FOR AGENDA

EBS/84/57

CONFIDENTIAL

March 16, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Peru - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a paper on a request from Peru for a stand-by arrangement equivalent to SDR 650 million. A draft decision appears on page 27.

It is expected that the Executive Director for Peru will be requesting the Board for a waiver of the circulation period, to enable this subject, together with Peru's request for a purchase under the compensatory financing facility (EBS/84/59, 3/16/84), to be brought to the agenda for discussion on Friday, April 6, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. van Houten (ext. (5)8624).

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

PERU

Request for a Stand-By Arrangement

Prepared by the Western Hemisphere and
Exchange and Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal, and
Treasurer's Departments)

Approved by Eduardo Wiesner and Manuel Guitian

March 15, 1984

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I. Introduction

On June 7, 1982 the Executive Board approved an extended arrangement for Peru in an amount equivalent to SDR 650 million for the period extending through May 1985 (EBS/82/77). External and internal developments since then have not been in conformity with the objectives of the program underlying the arrangement. By the end of 1983, midway through the period of the extended arrangement, deviations from the program path had become so substantial that the possibility of attaining the objectives had become remote. Accordingly, in the attached letter dated February 3, 1984, the authorities have requested a stand-by arrangement for the period extending through July 1985 and cancellation of the existing extended arrangement as of the day the stand-by arrangement comes into force. The program in support of which the stand-by arrangement is being requested is described in a memorandum annexed to the attached letter and is presented below.

Discussions on the stand-by program were conducted in Lima from November 17 to December 15, 1983 1/ and the negotiations were concluded in Washington in the period January 9-27, 1984. The Peruvian representatives in these discussions were headed by the Minister of Economy, Finance, and Commerce and included the Vice Ministers of Economy, Finance, and Commerce and the President, Vice President, and General Manager of the Central Reserve Bank.

The stand-by arrangement requested by the authorities is for an amount equivalent to SDR 250 million, or 75.6 percent of Peru's quota of SDR 330.9 million. Out of this amount, SDR 118 million (equivalent to 35.7 percent of quota) would be available during 1984 and the remaining SDR 132 million (equivalent to 39.9 percent of quota) would be disbursed during 1985. Disbursement would consist entirely of ordinary resources. The authorities also will be requesting a purchase under the compensatory financing facility in an amount of SDR 74.7 million, equivalent to 22.6 percent of Peru's quota. The staff report dealing with the use of resources under the compensatory financing facility will be circulated shortly.

Phasing under the requested arrangement is as follows: purchases would not, without the consent of the Fund, exceed the equivalent of SDR 15 million until May 15, 1984, SDR 30 million until August 15, 1984, SDR 74 million until November 15, 1984, SDR 118 million until February 15, 1985, SDR 162 million until May 15, 1985, and SDR 206 million until July 15, 1985.

1/ The staff team consisted of Messrs. van Houten (Head), Flickenschild, Jaramillo-Vallejo, Kohnert (all WHD), Sheehy (ETR), and Ms. Choy-Luy (Secretary-ETR). The mission was assisted by Mr. de Moraes, who took up his post as resident representative in Lima in February 1984.

As of January 31, 1984 Fund holdings of Peruvian soles amounted to SDR 912.3 million, or 275.7 percent of quota, of which 18.6 percent corresponded to use of the reserve tranche and 60.4 percent to purchases under the compensatory financing facility. On the assumption that Peru purchases the balance of its reserve tranche that originated from the quota increase and that repurchases are made on schedule, full use of the requested stand-by arrangement, together with the requested purchase under the compensatory financing facility, would raise Fund holdings of Peruvian soles to 364.9 percent of quota by the end of the stand-by period (Table 1). Further information on Peru's relations with the Fund is presented in Appendix I.

The 1983 Article IV consultations were conducted in Lima in September 1983, and were concluded by the Executive Board on November 28, 1983 (EBS/83/236).

II. Background and Recent Developments

The basic objectives of the medium-term plan initiated in 1982 and supported by the extended arrangement were the attainment of a viable external payments position, high and sustained economic growth, and declining inflation. These objectives were to be achieved by a tightening of demand policies, and the pursuit of flexible interest and exchange rate policies that would contribute to strengthening the role of market forces in the economy. Emphasis was placed on removing impediments to private investment, implementing a more efficient public investment program, opening up the economy to international competition, and eliminating price distortions.

In 1982, the economy's performance as regards progress toward attaining the basic objectives of the program was mixed. Real GDP rose by less than 1 percent and the 12-month inflation rate remained in the neighborhood of 70 percent. The overall balance of payments registered a small surplus principally because net capital inflows to the public sector were considerably higher than had been expected. The use of long-term credit and use of short-term loans financed a nonfinancial public sector deficit considerably in excess of the amount planned for 1982; the deficit rose to 8.6 percent of GDP, compared with a target of 4.2 percent. In turn, the current account deficit of the balance of payments widened with respect to the original program.

The program for 1983 was designed to correct the deviations of the previous year thereby bringing the Peruvian economy back to the adjustment path that had been envisaged under the arrangement. The external current account deficit was projected to drop from 8.3 percent of GDP in 1982 to 5.2 percent in 1983.1/ To achieve this reduction, the program contemplated a decline in the overall financing requirements of the nonfinancial public sector from 8.6 percent of GDP in 1982 to

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1/ Excluding US$146 million of interest payment obligations, subject to rescheduling by the Paris Club and socialist countries, the current account deficit in 1983 was programmed to be 4.4 percent of GDP.

Table 1. Peru: Fund Position During the Period of Stand-By Arrangement

	Outstanding on Mar. 31, 1984	1984 April-June	1984 July-Sept.	1984 Oct.-Dec.	1985 Jan.-March	1985 April-June	1985 July
			(In millions of SDRs)				
Transactions under tranche policies (net)	--	15.6	18.3	32.1	20.1	36.0	44.0
Purchases	--	30.0	44.0	44.0	44.0	44.0	44.0
Ordinary resources	(--)	(30.0)	(44.0)	(44.0)	(44.0)	(44.0)	(44.0)
Enlarged access resources	(--)	(--)	(--)	(--)	(--)	(--)	(--)
Repurchases	--	-14.4	-25.7	-11.9	-23.9	-8.0	--
Ordinary resources	(--)	(-9.1)	(-6.6)	(-6.6)	(-4.8)	(-2.7)	(--)
Enlarged access resources	(--)	(-5.3)	(-19.1)	(-5.3)	(-19.1)	(-5.3)	(--)
Transactions under special facilities (net)	--	74.8	--	--	--	--	--
Purchases	--	74.8	--	--	--	--	--
Repurchases	--	--	--	--	--	--	--
Total Fund credit outstanding (end of period)	635.6	726.0	744.3	776.4	796.5	832.5	876.5
Under tranche policies	435.7	451.3	469.6	501.7	521.8	567.8	601.8
Special facilities	199.9	274.7	274.7	274.7	274.7	274.7	274.7
			(As percent of quota)				
Total Fund credit outstanding (end of period)	192.1	219.4	224.9	234.6	240.7	251.6	264.9
Under tranche policies	131.7	136.4	141.9	151.6	157.7	168.6	181.9
Special facilities	60.4	83.0	83.0	83.0	83.0	83.0	83.0

Source: Fund staff estimates.

around 4 percent in 1983, together with a more flexible interest rate and exchange rate management. The tightening of demand policy and the pursuit of a restrictive wage policy were to hold inflation in check.

However, the weakness of external demand, the natural disasters that hit Peru in early 1983, and the deterioration of domestic security combined to create an environment that was not favorable for the attainment of the program's objectives. In the circumstances, the deficit of the nonfinancial public sector instead of falling to 4 percent of GDP as programmed, exceeded 10 percent of GDP. Real GDP in 1983, which was initially expected to show a moderate drop, is estimated to have declined by more than 10 percent (Table 2); the 12-month inflation rate increased to about 125 percent, close to double the projected rate; the external current account deficit at 5.5 percent of GDP, was close to the program target, but the overall deficit of the balance of payments in 1983, measured by the change in the net official international reserves, amounted to US$664 million, compared with US$100 million in the program.1/ Performance under the extended arrangement in 1983 is summarized in Table 3. A number of corrections have occurred in the initially reported data on the basis of which Peru made purchases from the Fund in 1983. The inadequacy of the reporting system resulted in the deterioration of the public finances becoming known only with a lag. As a consequence, remedial measures were delayed, and the imbalances were allowed to become very large.

Table 2. Peru: Rates of Change of Selected Economic Indicators

(In percent)

	1980	1981	1982	1983 Prog.	1983 Est.	1984 Prog.
Real GDP	3.0	3.1	0.7	-4.7	-11.0	4.0
Nominal GDP	61.0	70.6	64.0	83.1	88.9	99.2
Consumer price index (December-December)	60.8	72.7	72.9	70.0	125.1	70.0
Exchange rate depreciation (December-December)1/	36.6	48.3	95.3	70.0	129.5	70.0
Terms of trade index	9.7	-15.3	-13.7	0.7	3.8	0.4

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

1/ In terms of soles per U.S. dollar.

1/ US$87 million of the net reserve loss was accounted for by the rollover of short-term foreign debt that resulted in a shift in the Banco de la Nacion from contingency liabilities to direct liabilities.

Table 3. Peru: Performance Under Extended Arrangement

	1983			
	Mar. 31	June 30	Sept. 30	Dec. 31
	(In billions of soles) 1/			
Total net indebtedness of nonfinancial public sector				
Limit (adjusted) 2/	11,138.7	11,360.7	11,595.7	11,763.7
Actual	11,130.2	11,461.3	12,228.4	14,518.9
Margin	8.5	-100.6 3/	-632.7	-2,755.3
Net domestic assets of the monetary authorities 4/				
Limit (adjusted) 2/	1,221.1	1,271.1	1,152.2	998.5
Actual	1,205.1	905.9	1,231.3	1,574.7
Margin	16.0	365.2	-79.1	-576.3
	(In millions of U.S. dollars)			
Net international reserves of the monetary authorities 4/				
Target (adjusted) 2/	-210.0	-176.0	-11.0	232.0
Actual	-241.3	48.6	-29.6	-53.2
Margin	-31.3	224.6	-18.6	-285.2
Contracting of foreign debt				
1-5 years				
Limit	300.0	300.0	300.0	300.0
Actual	8.0	86.8	110.1	143.0
Margin	292.0	213.2	189.9	157.0
1-10 years				
Limit	1,250.0	1,250.0	1,250.0	1,250.0
Actual	23.0	948.3	1,099.3	1,284.0
Margin	1,227.0	301.7	150.7	-34.0

Source: Central Reserve Bank of Peru.

1/ Accounts denominated in foreign currency valued at US$1=S/. 1,250.
2/ In accordance with the program provisions.
3/ Domestic payment arrears were not explicitly included in the program definition of the stock of net indebtedness and hence are not included here. The identified increase in such arrears amounted to S/. 130 billion during the second quarter of 1983, and were repaid in the third quarter.
4/ Central Reserve Bank of Peru and Banco de la Nacion.

A major cause of the deep recession and the acceleration of inflation in Peru in 1983 was the adverse weather that hit the country during the early months of the year resulting in loss of output and scarcities of basic consumer goods. A combination of flooding in the normally dry coastal regions of northern Peru and drought conditions in the southern highlands resulted in large losses of agricultural output. Mud slides interrupted communications and electricity supplies, and led to declines in mining and petroleum output and contributed to a drop in manufacturing production. In addition, a shift in ocean currents resulted in a precipitous drop in fish catch. Other factors that contributed to the drop in economic activity were a weak external demand for Peruvian exports, the marked tightening of external capital markets, and an inflexible domestic productive apparatus characterized by rigidities in the labor and capital markets as well as obstacles to growth in the agricultural sector.

The fiscal situation deteriorated progressively during 1983. Although the authorities' initially reacted to the adverse shocks in the first months of the year by cutting expenditures, by midyear the fiscal program was off course. Central administration revenues ran below projections, emergency spending in the stricken regions was begun, and defense and domestic security expenditures, including wage payments, were raised in response to provincial unrest. In addition, adjustment of a number of controlled prices and utility rates was delayed. Monthly increases in the price of rice were introduced only in May 1983, instead of in January as programmed. In September, prices of diesel fuel, kerosene, and liquified gas were frozen until the end of 1983, and the increase in the price of gasoline, a number of other oil derivatives, and electricity rates was limited to approximately one half the rate of change of the immediately preceding months.

For 1983 as a whole, as was noted above, the deficit of the nonfinancial public sector is estimated to have been about twice the amount programmed (Table 4). About four fifths of the larger overall deficit is accounted for by slippages in the operations of the Central Administration. Current revenues declined to 13.9 percent of GDP in 1983 from 18.1 percent in 1982 and 16 percent projected in the program, as revenues were adversely affected by the unexpected depth of the economic recession and the increased incidence of tax evasion. Receipts from taxes on goods and services were 1.5 percent of GDP below projection, receipts from income taxes were 0.3 percent of GDP below projection, and receipts from import taxes were 0.5 percent of GDP lower than anticipated. At the same time central administration expenditure reached 21.4 percent of GDP, almost 3 percent of GDP more than programmed, reflecting higher than expected wage adjustments, additional defense outlays, and unforeseen costs related to external debt rescheduling.

The shortfall in the performance of the rest of the public sector (by 1.3 percent of GDP) in relation to the program resulted principally from the delay in raising controlled prices and higher than programmed wages and investment outlays. The increase in the overall deficit

Table 4. Peru: Operations of the Nonfinancial Public Sector

(As percent of GDP)

	1980	1981	1982	1983 Prog.	1983 Est.	1984 Prog.
Central administration current revenues	20.5	18.1	18.1	16.0	13.9	15.8
Income tax	6.1	3.9	3.7	3.0	2.7	2.3
Tax on goods and services	7.6	7.5	8.5	8.7	7.2	8.9
Import tax	3.2	3.8	3.5	3.1	2.6	2.8
Export tax	2.5	1.4	0.9	0.3	0.3	0.3
Other tax and nontax	1.1	1.5	1.5	0.9	1.1	1.5
Central administration current expenditures	18.1	17.9	18.0	15.5	18.2	15.4
Wages and salaries	4.8	5.3	5.2	4.5	5.1	4.2
Goods and services	0.7	0.8	0.8	1.1	1.0	1.0
Military outlays 1/	4.7	4.2	5.4	3.7	5.1	3.5
Interest payment	4.3	4.5	4.1	4.0	4.3	4.4
Transfers	3.6	3.1	2.5	2.2	2.7	2.3
Central administration current account surplus or deficit (-)	2.4	0.2	0.1	0.5	-4.3	0.4
Rest of public sector current account surplus or deficit (-)	-0.4	0.7	0.1	2.3	1.4	2.3
Nonfinancial public sector enterprises	-1.2	0.2	-0.3	2.0	1.2	2.2
Rest of general government	0.8	0.5	0.4	0.3	0.2	0.1
Public sector current account surplus or deficit (-)	2.0	0.9	0.2	2.8	-2.9	2.7
Capital expenditures (net of capital revenue)	8.4	9.3	8.8	6.9	7.4	6.5
Central Administration 2/	5.3	5.1	4.0	3.1	3.2	2.9
Nonfinancial public sector enterprises 3/	2.7	3.7	4.3	3.6	3.9	3.4
Rest of general government 3/	0.4	0.5	0.5	0.2	0.3	0.2
Overall public sector deficit (-)	-6.4	-8.4	-8.6	-4.1	-10.3	-3.8
Central Administration	-2.9	-4.9	-3.9	-2.6	-7.5	-2.5
Nonfinancial public sector enterprises	-3.9	-3.5	-4.6	-1.6	-2.7	-1.2
Rest of general government	0.4	--	0.1	0.1	-0.1	-0.1
Financing	6.4	8.4	8.6	4.1	10.3	3.8
External	2.1	1.1	7.8	3.1	8.0	4.8
Internal	4.3	7.3	0.8	1.0	2.3	-1.0

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

1/ Includes wages and salaries of military personnel.
2/ Includes transfers to rest of public sector.
3/ Net of capital transfers.

was financed mainly by larger than programmed supplier credits and by the use of greater balance of payments support than planned from socialist countries and members of the Paris Club. In addition, recourse to domestic financing was greater than projected. A consequence was that financial resources available to the private sector were limited, contributing to the downturn in economic activity in 1983.

