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EBS/86/228

CONFIDENTIAL

October 7, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Peru - Exchange System and Real Effective Exchange Rate
Information Notice

Attached for the information of the Executive Directors is a paper on recent changes in the exchange system of Peru and an information notice on the real effective exchange rate of the Peruvian inti.

Mr. Sheehy (ext. 8672) is available to answer technical or factual questions relating to this paper until October 20, 1986 and Mr. Belanger (ext. 8671) thereafter.

Att: (1)

INTERNATIONAL MONETARY FUND

Peru--Exchange System and Real
Effective Exchange Rate Information Notice

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

(In consultation with the Legal Department
and the Research Department)

Approved by E. Wiesner and Manuel Guitián

October 7, 1986

In July and August 1986, the Peruvian authorities introduced a number of changes to the exchange system. This paper reviews the recent evolution of the real effective exchange rate and the changes that have been introduced in the exchange system. 1/

I. Real Effective Exchange Rate--Information Notice

The recent evolution of Peru's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. 2/ Based on this index, as of July 1986 the Peruvian inti had appreciated in real effective terms by more than 10 percent since the last occasion on which Peru's exchange rate developments were brought to the attention of the Executive Board in an information notice in early March 1986 (EBS/86/61, 3/13/86). The appreciation from February 1986 to July 1986 is estimated to have amounted to 13.1 percent.

1/ For a description of economic policies in 1985 and early 1986, see "Peru--Exchange Arrangements and Exchange System (EBD/85/217, 8/19/85), "Peru--Overdue Financial Obligations to the Fund--Report and Complaints Under Rule K-1 and Rule S-1" (EBS/85/279, 12/13/85), "Peru--Overdue Financial Obligations to the Fund--Report and Complaint Under Rule K-1" (EBS/86/28, 2/4/86), "Peru--Real Effective Exchange Rate--Information Notice" (EBS/86/61, 3/13/86), and "Peru--Overdue Financial Obligations to the Fund--Review of Decision on Complaint Under Rule K-1" (EBS/86/79, 4/11/86).

2/ The index is based on developments in the official exchange rate only, as data are not yet available to permit the calculation of a composite index based on both the official and the parallel exchange markets.

On August 1, 1985, the exchange rate of the inti in the official market was changed from I/ 12.45 per U.S. dollar to I/ 13.94 per U.S. dollar on mid-point basis, resulting in a depreciation of 10.7 percent. Since that date, the exchange rate in the official market has remained fixed and, according to announcements made by the authorities, it is expected to remain fixed until the end of 1986. Despite the decline in the recorded rate of price increase from 184 percent in the 12 months ended July 1985 to 67 percent in the 12 months ended July 1986, inflation in Peru has remained substantially higher than in its main trading partners. The resulting appreciation of the inti in real effective terms since late 1985 has reversed most of the gains in competitiveness that had resulted from the depreciation of the currency in the official market in the period January-August 1985. 1/

II. Modifications of the Exchange System

The July 1986 changes to the exchange system included a two-year suspension of the servicing of most external debt and certain types of remittances relating to foreign investment and services. In addition, the authorities transferred a number of current transactions (including some merchandise trade transactions) from the official exchange market to the parallel market. Additional import payments were transferred to the parallel market in August 1986.

Supreme Decree No. 245-86-EF, which became effective on July 29, 1986, suspended until July 28, 1988 remittances of foreign exchange for debt amortization, interest, dividends, profits (including depreciation allowances), royalties, patent fees, and technical assistance fees by enterprises operating in Peru. The Central Reserve Bank may issue bonds denominated in U.S. dollars, redeemable after 24 months from the date of issue, against receipt of the national currency counterpart of suspended payments. The suspension now includes all payments by those foreign oil companies with which the authorities had recently agreed special remittance rights. The servicing of short-term trade credits, of short-term working capital credits that were contracted before July 28, 1985 and of

1/ Together with the depreciation of the official exchange rate in early August 1985, the authorities introduced a parallel market for some invisible payments and private capital transactions, and suspended the convertibility of foreign currency denominated certificates of deposit issued by domestic banks. Since then, the Central Reserve Bank has purchased foreign exchange in the parallel market to help meet the demand for foreign exchange in the official market. The exchange rate in the parallel market has been about I/ 17.50 per U.S. dollar, which implies a discount of 20 percent with respect to the official market rate. The purchases made by the Central Reserve bank have declined in recent months, in part because a number of payments were transferred from the official market to the parallel market (see below).

medium- and long-term debts contracted after July 28, 1986 is excluded from the suspension. The Ministry of Economy and Finance has the authority to determine any exceptions to these regulations. Payment of the national currency equivalent of amortization and interest payments on medium- and long-term loans and other credits included in the suspension decree is required to be made to the Central Reserve Bank on the dates that the payments fall due.

