INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/133

PERU

May 2015

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PERU

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 2015 Article IV consultation with Peru, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 20, 2015 consideration of the staff report that concluded the Article IV consultation with Peru.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 20, 2015, following discussions that ended on March 25, 2015, 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 May 5, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Peru.

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

Selected Issues Paper

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No.15/240
FOR IMMEDIATE RELEASE
May 27, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Peru

On May 20, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Peru.[1]

Peru remains one of the best performing economies in Latin America, with solid macroeconomic policies and fundamentals and visible gains in poverty reduction. However, like most of the region, Peru faced a challenging external environment in 2014. Lower metal prices and weaker demand from trading partners were a major drag on private investment and exports. On the domestic front, an unexpected drop in subnational public investment level and temporary supply disruptions in mining, fishing, and agriculture compounded external shocks. Against this background, real GDP growth slowed to 2.4 percent in 2014, from 5.8 percent a year earlier. Headline inflation closed the year slightly above the upper band of the central bank's target range due to supply shocks, but expectations remained well anchored. The high external current account deficit declined slightly despite lower commodity prices and sluggish external demand.

A strong policy framework and solid fundamentals allowed the authorities to loosen the macroeconomic policy stance. The authorities embarked on a series of fiscal and structural packages, including tax cuts, increases in fiscal spending, and structural measures to support investment, consumption, and growth. Monetary conditions were also eased against a widening negative output gap and stable inflation expectations, helping to lower lending rates and providing support to credit to the private sector. New de-dollarization measures were launched at the end of 2014.

Real GDP is projected to expand at about 3.75 percent this year, contingent on the reversal of last year's supply shocks and policy stimulus. Growth is expected to rise in 2016−17, assuming new mines come on stream, large infrastructure projects are implemented, and terms of trade shocks fade, with the output gap closing by 2018. Inflation is projected to converge towards the mid-point of the target range by end-2015, and the current account deficit will narrow gradually over the medium term as mining exports gain ground.

[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.

Important risks loom on the horizon, but ample buffers place Peru in a comfortable position to respond to future shocks.

Executive Board Assessment[2]

Executive Director commended the authorities for the country's solid macroeconomic policies and fundamentals and visible gains in poverty reduction, which have made Peru one of the best performing economies in Latin America. While noting that risks to the outlook are tilted to the downside, Directors considered that Peru is in a comfortable position to respond to shocks, given the ample buffers in place. They concurred that if negative shocks materialize, exchange rate flexibility should be the main line of defense, and liquidity could be provided to avoid an undue contraction in credit, while acknowledging that Peru's dollarized economy increases the risks from exchange rate volatility. Looking ahead, Directors encouraged the authorities to continue to implement ambitious structural reforms to sustain inclusive growth and diversify the economy, including through further de-dollarization.

Directors agreed that the 2015 fiscal stimulus was timely, and concurred that the immediate priority is executing the existing package with a focus on boosting investment, rather than developing new measures. Directors welcomed the authorities' intention to gradually withdraw the stimulus from 2016. They encouraged the authorities to implement careful expenditure management and revenue mobilization to return to the original fiscal path by 2018. Directors emphasized that hikes in non-priority current spending should be avoided, given the need to finance structural reforms, carry through the civil service reform, increase allocations for physical and human capital investment, and protect social programs. They agreed that, over the medium term, targeting a small structural fiscal surplus would be advisable to preserve buffers. Continued strong political commitment remains essential to maintain the credibility of the new fiscal framework.

Directors supported the accommodative monetary policy stance that has kept inflation expectations well anchored. Looking ahead, they concurred that monetary policy should remain responsive to inflation expectations and external developments, while limited foreign exchange rate intervention could be necessary to smooth excessive volatility in a still highly dollarized economy.

Directors welcomed the new de-dollarization measures. They agreed that strengthening prudential requirements on dollar lending and encouraging the private sector to hedge its foreign currency exposure could further support the de-dollarization process, along with deepening financial and capital markets. Directors supported enhancing data collection and

[2] 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.

analysis of corporate and household balance sheets to better assess risks from currency mismatches.

Directors observed that the financial system remains stable, although the recent deterioration in the quality of the loan portfolio of non-bank financial institutions warrants close monitoring and supervision. A more effective use of existing programs to support small and medium-sized enterprises could help mitigate the impact of the growth slowdown.

Directors underscored the importance of steadfast implementation of structural reforms to boost potential growth and foster social inclusion. They welcomed the authorities' priority on streamlining legal requirements and red tape. Directors concurred on the need to pursue ambitious education reform and inclusion polices within the framework of fiscal discipline.

Peru: Selected Economic Indicators

					Prel.	Projections	
	2010	2011	2012	2013	2014	2015	2016
Social Indicators							
Life expectancy at birth (years)	73.9	74.2	74.5	...	...	...	...
Infant mortality (per thousand live births)	15.2	14.3	13.6	12.9	...	...	...
Adult literacy rate	89.6	...	93.8	...	...	...	...
Poverty rate (total)	30.8	27.8	25.8	23.9	22.7	...	...
Unemployment rate	7.9	7.7	6.8	5.9	5.9	...	...
	(Annual percentage change; unless otherwise indicated)						
Production and prices							
Real GDP	8.5	6.5	6.0	5.8	2.4	3.8	5.0
Real domestic demand	14.9	7.7	7.4	7.4	2.0	3.8	4.2
Consumer Prices (end of period)	2.1	4.7	2.6	2.9	3.2	2.2	2.0
Consumer Prices (period average)	1.5	3.4	3.7	2.8	3.2	2.5	2.0
External sector							
Exports	32.3	29.5	2.2	-9.6	-7.8	-9.9	7.9
Imports	37.1	28.9	10.7	2.7	-3.4	-5.6	5.7
Terms of trade (deterioration -)	21.0	7.3	-2.1	-5.7	-5.4	-4.5	-0.8
Real effective exchange rate (depreciation -)	2.1	-1.4	8.1	-0.2	-1.5	...	...
Money and credit 1/ 2/							
Broad money	21.7	15.1	12.1	14.8	8.4	13.6	13.5
Net credit to the private sector	16.7	21.6	13.3	18.4	13.5	13.6	13.5
	(In percent of GDP; unless otherwise indicated)						
Public sector							
NFPS Revenue	26.0	27.2	27.6	27.8	27.5	25.9	26.1
NFPS Primary Expenditure	25.0	23.9	24.3	25.8	26.6	26.8	26.7
NFPS Primary Balance	1.0	3.2	3.3	2.0	0.9	-0.9	-0.6
NFPS Overall Balance	-0.2	2.0	2.3	0.9	-0.2	-2.0	-1.7
External Sector							
External current account balance	-2.4	-1.9	-2.7	-4.2	-4.0	-4.5	-4.2
Gross reserves							
In millions of U.S. dollars	44,150	48,859	64,049	65,710	62,353	61,353	61,553
Percent of short-term external debt 3/	342	559	494	539	514	449	507
Percent of foreign currency deposits at banks	241	228	301	275	262	259	245
Debt							
Total external debt	27.2	25.6	27.2	27.4	30.2	32.5	31.6
NFPS Gross debt (including Repayment Certificates)	25.4	23.0	21.2	20.3	20.7	21.5	22.3
External	13.2	11.4	9.8	8.8	8.7	8.8	8.8
Domestic	12.2	11.6	11.4	11.5	12.0	12.7	13.5
Savings and investment							
Gross domestic investment	25.2	25.7	26.2	28.2	26.8	26.6	26.1
Public sector 4/	5.9	4.8	5.4	5.8	5.5	5.8	5.8
Private sector	19.2	19.2	20.4	20.8	20.3	19.9	19.7
National savings	22.8	23.9	23.5	24.0	22.8	22.1	21.9
Public sector 5/	6.3	7.4	8.0	7.1	5.6	4.0	4.4
Private sector	16.5	16.4	15.5	16.9	17.2	18.0	17.5
Memorandum items							
Nominal GDP (S/. billions)	419.7	469.9	508.3	546.9	576.1	608.9	647.3
GDP per capita (in US$)	5,027	5,685	6,324	6,540	6,458	5,962	6,242

Sources: National Authorities; UNDP Human Development Indicators; and IMF staff estimates/projections.
1/ Corresponds to depository corporations.
2/ Foreign currency stocks are valued at end-of-period exchange rates.
3/ Short-term debt is defined on a residual maturity basis, and includes amortization of medium- and long-term debt.
4/ Includes Repayment Certificates (CRPAOs).
5/ Excludes privatization receipts.

INTERNATIONAL MONETARY FUND

PERU

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

May 5, 2015

KEY ISSUES

Context: Peru remains one of the best performing economies in Latin America, with solid macroeconomic fundamentals, strong policy frameworks, and visible gains in poverty reduction. Like most of the region, Peru faced a challenging external environment in 2014. External shocks were compounded by domestic supply disruptions and a drop in subnational public investment, and growth decelerated sharply. Headline inflation was slightly above the upper band of the central bank's (BCRP) target range due to supply shocks, but expectations remained well anchored. The external current account deficit declined slightly despite weaker external conditions.

Outlook and risks: Growth is expected to recover in 2015 and over the medium term, contingent on production at new mines approaching capacity, priority infrastructure projects advancing, and shocks to terms of trade fading. However, downside risks dominate. Externally, these include a surge in global financial volatility, further dollar appreciation, or lower commodity prices and external demand. Domestic downside risks include weaker investment, uncertainties surrounding 2016 Presidential elections, and persistent social conflicts. A faster unwinding of supply shocks or a more complete pass-through of lower food and fuel global prices constitute upside risks.

Near-term policy mix: The policy mix is broadly adequate to support the recovery and maintain macroeconomic stability. The immediate priority is expediting the execution of public investment in line with government plans, while avoiding increases in non-priority current spending. Monetary policy should remain responsive to inflation expectations and external developments. Exchange rate flexibility should be the main line of defense against any additional external pressures. The timely use of macro-prudential tools and ongoing de-dollarization efforts should further solidify financial stability.

Medium-term prospects: With the end of the commodity boom, a push to deepen structural reforms will be necessary to sustain potential growth and diversify the economy. Revenue losses would need to be offset to finance structural reforms, investment, and inclusion along a gradual fiscal consolidation path. Streamlining legal requirements and red tape is rightly a government reform priority and the ambitious education reform and inclusion polices should stay their course within the framework of fiscal discipline. Persevering with labor market reform remains important.

Approved By
A. Cheasty and L. Cubeddu

Discussions took place in Lima during March 12–25, 2015. The team comprised: A. Corbacho (Head), F. Lipinsky, K. Ross, M. Tashu, and S. Vtyurina (all WHD). A. Santos (Senior Resident Representative) assisted the mission and Z. Leal provided research assistance at headquarters. Oscar Hendrick (Alternate Executive Director) participated in the discussions. A. Cheasty (Deputy Director, WHD) joined the concluding meetings with Economy and Finance Minister Segura and Central Bank President Velarde.

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CONTEXT

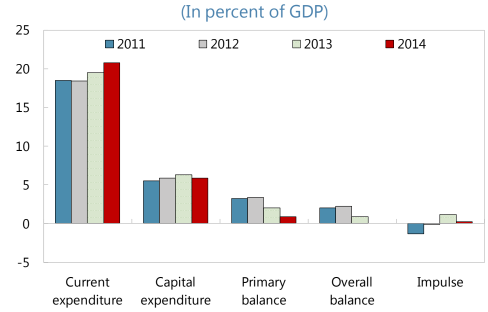
1. **Peru achieved impressive macroeconomic outcomes over the last decade.** During 2003–13, growth averaged 6.2 percent, among the highest in Latin America, and inflation was 2.9 percent, the lowest in the region. Over this period, gross public debt fell by more than half to 20 percent of GDP and net debt dropped to 5 percent of GDP. These exceptional outcomes were achieved through prudent macroeconomic management of the commodity boom, anchored by a strong policy framework and a far-reaching structural reform agenda. The economy recovered quickly from the 2008–09 global financial crisis. Accommodative macroeconomic policies played an instrumental role and were smoothly unwound as growth accelerated.

2. **Poverty reduction and inclusion strategies have had visible results.** Poverty in Peru has persistently declined throughout the last decade, from 59 percent in 2004 to 23 percent in 2014. Extreme poverty had an even more striking drop and income distribution improved. These results stand out in the region, where poverty reduction has stagnated more recently given weaker growth. The government has expanded the social safety net and embarked on multifaceted education and financial inclusion reforms to improve living standards and alleviate social tensions, with redistributive policies estimated to account for about half of poverty reduction since the mid-1990s (Appendix I).

3. **Like most of the region, Peru faced a challenging external environment in 2014 and growth slowed markedly.** A renewed slide in global metal prices and continued moderation in the growth of China (Peru's main trading partner) were a major drag on private investment and exports. External shocks were compounded by an unexpected drop in sub-national public investment due to implementation problems and temporary supply disruptions in fishing, mining, and agriculture. Against this background, growth decelerated to 2.4 percent in 2014, from 5.8 percent a year earlier. The current account deficit narrowed slightly to 4.0 percent of GDP, despite a further deterioration in the terms of trade, and international reserves fell as capital inflows were insufficient to cover the current account deficit. With weaker economic activity, labor market conditions softened towards the end of 2014.

4. **In mid-2014, the authorities announced a series of packages to stimulate the economy.** Measures included one-off bonuses, streamlined investment processes, and permanent cuts in income taxes (Box 1). Part of the package was executed in 2014, resulting in a fiscal deficit and a fiscal impulse of about ¼ percent of GDP. Strong tax collection and one-off revenue gains compensated for declining mining revenues.[1] Current expenditure continued to rise, partly

Peru: Fiscal Accounts
(In percent of GDP)



Sources: Ministry of Finance and Fund staff estimates.

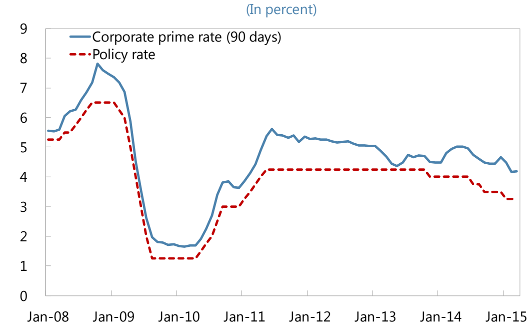
[1] A change in ownership of private commodity companies contributed ½ percent of GDP in capital gains tax revenue.

related to wage increases under the civil service reform,[2] while capital expenditure fell. Peru took advantage of favorable financing conditions and placed US$500 million in 36-year global bonds in 2014. Moody's raised Peru's rating to A3 (at par with Mexico), while S&P and Fitch rated Peru BBB+.

5. Monetary policy was eased against a widening negative output gap and stable inflation expectations. Headline inflation hovered above the 3 percent upper limit of the target band in 2014 and early 2015 due to high food prices and some pass-through from the depreciation of the nuevo sol. However, inflation excluding food and fuel and expectations remained within the band. Between November 2013 and January 2015, the BCRP lowered its policy rate by a cumulative 100 basis points to 3¼ percent. The BCRP also lowered reserve requirements on local currency deposits by a cumulative 23 percentage points to 7 percent between August 2013 and May 2015. These measures helped to support a robust, albeit slowing, growth of credit to the private sector of 9½ percent (yoy in FX-adjusted terms) in February 2015.[3] New de-dollarization measures were launched at the end of 2014 (Box 2).

Peru: Interest Rates

(In percent)

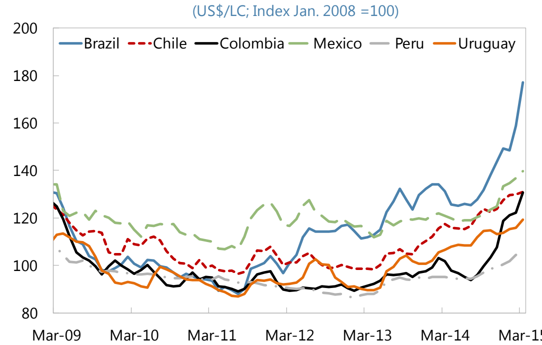


Source: Central Reserve Bank of Peru.

6. The exchange rate depreciated amid intervention. During 2014, the BCRP intervened in the spot and forward markets, which led to a fall in NIR of US$3½ billion to US$62½ billion (31 percent of GDP) at end-2014.[4] Intervention continued through the first quarter of 2015, with a further loss in NIR of US$1 billion.[5] Amid intervention, the nuevo sol depreciated by 6½ percent in 2014 (yoy in nominal terms) and by 3 percent in the first quarter of 2015 (less than the currencies of trading partners and competitors but more than the inflation differential with the U.S.). The real exchange rate is assessed to be broadly in line with fundamentals (Appendix II). The modest real exchange rate depreciation in 2014 corrected

Selected Latin American Countries: Exchange Rates

(US$/LC; Index Jan. 2008 =100)



Source: Bloomberg.

[2] One-off bonuses in the stimulus package accounted for ¼ percent of GDP in 2014.

[3] Credit growth remained relatively robust despite the slowdown in private investment, in part reflecting the substitution of external issuances with domestic bank credit.

[4] The interventions are sterilized via repo operations to safeguard local-currency liquidity in the financial system.

[5] FX intervention was larger than NIR losses partly because a sizable portion of the intervention was conducted through FX swaps and sales of dollar-indexed securities. In 2014, FX intervention amounted to US$4.2 billion in the spot market and US$14 billion in gross transactions in the forwards market.

the mild overvaluation observed at end-2013 (IMF Country Report 14/21), as the equilibrium real exchange rate remained relatively unchanged.

7. **The financial system remained stable.** The banking system remained profitable, liquid, well capitalized, and with strong operational efficiency. Deposit-to-loan ratios declined in recent years due to higher long-term financing from capital markets, but deposits continued to provide the lion's share of banks' funding. Also, direct exposure to the commodity sector appears limited. Nevertheless, the quality of loans to small- and medium-sized enterprises deteriorated. The balance sheets of small non-bank institutions, in particular *cajas rurales,*[6] also worsened as their portfolios concentrate on small firms. Credit dollarization fell to 36 percent in March 2015, from 70 percent a decade earlier, but continues to be a vulnerability of the financial sector.

Peru: Non-Performing Loans of Financial Institutions

(In percent)

	Dec-11	Dec-12	Dec-13	Dec-14
Banks	1.5	1.8	2.1	2.5
of which :				
Medium enterprises	2.1	2.5	3.7	4.7
Small enterprises	4.7	5.3	7.3	8.8
Cajas Municipales	4.9	5.2	5.8	5.8
Empresas Financieras	3.5	4.5	5.2	5.6
Cajas Rurales	4.3	5.3	6.7	12.6
Average	1.8	2.2	2.6	2.9

Source: Superintendency of Banks, Pensions, and Insurance.

8. **In previous Article IV consultations, staff and the authorities broadly agreed on policy issues.** Fund technical assistance and staff analyses were an input for the fiscal framework launched in the 2015 budget. The authorities are also implementing staff recommendations on public assets and liabilities management and on capital market reform, with the aim of creating a special offering regime for small-and medium-sized enterprises and reducing transaction costs in the stock market. Several FSAP recommendations have been taken on board. There is broad agreement on the structural reforms that are needed to boost potential growth. Finally, open communication remains a core component of the policy dialogue with the authorities, who continue to publish the concluding statement and the Staff Report and actively collaborate with staff on analytical projects. Staff and the authorities are preparing a joint book on Peru and several outreach seminars ahead of the 2015 IMF-World Bank Annual Meetings in Lima.

OUTLOOK AND RISKS

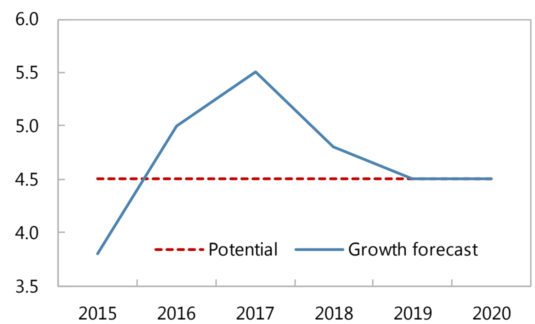
9. **Growth in 2015 is expected to recover supported by domestic conditions.** In staff's baseline scenario, real GDP is projected to expand at about 3¾ percent this year, on the assumption that temporary supply shocks unwind. The recovery also critically hinges on executing the public investment budget and the stimulus measures, with the 2015 fiscal deficit projected to rise to 2 percent of GDP. Inflation is expected to converge to the middle of the target band of 2 percent by end-2015 as domestic supply shocks dissipate. The 2015 external current account deficit is projected

[6] *Cajas rurales* constitute only 0.7 percent of assets of deposit taking institutions.

to remain elevated, given weak external conditions, but would be broadly financed by long-term capital flows.[7]

10. Staff estimates medium-term growth in line with potential. Staff expects growth to rise in 2016–17, assuming mines approach production capacity, planned public-private partnerships and "Public Works in Lieu of Taxes" projects are implemented,[8] and shocks to terms of trade fade, with the output gap closing by 2018. For the medium term, staff estimates that potential growth may have fallen to about 4½ percent (Box 3), given prospects of flat metal prices, moderating growth in China, and relatively weaker investment.[9] The current account deficit is projected to narrow gradually to 3 percent of GDP by 2020 as mining exports gain ground, with the external position assessed to be broadly consistent with medium-term fundamentals and desired policy settings (Appendix II). Fiscal deficits are projected to continue, reflecting the effect of the recent tax measures and the need to invest in infrastructure and structural reforms; public debt will rise slightly from still very low levels. Monetary aggregates are projected to continue growing faster than nominal GDP, consistent with past trends and Peru's relatively low level of financial deepening.

Peru: Medium-term and Potential Growth
(In percent)



Source: Fund staff estimates.

11. Downside risks to the outlook dominate, but Peru is in a strong position to respond to shocks.

- *Downside external risks* include: a further slowdown in the growth of China; even lower terms of trade; or a surge in global financial volatility. A surge in volatility triggered for instance by surprises about the liftoff in U.S. interest rates could lead to a reversal of capital flows and financial pressures on emerging markets, with knock on effects on commodity prices. A persistent strengthening of the U.S. dollar is also a risk for Peru given dollarization.

- *Downside domestic risks* include: weaker investment; uncertainty given the 2016 Presidential elections; continuing social tensions in mining regions;[10] and a stronger than expected impact from *El Niño* weather phenomenon. Moreover, a slower pace of structural reforms could further

[7] Profits of nonresident corporations account for a large part of the current account deficit, but are expected to be mainly re-invested in Peru.

[8] A private entity (usually a mining company) constructs a local public project in lieu of paying income taxes equivalent to the cost of the project determined by the national investment system.

[9] In staff's baseline, mining investment and FDI are projected to decline given lower commodity prices over the medium-term, partially compensated by the large infrastructure projects.

[10] Conflicts have nearly tripled from 76 in 2006 to 211 by March 2015 (see Appendix I).

encumber potential growth. At the same time, a faster pick-up in production in primary sectors entails *upside risks*. Further efforts to allow a more complete pass-through of lower global oil and food prices to domestic prices would also help support economic activity.[11]

- Outward spillover risks remain low.

12. The authorities concurred that the economy would return to a higher growth trajectory in 2015 and the medium term, but project a somewhat faster recovery than staff. The authorities were confident that supply disruptions in primary sectors would resolve in 2015 (contributing 1½ percentage points to growth), consumption would remain supportive, and investment—both private and public—would rebound from last year's dip. For 2015, the authorities project growth of around 4 percent. For the medium term, they estimate higher potential growth of 5 percent, primarily based on a more favorable investment outlook than staff's, especially linked to infrastructure projects. There was agreement that structural reforms were critical to boost competitiveness and productivity against less favorable external conditions over the medium term.

Peru: Staff's Macroeconomic Framework

	Prel.	Proj.					
	2014	2015	2016	2017	2018	2019	2020
Real GDP growth (in percent)	2.4	3.8	5.0	5.5	4.8	4.5	4.5
Output gap (in percent of potential GDP)	-1.0	-1.7	-1.2	-0.3	0.0	0.0	0.0
	(In percentage points)						
Contributions to growth							
Private consumption	2.5	2.5	2.9	3.3	2.9	2.7	2.8
Private investment, incl. invent.	-1.0	0.1	0.7	1.1	0.6	0.8	1.1
Exports	-0.1	0.7	1.7	2.0	1.8	1.3	1.0
	(Annual percentage change)						
Inflation (eop) 1/	3.2	2.2	2.0	2.0	2.0	2.0	2.0
Terms of trade (deterioration -)	-5.4	-4.5	-0.8	0.4	0.3	0.2	0.6
	(In percent of GDP)						
National savings	22.8	22.1	21.9	22.3	22.4	22.3	22.4
Gross domestic investment	26.8	26.6	26.1	26.0	25.5	25.3	25.3
External current account	-4.0	-4.5	-4.2	-3.7	-3.2	-3.1	-2.9
Fiscal balance 2/	-0.2	-2.0	-1.7	-1.4	-1.0	-1.0	-1.0
Structural balance 2/ 3/	0.2	-1.3	-1.1	-1.2	-0.9	-0.9	-1.0
Structural primary balance 2/ 3/	1.2	-0.2	0.0	0.0	0.3	0.2	0.0
Public debt 2/	20.7	21.5	22.3	22.2	21.7	21.3	22.0

Sources: National Authorities and Fund staff estimates.
1/ Inflation target 1-3 percent.
2/ Nonfinancial Public Sector (including Repayment Certificates).
3/ Staff's methodology.

[11] In March 2015, domestic food prices increased by 6.4 percent yoy, while international prices fell; and domestic fuel prices declined by 16.8 percent, while international prices declined by 45 percent. The pass-through has been limited given relatively weak local competition and price stabilization mechanisms. Nevertheless, Peru should benefit from lower global oil prices in the long run, given a net oil deficit of ½ percent of GDP.

Peru: Risk Assessment Matrix 1/

	Likelihood	*Impact*	*Policy Advice 2/*
		Country-specific risks	
Protracted period of weak domestic demand and confidence	H	(H ↓) Lags in policy implementation and slow structural reforms coupled with the upcoming 2016 election uncertainties and a prolongation of social conflicts could affect investment, consumption, and credit.	Implement the stimulus packages and persevere with structural reforms, especially those aimed a increasing investment. Keep up efforts to advance social inclusior
Faster than expected increase in mining and primary sectors' production	L	H (↑) Ongoing efforts to streamline regulation in mining, together with improvements in technology, could substantially increase production faster than expected.	
		External risks	
A surge in global financial volatility	H	H (↓) Peru 's risk premiums would increase, there could be pressures on the nuevo sol and capital outflows. Yields could increase in domestic bond markets together with potential crowding out by corporates of domestic private credit. FDI flows could slow down, which would affect growth outlook as FDI was key to financing large current account deficits and fostering growth.	Exchange rate flexibility and use c liquidity buffers. Persevere with measures to further reduce financ dollarization while smoothing the effects on the balance sheets. Eas reserve requirements to avoid a credit squeeze. Unwind macro prudential measures.
Protracted period of slower growth in advanced and emerging economies /Growth slowdown and financial risks in China	H/M	M/ H (↓) Continuing slowdown in global demand would lead to a worsening current account deficit and weaker growth, especially through lower exports, both in price and volume.	Exchange rate flexibility and use c liquidity buffers. Ease monetary a prudential policies. Accelerate structural reforms.
Persistent dollar strength	M	M (↓) Balance sheet strains will increase for dollar debtors.	Exchange rate flexibility, while intervening to smooth excessive volatility.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materializ the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is mean indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authori Non-mutually exclusive risks may interact and materialize jointly.

