

Research Department

The Banking System of Peru

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December 23, 1947

Summary

Peru is at present experiencing financial difficulties and urgent measures are necessary to strengthen the economic and financial position of the country.

The balance of payments deficit during 1946 and 1947 has reduced the gold and foreign exchange reserves of the country and the present balances can be maintained only by means of rigid exchange control. The exchange rates in the free market are an indication of the weakness of the Peruvian sol. The last available quotation was 14.90 (August 1947) soles per dollar compared to the official parity of 6.50 soles per dollar.

Budgetary deficits are being financed by loans from the Central Reserve Bank to the Government, resulting in a continuous expansion of the money supply. The cost of living is rising steadily and higher prices are responsible for social unrest, especially in the wage-earning classes.

This memorandum outlines the Peruvian banking system and shows the role played by the different banks in the present economic situation of Peru. As any program to strengthen the economy must first include measures for combatting inflation, the analysis of how financial institutions are working in Peru may be of special interest.

The Peruvian banking system includes the "Central Reserve Bank of Peru"; 9 commercial and savings banks with 124 offices; 2 mortgage banks (considering the Mortgage Division of the Savings Bank of Lima as a separate bank); and 3 development banks, one for agricultural development with 31 offices, another for industrial development and another for mineral development.

The Central Reserve Bank has the exclusive right of issue and is the depository for commercial bank reserves. It is privately owned, but the Government has 3 representatives on its Board of Directors of 11 members. Although its original law, issued in 1931, prohibited the Bank from lending to the Government more than 20 per cent of its authorized capital of 30 million soles, (a ceiling of 6 million soles), this regulation has been amended repeatedly, and as of July 31, 1947, the Government's

indebtedness to the Bank was more than 790 million soles. Actually the Central Bank has very weak powers in matters of foreign exchange policy, these functions being vested in the National Foreign Trade Council, an autonomous government agency. The powers of the bank over commercial banking credit are also mild: the law grants commercial banks the right to rediscount Government paper at the Central Bank. Commercial banks in general do not, however, resort to rediscount; reserve requirements are fixed and subject to change only by law.

Six of the nine commercial banks are Peruvian and three are branches of foreign banks. Commercial banks hold checking and savings deposits and are required, according to Article 65 of the General Banking Law, to maintain in cash or in deposits with the Central Reserve Bank a legal reserve against their obligations to the public of: a) at least 15 per cent against demand deposits, and b) at least 6 per cent against time deposits.

Commercial banks engage mainly in financing commercial transactions (import, export, wholesale and retail trade, etc.). They are permitted by law to grant medium or long-term credits within certain limitations. Outstanding balances of short-term loans of commercial banks were 1,004 million soles in June 1947, more than eight times the total of 1931.

Long-term credit is granted by two mortgage banks and by the government-owned development banks. The outstanding balances of loans granted by mortgage banks in Peru up to June 30, 1947, were 146.8 million soles, less than one-sixth of the balances of short-term loans of commercial banks.

The government-owned agricultural, industrial and mining banks are recent developments in Peruvian finance and the volume of their operations is not yet significant. Development credits amounted to 103.1 million soles in June 1947.

A review of the Peruvian banking structure shows (1) a Central Bank with very weak powers in questions of foreign exchange policy, with almost all of its loan operations assisting the Government in its fiscal difficulties; (2) a Central Bank with powers insufficient to control commercial bank credit policy either by increasing the legal deposit requirements or by ceilings on commercial bank loans; (3) a group of commercial banks with abundant resources dedicated to short-term loans in the money market rather than to productive loans in the investment or capital market; (4) banks that have no interest in investment either in government securities<sup>1/</sup> or in private issues, with a substantial proportion of their loans directed to speculative ends which the war situation made possible; (5) three government-owned development banks with very limited resources, the public being reluctant to participate.

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<sup>1/</sup> However, a large proportion of the unused resources of these banks are transitorily invested in Government bonds which, by virtue of a special decree, can be cashed in the Central Bank.

1. The Banks in Peru and Their Influence Upon the National Economy

Although the first commercial bank was created as early as 1863 in Peru (the Bank of Peru and London) and other banks were established soon afterwards (The "Italian Bank" in 1889, and the "German Transatlantic Bank" in 1905), it is only since 1914, when the first World War made its impact on the economy of the whole world, that the banks in Peru began to play an important role in the national economy.

The explanation of this fact is as follows: Peru up to 1914 was on a strictly hard-money basis; no bank notes or government paper money were in circulation. Peru adopted the gold standard in 1897 taking as the unit of its currency the English pound sterling. As a subsidiary unit, the silver sol was adopted. Gold and silver coins, therefore, were the only circulating medium. Commercial banks--the few that functioned up to 1920--were required to maintain in their vaults or in investments within the Republic, a sum equivalent to their capital and the total amount of their deposits. Thus, the circulation of checks was very limited.

