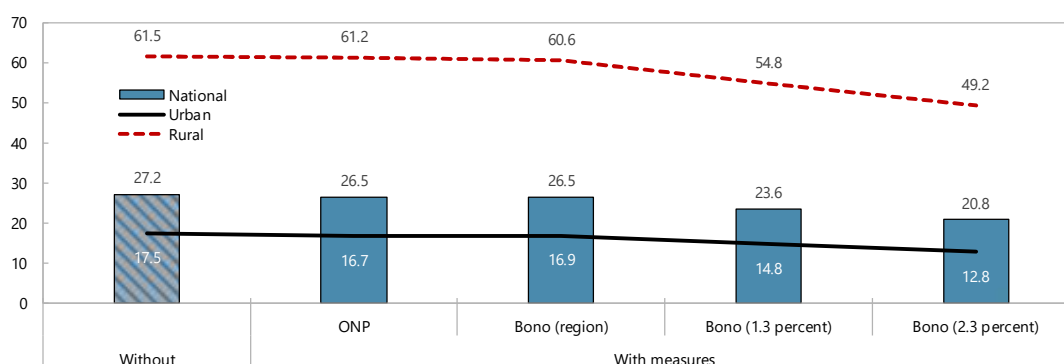


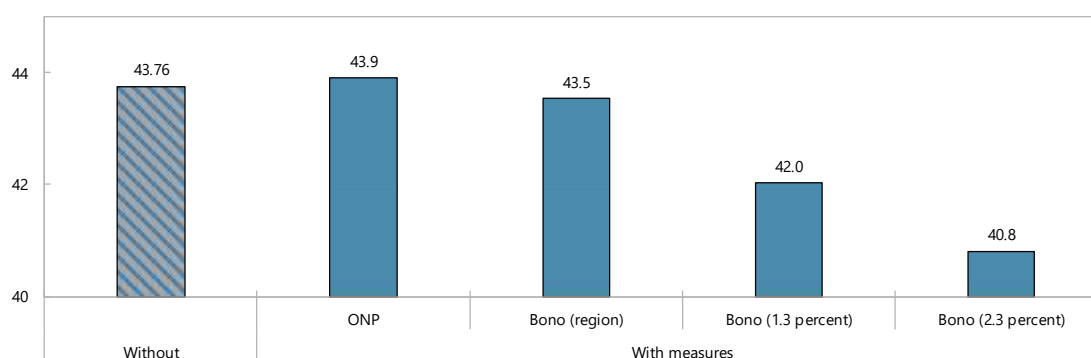
than 1 percentage point. This is because some of the regions targeted—such as Lima—have incomes substantially higher than excluded ones. Finally, the disbursement of *bonos* to those affiliated to the ONP system and the (now-denied) measure to allow early withdrawals from ONP would have only minimal poverty-reducing impacts, by about a percentage point or less.<sup>8</sup> The fiscal cost of such measure (at least 1.3 percent of GDP<sup>9</sup>) would have been similar to one of the universal *bonos* considered (“*Bono* (1.3 percent)”). However, the latter could reduce poverty by more than 3.6 percentage points in 2021. Figure 5 shows the coverage rates of the different programs by income quintiles.

**Figure 3. 2021 Poverty Rates including Four Scenarios of Mitigation Measures**  
(US\$5.5/day, in percent)



Source: Author's calculation based on ENAHO (2018).

**Figure 4. 2021 Gini Index including Four Scenarios of Mitigation Measures**  
(in percent)

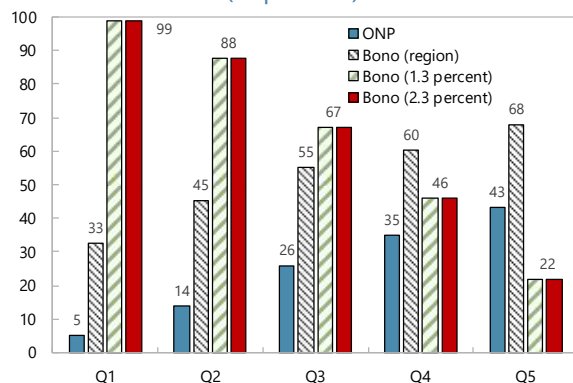


Source: Author's calculation based on ENAHO (2018).

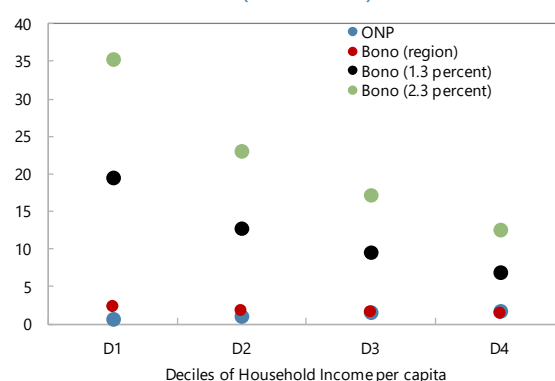
<sup>8</sup> As seen in Figure 5, ONP contributors and pensioners are mostly distributed in the upper quintiles. As such, poverty impacts from this measure would be minimal. On February 4, 2021 the Constitutional Court of Peru (*Tribunal Constitucional*) declared the Congress-proposed law of ONP withdrawals to be unconstitutional.

<sup>9</sup> According to the Fiscal Council (*Consejo Fiscal*), the fiscal cost of such measure would have been equivalent to 2.3 percent of GDP.

**Figure 5. Coverage of Mitigation Measures, by Quintiles**  
(In percent)



**Figure 6. Monthly Income Increase Compared to no Measures for the Bottom 40**  
(In Percent)



Source: Author's calculation based on ENAHO (2018).

**Table 1. Criteria and Amounts of the Simulated Mitigation Measures**

Program	Criteria	Amount
<b>Bono ONP<sup>1</sup></b>	<p>ONP will provide a one-time cash transfer equivalent to 1 <i>Remuneración Mínima Vital</i> (RMV) ~ S/.930 for all <b>ONP pensioners</b>.</p> <p><b>Pensioner Criteria:</b></p> <ul style="list-style-type: none"> <li>-To be a pensioner, a worker must have contributed to the public pension system for at least 20 years and be 65 years or older. Early retirement requires 30 years of contribution.</li> </ul> <p><b>Model Criteria:</b></p> <ul style="list-style-type: none"> <li>-Affiliated to the public pension system.</li> <li>-Receiving a pension from ONP.</li> <li>-50 years or older (in order to consider early retirement workers).</li> </ul>	S/.930 (~US\$260)
<b>Withdrawal ONP<sup>2</sup></b>	<p>One-time refund of up to 1 <i>unidad impositiva tributaria</i> (UIT) ~ S/.4300 for all <b>active and inactive contributors</b>.</p> <p><b>Contributors Criteria:</b></p> <ul style="list-style-type: none"> <li>-Workers (dependent or independent) who are not affiliated to the private pension system (AFP).</li> <li>-Contribute 13 percent of their monthly labor income to the public fund.</li> </ul>	Maximum of S/.4300 (~US\$1,200)

