

**FOR
AGENDA**

EBS/83/85
Correction 1

CONFIDENTIAL

May 18, 1983

To: Members of the Executive Board
From: The Secretary
Subject: Peru - Consultation Under Extended Arrangement

The following corrections have been made in EBS/83/85
(4/27/83):

Page 12, item 1, para. 1, line 4: for "dated , 1983."
read "dated May 13, 1983."

Page 70, line 2: for "April , 1983"
read "May 13, 1983"

Corrected pages are attached.

Att: (2)

Table 5. Peru: Summary Balance of Payments, 1979-1983

(In millions of U.S. dollars)

	1979	1980	1981	1982		Proj. 1983
				Prog.	Prel.	
<u>Current account</u>	729	62	-1,513	-1,368	-1,401	-877
Trade balance	1,540	836	-548	-133	-290	318
Exports, f.o.b.	(3,491)	(3,898)	(3,255)	(3,647)	(3,212)	(3,496)
Imports, f.o.b.	(-1,951)	(-3,062)	(-3,803)	(-3,780)	(-3,502)	(-3,178)
Investment income	-967	-835	-885	-1,072	-1,084	-1,205
Public sector	(-484)	(-478)	(-528)	(-628)	(-654)	(-830)
Private sector	(-483)	(-357)	(-357)	(-444)	(-430)	(-375)
Other services	34	-74	-247	-353	-217	-190
Transfers	122	135	167	190	190	200
<u>Long-term capital</u>	676	580	671	1,268	1,053	837
Nonfinancial public						
sector ^{1/}	778	480	348	828	651	587
Disbursement	(1,045)	(1,279)	(1,561)	(1,680)	(1,492)	(1,731)
Amortization	(-267)	(-799)	(-1,213)	(-852)	(-841)	(-1,144)
Financial public						
sector	-141 ^{2/}	8 ^{2/}	63	40	192	134
Private sector	39	92	260	400	210	116
Direct investment	(71)	(27)	(125)	(285)	(53)	(69)
Loans	(-32)	(65)	(135)	(115)	(157)	(47)
<u>Basic balance</u>	1,405	642	-842	-100	-348	-40
Short-term capital						
and errors and						
omissions (net)	152	58	317	--	440	-60
Allocation of SDRs	22	22	21	--	--	--
<u>Overall surplus of</u>						
<u>deficit (-)</u>	1,579	722	-504	-100	92	-100
Variation of non-						
official reserves						
(increase -)	-79	81	-31	--	29	--
<u>Net official inter-</u>						
<u>national reserve</u>						
<u>movement</u>						
(increase -)	-1,500	-803	535	100	-121	100

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

^{1/} Includes CENTROMIN from 1980.

^{2/} Includes repayments of 1978 rollover with US\$121 million in 1979 and US\$23 million in 1980.

institutional and legal barriers to investment in the basic sectors of the economy. Reflecting these conditions, real GDP in 1983 is projected to rise by less than 1 per cent for the second consecutive year (Table 6). In addition, because of the deterioration of world capital market conditions, the financing of the current account deficit in 1983, even one which is sharply reduced from that of 1982, would require close coordination between the authorities, foreign commercial banks, and the Fund.

The strengthening of Peru's financial position in 1983 is based on a reduction in Peru's current account balance of payments deficit from 7 per cent of GDP in 1982 to 4.5 per cent in 1983, and a corresponding improvement in the country's domestic savings performance. To achieve these objectives, the program contemplates a reduction in the overall financing requirements of the nonfinancial public sector from 6.6 per cent of GDP in 1982 to 3.8 per cent, and continued flexibility in interest and exchange rate management. Prudent demand management and wage policy are expected to bring about a modest lowering of inflation over the year--to around 55 per cent on a December-December basis--from more than 70 per cent during both 1981 and 1982. A summary of the assumptions, targets, and measures of the program for 1983 is provided in Attachment IV.

