INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/133

PERU

May 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PERU

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Peru, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 20, 2024 consideration of the staff report that concluded the Article IV consultation with Peru.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 20, 2024, following discussions that ended on March 7, 2024, with the officials of Peru on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 2, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Supplementary Information** updating information on recent developments.
- A **Statement by the Executive Director** for Peru.

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

Selected Issues

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

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PRESS RELEASE

PR24/172

IMF Executive Board Concludes 2024 Article IV Consultation with Peru

FOR IMMEDIATE RELEASE

Washington, DC – **May 21, 2024:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Peru on May 20, 2024.

The economy is recovering from consecutive climate-related shocks and social turmoil at the beginning of 2023. Inflation has receded thanks to the central bank's decisive monetary policy tightening, while the fiscal position and the financial system remain strong. The country is in a period of relative political stability, but lingering political uncertainty is denting the appetite for pressing reforms to boost potential growth.

A rebound in growth to 2.5 percent is expected in 2024, supported by a strong recovery in agriculture and fishing, continued momentum in mining, and a looser monetary policy stance. However, only a moderate recovery is expected for private consumption and private investment, as nominal wages gradually regain their purchasing power and elevated political uncertainty weighs on consumer and business confidence. As the effects from El Niño dissipate, inflation would rapidly decline towards the midpoint of the target band, aided by a negative output gap and the normalization of supply shocks, as the Central Bank continues with its cautious monetary policy easing cycle. The current account is envisaged to return to a deficit of 1.1 percent of GDP in 2024 as growth normalizes and to stabilize at 1.5 percent of GDP in the medium term, with external financing and debt rollover risks remaining low.

Evolving risks are broadly balanced, and Peru has ample buffers to cope with adverse shocks, although the outlook remains uncertain. In the short term, key domestic risks include an intensification of political uncertainty, social unrest, and climate-related shocks. Key external risks comprise weak trading-partner growth, commodity price volatility, and a sharp tightening of global financial conditions. On the upside, a stronger recovery in confidence could support stronger private consumption and investment growth. Peru's proven macroeconomic resilience is reinforced by very strong buffers including relatively low public debt, abundant international reserves, and access to international capital markets on favorable terms.

Executive Board Assessment[2]

Executive Directors commended the Peruvian authorities for their sustained track record of very strong macroeconomic policies and institutional frameworks, that have effectively steered the country through social turmoil and severe climate shocks and supported the ongoing

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

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recovery. They positively noted that low public debt, abundant international reserves, a robust financial sector, and favorable access to international capital markets provide strong buffers against adverse shocks. Against this background, they supported the authorities' decision to exit the Flexible Credit Line arrangement upon its expiry in May 2024 given broadly balanced risks and the strength of Peru's buffers. Directors noted the authorities' commitment to maintaining sound institutions and policies to further strengthen Peru's resilience against external risks.

Directors welcomed the strong fiscal position and the authorities' commitment to fiscal sustainability. They generally agreed that, given available fiscal space, a more gradual fiscal consolidation path could help support growth in the short run. However, Directors highlighted the need for ambitious revenue mobilization to support a more balanced medium-term consolidation plan. They also called for measures to further strengthen the fiscal framework, including reviewing the optimality of the medium-term fiscal target, the debt ceiling, and liquidity buffers, supported by Fund TA, and bolstering the effectiveness of the Fiscal Council. Directors highlighted the importance of pension reforms to address subpar income replacement and coverage, early withdrawals, and potential long-term fiscal contingencies.

Directors commended the central bank's early decisive monetary tightening, which was successful in anchoring inflation expectations and reducing inflation towards the target band. In that context, they agreed with the ongoing cautious data-dependent monetary policy easing. Directors also encouraged the central bank to maintain exchange rate flexibility to act as a shock absorber and support faster economic recovery. Noting the resilience of the financial system, Directors encouraged the authorities to remain vigilant and to continue to facilitate de-dollarization and capital market deepening.

Directors stressed that structural reforms are urgently needed to revive growth. They emphasized that efforts to boost productivity should focus on reforming labor and tax regulations, building resilience to climate shocks, and embracing the digital and artificial intelligence revolution. They commended the authorities' commitment to addressing corruption and encouraged the authorities to strengthen the effectiveness of governance institutions. Directors concurred that the OECD accession process provides a clear roadmap for more ambitious reforms to boost the business climate and ensure sustainable and inclusive growth.

Table 1. Peru: Selected Economic Indicators

	2020	2021	2022	Est. 2023	Proj. 2024	2025	2026	2027	2028	2029
Social Indicators										
Poverty rate (total) 1/	30.1	25.9	27.5	…	…	…	…	…	…	…
Unemployment rate for Metropolitan Lima (average)	13.0	10.7	7.8	6.8	…	…	…	…	…	…
Production and Prices	(Annual percentage change, unless otherwise indicated)									
Real GDP	-10.9	13.4	2.7	-0.6	2.5	2.7	2.3	2.3	2.3	2.3
Output gap (percent of potential GDP)	-5.5	0.9	0.6	-1.3	-0.7	-0.2	0.0	0.0	0.0	0.0
Consumer prices (end of period)	2.0	6.4	8.5	3.2	2.4	2.0	2.0	2.0	2.0	2.0
Consumer prices (period average)	1.8	4.0	7.9	6.3	2.3	2.0	2.0	2.0	2.0	2.0
Money and Credit 2/ 3/										
Broad money	29.2	2.7	-0.3	1.5	3.9	4.7	5.3	5.5	5.5	5.5
Net credit to the private sector	14.0	6.5	3.6	0.4	4.0	4.8	5.1	5.5	5.5	5.5
Credit-to-private-sector/GDP ratio (%)	52.4	45.9	44.4	41.8	41.4	41.4	41.6	42.0	42.5	43.0
External Sector										
Exports	-10.7	47.0	5.2	1.5	-0.8	3.1	4.0	3.4	3.5	3.6
Imports	-15.5	38.2	16.5	-10.8	5.3	4.3	3.1	3.3	3.5	3.2
External current account balance (percent of GDP)	1.1	-2.2	-4.0	0.6	-1.1	-1.4	-1.4	-1.5	-1.5	-1.5
Gross reserves In billions of U.S. dollars	74.9	78.5	72.2	71.3	73.8	76.3	78.4	80.8	82.7	84.4
Percent of short-term external debt 4/	495	583	530	409	459	438	438	430	483	493
Percent of foreign currency deposits at banks	222	229	207	205	210	212	211	210	206	202
	(In percent of GDP, unless otherwise indicated)									
Public Sector										
NFPS revenue	21.8	25.5	26.9	23.9	23.9	23.8	23.8	23.6	23.7	23.7
NFPS primary expenditure	29.1	26.5	27.0	25.0	24.7	24.1	23.6	22.9	23.0	23.2
NFPS primary balance	-7.3	-1.0	-0.1	-1.1	-0.8	-0.3	0.2	0.7	0.7	0.6
NFPS overall balance	-8.9	-2.5	-1.7	-2.8	-2.5	-2.0	-1.5	-1.0	-1.0	-1.0
NFPS structural balance 5/	-7.0	-4.0	-2.2	-2.5	-2.5	-2.2	-1.8	-1.2	-1.2	-1.1
NFPS structural primary balance 5/	-5.4	-2.5	-0.7	-0.9	-0.8	-0.5	-0.1	0.5	0.5	0.5
Debt										
Total external debt 6/	43.7	46.3	43.0	40.6	38.2	37.0	35.5	33.6	32.7	31.8
Gross non-financial public sector debt 7/	34.9	36.1	33.9	32.1	33.0	33.3	33.2	32.6	32.1	31.6
External	14.8	19.4	17.5	16.0	15.3	14.2	13.1	11.5	10.9	10.3
Domestic	20.1	16.7	16.4	16.1	17.8	19.0	20.1	21.1	21.3	21.4
Savings and Investment										
Gross domestic investment	19.9	21.7	22.1	19.2	20.4	20.8	20.9	21.1	21.3	21.5
Public sector (incl. repayment certificates)	4.3	4.7	5.1	5.0	4.8	4.8	4.9	4.9	5.0	5.1
Private sector	16.8	20.4	20.2	17.9	17.7	17.4	17.2	16.9	16.7	16.6
National savings	21.0	19.5	18.1	19.8	19.3	19.5	19.5	19.7	19.8	20.0
Public sector	-4.6	2.8	4.4	3.0	3.1	3.6	4.1	4.6	4.6	4.6
Private sector	25.6	16.7	13.7	16.8	16.1	15.8	15.4	15.1	15.2	15.4
Memorandum Items										
Nominal GDP (S/. billion)	721	878	939	1,002	1,051	1,102	1,151	1,202	1,255	1,309
GDP per capita (in US$)	6,320	6,848	7,336	7,933	8,291	8,567	8,839	9,115	9,397	9,685

Sources: National authorities; UNDP Human Development Indicators; and IMF staff estimates/projections.
1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.
2/ Corresponds to depository corporations.
3/ Foreign currency stocks are valued at end-of-period exchange rates.
4/ Short-term debt is defined on a residual maturity basis and includes amortization of medium and long-term debt.
5/ Adjusted by the economic cycle and commodity prices, and for non-structural commodity revenue. The latter uses as equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to the IMF's World Economic Outlook.
6/ Includes local currency debt held by non-residents and excludes global bonds held by residents.
7/ Includes repayment certificates and government guaranteed debt.

INTERNATIONAL MONETARY FUND

PERU

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

May 2, 2024

KEY ISSUES

Context: The economy is recovering after consecutive climate-related shocks as well as social turmoil at the beginning of 2023. Inflation has receded due to the central bank's decisive monetary policy tightening, while the fiscal position and financial system remain strong. The country is in a period of relative political stability, but lingering political uncertainty is denting the appetite for the reforms needed to boost potential growth.

Outlook and Risks: A modest rebound is expected in 2024, once the impact from *El Niño* dissipates, given weak business and consumer confidence. Inflation is expected to converge to the middle of the target band (of 1-3 percent). Evolving risks are broadly balanced. Peru's proven macroeconomic resilience is reinforced by very strong buffers including relatively low public debt, abundant international reserves, access to international capital markets on favorable terms, a robust financial sector, and the Flexible Credit Line (FCL).

Key Policy Advice: Policies are needed to support growth. In the short term, monetary and fiscal policies could support the recovery. Over the medium term, fiscal consolidation is necessary to preserve fiscal sustainability, and structural reforms are essential to lift potential growth:

- *Monetary and Exchange Rate (ER) Policies.* A cautious monetary policy easing cycle is appropriate as uncertainties associated with *El Niño* dissipate and inflation expectations remain anchored. Given the expectation of a narrowing interest rate differential vis-à-vis the U.S., the decline in financial stability risks from foreign exchange (FX) mismatches, and in the absence of large ER shocks that could endanger financial stability, the Central Bank (BCRP) should continue to allow for greater ER flexibility and consider targeted measures to support de-dollarization.

- *Fiscal Policy.* If revenues continue to disappoint, given available fiscal space, delaying the consolidation by one year could support the growth recovery. The envisaged medium-term fiscal consolidation is necessary to stabilize the debt ratio and preserve fiscal sustainability. Revenue mobilization measures would make fiscal consolidation more balanced. Improving fiscal policy guidance could also bolster fiscal policy credibility. Analyzing the optimality of the current medium-term fiscal targets would ensure that they are an effective anchor for fiscal sustainability.

- *Financial sector policies.* The financial system remains robust. The authorities should continue to proactively contain pockets of vulnerability from the growth slowdown and maintain liquidity cushions against private pension withdrawals. Fully operationalizing new regulations and closing remaining gaps will enhance financial resilience.

- *Structural reforms.* Reforms are urgently needed to lift potential growth, including reforming labor and tax regulations that create barriers for formalizing or growing a business, investing in resilient infrastructure and implementing effective climate adaptation measures, fully embracing the digital and artificial intelligence revolution by facilitating technological diffusion and job transition, and strengthening the effectiveness of governance institutions. The OECD accession process provides a clear roadmap for more ambitious reforms to improve local government capacity, boost the business climate, reduce informality, and reform the civil service. Government's plans for pension reform, cutting red tape (particularly for the mining sector), unblocking large infrastructure projects, streamlining the tax system, and reforming the procurement framework, and the recently approved political reform (to return to bicameralism and allow for the reelection of congressmen) are encouraging.

Approved By
Patricia Alonso-Gamo (WHD) and Jay Peris (SPR)

Discussions took place in Lima and Arequipa during February 21-March 7, 2024. The team comprised Sònia Muñoz (Head), Moya Chin and Jose Torres (all WHD), Brooks Evans (FAD), Maxym Kryshko (SPR), and Tomohiro Tsuruga (MCM). Zamid Aligishiev and Dmitry Vasilyev (both WHD) covered climate and digitalization issues, respectively, and Jonathan Pampolina (LEG) covered governance issues. Óscar Hendricks (OED) also participated in the discussions. The mission met with Central Bank Governor Julio Velarde; Minister of Economy and Finance José Arista; Minister of Energy and Mines Rómulo Mucho; Minister of Justice Eduardo Arana; Superintendent of Banks, Insurance and Pensions Socorro Heysen; Arequipa Regional Governor Rohel Sánchez; other senior government officials from the Presidency of the Council of Ministers, the Ministry of Environment, the Ministry of Transport and Communications, and the National Infrastructure Authority; anti-corruption institutions and judicial governance bodies; private sector and civil society representatives; think tanks; and academics. Additional analytical inputs were provided by Daria Kolpakova, Sophia Chen, and Matteo Ghilardi (all WHD), and Boele Bonthuis, Delphine Prady, and Julieth Pico (all FAD). Daria Kolpakova also provided research assistance. Nicolás Landeta (WHD) provided administrative assistance. Vanessa Husni and Vera Winkelried (CSF vendors) provided interpretation services.

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A RECOVERY FROM CONSECUTIVE SHOCKS WITH LOW CONFIDENCE

1. The country is in a period of relative political stability, although political uncertainty remains elevated. Former Vice President Dina Boluarte became President in December 2022, following the impeachment of Pedro Castillo. In February 2024, she replaced four Ministers including the Minister of Economy and Finance and the Minister of Mines, and shortly after a new Prime Minister was also appointed. In April 2024, she replaced six more cabinet members, including the Minister of Interior and the Minister of Education. However, the country is in a period of relative political stability, due to an implicit consensus between the legislative and executive powers to allow the administration to serve its term (in which case the next election would take place in April 2026). The recently approved constitutional reform to return to bicameralism and allow for the reelection of congressmen could also foster political stability. Prospects for social unrest have receded, but major reforms needed to lift potential growth are unlikely to be approved by a fragmented Congress.

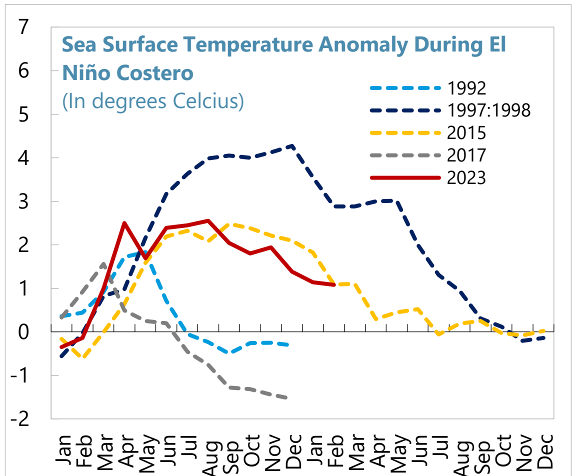
2. Very strong macroeconomic policies and institutional policy frameworks remain firmly in place, supporting a soft landing, despite political uncertainty. Very strong fiscal policies have allowed the country to maintain the lowest debt ratio in the region. Due to the central bank's (BCRP) decisive monetary policy tightening, both headline and core inflation and inflation expectations have declined towards the target band. Strong supervision and appropriate macroprudential policies have preserved financial stability. A long track record of sound macroeconomic policies (broadly in line with past IMF advice, Annex I) have reassured financial markets, as evidenced by a relatively stable ER and EMBI spread, despite political turmoil. The two-year Flexible Credit Line arrangement, approved in May 2022 (300 percent of quota), has provided strong signaling and insurance against tail scenarios. The authorities expect to treat the arrangement as precautionary and to exit upon expiration (on May 26, 2024), conditional on external risks.

3. The economy had a slight contraction in 2023, due to multiple consecutive shocks. Social unrest against the Boluarte government (which peaked in January 2023 but persisted until April 2023) contributed to a contraction of -0.4 percent y/y in the first quarter of 2023, primarily affecting mining and services.[1] Three consecutive quarters of slightly negative growth (y/y) followed on account of simultaneously strong *El Niño Costero* and *El Niño Global* episodes with negative impacts in agriculture and fishing (Box 1).[2] Growth was supported by mining (about 8 percent), as production in the new Quellaveco copper mine ramped up, while low consumer and business confidence negatively affected private consumption and investment.

[1] Social conflicts included protests and road blockades that affected commerce and transportation. These created further problems supplying inputs and transportation of production in other sectors, such as construction and mining.

[2] Abnormal sea temperatures from *El Niño Costero* likely contributed to the formation of Cyclone Yaku in March 2023, which brought intense rains to northern regions. In addition to social unrest and *El Niño*, the economy also suffered from droughts in August-December 2022 and an avian flu outbreak in November 2022-May 2023 that affected agricultural production. In total, the BCRP estimates these shocks contributed an estimated -2.1 percentage points to GDP growth. See BCRP (2023), Reporte de Inflación: Diciembre 2023.

Box 1. Peru: The Impact of *El Niño Costero* and *Global*



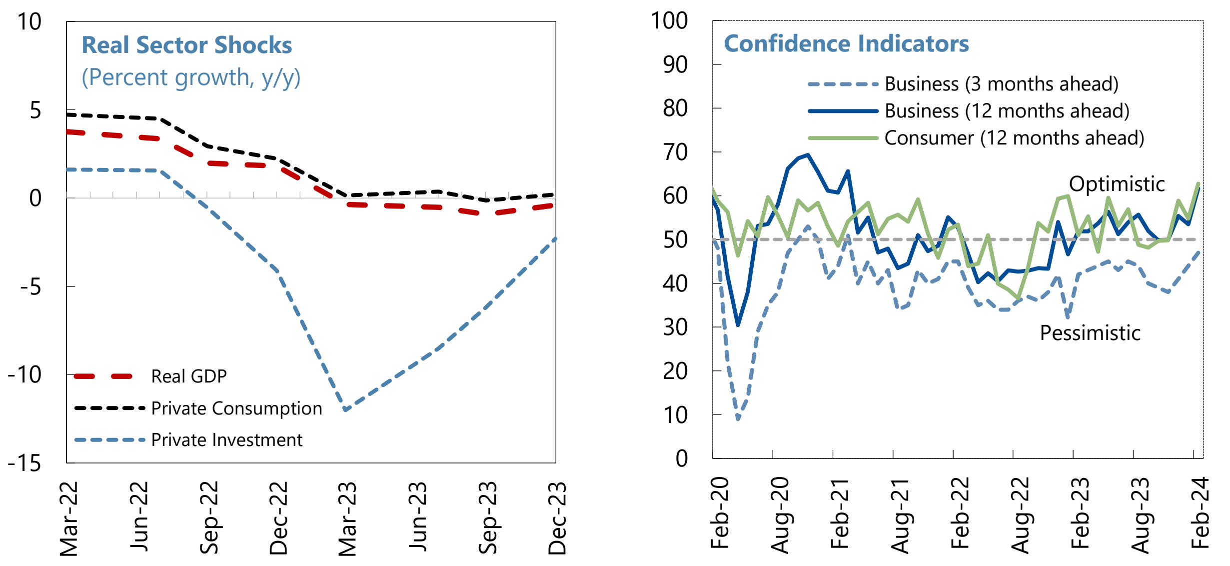
Sources: NOAA, BCRP Inflation Report.
Note: Based off 1+2 Region SST Index.

In March 2023, Peru experienced the onset of *El Niño Costero*, a recurring warming of the sea surface temperature along its coast with drastic implications for the country's economy. According to *Estudio Nacional del Fenómeno El Niño* (ENFEN) the 2023 *El Niño Costero* became strong in April 2023, weakened in early 2024, but persisted until early April 2024. Owing to its diverse geography and hydrology, Peru typically experiences a wide range of impacts from a strong *El Niño Costero*. In the northern regions, heavy rainfall translates into infrastructure damages from floods, lower agricultural yields (e.g., rice, lemons), and a slowdown in the construction sector. In the southern regions, a reduction in precipitation undermines rainfed agriculture (e.g., potatoes, forage crops). The rise in the sea surface temperature adversely affects fishing and associated manufacturing activities (e.g., fishmeal, fish oil), while higher air temperatures across the country disrupt flowering and pollination (e.g., blueberries, avocados, mangoes, olives).

Shortly after the onset of *El Niño Costero, El Niño Global* began in June 2023. *El Niño Global* is often associated with international spillovers and increases in energy prices. Due to lower global wheat, rice, and maize yields, global food prices usually increase. Similar to *El Niño Costero, El Niño Global* also produces drought-like conditions in the southern regions, lowering the harvests of rainfed crops. However, it also increases the likelihood of hurricane formation in the Eastern Pacific and decreases the demand for Peruvian textiles, due to higher global temperatures. *El Niño Global* became strong in September 2023, weakened to a moderate strength in February 2024, and is expected to dissipate by May 2024.

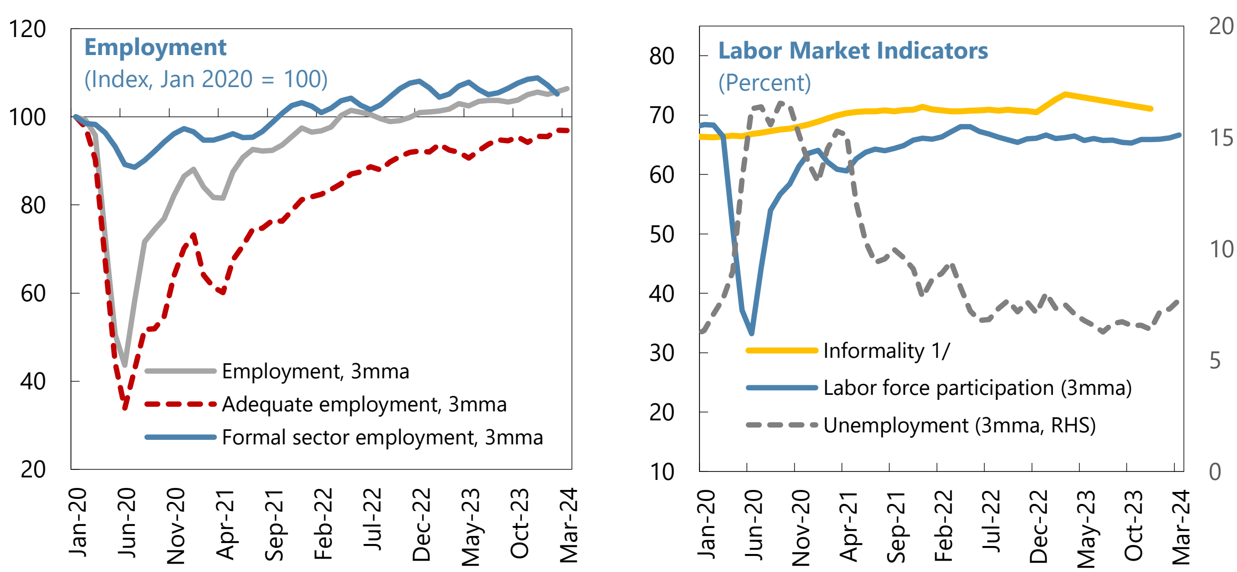
Staff analysis estimates a significant impact from the 2023 *El Niño Costero* on sectoral GDP (fisheries and agriculture) and the primary fiscal balance. Empirical estimates suggest that historical instances of strong/very strong *El Niño Costero* events on average resulted in 70 percent lower production in fisheries and 11 percent lower in agriculture, within a year of the onset of the event. Fiscal reaction resulted in a deterioration of the primary balance of about 2 percent of GDP during the same period. Consistent with these estimates, the ongoing *El Niño Costero* has so far disrupted two fishing seasons, lowered agricultural yields in the highlands and along the coast, and impaired construction and manufacturing activities. In March-December 2023, fishing and agriculture output were 27.3 and 4.9 percent below trend, respectively. Meanwhile, construction and manufacturing output were 9.2 and 6.6 percent lower, respectively.

***El Niño Costero* leads to higher headline inflation, with a potential pass-through to core inflation.** Based on staff estimates, past *El Niño Costero* events increase headline inflation during the first year of a strong/very strong event, with a possible pass-through to core inflation in the second year. Notably, non-core food inflation steadily increases at the start of *El Niño Costero*, peaking at an increase of 8.1 percentage points (p.p.) after eleven months. Meanwhile, core food inflation increases by 2.3 p.p. in the second year after the shock. Consistent with staff estimates, the ongoing *El Niño Costero* triggered temporary spikes in CPI inflation for the *Fish and Seafood* component (11 p.p. increase between February and June) and the *Fruits* component (22.6 p.p. increase between February and September). By the end of 2023, inflation rates for these categories fell.



Sources: BCRP, Haver Analytics, Apoyo Consultoría.

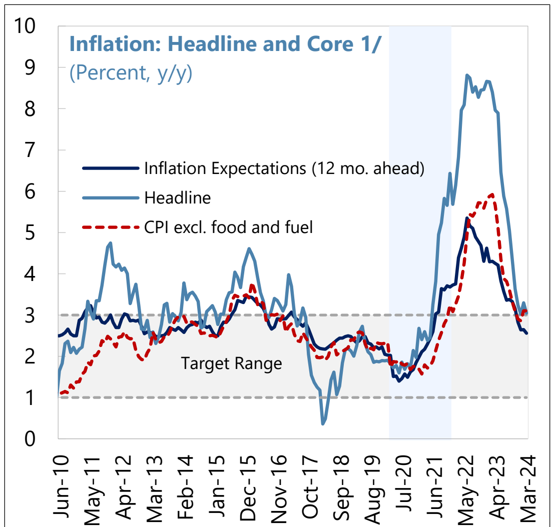
4. There remains slack in the labor market. Despite negative GDP growth, the unemployment rate fell from 7.1 percent at end-2022 to 6.4 percent at end-2023, as employment grew amid a slight decline in labor force participation. However, unemployment increased to 7.7 percent in March 2024. Informality declined in 2023, but the adequate employment rate remains below pre-pandemic levels.[3] Real wage growth averaged -3.4 percent y/y and was negative until October 2023.



Sources: INEI, BCRP and Haver Analytics.
Note: All series refer to Metropolitan Lima except for informality and formal sector employment which are national.
1/ In 2023, the EPEN replaced the ENAHO as the source for the INEI's official labor force statistics at the national level, with slightly higher estimates for informality.

[3] Adequate employment is defined as workers who a) work 35 hours or more per week and earn above a minimum reference income or b) work fewer than 35 hours per week, but do not wish to work more.

5. With inflation decelerating rapidly following decisive monetary policy tightening, the BCRP initiated an easing cycle in September 2023. After a temporary increase in early 2023, due to supply shocks related to social unrest, an avian flu outbreak, and adverse climate-related shocks, headline and core inflation rapidly declined towards the target band, reaching 3.0 percent y/y and 3.1 percent y/y in March 2024, respectively.[4] Inflation expectations also declined, in line with the disinflation, reaching 2.6 percent in March 2024. In the context of falling inflation and weak growth, the BCRP lowered its policy rate from 7.75 percent to 6.00 percent between September of 2023 and April of 2024 (with seven 25bps reductions and a pause in March 2024).[5]



Sources: INEI, BCRP, Haver Analytics.
1/ Data covers the Metropolitan Lima area. The shaded area refers to the COVID-19 pandemic shock.

6. The fiscal position remained strong in 2023. Reflecting a shortfall in tax revenues,[6] due to the economic slowdown, the fiscal deficit (of the non-financial public sector) reached 2.8 percent of GDP in 2023 (above the fiscal rule target of 2.4 percent of GDP).[7] Although pandemic-related measures expired, they were replaced by new stimulus programs (*Con Punche 1 and 2*) and climate-related spending (for the reconstruction after Cyclone Yaku and in preparation for an unusually strong rainy season—from December 2023 until March 2024—due to *El Niño*). Public debt moderated to 32.1 percent of GDP in 2023 (from 33.9 percent of GDP in 2022), with public assets amounting to 10.5 percent of GDP.

Nonfinancial Public Sector Fiscal Balance

	2022	2023
Revenues	**26.9**	**23.9**
Taxes	17.2	15.1
Other	9.7	8.8
Expenditures	**27.0**	**25.0**
of which stimulus:	1.4	1.5
Current	20.5	19.3
Capital	6.5	5.7
Interest	1.6	1.7
Overall Balance	**-1.7**	**-2.8**

Sources: BCRP, Ministry of Finance, and IMF staff estimates.
Note: In percent of GDP.

7. The financial sector remains sound. Despite headwinds from *El Niño* and political turmoil, banks remain sound with adequate capital, liquidity, and profitability.[8] However, due to the growth slowdown, real credit from deposit corporations contracted by 2.0 percent in 2023, reflecting tight financial conditions, weak credit demand, and a

[4] The main impact of the avian flu and adverse weather was on food inflation which increased to 15 percent y/y in January 2023 and did not fall below 10 percent y/y until September 2023.

[5] In March 2024 the reserve requirement ratio in domestic currency was lowered to 5.5 percent (from 6.0 percent) effective in April.

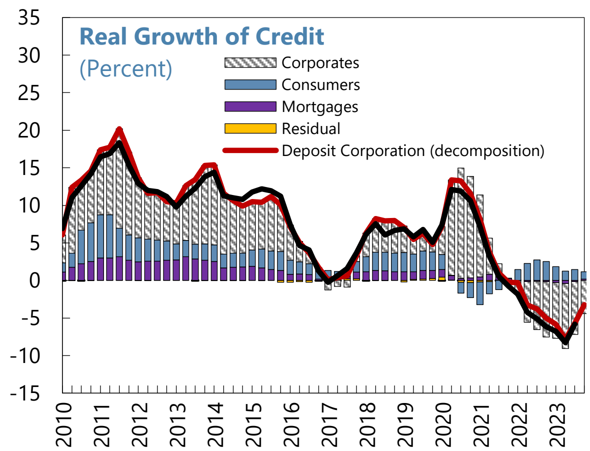
[6] The fall in tax revenues was equally split between income taxes and VAT.

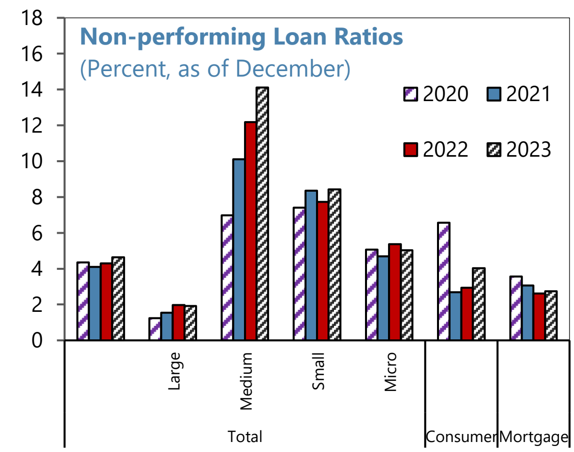
[7] The government transferred in November about 0.1 percent of GDP in profits from the public bank.

[8] At end-2023, total regulatory capital ratio and common equity Tier1 capital ratio of the financial system stood at 16.3 and 13.1 percent, well above the minimum requirements under the fully implemented Basel III framework. The liquidity coverage ratio (LCR) stood at 167 percent in local currency and 140 percent in foreign currency, above the

(continued)

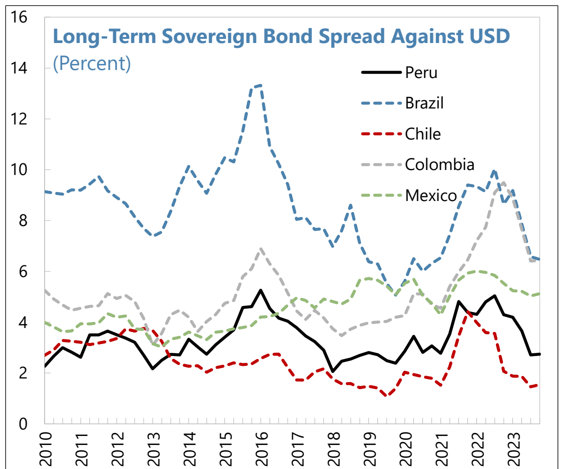
tightening of lending standards in small regional credit institutions, amid the unwinding of government credit support measures. Asset quality deteriorated accordingly, with the NPL ratio reaching 4.5 percent in 2023, driven by loans to small- and medium-sized businesses.[9] Deposit institutions appropriately increased their provisions to cover more than 100 percent of NPLs, reducing their profitability somewhat.[10]





Sources: BCRP, Haver Analytics, SBS

8. Financial market volatility has stabilized in line with global trends. Since late 2022, stock prices have continued a moderate recovery and volatility has declined. As in other Latin American countries, the ER appreciated slightly in 2023, driven by the expectation of lower policy rates in the U.S. However, in February 2024, market's expectation of a narrower interest rate differential vis-à-vis the U.S. pressured the exchange rate (ER). The cost of government funding declined, with the long-term sovereign yield at 7.2 percent in the fourth quarter of 2023 compared to 8.1 percent in the same quarter of 2022, consistent with lower U.S. long-term yields. Although the level of the long-term interest rate remains elevated compared to the pre-pandemic period, reflecting higher risk premia due to political uncertainty, sovereign spreads remain among the lowest in the region.



Sources: BCRP, Banco Central de Chile, Haver Analytics, Tullett Prebon Information.
Note: Sovereign bond spread calculated as the difference between 10 year sovereign bond yield minus that of the United States.

100 percent of the global minimum requirement under Basel III. The return on equity stood at 13 percent, slightly below the pre-pandemic level.

[9] Small- and medium-sized enterprises in the northern region were severely affected by *El Niño*.

[10] Despite the headwinds, Peru's financial system remains highly profitable compared to other LA5 peers. For example, ROE is second highest among LA5 countries (as of the third quarter of 2023).

9. Peru's 2023 external position was moderately stronger than the level implied by medium-term fundamentals and desirable policies (Annex II).[11] Led by sizable import compression, amid subdued private demand and lower non-resident profits, the current account balance increased (by around 4.6 p.p. of GDP) to a surplus of 0.6 percent of GDP in 2023.[12] Peru's terms of trade improved by about 5 percent in 2023, as import prices, especially the prices of refined oil products, declined more than export prices. The services trade deficit narrowed as freight costs declined in tandem with lower import demand, and tourism-related revenues started rebounding from the low levels during the pandemic. Nevertheless, the currency remained broadly stable and international reserves remained at a comfortable level at end-2023 (US$71.3 billion or 233 percent of the ARA metric, compared to US$72.2 billion at end-2022 or 240 percent of the ARA metric).

A BROADLY BALANCED OUTLOOK

10. A modest rebound is expected in 2024 with growth converging towards its potential over the medium term. A moderate *El Niño Global* and a weak *El Niño Costero* are expected to continue until early April 2024, which will constrain the recovery in the first half of the year.[13] A strong recovery in agriculture and fishing, continued momentum in mining, and a looser monetary policy stance would support a rebound in the second half of 2024. However, only a moderate recovery in private consumption and private investment growth is expected, as nominal wages regain their purchasing power and elevated political uncertainty continues to weigh on both consumer and business confidence. Consequently, real GDP is projected to grow at 2.5 percent in 2024 and a negative output gap is expected to continue until 2026. The current account is envisaged to return to a deficit of 1.1 percent of GDP in 2024 as growth normalizes and to stabilize at 1.5 percent of GDP in the medium term, with external financing and debt rollover risks remaining low. Credit growth is expected to rebound modestly, with a timid positive feedback effect on the real sector. As the effects from *El Niño* dissipate, inflation would rapidly decline towards the midpoint of the target band, aided by a negative output gap and the normalization of supply shocks, as the BCRP continues with its cautious easing cycle.

11. Evolving risks are broadly balanced, and Peru has ample buffers to cope with adverse shocks, although the outlook remains uncertain. In the short term, key domestic risks include an intensification of political uncertainty, social unrest, and climate-related shocks which could derail the recovery and necessitate fiscal support. Key external risks comprise weak trading-partner growth, commodity price volatility, and a sharp tightening of global financial conditions which could create

[11] The evaluation of the external sector is based on the actual current account balance in 2023. The difference between the estimated cyclically adjusted current account balance for 2023 (-0.2 percent of GDP) and the current account norm from the multilateral model (-1.4 percent of GDP) yields a current account gap of 1.3 percent of GDP. Thus, the assessment of the external position is "moderately stronger than implied by fundamentals."

[12] Also supported by a slight improvement in the terms of trade, lower investment income outflows amid softer export prices, a higher services balance, and worker remittance inflows.

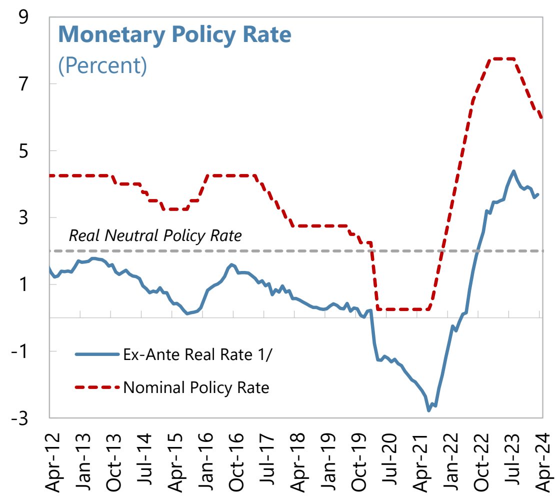
[13] Projections are based on the March 15, 2024 communication from ENFEN, which indicates that *El Niño Costero* will likely continue until March 2024 with a weak intensity. *El Niño Global* is likely to continue until April 2024 displaying a moderate intensity in March before dissipating by the end of April.

inflationary pressures and weigh on growth (Annex III). On the upside, a stronger recovery in confidence could support stronger private consumption and investment growth. Peru's proven macroeconomic resilience is reinforced by very strong buffers including relatively low public debt, abundant international reserves, and access to international capital markets on favorable terms.

ENSURING A RESILIENT AND INCLUSIVE RECOVERY

A. Managing the Monetary Policy Easing Cycle

12. The BCRP's data-driven monetary policy easing remains appropriate. The BCRP's decisive monetary tightening was successful in containing inflationary pressures (the real ex-ante policy rate stood at 3.4 percent in April 2024, substantially above the estimated real neutral rate of 2 percent). With inflation converging towards the middle of the target band and with anchored inflation expectations, additional data-dependent monetary policy easing is appropriate. As upside risks to inflation from *El Niño* dissipate, the easing cycle could resume to further support weak economic growth. However, the pace of easing might be constrained by the U.S. policy rate (which could remain higher for longer), as a smaller policy rate gap could pressure the ER.



