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IMF Approves 26-month US\$422.8 Million Stand-By Arrangement for Peru

The Executive Board of the International Monetary Fund (IMF) today approved a 26-month SDR 287.3 million (about US\$422.8 million) Stand-By Arrangement for Peru to support the country's economic program through mid-2006. The approval enables the release of a first drawing of SDR 80 million (about US\$118 million) under the arrangement. However, the authorities have indicated their intention to treat this arrangement as precautionary.

Following the Executive Board discussion, on Peru, Rodrigo de Rato, Managing Director and Chairman of the Board, said:

“Peru's recent economic performance has been favorable, with solid growth and low inflation. Substantial buffers, including a high level of international reserves and a well-capitalized banking system, have been built up to further reduce vulnerabilities associated with high dollarization and public debt, and there has been progress with structural reforms. The authorities' program for 2004-06 aims at consolidating macroeconomic stability, fortifying confidence, strengthening the basis for sustainable growth and employment creation so as to reduce poverty, and further reducing financial vulnerabilities. It focuses on the consistent implementation of their inflation-targeting framework and on fiscal consolidation, with a view to continue improving public debt dynamics and increasing the scope for priority social and infrastructure investment.

“The program also includes a broad set of growth-enhancing reforms aimed at reducing the high levels of unemployment and poverty. In 2004, the authorities plan to foster private investment by establishing commercial courts and improving collateral registries. They also plan to grant operating concessions to the private sector and enter into targeted public-private partnerships (PPPs), which will be implemented in a prudent manner and accounted for transparently in the budget. The reform program will also improve public resource management, modify public pension regimes—including the preferential *Cédula Viva*—reduce labor costs, and strengthen bank supervision and the legal framework for fiscal decentralization.

“The authorities' firm commitment to implementing prudent economic policies in the context of a challenging political and social environment is commendable. Strengthening political consensus for critical reforms will be crucial to press forward with the reform momentum of recent years and reduce the vulnerabilities facing the economy and reinforce confidence in the continuity of

prudent policies. This will help boost broad-based and sustainable growth and employment and reduce poverty, while strengthening the basis for Peru's successful exit from the series of Fund-supported programs," the Managing Director said.

Recent economic developments

Peru made progress in stabilizing its economy and adopting growth-enhancing structural reforms, under the 2002–03 Stand-By Arrangement with the Fund. Economic growth averaged 4.5 percent a year, inflation remained low under the inflation targeting framework of the central bank, and substantial buffers were built to mitigate financial vulnerabilities. These buffers included a high level of international reserves and a well-capitalized banking system. Progress was also made in structural reforms, including in the areas of decentralization, pension reform, clarifying fiscal rules, strengthening the financial system, and reorienting the privatization program towards granting concessions.

In 2003, Peru's GDP grew by 4 percent in real terms and inflation was limited to 2.5 percent. Fiscal consolidation was in line with the government's target—the deficit of the combined public sector was reduced from 2.2 percent of GDP in 2002 to 1.7 percent of GDP. Revenues were boosted by tax measures introduced in mid 2002 and mid 2003. Peru's external position also strengthened in 2003 and financial indicators improved. The external current account deficit fell from more than 2 percent of GDP in 2002 to about 1.75 percent, driven by commodity export growth. Private capital inflows remained strong, particularly foreign direct investment in the natural resource sector. Gross international reserves rose by about US\$500 million during 2003 and by a further US\$250 million during the first four months of 2004, to US\$10.5 billion at end-April 2004. The Lima stock exchange index surged by 75 percent during 2003, reflecting higher mineral product prices. Peru's sovereign spread continues to be among the lowest in the region.

Program summary

The objectives of the program for 2004–2006 are to maintain macroeconomic stability, foster robust growth and employment, further reduce vulnerabilities, and diminish poverty.

The program aims at enhancing the basis for strong economic growth, which is projected to average about 4.5 percent a year during 2004–06. It focuses on the continued implementation of the inflation-targeting framework and on fiscal consolidation, with a view to lowering the debt-to-GDP ratio from about 47.5 percent in 2003 to about 41 percent in 2006. Successful implementation of the program will enhance the basis for defining Peru's exit strategy from Fund supported programs.

The **fiscal program** is based on reducing the overall deficit of the combined public sector from 1.7 percent of GDP in 2003 to 1.4 percent in 2004, and to 1 percent a year in 2005–06. Over this period, about one third of the adjustment effort of the central government is to be achieved through higher revenue, and the remainder through a containment in current expenditure growth. **Monetary policy** will continue to be managed within the inflation-targeting framework.

While preserving its floating in the exchange rate regime, the authorities intend to maintain a

solid cushion of foreign reserves to mitigate potential external shocks and political uncertainties in the period up to the 2006 elections.

Boosting economic growth and employment creation depends critically on the sustained implementation of a broad set of reforms. The program includes **growth enhancing reforms** aimed at strengthening the investment climate, including the establishment of commercial courts to speed up contract enforcement and improvements in the functioning of collateral registries. To bolster infrastructure investment, the authorities plan to grant operating concessions to the private sector and enter into Public-Private Partnerships in a fiscally prudent and transparent manner. Also, the authorities intend to improve resource management in the public sector, modify public pension regimes, reduce labor costs, and strengthen the legal framework for decentralization. The program includes efforts aimed at further strengthening the regulation and supervision of financial intermediaries.

Peru joined the IMF on December 31, 1945, and its current quota is SDR 638.4 million (about US\$939 million). Its outstanding use of IMF financing currently totals SDR 80.3 million (about US\$118 million).

Peru: Selected Economic Indicators

	2002	Est. 2003	Proj. 2004	Proj. 2005	Proj. 2006
(Annual percentage change, unless otherwise indicated)					
Real economy					
Real GDP	4.9	4.0	4.0	4.5	4.5
Inflation 1/	1.5	2.5	2.5	2.5	2.5
Terms of trade	2.5	2.5	9.1	-0.9	-0.1
Real effective exchange rate (depreciation -) 1/ 2/	-5.5	-10.7
Nominal exchange rate (in soles per U.S. dollar) 1/	3.51	3.47
Money and credit					
Base money	11.0	10.1	8.0	8.0	8.0
Liabilities to the private sector 3/ 4/	8.7	13.5	9.3	11.3	11.8
Credit to private sector 3/ 4/	2.1	3.7	3.1	4.8	4.6
(In percent of GDP, unless otherwise indicated)					
Savings and investment					
Gross domestic investment	18.4	18.5	18.2	18.6	18.9
National savings	16.3	16.7	17.5	17.8	18.2
External savings	2.1	1.8	0.7	0.8	0.7
Balance of payments					
Current account	-2.1	-1.8	-0.7	-0.8	-0.7
Capital and financial account	3.5	2.5	0.8	0.9	0.8
Gross official reserves (in months of imports of goods and services) 1/	10.5	10.5	10.1	9.5	9.2
Gross official reserves (in percent of broad money) 1/	65.2	67.7	66.9	68.2	69.6
Public sector					
Combined public sector primary balance	0.0	0.4	0.8	1.4	1.5
Combined public sector overall balance	-2.2	-1.7	-1.4	-1.0	-1.0
Public sector medium-and long-term external debt	36.9	37.3	35.4	34.7	33.1

Sources: Central Reserve Bank of Peru; and IMF Staff estimates and projections.

1/ At end period.

2/ Based on the Information Notice System.

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

4/ Corresponds to the financial system.