January 2008
IMF Country Report No. 08/28

Peru: Second Review Under the Stand-By Arrangement—Staff Report; Staff Statement; Press Release News Brief on the Executive Board Discussion; and Statement by the Executive Director for Peru

In the context of the first review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- The staff report for the First Review Under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on November 13, 2007, 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 7, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of December 19, 2007 updating information on recent developments.

- A Press Release summarizing the views of the Executive Board as expressed during its December 19, 2007 discussion of the staff report that completed the review.

- A statement by the Executive Director for Peru.

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

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

*Also included in Staff Report

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

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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INTERNATIONAL MONETARY FUND

PERU

Second Review Under the Stand-By Arrangement

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

Approved by José Fajgenbaum and G. Russell Kincaid

December 7, 2007

- **Stand-By Arrangement (SBA).** A 25-month SBA for SDR 172.37 million (27 percent of quota) was approved on January 26, 2007. The SBA is treated as precautionary.

- **Performance under the program.** All performance criteria for end-June and end-September have been observed. However, there have been delays in the implementation of most structural benchmarks for end-September. As for end-December benchmarks, a new budget classification and chart of accounts will be incorporated into the 2009 Budget (instead of the 2008 Budget), and steps will be taken to expand the Treasury Single Account from the central to the general government, by end-September 2008. Mi Vivienda will now discontinue the provision of guarantees on foreign currency mortgage loans by end-2007 rather than end-June 2007. The authorities have requested that the issuance of new regulations for new risk categories and provisions to address exchange rate risk be reprogrammed to end-June 2008, as they intend to introduce capital requirements in line with Basel II, which will require legal amendments. The clarification of the tax treatment of securitization transactions will be completed by end-June 2008, as part of the capital markets reforms.

- **Review.** It focused on the implementation of the 2007 program and the policies for 2008 to: (i) sustain the strong fiscal performance and to strengthen the credibility of inflation targeting; (ii) enhance the fiscal framework, the effectiveness of the tax system, and the quality of public spending; (iii) effectively tackle high poverty levels; (iv) deepen financial intermediation and capital markets, and reduce dollarization; and (v) ensure strong and sustainable medium-term growth.

- **Discussions.** Took place in Lima, during October 30–November 13. The team comprised M. Cerisola (head), N. Batini (resident representative), M. Gonzalez, E. Jenkner (all WHD), O. Adedeji (FAD), P. Breuer (PDR), and G. Gasha (MCM). It met with Prime Minister del Castillo, Minister of Finance Carranza, Central Bank President Velarde, and other senior public officials and private sector representatives, as well as representatives of the World Bank and the InterAmerican Development Bank in Lima. Mr. Pereyra (OED) participated in the discussions.

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EXECUTIVE SUMMARY

Background

Peru's macroeconomic policies continue to be strong under the Fund-supported program. Real GDP growth remains high; inflation expectations are well-anchored; prudent fiscal policies have been maintained, and vulnerabilities continue to decline. The program is on track, but there were delays in the implementation of structural benchmarks.

Key Issues

Favorable economic conditions provide a unique opportunity to entrench prudent policies and advance reforms. Continued implementation of policies to entrench macroeconomic stability, lower poverty, and lessen vulnerabilities, would boost growth prospects sustainably.

Outlook and Risks. The economic outlook for 2008 is favorable, with risks broadly balanced. The ratification of the Free Trade Agreement with the United States brings upside risks to the outlook, which are balanced by the downside risks to global economic conditions.

The 2008 program. The authorities are committed to:

- ***Preserving fiscal prudence and macroeconomic stability,*** while striking a balance with the need to address large social and infrastructure needs. They intend to remain vigilant and to tighten monetary policy as needed to help keep inflation expectations anchored, especially in light of the envisaged loosening of the fiscal stance.

- ***Strengthening the fiscal framework and ensuring the high quality of public spending,*** by ensuring that private sector involvement in infrastructure projects is anchored by a sound framework that minimizes risks; keeping the consistency of the fiscal framework, maintaining a sound use of *canon*-resources and advancing public financial management reforms to protect the quality of spending.

- ***Raising the revenue-to-GDP ratio,*** by implementing the new framework for tax exemptions, and by further improving tax administration and compliance.

- ***Proceeding with the antipoverty strategy,*** by further strengthening the CIAS, social programs, and mechanisms to help address regional disparities.

- ***Deepening the financial system and capital markets,*** through reforms to internalize better exchange rate-related risks; improve the oversight of public banks and microfinance institutions, and advance reforms of pension fund investments to lessen systemic risks and deepen domestic capital markets.

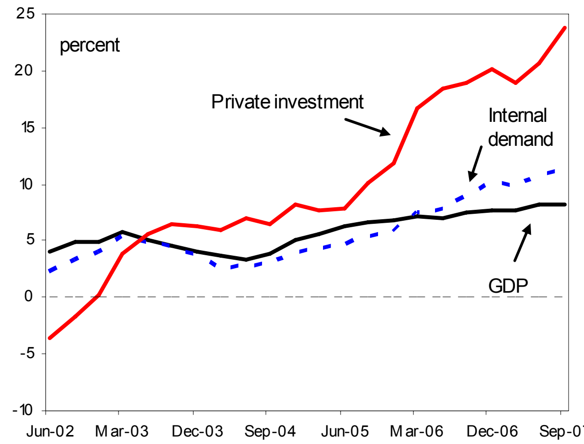
- ***Advancing other growth-enhancing reforms*****,** by liberalizing the trade regime further, raising labor market flexibility and improving the business climate.

I. Developments and Performance under the Program

1. **The second review of Peru's precautionary SBA took place against a backdrop of continued strong economic performance.**

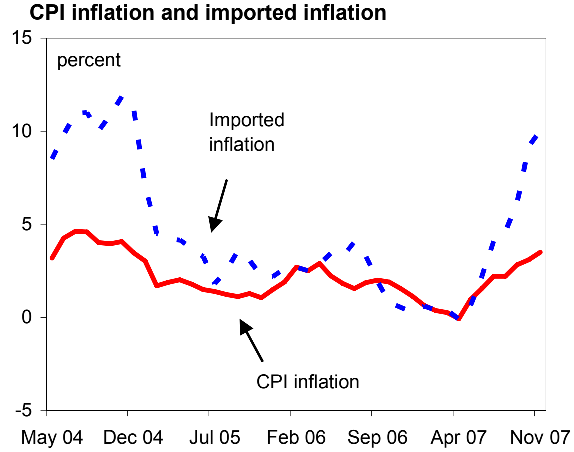
- ***Real GDP growth was 8.2 percent in the first three quarters of 2007.*** Growth has been broad based and led by strong private investment and consumption, with domestic demand rising at annual rates of 11 percent (Figure 1). Some deceleration in private consumption and withdrawal of stimulus from net exports in the fourth quarter is projected to bring growth to 7½ percent for the year as a whole.[1]

GDP Growth and Private Investment



- ***Inflation moved above the upper bound of the 1–3 percent target range***. 12-month inflation rose from 1 percent in May to 3.5 percent in November, led by a rise in imported inflation (most notably food and fuels) from 0.6 percent to 10 percent during the same period. Core inflation rose to 2.9 percent, reflecting the impact of selected food price increases.[2] The central reserve bank raised its policy interest rate preemptively to 5 percent in September to keep inflation expectations firmly anchored around 2 percent. Inflation is projected to stay slightly above the upper band of its target range by end-year.

CPI inflation and imported inflation



- ***Fiscal performance has been stronger than programmed.*** The public sector is expected to achieve an overall surplus of around 2¼ percent of GDP in 2007,

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[1] The November consensus forecast of growth and inflation for 2007 were 7.6 percent and 3.5 percent, respectively.

[2] Core inflation comprises all consumption items that exhibit low price volatility, including selected food items and food-related services with highly stable prices historically.

compared with a projected balanced position at the time of the first program review. This overperformance reflects higher revenue and significantly lower budgetary execution, particularly for capital expenditure at all government levels. In recent months, capital spending at the central government level has markedly accelerated, with its growth rate up to 15 percent (y/y) in real terms through October (Figure 2). The overall surplus falls to 1¼ percent of GDP when taking into account the issuance of liabilities for PPPs (*Certificados de Reconocimiento de Pago Anual por Obra,* CRPAOs).[3] The authorities are likely to allocate a significant part of the surplus to the Fiscal Stabilization Fund (FSF).[4]

Fiscal Outcome 2007

	Q1-Q3		Annual	
Combined Public Sector	CR/07/241	Prel.	CR/07/241	Proj.
Total revenue	20.5	22.1	20.0	21.1
Total expenditure	16.1	15.2	18.2	17.1
capital expenditure	3.3	2.7	4.7	3.7
Central bank operating balance	0.1	0.2	0.1	0.2
Primary balance	4.4	7.2	1.9	4.1
Interest payments	1.9	1.9	1.8	1.8
Overall balance (excluding CRPAOs)	2.5	5.3	0.0	2.3
Overall balance (including CRPAOs)	...	...	-0.3	1.3

Sources: Fund Staff estimates and Peruvian authorities

- ***Vulnerabilities have continued to decline*** (Figure 3). Official reserves have reached an all-time high of US$26.3 billion as of end-November (200 percent of foreign currency deposits). Active debt management has smoothed the public external debt amortization profile for 2007–12 and extended its average maturity.[5] Credit dollarization has continued to decline and strong overall credit growth to the private sector is deepening financial intermediation. These developments have led to a

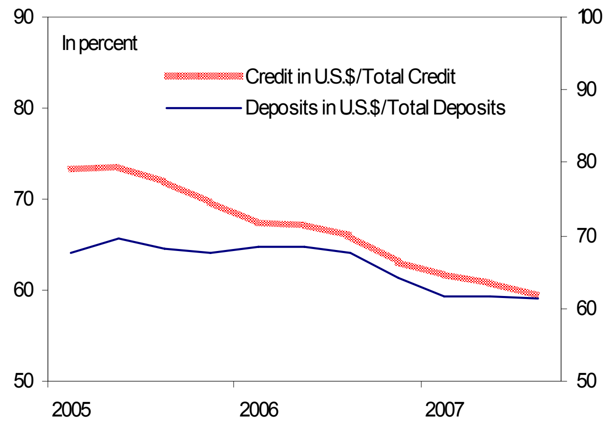
[3] The authorities are in the process of incorporating the CRPAOs into the fiscal accounts. The total amount of CRPAOs is now estimated at US$2.8 billion for 2006–10, of which US$1.9 billion would be issued in 2007–08. The larger amount of CRPAOs relative to that expected at the time of the program request ($2 billion) reflects mostly new issues related to the completion of two new sections of an ongoing investment project not considered before.

[4] The FSF reached almost 0.5 percent of GDP in August 2007. The FSF is replenished with freely disposable budgetary balances from ordinary resources, privatization proceeds, concessions, and royalties.

[5] In October, the authorities prepaid about $1.8 billion of Paris Club nonconcessional debt maturing in 2007–15, with roughly 80 percent financed by issuing a 30-year sol-denominated bond.

significant reduction in credit risk as perceived by rating agencies.[6] With strong fundamentals and resilient commodity prices, recent global financial market turbulence has had a limited impact on sovereign spreads. Equity prices have declined more sharply recently, although they remain close to 40 percent above end-December 2006 levels (Figure 4). The *Nuevo sol* has appreciated by 5½ percent against the U.S. dollar as of late November, reflecting renewed capital inflows.

Share of Credit and Deposits in Foreign Currency



2. **All quantitative performance criteria for end-June and end-September have been met comfortably; although progress with structural benchmarks in the program has been slower than expected.** A permanent head and technical staff have been appointed at the *Interministerial Committee for Social Assistance* (CIAS) (end-September structural benchmark). However, the authorities' efforts to secure a prudent reform of the *National System of Public Investment* (SNIP) took some toll on the capacity to advance other reforms, including the submission of a legal framework for PPP operations to Congress (end-September structural benchmark), as well as the structural benchmarks set for end-December 2007, which are being proposed to be either reset or rescheduled and strengthened (Table 3). The authorities have agreed to submit a legal framework for PPP operations to Congress by year-end, and in the event of further delays, the benchmark will be proposed to be set as an end-March structural performance criterion.

II. Policy Discussions

3. **Both sides agreed on the importance of preserving a prudent policy framework for 2008 and continuing to advance the reform agenda in line with program goals.** Discussions focused on the need to:

- *Maintain a prudent fiscal policy stance, while enhancing budget execution to continue addressing pressing social and infrastructure needs.*

- *Solidify the fiscal framework to minimize long-term fiscal risks, improve the quality of spending, and raise the tax revenue-to-GDP ratio.*

- *Accelerate the implementation of the antipoverty strategy.*

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[6] Fitch upgraded the rating outlook to positive in March 2007, while the Canadian rating agency DBRS elevated Peru's rating to investment grade in October. Fitch and S&P rate Peru one notch below investment grade.

- *Entrench greater exchange rate flexibility and strengthen the inflation targeting framework.*
- *Deepen financial intermediation, preserve a prudent role for public banks, and develop domestic capital markets.*
- *Promote trade integration, reduce labor market informality, and enhance the business environment.*

A. Macroeconomic Framework and Outlook

4. **The economic outlook for 2008 remains favorable, with risks broadly balanced.** Real GDP growth is projected to slow to 6½ percent, reflecting the global slowdown, a deterioration in the terms of trade, and the impact of the associated recent deterioration in consumer and business confidence on private consumption and investment growth.[7] Domestic demand growth should nevertheless remain supported by private investment and strong public spending, which would bring the current account balance into deficit. Inflation would decelerate gradually toward the 2 percent target in the second half of 2008, as the impact of recent commodity price shocks wanes. However, potentially renewed shocks, including from oil prices, bring upside risks to the outlook.[8] In addition, the recent ratification of the Free Trade Agreement with the United States could result in higher investment and growth, but may be balanced by downside risks to global economic conditions.

Macroeconomic Framework, 2006–08

	Prel.	Prog.	Staff Projection	
	2006	2007	2007	2008
(Annual percentage change)				
Real GDP growth	7.6	7.0	7.5	6.5
Inflation (end-year)	1.1	2.0	3.4	2.5
(In percent of GDP)				
External current account balance	2.8	0.9	1.3	-0.5
Public sector balance (excluding CRPAOs)	2.2	0.0	2.3	0.0
Public sector balance (including CRPAOs)	2.1	-0.3	1.3	-0.7
Total public debt (including CRPAOs)	32.9	30.0	29.2	26.2
Gross official reserve coverage of:				
Short-term debt (residual maturity)	190	337	500	489

Source: Fund staff estimates and Peruvian authorities.

[7] Consensus forecast of growth and inflation for 2008 are 6.6 percent and 2.5 percent, respectively.

[8] The weighted average of domestic fuel prices (before-tax) is currently 18 percent below international prices, mainly reflecting lower prices for diesel and, to a lesser extent, gasoline. The authorities are contemplating changes to the oil price stabilization fund to bring domestic pre-tax prices in line with international prices, while adjusting domestic fuel excises to limit the domestic inflationary impact.

B. Fiscal and Poverty Alleviation Issues

5. **The authorities intend to address social and infrastructure needs while firmly preserving macroeconomic stability.** The 2008 program envisages a zero overall balance for the nonfinancial public sector, in line with the approved 2008 Budget (a deficit of 0.7 percent of GDP including CRPAOs), and well below the deficit limit of 1 percent of GDP set by the Fiscal Responsibility and Transparency Law (FRTL). The authorities explained that such a balanced budget would provide flexibility to face an expected decline in revenues, as well as scope to accelerate public investment, given the significant underexecution experienced during 2007 and earthquake-related costs (about 0.2 percent of GDP).[9] Public investment not executed in 2007 (about 0.6 percent of GDP) would be carried over into 2008—to promote multi-year investment planning. General government current expenditure would rise by 6¼ percent in real terms, reflecting a new 4 percent limit to real central government consumption growth, and a "growth bonus" to be paid to civil servants (about 0.1 percent of GDP) in 2008.[10] They stressed that the potentially sharp expansion of expenditure—about 1.4 percent of GDP—would not compromise stability, that risks would be limited by the intrinsic difficulties in accelerating spending at all government levels, despite ongoing reforms. The authorities also noted that they will continue saving part of any potential revenue overperformance, and committed to saving up to ½ percent of GDP of any central government revenue windfall (net of mandatory transfers) (LOI, ¶4).[11]

6. **Strengthening the fiscal framework to minimize risks remains a priority**:

- ***Involving the private sector.*** The authorities are pressing ahead, with technical assistance from a private consulting firm and the World Bank, to complete a comprehensive draft legal framework for PPPs to be sent to Congress by end-year (LOI, ¶6). Finding instruments that could serve as alternatives to the issuance of CRPAOs has proved difficult, although no further issuance is foreseen. To facilitate investment in the mining regions, a new program, *Build and Transfer* (B&T), would allow private sector companies to execute investment projects at a cost that could be

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[9] Current revenues are projected to decline by about 0.6 percent of GDP in 2008, owing to a deterioration in the terms of trade, the impact from a recent reduction in average tariffs and the implementation of the Peru-U.S. FTA.

[10] The government amended the FRTL by changing the expenditure rule permanently to 4 percent for the central government (measured as wages plus goods and services excluding transfers net of pension payments) in the recently approved 2008 Budget. A "growth bonus" of about S./ 100 would be paid to most civil servants in the event economic growth exceeds 7 percent in 2007, with costs estimated at less than 0.1 percent of GDP.

[11] Staff estimates that the structural balance of the consolidated public sector would deteriorate by about 1½ percentage points of GDP in 2008. This impulse would be broadly in line with that originally envisaged for the 2007 program and its impact contained by the import content of public investment.

credited against their income tax liability.[12] The authorities stressed that these projects would be subject to SNIP procedures, and reported transparently in the fiscal accounts, while companies would remain subject to close tax auditing by SUNAT (tax administration agency) to preserve fiscal integrity and limit tax expenditures.

- ***Promoting consistent fiscal rules.*** A first priority is to restore the consistency of the expenditure limits applying to SNGs, by amending the Decentralization Law (DL) to bring it in line with the FRTL (LOI, ¶6).[13] The draft amendment to the FRTL is stalled in Congress, but the authorities still intend to seek its reform to strengthen fiscal coordination and compliance mechanisms among public sector entities.

- ***Ensuring an adequate use of canon resources.*** A proposal in Congress would distribute a share of *canon*-related resources as direct cash transfers to households in mining districts, to partly compensate for deficiencies in infrastructure and public service provision, and to assist private investment. The authorities intend to ensure that such transfers remain limited and well-targeted (LOI, ¶9). Staff noted that these transfers should either be phased out as soon as possible, or replaced with other mechanisms that reflect the nonrenewable nature of *canon*-related resources.

7. **Several measures are being implemented to enhance the quality of spending.** The authorities have made more flexible the use of SNGs's revenues for maintenance and pre-evaluation of public investment purposes and are expanding regional technical assistance offices related to the SNIP, critical to provide a more stable and comprehensive source of expertise for SNGs to evaluate public investment projects (LOI, ¶5). While efforts are underway to establish a unit to expedite specialized government purchases, staff noted the need to implement a comprehensive reform of the procurement system (Box 1). Efforts to roll out a new budget classification (consistent with GFS 2001) to all government levels for the 2009 budget cycle are well advanced. Delays in the external evaluation of the Integrated Financial Management System (SIAF) have hampered the implementation of the Treasury Single Account (TSA) for the central government. Following significant progress, the authorities now expect to submit required draft legislation and advance other needed measures—in line with FAD advice—and implement a TSA for the general government by end-September 2008 (LOI, ¶7). Performance budgeting will be initiated in 2008, through five pilot programs in strategic social areas.

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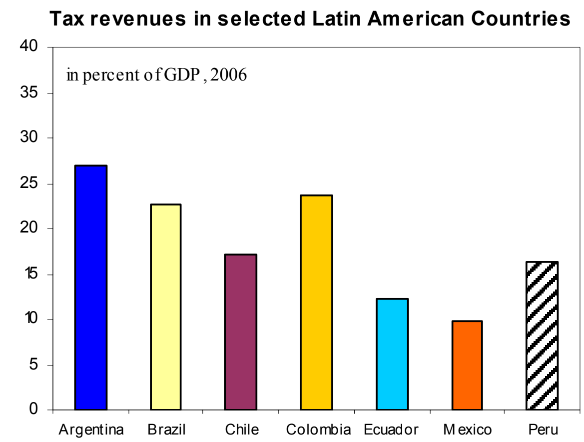
[12] Private sector companies would be able to deduct investment-related costs of up to 30 percent of their annual income tax liabilities with the central government. The central government would deduct these from SNG's *canon*-related revenues, which are earmarked corporate income tax collections transferred to mining regions.

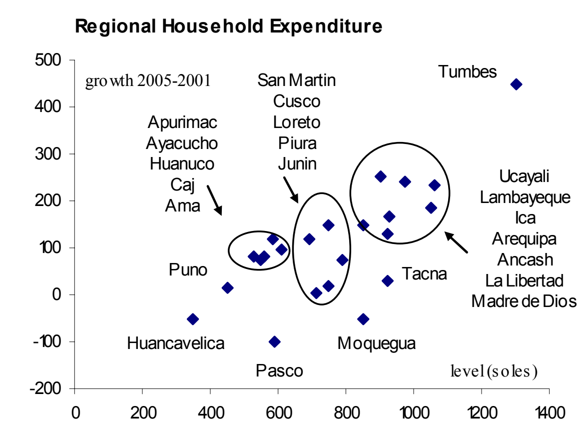
[13] While the FRTL imposes a ceiling of 4 percent growth to central government consumption in real terms, the DL limits the growth of total nonfinancial expenditure for the general government to 3 percent in real terms.

