Debt of SOEs guaranteed by government 6/	0.5	0.5	0.7	0.8	1.0	0.7	0.6	0.6	0.5	0.5	0.4	0.4

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

Table 5. Peru: Balance of Payments

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

					Est.			Projections		
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Current account	**-5.3**	**-0.7**	**-3.8**	**-3.3**	**-7.1**	**-7.6**	**-8.2**	**-8.9**	**-9.2**	**-10.2**
Merchandise trade	2.6	5.9	6.8	9.3	4.4	5.2	6.1	7.5	9.2	10.4
Exports	31.0	27.0	35.6	46.3	45.8	49.8	54.8	60.7	67.4	75.0
Traditional	23.3	20.6	27.7	35.8	34.6	37.1	40.3	44.5	49.3	54.7
Mining	18.1	16.4	21.7	27.4	26.6	28.8	32.1	36.2	40.9	46.0
Nontraditional and others	7.8	6.3	7.9	10.4	11.1	12.7	14.6	16.2	18.1	20.3
Imports	-28.4	-21.0	-28.8	-37.0	-41.4	-44.7	-48.7	-53.2	-58.2	-64.7
Services, income, and current transfers (net)	-7.9	-6.6	-10.5	-12.6	-11.5	-12.8	-14.4	-16.4	-18.4	-20.5
Services	-2.1	-1.1	-2.3	-2.1	-2.1	-2.4	-2.6	-2.8	-2.9	-3.1
Investment income	-8.7	-8.4	-11.2	-13.7	-12.7	-14.0	-15.5	-17.8	-20.1	-22.6
Current transfers	2.9	2.9	3.0	3.2	3.4	3.5	3.8	4.2	4.7	5.2
Capital and financial account balance	**8.6**	**2.5**	**13.6**	**9.2**	**20.6**	**12.7**	**11.7**	**12.4**	**12.7**	**13.2**
Public sector	-1.7	-0.2	2.4	0.8	2.0	2.0	0.9	0.9	0.9	0.9
Medium-term loans	-1.3	1.4	-1.0	0.1	0.3	0.7	-0.4	-0.4	-0.4	-0.4
Disbursements 1/	1.3	3.3	4.3	1.0	1.5	1.9	0.9	0.9	0.9	0.9
Amortization 1/	2.6	1.9	5.3	0.9	1.2	1.2	1.3	1.3	1.3	1.3
Other public sector flows 2/	-0.2	-1.1	3.5	0.7	1.7	1.3	1.3	1.3	1.3	1.3
Net external assets	0.1	-0.3	0.0	-0.3	-0.5	-0.2	-0.2	-0.2	-0.2	-0.2
Other transactions of Treasury bills	-0.2	-0.7	3.5	1.0	2.2	1.5	1.5	1.5	1.5	1.5
Short-term flows	-0.2	-0.6	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	10.3	2.7	11.2	8.3	18.6	10.7	10.8	11.6	11.9	12.3
Foreign direct investment (net) 3/	6.2	6.0	8.2	8.1	10.1	9.1	9.7	10.7	12.0	13.5
Medium- and long-term loans	2.7	1.1	3.9	2.8	5.0	4.8	3.3	3.5	3.5	3.5
Portfolio investment	0.7	-2.9	-0.7	-1.3	0.3	-0.9	-0.7	-1.1	-1.2	-1.6
Short-term flows 4/	0.7	-1.5	-0.2	-1.3	3.1	-2.3	-1.5	-1.6	-2.4	-3.1
Errors and omissions	**-0.2**	**-0.8**	**1.3**	**-1.1**	**1.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**3.1**	**1.0**	**11.2**	**4.7**	**14.8**	**5.1**	**3.5**	**3.5**	**3.5**	**3.0**
Financing	**-3.1**	**-1.0**	**-11.2**	**-4.7**	**-14.8**	**-5.1**	**-3.5**	**-3.5**	**-3.5**	**-3.0**
NIR flow (increase -)	-3.2	-1.0	-11.2	-4.7	-14.8	-5.1	-3.5	-3.5	-3.5	-3.0
Change in NIR (increase -)	-3.5	-1.9	-11.0	-4.7	-15.2	-5.1	-3.5	-3.5	-3.5	-3.0
Valuation change	0.3	0.9	-0.2	0.0	0.4	0.0	0.0	0.0	0.0	0.0
Exceptional financing	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief 4/	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
					(In percent of GDP)					
Current account balance	**-4.2**	**-0.5**	**-2.5**	**-1.9**	**-3.5**	**-3.5**	**-3.4**	**-3.3**	**-3.1**	**-3.0**
Trade balance	2.0	4.7	4.4	5.3	2.2	2.3	2.5	2.8	3.0	3.1
Exports	24.5	21.2	23.1	26.1	22.7	22.6	22.4	22.3	22.3	22.3
Traditional	18.3	16.2	18.0	20.2	17.2	16.8	16.4	16.4	16.3	16.3
Mining	14.3	12.9	14.1	15.4	13.2	13.1	13.1	13.3	13.5	13.7
Nontraditional and others	6.1	5.0	5.1	5.9	5.5	5.7	6.0	6.0	6.0	6.0
Imports	-22.4	-16.5	-18.7	-20.9	-20.5	-20.2	-19.9	-19.6	-19.3	-19.2
Services, income, and current transfers (net)	-6.2	-5.2	-6.8	-7.1	-5.7	-5.8	-5.9	-6.0	-6.1	-6.1
Investment income	-6.9	-6.6	-7.3	-7.7	-6.3	-6.3	-6.3	-6.6	-6.7	-6.7
Capital and financial account balance	**6.8**	**1.9**	**8.8**	**5.2**	**10.2**	**5.8**	**4.8**	**4.6**	**4.2**	**3.9**
Foreign direct investment (net)	4.9	4.7	5.3	4.6	5.0	4.1	4.0	4.0	4.0	4.0
Overall balance	**2.5**	**0.8**	**7.3**	**2.6**	**7.3**	**2.3**	**1.4**	**1.3**	**1.2**	**0.9**
Memorandum items										
					(Annual percentage change)					
Export value	10.4	-13.1	31.9	30.1	-1.1	8.9	10.1	10.7	11.0	11.3
Volume growth	10.3	-1.7	4.0	10.0	2.5	8.3	12.1	10.8	11.2	10.9
Price growth	0.1	-11.5	26.8	18.2	-3.6	0.5	-1.8	-0.1	-0.2	0.4
Import value	45.2	-26.1	37.1	28.3	11.9	8.0	9.0	9.2	9.4	11.1
Volume growth	20.0	-20.3	24.6	12.7	12.5	9.2	9.8	9.5	9.5	10.7
Price growth	21.0	-7.4	10.1	13.8	-0.6	-1.1	-0.7	-0.3	0.0	0.3
Terms of trade	-14.5	-3.1	18.2	5.5	-2.9	1.6	0.0	0.2	0.1	0.3
					(In percent of GDP)					
Net international position 5/	-25.1	-26.4	-27.8	-25.4	...	...	...	...	...	...
Assets	36.8	43.7	46.8	45.1	...	...	...	...	...	...
Reserve assets of the BCRP	24.6	26.0	28.7	27.6	...	...	...	...	...	...
Financial system (excludes BCRP) 6/	7.3	11.0	10.8	10.5	...	...	...	...	...	...
Other assets	4.9	6.6	7.4	7.0	...	...	...	...	...	...
Liabilities	61.9	70.1	74.6	70.5	...	...	...	...	...	...
Bonds and private and public external debt	27.5	27.6	28.4	26.9	...	...	...	...	...	...
Medium and long-term	22.6	23.9	24.3	23.3	...	...	...	...	...	...
Short-term	4.9	3.7	4.1	3.6	...	...	...	...	...	...
Direct investment	25.4	27.1	27.9	29.0	...	...	...	...	...	...
Equity securities	8.9	15.4	18.4	14.7	...	...	...	...	...	...
Gross international reserves (in billions of US$)	31.2	33.2	44.2	48.9	63.7	68.8	72.3	75.8	79.3	82.3
GDP (in billions of US$)	126.9	127.0	153.9	177.2	201.5	220.7	244.9	271.8	302.1	336.4
Average exchange rate (S/. per US$)	2.9	3.0	2.8	2.7	2.6	...	...	...	...	...

Sources: BCRP; MEF; and Fund staff estimates/projections.
1/ Includes debt swap operations.
2/ Includes public sector's net external assets and other transactions involving Treasury bonds.
3/ Excluding privatization.
4/ Includes COFIDE and Banco de la Nación.
5/ End of period.
6/ Includes domestic currency assets held by nonresidents.

Table 6. Peru: Monetary Survey 1/
(In billions of nuevos soles; unless noted otherwise)

	2008	2009	2010	2011	Est. 2012	Projections 2013	2014
				I. Central Reserve Bank			
Net international reserves 2/	**98.0**	**95.8**	**123.9**	**131.8**	**163.2**	**178.4**	**182.6**
(In billions of U.S. dollars)	31.2	33.1	44.1	48.8	64.0	69.1	72.6
Long-term net external assets	-2.1	-0.2	0.1	0.1	0.0	0.1	0.1
Foreign currency liabilities	-19.9	-16.0	-19.1	-21.9	-25.0	-21.7	-20.3
Net domestic assets	**-53.7**	**-56.0**	**-70.7**	**-70.0**	**-85.5**	**-95.4**	**-75.8**
Net credit to nonfinancial public sector	-24.9	-25.7	-30.3	-41.9	-54.9	-59.9	-64.9
Credit to the financial sector 3/	-5.0	-9.2	-10.1	-11.0	-8.9	-10.9	-10.7
Securities issued	-15.8	-14.2	-25.2	-16.4	-27.5	-31.9	-33.8
Other assets (net)	-7.9	-7.0	-5.1	-0.7	5.8	7.2	18.4
Monetary base	22.3	23.5	34.2	40.0	52.7	61.3	71.4
Currency	17.3	19.2	24.1	27.2	32.2	36.7	41.8
Reserve	4.97	4.3	10.1	12.7	20.6	24.6	29.6
				II. Depository Corporations 4/			
Net foreign assets	**84.7**	**86.9**	**107.9**	**110.7**	**132.5**	**152.2**	**157.0**
Net domestic assets	**20.5**	**25.5**	**28.9**	**46.3**	**41.4**	**43.8**	**63.8**
Net credit to the public sector	-36.3	-34.7	-41.2	-53.2	-69.7	-75.3	-81.3
Credit to the private sector	99.3	104.2	121.6	148.1	167.2	193.3	222.2
Other assets (net)	-42.5	-43.9	-51.5	-48.6	-56.1	-74.3	-77.1
Broad money	**105.2**	**112.4**	**136.8**	**157.0**	**173.9**	**195.9**	**220.8**
Domestic currency	57.1	65.3	85.4	99.0	119.3	136.4	155.9
Money	28.9	33.1	42.7	48.8	55.6	...	...
Currency	17.3	19.2	24.1	27.2	30.0	36.7	41.8
Demand deposits	11.6	13.9	18.5	21.6	25.7	...	...
Quasi-money	28.2	32.2	42.7	50.2	63.7	...	...
Foreign currency	52.7	52.2	56.6	61.9	54.6	59.5	64.9
				III. Financial System 5/			
Net foreign assets	**104.0**	**117.9**	**146.9**	**150.3**	**178.2**	**193.2**	**197.0**
Net domestic assets	**59.9**	**77.8**	**93.4**	**102.7**	**109.9**	**131.4**	**168.8**
Net credit to the public sector	-21.6	-16.1	-22.4	-36.4	-52.3	-56.4	-61.0
Credit to the private sector	124.1	137.0	164.5	187.8	211.6	246.8	285.6
Other assets (net)	-42.5	-43.2	-48.7	-48.7	-49.5	-59.0	-55.9
Liabilities to the private sector	**164.0**	**195.6**	**240.3**	**253.0**	**288.1**	**324.6**	**365.8**
Domestic currency	109.4	138.9	178.2	186.2	223.9	258.8	299.0
Foreign currency	54.6	56.7	62.1	66.8	64.1	65.8	66.8
				(12-month percentage change)			
Monetary base	25.5	5.5	45.3	16.8	31.9	16.2	16.5
Broad money	25.6	6.8	21.7	14.7	10.8	12.7	12.7
Domestic currency	27.2	14.4	30.7	16.0	20.5	14.3	14.3
Foreign currency	27.4	-0.9	8.3	9.5	-11.9	9.1	9.0
Liabilities to the private sector	4.0	19.3	22.8	5.3	13.9	12.7	12.7
Domestic currency	0.0	27.1	28.2	4.5	20.3	15.6	15.5
Foreign currency	13.0	3.7	9.6	7.6	-4.0	2.5	1.6
Depository corporations credit to the private sector	33.9	5.0	16.7	21.8	12.9	15.6	14.9
Domestic currency	46.9	17.9	21.2	20.7	14.8	19.7	18.8
Foreign currency	23.5	-7.3	11.3	23.3	10.4	10.2	9.3
Memorandum item							
End-of-period exchange rate (S/. per US$)	3.11	2.88	2.82	2.70	2.56	...	...

