February 2006
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Peru: Third Review Under the Stand-By Arrangement and Request for Establishment of Performance Criteria and Waiver of Applicability—Staff Report; and Press Release on the Executive Board Consideration

In the context of the third review under the Stand-By Arrangement and request for establishment of performance criteria and a waiver of applicability, the following documents have been released and are included in this package:

- the staff report for the Third Review Under the Stand-By Arrangement and Request for Establishment of Performance Criteria and Waiver of Applicability, prepared by a staff team of the IMF, following discussions that ended on October 14, 2005, 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 December 22, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the view of the Executive Board as expressed during its consideration of the staff report that completed the review and request.

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

Letter of Intent sent to the IMF by the authorities of Peru*
Memorandum of Economic and Financial Policies by the authorities of Peru*
Technical Memorandum of Understanding by the authorities of Peru*
*May also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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PERU

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

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

Approved by José Fajgenbaum and Juha Kähkönen

December 22, 2005

Discussions. Discussions for the third review under the Stand-By Arrangement were held in Lima during October 5–14, 2005. The staff team met with President of the Council of Ministers Pedro Pablo Kuczynski; Economy and Finance Minister Fernando Zavala; Acting Central Bank President Oscar Dancourt; other senior officials; private sector representatives; and the economic teams of the main presidential candidates. The staff team comprised G. Terrier (Head); A. López-Mejía; E. Jenkner (all WHD); M. García-Escribano (FAD); and K. Alexandraki (PDR). J. Guzmán (outgoing Senior Resident Representative) assisted the mission. Mr. Silva-Ruete, Alternate Executive Director, participated in the policy discussions.

Program. A 26-month Stand-By Arrangement in the amount of SDR 287.279 million (21 percent of quota on an annual basis) was approved by the Executive Board on June 9, 2004. The second review was completed on June 8, 2005. The authorities are treating the arrangement as precautionary and, with the completion of this review, a total of SDR 204.367 million would be available for drawing.

Review. The review focused on the implementation of macroeconomic policies and reforms under the 2005 program and on setting the policy targets for the first semester of 2006. In their Letter of Intent dated December 20, 2005, the authorities describe their economic program for 2006, for which quantitative performance criteria have been established through end-June. The structural reform program focuses on further strengthening the Private-Public-Partnership process, enhancing public financial management, reducing the risks associated with dollarization, and improving the business environment.

Relations with the Fund. Peru's outstanding Fund credit is SDR 40.1 million (6.3 percent of quota). The last Article IV consultation was concluded on February 23, 2004. Peru has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. Its economic statistics are adequate for surveillance and policy formulation.

Staff reports. The authorities have not agreed to publish the last two staff reports and, at this stage, have not indicated if they will consent to the publication of this report.

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EXECUTIVE SUMMARY

Background

- ***The Peruvian economy continues to perform well.*** Real GDP is expected to grow by close to 6 percent in 2005, inflation is low, achievement of the fiscal targets is well within reach, and the external position remains strong.
- ***Progress has been made in structural reforms.*** Fiscal transparency has been increased, including by establishing a reporting system of public sector liabilities associated with Private-Public-Partnership (PPP) operations. In addition, two major highways that had met the National Public Investment System viability assessment were awarded in concession, and the Superintendency of Banks has issued inspection guidelines strengthening the implementation of norms on foreign currency-induced credit risks (end-September 2005 structural performance criteria).
- ***Greater reliance on domestic natural gas production and fuel tax reductions have helped shelter Peru from higher oil prices.*** Reflecting the coming on stream of the Camisea gas project in mid-2004, net oil imports are expected to fall by ⅓ percent of GDP in 2005. The authorities have been reducing the excise tax on refined petroleum products on several occasions since mid-2004, at a total fiscal cost of ⅓ percent of GDP on an annual basis.
- ***With the approach of the presidential elections, political uncertainty has increased.*** The new cabinet, under the leadership of Mr. Kuczynski is expected to help ensure an orderly transition through end-July 2006, when a new administration is scheduled to take office.

Policy discussions and staff appraisal

- ***Preserving macroeconomic stability is at the core of the authorities' policies.*** The 2006 budget is consistent with an overall deficit of the combined public sector of 1 percent of GDP. The central bank remains committed to its inflation targeting framework.
- ***The authorities have reaffirmed their commitment to structural reforms.*** In 2006, their reform program will focus on further strengthening the institutional and legal framework for PPPs, enhancing public financial management, reducing the risks associated with financial dollarization, and improving the business environment.
- ***The medium term outlook is favorable.*** Assuming sound macroeconomic policies, continued progress in structural reform, and a positive external environment, economic growth is forecast at 4¾ percent a year in 2006–07.
- ***The political and social situation continues to be the main risk to the program.*** Although the government has so far preserved a consensus for prudent policies and reform, some volatility has recently developed in the stock and foreign exchange markets as the election campaign is gaining momentum.

I. Introduction

1. ***Peru has performed well under the current 26-month Stand-By Arrangement, which covers the period through August 2006.*** When completing the second review in June 2005, Directors observed that the successful implementation of the authorities' program had contributed to strong and broad-based growth and low inflation and reinforced confidence in the continuity of prudent economic policies, and that it should help set the stage for Peru's exit from Fund financial support.

2. ***In the attached Letter of Intent, the authorities specify their economic policies for the first semester of 2006.*** They reaffirm their commitment to preserving macroeconomic stability, fostering robust growth, and further reducing financial vulnerabilities. With the first round of presidential elections scheduled for April 9, 2006, the authorities view the Fund-supported program as an instrument to help maintain consensus on sound economic policies throughout the election period. Given that the window of opportunity for enacting key legislative initiatives is expected to be narrow until a new administration takes office at end-July 2006, the structural reform program focuses mainly on actions not requiring congressional approval.

II. Recent Economic developments

3. ***Economic performance in 2005 has been strong.*** Real GDP grew by close to 6 percent in the first three quarters of 2005, driven by a robust performance in investment and exports. Private consumption has also picked up, reflecting well-grounded consumer confidence, higher disposable income partly associated with favorable terms of trade, and growing urban employment. Inflationary pressures have declined, with 12-month inflation at 1.1 percent in November. The external current account registered a surplus of about 1 percent of GDP during January–September, compared with a small deficit a year earlier. Following several months with little nominal movement, the *Nuevo Sol* has depreciated by close to 6 percent against the U.S. dollar since end-July (Box 1).

4. ***Macroeconomic management has remained prudent.*** A supplementary budget was approved by congress in June, authorizing additional spending equivalent to

Figure 1. Contributions to Real GDP Growth

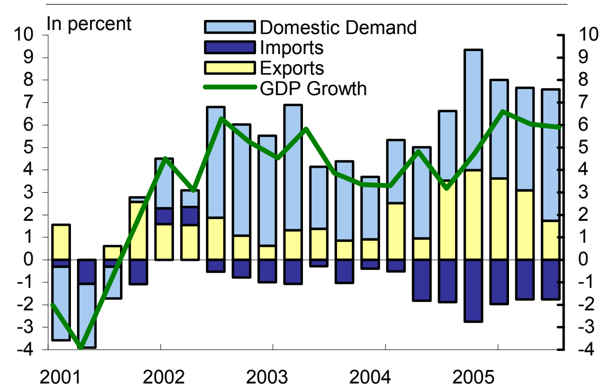
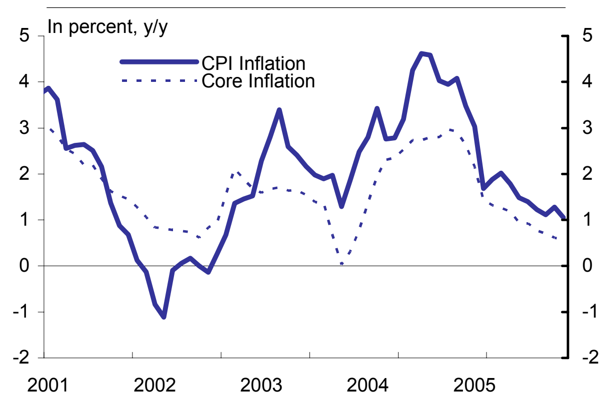


Figure 2. Inflation



Box 1. Peru: Recent Economic Developments

Real GDP grew by 5.8 percent in the first three quarters of 2005. Economic growth was broad-based and particularly strong in the agriculture, construction, manufacturing, and mining sectors.

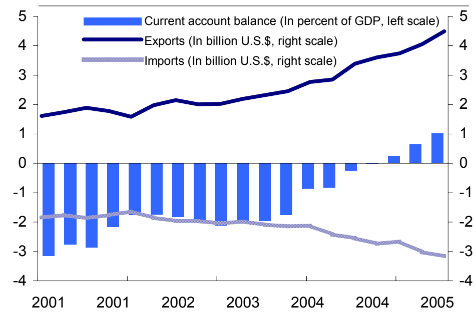
Inflation fell from 3.5 percent in December 2004 to 1.1 percent in November. This development partly reflected a nominal appreciation of the *Nuevo Sol* against the U.S. dollar in the second half of 2004 and the impact of a strong recovery in agricultural output on food prices.

Driven by an increase in exports in U.S. dollar terms, the external current account balance registered a surplus during January–September 2005. Export growth (37 percent) was led by volume and price increases of mineral products and a strong growth in non-traditional goods. Imports have also grown strongly (25 percent), particularly capital and intermediate good imports.

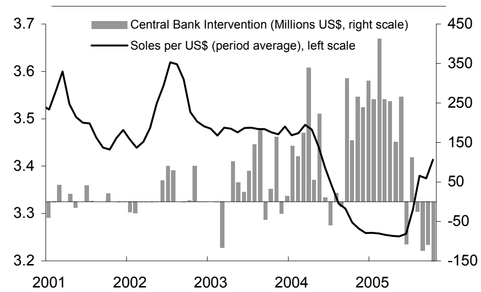
In recent months, the Nuevo Sol has been under depreciation pressures. After a long period of appreciation pressures, the *Nuevo Sol* began depreciating in August, due in part to a widening differential between domestic and U.S. dollar interest rates. More recently, the pressures have risen, reflecting an increase in political uncertainty associated with the forthcoming elections. The cumulative depreciation from end-July to mid-December was close to 6 percent, nearly reversing the earlier appreciation.

The level of net official international reserves is comfortable. In mid-December 2005, net reserves amounted to US$14 billion, covering more than 270 percent of maturing short-term external debt and over a year of merchandise imports. Net international reserves have increased by US$1.4 billion since end-2004, largely reflecting central bank foreign exchange purchases during the first half of 2005.

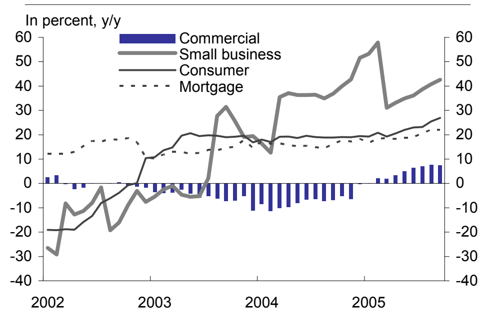
Current Account



Exchange Rate and Net Intervention in the Foreign Exchange Market



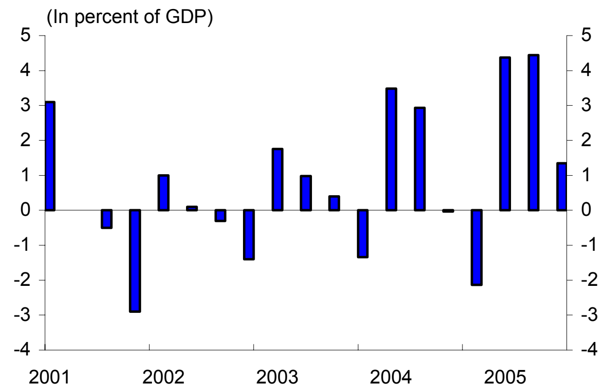
Bank Credit to the Private Sector



Bank balance sheets have continued to improve, and credit growth has been strong. The growth in bank credit for housing, consumption, and small enterprises has remained well-oriented, and commercial loans have picked up, despite increased borrowing in the domestic capital market by large corporations.

½ percent of annual GDP. However, during the first three quarters of 2005, the fiscal position was stronger than envisaged in the program as the combined public sector registered a surplus equivalent to 1.1 percent of annual GDP, compared with a programmed deficit of 0.1 percent of GDP. This development was due to higher-than-projected tax collections—reflecting stronger aggregate demand and corporate profits associated with high mineral export prices, lower interest payments, and delays in the execution of capital expenditure. In mid-August, the government prepaid US$1.6 billion to Paris Club creditors (Box 2). In the monetary area, the central bank raised its policy interest rate in early December by 25 basis points, to 3.25 percent (this rate had remained unchanged since October 2004).

Figure 3. Combined Public Sector Primary Balance



5. ***All end-June and end-September quantitative performance criteria were met, and all end-December quantitative performance criteria are expected to be met.*** Given that no information with respect to the end-December 2005 quantitative performance criteria has become available at the time of circulation of this report, it is recommended that a waiver of applicability be granted. Solid progress has been made in the implementation of the structural reforms under the program:

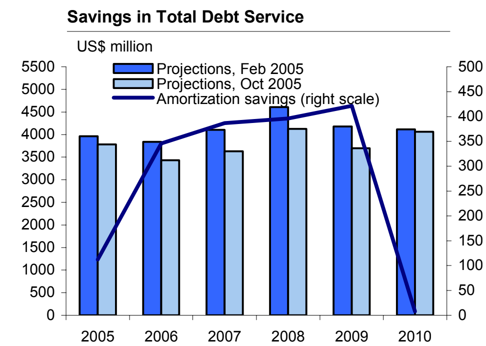
- ***General Law on Public Indebtedness.*** This law, approved in July (end-December benchmark), provides a permanent legal framework for transparent liability management, and specifies responsibilities for registering the financial commitments of the public sector. It also establishes an annual limit on the guarantees that can be granted or contracted by the national government with financial institutions in the context of Private-Public-Partnerships (PPPs).

- ***Public-Private Partnerships.*** Following the awarding in concession of a large regional integration highway in the Northern part of the country in early May, a second major highway (*Pucusana-Ica*) was awarded in concession in July (end-September structural performance criterion). The politically-motivated *InterOceánica* road project was also awarded in concession at end-June; this project, which was exempted by decree from the viability assessment of the National System of Public Investment (SNIP), is expected to entail government subsidies estimated at 0.1 percent of GDP a year over a protracted period of time.

- ***Fiscal transparency.*** The authorities have introduced a reporting system for public sector liabilities (including contingent liabilities) associated with PPPs and have issued a norm requiring the annual publication of such liabilities in the Multiyear Macro-economic Framework (end-September structural performance criterion). All liabilities associated with PPPs falling due over the next three years have already been published in the revised 2005 Multiyear Macro-economic Framework. Although the central government budget formulation module and the Integrated Financial Management System (SIAF) have not yet been unified (end-June benchmark) because of delays in preparing the software, such unification is now scheduled for January 2006.

Box 2. Peru: Public Debt Management Operations

The authorities are reinforcing medium-term sustainability through a sound public debt-management strategy. Taking advantage of favorable market conditions, several debt-management operations have been undertaken, aimed at reducing rollover risks as well as currency and interest rate exposure. These operations included US$1.6 billion in prepayments to Paris Club creditors, a US$832 million prepayment to the Japan Peru Oil Corporation (JAPECO) in early December, and US$1.7 billion in swap operations. As a result, the share of public debt in domestic currency has increased from 16 percent at end-2004 to 20 percent at end-September 2005.



Debt prepayments were aimed at shifting the debt composition toward longer-term instruments in domestic currency and providing cash flow relief. Four bonds were issued to finance the Paris Club pre-payment, including (i) a US$462 million 12-year domestic currency bond, with a coupon of 8.6 percent; (ii) a US$323 million 15-year domestic currency bond with a coupon of 7.84 percent; and (iii) a US$750 million 20 year U.S. dollar bond issued in the international market with a coupon of 7.35 percent. This operation provided cash flow relief of US$360 million a year in 2006–09 and generated NPV gains, stemming largely from the extension of maturities and the conversion of more than half of the debt into local currency obligations.

The JAPECO prepayment was financed in part by reopening two bond issues: (i) a 20-year international bond for US$500 million, with a coupon rate of 7.35 percent; and (ii) a 2020 domestic bond in *Nuevos Soles* for US$240 million, with a coupon rate of 7.84 percent.

- ***Decentralization.*** The implementing regulations of the Fiscal Decentralization Law were issued in early September (end-September benchmark). These regulations are expected to help promote a cautious and fiscally-sound decentralization process. The government's proposal to consolidate existing regional governments into large regions was rejected in a referendum in October, likely leading to a more gradual implementation of the decentralization process.

- ***Financial sector.*** A new methodology to price non-traded financial assets was published in August, to solicit comments from pension funds and the general public; reference prices are expected to be disseminated by end-2005 (end-July structural benchmark). In August, the government announced its plan to centralize the information on collateral registries (end-September benchmark), paving the way for enhanced access to bank credit.

- ***De-dollarization.*** In May, the Superintendency of Banks issued guidelines strengthening the implementation of norms on foreign currency-induced credit risks (end-September structural performance criterion). The authorities have also made good progress in developing a plan to encourage mortgage lending in domestic currency under the *MiVivienda* government program (end-December 2005 benchmark).

III. OUTLOOK AND THE PROGRAM FOR 2006

6. ***The program for 2006 aims at consolidating macroeconomic stability while strengthening policy credibility during the electoral period.*** Discussions on the program for 2006 took place against the backdrop of the forthcoming elections and renewed pressures to increase government spending. The authorities reaffirmed their commitment to continue implementing cautious monetary policies and to keep the overall deficit of the consolidated public sector at the equivalent of 1 percent of GDP in 2006. The projections assume a modest loss of reserves during the first half of 2006 (US$0.6 billion out of a stock of US$14 billion in mid-December) to take into account possible uncertainties associated with the elections. The structural reform program aims at fostering robust growth and further reducing financial vulnerabilities. The quantitative performance criteria and benchmarks for the 2006 program are attached to the Letter of Intent and the Memorandum of Economic and Financial Policies.

Table 1. Macroeconomic Framework

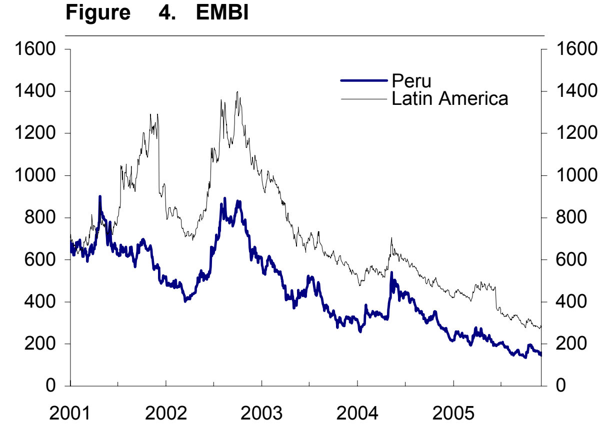
	2004		2005		Proj.
	Prog.	Proj.	Prog.	Proj.	2006
	(In percent of GDP, unless otherwise indicated)				
Real GDP growth (in percent)	4.0	4.8	4.5	5.8	5.0
Inflation (in percent, end of period)	2.5	3.5	2.3	1.5	2.5
External current account	-0.7	0.0	0.5	0.3	0.4
Public sector overall balance	-1.4	-1.1	-1.0	-0.7	-1.0
Public sector debt	44.6	45.1	42.2	39.1	37.2

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

A. Outlook and Risks

7. ***The Peruvian economy is expected to keep performing well in 2005 and 2006***. Under continued favorable global macroeconomic conditions, real GDP is projected to grow by close to 6 percent in 2005 and by 5 percent in 2006. Peru has remained relatively sheltered from higher world oil prices, owing to higher gas output from the Camisea field, which is also expected to help contain the hydrocarbon import bill (Box 3); consumers were also sheltered by excise tax reductions. In recent months, S&P and Fitch both raised Peru's sovereign credit rating outlook from stable to positive, and sovereign spreads remain among the lowest in the region, at about 200 basis points in late-December.

Figure 4. EMBI



8. ***Negotiations on a bilateral free trade agreement (FTA) with the United States were successfully concluded in early December.*** Since 2003, the United States has been granting preferential market access to Peruvian exports under the Andean Trade Preferences and Drug Eradication Act (ATPDEA). This has helped spur non-traditional export growth, particularly textiles and agricultural products and, at present, exports to the United States account for about one third of total Peruvian exports. The ATPDEA is due to expire at end-2006 and, thus, congressional approval of the FTA agreement will be key to making Peru's preferential

Box 3. Peru: The Impact of Higher Oil Prices

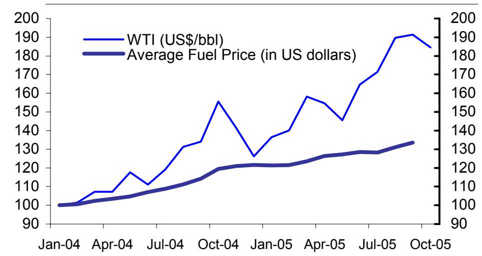
A net oil importer, Peru has been reducing its dependency on oil. Reflecting the coming on stream of the Camisea gas project in mid-2004, Peru's net oil imports are projected to fall from 1.5 percent of GDP in 2004 to 1.2 percent in 2005. As domestic demand continues to switch to natural gas, net oil imports are envisaged to fall further to 0.9 percent of GDP in 2006. The net energy balance would turn positive by 2009, if several liquefied gas export projects materialize.

The authorities have reduced excise taxes on petroleum products on several occasions since mid-2004, at a total annual fiscal cost of ⅓ percent of GDP. They have also increased to US$62 million the resources in the oil stabilization fund, which is aimed at limiting short-term price volatility. Although US$56 million had been already used by early-December, claims on the fund are likely to decline in the period ahead due to the recent fall in oil prices. At the retail level, the increase in fuel prices from December 2004 to September 2005 was thus limited to 10 percent on average, compared with a 52 percent rise in international oil prices.

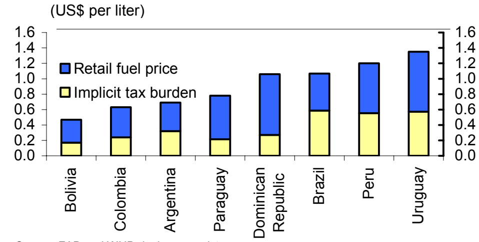
Nevertheless, prices of oil derivatives in Peru remain relatively high compared with other countries in the region. A regional comparison shows that Uruguay, Peru, and Brazil are among the countries with the highest prices in Latin America, reflecting a relatively high tax burden.

The government is actively promoting the use of domestic natural gas. At present, 95 percent of Camisea's output is used for electricity generation (accounting for 15 percent of electricity generation capacity). As gas is a relatively cheap source of thermal electricity generation, it has helped keep electricity tariffs low in recent months. Gas usage for transport, industry, and private residences has remained low, but is being promoted through subsidized connection costs and tax incentives. By October 2005, 49 energy-intensive companies had switched to natural gas, and the Ministry of Energy projects that natural gas could meet up to 15 percent of total demand for oil products by 2014.