1. Performance criteria, consultation provisions,
and review clauses

Quantitative performance criteria for the period through February 29, 1984 are set out in Table 7, and are described in the Memorandum on Economic Policy for the Second Year of the Extended Arrangement annexed to the letter dated May 13, 1983. The program includes a performance clause regarding the authorities' intentions in respect of multiple currency practices, restrictions on payments and transfers for current international transactions, bilateral payments agreements, and restrictions on imports for balance of payments purposes. In addition, as a performance criterion, the authorities will consult with the Fund before September 30, 1983 to assess progress achieved during the second year of the program.

The following quantitative criteria are subject to testing during the program year:

(a) A set of limits on the total net indebtedness of the nonfinancial public sector defined to include: (i) the outstanding net claims of the domestic banking system and COFIDE on the nonfinancial public sector; (ii) the outstanding amount of bonds issued by the nonfinancial public sector and held outside the nonfinancial public sector, the domestic banking system, and COFIDE; and (iii) the outstanding foreign debt of the nonfinancial public sector, regardless of maturity and financing source. Total indebtedness will be tested against these limits at the end of each calendar quarter.

<u>Measure</u>	<u>Impact as per cent of GDP</u>
1. Elimination of rice and wheat subsidy	0.5
2. Increases in domestic petroleum derivative prices	0.5
3. Substitution of a flat import tariff for the import surcharge	0.5
4. Tightened of wage policy	0.7
5. Other savings in current spending and other revenue measures and increases in public utility tariffs	0.4
6. Cut in investment spending	<u>1.8</u>
Total	4.4

The effect of these measures on the 1982 public sector performance is projected to be partially offset by (1) a decline in tax revenue due to the phasing out of the tax on traditional exports, a drop in imports, and a decline in taxable income, and (2) increases in interest payments. The combined net effect of these factors add up to 1.6 per cent of GDP. To monitor fiscal performance, the use of net new credit from both foreign and domestic sources by the nonfinancial public sector has been limited to S/. 935 billion. Quarterly limits on the use of net credit by the nonfinancial public sector have been established as performance criteria.

2. Money and credit

Total net domestic credit expansion of the Central Reserve Bank and the Banco de la Nación has been limited to S/. 50 billion over the program year, with quarterly ceilings as performance criteria. The program contemplates the creation of a sol-denominated savings instrument carrying an interest return competitive with the rates offered on dollar-denominated deposits.

3. External sector

a. The sol is expected to be depreciated on a daily basis, without preannouncement, at least in line with domestic inflation.

b. External borrowing commitments with maturities of one to ten years are to be limited to US\$1.25 billion with a sub-limit of US\$300 million for maturities of one to five years.

c. The exchange and trade system is to be maintained consistent with the obligation of Article VIII of the Articles of Agreement of the Fund.

Lima, Peru
May 13, 1983

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

Dear Mr. de Larosière:

1. In April 1982 the Government of Peru sent to you a letter requesting the support of the International Monetary Fund in the form of a three-year extended arrangement for a medium-term program of adjustment and structural change. The first year of this arrangement is about to be completed. Despite a number of setbacks, including the continuing recession and protectionist tendencies in the industrial world and adverse world financial market conditions, Peru has complied with all the quantitative performance criteria of the program and with the understandings related to its exchange and trade system.
2. In accordance with the extended arrangement approved by the Fund on June 7, 1982, we request that the equivalent of SDR 250 million be made available to Peru during the second year of the extended arrangement, including appropriate use of the Fund's borrowed resources.
3. During the second year of the extended arrangement, we plan to continue implementing the economic and financial policies as described in our letter of April 1982. The specific policies and understandings for the second year of the extended arrangement are set out in an economic policy memorandum attached to this letter. The Government of Peru understands that during any period in respect of which any of the policy understandings contained in paragraphs 7, 8, 10, 11, and 12 of the attached economic policy memorandum are not observed, Peru will not request any purchase under the arrangement until understandings with the Fund have been reached regarding the circumstances in which such purchases may be resumed.
4. The Government of Peru will not request any purchase under the arrangement during any period after March 1, 1984, in which understandings on performance clauses for the third year of the extended arrangement are not reached or understandings so reached are not observed.
5. The Government of Peru will periodically consult with the Fund, in accordance with the Fund's policies on such consultations, about the progress being made in the implementation of the program described in the attached economic policy memorandum and about policy adaptations which may be appropriate for the achievement of its objectives. In any event, the Government will review with the Fund before