Sources: BCRP; and Fund staff estimates/projections.

1/ Stocks in foreign currency are valued at the end-of-period exchange rate.
2/ Excludes subscriptions to the IMF and the Latin American Reserve Fund (FLAR), Pesos Andinos, credit lines to other central banks, Corporación Andina de Fomento (CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations.
3/ Including Banco de la Nacion.
4/ Depository corporations comprise the Central Reserve Bank of Peru, Banco de la Nacion, commercial banks, Agricultural Bank (Banco Agropecuario), financial firms, municipal banks, rural banks and credit unions.
5/ Financial system comprises depository corporations and other financial corporations. Other financial companies include mutual funds, COFIDE, insurance companies, leasing companies, pension funds, the Fund Edpymes and MIVIVIENDA.

Table 7. Peru: Financial Soundness Indicators 1/

(In percent; unless otherwise indicated)

	Dec-08	Dec-09	Dec-10	Dec-11	Sep-12
Capital Adequacy					
Capital to risk-weighted assets 2/	11.9	13.8	13.6	13.4	...
Regulatory Tier I capital to risk-weighted assets 3/	7.7	10.5	10.8	10.4	...
Nonperforming loans net of provisions to capital	-15.3	-14.6	-14.3	-14.5	...
Asset Quality					
Nonperforming loans to total gross loans 4/	1.3	1.6	1.5	1.5	1.7
In domestic currency	1.7	2.0	1.9	2.0	2.4
In foreign currency	1.0	1.2	1.1	1.0	1.1
Nonperforming, refinanced and restructured loans to total gross loans	2.2	2.7	2.6	2.5	2.7
In domestic currency	2.5	3.2	3.0	3.2	3.7
In foreign currency	1.9	2.3	2.2	1.8	1.7
Refinanced and restructured loans to total gross loans	0.9	1.1	1.1	1.0	1.0
Provisions to nonperforming loans	258.7	242.2	245.6	251.1	226.6
Provisions to nonperforming, restructured, and refinanced loans	151.0	139.3	141.9	149.8	144.2
Sectoral distribution of loans to total loans 5/					
Consumer loans	17.9	17.8	17.0	17.7	18.18
Mortgage loans	12.6	13.6	14.1	15.0	16.08
Commercial loans	63.4	62.5	...	...	...
Small and Micro Enterprises (MES)	6.0	6.1	...	...	...
Earnings and Profitability					
Return on assets (ROA)	2.6	2.3	2.4	2.3	2.2
Return on equity (ROE)	31.1	24.5	24.2	24.5	23.0
Gross financial spread to financial revenues	66.3	73.8	79.3	74.8	74.7
Financial revenues to total revenues	81.3	81.0	78.2	79.5	80.4
Annualized financial revenues to revenue-generating assets	11.7	10.7	9.6	9.6	9.8
Liquidity					
Total liquid assets to total short-term liabilities (monthly average basis)	41.4	40.4	48.0	42.1	45.3
In domestic currency	26.3	38.8	54.6	39.2	46.4
In foreign currency	53.0	41.7	41.1	45.0	44.0
Foreign Currency Position and Dollarization					
Global position in foreign currency to regulatory capital 6/	28.6	7.7	0.5	5.0	...
Share of foreign currency deposits in total deposits	58.0	55.8	47.8	47.3	42.8
Share of foreign currency loans in total credit	57.5	52.4	52.3	51.0	50.3
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	18,312	19,600	19,857	22,126	22,491
Commercial banks' short-term foreign assets (in millions of U.S. dollars)	1,641	1,373	1,613	1,753	1,806
Commercial banks' short-term foreign liabilities (in millions of U.S. dollars)	1,496	1,208	933	1,552	2,695
Operational efficiency					
Financing to related parties to capital 7/	13.9	14.6	12.3	10.2	...
Nonfinancial expenditure to total revenues 8/	28.7	29.6	31.0	32.1	31.6
Nonfinancial expenditure to total revenue-generating assets 8/	4.3	4.1	3.9	4.0	4.1
Memorandum items					
Number of Banks	18	17	17	17	18
Private commercial	16	15	15	15	16
Of which: Foreign-owned	11	11	11	11	12
State-owned	2	2	2	2	2
Banks' credit card loans to total loans	9.6	9.2	9.2	10.0	10.4
Bank loans' year-over-year change (in real terms)	28.9	0.3	16.3	11.7	9.1
General Stock market index IGBVL (U.S. dollars)	2,245	4,902	8,321	7,190	8,343
Foreign currency debt rating (Moody's)	...	...	...	...	...
EMBI+ PERU spread, basis points	509	165	165	216	124

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

1/ These indicators correspond to private commercial banks.

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

3/ Tier I regulatory capital was approximated by share capital plus reserves until June 2009. Since July 2009, Banking Law components establishes that the Tier I capital have to be defined, and Risk-weighted assets include overall risks (credit, market and operational).

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

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

6/ Global position in foreign currency includes the foreign currency position in the balance sheet and the net position in financial derivatives.

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

8/ Nonfinancial expenditures do not consider provisions nor depreciation.

Table 8. Peru: Financial and External Vulnerability Indicators

(In percent; unless otherwise indicated)

					Est.	Projections				
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Financial indicators										
Public sector debt/GDP	25.0	28.4	24.6	22.2	19.3	17.2	16.4	15.8	15.3	14.7
Of which: in domestic currency (percent of GDP)	9.2	11.4	11.0	10.4	8.2	7.2	7.3	7.6	7.9	8.0
90-day prime lending rate, domestic currency (end of period)	7.5	1.7	3.6	5.4	5.1	...	...	...	...	...
90-day prime lending rate, foreign currency (end of period)	5.2	1.2	2.1	2.4	2.8	...	...	...	...	...
Velocity of money 1/	3.5	3.4	3.2	3.1	3.0	2.9	2.8	2.7	2.6	2.5
Net credit to the private sector/GDP 2/	26.7	27.3	28.0	30.4	31.6	33.5	35.6	37.8	40.2	42.7
External indicators										
Exports, U.S. dollars (percent change)	10.4	-13.1	31.9	30.1	-1.1	8.9	10.1	10.7	11.0	11.3
Imports, U.S. dollars (percent change)	45.2	-26.1	37.1	28.3	11.9	8.0	9.0	9.2	9.4	11.1
Terms of trade (percent change) (deterioration -)	-14.5	-3.1	18.2	5.5	-2.9	1.6	0.0	0.2	0.1	0.3
Real effective exchange rate, (end of period, percent change) 3/	4.4	3.4	2.4	-1.0	...	...	...	...	...	...
Current account balance (percent of GDP)	-4.2	-0.5	-2.5	-1.9	-3.5	-3.5	-3.4	-3.3	-3.1	-3.0
Capital and financial account balance (percent of GDP)	6.8	1.9	8.8	5.2	10.2	5.8	4.8	4.6	4.2	3.9
Total external debt (percent of GDP)	28.3	29.2	27.5	25.6	25.6	26.2	25.3	24.4	23.6	22.7
Medium- and long-term public debt (in percent of GDP) 4/	16.0	17.4	14.0	12.4	11.1	10.4	9.2	8.2	7.2	6.3
Medium- and long-term private debt (in percent of GDP)	7.3	8.1	9.4	9.6	10.9	12.1	12.3	12.4	12.3	12.1
Short-term public and private debt (in percent of GDP)	5.0	3.7	4.1	3.6	3.6	3.6	3.7	3.9	4.1	4.3
Total external debt (in percent of exports of goods and services) 4/	103.7	121.2	107.6	89.5	102.3	106.0	103.2	100.3	97.2	93.7
Total debt service (in percent of exports of goods and services) 5/	15.9	15.2	20.8	7.2	8.6	8.7	8.7	7.9	7.3	6.7
Gross official reserves										
In millions of U.S. dollars	31,233	33,175	44,150	48,859	63,651	68,751	72,251	75,751	79,251	82,251
In percent of short-term external debt 6/	318.3	428.4	342.3	589.3	661.2	646.6	595.9	565.7	522.0	478.6
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	89.0	113.4	107.3	124.7	139.4	142.7	135.3	128.1	121.0	112.8
In percent of broad money 8/	92.4	84.6	90.8	83.9	91.8	87.9	78.9	70.5	62.8	55.8
In percent of foreign currency deposits at banks	203.6	203.6	241.1	227.7	298.5	298.1	280.0	263.1	247.1	232.1
In months of next year's imports of goods and services	14.5	11.4	12.2	12.2	14.8	14.6	14.1	13.6	12.8	13.7
Net international reserves (in millions of U.S. dollars)	31,196	33,135	44,105	48,816	63,991	69,091	72,591	76,091	79,591	82,591
BCRP's Foreign Exchange Position	21,365	22,988	32,422	33,300	48,092	53,192	56,692	60,192	63,692	66,692
Public sector deposits in BCRP	3,274	4,304	4,339	6,731	8,198	...	...	...	...	...
Banks' deposits in BCRP	6,581	5,853	7,326	8,799	10,068	...	...	...	...	...

Sources: BCRP; IMF Information Notice System (INS); and Fund staff estimates/ projections.
1/ Defined as the inverse of the ratio of end-period broad money to annual GDP.
2/ Corresponds to the financial system.
3/ End of period; data from INS.
4/ Includes Central Reserve Bank of Peru debt.
5/ Includes debt service to the Fund.
6/ Short-term debt includes amortization of medium- and long-term loans falling due over the following year, including debt swaps.
7/ Current Account deficit adjusted for 0.75*net FDI inflows; if adjusted CA balance>0, set to 0.
8/ At end-period exchange rate.