Sources: Haver Analytics; IMF Staff Calculations.
1/ Calculated on the basis of headline inflation expectations.

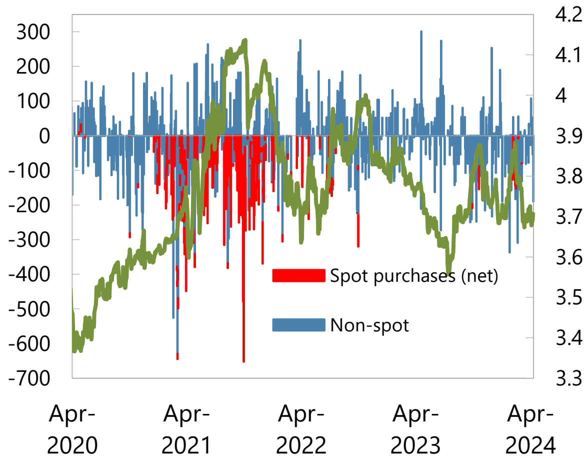
13. Given the decline in dollarization and limited open FX positions, the BCRP should continue to allow for ER flexibility. Financial stability risks from FX mismatches have diminished, thanks to a decline in dollarization and limited unhedged FX positions.[14] The BCRP's FX operations in 2022-23 were mostly to maintain its stock of derivative positions, except for the intervention in February 2024 (both in the spot and forward markets) in response to pressures arising from market's expectation of a rapidly narrowing interest rate differential vis-à-vis the U.S.. Going forward, with the interest rate differential against the U.S. expected to narrow further, greater ER flexibility would allow for a faster economic recovery through current account adjustment. Staff estimates, using the IMF's quantitative integrated policy framework (QIPF) model under a scenario of a higher foreign monetary policy shock, show that allowing ER depreciation could deliver the fastest economic recovery,

[14] See Annex VI of the Staff Report for 2023 Article IV Consultation.

compared to the case where foreign exchange interventions (FXI) is used to contain ER fluctuations (Annex V).[15]

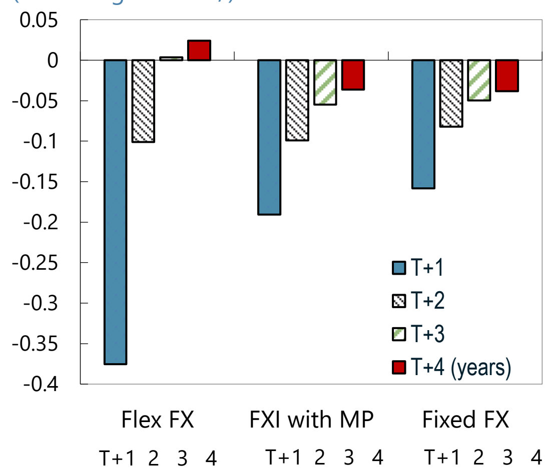
Foreign Exchange Intervention by BCRP

(LHS = Millions USD) (RHS = Soles/USD)



Impact of Foreign Policy Rate Shock on Output

(Percentage Point 1/)



Sources: BCRP, Haver Analytics, IMF Staff.

1/ Horizontal axis represents years passed after the shock. The size of the shock is rescaled so that it depreciates ER by five percent in the first year under Flex FX.

14. FX-targeted macroprudential measures could further support de-dollarization. Credit dollarization significantly declined, from around 50 percent in mid-2013 to 24 percent in 2022, partly aided by macroprudential tools such as a higher reserve requirement for foreign currency-denominated liabilities of financial institutions. More recently, the de-dollarization momentum has stalled,[16] with dollarization concentrated in holdings of unhedged FX credit by medium-sized firms and largely hedged large-sized firms. The authorities could consider FX-targeted macroprudential measures to facilitate de-dollarization, such as introducing additional capital buffers or higher risk weights for borrowers' unhedged FX exposures,[17] and maintaining sufficiently higher reserve requirements for foreign currency relative to domestic currency.

[15] See Chen et al. (2023) for details of the model. The model was estimated with the data in Peru, reflecting the relevant frictions such as ER volatility due to UIP premium and adaptive inflation expectations. The simulation analysis compares the reaction of the GDP gap under three FX policy regimes (Flex FX, FXI with monetary policy=MP, and Fixed FX) against a shock to foreign monetary policy. Flex FX represents a case where no FXI is used and ER moves freely in reaction to the shock, FXI with MP represents a case where the central bank intervenes in the FX market and ER changes moderately, Fixed FX represents a case where ER is completely fixed. The Flex FX (Fixed FX) is simulated by adding a shock to FXI that offsets the endogenous effect of the shock on FXI (ER). The size of the shock is scaled so that it depreciates the ER by five percent in the first year under Flex FX.

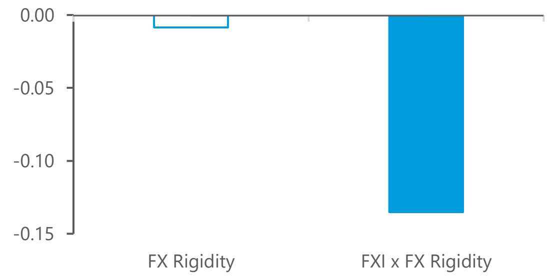
[16] This is partly because of the fluctuation of the USD/Sol rate. However, the increase of the reserve requirement for loans with local currency in 2022 could also be related, as it reduced the relative cost of financing denominated in USD.

[17] The SBS has introduced an 8 percent capital surcharge for FX-denominated loans when calculating Basel III capital ratios, in line with 2018 FSAP recommendation. More recently, the SBS published a regulatory proposal in February in

(continued)

15. Allowing greater ER flexibility and removing tax hurdles could foster greater private sector participation in the FX derivative market and allow for additional hedging opportunities. Peru's FX derivative market is the most underdeveloped compared to other LA5 countries, with an average daily turnover of less than 1 billion USD of (about 0.3 percent of GDP) in 2022.[18] The conservative tax treatment of hedging instruments held by the private sector could be contributing to low turnover in the FX derivative market.[19] Staff estimates also suggest that turnover in the FX derivatives market is lower when FX volatility is lower. By reducing the reliance on FXI to allow for a more flexible ER, Peru could incentivize foreign financial institutions to enhance hedging alternatives (Annex V).

Effect of FX Intervention and FX Rigidity
(Contribution of one standard deviation change to FX derivative turnover, percent of GDP)



Sources: Adler et al (2022), BIS, IMF, IMF staff calculations.
Note: Bars represents the effect of +1 standard deviation change. FXI x FX Rigidity (blue bar) is significant at the 5 percent level. FX=Foreign Exchange, FX rigidity is the inverse of realized volatility.

B. Preserving Fiscal Sustainability

16. The authorities remain committed to preserving fiscal sustainability. The 2024 Budget envisages a deficit of the non-financial public sector of 2 percent of GDP, consistent with the fiscal rule. While the required adjustment is within reach, it relies on unidentified measures to reduce current spending beyond recently announced measures,[20] and a potentially optimistic growth projection. Given substantial available fiscal space, if lingering effects from the shocks in 2023 lead to lower-than-expected revenues, delaying the consolidation by one year (which implies setting a fiscal target for 2024 of 2.5 percent of GDP instead of 2.0 percent) would be preferable to support growth and lessen the risk of missing the target again.[21] New tax benefits and unfunded spending initiatives by Congress would also jeopardize attaining the target. Recent announcements to restructure the governance of Petroperu are steps in the right direction, but further financial support should be

which higher risk weights could be imposed for unhedged FX loans, where financial institutions, multilateral agencies and firms with dollar-denominated revenues are assumed to be naturally hedged.

[18] Adjusted for local interbank double counting (net gross basis) as defined by BIS (2022) "Triennial Central Bank Survey of foreign exchange and Over-the-counter (OTC) derivatives markets in 2022".

[19] Market participants argue that profits that result from derivative positions should not be taxable as these are hedges done for insurance purposes and not for profit. Authorities are cognizant of these arguments but note that different treatments would require a change in the tax code.

[20] An emergency decree was issued in March 2023, establishing extraordinary measures to improve the efficiency of public expenditure and fiscal sustainability.

[21] In other words, staff's more conservative growth scenario leads to a higher fiscal deficit than envisaged in the Budget and staff recommends making use of the available fiscal space to avoid policy changes (expenditure cuts) to compensate for the shortfall.

conditional on the viability of the firm.[22] Public financial management reforms could further support consolidation plans via improved spending efficiency.[23]

Non-Financial Public Sector
(Percent of GDP)

	2022	2023		2024 1/ 2/			2025			2026			2027		
	Baseline	Budget	Baseline	Budget	Baseline	Staff Advice	Budget	Baseline	Staff Advice	Budget	Baseline	Staff Advice	Budget	Baseline	Staff Advice
	(Percent of GDP)														
Revenues (GG)	**22.0**	**20.4**	**19.7**	**20.5**	**20.0**	**20.2**	**20.6**	**20.1**	**20.5**	**20.6**	**20.1**	**20.7**	**20.6**	**20.1**	**20.9**
Taxes	17.2	15.8	15.1	15.9	15.3	15.5	15.9	15.4	15.8	15.9	15.4	16.0	15.9	15.4	16.2
Other	4.8	4.6	4.6	4.7	4.7	4.7	4.6	4.7	4.7	4.7	4.7	4.7	4.6	4.7	4.7
Primary Expenditure (GG)	**22.0**	**21.2**	**20.9**	**20.9**	**20.9**	**20.8**	**20.5**	**20.5**	**20.7**	**20.0**	**19.9**	**20.5**	**20.0**	**19.3**	**20.1**
Current	15.9	15.6	15.6	15.2	15.6	15.5	14.6	15.2	15.4	14.1	14.6	15.2	14.0	14.0	14.8
Capital	6.1	5.6	5.3	5.8	5.3	5.3	5.9	5.3	5.3	5.9	5.3	5.3	6.0	5.3	5.3
Primary Balance (GG)	**0.0**	**-0.8**	**-1.2**	**-0.4**	**-0.9**	**-0.6**	**0.1**	**-0.4**	**-0.2**	**0.6**	**0.2**	**0.2**	**0.6**	**0.8**	**0.8**
Interest	1.6	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.8	1.7	1.7	1.8	1.7	1.7
SOEs Net Operating Balance	-0.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.1	-0.1	-0.1
Overall Balance (NFPS)	**-1.7**	**-2.4**	**-2.8**	**-2.0**	**-2.5**	**-2.2**	**-1.5**	**-2.0**	**-1.8**	**-1.0**	**-1.5**	**-1.5**	**-1.0**	**-1.0**	**-1.0**

Sources: Ministry of Finance and staff estimates.
Note: General Government (GG), Non-Financial Public Sector (NFPS). Differences in the projections reflect different macro frameworks and the assumed speed of fiscal consolidation. Compared to the budget, the baseline projection shows the effect of more conservative assumptions with unchanged policies. Staff advice shows a more balanced consolidation with policy changes to mobilize revenues.
1/ The 2024 Budget was approved before the 2023 outturn was observed.
2/ The baseline projection assumes an underexecution of public investment consistent with history.

17. Revenue mobilization measures could strengthen fiscal consolidation plans in the medium term. The fiscal deficit is set to gradually decline by 0.5 percent of GDP per year to reach a deficit of 1 percent of GDP by 2026. This consolidation allows for a gradual reduction in the debt ratio to comply with the debt ceiling of 30 percent of GDP, which becomes binding in 2032. To achieve these targets, a more balanced composition of the planned fiscal consolidation is preferable given Peru's relatively low tax burden. To increase revenues, the authorities could consider environmental taxes; expanding taxes to the digital economy; homogenizing the rates of capital and labor income; and curtailing sectoral tax benefits, special regimes, and other tax expenditures. Personal income tax revenues (of about 1.7 percent of GDP) are modest, partly due to low tax rates, but also because of the high income thresholds that effectively exempt the majority of formal workers. The authorities' plans to improve tax administration and compliance are important, but will likely require additional resources for the tax authority.[24]

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[22] The government selected a new board for Petroperu and announced that a selection process would begin to also change the heads of various divisions and managers.

[23] FAD has a 3-year PFM project, aligned with the OECD ascension roadmap, focused on: (i) strengthening the institutional capacity of the main public finance areas; (ii) deepening the identification, analysis, management, and disclosure of fiscal risks; and (iii) improving assets and liabilities management at the Treasury.

[24] Tax administration and compliance have significantly improved in recent years (aided by the introduction of electronic invoicing, a digital tax registry, notices of tax due, leveraging of big data tools, and enhanced use of treaties to exchange taxpayer information). However, the tax administration has lost about 1/3 of its staff over the past decade and has lost critical funding for IT improvements, and their salaries could be better aligned with those of other supervisory institutions such as the BCRP and Financial Regulator. To this end, the modernization of the Fiscal Tribunal

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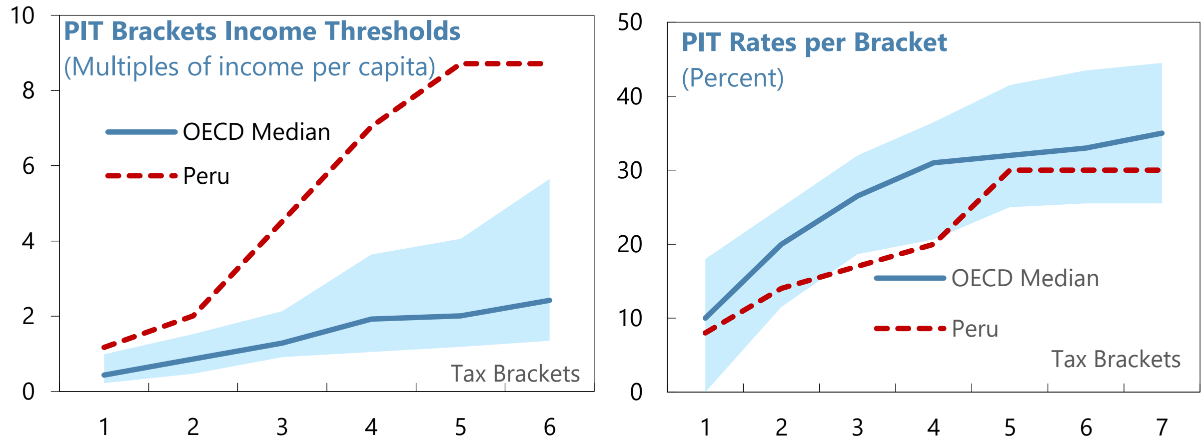

Sources: OECD and staff estimates
Note: Shaded area corresponds to the 25th and 75th percentiles.

18. Improving fiscal policy guidance could also bolster fiscal policy credibility. Looking forward, analyzing the optimality of the medium-term fiscal target, debt ceiling, expenditure growth limit, and liquidity buffers is necessary to ensure they are attainable, represent an effective anchor for fiscal sustainability, and provide adequate liquidity buffers. The opinion of the Fiscal Council (FC), on both the Budget and Mid-term Budget Update, and the response from the Ministry of Finance should be included as annexes in official documents as this practice greatly enhances the communication and quality of the technical debate.[25] The FC should have regular hearings before Congress, be allowed greater operational independence, and undergo a peer review.

19. Public debt is assessed to be sustainable with a high probability (Annex IV). Over the medium term, public debt is expected to gradually decline towards the debt ceiling, while gross financing needs would average 4.0 percent taxof GDP over the forecast horizon. The impact from higher interest rates is muted, given that around 84 percent of public debt has fixed interest rates with an average duration of about 14 years. Approximately 50 percent of public debt is denominated in local currency. Roll-over risks are low, and highly liquid assets of about 9 percent of GDP indicate a considerable cash buffer.

20. A long-awaited pension reform is urgently needed to address low coverage and adequacy and to prevent new rounds of early withdrawals from the private pension scheme.[26] Reform proposals are being considered by Congress with noteworthy features, such as expanding the minimum and social pension to protect the bottom of the income distribution, automatic enrollment, limiting early withdrawals from private pension accounts, and periodic assessment of

would be essential not only to speed the resolution of tax disputes and make the system more efficient and fairer, but also to dissuade litigation as an effective strategy to reduce the real cost of tax payments.

[25] The opinion of the Fiscal Council and the response from the Ministry of Finance are already included in the Budget but not in the Mid-term Budget Update. The Ministry does not respond to enquiries made by the Fiscal Council in public communications.

[26] Coverage as share of working age population contributing is less than 20 percent compared to a LAC average of 45 percent.

parameters.[27] Fine-tuning the proposed measures would maximize their impact, by: (i) clarifying the language limiting early withdrawals from private pension savings accounts; (ii) aligning the eligibility criteria for the minimum pension to avoid shrinking the pool of potential beneficiaries; and (iii) improving the targeting mechanism of the non-contributory pension. Staff calculations show that broadening the coverage of poor elderly and higher benefit amounts would substantially reduce old-age extreme poverty with a limited increase in fiscal costs (Box 2). Over the medium term, a comprehensive reform of the system is required to fully address the very low coverage and inadequate income support that it provides to the elderly (Annex VII). Early withdrawals from the private pension scheme are ill advised, as they undermine old-age income support and the functioning of the domestic capital market.[28]

Box 2. Peru: Welfare Impact and Costing of the Pension Reform

Given high informality and the lack of meaningful income support for the elderly, non-contributory pensions are the single most important source of old-age economic security in Peru. To improve the effectiveness of the non-contributory pension (Pensión 65) in reducing (extreme) poverty, staff analysis compares the current situation with three scenarios: (i) improved targeting, (ii) the authorities' proposal of broadening coverage of poor elderly while excluding poor pensioners affiliated with other earnings-related schemes, and (iii) a staff recommendation of broader coverage of poor elderly (without excluding poor pensioners affiliated with other earnings-related schemes) with a higher benefit amount (Annex VII).

Improving the targeting of the social pension is essential. Poor targeting results in less than 10 percent of poor elderly being covered, and low benefits do not meaningfully affect incomes. With improved targeting, the coverage of poor elderly would increase by 7 percentage points without additional cost.

Social Pension Reform Scenarios

	Current	Improved Targeting	Authorities' Proposal	Staff's Recommendation
Coverage of elderly, in thousands	626	626	795	826
(% of 65+ population)	*16.2*	*16.2*	*20.6*	*21.3*
Coverage of poor elderly, in thousands	357	626	454	476
(% of 65+ population)	*9.2*	*16.2*	*11.7*	*12.3*
Coverage of non poor elderly, in thousands	269	0	341	349
(% of 65+ population)	*6.9*	*0.0*	*8.8*	*9.0*
Benefit amount, Soles per month	125	125	125	226
(% of extreme poverty line)	*55.3*	*55.3*	*55.3*	*100.0*
Fiscal cost, in soles (billion)	0.94	0.94	1.19	2.24
(% of GDP)	*0.10*	*0.10*	*0.13*	*0.24*
Extreme poverty rate, in percent of 65+ pop.	4.23	3.30	3.40	1.83
Poverty rate, in percent of 65+ pop.	22.01	21.45	21.50	18.15

Source: Staff calculations based on the 2022 household survey.

The welfare impact of broadening coverage and adequacy is large with only limited costs. The authorities' proposal expands the social pension coverage of the poor by 2.5 percentage points, which implies that about 88 percent of poor elderly would remain uncovered. A greater poverty impact could be achieved by spending 0.24 percent of GDP to increase both the coverage and the benefit amount.

[27] PL N° 06120/2023-PE (congreso.gob.pe)/.

[28] In April 2024, Congress approved a seventh withdrawal from private pension funds (to be paid in four installments starting in June), of up to 4 UIT (about 5,700 USD).

C. Enhancing Financial Sector Resilience

21. Although systemic risk remains limited, the authorities should continue to closely monitor and proactively contain financial vulnerabilities from the growth slowdown. Banks remain profitable, with ample liquidity and capital buffers.[29] As the economy starts to rebound, NPLs are expected to gradually decline. The regulator should remain vigilant of pockets of vulnerability in the retail sector, particularly in small financial institutions (which were relatively more affected by weak economic growth). The regulator's latest top-down stress tests suggest that the banking system would remain sound even under adverse scenarios.[30]

22. Peru's financial system should continue to maintain liquidity cushions against pension withdrawals. Between 2020-24, Congress approved seven rounds of withdrawals from private pension funds (AFPs). Cumulative withdrawals until 2022 reached 9.4 percent of GDP, substantially reducing accumulated savings to only 11.2 percent of GDP in December 2022. The recently approved seventh withdrawal could result in outflows of up to 3 percent of GDP (about ¼ of assets under management). To insure against recurrent withdrawals, AFPs have increased their portfolio allocation towards more liquid assets and with shorter maturity, which affects their profitability.[31] In addition, the BCRP has installed a facility to provide emergency liquidity to AFPs to help them cope with the withdrawals. The recent liquidity stress test conducted by the financial authority shows that deposit corporations can cope with a substantial withdrawal of deposits from AFPs.[32] These liquidity cushions should be maintained in case of further pension withdrawals.

23. Fully operationalizing new regulations and closing remaining gaps will enhance financial resilience. Most institutions already comply with Basel III capital requirements, ahead of the deadline. The new resolution on counter-cyclical policies, including counter-cyclical capital buffers (CCyB) and counter-cyclical provisioning, becomes effective in June 2024, but is unlikely to be activated soon.[33] The authorities should revise the activation threshold and consider adopting a rule that is based on an indicator that better reflects the financial cycle, such as credit-to-GDP gap.[34] Recovery plans for domestic systemically important banks have been submitted for review and should be later extended to the financial group level. The authorities should build on their success in enhancing financial inclusion (Box 5) and continue lowering barriers to entry for Fintech providers,

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[29] Peru's financial system is highly concentrated in the banking sector. 17 banks dominate the financial system with almost 87 percent of total financial sector assets.

[30] The severest liquidity stress scenario replicates a shock observed in Argentina in early 2000 (that has never been observed in Peru), which imposes substantial stress on sovereign bonds.

[31] The share of investment abroad fell from 43.4 percent in 2021 to 36.9 percent in 2022, and the weight of fixed income in domestic assets increased from 27.9 percent to 32.1 percent.

[32] The deposits withdrawn from pension funds could revert to banks as retail deposits, with little impact on system-wide liquidity. The authorities' liquidity stress test scenario is more conservative as it does not include this positive reintermediation effect.

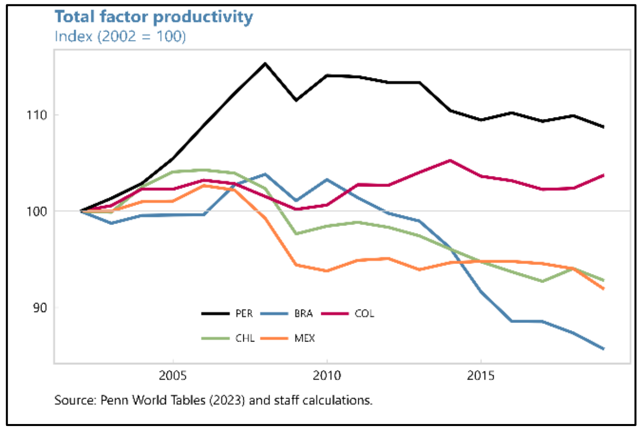
[33] These policies are activated when the 30-month historical average GDP growth exceeds a 4 percent threshold, which is substantially higher than current potential growth estimates of only 2.3 percent.

[34] Operationalizing the CCyB is also important for fully implementing Basel III, as recommended by the 2018 FSAP.

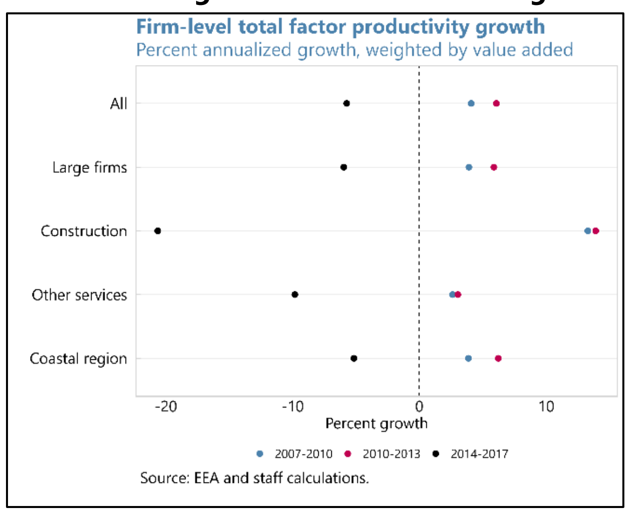
while maintaining appropriate risk-based regulation, continuing to enforce interoperability regulations, and introducing frameworks for Open Banking and Finance.[35]

D. Lifting Productivity and Boosting Resilience

24. Structural reforms are urgently needed to revive growth. Growth has disappointed since 2014 with average and potential growth falling to about 2.3 percent (from a 6 percent average in the previous decade). The decline in potential growth has been driven by a slower pace of investment and human capital accumulation, but most notably by a decline in the growth of total factor productivity. While Peru's high productivity growth between 2002-2013 coincided with a commodity price boom, this was concurrent with significant reforms that stimulated private investment and allowed the non-mining economy to expand and become more productive.[36] Without structural reforms, Peru risks losing the opportunity to restore confidence and raise productivity to ensure broad and inclusive growth.



25. Policies to boost productivity should focus on removing constraints for firms to grow. Since 2014, in line with macroeconomic trends, firm-level productivity has worsened. The decline has been broad based across firm size, region, and industry. Notably, productivity growth has been stagnant to negative in sectors of the economy that were historically most productive—large firms, firms in the coastal region, and firms in the service and construction sectors. Staff analysis finds that reforming special corporate tax regimes and labor legislations and regulations could remove barriers for firms to formalize and productivity



[35] The BCRP is exploring digital money in the context of deepening financial inclusion. In this context, the BCRP released a regulation (CIRCULAR NO 0011-2024-BCRP) on April 16, 2024 to specify the activities to be conducted as part of the BCRP's Digital Money Innovation Pilots, which are designed to test and evaluate alternative digital money models. The planned one-year Pilot intends to create the conditions to evaluate the performance of companies that offer innovative digital payment services. Such services are aimed at expanding access to digital payments, mainly in rural areas, particularly those with limited or without access to the internet. At the end of the Pilot, the BCRP will assess its success and potentially amend regulations to enable digital money services.

[36] These include a revamp of the macroeconomic policy framework (the introduction of inflation targeting and fiscal rules); trade and financial liberalization reforms; improvements in infrastructure; reforms in healthcare, education, civil service, pensions, and taxes; and development of the mining, agriculture, and tourism sectors (IMF, 2022; Ortiz and Winkelried, 2022; Vostroknutova et al., 2015).

growth (Box 3). These efforts would also reduce regulatory uncertainty and promote investment. Down the line, introducing greater labor market flexibility could help workers transition to more productive sectors and reduce labor informality.

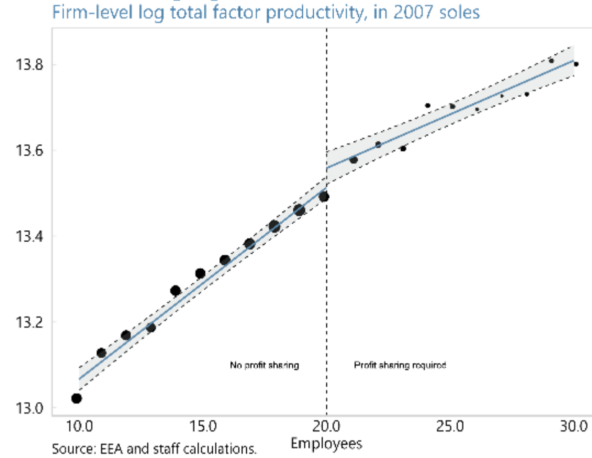
Box 3. Peru: Barriers to Firm and Productivity Growth[1]

The design of labor and tax legislations and regulations have created barriers to firm (and productivity) growth and formalization. Since 2014, Peru has experienced declining productivity growth, with worsening firm-level productivity in the formal sector and persistently high firm informality (which tends to be tightly linked with lower productivity). Legislations and regulations implemented with eligibility thresholds can create distortions that potentially affect productivity as follows:

- *Incentivizing firms to remain small or informal*. For example, staff analysis of the employee profit-sharing law, using a regression discontinuity design with data from Peru's Annual Economic Survey (EEA), shows a large mass of firms with just less than 20 employees (who are not subject to the profit-sharing law) and that these firms are about 40 percent less productive than firms with just above 20 employees.

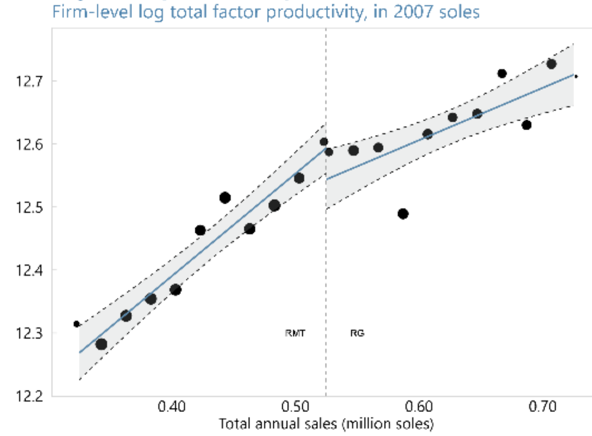
- *Imposing non-linear costs on firms*. For example, moving between various special corporate tax regimes in Peru can increase business tax liability by 30 to 50 percent. The existence of numerous tax regimes also increases compliance and administrative costs and opportunities for tax arbitrage. Staff analysis of the *Regimen Especial del Impuesto de la Renta* (RER), using a regression discontinuity design, shows that the higher tax rate and accounting obligations that firms face have distorted productivity, with firms just within the *Regimen General* (RG) about 40 percent less productive than firms just within the RER.

Profit-sharing regulation
Firm-level log total factor productivity, in 2007 soles



Source: EEA and staff calculations.

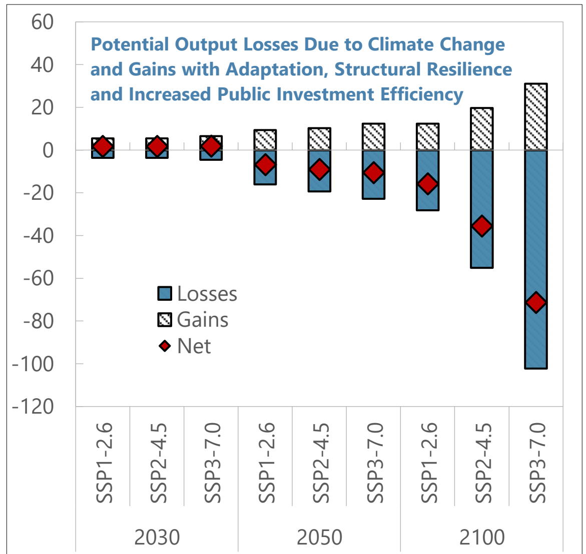
Regimen Especial del Impuesto de la Renta
Firm-level log total factor productivity, in 2007 soles



Source: EEA and staff calculations.

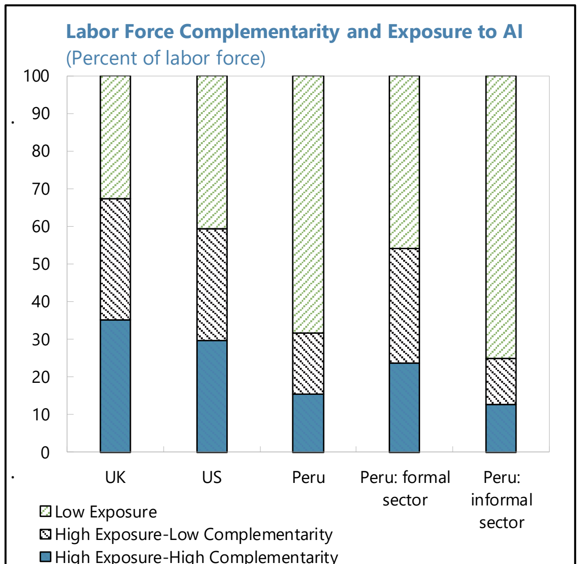
[1] Prepared by Moya Chin and Daria Kolpakova. See more details in the accompanying Selected Issues Paper "Productivity and Growth in Peru."

26. Given Peru's high vulnerability to climate change, increased efforts in building resilience are needed to unlock large potential output gains. Climate change will likely increase damages from natural disasters and undermine potential growth in the future. The authorities put in place a legal framework for climate change in 2018 and have two national plans on climate adaptation and disaster risk management (PLANAGERD 2022-2030 and Plan Nacional de Adaptación del Perú). They have made progress in enhancing public infrastructure, bolstering financial resilience, and identifying adaptation gaps.[37] The establishment of the National Infrastructure Agency (ANIN) in 2023 will take over a fraction of investment projects from subnational governments, to strengthen structural resilience of public assets. Nevertheless, climate spending remains low, budget planning lacks adequate costing of key adaptation measures, and territorial planning should be strengthened. Scaling up investments in climate adaptation and resilience would unlock significant potential output gains and fiscal savings over the long term (Box 4). A recent government initiative to develop a three-year multisectoral plan to address risks of intense rainfall and floods, shifting the focus to ex-ante resilience building to climate change, is a positive step.



Sources: IMF staff calculation using the FGG model, Massetti and Tagklis (2023), Harris et al. (2020), and Chirinos (2021).

27. Digital technologies and artificial Intelligence (AI) present an opportunity to increase productivity in the formal economy and lower informality. While Peru's overall labor force exposure to AI is relatively low, exposure to AI in the formal sector is comparable to that of advanced economies. High exposure is crucial to motivate businesses to integrate AI. Staff simulations show that fully embracing the AI revolution would increase long-term growth, especially in the financial, government, education, health, IT, and construction sectors. However, it will be crucial to encourage workers to develop skills for integrating AI into their work to facilitate the labor force transition (Box 5). Current advancements in the use of technology within the financial sector (FinTech) and the government sector (GovTech) are encouraging.



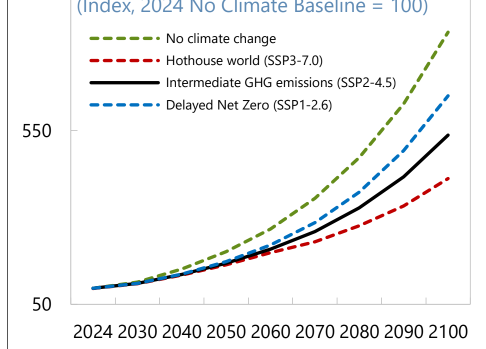
Sources: ILO; Peru ENAHO; Pizzinelli et al. (2023); IMF staff calculations.

[37] Recent initiatives to build structural resilience include the construction of new bridges with adequate provisions in areas exposed to riverine floods. In terms of adaptation efforts, as of July 2023, implementation has commenced for 33 out of the 84 measures included in the National Adaptation Plan, 18 of which are concentrated in the water sector.

Box 4. Peru: Growth and Fiscal Benefits of Climate Adaptation and Resilience Policies[1]

Climate change and natural hazards expose Peru to severe losses in potential output. Staff simulations, based on an extension of the IMF FGG climate model to account for the impact of *El Niño* on natural capital, suggest that the prevailing natural disaster profile reduces potential output by about 4.1 percent in 2023, relative to a counterfactual without natural disasters. These costs are expected to significantly rise as Peru is the most vulnerable country to climate change among LA5 countries. Global warming is expected to increase the frequency of severe *El Niño* events, reduce agricultural yields across the board, and undermine the country's fishing industry. Under the intermediate GHG emission scenario (SSP2-4.5), the potential output losses may be as high as 19.4 percent of GDP by 2050 and 55.2 percent of GDP by 2100.

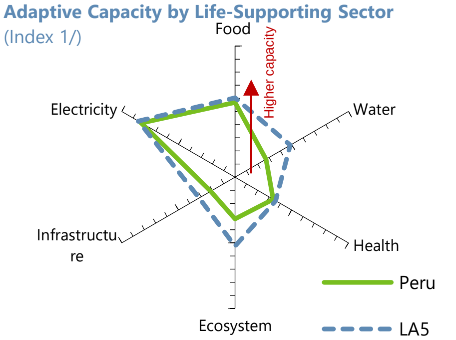
Potential GDP and Climate Change
(Index, 2024 No Climate Baseline = 100)



Sources: IMF staff calculations using the FGG model, Massetti and Tagklis (2023), Harris et al. (2020), and Chirinos (2021).

Climate adaptation and resilience policies can enhance long-term economic performance, but current implementation is limited. Peru has one of the lowest adaptive capacities in the region. The country's expenditure on disaster risk management and adaptation to climate is well below levels implied by national strategies. Moreover, budgeted investments are undermined by chronically low execution. Investing 0.8 percent of GDP in public adaptation per year until 2030, climate proofing 80 percent of Peru's transport infrastructure, and increasing public investment efficiency by 5 percentage points could produce 9.3-12.3 percent gains in the potential output level by 2050 and 12.4-31 percent gains by 2100, depending on the global warming scenario.[2] These gains imply a 0.1-0.3 percentage point increase in the average annual potential growth rate.[3]

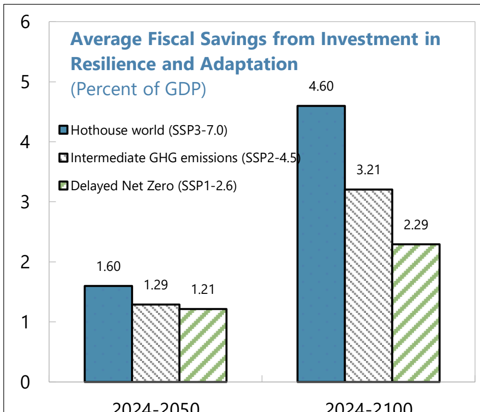
Adaptive Capacity by Life-Supporting Sector
(Index 1/)



Source: IMF-adapted ND-GAIN index.
1/Capacity index is the difference between one and the IMF-adapted ND-GAIN capacity indicator so that higher values indicate greater capacity.

Fiscal performance is also strengthened in the long run with additional investments in resilience and adaptation. Climate measures could produce average annual fiscal savings of 1.2-1.6 percent of GDP by 2050 and 2.3-4.6 percent of GDP by 2100, thanks to the expected increase in the tax base trajectory and lower post-disaster reconstruction costs.

Average Fiscal Savings from Investment in Resilience and Adaptation
(Percent of GDP)



Source: IMF Staff Calculations using FGG model and climate projections in Masseti and Tagklis (2023).