Peru was a gold and silver producer, and the stock of gold was sufficient to provide the necessary amount of medium of payment to cover foreign remittances. Foreign exchange suffered practically no fluctuations.

This picture changed in 1914. Following the disturbances brought about by the first World War, the gold currency, which had been abundant up to August 1914, was hoarded. Even silver coins became so scarce that a complete tie-up in business resulted.

Under these circumstances it became necessary to provide a circulating medium of an emergency character. A monetary commission under the supervision of the government, but composed of private banks, was formed. It was made responsible for the issuance, security and administration of an issue of bank notes named circulating checks. Thus the commercial banks in Peru began to play an important role in the Peruvian economy.

At the beginning of this note issue, a gold guaranty, at first no more than 20 per cent, was provided, supplemented by commercial bills, stocks and bonds, and other collateral supplied by private banks. After a period of adjustment the circulating checks gradually attained public confidence and were soon placed upon a solid basis. The gold guaranty backing them was gradually increased until it attained 50 per cent as of June 30, 1917, thereafter rising to 90 per cent in 1922. In this year the Monetary Commission was replaced by a Reserve Bank which was created on March 9, 1922. Thus a Central Bank began to complement the functions of the commercial banks in that year.

## 2. The Central Reserve Bank of Peru

As explained above, the exchange problem in Peru arose in 1914 because of the hoarding of gold. In June 1915 foreign exchange was sold at a 10 per cent premium, but as a result of an increasing export trade and with the return of confidence in commercial and financial stability, par was reached in February 1916. A heavy excess of exports, which began in 1916, carried the Peruvian pound to a premium in spite of the importation of gold from the U.S. In 1921 a reversal of foreign trade conditions brought above heavy imports and diminished the value of exports. The Peruvian pound oscillated below parity and a Central Bank was established in 1922 mainly with the purpose of providing a mechanism to maintain a stable currency.

On March 9, 1922, Peru established the Reserve Bank of Peru giving it the sole right of note issue. Private banks and the public contributed to its capital, the majority of the capital, however, being held by private banks.

Between 1922 and 1929 there were marked fluctuations of the Peruvian currency which were arrested at certain times by favorable export conditions or by the importation of foreign capital, as may be seen in the following table.

<u>Year</u>	<u>Rates of Exchange</u>	<u>Soles per \$</u>
1901	-- Parity established by Law of 1901	2.04
1921	- New York yearly average	2.65
1922		2.60
1923		2.40
1924		2.44
1925		2.46
1926		2.66
1927		2.67
1928		2.51
1929		2.50
1930	- New parity established by Law of Feb. 10	2.50
1930		2.75
1931	- New parity established by Kemmerer	3.60

The Reserve Bank established in 1922 was not completely successful during its nine years of existence. Especially since 1929, when the world depression caused a decline in Peruvian exports and checked the inflow of foreign capital, the Peruvian currency depreciated rapidly. The Kemmerer Mission was called upon for advice in January 1931 and, according to their report "found the country's currency and banking machinery in a most unsatisfactory condition". "The Reserve Bank," - the Mission added, - "was entirely out of the exchange market and was doing little or nothing in the performance of that most important function of a real central bank, the maintenance of the stability of the nation's currency."

The recommendations of the Kemmerer Mission resulted in three laws, one providing for the reorganization of the Reserve Bank of Peru into a modern Central Bank, the second amending the Peruvian Monetary Law and creating a new monetary unit based on gold, and the third, a General Banking Law. The original laws recommended by Kemmerer have been maintained up to the present time, but frequent amendments have been made so that the original meaning has sometimes been obscured.

The Kemmerer Mission thought that the Bank should initiate its operations with free convertibility. The balance of payments in 1932 showed a deficit which was covered substantially by the reserves of the Central Bank. On the other hand, the automatic effect of convertibility was through losses in reserves to reduce the volume of currency and credit, and thus help bring about a drastic deflation. Monetary convertibility, decreed in April 1931, was suspended in May, 1932, following a request of the Board of Directors of the Central Reserve Bank. This suspension of convertibility has been maintained until the present time.

Since 1932 there have been three distinguishable periods in the history of the Peruvian exchange rate. Between 1932 and 1941, the Central Bank allowed the free forces of supply and demand in the exchange market to determine exchange quotations, and the exchange rate fluctuated from 3.60 soles per dollar to 6.50, as may be seen in the following table.