Table 9. Peru: Medium-Term Macroeconomic Framework

					Est.	Projections				
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(Annual percentage change)									
Production										
GDP at constant prices	9.8	0.9	8.8	6.9	6.3	6.3	6.3	6.1	6.0	6.0
Consumer prices (end of period)	6.7	0.2	2.1	4.7	2.8	2.0	2.0	2.0	2.0	2.0
GDP deflator	0.7	2.2	4.5	4.7	2.4	2.5	1.7	1.8	1.8	2.0
Trade										
Merchandise trade										
Exports, f.o.b.	10.4	-13.1	31.9	30.1	-1.1	8.9	10.1	10.7	11.0	11.3
Imports, f.o.b.	45.2	-26.1	37.1	28.3	11.9	8.0	9.0	9.2	9.4	11.1
Terms of trade (deterioration -)	-14.5	-3.1	18.2	5.5	-2.9	1.6	0.0	0.2	0.1	0.3
	(In percent of GDP; unless otherwise indicated)									
External current account balance	-4.2	-0.5	-2.5	-1.9	-3.5	-3.5	-3.4	-3.3	-3.1	-3.0
External current account, excluding interest obligations	-2.4	0.7	-1.4	-0.8	-2.6	-2.5	-2.4	-2.4	-2.2	-2.2
Total external debt service 2/	4.3	3.7	5.3	2.1	2.1	2.1	2.1	1.9	1.8	1.6
Medium- and long-term	4.0	3.5	5.2	2.0	2.1	2.1	2.1	1.8	1.7	1.5
Nonfinancial public sector	3.0	2.3	4.1	1.1	1.1	1.1	1.0	0.9	0.8	0.7
Private sector	1.0	1.2	1.1	0.9	0.9	1.0	1.1	0.9	0.9	0.8
Short-term 1/	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Interest	1.6	1.3	1.0	0.9	0.9	1.0	0.9	0.9	0.8	0.8
Amortization (medium-and long-term)	2.7	2.4	4.3	1.1	1.2	1.2	1.2	1.0	0.9	0.8
Public sector										
Combined public sector primary balance 3/	4.0	0.0	0.9	3.0	3.1	2.5	2.2	1.9	1.8	1.7
General government revenue	21.1	18.7	20.0	21.1	21.3	21.6	21.7	21.9	22.3	22.3
General govt. non-interest expenditure 3/	23.0	24.0	24.2	23.2	23.2	23.8	24.0	24.2	24.6	24.5
Combined public sector interest due	1.6	1.3	1.2	1.2	1.0	1.0	1.0	0.9	0.8	0.7
Combined public sector overall balance 3/	2.4	-1.3	-0.3	1.9	2.1	1.5	1.2	1.0	1.0	1.0
Public sector debt 3/	25.0	28.4	24.6	22.2	19.3	17.2	16.4	15.8	15.3	14.7
Savings and investment										
Gross domestic investment	26.9	20.7	25.3	26.2	26.8	26.6	26.6	27.0	27.1	26.9
Public sector 3/	4.3	5.2	5.9	5.2	5.7	5.8	6.0	6.1	6.4	6.4
Private sector	22.6	15.5	19.3	20.9	21.1	20.8	20.6	20.9	20.7	20.6
Private sector (excluding inventories)	21.5	17.7	19.2	19.6	20.7	20.7	20.8	20.7	20.6	20.5
Inventory changes	1.0	-2.1	0.2	1.4	0.4	0.1	-0.2	0.2	0.1	0.1
National savings	22.7	20.2	22.8	24.3	23.3	23.2	23.3	23.7	24.0	23.9
Public sector 4/	6.8	4.5	6.1	7.1	7.8	7.3	7.2	7.1	7.4	7.3
Private sector	15.9	15.5	16.9	17.2	15.5	15.9	16.0	16.6	16.7	16.6
External savings	4.2	0.5	2.5	1.9	3.5	3.5	3.4	3.3	3.1	3.0
Memorandum items										
Nominal GDP (billions of Nuevos Soles)	371.1	382.3	434.7	486.5	529.7	577.0	624.2	674.4	727.6	786.5
Gross international reserves (billions of U.S. dollars)	31.2	33.2	44.2	48.9	63.7	68.8	72.3	75.8	79.3	82.3
Gross international reserves to broad money	92.4	84.6	90.8	83.9	91.8	87.9	78.9	70.5	62.8	55.8
External debt service (percent of exports of GNFS)	15.9	15.2	20.8	7.2	8.6	8.7	8.7	7.9	7.3	6.7
Short-term external debt service (percent of exports of GNFS)	1.3	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4
Public external debt service (percent of exports of GNFS)	11.2	9.6	16.1	3.8	4.6	4.3	4.1	3.7	3.3	3.0

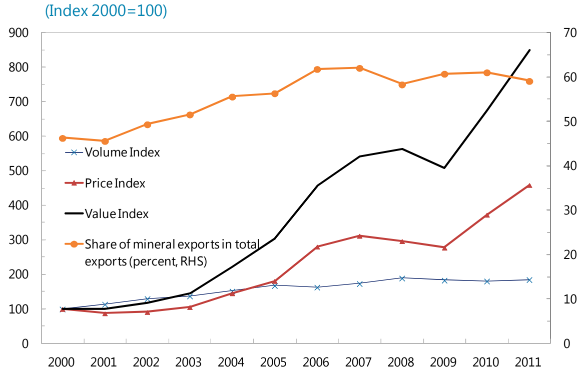
Sources: BCRP; MEF; and Fund staff estimates/projections.
1/ Includes interest payments only.
2/ Includes the financial public sector.
3/ Includes CRPAOs.
4/ Excludes privatization receipts.

Annex I. Balance of Payments Stability Analysis

Current Account

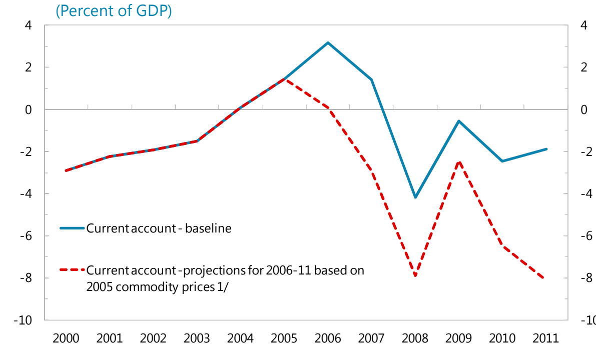
1. The current account remains in deficit with net outflow of investment income. Exports doubled during the last 5 years to 26 percent of GDP in 2011 on the back of rapidly rising mineral exports that accompanied the surge in copper and gold prices. As a result, traditional exports accounted for 20 percent of GDP in 2011. Non-traditional exports have also been growing, albeit at a slower pace, to 6 percent of GDP in 2011. However, the increase in trade surpluses was offset by an increase in the profit reparation in the range of 6½ to 7¾ percent of GDP. As an illustration of the impact of commodity prices, if commodity prices were to return to their 2005 levels, the current account deficit would have reached close to 8 percent of GDP in 2011 (compared with the actual -1.9 percent of GDP), if the real exchange rate did not depreciate.

Peru: Mineral Exports
(Index 2000=100)



Sources: BCRP; and Fund staff estimates.

Peru: Current Account Balance
(Percent of GDP)



Sources: BCRP; and Fund staff estimates.
1/ Profit remittances are reduced accordingly assuming about 40 percent of revenue from mineral exports are repatriated.

2. The current account deficit is estimated to have widened to about 3½ percent of GDP in 2012 and is expected to narrow to 3 percent of GDP over the medium term. This is due the combined effect of weaker export growth with the moderation of metal prices (export fell to about 23 percent of GDP in 2012) and buoyant import growth supported by domestic demand. Capital inflows, in particular FDI, are expected to continue to provide stable financing for the current account over the medium term.

Capital Account

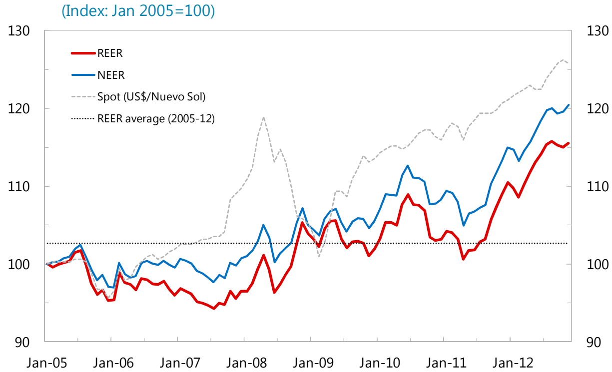
3. Peru has received large FDI inflows of 5 percent of GDP on average during 2007–11, and strong FDI inflow is expected to continue over the medium term. About one-quarter of FDI goes to mining projects. Prospect for FDI inflows remain positive over the medium term at around 4 percent of GDP per annum as investors are attracted by Peru's rich mineral resources and medium term growth outlook.

4. Other capital flows are small in comparison. Portfolio investment inflows from foreign investors remained small during 2007–11 and were in most years (except 2008) offset by larger net portfolio investment outflows by domestic investors such as the pension funds. However, non-residents' holdings of government securities have risen in recent years, accounting for about 2¼ percent of GDP in 2010 and 1 percent of GDP in 2012. While Peru is to some extent exposed to the global short-term capital inflows like its regional peers, net flows are relatively small, other than the net inflows equivalent to 1.9 percent of GDP in 2007 and net outflows of 1.7 percent of GDP in 2009, and an estimated net inflows of 2.2 percent of GDP in 2012.

Real Exchange Rate

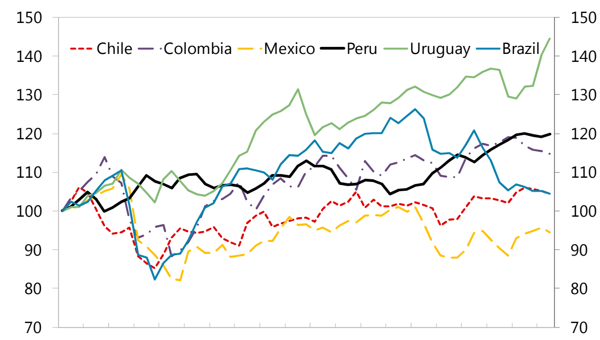
5. Peru's currency appreciation trend is broadly in line with its fundamentals, including its strong prospects for growth and terms of trade. As of November 2012, the real effective exchange rate (REER) has appreciated by 15 percent since April 2011, and about 4½ percent since end-2011.

Peru: Exchange Rates
(Index: Jan 2005=100)



Sources: INS database; Haver; and Fund staff calculations.

LA6: Real Effective Exchange Rate
(Jan 2008=100; increase denotes appreciation)



Source: INS

6. In staff's view, there is no significant misalignment of the exchange rate. The average of the traditional CGER methodologies gives a potential overvaluation of the nuevo sol of about 3 percent, whereas the new EBA methodology suggests a higher misalignment. However, the panel

Current Account and REER Gaps
(In percent of GDP; unless noted otherwise)

	EBA Methodologies		CGER Methodologies		
	CA Regression	RER Regression	MB	ERER	ES
CA norm	-1.8	…	-1.5	…	-1.8
CA underlying 1/	-3.4		-3.0	…	-3.0
CA gap 2/	1.6	…	1.5	…	1.2
RER gap (in percent) 3/	…	…	7	-1	6
Multilaterally consistent RER gap (in percent)	**8**	**11**	**9**	**-0.4**	**6**
Adjusted CA underlying 4/	-2.9	n.a.	-2.5	n.a.	-2.5
Adjusted CA gap 4/	1.1	n.a.	1.0	n.a.	0.7
Adjusted RER gap (in percent) 4/	…	…	4	…	3
Adjust Multilaterally consistent RER gap (in percent) 4/	**5**	**11**	**7**	**-0.4**	**3**

1/ Cyclically adjusted CA of 2012 for EBA; and medium-term CA for CGER.
2/ CA gap is CA norm minus CA underlying.
3/ Positive values indicate overvaluation; and exchange rate elasticity of 0.21.
4/ Adjusted for under-reporting in the illegal exports of gold estimated at 0.5 percent of GDP.

regression used in the EBA assessment for the exchange rate does not have a good track record of fitting Peru well over the years, and these results should be interpreted with some caution. Against this background, staff believes that the small overvaluation estimated by these methodologies is in line with an assessment of no misalignments in the exchange rate. The relatively large residuals in the regressions may indicate that these models are not well suited in Peru's case and they could be further improved to reflect the large profit reparation from inward FDI which contributed to the current account deficit as well as inadequate recordings of illegal gold exports.