Real money and quasi-money, including dollar-denominated certificates of deposit, declined by 12.5 percent in 1983 compared with a small increase projected in the program. The decline in real terms reflected the drop in GDP as well as uncertainty about the direction of economic developments. In addition, the difficulties experienced during the first half of 1983 by two financial institutions and their subsequent absorption by other financial institutions are likely to have had adverse effects on domestic financial savings.

The decline in real balances was not evenly distributed. The dollar value of foreign currency-denominated certificates of deposit in Peru stayed unchanged in 1983 while the real value of sol-denominated financial assets declined 21 percent. By the end of 1983, the share of dollar-denominated deposits in the total of money and quasi-money had increased to 45 percent from 39 percent at the end of 1982, notwithstanding a number of measures taken to promote the growth of sol-denominated financial instruments. In April 1983 the authorities introduced an indexed saving instrument denominated in soles with an effective rate of return of 98 percent per annum, and in September 1983, maximum rates on nonindexed sol-denominated deposits were raised from 55 percent to 60 percent, implying an increase in the effective annual rate from 71 percent to 80 percent if compounded monthly, still considerably below the rate of return on assets denominated in foreign currency.

The net domestic assets of the monetary authorities (Central Reserve Bank and the Banco de la Nacion), grew as programmed during the first half of 1983, but began to expand rapidly in the third quarter and continued at a pace higher than that programmed in the last quarter of the year, reflecting greater than anticipated domestic financing needs of the nonfinancial public sector. For the year as a whole, the net domestic assets of the monetary authority expanded by 160 percent in relation to the initial stock of liabilities to the private sector of the monetary authorities; such liabilities rose by 94 percent over the same period and the net official international reserves declined by US$614 million (Table 5).1/ The expansion of total bank credit in 1983 amounted to 123 percent of the initial stock of total liabilities to the private sector. Of this amount, some 70 percent was directed

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1/ At the end of 1983, US$50 million in international reserve liabilities were refinanced and assumed by the Central Government. Hence, for balance of payments presentation, the net official reserve loss amounted to US$664 million.

Table 5. Peru: *Changes in Monetary Indicators*

(In percent, or as indicated) 1/ 2/

	1983				Dec. 1982-	Programmed Dec. 1983-
	Dec. 1982-March	Mar.-June	June-Sept.	Sept.-Dec.	Dec. 1983	Dec. 1984
A. Central Reserve Bank						
Net international reserves	-31.8	91.6	-0.8	1.9	65.3	70.3
(In millions of US$)	(-329.1)	(295.0)	(-171.7)	(-52.0) 3/	(-257.8) 3/	(--)
Net medium- and long-term foreign assets	1.4	-7.8	12.5	-1.2	5.1	6.4
(In millions of US$)	(-2.4)	(-44.2)	(43.2)	(-9.8)	(-13.2)	(5.3)
Net domestic assets	34.5	-79.4 4/	24.2	22.9	11.9	-0.6
Credit to nonfinancial public sector (net)	(-2.3)	(-45.7)	(45.1)	(237.8)	(350.1)	(-344.4)
Credit to banks (net)	(0.3)	(-16.8)	(-34.0)	(-60.4)	(-114.5)	(209.4)
Liabilities to the private sector	4.1	4.3	35.9	23.5	82.3	76.9
B. Central Reserve Bank and Banco de la Nacion 5/						
Net international reserves	-50.3	53.6	1.5	-39.1 3/	-52.5 3/	...
(In millions of US$)	(-477.5)	(216.9)	(-104.9)	(-248.5) 3/	(-614.0) 3/	(...)
Net medium- and long-term foreign assets	-0.6	-11.0	2.8	-3.5	-12.9	...
(In millions of US$)	(20.3)	(-43.2)	(35.6)	(-11.3)	(1.4)	(...)
Net domestic assets	52.8	-37.5	34.8	71.2	160.0	...
Credit to nonfinancial public sector (net)	(32.3)	(-37.5)	(86.5)	(199.1)	(388.9)	(...)
Credit to banks (net)	(15.5)	(-6.5)	(-56.3)	(-12.4)	-71.3)	(...)
Liabilities to the private sector	3.2	5.4	39.1	28.5	94.4	...
C. Banking System						
Net international reserves	-15.8	-3.0	3.0	-1.4 3/	-17.5 3/	0.9
(In millions of US$)	(-643.6)	(-108.1)	(66.0)	(-44.4) 3/	(-730.1) 3/	(--)
Net medium- and long-term foreign assets	-1.0	-3.7	-1.2	-1.2	-8.6	-24.1
(In millions of US$)	(27.0)	(-43.2)	(38.1)	(-5.7)	(16.2)	(-45.2)
Net domestic assets	27.1	19.3	29.0	23.9	123.3	83.8
Credit to nonfinancial public sector (net)	(9.1)	(-4.1)	(15.4)	(39.0)	(87.2)	(-8.2)
Credit to private sector (net)	(18.8)	(21.5)	(22.1)	(10.0)	(86.1)	(83.1)
Liabilities to the private sector	10.5	12.5	30.8	21.3	97.2	76.8
Domestic currency	(4.5)	(7.4)	(27.3)	(24.5)	(77.8)	(82.8)
Foreign currency	(19.9)	(19.4)	(35.2)	(17.3)	(127.1)	(69.5)
Memorandum items						
Consumer price index	27.5	22.4	25.7	14.7	125.1	70.0
Exchange rate (soles per US$)	25.1	28.0	28.7	11.0	129.6	70.0

Sources: Central Reserve Bank of Peru; Fund staff estimates; and Table 13.

1/ Percent changes in the monetary accounts are taken in relation to the stock of liabilities to the private sector outstanding at the beginning of the period.
2/ Foreign currency accounts valued at end-of-period exchange rates.
3/ Includes a reduction in liabilities of US$50 million of the Central Reserve Bank to Arlabank which were assumed by the Central Administration.
4/ Reflects a bridge loan of US$200 million provided by foreign banks to the Central Administration.
5/ For the 1983 program the monetary authorities were defined to include the Central Reserve Bank and the Banco de la Nacion. The 1984 program considers the Central Reserve Bank as the monetary authority.

to the nonfinancial public sector. The flow of credit to the private sector did not keep pace with inflation and in real terms contracted by 8.3 percent.

The current account deficit of the balance of payments in 1983 amounted to US$880 million, about one half the deficit of US$1.6 billion registered in 1982 (Table 6). The trade balance in 1983 improved by US$730 million to a surplus of US$300 million, slightly more than projected. The value of exports in 1983 declined by 8.4 percent from the 1982 level because of lower mineral prices and a decline in export volumes that occurred because of weather conditions and limited external demand. The value of imports in 1983 declined by 27 percent, somewhat more than had been anticipated. Net service payments in 1983 were virtually unchanged from 1982 as programmed.

Net long-term capital inflows in 1983 amounted to US$1.2 billion, in line with the program; net short-term capital outflows were larger than had been expected, so that net official international reserves declined by more than programmed.

The composition of the net long-term capital inflows in 1983 differed substantially from those programmed. Net flows to the nonfinancial public sector were US$418 million greater than expected, while net loan disbursements to the financial system and the private sector fell short by a similar amount. Rescheduling arrangements with suppliers and socialist countries, and new supplier credits were larger than expected, but disbursements from foreign banks fell short by US$200 million 1/ and a structural adjustment loan from the World Bank failed to materialize.

Rescheduling arrangements were an important element of Peru's balance of payments strategy in 1983, as agreements were concluded with commercial banks, official bilateral creditors under the Paris Club, and socialist countries. The agreement with the international banking community involved the maintenance of the short-term exposure at the level existing on March 7, 1983, the extension of a medium-term loan covering US$304 million in principal payments falling due between March 7, 1983 and March 6, 1984, and a loan of US$450 million in new money (of which US$250 million was disbursed during 1983). With the member countries of the Paris Club, agreement was reached to reschedule the bulk of principal and interest falling due in the period from May 1, 1983 to February 29, 1984. The net debt relief available to Peru in 1983 under this arrangement is estimated at US$460 million. The authorities also approached several socialist creditor countries and obtained a rescheduling of principal and interest payments due in 1983 (totaling US$247 million) and 1984.2/

1/ Of this amount, US$100 million was disbursed in February 1984, and the remainder is to be disbursed following Executive Board approval of Peru's request for a stand-by arrangement.

2/ A detailed description of the renegotiatons is contained in Appendix VII of SM/83/235.

Table 6. Peru: Balance of Payments, 1980-84

(In millions of U.S. dollars)

	1980	1981	1982	1983 Program	1983 Estimate	1984 Program
Current account	-101	-1,728	-1,609	-929	-882	-852
Merchandise trade	826	-553	-428	244	300	569
Exports, f.o.b.	(3,916)	(3,249)	(3,293)	(3,030)	(3,015)	(3,131)
Imports, f.o.b.	(-3,090)	(-3,802)	(-3,721)	(-2,786)	(-2,715)	(-2,562)
Investment income	-909	-1,019	-1,034	-1,271	-1,152	-1,415
Public sector	(-479)	(-533)	(-640)	(-860)	(-715)	(-985)
Private sector	(-430)	(-486)	(-394)	(-411)	(-437)	(-430)
Other services	-165	-317	-314	-102	-249	-195
Transfers	147	161	167	200	219	189
Long-term capital	462	648	1,200	1,199	1,244	852
Public sector	371	388	995	1,130	1,305	952
Nonfinancial	(363)	(325)	(878)	(715)	(1,199)	(877)
Disbursements	/783/	/1,442/	/1,764/	/1,241/	/1,315/	/1,031/
Rescheduling	/372/	/80/	/109/	/654/1/	/1,015/	/1,140/2/
Amortization	/-792/	/-1,197/	/-995/	/-1,180/	/-1,131/	/-1,294/2/
Financial	(8)	(63)	(117)	(415)1/	(106)	(75)
Disbursements	/425/	/178/	/170/	/437/	/120/	/140/
Amortization	/-417/	/-115/	/-53/	/-22/	/-14/	/-65/
Private sector	91	260	205	69	-61	-100
Direct investment	(27)	(125)	(48)	(43)	(15)	(-39)
Loans	(64)	(135)	(157)	(26)	(-76)	(-61)
Basic balance	361	-1,080	-409	270	362	--
Short-term capital and errors and omissions	323	469	544	-370	-1,142	--
Allocation of SDRs	23	21	--	--	--	--
Overall balance	707	-590	135	-100	-780 3/	--
Change in commercial bank reserves (increase -)	63	-21	49	--	116	--
Change in official reserves (increase -)	-770	611	-184	100	664 2/	--
Use of Fund credit (net)	-18	-86	262	150	48	114
Other official reserves	-752	697	-446	-50	616	-114
Memorandum items:						
As percent of GDP						
Current account balance	-0.6	-8.7	-8.1	-5.8	-5.5	-5.0
Exports	22.7	16.4	16.7	18.9	18.8	18.3
Imports	17.9	19.2	18.9	17.4	17.0	15.0

Source: Central Reserve Bank of Peru.

1/ Rescheduling of US$281 million is included in program estimates of disbursements to financial public sector in 1983.
2/ Excludes refinancing of US$50 million Arlabank loan to the Central Reserve Bank.
3/ Includes US$366 million of nonbank external debt assumed by the banking system in accordance with Exchange Resolution 002 and still remaining outstanding. Of this amount, US$87 million was assumed by the Banco de la Nacion and is an official reserve liability; the remaining US$279 million is a commercial bank reserve liability.

During the period January-July 1983, the sol was depreciated with respect to the dollar on a daily basis and without preannouncement at a rate somewhat faster than domestic inflation. The real effective depreciation of the sol against trading partner currencies amounted to 2.4 percent in these seven months. On August 8, 1983 the sol was depreciated by 6 percent in nominal terms with respect to the U.S. dollar, and on September 1, 1983 the authorities began to preannounce the exchange rate of the sol for up to three months in advance with monthly rates of depreciation no larger than 4 percent, or approximately one half the domestic rate of inflation in the immediately preceding months.1/ As a result, real depreciation of the sol against trading partner currencies in the 12 months ended December 1983 was reduced to 2.4 percent (Chart 1).

III. The Program for the Period through July 1985

The major cause of the internal and external imbalances experienced by Peru during the past two years has been the maintenance of a public sector deficit at a level averaging 9 percent of GDP. Public financial requirements of this magnitude led to an unsustainably high level of net foreign financing, a serious crowding out of the private sector in financial markets, and the maintenance of inflationary pressures.

The program for the period through July 1985 has been designed to reduce substantially the domestic and external imbalances. Accordingly, major adjustments in the areas of fiscal, monetary, and incomes policies have been undertaken. In addition, the program incorporates a number of structural modifications to improve the allocation of domestic productive resources over the medium term.

The program's immediate objectives are to maintain the level of net official international reserves, reduce the reliance on net foreign savings in relation to GDP to 5 percent in 1984 and 4.3 percent in 1985, lower the rate of inflation from an annual rate of 100 percent in the first quarter of 1984 to approximately one half that rate by the last quarter of 1984, and to continue to lower inflation in 1985.

Barring the recurrence of adverse weather conditions, the outlook is for a moderate recovery in 1984 and 1985 from the deep recession of 1983. Agricultural production is projected to expand in 1984 from the abnormally low level of 1983, and the return of colder ocean currents off the coast is expected to result in a bigger fish catch. Spending on reconstruction should benefit the construction sector and the faster pace of economic growth in a number of industrial countries should lead to firmer prices for a number of exports and some growth in the volume of exports. However, the service sectors are expected to show little growth. All in all, real GDP is projected to grow on average at an annual rate of about 4 percent in 1984 and 1985.

