

V.

Public finances

During 2006 the non-financial public sector (NFPS) posted an economic surplus equivalent to 2.0 percent of GDP, favored by a positive international environment characterized by a stage of expansion in the global economy and high level of prices for commodities. This result was also favored by the domestic context, where domestic demand grew at increasingly higher rates throughout the year, and consumers and business confidence also increased.

The strategy for managing the State's assets and liabilities in 2006 included readjusting the profile of the public debt in order to lower market risks by reducing the vulnerability of fiscal accounts vis-à-vis adverse external shocks. In this sense, public debt management operations were carried out in order to set relevant maturities to establish the yield curve on Public Treasury bonds, reduce the risk of refinancing the public debt by replacing short-term maturities with longer-term amortizations, and provide the secondary market of domestic public debt with greater liquidity and depth. Moreover, the process of dedollarization of public debt continued to be reinforced through programs for the placement of Public Treasury bonds in domestic currency. Thus, 20-year bonds were placed, which serve as reference for mortgage loans in soles.

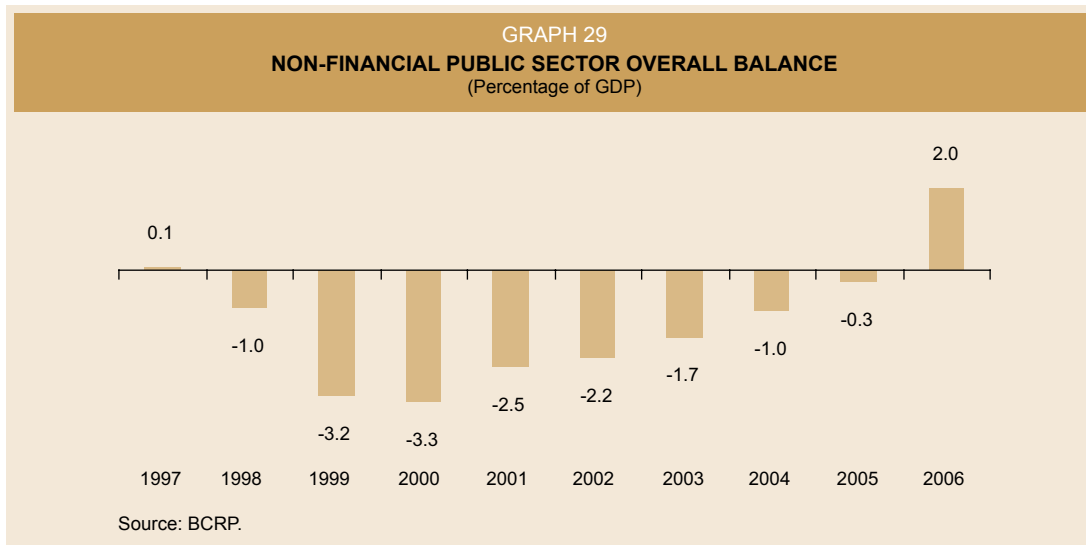
1. Fiscal policy indicators

1.1 Conventional economic result

The positive performance of public finances in 2006, reflected in a surplus of 2.0 percent of GDP, was mostly associated with the increase seen in the general government's current revenues, which represented 19.6 percent of GDP (18.3 percent of GDP in 2005). This result was not observed since the late seventies and early eighties when the revenues of the central government ranged between 18 and 23 percent of GDP due to the high prices of commodities. Another factor contributing to this improvement in the fiscal result was the lower non-financial expenditure of the general government which amounted to 16.1 percent of GDP –the lowest expenditure level seen since 1993–, while state enterprises posted a primary

result equivalent to 0.2 percent of GDP. As a result of this, the primary surplus in the NFPS was 3.9 percent of GDP in 2006 (1.6 percent in 2005).

The results posted by the NFPS complied with the fiscal rules established in the Fiscal Transparency and Accountability Act (FTAA), including those applicable for years when general elections are held. First, a surplus was recorded in the NFPS; according to the law, the deficit in the NFPS should not be higher than 1 percent. Likewise, the real growth of the non-financial expenditure of the general government calculated with the GDP implicit deflator was 2.6 percent, a lower level than the 3 percent set forth in the FTAA, although according to Law N° 28880 (September 2006) the NFPS was exempted from complying with this regulation during the 2006 fiscal year.



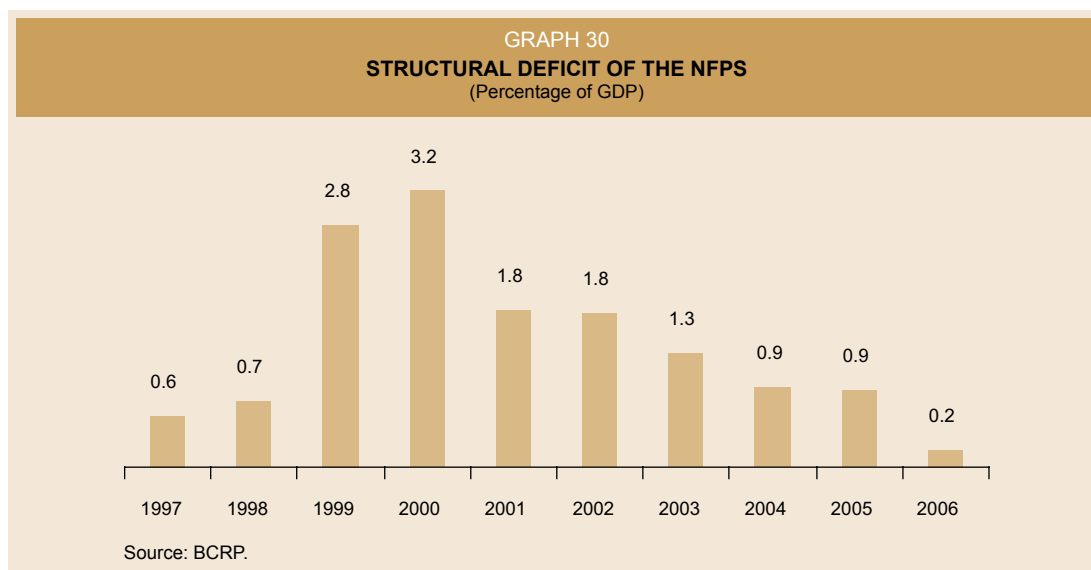
As regards the regulations applicable in years of general elections, the general government's non-financial expenditure executed during the first seven months of the year did not exceed 54 percent of the budgeted expenditure (the

limit was 60 percent) and a surplus was posted in the first half of the year (according to the law, the fiscal deficit should not exceed 40 percent of the deficit anticipated for the year).

TABLE 30
NON-FINANCIAL PUBLIC SECTOR OVERALL BALANCE

	Millions of Nuevos Soles			Percentage of GDP		
	2004	2005	2006	2004	2005	2006
I. PRIMARY BALANCE	2,409	4,277	11,956	1.0	1.6	3.9
1. Central government primary balance	2,080	3,720	11,098	0.9	1.4	3.6
a. Current revenues	41,594	47,815	60,056	17.5	18.3	19.6
i. Tax revenue	31,828	36,311	46,218	13.4	13.9	15.1
ii. Non-tax revenue	9,765	11,504	13,837	4.1	4.4	4.5
b. Non-financial expenditure	39,730	44,481	49,318	16.7	17.0	16.1
i. Current	33,394	37,320	40,833	14.0	14.3	13.4
ii. Capital	6,336	7,162	8,486	2.7	2.7	2.8
c. Capital revenues	216	386	361	0.1	0.1	0.1
2. Primary balance of other entities	329	557	858	0.1	0.2	0.3
II. INTERESTS	4,867	5,066	5,693	2.0	1.9	1.9
1. External debts	3,951	4,175	4,337	1.7	1.6	1.4
2. Internal debts	915	891	1,357	0.4	0.3	0.4
III. INTEREST PAYMENTS	-2,458	-789	6,263	-1.0	-0.3	2.0
1. Net financing abroad (a+b+c) (Millions of US\$)	3,598	-3,813	-2,175	1.5	-1.5	-0.7
a. Disbursements	\$1,076	-\$1,167	-\$658	1.5	-1.5	-0.7
b. Amortization	\$2,474	\$2,628	\$609	3.5	3.3	0.7
c. Other	\$1,348	\$3,678	\$1,193	1.9	4.6	1.3
2. Net domestic financing	-\$49	-\$117	-\$74	-0.1	-0.1	-0.1
3. Privatization	-1,529	4,417	-4,392	-0.6	1.7	-1.4
4. Privatization	389	185	304	0.2	0.1	0.1

Source: MEF, Banco de la Nación, BCRP, SUNAT, EsSalud, local governments, state-owned companies and public institutions.