Table 1. Criteria and Amounts of the Simulated Mitigation Measures (concluded)

Program	Criteria	Amount
	<b>Model Criteria:</b> We can observe the minimum amount of money in a worker's fund using the time in current employment and last contribution to ONP. If the amount surpasses S/.4300, we assign a withdrawal of S/.4300. For affiliated people whose last contribution to ONP was prior to the start date of their current job or are unemployed, we simulate a scenario with a top withdrawal of S/.4300.	
<b>Bono Universal</b>	Simulation of a one-time cash transfer to households who: -Are recipients of the <i>Juntos</i> and <i>Pensión 65</i> . <sup>3</sup> -HH in poverty conditions in urban or rural areas. -HH with members who are no formal waged workers <sup>4</sup> in the public or private sectors, and who earn below S/.3000 each (837 USD). <sup>5</sup>	Amounts of S/.1530 and S/.2760 (US\$425 and US\$767) to match 1.3 percent and 2.3 percent of GDP.
<b>Bono of S/.600 for regions in Lockdown</b>	Same criteria as for <i>Bono Universal</i> .  Only for households in Ancash, Apurímac, Callao, Huancavelica, Huánuco, Ica, Junín and Lima.	S/.600 (US\$167 USD).
<p><sup>1</sup> Based on Law N° 31082 (<a href="https://busquedas.elperuano.pe/download/url/ley-que-establece-un-regimen-especial-facultativo-de-devoluc-ley-n-31083-1909102-4">https://busquedas.elperuano.pe/download/url/ley-que-establece-un-regimen-especial-facultativo-de-devoluc-ley-n-31083-1909102-4</a>). Total withdrawals from inactive workers who do not comply requirements to be pensioners (at least 20 years of contribution to the system) are not simulated.</p> <p><sup>2</sup> Ídem.<sup>3</sup> Even though the Government also includes HH with members of the <i>Contigo</i> program, it was not included in the simulation as question for this social program are not included in ENAHO.</p> <p><sup>4</sup> <i>Trabajadores en planilla</i>.</p> <p><sup>5</sup> <i>Bono Independiente</i> originally included HH with members who earned less than S/.1200, then <i>Bono Familiar Universal</i> included HH whose members earned less than S/.3000.</p>		

## Annex V. Withdrawals from Pension Funds

*To alleviate the hardship caused by COVID-19, three rounds of extraordinary withdrawals from private pension funds accounts have been approved along with a one-off payment from the public pension fund (ONP). While the private pension funds appear to have absorbed the immediate shock and the overall financial market reaction has been muted, adverse medium-term implications are expected. The withdrawals have likely helped support household consumption in an environment of arguably inadequate budget support.*

**1. About five million members of private pension funds made withdrawals of an estimated S/.24.3 billion in the first two rounds.**<sup>1</sup> Withdrawals of up to S/.2,000 by members who had not contributed for six consecutive months from private pension fund accounts were authorized under emergency decrees by the government in the context of the health emergency early in April.<sup>2</sup> Congress-led legislation later in May allowed access of up to 25 percent of the savings accounts, subject to a maximum of S/.12,900 (about US\$3,600). Overall, about 2.8 million people made withdrawals under the April measures amounting to about S/.5.2 billion (for an average withdrawal of S/.1,761). In turn, some 3.7 million people made withdrawals under the May authorization amounting to about S/.19.2 billion over the entire withdrawal window of April through July (for an average withdrawal of S/.5,147).

**2. A law authorizing a third round of withdrawals was approved by Congress in November.** The law allowed those who had not contributed to the system in the past twelve months and others with health conditions to withdraw up to S/.17,200 from their pension accounts. The expected withdrawal is S/.11.8 billion, which some 2 million potential beneficiaries. The first tranche of withdrawals started in December and will continue into 2021. About S/.7.8 billion has already been withdrawn. In early December, Congress passed a law authorizing exceptional payments by the public pension fund (ONP) of up to S/.4,300. The law also authorizes additional one-off payments to current retirees and allows those over 65 years of age that have not met the requisites for a pension to withdraw the full amount of their contribution. The law was struck down by the Constitutional Tribunal, which ruled against its constitutionality in February.

**3. So far, pension funds appear to have managed the shock well, helped by liquidity support from the Central Bank.** Four private pension fund companies (APFs) operate in Peru. In March, assets under management stood at about US\$46 billion. APFs were able to respond to the extraordinary demand for cash during the first round of withdrawals by using monthly contributions, repos provided by the central bank (about S/.4.9 billion), liquidating some positions abroad (about US\$410 million), using their deposits, and selling some domestic assets.

**4. The first two rounds of withdrawals did not cause major disruptions in financial markets either** (Figure). Financial markets went through turbulence before the first measure was

<sup>1</sup> Preliminary estimate based on the variation of the system's assets under management.

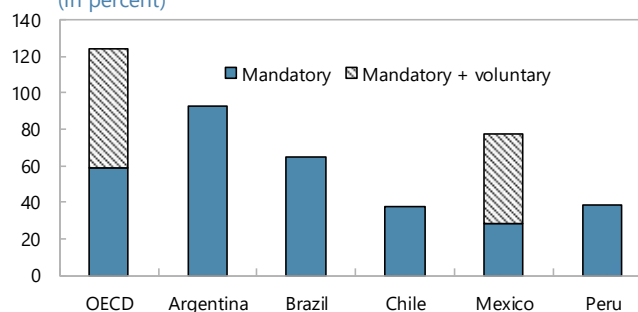
<sup>2</sup> The benefit was later extended to furloughed workers.

adopted, but that seems to be mainly related to the onset of the COVID-19 pandemic. Asset prices moved down in April (the exchange rate slightly depreciated, bond yields slightly increased, and stock prices declined), but the losses were quickly reversed in the following months. The financial system took in stride the following measures as well. Within the domestic financial sector, the outflow of savings from the private pension funds has boosted bank deposits and liquidity. Overall, the weakening of pension funds vis-a-vis banks is not desirable in terms of competition within the financial sector and long-term financing availability.

**5. While pension withdrawals may have helped support consumption, they have likely benefitted mostly the relatively well-off households.** Subsidies to households in response to the crisis were relatively small. Most families benefitted from two rounds of cash transfers of S/.760, with delays in implementation and the second round rolled out only in August. These compare with an average pension withdrawal of S/.3,683 in the first two rounds alone. The additional provision of cash may have provided some relief but its effect on consumption may have not been very strong. Pension withdrawals benefitted mostly workers in the formal sector, who have higher income and lower propensity to consume.<sup>3</sup> Anecdotal evidence points to some households using the liquidity to pay down existing debt or increasing their liquid assets. Most workers in the informal sector, who are a large majority (70 percent) with lower incomes and hit harder by the crisis, do not have pension savings to access.