- The average of all the EBA and CGER methodologies (adjusting for illegal gold exports), yields an overvaluation of about 5 percent, which is within the margin of error.

- The preliminary External Balance Assessment (EBA) model estimates suggest that difference between the cyclically adjusted current account (CA) norm of a deficit of 1.8 percent of GDP and the adjusted CA deficit (cyclically adjusted) is 1.1 percent of GDP (CA gap), representing an overvaluation of about 5 percent. The EBA's real exchange rate (RER) regression approach (with its weak fit) points to an overvaluation of 11 percent.

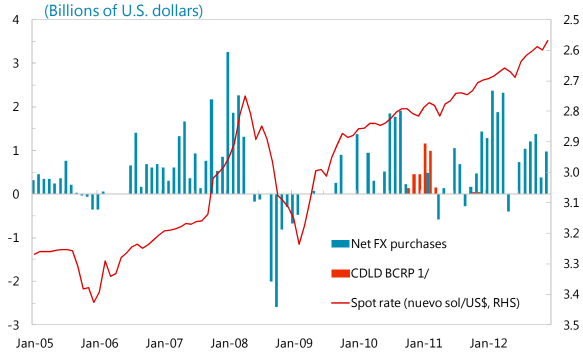
- CGER estimates show an overvaluation between 0 to 7 percent. The deviation ranges from 3 percent for the external sustainability (ES) approach (which calculates the RER adjustment needed to stabilize the net foreign asset position), to 7 percent for the macroeconomic balance (MB) approach (which computes the RER adjustment needed to close the current account gap), and zero percent overvaluation/undervaluation for the equilibrium real exchange rate (ERER) approach (which directly estimates the RER needed to restore the equilibrium RER determined by a set of fundamentals).

FX Intervention and Reserves

7. BCRP's interventions in the foreign exchange market have been aimed at reducing excessive currency volatility, taking into account Peru's vulnerability to exchange rate reversal given its still high level of financial dollarization. During 2012, in response to significant capital inflows, the central bank intervened in the foreign exchange market with a net foreign currency purchase of US$13 billion or 6½ percent of GDP, surpassing the large net FX purchases in previous years (US$10 billion in 2007 and US$9 billion in 2010). These interventions are sterilized through the issuance of BCRP's Certificate of Deposits, a term deposit with BCRP, reserve requirements in nuevo sol and fiscal withdrawal (about 30 percent of the total amount). More recently, in response to the rising appreciation pressure, BCRP also announced the plan to intervene in a fixed daily amount to further enhance the flexibility of the exchange rate.

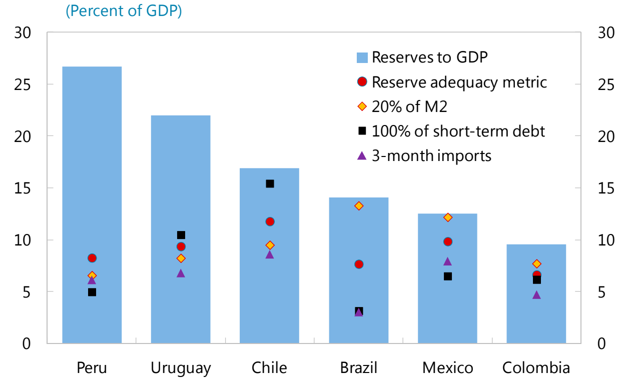
8. Peru's net international reserves are adequate by any metric. Net international reserves (NIR) amounted to over US$64 billion (32 percent of GDP) at end 2012. They are adequate based on various reserve metrics, covering 3 times the NIR deemed adequate as measured by the IMF new reserve adequacy metric, and Peru's reserve adequacy is well above its regional peers.

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



Source: BCRP.
1/ CDLD BCRP: BCRP Certificate of Deposits settled in U.S. dollars.

LA6: NIR Coverage in 2011
(Percent of GDP)

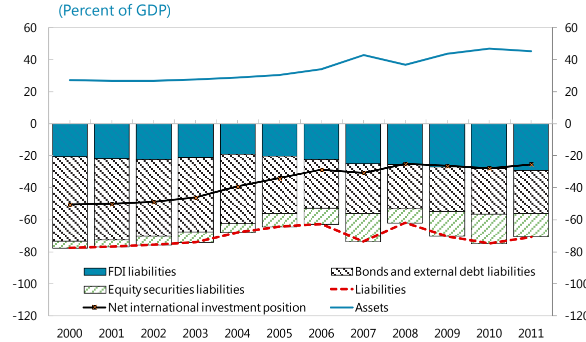


Sources: IMF Reserve Adequency Database; and Fund staff calculations.

Foreign Assets and Liability Position

9. Peru's international investment position (IIP) and its composition have improved. Its net foreign liability position has declined steadily by one-half to 25 percent of GDP during 2000–11. Foreign liabilities declined by 7 percent of GDP since 2000 to 70.5 percent of GDP in 2011. A key contributing factor is external borrowing which fell by one-half to 27 percent of GDP in 2011. In contrast, FDI liabilities have increased by 8 percent of GDP to 29 percent of GDP in 2011, accounting for 40 percent of total liabilities in 2011 from about one-quarter of total liabilities in 2000. Foreign assets, at 45 percent of GDP in 2011, have increased by 1.7 times during 2000–11, with the build-up of reserve assets of the BCRP accounting for slightly less than 2/3 of the increase.

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



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

Annex II. Debt Sustainability Analysis

1. Peru's public debt is projected to decline under the baseline debt scenario to below 15 percent of GDP over the medium term. Public sector gross debt declined by half to 23 percent of GDP in 2011 from 44 percent in 2004. Currency risks have also declined significantly, with the share of foreign currency denominated public debt in total public debt declining to 54 percent in 2011. High real GDP growth averaging 6.4 percent and overall fiscal surpluses averaging 0.2 percent of GDP over the 10-year period of 2002–11 have contributed to debt consolidation. In the medium term, real GDP growth will average 6 percent a year in 2012–17 underpinned by domestic demand dynamics and external demand supported by high commodity prices. In this context, overall fiscal surpluses are projected to average 1.8 percent of GDP. Under the baseline scenario, Peru's public sector debt stock (including CRPAOs) would decline further from an estimated 19 percent of GDP at end-2012, to 12 percent of GDP by 2017.

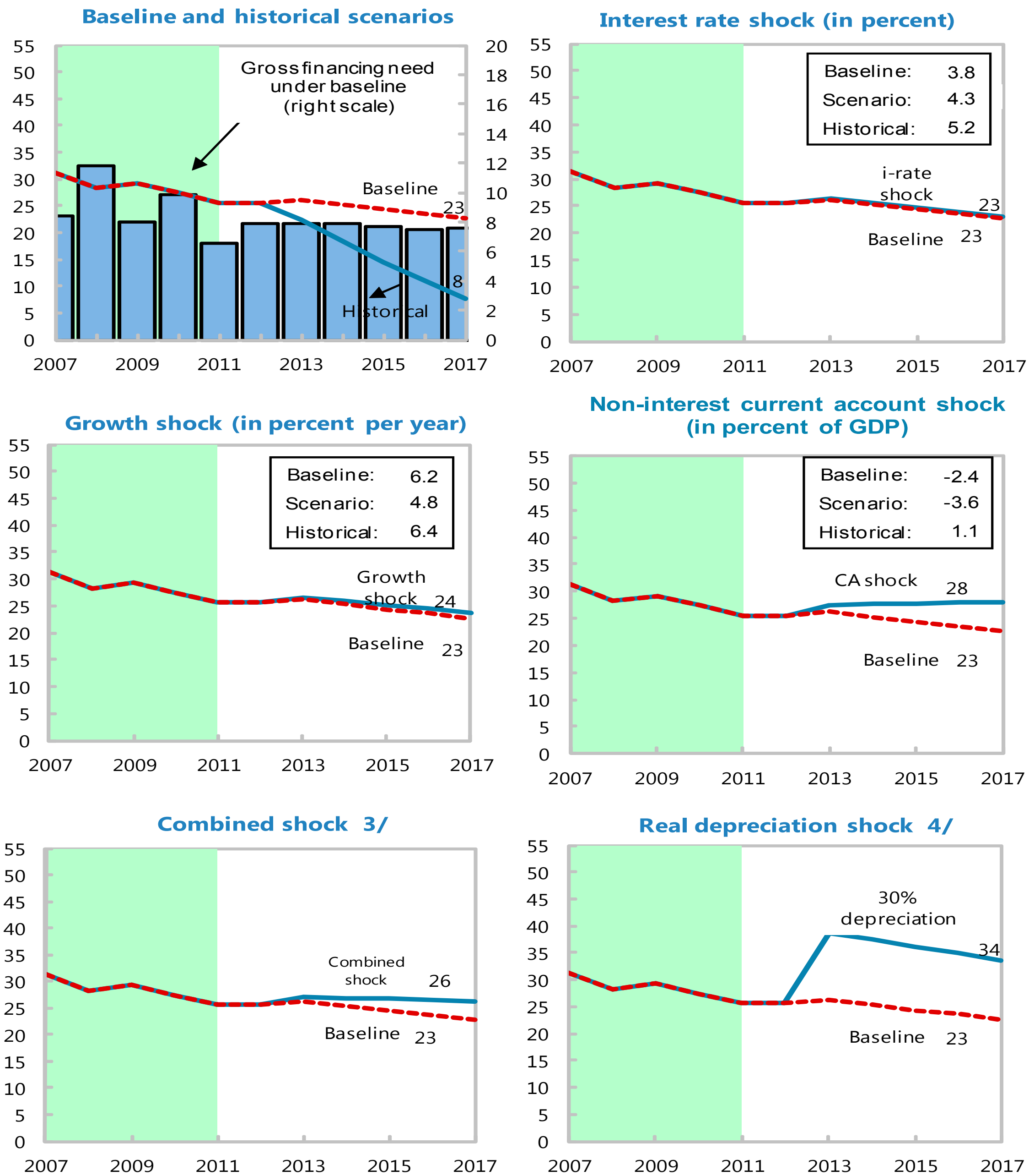
2. External debt is projected to decline further to about 23 percent of GDP. Peru's external debt has been on a downward trajectory, declining by half to 26 percent of GDP in 2011 from 50 percent of GDP in 2001, as a result of a decade of a continuously improving external position. The baseline scenario projects total external debt to decline further by about 3 percentage points of GDP from end-2012 to 23 percent by 2017

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

4. However, external and public debt ratios remain sensitive to large and permanent exchange rate shocks. Under a one-off 30 percent real depreciation of the exchange rate, the external and public debt ratios would increase by about 11 and 5 percentage points, respectively above the baseline projections over the medium term.

5. A contingent liabilities shock to the public sector of 10 percent of GDP would increase public debt by a similar amount over the medium term. The public debt ratio would rise sharply in the short run to 26 percent of GDP and decline over the medium term to 21 percent of GDP. By 2017, the debt ratio would remain 9 percentage points of GDP above the baseline scenario.