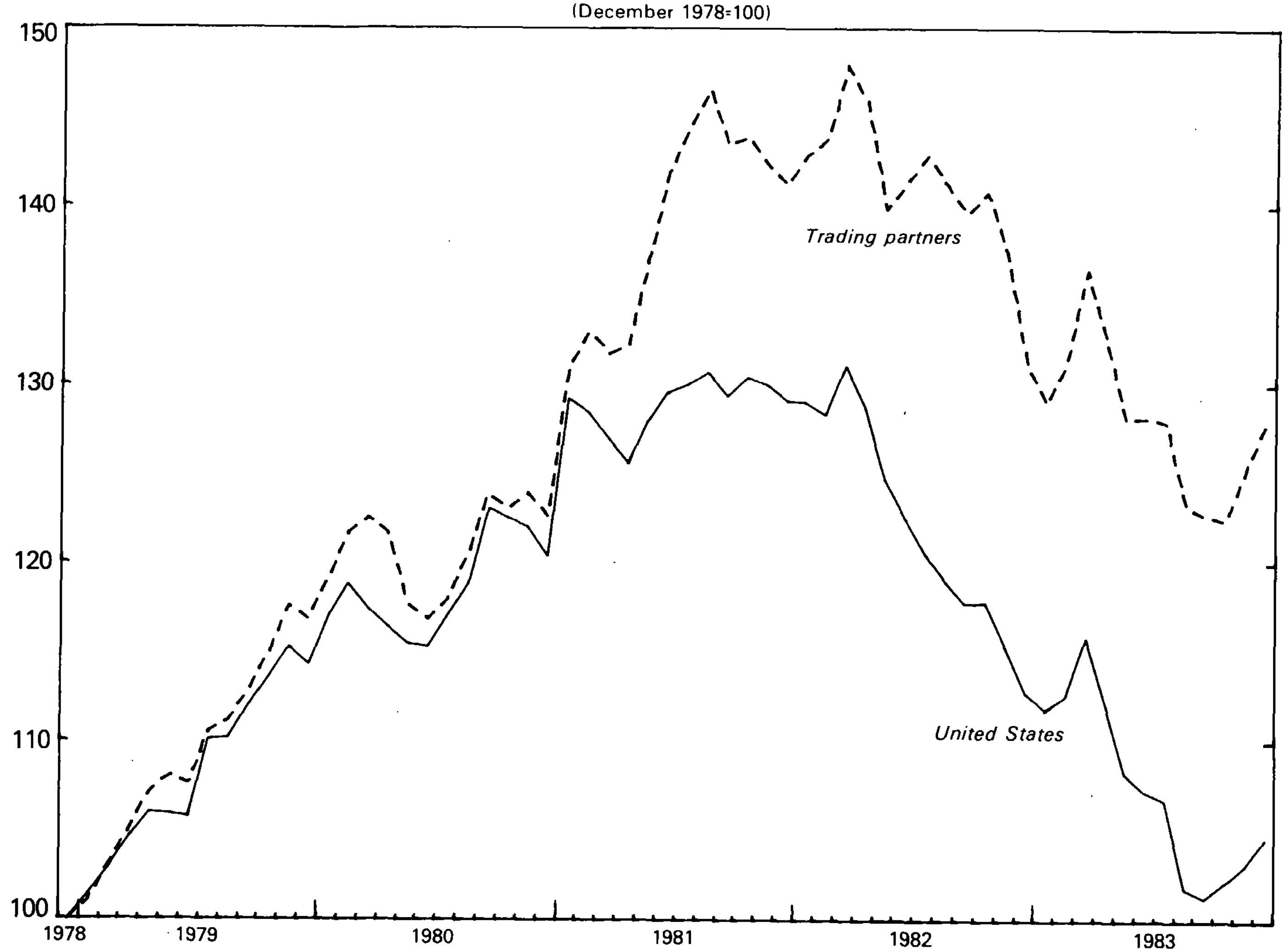
1/ The system of preannouncement ceased after February 29, 1984.

CHART

PERU

REAL EXCHANGE RATE INDICES[1]

(December 1978=100)



Source: Staff calculations.

[1]Increase in index indicates real appreciation.

1. Demand management

The program places heavy emphasis on the tightening of fiscal and monetary policies to achieve the inflation and balance of payments objectives. With respect to fiscal policy, the program calls for a reduction in the net financing requirement of the nonfinancial public sector from an estimated 10 percent of GDP in 1983 to 3.8 percent in 1984 and 2 percent in 1985. The improvement in the public sector finances is to be brought about by spending restraint and revenue measures covering both the Central Government and the public enterprises. Central government expenditures are to be reduced from 21.4 percent of GDP in 1983 to 18.3 percent in 1984. The wage bill is expected to decline by 0.9 percent of GDP, as wage increases in the Central Administration are to be limited to three adjustments in the course of the year cumulating to a total below the rate of inflation. Purchases of goods and other services are projected to decrease from 6.1 percent of GDP in 1983 to 4.5 percent in 1984, principally because of lower defense expenditures. Central government investment spending is programmed to decline from 3.9 percent of GDP in 1983 to 2.9 percent, mainly by eliminating capital transfers to the public enterprises, as spending on reconstruction of the regions affected by the natural disasters of 1983 is projected to increase. The execution of the Government's austere spending plans will depend critically on the improvements introduced in 1983 in monthly budget control and program monitoring.

Introduction of a comprehensive wage policy for the rest of the public sector, to be implemented by the Ministry of Economy, Finance, and Commerce, is expected to help cut operational expenditures of the principal public enterprises. The investment plan for the rest of the public sector is to be reduced from 4.2 percent of GDP in 1983 to 3.6 percent and has been developed with the help of technical assistance provided by the World Bank and the Inter-American Development Bank. The investment plan emphasizes spending on electric energy generation and petroleum exploration in order to assure an exportable surplus of petroleum products in the future. Control over investment spending by the public enterprises is to be strengthened through direct supervision of projects by the Budget Office and by limiting access to foreign and domestic sources of financing.

The austerity in expenditure is accompanied by a major revenue effort. New tax measures put in place at the start of 1984 are projected to raise central government revenue by the equivalent of 2 percent of GDP this year. These measures include a 2 percentage point increase in the general sales tax; increases in selective taxes on a number of consumer goods by 2-15 percentage points; the elimination of certain tax exemptions starting in April 1984; an increase in restaurant and hotel taxes; the introduction of a tax on traditional exports; the imposition of a minimum import duty of 11 percent, except on a limited number of products including wheat, rice, milk, and certain medicines; a 1-3 percent tax on the value of automobiles, airplanes, boats, and other luxury consumer goods; and a tax of up to 1 percent on purchases of foreign exchange. In addition, income and sales tax administration is being overhauled and an analysis of the tax system is being undertaken with technical assistance provided by the Fiscal Affairs Department.

Operational revenues of the public enterprises are expected to be boosted by the corrective price increases already taken during the first months of 1984. These pricing measures, together with a full-year impact of the price corrections taken in the course of 1983 and the increased control over current spending referred to above, are projected to result in an increase in the operational surplus of the public enterprises by about 1 percent of GDP compared with 1983. Specifically, the price of rice has been raised by 25 percent in the period January-February 1984 and is to be raised on a monthly basis thereafter so as to eliminate the deficit of the rice marketing agency. The price of regular gasoline was raised at the start of February 1984 to the equivalent of US$1.15 per U.S. gallon, and the prices of other petroleum derivatives were raised commensurately. Henceforth, prices for petroleum derivatives will be adjusted monthly at least in line with the devaluation of the sol. Electricity rates in the period January 1-March 10, 1983 have been increased by 32 percent; further corrective adjustment is programmed for April, and thereafter rates will be raised on a monthly basis in line with cost increases, or by larger amounts if required to help cover the costs of investments. Other increases in controlled prices in January and February 1984 include a 24 percent increase in the price of bread, a 7 percent increase in the price of urban transportation fares, an 11 percent increase in air fares, and a 15 percent increase in postal rates. These controlled prices and tariffs will continue to be raised so as to avoid incurring subsidies.

The deficit of the nonfinancial public sector for 1984 is programmed to be financed without any recourse to domestic credit. In fact, since most of the external resources that are to become available are to be directed to the nonfinancial public sector, the program calls for the nonfinancial public sector to reduce its net domestic indebtedness by about 1 percent of GDP in 1984, to allow resources to be channeled to the private sector. To monitor the implementation of the public sector program for 1984, quarterly limits have been placed on the net indebtedness of the nonfinancial public sector, defined as the sum of all domestic and foreign sources of finance. To strengthen the Government's control over external borrowing by the public sector, the program includes limits on the total gross direct external indebtedness of the Banco de la Nacion and COFIDE (a government-owned development corporation), the legally designated agents for external borrowing by the nonfinancial public sector. These limits include external borrowing by the Banco de la Nacion and COFIDE relating to operations with the private sector.

Given that inflationary expectations are high and that private confidence in exchange rate management is still to be established, following the abandonment of the system of exchange rate preannouncement, monetary policy has been tightened. The Central Reserve Bank is to pursue policies directed toward reducing its role in the intermediation process. To this end it will continue with its plan to lower average reserve requirements to the legally established minimum levels and refrain from imposing new portfolio requirements and from expanding special credit facilities beyond those strictly necessary to provide emergency support to industry. To ensure that the beneficiaries of these credit facilities improve their solvency, increased equity participation in an equivalent amount is required. Existing emergency credit lines are to be phased out as the conditions which gave rise to them subside.

In 1984 the expansion of net domestic bank credit is projected to be financed by an expansion in liabilities to the private sector in line with the increase of GDP and by an increase of about US$50 million in medium- and long-term foreign borrowing by the banking system. Bank credit to the private sector is expected to account for all of the expansion in bank credit.

To guide monetary policy, ceilings have been set on the net domestic assets of the Central Reserve Bank and targets have been established for the net official reserves of the Central Reserve Bank. The operations of the state-owned Banco de la Nacion are no longer consolidated with the operations of the Central Reserve Bank. Under the new program, operations of the Banco de la Nacion are effectively constrained by the combination of ceilings on the Central Reserve Bank net domestic assets and limits on the gross external indebtedness of the Banco de la Nacion and COFIDE.

With the objective of continuing to improve the efficiency of financial intermediation and resource allocation, and of providing a realistic alternative to dollar certificates of deposit, in early 1984 all financial institutions were authorized to sell certificates of deposit with a freely negotiated discounted rate of return. The program calls on the authorities to continue with the policy of adjusting over time the rate of indexation of existing indexed financial instruments, as well as the level of nominal interest rates, to ensure that deposit rates remain positive in real terms. As the Central Reserve Bank at present is a principal intermediary in the domestic financial system, its interest rate policies have a profound effect on market rates. Hence, to promote the efficient operation of the domestic financial market, the program calls on the Central Reserve Bank to channel financial resources to the rest of the domestic system at market determined interest rates, through open market operations or auction techniques.

2. Wage policy

Corrective adjustments of several controlled prices are expected to lead to a significant increase in the consumer price index in the early months of 1984. Thereafter, the speed at which inflation is brought down will be greatly influenced by the success in implementing the fiscal and monetary policies outlined above and by a cautious wage policy. The program calls for a moderate wage policy in relation to inflation in both the Central Government and the rest of the public sector. The Government's ability to influence wage awards in the public enterprises has been strengthened by the 1984 budget law which provides that the Ministry of Economy, Finance, and Commerce is to ensure that the wage agreements are compatible with the inflation objectives. In August 1983, moreover, a decree was issued stipulating that all increases in salary or supplemental pay of public enterprises, irrespective of whether they are subject to collective bargaining, be submitted for approval to the Ministry of Economy, Finance, and Commerce and instructing the Ministry of Labor to reject any unapproved collective bargaining agreement in the public sector.

With respect to wage policy toward the private sector, the Government will continue its policy of protecting the lowest income groups through periodic increases in the wage reference unit, which is the lowest income any private sector worker can legally earn. The program relies on collective bargaining to settle wage awards in the unionized private sector. Individual workers will continue to negotiate agreements with their employers on wages and benefits as the Government does not intend to mandate general wage increases or bonuses for private sector workers.

3. External sector policies

The balance of payments for 1984 is targeted to be in equilibrium, and the current account deficit is projected at US$850 million or 5 percent of GDP. The trade surplus is projected to improve by US$270 million, to US$570 million in 1984, on the basis of a 3.8 percent decline in imports and a 5.6 percent increase in exports. At the same time, net financial service payments are projected to rise by US$320 million, reflecting higher indebtedness and a full year's impact of increased interest rate spreads and fees on principal and interest payments that have been refinanced.

The import contraction reflects mainly a lower level of defense-related imports as envisaged in the fiscal plan, and a decline in food imports associated with the recuperation of agricultural output. Copper shipments are projected to rise by 19 percent in reflection of the re-establishment of a more normal sales volume following interruptions during 1983 on account of weather and strikes. Average copper prices for the year are projected to remain virtually without change. The value of other mineral exports is expected to remain unchanged, except for the value of tin exports which is projected to rise because of higher prices. The value of petroleum exports is projected to decline by 5 percent because of lower shipments stemming from declining production and increasing domestic consumption. The value of agricultural exports is expected to be unchanged, with higher coffee exports offset by lower cotton exports. Nontraditional exports are projected to rise substantially principally because of US$100 million of new exports to the Soviet Union under the agreed terms of repayment of loans that had been rescheduled. The value of nontraditional exports to countries other than the Soviet Union are projected to rise by about 10 percent.

For 1984 the program projects that the current account of the balance of payments will be fully financed by medium- and long-term capital inflows. As in 1983, virtually all of gross foreign disbursements, amounting to US$2.2 billion, will be directed to the nonfinancial public sector, with the rescheduling of debt service accounting for US$1 billion and new disbursements from foreign banks amounting to US$200 million.1/ Disbursements from suppliers and bilateral and multilateral sources account for the remainder.

The Paris Club creditors agreed in July 1983 to refinance principal and interest payments of debts falling due from May 1, 1983 to February 28, 1985. Bilateral agreements pursuant to these agreed minutes have been signed covering the period from May 1, 1983 to April 30, 1984, with most but not all Paris Club creditors. Agreements covering the remaining period are expected to be signed in the course of 1984.

Rescheduling has been arranged with socialist country creditors for 1984. An agreement was signed in September 1983 with the Soviet Union, but the agreements with other socialist countries still have to be finalized. The rescheduling of principal payments due to foreign banks in 1984 and part of 1985 has been negotiated with the bank steering committee and has been submitted for approval to the commercial banks. Pending the conclusion of final agreements, the restriction on payments and transfers for current international transactions remain. In view of the fact that agreements in principle have already been reached with the creditors, the staff recommends their approval.

a. Exchange rate system

As of February 29, 1984 the policy of preannouncing the exchange rate lapsed and the authorities re-established a flexible exchange rate policy involving frequent small changes in the rate of the sol at least in line with the rate of domestic inflation. The adequacy of the exchange rate policy in preserving Peru's competitiveness will be reviewed with the Fund before October 1, 1984 in conjunction with the 1984 Article IV consultation discussions.

Peru maintains a second exchange market for capital transactions where dollar certificates of deposit are traded. During 1983 the exchange rate for the sol in the certificate market was close to the rate in the official market. Spreads in excess of 1 percent have been uncommon and of short duration. However, in January and February 1984, the spread widened to as much as 10 percent in view of the uncertainties about the course of the official exchange rate beyond February 29, 1984, when preannouncement ceased. It is expected that the spread will tend to decline again in coming months with the re-establishment of a flexible exchange rate policy and the implementation of the demand policies described above. With the objective of controlling speculative capital transactions, the authorities on March 6, 1984 tightened the regulations

1/ This amount was carried over from the 1983 foreign bank loan.

governing the sale of exchange for travel abroad. Sales of exchange for travel would continue to be effected up to US$8,000 per year without Central Reserve Bank review as before, but only up to US$300 per trip would be sold in cash in Peru, and the remainder would be made available in the form of a bank draft or letter of credit in favor of the traveler and drawn on a correspondent bank in the country of destination. The tighter regulations may not involve a restriction; but to make a final determination of this it will be necessary to establish whether they do not constitute an added impediment to the availability of exchange to the legitimate foreign traveler. The operation of this new regulation will be reviewed with the Fund before October 1, 1984 to ascertain whether or not it entails an exchange restriction.

