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Peru: Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

December 20, 2005

The following item is a Letter of Intent of the government of Peru, which describes the policies that Peru intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Peru, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Lima, December 20, 2005

Dr. Rodrigo de Rato y Figaredo
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato,

1. This letter and the attached Memorandum of Economic and Financial Policies (MEFP) set out the policies that the Government of Peru will pursue during 2006 under its economic program, supported by the current Stand-By Arrangement from the Fund. It supplements the letters from the Minister of Economy and Finance and the President of the Central Reserve Bank of Peru dated May 25, 2004 and May 20, 2005, and the letter from the Minister of Economy and Finance dated November 4, 2004.
2. During 2005, the government of Peru has continued implementing its program to sustain strong economic growth. Peru's output growth is expected to be close to 6 percent in 2005, inflation has declined, and its external position has strengthened. Significant progress has also been made in areas related to the fiscal legal framework, the granting of privately-operated concessions for public asset management, and financial regulation and supervision. All quantitative performance criteria for end-September 2005 were met.
3. The economic program for 2006 aims at maintaining macroeconomic stability, fostering robust growth and employment, and further reducing financial vulnerabilities, particularly those associated to financial dollarization. Monetary policy will continue to be guided by the inflation targeting framework, with the 12-month inflation target set at 2.5 percent (within a band of ± 1 percent). Fiscal discipline will remain at the center of the authorities' strategy to consolidate macroeconomic stability. Structural fiscal reforms will focus on the institutional framework for PPP operations, further enhancing tax administration and public financial management, strengthening banking supervision and regulation, and enhancing private sector investment.
4. In view of the strong performance under the program and of our continuing commitment to sound macroeconomic policies, we hereby request the completion of the Third Review under the Stand-By Arrangement. The quantitative performance criteria for the 2006 program are presented in Table 1, and structural benchmarks in Table A attached to the Memorandum of Economic and Financial Policies (MEFP). In addition, the government stands ready to take further measures to ensure the achievement of its program's objectives and will maintain the usual close policy dialogue with the Fund.

Sincerely yours,

_____/s/_____
Fernando Zavala
Minister of Economy and Finance

_____/s/_____
Oscar Dancourt, Acting President
Central Reserve Bank of Peru

Table 1. Peru: Quantitative Performance Criteria and Inflation Consultation Mechanism, 2005-06

	2005	2006	
	Dec. 31	Prog. Mar. 31	June 30
	(Cumulative amounts from December 31, 2004, millions of New Soles)	(Cumulative amounts from December 31, 2005, millions of New Soles)	
Borrowing requirement of the combined public sector 1/ 2/	2,605	-596	-2,090
	(Cumulative amounts from December 31, 2004, millions of U.S. dollars)	(Cumulative amounts from December 31, 2005, millions of U.S. dollars)	
Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions 3/4/	-300	-387	-804
Outstanding short-term external debt of the nonfinancial public sector	50	50	50
Contracting or guaranteeing of nonconcessional public debt with maturity of at least one year 5/ 6/	3,100	960	1,101
<i>Of which:</i> external debt of 1-5 year maturity	100	100	100
External payments arrears of the public sector (on a continuous basis)	0	0	0
	(Consultation bands for the 12-month rate of inflation, in percent) 7/		
Outer band (upper limit)	5.5	5.5	5.5
Inner band (upper limit)	4.5	4.5	4.5
<i>Central point</i>	2.5	2.5	2.5
Inner band (lower limit)	0.5	0.5	0.5
Outer band (lower limit)	-0.5	-0.5	-0.5

Sources: Central Reserve Bank of Peru; and Ministry of Economy and Finance.

1/ The borrowing requirement of the combined public sector will be adjusted upward by up to S./400 million for any negative operating financial result of the BCRP in 2005, and by up to S./200 million during the first half of 2006.

2/ PIPP proceeds are included below the line.

3/ The target for net international reserves will be adjusted upward by the amount by which net foreign borrowing of the nonfinancial public sector exceeds US\$97 million at end-December 2005, -US\$6 million at end-March, and -US\$128 million at end-June. It will be adjusted downward for shortfalls from programmed net foreign borrowing. The amounts in excess will be deposited at the BCRP.

4/ The target for net international reserves will be adjusted downward for withdrawals for portfolio management purposes of deposits held at the Central Reserve Bank by the Consolidated Pension Reserve Fund (FCR) and any other funds managed by the ONP. This downward adjustment will not exceed US\$300 million at any time in 2005 and the first half of 2006.

5/ The limit will be adjusted upward by any amount of debt issued for, and used in, debt-exchange operations, or for prefinancing government operations.

6/ In 2005, the limits will be adjusted upward by up to US\$400 million for guarantees provided by or contracted by the government, including with multilaterals, in context of Private Public Partnerships (PPPs) and concessions. In 2006, targets will be adjusted upwards by up to US\$250 million for guarantees provided by or contracted by the government, including with multilaterals, in the context of PPP concessions. In the event of delays in PPP operations programmed for 2005, guarantees can be carried over to the 2006 adjuster.

7/ Should inflation fall outside the inner band, the authorities will discuss with the Fund staff the appropriate policy response. Should inflation fall outside the outer band, the authorities will discuss with the Fund staff the appropriate policy response and complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the arrangement.

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2006

Performance under the 2005 Economic Program

1. Peru's macroeconomic performance in 2005 has been very strong, reflecting a close adherence by the government to its economic program and a favorable external environment. Led by private investment and exports, output growth is expected to be close to 6 percent and formal employment growth has picked up significantly. Twelve-month inflation has temporarily declined below the inflation target range of the central bank in recent months, but is expected to be within the band by year-end. With surging exports, the external current account is expected to register a surplus of about $\frac{1}{3}$ percent of GDP, and official net international reserves are projected to reach US\$13.6 billion by end-2005, representing over 280 percent of maturing short-term external debt. The overall deficit of the combined public sector is expected to be at 1 percent of GDP in 2005, with the public debt-to-GDP ratio projected below 40 percent of GDP.