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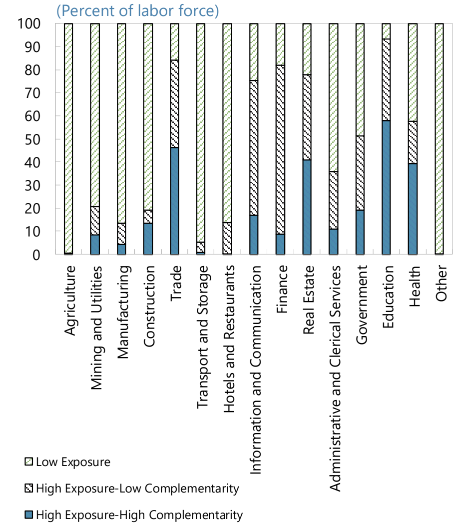
[1] Prepared by Zamid Aligishiev and Daria Kolpakova. See more details in the accompanying Selected Issues Paper "Economic Benefits of Building Resilience to Natural Hazards and Climate Change."

[2] Proposed investments in resilience include retrofitting public infrastructure (e.g., roads, bridges), upgrading existing investment plans, investing in coastal protection, as well as other Disaster Risk Management measures identified by the authorities. Investments in adaptation are those identified in the National Adaptation Plan (e.g., water management and irrigation infrastructure, diversification in agriculture and fisheries).

[3] Moreover, authorities are encouraged to consider improving coordination within the government, continuing to enhancing financial resilience, and enforcing stricter territorial planning. Reducing informality could help better enforce building codes and zoning laws, as well as encourage private insurance uptake.

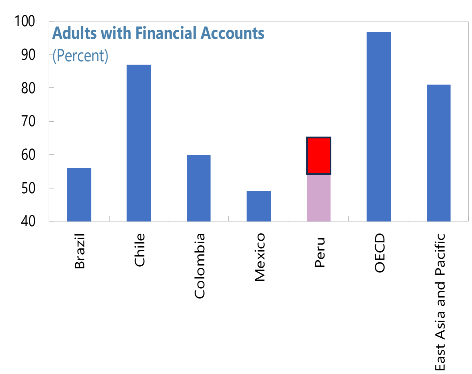
Box 5. Peru: Growth Opportunities from Digital Technologies and AI[1]

Digital technologies and AI could boost productivity in the formal sector. Over 50 percent of the workforce is significantly exposed to AI in the trade, financial, government, education, health, IT, and real estate sectors.[2] This suggests that employees in these sectors could integrate AI into their work to augment their existing skills and increase their productivity. AI automation could enhance the quality-to-price ratio, leading to price declines and/or new and improved services could emerge, such as service delivery of healthcare and education to underserved populations. Some of these sectors are already showing progress in digitalization, highlighted by initiatives such as the development of e-commerce platforms BEES and Insuma within the trade sector, and the adoption of digital payment solutions in the financial industry. In the health sector, however, despite advancements in telemedicine, only a third of hospitals have internet connectivity, indicating an area where further development is needed. Staff simulations, based on Comin and Mestieri (2018), show that halving the technology gap with the U.S. could increase Peru's long-term growth by up to 0.2 percentage points annually between 2030-2050. Automation through AI also presents social challenges, as about 17 percent of the workforce falls into a category characterized by high exposure to AI and low complementarity with it, highlighting the risks of job substitution.



Sources: ILO; Peru ENAHO; Pizzinelli et. al. (2023); IMF Staff Calculations.

While access to digital services is still limited, rapid growth in the FinTech and GovTech sectors indicates the potential to leverage digital technologies. While only 53 percent of adults have a traditional financial account, the rapid expansion of digital wallets has increased financial inclusion to 65 percent. The country has also made significant progress in digitizing its revenue administration at the central level, as evidenced by its classification in the "very high" group of the UN 2022 E-Government Development Index., though progress at the regional level remains slow. The authorities are planning a comprehensive digitalization of PFM, covering budget preparation, accounting, procurement, public investment, debt management, and payroll.



Sources: : World Bank Findex database, BCRP, IMF staff calculations.
Note: The chart includes end-2023 data for Peru from the BCRP, highlighting the impact of digital wallet proliferation (indicated in red); Findex data for other countries correspond to 2021, with the exception of Mexico, which is updated for 2022.

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[1] Prepared by Dmitry Vasilyev and Brooks Evans. See more details in the accompanying Selected Issues Paper "Productivity, Digitalization, and Artificial Intelligence in Peru."

[2] The AI occupational exposure and complementarity indexes measure AI's potential to substitute or complement labor in each occupation (Pizzinelli et al., 2023). The aggregated industry level of AI exposure and complementarity is calculated using these indexes and Peru's 2022 household survey ENAHO.

28. Effective governance institutions would also reinforce inclusive growth. Peru faces severe governance weaknesses and a high level of corruption that undermine management of public funds and trust in institutions, and hamper investments.[38] However, several action plans (including Peru's roadmap for OECD accession) demonstrate commitment to address corruption, improve institutional investigative capacities and resources, and mitigate impunity for corruption. Moreover, anti-corruption frameworks are in place (such as asset declaration of public officials, integrity officers in public agencies, and a beneficial ownership registry), but their implementation must be prioritized and supported with adequate resources. Specifically, full, timely and public access to asset declarations of high-level public officials would support verification and investigation efforts. The independence and effectiveness of judicial bodies (such as the *Junta Nacional de Justicia* and *Ministerio Público*) should be enhanced through robust judicial vetting processes of regular judges and reduction in the high reliance on temporary judges. Effective use of AML tools (including enhanced due diligence for politically exposed persons and freezing of illicit assets) will further prevent and deter corruption. Improving coordination among relevant agencies could contribute to effective prosecution and ending corruption impunity (Annex VIII).

29. A more ambitious medium-term structural reform agenda is required to durably raise potential growth. Government's plans for cutting red tape (particularly for the mining sector), unblocking large infrastructure projects, streamlining the tax system, and reforming the procurement framework and the recently approved political reform (to return to bicameralism and allow for the reelection of congressmen) are steps in the right direction. The OECD accession process provides a clear roadmap for other needed ambitious reforms to improve local government capacity, boost the business climate, reduce informality, and reform the civil service, to further boost productivity and a green and inclusive growth.

AUTHORITIES' VIEWS

30. The authorities agreed with the medium-term growth path but envisaged a stronger recovery in 2024. They emphasized that growth in 2023 was severely affected by several transitory shocks that are normalizing in 2024 which, combined with a robust recovery in domestic demand, would support a growth rate close to 3 percent. They noted that consumer and business confidence have been improving since December 2023, while the labor market strengthened, and real wage growth turned positive in October 2023. They also expect that inflation will continue to converge towards the middle of the target band, but they deemed that the risks to inflation remain tilted to the upside.

31. The authorities will pursue cautious monetary policy normalization. They signaled their intention to continue with their data-dependent monetary policy easing cycle consistent with the evolution of inflation and its determinants. They explained that while inflation expectations are anchored within the central bank's target range, core inflation remains close to the upper limit of the range and uncertainty surrounding climatic and external risks to inflation subsist. They indicated that

[38] The Contraloría General de la República estimates that around 3 percent of GDP was lost to corruption in 2023.

exchange rate pressures could constrain monetary policy, and judged that the market's expectation of a rapidly narrowing interest rate differential resulted in speculation-induced excessive exchange rate volatility in February 2024, which triggered the BCRP to intervene both in the spot and forward markets.

32. The authorities explained the tradeoffs associated with exchange rate volatility. They clarified that their use of FX interventions to mitigate excessive volatility has helped to preserve the transmission mechanism of monetary policy. They believe that, despite having achieved substantial de-dollarization, further progress could be challenging as holdings of FX credit by large corporates are more difficult to target. They noted that targeted macroprudential measures would be preferable to avoid credit disintermediation and agreed on the need to remove hurdles to foster the development of the local capital market.

33. The authorities remain committed to a gradual fiscal consolidation consistent with the fiscal rule. They are conscious that a medium-term fiscal consolidation is necessary to preserve fiscal sustainability and rebuild buffers and have announced austerity measures to improve spending efficiency. They concurred that revenue mobilization measures would strengthen their consolidation plans and view staff's recommended options as technically sound. However, given political constraints, they will instead focus on improving tax administration to reduce tax evasion and avoidance. They agreed that modernizing the Fiscal Tribunal is essential to speed the resolution of disputes and dissuade litigation as an effective strategy to defer tax obligations. They also stated their interest in analyzing the optimality of the medium-term fiscal target, debt ceiling, current expenditure growth limit, and liquidity buffers. They confirmed their intention to pursue the reforms to pensions, tax simplification, and public procurement, but would likely refine their proposals as the discussion in Congress progresses.

34. The authorities concur that the financial system remains sound and profitable. They emphasized that capital holdings in the financial system comfortably exceed minimum requirements and would be sufficient to withstand severely adverse scenarios. They noted that the loan deterioration is driven by SMEs, but that NPLs are more than covered by voluntary provisioning. They believe the vulnerabilities among some microfinance institutions to be limited and expect them to improve with the economic recovery. They confirmed that most financial institutions are prepared for the full implementation of new capital rules under Basel III requirements and that most FSAP recommendations have been implemented. Recalibrating the current activation criteria of the counter-cyclical policies is not on the short-term regulatory agenda.

35. The authorities remain strongly opposed to early pension withdrawals. They have vehemently explained to the public that withdrawals not only have a detrimental impact on future pensions but are also devastating the local capital market. They remain vigilant of ongoing modifications in Congress to the original pension reform proposal, which might have unintended consequences or result in high fiscal cost. The welfare and costing analysis of the social pension was well received, and they noted that staff's recommended improvements would have a substantial social impact with only a minimal fiscal cost.

36. The authorities have a firm belief that structural reforms are needed to reverse the decline in potential growth. They acceded that labor and tax regulations, as well as shortcomings in public services, have likely created bottlenecks for firms to grow and become more productive. They highlighted recent progress in improving regulatory quality and expressed their commitment to gradually tackle barriers for firms' growth. They stressed that durably increasing potential growth will need to address the decline in private investment and elevated political uncertainty. They anticipate that recent initiatives to unlock large infrastructure and mining projects could catalyze further investments and elevate potential growth. The authorities concurred with the importance of the OECD accession process in advancing the structural reform agenda.

37. The authorities see climate-related shocks as a significant economic threat that would intensify with climate change. They agreed on the importance of complementing post-disaster response with ex-ante resilience building and shared plans to direct efforts towards disaster risk prevention. However, they recognized that spending on disaster risk management and climate adaptation should increase to cover identified needs and that improved coordination among relevant government agencies will help increase adaptation capacity. They emphasized ongoing work to incorporate climate risks in macroeconomic projections and expanding the toolkit for quantifying natural disaster risks.

38. The authorities remain determined to promote digitalization and reduce the digital divide. They aim to sharpen their efforts in harnessing digital technologies to boost financial inclusion, improve taxation and public finance management, and enhance access to healthcare services through telemedicine. They also expressed interest in further studying the potential effects of AI on labor markets and productivity, and understanding their technological gaps compared to technologically-intensive economies.

39. The authorities underscored their commitment to enhancing their effectiveness in combatting corruption. Efforts to address past grand corruption cases are ongoing and will contribute to their goal of joining the OECD. They view that the low scores in indicators of perception of corruption are explained by increased public awareness due to enhanced investigation efforts on corrupt activities. They agreed that an unbalanced distribution of resources and delays in prosecution are contributing to a sense of impunity for corruption. They remain concerned about the potential chilling effect of anti-corruption efforts on decision making by public officials and its impact on investment. They consider that the asset declaration system for public officials negatively impacts their ability to attract and retain talent in the public service.

STAFF APPRAISAL

40. The economy is slowly recovering after multiple consecutive shocks. A strong recovery in agriculture and fishing, ongoing momentum in mining, and a looser monetary policy support a growth revival, while political uncertainty continues to hamper consumer and business confidence. Inflation is expected to converge to the target band (of 1-3 percent). The external position in 2023 was moderately stronger than the level implied by medium-term fundamentals and desirable policies, due to sizable import compression amid subdued growth.

41. Evolving risks are broadly balanced, and Peru has ample buffers to cope with shocks. Very strong macroeconomic policies and institutional policy frameworks remain firmly in place, supporting a soft landing, despite political uncertainty. Peru's proven macroeconomic resilience is reinforced by very strong buffers including low public debt, abundant international reserves, and access to international capital markets on favorable terms.

42. Conditions allow for further monetary policy easing. With inflation converging towards the target band and anchored inflation expectations, additional monetary policy easing is appropriate to bring the monetary policy rate to a neutral level. With the interest rate differential against the U.S. expected to narrow, the BCRP should continue to allow greater exchange rate flexibility.

43. Targeted macroprudential measures could facilitate de-dollarization. The decline in credit dollarization has stalled, with dollarization concentrated in holdings of unhedged FX credit by medium-sized firms and largely hedged large-sized firms. The authorities could consider introducing additional capital buffers or higher risk weights for borrowers' unhedged FX exposures to reduce unhedged positions. Allowing greater ER flexibility and removing tax hurdles could foster the development of derivative markets.

44. Given available fiscal space, fiscal consolidation could be delayed. The authorities remain committed to preserving fiscal sustainability. The 2024 budget envisages a deficit of 2 percent of GDP, consistent with the fiscal rule target. If revenues continue to disappoint, delaying the consolidation by one year (setting a fiscal target for 2024 of 2.5 percent) could help support the growth recovery and lessen the risk of missing the target again. Recently announced measures to improve spending efficiency and plans to strengthen expenditure control and public procurement are welcome. New tax benefits and unfunded spending initiatives by Congress would jeopardize attaining the target. Efforts to restructure the governance of Petroperu are positive, but further financial support should be conditional on the viability of the firm.

45. Revenue mobilization measures could strengthen medium term fiscal consolidation plans. The fiscal deficit is set to gradually decline by 0.5 percent of GDP per year to reach a deficit of 1 percent of GDP by 2026, to preserve medium-term fiscal sustainability. Given Peru's relatively low tax burden, a more balanced composition of the envisaged consolidation would be preferable. Plans to reduce tax evasion and avoidance should be reinforced with additional independence and resources for the tax administration. Improving fiscal policy guidance could also bolster fiscal policy credibility. The optimality of the medium-term fiscal target, debt ceiling, and liquidity buffers could be carefully analyzed.

46. A long-awaited pension reform is urgently needed to address low coverage and adequacy and to prevent new rounds of early withdrawals from the private pension scheme. Reform proposals, being considered by Congress, are steps in the right direction—such as expanding the minimum and social pension, automatic enrollment, and limiting early withdrawals from private pension accounts—and some fine-tuning would maximize their impact. Over the medium term, a comprehensive reform of the system is required. Early withdrawals from the private pension scheme are ill advised.

47. Systemic risks are limited, but the authorities should continue to closely monitor and proactively contain financial vulnerabilities. The financial system is sound. Banks remain profitable, with ample liquidity and capital buffers. Pockets of vulnerability, particularly in small financial institutions, should continue to be closely monitored. Private pension funds should continue to maintain appropriate liquidity cushions against pension withdrawals.

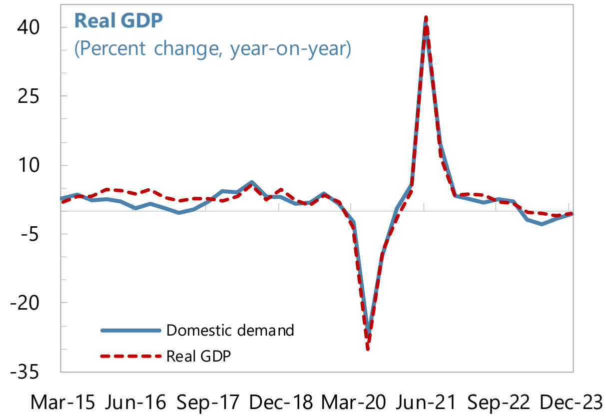
48. Operationalizing new regulations and closing remaining gaps will enhance financial resilience. Most financial institutions are prepared for the full implementation of the Basel III capital requirements. The introduction of the new rule for countercyclical policies is a step forward, but revising the activation criteria will further increase effectiveness. Recovery plans for domestic systemically important banks have been submitted for review, but should be later extended to the financial group level. Further lowering barriers to entry for Fintech providers, while maintaining appropriate risk-based regulation, continuing to enforce interoperability regulations, and introducing frameworks for Open Banking and Finance, could foster competition in the financial sector.

49. Reforms are urgently needed to lift potential growth. Efforts to boost productivity should focus on reforming labor and tax regulations that impose excessive costs for formalizing or growing a business. Given Peru's high vulnerability to climate change and low adaptive capacity, increased efforts in investing in resilient infrastructure and climate adaptation policies are needed to unlock output gains. Fully embracing the digital and artificial intelligence revolution, while facilitating the labor force transition, offers a pathway to enhance productivity. Strengthening the effectiveness of governance institutions will contribute to attracting investment, augment public trust, and mitigate impunity for corruption. Strong political commitments to fight corruption should be translated to adequate resourcing of anti-corruption and judicial bodies and improved inter-agency coordination. The OECD accession process provides a clear roadmap for more ambitious reforms to improve local government capacity, boost the business climate, reduce informality, and reform the civil service. Government's efforts in cutting red tape and unblocking large infrastructure projects, streamlining the tax system, and reforming the procurement framework; and the recently approved political reform are welcome.

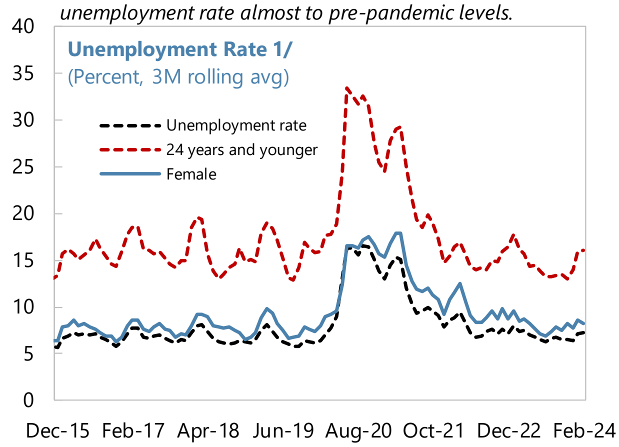
50. Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Peru: Real Sector Developments

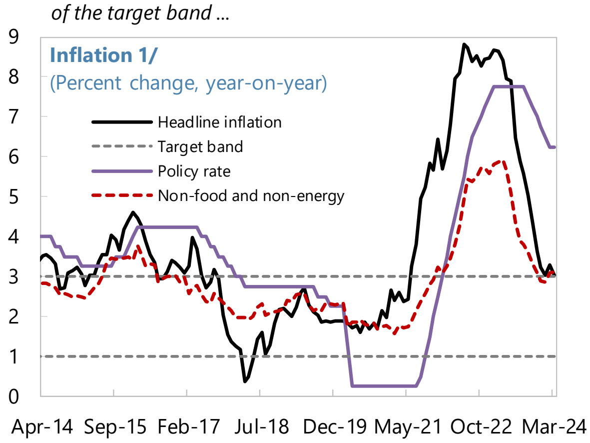
Growth in 2023 was slightly negative, amid weak domestic demand.



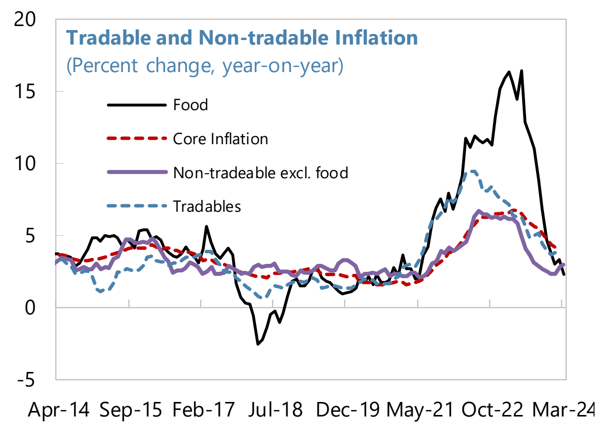
Labor market continues to improve with the unemployment rate almost to pre-pandemic levels.



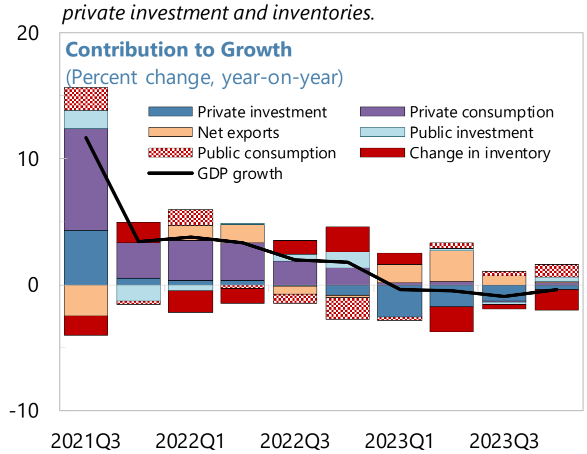
Headline and core inflation are converging to the middle of the target band ...



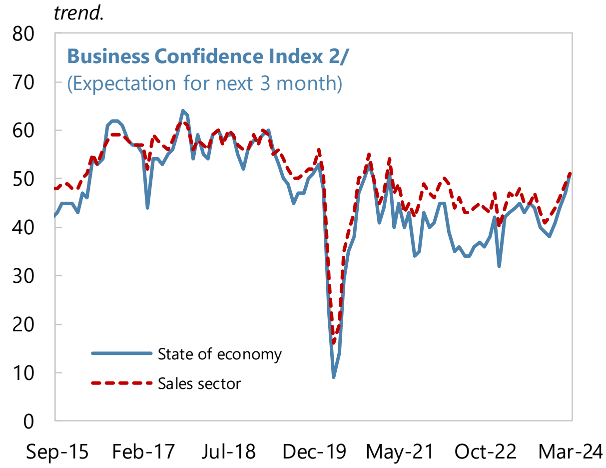
... with inflation declining in all subcomponents.



In 2023, the contraction is driven by a continued decline in private investment and inventories.

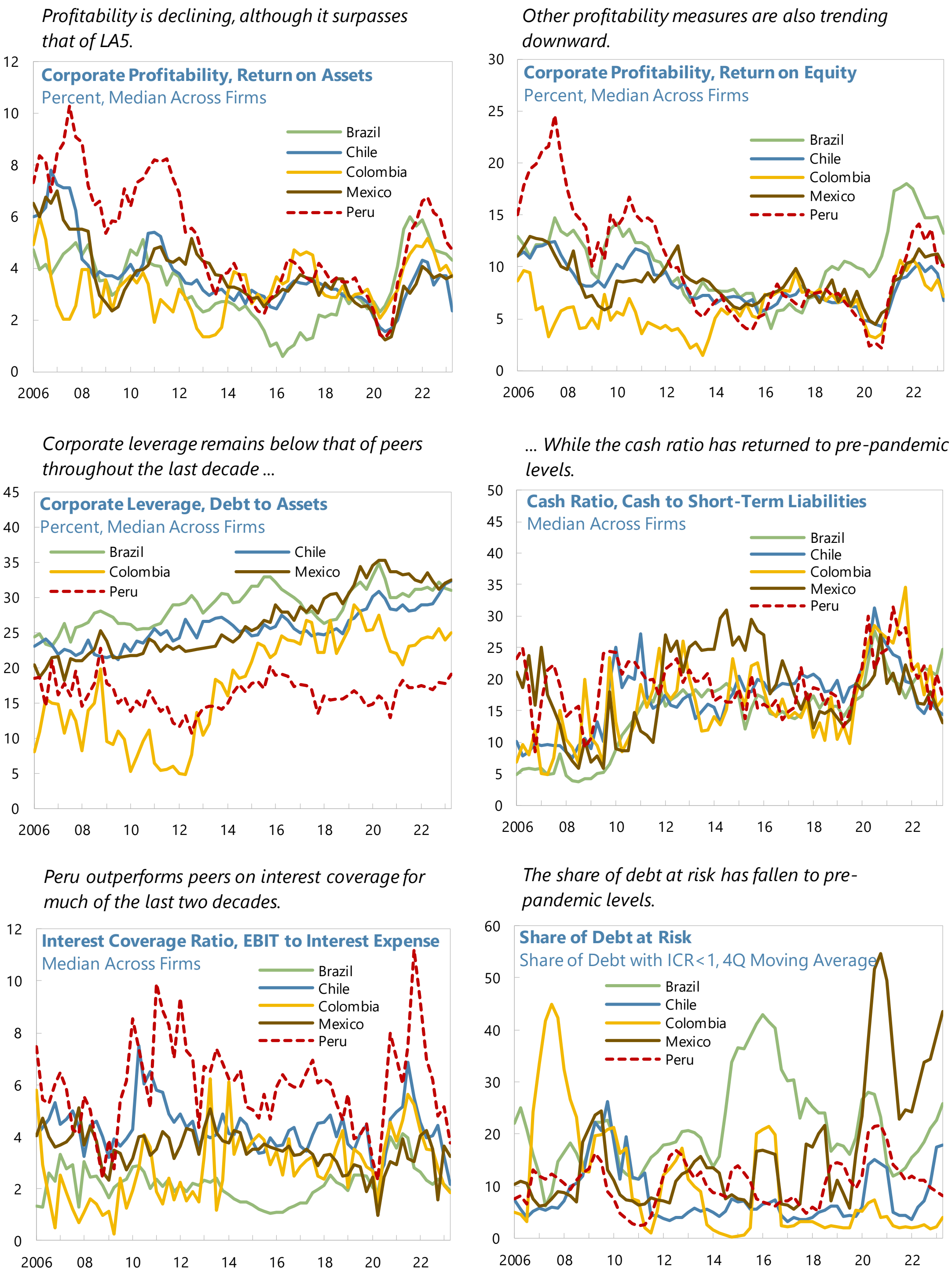


Business confidence has not recovered from its downward trend.



Sources: Banco Central de Reserva del Perú, Haver Analytics, IMF staff calculations, INEI.
1/ Data covers the Metropolitan Lima area.
2/ Index values of 50 and greater indicate positive growth expectations.

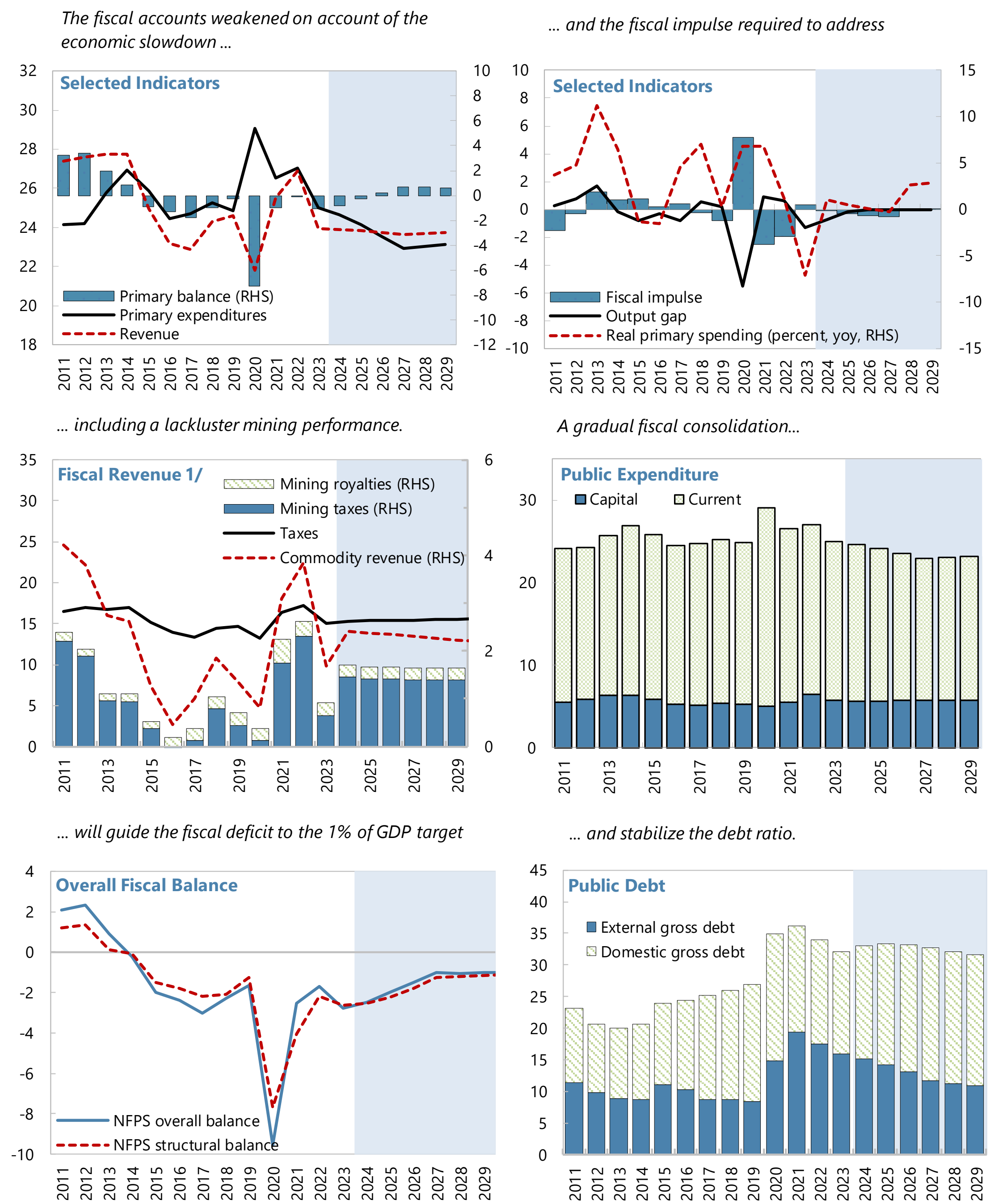
Figure 2. Peru: Corporate Sector Indicators



Sources: Bloomberg Finance L.P., IMF WHD Regional Economic Outlook 2020, and IMF staff calculations.

Figure 3. Peru: Fiscal Policy Developments

(Non-Financial Public Sector, Percent of GDP unless otherwise indicated)

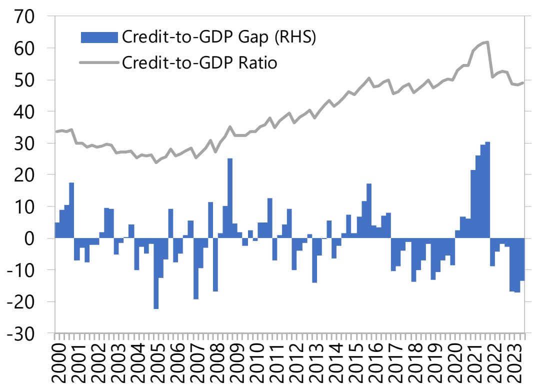


Sources: National authorities and IMF staff estimates.
1/ Net of restitutions.

Figure 4. Peru: Macrofinancial Conditions

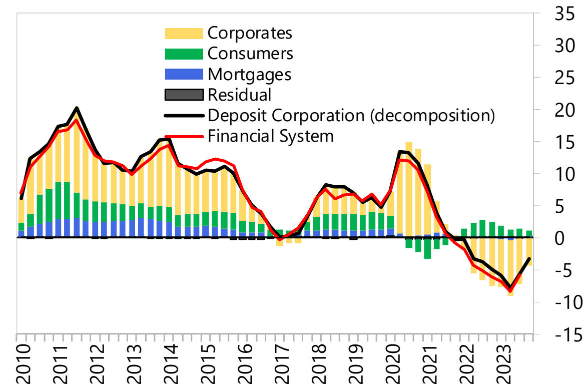
Credit is contracting amid the waning effect of pandemic support measures, El Niño, and political turmoil.

Financial System Credit-to-GDP Ratio and Gap
(Percent)



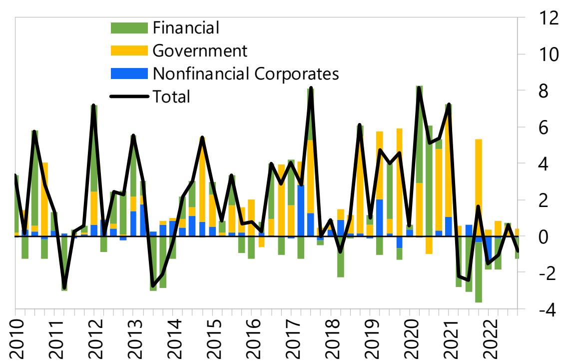
The decline of credit is visible for all sectors, but especially for corporates.

Real Growth of Credit
(Percent)



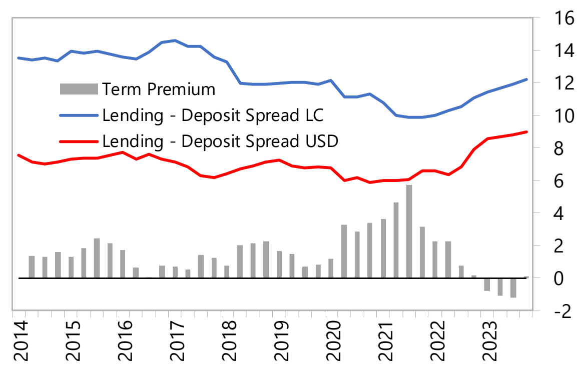
Flows related to debt securities have been negative in all sectors.

Net Debt Securities Flows
(Billions U.S. Dollars)



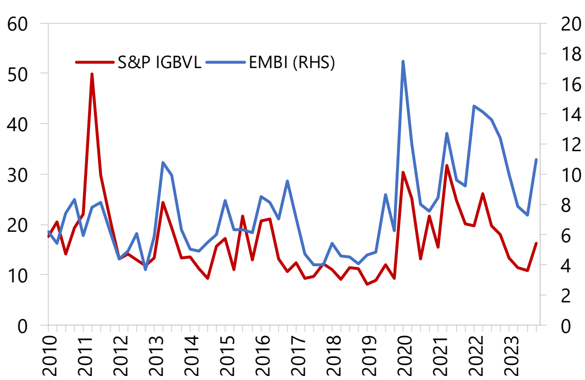
The loan-deposit spread for loans in LC is around the pre-pandemic level, while the spread with USD is widening.

Loan Effective Credit Spread against Deposit Rate 1/
(Percent)



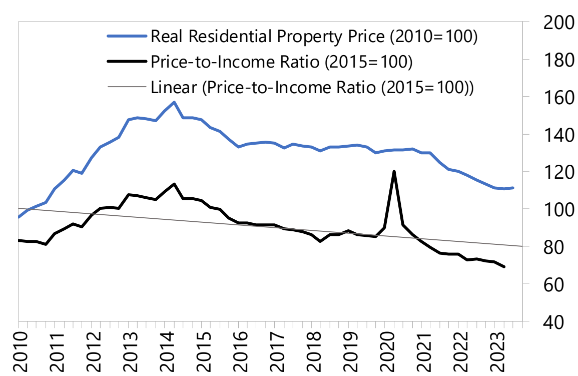
Declining volatilities indicate that the capital market is stabilizing.

Market Realized Volatility 2/
(Percent)



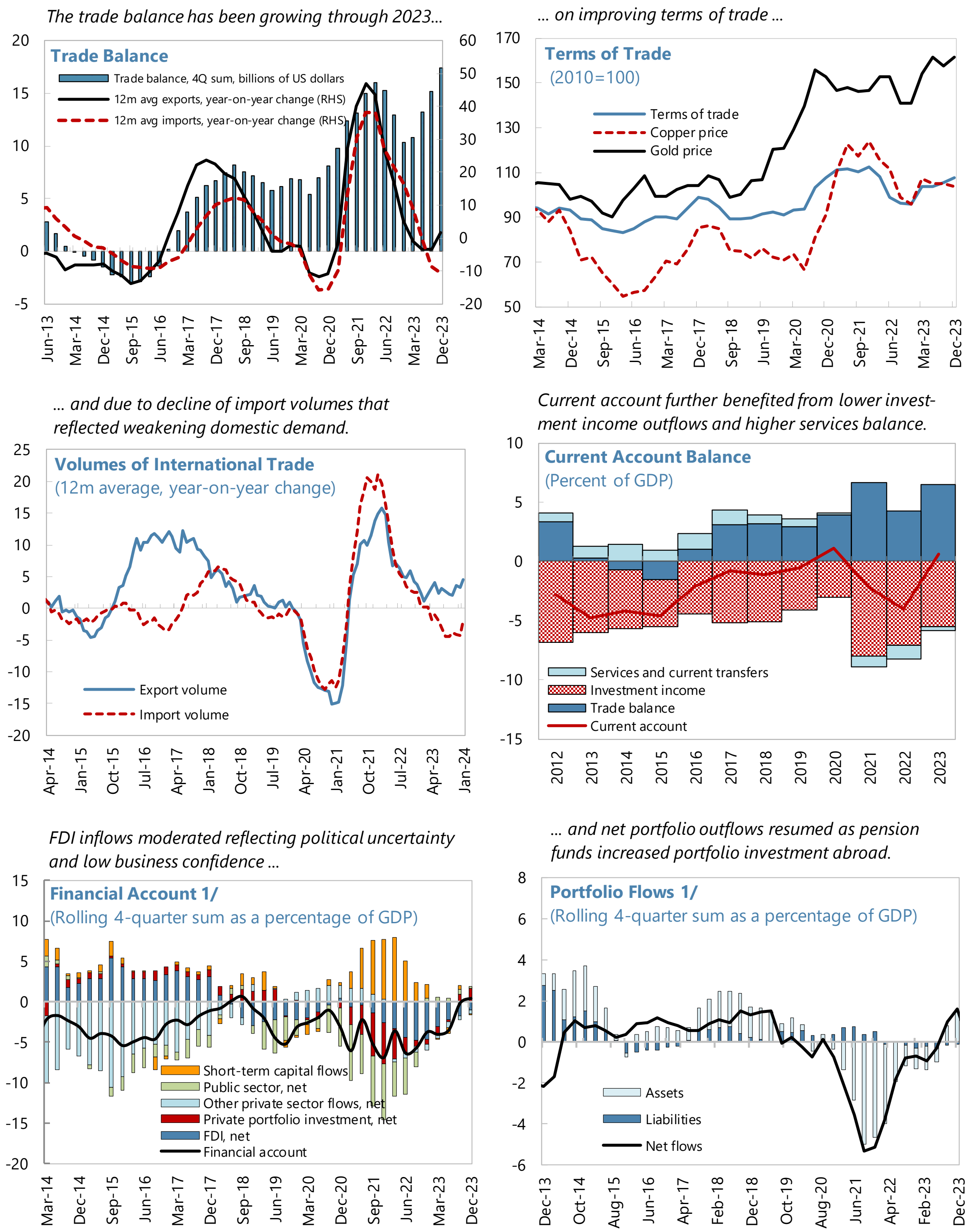
Residential property prices have been underpriced.

Development of Real Residential Property Price
(Index)



Sources: BCRP, BIS, IMF, Refinitive, SBS.
1/ LC=Local Currency. Term premium = 10-year sovereign bond yields - 3-month repo operation rates.
2/ S&P IGBVL and J.P. Morgan EMBI (Peru) total return index. Realized volatility of daily returns by moving 30-days average (backward -14days and forward +15days).