Figure A1. Peru: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



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

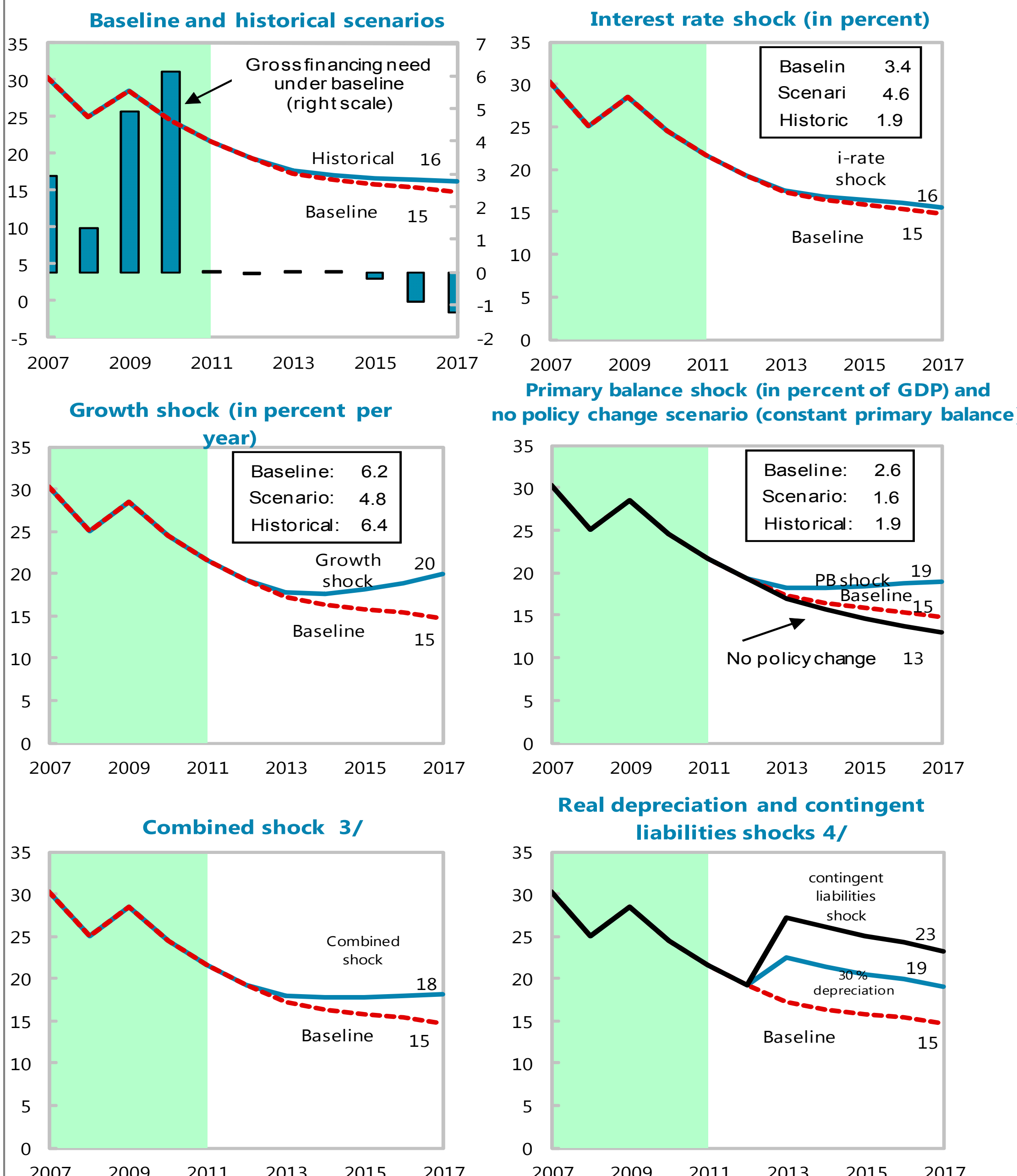
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

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

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

4/ One-time real depreciation of 30 percent occurs in 2013.

Figure A2. Peru: Public Debt Sustainability: Bound Tests 1/ 2/
(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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table A1. Peru: External Debt Sustainability Framework, 2007-2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing non-interest current account 6/
Baseline: External debt	31.3	28.3	29.2	27.5	25.6	**25.6**	**26.2**	**25.3**	**24.4**	**23.6**	**22.7**	**-5.1**
Change in external debt	-0.1	-3.0	0.9	-1.8	-1.9	0.0	0.6	-0.9	-0.9	-0.8	-0.9	
Identified external debt-creating flows (4+8+9)	-10.7	-6.1	-2.0	-7.5	-5.6	-3.1	-1.7	-1.8	-1.7	-1.8	-1.8	
Current account deficit, excluding interest payments	-3.3	2.5	-0.7	1.4	0.9	2.6	2.5	2.4	2.4	2.2	2.2	
Deficit in balance of goods and services	-6.8	-0.4	-3.8	-2.9	-4.0	-1.1	-1.3	-1.5	-1.7	-2.1	-2.1	
Exports	29.1	27.3	24.1	25.5	28.6	25.0	24.7	24.5	24.3	24.2	24.2	
Imports	22.3	26.9	20.3	22.6	24.5	23.9	23.5	23.0	22.6	22.2	22.0	
Net non-debt creating capital inflows (negative)	-4.9	-5.4	-2.5	-4.8	-3.9	-5.2	-3.7	-3.7	-3.5	-3.6	-3.5	
Automatic debt dynamics 1/	-2.5	-3.2	1.3	-4.1	-2.7	-0.5	-0.5	-0.6	-0.5	-0.5	-0.5	
Contribution from nominal interest rate	1.9	1.6	1.3	1.0	0.9	0.9	1.0	0.9	0.9	0.8	0.8	
Contribution from real GDP growth	-2.4	-2.6	-0.2	-2.1	-1.6	-1.4	-1.5	-1.5	-1.4	-1.3	-1.3	
Contribution from price and exchange rate changes 2/	-2.0	-2.2	0.2	-3.0	-2.0	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	10.6	3.1	2.8	5.7	3.7	3.1	2.4	0.9	0.8	1.0	0.9	
External debt-to-exports ratio (in percent)	107.5	103.7	121.2	107.6	89.5	102.3	106.0	103.2	100.3	97.2	93.7	
Gross external financing need (in billions of US dollars) 4/	9.0	14.9	10.1	15.1	11.6	15.9	17.5	19.2	20.9	22.6	25.3	
in percent of GDP	8.4	11.8	8.0	9.8	6.6	7.9	7.9	7.9	7.7	7.5	7.5	
Scenario with key variables at their historical averages 5/						**25.6**	**22.5**	**18.4**	**14.5**	**11.1**	**7.7**	**-3.8**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	8.9	9.8	0.9	8.8	6.9	6.3	6.3	6.3	6.1	6.0	6.0	
GDP deflator in US dollars (change in percent)	6.7	7.7	-0.8	11.4	7.7	7.0	3.0	4.4	4.6	4.8	5.0	
Nominal external interest rate (in percent)	7.0	6.2	4.5	4.3	4.0	4.2	4.1	3.9	3.8	3.8	3.7	
Growth of exports (US dollar terms, in percent)	18.0	11.0	-11.7	28.3	29.0	-0.5	8.3	9.8	10.4	10.8	11.0	
Growth of imports (US dollar terms, in percent)	31.2	42.7	-24.5	35.1	24.7	10.7	7.6	8.8	8.9	9.2	10.6	
Current account balance, excluding interest payments	3.3	-2.5	0.7	-1.4	-0.9	-2.6	-2.5	-2.4	-2.4	-2.2	-2.2	
Net non-debt creating capital inflows	4.9	5.4	2.5	4.8	3.9	5.2	3.7	3.7	3.5	3.6	3.5	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, 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 $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

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

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

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

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

Table A2. Peru: Public Sector Debt Sustainability Framework, 2007-2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	30.4	25.0	28.4	24.6	22.2	**19.3**	**17.2**	**16.4**	**15.8**	**15.3**	**14.7**	**-0.6**
o/w foreign-currency denominated	21.3	15.8	17.0	13.6	11.8	11.1	10.1	9.1	8.2	7.4	6.7	
Change in public sector debt	-2.7	-5.3	3.4	-3.9	-2.4	-2.9	-2.0	-0.9	-0.6	-0.5	-0.6	
Identified debt-creating flows (4+7+12)	-8.3	-4.3	0.1	-3.5	-5.0	-3.8	-3.3	-2.9	-2.9	-3.0	-3.2	
Primary deficit	-5.0	-3.8	0.8	-0.9	-3.0	-3.0	-2.7	-2.5	-2.5	-2.6	-2.8	
Revenue and grants	20.9	21.1	18.7	20.0	21.1	21.3	21.6	21.7	21.9	22.3	22.3	
Primary (noninterest) expenditure	15.9	17.3	19.6	19.1	18.1	18.3	18.9	19.2	19.4	19.7	19.5	
Automatic debt dynamics 2/	-3.2	-0.5	-0.7	-2.6	-2.0	-0.8	-0.6	-0.4	-0.4	-0.4	-0.4	
Contribution from interest rate/growth differential 3/	-1.5	-1.4	0.5	-2.3	-1.5	-0.8	-0.6	-0.4	-0.4	-0.4	-0.4	
Of which contribution from real interest rate	1.1	1.3	0.8	-0.1	0.1	0.5	0.5	0.6	0.5	0.5	0.4	
Of which contribution from real GDP growth	-2.7	-2.7	-0.2	-2.2	-1.5	-1.3	-1.1	-1.0	-0.9	-0.9	-0.9	
Contribution from exchange rate depreciation 4/	-1.7	0.9	-1.2	-0.3	-0.5	...	...	...	...	...	...	
Other identified debt-creating flows	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	5.5	-1.1	3.3	-0.4	2.6	0.9	1.3	2.1	2.3	2.5	2.6	
Public sector debt-to-revenue ratio 1/	145.2	118.7	151.7	122.9	105.4	90.4	80.0	75.5	72.3	68.8	66.0	
Gross financing need 6/	3.0	1.4	4.9	6.1	0.1	-0.1	0.0	0.0	-0.3	-0.9	-1.3	
in billions of U.S. dollars	3.2	1.7	6.3	9.4	0.1	-0.3	0.0	0.0	-0.7	-2.8	-4.3	
Scenario with key variables at their historical averages 7/						**19.3**	**17.8**	**17.1**	**16.7**	**16.5**	**16.5**	**-0.9**
Scenario with no policy change (constant primary balance) in 2012-2017						**19.3**	**16.9**	**15.6**	**14.5**	**13.6**	**12.8**	**-0.5**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	8.9	9.8	0.9	8.8	6.9	6.3	6.3	6.3	6.1	6.0	6.0	
Average nominal interest rate on public debt (in percent) 8/	5.9	5.6	5.3	4.6	5.2	4.9	5.5	5.7	5.4	5.2	4.9	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	4.0	4.9	3.1	0.1	0.6	2.5	3.0	4.0	3.6	3.4	3.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	7.5	-4.3	8.2	2.2	4.4	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	1.9	0.7	2.2	4.5	4.7	2.4	2.5	1.7	1.8	1.8	2.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	6.5	19.3	13.9	6.3	1.0	7.7	9.6	8.2	7.3	7.7	5.1	
Primary deficit	-5.0	-3.8	0.8	-0.9	-3.0	-3.0	-2.7	-2.5	-2.5	-2.6	-2.8	

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.

