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November 6, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Peru - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Peru.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Flickenschild (ext. (5)8621).

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INTERNATIONAL MONETARY FUND

PERU

Staff Report for the 1984 Article IV Consultation

Prepared by the Western Hemisphere and the Exchange and Trade Relations Departments

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

Approved by Sterie T. Beza and Manuel Guitian

November 5, 1984

Contents

Text Tables

Chart

The Article IV consultation discussions with Peru were conducted in Lima in the period August 14-September 7, 1984. Representatives of Peru in these discussions included the Prime Minister; the Ministers of Economy, Finance, and Commerce; Agriculture and Food; Fisheries; Industry, Tourism, and Integration; Labor and Public Welfare; the three Vice Ministers of Economy, Finance, and Commerce; the President, Vice President and General Manager of the Central Reserve Bank of Peru; the Presidents of the National Bank and the External Debt Committee; and the Superintendent of Banks and Insurance Companies. The mission chief also met with the President of the Republic. The staff representatives were Messrs. van Houten (Head), Flickenschild, Jaramillo-Vallejo, Kohnert (all WHD), Lipton (ETR), and Ms. Valencia (Secretary-WHD). Mr. de Moraes, the Fund resident representative in Lima, assisted the staff during the consultation discussions. The mission worked closely with Mrs. Casanegra-Jantscher (FAD), who was in Lima concurrently on a follow-up technical assistance visit in the area of taxation and revenue administration.

Peru has accepted the obligations of Article VIII, Sections 2, 3, and 4. The previous Article IV consultation was conducted in Lima in September 1983 and was concluded by the Executive Board on November 28, 1983 (EBS/83/236). A summary of Peru's relations with the Fund is presented in Attachment I.

I. Background and Performance under the Stand-By Arrangement

The extended arrangement approved in mid-1982 ran into serious difficulties in the second half of 1983 and performance criteria for 1984 were not established because of large slippages in program implementation. The major factor behind the internal and external imbalances experienced by Peru during 1982-83 was the persistence of a public sector deficit averaging more than 10 percent of GDP. Public financing requirements of this magnitude led to unsustainably high net foreign borrowing, a crowding out of the private sector in the domestic financial market, and the intensification of inflationary pressures.

In April 1984 the extended arrangement was canceled and a stand-by arrangement was approved for the period through July 1985--the end of the five-year term of the present administration--in an amount of SDR 250 million, or 75.6 percent of quota (EBS/84/57, and Sup. 1 and 2).1/ The program was designed to reduce substantially the internal and external imbalances through major adjustments in fiscal, monetary, and incomes policies. In addition, the program envisaged a number of structural modifications to improve the allocation of resources over the medium term.

1/ At the time of the approval of the stand-by arrangement in April 1984, the Executive Board also agreed to a purchase under the compensatory financing facility in an amount of SDR 74.7 million, equivalent to 22.6 percent of Peru's quota (EBS/84/59 and Sup. 1).

The program's immediate objectives were to maintain the level of net international reserves; reduce the reliance on net foreign borrowing from 5.4 percent of GDP in 1983 to 5.3 percent in 1984 and 4.3 percent in 1985; and 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 bring inflation down in 1985. Barring the recurrence of adverse weather conditions, the outlook was for a moderate recovery of GDP in 1984-85 from the deep recession of 1983.

Initially, developments were in accordance with the program and Peru made two purchases from the Fund of SDR 15 million each; one following Executive Board approval of the arrangement and the other in June on the basis of compliance with all performance criteria applicable on that date, including the ones established for March 31, 1984. The purchase scheduled for after August 15, 1984 has not been made because Peru exceeded the June 30 limit on the indebtedness of the nonfinancial public sector; all other performance criteria applicable to June 30, 1984 were met (Table 1). Since midyear the fiscal situation has deteriorated substantially, and Peru has been incurring increasing delays in its external debt service payments and in certain domestic payments.

II. Developments in 1983

A major cause of the deep recession and the acceleration of inflation in Peru in 1983 was the adverse weather that hit the country in the first months of the year, resulting in loss of output and scarcities of basic consumer goods. Other factors that contributed to the drop in economic activity were the reduced access to foreign capital markets and the crowding out of the private sector in the domestic financial market.

The fiscal situation deteriorated progressively during 1983 as central administration revenues ran below projections, emergency spending in the regions affected by bad weather was initiated, and defense and domestic security expenditures (including wage payments) were raised in response to unrest in certain provinces. In addition, in September the authorities began to slow the price adjustments on the goods and services marketed by public enterprises. As a result, the deficit of the nonfinancial public sector for 1983 rose to almost 12 percent of GDP, three times the programmed level. The increase in the overall deficit was financed by recourse to domestic credit, larger than projected foreign suppliers credits, and by the use of greater than expected balance of payments support from socialist countries and participating creditors of the Paris Club.

Monetary developments in 1983 were characterized by a decline in real monetary balances by 12 1/2 percent and by a large expansion of bank credit to the nonfinancial public sector in the second half of the year. As a consequence, the net international reserves of the Central Reserve Bank, which had declined by about US$35 million in the first semester, dropped further by about US$225 million in the second half of the year.

Table 1. Peru: Performance Under Stand-By Arrangement

	1984		
	March 31	June 30	Sept. 30
(In billions of soles)1/			
Total net indebtedness of nonfinancial public sector			
Limit (adjusted)2/	23,677.3	24,113.8	24,565.8
Actual	23,645.1	24,518.5	...
Margin	32.2	-404.7	...
Net domestic assets of the Central Reserve Bank 3/4/			
Limit (adjusted)2/	180.6	502.9	231.2
Actual	-278.0	-279.7	-536.7
Margin	458.6	782.6	767.9
(In millions of U.S. dollars)			
Net international reserves of the Central Reserve Bank			
Target (adjusted)2/	406.4	308.4	418.3
Actual	620.5	612.4	745.3
Margin	214.1	304.0	327.0
Gross foreign liabilities of Banco de la Nacion and COFIDE			
Limit (adjusted)2/	989.6	1,003.6	1,023.6
Actual	953.4	915.8	...
Margin	36.2	87.8	...
Contracting of external public debt 3/			
1-5 years			
Limit	200	200	200
Actual	23	33	59
Margin	172	167	141
1-10 years			
Limit	1,660	1,660	1,660
Actual	323	785	1,109 5/
Margin	1,337	875	551

Source: Central Reserve Bank of Peru.

1/ Accounts denominated in foreign currency valued in accordance with program provisions.
2/ Adjustments introduced in accordance with program provisions.
3/ Continuous ceiling.
4/ Under the program, an intermediate ceiling applied until August 15. For that date, the adjusted limit was S/. 366.2 billion, the actual was S/. -624.8 billion, and the margin was S/. 991.0 billion.
5/ As of August 31, 1984.

The reduction in real money and quasi-money in 1983 reflected the deep recession, difficulties experienced by two domestic banks, and uncertainties about the direction of economic policy. The decline in real balances was not evenly distributed. The dollar value of foreign-currency denominated deposits stayed unchanged, while the real value of sol-denominated financial assets fell by 20 percent as measures taken to promote the growth of sol-denominated financial instruments failed to win the confidence of depositors. By the end of 1983, the share of dollar-denominated deposits in the total of money and quasi-money had increased to 44 percent from 39 percent at end 1982.

Notwithstanding the much larger than programmed deficit of the non-financial public sector, the balance of payments underwent a substantial adjustment in 1983 as economic activity contracted sharply. The current account deficit was almost cut in half from US$1.6 billion in 1982 to US$870 million. The trade balance accounted for virtually all of the improvement, moving from a deficit of US$430 million in 1982 to a surplus of US$290 million. Although the value of exports declined by 8 1/2 percent, the value of imports dropped by 27 percent reflecting the severe recession.

Net long-term capital inflows in 1983, at US$1.4 billion, were slightly higher than in 1982, but their composition changed substantially. After receiving US$200 million in net long-term capital in 1982, the private sector repaid US$50 million in 1983. Thus, all of the long-term capital inflow in 1983 went to the public sector. The bulk of it took the form of debt restructuring agreements with commercial banks, official bilateral creditors under the Paris Club, socialist countries, and private suppliers without official guarantees. In addition, Peru's foreign bank creditors agreed to maintain their short-term credit exposure at the level existing on March 7, 1983, and to provide US$450 million in new medium-term financing, of which US$250 million was disbursed during 1983.

Despite the improved current account outcome and slightly higher net long-term capital inflows, the overall balance deteriorated from a surplus of US$135 million in 1982 to a deficit of about US$780 million in 1983. About US$460 million of this deterioration resulted from the assumption of short-term debt to foreign banks by the domestic banking system under the terms of the refinancing agreement.

III. Developments in 1984

In the first half of 1984, the Peruvian economy recovered somewhat from the deep recession experienced in 1983, on the basis of a recovery of output in the primary sector (agriculture, fishing, mining, and petroleum). The industrial, construction, and service sectors remained depressed. If this general trend should be maintained in the second semester, as now seems likely, real GDP should grow by about 3.5 percent in 1984, following an 11 1/2 percent drop in 1983. The consumer price index in the first half of 1984 rose by 48 percent--or about 10 percentage points more than projected--compared with 56 percent in the same period of 1983. For 1984 as a whole, inflation is now projected at over 100 percent, compared with a program rate of 70 percent (Table 2).

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

(In percent)

	1980	1981	1982	1983	1984 Prog.	1984 Proj.
Real GDP	3.0	3.0	0.7	-11.6	4.0	3.5
Nominal GDP	61.0	70.9	66.5	87.3	99.2	114.6
Consumer price index (December-December)	60.8	72.7	72.9	125.1	70.0	106.5
Exchange rate depreciation (December-December) 1/	36.6	48.3	95.3	129.5	70.0	110.1
Terms of trade index	13.4	-17.8	-17.0	8.5	0.4	-4.7 2/

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

1/ In terms of soles per U.S. dollar.
2/ Reflects variation of the index between December 1983 and June 1984.