Rates of Exchange

New York - Soles per dollar

<u>Year</u>	<u>Maximum</u>	<u>Minimum</u>	<u>Average</u>
1931	3.74	3.36	3.58
1932	6.25	3.59	4.68
1933	6.30	4.28	5.30
1934	4.59	4.04	4.34
1935	4.40	3.86	4.18
1936	4.18	3.94	4.01
1937	4.17	3.83	3.95
1938	5.00	4.10	4.46
1939	5.77	4.98	5.34
1940	6.50	5.27	6.17

Between 1941 and 1945 the favorable balance of payments made it possible for the Central Bank and the commercial banks to maintain a stable exchange rate of 6.50 soles per dollar. The third period began at the beginning of 1945. With the end of the war the Government saw that the demand for exchange would exceed the available supply and in order to avoid a steep rise in the exchange quotation it established exchange control. These controls with continuous modifications have been maintained until the present time.

The fluctuations of the Peruvian currency described above are an indication of the role that was played by the Central Reserve Bank in the Peruvian economy.

The monetary history of Peru shows that the external stability of the sol has been closely related to fluctuations in the balance of payments. The question which has to be decided is to what extent factors outside the control of the Central Reserve Bank brought about these deficits and to what extent they were occasioned by undue increases in the money supply as a result of the loan operations of the bank of issue.

The following description of (a) the characteristics of the Central Reserve Bank of Peru, (b) the policies it pursued after being established and (c) the changes in legislation that were made from time to time in connection with monetary and credit policy may help in the correct interpretation of these problems.

#### A. Characteristics of the Central Reserve Bank

The detailed characteristics of the Central Reserve Bank, according to the original terms of the Kemmerer legislation, were as follows:

(a) Capital - The Central Reserve Bank had an authorized capital of 30 million soles of which 50 per cent was paid up. The shares were divided into three classes. Class "A" shares were owned by banks doing a commercial banking business in Peru, class "B" shares by the public and class "C" shares by the Government of Peru. Each commercial bank is required to buy class "A" shares up to the amount of 10 per cent of its own capital and surplus. The profits arising from the revaluation of gold following the 1931 devaluation of the Peruvian currency were used by the Government to constitute its capital in the Central Bank.

(b) Board of Directors - The Central Reserve Bank was put under the direction of a board of eleven members: three, appointed by the President of Peru, were known as class "C" directors; three, elected by member banks, were known as class "B" directors; one was elected by holders of class "B" shares, one by the National Agricultural Society, one by the Chamber of Commerce, one by the National Society of Industries, and one by foreign banks operating in Peru.

(c) Operations of the Bank - The Central Reserve Bank was authorized to engage in the following transactions with its member banks:

- (1) To rediscount the first class short term paper of their customers,
- (2) To grant them direct loans of a liquid character adequately secured by paper eligible for rediscount,
- (3) To buy and sell domestic and foreign exchange and gold bullion,
- (4) To receive from them non-interest bearing deposits including their reserve accounts.

The Central Reserve Bank was authorized to engage in the following transactions with the public:

- (1) To buy and sell gold bullion and domestic and foreign currencies and foreign exchange drafts,
- (2) To buy, sell and discount domestic bills of exchange, promissory notes and other credit instruments arising from the production, manufacture, transportation or sale of goods.

(3) To receive non-interest bearing deposits payable on demand.

B. Policies followed by the Central Reserve Bank

A comparison between two condensed statements of the Bank-when it began operations in 1931 and at a later date (July 1947)-explains more clearly than any extensive commentary the policies followed by the Bank and the changes which have occurred since it was established.

Central Reserve Bank of Peru

Condensed Statement of Assets and Liabilities

	<u>November - 1931</u>		<u>July - 1947</u>	
	<u>Millions</u> <u>of Soles</u>	<u>Percentage</u>	<u>Millions</u> <u>of Soles</u>	<u>Percentage</u>
<u>Assets:</u>				
Legal gold and foreign exchange reserve.....	64.2	80.6	136.8	12.00
Surplus legal reserve.....	1.4	1.7	0.0	0.00
Foreign exchange by account of third persons.....	—	—	17.9	1.60
<u>Loans to:</u>				
Banks.....	5.4	6.8	78.5	6.90
Public.....	7.1	8.9	—	—
Treasury.....	—	—	701.6	61.20
Investment.....	1.1	1.4	3.1	0.30
Other assets.....	.4	0.5	66.3	5.80
International Monetary Fund	—	—	142.0	12.20
<u>Total.....</u>	<u>79.6</u>	<u>99.9</u>	<u>1,146.4</u>	<u>100.00</u>
<u>Liabilities:</u>				
Capital.....	16.3	20.4	13.8	1.30
Note issue.....	56.3	70.7	679.5	59.50
Deposits.....	6.4	8.0	211.8	18.60
Deposits in foreign exchange.	—	—	17.9	1.80
Other liabilities.....	0.6	0.7	81.4	6.50
International Monetary Fund..	—	—	142.0	12.30
<u>Total.....</u>	<u>79.6</u>	<u>99.8</u>	<u>1,146.4</u>	<u>100.00</u>

In 1931 gold and foreign exchange reserves of the bank represented 82 per cent of its total assets, short term loans were 16 per cent and investment formed only one per cent.

