

## International Monetary Fund

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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, Peru  
December 5, 2007

Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
Washington, DC 20431

Dear Mr. Strauss-Kahn,

1. This letter reiterates our commitment to the economic reform agenda supported by the Stand-By Arrangement (SBA), approved by the Fund's Executive Board on January 26, 2007, and informs you of performance under the program in 2007 and our policy intentions for 2008. It supplements our letters of January 3, 2007, and of June 12, 2007.
2. Peru's economic performance has been strong during the first year of the Fund-supported program and we expect this to continue during 2008. All performance criteria for end-June and end-September 2007 were observed with a comfortable margin. New performance criteria and structural benchmarks for 2008 are set out in Tables 1 and 2.
3. The Government believes that the policies set forth in this letter are adequate to achieve the objectives of its program, but stands ready to take any further measures that may become appropriate or needed for this purpose. We will maintain a close and proactive policy dialogue with the Fund, in accordance with Fund policies on such matters.

#### **A. Fiscal Issues**

4. Following an overall public sector surplus of 2¼ percent of GDP expected for 2007, the program for 2008 maintains a prudent fiscal strategy. The 2008 budget envisages a balanced fiscal position, significantly below the deficit limit of 1 percent of GDP under the Fiscal Responsibility and Transparency Law (FRTL). Central government current expenditure growth (net of transfers excluding pensions) would be limited to 4 percent in real terms, while public investment not executed during 2007 would be carried forward into 2008 in order to continue addressing social and infrastructure needs. Were revenues net of mandatory transfers—as defined in the Technical Memorandum—to exceed the level envisaged under the program, the public sector borrowing requirement would be reduced up to a ceiling of 0.5 percent of GDP to assist macroeconomic stability. The public debt ratio is projected to decline from 47 percent of GDP in 2003 to an estimated 26 percent of GDP at end-2008.
5. To enhance budget execution, the government has simplified the *National System of Public Investment* (SNIP) procedures and is aiming at streamlining procurement processes. Subnational governments (SNGs) can now use part of their canon-related resources and

revenues for maintenance and pre-evaluation of investment projects. To further enhance the capacity of SNGs to implement timely and high-quality investment projects, the government intends to strengthen existing regional Technical Assistance Offices supporting the SNIP by allocating additional staff and providing more training for evaluation of investment projects. The government will also increase the number of Technical Assistance offices from 16 to 28 by end-December 2008 (structural benchmark).

6. To strengthen the fiscal framework and minimize long-term risks, the government intends to:

- Submit to Congress a draft amendment to the Decentralization Law (DL) to ensure that limits to subnational government spending are consistent with those for the central government as prescribed in the FRTL (an end-September 2008 structural benchmark). The government will continue with its efforts to amend the FRTL to strengthen compliance and its consistency, including for better aligning the limit on real growth of consumption expenditure for all government levels with the economy's medium-term growth capacity.
- Finalize and submit a draft law to Congress to establish a comprehensive framework for PPPs by end-December (end-September 2007 structural benchmark that will be proposed to be set as a structural performance criterion for end-March 2008 otherwise).

7. Progress with modernizing the budget classification system has not been timely enough to incorporate it into the 2008 Budget and into the charts of accounts (end-December 2007 benchmark). However, the new classification will be rolled out at the start of the 2009 budget cycle at all government levels (end-September 2008 structural benchmark). Delays in the external evaluation of the Integrated Financial Management System (SIAF) have complicated the full implementation of a Treasury Single Account (TSA) for the central government by end-2007 (structural benchmark). To implement this reform, the Ministry of Finance intends to take the following steps by end-September 2008: i) submit to Congress a new draft Treasury Law to include all general government resources in the TSA; ii) adopt the new budget classification, as noted above; and iii) establish a Treasury General Ledger (TGL) or modify the SIAF to ensure it provides TGL-type information.

8. Broadening the tax base is essential to meeting social and infrastructure needs. To this end, the government will issue methodological guidelines that should be used by ministries and other public entities for evaluating existing tax exemptions by end-June (structural benchmark), as contemplated in the new framework for tax exemptions enacted in December 2006 (Legislative Decree No. 977).

