



PERU

Ministry
of Economy and Finance

Vice Minister
of Finance

National Directorate
of Public Indebtedness

"DECADE OF THE DISABLED IN PERU"
"YEAR OF THE CENTENARY OF MACHU PICCHU FOR THE WORLD"

MINISTRY OF ECONOMY AND FINANCE

ANNUAL PROGRAM OF INDEBTEDNESS AND DEBT MANAGEMENT

2011



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INTRODUCTION

As is customary every year, the Ministry of Economy and Finance (MEF) presents the Annual Indebtedness and Debt Management Program (PAEAD), document which in addition to disseminating the objectives and main public debt management guidelines, contains quantitative targets to be met as of the closing of this year.

The continuity of policies in this field, based on best international debt management practices, has been institutionalized through the disclosure of the Annual Program, which now helps provide transparency and predictability to the market about the orientation of debt policy, to support the economic agents in the investment decision making process. In addition, it provides elements for a better understanding of the reasons behind the actions being taken.

During 2011, debt management – being consistent with macroeconomic policy in general – will continue to apply essentially the main guidelines of the policy being implemented in recent years, which have allowed for the composition of government liabilities to undergo significant qualitative changes, contributing to a reduction in the vulnerability of public finance against adverse external shocks in the financial markets, and to the strengthening of the government's patrimonial situation.

However, the market dynamics and the progress made in recent years, pose new challenges today, which will involve certain variations to the strategy being followed, which in addition to preventing portfolio risks, will support the strengthening of the domestic capital market's development, as an important strategic hub. Thus, debt management will continue to help the country maintain its current expectant position, to continue to move up the scale within the investment grade category obtained.

The Annual Program is made up of seven sections. The first section provides a glimpse of the public debt situation; the second section offers a diagnosis of refinancing and market risks of the outstanding debt portfolio. The third section states the Program's purpose and guidelines, which make up the fundamental principles of the strategy to follow. The fourth section provides a brief analysis of the external and internal financial market's context, setting out the goals expected to be achieved by December 2011.

The fifth section quantifies the portfolio risks for the year 2011; and the sixth section presents some additional indicators to analyze the medium and long term public debt's behavior. Finally, there is a preliminary assessment of compliance with the goals set for the closing of 2010 financial year.



1. STATUS OF THE MEDIUM-AND LONG-TERM PUBLIC DEBT

As of November 30, 2010, the medium- and long-term public debt totals US\$ 33,424 million¹, of which, US\$ 19,705 million (59.0%) relate to external obligations.

By origin, the market debt is now 58.5% of the total, increasingly acquiring a more influential² weight in financing fiscal needs. Greater access to capital markets has been possible thanks to the improved perception of the country risk, which has encouraged traders to take higher positions in government securities, especially in local currency, in the long term, at fixed rate, which is reflected in the sovereign bonds' share in the total debt (30%), and in the level of other indicators of the portfolio (see Table N° 1 and Annex 1). Thus, the Republic now has a wider range of alternative funding, which by its nature will provide greater flexibility for a more efficient management of portfolio risk.

Table N° 1
Public debt: Position and indicators

	Debt Balance (million US\$)	Share (%)	Average Life (years) ^{1/}	Duration (years) ^{2/}	ATR ^{3/} (years)	Equiv Rate. (%) ^{4/}
BY ORIGIN						
Market	19,563	58.5	17.1	9.4	17.0	6.4
Sovereign bonds	9,975	29.8	18.1	9.4	18.1	7.5
Global bonds	9,386	28.1	16.3	9.5	16.3	5.3
Other bonds	201	0.6	8.0	6.1	3.8	6.6
Non-market	13,861	41.5	7.1	5.4	4.3	4.0
Multilateral	7,519	22.5	7.0	5.2	7.0	3.9
Paris Club	2,524	7.6	6.7	5.3	2.5	4.0
Other	3,817	11.4	9.2	6.3	9.2	3.7
TOTAL	33,424	100.0	13.4	8.1	12.4	5.5
BY RESIDENCE						
External debt	19,705	59.0	12.1	7.5	10.5	5.7
Domestic debt	13,719	41.0	15.6	9.2	15.6	5.2
TOTAL	33,424	100.0	13.4	8.1	12.4	5.5

1 / **Average Life:** Weighted average term (in years) for the reimbursement of loan nominal principal.

2 / **Duration:** Average term for the reimbursement of principal and interest at present value.

3 / **ATR:** Average term to refix a new rate for the debt portfolio.

4 / **Equivalent rate:** Average cost of debt expected equivalent in US Dollar.

Source: MEF- National Directorate of Public Indebtedness (DNEP)

A relative measurement of the debt stock position, through the public debt ratio as a percentage of GDP³, shows a steady downward trend of this indicator⁴, placing us in an expectant position versus our regional peers (see Chart N° 1). It is worth noting that the reduction of this ratio has been accompanied by a qualitative improvement in the debt structure, as the share of the local currency substantially

¹ Preliminary information using the official public debt base as of September 30, 2010 (including swap transactions), using prices as of November 30, 2010 and considering the effect of the prepayment operation conducted in December 2010 and the US\$ 1.0 billion pre-financing for 2011.

² Since 2002, when Peru returned to the capital market with the 2012 global bond issue.

³ This involves the short, medium and long-term public debt.

⁴ Only interrupted due to the conditions prevailing in 2009 due to a greater need for financing and a lower growth of the GDP, as a result of the international financial and economic crisis unleashed in 2008.



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increased, which contributes to the reduction of the portfolio's vulnerability to potentially adverse movements in the international markets. (See Chart N° 2).

Chart N° 1
Public Debt/GDP

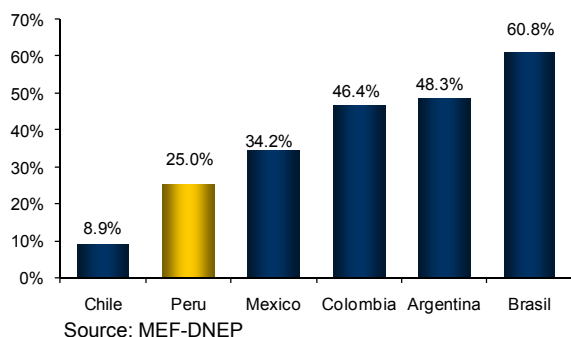
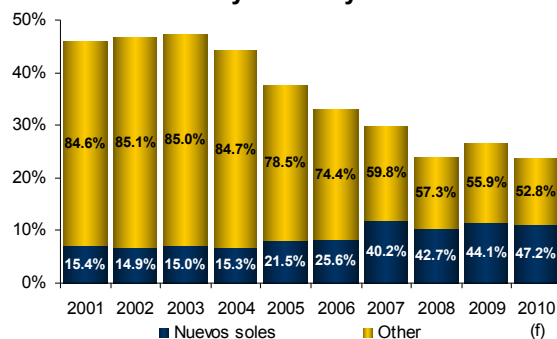


Chart N° 2
Composition of the public debt/GDP ratio by currency

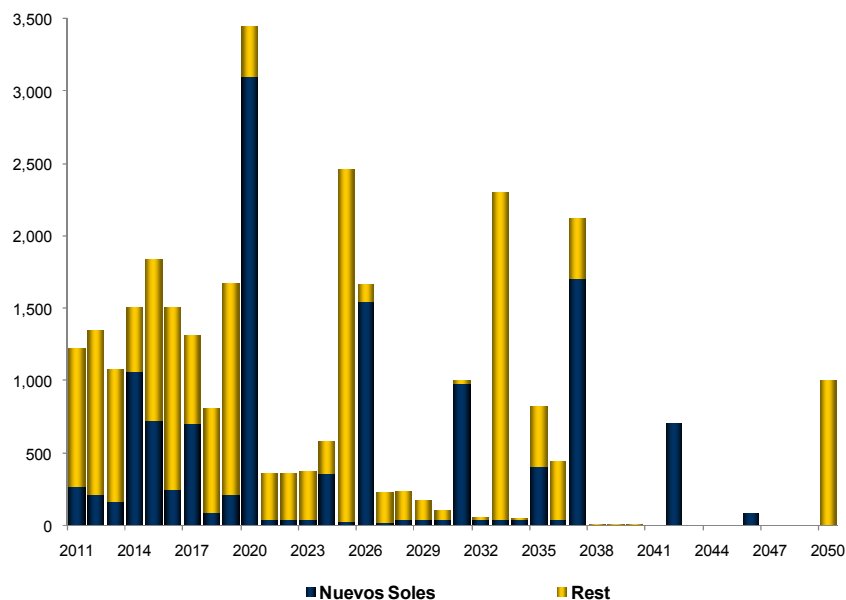


2. PUBLIC DEBT RISKS

The major risks affecting the portfolio of public liabilities are primarily those generated by the concentration of payments and their exposure to the volatility of interest rates and exchange rates.

The **refinancing risk** exists due to the possibility of refinancing maturities debt at high cost, or in the extreme case that certain debt cannot be renewed. This risk increases whenever there is a concentration of amortizations in the closer periods and it becomes more demanding due to their currency structure.

Chart N° 3
Public Debt: Amortization flow by currency
(US\$ million)



Source: MEF-DNEP



An indicator by which it is possible to measure some of this risk is the average life of the public debt portfolio, which estimated as of November 30, 2010, stood at 13.4 years (12.1 years for external obligations and 15.6 years for domestic debt), one of the longest among the region's countries. It should be noted that the average life has maintained an increasing rate in recent years, and this is basically explained by the market's willingness to invest in long-term local currency bonds, reflecting its confidence in the soundness of the country's macroeconomic fundamentals. See Chart N° 4.

However, this indicator does not provide information on specific periods, particularly in the short term, which could face a concentration of payments; so, it would be convenient for this to be supplemented by other indicators that would alert of these potential risks. One of them is the concentration of amortization payments in the next 12 months, which measures the more immediate pressure of payments, representing for 2011 only 3.9% of the total outstanding debt⁵, below the previous year's 4.2% rate.