Peru does not maintain restrictions on payments and transfers for current international transactions other than the restriction that remains, pending conclusion of the final agreements with the various creditors on Peru's external debt, provided that agreement in principle has been reached. Capital transactions can be made through the certificate market as well as through the unrestricted export and import of domestic currency. Under the program, the Government will continue with the policy of allowing exporters to dispose freely of a portion of export receipts by limiting mandatory export surrender requirements to a level sufficient to meet the Central Reserve Bank's own exchange requirements. The Government does not intend to introduce or modify any multiple currency practice, impose or intensify restrictions on payments or transfers for current international transactions, conclude bilateral payments agreements which are inconsistent with Article VIII of the Articles of Agreement, or impose or intensify restrictions on imports for balance of payments reasons.

b. The trade system

The authorities intend to continue to avoid new restrictions on imports. The level of protection to local industry is substantial and includes a surcharge of 10 percent. This surcharge was imposed in early 1982 and was changed in March 1983 from 15 percent of the import duty to 10 percent of the c.i.f. value of imports, thus raising the average unweighted tariff from 36 percent to 41 percent. The original measure and its modification were taken for fiscal rather than balance of payments reasons. Given the continuing difficult fiscal situation, the authorities do not feel that the surcharge of 10 percent can be eliminated in the near term. However, the program calls for a further reduction in the tariff disparity through the reduction of the number of duty exemptions.

Since the late 1970s the authorities have supported nontraditional exports through a number of incentives. A direct subsidy in the form of tax payment certificates is paid on the f.o.b. value of certain nontraditional exports at a rate up to 22 percent, or up to 32 percent if the product originates outside the Lima-Callao area. In addition, the Central Reserve Bank provides concessional financing to exporters of nontraditional products. In mid-September 1983 textile products sold to the United States became ineligible to receive these export facilities with a view to inducing the United States to withdraw the countervailing duties imposed on such products in early 1983. The authorities plan to review the system of export incentives with the objective of ensuring that support for nontraditional exports is in accord with conventions under the General Agreement on Tariffs and Trade.

c. External debt management

Progress already has been made in establishing control over external borrowing by the public sector. Since 1981 the contracting of medium- and long-term debt has been brought under the control of the General Directorate of Public Credit (GDPC) and, in late 1982, GDPC's control was extended to short-term debt. Public sector enterprises were required to register their short-term external indebtedness (except export prefinancing) with GDPC and to obtain GDPC's approval for the renewal, rollover, or consolidation of such debt. In addition, starting in 1983, public sector enterprises have had to submit annual short-term borrowing programs (excluding export prefinancing) to GDPC for approval.

The authorities' program of external indebtedness is to lower reliance on external financial resources in relation to GDP from 5.5 percent of GDP in 1983 to 5 percent in 1984, and to continue shifting to multilateral and official sources of credit to improve credit terms. Rescheduling arrangements are expected to reduce scheduled debt service payments in 1984 from the equivalent of 63 percent of exports of goods and services to 35 percent (Table 7). Medium-term projections of public and publicly guaranteed debt service in relation to GDP--on the basis of debt contracted through end-December 1983 and the expected level of new disbursements over the next five years (assuming a reduction in the current account balance of payments deficit from 5 percent of GDP in 1984 to below 3 percent)--indicate that in the absence of future rescheduling the ratio will rise to 55 percent by the end of the decade. Interest payments are projected to decline from 6.3 percent of GDP in 1984 to 5.7 percent by 1989.

To monitor the external debt and control the pattern of future debt service payments, the program includes a ceiling of US$1,660 million on the contracting and guaranteeing by the public sector of external debt of over one year and up to twelve years. This amount includes US$1,140 million of rescheduling and US$520 million of new indebtedness. A subceiling of US$200 million on debt maturities of over one year and up to five years is included to help improve the external debt profile.

The above ceilings do not include external debt contracted and guaranteed by the private financial system since the authorities do not wish to suggest that new external debt by commercial banks requires approval by the Central Reserve Bank and thus carries an implicit official guarantee. As to short-term debt, the policy is to maintain the existing level of such debt, which will consist mainly of trade credits when working capital debt has been refinanced into a medium-term

Table 7. Peru: Public Sector External Debt Service Payments, 1983-89

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987	1988	1989
A. Amortization	1,239	1,479	1,418	1,577	1,639	1,575	1,695
Public and publicly guaranteed	1,145	1,359	1,241	1,351	1,489	1,443	1,550
Central Reserve Bank	94	120	177	226	150	132	145
IMF	(94)	(87)	(112)	(161)	(118)	(132)	(145)
Other	(--)	(33)	(65)	(65)	(32)	(--)	(--)
B. Interest	798	1,070	1,123	1,156	1,198	1,216	1,246
Public and publicly guaranteed	645	904	963	1,010	1,064	1,106	1,146
Central Reserve Bank	87	96	90	76	64	40	30
IMF	(51)	(57)	(65)	(56)	(44)	(25)	(15)
Other	(36)	(39)	(25)	(20)	(20)	(15)	(15)
Banco de la Nacion	66	70	70	70	70	70	70
C. Total debt service (A+B) 1/	2,037	2,549	2,541	2,733	2,837	2,791	2,941
D. Agreed refinancing 2/	1,015	1,140	391	--	--	--	--
Amortization	842	931	371	--	--	--	--
Interest	173	209	20	--	--	--	--
E. Net debt service (C-D)	1,022	1,409	2,150	2,733	2,837	2,791	2,941
Memorandum items							
As percent of exports of goods and services							
Total debt service	53.6	63.2	57.5	58.8	57.7	54.3	55.0
Amortization	(32.6)	(36.7)	(32.1)	(33.9)	(33.3)	(30.6)	(31.7)
Interest	(21.0)	(26.5)	(25.4)	(24.9)	(24.4)	(23.7)	(23.3)
Net debt service	26.9	34.9	48.6	58.8	57.7	54.3	55.0
As percent of GDP							
Interest payments	5.0	6.3	6.2	6.1	6.1	5.8	5.7

Sources: Central Reserve Bank of Peru; Fund staff estimates; and Table 11 in Appendix III.

1/ Includes cost of refinancing and future amortization and interest payments on rescheduled debt service in 1983-85.

2/ For 1984-85, includes rescheduling agreed in principle with Paris Club and socialist countries, and rescheduling under discussion with foreign banks.

loan upon the signing of an agreement with foreign banks in coming months. Given the difficult foreign market conditions, growth of short-term debt is expected to be limited to trade financing. Nevertheless, inasmuch as in the past short-term foreign borrowing by the state enterprises has been a problem, the program intends to monitor and control such operations through limits on the total external indebtedness of the Banco de la Nacion and COFIDE, which are the sole authorized fiscal agents for the public sector.

4. Elements of structural change and medium-term prospects

Recent developments in Peru have brought into focus the need for greater efficiency as a means of fostering economic growth. A number of rigidities in the labor market, including certain aspects of regulations covering employment stability and participation of labor in management and profits, have hampered enterprises in achieving the degree of operational efficiency that seems needed. Flexibility in Peru's labor laws would be introduced by ratification of an international convention involving criteria established by the International Labor Organization; such legislation is pending ratification by the Congress.

Existing policies with regard to controlled prices, state marketing, and land ownership are believed to affect adversely the growth of the agricultural sector. The program contemplates the establishment of market prices for rice and greater participation by rice growers in the marketing process. In addition, modifications in the rules of land tenure are to be introduced with a view to enabling farmers to transfer ownership more easily and gain greater access to credit.

Over the medium term, the balance of payments position is likely to remain tight. A tentative medium-term scenario prepared by the staff indicates that, even under reasonably favorable assumptions with respect to growth of GDP and exports, the external current account deficit can be expected to decline only slowly during the remainder of the decade (Table 12 in Appendix III). The principal constraints in this respect are the relatively high interest payments on the external debt (expected to decline only gradually in relation to GDP) and the level of imports consistent with the average GDP growth assumption of 4 percent per annum. The implication is that the maintenance of external competitiveness will have to continue to be a primary objective to ensure an average nominal expansion of exports of close to 6 percent per year as assumed in the projection. The scenario is based on the successful completion of refinancing agreements currently under negotiation with the commercial banks and members of the Paris Club for the period through July 1985. Subsequently, it is assumed that Peru will continue to have access to gross disbursements of external resources (including possible refinancing) in amounts declining from 14 percent of GDP in 1984 to 11.5 percent in 1985 and to 9 percent by the end of the decade. These gross disbursements are consistent with a decline in the current account deficit from 5 percent of GDP in 1984 to close to

2 percent in 1989. This level of external support is likely to be forthcoming only if foreign creditors remain convinced that economic policies are consistent with a viable medium-term external payments position.

5. Performance criteria

The program includes five quantitative performance criteria (Table 8). Limits have been established on the net indebtedness of the nonfinancial public sector from all domestic and foreign sources. Any net increase in domestic payment arrears during the course of the program period is to be added to total net indebtedness. Performance in respect of these limits is to be tested at the end of each quarter.

Limits have been established on the gross direct foreign liabilities of the Banco de la Nacion and COFIDE regardless of initial maturity. These limits include up to specified amounts each quarter, foreign liabilities that are used for financing operations with the private sector and the rest of the banking system; these limits are to be reduced to the extent that such operations fall short of the amounts foreseen in the program. With regard to guarantees on foreign borrowing given by the Banco de la Nacion and COFIDE, indicative limits have been established as the data base is not firm enough to warrant the establishment of a performance criterion. Performance in respect of the above limits also is to be tested at the end of each quarter.

The program incorporates limits on the net domestic assets of the Central Reserve Bank which are tested continuously. The net domestic assets are defined as the difference between the Central Reserve Bank liabilities to the private sector and the sum of the net international reserves and net medium- and long-term foreign liabilities. Targets have been established for the net official international reserve position of the Central Reserve Bank. Performance in respect of these targets is to be tested at the end of each quarter.

Finally, the program incorporates limits on the contracting and guaranteeing of external public debt with original maturity of at least one year and up to and including twelve years, with sublimits on debt with original maturity of at least one year and up to and including five years. The public sector is defined to include COFIDE, the Central Reserve Bank, Banco de la Nacion, and a number of state-owned specialized banks. The contracting limits include refinancing loans on public debt service payments and any nonpayment of a scheduled debt service payment by the public sector. Performance under the limits and sublimits is to be tested continuously.

In addition to these quantitative performance criteria, the program also contains performance clauses on (1) the imposition or intensification of restrictions on payments and transfers for current international transactions, the introduction or modification of multiple currency practices, the conclusion of bilateral payments agreements

Table 8. Peru: Quantitative Performance Criteria of the Stand-By Arrangement for 1984

	Targets and Limits for 1984					
	March 31	June 30	Aug. 15	Sept. 30	Nov. 15	Dec. 31
	(In billions of soles)					
Net domestic assets of Central Central Reserve Bank 1/2/	194 3/	518 4/	383 5/	248 5/	121 6/	-5 6/
Net indebtedness of the non-financial public sector 7/8/	23,887 3/	24,354 4/	...	24,757 5/	...	25,357 6/
	(In millions of U.S. dollars)					
Net official international reserves 9/	412	314	...	424	...	541
Gross foreign liabilities of the Banco de la Nacion and COFIDE 10/	870	885	...	905	...	930
Contracting of external debt 2/11/						
1-5 year maturity	200	200	200	200	200	200
1-12 year maturity	1,660	1,660	1,660	1,660	1,660	1,660

Sources: Central Reserve Bank of Peru; and Memorandum on Economic Policy of the Government of Peru.

1/ Defined as the difference between (1) the Central Reserve Bank liabilities to the private sector, and (2) the sum of the net international reserves of the Central Reserve Bank and the medium- and long-term net foreign assets of the Central Reserve Bank.
2/ These limits are applied throughout the period.
3/ Foreign currency accounts valued at S/. 2,433 per U.S. dollar.
4/ Foreign currency accounts valued at S/. 2,855 per U.S. dollar.
5/ Foreign currency accounts valued at S/. 3,287 per U.S. dollar.
6/ Foreign currency accounts valued at S/. 3,673 per U.S. dollar.
7/ Defined as the sum of (i) net claims of the domestic banking system and COFIDE on the nonfinancial public sector, (ii) the outstanding amount of bonds issued by the nonfinancial public sector and held outside the domestic banking system, COFIDE, and the nonfinancial public sector and (iii) the outstanding foreign debt of the nonfinancial public sector. In addition, any net increase in domestic payment arrears during 1984 will be added to the total of net indebtedness.
8/ When testing against these limits in the course of 1984, foreign exchange transactions are accounted for at the average buying rate in the unified exchange market for the month in which the transactions take place.
9/ Defined as the difference between the foreign assets of the Central Reserve Bank and the sum of its external liabilities with original maturity of less than one year, and those with original maturity of one year or more which constitute balance of payments support loans.
10/ Defined as the sum of gross short-, medium-, and long-term foreign liabilities of the Banco de la Nacion and COFIDE.
11/ Defined to include contracting or guaranteeing since January 1, 1984 of external debt by the nonfinancial public sector, COFIDE, and the official banking system except for loans classified as reserve liabilities of the Central Reserve Bank. The contracting limits include refinancing loans on public sector debt service payments to all foreign creditors.

inconsistent with Article VIII, and the imposition or intensification of import restrictions for balance of payments reasons; (2) a review with the Fund before October 1, 1984 on the progress made in implementing the program; and (3) the reaching of understandings with the Fund before December 31, 1984 on the policies and performance criteria relating to the remaining period of the stand-by arrangement.

IV. Staff Appraisal

Performance under the extended arrangement, which entered into effect in June 1982, has been well below expectations. By the end of 1983 deviations from the program had become so substantial that the possibility of attaining the program's objectives in the remaining period of the arrangement had become remote.

In early 1983 Peru suffered a series of natural disasters which affected adversely a number of sectors of the economy and contributed to a sharp contraction of real GDP. Foreign demand for Peru's exports turned weak and access to international capital markets continued to be difficult. These factors, together with a deterioration in revenue administration, additional public outlays for relief operations, defense and internal security, and lags in the adjustment of certain regulated prices, widened the deficit of the nonfinancial public sector to more than 10 percent of GDP in 1983, compared with a limit of about 4 percent of GDP. The public sector's heavy financing requirements led to a crowding out of the private sector and a larger than programmed credit expansion by the monetary authorities. As a consequence of these developments, inflation accelerated to 125 percent and the net official international reserves declined by US$664 million.

The authorities' program for the period through July 1985 seeks a substantial reduction in internal and external imbalances through a major correction of fiscal, monetary, and incomes policies together with the pursuit of flexible exchange rate and interest rate policies. In addition, the program incorporates a number of structural measures to improve the efficiency of the economy over the medium term.

The major factor behind the imbalances in the Peruvian economy and deviations from the economic program during 1982 and 1983 was the large deficit of the nonfinancial public sector. Thus, the authorities' new program incorporates a major fiscal adjustment that is based on a strengthening of revenue and spending restraint. The principal revenue measures of the program, involving major tax increases and adjustments of controlled prices, have already been put into place. However, the staff would emphasize that controlled prices and tariffs will need to be raised frequently during the year and tax administration must be improved substantially if the revenue increases that are planned are to be achieved.

A strict public spending policy is the other main ingredient in the fiscal plan. Wage policy in the public sector is to be restrained in relation to inflation; spending on goods and nonwage services, in particular in the area of defense, is to be reduced in relation to 1983, and public investment is to be limited to projects with the highest priority. Implementation of the spending plan will require that the authorities strengthen further the monitoring and control system put in place in the course of 1983, in particular with respect to the operations and capital outlays of the public enterprises.