## B. Poverty Alleviation

9. In 2007, the government rationalized social assistance programs (SAPs) and integrated several of them into the strategy *Crececer*, to address chronic child malnutrition. A new permanent head and staff were assigned to the Interministerial Committee for Social Affairs (CIAS) in July (end-September 2007 structural benchmark). In 2008, efforts will be bolstered further:

- The conditional cash-transfer program *Juntos* will be extended from 360,000 beneficiaries at end-2007 to at least 500,000 beneficiaries by end-2008. The strategy *Crececer*, which currently attends 638 rural districts in extreme poverty, will be expanded into a second phase to reach 880 districts. To provide complementary basic infrastructure, a new social strategy *Progresar* will be launched soon. The recently completed Household Targeting Database (SISFOH) will assist in improving the quality of social expenditures and enhancing targeting of social programs.
- A prompt approval by Congress of the Executive Power Organic Law (LOPE) will strengthen budgetary resources for the CIAS.
- To further assist the poorest SNGs—especially those without access to canon resources—the *Fondo para la Inversion Regional y Local* (FONIPREL) will be expanded once its initial allocation of S/. 650 million is used. The government will also submit to Congress amendments to the SNIP Law, to allow for the outsourcing of the studies required for the formulation and approval of investment projects; which will help assist those SNGs with low capacity (end-March 2008 structural benchmark).
- In addition, the government intends to ensure that the canon-related cash transfers to households remain limited and well-targeted.

## C. Monetary and Financial Sector Issues

10. The authorities remain fully committed to their inflation targeting framework. The bands of the inflation consultation mechanism have been adjusted to reflect our new inflation target of 2 percent introduced in early 2007, while minimizing deflationary risks (Table 1). To further strengthen central bank independence, the Economics Commission in Congress has approved a draft constitutional amendment for de-linking future appointments of board members from the political cycle after 2011. We will continue with our efforts to ensure a prompt ratification by Congress in the year ahead.

11. The government will also continue implementing reforms aimed at enhancing the resilience of the financial sector, by sustaining dedollarization, strengthening the regulation and supervision of banks, and advancing reforms to deepen capital markets. Specifically:

- The government will submit to Congress amendments to the General Banking Law (GBL) to allow the Superintendency of Banks (SBS) the introduction of capital requirements for foreign-currency-induced credit risks via regulations (end-June structural benchmark, reset from end-December 2007), in line with our roadmap to fully adopt Basel II. In addition, financial institutions requested to *MiVivienda* an extension of the deadline to discontinue the provision credit risk guarantees and the *Bono al Buen Pagador* for new foreign currency mortgages (end-June 2007 structural benchmark) and *MiVivienda* has agreed that this will be implemented by end-December 2007.
- Public banks should remain properly supervised and not undermine competition in the financial system. To that effect, *Banco de la Nación* (BN) will again comply with the 25 percent growth limit on its consumer lending during 2008. The government will ensure that the interest rates associated with BN's handling of the TSA are transparent and aligned to reflect BN's administrative costs for management services of public sector accounts. Also, we have submitted to Congress a draft law to align the regulatory and supervisory framework for BN and COFIDE with that for private financial institutions. With this reform, the GBL will have precedence over BN's and COFIDE's statutes.
- Amendments to the GBL to increase the minimum capital required to establish microfinance institutions will also be submitted to Congress by end-June 2008 (structural benchmark). The central bank intends to submit to congress legal changes to empower the Central Bank to oversee and regulate the entire payments system.
- The clarification of the tax treatment of securitized transactions (an end-December 2007 benchmark, reset from end-March 2007) will now be completed by end-June, 2008 (structural benchmark), through: (i) eliminating the application of VAT to the collection of receivables used by Trusts and SPVs when originators are exempt; (ii) allowing the possibility of offsetting the effect of income taxes withheld at the Trust or SPV level in the case of future capital losses from equities or in the case of losses posted by the ultimate beneficiary on a consolidated basis. Regulation related to the tax treatment of financial derivatives will be issued by end-December 2007 (Legislative Decree No. 970).
- The government will submit to Congress an amendment to the Law of Pension Funds to significantly increase the 20 percent limit of private pension funds (AFPs) investment abroad by end-June 2008 (structural benchmark), redefine investment limits on public sector assets, broaden the set of investible domestic securities for AFPs, and ease limits on the use of forwards as hedges. The minimum return guarantee will be reformed in order to minimize herding behavior.