**6. The weakening financial position of pension systems poses challenges for the viability of the private social insurance model and may create implicit liabilities for the state.** Pensions are already relatively low, with an average monthly pension of below S/.440, and only one percent of APF members receive above S/.775 compared with average wage of S/.2,283. This reflects both low coverage and low replacement rates (40 percent average). The ad-hoc withdrawal authorizations would further worsen the replacement rates, which had already been projected to decline to 12-34 percent in the next 30 years (Freudenberg and Toscani, 2019).

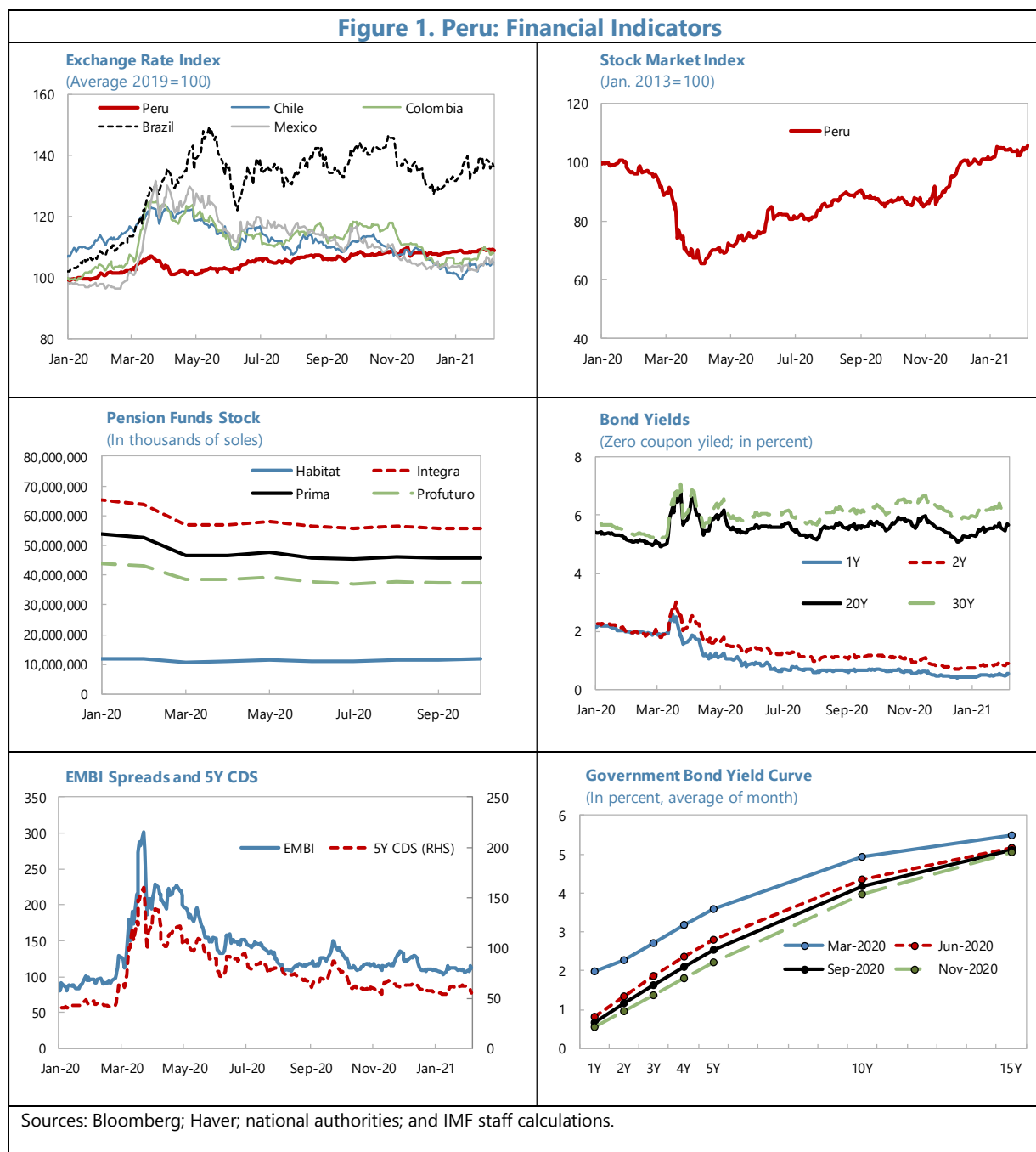
**Net Replacement Rate for Full-Career Average-Wage Worker**  
(In percent)



Sources: OECD, Pensions at Glance, 2019; Freudenberg and Toscani, 2019.

<sup>3</sup> See also Annex IV, which provides estimates on the impact of pension withdrawals on poverty and inequality.