8. **The authorities are also proceeding with reforms to broaden the tax base.** Pressures to resist the replacement of tax exemptions with direct budgetary transfers have persisted in a few regions, but the authorities are committed to proceed with this reform, critical to broadening the tax base. In addition, they intend to issue methodological guidelines to ensure that ministries and other public entities assess existing tax exemptions consistently within the next two years, as required by the new regime for tax incentives (LOI, ¶8). Efforts at SUNAT remain focused on strengthening auditing functions and in finalizing a strategic plan for 2008–11. Efforts are also underway to make customs procedures more efficient, in line with the requirements posed by the Peru-U.S. FTA.



9. **The authorities were satisfied with the implementation of the poverty alleviation strategy.** They noted that efforts to provide the CIAS with higher political status and additional resources would be embedded in the draft *Organic Law of the Executive Power*, soon to be discussed by Congress. The CIAS has been leading the implementation of *Crecer*, a new strategy to combat child malnutrition in rural areas (LOI, ¶9), which will be supported by a complementary strategy to strengthen relevant infrastructure. To guide poverty alleviation over the medium-term, the CIAS is also preparing a *Multi-Annual Social Framework*, in line with the comprehensive strategy published last March. The authorities recognized that a review of universal and large focused programs was needed, but stressed that these programs would be politically difficult to reform.

10. **Poverty alleviation efforts are also being complemented by measures to lessen regional disparities.** The Regional Equalization Fund was changed recently to allocate more resources toward regions without *canon*. Moreover, the *Fondo para la Inversion Regional y Local* (FONIPREL) has been established to allow SNGs to bid for resources for investment projects, particularly in the poorest regions, some of which have experienced limited improvement in living standards in recent years. In addition, the authorities will submit to congress amendments to the SNIP law to facilitate the outsourcing of the evaluation required for public investment projects (end-March 2008 structural benchmark), which will help SNGs with poor capacity (LOI, ¶9).

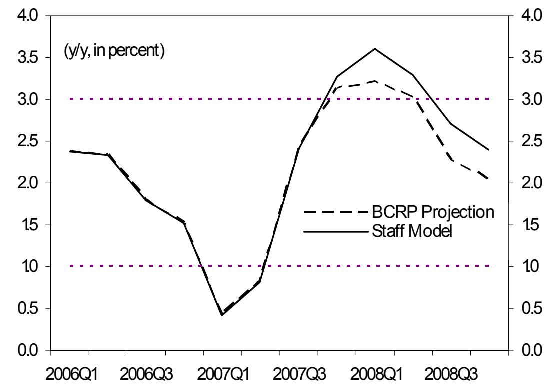


Source: Instituto Peruano de Economia; National Household Survey

C. Monetary and Exchange Rate Policies

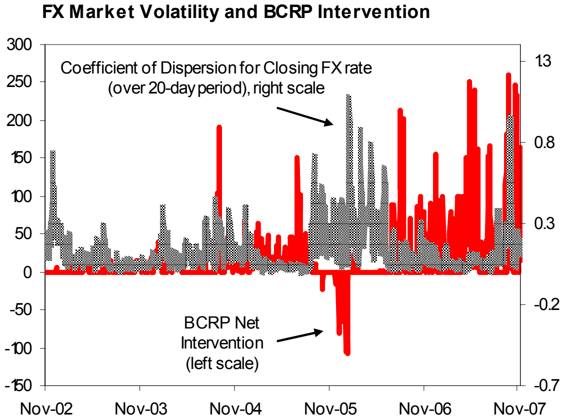
11. **The inflation outlook proves challenging for the conduct of monetary policy.** The authorities view the recent increase in inflation as transitory, although they remain vigilant to underlying inflation pressures in light of the strong growth in domestic demand and high levels of capacity utilization. While they were reassured by high productivity growth and subdued unit labor costs, they underscored their intention to tighten monetary conditions as needed to keep inflation expectations well-anchored. While surging capital inflows had led to much stronger money and credit growth than originally anticipated, the tight fiscal policy stance facilitated the conduct of monetary policy during 2007. It was agreed that the budgeted fiscal stance in 2008 could complicate the conduct of monetary policy, by forcing the central bank to intensify its own sterilization efforts. However, the authorities viewed the possible sterilization need as manageable at this juncture.

Baseline Inflation Projections

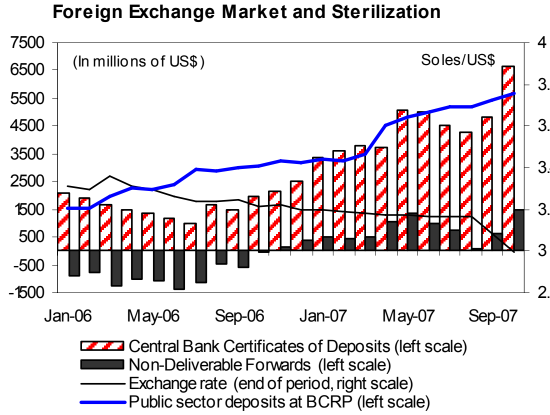


12. **It was agreed that the recent increase in exchange rate flexibility has served Peru well.** The authorities noted that their strategy of intervention in the foreign exchange market, while allowing gradually for greater flexibility, has been useful in arresting pressures from higher imported inflation and from capital inflows. While official reserves were approaching very comfortable levels, they noted that the still high level of dollarization, risks to the competitiveness of non-traditional exports, and shallow foreign exchange markets justified their current approach. The staff noted that improved macroeconomic fundamentals, including the increased resilience of the banking system to a large exchange rate depreciation, lowered the risks associated with greater two-way exchange rate flexibility (Box 2). Peru's favorable prospects suggested sustained pressures for appreciation and the staff encouraged the authorities to maintain greater exchange rate flexibility to help contain capital inflows and limit sterilization costs.

FX Market Volatility and BCRP Intervention



Foreign Exchange Market and Sterilization



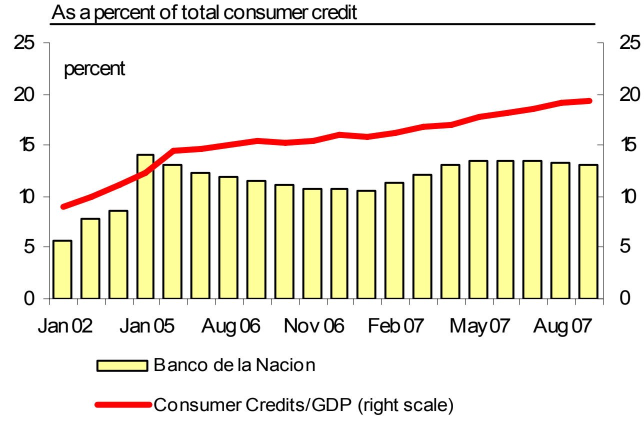
13. **Further progress is being made to strengthen central bank independence.** The Economics Commission in Congress approved a draft constitutional amendment for de-linking the appointments of board members and the President of the central bank from the political cycle, after 2011. The authorities see this reform as critical to solidifying the inflation targeting framework and will continue working toward ensuring a prompt ratification by Congress in 2008 (LOI, ¶10).

D. Deepening Financial Intermediation and Domestic Capital Markets

14. **Reforms to sustain dedollarization and strengthen the resilience of the financial sector continue at the top of the authorities' agenda (LOI, ¶11).** *MiVivienda* will discontinue the provision of credit risk guarantees and the *Bono al Buen Pagador* for foreign currency mortgage loans by end-2007, while the mortgage loan market in domestic currency is being propelled by the extension of the domestic yield curve to 30 years. The authorities will also submit to Congress amendments to the *General Banking Law* to allow the Superintendence of Banks (SBS) to introduce capital requirements for foreign-currency-induced credit risk via regulations, in line with Pillar II of Basel II (an end-June 2008 structural benchmark). The authorities and staff concurred on the need to continue monitoring the rapid growth in consumer credit and apply in full force the new regulations to contain the risks of overborrowing starting in 2008. This seemed particularly important in light of new entrants to the system, including in the microfinance sector, which involves a large number of small customers across the country. Therefore, the authorities intended to raise minimum capital requirements for microfinancial institutions to bring them more in line with international standards and reduce potential risks to the system (LOI, ¶11).[14]

15. **The expansion of public banks' activities brings to the fore the need to strengthen their oversight.** Staff expressed concern about the rapid expansion of consumer loans by *Banco de la Nación* (BN)—at around 60 percent since end-2007—and the modest rise in nonperforming loans. While BN remains well capitalized and profitable, staff stressed that it was important to preserve its role as a second-tier institution, as well as to ensure that the establishment of the TSA at BN did not entail increased subsidies. The authorities stressed that

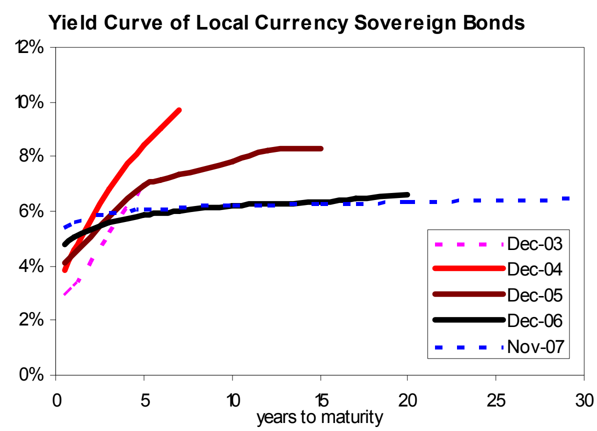
Banco de la Nacion: Consumer Credit
As a percent of total consumer credit

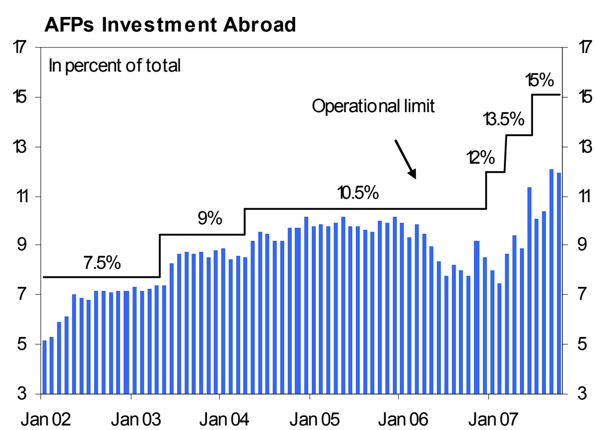


[14] Two new foreign commercial banks have recently initiated operations, with two others expected to enter in 2008. The minimum capital requirement for microfinance institutions is $250,000, well below the minimum of $1 million suggested by international best practice.

the public financial institutions aim at providing direct financial services mostly in market segments where private sector participation is low or non-existent. Nevertheless, they agreed that the subsidiary role of the GBL for public banks, and their expected expansion plans, made enhanced supervision more critical. Therefore, they have submitted to Congress a draft law to align the regulatory and supervisory framework for BN and COFIDE with that for private financial institutions. They also intend that BN reins in its consumer lending and that the interest rate spread from managing the TSA is aligned with BN's administrative costs (LOI, ¶11).

16. **The authorities have announced an important reform of capital markets.** Following MCM recommendations, several measures will be implemented to allow for a greater diversification of investments by private pension funds and to strengthen the regulatory framework, in order to limit potential domestic systemic risks, assist with appreciation pressures, and raise pensioners' welfare over the medium term (Box 3). Staff encouraged the authorities to support these measures by allowing greater competition for the management of retirement savings and reforming the salary-based commissions with asset-based ones to improve the system's efficiency. The authorities also explained that, following MCM's technical assistance, the clarification of the tax treatment of securitized transactions will now require previously unforeseen changes in legislation, to be implemented as part of these reforms (LOI, ¶11).

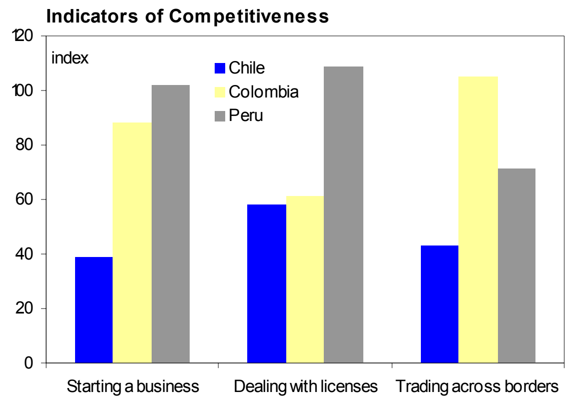




E. Other Growth-Enhancing Reforms

17. **The authorities will continue working on liberalizing the trade regime.** The U.S. Senate gave final ratification to the FTA in early December. The agreement incorporates enhanced labor and environmental protection provisions, and an enhanced enviroment for bilateral trade and long-term investment. Full implementation of the FTA will require changes to Peru's legal framework before it can enter into force, expected for early 2009. The authorities have also reduced effective tariffs by 3⅓ percentage points in 2007—to just above 2 percent, which will be reduced further to 1.8 percent when the FTA takes effect.

18. **Work continues on how best to tackle high labor market informality and enhance the business environment.** The authorities have been assessing different options to reduce the costs of formalization, while providing informal sector workers with gradual access to basic health and social security benefits. A one-stop window for external trade is now operational, three new provincial commercial courts have been established, and the implementing regulations for the new law on the *Positive Administrative Silence* have been issued (LOI, ¶12–13).



Source: World Bank Doing Business (2008)

III. Program Issues and Risks

19. **Conditionality.** The attached letter of intent reaffirms the authorities' commitment to the program and its targets. Quantitative performance criteria are being set through end-December 2008. The bands of the inflation consultation mechanism have been realigned with the authorities' new central target, while the lower outer band was maintained at -0.5 percent to signal concern for deflation. Several structural benchmarks for 2007 are being proposed to be either reset or strengthened and reprogrammend to 2008, as explained in Table 3, and new structural benchmarks for 2008 are described in Table 4 of the staff report and Table 2 of the LOI.

20. **Paris Club Debt.** Disputed claims that had emerged ahead of the pre-payment in October were settled, except for a $1 million claim that has yet to be verified by the creditor. The disputed claims did not affect the pre-payment.

21. **Risks.** These appear well balanced due to the favorable economic conditions and authorities' commitment to prudent policies. Looking ahead, with rising canon-related resources and subnational governments expected to enhance their capacity to spend, the central government may need to take offsetting measures to preserve macroeconomic stability.

IV. Staff Appraisal

22. **Peru will achieve another year of strong economic performance in 2007.** This owes much to the authorities' commitment, in a favorable external environment, to preserve prudent macroeconomic policies and advance structural reforms with a view to reducing vulnerabilities. Economic growth has been strong and broad-based, and although inflation has accelerated recently—reflecting global trends—it remains under control. Active debt management has strengthened the structure of public debt, and declining dollarization and comfortable official reserves levels have reduced exposure to external risks.

23. **Recent events in the global economy underscore the need to sustain prudent macroeconomic policies and press ahead with the structural reform agenda.** The strong momentum in the economy provides an opportunity to advance far-reaching reforms, to strengthen further the resilience of the economy to shocks, effectively reduce poverty, and enhance medium-term growth prospects. In this light, staff welcomes the authorities' commitment to implement a program well-geared toward achieving these goals in 2008.

24. **Fiscal policy remains focused on balancing the need to preserve macroeconomic stability while addressing large infrastructure and social deficits.** Staff supports the authorities' decision to aim for a balanced budget—well below the deficit limit of 1 percent of GDP envisaged in the Fiscal Responsibility and Transparency Law. Such a target provides much needed space to increase capital expenditure to address the infrastructure deficit and social assistance needs. Nevertheless, staff encourages the authorities to continue with their fiscal strategy of recent years, by saving part of any revenue overperformance, and to achieve a stronger fiscal outcome in 2008 to assist macroeconomic stability.

25. **It will be important to ensure an adequate execution of high-quality public expenditure in 2008.** Facing significant budgetary underexecution in recent times, the authorities are making progress to facilitate the execution of public spending and it will be important to sustain these efforts. Building capacity at subnational governments remains a major challenge, which will take several years to accomplish. In this regard, private sector involvement in carrying out public investment projects is welcome but should preserve fiscal transparency and budgetary integrity. Staff also welcomes the authorities' plan to expand and strengthen the regional technical assistance offices, which should provide an important anchor to evaluating and executing investment projects over time. Efforts need to be sustained to implement a comprehensive reform of the government procurement system, while preserving its transparency and governance. Preserving the allocation of *canon* resources toward sound investment projects is also critical to improve the quality of spending and promote lasting improvements in poverty.

26. **These efforts should go hand-in-hand with measures to minimize related fiscal risks.** Staff welcomes the authorities' commitment to promptly establish a comprehensive legal framework for PPPs to ensure an adequate balance of risks between the public and private sectors. It will also be important to restore the comprehensiveness and consistency of the Fiscal Responsibility and Transparency Law, by aligning its consumption expenditure limits for subnational governments with those set in the Decentralization Law.

27. **Staff welcomes the authorities' plans to address other key structural fiscal weaknesses.** Completing a new budget classification that could be incorporated in the 2009 budget, and continue advancing toward fully implementing a Treasury Single Account for the general government should help improve the quality of public spending. Staff welcomes the authorities' intention to advance with the implementation of the new regime for tax

incentives, critical to broaden the tax base. In general, it will be important to redouble efforts to fully implement the structural reform agenda in 2008.

28. **The favorable economic environment provides a good opportunity to advance with the March 2007 poverty alleviation strategy.** It will be important to provide the CIAS with the resources and status needed to successfully lead the reform, including to conduct a review of universal and large focused social assistance programs to begin building political consensus toward reform. Staff welcomes the authorities' decision to let the National System of Public Investment (SNIP) outsource the evaluation of public investment projects and to implement the new *Fondo para la Inversion Regional y local (FONIPREL)*, to boost the execution capacity of investment projects by subnational governments.

29. **The authorities have taken an important step toward greater two-way exchange rate flexibility**. Staff encourages the authorities to entrench this greater flexibility, which along with the de-linking of the appointment of board members from the political cycle, would help consolidate the inflation targeting framework and strengthen the economy's resilience to shocks. Facing a challenging inflation outlook, staff welcomes the authorities' plans to bring domestic fuel prices in line with international ones while limiting their inflationary impact and the authorities' commitment to tighten the monetary stance as needed.

30. **Plans to strengthen the regulatory oversight of public financial institutions, reduce dollarization, and reform capital markets are welcome.** The introduction of capital requirements for foreign-currency-induced credit risks, in line with Pillar II of Basel II is an important step forward to strengthen further the resilience of the banking system to exchange rate shocks. Aligning the regulatory and supervisory framework of public institutions with that of private banks, while closely monitoring their lending practices and implicit subsidies will help ensure a competitive playing field in the financial sector. Raising the minimum capital requirements for microfinance institutions will also be important to strengthen the resilience of the financial sector. The envisaged reforms to the private pension funds framework will help mitigate systemic risks, arrest appreciation pressures, and raise retirees' income over the medium term.

31. **Staff recommends completion of the second review under the SBA.** In light of the authorities' continuous strong commitment to the program, and generally good performance, staff supports the completion of the second SBA review.

Box 1. Reforms to Expedite Public Expenditure

Efforts to improve the execution of high quality public spending are three-pronged:

First, along with its decentralization, SNIP procedures have been simplified to take into account the size of projects. Smaller projects would face simplified and abridged approval procedures. For example, projects smaller than S/. 0.3 million (some US$100,000) will be required to provide an adequate "simplified profile" for their SNIP approval; while projects between S/. 0.3 and S/. 6 million will require a "full profile" assessment, and those up to S/. 10 million will require a pre-feasibility study. Projects above S/. 10 million will require a feasibility study.[1/]

The Ministry of Finance (MEF) retains a key role in the SNIP to help maintain the quality of spending. The Multiannual Programming Directorate of the Ministry of Finance (DGPM) is entitled to:

- Monitor the execution of any government project, provide technical opinions, and request information related to any project. The DGPM can also assess compliance with SNIP rules and the quality of evaluations of a sample of investment projects.
- Coordinate with the Comptroller General's office (CGR) the guidelines to include in the control activities performed by the CGR and report to the CGR cases of non-compliance with SNIP procedures.

Second, a proposed framework for concessions also aims at accelerating high-quality investment by:

- Differentiating between concessions that require government cofinancing or guarantees from those that do not, and providing the latter with expedited approval processes. Projects that are cofinanced will need to be accompanied by feasibility studies for their approval at the pre-investment phase. In all cases, MEF has the authority to determine whether the concession is cofinanced or self-financed.
- Investment under the government's public sector enterprise holding agency (FONAFE) that requires no obligations for the state will no longer be subject to SNIP procedures. FONAFE is to provide a manual of project evaluation for enterprises within its control.

Third, efforts are being made to speed up the procurement process.

- A new entity *Perú-Compras* will be established in the second half of 2008. This small unit will: (i) implement a new system of corporate purchases; (ii) subscribe comprehensive price agreements to serve as benchmarks to procurement specialized operations; and (iii) complete difficult of highly-specialized purchases for the central government.
- A *National Procurement Strategy* with World Bank assistance will review procurement processes over the medium-term. In addition, a *Catalog for International Purchases* is currently being prepared, also with the Bank's support.

