Statement by Mr. Chodos and Mr. Hendrick on Peru
May 27, 2022

Key Points

- Peru continues to meet the FCL qualification criteria.
- The Executive Board's assessment of the 2022 Article IV Consultation noted that Peru has very strong policy and institutional frameworks and economic fundamentals.
- The strong pillars of a highly credible central bank, implementing a very effective inflation targeting regime, together with a strong technocracy in the Ministry of Finance, implementing sound fiscal policies, have been instrumental in sustaining economic growth with a very low one-digit inflation during the last two decades.
- The Flexible Credit Line (FCL) approved in May 2020 was a critical component of the authorities' strategy to hedge against tail risks and provide a signal to the markets about their commitment to maintain sound macroeconomic policies.
- Peru had a strong economic recovery in 2021, after the sharpest contraction ever recorded in 2020. The fiscal position has improved substantially, and the monetary authority has embarked on a tightening cycle to contain emerging inflationary pressures. Fiscal buffers are being rebuilt and the external position has strengthened with a higher level of international reserves.
- However, there are renewed headwinds leading to a significant deceleration in global activity in 2022, due to several factors, including the war in Ukraine, affecting fuel and food prices, risks of additional COVID-19 variants, and the potential risks associated with the tightening of financial conditions, following the faster-than-expected normalization of monetary policy in the U.S.
- In this context, the authorities are requesting a successor precautionary arrangement under the FCL in the amount of SDR 4.0 billion, equivalent to 300 percent of quota, for a period of 24 months. This lower amount (half of the current arrangement) is part of Peru's gradual exit strategy and continues to signal to the markets the strength of the Peruvian economy.
- The Peruvian authorities remain committed to very strong policies and will respond appropriately to any shocks that may arise. Peru's long-standing macroeconomic track record, strong buffers, and a new FCL for two additional years will help the economy to navigate these highly uncertain and unprecedent times affecting the global economy.

INTRODUCTION

1. **Our Peruvian authorities would like to convey their appreciation to the Fund's Management, Executive Board, and staff for their continued support to Peru and for the positive initial response to the request for a successor FCL arrangement**. We would also like to thank Mr. Santos, the new mission chief, and his team for their hard work, under very tight deadlines, to deliver the excellent analytical work and overall assessment of the qualifications of Peru for the FCL, and to be able to produce the required documents on time for this Board discussion. We believe that Peru is another good example of how the FCL is fulfilling its purpose of providing additional protection against tail risks to countries with solid macroeconomic fundamentals, facing temporary risks. The positive role of the FCL in signaling to the markets the strength of a member's economy, should be seen as a success for the Fund that this important facility is fulfilling the goals as envisaged by the Board.

2. **Peru has very strong policy and institutional frameworks and economic fundamentals, among the strongest in the region.** At the time of the recent 2022 Article IV Consultation, the Executive Board took positive note of Peru's very strong macroeconomic policy framework, the impressive track record of prudent policies across various governments, and different external and domestic shocks, including the global financial crisis, the shock of commodity prices, and more recently the COVID-19 pandemic. Peru was able to navigate these challenges thanks to the substantial buffers accumulated during more than two decades of sound fiscal and monetary policies, a solid external position, low public debt, and low country risk premium, as shown by the ample access to international markets at relatively low cost. The sovereign credit rating remains investment grade by the three major credit rating agencies, Fitch, Moody's, and S&P.