In the first months of 1984, the Peruvian authorities implemented a number of adjustment measures in accordance with the policy understandings of the economic program. Subsequently, however, implementation of programmed fiscal, wage, and public pricing policies weakened considerably.

During the first quarter of 1984, the authorities adopted measures to raise revenues by about 2 percent of GDP in 1984. These measures included a 2 percentage point increase in the value added tax to 18 percent; an increase in restaurant and hotel taxes; the introduction of a tax on traditional exports; the imposition of a minimum import tariff of 1 percent, except on a limited number of basic necessities including wheat, rice, milk, and certain medicines;1/ a 1-3 percent tax on the value of luxury consumer goods; and a tax of up to 1 percent on most purchases and sales of foreign exchange. At the same time, operational revenues of a number of public enterprises were boosted through increases in controlled prices.

1/ Together with the 10 percent import surcharge, this measure signified effective import duty collections from the products affected of 11 percent.

Despite these measures, central government revenue performance in the first quarter was below expectations, mainly because of delays in implementing some of the tax measures and poor receipts from sales taxes and import duties reflecting both a deterioration in administration and lower private sector imports. The revenue shortfall was offset by lower than programmed spending by the Central Government. The overall operations of the public enterprises were as anticipated, with the state petroleum company (PETROPERU) turning in a better performance than anticipated, while a number of other entities experienced unexpected difficulties. The state fishing company (PESCAPERU) was reorganized to resolve its chronic deficit by reducing its work force, selling some of its assets, and replacing its management.

During the second quarter of 1984, the finances of the public sector began to veer off track despite further revenue measures, including an increase of the import surcharge from 10 percent to 15 percent and the repeal of certain exemptions from the value added tax. The major factors behind the growing fiscal imbalances were the special wage increases for teachers, health workers, police, and national defense forces; additional spending authorization for the Ministries of Transport, Agriculture, and Defense; higher foreign interest rates; lagging adjustments of controlled prices and utility rates; and departures from plan in respect of the operations and investment programs of the public enterprises.

After midyear the cash shortage of the Central Government became acute. Even after the termination of a strike of customs personnel, central government revenue collections continued to be below expectations, while virtually the entire burden of public sector debt service payments fell on the Central Government, as public enterprises generally stopped making such payments. In accordance with the program, the Central Reserve Bank maintained its policy of not providing credit to the public sector, and sizable arrears on domestic and external payments emerged.

Efforts to contain the fiscal deficit after midyear have so far been unsuccessful. On the contrary, strong pressures from the business community led to a lowering of the value added tax in July from 18 percent to 8 percent, thereby reducing projected tax revenue in the second semester by 1 percent of GDP. At the same time a number of new revenue measures were implemented, but these fell short of offsetting the reduction in the value added tax.

By September 1984 domestic and external payment arrears had become very large and delays in foreign debt service payments began to exceed 90 days. The financing requirements of the nonfinancial public sector during the first nine months of 1984 are estimated to have exceeded the program level by about 3 percent of GDP.1/ On the basis of present trends and without corrective fiscal measures, the deficit of the nonfinancial public sector for the full year is expected to reach about 10 percent of GDP, compared with a deficit of 4.1 percent of GDP expected in the program (Table 3).

1/ All ratios to GDP are in terms of annual GDP.

Table 3. Peru: Operations of the Nonfinancial Public Sector

(As percent of GDP)

	1980	1981	1982	1983	1984 Prog.	1984 Proj.
Central administration current revenues	20.5	17.9	17.6	14.1	15.8	14.9
Income tax	6.1	3.8	3.6	2.7	2.3	2.8
Tax on goods and services	7.6	7.4	8.3	7.3	8.9	7.4
Import tax	3.2	3.8	3.4	2.7	3.1	3.2
Export tax	2.5	1.4	0.8	0.4	0.3	0.2
Other tax and nontax	1.1	1.5	1.5	1.0	1.2	1.3
Central administration current expenditures	18.1	17.7	17.4	19.2	15.4	18.4
Wages and salaries	4.8	5.3	5.2	5.2	4.2	4.9
Goods and services	0.7	0.8	0.7	0.9	1.0	0.9
Military outlays 1/	4.7	4.1	5.0	4.6	3.5	3.8
Interest payment	4.3	4.5	3.9	5.3	4.8	5.7
Transfers	3.6	3.0	2.6	3.2	1.9	3.1
Central administration current account surplus or deficit (-)	2.4	0.2	0.2	-5.1	0.4	-3.5
Rest of public sector current account surplus or deficit (-)	0.6	-0.1	--	2.5	2.3	1.6
Public sector current account surplus or deficit (-)	3.0	0.1	0.2	-2.6	2.7	-1.9
Capital expenditures (net of capital revenue)	7.8	8.9	9.3	9.1	6.8	8.2
Central Administration	5.3	5.1	4.2	3.7	3.2	3.3
Rest of public sector	2.5	3.8	5.1	5.4	3.6	4.9
Overall public sector deficit (-)	-4.8	-8.8	-9.1	-11.7	-4.1	-10.1
Central Administration	-2.9	-4.9	-4.0	-8.8	-2.8	-6.8
Rest of public sector	-1.9	-3.9	-5.1	-2.9	-1.3	-3.3
Financing	4.8	8.8	9.1	11.7	4.1	10.1
External	2.1	1.1	7.6	5.9	5.1	6.3 2/
Internal	2.7	7.7	1.5	5.8	-1.0	3.8
Memorandum items						
Central Administration						
Total revenues	20.5	17.9	17.6	14.1	15.9	15.0
Total expenditures	23.4	22.8	21.6	22.9	18.7	21.8
Nonfinancial public sector						
Total expenditures 3/	59.7	58.0	60.0	65.2	...	...

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

1/ Includes transfers to rest of public sector.
2/ Includes delayed debt service payments amounting to 2.3 percent of GDP.
3/ Net of intrasectoral transfers.

The deficit in the first semester of 1984 was financed entirely with external medium- and long-term loans and refinancing credits. Net domestic credit was reduced somewhat, reflecting chiefly deposits frozen at the Central Bank in connection with refinanced external debt service payments. The projected increase in the deficit in the second semester is expected to be financed mainly by domestic and external payment arrears and the issuance of bonds to domestic contractors, assuming the Central Reserve Bank maintains its tight credit policy.

The small net decline in the domestic indebtedness of the nonfinancial public sector in the first semester of 1984 ensured that domestic bank credit expansion was directed entirely to the private sector. This was in sharp contrast to 1983 when the large fiscal domestic borrowing requirement had resulted in a crowding out of the private sector. Even so, bank credit to the private sector in the first semester of 1984 contracted slightly in real terms, as the growth of money and quasi-money was below the rate of inflation and the net external position of the banking system improved (Table 4).

The Central Reserve Bank maintained a tighter credit policy than had been programmed in the first semester of 1984. The increase in net domestic assets was S/. 770 billion less than programmed, and the net international reserves of the Central Reserve Bank at midyear were some US$300 million above the level that had been targeted.1/ The better than expected performance occurred despite short-term capital outflows and resulted chiefly from much lower imports, the receipt of US$100 million from foreign banks several months ahead of the programmed disbursement date and US$25 million of unanticipated silver sales from Central Reserve Bank stocks.

Money and quasi-money in real terms showed a slightly more than seasonal decline of about 4 1/2 percent in the first half of 1984, after falling by 12 1/2 percent in all of 1983. Currency and demand deposits declined by about 13 percent in real terms in the first six months, while real quasi-money holdings were about unchanged, principally because of an increase in dollar-denominated certificates of deposits, which rose from 44 percent of total bank liabilities to the private sector at the end of 1983 to close to 50 percent at midyear. The further shift of savings toward foreign currency certificates indicates that interest rates on domestic currency deposits continued to be inadequate, notwithstanding some improvements. Since February 1984, financial institutions have been authorized to pay on some financial instruments interest rates that reflect market forces. Since July such instruments also have been offered as bearer documents to make them more attractive. However, the interest rate ceiling on nonindexed savings instruments--which account for the bulk of soles-denominated private sector financial assets--remained below the rate of inflation.

1/ The overperformance on the reserve target would have been some US$450 million if account is taken of the assumption by the Central Government of US$145 million of Central Reserve Bank debt to a foreign bank.

Table 4. Peru: Monetary Indicators

	December-December			December-June	
	1980-81	1981-82	1982-83	1982-83	1983-84 Prel.
	I. Central Reserve Bank				
	(Change in millions of U.S. dollars)				
Net international reserves	-693	78	-258	-34	222
Net medium- and long-term foreign assets	11	16	-14	-4	5
	(Percentage change)				
Net domestic assets	90.4	-54.1	10.2	-58.6	-78.8
Of which: credit to non-financial public sector (net)3/	(78.1)	(38.5)	(100.9)	(-50.1)	(-214.0)
Credit to banking system (net)4/	(-9.6)	(-104.9)	(-136.3)	(-30.2)	(18.2)
Liabilities to the private sector	53.1	47.5	80.6	8.6	31.7
	II. Banking System				
	(Change in millions of U.S. dollars)				
Net international reserves	-522	65	-728	-752	229
Net medium- and long-term foreign assets	-146	24	45	46	11
	(Percentage change)				
Net domestic assets	89.1	61.7	121.6	46.2	34.7
Of which: credit to non-financial public sector (net)3/	(37.3)	(8.0)	(45.1)	(4.6)	(-16.4)
Credit to private sector (gross)	(65.8)	(69.2)	(94.2)	(42.1)	(38.0)
Liabilities to the private sector	75.9	74.1	96.9	24.3	41.4
Domestic currency	(77.5)	(53.0)	(80.1)	(12.3)	(28.2)
Foreign currency	(72.4)	(122.6)	(123.2)	(43.3)	(58.2)
Memorandum items					
Consumer price index	72.7	72.9	125.1	56.1	47.7
Exchange rate (soles per U.S. dollar)	48.4	95.2	129.5	60.3	46.8

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

1/ Percentage changes in the monetary accounts are taken in relation to the corresponding 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/ Net of ordinary deposits and debt rescheduling frozen accounts.
4/ Includes, since March 1983, deposits by domestic banks of the unused portions of refinanced foreign bank loans.