2/ Recommended by staff.

POLICY DISCUSSIONS

A. Securing the Recovery

13. **Within the constraints of a still weak external environment, staff assessed the policy mix as broadly adequate to support the recovery and maintain macroeconomic stability.** Tax cuts, higher public spending, and accommodative monetary conditions should provide needed stimulus to activity. Under the baseline scenario, growth is expected to improve in 2015, but the negative output gap will close only gradually by 2018. The immediate priority is timely implementation of the stimulus package (rather than additional fiscal measures), with a focus on public investment. If negative shocks materialize, exchange rate flexibility should be the main line of defense, liquidity could be provided to avoid an undue contraction in credit, and monetary conditions could be eased if downside risks to inflation projections become evident.

14. **In April, the authorities revised the 2015 fiscal deficit target as permitted by the escape clauses to incorporate the stimulus package.** They raised the overall fiscal deficit target to 2 percent of GDP, consistent with stimulus of 1½ percent of GDP and financed mainly through domestic sources. The revised target exceeds the original indicative structural deficit target of 1 percent of GDP under the fiscal rule given lower taxes. It also incorporates an ambitious yet more realistic public investment envelope and a re-prioritization of spending on operation and maintenance. The authorities also outlined the exceptional economic circumstances for deviating from the fiscal rule and a gradual consolidation plan starting in 2016. They underscored that fiscal consolidation should commence in 2016 as growth gained speed, but noted that the incoming administration would need to determine the fiscal path for 2017 and beyond as required by the new fiscal framework. They also indicated that the Fiscal Council will be established in 2015.

15. **Staff agreed that the sharp slowdown in growth warranted a fiscal stimulus that should be gradually withdrawn from 2016 onwards.** Staff concurred that the adoption of the revised target along with the adjustment path was an important signal of commitment to fiscal sustainability and would help maintain the credibility of the fiscal framework. Staff also noted that the early formulation of high quality measures could further enhance the credibility of the fiscal adjustment path. For the medium term, staff reiterated its previous recommendation to target a small structural fiscal surplus of around ½ percent of GDP to preserve buffers in the face of commodity shocks, contingent liabilities, and natural disaster risks (Appendix III).

16. **The authorities remain committed to stepping up public investment execution, given its higher effectiveness in stimulating growth in the short and the long run.** They initiated several actions to strengthen investment execution capacity and to capitalize on private sector expertise through joint infrastructure projects. Staff recommended embedding public-private partnerships in the medium- and long-term budget planning and debt sustainability analysis to ensure that commitments remain manageable and contingent liabilities and risks are transparently reported. On the "Public Works in Lieu of Taxes" projects, staff recognized that they could offer a pragmatic solution in current circumstances to deliver on infrastructure needs at the sub-national

level, but advised that they be monitored closely adhering to high transparency standards. The authorities agreed that hikes in non-priority current spending should be avoided and explained that the new fiscal path had taken into consideration the need to close a wide infrastructure gap and persevere with structural reforms to increase long-term growth.

17. The authorities recognized that the recent erosion of tax revenues would need to be offset over the medium term to support investment and inclusion along a consolidation path. They noted that the cut in corporate income taxes had aligned rates in Peru with the rest of the region and would support private investment and growth. However, staff emphasized the tax cuts had amplified the existing tax collection gap, both with respect to peers and to the tax effort expected for Peru's level of development, at a time when commodity fiscal revenues were declining. The authorities agreed that compensatory measures should unwind the revenue losses and aim to enhance the equity and efficiency of the tax system by widening the tax base, streamlining exemptions, promoting formalization, boosting the collection of local property taxes, and reviewing excise taxes to address negative externalities. Staff welcomed the important efforts made by the revenue administration to transition towards a client-based institution and support revenue goals.

18. There was broad agreement that monetary policy should remain responsive to inflation expectations and external developments. Staff acknowledged that monetary policy continued to respond effectively to changing conditions, while expectations remained well anchored. Staff highlighted that a widening negative output gap and a more complete pass-through of low commodity prices could create some space for monetary policy. At the same time, the room for further easing could be constrained by pressure in the FX market in the context of the anticipated U.S. monetary policy normalization. The BCRP noted that under the baseline scenario the rise in U.S. interest rates would proceed gradually, with near-term constraints to monetary policy in Peru likely to be limited. Liquidity buffers and reserves would allow the authorities to manage a potential surge in global financial volatility.

19. Staff emphasized that exchange rate flexibility should be the main line of defense against downside external risks.[12] Exchange rate flexibility would help cushion any additional pressures from further declines in commodity prices and the expected normalization of U.S. monetary policy. It would also support the authorities' de-dollarization agenda by creating incentives for deepening markets for FX derivatives as the private sector appropriately internalizes the costs of un-hedged FX exposures. Staff also advised the authorities to consider the case for regulations on foreign currency exposure of pension funds, as these are large market players.

20. The authorities reiterated their commitment to exchange rate flexibility, but underscored the need to contain excessive volatility in a still dollarized economy. They stressed that financial dollarization posed risks to balance sheets; FX intervention aimed to contain these risks without targeting any level or path for the exchange rate. The authorities also noted that

[12] Peru does not maintain exchange restrictions or multiple currency practices subject to Fund jurisdiction (under Article VIII, Section 2 (a) or 3) and has an open capital account.

the costs of FX intervention through FX swaps had been negligible, in particular compared to the gains from valuation changes in NIR due to the depreciation of the nuevo sol.

B. Solidifying Financial Stability

21. The authorities concurred that the financial system remained stable, with no evidence of imminent systemic risks (Appendix IV). They noted that financial institutions with worsening balance sheets such as *cajas rurales* were a small share of the financial system and held sufficient loss-absorbing capital of 14¾ percent at end-2014. Moreover, the authorities' stress tests showed that the financial system would remain resilient to tail risks of weak economic activity and large exchange rate depreciation. The authorities also underlined that the legal framework for bank resolution was in line with best practices and that they continue to strengthen supervisory and regulatory standards in line with FSAP recommendations and Basel III principles.

22. Staff welcomed the new de-dollarization measures. Given heightened market volatility and weak economic activity, staff cautioned that financial market developments would need to be followed closely and the de-dollarization measures implemented flexibly to ensure a smooth flow of credit and avoid liquidity-maturity mismatches. Staff also discussed other de-dollarization options, such as a strengthening of prudential requirements on dollar lending to un-hedged borrowers by the bank supervisor, which could be effective in addressing FX risk without undue pressure on dollar deposits and covered dollar loans.[13] In this regard, improving data collection and analysis of private sector balance sheets would allow a better assessment of systemic risks from currency mismatches and inform any need for additional targeted macro-prudential tools.

23. Staff also emphasized that deepening financial and capital markets would help de-dollarization efforts. Despite recent progress, Peru's capital market remains underdeveloped by regional standards. For instance, the average turnover ratio for secondary bond markets was ½ percent in 2014, compared to 56 percent in Chile, and the share of transactions in FX derivatives in the FX market was very low compared to the average for emerging economies (Box 2). Recent IMF technical assistance suggested that developing a deeper and more liquid money market, easing restrictions on the use of derivatives by pension funds, and building the capacity of supervisory staff would help address remaining structural and regulatory constraints.

24. The authorities broadly agreed with staff's views on the de-dollarization measures. They did not see a material risk of capital outflows due to higher reserve requirements on dollar deposits. They noted that the largest dollar depositors were pension funds, which were subject to a binding prudential limit on investment abroad. Commercial banks agreed with the authorities' view that the risk of capital outflows due to the new measures was limited and welcomed the coordinating role of the BCRP in moving towards lower credit dollarization. The authorities

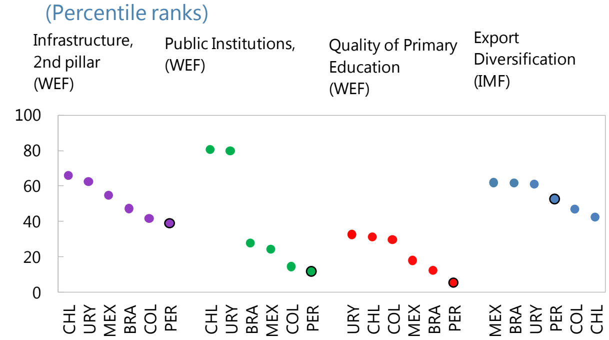
[13] Although credit dollarization amounts to 36 percent, estimates by the Superintendence of Banks, Insurance, and Pension Funds (SBS) show that only 13 percent of total credit (5 percent of GDP) is exposed to FX credit risk.

concurred on the need to deepen financial and capital markets and noted ongoing efforts in line with IMF technical assistance.

C. Unlocking Growth Potential

25. Past structural reforms set the stage for the investment and growth boom of the last decade. Deep seated reforms in the pre-commodity boom period allowed the country to take advantage of the favorable external environment and improve productivity. However, reform implementation slowed more recently, resulting in some stagnation or weakening in international competitiveness rankings. For example, Peru fell from 61st to 65th place in the Global Competitiveness Ranking, given still weak human capital, labor market rigidities, and relatively low institutional capacity. Doing Business indicators have ticked up slightly, though methodological changes make comparisons over time difficult.

Structural Performance Indicators 1/
(Percentile ranks)



Sources: World Economic Forum (WEF); and Export Diversification Database, IMF, 2010.
1/ The scale reflects the percentile distribution across all countries in the respective survey; higher scores reflect higher performance.

26. With the end of the super commodity cycle, structural reforms are needed to boost growth potential and advance social inclusion. One overriding challenge is high informality, which limits firm size, human capital development, innovation, and financial deepening—all of which constrain productivity. Labor market rigidities, as reflected in legally-mandated high non-salary compensation compared to the region, are one example of barriers to formality that negatively impact competitiveness. Another important impediment, evident through the growth slowdown of last year, is bureaucratic red tape, or *tramitologia*, which increases costs and hampers investment.

Selected Latin American Countries: Non-Salary Labor Costs
(In percent of salaries)

	Chile	Mexico	Colombia	Peru
Contributions and taxes	25.2	31.5	36.8	27.0
Vacations	4.2	1.7	4.2	8.3
Bonus/extra payments	0.0	0.0	4.2	16.7
Firing costs	2.3	3.2	8.3	7.0
Total non-salary labor costs	**31.7**	**36.4**	**53.5**	**59.0**
Memorandum item:				
Minimum salary/GDP per capita	0.30	0.15	0.41	0.46

Sources: World Bank DB 2014 and International Labor Organization.

27. The authorities' broad-based structural reform agenda tackles important challenges. Staff noted that the ambitious education reform and inclusion polices were already showing noteworthy results and should stay their course within the framework of fiscal discipline. Ongoing efforts to reform the civil service, streamline permit procedures, strengthen public enterprise governance, simplify public investment processes, enhance innovation, and diversify exports were also steps in the right direction. Finally, the OECD Country Program with Peru could provide a useful new platform for designing reforms and strengthening policies.[14] Staff also emphasized the importance of persevering with labor market reform, focusing on reducing non-wage costs and streamlining work rules. Strong across-the-board political commitment remained essential for fostering reform efforts in the short and medium term.

STAFF APPRAISAL

28. Peru remains one of the best performing economies in Latin America, with solid macroeconomic policies and visible gains in poverty reduction. Challenging external conditions, coupled with domestic supply shocks, were an important drag on economic activity in 2014. In the face of a widening negative output gap, loosening the macroeconomic policy stance was appropriate. Growth is expected to recover in 2015 and over the medium-term, contingent on production at new mines approaching capacity, priority infrastructure projects proceeding according to plan, and external shocks fading.

29. Important risks loom on the horizon, but strong policy frameworks and fundamentals place Peru in a comfortable position to respond to future shocks. The external environment is expected to continue to pose downside risks, from further slowdown in China, lower terms of trade, or a surge in global financial volatility. Weak investment confidence and uncertainty given upcoming elections may also entail downside domestic risks. On the other hand, a faster unwinding of last year's supply shocks or a more complete pass-through of lower global prices are upside risks. If negative shocks materialize, exchange rate flexibility should be the main line of defense, liquidity could be provided to avoid an undue contraction in credit, and monetary conditions could be eased if downside risks to inflation projections become evident. While fiscal buffers are ample, the immediate priority is to follow through with the approved investment envelope rather than consider additional fiscal measures.

30. The 2015 fiscal stimulus was timely but should be gradually withdrawn. Careful expenditure management and revenue mobilization will be essential to return to the original fiscal path by 2018, while attending to social and infrastructure needs. Hikes in non-priority current spending should be avoided, given the need to finance structural reforms, carry through the civil service reform, increase allocations for physical and human capital investment, and protect social programs. Over the medium term, it would be advisable to target a small structural fiscal surplus of ½ percent of GDP to preserve buffers in light of commodity shocks, natural disaster risks, and contingent liabilities. Continued strong political commitment to the new fiscal framework is essential to maintain its credibility.

31. Monetary policy has been adequately accommodative. Inflation excluding food and fuel has stayed within the band and expectations remain well anchored. Looking ahead, monetary policy should continue to respond to changes in inflation expectations and external developments.

[14] Program discussions will take place over the next two years, reviewing best practices in 18 key public policy areas.

Exchange rate flexibility will be key to cushion any additional external pressures, while limited foreign exchange intervention may be necessary to smooth excessive volatility that could lead to disorderly market conditions and undermine macro-financial stability.

32. The new de-dollarization measures will help address a key structural vulnerability of the financial system. However, financial market developments will need to be monitored closely and the de-dollarization measures implemented flexibly to ensure a smooth flow of credit. Strengthening prudential requirements on dollar lending to un-hedged borrowers and improving data and analysis of private sector balance sheets could prove helpful in this process. Exchange rate flexibility would support de-dollarization by appropriately encouraging the private sector to hedge its foreign currency exposures. Deepening financial and capital markets should also be an important component of the de-dollarization agenda.

33. Despite weaker economic conditions, the financial system remains stable. The recent deterioration in the quality of the loan portfolio of non-bank financial institutions warrants close monitoring and supervision. While these institutions are small and non-systemic, they serve a large number of relatively vulnerable clients. More effective use of existing programs to support small and medium-size enterprises could help mitigate the impact of the growth slowdown and the softening of labor market conditions. Balance sheet information for medium and small firms and households should be collected to better assess risks from currency mismatches.

34. Structural reforms are critical to boost growth potential and advance social inclusion. The continued slide in metal prices, the moderation of growth in China, and the decline in investment suggest that potential growth may have fallen from the heights of the last decade. Boosting potential growth requires steadfast implementation of structural reforms to enhance productivity, investment, human capital, and formal employment. Streamlining legal requirements and red tape is rightly a reform priority of the government and the ambitious education reform and inclusion polices should stay their course within the framework of fiscal discipline. Persevering with labor market reform remains a challenge.

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

Box 1. Peru: Fiscal and Structural Measures to Stimulate Growth and Investment[1]

In mid-2014, the authorities announced a series of stimulus packages with a total net cost of about 2 percent of GDP. About a ¼ percent of GDP was spent in 2014,[2] with the rest of the measures planned for 2015. Some structural measures are awaiting approval by congress.

On the revenue side, the authorities estimate the tax cuts would result in a revenue loss of about 0.7 percent of GDP in 2015. The personal income tax rate was cut for the lowest income segment from 15 to 8 percent. The corporate tax rate will decline gradually from 30 to 26 percent over the next four years, while the dividend tax will increase for payments to non-residents. A gradual elimination of VAT withholding schemes, which were deemed to negatively affect the liquidity of small firms, and a gradual reduction of the drawback mechanism seen as an export subsidy, were also adopted. Changes were also introduced to the temporary tax on net assets and to the General Sales Tax, along with other amendments to the Tax Code.[3]

Peru: Fiscal Measures

(In percent of GDP)

A. Taxes (2015)	**0.7**
B. Net expenditure (2014)	**0.3**
Bonuses and salary increases	0.3
C. Expenditure (2015)	**0.9**
Current expenditure	0.1
Capital expenditure	0.4
Repayment of debt in arrears	0.3
Social assistance	0.1
Total (A+B+C)	**1.9**

Sources: National authorities and Fund staff estimates.

On the regulatory side, speeding up investment is mostly targeted at streamlining requirements for both public and private investment. For example: (i) the maximum time for registrations, amendments and registration renewals required for large-scale investment projects will be reduced by 25 percent; (ii) changes in the approval of archeological certificates is expected to reduce discretion and add predictability to investments; (iii) a tax benefit and the accelerated depreciation benefit for hydroelectricity generation will be extended until 2025, targeting investment of US$3 billion; (iv) an increase in the depreciation rate from 5 to 20 percent was introduced to spur housing construction; and (v) the percentage of mining revenues that may be used for infrastructure maintenance was increased from 20 to 40 percent.

Other measures include:

- Expedited land expropriation for infrastructure projects.
- Greater funding and subsidies to encourage productivity in the small business sector.
- More direct contracting between public sector and suppliers and between the Peruvian and foreign states in all sectors.
- Standardized requirements for public procurement and prevention of price collusion.

Fiscal multipliers of expenditure and revenue measures on growth depend on various factors, including the economic cycle and structural characteristics. According to BCRP (Inflation Report, 2012), tax cuts have small multipliers in Peru due to changes in the propensity to consume. The largest bang for the nuevo sol during downturns comes from increasing capital spending, with a multiplier of ½–1½ in the short and medium terms, while current spending has a multiplier of ¼–1. IMF Working Paper 14/93 calculates a short-term multiplier of about ½ for middle income emerging economies like Peru. For 2015, staff estimates the contribution of the fiscal measures to GDP growth at about ½ percentage point.

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[1] Prepared by S. Vtyurina.

[2] In net terms.

[3] A staff Selected Issues paper discusses Peru's tax system and recent reforms.

Box 2. Peru: Measures to Foster De-Dollarization[1]

Instability and hyperinflation during the 1970–80s resulted in financial dollarization of about 80 percent of credits and deposits by the end of the 1990s. The process of de-dollarization began in the early 2000s and is still ongoing at a steady pace, following policy initiatives that included:

- An inflation targeting framework, which anchored inflation to the level of advanced economies.
- Prudential measures, including differential reserve requirements on local currency versus foreign currency deposits and additional provisioning, liquidity, and capital requirements for FX loans. Based on the Fund's institutional view on the liberalization and management of capital flows, the marginal reserve requirement on local currency short-term deposits of some non-resident financial entities is assessed as a capital flow management measure. In December 2014, the reserve requirement ratios were equalized across all types of local currency deposits.
- Development of capital markets in local currency and the de-dollarization of public debt.

Despite significant progress, 38 percent of credit and 43 percent of deposits were still denominated in U.S. dollars at end-2014. Similarly, about 40 percent of transactions (estimated by payments and withdrawals from the banking system) were conducted in U.S. dollars. Financial and transactional dollarization is particularly high in the corporate sector. About 60 percent of credits to the corporate sector were denominated in U.S. dollars at end-2014 and a 2013 Survey by the BCRP shows that about 58 percent of the value of transactions in inputs/supplies among firms was denominated in U.S. dollars.

In December 2014, the BCRP introduced a new set of measures aimed at the de-dollarization of credit:

- New Repos in nuevo soles to support the growth of credit in local currency and to encourage the substitution of foreign currency loans with local currency loans. In the first case (expansion), financial institutions can conduct Repos in local currency with the BCRP up to the equivalent of 10 percent of their required foreign currency reserves, using these reserves as collateral, to expand new credits in local currency (Figure a). In the second case (substitution), financial institutions can access liquidity in local currency from the BCRP if they want to convert their foreign currency loans (assets) into local currency loans (Figure b).

Figure a. Repo to support expansion of credit in nuevo soles

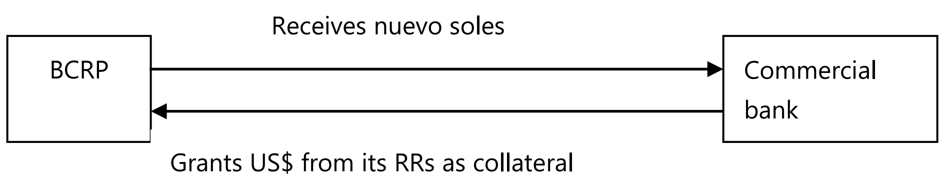
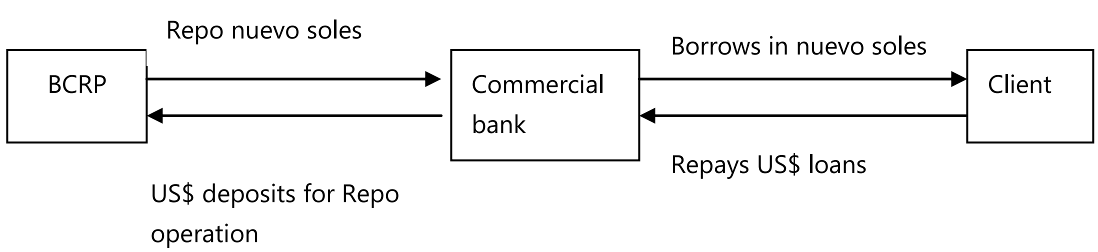


Figure b. Repo to substitute foreign currency loans with local currency loans



1/ Prepared by M. Tashu.

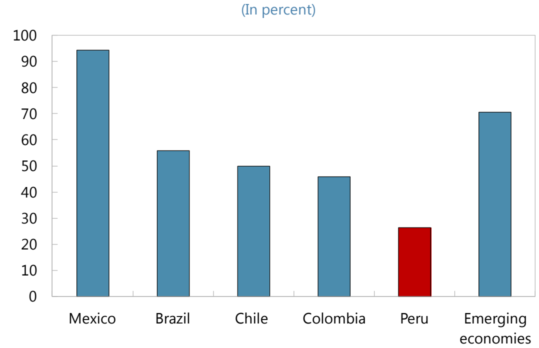
Box 2. Peru: Measures to Foster De-Dollarization (concluded)

- Higher reserve requirements on foreign currency deposits. The marginal reserve requirement on foreign currency deposits was increased by 10 percentage points effective in January and by another 10 percentage points effective in March, 2015 to 70 percent. In addition, reserve requirements on foreign currency deposits will be increased for financial institutions that do not meet certain de-dollarization targets for credits excluding foreign trade and long-term investment financing. Specifically, financial institutions that do not reduce the balance of their foreign-currency loans by 5 percent (by June 2015) or by 10 percent (by December 2015), compared to the balance in September 2013, will face additional reserve requirements on foreign currency deposits. Additional reserve requirements will apply on dollar deposits if mortgage and vehicle credits in foreign currency do not fall by more than 10 percent by June and 15 percent by December 2015, compared to levels in February 2013.

While these measures could reduce dollarization incrementally, experience shows that deepening financial and capital markets is an effective way to achieve lasting de-dollarization. For instance, Israel's and Poland's success in de-dollarization is associated with an active policy of de-dollarizing public debt, deepening the local-currency bond market, and promoting the development of markets for FX derivatives along with increased FX flexibility. Deep and liquid bond markets in local currency provide alternative investment vehicles to dollar deposits. Also, advanced financial markets with opportunities for hedging instruments and indexed local bonds can reduce the need for foreign currency to hedge against FX risks.

In Peru, efforts to develop the local capital market have helped to increase the share of local currency debt to total public debt, from 10 percent in 2004 to over 50 percent in 2013, and extend the average duration of local currency debt, from 4 years to 8 years. However, important weaknesses remain. The secondary market for bonds remains thin and illiquid, with an average turnover ratio of about 0.4 percent in 2014, compared to about 56 percent in Chile. Also, FX trading in Peru is dominated by spot transactions; the share of transactions in FX derivatives is the lowest among regional peers and very low compared to the average for emerging economies. Recent initiatives, including new regulations on repo markets, improving the safety of the securities clearing and settlement systems, and creating a reference rate (interbank overnight rate) based on effective transactions are welcome steps.

Share of FX Derivatives to Total FX Trade, April 2013
(In percent)

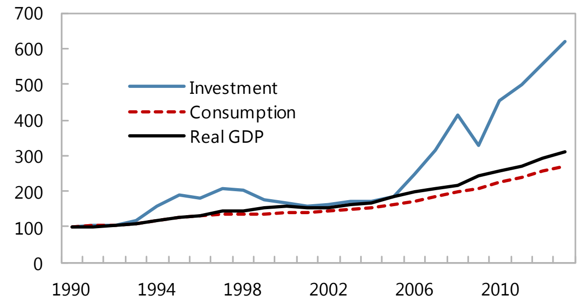


Sources: Bank for International Settlements; and Fund staff calculations.

Box 3. Peru: Reassessing Potential Growth After the Investment Boom[1]

Peru's productive capacity increased over the last decade. A series of structural reforms and the implementation of solid macroeconomic and investment frameworks allowed the country to take advantage of a sizable and prolonged improvement in its terms of trade and historically low global interest rates. The result was a surge in investment and FDI flows, and a significant improvement in productivity. During 2003–13 growth averaged 6.2 percent—with investment contributing around half of the total.[2] Not surprisingly, these events also led to an increase in Peru's estimated potential growth rate, from around 4 percent in 2003 to about 6 percent in 2013. From a simple growth accounting exercise, approximately half of the expanded capacity stemmed from an increase in the contribution from total factor productivity (TFP), with the remaining evenly split between capital and labor additions.

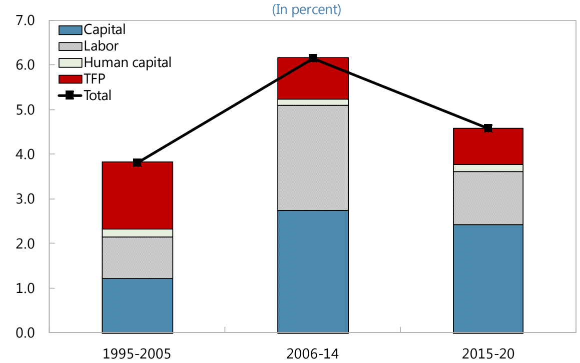
Peru: Investment, Consumption, and Real GDP
(1990=100)



Source: National Authorities.