As shown in Chart N° 5, this indicator has had a downward trend in recent years as a result of the policy to reduce the refinancing risk through the execution of liability management operations that allowed for the generation of amortization payments relief in future years, as well as entering into new debt to longer maturities.

Looking ahead at the schedule of maturities for the next three years⁶ to verify that the efforts made to smooth down the profile of the payment have not resulted in the pressure being deferred to this mediate period, also serves to verify that this ratio has also decreased from 13.0% to 11.8% of the total debt.

It is expected that the refinancing risk will continue to decline in the coming years due to the reduction of government funding needs, which would be at levels close to 1% of GDP in 2011⁷, well below the median of countries with a BBB investment grade rating, which is above 7%⁸. These reduced requirements are the result of the fiscal discipline of recent years (low fiscal deficits and surpluses between 2006 and 2008), the financial cost of debt that has remained relatively stable, as well as the aforementioned relief.

⁵ The calculation of this ratio involved the exclusion of the debt with the National Pension Bureau - ONP, since service of these obligations is charged against the Consolidated Reserve Fund.

⁶ To make the analysis compatible with the timeframe covered by the Multi-Annual Macro-Economic Framework (Marco Macroeconómico Multianual - MMM), a document published on an annual basis by the Ministry of Economy and Finance, which includes the macro-economic projections for the year corresponding to the budget being prepared, and for the two subsequent years.

⁷ Considering a 0.3% deficit, according to the adjusted figure of the Pre-Election Report and the reserves for amortization payments to be made for the year, published in the Revised 2011-2013 MMM.

⁸ Considering Fitch estimates appearing in its "Full Rating Report" June 2010 report for 2010 and 2011.

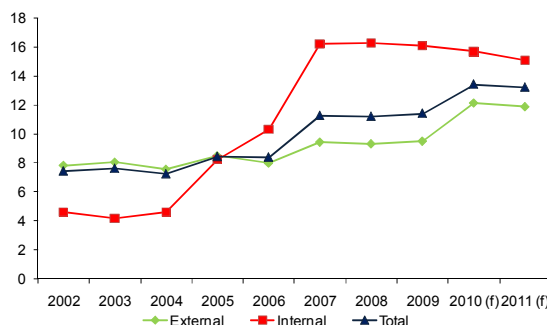


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Chart N° 4
Historical Average Life



Source: MEF-DNEP

Chart N° 5
Public Debt: Amortizations

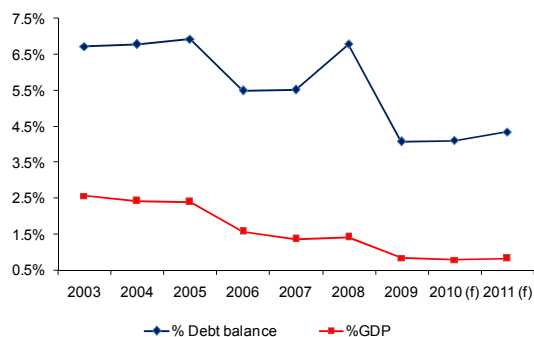
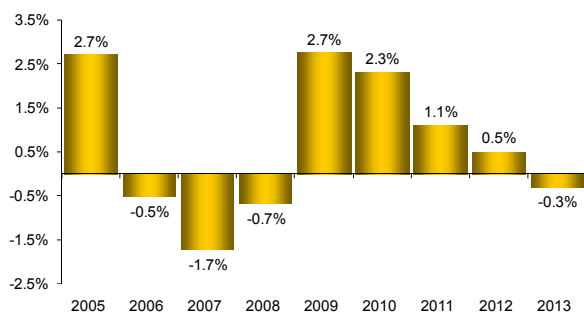


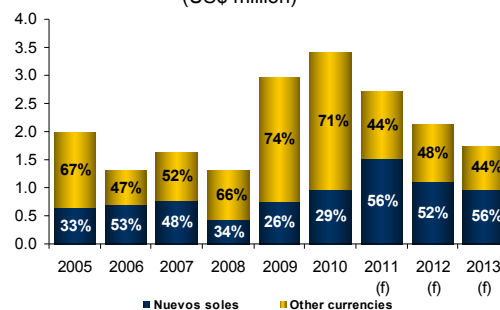
Chart N° 6 offers a retrospective view of the behavior of the funding needs, given that in the two years prior to the financial crisis in 2008, and even in that year, there were already fiscal surpluses generated, which would have far covered the respective amortization payments; however, during this period, the debt policy became a tool used in the implementation of a counter-cyclical fiscal policy, which benefits have been especially evident in the years when the market became more volatile and illiquid as a result of the crisis.

Chart N° 6
Financial Requirements / GDP



Source: MEF- DGAES - DNEP

Chart N° 7
Financing of requirements through borrowing (US\$ million)



Extrapolating this analysis in order to measure the vulnerability from a different perspective, we note that the ratios measuring the weight of debt service versus GDP (See Chart N° 8) and the Government's ability⁹ to meet the cost of debt with its revenues (See Chart N° 9), generally show a downward trend, mainly due to the sustained growth of GDP in recent years, which in turn has generated a substantial increase in Government revenue.

The results shown by these indicators, combined with higher probabilities of the country to access market financing sources, in addition to traditional sources, make it possible to infer that the refinancing risk is increasingly no longer a factor of concern for the Treasury.

⁹ Central Government revenues are taken into consideration.



Chart N° 8
Total debt service/ GDP

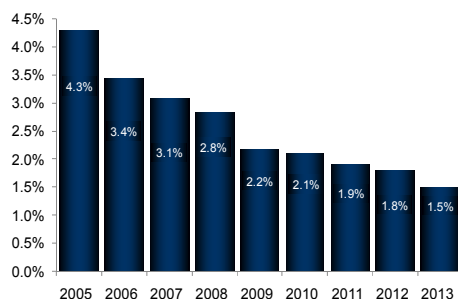
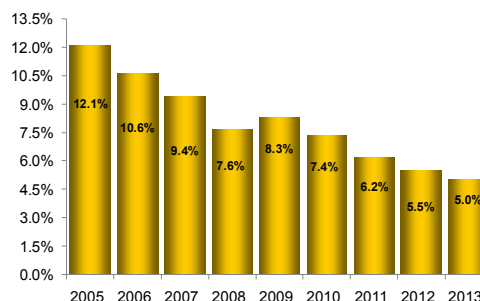


Chart N° 9
Debt interest/ Central Government's revenues



Source: MEF- DGAES - DNEP

Market risk, in turn, is defined as the exposure of the debt portfolio and the cost of its service to interest rate and exchange rate variations. The more share of the domestic currency in the total liabilities, the less exchange risk, while a higher proportion of fixed rate debt, maintained for a longer period, reduces the uncertainty of adverse movements in interest rates.

Regarding the debt's currency structure, obligations in Nuevos Soles amounted to approximately 46.3%, with the remaining in other currencies, most notably US Dollars (47.0%). While this percentage represents a significant growth over prior years' positions, and its increase is one of the main guidelines for the management of public debt, it is still far from certain international standards which can be taken as a reference, such as the average percentage of local currency debt held by other countries with a Baa investment grade rating¹⁰.

An analysis made of the maturities to become due in 2011 shows that 78.1% of payments (approximately US\$ 947.2 million) will be made in currencies other than the Nuevo Sol. Similar behavior, although with a higher percentage, is noted in the maturities for the next few years (See Chart N° 10). However, the magnitude of maturities and the fact that 50.8% of them are US Dollar related, a currency which would maintain its current levels or would tend to depreciate slightly versus the Nuevo Sol¹¹, would reduce the potential impact of this risk and would make -in practical terms-, probably fewer resources would be required in its domestic currency equivalent to meet such payments. While it appears as though the current weakness of the US Dollar, in the short-term, result in favor of the country's interests, it is advisable to keep in mind that medium- and long-term debt management must always guide its actions and that indebtedness in Nuevos Soles should remain the priority.

As regards to interest rates, fixed rate contract obligations represent 78.5% of the total public debt, and this is consistent with the guidelines established to reduce exposure to the volatility of rates and to have a greater predictability in scheduling service payments. However, this figure does not reveal, per se, which part of that debt at fixed rate must be refinanced soon, nor the pace, in terms of time, over

¹⁰ According to Moody's projections included in the "Peru Credit Analysis Report" published on August 24, 2010, the average level of the Baa category is approximately 40% in foreign currency in the portfolio.

¹¹ Due to the effect from the flow of capital into emerging markets.



which it will have to be replaced in the portfolio, and this would lead to the risk of incurring in a higher cost than that has been attending, depending on the market conditions prevailing each time this occurs.

The indicator that makes it possible to measure the potential risk at the portfolio level is the average life to refix interest rates (ATR), which expresses the average time over which a new rate will be set for the liabilities portfolio¹². This indicator, which stands at 12.4 years¹³, is consistent with the guidance of the strategy followed in recent years, which has prioritized going into long-term debt at fixed rates, which affords considerable room to mitigate this exposure.

A more careful analysis to assess the proportion of debt that could lead to adverse movements in interest payments over the next 12 months and in the three following years reveals that 78.2% and 82.0%, respectively, of the maturities to be addressed in these time periods, correspond to fixed rate debt (See Chart N° 11). While there may be a lower risk margin, in the percentages maintained at variable and indexed rate, both the levels of market interest rates and the inflation rate are now historically low, and the projection is that they will remain so for some time.

Chart N° 10
Maturities by currency
(US\$ million)

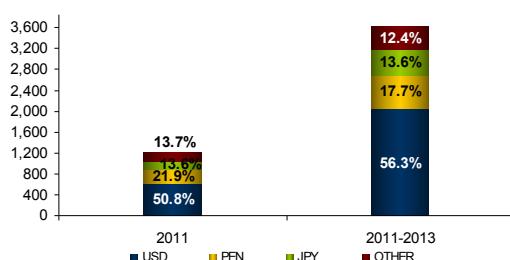
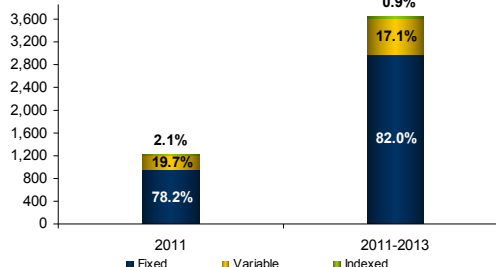


Chart N° 11
Maturities by interest rate
(US\$ million)



Source: MEF-DNEP

The analysis of the above-mentioned risks provides a scope of the sensitivity of debt service given adverse changes in market variables. The size and structure of maturities (currencies and rates) may involve higher expenditures than expected, and eventually exert unwanted pressure on the National Treasury.