- The supervision of capital markets will be enhanced by strengthening the coordination between CONASEV and the SBS, including by signing a Memorandum of Understanding by end-March 2008.
- Debt management operations will be conducted to improve its profile, including by resolving the issue of some disputed claims following the prepayment of part of our nonconcessional obligations with the Paris Club in October 2007.

#### **D. Other Growth-Enhancing Reforms**

12. With regard to the business environment, a one-stop window for external trade transactions is now operational and the implementing rules of the rules of the “Positive Administrative Silence” law will be issued in the coming months. New commercial courts have been established in Lambayeque, Junin, and Tacna during 2007, and more courts are on the way to be implemented in 2008.

13. In light of the strong performance under the program and the important progress being made in the structural reform agenda, we hereby request the completion of the Second Review under the Stand-By Arrangement.

Sincerely yours,

/s/

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Luis Carranza

Minister of Economy and Finance

/s/

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Julio Velarde

President Central Reserve Bank of Peru

Table 1. Peru: Quantitative Performance Criteria and Inflation Consultation Mechanism for 2008

|  | Mar. 31 | Jun. 30 | Sept. 30 | Dec. 31 |
|--|---------|---------|----------|---------|
| (Cumulative amounts from December 31, 2007, millions of New Soles)   |         |         |          |         |
| <b>Borrowing requirement of the combined public sector</b>   |         |         |          |         |
| Unadjusted limits 1/ 2/ 3/ 4/  | -2,036  | -5,555  | -5,254   | 0       |
| (Cumulative amounts from December 31, 2007, millions of U.S. dollars)  |         |         |          |         |
| <b>Net international reserves of the Central Reserve Bank, excluding foreign-currency deposits of financial institutions</b> |         |         |          |         |
| Unadjusted targets 5/ 6/   | -645    | -404    | -437     | 0       |
| <b>Outstanding short-term external debt of the nonfinancial public sector</b>  |         |         |          |         |
| Limits   | 50      | 50      | 50       | 50      |
| <b>Contracting or guaranteeing of nonconcessional public debt with maturity of at least one year</b>                         |         |         |          |         |
| Unadjusted limits 7/ 8/ 9/   | 1,568   | 1,673   | 2,354    | 2,680   |
| <b>Of which: external debt of 1-5 year maturity</b>  |         |         |          |         |
| Limits   | 100     | 100     | 100      | 100     |
| <b>External payments arrears of the public sector (on a continuous basis)</b>  |         |         |          |         |
| Limits   | 0       | 0       | 0        | 0       |
| <b>NPV of future government payments associated with PPP operations (on a continuous basis)</b>                              |         |         |          |         |
| Unadjusted Limits 10/  | 1,860   | 1,860   | 1,860    | 1,860   |
| (Consultation bands for the 12-month rate of inflation, in percent) 11/  |         |         |          |         |
| <b>Outer band (upper limit)</b>  | 5.0     | 5.0     | 5.0      | 5.0     |
| Inner band (upper limit)   | 4.0     | 4.0     | 4.0      | 4.0     |
| Central point  | 2.0     | 2.0     | 2.0      | 2.0     |
| Inner band (lower limit)   | 0.0     | 0.0     | 0.0      | 0.0     |
| <b>Outer band (lower limit)</b>  | -0.5    | -0.5    | -0.5     | -0.5    |

Sources: Staff estimations.

1/ PIPP proceeds are included below the line.

2/ The limit on the borrowing requirement of the combined public sector will be adjusted downwards by the amount central government revenues net of mandatory transfers exceed program estimates of S/. 12,767 million at end-March, up to a ceiling of S/. 450 million; S/. 26,493 million at end-June, up to a ceiling of S/. 900 million; S/. 40,471 million at end-September, up to a ceiling of S/. 1350 million; and S/. 54,751 million at end-December, up to a total ceiling of S/. 1,800 million.

3/ The limit on the borrowing requirement of the combined public sector will be adjusted for the operating balance of the BCRP.

4/ The limit on the borrowing requirement of the combined public sector will be adjusted upward by up to US\$100 million for capital spending by Petroperu, over the \$30 million already included in the program.