The monetary program for 1984 is designed to protect the level of official net international reserves and contribute to the deceleration of inflation. This program seeks to ensure a flow of credit adequate to finance the activities of the private sector so long as the public sector deficit is held down as planned.

The policies of fiscal and monetary restraint described above need to be accompanied by a realistic exchange rate and interest rate policies if the objectives of the program are to be achieved. The recent abandonment of the policy of preannouncing the exchange rate and the return to a flexible exchange rate policy, along with the introduction of a new saving instrument with a market-determined rate of discount, constitute important steps in the right direction. The staff notes the existence of a second exchange market for dollar certificates of deposit used for capital transactions and would encourage the authorities to reassess the continued need for this market in the context of a credible exchange system. Peru maintains a system free of restrictions on payments and transfers for current international transactions, with the exception of the restriction that remains pending the conclusion of the agreements with the creditors. Agreement in principle has already been reached with these creditors, which points to the temporary character of this restriction; therefore, the staff recommends its approval. The staff would urge the authorities to continue to avoid new barriers to trade and further protection to domestic industry.

A key objective of the program is a reduction in the rate of inflation; however, the adjustment of controlled prices to realistic levels and the return to exchange rate flexibility may well give rise to a high rate of price increase in the short run. Thereafter, the success achieved in reducing inflation will depend fundamentally on the quality of the demand and wage policies pursued. The staff is satisfied that the demand policies described above should contribute to a lowering of inflationary pressures. Also, it welcomes the authorities' intention to pursue a restrained wage policy in the public sector as a means of influencing wage agreements in the private sector. The staff would urge the authorities to avoid authorizing general wage increases or bonuses to the private sector with a view to ensuring that private wages do not move out of line with those for public employees.

The staff welcomes the authorities' adoption of policy of reducing foreign market borrowing and of relying increasingly on resources from multilateral agencies and other sources, since this strategy should make it possible to improve the country's debt structure over the medium term. In view of the projected heavy principal payments in 1985 and subsequent years, the staff would encourage the authorities to continue to seek the necessary understandings with Peru's main foreign creditors that would facilitate an orderly settlement of future principal payments.

In summary, for the third consecutive year, the authorities of Peru have presented a program which calls for a major reduction in the financing requirement of the nonfinancial public sector as the means of reducing internal and external imbalances. It is to be noted that the record of performance over the last two years has been disappointing. The staff is aware that adverse external factors in 1983 rendered economic management difficult, but inadequate implementation of domestic policies accounts for a good deal of the unfavorable results obtained in the recent past.

An important feature of the program the authorities now propose to adopt is that certain major revenue measures and corrective price increases have already been put in place. Even so, the program entails considerable risks in that it also relies on major spending restraint that must be implemented on a continuing basis in the course of the program; therefore, close monitoring of policy implementation will be required to ensure that the revenue effort is maintained and that the planned public spending restraint is carried out.

In view of the difficulties experienced in previous years in regard to the availability of accurate information needed to monitor progress under the economic program, the staff urges the authorities to improve the flow of data to help ensure success in their economic management. Given the need to avoid slippages, the staff would urge the authorities to give particular attention to the consultation provisions under the stand-by arrangement to ensure that timely understandings are reached regarding any additional measures that may be needed to achieve the objectives of the program.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Government of Peru has requested a stand-by arrangement for the period from April 6, 1984 through July 1985 in an amount equivalent to SDR 250 million.

2. The Fund notes that the Government of Peru wishes to cancel the extended arrangement approved on June 7, 1982, as of the date on which the requested stand-by comes into force.

3. The Fund approves the stand-by arrangement attached to EBS/84/57.

4. The Fund waives the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement.

5. Pending the conclusion of agreements for the rescheduling of Peru's external debt, the Fund grants approval of the restriction on the making of payments and transfers for current international transactions maintained by Peru, described in EBS/84/57.

Peru - Fund Relations
(As of February 29, 1984, unless otherwise indicated)

I. Membership Status

(a) Date of membership: December 31, 1945.
(b) Status: Article VIII.

(A) Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 330.9 million.

(b) Total Fund holdings of soles: SDR 949.9 million or 287.1 percent of quota.

(c) Fund credit:
Of which:

	Amount	Percent of Quota
Fund credit	640.2	193.5
Compensatory financing	(199.9)	(60.4)
Stand-by	(41.9)	(12.7)
Extended Fund facility	(211.1)	(63.8)
Supplementary financing	(142.9)	(43.2)
Enlarged access resources	(53.9)	(16.3)

(d) Reserve tranche position: SDR 21.2 million.

III. Proposed Stand-by Arrangement and Special Facilities

(a) Proposed stand-by arrangement:

(i) Duration: From April 1984 through July 1985.
(ii) Amount: SDR 250 million or 75.6 percent of quota.
(iii) Utilization: Not used.
(iv) Undrawn balance: SDR 250 million.

(b) Previous stand-by and extended arrangements during the last 10 years:

(i) 1982 extended arrangement:

Duration: From June 7, 1982 to May 1985. The Peruvian authorities wish to cancel this arrangement as of the date the proposed stand-by comes into force.

Amount: SDR 650 million.

Utilization:	Cumulative	SDR 265 million
	1983	SDR 165 million
	1982	SDR 100 million

Undrawn balance: SDR 385 million.

(ii) 1979 Stand-by Arrangement.

Duration: From August 1979 to December 1980.

Amount: SDR 285 million.

Utilization: SDR 285 million.

(iii) 1978 Stand-by Arrangement.

Duration: Initially requested to cover the period from September 1978 to December 1980, was canceled in August 1979 by request of the Peruvian authorities.

Amount: SDR 184 million.

Utilization: SDR 64 million.

(iv) 1977 Stand-by Arrangement.

Duration: From November 1977 to August 1978. The request covered the period through December 1979 but was later shortened by request of the authorities.

Amount: SDR 90 million.

Utilization: SDR 10 million.

(c) Special facilities: The authorities are shortly expected to request a purchase of SDR 74.8 million under the compensatory financing facility (exports). Outstanding purchases under the compensatory financing facility amount to SDR 199.9 million or 60.4 percent of quota.

IV. SDR Department

(a) Net cumulative allocation: SDR 91.3 million.

(b) Holdings: SDR 1.3 million or 1.4 percent of net cumulative allocations.

(c) Current designation plan: None.

B. Nonfinancial Relations

V. Exchange rate: February 29, 1984, S/. 2,482.6 per U.S. dollar. The exchange rate for the sol in the official market is adjusted on almost a daily basis, and the regime is classified as other managed floating. Transactions with certificates of deposit denominated in dollars provide a parallel market with a market-determined exchange rate. As of January 31, 1984, this certificate rate was 9.1 percent above the official rate. The representative rate for the sol is the midpoint between buying and selling rates in the official market. Since April 30, 1983 the Fund's holdings of soles have been accounted for at the rate of SDR 0.000687979 per sol, or S/. 1,453.53274 per SDR. Peru maintains an exchange system free of restrictions on payments and transfers for current international transactions, other than those that remain pending conclusion of the final agreements with the various creditors.

VI. Last Article IV Consultation: The 1983 Article IV consultation discussion was completed on November 28, 1983 (EBS/83/236 and SM/83/235). The consultation is under the normal 12-month cycle.

VII. Technical Assistance: The Central Banking Department provided a consultant on central bank administration and control procedures during the periods June 1-December 15, 1981 and April 5, 1982-April 4, 1983. The same consultant has been reassigned for a period of six months beginning November 1983 to follow-up on the implementation of the administrative reform. A staff member of the same department is currently assigned in Lima as a senior advisor to the Central Reserve Bank in matters relating to the administrative and monetary reforms. His assignment covers a period of one year beginning August 1983.

The Fiscal Affairs Department has assigned three panel members that have provided assistance to the authorities in various periods. One of the panelists served as a consultant on the implementation of the value added tax in early 1982. Another one was assigned in 1983 to provide assistance on the design and implementation of control procedures of the value added tax. The third one, still on assignment, is assisting the authorities with procedures designed to control tax collections. In March 1984 an in-depth review of the tax system was initiated with technical assistance provided by the Fiscal Affairs Department and two panelists.

The Bureau of Statistics has recently provided technical assistance to the Central Reserve Bank on the sectorization of the monetary accounts.

VIII. Resident Representative: Mr. Waldemar de Moraes has been assigned for a two-year appointment beginning January 1984.

Peru--Basic Data

Area and population	
Area	1,280,000 sq. kilometers
Population (end of 1982)	18.8 million
Annual rate of population increase (1978-82)	2.8 percent
Unemployment rate (September 1983; Lima Metropolitan Area)	8.8 percent
GDP (1983)	SDR 14.98 billion
	US$16.02 billion
	S/. 26,089.1 billion
GDP per capita (1983)	SDR 775

Origin of GDP	1980	1981	1982	Proj. 1983
		(percent)		
Agriculture & Fishing	13	14	14	14
Mining	9	9	9	9
Manufacturing	25	24	23	22
Construction	5	5	6	5
Government	8	8	8	8
Other	40	40	40	42
Ratios to GDP				
Exports of goods and services	28.9	22.1	22.0	23.2
Imports of goods and services	29.5	30.8	30.3	28.7
Current account of the balance of payments	-0.6	-8.7	-8.1	-5.5
Central administration revenues	20.5	18.1	18.1	13.9
Central administration expenditures	23.4	23.0	22.1	18.2
Nonfinancial public sector savings	2.0	0.9	0.2	-2.9
Nonfinancial public sector overall surplus or deficit (-)	-6.4	-8.4	-8.6	-10.3
External public debt (end of year)	35.1	31.4	34.9	51.3
Gross national savings	17.1	13.4	11.7	11.8
Gross domestic investment	17.7	22.1	20.0	17.3
Money and quasi-money (end of year)	25.0	26.1	27.8	28.9
Annual changes in selected economic indicators				
Real GDP per capita	0.2	0.3	-2.1	-13.4
Real GDP	3.0	3.1	0.7	-11.0
GDP at current prices	61.7	69.7	63.4	88.9
Domestic expenditures (at current prices)	74.4	85.4	62.7	88.8
Investment	95.8	112.2	47.7	50.6
Consumption	70.2	79.3	66.8	98.9
GDP deflator	57.0	64.6	62.3	112.2
Cost of living (annual averages)	60.8	72.7	72.9	111.1
Central administration revenues	84.6	49.5	63.7	45.6
Central administration expenditures	103.3	67.1	56.8	84.0
Money and quasi-money	93.9	76.7	74.1	97.2
Money	71.3	48.4	35.8	92.4
Quasi-money	116.0	98.6	96.2	99.1
Net domestic bank assets 1/	60.8	93.8	75.0	123.3
Credit to public sector (net)	24.8	30.4	15.4	87.2
Credit to private sector	55.7	67.4	74.9	86.1
Merchandise exports (f.o.b., in U.S. dollars)	6.5	-17.0	1.4	-8.4
Merchandise imports (f.o.b., in U.S. dollars)	58.1	23.0	-0.4	-27.0

Central administration finances	1980	1981	1982	Proj. 1983
	(billions of soles)			
Revenues	1,019	1,523	2,493	3,629.0
Expenditures	1,160	1,938	3,038	5,591.1
Current account surplus or deficit (-)	121	19	5	-1,131.1
Overall deficit (-)	-141	-415	-545	-1,962.1
External financing (net)	23	-9	407	1,655.0
Internal financing (net)	118	424	138	307.1
Balance of payments	(millions of U.S. dollars)			
Merchandise exports, f.o.b.	3,916	3,249	3,293	3,015
Merchandise imports, f.o.b.	-3,090	-3,802	-3,721	-2,715
Investment income (net)	-909	-1,019	-1,034	-1,152
Other services and transfers (net)	-18	-156	-147	-30
Balance on current and transfer accounts	-101	-1,728	-1,609	-882
Official capital (long-term net)	371	388	995	1,305
Private capital (long-term net)	91	260	205	-61
Short-term capital and errors and omissions (net)	386	448	593	-1,026
Allocation of SDRs	23	21	--	--
Change in net official reserves (increase -)	-770	611	-184	664 2/

International reserve position	Dec. 31 1981	Dec.31 1982	Dec. 31 1983
	(millions of SDRs)		
Monetary authorities (gross)	1,308.2	1,510.4	1,597.3
Monetary authorities (net)	495.0	689.2	139.6 2/
Rest of banking system (net)	55.7	13.9	-154.0 2/

1/ Based on data at end-of-period exchange rates and calculated in relation to the stock of money and quasi-money at the beginning of the period. Excludes contra-entry of SDR allocations.

2/ Includes the assumption of guaranteed short-term foreign debt by domestic banks as provided by the agrement with foreign commercial banks.

Summary of the Financial Program for the First Period of the Standy-By Arrangement

I. Major Assumptions

1. Real GDP is estimated to grow by 4 percent in 1984 reflecting a strong recovery of agriculture and fishing and moderate growth in the mining and manufacturing sectors. A growth rate of 4 percent is also projected for 1985.

2. The U.S. dollar value of exports is estimated to increase by 3.8 percent in 1984 and by 10.6 percent in 1985, while the corresponding value of imports is expected to decline by 5.6 percent in 1984 and then to increase by 6.9 percent in 1985. Terms of trade are anticipated to improve slightly by 0.4 percent in 1984 and to improve further by 1 percent in 1985.

3. During 1984 the real stock of money and quasi-money is projected to increase by 4 percent. Accordingly, the ratio of money and quasi-money in relation to GDP is expected to remain constant at 29 percent.

II. Targets

1. The consumer price index is expected to increase by 70 percent in 1984. This result is to be achieved by lowering the monthly inflation rate from about 7 percent during the first quarter of the year to about 3 1/2 percent in the final quarter of the year.

2. The overall balance of payments is expected to be in equilibrium in 1984 and 1985. The overall balance of payments outcome is measured in terms of changes in the net international reserves of the Central Reserve Bank.

3. The current account deficit of the balance of payments is expected to decline from 5.5 percent of GDP in 1983 to 5 percent in 1984 and 4.3 percent in 1985.

III. Principal Elements of the Program for 1984

1. Fiscal policy

The overall deficit of the nonfinancial public sector is to be reduced by the equivalent of 6.5 percentage points of GDP to 3.8 percent. The reduction rests on the implementation of an austere expenditure plan and a set of revenue measures.

The main discretionary measures accounting for the improvement in the nonfinancial public sector's performance are:

Measure	Impact as a Percent of GDP
1. Revenue measures:	2.9
(a) Tax increases	(2.0)
(i) Taxes on goods and services	/1.7/
(ii) Import taxes	/0.3/
(b) Pricing policies regarding oil derivatives, rice, and electricity	(0.9)
2. Expenditure measures:	3.7
(a) Central administration current expenditure cuts	(2.8)
(i) Tight wage policy	/0.9/
(ii) Reduction in military outlays	/1.6/
(iii) Other cuts	/0.3/
(b) Cuts in investment expenditure	(0.9)
(i) Central Administration	/0.3/
(ii) Rest of nonfinancial public sector	/0.6/
Total	6.5

To allow for an increase in real credit to the private sector, the deficit of the nonfinancial public sector will be financed without any recourse to net domestic credit. To monitor fiscal performance, quarterly limits on the use of net credit from all sources have been established as performance criteria.