2. Solid progress has been made in the structural area. The General Law on Public Indebtedness (end-December 2005 benchmark) was approved in July 2005 and immediately implemented. In July 2005, a reporting system of public sector liabilities (including contingent) associated with Private-Public Partnerships (PPPs) was established, and a norm requiring the annual publication of such liabilities in the Multiyear Macroeconomic Framework beginning in 2006 was issued in July (end-September 2005 structural performance criteria). Information of such liabilities was presented in the revised Multiyear Macroeconomic Framework published in August 2005. Although the central government budget formulation system and the Integrated Financial Management System (SIAF) have not been unified (end-June benchmark) because of delays in preparing the software, such a unification is now scheduled for January 2006. The publishing and dissemination of a methodology to price infrequently traded financial instruments and a set of reference prices is expected to be undertaken in December (end-July benchmark). Progress in other areas of structural reform include:

- **Decentralization.** The implementing regulations of the Fiscal Decentralization Law were issued in September (end-September benchmark), with a view to promoting a cautious and fiscally-sound decentralization process.
- **Awarding of concessions.** The concession of a large regional integration highway in the Northern part of the country was awarded in early-May and a second major highway (Pucusana-Ica) concession was awarded in July (end-September structural performance criterion). Total infrastructure investment commitments in 2005 via concessions or PPPs are expected to total US\$1.5 billion.
- **Financial sector.** Progress has been made toward implementing norms on foreign currency-induced credit risks, with the Superintendency of Banks issuing implementing guidelines in May (end-September structural performance criterion). Also, the government announced a plan to centralize the information on collateral registries in August (end-September benchmark), thus paving the way for enacting associated legislation to improve access to financing for credit-worthy borrowers.

The 2006 Economic Program

3. The government's economic program for 2006 seeks to sustain high economic growth through the continued implementation of prudent macroeconomic policies and a deepening of its growth-enhancing reform program. Real GDP is projected to grow by 5 percent in 2006, supported by private investment and continued strong export performance. Year-end inflation is projected at 2½ percent. Gross official international reserves are expected to remain at comfortable levels, providing a solid cushion against possible adverse shocks.

4. Monetary policy will continue to be guided by the inflation targeting framework. The Central Bank plans to shift from an end-year inflation target to a continuous one. The Central Bank inflation target is set at 2.5 percent, within a band of plus or minus 1 percent. Consistent with this framework, Central Bank intervention in the foreign exchange market will be primarily limited to smoothing out excessive volatility. Also, the Central Bank has been coordinating with Congress an amendment to the Civil Code to restore the *Nuevo Sol's* full legal tender status in accordance with article 43 of its Organic Law.

5. The budget submitted to congress targets an overall deficit of the nonfinancial public sector of 1 percent of GDP in 2006. The government is committed to the rules of the Fiscal Responsibility and Transparency Law (FRTL), including those applying to electoral years. To help ensure adherence to the deficit target, expenditure growth will be restrained while ensuring that public sector capital spending is increased as percent of GDP. If central government revenue turns out to be less buoyant than anticipated, expenditure reduction will be implemented while protecting targeted poverty-reducing programs.

6. The government will continue to undertake public liability management operations to further reduce rollover and market risks (currency and interest rate) and gradually increase the share of long-term local currency instruments. All external bond issues will continue to have collective action clauses.

7. The structural and institutional fiscal reforms will aim at maintaining a prudent fiscal stance and improving efficiency in revenue collection and expenditure allocation. To that effect, the main policy actions will be as follows:

- ***The legal and institutional fiscal framework.*** A draft law will be submitted to congress in March 2006 that strengthens procedures for compliance with the FRTL, monitoring of budget execution, and the requirements for quarterly reporting to congress and the public. In particular, a coordination committee of fiscal policy will be established in the Ministry of Economy and Finance to monitor on a monthly basis the fiscal program and, if needed, recommend measures to comply with the FRTL's fiscal limits.
- ***Tax policy and administration.*** The government will avoid further reductions of excise tax rates on fuels in the first half of 2006 and study contingent measures to prevent a drop on revenues as a result of the phasing out of the tax on net assets. In order to facilitate tax administration, existing value added tax withholding schemes will be consolidated in 2006. Following the recent elimination of tax exemptions applying in one regional government, the government will continue to seek the