One way of measuring this sensitivity is through the Service at Risk (SeR¹⁴). This indicator, based on which it is possible to quantify the overall and correlated impact of the fluctuation of interest rates and exchange rate on the debt service, with a confidence level of 95%, allows for an estimate to be made of the additional expenditure that might be incurred due to these movements with respect to the service anticipated for the year. Calculations show that by 2011, the debt obligation service¹⁵ would total S/. 8,995 million, while the risk derived from the volatility of the interest rates and exchange rate that might be incurred, would be approximately

¹² If the debt is agreed at fixed rate, the ATR is equal to the average life; however, if the debt has been contracted at a variable rate, the ATR is equal to one divided by the number of times interest is paid each year. If this indicator is calculated combined, for fixed rate debt and at variable rate, it is defined as a weighted average of the corresponding ATRs. Clearly, this index rises whenever interest rate hedging operations are conducted, and/or if there is a debt prepayment at variable rate using fixed rate debt.

¹³ In 2009, ATR was 10.2 years.

¹⁴ This model assumes that each of the interest rate and exchange rate variables follows a Geometric Brownian process variant, and that they are inter-related. Based on these premises, an adequate number of Monte Carlo simulations are generated of possible combined paths of these variables, which are used to build a distribution of the accumulated debt service in the selected period.

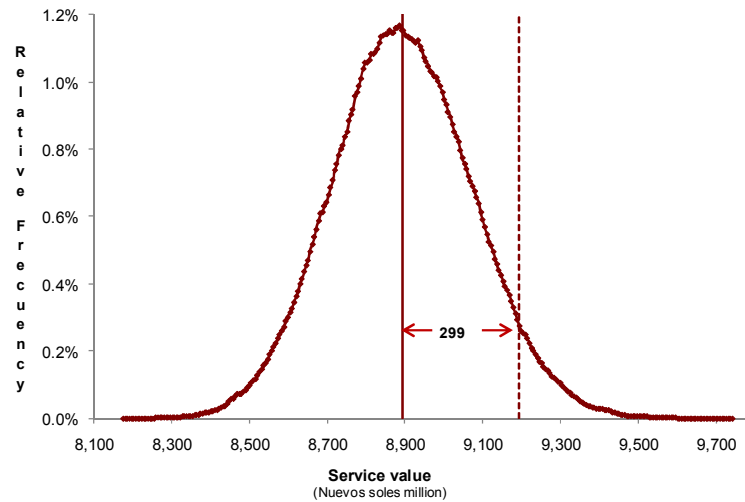
¹⁵ Considering the position of the contracted debt maintained in the portfolio as of the closing date.



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S/.299 million (measured by the difference between 95% and the average), amount representing approximately 3.4% of the proposed service¹⁶.

Chart N° 12
Public debt: Debt obligation service risk for the year 2011



Source: MEF - DNEP

¹⁶ Extending this analysis to the maturities for the 2011-2013 period, the service would total S/ 26 434 million and the probable deviation from this amount amounts to S/.1 486 million, or 5.6% of the total.



Box 1 Achievements of Public Debt Management

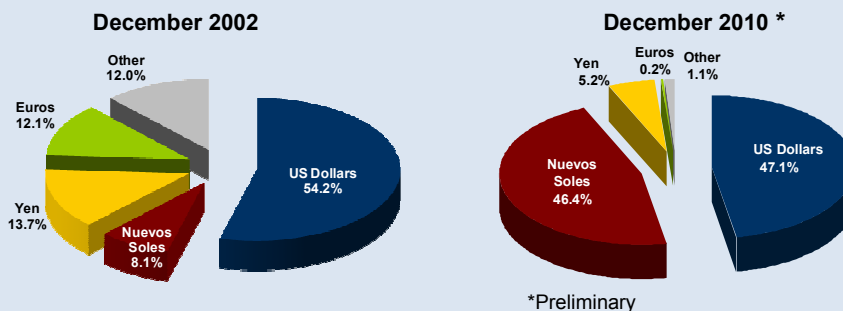
In recent years, through the proactive management of the public debt intended to reduce refinancing and market risk, the achievements, among others, include the gradual modification of the structure of the Republic's obligations portfolio, obtain relief in payments to be made in the coming years, and develop the local sovereign bonds market, one of the chief foundations for strengthening domestic capital markets.

The positive results have been made possible by the combined effect of the implementation of various debt management operations and the ability to capture an increasing amount of funding in Nuevos Soles in the local market.

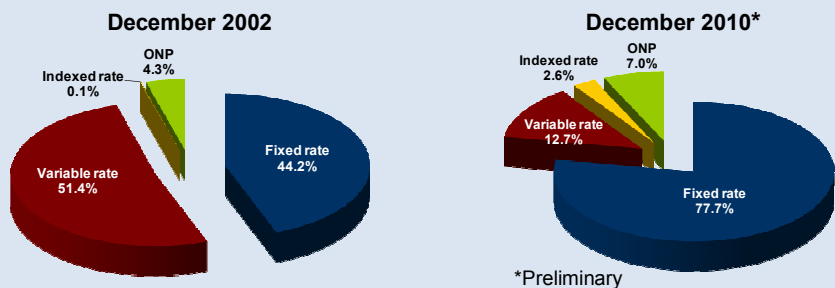
Liability management operations (prepayments, exchanges, hedging, etc.), had an orbital impact on cost reduction and on the mitigation of the risks affecting the liabilities portfolio, smoothing down the profile of payments and protecting the potential impact of an adverse external shocks, which could, via an increase of the debt service, affect the good performance of public finances. In turn, the fact that a significant portion of the financing required to implement some of these operations and to meet the financing needs of the fiscal requirements was obtained through sovereign bond issues in local currency in increasingly longer periods, it has been a key factor to advance towards the goal of boosting the share of Nuevos Soles in the portfolio, and enhancing the development of the domestic capital market.

The achievements made are evident in the pattern followed by some of the following indicators:

- An 8.1% increase in the percentage of Nuevos Soles debt in December 2002 to 46.4% as of December 2010, narrowing the gap between government assets and liabilities, and decisively supporting the process for the de-Dollarization of the economy.



- Reducing exposure to the volatility of interest rates, increasing, in the same period, the percentage of debt agreed to be at fixed rate, from 44.2% to 77.7%. This provides predictability in the scheduling of resources to meet the debt service.





- The refinancing risk mitigation, resulting in a significant relief in the payment of principal and increasing the average life of principal repayment obligations between 2002 and 2010, from 7.4 years to 13.4 years, respectively. In addition, as a result of liability management operations, there was a reduction in the outstanding balance of approximately US\$1,382 million.

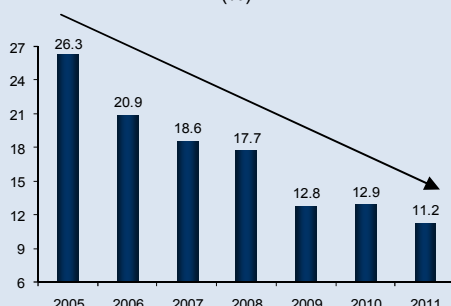
Relief in debt amortization payments

Operations	2002-2010 ¹	2011	2012	2013	2014	2015	2016
Prepayments	317	675	685	717	483	426	153
Exchanges and repurchases	118	179	552	235	750	581	392
Other	46	57	63	33	33	33	33
TOTAL	481	910	1,300	984	1,266	1,040	578

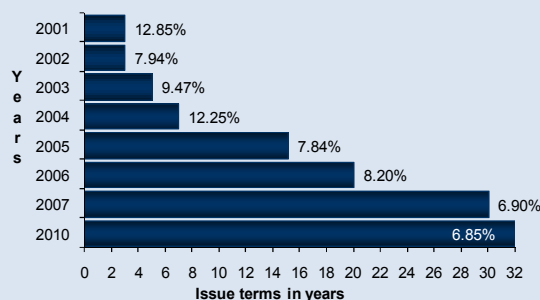
¹ / Period's annual average.

- The deconcentration of maturities has been allowing in recent years, for a reduction in the debt service pressure on the National Treasury, significantly reducing the amounts allocated in the Republic's budget for public debt service (from 26.3% in 2005 to 11.2% in 2011), which implies freeing resources that can be reoriented to meet the high priority needs of the population.
- The development of the domestic debt market, which has allowed for an extension of the yield curve in Nuevos Soles at fixed rate, up to 32 years, providing references for the market, and steadily increasing liquidity and depth in the secondary market.

Debt Service Share of the Budget (%)



Pattern of fixed rate sovereign bonds terms and coupons



3. DEBT STRATEGY

The main objective of public debt management will continue to be to obtain the necessary resources to meet fiscal requirements, consistent with the overall macroeconomic policy, at a minimum cost assuming reasonable levels of risk.

In addition, an ongoing evaluation will continue with respect to actions needed to mitigate liabilities portfolio risk and to reduce its financial costs, primarily through market mechanisms.

On the other hand, considering that due to the effect of proactive risk management in recent years, there have been significant qualitative developments in the public debt structure, the strategy for the next few years will introduce new elements that



will primarily seek to improve the functioning and further development of the public debt market to strengthen its position as a funding source for Government's needs.

The guidelines that will define the debt strategy, which implementation is subject to prevailing market conditions, will be:

- ◆ Continue to increase the share of the debt in Nuevos Soles and the percentage of the fixed rate debt in the liabilities portfolio. (Indicators: share of Nuevos Soles in the debt total, percentage of the fixed rate debt and ATR).
- ◆ Closely monitor the size and structure of repayments, mainly for the next three years (Indicators: ratio of concentration of payment of annual amortizations¹⁷ average life, maturities in the next 12 months and ATR).
- ◆ Strengthen the development of the domestic capital market, through the consolidation of the market of public debt (Indicators: percentage of financing in local currency¹⁸).