2. Monetary policy

a. Total net domestic assets of the Central Reserve Bank over the program year are projected to decline by S/. 10 billion, equivalent to about 1 percent of the end of 1983 currency stock. Net domestic assets of the banking system are estimated to increase by 84 percent in relation to the initial stock of liabilities to the private sector with credit to the private sector accounting for all of the increase. As performance criterion, the financial program includes a set of limits on the net domestic assets of the Central Reserve Bank which are subject to continuous testing.

b. To help defend the balance of payments and promote savings, the program contemplates the introduction of sol-denominated certificates of deposit with a freely negotiated discounted rate of return. In addition, the Central Reserve Bank will redirect the resources available in the blocked accounts to the rest of the domestic financial system at market-determined interest rates.

3. External sector policies

a. Beginning March 1, 1984 exchange rate policy is to be conducted by depreciating the sol on a daily basis without preannouncement at least in line with inflation. To help guide monetary and exchange rate policy, quarterly targets on the net international reserves of the Central Reserve Bank have been set as performance criterion.

b. To keep the size of the external debt in check, external borrowing commitments with maturities of one to twelve years are to be limited to US$1.66 billion with a subceiling of US$200 million on maturities of one to five years. In addition, a set of quarterly limits has been placed on the gross foreign liabilities of the Banco de la Nacion and COFIDE, the legally designated fiscal agents for the external borrowing by the nonfinancial public sector.

c. The program contains the usual nonquantitative performance clauses with respect to the exchange and trade system and includes a midyear review with the Fund by October 1, 1984, and the reaching of understandings by December 31, 1984 on the policies and performance criteria relating to the program period in 1985.

Table 9. Peru: Selected Economic and Financial Indicators, 1981-84

	1980	1981	1982	Proj. 1983	Prog. 1984
(Annual percent changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	3.1	2.7	0.6	-11.0	4.0
GDP deflator	57.0	64.6	62.3	112.2	91.5
Consumer prices (end of year)	59.2	72.7	72.9	125.1	70.0
External sector (on the basis of U.S. dollars)					
Exports, f.o.b.	11.7	-17.0	1.4	-8.4	3.8
Imports, f.o.b.	57.0	23.0	-0.4	-27.0	-5.6
Non-oil imports, f.o.b.	56.4	24.6	-0.8	-27.0	-5.6
Export volume	-10.3	-3.4	16.3	-7.5	-4.3
Import volume	39.4	21.2	-1.1	-28.0	-3.9
Terms of trade (deterioration -)	9.7	-15.3	13.7	3.8	0.4
Nominal effective exchange rate (depreciation -)(end of year)	-23.5	-22.9	-39.5	-50.0	-41.2
Real effective exchange rate (depreciation -)(end of year)	5.0	15.2	-7.2	-2.4	--
Central administration budget					
Revenue and grants	84.6	49.5	63.7	45.6	127.3
Total expenditure	103.3	67.1	56.8	84.0	70.6
Money and credit 1/					
Domestic credit 2/ 3/	65.8	85.1	61.3	123.3	83.8
Public sector (net) 3/	59.5	30.4	15.4	87.2	-8.2
Private sector (gross) 3/	76.6	67.4	74.9	86.1	83.1
Money and quasi-money (M2)	85.8	76.7	74.1	97.2	76.8
Velocity (GDP relative to M2)	4.0	3.8	3.6	3.5	3.9
Interest rate (effective annual rate on three-month time deposit)	34.8	62.3	71.2	79.6	... 4/
(In percent of GDP)					
Nonfinancial public sector deficit (-)	-5.7	-8.4	-8.6	-10.3	-3.8
Central administration savings	2.4	0.2	--	-4.3	0.4
Central administration budget deficit (-)	-2.8	-4.9	-4.0	-7.5	-2.5
Domestic financing	0.6	5.0	1.0	6.3	3.5
Foreign financing	2.2	-0.1	3.0	1.2	-1.0
Gross domestic investment	17.7	22.1	20.0	17.3	18.1
Gross national savings	18.1	13.4	11.7	11.8	13.1
Current account deficit (-)	0.4	-8.7	-8.3	-5.5	-5.0
External debt inclusive of use of Fund credit (end of year)	56.1	49.5	56.2	77.5	77.1
Debt service ratio 5/	9.9	11.7	9.5	13.2	
Interest payments (in percent of exports of goods and nonfactor services) 5/	16.0	21.7	24.5	21.0	26.5
(In millions of SDRs, unless otherwise specified)					
Overall balance of payments	519.0	-500.3	122.2	-634.2	--
Gross official reserves (months of imports)	9.8	5.2	5.2	7.4	7.8
External payments arrears	--	--	--	--	--

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

1/ In this subsection foreign currency denominated balances are valued at end-of-period exchange rates.
2/ Includes other assets and liabilities.
3/ Change in relation to the stock of liabilities to the private sector at the beginning of the period.
4/ Market-determined rates were introduced in January 1984.
5/ Debt service on medium- and long-term private and public debt, including IMF, plus interest payments on short-term debt.

Table 10. Peru: Macroeconomic Flows

(In percent of GDP)

	1980	1981	1982	1983 Prog.	1983 Proj.	1984 Prog.
I. Balance of Payments						
Current account balance	-0.6	-8.7	-8.3	-5.2	-5.5	-5.0
Trade balance	4.8	-2.8	-2.5	1.4 1/	2.0	3.4
Factor payments	-5.3	-5.1	-5.1	-7.1	-7.2	-8.5
Other services and transfers	-0.1	-0.8	-0.7	0.5	-0.3	-0.1
Capital account	5.1	5.6	9.2	4.2	1.3	5.0
Private capital 2/	3.0	4.5	1.4	1.0	6.8	0.2
Nonfinancial public sector	2.1	1.1	7.8	3.2	8.1	4.8
Change in net official international reserves (increase -)	-4.5	3.1	-0.9	1.0	4.2	--
II. Nonfinancial Public Sector 3/						
Central Administration						
Current account	2.4	0.2	0.1	0.5	-4.3	0.4
Revenues	(20.5)	(18.1)	(18.1)	(16.1)	(13.9)	(15.8)
Expenditures	(18.1)	(-17.9)	(-18.0)	(-15.6)	(-18.2)	(-15.4)
Rest of nonfinancial public sector's operating surplus	-0.4	0.7	0.1	2.3	1.4	2.2
Nonfinancial public sector savings	2.0	0.9	0.2	2.8	-2.9	2.6
Less: Fixed investment	7.3	9.2	8.7	6.9	7.4	6.4
Other capital expenditures	1.1	0.1	0.1	--	--	--
Overall deficit	-6.4	-8.4	-8.6	-4.1	-10.3	-3.8
Net foreign financing	2.1	1.1	7.8	3.2	8.1	4.8
Net domestic financing	4.3	7.3	0.8	0.9	2.2	-1.0
III. Savings and Investment						
Fixed capital formation	17.7	22.1	20.0	17.5	17.3	18.1
Nonfinancial public sector	7.3	9.2	8.7	6.9	7.4	6.4
Private sector 4/	10.4	12.9	11.3	10.6	9.9	11.7
Investment = savings	17.7	22.1	20.0	17.5	17.3	18.1
External savings	0.6	8.7	8.3	5.2	5.5	5.0
National savings	17.2	13.4	11.7	12.3	11.8	13.1
Nonfinancial public sector	(2.0)	(0.9)	(0.2)	(2.8)	(-2.9)	(2.6)
Private sector	(15.2)	(12.5)	(11.5)	(9.5)	(14.7)	(10.5)
Memorandum items						
Nominal GDP						
In billions of Peruvian soles	4,962.0	8,423.0	13,767.0	25,295.0	26,089.0	51,960.0
In billions of U.S. dollars	17.2	19.8	19.8	17.9	16.0	16.9

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

1/ Includes US$146 million of refinanced interest payments.
2/ Includes net borrowing by the financial public sector, net errors and omissions, and movements in nonofficial reserves.
3/ Includes CENTROMIN and Tintaya.
4/ Includes inventory changes.

Table 11. Peru: Net International Reserves of the Banking System

(In millions of U.S. dollars)

	December 31				1983			
	1979	1980	1981	1982	March 31	June 30	Sept. 30	Dec. 31
Central Reserve Bank	386.4	1,408.1	715.3	793.2	464.1	759.1	587.4	535.4 3/
Assets	1,260.9 1/	2,140.8 2/	1,134.3	1,521.3	1,368.8	1,905.1	1,701.9	1,597.4
Liabilities	-874.5	-732.7	-419.0	-728.1	-904.7	-1,146.0	-1,114.5	-1,062.0 3/
To IMF	(-519.9)	(-558.7)	(-385.7)	(-649.5)	(-610.4)	(-702.3)	(-724.5)	(-697.6)
Other	(-354.6)	(-174.0)	(-33.3)	(-78.6)	(-294.3)	(-443.7)	(-390.0)	(-364.4)
Banco de la Nacion	30.5	-220.6	-139.1	-33.0	-181.4	-259.5	-192.7	-389.2 4/
Assets	406.1	229.2	388.5	144.7	36.5	11.6	49.6	75.0
Liabilities	-375.6	-449.8	-527.6	-177.7	-217.9	-271.1	-242.3	-464.2 4/
Net official international reserves	416.9	1,187.5	576.2	760.2	282.7	499.6	394.7	146.2 3/4/
Assets	1,667.0	2,370.0	1,522.8	1,666.0	1,405.3	1,916.7	1,751.5	1,672.4
Liabilities	-1,250.1	-1,182.5	-946.6	-905.8	-1,122.6	-1,417.1	-1,356.8	-1,526.2 3/4/
Specialized banks	26.5	15.6	24.3	-58.6	-51.3	-72.0	-53.0	30.8
Assets	33.8	46.7	46.0	57.6	62.6	45.8	58.4	71.4
Liabilities	-7.3	-31.1	-21.7	-116.2	-113.9	-117.8	-111.4	-40.6
Commercial banks	80.6	28.2	40.5	73.9	-99.5	-403.8	-251.9	-131.6
Assets	127.5	89.2	133.9	167.4	131.1	138.0	193.7	190.3
Liabilities	-46.9	-61.0	-93.4	-93.5	-230.6	-541.8	-455.6	-321.9
Net international reserves of the banking system	524.0	1,231.3	641.0	775.5	131.9	23.8	89.8	45.4 3/4/
Assets	1,828.3	2,505.9	1,702.7	1,891.0	1,599.0	2,100.5	2,003.6	1,934.1
Liabilities	-1,304.3	-1,274.6	-1,061.7	-1,115.5	-1,467.1	-2,076.7	-1,913.8	-1,888.7 3/4/

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

1/ Includes a gold valuation gain of US$39.4 million during the year.
2/ Includes a gold valuation gain of US$128.2 million during the year.
3/ Includes a reduction of US$50 million in liabilities to Arlabank which were assumed in 1983 by the Central Administration.
4/ Includes the assumption by the Banco de la Nacion of US$87 million in direct liabilities as a consequence of Exchange Resolution 002/83.

Table 11. Peru: Medium-Term Balance of Payments, 1983-89

	1983	1984	1985	1986	1987	1988	1989
	(In billions of U.S. dollars)						
Current account	-0.9	-0.9	-0.8	-0.7	-0.6	-0.5	-0.5
Merchandise trade	0.3	0.5	0.7	0.8	0.9	1.0	1.1
Factor services	-1.2	-1.4	-1.5	-1.5	-1.5	-1.5	-1.6
Nonfactor services	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Transfers	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Capital account	0.1	0.9	0.8	0.7	0.6	0.5	0.5
Direct investment	--	--	--	--	--	--	--
Amortization	-1.1	-1.4	-1.2	-1.4	-1.5	-1.4	-1.5
Of which: to banks	(-0.3)	(-0.4)	(-0.3)	(-0.4)	(-0.5)	(-0.5)	(-0.5)
Medium-term capital inflows	2.4	2.3	2.0	2.1	2.1	1.9	2.0
Short-term capital inflows	-1.2	--	--	--	--	--	--
Overall balance	-0.8	--	--	--	--	--	--
	(As percent of GDP)						
Memorandum items							
Current account	-5.5	-5.0	-4.3	-3.7	-3.0	-2.4	-2.1
Interest payments	5.0	6.3	6.2	6.1	6.1	5.8	5.7
Disbursed external debt (end of year)	77.5	77.1	77.8	77.8	77.3	76.0	74.8

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

Table 13. Peru: Total Disbursed External Debt Outstanding

(In millions of U.S. dollars)

End of Period	1980	1981	1982	1983	Proj. 1984
Total external debt	9,594	9,842	11,079	12,484	13,183
Medium- and long-term debt 1/	8,125	8,172	9,261	10,993	11,692
Public sector debt	6,043	6,210	6,908	8,213	...
Central Reserve Bank 2/	710	455	689	1,177	...
Private debt	1,372	1,507	1,664	1,603	...
Short-term debt	1,469	1,670	1,818	1,491	1,491
Central Reserve Bank	25	24	39	--	...
Banco de la Nacion	450	528	178	242 3/	...
Other banks 4/	92	115	209	557 3/	...
Other credits guaranteed by the banking system	902	1,003	1,392	692	...
Memorandum item					
Total external debt in relation to GDP	56.1	49.5	56.2	77.5	77.1

Sources: Central Reserve Bank of Peru; General Directorate of Public Credit; and Fund staff estimates.

1/ With an original maturity of at least one year.
2/ Includes liabilities to the IMF and to the Andean Reserve Fund.
3/ Includes US$27 million (Banco de la Nacion) and US$339 million (other banks) of private sector debt assumed by the banking system in accordance with Exchange Resolution 002. These obligations were included in other credits guaranteed by the banking system in earlier periods.
4/ Commercial and specialized banks.