Changes in the external environment, however, call for a reassessment of potential growth. The two apparent secular factors that provided a strong tailwind to growth—positive terms of trade changes and low U.S. interest rates—have started to reverse, and investment growth has softened. To assess how potential growth will be impacted, staff projected factors of production and estimated a TFP regression model based on changes in terms of trade and an index of structural reforms to forecast future TFP movements. Specifically, for 2015–20, it is assumed that: (i) capital accumulates at the rate of investment growth in staff's baseline macroeconomic outlook; (ii) employment grows at the current (2014) 2 percent rate; and (iii) human capital growth remains at its historical rate of 0.3 percent. Predicted TFP values are based on the regression coefficients of the TFP model, WEO terms of trade projections, and staff assumptions on how structural reforms may evolve. For example, if structural reforms were to improve at the same rate as during the commodity boom—a period with few incentives to make structural improvements—potential growth would only be 3.2 percent. Staff's baseline scenario estimates potential growth at 4½ percent, assuming structural reforms proceed at a slightly faster pace in line with the authorities' reform plans (with their contribution to TFP partially offset by lower metal prices).

Peru: Contributions to Growth
(In percent)



Source: Fund staff estimates.

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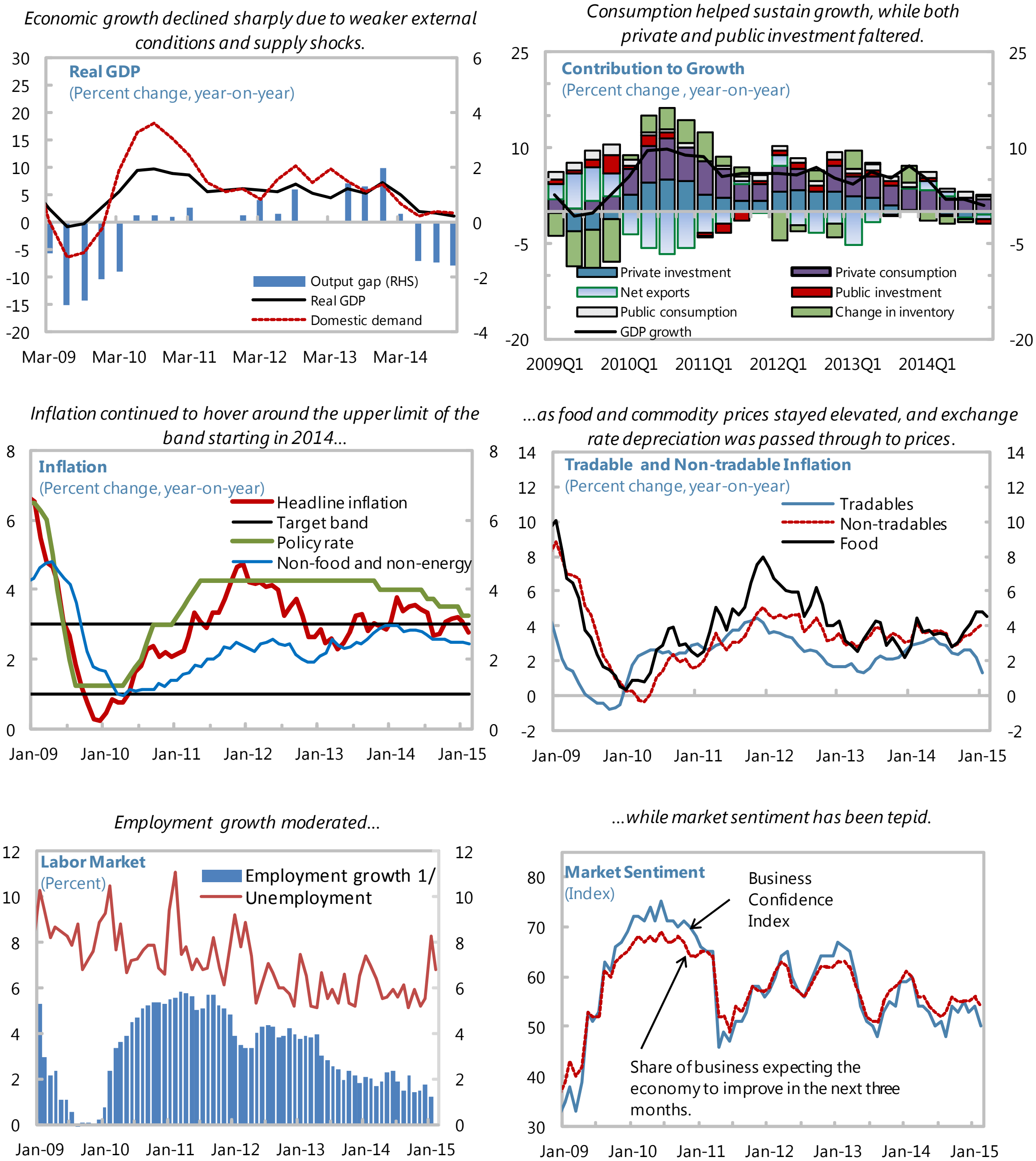
[1] Prepared by K. Ross and M. Tashu.

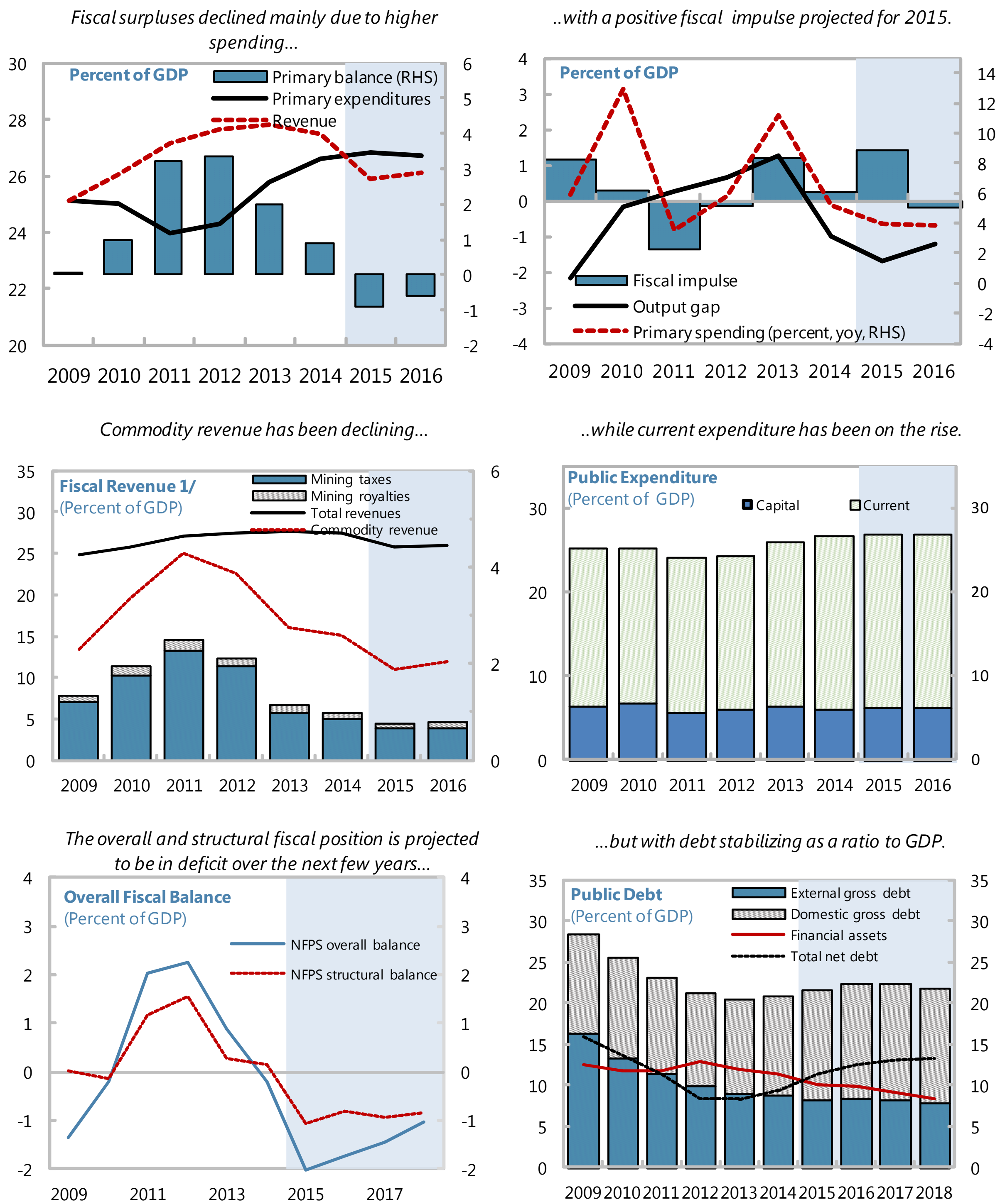
[2] Staff Selected Issues papers examine the decade long boom in investment and implications for growth.

Figure 1. Peru: Real Sector Developments



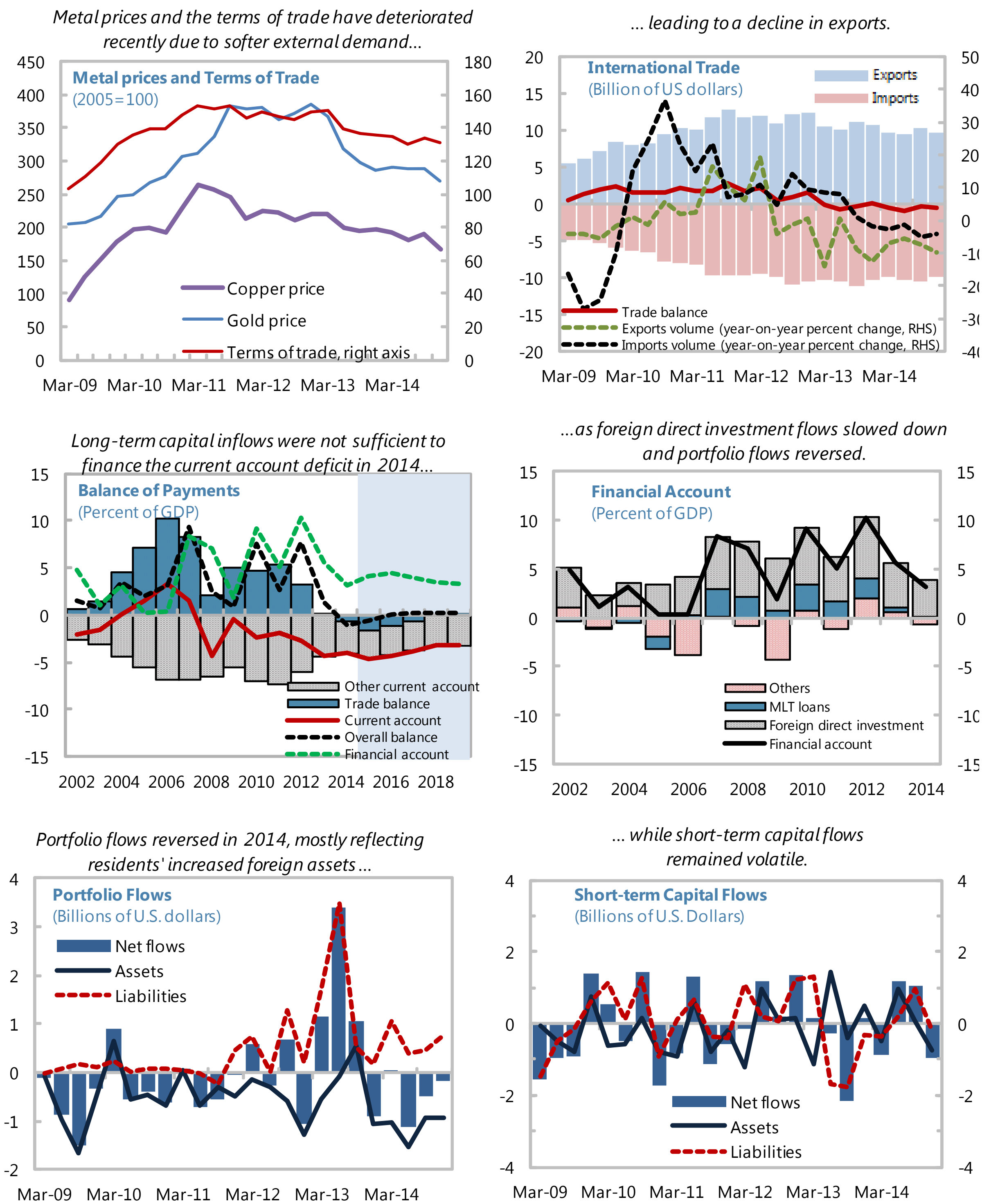
Sources: National Authorities; and Fund staff calculations.
1/ In firms with 10 or more employees, all urban areas.

Figure 2. Peru: Fiscal Sector Developments



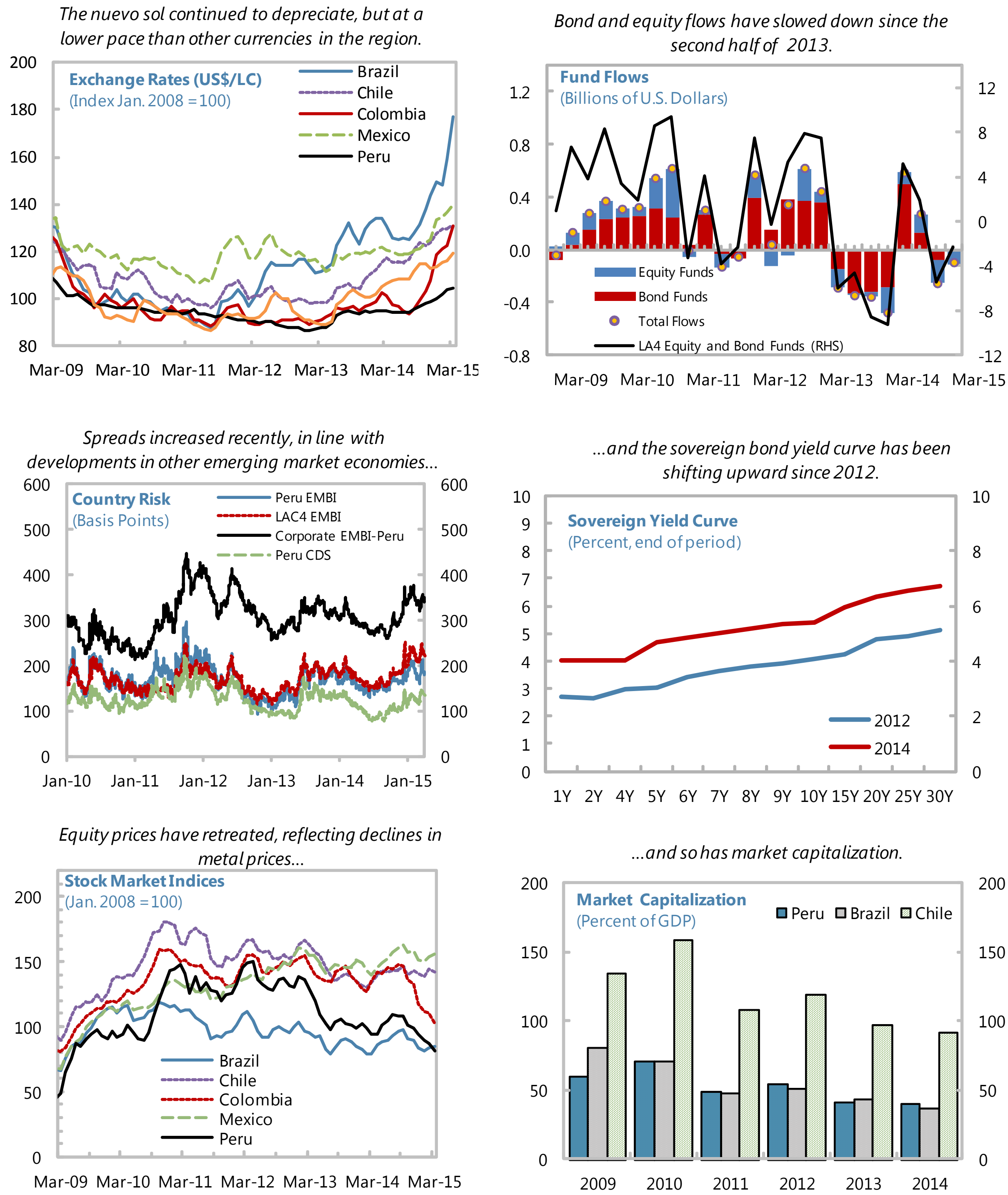
Sources: National Authorities; and Fund staff estimates.
1/ Net of restitutions.

Figure 3. Peru: External Sector Developments



Sources: National Authorities; and Fund staff estimates.

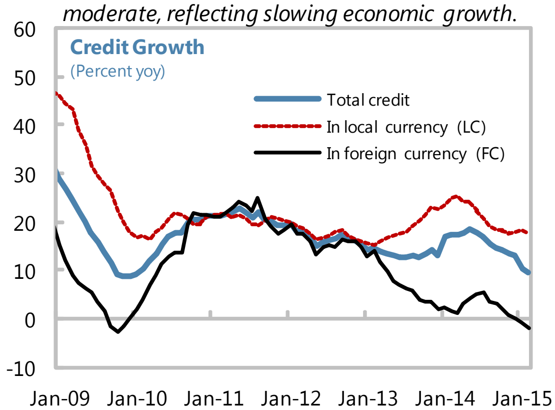
Figure 4. Peru: FX and Capital Market Developments



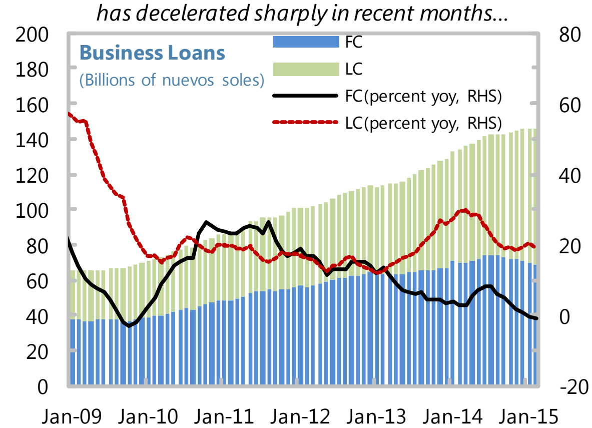
Sources: Bloomberg; Haver Analytics; National Authorities; and Fund staff estimates.

Figure 5. Peru: Financial Sector Developments

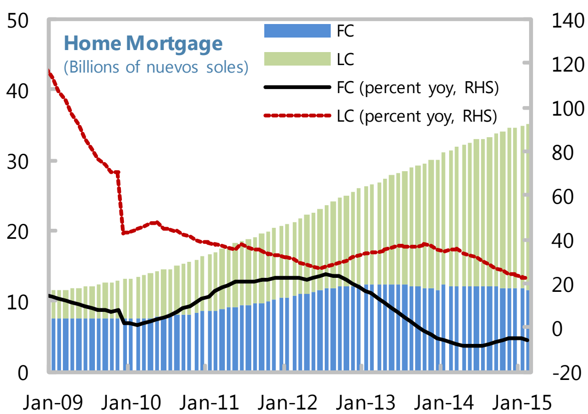
Private sector credit growth has continued to moderate, reflecting slowing economic growth.



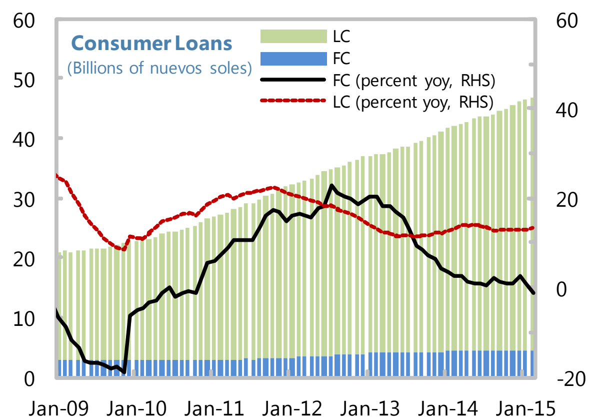
Dollarization of corporate loans remains high, although it has decelerated sharply in recent months...



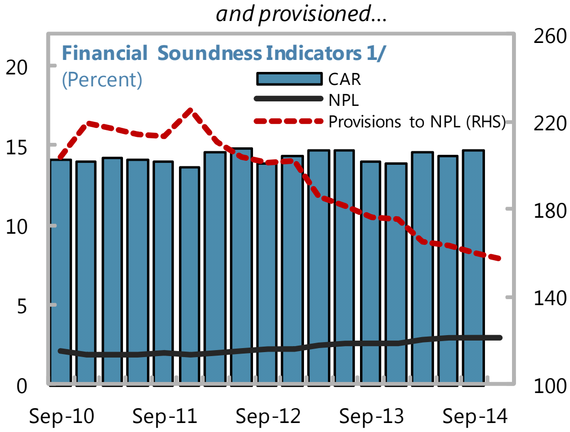
... and the same pattern applies to mortgage loans.



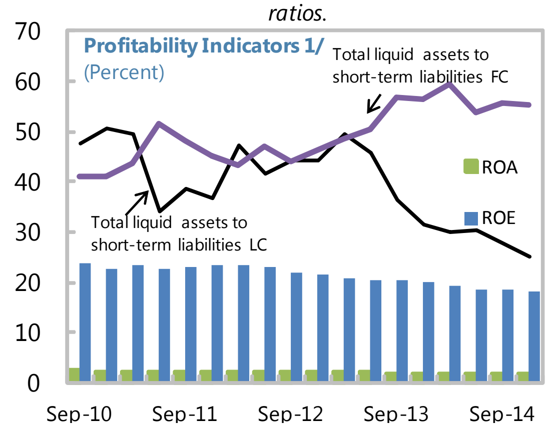
Dollarization of consumer loans remains low.



Deposit-taking institutions are well-capitalized and provisioned...

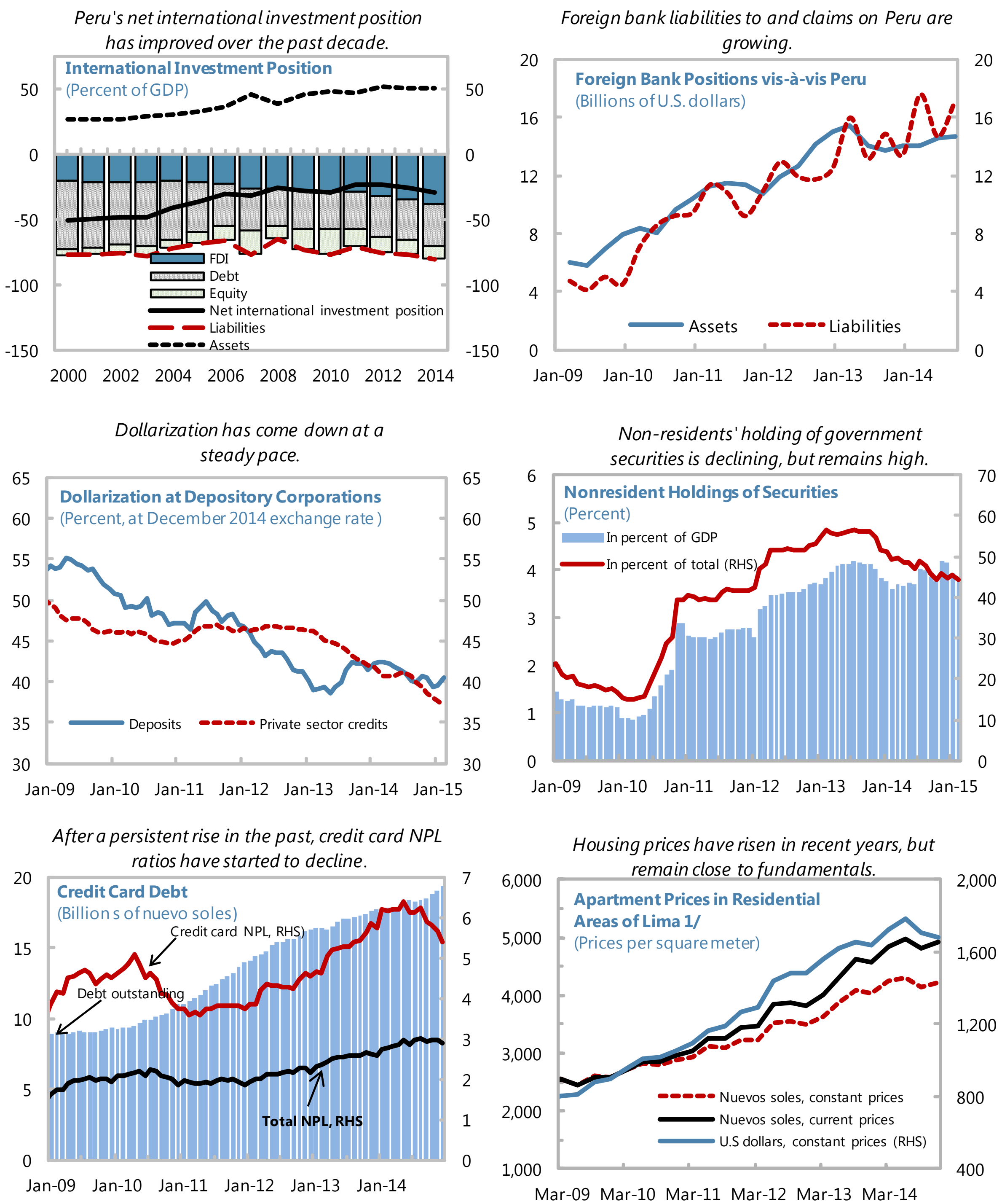


...with comfortable liquidity and profitability ratios.



Sources: National Authorities; and Fund staff estimates.
1/ Data corresponds to depository corporations.

Figure 6: Peru: Balance Sheet Indicators



Sources: National Authorities; Association of Banks; Bank for International Settlements; and Fund staff estimates.

1/ La Molina, Miraflores, San Borja, San Isidro, and Surco.