1/ A "profile" entails an initial technical assessment of the project, as well as a cost-benefit analysis relative to other alternatives. The pre-feasibility study analyzes more fully the selected costs and benefits of those alternatives; and the feasibility study provides the precise evaluation of the selected alternative for the investment project, considering its optimized design.

Box 2. Exchange Rate Risks and Sterilization

The banking system has become more resilient to exchange rate risks. While dollarization is still high, the share of foreign currency loans has been declining and regulations requiring banks to internalize credit risks associated with borrowers' currency mismatches have reduced exchange rate-induced credit risk. As a result, a depreciation of the currency would now have a much more limited impact on the capital adequacy ratio of the system (CAR). Also, the ratio of banks' global net open position remains at 28 percent of capital at end-June 2007, while liquid assets represent more than 40 percent of total short-term liabilities, well above the regulatory minimum of 20 percent.

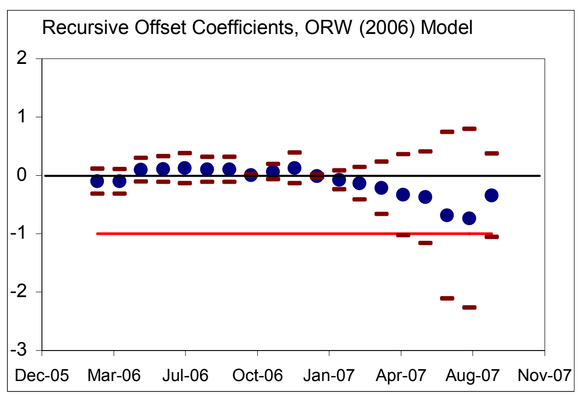
	Market exchange rate risk		Foreign exchange induced credit risk	
	2005 FSAP update 1/	June 2007	2005 FSAP update 1/	June 2007
Initial banking system CAR	13.5	12.1	13.5	12.1
New banking system CAR	11.8	12.0	9.9	10.2
Change in CAR (in percent)	-12.6	-0.8	-26.7	-15.7
Memorandum items:				
Share of loans in foreign currency (percent	75.7	65.0		
Net foreign exchange open position/capital	24.2	28.6		
Stress scenario 2/	20 percent depreciation			

Source: Staff estimates

1/ Data as of December 2004.

2/ Both the 2005 FSAP update and the SBS methodology determined the 20 percent depreciation by the 99 percent confidence level of the normalized distribution of the monthly changes in the exchange rate in the period January 1997 to December 2004, and January 1991 to February 2007 respectively.

Greater exchange rate flexibility has strengthened the effectiveness of sterilization. In October, the average annual return on the central bank's stock of reserves amounted to 4.7 percent–60 basis points below the average interest paid on the *Certificados de Deposito* used to sterilize foreign exchange purchases. However, banks' foreign currency reserve requirements, which constitute about one-sixth of the stock of net international reserves, are only remunerated at 3.5 percent. Staff's estimates suggest that the effectiveness of sterilization policies may have weakened over the last year, with the offsetting response of capital inflows to sterilization becoming stronger. However, sterilization has become more effective in recent months, reflecting greater exchange rate flexibility.



Box 3. Development of Domestic Capital Markets

Capital markets remain relatively small, illiquid, and dominated by AFPs. Equity and bond markets are smaller than others in Latin America. In the equity market, there have been few new listings in recent years and value traded represents only 4.8 percent of GDP. In the bond market, 61 percent of outstanding bonds are public. The corporate bond market is growing, but it also remains rather small and illiquid (it represents only 3 percent of GDP). Securitized instruments, derivatives, and repos are still underdeveloped. AFPs have become a major player in the financial system, with assets amounting to approximately US$19.5 billion (about 20 percent of GDP, similar to total deposits in the banking system).

Comparative Size of Capital Markets, end 2006

	Equity Market	Bond Markets 1/
	(% of GDP)	
Brazil	66.3	61.9
Chile	116.4	28.0
Colombia	38.6	29.2
Mexico	43.9	36.7
Peru	**51.4**	**10.0**
Latin America	56.6	49.6
Emerging countries	64.6	42.4
World	86.2	85.6

1/ Includes Public and Private domestic debt.
Sources: BIS, World Federation of Stock Exchanges, Bloomberg., National Aurthorities and Staff Estimates.

While a number of reforms have been implemented recently to foster the development of capital markets, there are still important challenges. A recent MCM TA mission suggested the need to: (i) improve regulation for AFPs investments to foster competition and promote capital market development; (ii) enhance CONASEV's capacity to supervise securities markets; (iii) streamline and clarify the taxation framework for financial instruments; and (iv) facilitate the development of financial products, including derivatives, repos and asset-backed securities.

A comprehensive capital markets reform comprising these areas is being prepared by the authorities. The reform will include a number of measures in the Fund-supported program:

- ***Increase the 20 percent limit on AFPs investment in foreign assets to reduce risks*** and improve returns by allowing greater diversification in line with international practice. The authorities are still contemplating several options, including to increase the limit in two steps: (i) to 30 percent in the next 12 months; and (ii) to 50 percent in the next five years.

Foreign Invesment Limits for Pension Funds

OECD Countries with No Limits	Emerging Markets with No Limits
Australia, Belgium, Canada, Germany Ireland, Japan, Luxembourg, New Zealand Norway, Spain, Sweden, Turkey UK, US	Estonia, Lithuania

OECD Countries with Unlimited Investment in Other OECD Countries	Emerging Markets with High Limits
Denmark, Greece, Iceland, Portugal	Slovak Republic 70% Israel 70% Chile 45%

- ***Broaden the set of investible domestic instruments of AFPs to allow greater diversification.*** In the next months the set will be gradually broadened to include a larger set of equities, security lending, hedge funds among others, while strengthening the market watch.

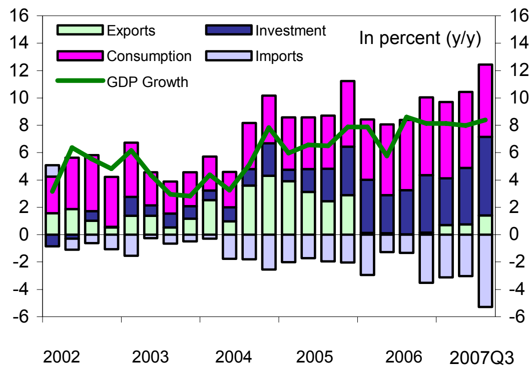
- ***Eliminate the minimum return guarantee of AFPs to minimize herding behavior.*** A two-step process will consist of: (i) reforming the guarantee by measuring the return with respect to benchmarks per class of assets and currency, and reducing the reserve requirement in the next 12 months; and (ii) eliminating the guarantee in the next five years.

- ***Clarify the tax treatment of securitized transactions*** (i.e., application of income and VAT taxes) to develop this market, and further solidify the mortgage market.

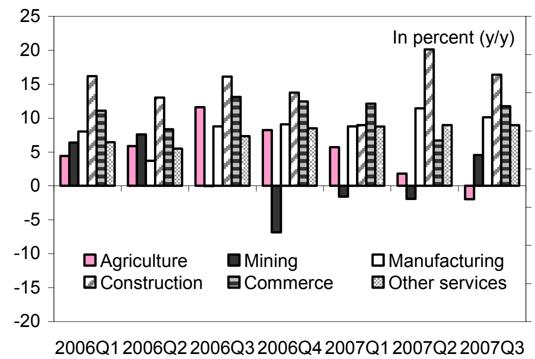
- ***Implement mechanisms to improve the coordination between CONASEV and SBS,*** including by signing the Memorandum of Understanding that is being discussed.

Figure 1. Peru: Real Sector Developments

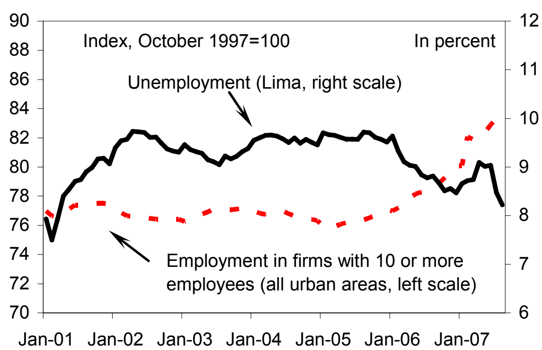
Investment and consumption remain strong...



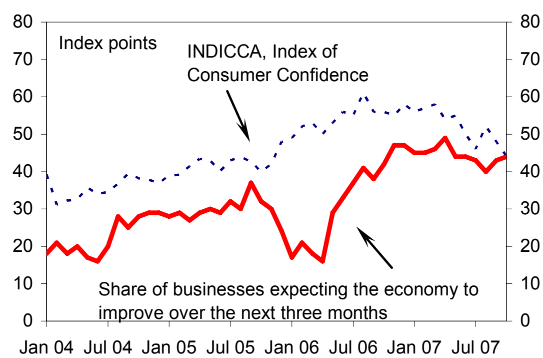
...and economic growth broad...



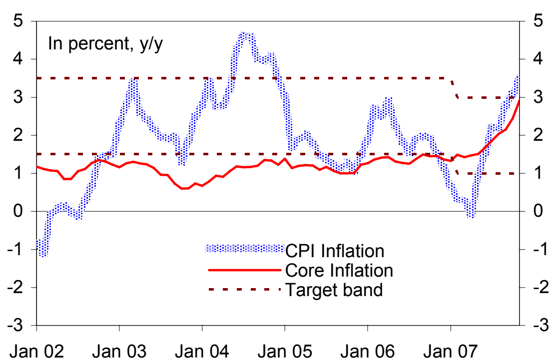
...with formal employment expanding...



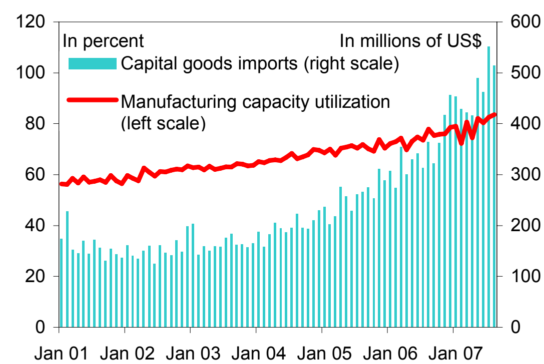
...but business and consumer confidence indicators softening somewhat.



Inflation has surpassed the upper limit of the target range mainly due to supply shocks...



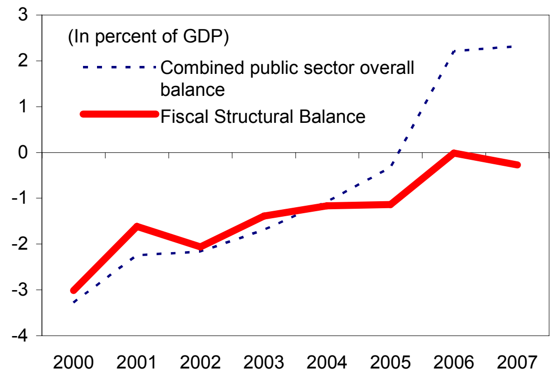
...as high capital investment contains a steady but gradual rise in capacity utilization.



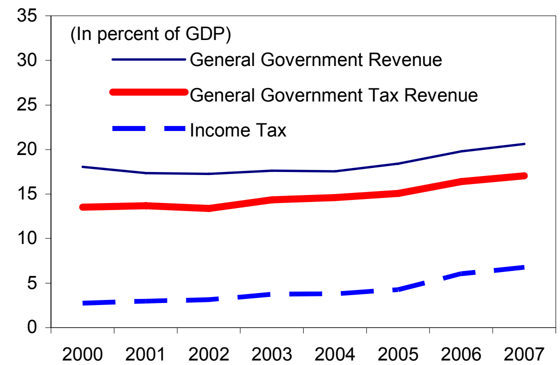
Sources: Banco Central de Reserva del Peru and IMF staff estimates.

Figure 2. Peru: Fiscal Sector Developments

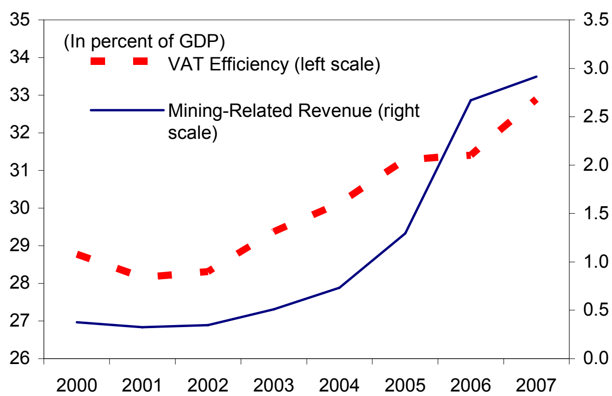
There has been a sharp improvement in the fiscal balance...



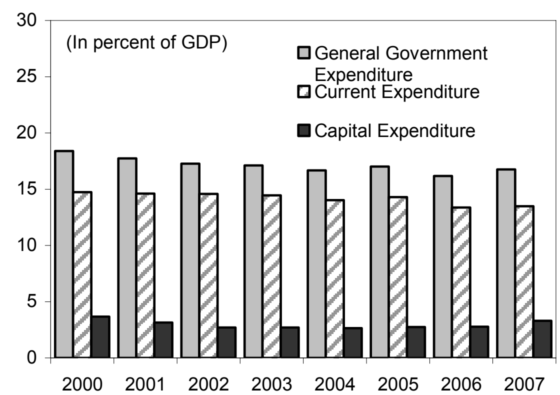
...supported by increased revenue collection.



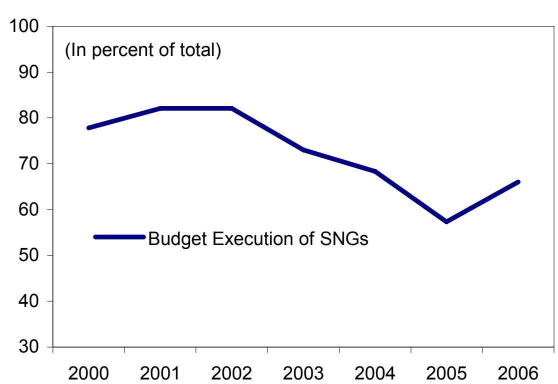
The improvement reflects better tax administration and higher commodity prices.



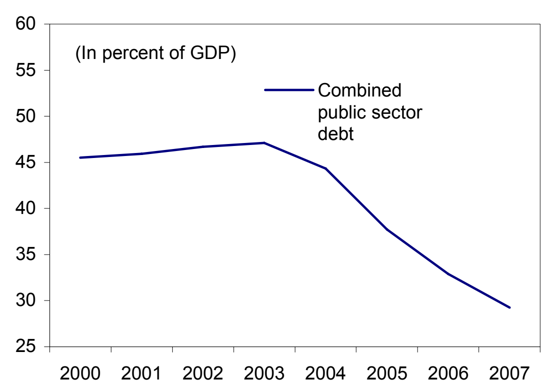
While poised for recovery, the share of expenditure to GDP has declined...



...partly reflecting low budget execution by sub-national governments.



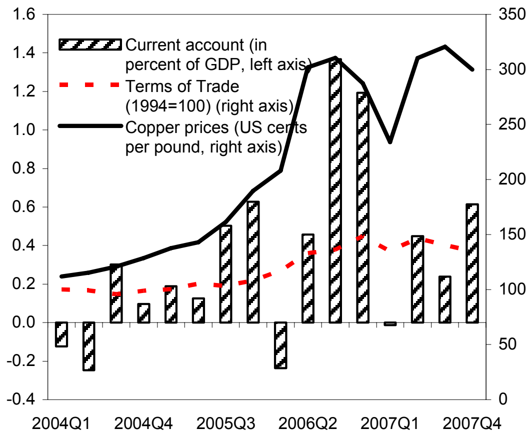
The strong fiscal performance has allowed public debt to decline markedly.



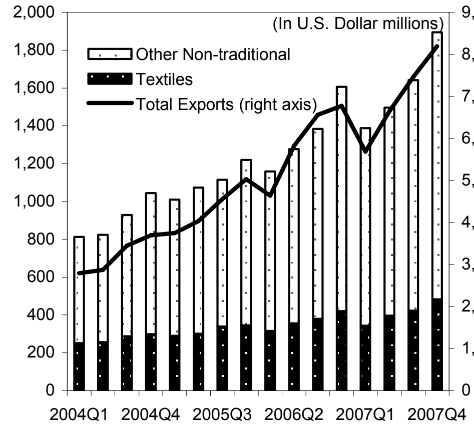
Sources: Central Reserve Bank of Peru; Ministry of Economy and Finance and IMF staff Estimates

Figure 3. Peru: External Sector Developments

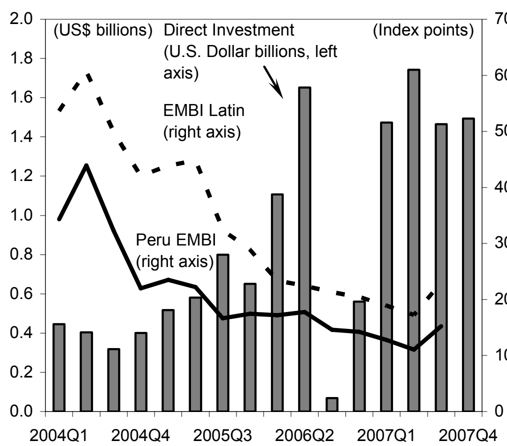
The strong balance of payments was boosted by improved terms of trade...



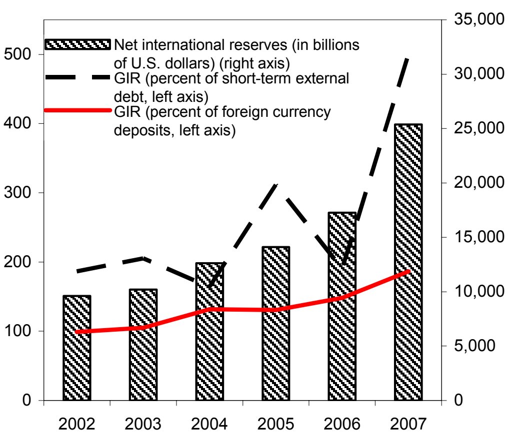
...and increasing non-traditional exports...



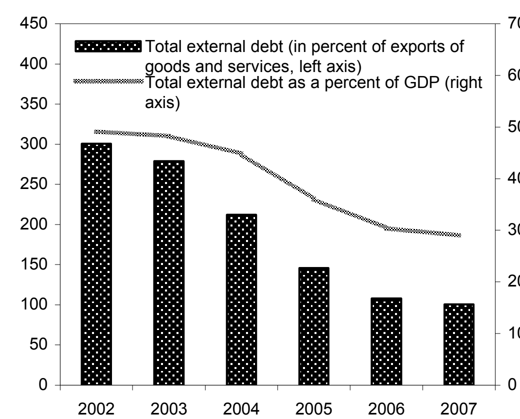
...and strong investment as the impact of global market turmoil remained subdued.



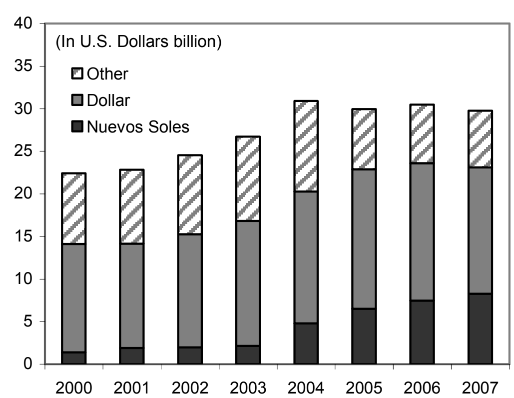
This has helped to build reserves.



External Debt has declined markedly...



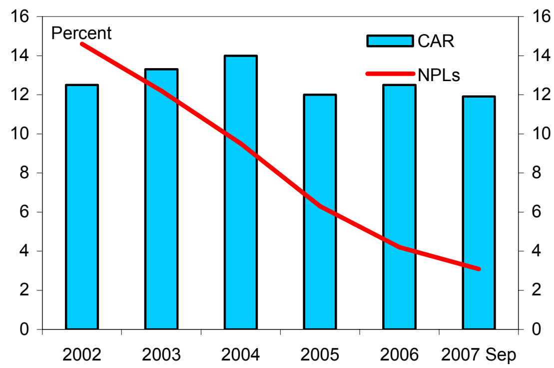
...while the domestic currency share in public debt is rising.



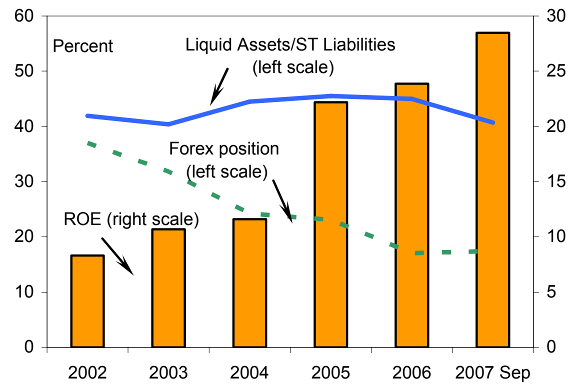
Sources: Banco Central de Reserva del Peru, Ministry of Finance, JP Morgan and IMF staff estimates.