Average Fuel Price Increase in Peru
(January 2004=100)

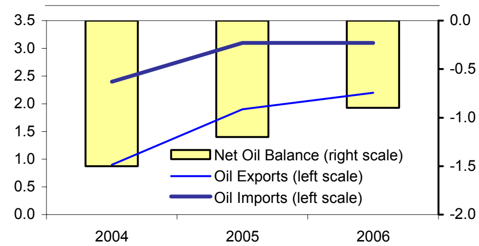


Gasoline Prices and Implicit Tax Burden in Regional Comparison, July 2005
(US$ per liter)



Source: FAD and WHD desk economists.

Net Oil Balance
(In percent of GDP)



status permanent. In particular, this would help maintain the competitiveness of Peruvian textile exports in the face of the competition from Asia.

9. ***Downside risks to the outlook stem mainly from existing global imbalances and a possible downturn in commodity prices.*** If global imbalances were to be corrected by abrupt adjustments in the exchange rates of major currencies or a sharp rise in interest rates, this

could lead to reduced global growth, smaller capital inflows, and higher debt-service payments. A sharp drop in Peru's terms of trade would adversely affect the fiscal accounts, in part through lower corporate tax payments, and could have a negative effect on the stock market, given that its rise over the last years has partly reflected higher commodity prices. Against these risks, Peru has built important buffers. Its level of official reserves is comfortable, and the banking system is well-capitalized. Reflecting a significant decline in the debt-to-GDP ratio, the debt sustainability analysis indicates that debt dynamics are relatively robust to possible shocks, but remain sensitive to exchange rate changes due to the large share of foreign-currency denominated public debt (Appendix I).

Figure 5. Lima General Stock Index (IGBVL)

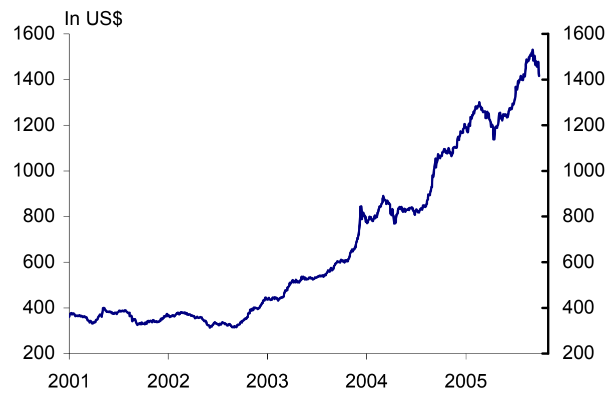
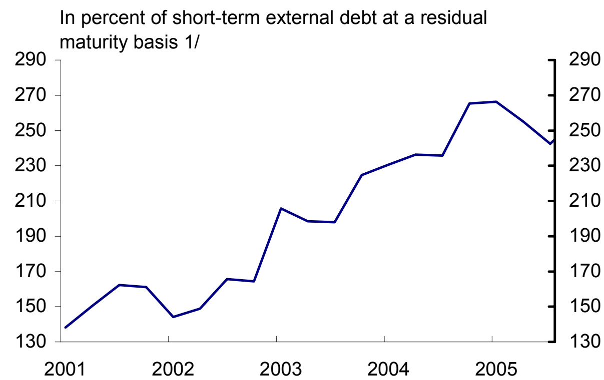


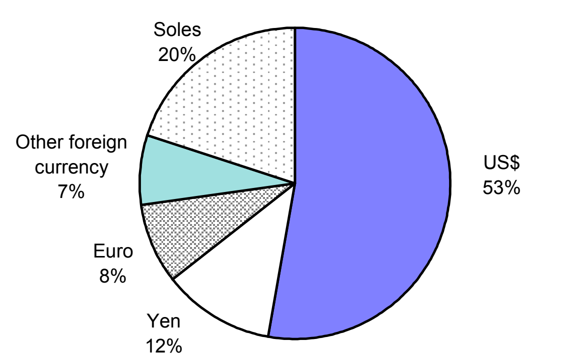
Figure 6. Gross International Reserves



1/ Does not include pre-payments made to the Paris Club in August of US$ 1.55 billion.

Figure 7. Total Public Debt by Currency

September, 2005



10. ***In the political area, the authorities' commitment to the program will continue to be tested in the run-up to the elections.*** The current cabinet is expected to help anchor sound economic policymaking, but challenges are likely to continue to mount from a society highly fragmented along economic, social, and ethnic lines. Pressure could mount to reverse some of the gains of recent years, and increases in government spending could threaten attainment of the overall deficit objectives in 2006 and subsequent years. With elections approaching, the political situation is becoming increasingly volatile. In recent weeks, a candidate with a populist message has risen considerably in the polls, leading to downward pressure on the currency, some increase in sovereign spreads, and volatility in the stock market.

11. ***The medium-term outlook is favorable, but challenges persist.*** Real GDP is projected to grow by 4½ percent a year over the medium term and inflation is expected to average 2½ percent—the mid-point of the authorities' target band. The main challenge ahead

will be to achieve high rates of economic growth over a sustained period of time while reducing poverty. To attain these objectives, there is a need to strengthen institutions, implement key growth-enhancing reforms, and consolidate macroeconomic stability. In this regard, the next government's ability to build a solid majority in congress will be essential to press ahead with institutional and growth-enhancing reforms. Particularly important in these efforts will be the government's ability to secure a consensus aimed at addressing the decline in tax revenue expected to be faced by the new government due to the elimination of temporary taxes at end-2006 and to the impact of trade arrangements. Increasing revenue will be essential to generating adequate resources necessary to meet critical social needs and support strengthened public investment. In addition, the fight against poverty will need to address gaps in poverty data, increase the share of pro-poor spending, and rationalize a myriad of existing social programs to improve targeting and efficiency.

B. Fiscal Policy

12. ***In 2005, the overall deficit of the combined public sector is likely to be somewhat lower than the programmed level of 1 percent of GDP.*** Central government revenue is expected to exceed program projections by ½ percent of GDP which, together with somewhat lower interest payments, would more than offset higher government spending.[1] Accordingly, the 2005 overall deficit of the combined public sector is estimated at about 0.7 percent of GDP. The primary spending of the general government is projected to rise by about 7 percent in real terms; while this increase is only slightly higher than real GDP growth, it is well above the 3 percent limit established in the Fiscal Responsibility and Transparency Law.

13. ***There was agreement that part of the revenue over performance has been driven by cyclical factors, largely associated with the improvement in Peru's terms of trade.*** The strong tax collections in 2005 reflect high mineral prices, strong economic activity, and one-off corporate income tax filing effects.[2] The mission stressed the medium-term risks for the fiscal position of increasing expenditure commitments in boom years, and recommended using part of the excess revenue to continue reducing the public debt burden. In this context, the authorities stressed their efforts to avoid boosting expenditure on a permanent basis, including by limiting and prioritizing spending demands. They noted that one-off payments and extra capital spending in 2005 were estimated at about 0.2 percent of GDP.

14. ***The 2006 budget, approved by congress in late November, is consistent with an overall deficit of the nonfinancial public sector of 1 percent of GDP, in line with the program.*** Achievement of this objective is expected to help reduce the public debt-to-GDP

[1] Lower interest payments reflect exchange rate movements, lower risk premia, and the government's prepayment to Paris Club creditors.

[2] The strong corporate income filing effect in 2005 reflects lags in 2004 taxes payments because advanced payments are based on past mineral prices.

ratio further. However, during the budget debate congress reversed an earlier decision and refused to approve a reduction in the rate of the tax on financial transactions (from 0.08 percent to 0.06 percent; as the tax is applied on bank debits and credits, the effective rate remains at 0.16 percent), as envisaged under the program. Revenue associated with this decision is relatively small (less than 0.1 percent of GDP) and will be used to increase expenditure. Staff urged the authorities to work closely with congress toward lowering the rate of the tax on financial transactions in coming months, particularly if, as expected, tax revenue turns out to be higher than assumed in budget projections. All the financing needs of the public sector in 2006 are expected to be met through multilateral disbursements and domestic financing, including with the placement of bonds in the domestic market. The authorities have indicated their intention to continue including collective action clauses in sovereign debt placements and to undertake further debt-management operations, as market conditions permit. Over the past year, sound policies and favorable market conditions have helped push yield curves downward (Figures 8 and 9).

Figure 8. Estimated Historic Yield Curves for Domestic Public Debt

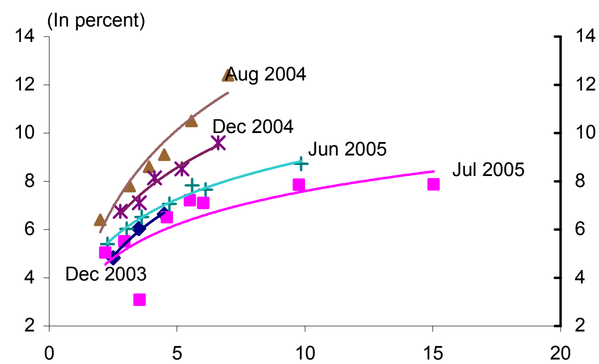
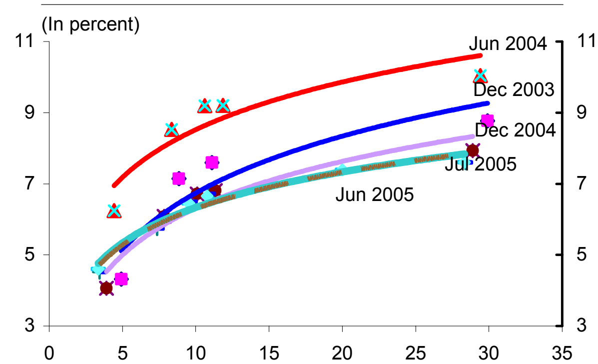


Figure 9. Estimated Historic Yield Curves for Dollar-Denominated External Debt



15. ***Achievement of the 2006 fiscal target will be a challenge.*** On the revenue side, collections are conservatively projected to decline slightly as a percentage of GDP, reflecting the one-off income tax filing effect that materialized in 2005 and recent cuts in fuel tax rates.[3] The authorities noted that they intended to avoid reducing excise taxes further or increasing the resources in the temporary oil stabilization fund. They also indicated their readiness to increase the specific excise tax on oil derivatives (thus partially reverting cuts implemented since mid-2004) to offset any revenue shortfall arising from the elimination of custom duties on fuel imports that is expected to become effective in January 2006 as a result of the ongoing Andean trade integration.[4]

[3] The one-off income filing effect will decline from 0.8 percent of GDP in 2005 to 0.6 percent of GDP in 2006—but will still be higher than that observed in 2004 (0.4 percent of GDP).

[4] Preliminary estimates indicate that full implementation of the Free Trade Agreement with the United Sates could lead to a decline in fiscal revenues of about 0.3 percent of GDP over time.

16. ***Faced with a need to tightly contain the increase in government spending in 2006, the authorities are making renewed efforts to limit and prioritize new demands.*** As in 2005, the budget includes the full-year effect of the wage increases already granted. However, there is a risk that the favorable 2005 context, in which buoyant tax collections provided the government with additional room for budgetary appropriations, may not be repeated in 2006. To protect against the risks of exceeding the fiscal deficit, the program incorporates prudent quarterly ceilings for the first half of 2006. These ceilings are consistent with an overall fiscal surplus in the first half of the year (0.8 percent of annual GDP) and are significantly more ambitious than the provisions in the FRTL for electoral years.[5] The authorities are also committed to implementing spending cuts while safeguarding targeted social programs, in the event of revenue shortfalls or expenditure overruns in some areas.

17. ***To improve further the framework for prudent fiscal management, the government plans to strengthen the procedures for compliance with the Fiscal Responsibility and Transparency Law (FRTL).*** A draft law has been prepared, strengthening quarterly reporting to the public on compliance with the FRTL and establishing a high level coordination committee of fiscal policy, with participation of the Minister of Economy and Finance. This committee would be responsible for assessing budget execution and ensuring compliance with the fiscal program and the FRTL. The draft law also imposes sanctions on the members of this committee for noncompliance and provides for the discontinuation of central government transfers to subnational governments in breach of the FRTL's rules.

Structural Fiscal Reforms

18. ***The authorities are committed to broadening the tax base and deepening tax administration reform efforts.*** In early July, a law was enacted removing tax exemptions in one region (*San Martín*), and the resources generated are to be used to increase infrastructure spending in that region. The authorities stressed their intention to continue to work with congress toward eliminating other tax exemptions, and concurred with staff that there was room to reduce evasion through further improvements in tax administration. Staff noted the need to address the issue of multiplicity of VAT treatments in the agricultural sector and to establish a minimum income tax after the tax on net assets phases out in 2006; the authorities agreed to study contingent measures to prevent a drop in revenues as a result of the elimination of this temporary tax. In line with the recommendations of recent Fund technical assistance, the authorities plan to review existing value added withholding schemes.[6] In addition, the tax collection agency SUNAT is refocusing its activities on improving audit

[5] The Fiscal Responsibility and Transparency Law seeks to prevent spending increases during election years by establishing that: (i) noninterest expenditure during the first seven months of the year cannot exceed 60 percent of total spending for the year; and (ii) the overall deficit during the first semester cannot exceed 40 percent of the deficit for the year.

[6] These schemes have been an effective tool to reduce tax evasion since their implementation in 2002, but may also complicate tax administration.

quality, tracking non-filers, streamlining audit procedures, introducing electronic invoicing, and combating customs undervaluation. The authorities agreed with the mission that it will be important to continue to avoid granting new tax amnesties, and they intended to seek a modification in the tax code, to enable SUNAT again to close temporarily the establishments that do not issue invoices.

19. ***The authorities are pressing ahead with the program of Private-Public-Partnerships (PPPs).***[7] They plan to award in concession to the private sector investment commitments of US$2½ billion in 2006, following close to US$2 billion in 2005. About 80 percent of these investments are in infrastructure, including highways, several roads connecting the coast with the highlands, regional airports, and a new terminal in Peru's largest port (Callao). The authorities intend to continue publishing public sector liabilities associated with PPPs in the Multiyear Macroeconomic Framework, including those associated with the *Olmos* water project—awarded in concession in mid-2004, but with actual work starting only in 2006.[8]

20. ***The Ministry of Economy and Finance has been under strong pressures to weaken the institutional framework that assesses investment projects.*** As noted, the politically-motivated *InterOceánica* road project, which by-passed the National System of Public Investment (SNIP) viability assessment despite entailing large government subsidies over time, was awarded to the private sector in concession in June.[9] Also, while the recently-approved Law on Public Indebtedness established a strict limit (1 percent of GDP) on the NPV of actual and contingent liabilities associated with PPPs, this limit was subsequently modified by a decree that introduced a ceiling of 0.5 percent of GDP on the annual flows of government liabilities under PPPs. In NPV terms, this new ceiling is equivalent to close to 10 percent of GDP. The mission urged the authorities to introduce a more binding ceiling than the current one which, if care is not taken, could lead to a large number of concessions requiring future subsidies from the government, thus reducing expenditure flexibility over the medium-term. The authorities reaffirmed their commitment to pursue sound fiscal policies, and noted the limited amount of liabilities associated with PPP projects awarded in

[7] The program for 2006 continues to include an adjustor for guarantees provided or contracted by the government in the context of PPPs. This adjustor excludes annual payment obligations arising from PPP contracts.

[8] Under this project, the regional government (with central government backing) will make water purchase payments of up to US$32 million a year during 2009–23 (0.03 percent of GDP). The project was exempted from the viability assessment of the National System of Public Investment in 2004.

[9] This 25-year concession project has a total estimated cost of US$900 million and is expected to entail government subsidies (including contingent liabilities) equivalent to about 0.1 percent of GDP a year for 15 years, starting in 2008.

concession thus far.[10] They also stressed that all major projects undertaken via concessions and PPPs are now required to meet SNIP's viability requirements.

21. ***The authorities agreed with staff that the institutional framework to assess public investment projects needed to be strengthened further.*** They are working on a permanent framework for PPP operations together with a plan for its implementation (end-March 2006 benchmark). This framework is expected to help strengthen the role of the Ministry of Economy and Finance in the selection of projects to be undertaken under PPPs, enhance coordination among agencies, and define the institutional set-up and technical procedures for estimating the fiscal impact of PPP operations. Staff urged the authorities to swiftly implement this framework to help ensure fiscal sustainability and strongly suggested that a solid institutional framework should be based on a framework law. The authorities agreed to give consideration to such a law. They are also stepping up their efforts to strengthen the SNIP, with a view to ensuring a prompt assessment of projects, the weeding out of socially unviable projects, enhancing the capacity of spending units in project preparation, and strengthening ex-post project evaluation.

22. ***The authorities are taking steps to improve resource management in the public sector, with a view to generating additional savings for social and infrastructure spending.*** In line with technical assistance recommendations provided by the Fund's Fiscal Affairs Department, the authorities plan to establish a Treasury Single Account, enhance the budget classification to bring it closer to international standards, and incorporate this classification into the chart of accounts. Implementation plans for these reforms are expected to be ready by mid-2006 (end-June 2006 benchmark), representing further steps toward increasing the clarity of the budget process and strengthening information and controls on spending. The authorities are also preparing plans to establish an automatic accounting system for SIAF. Progress has also been made in preparing the reform of the pension regime of the police and military, centralizing the administration of the preferential *Cédula Viva* public pension system, and implementing a pilot program to improve the quality of priority social programs, with World Bank support. The authorities are proceeding with care in implementing the new targeted program of conditional transfers to the poor (*Juntos*). They are committed to implementing the reform of the public wage structure gradually, consistent with the preservation of fiscal discipline over the medium term.[11]

23. ***The government is proceeding cautiously in the area of decentralization.*** The mission welcomed the authorities' efforts to strengthen further the monitoring of the operations of subnational governments and the assessment of their compliance with fiscal

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[10] At present, the total NPV of liabilities associated with PPP projects awarded in concession is equivalent to 1.5 percent of GDP.

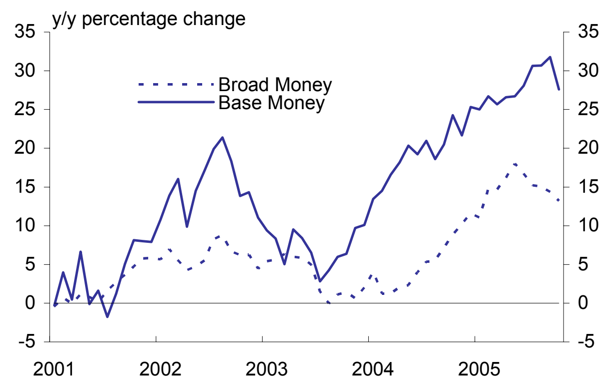
[11] The authorities are working with congress to reduce the fiscal costs of a draft law on public sector employment, which includes a reform of the public wage structure. The fiscal costs of this draft law are currently estimated at about 2 percent of GDP a year over a four-year implementation period.

rules. The authorities also plan to provide assistance to subnational governments in the area of public financial management and the preparation of investment projects, with a view to ensuring transparent, timely, and efficient spending. The decentralization process needs to increase its focus on the spending and revenue-raising responsibilities of subnational governments to avoid increasing overall fiscal imbalances. In this context, staff advised the authorities to undertake a comprehensive assessment of the fiscal risks associated with the decentralization strategy, and stressed the need to complete the legal decentralization framework by further clarifying spending responsibilities among the different levels of government. Such a clarification would help ensure that decentralization proceeds in a fiscally-sound manner.

C. Monetary Policy and Financial Sector Issues

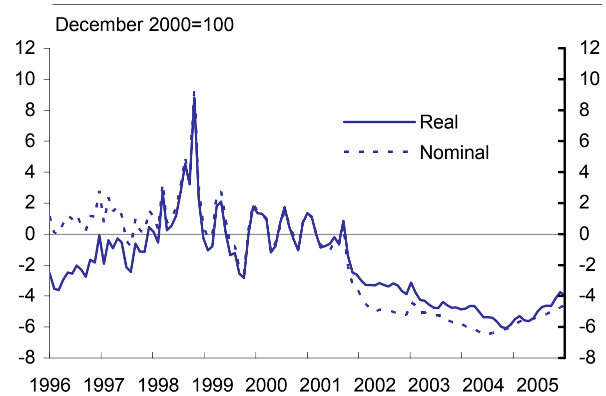
24. ***Monetary policy continues to be managed prudently.*** Despite strong economic growth and a relatively accommodative monetary stance, inflationary pressures have been low, in part due to the unwinding of weather-related bottlenecks. In recent months, 12-month inflation has been below the central bank's year-end target band. Staff noted that the increase in base money had remained high (28 percent year-on-year, in November), but the authorities did not view this increase as a cause for concern, given that it is thought to reflect a rising demand for domestic currency. Given the high degree of financial dollarization in Peru, the authorities noted that increases in the policy rate in the United States had resulted in some tightening in monetary conditions, as reflected in the monetary conditions index (Figure 11 and Box 4).[12] In view of the growing maturity of the inflation targeting regime, the central bank indicated its intention to shift from an end-year inflation target to a continuous target in early 2006.

Figure 10. Money 1/



1/ U.S. dollar stocks are valued at market exchange rates.

Figure 11. Monetary conditions index 1/



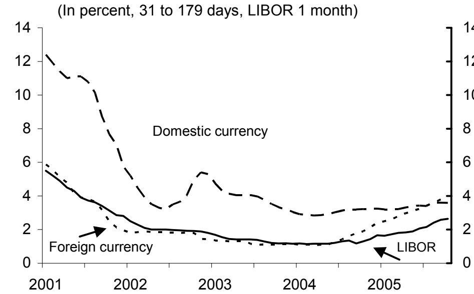
1/ An increase in the monetary conditions index indicates a tightening of monetary conditions.

[12] The computation of the monetary conditions index takes into account changes in: (a) the domestic currency overnight interbank interest rate (35 percent): (b) 3-month LIBOR (50 percent); and (c) the logarithm of the nominal and real effective exchange rates indices (15 percent).

Box 4. Peru: Interest Rate Developments

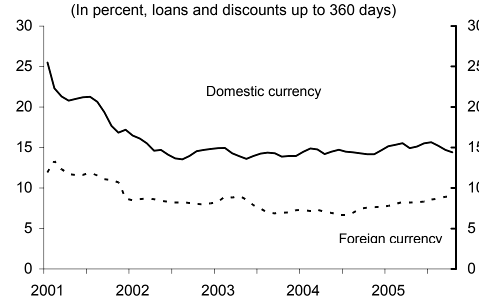
Average Deposit Rates

(In percent, 31 to 179 days, LIBOR 1 month)

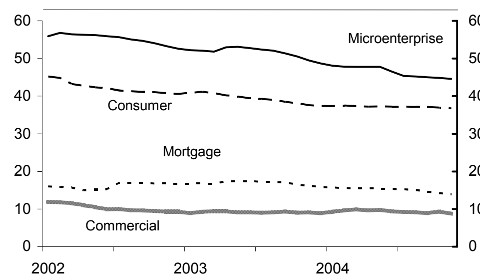


Average Lending Rates

(In percent, loans and discounts up to 360 days)



Average Lending Rates in Domestic Currency of Commercial Banks by Type of Credit
(In percent, annual effective rates)



Following a sharp drop in 2001, interest rates have remained broadly stable in recent years. The large drop in foreign and domestic currency rates coincided with lower U.S. interest rates and the introduction of the inflation targeting regime in Peru—a period associated with low inflation and reduced interest and exchange rate volatility.