When the General Budget was discussed in the second half of the year, the criterion used to evaluate the regulation on the growth of spending was modified. As of 2007, regulations establish that “the real annual increase in central government’s non-financial current spending, after deducting maintenance expenditure, shall not be over 3 percent in real terms based on the average Consumer Price Index for Metropolitan Lima”. The concept regarding the resources to be transferred to the Fiscal Stabilization Fund (FSF) was also modified, as a result of which a surplus is defined as the freely disposable budgetary balance obtained by the Public Treasury at the end of each fiscal year in the financing source of Ordinary Resources.

1.2. Structural economic result

The estimated structural economic result is aimed at isolating the effect of the economy’s position in the economic cycle, as well as the impact of the higher prices of mineral exports and the price of hydrocarbons on fiscal accounts. The general government’s expenditure and the results of state enterprises are not adjusted in case they should not automatically respond to the economic context in which the treasury operates in order that the changes observed in

these variables reflect the decisions of fiscal authorities.

Estimates show that the structural deficit has been declining from levels of 3.2 percent in 2000 to 0.9 percent of GDP in 2005 and to 0.2 percent of GDP in 2006. In contrast with the conventional deficit –measured by the NFPS economic result– which shows a movement from a deficit of 0.3 percent to a surplus of 2.0 percent of GDP, the structural deficit shows only a reduction of 0.7 percentage points, since a great deal of the deficit reduction was due to the 36 percent increase seen in the prices of exports, which generated higher revenues on account of income tax.

1.3. NFPS financial requirements

Another fiscal policy indicator is financial requirements, which measures the resources the public sector requires for its economic result and to cover internal and external amortizations. In 2006, the public sector financial requirements amounted to S\$ 675 million –a sum significantly lower than in the previous year– as a result of the economic surplus achieved (US\$ 1,883 million), as well as of the amortization of public debt (US\$ 2,557 million), which was 43 percent lower than in 2005. This reduction



TABLE 31
FINANCING OF NON-FINANCIAL PUBLIC SECTOR

	2004	2005	2006
1. Overall balance (millions of nuevos soles)	-2,458	-789	6,263
(% of GDP)	-1.0	-0.3	2.0
Millions of US\$	-752	-196	1,883
2. Amortization (millions de US\$)	-2,106	-4,517	-2,557
Payment of Recognition bonds	-212	-188	-145
Domestic	-546	-652	-1,220
External	-1,348	-3,678	-1,193
3. Financial requirements (millions of US\$)	2,858	4,713	675
External disbursements	2,474	2,628	609
Free disposal	2,158	2,277	315
Investment projects	315	350	294
Domestic bonds	766	2,096	1,741
Privatization	114	56	94
Other	496	67	-1,770

Source: MEF, Banco de la Nación, BCRP, SUNAT, local governments, state-owned companies, and public institutions.

was mainly due to the fact that two operations of prepayment of the external debt for a total of US\$ 2,312 million were carried out in 2005 and to the fact that the pending debt with JAPECO (US\$ 86 million) was repaid in 2006. This lower amortization more than compensated the increase in the amortization of domestic debt resulting from a debt exchange that included the equivalent of US\$ 838 million in Treasury bonds. This debt exchange was carried out in two stages; a total of US\$ 747 million were exchanged in May and the rest was exchanged in June.

The public sector financial requirements were covered mainly through external resources (US\$ 609 million) and through the issue of sovereign bonds (US\$ 1,741 million), which included the placement of bonds for the operations described above in the domestic market. Moreover, Public Treasury deposits increased considerably: from S/. 2,602 million at end-December 2005 to S/. 7,097 million in December 2006, which mainly accounts for the variation in the heading "other requirements" (US\$ 1 770 million).

2. Central government

The central government recorded its best economic result since the seventies and reached a surplus of 1.4 percent of GDP (whereas a 0.7 percent deficit had been posted in the previous year). This improvement in the primary result (3.2 percent of GDP) is mainly explained by the evolution of revenues in a context where tax collection increased due to the higher international prices of commodities and growing domestic demand.

2.1 Central government revenues

The central government **current revenues** amounted to 17.2 percent of GDP, a level higher by 1.5 points of GDP than the one recorded in 2005. This increase was mainly associated with higher revenues for income tax, as a result of the rise of export prices, greater dynamism of economic activity and higher ratios of payment on account of income tax than in 2005. Moreover, other factors contributing to this result were the revenues

for mining royalties and royalties transferred to sub-national governments. Some tax measures were approved during the year that affected the

revenues for import duties and the excise tax on fuel, both of which reduced revenues by 0.4 percentage points.

TABLE 32
CENTRAL GOVERNMENT REVENUES

	Percentage of GDP			Real % change		Percent structure		
	2004	2005	2006	2005	2006	2004	2005	2006
I. TAX REVENUE	13.1	13.6	14.9	12.5	25.3	88.0	86.7	86.3
1. Income tax	3.8	4.3	6.0	22.0	61.4	25.5	27.3	34.9
- Individual	1.2	1.2	1.3	8.0	25.3	7.9	7.5	7.4
- Coporate	2.2	2.3	3.7	14.4	80.7	14.8	14.8	21.3
- Clearing ^{1/}	0.4	0.8	1.1	100.8	57.9	2.8	5.0	6.2
2. Import tax	1.2	1.2	0.9	12.7	-11.2	7.8	7.7	5.4
3. Value-added tax	6.8	7.0	7.0	11.1	15.3	45.8	44.6	40.8
- Domestic	4.0	4.0	3.9	9.4	11.0	26.9	25.8	22.7
- Imports	2.8	2.9	3.1	13.7	21.2	18.9	18.8	18.1
4. Excise tax	1.9	1.6	1.3	-10.4	-2.5	12.6	9.9	7.7
- Fuel	1.3	1.0	0.8	-19.2	-9.8	9.0	6.4	4.6
- Others	0.5	0.6	0.5	11.2	10.4	3.7	3.6	3.1
5. Other tax revenues	0.9	1.1	1.1	35.7	10.8	6.1	7.3	6.4
- ITF	0.3	0.3	0.3	6.8	17.1	1.8	1.7	1.6
- ITAN	--	0.4	0.4	--	13.3	--	2.6	2.4
- IAE	0.0	0.0	--	-10.0	--	0.2	0.2	--
- IES	0.2	0.0	0.0	-97.1	-30.1	1.3	0.0	0.0
- Divisions	0.2	0.2	0.2	-12.0	26.7	1.3	1.0	1.0
- Others	0.2	0.3	0.2	32.7	4.8	1.5	1.7	1.4
6. Tax refund	-1.5	-1.6	-1.5	16.2	12.8	-9.8	-10.0	-8.9
II. NON-TAX REVENUES ^{2/}	1.8	2.1	2.4	26.7	29.9	12.0	13.3	13.7
III. TOTAL (I+ II)	14.9	15.7	17.2	14.2	25.9	100.0	100.0	100.0
Memo:								
Income tax generated ^{3/}	4.2	4.8	6.3	23.5	51.8	28.0	30.3	36.5

1/ Represents the income tax generated the previous year.