Figure 1. Peru: Financial Indicators



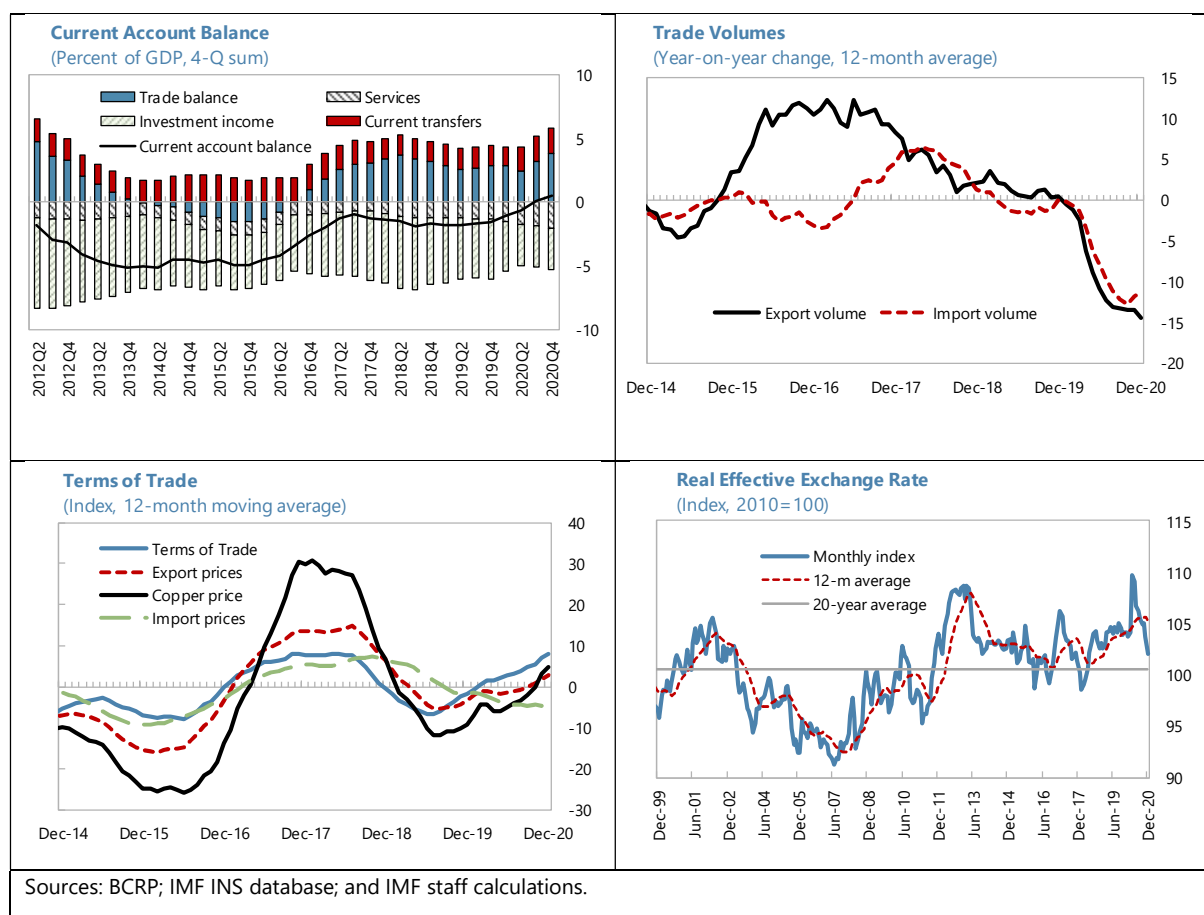
## Annex VI. External Sector Assessment

*Based on preliminary estimates, Peru's external position in 2020 is assessed as moderately stronger than implied by fundamentals and desirable policies, nevertheless, uncertainty around the estimates is very high. Reserve coverage remains adequate, including after accounting for dependence on commodity prices and significant domestic FX liabilities.*

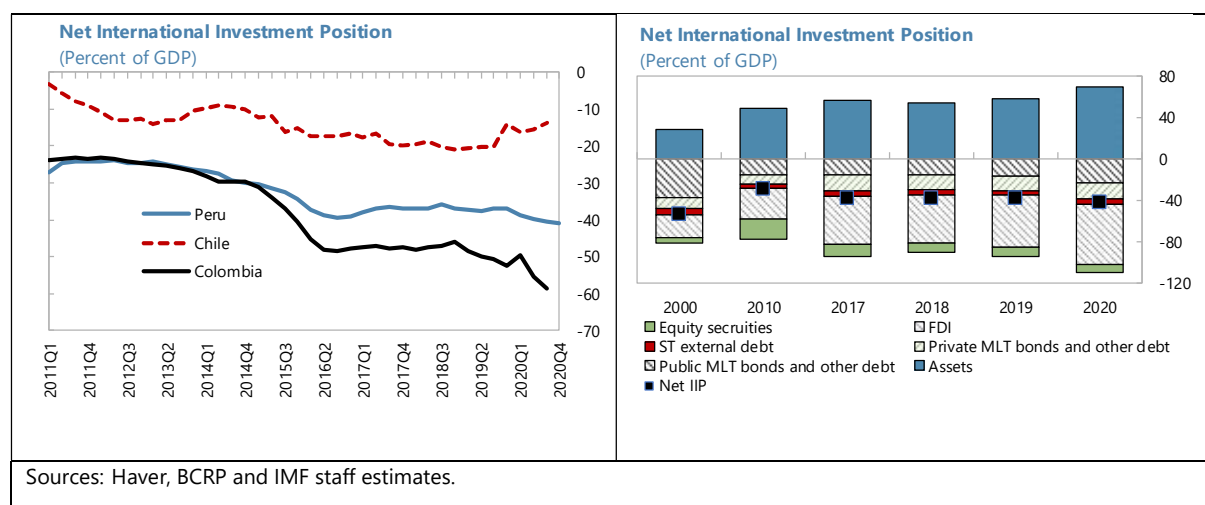
### Background

1. **The current account balance narrowed sharply in 2020 as the COVID-19 shock took effect.** The current account deficit was 1.5 percent of GDP in 2019 (as compared to 1.7 percent in 2018). Dramatic shift in the first nine months of 2020 included a collapse of trade volumes, commodity price volatility, and unprecedented low levels of profit repatriation, on balance leading to a near zero deficit. The contraction of exports owed to a combination of supply and demand factors, notably the restriction of most economic activities, including mining, especially in Q2, and the fall of most of Peru's export prices, including copper, partially compensated by favorable prices for gold. Tourism related services registered unprecedented low levels. The decline of imports was sharpest for intermediate goods in part due to lower fuel prices.
2. **Both commodity exports and imports recovered strongly in Q4 with the partial reopening of the economy and favorable terms of trade.** According to preliminary data the current account registered a surplus of 0.5 percent of GDP for the year of 2020, helped also by temporarily higher current transfers due to income tax proceeds from the sale of shares of Luz del Sur electric power distribution company to China Three Gorges Corporation. As recovery takes effect, imports are expected to rebound strongly in part driven by projected larger public spending in 2021-21 and gradual recovery of private demand. Exports are also expected to rebound, helped by favorable prices, albeit at a slower pace. Over the medium term, the current account deficit is expected to stabilize at about 1.8 percent of GDP.
3. **The REER has increased somewhat in 2019 and 2020.** The average REER in 2019 was 2.3 percent stronger than in 2018 and in 2020 it strengthened by another 1.6 percent y-o-y, mostly driven by nominal depreciation while relative prices stayed broadly stable. The 12-month average REER as of end- 2020 was about 5 percent higher than the 20-year average.
4. **The capital and financial account in 2020 was dominated by public sector borrowing as private sector flows diminished sharply.** The impact of the COVID-19 chock was felt most dramatically on FDI inflows, which declined by 67 percent in year-on-year. At the same time, external borrowing by the private sector including MLT loans, portfolio investment and ST borrowing stayed at broadly similar levels to last year. The foreign borrowing by the public sector was substantial and included large bond issuances of US\$3 billion in April and US\$4 billion in November.

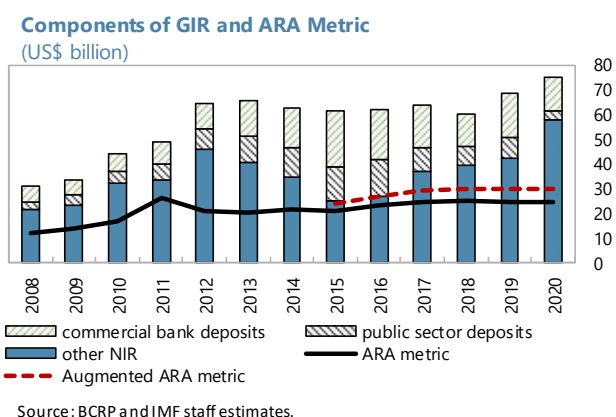
**5. Peru's IIP is characterized by large foreign reserves, moderate external debt and large FDI liabilities.** After improving from a minimum of -54 percent of GDP in the late 90s to -24 percent of GDP in 2011, Peru's IIP has been on a declining trend, driven by the accumulation of FDI liabilities. As of end-2019 Peru's external assets were (57.1 percent of GDP) including sizeable holdings of foreign assets by the central bank (29.6 percent of GDP). The assets are offset by large FDI liabilities (50 percent of GDP), moderate external indebtedness (public and private external debt of 35 percent of GDP) and other liabilities (9.5 percent of GDP). In 2020 the large increase in central bank assets was offset by large fiscal borrowing and other flows, leaving the IIP balance in dollar terms largely unchanged. These developments are expected to be short-lived and the IIP is projected to stay broadly stable in percent of GDP in the medium term.