The following are the actions that will make it possible to implement these guidelines in 2011, in the various fields of competence of public debt management:

3.1 Indebtedness

According to what was provided in the Pre-Election Report, which includes adjusted figures of the Revised 2011-2013 MMM, for the closing of 2011, the estimated financial deficit of the Non-Financial Public Sector is approximately 0.3% of GDP¹⁹, equivalent to around US\$ 426²⁰ million,. In addition, there are plans for amortization payments worth approximately US\$ 1,213 million²¹.

These needs will be financed through public indebtedness to be incurred with bilateral, multilateral and market sources. The resources to be gathered for these purposes, by issuing bonds, will come derive exclusively from the issuance of sovereign bonds in Nuevos Soles. In the latter case, it is expected that the new indebtedness incurred during the year, which may exceed the amount of the expected requirements, may be used to finance debt management operations and/or pre-finance in 2012.

¹⁷ It measures deviation over and above the maximum predetermined levels of payment of amortizations of the portfolio in the next 5 years. These levels are in line with the growth rate of government's current revenues stipulated in the Revised 2011-2013 MMM. This index which helps evaluate the payments level (refinancing risk) and therefore, a policy on the terms of the new debt to be contracted, weighs the differences, with respect to the maximum levels, based on the term when the maturities occur. A higher weight is given to figures with the closest maturities.

¹⁸ Considering the financing of fiscal requirements and debt management transactions.

¹⁹ Deficit of the Non-Financial Public Sector without Certificates of Recognition of Rights Over the Annual Work Payment (CRPAOs). CRPAOs increase the deficit by US\$ 70 million to US\$ 496 million.

²⁰ Considering a GDP of US\$ 170,057 million.

²¹ Preliminary information adjusted due to the effect of prepayment made in December 2010.



Table N° 2
2011 Financial requirements
To be financed with indebtedness
(US\$ million)

Sources	Amounts
External 1_/	1,235
Free availability 2_/	295
Investment projects	940
Internal	1,470
Bonds 3_/	1,271
Credits 3_/	199
Total	2,705

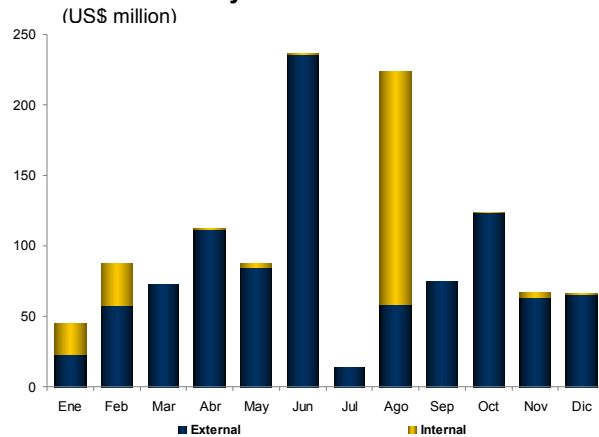
1_/ Not included US\$ 14 million condonations.

2_/ This amount is additional to the pre-financing obtained in 2010.

3_/ Exchange rate: S/. 2.80

Source: MEF- DGAES

Chart N° 13
Public debt:
Monthly amortizations flow



Source: MEF - DNEP

3.1.1 External Indebtedness

Investment projects will be financed, on a priority basis, with funds from loans contracted with multilateral agencies, taking advantage of the expertise and technical assistance these entities provide to borrowers in this field, as well as the favorable financial terms currently available when funding is provided for these purposes.

On the other hand, as part of a preventive policy in place to deal with the impact on financing needs originating from natural disasters or financial crises, as of the closing of 2010, there are contingent lines with such entities, for up to US\$ 1.5 billion.

The following has been planned for 2011:

- Continue to enhance the use of the financial products offered by multilateral agencies, making them compatible with the main guidelines of the debt strategy in regard to timing, cost and currency.
- Not use the international capital market for financing fiscal needs, considering the fact that in 2010, a significant portion thereof was prefinanced.
- Finance debt management operations in the foreign market, only when the local market is not able to provide some or all of the required resources, or for strategic reasons consistent with the comprehensive management of economic policy.



3.1.2 Internal Indebtedness

The plan is to continue to strengthen the role of fixed-rate sovereign bonds as a priority source of fiscal requirements financing. Sufficient flexibility necessary to adapt the strategy to unforeseen situations warranting an unusual behavior of the market to resume its orientation as soon as possible, will be maintained. In this line of thought:

- Sovereign bonds will be issued up to S/. 3,560 million (approximately US\$ 1,271 million). In line with the maximum amount authorized under Law No. 29627²², S/. 2,565 million will be placed to fund financial requirements, and the remaining S/. 995 million will be issued within the scope of Urgency Decree 040-2009²³, as amended, to finance projects in the regional Governments²⁴. Additionally, the possibility of contracting domestic credit up to S/. 556 million has been considered.
- Sovereign bond auctions will be normally held on the third Tuesday of each month, according to the planned schedule of issues (see Annex 2). These dates will only be changed due to market conditions.
- Referential quarterly amounts will be established for bond issuances that will be adjusted according to the progress made in the Program. (See Annex 2). In the case of bonds under Urgency Decree No. 040-2009, collection of resources will occur in accordance with the pace of implementation of works.
- The MEF will continue its effort to maintain ongoing dialogue with market participants, to get to know their specific demands for government papers and to report any changes in the issuance strategy.

3.2 Debt Management

Permanent monitoring of market conditions and their impact on the liabilities portfolio will remain, so as to define the actions to be taken to further improve the debt's cost-risk ratio. Special priority will be given to operations which will increase the position of the local currency in the portfolio. Based on this guidance:

- We will continue, if possible, to replace obligations contracted in previous years with others which terms are favorable as far as cost and risks are concerned.
- The use of the financial instruments offered by the market and the facilities included in credit agreements with multilateral agencies will continue, in order to synthetically increase the fixed rate Nuevos Soles position in the portfolio.

²² Law of the Public Sector's Indebtedness for Fiscal Year 2011. These bonds are placed in accordance with the regulations applicable to the Market Makers Program, in one or more sessions.

²³ Issued within the framework of the Economic Stimulus Program implemented by Government in an effort to add dynamism to the economy.

²⁴ In the case of the bond issuance, which aim is the financing of infrastructure projects in the regions, only an auction is conducted without the possibility of additional assignments.



- Measures will be taken to ensure that the Republic will minimize counterparty risk²⁵ in any hedging transaction carried out, since they involve a relationship that prevails over time. For this purpose, risk quality will be arranged from lowest to highest for the entities with which ISDAs²⁶ have been signed, based on credit ratings²⁷ issued by Standard & Poor's, Moody's and Fitch. Only entities, which when selection is made, are in the top half of the ranking, will be eligible.
- Efforts will continue to be made to ensure that the total volume of swaps kept by the Republic in the debt portfolio is diversified among a larger number of low-risk counterparties.
- Only in the case of debt management operations in the form of exchange and/or repurchase, carried out under market conditions, in which prices play a deciding factor, may the debt stock increase in an amount not greater than 20% of the nominal amount involved in the transaction. This possibility will be considered provided that such operations meet the condition of replacing external obligations with Nuevos Soles denominated domestic obligations. This guideline is consistent with the need to seek new mechanisms to increase the Nuevos Soles position in the liabilities portfolio, without significantly affecting the downward trend of the Public Debt / GDP ratio.

3.3 Development of Public Debt Market

In recent years, public debt management set priorities for the handling of risk, which have significantly contributed to the improvement of the country's credit rating.

To the extent that progress has been successfully achieved in order to reduce the concentration of amortization maturities for the years immediately ahead, there is greater scope for adjustments to be made to the bond issuances policy, in order to adapt it to the new challenges posed by the development of the local debt market, without generating greater exposure to the refinancing risk, which may be defined as tolerable.

Accordingly, the debt strategy for the coming years includes playing a more active role, particularly in the development of the short and medium sovereign curve to provide references to the market in that segment.

²⁵ Defined as the possibility that one of the parties to a financial agreement fails to live up to its agreed obligations.

²⁶ International Swap Dealers Association, Inc. Master Agreement. This is a standard agreement configuring a contractual framework to carry out hedging operations. It sets forth the definitions and general conditions that regulate any derivative entered into by the parties. To date, 16 banks have the legal framework to carry out this type of transactions.

²⁷ This measures the payment capacity and willingness of an issuer to fully and punctually meet its payment obligations. It has been ascertained that, unlike the case of the Credit Default Swaps, which are volatile indicators, credit rating is more relevant, since it reflects a structural evaluation of the institution.



Box 2 Public debt's domestic market

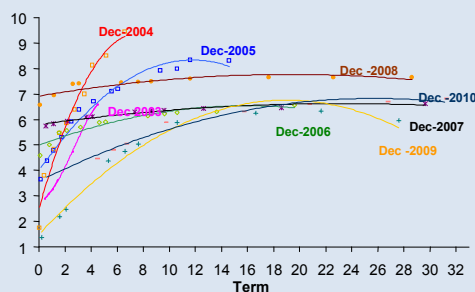
In late 2000, domestic public debt represented 14% of the total medium-and long-term public debt; however, a major part thereof related to obligations contracted in U.S. Dollars, reflecting the Peruvian economy's high dollarization level. Thus, in terms of risk, the portfolio's real exposure to currencies other than the Nuevo Sol, in practice, amounted to approximately 94% of the total debt.

As part of the strategy for the de-dollarization of the economy, public indebtedness policy in 2001 took the first steps to cover part of the resources needed by the non-financial public sector, through Nuevos Soles denominated bond issuance placed in the local market. With this approach, in early 2003, Peru formally began the Market Makers Program, whose purpose, in addition to developing public debt market in local currency, was to establish a yield curve to serve as a reference for private sector issues and for mortgage lending.