- removal of other tax exemptions. The government will also concentrate efforts in reducing tax evasion and the tax agency *SUNAT* will focus its activities on improving audit quality, tracking non-filers, streamlining audit procedures, introducing electronic invoicing, and applying modern technologies to tackle contraband and customs undervaluation.
- ***Public financial management.*** The Ministry of Economy and Finance aims to prepare an action plan to modernize the budget classification system to make it compatible with international standards and incorporate this classification into the chart of accounts, by end-June 2006. In addition, the Ministry will prepare plans by end-June 2006 to: (i) establish SIAF automatic accounting by end-2006; and (ii) implement a Treasury Single Account (TSA), with a view to help further strengthen control and transparency over the central government finances and improve Treasury cash management.
 - ***Public sector reform.*** In order to improve the management of the *Cédula Viva* system, a decree was issued in October centralizing its administration at the National Pension Office (ONP). In addition, by end-June 2006 the government will submit to congress legislation for a fiscally prudent and comprehensive reform of the pension regime of the police and military, aimed at restoring its financial viability.
 - ***Government decentralization.*** Decentralization will continue to be implemented in a fiscally-neutral manner, while improving service delivery. The Ministry of Economy and Finance will strengthen further its efforts to monitor the public finances of subnational governments and of the largest municipalities. Also, it will work closely with the subnational governments to ensure that their 2007 finances are consistent with the limits set in the FRTL and the Fiscal Decentralization Law. The government will not guarantee or on-lend external credits to subnational governments that exceed the limits in these laws. Trust funds set up by subnational governments will be covered under the limits of this legislation. The Ministry of Economy and Finance will encourage implementation of the budget execution and debt management modules of the SIAF in 100 municipalities. In addition, a pilot program will be implemented in 2006 to improve regional and local government financial management capacity, covering a representative sample of municipal governments.
8. Supporting efficient and transparent infrastructure investment will be a key ingredient of the growth enhancing reform program for 2006. In particular:
- ***The Private Investment Promotion Program (PIPP).*** The government will continue strengthening investment and maintenance of infrastructure in a fiscally sound manner, including through the PIPP, which includes concessions and Private-Public Partnership (PPP) operations. In 2006, total infrastructure investment commitments via concessions or PPPs are expected to total US\$1.7 billion. The government will improve further its reporting of public sector liabilities associated with PPPs and concessions, and will continue to report such liabilities in the Multiyear Macroeconomic Framework.

- ***Permanent framework for PPPs.*** An action plan will be prepared by March 2006 with a view to implementing the recommendations of ongoing technical assistance on PPPs. Implementation of this plan will strengthen the role of the Ministry of Economy and Finance in the selection of projects to be undertaken as PPPs and enhance coordination among agencies. The plan would also define the institutional framework and technical procedures for estimating the fiscal impact (including that of minimum revenue guarantees) of any PPP.
- ***Public investment efficiency.*** The National System of Public Investment (SNIP) will continue to be strengthened in order to rise the quality of public investment. In particular, it will focus on ensuring prompt assessment of projects, weeding out socially unviable projects, and improving the capacity of spending units in project preparation. The government will ensure that any new PPP projects involving financial guarantees or subsidies are assessed by the SNIP.

9. The government growth-enhancing reform program for 2006 will also focus on further reducing vulnerabilities of the financial system, continuing to increase Peru's integration into the regional and world economy, and fostering a better business climate and competitiveness. In this regard, to help expedite the judicial resolution of business-related disputes and bolster contract enforcement, the government will work toward completing the commercial court system of Lima and establishing a commercial court module outside Lima in 2006. Moreover, to improve credit access to credit-worthy agents, the government will begin implementing the centralization of collateral registries by end-June 2006. It will also continue to promote employment in the formal sector of the economy.

10. Efforts to reduce financial dollarization risks are being strengthened. A plan that aims at ensuring that at least 50 percent of the mortgage loans supported by the *MiVivienda* program during the period January–June 2006 are denominated in domestic currency will start being implemented by end-2005. Under the plan, *MiVivienda* will provide financial institutions with a package of incentives, including credit risk coverage, to offer long-term mortgages in domestic currency. The Superintendency of Banks (SBS) will implement fully, by end-June 2006, the regulation issued in 2005 in the area of foreign currency-induced credit risks. Moreover, the SBS will continue implementing stricter measures aimed at ensuring that financial intermediaries fully incorporate foreign currency-induced credit risks.

11. The Superintendency of Banks has developed detailed actions to strengthen off-site and on-site supervision of financial intermediaries. It will continue to take steps to ensure that consolidated supervision and regulation is effective, including via the implementation of high risk-based capital requirements or the full provisioning on financial intermediaries' risky offshore operations. The SBS will also tighten the regulations governing restructured loans. In particular, by end-December 2005, it will eliminate the provision that allows for an automatic upgrade of borrowers classified in doubtful or loss category before the debtor's repayment capacity is fully assessed. In addition, the SBS will fully implement the recently issued Law on Consumer Protection in Banking Services by end-2005. A special unit for consumer protection has been set up within the SBS. Moreover, a roadmap for implementing Basel II will be finished by end-December 2005.

12. The government will continue to promote greater efficiency in financial intermediation, including through development of the domestic capital market. With the support of technical assistance from the Fund, the government is stepping-up its efforts to deepen the secondary securities market, reduce administrative barriers to securitization and standardize financial contracts. In addition, regulatory changes facilitating the transfer of funds between private pension fund administrators (PPFAs) and the entrance of a fifth administrator in the market in July 2005 have led to increased competition among PPFAs, thereby helping reduce costs to contributors. Competition will be further fostered by a widening of the permissible band around the required rate of return, which is expected to take place in the first half of 2006. Significant progress has also been made toward establishing a system to allow each PFFA to offer investment portfolios with different risk return characteristics. The SBS will issue regulations to limit the market risk of PFFA investments, including those associated with stock market prices, currencies, and interest rates. The Central Bank will continue to establish operative limits on PFFA investments abroad, in accordance with its constitutional mandate to preserve monetary stability, and the SBS will focus on supervisory and regulatory functions in this area.

13. Public bank lending to the private sector will continue to be closely monitored. During 2006, the Ministry of Economy and Finance will continue monitoring *Banco de la Nación's* consumer lending to ensure observance of the agreed quarterly targets between these two institutions. The quasi-fiscal operations of *Agrobanco* associated with lending to small-scale farmers will continue to be recorded in the budget.