Figure 4. Peru: Banking and Financial System 1/

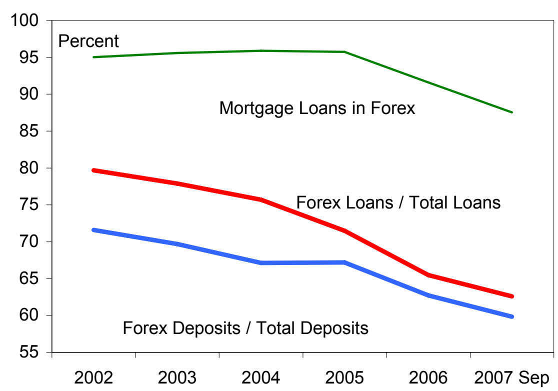
The banking system remains sound, with strong capitalization ratios and declining non-performing loans...



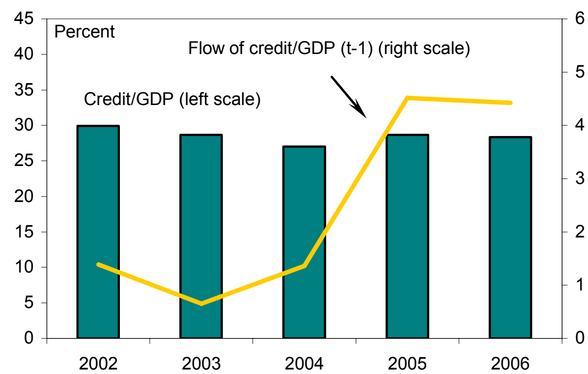
...increasing profitability, and comfortable levels of liquidity and foreign exchange positions.



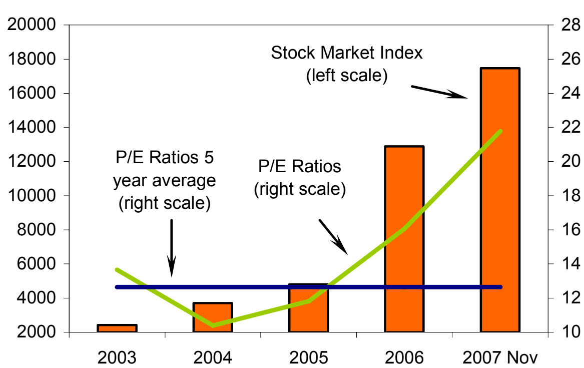
However, the system remains highly dollarized, particularly mortgage loans...



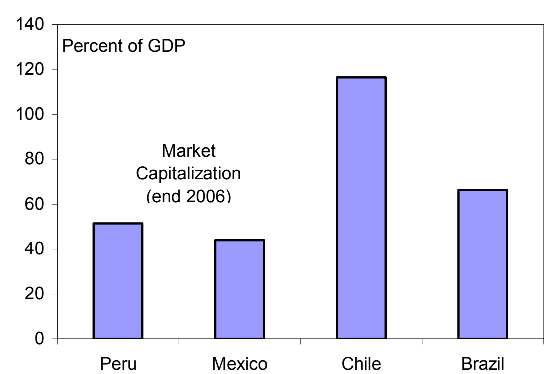
...and financial deepening remains quite low, despite high rates of credit growth in recent years.



Equity prices and price/earnings ratios have increased sharply.



However, capital markets remain relatively small.



Sources: Bloomberg, SBS, World Federation of Exchange Rates and Fund staff estimates.
1/ Banking sector data corresponds to December 2006.

Table 1. Peru: Selected Economic Indicators

	2003	2004	2005	Prel. 2006	Prog. 2007	Projection 2007	Projection 2008
Social Indicators							
Life expectancy at birth (years)	70.0	...	...	...	...	...	...
Infant mortality (per thousand live births)	26.0	...	...	...	...	...	...
Adult literacy rate	87.7	87.8	...	...	...	...	...
Poverty rate (Total) 1/	52.2	48.6	48.7	44.5	...	...	...
Unemployment rate	9.4	9.4	9.6	8.6	...	...	...
(Annual percentage change; unless otherwise indicated)							
Production and prices							
Real GDP	4.0	5.1	6.7	7.6	7.0	7.5	6.5
Real domestic demand	3.7	4.0	5.7	10.1	9.2	10.9	8.0
Of which: Private sector	3.8	4.4	5.9	8.8	7.8	10.0	6.5
Consumer Prices (end of period)	2.5	3.5	1.5	1.1	2.0	3.4	2.5
Consumer Prices (period average)	2.3	3.7	1.6	2.0	1.1	1.7	3.0
External sector							
Exports	17.8	40.9	35.6	37.0	9.4	17.6	7.9
Imports	10.6	19.5	23.2	23.0	20.2	28.9	21.1
Terms of trade (deterioration -)	1.3	9.2	5.9	28.3	-0.6	3.9	-4.8
Real effective exchange rate (depreciation -) 2/	3.8	1.6	0.5	1.3	...	...	...
Money and credit 3/ 4/							
Liabilities to the private sector	1.0	8.3	18.4	8.8	14.5	18.2	12.9
Net credit to the private sector	-4.5	-0.3	16.3	6.2	12.5	18.4	14.5
(In percent of GDP; unless otherwise indicated)							
Public sector							
General government current revenue	17.5	17.5	18.3	19.7	19.6	20.5	19.9
General government noninterest expenditure	17.1	16.7	17.0	16.2	17.8	16.8	18.2
Combined public sector primary balance	0.5	1.0	1.6	4.1	1.9	4.1	1.6
Interest due	2.2	2.0	1.9	1.9	1.8	1.8	1.6
Combined public sector overall balance	-1.7	-1.1	-0.3	2.2	0.0	2.3	0.0
Combined public sector overall balance (including CRPAOs)	-1.7	-1.1	-0.3	2.1	-0.3	1.3	-0.7
External Sector							
External current account balance	-1.5	0.0	1.4	2.8	0.9	1.3	-0.5
Gross reserves							
In millions of U.S. dollars	10,206	12,649	14,120	17,329	21,329	25,429	28,679
Percent of short-term external debt 5/	205.4	163.9	311.4	190.1	336.9	500.1	489.1
Percent of foreign currency deposits at banks	108.5	137.3	125.9	151.7	167.0	204.9	207.7
Debt							
Total external debt	48.2	44.8	36.1	30.4	28.1	29.0	25.8
Combined public sector debt (including CRPAOs)	47.1	44.3	37.7	32.9	30.0	29.2	26.2
Domestic	10.0	9.2	9.7	9.3	8.7	10.8	10.4
External 6/	37.1	35.1	28.0	23.6	21.3	18.4	15.8
Savings and investment							
Gross domestic investment	18.4	18.1	17.9	19.9	22.5	22.1	23.9
Public sector 7/	2.8	2.8	2.9	2.8	4.8	4.2	5.7
Private sector	15.0	15.1	15.5	16.3	18.0	18.2	19.1
Inventories changes	0.6	0.2	-0.4	0.7	-0.3	-0.4	-0.8
National savings	16.9	18.1	19.4	22.7	23.4	23.3	23.4
Public sector 8/	1.2	1.7	2.6	5.1	4.6	5.8	5.3
Private sector	15.6	16.4	16.8	17.6	18.7	17.6	18.2
External savings	1.5	0.0	-1.4	-2.8	-0.9	-1.3	0.5
Memorandum items:							
Nominal GDP (S/. billions)	213.4	238.0	261.9	304.6	329.2	335.0	359.3
GDP per capita (in US$)	2,324	2,602	2,920	3,366	3,672	3,818	4,346

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

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

2/ Based on Information Notice System.

3/ Corresponds to the banking system.

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

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

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

7/ Includes CRPAOs.

8/ Excludes privatization receipts.

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

	Mar. 31	Jun. 30	Sept. 30	Dec. 31
(Cumulative amounts from December 31, 2006, millions of New Soles)				
Borrowing requirement of the combined public sector				
Unadjusted limits 1/ 2/ 3/ 4/	-1,396	-4,190	-2,761	2,418
Adjusted limits	-1,646	-4,690	-3511	
Actual	-4,194	-11,749	-14,181	
Margin	2,548	7,059	10,670	
(Cumulative amounts from December 31, 2006, millions of U.S. dollars)				
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions				
Unadjusted targets 5/ 6/	-260	44	336	350
Adjusted targets	-635	-478	-8	
Actual	948	4,126	4,761	
Margin	1,583	4,604	4,769	
Outstanding short-term external debt of the nonfinancial public sector				
Limits	50	50	50	50
Actual	0	0	0	
Margin	50	50	50	
Contracting or guaranteeing of nonconcessional public debt with maturity of at least one year				
Unadjusted limits 7/ 8/ 9/	751	1,237	1,608	2,636
Adjusted limits	3,146	3,632	5,506	
Actual	2,741	3,028	4,627	
Margin	405	604	879	
Of which: **external debt of 1-5 year maturity**				
Limits	100	100	100	100
Actual	0	0	0	
Margin	100	100	100	
External payments arrears of the public sector (on a continuous basis)				
Limits	0	0	0	0
Actual	0	0	0	
NPV of future government payments associated with PPP operations (on a continuous basis)				
Unadjusted Limits 10/	1,500	1,500	1,500	1,500
Actual	58	58	58	
Margin	1,442	1,442	1,442	
(Consultation bands for the 12-month rate of inflation, in percent) 11/				
Outer band (upper limit)	5.5	5.5	5.5	5.5
Inner band (upper limit)	4.5	4.5	4.5	4.5
Central point	2.5	2.5	2.5	2.5
Inner band (lower limit)	0.5	0.5	0.5	0.5
Outer band (lower limit)	-0.5	-0.5	-0.5	-0.5
Actual	0.3	1.6	2.8	...

Sources: Staff estimations.

1/ PIPP proceeds are included below the line.

2/ The limit on the borrowing requirement of the combined public sector will be adjusted downwards by the amount central government revenues net of mandatory transfers exceed program estimates of S/. 10,489 million at end-March, up to a ceiling of S/. 250 million; S/. 23,359 million at end-June, up to a ceiling of S/. 500 million; S/. 32, 807 million at end-September, up to a ceiling of S/. 750 million; and S/. 44,821 million at end-December, up to a total ceiling of S/. 1,000 million.

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

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

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

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

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

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

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

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

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

Table 3. Peru: Structural Benchmarks for 2007

Measures	Date of Implementation	Current Status and Resolution
Ensure that most of new mortgage loans extended by banks with the guarantee of *MiVivienda* are denominated in nuevo soles.	June 30, 2007	Not observed. Private banks have been notified by *MiVivienda*, and a calendar has been set to phase out the guarantees by January 1st, 2008. The Executive Board was notified of an expected delay to December 31, 2007, at the time of the first review.
Submit to congress a legal framework for PPP operations.	September 30, 2007	Not observed. Delayed to December 31, 2007. Proposed to become a Structural Performance Criterion for end-March 2008 in case of further delay.
Appoint a new head of CIAS and technical staff.	September 30, 2007	Observed.
Clarify the tax treatment of securitized transactions.	December 31, 2007	An MCM mission defined required legal amendments. The benchmark is proposed to be reset to end-June 2008, to allow time for such changes to be submitted to Congress along with the package for reforming the domestic capital markets.
Full implementation of the Treasury Single Account (TSA) for the central government.	December 31, 2007	While significant progress has been achieved, full coverage of central government funds and appropriate information controls through the government's information management system (SIAF) have been delayed. The benchmark has been broadened and is proposed to be reset to end-September 2008. The authorities are to take specific steps to implement the TSA at the general government level, by submitting legislation to bring all general government funds under the TSA, and by either establishing a Treasury-General Ledger or modifying the SIAF to ensure it provides information in a Treasury-General Ledger format.
2008 Budget prepared according to the modernized budget classification system and incorporated into the charts of accounts.	December 31, 2007	Some progress, but full observance is proposed to be reprogrammed for end-September 2008.
Issue new regulations regarding new risk categories and provisions to address foreign currency risk.	December 31, 2007	Redefined and proposed to be set for June 30, 2008. The authorities now plan to raise capital requirements to deal with foreign-currency risks, in line with Basel II, which requires legal amendments.

Table 4: Structural Program 2008

Structural Benchmark	Macrocritical Objective
End-March	
Submit to Congress an amendment to the SNIP law to allow for the outsourcing of the studies required for the formulation and approval of investment projects	Speed up high quality public investment, particularly in SNGs with low capacity, to address the infrastructure gap, and ensure sustainable growth
End-June	
Clarify the tax treatment of securitization transactions in line with parag. 11, bullet 4 of the Letter of Intent	Deepen domestic financial markets
Issue methodological guidelines for ministries and public entities to assess tax exemptions in line with new regime for tax exemptions	Broadening the tax base to help raise the tax-to-GDP ratio and ensure a sustainable fiscal stance
Submit to Congress amendment to the General Banking Law to allow the SBS the introduction of capital requirements for exchange-rate related risk in line with Basel II	Strengthen the banking system to raise the economy's resilience to exchange rate shocks
Submit to Congress amendment to General Banking Law to raise the minimum capital requirement for microfinance institutions	Reduce the potential systemic risks of microfinance institutions by brining them more in line with international standards, given their large number of small customers.
Submit to Congress amendment to the Law of Pension Funds that would significantly raise the limit for foreign investments by private pension funds	Mitigate systemic risks, arrest appreciation pressures, and raise retirees' income over the medium term.
End-September	
2009 Budget to be prepared according to modernized budget classification system and incorporated into the chart of accounts	Ensure a sustainable fiscal stance by preserving the high quality of public spending.
Implement the TSA, as described in paragraph 7 of the Letter of Intent	Ensure a sustainable fiscal stance and the highquality of public spending by enhancing public financial management.
Submit to Congress amendments to the Decentralization Law to reconcile subnational government spending with that for the central government as presented in the FRTL	Minimize long-term fiscal risks by ensuring the consistency of the fiscal framework.
End-December	
Expand the number of Technical Assistance Regional Offices from 16 to 28	Provide an important anchor to evaluating and executing investment projects over time, to help address the infrastructure gap, and ensure sustainable growth.

Table 5. Peru: Fiscal Operations of the Combined Public Sector

(In percent of GDP; unless otherwise indicated)

				IMF Country Report No. 07/5	Prel.	Prog.	Projection	
	2003	2004	2005	2006		2007	2007	2008
Central government primary balance	**0.2**	**0.6**	**1.1**	**2.5**	**3.2**	**1.3**	**2.8**	**1.8**
Revenue	**14.9**	**14.9**	**15.8**	17.4	**17.4**	**17.3**	**18.1**	**17.6**
Current	14.7	14.9	15.6	17.2	17.3	17.2	18.0	17.5
Of which : Tax revenue	12.8	13.1	13.6	15.1	15.0	15.2	15.6	15.6
Of which: Financial transaction tax	...	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Capital	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Noninterest expenditure	14.7	14.4	14.7	14.9	14.2	15.9	15.4	15.8
Current 1/	12.8	12.5	12.8	13.1	12.2	13.0	13.2	12.4
Capital	1.9	1.8	1.9	1.8	2.0	3.0	2.1	3.4
Rest of the general government primary balance	**0.3**	**0.3**	**0.3**	**0.2**	**0.4**	**0.5**	**1.1**	**-0.1**
Revenue	5.8	5.7	5.9	6.1	6.2	6.6	6.7	5.9
Current	5.7	5.7	5.9	5.9	5.9	6.5	6.6	5.9
Capital	0.1	0.0	0.1	0.2	0.3	0.1	0.2	0.1
Noninterest expenditure	5.5	5.4	5.7	5.8	5.8	6.0	5.6	6.0
Current	4.6	4.6	4.7	4.8	4.7	4.6	4.3	4.4
Capital	0.9	0.9	1.0	1.0	1.1	1.5	1.4	1.6
Public enterprise primary balance	**0.0**	**0.1**	**0.2**	**0.1**	**0.3**	**0.0**	**0.1**	**-0.1**
Current balance	0.3	0.4	0.5	0.4	0.5	0.3	0.3	0.3
Capital balance	-0.4	-0.2	-0.3	-0.3	-0.2	-0.3	-0.2	-0.5
Nonfinancial public sector primary balance	**0.4**	**1.0**	**1.6**	**2.8**	**3.9**	**1.8**	**3.9**	**1.6**
Central bank operating balance	0.1	0.0	0.0	0.1	0.2	0.1	0.2	0.0
Combined public sector primary balance	**0.5**	**1.0**	**1.6**	**3.0**	**4.1**	**1.9**	**4.1**	**1.6**
Interest payments	2.2	2.0	1.9	2.0	1.9	1.8	1.8	1.6
External	1.8	1.7	1.6	1.5	1.4	1.4	1.3	1.0
Domestic	0.4	0.4	0.4	0.5	0.4	0.5	0.5	0.6
Combined public sector overall balance	**-1.7**	**-1.1**	**-0.3**	**1.0**	**2.2**	**0.0**	**2.3**	**0.0**
Financing	**1.7**	**1.1**	**0.3**	**-1.0**	**-2.2**	**0.0**	**-2.3**	**0.0**
External	1.4	1.5	-1.3	-0.2	-0.6	0.0	-1.9	0.0
Disbursements 2/	3.4	3.5	3.4	1.1	0.7	3.2	3.0	1.2
Amortization 3/	-1.9	-1.9	-4.6	-1.3	-1.3	-3.3	-5.0	-1.2
Rescheduling/arrears (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 4/	-0.1	-0.1	-0.1	0.0	0.0	0.1	0.1	0.0
Domestic	0.2	-0.6	1.6	-0.9	-1.7	-0.1	-0.5	0.0
Bond placements 5/	0.8	1.1	2.6	1.9	1.8	1.6	2.9	0.7
Amortization 6/	-0.9	-1.0	-1.0	-1.5	-1.5	-1.2	-1.1	-0.4
Net deposits	0.3	-1.0	0.0	-1.4	-2.1	-0.5	-2.3	-0.3
Privatization	0.1	0.2	0.1	0.1	0.1	0.0	0.1	0.1
Memorandum items:								
Combined public sector overall balance (including CRPAOs)	**-1.7**	**-1.1**	**-0.3**	**0.9**	**2.1**	**-0.3**	**1.3**	**-0.7**
General government current revenue 7/	17.5	17.5	18.3	19.6	19.7	19.6	20.5	19.9
General government noninterest expenditure 7/	17.1	16.7	17.0	16.9	16.2	17.8	16.8	18.2
Public sector debt (including CRPAOs)	47.1	44.3	37.7	32.0	32.9	30.0	29.2	26.2
Nominal GDP (S/. billions)	213.4	238.0	261.9	298.9	304.6	329.2	335.0	359.3

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

1/ Revised projection for 2007 accommodates the acceleration of transfers associated with income tax payments from the extractive industries to sub-national governments.

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. In 2007 (the projection column), includes the swap of $2.3 billion to extend the average maturity of public debt.

3/ In 2005, includes the prepayment of US$1.55 billion to the Paris Club. In 2007 (the projection column), includes the swap of $2.3 billion to extend the average maturity of public debt.

4/ Includes condonations, plus the net increase in short-term external credit to the NFPS and the net decrease in foreign assets of the NFPS.

5/ In 2005, includes the placement of US$323 and US$462 million Soles-denominated bonds to finance the Paris Club prepayment. In 2006, includes the placement of US$85 million Soles-denominated bonds to finance the Japeco prepayment.

6/ Includes in 2005 the amortization of US$390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.

7/ Net of transfers among non-financial public institutions.