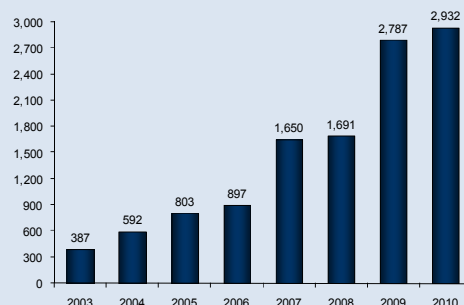
The results obtained from the Market Makers Program are more than encouraging, since, to date they have made it possible to:

- Extend the yield fixed rate Nuevos Soles curve from 5 years in 2003, to 32 years in 2010, allowing our country to be the only economy in the region with government papers in that term.
- To increase secondary market liquidity, as reflected in the significant increase in sovereign bond trading, which rose from a monthly average of S/. 387 million in the year 2003, to a monthly average of S/. 2,932 million in 2010, confirming the market's confidence in the strength of our macroeconomic fundamentals.

**Fixed Rate Sovereign
Yield Curve**
(%)

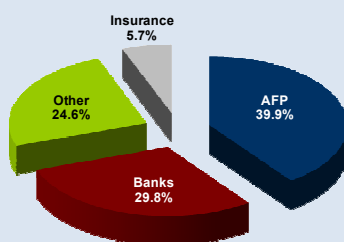


**Trading in the Secondary
Market**
(Nuevos Soles million)

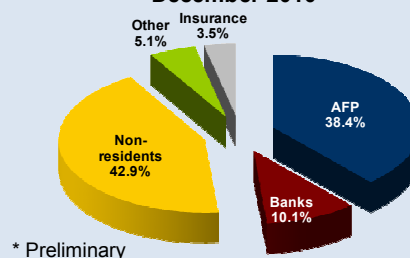


- Significantly increase the share of non-resident investors, which, from being non-existent in 2003, went up to 42.9% as of December 2010.

December 2003



December 2010 *



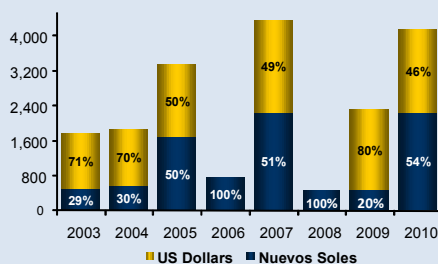
* Preliminary



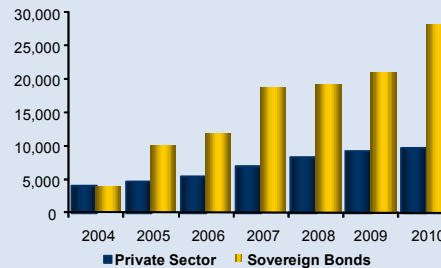
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- Play a major role in the financing of fiscal requirements and debt management operations (42% of the total captured in the capital markets) through the issuance or reopening of fixed rate Nuevos Soles instruments.
- Contribute to the process of de-dollarization of the economy, encouraging private issuers to venture into local currency issues.

**Share of local bonds in financing
obtained in the capital markets**
(Nuevos Soles million)



**Private Sector
and Public Sector Issuances**
(Nuevos Soles million)



This will continue to promote actions that will contribute to the further development and efficient operation of the public debt market and thus strengthen the local capital market, which could include:

- Making efforts in the future, to permanently provide references to the market along the fixed-rate sovereign curve, favoring the short end and medium end, around the two to five year range. It is by keeping this new perspective that the new 2013 domestic sovereign bond will be issued, up to a ceiling of S/. 1.0 billion during 2011 and reopening the 2015 domestic sovereign bond, up to S/. 1.0 billion.
- The process will continue for the consolidation of the liquidity of long-term benchmark bonds in the secondary market, with special emphasis on increasing the level of balances due on those references with amounts lower than S/. 4.0 billion. To that end, priority will be given to reopen the 2031 and 2042 bonds series.
- Local debt exchanges will be made primarily for the purpose of increasing the liquidity of benchmark points. Endeavors will be made so that such operations will become regular practice for debt management, as they will help having a more efficient market, as well as enabling holders to adjust their positions to the needs of their investment portfolios.
- Only with the purpose of raising special funds for liability management operations, will it be considered to place government papers through the syndication mechanism²⁸. The MEF will conveniently advise the Program's participants, if applicable, as to the selection criteria and the terms to govern the implementation of such mechanism.

²⁸ Bond issues with the participation of several financial institutions grouped in a syndicate, which liability will be assumed by a single institution acting as the leader. Unlike the case of auctions the Republic would offer an indicative price.



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- References for actual rates will continued to be offered to the private sector, through the reopening of inflation-indexed bonds (VAC), in order to provide more instruments that will allow for risk diversification. To that end, the 2046 sovereign bond will be reopened in an amount not greater than S/. 350 million²⁹.
- The new Regulations governing the Market Makers Program and the Regulation for the Issuance and Placement of Sovereign Bonds in the Market are going to be published. They will be consistent with the current context and seek to promote greater competition among the participating entities.
- The possibility of the creation of strippable bonds (strips³⁰) will be explored, and a more active role will be played in the coordination with relevant entities (Superintendency of Banking and Insurance, National Commission for the Supervision of Companies and Securities, Central Reserve Bank), for a joint assessment of the possibility of implementing other instruments that will contribute to the efficient development of capital markets.
- The possibility of designing a program for the direct sale of sovereign bonds to the public will soon be evaluated, to encourage savings and to configure an investment alternative for small and medium savers. This program would also allow for an expansion and diversification of the investors base.
- Enhanced communication with local and foreign investors will be sought, through conference calls and/or periodical presentations, to directly provide information on economic developments and prospects, as well as about public debt management.

²⁹ Taking into account the total amount to be placed in sovereign bonds for this year, if the entire amount is issued, the current debt proportion at VAC rate (8,78%) within the Nuevos Soles denominated portfolio would be at approximately 9,10%, as of December 2011.

³⁰ Strip: Separately Trade Registered Interest and Principal. Strips are financial instruments created on the basis of fixed-income titles, such as bonds, arising from the segregation of the flows corresponding to the payment of each coupon and principal payment, with each of these flows giving rise to a zero-coupon title (strip). Therefore, it is possible to obtain as many implicit yield titles (strips), as there are coupons in a bond, plus the strip corresponding to the principal. In this case, an evaluation will be done of the mechanisms allowing for sovereign bond holders to be able to change their current position for other titles which segregation is possible.



Box 3 Market Makers Program (PCM)

- During 2011, the following institutions will participate in the PCM: Banco de Crédito del Perú, BBVA Banco Continental, Banco Internacional del Perú, Citibank del Perú, Deutsche Bank Perú and Scotiabank Perú. New institutions may join throughout the course of the year.
- The PCM holds auctions on a monthly basis, mainly conducted on the third Tuesday of each month.
- Bonds are adjudicated under Dutch Auction rules.
- Settlement of the auctioned bonds takes place on T+1.
- Interest and capital gains deriving from the bonds will not be subject to income tax.
- The Auction Notice will be published to the market one day prior to the placement; and the results will be reported on the day of the auction. In both cases, dissemination of this information will be accomplished through the MEF web site, at the following link: http://www.mef.gob.pe/contenidos/deuda_public/emision2011.php
- The fixed rate benchmark sovereign bonds in effect for 2011, are as follows:

Denomination	Original Term (years)	Coupon Rate (%)	Outstanding (Nuevos Soles thousands)
5-May-15	10.0	9.91	1,586,627
12-Aug-20	15.1	7.84	8,830,637
12-Aug-26	20.3	8.20	4,314,353
12-Aug-31	23.3	6.95	2,675,239
12-Aug-37	30.0	6.90	4,750,000
12-Feb-42	32.0	6.85	2,102,300

4. DEBT STRATEGY'S QUANTITATIVE GOALS

4.1 Current context and outlook

The weak economic recovery evident in the U.S.A., the Eurozone and Japan³¹, and the debt problems prevailing in some European countries, have delayed the short-term interest rate hikes expected worldwide in late 2010. The current market outlook is that the central banks will keep their reference interest rates at their lowest historical levels³², at least until the fourth quarter of 2011.

However, it is worth noting the significant and rapid increase in long-term US Dollar interest rates taking place since late 2010, in response to a more positive economic outlook in the U.S.A., the recent agreement to cut down on taxes and its impact on the fiscal deficit and the possibility of inflation pressures in the medium term as a result of the current expansion-oriented monetary policy. Despite signs of an improvement in the economy, it will not be sufficient for the Federal Reserve, which will reportedly make no changes to its bond purchase program announced, up to US\$ 600 billion, thus helping to mitigate the increase in long-term interest rates.

³¹ For 2010, the estimate is 2.8% growth for the U.S.A., 4.3% for Japan and 1.7% for the Euro Zone.

³² U.S.A. 0.25%, Euro Zone 10% and Japan 0.10%.



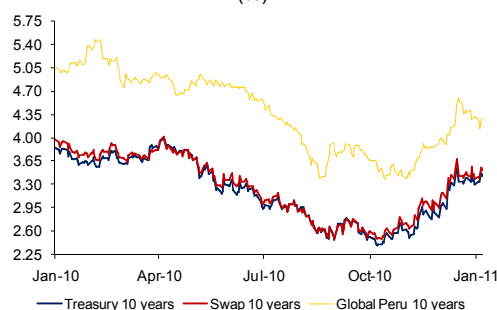
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Table N° 3
US\$ interest rate
(%)

Dates	10-year Treasury Bond	3-month Libor	Reference rate
Current	3.38	0.30	0.25
I-11	3.17	0.37	0.25
II-11	3.25	0.41	0.25
III-11	3.37	0.51	0.25
IV-11	3.53	0.71	0.50

Source: Bloomberg

Chart N° 14
US\$ interest rates evolution
(%)



The increase in these rates and the debt problems prevailing in Europe have led to an increase in the emerging countries' cost of borrowing in US Dollars, which could remain unchanged throughout 2011. This scenario would not have a significant impact for the Republic, because some of the financial requirements for the year, were already prefinanced in the foreign market in 2010. On the other hand, low levels of short-term US Dollar interest rates and rising long-term rates would generate an increase in initial cost (a "negative carry") which would have to be assumed if rates interest hedging (from variable to fixed) is performed³³, which would delay the decision to conduct operations of this nature.