PERU

January 30, 2013

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The Western Hemisphere Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of December 31, 2012)

I. **Membership Status**: Joined 12/31/1945; accepted Article VIII obligations on 2/15/1961.

II. General Resources Account:

	SDR Million	Percent of Quota
Quota	638.40	100.00
Fund holdings of currency	427.92	67.03
Reserve Tranche Position	210.50	32.97

III. SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	609.89	100.00
Holdings	526.34	86.30

IV. **Outstanding Purchases and Loans:** None

V. Latest Financial Arrangements:

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

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

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

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

VII. Exchange Arrangements

Peru maintains a unified, floating exchange rate. On January 3, 2013, the average of interbank buying and selling rates was 2.55 nuevos soles per U.S. dollar. The exchange system is free of restrictions, except for those maintained solely for the preservation of national or international security, and which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). Those restrictions are maintained pursuant to UN

Security Council Resolutions 1267 (October 15, 1999) and 1373 (September 28, 2001). Peru has maintained a clearing arrangement with Malaysia since 1991.

VIII. Last Article IV Consultation

The 2011 Article IV consultation was concluded on December 5, 2011 (IMF Country Report No. 12/26).

IX. FSAP and ROSCs

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

X. Technical Assistance

Technical assistance provided in 2000 through December 2012 is summarized in Annex V.

XI. Resident Representative

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

WORLD BANK RELATIONS

(As of December 13, 2012)

A. Bank Group Strategy

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

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

Peru's current lending portfolio includes 17 active projects with a commitment of US$1.9 billion and an undisbursed balance of US$1.4 billion. The portfolio includes twelve investment loans, four DPL/DDOs and two GEF grants. The areas covered by the existing portfolio are economic policy, environment, social protection, transport infrastructure, water resources, among others. Examples of projects include Irrigation in Sierra (US$20 million), Second Justice Improvement (US$20 million), Rural Water and Sanitation Program Additional Financing (US$30 million), Lima Optimization of Water Systems (US$54.5 million), and Second Rural Electrification Project (US$50 million).

During FY 12, there were no deliverables given that there was a newly elected government, and a review of the paused work was carried out during that year. For FY13, a new Social Inclusion DPL (U$45 million) and a new Social Inclusion Technical Assistance Loan ($10 million) were approved by the Board on December 13, 2012. New operations such as Higher Education (US$25 million) and Basic Education (US$25 million) are also being prepared.

In addition, the Bank has an extensive program of analytical and advisory activities for FY 12–14, including both economic and sector work and non-lending technical assistance. The economic and sector work covers areas such as public expenditure, fiscal incidence, infrastructure, gas development strategy, social sectors, climate change, and housing and municipal financing.

Finally, the Bank's TF portfolio (currently over US$29 million) has been also expanding significantly. The majority of TFs complements other WB support in the current core engagement areas of this CPS by providing valuable Analytical and Advisory Activities (AAA) and technical assistance. They support the harmonization and alignment of funding from various development partners behind core government programs.

B. Bank-Fund Collaboration in Specific Areas

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

Financial Sector. A joint FSAP was completed in May 2001. Follow up technical assistance to implement FSAP recommendations has been given by both institutions. Joint FSAP updates were completed in June 2005 and April 2011.

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

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

Peru: IBRD Portfolio Status

As of November 30, 2012

(In millions of US$)

Project Name	Approval	Lending Instrument	Net Commitment Amount	Total Undisbributed Balance	Total Disbursement	Disbursement in FY
Investment						
GEF National Protected Areas System	5/20/2010	SIL	8.9	3.6	5.3	0.6
Sierra Irrigation	7/27/2010	SIL	20	17	3	0.9
Water Resources Mgmt.	7/2/2009	SIL	10	7.3	2.7	0.5
Sierra Rural Development Project	4/24/2007	SIL	20	2.8	17.2	0.6
Rural Electrification	3/7/2006	SIL	10	6.2	3.8	0.3
Second Rural Electrification	4/21/2011	SIL	50	50	0	0
Regional Transport Decentralization	7/12/2005	SIL	50	20	30	3
Decentralized Rural Transport Project	12/19/2006	SIL	50	2.7	47.3	2.5
(APL2) Health Reform Program	2/17/2009	APL	15	10.4	4.6	0.5
Justice Services Improv. II	11/18/2010	TAL	20	13.8	6.2	1.4
National rural Water Supply	8/29/2002	SIL	80	26.1	53.9	5.7
Results Nutrition for Juntos SWAp	3/8/2011	SIL	25	25	0	0
Optimization of Lima Wat & Sewerage	4/7/2011	SIL	54.5	54.3	0.2	0
Adjustment						
2nd Results & Accnt.(REACT)DPL/DDO	4/9/2009	DPL	330	310	20	0
CAT DDO	12/9/2010	DPL	100	100	0	0
2nd Prg Fiscal Mgmt & Comp. DPL/DDO	8/5/2008	DPL	700	480	220	0
First Prog. Environ DPL/DDO	2/17/2009	DPL	330	310	20	0
Total			**1,873.40**	**1,439.10**	**434.3**	**16**

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

Peru: Committed and Disbursed Outstanding Investment Porfolio

As of October 31, 2012

(In millions of US$)

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

*Quasi equity includes both loan and equity types

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

A. Country Strategy

Peru's recently approved a new Country Strategy covering the period 2012–2016. The new strategy will focus IDB's assistance in helping the authorities on their efforts to close the economic and social gaps that exist between urban and rural areas, and support productivity gains as the main basis for inclusive, sustainable economic growth.

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

To implement the new Country Strategy, IDB will work with the government on a multi-sector approach of articulated interventions addressing various development gaps at the same time. Also, IDB will diversify the instruments it uses to support the country, potentially through service contracts in priority areas ("fee for services"), larger private sector operations, knowledge sharing and technical cooperation.

IDB's financial engagement scenario would entail positive but small net flows between 2012 and 2016, with a base scenario where the Bank maintains its share in Peru's multilateral debt. The lending framework for the strategy is consistent with the demand assumptions of the government's financing strategy.

B. Lending

As of November 30, 2012, the Bank's portfolio of active, public sector operations consisted of 24 loans for a total amount of US$738.80 million, of which US$226.91 million (31 percent) had been disbursed. The public sector lending program for 2012 has all been approved and comprised seven operations for a total of US$230 million. The public sector lending program for 2013 comprises three policy-based loans for US$80 million and seven investment loans for US$170 million.

Regarding private sector operations, the Structured Corporate Finance Department's (SCF) portfolio in execution consists of four operations amounting to US$205 million in infrastructure and financial services, the Inter-American Investment Corporation (IIC) portfolio comprises 12 operations for US$142.9 million, primarily in manufacture and financial services, and the Opportunities for the Majority (OMJ) department portfolio consists of two operations amounting US$18 million, in the agriculture sector and education. As of November, 2012 disbursement projections for SCF & OMJ total US$26.4 million.

Private sector lending for 2012 includes one SCF projects for US$5 million in financial markets (there is a Regional Project in the infrastructure sector that highly benefits Peru of US$100 million), two OMJ operations for US$18 million, in education and agriculture, nine MIF projects for US$6.4 million and five IIC operations for US$60.7 million, focused on financial services, retail and infrastructure.

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

As of November 30, 2012

(In millions of U.S. dollars)

Sector	Commitments	Disbursements	% Disbursed
Agriculture	25.0	19.0	76.0
Science, Technology and Competitiveness	95.0	26.5	27.9
Social Investment	46.0	11.0	23.9
Modernization of the State	81.8	18.4	22.5
Water and Sanitation	127.0	4.3	3.4
Transportation	334.0	147.7	44.2
Energy	30.0	0.0	0.0
Total	738.8	226.9	30.7

STATISTICAL ISSUES

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

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

National accounts. The authorities published a revised GDP series in 2000. The series used the 1994 benchmark estimates as the base year, and included input-output tables. However, due to limited availability of periodic source data, estimates after 1994 are largely based on extrapolation techniques. The lack of current detailed tables for supply and use hampers the reconciliation of discrepancies. As a result, changes in inventories are mainly determined as a residual. Although the quarterly accounts have benefited from some improvements in the timeliness of monthly production indices, coverage is still very limited. The National Statistics Office (INEI) is working on a new national account series implementing the 1993 SNA and using 2007 as the base year. Four national accounts statistics missions visited the country in November 2008, May 2009, September 2009, and September 2010. The missions were aimed at are assisting the authorities in compiling the complete set of national accounts by institutional sectors, and in developing the sequence of accounts of nonfinancial corporations. More technical assistance will be needed in the coming years.

Price statistics. At the present time, the official measure of inflation for Peru is the CPI for Metropolitan Lima, compiled and published by INEI. Starting in January 2010, the Metropolitan Lima CPI has been compiled using updated weights based on the 2008/09 Encuesta Nacional de Presupuestos Familiares (ENAPREF). Since January 2011, city level indices have been compiled and disseminated for the 24 departmental capitals and another large urban area using weights from the 2008/09 ENAPREF and a methodology matching that employed for the Metropolitan Lima CPI. A new law issued in 2009 requires the INEI to compile a new national level CPI that will serve as the official CPI for Peru in the future. An STA mission on the CPI was conducted in May 2–13, 2011 to evaluate the methodology of the new national CPI index. The new national level CPI, starting with the January 2012 index, was disseminated since February 2012 The WPI, statistical techniques used to compile the index generally follow international standards but the weights for the WPI are outdated, and were derived from the 1994 input-output table and other reports and publications of relevant ministries.

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

Government financial statistics. The Central Bank (BCRP) compiles government finance statistics (GFS) following the GFSM2001, for the general government and its subsectors. Data for all subsectors are reported on a cash basis and financial assets and liabilities are reported at face value. The authorities have not yet sent to the Fund information on the components of expenditures by function. The coverage of published national budget data is narrower than the fiscal statistics prepared for the combined public sector. The new budget aligned to GFSM 2001 was used for the 2009 budget processing. The authorities report data for publication in the Government Finance Statistics Yearbook (GFSY) using the GFSM 2001. No high frequency data is reported for publication in International Financial Statistics (IFS).

Monetary statistics. The BCRP compiles and publishes the analytical accounts of the central bank, depository corporations, and financial corporations broadly in line with the methodology recommended by the Monetary and Financial Statistics Manual. The main divergences are the exclusion of the deposits of other financial corporations, state and local governments, and public nonfinancial corporations from the definition of broad money; and valuation of some financial assets held to maturity at cost rather than at market prices or at the lower of cost or market price for investment securities. At the request of the authorities, a mission visited the country in January 2007 to assist with the migration to the new standardized report forms (SRFs) for reporting monetary data to the IMF. The mission finalized the SRF for the central bank, recommending improvements in the classification and sectorization of some accounts. A follow-up mission took place in September 2008. The mission completed the work on the SRF for the central bank and developed a bridge table linking the source data reported by banks to the BCRP to the report form 2SR (other depository corporations). The mission identified shortcomings in the management of the database that generate the accounts of the other depository corporations sector at the BCRP. Although the two technical assistant missions finalized the groundwork for the migration to the SRFs, the BCRP has not yet started reporting monetary data using the SRFs. No set date is foreseen for the migration to the SRFs.

Financial soundness indicators. Peru started reporting data and metadata for financial soundness indicators (FSIs) with a quarterly frequency in June 2011.