Table 6. Peru: Fiscal Operations of the Combined Public Sector

(In billions of Soles; unless otherwise indicated)

	2003	2004	2005	2006 IMF Country Report No. 07/5	2006 Prel.	2007 Prog.	Projection 2007	Projection 2008
Central government primary balance	**0.5**	**1.4**	**2.9**	**7.5**	**9.8**	**4.4**	**9.3**	**6.5**
Revenue	**31.8**	**35.6**	**41.4**	**51.9**	**53.1**	**56.9**	**60.7**	**63.3**
Current	31.5	35.4	41.0	51.6	52.7	56.6	60.3	62.9
Of which: Tax revenue	27.4	31.3	35.6	45.2	45.6	50.1	52.2	55.9
Capital	0.4	0.2	0.4	0.3	0.4	0.3	0.4	0.4
Noninterest expenditure	31.4	34.2	38.5	44.4	43.3	52.5	51.4	56.8
Current 1/	27.3	29.9	33.6	39.1	37.3	42.7	44.4	44.5
Capital	4.1	4.3	4.9	5.3	6.0	9.8	7.1	12.3
Rest of the general government primary balance	**0.6**	**0.7**	**0.7**	**0.7**	**1.3**	**1.7**	**3.6**	**-0.2**
Revenue	12.3	13.6	15.6	18.2	18.9	21.6	22.5	21.2
Current	12.2	13.5	15.3	17.7	18.1	21.3	22.0	21.0
Capital	0.2	0.1	0.2	0.5	0.8	0.3	0.5	0.2
Noninterest expenditure	11.8	12.9	14.8	17.5	17.6	19.9	18.9	21.4
Current	9.9	10.8	12.3	14.3	14.3	15.0	14.3	15.8
Capital	1.9	2.1	2.5	3.1	3.3	4.9	4.6	5.6
Public enterprise primary balance	**-0.1**	**0.3**	**0.6**	**0.2**	**0.9**	**-0.1**	**0.3**	**-0.5**
Current balance	0.7	0.9	1.3	1.2	1.4	1.0	1.1	1.2
Capital balance	-0.8	-0.5	-0.7	-1.0	-0.6	-1.1	-0.8	-1.7
Nonfinancial public sector primary balance	0.9	2.4	4.2	8.4	12.0	6.0	13.2	5.8
Central bank operating balance	0.1	-0.1	0.0	0.4	0.5	0.2	0.6	0.0
Combined public sector primary balance	**1.0**	**2.3**	**4.2**	**8.8**	**12.4**	**6.2**	**13.8**	**5.8**
Interest payments	4.6	4.9	5.1	5.9	5.7	6.1	6.0	5.8
External	3.8	4.0	4.2	4.4	4.3	4.5	4.3	3.6
Domestic	0.9	0.9	0.9	1.4	1.4	1.6	1.7	2.1
Of which: Pension recognition bonds	0.2	0.3	0.1	0.2	0.3	0.2	0.4	0.4
Combined public sector overall balance	**-3.6**	**-2.6**	**-0.9**	**3.0**	**6.7**	**0.1**	**7.8**	**0.0**
Financing	**3.6**	**2.6**	**0.9**	**-3.0**	**-6.7**	**-0.1**	**-7.8**	**0.0**
External	2.9	3.7	-3.5	-0.6	-1.8	0.0	-6.4	-0.1
Disbursements 2/	7.3	8.4	9.0	3.3	2.0	10.5	10.1	4.1
Amortization 3/	-4.1	-4.6	-12.1	-4.0	-3.9	-10.8	-16.8	-4.4
Rescheduling/arrears (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 4/	-0.2	-0.2	-0.4	0.0	0.1	0.3	0.3	0.1
Domestic	0.5	-1.5	4.2	-2.6	-5.2	-0.2	-1.8	-0.1
Bond placements 5/	1.8	2.6	6.8	5.7	5.5	5.4	9.7	2.6
Amortization 6/	-1.9	-2.5	-2.7	-4.4	-4.5	-3.8	-3.7	-1.6
Net deposits	0.7	-2.5	0.0	-4.2	-6.3	-1.8	-7.8	-1.1
Privatization	0.2	0.4	0.2	0.3	0.3	0.1	0.4	0.2
Memorandum items:								
Combined public sector overall balance (including CRPAOs)	**-3.6**	**-2.6**	**-0.9**	**2.7**	**6.4**	**-1.1**	**4.5**	**-2.7**
General government current revenue 7/	37.3	41.6	47.9	58.6	60.1	64.7	68.8	71.5
General government noninterest expenditure 7/	36.6	39.7	44.6	50.6	49.3	58.7	56.2	65.6
Public sector debt (including CRPAOs)	100.5	105.5	98.7	95.8	100.1	98.7	98.0	94.3
Nominal GDP (S/. billions)	213.4	238.0	261.9	298.9	304.6	329.2	335.0	359.3

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

1/ Revised projection for 2007 accommodates the acceleration of transfers associated with income tax payments from the extractive industries to sub-national governments.

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. In 2007 (the projection column), includes the swap of $2.3 billion to extend the average maturity of public debt.

3/ In 2005, includes the prepayment of US$1.55 billion to the Paris Club. In 2007 (the projection column), includes the swap of $2.3 billion to extend the average maturity of public debt.

4/ Includes condonations, plus the net increase in short-term external credit to the NFPS and the net decrease in foreign assets of the NFPS.

5/ In 2005, includes the placement of US$323 and US$462 million Soles-denominated bonds to finance the Paris Club prepayment. In 2006, includes the placement of US$85 million Soles-denominated bonds to finance the Japeco prepayment.

6/ Includes in 2005 the amortization of US$390 million U.S. dollar denominated domestic bonds for the restructuring of the financial sector.

7/ Net of transfers among non-financial public institutions.

Table 7. Peru: Public Sector Social Expenditure

	2002	2003	2004	2005	Prel. 2006	Proj. 2007
(In millions of New Soles)						
Total social expenditure and pensions	**20,698**	**21,613**	**23,578**	**25,708**	**27,711**	**31,905**
Universal coverage (Education and Health) 1/	8,197	8,916	10,396	10,892	12,285	14,685
Education	5,759	6,366	7,289	7,682	8,244	9,648
Health	2,438	2,550	3,107	3,210	4,041	5,037
Targeted programs (Extreme Poverty)	2,840	2,988	2,994	3,453	3,565	5,027
Non-Targeted Social Programs	9,661	9,710	10,187	11,363	11,861	12,193
(In percent of general government expenditure)						
Total social expenditure and pensions	**53.5**	**52.6**	**53.0**	**51.9**	**50.5**	**51.4**
Universal coverage (Education and Health) 1/	21.2	21.7	23.4	22.0	22.4	23.7
Education	14.9	15.5	16.4	15.5	15.0	15.6
Health	6.3	6.2	7.0	6.5	7.4	8.1
Targeted programs (Extreme Poverty) 2/	7.3	7.3	6.7	7.0	6.5	8.1
Non-Targeted Social Programs	25.0	23.6	22.9	22.9	21.6	19.7
(In percent of GDP)						
Total social expenditure and pensions	**10.3**	**10.1**	**9.9**	**9.8**	**9.1**	**9.5**
Universal coverage (Education and Health) 1/	4.1	4.2	4.4	4.2	4.0	4.4
Education	2.9	3.0	3.1	2.9	2.7	2.9
Health	1.2	1.2	1.3	1.2	1.3	1.5
Targeted programs (Extreme Poverty)	1.4	1.4	1.3	1.3	1.2	1.5
Non-Targeted Social Programs	4.8	4.5	4.3	4.3	3.9	3.6
Memorandum items:						
Total social expenditure and pensions (annual percentage change, deflated by CPI)	8.4	2.2	5.9	7.4	5.8	13.4
General government expenditure (in millions of New Soles)	38,721	41,098	44,475	49,565	54,915	62,026

Source: Ministry of Economy and Finance.

1/ Net of spending on education and health already included in the extreme poverty programs.
2/ Includes expenditures for the targeted poverty-reduction program Juntos in 2006.

Table 8. Peru: Monetary Survey 1/

				Prel.	Prog.	Projection	
	2003	2004	2005	2006	2007	2007	2008
	I. Central Reserve Bank (In millions of New Soles)						
Net international reserves 2/	**35,272**	**41,430**	**48,353**	**55,279**	**68,079**	**74,856**	**81,581**
(In millions of U.S. dollars)	10,194	12,631	14,097	17,275	21,275	25,375	28,625
Net domestic assets	**-28,902**	**-33,394**	**-38,237**	**-43,483**	**-54,368**	**-59,613**	**-64,323**
Net credit to nonfinancial public sector	-10,713	-12,930	-13,770	-19,925	-23,205	-29,114	-29,614
Rest of banking system	-14,805	-19,191	-21,585	-22,158	-27,275	-32,917	-36,011
Other	-3,384	-1,273	-2,881	-1,400	-3,888	2,417	1,302
Currency	**6,370**	**8,036**	**10,116**	**11,796**	**13,711**	**15,243**	**17,258**
	II. Banking System (In millions of New Soles)						
Net foreign assets	**35,071**	**40,903**	**47,582**	**56,057**	**67,898**	**71,557**	**76,257**
Net domestic assets	**17,672**	**16,191**	**20,017**	**17,505**	**16,285**	**15,420**	**21,971**
Net credit to nonfinancial public sector	-10,629	-12,970	-14,254	-20,601	-26,274	-33,943	-34,943
Net credit to private sector	43,809	43,683	50,799	53,948	60,655	63,850	73,109
Other	-15,508	-14,522	-16,528	-15,842	-18,097	-14,487	-16,195
Net credit to COFIDE	-1,018	-1,087	-850	-850	-850	-850	-850
Other	-14,490	-13,435	-15,678	-14,992	-17,247	-13,637	-15,345
Liabilities to the private sector	**52,743**	**57,094**	**67,599**	**73,562**	**84,182**	**86,977**	**98,227**
	(12-month percentage change)						
Base money	10.1	25.3	25.7	18.3	15.4	26.0	14.0
Broad money	1.0	8.3	18.4	8.8	14.5	18.2	12.9
Domestic currency	10.5	28.1	19.5	18.0	21.4	33.3	20.8
Foreign currency	-4.0	-3.9	17.5	1.2	7.8	3.7	3.2
Net credit to private sector	-4.5	-0.3	16.3	6.2	12.5	18.4	14.5
Domestic currency	5.1	11.9	34.8	29.0	28.6	34.8	29.8
Foreign currency	-7.1	-4.0	9.8	-3.7	3.2	8.8	3.5
	III. Financial System (In millions of New Soles)						
Net foreign assets	**34,820**	**40,771**	**47,504**	**56,032**	**64,346**	**72,842**	**76,484**
Net domestic assets	**38,822**	**42,060**	**54,322**	**67,296**	**80,871**	**72,822**	**90,595**
Net credit to the public sector	-8,772	-10,121	-8,908	-10,746	-12,882	-16,118	-16,280
Net credit to private sector	61,358	64,271	74,945	86,575	98,674	101,714	116,568
Other	-13,763	-12,090	-11,715	-8,533	-4,920	-12,774	-9,694
Liabilities to the private sector	**73,642**	**82,831**	**101,825**	**123,329**	**145,218**	**145,664**	**167,079**
	(12-month percentage change)						
Liabilities to the private sector	12.3	12.5	22.9	21.1	17.8	18.1	14.7
Domestic currency	24.3	23.5	29.1	30.4	24.0	25.0	20.0
Foreign currency	1.4	0.1	14.4	6.7	6.0	5.0	2.7
Net credit to private sector	2.2	4.7	16.6	15.5	14.1	17.5	14.6
Domestic currency	18.0	17.9	26.0	38.2	25.0	30.0	25.0
Foreign currency	-4.1	-1.7	11.1	0.4	4.0	6.0	2.9
Memorandum item:							
End-of-period exchange rate (S/. per US$)	3.46	3.28	3.43	3.20	...	...	...

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

1/ Stocks in foreign currency are valued at the end-of-period exchange rate.

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

Table 9. Peru: Financial Soundness Indicators 1/
(In percent; unless otherwise indicated)

	Dec-01	Dec-02	Dec-03	Dec-04	Dec-05	Dec-06	Sep-07
Capital Adequacy							
Equity capital to risk-weighted assets	12.8	12.5	13.3	14.0	12.0	12.5	11.9
Regulatory Tier I capital to risk-weighted assets 2/	12.4	13.0	12.1	13.1	11.2	10.6	9.4
Nonperforming loans net of provisions to capital	-11.1	-17.2	-15.2	-17.3	-21.7	-18.0	-17.3
Asset Quality							
Nonperforming loans to total gross loans 3/	9.0	7.6	5.8	3.7	2.1	1.6	1.5
In domestic currency	5.2	5.2	4.0	3.0	2.1	1.9	1.9
In foreign currency	9.9	8.2	6.3	3.9	2.2	1.5	1.3
Nonperforming loans to total gross loans 4/	17.0	14.6	12.2	9.5	6.3	4.1	3.1
In domestic currency	9.9	8.8	6.6	6.1	4.2	3.2	2.8
In foreign currency	19.0	16.4	14.1	10.6	7.1	4.6	3.2
Refinanced and restructured loans to total gross loans 5/	8.0	7.0	6.4	5.8	4.1	2.4	1.6
Provisions to nonperforming loans 3/	118.9	133.2	141.1	176.5	235.3	251.4	249.7
Provisions to nonperforming, restructured, and refinanced loans 4/	63.0	69.1	67.1	68.7	80.3	100.3	122.3
Sectoral distribution of loans to total loans							
Consumer loans	8.6	9.4	11.6	13.4	14.4	16.5	18.2
Mortgage loans	9.6	10.7	12.9	14.2	14.8	14.0	13.0
Commercial loans	79.2	77.6	72.6	68.1	65.8	64.2	63.5
Small business loans	2.5	2.3	2.9	4.3	5.0	5.3	5.3
Earnings and Profitability							
ROA	0.4	0.8	1.1	1.2	2.2	2.2	2.6
ROE	4.3	8.3	10.7	11.6	22.2	23.9	28.5
Gross financial spread to financial revenues	51.9	66.1	71.2	71.9	70.5	67.6	68.4
Financial revenues to total revenues	78.7	72.7	70.6	69.1	76.3	76.6	80.4
Annualized financial revenues to revenue-generating assets	11.6	9.9	9.2	9.0	10.3	10.6	11.8
Liquidity							
Total liquid assets to total short-term liabilities	39.2	41.9	40.4	44.5	45.5	44.2	40.7
In domestic currency	22.6	23.5	32.9	44.8	38.6	43.1	40.6
In foreign currency	46.0	49.3	43.9	44.3	49.2	45.0	40.7
Foreign Currency Position and Dollarization							
Global position in foreign currency to regulatory capital 6/	37.6	37.0	31.8	24.2	23.1	17.1	17.4
Share of foreign currency deposits in total deposits	71.9	71.6	69.7	67.1	67.2	62.7	59.8
Share of foreign currency loans in total credit	80.5	79.7	77.9	75.7	71.5	65.5	62.6
Foreign currency deposits at commercial banks (in millions of U.S. dollars)	9,357	9,658	9,210	9,596	10,913	11,855	13,505
Commercial banks' short-term foreign assets (in millions of U.S. dollars)	748	779	601	547	796	878	715
Commercial banks' short-term foreign liabilities (in millions of U.S. dollars)	1,161	763	702	733	1,085	754	1,881
Operational efficiency							
Financing to related parties to capital 7/	...	20.1	18.7	14.3	17.9	15.5	14.5
Nonfinancial expenditure to total revenues 8/	32.1	36.2	37.7	35.9	33.3	31.3	29.2
Nonfinancial expenditure to total revenue-generating assets 8/	4.7	4.9	4.9	4.7	4.6	3.4	4.6
Memorandum items:							
Number of Banks	16	16	16	16	14	13	14
Private commercial	15	14	14	14	12	11	12
Of which: Foreign-owned	10	9	9	9	9	7	8
State-owned	1	2	2	2	2	2	2
Banks' credit card loans to total loans	2.4	3.3	4.6	6.4	6.9	8.1	9
Bank loans' 12 month increase (in real terms)	-3.3	1.0	-8.3	-1.9	19.0	14.0	27.4
Stock market index (U.S. dollars)	342.1	396.0	700.6	1,131.6	1,400.1	4,032.0	7,072.9
Foreign currency debt rating (Moody's)	Ba3	Ba3	Ba3	Ba3	Ba3	Ba3	Ba2
Spread of Peruvian Brady bonds, basis points	521	610	312	220	257	118	137

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

1/ These indicators correspond to private commercial banks.

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

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

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

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

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

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

8/ Nonfinancial expenditures do not consider provisions nor depreciations.

Table 10. Peru: Balance of Payments

(In millions of U.S. dollars)

				Prel.	Prog.	Projection	
	2003	2004	2005	2006	2007	2007	2008
Current account	**-949**	**19**	**1,147**	**2,589**	**877**	**1,378**	**-618**
Merchandise trade	886	3,004	5,284	8,934	8,066	8,833	7,005
Exports	9,091	12,809	17,368	23,800	25,974	27,990	30,203
Traditional	6,356	9,199	12,950	18,374	19,766	21,569	22,839
Nontraditional and others	2,734	3,611	4,418	5,426	6,208	6,422	7,364
Imports	-8,205	-9,805	-12,084	-14,866	-17,908	-19,157	-23,198
Services, income, and current transfers (net)	-1,835	-2,985	-4,137	-6,345	-7,189	-7,455	-7,623
Services	-900	-732	-834	-949	-1,296	-1,268	-1,464
Investment income	-2,144	-3,686	-5,074	-7,581	-8,522	-8,739	-9,046
Current transfers	1,209	1,433	1,772	2,185	2,630	2,552	2,887
Financial and capital account	**672**	**2,155**	**141**	**847**	**2,969**	**6,583**	**3,829**
Public sector	630	988	-1,440	-599	135	-1,251	763
Disbursements 1/	2,107	2,535	2,656	747	3,689	4,280	2,463
Amortization 1/	-1,229	-1,389	-3,718	-1,222	-3,460	-5,406	-1,603
Other medium- and long-term Public sector flows 2/	-248	-158	-378	-125	-94	-125	-97
Capital transfers (net)	0	0	0	0	0	0	0
Privatization	10	31	31	79	0	0	0
Private sector	32	1,288	1,791	658	2,834	7,520	3,067
Foreign direct investment (FDI) excluding privatization	1,265	1,568	2,548	3,388	2,893	6,175	4,771
Other private capital	-1,233	-432	-997	-2,020	-59	1,659	-1,704
Medium- and long-term loans	-166	-285	-840	148	262	1,373	61
Portfolio investment	-1,214	-377	79	-1,540	-1,717	-1,656	-2,975
Short-term flows 3/	147	231	-237	-628	1,395	1,942	1,210
Net Errors and Omissions	762	151	240	-710	0	-314	0
Balance	**485**	**2,326**	**1,528**	**2,726**	**3,846**	**7,647**	**3,211**
Financing	**-485**	**-2,326**	**-1,528**	**-2,726**	**-3,846**	**-7,647**	**-3,211**
NIR flow (increase -)	-477	-2,353	-1,628	-2,753	-3,925	-7,733	-3,250
Change in NIR (increase -)	-596	-2,437	-1,466	-3,178	-4,000	-8,100	-3,250
Valuation change	-119	-84	162	-425	-75	-367	0
Exceptional financing	-8	27	100	27	79	86	39
Debt relief 4/	64	27	100	27	79	86	39
Change in arrears	-72	0	0	0	0	0	0
Rescheduling	0	0	0	0	0	0	0
Memorandum items:							
Current account balance (in percent of GDP)	**-1.5**	**0.0**	**1.4**	**2.8**	**0.9**	**1.3**	**-0.5**
Capital and financial account balance (in percent of GDP	1.1	3.1	0.2	0.9	2.9	6.1	3.1
Export value (US$), percent change	17.8	40.9	35.6	37.0	9.4	17.6	7.9
Volume growth	10.0	13.9	15.0	-0.1	5.9	4.3	8.7
Price growth	7.1	23.7	17.9	37.2	3.3	12.7	-0.8
Import value (US$), percent change	10.6	19.5	23.2	23.0	20.2	28.9	21.1
Volume growth	4.8	7.9	10.8	15.0	15.7	18.8	16.1
Price growth	5.5	10.7	11.3	7.0	3.9	8.5	4.3
GDP (in billions of US$)	61.3	69.7	79.5	93.0	103.1	107.2	123.9

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

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

Table 11. Peru: External Financing Requirements and Sources

(In millions of U.S. dollars)

				Prel.	Prog.	Projection	
	2003	2004	2005	2006	2007	2007	2008
Gross financing requirements	**6,076**	**7,247**	**8,436**	**5,133**	**9,855**	**15,173**	**10,111**
External current account deficit (excluding official transfers)	**949**	**-19**	**-1,147**	**-2,589**	**-877**	**-1,378**	**618**
Debt amortization	4,578	4,914	7,956	4,969	6,807	8,819	6,243
Medium- and long-term debt	1,954	2,400	5,205	1,783	3,901	5,929	2,195
Public sector	1,229	1,389	3,718	1,222	3,460	5,406	1,603
Multilateral 1/	486	571	628	647	705	712	698
Bilateral	686	742	2,159	394	411	2,177	293
Bonds and notes	44	66	90	90	2,340	2,513	544
Other	13	10	842	92	4	4	67
Private sector	725	1,011	1,486	561	441	523	593
Short-term debt 2/	2,624	2,514	2,751	3,186	2,906	2,890	4,047
Rescheduling and repayment of arrears	72	0	0	0	0	0	0
Accumulation of NIR (flow)	477	2,353	1,628	2,753	3,925	7,733	3,250
Change in gross reserves	514	2,443	1,471	3,177	4,000	8,100	3,250
Payments of short-term liabilities incl. IMF	82	-6	-5	1	0	0	0
Other	-119	-84	162	-425	-75	-367	0
Available financing	**6,076**	**7,247**	**8,436**	**5,133**	**9,855**	**15,173**	**10,111**
Foreign direct investment (net)	1,275	1,599	2,579	3,467	2,893	6,175	4,771
Privatization	10	31	31	79	0	0	0
FDI	1,265	1,568	2,548	3,388	2,893	6,175	4,771
Portfolio (net)	-1,214	-377	79	-1,540	-1,717	-1,656	-2,975
Short-term assets (flow)	944	163	-431	-1,010	1,438	470	1,209
Of which: Errors and omissions	762	151	240	-685	0	-314	0
Debt financing from private creditors	4,346	4,753	5,513	3,691	6,256	9,277	5,978
Medium- and long-term financing	1,811	2,021	2,328	809	3,393	5,230	1,930
To public sector 3/	1,252	1,295	1,682	100	2,690	3,333	1,277
To private sector	559	726	647	709	703	1,896	654
Short-term financing	2,535	2,732	3,185	2,882	2,863	4,047	4,047
Official creditors 4/	909	1,240	974	623	999	946	1,186
Multilateral 1/	699	1,049	762	499	725	780	938
Of which: Balance of payments financing	527	863	581	315	404	604	541
Bilateral	210	191	212	123	274	167	248
To public sector	210	191	212	123	274	167	248
To private sector	0	0	0	0	0	0	0
Other medium- and long-term public sector flows 5/	-184	-131	-278	-98	-15	-39	-58
IMF	0	0	0	0	0	0	0
Accumulation of arrears (exceptional)	0	0	0	0	0	0	0

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

1/ Excluding IMF.
2/ Original maturity of less than one year. Equals stock at the end of the previous period.
3/ Based on projections of no placements in external markets over the program period. Projections exclude possible external issuance for debt prepayments.
4/ Includes both loans and grants. Breakdown not available as of 2008.
5/ Includes debt relief and subscription payments to international organizations and changes in Banco de la Nación's long-term assets.