Figure 5. Peru: External Sector Developments



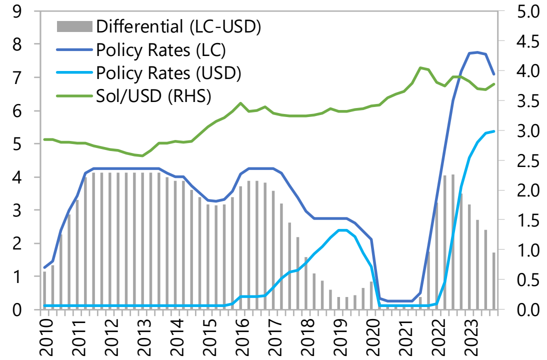
Sources: National authorities, Haver Analytics, and IMF staff estimates.
1/ Negative values indicate inflows.

Figure 6. Peru: Exchange Rate Developments

The interest differential between the Sol and USD has narrowed substantially.

Exchange Rate and Interest Rate Differential

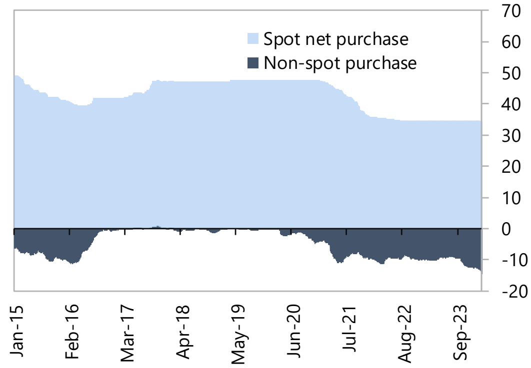
(Percent) (S/USD)



The BCRP's FXI operations have been somewhat passive since 2022, with very little spot market operations.

Cumulative Net Purchase of Sole by BCRP

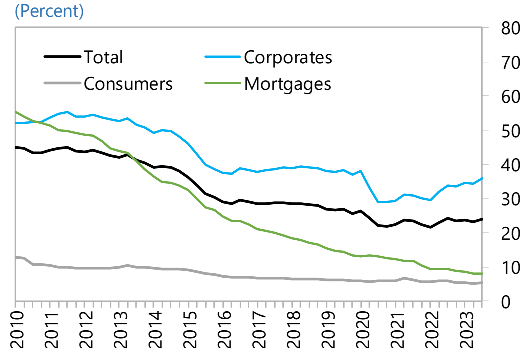
(Billions U.S.dollar)



The dollarization rate has been declining, but since 2022 it has picked up for corporates.

Dollarization Rate of Credit 1/

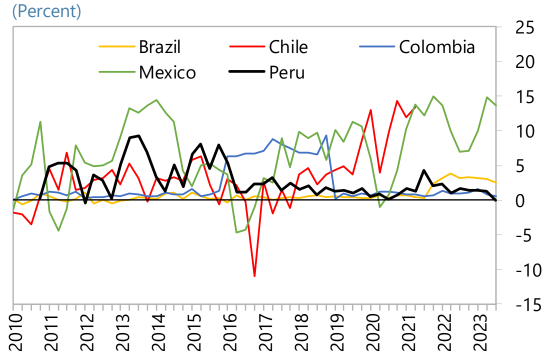
(Percent)



The open FX position of deposit institutions is small.

Deposit Institutions' Open FX Positions Per Capital

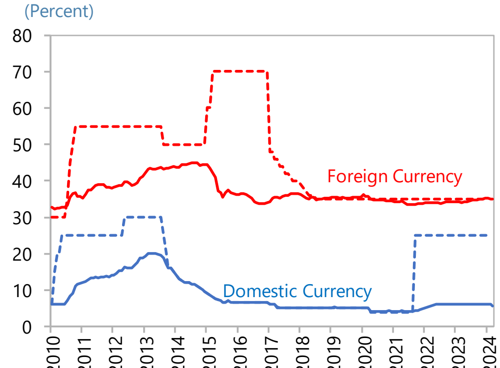
(Percent)



The spread between BCRP's required reserve ratio for foreign currency and for domestic currency has narrowed since late 2021.

Central Bank Reserve Requirement by Currency 2/

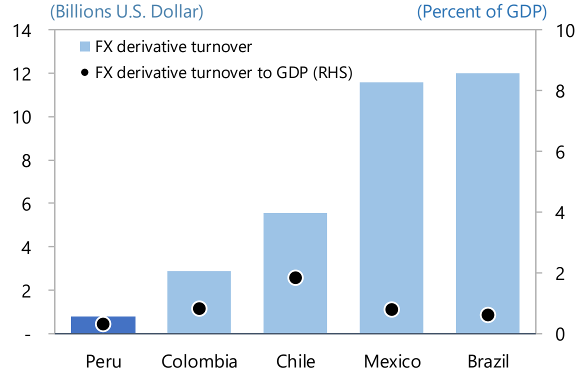
(Percent)



The FX derivative market turnover of Peru is the lowest among LA5 countries.

Turnover of Foreign Exchange Derivatives in 2022

(Billions U.S. Dollar) (Percent of GDP)



Sources: BCRP, BIS, IMF, Haver, Refinitive EIKON, DataStream, Velarde and Montoro (2022).

1/ Dollarization of credit from deposit insitution to private sector. Calculation is based on IMF staff calculation with exchange rate implied in total credit from deposit institution to private sector.

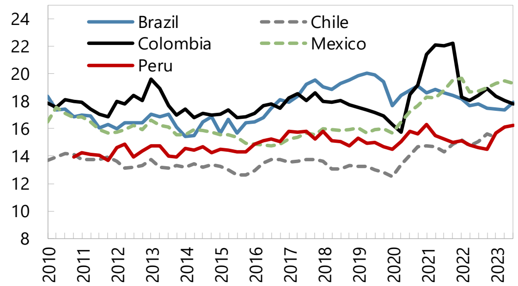
2/ Solid lines represent average reserve requirement rates for outstanding balance. Dotted lines represent marginal reserve requirement rates for new positions.

Figure 7. Peru: Financial Sector Developments

The regulatory capital ratio has increased since last year and is well above the required level of Basel III.

Regulatory Capital Ratio (1/)

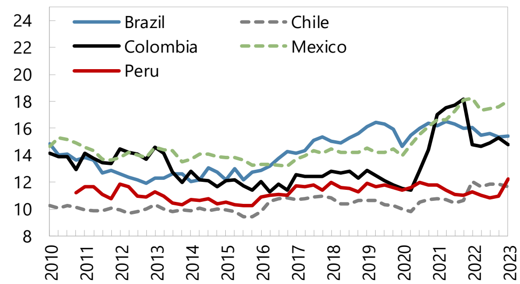
(Percent)



The Tier1 capital ratio is well above the minimum required level under Basel III.

Tier1 Capital Ratio (1/)

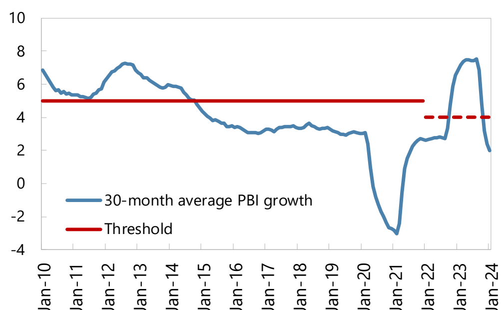
(Percent)



The counter-cyclical policy rule becomes effective in June 2024 but is unlikely to be activated.

Counter-cyclical Policy Threshold (2/)

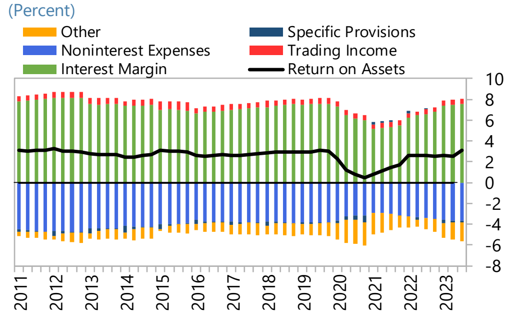
(Percent)



The positive contribution from a higher interest margin has been offset by increasing costs and provisions.

Decomposition of ROA

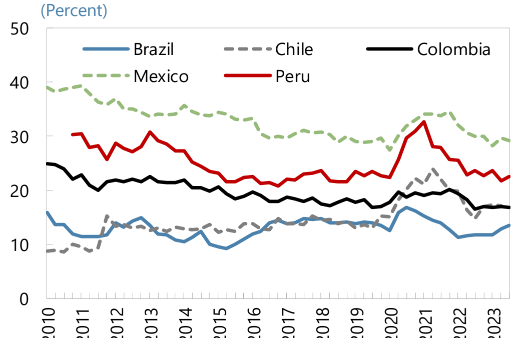
(Percent)



While most of the excess liquidity during the pandemic has been unwound, a relatively high level of liquidity is maintained.

Liquid Asset Ratio

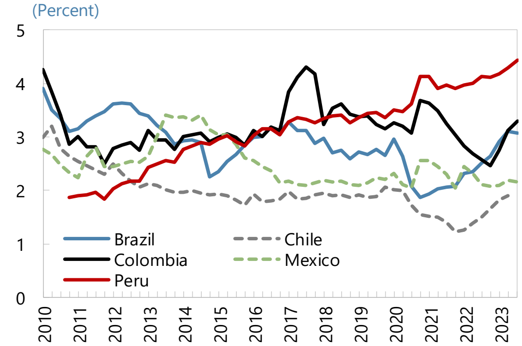
(Percent)



The NPL ratio is high and increasing.

Non-Performing Loans per Gross Loans (3/)

(Percent)



Sources: IMF Financial Soundness Indicators.

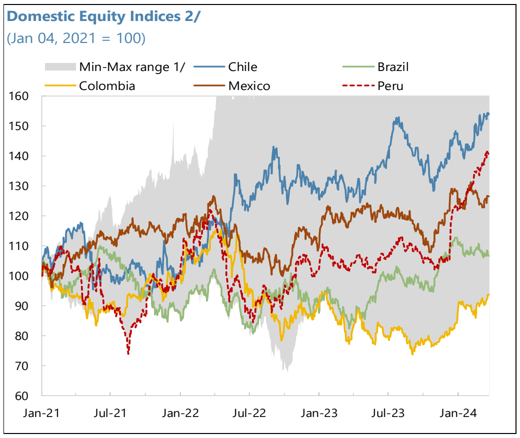
1/ Under full implementation of Basel III, financial institutions are required to satisfy the minimum required Tier1 ratio (8.5%) = CET1 (4.5%) + conservation buffer CET1 (2.5%) + AT1 (1.5%), and minimum required total capital ratio (12.5%) = minimum Tier1 ratio (8.5%) + Tier2 capital ratio (4%) by September 2024.

2/ Counter-cyclical policy is activated when (i) 30-month average PBI growth cross the threshold from below, or (ii) the same indicator is above the threshold, and 12-month average PBI growth is 2% higher than the one in the previous year. As of December 22, 2022, SBS approved a resolution regarding cyclical component of capital conservation buffer, clarifying the procyclical rule to apply starting from June 2024 (Resolución S.B.S. N°3954-2022).

3/ Nonperforming loans are defined in each jurisdiction. For Peru they are defined as overdue loans after 15 days since the due date for commercial loans and after 30 days for small business loans. Mortgage, consumer, and leasing loans are considered overdue after 30 days since the due date for the non-paid portion and after 90 days for all the credit. The overdue loans include credits under judicial resolution.

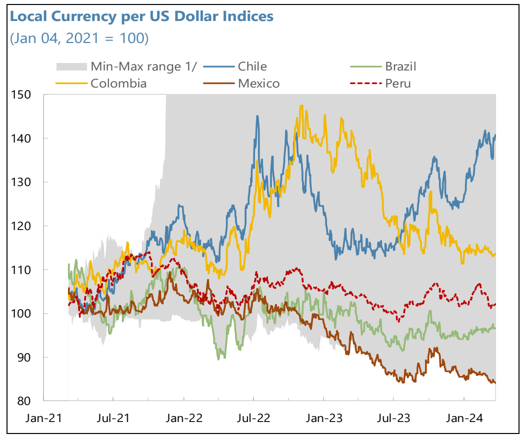
Figure 8. Peru: Financial Market Indicators

Peruvian equities continue to trend upward after monetary tightening domestically and abroad.



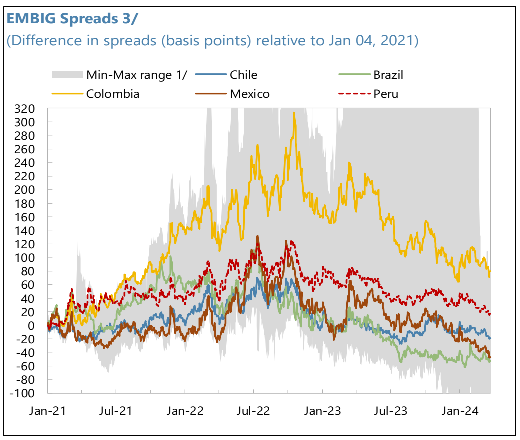
Domestic Equity Indices 2/
(Jan 04, 2021 = 100)

The PEN remains stable relative to the USD, with low levels of volatility compared to peers.



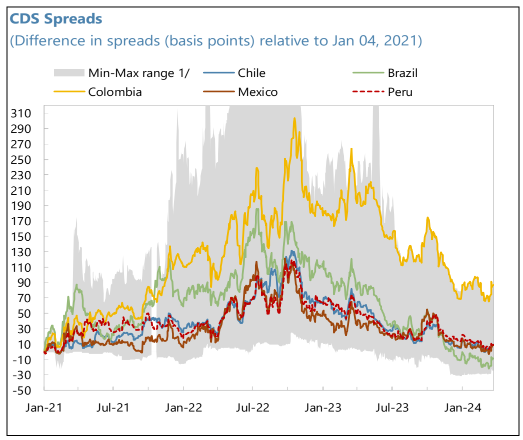
Local Currency per US Dollar Indices
(Jan 04, 2021 = 100)

After widening in recent years in response to political uncertainty and external shocks, spreads have begun to stabilize …



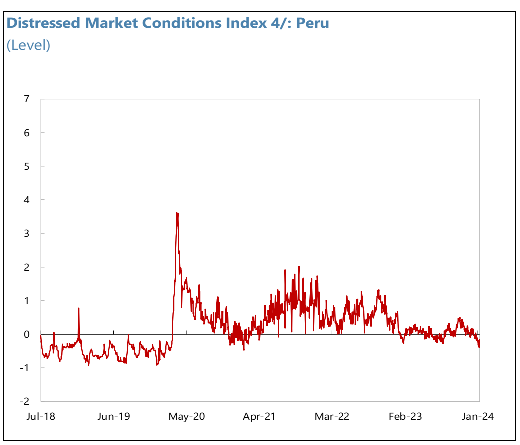
EMBIG Spreads 3/
(Difference in spreads (basis points) relative to Jan 04, 2021)

… While CDS spreads have followed the same trend.



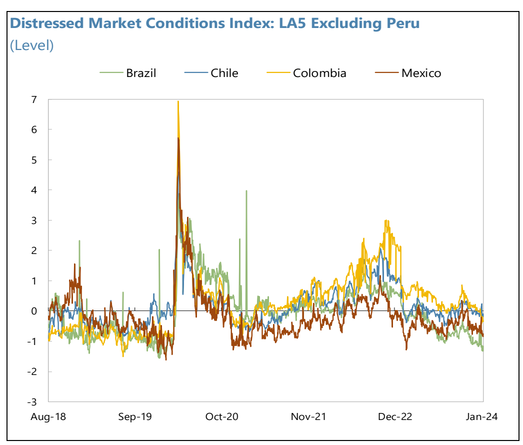
CDS Spreads
(Difference in spreads (basis points) relative to Jan 04, 2021)

Market conditions in Peru have stabilized …



Distressed Market Conditions Index 4/: Peru
(Level)

… similar to that of regional peers.



Distressed Market Conditions Index: LA5 Excluding Peru
(Level)

Sources: Haver Analytics and Bloomberg LLP.
1/ Selected sample of emerging market countries including Brazil, Chile, Colombia, Mexico, Peru, Uruguay, Czech Republic, Croatia, Hungary, Poland, Turkey, India, Indonesia, Malaysia, Philippines, Thailand and Vietnam.
2/ National benchmark share price indices.
3/ Mexico's EMBIG includes Sovereign and Quasi.
4/ DMC Index is a composite of 23 indicators measuring market conditions

Table 1. Peru: Selected Economic Indicators

(In percent of GDP, unless otherwise indicated)

	2020	2021	2022	Est. 2023	Proj. 2024	2025	2026	2027	2028	2029
Social Indicators										
Poverty rate (total) 1/	30.1	25.9	27.5	...	...	...	...	...	...	...
Unemployment rate for Metropolitan Lima (average)	13.0	10.7	7.8	6.8	...	...	...	...	...	...
(Annual percentage change; unless otherwise indicated)										
Production and Prices										
Real GDP	-10.9	13.4	2.7	-0.6	2.5	2.7	2.3	2.3	2.3	2.3
Output gap (percent of potential GDP)	-5.5	0.9	0.6	-1.3	-0.7	-0.2	0.0	0.0	0.0	0.0
Consumer prices (end of period)	2.0	6.4	8.5	3.2	2.4	2.0	2.0	2.0	2.0	2.0
Consumer prices (period average)	1.8	4.0	7.9	6.3	2.3	2.0	2.0	2.0	2.0	2.0
Money and Credit 2/ 3/										
Broad money	29.2	2.7	-0.3	1.5	3.9	4.7	5.3	5.5	5.5	5.5
Net credit to the private sector	14.0	6.5	3.6	0.4	4.0	4.8	5.1	5.5	5.5	5.5
Credit-to-private-sector/GDP ratio (%)	52.4	45.9	44.4	41.8	41.4	41.4	41.6	42.0	42.5	43.0
External Sector										
Exports	-10.7	47.0	5.2	1.5	-0.8	3.1	4.0	3.4	3.5	3.6
Imports	-15.5	38.2	16.5	-10.8	5.3	4.3	3.1	3.3	3.5	3.2
External current account balance (percent of GDP)	1.1	-2.2	-4.0	0.6	-1.1	-1.4	-1.4	-1.5	-1.5	-1.5
Gross reserves In billions of U.S. dollars	74.9	78.5	72.2	71.3	73.8	76.3	78.4	80.8	82.7	84.4
Percent of short-term external debt 4/	495	583	530	409	459	438	438	430	483	493
Percent of foreign currency deposits at banks	222	229	207	205	210	212	211	210	206	202
(In percent of GDP; unless otherwise indicated)										
Public Sector										
NFPS revenue	21.8	25.5	26.9	23.9	23.9	23.8	23.8	23.6	23.7	23.7
NFPS primary expenditure	29.1	26.5	27.0	25.0	24.7	24.1	23.6	22.9	23.0	23.2
NFPS primary balance	-7.3	-1.0	-0.1	-1.1	-0.8	-0.3	0.2	0.7	0.7	0.6
NFPS overall balance	-8.9	-2.5	-1.7	-2.8	-2.5	-2.0	-1.5	-1.0	-1.0	-1.0
NFPS structural balance 5/	-7.0	-4.0	-2.2	-2.5	-2.5	-2.2	-1.8	-1.2	-1.2	-1.1
NFPS structural primary balance 5/	-5.4	-2.5	-0.7	-0.9	-0.8	-0.5	-0.1	0.5	0.5	0.5
Debt										
Total external debt 6/	43.7	46.3	43.0	40.6	38.2	37.0	35.5	33.6	32.7	31.8
Gross non-financial public sector debt 7/	34.9	36.1	33.9	32.1	33.0	33.3	33.2	32.6	32.1	31.6
External	14.8	19.4	17.5	16.0	15.3	14.2	13.1	11.5	10.9	10.3
Domestic	20.1	16.7	16.4	16.1	17.8	19.0	20.1	21.1	21.3	21.4
Savings and Investment										
Gross domestic investment	19.9	21.7	22.1	19.2	20.4	20.8	20.9	21.1	21.3	21.5
Public sector (incl. repayment certificates)	4.3	4.7	5.1	5.0	4.8	4.8	4.9	4.9	5.0	5.1
Private sector	16.8	20.4	20.2	17.9	17.7	17.4	17.2	16.9	16.7	16.6
National savings	21.0	19.5	18.1	19.8	19.3	19.5	19.5	19.7	19.8	20.0
Public sector	-4.6	2.8	4.4	3.0	3.1	3.6	4.1	4.6	4.6	4.6
Private sector	25.6	16.7	13.7	16.8	16.1	15.8	15.4	15.1	15.2	15.4
Memorandum Items										
Nominal GDP (S/. billion)	721	878	939	1,002	1,051	1,102	1,151	1,202	1,255	1,309
GDP per capita (in US$)	6,320	6,848	7,336	7,933	8,291	8,567	8,839	9,115	9,397	9,685

Sources: National authorities; UNDP Human Development Indicators; and IMF staff estimates/projections.

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

2/ Corresponds to depository corporations.

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

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

5/ Adjusted by the economic cycle and commodity prices, and for non-structural commodity revenue. The latter uses as equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to the IMF's World Economic Outlook.

6/ Includes local currency debt held by non-residents and excludes global bonds held by residents.

7/ Includes repayment certificates and government guaranteed debt.

Table 2. Peru: Nonfinancial Public Sector Main Fiscal Aggregates
(In percent of GDP, unless otherwise indicated)

					Est.	Proj.					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
	(In billions of soles; unless otherwise indicated)										
Revenues	**191.0**	**157.2**	**223.8**	**252.7**	**239.7**	**250.8**	**262.5**	**273.4**	**284.1**	**297.0**	**310.7**
Taxes	113.9	95.6	143.2	161.3	151.1	160.8	169.4	177.2	185.5	194.2	203.5
Other	77.1	61.7	80.5	91.4	88.6	90.0	93.1	96.2	98.6	102.8	107.2
Primary Expenditures 1/	**192.9**	**209.7**	**232.7**	**254.0**	**250.6**	**259.2**	**265.8**	**271.2**	**275.9**	**288.8**	**303.0**
Current	152.3	173.3	184.2	192.7	193.5	199.6	203.1	205.6	207.4	217.3	228.5
Capital	40.5	36.4	48.5	61.3	57.1	59.6	62.7	65.6	68.5	71.5	74.6
Primary Balance	**-1.9**	**-52.4**	**-9.0**	**-1.3**	**-11.0**	**-8.3**	**-3.3**	**2.2**	**8.2**	**8.2**	**7.7**
Interest	10.7	11.6	13.1	14.7	16.6	17.7	18.7	19.7	20.5	21.2	21.1
Overall Balance	**-12.6**	**-64.0**	**-22.1**	**-16.0**	**-27.6**	**-26.0**	**-22.0**	**-17.4**	**-12.3**	**-13.0**	**-13.5**
External financing	4.7	34.2	53.2	4.6	-1.6	-1.0	-3.3	-5.5	-10.5	0.8	1.5
Domestic financing	7.9	29.9	-31.1	11.4	29.2	27.1	25.3	23.0	22.8	12.2	12.0
Public Gross Debt 2/	**209.1**	**251.7**	**317.0**	**318.7**	**321.4**	**346.8**	**366.8**	**382.2**	**392.4**	**403.1**	**414.1**
External	65.7	107.0	170.4	164.5	160.2	160.3	157.0	150.6	138.2	136.3	134.2
Domestic	140.6	142.2	144.5	152.9	160.2	185.8	209.4	231.5	254.4	266.8	279.9
Repayment Certificates	2.8	2.5	2.1	1.3	1.0	0.7	0.4	0.1	-0.2	0.0	0.0
Public Assets 3/	**92.5**	**74.4**	**107.9**	**103.7**	**88.3**	**86.4**	**84.4**	**82.3**	**80.1**	**77.8**	**75.5**
	(In percent of GDP; unless otherwise indicated)										
Revenues	**24.6**	**21.8**	**25.5**	**26.9**	**23.9**	**23.9**	**23.8**	**23.8**	**23.6**	**23.7**	**23.7**
Taxes	14.7	13.3	16.3	17.2	15.1	15.3	15.4	15.4	15.4	15.5	15.5
Other	9.9	8.6	9.2	9.7	8.8	8.6	8.4	8.4	8.2	8.2	8.2
Primary Expenditures 1/	**24.9**	**29.1**	**26.5**	**27.0**	**25.0**	**24.7**	**24.1**	**23.6**	**22.9**	**23.0**	**23.2**
Current	19.6	24.0	21.0	20.5	19.3	19.0	18.4	17.9	17.2	17.3	17.5
Capital	5.2	5.0	5.5	6.5	5.7	5.7	5.7	5.7	5.7	5.7	5.7
Primary Balance	**-0.2**	**-7.3**	**-1.0**	**-0.1**	**-1.1**	**-0.8**	**-0.3**	**0.2**	**0.7**	**0.7**	**0.6**
Interest	1.4	1.6	1.5	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.6
Overall Balance	**-1.6**	**-8.9**	**-2.5**	**-1.7**	**-2.8**	**-2.5**	**-2.0**	**-1.5**	**-1.0**	**-1.0**	**-1.0**
External financing	0.6	4.7	6.1	0.5	-0.2	-0.1	-0.3	-0.5	-0.9	0.1	0.1
Domestic financing	1.0	4.1	-3.5	1.2	2.9	2.6	2.3	2.0	1.9	1.0	0.9
Public Gross Debt 2/	**27.0**	**34.9**	**36.1**	**33.9**	**32.1**	**33.0**	**33.3**	**33.2**	**32.6**	**32.1**	**31.6**
External	8.5	14.8	19.4	17.5	16.0	15.3	14.2	13.1	11.5	10.9	10.3
Domestic	18.1	19.7	16.5	16.3	16.0	17.7	19.0	20.1	21.2	21.3	21.4
Repayment Certificates	0.4	0.3	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Public Assets 3/	**11.9**	**10.3**	**12.3**	**11.0**	**8.8**	**8.2**	**7.7**	**7.1**	**6.7**	**6.2**	**5.8**
Public Net Debt	**15.0**	**24.6**	**23.8**	**22.9**	**23.3**	**24.8**	**25.6**	**26.1**	**26.0**	**25.9**	**25.9**
Memorandum Items											
Commodity related revenues 4/	1.4	0.8	3.1	3.8	1.7	2.4	2.4	2.4	2.3	2.3	2.2
Output gap (percent of potential GDP)	0.2	-5.5	0.9	0.6	-1.3	-0.7	-0.2	0.0	0.0	0.0	0.0
NFPS non-commodity structural balance	-3.0	-8.0	-5.9	-5.9	-4.2	-4.7	-4.3	-3.9	-3.3	-3.3	-3.3
NFPS non-commodity primary structural balance	-1.7	-6.4	-4.4	-4.3	-2.5	-3.0	-2.6	-2.1	-1.6	-1.6	-1.6
NFPS structural balance 5/	-1.3	-7.0	-4.0	-2.2	-2.5	-2.5	-2.2	-1.8	-1.2	-1.2	-1.1
NFPS structural primary balance 5/	0.1	-5.4	-2.5	-0.7	-0.9	-0.8	-0.5	-0.1	0.5	0.5	0.5
Fiscal impulse (+ = expansionary) 6/	-0.8	5.2	-2.5	-1.9	0.2	-0.1	-0.3	-0.5	-0.5	0.0	0.0

Sources: National Authorities; and IMF staff estimates.
1/ Official data excludes expense accrued during the period by Repayment Certificates (CRPAOs) but includes cash payments.
2/ Official data excludes stock of debt accumulated and not paid during the period by CRPAOs.
3/ Obligations of depository corporations with the public sector.
4/ Net of tax restitutions. In 2014, excludes one-off revenue from the sale of a mine Las Bambas.
5/ Adjusted by the economic cycle and commodity prices, and for non-structural commodity revenue. The latter uses as equilibrium commodity prices a moving average estimate that takes 5 years of historical prices and 3 years of forward prices according to the IMF's World Economic Outlook.
6/ Percentage points of potential GDP.

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

(In percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	Est. 2023	Proj. 2024	2025	2026	2027	2028	2029
Revenue	**19.8**	**17.8**	**21.0**	**22.0**	**19.7**	**20.0**	**20.1**	**20.1**	**20.1**	**20.2**	**20.3**
Taxes	14.7	13.3	16.3	17.2	15.1	15.3	15.4	15.4	15.4	15.5	15.5
Social Contributions	2.2	2.2	2.1	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other revenue	2.8	2.3	2.5	2.8	2.6	2.7	2.7	2.7	2.7	2.7	2.7
Expense 2/	**16.7**	**21.6**	**18.5**	**17.3**	**17.1**	**17.2**	**16.6**	**15.9**	**15.2**	**15.2**	**15.1**
Compensation of employees	6.3	7.3	6.2	6.0	6.3	6.2	6.2	6.2	6.2	6.2	6.2
Use of goods and services	5.7	6.3	6.1	6.0	5.9	5.7	5.6	5.4	5.4	5.4	5.4
Interest	1.3	1.5	1.4	1.4	1.5	1.6	1.5	1.3	1.2	1.1	0.9
Social benefits	1.8	1.9	1.8	1.8	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Other 3/	1.6	4.7	3.0	2.2	1.8	2.0	1.8	1.3	0.7	0.8	0.9
Net Acquisition of Nonfinancial Assets	**4.5**	**4.5**	**5.0**	**6.1**	**5.3**	**5.3**	**5.3**	**5.3**	**5.3**	**5.3**	**5.3**
Acquistion of nonfinancial assets	4.5	4.5	5.0	6.1	5.3	5.3	5.3	5.3	5.3	5.3	5.3
Gross Operating Balance	3.1	-3.8	2.5	4.7	2.5	2.8	3.5	4.2	5.0	5.0	5.1
Net Lending (+) Borrowing (-) 4/	**-1.4**	**-8.3**	**-2.5**	**-1.4**	**-2.8**	**-2.5**	**-1.9**	**-1.1**	**-0.4**	**-0.3**	**-0.2**
Net Acquistion of Financial Assets 5/	**0.6**	**-0.7**	**3.7**	**-1.0**	**-2.9**	**-2.3**	**-1.9**	**-1.3**	**-0.9**	**0.0**	**0.2**
By instrument											
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits 6/	0.6	-0.7	3.7	-1.0	-2.9	-2.3	-1.9	-1.3	-0.9	0.0	0.2
By residency											
Domestic	0.6	-0.7	3.7	-1.0	-2.9	-2.3	-1.9	-1.3	-0.9	0.0	0.2
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Incurrence of Liabilities 7/	**2.0**	**7.6**	**6.2**	**0.4**	**-0.2**	**0.2**	**0.0**	**-0.2**	**-0.6**	**0.4**	**0.4**
By instrument											
Debt securities	1.2	3.1	0.5	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3
Loans	0.7	4.5	5.8	0.3	-0.3	-0.1	-0.3	-0.5	-0.9	0.1	0.1
By residency											
Domestic	1.2	3.1	0.5	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.3
External	0.7	4.5	5.8	0.3	-0.3	-0.1	-0.3	-0.5	-0.9	0.1	0.1
Memorandum Items											
Central Government Net lending (+) borrowing (-)	-2.5	-8.9	-3.8	-3.3	-4.0	-3.3	-2.6	-1.7	-0.8	-0.6	-0.7
Regional Governments Net lending (+) borrowing (-)	0.5	-0.1	0.7	1.0	0.5	0.5	0.5	0.6	0.6	0.6	0.7
Local Governments Net lending (+) borrowing (-)	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0
General Government Primary Balance	-0.1	-6.8	-1.2	0.0	-1.2	-0.9	-0.4	0.2	0.8	0.8	0.7
General Government Overall Balance	-1.4	-8.3	-2.5	-1.4	-2.8	-2.5	-1.9	-1.1	-0.4	-0.3	-0.2
Gen. Gov. primary spending (real percentage change)	1.3	12.8	5.3	-1.5	-4.7	2.7	0.7	-0.4	-0.8	2.7	3.0
Of which: Current spending	3.4	19.4	-0.4	-7.8	-1.8	2.7	0.0	-1.5	-1.9	2.8	3.2
Capital spending	-5.1	-9.6	31.2	20.1	-12.1	2.6	2.9	2.6	2.4	2.3	2.3
General Government non-financial expenditures	19.9	24.6	22.1	22.0	20.9	20.9	20.5	19.9	19.3	19.4	19.5

Sources: National authorities and IMF staff estimates.
1/ Fiscal data is not fully compiled on an accrual basis.
2/ Official data excludes expense accrued during the period by Repayment Certificates (CRPAOs) and Petroleum Price Stabilization Fund (FEPC), but includes cash payments.
3/ Includes other transfers.
4/ Net lending (+)/ borrowing (-) is equal to gross operating balance minus net acquistions of nonfinancial assets.
5/ (+) corresponds to increase in financial assets; (-) to a decrease in financial assets.
6/ Includes Fiscal Stabilization Fund (FEF).
7/ (+) corresponds to increase in liabilities (disbursement and/or issuance); (-) to decrease in liabilities (amortizations).

Table 4. Peru: Monetary Survey 1/

(In billions of soles, unless otherwise indicated)

	2019	2020	2021	2022	Est. 2023	Proj. 2024	2025	2026	2027	2028	2029
					Central Bank						
Net Foreign Assets	**170**	**223**	**236**	**211**	**210**	**196**	**202**	**211**	**221**	**232**	**240**
(In billions of U.S. dollars)	85	88	92	83	80	90	93	95	97	98	100
Net international reserves 2/	226	270	312	274	264	274	285	293	303	311	318
(In billions of U.S. dollars)	68	75	78	72	71	74	76	78	81	82	84
Long-term net external assets	0	0	-10	-10	-9	-9	-9	-9	-9	-9	-10
Foreign currency liabilities	-57	-48	-65	-53	-44	-69	-73	-73	-73	-69	-69
Net Domestic Assets	**-105**	**-137**	**-139**	**-118**	**-116**	**-107**	**-111**	**-114**	**-119**	**-125**	**-127**
Net credit to nonfinancial public sector	-64	-49	-71	-65	-43	-43	-43	-43	-43	-43	-43
Credit to the financial sector 3/	5	41	30	11	4	11	17	24	30	37	37
Securities issued	-28	-89	-42	-29	-41	-44	-47	-52	-57	-62	-68
Other assets (net)	-18	-40	-56	-36	-36	-31	-38	-43	-50	-57	-53
Monetary Base	**65**	**86**	**97**	**93**	**90**	**89**	**91**	**96**	**101**	**107**	**113**
Currency	52	72	83	80	75	75	77	81	86	90	95
Reserve	12	14	14	13	15	14	14	15	16	17	18
					Depository Corporations 4/						
Net Foreign Assets	**194**	**248**	**274**	**237**	**222**	**241**	**252**	**261**	**271**	**280**	**288**
Net Domestic Assets	**143**	**189**	**174**	**210**	**232**	**230**	**242**	**259**	**277**	**298**	**323**
Net credit to the public sector	-62	-40	-74	-58	-31	-40	-39	-40	-42	-40	-36
Credit to the private sector	331	378	403	417	419	435	456	479	505	533	562
Other assets (net)	-126	-150	-155	-149	-155	-165	-175	-181	-186	-195	-204
Broad Money	**338**	**436**	**448**	**447**	**454**	**471**	**494**	**520**	**548**	**578**	**610**
Domestic currency	237	314	312	314	324	340	359	381	404	427	452
Foreign currency	101	122	136	133	129	131	134	139	145	151	158
					Financial System 5/						
Net Foreign Assets	**298**	**366**	**359**	**316**	**304**	**316**	**327**	**336**	**347**	**356**	**364**
Net Domestic Assets	**256**	**289**	**265**	**273**	**309**	**315**	**324**	**341**	**359**	**379**	**401**
Net credit to the public sector	-15	1	-43	-50	-23	-32	-31	-32	-34	-32	-28
Credit to the private sector	393	442	469	478	493	507	529	556	585	617	650
Other assets (net)	-122	-155	-160	-160	-184	-192	-205	-215	-226	-238	-249
Liabilities to the Private Sector	**554**	**654**	**624**	**604**	**613**	**631**	**651**	**677**	**706**	**735**	**765**
Domestic currency	428	501	462	441	453	472	491	514	539	563	589
Foreign currency	127	153	162	163	160	159	160	163	167	171	176
Monetary base	5.2	33.2	13.1	-4.4	-3.2	-1.3	2.8	5.3	5.5	5.5	5.5
Broad money	8.8	29.2	2.7	-0.3	1.5	3.9	4.7	5.3	5.5	5.5	5.5
Domestic currency	10.2	32.7	-0.7	0.5	3.4	4.9	5.5	5.9	6.0	5.9	5.8
Foreign currency	5.6	21.1	11.4	-2.3	-2.8	1.4	2.6	3.6	4.1	4.3	4.6
Liabilities to the private sector	11.3	18.1	-4.6	-3.2	1.4	2.9	3.2	4.0	4.2	4.1	4.1
Domestic currency	11.8	17.1	-7.7	-4.6	2.8	4.0	4.1	4.7	4.8	4.5	4.5
Foreign currency	9.6	21.3	5.7	0.7	-2.3	-0.3	0.6	1.8	2.4	2.6	2.9
Depository corp credit to the private sector	6.4	14.0	6.5	3.6	0.4	4.0	4.8	5.1	5.5	5.5	5.5
Domestic currency	9.8	19.7	5.6	2.5	0.6	4.5	5.6	6.1	6.5	6.6	6.5
Foreign currency	-2.2	-2.5	10.0	7.3	-0.5	2.1	2.0	1.6	1.6	1.5	1.5

Sources: National Authorities; and IMF staff estimates.

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

2/ Excludes subscriptions to the IMF and the Latin American Reserve Fund, Pesos Andinos, credit lines to other central banks, Andean Development Corporation bonds, and foreign assets temporarily held by the Central Bank as part of swap operations.

3/ Including the National Bank.

4/ Depository corporations comprise the Central Bank, the National Bank, commercial banks, the Agricultural Bank, financial firms, municipal banks, rural banks and credit unions.

5/ Financial system comprises depository corporations and other financial corporations. Other financial companies include mutual funds, COFIDE, insurance companies, leasing companies, pension funds, the Financing Agency for SMEs and the Fund for Financing Housing.

