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March 17, 2021

Statement by Mr. Merk and Mr. Krahnke on Peru
(Preliminary)
Executive Board Meeting
March 19, 2021

We thank staff for its comprehensive set of reports and Mr. Chodos and Mr. Hendrick for their very helpful Buff statement. **We broadly concur with the thrust of the staff's appraisal.** Supported by strong fundamentals and economic policies, Peru has achieved sound macroeconomic outcomes. This is inter alia reflected in the fact that Peru's inflation has been moderate and stable, its financial markets have proven relatively resilient with limited solvency problems and that market access has been remarkably stable. Peru's external position has been strengthening, with the international reserves cushion very comfortable and increasing further in 2020. The resilient external position and strong buffers should give the authorities confidence to pursue their exit strategy from the FCL. At the same time, the Covid-crisis has also struck Peru, especially those employed in the informal sector. Stalling progress on reforms, inter alia through political tensions, could depress investment, curb economic growth and have significant medium-term implications. We therefore agree with staff that sustained reform efforts are key to maintain favorable economic conditions.

We take positive note of the sustainable public debt and ample policy buffers. Notwithstanding an increasing share of public debt held by non-residents and in foreign currency, breaching the respective lower early warning thresholds (DSA, fig. 5), the overall level of public debt remains low. Furthermore, Peru's ample access to market financing with low spreads and long maturities reflect the country's strong fundamentals and policies. Going forward, we encourage the authorities to factor in the current uncertainty around the macroeconomic outlook and thus to appropriately pace their withdrawal of the fiscal stimulus needed to address the pandemic and limit its impact on poverty. We particularly welcome the authorities' request for Fund TA to identify measures to potentially increase fiscal revenues.

We share staff's view that rising poverty and unemployment as well as high informality pose significant challenges to the economy. We take note that the support to household incomes was not sufficient to prevent a rise in poverty, also due to administrative problems. We therefore agree with staff that a multi-pronged approach to address these challenges is necessary and should focus on enhancing social protection while reducing incentives to informality. In this context, we would appreciate if future reports include a discussion of the effectiveness of social protection during and after the Covid-crisis along the lines of paragraph 20.

We caution against medium- to long-term challenges with regard to the pension system. We welcome the insights provided in Annex V on the withdrawals from pension funds. As staff constitutes, the authorities' measure to open access to private pension funds during the Covid-crisis has resulted in a depletion of personal accounts in private pension funds. We further take note that the withdrawals from the private pension funds not only weakened their position vis-à-vis the banking system (with potential unfavorable implications for competition in the financial system) but may also create implicit liabilities for the state. *We therefore echo staff's call for reforms to improve the private pension system and would be interested to hear from staff whether the authorities have expressed a view on this. In this context, could staff also elaborate on the Multiparty Commission of Congress' proposed reform, which has "created confusion about policy intentions" (Annex X)*?

Peru's financial soundness indicators and the results of the stress tests are reassuring. Going forward, the authorities would still be well-advised to gradually follow a more prudent macroprudential approach. We agree with staff that macroprudential policies could now start to encourage banks to focus more strongly on borrowers' viability in order to contain financial stability risks. In addition, as indicated by staff, we also believe that it is important to complete the legislative and regulatory reform agenda for a holistic and effective supervision of the financial sector. We therefore encourage the authorities to implement the remaining recommendations from the 2018 FSAP, including on the specific mandate for macroprudential policy to the BCRP and SBS as well as strengthening the legal protection of the SBS. With regard to corporate leverage, we were wondering about the reasons behind the relatively sharp increase in the debt to assets-ratio, especially compared to other countries in the region (fig. 5). *Staff comments would be welcome.*

On the structural front, we echo staff's call for labor market and governance reforms. We noted that Peru slipped from place 39 in the World Bank's Ease of Doing Business Ranking in 2011 to place 54 in 2016 and to 76 in 2020, faring particularly poor in the categories "starting a business", "paying taxes", and "trading across borders". These obstacles to economic growth need to be tackled decisively through wide-ranging structural reforms. We are confident that Peru can facilitate sustainable growth when looking at the potential strong impact of appropriate reforms on the GDP level.