The transmission mechanism from the monetary policy target rate to domestic currency interest rates differs according to the term and type of rates. Short-term corporate prime lending rates tend to follow movements in the interbank rate closely. Estimates of the central bank show that rates on loans and deposits of up to one year generally respond with a 3–4 month lag, whereas longer-term lending and deposit rates react with a lag of 5-8 months.

Given the still-high degree of dollarization of the banking system, a tightening in U.S. interest rates also influences monetary conditions in Peru. Recent increases in U.S. interest rates have pushed the foreign currency corporate prime rate above its domestic currency equivalent. In the past, cuts in U.S. interest rates were transmitted almost instantaneously to the rates on U.S. dollar denominated operations in Peru. By contrast, recent increases in Federal Funds Rate have been transmitted with a lag, likely reflecting abundant liquidity in the banking system.

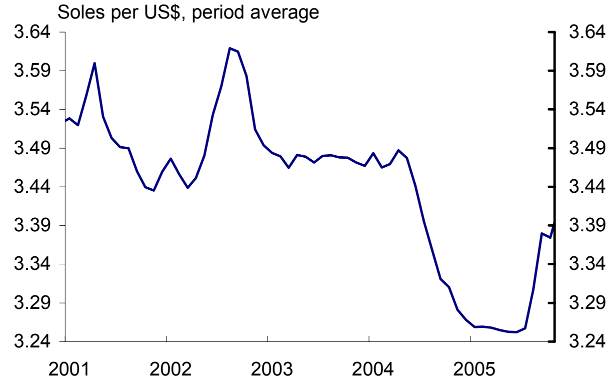
The credit market in Peru is highly segmented. Rates vary considerably according to the perceived credit risk of borrowers, with corporate borrowers generally charged with the lowest interest rates. The average lending rate in domestic currency has remained high, reflecting in part the fact that such lending tends to be concentrated in loans to consumers and small companies.

25. ***Faced with increasing pressures on the currency to depreciate, in early December the central bank raised its policy interest rate by 25 basis points.*** These pressures are thought to be associated with political uncertainty ahead of the elections, at a time when the differential between interest rates on operations in domestic currency and those in foreign

currency has widened.[13] The authorities' action was designed to help stem these pressures and the attendant effects on expected inflation and financial stability. Staff agreed with the authorities that, given the highly dollarized banking system, too large a depreciation of the currency over a short period of time could rapidly lead to a significant shift away from domestic currency, a rise in inflationary expectations, and a deterioration in the quality of bank portfolios.

Figure 12. Nominal Exchange Rate

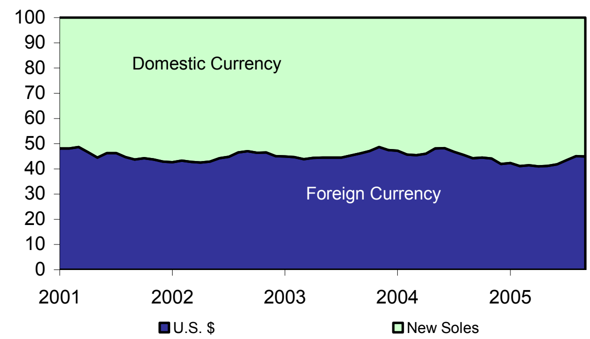
Soles per US$, period average



26. ***The authorities noted that, since July, central bank net intervention in the foreign exchange market had been relatively modest.*** They are working toward improving the functioning of the foreign exchange market by ensuring a better flow of information from pension funds to the central bank, with a view to helping reduce volatility. Staff noted that, with the approach of the elections, the authorities would need to keep developments in the foreign exchange market under close scrutiny. Further, staff reaffirmed its advice that central bank intervention in the foreign exchange market should be aimed primarily at avoiding excess exchange volatility.

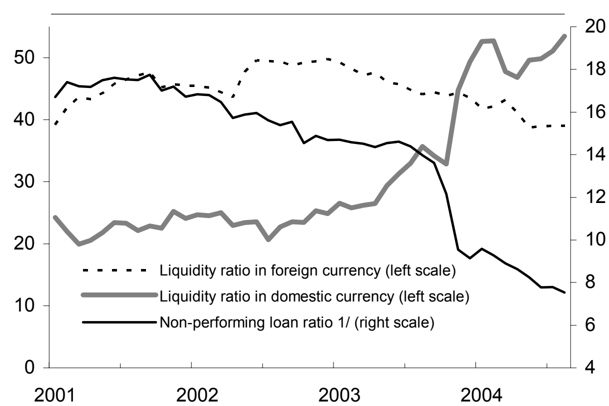
Figure 13. AFPs Portfolio Composition by Currency

In percent of total



27. ***Staff welcomed the authorities' continued efforts to strengthen the financial system.*** Bank capitalization and liquidity conditions have remained comfortable, profitability has continued to increase, and the quality of their loan portfolio has improved further. The authorities plan to complete a roadmap for implementation of the Basel II framework by year-end. They are also tightening regulations governing restructured loans and taking steps to implement the Law on Consumer Protection in Banking Services.

Figure 14. Banking Indicators



1/ Non-Performing Loans/Gross Credit.

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[13] While the Fed Funds rate had increased from 2¼ to 4 percent over the year through October, the policy rate of the central bank had remained unchanged at 3 percent since October 2004.

Staff welcomed the recent recapitalization of Banco Wiese (the third largest Peruvian bank by the size of assets), and its sale to a large foreign bank, after the completion of a protracted restructuring process.[14] Staff also welcomed improvements in the supervision of offshore subsidiaries, and advised the authorities to stand ready to strengthen capital reserve requirements on a consolidated basis and impose the same provisioning requirements on both offshore and onshore loans for which comprehensive information is not available. Staff encouraged the authorities to keep monitoring credit quality closely to avert potential problems associated with the increase in credit growth and to work closely with congress to ensure enactment of legislation aimed at granting legal protection to supervisors.

28. ***The authorities reaffirmed their commitment to reducing the vulnerabilities associated with financial dollarization.*** In recent months, the share of dollarized credit as a percent of total credit has continued to decline gradually. On the deposit side, however, there has been a slowdown in the pace of de-dollarization, probably associated with lower interest rate spreads between operations in foreign and domestic currency. Banks are also making progress toward implementing the new regulation aimed at reducing the risks associated with lending in foreign currency to unhedged borrowers. The mission encouraged the authorities to continue monitoring bank's progress in this area closely, to ensure its full implementation by mid-2006 (end-June 2006 benchmark). The authorities indicated that, should banks fail to measure rigorously the risks associated with unhedged borrowers, they stood ready to tighten the regulation. They are also committed to implementing plans to ensure that at least 50 percent of the new mortgage loans supported by *MiVivienda* during January–June 2006 are denominated in local currency (end-June 2006 benchmark). Finally, at the initiative of the central bank, steps are being discussed to amend the civil code with a view to reestablishing the *Nuevo Sol* as full legal tender.

Figure 15. Share of Credit and Deposits in Foreign Currency

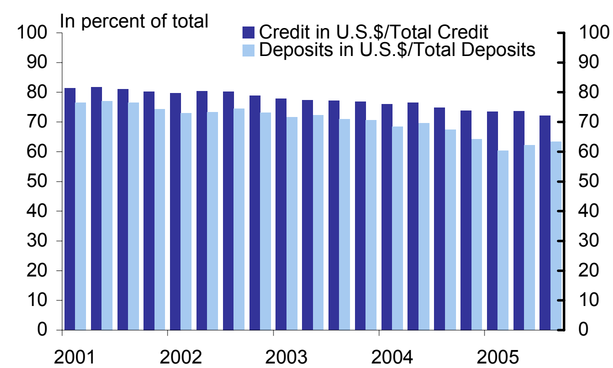
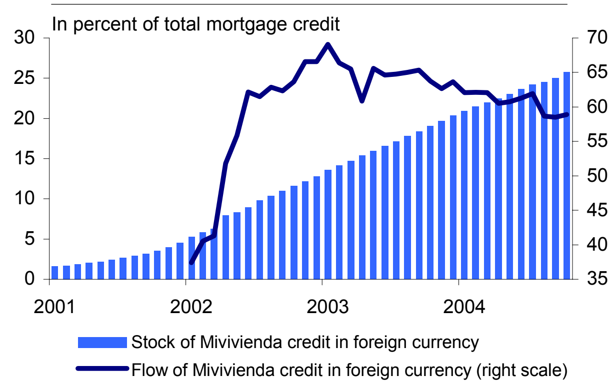


Figure 16. MiVivienda mortgage lending in US$



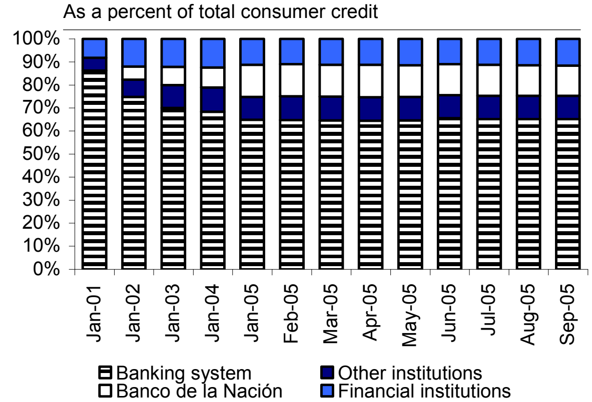
[14] As part of this operation, the shareholders will abandon a claim on the government (a US$260 million promissory note) that matures in June 2006.

29. ***The authorities continue to promote a deepening of the domestic capital market and competition among private pension funds.*** With technical assistance from the Fund's International Capital Markets Department, the government plans to identify steps to deepen further the secondary market for securities, reduce administrative barriers to securitization, and standardize financial contracts. In recent months, regulatory changes facilitating the transfer of individual accounts between private pension fund administrators and the recent entry of a new administrator have helped reduce fees and commissions charged by pensions funds.[15] Competition is expected to be further enhanced by allowing funds to offer portfolios with different risk-return characteristics.

30. ***Staff underscored the need to continue limiting government participation in the financial system.*** Under the 2005 program, understandings had been reached to limit the increase in the consumer-lending program of the state bank *Banco de la Nación* to 20 percent, but the authorities subsequently revised this increase to 30 percent. In the event, the increase during January–September only reached 13 percent, and staff urged the authorities to ensure that the originally agreed-upon 20 percent limit would not be exceeded in 2005. Understandings were also reached with the authorities to take the necessary steps to ensure that a 20 percent limit will be implemented in 2006. Under the program, the lending operations of *Agrobanco* will remain restricted, and the authorities will continue recording its quasi-fiscal operations in the budget.

Figure 17. Consumer Credit by Institution

As a percent of total consumer credit



31. ***Progress has been made toward strengthening the AML/CTF legal and regulatory framework.*** The Financial Action Task Force against Money Laundering in South America officially approved a favorable evaluation of Peru's progress at its plenary meeting in July 2005. The authorities plan to address some remaining weaknesses in the near future, including introducing a legal provision to freeze terrorist accounts. The Financial Intelligence Unit, created in 2002 to help ensure compliance with the law on money laundering, became a member of the Egmont group of International Financial Intelligence Units in July, thus facilitating the exchange of information with other member countries.

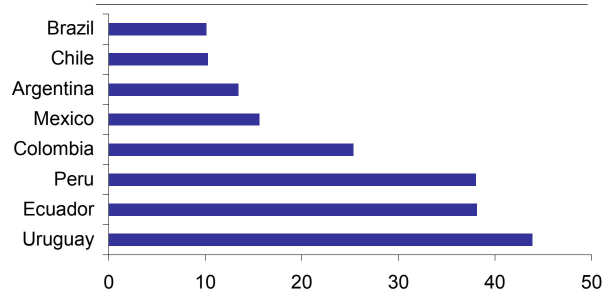
[15] On average, the fees and commissions charged by pension funds were reduced from 2.3 percent of wages in September–December 2004 to 2.1 percent in August–October 2005.

D. Other Growth-Enhancing Reforms

32. ***Further improvements in the business climate will be key to enhancing the competitiveness of the Peruvian economy.*** To expedite business-related legal disputes and bolster contract enforcement, the authorities plan to complete the creation of the modules of the commercial court system in Lima in 2006 and establish similar courts in the rest of the country over the medium term. Congressional approval of legislation on collateral registries would pave the way to implementing the plan to centralize registries, helping increase the access to, and quality of, credit (end-June 2006 benchmark). Although these are important steps, further challenges remain, including reducing the burden of entry costs for new businesses—which are still high by regional standards.

Figure 18. Entry Costs in Starting a Business in Selected Latin American Countries in 2006

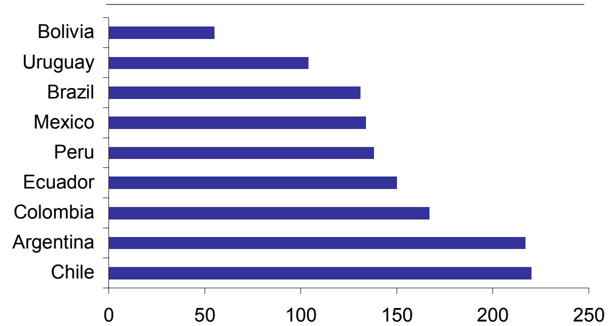
(In percent of GNI per capita)



Source: World Bank, *Doing Business in 2006.*

Figure 19. Monthly Minimum Wage in Selected Latin American Countries, September 2005

(In US$)



33. ***As noted above, negotiations on a bilateral Free Trade Agreement (FTA) with the United States were successfully concluded in early-December.*** Trade agreements are also being considered with the European Union, Mexico, Thailand, and Singapore, as well as an expansion of the FTA with Chile into services and investment. Further integration is also being pursued with the Andean Community (CAN), and the last stage of tariff reduction for intra-CAN trade is scheduled to take place on January 1, 2006. In November, Peru unilaterally lowered its external tariffs on certain capital goods and raw materials, to help streamline the tariff structure and reduce the potential of trade diversion.

34. ***The authorities agreed with staff that additional measures would be needed to help promote employment in the formal sector of the economy.*** Securing the needed consensus on a set of reforms, including increasing the flexibility of labor market regulations, is expected to be very difficult to achieve during the run-up to the elections. In view of the high levels of informal employment, the mission recommended that the authorities refrain from increasing the minimum wage. At present, the level of the minimum wage, which was last raised by 12 percent in September 2003, is broadly in line with the average in Latin America, and the authorities have recently announced that the increase that will be given will be modest (5 to 10 percent).

E. Other Issues

35. ***Safeguards Assessment.*** The central bank and the office of the comptroller general have clarified their respective responsibilities in the area of internal and external audits, which was the main recommendation of the 2004 Safeguards Assessment. The involvement of the office of the comptroller general has been better specified to clearly limit it to the administrative aspects of the bank's operations, thus excluding its participation in the bank's core functions, such as the conduct of the monetary and exchange rate policies.

36. ***Statistical Issues.*** Peru's statistics are broadly adequate for policy formulation, surveillance, and program monitoring. The authorities are continuing to make progress in addressing some shortcomings identified in the statistical annex. In particular, they are preparing an action plan to make the budget classification system compatible with international standards.

37. ***G8 Anti-corruption and Transparency Initiative and Extractive Industries Transparency Initiative (EITI).*** Under the G8 initiative, a matrix aimed at promoting transparency in public management and combating corruption has been completed. It incorporates an action plan under the EITI, prepared by a working group composed of representatives from the government, private industries, and civil society. The Ministry of Energy and Mines has signed a Memorandum of Understanding with the World Bank supporting implementation of the plan in collaboration with the Department for International Development of the United Kingdom (DFID). The plan focuses on regional governance, and will start with two pilot cases in the regions of Cusco and Cajamarca.

IV. Program Modalities

38. ***Program monitoring in the first half of 2006 will be similar to that in 2005.*** The program includes quarterly quantitative performance criteria through end-June 2006, the inflation consultation mechanism, and benchmarks for the first semester of next year in areas that are critical to achieving the macroeconomic objectives of the program (Table 1 of the LOI, and Table A of the MEFP). In 2006, the reform program will focus on strengthening the PPP process, enhancing public financial management, reducing the risks of dollarization, and improving the business environment. Staff agreed to the absence of new structural performance criteria for the next six months, given that the reforms being implemented could not be precisely defined and are not objectively monitorable.

39. ***Peru's capacity to repay the Fund is strong.*** Even if Peru were to draw the full amount available under the program, Fund credit outstanding would peak in 2006 at SDR 300.7 million, representing 0.5 percent of GDP and 3.2 percent of gross foreign reserves. At its peak in 2009, debt service to the Fund would be equivalent to 5.3 percent of Peru's total public debt service and 0.9 percent of exports of goods and services. Fund credit outstanding would rise from 6.3 percent of quota in September 2005 to 47.1 percent of quota in 2006 and then decline to zero by 2011.

V. Staff Appraisal

40. ***The Peruvian economy has continued to perform strongly.*** The sustained implementation of sound macroeconomic policies, in the context of a very favorable external environment, has led to strong economic growth, low inflation, and a further strengthening of the external position. All end-June and end-September quantitative performance criteria were met, and all end-December quantitative performance criteria are expected to be met. Given that no information with respect to the latter has become available at the time of circulation of this report, it is recommended that a waiver of applicability be granted for all end-December quantitative performance criteria. Progress has also been made in the structural reform area, including with respect to infrastructure concessions, fiscal transparency, the legal and institutional fiscal framework, and the reduction of the risks associated with dollarization. The authorities' commitment to further progress in these areas is welcome.

41. ***Peru has remained relatively sheltered from higher oil prices, as gas production has increased.*** At the same time, price increases of domestic petroleum derivatives have been limited, as the government has reduced the excise tax on petroleum products on several occasions since mid-2004. Although the fiscal cost of the tax reduction has been moderate, staff welcomes the authorities' commitment to avoid further reductions in excise tax rates.

42. ***Fiscal consolidation continues to be at the core of the authorities' macroeconomic strategy.*** The fiscal target for 2005 is expected to be met with some margin, thus helping further reduce Peru's public debt-to-GDP ratio. However, government spending is projected to be higher than originally envisaged, breaching the expenditure growth limit in the Fiscal Responsibility and Transparency Law. This additional spending is expected to be covered by higher revenue collections, largely associated with Peru's favorable external environment. Staff therefore strongly encourages the authorities to avoid boosting expenditures on a permanent basis and use part of the additional revenue to keep the fiscal deficit below programmed levels.

43. ***The authorities' commitment to maintain fiscal discipline in 2006, an election year, is commendable.*** Although challenging, the 2006 budget aims at a fiscal deficit of 1 percent of GDP, in line with the program. Given that in the months ahead expenditure pressures are expected to remain strong, vigilance will be needed to meet the deficit target. In this context, staff welcomes the authorities' commitment to achieving an overall fiscal surplus during the first half of 2006 and commends them for their efforts at limiting and prioritizing spending demands. Staff encourages the authorities to reinforce their efforts at broadening the tax base by eliminating tax exemptions and at further improving tax administration. Congress' decision to keep the rate of the tax on financial transactions unchanged is regrettable. Staff encourages the authorities to work closely with congress to ensure that, as envisaged under the program, this tax rate is reduced in coming months, particularly if tax collections turn out to be higher than envisaged in the budget. At the same time, reaching a political consensus will be essential to addressing the decline in revenues to be faced by the new government due to the phasing-out of temporary taxes at end-2006 and the impact of the trade arrangements.

44. ***Public debt management is appropriately focusing on reducing rollover, exchange rate, and interest rate risks.*** The recent prepayment of debt to Paris Club creditors has helped improve the debt service profile in coming years. Staff welcomes the authorities' intentions to continue seeking opportunities to improve the public debt profile further by shifting its composition toward local currency and longer maturity obligations.

45. ***The implementation of structural fiscal reforms is helping reinforce prudent fiscal management.*** The authorities' plans to improve public expenditure management are commendable, particularly the modernization of the budget classification system, the establishment of SIAF automatic accounting, and implementation of a Treasury Single Account. Implementation of these plans will help improve the clarity of the budget process and strengthen information and controls on spending. The recent centralization of the administration of the *Cédula Viva* pension regime should also help ensure better resource management in the public sector over the medium term. Staff supports the authorities' intention to strengthen the legal and institutional fiscal framework, including through reinforcing the procedures for compliance with the Fiscal Responsibility and Transparency Law.

46. ***In the area of decentralization, the envisaged issuance of regulations for the Fiscal Decentralization Law will help support prudent fiscal management at the subnational government level***. However, these regulations need to be accompanied by clear spending responsibilities among the different levels of government. Also, it will be important to strengthen the capacity of the Ministry of Finance to assess the compliance of subnational governments with their fiscal rules. A comprehensive assessment of the financial risks related to the decentralization strategy would be advisable.

47. ***Strengthening the institutional framework for PPP operations is key to consolidating sound fiscal policy.*** The authorities need to design and implement a permanent framework for PPP operations swiftly. This framework will help strengthen the role of the Ministry of Economy and Finance in the selection of projects to be undertaken under PPPs, enhance coordination among agencies, and define the institutional set-up and technical procedures for estimating the fiscal impact of PPP operations. The decision to by-pass standard procedures in approving the *InterOceánica* road project is regrettable, and staff urges the authorities to introduce a stricter ceiling on PPP liabilities to avoid the proliferation of new concessions requiring large government subsidies that could erode fiscal discipline and/or reduce the flexibility of expenditures over the medium-term. Staff welcomes the authorities' commitment to continue publishing public sector liabilities associated with PPPs in the Multiyear Macroeconomic Framework. Staff also supports the authorities' efforts to strengthen the SNIP and to continue requiring that all major projects undertaken via concessions and PPPs meet SNIP's viability requirements.

48. ***Monetary policy continues to be managed prudently.*** In recent months, inflation has been below the authorities' target band, partly reflecting the unwinding of weather-related bottlenecks. Staff supports the authorities' intention to shift from an end-year inflation target to a continuous target. In the context of Peru's highly dollarized financial system, staff

encourages the authorities to monitor developments in the foreign exchange market closely, and to stand ready to take steps that would maintain financial stability. Staff continues to advise the central bank to limit its interventions in the foreign exchange market to minimizing short-term volatility.

49. ***Progress is being made toward improving the efficiency of the financial sector and strengthening financial regulations and supervision.*** The recent recapitalization of a large private bank and its sale to a large foreign bank is a positive development for the Peruvian banking system. Staff commends the authorities' efforts to increase competition among private pension funds and their plans to deepen the secondary market for securities, reduce administrative barriers to securitization, and standardize financial contacts. Staff also welcomes the authorities' intention to tighten regulations governing restructured loans and encourages them to stand ready, if needed, to strengthen capital reserve requirements and impose the same provision requirements on both offshore and onshore loans for which complete information is not available. Staff also recommends that the authorities strictly adhere to the original limit on the expansion of *Banco de la Nación*'s consumer lending operations in 2005, and ensure that such a limit is also implemented in 2006.