At the present time, the situation is quite different. Short term portfolio which in 1931 totalled 12.5 million soles, that is to say, 16 per cent of total assets, had risen to more than 700 million soles, or more than 68 per cent of its assets, gold and foreign exchange being only 12 per cent. As 61 per cent of this portfolio is formed by long-term loans to the Treasury, the degree of liquidity of the resources has changed completely.

In the same way the note issue of 56 million soles in 1931 increased to 679 million soles by July 1947. The capital of the bank which was 20.4 per cent of total liabilities in 1931 was only 1.3 per cent in 1947.

In absolute figures, however, gold and foreign exchange resources totalled about \$20 million in 1931, while in July 1947, although it had a note issue which was ten times greater, it scarcely reached \$33 million.

The Central Reserve Bank, therefore, has dedicated almost all its resources to loan operations with the Government.

### C. Changes in Legislation

Reforms in the law authorizing advances and loans to the Government have been frequent since 1932, when Law No. 7,488 ordered an advance payment to the Treasury of 2 million soles.

The ceiling fixed by Article 50 of the law for the operations of the bank with the Government (20 per cent of the capital of the bank) was changed first in 1932 to a ceiling equivalent to the fiscal revenues of one month. One year later, it was extended to 3 months' revenues (Law 7,701, February 1933). In 1941 this ceiling was increased to six months of fiscal revenues. But the law of 1941 authorized the Central Bank, furthermore, to purchase and sell Government and municipal bonds without limit, and to make loans to holders of Government paper up to 75 per cent of its market value.

At various times when the Government required funds decrees have also been issued which expressly suspended any specific legal limitations on the making of such loans.

As a result of all these changes in the law the Government was soon able to borrow from the Central Bank much more than had originally been contemplated. The end of the year balances of loans to the Government made by the Central Bank have been as follows:

	<u>Millions of soles</u>
Kemmerer ceiling	6.0
End of: 1933	49.0
1934	61.8
1935	58.1
1936	83.7
1937	85.0
1938	109.4
1939	129.4
1940	152.9
1941	204.6

Millions of soles (Cont'd)

1942	282.7
1943	366.2
1944	473.5
1945	599.0
1946	689.9
June-1947	747.9
July-1947	790.1

During 1946 the Peruvian Congress appeared to be favorably disposed to limit the Central Bank's authority to lend to the Government, and three laws were passed restricting the extension of credit by the Central Bank to the Government.

Law 10,535, issued April 4, 1946, eliminated the Central Bank's authority to purchase and sell Public Bonds, and provided that profits in excess of the maximum dividend of 6 per cent be applied to the repayment of the Government consolidated debt to the Central Bank instead of being invested in the purchase of Government bonds.

Another law (No. 10,536) consolidated the loans made by the Central Reserve Bank to the Government, and a third law (No. 10,523) limited the Central Bank's authority to purchase short-term Government bonds to a limit of two months of budgetary revenues instead of the previous limit of six months. No statistics are yet available to show the results of these laws. The 1947 budgetary deficit is, however, expected to exceed all previous records.

### 3. Private Banks

The establishment of the first private banks in Peru was closely connected with the interest of foreign capital for investment in the country. Peruvian mines, petroleum resources, cotton and sugar production attracted private foreign capital, and as the exploitation of these resources required the construction of expensive transportation facilities, costly irrigation works, etc., public foreign loans were added to the inflow of private foreign capital in order to finance such projects. On the one hand, the friendly attitude of the Peruvian government toward foreign investments facilitated these operations, but, on the other hand, foreign investments in Peru required large resources and heavy initial expenditures before returns could be expected, and fluctuations in external economic conditions were strongly felt.

The depressions of 1921 and 1930, for example, produced a drop in Peruvian export prices. Thus, the value of exports was not sufficient to pay for imports and capital services. Shortages of foreign exchange produced a rise in domestic prices. Imports had to be limited. These conditions were a stimulus for the production of goods in the country that otherwise had been imported. Consequently, a domestic producer market was developed in a process which was sometimes painful and slow. The role of the Peruvian banks thus increased in importance. Branches of foreign banks had to limit their operations because depreciation of the national currency created a risk that did not exist when gold currencies circulated freely in the market.

Rice, cement, textiles and other products formerly imported, were substituted by Peruvian products. This process, however, was always limited by the necessity of importing machinery which in turn was limited by the foreign exchange resources derived from exports.