Table 5. Peru: Financial Soundness Indicators 1/

(In percent, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Credit										
Total assets (in billions of domestic currency)	327.5	393.9	394.9	415.0	433.6	468.0	578.6	579.0	569.0	581.0
Total assets (percent of GDP)	56.9	64.4	59.8	59.0	58.1	60.3	80.3	66.1	60.7	57.6
Total non-interbank loans (in billions of domestic currency)	222.6	254.5	267.8	282.4	311.1	329.7	372.4	397.4	410.9	408.0
Total non-interbank loans (percent of GDP)	38.6	41.6	40.6	40.1	41.7	42.5	51.7	45.3	43.8	40.4
Loan to asset ratio	71.5	70.7	68.2	70.5	74.5	72.8	70.1	68.0	71.3	70.8
Credit-to-GDP ratio of financial system	43.8	47.9	48.6	47.0	47.8	48.8	52.8	60.7	50.6	48.1
Credit-to-GDP gap of financial system	0.0	4.7	2.9	-3.0	-4.0	-4.5	0.8	13.0	-3.1	-6.6
Real growth of credit to private sector (total, deposit institutions, yoy)	9.8	10.5	1.6	2.1	8.8	4.5	11.7	1.9	-3.9	-2.0
In domestic currency	14.3	24.6	3.6	2.3	10.1	7.9	17.4	1.2	-5.9	-5.7
In foreign currency	3.0	-12.6	-3.1	1.6	5.6	-4.4	-4.6	4.5	-0.8	-5.9
Real growth of credit from deposit institutions to private sector (NFC, yoy)	9.6	10.1	0.6	0.3	7.8	1.5	22.4	2.3	-10.9	-11.2
Real growth of credit from deposit institutions to private sector (consumers, yoy)	8.7	12.6	5.0	5.5	11.9	10.4	-8.2	-0.6	13.2	6.6
Real growth of credit from deposit institutions to private sector (mortgages, yoy)	11.8	9.0	0.9	4.7	8.3	6.4	2.4	4.0	-0.8	-0.9
Capital Adequacy										
Capital to risk-weighted assets	14.2	14.3	15.1	15.2	14.7	14.7	15.6	15.0	14.5	16.3
Regulatory Tier 1 capital to risk-weighted assets	10.4	10.3	11.0	11.4	11.3	11.6	11.8	11.0	11.0	13.1
Financial leverage	9.2	8.6	9.5	9.8	10.4	10.9	9.1	9.4	10.3	11.7
Asset Quality										
NPLs net of provisions to capital 2/	0.2	-0.3	-0.4	-0.6	-0.6	-0.5	-3.6	-1.4	0.3	-0.5
NPLs to gross loans 2/	2.9	2.8	3.0	3.3	3.3	3.4	4.1	3.9	4.1	4.5
Earnings and Profitability										
Return on equity (ROE)	18.4	21.2	19.3	17.7	17.9	18.0	3.1	12.1	16.5	13.0
Return on assets (ROA)	2.7	2.9	2.7	2.7	2.9	3.0	0.4	1.7	2.5	2.2
Interest margin to gross income	86.1	81.0	86.0	87.4	88.4	88.0	91.7	90.2	90.7	91.7
Trading income to gross income	6.9	9.6	6.5	6.5	5.8	6.9	7.7	7.8	5.9	5.8
Noninterest expenses to gross income	49.1	45.9	46.9	46.2	45.5	44.6	48.0	51.2	46.6	44.8
Provisions to NPLs to gross income	23.4	23.7	26.4	28.7	29.4	29.4	51.3	46.4	38.4	39.2
Liquidity										
Total liquid assets to total assets	23.4	22.3	20.9	23.2	21.6	22.6	30.9	25.7	22.7	23.3
Total liquid assets to total short-term liabilities	39.4	37.7	35.4	38.5	34.6	36.4	50.3	40.4	35.2	35.1
Deposit-to-loan	89.6	91.6	88.1	91.1	88.6	90.5	98.2	91.5	89.1	92.4
Foreign Currency Position and Dollarization										
Net open foreign exchange positions to capital	1.9	7.9	2.3	2.5	1.8	1.7	0.8	2.1	1.3	1.4
Share of foreign currency liabilities in total liabilities	48.2	49.1	44.4	40.7	39.1	37.6	33.4	37.7	36.6	35.9
Share of foreign currency loans in total loans	38.2	30.1	28.7	29.3	28.3	26.4	22.7	23.2	24.2	24.6
Share of foreign currency credit to private sector in total credit to private sector	40.2	35.8	31.7	30.4	30.2	28.3	25.8	24.8	24.3	23.3
Equity and Property Market										
General stock market index, IGBVL, point	15,794.7	12,007.7	13,500.8	17,155.5	20,147.9	20,081.4	17,733.8	20,097.5	21,361.7	22,440.5
Equity market capitalization-to-GDP ratio	38.9	29.4	41.0	46.0	41.2	42.6	42.3	34.5	29.2	32.1

Sources: BCRP, BIS, IMF, SBS, World Federation of Exchanges.

1/ These indicators are those for deposit institutions, unless otherwise indicated.

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

Table 6. Peru: Balance of Payments

(In billions of U.S. dollars, unless otherwise indicated

	2019	2020	2021	2022	Est.	Proj.					
					2023	2024	2025	2026	2027	2028	2029
Current Account	**-1.3**	**2.2**	**-5.1**	**-9.9**	**1.7**	**-3.2**	**-4.0**	**-4.4**	**-4.7**	**-4.9**	**-5.1**
Merchandise trade	6.9	8.1	15.0	10.3	17.4	14.3	14.1	15.1	15.7	16.3	17.1
Exports	48.0	42.8	63.0	66.2	67.2	66.7	68.8	71.5	74.0	76.6	79.4
Traditional	34.0	30.0	46.7	47.8	48.6	47.6	48.7	50.6	52.1	53.7	55.6
Mining	28.3	26.1	39.8	38.1	42.5	41.6	42.1	43.7	45.2	46.8	48.7
Nontraditional and others	14.0	12.8	16.3	18.5	18.6	19.2	20.0	20.9	21.9	22.9	23.8
Imports	41.1	34.7	48.0	55.9	49.8	52.5	54.7	56.4	58.3	60.3	62.3
Services, income, and current transfers (net)	-8.2	-5.9	-20.0	-20.2	-15.7	-17.5	-18.1	-19.5	-20.4	-21.2	-22.2
Services	-4.0	-4.9	-7.8	-8.6	-7.8	-7.3	-7.4	-7.2	-7.0	-6.7	-6.8
Investment income	-9.6	-6.2	-18.1	-17.4	-14.7	-16.5	-17.2	-18.9	-20.0	-21.3	-22.6
Current transfers	5.4	5.2	5.8	5.8	6.8	6.4	6.4	6.6	6.6	6.9	7.2
Capital and Financial Account Balance	**-7.3**	**-6.5**	**-15.6**	**-9.2**	**1.0**	**-5.7**	**-6.5**	**-6.5**	**-7.1**	**-6.8**	**-6.8**
Public sector MLT flows	-4.4	-9.8	-15.6	1.0	0.9	0.2	0.8	1.4	2.7	-0.3	-0.5
Assets	-0.2	0.3	0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	4.2	10.1	15.6	-1.1	-0.8	-0.2	-0.8	-1.4	-2.7	0.3	0.5
Portfolio investment	-0.8	6.9	11.2	-0.1	-1.8	-0.4	-1.3	-1.9	-1.8	0.0	-0.2
Other transactions involving Treasury bonds	4.5	1.1	0.3	-1.8	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Medium-term loans 1/	0.4	2.1	2.4	0.8	0.9	0.1	0.4	0.4	-1.0	0.2	0.6
Disbursements	1.1	2.5	2.8	1.8	2.0	1.2	1.8	1.5	0.9	2.1	2.2
Amortization	-0.7	-0.3	-0.4	-1.1	-1.1	-1.1	-1.4	-1.1	-1.8	-1.9	-1.6
BCRP: other transactions	0.0	0.0	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector MLT flows	-2.4	2.6	-16.6	-14.6	0.4	-5.6	-6.4	-8.0	-8.3	-8.9	-9.4
Assets	1.1	0.8	-8.7	-2.9	5.5	6.0	5.4	4.2	4.2	4.2	4.2
FDI	-0.4	1.6	1.7	-0.4	1.4	1.6	1.6	1.6	1.6	1.6	1.6
Portfolio investment	1.6	-0.8	-10.4	-2.5	4.0	4.5	3.8	2.7	2.7	2.7	2.7
Liabilities	3.6	-1.8	7.9	11.7	5.1	11.7	11.7	12.3	12.5	13.2	13.6
FDI 2/	4.8	0.8	7.4	10.8	4.2	9.5	9.8	10.7	11.2	12.1	12.7
Portfolio investment	1.1	0.7	1.1	-0.8	-0.3	0.9	0.9	0.9	0.9	0.9	0.9
Medium- and long-term loans (net)	-2.3	-3.3	-0.6	1.6	1.2	1.3	1.0	0.7	0.4	0.2	0.0
Short-term capital 3/	-0.5	0.6	16.6	4.4	-0.2	-0.2	-0.9	0.2	-1.5	2.5	3.1
Assets	-1.9	2.5	16.3	4.1	1.9	-0.2	-0.9	0.2	-1.5	2.5	3.1
Liabilities	-1.4	1.9	-0.2	-0.3	2.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors and Omissions	**0.8**	**-3.5**	**-6.1**	**-4.4**	**-3.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall Balance	**6.9**	**5.3**	**4.4**	**-5.1**	**-2.8**	**2.5**	**2.5**	**2.1**	**2.4**	**1.9**	**1.7**
Financing	**-6.9**	**-5.3**	**-4.4**	**5.1**	**2.8**	**-2.5**	**-2.5**	**-2.1**	**-2.4**	**-1.9**	**-1.7**
NIR flow (increase -)	-6.9	-5.3	-4.4	5.1	2.8	-2.5	-2.5	-2.1	-2.4	-1.9	-1.7
Change in NIR (increase -)	-8.2	-6.4	-3.8	6.6	0.9	-2.5	-2.5	-2.1	-2.4	-1.9	-1.7
Valuation change	1.3	1.1	-0.6	-1.5	1.9	0.0	0.0	0.0	0.0	0.0	0.0
					(In percent of GDP)						
Current Account Balance	**-0.6**	**1.1**	**-2.2**	**-4.0**	**0.6**	**-1.1**	**-1.4**	**-1.4**	**-1.5**	**-1.5**	**-1.5**
Capital and Financial Account Balance	**-3.2**	**-3.2**	**-6.9**	**-3.8**	**0.4**	**-2.0**	**-2.2**	**-2.1**	**-2.2**	**-2.0**	**-2.0**
Foreign direct investment (net)	-2.2	0.4	-2.5	-4.6	-1.0	-2.8	-2.8	-3.0	-3.0	-3.2	-3.2
Overall Balance	**3.0**	**2.6**	**2.0**	**-2.1**	**-1.0**	**0.9**	**0.8**	**0.7**	**0.8**	**0.6**	**0.5**
Memorandum Items					(Annual percentage change)						
Export value	-2.2	-10.7	47.0	5.2	1.5	-0.8	3.1	4.0	3.4	3.5	3.6
Volume growth	1.2	-13.9	12.5	3.3	3.4	-1.4	2.0	3.0	2.7	2.8	2.6
Price growth	-3.4	3.6	30.7	1.8	-1.9	0.7	1.0	1.0	0.8	0.7	1.0
Import value	-1.8	-15.5	38.2	16.5	-10.8	5.3	4.3	3.1	3.3	3.5	3.2
Volume growth	-0.2	-11.0	18.5	2.4	-4.4	4.6	3.7	2.6	2.5	2.3	2.0
Price growth	-1.7	-5.0	16.7	13.7	-6.8	0.6	0.5	0.6	0.8	1.1	1.2
Terms of trade	-1.8	9.1	12.0	-10.5	5.3	0.1	0.5	0.4	0.0	-0.4	-0.2
Gross international reserves (in billions of US$)	68.4	74.9	78.5	72.2	71.3	73.8	76.3	78.4	80.8	82.7	84.4
Average exchange rate (S/. per US$)	3.34	3.50	3.88	3.83	3.74	3.72	3.74	3.75	3.76	3.77	3.77

Sources: National authorities and IMF staff estimates and projections.

1/ Includes financial public sector.

2/ Excluding privatizations.

3/ Includes Financial Corporation for Development (COFIDE) and the National Bank.

Table 7. Peru: Financial and External Vulnerability Indicators

(In percent, unless otherwise indicated)

					Est.	Proj.					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Financial Indicators											
Public sector debt/GDP	27.0	34.9	36.1	33.9	32.1	33.0	33.3	33.2	32.6	32.1	31.6
Of which: in domestic currency (percent of GDP)	18.5	20.1	16.7	16.4	16.1	17.8	19.0	20.1	21.1	21.3	21.4
90-day prime lending rate, domestic currency (end of period)	3.3	0.6	2.9	8.7	...	...	...	...	...	...	...
90-day prime lending rate, foreign currency (end of period)	2.7	1.1	1.0	5.5	...	...	...	...	...	...	...
Velocity of money 1/	2.3	1.7	2.0	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.1
Net credit to the private sector/GDP 2/	42.7	52.4	45.9	44.4	41.8	41.4	41.4	41.6	42.0	42.5	43.0
External Indicators											
Exports, U.S. dollars (percent change)	-2.2	-10.7	47.0	5.2	1.5	-0.8	3.1	4.0	3.4	3.5	3.6
Imports, U.S. dollars (percent change)	-1.8	-15.5	38.2	16.5	-10.8	5.3	4.3	3.1	3.3	3.5	3.2
Terms of trade (percent change) (deterioration -) 3/	-1.8	9.1	12.0	-10.5	5.3	0.1	0.5	0.4	0.0	-0.4	-0.2
Current account balance (percent of GDP)	-0.6	1.1	-2.2	-4.0	0.6	-1.1	-1.4	-1.4	-1.5	-1.5	-1.5
Capital and financial account balance (percent of GDP)	-3.2	-3.2	-6.9	-3.8	0.4	-2.0	-2.2	-2.1	-2.2	-2.0	-2.0
Total external debt (percent of GDP)	34.8	43.7	46.3	43.0	40.6	38.2	37.0	35.5	33.6	32.7	31.8
Medium- and long-term public debt (in percent of GDP) 4/	16.9	23.7	26.8	24.6	22.6	21.3	20.1	18.8	17.2	16.6	16.0
Medium- and long-term private debt (in percent of GDP)	14.5	15.2	15.3	14.5	13.6	13.7	13.7	13.7	13.6	13.4	13.1
Short-term public and private debt (in percent of GDP)	3.4	4.8	4.2	3.9	4.3	4.1	3.9	3.8	3.6	3.5	3.4
Total external debt (in percent of exports of goods and services) 4/	148.0	197.4	158.8	147.7	148.7	148.1	144.7	138.8	131.8	128.3	124.7
Total debt service (in percent of exports of goods and services) 5/	34.7	34.8	25.3	23.9	27.5	29.3	30.3	29.9	29.9	26.5	25.2
Gross official reserves											
In millions of U.S. dollars	68,370	74,909	78,539	72,246	71,319	73,819	76,319	78,419	80,819	82,719	84,411
In percent of short-term external debt 6/	473	495	583	530	409	459	438	438	430	483	493
In percent of short-term external debt, foreign currency deposits, and adjusted CA balance 6/ 7/	152	153	162	145	136	144	143	143	141	145	143
In percent of broad money 8/	68	62	70	62	58	58	58	57	55	54	52
In percent of foreign currency deposits at banks	224	222	229	207	205	210	212	211	210	206	202
In months of next year's imports of goods and services	19.4	15.3	13.6	13.7	13.0	12.9	13.0	13.3	13.3	13.2	13.0
Net international reserves (in millions of U.S. dollars)	68,316	74,707	78,495	71,883	71,033	73,533	76,033	78,133	80,533	82,433	84,125
Central Bank's Foreign Exchange Position	42,619	58,258	57,345	52,040	51,571	54,071	56,571	58,671	61,071	62,971	64,663

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

Table 8. Peru: Medium-Term Macroeconomic Framework

					Est.	Proj.					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
	(Annual percentage change)										
Production											
GDP at constant prices	2.2	-10.9	13.4	2.7	-0.6	2.5	2.7	2.3	2.3	2.3	2.3
Domestic demand at constant prices	2.2	-9.7	14.5	2.3	-1.7	4.1	3.1	2.2	2.3	2.2	2.1
Consumption	3.1	-7.3	12.1	2.4	0.6	2.5	2.5	1.9	1.9	1.9	1.8
Private	3.2	-9.9	12.4	3.6	0.1	2.6	2.6	2.0	1.8	1.9	1.8
Public	2.2	7.5	10.9	-3.4	3.3	1.7	1.7	1.3	2.2	2.1	2.1
Investment	3.3	-16.2	34.6	1.0	-5.6	2.3	2.0	1.7	1.7	1.7	2.2
Of which: Private	4.5	-16.5	36.9	-0.4	-7.2	2.7	1.6	1.2	1.2	1.2	1.7
Of which: Public	-1.5	-15.1	24.8	7.7	1.4	1.1	3.7	3.6	3.6	3.7	3.7
Net exports (contribution to GDP growth)	0.1	-1.3	-1.0	0.4	1.2	-1.5	-0.4	0.1	0.0	0.1	0.1
Exports	1.1	-19.7	13.2	6.1	3.7	-1.4	2.0	3.0	2.7	2.8	2.6
Imports	1.0	-15.8	18.0	4.4	-0.9	4.6	3.7	2.6	2.5	2.3	2.0
Consumer prices (end of period)	1.9	2.0	6.4	8.5	3.2	2.4	2.0	2.0	2.0	2.0	2.0
GDP deflator	1.7	4.3	7.4	4.2	7.2	2.3	2.1	2.1	2.1	2.0	2.0
Trade											
Merchandise trade											
Exports, f.o.b.	-2.2	-10.7	47.0	5.2	1.5	-0.8	3.1	4.0	3.4	3.5	3.6
Imports, f.o.b.	-1.8	-15.5	38.2	16.5	-10.8	5.3	4.3	3.1	3.3	3.5	3.2
Terms of trade (deterioration -)	-1.8	9.1	12.0	-10.5	5.3	0.1	0.5	0.4	0.0	-0.4	-0.2
	(In percent of GDP; unless otherwise indicated)										
External Current Account Balance	-0.6	1.1	-2.2	-4.0	0.6	-1.1	-1.4	-1.4	-1.5	-1.5	-1.5
Total External Debt Service 1/	8.2	7.7	7.4	7.0	7.5	7.6	7.8	7.6	7.6	6.7	6.4
Medium- and long-term	4.0	3.7	2.9	2.9	3.7	3.2	3.6	3.7	3.9	3.1	3.0
Nonfinancial public sector	0.8	0.7	0.8	1.4	1.9	1.6	1.8	1.8	1.9	1.3	1.2
Private sector	3.2	3.0	2.1	1.5	1.8	1.7	1.8	1.9	1.9	1.8	1.8
Short-term 2/	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Nonfinancial public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Interest	1.3	1.3	1.2	1.4	1.7	1.9	1.8	1.8	1.7	1.6	1.5
Amortization (medium-and long-term)	2.8	2.5	1.7	1.6	2.2	1.6	2.0	2.0	2.2	1.6	1.6
Public Sector											
NFPS primary balance 3/	-0.2	-7.3	-1.0	-0.1	-1.1	-0.8	-0.3	0.2	0.7	0.7	0.6
NFPS interest due	1.4	1.6	1.5	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.6
NFPS overall balance 3/	-1.6	-8.9	-2.5	-1.7	-2.8	-2.5	-2.0	-1.5	-1.0	-1.0	-1.0
Public sector debt 3/	27.0	34.9	36.1	33.9	32.1	33.0	33.3	33.2	32.6	32.1	31.6
Savings and Investment											
Gross domestic investment	21.8	19.9	21.7	22.1	19.2	20.4	20.8	20.9	21.1	21.3	21.5
Public sector 3/	4.6	4.3	4.7	5.1	5.0	4.8	4.8	4.9	4.9	5.0	5.1
Private sector	17.3	15.7	17.1	17.0	14.2	15.5	16.0	16.1	16.2	16.3	
Private sector (excluding inventories)	18.0	16.8	20.4	20.2	17.9	17.7	17.4	17.2	16.9	16.7	16.6
Inventory changes	-0.7	-1.1	-3.3	-3.2	-3.7	-2.2	-1.5	-1.1	-0.7	-0.4	-0.1
National savings	21.3	21.0	19.5	18.1	19.8	19.3	19.5	19.5	19.7	19.8	20.0
Public sector 4/	3.4	-4.6	2.8	4.4	3.0	3.1	3.6	4.1	4.6	4.6	4.6
Private sector	17.9	25.6	16.7	13.7	16.8	16.1	15.8	15.4	15.1	15.2	15.4
External savings	0.6	-1.1	2.2	4.0	-0.6	1.1	1.4	1.4	1.5	1.5	1.5
Memorandum Items											
Nominal GDP (billions of nuevos soles)	775.6	720.8	877.8	939.4	1001.7	1050.8	1,101.6	1,151.1	1,202.1	1,254.7	1,308.8
Gross international reserves (billions of U.S. dollars)	68.4	74.9	78.5	72.2	71.3	73.8	76.3	78.4	80.8	82.7	84.4
External debt service (percent of exports of GNFS)	34.7	34.8	25.3	23.9	27.5	29.3	30.3	29.9	29.9	26.5	25.2
Short-term external debt service (percent of exports of GNFS)	0.5	0.5	0.3	0.5	0.8	0.9	0.7	0.5	0.5	0.5	0.4
Public external debt service (percent of exports of GNFS)	3.4	3.2	2.8	4.7	6.9	6.0	7.2	7.1	7.6	5.1	4.7

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

Annex I. Recommendations of the 2023 Article IV Consultation and Authorities' Actions

Recommendations	Policy Action
Fiscal Policy	
Fiscal stance. A slightly expansionary fiscal stance in the short term is appropriate. The fiscal adjustment path over the medium term to achieve the fiscal target of a deficit of 1 percent of GDP should be gradual.	**Implemented.** The fiscal impulse was slightly positive in 2023. The authorities remain committed to a gradual fiscal consolidation consistent with the fiscal rule, with the NFPS deficit reduced by about 0.5 percent of GDP per year during 2024-26.
Fiscal Council. Augment the Fiscal Council's (FC) operational independence and enhance transparency and accountability in the dialogue with the government to support confidence in the fiscal framework.	**Partially implemented**. The opinion of the FC and the response from the Ministry of Finance are included in the Budget but not in the Mid-term Budget Update. Both institutions would benefit from a more regular and transparent dialogue.
Fiscal consolidation. Tax administration should be improved, tax expenditures streamlined, and the tax system simplified. Enhanced targeting of social benefits, a comprehensive civil service reform, and improved governance at SOEs will help address rising spending needs, strengthen government effectiveness, and contain fiscal risks.	**Partially implemented**. The government presented in January 2024 a proposal to reduce the number of corporate tax regimes from four to just two. Tax administration and compliance have significantly improved in recent years, but further improvements would require additional resources and independence.
Pension Reform. Is urgent following large withdrawals from private pension funds. Additional withdrawals will exacerbate existing problems.	**In progress**. The government presented a reform proposal in October 2023, which contains measures to limit early withdrawals. Congress approved in April 2024 a seventh round of pension withdrawals.
Monetary and ER Policy	
Monetary stance. Monetary policy tightening should continue to remain data dependent. Decisions to pause are warranted, but a premature end to the tightening cycle should be avoided.	**Implemented**. Monetary policy remained tight, leading to a rapid decline in inflation and inflation expectations throughout the year and reaching the inflation target in January 2024. An easing cycle began in September, after 8 months of declining inflation.

Recommendations	Policy Action
Foreign exchange interventions (FXI). Consider the tradeoffs of frequent FXI. Fewer and more targeted interventions can address risks while permitting the FX market to develop.	**Partially implemented**. The authorities have maintained a discretionary approach since the 1990s and provide ample information on FXI. Market participants understand that FXI is limited to moderate FX volatility and to mitigate financial risks. There has been a development in the FX market in the last years, both in the spot and derivatives markets.
Financial Policies	
Macroprudential. Closely monitor bank portfolios and lending standards, should vulnerabilities emerge in an environment of tightening financial conditions.	**Implemented**. Enhanced vigilance is in place given emerging pockets of vulnerability amid the slowing growth.
Regulation. Close key regulatory and supervisory gaps in line with the recommendations of the 2018 FSAP.	**In progress**. See Annex VI. The full implementation of Basel III capital requirements was delayed due to El Niño and political instability.
Structural Policies	
Productivity. Boost productivity by improving education, enhancing infrastructure, facilitating labor reallocation, and improving the business climate.	**Partially implemented.** The government has taken measures to improve the business climate, reduce red tape and unblock large infrastructure projects.
Informality. Reduce informality.	**Partially implemented.** Informality has been reduced from the high levels observed in 2020 but remains elevated.
Governance. Improve the effectiveness of public services and enhance transparency, including by strengthening anti-corruption enforcement and institutions.	**In progress.** The National Board of Justice, which appoints judges and prosecutors, is fully operational, but civil service reform is pending.
Infrastructure. Strengthen the capacity to execute public investment to reduce the large infrastructure gap.	**Partially implemented.** Public investment was low in 2023 following local elections in 2022. The government has implemented initiatives to improve local government capacity. The government has taken measures to unblock large infrastructure projects.

Annex II. External Sector Assessment

Overall Assessment: *Peru's external position in 2023 was moderately stronger than the level implied by medium-term fundamentals and desirable policies. This assessment is informed by the current account model, based on actual 2023 current account. Despite volatile external environment, the impact of softer export prices, and political uncertainty, reserve coverage remains strong and adequate even after considering the dependence on commodity prices and the existence of substantial domestic FX liabilities. These estimates are subject to uncertainty related to the impact of multiple shocks that affected the economy in 2023.*

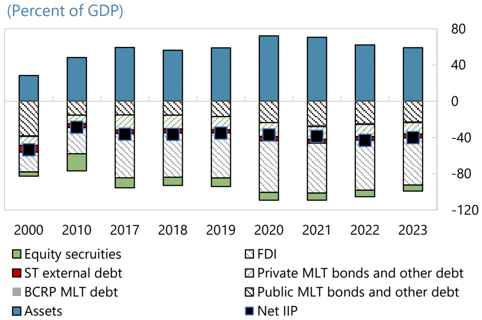
Potential Policy Responses: *Cautious and prudent monetary policy stance, continued exchange rate (ER) flexibility amid limited FX interventions and medium-term fiscal consolidation to return to the fiscal rule would help create a strong macroeconomic policy mix that would support the external position going forward. Given available substantial fiscal space, delaying the fiscal consolidation by one year in the short run would support the growth recovery and rebalancing of the current account closer to the norm. An acceleration of structural reforms, including growth-enhancing public and private investment and measures to improve productivity and reduce informality, could increase Peru's competitiveness, and support a balanced external position in the medium term.*

Foreign Assets and Liabilities: Position and Trajectory

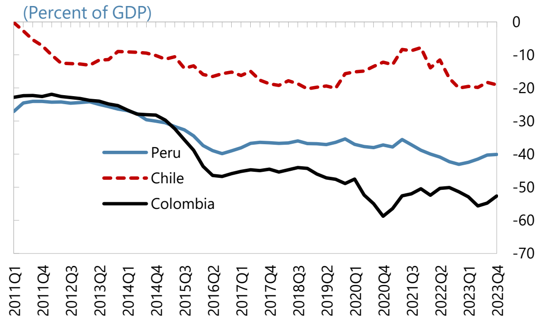
Background. Peru's IIP is characterized by large foreign reserves, moderate external debt, and large FDI liabilities. After increasing from a low of -53 percent of GDP in the late 90s to -24 percent of GDP in 2011, Peru's net IIP has been on a declining trend, driven by the accumulation of FDI liabilities. In 2023, the ratio of the net IIP to GDP rose slightly to -40 percent of GDP compared to 2022 (-43 percent of GDP). Peru's external assets (about 59 percent of GDP) include sizeable holdings of foreign assets by the central bank (27 percent of GDP) and the financial system (about 10 percent of GDP). The assets are offset by large FDI liabilities (52 percent of GDP), moderate external indebtedness (public and private external debt of about 40 percent of GDP), and equity securities (6.6 percent of GDP). The net IIP is projected to increase slightly and stay at about -38 percent of GDP over the medium term.

Assessment. Gross external financing needs declined, due to higher current account balance, to an estimated 5 percent of GDP in 2023. That said, the risks of pension withdrawals led to increased portfolio investments abroad by the pension funds and to lower NIIP. The external stability (ES) approach does not suggest a need for an external adjustment. The estimated medium-term current account balance (CAB) required to stabilize the NIIP at its end-2023 level is -2.3 percent of GDP, which is below the medium-term CAB projections in the baseline.

Net International Investment Position
(Percent of GDP)



Net International Investment Position
(Percent of GDP)



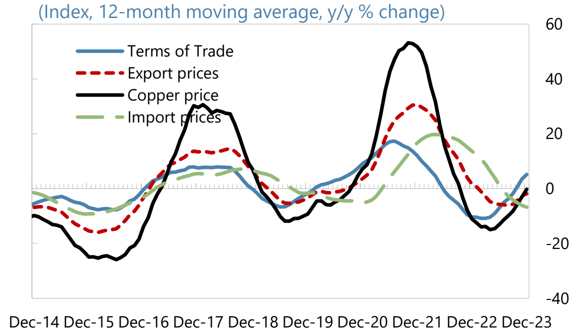
Sources: Haver, BCRP and IMF staff estimates.

2023 (% GDP)	NIIP: -40.1	Gross Assets: 59	Reserve Assets: 27	Gross Liab.: 99.2	Debt Liab.: 40.6

Current Account

Background. Led by sizable import compression amid subdued private consumption and investment, the current account deficit rapidly narrowed by about 4.6 pp of GDP to a surplus of 0.6 percent of GDP in 2023. The trade balance increased from 4.2 percent of GDP in 2022 to 6.5 percent of GDP, reflecting an improvement in the terms of trade and decline in import volume (about 5.2 percent and 4.2 percent over Jan-Dec 2023, respectively). Exports of goods increased by about 1.5 percent, reflecting a modest volume growth and lower export prices. Imports of goods contracted by about 11 percent, reflecting contraction both in volumes due to negative domestic demand (about 4 percent) and in import prices (about 6.8 percent). Investment income outflows declined by about 1.6 pp of GDP but remained high at 5.5 percent of GDP, as foreign companies still registered large profits. The services trade deficit narrowed by 0.6 pp of GDP as freight costs declined in line with lower import demand and tourism-related revenues started rebounding from low levels seen during pandemic. Over the medium term, the current account deficit is expected to stabilize at about 1.5 percent of GDP.

Terms of Trade
(Index, 12-month moving average, y/y % change)

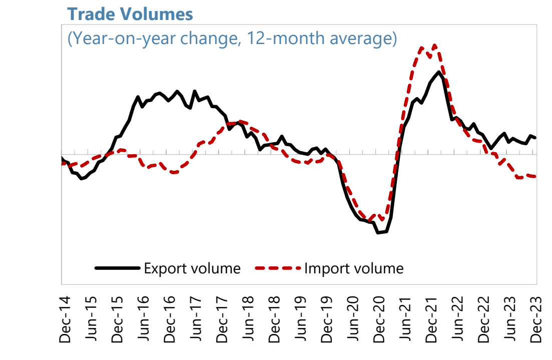


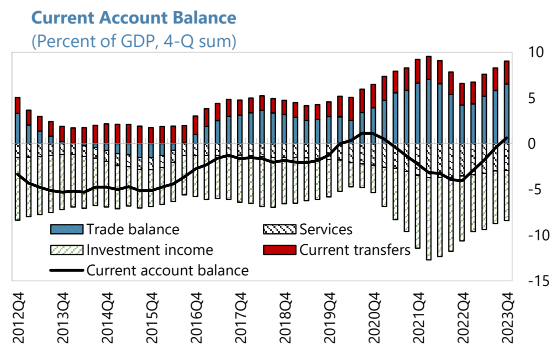
Current Account and REER Gaps, 2023
(Percent of GDP, unless stated otherwise)

	EBA CA regression	EBA REER (index)	EBA REER (level)
2023 CA act	**0.6**	..	..
Cyclical contributions (from model) (-)	0.8	..	..
COVID-19 adjustor (+)	0.0	..	..
Cyclically adjusted CA	**-0.2**	..	..
CA norm (from model) 1/	**-1.4**	..	..
CA gap 2/	**1.3**	..	..
o/w Policy gaps	0.5	..	..
Elasticity	-0.19	..	..
REER gap (in percent) 3/	***-7.0***	***9.7***	***28.5***

Source: IMF staff estimates.
1/ Cyclically adjusted
2/ The CA gap is the cyclically adjusted CA minus the CA norm.
3/ Positive value indicates overvaluation.

Assessment. The External Balance Assessment (EBA) CA model estimates a current account norm of -1.4 percent of GDP. After accounting for the temporary impact of cyclical factors such as terms of trade and business cycle, staff estimates the 2023 cyclically adjusted current account balance to be -0.2 percent of GDP, based on the actual 2023 CA of 0.6 percent of GDP. Thus, the overall CA gap is about 1.3 percent of GDP, indicating that the external position of Peru in 2023 was moderately stronger than the level implied by medium-term fundamentals and desirable policy settings. The positive policy gap (0.5 percent of GDP) is mainly explained by stronger fiscal balances compared to the rest of the world (the contribution of the relative fiscal policy gap to the overall CA gap being estimated at 0.8 percent of GDP) and a larger credit gap (the contribution estimated at -0.2 percent of GDP).



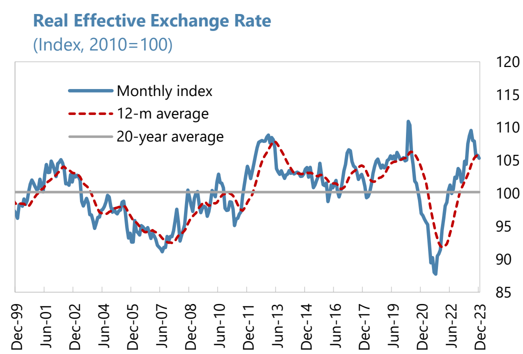


Sources: BCRP and IMF staff calculations.

Real Exchange Rate

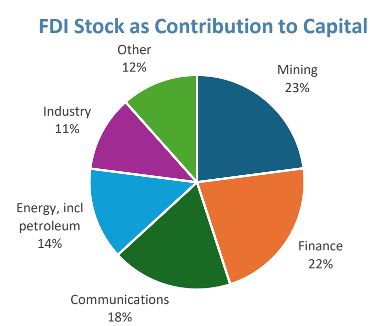
Background. The real effective exchange rate (REER) appreciated in 2023. The REER in 2023 was about 5.8 percent (average) and 1.9 percent (eop) stronger than in 2022, reflecting primarily the appreciation of the nominal effective exchange rate against trading partners (5 percent avg and 3.5 percent eop). The nominal ER against the US dollar appreciated by about 2.7 percent and was fluctuating during the year amid changing fundamentals.

Assessment. The EBA REER approaches estimate an overvaluation of 9.7 percent (index method) and an overvaluation of 28.5 percent (level method) in 2023. The REER gap derived from the IMF staff CA gap assessment, with an estimated elasticity of 0.19, implies a REER undervaluation of about 7 percent. Placing greater weight on the EBA CA model assessment—while considering all estimates and the uncertainties around them — staff assesses the REER gap in 2023 to be in the range of -4.5 and -8.7 percent, with a midpoint of -7 percent. The estimated REER undervaluation is subject to elevated model uncertainty against the backdrop of multiple shocks affecting the economy in 2023.



Capital and Financial Accounts: Flows and Policy Measures

Background. Net inflows into the capital and financial account are estimated to have declined in 2023 to -0.4 percent of GDP after highs of 3.8 percent of GDP observed a year before. Inflows were dominated by FDI liabilities (increased by about US$4.2 billion), that remained resilient in recent years despite political uncertainty but declined in 2023 and reflected primarily reinvested earnings associated with still elevated metal prices, and disbursements of public and private sector long-term loans. These inflows were offset by increased portfolio investments abroad by the pension funds reflecting uncertainty with potential early pension withdrawal, public sector debt amortization, including on global bonds held by non-residents, as well as purchases of short-term foreign assets.



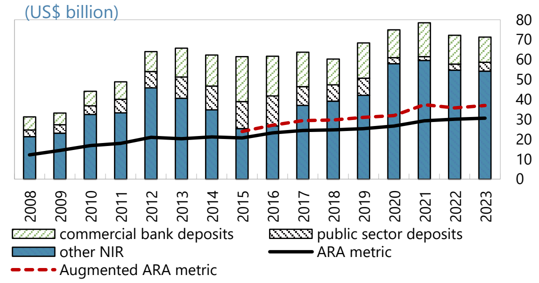
Source: ProInversion, end December 2023

Assessment. Strong economic fundamentals and diversification of creditors have underpinned capital inflows, including in periods of stress. FDI inflows have benefitted from capital contributions to, and profits earned in, major sectors of the economy such as mining and infrastructure. Going forward, lower commodity prices is the key risk to FDI, while political uncertainty will likely play a secondary role. That said, Peru's attractiveness as an investment destination and expected economic recovery should allow investments to pick up in the medium term.

FX Intervention and Reserves Level

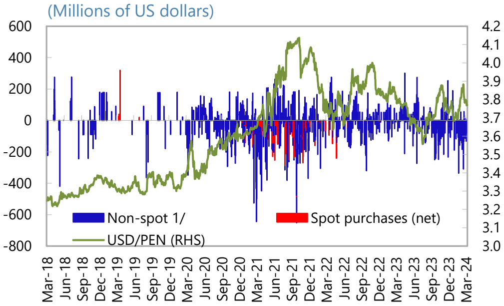
Background. The BCRP has been active in the foreign exchange (FX) market to smooth the ER volatility caused by various shocks without targeting a specific rate. While interventions were limited at the beginning of pandemic, in 2021 the BCRP increased them dramatically to contain volatility and relieve market pressure in the context of heightened political uncertainty, selling US$17.5 billion (8.1 percent of GDP), including US$11.6 billion on the spot market (5.1 percent of GDP). Afterwards, interventions subsided, with the central bank selling US$1.2 billion on the spot market in 2022 and only US$ 81 million in 2023. Interventions on the non-spot market (about $2.4 billion in 2023) were done primarily through FX swap transactions. Peru's gross international reserves decreased by about US$ 0.9 billion in 2023. That said, in Q1 2024, FX sales picked up as BCRP intervened in the spot and non-spot FX market to ease depreciation pressures related to expected narrowing of interest rate differential vis-à-vis the U.S.

Components of GIR and ARA Metric
(US$ billion)



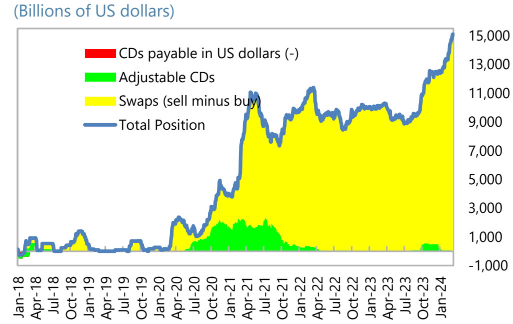
Source: BCRP and IMF staff estimates.

Foreign Exchange Intervention
(Millions of US dollars)



Source: BCRP and IMF staff estimates.
1/ Net maturity of CDR BCRP, net maturity of FX (sell) swaps, net issuance of CDLD and net purchases of FX (buy) swaps.

Net position of non-spot intervention 1/
(Billions of US dollars)



Source: BCRP and IMF staff estimations.
1/ An increase is equivalent to a sale of foreign exchange.