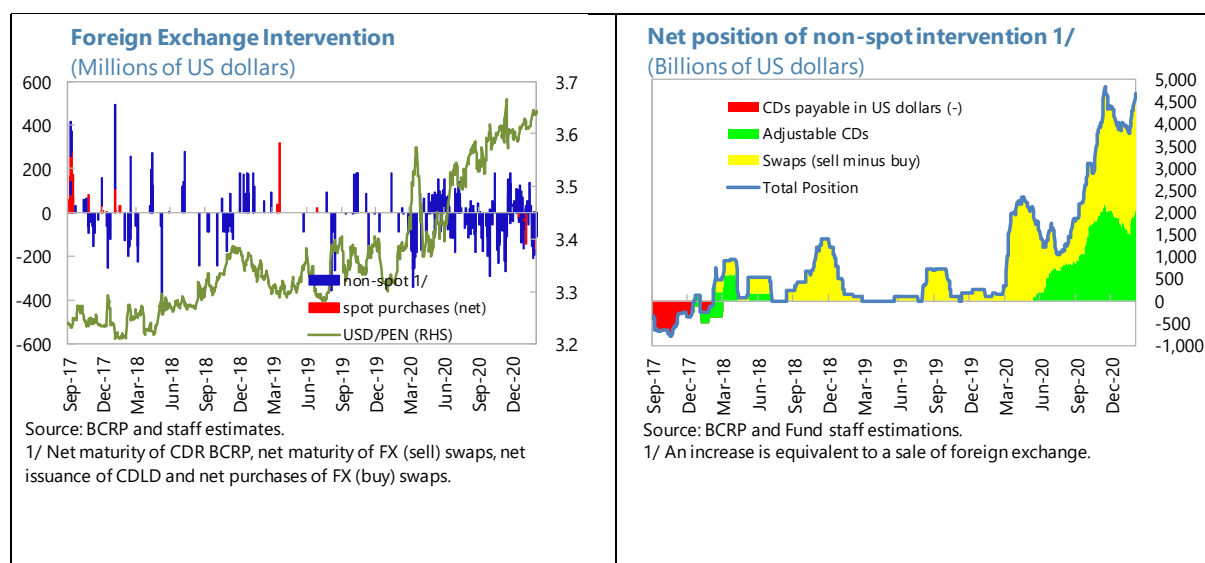




**6. Peru's international reserve coverage exceeds adequacy metrics.** Gross international reserves were US\$74.9 billion (estimated 37.4 percent of GDP) at end-2020, or 307 percent of the ARA metric, well above the 100–150 percent adequacy range. Reserves also exceed an augmented ARA metric that incorporates the volatility of copper and gold prices and Peru's heavy reliance on commodity exports. Reserves also exceed the augmented metric even after subtracting large FX liabilities to the banking sector (reserve requirements and deposits from de-dollarization swaps).



**7. The BCRP has been active in the foreign exchange market to smooth the volatility caused by recent shocks, but as before, it does not target a specific level of the exchange rate.** While the central bank stepped in to smooth the volatility at the outset of the COVID-19 and during later episodes of significant market pressure, the intervention was limited, and the sol continued to depreciate along with other regional currencies. More recently, interventions were aimed at calming the markets in the context of the heightened political uncertainty surrounding the impeachment of the president followed by the resignation of his newly sworn-in successor after public protests. Overall, in 2020 the BCRP has sold US\$4 billion (about 2 percent of GDP) in the non-spot market, including swaps and adjustable CDs. Interventions in the spot market were limited, with net of close to zero.



## Assessment

**8. Based on preliminary estimates, the external position in 2020 is assessed as moderately stronger than implied by fundamentals and desirable policies.** The EBA current account model estimates a current account norm of -2.4 percent of GDP. After excluding the one-off tax payment of about 0.3 percent of GDP due to foreign sales of shares of a domestic corporation, the current account was cyclically adjusted considering the output and the terms of trade gaps, arriving at -1 percent of GDP. Thus, the overall CA gap is about 1.4 percent of GDP pointing to an external position in 2020 that was moderately stronger than implied by fundamentals and desirable policy settings. Out of the CA gap of 1.4 percent of GDP, policy gaps account for 1 percent of GDP. This is explained by stronger fiscal balances compared to the rest of the world, implying that a more supportive fiscal policy, as recommended by staff, would have helped reduce the policy gap. REER models point to different results than the CA model: an external position moderately weaker than fundamentals in case of the REER index model and weaker in case of the REER level model. Normally, the CA regression-based approach is more reliable for Peru and therefore the assessment places more weight on this approach. Nevertheless, it needs to be emphasized that, given the unprecedented year of 2020, uncertainty around these estimates is very high.

Current Account and REER Gaps, 2020 (Percent of GDP, unless stated otherwise)			
	CA regression	REER (index)	REER (level)
Actual CA	0.5	..	..
Actual CA, adjusted for one-off factor:	0.2		
Cyclically adjusted CA	-1.0	..	..
Cyclically adjusted CA norm	-2.4	..	..
CA gap 1/	1.4	..	..
o/w Policy gaps	1.0	..	..
Elasticity	-0.2		
<b>REER gap (in percent) 2/</b>	<b>-6</b>	<b>5.6</b>	<b>12.1</b>
Source: IMF staff estimates.			
1/ CA gap is cyclically adjusted CA minus CA norm.			
2/ Positive value indicates overvaluation.			