Table 1. Peru: Selected Economic Indicators

				Prel.	Proj.					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Social Indicators										
Life expectancy at birth (years) 1/	74.2	74.5	...	...	...	...	...	...	...	...
Infant mortality (per thousand live births)	14.3	13.6	12.9	...	...	...	...	...	...	...
Adult literacy rate 1/	...	93.8	...	...	...	...	...	...	...	...
Poverty rate (total)	27.8	25.8	23.9	...	...	...	...	...	...	...
Unemployment rate	7.7	6.8	5.9	5.9	...	...	...	...	...	...
	(Annual percentage change; unless otherwise indicated)									
Production and prices										
Real GDP	6.5	6.0	5.8	2.4	3.8	5.0	5.5	4.8	4.5	4.5
Real domestic demand	7.7	7.4	7.4	2.0	3.8	4.2	4.8	4.1	4.2	4.5
Consumer prices (end of period)	4.7	2.6	2.9	3.2	2.2	2.0	2.0	2.0	2.0	2.0
Consumer prices (period average)	3.4	3.7	2.8	3.2	2.5	2.0	2.0	2.0	2.0	2.0
External sector										
Exports	29.5	2.2	-9.6	-7.8	-9.9	7.9	9.8	8.4	6.2	5.5
Imports	28.9	10.7	2.7	-3.4	-5.6	5.7	6.4	5.1	5.0	4.8
Terms of trade (deterioration -)	7.3	-2.1	-5.7	-5.4	-4.5	-0.8	0.4	0.3	0.2	0.6
Real effective exchange rate (depreciation -)	-1.4	8.1	-0.2	-1.5	...	...	...	...	...	...
Money and credit 2/ 3/										
Broad money	15.1	12.1	14.8	8.4	13.6	13.5	14.1	13.8	13.5	13.5
Net credit to the private sector	21.6	13.3	18.4	13.5	13.6	13.5	14.1	13.8	13.5	13.5
	(In percent of GDP; unless otherwise indicated)									
Public sector										
NFPS revenue	27.2	27.6	27.8	27.5	25.9	26.1	26.0	26.0	26.0	25.8
NFPS primary expenditure	23.9	24.3	25.8	26.6	26.8	26.7	26.2	25.8	25.8	25.8
NFPS primary balance	3.2	3.3	2.0	0.9	-0.9	-0.6	-0.2	0.2	0.1	0.1
NFPS overall balance	2.0	2.3	0.9	-0.2	-2.0	-1.7	-1.4	-1.0	-1.0	-1.0
External Sector										
External current account balance	-1.9	-2.7	-4.2	-4.0	-4.5	-4.2	-3.7	-3.2	-3.1	-2.9
Gross reserves										
In millions of U.S. dollars	48,859	64,049	65,710	62,353	61,353	61,553	62,053	62,553	63,053	64,053
Percent of short-term external debt 4/	559	494	539	514	449	507	533	520	478	539
Percent of foreign currency deposits at banks	228	301	275	262	259	245	233	223	216	213
Debt										
Total external debt	25.6	27.2	27.4	30.2	32.5	31.6	30.6	29.3	27.7	26.7
Gross non-financial public sector debt (incl. repayment certificates)	23.0	21.2	20.3	20.7	21.5	22.3	22.2	21.7	21.3	22.0
External	11.4	9.8	8.8	8.7	8.8	8.8	8.6	8.1	7.2	6.9
Domestic	11.6	11.4	11.5	12.0	12.7	13.5	13.5	13.6	14.2	15.1
Savings and investment										
Gross domestic investment	25.7	26.2	28.2	26.8	26.6	26.1	26.0	25.5	25.3	25.3
Public sector (incl. repayment certificates)	4.8	5.4	5.8	5.5	5.8	5.8	5.7	5.7	5.7	5.7
Private sector (incl. inventories)	20.9	20.8	22.3	21.3	20.8	20.4	20.3	19.9	19.6	19.6
National savings	23.9	23.5	24.0	22.8	22.1	21.9	22.3	22.4	22.3	22.4
Public sector	7.4	8.0	7.1	5.6	4.0	4.4	4.6	5.0	5.1	5.1
Private sector	16.4	15.5	16.9	17.2	18.0	17.5	17.7	17.4	17.2	17.3
Memorandum items										
Nominal GDP (S/. billions)	469.9	508.3	546.9	576.1	608.9	647.3	692.8	740.4	788.6	840.6
GDP per capita (in US$)	5,685	6,324	6,540	6,458	5,962	6,242	6,579	6,924	7,262	7,623

Sources: National Authorities; UNDP Human Development Indicators; and Fund staff estimates/projections.
1/ Data for 2012.
2/ Corresponds to depository corporations.
3/ Foreign currency stocks are valued at end-of-period exchange rates.
4/ Short-term debt is defined on a residual maturity basis and includes amortization of medium and long-term debt.

Table 2. Peru: Nonfinancial Public Sector Main Fiscal Aggregates

	2011	2012	2013	Prel. 2014	Projections 2015	2016	2017	2018	2019
	(In millions of nuevos soles; unless otherwise indicated)								
Revenues	**127,673**	**140,437**	**152,051**	**158,411**	**157,742**	**169,139**	**180,010**	**192,262**	**204,866**
Taxes	77,261	86,097	91,698	97,804	96,818	103,804	109,852	116,811	123,746
Other	50,412	54,340	60,353	60,607	60,924	65,335	70,158	75,450	81,119
Primary expenditures 1/	**112,525**	**123,413**	**141,130**	**153,282**	**163,356**	**173,012**	**181,715**	**191,041**	**203,722**
Current	86,729	93,507	106,516	119,403	126,043	132,931	139,365	145,850	155,429
Capital	25,796	29,906	34,614	33,879	37,312	40,081	42,351	45,191	48,294
Primary balance	**15,149**	**17,024**	**10,921**	**5,129**	**-5,614**	**-3,873**	**-1,706**	**1,221**	**1,143**
Interest	5,541	5,568	6,090	6,250	6,630	7,275	8,222	8,843	8,829
Overall balance	**9,608**	**11,456**	**4,832**	**-1,121**	**-12,244**	**-11,148**	**-9,928**	**(7,622)**	**(7,685)**
External financing	747	-1,385	-4,386	-185	-368	3,360	2,781	54	(3,325)
Domestic financing	-10,355	-10,072	-446	1,305	12,612	7,788	7,147	7,567	11,010
Public Gross Debt 2/	**108,184**	**107,704**	**111,017**	**119,303**	**130,776**	**144,323**	**153,635**	**160,641**	**168,326**
External	53,534	49,719	48,084	50,373	53,633	56,993	59,774	59,828	56,504
Domestic	49,990	53,925	58,961	65,192	73,665	84,112	90,743	97,794	108,905
Repayment Certificates	4,328	3,893	3,972	3,738	3,477	3,218	3,118	3,018	2,918
Public Assets	**62,031**	**76,999**	**85,404**	**90,618**	…	…	…	…	…
	(In percent of GDP; unless otherwise indicated)								
Revenues	**27.2**	**27.6**	**27.8**	**27.5**	**25.9**	**26.1**	**26.0**	**26.0**	**26.0**
Taxes	16.4	16.9	16.8	17.0	15.9	16.0	15.9	15.8	15.7
Other	10.7	10.7	11.0	10.5	10.0	10.1	10.1	10.2	10.3
Primary expenditures 1/	**23.9**	**24.3**	**25.8**	**26.6**	**26.8**	**26.7**	**26.2**	**25.8**	**25.8**
Current	18.5	18.4	19.5	20.7	20.7	20.5	20.1	19.7	19.7
Capital	5.5	5.9	6.3	5.9	6.1	6.2	6.1	6.1	6.1
Primary balance	**3.2**	**3.3**	**2.0**	**0.9**	**-0.9**	**-0.6**	**-0.2**	**0.2**	**0.1**
Interest	1.2	1.1	1.1	1.1	1.1	1.1	1.2	1.2	1.1
Overall balance	**2.0**	**2.3**	**0.9**	**-0.2**	**-2.0**	**-1.7**	**-1.4**	**-1.0**	**-1.0**
External financing	0.2	-0.3	-0.8	0.0	-0.1	0.5	0.4	0.0	-0.4
Domestic financing	-2.2	-2.0	-0.1	0.2	2.1	1.2	1.0	1.0	1.4
Public Gross Debt 2/	**23.0**	**21.2**	**20.3**	**20.7**	**21.5**	**22.3**	**22.2**	**21.7**	**21.3**
External	11.4	9.8	8.8	8.7	8.8	8.8	8.6	8.1	7.2
Domestic	10.6	10.6	10.8	11.3	12.1	13.0	13.1	13.2	13.8
Repayment Certificates	0.9	0.8	0.7	0.6	0.6	0.5	0.5	0.4	0.4
Public Assets	**13.2**	**15.1**	**15.6**	**15.7**	**…**	**…**	**…**	**…**	**…**
Of which: Treasury Deposits and Fiscal Stabilization Fund	6.3	8.2	8.1	8.1	…	…	…	…	…
Public Net Debt	**9.8**	**6.0**	**4.7**	**5.0**	…	…	…	…	…
Memorandum items									
Commodity related revenues 3/	4.3	3.9	2.8	2.6	1.9	2.0	2.2	2.2	2.2
Output gap (% of potential GDP)	0.3	0.6	1.3	-1.0	-1.7	-1.2	-0.3	0.0	0.0
NFPS structural balance 4/	1.2	1.6	0.3	0.2	-1.3	-1.1	-1.2	-0.9	-0.9
NFPS structural primary balance 4/	2.3	2.7	1.5	1.2	-0.2	0.0	0.0	0.3	0.2
Fiscal impulse (+ = expansionary)	-1.6	-0.3	1.2	0.3	1.4	-0.2	0.0	-0.2	0.1

Sources: National Authorities; and Fund staff estimates.

1/ Official data excludes expense accrued during the period by Repayment Certificates (CRPAOs) and Petrolium Price Stabilzation (FEPC) but includes corresponding cash payments.

2/ Official data excludes stock of debt accumulated and not paid during the period by Repayment Certificates (CRPAOs) and Petrolium Price Stabilzation Fund (FEPC).

3/ Net of tax restitutions.

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

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

(In percent of GDP; unless otherwise indicated)

				Prel.	Projections					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	**21.8**	**22.4**	**22.3**	**22.4**	**21.1**	**21.3**	**21.1**	**21.0**	**21.1**	**20.9**
Taxes	16.4	16.9	16.8	17.0	15.9	16.0	15.9	15.8	15.7	15.6
Social Contributions	1.9	2.0	2.1	2.2	2.1	2.3	2.2	2.2	2.2	2.3
Grants	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	3.2	3.3	3.3	3.2	3.0	2.9	2.9	2.9	3.1	3.1
Of which: Interest income	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Expense 2/	**14.8**	**14.7**	**15.6**	**16.7**	**16.8**	**16.7**	**16.3**	**15.9**	**15.8**	**15.7**
Compensation of employees	4.9	4.9	5.3	6.0	6.1	6.3	6.1	6.0	6.1	6.1
Use of goods and services	5.1	5.6	6.3	6.0	6.4	6.0	5.6	5.6	5.6	5.6
Consumption of fixed capital 2/	5.0	5.6	6.0	5.8	5.9	5.9	5.9	6.0	6.0	6.0
Interest	1.2	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.0
Social benefits	2.1	2.0	2.0	1.9	2.0	1.9	2.2	2.0	1.9	1.8
Other expenses 3/	1.5	1.1	1.0	1.7	1.3	1.4	1.3	1.1	1.1	1.2
Net acquisition of nonfinancial assets	**5.0**	**5.6**	**6.0**	**5.8**	**5.9**	**5.9**	**5.9**	**6.0**	**6.0**	**6.0**
Acquistions of nonfinancial assets	5.0	5.6	6.0	5.8	5.9	5.9	5.9	6.0	6.0	6.0
Gross Operating Balance	7.0	7.7	6.7	5.7	4.3	4.6	4.8	5.1	5.3	5.3
Net lending (+) borrowing (-) 4/	**2.0**	**2.1**	**0.8**	**-0.1**	**-1.6**	**-1.3**	**-1.1**	**-0.9**	**-0.8**	**-0.7**
Net acquistion of financial assets 5/	**1.3**	**2.1**	**0.0**	**0.0**	**-0.7**	**0.4**	**-0.1**	**-0.1**	**0.0**	**-1.0**
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 6/	1.3	2.1	0.0	0.0	-0.7	0.4	-0.1	-0.1	0.0	-1.0
By residency										
Domestic	1.3	2.1	0.0	0.0	-0.7	0.4	-0.1	-0.1	0.0	-1.0
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 7/	**-0.7**	**0.0**	**-0.8**	**0.1**	**0.9**	**1.7**	**1.0**	**0.8**	**0.8**	**-0.2**
By instrument										
Debt securities	-0.9	0.1	0.1	0.1	1.0	1.1	0.6	0.8	1.2	-0.4
Loans	0.2	-0.1	-0.8	0.0	-0.1	0.5	0.4	0.0	-0.4	0.1
By residency										
Domestic	-0.9	0.1	0.1	0.1	1.0	1.1	0.6	0.8	1.2	-0.4
External	0.2	-0.1	-0.8	0.0	-0.1	0.5	0.4	0.0	-0.4	0.1
Memorandum items										
Central Government Net lending (+) borrowing (-)	0.4	0.8	-0.1	-1.0	-1.8	-1.2	-1.1	-1.0	-1.1	-1.1
Regional Governments Net lending (+) borrowing (-)	0.6	0.6	0.4	0.6	0.4	0.4	0.4	0.5	0.6	0.7
Local Governments Net lending (+) borrowing (-)	-1.1	-0.2	-0.2	0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
General Government Primary Balance	3.2	3.1	1.9	0.9	-0.7	-0.3	-0.1	0.2	0.2	0.2
General Government Overall Balance	2.0	2.1	0.8	-0.1	-1.7	-1.4	-1.2	-1.0	-0.8	-0.8
Gen. Gov. primary spending (real percentage change)	1.8	7.6	11.2	7.0	4.2	3.4	2.7	3.2	4.5	4.3
Of which: Current spending	7.0	4.8	11.2	10.2	4.1	3.3	2.0	1.9	4.4	4.0
Capital spending	-9.6	14.8	11.0	-0.5	4.6	3.8	4.7	6.5	4.9	5.0
General Government non-financial expenditures	18.6	19.2	20.4	21.4	21.7	21.5	21.1	20.7	20.8	20.7

Sources: National Authorities; 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 Repayment Certificates (CRPAOs) and Petrolium Price Stabilzation Fund (FEPC), but includes corresponding cash payments.

3/ Includes transfers to the Petrolium Price Stabilzation Fund (FEPC).

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

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

6/ Includes Fiscal Stabilization Fund (FEF).

7/ (+) 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)

				Prel.	Projections 1/					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Stock positions:										
Net worth	....	....	....	....	....	....	....	....	....	....
Nonfinancial assets	....	....	....	....	....	....	....	....	....	....
Net financial worth	**-7.2**	**-4.5**	**-3.5**	**-3.4**	**-4.9**	**-5.9**	**-6.6**	**-7.0**	**-7.4**	**-7.7**
Financial assets	**11.7**	**12.9**	**12.0**	**11.4**	**10.1**	**9.8**	**9.1**	**8.4**	**7.9**	**6.4**
By instrument										
Currency and deposits 2/	11.4	12.6	11.7	11.1	9.8	9.6	8.9	8.2	7.7	6.2
Debt securities	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
By residency										
Domestic	11.4	12.6	11.7	11.1	9.8	9.6	8.9	8.2	7.7	6.2
External	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
By currency 3/										
Domestic	11.6	12.8	11.2	10.5	9.7	9.5	8.8	8.2	7.7	6.2
Foreign	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Liabilities 4/	**18.9**	**17.5**	**15.5**	**14.8**	**14.9**	**15.7**	**15.7**	**15.5**	**15.3**	**14.1**
By instrument										
Debt securities	12.7	11.9	11.1	10.7	11.1	11.5	11.4	11.4	11.9	10.8
Loans	6.1	5.6	4.4	4.1	3.9	4.2	4.3	4.0	3.3	3.3
By residency										
Domestic	7.1	6.6	6.2	6.0	6.7	7.4	7.5	7.8	8.5	7.6
External	11.8	10.8	9.3	8.8	8.2	8.3	8.1	7.6	6.7	6.5
By currency 3/										
Domestic	10.5	10.4	10.0	10.3	11.7	12.6	12.7	12.8	13.5	14.5
Foreign	8.4	7.0	5.5	4.5	3.3	3.1	3.0	2.6	1.8	-0.4
Memorandum items										
Fiscal Stabilization Fund and other public savings	3.3	3.7	3.5	3.5	3.0	3.2	2.9	2.7	2.5	2.3
Debt of SOEs guaranteed by government 5/	0.7	0.7	0.7	0.7	0.7	0.6	0.6	0.6	0.5	0.5

Sources: National Authorities; and Fund staff estimates.

1/ Assuming zero other economic flows.

2/ Includes stocks of Fiscal Stabilization Fund (FEF).

3/ Preliminary data.

4/ Excludes debt of public enterprises guaranteed by the central government, debt of Petrolium Price Stabilzation Fund (FEPC), and Repayment Certificates (CRPAOs).

5/ 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 otherwise noted)

	2011	2012	2013	2014	Projections 2015	2016	2017	2018	2019	2020
Current account	**-3.2**	**-5.2**	**-8.5**	**-8.0**	**-8.6**	**-8.5**	**-8.0**	**-7.3**	**-7.5**	**-7.6**
Merchandise trade	9.2	6.3	0.6	-1.3	-2.9	-2.3	-1.1	0.2	0.8	1.1
Exports	46.4	47.4	42.9	39.5	35.6	38.4	42.2	45.7	48.6	51.3
Traditional	35.9	35.9	31.6	27.7	23.6	25.8	28.9	31.5	33.2	35.0
Mining	27.5	27.5	23.8	20.5	18.4	19.8	22.3	24.5	26.0	27.5
Nontraditional and others	10.5	11.5	11.3	11.8	12.0	12.6	13.3	14.3	15.4	16.3
Imports	-37.2	-41.1	-42.2	-40.8	-38.5	-40.7	-43.3	-45.6	-47.8	-50.1
Services, income, and current transfers (net)	-12.4	-11.5	-9.1	-6.8	-5.7	-6.2	-6.9	-7.5	-8.3	-8.7
Services	-2.2	-2.4	-1.8	-1.8	-1.5	-1.7	-2.1	-2.3	-2.6	-2.8
Investment income	-13.4	-12.4	-10.6	-9.3	-7.6	-8.1	-8.7	-9.2	-10.0	-10.5
Current transfers	3.2	3.3	3.3	4.4	3.5	3.7	3.9	4.0	4.2	4.6
Capital and financial account balance	**8.7**	**19.8**	**11.4**	**6.4**	**7.6**	**8.7**	**8.5**	**7.8**	**8.0**	**8.6**
Public sector	0.7	1.4	-1.3	0.0	0.5	1.8	1.6	0.8	-0.2	1.2
Medium-term loans	0.1	0.2	-1.3	1.3	-0.1	1.1	0.9	0.0	-1.0	0.4
Disbursements	1.0	0.9	0.7	1.3	2.8	2.4	1.7	1.1	1.1	1.1
Amortization	0.9	1.2	2.4	1.5	2.9	1.4	0.8	1.1	2.1	0.7
Other public sector flows 1/	0.5	1.2	0.0	-1.3	0.6	0.7	0.7	0.8	0.8	0.8
Net external assets	-0.3	-0.5	0.1	-0.6	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other transactions of Treasury bonds	0.8	1.7	-0.1	-0.8	0.8	0.9	0.9	1.0	1.0	1.0
Short-term flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	8.1	18.4	12.8	6.4	7.1	6.9	7.0	7.0	8.3	7.4
Foreign direct investment (net) 2/	7.5	11.8	9.2	7.5	6.9	6.9	6.9	7.1	7.2	7.4
Medium- and long-term loans	3.0	4.0	1.0	0.3	0.3	0.5	0.6	0.6	0.6	0.6
Portfolio investment	-1.2	-0.1	4.7	-1.8	-0.3	-0.3	0.1	0.1	0.1	0.1
Short-term flows 3/	-1.2	2.6	-2.1	0.4	0.2	-0.1	-0.6	-0.8	0.4	-0.6
Errors and omissions	**-0.9**	**0.2**	**0.0**	**-0.5**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**4.7**	**14.8**	**2.9**	**-2.2**	**-1.0**	**0.2**	**0.5**	**0.5**	**0.5**	**1.0**
Financing	**-4.7**	**-14.8**	**-2.9**	**2.2**	**1.0**	**-0.2**	**-0.5**	**-0.5**	**-0.5**	**-1.0**
NIR flow (increase -)	-4.7	-14.8	-2.9	2.2	1.0	-0.2	-0.5	-0.5	-0.5	-1.0
Change in NIR (increase -)	-4.7	-15.2	-1.7	3.4	1.0	-0.2	-0.5	-0.5	-0.5	-1.0
Valuation change	0.0	0.4	-1.2	-1.2	0.0	0.0	0.0	0.0	0.0	0.0
					(In percent of GDP)					
Current account balance	**-1.9**	**-2.7**	**-4.2**	**-4.0**	**-4.5**	**-4.2**	**-3.7**	**-3.2**	**-3.1**	**-2.9**
Trade balance	5.4	3.3	0.3	-0.6	-1.5	-1.1	-0.5	0.1	0.3	0.4
Exports	27.2	24.6	21.2	19.5	18.7	19.0	19.5	19.8	19.7	19.5
Traditional	21.0	18.6	15.6	13.6	12.4	12.8	13.4	13.6	13.5	13.3
Mining	16.1	14.3	11.8	10.1	9.7	9.8	10.3	10.6	10.5	10.5
Nontraditional and others	6.1	6.0	5.6	5.8	6.3	6.2	6.1	6.2	6.2	6.2
Imports	-21.8	-21.3	-20.9	-20.1	-20.2	-20.1	-20.0	-19.7	-19.4	-19.1
Services, income, and current transfers (net)	-7.3	-6.0	-4.5	-3.3	-3.0	-3.1	-3.2	-3.2	-3.4	-3.3
Investment income	-7.8	-6.4	-5.3	-4.6	-4.0	-4.0	-4.0	-4.0	-4.0	-4.0
Capital and financial account balance	**5.1**	**10.3**	**5.6**	**3.1**	**4.0**	**4.3**	**3.9**	**3.4**	**3.3**	**3.3**
Foreign direct investment (net)	4.4	6.1	4.5	3.7	3.6	3.4	3.2	3.1	2.9	2.8
Overall balance	**2.7**	**7.7**	**1.4**	**-1.1**	**-0.5**	**0.1**	**0.2**	**0.2**	**0.2**	**0.4**
Memorandum items				(Annual percentage change)						
Export value	29.5	2.2	-9.6	-7.8	-9.9	7.9	9.8	8.4	6.2	5.5
Volume growth	6.6	4.6	-4.2	-1.0	2.7	7.0	8.0	7.0	5.0	4.0
Price growth	21.5	-2.2	-5.7	-6.9	-12.3	0.8	1.7	1.3	1.1	1.4
Import value	28.9	10.7	2.7	-3.4	-5.6	5.7	6.4	5.1	5.0	4.8
Volume growth	13.8	10.9	2.7	-1.9	2.8	4.0	5.0	4.1	4.0	4.0
Price growth	13.3	-0.2	0.0	-1.5	-8.1	1.6	1.3	1.0	0.9	0.8
Terms of trade	7.3	-2.1	-5.7	-5.4	-4.5	-0.8	0.4	0.3	0.2	0.6
Gross international reserves (in billions of US$)	48.9	64.0	65.7	62.4	61.4	61.6	62.1	62.6	63.1	64.1

Sources: National Authorities; and Fund staff estimates/projections.
1/ Includes public sector's net external assets and other transactions involving Treasury bonds.
2/ Excluding privatization.
3/ Includes Financial Corporation for Development (COFIDE) and the National Bank.

Table 6. Peru: Monetary Survey 1/

(In billions of nuevos soles; unless otherwise noted)

	2011	2012	2013	2014	Projections 2015	Projections 2016
				I. Central Reserve Bank		
Net foreign assets	**110**	**138**	**144**	**140**	**150**	**150**
(In billions of U.S. dollars)	57	74	80	78	76	76
Net international reserves 2/	132	163	184	186	196	197
(In billions of U.S. dollars)	49	64	66	62	61	62
Long-term net external assets	0	0	0	0	0	0
Foreign currency liabilities	-22	-25	-40	-46	-47	-47
Net domestic assets	**-70**	**-85**	**-92**	**-95**	**-90**	**-83**
Net credit to nonfinancial public sector	-42	-55	-61	-67	-66	-65
Credit to the financial sector 3/	-11	-9	-8	-8	-8	-8
Securities issued	-16	-27	-22	-14	-16	-18
Other assets (net)	-1	6	-2	-6	0	7
Monetary base	**40**	**53**	**52**	**54**	**60**	**67**
Currency	27	32	35	39	43	48
Reserve	13	20	17	15	17	19
				II. Depository Corporations 4/		
Net foreign assets	**111**	**132**	**152**	**151**	**159**	**160**
Net domestic assets	**46**	**45**	**50**	**68**	**90**	**124**
Net credit to the public sector	-53	-69	-73	-74	-62	-54
Credit to the private sector	148	168	198	225	256	291
Other assets (net)	-49	-54	-76	-83	-104	-113
Broad money	**157**	**176**	**203**	**220**	**250**	**283**
Domestic currency	100	122	136	149	174	203
Foreign currency	58	54	67	71	76	80
				III. Financial System 5/		
Net foreign assets	**151**	**178**	**203**	**211**	**218**	**219**
Net domestic assets	**103**	**115**	**119**	**143**	**184**	**238**
Net credit to the public sector	-36	-51	-58	-51	-42	-37
Credit to the private sector	188	213	240	271	296	330
Other assets (net)	-49	-48	-63	-77	-70	-55
Liabilities to the private sector	**254**	**293**	**322**	**354**	**402**	**457**
Domestic currency	187	229	246	272	315	365
Foreign currency	67	64	76	82	87	92
				(12-month percentage change)		
Monetary base	16.8	31.9	-1.5	3.7	10.9	12.0
Broad money	15.1	12.1	14.8	8.4	13.6	13.5
Domestic currency	16.6	22.8	11.0	9.5	17.0	16.8
Foreign currency	12.6	-6.4	23.5	6.1	6.6	6.1
Liabilities to the private sector	5.5	15.4	10.1	9.9	13.6	13.5
Domestic currency	4.8	22.4	7.6	10.7	15.8	15.7
Foreign currency	7.6	-4.3	19.0	7.4	6.2	5.7
Depository corporations credit to the private sector	21.6	13.3	18.4	13.5	13.6	13.5
Domestic currency	20.4	16.0	22.5	18.5	24.0	20.0
Foreign currency	23.2	9.9	12.9	6.2	-3.4	0.0

Sources: National Authorities; and Fund staff estimates.

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, Pesos Andinos, credit lines to other central banks, Andean Development Corporation bonds, and foreign assets temporarily held by the Central Bank as part of swap operations.

3/ Including the National Bank.

4/ Depository corporations comprise the Central Bank, the National Bank, commercial banks, the Agricultural Bank, 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 Financing Agency for Small and Medium-sized Enterprises and the Fund for Financing Housing.