2/ Includes current transfers of public enterprises.

3/ Represents the payments received in February of the current year to January of the following year, plus the regularization campaign on March and April of the following year.

Source: MEF, Banco de la Nacion, BCRP and Sunat.

TABLE 33
FISCAL REVENUES COEFFICIENTS
(Percentage of GDP)

	2004	2005	2006
Tax burden of the central government ^{1/}	13.1	13.6	14.9
Fiscal burden of the central government	14.9	15.7	17.2
Fiscal burden of the consolidated central government ^{2/}	16.5	17.4	18.8
Fiscal burden of the general government ^{3/}	17.5	18.3	19.6

1/ Central government tax revenues.

2/ Including central government current revenues, contributions to the social security system and pension system, and own resources of the Consolidated Previsional Reserve Fund (FCR), the National Pension.

3/ Fiscal burden of the consolidated central government and own resources of local government.

Source: MEF, Banco de la Nacion, BCRP and SUNAT.

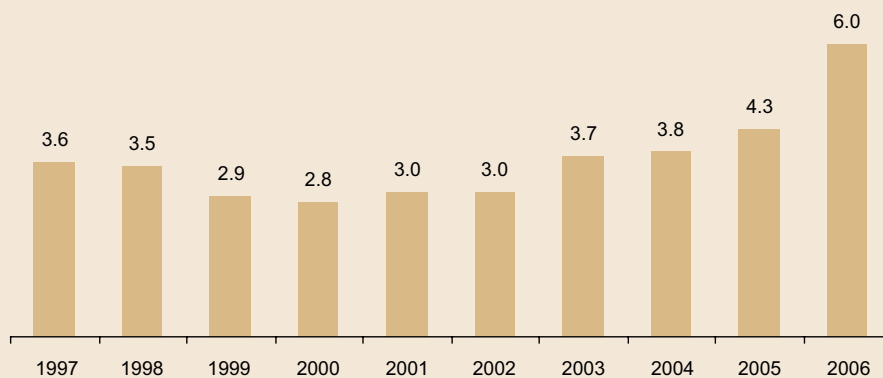


TABLE 34
INCOME TAX REVENUE BY THIRD CATEGORY
(Millions of Nuevos soles)

	2004	2005	2006	Real % change	
				2005/2004	2006/2005
Mining	989	2,168	5,767	116	161
Fuel	359	413	970	13	130
Financial System	638	372	814	-43	114
Manufactures	891	1,110	1,597	23	41
Telecommunications	324	559	717	70	26
Others	2,184	2,601	3,234	17	22
TOTAL	5,386	7,223	13,100	32	78

Source: SUNAT.

GRAPH 31
INCOME TAX REVENUE
(Percentage of GDP)

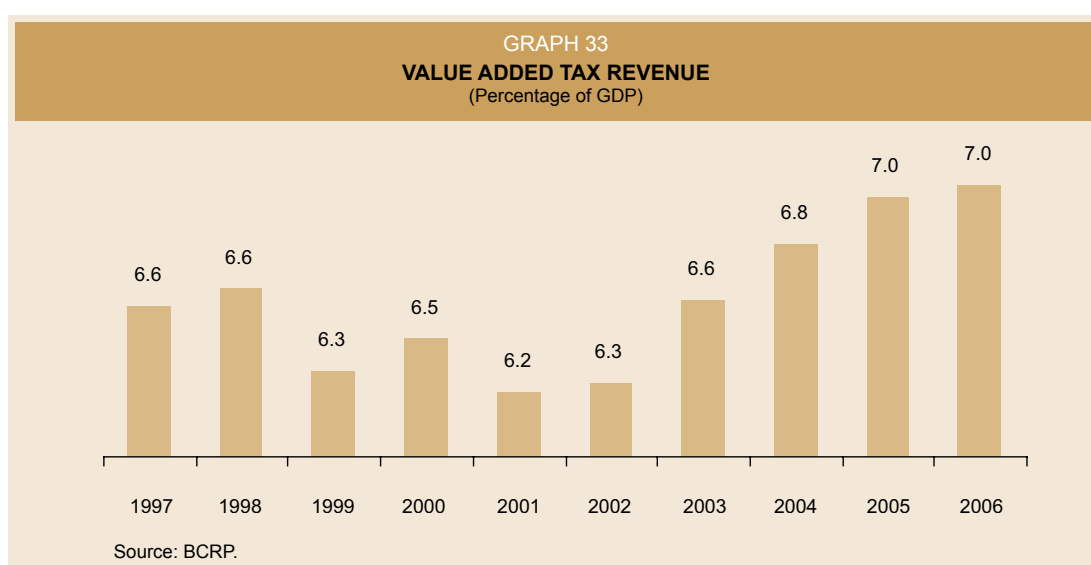
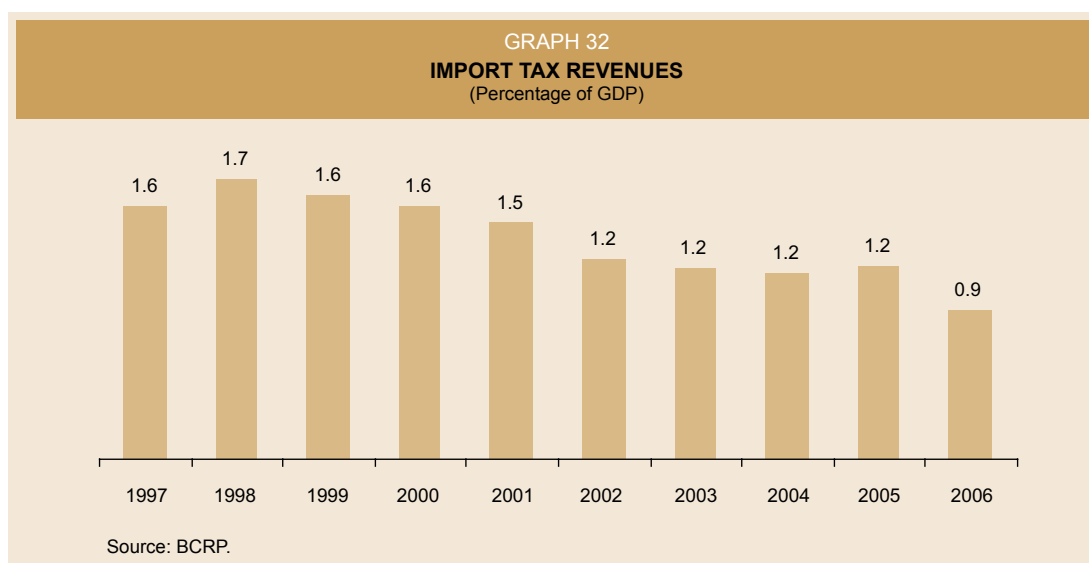


Source: BCRP.

The collection of **income tax** led the growth of central government tax revenues in 2006 as they increased from 4.3 to 6.0 percent of GDP between 2005 and 2006. The contribution of the mining sector was noteworthy as it grew by 161 percent, thereby increasing in terms of third-category income tax from 30 percent in 2005 to 44 percent in 2006. Revenues for income tax of individuals also increased 25 percent in real terms due to the improvement seen in the disposable income, the higher levels of employment in the country, and the distribution of profits to workers, especially in the mining sector.

Revenues for **import duties** fell 11 percent in real terms, reaching a level of 0.9 percent of GDP. This result is mainly explained by the tariff reduction implemented in 2005, which reduced the average tariff in 2006 from 9.9 percent in 2005 to 7.3 percent.