50. ***Reducing the vulnerabilities associated with dollarization is at the core of the structural reform program.*** Lending in foreign currency to unhedged borrowers involves significant risks for the banking system, and staff welcomes the authorities' intention to start implementing a plan to encourage lending in domestic currency under the *MiVivienda* program. It will also be key for the Superintendency of Banks to ensure that the regulation to mitigate foreign currency-induced risks is fully implemented by mid-2006. Should banks fail to measure rigorously the risks associated with unhedged borrowers, the authorities would need to stand ready to tighten this regulation.

51. ***Staff welcomes the authorities' plans to further integrate Peru into the global economy and to improve the business climate.*** The recent conclusion of the negotiations on a bilateral free trade agreement with the United States should help enhance further the performance of Peruvian nontraditional exports. Staff commends existing plans to improve the investment climate, including the authorities' objective to establish additional commercial courts and start implementing their plan to centralize collateral registries, but notes that significant challenges remain. Staff also encourages the authorities to continue working toward reducing labor market rigidities and promoting formal employment.

52. ***The medium term outlook is favorable.*** The authorities' commitment to sound macroeconomic policies and further progress in structural reforms has helped ensure Peru's successful exit strategy from Fund-supported programs. Risks to the program continue to stem from a possible downturn in commodity prices, existing global imbalances, high debt and dollarization, the large share of foreign-currency denominated public debt, and policy slippages associated with a challenging political and social situation. However, Peru has built important buffers, including a comfortable level of reserves and a well-capitalized banking system. The main challenge over the medium term will be to boost economic growth over a sustained period of time while reducing poverty. Further strengthening the institutions will be

key to achieving this objective. In these circumstances, the next government's ability to follow sound policies and build a broad consensus will be essential.

53. ***In summary, Peru has continued to perform well under the program supported by the Stand-By Arrangement, and the staff recommends completion of the third review.*** Overall macroeconomic policy and the structural reform agenda are broadly appropriate. Although there are risks to the program, the authorities recognize these risks, are working to address them, and stand ready to take additional actions if needed.

Table 1. Peru: Selected Economic Indicators

	2002	2003	Prel. 2004	2005 Prog.	2005 Proj.	Proj. 2006
Social Indicators						
Life expectancy at birth (years)	69.8	70.0	...	...	...	...
Infant mortality (per thousand live births)	30.0	26.0	...	...	...	...
Adult literacy rate	87.3	87.7	87.8	...	...	...
Poverty rate (Total) 1/	53.8	52.2	51.6	...	...	...
Unemployment rate	9.4	9.4	9.4	...	...	...
(Annual percentage change; unless otherwise indicated)						
Production, prices, and trade						
Real GDP	4.9	3.8	4.8	4.5	5.8	5.0
Real domestic demand	4.0	3.3	3.9	4.6	5.4	5.5
Consumer Prices (end of period)	1.5	2.5	3.5	2.3	1.5	2.5
Consumer Prices (period average)	0.2	2.3	3.7	2.1	1.6	2.4
External Sector						
Exports	9.8	16.5	40.4	8.8	29.8	5.8
Imports	2.8	11.2	19.0	8.4	24.9	13.5
Terms of trade (deterioration -)	3.1	1.3	9.1	...	5.6	-2.8
Real effective exchange rate (depreciation -) 2/	-5.5	-9.9	0.8	...	-1.0	...
Money and credit 3/ 4/						
Liabilities to the private sector	4.4	1.9	11.5	5.3	13.4	7.0
Net credit to the private sector	-1.5	-3.5	3.6	3.2	8.9	5.6
(In percent of GDP; unless otherwise indicated)						
Public sector						
General government current revenue	17.2	17.6	17.8	17.8	18.4	18.3
General government noninterest expenditure	17.4	17.3	16.9	16.7	17.1	17.3
Combined public sector primary balance	0.0	0.5	1.0	1.2	1.3	1.2
Interest due	2.2	2.2	2.1	2.2	2.1	2.2
Combined public sector overall balance	-2.2	-1.7	-1.1	-1.0	-0.7	-1.0
External Sector						
External current account balance	-1.9	-1.6	0.0	0.5	0.3	0.4
Gross reserves						
in millions of U.S. dollars 5/	9,690	10,206	12,649	12,343	13,669	13,669
percent of short-term external debt 6/	214.2	214.4	185.8	243.3	279.4	280.2
percent of foreign currency deposits at banks	100.6	107.3	127.4	122.7	127.0	124.9
Debt						
Total external debt	49.4	48.7	45.3	41.8	37.9	35.5
Combined public sector debt	47.1	47.5	45.1	42.2	39.1	37.2
Domestic	10.2	10.1	9.4	8.8	9.6	9.5
External 7/	36.8	37.5	35.6	33.4	29.5	27.7
Savings and investment						
Gross domestic investment	18.8	18.8	18.5	19.0	19.0	19.5
Public sector	2.8	2.9	2.8	2.9	3.0	3.2
Private sector	15.9	15.9	15.7	16.1	16.1	16.3
National savings	16.8	17.0	18.3	19.5	19.3	19.9
Public sector 8/	0.8	1.3	1.7	1.9	2.3	2.3
Private sector	16.0	15.8	16.5	17.5	17.0	17.6
External savings	2.0	1.7	0.0	-0.5	-0.3	-0.4
Memorandum item:						
Nominal GDP (S/. billions)	198.9	211.5	234.3	249.3	254.3	271.3
GDP per capita (in US$)	2,247	2,385	2,658	2,699	2,955	3,081

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

1/ Defined as the percentage of households whose total spending is below the cost of basic basket of consumption goods.

2/ End of period. 2005 data up to August. Based on Information Notice System.

3/ Corresponds to the banking system.

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

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

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

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

8/ Excludes privatization receipts.

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

	2005	
	June 30	Sept. 30
(Cumulative amounts from December 31, 2004, millions of New Soles)		
Borrowing requirement of the combined public sector 1/		
Unadjusted limits	-850	270
Adjusted limits 2/	-706	402
Actual	-2,850	-2,810
Margin	2,144	3,212
(Cumulative amounts from December 31, 2004, millions of U.S. dollars)		
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions		
Unadjusted targets	-232	-483
Adjusted targets 2/	-537	-1,669
Actual	1,518	1,195
Margin	2,055	2,864
Outstanding short-term external debt of the nonfinancial public sector		
Limits	50	50
Actual	0	0
Margin	50	50
Contracting or guaranteeing of nonconcessional public debt with maturity of at least one year		
Unadjusted limits	1,627	2,296
Adjusted limits 2/	1,884	4,227
Actual	1,409	3,086
Margin	475	1,141
Of which: **external debt of 1-5 year maturity**		
Limits	100	100
Actual	0	0
Margin	100	100
External payments arrears of the public sector (on a continuous basis)		
Limits	0	0
Actual	0	0
Margin		
(Consultation bands for the 12-month rate of inflation, in percent) 3/		
Outer band (upper limit)	5.5	5.5
Inner band (upper limit)	4.5	4.5
Central point	2.5	2.5
Inner band (lower limit)	0.5	0.5
Outer band (lower limit)	-0.5	-0.5
Actual	1.5	1.1

Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance; and (See www.imf.org).

1/ PIPP proceeds are included below the line.
2/ The targets and limits were adjusted in accordance with the table attached to the letter of intent dated May 20, 2005 (See www.imf.org).
3/ Should inflation fall outside the inner band, the authorities will discuss with the Fund staff the appropriate policy response. Should inflation fall outside the outer band, the authorities will also complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the arrangement.

Table 3. Peru: Structural Performance Criteria and Benchmarks for 2005

Measures	Date of Implementation	Current Status
I. Performance Criteria		
Grant concessions or enter into Public Private Partnerships for the construction and maintenance of the portion of the Pan-American highway from Pucusana to Ica, and a large regional integration highway in the north of Peru.	September 30	Observed.
The Ministry of Economy and Finance will establish a reporting system of public sector liabilities (including contingent) associated with PPPs and concessions, and will issue a norm requiring the annual publication of such liabilities in the Multiyear Macroeconomic Framework beginning in 2006.	September 30	Observed.
The Superintendency of Banks will issue inspection guidelines strengthening the implementation of the norms on foreign currency-induced credit risk, including at a minimum the concepts of unhedged borrowers and significant impact on the repayment capacity of economic agents.	September 30	Observed.
II. Benchmarks		
Unify the Central government budget formulation system and the Integrated Financial Management System (SIAF)	June 30	Not observed. Expected for January 2006.
The Superintendency of Banks will publish and disseminate the new pricing methodology and reference prices of nontraded financial assets.	July 30	Not observed. Expected for December 2005.
Announce a plan to centralize the information on collateral registries.	September 30	Observed.
Issue the implementing regulations of the Fiscal Decentralization Law that support prudent budget decisions and management of the regional and local governments.	September 30	Observed.
Start implementing a law on public indebtedness, as specified in paragraph 9 of the MEFP dated May 20, 2005.	December 31	Observed.
The government will develop an operational plan to ensure that at least 50 percent of the mortgage loans financed by the *MiVivienda* program during the period January-June 2006 are denominated in domestic currency.	December 31	Progress.

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

(In percent of GDP; unless otherwise indicated)

	2003	2004	Program 2005 H1	Program 2005 H2	Program 2005 year	Projection 2005 H1	Projection 2005 H2	Projection 2005 year	Proj. 2006 1/
Central government primary balance	**0.2**	**0.6**	**1.2**	**-0.2**	**1.0**	**1.9**	**-0.8**	**1.1**	**0.9**
Revenue	15.1	15.2	7.7	7.7	15.4	8.2	7.7	15.9	15.8
Current	14.9	15.1	7.6	7.7	15.3	8.1	7.6	15.8	15.7
Of which: Tax revenue	13.0	13.3	6.7	6.6	13.3	7.1	6.6	13.8	13.7
Of which: Financial transaction tax	...	0.3	0.1	0.1	0.2	0.1	0.1	0.2	0.1
Capital	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.1
Noninterest expenditure	14.9	14.6	6.5	7.9	14.4	6.3	8.4	14.7	14.9
Current	12.9	12.8	5.9	6.7	12.6	5.8	7.1	12.9	12.9
Capital	1.9	1.8	0.6	1.2	1.8	0.5	1.3	1.9	2.0
Rest of the general government primary balance	**0.3**	**0.3**	**0.2**	**0.0**	**0.2**	**0.2**	**0.0**	**0.2**	**0.3**
Revenue	5.8	5.8	2.7	3.0	5.7	2.7	3.2	6.0	6.1
Current	5.8	5.8	2.7	3.0	5.7	2.7	3.2	5.9	6.0
Capital	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Noninterest expenditure	5.6	5.5	2.5	3.0	5.5	2.5	3.2	5.8	5.8
Current	4.7	4.6	2.1	2.5	4.6	2.1	2.7	4.8	4.7
Capital	0.9	0.9	0.4	0.5	0.9	0.4	0.6	1.0	1.1
Public enterprise primary balance	**0.0**	**0.1**	**0.0**	**0.0**	**0.1**	**0.1**	**-0.1**	**0.0**	**0.1**
Current balance	0.3	0.4	0.2	0.2	0.4	0.3	0.1	0.4	0.5
Capital balance	-0.4	-0.2	-0.2	-0.2	-0.4	-0.1	-0.2	-0.3	-0.4
Nonfinancial public sector primary balance	**0.4**	**1.0**	**1.4**	**-0.2**	**1.2**	**2.2**	**-0.8**	**1.4**	**1.2**
Central bank operating balance	0.1	0.0	0.0	0.0	-0.1	-0.1	0.0	-0.1	0.0
Combined public sector primary balance	**0.5**	**1.0**	**1.4**	**-0.2**	**1.2**	**2.1**	**-0.8**	**1.3**	**1.2**
Interest payments	2.2	2.1	1.0	1.2	2.2	1.0	1.1	2.1	2.2
External	1.8	1.7	0.8	1.0	1.8	0.8	0.9	1.7	1.6
Domestic	0.4	0.4	0.2	0.2	0.4	0.2	0.2	0.4	0.6
Of which: Pension recognition bonds	0.1	0.1	0.1	0.0	0.1	0.0	0.0	0.1	0.1
Combined public sector overall balance	**-1.7**	**-1.1**	**0.3**	**-1.4**	**-1.0**	**1.2**	**-1.9**	**-0.7**	**-1.0**
Financing	1.7	1.1	-0.3	1.4	1.0	-1.2	1.9	0.7	1.0
External	1.4	1.6	0.2	-0.1	0.1	-0.2	-0.8	-1.0	-0.2
Disbursements 2/	3.5	3.6	1.2	0.8	2.0	0.9	2.0	2.9	1.2
(In millions of U.S. dollars)	2,101	2,474	882	614	1,496	697	1,575	2,273	999
Amortization 3/	-2.0	-2.0	-1.0	-1.0	-2.0	-0.9	-2.9	-3.8	-1.4
(In millions of U.S. dollars)	-1,187	-1,348	-776	-753	-1,529	-732	-2,197	-2,929	-1,149
Other 4/	-0.1	-0.1	0.1	0.0	0.1	-0.1	0.0	-0.2	0.0
Domestic	0.2	-0.6	-0.6	1.5	0.8	-1.1	2.7	1.6	1.1
Bond placements 5/	0.8	1.1	0.5	0.3	0.8	0.8	1.5	2.3	0.8
(In millions of U.S. dollars)	508	759	366	260	625	620	1,184	1,804	650
Amortization 6/	-0.9	-1.1	-0.3	-0.7	-1.1	-0.7	-0.4	-1.1	-0.6
(In millions of U.S. dollars)	-556	-754	-250	-554	-805	-527	-289	-816	-470
Of which: Pension recognition bonds	-170	-215	-90	-103	-193	-90	-101	-190	-95
Net deposits	0.3	-0.7	-0.8	1.9	1.1	-1.2	1.5	0.4	0.9
(In millions of U.S. dollars)	190	-448	-590	1,397	807	-912	1,188	276	757
Privatization	0.1	0.2	0.1	0.1	0.1	0.0	0.1	0.1	0.0
(In millions of U.S. dollars)	52	114	43	44	87	36	61	97	24
Memorandum items:									
Overall fiscal deficit (old definition) 7/	-1.9	-1.3	0.3	-1.5	-1.2	1.1	-2.0	-0.9	-1.0
Tax on assets on public enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General government current revenue 8/	17.6	17.8	8.8	8.9	17.8	9.4	9.0	18.4	18.3
General government noninterest expenditure 8/	17.3	16.9	7.5	9.2	16.7	7.4	9.7	17.1	17.3
Public sector debt-to-GDP	47.5	45.1	...	...	42.2	...	...	39.1	37.2
Nominal GDP (S/. billions)	211.5	234.3	249.3	249.3	249.3	254.3	254.3	254.3	271.3

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

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

Table 5. Peru: Financing of the Combined Public Sector

	2002	2003	2004	2005 Prog.	2005 Proj.	Proj. 2006 1/
	(In millions of U.S. dollars)					
Combined balance	**-1,227**	**-1,037**	**-748**	**-787**	**-578**	**-820**
Financing	**1,227**	**1,037**	**748**	**787**	**578**	**820**
Net External	1,169	843	1,078	73	-783	-141
Disbursements	2,863	2,101	2,474	1,496	2,273	999
Bonds 2/ 3/	1,886	1,245	1,295	400	1,177	0
Multilaterals	807	519	863	596	596	499
Bilaterals and other	170	337	315	500	500	500
Amortization 4/ 5/	-1,837	-1,187	-1,348	-1,529	-2,929	-1,149
Other 6/	143	-71	-48	106	-127	9
Privatization	421	52	114	87	97	24
Net Domestic financing	-363	142	-443	628	1,264	937
Bonds 7/	267	508	759	625	1,804	650
Amortization	-193	-556	-754	-805	-816	-470
Of which : Pension recognition bonds	-55	-170	-215	-193	-190	-95
Net deposits	-437	190	-448	807	277	757
Of which: Central government	-396	299	-300	829	322	936
	(In percent of GDP)					
Combined balance	**-2.2**	**-1.7**	**-1.1**	**-1.0**	**-0.7**	**-1.0**
Financing	**2.2**	**1.7**	**1.1**	**1.0**	**0.7**	**1.0**
Net External	2.1	1.4	1.6	0.1	-1.0	-0.2
Disbursements 2/	5.1	3.5	3.6	2.0	2.9	1.2
Bonds	3.3	2.0	1.9	0.5	1.5	0.0
Multilaterals	1.4	0.9	1.3	0.8	0.8	0.6
Bilaterals and other	0.3	0.6	0.5	0.7	0.6	0.6
Amortization 2/	-3.3	-2.0	-2.0	-2.0	-3.8	-1.4
Other	0.3	-0.1	-0.1	0.1	-0.2	0.0
Privatization	0.7	0.1	0.2	0.1	0.1	0.0
Net Domestic financing	-0.6	0.2	-0.6	0.8	1.6	1.1
Bonds	0.5	0.8	1.1	0.8	2.3	0.8
Amortization	-0.3	-0.9	-1.1	-1.1	-1.1	-0.6
Of which: Pension recognition bonds	0.1	0.3	0.3	0.3	0.2	0.1
Net deposits	-0.8	0.3	-0.7	1.1	0.4	0.9
Of which: Central government	-0.7	0.5	-0.4	1.1	0.4	1.1
Memorandum item:						
Nominal GDP (S/. billions)	198.9	211.5	234.3	249.3	254.3	271.3

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

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

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

	2002	2003	2004	2005 Prog.	2005 Proj.	Proj. 2006 1/
Current primary balance	**1.6**	**2.0**	**2.4**	**2.7**	**2.9**	**2.7**
Current revenue	14.4	14.9	15.1	15.3	15.8	15.7
Tax revenue	11.9	13.0	13.3	13.3	13.8	13.7
Direct taxes	3.2	4.0	4.0	3.7	4.3	4.0
Indirect taxes	8.7	9.0	9.3	9.5	9.5	9.6
Of which: Financial transaction tax	...	...	0.3	0.2	0.2	0.1
Other current revenue 2/	2.5	1.9	1.8	2.0	2.0	2.0
Current noninterest expenditure	12.7	12.9	12.8	12.6	12.9	12.9
Labor services 3/	6.7	6.7	6.5	6.4	6.5	6.5
Goods and nonlabor services	3.4	3.5	3.5	3.3	3.5	3.4
Transfers and other	2.6	2.7	2.8	2.9	3.0	3.0
Capital balance	**-1.9**	**-1.8**	**-1.8**	**-1.7**	**-1.8**	**-1.9**
Capital revenue	0.2	0.2	0.1	0.1	0.1	0.1
Capital expenditure	2.0	1.9	1.8	1.8	1.9	2.0
Gross capital formation	1.8	1.7	1.6	1.7	1.7	1.8
Other	0.2	0.3	0.2	0.2	0.2	0.1
Primary balance	**-0.2**	**0.2**	**0.6**	**1.0**	**1.1**	**0.9**
Interest payments	2.0	2.0	1.9	2.0	1.9	2.1
External	1.8	1.8	1.7	1.8	1.6	1.6
Domestic	0.2	0.2	0.2	0.3	0.3	0.5
Overall balance	**-2.2**	**-1.8**	**-1.3**	**-1.1**	**-0.8**	**-1.2**
Memorandum items:						
General government tax revenues 3/	12.2	13.1	13.6	13.5	14.0	14.0
Primary balance before transfers	2.0	2.9	3.3	3.8	4.1	3.8
Overall balance before transfers	0.0	0.9	1.4	1.8	2.1	1.8
Tax compliance rate 4/	87	...	...	...	...	...

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

1/ Consistent with 2006 budget.
2/ Decline in 2003 reflects lower collections on the recovery of illicit funds from officials of the previous administration and special large fines paid by mining companies in 2002.
3/ Includes wages, salaries, and employer contributions to social security.
4/ Measured as the ratio between paid tax obligations and total tax obligations. Obligations covered as VAT and income tax for large taxpayers only.

Table 7. Peru: Public Sector Social Expenditure

	2000	2001	2002	2003	2004	Proj. 2005	Proj. 2006 1/
(In millions of New Soles)							
Total social expenditure and pensions	**18,821**	**19,056**	**20,698**	**21,613**	**23,578**	**24,713**	**25,804**
Universal coverage (Education and Health) 2/	7,106	7,135	8,197	8,916	10,396	10,432	11,149
Education	5,004	5,165	5,759	6,366	7,289	7,503	7,896
Health	2,102	1,970	2,438	2,550	3,107	2,929	3,253
Targeted programs (Extreme Poverty) 3/	3,043	2,986	2,840	2,988	2,994	3,494	3,483
Non-Targeted Social Programs	8,672	8,935	9,661	9,710	10,187	10,787	11,172
ESSALUD	2,836	2,775	2,961	3,023	3,156	3,248	3,614
Pensions	5,855	6,108	6,644	6,671	7,030	7,538	7,558
Housing Development Program (FONAVI)	-19	52	56	16	1	1	0
(In percent of general government expenditure)							
Total social expenditure and pensions	**48.7**	**50.7**	**53.5**	**52.6**	**53.0**	**50.8**	**48.9**
Universal coverage (Education and Health) 2/	18.4	19.0	21.2	21.7	23.4	21.4	21.1
Education	13.0	13.7	14.9	15.5	16.4	15.4	15.0
Health	5.4	5.2	6.3	6.2	7.0	6.0	6.2
Targeted programs (Extreme Poverty) 3/	7.9	7.9	7.3	7.3	6.7	7.2	6.6
Non-Targeted Social Programs	22.4	23.8	25.0	23.6	22.9	22.2	21.2
ESSALUD	7.3	7.4	7.6	7.4	7.1	6.7	6.8
Pensions	15.2	16.2	17.2	16.2	15.8	15.5	14.3
Housing Development Program (FONAVI)	0.0	0.1	0.1	0.0	0.0	0.0	0.0
(In percent of GDP)							
Total social expenditure and pensions	**10.2**	**10.1**	**10.4**	**10.2**	**10.1**	**9.7**	**9.5**
Universal coverage (Education and Health) 2/	3.8	3.8	4.1	4.2	4.4	4.1	4.1
Education	2.7	2.7	2.9	3.0	3.1	3.0	2.9
Health	1.1	1.0	1.2	1.2	1.3	1.2	1.2
Targeted programs (Extreme Poverty) 3/	1.6	1.6	1.4	1.4	1.3	1.4	1.3
Non-Targeted Social Programs	4.7	4.7	4.9	4.6	4.3	4.2	4.1
ESSALUD	1.5	1.5	1.5	1.4	1.3	1.3	1.3
Pensions	3.2	3.2	3.3	3.2	3.0	3.0	2.8
Housing Development Program (FONAVI)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
General government expenditure (in millions of New Soles)	38,718	37,707	38,721	41,098	44,475	48,658	52,806
Defense and national security (in percent of GDP)	2.6	2.5	2.3	2.2	2.1	2.0	2.0
Justice (in percent of GDP)	0.4	0.4	0.4	0.4	0.4	0.4	0.4

Source: Ministry of Economy and Finance.