Assessment. The flexible ER has long served as the primary mechanism of adjustment to external shocks. Peru's international reserve coverage exceeds adequacy metrics. Gross international reserves were US$71.3 billion (26.7 percent of GDP) at the end of 2023, or about 233 percent of the ARA metric, well above the 100–150 percent adequacy range. Reserves also exceed an augmented ARA metric that incorporates the volatility of copper and gold prices and Peru's heavy reliance on commodity exports. By early March 2024, GIR rose to US$ 75.6 billion or about 242 percent of 2024 ARA metric.

Annex III. Risk Assessment Matrix

Risks	Likelihood	Impact	Policy Response
		Global Risks	
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	**High**	**Medium.** Volatile import prices increase inflation and weaken private consumption. While higher commodity prices can strengthen exports, excessive volatility reduces confidence and adversely affects growth.	Adjust the pace of monetary easing according to the assessed impact on inflation and inflation expectations. Allow the ER to play its role as a shock absorber. Provide targeted fiscal support to the most vulnerable.
Abrupt global slowdown or recession. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs.	**Medium**	**High.** Weak trading partners' growth adversely affects exports. Falling terms of trade weighs on domestic activity and exerts downward pressure on the ER.	Stand ready to use existing policy space to provide temporary support to growth and vulnerable households.
Monetary policy miscalibration. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.	**Medium**	**High.** High US rates needed to fight inflation exert downward pressure on the ER. A tightening of financial conditions abroad lead to large capital outflows.	Adjust the pace of monetary easing, while allowing the ER to play its role as a shock absorber. ER interventions can be used to prevent excessive volatility. Accelerate efforts to support de-dollarization.
Systemic financial instability. High interest rates and risk premia and asset repricing amid economic slowdowns and political uncertainty (e.g., from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	**Medium**	**Medium.** Financial instability leads to a sudden exit of foreign investors. Regional and global stress weigh on domestic activity.	Stand ready to use existing policy space to provide temporary support to growth. Recalibrating FX targeted reserve requirement could facilitate accumulating liquidity buffer while promoting further de-dollarization. Maintain enhanced monitoring of the financial system.
Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	**High**	**High.** Although demand for Peru's mineral exports may increase, distortions in investment decisions lower potential growth and less diversified trading partners and supply-chain networks increase vulnerability to external shocks.	Advance structural reform agenda to boost investment and growth. Work with international community to foster cooperation on global issues. Engage with major trading partners to maintain open trade policies.

Risks	Likelihood	Impact	Policy Response
Domestic Risks			
Social unrest. Real income loss and slowing economic growth amplify risks of social unrest. Political polarization and instability weaken policymaking.	High	**High.** Political uncertainty and social conflict erode confidence, stifle investment, and generate capital outflows. Low government effectiveness further erodes trust in key institutions and entrenches low growth.	Advance structural reform agenda to boost investment and growth. Continue political reform to reduce political polarization and increase stability. Strengthen governance and enhance anti-corruption enforcement efforts.
Extreme climate events. Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	Medium	**High.** Peru is highly vulnerable to natural disasters related to climate change. Damage to infrastructure, agriculture, and other producing sectors results in economic, social, and fiscal costs.	Promptly deploy resources to promote timely reconstruction and employ countercyclical policies as needed. Invest in resilient infrastructure and implement effective adaptation measures.
Note: The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff subjective assessment of the risks surrounding the baseline (“low” is meant to indicate a probability below 10 percent, “medium” a probability between 10 and 30 percent, and “high” a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.			

Annex IV. Sovereign Risk and Debt Sustainability Analysis

The overall risk of sovereign stress in Peru is low and public debt is sustainable with a high probability. The results align with the fact that Peru has among the lowest public debt as a share of GDP and ample assets.

1. **The public debt ratio remains low and declining over the medium term with the planned fiscal consolidation.** Over the medium-term public debt is expected to stabilize and shift down to the long-run debt target due to the planned fiscal consolidation envisioned in the fiscal rules. The shares of marketable debt, foreign and domestic-currency denominated debt, and the residual maturity profile of public debt should remain broadly stable over the forecast horizon.

2. **The Non-Financial Public Sector is the statistical coverage of Peru's public debt statistics.** The investor base is well diversified, and the law of the debt is equally distributed between local and foreign. Most of the public debt is marketable, with over ten years of residual maturity.

3. **The feasibility analysis of the baseline scenario does not currently point to major concerns**. The track record for forecasting the main debt drivers does not highlight any systematic bias, and the projected fiscal consolidation is well within norms. The growth forecast for real GDP in the baseline is consistent with reasonable estimates of the fiscal multiplier.

4. **Medium-term liquidity risks are low.** The results are robust for the GFN Financeability Module, supported by low gross financing needs and the strength of the macroeconomic policy frameworks and institutions. The Fanchart module points to moderate levels of risk.
In turn, long-term risks are low. The stress tests suggest that debt should be manageable under risk scenarios, including large amortization, climate change adaptation, and natural resource scenarios.

Figure 1. Peru: Public Debt Sustainability Analysis—Risk of Sovereign Stress

Peru: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting generally subdued levels of vulnerability over short and long term horizons.
Near term 1/			
Medium term	Low	Low	Medium-term risks are assessed as low on the basis of the strength of macroeconomic policy frameworks and institutions, low debt, and low gross financing needs.
Fanchart	Moderate	...	
GFN	Low	...	
Stress test	Comm. Prices Nat. Diast.	...	
Long term	...	Low	Risks from large amortization profiles in the long term are low with debt broadly stabilizing at a low level. Risks for climate adaptation is low.
Sustainability assessment 2/		Sustainable with high probability	The projected debt path is expected to stabilize and GFNs will remain at manageable levels, conditional on the implementation of the planned fiscal adjustment measures envisioned in the fiscal rules. Debt is assessed as sustainable with high probability.
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Commentary: Peru's overall risk of sovereign stress is low and public debt is sustainable with a high probability. The public debt ratio and other indicators have stabilized as the recovery from the COVID-19 pandemic has advanced. The public debt ratio is expected to stabilize over the medium term as the authorities proceed with a planned fiscal consolidation. Medium-term liquidity risks are low, as signaled by GFN Financeability Module and supported by the strength of the macroeconomic policy frameworks and institutions. Long term risks appear manageable.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure 2. Peru: Public Debt Sustainability Analysis—Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

CPS / NFPS / GG: expected / CG		Subsectors captured in the baseline	Inclusion	Comments
CPS, NFPS, GG: expected, CG	1	Budgetary central government	Yes	
CPS, NFPS, GG: expected, CG	2	Extra budgetary funds (EBFs)	Yes	Not applicable
CPS, NFPS, GG: expected, CG	3	Social security funds (SSFs)	Yes	
CPS, NFPS, GG: expected	4	State governments	Yes	
CPS, NFPS, GG: expected	5	Local governments	Yes	
CPS, NFPS	6	Public nonfinancial corporations	Yes	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	**IPSGSs 3/**

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

ode: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-Government Debt Holdings

		Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS, NFPS, GG: expected, CG	1	Budget. central govt									0
CPS, NFPS, GG: expected, CG	2	Extra-budget. funds	2680.827								2680.827
CPS, NFPS, GG: expected, CG	3	Social security funds	405.793								405.793
CPS, NFPS, GG: expected	4	State govt.	1266.6905								1266.6905
CPS, NFPS, GG: expected	5	Local govt.									0
CPS, NFPS	6	Nonfin pub. corp.	1508.9526								1508.9526
CPS	7	Central bank	7441.907								7441.907
CPS	8	Oth. pub. fin. corp	7142.4429								7142.4429
		Total	20446.613	0	0	0	0	0	0	0	20446.613

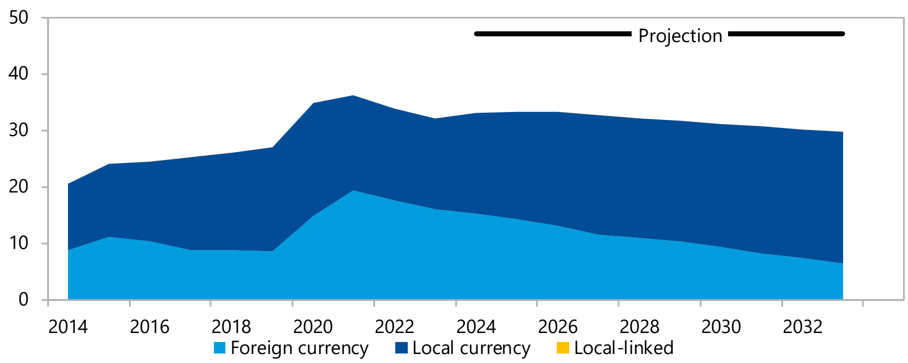
1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: Millions of PEN. Only includes debt securities and loans from the BCG to subnational governments and the rest of the public sector.

Figure 3. Peru: Public Debt Sustainability Analysis—Public Debt Structure Indicators

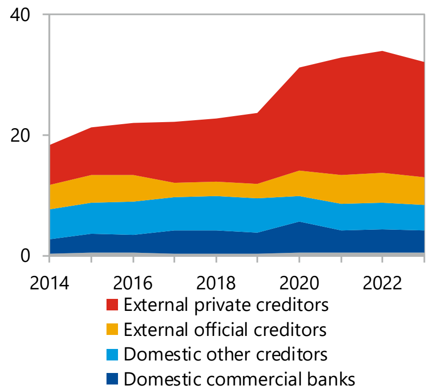
(Note, perimeter shown is Nonfinancial public sector)

Debt by Currency (Percent of GDP)



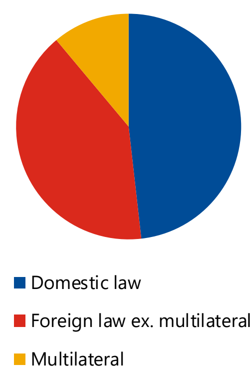
Note: The perimeter shown is nonfinancial public sector.

Public Debt by Holder (Percent of GDP)



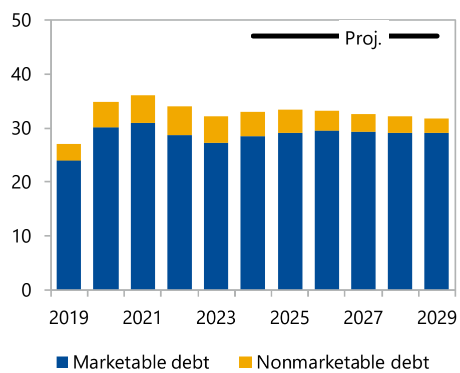
Note: The perimeter shown is nonfinancial public sector.

Public Debt by Governing Law, 2023 (percent)



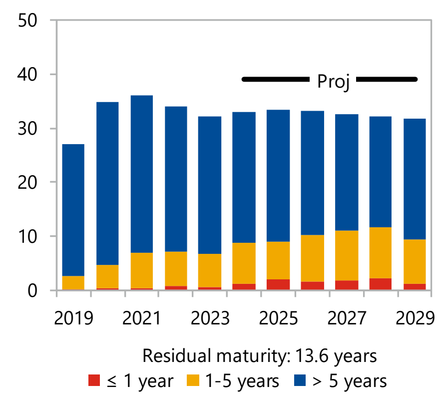
Note: The perimeter shown is nonfinancial public sector.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is nonfinancial public sector.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is nonfinancial public sector.

Commentary: The share of domestic and foreign-currency denominated public debt is expected to remain broadly stable over the forecast horizon. The lion's share of public debt is expected to remain marketable, and with a residual maturity longer than 10 years. The investor base is well diversified, and the law of the debt is equally distributed between local and foreign.

Figure 4. Peru: Public Debt Sustainability Analysis—Baseline Scenario

(Pecent of GDP, unless otherwise indicated)

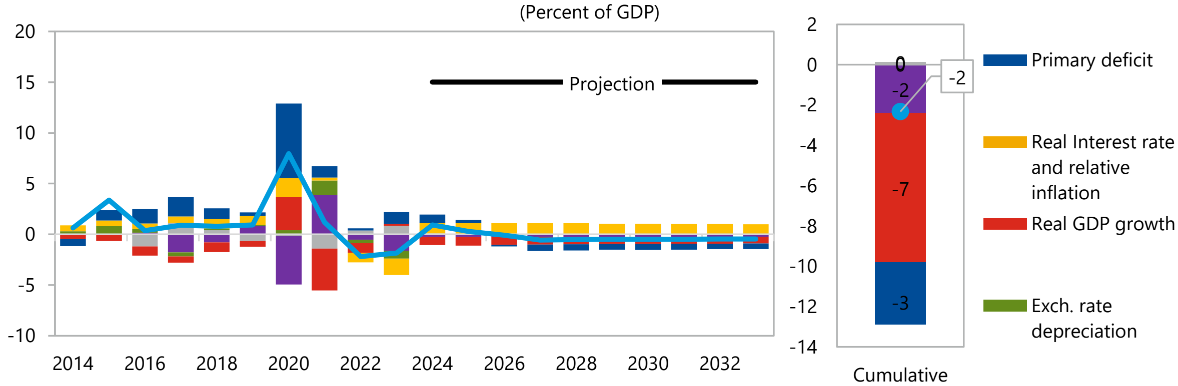
Peru: Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	32.1	33.0	33.3	33.2	32.6	32.1	31.6	31.2	30.7	30.2	29.8
Change in public debt	-1.8	0.9	0.3	-0.1	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Contribution of identified flows	-2.7	0.8	0.3	-0.1	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Primary deficit	1.2	0.9	0.3	-0.2	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Noninterest revenues	23.9	23.8	23.8	23.7	23.6	23.6	23.7	23.8	23.8	23.9	23.9
Noninterest expenditures	25.1	24.7	24.1	23.5	22.9	23.0	23.1	23.2	23.2	23.3	23.4
Automatic debt dynamics	-2.2	0.2	0.2	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Real interest rate and relative inflation	-1.6	1.0	1.1	1.1	1.1	1.1	1.0	1.0	1.0	1.0	1.0
Real interest rate	-2.0	1.0	1.1	1.1	1.1	1.1	1.0	1.0	1.0	1.0	1.0
Relative inflation	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	0.2	-0.8	-0.9	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Real exchange rate	-0.8	…	…	…	…	…	…	…	…	…	…
Other identified flows	-1.6	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
Other transactions	-1.5	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Contribution of residual	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	3.6	3.6	3.1	3.7	3.0	3.5	4.2	3.4	5.1	5.0	5.2
of which: debt service	2.6	2.8	2.9	3.9	3.7	4.2	4.8	4.0	5.8	5.6	5.8
Local currency	1.5	1.6	1.3	2.2	1.8	2.9	3.5	2.4	3.9	4.2	4.2
Foreign currency	1.0	1.3	1.6	1.7	1.9	1.3	1.3	1.6	1.9	1.4	1.6
Memo:											
Real GDP growth (percent)	-0.6	2.5	2.7	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator; percent)	6.3	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	6.6	4.9	4.8	4.5	4.4	4.4	4.3	4.3	4.3	4.3	4.3
Effective interest rate (percent)	0.0	5.5	5.4	5.4	5.4	5.4	5.3	5.4	5.3	5.4	5.4

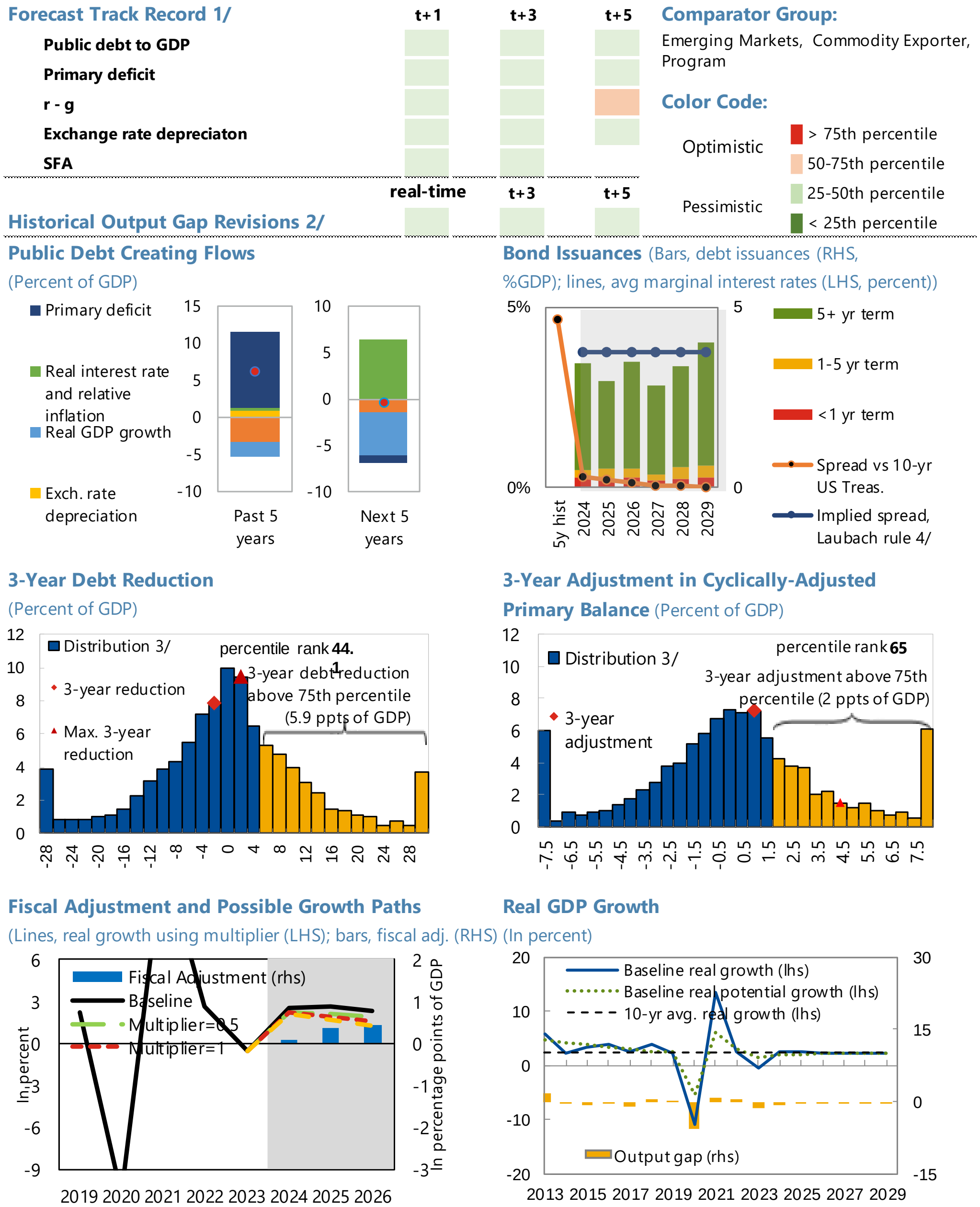
Contribution to Change in Public Debt

(Percent of GDP)



Commentary: Public debt is expected to stabilize over the medium term and fall toward the long-run debt target reflecting the planned fiscal consolidation envisioned in the fiscal rules.

Figure 5. Peru: Public Debt Sustainability Analysis—Realism of Baseline Assumptions



Commentary: The realism analysis does not point to major concerns. The forecast track record for the main drivers does not reveal any systematic bias, and the projected fiscal consolidation is w ell w ithin norms. The real GDP grow th forecast in the baseline is consistent w ith reasonable estimates of the fiscal multiplier, and converges to potential GDP grow th over the forecast horizon.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

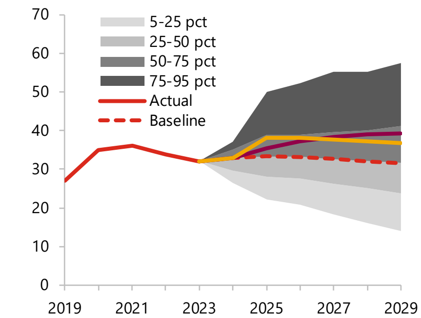
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical a

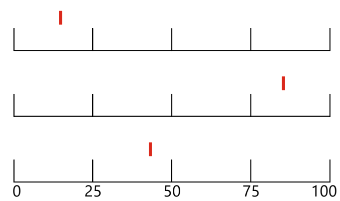
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 6. Peru: Public Debt Sustainability Analysis—Medium-Term Risk Assessment

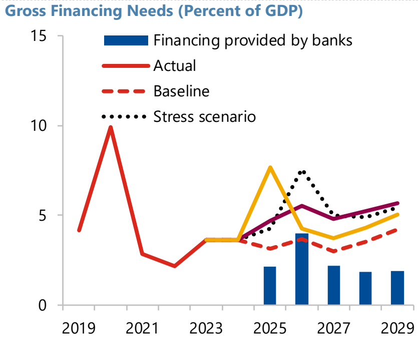
Final Fanchart (Percent of GDP)



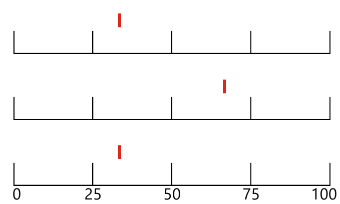
Debt fanchart module	Value	Contrib 1/	Percentile in peer group 2/
Fanchart width *(percent of GDP)*	43.7	0.6	
Probability of debt non-stabilizaiton *(percent)*	32.3	0.3	
Terminal debt-to-GDP x institutions index	19.6	0.4	
Debt fanchart index (DFI)		1.3	
Risk signal: 3/		**Moderate**	



Gross Financing Needs (Percent of GDP)



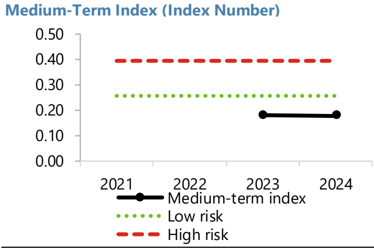
Gross financing needs (GFN) module	Value	Contrib 1/	Percentile in peer group 2/
Average baseline GFN *(percent of GDP)*	3.5	1.2	
Initial Banks' claims on the gen. govt *(pct bank assets)*	5.0	1.6	
Chg. In banks' claims in stress *(pct banks' assets)*	2.1	0.7	
GFN financeability index (GFI)		3.5	
Risk signal: 4/		**Low**	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	1.3	0.3	0.5	0.1
GFN finaceability index	3.5	0.1	0.5	0.0
Medium-term index		0.2		
Risk signal: 5/		**Low**		
Final assessment:		**Low**		

Prob. of missed crisis, 2024-2029, if stress not predicted: 9.1 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 58.0 pct.

Commentary: Of the two medium-term tools, the Debt Fanchart Module is pointing to a moderate level of risk, while the GFN Financeability Module suggests a low risk level, supported by low gross financing needs.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is emerging markets, commodity exporter, program.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Figure 7. Peru: Public Debt Sustainability Analysis–Long-Term Risk Assessment–Large

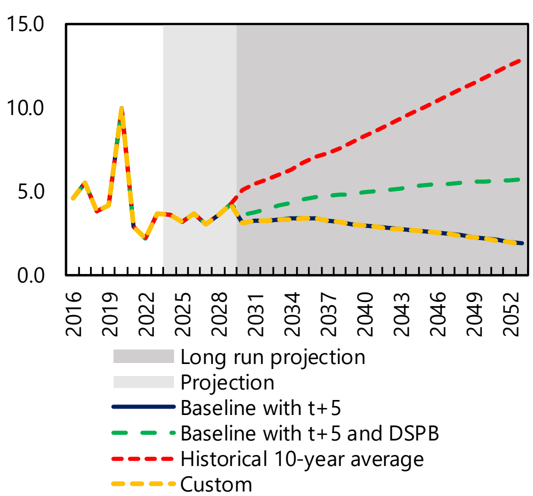
Large amortizations	Pensions	**Climate change: Adaptation**	**Natural Resources**
	Health	Climate change: Mitigation	

Peru: Long-Term Risk Assessment: Large Amortization Incl. Custom Scenario

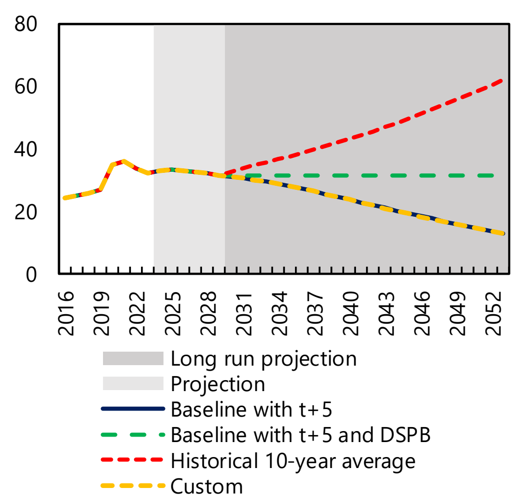
Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

Variable	2029	2032 to 2026 Avg.	Custom Scenario
Real GDP growth	2.3%	2.3%	2.3%
Primary Balance-to-GDP ratio	0.6%	0.6%	0.6%
Real depreciation	-1.8%	-1.8%	-1.8%
Inflation (GDP deflator)	2.0%	2.0%	2.0%

GFN-to-GDP Ratio



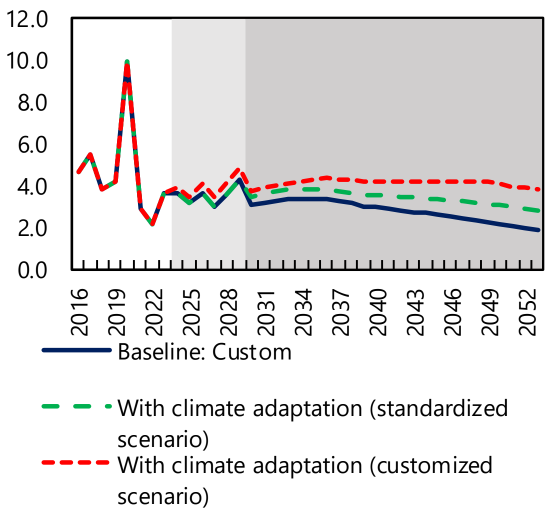
Total Public Debt-to-GDP Ratio



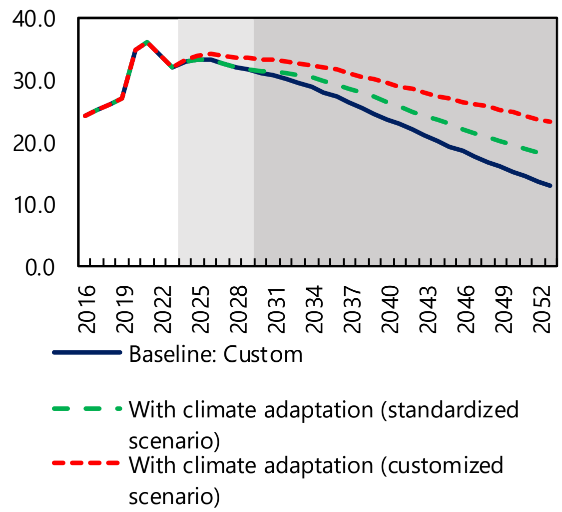
Commentary: Peru is assessed to have low long-term risk for reasons such as a favorable gross financing needs to GDP ratio.

Figure 8. Peru: Public Debt Sustainability Analysis - Long-Term Risk Assessment – Climate Change: Adaptation

GFN-to-GDP Ratio



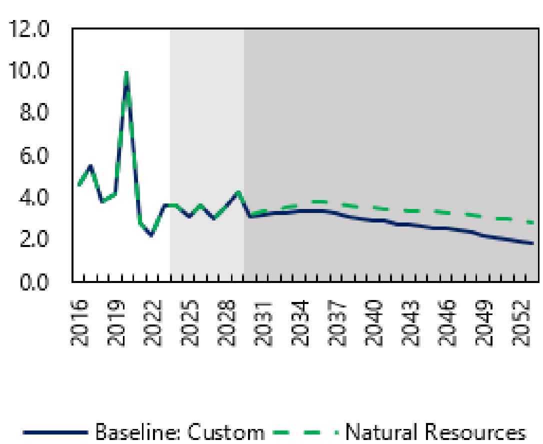
Total Public Debt-to-GDP Ratio



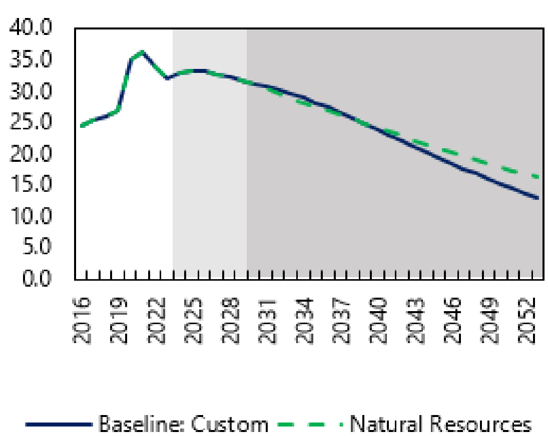
Commentary: Debt in the long run should be sustainble in light of risk with regards to climate adaptation.

Figure 9. Peru: Public Debt Sustainability Analysis - Long-Term Risk Assessment – Natural Resources

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio



Commentary: Debt in the long run should be sustainable when considering natural resource discovery and depletion.

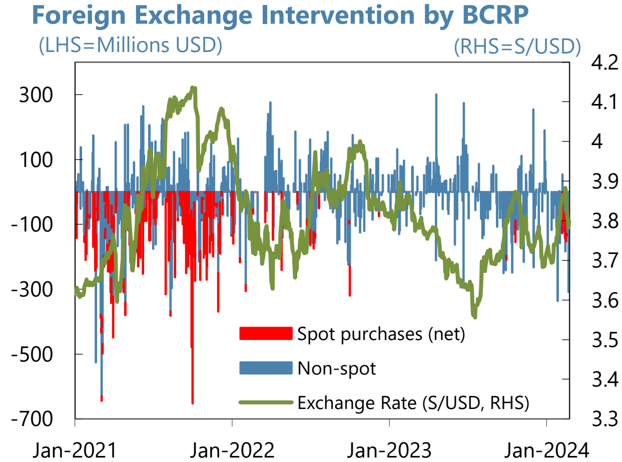
Annex V. Tradeoffs in Managing Foreign Exchange Volatility[1]

Further tightening of global financial condition is one of the top external risk scenarios in Peru. Under the current context, tighter for longer monetary policy in the U.S. could affect not only the real economy but also the risk premium and capital flows, given the shallowness of the FX market and elevated dollarization. With the presence of these frictions, IMF's IPF guidance finds a benefit in using FXIs in case a large external shock pose significant risks to financial stability.[2] Depending on the nature of the shock, the central bank should carefully choose the appropriate policy tools to respond by assessing the effectiveness and costs in the short and long term. Staff estimates suggest FXI is effective to alleviate macroeconomic volatility due to non-fundamental shock in the short-term. However, in the presence of a foreign interest rate shock, less flexible ER may lead to a slower economic recovery. Staff calculations also suggest that FXIs could disincentivize the development of the FX market.

A. Foreign Exchange Interventions (FXI) in Peru

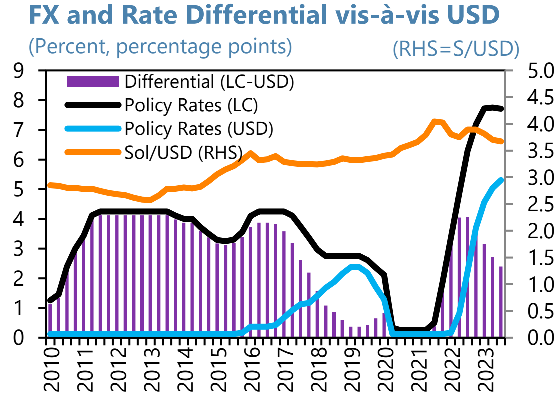
1. **The narrowing interest rate differential against U.S could impact the ER dynamics.** The BCRP started monetary policy tightening in mid-2021, and interest rate differential against U.S. had widened until mid-2022. During this period ER dynamics was on a moderate appreciation trend. With the inflation lowered substantially, and BCRP started reducing policy rate since October 2023, while U.S. Federal Reserve has paused their monetary policy, the interest rate differential vis-à-vis against U.S. is narrowing.

Foreign Exchange Intervention by BCRP



Source: BCRP

FX and Rate Differential vis-à-vis USD



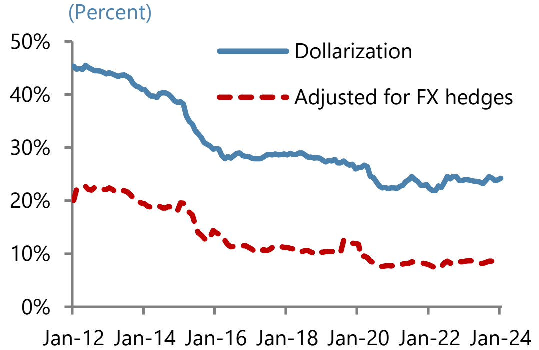
Source: BCRP, Haver Analytics
Note: LC=Local Currency

[1] Prepared by Tomohiro Tsuruga (MCM).

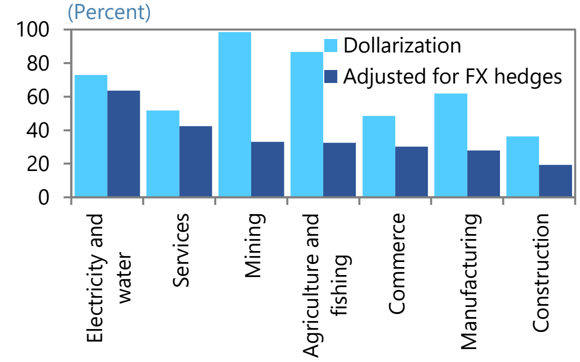
[2] The 2023 Article IV Staff Report assessed Peru's FXI and identified the shallowness of the foreign exchange (FX) market and elevated dollarization as the key frictions. By contrast, inflation expectations were found to be well-anchored.

2. Peru's dollarization rate is elevated, while the FX market is underdeveloped. Peru's financial system credit dollarization rate has dropped substantially in the last decade, from about 45 percent at the end of 2013 to 24 percent at the end of 2023, although the level is higher compared to other LA5 countries. While much of the dollar-credit exposure of large corporates is hedged, some sectors such as electricity and water and services still exhibit elevated unhedged positions.

Dollarization Rate for Total Credit
(Percent)



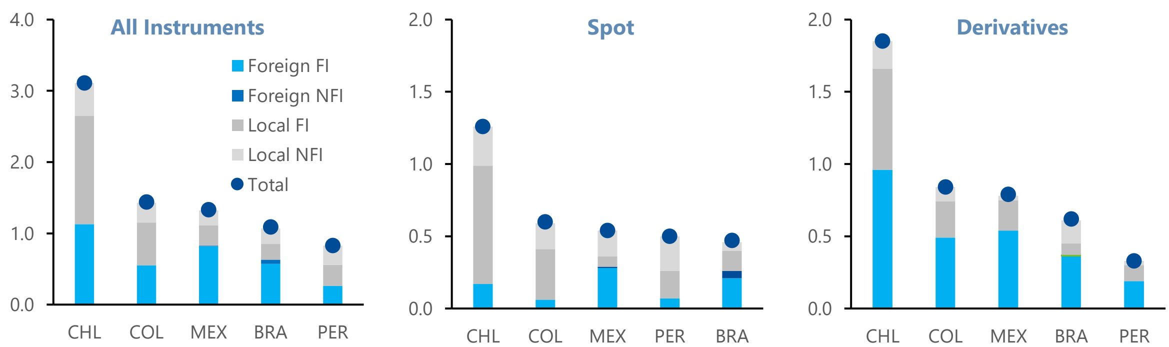
Debt dollarization by Sector
(Percent)



Source: SBS.

3. In addition, Peru's FX market is underdeveloped compared to other LA5 countries. The average FX turnover in Peru is lowest among LA5 countries, specifically in FX derivatives market, mainly because of the lower participation of the foreign financial institutions. The low turnover, along with the high level of dollarization, could pose significant challenges to the BCRP in case of an abrupt tightening of global financial conditions, as they can prompt greater risk premia, create higher depreciation pressure, and undermines financial stability by affecting dollar-denominated liabilities and domestic financial conditions.

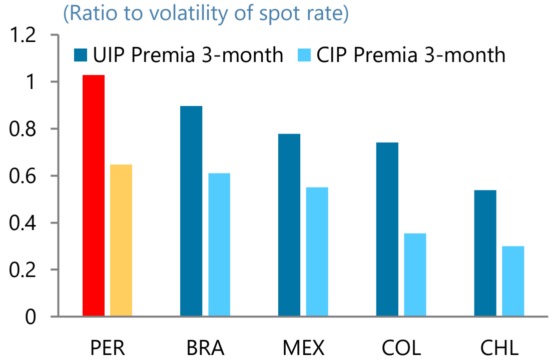
Foreign Exchange Market Average Daily Turnover
(Percent of GDP)



Sources: Bank for International Settlement, IMF staff calculations.
Note: Turnover is adjusted for interbank double counting (net-gross basis). FI=Financial Institutions. NFI=Non-Financial Institutions.

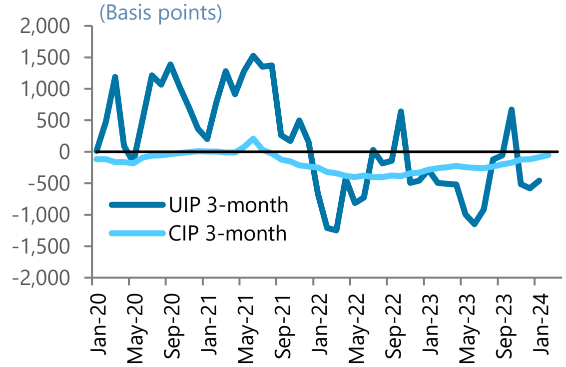
Average Size of UIP and CIP Premia 1/

(Ratio to volatility of spot rate)



UIP and CIP Deviation in Soles 2/

(Basis points)



Sources: Refinitive EIKON, IMF staff calculations.

1/ Average of the absolute value of monthly UIP premia divided by the 30-days realized volatility during January 2010-2024.

2/ UIP and CIP premia adjusted with exchange rate.

B. Medium-Term Cost/Benefit Trade-Offs of FXI

4. **Staff estimates using the IMF's estimated quantitative integrated policy framework (IPF) model shows that FXI is effective in containing the effect of risk premium shocks.**[3] The model is a small-open economy dynamic stochastic general equilibrium (DSGE) model that incorporates potentially shallow FX markets, and a range of nominal rigidities considered in the DSGE literature including sticky prices and wages with indexation to past inflation, estimated with the data of Peruvian economy from 2003Q1 to 2022Q1.[4] The impulse responses from the model show that one standard deviation shock in risk premium (an increase in UIP premium) results in about 1-2.5 percent depreciation in real effective exchange rate (REER), and an increase of price by about 0.04-0.14 percent point. The impact on output gap is ambiguous, as the negative effect from increased import price and positive effect from higher trade surplus. The effect of a shock in FXI (FXI shock) mirrors the impulse response of the UIP premium shock, indicating that FXI is effective in containing the effect arising from UIP premium.