Branches of foreign banks thus helped in the development of the foreign trade of Peru. Private Peruvian banks in turn helped the development of the national economy, but in some critical moments, the former were limited in their activities by adverse external conditions, and the expansion of credit by the latter did not bring about greater production but higher prices instead. This factor seems to be especially true in the last years when domestic production of food, for example, has remained static, volume of exports of many products is lower than ten years ago, but money supply is so abundant as to bring about a general and continuous rise of prices.

The actual structure of the private banking system is described in detail as follows:

A. The Commercial and Savings Banks

Commercial and savings banking in Peru is carried on at present by nine institutions, three of which are branches of foreign banks and six of which are purely domestic.

Basic Legislation

Up to 1921 all the banking legislation of Peru was contained in three short articles in the Commercial Code. On May 2, 1921, an office was created for the inspection of banks, but its duties were never clearly defined.

The first general banking law in Peru was approved in accordance with the suggestions of the Kemmerer Mission; the law created a Superintendency of Banks to supervise the banking establishments of the country and to enforce the law. It laid down a procedure for organizing a bank and outlined the rights and duties of commercial banks, savings banks and savings departments of commercial banks. It also authorized banks to perform trustee functions and described the conditions under which they might be performed. The law outlined how banking concerns are to be inspected and controlled, provided for publicity for their operations and imposed penalties to enforce compliance with the law. Finally, it provided special machinery for the liquidation by the Superintendent of Banks of banking concerns which have failed or which wish to discontinue business.

Banks are required by law to carry enough cash in their vaults or to have it readily available in deposits in the Central Bank to meet the current demands of depositors. These regulations were drawn up exclusively from the point of view of depositors, minimum requirements being established of 15 per cent against demand obligations, and 6 per cent against time obligations; the Central Reserve Bank has not been given the right to change these ratios as a means of controlling the volume of credit. The enormous increase in the note issue of the Central Reserve Bank in the last 8 years has thus been followed by a parallel expansion of credit by commercial banks.

The effects of the expansion of the money supply by the Central Bank multiplied by the activities of the commercial banks, and the corresponding impact on prices is clearly reflected in the increase of the cost of living index and the decline of foreign exchange reserves.

Commercial and Savings Banks  
(Millions of soles)

Assets

<u>End of Year</u>	<u>Cash and Deposits</u>	<u>Loans</u>	<u>Investments</u>	<u>Others</u>	<u>Total</u>
1931	31.0	118.9	23.1	17.6	190.7
1932	28.0	133.9	22.4	23.5	207.9
1933	65.2	94.1	22.3	33.7	215.4
1934	78.2	118.2	22.9	68.2	287.5
1935	77.7	138.8	29.9	67.0	313.6
1936	89.1	175.0	34.6	102.8	401.6
1937	102.8	191.4	37.2	104.3	435.7
1938	111.4	214.1	44.2	105.9	475.6
1939	121.2	235.5	50.9	64.3	471.9
1940	164.8	267.9	58.1	53.4	544.3
1941	181.6	304.5	56.3	78.4	620.9
1942	304.3	327.9	64.2	96.9	793.3
1943	379.7	460.6	69.2	135.6	1,045.0
1944	461.0	586.4	77.4	131.1	1,256.0
1945	510.4	657.6	86.8	172.4	1,427.3
1946	422.0	912.3	101.2	207.2	1,642.8
1947 June	417.6	1,004.5	114.9	170.5	1,739.8

Liabilities

<u>End of Year</u>	<u>Capital and Surplus</u>	<u>Public</u>				<u>Bank Deposits</u>	<u>Other Liabilities</u>	<u>Profit and Loss</u>	<u>Total</u>
		<u>Sight Deposits</u>	<u>Time Deposits</u>	<u>Saving Deposits</u>					
1931	40.3	50.8	34.1	18.3	19.4	26.1	1.7	190.7	
1932	38.9	53.9	28.3	20.1	23.7	41.7	1.3	207.9	
1933	39.2	70.5	30.3	26.4	9.2	37.8	1.9	215.4	
1934	40.1	97.9	31.9	32.9	6.8	75.9	1.9	287.5	
1935	42.0	108.2	39.9	40.3	4.6	75.6	2.8	313.6	
1936	43.5	127.6	46.3	49.2	7.7	123.8	3.4	401.6	
1937	46.7	139.7	55.2	60.8	4.8	125.5	3.0	435.7	
1938	49.9	156.6	61.7	71.6	12.8	119.5	3.5	475.6	
1939	53.8	173.4	66.6	83.6	6.9	82.7	4.8	471.9	
1940	57.1	235.9	79.6	97.5	5.0	63.5	5.6	544.3	
1941	61.6	272.1	81.7	100.4	5.6	92.5	6.9	620.9	
1942	64.3	378.5	91.6	142.6	2.2	105.8	8.4	793.3	
1943	76.3	491.9	127.4	197.7	.7	139.6	11.3	1,045.0	
1944	91.8	628.4	140.7	236.6	.4	144.3	13.8	1,256.0	
1945	102.2	670.8	168.3	269.5	3.5	199.2	13.8	1,427.3	
1946	113.4	812.8	167.7	300.1	3.1	230.5	15.2	1,642.8	
1947 June	141.1	868.3	165.9	318.3	3.5	201.5	1.8	1,739.8	

Source: Reports from Superintendencia of Banks, Lima.