Table 7. Peru: Financial Soundness Indicators 1/

(In percent; unless otherwise indicated)

	Dec-11	Dec-12	Dec-13	Nov-14	Dec-14
Capital Adequacy					
Capital to risk-weighted assets 2/	13.7	14.4	13.9	14.5	...
Regulatory Tier I capital to risk-weighted assets 3/	10.8	10.9	10.4	10.6	...
Nonperforming loans net of provisions to capital 4/	-14.7	-12.6	-10.8	-9.1	...
Leverage 5/	7.7	7.9	7.9	8.5	...
Asset Quality					
Nonperforming loans to total gross loans 4/	1.8	2.2	2.6	3.0	2.9
In domestic currency	2.5	3.0	3.3	3.6	3.4
In foreign currency	1.0	1.1	1.5	2.0	2.1
Nonperforming, refinanced and restructured loans to total gross loans 4/ 6/	2.9	3.2	3.6	4.1	4.0
In domestic currency	3.5	4.2	3.3	3.6	3.4
In foreign currency	1.9	1.8	1.5	2.0	2.1
Refinanced and restructured loans to total gross loans	1.1	1.1	1.0	1.1	1.1
Provisions to nonperforming loans 4/	225.2	202.0	175.2	158.2	157.7
Provisions to nonperforming, restructured, and refinanced loans 4/ 6/	142.3	134.9	126.3	116.1	114.4
Sectoral distribution of loans to total loans					
Consumer loans	18.6	19.1	18.4	18.2	18.1
Mortgage loans	13.5	14.7	15.3	15.6	15.5
Corporate	18.1	15.8	17.6	17.1	17.2
Large firms	15.4	15.3	15.5	16.9	17.0
Medium size firms	17.2	17.5	17.6	18.0	18.3
Small firms	11.8	12.5	11.4	10.4	10.1
Microenterprises	5.5	5.2	4.3	3.9	3.8
Earnings and Profitability					
Return on equity (ROE)	23.5	21.5	20.0	18.5	18.2
Return on assets (ROA)	2.3	2.2	2.0	1.9	1.9
Financial revenues to total revenues	82.0	82.7	85.6	85.2	85.0
Annualized financial revenues to revenue-generating assets	11.1	11.2	10.9	10.6	10.6
Liquidity					
Total liquid assets to total short-term liabilities (monthly average basis)	40.5	45.0	43.0	40.8	39.4
In domestic currency	36.7	44.2	31.4	25.2	25.3
In foreign currency	45.0	46.2	56.4	57.9	55.2
Deposit-to-loan	95.3	95.2	98.1	91.1	90.5
Foreign Currency Position and Dollarization					
Share of foreign currency deposits in total deposits	43.9	38.2	43.6	43.5	43.4
Share of foreign currency loans in total credit	45.8	44.4	41.1	38.7	38.4
Operational efficiency					
Financing to related parties to capital 7/	9.3	11.5	9.3	8.8	9.43
Nonfinancial expenditure to total revenues 8/	33.7	33.6	33.7	33.1	33
Annualized Nonfinancial expenditure to total revenue-generating assets 8/	4.6	4.6	4.3	4.2	4.13
Memorandum items					
General Stock market index IGBVL	19,474	20,629	15,754	15,107	14,794.3
EMBI+ PERU spread, basis points	216	114	159	165	181

Source: National Authorities.

1/ These indicators correspond to depository corporations.

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

3/ Since July 2009, Banking Law component 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, and 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/Tier I regulatory capital / Total Exposure (on-balance sheet exposures, derivative exposures and off-balance exposures converted into credit exposure equivalents using credit conversion factors).

6/ Includes restructured loans, refinanced loans, and arrears. Refinanced loans refer to those loans subjected to 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."

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)

					Projections					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Financial indicators										
Public sector debt/GDP	23.0	21.2	20.3	20.7	21.5	22.3	22.2	21.7	21.3	22.0
Of which: in domestic currency (percent of GDP)	11.2	11.0	11.5	12.0	12.7	13.5	13.5	13.6	14.2	15.1
90-day prime lending rate, domestic currency (end of period)	5.4	5.0	4.5	4.7	...	...	...	...	...	...
90-day prime lending rate, foreign currency (end of period)	2.4	4.0	1.0	0.7	...	...	...	...	...	...
Velocity of money 1/	3.0	2.9	2.7	2.6	2.4	2.3	2.1	2.0	1.9	1.8
Net credit to the private sector/GDP 2/	31.5	33.0	36.3	39.1	42.0	44.9	47.9	51.0	54.3	57.8
External indicators										
Exports, U.S. dollars (percent change)	29.5	2.2	-9.6	-7.8	-9.9	7.9	9.8	8.4	6.2	5.5
Imports, U.S. dollars (percent change)	28.9	10.7	2.7	-3.4	-5.6	5.7	6.4	5.1	5.0	4.8
Terms of trade (percent change) (deterioration -) 3/	7.3	-2.1	-5.7	-5.4	-4.5	-0.8	0.4	0.3	0.2	0.6
Current account balance (percent of GDP)	-1.9	-2.7	-4.2	-4.0	-4.5	-4.2	-3.7	-3.2	-3.1	-2.9
Capital and financial account balance (percent of GDP)	5.1	10.3	5.6	3.1	4.0	4.3	3.9	3.4	3.3	3.3
Total external debt (percent of GDP)	25.6	27.2	27.4	30.2	32.5	31.6	30.6	29.3	27.7	26.7
Medium- and long-term public debt (in percent of GDP) 4/	11.6	10.2	9.2	10.2	11.2	11.5	11.5	11.1	10.3	10.1
Medium- and long-term private debt (in percent of GDP)	10.3	12.4	15.0	16.5	17.6	16.6	15.8	15.1	14.5	13.8
Short-term public and private debt (in percent of GDP)	3.7	4.6	3.2	3.5	3.7	3.5	3.3	3.1	2.9	2.8
Total external debt (in percent of exports of goods and services) 4/	86.3	100.3	113.9	134.8	150.2	144.9	137.8	130.9	124.7	121.8
Total debt service (in percent of exports of goods and services) 5/	8.0	11.0	16.0	16.1	20.9	16.0	13.8	13.7	15.0	11.9
Gross official reserves										
In millions of U.S. dollars	48,859	64,049	65,710	62,353	61,353	61,553	62,053	62,553	63,053	64,053
In percent of short-term external debt 6/	559.1	494.2	539.5	514.3	448.8	506.9	533.2	520.4	478.0	539.0
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	125.2	132.5	127.8	125.6	120.1	121.0	120.5	118.9	114.0	116.1
In percent of broad money 8/	83.7	93.6	90.7	84.8	78.7	69.5	61.4	54.4	48.3	43.3
In percent of foreign currency deposits at banks	227.7	301.2	274.8	261.5	259.2	245.2	233.1	223.5	216.2	212.5
In months of next year's imports of goods and services	12.1	15.4	16.3	16.4	15.3	14.4	13.8	13.3	12.8	12.4
Net international reserves (in millions of U.S. dollars)	48,816	63,991	65,663	62,308	61,308	61,508	62,008	62,508	63,008	64,008
Central Bank's Foreign Exchange Position	33,300	46,063	41,097	35,368	34,368	34,568	35,068	35,568	36,068	37,068

Sources: National Authorities; IMF's 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 depository corporations.
3/ End of period; data from INS.
4/ Includes Central Bank's 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. Medium-Term Macroeconomic Framework

	2011	2012	2013	Prel. 2014	Projections 2015	2016	2017	2018	2019	2020
	(Annual percentage change)									
Production										
GDP at constant prices	6.5	6.0	5.8	2.4	3.8	5.0	5.5	4.8	4.5	4.5
Consumer prices (end of period)	4.7	2.6	2.9	3.2	2.2	2.0	2.0	2.0	2.0	2.0
GDP deflator	5.2	2.1	1.7	2.9	1.8	1.3	1.4	2.0	1.9	2.0
Trade										
Merchandise trade										
Exports, f.o.b.	29.5	2.2	-9.6	-7.8	-9.9	7.9	9.8	8.4	6.2	5.5
Imports, f.o.b.	28.9	10.7	2.7	-3.4	-5.6	5.7	6.4	5.1	5.0	4.8
Terms of trade (deterioration -)	7.3	-2.1	-5.7	-5.4	-4.5	-0.8	0.4	0.3	0.2	0.6
	(In percent of GDP; unless otherwise indicated)									
External current account balance	-1.9	-2.7	-4.2	-4.0	-4.5	-4.2	-3.7	-3.2	-3.1	-2.9
Total external debt service 1/	2.4	3.0	3.8	3.6	4.5	3.5	3.1	3.1	3.3	2.6
Medium- and long-term	2.3	2.9	3.8	3.5	4.5	3.4	3.0	3.0	3.3	2.6
Nonfinancial public sector	1.1	1.2	1.8	1.3	2.0	1.1	0.8	0.9	1.3	0.6
Private sector	1.2	1.7	1.9	2.2	2.5	2.3	2.2	2.1	2.0	1.9
Short-term 2/	0.1	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.1	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Interest	1.0	0.9	1.0	1.1	1.1	1.0	1.0	1.0	0.9	0.8
Amortization (medium-and long-term)	1.4	2.1	2.8	2.5	3.5	2.5	2.1	2.1	2.4	1.8
Public sector										
NFPS primary balance 3/	3.2	3.3	2.0	0.9	-0.9	-0.6	-0.2	0.2	0.1	0.1
General government revenue	21.8	22.4	22.3	22.4	21.1	21.3	21.1	21.0	21.1	20.9
General govt. non-interest expenditure 3/	23.9	24.3	25.8	26.6	26.8	26.7	26.2	25.8	25.8	25.8
NFPS interest due	1.2	1.1	1.1	1.1	1.1	1.1	1.2	1.2	1.1	1.0
NFPS overall balance 3/	2.0	2.3	0.9	-0.2	-2.0	-1.7	-1.4	-1.0	-1.0	-1.0
Public sector debt 3/	23.0	21.2	20.3	20.7	21.5	22.3	22.2	21.7	21.3	22.0
Savings and investment										
Gross domestic investment	25.7	26.2	28.2	26.8	26.6	26.1	26.0	25.5	25.3	25.3
Public sector 3/	4.8	5.4	5.8	5.5	5.8	5.8	5.7	5.7	5.7	5.7
Private sector	20.9	20.8	22.3	21.3	20.8	20.4	20.3	19.9	19.6	19.6
Private sector (excluding inventories)	19.2	20.4	20.8	20.3	19.9	19.7	19.6	19.1	18.8	18.3
Inventory changes	1.8	0.4	1.5	1.0	1.0	0.7	0.8	0.7	0.8	1.2
National savings	23.9	23.5	24.0	22.8	22.1	21.9	22.3	22.4	22.3	22.4
Public sector 4/	7.4	8.0	7.1	5.6	4.0	4.4	4.6	5.0	5.1	5.1
Private sector	16.4	15.5	16.9	17.2	18.0	17.5	17.7	17.4	17.2	17.3
External savings	1.9	2.7	4.2	4.0	4.5	4.2	3.7	3.2	3.1	2.9
Memorandum items										
Nominal GDP (billions of nuevos soles)	469.9	508.3	546.9	576.1	608.9	647.3	692.8	740.4	788.6	840.6
Gross international reserves (billions of U.S. dollars)	48.9	64.0	65.7	62.4	61.4	61.6	62.1	62.6	63.1	64.1
External debt service (percent of exports of GNFS)	8.0	11.0	16.0	16.1	20.9	16.0	13.8	13.7	15.0	11.9
Short-term external debt service (percent of exports of GNFS)	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Public external debt service (percent of exports of GNFS)	3.8	4.4	7.6	5.8	9.3	5.1	3.7	4.1	5.8	2.9

Sources: National Authorities; and Fund staff estimates.
1/ Includes interest payments only.
2/ Includes the financial public sector.
3/ Includes Repayment Certificates (CRPAOs).
4/ Excludes privatization receipts.

Table 10. Peru: Public Sector Debt Sustainability Analysis—Baseline Scenario

(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators 1/

	Actual 2009-2012 2/	Actual 2013	Prel. 2014	Projections 2015	2016	2017	2018	2019	2020
Nominal gross public debt	24.5	20.3	20.7	21.5	22.3	22.2	21.7	21.3	22.0
Public gross financing needs	1.3	0.6	1.8	3.9	2.9	3.0	2.4	2.8	3.3
Real GDP growth (in percent)	5.5	5.8	2.4	3.8	5.0	5.5	4.8	4.5	4.5
Inflation (GDP deflator, in percent)	2.9	2.8	3.2	2.5	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (in percent)	9.4	7.6	5.3	5.7	6.3	7.0	6.9	6.5	6.6
Effective interest rate (in percent) 4/	5.1	5.7	5.6	5.4	5.9	6.4	7.1	7.4	7.9

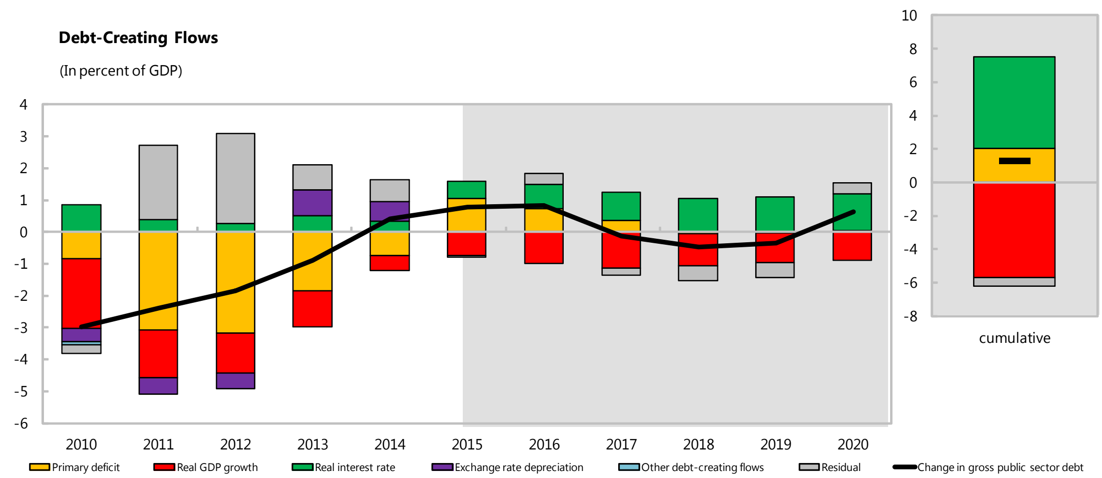
As of April 14, 2015			
Sovereign Spreads			
Spread (bp) 3/			179
CDS (bp)			138
Ratings		Foreign	Local
Moody's	n.a.	A3 positive	A3 positive
S&Ps		BBB+ stable	A stable
Fitch		BBB+ Stable	A Stable

Contribution to Changes in Public Debt

	Actual 2009-2012	Actual 2013	Prel. 2014	Projections 2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance 9/
Change in gross public sector debt	-1.7	-0.9	0.4	0.8	0.8	-0.1	-0.5	-0.4	0.6	1.3	
Identified debt-creating flows	-3.2	-1.7	-0.3	1.5	0.5	0.1	0.0	0.1	0.3	2.4	
Primary deficit	-1.7	-1.9	-0.8	1.0	0.7	0.4	-0.1	0.0	0.0	2.0	0.3
Primary (noninterest) revenue and grant	26.3	27.7	27.4	25.8	26.0	25.9	25.9	25.9	25.8	155.2	
Primary (noninterest) expenditure	24.6	25.8	26.6	26.8	26.7	26.2	25.8	25.8	25.8	157.2	
Automatic debt dynamics 5/	-1.5	0.2	0.5	0.4	-0.2	-0.3	0.0	0.2	0.3	0.4	
Interest rate/growth differential 6/	-0.8	-0.6	-0.1	-0.2	-0.2	-0.3	0.0	0.2	0.3	-0.2	
Of which: real interest rate	0.5	0.5	0.3	0.5	0.8	0.9	1.0	1.1	1.2	5.5	
Of which: real GDP growth	-1.3	-1.1	-0.5	-0.7	-1.0	-1.1	-1.0	-0.9	-0.9	-5.7	
Exchange rate depreciation 7/	-0.7	0.8	0.6	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 8/	1.6	0.8	0.7	-0.1	0.3	-0.2	-0.5	-0.5	0.3	-0.5	

Debt-Creating Flows

(In percent of GDP)



Sources: National Authorities; Fund staff estimates.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ Bond Spread over U.S. Bonds.

4/ Defined as interest payments divided by debt stock at the end of previous year.

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

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

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

8/ For projections, this line includes exchange rate changes during the projection period.

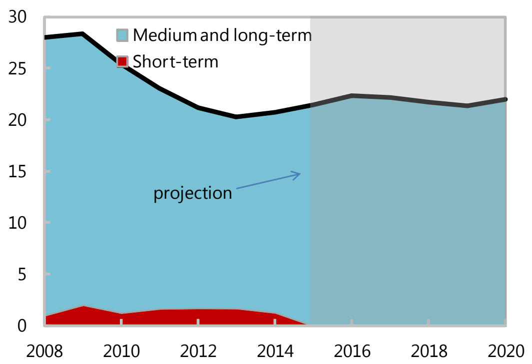
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 7. Peru: Public Sector Debt Sustainability Analysis—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

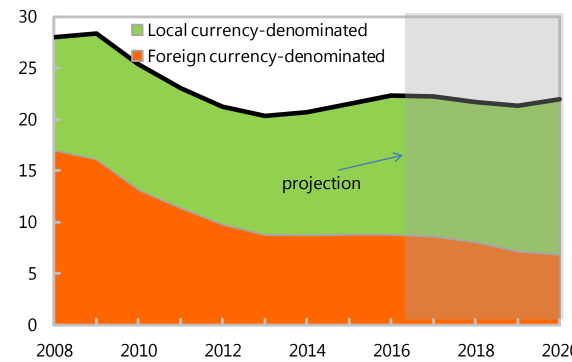
By Maturity

(In percent of GDP)



By Currency

(In percent of GDP)

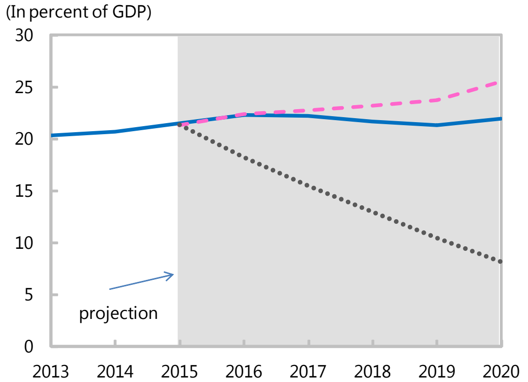


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

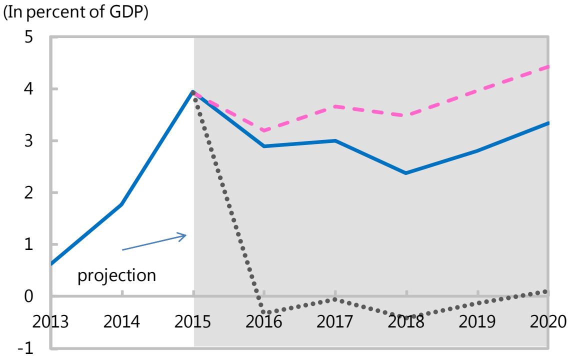
Gross Nominal Public Debt

(In percent of GDP)



Public Gross Financing Needs

(In percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.8	5.0	5.5	4.8	4.5	4.5
Inflation	2.5	2.0	2.0	2.0	2.0	2.0
Primary Balance	-1.0	-0.7	-0.4	0.1	0.1	0.0
Effective interest rate	5.4	5.9	6.4	7.1	7.4	7.9
Constant Primary Balance Scenario						
Real GDP growth	3.8	5.0	5.5	4.8	4.5	4.5
Inflation	2.5	2.0	2.0	2.0	2.0	2.0
Primary Balance	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Effective interest rate	5.4	5.9	6.4	7.1	7.4	7.5

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.8	6.2	6.2	6.2	6.2	6.2
Inflation	2.5	2.0	2.0	2.0	2.0	2.0
Primary Balance	-1.0	2.4	2.4	2.4	2.4	2.4
Effective interest rate	5.4	5.9	6.7	7.9	8.9	9.8

Source: Fund staff estimates.

Table 11. Peru: External Debt Sustainability Framework, 2013–2020

(In percent of GDP, unless otherwise indicated)

	2013	2014	Projections 2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
Baseline: External debt	27.4	30.2	**32.5**	**31.6**	**30.6**	**29.3**	**27.7**	**26.7**	**-3.7**
Change in external debt	0.1	2.8	2.4	-0.9	-1.0	-1.3	-1.6	-1.0	
Identified external debt-creating flows (4+8+9)	-4.2	0.5	-0.2	-0.6	-1.2	-1.3	-1.1	-1.1	
Current account deficit, excluding interest payments	3.2	2.9	3.4	3.2	2.7	2.2	2.1	2.1	
Deficit in balance of goods and services	0.6	1.5	2.3	2.0	1.5	0.9	0.7	0.7	
Exports	24.0	22.4	21.7	21.8	22.2	22.4	22.2	21.9	
Imports	24.6	23.9	24.0	23.8	23.7	23.3	23.0	22.6	
Net non-debt creating capital inflows (negative)	-6.9	-2.8	-3.5	-3.2	-3.2	-3.1	-3.0	-2.8	
Automatic debt dynamics 1/	-0.5	0.4	-0.2	-0.5	-0.6	-0.4	-0.3	-0.3	
Contribution from nominal interest rate	1.0	1.1	1.1	1.0	1.0	1.0	0.9	0.8	
Contribution from real GDP growth	-1.5	-0.6	-1.2	-1.5	-1.6	-1.4	-1.2	-1.2	
Contribution from price and exchange rate changes 2/	...	...	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	4.3	2.3	2.6	-0.4	0.2	0.0	-0.5	0.1	
External debt-to-exports ratio (in percent)	113.9	134.8	150.1	144.8	137.7	130.9	124.6	121.7	
Gross external financing need (in billions of US dollars) 4/	23.1	19.6	22.2	20.6	19.6	19.3	20.7	19.5	
in percent of GDP	11.4	9.6	11.7	10.2	9.1	8.3	8.4	7.4	
Scenario with key variables at their historical averages 5/			**23.4**	**17.6**	**12.6**	**7.8**	**3.1**	**-1.1**	**-4.0**
Key Macroeconomic Assumptions Underlying Baseline									
Real GDP growth (in percent)	5.8	2.4	3.8	5.0	5.5	4.8	4.5	4.5	
GDP deflator in US dollars (change in percent)	-0.7	-2.0	-9.7	1.3	1.4	2.0	1.9	2.0	
Nominal external interest rate (in percent)	3.9	4.0	3.3	3.3	3.4	3.4	3.3	3.2	
Growth of exports (US dollar terms, in percent)	-7.0	-6.7	-9.2	7.1	9.0	7.6	5.7	5.1	
Growth of imports (US dollar terms, in percent)	2.9	-2.8	-5.7	5.5	6.5	5.1	4.9	4.8	
Current account balance, excluding interest payments	-3.2	-2.9	-3.4	-3.2	-2.7	-2.2	-2.1	-2.1	
Net non-debt creating capital inflows	6.9	2.8	3.5	3.2	3.2	3.1	3.0	2.8	

Source: National Authorities; and Fund staff calculations.

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, γ = 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.

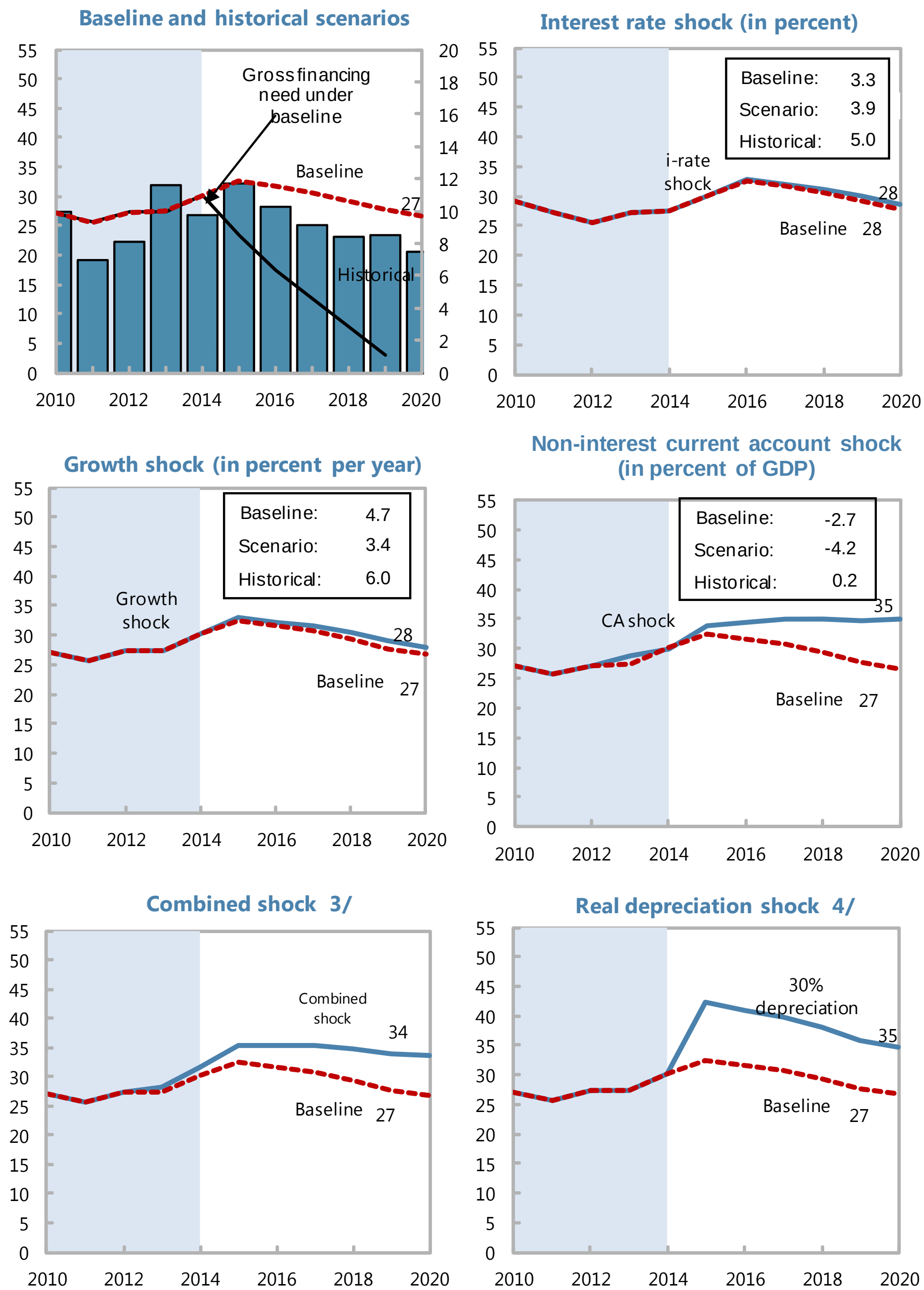
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

Figure 8. Peru: External Debt Sustainability: Bound Tests 1/ 2/

(In Percent of GDP)



Source: Fund staff estimates.