Revenues for the **value-added tax (VAT)** in 2006 grew 15 percent in real terms and amounted to a level equivalent to 7.0 percentage points of GDP. As regards domestic VAT, this increase was due to the greater dynamism of domestic demand, control actions implemented by the tax agency

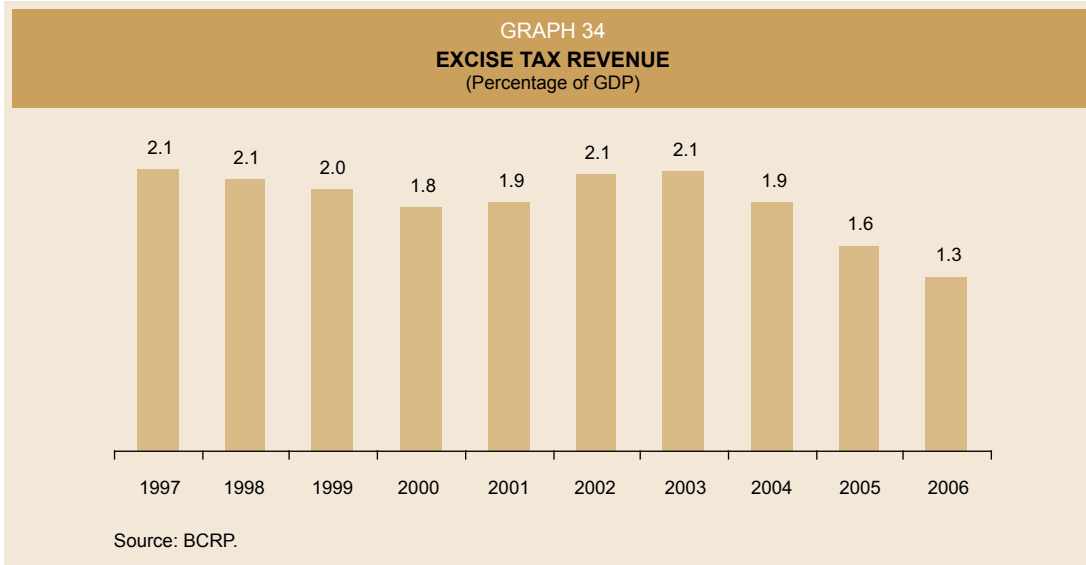


and the reinforcement of the tax withholding, collection and deduction systems. The latter were extended to some services provided to companies, such as the rental of facilities, transport of people and goods, and mercantile commission.

The **excise tax** (ISC) in 2006 represented 1.3 percentage points of GDP, a rate 0.3 points lower than in 2005. The lower collection of this tax was due to the lower specific average excise tax in the year resulting from the reductions in the prices of fuel approved in the months of April (on 2 occasions) and August. A reduction

was observed in the collection of the excise tax despite the fact that an increase was approved in the taxes on diesel and kerosene in order to compensate the loss of revenues generated when the CAN agreements came in force. The excise tax on “other goods and services” grew 10 percent, mainly due to higher sales of taxed products, particularly soft drinks, mineral water and beer.

The collection of **other tax revenues** remained at 1.1 percent of GDP and grew 11 percent in real terms. It is worth mentioning the higher revenues obtained due to the Tax on Financial



Transactions - ITF (17 percent) and to higher payments as a result of tax split (27 percent). Revenues for the Temporary Tax on Net Assets - ITAN (equivalent to 0.4 percentage points of GDP) showed a growth of 13 percent. It should be pointed out that the ITAN rate was reduced by Legislative Decree N° 971 (December 24, 2006) from 0.6 percent to 0.5 percent and will apply to firms with assets of over one million nuevos soles (until 2006, this tax only applied to assets over 5 million nuevos soles), an effect that will be reflected in tax revenues in 2007.

Tax refunds were mainly refunds for exports and represented 1.5 percent of GDP. In real terms, they grew 13 percent due to the growth of our sales abroad.

Finally, the increase of **non-tax revenues** (30 percent in real terms) was also associated with international quotations given that a great many of these taxes are revenues for royalties and mining royalties, connected to petroleum, gas and mining-related activities.

2.2 Central government expenditure

Total central government expenditure amounted to 15.9 percent of GDP, which represented an increase of 10 percent in real

terms relative to 2005. This increase was mostly explained by higher transfers to the sub-national governments and by increased capital expenditure.

Wage and salary expenditure grew 6 percent in real terms, mainly due to the salary increases approved in 2005 and in the first half of 2006 for workers in the sectors of health, education, interior, defense and regional governments (which included part of the payroll of the education sector). In GDP terms, wages and salaries reduced their share from 4.4 to 4.1 percent of the product.

Expenditure in goods and services grew 12 percent in real terms, reflecting the higher budgetary allocations implemented for the electoral process and for equipment in the Armed Forces. Greater spending was also recorded due to higher collection commissions paid to the tax agency (24 percent in real terms), given the important growth of tax collection in the year. In GDP terms, expenditure in goods and services decreased from 3.4 to 3.3 percent between 2005 and 2006.

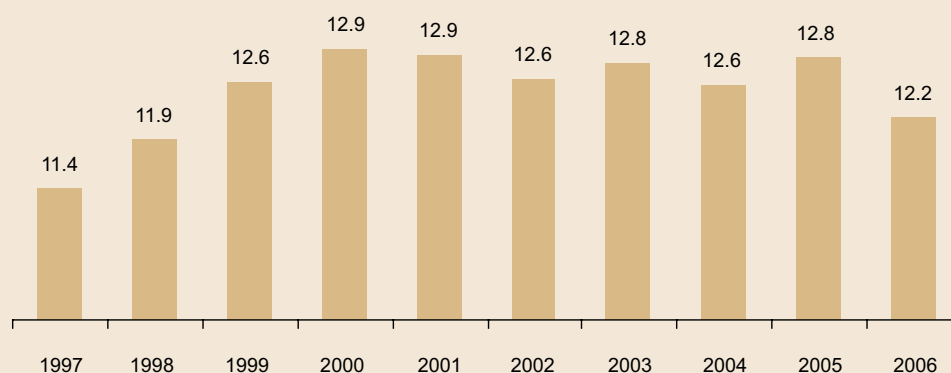
Expenditure on account of transfers grew 9 percent in real terms, mainly as a result of the greater resources transferred to local governments which amounted to an additional