5/ 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\$600 million at end-March, -US\$394 million at end-June, -US\$497 million at end-September, and -US\$41 million at end-December 2008. It will be adjusted downward for shortfalls from programmed net foreign borrowing. The amounts in excess will be deposited at the BCRP.

6/ 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 2008.

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

8/ The current debt limits do not include contracting of non-guaranteed debt by Petroperu and will be adjusted upward by up to US\$300 million for debt contracted by Petroperu during 2008.

9/ The limit on contracting and guaranteeing of nonconcessional public debt will be adjusted upwards for guarantees contracted or extended by the government in relation to concessions, up to a ceiling of US\$293 million for the year as a whole.

10/ Discount rates to calculate the NPV of the future stream of payments will be the currency-specific commercial interest reference rates (CIRRs) published by the OECD and specified in the TMU.

11/ 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 also complete a consultation with the Executive Board of the Fund on the proposed policy response before requesting further purchases under the arrangement.

Table 2: Structural Benchmarks for 2008

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***End-March***

Submit to Congress an amendment to the SNIP law to allow for the outsourcing of the studies required for the formulation and approval of investment projects

***End-June***

Clarify the tax treatment of securitization transactions in line with parag. 11, bullet 4 of the Letter of Intent

Issue methodological guidelines for ministries and public entities to assess tax exemptions in line with new regime for tax exemptions

Submit to Congress amendment to the General Banking Law to allow the SBS the introduction of capital requirements for exchange-rate related risk in line with Basel II

Submit to Congress amendment to General Banking Law to raise the minimum capital requirement for microfinance institutions

Submit to Congress amendment to the Law of Pension Funds that would significantly raise limit for foreign investments by private pension funds

***End-September***

2009 Budget to be prepared according to modernized budget classification system and incorporated into the chart of accounts

Implement the TSA, as described in paragraph 7 of the Letter of Intent

Submit to Congress amendments to the Decentralization Law to reconcile subnational government spending with that for the central government as presented in the FRTL

***End-December***

Expand the number of Technical Assistance Regional Offices from 16 to 28

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## PERU: 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 2008. It defines the concepts used to assess compliance with quantitative performance criteria specified in the letter of the Government of Peru dated December 5, 2007. It also sets the frequency of the data to be provided to the Fund for monitoring the program. For purposes of the program for 2008, operations in foreign currency will be converted into *Nuevos Soles* at the average program exchange rate of S/. 2.90 per U.S. dollar.

### I. DEFINITIONS OF CONCEPTS

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

**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 2008. 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**<sup>1</sup> on the NFPS, excluding Peruvian Brady bonds and other government bonds initially sold abroad; (ii) the net increase in the amount of public sector bonds<sup>2</sup> held outside the domestic financial system and the NFPS, excluding Peruvian Brady bonds and other bonds initially sold abroad; and (iii) the increase in the floating debt of the NFPS due to expenditure operations and tax refund arrears; *less* (iv) the accumulation of stocks, bonds, or other domestic financial assets by the NFPS and (v) the amortization of pension related bonds. In the case of enterprises that are divested after December 31, 2007, 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 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;

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<sup>1</sup> 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*.

<sup>2</sup> Excluding the new issuances of pension-related bonds.

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.

**The quarterly limits on the borrowing requirement of the combined public sector (PSBR) for 2008 will be reduced** by the amount to which revenues of the central government net of mandatory transfers exceed program estimates of S/.12,767 million at end-March, up to a ceiling of S/. 450 million; S/. 26,493 million at end-June, up to a ceiling of S/. 900 million; S/.40,471 million at end-September, up to a ceiling of S/. 1,350 million; and S/. 54,751 million at end-December, up to a total ceiling of S/. 1,800 million. Mandatory transfers are earmarked central government expenditures that are linked to revenue. These comprise the *canon and sobrecanon, fondo de Camisea, regalía minera, renta de aduanas*, and the *Impuesto de Promoción Municipal (IPM)*.

**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 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 above and 2.5 percentage points below the central point of 2 percent, the authorities will discuss with Fund staff an 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 program.

**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), including *Multired Maestro*, *Multired Policia* and *Multired Pensionistas ONP*, 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.