The balance of payments in the first semester of 1984 registered an overall surplus of US$84 million, compared with a program deficit of US$227 million (Table 5). This outcome reflected a US$417 million improvement in the current account deficit in relation to the program. Total net capital inflows (including errors and omissions) were about US$100 million below expectations, as larger net medium- and long-term capital inflows were more than offset by a sizable unprogrammed net short-term capital outflow.

The strong current account performance was related principally to a 20 percent shortfall in imports from the projected level. Public sector imports of food and defense equipment were postponed and private sector capital goods imports were smaller than expected. At the same time, exports were somewhat higher than projected, mainly because of a larger volume of shipments of petroleum and minerals. Net service payments were US$110 million less than projected, mainly because of a downward revision of scheduled interest payments by the public sector and postponement of debt renegotiation fees to the second semester of 1984.

The larger than projected net medium- and long-term capital inflow was due to the earlier than programmed disbursement of a US$100 million foreign bank loan, US$90 million in larger refinancing credits, and the unplanned delay of US$60 million of scheduled debt service obligations, mainly to bilateral creditors. At the same time, private long-term capital outflows were US$40 million larger than projected.

In the absence of policy adjustments, the current account deficit of the balance of payments in the second semester of 1984 is projected to rise substantially. Imports should rise on account of higher food imports and purchases of defense equipment, and exports are projected to decline reflecting lower prices for copper and silver. Scheduled financial service payments are projected to rise on account of higher world interest rates in the first semester of 1984 and payments of rescheduling fees postponed in the first semester of 1984.

Total net long-term capital flows are expected to be as programmed. However, the distribution is likely to be changed, with larger suppliers credits for food and defense equipment offsetting lower foreign bank loan disbursements. On the assumption of additional external payment arrears in the second semester of US$320 million and net short-term capital outflows of US$200 million, the net official international reserve loss is projected at US$100 million for that period.

Table 5. Peru: Summary of the Balance of Payments

(In millions of U.S. dollars)

	1984			
	January-June		July-December	
	Prog.	Prel.	Prog.	Proj.
Current account	-523	-106	-379	-667
Trade Balance	171	477	348	103
Exports, f.o.b.	(1,476)	(1,526)	(1,655)	(1,484)
Imports, f.o.b.	(-1,305)	(-1,049)	(-1,307)	(-1,381)
Investment income	-679	-573	-736	-744
Other services and transfers	-15	-10	9	-26
Capital account	296	190	606	631
Long-term capital	296	421	606	511
Nonfinancial public sector	(359)	(474)	(568)	(551)
Disbursements	/430/	/492/	/651/	/643/
Rescheduling	/632/	/582/	/508/	/652/
Amortization	/-703/	/-600/	/-591/	/-744/
Financial public sector	(11)	(64)	(64)	(61)
Private sector	(-74)	(-117)	(-26)	(-101)
Payment delays 1/	--	60	--	320
Short-term capital and errors and omissions	--	-291	--	-200
Overall balance	-227	84 2/	227	-36
Change in commercial bank reserves (increase -)	--	16	--	-64
Change in official reserves (increase -)	227	-100	-227	100
Central Bank	(227)	(-77) 2/	(-227)	(100)
Banco de la Nacion	(--)	(-23)	(--)	(--)

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

1/ Reflects the nonpayment of debt service by the nonfinancial public sector because of the lack of domestic funds.

2/ Excludes the transfer of a US$145 million liability to Arlabank from the Central Reserve Bank to the Central Government which is shown as a decline in official foreign liabilities in the monetary accounts.

IV. Report on the Discussions

The Article IV consultation discussions coincided with the review of the implementation of economic policies and the outlook under the stand-by arrangement and centered on the sharply rising deficit of the nonfinancial public sector projected for the second semester of 1984 and its possible effects on the balance of payments and inflation. The discussions took place against a background of unsettled political and social issues which were expected to have a bearing on economic decisions through at least mid-1985. Unrest in a number of provinces and terrorist incidents in the main cities had become critical and had resulted in the mobilization of the armed forces. At the same time, the political campaign leading to the presidential election in April 1985 had started.

1. Fiscal policy

As early as May 1984, the authorities had begun to worry about the impact on the public finances of the additional wage and spending increases authorized under political pressure. They foresaw that, in the absence of corrective measures, the overall public deficit would rise to close to 10 percent of GDP in 1984 and that such a deficit would mean high inflation, a loss of net international reserves, and domestic and external payment arrears.

Following a major policy debate, a set of measures was announced at the end of July under 60-day emergency powers obtained from Congress. The principal measure was the reduction of the value added tax from 18 percent to 8 percent. The authorities defended this action on the grounds that the higher tax rate had encouraged evasion and that its reduction would contribute over time to improve compliance and collections. They recognized that, in the short term, revenue from the value added tax would decline and would need to be replaced by a number of compensatory measures. Hence, the tax package also provided for the removal of petroleum products from the value added tax and for a compensating increase in the excise tax on these products. In addition, excise taxes were raised on cigarettes, certain consumer durables, jewelry, beer, perfume, certain categories of automobiles, and pleasure crafts but were lowered slightly on wine, softdrinks, and certain other categories of automobiles. Import duties were raised by 5 to 16 percentage points. The exemption from the value added tax of a number of industrial inputs was eliminated; and, as of 1985, some rates of the income tax were increased and the base subject to this tax was extended to cover previously exempted sources of income. Also with effect from 1985, the tax on property transfers was abolished. Finally, a 17 percent tax on interest payments on bank loans that had been reinstated in June was lowered to 8 percent.

As the legislation enacted under the emergency powers is expected to entail a loss in revenue, the staff discussed with the authorities alternative measures to reduce the sharply rising financing requirements of the nonfinancial public sector. In view of the short time remaining in 1984 to carry out corrective actions, the authorities did not believe that it was feasible to bring the fiscal program fully back on track this year. The staff suggested that, in these circumstances, corrective action should aim, as a minimum, to avoid additional payments arrears and provide the basis for a 1985 budget that would help to stop the deterioration of the economic situation. To achieve this minimum objective, substantial fiscal measures yielding about 3.5 percent of GDP in the remainder of 1984 were judged to be required.

In reviewing possible fiscal actions to achieve this objective, the authorities stated that spending cuts would be very difficult to implement in the Central Government. The bulk of spending consisted of wages, pensions, defense, and interest payments, which could not be reduced, and spending on goods and services, which had already been cut to minimal levels. Some reductions in capital outlays appeared to be feasible, although there were strong pressures to maintain spending on certain projects.

The operations and investment plans of the public enterprises constituted another area where cuts appeared to be possible, but the Ministry of Economy, Finance, and Commerce has no control over expenditures and pricing policies of the enterprises. Most enterprises operate under a sectoral ministry, which traditionally defends the spending plans of the enterprises in its domain. Repeated efforts to bring together the public enterprises in a holding company under the control of the Ministry of Economy, Finance, and Commerce have been unsuccessful. The result has been that spending priorities are not subject to scrutiny; public sector price and rate increases are not effected on a timely basis; and wages and other operational expenditures often are raised in an uncoordinated fashion. As was mentioned above, the nonpayment of external debt service (and the failure to deposit soles in the Central Reserve Bank on account of refinanced external debt service payments) by most public enterprises provided the resources by which enterprise spending programs were maintained and, in some instances, even increased.

In regard to central government revenues, the authorities considered that the most effective way to raise revenue quickly would be a substantial increase in the excise tax on petroleum derivatives. However, the authorities were concerned about the strong impact of this measure on prices. An increase in the value added tax, to raise it back toward the previous level of 18 percent, also was suggested for consideration, as were the implementation of a temporary tax on wages above a certain minimum level and a further increase in import duties. However, decisions have not been taken on these possibilities.

The authorities elaborated on the steps taken to improve the collection of income and sales taxes. Fund technical assistance provided through the Fiscal Affairs Department has resulted in the establishment of a more timely flow of information on the income and value added tax payments by the 500 largest taxpayers in the Lima-Callao metropolitan area. Moreover, voter registration rolls for the forthcoming presidential election are to be used in conjunction with existing records on land and automobile ownership to identify new taxpayers. The authorities observed that lack of adequate technical staff limited severely the scope of administrative improvements in the income and value added tax areas, as well as in customs. Poor salaries and low prestige made it very difficult to attract and retain qualified staff.

The authorities were concerned that the need to find revenue sources in the short term had led to the implementation of a number of measures which had reduced the economic efficiency of the tax structure. Hence, they had initiated a review of Peru's tax structure with the objective of establishing guidelines for the reform of the tax system over the medium term. An important input in this review was the report on the Peruvian tax system prepared by the Fiscal Affairs Department on the basis of a March 1984 mission which recommends, inter alia, a widening of the base of the income and value added taxes by eliminating exemptions and a simplification of the system by eliminating a number of small taxes that unduly burden administrative capacity.

2. Monetary policy

In the first nine months of 1984, monetary policy was aimed mainly at protecting the balance of payments and dampening inflationary pressures. Faced with the expanding fiscal deficit, the Central Reserve Bank maintained tight control over net credit to the nonfinancial public sector and to the Banco de la Nacion (one of the two fiscal agents of the nonfinancial public sector), and it held net credit to commercial banks to below program levels. The overall tight credit stance was facilitated by the preference of commercial banks to maintain remunerated excess reserve deposits at the Central Reserve Bank. In part banks were reluctant to extend credit in soles to domestic borrowers in an uncertain economic environment and in part domestic borrowers were unwilling to assume the exchange risk of foreign currency loans, the unlent proceeds of which the banks were required to deposit with the Central Reserve Bank under the terms of the refinancing agreement with the foreign banks.