TABLE 35
CENTRAL GOVERNMENT EXPENDITURES

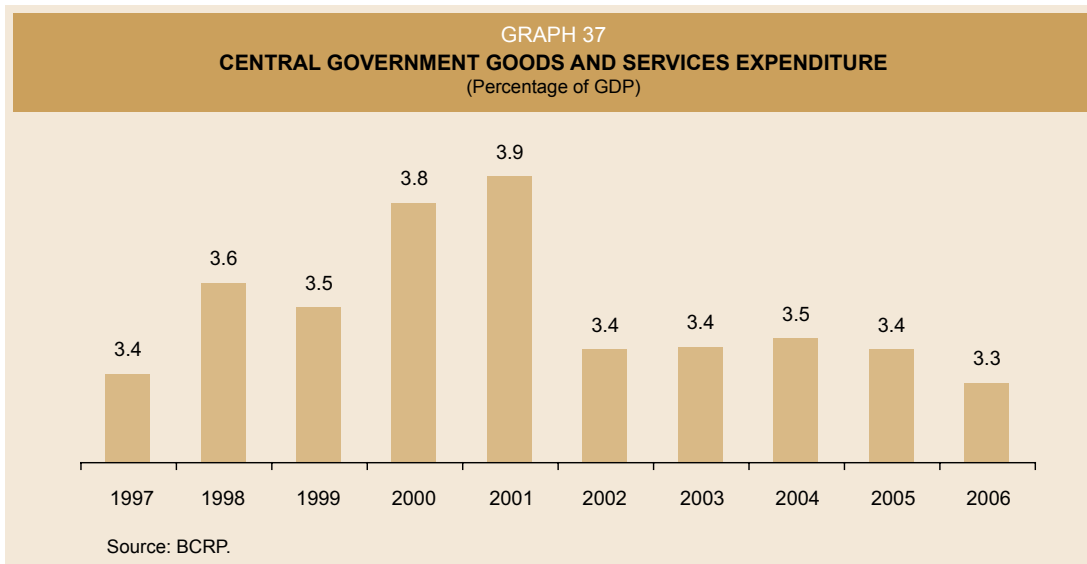
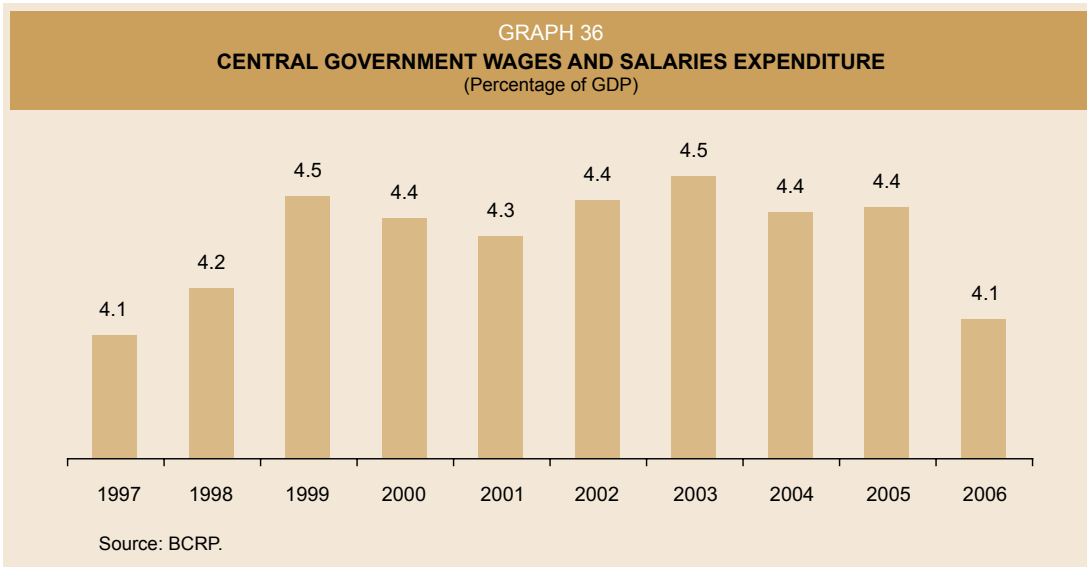
	Percentage of GDP			Real % change		Percent structure		
	2004	2005	2006	2005	2006	2004	2005	2006
I. NON-FINANCIAL EXPENDITURE	14.4	14.7	14.1	10.8	10.2	88.6	88.9	88.9
1. CURRENT EXPENDITURE	12.6	12.8	12.2	10.6	8.8	77.5	77.6	76.5
a. Wages and salaries	4.4	4.4	4.1	8.6	6.2	27.3	26.8	25.8
b. Goods and services	3.5	3.4	3.3	7.3	11.5	21.3	20.7	20.9
c. Transfers	4.7	5.0	4.7	15.0	9.2	28.9	30.1	29.8
- Pensions	1.6	1.5	1.3	6.3	-1.6	9.6	9.3	8.3
- ONP-Fonahpu	1.0	1.0	0.8	7.1	-6.6	6.4	6.2	5.3
- To Foncomun	0.8	0.8	0.8	11.5	16.3	4.7	4.7	5.0
- Royalties	0.3	0.5	0.7	72.7	59.1	1.9	3.0	4.3
- Other	1.0	1.1	1.1	21.5	11.3	6.3	6.9	7.0
2. CAPITAL EXPENDITURE	1.8	1.9	2.0	12.1	20.4	11.1	11.3	12.3
a. Gross capital formation	1.6	1.7	1.6	14.8	5.1	9.9	10.3	9.8
b. Other	0.2	0.2	0.4	-9.9	178.4	1.2	1.0	2.5
II. INTEREST PAYMENTS	1.8	1.8	1.8	7.7	10.7	11.4	11.1	11.1
1. Domestic debt	0.2	0.3	0.4	40.4	66.7	1.2	1.5	2.3
2. External debt	1.6	1.6	1.4	3.8	1.8	10.2	9.6	8.8
III. TOTAL (I+II)	16.2	16.5	15.9	10.4	10.3	100.0	100.0	100.0
Memo:								
Non financial Expenditures excluding transfers ^{1/}	11.5	11.7	10.8	9.4	6.4	71.2	70.5	68.0

1/ Non includes Cental government transfers to the rest of Public sector entities.
Source: MEF, Banco de la Nacion, and BCRP.

GRAPH 35
CENTRAL GOVERNMENT CURRENT EXPENDITURE
(Percentage of GDP)



Source: BCRP.



S/. 1,318 million. The Fondo de Compensación Municipal -Foncomun- and the mining and oil royalties accounted for 88 percent of the total of these additional resources. A total of S/. 5,367 million were transferred to local governments.

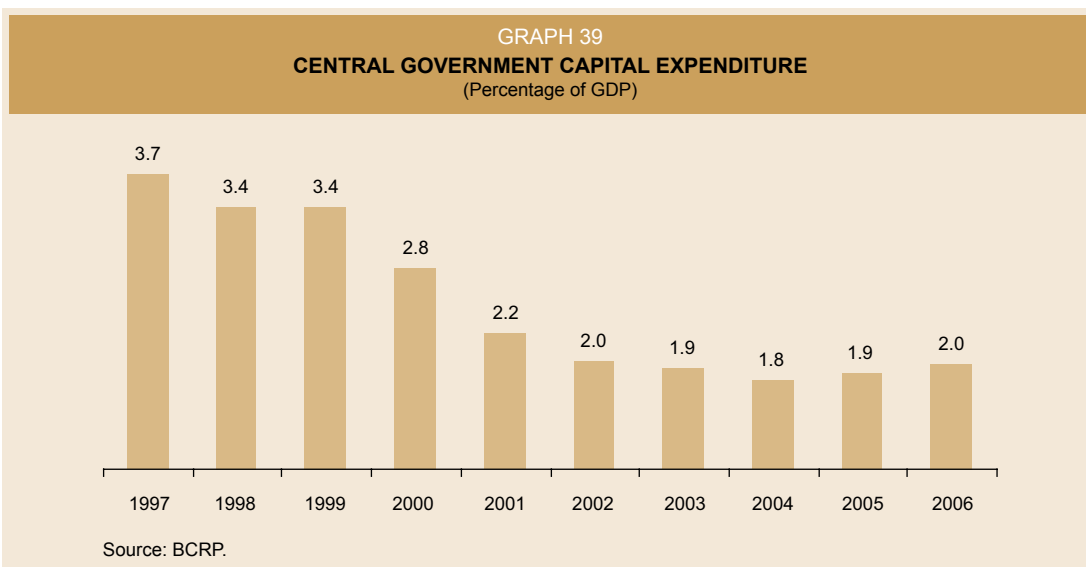
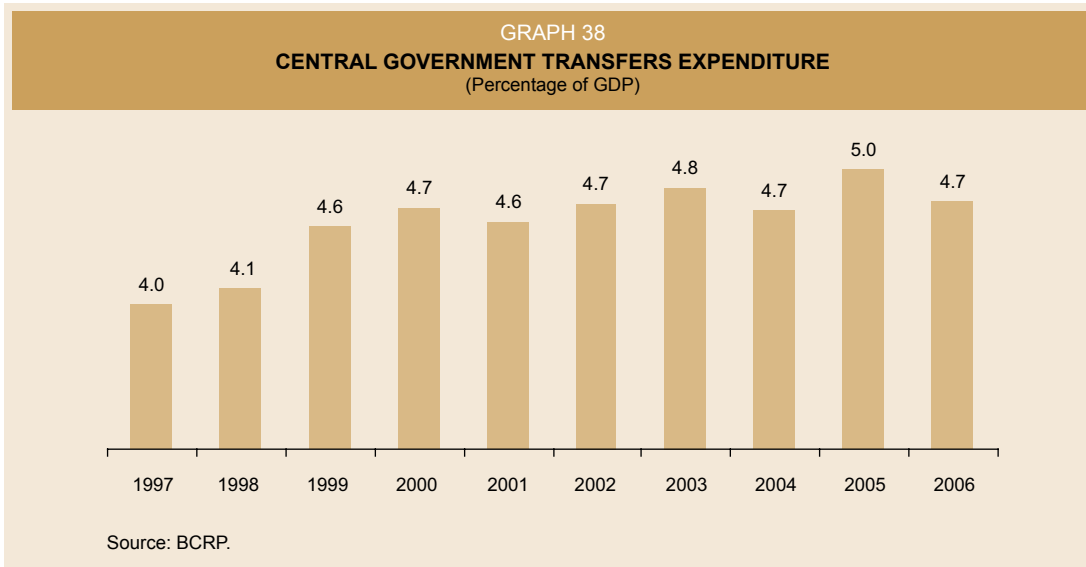
Capital spending grew 20 percent in real terms, increasing from 1.9 percent of GDP in 2005 to 2.0 percent in 2006. This increase was mainly due to the growth of other capital expenditure, which increased 0.2 percent of GDP due to the greater transfers of capital to local governments, as well as to the exceptional transfer of US\$ 100 million to the Fondo Consolidado de Reservas