Annex VII. Risk Assessment Matrix<sup>1</sup>

	Likelihood	Time horizon	Impact	Policy Advice <sup>2</sup>
<b>Domestic Risks</b>				
<b>Unexpected shift in the COVID-19 pandemic.</b> The disease proves harder to eradicate (e.g., due to vaccines' ineffectiveness and difficulties in distribution), requiring more containment efforts and impacting economic activity directly and through persistent behavioral changes (prompting costly reallocations of resources).	Medium	ST	<b>H</b> (1) Peru is vulnerable to a prolonged pandemic owing to low capacity in the health system and delays in vaccination plans. Repricing of risk assets and financial market volatility may lead to capital outflows and depreciation pressures. Lower external demand due to disruption of trade and global value chains would further reduce growth.	Countercyclical policies should be recalibrated to mitigate the impact of the larger or more prolonged shock, building on the lessons learned so far. In addition to protecting the vulnerable, policies should focus on limiting scarring and facilitating adjustment to the new normal.
<b>Widespread social discontent and political instability</b> ahead of general elections in 2021. Tensions between executive and legislative powers continue; requests of higher wages and better working conditions lead to industrial conflict; and demands for a new Constitution intensify.	Medium /Low	ST, MT	<b>M/H</b> (1) Political uncertainty and industrial conflict could stifle investment and economic recovery in the short-term (probability: <b>M</b> ; impact: <b>M</b> ). A constitutional reform that undermines policy frameworks underpinning prudent policies could have significant medium-term implications (probability: <b>L</b> ; impact: <b>H</b> ).	Continue institutional reforms and strengthen anticorruption institutions. Use policy space (particularly fiscal) if necessary. Persevere with structural reforms, especially those aimed at increasing investment potential and improving framework for PPPs.
<b>Faster execution of public investment.</b> Recent changes may have improved the speed of execution as shown by the rapid growth of capital spending in the second part of 2020.	Medium	ST, MT	<b>M</b> (1) The rapid execution of investment in the health sector would help address the needs related with the pandemic while stimulating domestic demand.	Countercyclical policies should be recalibrated. In the medium term, the ability to mobilize public investment rapidly would increase the effectiveness of fiscal policy.

<sup>1</sup> The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

<sup>2</sup> Recommended by staff.

<b>External Risks</b>				
<b>Accelerating de-globalization.</b> Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation (globally). Reshoring and less trade reduce potential growth.	<b>High</b>	<b>MT</b>	<b>H</b> (1) Given its high exposure to international trade, Peru would be strongly affected. Falling commodity prices and export volumes would lead to a decline of potential growth.	The exchange rate should be allowed to adjust in response to permanent real shocks. Structural reforms should be accelerated to mitigate the decline in potential.
<b>Sharp rise in risk premia that exposes financial vulnerabilities.</b> An abrupt reassessment of market fundamentals (e.g., in response to adverse COVID-19 developments or a premature withdrawal of policy support) triggers widespread risk-off events. This exposes financial vulnerabilities that have been building up in the aftermath of COVID-19, including in sectors that are no longer viable after the pandemic. Risk asset prices fall sharply, leading to significant losses in major financial institutions. Higher risk premia generate debt service and refinancing difficulties for leveraged firms and households, and a wave of bankruptcies further erode banks' capital buffers. Financing difficulties extend to vulnerable sovereigns, in the case of Emerging and Frontier Markets leading to capital outflows, depreciation pressures, and cascading debt defaults.	<b>Medium</b>	<b>ST</b>	<b>M</b> (1) Peru is vulnerable to a sudden exit of foreign investors, which hold a large share of its sovereign bonds. This risk is mitigated by its large policy buffers, including the FCL and a dollar repo line with the NY Fed, and the financial sector can absorb major shocks.	The central bank should use all its tools to provide liquidity both in soles and dollars as needed and maintain financial markets functioning. Exchange rate interventions could be used to prevent excessive volatility but their rationale should be clearly communicated. Avoiding a premature withdrawal of fiscal policy support, accompanied by a clear path of return to the fiscal rules in the medium term, would help maintain confidence.
<b>Unexpected shift in the COVID-19 pandemic.</b> Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity.	<b>Medium</b>	<b>ST</b>	<b>H</b> (1) Given its high exposure to international trade, Peru would strongly benefit. Rising commodity prices and export volumes would provide an impulse to growth.	Countercyclical policies should be recalibrated, and policy stimulus could be withdrawn sooner than expected.

<b>Higher frequency and severity of natural disasters related to climate change</b> cause severe economic damage, reduces GDP, and prompts a recalculation of risk and growth prospects.	<b>Medium</b>	<b>ST, MT</b>	<b>M</b> (↓) Peru is vulnerable to extreme weather events (El Niño) with large adverse impacts on human life, economic activity, and fiscal costs.	Preparedness in the immediate aftermath and building resilience in economic activities and infrastructure would reduce the medium-term impact. Countercyclical policies should be deployed as needed.
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## Annex VIII. Public Debt Sustainability Analysis

*The public debt sustainability analysis (DSA) indicates that Peru's public debt is expected to remain sustainable given the projected recovery of the economy in the medium term, and a gradual withdrawal of the fiscal impulse deployed to attend the COVID-19 health emergency. Under the baseline scenario, the public debt-to-GDP ratio is forecast to stabilize at about 38 percent of GDP in over the medium term. Gross financing needs are expected to average about 5 percent of GDP over the forecast horizon. While historical projections have been optimistic, medium term projections are conservative. Nonetheless, a negative growth shock represents one of the major risks to the debt outlook. An elevated share of public debt held by non-residents stands out as the main debt profile risk, along with moderate external financing requirements risks.*

### Background

**1. The last DSA for Peru assessed the country's public debt as sustainable with a high probability (see Country Report 20/181).** The COVID-19 pandemic triggered a large policy response in 2020 that triggered an increase in the Non-Financial Public Sector (NFPS) deficit to 8.8 percent of GDP in 2020, from 1.6 percent of GDP in 2019. Public debt rose by about 8.3 percentage points to 35.4 percent of GDP in 2020. The fiscal deficit is expected to decline to 5.0 percent of GDP in 2021, as some of the COVID-19 transitory measures are phased out. The debt-to-GDP ratio would peak at about 38 percent of GDP in 2025 and fall slowly thereafter.

**2. Peru's strong track record of credit worthiness has allowed it to maintain access to both local and international capital markets.** The bulk of the government's borrowing requirement is sourced from a highly liquid domestic market, with external public debt representing around 40 percent of the total. About 90 percent of the debt is marketable and contracted at fixed rates, with a half-life of 12 years (above the median for EMs).<sup>1</sup> Peru's sovereign debt is rated investment grade by all major rating agencies. The credit rating sits comfortably above speculative grade (1 full grade in the case of Moody's, and two notches above in the case of S&P and Fitch). Moody's and S&P have qualified the outlook as stable. Fitch downgraded the outlook to negative on concerns over political instability stalling progress on reforms and curbing economic growth on December 2020.

### Baseline Scenario

**3. The baseline scenario is built on two main assumptions.** First, the COVID-19 health emergency is expected to remain broadly contained until a vaccine or treatment is broadly deployed, and any health policies to address emerging outbreaks would have a limited impact on economic activity. Second, a return to the pre-COVID-19 targets of the fiscal rules would occur outside the forecast horizon (2021-26). Other main parameters of the macroeconomic framework are summarized below.

<sup>1</sup> Excluding the century bond issued in November 20, 2020.