The authorities said that their policies with respect to the domestic financial market continued to be guided by the objective of developing a more efficient financial system. The principal instruments in this regard have been interest rate policy, the reduction of required reserve holdings against sol deposits, the relaxation of limits on foreign participation in domestic financial institutions, and the encouragement of mergers of financial intermediaries or their conversion into commercial banks.

The resumption in February 1984 of the policy of depreciating the sol at least in line with domestic inflation resulted in increased returns on dollar-denominated assets in relation to assets denominated in soles. In an effort to correct this situation, the authorities have begun to give market forces a greater role in the determination of domestic interest rates. In February 1984 advance payments of interest on time certificates have been permitted at freely determined discount periods. However, financial market acceptance of the new certificates has been below expectations, reportedly because of resistance by some major banks. Most of the new certificates have been issued by medium and small financial institutions, and almost 60 percent has been issued by nonbank intermediaries.

The Central Reserve Bank still determines the yield on indexed certificates of deposit and on savings and time deposits. With respect to indexed certificates of deposit, a maximum interest rate of 10 percent per annum is applied to the adjusted base. Until September 30, 1984, the adjustment rate was fixed in a discretionary manner by the Central Reserve Bank. 1/ As of October 1, the adjustment rate was made equivalent to past changes in the cost of living index, thus raising the yield to 10 percentage points above the past rate of inflation. Banks reportedly have not been keen to increase their indexed deposit base, as the proceeds of these instruments must be used for extending credits of over one year or be deposited at the Central Reserve Bank, which pays only the adjustment rate on such deposits.

The authorities explained that the maximum rate on nonindexed deposits--which continue to represent the bulk of deposit in soles--has not been raised since it was increased to 60 percent in September 1983 in the expectation that the rate of inflation would decline. As this deceleration failed to take place and the new financial instruments with freely determined discount periods have not received the expected market acceptance, U.S. dollar CDs in Peru and deposits in U.S. dollars abroad continued to be attractive alternatives. In an effort to stem the trend toward dollarization of the domestic financial system, in November 1983 the authorities limited the commercial banks' positions in dollar-denominated CDs to 10 percent of their capital and reserves. However, banks reportedly circumvented the limit by holding other dollar-denominated assets, or by operations with wholly owned nonbank intermediaries.

The authorities were concerned about the dollarization trend because the withdrawal of foreign currency deposits at domestic banks could lead to a depletion of official reserve holdings. At present foreign currency deposits held by residents are approximately equal to the foreign currency reserves of the Central Reserve Bank. Hence, the authorities' aims in respect of reserve management have reflected in

1/ Since its introduction in April 1983, the annual rate had been raised from 40 percent to 92 percent, so that certificates yielded recently about 112 percent per annum.

part the objective of maintaining the confidence of the holders of U.S. dollar claims on the domestic banking system. In the first semester of 1984, gross reserves were bolstered by the earlier than planned disbursement of US$100 million from foreign banks and through sales of silver (US$25 million) accumulated in the 1979-80 period.

The authorities noted that the policy of zero marginal legal reserve requirements on sol-denominated bank deposits, which was initiated in 1982, had operated satisfactorily. As a result of the rapid growth in the nominal value of deposits, average required reserve holdings of a number of banks had declined to the legally prescribed minima of 15 percent on sight deposits up to 30 days and 6 percent for all other deposits, and hence these ratios had effectively become the new marginal requirements. Since most banks continued to hold substantial excess reserves at the Central Reserve Bank, the new reserve requirements were expected to be met by reducing excess holdings during the coming months. On October 1, 1984, as part of the Central Reserve Bank's policy of tightening credit, legal reserve requirements on local currency bank deposits were raised to a unified level of 15 percent. At the same time, an average reserve requirement of 75 percent was introduced on foreign currency deposits, in addition to the existing marginal requirement of 90 percent. The two changes were expected to absorb the bulk of the banks' excess reserves in soles and U.S. dollars.

Within its restrained overall credit policy, the Central Reserve Bank established and amplified a number of special sectoral credit lines. The authorities viewed the utilization of the special credit lines as a limited undertaking aimed at reactivating specified industries or regions. On October 1, 1984 the Central Reserve Bank raised interest rates on its special credit lines toward the legal maximum nominal rate of 60 percent. The Central Reserve Bank also provides subsidized export financing. Such financing, in the form of 90-day pre and post-shipment credits, was said to be necessary to provide Peruvian exporters with conditions similar to those offered by other countries.

The marginal portfolio requirement instituted in 1983 to channel commercial bank resources to the Agricultural Bank has yielded only a minimal amount since the banks apparently preferred to comply with the requirement of sectoral credit allocation by lending directly to clients in the agro-industrial sector.

So far the policy to encourage mergers and conversions has met with little success. No mergers had occurred and only one conversion of an investment company into a commercial bank had taken place. The enabling legislation for mergers and conversions is to lapse in December 1984, but the authorities had no plans to extend its application. However, they noted that the Congressional Banking Commission had expressed renewed interest in discussing a new general banking law that would treat these issues. While the increase in the limit on foreign capital participation in domestic financial institutions to one third of total capital had not led to any new investment in existing financial institutions, one new foreign bank had recently been licensed to operate in Peru and discussions with a second one were in an advanced stage.

3. Wage policy

Wage policy in the public sector in 1984 has been less restrained than programmed. After a 15 percent wage increase granted in February in accordance with program provisions, strikes by public health workers, teachers, and central administration employees were settled in June by granting wage adjustments amounting to 26 percent instead of the 16 percent programmed. The June increase was granted in addition to special increases given earlier to some sectors (health, education, defense, and security forces) and involved an effort to standardize pay scales throughout the Central Administration. Concurrent with the June increase, the authorities introduced institutional changes designed to provide the Central Government with a uniform wage policy. These changes include the creation of a commission 1/ empowered to set wage policy and the establishment of a new wage reference unit that breaks the link between central government wages and the economywide minimum wage.

In an effort to exert effective control over wages paid by public enterprises, a supreme decree was issued in August 1983 that required public enterprises to submit planned wage increases to the Ministry of Finance, Economy, and Commerce for approval. This requirement also was incorporated in the 1984 budget law. However, because of staffing problems, in early 1984, control over public enterprise wage decisions was shifted to CONADE (the National Development Council). Since then guidelines for public enterprise wage adjustments have been developed that aim at limiting wage increases for all but the highest ranking managers to 70 percent of past inflation and prohibiting the introduction of new fringe benefits. However, as these guidelines do not affect existing union contracts in public enterprises, their effectiveness has been less than had been expected.

In regard to private sector wages, the authorities said that it was their policy to protect the purchasing power of wage earners in the lowest income brackets of the nonunionized sector through periodic increases in the minimum wage or in the compensation of low-wage nonunionized workers. In pursuance of this policy, wage increases were mandated for nonunionized workers in the private sector as follows: 13 percent on the first three minimum wages in February 1984; 25 percent on the first five minimum wages in June; and 14 percent on the first eight minimum wages in September.

Wage negotiations in the unionized private sector take place without government participation. The Ministry of Labor is asked to arbitrate in approximately 25 percent of the negotiations. The authorities

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1/ The commission is composed of the Prime Minister and the Ministers of Finance, Labor, and Justice.

attributed this low proportion to their policy of recommending settlements involving wage awards equivalent to no more than 70 percent of past inflation.

The authorities said that it had not been possible to begin reducing the rigidities of existing labor legislation as had been planned under the program. They agreed that the strong labor stability provisions discouraged employers from hiring workers on a full-time or permanent basis. Moreover, the existing legislation encouraged employers to limit labor contracts to less than four work hours a day so as to avoid granting vacation time and payment of bonuses, and to limit full-time employment contracts to three months so as to avoid job tenure provisions.

4. External sector policies

The authorities were of the view that in the short term the balance of payments disequilibrium could best be corrected through fiscal adjustment and a continued tight monetary policy, including greater interest rate flexibility. They did not foresee any substantial changes in Peru's exchange rate or exchange and trade policies in the near future.

a. Exchange system

On February 29, 1984 the authorities discontinued the policy of preannouncing the exchange rate and re-established a flexible exchange rate regime involving frequent small changes in the rate of the sol in relation to the U.S. dollar at least in line with the rate of domestic inflation. In fact, the sol has been depreciated at a faster rate than domestic inflation. The authorities noted that this policy resulted in a small real effective (trade weighted) depreciation of the sol in the March-September period. However, the real effective (trade weighted) value of the sol remained substantially appreciated in relation to the period 1978-80, following the last major depreciation in 1978 (Chart 1). The Peruvian officials were generally in agreement with the staff that a major adjustment of relative prices was needed to establish the basis for an export-led economic growth over the medium term. However, they did not foresee the implementation of this policy during the remaining period of the present administration.

