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January 2, 2020

Statement by the Staff Representative on Peru
Executive Board Meeting
January 8, 2020

This statement provides information that has become available since the staff report was issued on December 19, 2019. This information does not alter the thrust of the staff appraisal.

1. **The latest data and information releases suggest that economic activity remains sluggish.** The monthly GDP data for October shows a 2.1 percent y-o-y growth, with the growth for the period January-October staying at 2.2 percent (y-o-y). While the October data recorded some recovery in the primary sectors, this positive development was offset by a weakening in the nonprimary sectors, particularly in manufacturing and construction. In its last quarterly inflation report for the year, issued on December 20th, the BCRP revised down its 2019 growth projection from 2.7 percent to 2.3 percent. This revision is in line with Staff's projections. The BCRP left its 2020 growth forecast unchanged at 3.8 percent.

2. **The government invoked the escape clause of the fiscal rule framework to relax the fiscal deficit ceilings for the period 2021-23.** As indicated in the staff report, in 2017 the government invoked the fiscal rule's escape clause after the economy was impacted by a severe El Niño weather pattern. This allowed the fiscal deficit to exceed the 1 percent ceiling for the period 2017-20, but the deficit was required to meet the ceiling again in 2021. Given the current economic slowdown, the government has invoked the escape clause one more time in order to implement a more gradual consolidation. Under the new path, the fiscal deficit ceiling will be 1.8, 1.6, and 1.3 percent of GDP in 2021, 2022, and 2023, respectively. The increase in the ceiling is primarily aimed at creating room for higher capital expenditure. The deficit ceiling for 2020 remains unchanged at 2 percent of GDP. The temporary modification of the fiscal rule has been legislated via a government decree. The latter has been submitted to Congress' Permanent Commission, which will in turn bring it to the new Congress once it is in session.

3. **On balance, staff assess this measure as appropriate, although some actions are needed to enhance its benefits and mitigate its shortcomings.** The relaxation of the deficit ceiling is in line with staff's view about the desirability of short-term fiscal easing. In addition, using the additional fiscal room for capital spending is in line with the objective of closing infrastructure gaps. Finally, Peru's sound fiscal position, with low public debt and significant fiscal assets, limits risks to the debt dynamics. Nonetheless, the actual impact of this measure will crucially depend on the government's capacity to reverse the budget under-execution, which has been a difficult task in recent years. It will also be important to the government to implement measures to maintain the credibility of the fiscal framework. As indicated in the staff report, frequent revisions may weaken the integrity of the rules-based fiscal framework. As a result, it may be important for Peru to add additional flexibility to the

fiscal framework in the medium term rather than relying on frequent uses of the escape clause.

4. **The government has also extended the agriculture promotion law until 2031, although with some modifications.** As indicated in the staff report, the law was set to expire in 2021 and the uncertainty about its future was affecting investment decisions. The government has issued a decree extending the law for an additional ten years, while also applying some of its provisions to the forestry and aquaculture sectors. The decree includes some modifications to the existing law, including an increase in the number of vacation days (from 15 to 30), an 8 percent increase in the minimum daily remuneration, as well as an increase in employers' health care contributions (which will gradually converge to the 9 percent rate applicable economy wide). The extension of the agriculture promotion law is in line with staff's policy advice and, as in the case of the modification of the fiscal rules, the decree has been submitted to Congress' Permanent Commission, which will in turn bring it to the new Congress once it is in session.