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

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

Peru: Table of Common Indicators Required for Surveillance

(As of December 31, 2012)

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of Publication[7]	Memo Items: Data quality – Methodological soundness[8]	Memo Items: Data quality accuracy and reliability[9]
Exchange Rates	12/28/12	12/28/12	D	M	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/26/12	12/28/12	D	M	W		
Reserve/Base Money	12/15/12	12/21/12	W	M	W	O, LO, LO, LO	O, O, O, O, O
Broad Money	12/15/12	12/21/12	W	M	W		
Central Bank Balance Sheet	12/15/12	12/21/12	W	M	W		
Consolidated Balance Sheet of the Banking System	11/30/12	12/28/12	W	M	W		
Interest Rates[2]	12/28/12	12/28/12	D	M	D		
Consumer Price Index	Nov 2012	12/07/12	M	M	M	O, LO, LO, LO	LO, LO, O, O,
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q32012	11/23/12	Q	Q	q	O, LO, O, O	O, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Q32012	11/23/12	Q	Q	q		
Stocks of Central Government Debt[5]	Q32012	11/23/12	Q	Q	q		
International Investment Position[6]	Q32012	11/23/12	Q	Q	Q		
External Current Account Balance	Q3 2012	11/23/12	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	Q3 2012	11/23/12	M	M	M		
GDP/GNP	Q3 2012	11/23/12	Q	Q	Q	LO, LO, LO, LO	LNO, LNO,
Gross External Debt	Q3 2012	11/23/12	Q	Q	Q		

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

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

[3] Revenue and expenditure data are available monthly; and the composition of financing are available quarterly. Financing comprises of foreign, domestic bank, and domestic nonbank financing.

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

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

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

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

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

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

TECHNICAL ASSISTANCE

Department	Purpose	Date
FAD	Medium-term budget framework, IFMIS, and treasury management	September–October 2012
	Improving cash management	August–September 2012
	Macro-fiscal framework and fiscal rules	August 2012
	Derivatives, concession contracts and budget information in financial statements	April 2012
	Distribution of natural resource revenue to sub-national governments	February 2012
	Defining a methodology for the structural fiscal balance	January–February 2012
	Fiscal regimes for copper mining: an international comparison	September 2011
	Fiscal consideration in establishing a sovereign wealth fund	March 2011
	Modernizing treasury management and improving public accounting	November–December 2010
	Public financial management	June 2005, March 2006, November 2006, May 2007–present
	Tax policy and administration, customs administration.	February, May, July and September 2012, October 2011, February 2011, February and June 2009, April, June and October 2008, February, June and August 2007, February, September, and November 2006, and May 2005
	Public investment and fiscal policy, including issues related to PPPs.	August 2004, September 2003, and September 2002
	Fiscal rules	November 1999
MCM	Capital market regulation	October–November 2012
	Developing repo market	April 2010
	Mortgage covered bonds	May and August 2009
	Supervision of capital markets.	September 2008
	Implementation of Basel II	March 2008
	Strengthening the capital markets	October 2007, July 2007, and April 2007
	Financial sector supervision	April 2006
	Consumer protection in the banking system	April 2005
	Central bank organization	March, 2005
	Inflation targeting	April, December 2002, February 2003, March and September 2004
	Foreign exchange operations	October 2002
	Accounting and organizational issues	August 2002
	Inflation targeting	May 2002
	Monetary operations and government securities market	March 2002

Department	Purpose	Date
LEG	Strengthening the AML/CFT supervisory framework in the securities sector	Ongoing since April 2012
	AML/CFT national strategies and coordination	Ongoing since January 2011.
	ML/FT risk assessment	August 2009–July 2011
	Strengthening the AML/CFT financial supervisory framework	June 2008–July 2010
STA	New national CPI, national account statistics, new base year for the national account series; and Government Finance Statistics 2001.	May 2011, September 2010, May and September 2009, March, September and November 2008, October 1999, and January 1998

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 13/18
FOR IMMEDIATE RELEASE
February 14, 2013

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

IMF Executive Board Concludes 2012 Article IV Consultation with Peru

On February 13, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Peru.[1]

Background

Strong economic performance and sound macroeconomic management continued in 2012. Economic growth is estimated at 6⅓ percent of gross domestic product (GDP) in 2012, and the economy is near its potential. Economic activity was driven by domestic demand, in particular investment, as the weak external environment is taking a toll on exports and widened the external current account deficit. Inflation declined to 2¾ percent (y-o-y) in December 2012, falling with the inflation target band (1–3 percent) as the adverse supply shocks unwound after being above the upper limit of the target band during the first ten months of 2012.

Monetary policy has been geared to deal with a surge in capital inflows. While the Banco Central de Reserva del Perú (BCRP) has kept the policy rate unchanged at 4¼ percent since May 2011, monetary conditions tightened in 2012 through the use of reserve requirements. The large capital inflow, of which about one-half is in the form of foreign direct investment (FDI), has led BCRP to a policy of foreign exchange intervention cum sterilization, to avoid a sharp appreciation of the currency in the context of a dollarized economy. Private credit growth has remained at around 16½ percent (y-o-y) for the first ten months of 2012, with significant growth

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

in the consumer and mortgage segments—both also reporting a pickup in U.S. dollar lending. The banking system continues to be sound, profitable and well-capitalized.

The fiscal stance was tighter than envisaged in the 2012 budget. The non-financial public sector overall surplus is estimated to have reached over 2 percent of GDP in 2012, (higher than the 1 percent surplus included in the 2012 budget), due to higher-than-forecasted revenues and the lower budget implementation despite efforts to accelerate public sector investment.

The near-term outlook remains favorable but risks to the economy lurk in both directions. Real GDP growth is projected at around potential (6−6½ percent) in 2013 supported by domestic demand and elevated commodity prices. Inflation in 2013 is expected to remain subdued and converging to the mid-point of the target band (1−3 percent). *On downside risks, the economy* is most vulnerable to a growth shock in China that permeates through lower commodity prices in the short term. The lack of a medium-term plan for U.S. fiscal consolidation could also hamper Peru's economy over the medium term. Upside risks to growth and inflation could result from ample global liquidity and capital inflows in the context of low growth in advanced economies. Over the medium term, the economic outlook hinges on bolstering resilience to shocks and fostering productivity growth.

Executive Board Assessment

Directors commended Peru's impressive macroeconomic performance, underpinned by strong fundamentals and sound policy management. Growth is strong, inflation and public debt are low, and progress has been made in reducing poverty and improving living standards. The near term outlook remains favorable despite the adverse external environment. However, risks to the outlook are related to terms of trade shocks on the downside, and to excess global liquidity and a surge in capital inflows on the upside. Directors emphasized the importance of continued implementation of flexible and coordinated policies as well as structural reforms to maintain macroeconomic stability and foster more inclusive long term growth.

Directors considered near term fiscal policy to be broadly adequate and took note that the 2013 budget targets a surplus. While the current fiscal framework has served Peru well in reducing debt and building public sector savings, Directors saw merit in strengthening the framework by establishing an appropriate anchor which aims at ensuring prudent management of non renewable resources and intergenerational equity, and enhancing the predictability of public spending. They looked forward to the recommendations of the commission appointed by the authorities. Directors welcomed the efforts to strengthen tax administration and compliance and agreed that these measures will create space for priority social programs.

Directors supported the neutral stance of monetary policy given low inflation and well anchored inflation expectations. However, they encouraged the authorities to remain vigilant and flexible to changing domestic and global conditions. Proactive use of reserve requirements, in coordination with other prudential measures, should help manage excess liquidity and strong credit dynamics. Directors welcomed the central bank's recent modifications to its intervention policy which is expected to increase exchange rate flexibility. Continued efforts in this regard would help provide a buffer against external shocks, reduce sterilization costs and assist the private sector to better internalize foreign exchange risks.

Directors agreed that stronger macro prudential measures would help limit the buildup of financial vulnerabilities in the context of large capital inflows, strong credit growth, and increases in asset prices. They noted that enhanced institutional coordination between the monetary, financial and fiscal authorities in managing systemic risks and designing macro prudential policy would facilitate a prompt policy response. Directors supported closer monitoring of corporate and household balance sheets to better assess macro financial risks.

Directors underscored the importance of structural reforms to foster a more sustainable and inclusive growth path. Priorities should focus on enhancing competitiveness, defining a nationwide strategy to remove infrastructure bottlenecks, improving the business climate, and developing local capital markets to further facilitate investment and better allocate savings. Stronger emphasis on improving education and healthcare will also be important.

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

Peru: Selected Economic Indicators

	2008	2009	2010	2011	Est. 2012	Projections 2013	2014
Social Indicators							
Life expectancy at birth (years)	73.2	73.5	73.8	74.0	...	...	...
Infant mortality (per thousand live births)	17.3	16.2	15.1	14.1	...	...	...
Adult literacy rate	89.6	89.6	89.6	...	...	...	...
Poverty rate (total) 1/	37.3	33.5	30.8	27.8	...	...	...
Unemployment rate	8.4	8.4	7.9	7.7	6.8	6.8	6.8
	(Annual percentage change; unless otherwise indicated)						
Production and prices							
Real GDP	9.8	0.9	8.8	6.9	6.3	6.3	6.3
Real domestic demand	12.3	-2.8	13.1	7.2	8.3	6.6	6.4
Consumer Prices (end of period)	6.7	0.2	2.1	4.7	2.8	2.0	2.0
Consumer Prices (period average)	5.8	2.9	1.5	3.4	3.7	2.3	2.0
External sector							
Exports	10.4	-13.1	31.9	30.1	-1.1	8.9	10.1
Imports	45.2	-26.1	37.1	28.3	11.9	8.0	9.0
Terms of trade (deterioration -)	-14.5	-3.1	18.2	5.5	-2.9	1.6	0.0
Real effective exchange rate (depreciation -) 2/	4.4	3.4	2.4	-1.0	...	...	...
Money and credit 3/ 4/							
Broad money	25.6	6.8	21.7	14.7	10.8	12.7	12.7
Net credit to the private sector	33.9	5.0	16.7	21.8	12.9	15.6	14.9
	(In percent of GDP; unless otherwise indicated)						
Public sector							
NFPS Revenue	27.0	24.0	25.1	26.2	26.3	26.2	26.1
NFPS Primary Expenditure	23.0	24.0	24.2	23.2	23.2	23.8	24.0
NFPS Primary Balance	4.0	0.0	0.9	3.0	3.1	2.5	2.2
NFPS Overall Balance	2.4	-1.3	-0.2	1.9	2.1	1.5	1.2
General Government Primary Balance	3.7	-0.9	0.8	2.9	3.0	2.6	2.4
General Government Overall Balance	2.2	-2.1	-0.3	1.8	2.0	1.7	1.6
External Sector							
External current account balance	-4.2	-0.5	-2.5	-1.9	-3.5	-3.5	-3.4
Gross reserves							
In millions of U.S. dollars	31,233	33,175	44,150	48,859	63,651	68,751	72,251
Percent of short-term external debt 5/	318.3	428.4	342.3	589.3	661.2	646.6	595.9
Percent of foreign currency deposits at banks	203.6	203.6	241.1	227.7	298.5	298.1	280.0
Debt							
Total external debt	28.3	29.2	27.5	25.6	25.6	26.2	25.3
NFPS Gross debt (including CRPAOs)	25.0	28.4	24.6	22.2	19.3	17.2	16.4
External 6/	15.2	16.2	12.9	11.2	9.5	8.7	7.9
Domestic	9.9	12.2	11.6	11.0	9.7	8.6	8.5
Savings and investment							
Gross domestic investment	26.9	20.7	25.3	26.2	26.8	26.6	26.6
Public sector 7/	4.3	5.2	5.9	5.2	5.7	5.8	6.0
Private sector	21.5	17.7	19.2	19.6	20.7	20.7	20.8
Inventory changes	1.0	-2.1	0.2	1.4	0.4	0.1	-0.2
National savings	22.7	20.2	22.8	24.3	23.3	23.2	23.3
Public sector 8/	6.8	4.6	5.9	7.1	7.8	7.3	7.2
Private sector	15.9	15.5	16.9	17.2	15.5	15.9	16.0
External current account deficit	4.2	0.5	2.5	1.9	3.5	3.5	3.4
Memorandum items							
Nominal GDP (S/. billions)	371.1	382.3	434.7	486.5	529.7	577.0	624.2
GDP per capita (in US$)	4,427	4,362	5,207	5,904	6,614	7,132	7,794

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

1/ 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.