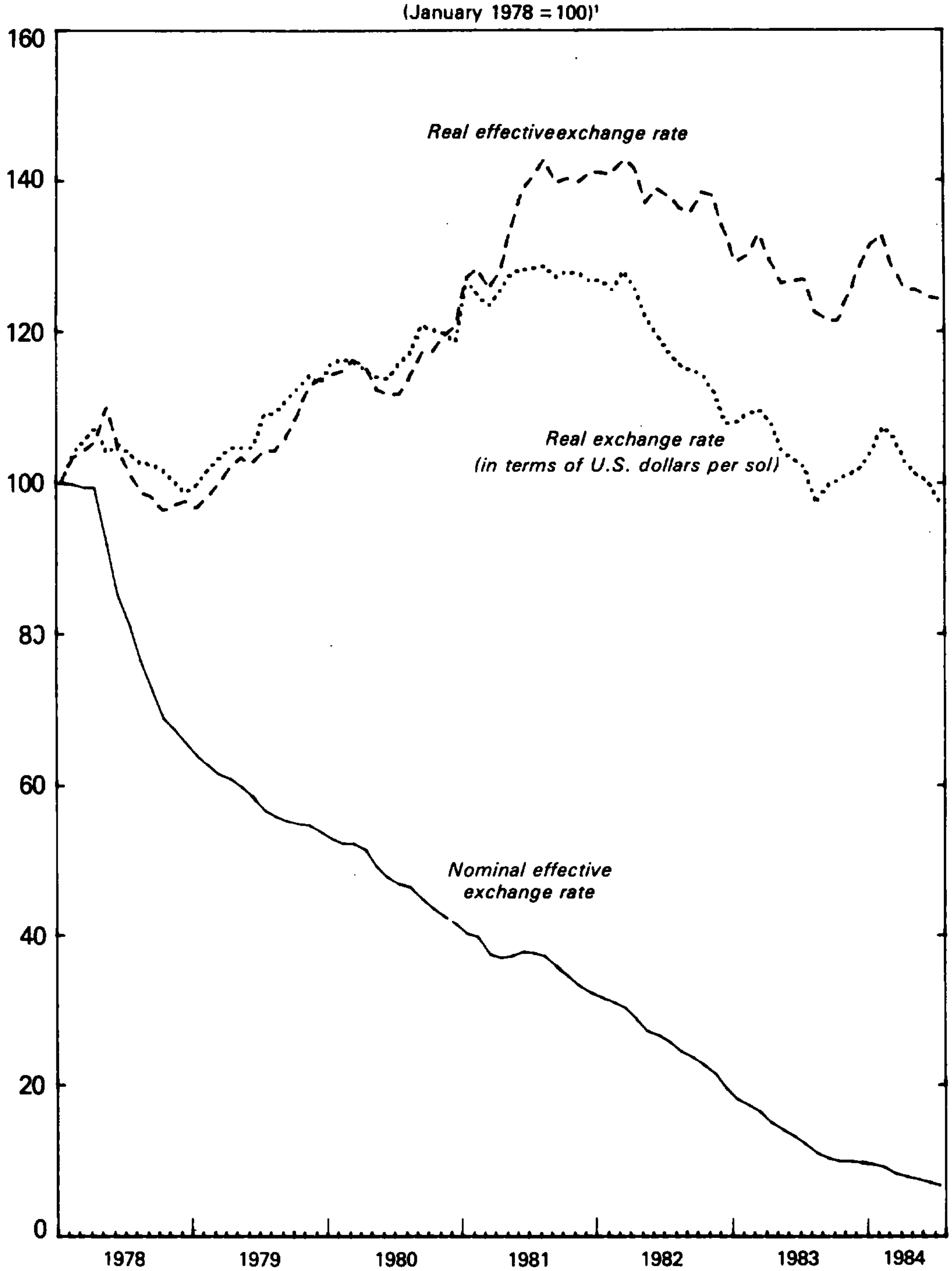
Peru maintains a second exchange market for capital transactions where U.S. dollar-denominated certificates of deposit are traded. In the past several years, the exchange rate for the sol in the certificate market was close to the rate in the official market, and spreads in excess of 1 percent were uncommon 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 was to cease. With the exception of an intermittent peak of 8 1/2 percent in May, the spread declined until July, when renewed uncertainty about the direction of economic policies gave rise to spreads that at times have exceeded

CHART 1

PERU

REAL AND NOMINAL EXCHANGE RATES

(January 1978 = 100)[1]



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

[1] Indices in terms of units of foreign currency per sol; increase represents appreciation.

10 percent. The authorities viewed the latest, sustained increase with concern and in early October responded by raising reserve requirements and interest rates.

In late October the staff was informed that the Central Reserve Bank stopped the sale of foreign exchange for travel abroad, which could from then on be acquired only in the certificate market. At the same time, the Central Reserve Bank ceased to issue freely disposable exchange certificates for traditional exports. These certificates, which in the past had been issued for 15 percent of exchange surrenders from exports, could be converted into U.S. dollar certificates of deposit. Relegation of exchange sales for travel abroad to the certificate market would give rise to a multiple currency practice subject to Fund approval if the spread between the rates in the certificate market and the official market exceeds 2 percent.

In April 1984, at the time of the approval by the Executive Board of the stand-by arrangement for Peru, approval was given of an exchange restriction giving rise to arrears on debt service payments due to commercial banks and countries participating in the Paris Club pending the formalization of agreements in principle with both creditor groups to restructure those debts. Also covered by the approval were arrears on debt service payments to suppliers without official guarantee and to socialist countries that are members of the Fund, from which Peru had been seeking debt relief on similar terms. While no specific date for the lapse of the approval was set in the decision, the approval was given only in respect of payments arrears on debts falling due during the consolidation periods (extending through July 1985)1/ covered by the agreements in principle with the advisory committee of the banks and the delegations representing the countries participating in the Paris Club, respectively.

Since the approval was given, Peru has signed the bilateral agreements under the 1983 agreed minute of the Paris Club with virtually all countries and agencies concerned, and a new agreed minute was signed in early June 1984 which covers the maturities falling due in the period May 1984-July 1985 (EBS/84/145, 7/6/84). Bilateral agreements under the terms of the 1984 agreed minute have yet to be signed. Progress toward finalizing the agreement with the banks has been more limited. Members of the consortium representing more than the critical mass levels for both the formal signing and subsequent effectiveness of the various parts of the restructuring agreement have given positive replies. However, a number of specific issues relating to the loan documentation remain outstanding between the advisory committee and the Government of Peru, and the formal signing has not taken place. More recently, noncompliance with the fiscal performance criterion under the stand-by arrangement and the emergence of arrears on interest payments to the

1/ The consolidation period for debt service falling due to countries participating in the Paris Club was extended from February 1985 to July 1985 in the agreed minute of the June 1984 Paris Club meeting.

banks have created additional problems. Contacts between Peru and the advisory committee have continued and another meeting is planned for early November 1984.

Since June 1984 arrears have arisen on external debt service payments by the Central Government and one public sector enterprise, the external debt of which the Central Government had been paying as guarantor. At the end of September 1984, the arrears amounted to about US$200 million, including US$7.3 million attributable to the enterprise. The central bank officials explained that these arrears were the consequence of a cash shortage of the Central Administration arising from inadequate fiscal adjustment and poor management by the enterprise. The officials stated that the Central Reserve Bank had at no time refused to sell exchange to the public or private sectors for foreign debt service payments. In their view, the appropriate solution to the public sector's arrears on domestic and external payments was to strengthen the Government's financial position. Settlement of arrears through central bank credit expansion would lead to an acceleration of inflation and a loss of international reserves; the best means of addressing this problem would be to introduce measures to raise revenues and reduce outlays and thus effect a sustained improvement in the fiscal position.

The staff expressed its concern that these arrears would have serious effects on Peru's international creditworthiness, and would lead to further resort to exchange restrictions. In this context, an issue arises regarding whether or not these arrears evidence an exchange restriction.1/ The public enterprise, which is an off-budget entity, appears to have suffered in recent years from illiquidity, partly as a result of inadequate government pricing policies. Following suspension of the payments of its external debt service by the Central Government, this enterprise has continued to make certain domestic payments with the resources at its disposal, but has not resumed payment of these external obligations. However, the role of official action (involving either the Central Reserve Bank or the fiscal authorities), if any, in the incurrence of these arrears has not been ascertained conclusively yet. As noted above, foreign exchange has been made available by the Central Reserve Bank for payment of the external debt. Nevertheless, further external and internal arrears have accumulated in recent months as a result of choices made regarding alternative use of available domestic resources in the face of a precarious foreign exchange position. The staff will investigate further whether discontinuance by the Central Government of payment of the guaranteed debt reflects the fact that foreign exchange is not made available to the enterprise as original debtor and thus gives rise to an exchange restriction.

1/ The existence of a restriction depends on whether the arrears result from the inability of the enterprise to obtain foreign exchange and on whether the enterprise is "clearly independent of the Government's day-to-day budgetary controls and has at its disposal domestic currency resources with which to meet its external payments obligations" (EBS/80/190, 8/27/80, p. 9).

With regard to the tightening of the regulations governing the sale of exchange for travel abroad, which had been introduced in March 1984 with the objective of controlling speculative capital transactions, the authorities noted that the intended result had been achieved without impeding the availability of exchange to legitimate travelers. The tightening of the regulations does not appear to involve an exchange restriction subject to Fund approval. As noted above, the staff was informed in late October 1984 that the Central Reserve Bank had ceased to sell foreign exchange in the official market for travel abroad. An exchange restriction does not appear to be involved because would-be travelers may freely obtain foreign exchange through recourse to the certificate market.1/

b. The trade system

The authorities have been under strong pressure to increase protection to local industry. They noted that the level of protection was raised in 1982 and again in 1983 through tariff increases which were taken for fiscal rather than balance of payments reasons. In April 1984 the tariff surcharge was raised again from 10 to 15 percentage points, increasing the average unweighted tariff from 41 percent to 46 percent. At the end of July, in connection with the reduction of the value added tax, the import tariff was raised further by 5-16 percentage points in rough proportion with the original tariff rates. This increase raised the average unweighted tariff further to about 56 percent. The authorities concurred with the staff's view that the recent tariff increases encourage economic inefficiency and are harmful to the growth of the export sector. They also were concerned that the fiscal gains from higher tariffs were being offset by increased evasion, widespread exemptions, and temporary import duty concessions for particular groups. They hoped to be able to reduce the disparity of tariffs through the elimination of duty exemptions.

Peru's trade system has been relatively free of quantitative restrictions. However, in June and July 1984, prior licensing requirements were imposed on 17 tariff items, including steel, tobacco, clothing, and footwear. At the same time, importation of the latter three products was suspended until the end of 1984, except for goods originating in the Andean group countries.

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. The subsidy varies according to product and region of origin. On the basis of legislation passed in July 1984, the export subsidy system was simplified in September 1984 and new, generally higher rates were established and the coverage of the system was extended.

1/ Would-be travelers can acquire maturing certificates of deposit in that market that are immediately redeemed in U.S. dollars by the issuing bank.