Table A. Peru: Growth Enhancing Policy Actions for 2005 and 2006

Structural Benchmarks

The government will develop an operational plan to ensure that at least 50 percent of the mortgage loans financed by the <i>MiVivienda</i> program during the period January–June 2006 are denominated in domestic currency.	December 31, 2005
Prepare an action plan to introduce a permanent framework for Private-Public Partnerships, as specified in paragraph 8 of the MEFP.	March 31, 2006
Completion of plans for implementing a Treasury Single Account and update the budget classification system to international standards, as specified in paragraph 7 of the MEFP.	June 30, 2006
Implementation of the plan to centralize collateral registries.	June 30, 2006
Implement the plan under which at least fifty percent of the mortgage loans financed by the <i>MiVivienda</i> program during the period January–June 2006 are denominated in domestic currency.	June 30, 2006
Fully implement the regulation measuring risks associated with foreign currency denominated loans.	June 30, 2006

TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

This technical memorandum sets out the understandings between the Peruvian authorities and the Fund relating to the monitoring of the program for 2006. It defines the concepts used to assess compliance with quantitative performance criteria specified in the letter of the Government of Peru dated December 20, 2005. It also sets the frequency of the data to be provided to the Fund for monitoring the program. For purposes of the program for 2006, operations in foreign currency will be converted into *Nuevos Soles* at the average program exchange rate of S/. 3.32 per U.S. dollar.

I. DEFINITIONS OF CONCEPTS

1. The nonfinancial public sector (**NFPS**) includes the central government, the autonomous agencies, the local and regional governments, and the nonfinancial public enterprises.

2. **The borrowing requirement of the combined public sector (PSBR)** will be measured as: (a) net domestic financing of the NFPS; plus (b) net external financing of the NFPS; plus (c) proceeds from the Private Investment Promotion Program (PIPP); and less (d) the operating balance of the Central Reserve Bank of Peru (BCRP). The PSBR will be adjusted to exclude the impact of data revisions that do not represent a change of its flows during 2006. The components of the PSBR (see Table 1), will be defined and measured as follows:

(a) **The net domestic financing of the NFPS** is defined as the *sum* of: (i) the increase in net claims of the domestic **financial system**¹ on the nonfinancial public sector, excluding Peruvian Brady bonds and other government bonds initially sold abroad; (ii) the net increase in the amount of public sector bonds² held outside the domestic financial system and the nonfinancial public sector, excluding Peruvian Brady bonds and other bonds initially sold abroad; and (iii) the increase in the floating debt of the nonfinancial public sector due to expenditure operations and tax refund arrears; *less* (iv) the accumulation of stocks, bonds, or other domestic financial assets by the nonfinancial public sector and (v) the amortization of pension recognition bonds. In the case of enterprises that are divested after December 31, 2005, the net credit of the financial system to these enterprises will be recorded, for the remainder of the program period, as unchanged from their level at the time of the PIPP.

(b) **The net external financing of the NFPS** comprises (i) disbursements of loans; plus (ii) receipts from the issuance of government bonds abroad; minus (iii) cash payments of

¹ The financial system comprises the banking system, the Corporación Financiera de Desarrollo (COFIDE), *MiVivienda* and all other nonbank financial intermediaries. The banking system includes the BCRP, the commercial banks, *Banco de la Nación* (BN), and *AgroBanco*.

² Excluding the new issuances of pension recognition bonds.

principal (current maturities of both loans and bonds); minus (iv) cash payments of arrears (principal and interest); plus/minus (v) the net increase/decrease in short-term external debt; minus (vi) debt buy-backs or other prepayments of debt (at market value) not included in the following item (including repayments of short-term external debt assumed by the government at the time of the divestiture of public enterprises, net of the proceeds from the sale of inventories of such enterprises); minus (vii) debt-equity swaps used in the PIPP accounted at the market value of these papers as defined by *ProInversion*; minus/plus (viii) the net increase/decrease in foreign assets of the nonfinancial public sector (including those held abroad by the *Fondo Consolidado de Reservas* (FCR), and any other fund managed by the *Oficina de Normalización Previsional* (ONP)) (see Table 2).

(c) **PIPP proceeds** are defined as (i) the cash payments received by the Treasury from the sale of state-owned assets (including proceeds transferred to the FCR, and any other specialized funds) valued at the program exchange rate, plus (ii) debt equity swaps used in the PIPP, accounted at market values as defined by *ProInversion*. PIPP proceeds also include up-front payments received by the Treasury for the granting of concessions for public services but exclude the annual payments under the concession program, which are part of nontax revenue.

(d) **The operating balance of the BCRP** includes: (i) cash interest earnings of the BCRP minus cash interest payments by the BCRP, in both domestic and foreign currency; (ii) the administrative expenses of the BCRP; and (iii) any realized cash losses or gains from activities in currencies, financial instruments, and derivatives.

3. **The consultation bands for inflation** are based on the 12-month rate of change in consumer prices as measured by the *Indice de Precios al Consumidor (IPC)* at the level of Metropolitan Lima by the *Instituto Nacional de Estadística e Informática* (INEI). Should inflation fall outside an inner band of 2 percentage points around the central point of 2.5 percent, the authorities will discuss with the Fund staff on an appropriate policy response. Should inflation fall outside an outer band of 3 percentage points around the central point of 2.5 percent, the authorities will discuss with Fund staff on a policy response and complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the program.

4. **The net consumer lending of the Banco de la Nación** will be defined as disbursements of all consumer loans, including these under the “*Multired Program*” (established in November 2001) and “*Prestamos a 60 Quotas*” (established in September 2004) less cash amortizations under the loan programs. Interest payments on these loans are excluded from the definition of net lending.

5. **The net international reserves of the BCRP, excluding foreign-currency deposits of financial institutions**, are defined for the purpose of the program as: (a) the foreign assets of the BCRP (excluding subscriptions to the IMF and the Latin American Reserve Fund (FLAR), *Pesos Andinos*, credit lines to other central banks, *Corporación Andina de Fomento* (CAF) bonds, and foreign assets temporarily held by the BCRP as part of swap operations);

less (b) reserve liabilities, defined as the sum of: (i) the BCRP's external liabilities with an original maturity of less than one year, and (ii) its liabilities to the IMF, to the Inter-American Development Bank (IADB) and to the FLAR; less (c) deposits in foreign currency by the banking system, other financial intermediaries and the private sector, net of repos of Treasury bonds with the financial system.