**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.

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

**BCRP’s gold holdings** will be accounted at US\$646.89 per troy ounce (the average book value as of June 30, 2007), SDRs at US\$1.514 per SDR. Foreign currency assets and liabilities of the BCRP in other currencies than US\$ will be valued at the exchange rate of June 30, 2007. 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-June 2007 level of net international reserves is shown in Table 3.

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-June 2007 stock of short-term external debt of the NFPS is shown in Table 4.

**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 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 loans on concessional terms; and (iii) certificates (BCRPCD) issued by the BCRP for conducting monetary policy. The program limits will be adjusted upward by up to US\$300 million for debt contracted by *Petroperu* during 2008 that is not guaranteed by the central government.

**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; (iv) PAO Entitlement Recognition Certificates (CRPAOs) used to facilitate the financing of Public-Private Partnership (PPP) projects by concessionaires.<sup>3</sup> 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.

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<sup>3</sup> Under Peruvian law, the CRPAOs are not treated as sovereign debt.

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-December 2008, the CIRRs published by the OECD in August 2007 will be used (Table 5).

**The concessionalality 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 concessionalality 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.

**The NPV of the future government payments associated with PPP operations** will include all payments, firm and contingent, committed by the government in relation to new PPP projects signed during the program period. Specifically, such payments will include, *inter alia*, annual payments for the coverage of the investment made by the concessionaire (*Pagos Anuales por Obra*, or PAOs); annual payments for the maintenance and operation of the project (*Pagos Anuales por Mantenimiento y Operación* or PAMOs); and the minimum annual revenues guaranteed to a concessionaire by the government (*Ingresos Minimos Anuales Garantizados*, or IMAGs). For those projects where the government's payment commitments have yet to be defined in terms of PAOs and PAMOs, the target also includes the estimated aggregate annual payments for the project (*Pagos Anuales por Servicio*, or PAS). The discount factor used in the calculation of the NPV of the payments will be the 10-year commercial interest reference rate (CIRR). For purposes of the program through end-December 2008, the CIRRs published by the OECD in August 2007 will be used (Table 5).

**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-2007 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.

**Definitions used in Table 1 of the letter of intent dated December 5, 2007 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 6 of Table 1 attached to the letter of intent dated [December x, 2007] 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

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) Disaggregation of the net domestic assets of the BCRP and BN with details of the other net accounts.
    - (b) Evolution of gross disbursements and cash amortizations of consumer loans under the "*Multired Program*" of *Banco de la Nación*.
  - (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) 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).
- (d) **Quarterly data on the breakdown of public sector debt**, distinguishing between external and domestic total public sector debt by currency composition and instruments, according to the debt definition of the *Marco Macroeconomico Multianual* (MMM), and including CRPAOs.
- (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 2007**  
(In millions of nuevos soles)

|  | Stock as of<br>Dec. 31<br>2006 1/ | Stock as of<br>Jun.30<br>2007 1/ | Flow<br>Jan-Jun          |
|--|-----------------------------------|----------------------------------|--------------------------|
| <b>a. Net domestic financing of the nonfinancial public sector</b>                                   | <b>1 050</b>                      | <b>-8 022</b>                    | <b>-9 072</b>            |
| i. Net claims of the financial system (1+2+3)  | -10 015                           | -17 651                          | -7 636                   |
| 1. Net credit of the banking system on the NFPS, COFIDE and MiVivienda                               | -20 431                           | -29 904                          | -9 473                   |
| Credits  | 4 981                             | 4 885                            | - 95                     |
| Liabilities  | 25 412                            | 34 789                           | 9 377                    |
| 2. Net credit of COFIDE and MiVivienda on the banking system   | 2 843                             | 3 396                            | 553                      |
| Credits  | 2 987                             | 3 507                            | 519                      |
| Liabilities  | 145                               | 111                              | - 34                     |
| 3. Net credit of nonbanking financial institutions on the NFPS                                       | 7 574                             | 8 858                            | 1 284                    |
| Credits  | 8 159                             | 9 453                            | 1 294                    |
| Liabilities  | 585                               | 595                              | 10                       |
| ii. Stock of NFPS bonds in circulation<br>(excluding bonds held by NFPS and of the financial system) | 10 766                            | 10 934                           | 168                      |
| 1. Total   | 21 842                            | 25 449                           | 3 606                    |
| 2. Less: holdings of the financial system (including COFIDE and MiVivienda)                          | 10 726                            | 14 131                           | 3 405                    |
| 3. Less: holdings of nonfinancial public sector entities   | 350                               | 384                              | 34                       |
| iii. Floating debt   | 3 695                             | 2 318                            | -1 377                   |
| iv. Less: Accumulation of stocks, bonds, or other domestic financial<br>assets by the NFPS           | 2 316                             | 2 490                            | 174                      |
| v. Less: Issuance of pension recognition bonds in program period                                     | 1 080                             | 1 133                            | 53                       |
| <b>b. Net external financing</b><br>(Millions of US dollars)   |                                   |                                  | <b>-1 924</b><br>-\$ 664 |
| <b>c. Privatization</b><br>(Millions of US dollars)  |                                   |                                  | <b>73</b><br>\$ 25       |
| <b>d. Operating balance of the BCRP</b>  |                                   |                                  | <b>328</b>               |
| <b>PSBR (a+b+c-d)</b>  |                                   |                                  | <b>-11 252</b>           |