The Central Reserve Bank provides concessional financing to exporters of nontraditional products. In September 1983, certain textile products to the United States became ineligible to receive these export facilities with a view to achieving a lifting of the countervailing duties imposed by the United States on such products in early 1983. The authorities stated that they will continue to work toward establishing a system of export incentives in accordance with the conventions under the General Agreement on Tariffs and Trade.

c. External debt management

A number of institutional improvements relating to the control and management of external debt were made in the 1981-83 period, but serious difficulties remain, particularly as regards control over debt service payments.

In 1981 the contracting of medium- and long-term debt was brought under the control of the General Directorate of Public Credit, and in late 1982 this control was extended to short-term debt. Public enterprises were required to register short-term external debt (except export prefinancing) with the Directorate and to obtain its approval for the renewal, rollover, or consolidation of such debt. Starting in 1983, the public enterprises were required to submit short-term borrowing programs (excluding export prefinancing) to the Directorate for approval. Technical assistance provided by the World Bank contributed to reducing substantially the delays in reporting disbursements of medium- and long-term loans. However, problems still remain in accounting for certain suppliers credits.

The need to improve control over external indebtedness is underscored by the high level of external indebtedness of Peru. The stock of total external debt outstanding at midyear 1984 amounted to US$12.8 billion, equivalent to more than 75 percent of GDP. Service payments on public and publicly guaranteed debt have risen considerably since 1980 and in 1984 debt service obligations are estimated at 69 percent of exports of goods, nonfactor services, and transfers. Payments due after conclusion of the 1984 debt restructuring agreements are estimated to amount to 40 percent of the same receipts. A projection of public and publicly guaranteed debt service payments on the basis of a gradually declining external current account deficit (see medium-term outlook, below) and refinancing agreements in place or currently in process, indicates that the debt service ratio would decline gradually after 1984 (Appendix IV).

The authorities noted that because of the exceptionally high debt service obligations in 1984, the restructuring of a sizable part of these payments had been a major objective of external debt management. External creditors had already consented to restructure debt service payments due in 1983 and early 1984. The same creditors were subsequently asked to restructure payments falling due in the remainder of 1984 and in the January-July 1985 period, coinciding with the duration of the stand-by arrangement with the Fund.1/

With its foreign bank creditors Peru reached agreement in principle in February 1984 on the refinancing of amortization payments due in the period March 7, 1984-July 31, 1985, the conversion into a medium-term loan of short-term working capital credits, the maintenance of commercial credit lines, and the disbursement of the balance of US$200 million of the 1983 new money facility.2/ Paris Club creditors agreed in June 1984 to conclude bilateral arrangements rescheduling the bulk of principal and interest payments falling due from May 1, 1984 to July 31, 1985. Nonguaranteed suppliers have been approached for similar rescheduling conditions. In November 1983 an agreement was signed with the Soviet Union to restructure debt service payments falling due during 1983-85. Provisions were made for the settlement of debt service payments on previously rescheduled debt through shipments of nontraditional exports. Other socialist country creditors have been approached for restructuring arrangements on similar terms. The authorities noted that the formal conclusion of the restructuring agreements with foreign banks, nonguaranteed suppliers, and bilateral official creditors had been delayed by the debt service arrears accumulated since mid-1984.

5. Medium-term outlook

In view of the forthcoming presidential election, the authorities were not in a position to discuss medium-term objectives and policy intentions in specific terms. As a result, the discussion of medium-term prospects centered on the nature of policies needed to correct the fundamental imbalances. The Peruvian officials who commented on medium-term issues stressed that a return to economic growth in a framework of financial stability would require a strengthening of the public finances, and an improvement in the current account of the balance of payments through an adjustment of relative prices.

The staff has prepared a projection of the balance of payments and debt service obligations covering the remainder of the decade (Appendix IV). This scenario is based on the assumption that Peru's international competitiveness is restored to the 1979 level at the beginning of 1985 and maintained thereafter through appropriate exchange rate management and wage policies. In addition to faster growth in the traded goods sector, the scenario presupposes a redirection of resources toward the private sector on the basis of a policy that eschews domestic financing of the nonfinancial public sector. Furthermore, domestic savings are presumed to recover through the maintenance of a positive real return on savings.

1/ Full details of the refinancing agreements are presented in Appendix V of the forthcoming report on recent economic developments.

2/ US$100 million of this balance was disbursed in March 1984.

Real GDP growth is expected to be only 1 to 2 percent in 1985 and 1986, but then gradually to recover to 4 percent by 1988. The rate of growth of exports would accelerate and the current account deficit would fall from US$0.8 billion in 1984 to US$0.7 billion in 1985 and then decline to US$0.5 billion by the end of the decade. Measured in relation to GDP, the current account deficit would decline from 4.9 percent in 1985 to 2.5 percent by the end of the decade. Even on the assumption that loans from bilateral and multilateral lenders and suppliers credits continue at the pace of the past (typically 4-5 percent of GDP a year), Peru would likely need to continue to seek restructuring arrangements with its principal foreign creditors to reduce amortization payments to manageable levels. Under this scenario, the ratio of external public debt (both short- and long-term) to GDP would fall gradually from 86 percent in 1985 to 70 percent by the end of the decade, and the debt service ratio would decline to 55 percent at the end of the 1980s. In any event, Peru would remain vulnerable to fluctuations in the terms of trade. The medium-term scenario does not make provision for increases in net official international reserves, in as much as Peru's short-term debt will be comparatively low after the formal completion of the conversion of short-term debt to banks into medium-term credit and gross official reserves (after deducting external arrears) currently amount to about seven months of imports. Nevertheless, the authorities may wish to consider an alternative scenario that would involve some accumulation of reserves in order to lessen the country's vulnerability to fluctuations in the terms of trade and in capital inflows.

III. Staff Appraisal

In 1984, for the third consecutive year, the authorities of Peru developed a program to reduce the economy's internal and external imbalances through a major reduction in the financing requirements of the nonfinancial public sector. The fiscal adjustment was to be based both on a strengthening of revenue and restraint on expenditure. To improve the chances for success of the program, certain major revenue measures and corrective price increases were put in place before Executive Board approval of the stand-by arrangement in April 1984. Nevertheless, implementation of the program required the maintenance of a strong revenue effort and the exercise of strict control over spending throughout the year. By the middle of 1984, deviations from the program path had appeared, and projections for the second semester pointed to the re-emergence of substantial imbalances. Without corrective action, the deficit of the nonfinancial public sector would rise to 10 percent of GDP for 1984 as a whole, with adverse repercussions on the balance of payments and inflation.

The principal factor behind the widening of the public sector deficit is a rise of spending above the level planned, including wage awards in excess of those contemplated under the program. The weakening of central administration control over the operations and investment activities of the public enterprises has been an additional element in the widening of the public sector deficit. Also, revenue performance has not been as strong as had been projected as a number of publicly controlled prices were not raised in line with cost increases and the value added tax was reduced substantially; a moderate increase of this tax had been the most important revenue measure put in place before Executive Board approval of the stand-by arrangement. Revenue measures introduced to compensate for the reduction of the value added tax are not yielding enough to produce an offset.

The growing disequilibrium in the public finances has put renewed pressure on the balance of payments and domestic prices. It has had negative effects on the private sector's access to domestic credit and, therefore, on its recovery. Since about the middle of 1984, the rise of the public sector deficit above the amount programmed has led to the incurrence of substantial domestic and external payment arrears. It is therefore urgent that the authorities take action to strengthen the fiscal situation. An immediate aim would be to stop the accumulation of domestic and external payment arrears without recourse to domestic bank financing. This will require measures to curb expenditure, raise revenue, and improve control over the operations of the public enterprises. In this connection, the staff would emphasize the need for a major improvement in tax administration as an integral element of the revenue effort, and it would recommend that a start be made on a medium-term plan to improve the economic efficiency of the tax system. Even with prompt action along these lines, it is unlikely that the economic program for 1984 can be brought back on track. However, the early adoption of the necessary remedial measures would help to stabilize the situation and provide the basis for a satisfactory fiscal plan for the coming year.

In 1983 the monetary authorities expanded credit to the public sector to finance the larger than programmed deficit of that year, thus contributing to the acceleration of inflation and to a substantial loss of net international reserves. Thus far in 1984 the Central Reserve Bank has been firm in maintaining a tight credit policy. Net credit from the Central Reserve Bank to the banking system has remained below programmed levels, and no expansion of net credit to the nonfinancial public sector has been authorized. Domestic interest rates have been permitted to reflect market forces to a greater extent than in the past. The staff supports these policies and it welcomes in particular the measures taken recently to tighten credit further. However, the staff would urge additional steps to make interest rates more flexible. While heavy reliance on monetary policy is unavoidable in current circumstances, the staff would note that the combination of tight credit, high public sector deficits, and laxity in wage policy, will impair the attainment of growth and employment objectives.

The exchange rate policy pursued since March 1984, involving frequent small depreciations of the sol at a rate somewhat faster than past inflation, has worked with monetary policy to help protect the balance of payments. Nevertheless, the apparent need to resort to a substantial increase in import duties, together with the introduction of licensing requirements and prohibition for certain imports, raises questions about the adequacy of the present exchange rate. The existence of a second exchange market, in which the spread with respect to the rate in the official market recently exceeded 10 percent, poses similar questions. Viewed in a medium-term perspective, the present exchange rate of the sol does not appear to provide sufficient incentive for a growth of exports that would enable Peru to service its external debt without serious difficulty.

At present Peru is incurring arrears in its debt service to many of its foreign creditors. It is clear that the emergence of external payment arrears is doing serious damage to Peru's creditworthiness. It is therefore very important that the authorities take the corrective measures necessary to enable the public sector to pay all commitments for outlays--including external debt payments service obligations--as they arise without reliance on the expansion of central bank credit because, given the precarious foreign exchange position of Peru, credit expansion would risk triggering an exchange crisis.

Peru maintains a restriction on payments and transfers for current international transactions in respect of which approval was given in April 1984, pending the formal conclusion of restructuring agreements with foreign creditors. While the decision granting the approval did not expressly set a terminal date, the approval was given in the context of the existence of agreements in principle on the restructuring of Peru's external debt and with the intention to give Peru adequate and reasonable time to conclude these agreements. As these agreements in principle are still in place and the parties pursue their efforts toward a successful conclusion of the formal agreement, the approval of the exchange restriction remains in effect.