Statement by Pablo Garcia-Silva, Executive Director for Peru and Oscar Hendrick, Advisor to Executive Director February 13, 2013

Key Points

- Peru continues to be a success story despite the external environment and enhanced risks to the world outlook. The Peruvian economy almost doubled in size over the period 2002-12, registering a sustained period of strong growth with the lowest inflation in Latin America. The poverty rate has dropped from near 50 percent of the population in 2005 to 27.8 percent in 2011, an impressive improvement in only a six-year period. This process has continued in 2012 and it is expected to be sustained in the following years. The Peruvian authorities are paying special attention to the implementation of their socially inclusive growth strategy.

- Peru's economic performance in 2012 continues to be outstanding, with a 6.3 percent real GDP growth, 2¾ percent inflation, low unemployment of 6.8 percent, a 2.0 percent fiscal surplus, and a net international reserve position equivalent to 34 percent of GDP. The financial system remains very liquid, profitable, and well regulated. The net public debt is one of the lowest among emerging markets and industrialized countries at only 5 percent of GDP.

- This favorable outcome reflects the strong economic fundamentals after two decades of continuity in the implementation of sound economic policies; key structural reforms, and a very proactive policy response by the Peruvian authorities to deal with the recent financial crisis.

- The economic outlook remains favorable in the short and medium term. The Peruvian economy is set for a steady growth of around 6–6½ percent in the medium term, with stable inflation at the mid-point of the inflation-targeting band of 1-3 percent. The main challenges are how to manage the strong flows of foreign direct investment and portfolio inflows, and how to improve public infrastructure, health, and education to provide a better quality of labor force to the growth momentum, while reinforcing the process of the improvement in the standard of living of the population.

- Nevertheless, many challenges and risks remain. Poverty is still relatively high, despite substantial progress achieved in recent years, and risks to global recovery remain a factor that could undermine external demand and induce higher volatility in commodity prices.

INTRODUCTION

1. ***Our Peruvian authorities would like to convey their appreciation to Mr. Santos and his team for a constructive and candid policy dialogue during the Article IV Consultation.*** The Staff Report and companion Selected Issues Paper provide an in-depth analysis of the strong performance by the Peruvian economy and the challenges ahead. Our authorities are in broad agreement with the staff's assessment and policy recommendations. We appreciate the focus on the consultation on the appropriate near-term policy mix, including dealing with additional global spillovers, and policies to reinforce high growth prospects over the medium term.

2. ***Peru continues to be a success story, but it is fair and important to recognize that many challenges remain ahead.*** As clearly shown in the first text-chart of the staff

report, during the last decade, Peru grew at an average annual rate of 6½ percent with the lowest inflation in the region, even below those countries with fully dollarized economies. The Peruvian economy almost doubled in size over the period 2002-12, while the gross public debt-to-GDP ratio fell to less than 20 percent of GDP. The country risk premium is at a historical low. Peru is the second best country in Latin America in the Doing Business ranking, and the strong fundamentals and excellent economic outlook makes Peru a magnet for portfolio and foreign direct investment. All these achievements have been possible thanks to more than two decades of continued implementation of sound economic policies—despite temporary setbacks—and a strong political commitment to modernize the country and improve the standard of living of the population.

3. ***Our authorities are mindful of the importance of maintaining a socially inclusive growth strategy.*** The poverty rate has dropped from nearly 50 percent of the population in 2005 to 27.8 percent in 2011, a very substantial improvement in only a six-year period. Unemployment maintains a declining trend and it was reduced to 6.8 percent by end-2012. These figures are not only "statistics" but, the "trickle down effect" can be observed in the dramatic increase in the size of the middle class, and its powerful positive impact on domestic demand across all economic sectors. Yet, there is still plenty of room for improvement, and our authorities remain committed to prudent financial policies to preserve the hard-earned macroeconomic stability and a further deepening of structural reforms to sustain growth and entrench poverty reduction.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

4. ***In 2012, Peru's economic performance was robust and converging to potential, while inflation remained within the target band, despite a weak external demand and the enhanced risks to the outlook for the Euro Area, China, and the United States.*** For the second consecutive year, economic growth was higher than originally envisaged by the staff and the authorities. Real GDP grew 6.3 percent in 2012, and according to the Central Bank of Peru's most recent Monetary Program, released in February 2013, the economic expansion will continue in the medium term at around 6 percent, in line with the staff's projections. Inflation declined to 2¾ percent (yoy) by end-2012, despite the adverse supply shocks in the first half of the year. Core inflation has remained within the inflation-target band (1-3 percent). Headline inflation in January 2013 was 0.12 percent. According to the latest Central Bank survey, inflation expectations remain well anchored, and market participants expect at least a real GDP growth of 6.0 percent for the period 2012-14. Peru has a very strong external position, net international reserves grew to US$67.7 billion by February 4, 2013, equivalent to 34 percent of 2012 GDP. As explained by the staff in Annex I, *Balance of Payments and Stability Analysis*; Peru's net international reserves are adequate by any metric, including the IMF's new reserve adequacy metric, and Peru's reserve adequacy is well above its regional peers. Our authorities feel comfortable with this policy, which has proven to be very effective in dealing with the capital outflows during the peak of the crisis in 2008-09, without the need to request emergency credit lines to multilateral organizations. This is also cited as a one of the sources of strength by rating agencies, investment banks, and corporations interested in doing business in Peru.

5. ***The fiscal position has remained strong in 2012 with a sizable surplus for a second consecutive year, after withdrawing the fiscal stimulus in 2008-09.*** The authorities are taking decisive actions to revamp the tax administration authority—SUNAT, including improving tax compliance and enforcement, and updating technological infrastructure. The Fund's technical assistance is playing a crucial role in helping SUNAT, as well as the efforts to enhance the macro-fiscal framework in the Ministry of Finance. In 2012, revenues were higher-than-forecast, and budget execution was lower in public investment. Thus, the non-financial public sector overall surplus is estimated to have reached over 2 percent of GDP, about twice as much as originally envisaged in the 2012 budget. To further enhance the fiscal buffers for future shocks, the 2013 budget approved by Congress last December aims at a fiscal surplus of 1.1 percent of GDP. It is worth underscoring that this outcome (which could be even higher according to the staff's assessment), already accommodates an increase of primary spending of about 10 percent in real terms, consistent with the authorities' goals for social inclusion and a gradual civil service reform. The accumulated public savings by end-2012 were equivalent to about 15 percent of GDP, which brought the net public debt ratio to around 5 percent of GDP.

6. ***The Central Bank's anti-inflationary stance has limited the pass-through from adverse supply shocks into domestic inflation.*** The monetary authority has been very successful in complying with the goals set within the inflation-targeting framework. Headline inflation ended in 2012 within the target band, and the policy rate has been stable at 4¼ percent since May 2011. The persistence of capital inflows to Peru, both FDI and portfolio flows, is posing new challenges to the monetary and fiscal authorities. The Central Bank has been using the whole range of instruments at its disposal, including the use of reserve requirements, and placement of Central Bank securities to sterilize large foreign exchange purchases. In the last few weeks, the authorities have continued fine tuning the implementation of macroeconomic policy to moderate potential risks stemming from robust capital inflows. While the Central Bank has tightened reserve requirements further, and allowed more investment abroad of the private pension funds, the Ministry of Finance has announced additional efforts to ameliorate appreciation pressures, including prepayment of external debt, larger accumulation of foreign currency to repay debt, and a significant increase in the Fiscal Stabilization Fund.

7. ***Looking forward, the authorities agree with the staff's assessment that, despite the adverse external environment, the outcome for the Peruvian economy remains favorable.*** The investment opportunities and interest in Peru grow by the day. Only the pipeline of new investment in mining and agriculture, which is already in different stages of implementation, ensure at least a sustained real GDP growth of 6-6 ½ percent in the medium term. The Peruvian authorities are cautiously optimistic that structural changes and robust private and public investment will increase the potential output to a higher level.

POLICY ISSUES AND OBJECTIVES GOING FORWARD

8. ***The Peruvian authorities are closely monitoring the risks associated with large capital inflows and rapid credit growth, and they stand ready to use the available***

toolkit, including macro prudential regulations. In particular, the Central Bank has made some recent modifications to its intervention policy to increase exchange rate flexibility in the short term to minimize speculative flows looking only for carry-trade benefits, to help enhance the shock-absorber role of the exchange rate, and encourage the private sector to internalize exchange rate risks. This new approach is leading to higher intra-and-inter-day foreign exchange flexibility, reducing incentives to one-way bets on exchange rate movement. The authorities agree with the staff that the real exchange rate is in line with fundamentals. Although credit dollarization has continued to decline, from 67 percent in 2005 to 43.1 percent in 2012, the economy is still highly dollarized, despite more than two decades of stable inflation and steady appreciation of the exchange rate. This is the main reason for the monetary authority to closely monitor abrupt variations in the exchange rate due to the possible negative impact on the balance sheet of corporate and financial institutions. The Central Bank expects a moderation of capital inflows in 2013 but, if this were not the case, there would still room to increase reserve requirements as a complementary measure to additional exchange rate flexibility to reduce the volume of short-term capital inflows.

9. ***The financial sector remains strong and resilient and macro prudential regulations have also been strengthened including liquidity requirements in line with Basel III criteria.*** It is relevant to remind the Executive Board that a second FSAP update was undertaken in 2011, together with the 2011 Article IV, both of which were considered on a lapse-of-time basis according to the new policy to skip one annual discussion on countries with sound macroeconomic fundamentals and without substantial changes to the economic outlook. This joint Fund-Bank mission ratified that the Peruvian financial system continues to be highly profitable, well capitalized, and resilient to severe shocks simulated in a variety of scenarios. Yet, the regulatory and supervisory authority has implemented new safeguards including higher provisioning and capital requirements for mortgages and long-term consumption lending, and measures to discourage foreign exchange lending in automobile and other consumer loans. The authorities are evaluating the staff's most recent recommendations to further strengthen the regulatory framework, including the advice to penalize foreign exchange lending at long-term maturities more heavily.

10. ***The sustained economic growth during more than two decades has brought a different challenge; how to maintain the momentum of economic growth and poverty reduction.*** Expanding the public infrastructure (roads, energy, irrigation projects, etc.) is an ongoing effort, with the help of the private sector in some key projects. But, expanding the availability of qualified workers may take more time. There is already a shortage of personnel for qualified positions at the professional and managerial level. The government is already taking action through the civil service reform, which will require better training for teachers in schools and universities to improve the quality of education at all levels. This is a long-term goal but, with a high priority. Our authorities believe that current policies will deliver a steady economic growth, stable and low inflation, a lower level of public and external debt, a stronger external position, a consolidated fiscal position, and sustained poverty reduction. This will take some additional time, but we need to remind ourselves that it has taken 22 years of continued implementation of sound economic policies to reach this point.