1/ Consistent with 2006 budget.

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

3/ Includes S/.120 million and S/.300 million for the targeted poverty-reduction program Juntos in 2005 and 2006, respectively.

Table 8. Peru: Monetary Survey

	2002	2003	Prel. 2004	2005 Prog.	2005 Proj.	Proj. 2006
I. Central Reserve Bank (In millions of New Soles at program exchange rate)						
Net international reserves 1/	**32,954**	**35,361**	**42,125**	**39,802**	**44,165**	**44,362**
(In millions of U.S. dollars)	9,309	9,905	12,342	12,042	13,362	13,362
Net domestic assets	**-27,339**	**-28,991**	**-34,090**	**-30,993**	**-34,046**	**-32,997**
Net credit to nonfinancial public sector	-10,147	-10,709	-12,974	-10,291	-13,711	-11,014
Rest of banking system	-14,338	-14,757	-19,146	-20,208	-20,247	-21,701
Other	-2,854	-3,525	-1,970	-494	-88	-282
Currency	**5,615**	**6,370**	**8,035**	**8,809**	**10,119**	**11,365**
II. Banking System (In millions of New Soles at program exchange rate)						
Net foreign assets	**33,300**	**35,010**	**42,973**	**49,757**	**46,846**	**47,510**
Net domestic assets	**18,407**	**17,699**	**15,808**	**12,050**	**19,839**	**23,822**
Net credit to nonfinancial public sector	-10,532	-10,664	-13,622	-11,321	-14,335	-12,608
Net credit to private sector	46,621	44,994	46,632	48,129	50,761	53,592
Other	-17,682	-16,631	-17,202	-24,758	-16,587	-17,162
Net credit to COFIDE	-1,340	-1,018	-903	-904	-948	-948
Other	-16,342	-15,613	-16,299	-23,854	-15,639	-16,214
Liabilities to the private sector	**51,707**	**52,709**	**58,781**	**61,807**	**66,686**	**71,333**
(12-month percentage change)						
Base money	11.0	10.1	25.3	10.0	25.0	12.0
Broad money	4.4	1.9	11.5	5.3	13.4	7.0
Domestic currency	11.5	10.0	28.1	9.7	24.4	11.9
Foreign currency 2/	1.1	-2.3	1.7	2.2	5.2	2.6
Net credit to private sector	-1.5	-3.5	3.6	3.2	8.9	5.6
Domestic currency	7.0	5.1	11.9	10.0	22.0	15.0
Foreign currency 2/	-3.6	-5.7	1.2	0.9	4.6	2.0
III. Financial System (In millions of New Soles at program exchange rate)						
Net foreign assets	**37,354**	**44,893**	**52,416**	**48,844**	**56,609**	**60,746**
Net domestic assets	**28,499**	**30,212**	**31,828**	**36,171**	**35,207**	**38,370**
Net credit to the public sector	-9,697	-8,976	-10,442	-7,209	-9,397	-8,552
Net credit to private sector	60,422	62,666	65,913	68,829	70,005	73,874
Other	-22,226	-23,478	-23,644	-25,450	-25,401	-26,952
Liabilities to the private sector	**65,854**	**75,105**	**84,243**	**85,015**	**91,816**	**99,116**
(12-month percentage change)						
Liabilities to the private sector	9.0	14.0	12.7	8.0	9.0	8.0
Domestic currency	17.5	24.9	23.5	12.2	13.5	12.0
Foreign currency 2/	2.3	4.2	0.9	2.7	3.0	2.0
Net credit to private sector	2.1	3.7	5.2	6.1	6.2	5.5
Domestic currency	18.9	18.0	17.9	14.8	11.0	13.0
Foreign currency 2/	-3.3	-1.9	-0.9	1.0	3.5	1.0
Memorandum item:						
Program exchange rate (S/. per US$)	3.54	3.57	3.41	3.31	...	3.32

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

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

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

Table 9. Peru: Balance of Payments

	2002	2003	Prel. 2004	2005 Prog.	2005 Proj.	Proj. 2006
(In millions of U.S. dollars)						
Current account	**-1,063**	**-985**	**-11**	**365**	**254**	**295**
Merchandise trade	292	731	2,793	3,011	4,106	3,396
Exports	7,714	8,986	12,617	13,652	16,378	17,329
Traditional	5,369	6,267	9,028	9,583	12,056	12,430
Nontraditional and others	2,345	2,719	3,589	4,068	4,322	4,899
Imports	-7,422	-8,255	-9,824	-10,641	-12,272	-13,933
Services, income, and current transfers (net)	-1,355	-1,716	-2,803	-2,646	-3,852	-3,100
Services	-941	-854	-843	-919	-959	-1,001
Investment income	-1,457	-2,082	-3,421	-3,313	-4,592	-3,941
Current transfers	1,043	1,220	1,460	1,586	1,700	1,842
Financial and capital account	**1,881**	**1,392**	**2,337**	**-770**	**788**	**-317**
Public sector	1,096	684	988	-106	-1,006	-298
Disbursements 1/	2,902	2,161	2,535	1,573	2,300	1,003
Amortization 1/	-1,843	-1,229	-1,389	-1,571	-2,971	-1,186
Other medium- and long-term Public sector flows 2/	37	-248	-158	-108	-335	-115
Capital transfers (net)	0	0	0	0	0	0
Privatization	186	10	31	10	31	10
Private sector	599	697	1,318	-674	1,763	-30
Foreign direct investment (FDI) Excluding privatization	1,970	1,265	1,785	483	2,122	772
Other private capital	-1,412	-1,233	-557	-1,157	-285	-801
Medium- and long-term loans	-146	-166	-411	220	-470	-84
Portfolio investment	-472	-1,214	-376	-794	20	-678
Short-term flows 3/	-794	147	231	-583	164	-39
Net Errors and Omissions	41	665	90	0	-75	0
Balance	**818**	**407**	**2,326**	**405**	**1,042**	**-22**
Financing	**-818**	**-407**	**-2,326**	**300**	**-1,042**	**22**
NIR flow (increase -)	-832	-477	-2,353	300	-1,171	0
Change in NIR (increase -)	-985	-596	-2,437	300	-1,020	0
Valuation change	-153	-119	-84	0	151	0
Exceptional financing	14	70	27	105	129	22
Debt relief 4/	14	70	27	105	129	22
Change in arrears	0	0	0	0	0	0
Rescheduling	0	0	0	0	0	0
				0		
Memorandum items:						
Current account balance	**-1.9**	**-1.6**	**0.0**	**0.5**	**0.3**	**0.4**
Capital and financial account balance (in percent of GDP)	3.3	2.3	3.4	-1.0	1.0	-0.4
Export value (US$), percent change	9.8	16.5	40.4	8.8	29.8	5.8
Volume growth	5.7	8.7	14.2	8.9	12.8	5.1
Price growth	3.9	7.1	23.0	0.4	15.1	0.7
Import value (US$), percent change	2.8	11.2	19.0	8.4	24.9	13.5
Volume growth	1.7	5.4	7.5	5.2	14.7	9.6
Price growth	1.1	5.5	10.7	3.0	8.9	3.5
GDP (in billions of US$)	56.5	60.8	68.6	75.4	77.3	81.7
Average exchange rate (S/. per US$)	3.52	3.48	3.41	3.31	3.29	3.39

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

1/ In 2002, includes the Brady Bond swap. For details of the swap, see Country Report No. 03/72, Box 3.
2/ Includes portfolio flows of the pension reserve fund and subscription payments into international funds.
3/ Includes COFIDE and Banco de la Nación. Outflows in 2002 reflect a further reduction in the financial system's short-term debt.
4/ Debt relief under existing operations.

Table 10. Peru: External Financing Requirements and Sources

(In millions of U.S. dollars)

			Prel.	2005		Proj.
	2002	2003	2004	Prog.	Proj.	2006
Gross financing requirements	**7,768**	**5,986**	**7,125**	**4,255**	**7,727**	**4,598**
External current account deficit (excluding official transfers)	**1,063**	**985**	**11**	**-365**	**-254**	**-295**
Debt amortization	5,873	4,524	4,761	4,920	6,809	4,893
Medium- and long-term debt	2,664	1,954	2,247	2,151	4,058	2,006
Public sector	1,843	1,229	1,389	1,571	2,971	1,186
Multilateral 1/	399	486	571	612	604	650
Bilateral	496	686	742	856	2,266	401
Bonds and notes	940	50	67	93	90	90
Other	8	7	9	10	11	45
Private sector	821	725	858	580	1,087	820
Short-term debt 2/	3,209	2,570	2,514	2,769	2,751	2,887
Rescheduling and repayment of arrears	0	0	0	0	0	0
Accumulation of NIR (flow)	832	477	2,353	-300	1,171	0
Change in gross reserves	852	513	2,440	-320	1,014	-6
Payments of short-term liabilities incl. IMF	133	84	-3	20	6	6
Other	-153	-119	-84	0	151	0
Available financing	**7,768**	**5,986**	**7,125**	**4,255**	**7,727**	**4,598**
Foreign direct investment (net)	2,156	1,275	1,816	493	2,153	782
Privatization	186	10	31	10	31	10
FDI	1,970	1,265	1,785	483	2,122	772
Portfolio (net)	-472	-1,214	-376	-794	20	-678
Short-term assets (flow)	-163	847	102	-615	-47	-39
Of which: Errors and omissions	41	665	90	0	-75	0
Debt financing from private creditors	5,179	4,346	4,474	4,028	4,682	3,623
Medium- and long-term financing	2,560	1,811	1,742	1,227	1,795	735
To public sector	1,886	1,252	1,295	427	1,177	0
To private sector	675	559	447	800	618	735
Short-term financing	2,619	2,535	2,732	2,801	2,887	2,887
					68	46
Official creditors 3/	1,016	909	1,240	1,146	1,123	1,003
Multilateral 1/	807	699	1,049	919	877	811
Of which: Balance of payments financing	625	527	863	581	581	499
Bilateral	209	210	191	227	246	193
To public sector	209	210	191	227	246	193
To private sector	0	0	0	0	0	0
Other medium- and long-term public sector flows 4/	51	-178	-131	-3	-205	-93

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

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

Table 11. Peru: Medium-Term Macroeconomic Framework

				Staff Projections					
	2002	2003	2004	2005	2006	2007	2008	2009	2010
			(Annual percentage change)						
GDP at constant prices	4.9	3.8	4.8	5.8	5.0	4.5	4.5	4.5	4.5
Consumer prices (end of period)	1.5	2.5	3.5	1.5	2.5	2.5	2.5	2.5	2.5
GDP deflator	0.6	2.2	5.4	2.6	1.6	2.1	2.1	2.2	2.3
Merchandise trade									
Exports, f.o.b.	9.8	16.5	40.4	29.8	5.8	1.8	3.4	5.6	6.3
Imports, f.o.b.	2.8	11.2	19.0	24.9	13.5	8.8	7.0	7.2	6.8
Terms of trade (deterioration -)	3.1	1.3	9.1	5.6	-2.8	-3.1	-2.7	-2.2	-1.1
			(In percent of GDP; unless otherwise indicated)						
External current account balance	-1.9	-1.6	0.0	0.3	0.4	0.0	-0.3	-0.3	-0.3
External current account, excluding interest obligations	0.7	1.8	5.0	6.3	5.2	3.9	3.2	2.9	2.7
Total external debt service 1/	7.4	5.5	5.4	7.4	4.7	4.4	4.7	4.0	4.1
Medium- and long-term	7.2	5.4	5.2	7.2	4.5	4.2	4.5	3.8	3.9
Nonfinancial public sector	5.1	3.8	3.7	5.5	3.1	3.0	3.4	2.7	2.8
Private sector	2.1	1.5	1.5	1.7	1.4	1.2	1.2	1.1	1.0
Short-term 2/	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
External debt service 3/	7.4	5.5	5.4	7.4	4.8	4.4	4.8	4.0	4.1
Interest	2.4	2.2	2.1	2.2	2.3	2.2	2.1	1.9	1.8
Amortization (medium-and long-term)	5.0	3.3	3.3	5.3	2.5	2.3	2.7	2.1	2.2
Combined public sector primary balance	0.0	0.5	1.0	1.3	1.2	1.1	1.1	1.1	1.0
General government current revenue 4/	17.2	17.6	17.8	18.4	18.3	18.2	18.1	18.1	18.1
General govt. non-interest expenditure 5/	17.4	17.3	16.9	17.1	17.3	17.1	17.1	17.1	17.2
Combined public sector interest due	2.2	2.2	2.1	2.1	2.2	2.2	2.1	2.0	2.0
Combined public sector overall balance	-2.2	-1.7	-1.1	-0.7	-1.0	-1.0	-1.0	-1.0	-1.0
Public sector debt 1/	47.1	47.5	45.1	39.1	37.2	35.9	34.6	33.4	32.2
Gross domestic investment	18.8	18.8	18.5	19.0	19.5	19.7	20.0	20.2	20.4
Public sector	2.8	2.9	2.8	3.0	3.2	3.3	3.3	3.4	3.4
Private sector	15.9	15.9	15.7	16.1	16.3	16.5	16.7	16.8	17.0
National savings	16.8	17.0	18.3	19.3	19.9	19.8	19.7	19.8	20.0
Public sector 6/	0.8	1.3	1.7	2.3	2.3	2.3	2.3	2.5	2.5
Private sector	16.0	15.8	16.5	17.0	17.6	17.4	17.3	17.4	17.5
External savings	2.0	1.7	0.0	-0.3	-0.4	0.0	0.3	0.3	0.3
Memorandum items:									
Nominal GDP (billions of New Soles)	198.9	211.5	234.3	254.3	271.3	289.5	308.9	330.0	352.7
Gross international reserves (billions of U.S. dollars)	9,690	10,206	12,649	13,669	13,669	13,819	14,019	14,239	14,459
Gross international reserves to broad money	65.9	67.4	73.6	67.4	63.6	61.6	59.8	58.1	56.4
External debt service (percent of exports of GNFS)	45.1	31.4	25.4	31.1	19.7	19.5	21.0	17.7	18.1
Short-term external debt service (percent of exports of GNFS) 6/	1.3	0.8	0.7	0.9	1.0	1.0	0.9	0.9	0.8
Public external debt service (percent of exports of GNFS)	30.9	21.7	17.6	22.8	12.7	13.0	14.9	12.0	12.7

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

1/ Spike in 2008 reflects bullet-payment amortizations of international bond issues from 2002 and 2003.
2/ Includes interest payments only.
3/ Includes the financial public sector
4/ Assumes that the financial transactions tax expires at end-2006.
5/ Real expenditure growth is limited to 3 percent a year under the nation's fiscal responsibility law.
6/ Excludes privatization receipts.
7/ Interest only.

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

	Dec-00	Dec-01	Dec-02	Dec-03	Dec-04	Sep-05
Capital Adequacy						
Equity capital to risk-weighted assets 2/	12.8	12.8	12.5	13.3	14.0	13.3
Regulatory Tier I capital to risk-weighted assets 2/ 3/	12.7	12.4	12.4	12.1	13.1	12.3
Nonperforming loans net of provisions to capital	-4.6	-11.1	-17.2	-15.2	-17.3	-19.3
Asset Quality						
Nonperforming loans to total gross loans 4/	9.7	9.0	7.6	5.8	3.7	2.68
In domestic currency	7.0	5.2	5.2	4.0	3.0	2.74
In foreign currency	10.3	9.9	8.2	6.3	3.9	2.66
Nonperforming loans to total gross loans 5/	16.8	17.0	14.6	12.2	9.5	7.5
In domestic currency	11.5	9.9	8.8	6.6	6.2	5.2
In foreign currency	17.9	19.0	16.4	14.1	10.8	8.4
Refinanced and restructured loans to total gross loans 6/	6.1	8.0	7.0	6.4	5.8	4.9
Provisions to nonperforming loans	107.4	118.9	133.2	141.1	176.5	205.3
Sectoral distribution of loans to total loans						
Consumer loans	6.7	8.6	9.4	11.6	13.4	14.5
Mortgage loans	7.8	9.6	10.7	12.9	14.2	15.0
Commercial loans	84.7	79.2	77.6	72.6	68.1	65.7
Small business loans	0.9	2.5	2.3	2.9	4.3	4.8
Earnings and Profitability						
ROA	0.3	0.4	0.8	1.1	1.2	2.0
ROE	3.0	4.5	8.4	10.8	11.3	19.5
Gross financial spread to financial revenues	47.9	51.9	66.1	71.2	71.9	71.3
Financial revenues to total revenues	80.3	78.8	72.7	70.6	69.1	73.8
Annualized financial revenues to revenue-generating assets	14.7	11.6	9.9	9.2	9.0	10.1
Liquidity						
Total liquid assets to total short-term liabilities	...	39.2	41.9	40.4	44.5	44.2
In domestic currency	19.4	22.6	23.5	32.9	44.8	53.5
In foreign currency	37.7	46.0	49.3	43.9	44.3	39.0
Foreign Currency Position and Dollarization						
Global position in foreign currency to regulatory capital 7/	35.7	37.6	37.0	31.8	24.2	20.2
Share of foreign currency deposits in total deposits	73.5	71.9	71.6	69.7	67.1	64.8
Share of foreign currency loans in total credit	81.9	80.5	79.7	77.9	75.7	74.1
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	8,729	9,357	9,658	9,210	9,596	8,939
Commercial banks' short-term foreign assets (in millions of U.S. dollars)	824	748	779	601	547	652
Commercial banks' short-term foreign liabilities (in millions of U.S. dollars)	1,519	1,161	763	702	733	829
Operational efficiency						
Financing to related parties to capital 2/ 8/	...	...	20.1	18.7	14.3	15.7
Nonfinancial expenditure to total revenues 9/	29.8	32.1	36.2	37.7	35.9	32.0
Nonfinancial expenditure to total revenue-generating assets 9/	5.5	4.7	4.9	4.9	4.7	4.6
Memorandum items:						
Number of Banks	17	16	16	16	16	14
Private commercial	16	15	14	14	14	12
Of which: Foreign-owned	10	10	9	9	9	7
State-owned	1	1	2	2	2	2
Banks' credit card loans to total loans	0.0	2.4	3.3	4.6	6.4	6.7
Bank loans' 12 month increase (in real terms)	-11.7	-3.3	1.0	-8.3	-1.9	10.9
Stock market index (U.S. dollars)	342.8	342.1	396.0	700.6	1,131.6	1,516.1
Foreign currency debt rating (Moody's)	Ba3	Ba3	Ba3	Ba3	Ba3	Ba3
Spread of Peruvian Brady bonds, basis points	687	521	610	312	220	138

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

1/ These indicators correspond to private commercial banks.
2/ In 2005, corresponds to August.
3/ Tier I regulatory capital is equivalent to share capital and reserves. Risk-weighted assets include market risk exposure. In year 2002, the Tier I considers a reduction on Banco Santander Central Hispano capital due to the valorization before its merge with Banco de Crédito.
4/ Nonperforming loans are overdue loans after 15 days since the due date for commercial loans, after 30 days for small bussines loans. In the case of mortgage, consumer and leasing loans, they are considered overdue after 30 days since the due date only for the non paid portion and after 90 days, for all the credit. The overdue loans include credits under judicial resolution.
5/ Includes restructured loans, refinanced loans, and arrears.
6/ Refinanced loans refer to those loans subjected either term and/or principal modifications with respect to the initial debt contract. Restructured loans refer to those loans whose payments have been restructured according to the "Ley General del Sistema Concursal".
7/ Global position in foreign currency corresponds to those items in the balance sheet subject to exchange rate risk.
8/ Financing to related parties corresponds to those loans to individuals and firms owning more than 4 percent of the bank.
9/ Nonfinancial expenditures do not consider provisions nor depreciations.

Table 13. Peru: Financial and External Vulnerability Indicators

(In percent; unless otherwise indicated)

	2002	2003	Prel. 2004	2005 Prog.	2005 Proj.	Proj. 2006
Financial indicators						
Public sector debt/GDP	47.1	47.5	45.1	42.2	39.1	37.2
Of which: in domestic currency (percent of GDP)	7.0	7.2	7.0	6.8	8.2	7.8
90-day prime lending rate, domestic currency (end of period)	5.1	3.3	3.8	...	...	...
90-day prime lending rate, foreign currency (end of period)	2.4	1.7	2.6	...	...	...
Velocity of money 1/	3.8	4.0	4.0	4.0	3.8	3.8
Net credit to the private sector/GDP 2/	30.4	29.6	28.1	25.9	25.8	25.5
External indicators						
Exports, U.S. dollars (percent change)	9.8	16.5	40.4	8.8	29.8	5.8
Imports, U.S. dollars (percent change)	2.8	11.2	19.0	8.4	24.9	13.5
Terms of trade (percent change) (deterioration -)	3.1	1.3	9.1	...	5.6	-2.8
Real effective exchange rate, (end of period, percent change) 3/	-5.5	-9.9	0.8	...	-1.0	...
Current account balance (percent of GDP)	-1.9	-1.6	0.0	0.5	0.3	0.4
Capital and financial account balance (percent of GDP)	3.3	2.3	3.4	-1.0	1.0	-0.4
Total external debt (percent of GDP)	49.4	48.7	45.3	41.8	37.9	35.5
Medium- and long-term public debt (in percent of GDP) 4/	36.8	37.5	35.6	32.4	29.7	27.9
Medium- and long-term private debt (in percent of GDP)	8.0	7.1	5.7	5.7	4.4	4.1
Short-term public and private debt (in percent of GDP)	4.6	4.2	4.0	3.7	3.8	3.5
Total external debt (in percent of exports of goods and services) 4/	301.5	277.0	214.1	201.7	158.1	147.3
Total debt service (in percent of exports of goods and services) 5/	45.1	31.4	25.4	25.0	31.1	19.7
Gross official reserves, in						
millions of U.S. dollars	9,690	10,206	12,649	12,343	13,669	13,669
percent of short-term external debt 6/	214.2	214.4	185.8	243.3	279.4	280.2
percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	68.3	71.6	75.6	...	87.3	86.4
percent of broad money 8/	65.9	67.2	70.7	68.7	67.4	63.6
percent of foreign currency deposits at banks	100.6	107.3	127.4	122.7	127.0	124.9
months of next year's imports of goods and services	10.8	9.7	9.9	10.9	9.5	8.9
Net international reserves (in millions of U.S. dollars)	9,598	10,194	12,631	12,331	13,651	13,651
Net international reserves (program definition; in millions of U.S. dollars) 9/	5,830	6,906	9,304	9,005	10,385	10,214
Net foreign exchange position (in millions of U.S. dollars) 10/	3,341	4,583	6,939	6,592	8,020	7,849

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

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

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

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

1/ Total access under the Stand-By Arrangement is SDR 287.279 million (21 percent of quota on an annual basis).

2/ This amount is required to bring total disbursements outstanding to above 25 percent of quota.