As has been pointed out above, the commercial and savings banks have made little use of the rediscounting facilities available to them at the Central Reserve Bank. Rediscounting is permitted only for short term Government promissory notes, most of which are held directly by the Central Bank.

In short, the statistics show that with the exception of 1932, the year in which liquid resources of the commercial banks were at the lowest point, the means of payments created by the Central Reserve Bank's credit operations with the Government have each year reached the commercial banks through an increased volume of deposits and been in turn transformed into short-term loans presumably made to meet the needs of trade, thus contributing to the inflationary spiral. The Central Reserve Bank had insufficient power to stop this process since liquid resources in the hands of the commercial banks minimized the need to have recourse to rediscounting.

### Savings Banks

Peru has no separate "savings" banks, but the functions of such institutions are performed by the commercial banks through savings departments.

The so-called "Savings Bank of Lima", an official institution which was partially capitalized by the government in 1931 by transferring part of the government capital stock in the Central Bank (1½ million soles), today performs commercial banking functions in addition to its savings operations.

Savings deposits, however, which carry interest, but are repayable on demand, total deposits in commercial banks. At the end of 1946 they amounted to 300.1 million soles or 23.44 per cent of the total as against 63.47 per cent sight deposits and 13.09 per cent time deposits.

At that time, i.e., in December 1946, the balance of 300.1 million soles of savings deposits were divided as follows:

	<u>Amount of the Account</u>	<u>Number of Accounts</u>	<u>Total (Millions of soles)</u>	<u>Average by Account</u>
From	1 sol to 1,000 soles	295,371	39.83	135
"	1,001 soles to 2,000 "	23,197	32.39	1,396
"	2,001 " to 3,000 "	14,973	36.40	2,432
"	3,001 " to 20,000 "	<u>30,981</u>	<u>191.50</u>	<u>6,181</u>
		<u>364,522</u>	<u>300.12</u>	<u>823</u>

### B. Mortgage and Development Banks

Peru, as almost all Latin American countries, has been faced with the problem of obtaining domestic capital for development.

The number of people who are able to save is small although they command a considerable proportion of the national income. In Peru, moreover, as in other Latin American countries, there is a traditional preference for investment in land, both rural and urban real estate property, and the tendency to invest in land and building has been strengthened during the last years by

inflation. In addition to direct land purchases, there has been considerable investment in "Mortgage Bonds" of the Mortgage Banks.

Funds needed for encouraging production have come almost entirely from the Government. The Government, under pressure of agricultural, industrial and mining activities, has undertaken the task of establishing specialized agencies for the aiding of developmental projects but without the possibility of using regular revenue from the budget or public savings it has had to take recourse to loans of the Central Bank, which have contributed to the inflationary spiral.

The Peruvian mortgage banking system includes one mortgage bank established in 1929, and the Mortgage Department of the Savings Bank of Lima. The latter, has, however, in recent years tended to liquidate its mortgage operations in order to stimulate and concentrate upon the operations of its Commercial Department.

Funds for making mortgage loans are obtained by issuing mortgage certificates and mortgage bonds ("Cedulas Hipotecarias" and "Bonos Hipotecarios"). In the first case an individual or firm issues a mortgage certificate (cedula) to which a mortgage bank gives its guarantee, thereby making the security more attractive to the investor.

In addition to guaranteeing certificates, the mortgage banks issue securities of their own. These are called mortgage bonds (bonos). They are secured by mortgage loans which the bank itself makes.

The figures in the balance sheets of these two institutions show a continued increase but not at the same rate as for the commercial banks. While the loans of the Mortgage Bank merely doubled between 1931 and 1945, those of the commercial banks have increased 6 times in the same period.

A number of factors may explain the slower expansion of mortgage credit. The Kemmerer reforms of the banking system, associated with the establishment of the Central Reserve Bank demanded a high degree of liquidity in banking operations. The emphasis was therefore placed upon short term operations. Secondly, the money profits arising from inflation were directed almost exclusively towards commercial transactions.

The following table shows the development of the mortgage banks.