6. **BCRP's silver holdings** will be included as net domestic assets and excluded from the net international reserves.

7. **BCRP's gold holdings** will be accounted at US\$438.35 per troy ounce (the average book value as of December 31, 2004), SDRs at US\$1.55301 per SDR, and foreign currency assets and liabilities of the BCRP in other currencies at the exchange rate of December 31, 2004. Net international reserves will be adjusted to exclude any valuation gains or losses resulting from net sales or deliveries of gold by the BCRP. The end-September 2005 level of net international reserves is shown in Table 3.

8. The flows of the **short-term external debt of the NFPS** are defined as the net change in the NFPS's outstanding external indebtedness with a maturity of less than one year (including instruments with put options that would be triggered within one year of the contracting date), measured, in part, on the basis of the operations of a selected sample of public enterprises comprising *Petroperú*, and *Electroperú*. These limits exclude normal import financing but include forward commodity sales. In the case of companies sold to the private sector under the PIPP, the short term debt of these entities will be recorded, for the remainder of the program period, as unchanged from their level at the time of the PIPP. The end-September 2005 stock of short-term external debt of the NFPS is shown in Table 4.

9. **The contracting or guaranteeing of nonconcessional public debt with a maturity of at least one year** refers to all domestic and external obligations of the NFPS contracted or guaranteed by the central government, COFIDE, the BCRP, the BN, and any other public financial entity, except for loans classified as reserve liabilities of the BCRP. The program limits on nonconcessional debt will exclude: (i) any new loans extended in the context of a debt rescheduling or debt reduction operation; (ii) any lending at concessional terms; and (iii) certificates (BCRPCD) issued by the BCRP for conducting monetary policy.

10. **For the purpose of the performance criterion on the contracting or guaranteeing of public debt**, external public debt applies also to commitments contracted or guaranteed for which value has not been received. In this regard, the term "debt" has the meaning set forth in point No.9 of the Guidelines on Performance Criteria with respect to Foreign Debt adopted on August 24, 2000 (Board Decision No. 12274-(00/85)). Thus, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time: these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the

obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the performance criterion, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt. Foreign currency public debt to be contracted or guaranteed will be converted based on the program exchange rate, with cross rates for non-dollar foreign currencies set based upon the rate on the day of the transaction, published by REUTERS.

11. For program purposes, **a debt is concessional** if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt (i.e., grant element) is equal to nominal value minus NPV divided by nominal value. The NPV of debt at the time of its disbursement is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the OECD. For debt with a maturity of at least 15 years, the ten-year average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. For the purposes of the program through end-June 2006, the CIRRs published by the OECD in October 2005 will be used (see Table 5).

12. **The concessional of loans in currency baskets** will be assessed on the basis of U.S. dollar interest rate tables. For loans with interest rates based on the internal policy of the creditors, the relevant interest rate to define concessional will be the interest rate for each creditor at the time of the commitment. Loans or portions of loans extended in the context of a debt rescheduling or a debt reduction operation will be excluded from the ceiling.

13. **The external payments arrears of the public sector** include arrears to multilateral financial institutions, to Paris Club creditors, and to other foreign creditors with whom debt restructuring agreements have been concluded. They exclude arrears outstanding at end-2005 that were not covered under restructuring agreements. The public sector will be defined to include the NFPS, COFIDE, the BCRP, the BN, and any other state development bank.

14. **Definitions used in Table 1 of the letter of intent dated December 20, 2005 for the calculation of adjusters, limits and targets for net international reserves:**

- a. **Net foreign borrowing** (Table 2) is defined as the sum of disbursements of loans (I.2.b.i); plus receipts from the issuance of government bonds abroad (I.2.b.ii); minus cash payments of principal (I.2.b.iii); minus cash payments of arrears (principal and interest) (I.2.b.iv); plus/minus the net increase/decrease in short-term external debt (I.2.b.v).
- b. **The withdrawals for portfolio management purposes** of deposits held at the BCRP by the FCR and any other fund managed by the ONP, mentioned in footnote 4 of Table 1 attached to the letter of intent dated December 20, 2005 refer to placements of funds that are in accord with an investment plan approved by the Board of the FCR, excluding deposits in public financial institutions and government securities.

II. PERIODIC REPORTING

15. Periodic reporting includes:

- (a) The latest *Nota Semanal* published by the BCRP;
- (b) Report of BCRP daily operations;
- (c) Daily exchange rate statistics.
- (d) Monthly Report of:
- (i) **Performance criteria**
Data on the program's quarterly *quantitative* performance criteria.
- (ii) **Financial sector**
- (a) Balance sheets of the consolidated financial system, consolidated banking system, BCRP, BN, commercial banks, *AgroBanco*, and development banks in liquidation.
- (b) Disaggregation of the net domestic assets of the BCRP and BN with details of the other net accounts.
- (c) Balance sheet of COFIDE and data on COFIDE guarantees.
- (d) Balance sheet of the private pension system.
- (e) Evolution of gross disbursements and cash amortizations of consumer loans under the "*Multired Program*" of *Banco de la Nacion*.
- (f) The stock of government guarantees for housing support programs and the balance sheet of MiVivienda.
- (iii) **Fiscal sector**
- (a) PSBR as defined in Table 1.
- (b) List of domestic and external debt instruments contracted or guaranteed by the public sector, including data on the amount, lender, grace period, maturity, and interest rate (refinancing credits should be labeled as such),

collateral guarantees, any instrument enhancements (such as but not limited to put or call options) that affect the price or maturity of the debt instrument.