Table 15. Peru: Capacity to Repay the Fund as of October 31st, 2005 1/

(In millions of SDRs; unless otherwise indicated)

	2005 2/	2006	2007	2008	2009	2010	2011	Total
Obligations from existing drawings								
Principal (repurchases)	0.0	26.8	13.4	0.0	0.0	0.0	0.0	40.1
Charges and interest 2/								
GRA charges	0.4	1.2	0.2	0.0	0.0	0.0	0.0	1.7
SDR charges	0.6	2.6	2.6	2.6	2.6	2.6	2.6	16.4
Credit outstanding	40.1	13.4	0.0	0.0	0.0	0.0	0.0	...
(percent of quota)	6.3	2.1	0.0	0.0	0.0	0.0	0.0	...
Obligations from prospective drawings								
Principal (repurchases)	0.0	0.0	0.0	0.0	122.9	143.6	20.7	287.3
Charges and interest 3/								
GRA charges	0.0	10.0	12.2	12.2	10.6	4.9	0.4	50.2
Service charges	1.0	0.4	0.0	0.0	0.0	0.0	0.0	1.4
Credit outstanding	204.4	287.3	287.3	287.3	164.4	20.7	0.0	...
(percent of quota)	32.0	45.0	45.0	45.0	25.7	3.2	0.0	...
Cumulative (existing and prospective)								
Principal (repurchases)	0.0	26.8	13.4	0.0	122.9	143.6	20.7	327.4
Charges and interest 3/								
GRA charges	0.4	11.1	12.3	12.2	10.6	4.9	0.4	52.0
SDR and Service charges	1.6	3.0	2.6	2.6	2.6	2.6	2.6	17.8
Credit outstanding	244.5	300.7	287.3	287.3	164.4	20.7	0.0	...
percent of quota	38.3	47.1	45.0	45.0	25.7	3.2	0.0	...
percent of GDP	0.5	0.5	0.5	0.5	0.2	0.0	0.0	...
percent of exports of goods and services	2.0	2.2	2.1	2.0	1.1	0.1	0.0	...
percent of public sector debt service	6.8	12.7	11.5	10.1	6.5	0.7	0.0	...
percent of external public debt	1.6	1.9	1.9	1.8	1.1	0.1	0.0	...
percent of external public debt service	8.6	17.6	16.2	13.5	9.1	1.0	0.0	...
percent of gross foreign reserves	2.6	3.2	3.0	3.0	1.7	0.2	0.0	...
Memorandum items:								
Purchases	204.4	82.9	0.0	0.0	0.0	0.0	0.0	287.3

Sources: Fund staff estimates/projections.

1/ Assuming all purchases are made. Repurchases assumed to be made under obligations schedule.
2/ November - December 2005
3/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA. The current SDR interest rate is assumed for net use of SDRs.

Table 16. Peru: Millennium Development Goals

	1995	2001	2002	2003	2015 Target
Goal 1: Eradicate extreme poverty and hunger					
Population below $1 a day (in percent of population)	...	18.1	...	...	9.1
Poverty gap at $1 a day (in percent of total population,)	...	9.1	...	...	4.6
Percent of income or consumption held by poorest 20 percent	...	2.9	...	...	1.5
Prevalence of child malnutrition (in percent of children under 5)	7.8	7.1	...	...	5.4
Pop. below min. of dietary energy consumption (in percent of total)	18.0	11.0	13.0	...	20.0
Goal 2: Achieve universal primary education					
Net primary enrollment ratio (in percent of relevant age group)	90.8	99.9	...	99.7	100.0
Percentage of cohort reaching grade 5 (in percent)	...	87.4	...	...	100.0
Youth literacy rate (in percent of ages 15-24)	95.7	96.9	96.8	...	100.0
Goal 3: Promote gender equality and empower women					
Ratio of girls to boys in primary and secondary education (in percent)	96.0	97.0	97.1	...	100.0
Ratio of young literate females to males (in percent of ages 15-24)	96.0	97.1	97.8	...	100.0
Share of women employed in the nonagricultural sector (in percent)	30.5	34.6	35.0	37.2	...
Proportion of seats held by women in national parliament (in percent)	10.0	...	...	18.0	...
Goal 4: Reduce child mortality					
Under 5 mortality rate (per 1,000)	60.0	42.0	39.0	34.0	53.3
Infant mortality rate (per 1,000 live births)	46.0	40.0	30.0	26.0	...
Immunization, measles (in percent of children under 12 months)	98.0	97.0	95.0	95.0	...
Goal 5: Improve maternal health					
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	410.0	...	...	307.5
Births attended by skilled health staff (in percent of total)	56.4	59.3	...	...	...
Goal 6: Combat HIV/AIDS, malaria and other diseases					
Prevalence of HIV, female (in percent of ages 15-24)	...	0.2	0.2	0.5	0.1
Contraceptive prevalence rate (in percent of women ages 15-49)	64.0	68.9	...	...	...
Number of children orphaned by HIV/AIDS	...	17000	...	...	...
Incidence of tuberculosis (per 100,000 people)	196.7	196.0	202.4	187.6	...
Tuberculosis cases detected under DOTS	99.0	94.0	84.5	81.1	...
Goal 7: Ensure environmental sustainability					
Forest area (in percent of total land area)	...	50.9	...	...	...
Nationally protected areas (in percent of total land area)	2.7	2.7	6.1	6.1	...
GDP per unit of energy use (PPP $ per kg oil equivalent)	8.9	10.4	10.7	...	...
CO2 emissions (metric tons per capita)	1.0	1.1	...	...	...
Access to an improved water source (in percent of total population)	...	80.0	81.0	...	87.0
Access to improved sanitation (in percent of total population)	...	71.0	62.0	...	...
Access to secure tenure (in percent of total population)	...	...	...	...	...
Goal 8: Develop a Global Partnership for Development					
Youth unemployment rate (in percent of labor force ages 15-24)	11.4	13.2	15.2	15.2	...
Fixed line and mobile telephones (per 1,000 people)	50.3	136.7	152.3	173.1	...
Personal computers (per 1,000 people)	14.9	47.9	43.0	...	...

Sources: United Nations, Report 2004.

Peru—Debt Sustainability Analysis[16]

Under the baseline debt sustainability scenario, Peru's debt-to-GDP ratio is projected to decline to moderate levels over the medium term. Economic growth would average 4.5 percent a year, and the overall deficit of the combined public sector would be kept at the equivalent of 1 percent of GDP, in line with the requirements of the Fiscal Responsibility and Transparency Law. Medium-term fiscal projections assume that government revenue would remain broadly unchanged as a percent to GDP, which implies that new tax measures will likely have to be implemented to compensate for the revenue loss associated with the elimination of several temporary taxes and the reduction in custom duties resulting from trade agreements. Under these assumptions, Peru's public sector debt stock would decline from 45.1 percent of GDP at end-2004 to about 32.4 percent of GDP by 2010.

Given that 80 percent of total external debt is public, in the baseline scenario the projected drop in public debt largely determines the path of Peru's total external debt. Private sector external debt is projected to decline slightly, as companies continue to fund investments through FDI or, increasingly, the domestic capital market. As a result, total external debt is projected to decline from 45 percent of GDP at end-2004 to 28 percent by 2010 (public external debt would decline from 36 percent to 22 percent over the same period).

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

In contrast, external and public debt ratios are sensitive to changes in exchange rate changes, given the high foreign currency composition of Peru's debt. Specifically, under a one-off 30 percent depreciation of the exchange rate, the external debt to GDP ratio would shift by 17 percentage points above the baseline projections in medium-term. It should be noted that this test assumes that the exchange rate would remain at its depreciated level over the medium-term—a scenario that would only occur if the current exchange rate were to be significantly overvalued. Available data, however, do not point to such an overvaluation.

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

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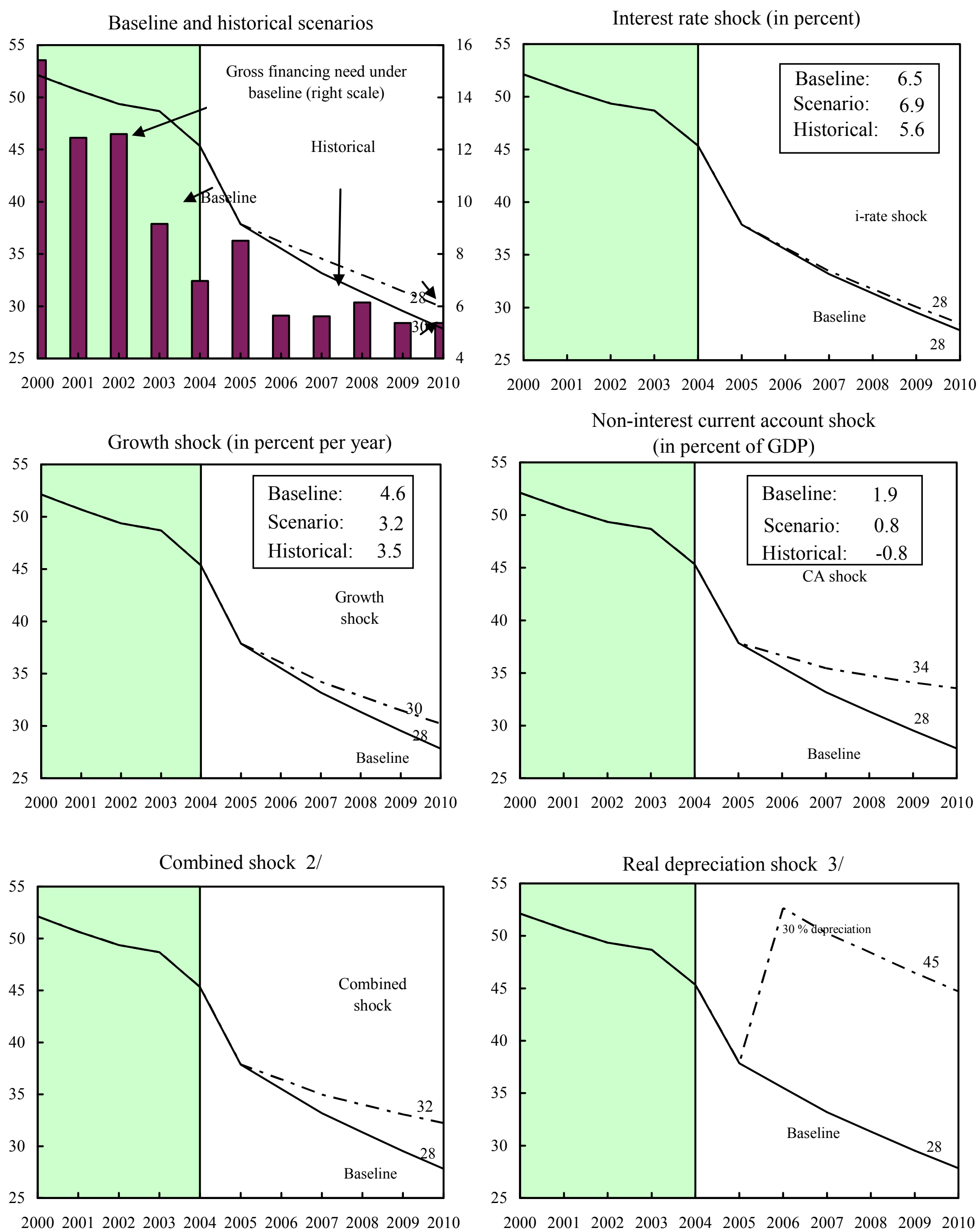
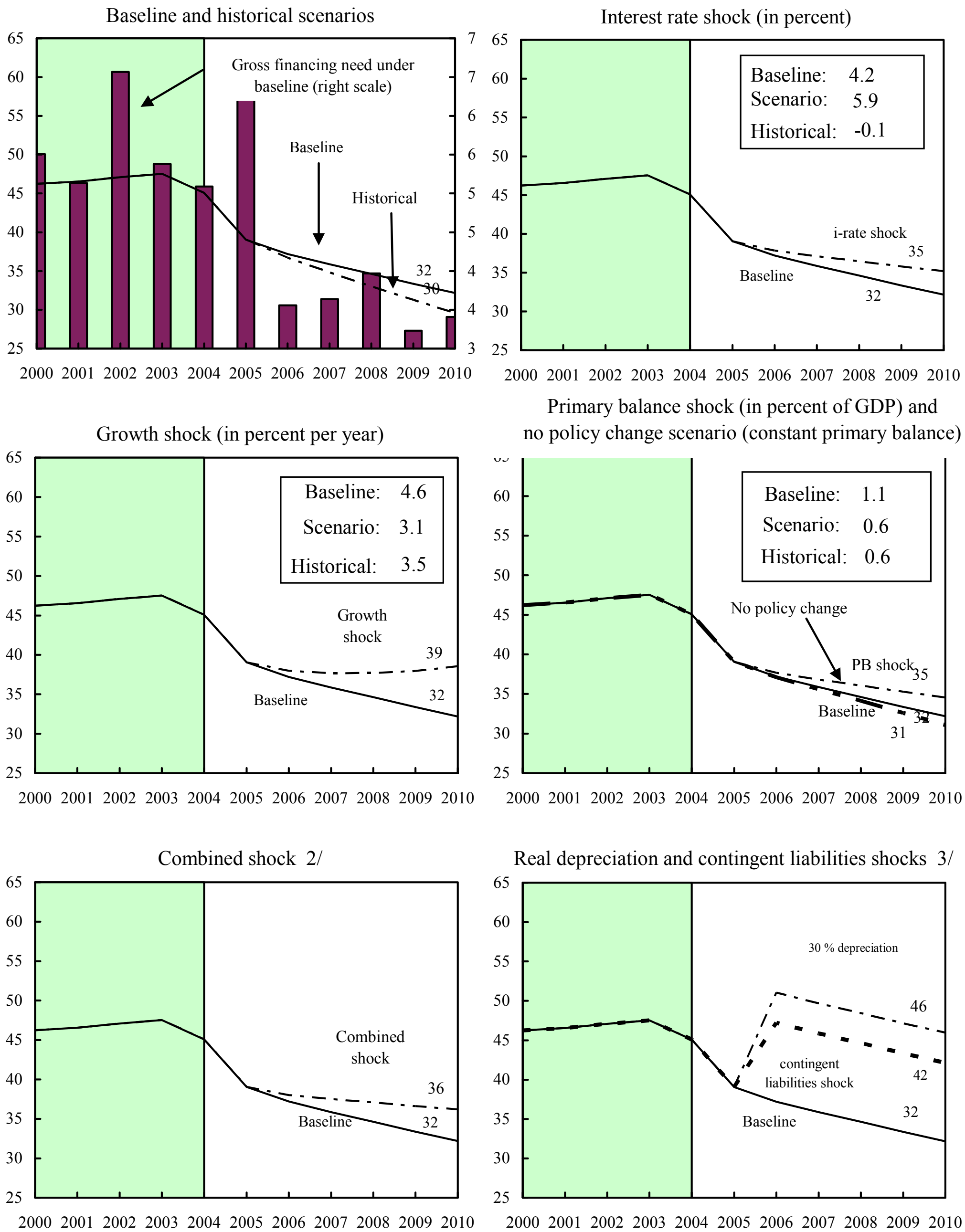
[16] The DSA includes standard sensitivity tests around the baseline medium-term scenario.

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



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2006.

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



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

Table 1. Peru: External Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	52.1	50.7	49.4	48.7	45.3	**37.9**	**35.5**	**33.2**	**31.3**	**29.5**	**27.8**	**-0.4**
Change in external debt	-3.2	-1.5	-1.3	-0.7	-3.3	-7.5	-2.3	-2.3	-1.8	-1.8	-1.7	
Identified external debt-creating flows (4+8+9)	-0.3	0.6	-3.3	-1.9	-7.4	-5.1	-2.1	-1.9	-1.5	-1.5	-1.4	
Current account deficit, excluding interest payments	-0.5	-0.9	-0.5	-0.6	-2.1	-2.5	-2.7	-2.2	-1.7	-1.6	-1.5	
Deficit in balance of goods and services	2.1	1.9	1.1	0.2	-4.1	-4.1	-2.9	-1.6	-0.9	-0.7	-0.5	
Exports	15.8	15.9	16.4	17.6	21.2	24.0	24.1	23.2	22.7	22.5	22.5	
Imports	17.9	17.8	17.5	17.8	17.1	19.9	21.2	21.6	21.7	21.9	21.9	
Net non-debt creating capital inflows (negative)	-1.1	-1.5	-2.7	0.0	-1.9	-2.4	0.1	-0.4	-0.4	-0.5	-0.5	
Automatic debt dynamics 1/	1.3	3.0	-0.1	-1.3	-3.5	-0.1	0.5	0.6	0.6	0.6	0.6	
Contribution from nominal interest rate	3.4	3.1	2.4	2.2	2.1	2.2	2.3	2.2	2.1	1.9	1.8	
Contribution from real GDP growth	-1.5	-0.1	-2.3	-1.9	-2.1	-2.3	-1.8	-1.5	-1.4	-1.3	-1.2	
Contribution from price and exchange rate changes 2/	-0.6	0.1	-0.2	-1.6	-3.5	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-3.0	-2.0	2.0	1.2	4.1	-2.4	-0.3	-0.4	-0.3	-0.3	-0.3	
External debt-to-exports ratio (in percent)	329.8	317.9	301.5	277.0	214.1	158.1	147.3	143.0	138.3	131.2	123.9	
Gross external financing need (in billions of US dollars) 4/	8.3	6.7	7.1	5.6	4.8	6.6	4.6	4.9	5.7	5.2	5.6	
in percent of GDP	15.4	12.4	12.6	9.2	7.0	8.5	5.6	5.6	6.1	5.4	5.4	
Scenario with key variables at their historical averages 5/						**37.9**	**36.1**	**34.5**	**33.0**	**31.4**	**29.8**	**-2.6**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.8	0.2	4.9	4.0	4.8	5.8	5.0	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	1.1	-0.1	0.3	3.5	7.7	6.4	0.7	1.6	1.6	1.7	1.8	
Nominal external interest rate (in percent)	6.3	5.9	5.0	4.9	4.9	5.4	6.4	6.4	6.6	6.5	6.6	
Growth of exports (US dollar terms, in percent)	10.4	0.8	8.1	15.6	36.0	27.4	6.4	2.2	3.7	5.6	6.2	
Growth of imports (US dollar terms, in percent)	6.7	-0.4	3.4	9.2	8.5	31.1	12.6	8.3	6.8	6.9	6.8	
Current account balance, excluding interest payments	0.5	0.9	0.5	0.6	2.1	2.5	2.7	2.2	1.7	1.6	1.5	
Net non-debt creating capital inflows	1.1	1.5	2.7	0.0	1.9	2.4	-0.1	0.4	0.4	0.5	0.5	

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

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

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

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

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

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

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

	Actual					Projections						
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	46.2	46.5	47.1	47.5	45.1	**39.1**	**37.2**	**35.9**	**34.6**	**33.4**	**32.2**	**-0.1**
o/w foreign-currency denominated	40.2	39.4	40.1	40.3	38.1	30.8	29.4	28.3	27.4	26.4	25.4	
Change in public sector debt	-2.0	0.3	0.6	0.4	-2.5	-6.0	-1.8	-1.3	-1.2	-1.3	-1.2	
Identified debt-creating flows (4+7+12)	-0.1	0.0	-0.9	-1.0	-4.4	-2.9	-1.5	-1.3	-1.2	-1.3	-1.2	
Primary deficit	0.7	0.0	0.0	-0.4	-1.0	-1.3	-1.2	-1.1	-1.1	-1.1	-1.0	
Revenue and grants	18.2	18.2	17.7	18.2	18.2	18.8	18.8	18.6	18.5	18.5	18.5	
Primary (noninterest) expenditure	18.9	18.2	17.7	17.8	17.2	17.5	17.6	17.5	17.4	17.4	17.5	
Automatic debt dynamics 2/	-0.1	0.6	-0.1	-0.5	-3.2	-1.5	-0.2	-0.2	-0.1	-0.2	-0.2	
Contribution from interest rate/growth differential 3/	-0.5	1.5	-0.3	-0.8	-2.5	-1.5	-0.2	-0.2	-0.1	-0.2	-0.2	
Of which contribution from real interest rate	0.7	1.6	1.9	0.9	-0.4	0.9	1.6	1.4	1.4	1.3	1.2	
Of which contribution from real GDP growth	-1.3	-0.1	-2.1	-1.7	-2.2	-2.4	-1.8	-1.6	-1.5	-1.5	-1.4	
Contribution from exchange rate depreciation 4/	0.4	-1.0	0.1	0.3	-0.7	...	...	...	...	...	...	
Other identified debt-creating flows	-0.8	-0.6	-0.7	-0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.8	-0.6	-0.7	-0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-1.9	0.3	1.4	1.4	1.9	-3.1	-0.4	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	254.7	255.9	266.2	261.7	247.2	207.9	197.5	192.8	187.5	180.3	174.1	
Gross financing need 6/	5.5	5.1	6.6	5.4	5.1	6.4	3.6	3.6	4.0	3.2	3.4	
in billions of U.S. dollars	2.9	2.8	3.7	3.3	3.5	5.0	2.9	3.2	3.7	3.2	3.5	
Scenario with key variables at their historical averages 7/						**39.1**	**36.7**	**34.8**	**33.0**	**31.3**	**29.6**	**-0.9**
Scenario with no policy change (constant primary balance) in 2005-2010						**39.1**	**37.1**	**35.6**	**34.1**	**32.6**	**31.1**	**-0.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.8	0.2	4.9	3.8	5.1	5.8	5.0	4.5	4.5	4.5	4.5	
Average nominal interest rate on public debt (in percent) 8/	5.4	4.9	4.9	4.7	4.8	4.9	6.1	6.2	6.3	6.3	6.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.7	3.6	4.3	2.1	-0.6	2.3	4.5	4.1	4.2	4.0	4.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-1.0	2.4	-0.3	-0.6	1.9	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	3.7	1.4	0.6	2.6	5.4	2.6	1.6	2.1	2.1	2.2	2.3	
Primary deficit	0.7	0.0	0.0	-0.4	-1.0	-1.3	-1.2	-1.1	-1.1	-1.1	-1.0	

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

Peru: Fund Relations
(As of October 31, 2005)

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

II. General Resources Account	**SDR Million**	**Percent Quota**
Quota	638.40	100.00
Fund holdings of currency	678.56	106.29

III. SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	91.32	100.00
Holdings	1.38	1.51

IV. Outstanding Purchases and Loans	**SDR Million**	**Percent Quota**
Extended arrangements	40.13	6.29

V. Financial Arrangements

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

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

	Overdue 12/31/03	**2005**	**2006**	**2007**	**2008**	**2009**
Principal	0	0	26.75	13.38	0.00	0.00
Charges/interest	0	1.05	3.78	2.79	2.63	2.62
Total	0	1.05	30.53	16.16	2.63	2.62

VII. Safeguards Assessments

The safeguards assessment of the central bank was completed on October 26, 2004. The assessment found that, with few exceptions, safeguards at the Banco Central de Reserva del Peru (BCRP) meet the requirements of the safeguards policy. The assessment recommended that by end-January 2005 the BCRP and the Comptroller General's Office agree on a Memorandum of Understanding, which would harmonize the respective organic laws in the area of oversight of the external and internal audit mechanisms. Letters clarifying the two institutions' respective responsibilities were exchanged.