5. **The cost of FXI should not be underestimated.** While the above staff estimates suggest effectiveness of the FXI in case of a non-fundamental risk premium shocks, the exchange rate can also be driven by a fundamental shock, such as the U.S. interest rate staying high for longer than expected. Besides the effect of reducing external demand, in the absence of FXI, a narrowing of the interest rate differential could lead to a depreciation of the currency, an increase of the import prices in the near term, which generates expenditure switching from imports to home-produced goods, and possibly a boost of exports in the medium term (J-curve effect). With FXI, this channel

[3] Chen Kaili, Marcin Kolasa, Jesper Linde, Hou Wang, Pawel Zabczyk, and Jianping Zhou (2023) "An Estimated DSGE Model for Integrated Policy Analysis," IMF Working Paper, WP/23/135.

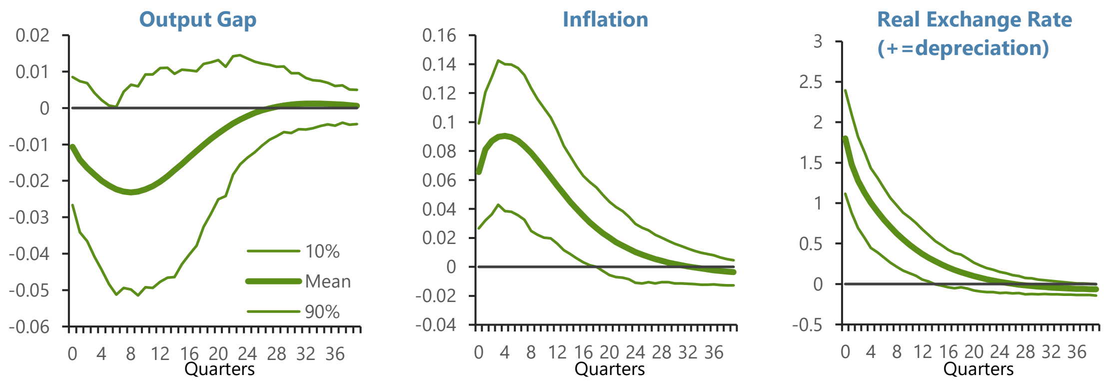
[4] Three major caveats apply. First, while the model assumes that all prices are set with local currency, export and import price can be set in U.S. dollar, possibly affecting the exchange rate pass-through. Second, the model does not include the banking sector. Third, zero lower bound of interest rate and unconventional monetary policy in large economy are not considered.

could be milder, as lower FX flexibility could prevent faster current account adjustment in the medium term and lead to a larger output gap. In addition, by providing hedges against private sectors, FXI could prevent development of FX derivatives market in the longer term.[5]

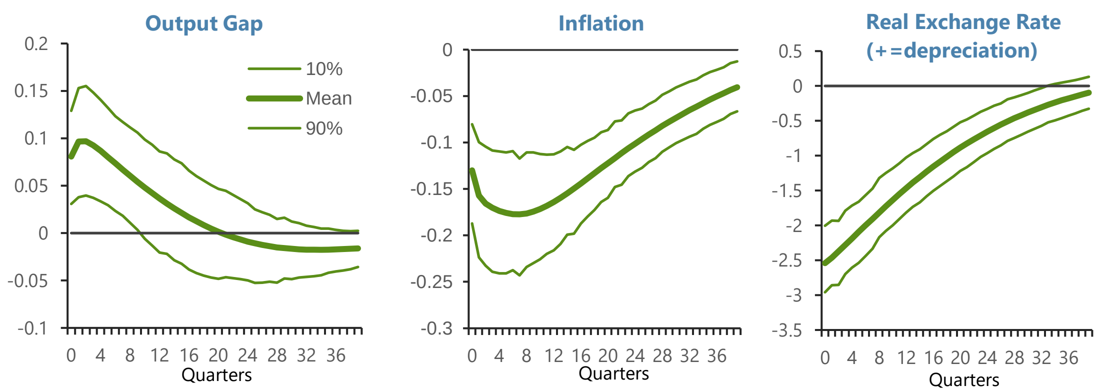
Impulse Response of Estimated Model

(Percentage point deviation from the steady state)

a. Impulse Response against UIP Premium Depreciation Shock (+one standard deviation)



b. Impulse Response against FXI Shock to Purchase Domestic Currency (+one standard deviation)



Source: IMF staff calculations.
Note: 10% and 90% lines are simulated Bayesian credible interval.

6. FXI could slow the economic recovery under a scenario of higher foreign monetary policy shock. A simulation exercise is performed to quantify the outcomes under three possible FX regimes (Flexible FX, FXI with MP (Monetary Policy), and Fixed FX) with different shock scenarios (UIP premium shock and foreign monetary policy shock).[6] As shown in the panel (a), in the case

[5] Other costs could include opportunity cost of holding large amount of international reserves. The government could use the reserves for more productive purposes.

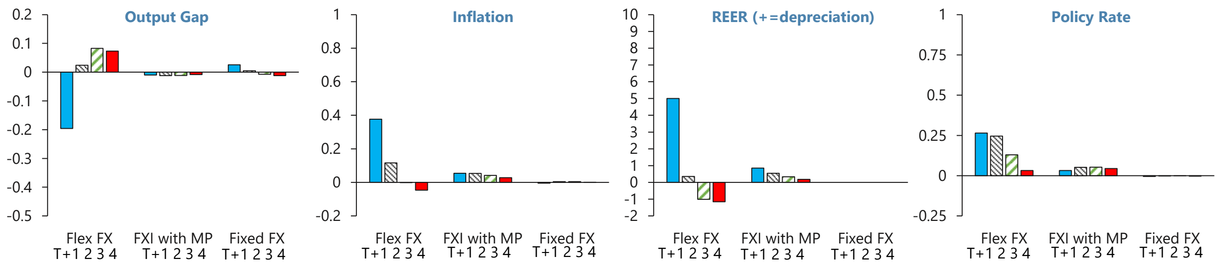
[6] A flexible FX regime is simulated by fully offsetting endogenous FXI response by adding opposite FXI shock. Similarly, A fixed FX regime is simulated by fully offsetting ER change by adding FXI shock. Size of the shock was calibrated so that it depreciates the ER by 5 percent under Flex FX regime. The simulation assumes that the FX market is shallow. It also assumes that there is a mild risk of inflation expectations being de-anchored from a large depreciation (even though these expectations have been anchored in past years).

that the depreciation originates from a UIP premium shock, FXI with MP and fixed FX deliver the smallest output gap fluctuations and inflation. In the case of a foreign interest rate shock, as shown in panel (b), inflation is affected in the short term due to higher import price, but the impact is short lived. The effects on output gap under flexible regime are the smallest after 3 years, while the impact on inflation is only moderately larger than the other two FX scenarios. Because of the higher inflation risk, the domestic policy rate must be tightened.[7] The simulations suggest a possible intertemporal cost/benefit trade-off that the central bank may face by using FXI. FXI can mitigate FX volatility in the short-term, at the cost of a slower economic recovery in the medium term.

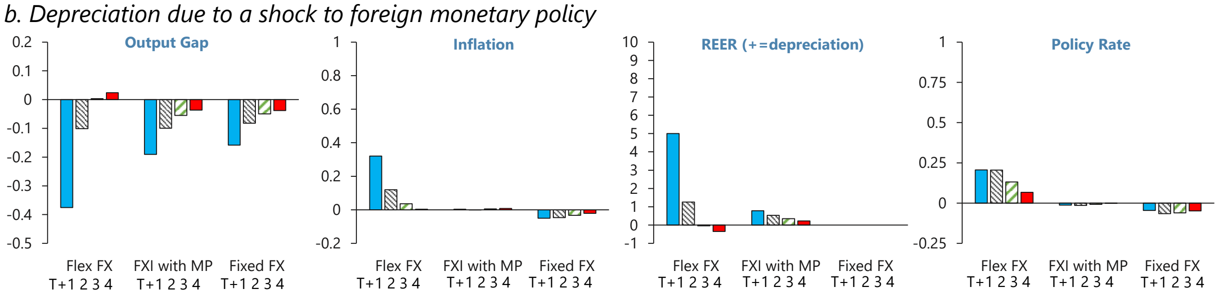
FXI and Economic Performance

(Percentage point deviation from the steady state)

a. Depreciation due to a shock to UIP premium



b. Depreciation due to a shock to foreign monetary policy



Source: IMF staff calculations.
Note: REER=Real Effective Exchange Rate. Horizontal axis represents years after the start of the shock. The size of the shock is calibrated such that the ER depreciates by 5 percent under the Flex FX.

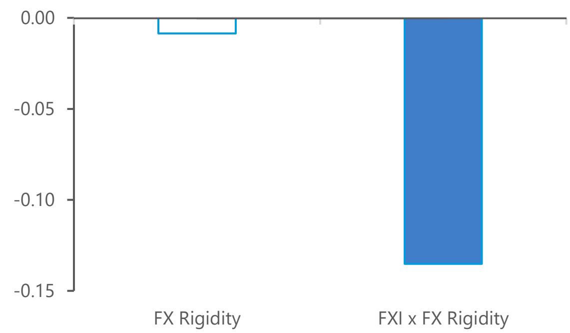
C. Long-Term Cost of FXI

7. High FX rigidity could prevent the development of the FX derivative market. With higher FX rigidity, firms and financial institutions are less likely to be affected by large stress due to fluctuations of ER changes. In Peru's case, corporate sector is relatively more dollarized with greater FX mismatches, and higher FX rigidity can mitigate the stress to these firms. While the low volatility environment can be favorable to these firms, this may prevent the development of FX derivative market, as these firms are less obliged to buy/sell hedges against FX fluctuations.

[7] In this case, there would be no case for FXI in the absence of a risk of inflation expectations being de-anchored. With such a risk incorporated into the model, the trade-offs become more complex.

8. FX rigidity and FXI are associated with a less developed FX derivative market. With greater magnitude of FXI, the fluctuations of ER can be limited, not just because of the intervention itself but also because it affects expectations of market participants, possibly affecting the incentive for buying/selling hedges against FX fluctuations. Staff estimates suggest that the effect of FX rigidity itself is ambiguous, but a combination of greater rigidity of FX rate (inverse of volatility) and FXI could significantly reduce the turnover of FX derivatives.[8]

Effect of FX Intervention and FX Rigidity
(Contribution of one standard deviation change to FX derivative turnover, percent of GDP)



1/ Bars represents the effect of +1 standard deviation change. FXI x FX Rigidity (blue bar) is significace at 5 percent level.
FX=Foreign Exchange, FX rigidity is the inverse of realized volatility.
Source: Adler et al (2022), BIS, IMF, IMF staff calculation.

D. Policy Implications

9. By targeting FXI to excessive volatility arising from market frictions, the BCRP could allow greater FX flexibility, while fostering the FX derivatives market. As shown in the simulation results, FXI could greatly mitigate the effect of excessive volatility on the economy and inflation due to the market frictions, such as UIP risk premium shock. However, it could slow the economic recovery in case of foreign monetary policy shock. Moreover, FXI could, along with the higher FX rigidity, be associated with the underdevelopment of FX derivative market. By using FXI sparingly for the case of significant nonfundamental shock, BCRP could help promote faster economic recovery, while keeping the costs of FXI being moderated. Fostering the FX derivative market should in turn, mitigate the market frictions.

[8] In this regression, annual average daily turnover in FX derivatives per GDP is regressed with FX rigidity, FXI per GDP, and a product of these two variables, along with control variables including deposit corporations' liability dollarization rate, deposit corporations' FX open position to asset ratio, financial market development index, and individual and time-fixed effects, using the data of 14 emerging market and developing economies during the period of 2007-22.

Annex VI. Implementation of FSAP Recommendations[1]

1. The financial system has improved and gained strength with time. The 2018 FSAP for Peru found that the financial system had developed and become more resilient since the 2011 FSAP. Peru's main vulnerabilities were assessed to be external, particularly related to growth in trading partners due to reliance on commodity exports, as well as to exchange rate depreciation due to significant dollarization. At that time, shocks in the form of uncertainty and spillovers from the ongoing *Lava Jato* investigation were judged as significant domestic headwinds. The mission's stress-test analysis showed that although highly concentrated, the banking system proved resilient to adverse shocks due to the strong capital buffers and profitability. The interconnectedness analysis found that the joint probability of distress across all banks had fallen since the peak of the global financial crisis; however, shocks affecting credit exposures, which are strongly correlated among large banks, could become systemic events due to the highly concentrated nature of the banking system.

2. The FSAP found that the Peruvian authorities could improve financial stability by acting across a number of dimensions. The macroprudential framework could be improved by bringing capital surcharges in line with Basel III requirements, enhancing monitoring of off-balance-sheet exposures, increasing foreign currency lending risk weights, and introducing new risk-monitoring tools. Oversight of banks could be strengthened by granting the Superintendency of Banks (SBS) powers to exercise consolidate supervision, enhancing financial group supervision, implementing recovery and resolution requirements for domestic systemically important banks (D-SIBs), finalizing the review of the capital requirement framework, implementing risk-based supervision for insurers, and creating a deposit-insurance system for cooperatives. The FSAP also recommended measures to strengthen crisis preparedness and cooperation between relevant agencies. Finally, measures that would deepen money markets and improve the private pension system were also proposed.

3. The authorities have made significant progress on the recommendations from the 2018 FSAP. Notably, countercyclical provisions and capital surcharges fully aligned with the Basel III framework will be in effect starting in June 2024. Recovery plans for domestic systemically important banks (D-SIBs) are already under review. The deposit insurance system for cooperatives was implemented in March 2022, and will start providing coverage from 2025. The SBS has enhanced its monitoring of off-balance-sheet exposures, while also implementing various additional tools for monitoring systemic risks. Further progress has been made on other recommendations, including amending the SBS' authority to exercise consolidated supervision, risk-based supervision for insurance companies, strengthening crisis preparedness, and efforts to strengthen money markets. Notable areas of non-compliance with recommendations include the reforms to improve the private pension system, as well as reforms that strengthen the legal protection of SBS staff.

[1] This table is based on information provided by the authorities.

FSAP Key Recommendations	
Recommendations	**Update on Progress**
Systemic Risk and Macroprudential Policy	
Increase capital surcharges for systemic banks to levels in line with Basel III framework; increase countercyclical provisioning for smaller banks. (SBS) (ST)	New regulation was issued with a new methodology for determining systemic risk capital requirement, which includes size, interconnectedness, substitutability and complexity. New regulation was issued changing the provisioning scheme to be more sensitive to risk, requiring higher countercyclical provisions for SME portfolio. Banking Law was modified to adapt the composition and quality of the regulatory capital to the Basel III standard, and to require minimum common equity Tier 1 and Tier 1 ratios.
Enhance the monitoring of off-balance-sheet exposures of banks. (SBS) (IT)	Off balance sheet bank exposures are being closely monitored. A new regulation for a standardized report of credit commitments was published.
Increase foreign currency lending risk weights in line with Basel III guidelines. (SBS) (ST)	Current regulation requires an additional 8% in capital surcharges applied to foreign currency exposures subject to foreign exchange credit risk.
Introduce new risk-monitoring tools, such as growth-at-risk, systemic risk analysis, and corporate sector stress testing; give enhanced mandate for macroprudential policy to BCRP and SBS; implement Memorandum of Understanding between BCRP and SBS to strengthen coordination. (BCRP/SBS) (ST/MT)	The growth at risk methodology and a granular risk model for corporate debtors have been incorporated in the stress test model.
Financial Sector Oversight	
Banks	
Amend legal framework to grant SBS powers to exercise full consolidated supervision. (SBS) (MT)	A draft law for holding companies has been prepared It needs to be approved by Congress.
Enhance financial group supervisory and regulatory approach regarding (i) group governance and risk-management requirements; (ii) consolidated capital adequacy and liquidity risk-management assessment; (iii) establishing a lead supervisor; and (iv) establishing a supervisory group rating. (SBS) (ST)	Liquidity contingency plans at a consolidated level are required and assessed by the SBS. Current regulation of consolidated supervision defines a responsible supervisor. The risk of being part of a financial group is considered in the internal classification process.

Recommendations	Update on Progress
Implement requirements for recovery and resolution planning for D-SIBs, as well as for financial groups. (SBS) (MT)	The SBS has received the recovery plans from D-SIBs (approved by the Board of Directors) The SBS is evaluating the plans to give them feedback.
Strengthen legal protection of all SBS staff in line with international best practice. (MEF) (MT)	Not implemented.
Strengthen the SBS's internal governance and control framework by enhancing the Internal Audit Function, including the establishment of an Internal Audit Committee. (SBS) (ST/MT)	The functions of the Internal Control Committee at SBS were expanded to include aspects related to internal risk management, information security and compliance with external regulations. The Ethics Tribunal was formed. A good governance model with appropriate levels of authority, responsibility, accountability, and control mechanisms was established.
Finalize the review of the current methodology for the calculation of the additional capital requirements as planned; enhance the activation trigger of the countercyclical buffer and enhance the systemic and single name risk buffers. (SBS) (ST)	Regulatory changes have been completed: regulatory capital requirement for systemic risk, (ii) reduction of the trigger that activates the rule for countercyclical provisioning and capital requirement and (iii) capital requirements for additional risks.
Insurance	
Implement risk-based supervision for all insurers and brokers. (SBS) (ST)	Risk-based supervision model for insurance companies is applied since 2019-2020. A trial of a risk-based supervision model for brokers was run in 2022. The final model was approved in February 2024 and is applied since then.
Cooperatives	
Design a deposit-insurance system after passage of law to bring financial cooperatives under supervisory umbrella of SBS. (BCRP, MEF and SBS) (MT)	The regulation for a deposit-insurance system has been approved and the premiums began to be collected. The insurance begins to provide coverage in January 2025 to those cooperatives that have complied with 24 contributions (2 years of premiums).
Crisis Management	
Strengthen crisis preparedness and management arrangements. (MEF, BCRP, SBS, FSD) (MT)	The BCRP and SBS participated in a cross border crisis simulation exercise for 7 countries of the Americas. This exercise, leaded by the FSI BIS, aims to test the effectiveness of the existing resolution framework.
Enhance information-sharing between SBS and FSD. (SBS, FSD) (MT)	Work is underway to develop a proposal for a comprehensive bank resolution framework.
Require payout of most insured deposits within seven working days and provide legal protection to FSD staff/agents. (SBS, MEF) (MT)	FSD payouts are usually carried out within 48 hours.

Recommendations	Update on Progress
Enhance the ELA framework by specifying eligibility and collateral requirements, and by providing for enhanced supervision, to ensure its effectiveness. (BCRP) (ST)	Previously, the BCRP could grant loans of last resort to financial institutions that need short-term liquidity. Coordination between the BCRP and the supervisory authority is not required to provide liquidity through the discount window (créditos de regulación monetaria/ CRM), but the BCRP shares information with the supervisory authority. In addition to CRM, the BCRP can offer liquidity using repos, for which eligible instruments are announced. SBS should consider the accessibility of financial companies to the ELA and repo facility of BCRP in their liquidity stress test.
Financial Integrity	
Strengthen risk-based AML/CFT supervision (including sanctioning powers to enhance effectiveness) for banks and other high-risk reporting entities, focusing on preventive measures for mitigating risks of laundering of proceeds of corruption and drug trafficking. (MEF/SBS) (ST/MT)	A new regulation was issued containing stricter clauses on moral suitability of shareholders, ultimate beneficial owners, directors, managers, and principal officers of companies. A draft law for increasing the cap on fines has been prepared. It needs to be approved by Congress.
Financial Deepening and Pension Reform	
Deepen repo markets, improve clearing and settlement infrastructure, prioritize medium- and long-term issuance around benchmark tenors. (BCRP/MEF) (ST/MT)	Work is ongoing to improve Repurchase Agreements related to the temporary transfer of securities to give greater dynamism to the public debt market and allow financial institutions to improve their settlement procedures in the secondary market. Currently, regulations for these operations have been approved while a framework contract is being prepared. To facilitate securities loans, a collateral management system is being developed. The Strategy for Global Asset and Liability Management (EGIAP for its acronym in Spanish) aims to strengthen the market for public debt securities in the national currency with medium and long-term maturities. The EGIAP also aims to achieve interconnection with Euroclear. The implementation of phase 2 “Secondary Market Link” would allow all bonds to be euro-clearable and can be registered and settled in the local ICLV, improving investors’ access to this market.
Design reforms to improve the private pension system. (MEF) (ST/MT)	In October 2023, a pension reform proposal was presented to Congress that includes features such as expanding minimum and social pension, automatic enrollment, limiting early withdrawals from the private pension accounts, and periodic assessment of parameters.
Time Frame: IT (Immediate) = less than 1 year; ST (short-term) = 1- 3 years; MT (medium-term) = 3-5 years.	

Annex VII. Welfare Impact and Costing of the Pension Reform[1]

The social welfare impact of Peru's pension system is limited due to both low coverage and benefits for the bottom of the income distribution. Poor targeting of the social pension contributes to less than 10 percent of poor elderly being covered, while the low benefits do not meaningfully affect incomes. The envisioned reform expands the social pension coverage of the poor elderly by 2.5 percentage points, though an estimated 88 percent of this group would remain uncovered. If targeting were improved, the share of poor elderly covered would increase by 7 percentage points with negligible fiscal cost. Alternatively, with no targeting improvement but a small fiscal cost of 0.13 percent of GDP, more poor elderly could be covered. A greater poverty impact would be achieved by spending 0.24 percent of GDP to also increase the benefit amount.

1. **Peru's fragmented pension system consists of a non-contributory pension and parallel pay-as-you-go (PAYGO) and funded contributory schemes.** The non-contributory pension (*Pensión 65,* or social pension) provides benefits for the elderly living in extreme poverty with no affiliation to one of the contributory schemes. Formal sector workers are required to contribute to one of the contributory schemes, choosing between the PAYGO scheme, called the SNP (a defined benefit scheme, publicly managed by the Social Security Office, ONP), or the funded and privately managed defined contribution (DC) scheme (SPP). The retirement age is 65 for both men and women.

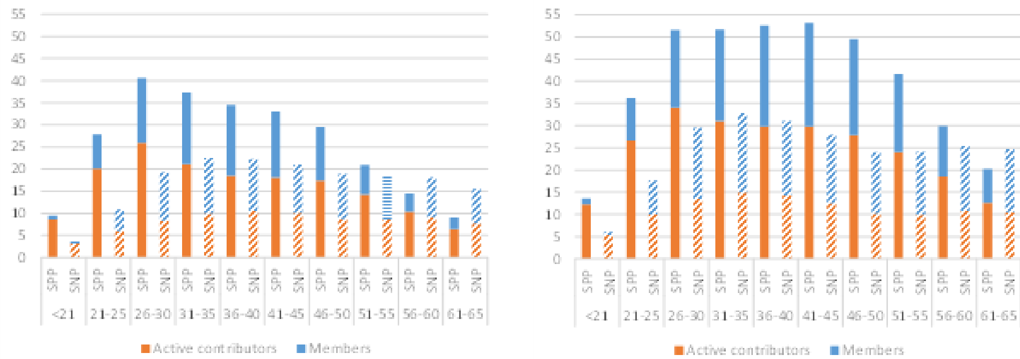
2. **Public spending on pensions in Peru is relatively low with 0.1 percent of GDP spent on social pensions and 0.4 percent of GDP on old-age and survivor pension under SNP in 2022.** In 2023, a commission created to investigate potential pension reform options presented its recommendations. While short on certain details, especially for contributory pension, the new pension law proposal addresses some pressing issues for the non-contributory pension.

3. **Few workers in Peru consistently contribute to the contributory schemes.** With an employment rate of 63 percent for women and 76 percent for men over the age of 15, around three-quarters of those are in informal employment according to the ILO. This is reflected in active coverage rates of 7 percent for women and 10 percent for men over the age of 15 for the SNP and 14 percent for women and 22 percent for men for the SPP. The share of the population who at some point in their working lives contributed to the pension system is a little higher, especially for prime aged workers (Figure 1), but it still falls well short of full coverage.

[1] Prepared by Boele Bonthuis, Delphine Prady, and Julieth Pico (all FAD).

Figure 1. Peru: Contributors and Members of the SNP and SPP (2022)

a. Women. *b. Men.*



Source: ONP, SBS.

4. Once workers reach retirement, very few receive permanent pension benefits from the earnings-related pension schemes. The SNP requires workers to have contributed for a minimum of 20 years to receive a pension, with only 17 percent of current SNP contributors between the ages of 60-64 reaching this minimum, leading to relatively low share of the older population receiving a pension from the SNP (around 16 percent for both men and women in 2022).[2] The SPP has slowly lost its function of providing permanent or at least long-term income replacement. Initially, DC assets would either be converted in a phased withdrawal or an annuity at retirement. Since 2009, early retirement was introduced for unemployed members at the age of 50 for women and 55 for men, with the possibility to take 50 percent of the SPP funds as a lump sum.[3] From 2016, 95.5 percent of assets could be taken as a lump sum at retirement. As a result, the number of new regular pension benefits paid has dropped from around 600 per month in 2015 to 30 in 2019. As a result of the low beneficiary ratios of the earnings-related schemes, a large share of the elderly population receives a permanent pension benefit from Pensión 65 (16 percent of the 65+ population in 2022).

5. Since the onset of the Covid-19 pandemic, further lump-sum withdrawals have been allowed to all participants, further weakening the system. While the sharp and abrupt slowdown in economic activity early in the pandemic may have made such withdrawals more warranted, they have since continued, with the private pension scheme assets declining from 22 percent of GDP in 2020 to around 12 percent in 2022. Only 30 percent of SPP members did not withdraw anything. However, members without any withdrawals were largely concentrated among the very young (with limited balances) or very old and therefore close to being able to withdraw their entirety of balances anyway.

[2] A lower minimum pension (pension proporcional) is available for those with more than 10 but fewer than 20 years of contributions, no regular earnings-related benefits are available though, only 6 percent of SNP beneficiaries receive this type of pension.

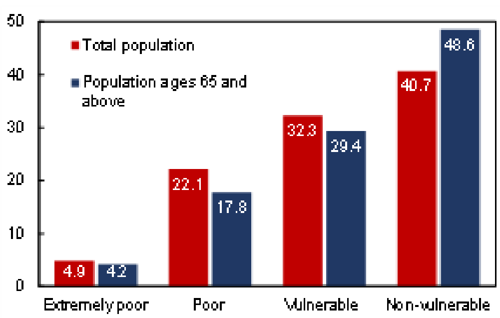
[3] In practice, a not having contributed to the SPP for 12 months has proven a sufficient criterion.

6. The distribution of pension benefits in Peru is concentrated around a few distinct values. Pensión 65 recipients receive S/250 every two months, which is about 30 percent of the poverty line and 55 percent of the extreme poverty line.[4] The SNP pension distribution is multimodal with smaller peaks at the lowest minimum pensions (S/250 and S/350 per month) and the maximum pension (S/893 per month) and a very large peak at the main minimum pension of S/500 per month. For the few SPP recipients who receive a permanent pension benefit, the pension benefit is significantly higher, around S/1000 for women and S/1200 for men. Lump sum withdrawals are more difficult to put into context, but average lump sum withdrawals in 2022 equally spread out over 16 years (life expectancy at 65) would result in S/390 per month for women and S/560 for men. Overall, despite the complexity of the earnings-related pension system and the illusion of choice, the outcomes clearly divide Peruvian elderly into distinct brackets, with little room for maneuver for most.

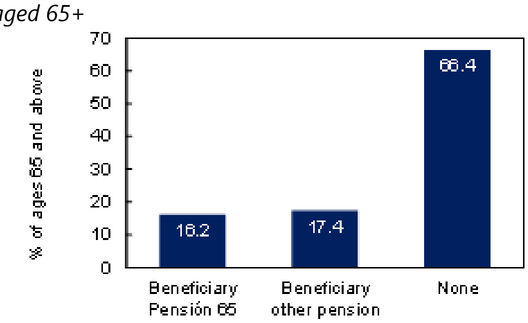
7. More than 1 out 5 elderly is poor, with 4 percent of people aged 65 and above falling into extreme poverty. At 22 percent, the elderly poverty rate is smaller than that of other age groups as the general poverty rate reached 27 percent in 2022. This lower poverty rate is partially attributable to people receiving earnings-related pensions (Figure 2), with only 8.1 percent of those at risk of poverty, from which 0.8 percent are at risk of extreme poverty. At 4.2 percent, the prevalence of extreme poverty among elderly is however similar to that among the general population, which reached 4.9 percent in 2022 (Figure 2). This reflects the impact of the non-contributory pension. In 2022, about 625,000 people benefited from Pensión 65, or about 16.2 percent of the elderly. Among Pensión 65 recipients, the transfer manages to divide the extreme poverty rate by 3, from 27.8 percent to 9.3 percent (Figure 3); among the elderly, Pensión 65 effectively reduces the prevalence of extreme poverty by 3 percentage points, from 7.2 to 4.2 percent.

Figure 2. Peru: Poverty and Pension Coverage Rates

Poverty headcount rate, total population, and population aged 65+



Pension and Pension 65 coverage rates among population aged 65+

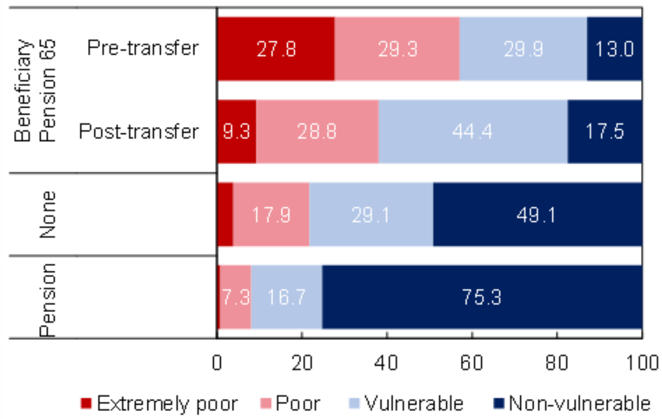


Source: IMF staff calculations-based Peru's ENAHO 2022.

[4] The poverty line is S/415 and the extreme poverty line is S/226, about 112 and 61 USD per month respectively in 2022.

Figure 3. Peru: Poverty Rates Among People Aged +65

Before And After Receiving Pensión 65

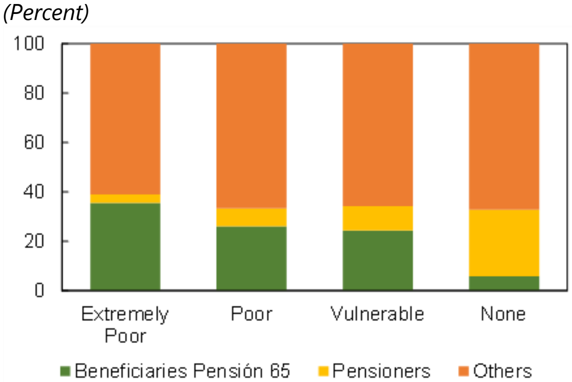


Source: IMF staff calculations-based Peru's ENAHO 2022.

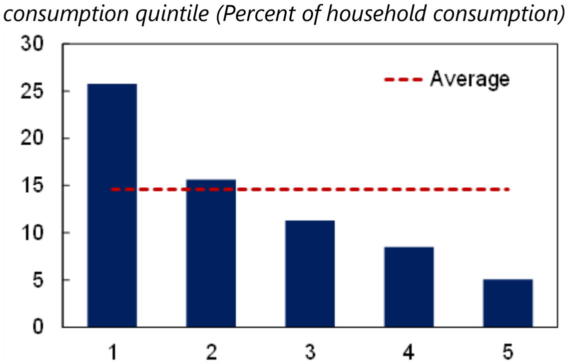
8. **Poor targeting and adequacy of the Pensión 65 scheme weakens Peru social pension's effectiveness in reducing poverty among the elderly.** Created in 2011, Pensión 65's current household targeting system based on proxy-means testing (Sistema de Focalización de Hogares, SISFOH), considers multidimensional poverty and is therefore expected to reach a larger share of the elderly population than the 4.2 percent extremely poor elderly based only on income criteria. However, while Pensión 65 has gradually increased its coverage to about 16 percent of elderly in 2022, it is falling short of covering all people aged 65 who fall in extreme poverty. Moreover, weaknesses in the current household targeting system imply that non-poor elderly can be covered by Pensión 65 (Figure 4). These leakages weaken the non-contributory pension's effectiveness in reducing extreme poverty by diverting resources away from extremely poor elderly. In the same vein, the current benefit amount is only 55 percent of the extreme poverty line. As a result, current benefit amounts represent on average 14.6 percent of the per-capita beneficiaries' consumption, with an incidence rapidly decreasing between the first two deciles of the income distribution. This relatively low incidence, along with the current non-indexation of benefits to inflation, reduces Pensión 65 capacity in alleviating (extreme) poverty among the elderly.

Figure 4. Peru: Pension Beneficiaries and Relative Transfer

Pension beneficiaries by vulnerability category (Percent)



Pension 65 transfer importance, by per-capita consumption quintile (Percent of household consumption)



Source: IMF staff calculations-based Peru's ENAHO 2022.

A. Social Pension Proposal

9. In a pension reform proposal currently under discussion in Parliament, the non-contributory pension would be adjusted to cover a larger share of the elderly population. The coverage would be increased by lowering the eligibility requirement from living in extreme poverty (under S/226 per month) to living in poverty (under S/415 per month), while still considering the multidimensional nature of poverty. A potential extension to people aged 65 years and over who are affiliated with the SNP or SPP and who have income below the extreme poverty line is also under consideration. Under this extension, members of the SPP system should transfer their private pension account balance to the ONP reserve fund. A further extension is explored for workers 75 years and older who have income below the poverty line.

B. Policy Options

10. Given the high informality and limited coverage and adequacy of the contributory schemes, the social pension is the most important tool for elderly economic security. The contributory schemes do not provide meaningful long-term benefits to a large share of their membership, and so the non-contributory pension is the single most important type of pension benefit to provide economic security in old age. While the extension of access to the non-contributory pension is an important step to prevent old-age poverty, the proposed design reform could be adjusted to improve its effectiveness.

11. Indexation criteria should be rules-based. The goal of non-contributory pensions is to prevent old-age poverty, and a lack of consistent indexation makes this goal difficult to reach and maintain. Since poverty lines often follow inflation closely, the most straightforward rule would be to index non-contributory pension benefits to inflation. Alternatively, indexation can be linked to a specific minimum consumption basket for the elderly.

12. To improve Pensión 65 effectiveness in reducing (extreme) poverty, three scenarios are presented that gradually strengthen the program's coverage and adequacy. Table 1 summarizes key features of each scenario and their estimated fiscal impact. It also compares these features to the current situation, the baseline scenario, and to a counterfactual baseline in which targeting would be improved and effectively exclude non-poor elderly from the beneficiaries.

- **Counterfactual baseline with improved targeting.** This scenario has the same coverage in number of beneficiaries and the same fiscal cost as the current baseline (0.10 percent of GDP). However, targeting is modified to effectively exclude non-poor elderly from Pensión 65, and only select extremely poor and poor elderly who do not receive any pension. This scenario helps assess efficiency gains that could be generated through improving the existing proxy-means-test (SISFOH): with the same fiscal envelop of about S/1 billion, the extreme poverty rate among elderly could be further reduced from 4.2 percent under the baseline to 3.3 percent. Indeed, under the baseline leakage is high, with 43 percent of all Pensión 65 beneficiaries are non-poor, and so improved targeting would have a considerable impact.

- **Scenario 1 (authorities' proposal)– broader coverage of poor elderly excluding poor pensioners affiliated with one of the earning-related schemes.** This scenario corresponds to the authorities' extension plan. It expands Pensión 65 benefit to about 170,000 elderly who do not currently receive a pension. Selection in the program for new beneficiaries mimics SISFOH targeting, therefore generating some leakages to non-poor elderly (i.e., 43 percent of beneficiaries are non-poor as in the baseline scenario). Benefit amount remains S/125 per month. This scenario shows that broadening Pensión 65 coverage while keeping the same inefficient targeting mechanism, still excluding poor other pension benefit recipients, would achieve similar results in terms of (extreme) poverty reduction to the counterfactual baseline, but at an extra fiscal cost of S/200 million (bringing total spending on the social pension to 0.13 percent of GDP).51F51F

- **Scenario 2 – broader coverage of poor elderly <u>including</u> poor other pension recipients.** This scenario further extends Pensión 65 benefit to about 30,000 poor pensioners affiliated with one of the earning-related schemes. Scenario 2 therefore increases Pensión 65 coverage to about 825,000 elderly, or 21.3 percent of all people aged 65 and above. Selection in the program for new beneficiaries mimics SISFHO targeting, therefore generating some leakages to non-poor elderly (i.e., 43 percent of beneficiaries are non-poor as in the baseline scenario). The benefit amount remains S/125 per month. This scenario shows that relaxing the exclusion of poor pension recipients from Pensión 65 would help reduce old age extreme poverty to 3 percent, at a reasonable extra fiscal cost of S/50 million (total spending of 0.13 percent of GDP). This fiscal cost could increase in the future because of the extraordinary withdrawals, if the amount withdrawn is spent and not recovered enough through future contributions to finance at least a pension high enough to be excluded by SISFOH.

- **Scenario 3 (staff recommendation)– broader coverage of poor elderly <u>including</u> poor other pension recipients and higher benefit amount.** Pensión 65 coverage is the same as in scenario 2 and individual benefit is increased to the extreme poverty line of S/226 per month. This scenario shows that, beyond coverage, adequacy of benefit amount is key to effectively reduce (extreme) poverty. Representing 55 percent of the extreme poverty line and 30 percent of the poverty line, the current Pensión 65 benefit amount can make a difference on extreme poverty but will hardly reduce poverty, except for people with income already close to the poverty line. Raising Pensión 65 benefit to 100 percent of the extreme poverty line (i.e., S/226 per month) can substantially reduce old age extreme poverty to 1.8 percent and significantly reduce old age poverty by almost 4 percentage points to 18.2 percent.[5] These results come at an extra fiscal cost of S/1 billion after accounting for the coverage broadening of scenario 2 (total spending of 0.24 percent of GDP).[6]

[5] Extreme poverty is not entirely eliminated because poverty is determined on the household level while pension benefits are granted only to elderly household members.

[6] To contain cost, pension testing of the level of the social pension benefits can be considered (this is for instance done in Chile). While estimated household income of a proxy means-test might not be accurate enough to apply a full means-tested benefit level, information on the level pension benefits received should be available.