3. **In 2021 Peru experienced a strong economic recovery, after a deep recession in 2020.** Real GDP grew 13.5 percent in 2021, one of the highest rates in the LAC region, after a decline of 11.1 percent in 2020, the worst recession ever recorded. This strong recovery was not an isolated event, but a result of the strong fundamentals and timely policies implemented by the authorities, using some of the buffers accumulated during the boom years of economic growth. As stated in the first paragraph of the staff report, prior to the pandemic, Peru's economy grew at an annual rate of almost 5 percent during 2001-2019. Inflation was kept at an annual average rate of only 2 ½ percent, the lowest in South America and lower than most EMEs. Ambitious structural reforms and strong stabilization programs since the 1990s set the foundation for a sustained inclusive growth, low inflation, and poverty reduction by two-thirds, transforming the economy into a success story, as documented in a book published by the Fund in 2015.[1]

[1] "Peru, Staying the Course of Economic Success", Ed Alejandro Werner & Alejandro Santos, IMF Book Series,

REQUEST FOR A SUCCESSOR FCL ARRANGEMENT

4. **However, despite the sound rebound of the Peruvian economy, the global outlook does not look good, and downside risks are beginning to materialize.** As widely discussed during the recent Spring Meetings, there are renewed headwinds leading to a significant deceleration in global activity in 2022, due to several factors, including the war in Ukraine, affecting fuel and food prices, risks of additional COVID-19 variants, and the potential risks associated to the tightening of financial conditions, following the faster-than-expected normalization of monetary policy in the U.S. Most recently, the stock markets' dive into bear market territory is also reflecting this uncertainty, fear of a recession, and the risks surrounding the outlook.

5. **Against this background, the Peruvian authorities decided to request a successor two-year FCL arrangement with reduced access.** Despite Peru's sizeable macroeconomic buffers, risks remain elevated. Directors may recall that at the time of the May 2021 mid-term review, as indicated in our Buff statement, the authorities expressed their intention to exit the FCL arrangement after the end of the second year of the arrangement, conditional on a reduction in global risks. Unfortunately, this has not been the case. Yet, despite the ongoing risks to the outlook, the authorities decided to reduce their access by half, from 600 percent to 300 percent of quota, to signal the market their intention for a gradual exit and communicating the markets that the request for the lower access is based on the higher level of international reserves since the 2020 FCL was requested, and the replenishment of the fiscal buffers. As with the current arrangement, the authorities will continue to treat the new FCL as precautionary.

RECENT DEVELOPMENTS

6. **Peru's economic activity is evolving as expected, real GDP growth was 3.8 percent during the first quarter of 2022.** This development was driven by a recovery of domestic demand and strong exports growth of 8.2 percent. Private consumption grew 6.9 percent reflecting the normalization of consumption patterns, recovery in personal income, and the success of the vaccination programs which allow for a development of the high contact sectors, which are beginning to rebound from the pandemic. From the supply side, this is driven by growth in the manufacturing, commerce, and services sectors. Formal employment at the national level increased 7.9 percent in March 2022 (yoy), which is the 12th consecutive increase since the lockdown measures were gradually lifted. Also, as mentioned in the staff report, formal employment in the city of the Lima Metropolitan Area (with 11 million people, which is one-third of the country's population) fully regained its pre-pandemic levels. These

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September 16, 2015. IMF Videos - Peru: Staying the Course of Economic Success

positive developments also help to retake the downwards trend in the poverty rate, with a 25.9 percent poverty rate in 2021, down from the 30.1 percent in 2020.

7. **Headline and core inflation have risen in line with global trends, but inflation is expected to return to the target range in 2023.** In the context of global inflationary pressures, 12-month headline inflation increased to 7.96 percent in April 2022, due to higher fuel and food prices and currency depreciation. Core inflation rose to 3.81 percent, above the 1-3 percentage target range of the Central Bank of Peru. On May 12, 2022, the monetary authority raised its policy rate by an additional 50 bps to 5.0 percent. The policy rate has increased by accumulative 475 bps, in 10 consecutive steps since the central bank began the normalization of the monetary policy in September 2021. The monetary authority will continue to carefully monitor inflationary developments and risks and will continue to provide guidance to the markets. The central bank stands ready to adjust the policy rate until inflation is back to the target range. Despite the temporary increase in inflation, market participants have confidence on the central bank and its ability to bring the inflation back to the target range. This is reflection of a well-established long track record of low and stable inflation since the adoption of a full-fledged inflation targeting framework in 2002.