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

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

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

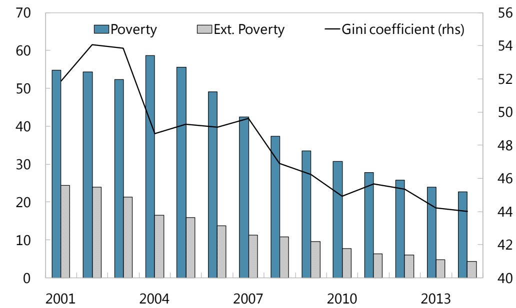
4/ One-time real depreciation of 30 percent occurs in 2015.

Appendix I. Peru: Social and Financial Inclusion[1]

Over the last decade, Peru has made progress in expanding access to financial and social services, effectively increasing the number of stakeholders in the economy. To achieve further gains in inclusion, the authorities are adding to existing successful programs and implementing a variety of interesting new initiatives.

1. Over the last decade, Peru has made significant strides in reducing poverty and inequality. The poverty rate declined by more than half, from 59 percent in 2004 to 23 percent in 2014. This means about ⅓ of the population has moved into an expanding middle class since mid-2000. Similarly, the extreme poverty rate has fallen to about 4 percent by 2014 from 20 percent in 2004. Income distribution has also improved, with the Gini coefficient declining to 44 by 2014.

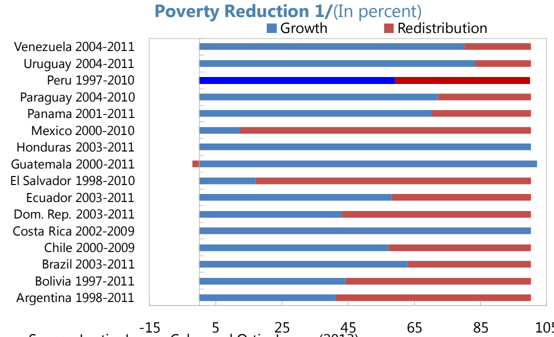
Peru: Poverty and Inequality Trends, 2001-14
(In percent of total population)



Sources: National Authorities; and World Development Indicators.

2. Social conflicts, however, continue to pose an important challenge. The number of conflicts has nearly tripled from 76 in late 2006 to 211 by March 2015. Approximately half of these have entailed violence at some stage. Over 65 percent are related to socio-environmental disputes in mining or other extractive industry activities. A significant proportion of Peru's mineral and hydrocarbon deposits are located on or near lands owned by peasant and indigenous communities. Thus accessing mineral deposits often involves moving or displacing those living on or nearby the resource. Mineral extraction also places additional demands on scarce resources, such as land and water, which are often crucial for the livelihoods of nearby communities.

Latin America: Contribution of Growth and Redistribution to Poverty Reduction 1/(In percent)



Source: Lustig, Lopez-Calva and Ortiz-Juarez (2013).
1/ Datt and Ravallion decomposition using $4 PPP poverty

3. Other important challenges include high rural poverty, malnutrition, and youth unemployment. For example, the poverty rate is over 46 percent in rural areas and only 15 percent in urban settings, while some 15 percent of children suffer from chronic malnutrition. Moreover, given that approximately half of past poverty reduction is attributed to growth (with the remaining portion linked to redistributive policies), stronger efforts will be needed to continue advancing social inclusion in a lower growth environment.

[1] Prepared by K. Ross.

4. The government has a number of initiatives to promote social inclusion and poverty reduction:

- **Increased allocations for social programs.** Peru's social safety net consists of 5 programs focused on: (i) the provision of school meals (Qali Warma); (ii) human capital development of female headed households (Juntos); (iii) elderly support (Pension 65); (iv) rural assistance (Haku Winay, Foncodes, FONIE); and early infant development (Cuna Mas). These programs are woven within a national social inclusion and development strategy (Incluir para Crecer), which covers all stages of life. Social spending in 2015 will be raised by 26 percent to fund an expansion in the coverage of Juntos and Pension 65 programs.

Peru: 2015 Social Programs

	Budget 1/	Coverage
Quali Warma	0.24	3 million children
Juntos	0.18	800,000 families
Pension 65	0.13	520,000 elderly
Rural assistance	0.10	20,000 households
Cuna Mas	0.06	70,000 infants
Total	**0.71**	**Over 5 million people**

1/ In percent of GDP.

Sources: Ministry of Development and Social Inclusion.

- **Education reforms.** Recent efforts center on improving the quality of infrastructure, instruction, learning processes, and school administration at primary and secondary levels. Specifically, there are plans to raise basic compensation based upon annual teacher evaluations and additional training; increase the number of performance-based teaching grants and bonuses; and make major investments in new school construction as well as renovate older facilities. The length of the school day will be expanded in a number of pilot schools, and English language classes will be gradually introduced nationwide. The goal is to raise education spending—from the current level of below 3 percent to around 4 and 6 percent by end-2016 and 2020, respectively—through annual ½ percentage point of GDP increments.

- **Financial inclusion.** Only ¼ of adults in Peru have a bank deposit account. Credit and deposit-to-GDP ratios have increased gradually, but at under 35 percent, still remain low by regional standards. Geographic isolation, high costs, and lack of trust in the banking system are often cited as key barriers to greater financial inclusion. More intensive use of financial education and lower cost product options such as mobile banking could help improve the situation. In recent years, the Superintendence of Banks, Insurance, and Pension Funds (SBS) has taken various measures to expand access and usage of financial services through improved regulation and supervision, transparency, consumer protection, and

Peru: Obstacles and Opportunities for Financial Inclusion
(In percent of respondents)

Obstacles	
Limited financial literacy	73
Unsustainable growth	60
Product costs	59
Limite understanding of customers needs	55
Poor business practices	54
Opportunities	
Financial education	78
Expanding the range of products	55
Moble phone banking	53
Correspondent banking	52
Provision of no-frills accounts	48

Source: Center for Financial Inclusion, Publication 21.

financial education. In 2013, it implemented a training program for teachers on financial issues, and in late 2014 it unveiled a "financial inclusion opportunities map." The map is an interactive tool that provides detailed geographical information on more than 150 indicators regarding the access and use of financial services throughout the country. In addition, it pushed the creation of more low cost savings products within the financial system. The banking system is also working to improve access to financial services with the promotion of an innovative "Peruvian model" based on electronic e-money legislation passed in 2012 and a new unified mobile payments platform that links together financial institutions, telephone service providers, and customers. The goal is to leverage the high penetration of mobile telephone in Peru (over 75 percent) and create a system of mobile payments based on electronic money that can become an access point for other financial services. The platform is expected to become operational by mid-2015 with simple utility payments and transfers allowed in the first stage.

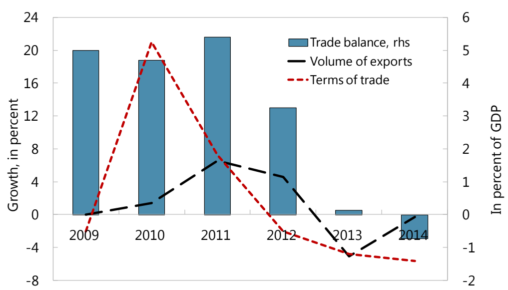
Appendix II. Peru: External Assessment[1]

Peru's external position is assessed to be broadly consistent with medium-term fundamentals and desired policy settings. The current account deficit is expected to narrow gradually over time, broadly financed by long-term capital flows. At the same time, Peru has adequate international reserves and low external debt.

A. Current Account

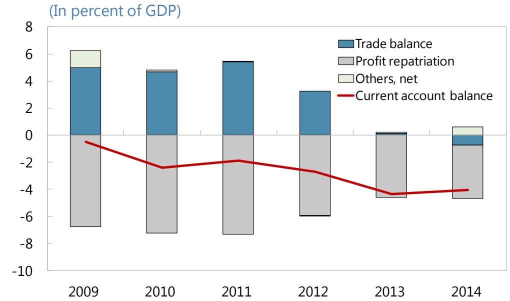
1. The current account deficit declined slightly in 2014, despite lower terms of trade and sluggish external demand. The current account deficit has widened since 2012, mostly reflecting deteriorations in the terms of trade and the volume of exports. In particular, the trade surplus that Peru had recorded since 2002 swung into deficit in 2014. Also, profit repatriation (i.e., profits realized by nonresident corporations) continues to be large, explaining over 90 percent of the current account deficit in 2014. Capital flows fell short of covering the current account deficit in 2014 as FDI flows slowed and portfolio flows reversed, leading to a decline in international reserves.

Peru: External Trade



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

Peru: Current Account Balance
(In percent of GDP)



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

2. Staff assesses that Peru's external position is consistent with medium-term fundamentals and desired policies settings. The External Balance Approach (EBA) estimates a current account norm of -2.6 percent of GDP and a gap of 1 percent of GDP after adjusting for estimated under-reporting of gold exports. This gap is likely to be corrected in coming years as the current account deficit is projected to narrow given an expected rebound in the volume of mining exports. Long-term capital inflows are expected to finance the projected medium-term current account deficit of about 3 percent of GDP.

B. Exchange Rate and Competitiveness

3. The nominal and real effective exchange rates were broadly stable in 2014. The nuevo sol depreciated by about 6½ percent in nominal terms against the U.S. dollar in 2014. However, the nominal and real effective exchange rates depreciated only by 1¼ percent and 1½ percent,

[1] Prepared by M. Tashu.

respectively, reflecting the faster depreciation of the currencies of major trading partners against the U.S. dollar.[2] Meanwhile, cost-based indicators of competitiveness show that Peru is competitive in mining (with the average cost of copper per pound of US$0.88 vs. Chile's US$1.42 in 2012), but its non-cost competitiveness indicators worsened somewhat as measured by Global Competitiveness Report rankings (2014).

4. Staff assesses that the real exchange rate is broadly in line with fundamentals. The estimated REER overvaluation ranges from about 2 percent, based on the real exchange rate regression to about 7 percent based on the current account regression. Adjusting for estimated under-reporting of gold mining exports, the REER overvaluation is estimated to be in the range of 2−4.5 percent, within the margin of estimation errors. Staff estimates based on a time-series REER model also suggest a small overvaluation of about ½ a percentage point in 2014.[3]

Peru: Current Account and REER Gaps, 2014

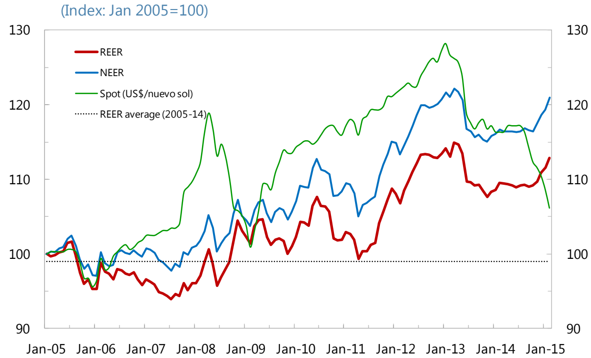
(In percent of GDP; unless stated otherwise)

	EBA Methodologies		CGER External
	CA Regression	RER Regression	Sustainability
CA norm	-2.6	...	-2.0
CA underlying 1/	-4.0	...	-3.1
CA gap 2/	1.4	...	1.1
RER gap (in percent) 3/	***7.0***	***1.9***	***5.5***
Adjusted: 4/			
CA underlying 1/	-3.5	...	-2.6
CA gap 2/	0.9	...	0.6
RER gap (in percent) 3/	***4.5***	***1.9***	***3.0***

Source: Fund staff estimates.
1/ Cyclically adjusted CA of 2014 for EBA; and medium-term CA for CGER ES
2/ CA gap is CA norm minus CA underlying.
3/ Positive value indicate overvaluation.
4/ Adjusted for under-reporting in the illegal exports of gold estimated at 0.5 percent of GDP.

Peru: Exchange Rates

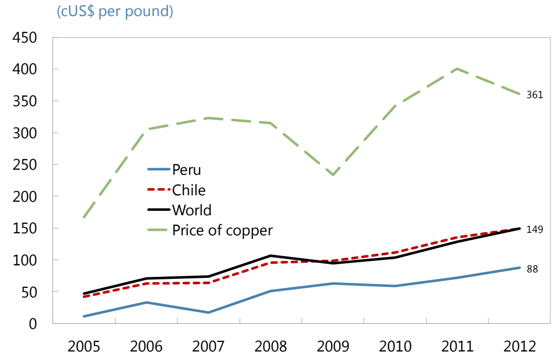
(Index: Jan 2005=100)



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

Price and Cash Cost of Copper Production

(cUS$ per pound)



Sources: Wood Mackenzie.

[2] The divergence between the bilateral and multilateral (effective) exchange rates has been notable in particular since the fourth quarter of 2014.

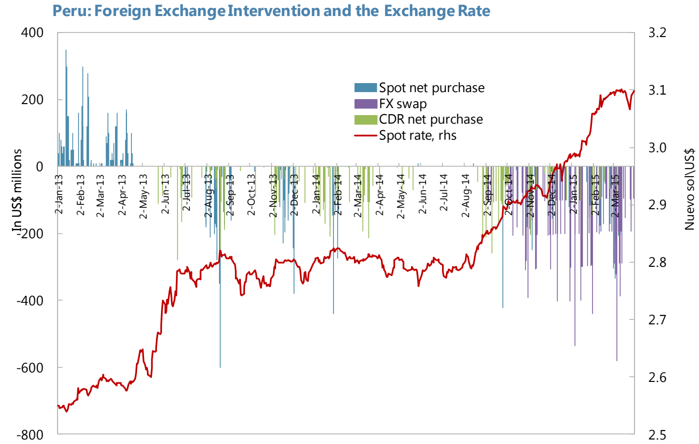
[3] A staff Selected Issues paper presents a model-based REER assessment.

C. Capital Flows, FX Intervention, and International Reserves

5. Capital flows moderated following declines in commodity prices and rising long-term global interest rates. After averaging about 7½ percent of GDP a year during 2010–13, net capital inflows slowed to about 3 percent of GDP in 2014. An FDI inflow of about 3¾ percent of GDP was partially offset by net portfolio outflows. Over two-thirds of the capital inflows during the upswing were FDI flows, providing relative stability to the financing of the current account deficit.

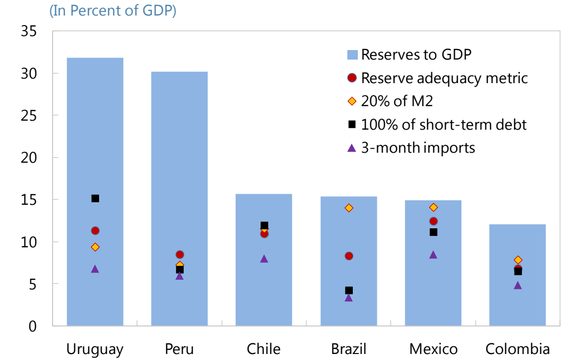
6. The authorities employ FX intervention and macro-prudential measures to contain excessive exchange rate volatility and avoid disorderly market conditions. To mitigate the potential adverse consequences of a sharp exchange rate appreciation, the BCRP deployed a number of measures including FX intervention (purchases), raising reserve requirements, and encouraging outflows during 2012–14. Total net FX purchases by the BCRP during this period amounted to US$26 billion (13 percent of 2012 GDP). In addition, the SBS employed prudential measures, such as additional provisioning, capital, and liquidity requirements for dollar credits to contain FX risks. Some of these measures, in particular the FX intervention, have been reversed since the second half of 2013 when external conditions changed. In 2014, the BCRP sold US$4.2 billion in the spot market, US$6.2 billion in dollar-indexed securities, and US$7.9 billion in FX swaps to contain FX volatility.[4] Consequently, risks from the capital flows cycle on credit growth and asset prices have been contained.

Peru: Foreign Exchange Intervention and the Exchange Rate



Sources: BCRP and Fund staff calculations.

Selected LA Countries: NIR Coverage in 2014
(In Percent of GDP)



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

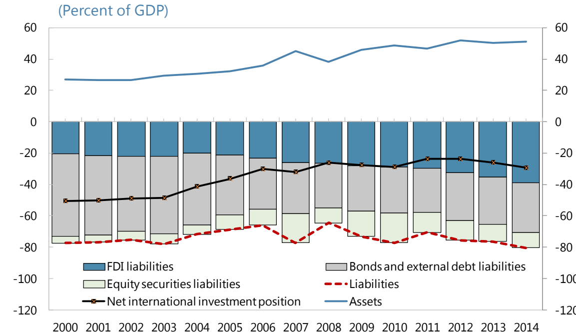
7. Peru's net international reserves remain adequate. Net international reserves reached US$62.3 billion (about 31 percent of GDP) at end-2014, which is adequate with respect to various metrics, including the IMF's composite adequacy measure. Peru's NIR adjusted for the size of its economy is similar to that of Uruguay (also a highly dollarized economy) and larger than other LA6 countries.

[4] The figures for dollar-indexed securities and FX swaps refer to gross transactions.

D. Foreign Asset and Liability Position

8. Peru's international investment position (IIP) and its composition has improved over the last decade. The negative IIP fell significantly since the early 2000s mostly due to accumulation of foreign assets while the composition of the foreign liabilities shifted significantly into non-debt creating items. Foreign assets almost doubled between 2000 and 2014, on the back of the BCRP's accumulation of international reserves. On the other hand, while total foreign liabilities fell only by a few percentage points of GDP, the composition of non-debt creating liabilities (FDI and equity) almost doubled to 60½ percent in 2014.

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



Sources: Central Reserve Bank of Peru and Fund staff's calculations.
1/ Liabilities are presented in negative figures.

Appendix III. Peru: New Fiscal Rules and Implications for Savings[1]

The fiscal framework approved in 2013 became operational in the 2015 budget. It includes a multi-annual macroeconomic framework that sets three-year projections for the main macroeconomic and fiscal variables. The new structural deficit target implies an important shift in the government's fiscal policy stance compared to past years as it will reduce savings as a share of GDP. More conservative targets would be advisable to preserve fiscal buffers.

1. The new fiscal framework includes the following elements:

- Numerical fiscal rules include a structural balance indicative target for the NFPS.
- The current fiscal stabilization fund for the national government can be used if revenue declines below the average of the past three years or during exceptional crises.
- A fiscal council will provide independent analyses of macro-fiscal projections, the evolution of public finances, and compliance with fiscal laws and rules.

Peru: New Fiscal Rules 1/ 2/

	NFPS	NG	SNGs
Budget Balance	Indicative structural deficit ceiling of 1 percent of GDP	…	…
Expenditure	…	Level of primary spending consistent with the structural balance target for the nonfinancial public sector given spending limits for sub-national governments and projections for other entities of the nonfinancial public sector. 1/ 2/ The growth rate of wage and pension spending cannot exceed the nominal growth rate of potential GDP.	Primary spending growth at time t below the average revenue growth rate over the previous four years (from t-6)
Debt	Debt ceiling at 30 percent of GDP	…	Debt/(average of last 4 years revenue) <100 percent
Other	…	New permanent spending requires new permanent revenue sources	Restrictions on external borrowing

Source: Fund staff and Country Documents.

1/ The limit can rise by up to 0.2 percent of GDP in case of budget under-execution in the previous year. If the expected output gap (positive or negative) is larger than 2 percent, the expenditure limit must adjust, counter cyclically, by up to ¼ of the output gap. When new tax measures yield a permanent change in revenue of 0.3 percent of GDP or more, the expenditure limit changes accordingly.

2/ In the first seven months of election years, two additional limits apply: (1) the budget execution of national government's primary spending cannot exceed 60 percent of the annual budget and (2) no measures can be taken that increase future current spending or reduce the fiscal space for the future administration.

2. A new methodology was introduced in 2014 to calculate the structural fiscal balance. Non-commodity related revenues are adjusted by the non-primary GDP output gap. Direct taxes and royalties levied on the mining and hydrocarbon sectors (i.e., natural resource revenue) are

[1] Prepared by S. Vtyurina.

instead assumed to depend on a Peru-specific export price index that reflects Peru's commodity-related export basket. No cyclical adjustment is made on expenditures, capital revenue, or the balance of state-owned enterprises. To calculate the price gap between current and structural prices and compute structural resource revenues, the methodology assumes a 30-year price cycle according to which current market prices would steadily decline over the next 20 years, converging to pre-2002 levels by 2033. Then, structural prices are derived using an HP filter over the 1980–2033 price series, and the price gap is obtained as a difference.

3. **In the original 2015 medium-term framework, the authorities chose an indicative structural deficit target for the nonfinancial public sector of 1 percent of GDP for the next three years.** However, the authorities revised the targets in April 2015 due to the exceptional economic circumstances and to account for the expected effect of the new tax measures. The expenditure ceilings for the general government remained binding. Gradual fiscal consolidation would commence in 2016, returning to the 1 percent structural fiscal deficit by 2018.

Macroeconomic Assumptions and Fiscal Revenue Implications

	Average 2008-13	2014 (Prel.)	2015	2016	2017	2018	2019	2020
Real GDP Growth, in percent	6.1	2.4	3.8	5.0	5.5	4.8	4.5	4.5
Output Gap, in percent		-1.0	-1.7	-1.2	-0.3	0.0	0.0	0.0
Commodity price gap, in percent 1/		34.5	26.8	20.3	14.8	10.2	6.4	3.2
Total Structural Revenue of the GG, percent of GDP	20.3	21.9	20.9	21.1	20.7	20.7	20.9	20.8
Natural Resource Related Revenue, percent of GDP 2/	3.5	2.6	1.9	2.0	2.2	2.2	2.2	2.1

Sources: National Authorities; and Fund staff calculations.
1/ Based on the authorities' methodology.
2/ Includes indirect taxes, which are adjusted by the output gap in the calculation of structural revenue.

4. **The targeted level of structural deficit will lead to a reduction of savings as a share of GDP.**[2] While, over the period 2014−20, the real growth rate of government spending will average about 5 percent, structural revenue will decline by more than 1 percentage point. Despite the projected positive commodity price gap, maintaining this level of structural deficit would require to use any cyclical revenue windfalls (as calculated under the rule), leading to growing overall deficits and reducing the stock of government's savings, as a share of GDP, by about 2 percentage points by 2020.[3] The general government debt-to-GDP ratio will increase slightly and then hover at slightly above 20 percent of GDP.

[2] During 2008−2013, Peru saved on average the equivalent of a third of its natural revenue, contributing to a fast decline in net debt and the accumulation of overall public savings of about 15½ percent of GDP by 2014.

[3] Projections assume that any fiscal surplus is saved and any deficit is financed by new debt, with no saving withdrawals, except in 2015. This assumption reflects the authorities' preference so far to accumulate fiscal buffers given the relatively low level of debt and the parsimonious use of the Fiscal Stabilization Fund resources. Alternatively, part of the fiscal savings could be used to finance fiscal deficits, leaving the stock of debt unchanged.

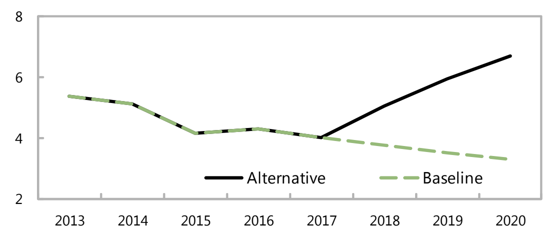
Fiscal Outlook under the New Rule and Structural Balance Target in Comparison with Historical Averages 1/

		Prel.			Proj.			
	Average 2008-13	2014	2015	2016	2017	2018	2019	2020
		(In percent of GDP, unless otherwise indicated)						
Fiscal Balances								
Structural Balance, NFPS	0.3	-0.7	-2.5	-2.0	-1.5	-1.0	-1.0	-1.0
Overall Balance, NFPS	1.5	-0.2	-2.0	-1.7	-1.4	-1.0	-1.0	-1.0
Savings and debt, GG								
Gross debt	23.3	19.8	20.7	21.5	21.4	20.9	20.6	21.2
Average real interest rate (in percent)	*-2.1*	*-2.4*	*-2.6*	*-2.5*	*-2.8*	*-3.1*	*-3.2*	*-3.3*
Change in savings 2/	-	-0.3	-1.2	-1.1	-1.4	-1.6	-1.9	-2.1
Share of natural resources saved (+)/used (-) 3/	32.3	-6.4	-107.7	-85.1	-65.8	-48.5	-46.2	-47.0
Spending pressure, GG								
Expenditure	19	21.4	22.3	21.9	21.0	20.5	20.8	20.8
Real growth rate of expenditure	10.6	7.6	8.2	3.2	1.1	2.3	5.9	4.9

Sources: National Authorities; and Fund staff calculations.
1/ Balances are calculated under the authorities' methodology.
2/ Change in the General Government savings ratio to GDP, from end 2013.
3/ Calculated as overall balance as a share of natural resource revenue (including indirect tax revenue).

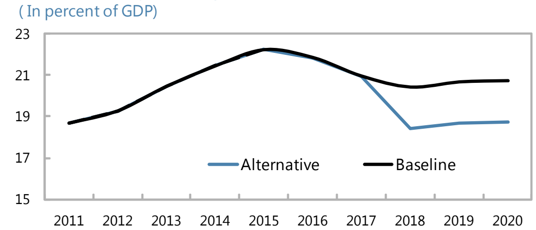
5. More conservative targets would be advisable to preserve fiscal buffers.[4] A structural fiscal balance of around ½ percent of GDP, achieved through careful expenditure prioritization and revenue mobilization, would preserve the current level of savings as a share of GDP and conserve enough buffers to cover against macroeconomic shocks and contingent liabilities. To avoid sudden adjustments in the real rate of growth of government spending, and protect fiscal space for important structural reforms (e.g., education, poverty programs, and civil service), a gradual move to a more conservative target would be suitable. Over the medium-term, higher tax collection should be achieved through widening the tax base, streamlining exemptions, promoting formalization, boosting the collection of local property taxes, and reviewing excise taxes to address negative externalities.

Peru: Illustrative Path of Accumulated GG Savings 1/
(In percent of GDP)



1/ Fiscal Stabilization Fund and remaining balances (*saldo de*

Peru: GG Primary Spending
(In percent of GDP)



Sources: National Authorities and Fund staff calculations.

[4] See also IMF Country Reports No. 14/21 and No. 14/22.