Table 1. Peru: Characteristics and Fiscal Cost of Three Pension Reform Scenarios

	Baseline (SISFOH targeting)	Counterfactual (improved targeting)	Authorities' Proposal - Scenario 1	Scenario 2	Staff's Recommendation - Scenario 3
Coverage of elderly, in thousands	626	626	795	826	826
(% of 65+ population)	*16.2*	*16.2*	*20.6*	*21.3*	*21.3*
Coverage of poor elderly, in thousands	357	626	454	476	476
(% of 65+ population)	*9.2*	*16.2*	*11.7*	*12.3*	*12.3*
Coverage of non poor elderly, in thousands	269	0	341	349	349
(% of 65+ population)	*6.9*	*0.0*	*8.8*	*9.0*	*9.0*
Benefit amount, Soles per month	125	125	125	125	226
(% of extreme poverty line)	*55.3*	*55.3*	*55.3*	*55.3*	*100.0*
Fiscal cost, in soles (billion)	0.94	0.94	1.19	1.24	2.24
(% of GDP)	*0.10*	*0.10*	*0.13*	*0.13*	*0.24*
Extreme poverty rate, in percent of 65+ pop.	4.23	3.30	3.40	3.04	1.83
Poverty rate, in percent of 65+ pop.	22.01	21.45	21.50	21.43	18.15

Source: Staff calculations based on the 2022 household survey.

13. **Improving Pensión 65 targeting system should be a priority alongside strengthening the program's coverage and the adequacy.** Almost half Pensión 65 beneficiaries are not poor, and therefore are incorrectly included in the program. Consequently, many poor eldery cannot benefit from the social pension. As shown in the counterfactual baseline, reducing both inclusion and exclusion errors of the SISFOH targeting system would significantly increase the program's efficiency, all else being equal, and give the authorities more "bang for the buck" in terms of (extreme) poverty reduction results. This would require *inter alia* i) broadening the coverage to all households/individuals of the SISFOH data collection system, ii) regularly updating collected data and build interoperability across socioeconomic databases (possibly at different government levels) to reduce validation costs, and iii) updating the algorithm that grants socioeconomic scores. Costa Rica's Sistema Nacional de Información y Registro Único de Beneficiarios del Estado (SINIRUBE, Box 1) provides a relevant example on how this type of targeting system can be improved and maintained to help ensure both exclusion and inclusion errors in social assistance programs are kept in check.

Box 1. Peru: Costa Rica's Centralized Social Registry SINIRUBE

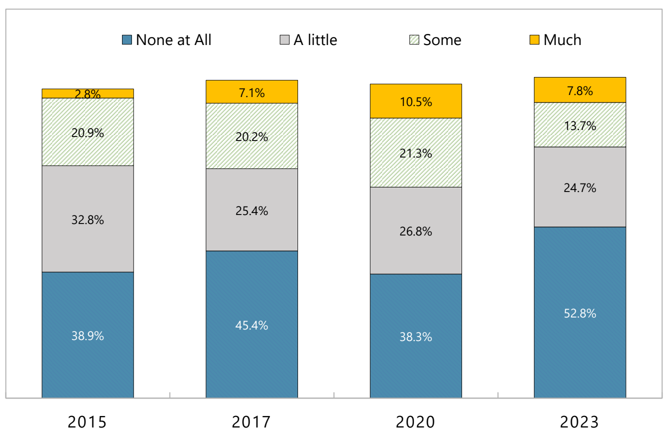
SINIRUBE (Sistema Nacional de Información y Registro Único de Beneficiarios del Estado) is an advanced IT platform designed to integrate social databases across multiple public institutions. It encompasses a total of 34 public institutions. This system is crucial for identifying beneficiaries of all social programs using homogeneous criteria, which helps to avoid duplication. SINIRUBE currently has extensive socioeconomic information concerning approximately 80 percent of households. Additionally, there has been a focus on developing user-friendly interfaces for data analysis, including modules for beneficiary referral and information collection, as well as mobile applications to facilitate data collection from rural households.

SINIRUBE data is high quality and comprehensive and serves as the backbone of revising existing social protection schemes in Costa Rica. The inclusion and exclusion errors of SINIRUBE were estimated at 23 percent, showing the system's effectiveness in accurately targeting beneficiaries of social protection programs.

Annex VIII. Deepening Effectiveness of Governance Institutions[1]

1. **The severity of corruption, together with severe weaknesses in governance, has undermined the management of funds and public trust in institutions in Peru**. In 2023, more than 24 billion soles (around 3 percent of GDP) were estimated to have been lost to corruption, according to the *Contraloría General de la República* (CGR) (arising from incomplete or abandoned projects and abuse of consultancy contracts). Peru's national risk assessments point to corruption as an important vulnerability and noted the increase in corruption activities (i.e., high-value crimes associated with irregularities in bidding and management of public services to petty bribery). The OECD also conclude that high corruption hampers the government's ability to implement, policy collect revenues and enforce laws.[2] Significantly, the fallout from the *Lava Jato* investigations[3] contributed to hampering growth and investments, resulting a slowdown in GDP growth in 2017.[4] Negative public perception about the progress made by state institutions to reduce corruption is at the highest in the last few years (reaching 52.8 percent in 2023) (Figure 1).

Figure 1. Peru: Public Trust on Institutional Ability to Reduce Corruption is Low



Source: LatinoBarometro
Note: The Latinobarometro is a periodic survey, capturing individual perceptions on socioeconomic and political issues in 18 Latin American countries since 1995, including on trust in state institutions and progress on combatting corruption.

2. **The nature of corruption is aggravated by impunity.** Grand-scale corruption (such as the *Lava Jato* case) highlights involvement of senior public officials, whose cases remain pending even after several years.[5] The CGR described the nature of corruption as *roba pero hace* ("steals but

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[1] Prepared by Jonathan Pampolina (LEG).

[2] OECD, Economic Surveys (Peru), September 2023.

[3] The Lava Jato case involved hundreds of millions of dollars bribe payments made by construction companies to government officials in several countries. Odebrecht, one of the involved companies, acknowledged paying bribes to high level public officials of up to $29 million between 2005-2014 to secure public works contracts.

[4] IMF, Staff Concluding Statement of the 2018 Article IV Mission, May 23, 2018.

[5] According to the *Defensoría del Pueblo*, criminal proceedings for crimes of corruption officials are noted to last an average of 4.5 years. (*Inteoperabilidad en el Sistema de Justicia Penal,* August 2020).

delivers"), where transactional and petty corruption is seen as necessary to deliver on or access public goods and services.[6] Resource and staffing constraints in the investigative, prosecutorial and adjudicative agencies contribute to significant delays in adjudicating of corruption cases. Thus, while the public generally rejects corruption and recognize its negative impacts, there is a high tolerance or resignation in the face of impunity.

3. Peru continues to make progress in enhancing its anti-corruption infrastructure. Combatting corruption has been a key priority for the authorities. The *Plan Nacional de Integridad y Lucha Contra La Corrupción* (2018-21) included measures to enhancing preventive capacity, managing risks, and strengthening sanctions for non-compliance. With expanded resources coming from the 2% allocation of public investments under its concurrent control,[7] the CGR has been able to extend its public audit coverage from 27 percent of the government in 2017 to 95 percent by end of 2024. This helps uncover corruption and misconduct in public procurement. The *Unidad de Inteligencia Financiera del Peru* (UIF), the country's financial intelligence unit, has built good partnerships with public agencies and private sector (banks) to enable identification, freezing and confiscation of proceeds of crime (including corruption). In 2020, the *Junta Nacional de Justicia* (JNJ) was established as an independent and constitutional body responsible for the vetting and discipline of judges and prosecutors, following public outrage over judicial corruption. Even prior to the OECD Accession Process, Peru became a party to the OECD Anti-Bribery Convention in 2018 and has made some progress on implementing recommendations enacting laws on Corporate Liability Law and conducting awareness-raising and trainings.[8]

4. Enhancing effectiveness and coordination of anti-corruption institutions would support checks against abuse of powers and contribute to end impunity for corruption. Enhancing compliance with the asset declarations and conflict of interest statements by politically exposed persons and their robust verification by the CGR will help uncover illicit wealth. Ensuring full and timely access to agencies and entities with legitimate interests (such as banks) can support verification and identification of discrepancies in these declarations.[9] Institutional integrity offices within public sector agencies should be better resourced to effectively manage and process complaints of abuse of power and protect whistleblowers. Strengthening the transparency of the Single Digital Platform for Citizen Complaints will enable individuals to monitor progress and actions on their complaints and help address perceptions of impunity. Strengthened mechanisms for coordination and cooperation among the anti-corruption institutions are also needed to ensure effective prosecution and dissuasive sanctions for corrupt activities.

[6] Shack, N., Pérez, J. & Lozada, L. (2021). *Los esfuerzos en la lucha anticorrupción en contexto: Un análisis desde la experiencia del control gubernamental. Documento de Política en Control Gubernamental*. Contraloría General de la República. Lima, Perú.

[7] Ley No. 31358: *Ley Que Establece Medidas Para La Expansion del Control Concurrente* (November 2021).

[8] OECD, Phase 2 Two-Year Follow-up Report Peru (June 2023).

[9] Summaries of the asset declarations of public officials in Peru are publicly available here: https://apps1.contraloria.gob.pe/ddjj/.

5. An independent and effective judicial system is critical to the rule of law and a key component towards sustainable development. Judicial independence is positively correlated with higher levels of economic growth, and lower levels of corruption.[10] In Peru, the weak transparency and accessibility to courts, significant case backlogs, and low control of judicial corruption are serious challenges.[11] A significant number of judges are employed on short-term contracts and can be easily removed (e.g., supernumerary judges are temporary hires not selected through a merit-based process), which negatively impacts the judicial independence and efficiency. Strengthening the system of regular judges and reducing reliance on temporary judges should be prioritized to improve the quality of the judicial system. Ensuring the effectiveness of the JNJ and safeguarding its independence against undue political interference will ensure that judges and prosecutors are sufficiently vetted and held accountable under disciplinary processes. The organic law of the *Ministerio Público - Fiscalía de la Nación* should be modernized to strengthen its institutional independence and enable it to better organize resources and expertise in prosecuting high-level crimes (including corruption). Finally, adequate resourcing of the judiciary, JNJ and *Ministerio Publico* as well as digitalization to support judicial organization and case management will also contribute to enhancing judicial efficiencies.

6. Robust use of AML/CFT tools can also help prevent, detect, and deter corruption. Continuing supervisory efforts to implement enhanced due diligence measures against politically exposed persons (including their family members and close associates) will ensure that the financial system is not misused to launder proceeds of corruption. Timely and effective access to key information (e.g., bank secrecy, tax, beneficial ownership, and asset declarations) by the UIF will enhance its capacity to analyze suspicious transactions, provide quality intelligence in support of corruption investigations, and freeze criminal assets. Ongoing efforts by the SUNAT (the tax agency) to populate and verity the registry of beneficial owners will enhance corporate transparency and prevent the misuse of companies by public officials (e.g., fraudulently awarding procurement contracts owned by their spouses or children). The pending creation of a centralized register for all notarized documents (e.g., contracts of sale and transfer of real estate) can be another useful database.

[10] Rose-Ackerman, S., and B. Palikfa. 2016. *Corruption and Government—Causes, Consequences and Reform*. New York: Cambridge University Press.

[11] OECD Economic Surveys – Peru (September 2023).

Table 1. Peru: Recommendations on Governance

Anti-Corruption

1. Enhance compliance with asset declarations and conflict of interest statements by politically exposed persons and their robust verification by the CGR
2. Ensure full, timely and public access of asset declarations of high-level public officials to support verification and identification of discrepancies.
3. Improve resources for institutional integrity offices to manage and process complaints of abuse of power and protect whistleblowers
4. Strengthen transparency of the Single Digital Platform for Citizen Complaints
5. Strengthen mechanisms for coordination and cooperation among anti-corruption institutions

Rule of Law

6. Ensure the effectiveness of the Junta Nacional de Justicia and safeguard its independence
7. Modernize the organic law of the Ministerio Publico – Fiscalia de la Nacion to strengthen its independence and organize resources to prosecuting high-level crimes (including corruption)
8. Enhance judicial efficiencies by providing adequate resourcing for the judiciary, Junta Nacional de Justicia and the Ministerio Publico – Fiscalia de la Nacion, and supporting digitalization of judicial organization and case management

AML/CFT

9. Continue supervisory efforts to implement enhanced due diligence measures against politically exposed persons (including their family members and close associates)
10. Enhancing financial intelligence capacities of the UIF by providing timely and effective access to key information (e.g., bank secrecy, tax, beneficial ownership, and asset declarations).
11. Populate and verify registry of beneficial ownership information held by the SUNAT
12. Create a centralized register for all notarized documents

Annex IX. Data Issues

(As of April 11, 2024)

A. Data Adequacy Assessment for Surveillance

Peru: Data Adequacy Assessment Rating 1/

B

Questionnaire Results 2/

Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral	Median Rating
	A	B	B	B	B	B	B

Detailed Questionnaire Results

Data Quality Characteristics

	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral
Coverage	B	B	B	A	B	
Granularity 3/	A		A (GO) B (Debt)	B	B(MFS) B(FSI)	
Consistency			B	B		B
Frequency & Timeliness	A	A	A	A	A	

Note: GO: Government Operations; Debt: Government Debt; MFS: Monetary and Financial Statistics; FSI: Financial Soundness Indicators. When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is color-coded in gray.

1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.

2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).

3/ The top cell for Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance
C	The data provided to the Fund has shortcomings that somewhat hamper surveillance
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance

Rationale for the assessment. Data provided to the Fund for surveillance are timely, comprehensive, and adequate for macroeconomic and financial analysis. Data coverage, frequency, and timeliness are generally in line with expectations and requirements set in the IMF Data Standards Initiatives. Improving the granularity and coverage of government finance statistics, public debt statistics, and financial soundness indicators would further strengthen the adequacy of data for surveillance. Coordination among agencies that compile official statistics would avoid duplication of efforts and enhance consistency of data across sectors.

Changes since the last Article IV Consultations. In 2023, the EPEN replaced the ENAHO as the source for the INEI's official labor force statistics at the national level.
Corrective actions and capacity development priorities. Government finance statistics should be migrated to the GFSM 2014 Manual to improve data quality, coverage, and granularity and to support consistency of data across sectors. Efforts should continue to improve public debt statistics, including its granularity, consistency between stocks and flows, and harmonization of data between the Ministry of Finance and BCRP. Financial sector surveillance should include additional core indicators and expand coverage (to nonbank financials and nonfinancial sectors such as real estate markets).
Use of data and/or estimates different from official statistics in the Article IV consultation. Staff do not use data and/or estimates different from official statistics.
Other data gaps. Core labor market statistics are timely (unemployment, underemployment, remuneration of formal employment), but timeliness of statistics of the informal sector could be improved. Foreign exchange intervention (FXI) data is published daily but could include average maturity of derivative positions. Data related to climate change, particularly related to natural disasters, could be provided.

B. Data Standards Initiative

Peru: Data Standards Initiatives
Peru subscribes to the Special Data Dissemination Standard (SDDS) since August 1996 and publishes the data on its National Summary Data Page. The latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Table 1. Peru: Common Indicators Required for Surveillance

As of April 11, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives via the National Summary Data Page (NSDP)[6]			
	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency		Timeliness	
					Expectation[8]	Current Practice	Expectation[8]	Current Practice
Exchange Rates	2/2024	3/2024	M	M	D	D	...	1D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	3/2024	4/2024	M	M	M	W	1W	1W
Reserve/Base Money	3/2024	4/2024	M	M	M	W	2W	1W
Broad Money	11/2023	12/2023	M	M	M	M	1M	1M
Central Bank Balance Sheet	3/2024	4/2024	M	M	M	W	2W	1W
Consolidated Balance Sheet of the Banking System	2/2024	3/2024	M	M	M	M	1M	1M
Interest Rates[2]	3/2024	4/2024	M	M	D	D	...	1D
Consumer Price Index	3/2024	4/2024	M	M	M	M	1M	1D
Revenue, Expenditure, Balance and Composition of Financing[3] — General Government[4]	Q4/2023	1/2024	Q	Q	A	Q	2Q	2M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2/2024	3/2024	M	M	M	M	1M	1M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q4/2023	2/2024	Q	Q	Q	Q	1Q	2M
External Current Account Balance	Q4/2023	2/2024	Q	Q	Q	Q	1Q	2M
Exports and Imports of Goods and Services	Q4/2023	2/2024	Q	Q	M	M	8W	6W
GDP/GNP	Q4/2023	2/2024	Q	Q	Q	Q	1Q	2M
Gross External Debt	Q4/2023	2/2024	Q	Q	Q	Q	1Q	2M
International Investment Position[6]	Q4/2023	2/2024	Q	Q	Q	Q	1Q	2M

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions. Every Friday the central bank disseminates daily net international reserves, and weekly International Reserve Assets and Reserve Liabilities.

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

[3] Foreign, domestic bank, and domestic nonbank financing.

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

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

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

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

[8] Recommended frequency and timeliness under the e-GDDS and required frequency and timeliness under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are reflected.

PERU

May 2, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The Western Hemisphere Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of March 31, 2024)

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

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	1334.50	100.00
Fund holdings of currency	965.82	72.37
Reserve Tranche Position	368.73	27.63

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	1888.95	100.00
Holdings	1782.52	94.37

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
FCL	May 27, 2022	May 26, 2024	4,003.50	0.00
FCL	May 28, 2020	May 26, 2022	8,007.00	0.00
Stand-By	Jan. 26, 2007	Feb. 28, 2009	172.37	0.00
Stand-By	Jun. 09, 2004	Aug. 16, 2006	287.28	0.00

Projected Payments to the Fund:

	2024	2025	2026	2027	2028
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	3.30	4.40	4.40	4.40	4.40
Total	3.30	4.40	4.40	4.40	4.40

Exchange Arrangement

Peru has a floating exchange rate arrangement. Peru accepted the obligations under Article VIII, Sections 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, except for those maintained solely for the preservation of national or international security, and which have been notified to the Fund pursuant to Executive Board Decision No. 144–(52/51).

Last Article IV Consultation
The 2023 Article IV consultation was concluded on March 22, 2023 (IMF Country Report No. 23/123).

FSAP and ROSCs
Several joint Fund-Bank missions visited Lima in the period September 2000–January 2001 to conduct an FSAP for Peru. The corresponding Financial System Stability Assessment (FSSA) report was discussed by the Executive Board on March 12, 2001. A follow-up FSAP mission was concluded in February 2005. In April 2011, the Executive Board took note of the staff's analysis and recommendations in the report on Peru's FSAP Update. More recently, Fund-Bank missions visited Lima in the period July 2017—February 2018 to conduct another FSAP Update. Regarding ROSCs, In October 2002, an FAD mission conducted a Fiscal ROSC for Peru (IMF Country Report No. 04/109, 4/16/04), while an STA mission conducted a Data ROSC for Peru in February 2003 (IMF Country Report No. 03/332, 10/24/03).

Technical Assistance

FAD		
Year	**Purpose**	
2014	Follow-up Macro-fiscal	7/30/2014
2014	Treasury Management	11/23/2014
2015	Follow-up on Tax and Customs Administration	1/19/2015
2015	Local Government Revenues and BEPS in Natural Resource Sector	12/1/2015
2015	RA-GAP	7/7/2015
2016	Budget Management	2/15/2016
2017	Fiscal Reporting and Budgeting	1/16/2017
2017	Follow-up on Tax and Customs Administration - TADAT	3/7/2017
2017	Tax Administration	6/7/2017
2017	Public Investment Management	8/17/2017
2018	Treasury Management	2/20/2018
2018	Governance Pilot	9/23/2018
2019	Budgeting Investment and PIMA	4/29/2019
2019	Tax Regimes	08/12/2019
2019	Revenue Administration	11/13/2019
2019	Public Financial Management (PFM) - MTBF	12/6/2019
2020	Large Taxpayer Units	1/20/2020
2020	PFM - MTBF	5/15/2020
2020	PFM/Budget - MTBF	7/16/2020
2020	Customs – Risk Management	8/9/2020
2020	PFM/Treasury Management and Payments Digitalization	10/14/2020
2020	PFM/Treasury Management: Cash Flow Plans	11/24/2020
2021	Tax Administration – Risk Management	4/20/2021

2021	Tax and Customs Administration – Risk Management and Research	3/14/2021
2021	Tax and Customs Administration – Risk Management and Exchange of Information	3/13/2021
2021	Tax Policy – Mining Sector, Digital Services and Capital Gains Taxation	11/15/2021
2022	Debt Management – Debt Servicing Payment Process	2/15/2022
2022	Public Financial Management - Fiscal Risks Assessment Tool	11/18/2022
2023	Revenue Administration – Compliance Improvement Plan	3/6/2023
2023	Revenue Administration – Compliance Plan Finalization	8/28/2023
2023	Revenue Administration – Customs Compliance	10/02/2023
2023	Public Financial Management - Digitization Modernization	10/10/2023
MCM		
2021	CBDC Feasibility	08/27/2021
2022	Back Office Processes	02/15/2022
2022	CBDC Design Phase 1/3	08/01/2022
2022	CBDC Design Phase 2/3	12/20/2022
2023	CBDC Design Phase 3/3	6/19/2023
LEG		
2017	Strengthening AML/CFT Supervision of the SMV	2/7/2017
STA		
2018	Monetary and Financial Sector Statistics	10/22/2018
2019	Sectoral Accounts	7/15/2019
2020	National accounts (sectoral balance sheets, GDP statistics)	1/16/2020
2020	Follow-up National accounts (sectoral balance sheets, GDP statistics)	4/27/2020
2020	CPI Weights	10/19/2020
2020	Follow-up Sectoral Accounts	11/23/2020
2021	Sectoral Accounts	06/21/2021
2023	Government Finance Statistics and Public Sector Debt Statistics	07/10/2023

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

World Bank Group:

- Country page: http://www.worldbank.org/en/country/peru
- Overview of World Bank Group lending to Peru: http://financesapp.worldbank.org/en/countries/Peru/
- IBRD-IDA project operations: http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=PE

Inter-American Development Bank:

- Country page: https://www.iadb.org/en/countries/peru/overview
- IADB's lending portfolio: https://www.iadb.org/en/countries/peru/projects-glance

INTERNATIONAL MONETARY FUND

PERU

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

May 15, 2024

Prepared By

Western Hemisphere Department

This supplement provides an update on recent developments since the issuance of the staff report on May 6, 2024. The update does not alter the thrust of the staff appraisal.

1. **The Ministry of Finance unveiled new projections under the Updated Macroeconomic Projections Report published in May 2024.** The authorities now envisage economic growth at 3.1 percent for 2024, compared to 3.0 percent in the 2024 Budget. They also increased their projection for the 2024 non-financial public sector fiscal deficit from 2 percent of GDP to 2.5 percent of GDP, which is now aligned with staff's baseline projection.

2. **The new medium-term fiscal projections postpone the fiscal consolidation.** The new projections delay the fiscal consolidation, which is justified and broadly consistent with staff's recommendations. The new authorities' fiscal consolidation path implies that the 1 percent-of-GDP fiscal target would now be reached in 2028 instead of 2026.

3. **The government requested special legislative powers to introduce measures to foster the economic recovery.** The executive has requested special legislative powers for 90 days to introduce measures to foster the economic recovery. One of the envisaged measures includes changes to the fiscal rule targets. The IMF stands ready to provide technical assistance on assessing the optimality of the current medium-term fiscal rule targets to ensure they effectively anchor fiscal sustainability.

Table 1. Peru: Non-financial Public Sector Fiscal Deficit Projections

(Percent of GDP)

	Budget Projections	Authorities' New Projections	Staff Baseline Projections
2024	2.0	2.5	2.5
2025	1.5	2.2	2.0
2026	1.0	1.8	1.5
2027	1.0	1.4	1.0
2028	1.0	1.0	1.0

Statement by Mr. Alfaro and Mr. Hendrick on Peru
May 20, 2024

Key Points

- The Peruvian economy is expected to grow 3.0 percent in 2024 after a slight contraction in 2023, and a similar growth rate is expected in 2025. Even with the conservative staff estimates, Peru's growth is still one of the highest among LAC-5, as reported in the April World Economic Outlook (WEO). This performance is supported by very strong macroeconomic policies and institutional frameworks, despite the impact of multiple external and domestic shocks.
- After a temporary increase in early 2023, headline and core inflation have rapidly declined towards the target band due to the determined monetary tightening implemented by the Central Reserve Bank of Peru (BCRP). In April 2024, year-on-year headline inflation declined to 2.4 percent, and core inflation to 3.0 percent. Inflation expectations remain firmly anchored within the inflation targeting range of 1 to 3 percent. On May 9, the BCRP continued its easing cycle, reducing the policy rate by 25 bps to 5.75 percent.
- The fiscal position remains strong despite the multiple persistent shocks that affected Peru's economy and public finances. The fiscal deficit was 2.8 percent in 2023 reflecting a sharp shortfall in tax revenues, partially compensated by lower current and capital expenditure. Yet, public debt decreased from 33.9 to 32.9 percent of GDP between 2022 and 2023, still one of the lowest among emerging markets. Sovereign spreads remain among the lowest in the region and Peru continues to hold investment grade status with all three major rating agencies.
- Peru's external position continues to be one of the strongest among emerging market economies. At end-April 2024, international reserves amounted to US$ 74.5 billion, equivalent to 28.6 percent of GDP, well above the Fund's ARA metric. This buffer, together with access to international capital markets in very favorable terms and a very low public debt, provides additional insurance against tail risks.
- The financial sector remains solid. Banks are profitable and well-capitalized, with ample liquidity and capital buffers, despite the slowdown in economic activity. Recent stress testing continues to suggest that the financial system is resilient even under severely adverse scenarios. Most financial entities already comply with Basel III capital requirements well ahead of the deadline.
- Looking ahead, and with the OECD accession process underway, the authorities are working on a broad range of structural reforms to boost growth and address social needs. They also plan to follow up on staff's recommendation to continue working on policies to address climate-related shocks, and to promote the use of digitalization and artificial intelligence to boost productivity and inclusive growth.

INTRODUCTION

1. **Our Peruvian authorities would like to convey their appreciation to Mrs. Muñoz and her team for an open and constructive dialogue during the Article IV Consultation.** Staff offers a balanced analysis of recent economic developments and the challenges ahead in the staff report and provides an in-depth analysis of relevant topics to boost economic productivity and inclusive growth in the selected issues paper. Our authorities are in broad agreement with the staff's assessment and policy recommendations. We appreciate the focus on the policies to ensure a resilient and inclusive recovery. We agree that policies are needed in the short term to support growth momentum, while over the medium term, structural reforms and policies are necessary to rebuild buffers and reinforce high growth prospects.

2. **We concur with staff's assessment that Peru has maintained strong macroeconomic policies and institutional policy frameworks, despite political uncertainty.** Over the last three decades, Peru has successfully navigated significant economic shocks and occasional political uncertainty, while maintaining sound macroeconomic policies and building substantial policy buffers, which were instrumental during the global financial crisis and the recent COVID-19 pandemic. As explained in the staff report, very strong fiscal policies allowed Peru to maintain the lowest debt ratio in the region and one of the lowest in the world. An economic recovery is underway, inflation is already within the BCRP's inflation targeting band, and international reserves continue to increase, well above the Fund's ARA metrics. Fiscal buffers are around 9 percent of GDP, and the country continues to have access to international markets with one of the lowest sovereign spreads in the region.

3. **In this context, our Peruvian authorities have decided not to renew the Flexible Credit Line (FCL) after its expiration at the end of May 2024**. Our authorities express their gratitude to the Board, Management, and staff for their support during our past request for a two-year FCL arrangement in 2020 and subsequently in 2022. Peru has treated the FCL as precautionary and has been reducing its access under this agreement, in line with its intention to exit once external conditions improve. The latest WEO forecasts point to a relative improvement in the world economy, evolving risks are broadly balanced, and as underscored by staff, Peru has ample buffers to cope with adverse shocks. Additionally, the current account is expected to show moderate deficits in the upcoming years. These deficits are anticipated to be broadly covered by private long-term capital inflows, which should not only fulfill financing needs but also enhance the international reserve position.

RECENT DEVELOPMENTS

4. **The Peruvian economy is expected to rebound in 2024, with a projected real GDP growth of 3.0 percent, after the slight contraction in 2023.** The main drivers of growth in 2024 will be exports, investment, and private consumption. In 2023, as clearly explained by staff in Box 1, Peru had multiple consecutive shocks, beginning with some social unrest in early 2023 affecting the mining and services sectors, and the negative impact of El Niño Costero, and El Niño Global affecting the agriculture and fishing sector. These combined shocks contributed an estimated -2.1 percentage points to GDP growth in 2023. Despite the slight recession, the unemployment rate fell at end-2023 and informality also declined. However, the authorities are aware that adequate employment remains below pre-pandemic levels. A strong recovery is expected in agriculture and fishing in 2024, and a moderate boost in the mining sector. High frequency indicators of economic activity in March 2024 point towards a healthy and sustained recovery. Additionally, the US$ 3.5 billion deep-water mega

port in Chancay, built by the Chinese company Cosco Shipping Ports Chancay Peru (CSPCP), is set to start operations late this year, providing Peru and China with a direct gateway to Asian and Latin American markets, saving around 12 days in relation to current routes. The port and related activities will generate thousands of jobs and create many business opportunities in the region.

5. **The BCRP responded decisively and swiftly to curb inflation and inflation expectations, successfully bringing both headline and core inflation back within the target range by April 2024.** After domestic and external supply shocks began to fade, the BCRP was one of the first to begin an easing cycle in September 2023. It lowered its policy rate by a cumulative 200 bps, with eight 25 bps reductions from 7.75 percent in September 2023 to 5.75 percent last May 9, 2024. In April 2024, monthly inflation was -0.05 percent and core inflation was 0.11 percent, inflation decreased to 2.4 percent and core inflation to 3.0 percent. One year inflation expectations remained at 2.6 percent, marking the fifth consecutive month it has remained within the central bank inflation target of 1 to 3 percent. The monetary authority expects inflation to continue decreasing and to stay around the center of the target range in the coming months. At the same time, the BCRP has signaled the markets that its policy stance is data-dependent and may be adjusted if warranted by market conditions.

6. **The fiscal position remained strong in 2023 despite the multiple shocks that affected Peru's economy and public finances.** Due to the economic slowdown, the non-financial public sector deficit (NFPS) reached 2.8 percent of GDP in 2023. General Government revenues fell by 2.3 percentage points of GDP, which more than compensates for the reduction in current and capital expenditure, even after taking into account new stimulus programs (*Con Punche Perú* 1 and 2) and climate-related spending. Yet, the public debt declined from 33.9 percent of GDP in 2022, to 32.9 percent of GDP in 2023, one of the lowest among LAC and emerging markets. As detailed in Annex IV, 87 percent of the public debt has fixed interest rates with an average duration of about 14 years, and about 51 percent of public debt is denominated in local currency. Thus, interest rate and exchange rate risks are very low. In addition, public savings stood at 10.5 percent of GDP by end-2023. Peru's sovereign credit rating remains at investment grade by the three major rating agencies, and sovereign spreads remain among the lowest in the region. Going forward, fiscal consolidation will continue, and the deficit is expected to decrease to a medium-term target of 1 percent of GDP in 2028.

7. **Peru's external position remains strong and international reserve coverage remains adequate under all Fund metrics.** For a small open and commodity exporting economy, with domestic foreign currency liabilities, maintaining large external buffers is key to enhance the resilience of the Peruvian economy. At end-April 2024, net international reserves amount to US$ 74.5 billion, equivalent to 28.6 percent of GDP, higher than the level at end-December 2023. The temporary 0.8 percent of GDP surplus of the current account in 2023 is explained by the sizable import compression associated with the economic slowdown, despite a 4.8 percent improvement in the terms of trade. The current account is expected to converge to a deficit of around 1.5 percent in the medium term. The exchange rate appreciated moderately in 2023 and remains stable in 2024.

8. **The financial sector remains strong and resilient despite the slowdown in economic activity and the negative impact of El Niño on households and corporations.** Banks are profitable and well-capitalized, with ample liquidity and capital buffers despite the slowdown. The results of an updated top-down stress test conducted in April 2024 by the Superintendency of Banks, Insurance and Pension Funds (SBS) confirm the financial system's resilience to a hypothetical materialization of adverse macroeconomic scenarios. In particular, the financial system's average

capital ratio would fall from 16.3 percent in December 2023 to 12.2 percent in December 2025, under a severely adverse scenario. Most institutions already comply with Basel III capital requirements ahead of the deadline. Nevertheless, the SBS will continue to monitor market conditions and take measures as needed.

ENSURING A RESILIENT AND INCLUSIVE ECONOMIC RECOVERY

9. **The authorities remain committed to preserve fiscal sustainability and agree with staff that a supportive fiscal stance is appropriate in the short term, while maintaining fiscal consolidation in the medium term.** Although the 2024 Budget envisages an NFPS deficit of 2 percent of GDP, consistent with the current fiscal rule, the impact on revenues from the slowdown of the economy in 2023 calls for a review of the current fiscal consolidation path. The Ministry of Finance has recently announced a review of the fiscal targets for the period 2024-2026, with a view to reaching the target of an NFPS deficit of 1 percent by 2028. The revised fiscal target for 2024 is now in line with staff's estimate of 2.5 percent of GDP, which is consistent with the expected tax collection for this year and the execution of the budget approved for 2024. As explained by staff, this would be preferable to support growth and lessen the risk of missing the target again. The authorities have requested the Fund's technical assistance to review the current fiscal rule and consolidation path, considering the external shocks in 2023, and Peru's high exposure to future climate-related shocks to the economy.

10. **Revenue mobilization and strengthening of the tax administration authority (SUNAT) is also an important component of the fiscal consolidation strategy.** It is worth underscoring that tax administration and compliance have significantly improved in recent years, with the introduction of electronic invoicing, a digital tax registry, notices of tax due, leveraging of big data tools, and enhanced use of treaties to exchange taxpayer information. The Fund has provided several technical assistance missions to help SUNAT in revamping its capabilities. The Fiscal Council has played a key role in guiding the Ministry of Finance's performance in budget execution and in ensuring compliance with the fiscal rule. The authorities are grateful for staff's recommendations on ways to improve the role of the Fiscal Council. These will be carefully considered in the context of the ongoing review of the optimality of the medium-term fiscal target, the debt ceiling, the expenditure growth limit, and the liquidity buffers. It is important to highlight that the Fiscal Council has been supporting Peru's fiscal framework with transparency and independence. Their opinions and views, even when differing from those of the Ministry of Finance, have always been welcomed and openly disseminated to both the markets and the general public.

11. **The BCRP's long track record of implementing a successful inflation targeting framework is the best guarantee to maintain a stable and low inflation to support growth and poverty reduction.** After the transitory shocks dissipated, the monetary authority is focused on securing headline inflation back within the 1-3 percent target band. It is worth mentioning that inflation in Peru has been one of the lowest and less volatile in LAC-5, and that the country has maintained single-digit inflation for more than two decades. This has been critical in creating a favorable business climate, generating stable real household incomes, and promoting substantial poverty reduction. The exchange rate serves as a pivotal shock absorber, which is why Peru has upheld a flexible exchange rate regime. This approach includes sporadic interventions designed to smooth out excessive volatility in the FX and to safeguard the efficacy of the monetary policy transmission mechanism. As explained by staff, despite the reduction in dollarization, further progress could be challenging as holdings of FX credit by large corporates are more difficult to target. One possible line of action could be to adopt targeted macroprudential measures to avoid credit disintermediation. For instance, the

SBS has introduced an 8 percent capital surcharge for FX-denominated loans when calculating Basel III capital ratios, in line with 2018 FSAP recommendations.

12. **The resilience and strength of the financial system and the absence of systemic risks provides strong support to sustain economic recovery and credit growth in the future.** The ample liquidity in the system is a crucial financing source for economic activities, not only for big corporations, but also for small and medium-sized enterprises (SMEs) and micro businesses. Lending standards and interest rates are customized to the different sectors of the economy. On the potential additional withdrawals from private pension funds, due to recent Congress approval of a seventh withdrawal, it is important to underscore that the recent liquidity stress test conducted by the SBS shows that banks can cope with a substantial withdrawal of deposits from private pension funds. This outcome is clearly anticipated, not only due to the abundant liquidity present in the system, but also because a significant portion of that capital invariably cycles back to the banks in the form of deposits. This is because currently, only high-income segments still have significant balances in their private pension funds, therefore, their marginal propension to consume is relatively low. The effect is a change in the composition of bank deposits from long-term to short-term instruments.

13. **The authorities concur with staff that additional structural reforms are needed to boost potential growth and welcome staff's recommendations in the analytical chapters of the selected issues paper.** Indeed, with the OECD accession process underway, the authorities are focusing on a broad range of structural reforms since 2021. Progress has been made in some areas but under current political circumstances, reforms that need approval by Congress may take longer than expected. Staff's analysis on productivity and boosting resilience is appreciated and their recommendations for increasing firm-level productivity will be carefully considered. Regarding the barriers to firms and productivity growth explained in Box 3, it is important to mention that the same factors were effective in reducing informality and supporting the development of micro businesses and SMEs, but a review of this framework may be warranted. The government is making efforts to promote digitalization and is exploring the use of artificial intelligence to boost productivity.

14. **Staff's assessment of growth and fiscal benefits of climate adaptation and resilience policies is greatly appreciated.** This analysis provides interesting and useful guidance for policy formulation. Nevertheless, it is important to know that Peru is not a large carbon emitter, as its energy matrix is intensive in natural gas and hydroelectric power. It is land use and deforestation which account for most of the country's emissions. At the same time, as the recent negative impact of El Niño and El Niño Costero has shown, Peru is one of the most vulnerable countries due to the impact of extreme weather events, and policies for prevention in addition to posts-disaster response would be needed. There is ongoing work to incorporate climate risks in macroeconomic forecasts and expand the toolkit for qualifying disasters risks.

FINAL REMARKS

15. **The Peruvian authorities remain committed to maintaining very strong macroeconomic policies and will respond in a timely and effective manner to any emerging shocks.** Over the last three decades, the Peruvian economy has strengthened significantly due to the implementation of sound economic policies, with sustained growth, low inflation, and a substantial reduction in poverty since the turn of the century. These policies have paved the way for a resilient economy, with the buffers and drive to navigate through these difficult times and potential challenges ahead. The authorities are in constant review of their growth strategy and use every window of opportunity to fine-

tune and recalibrate policies where needed. They remain vigilant and are ready to implement any necessary adjustments to continuously improve the population's living standards.

16. **Finally, on behalf of the Peruvian authorities, we would like to reiterate our appreciation to Management, Executive Directors, and staff for their advice and support.** As we committed one year ago, after careful consideration of global risks and the resilience and strength of the Peruvian economy, we do not intend to renew the two-year FCL arrangement following its expiration on May 27th. The FCL has successfully served its intended role for Peru, providing added insurance against tail risks and uncertainties in the global outlook. Now, there are emerging signs of improving global conditions, and Peru's external position is expected to strengthen over the next few years, amid moderate current account deficits and a rise in long-term private capital inflows. These factors are anticipated to bolster buffers against potential economic shocks. In this context, our Peruvian authorities believe that the FCL has fulfilled its precautionary objectives and see this as the right moment to exit the arrangement.