Table 14. Peru: Summary Accounts of the Banking System

(In billions of soles)1/

	Dec. 1982			Mar. 1983			Jun. 1983		
	Domestic Currency	Foreign Currency	Total	Domestic Currency	Foreign Currency	Total	Domestic Currency	Foreign Currency	Total
A. Central Reserve Bank									
Net international reserves	--	785.0	785.0	--	574.9	574.9	--	1,204.1	1,204.1
Medium- and long-term foreign assets	-3.0	51.9	48.9	-6.7	64.9	58.2	-9.7	14.1	4.4
Net domestic assets	643.0	-816.9	-173.9	656.7	-602.8	53.1	678.4	-1,170.1	-491.7
Credit to nonfinancial public sector (net)	518.0	-18.0	500.0	518.4	-33.7	484.7	518.6	-347.6 2/	171.0 2/
Credit to banks (net)	8.0	-801.0	-793.0	333.4	-934.0	-600.6	390.3	-1,106.3	-716.0
Other assets (net)	117.0	2.1	119.1	-195.1	364.9	169.8	-230.5	283.8	53.3
Liabilities to private sector	640.0	20.0	660.0	650.0	37.0	687.0	668.7	48.1	716.8
Money	640.0	--	640.0	650.0	--	650.0	668.7	--	668.7
Quasi-money	--	20.0	20.0	--	37.0	37.0	--	48.1	48.1
B. Central Reserve Bank and Banco de la Nacion 4/									
Net international reserves	--	751.8	751.8	--	350.3	350.3	--	792.4	792.4
Medium- and long-term foreign assets	-3.0	-79.0	-82.0	-6.7	-70.8	-77.5	-9.8	-158.0	-167.8
Net domestic assets	662.0	-532.8	129.2	677.3	-126.0	551.3	704.6	-460.1	244.5
Credit to nonfinancial public sector (net)	498.0	190.0	688.0	664.9	281.0	945.9	511.6	124.9 2/	636.5 2/
Credit to banks (net)	94.0	-772.0	-678.0	267.5	-821.9	-554.4	398.1	-1,006.4	-608.3
Other assets (net)	70.0	49.2	119.2	-255.1	414.9	159.8	-205.1	421.4	216.3
Liabilities to private sector	659.0	140.0	799.0	670.6	153.5	824.1	694.8	174.3	869.1
Money	653.0	--	653.0	663.0	--	663.0	685.0	--	685.5
Quasi-money	6.0	140.0	146.0	7.6	153.5	161.1	9.0	174.3	183.3
C. Banking System									
Net international reserves	--	767.7	767.7	--	163.5	163.5	--	37.6	37.6
Medium- and long-term foreign assets	--	-282.1	-282.1	-23.6	-296.0	-319.6	-28.2	-449.5	-477.7
Net domestic assets	2,343.0	1,000.4	3,343.4	2,472.6	1,914.6	4,382.7	2,657.6	2,540.4	5,198.0
Credit to nonfinancial public sector (net)	669.0	241.0	910.0	812.4	444.6	1,257.0	644.1	440.8 2/	1,084.9 2/
Credit to banks (net)	2,106.0	1,000.0	3,106.0	2,485.4	1,341.1	3,826.5	2,794.7	1,941.8	4,736.5
Other assets (net)	-432.0	-240.6	-672.6	-825.2	128.9	-696.3	-781.2	157.8	623.4
Liabilities to private sector	2,343.0	1,486.0	3,829.0	2,449.0	1,782.1	4,231.1	2,629.4	2,128.5	4,757.9
Money	1,092.0	--	1,092.0	1,162.4	--	1,162.4	1,165.0	--	1,165.0
Quasi-money	1,251.0	1,486.0	2,737.0	1,286.6	1,782.1	3,068.7	1,464.4	2,128.5	3,592.9
Memorandum item									
Exchange rate (soles per US$)		989.67			1,238.57			1,585.96	

Table 14. Peru: Summary Accounts of the Banking System (Concluded)

(In billions of soles)1/

	Sept. 1983			Dec. 1983			Dec. 1984		
	Domestic Currency	Foreign Currency	Total	Domestic Currency	Foreign Currency	Total	Domestic Currency	Foreign Currency	Total
A. Central Bank									
Net international reserves	--	1,198.1	1,198.1	--	1,216.3 4/	1,216.3 4/	--	2,061.7	2,061.7
Medium- and long-term foreign assets	-7.0	100.8	93.8	-29.0	111.3	82.3	-29.0	188.7	159.7
Net domestic assets	908.0	-1,225.9	-317.9	1,178.5	-1,273.8	-95.3	2,056.5	-2,159.0	-102.5
Credit to nonfinancial public sector (net)	524.0	-30.0	494.0	2,866.3	-55.8	2,810.5	2,866.3	-4,200.4	-1,334.1
Credit to banks (net)	776.0	-1,736.0	-960.0	288.2	-1,836.6	-1,548.4	4,084.2	-3,113.2	971.0
Other assets (net)	-392.0	540.1	148.1	-1,976.0	618.6	-1,357.4	-4,894.0	5,154.6	260.6
Liabilities to private sector	901.0	73.1	974.1	1,149.5	53.9	1,203.4	2,027.5	91.4	2,118.9
Money	901.0	--	901.0	1,149.5	--	1,149.5	2,027.5	--	2,027.5
Quasi-money	--	73.1	73.1	--	53.9	53.9	--	91.4	91.4
B. Central Reserve Bank and Banco de la Nacion 3/									
Net international reserves	--	805.2	805.2	--	332.0 4/	332.0 4/	...	...	...
Medium- and long-term foreign assets	-7.0	-136.2	-143.2	-29.1	-156.1	-185.2	...	...	...
Net domestic assets	944.0	-397.0	547.0	1,225.3	182.0	1,407.3	...	...	...
Credit to nonfinancial public sector (net)	921.0	467.0	1,388.0	2,759.8	1,035.9	3,795.7	...	...	...
Credit to banks (net)	375.0	-1,473.0	-1,098.0	459.1	-1,706.5	-1,247.4	...	...	...
Other assets (net)	-352.0	609.0	257.0	-1,993.6	852.6	-1,141.0	...	...	...
Liabilities to private sector	937.0	272.1	1,209.1	1,196.2	357.9	1,554.1	...	...	...
Money	925.0	--	925.0	1,171.4	--	1,171.4	...	...	...
Quasi-money	12.0	272.1	284.1	24.8	357.9	382.7	...	...	...
C. Banking System									
Net international reserves	--	182.5	182.5	--	98.4 4/	98.4 4/	--	166.8	166.8
Medium- and long-term foreign assets	-27.0	-510.1	-537.1	-54.2	-556.5	-610.7	-54.2	-1,155.2	-1,209.4
Net domestic assets	3,374.0	3,204.5	6,578.5	4,221.1	3,843.1	8,064.2	7,670.1	6,726.4	14,396.5
Credit to nonfinancial public sector (net)	1,047.0	769.0	1,816.0	2,870.7	1,376.4	4,247.1	5,401.7	-1,772.7	3,629.0
Credit to banks (net)	3,385.0	2,401.0	5,786.0	4,087.2	2,324.0	6,411.2	8,422.2	4,266.7	12,688.9
Other assets (net)	-1,058.0	34.5	-1,023.5	-2,736.8	142.7	-2,594.1	-6,153.8	4,232.4	-1,921.4
Liabilities to private sector	3,347.0	2,876.9	6,223.9	4,166.9	3,385.1	7,552.0	7,615.9	5,738.0	13,353.9
Money	1,678.0	--	1,678.0	2,101.5	--	2,101.5	...	--	...
Quasi-money	1,669.0	2,876.9	4,545.9	2,065.4	3,385.1	5,450.5	...	5,738.0	...
Memorandum item									
Exchange rate (soles per US$)		2,041.09			2,272.17			3,851.55	

Sources: Central Reserve Bank; and Fund staff estimates.

1/ Foreign currency accounts valued at end of period exchange rates.
2/ Reflects US$200 million of bridge financing from foreign banks to the Central Administration.
3/ For the 1983 program the monetary authorities were defined to include the Central Reserve Bank and the Banco de la Nacion. The 1984 program considers the Central Reserve Bank as the monetary authority.
4/ Includes a reduction in liabilities of US$50 million of Central Reserve Bank liabilities to Arlabank which were assumed by the Central Administration.

Peru--Stand-By Arrangement

Attached hereto is a letter, with annexed memorandum, dated February 3, 1984 from the Minister of Economy, Finance, and Commerce and the President of the Central Reserve Bank of Peru requesting a stand-by arrangement and setting forth:

(a) The objectives and policies that the authorities of Peru intend to pursue for the period of this stand-by arrangement;

(b) the policies and measures that the authorities of Peru intend to pursue through December 31, 1984; and

(c) understandings of Peru with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Peru will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period from April 6, 1984 through July 1985, Peru will have the right to make purchases from the Fund in an amount equivalent to SDR 250 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 15 million until May 15, 1984, the equivalent of SDR 30 million until August 15, 1984, the equivalent of SDR 74 million until November 15, 1984, the equivalent of SDR 118 million until February 15, 1985, the equivalent of SDR 162 million until May 15, 1985, and the equivalent of SDR 206 million until July 15, 1985.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Peru's currency in the credit tranches beyond 25 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources.

4. Peru will not make purchases under this stand-by arrangement, other than the initial purchase in an amount equivalent to SDR 15 million that it may request until April 30, 1984, that would increase the Fund's holdings of Peru's currency in the credit tranches beyond 25 percent of quota.

(a) During any period in which:

(i) the data at the end of the preceding period indicate that the limit on the net indebtedness of the non-financial public sector described in Table 1 of the memorandum annexed to the attached letter has not been observed, or

(ii) the data at the end of the preceding period indicate that the limit on the gross foreign liabilities of the Banco de la Nacion and COFIDE described in Table 2 of the memorandum annexed to the attached letter has not been observed, or

(iii) the limit on the net domestic assets of the Central Reserve Bank of Peru described in Table 3 of the memorandum annexed to the attached letter is not observed, or

(iv) the data at the end of the preceding period indicate that the targets on the net official international reserve position of the Central Reserve Bank of Peru described in Table 4 of the memorandum annexed to the attached letter has not been observed, or

(v) the limits or sublimits on the contracting and guaranteeing of external public debt described in Table 5 of the memorandum annexed to the attached letter are not observed, or

(b) After October 31, 1984, until the review contemplated in paragraph 5 of the attached letter has been completed.

(c) After December 31, 1984, until suitable performance criteria for the remainder period of the arrangement have been established in consultation with the Fund as contemplated by paragraph 5 of the attached letter, or after such performance criteria have been established while they are not being observed, or

(d) During the entire period of this stand-by arrangement if Peru

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Peru is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Peru and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Peru's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Peru. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Peru and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Peru, the Fund agrees to provide them at the time of purchase.

7. Peru shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

8. (a) Peru shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Peru's balance of payments and reserve position improve.

(b) Any reduction in Peru's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

9. During the period of the stand-by arrangement Peru shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Peru or of representatives of Peru to the Fund. Peru shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Peru in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

10. In accordance with paragraph 6 of the attached letter, Peru will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that the consultation on

the program is desirable. In addition, after the period of the arrangement and while Peru has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Peru's balance of payments policies.

Lima, Peru
February 3, 1984

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. In May 1983 the Government sent you a letter describing the policies and objectives for the second year of the extended arrangement which had been approved by the Fund on June 7, 1982 in support of a medium-term program of adjustment and structural reform. During the past year the Government of Peru has encountered a number of difficulties in meeting the objectives of the program. Natural disasters contributed to a sharp decline in GDP and the resulting scarcities led to substantial price increases. Foreign demand for Peru's exports has been weak and the international capital market has remained tight. These and other factors have led to slippages in domestic demand policies that adversely affect internal and external economic stability.

2. To redress this situation the Government of Peru has taken the decision to implement a comprehensive set of measures in the areas of domestic demand management, incomes, financial, and external sector policies. In addition, it has implemented and is preparing reforms in support of agricultural and industrial development.

3. On the basis of these policies and objectives, which are described in the attached memorandum and which cover the period through July 1985, we request that the equivalent of SDR 250 million be made available to Peru under a stand-by arrangement through the same period. At the same time, the Government requests that the present extended arrangement be canceled as of the date the new arrangement comes into force.

4. The Government of Peru acknowledges that during any period in respect of which any of the policy understandings contained in paragraphs 9, 10, 11, 13, 14, and 15 of the attached economic policy memorandum are not observed, Peru will not request any purchase under the arrangement until understandings with the Fund have been reached regarding the circumstances in which such purchases may be resumed.

5. The Government of Peru will periodically consult with the Fund, in accordance with the Fund's policies on such consultations, about the progress being made in the implementation of the program described in the attached economic policy memorandum and about policy adaptations which may be appropriate for the achievement of its objectives. In any event, the Government will review with the Fund before October 1, 1984 the progress made in implementing the program in conjunction with the 1984 Article IV consultation discussions. Also, on or before

December 31, 1984, the authorities of Peru will consult with the Fund in order to reach understandings on the policies and performance criteria relating to the remaining period of the stand-by arrangement.

Yours sincerely,

Richard Webb Duarte	Carlos Rodriguez Pastor
President	Minister of Economy,
Central Reserve Bank of Peru	Finance, and Commerce

Attachment: Memorandum on Economic Policy of the Government of Peru

Memorandum on Economic Policy of the Government of Peru

1. In June 1982 the Government of Peru embarked upon a medium-term program of adjustment and structural change aimed at providing a framework for high and sustained economic growth and a substantial increase in employment opportunities, while reducing inflation and attaining a viable external payments position. These objectives were to be achieved by a tightening of demand management and a strengthening of market mechanisms. Emphasis was to be placed on removing the impediments to private investment in the basic sectors of the economy, implementing a more efficient investment program, opening the economy to international competition, and eliminating price distortions.

2. Performance so far has fallen short of expectations. In 1982 Peru had to contend with falling prices for its main exports, a tightening of world financial markets, and the onset of a domestic recession. The situation was exacerbated by slippages in the control of spending by large public sector enterprises and in the adjustment of controlled prices. As a result of these adverse conditions, GDP growth in 1982 was only 0.7 percent and the inflation rate failed to decline. The continued weakness of external demand, the deepening of the domestic recession, a number of serious natural disasters that hit Peru in early 1983, and the worsening of external financial market conditions combined to create an unfavorable environment for the performance of the Peruvian economy in 1983. It is estimated that the natural disasters alone were responsible for a decline of about 5 percent of GDP and that the resulting scarcities contributed to price increases. These factors--together with additional outlays in some areas, weaknesses in the revenue system and lags in the adjustment of certain regulated prices--substantially widened the deficit of the nonfinancial public sector. As a result, real GDP fell sharply and inflation rose to 125 percent.

3. In spite of these developments, the Government remains committed to its medium-term objectives and it has taken the decision to implement a comprehensive set of policy measures to reduce substantially domestic and external imbalances. In addition to adjustment measures in the area of monetary, fiscal, and incomes policy, the Government's economic program emphasizes a number of structural corrections to improve the efficient allocation of domestic productive resources and thus contribute to a lowering of inflation and an increase in exports. This memorandum describes the Government's policies and specifies the objectives and goals which the Government has set for the period ending in July 1985.

4. Barring the recurrence of adverse weather conditions, the economic outlook for 1984 and 1985 appears to be positive. Agricultural production is projected to rebound strongly from the abnormally low level of 1983, and the return of cooler ocean currents off the coast is expected to result in a higher fish catch. The upturn in the economies of a number of industrial countries is expected to lead to firmer

prices for a number of exports, and a flexible exchange rate policy is expected to defend Peru's external competitiveness. The average annual rate of GDP growth for 1984-85 is projected to exceed 4 percent. After an initial increase in prices in early 1984 reflecting corrective adjustments in basic prices, inflation is projected to decline from an annual rate of about 100 percent in the first quarter of 1984 to approximately half that rate in the last quarter of 1984 and to continue declining in 1985. Monetary, fiscal, and external sector policies have been designed so that the inflation objective will be achieved without a decline in net official international reserves.

5. A major element in the deceleration of the rate of inflation in the course of 1984 and 1985 is the reduction of the net financing requirements of the nonfinancial public sector from an estimated 10 percent of GDP in 1983 to 3.8 percent in 1984, and to 2 percent in 1985. These deficits are expected to be covered from foreign credit sources thus avoiding a crowding out of the domestic financing requirements of the productive sector.

6. To bring about the planned improvement in the public sector finances, the Government has adopted an austere expenditure plan. Central Government's expenditures have been cut from the equivalent of 20.6 percent of GDP in 1983 to 18.3 percent in 1984, notwithstanding a rise in interest payments equivalent to 0.3 percent of GDP. Incomes policy has been designed to be consistent with the above inflation objective, and the wage bill is expected to decline by 0.7 percent of GDP. Purchases of goods and other services are programmed to decline from 5.9 percent of GDP in 1983 to 4.6 percent in 1984, and investment spending by the Central Government is programmed at 2.9 percent of GDP in 1984, compared with 3.1 percent in 1983. These reductions will be achieved despite the necessity of increased spending for reconstruction and rehabilitation of the regions affected by the natural disasters of 1983. The successful execution of the Government plan will depend on a careful control and monitoring of expenditures. In this regard, the improvements made during 1983 in monthly budget control and program monitoring are expected to play a decisive role. The introduction of a comprehensive incomes policy for the rest of the public sector, implemented by the Ministry of Economy, Finance, and Commerce, is expected to contribute to a curtailment of the operational expenditures of the principal public enterprises. The investment plan for the rest of the public sector has been reduced from 4.1 percent of GDP in 1983 to 3.6 percent and has been structured with the help of technical assistance provided by the World Bank and the Inter-American Development Bank. The investment plan emphasizes spending in the electric energy sector and in petroleum exploration. Control over the investment spending of the public enterprises has been strengthened through direct supervision and through limitation on access to foreign and domestic sources of finance.