Previsionales (FCR) for the redemption of the “bonos de reconocimiento”. Moreover, a capital contribution of S/. 130 million was made to the Banco Agrapeuario.

The central government’s gross capital formation decreased from 1.7 to 1.6 percent of GDP. The main investment projects implemented included road construction and rehabilitation (S/. 708 million) by the Ministry of Transport and Communications; the rehabilitation, construction and improvement of urban roads (S/. 412 million) by regional governments; and support to agricultural production (S/. 354 million).

TABLE 36
GROSS CAPITAL FORMATION OF CENTRAL GOVERNMENT
(Millions of Nuevos Soles)

SECTOR	2005	2006
MINISTRY OF TRANSPORT AND COMMUNICATIONS	858	984
Construction and Rehabilitation of Highways	647	708
Rehabilitation and Maintenance of Rural and Urban Ways	81	110
Management of projects	55	47
Construction, Rehabilitation and Improvement of Airports	19	4
Telecommunications and Concessions	7	69
Other	49	45
MINISTRY OF CONSTRUCTION AND HOUSES	231	206
Improvement of the Water System and Sewage system in Chimbote	95	64
National Program Improvement and Extension Potable Water System and Sewage system	52	73
Integral Program of Support to the house Sector	47	33
National Potable Water project and Rural Cleaning - PRONASAR	15	14
Improvement of the Sewage system of the South Zone of Metropolitan Lima	4	3
Other	18	20
MINISTRY OF AGRICULTURE	161	265
Registry of lands	50	59
Ground Conservation proram	37	94
Support to the Agriculture and livestock Production	26	22
Rehabilitation and Reconstruction of Fenómeno del Niño	19	60
Subsectorial Project of Water	15	16
Other	15	14
MINISTRY OF ECONOMY AND FINANCES	63	61
Support to Private and Public Institutions	23	23
Promotion of the Private Investment	20	23
Sectorial program of the Reform of the Public Finances	8	0
Development and Implementation of SIAF for Local Governments	7	6
Other	6	10
MINISTRY OF EDUCATION	234	246
Special Program Improvement of the Quality of the Primary Education	176	145
Long distance Education in Rural Areas	47	42
Other	11	59
MINISTRY OF ENERGY	160	83
Infrastructure of Generation and Transmission of Energy	148	57
Other	12	26
MINISTRY OF LABOR	166	183
Project of Productive Social Emergency - PESP	156	178
Youthful Labor formation	11	5
MINISTRY OF HEALTH	114	134
Program of Support to the Reform of Sector Health PAR-SALUD	95	61
Improvement of Infrastructure, Equipment and Re-equipment of Hospitals	11	33
Development and Modernization program	6	17
Other	2	23
MINISTRY OF WOMAN AND SOCIAL DEVELOPMENT	30	25
Program Against the Poverty in Marginal Urban Zones of Lima	21	22
WAWA WASI Project	1	0
Other	8	3
DEVELOPMENT NATIONAL INSTITUTE	110	131
Support to the Promotion of the Agriculture Production	47	60
Management of projects	31	43
Terrestrial transport	24	17
Cleaning	8	11
FONCODES	426	314
Social investment and Generation of employment/Social and Productive Infrastructure in Local Governments	249	141
Economic and Social Investment	123	96
Social development in the Higland and Jungle	32	29
Development of the corridor Puno Cusco	16	18
Other	6	31
REGIONAL GOVERNMENTS	1,012	1,496
Rehabilitation, Construction and Improvement of the Urban ways	316	412
Support to the agriculture and livestock production	248	354
Support to the Education Sector	168	226
Management of Projects	101	123
Cleaning Program	57	117
Improvement of the Energy Infrastructure	44	94
Social and Community Help	44	42
Health Program	35	127
COFOPRI	1	0
HEALTH INSTITUTE	14	4
Educative support and Nutrition	14	4
PUBLIC UNIVERSITIES	143	156
Construction, Improvement and Extension of Units of Education	143	156
REST	735	490
TOTAL	4,458	4,779



Financial expenditure remained at 1.8 percent of GDP, of which 1.4 percent of GDP was interests on the external debt and the rest was interests on the domestic debt.

3. Promotion of private investment

During 2006, incomes generated by the private investment promotion process amounted to US\$ 113.4 million. It is worth highlighting the operations carried out by Empresa Siderúrgica del Perú, Consorcio Transmantaro, Empresa Eléctrica de Piura

and the sale of Empresa Agroindustrial Casagrande S.A..

On June 28 the Brazilian corporation acquired 50 percent plus one of the shares that the State owned in Siderúrgica del Perú (Siderperú). Gerdau paid US\$ 61 million for this transaction and committed itself to investing US\$ 100 million during the first five years of operations. The state-owned shares of Empresa Agroindustrial Casa Grande were sold on January 25, 2006 through a public auction to the Gloria group. These shares represented 31

TABLE 37
PRIVATIZATIONS AND CONCESSIONS: 2006
(Millions of US\$)

Privatizations and Concessions	Date	Buyer	Sale Value	Investment Projects
PRIVATIZATIONS			108.4	101.2
1. Complejo Agroindustrial Cartavio S.A	Jan-16	Sale in Stock Exchange	2.0	
2. Empresa Agrícola San Juan S.A.	Jan-16	Sale in Stock Exchange	0.3	
3. Empresa Agroindustrial Casa Grande S.A.	Jan-25	Sale in Stock Exchange	11.8	
		Oferta Publica de Adquisicion (OPA)		
4. Buildings	Mar-Jun	Several	0.4	
5. Access to Internet in Capitals of District First stage.	Apr-12	Gilat To Home Peru S.A.		1.2
6. Empresa Siderurgica del Peru S.A.	Jun-28	Sale in Stock Exchange	60.5	100
		Gerdau do Brasil		
7. Consorcio Transmantaro	Sep-14	Consorcio Interconexion Electrica S.A.(ISA) y Empresa de Energia de Bogota S.A (EEB)	17.7	
8. Empresa Electrica de Piura S.A.	Sep-27	Sale in Stock Exchange	15.2	
9. Buildings	Jul-Dec.	Several	0.5	
CONCESSIONS			5.0	883.0
1. Local house telephony and Local Carrier	Apr-12	Telmex Peru S.A.	5.0	15.0
2. Harbor terminal in Callao and new terminal Containers -Muelle Sur	Jun-19	Consorcio Terminal Internacional de Contenedores del Callao P&P Dover/Dubai Ports Internacional y Uniport S.A.		617.0
3. Regional airports (First Package) ^{1/}	Aug-18	Consorcio Swissport-GBH		220.0
4. Section Joint 1B -Buenos Aires-Canchaque	Oct-31	Graña y Montero S.A.		31.0
TOTAL			113.4	984.2

^{1/} The Government guarantees to the operator one PAMO (payment by maintenance and operation) annual ascending to US\$ 9.4 million.
Source: PROINVERSION.

percent of the firm's equity and the transaction amounted to S/. 40 million.