- **Real GDP Growth.** Real output growth is anticipated to recover strongly in 2021-22 reflecting a post-pandemic rebound. Afterwards, real GDP growth would converge gradually to potential GDP growth. The level of real GDP would reach pre-pandemic levels by end-2022. A large negative output gap is expected to close by end-2024.
- **Consumer prices and GDP deflator.** Consumer price inflation and the GDP deflator are expected to remain anchored at about 2 percent over the forecast horizon
- **Fiscal strategy.** The baseline scenario assumes a gradual fiscal consolidation is in place. The primary deficit is anticipated to progressively narrow from 7.2 percent of GDP in 2020 to reach balance in 2026. New debt issuances are assumed to principally consist of domestic currency debt, in line with the authorities' medium-term debt management strategy of mitigating exchange rate, interest rate, and rollover risks.
- **Current Account.** The current account deficit is expected to average 1.2 percent of GDP over the medium term. The external accounts are anticipated to remain balanced, secured by continued market access to international capital markets and support from FDI.

## Public DSA Assessment

**4. Public-sector debt dynamics are sustainable with a high probability both under the baseline and historical scenarios** (Figure 1 and Figure 2). Under the baseline scenario, the public debt-to-GDP ratio is expected to reach its peak of about 38 percent of GDP in 2025, where after it would decline gradually. The reduction in the primary deficit will be partly offset by a negative interest rate and real GDP growth differential. Under the historical scenario (where real GDP growth, the primary balance, and real interest rates are set at their historical average while other variables are the same as in the baseline) the debt ratio would peak outside the forecast horizon.

**5. The baseline scenario is realistic for purposes of the DSA** (Figure 3). An analysis of staff's forecast errors shows that while estimates of real GDP growth have tended to be optimistic, these have reflected unexpected shocks such as the commodity price downturn in 2014-2016 and climate-related natural disasters. Partly addressing any potential bias, staff's real GDP growth forecast is below both the consensus and the authorities' forecasts for 2021. On the other hand, the primary balance, and inflation (deflator) forecast errors have been closer to the median for all countries. Finally, the projected fiscal consolidation underpinning the debt burden trajectory looks realistic.

## Stress Tests and Distribution of Risks

**6. Standardized stress tests reveal that the public debt ratio is likely to remain at manageable levels over the forecast horizon** (Figure 4). In all cases, the debt ratio remains below the 70 percent of GDP benchmark for EMs. The assessment is further confirmed by a probabilistic analysis of the uncertainty surrounding the baseline scenario, as indicated by the Fan Charts.

- **Real GDP growth shock.** Lower real output growth than in the baseline by one standard deviation for 2 years starting in 2021 would take the public debt level towards 55 percent of GDP and public gross financing needs of about 7 percent of GDP over the medium term.
- **Real interest rate and real exchange rate shock.** Simulations of a 200bp increase in real interest rates or a 20 percent depreciation of the exchange rate yield similar results. Any of these events would take the public sector debt level to about 44 percent of GDP in 2026. Gross financing needs would stand at about 5.1 percent of GDP through 2026.
- **Primary balance shock.** Fiscal slippage in the form of a deterioration in the primary balance of an additional cumulative 3 percent of GDP over the 2021-26 period would take the debt ratio to about 46 percent of GDP in 2026. Public gross financing needs would remain at about 6.1 percent of GDP during 2021-26.
- **Combined macro-fiscal shock.** A single scenario that combines the above-mentioned shocks would imply a debt ratio of about 60 percent of GDP by 2026. The ratio of public debt to revenue, and public gross financing needs would remain at elevated levels over the medium term.
- **COVID-19 contingent liabilities shock.** Under the baseline scenario, a fifth of the guarantees issued under *Reactiva Perú* will be called, amounting to 1.8 percent of GDP during the 2021-23 period. A doubling of the expected rate of materialization of these contingent liabilities issued under *Reactiva Perú*, along with lower real GDP growth by 0.5 percentage points, would keep the public debt ratio over 46 percent of GDP by 2025.

**7. The risk assessment shows that debt profile vulnerabilities are limited.** Risks arise mostly from a high share of public debt held by non-residents, as the corresponding risk indicator is close to the upper early warning threshold. Meanwhile, moderate risks arise from the share of public debt in foreign currency and external financing requirements, which could give rise to concerns over financial stability in the case of large exchange rate adjustments (Figure 5).

## Conclusion

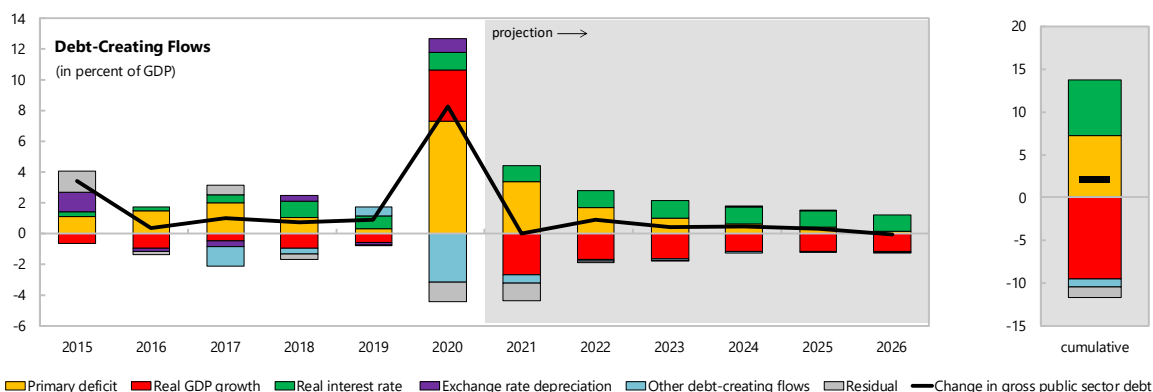
**8. Peru's public-sector debt level is sustainable with a high probability.** The debt sustainability analysis is broadly positive. Debt is unlikely to exceed 70 percent of GDP over the medium term, including in the event of large shocks to key macroeconomic variables. However, in the absence of fiscal consolidation an adverse shock could take the debt ratio close to the 70 percent of GDP benchmark. The main sources of risk arise from the high proportion of public debt held by non-residents and real GDP growth shocks. Moderate risks from the share of public debt in foreign currency and external financing requirements are emerging.