1/ Foreign currency valued at US\$ 1 = S/. 2,90



**Table 2. Peru: Public External Debt 1/  
Net External Financing N.F.P.S. 2008**  
(In millions of dollars)

|  | Jan - Mar   | Jan - Jun   | Jan - Sep   | Jan - Dec  |
|--|-------------|-------------|-------------|------------|
|  |             |             |             |            |
|  | Programmed  | Programmed  | Programmed  | Programmed |
| i. Loan Disbursements                            | 145         | 291         | 436         | 1140       |
| -Projects  | 145         | 291         | 436         | 600        |
| -Non Projects                                    | 0           | 0           | 0           | 540        |
| ii. Bonds  | 0           | 290         | 290         | 290        |
| iii. Cash payments on amortization               | 745         | 975         | 1224        | 1470       |
| - Loans  | 223         | 453         | 679         | 926        |
| - Bonds  | 522         | 522         | 544         | 544        |
| - Prepayments                                    |             |             |             |            |
| iv. Cash payments to settle arrears              | 0           | 0           | 0           | 0          |
| v. Change in short term debt (increase+)         | 0           | 0           | 0           | 0          |
| <b>A. NET FOREIGN BORROWING (i+ii-iii-iv+v)</b>  | <b>-600</b> | <b>-394</b> | <b>-497</b> | <b>-41</b> |
| vi. Debt equity swaps                            | 0           | 0           | 0           | 0          |
| vii. Change in foreign assets held by the NFPS   | 7           | 10          | 17          | 20         |
| viii. Investment project under the PIPP 2/       | 0           | 2           |             |            |
| <b>B. NET EXTERNAL FINANCING (A-vi-vii+viii)</b> | <b>-607</b> | <b>-402</b> | <b>-514</b> | <b>-61</b> |

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 US dollars)**

|  | Stocks as of<br>June 30, 2007 |
|--|-------------------------------|
| <b>a. <u>Assets</u></b>  | <b><u>21,186</u></b>          |
| Deposits abroad  | 8,060                         |
| Securities   | 12,378                        |
| Gold 1/  | 721                           |
| Holdings of SDR 2/   | 12                            |
| Reciprocal credit agreement  | 6                             |
| Cash   | 10                            |
| Others   | 0                             |
| <b>b. <u>Liabilities</u></b>   | <b><u>27</u></b>              |
| Reciprocal credit agreement  | 0                             |
| Liabilities with international organizations   | <b>26</b>                     |
| IMF 2/   | 0                             |
| IADB   | 26                            |
| FLAR   | 0                             |
| <b>c. <u>Foreign currency deposits of financial institutions at the Central Bank</u></b> | <b><u>3,547</u></b>           |
| Banking enterprises  | 3,395                         |
| Banco de la Nación   | 58                            |
| COFIDE   | 24                            |
| Financial enterprises  | 70                            |
| <b>d. <u>Treasury bond repos</u></b>   | <b><u>0</u></b>               |
| <b>e. <u>Swaps</u></b>   | <b><u>0</u></b>               |
| <b>f. <u>Valuation US\$/other currencies</u></b>   | <b><u>0</u></b>               |
| <b>g. <u>Net international Reserves - Program definition (a-b-c+d-e-f)</u></b>           | <b><u>17,612</u></b>          |
| <b><u>Memorandum items:</u></b>  |                               |
| 1. Subscription to the IMF and FLAR  | 348                           |
| 2. Pesos andinos   | 20                            |
| 3. CAF bonds   | 0                             |
| 4. Valuation change by BCRP's gold holdings  | 0                             |
| 5. Valuation change by BCRP's SDR holdings   | 0                             |
| 6. Net international reserves, official definition (g+c-d+e+f+1+2+3+4+5)                 | 21,528                        |