VIII. Exchange Arrangements

Peru maintains a unified, managed floating exchange rate. On December 14, 2005, the average of interbank buying and selling rates was 3.44 *Nuevo Sol* per U.S. dollar. The central government maintains external payments arrears to unguaranteed suppliers, some of whom are in discussions with the government, while the rest have not been located. Peru has maintained a clearing arrangement with Malaysia since 1991.

IX. Last Article IV Consultation

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

X. FSAP and ROSCs

Several joint Fund-Bank missions visited Lima in the period September 2000–January 2001 to conduct an FSAP for Peru. In October 2002, an FAD mission conducted a Fiscal ROSC for Peru, while an STA mission conducted a Data ROSC for Peru in February 2003.

XI. Technical Assistance

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

XII. Resident Representative

Ms. Nicoletta Batini has been selected as Resident Representative.

Peru—World Bank Relations

Bank Group strategy

The World Bank Group Country Assistance Strategy (CAS), discussed by the IBRD Board on September 17, 2002, supports the implementation of the government's poverty reduction strategy with programs addressing fiscal, national competitiveness, and social-sector needs. In November 2003, the Bank decided to move Peru to a CAS high-case lending scenario with a total envelope of around US$300–400 million a year over FY04–06. New lending includes quick-disbursing programmatic loans investment projects for an additional US$200 million a year.

In FY 2005, following the additional priorities outlined in the CAS progress report, the Bank approved eight operations (including 2 adjustment loans for US$100 million) for US$255 million, and an additional US$200 million Infrastructure Guarantee Facility. US$233 million (adjustment and investment) were disbursed in FY05. To date, in FY06 two operations have been approved, the Regional Transport Decentralization project for $50 million and the Decentralization and Competitiveness Development Policy Loan for $150 million. It is expected that by the end of FY06, 4 more operations will have gone to the Board for a net commitment of about US$285 million. The disbursement level should hover around US$200 million.

Bank-Fund collaboration in specific areas

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

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

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

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

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

Statement of World Bank Loans
(As of November 2005)

Loan Number	Year approved	Borrower	Purpose	In millions of U.S. dollars: Total (Net of Cancellation)	Undisbursed
One hundred ten (118) loans fully disbursed[1]				4,799.8	
Partially disbursed or undisbursed loans:					
45270	1999	Republic of Peru	Health Reform Program	27.0	4.2
46140	2001	Republic of Peru	Second Rural Roads Rehabilitation and Maintenance	50.0	16.5
71760	2003	Republic of Peru	Rural Education Project	52.5	46.1
71770	2003	Republic of Peru	Trade Facility and Productivity Improvement TA	20.0	18.7
72090	2003	Republic of Peru	Lima Transport Project	45.0	42.2
71600	2003	Republic of Peru	Lima Water Rehabilitation Additional Financing	20.0	19.2
71420	2003	Republic of Peru	National Water Rural Supply	50.0	46.3
72190	2004	Republic of Peru	Justice Services Improvement	12.0	11.9
72570	2004	Republic of Peru	Vilcanota Valley Rehabilitation Program	5.0	5.0
72550	2004	Republic of Peru	Institutional Capacity for Decentralization and Management	8.8	8.6
72540	2005	Republic of Peru	Accountability for Decentralization Soc.Sector	7.8	6.2
72850	2005	Republic of Peru	Agricultural Research and Extension	25.0	25.0
88809	2005	Republic of Peru	Institutional Capacity for Decentralization	8.8	8.6
82625	2005	Republic of Peru	Vilcanota Valley Rehabilitation Project	5.0	5.0
78953	2005	Republic of Peru	Accountability for Decentralization Soc.Sector	7.8	6.2
78813	2005	Republic of Peru	Regional Transport Decentralization	50.0	50.0
Total disbursed:				4,799.8	
of which : amount repaid				2,463.5	
Total outstanding 1				2,468.2	
Total indisbursed					319.8

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

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

	Loans	Equity	Quasi	Participation Loans	Total
Total commitments held by IFC	236.4	7.6	33.6	24.8	302.4
Total disbursed	130.6	7.0	29.1	24.8	191.5

Source: World Bank.

Peru: Relations with the Inter-American Development Bank

Country Strategy 2002–2006

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

Lending

As of November 1st, 2005, the country's portfolio consists of 28 loans for a total amount of US$1,594.9 million. These resources are distributed among 26 investment loans (US$994.9 million) and two policy-based loans (US$600.0 million). The lending program for 2005 relies on the approval of eight investment loans for US$410.0 million.

In addition, the country portfolio with Peru includes 28 non-reimbursable technical cooperation grants (US$6.0 million) and seven small projects (US$3.1 million). The Multilateral Investment Fund (MIF) has 28 non-reimbursable technical cooperation grants under execution (US$16.4 million).

IDB Loans Portfolio By Sector as of November 1st, 2005
(In millions of US$)

	Commitments	Disbursements	Percent Disbursed
Agriculture	98.9	61.6	62.3
Education	87.0	44.0	50.5
Environment	5.0	2.4	48.0
Health	28.0	18.1	64.6
Industry	190.6	190.6	100.0
Public sector management	371.8	211.9	57.0
Sanitation	0.8	0.0	0.0
Science and technology	25.0	0.0	0.0
Social investment	432.9	206.7	47.8
Transportation	295.0	152.3	51.6
Urban development	60.0	7.1	11.8
Total	**1,594.9**	**894.7**	**56.1%**

Peru: Statistical Issues

Peru is in observance of the Special Data Dissemination Standard (SDDS) since August 1996 and meets the specifications for coverage, periodicity, and timeliness of the data categories. An advance release calendar and the metadata for Peru are posted on the Fund's Dissemination Standards Bulletin Board. A data ROSC module was completed in 2003.

I. Real Sector

In June 2000, the authorities published a revised GDP series using the 1994 benchmark estimates, which includes detailed input-output tables, as the base year. However, due to limited availability of periodical source data, estimates after 1994 are largely based on extrapolation techniques. The lack of current detailed tables for supply and use hampers the reconciliation of discrepancies in the data. As a result, changes in inventories are mainly determined as a residual. Even though the quarterly accounts have benefited from some improvements in the timeliness of monthly production indices, their coverage is still very limited. The National Statistics Office (INEI) is working on a new national account series using 2001 as the base year.

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

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

II. Fiscal Sector

For the general government, GFS data are compiled using the analytical framework of the *GFS Manual 1986*. For the consolidated central government, revenues are compiled on a cash basis, while expenditures are compiled on an accrual basis. The authorities have sent to the Fund information on the components of consolidated central government expenditures by function. The authorities have recently prepared a plan to migrate to the *GFS Manual 2001,* but the schedule for migration has yet to be defined.

The authorities annually report GFS data for publication in the *Government Finance Statistics Yearbook (GFSY)* and monthly for the *International Financial Statistics (IFS)*.

The coverage of national budget accounting is narrower than the fiscal accounting carried out in the program.

III. Monetary Sector

The BCRP prepares and publishes the analytical accounts of the banking system and of the central bank broadly in line with the methodology recommended by the Fund's *Monetary and Financial Statistics Manual*. The main discrepancy is the valuation of some financial instruments at cost rather than at market prices. Until early-2003, nonbank deposit-taking institutions were not included in the depository corporations' survey. However, following the recommendations of the February 2003 data ROSC mission, the BCRP expanded the coverage of the survey to incorporate them. Monetary statistics are disseminated only in a summary form.

IV. External Sector

The BCRP is responsible for the compilation and dissemination of balance of payments and international investment position 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).* These data are reported to the Fund for publication in the *IFS* and the Balance of Payments Statistics Yearbook. Some departures from *BPM5* include the lack of coverage of assets held abroad and land acquisition abroad by residents; lack of separate identification of liabilities to affiliated enterprises; and the recording of some external debt transactions that are not on an accrual basis.

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

V. Findings of the Data ROSC Mission

A ROSC data module mission visited Lima during February 12–26, 2003. Although Peru's macroeconomic statistics are largely adequate for effective surveillance, the mission identified important shortcomings mainly in national accounts and price statistics. Most of the mission recommendations have been implemented. However, there is scope for improvement in the following areas: (i) coordination among the agencies that compile official statistics as to avoid duplication of efforts and confusion among users; (ii) establishing an updated business register that provides the basis for sample surveys; (iii) implementing a new benchmark and base year for GDP; (iv) expanding the coverage of the wholesale price index to include mining, oil and gas extraction, electricity and water, public transportation, and communication; (v) preparing sectoral breakdowns of depository corporations and financial surveys in accordance with the *MFSM* methodology; and (vi) expanding the scope of data sources for compiling financial flows of individual residents.

PERU: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
AS OF DECEMBER 13, 2005

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items: Data Quality – Methodological soundness[7]	Memo Items: Data Quality Accuracy and reliability[8]
Exchange Rates	11/30/05	12/9/05	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/30/2005	5/06/2005	D	W	W		
Reserve/Base Money	9/30/05	11/14/05	W	W	W	O, LO, LO, LO	O, O, O, O, O
Broad Money	9/30/05	11/14/05	W	W	W		
Central Bank Balance Sheet	9/30/05	11/14/05	W	W	W		
Consolidated Balance Sheet of the Banking System	9/30/05	11/14/05	W	W	W		
Interest Rates[2]	10/31/05	11/14/05	D	D	D		
Consumer Price Index	October 2005	November 2005	M	M	M	O, LO, LO, LO	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q4/2004	2/21/2004	Q	Q	Q	O, LO, O, O	O, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	February 2005	3/25/2005	M	M	M		
Stocks of Central Government Debt[5]	Q4 2004	2/21/2004	Q	Q	Q		
External Current Account Balance	Q4 2004	2/21/2004	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	January 2005	3/14/2005	M	M	M		
GDP/GNP	December 2005	2/18/2005	M	M	M	LO, LO, LO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	Q1 2005	July 2005	Q	Q	Q		

[1] Every Friday the Central Bank disseminates daily net international reserves, and weekly International Reserve Assets and Reserve Liabilities.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including type of instrument, maturity and type of creditor.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published on October 4, 2003 and based on the findings of the mission that took place during February 12-26, 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), not observed (NO), or not available (NA).
[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Lima, December 20, 2005

Dr. Rodrigo de Rato y Figaredo
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato,

1. This letter and the attached Memorandum of Economic and Financial Policies (MEFP) set out the policies that the Government of Peru will pursue during 2006 under its economic program, supported by the current Stand-By Arrangement from the Fund. It supplements the letters from the Minister of Economy and Finance and the President of the Central Reserve Bank of Peru dated May 25, 2004 and May 20, 2005, and the letter from the Minister of Economy and Finance dated November 4, 2004.

2. During 2005, the government of Peru has continued implementing its program to sustain strong economic growth. Peru's output growth is expected to be close to 6 percent in 2005, inflation has declined, and its external position has strengthened. Significant progress has also been made in areas related to the fiscal legal framework, the granting of privately-operated concessions for public asset management, and financial regulation and supervision. All quantitative performance criteria for end-September 2005 were met.

3. The economic program for 2006 aims at maintaining macroeconomic stability, fostering robust growth and employment, and further reducing financial vulnerabilities, particularly those associated to financial dollarization. Monetary policy will continue to be guided by the inflation targeting framework, with the 12-month inflation target set at 2.5 percent (within a band of ±1 percent). Fiscal discipline will remain at the center of the authorities' strategy to consolidate macroeconomic stability. Structural fiscal reforms will focus on the institutional framework for PPP operations, further enhancing tax administration and public financial management, strengthening banking supervision and regulation, and enhancing private sector investment.

4. In view of the strong performance under the program and of our continuing commitment to sound macroeconomic policies, we hereby request the completion of the Third Review under the Stand-By Arrangement. The quantitative performance criteria for the 2006 program are presented in Table 1, and structural benchmarks in Table A attached to the Memorandum of Economic and Financial Policies (MEFP). In addition, the government stands ready to take further measures to ensure the achievement of its program's objectives and will maintain the usual close policy dialogue with the Fund.

Sincerely yours,

/s/	/s/
Fernando Zavala	Oscar Dancourt, Acting President
Minister of Economy and Finance	Central Reserve Bank of Peru

Table 1. Peru: Quantitative Performance Criteria and Inflation Consultation Mechanism, 2005-06

	2005	2006	
	Prog.		
	Dec. 31	Mar. 31	June 30
	(Cumulative amounts from December 31, 2004, millions of New Soles)	(Cumulative amounts from December 31, 2005, millions of New Soles)	
Borrowing requirement of the combined public sector 1/ 2/	2,605	-596	-2,090
	(Cumulative amounts from December 31, 2004, millions of U.S. dollars)	(Cumulative amounts from December 31, 2005, millions of U.S. dollars)	
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions 3/4/	-300	-387	-804
Outstanding short-term external debt of the nonfinancial public sector	50	50	50
Contracting or guaranteeing of nonconcesional public debt with maturity of at least one year 5/ 6/	3,100	960	1,101
Of which: external debt of 1-5 year maturity	100	100	100
External payments arrears of the public sector (on a continuous basis)	0	0	0
(Consultation bands for the 12-month rate of inflation, in percent) 7/			
Outer band (upper limit)	5.5	5.5	5.5
Inner band (upper limit)	4.5	4.5	4.5
Central point	2.5	2.5	2.5
Inner band (lower limit)	0.5	0.5	0.5
Outer band (lower limit)	-0.5	-0.5	-0.5

Sources: Central Reserve Bank of Peru; and Ministry of Economy and Finance.

1/ The borrowing requirement of the combined public sector will be adjusted upward by up to S./400 million for any negative operating financial result of the BCRP in 2005, and by up to S./200 million during the first half of 2006.
2/ PIPP proceeds are included below the line.
3/ The target for net international reserves will be adjusted upward by the amount by which net foreign borrowing of the nonfinancial public sector exceeds US$97 million at end-December 2005, -US$6 million at end-March, and -US$128 million at end-June. It will be adjusted downward for shortfalls from programmed net foreign borrowing. The amounts in excess will be deposited at the BCRP.
4/ The target for net international reserves will be adjusted downward for withdrawals for portfolio management purposes of deposits held at the Central Reserve Bank by the Consolidated Pension Reserve Fund (FCR) and any other funds managed by the ONP. This downward adjustment will not exceed US$300 million at any time in 2005 and the first half of 2006.
5/ The limit will be adjusted upward by any amount of debt issued for, and used in, debt-exchange operations, or for prefinancing government operations.
6/ In 2005, the limits will be adjusted upward by up to US$400 million for guarantees provided by or contracted by the government, including with multilaterals, in context of Private Public Partnerships (PPPs) and concessions. In 2006, targets will be adjusted upwards by up to US$250 million for guarantees provided by or contracted by the government, including with multilaterals, in the context of PPP concessions. In the event of delays in PPP operations programmed for 2005, guarantees can be carried over to the 2006 adjustor.
7/ Should inflation fall outside the inner band, the authorities will discuss with the Fund staff the appropriate policy response. Should inflation fall outside the outer band, the authorities will discuss with the Fund staff the appropriate policy response and complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the arrangement.

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2006

Performance under the 2005 Economic Program

1. Peru's macroeconomic performance in 2005 has been very strong, reflecting a close adherence by the government to its economic program and a favorable external environment. Led by private investment and exports, output growth is expected to be close to 6 percent and formal employment growth has picked up significantly. Twelve-month inflation has temporarily declined below the inflation target range of the central bank in recent months, but is expected to be within the band by year-end. With surging exports, the external current account is expected to register a surplus of about ⅓ percent of GDP, and official net international reserves are projected to reach US$13.6 billion by end-2005, representing over 280 percent of maturing short-term external debt. The overall deficit of the combined public sector is expected to be at 1 percent of GDP in 2005, with the public debt-to-GDP ratio projected below 40 percent of GDP.

2. Solid progress has been made in the structural area. The General Law on Public Indebtedness (end-December 2005 benchmark) was approved in July 2005 and immediately implemented. In July 2005, a reporting system of public sector liabilities (including contingent) associated with Private-Public Partnerships (PPPs) was established, and a norm requiring the annual publication of such liabilities in the Multiyear Macroeconomic Framework beginning in 2006 was issued in July (end-September 2005 structural performance criteria). Information of such liabilities was presented in the revised Multiyear Macroeconomic Framework published in August 2005. Although the central government budget formulation system and the Integrated Financial Management System (SIAF) have not been unified (end-June benchmark) because of delays in preparing the software, such a unification is now scheduled for January 2006. The publishing and dissemination of a methodology to price infrequently traded financial instruments and a set of references prices is expected to be undertaken in December (end-July benchmark). Progress in other areas of structural reform include:

- ***Decentralization.*** The implementing regulations of the Fiscal Decentralization Law were issued in September (end-September benchmark), with a view to promoting a cautious and fiscally-sound decentralization process.

- ***Awarding of concessions.*** The concession of a large regional integration highway in the Northern part of the country was awarded in early-May and a second major highway (Pucusana-Ica) concession was awarded in July (end-September structural performance criterion). Total infrastructure investment commitments in 2005 via concessions or PPPs are expected to total US$1.5 billion.

- ***Financial sector.*** Progress has been made toward implementing norms on foreign currency-induced credit risks, with the Superintendency of Banks issuing implementing guidelines in May (end-September structural performance criterion). Also, the government announced a plan to centralize the information on collateral registries in August (end-September benchmark), thus paving the way for enacting associated legislation to improve access to financing for credit-worthy borrowers.

The 2006 Economic Program

3. The government's economic program for 2006 seeks to sustain high economic growth through the continued implementation of prudent macroeconomic policies and a deepening of its growth-enhancing reform program. Real GDP is projected to grow by 5 percent in 2006, supported by private investment and continued strong export performance. Year-end inflation is projected at 2½ percent. Gross official international reserves are expected to remain at comfortable levels, providing a solid cushion against possible adverse shocks.

4. Monetary policy will continue to be guided by the inflation targeting framework. The Central Bank plans to shift from an end-year inflation target to a continuous one. The Central Bank inflation target is set at 2.5 percent, within a band of plus or minus 1 percent. Consistent with this framework, Central Bank intervention in the foreign exchange market will be primarily limited to smoothing out excessive volatility. Also, the Central Bank has been coordinating with Congress an amendment to the Civil Code to restore the *Nuevo Sol's* full legal tender status in accordance with article 43 of its Organic Law.

5. The budget submitted to congress targets an overall deficit of the nonfinancial public sector of 1 percent of GDP in 2006. The government is committed to the rules of the Fiscal Responsibility and Transparency Law (FRTL), including those applying to electoral years. To help ensure adherence to the deficit target, expenditure growth will be restrained while ensuring that public sector capital spending is increased as percent of GDP. If central government revenue turns out to be less buoyant than anticipated, expenditure reduction will be implemented while protecting targeted poverty-reducing programs.

6. The government will continue to undertake public liability management operations to further reduce rollover and market risks (currency and interest rate) and gradually increase the share of long-term local currency instruments. All external bond issues will continue to have collective action clauses.

7. The structural and institutional fiscal reforms will aim at maintaining a prudent fiscal stance and improving efficiency in revenue collection and expenditure allocation. To that effect, the main policy actions will be as follows:

- ***The legal and institutional fiscal framework.*** A draft law will be submitted to congress in March 2006 that strengthens procedures for compliance with the FRTL, monitoring of budget execution, and the requirements for quarterly reporting to congress and the public. In particular, a coordination committee of fiscal policy will be established in the Ministry of Economy and Finance to monitor on a monthly basis the fiscal program and, if needed, recommend measures to comply with the FRTL's fiscal limits.

- ***Tax policy and administration.*** The government will avoid further reductions of excise tax rates on fuels in the first half of 2006 and study contingent measures to prevent a drop on revenues as a result of the phasing out of the tax on net assets. In order to facilitate tax administration, existing value added tax withholding schemes will be consolidated in 2006. Following the recent elimination of tax exemptions applying in one regional government, the government will continue to seek the removal of other tax exemptions. The government will also concentrate efforts in reducing tax evasion and the tax agency *SUNAT* will focus its activities on improving audit quality, tracking non-filers, streamlining audit procedures, introducing electronic invoicing, and applying modern technologies to tackle contraband and customs undervaluation.

- ***Public financial management.*** The Ministry of Economy and Finance aims to prepare an action plan to modernize the budget classification system to make it compatible with international standards and incorporate this classification into the chart of accounts, by end-June 2006. In addition, the Ministry will prepare plans by end-June 2006 to: (i) establish SIAF automatic accounting by end-2006; and (ii) implement a Treasury Single Account (TSA), with a view to help further strengthen control and transparency over the central government finances and improve Treasury cash management.

- ***Public sector reform***. In order to improve the management of the *Cédula Viva* system, a decree was issued in October centralizing its administration at the National Pension Office (ONP). In addition, by end-June 2006 the government will submit to congress legislation for a fiscally prudent and comprehensive reform of the pension regime of the police and military, aimed at restoring its financial viability.

- ***Government decentralization.*** Decentralization will continue to be implemented in a fiscally-neutral manner, while improving service delivery. The Ministry of Economy and Finance will strengthen further its efforts to monitor the public finances of subnational governments and of the largest municipalities. Also, it will work closely with the subnational governments to ensure that their 2007 finances are consistent with the limits set in the FRTL and the Fiscal Decentralization Law. The government will not guarantee or on-lend external credits to subnational governments that exceed the limits in these laws. Trust funds set up by subnational governments will be covered under the limits of this legislation. The Ministry of Economy and Finance will encourage implementation of the budget execution and debt management modules of the SIAF in 100 municipalities. In addition, a pilot program will be implemented in 2006 to improve regional and local government financial management capacity, covering a representative sample of municipal governments.

8. Supporting efficient and transparent infrastructure investment will be a key ingredient of the growth enhancing reform program for 2006. In particular:

- ***The Private Investment Promotion Program (PIPP).*** The government will continue strengthening investment and maintenance of infrastructure in a fiscally sound manner, including through the PIPP, which includes concessions and Private-Public Partnership (PPP) operations. In 2006, total infrastructure investment commitments via concessions or PPPs are expected to total US$1.7 billion. The government will improve further its reporting of public sector liabilities associated with PPPs and concessions, and will continue to report such liabilities in the Multiyear Macroeconomic Framework.

- ***Permanent framework for PPPs.*** An action plan will be prepared by March 2006 with a view to implementing the recommendations of ongoing technical assistance on PPPs. Implementation of this plan will strengthen the role of the Ministry of Economy and Finance in the selection of projects to be undertaken as PPPs and enhance coordination among agencies. The plan would also define the institutional framework and technical procedures for estimating the fiscal impact (including that of minimum revenue guarantees) of any PPP.

- ***Public investment efficiency.*** The National System of Public Investment (SNIP) will continue to be strengthened in order to rise the quality of public investment. In particular, it will focus on ensuring prompt assessment of projects, weeding out socially unviable projects, and improving the capacity of spending units in project preparation. The government will ensure that any new PPP projects involving financial guarantees or subsidies are assessed by the SNIP.