Several new regulations that affect the parallel market for foreign exchange also have been introduced. First, Exchange Resolution No. 011-86-EF/90 of July 25, 1986 reduced the surrender requirement in the official exchange market from 70 percent to 60 percent for non-traditional exports and from 90 percent to 70 percent for mineral exports by small- and medium-size mines. However, it also increased the surrender requirement for other traditional exports (excluding oil) from 90 percent to 95 percent and for oil exports from 90 percent to 100 percent. ^{1/} Second, Exchange Resolution No. 012-86-EF/90 of July 25, 1986 transferred a number of transactions from the official exchange market to the parallel market, including import payments for some foodstuffs, alcoholic beverages, textiles, clothing, shoes, and electric household appliances. Also transferred to the parallel market under prescribed conditions were certain other current payments, such as profit remittances and royalties (applicable once the suspension described above is lifted), travel expenses, study travel abroad, medical treatment, advertising expenses relating to exports and tourism in Peru, payments of commissions and other expenses for overseas agents, remittances of income to nonresidents, and some insurance payments. Third, Exchange Resolution No. 013-86-EF/90 of July 25, 1986 introduced a surveillance system by which the Central Reserve Bank monitors the operations of the intermediaries permitted to operate in the parallel

^{1/} Under the existing exchange control system, export proceeds are required to be surrendered to the Central Reserve Bank, which issues ten-day exchange certificates for the full value of the exchange surrendered. These exchange certificates are held by the surrendering bank (or any other bank to which they may be subsequently assigned) for use by the exporter for his own permitted foreign exchange payments and transfers or for conversion into intis at the official market rate of the day. If not so utilized within their maturity, the certificates are canceled, and the corresponding amount in intis is credited to the account of the bank and subsequently by the bank to the account of the exporter at the buying rate in effect at the close of the preceding business day, minus a discount of 2 percent. Prior to July 25, 1986, exchange certificates were issued for 90 percent of the value of receipts from traditional exports and for 70 percent of the value of receipts from nontraditional exports. As a result of the new regulations, the exchange rate system now involves an official rate, a parallel market rate, and three additional mixing rates associated with the surrender requirements of 60 percent, 70 percent and 95 percent for certain transactions.

market. Fourth, Exchange Resolution No. 017-86-EF/90 of August 27, 1986, transferred additional import payments from the official market for foreign exchange to the parallel market. The total number of items transferred now covers about 3,000 tariff positions.

It was announced in July 1986 that a limit on the servicing of external public debt equivalent to 10 percent of export earnings would be extended for an additional 12 months. Within that constraint, debt service payments would be made only to those creditors from whom net inflows of resources are expected.

Finally, as from July 31, 1986, the authorities permitted the withdrawal in U.S. dollars from foreign currency accounts with principal amounting to less than US\$1,000. For accounts exceeding US\$1,000 (including certificates of deposits), the suspension of transferability was extended until April 30, 1987.

The limits imposed by Peru on availability of foreign exchange for the servicing of external debt and other invisible payments abroad and the new regulations concerning surrender requirements constitute an intensification of restrictions on payments and transfers for current international transactions as well as an increase in the number of multiple exchange rates; these restrictions and multiple currency practices are subject to approval under the Fund's Article VIII. The staff would encourage the Peruvian authorities to adopt policies that would make possible an early elimination of their restrictions and multiple currency practices, including policies that would increase the scope for the recognized parallel market exchange rate as a means toward the eventual unification of the exchange system. In this respect, the transfer to this market of a number of current transactions from the official market is to be welcomed. Pending adoption of policies that would permit the elimination of these restrictions and multiple currency practices, Executive Board approval for their maintenance is not proposed.

Table 1. Peru: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1982						
I	122.9	65.0	187.8	53.1	233.5	233.2
II	120.7	57.9	207.1	45.7	264.7	266.0
III	117.7	51.9	225.4	39.0	298.4	301.7
IV	118.5	44.8	263.2	32.4	358.0	352.7
1983						
I	113.8	36.5	309.6	26.1	432.5	431.1
II	110.7	29.7	370.5	20.4	534.9	538.1
III	106.1	23.9	442.4	15.7	664.1	673.7
IV	108.7	21.0	514.6	13.3	805.9	793.2
1984						
I	114.1	19.1	593.9	11.7	966.9	961.0
II	108.6	15.9	679.6	9.5	1,147.8	1,155.5
III	106.2	13.8	764.7	7.8	1,344.4	1,367.7
IV	105.6	11.6	908.2	6.2	1,665.1	1,636.4
1985						
I	95.7	8.3	1,149.0	4.1	2,201.1	2,182.6
II	89.5	6.1	1,467.9	3.0	2,940.6	2,961.6
III	83.2	4.4	1,870.4	2.2	3,862.4	3,937.9
IV	86.8	4.1	2,112.1	2.1	4,484.5	4,405.8
1986						
I	93.0	4.0	2,306.2	2.1	5,029.0	4,980.8
II	108.6	3.9	2,536.1	2.1	5,584.3	5,621.3
Monthly						
1986						
Feb. <u>3/</u>	92.6	4.0	2,301.7	2.1	5,025.5	4,960.8
Mar.	95.0	4.0	2,382.5	2.1	5,211.6	5,221.5
Apr.	98.8	4.0	2,479.9	2.1	5,437.4	5,433.5
May	100.2	3.9	2,539.6	2.1	5,589.1	5,615.3
June	102.7	3.9	2,588.9	2.1	5,726.3	5,815.1
July	104.7	3.9	2,674.0	2.1	5,938.6	6,082.6
Percentage change						
Feb.- July 1986	13.1	-2.7	16.2	0.0	18.2	22.6

Source: Information Notice System.