Table 12. Peru: Medium-Term Macroeconomic Framework

		Prel.	Staff Projection					
	2005	2006	2007	2008	2009	2010	2011	2012
(Annual percentage change)								
GDP at constant prices	6.7	7.6	7.5	6.5	6.0	5.5	5.5	5.5
Consumer prices (end of period)	1.5	1.1	3.4	2.5	2.0	2.0	2.0	2.0
GDP deflator	3.1	8.1	2.3	0.7	0.6	1.2	1.8	2.0
Merchandise trade								
Exports, f.o.b.	35.6	37.0	17.6	7.9	-1.5	0.2	1.7	4.6
Imports, f.o.b.	23.2	23.0	28.9	21.1	9.6	7.7	7.1	6.4
Terms of trade (deterioration -)	5.9	28.3	3.9	-4.8	-9.3	-7.7	-5.9	-1.8
(In percent of GDP; unless otherwise indicated)								
External current account balance	1.4	2.8	1.3	-0.5	-0.6	-0.9	-1.2	-1.3
External current account, excluding interest obligations	3.5	4.8	3.2	1.2	0.8	0.6	0.1	-0.1
Total external debt service	8.6	3.9	7.5	3.4	2.8	3.1	2.9	3.5
Medium- and long-term	8.4	3.7	7.2	3.2	2.6	2.8	2.7	3.4
Nonfinancial public sector	6.2	2.7	6.3	2.3	1.8	2.1	2.0	2.7
Private sector	2.2	0.9	0.9	0.8	0.8	0.7	0.7	0.6
Short-term 1/	0.2	0.2	0.3	0.3	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
Private sector	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2
External debt service 2/	8.6	3.9	7.5	3.4	2.8	3.1	2.9	3.5
Interest	2.1	2.0	1.9	1.7	1.5	1.5	1.3	1.2
Amortization (medium-and long-term)	6.5	1.9	5.5	1.8	1.4	1.6	1.6	2.4
Combined public sector primary balance 3/	1.6	3.9	3.1	0.9	0.9	1.2	1.2	1.1
General government current revenue	18.3	19.7	20.5	19.9	20.4	20.7	21.0	21.3
General govt. non-interest expenditure 3/	17.0	16.3	17.7	19.0	19.3	19.4	19.6	20.0
Combined public sector interest due	1.9	1.9	1.8	1.6	1.5	1.4	1.4	1.3
Combined public sector overall balance 3/	-0.3	2.1	1.3	-0.7	-0.6	-0.3	-0.2	-0.2
Public sector debt 3/	37.7	32.9	29.2	26.2	24.9	23.4	21.4	19.5
Gross domestic investment	17.9	19.9	22.1	23.9	26.2	26.9	27.8	28.4
Public sector 3/	2.9	2.8	4.2	5.7	6.3	6.5	6.8	7.3
Private sector	15.5	16.3	18.2	19.1	19.8	20.4	20.9	21.1
Inventories changes	-0.4	0.7	-0.4	-0.8	0.0	0.0	0.0	0.0
National savings	19.4	22.7	23.3	23.4	25.5	26.0	26.5	27.1
Public sector 4/	2.6	5.1	5.8	5.3	6.1	6.6	7.1	7.5
Private sector	16.8	17.6	17.6	18.2	19.4	19.4	19.5	19.6
External savings	-1.4	-2.8	-1.3	0.5	0.6	0.9	1.2	1.3
Memorandum items:								
Nominal GDP (billions of New Soles)	261.9	304.6	335.0	359.3	383.1	409.0	439.3	472.7
Gross international reserves (billions of U.S. dollars)	14,120	17,329	25,429	28,679	30,479	32,079	33,479	34,679
Gross international reserves to broad money	71.6	75.3	86.2	83.2	82.2	81.2	80.7	81.2
External debt service (percent of exports of GNFS)	35.0	13.9	25.9	12.8	11.5	13.2	13.2	16.7
Short-term external debt service (percent of exports of GNFS)	0.8	0.8	0.9	1.1	0.9	0.9	0.9	0.9
Public external debt service (percent of exports of GNFS)	25.2	9.6	22.0	8.6	7.4	9.2	9.2	12.9

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

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

Table 13. Peru: Financial and External Vulnerability Indicators

(In percent; unless otherwise indicated)

				Prel.	Prog.	Projection	
	2003	2004	2005	2006	2007	2007	2008
Financial indicators							
Public sector debt/GDP	47.1	44.3	37.7	32.9	30.0	29.2	26.2
Of which: in domestic currency (percent of GDP)	3.8	6.9	8.2	8.0	7.4	8.0	7.5
90-day prime lending rate, domestic currency (end of period)	3.3	3.8	4.4	5.2	...	...	...
90-day prime lending rate, foreign currency (end of period)	1.7	2.6	5.5	6.1	...	...	...
Velocity of money 1/	4.0	4.1	4.0	4.1	3.9	3.7	3.6
Net credit to the private sector/GDP 2/	29.4	27.7	28.0	28.8	30.0	31.2	31.9
External indicators							
Exports, U.S. dollars (percent change)	17.8	40.9	35.6	37.0	9.4	17.6	7.9
Imports, U.S. dollars (percent change)	10.6	19.5	23.2	23.0	20.2	28.9	21.1
Terms of trade (percent change) (deterioration -)	1.3	9.2	5.9	28.3	-0.6	3.9	-4.8
Real effective exchange rate, (end of period, percent change) 3/	3.8	1.6	0.5	1.3	...	...	...
Current account balance (percent of GDP)	-1.5	0.0	1.4	2.8	0.9	1.3	-0.5
Capital and financial account balance (percent of GDP)	1.1	3.1	0.2	0.9	2.9	6.1	3.1
Total external debt (percent of GDP)	48.2	44.8	36.1	30.4	28.1	29.0	25.8
Medium- and long-term public debt (in percent of GDP) 4/	37.1	35.1	28.0	23.7	21.6	19.5	17.6
Medium- and long-term private debt (in percent of GDP)	7.0	5.7	4.0	3.6	3.7	5.7	4.9
Short-term public and private debt (in percent of GDP)	4.1	4.0	4.0	3.1	2.8	3.8	3.3
Total external debt (in percent of exports of goods and services) 4/	274.3	212.2	145.8	107.8	101.6	100.7	96.2
Total debt service (in percent of exports of goods and services) 5/	31.0	26.1	35.0	13.9	20.6	25.9	12.8
Gross official reserves							
In millions of U.S. dollars	10,206	12,649	14,120	17,329	21,329	25,429	28,679
In percent of short-term external debt 6/	205.4	163.9	311.4	190.1	336.9	500.1	489.1
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	71.0	74.7	89.6	84.4	118.9	145.4	145.8
In percent of broad money 8/	67.2	72.7	71.6	75.3	81.1	86.2	83.2
In percent of foreign currency deposits at banks	108.5	137.3	125.9	151.7	167.0	204.9	207.7
In months of next year's imports of goods and services	9.8	10.0	9.8	9.6	8.5	11.0	11.3
Net international reserves (in millions of U.S. dollars)	10,194	12,631	14,097	17,275	21,275	25,375	28,625
Net international reserves (program definition; in millions of U.S. dollars) 9/	6,906	9,304	9,748	12,981	13,331	21,119	...
Net foreign exchange position (in millions of U.S. dollars) 10/	4,583	6,936	7,450	11,086	15,086	19,186	22,436

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

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

Table 14. Peru: Proposed Schedule of Purchases Under the Stand-By Arrangement, 2007–09 1/

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

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

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

Table 15. Peru: Capacity to Repay the Fund as of November 22, 2007 1/

(In millions of SDRs; unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013	2014	Total
Obligations from existing drawings									
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest									
GRA charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDR charges	0.0	3.2	3.2	3.2	3.2	3.2	3.2	3.2	22.6
Credit outstanding	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
(percent of quota)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
Obligations from prospective drawings									
Principal (repurchases)	0.0	0.0	0.0	0.0	83.4	86.0	2.8	0.2	172.4
Charges and interest 2/									
GRA charges	0.0	7.1	8.5	8.5	7.4	3.4	0.2	0.0	35.0
Service charge	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8
Credit outstanding	164.4	170.8	172.4	172.4	89.0	3.0	0.2	0.0	...
(percent of quota)	25.8	26.8	27.0	27.0	13.9	0.5	0.0	0.0	...
Cumulative (existing and prospective)									
Principal (repurchases)	0.0	0.0	0.0	0.0	83.4	86.0	2.8	0.2	172.4
Charges and interest 2/									
GRA charges	0.0	7.1	8.5	8.5	7.4	3.4	0.2	0.0	35.0
SDR and Service charges	0.8	3.2	3.2	3.2	3.2	3.2	3.2	3.2	23.5
Credit outstanding	164.4	170.8	172.4	172.4	89.0	3.0	0.2	0.0	...
Percent of quota	25.8	26.8	27.0	27.0	13.9	0.5	0.0	0.0	...
Percent of GDP	0.2	0.2	0.2	0.2	0.1	0.0	0.0	0.0	...
Percent of exports of goods and services	0.9	0.8	0.8	0.8	0.4	0.0	0.0	0.0	...
Percent of public sector debt service	3.8	6.4	7.5	6.7	3.0	0.1	0.0	0.0	...
Percent of external public debt	1.1	1.2	1.2	1.2	0.7	0.0	0.0	0.0	...
Percent of external public debt service	5.1	49.1	43.5	9.7	5.5	0.1	0.0	0.0	...
Percent of gross foreign reserves	1.2	0.9	0.9	0.8	0.4	0.0	0.0	0.0	...
Memorandum item:									
Purchases	164.4	6.4	1.6	0.0	0.0	0.0	0.0	0.0	172.4

Sources: Fund staff estimates/projections.

1/ Assuming all purchases are made. Repurchases assumed to be made under obligations schedule.

2/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA. The current SDR interest rate is assumed for net use of SDRs.

ANNEX 1. PERU: LETTER OF INTENT

Lima, Peru
December 5, 2007

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

Dear Mr. Strauss-Kahn,

1. This letter reiterates our commitment to the economic reform agenda supported by the Stand-By Arrangement (SBA), approved by the Fund's Executive Board on January 26, 2007, and informs you of performance under the program in 2007 and our policy intentions for 2008. It supplements our letters of January 3, 2007, and of June 12, 2007.

2. Peru's economic performance has been strong during the first year of the Fund-supported program and we expect this to continue during 2008. All performance criteria for end-June and end-September 2007 were observed with a comfortable margin. New performance criteria and structural benchmarks for 2008 are set out in Tables 1 and 2.

3. The Government believes that the policies set forth in this letter are adequate to achieve the objectives of its program, but stands ready to take any further measures that may become appropriate or needed for this purpose. We will maintain a close and proactive policy dialogue with the Fund, in accordance with Fund policies on such matters.

A. Fiscal Issues

4. Following an overall public sector surplus of 2¼ percent of GDP expected for 2007, the program for 2008 maintains a prudent fiscal strategy. The 2008 budget envisages a balanced fiscal position, significantly below the deficit limit of 1 percent of GDP under the Fiscal Responsibility and Transparency Law (FRTL). Central government current expenditure growth (net of transfers excluding pensions) would be limited to 4 percent in real terms, while public investment not executed during 2007 would be carried forward into 2008 in order to continue addressing social and infrastructure needs. Were revenues net of mandatory transfers—as defined in the Technical Memorandum—to exceed the level envisaged under the program, the public sector borrowing requirement would be reduced up to a ceiling of 0.5 percent of GDP to assist macroeconomic stability. The public debt ratio is projected to decline from 47 percent of GDP in 2003 to an estimated 26 percent of GDP at end-2008.

5. To enhance budget execution, the government has simplified the *National System of Public Investment* (SNIP) procedures and is aiming at streamlining procurement processes. Subnational governments (SNGs) can now use part of their canon-related resources and revenues for maintenance and pre-evaluation of investment projects. To further enhance the capacity of SNGs to implement timely and high-quality investment projects, the government intends to strengthen existing regional Technical Assistance Offices supporting the SNIP by allocating additional staff and providing more training for evaluation of investment projects. The government will also increase the number of Technical Assistance offices from 16 to 28 by end-December 2008 (structural benchmark).

6. To strengthen the fiscal framework and minimize long-term risks, the government intends to:

- Submit to Congress a draft amendment to the Decentralization Law (DL) to ensure that limits to subnational government spending are consistent with those for the central government as prescribed in the FRTL (an end-September 2008 structural benchmark). The government will continue with its efforts to amend the FRTL to strengthen compliance and its consistency, including for better aligning the limit on real growth of consumption expenditure for all government levels with the economy's medium-term growth capacity.

- Finalize and submit a draft law to Congress to establish a comprehensive framework for PPPs by end-December (end-September 2007 structural benchmark that will be proposed to be set as a structural performance criterion for end-March 2008 otherwise).

7. Progress with modernizing the budget classification system has not been timely enough to incorporate it into the 2008 Budget and into the charts of accounts (end-December 2007 benchmark). However, the new classification will be rolled out at the start of the 2009 budget cycle at all government levels (end-September 2008 structural benchmark). Delays in the external evaluation of the Integrated Financial Management System (SIAF) have complicated the full implementation of a Treasury Single Account (TSA) for the central government by end-2007 (structural benchmark). To implement this reform, the Ministry of Finance intends to take the following steps by end-September 2008: i) submit to Congress a new draft Treasury Law to include all general government resources in the TSA; ii) adopt the new budget classification, as noted above; and iii) establish a Treasury General Ledger (TGL) or modify the SIAF to ensure it provides TGL-type information.

8. Broadening the tax base is essential to meeting social and infrastructure needs. To this end, the government will issue methodological guidelines that should be used by ministries and other public entities for evaluating existing tax exemptions by end-June (structural benchmark), as contemplated in the new framework for tax exemptions enacted in December 2006 (Legislative Decree No. 977).

B. Poverty Alleviation

9. In 2007, the government rationalized social assistance programs (SAPs) and integrated several of them into the strategy *Crecer*, to address chronic child malnutrition. A new permanent head and staff were assigned to the Interministerial Committee for Social Affairs (CIAS) in July (end-September 2007 structural benchmark). In 2008, efforts will be bolstered further:

- The conditional cash-transfer program *Juntos* will be extended from 360,000 beneficiaries at end-2007 to at least 500,000 beneficiaries by end-2008. The strategy *Crecer*, which currently attends 638 rural districts in extreme poverty, will be expanded into a second phase to reach 880 districts. To provide complementary basic infrastructure, a new social strategy *Progresar* will be launched soon. The recently completed Household Targeting Database (SISFOH) will assist in improving the quality of social expenditures and enhancing targeting of social programs.

- A prompt approval by Congress of the Executive Power Organic Law (LOPE) will strengthen budgetary resources for the CIAS.

- To further assist the poorest SNGs—especially those without access to canon resources—the *Fondo para la Inversion Regional y Local* (FONIPREL) will be expanded once its initial allocation of S/. 650 million is used. The government will also submit to Congress amendments to the SNIP Law, to allow for the outsourcing of the studies required for the formulation and approval of investment projects; which will help assist those SNGs with low capacity (end-March 2008 structural benchmark).

- In addition, the government intends to ensure that the canon-related cash transfers to households remain limited and well-targeted.

C. Monetary and Financial Sector Issues

10. The authorities remain fully committed to their inflation targeting framework. The bands of the inflation consultation mechanism have been adjusted to reflect our new inflation target of 2 percent introduced in early 2007, while minimizing deflationary risks (Table 1). To further strengthen central bank independence, the Economics Commission in Congress has approved a draft constitutional amendment for de-linking future appointments of board members from the political cycle after 2011. We will continue with our efforts to ensure a prompt ratification by Congress in the year ahead.

11. The government will also continue implementing reforms aimed at enhancing the resilience of the financial sector, by sustaining dedollarization, strengthening the regulation and supervision of banks, and advancing reforms to deepen capital markets. Specifically:

- The government will submit to Congress amendments to the General Banking Law (GBL) to allow the Superintendency of Banks (SBS) the introduction of capital requirements for foreign-currency-induced credit risks via regulations (end-June structural benchmark, reset from end-December 2007), in line with our roadmap to fully adopt Basel II. In addition, financial institutions requested to *MiVivienda* an extension of the deadline to discontinue the provision credit risk guarantees and the *Bono al Buen Pagador* for new foreign currency mortgages (end-June 2007 structural benchmark) and *MiVivienda* has agreed that this will be implemented by end-December 2007.

- Public banks should remain properly supervised and not undermine competition in the financial system. To that effect, *Banco de la Nación* (BN) will again comply with the 25 percent growth limit on its consumer lending during 2008. The government will ensure that the interest rates associated with BN's handling of the TSA are transparent and aligned to reflect BN's administrative costs for management services of public sector accounts. Also, we have submitted to Congress a draft law to align the regulatory and supervisory framework for BN and COFIDE with that for private financial institutions. With this reform, the GBL will have precedence over BN's and COFIDE's statutes.

- Amendments to the GBL to increase the minimum capital required to establish microfinance institutions will also be submitted to Congress by end-June 2008 (structural benchmark). The central bank intends to submit to congress legal changes to empower the Central Bank to oversee and regulate the entire payments system.

- The clarification of the tax treatment of securitized transactions (an end-December 2007 benchmark, reset from end-March 2007) will now be completed by end-June, 2008 (structural benchmark), through: (i) eliminating the application of VAT to the collection of receivables used by Trusts and SPVs when originators are exempt; (ii) allowing the possibility of offsetting the effect of income taxes withheld at the Trust or SPV level in the case of future capital losses from equities or in the case of losses posted by the ultimate beneficiary on a consolidated basis. Regulation related to the tax treatment of financial derivatives will be issued by end-December 2007 (Legislative Decree No. 970).

- The government will submit to Congress an amendment to the Law of Pension Funds to significantly increase the 20 percent limit of private pension funds (AFPs) investment abroad by end-June 2008 (structural benchmark), redefine investment limits on public sector assets, broaden the set of investible domestic securities for AFPs, and ease limits on the use of forwards as hedges. The minimum return guarantee will be reformed in order to minimize herding behavior.

- The supervision of capital markets will be enhanced by strengthening the coordination between CONASEV and the SBS, including by signing a Memorandum of Understanding by end-March 2008.

- Debt management operations will be conducted to improve its profile, including by resolving the issue of some disputed claims following the prepayment of part of our nonconcessional obligations with the Paris Club in October 2007.

D. Other Growth-Enhancing Reforms

12. With regard to the business environment, a one-stop window for external trade transactions is now operational and the implementing rules of the rules of the "Positive Administrative Silence" law will be issued in the coming months. New commercial courts have been established in Lambayeque, Junin, and Tacna during 2007, and more courts are on the way to be implemented in 2008.

13. In light of the strong performance under the program and the important progress being made in the structural reform agenda, we hereby request the completion of the Second Review under the Stand-By Arrangement.

Sincerely yours,

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

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

	Mar. 31	Jun. 30	Sept. 30	Dec. 31
(Cumulative amounts from December 31, 2007, millions of New Soles)				
Borrowing requirement of the combined public sector				
Unadjusted limits 1/ 2/ 3/ 4/	-2,036	-5,555	-5,254	0
(Cumulative amounts from December 31, 2007, millions of U.S. dollars)				
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions				
Unadjusted targets 5/ 6/	-645	-404	-437	0
Outstanding short-term external debt of the nonfinancial public sector				
Limits	50	50	50	50
Contracting or guaranteeing of nonconcessional public debt with maturity of at least one year				
Unadjusted limits 7/ 8/ 9/	1,568	1,673	2,354	2,680
Of which: **external debt of 1-5 year maturity**				
Limits	100	100	100	100
External payments arrears of the public sector (on a continuous basis)				
Limits	0	0	0	0
NPV of future government payments associated with PPP operations (on a continuous basis)				
Unadjusted Limits 10/	1,860	1,860	1,860	1,860
(Consultation bands for the 12-month rate of inflation, in percent) 11/				
Outer band (upper limit)	5.0	5.0	5.0	5.0
Inner band (upper limit)	4.0	4.0	4.0	4.0
Central point	2.0	2.0	2.0	2.0
Inner band (lower limit)	0.0	0.0	0.0	0.0
Outer band (lower limit)	-0.5	-0.5	-0.5	-0.5

Sources: Staff estimations.

1/ PIPP proceeds are included below the line.

2/ The limit on the borrowing requirement of the combined public sector will be adjusted downwards by the amount central government revenues net of mandatory transfers exceed program estimates of S/. 12,767 million at end-March, up to a ceiling of S/. 450 million; S/. 26,493 million at end-June, up to a ceiling of S/. 900 million; S/. 40,471 million at end-September, up to a ceiling of S/. 1350 million; and S/. 54,751 million at end-December, up to a total ceiling of S/. 1,800 million.