Likewise, the state-owned shares of Consorcio Transmantaro S.A., representing 15 percent of the company's equity, were sold through a public auction to Consorcio Interconexión Eléctrica S.A. and Empresa de Energía de Bogotá S.A. on September 14 for a total of US\$ 17.7 million. Finally, on September 27, 2006, the state-owned shares of Empresa Eléctrica de Piura S.A. were sold for a total of S/. 49.4 million.

Moreover, the concessions awarded in the year included the Terminal Portuario del Callao Nuevo Terminal de Contenedores-Muelle Sur and the first package of regional airports. On

June 19, the Consorcio Terminal Internacional de Contenedores del Callao was awarded the bid for the construction of the new terminal for containers at the Muelle Sur del Callao and its management for 30 years. The Consortium offered an additional investment of US\$ 144 million which, together with the amounts to be invested in two stages, would amount to a total investment of US\$ 617 million. Furthermore, the winning consortium offered a rate of 90 dollars per container of 20 cubic feet, considered as one of the lowest rates in the region.

On August 18, 2006 the consortium Swissport-GBH – Airports was awarded the concession of the following regional airports: Anta – Huaraz, Cajamarca, Chachapoyas, Chiclayo, Iquitos,



Piura, Tumbes, Talara, Tarapoto, Trujillo, Pisco y Pucallpa. The financial bid submitted includes a guarantee for an Annual Payment for Maintenance and Operations amounting to US\$ 9.4 million. The investments to be made by this concession are estimated at US\$ 220 million and will be divided in two stages: the first stage (during the first 3 years) will include works with a fast impact and minimum equipment; and the second stage (from year 4 to year 25) will include investment in infrastructure works, equipment, and periodical maintenance.

The incomes generated in 2006 through the private investment promotion process amounted to US\$ 94 million, of which US\$ 79 million resulted from new processes and US\$ 15 million from previous concession processes.

4. Public debt

At end-2006, the balance of the public debt amounted to US\$ 30,484 million, a sum equivalent to 32,6 percent of GDP. The external debt amounted to US\$ 21,972 million, which represents 72 percent of the total debt, while the balance of the domestic debt amounted to US\$ 8,512 million.

The total public debt expressed in foreign currency increased by US\$ 516 million, due to a higher domestic debt (US\$ 824 million), which was offset by a reduction in the external debt (US\$ 307 million). The reduction in the external debt was due to increased amortizations (US\$ 1,223 million) relative to the disbursements (US\$ 609 million) and to the effect of the appreciation of other currencies –particularly the yen and the euro (US\$ 307 million)– against the dollar. It should be pointed out that no bonds were placed abroad in 2006, which contributed to “solarize” the debt, thus reducing the exchange risks associated with it.

Despite the increase seen in the nominal balance of the public debt, the higher level of economic

activity and the lower financial requirements associated with the primary surplus of the NFPS determined a reduction in the balance of the public debt of 5.0 percentage points in GDP terms: thus, the balance of the public debt decreased from 37.7 percent in 2005 to 32.6 percent in 2006.

Net public debt

The net public debt measured as the difference between the public sector’s financial assets (defined as total deposits) and liabilities (defined as the total public debt) showed a reduction in the last years and declined from US\$ 25,050 million in 2004 to US\$ 22,419 million in 2006 (a US\$ 2,631 million decrease). This evolution is mainly due to the increase seen in the government’s deposits in 2006, which grew by US\$ 1,900 million relative to 2005. In GDP terms, the net public debt decreased from 35.9 percent of GDP in 2004 to 24.0 percent in 2006. However, this drop is mainly explained by the increase seen in the GDP, which would account for approximately 8 percentage points of the reduction observed in the net debt.

TABLE 38
NET PUBLIC DEBT
(Millions of US\$)

Years	Assets (Deposits)	Liabilities (Debt)	Net Public Debt	
			US\$ mill	% GDP
2004	5,855	30,905	25,050	35.9
2005	6,171	29,968	23,797	30.0
2006	8,065	30,484	22,419	24.0

Source: BCRP and MEF.

External public debt

The external public debt amounted to US\$ 21,972 million, or 23.5 percent of GDP. This year’s **disbursements** (US\$ 609 million) included US\$ 288 million for investment projects, US\$ 315 million for freely available payments, and US\$ 5 million for imports of food products. Resources for investment projects were financed by international organizations

TABLE 39
PUBLIC DEBT STOCK

	Millions of US\$			Percentage of GDP		
	2004	2005	2006	2004	2005	2006
PUBLIC DEBT	30,905	29,968	30,484	44.4	37.7	32.6
I. FOREIGN PUBLIC DEBT ^{2/}	24,466	22,279	21,972	35.1	28.1	23.5
CREDITS	17,522	13,886	13,580	25.1	17.5	14.5
Multilateral Organizations	7,875	7,983	7,843	11.3	10.1	8.4
Paris Club	8,508	5,696	5,629	12.2	7.2	6.0
Suppliers	1,070	158	73	1.5	0.2	0.1
Commercial Banks	4	1	1	0.0	0.0	0.0
Latin America	42	33	25	0.1	0.0	0.0
Eastern European Countries ^{3/}	23	16	9	0.0	0.0	0.0
BONDS	6,944	8,393	8,392	10.0	10.6	9.0
II. DOMESTIC PUBLIC DEBT	6,439	7,688	8,512	9.2	9.7	9.1
1. LONG TERM	5,812	6,896	7,597	8.3	8.7	8.1
CREDITS FROM BANCO DE LA NACION	929	890	774	1.3	1.1	0.8
1. Central Government	871	857	772	1.2	1.1	0.8
2. Local Government	58	33	2	0.1	0.0	0.0
TREASURY BONDS	4,884	6,006	6,809	7.0	7.6	7.3
1. BCRP Capitalization Bonds	12	0	0	0.0	0.0	0.0
2. Financial System Support Bonds	637	222	224	0.9	0.3	0.2
3. Debt Exchange Bonds ^{4/}	152	122	91	0.2	0.2	0.1
4. Sovereign Bonds	1,149	2,951	3,699	1.6	3.7	4.0
5. Caja de Pensiones Militar-Policial Bonds	34	34	0	0.0	0.0	0.0
6. Pension Recognition Bonds	2,899	2,677	2,795	4.2	3.4	3.0
LIMA MUNICIPALITY BONDS	0	0	14	0.0	0.0	0.0
2. SHORT TERM	627	793	915	0.9	1.0	1.0
TREASURY BILLS	0	0	0	0.0	0.0	0.0
CREDITS FROM BANCO DE LA NACION ^{5/}	265	139	0	0.4	0.2	0.0
FLOATING DEBT	362	654	915	0.5	0.8	1.0

1/ The external debt includes medium and long term debt of COFIDE, excludes loans to balance of payments.

2/ Former Soviet Union countries. Includes the People's Republic of China.

3/ D.U. N° 068-99.