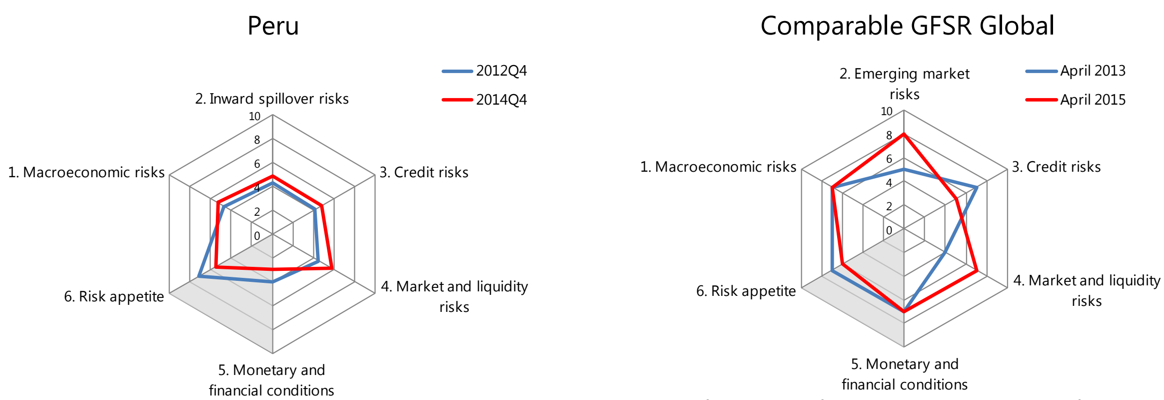
Appendix IV. Peru: Macro-Financial Stability Assessment[1]

Staff assesses that Peru's macro-financial system is stable, with no signs of imminent systemic risk. The financial sector vulnerability risk is medium, due to structurally high dollarization, but prudential buffers remain ample. Corporate and household balance sheets remained strong on average, but the recent deterioration of small firms' balance sheets calls for close monitoring. There is no evidence of over-pricing of assets.

A. Macro-financial Stability Map

1. Peru's macro-financial system remains stable. A comparison of Peru's latest macro financial stability map with 2012, towards the end of the commodity boom, shows that the macro-financial system remains stable albeit with some signs of increased macroeconomic, inward spillovers, credit, and market and liquidity risks. However, the levels of these risks are consistent with corresponding global risks as reported in the April 2015 Global Financial Stability Report (GFSR). In particular, the increase in market and liquidity risks reflects widening foreign exchange funding spreads and falling stock market turnovers. Risk appetite has come down since the third quarter of 2013, following U.S. Fed Reserve's (USFR) announcement of tapering its quantitative easing, but is still higher than the level before the announcement of QE3 by USFR.

Macro-Financial Stability Map



Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

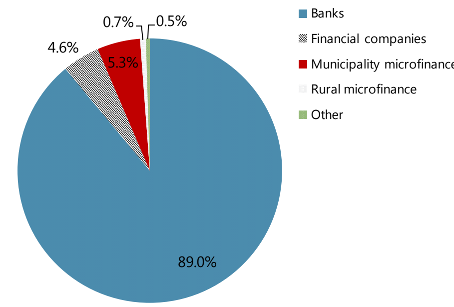
Source: IMF.

[1] Prepared by M. Tashu.

B. Financial Sector Risk Assessment

2. The financial sector vulnerability risk is assessed to be medium, but risks are contained due to large buffers. High dollarization of financial assets and liabilities remain a key structural risk, although the share of credits exposed to FX risk is lower than that suggested by the ratio of credit dollarization.[2] Non-performing loan ratios (NPLs) of small non-bank deposit-taking institutions are increasing, reflecting the vulnerability of their client base (small and micro enterprises) to the business cycle. The SBS rightly identifies FX credit risk and potential over-indebtedness of the large informal sector, including households and micro- and small-enterprises, as the main idiosyncratic risks to Peru's financial system and has built safeguard mechanisms by putting in place regulatory requirements above international standards.[3] As a result of these and other macro-prudential requirements, the financial system has built large buffers. The authorities' stress test results with tail risks of deceleration in economic activity and large exchange rate depreciations show that the financial system would remain resilient.

Peru: Structure of the Financial System
(In percent of total assets, end-2014)



Sources: National Authorities and Fund staff calculations

Peru: Financial Soundness Indicator Map

	2008Q4	2009Q4	2010Q4	2011Q4	2012Q4	2013Q4	2014Q4
Overall Financial Sector Rating	H	M	M	M	M	M	M
Credit cycle	H	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	4.3	1.6	1.6	2.0	2.2	1.7	1.5
Growth of credit / GDP (%, annual)	18.0	5.8	5.4	6.5	6.7	4.9	4.0
Credit-to-GDP gap (st. dev)	1.8	-2.0	-1.6	-0.7	0.2	1.3	0.4
Balance Sheet Soundness	M	M	M	M	M	M	M
Balance Sheet Structural Risk	M	M	M	H	M	H	M
Deposit-to-loan ratio	105.1	105.5	102.8	95.3	95.2	98.1	90.5
FX liabilities % (of total liabilities)	55.9	53.0	44.8	43.9	38.2	43.6	43.4
FX loans % (of total loans)	54.1	47.5	47.3	45.8	44.4	41.1	38.4
Balance Sheet Buffers	L	M	L	L	L	L	L
Leverage	n.a.	n.a.	L	L	L	L	L
Leverage ratio (%)	n.a.	n.a.	7.1	7.7	7.9	7.9	8.5
Profitability	L	L	L	L	L	L	L
ROA	2.6	2.3	2.3	2.3	2.2	2.0	1.9
ROE	30.0	23.6	22.9	23.5	21.5	20.0	18.2
Asset quality	n.a.	H	L	L	M	M	M
NPL ratio	1.5	1.9	1.9	1.8	2.2	2.6	2.9
NPL ratio change (%, annual)	n.a.	31.5	-2.6	-1.6	17.9	18.4	13.2

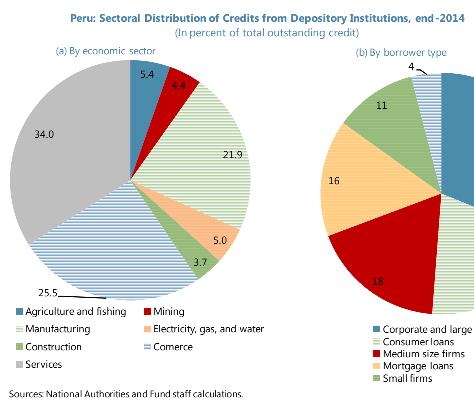
Source: National Authorities and Fund staff calculations.
High vulnerability   Medium vulnerability   Low vulnerability

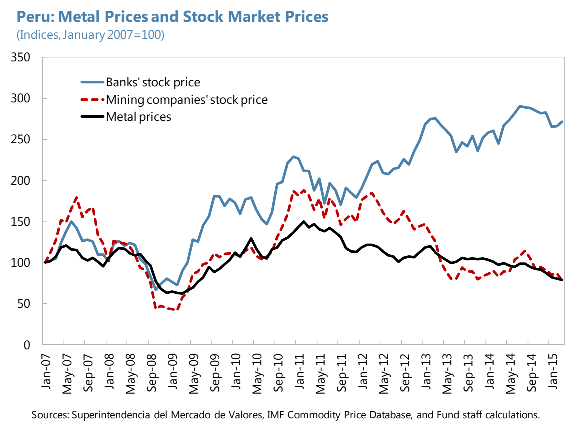
3. The financial sector's exposure to external and sector-specific shocks appears limited. Peruvian banks' exposure to a tightening of external financing is limited as over 90 percent of their funding source is deposits, although the deposit-to-loan ratio has come down recently. Similarly, banks' direct exposure to the commodity sector is relatively low, with only about 10 percent of banks' credit going to the agriculture and mining

[2] Although credit dollarization is high at about 38 percent, estimates by the SBS show that only 13 percent of total credit (about 5 percent of GDP) is exposed to FX credit risk.

[3] The regulatory requirements against FX credit risk include; (i) a minimum package of management measures to identify, assess, and mitigate FX credit risk, (ii) additional provisions if in the opinion of the supervisor the management measures adopted prove insufficient, and (iii) additional capital requirement for operations subject to FX credit risk. To build buffers against potential over-indebtedness of households and micro-and small enterprises, the SBS requires lower loan-to-value ratios and higher risk weighting of assets held by these clients.

sectors, indicating that their exposure to a commodity price shock is also limited. Nevertheless, credit portfolio is relatively concentrated with firms, highlighting the exposure of the financial system to corporate weaknesses, and the financial sector remains vulnerable to indirect impacts of commodity price shocks with broader macroeconomic consequences.





4. The regulation, supervision, and safety net of the banking system were assessed to be of high quality and well developed by the 2010 FSAP update. According to the FSAP report, Peru's legal framework for bank resolution is in line with best practices. Recommendations to strengthen supervision by better balancing qualitative judgment and rule-based standards, and by making on-site supervision more inclusive, have been implemented by the SBS since then. However, legislation is needed to establish a special resolution regime for systemic situations in line with FSAP recommendations.

C. Corporate and Household Balance Sheets

5. The recent increase in corporate debt issuance in the international market could be a source of vulnerability, but macro-financial risks seem limited. During 2012–14, Peruvian companies issued about 7½ percent of GDP debt in the international market to take advantage of low interest rates. This along with domestic FX borrowing has created large FX asset-to-liability gaps in some sectors, making firms in these sectors vulnerable to large exchange rate depreciations. For instance, a 10 percent depreciation of the nuevo sol in 2015 could lead to losses in percent of 2014 sales, ranging from 1.3 percent for manufacturing sector firms to 4.3 percent for construction sector firms (Figure 1). At the aggregate level, however, the corporate sector would gain in net terms from such a shock as gains by the mining and financial sectors would more than offset losses by the remaining sectors. Balance sheet and profitability indicators of issuing firms and the overall corporate sector in general deteriorated recently, reflecting declines in commodity prices and the slowdown in economic growth. Nevertheless, there are no indications of risk to macro-financial stability as the corporate sector remains current on its obligations to the financial system and the ratio of current assets to current liabilities remained comfortable at about 2, suggesting that the corporate sector has sufficient liquidity to meet short-term obligations. Furthermore, Peru has one of the lowest corporate debt-at-risk ratios among emerging economies.

6. Although comprehensive data is not available, there are indications that the balance sheets of small and medium firms are deteriorating. NPL ratios of small and micro firms, which held about 14 percent of total assets of depository institutions as of end-2014, increased about 2½ percentage points since end-2012 to 7¾ percent at end-2014. Similarly, NPLs of medium firms, which held about 18 percent of total assets of depository institutions as of end-2014, increased about 2 percentage points to 4¾ percent during the same period. On the other hand, consumer and mortgage NPL ratios have been relatively low and stable indicating that household balance sheets remained relatively healthy.[4] Although dollarization of consumer credit is low (9⅓ percent at end-2014), high dollarization of mortgage loans at 34 percent at end-2014 remains the main vulnerability to household balance sheets.

Peru: Corporate Issuance in the International Market, 2012-14

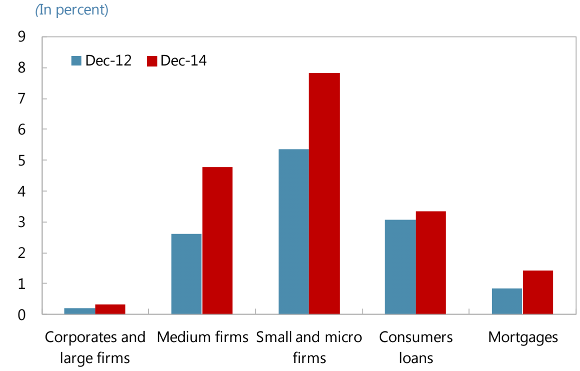
Issuing sector	In billions of US$	In percent of 2014
Non-financial	**9.3**	**4.6**
Tradable sectors	*4.4*	*2.2*
Agriculture	0.5	0.3
Fishing	0.3	0.1
Manufacturing	1.4	0.7
Mining	1.8	0.9
International trade[1/]	0.5	0.3
Non-tradable sectors	*4.8*	*2.4*
Construction	1.1	0.6
Energy[2/]	2.5	1.3
Retail	0.7	0.3
Transport	0.5	0.3
Financial	**5.5**	**2.7**
Total	**14.8**	**7.3**

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

1/ Importing, port, maritime, and logistic services.

2/ Production and distribution of energy.

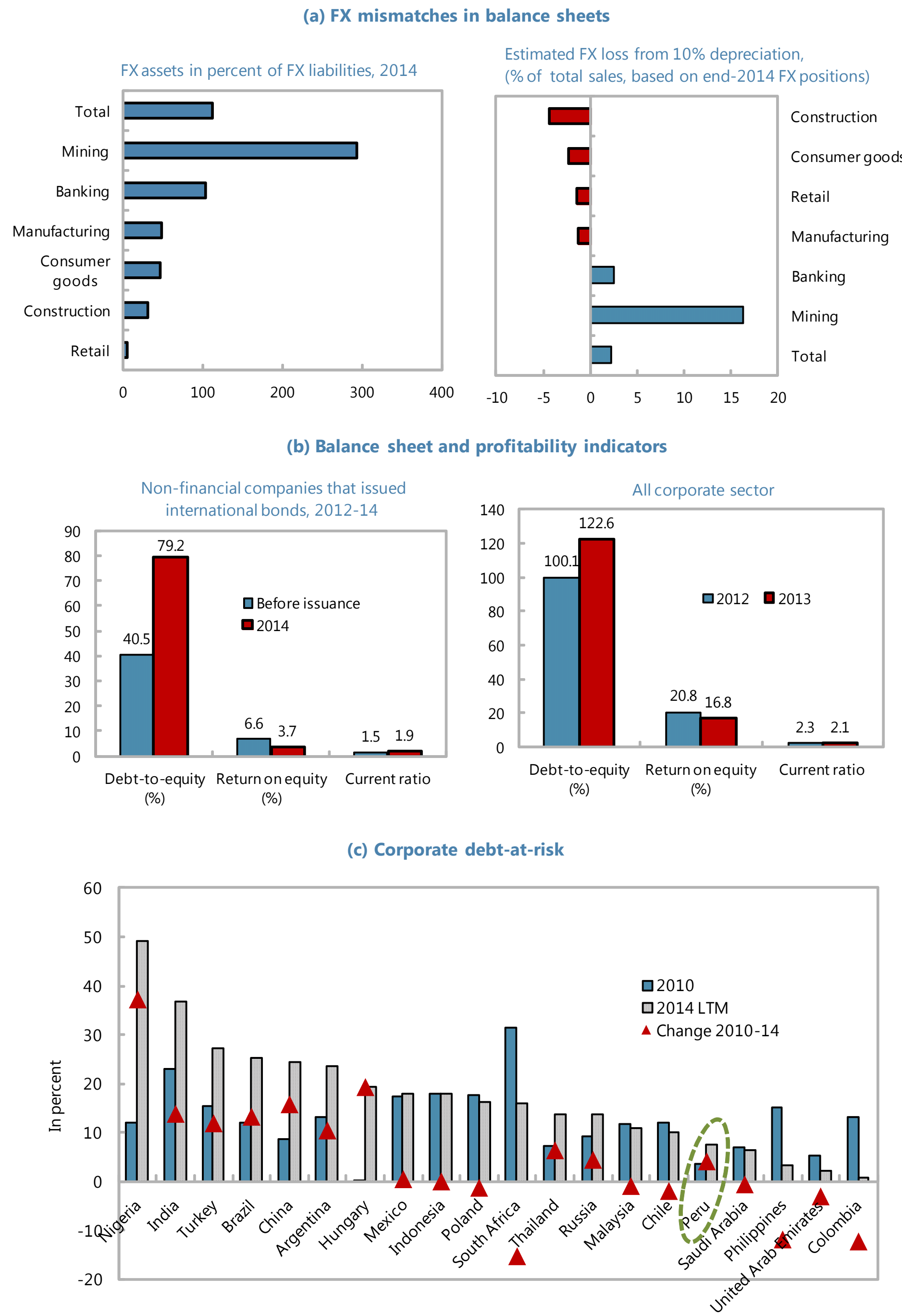
Peru: NPL Ratios at Depository Institutions by Type of Credit
(In percent)



Sources: National Authorities and Fund staff calculations.

[4] Growth of private consumption also remained robust at about 4 percent in 2014, when the overall economic growth was only 2.4 percent.

Figure 1. Peru: Corporate Vulnerability Indicators

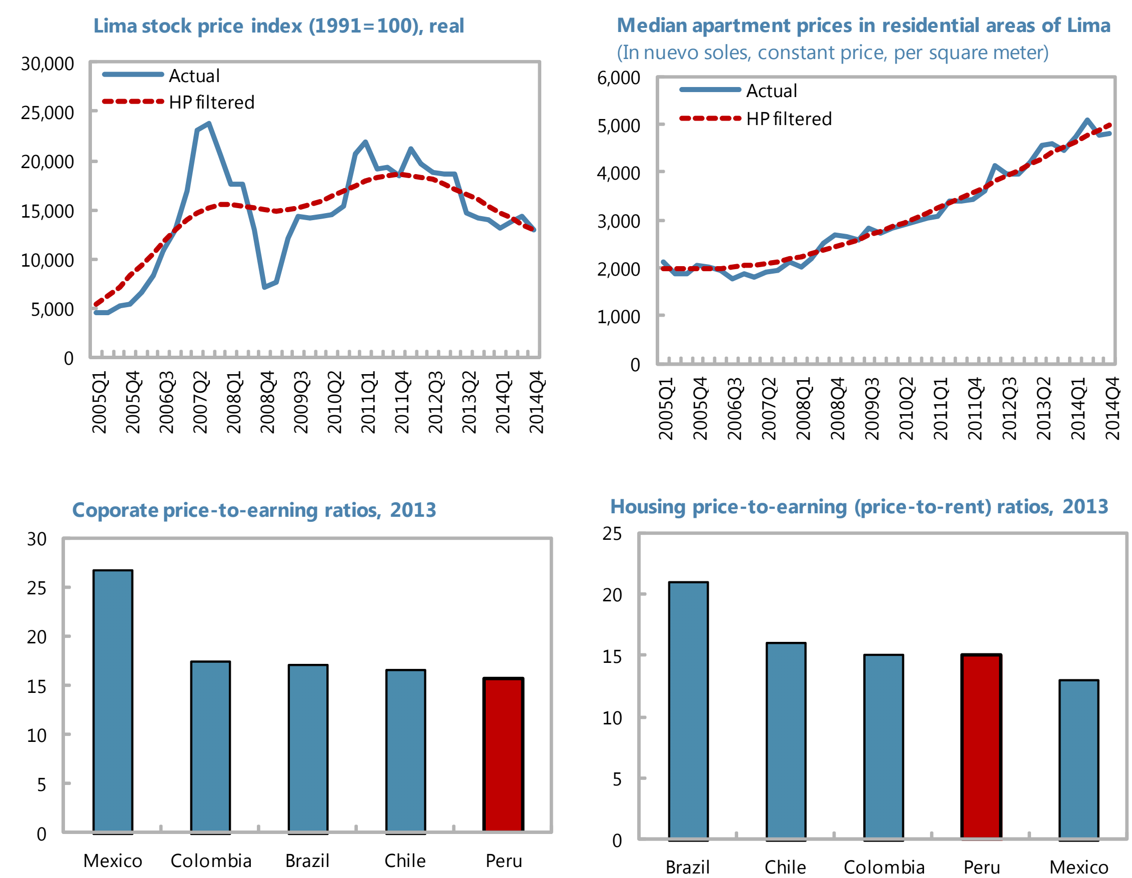


Sources: Apoyo Consultoria, Corporate Vulnerability Utility (IMF), Superintendencia del Mercado de Valores, Global Financial Stability Report (April 2015), and Fund staff calculations.
Note: Debt-at-risk is the share of corporate debt held by the "weak firms" or those with interest coverage ratios (EBITDA divided by interest expense) less than two. EBITDA = earnings before interest, taxes, depreciation, and amortization; LTM = last 12 months.

D. Asset Prices

7. There are no signs of asset price bubbles. After a significant appreciation during the commodity price boom, the Lima Stock Exchange price index has moderated recently and is in line with the trend average (Figure 2). The average price-to-earning (PE) ratio of Peruvian firms was 15 percent and was the lowest among regional peers in 2013, indicating no signs of over pricing. Housing prices continued to increase, but there is no evidence of misalignment from the trend average and the housing price-to-rent ratio was 15 percent—one of the lowest in the region.

Figure 2. Asset Prices



Sources: Corporate vulnerability utility (IMF), Global property guide, Reserve Central Bank of Peru, and Fund staff calculations.

INTERNATIONAL MONETARY FUND

PERU

May 5, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The Western Hemisphere Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of March 31, 2015)

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

General Resources Account:	SDR Million	Percent of Quota
Quota	638.40	100.00
Fund holdings of currency	438.31	68.66
Reserve Tranche Position	200.10	31.34

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	609.89	100.00
Holdings	531.11	87.10

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

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

	Forthcoming				
	2015	2016	2017	2018	2019
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.03	0.04	0.04	0.04	0.04
Total	0.03	0.04	0.04	0.04	0.04

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

Exchange Arrangements

Peru maintains a unified, floating exchange rate. On December 31, 2015, the average of interbank buying and selling rates was 2.98 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).

Last Article IV Consultation

The 2013 Article IV consultation was concluded on January 23, 2014 (IMF Country Report No. 14/31).

FSAP and ROSCs

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

Technical Assistance

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

Resident Representative

Mr. Alejandro Santos became the Senior Resident Representative in Peru in December 2014.

WORLD BANK RELATIONS

(As of April 10, 2015)

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 on four strategic objectives: (i) increased access and quality of social services for the poor; (ii) connecting the poor to services and markets; (iii) sustainable growth and productivity; and (iv) inclusive governance and public sector performance. The CPS also addresses cross-cutting issues such as those of governance and gender. The CPS is a result of extensive consultations with government and civil society.

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

Peru's current lending portfolio includes 20 active projects with a commitment of US$1.7 billion and an undisbursed balance of US$1.5 billion. In addition to 14 on-going investment lending operations, there are two active DPL-DDOs (Development Policy Loans with Deferred Drawdown Option) and two DPL with a CAT DDO (Catastrophes Deferred Drawdown Options) and two GEFs. The GOP took the DPL-DDOs during the 2008–09 global financial crisis as part of its overall strategy to ensure adequate contingency funding. New lending commitments since the start of the CPS period total US$310 million in seven new projects. Some large investment projects (for example, the Lima Metro II project) and a new CAT-DDO are expected to increase the commitment amounts significantly during the second half of the CPS implementation period (FY 15–FY 16).

As Peru is becoming a stronger middle income country, demand for knowledge services is increasing. This growing demand for knowledge is reflected in the increase in the number of Reimbursable Advisory Services (RAS) arrangements in Peru with the Bank in Education, Social Protection, Financial Inclusion, Disaster Risk Management, Water Resource Management, Water Supply and Sanitation, and Justice sectors. In addition to this new stream of RASs, the Bank has continued to provide analytical services, hands-on support to improve capacities, South-South and South-North knowledge exchanges and just-in-time support on a variety of issues as demanded by the clients.

Finally, the Bank's TF portfolio (currently over US$21 million considering GEF) complements other WB support in the current core engagement areas of this CPS by providing valuable Analytic and Advisory Activities 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

Road to Lima events. Peru will host the 2015 WBG-IMF Annual Meetings in October, 2015. As part of the preparation activities, which involve joint organization with the Fund, the WBG is conducting a series of events under the "Road to Lima". The seminars address development milestones that are essential for emerging economies in the 21st century: from equitable growth and quality of education and jobs to efforts to address climate change and citizen security. This process will provide a platform for knowledge exchange on challenges that middle-income countries face as they are striving to move to higher income levels by sustaining high growth and expansion of their economies, as well as by improving opportunities for the poor.

OECD. Peru has formally declared its intention to join the OECD by 2021. In July 2014, Peru's Minister of Finance requested support from the WBG for the preparation of the Country Program. While the Bank is finalizing the framework for this technical assistance, it will coordinate the work with other development partners, including with the Fund.

Tax Reform and Fiscal Decentralization. While the Fund has been active in providing various technical assistance missions in the tax area, the Bank has finalized a study on Taxation and Equity, looking at the challenges of increasing tax collection equitably. 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.

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.