**Figure 1. Peru: Public Debt, Economic and Market Indicators<sup>1</sup>**  
(In percent of GDP unless otherwise indicated)

<b>Debt, Economic and Market Indicators<sup>1/</sup></b>										<b>As of February 08, 2021</b>		
	<b>Actual</b>			<b>Projections</b>								
	2010-2018 <sup>2/</sup>	2019	2020	2021	2022	2023	2024	2025	2026			
Nominal gross public debt	23.4	27.1	35.4	35.4	36.2	36.7	37.2	37.5	37.4	Sovereign Spreads		
Public gross financing needs	2.3	4.1	9.2	5.4	4.3	4.4	4.8	4.6	5.9	EMBIG (bp) 3/	136	
Real GDP growth (in percent)	4.8	2.2	-11.1	8.5	5.2	4.8	3.4	3.3	3.3	5Y CDS (bp)	55	
Inflation (GDP deflator, in percent)	2.9	2.1	1.8	2.0	2.0	2.0	2.0	2.0	2.0	Ratings	Foreign	Local
Nominal GDP growth (in percent)	8.2	4.0	-7.5	14.4	7.1	6.5	5.0	4.9	5.1	Moody's	A3	A3
Effective interest rate (in percent) <sup>4/</sup>	5.3	5.5	5.5	5.5	5.4	5.4	5.2	5.1	5.0	S&Ps	BBB+	A-
										Fitch	BBB+	BBB+

<b>Contribution to Changes in Public Debt</b>											
	<b>Actual</b>			<b>Projections</b>							
	2010-2018 <sup>2/</sup>	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	
Change in gross public sector debt	-0.2	0.9	8.3	0.0	0.9	0.4	0.5	0.3	-0.1	2.0	debt-stabilizing
Identified debt-creating flows	-1.2	1.0	9.5	1.2	1.0	0.4	0.5	0.3	0.0	3.3	primary
Primary deficit	-0.5	0.3	7.3	3.3	1.7	1.0	0.6	0.4	0.1	7.2	balance <sup>9/</sup>
Primary (noninterest) revenue and grants	25.7	24.7	22.0	22.3	23.0	23.0	23.1	23.2	23.2	137.8	-0.2
Primary (noninterest) expenditure	25.2	25.0	29.3	25.6	24.7	24.0	23.7	23.6	23.3	145.0	
Automatic debt dynamics <sup>5/</sup>	-0.4	0.1	5.4	-1.7	-0.6	-0.5	-0.1	-0.1	-0.1	-3.0	
Interest rate/growth differential <sup>6/</sup>	-0.6	0.3	4.5	-1.7	-0.6	-0.5	-0.1	-0.1	-0.1	-3.0	
Of which: real interest rate	0.5	0.8	1.2	1.1	1.1	1.1	1.1	1.1	1.0	6.5	
Of which: real GDP growth	-1.1	-0.6	3.3	-2.7	-1.7	-1.6	-1.2	-1.1	-1.2	-9.5	
Exchange rate depreciation <sup>7/</sup>	0.1	-0.2	0.9	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.3	0.6	-3.2	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-1.0	
General government net privatization proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Use of stabilization fund	-0.3	0.6	-3.2	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-1.0	
Residual, including asset changes <sup>8/</sup>	0.9	-0.1	-1.3	-1.2	-0.1	0.0	0.0	0.0	0.0	-1.2	



Source: IMF staff calculations.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

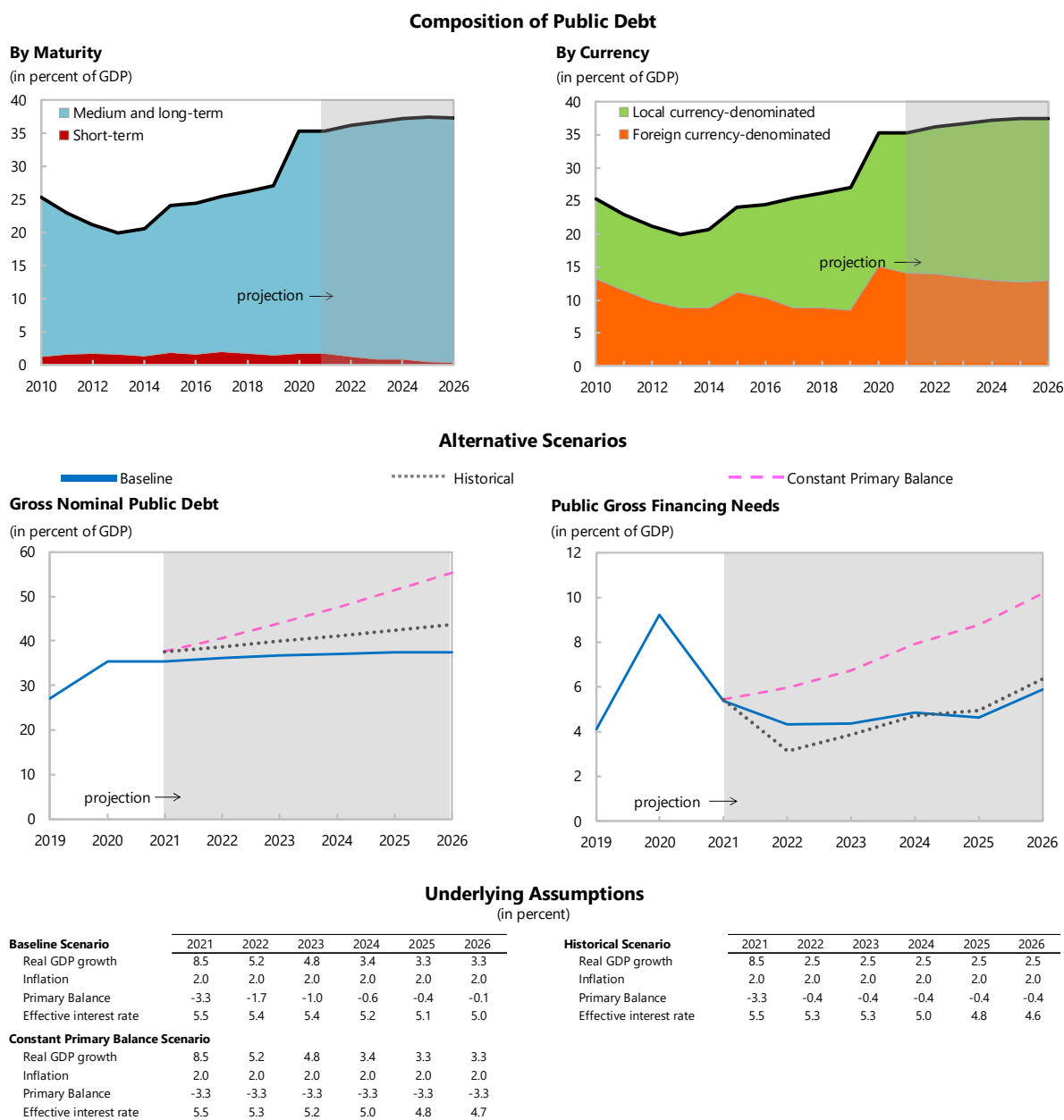
5/ Derived as  $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+gn)]$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $a$  = share of foreign-currency denominated debt; and  $e$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

7/ The exchange rate contribution is derived from the numerator in footnote 5 as  $ae(1+r)$ .

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

**Figure 2. Peru: Public DSA – Composition of Public Debt and Alternative Scenarios**

Source: IMF staff calculations.