9. The government growth-enhancing reform program for 2006 will also focus on further reducing vulnerabilities of the financial system, continuing to increase Peru's integration into the regional and world economy, and fostering a better business climate and competitiveness. In this regard, to help expedite the judicial resolution of business-related disputes and bolster contract enforcement, the government will work toward completing the commercial court system of Lima and establishing a commercial court module outside Lima in 2006. Moreover, to improve credit access to credit-worthy agents, the government will begin implementing the centralization of collateral registries by end-June 2006. It will also continue to promote employment in the formal sector of the economy.

10. Efforts to reduce financial dollarization risks are being strengthened. A plan that aims at ensuring that at least 50 percent of the mortgage loans supported by the *MiVivienda* program during the period January–June 2006 are denominated in domestic currency will start being implemented by end-2005. Under the plan, *MiVivienda* will provide financial institutions with a package of incentives, including credit risk coverage, to offer long-term mortgages in domestic currency. The Superintendency of Banks (SBS) will implement fully, by end-June 2006, the regulation issued in 2005 in the area of foreign currency-induced credit risks. Moreover, the SBS will continue implementing stricter measures aimed at ensuring that financial intermediaries fully incorporate foreign currency-induced credit risks.

11. The Superintendency of Banks has developed detailed actions to strengthen off-site and on-site supervision of financial intermediaries. It will continue to take steps to ensure that consolidated supervision and regulation is effective, including via the implementation of

high risk-based capital requirements or the full provisioning on financial intermediaries' risky offshore operations. The SBS will also tighten the regulations governing restructured loans. In particular, by end-December 2005, it will eliminate the provision that allows for an automatic upgrade of borrowers classified in doubtful or loss category before the debtor's repayment capacity is fully assessed. In addition, the SBS will fully implement the recently issued Law on Consumer Protection in Banking Services by end-2005. A special unit for consumer protection has been set up within the SBS. Moreover, a roadmap for implementing Basel II will be finished by end-December 2005.

12. The government will continue to promote greater efficiency in financial intermediation, including through development of the domestic capital market. With the support of technical assistance from the Fund, the government is stepping-up its efforts to deepen the secondary securities market, reduce administrative barriers to securitization and standardize financial contracts. In addition, regulatory changes facilitating the transfer of funds between private pension fund administrators (PPFAs) and the entrance of a fifth administrator in the market in July 2005 have led to increased competition among PPFAs, thereby helping reduce costs to contributors. Competition will be further fostered by a widening of the permissible band around the required rate of return, which is expected to take place in the first half of 2006. Significant progress has also been made toward establishing a system to allow each PPFA to offer investment portfolios with different risk return characteristics. The SBS will issue regulations to limit the market risk of PPFA investments, including those associated with stock market prices, currencies, and interest rates. The Central Bank will continue to establish operative limits on PPFA investments abroad, in accordance with its constitutional mandate to preserve monetary stability, and the SBS will focus on supervisory and regulatory functions in this area.

13. Public bank lending to the private sector will continue to be closely monitored. During 2006, the Ministry of Economy and Finance will continue monitoring *Banco de la Nación*'s consumer lending to ensure observance of the agreed quarterly targets between these two institutions. The quasi-fiscal operations of *Agrobanco* associated with lending to small-scale farmers will continue to be recorded in the budget.

Table A. Peru: Growth Enhancing Policy Actions for 2005 and 2006

Structural Benchmarks	
The government will develop an operational plan to ensure that at least 50 percent of the mortgage loans financed by the *MiVivienda* program during the period January–June 2006 are denominated in domestic currency.	December 31, 2005
Prepare an action plan to introduce a permanent framework for Private-Public Partnerships, as specified in paragraph 8 of the MEFP.	March 31, 2006
Completion of plans for implementing a Treasury Single Account and update the budget classification system to international standards, as specified in paragraph 7 of the MEFP.	June 30, 2006
Implementation of the plan to centralize collateral registries.	June 30, 2006
Implement the plan under which at least fifty percent of the mortgage loans financed by the *MiVivienda* program during the period January–June 2006 are denominated in domestic currency.	June 30, 2006
Fully implement the regulation measuring risks associated with foreign currency denominated loans.	June 30, 2006

TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

This technical memorandum sets out the understandings between the Peruvian authorities and the Fund relating to the monitoring of the program for 2006. It defines the concepts used to assess compliance with quantitative performance criteria specified in the letter of the Government of Peru dated December 20, 2005. It also sets the frequency of the data to be provided to the Fund for monitoring the program. For purposes of the program for 2006, operations in foreign currency will be converted into *Nuevos Soles* at the average program exchange rate of S/. 3.32 per U.S. dollar.

I. DEFINITIONS OF CONCEPTS

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

2. **The borrowing requirement of the combined public sector (PSBR)** will be measured as: (a) net domestic financing of the NFPS; plus (b) net external financing of the NFPS; plus (c) proceeds from the Private Investment Promotion Program (PIPP); and less (d) the operating balance of the Central Reserve Bank of Peru (BCRP). The PSBR will be adjusted to exclude the impact of data revisions that do not represent a change of its flows during 2006. The components of the PSBR (see Table 1), will be defined and measured as follows:

(a) **The net domestic financing of the NFPS** is defined as the *sum* of: (i) the increase in net claims of the domestic **financial system**[17] on the nonfinancial public sector, excluding Peruvian Brady bonds and other government bonds initially sold abroad; (ii) the net increase in the amount of public sector bonds[18] held outside the domestic financial system and the nonfinancial public sector, excluding Peruvian Brady bonds and other bonds initially sold abroad; and (iii) the increase in the floating debt of the nonfinancial public sector due to expenditure operations and tax refund arrears; *less* (iv) the accumulation of stocks, bonds, or other domestic financial assets by the nonfinancial public sector and (v) the amortization of pension recognition bonds. In the case of enterprises that are divested after December 31, 2005, the net credit of the financial system to these enterprises will be recorded, for the remainder of the program period, as unchanged from their level at the time of the PIPP.

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

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

[18] Excluding the new issuances of pension recognition bonds.

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

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

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

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

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

5. **The net international reserves of the BCRP, excluding foreign-currency deposits of financial institutions,** are defined for the purpose of the program as: (a) the foreign assets of the BCRP (excluding subscriptions to the IMF and the Latin American Reserve Fund (FLAR), *Pesos Andinos*, credit lines to other central banks, *Corporación Andina de Fomento*

(CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations); less (b) reserve liabilities, defined as the sum of: (i) the BCRP's external liabilities with an original maturity of less than one year, and (ii) its liabilities to the IMF, to the Inter-American Development Bank (IADB) and to the FLAR; less (c) deposits in foreign currency by the banking system, other financial intermediaries and the private sector, net of repos of Treasury bonds with the financial system.

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

7. **BCRP's gold holdings** will be accounted at US$438.35 per troy ounce (the average book value as of December 31, 2004), SDRs at US$1.55301 per SDR, and foreign currency assets and liabilities of the BCRP in other currencies at the exchange rate of December 31, 2004. Net international reserves will be adjusted to exclude any valuation gains or losses resulting from net sales or deliveries of gold by the BCRP. The end-September 2005 level of net international reserves is shown in Table 3.

8. The flows of the **short-term external debt of the NFPS** are defined as the net change in the NFPS's outstanding external indebtedness with a maturity of less than one year (including instruments with put options that would be triggered within one year of the contracting date), measured, in part, on the basis of the operations of a selected sample of public enterprises comprising *Petroperú*, and *Electroperú*. These limits exclude normal import financing but include forward commodity sales. In the case of companies sold to the private sector under the PIPP, the short term debt of these entities will be recorded, for the remainder of the program period, as unchanged from their level at the time of the PIPP. The end-September 2005 stock of short-term external debt of the NFPS is shown in Table 4.

9. **The contracting or guaranteeing of nonconcessional public debt with a maturity of at least one year** refers to all domestic and external obligations of the NFPS contracted or guaranteed by the central government, COFIDE, the BCRP, the BN, and any other public financial entity, except for loans classified as reserve liabilities of the BCRP. The program limits on nonconcessional debt will exclude: (i) any new loans extended in the context of a debt rescheduling or debt reduction operation; (ii) any lending at concessional terms; and (iii) certificates (BCRPCD) issued by the BCRP for conducting monetary policy.

10. **For the purpose of the performance criterion on the contracting or guaranteeing of public debt,** external public debt applies also to commitments contracted or guaranteed for which value has not been received. In this regard, the term "debt" has the meaning set forth in point No.9 of the Guidelines on Performance Criteria with respect to Foreign Debt adopted on August 24, 2000 (Board Decision No. 12274-(00/85)). Thus, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time: these payments will

discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the performance criterion, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt. Foreign currency public debt to be contracted or guaranteed will be converted based on the program exchange rate, with cross rates for non-dollar foreign currencies set based upon the rate on the day of the transaction, published by REUTERS.

11. For program purposes, **a debt is concessional** if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., grant element) is equal to nominal value minus NPV divided by nominal value. The NPV of debt at the time of its disbursement is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the OECD. For debt with a maturity of at least 15 years, the ten-year average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. For the purposes of the program through end-June 2006, the CIRRs published by the OECD in October 2005 will be used (see Table 5).

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

13. **The external payments arrears of the public sector** include arrears to multilateral financial institutions, to Paris Club creditors, and to other foreign creditors with whom debt

restructuring agreements have been concluded. They exclude arrears outstanding at end-2005 that were not covered under restructuring agreements. The public sector will be defined to include the NFPS, COFIDE, the BCRP, the BN, and any other state development bank.

14. **Definitions used in Table 1 of the letter of intent dated December 20, 2005 for the calculation of adjusters, limits and targets for net international reserves:**

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

b. **The withdrawals for portfolio management purposes** of deposits held at the BCRP by the FCR and any other fund managed by the ONP, mentioned in footnote 4 of Table 1 attached to the letter of intent dated December 20, 2005 refer to placements of funds that are in accord with an investment plan approved by the Board of the FCR, excluding deposits in public financial institutions and government securities.

II. PERIODIC REPORTING

15. Periodic reporting includes:

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

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

(ii) **Financial sector**
(a) Balance sheets of the consolidated financial system, consolidated banking system, BCRP, BN, commercial banks, *AgroBanco*, and development banks in liquidation.
(b) Disaggregation of the net domestic assets of the BCRP and BN with details of the other net accounts.
(c) Balance sheet of COFIDE and data on COFIDE guarantees.
(d) Balance sheet of the private pension system.
(e) Evolution of gross disbursements and cash amortizations of consumer loans under the *"Multired Program"* of *Banco de la Nacion*.
(f) The stock of government guarantees for housing support programs and the balance sheet of MiVivienda.

(iii) **Fiscal sector**

(a) PSBR as defined in Table 1.
(b) List of domestic and external debt instruments contracted or guaranteed by the public sector, including data on the amount, lender, grace period, maturity, and interest rate (refinancing credits should be labeled as such), collateral guarantees, any instrument enhancements (such as but not limited to put or call options) that affect the price or maturity of the debt instrument.
(c) Summary of disbursements and interest and amortization due and paid (identifying the payments of arrears) of loans included in the records of the General Directorate of Public Credit by creditor and debtor, indicating foreign origin (distinguishing between financial and nonfinancial public sector debt) and domestic origin (Table 6).
(d) Cash operations of the treasury (which includes floating debt, with a memorandum item on tax refund arrears).
(e) Data on PIPP revenue, which will include gross receipts, costs of the PIPP, use of debt-for-equity swaps, commissions received by *ProInversion* and the resulting cash receipts received by the Treasury and the FCR. In addition, the report will include debts assumed by the government in connection with the PIPP.
(f) Operations of the Central Government, Central Government Current Revenue (SUNAT Format); Central Government Noninterest Expenditure; and Transfers from the Central Government to the Rest of the General Government.
(g) Fuel prices of *Petroperu* and *Relapasa*, and international prices of products commercialized by *Petroperu* including tariffs, indirect taxes and distribution margins (prices would be listed for all grades of gasoline, diesel fuel, kerosene and fuel oils.)
(h) Stocks of the central government PIPP accounts in the BCRP and the BN.

(iv) **External sector**

(a) Summary of imports by products (volume and prices); and
(b) Summary of exports by products (volume and price).

(e) **Quarterly data of fiscal and external accounts, and public sector debt,** distinguishing between external and domestic total public sector debt and total NFPS.

(f) **Other**

(a) Summary of legislative changes pertaining to economic matters.
(b) BCRP circulars.
(c) BCRP inflation report.

Table 1. Peru: Public Sector Borrowing Requirement 2005
(In millions of nuevos soles)

	Stock as of Dec. 31 2004 1/	Stock as of Sep. 30 2005 1/	Flow Jan-Sep
a. Net domestic financing of the nonfinancial public sector	**433**	**1 454**	**1 021**
i. Net claims of the financial system (1+2+3)	-7 801	-8 020	- 218
1. Net credit of the banking system on the NFPS, COFIDE and MiVivienda	-14 177	-15 926	-1 749
Credits	6 721	5 967	- 754
Liabilities	20 898	21 894	995
2. Net credit of COFIDE and MiVivienda on the banking system	3 328	3 316	- 13
Credits	3 460	3 467	7
Liabilities	131	151	20
3. Net credit of nonbanking financial institutions on the NFPS	3 048	4 591	1 543
Credits	3 528	5 102	1 574
Liabilities	480	511	31
ii. Stock of NFPS bonds in circulation	9 737	11 486	1 749
(excluding bonds held by NFPS and of the financial system)			
1. Total	16 033	19 690	3 657
2. Less: holdings of the financial system (including COFIDE and MiVivienda)	5 949	7 865	1 921
3. Less: holdings of nonfinancial public sector entities	348	339	- 14
iii. Floating debt	1 715	1 519	- 196
iv. Less: Accumulation of stocks, bonds, or other domestic financial assets by the NFPS	2 437	2 624	187
v. Less: Issuance of pension recognition bonds in program period	780	907	127
b. Net external financing			**-3 894**
(Millions of US dollars)			-$ 1,173
c. Privatization			**134**
(Millions of US dollars)			$ 41
d. Operating balance of the BCRP			**-132**
PSBR (a+b+c-d)			**-2 607**

1/ Foreign currency valued at US$ 1 = S/. 3,32

Table 2. Peru: Net External Financing NFPS: 2006 [1/]
(In millions of US$)

		2006 Prog.	
		Jan.-Mar.	Jan.-Jun.
i.	Loan disbursements	259	401
	-Projects	159	301
	-Nonprojects	100	100
ii.	Bonds	0	0
iii.	Cash payments on amortization	265	529
	- Loans	220	484
	- Bonds	45	45
iv.	Cash payments to settle arrears	0	0
v.	Change in short term debt (increase+)	0	0
A.	**Net foreign borrowing (i+ii-iii-iv+v)**	**-6**	**-128**
vi.	Prepayments	0	0
vii.	Debt equity swaps	0	0
viii.	Change in foreign assets held by the NFPS	4	9
ix.	Investment project under the PIPP	0	0
B.	**Net external financing (A-vi-vii-viii+ix)**	**-10**	**-136**

1/ Excludes balance of payments support loans to the Central Reserve Bank of Peru.

Source: Central Reserve Bank of Peru

Table 3. Peru: Net International Reserves of the Central Reserve Bank of Peru excluding foreign currency deposits of financial institutions as defined in the Technical Memorandum of Understanding (TMU)
(In millions of U.S. dollars)

		Stocks as of September 30, 2005
a.	**Assets**	**13,338**
	Deposits abroad	4,097
	Securities	8,727
	Gold 1/	489
	Holdings of SDR 2/	10
	Reciprocal credit agreement	4
	Cash	10
	Others	1
b.	**Liabilities**	**19**
	Reciprocal credit agreement	3
	Liabilities with international organizations	16
	IMF 2/	0
	IADB	16
	FLAR	0
c.	**Foreign currency deposits of financial institutions at the Central Bank**	**3,027**
	Banking enterprises	2,876
	Banco de la Nación	56
	COFIDE	43
	Financial enterprises	52
d.	**Treasury bond repos**	**0**
e.	**Swaps**	**0**
f.	**Valuation US$/other currencies**	**-206**
g.	**Net international Reserves - Program definition (a-b-c+d-e-f)**	**10,499**
Memorandum items:		
1.	Subscription to the IMF and FLAR	322
2.	Pesos andinos	20
3.	CAF bonds	0
4.	Valuation change by BCRP's gold holdings	35
5.	Valuation change by BCRP's SDR holdings	-1
6.	Net international reserves, official definition (g+c+f+1+2+3+4+5)	13,695

Source: Central Reserve Bank of Peru.

1/ Gold valued at US$ 438,350.
2/ Valued at US$ 1,55301 per SDR.

Table 4. Peru: Short Term External Debt Owed by the
Non Financial Public Sector (as of September 30, 2005)

(In millions of US$)

	Export Financing	Working Capital	Import Financing	Total
Total	**0**	**0**	**62**	**62**
Petroperu	0	0	62	62
Electroperu	0	0	0	0
General government	0	0	0	0
Memorandum item:				
Total of export financing plus working capital loans	0	0	0	0

Sources: Central Reserve Bank of Peru and state companies.

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

	Average CIRRs		Previous rates for loans with maturity =>15 years contracted in						
	Six-month	**Ten-year**	**before 1999**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
	02/15/05-08/14/05	1/95 - 12/04 1/	1/86-12/95	1/89-12/98	1/90-12/99	1/91-12/00	1/92 - 12/01	1/93 - 12/02	1/94 - 12/03
Australian Dollar	6.36%	7.24%	12.15%	10.15%	9.28%	8.55%	7.98%	7.68%	7.48%
Austrian Schiling 2/	n.a.	5.76%	8.35%	7.73%	7.65%	7.43%	6.72%	6.34%	6.03%
Belgian Franc 2/	n.a.	6.07%	9.25%	8.60%	8.45%	8.13%	7.21%	6.80%	6.44%
Canadian Dollar > 8.5 years	4.85%	6.69%	9.83%	8.90%	6.07%	6.78%	7.41%	7.34%	7.05%
Danish Krone	4.13%	6.09%	10.37%	8.88%	8.33%	7.80%	7.29%	6.81%	6.37%
Finnish Markkaa 2/	n.a.	6.02%	10.64%	9.32%	9.15%	8.72%	7.56%	6.92%	6.43%
French Franc 2/	n.a.	5.89%	9.62%	8.42%	8.19%	7.82%	6.95%	6.50%	6.16%
German Mark 2/	n.a.	5.73%	7.91%	7.62%	7.54%	7.27%	6.58%	6.23%	5.96%
Irish Punt 2/	n.a.	6.16%	10.37%	7.59%	8.36%	8.44%	7.44%	6.97%	6.50%
Italian Lira 2/	n.a.	6.47%	11.50%	10.38%	10.06%	9.71%	8.30%	7.61%	6.94%
Japanese Yen	1.87%	2.24%	5.53%	4.65%	4.30%	3.75%	3.17%	2.77%	2.45%
Korean Won	5.10%	9.04%	n.a.	n.a.	n.a.	11.57%	10.74%	10.19%	9.55%
Netherlands Guilder >8.5 years 2/	n.a.	6.11%	8.08%	5.24%	5.81%	6.52%	6.95%	6.75%	6.43%
New Zealand dollar	7.02%	7.68%	12.17%	9.62%	8.90%	8.33%	7.97%	7.94%	7.80%
Norwegian Krone	4.21%	6.74%	11.27%	8.93%	8.36%	7.94%	7.60%	7.28%	7.04%
Spanish Peseta 2/	n.a.	6.65%	12.99%	11.35%	10.89%	10.31%	8.65%	7.92%	7.20%
Swedish Krona	4.33%	6.67%	11.67%	10.10%	9.42%	8.61%	8.04%	7.52%	7.08%
Swiss Franc	2.85%	4.31%	6.68%	3.78%	5.97%	5.67%	5.26%	4.85%	4.55%
U.K. Pound	5.54%	6.91%	10.37%	9.53%	8.99%	8.38%	7.85%	7.41%	7.16%
U.S. Dollar > 8.5 years	5.04%	6.36%	8.62%	7.93%	7.59%	7.35%	7.06%	6.85%	6.63%
Euro (ECU for ten-year avg)	4.17%	5.80%	8.56%	7.99%	7.82%	7.13%	6.79%	6.40%	6.07%
Memorandum:									
SDR 3/	4.37%	5.64%	8.22%	7.51%	7.21%	6.85%	6.49%	6.17%	5.90%

1/ Estimates based on actual CIRRs for 1/95 to 12/04.
2/ For the current 10-year averages, rates for Euro are used from 1/99.
3/ The 10-year SDR denominated CIRR rate was constructed based on the weighted average of the five 10-year CIRR averages for the underlying currencies.

Previous six-month rates

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

Sources: OECD and Fund staff calculations.

Table 6. Peru: Stock of Domestic Debt of the NFPS (as of September 30, 2005)

	Legal Norm	Gross placements		Stock (estimated)
		Currency	Amount	(Millions of Nuevos Soles)
Credits from BN				**3 010**
Credit to central government		US$ / S/. / Y		2 876
Credit to local governments		US$ / S/.		135
Net public treasury overdraft		S/.		0
Bonds				**10 461**
Capitalización BCRP	D.S.066-94-EF	S/.	614	0
Serie A			239	0
Serie B			375	0
Bonos TP - Financial system strengthening	D.U. 041-99	US$	175	234
Bonos TP - Temporal suscription of stocks	D.U. 034-99	US$	52	174
Bonos TP - Temporal portfolio exchange	D.S. 114-98-EF	US$	136	0
Bonos TP - Debt exchange bonds	D.S. 068-99-EF	US$	259	459
Bonos TP - RFA and FOPE programs	D.S. 059-2000-EF / D.U. 050-2002	US$	108	370
Bonos TP - Financial system consolidation	D.U. 108-2000 / D.U. 099-2001	US$	392	27
Bonos TP - Sovereign bonds 1/	D.S.007-2002-EF / D.S.041-2003-EF / D.S.079-2003-EF	S/.	6 720	
	D.S.162-2003-EF / D.S.015-2004-EF			9 085
Bonos TP - Caja de Pensiones Militar Policial Bonds	D.U. 030-2001	US$	34	113
Total				**13 472**
Memorandum item:				
Pension Reform Bonds (Bonos de Reconocimiento)	D.S. 096-95-EF	S/.		9 105
Floating debt		S/.		1 534

1/ Include public debt swap operations to exchange Bonos de Consolidación del Sistema Financiero for Sovereign Bonds (S/. 851 millions in May and S/. 393 millions in September), and the bond issue, in July and August, to prepay the Paris Club debt (S/. 2 619 millions).

Source: Central Reserve Bank of Peru.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/8
FOR IMMEDIATE RELEASE
January 11, 2006

International Monetary Fund
Washington, D.C. 20431 USA

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

The Executive Board of the International Monetary Fund completed the third review of Peru's economic performance under a 26-month Stand-By Arrangement approved on June 9, 2004 (see Press Release No. 04/112). The completion of the review makes available for purchase a total equivalent to SDR 204.4 million (about US$296 million). The Peruvian authorities intend to continue to treat the arrangement as precautionary.

In completing the review, the Board granted a waiver for the non-applicability of the December 31, 2005 quantitative performance criteria.