Source: Central Reserve Bank of Peru.

1/ Gold valued at US\$ 646,88755

2/ Valued at US\$ 1,51434 per SDR.

**TABLE 4: PERU SHORT TERM EXTERNAL DEBT OWED BY THE  
NON FINANCIAL PUBLIC SECTOR AS OF JUNE 30, 2007**

(In millions of US\$)

|   | Export<br>Financing | Working<br>Capital | Import<br>Financing | Total     |
|---|---------------------|--------------------|---------------------|-----------|
| <u>Total</u>  | <u>0</u>            | <u>0</u>           | <u>99</u>           | <u>99</u> |
| Petroperu   | 0                   | 0                  | 99                  | 99        |
| Electroperu   | 0                   | 0                  | 0                   | 0         |
| General government  | 0                   | 0                  | 0                   | 0         |
| Memorandum item:  |                     |                    |                     |           |
| <u>Total of export financing plus working capital loans</u> |                     |                    |                     | <u>0</u>  |

Source: Central Reserve Bank of Peru and state companies.



Table 6. Peru: Stock of Domestic Debt of the NFPS ( June-30-2007)

|  | Legal Norm                       | Gross placements |        | Stock (estimated)<br>(Millions of Nuevos Soles) |
|--|----------------------------------|------------------|--------|---|
|  |                                  | Currency         | Amount |   |
| <b>Banking Credits</b>                         |                                  |                  |        | <b>116</b>                                      |
| <b>Credits from BN</b>                         |                                  |                  |        | <b>13</b>                                       |
| Credit to central government                   |                                  | US\$ / S/. / Y   |        | 0   |
| Credit to local governments                    |                                  | US\$ / S/.       |        | 13  |
| Net public treasury overdraft                  |                                  | S/.              |        | 0   |
| <b>Other Banks</b>                             |                                  | S/.              |        | <b>102</b>                                      |
| <b>Bonds</b>                                   |                                  |                  |        | <b>16509</b>                                    |
| Bonos TP - Financial system strengthening      | D.U. 041-99                      | US\$             | 175    | 167   |
| Bonos TP - Temporal suscription of stocks      | D.U. 034-99                      | US\$             | 52     | 165   |
| Bonos TP - Debt exchange bonds                 | D.S. 002-2007-EF                 | S/.              | 2645   | 2645  |
| Bonos TP - RFA and FOPE programs               | D.S. 059-2000-EF / D.U. 050-2002 | US\$             | 109    | 381   |
| Bonos TP - Sovereign bonds 1/                  |                                  | S/.              | 13812  | 13042   |
| Bonos Municipalidad de Lima                    |                                  | S/.              | 250    | 109   |
| <b>Total</b>                                   |                                  |                  |        | <b>16624</b>                                    |
| Memorandum item:                               |                                  |                  |        |   |
| Pension Reform Bonds (Bonos de Reconocimiento) | D.S. 096-95-EF                   | S/.              |        | 8896  |
| Floating debt                                  |                                  | S/.              |        | 1565  |

1/ Include public debt operations to exchange Bonds Financial system consolidation for Sovereign Bonds (S/. 851 millions in May and S/. 393 millions in September of 2005), the Bonds to prepay external public debt with Paris Club (S/. 2 619 millions in July and August of 2005) and Japeco ( S/. 811 millions in November of 2005), the Bonds to prepay external public debt with Japeco ( S/. 278 millions in May of 2006), and the Bonds to prepay external public debt with Japeco ( S/. 280 millions in February of 2007).

Source: Central Reserve Bank of Peru