1/ Increases mean appreciation.

2/ Using seasonally adjusted price indices.

3/ Date of latest consideration by Executive Board.

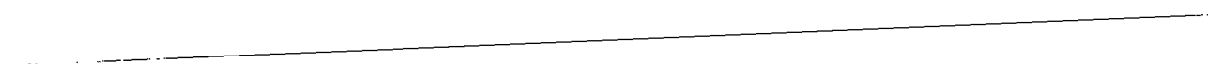
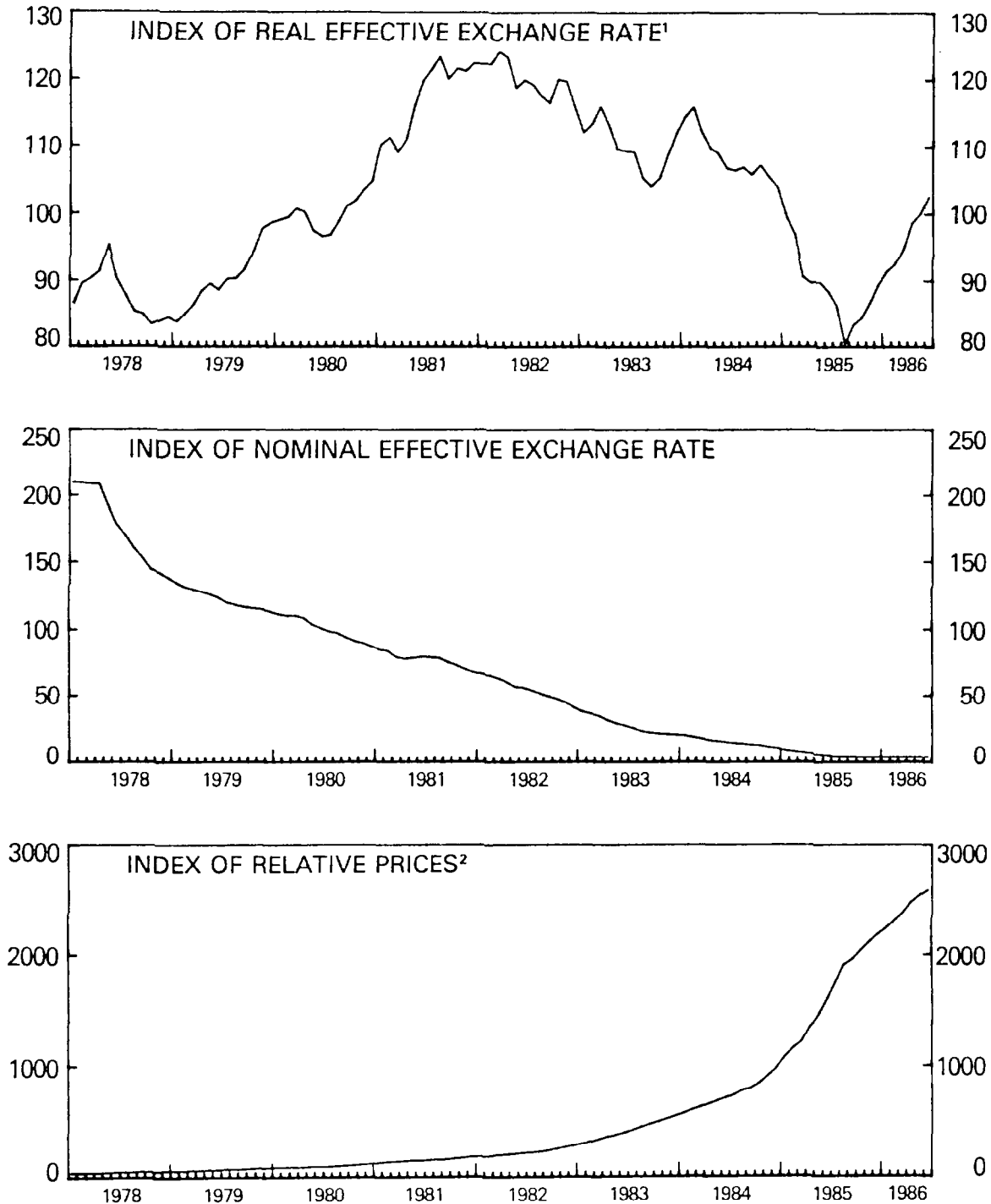


CHART 1

PERU

INFORMATION NOTICE SYSTEM
INDEX OF EFFECTIVE EXCHANGE RATE

(1980 = 100)



Source: Information Notice System.

¹ Trade weighted index of nominal effective exchange rate deflated by seasonally adjusted consumer prices, a rise (fall) in the index reflects an appreciation (depreciation).

² Relative prices as measured by seasonally adjusted consumer price indices.