However, should the agreements in principle cease to be operative because the parties discontinue their efforts to implement them or because, under the circumstances, no finalization of the agreements can be reasonably expected, the approval would need to be regarded as terminated and an appropriate proposal to that effect would be made by the staff to the Executive Board.

While Peru has made some progress toward finalizing the agreements with its foreign creditors, the formal agreements have not yet been signed. The consolidation period covered by the agreements in principle between Peru and the Paris Club countries and the advisory committee of the banks ends on July 31, 1985 and the staff would propose that if final agreements are not in place by such date, nor are there firm expectations that they will be concluded soon thereafter, those agreements in principle would be deemed to have ceased to be operative and recommend that approval of the restriction involved be regarded as discontinued.

The transfer of sales of foreign exchange to the certificate market in late October 1984 would give rise to a multiple currency practice if the spread between the exchange rates in the official and the certificate markets exceeds 2 percent. It is not proposed that the Executive Board approve this multiple currency practice at this time.

It is recommended that the next Article IV consultation with Peru be held on the standard 12-month cycle.

Attachments

Peru - Fund Relations

(As of September 30, 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 1,031.1 million or 311.6 percent of quota.

(c) Fund credit:

	Amount	Percent of Quota
Fund credit	700.2	211.6
Compensatory financing	(274.6)	(83.0)
Stand-by	(44.6)	(13.5)
Extended Fund facility	(211.1)	(63.8)
Supplementary financing	(116.0)	(35.0)
Enlarged access resources	(53.9)	(16.3)

III. Stand-by Arrangement and Special Facilities

(a) Stand-by arrangement:

(i) Duration: From April 26, 1984 through July 31, 1985.
(ii) Amount: SDR 250 million or 75.6 percent of quota.
(iii) Utilization: SDR 30 million.
(iv) Undrawn balance: SDR 220 million.

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

(i) 1982 extended arrangement:

Duration: Originally scheduled to cover the period from June 1982 to May 1985, was canceled as of April 26, 1984 at the request of the Peruvian authorities.

Amount:	SDR 650 million.	
Utilization:	Cumulative	SDR 265 million
	1983	SDR 165 million
	1982	SDR 100 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 at the 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 at the request of the authorities.

Amount: SDR 90 million.

Utilization: SDR 10 million.

(c) Special facilities: On May 1984 Peru purchased SDR 74.7 million under the compensatory financing facility (exports). Outstanding purchases under the compensatory financing facility amount to SDR 274.6 million or 83 percent of quota.

IV. SDR Department

(a) Net cumulative allocation: SDR 91.3 million.

(b) Holdings: SDR 0.68 million or 0.74 percent of net cumulative allocations.

(c) Current designation plan: None.

B. Nonfinancial Relations

V. Exchange rate: September 30, 1984, S/. 4,067.10 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 U.S. dollars provide a parallel market with a market-determined exchange rate. As of September 21, 1984, this certificate rate was 8.3 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, 1984 the Fund's holdings of soles have been accounted for at the rate of SDR 0.000328267 per sol, or S/. 3,046.30 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 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 was 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, which was recently extended for a second year, began 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 the period

March-September 1984 an in-depth review of the tax system was made with technical assistance provided by the Fiscal Affairs Department and two panelists. One of the panelists has been assigned for a 3-week period to help the authorities implement some of the reforms recommended in the review.

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 1983)	19.3 million
Annual rate of population increase (1978-83)	2.8 percent
Unemployment rate (September 1983; Lima Metropolitan Area)	8.8 percent
GDP (1983)	SDR 15.20 billion
	US$16.25 billion
	S/. 26,475.9 billion
GDP per capita (1983)	SDR 763

Origin of GDP	1981	1982	Prel. 1983	Prog. 1984	Proj. 1984
			(percent)		
Agriculture & Fishing	13	14	14	14	15
Mining	9	9	10	9	10
Manufacturing	24	23	22	22	21
Construction	5	6	5	5	5
Government	8	8	9	8	8
Other	41	40	40	42	41
Ratios to GDP					
Exports of goods and services	20.0	20.2	23.2	23.3	22.6
Imports of goods and services	28.7	28.3	28.6	28.6	27.5
Current account of the balance of payments	-8.7	-8.1	-5.4	-5.3	-4.9
Central administration revenues	17.9	17.6	14.1	15.9	15.0
Central administration expenditures	22.8	21.6	22.9	18.7	21.8
Nonfinancial public sector savings	0.1	0.2	-2.6	2.7	-1.9
Nonfinancial public sector overall surplus or deficit (-)	-8.8	-9.1	-11.7	-4.1	-10.1
External public debt (end of year)	31.4	34.9	51.3	62.1	69.4
Gross national savings	13.5	14.6	11.6	12.8	10.7
Gross domestic investment	22.2	22.7	17.0	18.1	15.6
Money and quasi-money (end of year)	25.9	27.1	28.4	25.7	26.9
Annual changes in selected economic indicators					
Real GDP per capita	0.2	-2.0	-14.0	1.2	0.7
Real GDP	3.0	0.7	-11.6	4.0	3.5
GDP at current prices	70.9	66.5	87.3	99.2	114.6
Domestic expenditures (at current prices)	85.6	65.2	80.2	90.4	111.3
Investment	114.2	69.7	40.7	55.3	109.7
Consumption	79.2	64.0	91.3	99.2	111.7
GDP deflator	65.9	65.3	111.9	91.5	107.3
Cost of living (annual averages)	75.4	64.5	111.1	83.9	109.6
Central administration revenues	49.5	63.7	49.7	121.1	127.8
Central administration expenditures	67.1	57.4	99.5	61.6	100.6
Money and quasi-money	75.9	74.1	96.9	76.8	103.1
Money	(46.7)	(35.7)	(90.9)	(...)	(...)
Quasi-money	(98.7)	(96.3)	(99.2)	(...)	(...)
Net domestic bank assets 1/	89.1	61.7	121.6	83.8	102.1
Credit to public sector (net)	(31.6)	(7.5)	(88.1)	(-8.2)	(84.1)
Credit to private sector	(65.8)	(69.2)	(94.2)	(83.1)	(84.2)
Merchandise exports (f.o.b., in U.S. dollars)	-17.0	1.4	-8.4	3.8	-0.2
Merchandise imports (f.o.b., in U.S. dollars)	23.0	-2.1	-26.8	-3.8	-10.7

Central administration finances	1981	1982	Prel. 1983	Prog. 1984	Proj. 1984
		(billions of soles)			
Revenues	1,523	2,493	3,732	8,230	8,501
Expenditures	1,938	3,051	6,087	9,703	12,364
Current account surplus or deficit (-)	19	29	-1,366	227	-1,960
Overall surplus or deficit (-)	-415	-558	-2,355	-1,453	-3,863
External financing (net)	-9	407	1,302	...	2,544
Internal financing (net)	424	123	827	...	1,165

Balance of payments	1981	1982	Prel. 1983	Prog. 1984	Proj. 1984
	(millions of U.S. dollars)				
Merchandise exports, f.o.b.	3,249	3,293	3,015	3,131	3,010
Merchandise imports, f.o.b.	-3,802	-3,721	-2,722	-2,612	-2,430
Investment income (net)	-1,019	-1,034	-1,130	-1,415	-1,317
Other services and transfers (net)	-156	-147	-35	-6	-36
Balance on current and transfer accounts	-1,728	-1,609	-872	-902	-773
Official capital (long-term net)	388	995	1,431	1,002	1,530
Private capital (long-term net)	260	205	-47	-100	-218
Short-term capital and errors and omissions (net)	448	593	-1,186	--	-539
Allocation of SDRs	21	--	--	--	--
Change in net official reserves (increase -)	611	-184	674 2/	--	--

International reserve position	Dec. 31 1981	Dec. 31 1982	Dec. 31 1983	June 30 1984
		(millions of SDRs)		
Monetary authorities (gross)	1,308.2	1,510.4	1,597.3	1,642.4
Monetary authorities (net)	495.0	689.2	139.6 2/	588.3
Rest of banking system (net)	55.7	13.9	-154.0 2/	-456.8

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 for under the agreement with foreign commercial banks.

Peru - Statistical Issues

1. Coverage, Currentness, and Reporting of Data in IFS

		Latest Data in October 1984 IFS
Real Sector	- National Accounts	1983
	- Prices (Consumer)	July 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	May 1984
	- Financing	May 1984
	- Debt	n.a.
Monetary Accounts	- Central Bank	March 1984
	- Deposit Money Banks	March 1984
	- Other Financial Institutions	March 1984
External Sector	- Merchandise Trade: Values	April 1984
	- Merchandise Trade: Prices	April 1984
	- Balance of Payments	Q2 1982
	- International Reserves	April 1984
	- Exchange Rates	August 1984

During the past year, the reporting of data for inclusion in the IFS has been timely.

2. Outstanding Statistical Issues

Prices

The Consumer Price Index is derived from a household expenditure survey confined to Metropolitan Lima--consideration should be given to compiling a more representative national index.

Government Finance

The Government Finance Statistics Yearbook presentation for Peru does not include tables for financing and debt and seriously understates government operations by failing to cover government autonomous institutions and the Seguro Social del Peru.

No reply has so far been received to the GFS questionnaire for the 1984 GFS Yearbook.

Monetary Accounts

Peru is currently receiving assistance from the Fund's Bureau of Statistics. The primary objectives of this program are to revise the methodology used for the compilation of monetary data and to develop a standardized system of data collection. So far there have been two technical assistance visits to the Central Reserve Bank of Peru. During the first visit (November 1-19, 1983), the monetary authorities' accounts were revised and redesigned according to uniform criteria of both sectorization and classification. In the second visit (February 15-29, 1984), the methodology for the collection and production of data for the deposit money banks was revised, and new standardized balance sheets and analytical tables were designed. At the request of the Central Bank authorities, a follow-up visit has been scheduled for November 29-December 13, 1984. The primary objective of this third visit is to evaluate the work done in the monetary sector and to integrate the rest of the financial system within the new scheme of monetary accounts.