7. A major revenue effort has been put in place to help reduce the financing requirements of the nonfinancial public sector. New tax measures are projected to raise central government revenues in 1984 by the equivalent of about 2 percent of GDP. The full year's impact of the administrative improvements in sales and income tax collections introduced in 1983 with technical assistance from the Fund is expected to contribute another 0.3 percentage points of GDP to central government revenues in 1984. The revenue measures which have been put in place include a 2 percentage points increase in the general sales tax; an increase in consumption taxes on a number of consumer goods by 2 to 15 percent; the elimination of certain sales tax exemptions starting in April 1984; an increase in restaurant and hotel taxes; the introduction of a tax on traditional exports; the imposition of a minimum import duty of 11 percent, including the temporary surcharge of 10 percent, except on a limited number of products, including wheat, rice, milk, and certain medicines; a 1 to 3 percent tax on the value of automobiles, airplanes, boats, and other luxury goods; and a tax of up to 1 percent on certain exchange purchases and sales.

8. To increase the savings of the public enterprises, a number of corrective price actions have been taken which, together with the full-year impact of the price corrections taken in the course of 1983 and control over expenditures, are projected to increase the operational surplus of the public enterprises in 1984 by about 1 percent of GDP in relation to 1983. The price of rice was raised by 8 percent in January 1984, and will be raised on a monthly basis so as to eliminate the deficit of the state-owned rice marketing agency. The decision has been taken to increase the participation of rice growers in the marketing process with the objective of removing the price of rice from public control. The price of regular gasoline was raised in January 1984 to the equivalent of US$1.05 per U.S. gallon, and the prices of other petroleum derivatives were raised commensurately. Starting with February the price of regular gasoline will be raised to the equivalent of US$1.10 per U.S. gallon and will be adjusted monthly at least in line with the devaluation. Prices of other petroleum derivatives will be raised commensurately. As the law which placed a ceiling of US$1.10 on the price of gasoline was allowed to lapse on December 31, 1983, future increases in prices of gasoline and other petroleum derivatives may be implemented by decision of the Minister of Economy, Finance, and Commerce. Electricity rates were raised by 10 percent in January 1984 and together with other utility tariffs will be raised on a monthly basis in line with cost increases or by larger amounts where required to finance investments.

9. The deficit of the nonfinancial public sector for 1984 and 1985 will be financed without any net recourse to domestic credit, so that all of the increase in financial saving is expected to be available to meet the requirements of the productive sector. In contrast to 1983, the nonfinancial public sector will make all external debt service payments as originally scheduled. The equivalent of debt repayments that have been rescheduled by external creditors will be deposited

into blocked accounts maintained with the Central Reserve Bank. The implementation of these policies will make it possible to limit the net indebtedness of the nonfinancial public sector, defined as the sum of net credit from all domestic and foreign sources, to the amounts specified in the annexed Table 1.

10. To strengthen the Government's control over external borrowing by the public sector, including the utilization of short-term lines of credit by the public sector, limits have been placed on the gross direct external indebtedness of the Banco de la Nacion and COFIDE, the legally designated fiscal agents for external borrowing by the nonfinancial public sector. These limits are specified in the annexed Table 2. In addition, the Government will monitor closely the extending of guarantees by Banco de la Nacion and COFIDE. Moreover, the Government intends to de-emphasize the Banco de la Nacion's financial operations with the private sector, in order to concentrate the Bank's resources on serving the public sector more efficiently.

11. A number of advances were made in the course of 1983 in developing a more efficient financial system, including a reduction in the disparity of interest rates, the creation of an indexed saving instrument, the reduction of effective legal reserve requirements, and the elimination of the prohibition for entry into the domestic financial system. However, emergency conditions in a number of sectors called for an expansion of subsidized credit lines by the monetary authorities. In addition, portfolio requirements were introduced to channel credit to agriculture. Real deposit rates remained negative during most of the year, notwithstanding substantial increases in nominal rates. With the objective of continuing to improve the efficiency of financial intermediation and resource allocation and of providing a realistic alternative to dollar certificates of deposit, as of January 1984 all financial institutions have been authorized to sell short- and medium-term certificates of deposit with a freely negotiated discounted rate of return. It is the intention of the authorities to continue with the policy of adjusting over time the rate of indexation of existing indexed financial instruments and the level of nominal interest rates to ensure that deposit rates are positive in real terms. The Central Reserve Bank will continue to pursue financial policies directed toward reducing its role in the intermediation process. To this effect, the Central Reserve Bank will continue with its policy of reducing average reserve requirements to the legal minimum levels and of refraining from establishing new portfolio requirements and from expanding special credit facilities beyond those strictly necessary to provide emergency liquidity support to industry in the short term and at commercial rates. To ensure that the beneficiaries of these credit facilities improve their solvency, increased equity participation in an equivalent amount is required. Existing emergency credit lines will be phased out as the conditions which gave rise to them subside. The nature of external financing arrangements may well require that the Central Reserve Bank serve temporarily as an intermediary. In this event, the efficient operation of the domestic financial markets requires that the Central Reserve

Bank redirect financial resources to the rest of the domestic financial system at market-determined interest rates. To ensure the consistency of the above-described monetary policies with the Government's balance of payments and inflation objectives, limits will apply to the net domestic assets of the Central Reserve Bank as set forth in annexed Table 3.

12. The necessity of corrective adjustment in some basic prices in the very short term is likely to lead a temporary increase of inflation in the early months of 1984. Thereafter, given the need to maintain realistic basic prices, the speed at which inflation is brought down will be greatly influenced by the success in implementing the fiscal and monetary policies outlined above and by incomes policy. To achieve the results expected from incomes policy the Government will apply a moderate wage policy in relation to inflation in both the Central Government and the rest of the public sector. The Government's hand in influencing wage awards in the public enterprises has been strengthened by the 1984 budget law which provides that the Ministry of Economy, Finance, and Commerce ensure the consistency of the wage agreements with the objectives of incomes policy. The Government will continue its policy of protecting the lowest income groups through periodic increases in the wage reference unit, which is the lowest income any private sector worker can legally earn. However, the Government will no longer mandate general wage increases or bonuses for any other private sector workers. Instead, the Government will use its best endeavors to ensure that wage awards in the private sector are consistent with the deceleration of inflation that is being sought. A basic principle guiding the authorities in this regard will be the avoidance of indexation to past inflation so as to make wage determination forward looking.

13. The authorities have discontinued the policy of preannouncing the exchange rate and have introduced a flexible exchange rate policy directed toward ensuring Peru's competitiveness over the medium term, thereby providing appropriate incentives for the growth of the economy based on the expansion of the export sector. Targets for the net official reserve position of the Central Reserve Bank are set out in the annexed Table 4 to help guide exchange rate management.

14. At the present time Peru does not maintain any restrictions on payments and transfers for current international transactions, and capital transactions can be made through the certificate market as well as through the unrestricted export and import of domestic currency. The Government will continue with the policy of allowing exporters to dispose freely of a portion of export receipts by limiting mandatory export surrender requirements to a level sufficient to meet the Central Reserve Bank's own exchange requirements. The Government believes that the present exchange rate policy, which protects Peru's competitiveness, is the most appropriate way to offer incentives to exporters and protect domestic producers. The present difficult fiscal situation does not permit the abolition of the temporary import surcharge imposed

in 1982. However, the Government intends to begin replacing the surcharge with alternative revenues in the 1985 budget. These alternative revenue measures will be introduced before the start of 1985. The Government does not intend to introduce or modify any multiple currency practice, impose or intensify restrictions on payments or transfers for current international transactions, conclude bilateral payments agreements which are inconsistent with Article VIII of the Articles of Agreement, or impose or intensify restrictions on imports for balance of payments reasons.

15. A major constraint on the Government's economic and financial policies is posed by the high level of scheduled external debt service payments, which are expected to remain above 50 percent of the value of exports of goods and services for the next several years. A substantial reduction in the actual amount of debt service payments during 1983-84 has been achieved through debt rescheduling agreements with Peru's major creditors. The Government has also acted to improve the external debt service profile by centralizing control over the contracting of public sector external debt, increasing reliance on borrowing from multilateral and bilateral sources on concessional terms, and reducing the level of recourse to debt with short-to medium-term maturities. To achieve further progress in these areas, the Government intends to limit the contracting or guaranteeing by the public sector of external debt with original maturities exceeding one and up to twelve years through July 1985, with a subceiling in the one to five year maturity range, and intermediate limits for December 31, 1984, as described in annexed Table 5.

16. A major consideration in the design of the economic program has been to provide clear signals with respect to the desired direction of the economy over the medium term. The above-described policies in the fiscal, monetary, incomes, and external sectors are believed to be consistent in that respect. To help ensure the success of these policies, the Government has undertaken to reduce a number of structural rigidities in the economy. In the area of labor legislation, an international convention acceding to criteria established by the International Labor Organization is pending ratification by Congress. The increased flexibility introduced into Peru's labor laws by this action will encourage the hiring of new workers while contributing toward increased productivity and a more efficient industrial cost structure. As part of a *comprehensive plan to unlock the potential of the agricultural sector*, modifications in the rules of land tenure will be introduced geared to enabling farmers greater access to credit as well as to transfer ownership.

17. The Government is also carrying forward plans to reduce the public sector's participation in commercial activities. In 1983 the importation of wheat was liberalized, and the general direction of policy in this area will be continued. With respect to the commercialization of

rice, increased participation by producers is planned as described in paragraph 8. A number of public enterprises are to be phased out or transferred to the private sector. Of importance in this regard are the state fish processing company (PESCAPERU) and a state copper mining company (Tintaya). With respect to the latter company, the Government is establishing a trust composed of commercial banks with the objective of divesting majority ownership.

Table 1. Peru: Limits on the Net Indebtedness of the Nonfinancial Public Sector 1/

(In billions of soles)

Dates	Limits
March 31, 1984	23,887
June 30, 1984	24,354
September 30, 1984	24,757
December 31, 1984	25,357

1/ For purposes of this limit, the net indebtedness of the nonfinancial public sector is defined as the sum of (i) net claims of the domestic banking system and COFIDE on the nonfinancial public sector, (ii) the outstanding amount of bonds issued by the nonfinancial public sector and held outside the domestic banking system, COFIDE, and the nonfinancial public sector and (iii) the outstanding foreign debt of the nonfinancial public sector. In addition, any net increase in domestic payment arrears during the course of the program period shall be added to the total of net indebtedness of the nonfinancial public sector as defined above.

The above limits shall be adjusted by:

1. Adding the revaluation of foreign currency-denominated subscriptions to nonmonetary international organizations.

2. Adding any increase in the paid-in capital subscriptions to these international organizations.

3. Any change in the initial stock outstanding on December 31, 1983 made as a result of revisions of past data.

Table 2. Peru: Limits on the Gross Foreign Liabilities of the Banco de la Nacion and COFIDE 1/

(In millions of U.S. dollars)

Dates	Limits
March 31, 1984	870
June 30, 1984	885
September 30, 1984	905
December 31, 1984	930

1/ Defined as the sum of (1) gross short-term foreign liabilities, and (2) gross medium- and long-term foreign liabilities. The above limits shall be adjusted by any changes in the initial stock outstanding on December 31, 1983 made as a result of revisions of past data. The above limits include on-lending operations of Banco de la Nacion and COFIDE to the private sector and commercial banks of up to cumulative amounts of US$131 million on March 31, 1984, US$139 million on June 30, 1984, US$157 million on September 30, 1984, and US$174 million on December 31, 1984. The above limits also include the assumption by the Banco de la Nacion and COFIDE of up to US$7 million of guaranteed short-term working capital under the terms of Exchange Resolution No. 002/83 during the first quarter of 1984.

The limits in the table will be reduced to the extent that cumulative on-lending operations of the above specified types fall short of the cumulative amounts indicated and/or the assumption of guarantees under Exchange Resolution No. 002/83 during the first quarter of 1984 falls short of the amount indicated.

With respect to guarantees on short-, medium-, and long-term borrowing given by the Banco de la Nacion and COFIDE, the Government expects their cumulative total outstanding not to exceed US$842 million on March 31, 1984, US$928 million on June 30, 1984, US$1,043 million on September 30, 1984, and US$1,148 million on December 31, 1984.

Table 3. Peru: Limits on the Net Domestic Assets of the Central Reserve Bank 1/

(In billions of soles)

Time periods	Limits
Up to March 31, 1984	194
April 1-June 30, 1984	518
July 1-August 15, 1984	383
August 16-September 30, 1984	248
October 1-November 15, 1984	121
November 16-December 31, 1984	-5

1/ Defined as the difference between (1) the Central Reserve Bank liabilities to the private sector, and (2) the sum of the net international reserves of the Central Reserve Bank and the medium- and long-term net foreign assets of the Central Reserve Bank.

Each limit shall be adjusted by:

1. Adding the revaluation of foreign currency-denominated subscriptions to nonmonetary international organizations.

2. Adding any increase in the paid-in capital subscriptions to these international organizations.

3. Any changes in the initial stock outstanding on December 31, 1983 made as a result of revisions of past data.

Table 4. Peru: Targets on the Net Official International Reserve Position the Central Reserve Bank of Peru 1/

(In millions of U.S. dollars)

Dates	Targets
March 31, 1984	412
June 30, 1984	314
September 30, 1984	424
December 31, 1984	541

1/ Defined as the difference between the foreign assets of the Central Reserve Bank of Peru and the sum of its external liabilities with original maturity of less than one year, and those with original maturity of one year or more which constitute balance of payments support loans. Each target shall be adjusted by any change in the initial stock outstanding on December 31, 1983 made as a result of revisions of past data.

Table 5. Peru: Limits on the Contracting and Guaranteeing of External Public Debt with Original Maturity of at Least One Year and Up to and Including Twelve Years 1/

(In millions of U.S. dollars)

Maturity Ranges	January 1-December 31, 1984
At least one year and up to and including five years	200
At least one year and up to and including twelve years	1,660

1/ For the purposes of these limits, the public sector will be defined to include the nonfinancial public sector, COFIDE, and the official banking system (defined to include the Central Reserve Bank, Banco de la Nacion, and specialized banks), except for loans classified as reserve liabilities of the Central Reserve Bank. The contracting limits include refinancing loans on public sector debt service payments to all foreign creditors. Any nonpayment of a scheduled debt service payment by the public sector shall be treated as a refinancing loan and included under the limit.

These limits shall exclude:

1. Export prefinancing credits provided by the IDB or the IBRD.

2. The utilization by the private sector of credit lines provided by foreign official entities to promote exports to Peru, and which are channeled through COFIDE or the official banking system.

3. Guarantees by COFIDE or the official banking system of foreign credits contracted by the private sector.

4. The consolidation of short-term working capital credits into medium-term loans.