- (c) Summary of disbursements and interest and amortization due and paid (identifying the payments of arrears) of loans included in the records of the General Directorate of Public Credit by creditor and debtor, indicating foreign origin (distinguishing between financial and nonfinancial public sector debt) and domestic origin (Table 6).
 - (d) Cash operations of the treasury (which includes floating debt, with a memorandum item on tax refund arrears).
 - (e) Data on PIPP revenue, which will include gross receipts, costs of the PIPP, use of debt-for-equity swaps, commissions received by *ProInversion* and the resulting cash receipts received by the Treasury and the FCR. In addition, the report will include debts assumed by the government in connection with the PIPP.
 - (f) Operations of the Central Government, Central Government Current Revenue (SUNAT Format); Central Government Noninterest Expenditure; and Transfers from the Central Government to the Rest of the General Government.
 - (g) Fuel prices of *Petroperu* and *Relapasa*, and international prices of products commercialized by *Petroperu* including tariffs, indirect taxes and distribution margins (prices would be listed for all grades of gasoline, diesel fuel, kerosene and fuel oils.)
 - (h) Stocks of the central government PIPP accounts in the BCRP and the BN.
- (iv) **External sector**
- (a) Summary of imports by products (volume and prices); and
 - (b) Summary of exports by products (volume and price).
- (e) **Quarterly data of fiscal and external accounts, and public sector debt**, distinguishing between external and domestic total public sector debt and total NFPS.
- (f) **Other**
- (a) Summary of legislative changes pertaining to economic matters.
 - (b) BCRP circulars.
 - (c) BCRP inflation report.

Table 1. Peru: Public Sector Borrowing Requirement 2005
(In millions of nuevos soles)

	Stock as of Dec. 31 2004 ^{1/}	Stock as of Sep. 30 2005 ^{1/}	Flow Jan-Sep
a. Net domestic financing of the nonfinancial public sector	433	1 454	1 021
i. Net claims of the financial system (1+2+3)	-7 801	-8 020	- 218
1. Net credit of the banking system on the NFPS, COFIDE and MiVivienda	-14 177	-15 926	-1 749
Credits	6 721	5 967	- 754
Liabilities	20 898	21 894	995
2. Net credit of COFIDE and MiVivienda on the banking system	3 328	3 316	- 13
Credits	3 460	3 467	7
Liabilities	131	151	20
3. Net credit of nonbanking financial institutions on the NFPS	3 048	4 591	1 543
Credits	3 528	5 102	1 574
Liabilities	480	511	31
ii. Stock of NFPS bonds in circulation (excluding bonds held by NFPS and of the financial system)	9 737	11 486	1 749
1. Total	16 033	19 690	3 657
2. Less: holdings of the financial system (including COFIDE and MiVivienda)	5 949	7 865	1 921
3. Less: holdings of nonfinancial public sector entities	348	339	- 14
iii. Floating debt	1 715	1 519	- 196
iv. Less: Accumulation of stocks, bonds, or other domestic financial assets by the NFPS	2 437	2 624	187
v. Less: Issuance of pension recognition bonds in program period	780	907	127
b. Net external financing (Millions of US dollars)			-3 894 -\$ 1,173
c. Privatization (Millions of US dollars)			134 \$ 41
d. Operating balance of the BCRP			-132
PSBR (a+b+c-d)			-2 607

1/ Foreign currency valued at US\$ 1 = S/. 3,32

Table 2. Peru: Net External Financing NFPS: 2006 ^{1/}
(In millions of US\$)

	2006 Prog.	
	Jan.-Mar.	Jan.-Jun.
i. Loan disbursements	259	401
-Projects	159	301
-Nonprojects	100	100
ii. Bonds	0	0
iii. Cash payments on amortization	265	529
- Loans	220	484
- Bonds	45	45
iv. Cash payments to settle arrears	0	0
v. Change in short term debt (increase+)	0	0
A. Net foreign borrowing (i+ii-iii-iv+v)	-6	-128
vi. Prepayments	0	0
vii. Debt equity swaps	0	0
viii. Change in foreign assets held by the NFPS	4	9
ix. Investment project under the PIPP	0	0
B. <u>Net external financing (A-vi-vii-viii+ix)</u>	<u>-10</u>	<u>-136</u>

1/ Excludes balance of payments support loans to the Central Reserve Bank of Peru.

Source: Central Reserve Bank of Peru

Table 3. Peru: Net International Reserves of the Central Reserve Bank of Peru excluding foreign currency deposits of financial institutions as defined in the Technical Memorandum of Understanding (TMU)
(In millions of U.S. dollars)

	Stocks as of September 30, 2005
a. <u>Assets</u>	<u>13,338</u>
Deposits abroad	4,097
Securities	8,727
Gold 1/	489
Holdings of SDR 2/	10
Reciprocal credit agreement	4
Cash	10
Others	1
b. <u>Liabilities</u>	<u>19</u>
Reciprocal credit agreement	3
Liabilities with international organizations	16
IMF 2/	0
IADB	16
FLAR	0
c. <u>Foreign currency deposits of financial institutions at the Central Bank</u>	<u>3,027</u>
Banking enterprises	2,876
Banco de la Nación	56
COFIDE	43
Financial enterprises	52
d. <u>Treasury bond repos</u>	<u>0</u>
e. <u>Swaps</u>	<u>0</u>
f. <u>Valuation US\$/other currencies</u>	<u>-206</u>
g. <u>Net international Reserves - Program definition (a-b-c+d-e-f)</u>	<u>10,499</u>
<u>Memorandum items:</u>	
1. Subscription to the IMF and FLAR	322
2. Pesos andinos	20
3. CAF bonds	0
4. Valuation change by BCRP's gold holdings	35
5. Valuation change by BCRP's SDR holdings	-1
6. Net international reserves, official definition (g+c+f+1+2+3+4+5)	13,695

Source: Central Reserve Bank of Peru.