Merchandise Trade

Data on trade by partner countries are very uncurrent, the latest available data referring to 1981. Although annual data through 1981 were received by cable for the DOTS yearbook, regular reporting of monthly or quarterly data would be appreciated.

International Banking Statistics

In recent years, liabilities of banks in Peru to banks in the rest of the world, as reported by banks in Peru, were considerably less than the claims on banks in Peru that are identified in reports from banks in major international banking centers, received as part of the Fund's project on international banking statistics. The discrepancy arises from the fact that the Peruvian authorities treated Arlabank as an international license bank and did not include its accounts in the regular money and banking data. According to standard Fund practice, Arlabank should be regarded as a resident of Peru, and its accounts should be covered in the financial statistics provided by Peru. However, the Peruvian authorities currently do not have any data on Arlabank's operations because the bank, under its charter, is not subject to reporting requirements to, and supervision and control by, either the Central Reserve Bank or the Superintendency of Banking and Insurance Companies.

Peru: Balance of Payments

(In millions of U.S. dollars)

	1980	1981	1982	1983	1984 Prog.	1984 Proj.
Current account	-101	-1,728	-1,609	-872	-902	-773
Merchandise trade	826	-553	-428	293	519	580
Exports, f.o.b.	(3,916)	(3,249)	(3,293)	(3,015)	(3,131)	(3,010)
Imports, f.o.b.	(-3,090)	(-3,802)	(-3,721)	(-2,722)	(-2,612)	(-2,430)
Investment income	-909	-1,019	-1,034	-1,130	-1,415	-1,317
Public sector	(-479)	(-533)	(-540)	(-636)	(-985)	(-881)
Private sector	(-430)	(-486)	(-494)	(-494)	(-430)	(-436)
Other services	-165	-317	-314	-254	-195	-204
Transfers	147	161	167	219	189	168
Long-term capital	462	648	1,200	1,384	902	932
Public sector	371	388	995	1,431	1,002	1,150
Nonfinancial	(363)	(325)	(878)	(1,338)	(927)	(1,025)
Disbursements 1/	/783/	/1,442/	/1,764/	/1,454/	/1,081/	/1,135/
Rescheduling	/372/	/80/	/109/	/1,013/	/1,140/2/	/1,234/2/
Amortization	/-792/	/-1,197/	/-995/	/-1,129/	/-1,294/2/	/-1,344/2/
Financial	(8)	(63)	(117)	(93)	(75)	(125)
Disbursements 1/	/425/	/178/	/170/	/109/3/	/140/	/198/3/
Amortization	/-417/	/-115/	/-53/	/-16/	/-65/	/-73/
Private sector	91	260	205	-47	-100	-218
Direct investment	(27)	(125)	(48)	(38)	(-39)	(-108)
Loans	(64)	(135)	(157)	(-85)	(-61)	(-110)
Basic balance	361	-1,080	-409	512	--	159
Delays 4/	--	--	--	--	--	380
Short-term capital and errors and omissions	323	469	544	-1,291	--	-491
Allocation of SDRs	23	21	--	--	--	--
Overall balance	707	-590	135	-779	--	48
Change in commercial bank reserves (increase -)	63	-21	49	105	--	-48
Change in net official reserves (increase -)	-770	611	-184	-674 5/	--	-- 5/
Use of Fund credit (net)	-18	-86	262	48	114	27
Other official reserves	-752	697	-446	722	-114	-27
Memorandum items						
As percent of GDP						
Current account balance	-0.6	-8.7	-8.1	-5.4	-5.3	-4.9
Exports	22.7	16.4	16.7	18.5	18.3	18.0
Imports	17.9	19.2	18.9	16.7	15.5	14.5

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

1/ Includes increases in unpaid obligations.
2/ Excludes refinancing of US$195 million Arlabank loan to the Central Reserve Bank.
3/ Includes refinancing of US$11 million and US$78 million in 1983 and 1984.
4/ Reflects the nonpayment of debt service by the nonfinancial public sector because of lack of domestic funds
5/ Includes US$461 million of nonbank external debt assumed by the banking system in 1983 and US$9 million in 1984 in accordance with Exchange Resolution 002/83 and still remaining outstanding. Of these amounts, US$220 million represents official reserve liabilities and US$241 million represents nonofficial reserve liabilities in 1983.

Peru: Macroeconomic Flows

(In percent of GDP)

	1980	1981	1982	1983	1984 Prog.	1984 Proj.
I. Balance of Payments						
Current account balance	-0.6	-8.7	-8.1	-5.4	-5.3	-4.9
Trade balance	4.8	-2.8	-2.4	1.8	3.1	3.5
Factor payments	-5.3	-5.2	-5.0	-7.0	-8.3	-8.1
Other services and transfers	-0.1	-0.7	-0.7	-0.2	-0.1	-0.3
Capital account	5.1	5.6	9.0	1.2	5.3	4.9
Private capital 1/	3.0	4.5	1.4	-4.7	0.2	-1.4
Nonfinancial public sector	2.1	1.1	7.6	5.9	5.1	6.3
Change in net official international reserves (increase -)	-4.5	3.1	-0.9	4.2	--	--
II. Nonfinancial Public Sector 2/						
Central Administration						
Current account	2.4	0.2	0.2	-5.1	0.4	-3.5
Revenues	20.5	17.9	17.6	14.1	15.8	14.9
Expenditures	-18.1	-17.7	-17.4	-19.2	-15.4	-18.4
Rest of nonfinancial public sector's operating surplus	0.6	-0.1	--	2.5	2.3	1.6
Nonfinancial public sector savings	3.0	0.1	0.2	-2.6	2.7	-1.9
Less: fixed investment	7.3	9.0	10.3	9.8	6.8	8.6
Other capital expenditures 3/	0.5	-0.1	-1.0	-0.7	--	-0.4
Overall deficit	-4.8	-8.8	-9.1	-11.7	-4.1	-10.1
Net foreign financing	2.1	1.1	7.6	5.9	5.1	6.3
Net domestic financing	2.7	7.7	1.5	5.8	-1.0	3.8
III. Savings and Investment						
Fixed capital formation	17.7	22.2	22.7	17.0	18.1	15.6
Nonfinancial public sector	7.3	9.0	10.3	9.8	6.8	8.6
Private sector 4/	10.4	13.2	12.4	7.2	11.3	7.0
Investment = savings	17.7	22.2	22.7	17.0	18.1	15.6
External savings	0.6	8.7	8.1	5.4	5.3	4.9
National savings	17.1	13.5	14.6	11.6	12.8	10.7
Nonfinancial public sector	(3.0)	(0.1)	(0.2)	(-2.6)	(2.7)	(-1.9)
Private sector	(14.1)	(13.4)	(14.4)	(14.2)	(10.1)	(12.6)
Memorandum items						
Nominal GDP						
(In billions of Peruvian soles)	4,968.6	8,489.7	14,134.0	26,475.9	51,960.0	56,820.9
(In billions of U.S. dollars)	17.2	19.8	20.3	16.3	16.9	16.7

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

1/ Includes net borrowing by the financial public sector, net errors and omissions, and movements in nonofficial reserves.
2/ Includes the mining companies CENTROMIN and Tintaya.
3/ Net of capital revenues.
4/ Includes inventory changes.

Peru: Medium-Term Outlook

	1983	1984	1985	1986	1987	1988	1989
		Projected					
I. Balance of Payments							
(In billions of U.S. dollars) 1/							
Current account	-0.9	-0.8	-0.7	-0.6	-0.5	-0.5	-0.5
Exports	3.0	3.0	3.2	3.5	3.8	4.1	4.5
Imports	-2.7	-2.4	-2.5	-2.7	-2.9	-3.2	-3.6
Net investment income	-1.1	-1.3	-1.4	-1.4	-1.4	-1.4	-1.4
Other services	-0.3	-0.2	-0.2	0.2	0.2	0.2	0.2
Net transfers	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Capital accounts	0.1	0.8	0.7	0.6	0.5	0.5	0.5
Medium- and long-term official capital	1.4 2/	1.5 2/	0.8	0.7	0.5	0.5	0.5
Long-term private capital	--	-0.2	-0.1	-0.1	--	--	--
Short-term capital	-1.3	-0.5	--	--	--	--	--
Overall balance	-0.8	--	--	--	--	--	--
II. External public debt							
Debt outstanding 3/	10.0	11.6	12.2	12.6	13.0	13.4	13.8
Gross disbursements 4/	2.7	3.2	2.1	2.1	2.3	2.1	2.2
Amortization 4/	1.2	1.6	1.5	1.7	1.9	1.7	1.8
Interest 4/	0.8	1.1	1.2	1.3	1.3	1.3	1.3
(As a percent of GDP)							
Memorandum items							
Current account	-5.4	-4.9	-4.9 5/	-4.2	-3.2	-2.7	-2.5
Capital account	0.6	4.9	4.9	4.2	3.2	2.7	2.5
Overall balance	-4.8	--	--	--	--	--	--
External debt	76.5	81.1	99.2 5/	95.3	90.3	84.8	79.5
Of which: public sector	62.1	69.4	86.1	83.4	79.5	74.9	70.5
(As a percent of exports of goods and nonfactor services plus transfers)							
External public debt service obligations	52.4	68.7	64.1	66.6	65.6	57.1	55.0

Source: Fund staff estimates.

1/ Subtotals may not add up to totals due to rounding.
2/ Includes reschedulings and delays in payments, the assumed to be US$0.4 billion in 1984.
3/ Includes an estimate of the stock of public sector short-term commercial debt.
4/ Includes operations with the IMF and Andean Reserve Fund.
5/ Calculated with GDP figure converted to U.S. dollars on the assumption of a real depreciation of the sol.