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

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

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

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

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

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

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

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

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

Table 2: Structural Benchmarks for 2008

End-March

Submit to Congress an amendment to the SNIP law to allow for the outsourcing of the studies required for the formulation and approval of investment projects

End-June

Clarify the tax treatment of securitization transactions in line with parag. 11, bullet 4 of the Letter of Intent

Issue methodological guidelines for ministries and public entities to assess tax exemptions in line with new regime for tax exemptions

Submit to Congress amendment to the General Banking Law to allow the SBS the introduction of capital requirements for exchange-rate related risk in line with Basel II

Submit to Congress amendment to General Banking Law to raise the minimum capital requirement for microfinance institutions

Submit to Congress amendment to the Law of Pension Funds that would significantly raise limit for foreign investments by private pension funds

End-September

2009 Budget to be prepared according to modernized budget classification system and incorporated into the chart of accounts

Implement the TSA, as described in paragraph 7 of the Letter of Intent

Submit to Congress amendments to the Decentralization Law to reconcile subnational government spending with that for the central government as presented in the FRTL

End-December

Expand the number of Technical Assistance Regional Offices from 16 to 28

ANNEX 2. PERU: 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 2008. It defines the concepts used to assess compliance with quantitative performance criteria specified in the letter of the Government of Peru dated December 5, 2007. It also sets the frequency of the data to be provided to the Fund for monitoring the program. For purposes of the program for 2008, operations in foreign currency will be converted into *Nuevos Soles* at the average program exchange rate of S/. 2.90 per U.S. dollar.

I. DEFINITIONS OF CONCEPTS

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

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

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

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

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

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

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.

The quarterly limits on the borrowing requirement of the combined public sector (PSBR) for 2008 will be reduced by the amount to which revenues of the central government net of mandatory transfers exceed program estimates of S/.12,767 million at end-March, up to a ceiling of S/. 450 million; S/. 26,493 million at end-June, up to a ceiling of S/. 900 million; S/.40,471 million at end-September, up to a ceiling of S/. 1,350 million; and S/. 54,751 million at end-December, up to a total ceiling of S/. 1,800 million. Mandatory transfers are earmarked central government expenditures that are linked to revenue. These comprise the *canon and sobrecanon*, *fondo de Camisea, regalía minera, renta de aduanas,* and the *Impuesto de Promoción Municipal (IPM).*

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

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

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.

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

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

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

The contracting or guaranteeing of nonconcessional public debt with a maturity of at least one year refers to all domestic and external obligations of the NFPS contracted or guaranteed by the government, COFIDE, the BCRP, the BN, and any other public financial entity, except for loans classified as reserve liabilities of the BCRP. The program limits on nonconcessional debt will exclude: (i) any new loans extended in the context of a debt rescheduling or debt reduction operation; (ii) any loans on concessional terms; and (iii) certificates (BCRPCD) issued by the BCRP for conducting monetary policy. The program limits will be adjusted upward by up to US$300 million for debt contracted by *Petroperu* during 2008 that is not guaranteed by the central government.

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

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

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

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.

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

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

Definitions used in Table 1 of the letter of intent dated December 5, 2007 for the calculation of adjusters, limits and targets for net international reserves:

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

b. **The withdrawals for portfolio management purposes** of deposits held at the BCRP by the FCR and any other fund managed by the ONP, mentioned in footnote 6 of Table 1 attached to the letter of intent dated [December x, 2007] 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

Periodic reporting includes:

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

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

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

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

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

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

(iv) **External sector**

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

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

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

(f) **Other**

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

(b) BCRP circulars.

(c) BCRP inflation report.

Table 1 Peru: Public Sector Borrowing Requirement 2007
(In millions of nuevos soles)

	Stock as of Dec. 31 2006 1/	Stock as of Jun.30 2007 1/	Flow Jan-Jun
a. Net domestic financing of the nonfinancial public sector	**1 050**	**-8 022**	**-9 072**
i. Net claims of the financial system (1+2+3)	-10 015	-17 651	-7 636
1. Net credit of the banking system on the NFPS, COFIDE and MiVivienda	-20 431	-29 904	-9 473
Credits	4 981	4 885	- 95
Liabilities	25 412	34 789	9 377
2. Net credit of COFIDE and MiVivienda on the banking system	2 843	3 396	553
Credits	2 987	3 507	519
Liabilities	145	111	- 34
3. Net credit of nonbanking financial institutions on the NFPS	7 574	8 858	1 284
Credits	8 159	9 453	1 294
Liabilities	585	595	10
ii. Stock of NFPS bonds in circulation	10 766	10 934	168
(excluding bonds held by NFPS and of the financial system)			
1. Total	21 842	25 449	3 606
2. Less: holdings of the financial system (including COFIDE and MiVivienda)	10 726	14 131	3 405
3. Less: holdings of nonfinancial public sector entities	350	384	34
iii. Floating debt	3 695	2 318	-1 377
iv. Less: Accumulation of stocks, bonds, or other domestic financial assets by the NFPS	2 316	2 490	174
v. Less: Issuance of pension recognition bonds in program period	1 080	1 133	53
b. Net external financing			**-1 924**
(Millions of US dollars)			-$ 664
c. Privatization			**73**
(Millions of US dollars)			$ 25
d. Operating balance of the BCRP			**328**
PSBR (a+b+c-d)			**-11 252**

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

Table 2. Peru: Public External Debt 1/
Net External Financing N.F.P.S. 2008
(In millions of dollars)

		Jan - Mar	Jan - Jun	Jan - Sep	Jan - Dec
		Programmed	Programmed	Programmed	Programmed
i.	**Loan Disbursements**	145	291	436	1140
	-Projects	145	291	436	600
	-Non Projects	0	0	0	540
ii.	**Bonds**	0	290	290	290
iii.	**Cash payments on amortization**	745	975	1224	1470
	- Loans	223	453	679	926
	- Bonds	522	522	544	544
	- Prepayments				
iv.	**Cash payments to settle arrears**	0	0	0	0
v.	**Change in short term debt (increase+)**	0	0	0	0
A.	**NET FOREIGN BORROWING (i+ii-iii-iv+v)**	**-600**	**-394**	**-497**	**-41**
vi.	**Debt equity swaps**	0	0	0	0
vii.	**Change in foreign assets held by the NFPS**	7	10	17	20
viii.	**Investment project under the PIPP 2/**	0	2		
B.	**NET EXTERNAL FINANCING (A-vi-vii+viii)**	**-607**	**-402**	**-514**	**-61**

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 US dollars)

		Stocks as of June 30, 2007
a.	**Assets**	**21,186**
	Deposits abroad	8,060
	Securities	12,378
	Gold 1/	721
	Holdings of SDR 2/	12
	Reciprocal credit agreement	6
	Cash	10
	Others	0
b.	**Liabilities**	**27**
	Reciprocal credit agreement	0
	Liabilities with international organizations	**26**
	IMF 2/	0
	IADB	26
	FLAR	0
c.	**Foreign currency deposits of financial institutions at the Central Bank**	**3,547**
	Banking enterprises	3,395
	Banco de la Nación	58
	COFIDE	24
	Financial enterprises	70
d.	**Treasury bond repos**	**0**
e.	**Swaps**	**0**
f.	**Valuation US$/other currencies**	**0**
g.	**Net international Reserves - Program definition (a-b-c+d-e-f)**	**17,612**
Memorandum items:		
1.	Subscription to the IMF and FLAR	348
2.	Pesos andinos	20
3.	CAF bonds	0
4.	Valuation change by BCRP's gold holdings	0
5.	Valuation change by BCRP's SDR holdings	0
6.	Net international reserves, official definition (g+c-d+e+f+1+2+3+4+5)	21,528

Source: Central Reserve Bank of Peru.

1/ Gold valued at US$ 646,88755
2/ Valued at US$ 1,51434 per SDR.

TABLE 4: PERU SHORT TERM EXTERNAL DEBT OWED BY THE NON FINANCIAL PUBLIC SECTOR AS OF JUNE 30, 2007

(In millions of US$)

	Export Financing	Working Capital	Import Financing	Total
Total	0	0	99	99
Petroperu	0	0	99	99
Electroperu	0	0	0	0
General government	0	0	0	0
Memorandum item:				
Total of export financing plus working capital loans				0

Source: Central Reserve Bank of Peru and state companies.

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

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

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

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

Previous six-month rates

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

Table 6. Peru: Stock of Domestic Debt of the NFPS (June-30-2007)

	Legal Norm	Gross placements		Stock (estimated)
		Currency	Amount	(Millions of Nuevos Soles)
Banking Credits				**116**
Credits from BN				**13**
Credit to central government		US$ / S/. / Y		0
Credit to local governments		US$ / S/.		13
Net public treasury overdraft		S/.		0
Other Banks		S/.		**102**
Bonds				**16509**
Bonos TP - Financial system strengthening	D.U. 041-99	US$	175	167
Bonos TP - Temporal suscription of stocks	D.U. 034-99	US$	52	165
Bonos TP - Debt exchange bonds	D.S. 002-2007-EF	S/.	2645	2645
Bonos TP - RFA and FOPE programs	D.S. 059-2000-EF / D.U. 050-2002	US$	109	381
Bonos TP - Sovereign bonds 1/		S/.	13812	13042
Bonos Municipalidad de Lima		S/.	250	109
Total				**16624**
Memorandum item:				
Pension Reform Bonds (Bonos de Reconocimiento)	D.S. 096-95-EF	S/.		8896
Floating debt		S/.		1565

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

Source: Central Reserve Bank of Peru

ANNEX 3. PERU: DEBT SUSTAINABILITY ANALYSIS [1]

Peru's debt-to-GDP ratio is projected to decline considerably under the baseline debt sustainability scenario. Economic growth would average close to 6 percent a year in 2008–12 underpinned by a moderate deficit fiscal position. Public sector revenue would remain broadly stable. Under these assumptions, Peru's public sector debt stock (including CRPAOs) would decline from 33 percent of GDP at end-2006, to about 19 ½ percent of GDP by 2012.

Given that nearly 70 percent of total external debt is public, in the baseline scenario the projected drop in public debt largely determines the path of Peru's total external debt. Following a decline during 2004–05, as companies took advantage of favorable market conditions to pay down their external debt, private sector external debt is projected to decline slightly over the medium term, from already low levels. As a result, total external debt is projected to decline from 30 percent of GDP at end-2006 to 18 percent by 2012 (public external debt would decline from 24 percent to 12 percent over the same period).

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

Despite the increasing share of domestic currency in public sector debt, external and public debt ratios remain sensitive to exchange rate changes, given the high foreign currency share of Peru's debt. Specifically, under a one-off 30 percent depreciation of the exchange rate, the external debt-to-GDP ratio would shift by about 10 percentage points above the baseline projections in the medium term. This test assumes that the exchange rate would remain at its depreciated level permanently—a scenario that could only occur in case of the current exchange rate being significantly overvalued. Available data, however, do not point to such an overvaluation. Non-interest current account shocks (such as in the terms of trade) would have a moderate adverse impact on external indebtedness.

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

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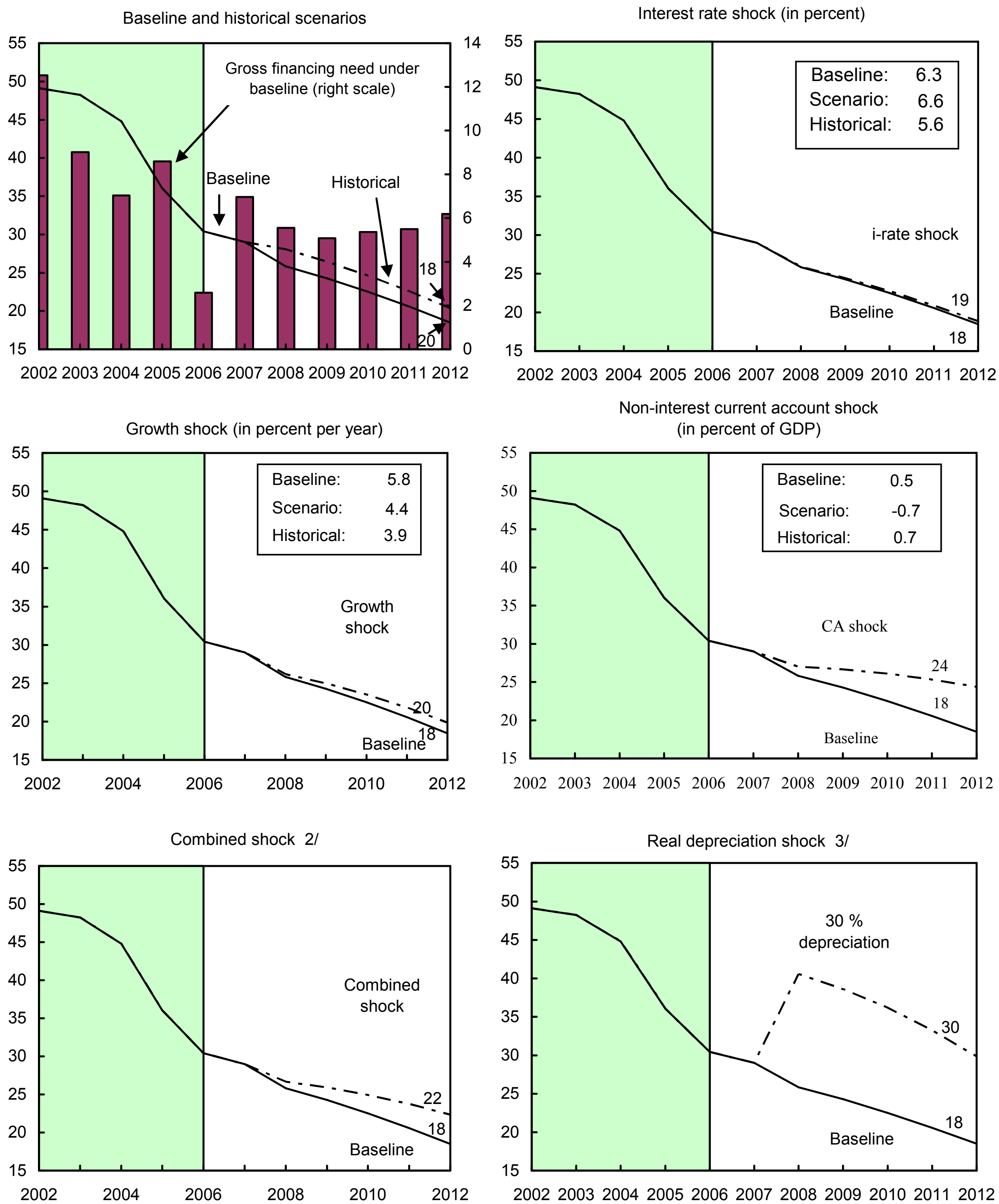
[1] The DSA includes standard sensitivity tests around the baseline medium-term scenario. The methodology used is in line with that endorsed in the Information Note on Modifications to the Fund's Debt Sustainability Assessment Framework for Market Access Countries, dated July 5, 2005.

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



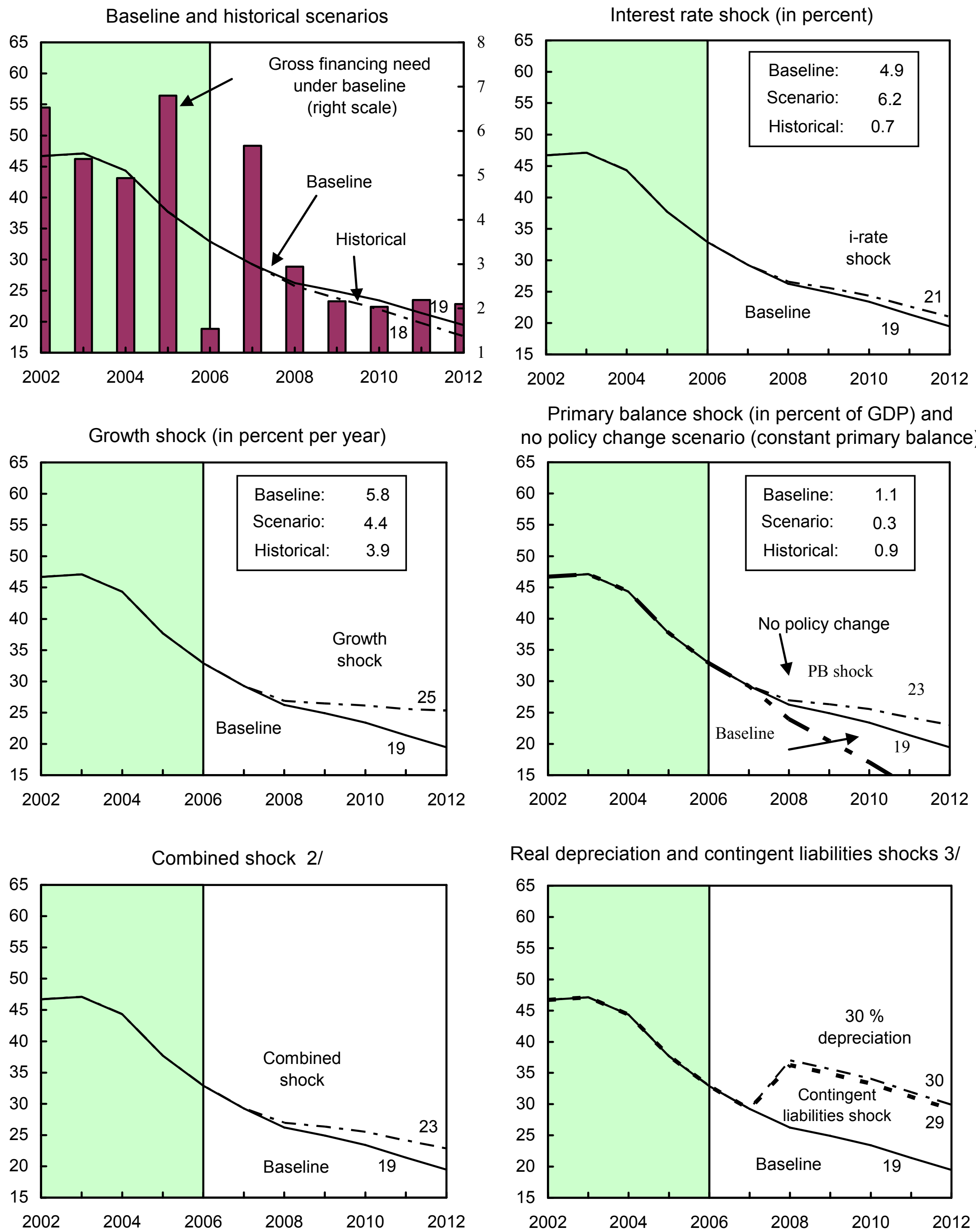
Sources: International Monetary Fund, Country desk data, and staff estimates.