1/ Gold valued at US\$ 438,350.

2/ Valued at US\$ 1,55301 per SDR.

Table 4. Peru: Short Term External Debt Owed by the
Non Financial Public Sector (as of September 30, 2005)

(In millions of US\$)

	Export Financing	Working Capital	Import Financing	Total
Total	0	0	62	62
Petroperu	0	0	62	62
Electroperu	0	0	0	0
General government	0	0	0	0
Memorandum item:				
Total of export financing plus working capital loans	0	0	0	0

Sources: Central Reserve Bank of Peru and state companies.

Table 5. Peru: Commercial Interest Reference Rates (CIRRs)

	Average CIRRs		Previous rates for loans with maturity =>15 years							
	Six-month	Ten-year	contracted in							
	02/15/05-08/14/05	1/95 - 12/04 1/	before 1999	1999	2000	2001	2002	2003	2004	
			1/86-12/95	1/89-12/98	1/90-12/99	1/91-12/00	1/92 - 12/01/93	12/02/94 - 12/03		
Australian Dollar	6.36%	7.24%	12.15%	10.15%	9.28%	8.55%	7.98%	7.68%	7.48%	
Austrian Schilling 2/	n.a.	5.76%	8.35%	7.73%	7.65%	7.43%	6.72%	6.34%	6.03%	
Belgian Franc 2/	n.a.	6.07%	9.25%	8.60%	8.45%	8.13%	7.21%	6.80%	6.44%	
Canadian Dollar > 8.5 years	4.85%	6.69%	9.83%	8.90%	6.07%	6.78%	7.41%	7.34%	7.05%	
Danish Krone	4.13%	6.09%	10.37%	8.88%	8.33%	7.80%	7.29%	6.81%	6.37%	
Finnish Markkaa 2/	n.a.	6.02%	10.64%	9.32%	9.15%	8.72%	7.56%	6.92%	6.43%	
French Franc 2/	n.a.	5.89%	9.62%	8.42%	8.19%	7.82%	6.95%	6.50%	6.16%	
German Mark 2/	n.a.	5.73%	7.91%	7.62%	7.54%	7.27%	6.58%	6.23%	5.96%	
Irish Punt 2/	n.a.	6.16%	10.37%	7.59%	8.36%	8.44%	7.44%	6.97%	6.50%	
Italian Lira 2/	n.a.	6.47%	11.50%	10.38%	10.06%	9.71%	8.30%	7.61%	6.94%	
Japanese Yen	1.87%	2.24%	5.53%	4.65%	4.30%	3.75%	3.17%	2.77%	2.45%	
Korean Won	5.10%	9.04%	n.a.	n.a.	n.a.	11.57%	10.74%	10.19%	9.55%	
Netherlands Guilder >8.5 years 2/	n.a.	6.11%	8.08%	5.24%	5.81%	6.52%	6.95%	6.75%	6.43%	
New Zealand dollar	7.02%	7.68%	12.17%	9.62%	8.90%	8.33%	7.97%	7.94%	7.80%	
Norwegian Krone	4.21%	6.74%	11.27%	8.93%	8.36%	7.94%	7.60%	7.28%	7.04%	
Spanish Peseta 2/	n.a.	6.65%	12.99%	11.35%	10.89%	10.31%	8.65%	7.92%	7.20%	
Swedish Krona	4.33%	6.67%	11.67%	10.10%	9.42%	8.61%	8.04%	7.52%	7.08%	
Swiss Franc	2.85%	4.31%	6.68%	3.78%	5.97%	5.67%	5.26%	4.85%	4.55%	
U.K. Pound	5.54%	6.91%	10.37%	9.53%	8.99%	8.38%	7.85%	7.41%	7.16%	
U.S. Dollar > 8.5 years	5.04%	6.36%	8.62%	7.93%	7.59%	7.35%	7.06%	6.85%	6.63%	
Euro (ECU for ten-year avg)	4.17%	5.80%	8.56%	7.99%	7.82%	7.13%	6.79%	6.40%	6.07%	
Memorandum:										
SDR 3/	4.37%	5.64%	8.22%	7.51%	7.21%	6.85%	6.49%	6.17%	5.90%	

1/ Estimates based on actual CIRRs for 1/95 to 12/04.

2/ For the current 10-year averages, rates for Euro are used from 1/99.

3/ The 10-year SDR denominated CIRR rate was constructed based on the weighted average of the five 10-year CIRR averages for the underlying currencies.