With regard to currencies like the Euro and the Yen, it is expected that the Euro will remain close to its current US\$ 1.33 level; while the Yen shows a depreciation against the US Dollar, reaching levels of 90 Yen per US Dollar. Accordingly, no significant variations are expected in the amount of resources that would be required, to meet the payment obligations that remain in the portfolio agreed upon in such currencies.

At the local level, economic activity continues to grow faster than its potential, in an environment featuring an acceleration in private spending. In this context, in line with what the market expected, the Central Bank resumed increases in its reference rate in the first quarter of 2011, to gradually take it to a neutral level.

³³ Because a higher fixed rate would have to be paid instead the low variable rate levels. Since approximately 77% of the public debt has been agreed at fixed interest rates, this type of risk is minimal; and thus, it would not warrant, for the time being, incurring any additional costs. Nonetheless, if the risk presumably to be mitigated is significant, such as the exchange rate (through currency swaps that will convert the flows to Nuevos Soles), the evaluation criteria should be different.

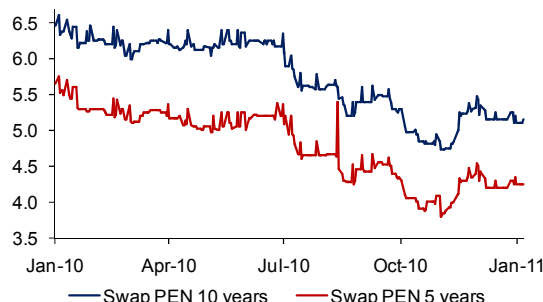


Table N° 4
Nuevos soles interest rate
and exchange rate
(%)

Dates	Nuevos soles rate (BCRP)	Nuevos soles/USD Exchange rate
Actual	3.25	2.79
I-11	3.25	2.80
II-11	3.50	2.75
III-11	3.75	2.69
IV-11	4.00	2.67

Source: Bloomberg

Chart N° 15
Nuevos soles Libor evolution
(%)



This scenario coupled with the positive outlook of the external accounts³⁴ would continue to push down the exchange rate. While it is true that the increase in interest rates by the Central Bank (BCRP) would impact on the short end of the yield curve and thus generate a rise in the long end, the expectation of an appreciation of the Nuevo Sol would attract a higher demand for local currency sovereign bonds by foreign investors, which could limit a disproportionate increase in long-term rates.

The appreciation of the Nuevo Sol and its potential effects on an inflow of capital would play in favor of a reduction in interest rates in Nuevos Soles taken as reference to price domestic currency hedging operations, a situation which would make the Republic consider taking a more active role in such operations.

4.2 Goals range quantification scenarios

In order to measure the effectiveness of the action lines defined in the strategy for achieving the debt management objectives, a targets reference range was estimated to monitor the evolution of some portfolio risk indicators as of the closing of 2011. The reference range, with minimum and maximum values, within which indicators must be, depending on market conditions, has been defined based on three alternative scenarios considering certain assumptions about the development of the economy, the amount of financing needed to meet fiscal needs and the undertaking of potential debt management operations, as well as prospects of the local and international financial markets that will define the access and the terms under which the new indebtedness will be captured.

The baseline scenario considered is a rather conservative position (given the recent developments in macroeconomic variables), in line with the assumptions made in the Revised 2011-2013 MMM. In this scenario, the average GDP growth estimated for the period is 5.5%, with an average inflation of 2.0%, in line with the BCRP goal; and an average exchange rate of S/. 2.80 per US Dollar. Moreover, in line with these projections, the fiscal deficit is expected to average 0.3%, with a downward trend to return until a surplus position is again taken in 2013. This scenario is consistent with the

³⁴ Commodity prices would remain at their current levels, with a slight rising trend.



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moderate growth prospects of our business partners, because of uncertainty about the sustainability of global economic recovery, the consequences of fiscal adjustment measures taken by the more advanced countries, and a correction in commodity prices. In this context, the financing of the fiscal requirements for the year would be covered under appropriate conditions, as well as the need for the implementation of debt management operations.

In the optimistic scenario, GDP would grow at an average rate of 6.2%, average inflation would be 2.0% and the average exchange rate would be S/. 2.73 per US Dollar. The good performance of the economy, would attract more revenues to the Treasury, and this would make it possible to obtain an average fiscal surplus of 0.5%, which would be attained as from 2012. Although this scenario assumes that the rather uncertain international environment would prevail, the greater dynamism of the economy would be driven by a better performance, mainly of private demand, especially as a result of higher execution of the investment projects announced for the coming years. In this case, lower financial requirements would be covered and a greater amount of the liability management operations would be executed, under more competitive conditions than those of the baseline scenario.

The pessimistic scenario assumes a less favorable trend of the macroeconomic variables and a slower than expected recovery of the global economic. This will affect the agents' expectations, resulting in a slower growth in private spending, mainly due to the lower investments and/or the postponements thereof. The terms under which fiscal requirements financing and liability management operations may be obtained would be less advantageous.

Table No. 5 shows the target reference ranges expected to be achieved by the end of 2011, which have been determined based on financing strategies that reflect the main public debt management orientation guidelines, which implementation will subject to prevailing market conditions.

Table N° 5
Reference quantitative goals as of the closing of 2011

Item	December 2010 1_/_	December 2011
Percentage of Nuevos Soles in the portfolio	46.4%	49.6% - 54.0%
Percentage of fixed rate debt in the portfolio	77.7%	76.6% - 77.9%
Average life (years)	13.4	12.7 - 13.3
ATR (years)	12.4	11.3 - 12.0
Concentration of amortizations in the next 12 months 2_/_	3.8%	4.1% - 3.9%
Annual amortization payment concentration rate 3_/_	0.0%	0.3% - 0.0%
Percentage of financing with local currency 4_/_	46.8%	64.4% - 73.4%

Source: MEF- DNEP

1_/_ Preliminary figure determined on the basis of September 2010 data, plus the effect of transactions carried out as of December 2010 and net indebtedness (disbursements less amortizations) for the fourth quarter of the year.

2_/_ Indicator that measures the most immediate pressure on payments.

3_/_ Measures the deviation of the portfolio's amortizations payments over and above predetermined maximum levels. This indicator allows for an evaluation of the payments pressure for the next 5 years (refinancing risk), representing an additional element to define policy over the terms for the new debt to be contracted.

4_/_ Includes the financing of the debt management transactions.



5. QUANTIFICATION OF THE PORTFOLIO'S RISKS FOR THE YEAR 2011

This section aims to quantify the risks to which the debt portfolio would be exposed at the end of 2011, from a dynamic perspective, which incorporates a specific strategy for financing fiscal needs and for liability management, consistent with the expectations of the base scenario.

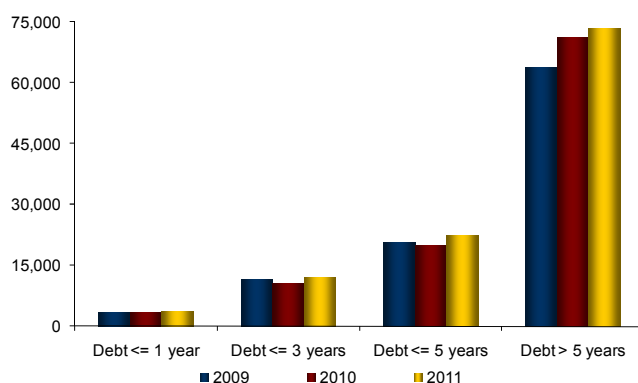
5.1 Refinancing risk

By the end of 2011, there would be a slight increase in the payments to be made in the next 5 years. These results are consistent with the new view to deliver in the short end and medium end of the sovereign curve, with the aim of supporting the development of the capital market, providing better information to private issuers.

The implementation of this new strategy is possible thanks to the policy implemented in recent years to reduce the concentration of payments which was one of the major risks being faced. Thus, despite the increase in absolute terms which result in schedule of maturities for the next 5 years, their magnitude would be manageable, as they represent 23.4% of the total debt, down from 26.3% the year before. This reduction in relative terms is compounded by the fact that these payments' currency structure would involve less risk.

Also contributing to this result is the increase to 76.6% (compared to the previous 73.7%) in the percentage of debt maturities over 5 years, explained by the 2050 global bond issue. In line with higher debt maturities obtained, it is expected that in the baseline scenario, the portfolio average life would be at about 13 years, above historical levels for this indicator.

Chart N° 16
Debt portfolio maturity term
(Nuevos soles million)



Source: MEF- DNEP

5.2 Market Risk and Cost Analysis

Further progress is expected to be made to mitigate currency risk by increasing the Nuevos Soles share in the portfolio at levels of approximately 54% at the end of 2011. This would represent a significant progress being



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made, compared to the rates reported in previous years, but still not sufficient to consolidate a low-risk position, according to the parameters being handled by some rating agencies. (See Chart N° 17).

Increasing this ratio is one of the main challenges of managing public debt, and it becomes more compelling in a context of lower borrowing requirements and a sustained rate of investment projects financing using external funds from multilateral and bilateral credit sources. In that sense, the possibility of financing a greater proportion of investment projects with domestic currency should be considered in the near future, as well as use other financially viable mechanisms that will allow for an increase in this position.