Mortgage Banks in Peru  
(millions of soles)

ASSETS

<u>End of Year</u>	<u>Cash and Deposits</u>	<u>Loans</u>	<u>Investments</u>
1931	1.6	57.8	1.1
1932	.8	55.9	.4
1933	1.6	53.2	.3
1934	4.2	53.4	.4
1935	6.3	55.6	.3
1936	4.4	59.6	.9
1937	5.0	65.3	.8
1938	6.9	73.3	.5
1939	6.2	83.1	1.6
1940	10.1	89.1	1.5
1941	6.7	95.8	1.3
1942	6.3	102.6	1.1
1943	8.7	101.1	1.1
1944	10.4	103.3	2.9
1945	11.9	112.2	4.9
1946	8.5	129.6	4.2
1947 June	2.8	146.8	3.5

LIABILITIES

<u>End of Year</u>	<u>Capital and Surplus</u>	<u>Public Deposits</u>	<u>Bank Deposits</u>	<u>Issue of "Cedulas"</u>
1931	8.5	1.8	3.1	47.1
1932	9.8	.9	2.7	43.8
1933	10.4	.8	1.3	41.5
1934	10.4	2.5	0.7	43.2
1935	10.6	5.1	0.4	44.8
1936	10.7	7.3	---	45.5
1937	10.2	6.6	---	51.9
1938	10.5	4.1	---	63.4
1939	10.7	3.1	---	73.9
1940	10.6	17.2	---	69.6
1941	10.8	15.2	0.4	73.4
1942	11.4	1.7	0.3	92.5
1943	12.4	1.9	0.2	92.5
1944	13.5	2.6	---	96.3
1945	16.3	2.4	---	106.1
1946	17.5	2.1	---	118.1
1947 June	23.6	2.5	---	127.4

D. The Agricultural Bank of Peru

The Agricultural Bank of Peru began operations on August 16, 1931, with a capital of ten million soles subscribed by the State, and in accordance with Law 7,273, which is still in effect. It took the place of an Agricultural Credit Bank, which as a result of the crisis of 1931 and the decline in the prices of practically all agricultural credit. Peruvian agricultural producers, as mentioned in the memorandum which explains the creation of the new bank, "did not build up reserves for bad times" and they were not able to raise the funds required in connection with the crops of 1931. In August 1931, therefore, the Government, as explained earlier, took steps to make available a capital of 5 million soles for a new Agricultural Bank. The Agricultural Bank was associated with the Central Bank and was permitted to enjoy the rediscounting facilities together with the other member banks. Capitalized in this way the bank has been in a position to give considerable help to agricultural producers particularly through short term loans.

From 1942 to 1945, the Agricultural Bank intervened in a series of purchases of basic agricultural products for domestic consumption, mainly rice, in accordance with the authorization granted to the Bank by government decree of March 24, 1942. The Bank accepted the producers' drafts and the producers discounted such drafts with the Central Bank. The item "Acceptances" therefore is a contingent liability which reflects the Bank's responsibility in these operations.

In 1945 such operations were transferred to a special institution created for the purpose of curbing the increase in the cost of living.

Agricultural Bank of Peru  
(Millions of soles)

ASSETS

<u>Year</u>	<u>Cash and Deposits</u>	<u>Loans</u>	<u>Investments</u>	<u>Others</u>
1933 Sept.	7.8	4.	---	---
1934	7.1	3.6	---	---
1935	7.9	2.8	---	---
1936	5.1	5.5	---	---
1937	3.9	6.7	---	---
1938	2.6	8.3	---	---
1939	0.6	10.3	---	---
1940	0.7	13.6	---	---
1941	0.3	12.3	---	0.2
1942 Dec.	0.6	40.5	---	0.2
1943 Dec.	1.1	26.2	31.2	0.2
1944 Dec.	0.2	26.0	47.6	0.3
1945 Dec.	0.2	33.5	43.7	---
1946 Dec.	0.1	37.8	2.2	0.3
1947 May	0.1	47.1	0.3	0.4

LIABILITIES

<u>Year</u>	<u>Capital and Surplus</u>	<u>Deposits</u>	<u>Acceptances</u>	<u>Private Banks</u>	<u>Central Bank</u>	<u>Others</u>
1933 Sept.	10.1	---	1.5	---	---	---
1934	10.3	---	---	---	---	0.2
1935	10.4	---	---	---	---	0.1
1936	10.4	---	---	---	---	0.2
1937	10.4	---	---	---	---	0.3
1938	10.4	---	---	---	---	0.3
1939	10.5	---	---	---	---	0.3
1940	10.4	0.1	---	---	2.3	1.0
1941	10.0	---	---	0.6	0.1	0.8
1942 Dec.	10.2	---	---	9.1	21.0	0.4
1943 Dec.	10.1	0.2	21.7	16.1	10.6	---
1944 Dec.	10.6	0.7	42.1	12.8	7.2	---
1945 Dec.	13.3	0.6	43.8	17.8	1.9	---
1946 Dec.	14.1	---	---	23.5	1.9	---
1947 May	14.1	0.7	---	31.2	1.9	1.1