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 2008, 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, 2002-2012
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	49.1	48.2	44.8	36.1	30.4	**29.0**	**25.8**	**24.3**	**22.5**	**20.6**	**18.5**	**-2.9**
Change in external debt	-1.3	-0.9	-3.4	-8.8	-5.6	-1.4	-3.2	-1.6	-1.8	-1.9	-2.1	
Identified external debt-creating flows (4+8+9)	-3.3	-2.1	-7.4	-9.0	-9.6	-8.1	-2.9	-2.8	-2.6	-2.4	-2.4	
Current account deficit, excluding interest payments	-0.5	-0.7	-2.1	-3.5	-4.8	-3.2	-1.2	-0.8	-0.6	-0.1	0.1	
Deficit in balance of goods and services	1.1	-0.1	-3.1	-5.6	-8.6	-7.1	-4.1	-1.6	0.0	1.2	1.7	
Exports	16.3	17.6	21.1	24.7	28.2	28.8	26.7	24.7	23.2	21.9	21.2	
Imports	17.4	17.5	18.0	19.1	19.6	21.8	22.6	23.1	23.2	23.1	22.9	
Net non-debt creating capital inflows (negative)	-2.7	0.0	-1.5	-2.0	-1.6	-4.8	-1.7	-1.9	-2.2	-2.5	-2.7	
Automatic debt dynamics 1/	-0.1	-1.5	-3.7	-3.4	-3.2	-0.1	0.0	0.0	0.2	0.2	0.1	
Contribution from nominal interest rate	2.4	2.2	2.1	2.1	2.0	1.9	1.7	1.5	1.5	1.3	1.2	
Contribution from real GDP growth	-2.4	-1.8	-2.2	-2.7	-2.3	-2.0	-1.6	-1.5	-1.3	-1.2	-1.1	
Contribution from price and exchange rate changes 2/	-0.1	-1.8	-3.6	-2.8	-2.9	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.0	1.2	3.9	0.2	4.0	6.7	-0.3	1.2	0.9	0.5	0.3	
External debt-to-exports ratio (in percent)	301.5	274.3	212.2	145.8	107.8	100.7	96.7	98.2	97.0	93.9	87.2	
Gross external financing need (in billions of US dollars) 4/	7.1	5.5	4.9	6.8	2.4	7.5	6.9	6.7	7.6	8.3	10.1	
in percent of GDP	12.5	9.0	7.0	8.6	2.6	7.0	5.6	5.1	5.4	5.5	6.2	
Scenario with key variables at their historical averages 5/						**29.0**	**28.1**	**26.5**	**24.6**	**22.6**	**20.3**	**-2.4**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.0	4.0	5.1	6.7	7.6	7.5	6.5	6.0	5.5	5.5	5.5	
GDP deflator in US dollars (change in percent)	0.2	3.9	8.2	6.8	8.8	7.2	8.5	0.6	1.2	1.9	2.1	
Nominal external interest rate (in percent)	5.0	4.9	4.9	5.3	6.5	7.3	6.7	6.0	6.4	6.3	6.1	
Growth of exports and services (US dollar terms, in percent)	9.0	16.7	36.5	33.5	33.5	17.6	7.2	-1.4	0.2	1.5	4.2	
Growth of imports and services (US dollar terms, in percent)	3.4	8.7	16.8	21.1	20.1	27.6	20.0	9.0	7.4	7.1	6.5	
Current account balance, excluding interest payments	0.5	0.7	2.1	3.5	4.8	3.2	1.2	0.8	0.6	0.1	-0.1	
Net non-debt creating capital inflows	2.7	0.0	1.5	2.0	1.6	4.8	1.7	1.9	2.2	2.5	2.7	

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 defl

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. Peru: Public Sector Debt Sustainability Framework, 2002–2012
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	46.7	47.1	44.3	37.7	32.9	**29.2**	**26.2**	**24.9**	**23.4**	**21.4**	**19.5**	**-0.3**
o/w foreign-currency denominated	42.9	43.3	37.5	29.5	25.0	21.3	18.6	16.9	15.4	13.7	12.1	
Change in public sector debt	0.8	0.4	-2.8	-6.6	-4.8	-3.7	-3.0	-1.3	-1.5	-2.0	-1.9	
Identified debt-creating flows (4+7+12)	-0.8	-1.1	-4.7	-5.0	-7.6	-4.5	-1.3	-1.1	-1.4	-1.5	-1.3	
Primary deficit	0.0	-0.4	-1.0	-1.6	-3.9	-3.1	-0.9	-0.9	-1.2	-1.2	-1.1	
Revenue and grants	17.6	18.0	17.9	18.9	20.5	21.2	20.3	20.7	21.1	21.3	21.6	
Primary (noninterest) expenditure	17.6	17.6	17.0	17.3	16.5	18.1	19.4	19.7	19.9	20.1	20.5	
Automatic debt dynamics 2/	-0.1	-0.7	-3.6	-3.3	-3.6	-1.2	-0.4	-0.1	-0.1	-0.2	-0.3	
Contribution from interest rate/growth differential 3/	-0.2	-0.9	-2.8	-2.1	-3.4	-1.2	-0.4	-0.1	-0.1	-0.2	-0.3	
Of which contribution from real interest rate	1.9	0.8	-0.7	0.6	-1.0	1.0	1.4	1.3	1.2	1.0	0.8	
Of which contribution from real GDP growth	-2.2	-1.8	-2.2	-2.7	-2.4	-2.2	-1.8	-1.5	-1.3	-1.2	-1.1	
Contribution from exchange rate depreciation 4/	0.1	0.3	-0.7	-1.2	-0.2	...	...	...	...	...	...	
Other identified debt-creating flows	-0.7	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.7	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	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/	1.6	1.5	1.9	-1.6	2.8	0.8	-1.7	-0.2	-0.2	-0.5	-0.6	
Public sector debt-to-revenue ratio 1/	265.3	261.7	247.0	199.2	160.6	137.7	129.3	120.5	111.2	100.1	90.3	
Gross financing need 6/	6.5	5.4	4.9	6.8	1.5	5.7	2.9	2.2	2.0	2.2	2.1	
in billions of U.S. dollars	3.7	3.3	3.4	5.4	1.4	6.1	3.6	2.9	2.9	3.3	3.4	
Scenario with key variables at their historical averages 7/						**29.2**	**25.7**	**23.8**	**22.0**	**19.8**	**17.6**	**-0.6**
Scenario with no policy change (constant primary balance) in 2007-2012						**29.2**	**24.0**	**20.5**	**17.0**	**13.2**	**9.3**	**-0.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.0	4.0	5.1	6.7	7.6	7.5	6.5	6.0	5.5	5.5	5.5	
Average nominal interest rate on public debt (in percent) 8/	4.9	4.8	4.8	4.8	5.8	6.0	5.9	6.1	6.2	6.3	6.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	4.5	2.0	-1.3	1.7	-2.4	3.7	5.2	5.5	5.0	4.5	4.3	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-0.3	-0.6	1.9	3.6	0.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	0.5	2.8	6.1	3.1	8.1	2.3	0.7	0.6	1.2	1.8	2.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	2.1	4.1	1.3	8.9	2.8	17.7	14.3	7.7	6.2	6.9	7.5	
Primary deficit	0.0	-0.4	-1.0	-1.6	-3.9	-3.1	-0.9	-0.9	-1.2	-1.2	-1.1	

1/ Combined public sector. Gross debt is used.

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

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

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

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

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

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

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

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

APPENDIX 1. PERU: FUND RELATIONS
(As of October 31, 2007)

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

II. General Resources Account	**SDR Million**	**Percent Quota**
Quota	638.40	100.00
Fund holdings of currency	638.43	100.01

III. SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	91.32	100.00
Holdings	3.25	3.56

IV. Outstanding Purchases and Loans None

V. Financial Arrangements

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

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

	2007	2008	2009	2010	2011
Principal					
Charges/interest	0.90	3.41	3.41	3.41	3.41
Total	0.90	3.41	3.41	3.41	3.41

VII. Safeguards Assessments

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

VIII. Exchange Arrangements

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

IX. Last Article IV Consultation

The 2006 Article IV consultation was concluded on January 26, 2007 (IMF Country Report No. 07/5).

X. FSAP and ROSCs

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

XI. Technical Assistance

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

XII. Resident Representative

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

APPENDIX 2. PERU: WORLD BANK RELATIONS

Bank Group strategy

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

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

Bank-Fund collaboration in specific areas

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

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

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

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

Statement of World Bank Loans
(As of October 2007)

Loan Number	Year Approved	Borrower	Purpose	In millions of U.S. Dollars: Total (Net of Cancellation)	Undisbursed
Sixty five loans have been fully repaid					
Partially disbursed or undisbursed loans:					
72090	2004	Republic of Peru	Lima Urban Transport Project	45	37.0
72850	2005	Republic of Peru	Agricultural Research and Extension - APL II	25	18.2
74230	2007	Republic of Peru	Decentralized Rural Transport Project	50	49.5
73080/40760	1997	Republic of Peru	Irrigation Subsector Project	95.26	4.3
72550	2005	Republic of Peru	Institutional Capacity for Sustainable Fiscal Decentralization	9	7.3
72190	2004	Republic of Peru	Justice Services Improvement	12	7.5
52856	2004	Republic of Peru	Lima Transport	7.93	4.6
71600	2003	Republic of Peru	Additional Financing Lima Water Rehabilitation and Management Project	20	10.1
71420	2003	Republic of Peru	National Rural Water Supply and Sanitation Project	50	36.5
73680	2006	Republic of Peru	Real Property Rights II Project	25	22.9
73220	2006	Republic of Peru	Regional Transport Infrastructure Decentralization	50	49.3
73660	2006	Republic of Peru	Rural Electrification	50	48.9
74430	2007	Republic of Peru	Sierra Rural Development Project	20	20.0
71770	2003	Republic of Peru	Trade Facilitation and Productivity Improvement Technical Assistance	20	9.6
72570	2005	Republic of Peru	Vilcanota Valley Rehabilitation and Management Project	5	4.3
71760	2003	Republic of Peru	Rural Education	53	27.3
72540	2005	Republic of Peru	Accountability for Decentralization in the Social Sectors	8	5.0
Total disbursed:				5,403.1	
Of which: amount repaid				2,668.9	
Total Outstanding: 1				2,658.1	
Total Undisbursed					362.2

Statement of IFC Investments
(As of October 2007)
In millions of U.S. dollars

	Loans 1/	Equity	Quasi	Participation Loans	Total
Total commitments held by IFC	344.9	85.4	58.9	4.8	489.2
Total disbursed	206.6	64.0	58.9	4.8	329.5

1/ Includes guarantees and risk management instruments

Source: World Bank

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

Country Strategy

The key objectives of the 2002-2006 strategy for Peru are poverty reduction and equity promotion, within a context of high economic growth needed to make these goals sustainable. Toward this end, the Bank supports government's efforts to: (i) raise economic productivity and competitiveness; (ii) improve the efficiency of social policy while implementing measures to mitigate poverty and protect vulnerable groups; and (iii) create a modern, decentralized and efficient state.

The Bank and the authorities have started the dialogue for the preparation of the new strategy for 2007–2011, which is projected for approval in December.

Lending

As of November 30, 2007 the Bank's active portfolio consists of 26 loans for a total amount of US$990,6 million, of which US$137,7 million (14%) has been disbursed.

The lending program for 2007 comprises two investment loans for US$55 million and three programmatic loans for US$375.0 million. Private sector lending is expected to reach US$510.0 million in 2007.

To assist Government efforts to de-dollarize the public sector debt, negotiations are currently underway to convert US$50.0 million of a previously disbursed loan into local currency.

The Structured Corporate Finance (SCF) department is completing due diligence on the Peru – Liquefied Natural Gas project for US$400.0 million, expected to be approved in December 2007.

Finally, the Bank's portfolio with Peru includes non-reimbursable technical cooperation totaling US$28.3 million.

PERU
IDB Loan Portfolio by Sector
As of November 30th, 2007
US$ million

Sector	Commitments	Disbursements	% Disbursed
Agriculture	30.0	12.5	41.5%
Water and Sanitation	400.8	0.0	0.0%
Science and Technology	25.0	0.3	1.0%
Urban Development	60.0	23.1	38.4%
Social Investment	103.3	78.0	75.5%
Environment	10.0	4.7	47.1%
Public Sector Management	51.6	9.1	17.6%
Transportation	310.0	9.6	3.1%
Total	**990.6**	**137.1**	**13.8%**

APPENDIX 4. PERU: STATISTICAL ISSUES

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

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

I. Real Sector and Prices

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

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 statistical techniques used to compile the WPI follow generally accepted international standards.

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

II. Fiscal Sector

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

III. Monetary Sector

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

IV. External Sector

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

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

Peru: Table of Common Indicators Required for Surveillance
As of November 26, 2007

	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	Oct. 2007	11/7/2007	D	M	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Oct. 2007	11/15/2007	D	M	W		
Reserve/Base Money	Aug. 2007	11/16/2007	W	M	W	O, LO, LO, LO	O, O, O, O, O
Broad Money	Aug. 2007	11/16/2007	W	M	W		
Central Bank Balance Sheet	Aug. 2007	11/16/2007	W	M	W		
Consolidated Balance Sheet of the Banking System	Aug. 2007	11/16/2007	W	M	W		
Interest Rates[2]	Oct. 2007	11/26/2007	D	M	D		
Consumer Price Index	Oct. 2007	11/16/2007	M	M	M	O, LO, LO, LO	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2004	9/21/2005	Q	Q	Q	O, LO, O, O	O, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing3– Central Government	May 2007	8/1/2007	M	M	M		
Stocks of Central Government Debt[5]			Q	Q	Q		
External Current Account Balance	Q1. 2007	8/16/07	Q	Q	Q	O, LO, LO, LO	LO, LO, O, O, O
Exports and Imports of Goods and Services	Q4. 2006	4/13/07	M	M	M		
GDP/GNP	Q1 2007	5/21/07	M	M	M	LO, LO, LO, LO	LNO, LNO, LNO, LO, LO
Gross External Debt	June 2006	Sep. 2006	Q	Q	Q		

[1] Every Friday the Central Bank disseminates daily net international reserves, and weekly International Reserve Assets and Reserve Liabilities.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including type of instrument, maturity and type of creditor.
[6] 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.

Statement by the IMF Representative
December 19, 2007

1. This statement provides additional information that has become available since the circulation of the staff report (www.imf.org). It does not alter the thrust of the staff appraisal.

2. **Macroeconomic conditions remain favorable.** The *Nuevo Sol* has appreciated by nearly 7½ percent against the U.S. dollar in the year through mid-December. The central bank has stepped up its intervention in the foreign exchange market in recent days, and net international reserves stand at around $26½ billion (about 200 percent of foreign currency deposits), about $1 billion above staff's projection for end-2007. Peru's EMBI spread has remained stable in recent days, hovering around 175 basis points.

3. **The central bank maintained its policy interest rate unchanged at 5 percent during its Board meeting last week.** The central bank reiterated that rising inflation reflects primarily transitory shocks and stressed its commitment to tighten monetary policy if needed to contain any emerging aggregate demand pressures and to keep inflation expectations well-anchored.

4. **Selected pending structural reforms are moving ahead:**

- ***With respect to the discontinuation of MiVivienda's guarantees on foreign currency mortgages envisaged for end-December,*** financial institutions have been reducing the provision of guarantees for new mortgages denominated in foreign currency relative to those issued in *Nuevos Soles,* broadly in line with the guidelines issued in September 2007. *MiVivienda* officials have assured staff that no further guarantees will be issued for new dollar-denominated mortgages starting January 1, 2008.

- ***Regarding the comprehensive legal framework for PPPs to be submitted to Congress by end-December,*** the authorities have made significant progress towards completing a draft law and expect to send it to Congress before end-year.

5. **On December 14, President Bush signed into law the implementing legislation for the Peru-U.S. Free Trade Agreement**.

Press Release No. 07/297
FOR IMMEDIATE RELEASE
December 19, 2007

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review under Peru's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Peru's economic performance under a 25-month Stand-By Arrangement in the amount equivalent to SDR 172.4 million (about US$270 million).

The authorities have indicated that they are treating the arrangement as precautionary. The arrangement was approved on January 26, 2007 (see Press Release No. 07/15).

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

"Peru has been enjoying strong economic growth, a solid external position, low inflation, and declining vulnerabilities, reflecting the implementation of prudent macroeconomic policies in the context of a favorable external environment.

"The authorities appropriately intend to preserve fiscal prudence and improve the quality of public spending, while addressing social and infrastructure needs. They will continue to save part of revenue overperformance, strengthen budget execution, and preserve fiscal transparency. Of particular importance will be to build capacity at subnational governments, allow for greater private sector participation in public investment, and allocate *canon* resources to sound investment projects in a prudent manner.

"The authorities' program continues to address important structural fiscal issues, including: establishing a comprehensive legal framework for public-private partnerships to ensure more balanced risk-sharing between the public and private sectors, ensuring consistency of expenditure limits set in the Fiscal Responsibility and Transparency Law and the Decentralization Law, and implementing a new regime for tax incentives to broaden the tax base.

"To strengthen poverty reduction efforts, the authorities are bolstering the capacity of the Interministerial Committee for Social Assistance. They will also continue to address regional income disparities and to build consensus for the reform of social programs.

"Greater exchange rate flexibility has been important to strengthen the effectiveness of monetary policy. A more comfortable level of reserves and the increased resilience of the banking system to exchange rate movements provide scope for keeping this flexibility ahead. This would help better internalize currency risks and improve the inflation targeting framework.

"Strengthening the financial sector remains an important priority. To maintain a level playing field, the authorities intend to monitor public institutions' lending practices and align the regulatory and supervisory frameworks of public and private banks. The envisaged reforms to deepen capital markets are an important step forward to promote diversification, mitigate systemic risks, and contain currency appreciation pressures.

"The recent ratification of the Free Trade Agreement with the United States is an important step. It underscores the importance of enhancing external competitiveness, including by tackling high labor market informality and improving the business environment," Mr. Portugal said.

Statement by Javier Silva-Ruete, Executive Director for Peru
December 19, 2007

1. Peru's performance under the SBA continues to be satisfactory. All end-June and end-September performance criteria were met comfortably. Albeit with some delays due to implementation complexities, the authorities are pressing forward to complete the structural benchmarks and remain fully committed to the reform agenda under the program. They consent to the publication of the staff report.

2. Supported by sound macroeconomic policies, strong market confidence, and a favorable external environment, GDP growth reached a solid 8.4 percent year-on-year in the third quarter. Recently released information points to over 10 percent growth year-on-year in October, and the forecast for 2007 is being revised upward to around 8 percent. All demand components -especially investment and consumption- continue to expand steadily and employment growth is becoming increasingly decentralized. With strong fundamentals and a sound external position (international reserves equal to 4 times the short-term debt and 92 percent of total banking liquidity), the impact of the recent global financial market turbulence on sovereign spreads has been limited.

3. In 2007, the consolidated public sector is expected to post a surplus of 2¼ percent of GDP, due to strong revenue growth and lower-than-expected expenditure implementation. In 2008, the authorities will continue to address social and infrastructure needs while remaining consistent with macroeconomic stability. They will aim at a balanced fiscal position and, in this context, they will cap central government current expenditure growth at 4 percent in real terms. In the coming months, structural fiscal policies will focus on further improving the fiscal framework and strengthening revenues:

- National System of Public Investment (SNIP) procedures have been simplified to expedite budget execution while preserving its quality. To further enhance the capacity of Subnational Governments (SNGs) to implement investment projects, the government will give additional support to the system of regional Technical Assistance Offices. Also, it will seek amendment of the Decentralization Law to align limits to SNG spending with those for the central government, as prescribed in the Fiscal Responsibility and Transparency Law.

- The authorities will finalize and submit a draft law to Congress to establish a comprehensive framework for Public-Private Partnerships by end-December 2007. Should the government not submit the draft law to Congress before the deadline, the structural benchmark will become a structural performance criterion for 2008.

- The modernized budget classification system could not be completed in time for the 2008 budget, but since 2009 it will be incorporated into the budget cycle at all government levels. Full implementation of the Treasury Single Account (TSA) for the central government was also delayed, but the Ministry of Finance will seek to ensure it by submitting to Congress a new draft Treasury Law to include all general government resources in the TSA, adopting the new budget classification, and establishing a Treasury General Ledger by September 2008.

- The government will issue guidelines for evaluating existing tax exemptions, as contemplated in the new framework enacted in December 2006.

4. Prepayment of Peru's commercial obligations with the Paris Club due in 2007-2015, made effective in October, further reduced exposure to foreign currency-denominated public debt. As a result of the authorities' active debt management policies, the public debt ratio is projected to decline to an estimated 26 percent of GDP at end-2008, from 47 percent in 2003.

5. Following an international trend, in recent months there has been a surge in inflation due to a continuing increase in world fuel and food commodity prices. Twelve-month inflation rose from 0.9 percent in May to 3.5 percent in November, above the target range under the inflation-targeting framework (2 percent with a tolerance band of ±1 percent). The central bank does not expect these developments to permanently erode expectations or affect other prices in the economy, but will remain vigilant about possible longer-run inflationary implications. At the same time, it raised its policy interest rate in July and September as a precautionary response to high demand growth. In the medium term, economic momentum is expected to remain consistent with the target range as productivity gains continue across economic sectors. In the foreign exchange market, the authorities will continue limiting interventions to those needed to confront excessive exchange rate volatility or abrupt fluctuations, without a commitment to any given exchange rate level. Institutionally, to further strengthen central bank independence and credibility, considerable progress has been made towards passage of a constitutional amendment for de-linking future appointments of board members from the political cycle after 2011; and work continues on the legal, regulatory, and supervisory framework for enabling the central bank to oversee the payments system.

6. The authorities continue their efforts to diminish dollarization, strengthen financial regulation and supervision in line with international standards, and deepen capital markets. In order to complete the necessary technical work, the following structural benchmarks have been reset for end-June 2008: (i) submission to Congress of an amendment to the General Banking Law (GBL) to introduce capital requirements for exchange-rate risks; and (ii) clarification of the tax treatment of securitization transactions. Also, financial institutions requested an extension of the deadline to discontinue credit risk guarantees for foreign-currency mortgages provided by *MiVivienda* (the government-sponsored housing program). In 2008, the authorities will submit to Congress: (i) an amendment to the GBL to increase the minimum capital required to established microfinance institutions; (ii) an amendment to the Pension Fund Law to further increase the limit on private pension funds' (AFPs) investments

abroad, redefine investment limits on public sector assets, broaden the set of investible domestic securities for AFPs, and ease limits on the use of forwards as hedges. The authorities attach much importance to improving coordination between supervisory agencies.

7. After rationalizing social assistance programs, a strengthened Interministerial Committee for Social Affairs (CIAS) will consistently monitor and assess results. The new Household Targeting Database will assist in improving the quality of social spending and ensuring adequate targeting. In 2008, the conditional cash-transfer program *Juntos* will be extended from 360,000 beneficiaries at end-2007 to at least 500,000; *Crecer* -which addresses chronic child malnutrition- will be expanded to a considerably higher number of rural districts in extreme poverty; and a new program (*Progresar*) will be launched to provide complementary basic infrastructure. To assist SNGs with no access to canon resources, the *Regional Equalization Fund* and the *Regional and Local Investment Fund* are being enhanced. The authorities will also seek to ensure that the recent initiative to provide canon-related cash transfers to households remain moderate and well targeted.

8. On December 5, the U.S. Senate gave final approval to the free-trade agreement with Peru. The authorities have high expectations about its impact on investment, exports, and employment. The FTA is expected to become effective in January 2009, and its preparation process will involve approval of several new bills -on customs, environmental protection, procurement, and intellectual property, among others- over the coming months. The authorities wish to thank the U.S. administration for their efforts to secure passage of this FTA, which will contribute significantly to Peru's further integration into the world economy and sustained growth. Peru is also committed to completing similar arrangements with other important trade partners.

9. In view of the progress under the SBA, the authorities request completion of the Second Review. They stand ready to take the necessary steps to meet their commitments and pledge to maintain the usual dialogue with the Fund.