Previous six-month rates

	loans with maturity <15 years, contracted between:																												
	2/15/99 and 8/15/99 and 2/15/00 and 8/15/00 and 2/15/01 and 8/15/01 and 2/15/02 and 8/15/02 and 2/15/03 and 8/15/03 and 2/15/04 and 8/15/04 and 2/15/05 and 8/14/05		8/14/99		2/14/00		8/14/00		2/14/01		8/14/01		2/14/02		8/14/02		2/14/03		8/14/03		2/14/04		8/14/04		2/14/05		8/14/05		
	based on rates:	2/15 thru 8/14/98	8/15/98- 2/15 thru 8/14/99	8/15/99- 2/15 thru 2/14/00	2/15 thru 8/14/00	8/15/00- 2/15 thru 2/14/01	2/15 thru 8/14/01	8/15/01- 2/15 thru 2/14/02	2/15 thru 8/14/02	8/15/02- 2/15 thru 2/14/03	2/15 thru 8/14/03	8/15/03- 2/15 thru 2/14/04	2/15 thru 8/14/04	8/15/04- 08/15/04- 2/14/05	2/15 thru 8/14/05	8/15/05- 2/14/06	2/15 thru 8/14/06	8/15/06- 2/14/07	2/15 thru 8/14/07	8/15/07- 2/14/08	2/15 thru 8/14/08	8/15/08- 2/14/09	2/15 thru 8/14/09	8/15/09- 2/14/10	2/15 thru 8/14/10	8/15/10- 2/14/11	2/15 thru 8/14/11	8/15/11- 2/14/12	2/15 thru 8/14/12
Australian Dollar	6.42%	6.01%	6.34%	7.20%	7.47%	6.99%	6.27%	6.18%	6.83%	6.23%	5.83%	6.45%	6.6%	6.34%															
Austrian Schilling	5.59%	4.99%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.															
Belgian Franc	5.99%	5.24%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.															
Canadian Dollar > 8.5 years	6.27%	6.12%	6.20%	6.88%	7.26%	6.80%	6.24%	6.17%	6.21%	5.69%	5.50%	5.24%	5.0%	5.23%															
Danish Krone	5.77%	5.44%	4.72%	5.71%	6.46%	6.55%	6.01%	5.66%	6.15%	5.48%	4.85%	5.02%	5.0%	4.75%															
Finnish Markkaa	5.52%	5.04%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.															
French Franc	5.71%	5.03%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.															
German Mark	5.57%	4.86%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.															
Irish Punt	5.69%	4.93%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.															
Italian Lira	5.31%	5.22%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.															
Japanese Yen	2.32%	2.28%	2.13%	2.05%	1.98%	2.02%	1.58%	1.55%	1.95%	1.64%	1.45%	1.92%	2.0%	2.08%															
Korean Won	n.a.	n.a.	n.a.	10.51%	10.18%	8.85%	7.91%	7.42%	7.95%	7.00%	6.11%	5.94%	5.9%	4.80%															
Netherlands Guilder >8.5 years	6.12%	5.43%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.															
New Zealand dollar	8.17%	6.76%	6.64%	7.74%	8.08%	7.57%	7.16%	7.10%	7.51%	7.00%	6.45%	6.36%	6.9%	7.10%															
Norwegian Krone	6.11%	6.58%	5.97%	6.82%	7.51%	7.98%	7.96%	7.46%	7.75%	7.34%	5.97%	5.27%	4.7%	4.45%															
Spanish Peseta	5.68%	4.98%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.															
Swedish Krona	6.04%	5.38%	4.78%	6.19%	6.46%	6.03%	5.63%	5.89%	6.42%	5.85%	5.22%	5.31%	5.4%	5.15%															
Swiss Franc	4.07%	3.91%	3.81%	4.50%	5.24%	5.17%	4.17%	3.89%	4.05%	3.06%	2.88%	3.39%	3.4%	3.30%															
U.K. Pound	7.15%	6.53%	5.79%	6.97%	7.03%	6.59%	6.11%	5.96%	6.17%	5.60%	5.22%	5.69%	5.9%	5.82%															
U.S. Dollar > 8.5 years	6.63%	5.92%	6.37%	7.18%	7.54%	6.86%	6.09%	5.67%	5.86%	4.75%	4.38%	4.75%	4.9%	4.89%															
ECU/Euro	5.36%	4.72%	4.72%	5.82%	6.27%	6.15%	5.73%	5.53%	5.91%	5.27%	4.73%	4.85%	4.8%	4.61%															
SDR	5.59%	5.01%	5.02%	5.80%	6.07%	5.88%	5.31%	5.04%	5.32%	4.53%	4.13%	4.46%	5.64%	4.49%															

Sources: OECD and Fund staff calculations.

Table 6. Peru: Stock of Domestic Debt of the NFPS (as of September 30, 2005)

	Legal Norm	Gross placements		Stock (estimated)
		Currency	Amount	(Millions of Nuevos Soles)
Credits from BN				3 010
Credit to central government		US\$ / S/. / Y		2 876
Credit to local governments		US\$ / S/.		135
Net public treasury overdraft		S/.		0
Bonds				10 461
Capitalización BCRP	D.S.066-94-EF	S/.	614	0
Serie A			239	0
Serie B			375	0
Bonos TP - Financial system strengthening	D.U. 041-99	US\$	175	234
Bonos TP - Temporal suscription of stocks	D.U. 034-99	US\$	52	174
Bonos TP - Temporal portfolio exchange	D.S. 114-98-EF	US\$	136	0
Bonos TP - Debt exchange bonds	D.S. 068-99-EF	US\$	259	459
Bonos TP - RFA and FOPE programs	D.S. 059-2000-EF / D.U. 050-2002	US\$	108	370
Bonos TP - Financial system consolidation	D.U. 108-2000 / D.U. 099-2001	US\$	392	27
Bonos TP - Sovereign bonds ^{1/}	D.S.007-2002-EF / D.S.041-2003-EF / D.S.079-2003-EF	S/.	6 720	
	D.S.162-2003-EF / D.S.015-2004-EF			9 085
Bonos TP - Caja de Pensiones Militar Policial Bonds	D.U. 030-2001	US\$	34	113
Total				13 472
Memorandum item:				
Pension Reform Bonds (Bonos de Reconocimiento)	D.S. 096-95-EF	S/.		9 105
Floating debt		S/.		1 534

1/ Include public debt swap operations to exchange Bonos de Consolidación del Sistema Financiero for Sovereign Bonds (S/. 851 millions in May and S/. 393 millions in September), and issued in July and August, to prepay the Paris Club debt (S/. 2 619 millions).

Source: Central Reserve Bank of Peru.