Chart N° 17
Evolution of portfolio composition
by currency

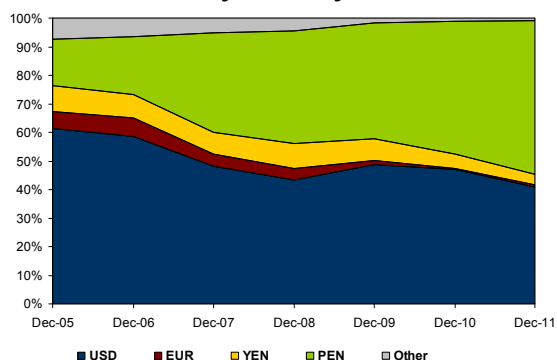
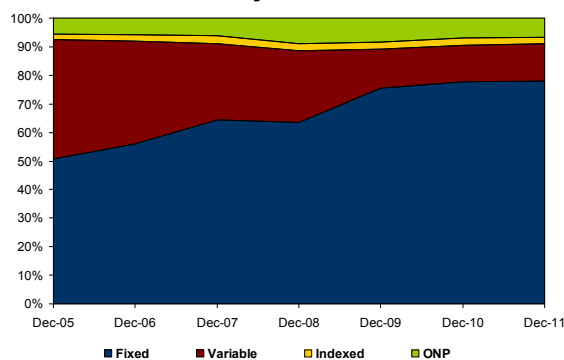


Chart N° 18
Evolution of portfolio composition
by rates *



Source: MEF- DNEP

* Indexed debt includes Sovereign Bonds (24%) and ONP Bonds (76%)

On the other hand, it is estimated that the agreed fixed rate debt would remain at roughly its current 77.9% rate, thus providing predictability to the payment of interest on the debt. (See Chart N° 18).

A measure of the historical behavior of the foreign exchange risk associated with the public debt stock³⁵, makes it possible to corroborate the downward trend, consistent with the gradual increase in the Nuevos Soles share in the portfolio and reducing the percentage of the currencies that exacerbate such risk, such as the Yen and the Euro, mainly. By the end of 2011, to drop significantly higher than the previous year's is expected, explained by the Nuevos Soles target percentage estimated for the year. (See Chart N° 19).

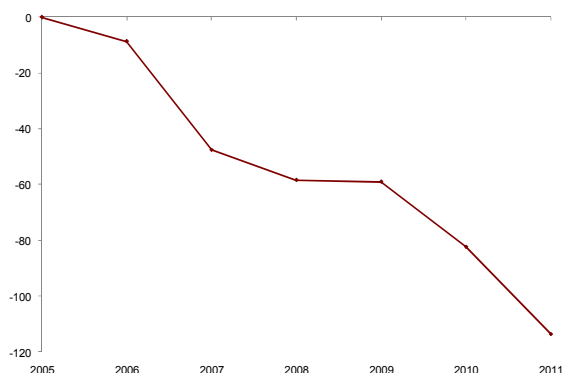
³⁵

In 2005, to quantify this risk a reference parameter was taken into account, in the form of the composition of the public debt by currency. Supposing that such composition is constant, a calculation is made of the variations of currency percentages in the portfolios of the following years, compared to 2005, also assuming a 1% appreciation of the US Dollar, the Yen and the Euro, compared to the Nuevo Sol in order to obtain any differences between the two positions.



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Chart N° 19
Risk variation in the debt stock
(US\$ million)



Source: MEF- DNEP

Furthermore, under the assumptions made, risk analysis in the debt service, with a confidence level of 95%, yields an estimate for the year 2011, of about S/. 8,833 million. The expected volatility and the correlation between rates and currencies that are part of the maturities to be dealt with, could potentially involve an expenditure higher than the expected service, of approximately S/. 264 million (3.0% of estimated payments)³⁶.

Moreover, an exercise was conducted to assess the cost, in terms of Nuevos Soles, of the 2011 debt portfolio; and in preliminary fashion, for 2012 and 2013, based on the balance due at the end of 2010, in Nuevos Soles. The domestic currency financing cost takes into account the potential growing development of interest rates³⁷ and the exchange rate's expected stability.

The average cost of the debt portfolio, measured in Nuevos Soles, is defined as the interest payments on the debt plus the additional amount which could be generated as a result of variations in exchange rates and interest rates. This excess, which is defined as a risk, was calculated taking into account the stochastic pattern of interest rates and exchange rates as well as their joint correlation³⁸.

Table N° 6
Cost and risk of public debt
Period 2011-2013

Year	Average Cost	Risk	Maximum cost
2011	5.58%	0.27%	5.85%
2012	5.64%	0.23%	5.87%
2013	5.76%	0.22%	5.99%

Source: MEF- DNEP

³⁶ For the 2011-2013 period, the estimated amount of the debt service would be S/. 29,250 million. The additional amount which could be incurred, would be approximately S/. 1,436 million.

³⁷ Variable outstanding debt rates and fixed rates related to the new financing, which would increase the debt cost in the coming years.

³⁸ The financial cost risk in Nuevos Soles terms, is defined as the maximum cost (at 95% confidence), less the average cost.



Consequently, an average cost of 5.6% was obtained for 2011, which could reach a peak of 5.9%, at a 95% confidence level. The portfolio's average cost would increase over the next two years as a result of debt management strategy that would give priority to taking on new debt or converting from existing debt at fixed rates, which reduces volatility and therefore risk.

6. DEBT RATIOS, SUSTAINABILITY INDICATOR AND AMORTIZATIONS PROFILE

Table No. 7 shows the expected behavior under baseline scenario assumptions, for some ratios relating to **medium and long-term** public debt versus GDP, from a dynamic perspective. These indicators provide a vision, in relative terms, of the debt's budget sustainability.

Table N° 7
Ratios of the medium and long term public debt
(In GDP percentage)

	2010	2011	2012	2013
Base scenario				
Medium and long term debt/GDP	22.7%	22.2%	21.3%	19.9%
Medium and long term service/GDP	2.0%	1.9%	1.9%	1.9%
Medium and long term amortizations/GDB	0.8%	0.8%	0.8%	0.8%
Medium and long term interest/GDP	1.2%	1.2%	1.2%	1.1%

Source: MEF- DNEP

As expected, after the increase experienced in 2009, due to the higher expenditure incurred to deal with the effects of the financial crisis, the debt ratios would be resuming the downward trend prevailing in previous years. Worth noting is the substantial reduction which would be observed in this indicator in 2010, which would equal 22.7%, compared to that of the end of 2009, which was 25.0%, especially considering that the debt stock includes the US\$ 1.0 billion raised as 2011 prefinancing.

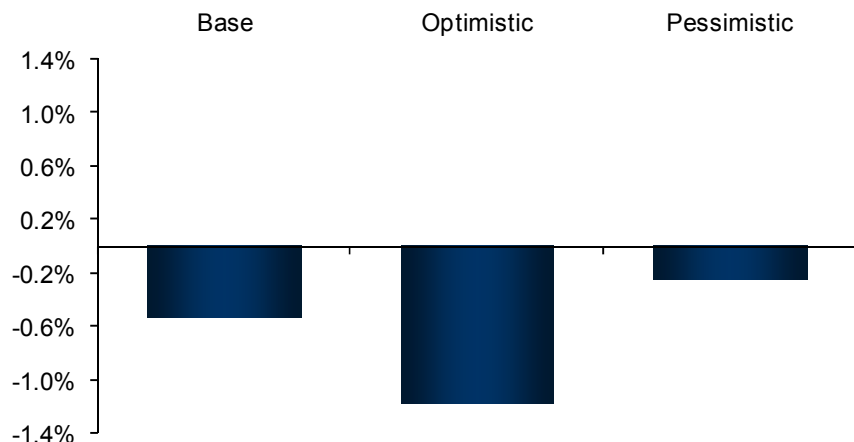
An analysis of the behavior of the **medium and long term** public debt ratio, through the sustainability indicator³⁹, it can be inferred that in all scenarios considered, under the assumptions made, the medium and long term public debt is sustainable. These results are predictable, if one takes into account that the country's growth prospects are very positive and that the management of fiscal policy would further reduce the financing needs and thus the relative weight of the public debt, even in the pessimistic scenario, which assumes a less favorable development of the macroeconomic variables. See Chart N° 20.

³⁹ This indicator is defined as the difference between the primary equilibrium surplus and the weighted average of the projected primary surpluses, as GDP ratios. The equilibrium surplus is that which ensures that the debt ratio will be constant through time. If the indicator has a negative sign, then the medium and long term public debt is sustainable.



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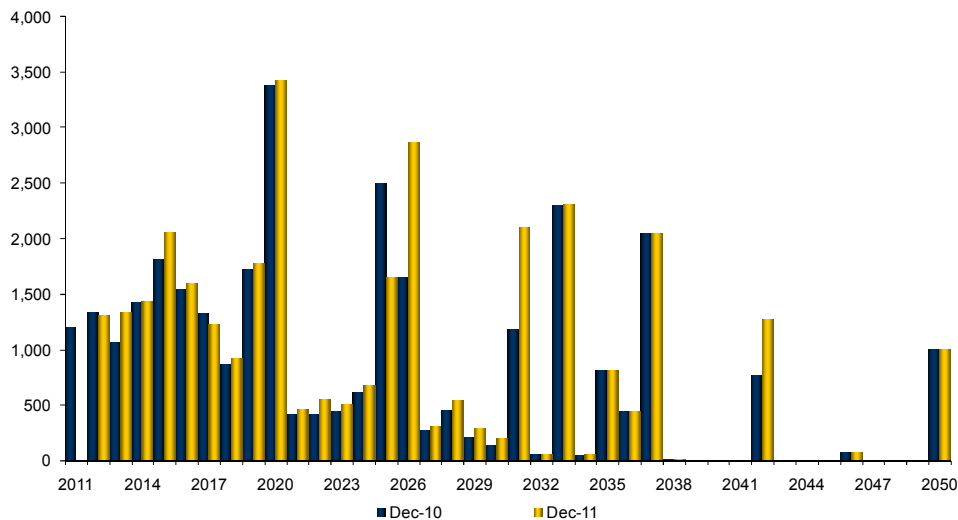
Chart N° 20
Sustainability indicator for medium and long term public debt
(GDP percentage)



Source: MEF- DNEP

Chart No. 21 shows the maturity profile of the dynamic public debt, which includes active debt flows generated by the new indebtedness that would be incurred in 2011 to fund any financial requirements and the liability management operations planned for this year. As noted, in line with the new strategy that would be followed to strengthen especially the short end and medium end of the local sovereign curve, there would be a slight increase in debt service payments in the coming years regarding the status of the debt obligation. A greater amount of maturities can be also observed in years further away, as a result of the policy favoring the issuance of certain sovereign securities in the long end of the curve, to instill more liquidity in them.