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

Peru World Bank Portfolio Status

As of April 10, 2015

(In Million of U.S. dollars)

Project Name	Practice Name	Date, Board App.	Net Comm. Amt. ($m)	Tot. Disb. ($m)	Tot. Undisb. Bal. ($m)	% Disb
Investment						
PE Sierra Rural Development Project	Agriculture	4/24/2007	39.8	20.2	19.6	51
PE GEF Nat'l Protected Areas System	Environment & Natural Resources	5/20/2010	8.9	8.1	0.8	91
PE-(APL2) Health Reform Program	Health, Nutrition & Population	2/17/2009	15.0	9.7	5.3	65
PE-Sierra Irrigation	Water	7/27/2010	20.0	14.1	5.9	70
PE Water Resources Mgmt.	Water	7/2/2009	10.0	9.0	1.0	90
PE Justice Services Improv. II	Governance	11/18/2010	20.0	16.4	3.6	82
PE Optimization of Lima Water & Sewerage	Water	4/7/2011	109.5	48.8	60.7	45
PE Results Nutrition for Juntos SWAp	Social Protection & Labor	3/8/2011	25.0	11.7	13.3	47
PE Cusco Regional Development	Social, Urban, Rural and Resilience	11/22/2013	35.0	0.0	35.0	0
PE Second Rural Electrification	Energy & Extractives	4/21/2011	50.0	12.0	38.0	24
PE HIGHER EDUCATION QUALITY IMPROVEMENT	Education	12/4/2012	25.0	2.6	22.4	10
PE Basic Education	Education	1/17/2013	25.0	0.0	25.0	0
PE-Strengthening Sust. Mgmt. Guano Islands	Environment & Natural Resources	12/6/2013	8.9	2.5	6.4	28
PE-National Agric. Innovation Program	Agriculture	12/17/2013	40.0	0.0	40.0	0
PE Social Inclusion TAL	Social Protection & Labor	12/13/2012	10.0	0.8	9.2	8
PE Cusco Transport Improvement	Transport & ICT	2/28/2014	120.0	0.0	120.0	0
Adjustment						
PE CAT DDO II	Social, Urban, Rural and Resilience	3/12/2015	400.0	0.0	400.0	0
PERU CAT DDO	Social, Urban, Rural and Resilience	12/9/2010	100.0	0.0	100.0	0
PE-2nd Results & Accnt.(REACT)DPL/DDO	Social Protection & Labor	4/9/2009	330.0	20.0	310.0	6
PE DDO First Prog. Environ DPL	Environment & Natural Resources	2/17/2009	330.0	20.0	310.0	6
Total	**20**		**1,722.1**	**195.8**	**1,526.3**	**11**

Source: BI as of March 30th, 2015

International Financial Corporation Portfolio

As of April 10, 2015

(In millions of U.S. dollars)

Commitment Fiscal Year	Institution Short Name	LN Cmtd - IFC	LN Repayment - IFC	ET Cmtd - IFC	QL + QE Cmtd - IFC	GT Cmtd - IFC	RM Cmtd - IFC	ALL Cmtd - IFC	ALL Cmtd - Part	LN Out - IFC	ET Out - IFC	QL + QE Out - IFC	GT Out - IFC	RM Out - IFC	ALL Out - IFC	ALL Out - Part
2013/ 2015	APMTC	57.52	0	0	0	0	7.21	64.73	209.48	42.44	0	0	0	2.05	44.49	154.56
2011	Arequipa Region	0	0	0	0	0.88	0	0.88	0	0	0	0	0.88	0	0.88	0.00
2007/ 2008/ 2011/ 2013	B.Continental	100.46	62.54	0	0	0	0	100.46	0	100.46	0	0	0	0	100.46	0.00
2007/ 2008/ 2009/ 2010	BPZ	0	2.50	0.29	0	0	0	0.29	0	0	0.29	0	0	0	0.29	0.00
	BPZR	0	0	0	9.94	0	0	9.94	0	0	0	9.94	0	0	9.94	0.00
2007/ 2009/ 2010/ 2011/ 2012/ 2013/ 2014	BanBif	18.33	11.67	46.46	18.00	0	0	82.79	0	18.33	46.46	18.00	0	0	82.79	0.00
2015	Banco Financiero	0	0	0	0	10.22	0	10.22	0	0	0	0	10.22	0	10.22	0.00
2004/ 2007/ 2009	Cartones America	0	0	0	0	0	0.20	0.20	0	0	0	0	0	0	0	0.00
2012/ 2015	Compartamos Peru	15.85	3.75	0	0	0	0	15.85	0	7.85	0	0	0	0	7.85	0.00
2004/ 2005/ 2008/ 2014	EDYFICAR	36.20	3.00	0	0	0	0	36.20	0	36.20	0	0	0	0	36.20	0.00
2010	Enfoca	0	0	10.63	0	0	0	10.63	0	0	9.94	0	0	0	9.94	0.00
2009/ 2011/ 2014	F. Confianza	16.16	9.07	12.00	0	0	0	28.16	0	16.16	11.98	0	0	0	28.14	0.00
2015	HMC Capital	0	0	10.50	0	0	0	10.50	0	0	0	0	0	0	0	0.00
2002/ 2003	ISA Peru, SA	0	11.82	0	0	0	0.08	0.08	0	0	0	0	0	0	0	0.00
2012	La Positiva Vida	0	0	9.43	0	0	0	9.43	0	0	9.43	0	0	0	9.43	0.00
2000/ 2007	Laredo	7.54	20.46	0	0	0	0.77	8.31	0	7.54	0	0	0	0.27	7.81	0.00
2007	Lima JCIAirport	0	0	16.76	0	0	0	16.76	0	0	13.41	0	0	0	13.41	0.00
2002/ 2006/ 2007/ 2008/ 2012	MIBANCOPERU	10.48	37.15	0	7.00	0	0	17.48	0.00	10.48	0	7.00	0	0	17.48	0.00
2014	PEIP	0	0	22.65	0	0	0	22.65	0	0	3.59	0	0	0	3.59	0.00
2007/ 2009/ 2010/ 2011	PHMC	0	0	0	0	0.08	0	0.08	0	0	0	0	0.08	0	0.08	0.00
2008	Peru LNG	240.40	59.60	0	0	0	0	240.40	0	240.40	0	0	0	0	240.40	0.00
2009/ 2010/ 2011/ 2012/ 2014	Protecta	0	0	2.74	0	0	0	2.74	0	0	2.74	0	0	0	2.74	0.00
2001/ 2012	UPC	33.10	3.09	0	0	0	0	33.10	0	28.04	0	0	0	0	28.04	0.00
1994/ 1995/ 2000	Yanacocha	0	12.00	0.33	0	0	0	0.33	0	0	0.33	0	0	0	0.33	0.00
Total Portfolio		**536.05**	**236.63**	**131.79**	**34.94**	**11.18**	**8.26**	**722.22**	**209.48**	**507.91**	**98.18**	**34.94**	**11.18**	**2.32**	**654.53**	**154.56**

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

A. Country Strategy

Peru's current Country Strategy covers the period 2012–16. The strategy has two pillars for the Bank's assistance to the Peruvian authorities by supporting (i) their efforts to close economic and social gaps that still persist between urban and rural areas; and (ii) productivity gains as the main basis for inclusive, and sustainable economic growth.

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

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

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

B. Lending

As of February 2015, the Bank's portfolio of active, public sector operations consisted of 21 loans for a total amount of US$890.9 million, of which US$221 million (25 percent) had been disbursed. The public sector lending program for 2014 comprised seven operations for a total of US$445 million, which includes the financing the Lima Metro Subway for US$300 million. The public sector lending program for 2015 comprises two policy-based loans for US$600 million and three investment loans for US$100 million.

Regarding private sector operations, the Structured Corporate Finance Department's (SCF) portfolio in execution consists of eight operations amounting to US$598.3 million mainly in infrastructure, the IIC portfolio comprises 19 operations for US$120.1 million, primarily in manufacture and financial services, and the Opportunities for the Majority (OMJ) department portfolio consists of four operations amounting US$19.1 million, in housing and education sectors. As of December 2014 disbursements for SCF & OMJ total have been US$113.2 million.

Private sector lending for 2015 includes one SCF project for US$57 million in agriculture sector, one OMJ operation for US$8 million in financial markets, nine MIF projects for US$7 million, and seven IIC operations for US$47 million.

Peru: IDB SG Loan Portfolio by Sector (Sovereign Guarantee)
As of February 2014
(In millions of U.S. dollars)

Sector	Commitments	Disbursements	% Disbursed
Agriculture	95.0	0	0
Science, Technology and Competitiveness	40	19.8	49
Social Investment	46.0	24.5	53
Modernization of the State	111.0	28.5	26
Water and Sanitation	125.0	19.8	16
Transportation	473.9	128.4	62
Total	890.9	221	25

STATISTICAL ISSUES

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

Despite progress in recent years, there is scope for improvement in the following areas:
(i) coordination among the agencies that compile official statistics to avoid duplication of efforts;
(ii) expanding the coverage of the wholesale price index to include mining, oil and gas extraction, electricity and water, public transportation, and communication; (iii) 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 corporation's; and (iv) expanding the scope of data sources for compiling financial flows of individual residents.

National accounts. In 2014, the National Statistics Office (INEI) released a new national account series implementing the 1993 SNA and using 2007 as the base year.

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 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 March 31, 2015)

	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	03/30/15	03/31/15	D	M	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/31/14	03/09/15	D	M	W		
Reserve/Base Money	12/31/14	03/09/15	W	M	W		
Broad Money	12/31/14	03/09/15	W	M	W		
Central Bank Balance Sheet	12/31/14	03/09/15	W	M	W		
Consolidated Balance Sheet of the Banking System	12/31/14	03/09/15	W	M	W	O, LO, LO, LO	O, O, O, O, O
Interest Rates[2]	12/31/14	03/09/15	D	M	D		
Consumer Price Index	03/30/15	04/01/15	M	M	M	O, LO, LO, LO	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – CG and GG[4]	Q4 2014	03/12/15	Q	Q	Q	O, LO, O, O	O, O, O, LO, O
Stocks of CG Debt[5]	Q4 2014	03/12/15	Q	Q	Q		
International Investment Position[6]	Q4 2014	02/20/15	Q	Q	Q		
External Current Account Balance	Q4 2014	02/20/15	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	Q4 2014	02/20/15	M	M	M		
GDP/GNP	Q4 2014	3/05/15	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	Q4 2014	02/20/15	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] Central government (CG) and General government (GG) revenue and expenditure data are available monthly; and the composition of financing are available quarterly. Financing comprises of foreign, domestic bank, and domestic nonbank financing.

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

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

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

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

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

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

TECHNICAL ASSISTANCE IN 2013–14

Department	Purpose
FAD	Treasury management
	Macro-fiscal framework and fiscal rules
	Tax policy and administration
	General Tax Policy
MCM	Payment systems
	Capital market regulation
	Developing fixed income swap markets
	Risk based supervision of securities markets
STA	Government finance statistics

Statement by the IMF Staff Representative on Peru
May 20, 2015

1. **This statement provides additional information that has become available since the staff report was issued. It does not alter the thrust of the staff appraisal**.

2. Headline economic indicators remain broadly consistent with the baseline scenario in the staff report.

- Advance estimates suggest activity in primary sectors started to pick up in March, with mining up 8.7 percent (y/y) and fishing up 17.7 percent (y/y). The rebound in mining follows scheduled production plan increases, while the uptick in fishing relates to the previously announced start of the fishing season. Leading indicators also suggest an improvement in April, with production of electricity up 5.8 percent (y/y), the highest rate in over a year.

- On the fiscal front, regional public investment grew 31.5 percent (y/y) in April, the highest rate since February 2014.

- Headline inflation fell slightly to 2.98 percent (y/y) in April, back within the central bank's target range. Inflation excluding food and fuel was 2.6 percent (y/y).

3. The authorities have taken additional steps to stimulate growth broadly in line with staff's recommendations.

- Import tariffs for a group of key agricultural products were reduced to better align international and domestic prices. If these reductions are passed onto the consumer, they could help ease inflationary pressures and support economic activity.

- A recently approved law facilitates budget reallocations and transfers to accelerate the execution of the 2015 budget; and a decree enables the issuance of sovereign bonds (for about 0.2 percent of GDP) to finance 174 investment projects.

- A draft law submitted to congress will extend some existing measures until end-2015, including: (i) the suspension of pension and social security tax payments on holiday bonuses; (ii) the flexible use of excess funds in unemployment insurance accounts; and (iii) monthly updates of oil price stabilization bands.

4. The central bank approved new measures to increase liquidity in local currency, promote de-dollarization, and smooth FX excess volatility. To provide liquidity in local currency at fixed rates and longer maturities, the central bank will implement a new repo operation with banks' loan portfolios and auction public sector deposits at the central bank. The increased liquidity will help reduce the periodic spikes in local currency interbank

interest rates. To further encourage de-dollarization, the central bank also instituted an additional reserve requirement on dollar deposits for institutions that do not meet certain de-dollarization targets compared to December 2014. Finally, an additional reserve requirement on FX derivatives aims to moderate excess volatility in the FX market.

Statement by Oscar Hendrick , Alternative Executive Director for Peru
May 20, 2014

Key Points

- Peru remains one of the best performing economies in Lain America, maintaining a sustained period of economic growth, low inflation, and poverty reduction for more than a decade.
- Economic growth averaged 6.2 percent in the 2003-13 period, and after a temporary decline in 2014, due mainly to exogenous shocks, growth is expected to recover to around 4 percent in 2015 and to reach growth rates above full potential of about 5.0 percent over the medium term in order to close output gap. It is worth noting that high frequency indicators in March-April 2015 already show a turning point, and suggest that economic activity in primary sectors started to accelerate.
- Inflation expectations remain well anchored, and headline inflation in 2015 and beyond is expected to fluctuate around the mid-point of the inflation targeting range of 1-3 percent.
- The external and fiscal positions are very strong, with net international reserves equivalent to 30 percent of GDP. Fiscal savings, equivalent to 15 percent of GDP, accumulated during the peak of the economic cycle, provide a substantial buffer for future shocks and countercyclical policies. Unemployment rate is at historical low level of 5.9 percent by end-2014. 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.
- These outstanding achievements reflect the authorities' sustained commitment, during more than two decades, to sound macroeconomic policies and structural reforms; accompanied by social policies to ensure that the benefits of growth reach all segments of the society. The reduction in poverty rate from near 59 percent in 2004 to 23 percent in 2014, and the decline in the Gini coefficient to 44 percent by 2014, illustrates the progress in social and financial inclusion.
- The main challenges ahead are how to sustain the economic recovery in the near term, and how to boost potential growth in the medium-term, given the uncertainty of economic growth among Peru's main trading partners (U.S., China, Latam), and the evolution of commodity prices.
- Authorities have designed a policy framework, based on three axis, to boost potential growth: i) building up human capital and reducing informality; ii) boosting investment to reduce the infrastructure gap; and, iii) reducing red tape and lowering cost overruns. This policy framework would be critical to provide better quality of labor force to the growth momentum, while reinforcing the process of the improvement in the standard of living of the population. In that sense, it is worth noting that, according to Moody´s, the Peruvian economy, along with Mexico and Chile, is the only one that shows continued momentum to adopt "second generation" reforms in order to improve long term growth.

INTRODUCTION

1. **The staff has provided a well-balanced description and analysis of recent economic developments and policy discussions.**[1] My authorities are in broad agreement with the staff's assessment and policy recommendations. We are also grateful for the in-depth analysis provided in the companion Selected Issues Paper, focusing on the current important topics of growth and investment dynamics, challenges in taxation, and the analysis of the Peruvian sol as a possible commodity currency. We appreciate the focus on the consultation on how to consolidate economic recovery and financial stability, while unlocking potential growth over the medium-term.

2. **Peru enjoys a favorable business climate and continues to attract foreign direct investment (FDI), reinforcing the solid conditions for sustained economic growth.** In percentage of GDP, Peru leads FDI in Latin America, followed by Chile, Brazil, Colombia, and Mexico. As explained in the staff report and in the Selected Issues chapter on Investment Dynamics in Peru, key structural reforms beginning in the 90s set the stage for the investment and growth boom during the last decade. According to the latest Doing Business report, in 2014, Peru was among the top 35 economies (out of 189) that improved business climate in the world, above Mexico and Chile. My authorities are mindful that with the end of the super commodity cycle, additional structural reforms are needed to maintain the growth momentum and enhance potential growth. The country risk premium continues well below the Latin American emerging markets, reflecting the strength and resilience of the Peruvian economy. For instance, Peru improved its credit rating even in periods of strong volatility in emerging markets (S&P: August 2013; Fitch: October 2013; Moody´s: July 2014). Moody's rated Peru A3, while S&P and Fitch rated Peru BBB+.

LatAm: Sovereigns Rating[1]

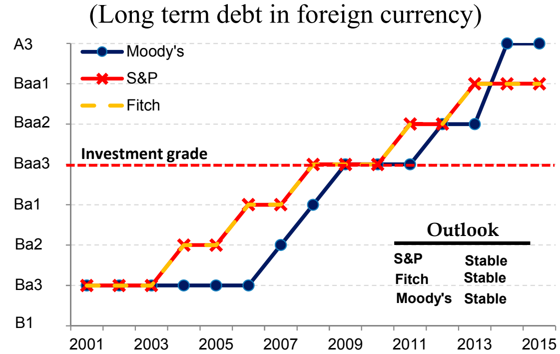
(Long term debt in foreign currency)

Country	Moody's	S&P	Fitch
Chile	Aa3	AA-	A+
Peru	A3	BBB+	BBB+
Mexico	A3	BBB+	BBB+
Colombia	Baa2	BBB	BBB
Panama	Baa2	BBB	BBB
Brazil	Baa2	BBB-	BBB
Uruguay	Baa2	BBB-	BBB-
Paraguay	Ba1	BB	BB
Bolivia	Ba3	BB	BB-
Ecuador	B3	B+	B
Venezuela	Caa3	CCC	CCC

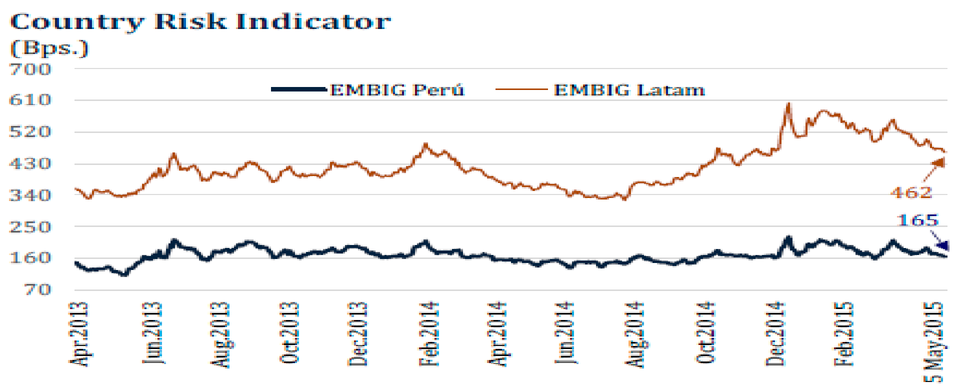
1/ Sorted by Moody's rating
Source: S&P, Fitch, Moody's.

Peru: Sovereign rating evolution

(Long term debt in foreign currency)



[1] IMF, Staff Report, SM/15/103



		Variation in basis points		
	5 May.15	Weekly	Monthly	Annual
EMBIG Perú (bps)	165	-5	-4	13
EMBIG Latam (bps)	462	-11	-10	96

3. **The resilience of the Peruvian economy is not only rooted in its strong economic fundamentals, but also in the ability of the institutional framework to operate under conditions of strain.** It is worth underscoring that the impressive economic growth of an annual average of 6.2 percent during the period 2003-13, accompanied by the lowest inflation in the region of 2.9 percent during the same period, took place during three different administrations. In each of the Presidential elections there were different degrees of uncertainty related to the orientation of economic policies and the investment climate. Yet, uncertainty was short lived and investors maintained their confidence in the business climate and the institutional framework in place. In this context, we do not see the forthcoming 2016 elections as particularly worrisome in terms of affecting long-term investment decisions. We believe that any delay in new investment would be only temporary and the strong dynamics of investment and growth will continue with renovated strength in 2016. Moreover, after more than 20 years of sustained growth and low inflation, the society has learned to appreciate the value of economic stability and improvements in the standards of living, and this would be very difficult to change dramatically by any future administration. This may be perhaps the best guarantee for continued success in the implementation of sound economic policies.

4. **Peru continues to make improvements with its socially inclusive growth strategy, expanding access to financial and social services.** The reduction in poverty rate from near 59 percent in 2004 to 23 percent in 2014, and the decline in the Gini coefficient to 44 percent by 2014, illustrates the progress in social and financial inclusion. Unemployment rate maintains a historical low level of 5.9 percent by end-2014. The substantial expansion of the middle class (about one third of the population) had important and positive impact on domestic demand, which has been very helpful to partially compensate for the lower external demand. The authorities are working hard to make progress on education reform and financial inclusion, while enhancing the quantity and quality of the social programs, which currently cover over 5 million people, more than half focused on children and the elderly.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

5. **After a temporary setback in 2014, economic growth is expected to recover in 2015 supported by countercyclical policies and the recovery of the primary sectors.** Real GDP grew 2.4 percent in 2014, from 5.8 a year earlier. About half of the decline is explained by temporary supply shocks in fishing, mining, agriculture; and a more than expected drop in sub-national public investment that more than offset the strong fiscal stimulus from the Central Government (national public investment grew 17 percent). The lower than expected growth in China (Peru's main trading partner), and the additional reduction in metal prices also contributed to a deceleration in economic activity. Against a widening negative output gap and stable inflation expectations, the authorities took timely fiscal and monetary countercyclical policy measures in 2014 and early 2015 to support domestic demand. The authorities are confident that these measures and the unwinding of temporary supply shocks will support economic recovery in 2015. Indeed, high-frequency indicators in April 2015 already show a turning point, and early indicators suggest that economic activity in primary sectors started to accelerate in March 2015. For instance, in March, GDP grew 2.7 percent, the highest record in the last 11 months. Furthermore, in April, electricity production grew 5.8 percent (y/y), the highest record in 13 months, and, according to BCRP, updated to 15th April, the credit in domestic currency grew 19.9 percent (y/y), the highest record in 9 months. On the fiscal side, in April 2015, the regional public investment grew 31.5 percemt, the highest record since February 2014.

6. **Headline inflation was slightly above the 3 percent upper limit of the target band at some moments in 2014, but inflation is expected to remain within the target band in 2015 and beyond. A r**ecent survey by the Central Bank shows that inflation expectations are well anchored within the band of 1-3 percent for 2015 and the following years. Core inflation has remained within the inflation target band. Headline inflation fell in April 2015 to 3.02 percent (y/y), close to the central bank's target range. The Central Bank has the credibility and the toolbox to maintain inflation expectations within the target band, while providing the stimulus that the economy may need during the transition period.

7. **Peru has a very strong external position and the real exchange rate is in line with fundamentals.** Net international reserves grew to US$ 61.5 billion by May 5, 2015, equivalent to 30 percent of GDP. As explained by the staff in Appendix II, *Peru: External Assessment*; net international reserves are adequate by any metric, including the IMF composite adequacy metric, and Peru's reserve adequacy is well above its regional peers. Our authorities feel comfortable with this policy, which proved to be very effective in dealing with the capital outflows during the peak of the crisis in 2008-09, and it is considered a source of strength by rating agencies, investment banks, and corporations interested in doing business in Peru. We agree with the staff's assessment that the real exchange rate is in line with fundamentals. The authorities will continue to employ FX interventions and macro-prudential measures to contain excessive exchange rate volatility and avoid disorderly market conditions.

8. **The Fiscal position remained strong in 2014 with an overall public sector deficit of 0.3 percent, despite the negative impact in tax revenues due to the lower commodity prices and the expansionary fiscal policy from the Central Government.** As shown in table 2 of the staff report, the NFPS balance has been a surplus of an annual average of 1.7 percent of GDP during the 2011-13. Strong fiscal buffers coupled with a net public debt of only 5 percent of GDP, the lowest among emerging markets and industrialized countries; provide the authorities with a lot of room to maneuver in order to implement countercyclical policies when needed. Yet, the authorities are aware of the challenges ahead in terms of withdrawing the transitory fiscal stimulus and keeping the level of fiscal buffers, while increasing revenues as percentage of GDP in line with peer countries. This is clearly explained in the taxation chapter of the selected issues paper, as well as the government efforts to continue making improvements in tax administration through widening the tax base, streamlining exemptions, promoting formalization, boosting collection of local property taxes, and reviewing excise taxes to address negative externalities; while increasing the efficiency of public expenditure. In the last two weeks, the Ministry of Finance has taken additional actions to further stimulate domestic demand in 2015. A bill was submitted to Congress in April 2015 with several policies aimed at providing additional disposable income to the population,. Also, the Congress has already approved a law in order to accelerate the execution of 2015 budget through some budgetary reallocations and transfers, and a Supreme Decree was approved in order to issue bonds to finance important public investment projects. It is worth mentioning that the authorities also indicated that the Fiscal Council will be established in 2015 as a sign of commitment with the new fiscal framework.

POLICY ISSUES AND OBJECTIVES GOING FORWARD

9. **We share the staff's assessment that Peru is in a strong position to respond to shocks, should the downside risks to the outlook dominate.** The Peruvian financial system is very resilient to changes in output growth, exchange rate movements, volatility induced by the liftoff in the U.S. interest rates, and other factors. Severe stress tests scenarios suggest that the system as a whole can manage very large shocks. The "acid test" took place during the 2008-09 global financial crises. The Peruvian economy had positive growth and had a strong rebound in the following year. We do not see the 2016 Presidential elections as a relevant domestic risk. Stronger than expected El Niño weather phenomenon and continuing social tensions in mining regions could be important downside risks. Yet, the authorities are confident the ongoing infrastructure projects and more in the pipeline to be finance under private public partnership schemes would create the basis for additional private investment and increasing growth potential.

10. **The Peruvian authorities value the staff's policy advice and the helpful technical assistance in a range of key issues including the design of the new Fiscal Rule.** As explained in Appendix III of the staff report, important changes were introduced to improve the old fiscal rules. The new methodology based on ex ante structural fiscal balance provides three years expenditure ceilings for the budget formulation. The authorities are

assessing the staff's suggestions to use conservative targets to preserve the hard won fiscal buffers. The temporary deviation from the fiscal rule has been done under escape clauses considered in the new Fiscal Rule , and a gradual consolidation will take place beginning in 2016.

11. **There is continued gradual progress to further reduce dollarization in Peru, including a new set of measures introduced by the Central Bank in December 2014 .** Despite a successful inflation targeting framework, and having one of the lowest inflation in the region and in the world for more than a decade (less than 3 percent annual average), by end 2014 38 percent of credit and 43 percent of deposits were still denominated in U.S. dollars; down from about 80 percent of credits and deposits by the end of the 1990s. There are idiosyncratic factors associated with previous hyperinflation (i.e. 7,650 percent in 1990) that partially explain this apparent inconsistent behavior by market participants. To help accelerate the de-dollarization process and reduce the currency mismatch risk to balance sheets of households or corporate, the central bank has issued new repos in domestic currency to support the expansion of credit in nuevo soles and to substitute foreign currency loans with local currency loans. The monetary authority also increased the marginal reserve requirement on foreign currency deposits by 10 percentage points twice to 70 percent, effective in January and March 2015. The authorities are aware that deepening financial and capital markets could also be an effective way to achieve lasting de-dollarization. In fact, several missions from the Capital and Monetary Market Department have provided technical assistance in related issues, but this is a gradual process and it will take time to develop.

12. **The authorities agree with the staff's assessment that Peru's macro-financial system is stable, with no signs of imminent systemic risks.** As discussed above, high dollarization of financial assets and liabilities remain a key structural risk, but as recognized by the staff, risks are contained due to large buffers by the financial system. The regulatory and supervisory banking authority has built safeguard mechanisms by putting in place regulatory requirements above international standards. It is worth to underscore that banks' direct exposure to the commodity sector is relatively low, with only about 10 percent of banks' credit going to the agriculture and mining sectors. The 2010 FSAP second update found that the regulation, supervision, and safety net of the banking system are of high quality and well developed. Moreover, according to the FSAP report, Peru's legal framework for bank resolution is in line with best practices.

13. **Looking ahead, how will Peru keep sustained economic growth and further reduce poverty in order to transition from an emerging market to a more advanced economy?** We need to continue creating the right conditions for private investments to lead economic expansion, while strengthening regulatory agencies to protect the public interest and the general public. Peru has made great progress in many areas including civil service, infrastructure, education, health, protection to private property, capital market, etc. However, much remains to be done and new generations of structural reforms are being implemented, as it is currently done in several areas such as: i) strengthening the human capital and reducing informality (higher public resources allocated to Education and Health sectors, civil service reform, Competitiveness Agenda 2014-2018, Productive Diversification Plan, etc.),

ii) boosting the investment to reduce the infrastructure gap through a higher use of PPP schemes, and iii) reducing “red tape” and lowering cost overruns. My authorities are working in all fronts, including the planned incorporation to the OECD, which could provide the motivation and the adequate political economy framework, to make progress with the authorities’ strategy to consolidate sustained and inclusive growth, low inflation, and the modernization of the country. This will take additional time, but we need to remind ourselves that it has taken 25 years of continued implementation of sound economic policies to reach this point.