E. The Industrial Bank of Peru

Although the law which establishes the Industrial Bank of Peru was promulgated in January 1933 the new bank did not begin operations until November 26, 1936, with an initial capital of 2,097,237 soles. The Government, which was interested in stimulating national industries, established certain taxes for the capitalization of the Industrial Bank, and by May 31, 1947 capital and reserves totalled 19,893,641 soles. The bank's principal operations are loans for the importation of machinery, implements and raw materials, and for the provision of working capital.

Industrial Bank of Peru  
(Millions of soles)

ASSETS

<u>End of Year</u>	<u>Cash and Deposits</u>	<u>Loans</u>	<u>Investments</u>
1936	2.1	---	---
1937	1.6	2.5	---
1938	1.6	5.0	---
1939	1.3	6.0	---
1940	1.3	8.3	---
1941	1.4	9.8	0.3
1942	0.9	11.9	2.6
1943	0.6	18.1	1.0
1944	0.7	20.1	0.9
1945	0.7	23.7	0.7
1946	0.7	29.3	0.3
1947 May	0.7	28.1	0.3

LIABILITIES

<u>End of Year</u>	<u>Capital and Surplus</u>	<u>Obligations</u>			
		<u>General</u>	<u>With Banks</u>	<u>With Central Bank</u>	<u>Central Bank Special Loans Others</u>
1936	2.2			---	
1937	3.4			0.8	
1938	4.5			1.8	0.4
1939	5.3			1.8	0.3
1940	6.3			2.9	0.4
1941	7.5		0.2	3.4	0.2
1942	8.6	0.4	2.4	2.6	0.3
1943	10.3	0.7	3.3	0.6	2.5 0.5
1944	12.9	---	5.1	0.6	1.3 0.5
1945	14.9		6.8	0.5	0.3 0.4
1946	18.2	0.3	9.1	0.4	0.3 0.3
1947 May	19.9	0.5	6.6	0.4	0.3 1.4

F. The Mineral Bank of Peru

The law, which established the Mineral Bank, was issued in 1940 and the Bank began operations in January 1942. The authorized capital of the Bank is 50 million soles of which the State is the only proprietor and has so far paid up less than 20 million. The capital is raised from the proceeds of special taxes on mining companies. The objective of the Bank is the development of mineral resources and its operations are shown in the following table:

Mineral Bank of Peru  
(millions of soles)

ASSETS

<u>End of Year</u>	<u>Cash and Deposits</u>	<u>Loans and Investments</u>
1942	1.2	3.9
1943	0.8	7.7
1944	1.6	10.6
1945	0.8	16.9
1946	0.6	26.3
1947 (May)	1.3	27.8

LIABILITIES

<u>End of Year</u>	<u>Capital and Surplus</u>	<u>Obligations</u>
1942	4.6	0.8
1943	7.6	1.4
1944	10.9	2.6
1945	13.8	5.5
1946	16.4	13.2
1947 (May)	17.6	14.5

## 5. Conclusions

The outstanding facts suggested by a review of the Peruvian Banking system are as follows:

- (a) A Central Reserve Bank theoretically independent but "de facto" entirely controlled by the Government;
- (b) A Central Reserve Bank with very weak powers in matters of foreign exchange policy;
- (c) A Central Reserve Bank with no power to control commercial bank credit policy either by increasing the legal deposit requirements or by ceilings on commercial bank loans;
- (d) A group of commercial banks with abundant liquid resources, which are however directed by law toward short-term loans in the money market rather than to productive loans in the investment or capital market. These banks have no interest in investment either in Government securities or in private issues, and a substantial proportion of their loans are directed to speculative ends which the war situation made possible;
- (e) Development banks with very limited resources, in whose activities the public is reluctant to participate;
- (f) A poorly developed capital market with very inadequate capital resources;
- (g) The absence of a sound and well-integrated economic plan for the utilization of Peru's varied economic resources;
- (h) Investors and business men whom a fear of labor disputes and of the encroachment of labor on the functions of management induces to hold considerable amounts of capital outside the country, the transfer of which presses on the balance of payments.

New banking legislation in Peru should take into account the desirability of action in the following fields: (a) Budget. Unless the continuous process of borrowing from the Central Bank is halted, it will be impossible to stop the inflation; (b) Credit Policy. A Central Bank which cannot control the credit policy of commercial banks is not in a position to implement a sound monetary policy; (c) Investments. The channelling of savings, in the direction of productive activities rather than of speculative transactions is of vital importance.