Chart N° 21
Projection of dynamic public debt amortizations
(Nuevos Soles million)



Source: MEF- DNEP



7. PRELIMINARY EVALUATION OF 2010 DEBT STRATEGY

In 2010, in addition to obtaining the necessary resources to finance the fiscal needs, debt management continued to focus its attention on improving the cost-risk ratio of the portfolio, to which effect, it carried out certain liability management operations both locally and externally.

It is worth noting that 100% of the total financing was required to carry out operations involving the use of resources, such as prepayments and repurchases, originated from the issuance of fixed rate bonds in the local market. In such cases, not only there was a reduction in the financial cost of the debt and/or a generation of payments relief over the following years, but also an additional impetus was afforded to the efforts being made to increase the Nuevos Soles share in the liabilities portfolio, as an essential element to further reduce the vulnerability of public finance through a better match between Government assets and liabilities.

On the other hand, considering the good conditions offered by the market, and the potential volatility that may be faced during the first half of 2011 as a result of the upcoming election process, it was decided to pre-finance part of the financial requirements of that year, through the issuance of a new global bond for US\$ 1 billion, in the international market, maturing in 2050. Thus, the new administration will have the resources necessary to easily deal with cash requirements.

Table No. 8 provides a **preliminary measure** of the impact of the policies implemented in 2010 and their contribution to achieving the goals that were established for some of the portfolio's risk indicators at year end.

Table N° 8
Evaluation of reference quantitative goals
considered in the 2010 PAEAD

Item	December 2010 PAEAD Goal	December 2010 1_/
Percentage of Nuevos Soles in the portfolio	43% - 45%	46.4%
Percentage of fixed rate debt in the portfolio	73% - 82%	77.7%
Average life (years)	11 - 12	13.4
ATR (years)	10 - 11	12.4
Rate concentration of annual amortization payment	8% - 3%	0.0%
Percentage of financing in local currency	42% - 53%	46.8%

Source: DNEP – MEF

1_/ Preliminary figure determined on the basis of September 2010 data, plus the effect of transactions carried out as of December 2010 and net indebtedness (disbursements less amortizations) for the fourth quarter of the year.

The analysis of the results shows a positive and encouraging balance, as the levels of the indicators would be pegged within the range or in some cases above the upper limits of the ranges specified in PAEAD 2010. Worth highlighting due to its relevance, is the increase in the proportion of the Nuevos Soles debt to 46.4%, which is explained by the sovereign bonds placed to finance the prepayment of certain debts kept with bilateral and multilateral credit sources⁴⁰. This new position

⁴⁰

It should be noted that level of this indicator dropped due to the increase of the debt balance owed as of the 2010 closing, as a product of the issuing of a US\$ 1 billion bond in the form of pre-financing. An exercise performed,



helps reduce the risk of the debt portfolio and provides a sort of shield against external events which may threaten to weaken the fiscal accounts.

Consistent with these results, the financing percentage in Nuevos Soles increased significantly over the previous year (from 24.6% to 46.8%) strengthening the role of the bonds in domestic currency as an alternative funding source, while the fixed rate debt was at the midpoint of the range, with a percentage close to 80%, a level considered by some rating agencies as an indicator denoting a position of low risk with respect to the potential fluctuations of interest rates. The indicator value to refix rates would reinforce this assessment.

In turn, the average life, despite its natural reduction due to the passing of time, experienced significant growth, explained by a major increase in global bond issues to 40 years, in the international market. This indicator, which currently stands at 13.4 years, one of the longest in the region, provides the space needed to act more actively in the short end of the local sovereign curve, without incurring a significant reduction in the level attained.

The amortization variation factor exceeded expectations, not just because of the substantial relief obtained in management liabilities operations, but mainly due to the substantial improvement in Government revenues, which reduced the relative weight of the payments for the next 5 years.

For 2011, it is expected that the levels of these indicators will continue to maintain the pattern shown in recent years, reflecting the effectiveness of the actions being implemented under public debt management.

excluding the effect of this placement, indicated that the Nuevos Soles proportion of the portfolio would cause a 47.7% increase.



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Annex 1

Table N° 1

Public debt: Outstanding by financing source*

Financing Source	Amount (Mill.US\$)	Amount (Mill. S/.)	%	Average Life (years)	Duration (years)	ATR (years)	Equiv. Rate (%)
External Debt	19,705	55,804	100.0	12.1	7.5	10.5	5.7
Bonds	9,386	26,582	47.6	18.1	9.4	18.1	7.5
Multilateral	7,519	21,294	38.2	6.7	5.3	2.5	4.0
Paris Club	2,524	7,148	12.8	7.0	5.2	7.0	3.9
Others	275	780	1.4	4.4	3.3	0.9	3.1
Domestic Debt	13,719	38,851	100.0	15.6	9.2	15.6	5.2
Bonds	13,349	37,805	97.3	16.0	9.4	16.0	5.2
- ONP	2,538	7,187		0.0	0.0	0.0	0.0
- Sovereign	9,975	28,251		16.3	9.5	16.3	5.3
- Others	836	2,368		12.8	8.3	12.8	4.6
Credits	370	1,046	2.7	3.9	3.6	3.9	3.6
Total Debt	33,424	94,656		13.4	8.1	12.4	5.5

Source: MEF-DNEP

*As of November 30, 2010, considering the hedge operations.

Table N° 2

Public debt: Outstanding by currency*

Currency	Amount (Mill.US\$)	Amount (Mill. S/.)	%	Average Life (years)	Duration (years)	ATR (years)	Equiv. Rate (%)
External Debt	19,705	55,804	100.0	12.1	7.5	10.5	5.7
Dollars	15,573	44,102	79.0	13.8	8.2	11.8	6.1
Yen	1,756	4,972	8.9	6.8	5.1	6.8	4.1
Nuevos Soles	1,893	5,361	9.6	4.9	4.2	4.9	5.9
Others	399	1,129	2.0	5.7	1.3	5.3	2.1
Domestic Debt	13,719	38,851	100.0	15.6	9.2	15.6	5.2
Nuevos Soles	13,586	38,477	98.8	15.7	9.3	15.7	5.1
Dollars	132	375	1.2	5.1	4.2	5.1	8.0
Total Debt	33,424	94,656		13.4	8.1	12.4	5.5

Source: MEF-DNEP

*As of November 30, 2010, considering the hedge operations.

Table N° 3

Public debt: Outstanding by interest rate*

Rates	Amount (Mill.US\$)	Amount (Mill. S/.)	%	Average Life (years)	Duration (years)	ATR (years)	Equiv. Rate (%)
External Debt	19,705	55,804	100.0	12.1	7.5	10.5	5.7
Fixed	15,945	45,156	80.9	12.9	7.6	12.9	6.2
Variable	3,760	10,648	19.1	8.8	6.7	0.5	3.6
- Libor	2,494	7,064	12.7	8.3	6.3	0.5	3.8
- Multilateral	1,205	3,413	6.1	9.5	7.3	0.5	3.3
- Others	60	171	0.3	15.6	10.8	0.5	4.0
Domestic Debt	13,719	38,851	100.0	15.6	9.2	15.6	5.2
Fixed	10,295	29,157	75.0	15.3	9.1	15.3	5.1
VAC	886	2,508	6.5	19.0	10.2	19.0	6.3
ONP	2,538	7,187	18.5	0.0	0.0	0.0	0.0
Total Debt	33,424	94,656		13.4	8.1	12.4	5.5

Source: MEF-DNEP

*As of November 30, 2010, considering the hedge operations.



PERU

Ministry
of Economy and FinanceVice Minister
of FinanceNational Directorate
of Public Indebtedness

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Annex 2

2011 Issuance Schedule

January 2011							February 2011							March 2011						
M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S	S
					1	2		1	2	3	4	5	6		1	2	3	4	5	6
3	4	5	6	7	8	9	7	8	9	10	11	12	13	7	8	9	10	11	12	13
10	11	12	13	14	15	16	14	15	16	17	18	19	20	14	15	16	17	18	19	20
17	18	19	20	21	22	23	21	22	23	24	25	26	27	21	22	23	24	25	26	27
24	25	26	27	28	29	30	28							28	29	30	31			
31																				
April 2011							May 2011							June 2011						
M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S	S
				1	2	3							1			1	2	3	4	5
4	5	6	7	8	9	10	2	3	4	5	6	7	8	6	7	8	9	10	11	12
11	12	13	14	15	16	17	9	10	11	12	13	14	15	13	14	15	16	17	18	19
18	19	20	21	22	23	24	16	17	18	19	20	21	22	20	21	22	23	24	25	26
25	26	27	28	29	30		23	24	25	26	27	28	29	27	28	29	30			
							30	31												
July 2011							August 2011							September 2011						
M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S	S
				1	2	3	1	2	3	4	5	6	7			1	2	3	4	
4	5	6	7	8	9	10	8	9	10	11	12	13	14	5	6	7	8	9	10	11
11	12	13	14	15	16	17	15	16	17	18	19	20	21	12	13	14	15	16	17	18
18	19	20	21	22	23	24	22	23	24	25	26	27	28	19	20	21	22	23	24	25
25	26	27	28	29	30	31	29	30	31					26	27	28	29	30		
October 2011							November 2011							December 2011						
M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S	S
					1	2		1	2	3	4	5	6			1	2	3	4	
3	4	5	6	7	8	9	7	8	9	10	11	12	13	5	6	7	8	9	10	11
10	11	12	13	14	15	16	14	15	16	17	18	19	20	12	13	14	15	16	17	18
17	18	19	20	21	22	23	21	22	23	24	25	26	27	19	20	21	22	23	24	25
24	25	26	27	28	29	30	28	29	30					26	27	28	29	30	31	
31																				

- Market Makers Meeting
- Sovereign Bonds Auction

Amounts to be issued within the 2011 Market Makers Program (Law N° 29627)

Quarter	Minimum amounts to be issued (S/. million)
I	285
II	854
III	712
IV	714
TOTAL 1_/	2 565

1_/ Not included the amounts to be financed under
Urgency Decree N°. 040-2009, as amended