4/ Includes Public Treasury overdrafts in the Banco de la Nacion and credit to the Instituto Nacional de Defensa Civil.

Source: MEF, Banco de la Nacion, ONP, and COFIDE.

and countries integrating the Paris Club, which granted loans for US\$ 184 million and US\$ 104 million respectively. These resources were channeled through the central government (90 percent) and public enterprises (10 percent).

Internal debt

The internal debt amounted to US\$ 8,512 million, of which 87.5 percent was issued in soles

(US\$ 7,450 million). The internal debt grew by US\$ 824 million relative to 2005 basically due to the net issue of public sectors liabilities, including sovereign bonds which increased from a level of S/. 6,343 million in 2005 to S/. 1,917 million in 2006^{1/}. At end-2006, the balance of these liabilities amounted to S/. 11,823 million.

The management of the domestic debt in 2006 was characterized by a preference for

1/ Issues of Sovereign bonds in the domestic market amounted to S/. 6,688 million and S/. 2,410 million in 2005 and 2006 respectively. Moreover, the redemption of said bonds amounted to S/. 345 million and S/. 493 million respectively.



domestic financing over external financing. This strategy allowed the government to offset exchange risks, while obtaining financing with longer maturity terms, thus extending the average maturity for the debt denominated in sovereign bonds from 9.1 years in 2005 to 12.5 years in 2006.

Moreover, the government has access to the market of bonds maturing in 40 years and today over 61 percent of total issued bonds have maturities of over 11 years. It is also relevant to point out here that the demand for Sovereign Bonds (S/. 5,446 million) exceeded by over 126

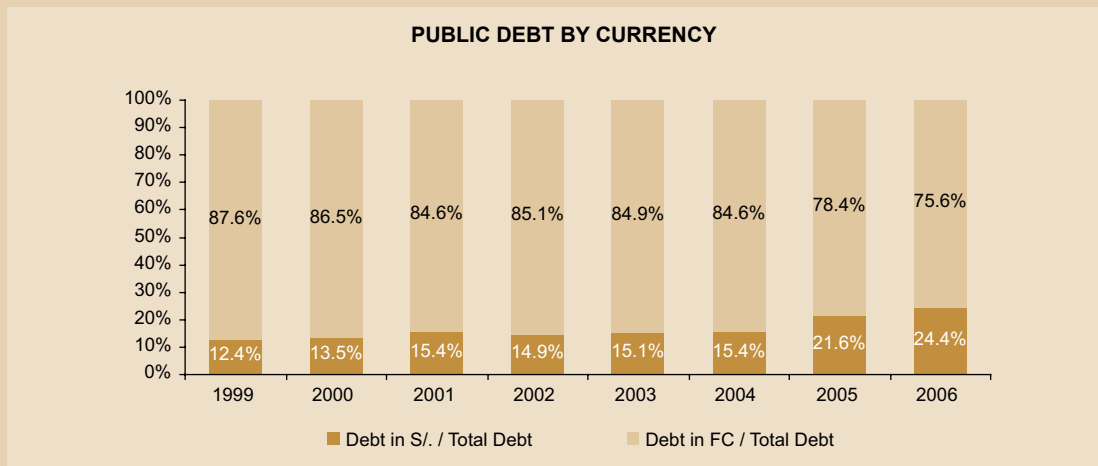
percent the amount of bonds issued (S/. 2,410 million), which contributed to reduce coupons offered in connection with issues with similar maturities in previous years.

Another measure implemented in 2006 was debt exchange, a process initiated in 2004. This operation was carried out in two stages: on May 31, Sovereign bonds for a total of S/. 2,455 million were issued and on June 22, Sovereign bonds for a total of S/. 294 million were issued. The total of bonds withdrawn from the market amounted to S/. 2,750 million, which reduced the balance of bonds by S/. 273 million.

BOX 5

PUBLIC DEBT MANAGEMENT

With the aim of improving the management of the State's assets and liabilities, mechanisms such as the prepayment to JAPECO and currency and interest rate risk coverage have been used, which allowed to reduce the dollarization of the debt. As illustrated in the graph below, public debt in foreign currency decreased from 87.6 percent in 1999 to 75.6 percent in 2006, while the share of domestic currency-denominated instruments within the portfolio of public debt increased from 12.4 percent to 24.4 percent in the same period.

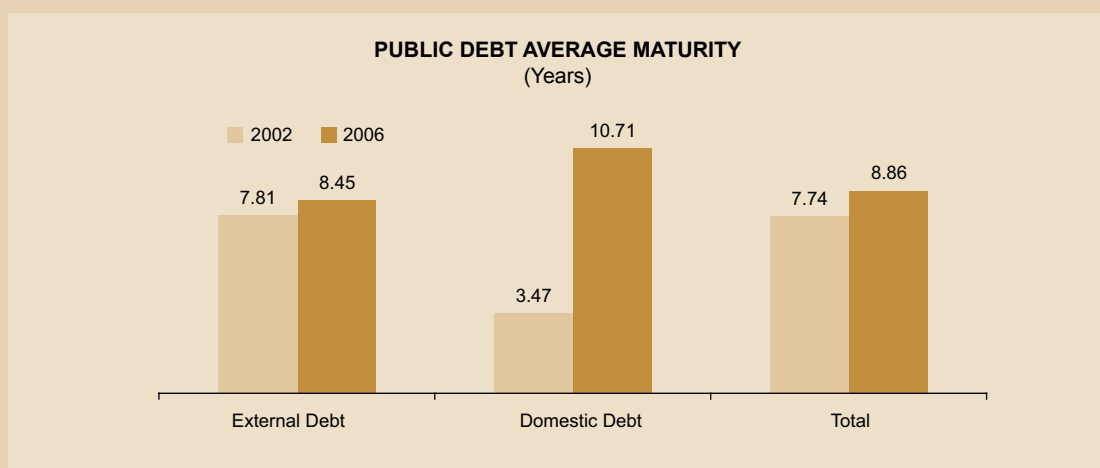


It is worth pointing out that as a result of the implementation of these risk coverage mechanisms called "Cross Currency Swap Extinguible" in 2006, the debt subject to fixed rates was 64 percent.

This mechanism has allowed Peru to reduce the cost of swap through the lower interest rate paid for this. This lower cost derives from the possibility that in the event that Peru should not comply with its obligations in soles, the swap commitments are no longer in force, as a result of which the hedging operation is void and Peru maintains its liabilities in dollars.

In 2006, these operations were carried out with the Credit Suisse International and the US Citibank, with which external debt operations with the World Bank –denominated in US dollars at a variable rate and in soles at a fixed

rate— for a total of US\$ 300 million (each transaction amounted to US\$ 150 million) were exchanged. Together with the swap of interest rates on Brady Bonds for US\$ 844 million carried out in 2005, these operations have implied that approximately 5 percent of the total debt is now serviced at a fixed rate.



As regards the debt maturity, if the year 2002 is used as reference, the government's management of its liabilities has contributed to extend the average term of the debt from 7.74 years in 2002 to 8.86 years in 2006. Although the term for the total debt has increased by 1.12 years, it is relevant to point out that a domestic market of capitals has been developed, thus contributing to generate a yield curve of nearly 40 years, as evidenced in the extension of the domestic debt maturity which increased from 3.47 years in 2002 to 10.71 years in 2006.

In addition to the operations aimed at readjusting the debt's profile and debt exchange operations in terms of both external and domestic debt, this greater extension of total debt has been possible due to a higher concentration of new debt in commercial instruments, such as bonds, as well as to an increasingly lower concentration of debt in other financial sources. Thus, the share of bonds in terms of total debt increased from 33.0 percent in 2002 to 50.1 in 2006. This was based on an increase of external issues which represented an increase of 16.8 percentage points in public financing through global bonds between 2002 and 2006.