8. **Peru's fiscal position remains strong, and the fiscal accounts have continued to strengthen during the first four months of 2022.** Peru was an early adopter of the Fiscal Responsibility and Transparency Law. Created in 1999 and revised in 2016, it is an important anchor of the country's fiscal discipline. As announced during the Article IV Consultation, the government sent a project law to Congress for a gradual adjustment of the fiscal position and a return to the original medium-term debt limit target of 30 percent of GDP for public debt in the next 10 years. The independent Fiscal Council further enhances Peru's very strong fiscal framework. After a decline of the fiscal deficit from 8.9 percent of GDP in 2020 to 2.5 percent in 2021, it continues its declining trend to a deficit of 1.0 percent in April 2022 (yoy). This positive outcome is driven by a substantial increase in fiscal revenues (24.5 percent of GDP, the higher figure on record since 1990) due to higher economic activity and strong exports, and the lower fiscal expenditure associated with the unwinding of fiscal stimulus associated with the pandemic. The authorities have taken advantage of this window of opportunity to replenish the Fiscal Stabilization Fund to face potential future crisis.

9. **The external position remains very solid and international reserve coverage exceeds all Fund metrics.** For a small open and commodity exporting economy, with substantial domestic foreign currency liabilities, maintaining large external buffers is a key tool to enhance the resilience of the Peruvian economy. Following the positive dynamics in 2021, during the first quarter of 2022, the financial account of the balance of payments had a net inflow of US$ 1.1 billion, but unlike 2021, capital inflows were dominated by private sector inflows, with US$ 6.0 billion coming from FDI and other private sources. The public sector had a net inflow of US$ 0.4 billion. As explained in the staff report, in the assessment of the

FCL qualifications, the capital account position has been historically dominated by private flows and the reserve position in terms of GDP is the largest in Latin America. As of May 18, 2022, international net reserves stand at US$ 76.7 billion. As illustrated in the evaluation of criterion 4, Peru's international reserve position in terms of GDP is the highest in Latin America, and it is also higher than the level of public debt. In addition, as shown in Figure 5 of the staff report, Peru's reserve coverage is one of the highest under different criteria, namely, close to 350 percent of ARA metric, 80 percent of Broad Money or more than 500 percent of short-term external debt at remaining maturity plus the current account deficit.

10. **The financial sector remains strong and resilient as emergency measures continue to be gradually unwound.** Assessment of criterion 7 and 8 clearly shows the soundness of the financial system, the absence of solvency problems that could threat systemic stability, and the acknowledgement of the effective financial supervision in place and the strength of the supervisory and regulatory framework. Despite the fact that top-down stress tests suggest that the financial system is resilient even under adverse scenarios, as found in the 2018 FSAP, the authorities continue to closely monitor the banking system and stand ready to take any additional measures if needed.

FINAL COMMENTS

11. **The authorities will continue to treat the FCL as a precautionary and temporary arrangement.** Peru is a first-time user of the FCL and is seeking to exit the facility on a gradual basis. Given the high risks and uncertainty surrounding the recovery of the world economy, and the still higher than average economic stress, as reflected by the updated external economic stress index in Box 1 of the staff report, the authorities decided to request a successor FCL arrangement, albeit with only 50 percent of the current access, to have an additional layer of protection to the strong buffers in place, to signal to the markets Peru's continued commitment to sound macroeconomic policies, and also to signal their intention to exit the FCL at the end of the new arrangement, conditional on a reduction of global risks.

12. Finally, on behalf of our Peruvian authorities, we would like to reiterate our appreciation to Management and Executive Directors for their advice and support, and to Mr. Santos and his team for their commitment and hard work**.** The FCL has provided a strong signal of confidence in the strength of Peru's policy framework and fundamentals, as well as valuable added insurance against tail risks amid unprecedented uncertainty and volatility in global financial markets. The Fund should be proud that this facility has fulfilled its role with flying colors.